

Jim's Perspective...

Reinsurance and Excess Surplus Lines Virtual Symposium

Recently, I viewed an on-line CPCU continuing education seminar involving current issues related to reinsurance and surplus lines insurance. This seminar ran for an hour and one-half, Monday through Thursday, beginning at 10:00 a.m. central time. As you know, reinsurance is a risk-transfer insurance product that primary insurers purchase to transfer some of the primary insurer's risk exposure to the reinsurer. One example of this product is catastrophe reinsurance. If there is a very severe storm that causes extensive damage to property, the primary insurer of that property hopefully has purchased catastrophe reinsurance which limits the total loss costs the primary insurer would sustain, with loss costs above the primary insurer's retention paid by the reinsurer. Surplus lines insurance involves insurance products available from an insurer that is not licensed to sell these products in a state. An agent or broker licensed in a state, may obtain a surplus lines license that allows the agent or broker to place or procure insurance on a risk in the state in which the agent or broker has a surplus lines license with insurers not admitted to write insurance in the state. There are many Lloyd's of London companies that operate as surplus lines insurers in the United States.

There were five panelists providing information and opinions about reinsurance and surplus lines insurance on Monday. These panelists worked for the following companies:

Acrisure RE
Gen. RE
Howden RE
Arch RE

Below are some of the opinions and observations these panelists provided regarding the reinsurance and surplus lines insurance marketplace.

- 2021 and 2022 saw extensive catastrophe losses, high inflation and increasing interest rates all of which imposed a significant increase in loss costs for reinsurance and surplus lines insurance. Looking only at property loss costs, the panelists noted that small insurers in the midwest were having the hardest time obtaining their typical reinsurance coverage. There were significant rate increases for reinsurance in 2023. So far, in 2024, the panelists believe the reinsurance market has softened a little bit, and things are a little more stable at this point in time. Renewal rates for June and July should be down a bit, barring a "major event."
- They did not view the Baltimore Bridge catastrophe as a "major event." They explained that rates are based on the long-term loss experience related to insured events that repeatedly occur over the years. The Bridge disaster is not the sort of thing that we see happening year after year, and therefore it does not provide an actuarially useful set of loss costs that can be used to figure future marine insurance rates. Interesting!

- The surplus lines market in 2010 provided products to only 13% of the property and casualty insurance marketplace. In 2022, the surplus lines market provided products to 22% of the P&C marketplace.

On Tuesday, there were three panelists providing information about "Collateralized Reinsurance." I have not really heard much about this product. The panelists noted that today there is a much smaller number of traditional reinsurance companies. This has resulted in the development of Collateralized Reinsurance which is reinsurance organized and funded by third-party investors. The collateral held by this type of reinsurer must be held in one of three different accounts:

Funds Withheld Trust Account. This involves a certain amount of cash-flow received by the collateralized reinsurer that must be held in this trust account with a "qualified" financial institution.

Trust Account. This is an account with a qualified financial institution which consists of collateral of the reinsurance company itself.

Letter of Credit. This is issued by an official with a qualified financial institution, usually a large bank.

These accounts are what a primary insurer looks at, to be sure that the collateralized reinsurer has the necessary assets to cover reinsurance losses. However, these accounts did not prevent financial trouble from surfacing within the collateralized reinsurance marketplace. Vesttoo was an Israeli fintech startup founded in 2018. It was designed to connect insurance companies with capital market investors acting as an alternative to traditional reinsurers. Investors in Vesttoo would purchase what was known as an "insurance basket" and would receive a payment from Vesttoo for the risk they were taking on. By investing in Vesttoo, investors are then exposed to helping pay for the losses incurred in an insured property loss event. Vesttoo developed a platform that would mediate between insurers and investors to ensure the transactions were properly conducted. Part of that process included ensuring that the investors had the appropriate collateral to cover losses, usually in the form of letters of credit. At some point, after a series of problems with letters of credit, an investigation found that there was significant fraud involving the letters of credit. These letters were issued mostly from the same bank by employees of the bank, who received some type of commission for issuance of the letters of credit. Broker, Aon, is reportedly attempting to recover about \$130 million in funds paid to Vesttoo for coverage provided by investors who had provided Vesttoo with a letter of credit, but it turned out that the letters of credit were fake. Also, the investigation showed that there was no fraud on the part of Vesttoo employees.

The panelists said the use of collateralized reinsurance has subsided, and any business involved in this form of insurance is now looking much more closely at the accounts held by a collateralized reinsurer.

Wednesday's panel focused on climate change and catastrophe weather losses. This panel included an insurance broker, an attorney, a meteorologist and a national mediator involving weather-related insurance coverage claims. The first item of discussion involved the 2024 hurricane season. The panelists noted that the atmospheric science department at Colorado State University is predicting a very active Atlantic hurricane season for 2024. It is predicting 23

"named storms" this year. The average for any year is only 13. Current El Nino conditions are likely to transition to La Nina conditions this summer, leading to hurricane-favorable wind shear conditions. Sea surface temperatures in the eastern and central Atlantic are at record warm levels which provides a more conducive dynamic for hurricane formation. I did not know that Colorado State University had an atmospheric science department! You would think the University of Florida might have this!

The panelists were unanimous in their opinion that there is no objective scientific evidence to absolutely confirm that the world is going through a unique "climate change" phenomena. They mentioned a number of things that are causing more weather events and increased losses for property insurers. They mentioned increased building developments in coastal areas (which results in more damaged property and higher loss costs), the increased development of "public adjusters" and court-developed coverage for losses involving "concurrent causation." Nebraska still requires a jury to determine the "immediate proximate cause" of a property loss, so the concurrent causation doctrine has not affected loss costs in Nebraska.

Panelists also noted that there are so many planetary oscillations associated with our climate that it is difficult to determine a specific cause of weather events around the world. They noted that many meteorologists are of the opinion that some climate events can run 40 to 50 years. Finally, of interest to Nebraska Insurance agents, the insurance broker on the panel was very positive about the National Flood Insurance Program. He said the flood insurance program has worked well for this clients.

The final day of the CPCU symposium focused on Generative AI such as Chatbot. Artificial Intelligence has been around since the 1950's, but Generative AI is a more recent development that can, as you know, create its own original content. The speakers laughed how Generative AI can "make up stuff" just like human brains do! Generative AI has many uses within the insurance industry and includes comparing the insurance policy with a filed claim, developing quote estimates for repair of property and being involved in interaction with customers.

However, Generative AI is not without controversy. There are many security and privacy concerns. Panelists noted that Generative AI can produce nonsensical outputs. They mentioned one problem associated with Generative AI is "hallucinations." Not sure what all is involved when Generative AI develops this, but it sure sounded weird to me! It was mentioned that a customer working with a car dealer's Chatbot, wanted to buy a car on-line. The Chatbot and customer chatted about the sale of a car, and ultimately, the customer convinced the Chatbot to sell the customer the car for \$1.00! As I know you can appreciate, there are many issues associated with Generative AI. Consequently, the government is developing laws and regulations related to the operation of Generative AI. The White House issued an Executive Order in 2023 involving proposed regulation of Generative AI. You can google this topic and see the Executive Order. Also, in 2023, the NAIC passed a model Bulletin related to use of Generative AI systems by insurers. You can also google this topic and see the Bulletin. Finally, 31 states have various forms of legislation pending this year related to the operation and use of Generative AI.

I leave you with my own personal observation about Generative AI. Back in the 1980's and 90's, the letters "AI" were used in the insurance industry to mean "additional insured." It bugs me that tech companies have stolen these letters and given them a new meaning!

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