EXECUTIVE INSIGHTS

U.S. Re Under 40s and Bermuda Under 40s asked Frank T. Harrison, President and CEO of Holborn, and Kathleen Reardon, CEO of Hamilton Re, to share their views regarding the current state of the reinsurance marketplace. We thank Frank and Kathleen for their time, valuable insight, and willingness to contribute to our collaborative newsletter.

INTERVIEW WITH **FRANK T. HARRISON,** PRESIDENT AND CHIEF EXECUTIVE OFFICER, HOLBORN

Q: In todays global (re)insurance market, innovation has become increasingly critical for maintaining a competitive edge. How do you define innovation in the context of (re)insurance and, in your view, where does the industry fall short in that respect?

A: I would define innovation in reinsurance as providing new forms of capital/protection at affordable prices to insurers that help them manage their own risk and capital.

Reinsurance is falling short with respect to innovation by failing to develop new products to cover certain existing and emerging exposures. The recent experience with the non-renewal of TRIA is an example of reinsurance not being as innovative as it could be. While some insurers were able to buy additional coverage to plug the gap created by the non-renewal of TRIA, some insurers could not get the coverage (at a reasonable price) and opted to go bare. This was an opportunity for the private reinsurance market to capture this part of the market from the government, at least the conventional part of the spectrum. Opportunity blown, at least for now.

With respect to emerging risks, cyber risk is a growing issue for most businesses, and insurers want to offer that coverage (it's a promising growth area for them at a time of falling revenues), but the uncertainty of the scope and magnitude of potential loss for any one insurer is limiting their ability to take advantage of this opportunity. Reinsurers could play a critical role in helping insurers deal with that uncertainty by helping to spread it across multiple balance sheets.

Q: Conversely, in your view, what was the (re)insurance industry's greatest achievement in innovation during the past 18 to 24 months?

A: The greatest achievement of the last 18 to 24 months has been the rapid integration of new capital into reinsurance. This has been accomplished in two ways: (1) the sheer amount of new capital and (2) the new products this new capital are willing to offer. As of year-end 2014, the new capital represented approximately 20% of the global property catastrophe capacity by some estimates, a staggering development. This new capital has come into the industry via more traditional forms (rather than via cat bonds, which have had their own growth spurt as well), which broadens their reach and ease of use.

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INTERVIEW WITH **KATHLEEN REARDON,** CHIEF EXECUTIVE OFFICER, HAMILTON RE

Q: In today's global (re)insurance market, innovation has become increasingly critical for maintaining a competitive edge. How do you define innovation in the context of (re)insurance and, in your view, where does the industry fall short in that respect?

A: Innovation in re/insurance doesn't have a different definition than it does in other industries. New product or service solutions, or a new way of doing business, are considered innovative in re/insurance, just as they are in other industries.

However, given current market conditions, there is a critical need to bring new ideas to the reinsurance table. With the ongoing infusion of alternative capital, the ever-morphing challenge of new risks like cyber security and climate change, and the escalating rate of convergence, it's imperative for reinsurers to adapt and execute quickly and efficiently, ensuring they provide value to their clients. This includes making sure their capital and products are relevant and that their underwriting skills are second to none. And the foundation for enabling innovation is technology, today's game-changing arrow in a reinsurer's quiver.

Given the re/insurance industry's traditionally conservative position, and the drag that legacy systems can place on being quick and responsive, "innovation" and "re/insurance" can seem to be an oxymoron. I don't agree. I believe there's great scope for innovation in our industry if we're willing to embrace change.

Q: Conversely, in your view, what was the (re)insurance industry's greatest achievement in innovation during the past 18 to 24 months?

A: Re/insurers and brokers alike are thinking of new ways to add value. One example over the last year or so has been the creation of several consortiums where a group of re/insurers agree to underwriting criteria and terms in advance and accept a portfolio of business on that basis. Clients may find this guaranteed large block of capacity attractive when filling their placement. Re/insurers may find the binding agreement more efficient with their resources. The brokers are the facilitators in the middle.

Several Lloyd's syndicates have also been on the forefront of innovation by assisting new entrants into Lloyd's by forming Special Purpose Syndicates. This has allowed companies from markets such as Asia to consider a permanent presence at Lloyd's.

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INTERVIEW WITH **FRANK T. HARRISON**

This dramatic increase in capacity, along with an on-going benign catastrophe environment, has driven down rates and contributed to a deepening soft market.

This new capacity is not only putting pressure on rates, it is offering new products and structures. For example, reinsurers are offering cascading coverage, hybrid occurrence-aggregate covers and are broadening coverage terms such as hours clauses and reinstatement provisions. Multiple year policies are now a part of the mainstream.

All of this benefits reinsurers' clients – they get better coverage for less. Many of our clients are using the savings and the flexibility to expand limit and fill in perceived gaps in coverage.

Q: The demand for innovation is not limited to a (re)insurer's product and service offerings. Instead, innovation must be fostered throughout an enterprise, potentially affecting risk management, marketing, capital management, and financial reporting, to name a few. Based on your experience, where will the (re)insurance industry see the greatest achievements in innovation over the next 18 to 24 months?

A: With the influx of new capital, traditional reinsurers will have to change their fundamental business strategies with respect to return expectations. As respects returns, as mentioned above, the new capital has been partially responsible for driving down property catastrophe reinsurance rates (and rates in other areas as part of a knock-on effect). The other driver of the soft market is the benign catastrophe loss experience. As such, many of the new capital providers have not had to deal with losses – paying claims, dealing with the basis risk of modeled versus actual loss, investor expectations, etc.

I believe the new capital needs to be tested and needs to settle in before we see substantial further innovation. Reinsurance brokers, on the other hand, continue to assist clients in a multitude of ways to achieve clients' targets. At Holborn, we work carefully with each client and build tools as necessary to produce a highly customized service offering to match the goals and objectives of the client. Enterprise risk management, regulatory (including Own Risk Solvency Assessment – "ORSA"), capital management, rating and modeling tools and so on, continue to become more sophisticated and highly customized in their use, client-by-client. The development and use of these tools is where we will see the greatest innovation in the next 18-24 months.

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INTERVIEW WITH **KATHLEEN REARDON**

Q: The demand for innovation is not limited to a (re)insurer's product and service offerings. Instead, innovation must be fostered throughout an enterprise, potentially affecting risk management, marketing, capital management, and financial reporting, to name a few. Based on your experience, where will the (re)insurance industry see the greatest achievements in innovation over the next 18 to 24 months?

A: Given the significant uptick in M&A activity in the last 12 months, and the expectation that this is likely to continue, reinsurers face at least a year or two of rapid adaptation - either from being a monoline, stand-alone operation or as the reinsurance arm of an international enterprise that's executing a strategic plan of diversification by product and geography.

In each scenario, there's a new normal for management, staff and operations. The greatest achievements will come from the manner in which the re/insurance industry successfully navigates operational and cultural change.

Q: In the area of "cyber" risks, the focus has largely been on data breaches and theft of personal information. With the recent high-profile data breaches and allegations of state-sponsored hacking, what are your thoughts with regard to how "cyber" exposures may develop, and the subsequent implications for (re)insurers?

A: Cyber risk is a daunting challenge. With exponential advances in technology, we barely master our understanding of one type of cyber risk before it's replaced by another, unanticipated one. Hamilton Insurance Group CEO, Brian Duperreault, has referred to cyber risk as a war, and has noted that, just as with war, it might be that there are some types of cyber risk that we can't underwrite. At least in the short term, this may be one category of risk that is largely retained by the insured rather than ceded to the reinsurer.

Q: Below average catastrophe claims over the last few years have left the industry with higher than expected profits and accumulated capital, while a low interest rate investment environment continues to attract alternative capital to the sector. In light of this, do you anticipate increased M&A activity in the sector and if so, what does that mean for the industry in the near to medium term?

A: Yes, I do anticipate that the recent surge in M&A activity will continue. Alternative capital is here to stay. This will mean unrelenting pressure on the few remaining monoline reinsurers, increased competition between the very large companies that are being formed, and a redefinition of the way we do business – in short, a seismic shift in the re/insurance landscape.

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INTERVIEW WITH **FRANK T. HARRISON**

Q: In the area of "cyber" risks, the focus has largely been on data breaches and theft of personal information. With the recent high-profile data breaches and allegations of state-sponsored hacking, what are your thoughts with regard to how "cyber" exposures may develop, and the subsequent implications for (re)insurers?

A: While security breaches and theft of personal information is getting all the press, this risk will eventually impact most lines of business – either in business interruption losses or property and casualty. With respect to BI, hackers could interrupt business through denial of service attacks (preventing customers from accessing the company) or by disrupting critical manufacturing processes (most of which are partially or fully automated). Hackers could also steal or otherwise prevent a company getting to critical data and then proceed to extort the company to get it back. There may be no physical damage in these events, so the definition of loss occurrence might have to evolve.

Hackers may, either intentionally or not, knock-out systems that control temperature, fire control or other essential processes, resulting in physical damage to a plant, injury to workers or to third parties. With the advent of driver assistance systems in cars, hackers could commandeer a vehicle resulting in an auto physical damage claim, liability and, if the person driving is on the job, workers' compensation claims. While the cyber claims of the future will create more traditional claims, it's unclear whether the insurance policies of today will provide coverage for the losses.

The motivation for these attacks will vary from terrorism to commercial interests to just plain pranksterism. In any case, the why and who may be impossible to determine, which may influence whether the insurance coverage applies. Reinsurers will have to accept broader definitions of loss occurrence or causes of loss and certain exclusions may have to be either eliminated or modified significantly to keep pace with this growing threat (and opportunity).

Q: Below average catastrophe claims over the last few years have left the industry with higher than expected profits and accumulated capital, while a low interest rate investment environment continues to attract alternative capital to the sector. In light of this, do you anticipate increased M&A activity in the sector and if so, what does that mean for the industry in the near to medium term?

A: At present, I believe we are merely witnessing a continuance of the unavoidable march in the evolution of the Financial Services industry. We have already seen in our lifetime a massive consolidation among retail, commercial and investment banks; accounting firms; stock and bond brokers; insurance and reinsurance brokers; insurers and reinsurers. The latest chapter involves reinsurer combinations (Partner/Axis, XL/Catlin, Ren/Platinum). Undoubtedly, there is more to come.

We live in a cyclical business and certain phases of the cycle, such as the current one, tend to accelerate the consolidation process. Our industry also tends to adopt a "herd mentality." Recent merger announcements are likely producing an awakening or even a panic on the senior floors of reinsurance companies who fear the new combinations create a new paradigm, one where the remaining (smaller) players may not be able to compete. I am betting some will rush into the arms of others as a consequence. Of course, human behavior is tough to predict. It is a fool's game to guess as to which companies might ultimately tie the knot.

But make no mistake about it – consolidation in financial services has been occurring for decades, and will continue in the coming decades, and it most certainly includes the insurance/reinsurance arena.

At the end of the day, fewer people will transact the business. Usually, coinciding with consolidation, technology creates efficiencies and, usually (but not always) the consumer benefits. Improvements in technology, coupled with consolidation, has, in fact, produced lower prices for the consumer in the financial services arena, but it has also produced homogeneity in products and few providers - better prices, but fewer choices.

As in the past, the consolidation phase will pass and new, smaller, more nimble competitors will emerge to offer specialized services and more choice. A new cycle begins and, inevitably over time, the new, smaller companies begin to consolidate. The cycle never ends.

All that said, I believe significant opportunity exists today and will always exist for client focused, advocacy-based organizations. People (and businesses) pay for good advice. People pay for those who "have their back." People value trust-based relationships and they value those they can count on. They also value consistent behavior in the folks and organizations with whom they trade. These things will never change and should reside at the core of every business plan in our industry.

My own company, Holborn, has remained independent for 95 years – something we are quite proud of. We have benefitted from the consolidation movement among the reinsurance brokers by having acquired culturally compatible clients and key staff. More importantly, our clients tell us they prefer our independence. Our place in the market gives them choice, and our privately-held, independent status allows us to solely focus on their interests.

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INTERVIEW WITH **FRANK T. HARRISON**

Q: If you could sum it up in a few sentences, how did you get where you are today in your career, and what advice would you give young professionals who are embarking on careers in re/insurance?

A: As the saying goes, "it's better to be lucky than good!" I have been blessed by being able to stand on the shoulders of giants. I have been surrounded by talented, driven, entrepreneurial-minded associates, all of whom believe in our crusade. It is hard to fail when surrounded by extraordinary talent. It helps you focus.

As far as advice for those embarking on a career in our industry, please know that your reputation is sacrosanct and must be protected and preserved no matter what. Do not rush your progress. Do not cut corners. Learn always. Do not compromise your standards or integrity. Ask questions, express ignorance, and, remember, a team will beat an individual every time!

Finally, understand that failure and rejection is a very natural part of life. I have often thought that my career "failure rate" established a new standard for mankind! I've never liked failure, of course, but I also never allowed it to interfere with my desire to succeed. Fear hasn't gotten in the way. I have often said that, somehow, I have had some success despite my ineptitude! I am living proof that success in our industry is more about "will" than "skill!" Resources are available, you need to commandeer them.

I have also been fortunate to work at Holborn these past 26 years. My employer (Holborn) is a rock solid organization with a long-term focus where internal politics are minimized, and where there is zero concern over quarterly earnings. There is a symbiotic relationship between employer/employee where each is highly faithful to the other allowing a pure focus on servicing clients and building for the future. I found the perfect home for me, a team-oriented company. I encourage you to do the same. Try to make sure that your company's goals and culture match up with those of your own to the extent you can. It helps to befriend the key decision-makers. Find out what makes them tick. What are their motivations? Do they take a long term view? Do they simply want to strike it rich quick? Are they focused? And, perhaps, more important of all, do they care about you?

Q: Finally, if television aired a special called "A Day in the Life of You," what would viewers see as it relates to your day-to-day work?

A: Instead of a special called "A Day in the Life of You," I would recommend a series where viewers would see a number of highly entertaining shows where no two episodes are even remotely the same. These shows would be shot all over the country – all over the world in fact. They would include glamorous places like Madrid and London. Some shows would be shot in small towns like Owatonna, MN and Grinnell, IA. Each episode would include professional meetings with senior executives of insurance company clients discussing their businesses, trends and strategic direction. But each episode would also include warm social engagements ranging from lively dinners to sporting events to late night discussions over a nightcap.

Some shows would focus on negotiations with reinsurers, while others would highlight internal meetings and strategy sessions on client and prospective clients, related issues and on Holborn specific issues like personnel and what needs to be done to secure our future.

Every episode would show me as Holborn's CEO working with colleagues internally, and keeping a "hands on" approach in all aspects of the company. It would also show me working with folks in every department. That's the beauty of working at a comparatively small but power-packed organization. We work daily on a vast assortment of issues with a wide array of clients domiciled all over the country. These include insurers that are large and small; global, national, regional; stock, mutual, reciprocal and also specialists. We enjoy warm relationships with the clients we serve, many have been with us for decades. They are like family to us. And no two days are ever the same.

Essentially, each show would include me working with talented people whom I like and trust, and have built relationships with over decades. Each show would see me interacting with a diverse group of people from our clients, reinsurers, outside trading partners (attorneys, auditors, bankers) and my associates at Holborn, including my Board.

I can assure you with all the characters I come across, there is never a dull moment! Each episode would take on a life of its own. The writers of the show would have a blast with the storylines and actors that I deal with routinely!

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A Wharton graduate with more than 30 years in the reinsurance industry, Frank T. Harrison serves as chairman of the board, president and CEO of New York-based Holborn Corporation, which he joined in 1989 as an assistant vice president. A former world-class decathlete and competitor in the Olympic decathlon trials, Frank now serves on the board of the U.S. Athletic Trust, a nonprofit organization that raises money for aspiring Olympic athletes.
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