INSIGHTS FROM INSURANCE
LEADERS ON THE FUTURE
OF THE INDUSTRY
LOOKING
FORWARD
Novae

Our independent researchers posed a series of questions* to our panel of industry leaders. Some chose to answer the questions directly whilst others responded with broader musings on the industry at large.

* For a full transcript of all questions and answers please turn to page 23.

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"A GOOD UNDERWRITER WITH A PENCIL IS BETTER THAN A BAD UNDERWRITER WITH A MODEL"

Although the future is never easy to predict, it is not impossible to prepare for.

This is the first industry survey carried out by Novae Group plc, interviewing many of the London insurance market's key players on what they perceive the future holds.

In an industry built on having eyes on future risk, how often do we look into our own future? This report aims to do just that, using original research into the insights and first-hand experience of most of the industry's leading players.

Although the future is never easy to predict, it is not impossible to prepare for. As we emerge from the financial crisis to greet an ever-changing environment full of instability and growing regulation, insurers are faced with increasing challenges.

Demographic shifts, the rise in influence of the emerging markets and changing customer behaviour will all help shape the sector's longer term future, and the insights in this document are some indication of where the industry sees itself.

With this research, we also felt it was right to tease out recognition of the importance of the industry, which is often seen in the media in a negative way. The truth is that the insurance industry, as a major contributor to the economy, is central to the financial services sector, not only in the UK, but worldwide. Hopefully this survey reinforces that reality.

Please enjoy the findings, with our compliments.

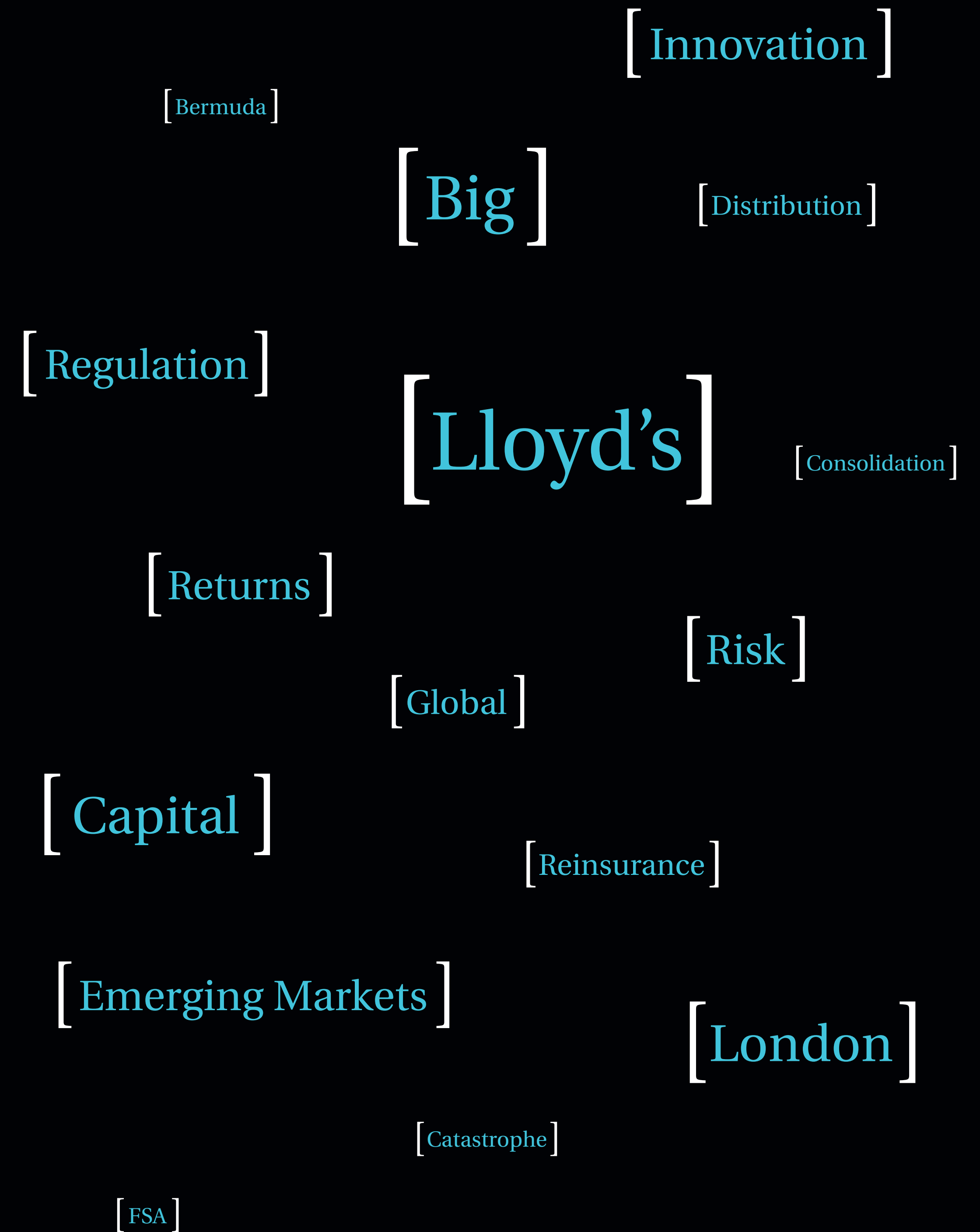
Matthew Fosh
Group Chief Executive

THE RESULTS ARE IN

Over the course of the research, [key words] and [topics] occurred time and again. While the difference in views of our contributors was stark, the subjects they wished to discuss weren't. We have extrapolated the following key words from the research with the most frequently mentioned displayed as the largest.

So what do you – the market leaders – predict?

There are some fascinating insights here on 'the future is big', 'regulators rule' and the role of Lloyd's in the international marketplace. But most especially, there is the feeling that it is innovation and specialisation that must drive the industry's development.



NOVAE VIEW

MACRO OVERVIEW

Interviewees see continued low interest rates and low yields affecting industry behaviour and investor returns.

It has been five years since a wave of financial turmoil broke over developed economies. Interest rates have been at record lows since 2008, and if you lend money to the US government for the next five years you receive less than 1% per annum in return.

It follows that growth prospects for the developed world in the next few years appear anaemic at best. Recovery from 30 years of debt-fuelled over-consumption by the West will take far longer than the five years we have already endured.

It is new markets and new products that will be the engine for global growth, and for the international insurance industry, which to a significant extent emerged from the 2008 global crisis with its capital unimpaired and its reputation intact, there is a chance to outperform.

"The return to good underwriting, now we have low interest rates, is a good discipline."

MARKET VIEW

"We are in for a prolonged period of low yields. Low interest rates do promote disciplined underwriting because you have to make a profit. In higher rate times you can be cavalier and undisciplined. In lower rate times you are likely to be much more black and white and do less loss-making underwriting to carve out market share."

"In future you will need a more technical approach to underwriting capital. If you have enough assets you can write against the macro-economics. So reinsurance will need high quality technical underwriters."

"Low interest rates should concentrate good underwriting, but they haven't yet. We have a constant parade of new syndicates and new capital wanting our business but the underwriting is still not good."

"In terms of macro-economics in the extreme and what might happen globally, two potential extremes could have very different effects on the industry:

- either massive inflation (with governments quantitative easing) and a scenario where inflation is going to hit us – and as there is a lag in insurance between when you collect the money in and when you pay, that's not good;
- or we will see something like the Japanese lost decade, with years and years of deflation – which means insurers will be fine."

NOVAE VIEW

THE FUTURE IS BIG

Our contributors believe that everything is getting bigger: brokers, underwriters, risks, claims, regulation, buildings, ships and catastrophes.

According to figures published by the ABI, the UK insurance industry is the largest in Europe and the third largest in the world, playing a unique role in helping individuals and businesses protect themselves against the everyday risks they face. It employs some 290,000 people in the UK alone and is responsible for investments equivalent to around 26% of the UK's total net worth. Notwithstanding these credentials, the insurance industry punches below its weight in the public's estimation.

MARKET VIEW

"Big is beautiful for security and leverage that scale gives. We will see fewer insurers, brokers and reinsurers."

"A £250 billion insured loss is possible."

"The cost of entry is so high it favours big existing firms."

"You have to be bigger because your risk capacity has to be higher."

"You need much more capital to start a syndicate - $100 million now and 40% of what you write has to be capital."

"The cost of regulation for us is millions of dollars - our ERM team is bigger than a managing agent payroll."

"Now there are computer models on which we have had to spend hundreds of thousands of dollars for a competitive edge."

"The minimum viable size of players keeps getting bigger – which contributes to the homogenisation of the industry and its centralisation."

"There will always be a place for smaller companies, provided you have a product that differentiates you."

"More consolidation in the reinsurance space will happen. In underwriting, speciality underwriters will reign."

NOVAE VIEW

REGULATORS RULE

The consensus is that regulation has changed the industry beyond recognition, but how a regulated future is viewed still divides our respondents.

Regulation certainly increases costs and has behavioural consequences. We are supportive of a strong leadership role to be played by 'London', and we are supportive of the virtues of the UK's firm but measured approach to insurance regulation - the industry did, after all, "have a good crisis." But the debate nevertheless remains fierce as to the net contribution of regulation.

"Lloyd's regulation, the FSA and Solvency II are the holy trinity of trouble."

MARKET VIEW

"Regulation over-burdens us and costs us time and money. It also means that companies become sluggish in responding to market opportunities."

"The Lloyd's market lacks width. What is driving consolidation is regulation. You can't start a syndicate now under £200-300 million,and this means that start-ups are discouraged."

"The regulatory burden on UK insurers from the FSA is seen as a risk factor... compared with Bermuda and Singapore who don't have those regulatory overlays. Lloyd's should raise their voice about the disproportionate burden."

"The FSA classes insurance and reinsurance with the banks; they don't understand the industry is different."

"If we get our regulation and our tax right in the UK, we can be very competitive."

"We need to address regulation as a market – it's not going away."

"Assessment of the risk aspect imposed on us by regulation is good. But you end up obeying the formula rather than looking at the idea. It enhances systemic risk. If Lloyd's insists on start-ups being £500 million then it cuts down new entrants."

NOVAE VIEW

ON INNOVATION

A strong clarion call emerges: the industry needs to be innovative, creating new product lines and ways to access the widest customer base and pools of capital.

If one thing emerges clearly from this survey it is that either we innovate or we 'wither on the vine'. It is not the size of the London market that will outgun the competition, but its creativity. The ability of insurance in London to reinvent itself has sustained the UK insurance industry for 300 years. We need to find ways to keep doing it.

"We need innovation – we need products that people want to buy – for example, against cyber-crime."

MARKET VIEW

"If we want to reverse the decline, more time needs to be spent on intellectual property, cyber-liability, non-damage business interruption, and loss of attraction type lines."

"Currently innovation is miniscule."

"Lloyd's needs new young entrepreneurs to be there. Lloyd's needs new products, new categories and new syndicates."

"I think that the smaller players will always be there. There will always be room for the good people to come out of the big players and be entrepreneurial in their own right."

"People need to be more innovative and write more business and create relationships in emerging markets and use their brains."

"Lloyd's should continue to innovate and focus on product development and new lines and innovate and keep it close to business. And they should seek to resist the homogenisation of all syndicates."

NOVAE VIEW

IT'S ALL ABOUT EMERGING MARKETS

Every industry in the West is trying to work out what part of the emerging market pie is available. The insurance industry is no different.

As the saying goes 'if you do what you've always done, you'll get what you've always got'. In a world order that is changing, what we 'get' is under attack. If there is one key theme above all others that emerges from this research, it is "new products, new markets".

"Go to emerging markets and get the 20% organic growth there, which will come."

MARKET VIEW

"In a globalised world where it is easier to move capital around opportunistically, it is inevitable that the emerging markets will thrive and grow and attract capital."

"The big European and Bermudan players are significantly ahead of London in the emerging markets space."

"You will continue to get increased regionalism on the grounds of insurance markets, and the reasons for cross-border insurance will be fewer. Local markets will prevail because of the ease of doing business in the same time zone and with the people you know."

"People are going out to the sources of business in the emerging markets."

"China in 10 years will have 10 zones with the economic exposure of Florida, but exposed to more risk of flood and storm."

"In 5 years' time, India will get there, Latin America has growth in a lot of places. Singapore will develop, but it is incredibly competitive to write business there. You won't make money in India for 20 years!"

"London is not as well placed for Mexico as Miami is. We've been spoilt, stuff has come to us. We have to get out there and understand the local risk levels. Don't go into India or China, and Singapore is overcrowded in my view."

NOVAE VIEW

LLOYD'S: A GLOBAL GIANT?

Respondents were notably opinionated in their views of how Lloyd's is adapting to the opportunities of globalisation.

The passion with which differing views about Lloyd's are debated is testimony not to its shortcomings, but to its achievements. Our interviewees, by no means all working for Lloyd's-centric businesses, hold the institution of Lloyd's in high esteem and want it to succeed.

But in a competitive world, it is not affection that will sustain Lloyd's as a global giant. For Lloyd's to succeed from here, in a changing world order, it must play its hand shrewdly and decisively.

MARKET VIEW

"The Lloyd's model has never been about gaining market share at any cost."

"Many people predict the demise of London and the rise of China and Asia, but I don't think that will happen in my lifetime."

"We have historic ties with the East and with Asia and the Chinese feel very comfortable trading with us - Lloyd's could be pivotal to increased trade with China."

"Lloyd's will enjoy the boost of emerging markets coming here to see how globally traded products are done. Then they'll take that knowledge home and do it locally."

"Some Lloyd's hubs are successful in emerging markets; they are doing a pretty good job of expanding their footprint globally."

"Lloyd's is well run. Its management is better than it has ever been. The brand licences of Lloyd's are very strong. The fad is to say: "We are worried." But Bermuda comes and goes, and a lot of the best people are in London."

"The infrastructure is here in London, the talent is here, the subscription market is here, and brokers like it. Lloyd's is more secure than it has ever been. Investors understand Lloyd's now."

"The London market has never been stronger, sitting between the two zones as it does - witness Aon moving their HQ here. Lloyd's has unique licensing all around the world - you can write business in Indonesia the next day without being there, and in Taiwan the day after a calamity."

"Lloyd's differentiates itself on trading with people on a relationship basis and on access to decision-makers, and on reacting quickly and the subscription model. London is still the centre and likely to remain so, that's why Aon moved here."

"Risk will be retained in territories overseas; Chinese growth doesn't necessarily mean growth in Lloyd's. Those new local insurance players in those markets will become international players, which will increase diversity in the market. As local markets grow, you get more premium written and some of those specialist bits will come to Lloyd's as the overall cake grows in size."

"The new Lloyd's chairman is focusing on bringing capital into London. Lloyd's has a great global platform and licensing scenario and is a good brand. Mr Nelson is doing the right thing."

The pioneering attitude which has been a hallmark of our past must also be the blueprint for our future.

CONCLUDING THOUGHTS

The insurance industry has a great story to tell. For centuries, we have protected individuals and businesses from external risks. Often we have been pioneers. Lloyd's insured the first cars and the first planes. We popularised reinsurance. More recently we have insured innovations in space exploration, and have a large percentage of the renewable energy market. Without insurance, new inventions which benefit society and the economy would not see the light of day. Our social value must not be underestimated.

If this survey of the insurance industry has demonstrated anything, it is that innovation remains crucial. The pioneering attitude which has been a hallmark of our past must also be the blueprint for our future. Writing good business in the face of uncertain economic conditions and a growing regulatory burden at home and emerging markets abroad requires caution and prudence, certainly, but also imagination and creativity.

Encouraging, then, the appetite for innovation shown by respondents to this survey. There is an understanding of the regulatory challenges facing the industry. There may be frustration at the lack of clarity surrounding the implementation of Solvency II, at unwieldy reporting structures and at increased fees, but there is nevertheless an appreciation of the role of regulation as we strive to adapt and improve. As one respondent put it, "We need to address regulation and address it as a market – it's not going away."

While a return to consistent double-digit returns may be some way off, there is great cause for optimism – for the insurance industry and for investors.

QUESTIONS ASKED BY THE RESEARCHERS

One

What will the global insurance industry look like in five years' time? And in ten years' time? (Are macro-economic factors, such as low interest rates / global availability of cheap capital going to force change in a way we are not currently prepared for / cannot currently foresee?)

Two

Will the global insurance industry eventually be dominated by three massive reinsurers, and three massive brokers?

Three

What can the London insurance industry (including Lloyd's) do to counter the threat of increasingly sophisticated and strong emerging markets insurance markets/industries?

Four

Is it realistic for the insurance industry to continue to deliver double digit returns – are we living on borrowed time, and if so, what can we do about it?

Five

Will there be new ways of doing new types of business?

INTERVIEW TRANSCRIPTS

1. What will the global insurance industry look like in five years' time and ten years' time? (macro-economic factors, cheap capital etc)

Macro-economic factors? Low interest rates should concentrate good underwriting, but they haven't yet. We have a constant parade of new syndicates and new capital wanting our business, but the underwriting is still not good.

The rise of the Insurance Linked Securities sector has transformed the landscape – it's quicker for capital to come into our business and relieve any capacity issues that would arise.

Solvency II is intrusive, and it has caused things to slow down, and companies to be less nimble in their ability to expand.

The other result has been less variation in offers – of products and services.

There has been a massive increase in financial dynamic analysis and we have been forced to quantify our thoughts.

Bermuda has a user-friendly environment – they are not so tied in knots as we are by European regulation – and Europe can't make a decision! Switzerland has become much more pragmatic as an environment.

Increased regulation is the biggest change in the last five years. In the next five years and longer, businesses will have to focus on capital management and allocation - which means running a good business and deploying capital optimally.

Lloyd's used to aspire to a rather peaky ROI, but investors now would rather have a steady 5-10% than a good year and then an appalling year.

Businesses are increasingly offering reinsurance and risk management, but despite this ostensible diversification, are looking all very much the same. They want different contributions from each of those business offerings to flex, so the future will be much more about the mix of your business.

The big issues are size, magnitude and scale of risk.

International shareholders need to understand that the returns they are likely to receive are lower than they have been historically. In property insurance business, returns can still stay high, but in long tail catastrophe, it's harder, because it is affected more by macro-economic factors.

In future you will need a more technical approach to underwriting capital. If you have enough assets you can write against the macro-economics. So reinsurance will need high quality technical underwriters.

The biggest threat that I see is managing agents potentially buying coverholders.

1.
What will the global insurance industry look like in five years' time and ten years' time? (macro-economic factors, cheap capital etc)

Because of regulation and compliance, the way people are underwriting is slowing down, and that makes it harder to get answers to quotes and harder for us to do business and means we can lose it. Will the underwriting fraternity cut out the broker industry and go direct? Or maybe that'll happen the other way round?

The other piece of regulation coming down the track is from the European Commission in 2019 - compulsory commission disclosure, which means a switch to fees.

But London is still the centre and likely to remain so, that's why Aon moved here.

The biggest question is how do we grow the business? Reinsurance is the same as in 2003 by volume. Casualty insurers have dropped casualty reinsurance cover. You can make returns in property, but it's cyclical, and with that alone you can't get the diversification and return. You need new innovative insurance and reinsurance products.

In terms of macro-economics in the extreme and what might happen globally, there is going to be:

- either massive inflation (with governments quantitative easing) and a scenario where inflation is going to hit us – and as there is a lag in insurance between when you collect the money in and when you pay, that's not good
- or we will see something like the Japanese lost decade – with years and years of deflation – which means insurers will be fine.

These two extremes have very different effects on the industry.

Return requirements will increase as financial markets improve, and there is less capital available. Distribution patterns will change. The portfolio split will move quite considerably east, via MGAs and brokers. Licensing is in place in a lot of these countries, but comprehension of the local requirement and the buying philosophy is not there yet, which leaves Lloyd's at a disadvantage.

Self-regulation in the insurance industry has worked better than in banking, and the industry learned tough lessons in 2003 and de-risked, and in Lloyd's in 1993.

Insurance companies can't enjoy double digit returns with low interest rates. So underwriting long tail business has become more important, but risky. Nimbler smaller institutions can manoeuvre and write short tail business and do better. But we have to adjust our prices.

There's lots of talk currently about a catastrophe hardening the market. But aside from that the industry needs to price effectively to earn its cost of capital and the industry has been collectively lazy. What we see is foregoing margin and market share in favour of profitability and that is what clients are telling us too.

It's either scale it and distribution, or expertise and niche.

You need global reach, but local distribution. There will always be smaller businesses, though.

What'll happen is that we are getting more and more regulated and we have to report in a consistent style, with models approved by the regulator which will all become the same.

We will believe the models, and their output, and think we are doing the right thing when we are actually not. Everything will get bigger, quicker and more detailed, and more complex. Which is when you miss the big picture because everyone is looking at the fine detail. The industry becomes too much the same, gets out of control, is unwieldy, inflexible and not fleet of foot.

Whilst this route stops the poor performers, it's a straitjacket that encourages dangerous group-think, as we have seen with the banks.

The single biggest change is regulation and compliance. We are regulated by the FSA, and so we now have compliance and cost, and also from a trading standpoint within Lloyd's by the Franchise Board.

It has quashed entrepreneurial spirit. If you bring a new client to the market, you do due diligence on them, then the syndicates do the same and Lloyd's does the same.

Lloyd's differentiates itself on trading with people on a relationship basis and on access to decision-makers, and on reacting quickly and the subscription model.

Now there are computer models on which we have had to spend hundreds of thousands of dollars for a competitive edge.

You need much more capital to start a syndicate - $100 million now, and 40% of what you write has to be capital.

Some of these changes are good.

Macro-economic factors are entirely negative for us. The issue is that there is so much capital. It now has to be a global loss of £100 billion to move the market. I don't see the market hardening or increasing.

The other issue is the consumer on the street can't afford insurance.

Specific markets like energy are in good shape.

The other issue is that you can now write property catastrophe anywhere, not just London. And that market has now become not a pure insurance play, you have cat bonds and all that stuff.

The big brokers are increasingly tendering their books and demanding premium for so doing.

So for the remaining specialists, both brokers and underwriters, it's knowing what you are good at, and sticking to it.

Increased regulation is the biggest factor - it is more and more intrusive and completely bloody relentless. It particularly impacts on new companies.

1. What will the global insurance industry look like in five years' time and ten years' time? (macro-economic factors, cheap capital etc)

The return to good underwriting, now we have low interest rates, is a good discipline.

The regulators here tell us what business we can do. If you want to borrow, the cost of capital is expensive and it is not readily available. The FSA on the one hand doesn't want new start-ups and the clients on the other want big nowadays.

The next five years will see more of the same - with no let-up in the governance. The regulators want people to be more solvent - you can't trade through catastrophe. The barriers to entry are higher than they have ever been.

Investors will play a role in allocating their money to those companies that do well, and will remove it from those who don't – so there will be a survival of the fittest effect.

The regulatory burden on UK insurers from the FSA is seen as a risk factor in the UK, compared with Bermuda and Singapore who don't have those regulatory overlays. Lloyd's should raise their voice about the disproportionate burden of regulation. PPI has been the only insurance mis-selling issue and that was a bank issuing an insurance product.

Regulation of the industry, both national and pan-European, will continue to feature. FSA class insurance and reinsurance with the banks; they don't understand the industry is different.

The FSA re-writing your rule book shouldn't matter if you are professional. But I think that as an industry we should be lobbying against over-regulation.

In future we will see more of the same regulation that we have seen.

We need to address regulation and address it as a market – it's not going away.

Low interest rates for the foreseeable future and no investment income; leading to people taking a punt on cat.

I can't see hard markets coming for some time.

There is no sign that interest rates will rise. The continual over-capitalisation in the market will increase competition and the drive to give everything away, so it will be tough to get growth or increase margins.

The low interest rates and cheap capital makes the insurance world more competitive, affects the balance sheet and the need for reserves. For brokers, it makes life slightly easier, because in times of economic uncertainty when companies cannot get bank lines, they buy more risk cover.

The FSA and regulation are the biggest changes in the last five years. It's resulted in a change in the way we manage our people; we are now much more focused on performance management, which is a good thing. But we reward people for filling in forms and not now for being entrepreneurial. This changes middle office recruitment, it changes us from being traders to being form fillers.

In the next five years, lumbering onto the horizon is Solvency II, in 2015, where the measure of success is no longer the prescribed ratio, but your return on capital. This changes the business you write. You adjust your internal capital allocation, and by extension it changes the way brokers broke. If Solvency II was applied tomorrow, rather than being a vastly over-capitalised market, the average European company would be undercapitalised by a third.

Interest rates are low and the return is low for the future. What was a 105% loss ratio now needs to be 94%.

Macro-economic factors like interest rates matter less than the absence of catastrophe.

Bigger and bigger losses are possible – a £250 billion insured loss is becoming possible.

As long as you have the global spread, you will be OK with catastrophe. The cost of transacting in the traditional manner is increasing so insurers will want more of the premium.

Risk will come at us from more angles, and volatility will feature more.

New lines that we may see? Terrorism, cyber-terrorism, security, hostile environments in the IT space, kidnap/ransom, extortion are all increasing. Product tampering, water source corruption, IT disruption increasing dramatically, crisis management, piracy.

There isn't one single biggest factor that will affect the global insurance industry in the next five years. There are short, medium-term and long term issues and factors, and cycle management and volatility.

We are in for a prolonged period of low yields.

Low interest rates do promote disciplined under-writing because you have to make a profit. In higher rate times you can be cavalier and undisciplined. In lower rate times you are likely to be much more black and white and do less loss-making underwriting to carve out market share.

There is a huge amount of capital through collateralised vehicles looking to write catastrophe in the next few years. The major companies have side-cars and are looking to write risk in a different way.

The cost of regulation is higher.

The world is more complex and global.

The cat severity is higher, although cat incidence is less - claims frequency is down, but claims severity is up. Container ships, the Shard, everything is bigger and more complex now and worse when it goes wrong.

Clients want syndicated spread, but without having to deal with lots of companies.

Difficult to know. In simple terms it seems to me that the big European and Bermudan players are significantly ahead of London in the emerging markets space - look at the domination of Latin America by Munich / efforts being made there by Swiss / Hannover / Ace.

1. What will the global insurance industry look like in five years' time and ten years' time? (macro-economic factors, cheap capital etc)

Regulation is the single biggest change in the last five years; the increasing scrutiny of our business by the FSA and also by Lloyd's. Regulation over-burdens us and costs us time and money. It also means that companies become sluggish in responding to market opportunities.

Lloyd's regulation, the FSA and Solvency II are the holy trinity of trouble.

The second change in the last five years is the trend towards modelling catastrophe and modelling generally. Models are driving the market. It's costing us as a company £50 million a year on analytics that we didn't offer to clients ten years ago, and we now have to offer this.

In my view, a good underwriter with a pencil is better than a bad underwriter with a model.

Therefore, a massive structure is needed to deliver both this and compliance. This hits the smaller companies hard. They can't now afford the level of cost associated with the cost of regulation.

The capital that is now in the market looking for returns, in my view is capital that doesn't have a long-term interest in insurance. The pension industry is looking for safer investments and diversified asset risk. Because there is plenty of money around, the market is soft. A global economic uptick would help.

The Lloyd's market lacks width. What is driving consolidation is regulation. You can't start a syndicate now under £200-300 million, and this means that start-ups are discouraged. Lloyd's needs those new young entrepreneurs to be there. Lloyd's needs new products, new categories and new syndicates.

Within Lloyd's we can't make some markets because there isn't enough depth there, like for example, US D&O.

The infrastructure is here in London, the talent is here, the subscription market is here, and brokers like it. Lloyd's is more secure than it has ever been. Investors understand Lloyd's now.

With a big catastrophe loss, you would see new insurers coming into the industry because the rates would go up.

In 5 years' time, China won't be a big issue, India will get there, Latin America has growth in a lot of places. The USA may very well not be the be-all and end-all of the insurance market. Singapore will develop, but it is incredibly competitive to write business there. A lot depends on the strength of Bermuda vs the US.

God knows what the global insurance industry will look like in five years' time, let alone ten…!

But people will continue to keep producing financial instruments in the field of insurance, catastrophe bonds and the like…

Risk will be retained in territories overseas; Chinese growth doesn't necessarily mean growth in Lloyd's. Those new local insurance players in those markets will become international players, which will increase diversity in the market. As local markets grow, you get more premium written and some of those specialist bits will come to Lloyd's as the overall cake grows in size.

Asia and Latin America - Mexico and Brazil - have more potential than Africa.

The insurance industry is slow to react, and look at opportunities in South Africa, America and in Asia. Africa is an opportunity.

Lloyd's is well out of some of the more esoteric financial instruments that Bermuda writes…

Managing agents have to lead the growth opportunities overseas.

We need the China Res to come and play a greater part in Lloyd's.

Bermuda is less of a threat to London than it was; though it did take Lloyd's growth away, Lloyd's could reassert itself now. Although we don't have the most insurance-friendly government here currently!

2. Will the global insurance industry eventually be dominated by three massive reinsurers and three massive brokers?

It is an issue of where a player wants to sit in the industry. Twenty years ago you had many players whether brokers or underwriters. In the next ten years you won't have so many.

Now the corporate / industry players are £1 billion and upwards. I don't see underwriting operation(s) of sub £250 million unless they are MGAs and I don't believe London brokers will survive if sub £150 million in 5 years. So everything is about identifying the right scale and then the right capital base for that scale. If public - then I think has to be big.

The big will get bigger. The ratings agencies want more and more capital, and expense bases are growing. You now need £4 million to be viable in Bermuda, it used to be £1 million.

The minimum viable size of players keeps getting bigger – which contributes to the homogenisation of the industry and its centralisation.

Reinsurance will be dominated by a small number of large players but it is still a wide industry. Same for brokers, where Aon / Marsh already dominate.

There will always be a place for smaller companies, provided that you have a product that differentiates you.

There will be further consolidation - some of the smaller, narrow, mono-lines, will go.

Consolidation will happen in the London market, because the only way to get reasonable growth is by acquisition. From a capital standpoint there is an opportunity to put it behind the Lloyd's licence and paper.

There will be consolidation.

2.
Will the global insurance industry eventually be dominated by three massive reinsurers and three massive brokers?

Clients want choice. Aon are leveraging their market premium but it is not actually theirs, it is their clients'. More consolidation in the reinsurance space will happen. In underwriting, speciality underwriters will reign.

If the big brokers get really big, they can't be brilliant at everything 24/7, and there will be bits of business they won't want because it's too fiddly or specialist. Lloyd's also should want to encourage competition and diversity.

Consolidation of brokers and leveraging of the premium and making the smaller syndicates sign agreements - the broker controls the business, not in the interests of the insurer, but the market has got tired of that and will support initiatives that dilute that. Unethical behaviour going on amongst the big brokers.

Scale is incredibly important.

The cost of regulation for us is $100 million - our ERM team is bigger than a managing agent payroll.

The vast majority of business goes through Aon/Willis/Guy Carpenter brokers.

The big reinsurers are Hannover, Swiss and Munich.

There are the big players – Swiss Re/Munich, Aon, Marsh, JLT Re, but people will always want alternatives as competition.

The consolidation of distribution is a worry - when it is controlled and tendered out by the big brokers.

You have to be bigger because your risk capacity has to be higher.

If you aren't writing £500 million you can't lead business. In the future lead underwriters will be paid to lead.

Big is beautiful for security and leverage that scale gives. We will see fewer insurers, brokers and reinsurers. There will always be a demand for alternatives for reinsurers because of the need for spread. But there could be two massive broking firms. It's hard to compete in reinsurance broking - nobody left to buy and the cost of entry is so high it favours big existing firms.

Small underwriters and brokers have too many limitations - holding and accessing capital - economies of scale can only be made when you scale.

The reality, rightly or wrongly, is that the big brokers are dominating. For new brokers to set up is hard, they need a big infrastructure, and the compliance costs. Brokers will change their distribution – they will take on risks and write business. Syndicates will need to have huge relationships with brokers – it will be the totality of services, not just passing the risk on.

People are more interested in stronger balance sheets and stronger organisations. The large brokers will grow and get into broader areas of risk.

I see either the large composites or the narrow specialists doing best in the future. But there will always be a need for specialists, because the big guys can't write all the business, there will always be distribution networks below the majors.

The industry will consolidate, and there will also be greater diversification, with those really big companies looking for business in every corner of the world.

Most businesses have a presence across Bermuda, Zurich and London.

I think that the smaller players will always be there. There will always be room for the good people to come out of the big players and be entrepreneurial in their own right. I think for quality operations there will always be room, especially if they specialise in good areas.

Small brokers will continue to consolidate – they don't actually do any marketing, they just buy each other.

Brokers will try to set up managing agents so that brokers can get two sets of fees.

Global brokers need to start charging proper fees and stop trying to sell their books to the highest bidder to make up the money they should charge to clients for advice and risk determination. Brokers are putting all their business into the people who will pay the most for it.

Underwriters will buy brokers and find that it's not so easy being a broker and they will divest again.

The reinsurance industry is pretty consolidated.

Consolidation in the major corporate area will continue; there could be two massive brokers. But the barriers to entry are still relatively low and talented people will go and break away and start up. The big brokers can now use their muscle in the market and they are.

There will be more consolidation, the three large brokers will consolidate down into two. There will be significantly more consolidation in the US and globally amongst small brokers because of the cost of capital and cost of regulation. Insurance companies don't welcome this loss of competition. But it is a given.

3. What can the London insurance industry do to counter the threat of emerging markets?

Lloyd's are too simplistic in their Vision 2025. They should really encourage new syndicates, especially as there are good young underwriters sitting there, who could raise the £200 million+ that they need to set up, but may be being hamstrung by the Franchise Board.

Lloyd's Japan didn't work and Lloyd's China won't. Lloyd's will set up in Latin America and probably fail, because they don't quite get it.

Lloyd's have made it much harder to create syndicates now; the Franchise Board is too powerful.

**3.
What can the London insurance industry do to counter the threat of emerging markets?**

The underwriter has moved from being King of the Hill to being merely part of the process. Lloyd's is a collection of independent businesses being competitive. If Lloyd's becomes uncompetitive, they will lose business. But all the big US insurers are there for the licensing of Lloyd's and the brand.

The key is to keep the entrepreneurial spirit of Lloyd's, and not to lose the differential.

For me it is the balance between risk and compliance.

The other point is that Lloyd's is still a really inefficient business awash with paper; their processes could become much more efficient.

Many people predict the demise of London and the rise of China and Asia, but I don't think that will happen in my lifetime. It won't be Asia and I think the US will remain strong.

The London market has never been stronger, sitting between the two zones as it does - witness Aon moving their HQ here. Lloyd's has unique licensing all around the world - you can write business in Indonesia the next day without being there, and in Taiwan the day after a calamity.

In Singapore Lloyd's tried to teleport the Lloyd's platform out there but it didn't work.

If the US went to a national regulator of insurance that would affect us - luckily there is no SEC for insurance yet there.

There's a ridiculous arrogance about Lloyd's; they sit there talking around topics pointlessly. There were 400 syndicates 20 years ago, now there are only really 28 that matter. In the Lloyd's environment, people get very complacent sitting under that brand and that licence, waiting for business to come to them.

We've had a nice time over the years, and frankly, you would have had to be exceptionally lazy not to make money.

Now we have to charge more with less return. Peer review and peer comparisons means there's nowhere for poor players to hide.

Lloyd's has lost market share, but you could argue that was the crappy elements which have now gone.

The Lloyd's model has never been about gaining market share at any cost.

Lloyd's is well run, its management is better than it has ever been. The brand licences of Lloyd's are very strong. The fad is to say: "We are worried." But Bermuda comes and goes, and a lot of the best people are in London.

Lloyd's will enjoy the boost of emerging markets coming here to see how globally traded products are done. Then they'll take that knowledge home and do it locally.

You can't sit here in London and wait for business to turn up any more.

Emerging markets attract business that doesn't come to London, but that is often local business. Opening overseas offices, is, in my view, feeding egos, and signposting that you are a forward-thinking company, but expensive, and I would urge caution. Some Lloyd's hubs are successful in emerging markets; they are doing a pretty good job of expanding their footprint globally, and the new Lloyd's Chairman will help.

Lloyd's will defend their market share with difficulty. You can do joint ventures with MGAs, and there will be significant hubs in Singapore or Florida, which is picking up. London is not as well placed for Mexico as Miami is. We've been spoilt, stuff has come to us. We have to get out there and understand the local risk levels, and the only way to do that is to be there.

We are a true market. Assessment of the risk aspect imposed on us by regulation is good. But you end up obeying the formula rather than looking at the idea. It enhances systemic risk. If Lloyd's insists on start-ups being £500 million then it cuts down new entrants, but as a cover-holder or MGA you can write on behalf of others, and do so outside of Lloyd's.

Lloyd's global share decline is nothing to be worried about. If something frightening happens, margins will go up again. Lloyd's has licences in most countries of the world, and this is under-appreciated. London is still the centre of excellence in specialist classes. Commoditised insurance business will be transacted over the Internet.

There is a fund of reinsurance and insurance talent in London.

The driver of Solvency II has been to create an economic level playing field across Europe for all insurers. The new model is based on actuarial modelling assumptions and probabilities and the level of risk in the portfolio. Lloyd's regulate the top line – but they could move to letting you have more leeway on what you can write, if you prove you have good bottom line results. This might encourage more entrepreneurialism. But equally they need to say to members: "I'm not going to let you write this line of business, because actually, you are bad at it." The result has been that a lot of "me-too" companies have sprung up who don't do it well.

Lloyd's needs to spend far more time on distribution. They have had dedicated distribution through tied agents. They need to address that by having a more active strategy through brokers to make Lloyd's attractive to emerging markets.

Lloyd's don't use the big brokers – only 10% of their business goes via the big brokers.

Members of Lloyd's need to avoid commoditised work and prove they have niche specialisms.

Lloyd's and London insurance and reinsurance companies will have to provide cat limits, niche products, and find strategic partners. In my view, going on the ground subscale is a waste of time - look how awful the results have been for some of your peers, especially in the USA. There is no such thing as a London insurance industry - there is a market made up of strong to weak players. Lloyd's is largely irrelevant in its attempts to "counter the threat of emerging markets". Underwriting and broking companies will only survive the changing world by employing the talent and expertise to be different and have enough scale to be relevant. In underwriting terms I think this means at least £500 million GWP and in broking at least £150 million brokerage which is why the small are dying – they can't attract the talent and don't have the credibility.

Lloyd's and the London insurance industry are doing enough to counter competitor centres. Lloyd's are setting up local underwriting capabilities in Singapore and MGAs and coverholders which bring the business to London, and brokers can write business internationally.

3.
What can the London insurance industry do to counter the threat of emerging markets?

You will continue to get increased regionalism on the ground of insurance markets, and the reasons for cross-border insurance will be fewer. Local markets will prevail because of the ease of doing business in the same time zone and with people that you know.
People are going out to the sources of business in the emerging markets.

In emerging markets, the products you can sell are not what you would associate with a Lloyd's wholesale insurance market. In China, families save against medical and education costs. China within 10 years will have 10 zones with the economic exposure of Florida but China is exposed to more risk of flood and storm.

You won't make money in India for 20 years!

Lloyd's use MGAs but this won't work in every market. Some of our licensing is reinsurance only and some territories won't allow binding authorities. As markets mature, more business will stay there, it's inevitable.

Lloyd's needs to change and accept trading globally and not face to face.

Lloyd's need to make better use of the intermediaries. Intermediaries can get the business to London - Lloyd's don't then chase an illusory pot of gold...

Lloyd's need to "man up" - they are being dictated to by the big brokers.

Lloyd's cost structure is prohibitive in terms of startups. Greater flexibility on regulation would help and the acceptance of managed business.

The Lloyd's new chairman is focusing on bringing capital into London. Lloyd's has a great global platform and a licensing scenario and is a good brand. Mr Nelson is doing the right thing. Lloyd's should continue to innovate and focus on product development and new lines and innovate and keep it close to business. And they should seek to resist the homogenisation of all syndicates. Lloyd's is chasing out some of the things that don't pass the Franchise Board's scrutiny; new syndicates are now not allowed to add/underwrite fringe activities.

The result of this is that in ten years' time every syndicate will look exactly the same and offer the same.

Lloyd's cannot address the fall in their global market share. It's been declining slowly and politely for 15 years. In a globalised world where it is easier to move capital around opportunistically, it is inevitable that these emerging markets will thrive and grow and attract capital. The Asian market will always be cheaper for Asian business, and it's been the same in the US for decades.

London is taking itself out of the risk opportunities that will come to them when the US market hardens.

If we want to reverse the decline, more time needs to be spent on intellectual property, cyber-liability, non damage business interruption, and loss of attraction type lines.

The Lloyd's strengths are:

- brand
- history
- syndicates
- diversity of markets
- one Lloyd's policy issued by a central servicing agent
- English
- London.

We have historic ties with the East and with Asia and the Chinese feel very comfortable trading with us - Lloyd's could be pivotal to increased trade with China.

If we get our regulation and our tax right in the UK, we can be very competitive (corporation tax is 22% right now and to be in London with all it offers is very attractive to companies).

In Lloyd's, we are a true market. Assessment of the risk aspect imposed on us by regulation is good. But you end up obeying the formula rather than looking at the idea. It enhances systemic risk. If Lloyd's insists on start-ups being £500 million then it cuts down new entrants, but as a cover-holder or MGA you can write on behalf of others, and do so outside of Lloyd's.

You can get business in London from smart brokers and from MGAs.

With Lloyd's licences, you can pick and choose. You don't need to have your flag in every country. You can play to the strengths of London and work on partnerships.

Mr Nelson's business plan is to get people from emerging markets to sit here in Lloyd's and do their business here. Lloyd's could have had three centres in London, Bermuda and Singapore and covered the three time zones, and it should concentrate on those three areas. Lloyd's is, and will stay, a market of last resort. Big businesses go outside Lloyd's; they have to. The point is that Lloyd's don't run the businesses inside it. Lloyd's open offices and hope that people will go there to do business.

It ought to be slick to do business with Lloyd's. But it's not.

There are other distribution channels via MGAs – and Lloyd's need to pay attention to these in the future. MGAs are the way for Lloyd's to come in quickly under cover into new territories and participate in new markets.

Lloyd's role has always been and will continue to be specialist and excess market in nature. The question is what is Lloyd's likely to look like in the future and can we influence this from within?

Lloyd's has made huge strides to being better regulated, but that can go too far, and the value of Lloyd's is in being innovative and responding to situations quickly.

Lloyd's also needs to look at the cost of doing business. Lloyd's used to have a cost advantage over the large global players and it needs to have that again, if Lloyd's can get the cost of doing business down, that will help. Lloyd's supposedly does business within one room, and yet it costs…

Lloyd's are an intermediated market, and they only facilitate business, they don't do the business of their members. They have tried to set up centres abroad, but that won't increase the business coming into Lloyd's. Lloyd's need to be more risk-taking in Africa particularly. Piracy policy and sophisticated war risk are typical Lloyd's innovations. Lloyd's are good in high-severity business and Lloyd's has lots of expertise in writing this business. The global insurance market needs to recognise that Lloyd's has cleaned up its act and is now regulated, and syndicates won't crash and burn as they did.

4. Is it realistic for the insurance industry to continue to deliver double digit returns?

Double digit returns? Hm, well because of low interest rates continuing, everyone should tone down their expectations a bit.

You can't now as a broker rely on a hardening market.

It is harder to deliver the returns, but still possible, maybe not across the insurance industry as a whole, but the London market is higher risk with higher returns. Even with all the models, we can only ever make an educated guess; we aren't like the banks.

We have to continue to offer double digit returns, we need 15% ROI because of the bad year possibility. But 8-9% is possibly more realistic than the returns we have had in the past.

I think it is still realistic to expect double digit returns in the future – but they will be only just double digit and we will have to work harder to get them.

You can't assume any investment return. 15% returns can't be guaranteed all the way through the cycle.

The insurance industry is not delivering double digit returns across the board. The only thing that will harden the market is Solvency II.

Depends on what stage of the cycle you ask the question. Over-capacity of capital and businesses and a cat-free environment means that there is currently an inexorable focus on price. You need to look realistically at returns over the long term; the market will soften and harden.

Double digit return is not an unfair expectation, but the PE guys need to understand that we won't always hit it in bad years.

But new capital has come in to the market, but we have to watch that new capital understands the volatility. It may like it when things are going well, but walk away when times are bad. We live with volatility and you have to judge over 10 years, not one.

Speciality cat has to deliver those double digit returns because we bring volatility to our clients. If base rates and investment stay where they are, it will be harder to return that.

We used to be half investment and half underwriting. This year it's 15% investment, and 85% underwriting.

Margins are under pressure in a low yield environment. People are positioned very short.

You need a strategy which depends on the desired risk metric you want to take.

Are you underwriting or investing?

If you are not more than covering the cost of capital, you can't play. Apple and ExxonMobil are capitalised at $648 billion and $426 billion respectively, where the capitalisation of the US and Bermuda together is only $240 billion, so if you want to make money, you can invest in companies rather than insurance, but the point is that investing in insurance diversifies. If you aim at 12% ROI, you'll be OK.

Pension funds need to be sold 4-6% return on writing reinsurance, and need to be sold to the sector, and the investor base in reinsurance may change over the next 10 years, when it will be about product design, new products, good people and technical skills.

If you don't deliver double digit returns, the money will flow out of the business. If you can't make the big returns, investors won't go near it, but they do have to be educated to understand that there is downside.

The dichotomy for the business is if they produce record returns, the question asked is: "Why should I pay you more premium when you have had the best year you've ever had?"

We have to have double digit returns for the bad years. Profits from investment are now negligible.

Sandy will stop rates softening in America, and coastal properties will have to pay more for insurance, but catastrophe in America doesn't mean that rates will harden in Scandinavia. It was only after 9/11 that rates hardened globally.

There is too much capital in the insurance business, but when people realise that there is less return than they thought, they will leave.

Returns are to do with one's perspective on how long the investment market's markets returns will stay at 2% and when they might return to 4-5%.

The insurance market is currently very competitive, given the amount of capital in it.

There is a lot of pain to come, because the future is going to be outperforming your peers on underwriting results.

To survive and get the ROI you need to have more scale to absorb bigger losses and you need significant capital. Global players with outside capital buy the expertise to deal with high-risk global opportunities.

In the long run, rates will rise and inflation has to come back; governments are keeping rates down by force and under pressure.

It's difficult to sustain high severity income consistently over time, but without Sandy, returns would have been in the 20's. Institutional investors accept this volatility.

5. Will there be new ways of doing new types of business?

Innovation is miniscule.

Underwriters are used to brokers ramming business down their throats in London, but elsewhere in the world brokers are incentivised, so London underwriters need to figure out how to get a chunk of this business by forming strategic alliances, rather than behaving as they always have done. If you don't build these alliances, you are competing with other reinsurers and insurers who do business differently. Your broker somewhere is getting ski trips/golf trips/best producer of the month stuff - incentives - and he doesn't have to write to London.

Brokers are your salesforce. Understanding how to engage with your sales force is crucial. You don't need to have expensive overseas offices, you need to have the right relationships. You can just have a couple of people in Miami and NY. Better to go to emerging markets and get the 20% organic growth there, which will come.

Brokers are better at building mid size distribution than underwriters so underwriters should selectively "lend" capital to broking partners via the MGA model. Be different - in a world dominated by a small number of very large players where leverage will play - and already does - a significant role, there must be an opportunity for smaller London led businesses who do things differently with good people.

In 20 years time will there even be a City at all? A lot hangs on distribution, will brokers be more or less powerful? Will underwriters find other ways to do business?

We need innovation – we need products that people want to buy – for example, against cyber-crime.

Moving money doesn't differentiate you. It's what you do behind that.

We have to create more efficiency.

We have to compete differently from the big reinsurers and brokers. They have started distilling their knowledge and leveraging off the market, and they have huge run-off experience. If we are smaller, we have to travel – we have to take our business into Lloyd's where there is an appetite for risk.

The Lloyd's global market share issue doesn't matter, frankly.

We all hope that there will be a market correction, but frankly, even the floods didn't do it.

We have to be more creative and innovative and get into the board room and sell our expertise on risk, with service and insight.

There is a danger that underwriters are becoming more in the nature of relationship managers – just passing it up the line to actuaries and failed tame lawyers – and this is a disincentive to innovation.

Relying on algorithms is not good.

People need to be more innovative and write more business and create relationships in emerging markets and *use their brains*. It's a challenge but it's a challenge for all of us that we have to work out. If you are struggling to write one line of business only, you will either get taken over, or no-one will want to do business with you.

You need to figure out some product lines that are different from other people's.

It's now all about people, distribution and clients.

The internet may change things - with direct quotes to consumers, where can the underwriter hide? - the power is now with consumers.

The big clunky brokers and the big insurers do business in a big clunky way, whereas everything small specialists do is driven by personal service.

We need product for emerging markets.

Even if there are only two brokers, Lloyd's should find ways of dealing with them from London directly.

Hindsight * Insight * Foresight

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