BEST'S REVIEW® ISSUES & ANSWERS:

- Environmental Risk
- CEO Perspective
- Asset Allocation

Industry professionals discuss the current state of the environmental liability market, the future of the reinsurance business and asset allocation strategies.

Interviewed Inside:

Jon Peeples
Philadelphia Insurance Cos.

Marcus Winter
Munich Re US

Ann Bryant
Barings

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Winning Environment

Jon Peeples, vice president of Environmental, Philadelphia Insurance Cos., said he sees the environmental insurance market going through a change related to climate change and the pandemic. "Because of COVID, the market started to tighten and rates increased, following in the footsteps of the casualty market," he said. Following are excerpts from an interview.

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What is the current state of the environmental market?

We're going through some changes. Most of them are positive; some are curtailing the market, getting us toward a hardening market. Generally speaking, there's still more capacity out there with more carriers becoming involved. We're seeing the market continue to grow. However, claims trends and certain factors have impacted the market that we're seeing a restriction in terms. Prices have gone up slightly but not nearly as much as the casualty marketplace. We're seeing a tightening of the terms and conditions that the carriers are offering.

What environmental liability claim trends are you noticing?

We're seeing an increase in claims associated with some of the recent disasters from storms and fires. Where we're seeing increases in claims has to do with flooding, and they're having an impact on buildings. Traditionally, Environmental's coverage of flooding tends to be if a factory or industrial site is flooded—it will spread chemicals, similar to what happened in Houston a few years ago when the flood waters spread chemicals throughout the area. Now we're seeing an increase in claims frequency with indoor issues, such as mold and Legionella being developed. Buildings such as apartment complexes, condos, and office buildings are getting hit with water and flooding, which is causing a high degree of moisture and they're having large outbreaks of mold. The frequency of mold events and Legionella in the water systems of buildings is impacting our marketplace more so than traumatic events such as flooding at a factory or in an industrial location.

Jon Peeples
Vice President of Environmental,
Philadelphia Insurance Cos.

"When it comes to Environmental liability, PHLY has an experienced team that is easily accessible via any of our six offices located throughout the country."

Go to the Issues & Answers section at *www.bestreview.com* to watch an interview with Jon Peeples.

How is climate change impacting environmental liability?

We're seeing an increase in frequency and severity of storm events. Conversely, in places like California, it's been getting drier, so we're seeing more fires. These events lead to a greater impact on environmental liability claims. Clients are experiencing more indoor air-quality issues, more impacts associated to fires, where runoff water coming off buildings and streets is causing contamination. I feel that the continual impact that is coming from climate change is increasing our claims frequency and severity which could drive us into a possible hard market in the near future.

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Risky Business

Marcus Winter, President and Chief Executive Officer of Munich Re US, said that the future of the reinsurance industry is one that will continue to take on both existing and emerging risks. "That's our core business and the new solutions that we are developing will help to transfer our data into insights for our clients," he said. Following are excerpts from an interview.

Marcus Winter
President and Chief Executive Officer
Munich Re US

"Given the changes in our risks we need to focus on sufficient margins in our portfolio as well as a very good alignment of interest between insurers and reinsurers."

Go to the Issues & Answers section at *www.bestreview.com* to watch an interview with Marcus Winter.

What are the key drivers in the U.S. market you're focusing on?

Our whole world seems to be getting more risky at an unprecedented speed. Our business is the transfer of risk. If we weren't concerned about that, we would not be a good reinsurer. We work diligently to understand the risk, assess the risk, weigh the risk, structure it properly and then take it on and work with brokers, with the clients and with the ultimate insureds all along the value chain.

How did those issues translate into the Jan. 1 renewal season?

We have a range of big topics right now that affect the whole industry—insurance-related inflation far beyond the consumer price index, especially in pockets like used cars or labor costs and costs for construction material. Those things cause a lot of uncertainty. Also, regarding the legal system, some of the verdicts that we see show that the social inflation is not over. Beyond that, we are still in an environment with extremely low interest rates, meaning not a significant return on assets. Topping that off, we have both climate change and cybercrime on our plates.

What are you seeing surrounding the cyber market?

The cyber market is one of our big growth opportunities globally. Munich Re is one of the largest providers of cyber insurance capacities and cyber reinsurance capacities. But with rate increase you cannot really address the quality of the portfolio. When you look at traditional insurance covers for homes, for cars, for companies, those risks usually are fairly static. On the cyber side, every day of the week, one change in your software architecture or one new piece of software can significantly change your cyberrisk profile. Therefore the quality assessment of the underlying cyberrisk is a core part of the underwriting process.

When it comes to climate change, what has you most worried about it and how are you addressing it?

First of all, I think that the insurance industry in total, this year and in the past years, has done a very good job addressing climate change. We have supported millions of families and businesses to rebuild what they had lost. That's what the industry should do. On the primary insurance side, a broad range of losses have meant an increase in rates and adjustments in coverage. For risks such as wildfire or severe convective storms, we have made significant progress. But events like the winter freeze in Texas earlier this year show that we cannot completely capture all the exposures in smart models. That's not just a topic in the climate change area. We also did not expect that one cargo ship could block the entire Suez Canal, or that one verdict would be in the hundreds of millions for a risk thought maybe to be in the tens of millions. Therefore, we have to expect that unexpected events do occur—on the climate side and beyond. That's why we need to make sure that our models cover the things that can be modeled, and that our margins also cover the things that cannot be modeled.

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Asset Allocation Strategies

Ann Bryant, Head of the Insurance Solutions Group for Barings, said that when it comes to the strategic asset allocation process, the models are only as good as their inputs. "So you need to take that with a grain of salt," she said. Following are excerpts from an interview.

BARINGS

- A $387 billion global investment management firm
- A subsidiary of MassMutual

Ann Bryant
Head of the Insurance Solutions Group
Barings

"If some liquidity can be given, then strategic asset allocation can enhance yield without sacrificing other components of risk."

Go to the Issues & Answers section at *www.bestreview.com* to watch an interview with Ann Bryant.

Can insurers enhance yield without taking on more risk in their asset allocations?

Yes, they can. I think one key thing there is the definition of risk. If we are talking about volatility, that is one thing. Liquidity is another. Default is a third, it really does depend on your definition there, but we do believe asset allocation can offer investors an opportunity to enhance yield without taking on more default risk. It can also reduce volatility in the process. Often, though, insurers need to sacrifice something, and, if there is room, liquidity.

What are some recent asset allocation strategies that insurers are considering?

When it comes to illiquid private assets, those strategies have been considered for some time, especially by life and annuity writers, and now even by property/casualty—although property/casualty insurers typically require more liquidity. Insurers have been considering commercial mortgage loans, private placements, infrastructure debt,and investment grade type private assets—where they can get diversification in their portfolio and enhance yield, while potentially taking on less risk because the covenants are negotiated privately and can be tighter than with public investments.

Can you explain the strategic asset allocation process, including liquidity and other asset liability management considerations?

Strategic asset allocation (SAA) is a modeling process. Models are only as good as their inputs, so you need to take that with a grain of salt, in some ways. Also, models are meant to be directional. Even so, taking in the information about the liability to develop constraints around risk parameters—such as how much can be in illiquid assets—can help identify an optimal solution. Also, with regard to asset liability management, because most SAA models do not incorporate the liability cashflows directly, you can use duration, convexity, and key rate duration to try to match those cash flows as well as possible to reduce that type of liquidity risk and to be able to have cash flows to pay off the liabilities as needed.

Do solvency rules come into play when considering asset allocation?

Yes, they do. Solvency is a broad term, and I would argue that all of the regulations are about solvency and making sure that insurers are solvent. I think, though, when that specific term is used, it's often thought of with regard to the European regulations, so Solvency II. Then, also, in Bermuda, the solvency rules there. Really, the key difference that that points out between the United States and other parts of the world is that the discount rate includes the yield on assets under a solvency regime. In the U.S., the discount rate tends to be more of a prescribed rate, versus a yield on the assets themselves. In the rest of the world, the yield on the assets themselves is used to calculate the liability, so there is an extra benefit from yield enhancing assets under a solvency regime. That folds into the overall SAA process.

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