London Market Looks Ahead: Preparing for the Next Big Insurance Event

Erin Bargate, Hiscox
Background

It is over fifteen years since 9/11, the last truly market-turning event.

Much has changed since then:

- Solvency II
- New regulators in the form of the PRA and FCA
- A new cadre of senior management

The three objectives of the dry run:

- **Support clients’ best interests**
  Pay claims quickly and fairly, and ensure cover continues to be offered

- **Maintain financial stability**
  Ensure sufficient financial resources to provide for the normal operation of the London Market

- **Uphold the London Market’s leading position and expertise in the global marketplace**

Contributors:

Notes:

- Participants were provided with up-front loss estimates (gross loss ratio impact)
- The capitalisation or health of participants’ ultimate parent company was not tested
- Anonymity of insurers preserved by indexing to a base case in order to protect commercially sensitive information
Each event was designed to test participants in a different way

Week 1
‘Halloween Blackout’
- $45bn insured losses
- Cyber-attack on power infrastructure
- 93m people impacted across 15 US states

Week 1
Global equity crash
- 16.2% drop in global stocks
- 28.3% drop in (re)insurer shares

Week 2
‘Hurricane Guy Fawkes’
- $150bn insured losses
- Category 5 hurricane over Miami
- Wind, storm surge and flood damage

Week 2
Liquidity stress
- Major reinsurer(s) failure
- Delays in recoveries
- Limits on reinsurance capacity

All scenarios are fictional in nature and devised purely for the purposes of this project.
At ~$200bn, insured losses were among the largest in history

Notes: Losses from past events include property and business interruption and exclude liability and life insurance; US Nat Cat figures based on Property Claim Services (PCS)/incl. NFIP losses. Losses converted to USD at end of year exchange rate. USD values are extrapolated using the US consumer price index to give 2015 values.

Source: Swiss Re, Sigma No 1/2016; Financial Stability and Commercial Working Groups.
### SCR coverage ratios changed significantly post-events

<table>
<thead>
<tr>
<th>Starting SCR Coverage Ratio for 2016</th>
<th>Greater than 175%</th>
<th>125-175%</th>
<th>100-125%</th>
<th>Under 100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater than 175%</td>
<td>1</td>
<td>2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>125-175%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
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<td>Under 100%</td>
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</table>

- More than half the participants incurred losses of over 90% of their reported net capital base prior to the catastrophic events, with the biggest loss being 120%.
- All participants assumed that capital could be replenished quickly so that the impact on year-end SCR was mitigated.
# Expectations on rate increases influenced participants’ underwriting plans

<table>
<thead>
<tr>
<th>Expected 2017 inwards rate change of market (%)* (as reported)</th>
<th>Implied change in exposure (%)</th>
<th>Change in GWP – 2017 versus base case (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurer 1</td>
<td>31</td>
<td>16</td>
</tr>
<tr>
<td>Insurer 2</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Insurer 3</td>
<td>-1</td>
<td>22</td>
</tr>
<tr>
<td>Insurer 4</td>
<td>13</td>
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<tr>
<td>Insurer 5</td>
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<td>3</td>
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<tr>
<td>Insurer 6</td>
<td>-2</td>
<td>7</td>
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<tr>
<td>Insurer 7**</td>
<td>13</td>
<td>4</td>
</tr>
<tr>
<td>Insurer 8</td>
<td>0</td>
<td>11</td>
</tr>
<tr>
<td>Insurer 9</td>
<td>3</td>
<td>9</td>
</tr>
</tbody>
</table>

*Rate change shown relates to expectations at highest level reported.

**Insurer 7’s expected 2017 inwards rate change of market was 15% for Week 1 and 13% for Week 2.
Additional capital requirements exceeded 50% of the opening net capital for participants in aggregate.

**Planned capital raise as a proportion of opening net capital**

<table>
<thead>
<tr>
<th></th>
<th>% of opening net capital</th>
</tr>
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<tbody>
<tr>
<td>Base case</td>
<td>~15%</td>
</tr>
<tr>
<td>Week 1</td>
<td>~17%</td>
</tr>
<tr>
<td>Week 2</td>
<td>~51%</td>
</tr>
</tbody>
</table>

**Uses of raised capital**

<table>
<thead>
<tr>
<th>Number of (re)insurers</th>
<th>Planned growth</th>
<th>Opportunistic growth</th>
<th>Replenishment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base case</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Week 1</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Week 2</td>
<td>9</td>
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<td>0</td>
<td>3</td>
<td>4</td>
<td></td>
</tr>
<tr>
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<td>0</td>
<td>4</td>
<td>4</td>
<td>9</td>
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White Paper
Three recommendations for the industry

Ensure customers are well served by putting in place internal processes to respond effectively to market-turning events
- Establish crisis management training programmes
- Ensure that a robust and well-tested response is in place
- Maintain clear plans for raising additional capital following a market-turning event

Maintain the London Market's leading position and expertise in the global marketplace by strengthening Lloyd's position and proactive stakeholder interactions
- Further strengthen and differentiate Lloyd's position
- Navigate a broad set of key stakeholders to maintain confidence during times of dislocation

Collaborate with the PRA to clarify mutual expectations and ensure an effective post-catastrophe response
- PRA supervisory statement released in July this year which responded to the white paper and clarified expectations

http://www.hiscoxgroup.com/london-market-looks-ahead
Considerations for actuaries

- **Updating your capital model post-loss, how quickly can it be done?**
  - Estimating size of loss and payment pattern
  - Proxy tools combined with expert judgement to get quick initial estimates
  - Different models across different entities
  - Documented information flows helpful

- **Interactions with the regulators**
  - Expectations in post-SII world
  - How will Lloyd’s deal with changes to the business plan?

- **Consider the customer**
  - How do we continue to operate?
  - Clients will need coverage the day after the event

- **Where will you find your additional capital?**
  - Relative competitiveness of the London Market
  - What happens if Lloyd’s suffers a ratings downgrade?

- **How will you support senior management in making quick decisions?**
  - What information is important to them?
  - War Room

Pragmatic approach with clear, timely and consistent communication with all stakeholders
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