

Forward thinking

Business insight for a changing world

Opening the way

The future direction of the London Insurance Market

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'Today's exceptionally unstable risk environment is an opportunity for London's insurers to leverage their specialist expertise in an otherwise increasingly commoditised sector.'

Gavin Phillips
London Insurance Market Leader
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The London Insurance Market is facing an exceptionally unstable risk environment, a shift in global economic power and growing competition from rival exchanges. While clearly challenging, these developments are an opportunity for London's insurers to leverage their specialist expertise in an otherwise increasingly commoditised sector. Andy Moore and Gavin Phillips look at how the London Market can emerge stronger from the testing times ahead.



The London Market has come through the financial crisis with its reputation firmly enhanced. Yet, after two years of solid profitability and relatively benign claims conditions, many London Market businesses will be looking at the final quarter of 2010 with increasing trepidation. Rates remain soft across many classes. Investment returns are generally down and insurers' own share values continue to under-perform against other sectors. Claims from major loss events have been mounting and could rise still further if the grim predictions about this year's windstorm season prove correct.

How to sustain profitability in today's tough market is clearly going to be uppermost in board members' minds. However, if executives' eyes are only fixed on short-term priorities, they could lose sight of the longer term trends that are set to have a decisive impact on the direction and fortunes of their businesses.

Foremost among these developments is the rapidly changing pattern of risk, which has been brought into sharp focus by this year's Gulf oil spill following the Deepwater Horizon rig explosion. The scale of BP's compensation claims and market losses highlight corporate vulnerability to a risk environment in which the once unthinkable now seems almost commonplace. It is notable that BP held minimal cover for such an event, as 'external insurance is not considered an economic means of financing losses for the group'.¹ Companies that have followed a similar approach in the past may now recognise the need for insurance, especially as the political fallout from the disaster will ensure that sustainability and environmental risk can no longer be ignored.

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Richard Ward,
CEO of Lloyd’s

For insurers, the economic cost of this event could be likened to a World Trade Center, Hurricane Katrina or a 9.0 Richter scale earthquake in Tokyo, forcing many of them to overhaul their realistic disaster scenarios and rethink their risk management and underwriting strategies. Other developments that fall into the same potentially cataclysmic category include pandemics, cyber risk and climatic volatility. The scale of the potential exposures is heightened by the interconnectivity of a global economy in which ‘distance no longer insures you’. The impact of Iceland’s volcanic ash cloud on the aviation industry and wider commerce worldwide is a clear case in point. The reliance on outsourcing and offshoring for a variety of business activities also means that a major incident at a key supplier overseas can have highly material local ramifications.

Playing to London’s strengths

We are seeing some evidence that energy rates are rising as a result of the Monacondo oil spill and some insurers around the world are seeking to reduce their exposures to the Gulf of Mexico and even the energy sector as a whole. London Market businesses will clearly need to review what is insurable and, if so, how and at what price. At the same time, these developments present valuable opportunities for the London Market as the leading centre for such risks. Indeed, in such a complex and uncertain risk environment, marine energy is just one of a number of areas where London’s specialist expertise will be more sought after than ever. Other key advantages include the ability to cover large risks through syndication and access to an established infrastructure of professional and support staff that employs some 40,000 people. However, the London Market still has a number of issues and challenges to address if it is to capitalise on these opportunities and stave off competition from rival centres.

Safeguarding the brand

Lloyd’s and the wider London Market’s ability to attract business is built around its reputation for specialisation and innovation. Fresh investment and a broader range of business can be beneficial. Yet it will be important to ensure that new entrants are able to sustain the quality and differentiation of London’s underwriting ‘brand’.

Attracting talent

The ability to attract and retain talent is clearly critical in sustaining this expertise and developing the solutions needed to address a changing risk environment. Soon after becoming CEO of Lloyd’s, Dr Richard Ward said that ‘we need to be able to out-think, out-smart, out-innovate and out-perform the competition’.² Lloyd’s has led the way with the reinstatement of its graduate programme and focus on leadership development, and other businesses are following suit. However, talent is still seen as a ‘soft’ issue in some corners of the Market. There is also a lingering reluctance to bring in people from outside. Attracting people from beyond the confines of the Market will not only be useful in addressing skills shortages, but can also provide the benefits of fresh perspectives and the ability to challenge convention. The current economic climate presents an excellent opportunity to bring in the fresh talent and ideas that could further improve efficiency and reduce costs, as well as relieve resource strains from the increasing demands on the market.

Accelerating modernisation

Despite ongoing initiatives such as the London Exchange, few believe that it is as easy or cost-effective for brokers to bring business into London as it should be. Failure to improve efficiency could leave the door open to rivals, including the new exchange in New York. The London Market therefore needs to continue to work together to accelerate modernisation.

¹ BP Annual Report and Accounts 2009

² Speech by Dr Richard Ward, CEO of Lloyd’s, to the Insurance Institute of London, 01.10.07

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Stable regulation

Without stable tax and regulation, more business and businesses could switch elsewhere. The relatively low tax rates and settled regulatory regime in Switzerland could prove particularly attractive. The real danger is that the London Market and wider insurance sector in the UK, which is already facing the upheaval of Solvency II, could find itself having to comply with higher taxes and more stringent regulatory demands that have been primarily designed for banks not insurers. Indeed, while the banking industry has been busily lobbying behind the scenes, insurers have been far less active. Wherever possible, the London Market therefore needs to increase its influence, stressing its distinctiveness and crucial contribution to the UK and global economy and society as a whole.

Shifting economic axis

The financial crisis has accelerated the shift in economic power to China, Brazil and other emerging markets. Demand for insurance in these economies is set to increase, creating an opportunity for Lloyd's to leverage its unique global licence. However, it cannot be assumed that emerging market business will naturally flow to London. Indeed, there is a growing concern that the new avenues of global trade could miss out the West altogether, including established financial centres such as London, as local insurers, including newly privatised formerly state-owned insurers, seek to establish themselves as major powerhouses. While Lloyd's and other London Market businesses have set up a number of overseas agents, offices and branches, they may therefore need to do much more to strengthen their presence and relevance on the ground. These economies are young and entrepreneurial and so the market will only succeed if products are relevant and actively marketed.

The underlying challenge is how to ensure that overseas clients have access to the same expertise and support that would be available in London.

Sharpening competitive differentiation

It can be difficult to take a long-term view in a Market that rarely sees past the next renewal season. This is especially so at a time when the Market is grappling with a trying combination of soft rates, higher claims and low investment returns, along with more self-insurance as businesses seek to control expenses in the face of a fragile economic recovery. Nonetheless, the Market needs to respond to emerging developments and their potential impact on its commercial relevance and pre-eminence. An exceptionally unstable risk environment and the losses it generates are making it even more important to look over the immediate horizon.

Any such change in the patterns of risk raises critical questions about risk selection, risk pricing and the boundaries of insurability. On the plus side, it is an opportunity for the London Market to leverage its specialist expertise, develop innovative underwriting solutions and ultimately sharpen competitive differentiation.

The underlying challenges are attracting talent, adapting to the shifts in global commerce and getting the basics of cost, efficiency and communication right, all of which will require considerable further effort. The London Market should also seek to exert greater influence over government policy-making in pursuit of a more stable and favourable platform for regulation and taxation.

Although the London Market can look to the future with confidence, it is operating in an increasingly competitive and rapidly evolving marketplace and therefore cannot afford to be complacent about the ever greater challenges ahead.

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