ISSUE 001 | SUMMER 2021

Global Risk Manager

MULTINATIONAL & SPECIALTY **INSURANCE** PERSPECTIVES

THE RISE OF MADRID

As part of our European focus in this issue, we look at the growing importance of the Spanish capital

INTERVIEW

Peter Eastwood of Berkshire Hathaway Specialty Insurance talks to GRM

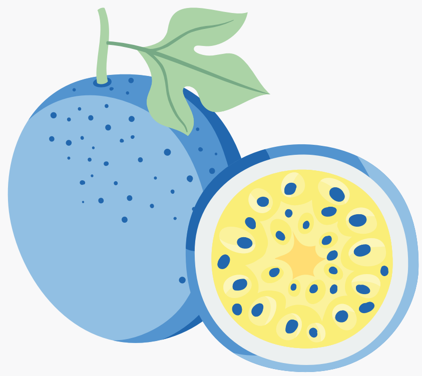
COVID: AN NDBI RISK TOO FAR

How can this gaping protection gap be bridged?

THE D&O HEADACHE

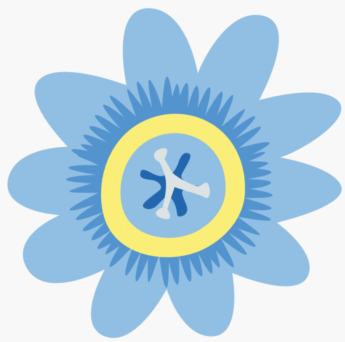
The eternal issue of coverage in non-admitted jurisdictions

ZURICH



fruit

Passion takes many forms



flower

Our passion is helping customers protect their businesses

That's why we've partnered with Commercial Risk to bring you Global Risk Manager

For more information visit www.zurich.com/commercialinsurance

heart

Global Risk Manager
MULTINATIONAL & SPECIALTY **INSURANCE** PERSPECTIVES

Welcome to the launch issue of *Global Risk Manager* (GRM), a new publication that builds on a new digital channel (www.commercialriskonline.com/globalriskmanager).

I have been a commercial insurance/risk management journalist for more than 30 years. I have seen the underwriting cycle in full flow, from soft to hard and back again. The market has changed dramatically in that time, with mergers, new capacity – an ever-evolving marketplace. But some things never change. The cycle never really goes away. People may have believed that the recent long, long soft market was the new normal. But it was never really sustainable.

Ultimately, what never changes is the requirement of risk and insurance managers for a sustainable insurance market that gives them what they need when it comes to their global insurance programmes: consistency, compliance, innovation and value for money.

And they also require independent information and analysis of the global insurance markets, with expert opinion and comment from seasoned observers. GRM has brought together a team of the most experienced risk and insurance journalists, many of whom have been writing on the market, like me, for many decades.

GRM is the first truly global media channel dedicated to the information needs of risk and insurance managers working for multinational companies across the globe. *Global Risk Manager* sheds light on the often opaque world of global insurance programmes and the specialty insurance/reinsurance sector.

GRM provides the core information needs of the individual and team responsible for the purchase of insurance and other risk financing tools to help protect the corporate balance sheet. Each issue focuses on a region, and this launch issue covers Europe. It examines three key areas: international insurance programme, captives and alternative risk transfer, and specialty insurance.

GRM also brings you some of the most incisive profiles and interviews, including Peter Eastwood, president and chief executive officer of Berkshire Hathaway Specialty Insurance; Matthew Shaw, CUO of Tokio Marine Kiln; and Mike Keating, head of the MGAA.

We hope you enjoy this major new publication. We aim to stimulate debate, questions and answers, new perspectives, opinions and thought leadership, to help you in your role, whether that be risk or insurance manager, insurance buyer, captive owner or manager, broker, insurer, service provider or industry observer.

Tony Dowding
Editor, *Global Risk Manager*

Contents

Content

GRM editor
Tony Dowding
tdowding@commercialriskonline.com

Editorial contributors
Liz Booth
Reports editor, Commercial Risk
Garry Booth
Senior journalist
Simon Challis
Senior journalist
Mark Geoghegan
Senior columnist
Ben Norris
Deputy editor, Commercial Risk
Rodrigo Amaral
Senior journalist, Madrid

Head of content
Adrian Ladbury
Commercial Risk

Design & Production

Head of production
Chris Morrish
cmorrish@commercialriskonline.com

Commercial

Head of sales
Hugo Foster
hfoster@commercialriskonline.com
Tel: +44 203 858 0191

Senior sales manager
Harvey Smith
hsmith@commercialriskonline.com
Tel. +44 7919 276471

Operations

Operations & events manager
Annabel White
awhite@commercialriskonline.com
Tel: +44 203 858 0193

Managing director
Stewart Brown
sbrown@commercialriskonline.com
Tel: +44 203 858 0190

Address

Rubicon Media Ltd, Unit 5, Parsonage Farm Business Centre, TN5 7DL, UK

Management

Steve Acunto, Stephen Acunto, Stewart Brown, Hugo Foster, Adrian Ladbury

Member: Beacon International Group, Ltd.

BHSI moving into leadership phase as growth picks up pace

Adrian Ladbury interviews *Peter Eastwood* of Berkshire Hathaway Specialty Insurance

Peter Eastwood joined Berkshire Hathaway back in 2013 to launch a new carrier for the group – Berkshire Hathaway Specialty Insurance (BHSI) – within its National Indemnity group of companies. The group has grown impressively since launch in a difficult market. Adrian Ladbury interviewed Mr Eastwood and asked him about the big plan for BHSI going forward, now that the foundations have been firmly laid...

Peter Eastwood says BHSI exists to serve all its stakeholders on a consistent, sustainable basis

Adrian Ladbury: You launched BHSI in April 2013 when the market wasn't faring well. Why did you take on such a big job at the time and how has your team managed to achieve your objectives in such a soft market, apart from the last couple of years?

Peter Eastwood: There was a moment in 2014 at the Berkshire Hathaway annual shareholders meeting when an equity analyst asked this same question to Warren Buffett. Market conditions at the time of our launch were not favourable and in the following years, in most lines of business, they became even less favourable for underwriters. Warren responded by saying we're not trying to time the market with our launch of BHSI – this is a forever investment, it's a forever business.

This was a wonderful moment for me and our team – it really crystallised our long-term focus. We are here to serve all our stakeholders on a consistent, sustainable basis. Warren's words gave a clear and concise way to convey our orientation: we are a forever business.

Adrian Ladbury: What do you offer risk managers and brokers that the competition does not offer?

Peter Eastwood: The products and services we offer are the entry point to the market, and our team has worked hard to bring to market a highly competitive suite of products and services.

In addition, our business has two core assets. The financial assets bestowed by Berkshire Hathaway put us in a unique position. Even as a startup we had the largest balance sheet and capital resources of any insurance company in the world. Then there are our people: anyone who has experienced our hiring process knows it is extensive. We hire people who have not only exceptional capabilities but excellent character. And that comes out in our every interaction. It makes us a company that our customers and brokers want to do business with, which is our aim.

Adrian Ladbury: Apart from the security offered to policyholders, why is this balance sheet strength so important?

Peter Eastwood: Underwriting is a balance-sheet business. We're taking risk from other companies and transferring it to our balance sheet, so from an underwriting perspective it's incredibly relevant. It's equally relevant from a claims-handling standpoint. Claims is our product, starting with our ability to pay claims, and carrying through to our willingness to pay claims, and to positively affect outcomes. When we move into a product line or a market, it's for the long term, and our balance sheet and financial strength are an important part of that proposition.

We have moved claims further up in the value chain. When an individual or a business is facing a claim, they are not having a good moment. At that moment, we are looking at the policy provided and endeavouring to find coverage. We are endeavouring to make that moment as positive as it can be for them.

Adrian Ladbury: How have you changed the business model to cope with the dramatic changes during the last two years caused by the pandemic?

Peter Eastwood: There are two things business leaders need to focus on in such times: the wellbeing of the team and the continuity of the business. Looking after our team members and their families, and ensuring that they are in a good place from a health perspective, is a priority. When it came to employment, we knew it was important that we could give our team members a high degree of certainty that they would have their jobs. If there was a downturn in a certain part of the business, we made it clear the team members associated with that part of the business should not be concerned. Everyone had enough concerns dealing with their own health and all the other issues that came with the pandemic.

As far as continuity of the business goes, our ability to work remotely with brokers and the risk management community has been largely seamless.

Adrian Ladbury: And the dramatic shift in market conditions – how did you manage that?

Peter Eastwood: Our job, through any market conditions, is to satisfy the needs of the buyer and the broker, while at the same time producing an underwriting profit.

Since our inception in 2013, there has been no better time to do that. Market conditions have given us an opportunity during a time of great need to do what we are here for: to listen and satisfy the needs of our customers and brokers, while at the same time generating an acceptable underwriting profit to support our forever business.

In 2020 our top line grew at 35%; and it will grow 45% in the first half of 2021. We feel good about the environment and the opportunities it is presenting, and our execution.

"European risk managers can expect BHSI to provide great risk-taking capabilities in the marketplace, and to work with very talented professionals who are unencumbered by bureaucracy"
Peter Eastwood, BHSI

When customers are in a crisis because of market conditions, it's a time to step forward and be supportive – to be there for them, to help them through the difficult period. If you do that well, you will elevate the levels of trust and the reservoirs of goodwill. That applies not only to the people that you do business with but, very importantly, to team members as well.

Adrian Ladbury: How does Europe fit into your strategy? You launched in the US and quickly expanded in the Asia-Pacific region, but you took longer to move in Europe. What can European risk managers expect from you?

Peter Eastwood: Our aim has always been to grow a global platform. In building that platform there are two things that we always keep in focus. First, we ask where in the world are there risks where we can be adding value for buyers in a way that produces an acceptable return for Berkshire Hathaway? Second, we want to continue to build a multinational platform that allows us to support customers that have exposures outside their country of domicile.

European risk managers can expect BHSI to provide great risk-taking capabilities in the marketplace, and to work with very talented professionals who are unencumbered by bureaucracy and able to be responsive and get their jobs done.

Our business is about giving the most relevant solutions to the buyer faster than anybody. We are a highly responsive underwriting and claims-paying organisation – and we have a long-term focus and will be here for them. And it's our job to demonstrate that with our every interaction.

At the end of this year, we expect our business across the UK and EU will be in excess of $1bn gross written premium. The company's London market-focused team enjoyed a year-on-year growth rate of some 300% in 2020. And no doubt you'll see more of us in both the UK and continental Europe. We will continue to expand.

300%
Y-O-Y GROWTH RATE ACHIEVED BY BHSI'S LONDON MARKET-FOCUSED TEAM IN 2020

Adrian Ladbury: You chose the word 'specialty' as a core part of your name. Does that mean you intend to be only a specialty insurer or are you also building a global programmes capability and offering?

Peter Eastwood: We wanted a name that would distinguish us from the other Berkshire Hathaway group companies. In the US, our focus has been on excess and surplus lines. Everywhere in the world we have been focused on the large corporate segment, but we are also moving into the upper middle market and, over time, will move into the SME space. Our solutions are largely bespoke in nature.

We have absolutely been building our global programmes capabilities. Today we have the ability to satisfy the needs of multinational companies and buyers in 200 countries worldwide. We have access to a lot of capital, we have great flexibility and we are going to continue to build.

Adrian Ladbury: What do you advise risk managers to focus on in this tough market to help them secure the best possible coverage?

Peter Eastwood: Very much the same things that will help them secure the best coverage through any market conditions. Build an open transparent relationship with your insurance company, really get to know your underwriters and truly understand the financial performance of your insurance company partner.

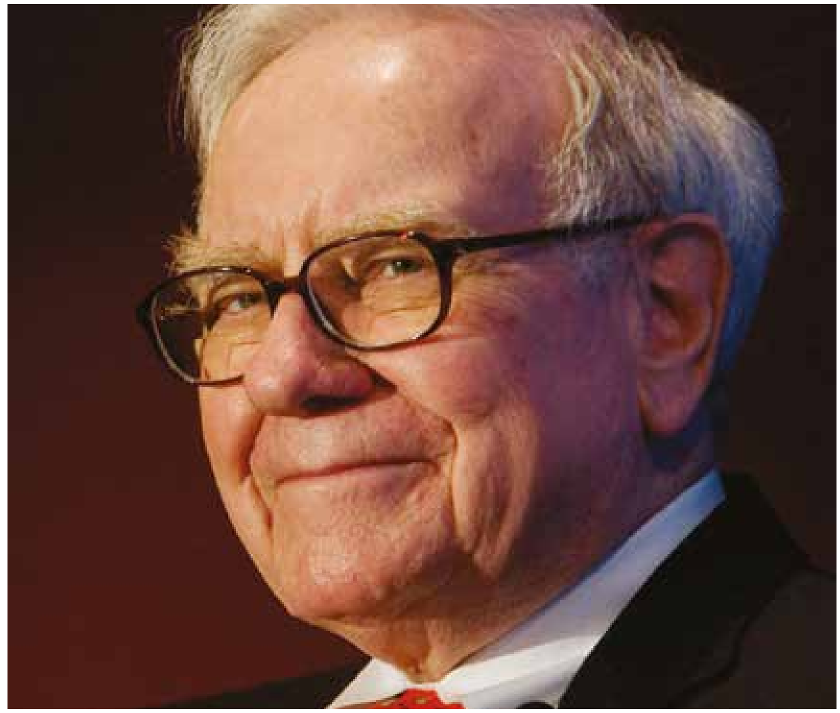
Too often there is just a surface-level conversation about the financial performance of an insurance company. Financial strength ratings with ratings agencies are important. But if I was a buyer, I would look at the quarterly and yearly financial figures for a prospective insurer's line of business.

The greatest differentiator that any insurance company has is its financial performance. The stronger the financial performance, the greater the certainty and consistency of the insurance offering will be for the customer.

In addition, it takes an investment of time to build a strong relationship. It requires transparency, openness, and honesty. Underwriters have a responsibility to understand every exposure that they are taking, and buyers should want them to.

All parties in these relationships – underwriters, brokers, and risk managers – need to take the time to work through the details and understand what is in the best interest of all parties. No one wants surprises.

Too often, the exposures and the risks being taken are not well understood and not priced properly. Over time, that can inevitably lead to some bad moments when a carrier retracts coverage and increases pricing.



Warren Buffet has said that BHSI is a 'forever business'

Adrian Ladbury: You talked earlier about the importance of getting the price right when underwriting to avoid nasty surprises and volatility in future, sometimes brutal market corrections such as in the last couple of renewals. How is it that carriers lose control when it becomes overcompetitive and end up having to post big reserving additions and then play catchup?

Peter Eastwood: There are a few things that lead to this. Insurance is the only business I know where you sell your product without knowing your largest component of cost of goods sold, which is losses. You're doing your best to estimate losses based on experience, and relying on the skills of the actuarial professionals in your organisation to make projections.

In addition, some companies start to rationalise business decisions in pursuit of growth and market-share gains. Most market participants are publicly listed and that construct often puts pressure on them to show steady growth.

Ultimately, an insurance company's use of capital should be based on a discussion between the management of the company and the board of that company, and its shareholders. Discipline in underwriting should be the cornerstone of those discussions and decisions.

My aim is to make sure that BHSI is delivering consistent profits to our shareholders as well as consistency to our customers, with an unerringly disciplined underwriting approach. The two can certainly coexist.

When the show won’t go on

Event cancellation insurers bore the brunt of lockdown-related losses – and have reacted accordingly, writes *Garry Booth*

The big-name property insurers saw their business interruption losses contained but their reputations trashed amid the economic fallout from Covid-19 lockdowns.

Specialty event-cancellation underwriters, on the other hand, emerged with their reputations intact – but their portfolios deep into the red.

Global contingency losses from Covid-19 are estimated to be in excess of £17bn ($23bn), of which as much as £10bn is insured, according to reports.

Events focused around live performances with crowds have been the worst hit by lockdown, including sport, music, festivals, theatrical productions, hospitality events and exhibitions. All require large crews and involve complex logistics to run and organise.

Informa, the world’s biggest exhibitions group, for example, reported a loss of £1.1bn for 2020, as lockdowns prevented gatherings from taking place around the world.

At Lloyd’s, gross contingency claims cost the market £2.9bn in 2020, nearly half its £6.2bn total Covid-19 loss, and were largely attributed to event cancellation claims.

About half a dozen Lloyd’s syndicates specialise in event cancellation insurance (ECI). Specialty insurer Beazley’s experience was fairly typical. In it its 2020 results, Beazley’s political, accident and contingency business recorded premium of $273.0m and a combined ratio of 212%. Covid-19-related contingency loss estimates of $70m net of reinsurance were reported in the first half of the year.

In September, Beazley’s overall loss estimate for first-party claims increased by a further $170m net of reinsurance, which was largely attributable to the cancellation of events into 2021.

“Our underwriting and claims teams have been working tirelessly with clients and brokers to pay claims quickly,” Beazley CEO Andrew Horton pointed out in the results statement.

Simon Henderson, executive director in the media, entertainment and events insurance practice of broker Gallagher, says the impact of lockdown on the market was unprecedented: “ECI is one of those classes that is fairly predictable – historically it doesn’t produce large fluctuations in losses… until this year.

Glastonbury festival in the UK has been cancelled for a second successive year

“Contingency market loss is estimated at $7bn-$10bn. That includes film and prize indemnity. Film losses were significant – circa $2bn – and ECI [losses] therefore came in at about $5bn-$7bn.

“It is a huge loss ratio and insurers won’t be making back those losses before people working in the market today retire,” Mr Henderson reckons.

The relatively small ECI constituency – roughly 20 players – reacted swiftly, with a number of high-profile carriers pulling out of contingency and ECI business altogether. Chubb and Markel International withdrew capacity last year. In April this year, Lloyd’s insurer Talbot announced that Syndicate 1183 – a lead market – was quitting contingency after posting $194.3m of Covid-19 claims in 2020.

Predictably, however, the promise of higher rates and improved terms and conditions attracted new players into contingency business, notably industry newcomers Convex and Fidelis, as well as IGI and

Cincinatti Global Underwriting. The latter insurer hit the ground running, having attracted Chubb's contingency team.

Rock-hard market

Businesses and events organisers renewing contingency cover have seen premium rates soar. The market hardening has affected the contingency market as a whole, even where lines weren't impacted by the lockdown – in prize indemnity insurance, for example.

In many cases, reinsurance programmes for contingency have been badly hit, adding to the uplift in primary rates, Mr Henderson says: "Primary rates are up between 25% and 150%, depending on type of risk and its location. Line size has reduced as carriers are more cautious; carriers are buying less reinsurance or even 'going net'."

Andy Thompson, senior vice-president at Lockton Companies, agrees: "The struggle for the market is the disparity in rating, and there have been increases of anything from 30% to 100% or maybe higher, depending on each individual risk being assessed.

"The increase in pricing has a huge impact on clients who for the most part have been unable to generate revenue due to their events being unable to proceed," Mr Thompson tells *Global Risk Manager*.

Like Mr Henderson, Mr Thompson notes that ECI underwriters have become more selective, and have shrunk their participation risk: "For example, if an underwriter wrote 25% of a certain risk last year, they may only write 15% this year. We've also seen underwriters apply deductibles on smaller productions, whereas in the pre-Covid world, there was a leeway of a certain number of shows before underwriters would consider imposing deductibles, whether that was monetary or a show deductible. Generally, we've also seen coverage become tighter."

Mr Thompson likens the future for ECI insurance supply to the path taken by cyber risk insurance: "Event cancellation insurance is still widely available but what still isn't available is Covid coverage (or a disease restart scheme).

"While cyber cover was previously typically included, it is now being excluded to remove insurers from the potential of a systemic loss.

"Organising and running events is now much more dependent on technology than ever before, so getting cyber cover is still important. Many are therefore addressing cyber as is a buyback option or purchasing a separate policy," Mr Thompson explains.

Gallagher's Mr Henderson is doubtful that a standalone market for pandemic ECI insurance will evolve any time soon, however.

"Event cancellation insurance is one of those classes that is fairly predictable – historically it doesn't produce large fluctuations in losses... until this year"

Simon Henderson, Gallagher

"Reinsurers have pulled back. There is no appetite. Limited cover is written on the film side that addresses [the risk of] an actor contracting Covid that shuts down filming. That would likely be written in the A&H market.

"There is talk of potential, limited cover at very high rates for shutdown – I don't see it being affordable though," he says. "I understand that ILS-type programmes are being discussed for major events, as opposed to conventional conference events. I don't expect event organisers to be able to buy communicable disease cover anytime soon."

Losses down the track

A big cloud that's loomed over the incumbent ECI market lifted earlier this year – the potential cancellation of the Olympic Games in Tokyo. Insurers were spared a biblical loss when it was decided not to cancel the event. At the time of writing, the Games are scheduled to open on 23 July and run to 8 August, albeit without a live audience in most venues.

The Olympics are insured for about $2bn, plus a further $600m for hospitality, according to estimates from analysts at investment bank Jeffries. Cancellation losses would come from multiple sources, including the International Olympic Committee (IOC) and local organising committee (about $800m and $650m in coverage respectively), as well as broadcasters and sponsors, teams, and many other organisations.

According to brokers, the organising committee cover is already blown, with significant losses. The IOC policy, covering TV and sponsorship, should not trigger because the event will go ahead behind closed doors. The same applies to TV company broadcast policies, assuming they can broadcast the event. But, with virtually no spectators, losses are likely now around hospitality packages and ticketing companies, however.

The enormity of the Olympic loss potential and also the devastating effect of lockdown on cultural events everywhere has led to suggestions that governments should do more to compensate event organisers. It seems unlikely however that any state-funded financial help, if forthcoming, would extend specifically to event cancellation.

It doesn't mean that this niche product will fade away. Instead, ECI carriers will tighten their focus on altogether more easily modelled risks: like the weather, earthquake and terrorism.

France (and Lloyd's) looking at hosting captives

With the French government and Lloyd's both taking an interest in captives, *Tony Dowding* examines whether it highlights a significant shift in the way they are viewed

The French government appears to have recently embraced the captive concept, while Lloyd's confirmed earlier this year that it is looking into the potential for hosting captive insurance companies in the market again. Does this represent a sea change in the market with greater acceptance of the captive concept and possibly other countries following suit? Or are they just headlines that will have little impact on the market?

Earlier this year, a senior executive within the French Treasury department confirmed its plans to help make it more attractive for bigger companies to use captives. Lionel Corre, director of insurance at the French Treasury, told French risk managers during Amrae's virtual conference that the proposals, first made public by the French government in December 2020, were being finalised with the aim of making it easier to set up captives.

He said that on the fiscal side, captives require a more beneficial tax treatment than they currently have in France, to enable them to efficiently build up reserves over time. It would seem that Luxembourg is the preferred model, with some element of equalisation reserves.

Francoise Carli of Zakubo Consulting said the French government has recently been active on insurance and captive matters. "There are important aspects, such as reserving processes or tax impact on reserves, which have been on the table to try to attract or pull back French multinational captives to France. On top of that, the Covid situation and the hard market pressure have made this topic even more interesting. Although this is not done yet, it is a clear signal given to the CAC40 companies that the captive system will change in the coming months and it should be seen as a new opportunity for French business to consider."

She added however: "I believe that this is highly political and therefore French only: other European countries have already set up solutions that are efficient, like the equalisation reserve in Luxembourg."

Speaking at Amrae's virtual conference, Lionel Corre said the French government's proposals were being finalised, with the aim of making it easier to set up captives

Real interest

Captive managers have responded with caution and are waiting to hear the detail. Claude Weber, captive consulting leader, continental Europe, Marsh Captive Solutions, said there seems to be a real interest from all the stakeholders to have a captive regime implemented in the near future, but believes that the success will largely depend on the conditions to be applied.

He highlighted several aspects that need to be considered in the legislation:

Lloyd's' recent push into the captive space was confirmed in February 2020

- The risks that a captive should be able to underwrite cannot be very restricted. Third-party risks, such as liability or affinity risks, would need to be accepted otherwise one of the main objectives of a captive will not be achieved.
- The captive would need to be able to set up long-term reserves to cope with the fluctuation of risks in the future. A captive would need to have the option to set up a comfortable level of equalisation reserves, to allow them to cope with their obligations in the event of significant claims.
- The use of cash for intragroup financing should not be restricted unnecessarily.
- The reporting requirements should be adapted by using the proportionality principle foreseen in the Solvency II directive.

If these elements are not adequately addressed by the captive legislation, the chances of success could be quite limited, he added.

Mike Matthews, commercial director – international at Artex, says the devil is in the detail and he would need to see how the initiative is implemented at a grassroots level. He notes that Lloyd's tried in the past to attract captive business onshore but failed due to the unacceptable bureaucracy and cost structures. "By comparison, Dublin, Malta and Luxembourg succeed in this area – who's to say France and other European countries can't follow suit? If it is a genuine effort to create a solution that works for captives, then why wouldn't it be a success?" he adds.

Derek Bridgeman, managing director of SRS Europe, says: "The French initiative is quite interesting in that although this has been mooted at various times over the years, it would appear that it has never been closer. The indications are that the relevant French authorities are considering the implementation of a carve-out and a proportionate regulatory regime for which captives in France can operate under. Naturally, this presents an opportunity for French corporates to establish new captives in France going forward."

The hope is that any legislative moves will be tabled along with the 2022 Budget in September, and that the new rules will kick off by January 2023.

> **"Lloyd's believes that its unique structure, rating and licence network provide the basis of a valuable contribution to the captive market"**
> ***Lloyd's spokesperson***

Lloyd's looking at captives (again)

Lloyd's' recent push into the captive space was confirmed in February 2020, when a Lloyd's spokesperson said: "Lloyd's has had the ability to host captive syndicates since 1998. Recent changes to the regulatory environment and the Future at Lloyd's strategy have stimulated a review of this capability. Lloyd's believes that its unique

structure, rating and licence network provide the basis of a valuable contribution to the captive market."

Lloyd's' last foray into the captive market resulted in just one captive syndicate being formed, in 1999, but then put into runoff in 2000 following a parental merger.

Peter Carter, head of the global captive practice at Willis Towers Watson, says the move is likely to attract multinational companies, "to consolidate their captives to the London platform to take advantage of Lloyd's' global footprint with licences that in turn could simplify their renewals and reduce fronting costs of existing approaches".

Marsh's Mr Weber agrees that the structure being proposed by Lloyd's could appeal to large multinationals that need to issue policies around the world, but is less likely to appeal to smaller companies looking for monoline solutions where a single parent captive or a PCC structure may be more appropriate.

Jonathan Drake, partner, regulatory, compliance and investigations, DWF Law, says he believes it could potentially have a significant impact. "There is support for reviving the concept among the third-party syndicate management community, and the concept chimes well with the Lloyd's vision for transformation through its Blueprint One and Blueprint Two strategic plans. The worldwide licensing advantages that Lloyd's enjoys could be very attractive for companies with global reach and complex insurance programmes," he said.

Artex's Mr Matthews notes that Lloyd's tried this once before and failed due to issues related to bureaucracy and costs. "If these, and concerns around the compensation fund, can be resolved under the new initiative, then the ability to issue policies globally, in place of costly and increasingly scarce fronting options, will be a very attractive proposition for some captive sponsors, albeit only the very large ones," he says.

Italy has indicated that it would be open to a proportionate approach to captives being domiciled there

" Captive managers suggest that there are a number of other countries considering following France"

As for other countries following France's lead, who knows whether a post-Brexit UK would look to encourage captives? But captive managers suggest that there are a number of other countries considering following France. For example, there are currently discussions on a captive regime in Italy. It has indicated that it would be open to a proportionate approach to captives being domiciled there, but as to whether any of these countries can implement a captive regulatory framework that will make it cost effective from an operational perspective, the jury is still out.


Do you
have what you
need to navigate
a complex world?
You can.
AIG's multinational capabilities go beyond insurance, helping you achieve your risk and contract certainty objectives. Our global network of over 215 jurisdictions is backed by over 400 dedicated multinational experts. You can count on expert local knowledge and insights in every country you do business. Our innovative technology and unique solutions unlock benefits like expert design and seamless implementation of your global program, with visibility into key claims trends and metrics. Let us put our award-winning products and world-class service to work for you. Visit www.AIG.com/multinational
Expertise that knows no borders.
AIG®
Insurance, products and services are written or provided by subsidiaries or affiliates of American International Group, Inc. Insurance and services may not be available in all jurisdictions, and coverage is subject to actual policy language. For additional information, please visit our website at www.AIG.com © American International Group, Inc. All rights reserved.

Protectionism means tougher approach to non-compliance

Protectionism is on the rise globally and insurance regulators in Europe certainly appear to be taking a tougher approach on non-compliance for global programmes, writes *Tony Dowding*

Protectionism is clearly a barrier when it comes to multinational insurance programmes, according to André Rohlmann, general manager of INI. "Some European countries are still protecting their own insurance industry by requesting foreign insurers to ensure compliance to local pools or insurance schemes," he says. "European legislation does not permit cessions to reinsurers domiciled outside of the EEA, except those being registered in the EEA or located in territories meeting EU Solvency II equivalence requirements."

However, he notes: "This tendency of rising protectionism is more noticeable outside of Europe rather than within. Having said that, complex and cumbersome reinsurance registration in certain markets, particularly in South America, as well as the right of first refusal in a number of African and Asian countries, is having a negative impact on multinational insurance programmes."

He adds: "In this day and age, insurers, brokers as well as clients have a much better understanding of what is expected from them in order to ensure compliance. However, we have observed that EU regulators are taking a tougher approach, in particular when it comes to tax and data security, as well as anti-money laundering. Therefore, it is important that all parties involved keep up to date with these developments."

Karen Jury, UK head of multinational, AIG, says that while the trend is not universal across all jurisdictions or product lines, making it difficult to give a single global answer, AIG is seeing increased regulation in a number of markets worldwide, including Europe. In these cases, regulators are typically changing and/or introducing regulations in an effort to protect local consumers and the local insurance market, she says, and this is often through mandatory local retentions and/or reinsurance, local market exhaustion, taxation and tariff ratings.

"We have seen a recent increase in thematic reviews carried out by national and local regulators and EU authorities," she adds. "The thematic reviews and regulator inquiries may focus on differing topics but general common themes of consumer protection, product oversight and governance, and ensuring customer-centric approaches are implemented, are clearly identifiable."

Increased focus

The economic situation in Europe has brought increased focus on capital requirements for insurance companies during the past year with the objective to ensure market stability, giving rise to for example further revisions on Solvency II regulation, according to Ayleen Frete, global head of market practice management, global client services and multinational, AGCS. "Other insurance regulation has been the focus in several countries, such as changes in the areas of reinsurance schemes, insurance tax changes in Spain and Germany, or stricter non-admitted insurance regulation such as in the Netherlands," she says, although she addsthat in international insurance, changing regulatory environments are nothing new.

Ian Long, head of international programmes proposition and transformation, Swiss Re Corporate Solutions, says: "Partly because of Brexit, we see insurance regulators across the EU reviewing their regimes for market access for 'third country' (non-EU) insurers, and there are certainly signs that positions are toughening. We expect to see challenges to the Lloyd's Brussels operating model, for instance, and it seems inevitable that harsher market access rules for UK insurers will have a knock-on effect on other non-EU insurers, as regulators will be anxious to be seen to apply a level playing field."

Jonathan Drake, partner, regulatory, compliance and investigations, DWF Law, says that Brexit has thrown into sharp focus the interaction between the EU's (and other countries') regulatory systems and those of third countries, and this has led to regulators scrutinising in greater detail the interaction in multinational insurance provision and distribution.

> **"Partly because of Brexit, we see insurance regulators across the EU reviewing their regimes for market access for 'third country' (non-EU) insurers"**
> *Ian Long, Swiss Re Corporate Solutions*


AXA
Insurance
Reinsurance
This is not just a sunset
It’s also a sunrise somewhere in our global network.
Combining our geographical reach and local expertise, we’ve got you covered wherever you are.
Find out more at axaxl.com
Know You Can
AXA XL is a division of AXA Group providing products and services through three business groups: AXA XL Insurance, AXA XL Reinsurance and AXA XL Risk Consulting. AXA, the AXA and XL logos are trademarks of AXA SA or its affiliates. © 2021

Pandemic: an NDBI risk too far

Garry Booth asks: If the private sector is unwilling and unable to provide businesses with pandemic NDBI coverage, how can this gaping protection gap be bridged? And could a solution be extended to other systemic risks?

The FCA's BI test case went to the UK's Supreme Court in January 2021

When businesses large and small went into lockdown across the world's developed economies, they looked to their property insurance providers for a much-needed cash injection – only to be disappointed.

In a bitter row fuelled by lawyers and public relations experts, insureds took their claims to court in the hope of persuading supervisors that their insurers had a legal obligation to pay for their non-damage business interruption (NDBI) losses.

Insurers argued that business interruption insurance contract wording was always intended to respond to local events and not the mandated closure of businesses such as happened in lockdown. Amid unprecedented public outcry, insurers declined to pay out on the majority of pandemic claims presented to them.

In the UK, the Financial Conduct Authority reacted to the ensuing tsunami of legal actions (including several class actions) by fast-tracking an industry test case before the UK courts on behalf of policyholders. In an unparalleled court action, the High Court sought to bring clarity to some 370,000 policies with more than 50 insurers that were subject to dispute.

The High Court's decision in September was appealed by insurers and a Supreme Court hearing followed in January 2021, finding that, except in rare circumstances, cover is restricted to policyholders that were mandatorily closed. However, the new ruling also found that the original High Court judgment was too narrow in its interpretation of denial-of-access wordings – not entirely letting carriers off the hook.

From Australia to North America, litigation between insurers and insureds has led policymakers and industry strategists to the same conclusion: pandemic-related business interruption risk is systemic, being characterised by widespread and simultaneous financial losses. Furthermore, it is largely linked to government decisions to introduce mandatory lockdown measures.

Insurers opt out

In short, pandemic risk is impossible for underwriters to model and price, and meaningful limits are unavailable in the face of such loss accumulation. As such, pandemic risk is beyond the capability of the private insurance sector and the role of the state must be extended to help provide pandemic risk transfer – and not simply making emergency cash handouts as happened in most OECD countries.

As Jad Ariss, managing director of the Geneva Association, put it: "It is a tragedy that businesses, particularly SMEs, have suffered so much financial loss during the pandemic as a result of the lockdowns, which were beyond their control. The public sector had to step in with multitrillion-dollar emergency relief measures. Governments and insurers must work together on how to close the massive protection gap exposed by Covid-19, with governments as the leading players."

Mr Ariss was speaking at the launch in April this year of a report from the Geneva thinktank that examines four possible ways for governments to become involved in pandemic risk schemes, three with the help of insurers:

- Mandatory or voluntary direct insurance offered by the government and administered by private insurers
- Government reinsurance, backstopping mandatory or voluntary private-sector coverages
- Mandatory social insurance.

The association discarded "post-event financial relief with no pre-event dimension whatsoever" on the basis that it foregoes any benefits from pre-event risk mitigation and preparedness measures.

Each of the other potential solutions discussed in the report points to a valuable role for the insurance industry to act as absorbers of limited risk, professional distributors and claims managers, and/or experts in risk assessment, mitigation and prevention.

With mandatory (or voluntary) direct insurance offered by the government and administered by private insurers, government insurers would not only collect premiums but also be able to borrow funds in case payouts exceed accumulated premiums, the Geneva Association argues.

The government insurer could market policies directly to insureds or, alternatively, through third parties such as banks, insurers and intermediaries.

Ferma president Dirk Wegener wrote to the European Commission in support of public-private initiatives

The same options are available for claims settlement and payment.

Is backstop best?

Government reinsurance that backstops voluntary private-sector coverages is an option that is already in use for other types of catastrophe, notably terrorism but also flood and windstorm.

European examples include the French Caisse Centrale de Réassurance, Spain's Consorcio de Compensación de Seguros, the UK's Pool Re, the German Extremus scheme, as well as nuclear industry pools in several countries.

In the case of pandemic, governments could provide reinsurance to insurers that sell pandemic coverage to businesses prior to a pandemic event, the Geneva Association points out. Variations on this theme have already been mooted in several markets (see table).

The reinsurance coverage would kick in for losses above a certain threshold and up to a designated limit. As for the direct insurance option, a major pandemic would probably require governments to borrow to raise funds, as well as to tax in order to service the debt, the paper points out.

> **"Governments and insurers must work together on how to close the massive protection gap exposed by Covid-19"**
> *Jad Ariss, Geneva Association*

In contrast to backstopped private-sector coverage, the distinguishing feature of the social insurance concept is mandatory participation. The Geneva Association paper also points out it involves a higher level of solidarity and more uniform non-risk adequate pricing.

With pandemic risk, participants would be required to make pre-event payments, for example through a special tax or levy. Benefits from such a scheme would be capped at a relatively modest level of potential losses, in line with the typical objective of social insurance to provide modest coverage for broad segments of the population.

Corporate insurance buyers not surprisingly lean towards the backstopped public-private risk transfer option. Earlier this year, Ferma president Dirk Wegener wrote to the European Commission in support of public-private initiatives, which he said would increase financial resilience for the bloc's economies against future pandemic risks.

"Many European businesses face inevitable and sometimes severe financial losses as a result of the pandemic event. Insurance provides little if any cover for these risks, and insurers are introducing more exclusions and tighter conditions as policies renew," Mr Wegener said. "We do not expect this to change. Pandemic risk, like climate change and cyber risk, is systemic. It is beyond the capital of the private insurance market to provide material capacity for transfer of risk."

Ferma's view is that public-private partnerships for pandemic risk would be on a national basis, but the EU should help member states. "It could, for example, provide expertise, such as modelling

NATURE AND TARGET OF THE SOLUTIONS

CATEX	FR. Proposal from FR insurance industry, November 2020. Public-private. Mandatory. New scheme, complementary to 'cat nat' and 'GAREAT' schemes, which cover physical damage. Distribution by insurance sector.	All companies covered by a retail or corporate comprehensive insurance policy, whatever their size and sector of business.
GDV proposal	Germany. Public-private. New scheme. Distribution by insurance sector.	Not restricted – potential to focus on SME with voluntary participation from large undertakings.
Pandemic Risk Insurance Act (PRIA)	US. Proposal for act introduced in US Congress in May 2020. Public-private (mostly public). Modelled on existing terrorism mechanisms (TRIA). Mandatory offer, voluntary takeup from businesses (no mandatory purchase).	Not restricted – businesses and organisations (including non-profits) of all sizes.
Business Continuity Protection Program (BCPP)	US. Alternative proposal from the US insurance industry, May 2020. Public federal business revenue reimbursement programme. Similar to the Federal Flood Insurance Program. Mandatory offer, voluntary takeup. Insurers provide administration services.	Not restricted – businesses and organisations (including non-profits) of all sizes. Supplementary voluntary programme for larger business.
Pandemic Business Interruption Program	US. Alternative proposal by global (re)insurer Chubb, July 2020. Public-private (mostly public). Mandatory offer for every P&C insurer to small business clients (<500 employees). Voluntary takeup, with strong 'opt-out' requirements. Additional voluntary programme offer for large businesses. New federally reinsured programme for large businesses (Pandemic Re). Distribution by insurance sector.	Businesses and organisations of all sizes: SME and large company programme.
ReStart	Model proposed by Lloyd's – not all design options fixed. Private insurance pool. Optional for customers.	Small companies. Options: define by geography, industry or customer segment.
Recover Re	Model proposed by Lloyd's – not all design options fixed. Public-private. insurance product: multi-year contract. Distribution by insurance sector.	Not restricted.
Black Swan Re	Model proposed by Lloyd's – not all design options fixed. Public-private. Government-backed industry reinsurance pool. Potentially mandatory.	Not restricted.
Indian Pandemic Risk Pool	Proposal from working group composed of industry representatives under the heading of the Indian Regulatory and Development Authority of India, September 2020. Pool with government backstop, administrated by GIC Re (manager of Indian terrorism and nuclear pools). Mandatory for sectors covered in the pool.	Initial focus on micro, small and medium-sized enterprises (MSME) and migrant workers.

Source: EIOPA staff paper on measures to improve the insurability of business interruption risk in light of pandemics and rate setting, and startup costs. There is also potential for additional EU support such as an EU backup layer, possibly via the European Stability Mechanism, allowing the convergence of all national systems to a European standard," Mr Wegener wrote in his letter.

Eiopa weighs in

At the time of writing, the European Commission was exploring its options, helped in part by the European Insurance and Occupational Pensions Authority (Eiopa).

In a paper out for consultation until the end of March 2021, Eiopa examined three mitigating aspects of the NDBI protection gap around risk prevention and risk transfer.

In the latter category it discusses the role of capital markets in risk transfer and, extending the brief, also pooling of different perils for addressing systemic risk.

Eiopa cautioned that capital markets investors won't be as receptive to pandemic risk as they have been for well-modelled windstorm or earthquake property events, saying: "Progress on pandemic risk modelling and pricing will be needed… Public-private solutions for a leveraged pandemic fund may be a relevant option to consider in order to involve investors in a shared resilience solution."

On pooling generally (and it doesn't say whether or not this would be backstopped), although the diversification benefit from pooling is not clear, multi-peril solutions can provide opportunities for addressing the risk of "following" events, developing common prevention measures, as well as addressing the opportunity cost of separate peril solutions.

"The option to introduce future-focused multi-peril solutions should be considered going forward, to address systemic risk. The next crisis is unlikely to be the same as today's, so we should improve our tools having in mind future challenges ahead," Eiopa said.

Black swan solutions

Eiopa is not alone in thinking that the global economy will be disrupted again in a way that business and wider society is not sufficiently prepared for. Plausible systemic risks could include a cyber disruption, a climate change event or apocalyptic meteor strike.

Pandemic Re, the London market project formed to find an industry solution for covering future pandemics, envisaged extending the UK government-backed terror mutual Pool Re into a vehicle that could help pay potential [systemic] losses that are outside the insurance industry's capital.

CONTAGIOUS DISEASE COVER CATCHES ON

Munich Re is offering 'customisable' protection, says Garry Booth

Like its peers on the global reinsurance stage, Munich Re took a big hit from Covid-19. The group incurred Covid-related losses of €3.5bn in 2020 and expects to pay a further €600m in 2021.

Having played its part in mitigating the financial impact of the pandemic, Munich Re has said it will exclude coverage for pandemic-related losses in the course of contract renewals for newly concluded business interruption (BI) contracts.

But it isn't washing its hands of the pandemic risk problem. As well as backing the call for a public-private partnership to protect national economies against systemic pandemic risk, Munich Re is also promoting a dedicated epidemic/pandemic insurance and capital market-backed risk solution via its Epidemic Risk Solutions (ERS) practice.

Günther Kraut

ERS was established within the Munich Re Markets unit in 2017, pre-dating the Covid-19 outbreak. Munich Re Markets' mission is to create bridges between insurance and capital markets, delivering solutions for both market and insurance risks.

"ERS wants to facilitate the transfer of risk concentrations found on balance sheets to pockets of capital for whom the bearing of such risk is attractive," says Günther Kraut, ERS head. "Therefore, it aims to establish a platform for the exchange and sharing of accumulative systematic risk across a wide variety of stakeholders, including capital market participants."

With ERS, Mr Kraut says it has created a fully customisable solution to protect companies against viral epidemic and pandemic catastrophes. Solutions include BI, extra expense and lost rental income, for example.

Such cover can assist directors and officers in meeting their fiduciary obligations by minimising damage to business revenues, while acting in the best interest of all stakeholders, Mr Kraut points out.

Target industries include education, hospitality and tourism, healthcare, manufacturing, real estate/REITs, retail and construction/infrastructure.

"Covid-19 certainly has accelerated interest significantly, whereas before Covid-19, demand was stronger in other lines such as life reinsurance," Mr Kraut tells Global Risk Manager.

Current purchasers have already sufficiently recovered from the Covid-19 event and now want to improve their risk management for the future: "In some cases, they are requested by their clients to find a cooperative way of reacting to a potential next event, which can often be mirrored by the structure of the insurance policy. It's a sign that risk management processes are becoming more resilient."

"One possible option is to turn Pool Re into a holding company where the surplus is held, and then form subsidiary companies – such as Pan Re, Cyber Re, even Climate Re," Pandemic Re's chairman Stephen Catlin suggested.

Lloyd's made a similar pitch with another government-backed pool it dubbed Black Swan Re.

Policymakers' wheels grind exceedingly slow however, and little progress has been made on industry proposals in Europe and around the world. Meanwhile, Eiopa has said it is analysing the feedback it received and "liaising with the European Commission regarding next steps".

That leaves risk managers and insurers alike watching the horizon for whatever the horsemen of the apocalypse next have in store – and hoping that the lessons learned from lockdown will make them better protected against it.

Is US-style class action litigation coming to Europe?

The spectre of US-style litigation coming to Europe has long been a concern for corporates, especially when it comes to class actions, says *Tony Dowding*

For class action litigation, the sums involved can be huge, both in terms of damages and defence costs, not to mention the time and effort it takes to defend against such claims, and the impact not only on the company but also its directors and officers.

US-style litigation has not yet arrived, but there have been some moves recently that have caused some concern. A recent court case in the UK, and the arrival of the Collective Redress Directive in the EU, are seen by many as a warning sign, although protections are in place that should mean that Europe does not go the way of the US just yet.

Most countries in Europe now have an established collective action mechanism, though procedures vary and, in some jurisdictions, are confined to consumer claims. However, the state of affairs in Europe has changed significantly in recent times, according to Henning Schaloske, partner at Clyde & Co in Duesseldorf, following the large losses suffered by investors in the wake of the global financial crisis and the bolstering of consumer rights across Europe, most notably from the General Data Protection Regulation (GDPR). He says that with the Collective Redress Directive, he expects the European landscape to continue to evolve.

The directive requires member states to implement minimum standards by December 2022, for consumer collective redress for claims within the scope of the GDPR, financial services and product liability.

Significant impact

Kenny Henderson, partner at CMS, says that the implications of the directive are significant. "Countries must enable 'qualified entities' to bring claims on behalf of consumers on an 'opt-in' basis. Importantly, the provisions in the directive are minimum standards, so member states are free to go further and, for example, have 'opt-out' collective redress mechanisms that automatically coalesce the class. Opt-out devices are typically associated with the US, but they are increasingly a feature of the European class action landscape and the directive will accelerate that trend," he says.

The arrival of the Collective Redress Directive in the EU is seen by many as a warning sign

Nima Rafiee, underwriting manager, financial lines, AIG EMEA, says the directive is likely to increase the number of class action-type lawsuits against companies, especially those with heavy B2C exposure such as those operating in the financial services, travel and tourism, energy and telecommunications industries. He stresses that most companies and industries will be affected to a certain degree as the directive also targets data breaches. "These type of lawsuits, if they gain traction, will likely be expensive and time consuming to defend," he adds.

Mr Schaloske explains that the directive "will introduce a quite far-reaching new tool for qualified entities, especially consumer associations, to bring claims against companies where individual claimants may so far refrain from enforcing claims".

In particular, he notes that the directive will allow the enforcement of damage claims and will not be confined to declaratory rulings. He adds that one potential area that could become relevant are claims under Article 82 of the GDPR, because claimants may not only bring claims for material but also immaterial damages, for example following cyberattacks and data breaches.

Law firm Kennedys says the directive is widely expected to result in the proliferation of collective actions brought against businesses across the continent, already fuelled by the influence of US class action law firms and third-party litigation funders setting up shop in the European market. "The increasingly digitalised and technological global market within which businesses are operating is particularly conducive to collective actions, as evidenced by the recent group proceedings brought against EasyJet and BA. The directive will provide a direct platform for future similar actions that could potentially involve thousands, if not millions of consumers, particularly if such actions are brought on an opt-out basis," says Kennedys.

Collective actions on the rise

It is not just the directive that is causing concern. Europe is already seeing a rise in collective actions, and a recent decision in the UK highlights the issue. The UK Supreme Court's decision in *Merricks v Mastercard*, a collective action on behalf of 46 million consumers for £14bn, has been described by one law firm, DAC Beachcroft, as "a seismic step towards the US-style model of class action litigation". It adds: "There are a number of extant multi-claimant claims in the competition sector that were, effectively, stayed pending this decision, which are now likely to be able to proceed efficiently with the use of collective proceedings orders. The decision also has the potential to open the floodgates for collective opt-out actions by many claimants, whose ability to participate in, and benefit from, large-scale competition damages claims will be greatly increased."

A recent report from Allianz Global Corporate & Specialty (AGCS), in collaboration with Clyde & Co, notes that securities class actions are presenting a significant risk to corporates and their directors and officers, adding that litigation funding is common in both consumer and shareholder collective redress actions, and in a number of jurisdictions it has acted as a catalyst for the use of collective actions.

Dr Henning Schaloske says risk managers be aware that funders are likely to be operating in the background and contemplate the impact this may have on the litigation

In the report, AGCS states: "The use of collective action presents a significant risk to companies that often face a tremendous exposure to damages (and, in some jurisdictions, punitive damages) and costs, given the size of the class, in addition to considerable operational and reputational damage from dealing with large-scale litigation. Securities class actions also present a serious and growing risk for directors and officers."

Clyde & Co says: "Overall, we are seeing a step change in Europe's litigation industry. Litigation funders, combining with new collective action options, are forming a growing trend of collective redress. The net result is increased liability exposure for commercial clients, as the hurdles for European consumers to embark on this type of action are lowered."

How to respond?

So what do risk managers need to do to make sure they are covered for this potentially escalating risk? Clearly, they should be checking their liability insurance coverage, looking out for exclusions, and having conversations with brokers about whether they require additional cover and higher limits. They should also examine the scope of policies, as traditional liability policies may not cover, for example, losses arising from cyber events, and look closely at the terms of the insurance, in particular exclusions and notification requirements.

Mr Schaloske says: "When looking at D&O insurance, it is also worth bearing in mind the limits of D&O Side-C cover, which frequently has

"Opt-out devices are typically associated with the US, but they are increasingly a feature of the European class action landscape"
Kenny Henderson, CMS

a high retention and is expensive to purchase. If obtained, it should be noted that there is also the risk that entity cover will erode the cover available for directors."

There are also a number of differences in the handling of large group claims which risk managers should note, according to Mr Schaloske. "Defendant companies need to deal with the claimants (who may be headed by a representative body) and there may even be several different claimant groups to tackle, each with different agendas. This can make settlement of the claim more challenging," he says.

"In addition, risk managers should envisage that funders are likely to be operating in the background and contemplate the impact this may have on the litigation – more resources are available so claims may not be able to settle quickly, plus there are other interests to be taken into account. The presence of funders undoubtedly changes the dynamics of the litigation, which risk managers should remain cognisant of," he adds.

Mr Henderson says that what is required initially is a good understanding of the claims that a corporate is likely to face under the changing procedural rules for class actions. Once the primary liability is understood, be that data protection class actions or antitrust class actions, corporates can ensure they have proportionate measures in place, he says.

While there are clearly signs of change in Europe, Mr Rafiee thinks the directive is unlikely to usher in a new era of US-style litigation, for a number of reasons. "For cross-border claims, the EU directive does not allow for contingency fees and only allows not-for-profit organisations to pursue these claims on behalf of consumers, which is far different from the model in the US. It also has some restrictions around litigation funding and there are still uncertainties [about whether] the EU and its member states will adopt an opt-in or opt-out principle, the latter being the one adopted by the US and one main reason for the litigation activity and size of settlements [there]. Currently in the EU, the opt-in principle is by far the most common."

And he notes that for many years several EU countries have had mechanisms in place for collective consumer actions without much activity.

Mr Schaloske agrees that it is unlikely that the landscape will start to mirror the US, noting that it is the combination of an aggressive litigation culture, plaintiff bar contingency fees, jury trials and punitive damages that makes the US system challenging. No mechanism in Europe mirrors this and legislators have been keen to ensure that there are safeguards against the environment swinging this way, he says.

"That having been said, the increase in collective actions in Europe has resulted in US firms establishing outposts in a number of jurisdictions (most notably, the Netherlands) and there has been an increase in homegrown claimant lawyer firms advertising their services. This is set alongside the increasing prevalence of litigation funders in many jurisdictions, which has been shown to spur on collective actions," says Mr Schaloske.

The dieselgate scandal led to a huge class action lawsuit against Volkswagen

On the road back to stability

Persistent losses have pushed Lloyd's and the London market into remediation mode during the last few years. But a meeting with *Matthew Shaw* of TMK shows *Mark Geoghegan* a carrier and market regaining confidence and looking to re-engage with the world of risk...

As chief underwriting officer of Tokio Marine Kiln (TMK), Matthew Shaw has one of the top ten individual underwriting jobs in the London market, managing gross written premium of more than $2bn in 2020.

In many ways, this Lloyd's stalwart is a bellwether for the health of the London market as a whole.

TMK has been a prestigious bluechip in the Lloyd's market for decades, since long before its formation through Japanese multinational insurer Tokio Marine's premium-priced acquisition of Kiln in 2008.

But even this consistent outperformer has felt the squeeze of loss-making years of late.

Everything that has happened at TMK has also happened at almost every major underwriter in the global wholesale and specialty insurance market in the past decade.

From around 2013, steadily falling prices and deteriorating core underlying results laid the foundation, a very large and very lumpy run of major catastrophes starting with Hurricane Irma in 2017 provided justification for price rises, while last year's Covid-19 losses gave the nascent market turn a stiffened backbone.

The descent into core underlying loss piqued major re-underwriting at TMK and a return to significant profit in 2019, only for a $250m-plus provision for Covid-19 in 2020 to provide a further setback.

In the wider market, fledgling businesses were abandoned or shut down by Lloyd's itself in a drive to return the market to profitability.

Indeed, Mr Shaw himself arrived at TMK a year ago from Chubb in a visible embodiment of the carrier's determination to work its way back to consistently profitable ways and to change the way it went about its business.

However, the carrier was undented and undaunted by a clear outlier like 2020, and this


Matthew Shaw

calendar year it has posted bullish 15% growth plans amid the heady combination of significant growth in submissions and continually improving underwriting conditions across the market.

Long-term sustainability

Mr Shaw is a considered character and in the course of our discussion repeatedly makes the case for long-term sustainable insurance relationships.

Prices may be rising but he certainly doesn't come across as someone looking to make a fast buck out of temporarily improved market conditions, but rather a long-term manager anxious to rebalance his portfolio for sustainable growth.

The executive explains that while sub-limited coverage limits, deductibles and premiums always wax and wane in hard and soft markets, providing a consistent approach has always been a major goal for the insurer.

"Working with market leaders such as ourselves, we would always try and craft core coverages to suit the needs of most of the customers, and this is something that we think we have done consistently over the decades," he explains.

But Mr Shaw reminds us that you do have to pay for the things you value, or they might not be there when you need them. "I think that it's important that everybody realises that it is in the long-term interests of both the carriers and the customers that they can rely on a well-capitalised, financially secure market to ensure their claims are settled promptly, properly and securely. That does mean that over time there is pricing adequacy in order for the market to continue offering that product and the coverage in a consistent manner," the seasoned executive explains.

Competitive pressures

But insurance operates in a highly-competitive global marketplace.

And while many industries always know their wholesale cost and mark-up, insurance often prices its product below cost for long periods, often due to extreme competitive pressures.

Or sometimes the price stays the same but the cost suddenly increases; this takes time to manifest itself and still longer to readjust for.

Mr Shaw asks buyers to respect and value underwriters' judgements about sensible long-term technical pricing for their products and explains that the best customers are willing to allow the underwriter the prospect of a fair return over the pricing cycle: "We've got certain clients that we've had on the books literally for decades… they would say that we have given them the right product at the right price and at the same time we have benefited from them being long-term customers of ours."

"The slow upwards trajectory of some lines means it could be a while before they get to adequacy in our view"
Matthew Shaw, Tokio Marine Kiln

This executive gives the impression of someone who sees sharp price corrections as an admission of past failures and aspires to the near elimination of the volatility of the pricing cycle in the long term.

It won't have escaped anyone's attention that we are once again at one of those inflection points in the market where buyers are being asked to pay more across many lines of business after a period of underpricing of the product.

Mr Shaw's view is that the underwriting and re-underwriting process is never complete from a carrier's perspective, and constant vigilance is required.

Adequate pricing

What can we learn about pricing trends from talking to such a technically-minded market insider?

The good news is that some lines are now adequately priced and stability should be on its way back.

The bad news from a buyer's perspective is that Mr Shaw is still not sure that even after sustained price rises, all classes are at or above what he considers adequate pricing levels.

"I would very much be happy with a line such as open-market property, but I think others we would say we are still well away from real adequacy, and the slow upwards trajectory of some of those lines means it could be a while before they get to adequacy in our view," he says.

Mr Shaw cautions further that despite momentum having been on the side of underwriters for some time, some lines may indeed never make it to full adequacy before an inevitable change in the weather arrives and prices start easing once more.

That is why he is keeping TMK's powder dry until he deems adequacy has been reached and exceeded in each class.

However, despite price rises in some lines running into a third year, demand remains strong, with Mr Shaw reporting the strongest flow of new business enquiries to the London market that it has seen "in a decade or so".

So, perhaps a more stable outlook can now be expected for readers with hefty property exposures. But for many other lines, all bets still appear to be off and further price rises cannot be ruled out.

Entrepreneurial approach

What else could put a spanner in the works?

Since the loss is so immature and the numbers so potentially high, could slippage and uncertainty around the true final cost of the Covid-19 pandemic upset the prospects of a welcome return to pricing stability?

Happily for TMK's customers, its Covid-19 charge is mostly short-tail in nature and Mr Shaw expresses confidence in the solidity of the estimates the firm has put up: "We very much believe that we are robustly reserved on Covid and I think nothing to date that we have seen would challenge those assumptions... There is always a possibility of a court somewhere overruling contract terms, which is the unknown, but we'd like to think and hope that the chances of that are relatively remote."

Welcome news indeed for hard-pressed buyers suffering their own Covid-19 woes.

More welcome news is that TMK has not lost its focus on innovation. Often, a period of loss-making can put an end to new product development, as businesses retrench to their core and ditch untried and often marginal experimental lines.

Long a pioneer of new forms of insurance for intangible assets such as covers for intellectual property or reputational risk, TMK has come through the market turn with appetites undiminished for an entrepreneurial approach to pushing the boundaries of the insurable.

Individually and through its backing of ventures

TMK has been a prestigious bluechip in the Lloyd's market for decades

"We are robustly reserved on Covid and I think nothing to date that we have seen would challenge those assumptions"

Matthew Shaw, Tokio Marine Kiln

such as Lloyd's Product Innovations, the firm is an enthusiastic backer of many novel ideas, including projects as diverse as the use of parametric triggers to facilitate the instant settlement of claims or the insurance of cryptocurrency wallets.

Mr Shaw explains that the benefits to the group are not just about giving it a strategic view of potential new classes. There are other intangible positives that stem from the active backing and encouragement of new ideas: "Some of these innovation products just make you think a little bit differently… and I think also they are of huge value because they add some credibility and they do focus an entrepreneurial spirit back into the London market."

> **"Some of these innovation products just make you think a little bit differently… and I think also they are of huge value because they add some credibility and they do focus an entrepreneurial spirit back into the London market"**
>
> *Matthew Shaw, Tokio Marine Kiln*

TMK is also an enthusiastic adopter of digitalisation and attempts to remove any unnecessary layers of cost from the Lloyd's subscription market.

Mr Shaw confirmed that the firm is currently working on variations around the theme of automatic, artificial intelligence-led underwriting and portfolio management for business it doesn't lead, with a view to improving efficiency and removing unnecessary frictional costs around placement.

So, while they may not be there yet, they are on their way back to business as usual at TMK.

A desire to return to pricing adequacy and rating stability is married with an entrepreneurial approach to emerging risk and the adoption of new technologies to aid underwriting and eliminate cost. All buoyed by strong demand.

Mr Shaw's TMK comes across as a carrier people will want to do business with in 2021 and beyond.

Listen to Mark Geoghegan's full podcast with Matthew Shaw at: www.thevoiceofinsurance.com

The D&O headache for multinationals

D&O insurance is going through one of the hardest markets ever seen, but the main issue for global programmes may be an old bugaboo of risks managers: the purchase of coverage in non-admitted jurisdictions, according to *Rodrigo Amaral*...

Experts tell GRM that, even though D&O programmes face tough challenges in the organisation of towers and the structuring of capacity, the threat of litigation in key markets such as China, Russia, Brazil, India and South Korea has become a major source of headaches for multinational companies.

"Non-admitted coverages are the biggest inhibitor of global D&O programmes. There are several countries where the insurance regulator will not allow foreign cover," says Michael Lea, the management liability executive at Lockton in London. "And D&O is not like property, where risks are localised in each country. Risks are everywhere."

For a long while, this kind of worry was mostly outside of the purvey of D&O insurers as losses were restricted to a few key markets like the US, the UK, Australia and Europe. But emerging markets have also caught the litigation bug, changing the way companies need to structure their programmes.

"Countries where foreign coverage is not allowed are now beginning to produce D&O claims," Mr Lea adds. "In the past, companies were not too worried about D&O liability in China or Brazil. But now some of the world's largest losses are coming from those places."

Andy Brett, head of Miller's North American professional risks team, says: "The authorities in countries like Russia, China, India and Brazil are putting more emphasis on compliance and regulation. Their insurance regulations can also be strict, demanding local paper and even sometimes locally-based brokers, which can create challenges for global programmes."

The threat of litigation in key markets has become a major source of headaches for multinational companies

Locally-sourced capacity

The standard solution for this conundrum is to organise a programme where capacity is sourced locally, which could even present an opportunity, as the market is less hard in countries like Brazil than in the developed world, and then look to expand the cover in global reinsurance markets. But that is usually easier said than done, as not many underwriting partners can help risk managers with this task.

"One of the problems is that the number of primary insurers that can offer non-admitted covers is not high," Mr Lea says. "Only Chubb, Zurich, AIG and Allianz are truly global D&O carriers."

Others see an even shorter list of companies that provide top-notch D&O policies for global programmes in non-admitted markets. It is just not a very lucrative activity for carriers and is offered mostly as a means to guarantee the loyalty of buyers.

"Global insurers offer access to local capacity and local brokers in difficult markets as a service to their clients," Mr Brett says.

Risk managers can follow two main roads to tackle this challenge. They can buy both the local and master policies from the same insurer, or from different carriers. Either option entails its own set of complexities.

"There are situations where the shareholder risk is covered by one D&O policy at the company's headquarters, and the risks of subsidiaries are covered by local policies. If the company buys both policies from the same insurer, they will have an aggregation clause that says the insurer is not going to pay the same claim in both territories," Mr Lea explains. "The alternative is to buy from different carriers. But then it will be necessary to identify the underlying cause of the claim, and insurers will point to each other, trying to make the other pay the claim or to make a contribution."

In the current market, the difficulty of integrating local covers into master policies is compounded by the capacity crunch that is affecting D&O at a global level.

"In 2019, some insurers would put out up to $25m in one chunk of capacity. Now you will never see this; you are lucky to get $10m. It immediately creates capacity issues," says Julian Martin, head of financial lines at McGill and Partners. "Two years ago, you could fill a $100m programme with four insurers. It was relatively rare but it was possible. Today, you will probably need ten to 15 insurers."

Heiko Würtz, head of financial lines at HDI Global Specialty, adds: "A remarkable amount of D&O towers have been restructured during the last 24 months. This creates questions regarding continuity, drop-down and runoff scenarios for underwriters and brokers. Since towers are often placed last minute and conditions change almost hourly, underwriters are under continuous pressure as well."

Growing exposure to litigation

The proliferation of participants in D&O towers creates challenges at the underwriting and claims levels alike.

"If a claim is worth several hundred million dollars, and the primary insurer has put only $5m, it is very hard to expect that the primary insurer will put much of an effort fighting the claim. Their limit would be eroded by defence costs," Mr Lea says. "It makes it more difficult to rely on the conduct of the primary insurer. It will be two or three layers up into the programme before people start talking about summary judgement, settlement or mediation."

It is a worrying picture as companies are ever more exposed to litigation, in a growing number of jurisdictions, and the values at stake tend to get ever bigger.

"Five or six years ago, a company with a market cap of $10bn would have been a truly gigantic organisation. Now there are many companies whose market cap reaches hundreds of billions of dollars," Mr Lea says. "If a $500bn company has a 10% stock drop, that is $50bn that it could be sued for, but capacity in the D&O market is only $500m."

But proper D&O coverage is a key tool for global companies to attract talent, so some are starting to look at different ways to transfer their risks.

Heiko Würtz says a remarkable amount of D&O towers have been restructured during the last 24 months

"We currently see a lot of international programme clients struggling to complete their previous capacities," Mr Würtz says. "In some cases, larger clients try to involve their captives and ask insurers to front for them."

Mr Brett adds: "We have seen one example of a client that has bought a standalone side-A coverage, and then set up a captive for sides B and C, complemented by additional excess layers of sides A, B and C insurance. Buyers are getting more adventurous with the structures of their D&O programmes."

However, the experts remark that D&O, due to its characteristic high volatility and intensity, is not well suited for self-insurance solutions like captives.

"Higher retention is only good for identifiable claims in the D&O market. Non-identifiable claims, which tend to be criminal, prosecutions and so on, have no retention in the policy," Mr Lea says. "We cannot place side-A cover in a captive very easily, because the company is prohibited from indemnifying the director.

"Captive insurers tend to look on a very long-term basis, a ten year-period. Risks like life and motor insurance are highly predictable and can be actuarily modelled. In D&O, you can have lawsuits that have no monetary value, and three years later you settle it for $1bn. Because of its volatility and lack of predictability, D&O does not sit well in a captive arrangement," he adds.

New 'class of 2021' insurers

The good news is that brokers have started to see light at the end of the D&O tunnel. New entrants are adding capacity to the segment, although rather tentatively at first. Some are eager to take $5m layers, others get as high as $10m, and at least one was mentioned to be open to forking out $25m, depending on the programme.

Market observers say that maybe as many as nine companies have entered or are about to open their D&O operations in the London market. They include the likes of Inigo, Convex, ERS, Arcadian, Rising Edge, Scor and HDI. Mr Lea estimates that some $50m of capacity has been added.

"There is a new 'class of 2021' of insurers entering the D&O market. Quite a few have hired some of the best underwriters in the London market and they will write global programme risks," Mr Martin says. "New players are having a real impact on choice, and they are competing for some of the better programmes. It is starting to curtail some of the biggest price rises."

However, Noona Barlow, head of financial lines claims at McGill and Partners, warns that the risks are unlikely to fade away any time soon, which makes sorting out the challenges of setting up a global D&O programme an urgent task for buyers and their brokers.

Noona Barlow says there has been an increase in the frequency and intensity of D&O claims

"We have seen an increase in the frequency and intensity of D&O claims from topics like bribery, corruption and insolvencies, and also from events-led litigation, such as claims linked to the #MeToo movement," she says. "We are starting to see some Covid-19-related litigation, mostly in the US so far, and the rise of litigation funding has had an impact as well."

Nicky Stones, head of management liability and financial institutions at New Dawn Risk, adds: "Sectors hit hard by Covid-19, such as hospitality and retail, are finding it difficult to find capacity."

Ms Barlow remarks that regulators are focusing ever more on the activities of individuals, trying to hold individual directors accountable, and that is another trend boosting demand and hiking claims in the D&O segment. Therefore, managing a D&O programme has become a year-round task, and risk managers cannot afford to leave decisions to the 11th hour before renewals.

"It is important for companies now to formulate every year what their buying strategy is," she says. "They must ask questions about whether they operate in countries that require or may require local policies, and whether they have licensed subsidiaries in a particular country, or just a sales office or a branch. Do they have a local board in that country? All those things should factor into a decision about when and where to buy local policies."

Cyber: time to tap global options

Cyber insurance market hardening has spread to all regions around the world and looks set to continue, writes *Ben Norris*. This means that multinational insurance buyers seeking the biggest limits will need to access the global market...

While Marsh's Global Insurance Market Index showed that price increases moderated in many major lines in the first quarter of this year, cyber bucked the trend. Average cyber prices were up 35% in the US, after rises of 17%, 11%, 7% and 6% in the previous four quarters. The UK saw a rise of 29% in Q1 2021, compared to a jump of 26% in the last quarter of 2020.

The Marsh index also shows that cyber insurance pricing increased by 20% to 30% in Latin America and the Caribbean during Q1, driven by increased claims frequency and severity across the region and worldwide. It notes that cyber became more challenging for buyers in Asia with premiums up 50%, on average, across all industries, while underwriters sought more details from insureds, restricted ransomware coverage and added exclusionary language.

Difficult year ahead

Experts believe this hardening is now prevalent in all regional cyber insurance markets as losses mount. Things are likely to get more difficult for multinational insurance buyers in the year ahead, they add.

According to Shannan Fort, a financial lines partner at brokerage McGill and Partners, the cyber market has hardened in the past 12 months, with substantial rate increases. "It's definitely not the same market it was this time last year," she says.

Difficult conditions have now spread to the continental European market, especially when it comes to the amount of limit available, she says. "Big slugs" of capacity previously available from key trusted European carriers have receded as insurers reassess their approach to cyber, says the broker, adding: "So, continental Europe is

Market hardening is now prevalent in all regional cyber insurance markets

35%

AVERAGE CYBER PRICES WERE UP THIS MUCH IN THE US IN Q1 2021

coming more into line with the London market and how it has been providing cover and building programmes."

Looking forward, she thinks this year will remain "tumultuous" for cyber insurance buyers as the market grapples with losses and the fallout from silent, or non-affirmative, cyber cover being removed from traditional lines. "That is not a 12-month answer; that will have to continue to evolve. So, I think we are in for a bit of bumpy ride," she says.

And in the meantime, the broker says multinational insurance buyers at the biggest companies wanting to build cyber limits in excess of $400m-$500m are going to have to start utilising the global market.

"For a European placement, for example, it won't necessarily be all available in Europe or London. You would have to look beyond that to the Bermuda market, the Asia market and the US. And you have to be quite innovative in how the programmes are structured if looking for really significant limits. So, my advice for these buyers is: utilise the global marketplace and don't be confined to the marketplace in your particular country or region. You must make sure you have access to the appropriate capacity all over the world. This is especially true if your programme requires a significant amount of limit," she says.

Experts explain that the global cyber insurance market hardening is being driven by heavy losses, particularly for ransomware. This is altering programme structure and ultimately capacity, says Ms Fort.

"It used to be that the burn layer was the first five insurers, then it was the first ten and now it is going above that. So there is still capacity available but what it tends to mean is, particularly lower down, it is taking more carriers to build the same amount of limit. We have to be very innovative in how we are building programmes to get clients to the limits they have had. And not everyone is seeing that same amount of limit as they did last year," she says.

Ms Fort adds that insurers are also now demanding to see cyber risk management is in place before granting over. "You can still get reward for risk management but it's not in price, it's in getting cover and terms and conditions. There is reward here but we need to move away from thinking its 10% off the premium," she says.

State of flux

James Bullock-Webster, head of tech, media and cyber at fellow broker New Dawn Risk, says the cyber market is in a "state of flux", with a "tremendous amount of change".

Shannan Fort says difficult conditions have now spread to the continental European market

"Carriers' appetite is changing on a weekly basis. This is not necessarily being driven by reinsurance or one particular event, rather it is insurers making decisions based on what their losses look like at the moment," he says. "There is a huge amount of demand but supply is contracting – as carriers are picking up a lot of losses that they weren't expecting and their loss ratios are deteriorating – which is why prices are going up."

Regionally, London insurers, who had focused on corrective actions in primary business, are now moving to entrenched positions on excess business too, says Mr Bullock-Webster. Meanwhile, in the US, cover seems to be restricting particularly when it comes to cyber extortion, he adds.

While it is difficult to gauge the exact pace of market hardening, 30% to 40% rate increases across the board are realistic, says Mr Bullock-Webster. Meanwhile, line sizes are reducing with carriers reluctant to put out more than $5m, whereas $10m was common just a year ago, he adds.

But despite well-publicised hardening in London's cyber insurance market, Mr Bullock-Webster says that it remains a very important and popular provider of capacity to companies around the world: "We are seeing a lot of interest [in cyber cover], it's just a question of price."

Shay Simkin, global head of cyber at Howden, says the cyber insurance market faces shrinking capacity, with many players leaving the sector after realising they don't have the expertise or capital to operate. In addition, line sizes have fallen and will continue to do so as demand remains and supply falls, he added.

"Carriers' appetite is changing on a weekly basis"
James Bullock-Webster, New Dawn Risk

Like others, Mr Simkin believes 2021 will remain "another challenging year" for the cyber insurance market and its customers. "Claims remain high, the market remains unstable, and it continues to face questions about ransomware fuelling the market and who, if anyone, should be taking on the associated risks," he says.

This means underwriters will still have "the freedom to cherry pick" which risks they take on, so prices are expected to rise until the end of the year, says Mr Simkin.

He says 2020 was a pivotal year for the cyber market as a "flood" of claims caused loss ratios to "skyrocket" to 100% and beyond by year-end. Insurers were forced to go back to the drawing board, understand what happened and "reinvent the wheel" for cyber cover, he adds.

This produced a market change with underwriting criteria becoming more stringent, explains Mr Simkin. Insurance buyers have encountered more scrutiny over the robustness of their cybersecurity, the quality of their technology and general preparedness for a cyberattack.

"Covid-19 and home working may have created somewhat of a crisis for the sector, but in reality the industry was headed toward this situation for some time and the events of 2020 simply accelerated this transition," he says.

Rate adjustments

Lindsey Nelson, cyber development leader at CFC, says there has been a "unanimous" recognition in the cyber market of the need to adjust rate, driven by claims and ransomware in particular, to ensure it can continue to provide cover for customers. "As a result, the cyber market is going through a lot of change at the moment, both with respect to capacity being provided, coverage being granted and rate increases," she says.

While there is now little regional variation in the state of the cyber market, some industries – such as public sector companies, education providers and professional services firms – are suffering high losses, continues Ms Nelson.

She expects the cyber market to continue making rate adjustments for the "foreseeable future" to ensure its long-term profitability. And she also thinks there could well be more market exits and further capacity reduction going forward.

"As a product line, cyber will no longer be something general insurers dabble in, given that the product being provided requires dedicated in-house incident response specialists, scalability to build data, and investments into threat analysis and data. As a result, it's not unreasonable to expect more markets exiting the line and therefore reducing capacity in the market," she says.

Shay Simkin says 2020 was a pivotal year for the cyber market

Alessandro Lezzi, international cyber and tech focus group leader at Beazley, says cyber insurance rates have continued to harden this year in response to large losses, while capacity is reducing as parts of the market reduce line size and, in some cases, exit. "This is putting yet additional pressure on rate as clients seek higher limits," he says, adding that cyber is a global market and exposures aren't confined to borders, so there is a similar market trend across territories.

But despite the upward ratings environment during the last 18 months, Mr Lezzi says it seems the market has not yet reached a pricing level that guarantees "long-term equilibrium", and there has not been material new capacity coming into the space.

"Capacity has reduced following some carrier exits from the cyber market and significant reduction in line sizes. For very large clients we have seen a number taking more 'skin in the game' with higher retentions and, sometimes, using their own capital through captives," he says.

"For very large clients we have seen a number taking more 'skin in the game' with higher retentions and, sometimes, using their own capital through captives"
Alessandro Lezzi, Beazley


HDI
> HDI Global SE
WE ARE
GLOBAL.
We create global solutions with a local perspective.
Many years of global market experience are the foundation of our international insurance programme expertise. No matter what size or type of company, we develop customised insurance solutions that are tailored to your operating risks. HDI Global SE is your dependable partner for business in more than 150 countries around the world.
www.hdi.global

Dealing with the Brexit afterburn

Outside the EU, the London insurance market could become a market-friendly alternative to Bermuda. But there is a lot to be resolved with the bloc's 27 member states before that can happen, according to *Garry Booth*

Shrouded by the Covid-19 lockdown, the signing of a new post-Brexit financial services pact in March caused little more than a ripple of interest across the insurance sector. But a lot still hinges on the so-called memorandum of understanding (MoU), an agreement between the UK and the EU that will allow both parties to cooperate on regulation.

As it stands, the MoU does nothing to improve the City of London's – and the London insurance market's – access to the bloc, and a number of questions remain unanswered concerning cross-border business. The UK and EU have concluded a trade agreement, but to the growing concern of UK banks and insurers it contains very little on the provision of financial services.

The UK effectively left the EU single market, including for insurance and insurance distribution, after the transition period ended on 31 December 2020 and it is now a third country as far as the EU is concerned.

It means that UK (re)insurers and intermediaries can no longer "passport" their UK authorisations across Europe, and European (re)insurers and intermediaries can no longer passport into the UK. Existing EU law (regulations and treaties but not directives) was transposed into UK statute, albeit with powers to amend it in the future.

The loss of passporting was widely anticipated since the UK Brexit referendum in 2016 by insurers and brokers. Those using UK-authorised firms to access EU markets have taken steps to make sure they can serve markets in the EU, by setting up separately licensed entities in an EU member state and making portfolio transfers.

For its part, the UK brought in a Temporary Permissions Regime that allows EU firms previously passporting into the UK to continue operating in the UK for three years while obtaining authorisation from the Prudential Regulation Authority (PRA). Any firms whose applications fail will automatically enter into a framework for the orderly runoff of their UK business activities.

The UK's MoU with the EU does nothing to improve the City of London's access to the bloc

The picture across Europe is less clear, as member states have taken steps independently to introduce regimes that apply to UK insurers (and intermediaries) since the end of the Brexit transition period.

Although recommendations were made by the European Insurance and Occupational Pensions Authority (Eiopa), there is no specific regime and as far as UK firms are concerned, the EU is now a patchwork of differing provisions for the runoff of their EU books.

Loose ends

Anecdotally, the compliance situation is not cut and dried even for insurance entities with licensed operations in the EU. Legal experts have pointed to possible questions being raised over substance in European jurisdictions and whether independent directors and c-suite employees are required 'in-country'.

The effective domicile of people and expertise is another potential issue, along with the extent of activities that can be carried out in the UK branch of an EU-authorised (re)insurer.

Lloyd's Europe, for example, recently ran into trouble with the Belgian Financial Services and Markets Authority (FSMA) when it looked more closely at the outsourcing arrangements of managing agents. The FSMA suggested that some managing agents were effectively in breach of rules because analysing submissions and pricing risks or preparing final quotes amounted to insurance mediation activities.

Such concerns about regulated activities are especially relevant for insurance brokers operating across borders from the UK. Intermediaries in the EU27 are governed by the Insurance Distribution Directive, which is implemented differently by member states. It means there are wide variations in its requirements across member states that third country entities need to be aware of.

Eiopa has made it clear that brokers wanting to register a licensed operation have to demonstrate appropriate corporate substance according to the nature, scale and complexity of their business – it's not possible to have a brass-plate operation.

In search of equivalence

With blanket access for the UK's financial firms to the EU now ended, much rides on the EU system known as equivalence. The UK has already granted the EU full equivalence under Solvency II (and in other areas) and it is intended that the recently signed MoU will enable discussions on how to advance with equivalence determinations from the EU perspective.

Clare Swirski says there is a balance to be struck between regulatory divergence and equivalence

Importantly, the EU has stated that it will consider equivalence decisions when they are in the EU's interest, but emphasised that it needs to better understand how the UK intends to amend or alter rules in future.

The key areas relating to Solvency II currently being examined by the PRA have a more domestic, life-oriented focus and include the recalibration of the matching adjustment and reform of the risk margin. Reporting requirements and the integration of the UK's Green Finance Strategy, which could influence

LONDON URGES REGULATORS TO SEIZE THE DAY

The London insurance market could have a bright future outside Europe – if the UK government moves to make regulation work better for underwriters and brokers...

The London Market Group of insurers and brokers is calling for a more proportionate approach to regulation that recognises the nature of large, complex risks .

Individual consumers and SMEs still need consumer-like protection but large corporate clients who have their own professional brokers and advisers need much less, the LMG says in an open letter published in June.

"The FCA makes almost no distinction in the way it supervises a London market broker working in the specialty markets in London from the way it supervises a retail insurance broker dealing with an individual's domestic and motor insurance requirements," the LMG says.

The LMG also urges the government to bring forward proposals for international competitiveness to become part of the regulator's statutory objectives, as it is in Bermuda or Singapore: "An international competitiveness objective could be used to benchmark against other international financial services hubs, and be used to help nurture innovative new products and promote the reputation and good governance of the UK industry to overseas investors."

The current Solvency II review offers the government two further opportunities to broaden London's role as a risk transfer hub. According to the LMG, it could develop a more attractive regime for captive insurers and also for foreign reinsurance companies.

"No company has chosen to set up a captive in the UK, despite our extensive financial services ecosystem. This is despite the fact that London market brokers have world-leading experience of managing their clients' captives across the world and could easily replicate these services within the UK," the LMG says.

investment choices, are also under review, however.

If, as seems likely, the EU insists the UK must agree not to diverge from EU regulations as a requirement for equivalence, any decisions could be a long time coming from Brussels.

Incremental changes

Speaking at a briefing webinar broadcast by the law firm Debevoise & Plimpton, Ben Lyon, an international counsel at the firm, said he expected industry groups to lean heavily on the UK government to back the insurance industry.

"But the Bank of England, the PRA and the FCA are not going to support wide-ranging political efforts to move too far away from our current Solvency II regime," Mr Lyon said. "Changes will likely be incremental and not seismic."

If and when the EU eventually does grant Solvency II equivalence status to the UK, it will come with conditions. Foremost will be the requirement for the UK to consult the EU for pre-approval of any changes to the regulatory regime – a red line for many Brexiteers.

"Operating outside the EU, UK regulators could become more flexible and accessible, much like the Bermuda authorities, without comprising their main objectives of protecting policyholders"

Clare Swirski, Debevoise & Plimpton

Mr Lyon predicted that there will be a slow regulatory divergence between UK and Europe – with bumps in the road along the way.

Speaking to GRM after the webinar, Clare Swirski, international consultant at Debevoise & Plimpton, said the opportunity to tailor regulation better and reduce reporting could ultimately boost the London market's profile: "There is a balance to be struck between regulatory divergence and equivalence. The UK has always gold-plated regulation from Europe, so the UK won't become less well regulated – but the right changes could make it easier to do business with, compared with European centres.

"Operating outside the EU, UK regulators could become more flexible and accessible, much like the Bermuda authorities, without comprising their main objectives of protecting policyholders," concluded Ms Swirski.

LOST IN TRANSITION

The post-Brexit outlook for cross-border corporate insurance is far from clear, according to Phillip K Schulz, attorney at law and head of principles, products and legal, HDI Global SE

Is the licensing of cross-border business between member states of the EU and the UK now clear?

Due to the transition regimes in place in the UK in particular, licensing issues have gained clarity significantly. The UK legislator developed two transition regimes designed to manage the runoff business of EU insurers declining to continue business in the UK on the basis of a licence (the Financial Services Contracts Regime, or FSCR), as well as the business of EU insurers opting to obtain a licence under Part 4A FSMA (the Temporary Permissions Regime, or TPR), respectively. TPR-registered insurers especially can avoid a "gap in permission" in the shift from the end of the transition period on 31 December 2020, until such time as local permission formally is received.

However, a number of issues have not been fully resolved to date. For one, it is not entirely certain how TPR protection will be managed once a formal decision has been rendered with respect to licence applications for local branch offices of EU insurers. Moreover, proper management of insurance premium tax is not fully clear. This is the case in Germany in particular, as the recent Insurance Premium Tax Act has given rise to the potential for double taxation where risks are domiciled in so-called third countries, which includes the UK as of this year.

Finally, as the EU declined to establish a transition regime for UK insurers acting in the European Union/European Economic Area on a community-wide basis, UK insurers find themselves confronted with a patchwork of transition rules, which (depending on the business model used) may complicate EU business. These issues should be regarded as exemplary, not comprehensive.

And for their corporate clients? Around claims payment, for example?

Ongoing communication with corporate clients is essential in order to ensure such insureds are fully aware of the limitations in place since the end of the transition period, including recent developments. Corporate clients on the whole understand that business cannot continue 'as is', unless the EU and the UK find a business-friendly solution for cross-border transactions in the financial services industry. Where HDI Global SE is concerned, a Brexit action plan had been developed and discussed with corporate clients well in advance of the expiration of the transition period. HDI Global SE's [UK] TPR registration has proven valuable in facilitating a smooth transition to our new business models with corporate clients.

What should the insurance industry be looking out for in the talks facilitated by the memorandum of understanding?

While hoping for the best, the insurance industry should remain prepared for a de facto 'hard Brexit' scenario. While certain issues, such as EU reciprocation of the UK's determination of solvency equivalency, could well be addressed, it is presently difficult to imagine a scenario in which a single passporting system might be re-established.

On the contrary, it may well be that the UK wishes to utilise the flexibility obtained in exiting the EU. Where the financial services industry is concerned, the UK may be inclined to develop a regulatory framework that differs from EU standards. In this way, it may become increasingly difficult for the UK and the EU to find common ground on some key issues, such as facilitating access to EU and UK markets, respectively. Ultimately, however, it may be too early to know what to expect of the Joint UK-EU Financial Regulatory Forum.

Uncertain future

The equivalence picture is far from clear. UK chancellor Rishi Sunak said at the end of June that a deal on financial services equivalence with the EU has simply "not happened", so the Government would move forward without sealing an agreement.

In a Mansion House speech, Mr Sunak said the UK hadn't achieved its "ambition" to be granted equivalence with EU rules, which would make it easier for its financial services firms, including insurers, to access business in Europe and vice versa.

Instead, Mr Sunak said the UK "now has the freedom to do things differently and better", and added he intends to "to use it fully".

COMMITTED PARTNERS. CONNECTED SERVICE.

When the road ahead is demanding, you need a partner for the whole journey.

An integrated claims team who act with strength, decisiveness and decency.

Providing assured quality in a fast-moving world; working together with continuity and confidence, delivering value at every turn.

For Mutual Advantage

libertyspecialtymarkets.com

Liberty Specialty Markets

Liberty Specialty Markets (LSM) is a trading name of the Liberty Mutual Insurance Group (LMIG).
For more information and the Privacy Notice, please see libertyspecialtymarkets.com.

The rise and rise of the Madrid insurance market

Madrid offers great food, a vibrant nightlife and a very high quality of life. It can also provide some flexible policy wordings that will come handy when it comes to integrating tricky markets into a global insurance programme, writes *Rodrigo Amaral*

With Spanish companies expanding their presence in regions like the US, Latin America and the Middle East in the past few decades, the local insurance market has also developed capabilities to meet their growing coverage needs.

It is a good thing, too. Some of the main markets for Spanish corporations include countries like Brazil, which has given plenty of headaches to many an insurance manager.

It is in such cases that wordings developed over the years by Spanish-based insurers and global carriers' subsidiaries show their value, says Cristina Fernández Miranda, the head of global services solutions at Willis Towers Watson.

"The Spanish market offers wordings that are significantly broad, compared to other markets such as Latin America, where there are more limitations. The language of wordings allows a higher degree of flexibility at the time of the claim," she says.

They can also rely on local capacity to meet their international programme needs in most cases, at least where the most common P&C lines are concerned.

"The traditional P&C market has a lot of capacity in Spain," Ms Fernández says. "Buyers only have to go to international markets when they have risks that are very specific to their activities, or if it is a very specialised specialty coverage."

Cyber and D&O

Such is the case with lines like cyber insurance, which has seen a significant boost in demand from Spanish corporations, which are now

The main advantage of Madrid is with regards to Latin America

looking to contract ever higher amounts of protection.

"In recent years, the increase in demand and purchasing of cyber insurance has been exponential by multinational companies that manage international programmes from Madrid," says Agustín Espinosa de los Monteros, head of global broking at Aon España. He also notes ever more demand for political violence and other covers linked to social unrest and instability.

Ms Fernández says companies can find up to €40-€50m of cyber insurance capacity in the Spanish market. Over that threshold, it is necessary to go to international reinsurers. A similar trend is taking place with D&O.

"D&O is a key cover for multinationals because of what is coming ahead of us," says Manuel García, head of P&C at broker Assiteca España. "There will be much litigation linked to Covid-19 and much of it will become D&O claims."

Some activities may not find the covers they need in Spain, however. For instance, financial institutions that have to go to international reinsurance for the levels of D&O and cyber protection required.

"The second source of capacity is the purely national and European markets that can lead or offer relevant capacity, if the risk meets their appetite," Mr Espinosa de los Monteros says. "The third one is the reinsurance market, which has earned ever more prominence in the current hard market."

It is once those two options are exhausted that Spanish companies usually look for capacity in London and other offshore jurisdictions, he says.

"It is possible to structure Spanish-based global programmes with high limits for traditional P&C risks," Ms Fernández points out. "Of course, the hard market is limiting capacities somewhat and also restricting wordings. And while, not long ago, insurers were virtually 'gifting' high sub-limits to buyers, now they are more resistant to providing them."

In fact, the capacity restrictions brought by the hard market are making some Spanish multinationals think twice about their global programmes, according to Mr García.

"Some buyers are dismantling their international programmes because costs have become too high," he says. "Costs have increased tenfold in some cases. Those companies are now looking for cheaper local coverage solutions."

Such a decision may make sense in the short run as a cost-saving measure, but could result in companies losing some of the benefits that a structured international programme can bring.

Jose Nuñez says access to Lloyd's capacity from Madrid is uncomplicated and has not been affected by Brexit

"A global programme provides a degree of wording homogenisation and security about what is covered by local policies. But it is true that some clients that have global programmes are studying whether local policies can save them some money," Ms Fernández says. "As a rule, it is hard to say that they will benefit from savings though. In the end, all markets will be affected by the hard market, which is not exclusive to Spain or London."

Those who persist are facing similar challenges that concern multinationals based in other countries these days. For instance, programmes require ever bigger towers, with several layers and different participants, and making use of facultative reinsurance and co-insurance arrangements in order to build up capacity.

The challenge to build such towers and manage claims, when they occur, is compounded by the need to comply with the rules of some devilishly complicated non-admitted markets such as Brazil, which is key for many Spanish multinationals.

"We try to ensure that there is a guarantee in the insurance contract for the covers the client has purchased," Ms Fernández says. "We will try to use local policies that mirror what was contracted by the client, although that is not always possible in markets such as Brazil. There, they need local policies approved by the insurance supervisor.

"Our goal is to make sure that clients have not standard local policies but covers that mirror the master policy. It is more expensive this way, but it saves many headaches at the time of a claim," she adds.

> **"It is possible to structure Spanish-based global programmes with high limits for traditional P&C risks"**
> *Cristina Fernández Miranda, Willis Towers Watson*

Ms Fernández also points out that financial interest clauses are often employed to integrate local coverages in non-admitted jurisdictions to master policies. After raising doubts at the beginning, she says, such clauses have effectively paid claims in recent years, eroding some of the resistance to their deployment when circumstances call.

"The most important is that the client understands that the clause is not covering the actual loss suffered by a subsidiary in a foreign market, but the financial loss that the corporation can have due to a loss that happened in said country," she remarks, adding that clients must also be aware that the indemnification in such cases is paid in Spain, with the legal and tax implications that it entails.

Hub for Latin America

It is in fact the expertise in tricky Latin American countries that is one of the arguments used by Spanish-based insurers to claim that the country is an ever more important insurance hub.

"The main advantage of Madrid is with regards to Latin America, as the main insurers and reinsurers have delegated underwriting authority to their Madrid offices in recent years," Mr Espinosa de los Monteros says. "This is due both to the presence of Spanish clients and investors in Latin America and our historical language and cultural links."

For this reason, he expects that the insurance market will continue to grow as part of the development of the Madrid hub in the future.

"Madrid is a very competitive market with great services," Mr Espinosa de los Monteros says. "From Madrid, we have followed without any problems our clients in the Middle East or the US, and we have even helped our colleagues to place some risks located in other jurisdictions."

Jose Nuñez, country manager of Lloyd's in Spain, stresses that access to Lloyd's capacity from Madrid is uncomplicated and has not been affected by Brexit, thanks to the establishment of the group's Brussels office.

"Our Spanish clients have no trouble to maintain their capacities and to find new solutions for their risks," he says.

Captive solutions

That could be useful if Spanish companies come to embrace captives as they try to mitigate the impact of the hard insurance market. Brokers say that demand for information about self-insurance has been noticeably up of late, although not many buyers have so far decided to take the next step and set up a captive.

Madrid is a very competitive market with great services

"The main stimulus for the creation of captives comes from the higher amounts of money budgeted to the transfer of risks from the same company, or from the lack of insurance solutions for some lines," Mr Nuñez says. "It is worth noting that one of the largest risk placement deals at Lloyd's this year for this kind of vehicle is from a European captive."

But Mr García warns that the growth of captives in Spain is hampered by a gap in risk management expertise, compared to some other markets.

"Not all companies in Spain have risk managers. The most likely is that insurance purchases are made by someone who is in charge of procurement of products and services," he says. "They want to optimise costs, but buying insurance is not the same as buying tomatoes, for example.

"When buyers learn what is implicated in the creation of a captive, they think it is too costly and requires a lot of work. It makes sense, as when the market turns around, possibly next year, and rates smooth down, the costs of managing a captive will be much higher than buying coverages," Mr García adds.

He points out that companies must understand that setting up a captive needs to be a strategic business decision, not one to face temporary market conditions, as such vehicles really prove their value in the middle to long run.


QBE.
Prepared.
How can businesses build resilience and look to the future with confidence?
Visit QBEEurope.com/resilience to find out.
QBE
Business insurance

Mind the shop

Mark Geoghegan, editor of _The Voice of Insurance_, explains what Alpine winters have in common with hard insurance markets...

A Swiss friend once explained to me that people who live up in the mountains always make a point of being regular patrons of their local food shops, so that they are on first-name terms with their owners.

Although people who live at altitude tend to work down in the cities below and therefore have the same opportunity to buy food much cheaper in large supermarkets as everyone else, they make an extraordinary effort to support their local merchants.

I asked him why this was. Were the otherwise no-nonsense Swiss really sentimental romantics at heart?

The reality was far more pragmatic. He explained that the apparent altruism was because in winter it is all too easy for heavy snow and ice to cut mountainside residents off from all civilisation, sometimes for days.

When that happens, the stock at the village shop becomes essential and established regulars are favoured as supplies dwindle. The difference between living well while riding out the blizzard and having to survive on dry rations until the snowploughs cut through depends entirely on the strength of your relationship with the local shop.

Paying a small regular premium can pay rich dividends when it really matters. Sound familiar?

In post-pandemic times, even city dwellers can appreciate such a story. In strict lockdowns many have come to rely on local suppliers for deliveries of essential supplies.

Swiss mountain-dwellers make a point of being regular patrons of their local shops

Cost is what you pay, but value is what you get in return.

Under the right circumstances, the added value a quality supplier can bring dwarfs the premium disbursed, often by many multiples.

Or in other words, if you spend all your money on loss leaders from the superbly cheap hypermarket out of town, don't complain when you discover your friendly local shop has gone out of business just when you have run out of milk and your dinner guests are at the door.

The importance of sustainability

As with alpine winters, so with hard insurance markets.

Even the most aggressive insurance buyer understands the need for its counterparties to be financially secure in a sustainable fashion.

Carriers that consistently make underwriting losses are rightly to be viewed as potentially unreliable partners when substantial future financial liabilities are to be assumed.

It's a little like the moment described in Michael Lewis's chronicle of the global financial crisis The Big Short.

In one chapter, a trader's euphoria when a bold bet on the imminent collapse of the financial system is about to pay off is suddenly replaced by a sickening realisation and fear that too much mercantile Armageddon may mean that there is no-one or nothing to collect from.

There's no point betting so big that you bust the whole casino. If that happens, on paper you may have made a chump out of the casino, but in fact the casino has made a chump out of you.

After all, countering accumulation risk is why we have co-insurance and reinsurance.

Insurers are not shopkeepers, but the best of them are equally essential in a crisis.

And if we value that sometimes essential service, we must be ready to support it so that it is there for us when we really need it.

As sophisticated buyers of insurance, we often have as good an understanding of what the cost of the product should be as an insurer does.

We also understand that a large part of the value of insurance at this level is the removal of volatility and the sharing of the insurer's diversification benefits with its customers.

We should add to this the added value of the transfer of risk management knowledge that comes from dealing with multiple customers and handling a greater variety of loss scenarios than we would expect to encounter alone.

If we appreciate and value the above, we must be willing to accept that it should be rewarded with a reasonable long-term return for its troubles.

Yes, often we could do it ourselves, but if well run, economies of scale mean a good insurer should always be able to do it slightly better and at a better price than we can.

What's more, the global and fluid nature of insurance means that we can often get the convenience and service levels of the local shop halfway up a mountain but with the attractive prices of the hypermarket below.

This is why as sophisticated buyers we must also bear some responsibility for our actions.

If we act in a pro-cyclical way and aggressively chase discounts at the bottom of soft markets, we can hardly lament the subsequent withdrawal of capacity and harsh repricing that may ensue when the market turns against us.

We have as much of a part to play in this cyclical dance as do the more short-term and opportunistic insurance entrepreneurs. It takes two to tango.

> **"If you spend all your money on loss leaders from the superbly cheap hypermarket out of town, don't complain when you discover your friendly local shop has gone out of business"**

Yes, some insurance shops provide terrible service and never seem to stock the products we want. Indeed, through exclusions over the years they have banned some of the things we prize the most.

But through experience we learn to recognise and avoid these poor partners.

As sophisticated buyers, we and our appointed brokers have the ability to construct a more mature relationship with our preferred insurance partners if we so wish.

So identify, cherish and support your favoured insurers and stick with them when market momentum begins to turn against them in the next couple of years. Allow them to consistently earn a small excess of their cost of capital over the pricing cycle and they will be eternally grateful to you for it. They will also maintain stable financial strength ratings that will help you sleep at night.

They will also be able to keep investing in strong service offerings and research and development to solve the risk management problems of the future.

And in doing this together, you will both have done your bit to remove the worst cyclical fluctuations in pricing and coverage.

Be like the Swiss: love your local shop and it will serve you right in your hour of need.

Building bridges for all

Adrian Ladbury interviews *Mike Keating*, managing director of the UK-based Managing General Agents' Association

Managing general agents (MGAs) continue to rise in significance as businesses across Europe and worldwide face up to ever more challenging and complex risks, and insurers struggle to deliver the risk management and transfer services that their customers need without assistance. MGAs can provide a crucial link and come up with the specialty solutions that are needed, hence the recent growth in the sector. To discuss the role and future of MGAs, Adrian Ladbury interviews Mike Keating, appointed managing director of the UK-based Managing General Agents' Association (MGAA) in September 2020. The former insurer and leader of MGA businesses is optimistic about the future of the sector...

Adrian Ladbury: Why did you join the MGAA last June? What experience and knowledge did you bring to the role to help continue the association's growth path?

Mike Keating: It was a great opportunity and I was attracted by the chance to be able to apply my experience of working at both large insurers such as AXA and, during the last ten years, at various different-sized MGAs.

I have seen MGAs through an insurer's lens in terms of providing capacity. I've seen the challenges an MGA has, and the products and services an MGA requires to be successful in the segment. Prior to joining the MGAA, I had also been working for a new MGA startup, which provided me with exposure to the funding aspect of working with private equity houses to raise funds for a startup.

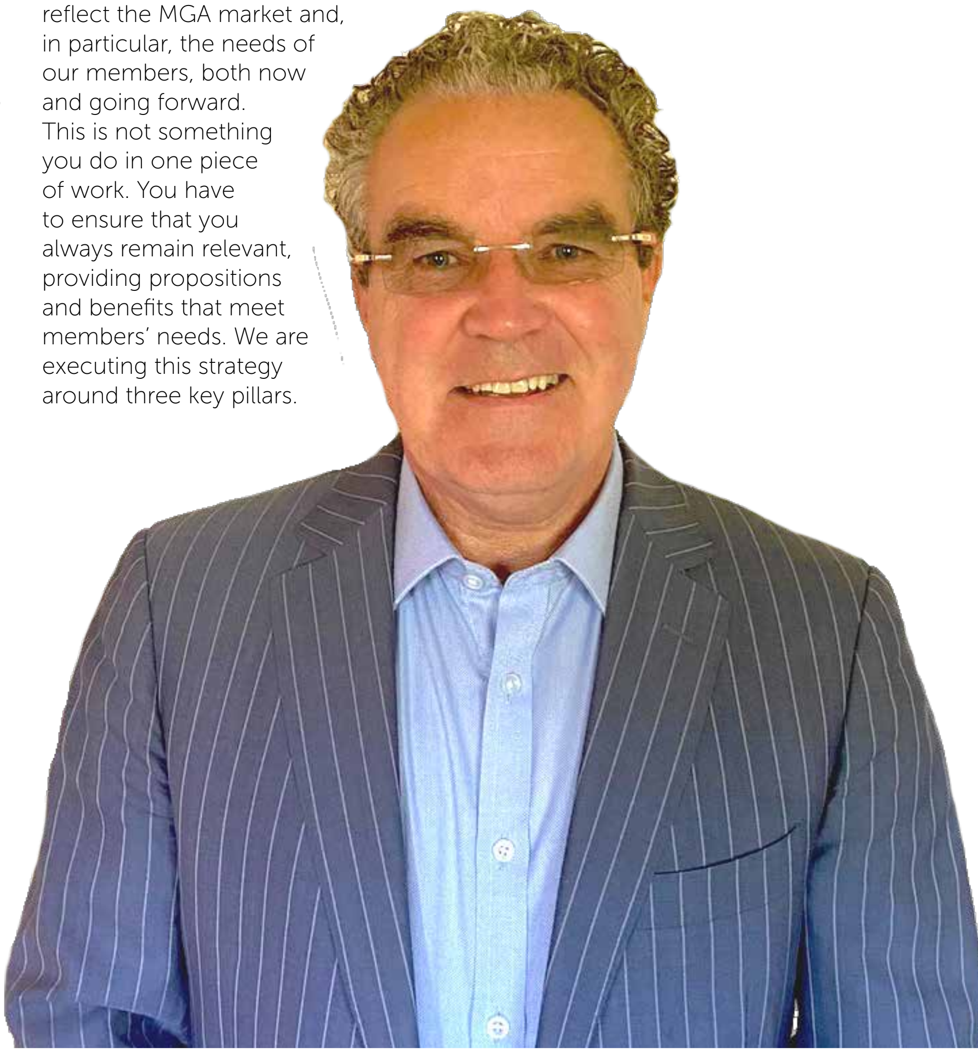
I also knew the MGAA well, having sat on its board in 2015/2016 as a representative of Primary Group, one of the larger MGAs in the UK.

> "You have to ensure that you always remain relevant, providing propositions and benefits that meet members' needs"

Adrian Ladbury: So, what was the plan when you came on board and what are your goals and strategy?

Mike Keating: It is our tenth anniversary this year and the association has grown impressively and been well run. My focus is to build on this good work and make sure the association is seen as forward-thinking and modern, yet maintaining its core values.

I believe we need to consistently reflect the MGA market and, in particular, the needs of our members, both now and going forward. This is not something you do in one piece of work. You have to ensure that you always remain relevant, providing propositions and benefits that meet members' needs. We are executing this strategy around three key pillars.



First, we naturally want to grow our membership among MGAs, our insurer partners and suppliers. A flourishing, forward-thinking organisation is one that has growth across its membership. That is key.

To do that, we have to ensure that we have a relevant proposition for our members, that we have excellent communication and engagement, and that we are alert to all issues and opportunities in the MGA segment, so that we can react on our members' behalf.

Second, I am very conscious that, although based in London, we have to avoid being labelled as a London-centric association. In order to achieve the first objective, it's important that we appeal to members across the whole of the UK. The pandemic and lockdown have restricted our ability, however as soon as we are able, we will be engaging with existing members and looking to attract new MGA members outside of London and the southeast.

Third, as an association we are firmly sighted on professional standards and education. Everything we do has to have that at its core. This helps our members continue to improve both as organisations and as individual staff, in terms of growing professionalism in the industry and the MGA segment.

Adrian Ladbury: Why does the market need an MGA? Why not just stick to the insurer and broker model?

Mike Keating: The MGA community provides specific products and services to the industry and profession, and provides added value to insurers. You have insurers that like to partner with MGAs because they may not have an operational infrastructure that allows them to reach all parts of the UK. They will also use MGAs for their underwriting expertise, to enter product sectors and customer segments that they are unable to get into themselves.

Most importantly, MGAs provide underwriting expertise in product innovation and niche areas such as non-standard home, flood area exposure, unoccupied property, cyber, professional indemnity, construction... very niche and specialist areas. So, MGAs really come to the fore when providing insurers with opportunities to grow profitable lines of business where they, first, don't necessarily want to invest and build the capability directly themselves; and second, do not have the expertise in particular product lines that they want to expand into.

That is why MGAs have continued to flourish. MGAs typically have agility, speed, innovation, are able to bring products to market quicky, and rapidly meet the changing needs of brokers and their clients.

> "MGAs provide underwriting expertise in product innovation and niche areas such as non-standard home, flood area exposure, unoccupied property, cyber, professional indemnity and construction"

Insurers can take quite a long time to replicate this because of their size, so that innovation, underwriting expertise and speed to market is something insurers find really attractive.

If you are looking through a broker perspective, MGAs give them more choice. They want choice for their customers and that comes from mainstream insurers and MGAs.

Adrian Ladbury: Did the pandemic actually help MGAs in a way, by providing an innovative and agile response capability?

Mike Keating: During the pandemic, it was no surprise that MGAA members recorded improved retention and increased new business throughput. This underpins the agility and innovative approach MGAs have embedded in their business models, which enables them to quickly adapt to changing market conditions.

Insurers needed time and investment to equip their underwriters and operational people to meet the demands and challenges that the pandemic and lockdown brought, whereas the natural agility of MGAs allowed them to very quickly carry on in a business-as-usual way.

Yes, MGAs did have to enact business continuity plans too. But that was pretty seamless and allowed them to deliver a level of service that was fantastic and evidenced in their final numbers.

160

APPROXIMATE NUMBER OF MGA MEMBERS OF THE MGAA

Adrian Ladbury: Can you give some numbers to show the scale, reach and growth of the MGA market?

Mike Keating: It is difficult to ascertain true numbers of MGAs. Our projection as an association is that there are probably about 350 MGAs, maybe slightly more, operating in the UK market. The association is close to having 160 of those as members, and we are growing.

The key definition is an MGA's duty to an insurer. It's not like a broker that operates on a binder on behalf of the insurers with a duty to the end customer. Our members are virtual insurers in their own right, operating with insurer capital to underwrite on their behalf and deliver underwriting earnings through the delivery

Manchester, UK: the MGAA is looking to attract new members outside of London and the southeast

of good consistent loss ratios to their insurer partners.

We, as an association, do not have brokers with binders. We have pure MGAs that are writing on behalf of insurers and capacity providers. Against that backdrop, it is growing and the appetite of insurers to support MGAs is strong because of everything I've outlined. Some insurers don't see this as a model they want to follow but that is the beauty of a large and diverse insurance world.

Adrian Ladbury: What are the key elements that make for a successful MGA?

Mike Keating: As an MGA, you need to consistently and relentlessly ensure that your portfolio of business meets what you have committed to your capacity partner. This includes a clear risk appetite, excellence in pricing and product knowledge, demonstrable underwriting expertise, supported by forensic data provision. Once you have these components in place, then identifying suitable distribution becomes easier.

I am confident that those MGAs that can consistently demonstrate these traits will never have issues in terms of securing capacity, because they will always be attractive to the insurer market.

Adrian Ladbury: There seems to have been rising interest in the MGA sector among the investment community in recent times. Is that correct and why is the sector so apparently attractive currently?

Mike Keating: As an MGA, you have a number of ways of obtaining capital. There is interest from the reinsurance market as well as investment funds looking to provide capital. I am not saying that, in current conditions, there is a lot of excess capital, but with the right MGA they are having

"As an MGA, you need to consistently and relentlessly ensure that your portfolio of business meets what you have committed to your capacity partner" very positive conversations in terms of how they should structure their capacity programmes. The use of captives to underwrite segments and/or a proportion of the MGA portfolio is also certainly on the increase.

It's an evolutionary process by which the more you understand your portfolio and the consistency of performance, then the more you would look at how you structure your capacity and programme.

Adrian Ladbury: How much capacity does an MGA typically have and how difficult is it to deliver continuity as the market changes, as it has recently?

Mike Keating: It depends on the preference of the MGA and the model. Some MGAs will have multiple carriers, maybe within the same product line. Other MGAs will have single carriers for single product lines. Smaller MGAs may have only one or two products and they may just have one or two carriers.

One of the overriding principles for any MGA is that you should always be networking with insurers in the event of a change in strategy that could leave you exposed. All MGAs focus on their insurer relationships, both existing and new, sharing their business strategy in the event that they may need a new capacity partner. This is particularly a challenge for smaller MGAs.

Adrian Ladbury: What does the MGA bring to the corporate risk management community? How do they access them?

Mike Keating: Risk managers can access MGA capacity in a number of ways and given the current state of the market in the UK, with rates rising in most lines and the probability of a severe recession, there are opportunities for brokers and risk managers.

MGAs work with their brokers to mitigate premium increases as best as they can but still ensure that they are providing the right level of cover for the customer. One of the routes is potentially a risk management programme. We know that during a hard market, policies that have nice add-ons quickly disappear, and that a robust and relevant risk management programme becomes much more valued by the insurance market.

Adrian Ladbury: Are broker facilities competition to MGAs?

Mike Keating: Brokers with binders are completely different to MGAs, which are underwriting on behalf of the insurer. You could argue that the lines may get blurred because there are some brokers that have facilities that enjoy high authority levels.

Some brokers with those facilities can move to become a fully-fledged MGA but it is not as straightforward as just swapping the binder. It completely changes the way you operate.

Brokers provide a service to end customers, which is what we are all here to do. MGAs provide a service to brokers. They are complementary bedfellows. There is a clear difference. A broker will talk to a customer and have the ability to bind that business on behalf of that customer. An MGA is looking at that same customer and underwriting that customer on behalf of the insurer. That is a key difference.

"We know that during a hard market, policies that have nice add-ons quickly disappear, and that a robust and relevant risk management programme becomes much more valued by the insurance market"

Adrian Ladbury: There is much talk about the potential impact of insurtech on the commercial insurance market. How could and should MGAs be using technology to make themselves more profitable, efficient and attractive for customers and brokers?

Mike Keating: The technology that drives an MGA is a key pillar of its success. The MGA needs to be data-rich. The ability to capture underwriting and life science, for example, provides the information to enhance pricing and risk selection. Moreover, all of that data ideally needs to be in one place.

I am encouraged by the systems and technology that I am seeing from our suppliers. They are concentrating on the whole holistic value chain rather than trying to focus on one element in that delivery mechanism.

That is real progress from the tech companies, because they will be able to design the architecture that enables the end-user MGA and its relationship with the insurers, so that it works for everybody. That's the key – to look at it from an end-to-end perspective and not from one link in that chain.

Maybe the next generation of MGA leaders and CEOs will see their *raison d'être* to be the swapping of systems as a competitive tool in terms of their overall model. There is a lot of potential out there for agile and forward-thinking MGAs. But anything future-proof right now is the real key.

When the going gets tough…

The last few years have been unprecedented and often traumatic for people, companies and countries. Even without the pandemic, nationalism has been on the rise, trade has been threatened, political instability and violence have continued, and globalisation has felt under threat. *Tony Dowding* finds out what this has meant for global insurance programmes, one of the beneficiaries of globalisation and trade liberalisation

Clearly, increasing nationalism and protectionism are not ideal for global programmes and will simply serve to make them more complex as greater compliance issues need to be considered, or barriers surmounted. But it may be that the need for a coordinated global programme, with local compliance, is even greater in 2021 that it ever has been.

The longer-term impact of the pandemic is still uncertain, but the global nature of the pandemic may just encourage multinational businesses to take a more coordinated approach to insurance generally (not just pandemic-related).

The global nature of the pandemic may just encourage multinational businesses to take a more coordinated approach to insurance

Rapid market contraction

The other issue to be factored in when looking at the current global programme landscape is the hard market. The soft market environment saw global programme offerings expand with broad form wordings, coverage extensions and increased capacity.

Marcel Weiss, head of international programmes, commercial insurance, Zurich Insurance Group, says that in the soft market of the last decade or so, it was challenging, especially in the international programme space.

"The market was soft for such a long time where every year rates decreased, terms and conditions broadened and capacity expanded," he explains. "But now, we are in a hard market environment. While the pandemic has accelerated certain changes, Covid-19 didn't start the hardening. The changes in the market already started before in the US, later came to

EMEA and finally arrived in APAC and LatAm, with perhaps less of an impact. For us it is crucial to continue to work closely with our customers and to provide them with the advice and services they need to achieve their strategic goals in a sustainable way."

Daniel Trautner, head of Aon Global, commercial risk solutions, health solutions and affinity, says the rapid contraction of the market as a result of the hard market cycle has been consistent across a number of lines of business, but particularly in PI/D&O/cyber. But he also notes that while the hard market conditions have impacted on policy covers, there has not been a reduction in cover impacting the policy language for global insurance (DIC/DIL clauses, FINC, etc).

"All insurers are managing volatility in various ways but mainly through capacity, which at best is being ventilated, at worst reduced or removed, and coverage scrutiny. Examples include communicable disease, cyber, strike, riot and civil commotion, US auto attachment points and product exclusions, to name but a few," says Mr Trautner.

In addition, he says, some insurers have exited whole portfolios of business, which creates its own disadvantages for competition, and while new insurers have entered the market, these are very specialised players. And he notes that there has also been a change in insurer referrals to head office, which means longer timeframes for decisions, and information requirements are quite intrusive even where there has been a long-term relationship.

Mr Weiss says: "The rate increases and the tightening and strengthening of terms and conditions globally have been challenging for businesses, as the change to a hard market happened very quickly. And at the same time, they have been hit by Covid-19 and have suffered as a result of the pandemic and the related lockdowns. It's challenging for them because the situation is quite volatile. What businesses are looking for is stability and the ability to plan for the future."

Pandemic response

It would seem that the pandemic has certainly not held back the development and growth of global programmes, and may even have served to focus minds, at a very senior level, on the need for a global solution to insurable risks, while acknowledging the need to address local issues.

Karen Jury, UK head of multinational, AIG, says that despite the many geopolitical challenges facing the world today, globalisation is continuing as organisations look to expand across geographies in their search for growth and cost efficiencies. She believes the pace of change and intensifying nature of global risks have elevated the role of insurance and risk management.

"As global trade is undertaken across increasingly protectionist regimes, subjecting companies to heightened regulation, there will invariably be an increased impact with respect to compliance as companies seek to avoid fines and the reputational consequences of falling foul of regulatory requirements. Beyond the benefits of price optimisation and balance sheet protection, multinational insurance programmes can help organisations respond consistently and proactively as the global environment remains uncertain. Carriers and brokers can optimise the architecture of the programme when there are changes in trade and legislation, ensuring there are no gaps in cover and that individual policies will respond as expected when a loss occurs," she says.

Ayleen Frete says it is equally important to look at the local risk approach as well as global

> "There will invariably be an increased impact with respect to compliance as companies seek to avoid fines and the reputational consequences"
> *Karen Jury, AIG*

Ayleen Frete, global head of market practice management, global client services and multinational, AGCS SE, agrees, pointing out that the pandemic and increased economic uncertainty "have moved companies to focus on global initiatives managed centrally and our multinational clients demand more information for decision-making regarding costs", adding: "In an international insurance programme, it is equally important to look at the local risk approach as well as global, however by continuing to promote consistency of coverage worldwide, insurers are able to minimise local issues arising."

She adds: "In the world of global insurance programmes, managing change and being flexible to accompany a client on their risk journey is the core. Global insurers have been managing changes in regulation across regions for a number of years and increasingly we are seeing queries from clients with regards to response of the local policies regarding claims."

Increased demand

Others agree that there is clearly an increased demand for international insurance solutions. "This was the trend prior to the pandemic and has continued throughout and has mainly been driven by the availability of capacity, centralised control, cost savings, centralised risk data as well as broad and consistent coverage," says André Rohlmann, general manager of International Network of Insurance. "We see that customers continue to demand globally consistent programmes that are locally responsive. We feel that the best way to cater for this demand is the establishment of a controlled master programme."

Ian Long, head of international programmes proposition and transformation, Swiss Re Corporate Solutions, adds: "In general, we see a move towards the coordinated approach that international programmes provide, adhering to compliance requirements, dealing with complex tax schemes and increasingly complex supply chains. Having the peace of mind in terms of fully understanding the global insurance cover in place is an important factor that contributes to this trend. It is too early to tell if the global pandemic alone increased demand for international programmes, although it is clear that our customers are assessing their risks afresh in the light of the experience."

The pandemic has certainly raised awareness of risk and companies will be looking at their response and their covers, and in particular the wordings, given the problems around business interruption. "We haven't seen evidence yet that the pandemic has had any meaningful effect on how companies structure their insurances or on the demand for global programmes, but we are expecting to see an increase over the next couple of years as risk managers have the opportunity, with the worst of the crisis hopefully now behind us, to reflect on lessons learned," says Tim Galloway, divisional leader for multinational, QBE Europe.

Ian Long sees a move towards the coordinated approach that international programmes provide

"The main concerns so far, from both a customer and insurer perspective, have been around coverage clarity in policy wordings and I can definitely envisage more risk managers being drawn to the greater consistency and certainty of global coverage that a multinational programme typically affords," he adds.

Mr Weiss says the insurance industry has changed dramatically over recent years. "While insurance used to be purely about risk transfer, the focus now is on complementary analytics and risk engineering services to help businesses improve their resilience and prevent and mitigate losses. Covid-19 demonstrated how fragile global supply chains really are. As a consequence, many businesses are now looking to strengthen their resilience to be prepared for future challenges, including new pandemics," he says.

Board-level interest

Perhaps what the pandemic, and to a lesser degree the hard market, has done is raise the issue of global insurance programmes and requirements to board level. Not surprisingly, one of the first thoughts of many a board member at the start of the pandemic would be: what cover do we have for this global risk?

"The pandemic has really been an eye-opener to many managers and they are now looking at their global programmes more closely," says Mr Weiss. "They look at the cost, alternatives and new services and products from insurers to help them better navigate through the impact of Covid-19, as well as the challenges of the hard market. In addition, customers are increasingly looking at captive solutions, to better manage some of the challenges related to the insurance cycle."

Karen Jenner, portfolio director, business development, TMF Group, agrees that there is an increase in more alternative programme structures and insurance placements. "Many European corporations are seeking more cost-effective insurance solutions, including, for example, from US providers, which can then provide challenges from a regulatory compliance as well as an insurance premium tax perspective. This isn't necessarily leading to a more local approach though, just more innovative placements to provide the levels of coverage required at an affordable price."

> **"Global programmes give risk managers a view of risk that is global, while allowing them to manage local needs and regulatory requirements"**
> ***Bruno Laval, AXA XL***

It should not be a surprise that global programmes have gained more visibility and interest since the start of the pandemic. "As a society, we are experiencing a very local response to the pandemic and a global awakening," says Bruno Laval, chief distribution officer, APAC amd Europe, and regional manager, European markets, AXA XL. "From a risk standpoint, global programmes are the perfect tool to address both trends; they give risk managers a view of risk that is global, while allowing them to manage local needs and regulatory requirements."

Reaping the reward

Global insurance programmes are complex structures that require time and effort to get right. But as *Tony Dowding* discovers, technology and digitalisation are helping to streamline the process, and in the end, they are worth all the hard work

Global insurance programmes have been around for a long time and should in theory be easier to structure, establish, and run than in the past. But in many ways they remain as difficult, complex and necessary as ever

It is still the case that global programmes remain complex and time-consuming by nature, says Karen Gorman, regional leader, global services and solutions, Willis Towers Watson (WTW). But she says brokers and insurers are working hard to try to eliminate duplications of effort and unnecessary administration, through greater use of technology and the streamlining of processes.

Indeed, all the leading brokers and insurers in the global programme space agree that technology provides the best response to the issues around complexity and timely programme delivery, and it is one of the areas that has seen the greatest investment.

Karen Gorman says brokers and insurers are working hard to try to eliminate duplications of effort and unnecessary administration

Complexity

There is no doubt that designing and implementing a global insurance programme can be a complex process, says Karen Jury, UK head of multinational, AIG, as these programmes can involve multiple countries, captives and/or sizeable reinsurance panels, varying regulatory environments, etc.

"We are also seeing a dynamic fronting marketplace with increased activity being driven by, among other things, cross-border expansion, captives participating in a broader range of traditional insurance coverages, and the emergence of new risks that may not be covered by traditional insurance markets. These factors, coupled with the importance of compliance with insurance and tax regulations in each programme jurisdiction, are just some of the challenges to successfully implementing a multinational insurance programme."

She adds that doing so requires in-depth local expertise, resources, technology and, above all, preparation and collaboration among the insurer, client and broker to navigate the many complexities towards optimal design and timely implementation.

Global programmes are sophisticated solutions that are by nature complicated to establish, according to Bruno Laval, chief distribution officer, APAC and Europe and regional manager, European markets, AXA XL. "In addition to managing many moving parts on the underwriting side, they must be set up by taking into account local regulatory frameworks which, in recent years, have become more stringent.

The largest global carriers have a wealth of experience putting in place and managing global programmes with underwriting, operations, claims and compliance functions that ask the right questions and are able to provide the right answers," he says.

The complexity of any global risk solution is related to the nature, reach and interdependency of the risks that any global businesses has to consider, says Nigel Leppitt, global head of global client services and multinational, AGCS SE. "Traditional risks like property and liability have become more difficult to plan for, when overlaid with ecological, business continuity and emerging risks like cyber. This increasing uncertainty, combined with the more strenuous supervisory and regulatory landscape across countries, demands transparency of cross-border information and tight central coordination," he says.

The important point to make is that however time-consuming and complex a global programme might be to establish, it is undoubtedly worth the time and effort. "It is true that global programmes require a good amount of planning and organisation, especially when building one from scratch, but in my experience most risk managers who have invested the time and effort to establish an integrated global programme feel that that it is a significantly better option than the alternative, which is a patchwork quilt of uncoordinated covers with different insurers all around the world," says Tim Galloway, divisional leader for multinational, QBE Europe.

Fiscal concerns

Karen Jenner, portfolio director, business development, TMF Group, believes there are probably two different arguments to this point: "Firstly, ever-increasing compliance requirements undoubtedly make multinational programmes more complex. Indeed, an increase in the amount of data the risk manager needs to collate from across the business to support the compliance of global programmes is evident across the board. Specifically, for fiscal purposes, tax authorities are seeking more and more granular information around both policyholders and risks where indirect taxes on premiums are due, either within the returns process or as additional reports."

But she adds: "On the other side of the coin, however, one could argue that developments in technology reduce some of the labour-intensive data collection and consolidation processes that rest with the risk manager. In addition, increasing compliance guidelines provide more transparency, which allows for more efficient global programme structures, resulting in more robust and effective insurance programmes."

Indeed, the fiscal side is one area where there is growing complexity. Part of this is that the pandemic and consequent economic downturn have meant that certain taxes, perhaps not perceived as directly impacting the ordinary person, such as insurance premium tax (IPT), are high on the agenda.

"There are clearly pressures on national treasuries, and IPT is one of many taxes that governments can use to increase their tax revenue," says Joseph Finbow, IPT assurance director, TMF Group. "How this goal is being achieved however varies, be it a blunt increase in the rate of IPT as we saw recently with Spain's increase from 6% to 8%; efficiencies in the collection of IPT as we have seen with the compulsory digitalisation of IPT returns, most recently in Luxembourg and Germany; increased controls in the collection of verifiable data, such as stamp duty reporting requirements in Portugal; or the intent to provide more clarity and consistency as evidenced in the significant update to IPT law in Germany."

> **"Traditional risks like property and liability have become more difficult to plan for, when overlaid with ecological, business continuity and emerging risks like cyber"**
> *Nigel Leppitt, AGCS*

Technology solutions

The complexity of implementing international programmes is a challenge for all parties involved, says Ian Long, head of international programmes proposition and transformation, Swiss Re Corporate Solutions: "There are several drivers behind this, not least the number of stakeholders involved and their varied interests. Clients are looking for a smooth response from their insurer when it comes to the issuance of local policies in terms of speed and accuracy of the documents being issued. Compliance with local requirements, transparency, financial management and timely premium distribution are all key factors, not to mention the handling of claims."

Part of the solution to this is technology and digitalisation, and insurers and brokers have been driven to invest heavily in order to keep providing a full global programme service that meets buyers' requirements for speed, compliance and transparency.

"Administering international programmes means sharing large amounts of unstructured data between all the parties involved, which can lead to a poor customer experience," says Mr Long. "Risk managers understandably expect the industry to up its game and to offer more cost-effective solutions. There is a growing need for technology support, and we believe that sophisticated platforms go a long way towards solving many of the issues customers are facing, particularly when it comes to data exchange."

André Rohlmann, general manager of the International Network of Insurance, says that establishing a programme can be quite daunting and a 'one-size-fits-all' approach cannot be taken when structuring a global programme.

"Customer expectations and coverage requirements vary and, in most instances, tailor-made solutions are needed that also involve multiple parties – insurer, broker and customer – at various levels, both domestic and local. This definitely complicates things but having a well-organised network of experienced partners as well as a digital communication and administration platform helps in overcoming these challenges, and also ensures clarity and transparency throughout the programme structuring process and beyond," he says.

Contract certainty

One of the biggest bugbears of risk and insurance managers when it comes to their global insurance programmes has been the question of contract certainty. It was raised some years ago by risk management associations, and the industry has worked to improve the situation. But it can still be a huge problem for multinationals, especially where there are 'cash before cover' requirements.

According to WTW's Ms Gorman: "The speed of the issuance of local policies and premium collection has improved over the years, mainly due to premium payment deadlines being put in place by local regulators and more countries becoming 'cash before cover'. Having said that, we are seeing more bureaucracy emerging at the local level and also more stringent compliance with anti-money laundering and 'know your client' rules, and although these are good things, they do create barriers and more work."

It is hoped that digitalisation will help to speed up the whole insurance process and ensure that policies are issued on time and documents made available to subsidiaries when the policy goes live. This is all part of insurers looking to improve their services and offerings to customers who are growing, expanding and moving into new product areas.

Karen Jenner says that tax authorities are seeking more and more granular information around both policyholders and risks where indirect taxes on premiums are due

"As businesses have expanded into more territories through growth/acquisition, the global insurance market has had to keep pace with clients' changing needs – through product innovation, expansion of global licences, or bundled services to complement their offering – and this will also provide differentiation and/or competitive advantage," says Daniel Trautner, head of commercial risk solutions, health solutions and affinity at Aon Global.

"Investment in systems and technology and global network offices also help deliver operational efficiencies, but at the end of the day, the drivers that will determine 'what looks good' will inevitably come down to a combination of price, coverage scope, claims effectiveness and efficiencies around programme administration/premium movement. The quid pro quo is to invest time and start planning early," he adds.

Global programmes: implementation and operation

An upcoming conference from Commercial Risk is set to shine a light on the process of implementing and operating a global insurance programme

As anyone who has been involved in establishing a global insurance programme will tell you, it can be a long, complex and difficult, albeit vital, process. It can be a daunting task to set out on, but an upcoming conference from Commercial Risk aims to demystify the process and tackle the nuts and bolts of implementing and operating a global insurance programme.

The conference, to be held virtually on 14-16 September 2021, will examine the structure, implementation and operation of global insurance programmes. It will consist of a mixture of sessions, case studies, workshops and extended deep-dive discussions held over three half-days.

Implementation

On the implementation side, the conference will examine the information that is required before the programme can be planned and implemented, how it can be collected, and what sort of information is required from the group and its overseas subsidiaries. The conference will also look at the importance of contract certainty for global programmes, an area that can be vital for local subsidiaries looking for proof of coverage.

There are a number of areas of conflict that need to be resolved before a programme can be successfully implemented, as a result of the different requirements of the head office and the local operations, and the conference will look at solutions and ways to minimise these areas of conflict.

Operation

On the operation side, the conference will look at two crucial areas for the smooth running of a global programme. The first is the criteria for premium allocation to the different subsidiaries – what needs to be considered when allocating premium? How much flexibility is there? What tax and regulatory requirements are there? The second is the setting of retention levels. Multinationals must achieve a balance between the parent's desire for a higher retention level and the need to satisfy the subsidiaries' requirements of a realistic retention level and the ability to finance it.

The conference will assess how multinationals can mitigate the effects of the hard market globally

There are a number of current issues affecting global coverage that the conference will examine. Clearly, a hard market is here, in most classes and regions, with some classes of insurance particularly stressed, such as D&O and cyber. The conference will assess how multinationals can mitigate the effects of the hard market globally, and look at strategies to manage it, from retentions to captives to alternative risk financing.

Finally, the conference will include a number of workshops and case studies on employee benefits, accident and health, and captives.

To sign up for the conference, please visit: https://commercialriskevents.com/global-programmes

Captive sector expecting a new dawn

There is nothing quite like a hard insurance market, a global crisis, and new and emerging risks to make risk and insurance managers take a serious look at the alternatives to insurance, writes *Tony Dowding*

When it comes to alternatives to insurance, the obvious place to start is a captive. Not just for those without one, but also for those with an established captive that has probably been underused, understandably, during the long (well over a decade) soft market.

So it is no surprise that 2020/2021 has seen a surge of interest in captives as the hard market kicks in. Captive development has been steady in the US over the years, but much more sluggish in Europe. But now, domiciles are reporting increased interest, as are captive managers. The sector is being talked up by ratings agencies such as AM Best, which states in a report that large rate increases in commercial insurance will drive a surge in new captives among European firms and see risk managers turn to existing captives to 'plug' programme holes as they retain more risk.

Globally, the captive sector has been growing in the last year or two, largely in the US, and a recent Economic Insight from Swiss Re Institute points out that there are now more captive insurance companies than traditional insurers globally, estimated at more than 7,000 captives domiciled in more than 70 jurisdictions.

Luxembourg is set to benefit from numerous captive feasibility studies currently underway

European captives

So, are we actually seeing a rise in captive formations and usage in Europe or is it all talk? There is certainly more interest in captives according to captive specialists, and the expectation is that this will translate into growing numbers and more business written through exiting captives.

"There is certainly an increasing interest in the corporate market to explore the use of captives or protected cell captive solutions," says Paul Wöhrmann, head of captive services for Europe, the Middle East, Africa, Asia-Pacific and Latin America, Zurich Insurance. He says existing captive owners view their captives as strategic assets to manage the insurance market cycle: "They use their captives as a strategic door-opener to reinsurance and alternative capital markets when there is a shortage of capacity or an increase in rates."

He adds that he is seeing an increasing demand for 'captive health' services like retention studies and benchmarking: "We are observing that several captive managers and consultants based in Europe are currently very busy with captive feasibility studies, which is an indicator for later captive formations. It is likely that the European captive domiciles of Luxembourg and Ireland will benefit from this market development."

He also notes that the hardening market is also prompting more large and mid-sized companies to explore captive related opportunities like protected cell captive (PCC) solutions, and adds that emerging risks like cyber might become a more widely included line of business.

Claude Weber, captive consulting leader, continental Europe, Marsh Captive Solutions, says there is a lot of interest in new captives and in the extension of existing captive programmes. Marsh saw a number of new licences in European domiciles before year-end 2020, and it is working on more in 2021. "In addition, a number of companies that did not have captives are currently considering a feasibility study, while others that have already finished their study are working on the submission files in view of obtaining a licence before their next renewal," he says.

Mike Matthews, commercial director – international, Artex, agrees, noting that the momentum begun in 2020 has continued unabated. "In the first quarter of 2021 we saw a significant uptick in the number of captive enquiries, feasibility study engagements and, most telling, formation activity from feasibility work completed in 2020," he says.

Fronting insurers see the same picture. Stephen Morton, EMEA head of multinational, AIG, says it is seeing a continued increase in the use and diversification of existing captives. "Overall, captives are playing a larger and more important role in clients' overall risk strategies, largely via increased participation – for example, seeing a captive doubling a retention is not uncommon, and filling gaps in coverage, particularly in the energy and property space where capacity is a challenge," he says.

He continues: "The global fronting business also continues to grow as companies expand the use of existing captives to encompass additional geographies and lines of business such as cyber, A&H, trade credit and marine. We've also seen an increase in third-party coverages, such as warranty and tenants' liability, as companies look at their captives as a separate business unit and source of revenue."

Another fronting insurer, AXA XL, has seen a growing interest in captives in Europe since 2019. "This accelerated in 2020 and the trend is still going strong so far this year," says Marine Charbonnier, global programmes and captives regional director, Europe, AXA XL. "We are seeing a rise in demand from across Europe in both wholly-owned captives for larger organisations, and cell captives, primarily for middle-market companies."

Mixed picture

But the overall picture for captives is less obvious. It seems that while captive formations are on the increase, the overall numbers of captives were down in 2020. According to Peter Carter, head of global captive practice, Willis Towers Watson, the picture is mixed. "While we see an increase in demand for cell captives for point risks such as D&O and cyber benefiting domiciles with cell captive frameworks (Guernsey and Malta), the net picture for pure captives in Europe is more nuanced. While market conditions are driving continued interest in new captive formations, economic challenges arising from pandemic together with M&A are also driving licence surrenders, contributing to an overall decline in captive numbers in Europe during 2020," he says.

Derek Bridgeman, managing director of captive manager SRS Europe, says: "I would say that the formation of captives in Europe has certainly lagged behind the numbers of captives being created in the US and offshore islands such as Bermuda and Cayman. That said, there has certainly been an uptick in formations in the first half of 2021. The reason for the time lag is likely due to the implementation times, which are longer in Europe; where a captive implementation was not possible ahead of renewal then it may have been pushed out to the following period."

And for independent captive consultant Francoise Carli of Zakubo Consulting, former vice-president, insurance, at Sanofi: "The rise is not yet there, but there are increasing demands regarding captive and cells interest and setup process. Obviously, the market conditions for the 2021 renewals have put insureds in difficult positions, adding up pricing and deductible constraints on top of the Covid consideration. So it is not talk, it is clearly more than that, but it is not yet visible."

Mike Matthews says there was a significant uptick in the number of captive enquiries in Q1 2021

> "Overall, captives are playing a larger and more important role in clients' overall risk strategies"
> *Stephen Morton, AIG*

Traditional v innovation: which way will captives go?

Tony Dowding **asks: As interest in captives grows and more risk is pushed through captives, will the focus be on traditional uses of captive, or will there still be innovation?**

As the hard market bites for many companies and their captives, it will all be about rates and getting better value for money, improved terms and conditions, and exclusions reversed. But there may also, for some, be a case for expansion in the use of captives into other strategic areas and taking an innovative approach to risk financing.

Willis Towers Watson's Peter Carter says there is no question that they will be deployed with greater intensity to solve issues such as getting better value for money and improved terms and conditions on a tactical basis. "However, we are also seeing a greater appetite to deploy the captives more strategically. Good examples of this would be the greater use of risk portfolio analytics and solutions such as multiline/multiyear stop-loss policies and convertible bonds. Such trends underscore the long-term and strategic value of deploying capital in these structures to further optimise the cost of risk financing while building greater financial resilience for the sponsoring enterprise," he says.

For Carl Leeman, chief risk officer at Belgian logistics firm Katoen Natie and vice-president of Belrim, the argument for using a captive comes down to buying and selling. He told Commercial Risk's 'Captives 2021: Now is the time for action' virtual conference in May: "If you have to buy insurance, you have to sell your risk and if you have a captive involved, it will make that sale much easier."

He added that a captive can bring more stability to your insurance renewal. "It can take the fluctuations out of your insurance budget. It is not easy to ask your accountant to double your budget because of changes in the market... There is a greater need to have more tailor-made coverage that is adapted for the needs of your company," said Mr Leeman. He suggested that companies should consider a minimum of €1m to €1.5m premium for setting up a captive and to cover the cost of paying claims and fixed administration costs, which are subject to rising compliance expenses.

Marine Charbonnier says there is increased demand for programmes that could include a parametric trigger

Improved terms and conditions

AXA XL's Marine Charbonnier says that in the current upward-pricing market environment, the increased demand for captives is mainly driven by clients seeking better terms and conditions and deductible buybacks for their traditional global programmes. "That being said, we are also receiving more requests to include cyber-related risks within existing captives, as well as exclusion buybacks, as capacity for that class of business is sparser than it was in previous years. In that case, captives are set up as a complement to a traditional programme when the client couldn't source enough capacity on the direct market," she says, adding that there is increased demand for programmes that could include a parametric trigger.

Existing captive owners are likely to expand the use of their captives during a hard insurance market, particularly for difficult-to-place coverages. But the benefits of self-insurance, including having greater control over risk financing and risk management, as well as customisation of loss control and claims mitigation strategies, remain relevant when prices soften again, according to AIG's Stephen Morton.

He believes the most successful insurance programmes maintain a balance of traditional and alternative risk transfer, with a strategy that adapts to changing market cycles and risks.

"Global supply chains impacted by an accelerated move towards digital transformation are causing many organisations to re-evaluate their current insurance protections, with a view to expanded use of captives. Another factor is the changing risk landscape. Emerging and intangible risks, such as cyber, reputation, supply chain and non-damage business interruption underscore the need for new and innovative risk managed solutions," he says.

He points out that traditional lines are still driving most captive participation but there is also interest in evolving lines, particularly cyber, as well as warranty, tenants' liability and other third-party coverages as companies look at their captives as a separate business unit and additional source of revenue.

Risk prevention and filling gaps

Zurich's Paul Wöhrmann says: "Captives are very helpful to make risk prevention strategies happen, since captives generally keep a substantial net retention on their balance sheet (it is the captive owner's money and the core business of the captive owner that will be protected). Given the market environment, we believe that captive owners are highly interested in risk prevention and are focusing much more on the aftermath of loss events."

For risks that have become uninsurable or uneconomical in the commercial market, then a captive is likely to continue to play a role in filling gaps in the insurance tower until such time as the market adjusts. SRS Europe's Derek Bridgeman says that in response to hard market conditions, "we are seeing the approach to risk management become more sophisticated, with an increased focus on not just insured P&C and employee benefits exposures, but also risks that were historically difficult to insure such as non-damage business interruption, cyber, reputational and other pandemic-related risks".

He continues: "Here you have a continuation of trends in captive use during a soft market continuing into renewed interest in captives for traditional uses as the commercial market hardens. During the soft market we experienced a more strategic and entrepreneurial use of captives – third-party usage for risks such as warranty or customer-related coverages, as well as medical stop-loss. However, given the prolonged hardening market, traditional property, casualty and financial lines are of key importance currently and are likely to dominate throughout 2021 and 2022."

SWEDISH CAPTIVE MARKET

***Global Risk Manager* spoke to *Alex Dahlmann*, recently appointed head of office for Marsh's Swedish captive operations, Marsh Management Services AB Sweden, about the long-established onshore domicile for captives**

How long has Sweden been home to captives?

The first captive was established in Sweden in the 1940s. Sirius was a direct insuring captive for the Swedish Johnson family conglomerate, which then evolved to become a full-blown insurance carrier. Further captive activity did not exist until 1976 when SKF started a reinsurance captive, and in 1977 Electrolux started its own captive. We have Swedish captives where parent companies are from other domiciles.

Does Marsh expect to see growth in 2021 as the hard market continues?

There is a lot of activity in the market from companies looking into setting up captives; there is also an increased interest in PCCs. PDBI is an area where we seeing interest, and of course cyber is a product where clients want to be able to better understand the possibilities with the help of captives. For existing captives, some are looking to expand the current usage by adding new lines or increasing captive retention on existing lines.

Will the Solvency II review have any impact on captives?

We are seeing a maturity in the Swedish market and a better understanding around Solvency II. The main challenge for captives is to find the right competence in the market. This is where Marsh has been successful in mitigating the knowledge gap.

Are we likely to see a more of a move onshore in Europe?

Companies choosing Sweden as a domicile are ready to pay a premium to be EU-regulated and located in a mature captive market. Of course, startup costs and capital requirements are not a competitive advantage in Sweden, versus Guernsey for example. Companies seriously considering having a captive domiciled in Sweden will do this to ensure Nordic presence, value a credible and solid domicile (from both a political and Financial Services Authority perspective) and local market knowledge by having experienced captive managers.

Innovation

"Captives and innovation have always been good bedfellows," says Artex's Mike Matthews. "The best use of a captive has been, and remains, the ability to better manage an owner's total cost of risk by assisting in restructuring an existing insurance programme, addressing uninsured/uninsurable risk, designing new/bespoke coverages and/or providing additional capacity in both primary and excess layers. The hard market, fallout from Covid-19 and cyberattacks have all just heightened these benefits for large and mid-sized firms alike, leading to more innovative uses of various forms of captive, including greater use of distributed ledger technology."

Whether taking a classic approach to risk financing and focusing on the traditional lines of business in response to the hard market conditions, or looking to be proactive and innovative, and looking at new areas of risk, captive use is set to ramp up for the next year or so at least, and probably well beyond. As Adri van der Waart, director, global insurance at Dutch engineering firm Arcadis and president of Narim, said at Commercial Risk's 'Captives 2021: Now is the time for action' virtual conference in May, summing up the feeling of many risk and insurance managers about the hard market: "We don't like it and we are taking our risk back in-house. The captive is the solution of the future."

> **"Given the market environment, we believe that captive owners are highly interested in risk prevention and are focusing much more on the aftermath of loss events"**
> *Paul Wöhrmann, Zurich*

Solvency II review – what does it mean for captives?

Solvency II feels as though it has been around forever, perhaps because it took so long to discuss, consult, structure and implement. But it only came into force five years ago. And now it is being reviewed by the European Commission. For captives, writes *Tony Dowding*, the issue is whether any review will improve the situation, or potentially make it more difficult...

The EC's consultation on the prudential framework under Solvency II was wide-ranging

The European Commission's consultation on the prudential framework under Solvency II was quite wide-ranging, according to Jonathan Drake, partner, regulatory, compliance and investigations, DWF Law. "The potential areas where there may be some indirect impacts on captives are in relation to cross-border supervision and in relation to the recovery and resolution powers of regulators and guarantee funds in the event of insurer failure. There seems to be a fair degree of policyholder scepticism about the powers and abilities of regulators and it may be that there will be additional regulatory action in these areas, which may also affect captives."

Derek Bridgeman, managing director, SRS Europe, says it will be interesting to see whether the recent guidance by the European Insurance and Occupational Pensions Authority (Eiopa) will result in tangible benefits for captive owners and insurance managers. "For many the jury is still out, and it is only as time moves forward that we will be able to fully evaluate the impact, if any. There is, however, certainly some optimism that a more proportionate approach to captive regulation will result and this is a necessary consideration if EU domiciles wish to compete with their global competitors in respect of pure captives," he says.

Francoise Carli of Zakubo Consulting points out: "There is always a large difference between what you expect from an official legal review and what you finally get. The Solvency II constraints are extremely unfavourable to captives, but the various captive market representatives have delivered to the European authorities significant elements and insights to enhance Solvency II for captives. Should the European authorities introduce all the suggested changes, it would be perfect. But there is little chance that this will take place. In keeping positive, we can hope that at least some of them will appear in the next Solvency II version, and in particular simplification measures when the captive is fully dedicated to the mother company's risks."

Proportionality

One of the big words in connection with Solvency II and captives is 'proportionality'. This is perhaps the key, and Mike Matthews at Artex believes the recent announcement by Eiopa around proportionality "is expected to act like a 'reset button' for a number of projects that stalled due the overly complex Solvency II regime", adding: "We're already seeing renewed interest from longstanding prospects who had become disillusioned with the Solvency II rules and regulations, which were never designed for the different, often lower, risk profile of a pure captive insurance entity."

Peter Carter at Willis Towers Watson notes that there are new proportionality rules suggested by Eiopa. He says the new rules might decrease the burden in some calculations, governance requirements and reporting, and that might be of assistance to captives.

"We can expect there to be reform of discount rates used to estimate liabilities to make them more economically realistic," he explains. "Generally, lower interest rates after proposed new extrapolation methods will decrease own funds, while risk margin changes will work in the opposite way. Which effect will prevail is hard to judge at this point. On top of this, the new interest rate risk calculation will increase the solvency capital requirement, and therefore the overall impact on solvency ratios is likely to be negative."

Simplifications

It is difficult to predict whether the changes in the Solvency II rules will have a significant impact at this stage, for several reasons, according to Claude Weber, Marsh Captive Solutions. "Currently, it is not yet clearly defined which simplifications could be applied to captives. In addition, the conditions to benefit from these simplifications are quite restrictive. When captives, in the current environment with negative interest rates, are further restricted on intragroup lending, or cannot write any third-party or affinity risks to be able to benefit, it is likely that only a very limited number of companies will avail of the simplifications," he says.

He adds: "As the changes will probably not be very material in comparison to those already applied in certain captive domiciles, it is difficult to predict that a large number of companies would change their underwriting or investment strategies to be able to benefit from these changes. If the intention is to really create an advantage for captives, the definition of a captive would need to be kept as broad as possible. The currently envisaged definitions are unlikely to have any major impact."

Let's just hope any changes aren't too major, and all this isn't a precursor to Solvency III.

THE NEW (MIDDLE) MARKET

Middle-market companies are increasingly looking beyond their home markets for growth, and are also encountering new and emerging risks, writes *Tony Dowding*, and captives may prove a useful solution

As middle-market companies expand and become more sophisticated in terms of risk management, many will be looking at alternative risk financing options, including captives. Fronting insurers have already noted that there is increasing interest from mid-market companies in the use of cell captives.


Stephen Morton

AIG's Stephen Morton points out that while the captive market is more mature for large multinationals, there are thousands of organisations operating in slightly smaller footprints that may not have considered or have been required to consider a risk retention mechanism in the past.

"There has been growing interest in captive cell programmes as smaller and mid-sized companies seek to capitalise on the advantages that alternative risk management solutions can provide," he says. "Generally requiring a considerably smaller investment from a time, resource, compliance and capital perspective, a captive cell programme is a relatively simple and inexpensive way for a company that is new to captives to gain experience and enjoy many of the benefits of retaining risk in a captive structure. Despite a relatively long history, the rent-a-captive market is still poised for growth – both for new regions and new types of companies in existing markets."

> "There has been growing interest in captive cell programmes as smaller and mid-sized companies seek to capitalise on the advantages that alternative risk management solutions can provide"
> *Stephen Morton, AIG*

The largest of the middle-market companies are affected just like large corporates when capacity becomes scarcer, more expensive and more restricted regarding the terms and conditions, explains Zurich's Paul Wöhrmann. "Therefore, risk managers with no direct access to the reinsurance markets are less flexible to respond to market changes and might have more challenges to manage their core buying and selling processes compared to captive owners," he says. "Hence, they can only compare market choices provided by the insurance market. As a result, we have experienced that a lot of these top middle-market companies are seeking advice on how to obtain similar benefits by using protected cell captives."


Paul Wöhrmann

AXA XL's Marine Charbonnier says there is a higher demand than in previous years from European middle-market companies for both wholly-owned captives and cell captives. "This is true across Europe, including in countries where there has historically been a lower appetite for captives, such as Spain," she says. "Most of the middle-market companies that are looking to set up a captive are coming to us because the direct insurance market couldn't provide satisfactory terms and conditions to cover their property exposures, or because their deductibles are too high. They are also for the most part companies with significant international activity."

The view from insurers: insurance renewals and the hard market

The market was soft for so many years that for some commercial insurance buyers, the hardening market of the last year or two will have come as something of a surprise. There were even suggestions that soft market conditions were the new normal. But the market has certainly hardened, and the issues are whether this is a market-wide phenomena, how long it will last, and what can corporates do to manage and mitigate the impact.

***Tony Dowding*, editor of Global Risk Manager spoke to several of the leading multinational insurers to consider some of the issues relating to the state of the market in Europe.**

Participants

***Reto Collenberg*, head international programmes EMEA, Swiss Re Corporate Solutions**

***Peter Knaus*, country leader, Germany at AXA XL**

***Charlie Kitson*, international head of client and broker engagement at AIG**

***Melanie Windirsch*, head of global network management, AGCS SE**

***Brian McNamara*, head of global fronting, Allianz Risk Transfer**

***Sierra Signorelli*, chief executive officer for commercial insurance, Zurich Insurance Group**

How would you describe the pricing environment for European multinational companies and their global programmes/ specialty covers?

Sierra Signorelli: More than a decade of rate decreases, increasing loss costs with broadened terms and conditions, and risks that weren't always adequately priced for, has put pressure on most lines of business. Alongside this, there have been other challenges such as increased frequency in natural hazard events impacting physical risks, not only from a very active hurricane season but also as a result of increasing losses from events that include tornado, hail, flooding and wildfires.


Sierra Signorelli

There have also been the 'non-traditional' losses in 2020, namely Covid-19 and the US riots, which are estimated at approximately $50bn, (according to analysts at investment bank Berenberg in February 2021) and $2bn (https://www.weforum.org/agenda/2021/02/2020-protests-changed-insurance-forever) respectively. And with depressed returns from investment income for an extended period, there is little ability to make up for unfavourable loss ratios. The combination of all these factors made a hardening market inevitable, but some classes and regions are experiencing much greater levels of adjustment than others.

Charlie Kitson: There is no doubt that the market remains hard, especially for multinational companies with the more complex risk profiles, which are striving to secure a similar breadth of coverage to what they have been used to. Risk managers continue to find that terms and conditions are more restrictive, deductibles are under more pressure and pricing has seen significant increases in some cases. However, the encouraging news for risk managers is that there are some signs that the market is becoming 'less hard', albeit not softening at this point.

Risk managers are adapting to the situation. Those faced with big increases in 2020 were often scrambling to react but they are now being more strategic and working more proactively to weigh up their options and manage expectations internally. This year, more buyers are looking at alternative ways to structure their programmes and, in several cases, at their distribution. This has presented opportunities for a broader range of brokers, who are now being given new opportunities to test the market on individual lines for challenging placements, for example on D&O and property risks.

Reto Collenberg: The global insurance market has clearly changed since last year, as the market has continued to harden during 2020 in the face of many years of unprofitability/poor returns on capital. Clients are facing tougher pricing and the tightening up of terms and conditions as insurers exit certain lines of business because they can't foresee a sustainable return on their capital in the short to medium term. The consensus view is that this will continue into 2021.

Peter Knaus: What we're seeing so far in 2021 is in line with what the market saw last year. On the property side, we're still very much in a hard market environment, with – still – double-digit rate increases, lower cat limits and higher client retentions. For casualty programmes, the picture is a little more nuanced. For the larger European companies, the market remains hard, with increases around the 10% mark with a focus on limit management; but the middle-market segment remains more competitive, which is driven by local carriers.

Which lines are the most distressed in terms of rates and terms and conditions?

Reto Collenberg: While the market is increasing in general, there are naturally different dynamics within each line. Property is clearly a line of business in which we observe the hard market. In particular, high-hazard occupancies are experiencing significant double-digit rate increases. Furthermore, customers with considerable exposures to natural catastrophes are requested to pay more for insurance coverage. Executive risk is seeing the hardest market conditions in 20 years. The rise in US securities class actions and broadened director duties generally have led to disproportionate claims activity, necessitating substantial rating correction. Casualty is seeing steady but less severe rate increases, ranging from 10% on some smaller cases to 25% on larger corporate risks.

Peter Knaus

Peter Knaus: For property, we're seeing a reduction in capacity across the board. For casualty, claims in the automotive industry and large exposures, especially for US risks, are clearly driving rate increases and changes in terms and conditions.

Sierra Signorelli: Some lines are particularly stressed, such as D&O for example, where we have seen event-driven litigation and an increasing number of security class actions.

Charlie Kitson: The challenges in the D&O and – to a growing extent – cyber lines, have been well documented and are likely to persist for some time. However, it is also important not to lose sight of what's been happening in the property market. Insurance industry losses from natural catastrophes and man-made disasters globally amounted to $83bn in 2020, according to Swiss Re. That makes it the fifth-costliest year for the industry on record. With the frequency and severity of nat cat events, the balance between exposure and pricing is still not yet there.

> "For the larger European companies, the market remains hard, with increases around the 10% mark"
> *Peter Knaus*

Meanwhile, some of the larger insurers that had struggled for a number of years to run a profitable property book have withdrawn from the market. This reduction in capacity, combined with the high level of losses, has driven down capacity – leading to pressure on pricing and the limits that insurers are prepared to offer.

Are certain territories seeing harder market conditions than others or is it universal?

Sierra Signorelli: Some markets, like the US, started experiencing the hardening market earlier and are therefore firmly in a hard market for most lines of business. Hardening then followed in the UK and subsequently in continental Europe. But even within Europe, there is a differentiation according to geography, and by product and market segment.

Peter Knaus: European markets aren't seeing rate increases as dramatic as the UK and US markets, especially for property. That being said, the hardening of the market can be felt across Europe for property but is starker for casualty in France and Germany, where clients have larger international exposures.

Reto Collenberg: Across Europe, all countries are experiencing double-digit rate increases. When dealing with international programmes, the broader global aspects are critical to consider. For example, any US exposure on casualty or executive deals leads to more severe rate increases. London market executive risk deals exposed to US/ASX listings or side-C coverage have shown the most severe increases.

Is capacity an issue or are there signs of new capacity entering the markets?

Charlie Kitson: With insurers looking to restore the balance between exposure and pricing adequacy, brokers are struggling to fill towers, for example for some D&O and cyber risks. However, as there is a broad awareness that we are operating in a challenging market, this is translating into more realistic expectations from brokers now than this time last year.

There are signs of new capacity entering the market – alongside existing capacity which is starting to look for growth – including in the form of MGAs and startups, and it will be for clients, risk managers and brokers to assess that capacity and the role such capacity plays as programmes are designed together.

Reto Collenberg: Capacity remains an issue, yet of course the market doesn't sit still. Brokers work hard to provide customers with the capacity needed and explore different options. In general, we see the major carriers still bringing down exposure by reducing line size. We do not see new carriers aggressively entering the market, nor do we see pure opportunistic capacity at this stage. We believe there is a desire and demand for stability, therefore the purchasing side has clear expectations on the nature and quality of capacity. At the same time, there is disappointment from the customers with some hard market behaviour, as well as the need to complete the required capacity.


Reto Collenberg

> **"We believe there is a desire and demand for stability, therefore the purchasing side has clear expectations on the nature and quality of capacity"**
> *Reto Collenberg*

Sierra Signorelli: For certain risks we are now seeing a lack of capacity, or less capacity than in prior years. There is new capacity coming in, but these new entrants are generally dipping a toe in by participating in excess layers rather than providing primary products and services.

Peter Knaus: Capacity is definitely sparser than it has previously been, particularly for multinational clients with high cat and CBI exposures. The major carriers are reducing capacities and, so far, there doesn't seem to be new capacity entering the market, especially for those multinational clients with larger exposures. We should probably expect newcomers to enter some European markets over time to try to fill the gap, but the impact on international programmes would be limited.

Are customers looking at greater use of their captives? Are they looking at other alternative solutions?

Sierra Signorelli: A major concern for customers has been securing the capacity they need at an acceptable price. Customers are responding to the changed market conditions in a variety of ways, from starting renewal discussions early,

to retaining more risk through deductibles and co-insurance, and looking at alternative ways to transfer risk. We see our captive customers, for example, evaluating their options to retain more risk and looking at innovative solutions like combining life and non-life risks into one captive, taking an holistic approach to risk.

Brian McNamara: Given the current hard market, global companies are assuming larger retentions within their captives on the traditional P&C lines of business. They are also placing additional lines of coverage in their captive such as cyber, E&O and D&O (side B and C). There has also been an increase in new captive formations and brokers report an increasing number of requests from their clients for captive feasibility studies, and the use of cell captives has also increased.

In terms of alternative solutions to their risk financing requirements, companies are increasingly utilising structured insurance programmes – tailored solutions, designed to respond to a company's particular risk management needs. The multi-year and/or multi-line nature of these solutions means the client is able to manage the volatility emanating from partially retained risks efficiently over longer periods.

Charlie Kitson: In any hard market, in the face of rising prices for insurance, risk managers will consider alternative methods of risk transfer. Recent reports have suggested that the use of captives is on the rise, but our experience suggests that it is less a case of the formation of large numbers of new captives but rather a shift in how risk managers are looking to use their existing captives.

For example, they may now be more willing to consider placing some risks into their captive that they wouldn't have done previously, as they may now be struggling to place these risks in the open market, or they have been advised that it would be easier to get insurance on other risks if certain ones were taken into their captive.

Reto Collenberg: We are seeing a lot of current captive owners considering higher risk retentions in their captives, whether for the traditional lines (property, marine, casualty,) or for new lines such as cyber, D&O, credit or NDBI. That often comes with a need for additional captive capitalisation or capital protection by way of stop-loss reinsurance.

Customers who do not (yet) have a captive are looking for other risk retention vehicles to achieve the same risk financing strategy without the same

Charlie Kitson

need for capitalisation and setup efforts, such as cell captives or virtual captives. We expect the demand for these structures to remain high over a longer period and are continuously developing solutions to better address that need for our customers.

Peter Knaus: Clients with existing captives tend to increase their retentions and an increasing number of clients are looking into setting up a captive to outweigh some of the market trends impacting their property coverage. In addition, some of our climate-dependent clients with already sophisticated risk management strategies are investigating combining traditional direct insurance and/or the use of captives with parametric solutions.

> **"It is less a case of the formation of large numbers of new captives but rather a shift in how risk managers are looking to use their existing captives"**
> *Charlie Kitson*

Are renewal discussions taking place earlier?

Reto Collenberg: We have definitely observed a change. Especially in the different phases of

Brian McNamara

the hardening market during recent years, 'hard lessons' of the beginning have been learned. Based on this, brokers were better prepared for the renewal process in general during the 2020 renewals. This was demonstrated by an earlier start of renewal discussions, including earlier delivery of submissions.

Customers are learning that timely delivery of more detailed insights on their risks supports a better renewal in hard market conditions. In addition, we have seen an increase in customer contact during the last year, despite the challenging times restricting the ability to meet in person. Of course, there are big differences per line, customer, market segment and broker organisational readiness.


Melanie Windirsch

Charlie Kitson: Insurers need to bring more options to the table and look at how they can best benefit their clients. Part of this is greater transparency around providing solutions. But it is also about early communication; being upfront and having conversations sooner around issues, wordings and capacity.

Early dialogue should avoid last-minute surprises for risk managers. Providing good-quality data is so important, as well as discussing alternative options with their carrier, both in terms of risk transfer and captive solutions.

Melanie Windirsch: Renewal discussions for global programmes are starting earlier, considering the current market developments – this does not automatically result in renewal negotiations being closed earlier. Hence, we need to increasingly focus on and work closer together with brokers and clients to finalise the terms and also define premium allocation earlier, in accordance with local risk and exposure. This is vital for the success of a timely global programme implementation and for achieving the timelines as well as appropriate policy documentation required by customers. This is particularly important in cash-before-cover countries and also in cases where customers require certifications of insurance for the authorities.

Sierra Signorelli: Insurers are looking to support their customers during this challenging time, and open, clear and early communication is critical. Generally speaking, this is a tough market regardless of which side of the table you are sitting at, and early discussions are absolutely necessary. Insurers need to be willing to listen to the customer's needs and propose alternatives that allow them to consider the trade-offs available.

"We need to increasingly focus on and work closer together with brokers and clients to finalise the terms and also define premium allocation earlier"
Melanie Windirsch

Global Risk Manager roundup: Americas

Market remains hard while Brazil allows increased competition

North American commercial P&C market to remain hard

While the North American commercial P&C insurance market looks set to remain hard for the rest of 2021, there is some light at the end of the tunnel for buyers, according to Willis Towers Watson (WTW). The broker said that buyers will continue to face upward pressure on pricing across most lines of business for the remainder of 2021, primarily due to increasing severity of losses that have been the main driver of the hard market.

But it said that after a few year-on-year increases, rates are approaching technical adequacy in some lines and sectors, as new capital has entered the marketplace. WTW said the market has become more orderly and predictable, and as a result, insurance buyers can expect an "ever-so-slight turn for the better and a less difficult marketplace in the months ahead".

It added: "With higher rates attracting new entrants and coaxing some capacity to come off the sidelines, rate increases are beginning to decelerate, or at least stop climbing. It's still a hard market but, to a large degree, the hard/soft market cycle is – or will soon be – proven again."

MGAs double US premium revenue written under delegated authority

A surge in the number of managing general agents (MGA) has doubled US premium revenue written under delegated authority to $44bn in 2019, according to a new report on the sector from AM Best, and recorded an increase of 2% since 2017.

The ratings agency says firmer rates in commercial lines were behind the sector's growth from the second half of 2018, which has been supported by investors in startups as well as capital investments from reinsurers and fronting insurers.

Insurers have turned to MGAs for specialty programme and niche business at a time when insurers have curbed their own risk appetites and exited some lines, Best says.

Coverholders at Lloyd's remain attractive to Lloyd's managing agents, Best notes, particularly for quality specialist risks. However, Best warns that reforms at Lloyd's to improve results could restrict capacity. It adds that it expects the delegated authority model to remain popular, due to it largely avoiding sizeable losses from Covid-19.

Best has also revised its US excess and surplus lines market segment outlook to stable from negative, due to the sector's ongoing ability to successfully navigate the Covid-19 pandemic.

"The excess and surplus lines segment's continued profitability and premium growth signal persistent opportunities for surplus lines carriers to successfully operate," states Best. "Surplus lines carriers have generated consistent underwriting cashflow, experienced stability in claims activity and successfully managed the challenges of the investment market conditions."

It adds that capacity will remain stable and could even expand in the short term.

> "Surplus lines carriers have generated consistent underwriting cashflow"

Brazilian insurance regulation changes to increase competition

Changes to insurance regulation in Brazil, introduced during 2020 by the Superintendencia de Seguros Privados (SUSEP), should help to increase competition in the sector, according to Fitch Ratings.

During the past year, the regulator has published 16 new resolutions and more than 20 SUSEP circulars, amending previous regulations and resolutions – many more than in previous years. Fitch said it views the changes as positive and likely to increase competition, make the market more transparent, reduce costs for companies in the sector and lower prices for consumers.

The ratings agency said there are 120 insurers authorised to operate in Brazil and, according to SUSEP, just 10% of them hold about 80% of the total premiums issued in the market.

Fitch concluded that regulatory initiatives and changes carried out by the regulator should help the sector to resume growth in 2021, in addition to providing healthy competition with greater flexibility and product offerings, legal security and sector development.

10%

OF INSURERS IN BRAZIL HOLD 80% OF THE TOTAL PREMIUMS ISSUED

Global Risk Manager roundup: Asia

Asia sees growing deregulatory measures

A number of deregulatory measures have been undertaken in Asia-Pacific countries in the last few years. Most recently, in March 2021, the Indian parliament approved a bill to increase foreign direct investment in the insurance sector from 49% to 74%, which would allow foreign investors to hold majority stakes in Indian-based insurer for the first time. The move was made on the recommendations of the local regulator, the Insurance Regulatory and Development Authority. The cap was raised from 26% to 49% in 2015.

Also in March 2021, the China Banking and Insurance Regulatory Commission removed the 51% cap on foreign ownership of insurance companies, part of new rules amending the country's regulations relating to foreign-funded insurance companies. China permitted foreign companies to own 100% of domestic life insurers in early 2020.

Indonesia's regulator, meanwhile, allowed foreign investors with an ownership stake of above 80% in a private insurer to maintain their ownership percentage despite additional capital injections.

According to Fitch Ratings, India's proposed relaxing of foreign-ownership caps on insurers, and the listing of the country's largest state-owned insurer, will help the industry attract foreign capital, strengthen solvency and promote competition. The proposals could encourage global insurers to enter the fast-expanding Indian market, said Fitch.

Hong Kong pushed as captive domicile

The Hong Kong Insurance Authority is actively pushing Hong Kong as a captive domicile, with a range of initiatives designed to build Hong Kong into the ideal global domicile for captives, an international risk management centre and a regional (re)insurance hub.

Recent initiatives from the authority include legislative amendments expanding the scope of insurable risks of captives and providing a tax concession at 50% of the profits tax rate for specialty risk insurance and selected insurance brokerage businesses.

The authority said that in the past year, it has formulated a framework for the issuance of insurance-linked securities, and has been planning the establishment of the Hong Kong Specialty Risks Consortium to facilitate deal matching for overseas project risks between captives, mainland enterprises, banks, insurance brokers and specialist (re)insurers for risk management and (re)insurance solutions.

Hong Kong has also recently implemented a group-wide supervision framework, which commenced in March 2021. According to Fitch Ratings, this will improve the capital adequacy of Hong Kong-based insurance groups and will also enable the Insurance Authority of Hong Kong to align its supervisory practices more closely with international standards.

First-quarter price increases in Asia

Insurance pricing in Asia in the first quarter of 2021 increased 8% year over year, down from 11%, according to Marsh's Global Insurance Market Index. The report reveals that pricing in Asia was driven by property insurance and financial and professional lines.

Property insurance pricing across Asia saw the tenth consecutive quarter of increase, although the increase of 10% in the first quarter of 2021 was down from the 16% increase in the fourth quarter of 2020. As for casualty insurance pricing in Asia, Marsh says this remained generally flat, as it has for more than three years.

Financial and professional lines pricing across Asia saw the largest increase observed in several years (+23%) and the eighth consecutive quarter of increase, driven by stringent underwriting guidelines, reduction in capacity and heightened risk selection, particularly from global insurers. The cyber insurance market in Asia faced considerable upward pressure on rates and deductibles, with a reduction in capacity and narrowing of key coverages, with the premium increase up to 50%, on average, across all industries, says Marsh. The broker adds that insurers have also moved pricing in line with global cyber rates, given the perception that rates in Asia historically lagged.

> "The Hong Kong Insurance Authority is actively pushing Hong Kong as a captive domicile"

8%

AVERAGE RATE INCREASE IN ASIA IN Q1 2021 (YOY)

Global Risk Manager roundup: Middle East and Africa

Pandemic, business interruption and cyber incidents are top African risks

The top risks concerning businesses in Africa are pandemic outbreak, business interruption and cyber incidents, according to the *Allianz Risk Barometer 2021*.

The top risk concerning businesses in South Africa is cyber incidents, followed by business interruption and pandemic outbreak. In Nigeria, the top risks concerning businesses the most are pandemic outbreak, cyber incidents, macroeconomic developments and business interruption.

The top risks concerning businesses in Ghana are macroeconomic developments and fire/explosion, followed by business interruption, pandemic outbreak, theft, fraud and corruption, and cyber incidents. Pandemic outbreak is the number one business risk in Kenya, followed by business interruption, market developments, climate change/increasing volatility of weather and cyber incidents. The top risks concerning businesses in Cameroon are business interruption followed by theft, fraud and corruption, fire/explosion, and pandemic outbreak.

Growing interest in captives in GCC

There is growing interest in captives in the Gulf Cooperation Council (GCC) region, with growing enquiries about setting up captives. The Dubai International Financial Centre has published rules for the regulation of captives, which AM Best said have made it an attractive domicile, through applying rule waivers and rule modifications.

A recent consultation paper stated that the rule waivers and rule modifications that had already been applied during the last 15 years or so should be formalised in the rulebook. Best said the new regulations will make it far clearer for potential captive owners and are more in line with other, more-established domiciles.

Best also noted that the UAE and the GCC have applied VAT on insurance premiums as well as reinsurance premiums. International reinsurance premiums are normally tax-exempt and this has caused a number of challenges. Overall, VAT is not a cost to the business or the captive, but the latter becomes a sort of tax collector and this causes an extra layer of administration, said Best.

GCC facing pricing pressure

A "perfect storm for lingering pricing pressure" may be looming on the horizon for insurers in the GCC. The region's insurance markets are fiercely competitive and premium rate adequacy has been a concern for some time, according to AM Best.

It noted that certain regulators have taken steps to support price adequacy in recent years. For example, Saudi Arabia implemented technical pricing requirements and the authorities in the UAE introduced minimum tariffs on highly competitive classes of business, including motor business.

More robust regulatory frameworks have developed in all GCC markets, although regulatory standards vary across the region, according to Best. For example, there is the recent introduction of more stringent regulatory requirements in countries such as Saudi Arabia, the UAE and Qatar, which have prompted companies in these markets to implement more robust risk management and governance frameworks. Kuwait has begun to take steps to enhance supervision of insurers with the introduction of a new insurance law.

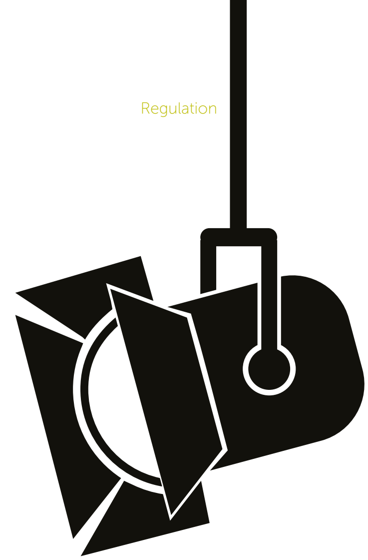
Liability capacity launched for Africa

Africa Specialty Risks (ASR) has launched liability capacity with the appointment of Martin Boreham as head of liability underwriting. The pan-Africa-focused reinsurance group will specialise in offering solutions cover across a number of lines including liability, professional indemnity, D&O and financial.

ASR will offer tailored liability insurance throughout Africa across a wide range of industries. "The liability division will write products proportionally or non-proportionally and is looking forward to working with and writing risks for well-managed and presented businesses that have a strong risk management ethos," said ASR.

ASR was launched by Helios Investment Partners with Mikir Shah, former CEO of AXA Africa Specialty Risks, and Bryan Howett, former CEO of Old Mutual's pan-African reinsurance operations.

"The UAE and the GCC have applied VAT on insurance premiums as well as reinsurance premiums"



Spotlight on regulation

No UK-EU financial services agreement, says UK chancellor

An equivalence deal on financial services equivalence with the EU has simply "not happened", according to UK Chancellor Rishi Sunak, so his government is "moving forward" without sealing an agreement.

In a Mansion House speech, Mr Sunak said the UK hasn't achieved its "ambition" to be granted equivalence with EU rules, which would make it easier for its financial services firms, including insurers, to access business in Europe and vice versa. Instead, Mr Sunak said the UK "now has the freedom to do things differently and better", and added he intends to intends "to use it fully".

But he suggested the UK won't diverge too much from EU regulatory standards. "The EU will never have cause to deny the UK access because of poor regulatory standards," he said. "The UK has an abiding interest in a prosperous and productive Europe."

Without equivalence, the UK and EU will work together on questions of global finance but the UK will set its own priorities, Mr Sunak told the Mansion House audience.

A "sweeping set of reforms" is on the agenda during the next few years to drive the UK's competitive position in financial services through both regulation and tax, Mr Sunak said.

Beware rising protectionism affecting insurance regs post-Covid

Experts have warned that rising protectionism is making cross-border insurance more difficult and the problem is only likely to get worse in the short to medium term following the pandemic, further undoing gains from past trade liberalisation.

Experts have pointed to increased or more onerous anti-money laundering and 'know your customer' requests, for example in China and CIMA countries. In addition, there has been an increase in local tariffs affecting local policies in certain territories such as India. There has also been an introduction of cash-before-cover requirements in countries like Kenya, as well greater focus on local retentions, with Korea introducing such recommendations this year.

Trade agreements the future for DIC/DIL

Discussions with the International Association of Insurance Supervisors on the value of DIC/DIL covers and the need to accept them as part of their insurance regulations have struggled to gain traction. But it seems there is another potential solution on the cards, according to risk and insurance experts – getting insurance regulations, including DIC/DIL arrangements, on the table in a growing number of bilateral or regional trade agreements taking place around the world.

Multilateralism has been replaced by a focus on bilateral or regional trade agreements, and these are showing signs of hope for buyers of cross-border insurance. US risk management association RIMS, for example, has successfully lobbied its government to include DIC/DIL in future trade agreements. The UK and Switzerland recently issued an encouraging joint statement pointing towards an improved cross-border market for services in the areas of banking and insurance, particularly for wholesale and sophisticated clients.

And Airmic in the UK is now lobbying its government to consider DIC/DIL acceptance in any post-Brexit agreements with countries like the US and Switzerland.

"Multilateralism has been replaced by a focus on bilateral or regional trade agreements, and these are showing signs of hope for buyers of cross-border insurance"

Changes to VAT rules in EU?

Could there be a change to the current VAT rules for financial and insurance services in the EU? The European Commission is undertaking a review of VAT rules for financial and insurance services, and said: "Current VAT rules for financial and insurance services are criticised for being complex, difficult to apply and not having kept pace with the development of new services in the sector."

It went on to say: "This seems to have led to a lack of VAT neutrality (businesses being unable to reclaim VAT associated with financial and insurance services), legal uncertainty for businesses, and high administrative and regulatory costs."

Insurance Europe said the VAT Directive is outdated and not correctly applicable to modern financial services, and has called for the directive to be reformed. Insurance Europe said the directive puts the sector at a disadvantage compared to other sectors and it should be reformed to reduce hidden VAT and to increase the possibilities for VAT to be reclaimed by financial companies in general, and insurers in particular.

GlobalRiskManager
MULTINATIONAL & SPECIALTY **INSURANCE** PERSPECTIVES

ISSUE 001 | **SUMMER 2021**