ASSURED BRIEFING

November, 2018

What's Inside

The *Assured Briefing* is a monthly research note analyzing business development, financial, legal, or claim matters relevant to property/casualty insurance professionals.

In this edition

In the research pipeline

Our December *Assured Briefing* will highlight a new analytical tool from an InsurTech firm that facilitates trend-spotting. We'll dig into the financial trends emerging from the 3Q18 reporting season and expand the credit analysis included in this *Briefing*. We'll also be updating our work on the commercial auto market.

Assured Research is dedicated to producing substantive and actionable research for property/casualty insurance and investment professionals. In addition to subscription research, we offer bespoke research and educational services.

Business Development: Pet Insurance is No Joke

A $1 billion business today, growth potential to $5-$10 billion over the next decade plausible

The pet insurance business is serious and has substantial growth potential. And yet, every article we've read in preparation for this note (and we've read a lot) includes countless silly canine or feline puns. A good trend is your best friend, a bad loss ratio could put you in the doghouse…you get it. Not us. With a straight face we share that **the pet insurance industry is no joke. With good profitability and substantial growth potential it's still at the early stages of development**. We don't suggest *any* insurer could simply walk into the market, but neither do we think the barriers to entry are insurmountable or even prohibitively expensive.

Insurance professionals charged with business development responsibilities should chew on the data we present and give this industry due consideration.[1]

Why pet insurance, why now?

There was an unusual spurt of news flow on pet insurance during the past month. The actuarial magazine Contingencies ran an article concluding that pet insurance is poised for big growth in the U.S. (see A Policy for Fluffy, Sep./Oct. magazine) and the Wall Street Journal focused on the robust outlook for animal-health stocks in a recent Heard on the Street column.

Then, in late September, Barron's Magazine ran an article called Shares of Pet Insurer Trupanion are Overvalued.

At that point…we couldn't resist!

The Pet Insurance Market and its Potential

Pet insurance products combine accident, illness, and wellness coverages. The average pet owner pays north of $500 per year for protection and **the current industry premiums in the U.S. are estimated to be $1.03 billion insuring some 1.83 million pets**. Dog owners clearly love their pets more – they account for about 90% of those premiums - but in total, **only about 1% of the pets in the U.S. are insured**. Oh, and **pet covers are offered through P/C insurance companies because pets are property**; this despite the coverage similarities to health insurance. **Pet insurers book their financial information to the Inland Marine line** in the annual statements because pets are property - on the move!

That was a lot of information in one paragraph, but with that as background we're confident the rest of this market-framing note will make sense. There is nothing too esoteric about this business, and if you've ever owned a pet and been to the vet (especially if you've faced a decision about a discretionary and expensive treatment or procedure); you intuitively

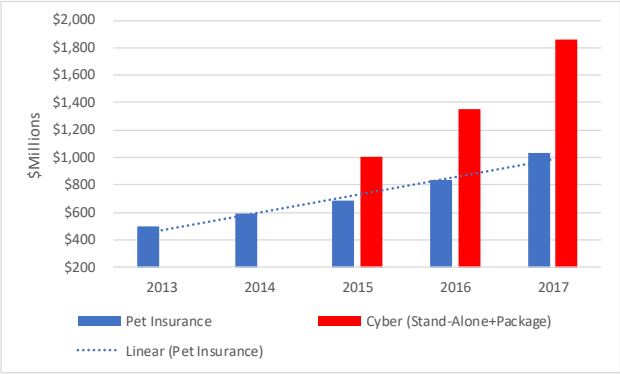
[1] That will be our only pun…we promise.

understand the competing financial and emotional dynamics underlying the numbers and claiming behaviors described throughout the remainder of this report.

Pet Insurance on a Similar Trajectory to Cyber?

We first thought to compare **pet insurance premiums to cyber insurance** – they're of **similar orders of magnitude**, see nearby Figure 1. Of course, cyber insurance receives loads of attention and counts scores of P/C insurers offering stand-alone and packaged cyber policies. That compares to about one dozen pet insurers where several of those writers are actually MGAs.

Figure 1: Premiums Cyber and Pet Insurance

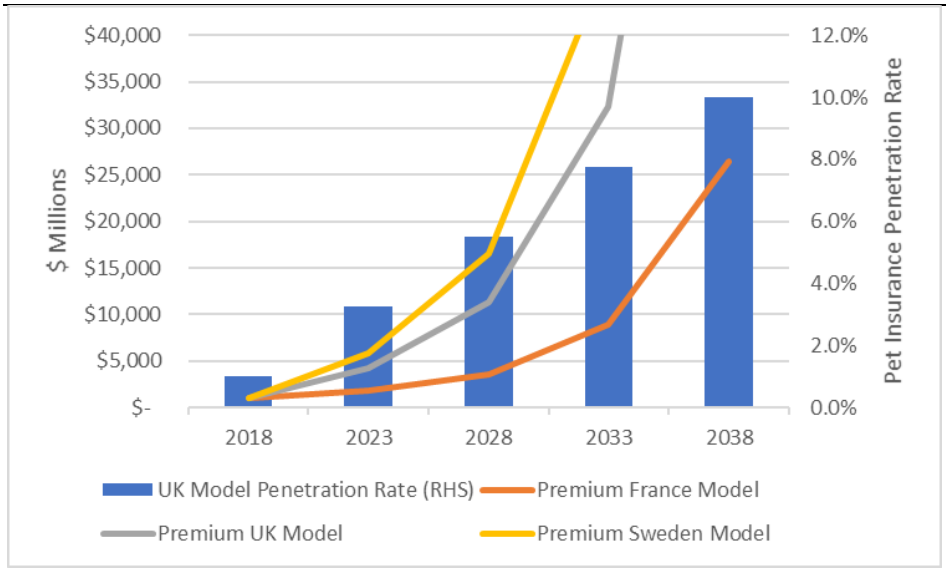


Source: NA Pet Health Ins. Assoc. (NAPHIA), S&P Global, Assured

And while cyber certainly looks more interesting than pet insurance based on the data in Figure 1, consider that **only about 1% of the pets in the U.S. are insured**. **In more developed pet insurance markets** like France, the UK, and Sweden, pet insurance **penetration rates are nearer 5%, 20%, and 30%** respectively.

Figure 2 guesstimates the size of the U.S. pet insurance market if the number of pets grows around 2% per annum and premiums-per-pet grows at about 3% annually. Importantly, we've cut the final penetration rate to ½ the figures cited for other countries. For instance, the insurance penetration rate for the UK model rises to 10% in 20-years or ½ their current level.

Figure 2: The Pet Insurance Market Could Reach $5-$10 billion Over Next Decade



Off the charts! *Using modest assumptions one can forecast a pet insurance market of some $5-$10 billion in ten years. Maybe cyber will be better…but that ain't bad!*

Source: NAPHIA, Barron's, Contingencies, Natl. Pet Owner's Survey, Assured Research

Focus on the Market Leader – Trupanion (NASDAQ: TRUP)

We don't normally use individual companies as the basis for our industry work, but there are a few reasons for doing so here, including:

1. Trupanion is the market leader writing around 20% of U.S. pet insurance premiums.
2. Trupanion is one of (maybe, the only) *pure play* pet insurer we could find. That is, we know their inland marine premiums are for pet insurance and can analyze accordingly.
3. The title of the Barron's article we read makes that author's view clear: *Shares of Pet Insurer Trupanion are Overvalued* (Sep. 28th by Vito Racanelli). We're not concerned with the stock price, but in stating his case, the author drew some interesting parallels to the valuation of *normal* P/C insurance companies. He argued that shares of TRUP were valued like a high-flying tech stock when they should be valued like a (*much* lower-flying) insurer.

With that as a backdrop, we thought: **What better insurer to compare TRUP against than auto insurer Progressive (NYSE: PGR)?**

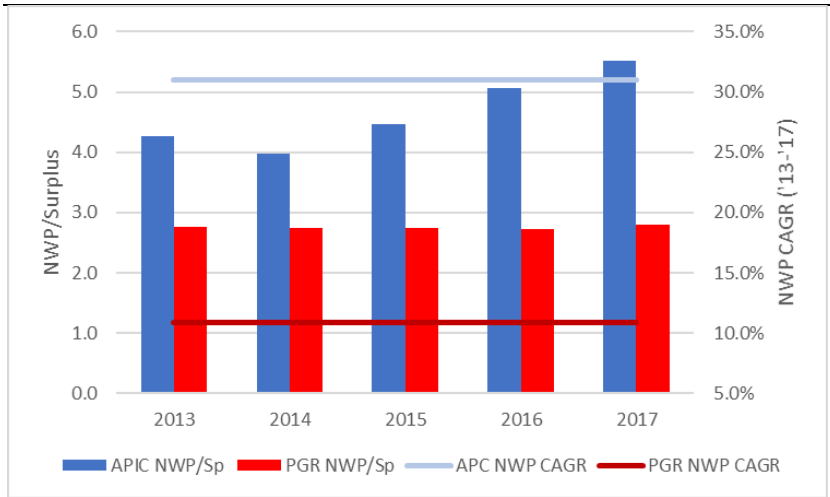
A stock-focused analysis would necessarily involve GAAP-based comparisons. We're not going there. Instead, and **with an eye on the role of this piece as a business development note for insurance professionals, we remain squarely in the world of statutory accounting**.

And that is possible because the **Trupanion's business is written through American Pet Insurance Company** – a statutory insurer readily comparable to the Progressive Group.

Growth, Regulatory Flexibility, Profitability: Progressive vs. American Pet Insurance

Our comparison focuses on three measures, with growth the focus of the next two exhibits.

Figure 2: American Pet Insurance Co. (APIC) vs. Progressive – Premium Levg. and Growth



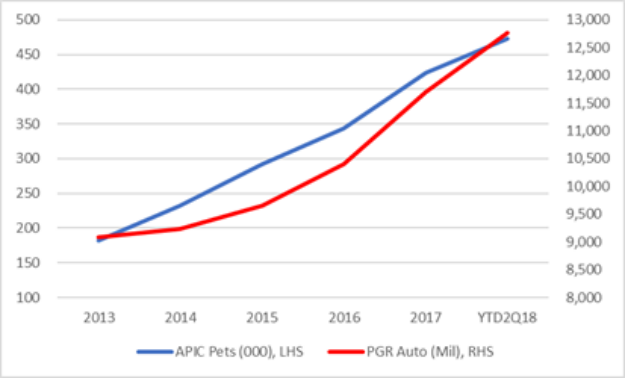
Progressive's much vaunted premium leverage (NWP/surplus) falls well below that of American Pet (at roughly 5.5x vs. 2.8x). Low average claim values and volumes of data – for the market leader anyway – allow that measure to rise.

Source: S&P Global, Assured Research

Another important takeaway from Figure 2: **American Pet's net written premium CAGR was 31% over the five years 2013-2017 compared to Progressive at "just" 11%**. Of course, the premium levels differ by several orders of magnitude, but whereas Progressive writes in a mature and slow-growing market (the CAGR for registered autos being just over 1% for the past decade), **pet insurance is under-penetrated and in its infancy**.

Nearby Figure 3 compares unit growth – PIF vs. PIF, or Policies in Force to Pets in Force. That, by the way, does not count as a silly pun...it really is the measure we're using. Both companies show enviable growth rates in their respective industries. And our scales are different (they have to be, of course), but **American Pet reports a compound unit growth rate of 23.5% since 2013 compared to Progressive at nearer 8%.**

Figure 3: Policies in Force vs. Pets in Force



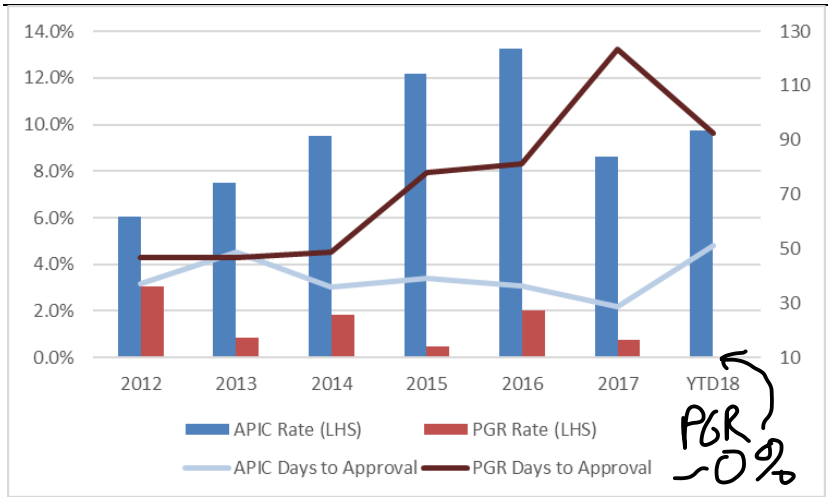
Source: S&P Global, Assured Research

Regulatory Flexibility – American Pet Has It

An important difference between a high-flying tech stock and an insurance company is that the technology company doesn't have to ask a regulator to approve its pricing model. Both companies have to deal with market forces, of course, but the Barron's article made much of the power regulators have over American Pet's pricing indications.

Figure 4 compares Progressive and American Pet on relevant regulatory measures.

Figure 4: Average Price Changes Granted since 2013 and Days Between Filing and Approval



American Pet has been steadily increasing its pricing – much more than Progressive – yet its 'days to approval' measure is consistently well below. Regulators have a reason to scrutinize PGR filings, they touch an avg. 16 mil. policyholders to American Pet at 170K each year.

Source: S&P Global, Assured Research

Interestingly, whereas Progressive touches volumes more policyholders annually than does American Pet, their numbers of annual rate filings are much closer – about 350 per annum for Progressive compared to around 100 for the pet insurer. American Pet works hard to keep its target loss ratio near 70%, which is the topic of both the next section on profitability and our nearby sidebar.

That's a lot of rate increases!
Figure 4 reveals an average annual increase of nearly 10% for APIC policyholders. While regulators may be approving the increases, is that a sustainable pace?

***Two thoughts to share**:*
First, vets like to deal with pets that are insured – it removes the cost element from the treatment discussion. More insured pets means more revenue, but that cost has to be passed back to the policyholders.

Second, the article in Contingencies included interesting observations about the need in pet insurance to underwrite the owners which, we presume, is hard to do. In a general sense, people with pet insurance are more likely to treat their animals (duh), but in an industry where data is still in the developing stage, we'd guess the human element of animal claim trends is still emerging.

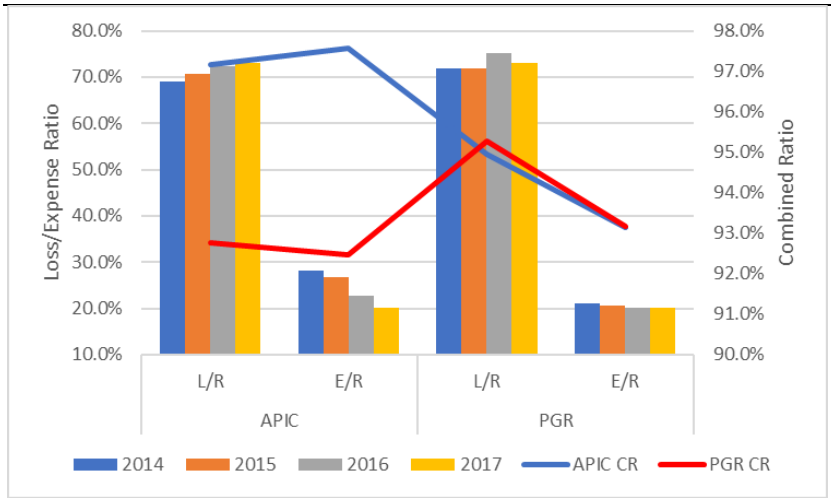
We're no experts, but these two dynamics probably put steady upward pressures on claim volumes and prices. Perhaps these trends will begin to stabilize as the industry matures and the insurance penetration rate rises.

Profitability – Not so Different!

Trupanion/American Pet uses a cost-plus pricing model where the company targets a 70% loss ratio.

From the data in Figure 5, they are close to that marker (though the L/R is rising) tempered by a steadily improving expense ratio as premium volume rises.

Figure 5: American Pet Insurance Co. (APIC) vs. Progressive Corp. Loss and Expense Ratios

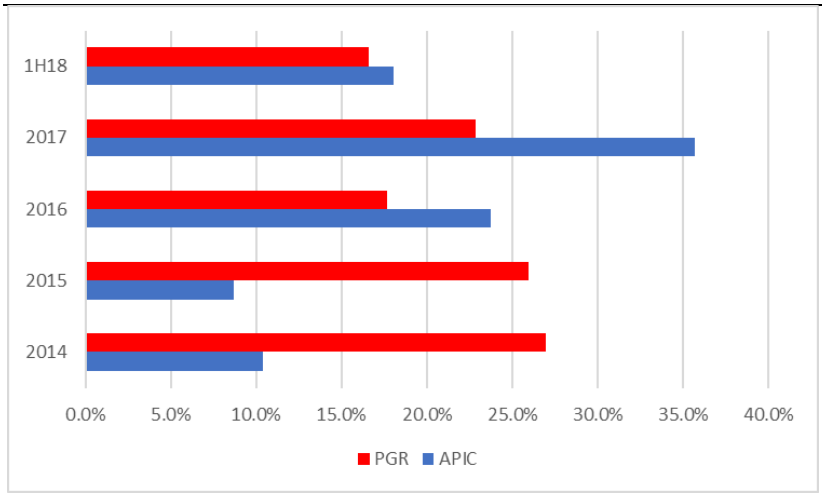


Piecing together data from the rate filings (Fig. 4) and the loss ratio to the left, it seems clear that APIC is working hard to catch up to rising loss trends. But trend aside, it's loss and expense ratios aren't too different from P/C industry leader Progressive.

Source: S&P Global, Assured Research

Recalling from an earlier chart that APIC sports higher premium leverage than Progressive (5.5x vs. 2.8x), and at similar levels of underwriting profitability, maybe it shouldn't be surprising that **American Pet has produced a higher statutory operating ROE than Progressive for the past few years**. A reminder that all of our figures use statutory data, not GAAP data where the picture could look quite different.

Figure 6: Operating Return on Average Surplus; American Pet (APIC) vs. Progressive



The power of American Pet's higher premium leverage is on display when one considers that APIC's investment leverage (invested assets-to-surplus) is well below that of PGR (2.8x vs. 1.0x) and APIC's investments at 2Q18 were nearly all cash!

Source: S&P Global, Assured Research

Pet Insurance - A Business Development Opportunity?

Yes, we think so. Pet insurance is enjoying substantial growth tailwinds and there are only a dozen (or so) insurers active in the space. We expect the incumbent insurers (and particularly the market leader) have established competitive advantages including data, sales networks and claim payment technologies.

But at just a 1% penetration the market is still in its infancy and we know there are MGAs with experience in the space…aren't they usually willing to talk with potential market entrants? We also expect there are knowledgeable professionals – including actuaries – within those MGAs who might be willing to take on a new professional challenge and build a business given the opportunity to join a firm ready to dedicate adequate resources.

A family's incumbent homeowner insurer would seem to have a natural sales advantage were they to offer pet insurance (they should already know if their policyholder owns a pet).

The P/C insurance market is mature and business opportunities with such low penetration rates and growth opportunities don't come around that often. And while the typical pet insurance owner may feel like their pet is part of the family – not property; it's fortunate for P/C insurers that the statutes read differently.

Claims Management: The Scientific Revolution is Here

Message to P/C insurers: Get on board or get run over!

In our February *Assured Briefing* we warned: *Insurers need to get on board with the scientific revolution or risk being run over by sophisticated and well-funded plaintiff counsel using science as their spearhead.*

It's not too late for insurers to engage in a scientific awakening, but the time to act is now. Whereas in February we described the scientific revolution as coming; it has since arrived.

What changed in less than one year?

The Nobel prize in medicine was awarded to two scientists who laid the foundation for immunotherapy treatments that empower the body's own immune system to attack cancer cells.

- *Why relevant?* The understanding is spreading that there is no 'one cancer' but rather different genetic subtypes of every cancer type. And yet, well-funded plaintiff's attorneys have won massive awards in civil litigation in which many individuals are joined (i.e., grouping multiple parties into one lawsuit) and in general treated as homogeneous, but then some genomic "susceptibility" arguments are invoked on behalf of some of the individuals

In July, a court in Missouri awarded $4.7 billion to lead plaintiff Gail Ingham and 21 others using just such courtroom tactics. Attorneys argued that some of the plaintiffs had a genetic susceptibility to ovarian cancer that was triggered by talcum powder which the plaintiffs allege contained asbestos.

- *And others*. Innovative Science Solutions has counted 23 verdicts in talcum powder litigation since 2015 (totaling more than $7 billion damages awarded). But that is just one type of personal injury litigation where genomics could play a critical role in determining fault (or, lack thereof) and in creating a fairer civil litigation system.

We've read a **white paper** entitled *The Litigator's Guide to Using Genomics In A Toxic Court Case*. The paper, which is available at no charge through the link, was written by a multidisciplinary group of scientists and lawyers called *ToxicoGenomica*. It **describes a number of recent legal cases illustrating the use of genomics in toxic tort litigation**.

***Our call to action**: Insurers with an emerging risk committee or a risk manager should task them with developing a report and, possibly an action plan to increase the firm's knowledge of the role of science and genomics in the courtroom. The process needn't be expensive – there are an increasing number of webcasts and seminars on this topic.*

The Terrible Troika: 3rd Party Litigation Finance, Social Inflation, Weaponizing Science

The title of this section overstates our case and our loyalties which, some might reasonably assume, are on the side of P/C insurers. They aren't.

We see the expansion of scientific and medical research in the courtroom as an incredible opportunity to make the civil litigation system fairer and more efficient - compensating those who were unjustly harmed by the negligent parties in a reasonable timeframe and at a reasonable cost. If the negligent party is indemnified by a P/C liability policy, then indemnification should be triggered.

But if the individual's bodily harm wasn't the result of exposure to a toxin or the act or product of the insured, no liability should be found.

We fear that several recent trends – all the subject of our research - are converging in a dynamic fashion but with a predictable outcome: P/C insurers will pay more claims and face larger liability claims.

We offer no data, no charts or graphs to back our concerns. We ask only that readers consider:

> ***What are genomics again?***
>
> *The human genome encompasses thousands of genes and several billion base pairs of DNA. The genome is the sum total of our DNA.*
>
> *Genomics can provide information about an individual's genetic predisposition to develop inherited diseases, risks from lifestyle choices, and predisposition or susceptibility to toxicants. In some cases, it can indicate whether toxicant exposure even took place. (excerpt from A Litigator's Guide…by ToxicoGenomica).*

1. **Trends in 3rd Party Litigation Finance**: The economic model of law firms is changing as 3rd Party Litigation becomes an established asset class with billions of professionally managed money flowing to plaintiff's firms. In short, law firms have the working capital to properly research cases, advertise for plaintiffs, and the incentive to seek the highest return on their investment with less fear that the holiday season bonus will disappear. We include an update on this trend in another research note in this *Assured Briefing*.

2. **Trends in social inflation**: We've regularly documented the rise in legal advertising, and with a plaintiff-friendly (re)interpretation of laws governing liability insurance just released by the American Law Institute (see our October *Assured Briefing* for more) we think social inflation is back.

3. **Weaponizing science**: In the section following we offer a specific example of how genomics was coopted and oversimplified to the advantage of plaintiffs alleging bodily harm from exposure to talcum powder.

How is science being coopted?

The $4.7 billion jury verdict against Johnson & Johnson is illustrative. Based on information and belief, the legal team for the 22 plaintiffs used a *genetic susceptibility* argument to plant a seed of doubt in the minds of the jurors as to some plaintiffs. That seed of doubt helped lead them to conclude that *but for* the plaintiffs' exposure to asbestos-contaminated talcum powder, some would not have developed ovarian cancer. The argument may be especially useful to a plaintiff who has "exposures" well below the exposure levels ordinarily viewed as causative.

The nearby sidebar speaks to the role genetic susceptibility plays in the courtroom. Our understanding is that genomic testing of these 22 women might have showed which, if any, carried a genetic susceptibility to develop ovarian cancer. Moreover, it might have shown that some had a genetically inherited predisposition (coupled with other lifestyle choices) as the actual cause of their ovarian cancer.

The genetic susceptibility argument and the eggshell plaintiff.

In a legal argument relying on genetic susceptibility, the plaintiff's attorney will seek to establish that one or more plaintiffs have a genetic susceptibility to ovarian cancer (in this case) and that exposure to the toxin (asbestos in talcum powder) pushed them over the cliff toward developing the cancer.

The eggshell plaintiff doctrine says that the frailty or sensitivity of a victim cannot be used as a defense by the party alleged to have committed the tort.

In this case, the women had ovarian cancer – genetic susceptibility or not. But if genomics been used to establish there was no genetic susceptibility, alternative causes of ovarian cancer might have been more seriously considered.

Where next? Don't get hung up on asbestos and mesotheliomas.

We acknowledge that our exhortations are never heard by insurance professionals who check out once they read the words *asbestos* or *mesothelioma*. ***That's Berkshire's problem*** is the thought many will have had.

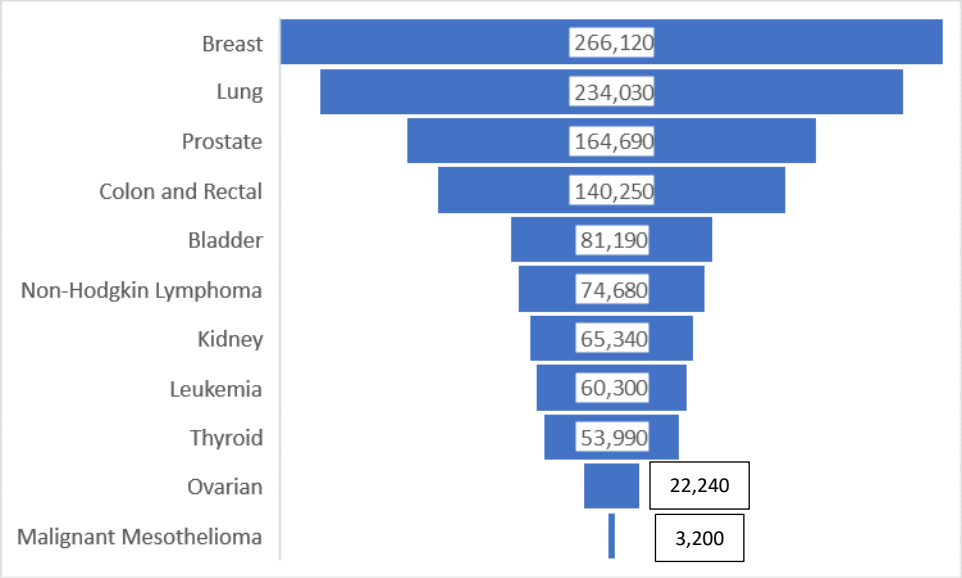
It's not that easy! Consider our observation that money from 3rd Party Litigation Finance is flowing into the legal industry. In turn, managers of that money will seek the highest return from the broadest pools of potential litigants. Now consider that there are a bit more than 3,000 malignant mesothelioma cases diagnosed each year but some 22,000 ovarian cancer cases.

That's a big increase in the number of potential plaintiffs, but **Figure 1 (next page) shows that 22,000 annual ovarian cancers pale in comparison to other forms of cancer diagnoses**.

Not all cancers have a toxin as their potential origin. But some do…or, might. Remember the recent case of the groundskeeper in California whose alleged exposure to Monsanto's Roundup

product caused his non-Hodgkin Lymphoma? While the original verdict was reduced to $78M from $289M initially, a CA-judge upheld the jury's findings. More claims have already followed.

Figure 1: Estimated New Cancer Cases Diagnosed Annually in the U.S.



Source: American Cancer Society, 2018. Not all cancer types shown. Assured Research

Why Should P/C Insurers engage?

We'll conclude with another quote from the *Litigator's Guide* paper:

Genomic data and genomic technologies can be applied to toxic tort and personal injury cases in ways that may assist both plaintiffs and defendants in uncovering the truth about the underlying causes of disease.

And if using the best scientific methods available to find 'the truth' isn't a sufficient motivating factor, P/C insurers should consider that well-funded plaintiff firms will use science as the tip of their spearhead to find the soft underbelly of insurers' outdated legal defenses – if P/C companies allow that to happen. The early stages of a scientific awakening don't need to be expensive – we can put your firm's emerging risk committee or risk managers in touch with people who can help to get the process started.

This note was prepared with assistance from professionals at Innovative Science Solutions and ToxicoGenomica. We used their writings, in particular, to develop our understanding of the many scientific/genomic references we have made and their application in the law both broadly and in particular legal cases. We have in some cases used their phraseology without citation. The resulting impact on P/C insurers (and the call to action) represents our own views.

Financial Analysis: Looking for Clues on Risk from the Credit Markets

Credit spreads are sometimes a leading indicator of risk, but P/C market looks stable presently

When looking to the capital markets for clues on risks, we're guilty of focusing too intently on data from the equity markets. We're in good company, however, as most financial analysts make the same mistake. But **with this research note we** endeavor to break out of the pack and **compare measures of risk both across time and between the equity and credit markets** with a focus, of course, on P/C insurance companies.

Our work reveals some interesting macro trends, but there's no 'Aha' moment in this note…we wish there was. **Rather**, with data from 2012, t**he financial markets convey a sense of both declining risk and investors' increasing comfort with the stock market**; in turn, the macro trends that have fueled the record stock market rally since the end of the Great Recession.

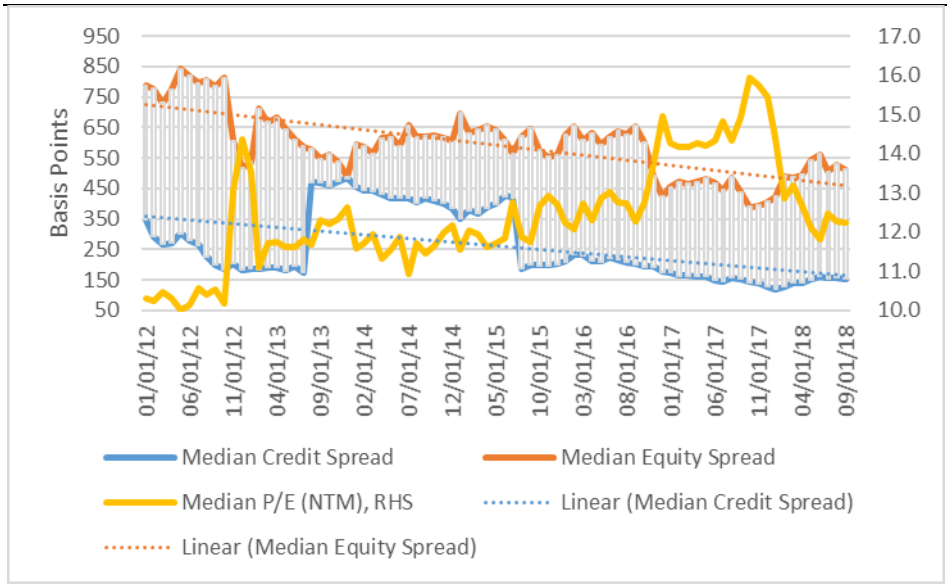
Our Measures of Risk: Credit and Equity Spreads

Try Googling terms like 'equity risk premium' with an eye toward brushing up on an opaque topic and you'll be inundated with lengthy academic papers; a rabbit hole we weren't prepared to do down.

So, with apologies to the titans of finance including Fama and French, Sharpe, and Merton…we deployed our own measures of 'risk premium' demanded by the equity and credit markets.

Figure 1 gets to the bottom line and in subsequent sections we describe our work.

Figure 1: Tracking the Credit and Equity Spreads (over 10-Yr Treasury) of 16 P/C Insurers



The premium over the risk-free rate demanded by both equity and debt investors in P/C insurance instruments has steadily declined. The gap will be interesting to watch – no real 'tell' at this point

Source: S&P Global, FACTSET, Assured Research. Data is through 9/28/18.

Methodology explained

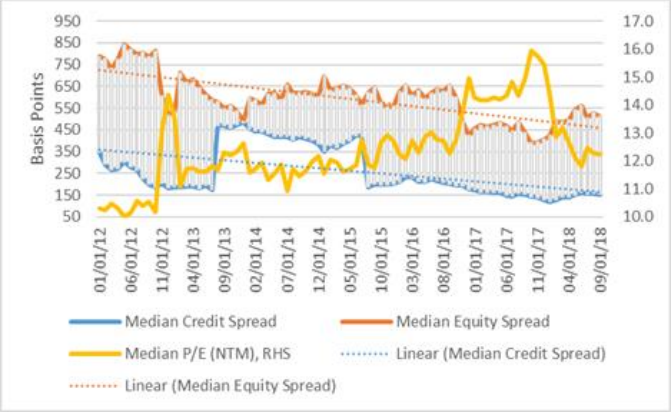
Figure 1 conveys a lot of information; let's pause to define both our measures of risk premium and the data we used

First, **on the data**, we **gathered monthly credit market data on the senior notes of 16 publicly traded insurance companies**.[2] We used senior unsecured bonds floated before 2012 and which, in most cases, had more than about 10 years left to maturity. Our key data was the weekly yield to maturity (YTM) for each bond, from which we subtracted the 10-year Treasury to calculate the **credit spread** – **a measure of the premium credit investors require to be compensated for the risks they see in a particular credit (i.e., company) and industry**. Of course, macro conditions also heavily influence spreads – more on that later.

> ***Equity Spread***
> *Readers will be familiar with the price-to-earnings (P/E) ratio as a common valuation metric for stocks. The reciprocal of the P/E ratio (or, E/P) is referred to as the earnings yield for a stock. As the P/E ratio rises, say because investors anticipate improving earnings or as the perception of the risk in a stock declines, the earnings yield declines…investors require less premium to invest in the stock. Conversely, if a stock's P/E ratio falls, it's earnings yield rises and the risk premium (earnings yield, or E/P minus the 10-year Treasury) rises.*

The explanation of the **equity spread** burns a few more brain cells, but in the end, it **is also a measure of the risk premium (over the 10-Year Treasury) demanded by equity investors** for investing, in the case of Figure 1, in the common stock of P/C insurers. We explain the equity spread in the nearby sidebar.

Figure 1: Repeated for Ease of Reference



Source: S&P Global, FACTSET, Assured Research. Data through 9/28/18.

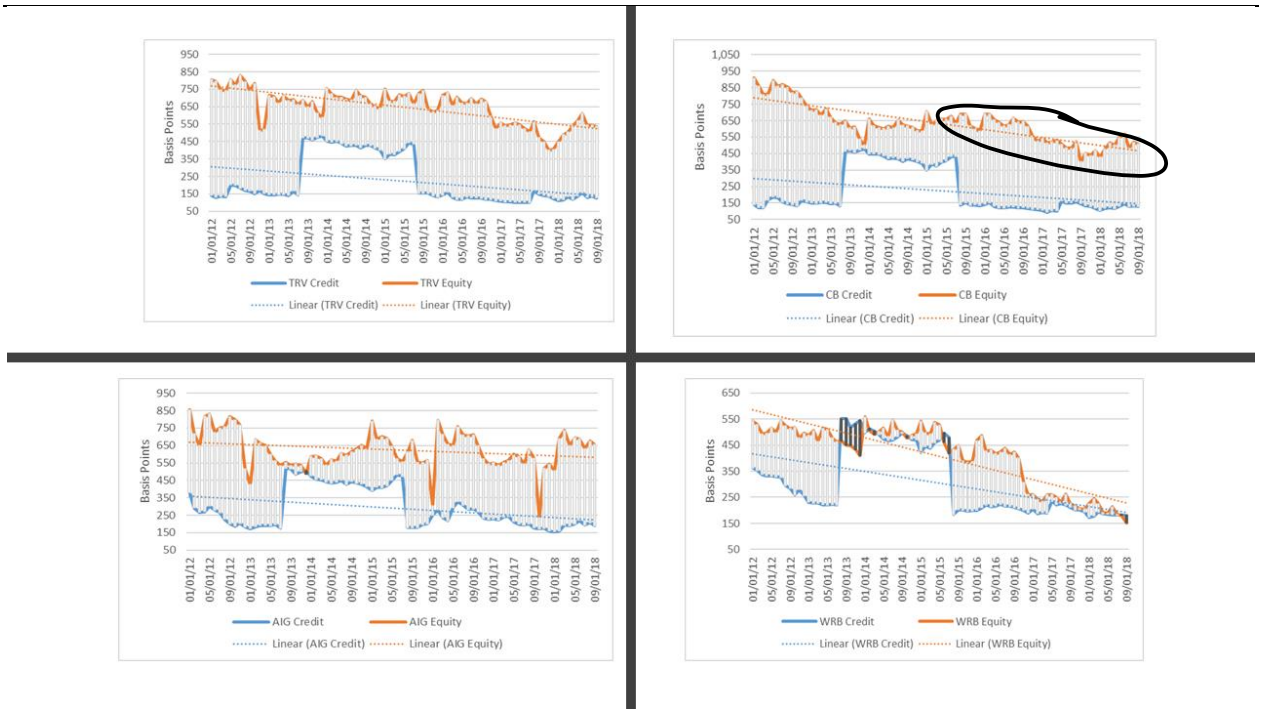
The key takeaway: **Measures of equity and credit risk premium** shown in Figure 1 and Figure 2 **are both directionally consistent** (higher conveys more risk, lower is less risk) **and both represent a premium to the risk-free rate**. It makes intuitive sense that **the equity risk premium is higher than the credit risk premium**; senior noteholders sit higher in the corporate waterfall than shareholders. **We added the median P/E ratio to Figures 1**. It shows that as the equity P/E ratio rises (as it did over most of this period), the risk premium required by equity investors declines.

[2] Companies used by ticker: TRV HIG AIG ALL CB WRB PGR RE AFG AXS THG ACGL RNR CNA MKL SIGI

Credit and Equity Risk Premiums for Individual Companies

In Figure 2 we show the similar chart for 4 of the 16 companies that constitute our Figure 1. Readers will see the same general pattern holds, though some differences warrant further comment. Subscribers can check with us either for the data we used or for graphs of other P/C insurers.

Figure 2: Credit and Equity Spreads (over 10-Yr Treasury) of Select P/C Insurers



Source: S&P Global, FACTSET, Assured Research

The graphs for **Chubb** (CB) and **Travelers** (TRV) are very similar. It's interesting, we think, that the equity risk premium for CB appears to have declined in the years since ACE's acquisition of Chubb; one measure of the success of the deal in our view.

The equity premium for **AIG** is volatile – no surprise considering its management turnover and sporadic reserving actions during this timeframe. The chart for **W.R. Berkley** (WRB) is unique insofar as there are three periods (including the present) when the credit spread exceeds the equity spread…curious! We can share a few thoughts: First, our formulas are reasonable directional indicators of risk premiums, we think, but there are surely more nuanced and technically rigorous

Why the spike in credit spreads from late 2013 for two years?

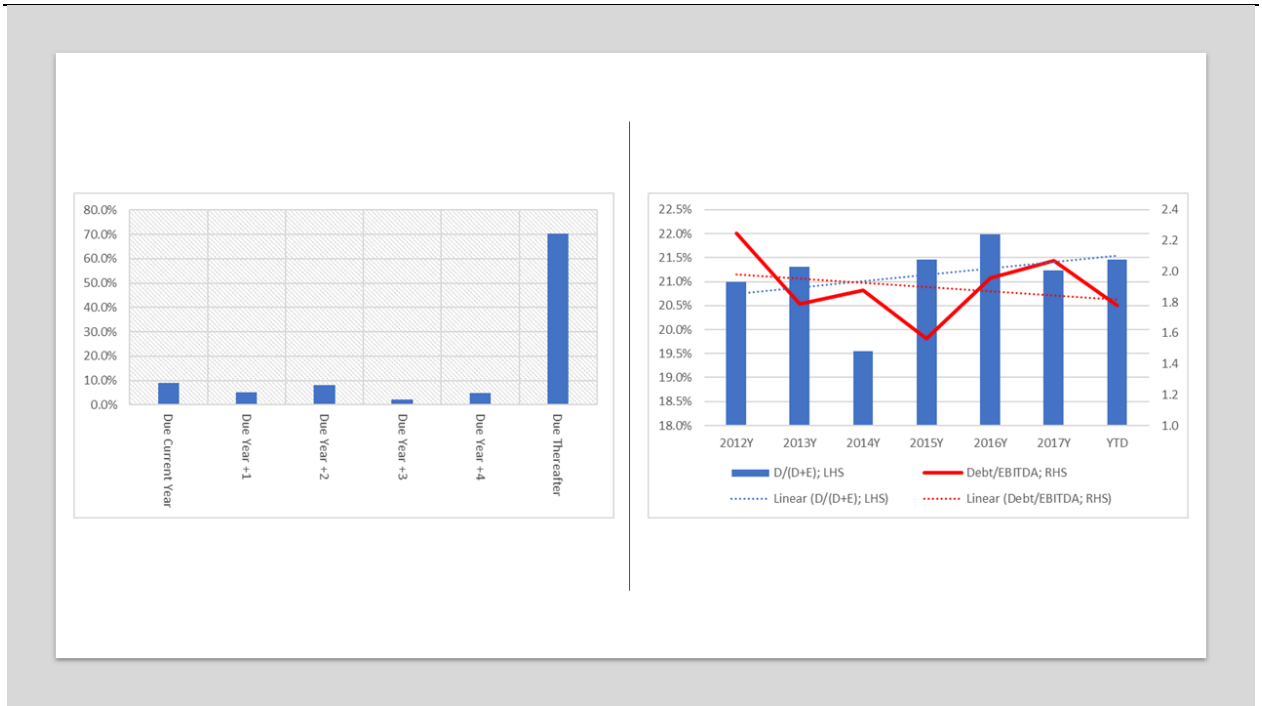
We'll admit, that seems like a long time ago and we had to remind ourselves that the Federal Govt' threatened to shut down for a period of time, that the Fed was still actively influencing the capital markets and that talk of rising interest rates first began during this period. The global economy was shaky and bank/financial market regulations were still being sorted out.

ways to go about comparing equity and credit spreads. Second, the bond market is not always liquid and that's particularly true for the bonds of smaller (by market capitalization) P/C insurers. In other words, the market price of the bonds in any given month may not be a good indication of that instrument's unique risks if there wasn't much trading in the notes. That said, the P/E ratio for WRB did rise from 13.8x in early 2012 to 21.8x by late September – a sign that investors buying the stock today are willing to accept a lower earnings yield (1/ (21.8) = 4.6%) than for the median of our group where the P/E ratio is 12.2 and the earnings yield is 8.2%.[3]

Other Credit Measures Appear Stable

We like to check on the macro trends in credit at least annually, but frankly for the past few years there hasn't been too much to see. There is no financing cliff looming as the chart on the left of Figure 3 shows. Meanwhile, despite the slow rise in debt-to-capital (on the right), the absolute level of leverage is still modest (at around 21.5%) and earnings coverage levels have been improving owing to decent earnings.

Figure 3: Debt Maturity Profile (Left); Measures of Debt/Capital and Coverage (Right)



Source: S&P Global, Assured Research. Cohort of insurers includes same 16 used throughout this research note.

Summary

The markets for P/C securities look sanguine…for now. But this is P/C insurance, it won't stay that way! We'll be on the lookout for any divergence between equity and credit indicators.

[3] Our measure of P/E for individual companies is the price to *next twelve months* (NTM) earnings. We used this metric to mitigate the earnings volatility endemic to P/C insurers.

Financial Analysis: Social Inflation is Back!

An update on the state of litigation finance by the industry leader – Burford Capital

Burford Capital – the world's largest 3rd party litigation finance firm -recently released its annual survey of the litigation finance industry[4]. In short, litigation finance is growing like gangbusters in both awareness and use by law firms. Among law firms either interviewed for or responding to Burford's survey, the competitive pressure to bring in new business was the number one challenge, and the vast majority of respondents see the working capital supplied by litigation finance as an essential tool for meeting that challenge.

But most of us had already connected those dots; that's not really new information. But **what is new** to us from this, Burford's seventh annual survey, **is the increasingly favorable view of litigation finance held by in-house counsel of large corporations**.

Why, when funds from litigation financiers are often used to research cases and advertise for plaintiffs against their very organizations, **would in-house counsel increasingly see litigation finance as more friend than foe?**

The answer is simple: costs.

In an ironic twist that won't be lost on insurance professionals, one of the main business challenges cited by in-house counsels in Burford's survey was the cost of litigation and shareholder pressures to contain legal costs.

"I cannot imagine any commercial project where the cost is $10 million with no payback for five or more years, in which a company would not consider litigation finance."

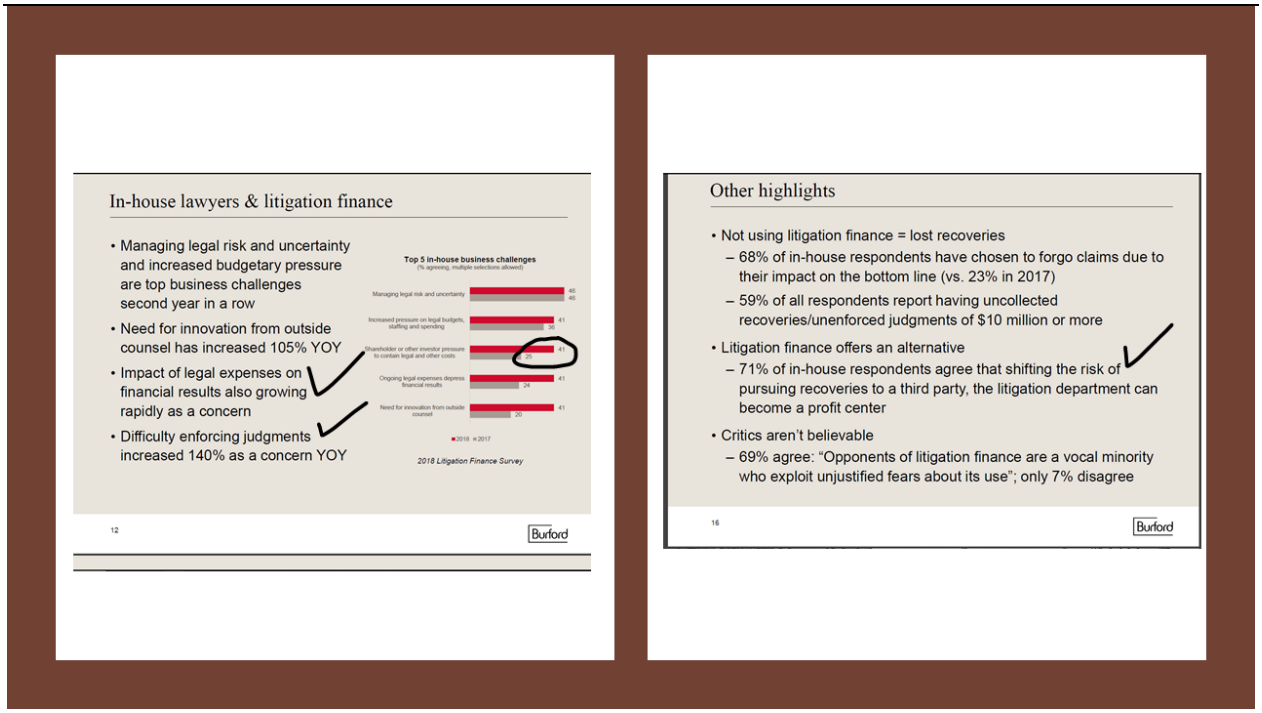
Quote of a law firm partner taken from Burford Capital's webinar presentation on its 2018 Survey.

Another business challenge – the difficulties of enforcing judgements and actually collecting cash to show a positive return (or, *any* return) on the legal departments that seem keenly aware of their status as a corporate cost center.

The nearby quote we pulled from the recent Burford webinar on their Survey ties together both of these business challenges. And it points to **what *all* members of the legal industry increasingly see as their best new tool since the founding of Westlaw or LexisNexis – litigation finance!**

[4] *2018 Litigation Finance Survey* found here.

Figure 1: Business Challenges Facing In-house Lawyers



Source: Burford Capital slides from 2018 Litigation Finance Survey, Assured Research

The responses to questions about business challenges on the left of Figure 1 make it clear that in-house lawyers worry about their own expenses and share a rising frustration with an inability to enforce judgements (the check-marked comments). In another section of the report, some 70% of the Survey's more than 500 participants said their organization had forgone claims because of the costs associated with pursuing them. And nearly 60% reported having uncollected recoveries or unenforced judgements valued at more than $10 million.

Turing to the slide on the right of Figure 1, the check-marked comment reveals that **the majority of in-house counsel see litigation finance as a means for turning their cost cent into a profit center**. *And who doesn't feel more secure working for profit rather than a cost center?*

How will the Chamber of Commerce React?

The Chamber of Commerce has been not been a friend of the litigation finance industry. That's not a surprise considering the industry's early focus on supplying plaintiff firms with the working capital needed to pursue litigation against the corporate counsel whose interests the Chamber of Commerce represents. But if, in the view of those same corporate counsel, the litigation finance industry turns from foe to friend, from cost center to profit center, will the Chamber soften their views?

And if they do, can that be good for P/C insurers? Probably not. **Social inflation is back!**

Personal Auto: Trends in Alternative Transportation, Car Sharing

Why own (or even lease) a car if your needs are modest?

For the past few months we have been studying **changes to the transportation ecosystem** that, we believe, **will eventually lead to reduced driving and disincentives to automobile ownership**. The increasing acceptance of these emerging alternatives foreshadow a future that includes fewer cars and less driving. In turn, this could mean that **the peak of auto insurers' earnings is on the not-too-distant horizon**.

But, rather than just accept the potential for decline, **we believe it is important for insurers to be on constant alert for opportunities within the changing landscape.**

This note is a continuation of our multi-month study of the threats and opportunities likely to emerge from the evolution of the alternative transportation ecosystem.

We previously reviewed the growth of the markets for bike and scooter sharing, and for car subscription programs. This month we look at car sharing services.

The Changing Ecosystem

As the sharing economy expands, there are numerous changes afoot that will alter both automobile ownership and usage. In Figure 1 (next page) we summarize the changes and list the major participants in the new developments. **In this note we discuss both the peer-to-peer (P2P) and fleet-based car sharing services where individuals rent cars for short periods of time.**

Peer-to-peer (P2P) car sharing

Not using your car for the next few days or weeks? Traditionally, the car would sit idle, which cars do an estimated 95% of the time. No longer! Your car can be rented and earn you a few bucks; there are numerous websites which leverage information technology to bring the owning and sharing parties together. ***Turo* and *Getaround* are the largest sites. Think of this as Airbnb for cars**.

Consistent with how most websites work, the process for both the car owner and sharer is simple. The owner registers the car at the site including basic details such as when the car is available and its overall condition…with a picture to keep the owner honest! For the sharer, this is just one more choice in a world where there are numerous alternatives to car ownership, particularly for those with small-to-modest driving needs.

The hassles seem minimal, from our perspective, though we must confess we have priced but not used a char-sharing service. We've ridden ebikes and escooters, used bike-sharing programs and ridden in a nearly self-driving Tesla…just no car-sharing (yet) because of its price. More on that shortly.

The car-sharing concept is still in its early stages. For example, **Turo, the largest site, currently has seven million members (potential users) and 258,000 cars available to be shared. That is a drop in the bucket compared to the 266 million registered cars on the road**. Like all emerging ideas, however, we expect considerable growth in the next few years.

As the car-sharing system expands we have little doubt that it will stem the growth of car ownership. For example, a recent study from the Institute of Transportation Studies at the University of California (Berkley) shows that **46% of the users in the P2P market did not own a car**. (For those wanting an in-depth discussion of the demographics and motivations of P2P users we recommend the Institute's report, *Peer-to-peer (P2P) Carsharing: Understanding Early Markets, Social Dynamics, and Behavioral Impacts*.

The P2P car sharing concept has been further validated by a recent decision at General Motors (which runs a fleet-based car sharing site, Maven). In July, GM announced that it will develop a P2P site allowing GM car owners to rent their cars.

The automakers are clearly aware of the potential changing patterns for car ownership. Insurers should be too!

Figure 1 The Changing Transportation Ecosystem

Changes to	Concept	System	Major Participants
Automobile usage	Ride Sharing		Uber, Lyft
	Car sharing	Fleets	Zipcar, Car2go
	Car sharing	Peer to peer	Turo, Getaround
Automobile ownership	Car subscriptions	Manufacturers	Cadillac, Ford, BMW, Mercedes,Volvo
	Car subscriptions	Independents	Flexdrive, Drive Flow
Reduced driving	Personal mobility	Bikes	Jump, Motivate, Lime
	Personal mobility	Scooters	Bird, Lime

Source: Assured Research

Car sharing should spread – if its cost declines! We're extrapolating from a sample of one!

A recent month spent working in Colorado offered the perfect opportunity to test car sharing. The Turo site had 60 choices of cars to rent for the month; all of which could have easily been picked up at the Denver airport without having to take the car rental shuttle or wait at the counter. **Convenient Yes!**

But while the car sharing sites generally claim their cars are cheaper to rent than through a traditional car rental company, this was not the case. The $95 price per day to rent a Ford Explorer via Turo was almost 50% more than the price from Budget. **Cheap No!**

Fleet-based car sharing

In addition to the P2P car sharing systems, there are fleet-based companies that own the cars that are used by individuals. **This is a different economic model since it requires capital to purchase the cars, but the system functions with the same goals; to provide short term mobility to users**.

According to its website, Zipcar has one million members and 12,000 cars for use in 500 cities and on 600 campuses, although these are global statistics not just for the US. Because the company is not owned by a manufacturer, it has a wide range of makes and models available.

There are **two different fleet models which are referred to as stationary and free-floating**. Under the **stationary model** (**Zipcar** being the best- known example) **cars are picked up and returned to the same location**, usually street parking spaces that are rented from the city or town in which the cars are located. (Zipcar was acquired by Avis in 2013).

By contrast, **under the free-floating model, cars can be picked up at one location and returned to another location within an established zone**. Example: pick the car up on the Upper West Side of New York City and drop it off near Battery Park.

The two largest free-floating sites are **Car2go**, which is owned By Daimler AG, and **DriveNow** which is owned by BMW. The two companies have agreed to merge their operations into an equally controlled joint venture. At present, Car2go is the larger of the two with three million members worldwide and 14,000 available cars, while DriveNow has one million members and 7,600 cars.

In both the stationary and free-floating models there are membership fees to be eligible to use the cars and the cost-per-use is calculated by the hour, with an additional charge for miles driven over a specified minimum. As an example, assume $10-12 per hour and say $0.50 for distances driven over 180 miles per day.

For longer term use (going away for the weekend, for example), there are daily, rather than hourly rates.

How does the insurance work?

Insurance is an important requirement for any sharing service, and **in both the P2P and fleet models the companies provide coverage**. **The cost of insurance is baked into the car-sharing fee.**

The coverage specifics vary depending on the sharing company, but if there is a generalization it would be **bodily injury limits of $100,000 per person and $300,000 per accident, with property damage limits ranging from $25,000 to $50,000**.

On the collision and comprehensive side, almost all the plans have some level of deductible; $1,000 is the most common, but that can vary depending on the type of membership, or specific options that the user has chosen.

The approach of the sharing company providing coverage shifts the coverage from the personal to the commercial market, and, in most cases, the insurance is written by a single company within specific geographic areas. For example, **Zurich is the carrier for Car2go** in most of North America (except Vancouver). **Liberty Mutual provides the coverage offered by Turo in the U.S.**, while Intact is the Canadian carrier for the company, and Allianz provides the coverage in Germany.

Summary

Our long-held belief has been that insurers shouldn't just accept that the changes to the transportation ecosystem will be negative for automobile insurance, but instead be on the lookout for opportunities. *Policy riders to offer extra protection for those sharing their cars—why not! Single-shot and supplement auto coverage for the 46% of car-sharing users who don't own a car—why not!*

Postscript from Italy

On a recent vacation in Italy, I came across an example of yet another new mode of transportation - the Twizy (see photo). This is a two-person vehicle which is technically not a car, but a quadricycle. The Twizy is all electric and can reach a speed of 50 mph (so the marketing brochure says) and go 100 miles on a single charge. The vehicle is manufactured by Renault and is for sale and rent in Europe. We should add that it would only be comfortable for very small people!

To us, this is just another example of the different types of transportation alternatives that will be developed and which will contribute to reduced car usage and ownership.

Alan reporting from Florence, Italy

I thought briefly about renting the Twizy and taking it for a spin. But, I quickly came to my senses; you have to be crazy to drive in Italy!