Remarks for David McGown

2017 Swiss Re Breakfast

Toronto, April 4, 2017

Good morning – and thank you for the introduction.

It is a pleasure to be here today with you for a second year.

When I spoke with you last April, I had all of three months of experience in the insurance business.

I recall standing here and calling myself "the new guy." I knew I had a lot to learn – but believed the lessons would proceed at some measured pace.

Then, on May 1st, a wildfire began southwest of Fort McMurray. Two days later, it had reached the outskirts of the city.

At that first emergency meeting of IBC staff, I naively suggested that they use me as their swing guy – I'll go wherever you need me, I recall saying.

Some of you may remember that famous line from David Broadfoot's Big Bobby Clobber --

"When I regained consciousness… "

It was three months later.

And I was still in Fort McMurray.

During those months, I experienced firsthand the dedication and focus of Canada's first responders.

I was so impressed by the exceptional work of those women and men who fight fires and help keep our streets and homes safe.

I also witnessed the vital role that the P&C insurance industry plays. I saw how it touches the lives of Canadians and their communities.

I learned more about disaster response and recovery and about our industry than I ever could have learned sitting in my office.

You are the second responders, arriving to help in the immediate aftermath of a disaster.

You were there in the evacuation centres writing cheques long before government or Red Cross financial aid was available.

And you will stick around until that last home is rebuilt and a community is truly back on its feet.

Everyone in this room should be extraordinarily proud of this industry's response to the Fort McMurray disaster.

You were there when your customers needed you. More than anything, that is essence of what this industry is all about.

And more than anything, that is the essence of what I want to talk to you about today.

And on that note, I'll begin.

First, I'll recap the 2016 macroeconomic trends.

Next, I'll review last year's industry financial results and provide some analysis. I'll also look forward to the 2017 outlook.

Finally, I'll delve deeper into our industry's results. Then I'll explore our growing efforts to embrace the innovations that are beginning to change this industry.

Let's kick off with the macroeconomic trends of 2016.

If we were to give the year a headline, it would be:

No One Saw THAT Coming.

The UK voted for Brexit.

The US voted for Trump.

The result is uncertainty and an uncharted path forward for governments, regulators, investors and, of course, businesses.

I won't delve into too much detail, but it's worth reminding ourselves of a few key numbers.

In Canada, overall growth in 2016 was 1.4% -- modestly better than 2015.

Interest rates remained unchanged. The overnight rate sits at 0.5%, where it's been stuck since July 2015.

As a result, yields on government bonds remained low for most of the year.

For our industry, this is significant because government bonds make up almost 40% of our industry's investments. And investment-grade bonds make up another 21%.

Finally, the T-S-X seesawed, dropping early in 2016 and then lifting to finish the year 18% higher.

Clearly we're operating in a challenging economy. Let's look at how that's reflected in the industry's financial results.

I won't sugar-coat it – 2016 was a difficult year.

Due to higher claims, underwriting income declined by over $1 billion. This pushed the combined ratio to 99.5%. Without reserve releases, we estimate the combined ratio could have hit a high of 104%.

The main culprits? The Fort McMurray fire and the damage caused by other large weather events. And the return on investment was just below 3%. That's the lowest in decades.

As a result, the return on equity for the industry was 5.6%, compared to over 10% in 2015.

Hardest hit were reinsurers who shouldered a significant proportion of the Fort McMurray claims. Reinsurers experienced a combined ratio of 102% and an ROE of 3.3%.

Let's dig a little deeper into the forces that influenced our industry's performance in 2016.

I'll look specifically at three:

- The continued increase in natural catastrophes
- Shrinking returns for private passenger automobile lines, and
- Continued low returns on investment.

At $5.2 billion, the 2016 total for CAT losses was truly unprecedented. And at $3.77 billion, the northern Alberta wildfire was the largest cat loss event in Canadian history.

But we can't lose sight of the fact that other CAT losses in 2016 added up to more than $1 billion.

These included:

- A major hail storm across the Prairies in August
- Extensive flooding in Windsor in September

$1 billion really has become the new normal for yearly cat losses.

As a result of this increase, the personal and commercial property loss ratios were 73% and 77% in 2016.

And when you look at the total property loss ratios by region, it's no surprise that the highest ratios were in the west. Total insured losses from cat events in Alberta have topped $450 million every year since 2010.

Now let's turn our attention to private passenger auto. In 2016, the total loss ratio increased about a percentage point to 76%.

Historically a loss ratio of around 75% was a sign for optimism.

But in this low-return environment, the 75% benchmark may now be too high for break-even.

And when we look at ROI, we have to ask: What drove it to new lows in 2016? Let's look at just one component of ROI –realized gains.

In 2015, there were two interest rate cuts, which drove bond values and improved realized gains. In 2016 – no interest rate cuts at all. Realized gains dropped by two-thirds.
When you look at the full picture, the 2016 ROE – at 5.6% -- was the lowest since 2002.

You could say this industry faced a perfect storm.

As you can see from this slide, investment returns continued their downward spiral…

And on this slide, that increase in the combined ratio is the result of a major drop in underwriting income.

Clearly, Canada's P&C insurance industry weathered a tough year.

In fact, reinsurance coverage likely prevented a challenging year from becoming a disastrous one for our industry.

Domestic and global reinsurers picked up an estimated 85% of the Fort McMurray losses.

So what can we expect for 2017? In this new political climate, it's a no-brainer to say that we should expect more uncertainty.

Upcoming elections in France and Germany may alter the political landscape even further.

The same goes for whatever a certain world leader tweets at 6:30 in the morning.

Speaking of which: The U.S. is in a robust recovery with an unemployment rate below 5%.

Yet, the perception of the U.S. president is that things are bad, very bad.

When policies are set based on misperceptions, the risk is incoherence.

We always ask how the U.S. administration's trade and immigration policies will affect Canada. What will be the effect on financial markets and bond yields?

Today I'd wager that none of us in the room would dare to predict.

Thankfully, there are other more hopeful signs that 2017 will be an improvement over 2016.

The IMF, World Bank, and OECD have all projected an increase in global economic activity.

And here at home, in January, our economy far exceeding expectations and is now growing at an annualized rate of 2.3%.

So there you have it. I'll be the first to acknowledge that this narrative so far has been a tad pessimistic.

The Canadian P&C insurance industry just had what may be its most challenging year in a decade or more.

And the stark reality is that 2016 may not be exceptional.

With nat cat losses now averaging $1 billion a year and rates of return remaining low, our industry may be facing a "new normal."

High cat losses and low returns aren't our only external challenges. The other big challenge is out-of-date regulation on auto products– which makes up almost half of our business.

The regulatory environment across the country for auto insurance lags far behind today's technology and today's consumer expectations.

So the obvious question is -- What's within our sphere of control to counter these external challenges?

The answer, of course, is that we can control how we respond to our customers, how we give them what they want.

That must be the test that both regulators and our industry use to make decisions about how we run our business. "Does it meet consumers' needs now?"

In a volatile world, that's the question we need to ask about each shiny new option that competes for our time and our capital.

It's also the question that governments should ask.

Governments respond to their voters – our customers.

When we can demonstrate that a new idea is good for consumers – and consumers demand it -- our political partners and regulators are more likely to champion innovation right alongside us.

Together with governments we can find the sweet spot between innovation and consumer protection.

I'll start with auto lines – our largest book of business. We've just seen that returns are down.

And what of our customers? How happy are they?

I think we can agree that our customers are as frustrated as the industry. And the root of the frustration – ours and theirs – is ultimately cumbersome provincial regulatory systems.

In Ontario, the system is clearly broken. Ontario consumers pay premiums at least 24% higher than anywhere else in the country.

Insurers wait months for rulings on rates and this has the effect of dampening both competition and innovation.

In Alberta, Newfoundland and Labrador, regulators and our industry have yet to find the right balance between consumer pricing and bodily injury benefits.

This has a negative effect on consumer satisfaction and our profitability.

What can we do as an industry? Firstly, we can recognize that fixing the problem is a shared responsibility among insurers, governments and consumers.

And then we can do the hard work of collaborating to find solutions together.

Here's how this collaboration is unfolding in Ontario. Our industry is working closely with the provincial government to support its efforts to modernize the regulatory system.

We're providing expertise, suggestions and detailed feedback – always focusing on the benefits for consumers.

Along with offering practical advice, sometimes it pays to lighten the moment.

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The government is beginning to make headway. This year, we hope to see progress on a new Financial Services Regulatory Authority with a mandate to revamp and modernize regulation.

And the insurance pink slip you carry in your wallet– now a piece of paper -- may finally be scrapped for a phone app.

Finally, our industry is looking at ways to offer Ontario consumers more product choice.

Currently the Ontario auto product contains the richest benefits of any in the country. But, to very loosely paraphrase a line from Spiderman, "With great benefits come great costs."

Next up, let's look at our property lines where soaring nat cat losses have been raising costs and eroding profits. There are two reasons why nat cat losses are off the charts:

- increases in severe weather linked to climate change AND
- short-sighted land use policies that continue to allow development on flood plains without appropriate risk reduction.

The situation in Fort McMurray is a case in point. One can't draw a straight line between climate change and the Fort McMurray fire.

But we do know that the 2015 winter was unusually dry and that warm weather arrived in Northern Alberta in April. In fact, it was 30 degrees when the fires hit.

In addition, one of its most devastated neighbourhoods – the aptly named Waterways – sits mostly on a flood plain.

The province or the municipality could have refused permission for people to rebuild.
They could have required them to move to a new area where they would be at reduced risk for another disaster.

But that didn't happen. Instead, the governments agreed that Waterways homes could be rebuilt.

The one bright spot is that the municipality is planning to build a flood defence for Waterways at the urging of the P&C insurance industry and others.

The way our industry is tackling ever-higher nat cat losses is to partner with governments and like-minded stakeholders to reduce risk. We are also calling for a nationwide natural catastrophe strategy.

At IBC, we call it Disaster-Proofing Canada.

I'm happy to say we're seeing results.

In last month's federal budget, Ottawa announced $2 billion -- a landmark investment -- for a Disaster Mitigation and Adaptation Fund.

A sizable chunk of these infrastructure dollars will be directed to flood mitigation projects.

Ottawa also allocated almost $200 million to implement new building codes to focus on climate resilience.

So how does this help consumers?

First, Canadians now have access to flood coverage.

Second, Canadians are better protected as provinces and municipalities begin to enforce better land-use policies.

I know everyone loves a view of the water but we also need appropriate land use policies like these

Let's go back again to our industry's new normal of high cats and low returns.

It's clear that insurers must embrace new approaches to create value for their customers and better returns for shareholders.

It's also becoming clear that technological innovation can help get us there.

There is much talk about the difference between innovation and disruption.

To paraphrase The Princess Bride, "Those words may not mean what you think they mean."

So let me suggest, just for our purposes, that those two words mean different things.

The way that I will approach this is to suggest that innovation improves the efficiency of the current business model. That could be new dollars for technology. It could be an improved claims process. It could be a way to segment higher value from lower value sales.

Disruption changes the business model. Uber didn't innovate. They did not build faster taxis. They found a way to monetize the idle time of personal vehicles and therefore disrupted the taxi marketplace.

In our highly regulated business, disruptors have yet to gain a foothold. I would suggest that what our industry is experiencing is innovation from both within and without.

Insurers and reinsurers are setting up their own venture capital funds for venture deals and partnerships.

Here's a measure of how quickly the landscape is changing. According to CB Insights, in 2012, total tech startup investment was $350 million US dollars. And in 2016, it was $1.7 billion. That's five times the investment in just four years

We are seeing some product innovation from insurers themselves. In the U.S., on the product side, Metromile is offering pay-as-you-go auto insurance online. Customers pay a small monthly fee and then fee per mile.

This model may be appealing to customers. But here in Canada, current regulations restrict its implementation. That's also why Usage Based Insurance isn't growing in Canada the way it is south of the border.

But Ontario recently lifted restrictions on UBC so that may change.

And on the internal process side, Canadian insurers are investing heavily in new technology to help them lower expense ratios.

By all accounts, this is the year that insurers will do a deep dive into partnering to form the new hybrid insurtech ventures.

We'll likely see progress on blockchain or distributed ledger technology. Blockchain has the potential to automate the writing and settling of contracts relying on centralized customer data storage.

In Europe, a consortium of insurers and reinsurers, including Swiss Re, has come together in a project called B3i to evaluate this new technology. We're all watching B3i with great interest.

And Canada is a contender in this space.

The corridor between Toronto and Kitchener-Waterloo is Canada’s first “technology supercluster.”

Ethereum, which may be the most important blockchain company in the world, was founded by Canadian developers.

And Ryerson’s DMZ, a tech startup incubator, is rated No. 1 in North America and third in the world by UBI Global.
Aviva recently partnered with DMZ on insurtech projects.

We’ll also see progress on artificial intelligence to assess risk and on the internet of things to help consumers seamlessly monitor and reduce their risks at home.

U of T recently announced the launch of the Vector Institute for Artificial Intelligence.

It will examine the potential for deep learning and machine learning in fields as diverse as health care, retail, transportation, and insurance.

The Institute has already received funding from government and corporate sources, including several insurance providers.

And here’s an example of AI in action: Lemonade has boasted that it paid an online claim for a lost jacket in three seconds.

That includes running the claim against 18 anti-fraud algorithms before paying. That’s three seconds from the time a customer pushes “submit,” to the time the funds were dropped into his account.

So -- after what some saw as a slow start, our industry is moving fast to partner with tech firms to innovate from within and from without. We’re on the cusp of the big changes that our customers are clamouring for.

And the regulatory environment is responding too.

The introduction of FSRA in Ontario is a promising sign. It says that at least one provincial government understands –in theory -- that regulation must not be the impediment to new ways and new opportunities.

And of course, our industry will be standing by to remind them. Along with our customers.

Thank you.