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Viewpoint: Dealing with the risk of digital protectionism

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Crisis ‘looming’ over post-Brexit contract continuity

Regulators must now intervene to solve the problem, TheCityUK warns

Lorenzo Spoerry
Deputy editor

Thirty-six million UK and European policymakers face a “crisis” if UK and EU regulators do not find a way to allow existing insurance contracts to be legally serviced after Brexit, TheCityUK has warned.

At the end of the transitional period in December 2020, UK carriers are expected to lose the passporting rights they rely on to service many existing contracts.

The UK government has said it will bring in legislation to allow contracts to be serviced in the UK. But that still leaves the problem of how contracts between UK carriers and EU policyholders will be serviced.

“While firms are doing everything they can, this is not a problem businesses can fix alone and requires a co-ordinated UK/EU approach.” Miles Celic, chief executive of the lobby group, said.

The lobby group recommended three different ways in which the problem might be solved. First, a bilateral agreement could be concluded between the UK and the EU, which would be supported by continued regulatory co-operation.

Alternatively, law-makers and regulators play a key role in developing new solutions and helping drive our growth”.

Barbican appoints cyber underwriter

Barbican Insurance Group has appointed Lauren Webb as a class underwriter for cyber within its Lloyd’s syndicate 1955, writes Michael Faulkner.

Webb joins from Chubb, where she was most recently London cyber underwriting manager.

Graeme King, business group leader for cyber at Barbican, said the cyber insurance market was evolving at a “phenomenal pace”. He added Webb “will play a key role in developing new solutions and helping drive our growth”.

TheCityUK warns the industry faces a crisis if UK and EU regulators cannot agree how in force insurance policies will be serviced after Brexit

Mr Jane Campbell/Shutterstock.com

TheCityUK warns the industry faces a crisis if UK and EU regulators cannot agree how in force insurance policies will be serviced after Brexit.

TheCityUK has warned, “the primary responsibility to prepare for Brexit remains with market participants”. Britons voted in June 2016 by a narrow majority in favour of leaving the EU.

The lobby group recommended three different ways in which the problem might be solved. First, a bilateral agreement could be concluded between the UK and the EU, which would be supported by continued regulatory co-operation.
Senior executives on the mid-Atlantic island face significant challenges, but for the nimble and innovative there are opportunities to be had

Michael Faulkner
Editor

Speaking to reinsurance executives in Bermuda last week revealed a mixture of optimism, frustration and disappointment. The June 1 Florida renewals were a case in point: following last year’s hurricane season, the renewal provided a good opportunity, through contemporary loss data, to identify which Florida cedants were performing better than others.

As a result, many reinsurers were hoping to reduce their exposure to weaker carriers, squeeze out some rate increases and tighten up coverage.

As it transpired, the renewal did not go according to plan. One Bermuda-based executive admits pruning the portfolio was easy, but achieving any improvement in coverage terms was pretty much impossible, such was the pressure of competition, particularly from insurance-linked securities (ILS) funds.

Others agreed. “It was disappointing – but was it unexpected?” Hamilton Re’s chief executive, Kathleen Reardon, says. “Many people used June 1 to optimise their portfolio. People tried to hang on to their top-tier clients.”

Nevertheless, there was some hope the pricing dynamics were at least pointing in the right direction.

“We might see a little bit of further improvement at January 1 [2019] or a flat renewal,” Konrad Rentrup, chief executive of Hanover Re (Bermuda), says. However, broad increases, without a major event or two (or three), were improbable, he adds. “Overall, when reinsurers start to lose money then rates will harden – but so far the market is not showing losses on their balance sheet.”

Of course, it is early days in the 2018 hurricane season and it is always earthquake season.

A source of immense frustration among the island’s executives is the assessment of losses from Hurricane Irma. Irma caused significant losses, with economic losses estimated at between $60bn and $95bn and insured industry losses of $35bn to $55bn. But it could still take a number of years for the full extent of the losses to become clear, some fear.

There is considerable irritation at soaring loss adjustment expenses (in some cases, $1,500 to get a loss adjuster to confirm whether a property is damaged or not) and the extent of fraudulent claims and overinflated claims.

Claims costs in Florida are continuing to creep up, approaching $10bn according to latest figures from Florida’s insurance regulator. Tens of thousands of open claims remain.

Growing strength

Away from catastrophe business, though, there is considerable excitement at Bermuda’s growing strength in insurance lines such as property direct and facultative (D&F) and cyber. Recent years have seen London-based carriers come to the island to tap into US business that might not find its way across the Atlantic.

Lloyd’s insurer Barbican, for instance, opened a property D&F operation earlier in this year and Neon did so last year.

There are now 12 carriers writing D&F in Bermuda and there is scope for further growth. “Even in a soft market Bermuda has been able to differentiate itself from London,” one senior property underwriter points out.

Bermuda is also becoming a significant force in the cyber market. Whether it is insurance or reinsurance, the challenge for Bermuda is to continue to innovate and provide relevant value-adding products for clients. Hamilton Re, for instance, is seeking to enhance its core product offering by using technology to make fast, dynamic and real-time pricing decisions.

Other companies like Hiscox are focusing on product development. “For me, growth has to come from new products as opposed to from cannibalising an increasingly commoditised market on the cat side,” Hiscox Re and ILS chief executive, Mike Krefta, says.

Reinsurance pricing rules ‘have changed’

The industry can no longer expect rating spikes in the aftermath of big loss events, analysts warned, as fears grow of rate decreases at upcoming renewals, writes Lorenzo Spoorry.

Last year’s $140bn-plus of catastrophe losses seem unlikely to lead to a prolonged rise in reinsurance prices and the industry could even see rates fall at the January 2019 renewals, Deutsche Bank analysts said.

Structural changes in the industry mean the size of any spike in pricing is likely to be more subdued than in the past, Berenberg’s analysts warned, with substantial price hikes now “difficult to envisage” even after large catastrophe years.

Part of the reason for this may be temporary, as the industry remains significantly overcapitalised compared to previous years. But there are also more permanent changes afoot. The willingness of alternative capital to remain in the market in the aftermath of the record losses capital investors suffered last year has convinced most observers that alternative capital is here to stay, ready to take advantage of any uptick in rates.

David Flando, head of analytics at JLT Re, has predicted the now-proven staying power of alternative capital will have “huge implications” for the industry.

Better modelling of insured loss events also means companies have a better understanding of their liabilities and thus can price more accurately, with significantly lower buffers, Berenberg said. This has had the effect of lessening the amplitude of the pricing cycle.

Finally, cedants and brokers have also become more sensitive to pricing and are less willing to accept price rises, especially on non-loss-affected books, the analysts said.

In January, in the immediate aftermath of hurricanes Harvey, Irma and Maria, Guy Carpenter’s property catastrophe rate-on-line index was up only 6.1% on the previous year, while JLT Re’s showed a 4.8% rise.

Risk-adjusted Florida property catastrophe rate-on-line increased an average of 1.2% in June, according to JLT Re’s analysis. As in January, this was at the extreme lower end of market expectations.

The reinsurance outlook now looks “very bleak”, Deutsche Bank warned, with the risk rates could start to deteriorate through the 2019 renewals, assuming cat losses and combined ratios stay within budget in 2018.

The larger carriers have reacted by writing more business outside property catastrophe, expanding in particular into casualty business.

But the room for manoeuvre of smaller property catastrophe reinsurers is limited and most market observers expect further merger and acquisition activity in the wake of AIG’s takeover of Validus and AIG’s purchase of XL Group.

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Minimising exposure to cladding

The lack of clarity around regulations and obligations relating to cladding and fire safety means that both professional indemnity insurers and their insureds must review their exposure and take pre-emptive action.

Follwing the tragic events at Grenfell Tower on June 14, 2017, matters relating to cladding and fire safety in general have become a concern for professional indemnity (PI) insurers.

As a result, many PI insurers in the construction sector have been asking questions of their insureds relating to such potential exposures, particularly in relation to buildings more than 18 metres tall.

Initially, the focus was on social housing, although attention has seemingly widened to include other tall buildings, including schools, hospitals and other commercial premises. Some PI insurers are focused on matters relating to cladding and fire safety in general, while others are asking more specific questions in relation to any projects involving aluminium composite panels.

At this stage, the situation surrounding regulations and obligations remains unclear, and the landscape is clearly still evolving (we are unlikely to know too much more until such time as the Grenfell Tower inquiry has concluded its investigation).

As a result, PI insurers are still considering their positions pending a full understanding of the facts and issues. The potential for PI claims in this area is clear (resulting from specification of materials, installation not being in accordance with specification, untested combination of materials used, inadequate supervision etc.), and, as ever, there will be scope for all manner of parties to be brought into a PI dispute, serious or otherwise.

There will be situations where an employer wants to rectify/improve fire safety and seeks contributions to do so — although while this could necessitate a PI notification, ultimately, it may prove to be more of a commercial/legal issue, shaped by the extent of the contractual obligations into which the firm has entered.

Response

Of course, how PI insurers will respond to their insured firms that face such exposures will depend on the specifics. Nonetheless, we do envisage a range of plausible responses.

At the extreme end, it is not beyond the realms of possibility that an insurer might refuse to renew a PI policy in the event of significant exposure. Equally, we may see no reaction from PI insurers where there is perceived to be little or no exposure. In the event of insurers deeming a firm to be (significantly) exposed, we would think a more likely course of action would entail the application of a higher level of self-insured excess to any potential cladding-related claims.

In addition, PI insurers might look to restrict the cover afforded — perhaps they would look to afford only an aggregate limit of indemnity in respect of cladding exposure, or to “sub-limit” cover afforded to a lower aggregate amount.

Some PI insurers have drafted cladding-related exclusions (some of which would serve to exclude liability in any way involving the combustibility or fire performance of any building cladding system), and the application of these is a possibility for those firms with a (significant) exposure.

Given the continued attention from PI insurers to date, it seems prudent for firms to review their involvement in any projects in which they have had any responsibility for the design, specification, installation of cladding/façade materials (or where they have supervised/inspected others doing so), and/or where they have had a specific role in relation to fire safety, especially in relation to multi-storey blocks. Such pre-emptive actions could prove valuable come their next PI renewal or, indeed, in the event that they are subsequently drawn into any related disputes.

In addition to considering historic projects and any potential issues arising from them, firms should also think about their current projects and their approach to future projects.

Are they comfortable that they are undertaking all duties they reasonably feel that they should be, taking into account the present focus on these matters and likely tighter regulation to follow? Are they accurately recording such work? Do they feel that their internal procedures and protocols are sufficiently robust? Are they comfortable with the performance and systems of any specialist subcontractors they are engaging for such work? Are they comfortable with the extent of contractual liabilities into which they enter?

This is by no means an exhaustive list of considerations, but should provide some food for thought.

A firm that has been involved in the design/specification/installation of cladding/fire safety systems, or which has been involved in the supervision of such projects does not automatically need to notify its PI insurers of potential claims to follow.

Evidently, if an internal audit highlights any concerns about a specific project, then they should talk to their broker to determine whether a precautionary claim notification to their PI insurers should be made. Similarly, if a client or other third-party queries their role in relation to cladding/fire safety on a project, or a project’s compliance with building regulations or other guidelines, and if after any subsequent internal consideration, they have any concerns, they should talk to their PI broker.

Other than the specific project details itself, central to ascertaining what action they should take will be the precise definition of a potential claim circumstance within their PI policy wording. Any definition will need careful consideration. The key will always boil down to the specifics of the situation.

John Roberts is UK construction industry leader at Willis Towers Watson.

The Grenfell Tower disaster has brought issues relating to cladding to the attention of PI insurers. (dominika sarpy/Shutterstock.com)
Setting the construction all-risks market back on course

In today’s challenging market environment, it is important construction all-risks underwriters maintain their discipline and adopt a long-term perspective to build a sustainable book of business

Andy Hottinger
Axis Re

Construction all-risks (CAR) and erection all-risks (EAR) insurance provide a scope of coverage that is essential to contractors: they literally could not work without it.

For brokers, the competitive market provides a range of flexible, relatively inexpensive products that allows them to meet each client’s needs precisely. The only group that is not doing well out of construction insurance is the insurers themselves – or at least a large sub-section of them. Late-ly the tenacious soft market has converted this staple line, like it has with so many others, into something akin to a loss-leader.

As a market, we provide comprehensive all-risks cover, which includes complete coverage certainty for the entire duration of any construction project, even when it takes longer than expected. The product insures against a multitude of material damage mechanisms, including all the perils of nature, testing and initial operations and design. It is often stretched even further through policy extensions, for example to cover maintenance, removal of debris, additional freight fees, strikes, riot and civil commotion and a host of other risks.

Financial impact of delay

The construction market now regularly insures the financial impact of delays due to material damage under advanced loss of profit or delay in start-up provisions. In this way, we now insure cashflows as well as the physical impact of both natural and man-made threats.

The product our market supplies is a base-level enabler of private equity investments, since without a CAR/EAR policy in place, no private investor will finance a project and no bank loan will be advanced. In this respect, insurers are the lifeblood of the commercial construction sector.

Equally, insurance provides an essential safety net for large public investments in social infrastructure, from hospitals to new railway lines.

Small wonder, then, brokers and customers like the products we provide. They sought to: today’s construction insurances are gold-plated – and in some cases more like solid gold... except, of course, for risk carriers. The price they are able to realise for this premium coverage is often more bargain basement than Fortnum & Mason, despite its quality.

Alongside the sector-wide challenge of overcapacity, which has helped to push prices to their nadir and hold them there, overly enthusiastic underwriting behaviour has sometimes prevailed. The lure of large nominal term premiums on slips can make prices look adequate under any circumstances, when in reality they may be fully insufficient. The consequences of this miscalculation are unlikely to be seen before five years have passed since underwriting a big construction risk and sometimes as many as 10 years down the line.

Construction projects are underwritten before they start but take a long time to complete. With risk severity much higher at the end of the project, when the potential physical loss is much greater than at the beginning, that long time must pass before the bulk of the premium is earned. Risk adequate earning of premium must be biased towards the end of the project. For some large infrastructure projects this timespan will easily reach, and sometimes exceed, 10 years from inception.

Long-term pricing

Three other factors complicate the long-term pricing view. One is the perception that the financial element of construction insurances under delay in start-up and advanced loss of profit is increasing as a share of total losses, which is driving severity.

Second is the erosion of premium through attritional losses as a result of the low and falling original deductibles and increasingly wide coverage that have been negotiated during the recent years of high competition and a soft market. Finally, high and rising acquisition costs owing to the market’s inefficient placing mechanisms lead to net premium erosion, leaving less cash in underwriters’ coffers to meet the ever-greater risk.

To set the market back on course and ensure construction insurance is as valuable to insurers as it is to clients and brokers, project premiums must be seen by underwriters in the context of the long duration of cover, the wide catastrophe and risk coverage granted, the attritional losses that inevitably arise when deductibles are low and the potential for severity to exceed expectations.

Adopting a long-term perspective and a technical appreciation of this important class is therefore essential to create and maintain a sustainable book of business, and to provide policyholders with continuing insurance support for key development projects and initiatives.

Andy Hottinger is head of property risk and engineering at Axis Re
Mali: violence erupts after Randgold dismisses 15 employees

One person was killed and at least six injured in the town of Kéniéba in Mali’s southern Kayes region on June 11, after youths staged a violent protest in response to grievance against Randgold Resources, which operates the Loulo-Gounkoto gold mining complex. Police used live ammunition and tear gas against protestors, who caused damage to local government property and set the prefect’s residence and office alight.

The violence was triggered by the dismissal of 15 Randgold Resources employees who staged a sit-in against hiring conditions and the perceived dismissive attitude of the local authorities towards their grievances.

The Kayes region contains Mali’s main gold mining reserves, particularly around Kéniéba, where there have been previous recent protests. If the authorities are perceived to continue their non-intervention over the issue of local employment, further protests in Kéniéba are likely.

Protesters are likely to stage strikes, sit-ins and demonstrations. Access roads leading to mining sites and town centres are likely to be blocked, disrupting cargo and traffic, while the use of live ammunition by police to disperse protesters poses death and injury risks to participants, mining personnel and bystanders. Conversely, the authorities’ willingness to engage with the issues or assurances from the mining companies would decrease protest risks.

IHS Markit leverages the company’s detailed qualitative and quantitative analysis of 204 countries, covering political, economic, legal, tax and security risks.

Duque beats Petro in Colombia’s presidential run-off election

President-elect likely to seek to form multi-party coalition government

On June 17, Colombians voted in the second round of the presidential election between Centro Democrático candidate, Iván Duque, and Colombia Hamuna’s candidate, Gustavo Petro. Colombia’s incoming president, Duque, is likely to form a multi-party coalition similar to the outgoing Partido Social de Unidad Nacional-led coalition of president Juan Manuel Santos, leading to a stable government. With the probable support of a multi-party coalition, Duque’s government is likely to be stable.

During his victory speech, Duque talked of the importance of building consensus; several of his more controversial backers, including former president Alvaro Uribe and Andrés Pastrana, were notably absent when he delivered the speech.

If a consensus government is formed, it is likely to broadly support his economic plans but is likely to be more guarded around amending the Farc peace agreement. Although some anti-corruption initiatives are likely (not least because of the scheduled referendum, if approved will force the government to adopt tougher measures) they are likely to be frustrated if they threaten coalition allies.

Over the coming weeks, Duque will announce his cabinet, while Congress will nominate its House and Senate presidents. The composition of these will be a strong indicator of the government’s future policy priorities and stability.

Main figures to watch are Uribe, whose inclusion in the cabinet would be highly divisive and undermine the government’s stability; and Germán Vargas Lleras, a defeated presidential candidate who retains considerable influence through his Cambio Radical (CR) party, the third-largest in Congress – if he receives an important portfolio, such as defence or ministry of the interior, it is likely to improve the government’s stability and his CR party will be more likely to stick with the coalition.

The appointment of justice minister, who will be crucial in implementing any amendment to the Farc peace agreement, will indicate to what extent the incoming government is serious about amending the agreement.

Libya: militia coalition seizes two oil ports

On June 14, a coalition of militias opposed to the Libyan National Army (LNA) launched a surprise attack on the LNA-controlled Oil Crescent area, taking control of the oil ports of Ras Lanuf and Es-Sider.

The coalition, led by former Petroleum Facility Guards commander Ibrahim Jadhran, included tribal militants from the Maghraba, Tebu and Qadada tribes, as well as jihadists from the Benghazi Defence Brigade, an Al-Qaeda-leaning group, expelled from Benghazi by the LNA in July 2017.

At least two storage tanks at Ras Lanuf terminal were set on fire during the latest fighting, while Libya’s National Oil Corporation declared force majeure at both ports.

The Jadhran-led offensive on the Oil Crescent indicates persisting opposition to the LNA’s attempt to consolidate its control over eastern Libya and the lawless rival Libyan military’s use of force to advance their partisan interests.

The failure of both the eastern “government” in Tobruk and the internationally recognised government of national accord to control these rival factions is an indicator of difficulties in any future attempt to achieve national reconciliation, especially as the UN plan involves their integration into a national army.

The suspension of the LNA’s offensive operations in Derna would be a likely indicator of the LNA’s intent to refocus its main effort to the Oil Crescent, increasing the likelihood of collateral damage arising from ground fighting.
Dealing with the risk of digital protectionism

Competing data regulatory regimes represent a growing threat to the resilience and prospects of global corporations

Suki Basi
Russell Group

The title of last week’s AirMic conference was “The future is now”. Technology is developing so fast that businesses can simultaneously be disruptors and disrupted. Corporates need to embrace strategic connected opportunities, adapt their skills and achieve operational excellence, the risk managers’ association argues.

Against this backdrop, the spectrum of corporate data risks and new European data protection regulations loom large. Risks abound in today’s data regulatory environment, particularly the growing digital “arms race” between reinsurers and corporates as they seek to adopt the latest technology, without truly understanding their relationship with the data they hold.

What is also interesting, however, are the potential geopolitical implications of the EU-inspired regulation. In the wake of the General Data Protection Regulation (GDPR), which went live on May 25, could the EU’s impending regulation also help to drive a growing protectionist mentality?

Is data going global or going local? What is becoming clear is today’s connected digital age poses potential threats to business resilience, national security and critical infrastructure.

In theory, the EU regulator has the power to levy huge fines on US (or other regions) businesses, healthcare providers, charities, individuals and other institutions that fail to comply. It will be interesting to see the reactions of the US administration if/when the fines land on the desktops of American corporate chief executives in 2018 or, more likely, 2019.

According to an article in AdWeek: “A protectionist mindset that has been brewing politically worldwide for quite some time is suddenly at the doorstep of every digital platform and global brand. Marketing players are now making locally minded data moves that stand to hurt companies of all types; though the business ramifications have yet to be appropriately recognised.”

Localisation laws

Certain governments already have data localisation laws in place. Russia, for example, enforces data localisation laws so citizens’ datasets have to remain in the country. Enforcing its laws, Russia has banned access to LinkedIn since 2016 and threatens to block Facebook in 2018 unless it agrees to comply with the data localisation laws.

We are living in a period where artificial intelligence (AI) can deliver smart business tools and predictive data, in which the connected risk is that digital protectionism could hinder progress with negative impacts. One example cited is that if all data must be stored locally, AI systems might draw only from data silos in each country, with the effect of creating seemingly nationally biased “intelligence”.

We live in a world of global data flows but the regulatory response is fragmented and the definitions of personal data vary. GDPR is part of the EU’s attempt to catch up with technological advances that have exploded into millennial public consciousness. It is astonishing to think that when the previous EU data directive was adopted, both Google and Facebook were just twinkles in their parents’ eyes. GDPR has, ultimately, been created to protect EU residents’ privacy from businesses in markets with less robust privacy protections and, in doing so, will act as a catalyst to the rest of the world to conform to its standards.

Yet, could GDPR be part of a wider picture of nationalist-based separatism that has been brewing for some time? AdWeek reports: “Before Brexit rocked the political-economic landscape in 2016 and GDPR was adopted the same year, there were already signs of digital protectionism in Europe. In 2014 German chancellor, Angela Merkel, momentarily proposed the idea of the EU building its own internet to prevent email and other data from flowing through US networks. That move was a direct reaction to unflattering reports of data collection by the US National Security Agency.”

Nigel Cory, a trade policy analyst at the Information Technology and Innovation Foundation, said in the Privacy Adviser: “We’re seeing a growing trend, as dozens of countries are enacting these kinds of barriers to data flows, targeting a growing range of data types, including personal data, but beyond that. Whether it’s a splintering or Balkanisation or whatever you call it, this presents a real risk to the global economy and innovation.”

Data wars

Some data experts anticipate consumer data wars between companies that customers trust enough to compile their personal data and the companies forced to let their data go. In the new data landscape, firms will look to access data from rivals and companies with a footprint outside their vertical sector by tempting customers to transfer their data. They could do this by offering cheaper services to clients that choose to let these companies hold their personal data.

Meanwhile, the online campaign to affect the 2016 US presidential election is just the start of a “dark future”, where data will become weaponised by hostile states, unless regulators and consumers push back, the author of a new book on how to fix the crisis of trust in Silicon Valley says.

“There will be major international crises and probably wars built around data,” Andrew Keen says.

There is a real prospect of a hot data war at some point in the future. In the wake of the 2008 global crisis, there were fears an escalation of protectionist pressures could trigger high-intensity protectionism as a reaction to the crisis. However, those fears failed to materialise in any significant form.

The new question is whether the simmering pressure cooker of international data regulation will bring together a harmonious blend of flavours or blow the lid off global digitally connected trade.

Suki Basi is managing director of Russell Group
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