Update from AM Best's 2019 Review & Preview Conference

March 2019

AM Best recently held its 26th annual insurance ratings conference, Review & Preview, in Scottsdale, Arizona. The conference theme was innovation and opened with Guy Kawasaki, Chief Evangelist at Canva, as the keynote speaker, and included an innovation fair showcasing 12 companies focused on ideas for the insurance industry. The agenda also consisted of industry leaders discussing topics such as M&A, ERM, regulation, mortgage risk, and current industry trends.

Below is Aon's view of the key points from the main property and casualty breakout sessions and a breakdown of the innovation fair companies looking to disrupt and add value to the P&C sector.

Introduction of Innovation Criteria

On March 14, 2019, AM Best released a request for comment (RfC) titled "Scoring and Assessing Innovation." Any comments are due from the industry by May 13. AM Best believes that now is the appropriate time to implement a separate innovation assessment in their ratings due to changes in demographics, climate-related trends, and technology. While innovation is already factored into the overall rating through the building blocks, AM Best intends to calculate an explicit innovation score that will impact companies' business profile assessments. The score is based on two elements, innovation inputs and outputs, which consist of the following sub-assessments: leadership, culture, resources, processes and structure, results, and level of transformation. Below are the five assessments that AM Best will score each company. Companies that achieve a measurable positive impact over time will receive higher innovation scores. No rating actions are expected to occur in the near-term after the criteria is implemented. See Aon's summary of the Innovation criteria at http://bit.ly/ec-bulletin-innovation-2019.

Innovation Assessment	Non-Innovator	Reactor	Adopter	Innovator	Innovation Leader

Market Segment Outlooks

AM Best publishes market segment outlooks with their view on the impact of current trends on carriers operating in specific segments of the insurance industry over the next year. Some typical factors AM Best uses in their assessments include current and forecast economic conditions, potential regulatory changes, emerging product developments, and competitive issues that may affect insurers in each segment.

The estimated 2018 combined ratio for the U.S. P&C industry is 101.5% and ROE is 5.8%. Due to Hurricane Michael and the California wildfires, 2018 estimated catastrophe losses remained high at $37 billion (although down from $53 billion in 2017). This marks the second consecutive year of catastrophic losses above long-term averages and the second highest since 2011. Companies affected by Hurricanes Irma and Maria experienced significant loss creep in 2018 due to assignment of benefits (Irma) and business interruption claims (Maria). AM Best expects personal lines rate increases in 2019 to be higher than commercial lines mainly due to severity trends. The BEAT tax reform led to significantly higher net premiums written retained in the U.S. as many companies that had been utilizing offshore affiliates chose to substantially alter those agreements

AM Best provided its net premiums written growth and combined ratio estimates for industry sectors shown in the tables below.

		Net Premiums Written Growth		
Industry sector	**Outlook**	**2017 A**	**2018 E**	**2019 P**
Personal	Stable	6.4%	6.0%	5.2%
Commercial	Stable	0.4%	10.2%	3.1%
Global Reinsurance	Stable	10.3%	14.3%	10.0%

		Combined Ratio		
Industry sector	**Outlook**	**2017 A**	**2018 E**	**2019 P**
Personal	Stable	104.4%	101.8%	100.2%
Commercial	Stable	102.1%	102.0%	102.7%
Global Reinsurance	Stable	110.1%	99.7%	97.9%

Source: AM Best's Review & Preview Materials

AM Best provided the following updates:

- **U.S. personal lines segment – maintain stable outlook:** Significant rate actions in recent years have improved the bottom line for many personal auto writers. Auto claims frequency has moderated in 2017 and 2018 mainly due to rising gas prices resulting in lower growth in miles driven. However, severity trends have risen due to costlier medical expenses and vehicle repairs. AM Best anticipates the following trends in 2019: improved efficiency as legacy systems are retired, more diversified distribution channels, more ways to bundle, and better technologies to combat fraud. The homeowners market continues to demonstrate strong risk-adjusted capitalization despite elevated catastrophe activity. Underwriting discipline and improved ERM capabilities with emphasis on risk selection and concentration management remain key. AM Best is also focusing on reinsurance capacity and potential rate increases, especially for companies with loss affected programs and concentrated exposures. Use of various reinsurance structures such as aggregates and top and drops have led to greater vertical and horizontal protection and have limited catastrophe driven downgrades.

Headwinds	Tailwinds
Elevated frequency and severity of weather patterns	Strong risk-adjusted capitalization
Potential reinsurance pricing pressures – particularly loss affected regions	On-going underwriting and pricing discipline
Evolving customer and agent expectations	Core property performance (excluding weather events)
Equity market volatility	Ample reinsurance capacity – increased use of innovative/flexible structures
Rate of technology adoption	Advanced pricing sophistication

Source: AM Best's Review & Preview Materials

- **U.S. commercial lines segment – maintain stable outlook:** Elevated catastrophe losses in 2018 were typically viewed as earnings events, as the sector maintains strong risk-adjusted capitalization. AM Best is concerned that the abundance of capital could relax underwriting discipline that would strain companies' balance sheets in the long-term. Workers' compensation, the largest line of business in the segment, remains profitable despite modest rate declines. Persistent favorable reserve development has led to improvement in calendar year combined ratios. Additional factors driving the stable outlook are the improving interest rate environment, lower tax rate from the Tax Cuts and Jobs Act and stable reinsurance pricing. AM Best maintains a negative outlook on the commercial auto segment due to prior year adverse reserve development and rate inadequacy. The medical professional liability line also remains on negative outlook due to shrinking demand and prolonged soft market conditions.

Headwinds	Tailwinds
Competitive Market Conditions	Strong risk-adjusted capitalization
Continued challenges in commercial auto	Rate increases across casualty lines
Elevated "Other Liability" losses	Loss costs "benign" across most lines
Potential for increased inflation	Rising interest rate environment / US economic growth slows, but continues
	Less volatile cycles driven by innovation

Source: AM Best's Review & Preview Materials

- **Global reinsurance segment – revised from negative to stable outlook:** Estimated 2018 premium growth of 14% attributed to the growing markets of mortgage and flood and the improving economy. Pricing appears to have settled at the bottom of the cycle for the near future. Alternative third-party capital is expected to maintain future return expectations following 2017 and 2018 catastrophe losses. Traditional reinsurers are experiencing a decline in earnings and capital volatility as third-party capital is being utilized in the retro market. The rising interest rate environment could bolster overall returns and create options for asset managers to re-allocate catastrophe risk capital. Increased rates in the retro market due to tight capacity are expected to be passed down to primary insurers.

Headwinds	Tailwinds
Intense competition	Increasing alignment between traditional and third-party capital
Excess capacity limits the potential for improvement	Improving price discipline
Potential for increased inflation	Rising interest rate environment
Rates stabilized, but remain under pressure	U.S. economic growth slows, but continues
Continued interest from third-party capital, even beyond prop-cat lines	Use of third-party capital in retrocession programs reducing earnings volatility

Source: AM Best's Review & Preview Materials

Benchmarking

AM Best compares companies' historical results in absolute terms as well as the degree of volatility, typically emphasizing the most recent five-year period. Some benchmarks used include industry composite, issuer credit rating (ICR) composite, building block assessment, and known competitors.

AM Best provided the following updates:

Balance sheet strength: AM Best emphasizes that while BCAR remains a key component of balance sheet strength, other considerations factor into the assessment. For example, in the chart below only 40% of companies that have "Strongest" BCAR levels receive the "Strongest" balance sheet strength assessment.

AM Best noted differences in the metrics between market segments. For personal lines companies, 27% receive the "Strongest" assessment and 51% have "Very Strong," versus the commercial lines companies where 42% receive the "Strongest" assessment and 46% have "Very Strong."

Final Balance Sheet Strength Assessment						
BCAR	Strongest	Very Strong	Strong	Adequate	Weak	Very Weak
Strongest	40%	51%	7%	2%		
Very Strong	5%	59%	27%	9%		
Strong			52%	43%	5%	
Adequate				63%	37%	
Weak					80%	20%
Very Weak						100%

Source: AM Best's Review & Preview Materials

Operating performance: AM Best noted that 29% of P&C companies receive "Strong" and 53% have "Adequate" assessment. AM Best shared an example exhibit shown below of their color-coded composite benchmarking analysis, which calculates the percentile of each ratio over a five-year period. For example, the illustrative company's 2018 combined ratio is 123% compared to the composite 105% thus putting them in the 93rd percentile.

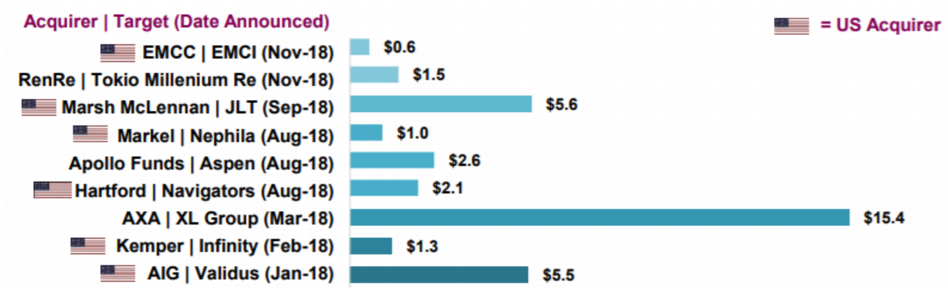
Year	Loss & LAE Ratio	Composite	Percentile	Expense Ratio	Composite	Percentile	Combined Ratio (CY)	Composite	Percentile
2013	60%	68%	35%	35%	31%	68%	96%	100%	37%
2014	58%	68%	29%	41%	31%	81%	99%	99%	58%
2015	68%	67%	62%	41%	31%	82%	107%	99%	87%
2016	74%	70%	74%	43%	31%	83%	115%	101%	91%
2017	77%	74%	74%	48%	31%	89%	123%	105%	93%
10-Yr Wt `Average	62%	71%		43%	31%		105%	102%	
10-Yr Std Dev	8%	8%		4%	3%		8%	8%	

Source: AM Best's Review & Preview Materials

Business profile: AM Best notes that the majority (53%) of U.S. P&C companies receive a ‘Limited’ assessment with only 9% achieving a ‘Favorable’ view and 34% a ‘Neutral’ evaluation.

Mergers and Acquisitions

2018 was an active year for U.S. buyers who completed six of the nine P&C public deals – EMCC, Marsh McLennan, Markel, Hartford, Kemper and AIG. In contrast, only two of fifteen buyers in 2014-2015 were U.S. based. AM Best also notes that P/BV for global reinsurance market is trending upwards, currently at 1.17x. The average since 1994 is 1.16x with a low of 0.75x in 2009.



Source: AM Best’s Review & Preview Materials

Enterprise Risk Management

AM Best disclosed that almost all (92%) of companies receive an “Appropriate” ERM assessment, with only about 1% achieving a “Very Strong” evaluation. However, AM Best emphasized that ERM is not meant to be a one-time assessment. As the industry continues to evolve in this area AM Best expects that companies will also keep improving. AM Best utilizes a risk impact worksheet to assess companies’ ERM in three facets – risk management framework, risk management capabilities relative to risk profile, and overall ERM. AM Best makes note of how demand surge following the HIM (Harvey, Irma, Maria) events has led to stronger ERM practices. For example, many insurers that paid high prices to independent adjusters due to a supply shortage now have contracts with independent adjusters that specify a pre-determined fee should another event occur. For reinsurers, the ability to manage aggregate exposures is key.

Coverage Gaps

The conference panel believes that addressing the following three coverage gaps begins with brokers because they have easier access to lead the conversation with and educate policyholders. Key areas include:

- Earthquake: it is estimated that <15% of California homeowners have EQ coverage
- Flood: Hurricane Harvey experienced 70% uninsured losses; 41 million at risk before sea level rise, while only 5 million are covered by the NFIP
- Cyber in commercial lines sector

Loss Reserving

AM Best views the U.S. P&C industry loss reserve to be $29 billion deficient at year-end 2018. This deficiency is about half from core lines of business and half from asbestos and environmental.

Most lines of business are in a stronger position compared to year-end 2017.

Line of Business	Estimated Reserve Deficiency ($billions) At 12/17	Estimated Reserve Deficiency ($billions) At 12/18	Change
Workers' Compensation	10.4	12.0	Weaker
Other/Products Liability	7.3	6.3	Stronger
Commercial Auto Liability	2.9	2.6	Stronger
Personal Auto Liability	1.0	-0.5	Stronger
Reins – Non-Proportional Assumed	1.3	1.8	Weaker
Homeowners	0.1	-0,2	Stronger
Commercial Multiperil	0.1	0.0	Stronger
Medical Professional Liability	-2.5	-2.0	Weaker
All Other Lines	-4.2	-4.7	Stronger
Total Core Reserves	16.5	15.3	Stronger
Asbestos & Environmental	16.4	14.0	Stronger
Total	32.9	29.3	Stronger

Notes: Includes statutory discount. Positive values indicate deficiency, negative values indicate redundancy.
Source: AM Best's Review & Preview Materials

Companies at Innovation Fair

amali SOLUTIONS GROUP	Amali is the creator of SubroProSM, an innovative subrogation platform delivering workflow, payment automation, and business intelligence impacting not just the subrogation process, but also the overall claims workflow.
Betterview	Betterview is a property data platform that captures, organizes, and analyzes data for buildings and properties and informs every transaction for decision-makers who want to minimize risk, cost & waste in an increasingly competitive environment.
dacadoo It's all about you.	dacadoo measures clients' heath with Health Score and helps them actively manage their health and well-being in an easy and fun way, while allowing life & health insurers to deploy their own fully branded digital and mobile health engagement solutions towards their individual and corporate clients.

Delos	Delos models wildfire risk, which allows for improved accuracy in underwriting and pricing by using a unique dataset of remote sending imagery, weather data, ignition models, and a proprietary simulation algorithm, to assess the likelihood of a wildfire at any address over the next year.
FairClaims	FairClaims is an online dispute resolution platform that provides digital arbitration, mediation, settlement analytics, and case assessment tools in an all-in-one web portal. Insurers & claimants can resolve claims from home or office without court or litigation.
flō BY MOEN	Flo is an all-in-one security system for home water supply that is proven to prevent water damage. The water monitoring and shut-off system proactively detects micro-leaks and other vulnerabilities anywhere in a home's water supply.
GIC GEOSPATIAL INTELLIGENCE CENTER	The Geospatial Intelligence Center (GIC) provides geospatial support and data (collected annually) as well as first responders in disaster situations. The GIC operates as a consortium of insurers sharing pass-through program costs proportionally across the GIC member insurers.
Life.io.	Life.io is a digital engagement and loyalty platform built for insurance carriers and agents. The platform delivers a personalized, fun, and engaging user experience that helps users improve and manage their life across physical goals, financial milestones, and emotional support.
sureify	Sureify provides an online platform for life insurance companies to digitally acquire, engage, and maintain customers, and drives customer engagement by incorporating mobile apps, health devices, and wellness programs in the insurance product experience.
Slice	Slice Labs Insurance Cloud Services (ICS) is transforming traditional insurers into digitally driven carriers by providing them with a platform that enables them to quickly ideate, experiment, test, and deploy new, on-demand insurance products.

The Institutes® RiskBlock Alliance	The Institutes RiskBlock™ Alliance is an industry-led consortium working to unlock the potential of blockchain in collaboration with the insurance industry. They accelerate time to market and adoption through real-world applications and impactful blockchain use cases.
TRUEPIC CERTIFIED. ORIGINAL.	Truepic is a photo and video verification platform that uses controlled capture technology and image forensics tools, and includes products for both underwriting and claims processing with a low-cost, one-click process for desk adjusters.

Contact Information

Aon's Rating Agency Advisory team can provide assistance in understanding rating agency requirements and potential changes. Please reach out to your Aon broker or contact a member of Aon's Rating Agency Advisory team.

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