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A New Look

We hope you enjoy the new layout of The Insurance Research Letter. In the next few months we will roll out an application for tablets. We are also considering unleashing a revamped website by keeping it utterly simple, easy to use and full of useful tools. PAGE 3

THE INSURANCE RESEARCH LETTER

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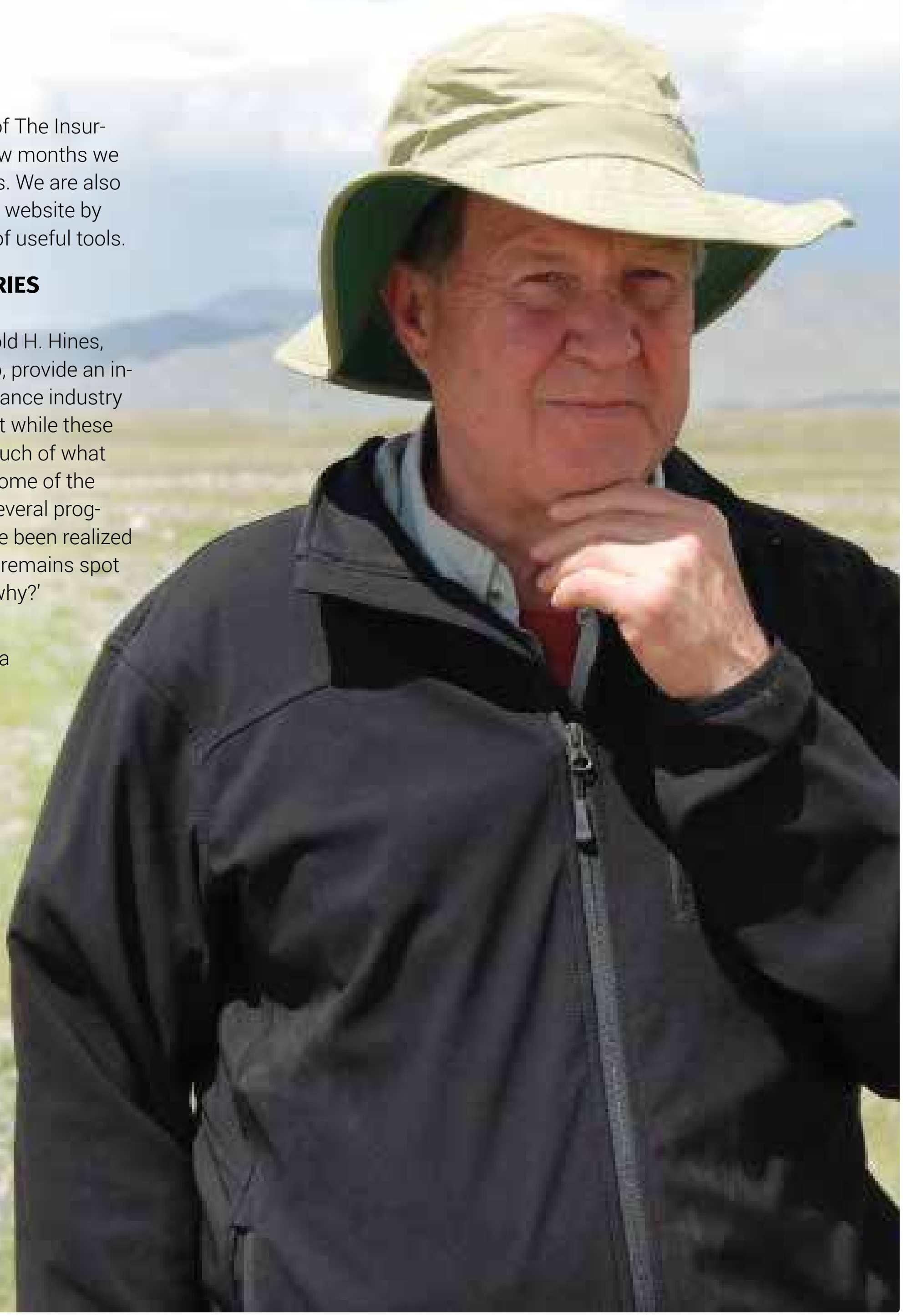
INSURANCE RESEARCH LETTER No. 2 · February 2014 · Year 48 · **SENIOR EDITOR** A. B. Hodges. **GRAPHIC DESIGN** Turcotte O'Keeffe, Inc. **CONTRIBUTORS** Harold H. Hines, Jr., Mauricio Kitaigorodzki, George Worsley, Mayer Brown, FiscalReps, Keith Purvis. **ADVERTISERS** Gambonini Consulting LTD.

Quote of the Month.

"It would have been a terrific shot had they placed the pin there today."

— David Feherty, CBS golf reporter.



A NEW LOOK AND MORE COMING

We hope you enjoy the new layout of The Insurance Research Letter. In the next few months we will roll out an application for tablets. We are also considering unleashing a revamped website by keeping it utterly simple, easy to use and full of useful tools.

A WORD ABOUT THE HAROLD HINES SERIES OF SPECIAL REPORTS

Our continuing series of the speeches of Harold H. Hines, Jr., President of the old Ryan Insurance Group, provide an insightful retrospective of the commercial insurance industry in the United Sates. What is remarkable is that while these speeches were delivered in the early 1980s much of what he speaks to remains true today. To be sure some of the numbers Mr. Hines cites have changed and several prognostications (e.g., the Risk Retention Act) have been realized but the fact is what he says for the most part remains spot on. It makes you scratch your head and ask 'why?'

In December 2013 we published "The Effective Risk Manager" and in January 2014 a speech titled "Cooperation and Conflict: The Ambivalence of the Risk Manager-Broker Relationship." These make for good reading.

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A. B. HODGES
Editor in Chief
info@insuranceresearchletter.com

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LLOYD’S BUILDING IN LONDON
The Lloyd’s building HDR version
Financial district London England

VOL 25 NO 2
FEB 2014

SYNOPSIS

INSURERS

Users of digital currency Bitcoin now can stow their virtual cash in a storage vault that has insurance underwritten at Lloyd's of London. Even though Bitcoin might be fundamentally bizarre, there's clearly money in it – and perhaps even more money in stealing it. So with that in mind, Elliptic *opened its doors as a Bitcoin vault. (Matt Beasley, a Lloyd's spokesperson, confirmed the arrangement, but declined to provide further details.)*

ACE has launched enhanced *D&O cover* for large private and listed companies in the UK and Ireland. The product *includes a new cyber privacy and confidentiality extension*.

ACE Limited announced that the company and its local partner have reached a conditional agreement to *purchase a 60.9 percent stake* for about $185 million in **The Siam Commercial Samaggi Insurance PCL**, a general insurance company in Thailand, from Siam Commercial Bank. Bangkok-based Siam Commercial Samaggi Insurance is a major writer of auto, small commercial and personal accident insurance and distributes its products through both Siam Commercial Bank's branches and independent agents through the insurer's own extensive branch network. In 2012, the insurer had approximately $138 million in gross premiums written.

AIG has announced that it has *received approval for the establishment of a servicing office* in Casablanca Finance City (CFC), Morocco, to support the strategic growth and expansion of its insurance business across North and West Africa. CFC serves as Morocco's finance centre for the development of business across the region, with a particular focus on financial

Left to Right: Said Ibrahimi, CEO CFCA; Michael Whitwell, President MEA, AIG; Mohamed Boussaid, Minister of Economy and Finance, Morocco; Nicholas Walsh, Vice Chairman, AIG Property Casualty

services.

Altitude Risk Partners, a *new managing general agency* (MGA), has been launched in London *to underwrite aerospace risks*. The company has been launched with support from Castel Underwriting Agencies and with backing from Barbican Insurance Group, HDI-Gerling Industrie Versicherung AG and Sompo Japan Insurance Inc. Altitude Risk Partners will underwrite a global portfolio of airlines, manufacturing products, general aviation, war and space risks.

Amlin Europe said it *received permission* from Dutch and German regulatory authorities to *open a branch office in Hamburg, Germany* effective January 1, 2014 to write business for small and medium-sized enterprises.

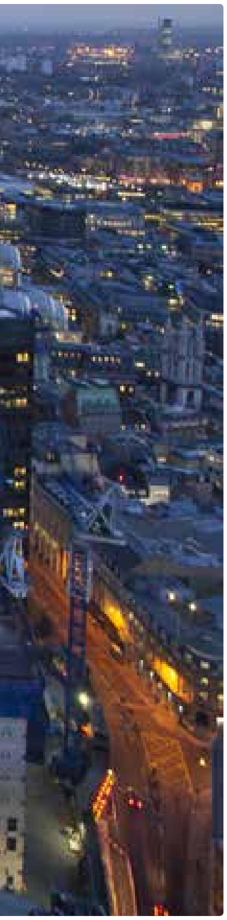
Warren Buffett's **Berkshire Hathaway** is backing a $1 billion prize offered by **Quicken Loans** if a contestant *predicts the winner of each game in the National Collegiate Athletic Association's men's basketball tournament*. The prize will be paid in 40 annual installments of $25 million and split among multiple winners if there is more than one perfect entrant, the Detroit-based lender said in a statement. The winner also has the option of a single payment of $500 million. Free registration begins March 3 ahead of the 68-team, single-elimination college basketball tournament that starts March 18. Winners can choose to share 40 annual installments of $25 million or a lump sum of $500 million.

The odds of picking every winner correctly in a 64-team bracket are less than 1 in 9 quintillion, according to Jeff Bergen, a math professor at DePaul University in Chicago. Even with some basketball knowledge, that only improves to about 1 in 128 billion, he said in a video posted on YouTube.

Ironshore's U.S. Specialty Casualty unit is offering a *coverage solution for U.S.-based companies with overseas operational risk exposure*. Ironshore **International Connect** will provide *excess casualty coverage* for U.S. companies' overseas operations on a *locally-admitted basis*, which is designed to be compliant with market rules and regulations. Coverage terms and conditions, which are written in English, are the same as Ironshore's U.S. domestic excess liability program,

FINANCIAL DISTRICT OF LONDON

City of London Skyline At Sunset, United Kingdom



Users of digital currency Bitcoin now can stow their virtual cash in a storage vault that has insurance underwritten at Lloyd's of London. Even though Bitcoin might be fundamentally bizarre, there's clearly money in it – and perhaps even more money in stealing it. So with that in mind, Elliptic opened its doors as a Bitcoin vault.

with limits available of up to $50 million.

RSA Insurance Group is looking to *sell assets and businesses* in Central and Eastern Europe, including **Balta** in Latvia and **Link4** in Poland, sources told Bloomberg.

PEOPLE

Ace Group has selected **Stuart Elliot** to be its terrorism and political violence underwriter, making him responsible for business outside of North American markets. He joins from Willis where he was Divisional Director responsible for the development of the African and Far Eastern portfolio of terrorism and political violence business.

Ace Group hired **Anthony O'Brien** to head its marine insurance division in the Asia-Pacific region from an office in Hong Kong. O'Brien has more than two decades of experience in transport insurance in Australia and for the past eight years has been engaged in the reinsurance industry in various Asian countries

Allied World Assurance said it has tapped **Lou Iglesias** as president of Allied World North America. Iglesias is taking over for **Gordon Knight**, who held the position since 2008 and plans to retire at the end of the month. Knight will continue to advise the company as part of a five-year employment/consulting agreement. As president of Allied World North America, Iglesias will oversee profitability, production, and distribution for all lines of business, including property/casualty and professional lines across 11 offices in the United States and Canada.

Former Citigroup Chairman and Chief Executive **Sanford I. "Sandy" Weill** will serve as chairman of Hamilton Insurance Group, Ltd

Scor S.E. has appointed **Frieder** Knüpling as chief risk officer.

Swiss Re Corporate Solutions, the large commercial primary insurance arm of Swiss Re Ltd., has appointed **Tony Buckle** as head of its Europe, Middle East and Africa operations.

Rebecca Dupre has been named senior vice president and underwriting manager for excess casualty at XL Bermuda insurance operations.

Zurich Insurance Group announced the appointment of **Saad Mered** (46, U.S. citizen) to the position of Chief Claims Officer for its General Insurance (GI) business, effective January 1, 2014. In this position, Mr. Mered is responsible for leading Zurich's global GI claims function, improving claims capabilities in the GI segment and strengthening customer focus. He reports to **Mike Kerner**, CEO General Insurance and is located in Zurich, Switzerland. **ISN**

The International Insurance Society said Denis Kessler (pictured), chairman and CEO of Scor S.E., has been named to its Insurance Hall of Fame. Denis Kessler will be inducted at the June 23 gala awards dinner taking place in conjunction with the IIS 50th Annual Seminar at the Park Plaza Westminster Bridge Hotel in London, UK, June 22 – 25, 2013.

ABC REVIEW

ABC NEWS

Cooper Gay Australia Pty. Ltd., a unit of **Cooper Gay Swett & Crawford Ltd.**, has launched a wholesale division for the Australian insurance market.

Hyperion Insurance Group Limited has reported a 51 percent increase in revenues to £166.6 million for the year ending September 30, 2013, reflecting a number of acquisitions. Organic revenue growth was 13 percent, while pre-tax profits were 74 percent higher at £35.9 million.

Jardine Lloyd Thompson (JLT) has acquired Hong Kong-based brokerage **Lambert Brothers Holdings Ltd.** LBH adds to JLT Asia's and JLT Hong Kong's marine, employee benefits and corporate business capabilities, says JLT Asia.

USI Insurance Services has acquired Dayton, Ohio-based **Quintessential Advisors Ltd.**, an independent broker specializing in insurance, investment and employee benefits for midsize firms.

Wells Fargo Insurance Services USA agreed to sell 42 of its smaller insurance brokerage and consulting offices to Valhalla, N.Y.-based **USI Insurance Services**.

Willis Group Holdings has combined its global specialty insurance business with the Willis U.K. retail business

Willis Group Holdings also announced that its U.S. facultative arm, **Willis Facultative North America**, has joined together with its global facultative operation, **Faber Global**.

Insurance Brokers: Highlights from a Recent Meeting with a Large, Regional Middle-Market Broker

- Carriers are still asking for 8% to 10% rate increases, but are willing to accept 3% to 5%. Carriers are still raising deductibles

WELLS FARGO

NEW YORK - JUNE 10: Wells Fargo Bank branch on June 10 2013 in New York. Wells Fargo was the 23rd largest company in the United States in 2011 (by revenues).

and thus risk-adjusted pricing is higher.

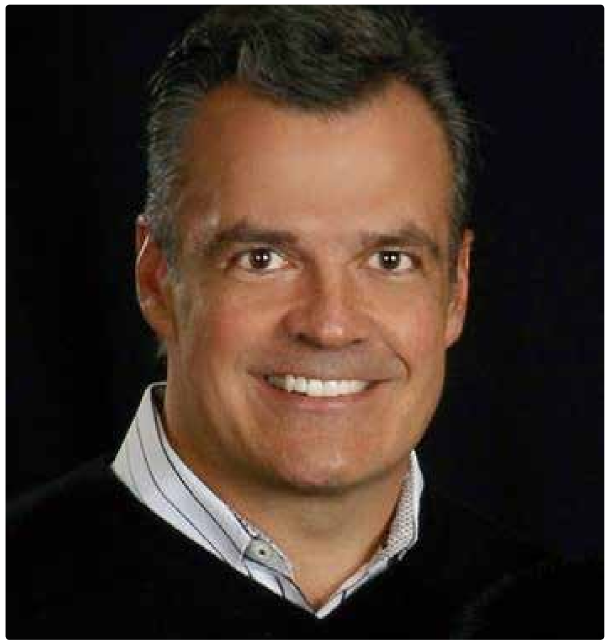
- Most lines are still seeing moderate rate increases. The most significant change is that D&O flattened after seeing material rate increases the year before. One industry exception is technology, which is still experiencing rate increases from 15% to 20% and rising deductibles.
- The broker we spoke with is regionally focused, which may positively skew his rate experience.
- The broker commented that most carriers were being relatively disciplined and there were no major outliers.
- One potential explanation, he mentioned, is significantly more "buy in" within midlevel management to the importance of meeting corporate financial return goals. This move is a departure from past practices, when regional managers' main focus was on quotas or retentions.
- Several larger carriers that had issues several years ago are showing major improvement in their ability to work with brokers as far as being active markets and having favorable service levels. These carriers are winning more business from some of the entrenched players.
- The broker experienced a roughly 7% increase in organic growth during 2013.
- While the company does not track organic growth drivers specifically, he estimated that half the growth came from new business and the other half from rate/exposure.
- The broker was not enthusiastic about exchanges since he believed that the current system worked well and provided clients with an adequate array of choice.
- This view is similar to that we have heard from other regional brokers and anecdotally suggests why adoption could be slow in the middle market.
- The broker did qualify that his middle-market client base is relatively conservative in benefit practices (i.e., most still have high value traditional plans) and prefer the status quo.

(Courtesy William Blair & Co.)

ABC PEOPLE

Aon announced the appointment of **Michael T. Wolf** as Vice President and Chief Counsel--Corporate. In this role, Wolf will provide legal counsel on a wide range of corporate and transactional matters. He also will be responsible for the management of all aspects of corporate transactions on a global basis, including mergers, acquisitions, divestures, joint ventures, partnerships and strategic alliances. He will report to **Peter Lieb**, Executive Vice President and General Counsel of Aon.

Lockton announced the addition of **Jackie Sukiasian** as an Account Executive and member of Lockton's expanding Trade Credit and Political Risk team. Prior to joining Lockton, Sukiasian worked at Willis Financial Solutions where she focused on client management, client servicing, and business development of trade credit and political risk insurance. **ISN**



Aon Benfield announced the appointment of Stephen Hofmann (pictured) as its Chicago Business Leader. In his new role Hofmann's responsibilities will include driving business growth, managing client teams, and creating and maintaining a business environment that is supportive to optimizing client results. Hofmann has worked at Aon since 1997. He most recently served both as Executive Managing Director within Aon Benfield's treaty team, and as a member of the origination team.

It with sadness that we report the passing of Thomas J. Holmberg, Sr (pictured). Tom was an outstanding broker, a real friend to many and a mentor extraordinaire. Tom worked for years at Marsh and later with Aon, both in Chicago. He was a fierce competitor and liked to bet on everything from backgammon matches to "which hand is the penny in."

RECENTLY PUBLISHED

Mayer Brown (MB) details the *latest noteworthy developments and regulations that occurred last month* in the insurance/reinsurance industry in the U.S., Asia and Europe. http://bit.ly/1dNjWK4

Aon's *2014 Terrorism and Political Violence Map* has been published @ http://www.riskmap.aon.co.uk/Terrorism_Risk_Map.aspx

Global insurance companies seeking to expand their businesses are increasingly looking to a new wave of rapid-growth markets (RGMs) as well as the BRICs. According to EY's ***Waves of Change: The shifting insurance landscape in rapid growth markets report***, China will continue to play an dominant role in driving premium growth in international markets but new emergers such as Mexico, Thailand, Colombia and Indonesia are offering valuable long-term opportunities. Download report (36 pages) @

http://www.ey.com/Publication/vwLUAssets/EY-Waves-of-change/$FILE/EY-Waves-of-change-The-shifting-insurance-landscape-in-rapid-growth-markets.pdf

ISN

UNITED NATIONS

NEW YORK CITY - JULY 17: The United Nations Building, home of the security council, June 17 2010 in New York, New York.

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Employee Benefits: With globalization comes a need for understanding employee benefits around the world. Swiss Life with its partner insurers has created an **Employee Benefits Reference Manual 2013**. This is without question the best resource for EB information and is available at no cost. Go to http://www.swisslife.com/international/corporateclients/service/downloads/ebrm/country_profiles.html

These popular guides provide vital information about local insurance requirements including compulsory coverages, legislation, supervision, non-admitted insurance, main classes, product information by class and more.

Australia – New South Wales has been hit by nearly 100 fires, United Press International reported.

Azerbaijan – The country's State Insurance Supervision Service, has said the insurance market growth could reach 15-20 percent in 2014, Forinsurer reported citing Interfax.

Bermuda – Ninety-one new insurance companies registered to do business in Bermuda in 2013, marking a 72 percent surge in registrations since 2012, according to an annual insurer registration statistics compiled by the Bermuda Monetary Authority.

Brazil – Brazilian bank Itaú Unibanco is looking to sell its corporate risk unit, according to local financial newspaper Valor Econômico. The company has since confirmed that it will begin a competitive sale process very soon. The unit, which generates annual revenue of about BRL 1.7 billion ($723m), provides insurance for large corporates and for high-risk segments such as oil and gas and infrastructure. Itaú is looking to sell its industrial insurance business to meet capital allocations under new Basel III rules, the newspaper said. Itaú is said to have sent prospectus to ten insurers, including Germany's Allianz, France's Axa, Italy's Generali and Swiss insurer Zurich.

Brazil – World Bank: "The Insurance Market Will Be Essential in the Economy". The Brazilian insurance industry may have a crucial role to close the infrastructure gap currently delaying the country's economic growth, said WB insurance consultant Bernardo Weaver. An inadequate infrastructure is negatively impacting Brazil's economic growth as the lack of ports, air terminals and quality highways increases transportation costs, and the low Internet connectivity reduces the penetration of more sophisticated international services, among other obstacles. Life and Pension insurance suppliers in Brazil manage combined assets of nearly USD 213 billion; 8 percent of this amount represents the Federal Government's total investment in the Growth Acceleration Program and 0.8 percent would cover the global investment in the five recent airport concessions in the country (Galeão, Guarulhos, Viracopos, Brasilia and Confins).

Canada – Canada experienced the highest level of severe weather-related insured losses in its history in 2013, reporting C$ 3.2 billion (US$2.92 billion) in claims. Floods, severe thunderstorms, and ice storms all contributed.

China – China's overall premiums in 2013 totaled 1.72 trillion Chinese yuan ($283.97 billion), increasing 11.2 percent year on year, China Insurance Regulatory Commission's chairman Xiang Junbo said.

Estonia – Estonian insurance industry's gross premiums written rose 24 percent year on year to € 320 million ($433 million) during the January to September 2013 period, the Financial Supervision Authority of Estonia said.

Guatemala – The Insurance Industry ends 2013 with a 24.3 percent growth. The insurance industry had profits (before income tax) of 93.9 million dollars, 24.3 percent more than in 2012 according to figures released by the country's Banks Superintendency. Total premiums increased 13 percent and retained premiums 10 percent. Premium increase was influenced mainly by Health, Life and Auto business. Financial results provided USD 56.5 million (4.5% more than in 2012) and underwriting results participated in total profits with USD 37.4 million (before income tax).

Guernsey – The Guernsey Financial Services Commission said it licensed 89 new insurers in 2013.

India – The mandatory indemnity insurance policies being purchased by various broker associations in India for their members do not cover them for the errors and omissions clause, Financial Chronicle reported.

India – India's central bank governor Raghuram Rajan is to discuss the issue of banks becoming insurance brokers with certain public sector banks as the central bank is yet to finalize guidelines on the matter, The Hindu Business Line reported. The Finance Ministry has said private sector banks will also have to follow the ministry's proposed insurance broking model, which requires banks to sell products from multiple insurers, The Economic Times reported.

India – India's insurance regulator, the Insurance Regulatory and Development Authority, is now (once again) looking at the possibility of raising the current limit of foreign direct investment in insurance intermediaries and third-party administrators as it has recently formed a committee to look into the matter.

Latin America – Fitch: "The

continued on page 34

AMERICAS

ARGENTINA

BUENOS AIRES CITYSCAPE

Aerial view of a residential neighborhood in Buenos Aires

ROAD HIJACKING: "POLITICALLY CORRECT" IN ARGENTINA[1]

Hijacking of cargo trucks has increased 12 percent. A truck is hijacked every four hours, never with loads worth less than USD 20,000[2] . Losses amount to almost USD 90 million. Hijackers defy security and set trends: Thieves raid directly manufacturing and warehouse plants to avoid road hijacks and work with less stress.

They are not very visible crimes and rarely make headlines. A short piece sometimes appears in the crime section or on TV, usually when a gang is busted. But hijacks happen four or five times a day, increasing 12 percent. Total approximate cost: about USD 90 million according to data in a working paper released by the *Truck Hijacking Working Group* (THWG) based on 1,774 actual and attempted cases occurring between August 2012 and July 2013. Foodstuffs head the ranking (28%), followed by electronics (21%) and pharmaceuticals (14%). As in previous years, hijacking concentrates in Buenos Aires

1. Based on an article published by the magazine "Estrategas" (Buenos Aires, #136, December 2013/January 2014

2. **Editor's note**: Original figures in Argentine Pesos; dollar conversions were made using approximate rates of exchange in view of the volatile Argentine foreign currency market.

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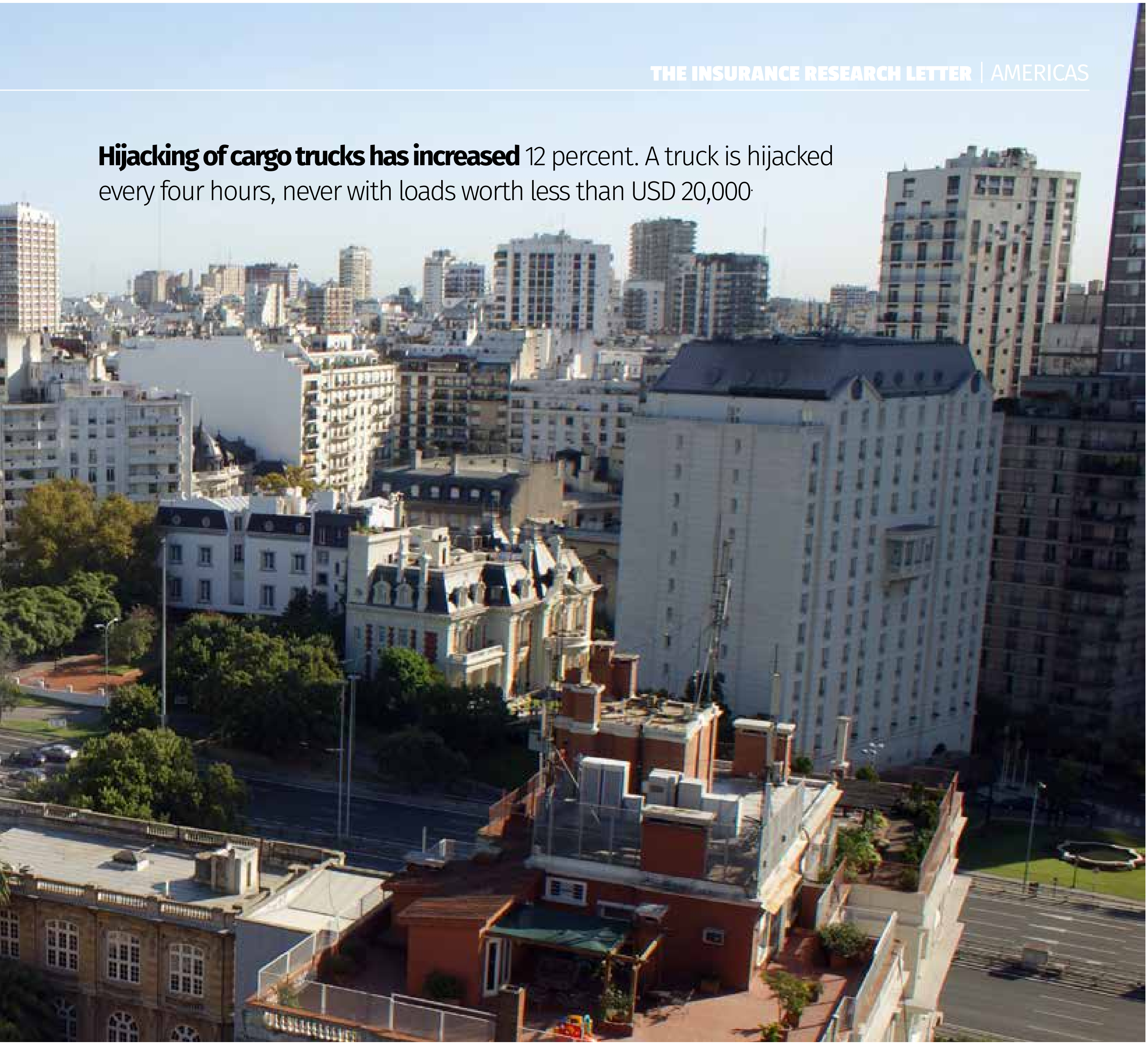

Province (67%) and Buenos Aires City (20%) while the rest – 13 percent – is spread over the rest of the country.

NEAR CITIES

Truck hijacks in Argentina started in the sixties and are hard to fight. Jose Luis Anselmi, CEO of *Anselmi Claims & Risk Management*, specialized cargo loss adjusters and risk managers, says that this crime "has reached a plateau at a high level". Although statistics show that "hot areas" are in the Southern suburban belt near Buenos Aires City where 53 percent of the hijacks are concentrated, Anselmi does not believe that the so-called "crime map" applies in these cases.

"Before trucks or shipping plants are hijacked, the stolen cargo is already sold; hijacks are made as near as possible to the buyer's domicile. I've been checking statistics in all American countries, including the USA, and curiously enough similar situations are seen in almost all of them".

"Hijackings take place around large cities or between them and major ports, as is the case in Mexico. This is simply 'logistics sense' as cargo thefts follow the same logic of 'formal' business transactions".

Criminal lawyer Gabriel Iezzi, partner of law firm *Iezzi & Varone* and coordinator of THWG, believes that the prosecution attorney offices specialized in road hijacking cases are doing a good job and some of them got good results in a short time, reducing the number of cases in their jurisdictions.

All specialists agree that hijacking is very well organized, like drug or human trafficking. They operate like parallel corporations following supply and demand, with one CEO or head and a full vertical structure.

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NO SHOTS

One of the reasons why road hijacks don't make headlines is because there is no violence. Hijackers are not improvised criminals; they do intelligence and research all movements and time schedules as well as the goods they need. This is not a coincidence, because the absence of media 'noise' is good for them because they can work without being troubled. "That's why we say that road hijacking is 'politically correct': it affects corporations and not people, and drivers are well treated", explains Anselmi.

Hijackers know exactly what they want. They never steal a shipment worth less than twenty thousand dollars because they must cover their costs and make a profit. Good tips can be worth up to four thousand dollars. Most robberies take place on Thursdays between 6am and noon.

"Although hijacking is a crime, it is in fact just a business transaction. More goods than required are stolen and products are sold in advance", explained Anselmi. "Now they are focusing less in high added value products such as electronics and more on food products because they are less traceable and, therefore, easier to sell", added Iezzi.

Organization heads get orders, 'medium managers' deal with gunmen who never know the top men directly. The number of cars used in the hijack will depend on the truck's security level and cargo is left at a pre-agreed destination. Then they are paid and disappear. The warehouse owners and the distribution chain start working afterwards. Hijackers have their own trucks and are real crime entrepreneurs.

CAT AND MOUSE

"There is one thing that can't be replaced by technology: human

wit”, says Iezzi. And hijackers have both of these assets. “Prevention requires, then, two things: Gather all available information on how criminals act, and invest in technology”.

“There is a real technological struggle between thieves and carriers”, adds Iezzi”. For instance, five years ago logistics operators installed GPS or TVLU hardware to increase truck security. Hijackers answered using signal inhibitors. Now satellite tracking companies designed inhibitors detectors and when they find one they shut off the truck’s fuel supply. “Day after day, one goes after the other, like a cat and mouse game”.

AND INSURANCE?

This fight between criminals and businessmen reflects on the relationship between insurers and their clients increasing insurance costs. Insurers are demanding greater protection such as the use of security vehicles following shipments; this type of security costs ten times more than a policy.

Hijackers are going even further: Instead of waiting until the truck leaves the plant, they just enter the plant, subdue the security guards and steal the cargo more comfortably.

WHERE ARE HIJACKED GOODS SOLD?

Usually, stolen goods are sold to the public in the same stores as legit goods. Original, stolen or falsified goods are sold together. “All depends on the trust between suppliers and shop owners”, explains Iezzi.

“Hijackers have their own accounting and create false companies that issue invoices. They must launder the money and get it back into the legal circuit. Tax authorities discover them in some cases, but there is an irrefutable fact: Part of Argentine economy operates underwater”.

ECONOMIC CRIMES

Anselmi explains that the economic side of this criminal business is its actual essence. “In a country where most of the economy is above board, cargo thefts should dwindle and disappear. On the other hand, if supply and demand work reasonably well and products are sufficient to cover existing demand, hijacking would be pointless”.

“I hope hijacking will fall … but I think that the level reached by robbery is strongly related to the informal economy”, he concluded.

However, Iezzi understands that prevention means working hard and he believes that things are following the right track. “Many logistics operators and insurers don’t know what to do, how to act on the day after; therefore they need contingency plans that will let them move fast after the robbery was committed. The risk is always there”.

INSURERS: LOWER PROFITS AND HIGHER EXPENSES AFTER ABRUPT DEVALUATION

Rating agencies anticipate that the Peso devaluation in late January will negatively affect domestic corporations and banks.

According to a Moody’s report – who anticipates that the dollar official quotation will continue to reach 12 pesos in late 2014

Moody’s pointed out the major fall of Argentine reserves which dropped almost USD 20 billion over the last two years was as a consequence of aggregate macroeconomic unbalances.

– warns that this devaluation is a negative factor for banks and companies with access to foreign credit.

In its weekly outlook report published on January 27 the U.S. agency said that the Government decision to adjust the rate of exchange does not seem to come with any evident plan to reduce the inflationary effect of this devaluation. In fact, Moody's calculates that the Argentine currency will devaluate about 50 percent in 2014 and inflation will exceed 30 percent (The second highest inflation in Latin America after Venezuela). "Although this devaluation may restrain temporarily the pressure on Argentina's foreign currency reserves, it is not clear what the Government's plans are to limit the leak of capital, control inflation and restore investors' confidence", Moody's added.

Moody's pointed out the major fall of Argentine reserves which dropped almost USD 20 billion over the last two years was as a consequence of aggregate macroeconomic unbalances.

This economic situation will have negative effects for banks, insurers and most corporations. Argentine insurers' profitability will fall, especially in Life business. They will also see reductions in their capital ratios due to increased costs.

Moody's said that these measures will reduce the profitability of the financial sector because of their operations in Argentina, because it will force entities to increase the interest rates they offer to attract clients' savings.

UNITED STATES

FIO RELEASES ITS LONG-AWAITED REPORT MANDATED BY DODD-FRANK

On December 12, 2013, the Federal Insurance Office (FIO) submitted to Congress and released a

report entitled, "How to Modernize and Improve the System of Insurance Regulation in the United States." The report was mandated by Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In its preparation of the report, FIO reviewed nearly 150 written comments and consulted with nearly 40 different insurance sector participants and stakeholders, including insurance regulators, insurance companies and consumer advocates.

In its report, FIO recognizes the importance of the state-based system of insurance regulation, but also notes that "[a]ny system with 56 independent jurisdictions is inherently limited in its ability to regulate uniformly and efficiently." The report therefore takes a two-pronged approach: specifying reforms FIO believes are needed in the state-based system of insurance regulation and also identifying new areas for direct federal involvement.

FIO's recommendations for state based reforms focus on three areas: (1) capital adequacy and safety/soundness; (2) reform of insurer resolution practices and (3) marketplace regulation.

The FIO report also identifies areas for direct federal involvement, which include, among other topics: (1) development and implementation of federal standards and oversight for mortgage insurers, (2) uniform reinsurance collateral requirements based on the NAIC models, (3) a national registration system for insurance agents and brokers, and (4) FIO participation in supervisory colleges that will oversee large national and internationally active insurers.

A complete list of the FIO recommendations for modernizing and improving insurance regulation in the United States is found under Section I of the report.

In its report, FIO states that it intends to work with all aspects of the insurance sector and promises to "recommend additional improvements to the U.S. system of insurance regulation that best integrate the interests of U.S. insurers and consumers."

The FIO report sets forth issues and challenges but does not present specific solutions. FIO will explore solutions in the next phase, including in discussions with the US Congress and the state insurance regulators. The NAIC's statements regarding the FIO report can be found here. (Courtesy Mayer Brown) **ISN**

EUROPE & RUSSIA

REGIONAL COMMENTARY: UK

HOUSES OF PARLIAMENT

Dramatic sunset over famous Big Ben clock tower in London, UK.

FLOOD RE: THE CART BEFORE THE HORSE?

Last year, the Association of British Insurers (ABI) and the UK Government agreed a Memorandum of Understanding to develop a non-profit scheme to ensure that flood insurance remains widely affordable and available. This MoU was the first step towards establishing Flood Re. The new flood insurance deal is aimed about 200,000 homeowners and residents living in high flood risk areas of Britain so they could continue to find affordable flood insurance by placing a cap on the total cost.

Flood Re would see all households across the UK pay into a collective fund through insurance premiums which would be used to offset the costs of flood damage and fund the flood insurance cap. The plan was that Flood Re would be ready for launch in summer 2015. Until then, flood insurers would continue to abide by an agreement extended in 2013, the Statement of Principles.

The way it works is for Flood Re to be funded by a levy added to all household insurance premiums – around £10.50 a year (about US$17.50) – the exact amount depending on council tax band/ location. This levy will provide a fund to offer people at high flood risk who might otherwise struggle to get affordable flood insurance with cover at a set price. Insurers will put into the fund those high flood risk homes they feel unable to insure themselves, with the premium to cover the flood risk part of the household premium being capped. However, some of those homes are still likely to be excluded from the scheme. Homes built after 2009 or those homes falling into a highest council tax band will not be protected by Flood Re. Such households could face unlimited flood insurance costs or be refused cover altogether. Not the sort of deal some voters would like to see their government offering.

Complications have now led to the likelihood of the launch scheduled for the summer of 2014 being delayed. Questions have arisen, such as would Flood Re have enough funds to foot the bill arising from an especially catastrophic flood – one which would be expected to strike the UK once every 200 years, with losses running into several billion pounds – and if not, who would pay? Although the government has said this is not the sort of risk Flood Re is being established to handle, it is an example of not all details being clarified adequately. Another concern is whether the government or insurance companies would be entitled to any surplus funds if Flood Re would be wound up several years later. Because insurers did want to give an open-ended commitment, the arrangement, although expected to remain in place for the long term, is not in perpetuity – hence the question about who gets the money, if there is any left.

It is now felt that questions like these could be handled effectively and possibly on time if Flood Re had a Chief Executive Officer, which it does not. Therefore, it looks like Flood Re will only be launched when there is someone to run it. Strange that no-one thought of that a while ago.

~ Mr. George Worsley, ACII, Chartered Insurance Practitioner, Director, Worldwide Risk Solutions; george.worsley@worldwidRisksolutions.com

CROATIA

TAX AUTHORITIES CONFIRM PREMIUM TAXES FOR FOS* INSURERS

FiscalReps recently received an official response to its queries from the Head of Indirect Tax at the Ministry of Finance (MoF) and from the National Protection and Rescue Directorate (NPRD) in relation to Motor IPT/Fire Brigade Contribution (FBC).

The MoF confirmed that insurance companies registered in the EU that conclude insurance policies in Croatia under FoS in relation to optional motor hull insurance (Class 3) and compulsory third party motor liability insurance (Class 10) are required to file/settle Motor IPT at 10 percent and 15 percent respectively. Furthermore, the NPRD requires FoS insurers to settle the 5 percent FBC in relation to all policies that cover fire risks. FiscalReps local associates advised that these are the only premium taxes that apply to FoS insurers.

Local premium taxes such as the Forest Contribution, Tourist Levy and Monument Levy have dated legislation (no reference is made to the EU) and should not apply to FoS insurers. Please note, however, that domestic insurers, including branches and subsidiaries of FoS insurers, are required to pay all premium taxes in Croatia.

FoS insurers have an obligation to settle Motor IPT and the FBC with effect from July 1, 2013 or when it made the first taxable supply in Croatia; whatever is the later date.

FoS insurers may appoint a fiscal agent to file/settle premium taxes on their behalf or file directly to the Tax Authorities, although there is no obligation to appoint a fiscal agent.

FiscalReps is willing to act as a fiscal agent for clients wishing to use this service. The Croatian Tax Authorities have remained silent in respect of interest and/ or penalty charges for any late filings/settlements. FiscalReps local associates advise that penalties should not be imposed but it is possible that a 12 percent (approximate value) penalty interest charge could be applied. FiscalReps will seek clarity around this point and remind the Tax Authorities about the repeated representations made on behalf of its clients since April 2013 and the subsequent response received eight months later.

If you would like to discuss any of these points further or if you have any queries then please contact Paul Chater or your Client Director on t: +44 (0) 20 7036 8070.

*(**Editor's Note**: Freedom of Services (FOS) – Allows a carrier who is licensed in the European Economic*

In a bid to boost growth in the City of London, the UK government, together with financial regulators, has pledged to cut the red tape that currently affects foreign insurers attempting to move to the UK.

Area (EEA) (the countries of the EU plus Iceland, Liechtenstein and Norway) to write insurance coverage on a cross-border, non-admitted basis, within the EEA. The policy can be underwritten by a carrier in any EEA member state/country, to cover exposures in any other EEA member states/counties the client is located in.)

ICELAND

ABOLITION OF STAMP DUTY ON INSURANCE CONTRACTS

On January 9, 2014 the Ministry of Finance announced a number of significant changes to Icelandic stamp duty.

From January 1, 2014 stamp duty will no longer apply on insurance contracts and any policies issued on or after this date will not be subject to stamp duty.

A new stamp duty Act was approved by Parliament on December 19, 2013, under which stamp duty applies only to transfers of real property and vessels over 5.00 gross tons. This Act replaces and repeals the old stamp duty Act (Act No. 36/1978) under which insurance contracts were taxed.

It is worth mentioning in passing that the other indirect taxes on non-life insurance business (Avalanche & Landslides Prevention Tax and Building Safety Tax), as well as the Catastrophe Premium and Property Valuation Fee, remain unchanged and are still payable. (Source: FiscalReps)

UNITED KINGDOM

BRITISH REGULATORS TO CUT RED TAPE FOR INSURERS MOVING TO THE UK

In a bid to boost growth in the City of London, the UK government, together with financial regulators, has pledged to cut the red tape that currently affects foreign insurers attempting to move to the UK.

According to the British finance ministry, the Prudential Regulation Authority (the "PRA") and the Financial Conduct Authority (the "FCA") are committed to ensuring that the authorization process for prospective insurers wishing to establish themselves in the UK is as streamlined as possible. This commitment has been driven largely by the success of the relocation of the world's biggest broker, Aon Corp, from Chicago to London in 2012 and the resulting increase in London's status in the insurance industry.

The government has also declared it will promote the UK insurance industry in economies key for their fast growth, such as China and Brazil, with the intention of putting the UK at the centre of trade negotiations.

In addition to the proposed streamlined authorization process, it is hoped that planned cuts to corporation tax and London's already well established links with emerging markets in Africa, the Middle East and Asia, will help entice firms to the UK.

In line with the British government's support of the insurance industry generally, in May 2012 Prime Minister David Cameron helped Lloyd's launch a new strategy for the development of its

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SPECIAL REPORT

INSURANCE COMPETITION: FROM SEPARATION TO CONVERGENCE


PHOTO
GETTY IMAGES

A look at history confirms that the whole commercial property-casualty insurance culture has – since the early 1950's – adjusted easily to early stages of convergence.


HAROLD H. HINES, JR.

The following speech presented by Harold H. Hines, Jr. was a major address to the National Conference on Risk and Insurance Management, Center for Management Development, American Management Associations on September 14, 1981 in New Orleans, Louisiana.

INSURANCE COMPETITION: FROM SEPARATION TO CONVERGENCE

Today's competition is shaping the future of The United States commercial property-casualty insurance industry. Current competition is forming what will inevitably come, what cannot happen differently, for necessity is already at work. Future competition is evident in present signs of convergence, in clear indications that independent but related property-casualty underwriting and distribution systems will become a single, integrated whole. The fractured competition encouraged by separate systems will, in time, be replaced by more efficient competition among the survivors of a consolidated order.

A look at history confirms that the whole commercial property-casualty insurance culture has – since the early 1950's – adjusted easily to early stages of convergence. Larger carriers absorbed their lesser competitors, and significant New York and Chicago brokers acquired their counterparts in major cities throughout the nation. Within the current framework of giant multi-line property-casualty carriers and national brokerage firms, the structural sources of ultimate convergence can be observed.

And frictions can also be discovered in existing practices. Between an underwriting structure

And frictions can also be discovered in existing practices. Between an underwriting structure capable of growing gross-lines risk bearing, and a distribution structure in constant search of segmented risk transfer transactions, there is a fundamental contradiction capable of challenging industry progress.

capable of growing gross-lines risk bearing, and a distribution structure in constant search of segmented risk transfer transactions, there is a fundamental contradiction capable of challenging industry progress. In this contradiction are latent conflicts currently being promoted in battles to provide service support, wholesale functions, risk acceptance, and buyer contact.

These adversary relations either produce a dysfunction of the close association of the underwriting and distribution systems, or they promote the convergence of these systems into a consolidated totality. Arguments in favor of cleavage and separation repudiate logic, for neither carriers nor brokers can exist in isolation. The systems must be joined; otherwise, life insurance companies, foreign insurers, broad-based financial institutions and banks will capture intrinsic opportunities to serve society's insurance needs. The integration imperative will be more compelling as rich and capable outside competitors intrude into the huge U.S. commercial property-casualty marketplace.

Verification of predictions about convergence requires examination of numerous countervailing forces evident in today's intense competition. Analysis of the present segmented underwriting and distribution systems yields perspective on the dynamics of current trade practices, the trends that are precursors of future structure, and the processes by which today's fragmented competition evolves to tomorrow's collective contests. Competition is never a "steady state"; it is an ever-changing response to the marketplace, a potent energy with a life of its own, intensified by the critical demands of buyers and the freedoms encouraged or repressed by government.

Understanding the possibilities of future competition calls for a close look at demand created by buyers and the economic atmosphere molded by government. The internal dynamics of the insurance industry will be dominated by the vicissitudes of these influences. For example, buyers' willingness to pay for losses in advance and to allow claims reserves to be held by underwriters will depend on the price of insurance and on the value of money. If inflation continues to compound rapidly in the decades ahead, and if there are periodic insurance price aggravations with scarcities of insurance supply, buyers will divert cash flow and capital from the insurance industry to their own or alternative uses. Buyer workers compensation decisions in the 1970's illustrate the employment of alternatives, for over one-third of all premiums paid went to plans that diverted cash and/or capital from traditional insurance vehicles. Should high inflation and exaggerated insurance price accelerations happen simultaneously, buyers are likely to consider retroactive protection to cover losses post-facto. Such responses will challenge the industry's ingenuity, for there will be new competitors, like banks, who will create new instruments to replace conventional insurance products.

The insurance industry will, of course, respond to all the far-reaching demands buyers will express, supporting the requirements of customers, so long as reasonable investment returns are available. And buyers, while appreciating the industry's need for adequate returns, will press hard for lower cost and more efficient risk management plans, service supports, risk transfers, and premium collections. Buyers will insist that the expense of all carrier and broker functions be identified, so that each function can be comparatively priced and judged for effectiveness. Carriers and brokers will have to demonstrate the precise value of their economic contributions, taking cognizance of the fact that advantageous prices and profit margins will go only to those organizations that add value not readily duplicated by competitors. When carriers and brokers fail to demonstrate clear product differentiation, their prices will be tempered and their profit margins will suffer. Future battles to achieve and to communicate differentiation will create tomorrow's commercial competition, as carriers and brokers strive to make insurance less a commodity and related services less stereotyped.

Government will continue to stimulate further competition by joining buyers in scrutiny of investment performance, evaluating its influence on rate-making.

The government, like the buyer, defines the perimeters of insurance industry competition. Recent developments at the state and Federal levels profoundly affect the way business will be conducted. Smaller commercial buyers, for example, are now permitted to arrange the same opportunities for self-funding, reserve management and service support as larger purchasers. States now allow pooled Workers' Compensation groups, and the National Congress will soon pass a progressive Risk Retention Act to encourage small enterprises to organize products and general liability protection in group self-funded plans. The impact of the new freedom of smaller commercial competition will be spectacular. Contests for market share among carriers and brokers will be severe, and the new contender life companies, direct writers and broad-based financial enterprises, are certain to enter the fray.

Government will continue to stimulate further competition by joining buyers in scrutiny of investment performance, evaluating its influence on rate-making. And government will also participate in mounting challenges to the validity of industry collected rating information. State commissioners already show a growing awareness of the need to nourish competition by changing the commercial insurance industry environment from narrow public utility status to one that invites broad market economic competition. It is too early to know if the profound "value changes" of the current Federal administration will cause permissive anti-trust interpretations that approve of the vertical as well as the horizontal mergers the insurance industry is certain to want. Is it now logical to assume that what is tacitly permitted the rest of U.S. industry will also be granted to the insurance industry? Isn't it equally sound reasoning to argue that financial institutions, including banks, will be allowed to participate more extensively in the creation of insurance transactions?

Anticipating eventual authorization, a number of money center banks are planning property-casualty entry strategies. Banks, currently permitted to sell only credit coverages to their own customers, are establishing strategic plans to sell life, personal lines and a full range of commercial insurance products.

A few are already earning fees by offering rudimentary risk management consulting and insurance related financial analytical services. Some bankers, remembering how standby credit was used in the property insurance crisis of the 1960's, are exploring ways to provide retroactive casualty coverage by replacing customers cash-flow after losses caused by insurance program

As the underwriting system adjusts to contemplated change, it must contend with growing competition from Lloyd's, the Bermuda market, the domestic reinsurance industry and foreign carriers.

gaps or inadequate policy limits.

Broad-based financial institutions, like American Express and Merrill Lynch, already have insurance underwriting and distribution facilities which they are likely to use in concert with their money management facilities. To these formidable potential competitors must be added the powerful life insurance companies whose loan contacts and distribution skills offer possibilities for the sale and underwriting of commercial property-casualty coverages. The Prudential already writes over six hundred million dollars of annual commercial property-casualty premiums and has recently acquired an investment firm which owns the eleventh largest U.S. insurance broker. Today's many successful commercial property-casualty carriers and brokers can hardly ignore the long-term implications of these kinds of adversaries.

Nor can the industry take comfort in the efforts large direct personal lines carriers are now making to capture smaller commercial business. In spite of the fact that early tests have been confined to a few states and isolated small businesses, plans call for aggressive sales to larger companies through captive sales organizations specializing in selected industries. Rather than "tailoring" products to fit the particular needs of any client – in the broker mode – these forceful competitors will merchandise meticulously constructed, standardized insurance plus relevant service products. Past prototypes of success are confirmed by the market share positions of the Factory Mutuals in superior-risk property insurance and by the Liberty Mutual in Workers' Compensation insurance. These companies continue to demonstrate the potentials of linking uniform products, services and sales approaches. Direct personal lines writers, possessed of large capital and management resources, will add their prodigious ability to innovate to commercial underwriting, distribution and service competition.

These exotic future sources of commercial competition are relatively distant threats to the accumulated market share of today's separate underwriting and distribution systems, currently locked in internecine battles fought within each system. Study of the countervailing competitive forces within today's separate systems reveals diminishing bonds of cooperation, the cement that has kept the systems related to each other and cohesive. Present carrier competition reveals contradictory practices that bring the underwriting system together and, at the same time, split it apart.

The trend of major U.S. carriers to accept ever-larger gross lines, supported by innovative facultative or treaty reinsurance, creates significant capacity and augments the competition between underwriters. Use of the world reinsurance market makes these gross line arrangements secure and quite independent of the kind of support from other major U.S. competitors that was historically essential. The ability of carriers to compete without interlocking commitments from their adversaries is growing; in fact, it is likely that new constellations of totally self-sufficient capacity for very large gross lines is very near reality.

Countervailing commitments to cooperation that transcend traditional trade practices are also being made by these same carriers in positions taken in the New York and Illinois exchanges. They bring the underwriting system together by offering net capacity, and related managed capacity, to meet tomorrow's anticipated competition from aggressive Lloyd's, Bermuda and excess-surplus lines markets. Whereas exchanges began as responses to brokers' fears of over-dependence on London as a gathering and spreading mechanism, they will become marketplaces dominated by U.S. carriers eager to protect market share in times of restricted underwriting or when risk spreading is difficult because reinsurance supply contracts.

To further complicate contemporary competitive processes,

carriers have purchased and will continue to acquire excess and surplus lines underwriting and distribution systems in order to provide specialty products to all brokers and "controlled know-how" to smaller, less sophisticated firms. Entry of major carriers into the wholesale distribution system is a development of great consequence, because it strengthens the ability of underwriters to build a controlled sales structure. In the years ahead, these ventures will be used defensively to guard against revenue base shrinkage by providing risk management plan design plus related risk transfer products for weaker brokers. To be successful, these carrier controlled vehicles will have to avoid attempts to bureaucratize the entrepreneurial verve that has made specialty company and wholesale brokers so effective.

Larger carriers absorbed their lesser competitors, and significant New York and Chicago brokers acquired their counterparts in major cities throughout the nation. Within the current framework of giant multi-line property-casualty carriers and national brokerage firms, the structural sources of ultimate convergence can be observed.

As the underwriting system adjusts to contemplated change, it must contend with growing competition from Lloyd's, the Bermuda market, the domestic reinsurance industry and foreign carriers. Lloyd's and related London underwriters have recently attracted much more capital poised to accept additional business when prices rise. The exceptionally innovative London gathering and spreading mechanism will not be content to commit half of its capacity for the long term as it has during past difficult years of soft rates. Because large American brokers now own or have "entente cordials" with Lloyd's brokers, the flow of business to London will increase. These new relationships should produce efficiencies that will eventually be passed to buyers in lower prices certain to enhance the tempo of competition.

So will actions of the Bermuda market which is still young but growing rapidly. The substantive capacity of Bermuda, comprised of corporate captives and commercial reinsurers, is engaged in an aggressive quest for premiums, confirmed by the fact that more than two-thirds of U.S. foreign reinsurance funds flowed to Bermuda in 1980. Indications are that this market will continue to compete aggressively for "working layer" and "catastrophe loss" business in the future, free from encumbering regulation and burdensome taxation.

United States domestic reinsurance carriers and non-London foreign insurance and reinsurance companies are additional competitive factors very much a part of the underwriting system. Domestic reinsurers are finding new ways to accept direct risks in support of self-insured or front plans. Foreign competitors, cognizant of the comparative size and stability of the U.S. commercial lines market and adroit at hedging currency fluctuations, are eager to gain American premium flow. These contestants have significant capital plus technical knowledge gained as reinsurance participants. They are important to the new constellation of competition that is shaping today's marketplace, and they will have an expanded role in the struggles predicted for the future.

While underwriting system competition is more obscure and sometimes inscrutable, distribution system competition is easy to understand. Primary competitors are the large national and regional firms that have grown so remarkably in the past few decades as finders and organizers of world insurance capacity. There are over 100 brokers capable of placing risks for America's largest corporations. These impressive firms will continue to be at the "cutting edge" of risk management innovation, as they compete with ever more intensity for commercial market share from enterprises of all types and sizes.

A paradox of this vigorous competition is the movement by the largest brokers to create or acquire wholesale brokerage operations. It is clear why these firms want to capture total commissions earned on their own excess and surplus

A paradox of this vigorous competition is the movement by the largest brokers to create or acquire wholesale brokerage operations.

lines business; however, it is difficult to reconcile their willingness to share their considerable proficiencies with competitors. Much more consonant with enlightened self-interest is the U.S. brokers development of interests in Lloyd's brokers, either by outright purchase, joint venture or formalized association. Reciprocal acquisitions by London houses of U.S. firms are part of the aggressive moves by capable brokers to seize international opportunities and to protect against emerging competition from the underwriting system. Efficiencies will grow from Lloyd's interactions that will interfere with the emerging desire of underwriters to establish meaningful contacts with buyers.

Franchise and carrier dependent agencies are two distribution system developments growing in importance and certain to heighten competition by extending the durability of smaller competitors and by contributing to overall improvements in total insurance industry productivity. More than a dozen competent broker-franchise operations function in the United States to make smaller brokerage firms competitive with national and regional organizations. By finding ways to use premium volume and geographic reach to gain economic incentives for participants, franchise operators attract stable firms with growth potentials to whom they can provide useful additions to their members' professionalism, managerial acumen, image and ability to share common problems and opportunities. Franchisors also offer their franchisees "state of the art" technical support services, creative products, and pre-funded succession planning. A few franchise groups are exploring benefits that might be derived from creation of a broker-owned captive carrier which would underwrite personal or small commercial business and return useful earnings to owners. Enough progress has been gained by franchise tests to suggest that some will endure as distinctive distribution system factors.

The most significant distribution system development is the move by carriers to establish special relationships with effective smaller brokers. Although these contractual associations preserve some broker prerogatives, absolute independence is compromised by special agreements the broker has to place minimum premium volumes and percentages of total volumes with a single controlling carrier who agrees to permit the broker limited underwriting authority, guaranteed capacity and renewal continuity. Controlling carriers also provide accounting, financial and management information services plus financing for acquisition or succession situations. In many communities, firms with the advantages of new prerogatives are introducing very competitive capabilities likely to become more influential as early experiments prove that efficiencies are delivered to buyers in lower costs and to carriers in lower loss and expense ratios. Over the next few years, there will be a proliferation of carrier controlled arrangements that will bring measurable market share increases to underwriters who sanction dependent agencies.

Market share battles between carrier controlled agents and larger national or regional brokers are subtle precursors of conflicts certain to put the underwriting and distribution systems in direct confrontation. This contention will be a logical extension of today's intense struggles between carriers and brokers for service support relationships. Former cooperation of distribution system participants with carrier domination of claims management, loss prevention and information retrieval has been replaced by the aggressive efforts national brokers have made to build service revenues. By replacing carriers, large brokers are generating significant new revenues which alone produce low profit margins but, when joined to broker commissions or fees, develop better overall profit results.

The most significant distribution system development is the move by carriers to establish special relationships with effective smaller brokers.

Carrier resistance to broker encroachments have caused insurance companies to sell their support services independently of risk transfers. Unbundling of service support from risk bearing is gaining momentum as brokers, carriers and unaffiliated service firms offer more sophisticated and valuable services to each other's customers. Actuarial analyses, financial studies, statistics trending, probability development, and captive management are some of the relatively new services major brokers invented for their clients and prospects that carriers and independent firms are now offering with improving proficiency.

The service war will escalate in the years ahead as competition shifts from pure price plus geographic reach to more meaningful contests of product differentiation and performance measurement. In claims management, pre-disaster planning will produce post-disaster adjustments that find new ways to overcome the incredible expense burdens of the American legal system. Extensions of innovations now used in airplane disasters will give buyers claims administration choices built into comprehensive risk management plans. Similar improvements will be developed in loss prevention techniques, as broker, carrier and independent competitors produce cost-benefit analyses for safety programs that incorporate behavioral science insights to control frequency and severity problems: Systems logic will change the concept of prevention and will replace the traditional focus on unsafe physical conditions and inspection patterns that have so little to do with mitigating losses. Future information service advances will also prove useful as they integrate loss control and claims management insights to augment operations management methods. Actuarial sciences and financial perspectives will explain emerging information in ways that relate service support objectives to balance sheet and P&L statement considerations.

Fights to create and merchandise progressive support services underline the confrontations already developing within and between the underwriting and distribution systems. Carriers are already buying interests in brokerage firms and brokers own or control underwriting operations. Both have positions in the wholesale and surplus lines business, and both manage underwriting and broker syndicates on the New York Exchange. These conflicts portend the intensity of future competition, and they make convergence of the separate underwriting and distribution systems inevitable. The accelerating pace of competition, in fact, leaves no alternative but integration. Buyers will demand it as a logical route to more efficiency; government regulations will approve it as part of the vertical integration necessary to the advance of American business; and carriers, brokers and independent service administrators will seek it to promote their enlightened self-interests.

There will, of course, be resistance to convergence as there is to all change. Natural inertia will most affect the very successful carriers and brokers who have the most to gain by preservation of the status quo. These achieving enterprises will not be proponents of integration; in fact, they will lead the competitive attack on convergence linkages.

Transition from today's separate systems to tomorrow's single system will be full of trauma. Carriers that engage in overt distribution activities will risk repudiation by their established broker sales organizations. Challenges to licensing arrangements will quarrel with the rights of converged firms to offer themselves as representatives of customers. Regulators will question the financial integrity of integrated firms that try to preserve revenues by permissive underwriting. Entrepreneurial performers from the broker work force will rebel against the implied confinement new associations may impose on their ability to discover new insurance sources and service supply alternatives.

These issues have already been articulated by the Fisher Working Party that studied self-regulation at Lloyd's. Because of fears that abuses might impair the security or the objectivity of the world's most effective and free insurance gathering and spreading mechanism, the Fisher Report and the British Parliament have proposed limitations on the common ownership of underwriting and brokering operations. The final outcome of deliberations mandating a schism may be the forerunner of similar resistance in the United States. Impediments to the natural evolution of convergence fostered by regulators may delay, but they will not prevent the improvements buyers demand.

Although it is clear that convergence will make the once sacred separation of insurance industry functions obsolete, it is difficult to predict the pace of change or the sequence of events that will consolidate underwriting and distribution.

Buyers desires will remain the primary forces that shape the way competition works. The growing sophistication buyers will continue to gain – added to the comprehensive skills they will build in their risk management departments – will prompt buyers to seek direct

risk transfer and service support negotiations with carriers. Brokers cannot impair this extension of buyer reach; in fact, the effective way brokers have differentiated their internal functional skills have encouraged carriers and buyers to create similar differentiations certain to compel buyers and carriers to direct interactions.

Although it is clear that convergence will make the once sacred separation of insurance industry functions obsolete, it is difficult to predict the pace of change or the sequence of events that will consolidate underwriting and distribution. Convergence will be further advanced by the end of this decade. Except for the continuing independence of a few excellent brokers or carriers, consolidation should be well developed by early in the next century.

Next stages of convergence will include the following dramatic events:

- Large multi-line carriers will buy their smaller less efficient competitors plus remaining excess and surplus lines companies to that surviving underwriters will be those relatively few with the greatest financial and human resources.
- National and regional brokers will merge with each other, continue to acquire some smaller firms with substantial commercial business, and establish more relations with foreign associates until the distribution system has a limited number of large survivors.
- Brokers and carriers will acquire the independent support organizations strong enough to endure accelerating competition.
- Franchise operations, effective enough to compete in the commercial marketplace, will be acquired or joined by contract to surviving carriers or brokers.
- The independent agent will become a sole survivor of a surviving carrier or be linked by exclusive contract to a surviving broker.

Later in the .inexorable process of convergence, large multiline property-casualty carriers will acquire major brokers, even at the expense of earnings dilution and the balance sheet burdens of enormous good will. Problems of direct sales reorientation of the acquired broker will present difficulties, but ingenuity will prevail to make these consolidated firms triumphant. While it is very unlikely that a major broker will acquire a substantial carrier, it is probable that giant life insurance companies and broad-based financial enterprises will acquire both substantial property-casualty carriers and national brokers. The foundations of convergence will finally be established upon which will be erected the new total consolidation of today's commercial property-casualty industry.

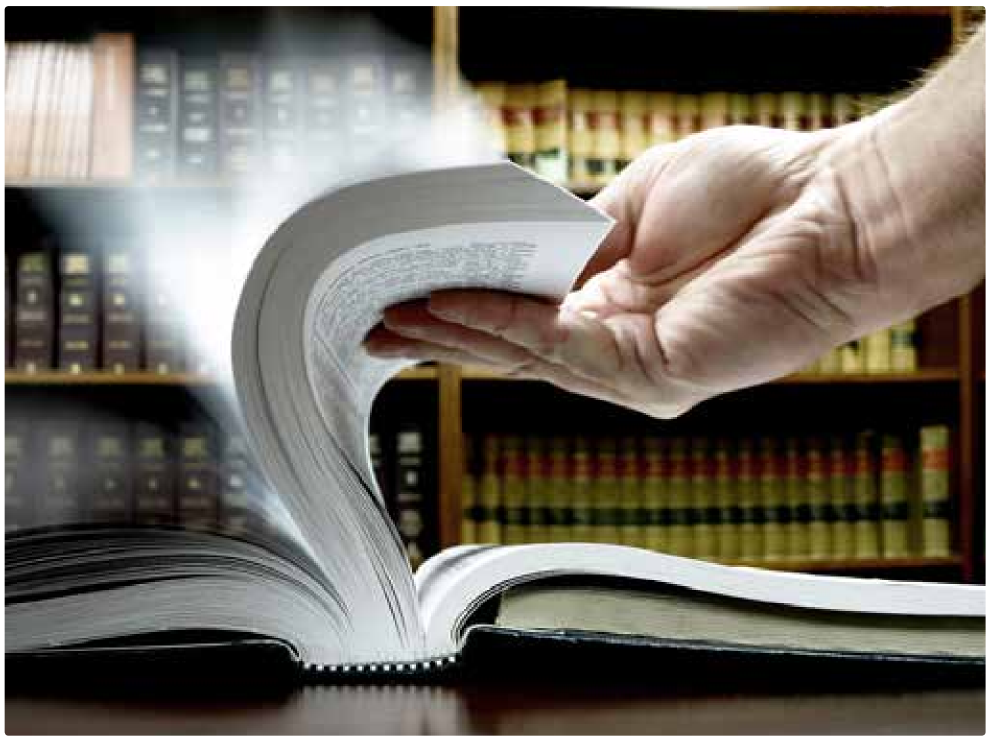
Observations of profound change provoke questions about the economic benefits and the moral values of integration. The public good will surely be served by an industry free to find its manifest destiny, motivated to serve the growing needs of all commercial buyers competently. Because integrated underwriter-distributors will be financially strong, managerially exceptional, and operationally advantaged by constant competition from formidable, near equal adversaries, convergence will benefit American business. Benefits will include enhanced insurance industry abilities to organize the capital available for risk transfer, to gather and spread risk more cost-effectively, and to create the new capital necessary to meet the industry's complex future obligations.

Moral objections to underwriter-distributors that counsel their own plan designs sell only their own products and service only their own programs will be overcome by knowledgeable evaluations of comparative performance. And comparative performance can best be developed and judged when competition is vigorous, free and responsible. Vigorous, free and responsible competition delivers value faithfully, balances the self-interests of buyers and sellers, arbitrates inequity and inefficiency, and augments society's perennial search for economic strength. Vigorous, free and responsible competition will move the insurance industry from separation to convergence for the benefit of buyers and society!

Editor's Note: Mr. Hines gave me the original copy of this address. **ISN**

THE BACK PAGE

NON-LIFE REINSURANCE MARKETS: PART 2: THE PROVIDERS



WORDS AND DEFINITIONS TO HELP INSURANCE PROFESSIONALS*

After describing the requirements of primary insurers in last month's Words and Definitions, the reinsurance market response is summarized here.

The University of Aston (UK) calls the largest reinsurers "portfolio partners", because they are active in almost all markets and have a high degree of technical expertise. They are the preferred partners of global primary insurers in providing excess of loss cover for peak risks and loss accumulations. They have the financial strength to satisfy the capital needs of local players and specialty insurers and also to walk away from unprofitable business.

The diversity of their portfolios reduces their capital requirements, thus finding favor with rating agencies, a trend that is likely to intensify when Solvency II is eventually implemented.

Another category consists of "monoline reinsurers" that are strongly capitalized and highly selective in their choice of cedants. They provide support for specific deals, often with specialty insurers on a quota share basis. This technical and customized approach results in long-term business relationships.

A third type of generally smaller reinsurer – the "blanket partner" – cultivates a traditional relationship with regional insurers. Such reinsurers may lack the technical sophistication of the largest reinsurers, but if they succeed in growing, they can transform themselves into "portfolio partners".

The three types of reinsurance strategy mentioned above rely on a strategy of long-term portfolio management. In contrast, the three types of reinsurer described below focus on price and in reacting appropriately to the market cycle.

So-called "patchwork partners" tend to select their business on the basis of the rates, a strategy that works most easily for smaller reinsurers. When they grow, however, relationships become more important, so that they may mutate into "portfolio partners". Even more price oriented are "price-taking profiteers" that write business when the market is hard and exit when it turns soft. Finally, reinsurers "of last resort" provide coverage at a high price when it is not otherwise available.

Mergers and acquisitions have reduced the need for reinsurance, and brokers and rating agencies currently regard reinsurers as being well-capitalized. These are two reasons why reinsurance rates have not increased as much as might have been expected in view of recurring natural catastrophes, and premium volume worldwide is stagnating. In this situation those large reinsurers enjoy a competitive advantage whose business strategy combines a seemingly paradoxical combination of diversification and market focus.

* Keith Purvis for Versicherungswirtschaft Nr. 17, September 1, 2013 (PIA Member)

ISN

continued from page 3

STANDARDIZED TESTING FOR INTERNATIONAL PROFESSIONALS

For as far back as I remember international departments have been considered in the best light as a necessary yet unheralded group and in the darker corners as fringe operators with not much to offer the bottom line.

It's all about the revenue from management's viewpoint. Little attention is given to international placements until either the risk manager starts screaming or the broker is threatened with a law suit stemming from an error or omission (e.g., non-compliance with local laws and regulations; claim or tax payment troubles; no local coverage; the list goes on).

When the 'red' light goes on all hell breaks loose. The offending broker(s) are summoned to the corner office, questions raised, answers are in short supply and people run for cover. Invariably a senior market relationship person is dispatched and the problem is 'fixed.' Well not really.

What needs to be addressed is how to avoid these dangerous and potentially expensive mistakes. Inadvertent errors can result in the loss of an entire account. In days gone by, brokers would hire knowledgeable people from AFIA, AIU or Johnson & Higgins who understood the complexities of international placements. Today those firms are a historical footnote. There are no professional international designations. There is no real training. International broker departments often rely on underwriters to tell them what needs to be done. It's a one-sided proposition. While on the job training is vital, brokers need to assess what their employees know about international insurance and backfill knowledge gaps with education. One way to do this would be to administer an industry-wide standardized test.

TIRED TERMINOLOGY

Two terms you will never see used in these pages are 'thought leader' and 'human capital.' Instead we will use 'smart people' and 'employees' or 'associates.'

The term 'thought leader' is demeaning to everyone who isn't of the 'smartest-guy-in-the-room' ilk. Everyone is capable of contributing. Right-brained creative people focus on the big picture rather than the details; something left-brainers who do a lot of advance planning, and approach challenges in a rational, linear way don't do. Both types working together are integral to all successful enterprises.

Seemingly I find many smart people cannot see the forest for the trees. Companies need to drop any reference to 'thought leadership' and let go the attitude.

Also, ditch the 'human capital' label. It conjures up thoughts of ancient Egyptian slavery. From where I sit, the old term 'personnel department' worked, was appropriate and didn't summon uncomfortable thoughts. The change started when business schools began urging aspiring young business leaders to consider employees as resources.

To those who dreamt up the irritating term 'thought leader', employees are 'human capital' – a replaceable commodity. As my able assistant in New York said "What am I, chopped liver?"

Readers, let's all get with the program and force these terms out of business-speak. **ISN**

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insurance industry faces in 2014 internal and external challenges": The Latin American insurance market enjoyed "a reasonably dynamic economic activity in most Latin American countries that supported the demand of premiums. However, price competition in massive lines (Motor and Health, mainly) kept pressing on the industry's aggregate underwriting results. Life and Life / Retirement Annuities show good results in spite of low interest rates", said Franklin Santarelli, Regional Managing Director of Fitch Ratings in an interview with Actualidad Aseguradora. "Central America excels again as the region with strongest results; Brazil and Mexico had good results as well in spite of the challenges in their environment. Results in Peru (due to pressures on underwriting results) and Chile (with pressures in investment results) were not so favorable, but still reasonably good". The 2014 industry forecast "comes with internal and external challenges", said Santarelli. "External challenges include each country's economic growth and interest rate trends which in most countries (if not in all) will stay at their low current levels", while "internal challenges are linked mainly to the recovery of underwriting results and a final way out from price competition practices which are certainly not sustainable". As regards 2014 ratings, he said that generally "prospects are stable in all countries where we are rating insurance companies" we have no country with negative rating prospects".

Latvia – Premiums collected by Latvian insurers in 2013 totaled 218.9 million Latvian lats ($429.3 million), a year-on-year increase of 11.7 percent, Forinsurer reported.

Nicaragua – The Insurance Market grew 31.6 percent. At December 2013 the Nicaraguan insurance system shows higher profits of 31.6 percent (before income tax) against the year ending in December 2013, reaching USD 14.4 million with an increase of 3.5 million dollars. Total premiums grew 13.5 percent and retained premiums 16.8 percent. The net operating profit of USD 14.4 million was obtained mainly by the financial area, with a profit of USD 10.94 million (15.7% more than in the preceding year). Underwriting results were positive – USD 5.38 million, 63 percent more than the preceding year. This is linked directly to the high increase in retained premiums (16.8%) allowing to fund different outlays of reserve variations, retained claims and net operating expenses. These items grew less than retained premiums allowing for a slight fall in loss and net expense ratios against 2012.

Russia – Proposed legislation in Russia calls for insurance to be made mandatory for space risks and if all goes as planned, the requirement could come into effect in 2015, Forinsurer reported.

Saudi Arabia – The Saudi government has decided to make third party insurance compulsory for high-risk facilities, Arab News reported.

South Africa – The South African Insurance Crime Bureau has stated that 30 percent of insurance claims filed in the country are estimated to be fraudulent, South African daily The Times reported.

United States (Vermont) – Vermont officials have reported licensing 29 new captives in 2013. After crossing the 1,000 licensed captives mark in 2013, Vermont captive regulators expect growth to continue in 2014, while new state legislation is pending that could ease the return of any captives that might wish to leave temporarily. **ISN**

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market, Vision 2025. Vision 2025 targets profitable growth from developed and developing economies and its aim is to ensure that the Lloyd's market remains the global centre for specialist insurance and reinsurance.

Alongside the pledges from the regulators and the government, the UK's biggest insurers have announced that over the course of the next five years they will invest 25 billion pounds in transport and energy projects, backing a government drive to shore up infrastructure investment. (Courtesy Mayer Brown) **ISN**

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–Paul Hering, PCPCU, Managing Director, Chief Executive Officer, Barney & Barney

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