The London Insurance Market

Blueprint for the future

Operational drivers in the London Market – a survey of insurers
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Introduction

Pressure to perform

Operational improvements are fuelling the drive to enhance value and sharpen the competitive edge.
The London Insurance Market has traditionally been seen as the world’s leading centre for insuring speciality risk. However, recent years have been marked by poor results and criticism about the efficiency of conducting business in London. These concerns have been cast in sharper focus by the World Trade Center losses and the growing threat from Bermuda to the London Market’s global pre-eminence.

The latest market reforms, though welcome, can only go so far in bolstering London’s reputation. Unless market participants are able to price risks more accurately, control exposures more effectively and generate higher and more consistent returns, the next few years could see a withdrawal of capital from London. As one chief executive told us, ‘by 2005 there will be no margin for error’.

Improving operational performance will be key to survival and success.

In the summer of 2002, PricewaterhouseCoopers surveyed a cross-section of insurers (encompassing a substantial proportion of the market’s 2002 capacity) to provide a unique insight into how they are addressing key operational challenges including underwriting performance, claims cost management and optimising the use of reinsurance. The results reveal a high degree of consensus about what needs to be done, with most respondents listing such factors as attracting quality people, closer control of risk aggregation and more appropriate reinsurance programmes among their top priorities. However, some appear to be finding it harder than others to turn words into action.

Admittedly, few of the issues are straightforward. Many organisations face the dilemma of how to instil tighter underwriting discipline without stifling the flexibility and entrepreneurial flair that are central to the London Market. Looking to the future, there is the vexed question of how to manage the business through the next downturn.

**Drivers for success**

Our research has enabled us to identify key attributes that we believe will be crucial for success in the long-term:

- **Clear focus on shareholder value creation, which is measurable and understood throughout the organisation;**
- **Decisive leadership and a strong positive culture;**
- **Clarity of decision-making based on quality information;**
- **Strong understanding of capital provider and key stakeholder expectations;**
- **Capability of attracting, retaining and rewarding quality people;**
- **Organisational structure that reflects the corporate culture and strategic goals;**
- **Receptiveness to change; and**
- **Willingness to innovate.**

These attributes manifest themselves in different ways across the organisations we surveyed and almost all ‘talk the talk’. However, to outperform in the long-term they also need to ‘walk the walk’. The cushion of the current strong rating increases may have abated the sense of urgency and purpose needed to transform the modus operandi.

Harder markets tend to mask weaknesses and flatter results. The acid test will come with the cycle downturn. This survey seeks to identify what constitutes operational best practice, and how it is being implemented to help organisations outperform their competitors across the cycle.

‘Too many capital providers have been prepared to back poor underwriters’

Survey respondent
Executive summary

The PricewaterhouseCoopers study focuses on the operational rather than strategic drivers for organisations within the London Market. The analysis is based on 22 in-depth questionnaires and 19 face-to-face interviews with executives from both Lloyd’s and Company market businesses. The respondents were selected to reflect a broad spectrum of entity sizes, product classes, independent businesses and subsidiary organisations.
Underwriting

The last five years have produced largely unsatisfactory results. Poorly controlled exposures have forced many London Market organisations to re-examine the operational basis of risk, reward and value management. WTC was the final wake-up call for many businesses, clearing away any remaining complacency and hastening change.

Nearly two-thirds of those surveyed are modifying the type of risks to be underwritten over the next 12 months. In addition, over a third of respondents in our survey said that WTC had led them to change the classes of business in which they operate. Most have now imposed stricter underwriting guidelines, including lower line size limits and more curbs on delegated authority business, backed up by more stringent peer review of underwriting decisions. Many organisations are also looking to develop more sophisticated scenario modelling and systems-based monitoring.

However, survey respondents acknowledged that more could be done:

- Many do not appear to fully understand all of the components of their ‘cost of sales’;
- Return on economic capital remains an alien concept for many underwriters; and
- Performance measures are not consistent and are sometimes arbitrary.

How can organisations improve performance and create value if they are not properly evaluating the prospective profitability of the business they are writing?

With notable exceptions, preparations for a future softening of the market are limited. Many respondents accept that they will face hard choices in cutting volumes and exiting markets, though forward planning generally lacks detail.

Claims management

Claims represent the bulk of an insurers’ post-commission costs. Yet, respondents indicated a limited focus on reducing expenditure, improving service or the effective monitoring of performance. Some organisations are embarking on limited claims leakage reviews, concentrating mainly on areas such as direct claims handling costs.

There are also moves to enhance the quality of case reserving and align it more closely to the pricing of new risks.

‘Anyone can write profitable business in a hard market, but you still need to sort the wheat from the chaff’

Survey respondent
Overall, we believe the opportunities for improvement are significant.

**Reinsurance**

WTC has forced many organisations to rethink their approach to reinsurance. Almost two-thirds of respondents have moved to higher quality reinsurers over the past year, despite the higher costs and numerous downgradings. Nearly three-quarters would like to reduce the emphasis on losses occurring during (‘LOD’) reinsurance and move to risks attaching cover, though most accept that this is often unavailable or too expensive.

To offset the higher costs and improve returns, many organisations are looking to reduce their reinsurance requirements through lower line size limits, better risk assessment and higher deductibles. Such moves are aligned to concerns, especially on the Lloyd’s side, that reinsurance is too often used to mask poor underwriting. Our research has also raised questions about the effectiveness of in-house teams in identifying and collecting potential recoveries, with a third of respondents continuing to rely on manual-only systems.

**People**

The pre-eminence of the London Market is underpinned by its unparalleled concentration of experience and specialist expertise. However, around a half of respondents believe that the London Market does not actually offer the requisite level of quality staff, which means paying well over the odds for suitable personnel.

Quite a number of respondents, especially on the Lloyd’s side, also expressed misgivings about the salaries and status enjoyed by many underwriters. In contrast, IT, claims and other key personnel can seem like the poor relations. Most recognise that this disparity needs attention, especially if they are to attract talented staff from outside the London Market.

Some organisations are looking to tie underwriters and other staff into broader corporate goals by basing their bonuses on return on equity and other capital-based measures. However, a perceived general lack of transparency and objectivity means that many staff remain sceptical about such moves.

Our interviews have highlighted that training and staff retention in many organisations also leave room for improvement.

**Issues coming to the fore**

Respondents gave surprisingly low rankings to the importance of regulation and terms of trade. Many organisations clearly feel that despite their levels of dissatisfaction within these areas, such issues are beyond their control. However, a brave few are taking the lead in pressing for more sensible terms of trade and more realistic compliance requirements.

Cost control seems to have slipped down the list of priorities for most organisations. This lack of importance is perhaps understandable at a time of substantial rating increases and the distraction of so many more immediate concerns.
In contrast, credit control and cashflow management have risen up the agenda. Most respondents have tightened up their credit terms and nearly 54% believe that cashflow is more important than a year ago – indeed, 45% believe it to be business critical. However, only a third are able to collect over 75% of the premiums on time. Some criticise brokers for sitting on the money, yet are reluctant to press too hard in case they lose business.

Although information management, systems and IT were not amongst the top priorities, the quality and clarity of reporting emerged as a defining issue in the interviews. Many now recognise that improving risk assessment and aligning performance/remuneration to return on capital are impossible without timely and focused performance data. In contrast, the Internet is clearly on the backburner, with 82% of respondents believing that it will be at least five years before it becomes a key distribution tool.

**Are you ready?**

While views of operational best practice differ widely within the London Market, management are united in their belief that improvement is needed. Progress to date, however, has been mixed, in part due to the constraints of the market’s structure. The winners, particularly in the next cycle downturn, will be those who make the move towards operational excellence and then sustain it.

‘Cut out the paperwork and concentrate on what is really important’

Survey respondent

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**Average rankings of operational drivers**

(1 being the most important. Operational drivers may be ranked equally)

<table>
<thead>
<tr>
<th>Operational drivers</th>
<th>Lloyd’s</th>
<th>Non Lloyd’s</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underwriting performance and cycle management</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Aggregations of exposure and impact on results</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Management of reinsurance programme performance</td>
<td>4</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Claims service and claims cost management</td>
<td>6</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Cost control</td>
<td>9</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>Subscription nature of London Market</td>
<td>14</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>Distribution and sourcing of business</td>
<td>9</td>
<td>12</td>
<td>11</td>
</tr>
<tr>
<td>Cashflow and credit control</td>
<td>6</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>People</td>
<td>2</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Information Management, Systems and IT</td>
<td>5</td>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>Regulation</td>
<td>9</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Investment performance</td>
<td>13</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>Own credit rating versus market credit rating</td>
<td>8</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Terms of trade</td>
<td>12</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>No response to question</td>
<td>7%</td>
<td>0%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
Surer footing

Underwriting performance and cycle management

Everyone recognises that underwriting risk and performance need to be more carefully managed. The real question is how?
### The market environment

The market environment is proving ever more challenging as London squares up to its global competitors in what is an increasingly fierce contest for investment. The major capital providers, upon which the future of the London Market depends, are not prepared to accept the volatility and poor returns that have dogged the market. WTC has intensified this pressure, forcing insurers and reinsurers to re-examine the nature, pricing and aggregation of the risks they underwrite.

14% of respondents are planning significant changes in the type of risks underwritten over the next 12 months. A further 59% expect some modification. WTC has specifically led 54% of respondents to change the classes of business in which they operate. Many are withdrawing from US casualty business, with some also considering reductions in aviation, US property and professional indemnity exposures. Almost 80% of respondents have increased year-on-year gross premium rates by at least 20%, with 14% recording rises of 50% or more. Rates for some lines have more than doubled.

#### Has September 11 led to you changing the classes of business in which you operate?

<table>
<thead>
<tr>
<th>Yes</th>
<th>Only to a limited extent</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>46%</td>
<td>36%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

#### What is the overall percentage gross rating increase in 2002 renewals?

<table>
<thead>
<tr>
<th>100%</th>
<th>20-50%</th>
<th>75-100%</th>
<th>Less than 20%</th>
<th>50-75%</th>
<th>No response to question</th>
</tr>
</thead>
<tbody>
<tr>
<td>14%</td>
<td>9%</td>
<td>64%</td>
<td>13%</td>
<td>4%</td>
<td>8%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

#### Has September 11 led to you changing the classes of business in which you operate?

<table>
<thead>
<tr>
<th>Lloyd’s</th>
<th>Non-Lloyd’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Only to a limited extent</td>
</tr>
<tr>
<td>43%</td>
<td>21%</td>
</tr>
<tr>
<td>25%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

#### What is the overall percentage gross rating increase in 2002 renewals over 2001 business?

<table>
<thead>
<tr>
<th>Lloyd’s</th>
<th>Non-Lloyd’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>20-50%</td>
</tr>
<tr>
<td>79%</td>
<td>38%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
However, all believe that these rate levels are not sustainable. Once the cycle turns, almost all interviewees stressed the need to then cut back on volume and be more selective in the risks they accept to enable them to maintain margins and profitability. Some are developing early warning systems to enable them to anticipate and promptly respond to declining rates. However, there seemed to be a general lack of clarity and detail about how the necessary reorientation was to be achieved.

Many appreciate that it may be difficult to convince underwriters to rein in their writings when many have traditionally ranked themselves on volume, especially if they still have access to ‘hard market’ levels of capital. Subsidiaries of larger global groups may also face difficulties in squaring the contraction in income with their capital providers, who demand ever increasing returns to satisfy the capital market. Nevertheless, it is generally recognised that sustainable profitability is the key to safeguarding the confidence and support of investors.

**Distribution**

The need for greater selectivity and vigilance about the risks underwritten has intensified concerns about the safety of delegated authority arrangements, which still account for at least 10% of business for nearly half of respondents. Most respondents were keen to curtail the use of ‘binders’, though it was generally accepted that this is still often the best way to manage certain business classes such as US direct property. Many felt that adequate control of such arrangements is feasible as long as there is an effective infrastructure to govern relationships and performance.

![Chart showing distribution of business through delegated authorities](chart.png)

Source: PricewaterhouseCoopers 2002
Closer to home, the subscription nature of the market is still an important foundation for most organisations. Only a third of respondents lead more than 50% of the business they write. However, many now recognise the need to build closer relationships with clients through regular face-to-face communication.

Although brokers are still powerful, direct contact with policyholders could act as a catalyst in the evolving relationship between insurer and broker. Two-fifths of respondents would support direct settlement with policyholders. As one interviewee commented, ‘brokers have got to accept that they’re under pressure, because direct sales are coming through’.

Most respondents remain cautious about trading over the Internet. 82% do believe that web-enabled technology should be used to reduce distribution and business acquisition costs. Nevertheless, only 18% anticipate any significant increase in their Internet trading capability over the next 12 months. 82% reckon that it will be at least five years before the web is a key distribution tool in the London Market, with only 9% feeling that it is already important. 9% feel that lloyds.com is currently useful. It seems that, for some time at least, people will remain the main distribution channel.

‘At the moment Lloyd’s is a subscription market which works in certain classes, but you need to get closer to the client and also closer to the brokers’

Survey respondent

‘People are still the main distribution channel’

Survey respondent

‘Do you anticipate significantly increasing your Internet trading capability in the coming 12 months?’

Source: PricewaterhouseCoopers 2002

‘What percentage of the business that you write, by premium volume, do you lead?’

Source: PricewaterhouseCoopers 2002

‘What percentage of the business that you write, by premium volume, do you lead?’

Source: PricewaterhouseCoopers 2002

‘People are still the main distribution channel’

Survey respondent

‘Do you anticipate significantly increasing your Internet trading capability in the coming 12 months?’

Source: PricewaterhouseCoopers 2002
Control

Concerns over their ability to control and monitor aggregations have forced most respondents to review their formal underwriting process and guidelines. Such controls are often backed up by increasingly sophisticated realistic disaster scenario (‘RDS’) and probable maximum loss (‘PML’) modelling, capable of identifying and capping aggregations. As one respondent noted, ‘the old RDS technique is no longer an effective benchmark after WTC; you’re now looking beyond that to other possibilities’.

Ultimately, controls depend on underwriter integrity and the capability and commitment to enforce it. While most respondents still value the importance of ‘at the box’ peer review, most have stepped up the scope and frequency of more formal scrutiny. Some larger and more complex risks are subject to pre-acceptance review, though most other risks are analysed after they have been bound. In many organisations, compliance and internal audit personnel contribute to the reviews. It would clearly be impractical to examine every slip, so most tend to base their selections on the size and exceptional nature of the risk.

The survey found that the quality of enforcement often tends to depend on the organisational structure. Clear lines of command are far harder to maintain in some of the more diffuse business entities. Wisely, some have now streamlined their operations. Many interviewees also stressed the importance of a strong culture. For some this is reflected in an uncompromising insistence that ‘break the rules and you’re out’, though such dictates may not be so appropriate within the more collegiate atmosphere we observed in some organisations. One interviewee insisted that laying down the letter of the law can inhibit initiative and that ‘trust and teamwork are far better than a book’.

A more subtle middle way that could equally apply to either kind of entity is to augment detailed rules with more broad-based principles, through which small-print compliance gives way to a more proactive and all-encompassing environment of risk control.

Performance measurement

Independent research (from McKinsey & Co) suggests that between 25% and 50% of under-pricing is due to poor underwriting execution. Only around a third of respondents actively involve actuaries or statisticians in the pricing of individual risks or treaties.

Historically much of the business has been underwritten without a true understanding of whether that business is actually making money. In response, many underwriting Key Performance Indicators (‘KPIs’) now take full account of reinsurance, investment income and directly attributable expenses to create a more realistic assessment of whether business is genuinely profitable. The challenge
here is to maintain responsibility and accountability, while ensuring that underwriters concentrate on maximising shareholder value. For example, some organisations do not believe that underwriters should be measured on their post investment income results, and that their focus should be on the combined ratio.

It is essential to ensure that management information systems are geared to creating timely and credible analysis of the KPIs used. However, only a quarter of respondents are fully satisfied with the quality of their internal management reporting and the effectiveness of the KPIs they employ. Most believe that ‘it is time to stop bombarding directors with bewildering streams of extraneous detail and concentrate on what is really important’. Where and how to streamline the management information depends on the organisation. The key factor is whether people trust and understand the numbers and are able to take decisions quickly.

The level of benchmarking against peer syndicates and companies is minimal. Most respondents did not consider it important in spite of operating in an environment where competition for capital is so intense.
The value of claims

Claims service and claims cost management

Claims are by far insurers’ biggest expense. How can they ensure that this money isn’t going down the drain?
Claims represent the bulk of an insurer’s post-commission outgo. Nearly a quarter of this is operational costs ranging from internal processing to professional fees. But only 32% of respondents are looking at ways to reduce either claims indemnity payouts or claims handling expenses.

In comparison to the underwriting area, the survey also found that the KPIs used to measure the performance of the claims function are sketchy at best. Very few organisations have set up programmes to measure or incentivise the performance of their claims teams. Very few respondents benchmark any aspect of their claims handling performance against peer organisations and syndicates. As one interviewee remarked, ‘claims are a black hole’.

The subscription basis of the market does not help. Nearly two-thirds of respondents believe that the nature and infrastructure of the London Market impairs the effectiveness of claims handling and settlement. The quality of claims staff is a key issue. While claims professionals are still the poor relations of underwriters in terms of pay, many organisations are introducing performance-based remuneration for claims teams. Nevertheless, these tend to be geared to corporate goals rather than claims-specific targets.
The value of claims  

continued

Claims leakage

Close to two-thirds of respondents are yet to implement any form of claims leakage programme. Those that have done so believe that they have made savings of between 5% and 10%, even though most were fairly limited exercises. In contrast to the London Market, reducing or eradicating claims leakage is now seen as a key priority for many global insurers, with some organisations generating claimed savings of up to 20%. Frequent reviews seek to identify and eliminate a variety of costly problems ranging from processing errors, delays and failure to investigate and repudiate invalid claims to fraud, pointless litigation, excessive legal and loss adjusting fees and poor recognition of subrogation and economic settlement opportunities.

Professional fees are a cause for concern, with 41% of respondents looking for reductions. Around a quarter of respondents retain more than 20 legal and 20 loss adjusting firms on their panels, though this does in part reflect the product or geographical spread of their business. Around two-fifths of respondents say that legal expenses represent more than 1% of their total claims indemnity and handling costs, with one paying out more than 6% of its overall claims expenditure to its lawyers.

Most recognise that policy wording needs to be tightened up to avoid disputes and expensive litigation. Many also hope to benefit from prompter and more economic settlement, with some respondents now sending their claims handlers on high-level negotiation skills courses.

Overall, claims handling costs, service and process efficiency are rarely monitored, with few organisations operating within a peer review or formal performance appraisal culture for their claims function.

The claims leakage review enabled us to cut our legal and loss adjusting costs

Survey respondent
Outsourcing

Nearly half of respondents now outsource a significant amount of their claims handling activity. However, while this has achieved some administrative savings, many arrangements have failed to live up to expectations. There are clearly differences in the level of service and performance demanded by London Market participants. For example, nearly a half of respondents are satisfied or very satisfied with the central facilities provided by Xchanging Claims Services, but a quarter have expressed misgivings.

Many respondents complain that outsourcers do not have the skills or commitment to deal effectively with the more complex tasks. Service level agreements also tend to be vague, concentrating more on volume than efficiency or creating value.

More competition, better monitoring and more effective reward mechanisms could pave the way for improved outsourcing performance.

‘The key is how effectively you manage the loss adjusters; are you getting the best deal and how are they performing?’
Survey respondent

What is your level of satisfaction with the central claims services provided by Xchanging Claims Services?

<table>
<thead>
<tr>
<th></th>
<th>Overall</th>
<th>Lloyd's</th>
<th>Non-Lloyd's</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not applicable</td>
<td>18%</td>
<td>14%</td>
<td>25%</td>
</tr>
<tr>
<td>Not satisfied</td>
<td>23%</td>
<td>36%</td>
<td>30%</td>
</tr>
<tr>
<td>Satisfied</td>
<td>41%</td>
<td>36%</td>
<td>10%</td>
</tr>
<tr>
<td>Very satisfied</td>
<td>1%</td>
<td>14%</td>
<td>11%</td>
</tr>
<tr>
<td>No response to question</td>
<td>13%</td>
<td>12%</td>
<td></td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
The value of claims continued

Forecasting

Although Lloyd’s in particular has struggled historically to shake off its poor reputation for forecasting, many organisations appear satisfied with their current procedures. Over one-third of Lloyd’s respondents believe their case estimating is ‘very good’. Although the Company market participants did not share such a high level of confidence, half described their case estimating as ‘good’. No respondents admitted that it was ‘poor’.

To ensure that the reserving process is robust, nearly three-quarters of respondents now have a committee responsible for setting reserves, which meets regularly. In addition, most use actuaries and some two-thirds regularly use external actuarial consultants to support the process. Nearly three-fifths look at ranges and explicit margins or loadings in setting their reserve levels. About half incorporate these evaluations into their risk pricing, at least for some classes, though only one in five use them in cashflow management.

The quality of reserving is undermined by rogue contracts, rogue underwriters and poor underwriting controls

Source: PricewaterhouseCoopers 2002
Many organisations within the London Market have also been keen to develop a more systematic approach to run-off. 82% of those with discontinued business have set clear, specific, business objectives to achieve the most efficient and effective management of the run-off. While techniques such as commutations, solvent schemes of arrangement and/or ex-gratia payments are regularly used by half of the Company respondents, the proportion for Lloyd’s is less than a third. Most of the rest are at least familiar with their use. However, only around a half of respondents with discontinued business portfolios use any KPIs to monitor the performance of their run-off managers, which is surprisingly low.

**Closing the book**

Do you use the services of an external actuarial consultant for reserving purposes?

<table>
<thead>
<tr>
<th></th>
<th>Yes – annually</th>
<th>Yes – ad hoc</th>
<th>No</th>
<th>No response to question</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>64%</td>
<td>23%</td>
<td>5%</td>
<td>8%</td>
</tr>
<tr>
<td>Lloyd’s</td>
<td>86%</td>
<td>7%</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
<td>25%</td>
<td>50%</td>
<td>13%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

Are the use of claims crystallisation techniques such as commutations, solvent schemes of arrangement and/or ex-gratia payments used to shorten the tail of the run-off, and save costs?

<table>
<thead>
<tr>
<th></th>
<th>Techniques familiar and used</th>
<th>Techniques not used at all</th>
<th>Techniques used by exception</th>
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<td>50%</td>
<td>21%</td>
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<td>Non-Lloyd’s</td>
<td>50%</td>
<td>25%</td>
<td>25%</td>
<td></td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
Rethinking reinsurance

Management of reinsurance programme performance

Higher costs and concerns about reinsurer security and programme performance have spurred many insurers to rethink their approach to reinsurance.
‘WTC was a big turning point for reinsurance,’ said one interviewee. ‘A lot of people came unstuck because they didn’t really understand their exposures, they didn’t have a reinsurance programme that worked and the reinsurance didn’t cover the tail.’

Others maintained that their programmes had performed reasonably satisfactorily, though they accepted that WTC had underlined the need for a more robust approach. Close to two-thirds of respondents have upgraded the quality of their reinsurer panel, despite the higher costs and widespread credit downgradings. An S&P credit rating of ‘A’ or its equivalent now appears to be the minimum threshold, with one in ten now insisting on ‘AA’ or its equivalent and above. Almost all of those surveyed now have a reinsurance security committee, with 78% of Lloyd’s respondents making use of reinsurance security experts.

32% of respondents reported significant changes to the cost of reinsurance, 27% substantial changes to the terms and limits and 9% noted changes to both over the past year. However, to the surprise of some, securing sufficient cover has not been a problem. This may stem from reduced demand as organisations write smaller gross or larger net lines. Higher insurance premiums and expected improvements in profitability, combined with better risk assessment and aggregation monitoring, have certainly encouraged greater retention.

‘Every pound spent on reinsurance is a pound wasted...we need to cut the line sizes’

Survey respondent

What is your minimum criterion for a reinsurer’s S&P credit rating?

<table>
<thead>
<tr>
<th>Overall</th>
<th>Lloyd’s</th>
<th>Non-Lloyd’s</th>
</tr>
</thead>
<tbody>
<tr>
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<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>32%</td>
<td>14%</td>
</tr>
<tr>
<td>AA</td>
<td>5%</td>
<td>1%</td>
</tr>
<tr>
<td>BBB</td>
<td>27%</td>
<td>7%</td>
</tr>
<tr>
<td>BB</td>
<td>27%</td>
<td>36%</td>
</tr>
<tr>
<td>Other – please specify</td>
<td>5%</td>
<td>63%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

How would you describe your 2002 outwards programme in comparison to the 2001 programme?

<table>
<thead>
<tr>
<th>Overall</th>
<th>Lloyd’s</th>
<th>Non-Lloyd’s</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Broadly the same</td>
<td>23%</td>
<td>14%</td>
</tr>
<tr>
<td>Broadly the same terms and limits but at significantly higher cost</td>
<td>12%</td>
<td>43%</td>
</tr>
<tr>
<td>Significant change in the terms and limits but broadly the same cost</td>
<td>27%</td>
<td>29%</td>
</tr>
<tr>
<td>Significant changes in structure and cost</td>
<td>9%</td>
<td>7%</td>
</tr>
<tr>
<td>No response to question</td>
<td>9%</td>
<td>13%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
Rethinking reinsurance

Nevertheless, this continues to be a heavily geared market, with many believing that reinsurance is too often used to mitigate sloppy underwriting. Partly as a result, more and more reinsurance is now bought centrally, albeit with strong input from senior underwriters to ensure that programmes purchased match the profile of the business written.

Cover

The survey also highlighted more specific concerns about the structure and matching of reinsurance protections with inwards writings.

Some respondents are now switching from whole account programmes to discrete product-orientated cover, which they believe is more suited to dealing with catastrophic events such as WTC.

Others are looking at how to ensure that reinsurance protection is properly aligned to the periods covered in the policies underwritten. Here, the most serious misgivings centre on the reliance on LOD covers, particularly in respect of the lack of protection for unexpired risks. Nearly three-quarters of respondents would like to reduce their use of LOD reinsurance and move to a wholly risks attaching programme. Most believe that the latter is either too expensive or not readily available, but as the quotes opposite show, views vary.

Several interviewees insisted that the use of LOD covers can be effective if properly managed. In particular, users need to ensure that the pricing of the underlying policies protected by LOD covers takes full account of the additional costs of purchasing reinsurance to cover unexpired risks at the end of the underwriting year. It is also possible to stagger the purchase of LOD protection over the course of the underwriting year.

Although such procedures may be effective, it is pertinent to ask whether organisations are sacrificing the effective matching of risks by buying lower-cost LOD cover, rather than accepting the expense of a more suitable risks attaching programme.

---

**Do you purchase a significant amount (more than 20% of total reinsurance premiums) of ‘losses occurring during’ (LOD) reinsurance?**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>No response to question</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>64%</td>
<td>23%</td>
<td>13%</td>
</tr>
<tr>
<td>Lloyd's</td>
<td>86%</td>
<td>14%</td>
<td></td>
</tr>
<tr>
<td>Non-Lloyd's</td>
<td>25%</td>
<td>63%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

**Would you like to reduce the amount of LOD reinsurance purchased and move to a wholly risks attaching programme?**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>No response to question</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>73%</td>
<td>18%</td>
<td>9%</td>
</tr>
<tr>
<td>Lloyd's</td>
<td>79%</td>
<td>14%</td>
<td>7%</td>
</tr>
<tr>
<td>Non-Lloyd's</td>
<td>63%</td>
<td>25%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
New horizons

Alternative risk transfer products continue to make little headway, though it has attracted a small but enthusiastic band of converts. One respondent believes that catastrophe bonds can work out cheaper to buy than comparable reinsurance cover. Electronic reinsurance exchanges have also failed to set the market alight, largely reflecting concerns about the ability to specify and place complex reinsurance requirements over such platforms and the relative simplicity of the products currently available. However, there is growing interest in purchasing facultative and specific covers through such exchanges.

Recoveries

Securing recoveries has become a hot topic in the wake of WTC, heightened by initial concerns about a possible domino effect of reinsurer failure. One-third of respondents recognise that the performance of their reinsurance collection function is acceptable at best. Similarly, a third still solely rely on manual processes to identify the available reinsurance recoveries. Those that do use automated systems, generally in relation to facultative and proportional coverage, believe that they can significantly improve the identification and collection of reinsurance recoveries. Some organisations have also outsourced the processing component to allow their in-house reinsurance teams to focus on late payments and doubtful debts, which continue to be a problem within the London Market.

‘Of course we’d like to get rid of LOD and replace it with risks attaching, but we can’t get it’
Survey respondent

‘Risks attaching is available, organisations just can’t afford it’
Survey respondent

How effective is your reinsurance collection function?

<table>
<thead>
<tr>
<th></th>
<th>Very strong</th>
<th>Strong</th>
<th>Acceptable</th>
<th>Poor</th>
<th>No response to question</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>18%</td>
<td>36%</td>
<td>32%</td>
<td>5%</td>
<td>9%</td>
</tr>
<tr>
<td>Lloyd’s</td>
<td>7%</td>
<td>43%</td>
<td>36%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
<td>38%</td>
<td>25%</td>
<td>25%</td>
<td>12%</td>
<td></td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

Are your reinsurance recoveries calculated manually or automatically?

<table>
<thead>
<tr>
<th></th>
<th>Automatically</th>
<th>A mixture, depending on class of business</th>
<th>Manually</th>
<th>No response to question</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>64%</td>
<td>32%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lloyd’s</td>
<td>64%</td>
<td>36%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
<td>63%</td>
<td>25%</td>
<td>12%</td>
<td></td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
A people business

Recruiting, retaining and nurturing quality staff

Everyone recognises that performance depends on the quality of the people. Aligning KPIs with remuneration and reward is increasingly seen as the key.
One of the key findings of the survey was respondents’ emphasis on the importance of people. As one interviewee commented, ‘success relies on having the right people covering the right issues, and keeping them driven to move the business forward’.

So for ‘a people business’, it must be galling that barely half of respondents believe that the London Market offers the requisite quality of staff. The competition to recruit good people is especially intense in today’s market. Half of the respondents are looking to hire extra finance and underwriting staff. For IT and claims personnel the proportion falls to one-third in both cases. The survey confirmed that many of these posts have been vacant for some time, with experienced and specialist positions proving most difficult to fill.

Market leadership in their area of business was considered an advantage in attracting the best candidates. Others were keen to stress the benefits of a supportive and convivial environment. However, the accepted wisdom is that if you want to get the best you need to pay the best.

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**Proportions of respondents looking to recruit extra resources:**

<table>
<thead>
<tr>
<th>Areas</th>
<th>Lloyd’s</th>
<th>Non-Lloyd’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underwriters</td>
<td>43%</td>
<td>50%</td>
</tr>
<tr>
<td>Underwriting support</td>
<td>64%</td>
<td>38%</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>43%</td>
<td>0%</td>
</tr>
<tr>
<td>Claims</td>
<td>29%</td>
<td>38%</td>
</tr>
<tr>
<td>Finance</td>
<td>57%</td>
<td>38%</td>
</tr>
<tr>
<td>Actuarial</td>
<td>36%</td>
<td>25%</td>
</tr>
<tr>
<td>Investment management</td>
<td>7%</td>
<td>0%</td>
</tr>
<tr>
<td>IT</td>
<td>57%</td>
<td>0%</td>
</tr>
<tr>
<td>Credit control</td>
<td>14%</td>
<td>25%</td>
</tr>
<tr>
<td>Other</td>
<td>7%</td>
<td>13%</td>
</tr>
<tr>
<td>No response to question</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

**Do you consider that the London Market offers the requisite level of quality staff?**

![Chart showing proportions of respondents considering quality of staff](chart1)

Overall: 45% Yes, 45% No, 10% No response to question

Lloyd’s: 36% Yes, 57% No, 7% No response to question

Non-Lloyd’s: 63% Yes, 23% No, 12% No response to question

Source: PricewaterhouseCoopers 2002

**If you do participate in remuneration surveys how do you compare against your peers?**

![Chart showing remuneration survey results](chart2)

Overall: 21% Above average, 45% Average, 32% Below average

Lloyd’s: 29% Above average, 29% Average, 42% Below average

Non-Lloyd’s: 11% Above average, 75% Average, 12% Below average

Source: PricewaterhouseCoopers 2002

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‘Expertise drives performance’

Survey respondent
A people business continued

Remuneration

Around a third of the respondents that participate in remuneration surveys believe they pay more than their peer average. Two-thirds augment salaries with share options and 45% with profit commission, though most felt that underwriters in particular ‘prefer cash’, with 86% offering such bonuses. Most interviewees believe that underwriters are generously, in one or two cases unjustifiably, rewarded in comparison with professions such as banking and investment management. They typically earn at least twice as much as colleagues with similar lengths of service in the claims area.

Many respondents also believe that focusing incentive programmes on the individual underwriter’s performance, which the tables below suggest is more marked in the Lloyd’s market, can tempt some individuals to ‘go for broke’ at the expense of the liabilities and overall interests of the organisation. As a result, more and more insurers are now looking at how to align their underwriters’ performance evaluation and rewards to their broader corporate goals.

These approaches include explicit rewards for business-wide measures such as return on equity. 18% of respondents now base their performance pay on share price/return.

| What split of underwriters’ remuneration is fixed and variable, in a profitable year? |
|-------------------------------|-------------------|------------------|
| Overall                       | 61%               | 39%              |
| Lloyd’s                       | 52%               | 41%              |
| Non-Lloyd’s                   | 71%               | 29%              |
| Source: PricewaterhouseCoopers 2002 |

| What split of underwriters’ remuneration is fixed and variable, in a poor year? |
|-------------------------------|-------------------|------------------|
| Overall                       | 89%               | 11%              |
| Lloyd’s                       | 89%               | 11%              |
| Non-Lloyd’s                   | 91%               | 9%               |
| Source: PricewaterhouseCoopers 2002 |
on capital measures. The key question is what criteria are most suitable for the organisation and how to ensure that underwriters understand and endorse them. It can sometimes be difficult to get underwriters to appreciate the importance of capital measures, though as one interviewee noted, ‘the best way to get them to understand return on equity is to build it into their bonuses’.

The survey revealed no single or simple answer as to how such remuneration programmes should be structured, especially as many tend to incorporate a variety of different elements to reflect the nature and organisation of the business. However, those respondents that have proved most successful have been able to develop transparent and clearly defined criteria covering capital allocation and incentivisation, preferably with feedback and ‘buy-in’ from their underwriters.

Stars

On the Lloyd’s side, reservations about underwriter remuneration are matched by misgivings about their vaulted status. Clearly, underwriters are the linchpin of the business and the very best will become ‘stars’. However, the new breed of corporate capital providers are much less likely to trust their investment to people who have traditionally been allowed to operate as virtually independent entrepreneurs. In the words of one respondent, ‘superstar underwriters can rapidly become unmanageable’.

Particular concerns centre on the ‘personal franchise’ built up by many top underwriters, much of which they can take with them when they leave. A variety of techniques are used to retain the business or ‘lock in’ senior underwriters, ranging from contractual restraints to equity and deferred bonuses, albeit with mixed results. As the Company market has demonstrated with some success, it is ultimately up to senior management to ensure that even stars recognise their responsibility to the cohesion and objectives of the group as a whole.

Lagging behind

Nurturing talent from within would seem preferable to buying it. However, training and staff retention within the London Market are generally poor in comparison with other financial sectors. The survey found that although 82% of respondents do have a formal training budget, the programmes can often be arbitrary and on average account for only 0.7% of net earned premiums. While around 40% of respondents

‘A lot of business has a personal franchise attached to it’

Survey respondent
We need to recognise that the market is not just about underwriters and reward others such as IT and claims people appropriately.

Survey respondent

Training in the market is awful

Survey respondent

They have reduced the level of staff turnover over the past year, it remains at over 15% for around a quarter of those surveyed. Apart from mergers and restructuring, it is unclear what is driving this high staff turnover, as less than a third of respondents conduct regular employee satisfaction surveys. The level of turnover appears to be lower in the Company market, where around 50% of organisations carry out such surveys, compared to Lloyd’s where only 14% of respondents have gone down that route.

In many other industries, training and staff retention are increasingly seen as intangible assets capable of underpinning sustainable value creation. Within the London Market, their status does at last appear to be improving. Most businesses now insist, or at least encourage, their younger underwriters to pursue ACII qualifications. Some organisations base pay rises and promotion on ACII exams passed. This is supported by continuous professional development in areas such as negotiation and presentation skills.

Such moves are likely to be given added impetus by the FSA’s directive on ‘training and competence’ for ‘approved persons’. One interviewee has effectively given up trying to hire seasoned underwriters, reasoning that most of those that are available are either unsuitable or too expensive. Instead, the organisation prefers to
recruit people in their late twenties and then mould them for senior positions. Such candidates can often be ‘more loyal, motivated and receptive to change’ than many of their older counterparts.

**New blood**

Many interviewees have also come to recognise that ‘the market is not just about underwriters’ and that it is time to value and reward other equally important members of the team. Most recognise that culture can be just as much of a problem as money, with many interviewees commenting that the London Market faces a tough challenge if it is to attract the best support and professional staff within the financial services sector.

Many respondents now include back office staff in their bonus and profit sharing programmes, explicitly linking such rewards to the organisation’s overall results or the extent to which they have met individual objectives. Others are stepping up efforts to draw staff from outside the London Market, with many of the people interviewed in this survey having themselves come from other sectors. Their fresh experience and expertise can prove a valuable catalyst for change.
Capital management

Turning capital into shareholder value

Securing and sustaining investment is crucial to the long-term future of the London Market. Yet surprisingly few organisations make use of return on capital measures.
Optimising return on capital employed (‘ROCE’) is especially crucial at a time of considerable competition for investment. Over a quarter of respondents need to attract a capital injection over the next 12 months. Inter-company funding or loans were seen as the most readily available source of capital, closely followed by LOC, bank loans and, in the case of Lloyd’s businesses, a cash call from Names.

Capital management tools allow organisations to allocate capital and measure added value by each policy, unit or class of business, enabling them to optimise returns, understand the dynamics of their enterprise and manage their underwriting and reinsurance strategy more effectively. However, the survey revealed that the use of even the most basic ROCE measures is still not widespread in the London Market. Only two-thirds of respondents now take into account a return on capital target in the pricing of particular classes of business, and only 41% consider such a return for individual risks.

‘Capital management is about keeping the capital provider happy’
Survey respondent

‘If the business is profitable we’ll get the capital. The problem is proving that it’s profitable’
Survey respondent
Some forward-thinking organisations are looking to develop more sophisticated asset/liability modelling and capital management tools. Others have gone further by insisting that underwriting teams include return on equity evaluations in their business plans.

Only one respondent makes extensive use of Lloyd’s risk based capital (‘RBC’) measures for internal capital management. A further 9% of those surveyed use them to some extent, supplemented by other tools or measures, and 23% of respondents employ RBC criteria as no more than a broad benchmark. The RBC criteria are not used by any of the non-Lloyd’s respondents. The majority of the respondents agreed that a clear focus on shareholder value creation, which is measurable and cascaded through the organisation, is essential for long-term success. The survey results and our interviews suggest that capital management within many organisations has some way to go to achieve this.

‘Underwriters do not have enough appreciation of return on capital’

Survey respondent

Do you actively consider a return on capital target in the pricing of individual risks?

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No response to question</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lloyd’s</td>
<td>14%</td>
<td>36%</td>
<td>36%</td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
<td>29%</td>
<td>12%</td>
<td>50%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
True, fair and transparent

Effective financial reporting

A fog of reporting is creating confusion. It’s time to clear the air.
Most respondents recognise that the London Market needs to improve the clarity and credibility of its financial disclosure if it is to compete more effectively for capital. Yet, those surveyed continue to use a large number of reporting bases including Lloyd’s, statutory returns, UK GAAP, US GAAP or variations or combinations thereof.

The survey revealed overwhelming support for the Lloyd’s market’s move to annual accounting, which will help make results more transparent and easier for outsiders to understand, especially US corporate capital providers. However, systems need rapid upgrading, with 45% of respondents still using a separate system or process to convert Lloyd’s three-year underwriting results onto annual accounting, often with intensive, manual input.
Such a multitude of reporting can create a damaging lack of cohesion and transparency within the organisation. In our experience, the board tends to manage the business on a GAAP basis, whereas underwriters often think and act on an underwriting year basis. While in the final analysis the results should be the same, variations in timing and measurement can influence the behaviour and mindset. We believe that within the most efficient organisations, key staff recognise the importance of focusing on performance as measured by GAAP accounting. The impending introduction of International Accounting Standards will also have an impact on this.

Our discussions also highlighted a tendency to ignore non-financial measures such as business relationships, reputation and innovation, which are increasingly being used in other financial sectors.
The purse-strings

Credit control and cashflow management

The credit control and cashflow problems within the London Market have generally been viewed as an occupational hazard. Could there now be a will to overcome them?
The aftermath of WTC has renewed the focus on credit control and cashflow management. Over half of respondents believe that cashflow is more important today than a year ago, with most of those now regarding it as critical. The priority afforded to cashflow is particularly high on the Lloyd’s side, given the high level of reinsurance gearing. Over 50% of all respondents draw up formal cashflow forecasts at least once a month. Over 80% review these projections against actual income and expenditure, either weekly or monthly.

Similarly, around two-thirds of respondents now see credit control as a potential source of competitive advantage, and two-thirds have tightened up their terms over the past six months, either generally or in specific classes. 77% would support standard premium collection terms, with most favouring 30 days.

‘Credit exposures that wouldn’t be tolerated in other industries are quite normal’

Survey respondent
The purse-strings continued

It remains to be seen whether this renewed commitment to credit control and cashflow management will eventually bear fruit. Only one in four respondents reward credit controllers against set performance targets. Only just under a third are able to collect over 75% of the premiums due on time, despite what are considered to be already generous credit terms.

‘If you write the business 10% quicker than anyone else, you collect the premiums 10% quicker, you collect the reinsurance recoveries 10% quicker, then you invest your money and it all multiplies’

Survey respondent

<table>
<thead>
<tr>
<th>Are your credit controllers set collection targets and rewarded on the basis of performance?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
</tr>
<tr>
<td>23%</td>
</tr>
<tr>
<td>Lloyd’s</td>
</tr>
<tr>
<td>29%</td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
</tr>
<tr>
<td>13%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

<table>
<thead>
<tr>
<th>What percentage of your premiums is collected on time?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
</tr>
<tr>
<td>2%</td>
</tr>
<tr>
<td>Lloyd’s</td>
</tr>
<tr>
<td>7%</td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
</tr>
<tr>
<td>11%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
Several interviewees criticised brokers for being slow in passing on the money they had received from policyholders, enabling them to earn extra investment income. Nevertheless, most organisations are reluctant to insist on stricter enforcement in case the broker simply takes the business elsewhere. Only one respondent has cancelled more than 10% of policies for non-compliance with terms of trade. Others feel that the brokers’ pique following a chase-up call is a small price to pay in comparison to the extra investment income that could be generated by prompt payment.

Ultimately this is a battle of wills, both collectively and individually. As one interviewee insisted, ‘if you get aggressive they soon cough up’.
Counting the costs

Cost control and procurement management

Surprisingly, the survey showed that most organisations do not regard costs as a key priority in today’s hard market. However, some feel that this is just the time to press for a better deal.
Cost has slipped down the agenda, with many organisations diverted by more urgent concerns such as risk and performance management. Less than a third of respondents plan to reduce their expenses over the next year. Overall, less than a fifth of respondents benchmark their expense ratio against their peer group in a detailed manner. A third employ a head of procurement and, of these, just over half are offered performance rewards for savings against set targets.

Overall Lloyd’s Non-Lloyd’s
Staff 5% 7% 0%
Broker commissions 14% 7% 25%
Premises 18% 14% 25%
IT and systems 9% 0% 25%
Lloyd’s/central charges 45% 64% 13%
Inter-group charges 27% 21% 38%
Capital raising/borrowing/funding 18% 21% 13%

Source: PricewaterhouseCoopers 2002

Some developments are in the pipeline. Around half of respondents set expense targets that are cascaded through the organisation. A significant proportion of respondents are considering outsourcing at least part of their IT, finance, investment, accounting & tax, actuarial and underwriting support functions. Over 80% also feel that web-

‘25% of costs come from data entry mistakes’
Survey respondent

‘It’s cheaper to write the same business in the Company market’
Survey respondent
enabled technology should be used to reduce distribution and business acquisition costs.

One key focus is commission levels, with three-fifths of respondents actively seeking reductions. Many believe that today’s buoyant market gives them greater leverage, with some brokers happy to agree lower rates on higher premiums. Others are closely monitoring charges to force brokers to justify their rates. In particular, some interviewees expressed concern that charges do not necessarily reflect the relative levels of processing and administrative support offered by their brokers, and that brokers are not adding anywhere near the level of value implied by their fees.

‘Rising premiums have helped us to set maximum commissions per class’
Survey respondent

Source: PricewaterhouseCoopers 2002
Fingers on the button

IT management

IT and systems development could enhance decision-making. It could also facilitate faster and cheaper processing and distribution. However, many remain sceptical.
Information is the foundation of quality underwriting and sound business management. In turn, effective systems are critical in delivering timely and precise performance data. The survey confirmed the increasing importance of IT, which now accounts for an average of 13% of overall expenses. Nearly 80% of respondents are currently implementing a major systems project. Around two-thirds are planning significant further investment over the next 12 months.

However, systems rationalisation and integration lags behind foreign competitors and other financial sectors. Half of respondents are equipped with a common underwriting platform across the organisation. For those who operate more than one platform, often the result of mergers and acquisitions, the average is three separate systems; some of the more diffuse businesses operate up to six. As a result, the survey highlighted a wide variation in the time taken to produce annual accounting information from underlying underwriting data, with many still forced to rely on manual input.

Similarly, only half of respondents

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Survey respondent

‘Systems development is poor in the London Market compared to other financial sectors’

Source: PricewaterhouseCoopers 2002
Fingers on the button  

have moved to a common claims handling platform.

Crystal ball

A key priority for IT investment is the development of new risk aggregation, risk management and premium rating models. These include the stochastic modelling capabilities that will be required under the new Integrated Prudential Sourcebook regulatory framework. Aside from meeting regulatory needs, many believe that such systems can help to underpin more accurate pricing and reserving.

Others believe that online networks will be able to take care of more and more routine processing and risk monitoring. 32% of respondents can now collect premiums and 27% track claims over the Internet within some elements of their business. 50% can review risks offered and 27% can monitor the activities of coverholders, though the actual level of functionality may be limited. Many believe that such capabilities can help them to keep a closer eye on delegated authority business.

However, as outlined earlier, confidence in online trading platforms is limited. It could be at least five years before such electronic marketplaces are firmly established as a viable distribution channel for most businesses within the London Market. Looking further ahead, most feel that greater commitment and standardisation are essential if the Lloyd’s Blue Mountain project is to get off the ground. This, they believe, will require more co-operation from brokers.

‘Suppliers can tell you that their software can do this, that and other and it probably could, but that’s with about five years of investment, tears and heartache, which just isn’t realistic’

Survey respondent

‘Standardisation is a prerequisite for Internet development... brokers are blocking standards’

Survey respondent

<table>
<thead>
<tr>
<th>Activity</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review risks offered</td>
<td>50</td>
</tr>
<tr>
<td>Issue policies</td>
<td>36</td>
</tr>
<tr>
<td>Monitor the activities of coverholders</td>
<td>27</td>
</tr>
<tr>
<td>Collect premiums</td>
<td>32</td>
</tr>
<tr>
<td>Track claims</td>
<td>27</td>
</tr>
<tr>
<td>Policy maintenance</td>
<td>23</td>
</tr>
<tr>
<td>Share information with fellow underwriters</td>
<td>23</td>
</tr>
<tr>
<td>Purchase outstanding coverholders</td>
<td>0</td>
</tr>
<tr>
<td>Purchase reinsurance from suppliers</td>
<td>36</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
Within limits

Regulation and governance

Regulation is seen by some as onerous and poorly focused, especially on the Lloyd’s side. Is this holding the market back?
All respondents report that they recognise the importance of sound governance in sustaining confidence in the market and guarding against systemic risk. However, 68% feel that the volume of work needed to satisfy the current regulations is too much. Frustration was especially marked on the Lloyd’s side, where each syndicate is required to submit 78 separate reports every year. More than half of respondents believe that the current regulatory framework partially or wholly inhibits their ability to pursue their strategy properly.

Two-thirds of respondents on the Company market side feel that N2 has so far made little or no difference to the activities of the regulator. However, most would like to see more secondment of market professionals into the FSA to ensure that the Authority has the necessary expertise to regulate complex businesses.

Looking specifically at Lloyd’s, most organisations welcome the Chairman’s Strategy Group proposals, at least in principle.

In the light of recent events, most see accounting integrity as a key priority. Around three-quarters of respondents have an audit committee, which generally meets either quarterly or half-yearly. Many are also looking to expand the scrutinising role of their non-executive directors.

‘We are overburdened by the reporting regime’
Survey respondent

---

**How do you view the volume of work required to satisfy the current regulations?**

<table>
<thead>
<tr>
<th></th>
<th>About right</th>
<th>Too little</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>32%</td>
<td>68%</td>
</tr>
<tr>
<td>Lloyd’s</td>
<td>21%</td>
<td>79%</td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

**Does the current regulatory framework inhibit your ability to pursue your strategy?**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>Only in limited ways</th>
<th>No response to question</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>23%</td>
<td>36%</td>
<td>36%</td>
<td>2%</td>
</tr>
<tr>
<td>Lloyd’s</td>
<td>29%</td>
<td>50%</td>
<td>14%</td>
<td>7%</td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
<td>17%</td>
<td>32%</td>
<td>75%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002

**Do you have an Audit Committee or equivalent?**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>77%</td>
<td>23%</td>
</tr>
<tr>
<td>Lloyd’s</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Non-Lloyd’s</td>
<td>38%</td>
<td>62%</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers 2002
The London Insurance Market

Background
What is the London Insurance Market?

A subscription market in which various entities participate:

- 87 Lloyd's syndicates (backed either by individual Names or corporate capital) in 2002;
- UK-domiciled insurers and reinsurers; and
- UK subsidiaries and branches of US, European and international insurers and reinsurers.

Total capacity of around £20 billion in 2002:

- £12 billion capacity within Lloyd's alone.

Reputation as long-established market:

- Large proportion of major global organisations have policies placed within the London Market; and
- Over two-thirds of FTSE 100 organisations and over 80% of the Dow Jones Index constituents have policies placed within the London Market.

Quality of underwriting expertise, particularly in speciality risks:

- The London Market share of the world's aviation market is over 30%; and
- The London Market also has substantial global market share in marine and energy risks.
Contacts
If you would like to discuss any of the issues raised in this survey in more detail please speak with your usual PricewaterhouseCoopers contact, or one of the partners listed below:

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**Survey Participants**

We would like to take this opportunity to thank all those organisations and executives who agreed to participate in the development of this survey. We are extremely grateful for the time that they gave us and especially for the openness with which they discussed the key issues facing their industry.

**Production**

The development and production of this survey involved a significant number of people and we would like to thank those listed for their valuable contribution.

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Áine O’Connor  
Alpa Patel
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If you would like additional copies of this survey please contact Áine O’Connor, Head of Financial Services Marketing, on email aine.r.oconnor@uk.pwcglobal.com

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