International Casualty

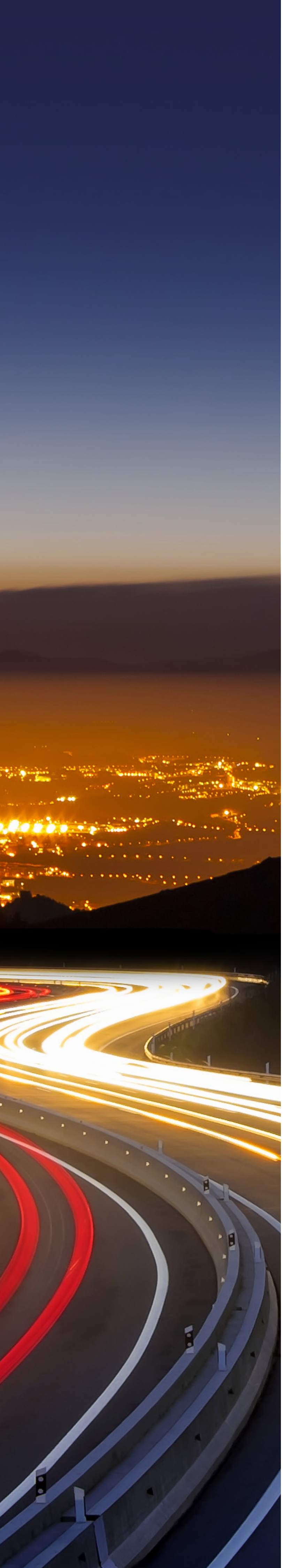
Q1 2020 Market Update

Miller

The first quarter of 2020 provides a useful time to look at what lies ahead throughout 2020 and for us to share with you some of the trends we saw throughout 2019. Syndicate business plans have all been signed off by Lloyd's and the impact of 1st January treaty renewals on upfront pricing can now be assessed, giving us a clearer idea of what to expect in the year ahead.

As ever we will continue to provide our clients with a competitive advantage by delivering best in class service and solutions with our 24 hour turnaround times and exclusive Miller facilities.

This update focuses specifically on Australian businesses but the more general updates on Lloyd's syndicate closures and rates are applicable to all of our international casualty clients.



Contents

Key points

The key points to take away from this update, and areas it focuses on, are:

Strong capacity

London remains a competitive and viable market for General Liability (GL) business, with Miller having access to over AUD 500m of GL capacity across our 12 core GL Lloyd's syndicates.

Our clients' renewals will be protected – we expect continued upwards pressure on rate (and minimum premiums where applicable) but don't envisage any further market-wide withdrawals on risks within their existing Miller portfolio.

Exclusive Miller facilities

We anticipate having a further two facilities shortly to further assist our clients' new business enquiries.

Differentiating yourself

The quality of submissions allows business to standout from everyone else's. Detailed exposure analysis, risk management & claims mitigation information is more important now than ever.

Syndicate closures & MS Amlin

Despite MS Amlin's withdrawal from writing International GL business, we have a plan in place for all the business they wrote for us.

Lloyd's 2018 Performance Review Update

2020 has seen a shift in focus from capping 'Gross Premium Income' (GPI) to reducing acquisition costs.

Casualty specific 'Future at Lloyd's' update

how the Lloyd's changes announced in 2019 are affecting the GL market, analysis of the potential GL under reserving issue and analysis of what the 'Future at Lloyd's' initiative might mean for GL.

Risks causing London GL carriers concern

Much like terrorism post 9/11, there are certain risks London GL markets feel are becoming uninsurable, or where market-wide solution are required. This includes Cyber, bushfire, combustible cladding, US jurisdiction and tailings dams.

Background on syndicate closures and GL under reserving

A more technical analysis of why syndicates who started trading in the 2010s have been particularly vulnerable, and why a GL under reserving issue may have arisen for those who are interested.

Updates to competitive wordings

We recently sent out our updated 2020 Australian Broadform Wordings. These have some enhancements of coverage, as well as some restrictions (such as a Cyber Exclusion in line with the Lloyd's-wide mandate on Cyber). These wordings remain competitive and we will continue to meet your clients' demands and needs.

AUD 500m of GL capacity and DOFI markets

Miller's exclusive facilities currently provide up to AUD 150m of capacity per risk, and we hope to have increased this to at least AUD 200m by 1st March 2020.

Across the 12 Syndicates we feel are most competitive on Australian GL business, we have access to over AUD 500m of capacity. All our markets are however increasingly looking to take subscription shares of a risk rather than write layers 100%. Getting submissions in early is therefore increasingly important to allow for the additional time in securing fully supported placement.

On certain specialist classes of business it is also possible for us to place business with A rated London company market security on a Direct Overseas Foreign Investment (DOFI) basis using Unauthorised Foreign Insurers (UFIs).

These UFI markets can often offer competitive solutions where Lloyd's cannot, and, as well as certain customised exemptions, any insured with more than AUD 200m in revenue/assets, or more than 500 employees, automatically qualifies. One good example of a possible 'customised exemption' is on rural pubs, outside of appetite for our Lloyd's markets, but where we have a DOFI market who are able to consider.

Rate Increases and Minimum Premiums

Throughout 2019, we saw an average 11% rate increase across our General Australian book against a reported market average rate increase of 19% on General Australian books of business.

Highly attritional claims accounts, and those exposed to bushfire, mining, hospitality etc. saw far higher increases – in some instances these were over 1,000%.

In the open market, Excess of Loss (XOL) pricing is now at a minimum of AUD 1,000 per million of capacity. Under our exclusive Miller facilities we are still able to achieve pricing as low as AUD 500 per million on benign risks, albeit there is upwards pressure on this pricing too.

Rate increases across 1st January 2020 treaty reinsurance pricing were not uniform. Larger Insurers who had not 'hit' their treaties saw increases of 5-10%. Smaller carriers or those who had 'burnt' their treaties however saw increases of 25% or more for their cover. This is likely to put a major squeeze on already struggling carriers. The increase in reinsurance costs has also caused more markets to reverse recent trends, seeing them move away from Quota Share treaties and towards XOL treaty reinsurance arrangement structures. This will mean that small to medium sized losses (anything up to AUD 5m) will now hurt our markets more, but the wider impact of this is as yet uncertain.

Miller facilities

Our dedicated Miller facilities enable you to leverage your wider books of business with underwriters to secure their support on the less attractive parts of your book by way of portfolio underwriting.

They provide time and cost efficiencies allowing us to obtain premiums significantly below the London open-market minimum premiums of AUD 25,000. We generally work to a minimum premium of AUD 10,000 under our facilities.

All our facility markets sign up to the Miller Broadform wordings, ensuring consistency of coverage across our quotations and more easily facilitating subscription placements.

They also allow us to pay enhanced commissions to our clients due to the additional work Miller perform on behalf of underwriters in terms of document production, portfolio analysis and risk modelling.

We are working with four markets on new Miller facilities, and expect at least two markets to provide us with facilities by 1st March 2020, ahead of the first quarter renewal season.

Standing out from the crowd

Underwriters have always responded favourably to well-presented risk information. In the absence of evidence to the contrary, underwriters typically assume the worst. This either results in declinatures or 'loaded' premiums.

Where we can demonstrate that the different risk exposures have been comprehensively analysed, and detail what the insured has done to mitigate the downside of these exposures, markets respond favourably. While London is not, and never has been, afraid of large losses, evidence is required to convince underwriters that those large losses will not reoccur annually.

In a Lloyd's environment where there continues to be pressures on GPI, insurers will be selecting those risks where:

- they are comfortable with the exposures; and
- where they can partner with producers they feel have their best interests at heart and who make their lives easier by providing a comprehensive risk analysis and pricing targets.

MS Amlin and Syndicate closures

MS Amlin Syndicate 2001 were the fourth largest International GL carrier in Lloyd's. They wrote over USD 100m in GPI per year, largely comprising primary business. MS Amlin were one of the recognised lead markets on both delegated authority binders and open-market placements. This book was put into run-off at the end of December 2019.

MS Amlin will be able to honour all existing business until its natural expiry date. They have not however been able to renew any business from 1st February 2020.

MS Amlin's closure of their International GL book was a company rather than Lloyd's decision. When their GL book was deemed not to stand up to actuarial scrutiny, it was closed by their Japanese parent.

We have allocated income from our existing facilities to take on all the MS Amlin renewals we have for the month of February and we plan for the rest of our MS Amlin business to be absorbed into our new facilities from 1st March 2020.

2019 however was a year which did not just see syndicates withdraw from individual product lines, but also widespread closures; Neon Syndicate 2468, Pioneer 1980, Acappella 2014, Vibe 5678 and Skuld Syndicate 1897 all went into run-off (the syndicates were shuttered) in 2019. This was primarily due to operating cost struggles, poor competitive positioning, results and limited access to capital.

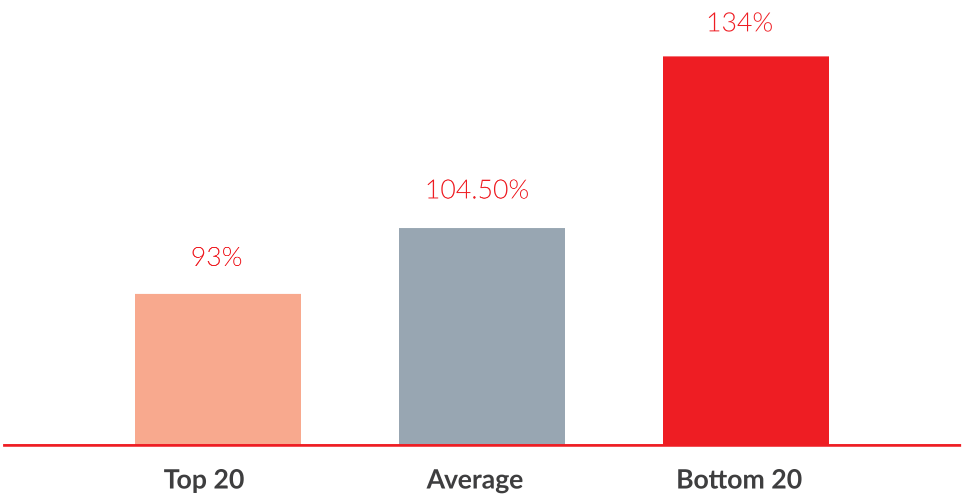
Since 2018 eight syndicates have shuttered accounting for circa AUD 2bn of lost capacity (about 3% of total Lloyd's market capacity). All eight shuttered syndicates have been bottom-quartile performers based on the latest combined ratio figures, and have consistently underperformed since their inception.

All Lloyd's syndicates have the same S&P A+ credit rating, as they are all protected by Lloyd's tripartite capital structure which is underpinned by the central fund, which currently stands at GBP 2.185 billion. It is because of this central fund that even where a syndicate cannot meet its obligations, Lloyd's has paid every single valid claim for the past 332 years.

Miller will continue to monitor other syndicates with broadly similar start dates (2010s), ownership, reliance on trade capital and market positioning to the eight stuttered syndicates, as well as poorly performing GL teams within other syndicates. This is because even though all syndicates have now finalised their capacity, and are trading according to their 2020 business plans, the ability of some syndicates to renew an account for the next 3 years is more questionable than for others.

With closures however comes new opportunity. Stephen Catlin (former CEO of Catlin) has set up Convex who are projecting to write USD 1.7bn of GPI in 2020. That is approximately 5% of all premium written in Lloyd's. Their licenses mean that they are currently only a DOFI market, but with senior underwriter Dervla Lynchehaun recently joining from Tokio Marine Kiln syndicate's International GL team, we will be monitoring their movements.

It is also worth reflecting that the lost capacity and shutteirng of syndicates will be more than counterbalanced by growth lined up by the 14-15 'light-touch' syndicates (longstanding and well performing syndicates). The top 20 performing syndicates in 2018 had a combined ratio of just 93% vs the worst 20 performing syndicates who had a combined ratio of 134%. The message from those better performing syndicates is that they are very much open for business (within appetite) and we are aligning ourselves closely with them.



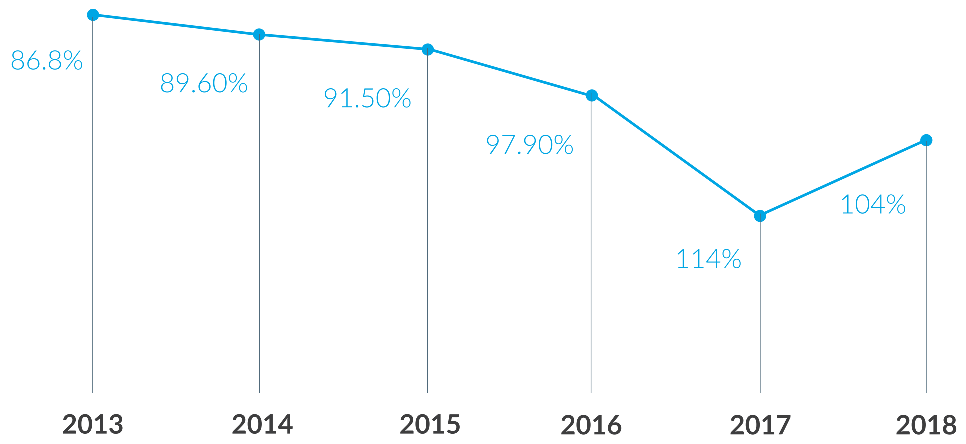
Lloyd's syndicates' 2018 combined ratio

Partnering closely with these top 20 performing syndicates means that both Miller and Lloyd's remain very much open for business.

Lloyd's performance review update

As a reminder, the Lloyd's 2018 performance review was driven by the fact the market which in 2013 had pre-tax profits of circa £3bn and was providing a 16.2% return on capital, had fallen to a pre-tax loss of over £2bn by 2017 and a negative 7.3% return on capital.

The below graphic demonstrates the deterioration in Lloyd's aggregate combined ratios from 2013 to 2018:



Lloyd's average combined ratio

In response to the market losing money and being on trend to keep losing money, the 2018 review marked a shift towards:

- Lloyd's being more assertive in syndicates business planning to protect its brand and central fund;
- Greater focus on 'underwriting for profit' rather than the 'top line' GPI focus of recent years; and
- Portfolio re-engineering and rate increases across all business lines but with a focus on worst performing classes of business (decile 10) and 'soft market' business.

The impact of this on decile 10 markets and rates across both Lloyd's and global markets was well documented last year.

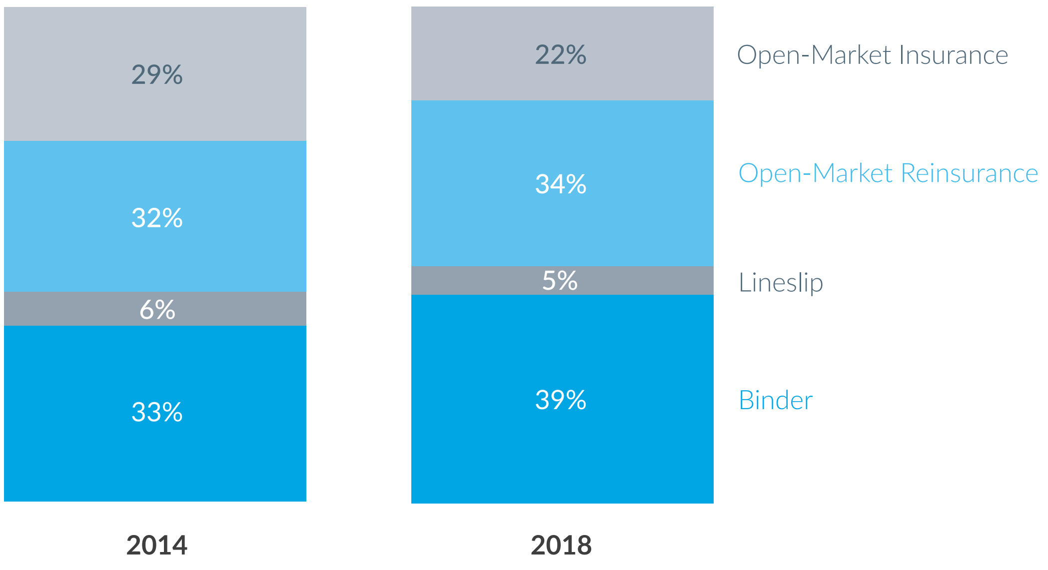
Other than the impact of shuttered syndicates discussed previously, the 2019 review continued to underscore good performance, but also saw an increased emphasis on reduced acquisition costs.

Despite a number of changes to how Lloyd's business is transacted, with a recent emphasis on streamlining and modernising, the cost of transacting business in Lloyd's still typically accounts for 40% of the policy premium. With increased pressure on expenses being applied by Lloyd's, underwriters are closely monitoring acquisition costs. In particular, they are making a move away from facility driven business towards open market business where total commissions are typically 8% lower.

Every 1% Lloyd's removes from its cost base increases its profitability by GBP 300m

The MGA/Coverholder model in particular is coming under scrutiny due to below average results and higher acquisition costs than in the open-market.

Non-performing MGAs are being non-renewed and markets are placing a greater emphasis on unique distribution, niche product, underwriting knowledge and insurtech platforms. Markets are therefore looking to rebalance their books away from binders and back towards 2013/ 14 open-market levels (where acquisition costs are on average 8%+ lower).



Proportion of total Lloyd's GWP by method of placement

Despite these pressures we will continue to make use of our dedicated Miller facilities where it is appropriate to do so. As commissions are renegotiated throughout the year, and as we set up new facilities and negotiate new commission structures, we will of course keep our clients updated.

Lloyd's update on General Liability

GL did not fall into decile 10 in the 2018 Lloyds Business Review. Decile 10 meant that those classes were the worst performing within Lloyd's, with the majority having lost money on aggregate since 2012.

For syndicates who wrote classes of business within that decile, they had to justify why they were doing so and, unless their book was an outlier with good results, they had to come up with a remediation plan / stop writing the class.

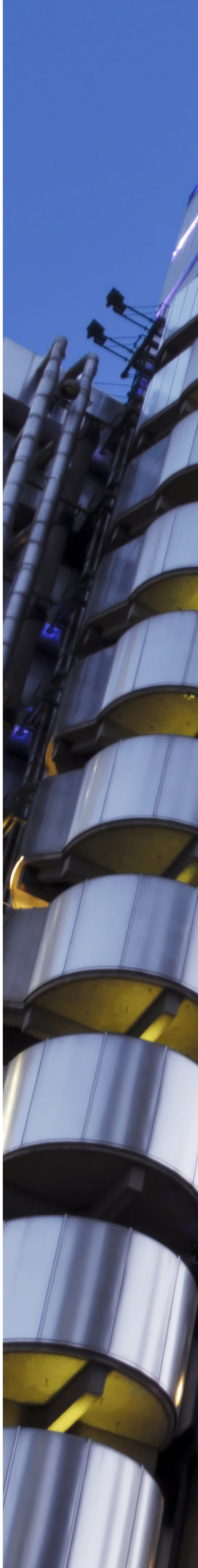
Casualty has however not been the most profitable line of business, and there are fears within the market that there is a systemic under reserving issue on GL business. Lloyd's reported rate change on the period 2012–17, on the GL risk codes 'NA' and 'NC', is just 8%. Having spoken to a number of underwriters in the International GL market who have been trading over this time frame, they would tell you that they estimate the GL market reduced rate by an average of at least 6% per year. If correct, the compounded rate change would be 34% on this basis. Given many actuaries are working off the negative 8% rate movement; this could mean that there is an under reserving issue as high as 26%. (Please see page 12 for more analysis of how these reserving errors may have arisen).

Indeed PWC's recent external audit of MS Amlin did reveal a systemic under reserving issue within their GL numbers. This ultimately led to the closure of their GL book which has consequently increased the scrutiny within Lloyd's of how GL books are being reserved even further. A deep dive by Lloyd's into GL is now anticipated to happen later this year. If this under reserving issue is a reality, it will have a major impact on GL markets. Miller is continuing to engage with markets, analysing individual syndicate results and working with our actuaries and claims teams to ensure we are extremely careful about placing business with any markets we feel may struggle, or where our claims team report trends of markets being obstructive.

As part of the 'Future at Lloyd's strategy', the market and the board of the Lloyd's Market Association (LMA) confirmed that the modernised syndication pilot will start with 'marine hull' and 'international casualty' classes. This is likely to begin in the 2nd quarter of this year. Modernised syndication would essentially see the market divided into 'Alpha' and 'Beta' syndicates or 'lead' and 'follow only' markets. We will keep a careful eye on how this pilot develops and be especially wary of anything which we determine could be anti-competitive.

We will also see what impact, if any, the recently announced departure of the Lloyd's Performance Director John Hancock will have as he was seen as integral to both this pilot, and the wider 'Future at Lloyd's strategy'.

Referring specifically to the pilot late last year, Hancock stated that "once agreed, the revised lead-follow model will deliver significant benefits including improved standards, cost reductions, more proportionate governance and oversight, and smoother implementation of the Future at Lloyd's solutions. This distinction between leaders and followers should make it easier for brokers to place business at Lloyd's, and should drive good quality, sustainable underwriting performance and growth."



GL market reactions to emerging risks

2019 was an eventful year with a number of GL losses increasing the awareness of markets to other catastrophe exposures within their books. This has led to a number of new considerations becoming concerning to GL underwriters.

Most notably and tragically are the bushfires in Australia which caused 33 deaths and destroyed nearly 17 million hectares, with over 1 billion animals estimated to have been lost.

It was reported that the Insurance Council of Australia reported that bushfire losses had now surpassed Black Saturday in 2009, exceeding AUD 1.65 bn in losses. While these have largely been property claims with most fires appearing to have started due to lightning strike/natural causes or arson, courts have shown precedent for going after the deeper pockets of the GL insurance market.

Furthermore, the true picture of the impact will take time to determine, and the trouble the authorities have had in controlling the fires once they have started, suggest Insurers cannot limit their downside if one of their Insureds were found to have been liable in contributing to bushfire losses. As such, not only have markets for traditional bushfire exposed risks continued to reduce, but all insurers are now concerned about any Insureds operating in rural areas, especially those where they deem there to be a spread of fire risk i.e. timber yards.

Following the Lacross and Grenfell Tower fires, the risks associated with aluminium composite panels (ACP) were brought into focus with many markets insisting on ACP exclusions for exposed risks. Combustible cladding has again become a topic of conversation with the NSW Civil and Administrative Tribunal ruling Biowood cladding is non-compliant with the Building Code of Australia and must be removed as it is a ‘major defect’. It is estimated Biowood cladding is used on hundreds of residential and commercial buildings across Australia however at this stage the true exposure is not known. All insurers continue to monitor the situation closely and for both property owners and building contractors with detailed analysis of the cladding exposures now a pre-requisite information requirement for insurers.

The Miller Broadforms have historically been silent on Cyber, but with Lloyd’s applying increasing pressure on syndicates to determine the exposure their portfolios have to cyber events, policies will need to either provide affirmative cover or specifically exclude Cyber. Our 2020 Broadform will therefore contain a limited exclusion moving forward, but Miller have a market-leading cyber team who we can happily put you in touch with should an insured have a major concern in this area.

With respect to risks with a US jurisdiction touch point underwriters are coming under increased pressure due to the substantial inflation of US claims costs. One recent claims example saw a US guest, on a jet ski at a Caribbean hotel, break their leg and suffer ‘mental anguish’. The claim they brought in a Californian court exhausted the USD 10m policy limit. Where US jurisdiction is required please note that it will have a material impact on both premium and excess, and full information on the exposure and on any assets the Insured has in the US will be required. Insureds may wish to consider the extent to which they truly need this cover, as policy jurisdictions of ‘Worldwide excluding the USA’ will avoid this problem.

Where any of these covers are required, we need to gather as much mitigating information as possible and prepare our insureds for increased premiums and excesses making them cognisant of market conditions. Getting well prepared information across early gives us the best possible chance of obtaining terms.

Background on syndicate closures and GL under reserving

The change in market conditions from 2012/13 onwards saw increased global insurance capacity which precipitated a soft market of year on year rate reductions.

For those syndicates who started writing business in Lloyd's in the early 2010s, this led to increased costs and poor loss ratios. These syndicates still had an imperative to secure growth to cover start-up costs at the wrong point in the cycle.

This led to adverse selection as these new syndicates fought to be shown business and pay above average acquisition costs. It also resulted in a fast expansion in the number of delegated authorities as they strived to gain market share – this therefore disproportionately increased their average commissions. This loosening of the reins via new MGAs and increase of capacity further exacerbated the soft market cycle. These syndicates also had to contend with additional Lloyd's costs, and in a market which in 2018 had an aggregate expense ratio of 39% anyway, all contributed to their combined ratios (loss ratio + operating costs) being well in excess of 100%.

In respect to a potential GL under reserving problem, it is important to recognise that Lloyd's has 219 active risk codes. The two most common GL risk codes we use on our clients' behalf are NA and NC. These are both general and miscellaneous risk codes, but essentially they collate everything which is GL, non-US and which doesn't have a more specific code. There are, for example, more specific risk codes for EIL, product recall, nuclear liability, terrorism liability, UK EL etc. NA is the risk code for occurrence business and NC the risk code for claims made business.

In just the 5 years between 2012 and 2017, the number of syndicates writing business under the NA risk code increased by 40% and the amount of business written under this code increased by almost 50% from circa USD 1bn to circa USD 1.5bn. There were two main drivers behind this:

1. Lloyd's allowing new entrants into the market who had to write business in order to cover their significant start up costs; and
2. The 2008 financial crisis lead to regulators around the world increasing the solvency ratios of banks and insurers. This had severe consequences for syndicates who had traditionally specialised in only handful of classes of business, as it drove down their return on capital. On the other hand, if they diversified into new product lines their aggregate capital holdings did not have to materially increase. This is because they were credited with portfolio diversification, meaning it reduced their capital holdings as a % of total GWP.

The other interesting trend over this time is that the amount of business written under delegated underwriting authorities (DUAs) within this cost code increased from around 34% to almost 66% of the total amount of business. To put it simply there was almost a 200% increase in the amount of DUA business written under the NA cost code between 2012 and 2017.

Factors which distort rate change data include writing new business to Lloyd's (as you can only track the rate movement on renewals), delegating authority (as historically not all syndicates have captured rate movements within DUAs) and business moving within Lloyd's (as Lloyd's only tracks rate movement at the individual Syndicate level).

Given the increase in both syndicates writing business under NA and the large premium and binder growth, this cost code is particularly susceptible to these distortions. It is for this reason that there may be an under reserving issue of around 26% in GL lines.

As mentioned earlier in this report, Lloyd's will likely be undertaking a deep dive into this issue later this year.

Updates to Australian Miller wordings

We have updated our wordings to reflect changing market dynamics such as the Lloyd's cyber directive.

We are however pleased to confirm that following much negotiation our 2020 Miller Broadform Wordings have now been signed off by key markets and were implemented earlier this month.

Let's keep talking

It will no doubt be another lively year, but by maintaining regular dialogue and working together we have every confidence we can continue to sustainability build your London portfolio for the long term.

Charles Lane
Partner – Head of Casualty
T +44 20 7031 2907
charles.lane@miller-insurance.com

Philip Johnson
Practice Leader – International Casualty
T +44 20 7031 2671
M +44 7795 061 103
philip.johnson@miller-insurance.com

Leela Tiralongo
Account Executive
T +44 20 7031 2963
M +7736 620 810
leela.tiralongo@miller-insurance.com

Tim Sloan
Head of Claims – Property & Casualty
T +44 20 7031 2908
tim.sloan@miller-insurance.com

Matthew Khoo
Account Handler / Broker
T +44 20 7031 2952
matthew.khoo@miller-insurance.com

Molly Westmore
Account Handler
T +44 20 7031 2954
molly.westmore@miller-insurance.com

Miller
70 Mark Lane
London
EC3R 7NQ
T: +44 20 7488 2345
F: +44 20 7702 3555
miller-insurance.com

Miller