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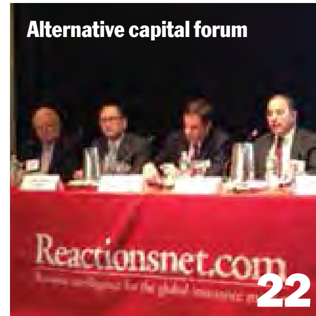

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David Benyon is editor of Reactions, based in London

DAVID BENYON

Anarchy in the UK

Well, not quite. Although there were a few street protests the morning after the surprise general election result on the night of May 7, which returned a majority Conservative government to power in Westminster for the first time since the 1992 election.

For London's re/insurance market, the new UK political scene still includes a good many question marks.
One obvious one is the promised referendum on EU membership, which re-elected Prime Minister David Cameron is now in a position to deliver. However, it will in no way spare the market from the upcoming final reckoning with Solvency II, the glacially slow European regulatory directive, which will finally be implemented in January 2016.

Another big question mark also looms. Before the election, Chancellor George Osborne – responsible for the UK economy, and Cameron's de facto deputy – broke with all political precedents by including reinsurance within his November Budget Speech.

Although it did not make tabloid headlines at the time, that speech pledged UK government support to "encourage new business like global reinsurance". Adding to this, there was a more interesting glimpse of something in the Budget document published alongside the speech.

"To take this forward, building upon the UK's position as a world leader in the global insurance market, the government will work with the industry and regulators to develop a new competitive corporate and tax structure for allowing Insurance Linked Securities (ILS) to be domiciled in the UK," it read.

And that's it. No more meat; no more detail. So what exactly does this mean? On the one hand, support for traditional re/insurance would play well to the Lloyd's community and the broader London market. David Cameron was there for Lloyd's Vision 2025 strategy back in 2012. While Lloyd's has been busy planting flags across the globe to open new hubs and branches in China, Dubai, India and Latin America, reinsurers face cutthroat underwriting pricing undercut by cheap alternative capital competition.

Which leads neatly to the commitment to creating an onshore ILS centre. Most competition in alternative reinsurance and ILS comes from a shortlist of offshore domiciles – Bermuda, Cayman, Gibraltar, Guernsey to name a few – which lever advantages as self-governing British Offshore Territories to combine the English legal system with low tax, kindly regulators and a can-do attitude to start-ups.

The City of London is no stranger to international bond markets – it arguably created them. However, it has also missed some previous bond market bandwagons, for example in competing for Eurobonds against other listing centres like Luxembourg. London arguably has decisive advantages, in the vast local talent pool available, and in market infrastructure already in place, to become an ILS hub.

But how does the UK government plan to attract interest in an ILS hub; and from a Leadenhall perspective why do this? After all, traditional re/insurance players are highly unlikely to relish another ILS hub right on One Lime Street's doorstep.

There seems to be a gap here for a new body, grouping or initiative to be formed (but who by?) to represent a nascent ILS community in London, tying together the potentially disparate perspectives of myriad practitioners and service providers and providing leadership for a would-be ILS hub.

There are some existing stakeholders and lobbying groups that we should or should not expect to make prominent contributions to this conversation, which has yet to properly begin, publicly at least.

Bank of England regulators, for example, at the Prudential Regulation Authority and Financial Conduct Authority, are not accustomed to playing an active role in promoting the City in the same way as their marketing-minded cousins at the Bermuda Monetary Authority, Guernsey International Finance Centre or Gibraltar Finance.

We can certainly expect industry groups like the Lloyd's Market Association and London Market Group to weigh in on the debate, although their loyalties lie to their existing – traditional reinsurance – memberships, rather than in fostering additional alternative competition whether by ILS or the much-complained-about private collateralised deals.

On the political side, Andrea Leadsom has now moved on from her post as economic secretary to the Treasury within the previous (coalition) government, following a post-election cabinet reshuffle.

Before moving on, she held meetings with Lloyd's CEO Inga Beale in January and helped shepherd in legislative changes in the form of a new UK Insurance Act which passed into law in February.

Leadsom's successor in the Treasury job is Harriet Baldwin, who entered politics from a City insider background at investment banking colossus JP Morgan Chase, where from 1998 she spent a decade as its London head of currency management.

Where reinsurance now sits on Baldwin's priorities list we can only guess, but it does have to fight for space with more overtly issues as diverse as childcare policy, women and the economy, tax credits, child poverty, and welfare reform.

Meetings and exchanging of letters is already taking place between government and industry stakeholders on what the government plans for reinsurance and ILS in London, **Reactions** understands. You can be sure that Reactions will be reporting on this developing story with interest. ●

Meetings and exchanging of letters is already taking place between government and industry stakeholders on what the government plans for reinsurance and ILS in London, Reactions understands.

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NEPAL EARTHQUAKE

Catch-22: rebuilding without insurance

The disparity between the economic and insured losses from the two recent Nepal earthquakes show the vast potential for insurance in the region, as well as insurance's sustainability role in catastrophe prone emerging markets. But with huge rebuilding costs, it will be hard to persuade local Nepalese that insurance should factor in severely restricted budgets.

After the first quake on April 25, Nepal was estimated to be facing economic losses of $5bn – which would equal to at least a quarter of the South Asian country's gross domestic product. That's on top of suffering the loss of 8,500 lives (as of May 17). Government figures revealed that more than 700,000 homes and other structures were damaged or destroyed by the April earthquake. For the second quake, a 7.3 magnitude aftershock, which struck near Mount Everest on May 12, early estimates suggest a further $1bn add-on on to the economic losses.

"While the level of damage and casualties was enormous, the seismological magnitude of the event in the Indo Nepal region was not unexpected. Scientists have been warning about a major event resulting from the 'central seismic gap' in the Himalayan fault system since the 1934 event," notes Adityam Krovvidi, Asia-Pacific head of Aon's Impact Forecasting business. "Unfortunately for the earthquake peril, timing is always the greatest unknown factor. The vulnerability of buildings and structures in Nepal poised a significant risk given the absence of good seismic code history and implementation practice," he added.

There are no commercially available earthquake models for a property insurance loss estimation in Nepal. Nepal's life insurance sector is also expected to be hit hard by quake deaths, given the death toll. Nepal's life premiums amounted $175m, accounting for about 63% of total insurance market share in 2013, according to AM Best figures.

George Attard, head of Aon Benfield Analytics, Asia-Pacific, told **Reactions**: "This is not unusual in the region, with many of the high growth territories exhibiting low penetration below the Asia-Pacific average penetration rate of 1.4% — India (0.6%), China (1.1%), Vietnam (0.7%), Indonesia (0.4%)."

Neither the April earthquake nor the aftershock quake are expected to have a significant impact on the global reinsurance market. Penetration is too low to factor on reinsurers' exposure dashboards. However, the event is expected to have an adverse impact on both local and some regional players due to significant cost from property and motor losses, AM Best has predicted.

"Most of the small-sized carriers in Nepal will be challenged to absorb this relatively huge catastrophe loss and its impact on their operating results. Additionally, some regional players, such as Indian companies with life, non-life and reinsurance business operations in the quake affected areas, are also expected to face recurred losses from the event," said AM Best.

The General Insurance Corporation of India (GIC) is Nepal's biggest reinsurer. The company has predicted it will face losses of $50m from the quake, a significant loss for India's biggest reinsurer. "Our gross exposure in the Nepalese insurance market is around $140m but it will take some time to arrive at any estimated figure of our losses due to the recent earthquake there," GIC responded to **Reactions** in a statement, adding that it was still waiting for claims to develop, but that these would be a "very small" proportion the economic loss.

There have been various statements in the industry about now being the chance to increase Nepal's insurance penetration, but as many in Nepal are self-insured, the aftermath of the disaster will be when cash is the tightest. "In terms of micro-insurance, what we're seeing right now is how real the potential is for that sort of protection. It always takes the very real human impact to drive that home and that is what we are seeing now," Tom Johansmeyer, assistant vice president of ISO reinsurance services, told **Reactions**.

He argues that providing micro-insurance in the region must be a long term investment so as not to abandon responsibilities to shareholders. "It is not the sort of thing you can walk into and hook to a good combined ratio in the first or second year. However, if you take a long-term view, there is relatively little capital needed in the first few years given the size of the markets and levels of insured value, so you could take that risk for the first couple of years as a learning opportunity," said Johansmeyer.

"That would provide benefits to real people up front and then create a foundation so that long-term cover can be delivered more efficiently and accurately, providing even better protection but also providing the returns that shareholders would be interested in."

However, the biggest challenge will be persuading locals that insurance is a priority in desperately restricted budgets. Johansmeyer is optimistic about this Catch-22 problem, though: "People respond to disaster and plan for disaster after it's occurred."

Governments have often led the way via public-private earthquake fund initiatives. Japan was the first in this respect, building up its protections in the years following 1952's Hokkaido Earthquake and ensuing disasters, which convinced its government, industry and society that insurance was necessary as a foundation for sustainable economic growth amid high cat risk. More recent government schemes designed boost insurance penetration and cat coverage include TRIEF in Taiwan, EQC in New Zealand and the Turkish Catastrophe Insurance Pool, set up in 2000.

"We are constantly surprised that the banking sector in Asia does not insist on full and comprehensive insurance cover on the properties it provides loans against, as this ultimately exposes the banks to significant levels of catastrophe risk," said Attard. "The key is to find a way of providing comprehensive, affordable cover for this space, having an efficient, low cost way of distributing it, and also actually ensuring payments are made in a consistent and timely manner in the event of a loss. This is not an easy task but it is an important one." ●

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LATIN AMERICA

Brazil business grows despite GDP drag

Melancholic headlines about Brazil's economy in recent months, including a possible recession, do not seem to have slowed insurance growth and investment. Brazil's insurance market continues to expand at a pace, despite fears the country's economy is about to enter recession. Brazilian gross domestic product (GDP) growth has slumped from 7.5% in 2010 to 2.5% in 2013 and is forecast to fall as low as 0.1% in 2014.

Marco Castro, president of Lloyd's in Brazil, said Brazil's insurance market continues to grow healthily. "Lloyd's reinsurance business in Brazil has grown at an average of 15% per year from $100m in 2007 to $314m in 2013, positioning Lloyd's as the second largest reinsurer in Brazil after IRB, with a 10% market share in 2013," he explained. However, total admitted and occasional reinsurance gross written premium (GWP) is likely to shrink as a percentage of total reinsurance GWP from 53% in 2012 to 30% in 2020.

Insurance growth is continuing despite an economic slowdown, partially because there is still plenty of infrastructure investment in Brazil and insurance penetration is still relatively low, according to Darren Powell, active underwriter for Allied World. "Even if we are not seeing growth in the economy itself, we are seeing it in property, construction, professional lines and general casualty and as Brazilian companies are expanding internationally they have greater requirements for carriers that understand international business," said Powell.

"Even if we are not seeing growth in the economy itself, we are seeing it in property, construction, professional lines and general casualty."

Darren Powell, active underwriter for Allied World

The news headlines about Brazil's potential recession could be enough to put off some foreign companies from investing in Brazil. Big Brazilian infrastructure projects may outsource to foreign contractors, but most current projects are being driven by local Brazilian companies rather than international firms, Powell said. Therefore some recent gloomy headlines are unlikely to deflect investors. One example of this is R$30bn private investment in the country's airport infrastructure anticipated over the next 20 years, Lloyd's has reported.

Brazil's biggest ever corruption scandal, by oil giant Petrobras, has also been good news for insurers and reinsurers, as now companies are placing far more importance on directors' and officers' liability (D&O) coverage. "Brazilian companies were previously buying pretty low limits compared to their counterparts around the world," said Powell. "Following the scandal we are seeing a surge in requests for D&O insurance quotes. I think Brazilian companies will buy bigger limits now as a result," he said.

The Petrobras matter has not only boosted demand for D&O coverage in Brazil but across Latin America as insurers and reinsurers in the continent are increasingly international, Powell said. "Comments made about Brazil will apply equally to other countries in the region. Once you start trading across the world, you are going to have different exposures that will require different coverages and limits. The same comments could be said for Chile, Colombia and Mexico as well," said Powell.

Itau, Allianz and Zurich currently dominate the Brazilian D&O market, with some focus on mid-tier D&O risks, according to Lloyd's. However, despite demand rising, insurance rates have fallen, Lloyd's claimed in its Brazilian market briefing in November 2014. Demand for casualty is also spreading, Powell said. "Lloyd's and Allied World are well placed to satisfy that demand," he added.

Allied World provides both treaty and facultative reinsurance to Brazil, with their largest portfolio and most profitable line of business being the treaty book. That is followed by property and construction, and then general casualty.

As highlighted earlier, Lloyd's has enjoyed considerable success in its Brazilian reinsurance business. Between 2008 and 2013, co-located syndicates experienced 87% average per year premium growth contrasting to a 6% growth for non-co-located syndicates, underlining Brazil's significance as a growth market for Lloyd's.

Following Lloyd's success in the country, Powell said that opening a Brazilian platform through Lloyd's is likely to be on the agenda in the near future. "It would be much more onerous and would take much longer to set up our own entity in Brazil whereas Lloyd's immediately gives us that platform," said Powell.

Allied World does not only have eyes for Brazil however. "Mexico is interesting," said Powell. "We already write Mexican business from London and Miami, and Lloyd's has just established in Mexico. Mexico has a growing economy and there are a lot of infrastructure projects happening there," he said, adding that Colombia is also an area of interest, with Lloyd's among those establishing a platform there. ●

RE/INSURANCE

M&A at highest levels since 2009

Merger and acquisition (M&A) activity has reached heights not seen since 2009 in signs that suggest the industry is finally recovering from the financial crisis.

A recent Swiss Re sigma report, revealed that M&A activity had continued to pick up in recent months, while the pipeline of future deals has also increased.

The study noted that total M&A announcements in the second half of 2014 rose to 359 from 295 in the first half, and this momentum continued into 2015 which has seen the highest level since the crisis, although still some way short of the numbers seen in 2009.

Evidence from a survey it conducted indicates that sentiment towards M&A is turning, as confidence about the economic outlook gradually improves and market participants look to acquisitions or mergers to boost profitability as well as bolster their balance sheets.

This sentiment has come about because market players are having to respond to heightened competitive pressures, therefore leading to a degree of consolidation.

The report noted that the emergence of alternative risk-absorbing capacity from hedge funds, investment banks and pension funds has put downward pressure on prices in some property and casualty lines, prompting some specialist re/insurers in Bermuda and Lloyd's to combine their operations to take on wider and emerging corporate risks and reduce operating costs.

"M&A activity in insurance has picked up in recent months, but the upswing is largely concentrated in certain sectors. There has been more activity in the specialty re/insurers sector as incumbent firms respond to heightened competitive pressures," Milka Kirova, senior economist at Swiss Re told **Reactions** following the release of the report.

"The emergence of alternative risk-absorbing capacity from hedge funds, investment banks and pension funds has put downward pressure on prices in some property and casualty lines, especially the US property cat segment, prompting some specialist re/insurers in Bermuda and Lloyd's to combine their operations to gain scale, diversify into more attractive market segments, and reduce operating costs."

The report noted that themes in insurance M&A transactions include divestments of closed blocks and run-off operations.

"Beyond the specialty re/insurance sector, there have also been strategic deals to expand expertise, distribution capabilities and geographical reach."

Milka Kirova, senior economist at Swiss Re

It added that such disposals can be an effective way to achieve an early exit from business in run-off so that capital may be redeployed to new or expanded lines of business.

M&A activity in the emerging markets was also identified as picking up in the Sigma study, particularly within the Asia-Pacific and Latin America regions, with some of the more advanced insurers in these areas continuing to focus on expansion in high growth markets.

"Beyond the specialty re/insurance sector, there have also been strategic deals to expand expertise, distribution capabilities and geographical reach," added Kirova.

"There has been a pick-up in M&A activity in the emerging markets, particularly Asia-Pacific and Latin America, with advanced country insurers continuing to focus on expansion in high growth markets. Increasingly too, emerging market insurers are eyeing acquisitions in advanced markets as a way to diversify geographically and across business lines."

While the report highlighted that this had been the highest period of M&A activity since the crisis, it still fell below the levels seen in the years previous to 2008.

While most commentators expect M&A to continue, Kirova noted that she expected it to be measured with each deal undertaken on a strictly strategic basis.

"We expect the upturn in M&A activity to remain sector specific. While the external environment has become more deal-friendly and continued globalisation is opening up new M&A opportunities, a frenzy of deal-making is unlikely" Kirova added.

"This is because there remains considerable uncertainty about the global macroeconomic and regulatory outlook, making selecting value-enhancing deals more challenging."

"We'll likely see a continuation of recent trends of increased M&A activity in certain segments as firms respond to cyclical and structural changes in the industry. The introduction of regulations such as Solvency II will encourage some insurers to restructure in pursuit of capital efficiencies and/or economies of scale or scope.

"Similarly, the influx of alternative capital will continue to stimulate deals, especially if financial investors become active sellers as well as buyers. Access to technology (eg. digital distribution or advanced analytics) is another M&A driver that will likely carry increasing weight."

Another area which is expected to see further consolidation is the broker market, and Kirova told **Reactions** that the intermediaries sector had already started to see significant consolidation efforts.

"The intermediaries sector has also experienced increased M&A activity," she added.

"Brokers in the wholesale segment have been actively pursuing expansion overseas in response to growing demand from large corporates wanting to partner with firms with an international footprint. Consolidation in domestic markets has also accelerated, the motivation for agents and brokers being economies of scale and the ability to provide a full range of analytical services to their clients." ●

BROKERS

Big three results defy logic in Q1

The biggest three reinsurance brokers have filed solid results seemingly "defying logic" in the first quarter of 2015, suggesting they are weathering tough conditions better than a lot of underwriters. Willis surprised the market with a relatively strong first quarter, but particularly so for its Willis Re reinsurance broking arm, negating investor concerns that numerous recent staff changes and plunging reinsurance rates would impact profits.

"We know pricing is down, so we expected to see [brokers] take hard hits in the reinsurance business, but that doesn't seem to be true."

Cliff Gallant, Nomura analyst

"Willis have had some new hires and have lost a few people as well. Investors were concerned about how that was going but the results looked good," Cliff Gallant, Nomura analyst told **Reactions**. The big three brokers in the reinsurance space seemed to "defy logic" in the first quarter results, said Gallant, with Willis perhaps the most surprising in this respect.

"We know pricing is down, so we expected to see [brokers] take hard hits in the reinsurance business, but that doesn't seem to be true," he said. "Their commissions seem to be okay, it seems to be stable."

"Given how much things are changing internally you would expect to see some drop off in Willis' growth or a reduced ability to improve margins, but it doesn't seem as if it's happening. It seems as if they are successfully executing their plan," he added. Willis Re and rival reinsurance intermediary Guy Carpenter, part of Marsh & McLennan, both reported modest revenue growth for 2015's first quarter.

This was not matched at Aon Benfield, however, which fell short of its two rivals with a 1% decrease in organic revenue. This figure compares to a 3% drop from the prior-year quarter. Aon Benfield's organic revenue drop was mainly attributed to an unfavourable global market scenario, and moderate decrease in capital market transactions.

"Results reflect near record levels of new business in treaty placements as well as modest growth in facultative placements, partially offset by a modest decline in capital markets transactions," said Greg Case, President and CEO of Aon.

Aon Benfield's core treaty reinsurance business saw a positive result, with net new business trends reaching record levels in the first quarter, making 16 consecutive quarters of positive results. Case said this reflects: "[Aon's Benfield's] long-term value proposition for clients and the application of excess capital in the industry to previously uninsured risk".

Despite the broader market headwinds, Guy Carpenter's organic revenue growth was up by 2% at $368m. Alex Moczarski, chairman, president and CEO of Guy Carpenter, said: "The first quarter [renewals] was actually a little stronger than we had expected and second-quarter may be a bit tougher."

Moczarski said he expects a slight to moderate underlying growth environment for the rest of the year. "We expect to grow over the year slightly, maybe even moderately. But next quarter may be a little bit tougher," he said, adding that Guy Carpenter is agnostic to where reinsurance capital comes from, and that clients are looking for "unbiased but informed alternatives".

Willis Re's results are not disclosed to allow a like-for-like comparison, only with Willis Capital and Wholesale, to which Willis Re contributes a large percentage of revenues. For the group, organic commissions and fees increased 1.3% year over year in the first quarter. Willis Re was itself reported to have "improved by mid-single digits on the strength of double-digit growth from strong new business and favourable timing in Willis Re North America."

While not organic growth, the 2014 acquisition of Surepoint Re is thought to have boosted the division's overall performance. Counteracting this, Willis Re's international and specialty business reported a decline in revenues due to lower market rates and some decline in demand. Nonetheless, Willis Capital Markets & Advisory and Willis Portfolio and Underwriting Services reported revenues flat with the prior-year period.

"There is a lot happening there right now with the Dominic Casserley [Willis Group CEO] turnaround efforts," said Gallant. "The results showed that it looked like he was having success and it looks like underlying margins are improving. It looks like things are on track there and I think that's a real positive." Analysts at Goldman Sachs altered their view on overall group's shares from "Sell" to "Neutral", although the investment bank's appraisal also slid the broker's stock price target down from $46 to $45.

JLT challenging

Jardine Lloyd Thompson's reinsurance arm, JLT Re, is always keen to punch its way into reinsurance broking's "big three", particularly angling to overtake Willis Re, which, factoring in Willis Group, has lacks the overall group-wide scale of rivals Aon and Marsh.

JLT Re is making some strides towards its big three rivals, following its 2013 acquisition of Towers Watson's reinsurance broking business (integrating as JLT Towers Re). The firm has also been aggressively expanding its broker headcount, snapping up brokers from rivals in London (where it has faced a legal battle with Willis), and in the US, where the firm has sacrificed profit this year to gain scale.

JLT issued a statement at the end of the quarter: "It is expected that JLT USA will generate revenues of $50m and a net trading loss of $35m in 2015...The group is expecting the phasing of its trading profit to be relatively even across the two halves of the year." JLT cites several reasons for this, including the timing of recent acquisitions, its changing business mix, the phasing of several significant accounts and the impact of its US investment. ●

BERMUDA

Banking sector changes underway

Bermuda's government is looking to restructure its banking industry as it seeks to make the jurisdiction even more attractive to the international re/insurance industry and also help improve the island's unemployment rates.

Not having a major central bank on the island can make conducting major business problematic, especially when Bermuda's re/insurance industry holds somewhere in the region of $500bn to $750bn of assets.

"We're looking at restructuring the banking industry in a way so that's it more useful to our economy."

The Honourable Everard Bob Richards, Bermuda Minister of Finance

As Bermuda's Minister of Finance, The Honourable Everard Bob Richards, explained, 99% of those re/insurance assets are managed by banks. But because Bermuda's banking industry is small, almost all of those assets are managed away from the island.

"The large reinsurance companies can't do much business with a Bermuda bank because they're just too small to handle those kinds of assets," Richards told **Reactions**. However, Bermuda wants this situation to change.

"What if we could take just a sliver of that $750bn of assets and actually handle them in Bermuda? We have an unemployment issue and we could create some jobs."

According to Richards, "banker" is an occupation that many of those involved in Bermuda's financial services industry have on their Curriculum Vitae, and as such, it makes sense to take advantage of that talent pool and put it to good use in advancing the island's prospects.

"We don't want to become a Grand Cayman or a Bahamas, but we do have a small source of business for financial services that's going begging to other countries and we would like to service some of that business here," said Richards.

"We're trying to formulate a way of doing that, but we haven't come up with an answer yet. Right now our banks aren't serving our economy the way they should. In order to expand an economy, you need expanding credit, and we're not getting any, so we're looking at restructuring the banking industry in a way so that's it more useful to our economy."

Bermuda's unemployment rate reached 9% in 2014, up from 7% in the previous year. That increase is yet another indication of some of the struggles the island has been facing in recent years, difficulties that culminated in Standard & Poor's (S&P) downgrading Bermuda's long-term issuer credit and senior unsecured debt ratings by one notch to A+ from AA- on April 28.

S&P said at the time the downgrade reflected Bermuda's continuing weak economic performance, a situation highlighted by 2014 being the sixth consecutive year the island found itself in recession.

While shaking up the banking industry will help improve Bermuda's growth in the long-term, more immediately the island is targeting further expansion of its insurance linked securities (ILS) and alternative capital industry.

This niche segment of the industry has been a real boon for the island, with Bermuda having emerged as the pre-eminent jurisdiction for the sector.

"The Cayman Islands and Ireland had about two-thirds of [this ILS] business in 2011 and 2012, and now Bermuda has some 60% of the overall ILS issued which is around $25bn," Grant Gibbons, Minister of Economic Development for the Government of Bermuda, said.

The island is proud of being at the forefront of this emerging and increasingly prominent industry segment, and Jeremy Cox, the chief executive of the Bermuda Monetary Authority, said much of this growth can be attributed to the hard work that has been done by the regulator to develop a credible regime.

"[That credibility] should not be understated because it's a very attractive feature," he said. "People are making decisions about which jurisdiction to end up in because of credibility, because of safety and soundness.

"ILS is an example of Bermuda getting it right on so many fronts with the industry, the government and the regulator working together. You can use that as an example of how we can distance ourselves from any jurisdiction when it comes to insurance and reinsurance. When those three get together, it's almost impossible to come up with an alternative to what Bermuda offers."

With the European Union's Solvency II coming into force in 2016, Bermuda is hopeful the European Insurance and Occupational Pensions Authority (Eiopa) will give it equivalence status.

Should that occur, Cox is confident that Bermuda's position as a leading jurisdiction will be cemented further, especially when compared with those in the nearby Caribbean.

"I think equivalence, once it happens, will put us in such a solid position that places like the jurisdictions to the south will have great difficulty in really competing in the insurance space," he said.

Aside from financial services, Bermuda's economy will also receive a short-term boost from the arrival of the America's Cup sailing competition.

"We will have teams, sponsors and others moving in," said Gibbons. "They are setting up houses and offices and it will be a good boost just in terms of the additional spending we are likely to see. We're estimating something in the order of $250m over the next couple of years.

"It's also had a catalytic effect on the tourism and infrastructure area with a number of new hotel announcements."

Bermuda Premier Michael Dunkley added: "There's been an infrastructure and development plan for the dockyards for a number of years, and this has given it an extra stimulus. There are a lot of old buildings in the dockyard that need renovating and they will be taken up by the America's Cup teams as they come in so it's going to be a short term boost for the America's Cup, but it will be a long-term sustainable boost for the area.

"We need every opportunity we can to put our name out there and the America's Cup will certainly allow us to do that. It's invaluable." ●

■ In the Lloyd's market, Aegis revealed the defection of managing director **Stuart Davies** to become the new group CEO of Canopius. Davies will replace chairman Michael Watson, who had stepped into the CEO role at Canopius when Inga Beale departed in December 2013 to become the current CEO of Lloyd's.

Aegis announced **David Croom-Johnson** would take up an interim managing director role, from his previous role as active underwriter at the firm's Lloyd's Syndicate 1225. His deputy, **John Chambers**, steps in to become interim active underwriter.

David Flandro

■ **David Flandro** is now global analytics head for JLT Re, based in London. Flandro moved to the firm in June last year from his previous role as global head of business intelligence at rival intermediary Guy Carpenter. He initially joined as global head of strategic advisory, "having developed that practice to combine the key disciplines of ERM, Rating Agency Advisory, and other strategic consulting", noted JLT.

■ UK-based insurer RSA has named **Darren McKenzie** as its new chief operating officer for UK and Western Europe. McKenzie will join the company on July 1, reporting to Steve Lewis, CEO for the same region. McKenzie was previously chief information officer at Santander in Germany, having previously worked at Santander acquisition Alliance & Leicester.

JLT mourns Stephen Ball's tragic death

Stephen Ball, chairman of the Australian arm of broker Jardine Lloyd Thompson (JLT), died of a heart attack on Friday while visiting the UK with his wife, according to a local news source. JLT Australia CEO Leo Demer said that Group CEO Dominic Burke had been in touch to express his condolences. In a note to staff, reported by insurancenews.com.au, Demer said that Ball's sudden death was "the most tragic day in the long history of Australia".

Ball, 59, had been in the insurance industry for more than 40 years, starting in Sydney in 1971 with Edward Lumley & Sons. He joined Jardine Glanville in 1982 and became chairman of JLT Australia in 2013. He was president of Australia's National Insurance Brokers Association from 2004 to 2006.

Willem van Wyk

■ **Willem van Wyk** has been appointed as Dubai chief executive officer of Allianz Global Corporate & Specialty (AGCS). He will report to Carsten Scheffel, member of the management board and insurer's chief regions and markets officer.

■ Howden International has hired **Goh Chye Huat** to head up its office in Singapore as the broker seeks to grow in what is an increasingly prominent international insurance marketplace. Chye Huat joins Hyperion-backed Howden after a 22 year stint at rival Jardine Lloyd Thompson. Meanwhile Jessie Tijoe will move up to the position of chair and focus on key client relationships.

Also moving to Howden, **Gerard Lee** will join as executive director – strategic business development; **Primus Lee** will join as executive director – head of employee benefits; **Jenny Lim** will join as executive director – head of special risks (financial lines), and **Gracy Khoo** will join as executive director – head of major corporate accounts.

■ Guy Carpenter has turned to rival Willis Re for its new US sales leader for its excess and surplus (E&S) lines specialty practice and brought in **Garrick Smith**. Smith, who has also been handed the title of managing director, will be based in Guy Carpenter's Elon, North Carolina office, and reports into William Allen, executive vice president and chairman of the reinsurance broker's E&S lines specialty practice.

Nigel Ingrouille

■ **Geoff Godwin**, UK chief operating officer at AIG Property Casualty, and **Nigel Ingrouille**, UK branch manager for Swiss Re International, take seats on the IUA board. The industry body said further board nominees are expected as it prepares for its annual general meeting on June 24.

The two new executives were brought in to replace members who have recently stepped down: **Stephen Riley** of Global Aerospace Underwriting Managers; **Jacqueline McNamee**, of AIG; and **Russell Higginbotham** of Swiss Re.

■ Former Citibank chief executive **Eugene McQuade** has replaced **Robert Glauber** as the chairman of international re/insurer XL Group. McQuade has been a director at XL Group since 2004 and recently retired as vice chairman of Citigroup. He had previously been CEO of Citibank, as well as the president of Bank of America Corporation and president and chief operating officer of FleetBoston Financial Corporation, among other roles. Glauber will remain a director on the board and will chair the Risk and Finance Committee.

■ ANV Group has appointed **Bruce Whitmee** as active underwriter for its Lloyd's Syndicate 5820, subject to regulatory approval. He will be based in London and report to ANV Syndicates' director of underwriting Gerard van Loon, who has been acting active underwriter for syndicate 5820 since August 2014. The syndicate underwrites business in three specialty areas: consumer products, US property & casualty and political & credit risks.

■ India-based Bharti Axa General Insurance has appointed **Deepak Iyer** as chief executive and managing director. Iyer comes to the joint venture from outside of the industry, having previously been managing director for the Indian sub-continent at Wrigley India, a subsidiary of the US-based Mars confectionary company.

He is expected to join the company from the end of next month, taking over from interim CEO and MD **Milind Chalisgaonkar**. Earlier this month Axa received official Indian approval to raise to 49% from 26% its stake in Bharti Axa Life and Bharti Axa General, following the increase in India's maximum Foreign Direct Investment (FDI) cap at the end of last year. The deal was worth about $65m. ●

Reactions

Human Capital Risk and Talent Management Summit

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Reactions

The global insurance industry is thus facing a catastrophe of its own making – human capital shortage. Unlike most events, this catastrophe is unlikely managed by clever insurance programs or risk transfer schemes. The industry is facing a brain drain of gigantic proportions and [re]insurers and brokers are at the greatest risk.

The employment outlook for the industry remains positive. The US Bureau of Labor Statistics projects that the industry employment will grow need to fill more than 400,000 jobs by 2020, including about 33,000 underwriting, 74,000 claims, 13,000 actuarial positions. The industry population is also aging at a fast rate. For example, actuaries outpace the national averages for both percent change of growth rate (26% for actuaries vs. 11% for all occupations) as well as replacement rate (60.4% vs. 23.6%). The replacement rate for underwriters outpaces the national average at 32.6%.

The Human Capital and Talent Management Summit is a new event produced in collaboration between Reactions and St. John's University's School of Risk Management. The Summit is sponsored by Korn Ferry and Mercer. Hosted in New York on September 24, the summit is expected to raise awareness through discussion, debate and editorial content about the human capital and talent management challenges in the [re]insurance industry, as well as how the industry can further greater levels of diversity in its workforce locally and internationally.

The will, for the first time, truly raise the talent war agenda on a global scale, and it is anticipated that this becomes an annual meeting that will consistently attract senior executives tasked with building and maintain a thriving workforce. The Summit will consist of a full day programme of keynote addresses, presentations and panel discussions.

Audience participation, through Q&A, will be welcomed and encouraged throughout the day as will the ability for sponsors, speakers and delegates to network. The day will include two coffee breaks, a lunch and a cocktail reception.

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NICK COOK

The new face of BMS

BMS has undergone a comprehensive revamp – strategically and financially – since June last year. One year on, Reactions talks with BMS Group CEO Nick Cook to find out more about the ambitious five year strategy the broker is implementing.

"The big difference from the BMS of old and the new BMS is the scale of the financial resources available to us," says Nick Cook, CEO of BMS Group, based in London and a director within the rebranded holding group Minova Insurance Holdings.

The name change to Minova came along with a £30m Capital Z private equity injection. Cook explains it also made a lot of sense to avoid confusion between Minova's broking outfit (retained as BMS), and its underwriting arm (Pioneer). The firm has a new spring its step, making a number of recent hires and expansions, including opening a new Latin American hub in Miami this year, building a wholesale team with connections into local ceding companies and reinsurance brokers in a number of LatAm territories.

"We see significant opportunities in Latin America, particularly in Peru, Mexico, Venezuela, Argentina, Colombia, and Ecuador. We also have strong relationships in Central America, which is an emerging market for us. Our offering in the region is multi-class, across aviation, energy, liability and construction," says Cook.

"Some of that business will come back into London, but a lot of it is placed domestically. Emerging markets are exciting for us. The rate of economic growth in countries like Peru, Mexico and Colombia is phenomenal. We'll offer products that we've developed here in London, through binders, cover holders and line slips and put those into Miami to distribute into the region," he continues.

Cook says the five year strategy involves opening up offices where there are common regulatory and legal frameworks, leading the firm to choose Miami as its LatAm entry point, bringing in Jose Astorqui to lead the team there, reporting to Cook in London.

The firm is looking at other new offices, too. "I would expect news within the next couple of months about us opening up a new office in either an existing territory or perhaps opening a new BMS office in another emerging territory, such as Africa."

The broker already has two Canadian offices: one in Vancouver and another opened up last year in Ottawa. "The location for the third office is still to be decided, but it will likely be in either Toronto or Calgary. We're keen to expand our distribution over the next 12-24 months," says Cook. "Part of our diversification strategy has been to look at new territories, new products and develop new teams. We opened up in Canada; we opened up in Australia; and the next stage of that strategy is Latin America."

Cook notes that Minova, the group's holding company led by Dane Douetil as CEO, now looks very different to how BMS Associates (the old name) looked five years previously. "There are four pillars to the group," he says. "There is BMS Group Ltd, of which I am CEO; there's BMS Inc, under Andy Bustillo, which is the US intermediary; there's BMS Capital Advisory, under Rom Brago; and finally the underwriting business, Pioneer Underwriters, led by Darren Doherty."

The group was quick to cotton on to the squeeze facing the reinsurance underwriting community, and launched a diversification plan which has dramatically altered the makeup of its business.

"Going back to our strategy in 2009, prior to my arrival in 2010, we recognised that the reinsurance market was facing a squeeze and that growth would become increasingly challenging. Given our strong focus in the sector we wanted to get on top of that, to diversify and be able to offer capital advisory, facultative reinsurance, binders, cover holder business, as well as traditional reinsurance. You can't just be a one stop shop in today's market," says Cook. "To be a credible player in the reinsurance sector we must cover all bases.

"Now the business is split 60% insurance, 40% reinsurance," he says. "Five years ago, it would have been 80% reinsurance. But that is only reflecting what is going on in the market. Life has changed. BMS has adapted and evolved accordingly.

"We're very proud of our reinsurance business. It's just that growing some of those where we are strong is difficult in the current climate," says Cook. The US reinsurance book is a very significant part of our business in London, but we also recognise the emerging markets' potential for growth, diversification and developing new markets are key to our strategy."

Nick Cook, CEO of BMS Group

Cook notes that BMS Capital Advisory is another new aspect to the business, although this unit reports into the US business, based in New York, with regular trips into Bermuda's insurance linked securities (ILS) market.

"That's not just an ILS play; it's also an M&A play and a capital raising play; it has all the necessary broker-dealer licenses. It sits within BMS Inc, which is our US operation. It's relatively new and will continue to evolve," says Cook. "We've worked with some of our existing clients on raising capital, but I can't disclose which clients. This is a key pillar of our strategy, working closely with our clients, servicing their business needs and helping them grow."

The company's diversification efforts are not just overseas. For example within London-based specialty reinsurance. "We're committed to adding new product lines to the London business. Mining, power, energy, accident and health are all areas where we're looking to recruit," says Cook. "And the financial lines market is another area of London strength where we have recruited. We wanted to build out in areas where our market share was tiny or non-existent.

"We also have a very large marine insurance business, by independent standards one of the biggest in the market," says Cook. "We have a substantial business in our subsidiary, BankServe, which has a large market share in aviation and marine finance. All that premium is going into the market, and we have taken some of the reinsurance premium too. That's why we hired in the specialty part of the business, and we will continue to strengthen this offering." ●

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The tussle for PartnerRe

A war of words has erupted between Turin-based investment fund Exor and the board of PartnerRe, over Exor's increasingly hostile attempt to disrail Axis Capital's bid to acquire its Bermudian peer PartnerRe and snap up the reinsurer for itself. Sam Kerr and Victoria Beckett report.

The bidding process for PartnerRe has escalated into increasingly hostile rhetoric between Italian investment company Exor and the Bermudian reinsurer's board. That is because PartnerRe's board of directors has consistently backed a previously announced strategic merger with Axis Capital over Exor's proposition.

The increased – and up front – cash value of Exor's own rejected bid has provoked the Turin-based investment company to accuse PartnerRe's management of damaging their shareholders' interests, by supporting what the Italians claim is an inferior financial deal.

PartnerRe's exasperated board has responded with equal venom and has blamed Exor for what it sees as at attempt to deliberately mislead PartnerRe shareholders to win the bidding process. With Axis resisting raising the bidding, and committing to sticking with its board-supported offer, set against the board's rejection of an upped bid from Exor, the decision over the future of the company has effectively been passed to its shareholders.

Incendiary rhetoric

The latest volley in the war of words followed a brief period when relations seemed to be quietening, after PartnerRe's board stated that it would begin negotiations with Exor at the end of May over an improved offer for the company.

However, despite that pledge to negotiate, the board still rejected Exor's second bid for the company, stating that the improved offer of $137.50 per share was still an undervaluation of the reinsurer. Exor's previous offer of $130 per PartnerRe share had been rejected at the beginning of May.

This release met with a provocative response from Exor, stating that the firm would be willing to negotiate with PartnerRe on the conditions of its offer, if only the reinsurer would say that Exor's bid was "reasonably likely to be a superior proposal" to the Axis merger offer – something PartnerRe's board has been loath to do.

In a letter to PartnerRe's board, Exor chairman and CEO, John Elkann, said that the Italian investment firm would not increase

its binding offer for PartnerRe but it would be willing to work with the board to clear up any uncertainties.

Elkann issued a challenge that if the PartnerRe board would not acknowledge what, in his view, was a superior offer from Exor than the Axis bid, then PartnerRe should hasten to let its shareholders decide.

"We look forward to hearing further from the PartnerRe board, and, if you really believe that the value for your shareholders under the Axis agreement is superior, then please announce a record date and a date for a shareholder meeting to allow your shareholders to decide what is in their best interest."

While there can be no guarantee that Exor will not increase its offer again, even if it does not, the latest cash offer (at time of press) of $137.50 per share represents a higher immediate pay out to shareholders – set against less upfront but potentially more strategic value of a merger with Axis.

"I think Exor will ultimately win because the shareholders like it better and that's even if it stays at $137.50," Meyer Shields managing director at Keefe, Bruyette & Woods (KBW) told **Reactions**.

"I don't know Exor well enough to know whether they will consider raising their bid again, they seemed pretty adamant against that. So I wouldn't expect a higher bid but I think the shareholders will be pretty satisfied with $137.50," he continued.

Despite the potential olive branch for further negotiations, PartnerRe's board issued a statement in response to Elkann's request to acknowledge its bid's superiority, saying the request went against PartnerRe's "good faith invitation" to negotiate, and did not represent the board's view of the value of Exor's bid.

"By demanding that we declare their offer 'reasonably likely to be a superior proposal' as a precondition to any negotiations, Exor has effectively rejected our board's good faith offer made yesterday to engage in discussions on price and other terms," wrote PartnerRe. "We have made it very clear that Exor's price and terms are unacceptable.

"The waiver we obtained from Axis to engage with Exor contained no restrictions whatsoever that would impede full and open discussions and we remain interested to proceed on that basis to determine whether the offer can be improved so that it is compelling to PartnerRe shareholders on price and terms."

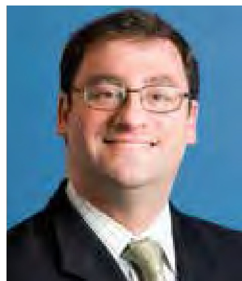
PartnerRe stated that it would now look to bring the Axis merger directly to its shareholders, while this will also give shareholders the chance to vote down the merger, potentially accepting Exor's terms instead.

Largest shareholder

Exor musters the largest single voice within PartnerRe's shareholdership. A straight shareholder vote could favour Exor, following its purchasing an increased number of PartnerRe shares, becoming the reinsurer's largest shareholder, with a 9.38% stake in the company.

As the company's largest shareholder Exor can vote in essence for its own bid for the reinsurer, while the greater immediate cash value of the Exor proposal could be sufficient inducement to sway other shareholders too; the Axis offer, by comparison, is an all share proposition.

When Exor's original PartnerRe bid of $130 per share was tabled, Franklin Mutual Advisors,



"I think Exor will ultimately win because the shareholders like it better and that's even if it stays at $137.50."

Meyer Shields, managing director at Keefe, Bruyette & Woods

another institutional shareholder with a large stake in PartnerRe, said that it felt the Exor deal was already superior to the terms being offered by Axis, and that it had been unhappy with the $11bn valuation of a combined PartnerRe and Axis marriage.

The value, size and strategic market positioning of the would-be combined entity – giving economies of scale in a competitive reinsurance market in which size is increasingly said to matter – is of course crucial to the Axis Capital proposition. If shareholders remain unconvinced – either by this rationale, or specifically by the market heft of the would-be combined entity, Exor stands to gain.

"As the largest shareholder they [Exor] can make things more complicated and Franklin Mutual has also said that they prefer the Exor offer and that was at $130," said Shields. "I think obviously everybody would appreciate more but even if they don't get it, I think that the Exor bid is a better deal and is better value per shareholder.

"I don't think that there is a great case to be made that level of gain can be materialised from the Axis deal on the same timeframe."

The 'superior proposal' row was only the latest exchange in the war of words between the PartnerRe board and Exor. Relations between PartnerRe and its prospective Italian suitor have been consistently fraught over recent weeks.

The debate has however twisted into an accusatory row not just over the bidding, but with each company accusing the other of being disingenuous or untruthful in their accounts and handling of negotiations.

PartnerRe has claimed that Exor stated its original $130 per share bid was its best and final offer. However the Italian investment firm has said that it was never asked to increase its offer by the board, which it suggested seemed unwilling to negotiate.

Exor's Elkann used his "superior offer" letter to present Exor's view about the previous set of negotiations and whether Exor's original offer of $130 a share had been final.

"On one additional point I want to be very clear: Mr Montupet [PartnerRe's chairman] never asked me if our original proposal of $130 per share was our best and final offer and I never said it was," wrote Elkann.

"The public statements of certain members of the Transaction Committee to the contrary, are either a reflection of their lack of direct involvement in the process or a failure of recollection. I did say that our offer was firm in the context of us not bidding against ourselves and not being given access to due diligence information.

"Our binding offer of $137.50 is clear evidence that our initial proposal was not our best and final offer," he added.

He went on to say that Exor's financial outlay greatly exceeded that of Axis in the bidding process, and that Exor's commitment to PartnerRe was evident through the fund already becoming PartnerRe's biggest shareholder.

PartnerRe's board continued to express its alternative view of events when it rejected Exor's request for a 'superior offer' acknowledgement, repeating its view that Exor's first offer for the company had been portrayed as final and non-negotiable.

"Exor's portrayal in its letter of discussions between Exor and PartnerRe is simply not credible," wrote the PartnerRe board. "While it relates to an earlier proposal, and is not relevant to the latest offer, we point out one last time that we consider inaccurate Exor's statement that they did not portray their prior proposal as 'best and final'."

Allegations of bias

This debate over the first Exor offer may at first appearances seem trivial given that Exor has increased its bid for the company. However, if Exor can convince other shareholders that it was willing to increase its offer – shown by its new $137.50 a share offer – that could support its argument that PartnerRe's board was unwilling to negotiate and biased towards the Axis deal.

It would then be able to state that the PartnerRe board's rejection of its offer was simply part of its continued support for the Axis merger, which, Exor has consistently maintained, it thinks is an inferior deal.

So if the board remains adamant that they will push for the Axis deal, against what could look like greater financial value for shareholders, there is potential that shareholders could look to bring a case against the board.

This was the sentiment expressed in a letter from Tom Sandell CEO of Sandell Asset Management, a PartnerRe shareholder, to PartnerRe interim CEO David Zweiner and to the chairman John Montupet, chastising the company for not viewing the Exor deal more positively, relatively to the initial deal with Axis.

"As we stated in our letter, and in our subsequent conversation with Mr Zweiner, in our view, there is ample evidence that the latest Exor offer from May 12 'would reasonably be likely to result in a Superior Proposal" under the merger agreement with Axis," wrote Sandell.

"We believe that PartnerRe should immediately and publicly acknowledge this, and follow the process outlined in Section 5.8 of the merger agreement with Axis – a process which was specifically negotiated by PartnerRe. Based on our understanding of the Axis merger agreement, such a determination would not jeopardise the potential merger with Axis," he added.

Reinforcing Exor's argument, Sandell wrote that in his view the continued refusal to designate the Exor bid as likely a superior offer on paper, raises questions about the board's commitment to a fair process. He concluded this broadside against the PartnerRe board by saying that if the board did not demonstrate its commitment to its shareholders then there is indeed potential for legal action.

"While we understand the importance of maintaining a cordial relationship with Axis, we would once again like to remind the board that it's first and foremost duty is to the company's shareholders, its true owners," Sandell wrote. "Consistent with our own duties to our investors, we will not hesitate to exercise the rights available to us to hold the board accountable."

Shields at KBW told **Reactions** that legal action could be on the cards if the board continued its stance on favouring the Axis deal in opposition to the wishes of most of the shareholders.

"I think [legal action] is always a threat that they have in the background because the case that they are making, which probably has some merit, is that if the Axis deal was so compelling in the first case, then there shouldn't have been the need for the adjustment," says Shields.

"Also some of the arguments that PartnerRe is making with regards to now wanting to get into a complicated sales process, doesn't really hold a whole lot of water I don't think. So I think that threat is there," Shields added.

Given the growing intransigence between the two companies, it looks increasingly like the decision will now be taken by the shareholders. The future of PartnerRe rests on whether the shareholders vote for a strategic vision of a combined Axis and PartnerRe, which represents the position of its board, or whether they decide to support the higher cash terms of the Exor offer.

By its offer, Axis valued PartnerRe at roughly 10% cheaper than the Exor proposition, but the deal has, as mentioned, been touted as a strategic merger to create economy of scale between two mid-sized Bermudian reinsurers, potentially creating a combined reinsurance group to rival the biggest firms – in response to consolidating pressures from cedant buying behaviour, with internationally-minded insurance groups preferring to purchase big reinsurance bundles, which only the biggest top tier of reinsurers can provide.

Despite its status as PartnerRe's biggest shareholder, Exor has remained little known among re/insurers. That is despite some pedigree: the Italian group has shown investment interest in a number of insurers, including Allied World and Swiss Re.

If the cash bid were to be accepted, instead of merging with Axis to become the world's fifth largest property/casualty reinsurer, PartnerRe would likely return to business as usual, under Exor's plans for the company.

Following its initial bid, Exor's chairman and chief executive, John Elkann said that the investment firm would look to allow Partner Re to continue to operate as a pure re/insurer with operations similar to their current state.

Axis's proposal differs from Exor's as it would seek to merge its business with PartnerRe's, a marriage which would likely lead to redundancies in areas where there are crossovers between the two Bermudian reinsurers.

"If [Axis and Partner Re] got together and they are still public, they could build a great company that might be worth significantly more than what the shares are trading at today," Cliff Gallant, Nomura analyst, told **Reactions**.

"From what Exor said in their statement, they would want a company that produces good, stable returns on equity (ROEs) and a lot of cash, is a good investment and is good value to hold. They won't necessarily be looking to build something great in the reinsurance business," added Gallant.

However there are operational benefits to PartnerRe from the Exor deal as well. Zacks, an investment research company, said on its analyst blog that the Exor deal not only provided additional liquidity to PartnerRe but also adds certainty since Exor may not need to raise any additional capital to fund the acquisition.

Exor have also promised to preserve PartnerRe's management and brand name. "Exor was offering something right now: cash in hand is nice. It is certain and there is no risk to it; you just take the money and go," said Gallant.

"So that will be the interesting question. Do they take the money and go, or do they make a bet that they can really make a great business? We will have to wait and see how it pans out," he added. ●

By Sam Kerr – sam.kerr@euromoneyny.com; additional reporting by Victoria Beckett – vbeckett@euromoneyplc.com

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Fosun on the march

Vying to become China's answer to Berkshire Hathaway, Fosun International is focused on growing its insurance arm as it seeks to further expand.

Fosun International fully expects to add to its expanding portfolio of insurance industry investments in the future with the Chinese firm also considering making a move into the run-off market should the opportunity arise.

Since its initial launch, Fosun, which was founded in 1992 by four graduates from the Shanghai-based Fudan University, has developed four separate divisions within its business consisting of insurance, industrial operations, investments and asset management.

Fosun, headed up by its chairman Guo Guangchang and chief executive Liang Xinjun, has evolved into the largest privately-held conglomerate in China with more than $50bn in total assets. The company still has big plans, and is aiming to develop into one of the world's leading investment firms by taking inspiration from the business model that has served US investment tycoon Warren Buffett so well.

"After 23 years of development, Fosun has developed its profound industrial-rooted global investment capability and been continuing to explore suitable business models," Wang Qunbin, president and chief executive officer of Fosun International, told **Reactions** exclusively.

"We've discovered that Warren Buffett's "insurance and investment" model is what we are looking for and the most suitable for Fosun. Therefore, Fosun has now developed a clear "twin driver" development model of an insurance-oriented comprehensive financial capability combined with a global industrial integration capability that has its roots in China. For both drivers, insurance is the core."

This model of having insurance at the very core of its operations has impacted the global re/insurance industry, with Fosun quickly making a name for itself within the sector after acquiring shares and entire companies over the course of the last seven years.

Fosun's first move into the re/insurance space occurred in 2008 when it bought a stake in Xi'an-based Yong'An P&C Insurance. Since then, the company has spent billions of dollars on expanding its international portfolio of re/insurance industry assets.

In 2011, the company entered into a partnership with US life insurance giant Prudential Financial, to establish a private equity fund. This relationship led to the two firms jointly launching Pramerica Fosun Life Insurance in 2012, offering life, health, casualty and other personal insurance products in China.

The following year, Fosun provided $550m of the start-up capital, equal to 85.1%, to Hong Kong-based reinsurer Peak Re. The remaining capital in Peak Re was provided by the International Finance Corporation.

In May last year, Fosun paid $1.29bn to acquire 80% of the share capital and voting rights of Portuguese insurance businesses Fidelidade SA, Multicare SA and Cares SA, all of which were fully owned operations of Caixa Seguros e Saude.

That was followed in August by Fosun buying a 20% stake in Bermudian specialty insurer Ironshore. That deal brought an end to Ironshore's plans to undertake an initial public offering.

At the very end of last year, Fosun revealed it was making its first foray into the US insurance market after agreeing to acquire Southfield, Michigan-based property and casualty (p/c) carrier Meadowbrook Insurance Group for $433m.

That deal was the first full purchase of a US insurer by a Chinese company, with Guangchang noting: "This transaction allows Fosun to establish a presence in the important US P&C market, consistent with our strategy of expanding our core insurance business."

"Meadowbrook has a talented employee base, comprehensive offering of high-quality specialty insurance products, robust distribution network and a strong commitment to meeting the evolving needs of its policyholders. The transaction represents another milestone for Fosun and will enable Fosun to further strengthen its insurance-oriented comprehensive financial capabilities."

As Robert Cubbin, the president and chief executive of Meadowbrook, explained in April after shareholders approved the deal, "combining with Fosun further strengthens our capital base as we focus on supporting the needs of our customers, partners and employees, improving our underwriting performance and driving profitability".

Then in early May, Fosun announced it was to acquire the remaining stock that it did not already own in Ironshore, a deal which means the Bermudian business is now an indirect wholly-owned subsidiary of Fosun International.

As Guangchang explained in May, Fosun "is fully confident about the existing management team and believe that the long term and stable cooperation with Ironshore is the key and essential foundation to achieve a win-win situation in further exploiting synergies for both parties".

"The acquisition of the remaining interest in Ironshore will further expand Fosun's insurance business and strengthen the Group's capability to access long-term high-quality capital," Guangchang added.

Fosun was also reportedly one of the firms looking to acquire Montpelier Re, although it ended up withdrawing its bid, with Endurance ultimately winning the race to purchase the Bermudian business.

As Qunbin explained, Fosun's investments in the re/insurance market cover the entirety of the risk bearing industry.

"[Our investments] constitute a wide-ranging insurance platform covering property and casualty insurance, life insurance, reinsurance, specialty insurance and general insurance."

Come the end of 2014, the assets under management of its re/insurance businesses amounted to more than RMB113.1bn ($18bn). That represented more than a third of Fosun's entire total assets, and once the recent Ironshore and Meadowbrook deals are factored in, the proportion of the investment firm's business that is made up of re/insurance industry entities will increase further.

Even discounting the latest deals, Fosun's re/insurance moves are already paying off with the company growing its capital base, thereby increasing its investible funds for use in other areas of its business.

"The investment of Fosun in the insurance industry has been

> **"On top of generally investing in insurance companies, it is expected that we will participate in investments in run-off insurance assets in the near future."**
> Wang Qunbin, president and executive officer, Fosun International

developed in a gradual pace and profound manner," said Qunbin.

"Our investment in Yong'An P&C Insurance started in 2008, and it has been seven years since then. During this period, we have initially acquired some knowledge and experience in the insurance sector, and learnt about the development potential of the insurance business."

Fosun's considerable investment in the re/insurance space in recent years means the company now regards this particular industry as the most significant on its books.

"Insurance has become the most important segment for Fosun," said Qunbin.

"The persistent low interest environment in the US, Europe and Japan has made the liability-end of insurance institutions relatively secure. Leveraging Fosun's globalised and professional insurance operations and investment teams, we envisage the emergence of more opportunities in investing in local leading insurance institutions at reasonable prices and expanding our insurance assets in the coming years."

Consequently, Qunbin said Fosun is keeping its eyes open for the chance to invest in insurance companies, both domestically and overseas, should they arise. There is a particular focus at the firm to invest in those markets that have a long and well established insurance industry already.

"We will continue to keep an eye on opportunities in domestic and overseas insurance projects, especially those markets with more developed and mature regulatory mechanism and policies, including US, Europe and the Asia-Pacific region," he said.

"The insurance projects in these markets can better combine with our investment capability and in line with our globalisation strategies. The products and services of the insurance companies in mature markets are better developed, [so] they can serve as examples and references for us to better develop the domestic insurance business."

While the US, Europe and Asia-Pacific are regions that are of particular interest to Fosun when it comes to the insurance industry, the company is not limiting itself to just these markets for its overseas expansion. As Qunbin outlined, Fosun is not limited by any geographical boundaries.

"Fosun has established the twin-driver development model of "insurance and investment" [along with] the investment model of "Combining China's Growth Momentum with Global Resources". [So] it is more important that we have a relatively large overseas insurance company so that we can have more overseas capital to support our development."

Qunbin pointed to Fosun's investment in Fidelidade as an example of how the firm has acquired a stake in an overseas insurance business, had some input into its operations and then started to reap the rewards.

"Fidelidade has over 200 years of history [and] it is the most influential insurance company in Portugal. Its past development and business results have been outstanding [and it] has done a good job in the insurance business. It is absolutely the number one, far bigger than the aggregate of its counterparts in the second and third places in Portugal.

"From the perspective of Fidelidade, the investment by Fosun can bring in more resources, and create more value for it, so it can be more competitive. Fosun's insurance segment can create synergies, for example, by reducing the reinsurance costs, developing products jointly and exploring new channels and markets. We can also make good use of the Fosun's core investment capabilities, optimising its existing investment portfolio and enhance its rate of return. This all led to Fidelidade achieving a rapid growth of 61% in net profit in 2014."

While this example highlights what Fosun found attractive in Fidelidade, when looking for potential investment opportunities, Qunbin said the Chinese firm looks for businesses that are underpriced but have a reasonable valuation.

This philosophy is very much in line with Fosun's investment and corporate guidelines, although each business that the company takes an interest in must have synergies with the overall company, as well as have strong teams and a good culture.

But it is not only live insurance business that is attracting Fosun's attention however, with the firm currently investigating opportunities in the legacy, or run-off, sector as well.

"We strive to discover more innovative models when making our investments," said Qunbin. "On top of generally investing in insurance companies, it is expected that we will participate in investments in run-off insurance assets in the near future."

However, each company that Fosun invests in must fit in with the firm's overall profile. That way, financial improvements can be achieved.

"We facilitate the cooperation and coordination among all the insurance companies under Fosun," said Qunbin. "[For example], the coordination among all companies with Peak Reinsurance to reduce reinsurance costs and the cooperation in techniques, products and channels to actively promote international business development." ●

By Christopher Munro – christopher.munro@euromoneyplc.com

Battling the low interest environment

Generating returns from the investment markets continues to prove problematic for those involved in the asset management side of the insurance and reinsurance industry. Reactions welcomed chief investment officers, chief financial officers, treasurers and asset managers to its 4th Insurance Asset Management Forum in New York to discuss how they can get the most out of their portfolios.

In an environment where re/insurer's profits are dependent on softening lines of business, the role of a chief investment officer (CIO) in a global re/insurer is becoming increasingly important.

However, prolonged low interest rates are putting pressure on re/insurers' balance sheets and are forcing other capital market investors into the market.

This highly competitive marketplace where balance sheet optimisation is a constant trial was the main topic of conversation at Reactions' Insurance Asset Management Forum which took place in New York last month.

Perhaps the biggest challenge facing any board at the moment, especially for those companies operating in the property catastrophe sector, is how to respond to the impact of alternative capital which is entering the market at a rapid pace and is causing rates and premium volume to decrease.

Regulation for ILS

According to Aon Benfield, the first quarter of 2015 saw capital entering the market at a rapid pace and set new records for ILS issuance. This competitive pressure combined with new regulatory standards for traditional re/insurers provides further food for thought for CIO's.

But there is a feeling that regulators around the world should be having more robust discussions about the impact that alternative capital is having on the re/insurance market and whether the sector needs specific regulation.

Thomas Leonardi, a senior advisor for investment banking at Evercore Partners, delivered the keynote speech at the event, and he said that regulators have not yet paid too much attention to the alternative capital sector, but suggested they take a closer look at this growing market.

"I think the answer [to the question whether regulators should be doing anything about alternative capital] is yes," said Leonardi, the former State Insurance Commissioner for Connecticut, while taking questions following his address to the forum.

"Not that they should be doing anything to prevent it because it's here. But I don't think we have had enough of a robust discussion, either at the NAIC or internationally, about what it means to the industry, the dislocation for reinsurance companies and what happens when a major catastrophe wipes it out.

"Like in Bermuda, lots of times you have a catastrophe and some companies fail and other new capital comes in. Will that happen or will pension funds decide they can't afford to have that loss of capital?"

At the moment, catastrophe bonds still make up a very small part of the average investment portfolio of a large pension or hedge fund.

However, given the relatively anaemic returns in some traditional investment classes, Leonardi noted that the influence of the capital markets on the re/insurance space was likely to increase, and regulators must pay more attention to it accordingly.

"One of the issues is of course it's such a small sliver of their assets that are being dedicated to this," he added. "But as the market continues to grow and as interest rate pressures continue to exist, those are things that I don't think my former regulatory colleagues are paying attention to."

During his keynote speech, Leonardi attributed the growth of the catastrophe bond market, and insurance linked securities (ILS) in particular, to a few primary factors: the prolonged low interest rate environment and institutional investors searching for yield as a result; the low correlation of catastrophe bonds with other asset classes, and the fact that there have not been any significant principal losses as a result of a catastrophe.

However, he warned that the falling level of returns in the ILS market could make investors reconsider the value of the space once a large catastrophe takes place.

"Just two or three years ago catastrophe bonds were generating between 6.5% and 7%, maybe a little more, in interest," said Leonardi. "Demand has been so high however that rates have begun to tumble to as low as 3.5% and these are for the same exact risk you were buying these catastrophe bonds for at 7% two years ago.

"As a regulator you say 'do the participants truly understand the risk?'

"When a big catastrophe event occurs and some of those bond holders lose the entirety of their principals, will that group of investors suddenly flee the market? And what will the impact be on traditional reinsurance?"

Life market

Alternative capital has been particularly influential in the property/casualty market and has forced re/insurers to change their approaches to balance sheet optimisation and profitable underwriting.

It has also allowed insurers to take advantage of different kinds of risk transfer and to utilise capital optimisation.

The life market so far has been unaffected by this influx of capital, but life insurers could learn some valuable lessons about the use of alternative capital from their counterparts in the property/casualty market, Michael Gordon, head of retirement, insurance and strategic solutions at BNY Mellon, told delegates at the forum.

Excess mortality bonds already exist, with the alternative capital space able to provide catastrophic covers to protect insureds facing financial risk from a sudden surge of deaths.

Recently in April, Axa Global Life sponsored Benu Capital Ltd, an Ireland-based special purpose vehicle (SPV) that provides the company with €285m of excess mortality protection in France, Japan and the US.

That followed on from the creation of Valins I Ltd, a Bermuda-based SPV that was sponsored by Aurigen Reinsurance. Valins I covers a closed book of Canadian life insurance coverages that Aurigen reinsured in the five years between 2008 and 2013. It provides the company with $175m of protection.

Broadening out from pure life and including the health insurance sector, Aetna once again sponsored the latest iteration of its Vitality Re catastrophe bond. This version, called Vitality Re VI, provides Aetna with $200m of coverage against a spike in medical benefit claims levels.

These three bonds have all come into being since the beginning of this year. While this shows that there is some innovative thinking in the industry, the number of life and health bonds issued is considerably lower than that for the property catastrophe segment.

Indeed, by the end of May, more than 25 insurance linked securities deals had been completed in 2015, and

"When growth is so low, if not anaemic, that really puts more downward pressure on inflation and I think the Fed is going to struggle to meet its inflation mandate over the coming years."

John Bellows, portfolio manager and research analyst, Western Asset Management

just three of these were related to the life and health market.

While some in the life and annuity markets have sought out innovative solutions in the alternative capital space, evidently their use has not been anywhere near the level seen within the property and casualty insurance sectors.

"Life and annuity has to catch up, and there has got to be a move to more active management on the life and annuity side," Gordon said.

"I think the attitude in the life and annuity model has mostly been 'don't touch it and don't change things too much'."

Gordon noted that by utilising reinsurance vehicles, life insurers can better manage their capital and optimise their balance sheets, allowing them to write multiple lines of business while remaining disciplined.

"They have been retreating from businesses which have been flat, and that to me has been problematic because this business is supposed to be growing, given the value it adds to the economy," said Gordon.

"So I think they need to think about more asset management in the business, which includes asset side underwriting and better management of liabilities, as well as a willingness to engage with outside capital and become less insular in order to optimise balance sheet exposure."

He predicted that alternative reinsurance vehicles and ILS funds were increasingly likely to start looking at opportunities in the life insurance market to add to their portfolios, and that convergence in the sector was inevitable.

Gordon noted that it was for life insurers to decide whether to embrace the capital markets and grow with them, as property and casualty re/insurers had done, or whether to cling to the status quo and possibly be replaced by less disciplined alternative capital vehicles which could offer bespoke insurance solutions at potentially better prices.

"We have to attract outside capital and the insurance industry in my view will have to change or ultimately be replaced," said Gordon.

"The question in my mind is are the people in the insurance industry going to drive the next generation of what the industry is supposed to be?

"Are we going to make all of these decisions, take a very nuanced view and question what we have done in the past to bear our expertise and drive these things forward?

"Or are we going to have the asset managers and Wall Street come in with bespoke solutions which I think will potentially create more risk in the system than what we would do."

China

Lower interest rates in developed markets have led to institutional investors searching further afield for investment gain, and one of the most interesting markets for investors is China.

The potential size and scope of China's economy continues to attract the attention of the capital markets, but delegates at this year's forum were warned that many challenges stand in the way before returns can be made.

China has long been seen as the next great economic superpower and its growing gross domestic product means that it is rapidly catching up to the US.

When this rapid growth is combined with the increasingly lenient position the country's once hard-line communist government is taking towards capitalism, China begins to look very attractive to the capital markets.

"I think China in particular is really going to be the next large capital market," said Tim Matson, chief investment officer at RGA.

While most investors were familiar with the Asian growth story, the sheer depth of China's potential capital market sets it apart from most other Asian nations, added Matson.

However, the relatively opaque nature of the Chinese market means that it also presents some challenges. Investors have to enter the market through an access vehicle and apply to get a currency allocation. Therefore, investing in the market is not something that investors should undertake lightly.

The barriers to entry are not the only potential concern for investors when looking to make moves in China.

The country's real estate market has long been a subject of discussion in the investment community, as Mark Roberts, global head of research and strategy for alternatives and real assets at Deustche Wealth & Asset Management, explained.

Roberts noted that one of the things that companies consider when evaluating international real estate is the property returns generated in each country in recent years and then comparing those against real interest rates and GDP.

Roberts said that has proven problematic for China.

"The one country that shows up as not being strong right now is China," said Roberts. "The real interest rates have risen and inflation has come down, so despite some of the stimulus policies which are being enacted there, the fact is the rates are really high.

"Also, while GDP is certainly turning into a better quality of growth, the level of growth today is certainly lower than where it has been. So that's one market from a real estate perspective that stands out today as probably not being priced well for some of its long term risks."

Srinivas Thiruvadanthai, director of research and managing director at The Jerome Levy Forecasting Center, also expressed concern over China's interest rate environment.

"China's interest rates are probably at peak leverage and they are already higher than where the US was at peak levels in 2007," he said. "Maybe they can go higher than that, but I somehow cannot see where Chinese returns are going to be great."

Despite concerns over a potentially overinflated real estate market, the growth in China cannot be ignored.

Roberts told the audience that if you look at the next 10 years and consider nominal GDP from today, putting aside purchasing price parity, China will likely grow from 53% of the size of the US, to 75%.

There is also an Asia-Pacific trade partnership being discussed by the Asia Pacific Investment Bank, and Roberts noted that if you were to reflect over the last 20 years when free trade zones like Nafta and the EU were established, the explosion in terms of trade has increased by trillions of dollars.

If investors want to get exposure to the potential Chinese growth without the market barriers to entry, they could look at

gaining exposure in more open markets that are China's trade partners, Roberts suggested.

"Given some of that growth that is expected there, Asia stands to benefit quite a bit," said Roberts. "I don't think you necessarily have to invest in China, but you can invest in major trading partners of theirs including South Korea, Japan, Australia and Singapore.

"They are all much more transparent markets which will stand to benefit from that growth in China. So you can get that exposure without necessarily having to go through the capital controls."

"The Next War"

Many questions have been raised regarding the Federal Reserve's (Fed's) handling of the financial crisis, and there are plenty of opinions both for and against the actions it has undertaken since 2008. John Bellows, Portfolio Manager and Research Analyst at Western Asset Management, believes the Fed has successfully navigated its way through some of the more pressing challenges it has faced in recent years, in particular, in winning the battles against what he calls "the past wars".

"Over the last six years, the Federal Reserve has been very focused on fighting the last wars," Bellows said. "It's been very focused on not repeating, or doing everything it can, to prevent a repeat of the mistakes it has made in its 100-year history."

Bellows believes the Fed has faced three major wars, each of which had its own specific nuances. In each, the Fed undertook various measures it believed would help, but not all of them were a success.

The first was The Great Depression, and according to Bellows, while the Fed was not the cause, it was certainly a contributor to the economic crisis.

"The Fed let a lot of banks fail in the early 1930s," said Bellows. "It was very much of the mindset that some failure was actually a good thing because it cleansed the system – that it would let more productive assets and companies rise. What it missed is that letting banks fail caused a considerable contraction of credit and liquidity."

This was not the only involvement the Fed had in The Great Depression. It raised interest rates even as the stock market was collapsing.

"Even as inflation was turning negative, the Fed was tightening monetary policy," Bellows explained. "To put that into perspective, in 1932 right after the crash in 1929, real interest rates were 15%. That's extraordinarily tight monetary policy given the conditions."

The second war the Fed has faced was the Great Inflation in the 1970s. The Fed knew inflation was a problem and it also knew how to deal with it. However, throughout the 1970s, the Fed deliberately chose to emphasise the employment part of its mandate over the inflation element.

"We all know that decade ended with inflation rates in the double digits. The Fed's mistake was emphasising its employment mandate at the expense of its inflation mandate," said Bellows.

The third war is the one the global economy is still recovering from: allowing financial risks to build up in the 2000s in an unsustainable way.

"Since 2008, the Fed has done everything in its power to make sure it avoids making the same mistakes again," added Bellows.

"Other than Lehman, it did not let any banks fail and it is certainly not going to let any banks fail like it did in the 1930s. Lehman was obviously the exception, but every other bank in the US was either provided with emergency liquidity or some workouts so we didn't have a bank failure."

Furthermore, the Fed has avoided a contraction of liquidity.

"The Fed swamped the system with liquidity. Most Federal Reserve officials would argue, convincingly in my mind, that they have avoided causing a second Great Depression.

"We have to attract outside capital and the insurance industry in my view will have to change or ultimately be replaced."

Michael Gordon, head of retirement, insurance and strategic solutions, BNY Mellon

"They have very clearly avoided making that mistake with inflation. Not only is inflation not a problem today, if anything it's too low. The Fed is clearly focused on not letting financial risks build up either. It has clamped down on risk taking, whether that's through higher capital restrictions or whatever else. The Fed is very intent on not making that mistake again."

Consequently, Bellows said the Fed deserves some credit for not repeating the mistakes it has made in the past.

While the Fed deserves praise for this, there may be some cause for concern in the future. While the scenario as it stands looks good, some of these issues may rise again in the future in perhaps one, two, or even five years' time. But Bellows is less concerned about this than he is about the next war, which he thinks could stem from a period of very low potential expansion and low productivity growth in the US.

The recovery from the financial crisis has been disappointing relative to every metric or forecast that was written in 2009, Bellows said. "What is surprising and notable is what the response to that disappointment has been. One potential response would be step on the gas even more – do more to get the economy back up to where it should be. What we've seen is the disappointment in the growth has been incorporated in outlooks. Over the last four or five years, expectations for the US economy have come way down. Lower growth and a slower, more disappointing outcome has not led to more policy. Instead it's led to lower expectations for growth."

This is the next big challenge for the Fed, Bellows believes, as expectations for growth are now falling.

"Where you would have expected growth to be in the three to four percent range in the 1990s, most people in the Fed and most people in the markets would agree that period is now behind us. Productivity growth is somewhat slower. We're certainly not seeing the labour force growth that we saw earlier, we're not seeing the capital formation we saw in the 1990s and the reality is this slower growth environment is likely to be the next war for the Fed."

As a result, Bellows believes the Fed should be extremely cautious in the way it raises interest rates.

"Given the low growth, the Fed doesn't have a lot of margin to bear here. When growth was 4%, it raised rates a little too fast and growth slipped to 3%, which was still okay. When growth is at 1% or 1.5%, if it raises rates prematurely and we're in a recession, it has a much bigger problem on its hands."

In Bellows' eyes, growth is usually the best indicator with what will happen to inflation.

"When growth is so low, if not anaemic, that really puts more downward pressure on inflation and I think the Fed is going to struggle to meet its inflation mandate over the coming years." ●

By Christopher Munro – christopher.munro@euromoneyplc.com and Sam Kerr – sam.kerr@euromoneyny.com

Micro insurance consortium

Developing products that actually meet the needs of those in emerging economies, as well as creating reliable and user-friendly ways of both paying premium and collecting claims, will all determine whether the multi-company multi insurance venture incubator is a success, says Aspen's Mario Vitale.

Creating products that are actually relevant to its audience and establishing reliable methods of distribution and payment will be critical to the success of the multi-company micro insurance consortium that was launched during the World Economic Forum (WEF), Aspen Insurance Holdings' Mario Vitale believes.

The micro insurance consortium and micro insurance venture incubator (MVI) were unveiled during the WEF in Davos back in January with the backing of some of the biggest names in the insurance and reinsurance industry: AIG; the aforementioned Aspen; Catlin Group; Guy Carpenter & Company, together with its parent Marsh & McLennan Companies; Hamilton Insurance Group; Transatlantic Reinsurance Company; XL Group and Zurich Insurance Group.

Joan Lamm-Tennant, global chief economist and risk strategist at Guy Carpenter, has been appointed to serve as the Bermuda-based MVI's chief executive, although she will actually be based in New York.

Alexander Moczarski, the president and CEO of Guy Carpenter and chairman of MMC International, will serve as the MVI's chairman, while Vitale, Aspen Insurance's CEO and president of Aspen US Insurance, is vice-chairman.

Speaking to **Reactions** at the Risk and Insurance Management Society's annual conference in New Orleans, Vitale said many companies have made moves into the micro insurance sector in various developing economies over the years, but these have enjoyed mixed levels of success.

"We've been trying to figure out how to sell relevant products to the emerging economies in Africa, Asia and parts of Latin America where the emerging middle classes are becoming consumers and entrepreneurs. However, they will not be able to get there without economic protection, whether it be micro financing or micro insurance products that are more relevant to them."

It is here where Vitale believes the re/insurance industry has struggled with micro insurance in the past – trying to create a product that is relevant to both underwriters and the cedants who, in many instances, may only make a dollar or two a day.

"The reason why we as an industry have struggled is most of our products and services are dedicated towards developed economies where there are developed risks, assets and experience. The foundation of the transfer of risk from either an individual or a business to a third-party has been well established for a couple of hundred years, so it's hard for our product development teams to understand what a stripped down product that is economically affordable from both the exposure and insured's view might look like.

"What the micro insurance consortium is doing is bringing the best and the brightest people together to help tackle this issue."

Trying to find a product that would interest potential buyers is only one of the challenges facing the MVI however, with issues over both premium and claims payments also needing to be addressed.

Vitale visited Uganda as part of Aspen's partnership with the Adara Group, and while he was in the country, he found that many of the people outside of the major cities had no way to pay for products other than via cell phone.

"What the micro insurance consortium is doing is bringing the best and the brightest people together to help tackle this issue."

Mario Vitale, CEO and president of Aspen US Insurance

"There are no banks, checking accounts or credit cards – if you want to pay for goods or services besides cash, you have to use your cell phone," said Vitale.

"We will have to find a way to participate in that sort of process which, as insurance companies today, none of us have been prepared to do. We have to work on distribution and sales, as well as how we pay claims. We can't give people checks because they don't have banks – there's no place to do that unless you're in the capital."

Despite these challenges, Vitale is confident that between the companies involved, the MVI will be able to come up with some creative solutions.

"This consortium has the considerable resources and brain power to figure all of this out. We all have a long term mindset – we've already agreed that when you sign up for one of these, you're in it for three years," Vitale said.

"We as a group don't want to approach this in the way we all might have done in the past, which was to think 'Well directors' and officers' (D&O) is a profitable product, let's try and do that in India'. We're looking to see where and what the demand is."

The MVI has pledged to launch 10 micro-insurance ventures in currently unserved or underserved emerging markets over the next decade. The companies taking part in the MVI are currently evaluating opportunities in Latin America, Africa and emerging Asia, with the initial venture set to be launched either later this year or in early 2016.

And Vitale believes by participating in the MVI, his own company will learn new ways of looking at the business.

"This is a way for us to expand our own company. The exploration and product development stage of this venture is such that by having six equal partners contribute to it means it's much more economical to think it through, research it, develop it and then incubate it. If we try it somewhere and it works, we can expand it in another part of the world. If it doesn't work, we can tweak it and make it better. I'm excited about it." ●

By Christopher Munro – christopher.munro@euromoneyplc.com

Healthcare growth opportunities

David A. Rains, Co-Leader of the Healthcare & Life Specialty Practice, Guy Carpenter & Company, LLC

In the insurance industry there are many factors driving change, with recent regulatory developments in the health insurance sector chief among them. It has been almost five years since the enactment of the Patient Protection and Affordable Care Act (ACA) and the impact on healthcare payers and providers in the United States has been tremendous and profound.

While there are many opportunities for achieving growth through innovation, the healthcare sector offers significant opportunities for market innovators and leaders.

Healthcare insurers operating in the United States now face challenges with the elimination of underwriting, and unlimited lifetime and annual medical benefits are redefining the potential size of large losses. Insurers are also looking for more ways to bend the rising cost curve downward. They are approaching the limits of negotiated savings with the very complex healthcare value chain, and many are focusing on wellness and population health management as key to a successful future.

Insurers recognise the need to stay on top of innovations in wearable technology and telemedicine, and how these emerging trends can help keep both well and chronically ill populations healthier, happier and less expensive to cover. These come with increased data flows that will create new opportunities and new threats for insurers and providers. Investment in the evolution of data collection and mining could have significant rewards.

With potentially radical changes in distribution and greatly reduced friction in moving between carriers, new analytic methods must be utilised to understand what population cohorts for insurers to expect and how they can influence that. Traditional actuarial methods will remain important, but advanced predictive analytics will be the toolset that helps carriers make better decisions going forward.

These investments will help insurers continue to add value to their self-funded clients as well. This will be increasingly important as smaller employers elect this path – a clear post-ACA trend. We expect this to fuel significant growth in the stop loss market.

As providers accept more risk, they will need to mitigate potential liabilities, manage increased capital requirements, form and utilise captive insurers – or even potentially transform their business model from fee-for-service to the outcomes-based methodologies of the future.

For both payers and providers, scale will be a critical watchword. Merger and acquisition activity will be constant – as will the need to monitor and participate in that market activity to ensure they remain relevant and see the right opportunities at the right times. There will be room for innovation, flexibility and agility from smaller players, but it must scale quickly.

Public and private exchanges are emerging as powerful distribution systems not only for healthcare, but also ancillary insurances such as life, disability, dental and vision. If they do not have it already, insurers across all employee benefits lines must have an exchange strategy.

With these changes redefining their businesses, insurers should redefine what they expect from reinsurance. Reinsurance can become not only a risk mitigation tool, but a vehicle to deliver strategic capital, in all its forms. Even beyond that, reinsurance is a gateway to the larger community of resources and capital dedicated to understanding and serving the healthcare value chain; learning and adapting to an evolving market and finding new ways to create and finance profitable growth.

In the far tail of potential risks, pandemics are among the top of the list of concerns of insurers these days. The recent Ebola outbreak serves as a reminder to the industry that this type of threat is not only possible but the potential magnitude both in terms of economic and insured losses is great. And Ebola is merely the latest harbinger of the pandemic threat, which includes Dengue, Monkeypox, Middle Eastern Respiratory Syndrome, as well as a variety of virulent flu threats and other infectious diseases. The devastating potential for loss of human life and economic value has driven the insurance sector to become more innovative.

(Re)insurers have been exploring new/alternative solutions to not only provide protection for potential large pandemic losses but also to be proactive and mitigate a loss before it happens. The industry has developed pandemic models and is encouraging risk management plans. Also, important and creative proactive solutions have been and continue to be developed, such as mortality bonds, World Bank Pandemic Emergency Facility, industry loss warranties and pandemic catastrophe reinsurance.

Looking beyond healthcare, reinsurance is being used in new ways for other life and health lines of business – particularly those with very long tail liabilities. Reinsurance of fixed annuities has been a growing market trend. These liabilities are very long and market yields since 2008 have forced portfolio yields below the guaranteed crediting rates for many of these blocks – creating losses or concerns. We consider this market, though, to also be the proving ground for other, more challenging problem areas. Fixed annuities are a relatively simple liability where investment strategy gains are easily demonstrated.

The same concerns are present in long-term care, with inforce premiums at approximately $14bn annually. Many of those blocks are dealing with the impact of declining portfolio yields as assets roll over. Liabilities for this space are very long and include more complicated morbidity and longevity factors. The industry has grappled with this cover and answers are elusive. However, the increasing demographic shift to an older population that needs this protection will fuel further research, innovation and solutions.

These obligations are significant and the market is ready for scalable solutions with magnitude. Most insurers do not have the capacity or appetite to match the potential transactions that will be available. But, consortiums of risk takers, tied together with risk sharing solutions including reinsurance, will find incredible opportunities in the near future. Healthcare risk takers will need more efficient capital. This collaborative approach to innovation benefits the marketplace and the industry.

The healthcare industry faces many challenges, but despite these challenges there continues to be growth opportunities for those who take a strategic approach. As the industry identifies ways to enter markets, leverage technology and develop new products – innovation will again play a critical role in the evolution of this business. ●

The future is bright

The impact of alternative capital on the traditional market is only set to increase, as Christopher Munro and Sam Kerr report from the Reactions' Alternative Capital in Re/Insurance Business Club in New York.

The alternative capital space continues to grow at a rapid rate with the first quarter of 2015 once again setting new records for catastrophe bond issuance, figures from Aon Benfield's Insurance-Linked Securities First Quarter 2015 Update show.

These numbers proved to be the perfect backdrop for the latest instalment of Reactions' Alternative Capital in Re/insurance Business Club in New York where some of the leading lights of this niche segment of the industry gathered to discuss some of the burning issues affecting the market.

Aon Benfield's report showed that ILS investors remained focused on the property catastrophe market during the first quarter of 2015, despite industry speculation that capital will begin to move into other sectors.

With more capital entering the natural catastrophe market, pricing has been driven down and returns for investors have fallen. As such, some have speculated what the future of the ILS market holds. This subject was one of the most hotly debated topics at the Business Club with numerous questions over whether ILS funds can move beyond what has been the most popular sector to date – the property catastrophe space – and into other lines of business.

Paschal Brooks, portfolio manager at Validus Group subsidiary AlphaCat Managers, expressed scepticism over whether the capital markets would move into the longer-tail specialty space.

"There have been discussions recently about moving into to other lines of business, [but] we're much more sceptical of that," said Brooks. "Catastrophe reinsurance is relatively well defined as a short-tail class and has been gaining acceptance among capital markets providers.

"Trying to expand into specialty lines is much more difficult because the absolute return margins are much lower. Those are probably better served by balance sheets and we think that is likely to be the case going forward."

One of the advantages in ILS investing is the speed and liquidity of the asset itself.

However, catastrophe is fairly unique in the re/insurance space owing to its liquidity, but limited liquidity in specialty lines is an immediately identifiable barrier to the capital markets entering that specific segment.

"I don't think that the typical benefits and framework associated with an ILS fund work particularly well for most lines of specialty and beyond, in the sense that one of the big advantages to ILS capital is the liquidity," said Brooks. "It is fairly liquid compared to other asset classes and compared to traditional reinsurance contracts it's very liquid.

"An investor can move in and out of this sector on a six month or yearly basis, it has a relatively fast claims development because when catastrophes happen you have a decent element of what your losses are, even if the capital isn't released for some time.

"Specialty lines are notoriously long compared to catastrophe in terms of development."

Some investors may be unable to invest in specialty lines depending on the current liquidity of their portfolio, according to Brian Barrett, partner at Sutherland Asbill and Brennan, who spoke on the day's second panel.

He noted that a lot of funds have rules about the level of illiquid assets they can hold within their investment portfolios, a possible stumbling block if they want to move into the specialty lines space.

Barrett also added that the lack of loss data on the asset could present a ratings issue which would put off much of the market from investing.

"Right now managers typically require a certain number of standard things in order to invest," said Barrett. "A rating may be imperfect, but it at least gives the manager some idea about expected loss.

"So if you have a new risk which doesn't have data by which ratings agencies can assess the expected loss, you are going to lose a lot of the market right off the bat."

While the impact of the ILS and alternative capital market

on carriers is obvious, it has also had significant impacts on re/insurance broking as well.

Erik Manning, managing director for alternative solutions at Markel Re, noted that large brokers were no longer operating in the way they were 20 years ago, and that the role of the broker had evolved significantly.

According to Manning, brokers have now evolved to the point where they are almost becoming diversified financial services companies, thereby fundamentally changing the very business of risk transfer.

However, despite the concern shown by some reinsurers over the future of the market, Manning expressed his confidence that there will still be a place in the market for traditional companies, especially given concern that some policy holders had about capacity being constantly available.

The discussion about what alternative capital will do following a big event lends credence to the view that the long standing relationships held by traditional re/insurers will continue to bear fruit. However he conceded that the overall book of re/insurance business is not getting any larger, which could potentially lead to further market consolidation, the likes of which the overall industry has been witnessing in recent months.

Another area that has been discussed as one of potential growth for the alternative capital space is that of pandemic. Excess mortality bonds already exist, with the alternative capital space able to provide catastrophic covers to protect insureds facing financial risk from a sudden surge of deaths.

However, it has also been suggested the alternative capital space could provide a solution to another area related to pandemic.

As seen most recently with the Ebola crisis, and in the past with avian flu, pandemic illness can travel across regions, and indeed continents, incredibly quickly. While much is done to try and limit the spread of such illnesses, one of the problems in trying to contain them is they often arise in areas of the world that are under developed.

Consequently, there is the possibility countries or organisations such as the World Health Organisation sponsor pandemic bonds that would provide sums of money to help stop the spread of pandemic illness.

But as Brent Slade, chief operating officer at Horseshoe Group, explained, while these concepts are interesting, questions remain as to whether they are commercially viable.

"When there have been initiatives in the past to create super national pools and risk sharing initiatives, there's been a huge amount of hurdles and road blocks, so we've seen relatively few," he said. "The ones we have seen become successfully funded and launched have been minimal… I just think it's interesting, but commercially very difficult."

Peter DiFiore, portfolio manager at Cartesian Re, said social impact bonds and other forms of financing that would be made available before a widespread outbreak have been garnering interest, with the modelling and pricing of the risk viable.

DiFiore also said there is an appetite from investors for these sort of risks, especially from certain areas of the industry.

"There's a widespread initiative across a lot of the investors in this asset class – meaning the pension funds that are out there – to think about more socially responsible investments. [At some of these funds] there's a lot of pressure for divestment from fossil fuels and there's a real struggle to find alternatives that are both transparent and socially responsible, so I think there's a lot of potential here from the ILS investors and the groups they serve."

While there may be an appetite from investors to provide capital to support these products, Rick Miller, managing director and co-head of ILS at JLT Capital Markets, remains sceptical whether such products would actually get purchased.

> **"I don't think that the typical benefits and framework associated with an ILS fund work particularly well for most lines of specialty and beyond."**
>
> **Paschal Brooks, portfolio manager, AlphaCat Managers**

"Creating the product is easy – we've had pandemic bonds in the past, and we can have parametric triggers around the number of lives lost and the number of people infected – there's plenty of data around pandemic vectors.

"But I think where the challenge lies is the politics around the buying decision. When you think of the World Health Organisation and you think of the politics and the perception of spending money to purchase insurance that may or may not ever be used, it is quite challenging."

Moves into lines of business outside the property catastrophe space may not be as quick as some had predicted, but one area of the sector that has been expanding is that of hedge fund reinsurance.

However, according to Steven Chirico, assistant vice president at AM Best, only a finite number of these operations will be able to set up shop owing to a lack of credible and viable underwriting teams. Chirico said he would be surprised if many of these operations actually came into being, despite the considerable interest in the sector.

"We do feel that there is a natural ceiling in the amount of hedge fund vehicles that we are going to see. It's hard for me to give you a number, but I would be really shocked if we had 20, and I would be surprised if we had 15," he said.

"We currently have five and there are three serious candidates that we are examining at this point, so we are about halfway to my surprise threshold. My guess is that we will have 10 or 12 and then that market will be exhausted.

"It will be exhausted because there is a lack of availability of good management teams that can execute a very good underwriting business plan and the lack of credible existing reinsurance partners that would want to get involved in something like this.

"The limitations are going to come from the underwriting side of the house, not the asset side of the house."

Chirico noted that there were plenty of potential hedge fund partners for reinsurance vehicles, but the quality underwriting teams are not so plentiful, and consequently only a limited number of these team-ups will actually be possible.

"There are plenty of good low volatility alpha inducing alternative asset managers out there that can be partners with existing reinsurers, grow their own management teams if they can find them, or actually merge their entities," he added. "So we believe that because of the underwriting piece, there is going to be a natural de-limiter of the numbers that I cited."

Speaking about his own experience with vehicles looking to establish themselves in the market, Chirico noted that they need a minimum of an A- rating to be regarded a viable player.

This requirement for an A- rating as a new market validates the need for an established underwriting team to support any capital entering the reinsurance market, thereby increasing the competition for hedge funds looking to enter the space. ●

By Christopher Munro – christopher.munro@euromoneyplc.com and Sam Kerr – sam.kerr@euromoneyny.com

Call the lawyers

Lawyers and legal services are in particular demand this year, as the sector faces feverish M&A and industry consolidation, challenges and opportunities related to international sanctions, plus huge regulatory changes. The Reactions Legal Survey 2015 looks to answer some of the big question marks around legal issues for today's re/insurance market.

For a lot of insurers and reinsurers it's a tough market out there. Whether it's loosening T&Cs leading to sticky insurance claims disputes, rival brokers in court over poaching allegations, or embattled reinsurers seeking mergers from necessity, there is great need for good legal advice. 2015 is likely to bring continued industry consolidation, regulatory upheavals and sanctions changes, whether concerning Iran or Russia. So to juxtapose this year's legal survey, **Reactions** asked some friendly legal experts to weigh in on what's keeping them busy and to forecast some challenges for the months ahead.

M&A

The prevailing narrative in the industry at the moment is one of consolidation and this year has seen a number of high profile merger and acquisition (M&A) deals including: XL Group acquiring Catlin to become XL Catlin, Endurance buying Montpelier Re, and RenaissanceRe announcing its purchase of US specialty player Platinum Underwriters.

The motives behind these marriages are not secret: to "tier up", find growth and achieve economies of scale in a highly capitalised and intensely competitive marketplace. While re/insurers have in the past attempted to expand organically by growing their in-house capabilities, it looks like expansion by acquisition will be the preferred method for some time.

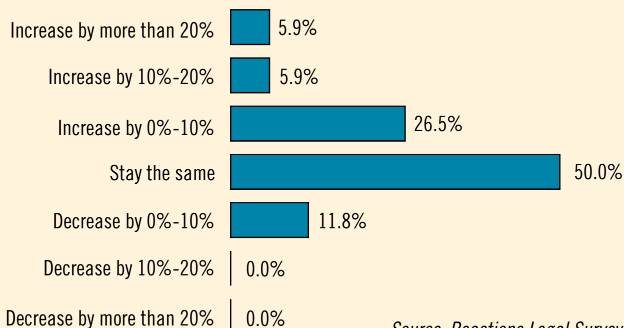
Any acquisition is fraught with legal risk and the two most common types of deal, according to David Whear, a partner at Norton Rose Fulbright, are an auction deal and a bilateral agreement with both representing differing levels of responsibility for buyer and seller.

"There are two types of process," says Whear, whose practice is making a recognisable push to expand its insurance activities. "Most of the Lloyd's deals have been structured as heavily administered auctions sales, if I can put it that way, where the investment bank appointed and the selling company, spend a lot of time preparing an investment memorandum, the content of which depends on the nature of the particular business and the target audience.

"There may also be vendor financial due diligence – so really packaging up the asset for a fairly wide initial range of potential bidders and then hopefully narrowing that down. In that sort of process there is lots of preliminary work, as you would expect, to make sure what you are putting together and selling to the market has been done in a thorough way and which will withstand that kind of process.

"Outside of those auction deals you have more ordinary bilateral deals where you may find two parties that want to do a particular transaction and that tends to be more of a buyer led process with their own diligence requirements being key.

Do you expect your spend on external law firms in 2015 to:

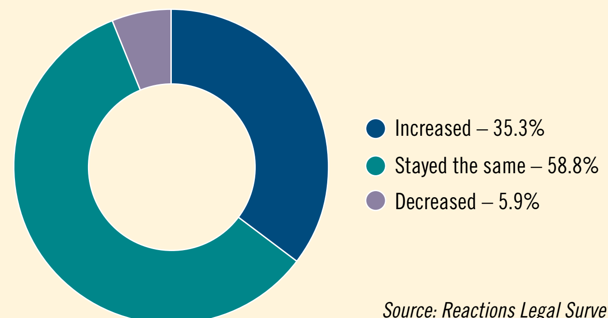


Source: Reactions Legal Survey 2015

Half of respondents this year expected their expenditure on external law firms to remain the same. This compared with just over 40% thinking this in last year's survey. The major change from last year's responses was a compression of anticipated price moves. Last year nearly a quarter of respondents thought that prices could move by more than 10% (most of them fearing an upward move). This year, perhaps reflecting the more deflationary outlook on the European side of the Atlantic, just under 12% anticipated a significant price hike.

Few people ever seem to think that their legal fees will go down.

How have your in-house legal resources changed in the past year?



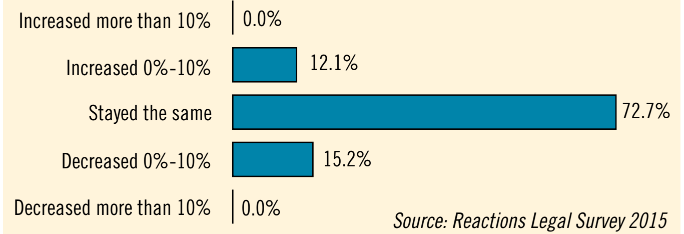
Source: Reactions Legal Survey 2015

Not much change here from the response last year. Significantly more increases of in-house resources than decreases. Is this enough to represent a trend, or is it a misapprehension of reality by respondents (they think that they are employing more in-house legal resources, but they notice the incomers more than they notice the disappearers). Legal resources are of necessity dynamic, changing as the product line and focuses of the insurers change. But new initiatives tend to take place in the glare of publicity. Burials tend to be quieter.

Reactions Legal Survey results 2015

Overall	Rank	Firm
In all legal dealings	1	Drinker Biddle
	2	Sidley Austin
	3	Clyde & Co
By area of specialty	**Rank**	**Firm**
Litigation	1=	Sidley Austin
	1=	Drinker Biddle
	3	Clyde & Co
Regulatory	1	Drinker Biddle
	2	Sidley Austin
	3=	Clyde & Co
	3=	Clifford Chance
	3=	Willkie Farr & Gallagher
	3=	Dentons
	3=	Sutherland Asbill & Brennan
M&A	1	Drinker Biddle
	2	Sidley Austin
	3	Mayer Brown
Insolvency	1	Sidley Austin
	2	Drinker Biddle
	3	Clyde & Co
ILS	1	Sidley Austin
	2	Drinker Biddle
	3	DLA Piper
Taxation	1	Sidley Austin
	2	Drinker Biddle
	3	Willkie Farr & Gallagher
By region	**Rank**	**Firm**
North America/US	1	Drinker Biddle
	2	Sidley Austin
	3=	Locke Lord Edwards
	3=	Willkie Farr & Gallagher
Europe	1	Clyde & Co
	2	Sidley Austin
	3	Drinker Biddle
London	1	Drinker Biddle
	2	Clyde & Co
	3	Sidley Austin
UK	1	Clifford Chance
	2	Drinker Biddle
	3=	Herbert Smith Freehills
	3=	Holman Fenwick Willan
	3	Norton Rose Fulbright
Latin America	1	Drinker Biddle
	2=	Mayer Brown
	2=	Willkie Farr & Gallagher
Asia-Pacific	1	Drinker Biddle
	2	White & Case
	3	Sutherland Asbill & Brennan
Middle East	1	Clyde & Co
	2=	Clifford Chance
	2=	Drinker Biddle

How has the volume of litigation or arbitration faced by your company changed in the past year?



Source: Reactions Legal Survey 2015

A similar response to last year here. Litigation volume seems to remain fairly constant in the industry even if it can vary significantly from one year to the next for individual companies. This is only a part of legal firms' offering to the industry; M&A activity tends to come in more consistent industry-wide waves. It might be argued that the same is the case for regulation, with periods of activity followed by periods of quiescence. However, in recent years the tidal wave of regulation has seemed to be never-ending.

"On an auction sale the seller will be setting the timetable and the process and documentation and driving it. On the other it would tend to be more buyer led and driven because you are just in a bi-lateral negotiation."

One of the more interesting deals taking place in the market at the moment is the battle for PartnerRe between Exor and Axis Capital, also featured in this month's **Reactions**.

The boards of Axis and PartnerRe announced last year their intent to combine in a merger of equals in an effort which would create one of the world's largest property/casualty reinsurers.

However, in April and May the deal has become at turns subject to much greater uncertainty since Turin-based fund Exor, used as an investment vehicle by Italy's Agnelli family of investment magnates, came up with a rival cash offer. PartnerRe's board rejected Exor's bid and pledged to push ahead with its merger with Axis Capital.

Since then, however, after a revised bid from the Italian investment group, Exor and PartnerRe have been trading thinly veiled insults and accusations of foul play, while a shareholder vote is still to come. There is a strong chance shareholders could back the Italian fund's bid over the board's preference for Axis, but hostile takeovers are not the norm within this industry.

"Generally received wisdom is that going effectively hostile on an insurance business without fairly rigorous diligence is quite difficult," he says. "Both from understanding reserves and the asset and liability position of the balance sheet and from a people perspective – it's critical to make sure that you have got your key guys aligned.

"So that makes it quite difficult to decide to interfere in a particular bid but it does happen. You may take the view depending on price that it's a place where you could get comfortable."

While PartnerRe and Axis are both known as Bermudian players, the Lloyd's market in London continues to be a hotbed of M&A activity because of the benefits from the vast array of international licences that it offers, as well as containing a bevy of small- and medium-sized specialty re/insurance players, potentially ripe for consolidation.

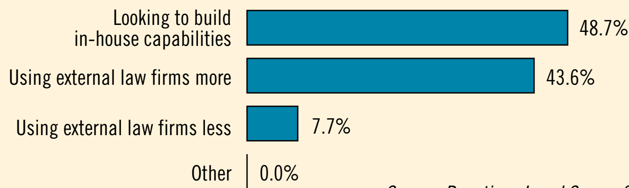
This year has already seen Hamilton Insurance Group agree a deal for Sportscover and Endurance announce that it was purchasing Montpelier Re, with both companies citing Lloyd's market opportunities as an important driver behind the activity.

The Lloyd's market's international reach could lead to more companies looking for a convenient way to enter that market as well as parachute into many emerging markets within which Lloyd's has established licenses, such as China or Brazil.

When combined with a level of international prestige associated with being a Lloyd's insurer in a market with over three centuries of insurance pedigree, taking out space on the underwriting floor at One Lime Street makes sense for some.

Alan Levin, a partner and vice chair at Locke Lord spoke to

How are increasing regulatory/compliance issues affecting how you approach legal services? *(respondents could select more than one option)*



Source: Reactions Legal Survey 2015

A slight increase this year in those looking to build their in-house capabilities and a slight increase into those looking to cut down on the use of external law firms. Respondents were permitted to pick more than one response and this has been remodelled to 100%. If the responses were not remodelled to 100%, there would have been a slight majority for the "looking to build in-house" over those looking to work more with external firms.

Reactions and stated that having a Lloyd's presence remains highly attractive for many players in the industry.

"I think that getting into Lloyd's from scratch continues to get harder and harder, so I think we will continue to see buying of those Lloyd's entrance vehicles so companies can get into Lloyd's; I don't think that's going to go away," says Levin. "The trading privileges that Lloyd's provides is clearly part of that, but I would add to that most global players are going to have a London market presence and also have a global plan with respect to where they want to grow, but the Lloyd's vehicle gives them immediate paper to trade on.

"The biggest challenge from now with Solvency II is undoubtedly going to be the Pillar III regulations on reporting and the collation of the granularity of required information."

David Whear, partner at Norton Rose Fulbright

"There's some serious large consolidation in both the re/insurance and property/casualty markets," he continued. "I think it is starting to show that the sheer size of a company's surplus and its global reach seems to matter as do economies of scale to keep down costs of insurance."

Regulatory tangles

Alongside M&A, regulation remains one of the more frequently cited concerns for the industry, with a number of capital standards reforms appearing on the horizon.

The largest single regulatory challenge now looms for European insurers as the Solvency II directive lumbers towards implementation in January 2016, marking the end of a glacial

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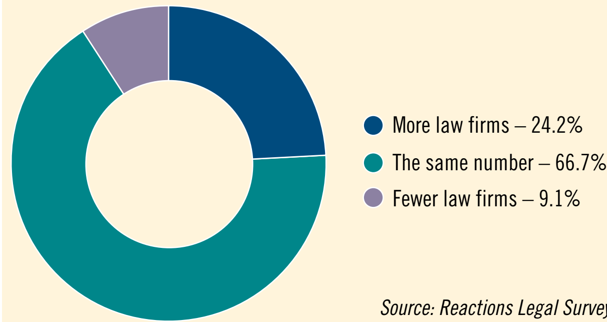
Do you have more, fewer, or the same number of law firms on your legal panel as you had this time last year?

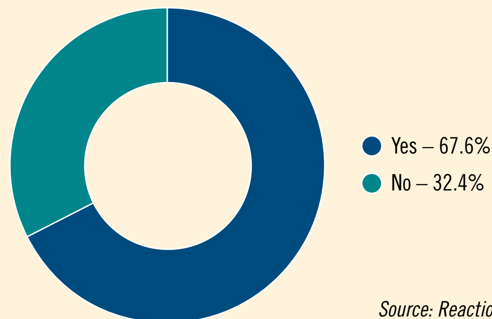


Source: Reactions Legal Survey 2015

A distinct increase this year in the "more law firms" response, up from 14% to 24%, while there was a 5 percentage point decline in each of the other two categories.

At first sight this is something of a strange response, and possibly not one that legal firms would be delighted to see. After all, the legal sector is consolidating. One would have imagined that, if anything, the number of firms on panels would be declining. But this does not seem to be the case.

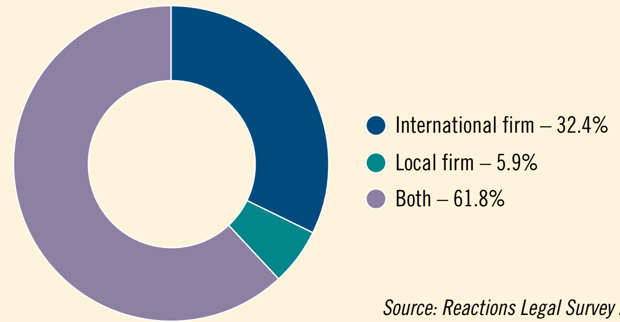
Are you looking for an increased international perspective from the law firms that you use?



Source: Reactions Legal Survey 2015

A significant increase here in the percentage looking for a greater international perspective from the law firms used by insurers (68%, from 57% last year). This is perhaps a reflection of the globalisation of the re/insurance industry. Several of the top reinsurers have emphasised the need to be a global player, and there could be a trickle down here into the primary sector – not least because of the increase in the number of insurers that now have an interest in the Lloyd's market. Throw in the growth of Dubai as a reinsurance hub, and it is not hard to see why an insurer or reinsurer would value a law firm that had international experience and skills, if not an actual presence.

If you had a legal question about operations abroad, would you tend to use an international firm, a locally based firm, or both?



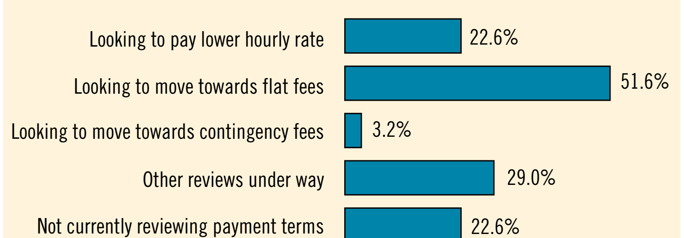
Source: Reactions Legal Survey 2015

The change from last year is that a greater percentage (62% from 47%) would use both a local firm and an international firm. Significantly fewer companies would trust a local firm to act internationally for them (6%, from 20.5%), while the same number would use an international firm only.

The conclusion to be drawn is that, while it is useful to have an international firm that knows the lie of the land, a local firm is more likely to appreciate fully the needs of the customer.

One could also perhaps tie this in with the increase in the number of law firms that companies are likely to have on their panel. In a globalising world, there is a need for a greater range of legal talent.

If you are reviewing the way you pay the law firms you use, how are you doing so? *(respondents could select more than one option)*



Source: Reactions Legal Survey 2015

The big increase this year compared with last (when it was also the most mentioned choice) was "looking to move towards flat fees" (mentioned by 52% of respondents, up from 40% last year). There was a decline in all other responses, most notably in the "looking to move towards contingency fees" section (down to 3% from 13%).

process towards uniform European insurance regulatory standards, while myriad compliance challenges will just be beginning.

Despite the looming deadline, there are still a number of question marks for many EU re/insurers, particularly around the Pillar III reporting standards, designed to enhance and harmonise disclosures, which are outlined in the new framework.

The measure which encourages greater levels of financial disclosure is proving troublesome for some re/insurers and a survey from financial advisor Grant Thornton revealed in March that nearly one quarter of re/insurers could still be inadequately prepared for Pillar III compliance.

"The biggest challenge from now with Solvency II is undoubtedly going to be the Pillar III regulations on reporting and the collation of the granularity of required information, particularly on investments that insurance groups are going have to demonstrate to regulators," says Whear.

"When you think how insurers' investment portfolios look and you have got significant investment in funds, effectively the Solvency II rules are saying that you have got to get into understanding what the underlying assets are and there are clearly conversations and processes that you have got to put in place with your investment managers so that they can deliver that information. That's not always that straight forward," he continued.

He added that there had already been extensive attempts to model the process for meeting Pillar III standards, some of which is similar to regulatory standards in the UK.

"A lot of work has gone into the modelling process and the governance process and making sure that you have got the right policies and procedures," says Whear. "Obviously there has been a change in dynamic in the number of groups that will have approved internal models, certainly in the UK. But that being said

How, if at all, has consolidation among law firms affected how you use external legal companies?

(selected responses)

- Allows me to choose a firm with a global reach in various jurisdictions
- We tend to stick with established practice groups regardless of where they go
- It has not. Relationship is usually with the attorney
- Harder to find quality mid-priced firms. Consolidation has led to higher overall cost per hour
- We tend to follow the partner not the firm, it's about value add added results
- In most cases it has forced us to use the newly consolidated firm because the team and or partner that we have a relationship with stayed with the newly consolidated firm. In other cases we walk away altogether
- We go with individuals but if the merger impacts delivery we would move
- We hire lawyers and teams
- Expanded as lawyers shift firms
- Made managing conflicts more difficult and time consuming
- Fewer choices and higher prices

How could law firms improve their services?

(selected responses)

- I think offering local and international services would be an asset
- Understand our business, don't overstaff projects
- Better and smarter billing. More prompt, and stop the "automatic" increase every year for the billable hour
- We are very pleased with our current stable of law firms and see no areas of needed improvements
- I am satisfied
- I only use firms I'm satisfied with
- More set rate per project pricing for regulatory research
- The consultancy services arms could be completely reengineered to actually provide value to clients, leveraged off the partners who know the clients
- More regular contact, in most cases we don't even remember a particular firm is on our panel
- Be more proactive on business issues
- Better communication and understanding of our business
- By getting to know our business and corporate structure better
- Not only provide budgets but include tracking against budget with each invoice tendered
- More customer focus. More transparent billing

all significant insurers and reinsurers have gone through this.

"Also every Lloyd's syndicate will have had to gone through the process so that they can meet Lloyd's requirements for models because Lloyd's has its own market wide internal model. The challenge on the modelling side will be for boards to make sure they are using those models in their decision making throughout the organisation, the so called 'use test'. I think that will be a challenge because it isn't something which boards have had to do historically."

Alongside the EU, the US is also experiencing a fair amount of regulatory upheaval. The National Association of Insurance Commissioners (NAIC) continues to work towards its own capital standards framework and on top of that, some insurers which have been deemed as having systemic importance to the financial system, now fall under an additional level of scrutiny and capital requirements from the Federal Reserve Board (the Fed).

"There's some serious large consolidation in both the re/insurance and property/casualty markets. I think it is starting to show that the sheer size of a company's surplus and its global reach seems to matter."

Alan Levin, vice chair at Locke Lord

These extra levels of regulation are in danger of slowing down business in general, as well as providing insurers with regulatory headaches and new challenges for their legal advisors.

"In the US you have state regulators, you have the Fed nosing in and you have various degrees of regulation all over the world" Locke Lord's Levin told **Reactions**. "It is a speed to market issue and the ability to be responsive.

"I don't see any improvement in that in the near future, I actually see it getting more complicated, certainly on our side of the pond, where there's not a season where we are not dropping new statutes onto regulations on the books that conflict with other statutes on those books," he says. "I think that's a really troublesome part of being in a regulated industry where we are just piling more regulation on top of older regulation."

Most players in the US and in Europe are global in their scope and therefore are subject to a number of regulatory regimes.

This is likely to become even more complex when the International Association of Insurance Supervisors (IAIS) implements a further global capital standards regime on top of what is being proposed in the US and in the EU.

Levin notes that this raises the danger of conflicting regulation. "They're not complimentary and certainly on the accounting side that is a major issue," he says. "It is getting more and more complicated and we don't seem to be making progress. We go to various meetings of regulators and it is the same discussion time and time again. I think it adds to the cost of insurance and it adds to the cost of trading."

Sanctions in flux

One of the more interesting legal quandaries for the market has arisen over changes to the sanctions environment. In particular, there is a tentative deal between the Islamic Republic of Iran and the P5 +1 nations (China, France, Russia, the UK, and the US, plus Germany), to lessen sanctions in exchange for concessions around Iran's nuclear ambitions.

That deal was agreed in April in Lausanne, Switzerland and is expected to be signed on June 30. Re/insurers could potentially use a relief in sanctions to benefit from the opening of a new market with Iran – a big oil exporter of particular interest for marine and energy lines – while they will also face new legal and regulatory risks looking for new business with the Islamic Republic.

The benefits to Iran's aviation and health industry from a lift in sanctions are also substantial and could provide specialty re/insurers with some growth opportunities. However, David Brummond, counsel at DLA Piper and former senior sanctions advisor at the Office of Foreign Asset Control (Ofac), says that despite the positive headlines, re/insurers should wait for movement from regulators before changing their policies on Iran.

Reactions top three law firms for all legal matters in 2015

Drinker Biddle and Reath

This year's number one insurance law firm for all legal dealings was Drinker Biddle. The firm's insurance team covers an extensive array of insurance issues in property/casualty, life, health and accident families of companies.

It represents agents, brokers, insurers and reinsurers and many members of the group have served in insurance company law departments, as claim professionals or as regulators.

Its insurance transactional and regulatory team has handled some of the highest profile cases in the insurance industry in recent years, including a number of Enstar acquisitions; a series of capital offerings for Radian Group totalling nearly $1bn; the launch and nationwide licensing of Build America Mutual, a $500m financial guaranty insurer; and multiple US corporate and regulatory matters for Canopius.

The practice is led by Stephen Baker in Philadelphia.

Sidley Austin

Number 2 for all legal dealings goes to Sidley Austin, which remains in the top three this year. Sidley's insurance practice offers experience in a wide range of domestic and international insurance and reinsurance transactions, as well as related regulatory matters.

The practice has more than 35 years of experience and an expanding team of more than 85 lawyers dedicated primarily to providing transactional and regulatory advice to the insurance industry and financial institutions that transact with insurance companies.

The firm has experience of handling traditional corporate and financing transactions for the insurance industry, such as mergers, acquisitions, divestitures, joint ventures, corporate reorganisations (including demutualisations and mutual holding company conversions), formation and capitalisation of new insurance companies, public and private debt and equity financings and complex insurance company investment transactions.

Sidley's insurance practice is led by co-heads Michael Goldman and Perry Shwachman in Chicago, and Jeff Liebmann leads the firm's New York insurance practice.

Clyde & Co

Coming in at number 3 for all legal dealings this year was Clyde and Co. Clyde and Co's insurance teams handle claims across every line of insurance and reinsurance businesses and has the international experience to provide advice to clients on complex multi-jurisdictional disputes, and on structuring global programmes.

Its global commercial and regulatory insurance teams advise clients on a number of high profile issues including: raising capital; M&A; new product development; overseas expansion and closing books of business.

The reinsurance team has experience ranging from acting for a global insurer in relation to a reinsurance arbitration involving a Thai airline crash to acting for a UK insurance company on reinsurance regulatory issues. Providing comprehensive advice on how a foreign insurer could do reinsurance business in China and proposing structures/corporate strategy for China

The team is led by Simon Konsta, with Nigel Brook co-heading the reinsurance practice.

"I think with Iran, we are reading the papers like everybody else and waiting for the Ofac pronouncements on how the arrangement is to be implemented and there isn't much that's actionable at this time," Brummond told **Reactions** following the announcement of the deal.

"There's a lot of news print and that is what everybody is looking at. Whether this is going to mean some change in policy and how that would be done is the question and we can't really do much until we see what it is that Ofac produces," he says.

There is also the potential for sanctions to be reinstated against Iran should the country not meet the nuclear objectives outlined in the Lausanne agreement. As part of the deal, Iran must fulfil a number of conditions to reduce its nuclear programme in ways satisfactory to the P5 +1 nations.

"The way the Iranian deal is constructed there has to be first a performance on the part of the Iranian side of the deal, a demonstration of that performance and acceptance on the P5 +1 side that indeed that has occurred."

David Brummond, counsel at DLA Piper

Whether or not all goes to plan, it is impossible to say. A part of this process will be the removal of the core from within the heavy water reactor at Arak, a unit required to create a nuclear warhead. Iran must also agree to further inspections from the International Atomic Energy Agency (IAEA) and a reduction in its stock-pile of low enriched uranium, among other conditions.

If these conditions are met, EU and US economic and financial sanctions would be lifted, as well as the block on Iran using the Swift system for international electronic payments, and all relating oil sanctions. However, even if Iran fulfils all its responsibilities under the deal, its need to demonstrate that it is meeting these conditions could mean it will be some time before sanctions relief takes place.

"The way the Iranian deal is constructed there has to be first a performance on the part of the Iranian side of the deal, a demonstration of that performance and acceptance on the P5 +1 side that indeed that has occurred," says Brummond. "They have got to go through all of that process before you can start with what you are going to implement in the way of reduced sanctions."

Brummond states that it could be potentially a three to five year process before all sanctions are lifted, although he says that there could be relief in some very specific sanctions sooner but that re/insurers should still be cautious in changing their approach towards Iran.

"I think it is just wise not to move in a different direction or take action based on news accounts of different policy until you really are clear on what the new rules are," he added. "I don't see that in the next three to six months, maybe later this year and that would likely come in very limited isolated areas.

"This would be where there would be an ability or a capacity to define a sanctions relief relatively easily and you can then act on it because it isn't broad authorisations it's pretty narrow. Insuring the transport of crude oil is an example and insurers could then pay claims arising from that coverage.

"Something that was very clearly and narrowly written and defined could be okay. But until you see those words in that context and you have confidence in what you are doing and that your transaction is going to completely fall within the framework of that narrow context, my advice would be not to not to do too much different to what insurers have been doing in the last year or two." ●

By Sam Kerr – sam.kerr@euromoneyny.com

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Transferring legacy books of business

By Nigel Montgomery, Kenneth R. Wylie, Adriana Cotter and Sean Keyvan, Sidley Austin LLP

Introduction

Legacy business in insurance companies can create a drag on performance and soak up capital. With the ever-greater focus on capital, risk management and resources, it is no surprise that the market for the sale and management of run-off is as lively as ever. The ways in which (re)insurers deal with their run-off remain as they have been for some years: internally (or externally) managed run-off, reinsurance and sale.

In each of these alternatives, the owner of the book of business is likely to be concerned with the reputational risk associated with the treatment of its legacy business, not only with insureds and brokers but, importantly, also regulators. Interestingly, the market reputation issues are generally less critical than the regulators' reaction and perception.

Although the number of plausible, well-funded, buyers is probably lower than in the past, the market for buying other companies' legacy books remains an active and relatively competitive one. Prices, however, seem to have dropped in recent years. There has also been a shift by the run-off acquisition market to move into full-scale going-concern bids, with a view to putting live entities into run-off and transferring renewal rights to others. This is a logical consequence of a period when the price of pure run-off seemed on occasions to be higher than that of whole businesses.

So, for any company or group looking at legacy business, exploring alternatives to disposal of legacy books of business may be timely. Moreover, time and expense spent addressing the fiscal hygiene of run-off management is unlikely to be wasted, since what may begin as an internal exercise can also optimise the books for external sale or reinsurance.

Managed run-off

For large (re)insurers, the run-off of legacy books of business ought not be limited to maintaining the status quo. There are many ways to centralise and streamline claims handling, collection of reinsurance and reduction of expenses to mitigate the ongoing drain on the company. There are many third-party administrators willing to take some or all of the administration from the original company, and some relatively innovative pricing structures for doing so. Interestingly, even with Solvency II and equivalent regimes looming, there are large groups that still hold their run-off business in separate silos; few have found a way of centralising it efficiently, managing global off-set and commutations across their whole operation, and also reducing operational risk and friction between different profit centres.

We are likely to see this change across Europe in anticipation of Solvency II, which comes into force on January 1, 2016. The change will almost certainly result in a series of major group reorganisations spinning off books of run-off into consolidated administration, if not also separate vehicles. What these books of business have in common is that they are now seen as a drag on the owner group's resources, as a consequence of the extensive reviews of capital and risk in preparation for Solvency II.

Managing run-off is very much about planning. Aside from the capital and claims managements aspects, other issues that have been encountered include IT systems migration, regulatory issues for the retention of records, and the potentially adverse consequences on banking and other covenants when entering into run-off. New, and sometimes aggressively opportunistic, creditors/policyholders can and do emerge during run-off reorganisation – particularly to seek advantage during a closure process, such

as business transfer, redomestication or scheme of arrangement. Time spent mapping the process and identifying the likely hazards is rarely wasted.

Reinsurance

Retrospective reinsurance arrangements, loss portfolio transfers and adverse loss development covers can be used to effect an economic transfer of legacy books of business – although without providing true exit finality, because the original carrier remains ultimately liable if and when the cover runs out. As most know, Berkshire Hathaway's National Indemnity Company (NICO), through the use of reinsurance, has been taking on discontinued books of business from companies (including Lloyd's 1992 and prior business) for the past 15 years. As a result, NICO has accumulated significant portions of the US asbestos and pollution claim exposures for pre-1986 insurance contracts.

Sale and sanctioned transfers

In the UK and some other EU jurisdictions there are statutory mechanisms for the transfer of business from one insurer to another. The UK version, Part VII transfers, enables not only the liabilities to be moved to a transferee, but also the assets supporting them, including inuring reinsurance.

In other countries, the sale of a legacy book of business first involves isolating the business in one or more entities that do not have active books of business. This "ring fencing" provides an opportunity to isolate the book of business with the possibility of then selling the shares of the company. The challenge is to find a way of effectively isolating the business.

An early example of such restructuring was the Cigna/Brandywine division that occurred in 1996. The transaction involved the transfer by Cigna of its pre-1987 inactive business associated with the Insurance Company of North America (INA) to the new Brandywine entity (while retaining the active business in INA). The old asbestos and pollution exposures were then reinsured with a new entity, Century Indemnity Company, which then ran off the asbestos and pollution books. (Interestingly, as part of a subsequent sale to ACE in 1999, Century entered into an adverse loss development reinsurance agreement with NICO.) Some of the Brandywine business was eventually sold to Randall & Quilter in 2006. The 1996 restructuring occurred under Pennsylvania corporate law (not insurance law). Subsequent restructurings using the same law have occurred in Pennsylvania. Other state laws may provide additional mechanisms for consideration of the splitting of an insurance company's business between "inactive" and "active." (See the discussion below.)

In general, however, the US insurance market lacks widely available mechanisms to facilitate the transfer of legacy books of business and indeed the UK Part VII mechanism is controversial in the eyes of many US reinsurers. This may change, State by State, as the US insurance regulatory regimes tighten capital requirements in ways that are not dissimilar to Solvency II, and may well lead to the consolidation of legacy books through reorganisations.

US insurance regulators have shown some willingness to explore alternatives, particularly in the context of "troubled" insurance companies. See, for example, the supervised run-off of Lumbermens Mutual Casualty Company (IL) (2002-2012); and the restructuring of financial guaranty insurers (e.g., MBIA and AMBAC) following the 2007-2008 financial crisis to separate the municipal bond business from the troubled structured finance business. A December 2009, NAIC White Paper, *Alternative Mechanisms for Troubled Companies*, provides a discussion of these alternatives. The White Paper identified some of the advantages of using alternative mechanisms to traditional receivership and insolvency proceedings to achieve faster resolution, lower costs, financial flexibility, and continuity of claim payments, all with the purpose of freeing up capital. It also recognised the need for:

- Heightened regulatory oversight to avoid the risk of adverse effects to policyholders (e.g., circumvention of state priority and preference rules), and;
- Meaningful disclosure to constituents (including guaranty associations).

Some of the alternatives and concepts addressed in the White Paper are being used by state insurance regulators in the context of evaluating the transfer of legacy books of business.

Further examples of statutory support for transfers in the US are Rhode Island's *Voluntary Restructuring of Solvent Insurers*, Gen. Laws 27-14.5-1 *et seq* (2002) (which mimics the UK's Part VII transfers) and Vermont's *Legacy Insurance Management Act* of 2014, 8 V.S.A. Ch.147. §7111 *et seq* (2014) (which tends to follow the Part VII transfer process for old non-admitted and reinsurance books of business to specialised insurers created in Vermont).

Regulatory attitude to sales and closure of legacy business

Whilst the UK may have led the way in developing methods to achieve transfers and finality in respect of legacy books of business, UK regulators are very stringent in their approach to them. For example, solvent schemes of arrangement, once a popular tool for achieving finality for (re)insurers, have been slow to materialise in recent years because the regulators' view of these schemes, at least in their traditional form, seems to have hardened. However, "option" schemes of arrangement, in which policyholders have the ability to keep cover as an alternative to receiving a valuation of their claims, are being worked on and should provide a useful alternative to the 'cut-off' schemes which have attracted opposition and disputes.

UK regulators have also been playing an increasingly active role in the Part VII process. This came at a point where there was an uptick in the number of insurers seeking to make Part VII transfers ahead of the Solvency II implementation date, which led to the Prudential Regulation Authority (PRA) issuing a letter to directors in January 2015, essentially stating that unless a fee has been paid and an insurer has already indicated its intention to complete a transfer this year (and is on track to do so), it is unlikely that the PRA will be in a position to conduct its review of a potential Part VII transfer given competing priorities with other elements of Solvency II (highlighting the PRA's limited resources at this time).

Where to next?

It is trite to say that today's underwriting is tomorrow's run-off; there is no shortage of existing, burdensome, legacy business, and the market will continue to produce more in the future. It follows that there needs to be a capital-and risk management-efficient way for the insurance industry to deal with its past. Run-off, as a separate part of that industry is seemingly here to stay and will, in fact, expand in the next few years. Well-conducted run-off, with proper regulatory oversight, would appear to be in the interest of the live market and also of policyholders who need their insurers to be strong and financially viable. ●

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Reactions' US reporter Sam Kerr reports on this year's Exceedance conference in Miami, hosted by catastrophe risk modelling company RMS.

The positive impact that the re/insurance community can have on the world and its role in sustaining global economic prosperity was a major theme at this year's Exceedance Conference in Miami, hosted by cat modeller Risk Management Solutions (RMS). The company presented an upbeat tone to an industry embattled by pricing and competition, focusing on the sector's enduring and vital role in solving global challenges.

Inescapably ILS

Capital markets' competition to traditional reinsurance was – unavoidably – a running theme throughout the event, reflecting industry anxieties in general. The current and future impact of the insurance linked securities (ILS) market – as each successive year brings higher catastrophe bond issuance, eating further into reinsurers' most profitable business – was never far from delegates' minds.

However, trying to seize opportunities, the narrative at Exceedance focused around commercial opportunities for many within the industry to work with the alternative capital, while many in the market can turn their attentions to modelling risks that have previously been uninsured.

While it is common to hear among traditional reinsurers that the ILS market is shy of taking on risk beyond the well-modelled North American natural catastrophe space, because of longer-tail risks, paucity of data, lack of models and more obscure nature of losses, catastrophe bond style triggers could be used beyond their present applications to make this point more moot.

For example, one of the areas where a catastrophe bond style investment solution could be used to cover new risk is in quelling the spread of a global pandemic. While speaking at this year's conference, Ben Brookes, vice president of capital markets at RMS noted that

West Africa's Ebola outbreak had been a wake-up call for the world and for the re/insurance industry, but that ILS solutions could aide in the fight against pandemic style diseases.

While the industry is used to the costs of catastrophes after they occur, the fight against pandemic is more difficult, as it needs to be combated while it is still taking place. This could open the door for capital market solutions to invest in the market and provide financial resilience against outbreaks.

"A disease isn't like an earthquake. It's not something you can respond to after it happens," said Brookes. "A disease is something that changes as it spreads and you can contain that outbreak if you can react fast enough – you can control the spread of that disease.

"But that requires rapid funding, so the trick is to use a cat bond approach to this. We can use a trigger that is based on new cases in a defined area, in a defined time and that would let us raise money fast. We can respond quickly and control an outbreak, reducing the chance of a global catastrophe," said Brookes.

He conceded that this was a highly ambitious proposal, but it could potentially succeed in taking capital into new markets and provide new resilience against pandemic. The rapid escalation of costs that were incurred in dealing with the Ebola outbreak last year demonstrates the need for rapid finding solutions to fight pandemics. The estimated cost of combating the disease last year was $70m in August, rocketing to about $1bn by September. The low transmission rate of the disease averted a global crisis, but as many experts have stated this might not be the case for the next pandemic disaster.

How the ILS market will respond to the next major catastrophe is impossible to know. The first quarter of 2015 broke issuance records in the ILS market. Traditional market players are understandably sceptical about how sticky alternative capital would be following a large catastrophe.

However the vast quantity of pension fund capital that can come into the space means that the ILS and alternative capital markets are likely to continue to affect the re/insurance industry in the future – even if some investors are scared off, there are plenty more to replace them.

Speaking to **Reactions** at Exceedance, BMS Intermediaries outlined how the sheer scale of the pension market and potential funds that could enter the ILS space dwarfs the existing sector. The company also said that other pension funds may be more likely to enter the space now that investors are establishing a track record for investing in the sector.

"To get money from a pension fund you have to in general have a track record as an asset manager of five years of managing other people's money," says Andrew Bustillo, president and CEO of BMS. "So from the early days it took a while for the market to open up the pension fund world, but along the way there has been a lot of education.

"Now because there have been no events there are a lot of asset managers that meet that five year threshold. The potential size of that pension fund market is in the trillions and the worldwide catastrophe risk transfer market is still relatively small compared to that," he added.

"We're particularly excited because it'll be the first time the industry will be able to model the accumulation of flood risk across all of central and western Europe; that class of modelling can only be delivered on the RMS(one) platform."

Hemant Shah, CEO, RMS

And finally, RMS(one)

As one might expect, RMS was keen to promote its own role in the re/insurance sector meeting global challenges. The cat modeller used its stage at Exceedance to herald the imminent launch of its new holistic modelling platform: RMS(one).

The firm stated that it believes the platform's capabilities give it an important role to play in efforts towards tackling modelling shortfalls, particularly for new lines of business and for the world's underinsured regions.

For Hemant Shah, the chief executive of RMS, the RMS(one) platform has been something of a labour of love, while last year's Exceedance conference was inescapably rocked by news that the model's launch to the market would be delayed. However, a year on from that dispiriting news, he says RMS(one) is back on track and ready to be rolled out this year.

Shah told **Reactions** that the first part of this roll-out will be a new European flood model. It will be the first of its kind to model storm peril as a whole across the many borders of Western and Central Europe.

"We will be rolling out RMS(one) over the next fifteen months; the first deliverable, this year, will be our new HD Europe flood model, which will cover 13 countries in Europe," said Shah.

"We're particularly excited because it'll be the first time the industry will be able to model the accumulation of flood risk across all of central and western Europe; that class of modelling can only be delivered on the RMS(one) platform," he said.

"Chile has a long history of thinking about cumulative improvements to its building codes following significant earthquake events, they know how to build structures to withstand earthquakes and save lives."

Patricia Grossi, senior director, global earthquake modelling, RMS

The roll-out will then proceed with RMS(one) Exposure Manager in early 2016 before the third element of the programme, Risk Modeller, comes online in the summer of next year. The firm says the Risk Modeller tool will allow companies to access the full suite of RMS models as well as loss analytics and other models form other firms.

"In 2016, we'll be releasing the RMS(one) Exposure Manager, which will help our customers manage their multi-line accumulations of exposure," said Shah. "It's one of the key innovations that will be unique to RMS(one), providing companies with the ability to express, in the way that they see fit, their underlying exposures and the key attributes of those exposures.

"They will no longer be limited to only capturing and recording exposure that we know how to model," he added.

Shah believes the model can readdress the current balance of exposure in risk modelling which he says sometimes can view exposure as a part of the modelling process rather than the driver behind the whole thing.

"The current paradigm of exposure management is upside down. Our Exposure Manager will right the system," he claims. "Today exposure data is just a subset of what we model, but it should be the superset that can be modelled in RMS models, our clients' own models or those of another company.

"Our Exposure Manager will, for the first time, enable companies to capture the data that represents the exposure they write whether it's for property, property catastrophe or other lines of business, enabling them to analyse and report their accumulations."

The delays to RMS(one) have been difficult and Shah concedes that RMS underestimated the task ahead of it when setting out to develop the product, but stresses that by its very nature the implementation of what could be a potentially revolutionary software platform was never going to be easy.

"We always knew RMS(one) was going to be a challenging undertaking; it's by no accident that no other company has previously taken up the challenge," said Shah.

"It's fair to say that we underestimated the challenge, but that's been healthy because it's helped us better understand our clients' needs to build and design RMS(one) in a way that will solve many of our clients' fundamental risk management problems. Innovation sometimes requires some trial and error, it's not like an immaculate conception, it can be challenging and that's what makes it real," he added.

"If you can react fast enough – you can control the spread of that disease. . . We can use a trigger that is based on new cases in a defined area, in a defined time and that would let us raise money fast. We can respond quickly and control an outbreak, reducing the chance of a global catastrophe."

Ben Brookes, vice president, capital markets, RMS

Building resilience

The devastating Nepal Earthquake struck just a few days prior to the Exceedance event, which understandably concentrated many attentions on catastrophe perils and how to better mitigate losses.

When looking at quake risk, speakers at the conference cited a number of examples of countries where the risk was prevalent but where efforts had been taken – with the industry playing a leading role – to work towards greater earthquake mitigation strategies.

The evolution of Chile's building code, developed in response to several large seismic events, particularly the 2010 quake, was held up as a good example of building resilience allowing countries to better respond to a future seismic event.

Patricia Grossi, senior director of global earthquake modelling at RMS, told this year's conference that when compared with other countries, Chile's earthquake resilience measures stand up well.

For example both Chile and Haiti suffered large seismic events in 2010, and while Chile suffered the largest earthquake of the year, Haiti's earthquake had the higher death toll and more widespread damage. Chile's recovery since 2010 has also been far more positive.

While some of this has to do with Chile's superior gross domestic product and insurance penetration, the country has also been very proactive in improving its building practices after earthquakes.

"Chile actually has a very long history of thinking about cumulative improvements to its building codes following significant earthquake events, they know how to build structures to withstand earthquakes and save lives," Grossi told Exceedance.

Chile has worked on its resilience for some time. Following a series of earthquakes in the 1920s, Chile enacted its first seismic design provisions in 1935, which included provisions for confined masonry construction. Grossi said that in Haiti – which was also struck by a major quake the same year as Chile – similar measures are only just being discussed in 2015.

An example similar to Chile can be seen in the US state of California which also has a long history of seismic events and a mature, extensively modelled re/insurance market. However, California too has been updating its building codes in recent years, while mercifully remaining free from a major quake.

"You've heard us speak of the evolution of the California building codes, and the Chilean building codes are very similar where we have seen significant updates to the building codes following significant events," said Grossi. ●

By Sam Kerr – sam.kerr@euromoneyny.com

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Garry Booth is Reactions' contributing editor, covering the UK and emerging risks

GARRY BOOTH

G7 in Germany: the heat is on

The annual summit meeting of the G7 heads of state and government takes place on June 7 and 8 at Schloss Elmau in Germany. Unusually the important role in global security played by the reinsurance industry will be brought to the attention of the world's leaders.

That's because climate change is high on the agenda for the G7 states (France, the UK, Italy, Japan, the USA and Canada) this year, against a background of migration and conflict between countries.

The link is that climate change will inevitably create new poor, especially in low-income countries and jeopardise sustainable development – all of which fuels migration and war.

The G7 unveiled an initiative on climate risk insurance in May, intended to increase access to insurance to as many as 400 million additional beneficiaries by 2020 that's underpinned by reinsurers' resources.

A background paper commissioned by Germany's Federal Ministry for Economic Cooperation and Development explains how the scope of schemes like the Caribbean Catastrophe Risk Insurance Facility (CCRIF), the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI) and the African Risk Capacity (ARC) that help national governments deal with climatic catastrophes could be extended.

Significant financing from the G7 will be necessary, the authors say, that can leverage several billion USD of risk capital from the private insurance and reinsurance industry.

The initiative is an example of the growing influence of the reinsurance industry on policymakers around climate change. Munich Re was asked by the German government to review papers relating to the June G7 discussions.

Peter Hoppe, Munich Re's point man on the G7 project, is optimistic that the initiative on climate risk insurance will be picked up by the G7 and get buy-in from the wider reinsurance sector: Swiss Re is already onboard alongside Munich Re.

After the G7, Hoppe told me, all eyes will be on Paris and the crucial COP21 conference where countries including China and the US aim to achieve a legally binding and universal agreement on keeping global warming below 2°C.

"I am more optimistic about Paris than previously because the pre-conditions are much better and the big emitters are committed to a binding protocol so I expect that an agreement will be signed by all the UNFCCC countries," he said. "But the pledges already made still won't be enough to keep global warming below the 2°C."

> **The G7 unveiled an initiative on climate risk insurance in May, intended to increase access to insurance to as many as 400 million additional beneficiaries by 2020.**

Cyber stability board needed

After climate change, the security of the world's cyber infrastructure is a high priority emerging risk for world leaders. The world desperately needs new measures to strengthen the global governance framework for managing evolving cyber risks, according to a recent report from Zurich Insurance Group.

While emerging technologies such as drones, 3-D printing and self-driving cars are fundamentally changing the nature of cyber risk, the governance regimes in place around the world are inadequate to ensure the security of the world's cyber infrastructure, the report states.

Geopolitical and ideological tensions between states, are increasingly played out in cyberspace – including over matters of governance. "Growing political instability could be exploited by some governments aiming to reduce capabilities and scope of some technical institutions that provide stability and resilience to cyberspace, thus undermining its multi-stakeholder approach" said Javier Solana, president of ESADEgeo, which collaborated with Zurich on the report. "Isolating effective cyber governance from the current geopolitical tensions must therefore be a priority."

Recommendations to policymakers include the creation of a Cyber Stability Board, and the creation of a cyber alert system.

Hole in the wall gang

With so much attention focused on the risk of cyber attacks, the old fashioned heist on Hatton Garden Safe Deposit in London recently was almost a refreshing surprise. The raid took place over the Easter weekend, the robbers first entering the building on Thursday night, coming and going over Easter before finally leaving the premises Easter Sunday morning.

They nicked off with the contents of 56 safe deposit boxes after drilling a (small) man sized hole in the strong room wall.

Arrests have been made but recriminations over why the police didn't respond to alarms, and why the firm's security arrangements didn't work, rumble on.

Loss adjuster Rick Marchant told the BBC that "of course some hadn't insured at all" because they assumed that their valuables would be OK in a safe deposit box. The same might be said about people and businesses and the cyber risk they face.

Obesity problem getting bigger

The hole in the wall type of heist could soon be a thing of the past, however, if only because of the ever increasing size of hole needed for such a technique. The serious news here – especially for life and health insurance carriers – is that Europe is heading for an obesity crisis, according to the WHO. Almost three quarters (73%) of men and 63% of women in the UK are expected to be overweight or obese by the year 2030, with a third of women categorised as obese. Other countries with projected steep rises in obesity included Greece, Spain, Sweden and Austria. But it's the same all over the world, even in emerging economies. ●

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MOODY'S

CTBC Financial in downgrade warning

CTBC Financial Holding Company has been placed on review for a downgrade of its A3 long-term foreign currency issue rating by Moody's. This follows the Taiwanese firm's announcement of its second attempt to acquire 100% of Taiwan Life Insurance via a share swap for a consideration of TWD32.3bn, based on CTBC Financial's closing share price on 12 May 2015. CTBC Financial had announced in October 2013 that it planned to acquire 100% of Taiwan Life through a share swap.

Taiwan Life ranks as the 9th largest life insurer in Taiwan by total assets with a market share of about 2.7% at end-December 2014, noted the rating agency. It had consolidated assets of TWD508.3bn and shareholders' equity of TWD16bn. Based on Taiwan Life's outstanding shares as of 31 December 2014, the share exchange ratio will be 1.44x.

CTBC Financial expects to complete the transaction in October 2015 and to consolidate Taiwan Life into its subsidiary, CTBC Life Insurance by 31 December 2015, Moody's reported. "The decision to review CTBC Financial's rating reflects the consideration that the Taiwan Life deal adds further negative pressure to CTBC Financial's credit profile," says Ginger Kao, a Moody's analyst.

"Taiwan Life has weak capitalisation, as measured by its capital-to-asset ratio of less than 5% in the past three years. Its high-risk assets are also significant relative to its shareholders' equity. Moreover, Taiwan Life's profitability has been volatile and under pressure due to the low interest rate environment," adds Kao.

The acquisition is not small when compared to the group's existing business, Moody's noted. The consideration of TWD32.3bn represents 14% of CTBC Financial's standalone shareholders' equity at the end of last year.

CTBC Financial's rating has been carrying a negative outlook since June 2014, which was initially and largely driven by the acquisition of Tokyo Star Bank by the group's banking subsidiary, CTBC Bank, completed in the second quarter of 2014. ●

Torus off the hook as AM Best ups outlook

Torus has had its rating outlook upped back to stable from negative by AM Best. The rating agency said Torus Insurance (Bermuda) and its subsidiaries in the US, UK and Europe had an "expectation of continuing improved performance".

London market and Bermuda underwriter Torus was acquired by run off specialist Enstar in a merger deal which completed last year. "The stable outlook reflects AM Best's recognition and expectation of continuing improved performance and the operational support of Enstar Group Limited (Enstar) and Stone Point Capital LLC," said AM Best.

The rating agency cited management commitment to improvement: expense savings; discontinuing unprofitable underwriting lines of business at the firm; as well as a commitment to not paying dividends for the next few years, allowing revenues to bolster its capital. Recent results showed a turnaround, according to the rating agency.

"Torus consolidated historical financial performance has been weak with underwriting losses reported in each year since 2010. However, a pre-tax profit was achieved in 2014, and performance over 2014 and 2013 has been broadly in line with AM Best's expectations," said AM Best. "Nevertheless, AM Best believes that achieving sustainable profitable results will be challenging given the strong competition in Torus' main business lines," added the rating agency.

MOODY'S

Australian life profits squeezed

Australian life insurer profits are predicted to be under pressure across 2015 and 2016, because of policy lapses and rising claims seen for their risk products, according to Moody's. "The higher number of policy lapses and claims for risk products largely reflects a combination of fundamental issues, including product mispricing and premium and commission structures. These issues will take time to address," said Frank Mirenzi, a Moody's vice president and senior analyst.

"The insurers that are most at risk of profit erosion will be those that are large providers of risk insurance products or those insurers which have been growing their risk insurance business significantly in the last few years," said Mirenzi.

Lapses and claims for risk products rose from 2011 through to 2013, with high upfront commissions for financial advisers and stepped premiums on policies being some of the prominent causes, Mirenzi writes in Moody's recent report on the issue. Life insurers were forced to revise their assumptions and lower their outlook on future profits, according to Mirenzi.

As policy lapses increase, the average duration of policies shorten, which, the rating agency noted, means that life insurers may not earn the full level of expected profits from those policies.

Higher levels of claims could also lead insurers to revise up their assumptions on future claims, and consequently to reduce their future profit expectations, according to Moody's.

Australia's life insurance industry is responding to the deteriorating profitability of its risk products through a working group sponsored by the Financial Services Council, Moody's pointed out.

There are several recommendations; most significantly regarding adviser remuneration. However, there is still much debate in the industry and the long transition period reflects the time needed to resolve the structural nature of the issue. Moody's has argued that the industry's profitability will likely stay weak over the next few years. ●

All actions are as of May 22 2015. This column is concerned primarily with interactive insurance financial strength ratings except where other types of rating are deemed relevant. This column is not intended to be a comprehensive record of all rating actions.

Sir Nobby

TOP LOSS SHOW ANNOUNCES NEW PRESENTER

The London Market's flagship TV programme, Top Loss, is returning to our screens with a new presenter and a brand new format. Following the acrimonious departure of Sir Dudley "Dumbo" Duddleston, Chief Executive, Hoggwartz Global Insurance, the producers were keen to move the programme in an exciting new direction.

Replacing Sir Dud was always going to be difficult for the show. He has a loyal following in EC3 who enjoyed his drunken blatherings about burning cost ratios and cut through endorsements. He was notoriously contemptuous of brokers and technology of any sort, and was famous for his comments on Bermuda ('Shorts-gate'), marketing executives ('Tosser-gate'), on-line platforms ('Total Crap-gate') and actuaries ("jolly sound fellows").

He received regular final written warnings, not least for his description of reinsurance brokers as "pathetic lightweights who can't hold their drink, don't know their Chateau Lafite from their arse," who spend their contingent commissions on school fees for little Tarquin rather than what it should be spent on – entertaining underwriters."

The final straw came as he punched a broker who had asked for improved terms and conditions on a paid loss retro policy. He was immediately sacked from the show four months later. He later issued an apology, stating: "That broker was an apology for a broker."

His surprise replacement, announced yesterday, is Mocha Re's chief executive and chairman, Sir Norbert "Nobby" Johnson. "We felt we needed to go in a new direction and have gone for a radical departure in appointing Sir Nobby," said a spokesman for the show. "We are excited by the change in ethos and style."

Sir Nob celebrated his appointment to the show by going on an EC3 pub crawl with his mates.

He later told insurance reporters that Bermuda shorts "were just wrong", and marketing executives were all tossers who could "stick their brand awareness up their iPad."

Top Loss is famous for road-testing new policies, 'specials' where the hosts travel to foreign countries and criticise the insurance regulations and the local market, and its long-running Reinsurance in a Reasonably Priced Sidecar segment.

Contact made with lost broker tribe

An expedition in a remote Amazonian region of Brazil has made contact with a tribe of indigenous insurance brokers never before exposed to western society. The 11-member team from London's Emerging Markets Bureau met about 30 members of the tribe for about an hour over the weekend, giving them business cards and desk tidies.

The broker tribe apparently already knew about the existence of other people. But the primitive brokers had heard about them from other tribes with little exposure to the developed world except at industry conferences in Florida. The first signs of their existence were uncovered last year when an aerial survey of the region revealed a previously undetected village made of 16 long houses and a wine bar. Curious markings in clearings were initially thought to be to do with worship. But they were later shown to be part of a crude golf course built by the brokers.

The research team apparently only made contact with the tribe to investigate rumours that they were being ruled and exploited by a neighbouring wholesale tribe.

"They had already had contact with our world through traded objects, but continued to live completely isolated," said a London spokesman. "We only made contact because the brokers were in danger of trading with our competitors," he added.

Unregulated, Amazon broker tribes live mainly from hunting and gathering commissions. With a strict hierarchy, those with the biggest protruding tummies appeared to have seniority. Hair slicked into spikes using a form of aloe gel denotes lowly rank.

BROKER BEAN TALKS CANDIDLY ABOUT ROLE REASSIGNMENT

"As of today I am an underwriter," said former broker Bruce Bean, his voice cracking with emotion. Bean is one of a growing number of insurance brokers opting to undergo role reassignment. "I've always wanted to be an underwriter and even as a child I have felt like an underwriter trapped in a broker's body."

Bean, who was recently appointed head of the newly formed Mega Underwriting Agency, said the transition was long overdue. "I've been living a lie for years, role playing behind closed doors but afraid to appear as an underwriter in public and especially at the office," he admitted. "However, with the encouragement of the Mega Group CEO who said he would sack me if I didn't become an underwriter, I have started on my journey."

Bean is aware of the challenges that lie ahead and the potential problem of finding acceptance among friends and colleagues on both sides of the divide. "People will treat me differently, but that's the idea. I may find that I have to rebuff the advances of former broker peers. But in this soft market I know that's unlikely," he said.

"Equally as Bruce Bean the pen holder I'm going to have new relationships in the underwriting community," he said. "But I'm excited about getting a new, more sober wardrobe. In fact being more sober will be a change. It will also help me to get in touch with my pompous side." Bean wouldn't be drawn on how much medical intervention would be necessary to make the transition. "I might need some shots to enhance my risk selection," he said. "The boss told me I would be in for the chop if I didn't bring decent risks in!" ●

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