

STABILITY AND SECURITY: CORPORATE TRUSTEES FOR A CHANGING WORLD

Caroline Cruickshank, Nancy Neumann and Robert Thorson of BNY Mellon speak to Captive Review about recent challenges facing their insurance clients and what's in store for 2017

Captive Review (CR): The insurance sector has faced many challenges over the past year. What were some of the biggest headwinds?

Caroline Cruickshank (CC): There were many challenges; however, I am going to focus on two of the larger.

In regards to the balance sheet, what became apparent last year was that some traditional insurers and reinsurance companies posted lower return on equity (ROE) results. ROE – which is a measure of profitability – certainly challenged many companies to deliver shareholder value. For example, this prompted a heightened rate of consolidation in the industry as firms were pressured to acquire growth where organic growth was limited. Additionally, the prolonged low interest rate environment had a significant impact to insurer and reinsurance investment portfolios. This challenged firms to sufficiently match asset and liabilities and produce investment income. As a result, this forced many firms to shift their investment strategy down the credit spectrum toward illiquid assets, such as loan assets.

In regards to regulation, the landscape for the insurance and reinsurance industry continues to evolve as new rules essentially impose higher capitalisation and risk requirements. For instance, the implementation of Solvency II in Europe proved a major challenge for firms to modernise systems and adapt processes in order to be compliant at the start of 2016. Furthermore, ongoing dialogue between the US and EU to recognise each other's regimes creates the potential for more challenges, as firms within the US and in certain other nations strive toward some form of equivalence with the EU.

Robert Thorson



Robert (Bob) Thorson is currently a senior sales executive at BNY Mellon focused on the ILS, Collateral Trust and CAT Bond business. Bob is accountable for identifying and cultivating new business opportunities as well as maintaining existing relationships throughout the reinsurance, insurance, and broker dealer industry.

Nancy Neumann



Nancy Neumann is a senior relationship manager for corporate and insurance companies within BNY Mellon's Corporate Trust Sales and Relationship Management division. Her portfolio includes insurance, reinsurance and corporate clients. Nancy is responsible for strengthening and building existing client relationships, as well as managing the risk and P&L for the portfolio.

Caroline Cruickshank



Caroline Cruickshank is a strategy manager within BNY Mellon's Corporate Trust group, driving strategic initiatives for the corporate and insurance client segments. Caroline provides subject matter expertise on insurance collateral and insurance-linked securities. She is also instrumental in promulgating Corporate Trust's strategic engagement on social finance issues and is a media spokesperson on Green Bonds.

CR: Last year saw a number of unexpected outcomes that fuelled a great deal of uncertainty within the financial markets and created the potential for further change across various sectors. What kind of uncertainty or changes could affect the insurance sector in 2017?

CC: I believe the anticipation of more competitive and political landscape changes in 2017 could raise further uncertainty for the sector.

On the competitive front, the market for alternative reinsurance capital is booming. In 2016 the total size stood at \$75bn, up from \$45bn in 2013, and seems on track to meet market forecasts that predict a doubling by 2020. This growth only highlights the attractiveness of the market to new third parties who are in effect making the cost of reinsurance capital much cheaper than traditional reinsurance capital and prolonging the current soft reinsurance cycle. This trend will likely force many of the traditional players to look at how they will reduce costs in 2017 and beyond, which could have an impact on firms' future business and operating models.

Robert Thorson (RT): I would also add that new style market participants, such as 'insurtech', are utilising more innovative distribution and cost models that will eventually alter the industry. It will take a lot of investment to get there. More transparency is needed to help investors assess their return on investment to attract more funding to this space.

CC: On the political front, there is also much uncertainty fuelling financial market volatility. For instance, with the new US administration coming into effect this month, there is



potential for inflationary policies. Increased government spending and unfunded tax cuts could pressure the US treasury to borrow more, steepening the yield curve and resulting in higher borrowing costs for capital markets issuers, like insurance and reinsurance companies. There is also the potential for repealing Obamacare; we don't know exactly how extensive this could be, but if cut, it could free up government spending for other purposes yet leave the insurance industry and consumers footing rising medical costs. Also the potential for repeal or modification of the Dodd-Frank Act could see some provisions affected by rising protectionist values. One has to wonder whether this could impact the current Credit For Reinsurance Collateral Reform and possibly see a reinstatement of full collateral requirements on non-admitted reinsurers to protect US cedents.

Other recent events like Brexit, and upcoming events like national elections across the EU that could be negatively influenced by anti-EU forces, consequently, could impact the future of how the insurance sector may operate or may be regulated in these locations.

CR: What impact is this having on the insurance clients you support?

Nancy Neumann (NN): We are in a privileged position due to our presence in the market and our support of a broad spectrum of clients, which provides us a unique insight into what is happening within this sector.

As traditional insurance and reinsurance companies look to improve their profitability, we are seeing an emergence of new strategies among global players who are beginning to focus on their largest and most profitable

relationships. Their aim is to enhance their competitive and cost positions and ensure consistent, long-term stability.

We are also seeing insurance clients looking to diversify their lines of business by underwriting different types of risks to raise price margins. For example, a large number of insurance companies are turning their attention to cyber risk, however, there is still a need for more modelling data to support the growth of this risk class.

Some of our clients are also becoming more liquidity-driven, whereas in the past they hadn't been as driven on the investment of

“The anticipation of more competitive and political landscape changes in 2017 could raise further uncertainty for the sector”

collateral. They are now looking not only for safe and secure assets but the ability to optimise liquidity and rates of return.

We are also seeing clients and their contracting parties negotiating contracts to compete on terms and price. I think that these firms are trying to manage contracts more efficiently on the underwriting side, in an effort to raise profitability as much as they can.

CR: So what do insurers need and how can a corporate trustee help them?

NN: We are all working in a time of uncertainty and our clients are not just looking for a service provider, they are looking for a service partner. In that partner, they are looking for somebody who provides consistent, high-quality service, as well as having a great presence in the marketplace and has the expertise to help navigate them through the challenges that they may face. Also, another important aspect is having some comfort in the financial health and creditworthiness of the business partners that they are working with. Everybody is looking to mitigate as much risk as they can so I think that it is very important to demonstrate our stability and security. In 2017, this will be more important than ever.

RT: For us, flexibility represents another important value proposition. The ability to work on different, innovative structures, and be able to hold various types of collateral assets globally, are some of the key things that we offer that sets us apart for our clients. As 2017 unfolds, it is crucial that insurers and reinsurance companies partner with a reputable and flexible corporate trustee who can offer the support they will need to achieve their growth and business objectives. 🌟

© 2017 The Bank of New York Mellon Corporation. All rights reserved. BNY Mellon is the corporate brand for The Bank of New York Mellon Corporation. Products and services referred to herein are provided by The Bank of New York Mellon Corporation and its subsidiaries. Content is provided for informational purposes only and is not intended to provide authoritative financial, legal, regulatory or other professional advice. For more disclosures, see <https://www.bnymellon.com/us/en/disclaimers/business-disclaimers.jsp#corporatetrust>.