MARKET NEWS, DATA AND INSIGHT ALL DAY, EVERY DAY

TUESDAY 10 JUNE 2014

ISSUE 4,121

insuranceday

www.insuranceday.com

Charman reiterates call for engagement from Aspen board after launching exchange offer

p3

Big Interview: Hugh Wynn-Williams on challenges for the UK P&I Club

p6-7

UK motor market returns to underwriting profit

p2

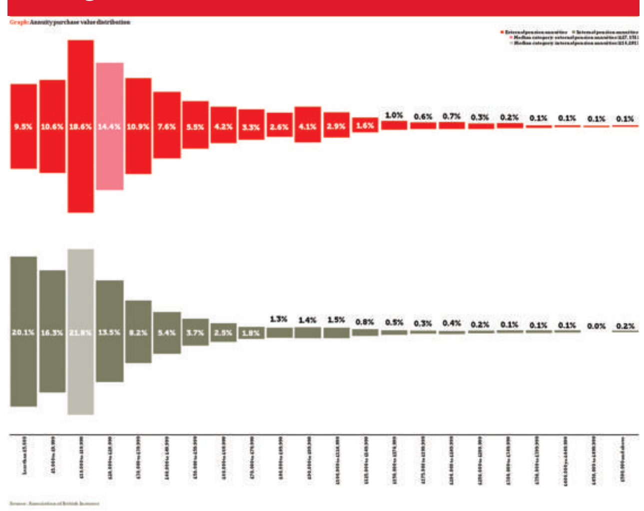
Companies House

Underwriting profit buoys US market in 2013 p8-11

World Loss Intelligence

Black Forest fire losses rise to $420.5m p12

Insight



UK annuities reform: not all doom and gloom p4-5

NEWS

insuranceday
www.insuranceday.com

Market news, data and insight all day, everyday
Insurance Day is the world's only daily newspaper for the international insurance and reinsurance and risk industries. Its primary focus is on the London market and what affects it, concentrating on the key areas of catastrophe, property and marine, aviation and transportation. It is available in print, PDF, mobile and online versions and is read by more than 10,000 people in more than 70 countries worldwide.

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

Insurance Day also produces a number of must-attend annual events to complement its daily output. The London and Bermuda summits are exclusive networking conferences for senior executives; meanwhile, the London Market Awards recognise and celebrate the very best in the industry. The new Insurance Technology Congress provides a unique focus on how IT is helping to transform the London market.

For more detail on Insurance Day and how to subscribe or attend its events, go to subscribe.insuranceday.com

Insurance Day, Christchurch Court, 10-15 Newgate Street, London EC1A 7HD

Editor: Michael Faulkner
+44 (0)20 7017 7084
michael.faulkner@informa.com

Editor, news services: Scott Vincent
+44 (0)20 7017 4131
scott.vincent@informa.com

Deputy editor: Sophie Roberts
+44 (0)20 7551 9906
sophie.roberts@informa.com

Global markets editor: Graham Village
+44 (0)20 7017 4020
graham.village@informa.com

Global markets editor: Rasaad Jamie
+44 (0)20 7017 4103
rasaad.jamie@informa.com

Reporter: Alexis Burris
+44 (0)20 7017 4252
alexis.burris@informa.com

Publisher: Karen Beynon +44 (0)20 8447 6953
Sales director: Mark Windsor +44 (0)20 8447 5266
Advertising director: Andrew Stone +44 (0)20 7017 4027
Sponsorship manager: Benali Hamdache +44 (0)20 7017 7999
Marketing manager: Randeep Panesar +44 (0)20 3377 3809
Subscriptions key account manager: Carl Josey +44 (0)20 7017 7952
Head of production: Liz Lewis +44 (0)20 7017 7389
Production editor: Toby Huntington +44 (0)20 7017 5705
Subeditor: Jessica Sewell +44 (0)20 7017 5161
Production executive: Claire Banks +44 (0)20 7017 5821
Events manager: Natalia Kay +44 (0)20 7017 5173

Editorial fax: +44 (0)20 7017 4554
Display/classified advertising fax: +44 (0)20 7017 4554
Subscriptions fax: +44 (0)20 7017 4097

All staff email: firstname.lastname@informa.com

ISSN 1461-5541. Registered as a newspaper at the Post Office. Published in London by Informa UK Ltd, Mortimer House, 37/41 Mortimer Street, London, W1T 3JH

Printed by St Clement's Press, Unit 16, Bow Industrial Park, Carpenters Road, London E15 2DZ

UK motor market returns to underwriting profit

Michael Faulkner
Editor

The UK motor market has made an underwriting profit for the first time in 20 years, according to analysis by consultancy Ernst & Young (EY).

The year-end results of the majority of listed insurers indicates the net combined ratio (NCR) is going to be 98.5%.

This is a 3.9 percentage point improvement year-on-year since 2012 and the strongest underwriting performance since 1994.

But the analysis also showed reserve releases are increasing, and since 2010 have risen by 7.8 percentage points.

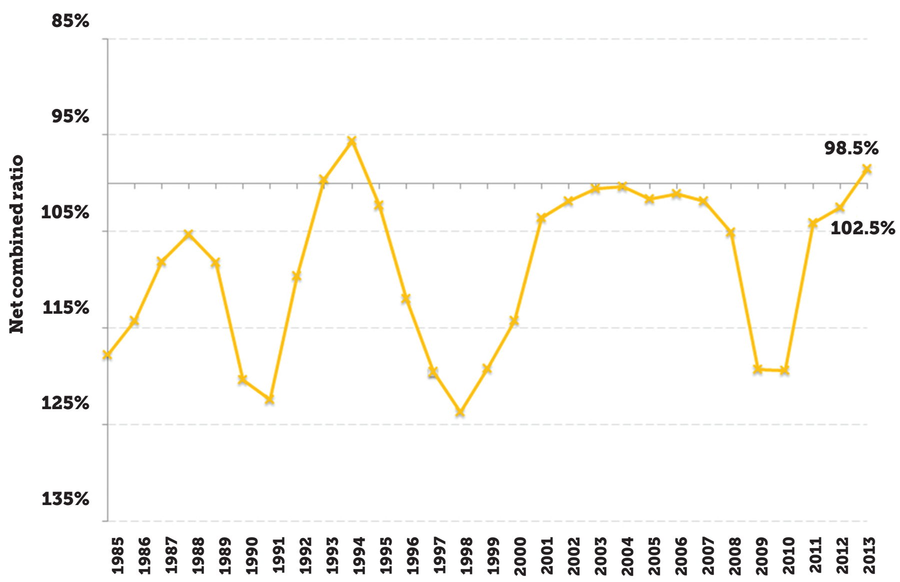
Without reserve releases, the COR for the industry for 2013 is 105.7%.

EY said this activity mirrors the pattern seen in the mid-noughties, where they peaked at 12.8% in 2007 before falling to below 0% in 2010.

Catherine Barton, head of retail property and casualty actuarial, Europe, the Middle East, India and Africa at EY, said: "Given the size of reserve releases this year, [the result] may not be the turning point and cause for celebration the industry is eager for.

"The question remains – are strong reserve releases simply masking true performance in the same way they did in the mid-noughties, and is profitability set to mirror the 2009 fall when reserve releases inevitably deplete?"

Chart: UK motor market underwriting performance



Source: Ernst & Young

Reserve releases are the actuarial equivalent of using a pair of tights to replace a broken fan belt

The UK motor market's underwriting profit in 2013 is on the face of it good news for a sector that has languished in unprofitability for the past 19 years, *writes Michael Faulkner*.

But do not open the best champagne yet: the market's return to profitability is likely to be short-lived.

Continued softening in motor premiums, coupled with rising claims costs are expected to push the market's combined operating ratio back above 100% in 2014, Ernst & Young (E&Y) estimates.

Only a record-breaking reserve release – greater than 12.8% released in 2007 – would be sufficient to keep the market's underwriting performance in the black, E&Y's analysis indicates.

That level is a great deal more than the industry had to release in 2013 to achieve a profit.

Insurers face two major problems. The first is the continued fall in motor premium rates. The AA reported car insurance premiums had reached their lowest level in three years at the end of the first quarter of this year – 16.6% lower than the same period in 2013.

Soaring claims costs due to rising claims numbers and injury costs are also adding to the market's woes.

Legal reforms introduced by the Ministry of Justice to curb organised attempts at whiplash injury fraud, coupled with better fraud detection measures by insurers, have had little impact on delivering any significant reduction in the number and value of personal injury claims, AA Insurance says.

Reserve releases are the actuarial equivalent of using a pair of tights as to replace a broken fan belt. It may provide a quick fix, but it fails to provide a long-term solution.

If the UK's motor sector is going to make a sustainable underwriting profit, fundamental issues need to be resolved.

NEWS

Charman reiterates call for engagement from Aspen board after launching exchange offer

Offers Aspens shareholders cash and Endurance shares in next stage of aggressive acquisition bid

Scott Vincent
Editor, news services

John Charman has reiterated his call for Aspen's board and management to engage in discussions about Endurance's increased acquisition proposal after launching an exchange offer to acquire all Aspen's shares.

The offer will give each Aspen shareholder the opportunity to receive cash, Endurance shares or a mixture of both at a value of $49.50 for each Aspen share.

Aspen has responded by saying it will review the exchange offer and advise shareholders of its recommendations within the next 10 business days.

"We again call on Aspen's board and management to act in the best interests of Aspen's shareholders by engaging with us in constructive discussions regarding our increased proposal and to cease with their rhetoric and entrenchment"

John Charman
Endurance

The offer is the latest in a series of moves by Endurance to push through the deal.

Charman said: "The commencement of the exchange offer further demonstrates our full commitment to a transaction with Aspen and provides an additional mechanism for shareholders to support the consummation of this very compelling combination.

"We again call on Aspen's board and management to act in the best interests of Aspen's shareholders by engaging with us in constructive discussions regarding our increased proposal and to cease with their rhetoric and entrenchment."

Endurance made public its latest bid to acquire Aspen on June 2, when it also filed a statement with the Securities and Exchange Commission seeking support from Aspen's common shareholders to convene a special general meeting at which a proposal will be considered to increase the size of Aspen's board from 12 to 19 members.

This would mean the majority of Aspen's directions would stand for election at Aspen's 2015 annual general meeting.

This would enable Aspen shareholders to hold board members to account and replace a majority of the Aspen board, Endurance said.

The statement also seeks support from Aspen's shareholders for a scheme of arrangement by Endurance, which if approved would see Endurance acquire all of Aspen's outstanding common shares.

When the latest bid was made public on June 2, Charman said shareholders of Aspen and Endurance had indicated "overwhelming support" for the proposed merger, but as the Aspen board had "stubbornly refused to engage", it was now time to take a new approach.

Endurance had communicated its increased offer to Aspen's board on May 7 but this was subsequently rejected.

LMA's David Gittings joins XIS board

David Gittings, chief executive of the Lloyd's Market Association (LMA), has joined the board of Xchanging Insurance Services (XIS) in a move that complements the service provider's electronic placement platform initiative, *writes Sophie Roberts.*

Gittings joins the board to replace Ewen Gilmour, who will step down after four-and-a-half years in the post.

He joins XIS as a non-executive board member alongside David Matcham, chief executive of International Underwriting Association, Sean McGovern, general counsel at Lloyd's, and Barnabas Hurst-Bannister, chairman of Xchanging's board.

In addition, Bev Stone, operations director for UK insurance at

Xchanging, has joined the board and will replace Rob Myers as he takes on the role of global director of operations at Xchanging.

"We are delighted to welcome both [Stone] and [Gittings] to the board of XIS and look forward to working closely with them both. [Gittings'] appointment is especially important as it will help us to better understand the expectations and ambitions of our core customer base," Richard Bucknall, chairman of the XIS board, said.

Xchanging recently facilitated its first electronic risk placement involving Lloyd's broker Howard Global and XL Group's insurance operations. The e-placement, using Xchanging's Placing Platform (XPP), was for a bloodstock risk.

Equinox Global opens office in the Netherlands

Equinox Global has appointed Frank Masteling as head of its new Netherlands operations, *writes Scott Vincent.*

The trade credit coverholder said the new office will allow the company a more flexible approach to operating in the Dutch market.

Masteling has joined from Atradius, where he was head of special products for northern Europe.

He previously spent around a decade at Rabobank, where he focused on credit analysis and risk management.

"The Netherlands is an interesting and unique market which offers exciting opportunities for a specialist trade credit insurance company"

Mike Holley
Equinox Global

"The Netherlands is an interesting and unique market which offers exciting opportunities for a specialist trade credit insurance company," said Mike Holley, chief executive of Equinox Global.

"The new office will allow Equinox to bring the benefits of bespoke, client orientated, specialist trade credit products and a more flexible approach to doing business in the Dutch market."

INSIGHT

UK annuities reform: not all doom

Although the markets have corrected themselves since the chancellor of the Exchequer's pensions announcement, the impact is a wake-up call to traditional providers as to the scale and pace of business transformation required

Andy Masters
KPMG

The greatest risk here is the changes that have been made undermine a core government objective, delivered through the pensions reform, to create a savings culture. People may now see the availability of a cash-only option at retirement as an opportunity to engage in a one-off binge of consumption, which would ultimately place the long-term care burden back on the state

Market commentary following George Osborne's budget announcement to reform the UK pensions market has predominately focused on the negative impact for the industry.

However, when we consider this in light of the wave of changes that have been announced in recent months, including capping charges on schemes and auditing of older-style pensions, the reality is there is a mix of both opportunities and threats for providers.

The impact of all the changes should be to the customer's benefit. Some of the changes redress several of the unintended consequences created post-retail distribution review (RDR), especially for the mass market. However, there are also plenty of potential pitfalls that could result in poor outcomes for customers.

The Australian experience

Suddenly being able to take small pension pots as tax-free cash or an entire pot as cash, clearly transfers greater financial control to the individual. But in light of this, one could ask the question: is the transfer of the risk of making the right choices providing a healthy income through retirement?

The greatest risk here is the changes that have been made undermine a core government objective, delivered through the pensions reform, to create a savings culture. People may now see the availability of a cash-only option at retirement as an opportunity to engage in a one-off binge of consumption, which would ultimately place the long-term care burden back on the state.

Fortunately, however, the Australian experience when a similar reform was introduced suggests the majority of customers do not buy a Lamborghini and in fact continue to invest in more conservative assets. Most roll into vanilla-managed funds with broad, balanced mandates that move to increasingly conservative options as they come closer to retirement.

It has been well documented - as a result of the RDR - paid-for advice has become the preserve of the wealthy, with the mass market left to its own devices. Conscious of this (and the risk of an Italian supercar boom) the chancellor of the Exchequer also announced the right to "free, impartial face-to-face guidance at the point of retirement".

At present, "guaranteed guidance" is still being defined by the industry via the Association of British Insurers (ABI) and the regulator, as well as HM Treasury. However, given the short timescale for this to become operational, we can expect any guidance will be limited in scope and will fall short of addressing what comes before and after the point of retirement. Changing attitudes to these aspects of financial awareness will require further action and only time will tell what the best solution will be.

Customer apathy, increased awareness of options and a lack of product innovation and choice means in the short term there will be little change for all but those with the smallest pots. These small pots could in theory make use of "pot follows member", which has the aim of consolidating smaller pots to provide a better financial deal, both in terms of the charges during asset accumulation and at the point of decumulation.

However, the changes mean an individual can take up to three pots with a combined value of £30,000 ($50,378) out as cash, providing no one pot is bigger than £10,000. Given the bulk of pension pots that fall within this range, we can certainly expect this mass market to cash in, albeit with little chance of a Lamborghini.

For the rest of the market, we predict customer outcomes will improve over the next five to 10 years, undoubtedly providing some relief to annuity providers in the short term. This will be driven by the credibility of guaranteed guidance, the potential for customers to adopt accessible non-advised, technology-based solutions, as well as increased appetite from high street banks to engage in long-term accumulation and decumulation themselves.

The provider's perspective

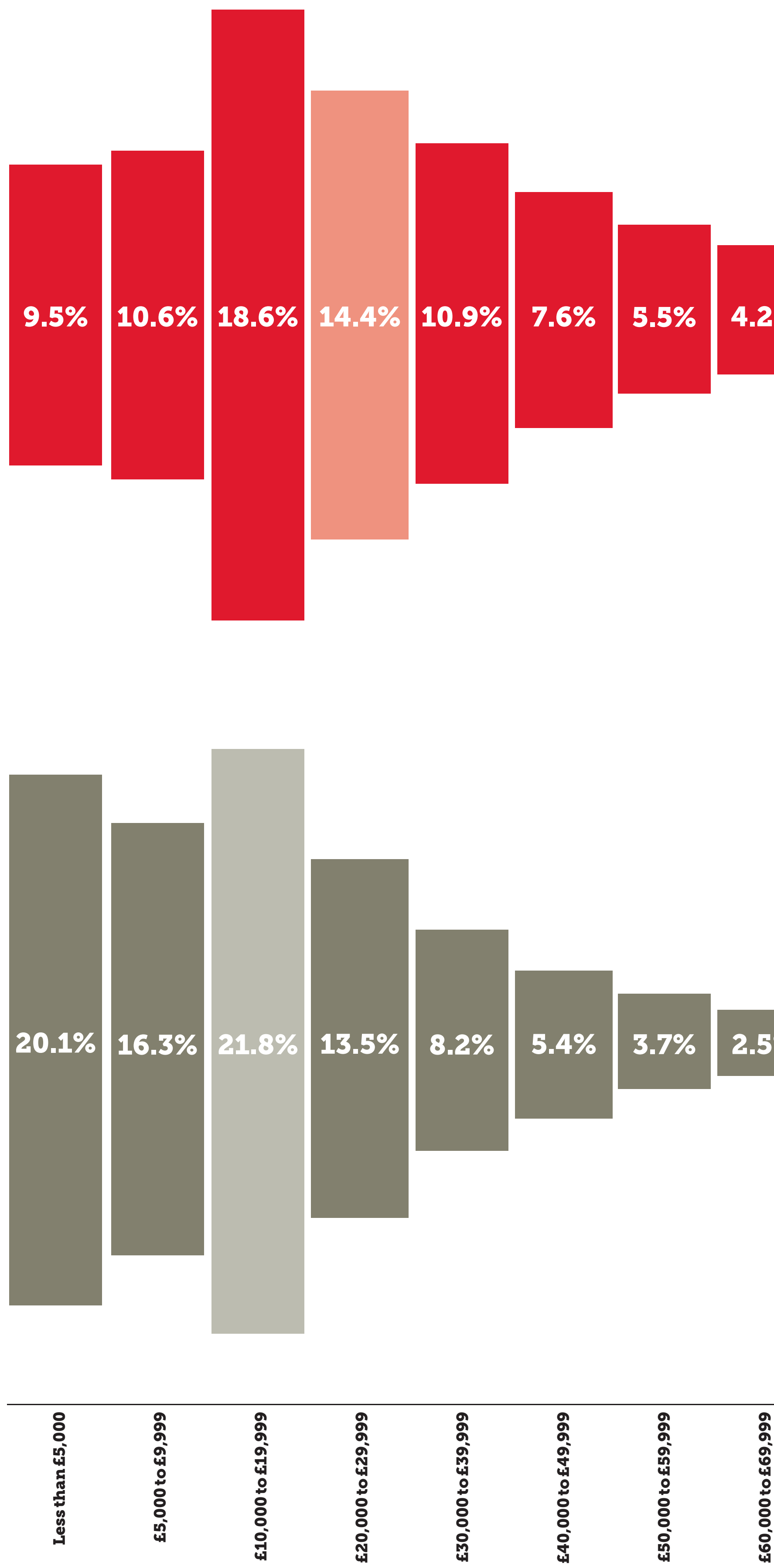
From a provider's perspective, there is no doubt there will be change in the annuities market; the question is by how much and at what pace.

The total value of annuity premiums was £11.9bn in 2013, according to the ABI, a significant proportion of revenue for many of those writing the business.

Hanging on to all but the smallest pots via annuities in the short term buys the industry some time to innovate and capitalise on the opportunities presented by these changes. Returning to Australia, the annuities market has died a slow death over the past 30 years following similar changes. Few lifetime annuities are now sold, replaced with mainly fixed-term or allocated pensions where the investor still bears all the investment risk.

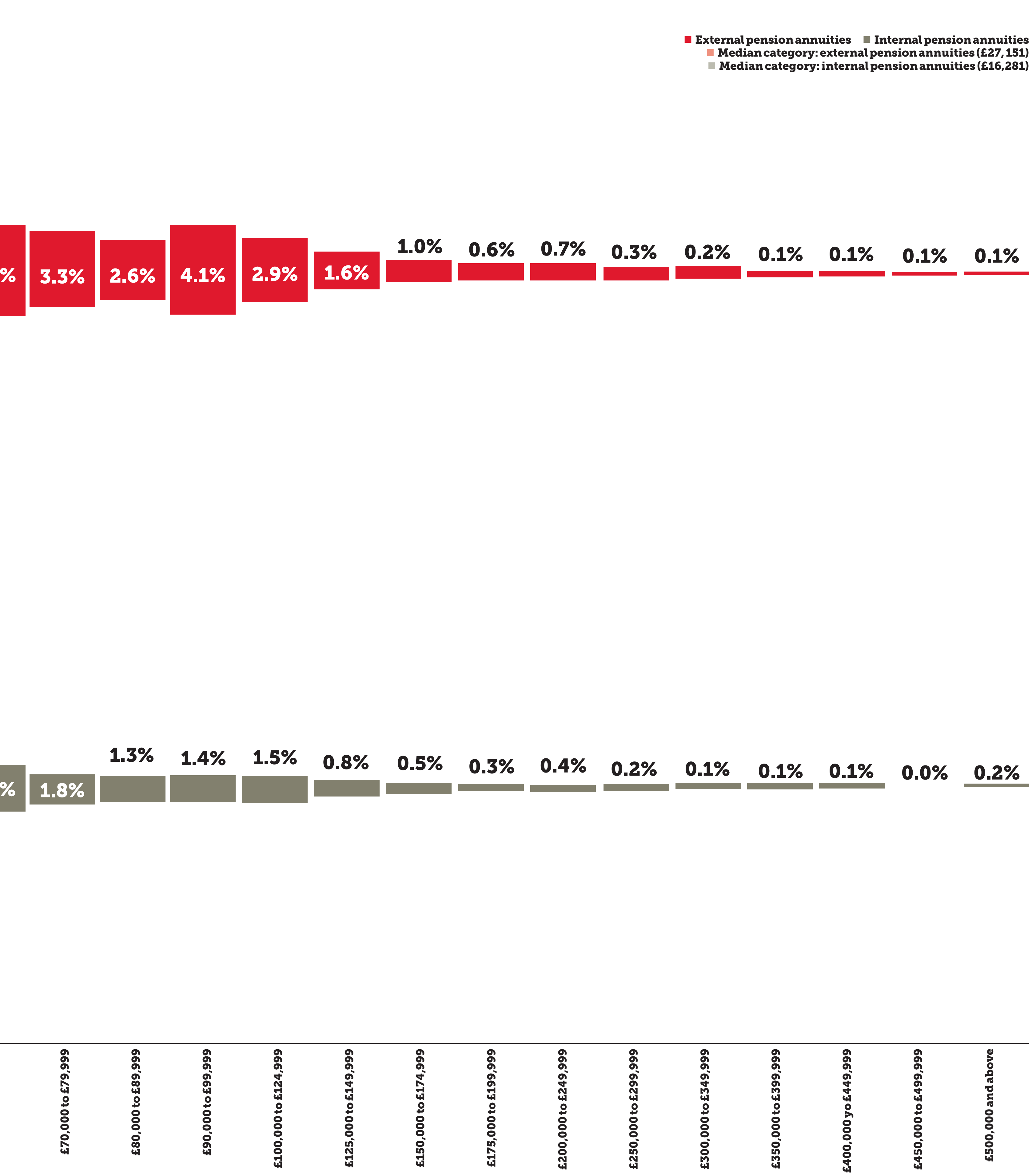
However, when we look at the UK market, there are four distinct

Graph: Annuity purchase value distribution



Source: Association of British Insurers

and gloom



segments where the impact of the reform will vary.

Pure open market option providers will see the most impaired level of their businesses affected; however, we expect the overall impact will be lower than predicted. The key for such providers will be the development of simpler, cost-effective and relevant solutions.

Large open market option players with vesting books are among the potential winners as they are best placed to maximise accumulation potential and offer decumulation solutions. Hence it is fundamental that accumulation and retirement business units work together to develop co-ordinated solutions across all savings products, not limited only to pensions.

Small to medium-sized vesting providers have already exited the manufacture end of the value chain, with others waiting for the Financial Conduct Authority review. Most of these companies are likely to be seeking a partner that can solve the operational challenges presented by the reform.

On the other hand, large vesting-only providers already have the vesting assets, so the key will be the extent to which they can develop propositions to continue saving or decumulate. The question here will be whether providers can take advantage of a longer deferral period through increased value-in-force, which may be greater than annuity profit on small to medium funds.

Winners and losers

The immediate winners from the chancellor's budget announcements were technology-enabled asset-accumulation businesses, offering transparent charging structures and ready access to customers, unencumbered by legacy processes.

Although the markets have corrected themselves since the announcement, the impact is a wake-up call to traditional providers as to the scale and pace of business transformation required. Success will be defined by a number of different factors, which include:

- Businesses should engage with their customers throughout their lifetime to retain more savings for longer;
- Technology must play a role, responding to customer demand in a way that is easy to use and readily accessible;
- Guidance and self-service should be promoted at every possible opportunity; and
- Providers must innovate their products, ideally creating a self-managed solution that protects through new-style guarantees and reviews lifestyle trends.

Clearly life insurers have a lot of work to do as a result of the reform. It is imperative for the life industry to engage constructively in the debate to ensure the laudable objectives of offering individuals more flexibility and control are achieved. ■

Andy Masters is an associate partner, advisory at KPMG

BIG INTERVIEW

Buyers' club

The International Group's reinsurance pool has to try to extract the best deal for the shipowners, while at the same time maintaining its relationship with the international reinsurance market for when it needs the higher cover levels, says Hugo Wynn-Williams, chair of the group's reinsurance sub-committee and chief executive of the UK P&I Club

Rasaad Jamie
Global markets editor

The financial year ending February 20 was, to say the least, a pretty eventful period for the UK P&I Club. As was the case for all of the 13 protection and indemnity (P&I) clubs belonging to the International Group (IG), the first six months of last year proved to be the most expensive for the UK P&I Club in terms of the cost of claims than during any other period over the past 15 years. In contrast to the commercial insurance market, the clubs provide P&I insurance to their shipowner members on a mutual basis. In this way, the mutual P&I sector, which also includes a number of other clubs that are not members of the IG, provides insurance cover to 95% of the world's shipping community.

Indeed, the situation was a concern for the UK P&I Club midway through the financial year when it reported a combined ratio of a 113%. However, by the end of the year, the ratio was down to 102% and, with the help of a 4.5% return on invested assets, the club was able to announce a surplus or profit of around $30m for the year as well as a 7% increase in its underlying capital resources to $528m.

To top it all off, in April Standard & Poor's (S&P) upgraded the UK Club's credit and financial strength ratings from an A- rating to a full A (stable) rating. The club's capital base consists of a combination of free reserves (the mutual equivalent of shareholders' funds) and capital raised through a hybrid perpetual bond the club issued in 2008.

Hugo Wynn-Williams, chief executive of the UK P&I Club, says it helped the claims experience was much more favourable for the club during the second half of last year. "First of all, claims activity calmed down considerably in the third quarter, although it did pick up again slightly in the fourth quarter. So it was a still a very expensive year for us, but it was not as bad as it could have been.

"The other thing was our actuaries reported a positive trend in the settlement of a number of larger claims from previous policy years and, as a result of that, we have been able to release some of our claims reserves, which also helped to offset some of the impact of the losses earlier in the year."

He says the outcome of the actuarial exercise not only affects the claims being settled by the club at present, but it also affects the view the club takes of the likely outcome of claims that have not yet been settled. Wynn-Williams is also the chairman of Thomas Miller Holdings, the holding company for the Thomas Miller Group.

Reinsurance

It has been a particularly challenging time for the broader P&I sector on the claims front in recent years. So much so the issue of reinsurance costs has become increasingly urgent for the clubs.

In the 2012 financial year, there were at least three major losses for the sector (the grounding, which resulted in an oil spill, and subsequent break-up of the *MV Rena*; the sinking of the *Costa Concordia;* and the fire on the *MV MSC Flaminia*) which went beyond the P&I Clubs' retention levels and hit the IG pool, forcing it to restructure its excess-of-loss reinsurance programme, thereby leaving clubs with increased reinsurance costs.

To mitigate the impact of the increase imposed by the market, the IG took the decision to increase the excess point on the contract from $70m to $80m, with the additional $10m retained by the group within its captive, Hydra. So within the structure of the pool, losses between $30m and $80m (previously $70m) are now reinsured by Hydra. For losses up to $9m, individual clubs make their own reinsurance arrangements. The first layer of the IG pool stretches from $9m to $45m, a second layer from $45m to $60m (within which there is a claiming club retention of 10%) and a third layer from $60m to $80m (within which there is claiming club retention of 5%).

Wynn-Williams, who chairs the reinsurance sub-committee of the IG, says the committee is always trying to balance getting the best value for the shipowners while at the same time maintaining the long-term relationship and strategic support the international reinsurance market provides to the IG.

"We know if we want the high levels of cover we have to be aware of what is going on lower down. We established the group captive Hydra so we could absorb more risk at the lower end. However, it is not as simple as saying Hydra will do this, because we have 13 P&I clubs, all of whom have a different risk appetite. So between the clubs, we are looking at a compromise and looking at the future of the reinsurance contracts we have in place to try and extract the best deal for shipowners, while maintaining our relationship with the international reinsurance market for when we need them for those high cover levels. There are a lot of moving parts and we have to be aware of all of them."

Beyond the $80m upper pool limit reinsured by Hydra, there are a number of further layers in the IG excess-of-loss reinsurance

Hugo Wynn-Williams on…

Performance in 2013

"First of all, claims activity calmed down considerably in the third quarter, although it did pick up again slightly in the fourth quarter. So it was a still a very expensive year for us, but it was not as bad as it could have been. The other thing was our actuaries reported a positive trend in the settlement of a number of larger claims from previous policy years and, as a result of that, we have been able to release some of our claims reserves, which also helped to offset some of the impact of the losses earlier in the year."

Attritional claims

"When Lehman Brothers collapsed, attritional claim levels came down about 25%. And they have remained down there since. World trade, in terms of the shipping industry, has not picked up as significantly as we expected but, in the background nevertheless, the average cost of claims is going up. In fact, average claims are now 50% more expensive than they were a decade ago. Our premise is at some point the number of claims at less than $500,000 will increase and therefore we will be hit by the higher average costs experienced in more recent years."

Hugo Wynn-Williams CV

Hugo Wynn-Williams joined Thomas Miller in 1978 after successful completion of the Bar finals examination, working initially at the UK P&I and Defence Clubs as a syndicate manager. He was elected to the partnership in 1989.

Wynn-Williams became chief executive of the UK P&I Club in 2004. He was elected chairman of Thomas Miller in 2009 and is chairman of the International Group of P&I Clubs reinsurance sub-committee. He is a former chairman of Dex Lloyd's Agency.

contract to a limit of $3.1bn with Hydra retaining a 30% share up to the $580m layer.

However, according to the UK P&I Club's most recent accounts issued in May of this, during this period of "increasing cost", the club has brought relatively few claims to the IG pool, which has afforded it some protection from the increasing cost of pool claims. According to the accounts, this and other changes to the pool-sharing mechanism, has served to reduce the club's contribution significantly over recent years. In addition, the club has bought reinsurance protection, which will result in significant recoveries on the 2012 and 2013 policy years if those years develop as expected.

Claims management

Despite the dramatic improvement during the second half of the year, 2013 still turned out to be the most expensive year for the UK P&I Club since 2007. According to Wynn-Williams, the increase in claims costs for the club during the first half of 2013, was attributable to the rise in the number of individual claims that cost between $1m and $5m. These claims, he says, fall into a category situated somewhere between the really large claims and attritional claims.

For the UK P&I Club, attritional claims are those costing less than $500,000. These claims, Wynn-Williams says, account for around 80% of the club's total claims volume. The belief within the club is the rise and fall in attritional claim levels is a fairly accurate reflection of the state of the global economy and the state of confidence in the shipping sector.

"When Lehman Brothers collapsed, attritional claim levels came down about 25%. And they have remained down there since. World trade, in terms of the shipping industry, has not picked up as significantly as we expected, but, in the background nevertheless, the average cost of claims is going up. In fact, average claims are now 50% more expensive than they were a decade ago. Our premise is at some point the number of claims at less than $500,000 will increase and therefore we will be hit by the higher average costs experienced in more recent years."

Although 99% of all claims notified to the UK P&I Club are less than $500,000, the remaining 1% – those greater than $500,000 – represent 60% of the total cost of the policy year. "So, if you have a run of large claims, you are going to be much more affected than you are by those claims that are less than $500,000. We invest considerably in our loss prevention services. For the lower-level claims, there is a lot you can do to keep costs down through education programmes and co-operating with members. But when it comes to the small number of larger claims, it is very much more difficult because you are not talking about an easily observable trend.

"The occurrence of events that lead to large claims tend to be more random and less easy to anticipate. Occasionally, you might be able to detect a trend and be in a position to address the underlying causes. With the one-off huge claims, you can try and learn lessons from them, but they are generally more difficult to address in terms of loss prevention."

At the renewals the UK P&I Club turned down 25% of the business that was offered to it. "And that would have been for numerous reasons and not necessarily because ships were in bad condition. The ships might not have been deemed to be in the categories that we are looking for. Almost certainly that business would not have been offered to us by existing members."

The grounding of the MV Rena in 2012 was one of three major marine losses that forced the International Group to restructure its excess-of-loss reinsurance programme

© 2014/Maritime New Zealand/AP

New business, he says, is more often than not scrutinised by the club's ship and membership quality committee, which is largely composed of the shipowner members themselves. "It is part of their role to look at our performance as managers, to ensure we are looking for new business in the right areas. They also deal with any question marks on ship surveys. It is also their role to decide whether it is appropriate to take measures against an existing member or to scrutinise the suitability of new members coming in.

"But is it is one of the curiosities of life in the P&I world there is not a direct correlation between someone who you may subjectively feel is not a good operator and the claims they may potentially bring to the club. The really bad accident can affect the great, the good and the not so good." ■

Capital management

An important factor that contributed to the UK P&I Club producing a $30m surplus for the last financial year, a tough and challenging period for the marine mutual insurance sector, according to Wynn-Williams, is the increased flexibility the perpetual hybrid capital bond provides to the club's investment and asset management strategies, particularly in the present low interest rate environment.

"The point about hybrid capital is it provides additional solvency capital that increases our capital base and our flexibility in terms of the investment options open to us. The way in which solvency capital works from the regulators' point of view, you always have to be aware of the investment market risks. But the stronger your capital base, the more risk you can take. For example, with a low capital base, it is not that easy to make a meaningful investment in equities, which means in the current financial market context, you are very likely to be missing out in terms of investment income.

"Last year, we were able to get a reasonable return out of our investment portfolio. About 4.5%. Had we been out of equities, our return would have been substantially less than that. So with the hybrid capital bond, we were able to enhance the capital of our shipowner members' capital. That is how we see it."

The hybrid bond, which accounts for $98m of the UK Club's total capital of $528m, was issued in 2008, during another challenging period and not only for the P&I sector. Indeed, it was so challenging, the bond did not prevent the club from having to make an additional call for funds from its members during the following year to compensate for negative investment income and an escalation in claims costs.

Wynn-Williams refrained from responding directly to the question as to whether the UK P&I Club shipowner members are among the hybrid capital bond holders. However, he says people likely to buy that kind of bond would be people who understood the credit profile a P&I club represents and, in that regard, they could potentially be P&I club members. By the same token, however, they could also be investment banks or wealth managers familiar with the P&I world.

The subject of capital management is a particularly important one for the UK P&I Club, which, between 2012 and 2013, has reorganised its structure largely in response to Solvency II. The object of the exercise, Wynn-Williams says, was to streamline the governance structure of the club, reduce compliance costs and manage the club's solvency capital requirements more efficiently.

UK Europe now constitutes the direct underwriting entity and issues insurance policies to the vast majority of UK P&I Club members.

"With UK Europe issuing the insurance policies to the members of the UK Club, that enables us to present an entity to our regulators here in the UK, the Prudential Regulatory Authority and the Financial Conduct Authority, which looks more like a normal insurance company board with executive officers, representatives of the shipowners and people, including those with auditing or accounting backgrounds, with specialist risk management backgrounds. People with the necessary qualifications to run a regulated insurance company in the modern business environment.

"The restructuring has also enabled us to bring our company entirely onshore. The enables us to hold the regulatory capital necessary for the business in UK and then to hold any excess capital in Bermuda. So that is how we operate now. The business is written by UK Europe and is reinsured by UK Bermuda."

In terms of service provision to members nothing much has changed, he says. "We are still providing all the services internationally for the UK P&I Club. Effectively, we are running the business as if it were ready for Solvency II. We are also going through the pre-application process for an internal solvency model for the club, which we hope will enable us to employ our capital in the business even more efficiently. Once we have it in place, it will enable us to reduce the capital required to support the business in the UK and Europe and still continue to write the same volume of business."

Underwriting profit buoys US market

US primary insurers have to get used to a softer market, as clients look to exploit the industry's surplus capital and strong performance last year

Graham Village
Global markets editor

Just about every key metric moved in the right direction for the US non-life insurance industry last year, enabling the market to post its best result since the financial crisis struck in 2008. It should come as no surprise, then, that rates are showing signs of coming under pressure as insurers think they can afford to offer price reductions as well as loosening conditions and still make money. Reinsurance is having an impact, with costs down for property-related risks, particularly catastrophe-exposed business, adding further to the downward momentum for rating at the primary level.

Broker Marsh identified distinct rate softening during the first quarter of the year, putting reductions for property accounts at 2.5%, the biggest fall for two-and-a-half years. Large company buyers in the US were offered more capacity than requested, the broker said, forcing risk managers to decide between new and existing insurer relationships. Insurers tried to stabilise rates by offering multi-year policies.

Liability rates were generally stable, although there has been some volatility in line with the insured's experience and risk characteristics. General liability and workers' comp rates ranged from flat to single-digit increases, while motor liability also averaged single-digit rises. Excess liability rates moved from mid-single-digit increases to low single digits, Marsh said.

First-quarter 2014 results

First-quarter figures saw the leading 25 insurers (table 1) reporting a net profit of about $10.8bn, down 7.5% on the comparable period of 2013 but most of the fall was the result of a reduction of 17.6% in investment income.

> **"Recent price increases represent a response to past underwriting losses and recognition underwriting profits are the only viable replacement for falling investment income in the current low-yield environment"**
>
> **Fitch**

Underwriting performance was mixed, with reductions and increases in combined ratio split evenly across those that give a figure. Net premium for the sample was up about 4.5%.

Rating agency Fitch recently maintained a stable rating outlook for the US commercial lines sector, noting last year's improved underwriting performance and continued growth. Net commercial lines premiums increased 3.6%, Fitch said, although that marked a slightly lower growth rate than in 2012. The accident-year loss ratio was nearly five percentage points better, at 67.7%.

Property-related business benefited from the lack of major loss activity and workers' compensation showed improvement, although this class is still operating at an underwriting loss. Medical professional liability is causing most concern as it suffers from weak pricing and deteriorating underwriting results. Commercial motor insurance posted a combined ratio of 106% last year, a single point better than in 2012. The poor performance is the result of years of poor pricing before 2011 and what Fitch described as "an erosion of underwriting standards to retain business in the economic downturn of 2008-09".

Loss ratios for non-life business overall are likely to improve a little this year, Fitch said, on the back of continued (but lower) price rises and modest loss cost growth. The insurance industry often seems to display irrational tendencies but Fitch drew attention to the logic behind recent behaviour: "The current hardening phase of the commercial lines underwriting cycle differs from previous hard markets. Specifically, recent price increases represent a response to past underwriting losses and recognition underwriting profits are the only viable replacement for falling investment income in the current low-yield environment".

AM Best maintained its negative outlook for the commercial lines sector earlier this year owing to uncertainty around loss reserve development and weak profit margins driven by the present low investment yields. For personal lines, the rating agency has a stable outlook, mostly because of the motor line of business, which represents more than 60% of the segment's premium income. Underwriters have made good use of telematics and other driver usage devices and this will become increasingly important for the sector, the rating agency said.

The personal lines sector avoided significant major catastrophic loss last year, AM Best said, and successful underwriters are enhancing the granularity of their pricing models for homeowners' business.

As always, the weather remains a crucial variable that promises to have an impact on insurers this year, whatever happens. If the hurricane season proves benign, once again, property rates are likely to come under further pressure. Major losses will affect the market even more, although reinsurers have provided additional protection at lower cost in an attempt to confront the challenge posed by third-party capital.

The latest forecast from the team at Colorado State University, which has tracked North Atlantic storm activity for many years, is for below-average activity compared with the 1981 to 2010 period. The entire US coastline has a 40% chance of suffering a major hurricane (of category three or higher on the Saffir-Simpson scale) compared with an average of 52% for the past century, the forecasters say. The forecast for the East Coast (including peninsular Florida) is 22%, compared with an average of 31%, while the Gulf coast has a 23% chance of a major windstorm, compared with 30% for the past century.

Hurricanes and tropical storms are historically the largest component of overall catastrophe losses, representing 40.4% of the total between 1993 and 2012, according to figures from the Insurance Services Office (ISO). Tornado losses have been increasing and accounted for 36% of the total during the 20-year period.

Full-year figures for 2013 issued jointly by the ISO and the Property Casualty Insurers Association of America (PCI) show the market posted an underwriting profit and strong realised investment gains,

Table 1: Leading US insurer performance, first quarter ($m)

	Gross written premium	
	2013	2014
Berkshire Hathaway	–	–
AIG	–	–
Travelers	6,188.0	6,401.0
Allstate	–	–
Nationwide	–	–
Hartford	–	–
Liberty Mutual	–	–
Chubb	–	–
CNA	‡2,384.0	‡2,494.0
Erie Indemnity	–	–
Alleghany	1,237.5	1,301.1
Markel	743.3	1,359.8
Cincinnati Financial	–	–
Assurant	–	–
American Financial	‡925.0	‡1,024.0
WR Berkley	1,631.6	1,805.3
American National	–	–
Old Republic	–	–
HCC	720.2	746.7
Hanover	1,318.1	1,408.1
First American	–	–
AmTrust	943.9	1,666.2
Selective	537.3	565.7
Navigators	393.2	422.8
State Auto	–	–

*earned **policyholders' surplus
†insurance operations only
‡non-life only
Source: company announcements/Insurance Day database

in 2013

Net written premium		Combined ratio (%)		Investment income		Net result		Shareholders' funds	
2013	2014	2013	2014	2013	2014	2013	2014	Dec 31, 2013	Mar 31, 2014
*,9377.0	*9,416.0	–	–	†951.0	†1,001.0	4,892.0	4,705.0	224,485.0	230,289.0
*9,372.0	*9,038.0	97.3	101.2	4,164.0	4,196.0	2,206.0	1,609.0	100,470.0	103,833.0
5,597.0	5,873.0	88.5	85.7	670.0	736.0	896.0	1,052.0	24,796.0	25,387.0
6,625.0	6,969.0	93.2	94.7	983.0	959.0	709.0	587.0	21,480.0	22,105.0
*4,721.0	*5,026.0	–	–	785.0	807.0	484.0	140.0	**19,991.0	**20,593.0
*3,252.0	*3,301.0	93.6	89.8	3,418.0	600.0	(241.0)	495.0	18,905.0	19,774.0
*8,165.0	*8,629.0	98.1	99.6	721.0	891.0	318.0	272.0	19,012.0	19,767.0
3,057.0	3,062.0	84.6	93.2	351.0	341.0	656.0	449.0	16,097.0	16,226.0
‡1,776.0	‡1,767.0	101.5	101.6	591.0	526.0	250.0	13.0	12,651.0	12,582.0
*1,175.0	*1,288.0	99.0	108.3	103.0	109.0	290.0	109.0	7,550.0	7,690.0
1,093.0	1,134.0	83.1	88.8	118.8	110.6	196.3	204.9	6,923.8	7,128.1
663.0	1,139.3	91.0	95.0	64.6	86.7	88.9	87.7	6,673.6	6,900.1
970.0	1,037.0	91.2	100.3	86.0	90.0	137.0	82.0	6,070.0	6,168.0
*1,850.5	*2,060.5	96.9	93.7	166.0	168.1	117.8	137.3	4,833.5	5,096.3
*717.0	*782.0	93.1	92.2	326.0	361.0	120.0	103.0	4,550.0	4,747.0
1,377.0	1,525.9	94.7	93.9	135.9	168.7	116.6	169.7	4,336.0	4,375.9
*419.8	*462.9	101.4	95.4	251.4	218.8	60.0	52.9	3,947.3	4,270.2
*1,165.6	*1,132.7	97.6	98.9	79.3	82.8	56.2	194.4	3,775.0	3,865.8
579.2	590.2	83.8	83.0	55.8	56.8	104.1	106.2	3,674.4	3,782.1
1,076.7	1,172.3	96.1	98.3	67.3	67.0	66.2	54.6	2,594.5	2,681.1
*962.3	*854.8	–	–	23.1	17.8	36.2	21.7	2,453.1	2,459.5
532.1	1,130.3	91.3	89.9	18.1	28.5	83.9	101.8	1,441.0	1,582.5
450.1	476.8	101.1	97.1	32.9	35.5	21.3	18.0	1,153.9	1,185.5
269.5	311.9	97.9	92.2	13.7	16.6	13.9	28.0	902.2	936.8
263.7	265.4	100.2	99.2	16.9	17.6	19.7	27.1	785.0	817.5

The aftermath of the Moore tornado in Oklahoma: the disaster was last year's largest catastrophic loss for the US market, costing insurers $2bn

leading to an overall net profit of $63.8bn. The ISO/PCI figures are total market estimates based on the reports of companies writing about 96% of all business.

Underwriting drove the improvement in 2013 as the market benefited from the absence of major loss activity, a welcome change after the large losses of the two previous years. ISO's Property Claim Services division calculated US insurers faced a cat bill of $12.9bn from domestic events last year, down from $35bn the year before, which was the third-highest total ever suffered. Last year's largest catastrophic loss for the US market was the tornado that hit Moore in Oklahoma, costing insurers about $2bn. The 2013 level is well below the average annual cat cost of $23.9bn over the past 10 years. Cat losses represented just 3.4 points of the 2013 combined ratio of 96.1%, a fall of 6.8 points on the previous year. The fall in losses accounted for 3.9 points of the improvement while premium growth accounted for the remaining 2.9 points.

Reserve releases

Another boost came in the shape of an increased release from reserves for prior-year losses of $16bn, up from $10.2bn in 2012. Releases rose mainly because of the mortgage and financial guarantee segment, which released $3.5bn last year after strengthening reserves $2bn the year before. Insurers also released in 2013 some reserves earmarked for hurricane Sandy claims. Stripping out the impact of releases leaves the industry with a combined ratio of 99.5% for 2013.

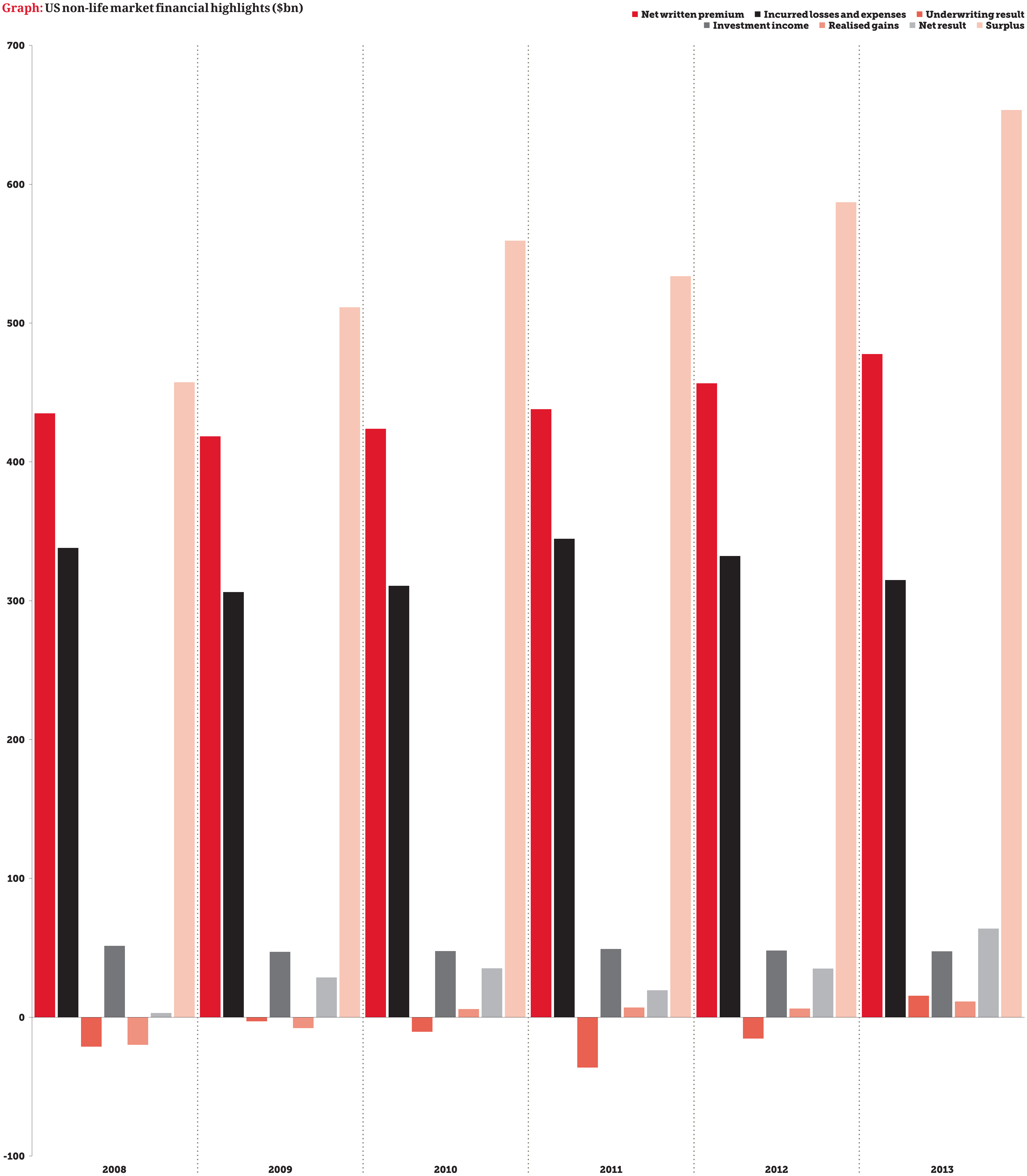
Reserving levels remain under scrutiny as companies continue to release significant amounts for prior years, despite predictions by many analysts the level should have slowed by now. Fitch said the overall rise in reserve releases last year came despite significant strengthening at some companies, including QBE Americas, Tower and Meadowbrook. These insurers showed above-average growth in the soft market years of 2008 to 2011, the rating agency said, and added business in weaker lines such as workers' compensation and commercial motor liability.

Interestingly, Fitch said the number of companies reporting releases has fallen over the past five years. Nearly 75% of the

Continued on p11 >>

COMPANIES HOUSE

Graph: US non-life market financial highlights ($bn)



Source: Insurance Services Office/Property Casualty Insurers Association of America

Continued from p9

reserves over the first nine months of 2013 came from just five companies: State Farm, National Indemnity, Travelers, Chubb and USAA.

Fitch predicted a fall in favourable reserve development in 2014 "as reserves from hard market years 2003 to 2007 pay out and loss reserves from more recent accident years do not exhibit the same level of redundancy. Given recent improvements in core underwriting results from a hardening pricing environment, insurers may be more inclined to strengthen reserves from older accident years and latent asbestos exposures in the near term".

AM Best said 2013 marked the eighth consecutive year of favourable reserve development but industry reserving levels have been weakening since 2007. At the end of 2013, the industry had a total net loss and loss expenses reserve deficiency of $45bn, consisting of a $34bn deficiency for core reserves and $11bn for asbestos and environmental reserves. The bulk of the deficiency lay in the workers' compensation line.

Conning calculated the reserve position for the US industry in 2013 was at least stable and perhaps increased, despite releases of more than $13bn. More than 50% of the releases came from the "all other lines" category, which includes motor physical damage, surety, accident and health and financial.

The firm calculates the industry has sufficient reserves, with a modest degree of safety, under the assumption claim-settlement patterns will remain as they are. As Conning admits, though, that assumption is of some concern, given ongoing low inflation and sluggish economic growth.

Reserving levels are important because deficient reserves and/or inadequate pricing have been the leading cause of insurance company failure in the US over the long term. AM Best estimated they were responsible for 43.4% of all failures between 1969 and 2012, ahead of rapid growth, accounting for 12.6% of failures.

The impact of any reserve deficiency lies in the future. For now, US insurers will be relieved 2013 proved such a strong year. To put the overall performance in its historical context, the US market has recorded underwriting profits in only 12 of the 55 years since the start of the ISO's data set, in 1959. But Michael Murray, assistant vice-president for financial analysis at ISO, warned the industry against complacency after last year's performance, saying: "With much of the improvement in underwriting results last year attributable to special developments including relatively benign weather, a sharp drop in catastrophe losses and increases in reserve releases, one has to wonder just how sustainable the net gains on underwriting will prove to be."

Table 2: US non-life market net profit ($bn)

Year	Profit ($bn)
2004	38.5
2005	44.2
2006	65.8
2007	62.5
2008	3.0
2009	28.7
2010	35.2
2011	19.5
2012	35.1
2013	63.8
10-year annual average	39.6

Source: AM Best, Insurance Services Office, Insurance Information Institute

Table 3: Atlantic hurricane activity, actual and forecast

	Median 1981 to 2010	2013	Forecast 2014
Hurricanes	6.5	2	4
Named storms	12	14	10
Hurricane days	21.3	3.25	15
Named storm days	60.1	42.25	40
Major hurricanes	2	0	1
Major hurricane days	3.9	0	3
Net tropical cyclone activity (%)	103	47	70

Source: Klotzbach/Gray, Colorado State University

Table 4: US insured catastrophe losses ($bn)

Year	Total insured cat loss	Major individual losses
2004	33.7	Charley 9.2
		Ivan 8.7
		Jeanne 5.6
		Frances 5.6
2005	73.4	Katrina 48.7
		Rita 6.7
		Wilma 11.1
2006	10.5	
2007	7.5	
2008	29.2	Ike 13.4
2009	11.5	
2010	14.4	
2011	33.6	Irene 4.4
		Tornadoes 7.1
		Tornadoes 7.5
2012	35.0	Sandy 18.8
2013	10.9	

Source: Property Claim Services, Insurance Services Office, Insurance Information Institute

Positive premium trends

Premium income trends were encouraging last year, posting rises of 4.6% on a net written and 4.2% on a net earned basis. The net written increase was the strongest since 2004 and followed a rise of 4.3% in 2012.Though relatively modest, premium growth is now experiencing its longest sustained period of gains in a decade, according to Bob Hartwig, president and economist of the Insurance Information Institute. Growth in premiums was strongly linked to the general development of the US economy and the creation of new jobs. This is seen most obviously in the workers' comp sector, where the contraction of the recession has given way to expansion. Workers' comp was the fastest-growing line within the overall non-life sector last year and is likely to remain so in 2014.

Hartwig highlighted the variation in premium trends between lines of business. Personal lines writers recorded a 5.3% increase in premium last year, up from 3.5%. Commercial lines companies saw their premium rise 4%, down from 5.5%. Those writing a mix of business recorded increases of 4.1%, down from 4.6%.

It is worth bearing in mind the mortgage and financial guarantee sector, scene of some horrendous results over the past few years, had a much stronger showing last year. Net premiums were up 6.1% to $5.1bn and net losses reduced to $1.3bn from $7.4bn the year before. Favourable reserve development of $3.5bn contrasted with reserve strengthening of $2bn in 2012.

Investment results

Investments have been an unreliable source of income for insurers since the financial crisis but net investment gains increased last year to $58.8bn from $54.2bn. Last year's total was the sum of reduced investment income of $47.4bn and higher realised gains of $11.4bn. Since the start of ISO's data collection in 1959, capital gains have ranged from a high of $39.8bn in 1997 to a low of $72.7bn in losses in 2008.

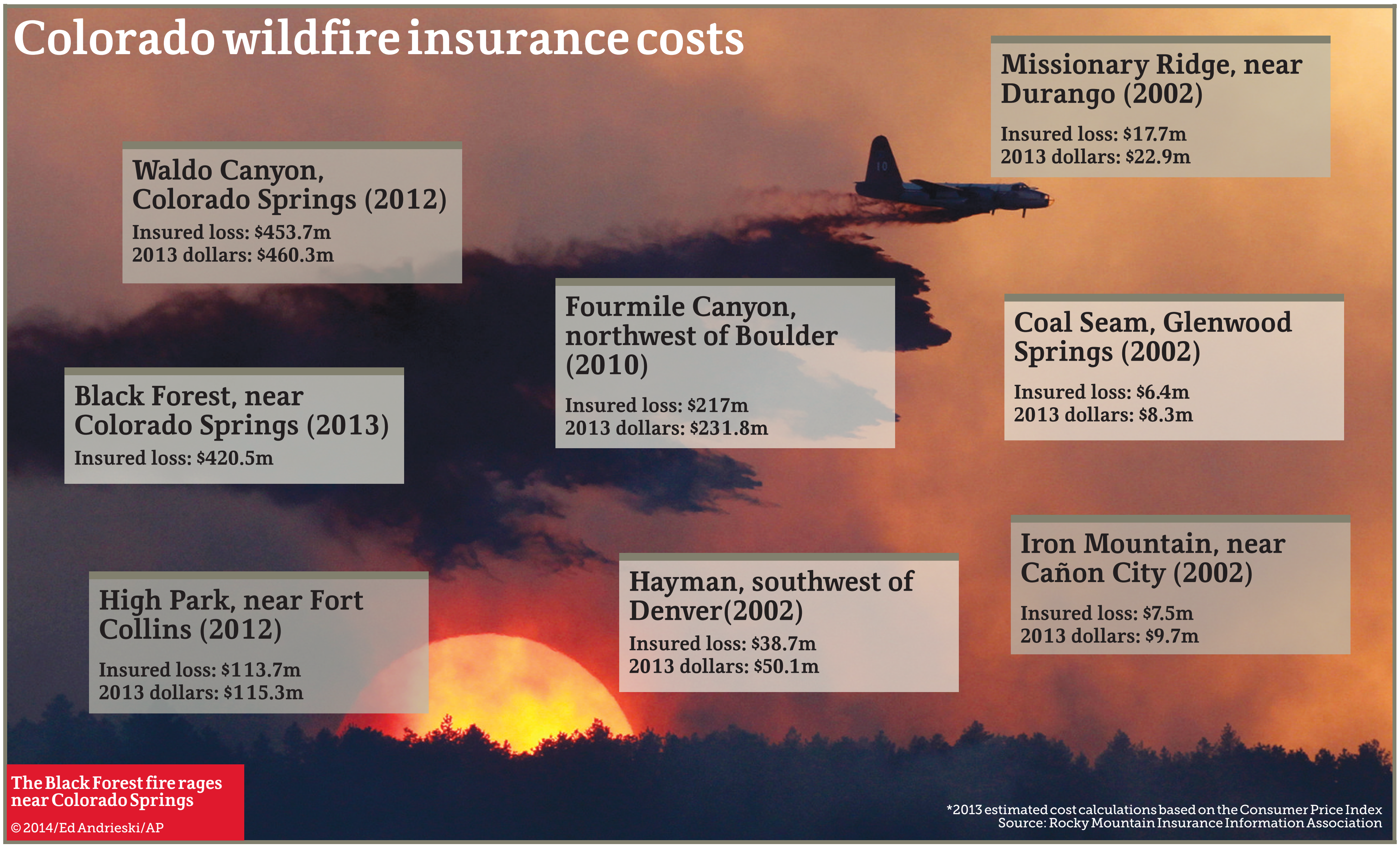
Investment income fell last year in line with declines in market yields, pushing insurers' yields to 3.4%, their lowest level since 1997. Investment income peaked at $55.1bn in 2007 before falling away to total $47.4bn last year owing to the low interest rate prevailing since the financial crisis. Fitch's analysis of the 48 publicly traded US non-life insurers found only 13 of the companies reported increases in investment income and in many cases the rises were modest and stemmed from improved results in alternative asset classes.

But capital gains increased last year on the back of rises in stock market levels. The New York Stock Exchange composite was up 23.2% and the Nasdaq composite climbed 38.3%.

Policyholders' surplus jumped 11.3% during the year to reach a record high of $653.3bn at the end of 2013. The net premium to surplus ratio of 0.73 was not only the lowest ever but also only about half the average annual ratio over the past 55 years. That means insurers are well capitalised in the event of major loss activity but also provides an incentive for companies to keep writing business even after rating and conditions have weakened. ■

insuranceday.com

World Loss Intelligence



The Black Forest fire rages near Colorado Springs

Black Forest fire losses rise to $420.5m

Alexis Burris
Reporter

Insured losses from the 2013 Black Forest fire in Colorado are now estimated at $420.5m, according to the Rocky Mountain Insurance Information Association (RMIIA). This is an increase of about $128m from the preliminary damage assessment of $292.8m.

Insured losses were from 4,173 homeowners and motor claims. A reported 488 structures were burned in the blaze.

Despite being the most destructive fire in the state as far as structures lost, the event ranks as the state's second-most expensive wildfire after the 2012 Waldo Canyon fire, which cost insurers $460.3m from 6,648 claims, with 347 structures reported burned during the Waldo Canyon fire.

Since 2002, wildfires have cost Colorado nearly $1.32bn.

"Wildfire continues to exact a tragic and financial toll on our state," Carole Walker, executive director of the RMIIA, said. "But insurance catastrophe adjusters were on the ground since the first Black Forest evacuation notice and insurers have spent the past year helping affected residents recover and communities rebuild."

Baseball-sized hail causes extensive damage in US Midwest

Hurricane-force winds, hail and severe thunderstorms pummelled several US states late last week, causing significant damage and highlighting a need for hail re-insurance, *writes Alexis Burris*.

Parts of Nebraska experienced the largest hail, some the size of baseballs. Reports from Blair, Nebraska claim no house or car left outside was left undamaged by the hail.

According to Matthew Neilsen, director and meteorologist at Risk Management Solutions (RMS), the severe weather has highlighted a greater need for reinsurance for this peril.

"This week's severe storms in Tornado Alley and the surrounding regions is yet another example of how hail is no longer an attritional peril," he said. "Widespread hail events in the US are not uncommon and can cause considerable damage to cars, homes, and buildings, while single hail events can produce very large losses.

"With 60% of average annual storm losses in the US coming from hail, insurers should consider looking at reinsurance for these events."

According to RMS the 2014 severe storm season has been quiet so far, with only one event producing insured losses of more than $1bn. Of the events that have occurred, hail and straight-line wind perils have occurred roughly six times as often as tornadoes.

Sri Lanka floods highlight risks to livelihoods in areas of low insurance penetration

Recent flooding in Sri Lanka has affected more than 100,000 people and threatened livelihoods dependent on rice and tea plantations.

According to Nikki Chambers, hazards scientist at Risk Management Solutions, tea exports brought in $1.5bn in government revenues in Sri Lanka in 2013, but this revenue is under threat after recent flooding.

"The government is investigating a national crop insurance scheme to help farmers cope with increasingly severe and disruptive weather and resulting crop losses," Chambers said. Few private dwellings have flood cover in Sri Lanka, while take-up for industrial and commercial organisations is only around 20%, with cover bought in combination with windstorm cover.