LONDON MATTERS 2017

June 2017

In May 2017, the London Market Group and the Boston Consulting Group published an update to their influential 2014 report concerning the significance and role of the London insurance market, both globally and domestically. The *London Matters Report 2017* focuses on developments between 2013-2015 in Lloyd's and company market business.

We consider the findings – looking at the forecasts made for global trends in claims and underwriting - as well as initiatives designed to make London more accessible to insureds and reinsureds, whatever their location.

Those trends include the growth in capacity worldwide affecting the direct insurance business being placed into London. However this may be offset by business placed with carriers' local offices, or being written via coverholders or managing general agents (MGAs). London market expansion and changes demonstrate London's continuing evolution and position at the forefront of the global insurance market, as well as its agility. Globally, we are seeing continuing growth across certain product classes, most notably D&O and cyber.

LONDON POSITION AND ACTIVITY

- With increasing capacity globally, London remains alive to the need to modernise and improve accessibility. Lloyd's traditional selling points of financial strength and willingness to write risks which others will not, are becoming less relevant. Agility, accessibility and price are instead the key determinants of success.

- The updated report shows London continuing to gain market share in marine, energy and aviation, and maintaining share in property and casualty.
- However Lloyd's has identified a concerning trend from their annual results for 2016 in respect of rising costs. Costs amounted to 40.6% of income, with operating expenses amounting to 14%. Acquisition costs were 26%, which related to commissions, handling fees, business taxes, surcharges and regulatory charges. Such overheads do not include claims payments - let alone profit and any return made on shareholders' investment. Lloyd's is understandably focussing on reducing operating expenses, where possible.
- The London Market Target Operating Model (TOM) should assist Lloyd's to reduce operating expenses, as well as improving the accessibility and agility of the London Market. The project has been ongoing for a number of years, but has gathered significant pace in 2016 and to date in 2017.
- The current TOM initiatives include:
  - **Placing Platform Limited (PPL)**: PPL is part of the drive to modernise the market infrastructure in London, creating a shared platform for brokers and underwriters to support both traditional face-to-face negotiation and pure electronic placements, or a combination of the two. The project is an ambitious one, seeking to make London the first and only commercial insurance market globally to implement electronic placing, which would be a significant point of prestige. Overheads will also be reduced and it is hoped it will make the market more accessible to all, with far greater transparency and better customer service. Real time status updates will be available to clients on the progress of quotes and placing processes may be streamlined by up to 30 days. The project is the first of its kind to be supported by all the major brokers.

    PPL went live on 11 July 2016. A large number of classes of business are now being written via PPL including financial lines, cyber, political risk and marine. Further classes of business will be added during the course of 2017 and additional planned improvements to allow the system to integrate with third parties' systems will also broaden its appeal. In an interview with Insurance Day, Nicholas Aubert, Chairman of the LMG advised the full benefit of PPL will not be apparent until 2019, when companies integrate the platform with their own internal systems. This has been reflected in underwriters' experience of PPL to date.
  - **Delegated Authority Initiative**: this initiative is seeking to improve data integration and functionality across coverholder systems. There is currently significant duplication in audit work being undertaken by both coverholders and MGAs. This project is designed to agree a consistent set of data reporting standards and to provide one repository for the submission of risk, premium and claims data, making it easier for coverholders to work with the London market. The DA Initiative should facilitate greater access to emerging markets. For example, in South America there has been an increase in the number of coverholders operating regionally. Australia has had steadily increasing numbers of coverholders for some years. This may also prove to be a growth area in Asia, with Singapore recently beginning to relax rules which currently restrict numbers of coverholders.
  - **Central Services Refresh Programme (CRSP)**: a strategic initiative designed to improve access to the London market by removing London specific systems and processes. The programme intends to reduce costs and improve access to the London market, ensuring brokers act in line with internationally accepted processes and messaging standards. CRSP also aims to make London a more accessible marketplace and, consequently, to increase global business being placed in London.

EMERGING MARKET ACTIVITY

The *London Matters Report* suggests that London is not keeping pace with emerging market growth, flagging a declining share from 2013-2015. Whilst the report considers company and Lloyd's business, it does not take into account the premium being written by the local offices of London Market insurers abroad.

Miami and South America

- Insurance companies are typically required to be registered in the jurisdiction in which they are writing direct business. As such, a large number of international carriers have opened local offices in Latin America to access business in the region.

- Reinsurers have either opened local offices as well, or have underwriters located in regional hubs, typically Miami, who travel extensively and provide capacity via non-domiciled reinsurers using local carriers as fronting cedants.
- Brazil remains the largest Latin American market by premium income, followed by Mexico and Argentina. Colombia, Chile, Peru, Panama and Puerto Rico likewise have respectable and relatively sophisticated markets. Bolivia and Ecuador are important as well, and the international presence will grow once there is political stability, as well as in Venezuela which was historically a thriving market.
- Lloyd's Syndicates gain access to the Latin American market via Lloyd's representation offices in Brazil, Mexico, and Colombia. By virtue of Lloyd's 'one licence' approach, it has been able to negotiate with regulators globally and Latin America is no exception. In the Commonwealth, Caribbean Lloyd's can write business on a direct insurance basis.
- There has been an increasing trend for capital providers in Latin America to buy up Lloyd's syndicates to take advantage of the vast licensing network available to Lloyd's syndicates.

Growth areas predicted:

- With Latin America's economies maturing, its population with access to disposable income is increasing. Consequently, we expect a marked development of liability lines that follow the initial growth in construction and property insurance typical of developing regions. Therefore, whilst growth in infrastructure-related policies will continue, it is likely that a marked increase will be seen in:
  - Cyber insurance.
  - Directors and officers insurance.
  - Medical malpractice and other forms of professional and specialised liability, such as environmental.
  - Energy cover.
- With regard to energy, in Mexico, in particular, in 2013/2014, foreign companies were allowed to tender for pipelines and refineries contracts. Consequently, we are seeing increasing demand for energy policies.
- In addition, whilst capacity abounds, there remains a shortage of skilled underwriters. However, we are seeing a notable increase in the number of coverholders and MGAs acting in the region, often from Miami as a regional hub, providing reinsurance support to local cedants on a non-domiciled basis. This is particularly common for facultative business.
- There is also a robust treaty reinsurance market in Miami, estimated to turn over about US$2 billion in premium annually.

Growth opportunities:

- Mexico. Under Article 71 of the Mexican Insurance Contract Law (Ley Sobre El Contrato De Seguro), claims monies are due to the insured by the insurer within 30 calendar days from the date on which the insurer receives the documents and information that allow it to determine the grounds of the claim. Mexico's insurers' association, AMIS, believes there is a need for Lloyd's underwriters to enhance their alignment with local claims settlement timelines and obligations. Given the regional trend of imposing short time frames for insurers' response to claims, those reinsurers that engage with their cedants and investigate claims with agility will likely have a competitive advantage when competing for business.

Asia

- Singapore continues to grow in strength and is now the reinsurance hub for Asia. There is presently significant capacity in Singapore because of changing legislation requirements for onshore capitalisation, which means that most business can be placed in Asia without reference to London.
- Nevertheless, aviation and offshore energy risks are routinely still presented to London due to London's specialised underwriting skills - an advantage of being a mature market with a history of writing special risks. It also remains common for participations in large mining risks, infrastructure projects and large bank risks to be placed in London, spreading the risk across difference markets for effective risk sharing. This is equally a tool for the broker to win business, showing it can persuade London markets to participate.
- In 2015, gross written premium at Lloyd's platform in Singapore exceeded US$680 million. Lloyd's has had a physical presence in Hong Kong and Japan for the last 20 years. Lloyd's has also had a physical presence in China for 10 years, with premium volumes doubling year on year since 2007. Lloyd's estimates that US$400 million of business is currently written from China, with continued rapid growth predicted. Inga Beale, CEO of Lloyd's, identified Asia as a growth area for the Lloyd's market, with around 10% GWP coming from the region. With 10% year on year growth expected to continue, she

understandably referred to Asia as “a critical part of Lloyd’s growth plans in the future”.

- Lloyd’s further continues to expand with an office in India opening in January 2017. The new branch sees new opportunities for Lloyd’s syndicates to access Indian domestic insurers, seeking to provide them with specialist reinsurance knowledge and products.

Growth areas predicted:

- Cyber: a growing area as a result of increasing sophistication in insurance demand. 53% of world internet users are in this region and it is a hub for the internet, with these factors having a significant impact on business models in region. Lloyd’s is a global market leader in cyber insurance with 25% of the global market share. However, currently 80% of that share originates from the US and demand is expected to increase dramatically from Asia - particularly as India is the world's largest sourcing destination for the information technology (IT) industry. With a population that includes an influential millennial start-up generation heavily involved in IT, the question of privacy and cyber-risk stands at the forefront of the Indian landscape.
- Political risk: with specialist expertise around trade credit or in the construction sector are lines that Lloyd’s expect to see in increasing demand.
- Errors and omission (E&O)/professional liability insurance: with increasing awareness in India of the risks and potential exposures of E&O claims, the popularity of these policies is likely to increase and higher policy limits are likely to be actively sought by Insureds.

Growth opportunities:

- Chinese and Japanese Risks (all lines):
  - From 1 January 2015, Lloyd’s has had its first Chinese syndicate trading, Syndicate 2088, backed by a single corporate member, China Re. For the year ending 31 December 2016, its gross premium written amounted to £99.24 million.
  - Equally, Lloyd’s has had great interest from Japanese insurers looking for growth opportunities outside of their domestic market by tapping into Lloyd’s vast licencing network.
  - Lloyd’s focus on overseas trade capital aims to bring in new specialist business and people to Lloyd’s from countries where Lloyd’s needs to increase its market share. Lloyd’s hopes that expanding its capital base in this way will increase business flow from Asia and improve understanding of local risks.
- In line with its “Vision 2025”, Lloyd’s continues to look at further expansion of its global licensing network, to include Korea and Malaysia.

REST OF WORLD ACTIVITY

Australasia

- The largest share of Australian business remains personal and statutory lines: motor insurance policies, domestic insurance policies, workers’ compensation policies and compulsory third party personal injury policies.
- There is significant domestic capacity for D&O insurance. However, the premium pool is not large enough to cover the risk. This is particularly the case given the rise of representative proceedings (class actions) against directors and officers.
- Many domestic insurers have scaled back their exposure because of these claims trends. Brokers will therefore look to overseas insurers to place such policies if necessary. Whilst this represents an opportunity for London insurers, they will of course be competing with Singapore. Whilst there are well- developed links between Australia and the London market, Singapore is making inroads given its greater proximity, as well as its depth of capacity.

Growth opportunities:

- General liability policies: risk of supply chain disruption in an increasingly globalised world is increasing demand, particularly in respect of the accumulation risk of damage in Asia.
- D&O insurance: as discussed above.
- Cyber insurance: increased regulation around data breach laws and the consequent likely increase in ‘cyber’ notifications.

North America

- The 2017 *London Matters Report* showed North America accounting for the largest share of London’s growth between 2013-2015 (amounting to US$29.7 billion). London’s overall market share remained stable.
- The growth is accounted for by the London market reinforcing its established position in the US market, commanding premium increases across the US and Canada of around 3.7% per annum during 2013-2015.
- The bulk of growth appears to result from an increase in coverholder and MGA premium,

which has risen by 13% per annum from 2013-2015. With Lloyd's TOM initiatives seeking to make London more attracting to coverholders and MGAs in particular, London is well placed to gain from further expansion in this area.

Growth opportunities:

- Cyber: as above, 80% of Lloyd's cyber business presently originates from North America. With US companies affected in the recent Wannacry attack, this area looks likely to continue to represent an opportunity for significant growth.
- Autonomous vehicles and technology: rapid growth in this area comes from the need for regulation and public protection. Dangers include the necessity to consider the potential implications of deliberate criminal and terrorist use.

FURTHER INFORMATION

To find out more about our services and expertise, and key contacts, go to: **kennedyslaw.com**

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