CFO Conference

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Overview and Outlook for the P & C Insurance Industry: Trends, Challenges & Trumponomics

Presenter: Robert P. Hartwig, Ph.D., CPCU, Insurance Information Institute

Summary

The P/C industry hasn't fully recovered from the recession. Interest rates are at their lowest since the 1970s. There is a lot of excess capital. Over 50 percent of 2016 premium volumes were under strong negative rate pressure. Interest rates bumped up after the election, but have slightly come down since. The rise in interest rates is not enough to reverse the damage done to investment income by the recession.

Highlights

- P/C industry as a whole had a pretty bad year last year – ROE has been declining as well as profitability
- P/C industry is fairly cyclical over the last few decades but now the cycle is broken due to interest rates and also very volatile (natural disasters, terrorism, etc.)
- Nobody predicted that interest rates would be so low for so long which is why industries priced their products wrong
- Return on capital has been falling and the industry has about 1/3 more capital than it needs today – excess capital
- Rate of growth for the industry in 2016 was 2.7 percent and predicted to be 2.5 percent but there is a discrepancy between personal and commercial lines
- Decent exposure growth in commercial industries
- AIG is getting its 7th CEO in the past 12 years, Brian Duperreault. At 70 years old, he expects to turn the company around and expand, rather than break up the company, which will increase marginal growth in competition for p/c commercial market.
- Investments – key driver of insurer profitability – interest rates bumped up under Trump and since come down a bit as of late
- Stock market is still doing fine under new administration
- Insurers invest around 20 percent and 2/3 go into fixed income securities, mostly investment grade portfolio securities
- U.S. Treasury Security rates are down since 2007 depression
- Underwriting profit consists of the earned premium remaining after losses have been paid and administrative expenses have been deducted. It does not include any investment income earned on held premiums.

Investments

- Insurers took a short approach to their investment portfolios and should have taken a long approach. Insurers also getting more into investing into physical assets, as they previously had done (railroad, real estate)
- Yields have been lowest in half a century for P/C insurers
- Inflation rates will probably be a little bit lower than predicted but can also depend on Trump Administration's activities that could boost inflation rates
- P/C insurers net realized capital gains have been down and need to be made up via expense management

The Economy

- 70 percent of GDP is accounted for by consumers – not businesses
- Expected growth is 2.5 percent but Trump is talking about growth being more like 3.5-4 percent – we need it to be 3 percent and stay there
- Consumers have been doing relatively well and the dollar has been pretty strong
- Consumer confidence had a sharp increase and fell a bit but still doing pretty well – due to confidences in jobs
- Small businesses are the most optimistic about the future – a lot of them were Trump supporters – optimistic about getting taxed less (corporate tax rates) and also strong consumer buying
- Manufacturing sector is growing and needs to have investments in order to help the manufacturing sector be more productive (would create more jobs with automation)
- Retailers are struggling but online businesses could be a good market to tackle for insurers (money on the table because online businesses are uninsured)
- Construction spending took 10 years to get back to where it was before the recession but some states will take longer
- Home construction is lower but we do not want it to go to pre-depression because it was a bubble number – also great market for exposure for insurance industry. Exposure is regional.
- Inventory of existing homes is relatively small
- Home prices are increasing about by 5.5–6 percent on a national basis but also very regional
- Unemployment rate not expected to change to much – should remain low (4 percent) but has not lead to increase inflation
- Household net worth has been increasing – people tend to spend out of their net worth – the additional worth added generally gets spent

Profitability & Politics

- It doesn't matter if a Democrat or Republican is elected into presidency in the P/C industry – ROE is pretty much the same for both

Trumponomics

- 5 elements: Fair Trade, Deregulation, Tax Reform, Infrastructure improvements, Immigration Reform/Enforcement
- Supply side philosophy
- Tax Reform – move from 7 federal brackets to 3:10, 25, and 35 percent
- For businesses/business owners the corporate income tax rate proposal is 15 percent

- Since lower taxes – need to tax somewhere else – wants to tax goods coming into U.S. – implications for foreign reinsurers
- Likely issues impacting insurers – Dodd-Frank, New Financial CHOICE Act, repeal Volker Rule (banks using deposits to invest), Tort System, NFIP: Flood Insurance, Trade (don't want trade war – some trade better than no trade but probably not heading there), Climate, Energy and Environment, Infrastructure Spending (creates exposures and potential opportunity for insurers), Terrorism & Cyber Risk (TRIA), M&A Activity (will most likely not affect P/C or Life Insurers but could affect health)

Commercial Lines Growth and Pricing Trends

- Large divergence between commercial and personal lines NPW growth – moving in opposite directions right now and personal lines are gaining share from commercial lines
- Smaller rural agricultural states had good positive growth for commercial lines – Florida had negative growth
- Modest increase in demand for commercial insurance in Q4 2016
- Commercial auto seeing large growth
- Personal lines – Homeowners insurance is more profitable than Auto
- Increase in CAT claims last year
- Personal Auto accounts for 37 percent of premiums written
- Collisions loss ratio had been slowly increasing
- Severity leads frequency for claims liability (accidents are more costly, so more severe vs. frequency of accidents)
- Why does severity lead frequency? Newer vehicles cost more to repair due to newer technologies; healthcare for people in an accident is higher, so "repairing" a person also costs more
- Private passenger auto insurance net written premium increasing and will continue to be really high – higher than other premiums written

Insured Catastrophe Losses

- Reasons for CAT losses – tropical storms are highest, next tornadoes
- Reinsurance pricing, nationally and internationally, has been softening due to less CATs and alternative capital.

Industry Disrupters

- Technology hype, autonomous cars, blockchain/bitcoin, machine learning
- Data breaches – cyber security
- Collecting data on new technologies and "internet of things" – Insurers would need to collect this data for underwriting and expend to having new partners in order to collect this new data

Insurance Technology

- Trend is going up for investment in insurtech – and substantial financing for it in 2016
- Who is investing in these technologies? Traditional VC firms but also insurers themselves
- Most of the funding is happening in the U.S. – next in Germany and UK

- Most startup insurtech firms will fail because they don't work in practice. This is because while most are technologically feasible and even impressive, they don't reflect of engage the reality that we have on a day to day basis like engaging with customers.

The New Department of Labor Rule & Retirement Plan Trends

Presenter: Daniel J. Peluse, AIF®, CPFA, CRPS®, CBFA, C(k)P Director – Wintrust Retirement Plan Services

Summary

Department of Labor was concerned that people wouldn't have enough money to retire and decided to get involved. One of the biggest problems firms are having with the new rule is recommendations about distributions and rollovers because that advice is technically now fiduciary advice. The goal of the DOL is to clean up advisor practices so clients are receiving most objective advice.

Highlights:

- ERISA is highly regulated and people are starting to move their funds into IRAs
- IRAs used to be governed by the SEC but now the DOL has taken over because they were rolled over from ERISA based accounts
- DOL is going to regulate and conduct how financial advisors are compensated
- Now firms and individual advisors (brokers and agents) giving retirement advice are being held as fiduciaries and held personally responsible for the retirement advice they give, increasing the liability for advisory firms
- Advice given on HSAs can also be counted as fiduciary advice
- If an advisor to a client is asked about whether to roll their money into an IRA or another 401k, the advice given is fiduciary advice under the new rule
- Anytime you are giving advice, receiving a fee, or there is retirement investment involved, you are a fiduciary
- There are exceptions you can apply for through the DOL (Best Interest Contract Exemption) but it could raise a red flag and result in the DOL monitoring or auditing your practices
- The rest of 2017 will essentially be an implementation period but by January 1, 2018, everything should be in line with the new rule
- There are a lot of prohibited transactions under the new rule that you have to identify
- A lot of firms are getting out of this business altogether because it's a small revenue generator that carries a lot of risk that you are now exposed to
- Only way for the DOL rule to go away is if the SEC changes the definition of fiduciary

Technical Accounting Update – Revenue Recognition and Leases

Presenter: Paul McIntosh, Ernst & Young LLP

Summary

FASB issued new accounting rules for accounting for revenue recognition and losses. The presentation goes over the ways to implement these new regulations into businesses. New leases standard concluded the presentation and discussed how to determine whether an arrangement contains a lease and understanding lease terms.

Highlights:

- 5 Step Model –
    - Identify the contracts with a customer
    - Identify the performance obligations – most important step
    - Determine the transaction price
    - Allocate the transaction price
    - Recognize revenue (over time or at a point in time)
- 3 Pillars of Impact – Financial Statement Impact, Support Items with no Change under new Model, Support Disclosure and presentation requirements
- 2 Transition Methods – Full Retrospective & Modified Retrospective
- FASB – issued four accounting standard updates – effective date referral, principal vs agent considerations, performance obligations and licenses, transitioned practical expedients, collectability, presentation of sales taxes, and noncash consideration.
- Scope of affected: Contracts with customers and sales of nonfinancial assets that are not an output of the companies' ordinary activities (e.g. property, plant, and equipment intangibles) and certain capitalized costs.
- Not in the scope: Leasing contracts, insurance contracts, financial instrument contracts, certain nonmonetary exchanges, certain put options on sale and repurchase agreements, and guarantees within the scope of ASC 460.
- Contract costs – incremental costs of obtaining a contract are capitalized if they are expected to be recovered. Costs of fulfilling a contract that are not in scope.
- Key disclosure requirements – disaggregation of revenue, performance obligations, remaining performance obligations

Leases

- New Leases Standard – determine whether an arrangement contains a lease
- Need to determine lease term – this also includes periods covered by an option to extend the lease
- Lease payments should be consistent with the lease term

Data Breaches

Presenter: **Nick Lozano, Director of Technology – The Council of Insurance Agents & Brokers**

Charlie Morris, Director of Management Liability and Cyber Insurance - Propel Insurance

Summary

A lot of breaches and hacks have been happening in recent years. The way to secure yourself from these attacks is being vigilant and ready to move with the newest and most update forms of cybersecurity.

Highlights

- Hackers breach websites or online services themselves by taking advantage of security

- They can gain access to peoples credentials through Wi-Fi trafficking monitor, phishing attacks (emails and phone calls), brute force
- Hackers also use “Credential Stuffing” which automates guessing your username/password to gain access to user accounts
- Using a password manager is a great way to stop hackers from guessing your password as they generate a complex and secure password for all of your accounts
- You generally have to pay ransoms out with Bitcoin once you are compromised
- You are also susceptible to law suits if you are breached because you have to follow government regulations
- Huge costs with being breached (notifications, public relations, legal advice, forensic computer experts, identity theft and credit monitoring)
- Cyber insurance doesn’t really cover too much but should generally have some kind of it

ABD Data and Systems Infrastructure

Presenter: Brent Rineck, CLU, ChFC, CPCU Chief Information Officer – ABD Insurance and Financial Services

Summary

ABD has made applications for its business that make security and access easier and more efficient. The presentation talks about how easy and integrated the new applications are and why companies should switch if they haven’t already. Moving to a 100 percent cloud infrastructure carries huge benefits and can help a firm realize large savings.

Highlights

- Salesforce is used as a platform for sales and marketing but also has a lot of other functionality and ability to link up with 3rd party applications and plugins
- Vlocity works with contact relationships within Salesforce and can also do data collection
- Community cloud has portals for employee portals and customer portals all connected with Salesforce allowing only certain access from different portals
- ABD a uses 100 percent cloud infrastructure powered by Amazon. This has saved a lot of money by getting rid of internal IT staff and server purchases/upgrades. Other benefits include flexibility and mobility for users, increased safety and protection, and simple upgrades of applications.
- Vertafore works with ABD to keep its applications up and running and up to date.
- Amazon is helping with upgrades to keep Vertafore current and safe.

Data Analytics – One Agency’s Approach

Presenter: Brian Comerford, Senior Vice President of Information Technology - The IMA Financial Group, Inc.

Summary

Data analytics only go as far as your business wants to take them. The key to moving forward and reaching business optimization is to have an open-minded staff that can get behind the initiative to collect and analyze date and educate those in the business to come to terms with the modern business practice. Defining why you want to collect the data is also another important step because it helps get a scope of how your business will use collected data and in turn how to build out the process of capturing the data.

Highlights

- Everyone has their own projects and desires for data analytics but the journey is long on the front-end and must introduce a lot of new processes that people can be uncomfortable with
- Define The Why: this helps to figure out where you want to go with your data and how complex the process of data analytics will become – it also helps with the initial discovery phase and begin the process of how you harness your data
- Data Maturity – A progression from Reporting (what happened) ➔ Analysis (why did it happen) ➔ Monitoring (what is happening now) ➔ Prediction (what might happen)
- You really need to have the business behind this initiative and hear it from the top level to underline its importance
- Requires a lot of investment, both time and money to create added value – the cost of data analytics is high, however consumers expect a lot more now and want better experiences
- The failure rate for data analytics is high – take small digestible steps and small sprints so you don't get too far down the road and realize it's not feasible to do – continue to review and assess
- Why do it? To retain clients, grow and scale the business, profitability, timing, differentiation, remain on the cutting edge