London needs to find its way
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Introduction

The London insurance market has long held a disproportionately influential role in the global insurance and reinsurance marketplace based on global premium volume throughput. This has recently raised questions about the longevity of its current position and its future role within the global marketplace.

However, history has shown that the London market has proved extremely resilient to the political, economic and social changes that have been observed over the last few decades. Furthermore, it has overcome challenges instigated from would-be competitors as well as the desire from market participants to maximise underwriting results through operational efficiencies.

A ‘tipping point’ has been reached at the intersection of new capital, new technology & emerging risks and new skillsets, combined with extraordinary external factors such as Brexit, mean that if London does not innovate and push existing traditional boundaries, its relevance and influence in a globally connected marketplace will diminish.
The evolution of the London market value proposition

The London Insurance Market is widely attributed as the birthplace of the modern global insurance market. The market has evolved from its humble beginnings of Edward Lloyd’s coffee shop as a place to obtain marine insurance into the global powerhouse where literally any type of risk, however previously unimaginable, could be successfully insured by the London Market. This dynamic coupled with a constantly innovating environment attracted the best talent and was considered the preeminent place to hold a career in the insurance industry. However, as times have changed and the global economy has developed, while there may still be certain niches in which this is still the case, it is certainly no longer the case across the board.

The strong reputation of Lloyd’s and the London market is still just about surviving in the international marketplace, however this is backed more by the past and historical performance rather than current reality of global commerce. The growing strength of domestic markets, as well as the development of regional hubs such as Singapore, has eroded the markets relevance.

The current status quo is preferred to radical change, in the hope that a major loss event diminishes the appetite to underwrite risk outside of London. The resulting hard market would allow pricing to increase, profitability to be restored and the imperative for wholesale change to disappear.

The benign loss environment shows no sign of ending and with over supply of capital in the market, what will it truly take to radically improve market conditions? The relatively short lived hardening of the market post major loss events such as Katrina, Rita and Wilma or even post 9/11 would suggest that either larger losses are anticipated or that the sustained hardening of the market is unlikely.

Of course, three major hurricanes making landfall or a significant terror attack on US soil were not expected events so an extreme loss event is possible, but is it probable?

The insurance industry and the current market cycle has been impacted by the wider macro-economic environment. Interest rates have been at historically low and unrealistic levels for nearly a decade. This removes underwriters’ ability to enhance profits with traditional methods such as interest earnings on premium paid before claims are due. These conditions in fact lead to a “double hit” for the London market, as with other investment options being less attractive, the previously unexciting returns offered in the insurance market have now become much more attractive.
to new sources of capital provision. In turn the attraction of additional capital has put increased downward pressure on insurance pricing, thereby limiting the potential for hardening market conditions.

It could be that it is a combination of loss events and capital providers moving away from insurance as an investment class, which leads to overall improvement in profitability of the market. Either way the result would be the turning of a blind eye to the reform that is required to reinvigorate the London market and re-establish its position as the preeminent insurance marketplace.

The alternative is for the market to look within itself to establish a sustainable way to grow in the 21st Century and beyond. In the same way as London led the world to develop a global marketplace it now needs to show the same leadership to make the changes necessary to thrive in a new environment. Whilst the much talked about ‘market disruptors’ have not managed to revolutionise the marketplace in the way they have in other industries, one thing we can be sure of is that they will continue to try. The billions of dollars that flow through the market annually are sufficient motivation to continue the quest to alter the dynamics of the marketplace and at some point an alternative will emerge. In order to maintain control of its own destiny the market needs to work out what it now stands for, what it wants to achieve and how it goes about achieving that vision.

Technology is seen as the threat but the reality is that it holds the solutions.

The insurance industry can use technology far smarter to handle data between the transacting parties with far greater efficiency. Currently, raw data is processed and enhanced by multiple insurers and brokers. It may even be processed by multiple teams within an organisation. This is a very simple but obvious area for improvement.

The opportunity to disrupt the traditional workflow to make efficiencies goes way beyond this. If data capture can be managed more effectively (possibly even standardised), the introduction of scalable risk assessments and artificial intelligence coupled with machine learning would create an unrivalled service offering that capital providers demand. This would also create a firm foundation for the industry to diversify and offer new products.

The one area that buyers consistently highlight as important to their organisations are technology and cyber risk. Conversely, the insurance market has been struggling to provide meaningful coverage in this space. Understandably underwriters need to understand the risks that they are writing but there appears to have little or no investment to bring the skill sets into the underwriting (or broking) community to develop this understanding. Major development in information technology will open the door to underwriting such products.

Technology not only provides an insight into customers’ needs and potential to improve what we currently do it also has the capability to re-design what we do and how we do it. If the London market can embrace this in the way that the tech start-ups based just to the north of the City have then the possibilities are enormous.

In summary

The market needs to decide whether to become increasingly marginalised by growing and competitive local markets or whether to change the game.

Assuming the London market wants to remain at the forefront of a global industry it needs to decide what it’s value proposition is and how it is going to achieve it.
The trap of traditional thinking

The London market is rightly proud of its heritage and tradition. However it is key for the market to understand the value placed by Clients on the various activities it performs. In the main, insurance is a necessary evil often mandated by law or financiers. In the same way as in personal life such purchases are made with the objective of minimising the cost and effort involved. In this context the market needs to focus on providing competitive risk transfer mechanisms in a highly efficient manner.

The market continues to defend the status quo and resist change, relying on the ‘more sophisticated buyers’ placing a value on ‘the relationship’ and ‘long term partners’. In reality these buyers are looking to maximise the credit they have built up with carriers to ensure that they beat their peers on premium and experience less resistance should a claim arise.

Originally London was the only market available but as domestic markets developed we became a market of last resort. However through being competitive and creative we grew market share in vanilla risks that didn’t necessarily need to come to London. We are now in a position where the local markets have caught up but are unwilling to acknowledge this and be flexible to retain share and grow.

If the London market is not willing to provide cost effective and efficient coverage then it needs to motivate buyers in other ways. One of these is to offer products not available elsewhere.

At one time London was known to insure anything, whilst technically it still can it chooses not to. Innovation has become the most overused phrase in the London market. The perception still exists outside the London market that we are innovative but in reality the clock is ticking before the myth is dispelled.

London can continue to maintain the status quo and rely on the loss event to get back to a profitable old model approach. However it needs to develop a compelling value proposition that delivers unique capabilities that are not available in other markets around the world. In addition it must establish a more efficient way to deliver risk transfer to buyers, both in terms of cost and experience.

In summary

We need to be realistic about what motivates buyers. If they can buy the same or better down the street from a guy who takes them for golf once a year why would they come to London?

The reality is that the London market needs to retain and grow the vanilla to allow it to innovate and take a position in the emerging risks to counter the volatility they will likely bring.
The final roll of the technology dice

The concept of paying people to stand in line for an appointment with someone who may or may not be prepared to discuss the subject is both out-dated, highly inefficient and costly.

While the value of a face-to-face discussion is not in dispute, the need for this to happen in every single instance and the timing of such interactions in the insurance placement process are.

As insurance carriers increasingly rely on the requirement to input risk data into their systems before being in a position to have an informed conversation regarding the risk, it makes sense for the flow of the placement process to enable this to be more effectively managed.

There are huge efficiencies to be gained from the current processes that risk data undergoes, as it passes from insured to broker to underwriter and back.

The London market has tried, unsuccessfully, for a number of years to establish an electronic trading platform that can meet the requirements of all market participants.

The London market has set out its stall with the implementation of a single placement platform, Placing Platform Ltd (PPL). As we enter the implementation stage of PPL – which has been described as the last chance for the London market to establish electronic trading – it will be interesting to see how the market responds. The project should allow for efficiencies to be quickly realised for simple placements and allow for some efficiency gains on more complex risks that continue to be handled in a traditional face to face manner. However whilst it is anticipated that the project will ultimately be successful the resistance along the way will likely demonstrate the reluctance for change from market participants.

PPL will address some of the issues around documentation flow and audit trail but there are also huge gains to be made in the way that data is handled. Currently data that is received from insureds may undergo some enhancement carried out by the broker before being passed on to multiple (often 10s) of carriers. Each of the carriers then takes this data and either via an in-house team or a third party supplier further cleanses and enhances the data. Once enhanced, the data is then fed by different carriers into the same or similar modelling software. If the market were able to agree to a single set of data standards, the time and cost associated with this process would be significantly reduced whilst delivering an improved product.

Maintaining the status quo is the easy option but will not deliver the efficiencies demanded by capital providers and Clients. Therefore the London marketplace has a choice to make; to proactively embrace the move towards a digital first environment as expected/demanded in so many other industries and hence drive its own destiny or to have thrust upon it an operational model that it did not design and cede control over.

In summary

PPL needs to be the first step in the journey of the London market becoming a modern and efficient marketplace, underpinned by robust data and electronic processing that delivers a superior client experience and maintains London’s relevance in the global marketplace.
The shift in cultural norms

Whilst the insurance industry was once seen as a dynamic and innovative place to work, recent cultural changes, enabled by technology advances and mobilisation of the global workforce, has led to a situation where the continued influx of a new generation of insurance practitioners desiring to join the industry cannot be guaranteed. The ‘war for talent’ has gone beyond the traditional competition from other financial services to industries unheard of just a few years ago.

In an emerging era where the largest hotel chain doesn’t own any real estate (Airbnb) and the largest taxi firm owns no vehicles (Uber), the need for products that focus purely on physical assets or the consequences of owning them do not align with the values of this current generation. Taking this thought process further, how much risk does the insurance market of the future retain?

For a generation driven by ethical rather than financial motivations and to develop solutions to broader social and cultural problems, the challenges of providing traditional insurance and risk mitigation solutions for tangible assets may seem rather old fashioned. The failure of the market to respond more fully to new and emerging social and technology risks in an ever increasingly connected world, has left the industry seeming even less relevant to the upcoming generation.

Not only does this mean that we are failing to provide the products our customers need but we are failing to attract leading talent to the industry. By seeming old fashioned and unable to evolve to the needs of the future generation of practitioners, they will likely seek a more rewarding career elsewhere.

By continuing to ignore the changing motivations of new generations, there is a risk that high class talent will migrate to other industries leaving a dearth of talent within the insurance market. This could lead to lack of innovation in new areas of risk, thereby further accelerating the decline in influence of the marketplace.

The obvious solution is to take a more aggressive approach to providing insurance solutions to technology and societal issues. This is likely to be easier said than done as there is currently a mismatch between the generation that fully understand these risks and issues and those that understand how to underwrite and to attract capital to offset those risks. This gap needs to be bridged but will require investment and the acceptance that there may be errors along the way.

In summary

The reality is that traditional insurance products will remain important as they underpin the financial landscape. However by not moving with the times and developing cutting edge solutions to modern day issues the industry will continue to be seen as a dull place to work. Moreover alternative mechanisms will be created to address very real issues facing the modern world. If these mechanisms succeed where the traditional mechanisms have not then it is only a matter of time before they look to move into the traditional risk transfer space.
Capital providers require greater efficiency

A driver for change in the London market has been the year on year rate reductions across the majority of lines, affecting profitability and return on capital. However the market has largely been in denial over the need to change existing ways of working, looking for a large loss event to return them to underwriting profit. Whilst this would result in rate increases it would be papering over the cracks rather than reforming a market so that it is fit for the 21st Century.

A lot of attention has been given to broker remuneration in the past 12 months. Most recently some senior underwriting figures have laid the blame for poor results at the door of additional broker remuneration. This highlights how important it is for the market to reform and find more efficient ways to deploy its capital. The additional broker remuneration that is supposed to be causing the pain is typically low single digits. Whilst at a low point in the cycle these additional demands are painful, the reality is that certain classes have experienced rate reductions of around 50% or more over the past 5 years.

A recent report estimated that acquisition costs totalled 27% of every £1 that made it to Lloyd's. Whilst this sounds high, Lloyd's is uniquely served by it brokers who provide not only business introduction services, often requiring payment to the overseas retail broker, but also a host of administrative support.

The issue is that the £1 should in fact be £2, which is determined by the market. It is this reduction in premium that has in turn reduced commission levels and pushed brokers to ask for a greater proportion of the reduced pot, creating a vicious circle of competing priorities and self-interest rather than finding the best ways to jointly serve clients.

As both sides of the marketplace, the capital providers and the brokers, strive to maintain and grow their levels of profitability, the old models of working become more and more uncompetitive.

The market needs to either accept that they need to compete and therefore find a more competitive way to provide risk transfer to clients around the world or else protect their current levels of profitability by developing new and innovative solutions not available elsewhere in international marketplaces.

The market will find a balance of how much of the pot goes to which providers in the supply chain. However properly quantifiable value needs to be placed on each service and the remuneration that goes with that service and if there is no value then that service needs to be eliminated or reduced.
How does London find its way?

The challenges facing the London marketplace are significant and reform is necessary if London is to continue to be looked upon as the leading global marketplace. London attracts a disproportionate number of clients but as local markets mature and are able to offer the same or better solutions this will continue to decline.

For London to thrive and grow it needs to offer better solutions to the vanilla coverages offered elsewhere and provide solutions that cannot be matched by other marketplaces for those coverages clients attach real value to. This requires London to rediscover its former entrepreneurial spirit and provide truly innovative solutions that Clients just can’t get elsewhere.

Technology has transformed many financial service industries yet our marketplace has failed to embrace either the tools it offers or the product opportunities it presents. Whilst the syndicated approach brings many positives to the market it is proving very difficult when building consensus for technological reforms. This hurdle needs to be overcome for the good of all market participants or the very real efficiency advantages technology presents will not materialise.

“My view is simple. [The industry will make] all kinds of radical changes because we know our business is inherently inefficient. How we harness technology, how we work with it, all of that can lead to wonderful, imaginative solutions about how we could make this whole ecosystem wildly less costly.”

Mike McGavick CEO XLC Group

The second part of the technology challenge is to build products that are relevant to an increasingly digital world. The market has barely scratched the surface of what is required in the cyber arena. The next imminent challenge will be driverless cars and on current performance the market is ill prepared to meet this challenge. This will require investment in the relevant disciplines to understand and develop solutions that are fit for purpose. Failing to do so will lead to other solutions being found outside the traditional insurance industry, which may also have application to the other products and services provided by the London marketplace.

By embracing change and technology the London market stands to re-gain its reputation as an exciting and dynamic workplace at the forefront of risk solutions. In turn, this will lead to attracting talent, from traditional specialisms such as finance and analytics as well as others like technology development, to innovate and develop solutions relevant to our Clients in the changing world in which we live.

The alternative is to see more business return to its home territory and allow others to find the better ways of working before London. Based on past performance this will not happened but time is getting very short to make the relevant changes.
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