London Matters

The competitive position of the London Insurance Market

THE FACT BASE

JOINT STUDY OF THE LONDON MARKET GROUP (LMG)
REPRESENTING ITS LONDON MARKET INSURANCE MEMBERS
AND THE BOSTON CONSULTING GROUP
LONDON, NOVEMBER 2014

LMG

BCG
The Boston Consulting Group

London Market Group (LMG) is the senior body helping to create and articulate the vision for the way insurance is transacted between members of the International Underwriting Association (IUA), Lloyd's Market Association (LMA) and London and International Insurance Brokers' Association (LIIBA). LMG oversees all elements of the market mechanism and identifies areas where proactive action can improve London's competitive position.

LMG is made up of senior representatives of each market constituency – IUA; LIIBA; LMA; and the Corporation of Lloyd's. Each of these constituencies suggests possible issues to be added to the LMG agenda.

The Boston Consulting Group (BCG) is a global management consulting firm and the world's leading advisor on business strategy. We partner with clients from the private, public, and not-for-profit sectors in all regions to identify their highest-value opportunities, address their most critical challenges, and transform their enterprises. Our customised approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organisation. This ensures that our clients achieve sustainable competitive advantage, build more capable organisations, and secure lasting results.

Founded in 1963, BCG is a private company with 78 offices in 43 countries.
For more information, please visit bcg.com

Contacts

Steve Hearn, Chairman of the London Market Group: steve.hearn@londonmarketgroup.co.uk

Pia Tischhauser, Senior Partner and Managing Director, The Boston Consulting Group: tischhauser.pia@bcg.com

Steve and Pia would welcome your comments, thoughts and feedback on the report.

To download the full copy of the report, visit www.londonmarketgroup.co.uk

Table of contents

Preface

Is the development of a globalised market for insurance undermining London's position as the pre-eminent centre? That is a question that I and my colleagues around the London Market Group (LMG) table have been wrestling with for some time. There is evidence to suggest that it is – the declining share of global premium that brokers bring to London; the growth of alternative centres such as Bermuda, Singapore and Zurich in recent years; the growth of alternative capital challenging the dominance of traditional London capital. All of these phenomena have put pressure on areas of insurance business where London has traditionally been strong – specialty commercial risks where broking and underwriting expertise are vital to finding a flexible solution to client need. Whilst London insurance results have tended to hold up, many of us active in the market have developed a sense of unease. Is our share of global business falling? Is that irreversible? Are we as important a contributor to the UK economy as we would like to think? Most importantly, what do our customers and their brokers want from us? Fundamentally, do we still matter?

I believe the answer to that last question is an unequivocal "yes". I remain convinced that, despite the relentless march of technology and ever increasing amounts of data into all our lives, true specialty insurance business requires an intense exchange of information and cumulative underwriting expertise that is best served in an efficient way in a centre of excellence. You need proximity of location to facilitate interaction between high quality, high intellect staff; the value delivered by having the necessary support services – legal, technology, accountancy – close at hand; all delivered within a square mile of a vibrant international city in which people wish to live, with English as the primary language of business and a time zone that places us neatly in the middle of international trade. As my description betrays, that has always been London, a unique face-to-face ecosystem of market players and support services in an attractive location. And I make no apology for my desire to see that it remains London. But if I am right, and our customers need this centre of excellence to be able to meet the full scope of their needs, then the international insurance industry has a strong motivation to share my passion.

So yes we in London matter. This makes finding the answer to the other questions I posed above matter too. When LMG began to consider these we realised that we were missing the basic set of facts and insights that would allow us to reach satisfactory conclusions. We could speculate on a trend here and a development there. But none of us had the wherewithal to provide definitive answers. As a market we have not been good at developing this sort of analysis of the competitive landscape in which we operate. So this report, which LMG has commissioned from The Boston Consulting Group (BCG), seeks to address this shortfall.

The aim is to provide a comprehensive overview of the London Insurance Market's position in global commercial insurance and reinsurance markets, the trends affecting this position, and the issues and opportunities that present themselves. The report seeks to answer my earlier questions:

- How is London Market business best defined and how big is it?
- How has the position of London evolved in relation to the global insurance market?
- What economic impact does our market have – and thus why should a wider set of stakeholders, including government and regulators – share our agenda?
- Why do our customers and their brokers seek to place insurance in London?
- Are we delivering the service they need?
- What macro trends might be affecting this demand for our products?
- Where do the threats to our position lie, and what opportunities might we exploit?

The answers to these questions are set out in the following pages. They provide us with the fact base that we have thus far lacked. From this we can begin to develop a strategy for the London Insurance Market that will allow it to continue to play that crucial role as the specialty centre of excellence the global industry needs. So, enjoy reading the report and I look forward to discussing it and the implications for the market's strategy with you.

Steve Hearn, Chairman of the London Market Group

Steve would welcome your comments, thoughts and feedback on the report. He can be contacted at:
steve.hearn@londonmarketgroup.co.uk

1 Executive Summary

1 Executive Summary

The London Insurance Market is currently the largest global hub for commercial and specialty risk

- The London Market is defined as specialty commercial insurance and reinsurance business backed by London capital, plus business controlled by, but not written by London Market participants
- In 2013, this totalled £60bn of gross written premium (GWP), with £45bn written in London, backed by London capital and £15bn controlled by, but not written by London Market participants
- In direct commercial insurance, London (£30.5bn) is nearly four times bigger than Bermuda (£8.5bn), 11 times bigger than Zurich (£2.7bn) and 15 times bigger than Singapore (£2.1bn)
- The US (£122bn in 2013) is the largest commercial insurance market in the world, but premiums are dispersed across states, with the largest being California (£15.3bn) and New York (£10.8bn)
- In reinsurance, London is one of the largest hubs in the world (£14.6bn), but is smaller than Germany (£27.6bn), Bermuda and Switzerland (both £16.1bn)

The London Market was a substantial contributor to the London and UK economy in 2013

- There are more than 65 Company Market insurers and reinsurers, 91 Lloyd's syndicates managed by 56 managing agents[1], 8 P&I clubs and over 200 brokers active in the London Market
- These organisations employed ~34,000 people in London and ~14,000 in the rest of the UK in 2013
- We estimate the direct GDP contribution of the London Market to be £12.0bn in 2013, representing 10% of UK financial services, 21% of 'the City' and 32% of the overall UK insurance sector contribution
- Including the indirect (affiliate professional services) and induced (household consumption) GDP contribution, the London Market contributed £29.9bn, representing ~8.2% of London GDP in 2013

From 2010-13 the London Market tracked commercial insurance industry, but not reinsurance industry growth

- We estimate the global commercial insurance industry GWP in 2013 to be £307bn (growing 4% p.a. 2010-13) and the global reinsurance industry GWP to be £117bn (growing 5% p.a.)
- In direct commercial insurance, the London Market grew at 5% p.a. (£4.1bn[1]), retaining its global share at 10%. This compares to Bermuda with GWP growth of 2% p.a. (£0.4bn[1]), Zurich with GWP growth of 3% p.a. (£0.3bn[1]) and Singapore with GWP growth of 16% p.a. (£0.8bn)
- In reinsurance, the London Market GWP grew at 1% p.a. (£0.6bn[1]), decreasing its share from 15% to 13%. This compares to Bermuda with GWP growth of 5% p.a. (£2.2bn[1]), Zurich with GWP growth of 5% p.a. (£2.1bn[1]) and Singapore with GWP growth of 10% p.a. (£0.6bn[1])

London's commercial insurance growth was underpinned by maintenance of share across most lines

- In Property (£7.7bn), Casualty (£6.9bn), Marine (£5.9bn) and Motor (£2.2bn) London grew with the global insurance industry, keeping its share at 6%, 5%, 33% and 2% respectively
- In Energy (£2.9bn), London grew below the industry, but still possesses a high share of 48% (from 51%)
- In Aviation (£1.9bn), London did not contract as fast as the market, growing its share from 49% to 57%

London Market premiums originate predominantly from the UK, US and Europe. The market gains a much lower share of high growth market flows and that share declined from 2010–13

- 33% (£14.8bn), 31% (£13.9bn), and 16% (£7.1bn) of London Market premiums originated from the UK and Ireland, North America and Europe respectively in 2013
- London outgrew the market in the UK and Ireland (47% to 53% share) and marginally outgrew North America, Europe and Australasia from 2010—13 (5.8% to 6%, 3.5% to 4%, 14.9% to 15% respectively)
- London grew below the market in the high growth regions of Asia, LATAM and Africa from 2010—13, its share of business in these markets declined by more than 20%, from 3.2% in 2010 to 2.5% in 2013

London's competitiveness is commonly seen to be underpinned by a complex set of factors, which were once unique, but are now under threat from other locations which are investing heavily

- Underwriting and broker expertise, reputation for innovation and breadth of product offering
- Dedicated broker network bringing specialty business to London and licences/ access to local markets
- Amount, security and flexibility of available capital, coupled with a reputation for paying claims
- Unique face-to-face ecosystem of market players and support services in an attractive location

London's competitive position could be impacted by a number of trends in the global (re)insurance industry

- Increasing global mobility and local availability of underwriting expertise
- Increasing availability of data and smart analytics taking a more central role in the underwriting process
- Emergence of new risks for which adequate insurance solutions are not yet available
- Growing protection gap in natural catastrophe insurance putting pressure on government assistance
- Globalised broker offices and insurer branch networks taking a global view of risk placement
- Higher growth, emerging markets taking over as the drivers for premium growth
- Superabundance of capital and securitisation of insurance risk
- Technology shortening the supply chain and challenging an antiquated insurance infrastructure

We consulted nearly 300 market participants from around the globe and across the distribution chain, in order to understand what drives placement decisions and how this impacts London's competitive position

Six main challenges to London's historic position

1. Customers have a preference for buying insurance in their local market, putting £13-18bn (30-40%) of London premiums at risk of being written locally, where capacity and expertise is increasingly available
2. London does not have a strong position in emerging markets, and its share of business in these markets declined by more than 20% from 3.2% in 2010 to 2.5% in 2013
3. London is losing share in reinsurance (from 15% share in 2010 to 13% share in 2013) as reinsurance purchasing is increasingly centralised and emerging market growth gains in importance
4. London's expense ratios were 9 percentage points higher than its peers in 2013, driven by higher acquisition and transaction costs, putting it at a price disadvantage for more price sensitive risks
5. The comparatively high regulatory burden on London Market participants raises costs and could put London at a further price disadvantage, if it is higher than the value of regulation to customers
6. The prolonged soft market cycle, propagated by the superabundance of capital and securitisation of insurance risk, challenges London's role as the supplier of additional capacity to meet local needs

Six key opportunities to enhance London's position

1. Meet substantial unmet demand for new products & solutions, building on London's reputation for innovation and flexibility in order to offset the commoditisation of more traditional risks
2. Reinforce London's strength in expertise based underwriting with improved analytical techniques to deliver value to customers, enable better selection of risk and help retain more commoditised business
3. Invest in marketing the strengths of the London Market, particularly in emerging markets, to stimulate customer demand and encourage brokers and carriers to remove barriers to placement
4. Break down barriers to (re)insurance, and intermediation and develop the distribution network creating appropriate local presence, to allow London to compete more effectively in high growth markets
5. Reduce the cost of doing business by delivering on infrastructure activities, removing London specific process and realising economies of shared service, to increase competitiveness for commoditised risk
6. Embrace the rise of alternative capital in order to take advantage of deep capital markets, build capacity in capital scarce lines and protect against extended soft market cycles

Our findings define a set of key questions the London Market must mobilise itself to answer

Market development

- How can London encourage product innovation and entrepreneurialism, and the talent required to deliver them?
- How can London supplement its reputation for expertise with analytical capabilities?
- How can London better attract and leverage alternative capital?
- How does London remain relevant to reinsurance buyers centralising reinsurance purchasing?

Market competitiveness

- How can London enhance the ease of doing business, in particular for brokers?
- To what extent can shared services and infrastructure activity lower costs and improve service?
- How to ensure market regulation is proportional and does not put London at a disadvantage
- How to ensure tax does not become a material disadvantage for London?

Market reach

- What is London's offering to its customers, carriers and brokers?
- What is the best way to communicate that offering?
- How can London best participate in high growth markets?
- How can London increase its local market knowledge and diversity of employees?

We thank the following organisations for their contribution to this research




2 Defining the London Market

2 Defining the London Market

The London Market heritage

The London Market, as it is known today, has a rich heritage tracing back to the seventeenth century when London merchants began exploring trades with the East Indies, the New World, Russia, Africa and the Middle East. London developed into the leading international trade centre, with its growth underpinned by the development of an insurance industry to distribute the risk of individual trading adventures. The banking and asset management industries that, together with the London insurance market, make up 'the city' ecosystem today grew in large part due to the trade and the accumulation of capital the insurance industry supported.

The Lloyd's market traces its history to Edward Lloyd's coffee house, which opened around 1688 on Tower Street, and to the group of underwriters, in 1787, who established the Society of Lloyd's. The London Company Market started to formalise in 1824 when a Bill was passed to abolish restrictions on insurance which had favoured Lloyd's.

Over time, Lloyd's and the Company Market started to write an ever increasing variety of risks, in particular risks with a high severity and low frequency such as natural catastrophe. The London Market became the leading market for companies that needed (re)insurance coverage for large, complex or bespoke risks. The London Market benefited from its set-up as a subscription market, where more than one carrier takes a share of the same risk, letting risk carriers efficiently diversify their risks and giving companies access to a deeper pool of capital, and from the global reach of London Market brokers.

Despite many challenges throughout the course of its history, the London Market still occupies a prominent position in the global economy. Whether it will continue to occupy this position depends on the market's ability to meet the new and evolving needs of more global customers and brokers, particularly in high growth markets, and to keep pace with and take advantage of the evolution of technology.

London Market definition

A wide variety of risks are written within the London Market, from highly specialist risks for international and domestic clients written by a specialty mono-liner, to more standardised risks which some Lloyd's syndicates also write. Therefore defining what is uniquely 'the London Market', beyond the more typical commercial insurance business that exists in all developed economies, is not straightforward.

Our definition of the London Market is founded on the underlying principle that London Market participants write globally mobile risk which local markets cannot easily accommodate. Based on this premise, the London Market Group (LMG) and its member associations have adopted a two layer approach to defining the London Market:

1. London Market specialty commercial insurance and reinsurance business, backed by London capital
2. Other business marketed through/ controlled by London Market participants.

The two layers capture all business that 'touches' London in its function as a global commercial and specialty (re) insurance hub. The two layers are defined as follows:

1. London Market specialty commercial insurance and reinsurance business

London Market business is defined as large commercial and wholesale specialty risks written in London through brokers or direct with clients by an insurer, reinsurer, Lloyd's syndicate or P&I club[3], plus internationally mobile 'specialty' personal and SME[4] risks written in London by a Lloyd's syndicate, all backed by capital in an entity regulated by the UK Prudential Regulatory Authority or in a London branch of an EU regulated business

These are risks that domestic risk carriers, choose not to write due to the non-standard risk characteristics, for which the London Market can offer competitive insurance solutions, e.g. worldwide property insurance for ultra high net worth individuals, and specialty business for which international brokers or their clients believe the London Market can offer a better price and/or better terms.

London Market business includes UK domestic Small and Medium sized Enterprises (SMEs) and personal lines business written at Lloyd's and at non-Lloyd's carriers via specialty managing general agents and local underwriting offices. However, the vast majority of domestic SME and personal lines business, which is written by composite insurers, is not included in the London Market definition (e.g. 'plain vanilla' personal lines motor policies), since this business is easily accommodated by "local markets".

2. Other business marketed through/ controlled by London Market participants

Business that is marketed through or controlled by London Market participants, but not backed by London capital is separately identified. It includes a) large commercial and wholesale risks placed with entities outside of the London Market but with input from London based broker teams, and b) large commercial and wholesale risks managed, controlled or underwritten by London based teams of global (re)insurers, but ultimately placed with entities outside of the London Market. This business highlights the position of London as a global market for commercial insurance and reinsurance broking. Many London Market brokers place risk both in London Market entities and in entities outside of London. Furthermore, several international (re)insurers have centres of expertise and global teams based in London to assess and underwrite risk regardless of the final risk carrier domicile.

The London Market was worth an estimated £60.1bn in gross written premium[5] in 2013, consisting of £45.1bn written directly in London and £15bn of other business marketed through, but not written in London (Figure 1). Of the business written directly in London (£45.1bn), 68% (£30.5bn) consisted of commercial and specialty insurance and around 32% (£14.6bn) is reinsurance. Meanwhile, Lloyd's constituted £26.1bn of the total £45bn, including £1.6bn of UK SME and personal lines business, while the Company Market wrote an estimated £17.4bn of premium and the P&I clubs, £1.6bn. Of the other business marketed through, but not written in London (£15bn), around 53% (£8.2bn) are risks placed with entities outside of the London Market by London based broker teams and around 47% (£6.8bn) are risks controlled or underwritten by London based teams of global (re)insurers, but ultimately placed with entities outside of the London Market.

London Market customers

In the London Market virtually all business is placed by brokers on behalf of their clients—the policyholders and cedents. The policyholder (for insurance) and cedent (for reinsurance) is the entity that seeks to (re)insure itself against a certain risk, such as a shipping company which seeks to insure a vessel against shipwreck or an insurer which seeks to reinsure parts of its natural catastrophe exposure. This (re)insurance is backed by capital which is held against a potential claim. The complex nature of large commercial risks led the London Market to develop a sophisticated distribution model with several layers of intermediaries along the value chain.

The (future) policyholder or cedent that seeks (re) insurance against a certain risk is typically the customer of a retail or wholesale broker. The broker in turn typically contacts a London Market broker to place the risk with a (re)insurer or syndicate who underwrites the risk. The insurer or syndicate has the option to cede parts of the premium to a reinsurer. The (re)insurers and syndicates are backed by capital which ultimately secures the claim of the insured. Hence, for the London Market companies the definition of their customers is dependent on where they sit within the value chain. A syndicate could see the global and wholesale brokers as its clients, whereas a global broker might deal directly with policyholders or with retail or wholesale brokers. In some markets, such as Germany, in-house brokers of large multi-national clients are common. In this instance the in-house broker may directly interact with the risk carrier.

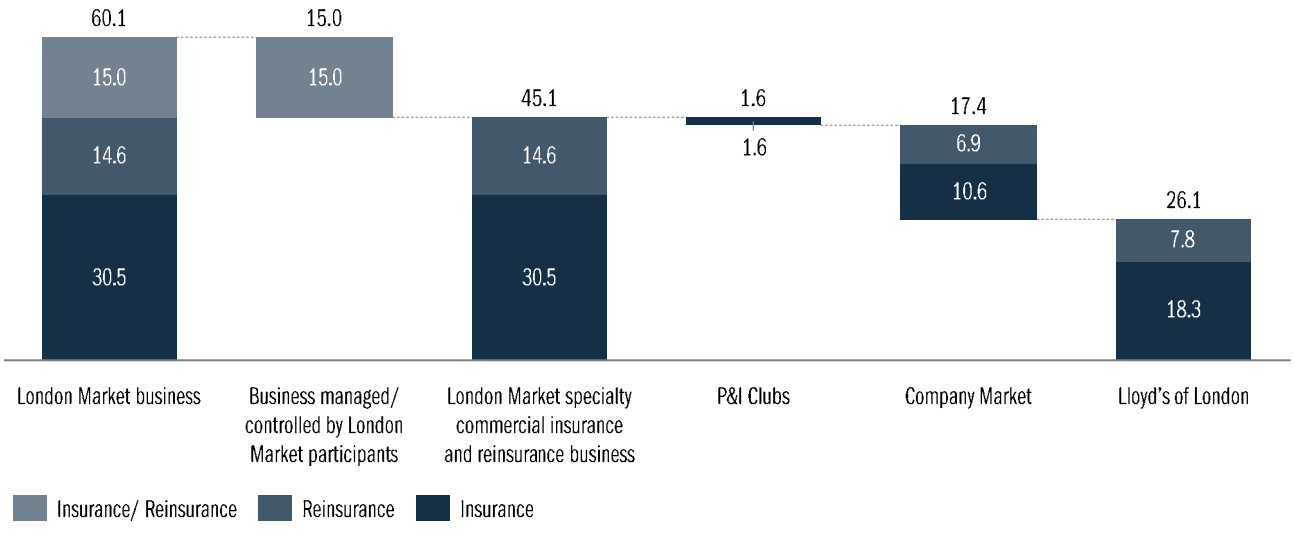
The London Market ecosystem

Based on the LMG definition of London Market business, we define a London Market organisation as any risk carrier or underwriter that writes London Market business and any broker that places London Market business. There are more than 65 Company[6] Market insurers and reinsurers, 91 Lloyd's syndicates managed by 56 managing agents, 8 P&I clubs and over 200 brokers active in the London Market.

The London Market is the largest (re)insurance subscription market globally and the London Market ecosystem extends to a wide range of affiliate professional services which include claims handlers and adjusters, actuarial consultants, asset managers, accountants, lawyers, IT service/ outsourcing providers and other ancillary services to the insurance sector. Figure 2 provides a graphical representation of the London Market ecosystem.

Figure 1: Breakdown of London Market business

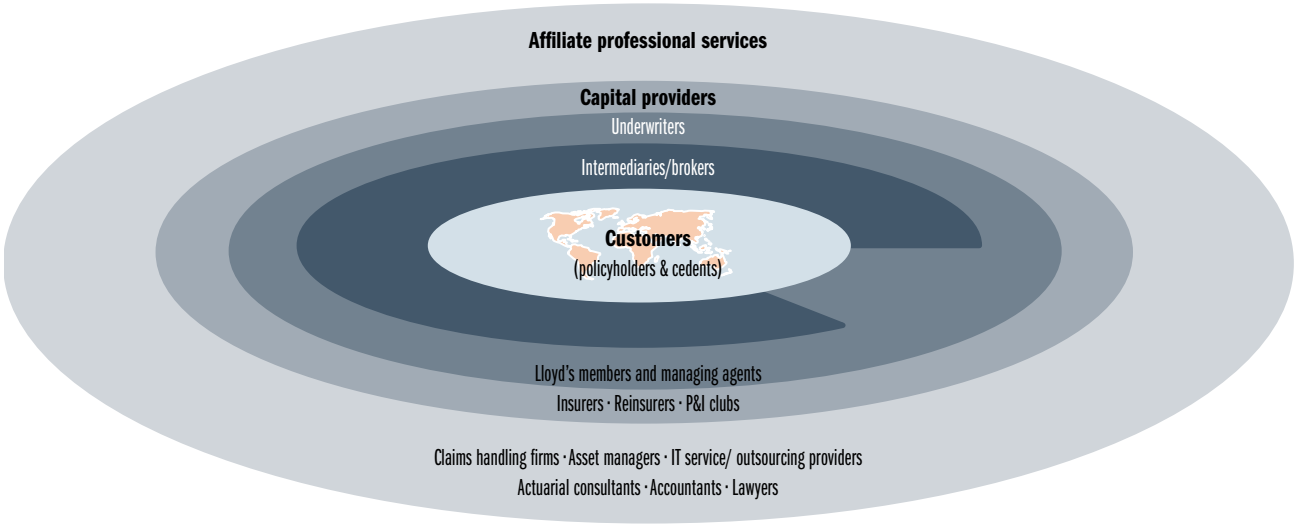
Gross written premaium 2013, £bn



Figures do not add up due to rounding

Source: LMG data request with sample managing agents, Company Market participants and brokers, IUA, Lloyd's of London, BCG analysis

Figure 2: The London Market ecosystem



Source: LMG, BCG analysis

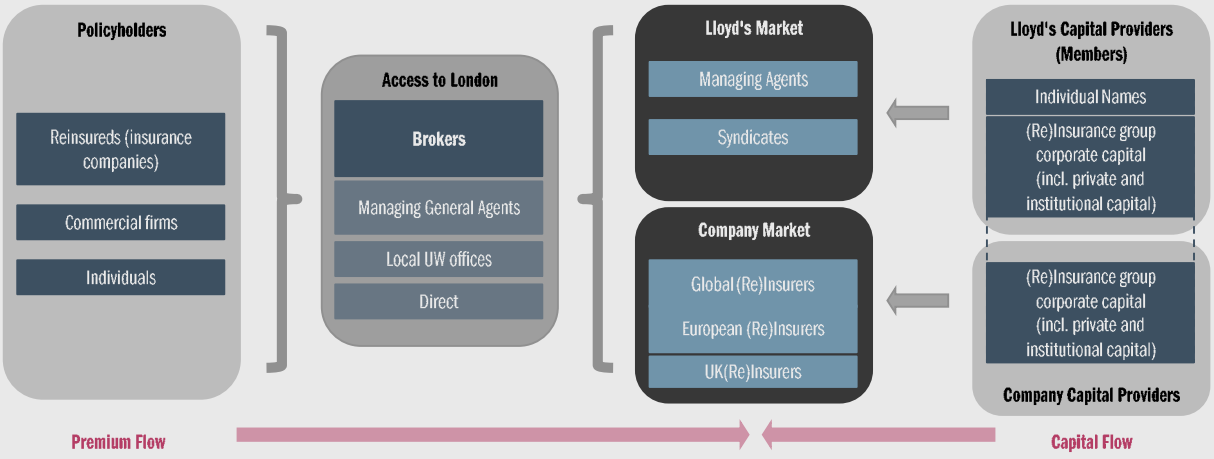
Commercial, specialty lines (re)insurance, market participants and distribution

What is "Specialty" Lines (re)insurance?

The specialty lines (re)insurance market is the segment of the (re)insurance industry where more complex and unusual risks are written. These risks require specialised underwriting and are often handled by specialised carriers and brokers. The market focuses on two types of products: unusual or complex (re)insurance and higher risk accounts. An example of an unusual or complex product is professional liability for a trustee, and an example of a higher risk account would be a collection of commercial properties in a natural catastrophe area e.g. the Gulf Coast area of the US. Other typical lines of specialty (re)insurance include Marine, Aviation, Energy, Director and Officers liability and Credit and Surety insurance.

Figure 3: London Market Participants

Who are the market participants and how is insurance distributed by the London Market?



Source: BCG analysis

Policyholders in the London market include commercial firms looking to insure their risk, insurance firms seeking to reinsure their premium with reinsurers, and, to a lesser degree, individuals seeking to insure individual risks. The Lloyd's and Company Market consist of entities willing to insure 'specialty' risk from these policyholders. At Lloyd's, syndicates are the entities who physically underwrite risks. The syndicates are managed and serviced by managing agents who are responsible for appointing and employing underwriters, other management and staff. Managing agents also help to determine the underwriting policy of the syndicate and are responsible for managing capital. In the Company Market, Global, European and UK (re)insurance groups replace the role played by syndicates and managing agents.

Access to London is predominantly via brokers acting as an intermediary between clients and underwriters. Today there are over 200 London brokers ranging from subsidiaries of the major global broking groups (e.g. Aon, Marsh and Willis) to specialist brokers focusing on particular business lines. In addition, Managing General Agents (MGAs)[5], a specialised type of intermediary that, unlike traditional agents is vested with underwriting authority from an insurer, together with local underwriting offices[6], who are wholly owned subsidiaries of managing agents or (re)insurance groups, offer access to London in many insurance markets around the world. Alternatively, in rare cases, an end client may go direct to an insurer to underwrite their risk.

The capital which enables syndicates, managing agents and companies to underwrite risk in London, is backed by many of the world's largest insurance groups, listed companies, limited partnerships and individuals. At Lloyd's, members are the capital providers and risk carriers. Members include individuals ('names') with either limited or unlimited liability as well as corporate members, typically (re)insurance group corporate capital. Today ~90% of Lloyd's capital is provided by corporate members, with a diminishing number of 'names' providing the remaining ~10% of the capital. In the Company Market, the capital is provided entirely by (re)insurance group corporate capital.

3 Size and development of the London Market in the global context

3 Size and development of the London Market in the global context

Composition of the London Market

London Market specialty commercial and reinsurance business can be analysed in more depth by breaking it down by line of business (Figure 4).

Breaking down the London Market business in this way (see appendix A for detailed definition), highlights the broad portfolio of risks underwritten in the London Market. The largest lines of direct business are Property (£7.7bn), Casualty (£6.9bn) and Marine (£5.9bn), which make up around 45% of the total London Market. In addition, Reinsurance accounted for £14.6bn (32%) worth of premium in 2013, with £8.9bn (20%) worth of treaty reinsurance and £5.7bn (13%) of facultative reinsurance.

Geographic breakdown of London Market business

The London Market serves as a hub for large commercial and specialty risk carriers and attracts internationally mobile large commercial and specialty risk from all over the world. As depicted in Figure 5, 33% of the London Market premium originates (based on the location of the insured) from the UK & Ireland, 31% from the US & Canada and 16% from Europe (excl. UK & Ireland).

While both Lloyd's and the Company Market write international risk, a large proportion of the Company Market premiums originate in the UK & Ireland (based on the location of the insured). Lloyd's strength in the US & Canada is based on the success of the Lloyd's coverholder model, its preparedness to write catastrophe risk and the reputation of Lloyd's in the US market (e.g. its track record of payment of claims after hurricanes). Both Lloyd's and the Company Market attract only relatively small shares of business from Continental Europe, Asia and South America. The majority of the commercial business in these regions is written domestically or in international insurance hubs, partially due to local regulations.

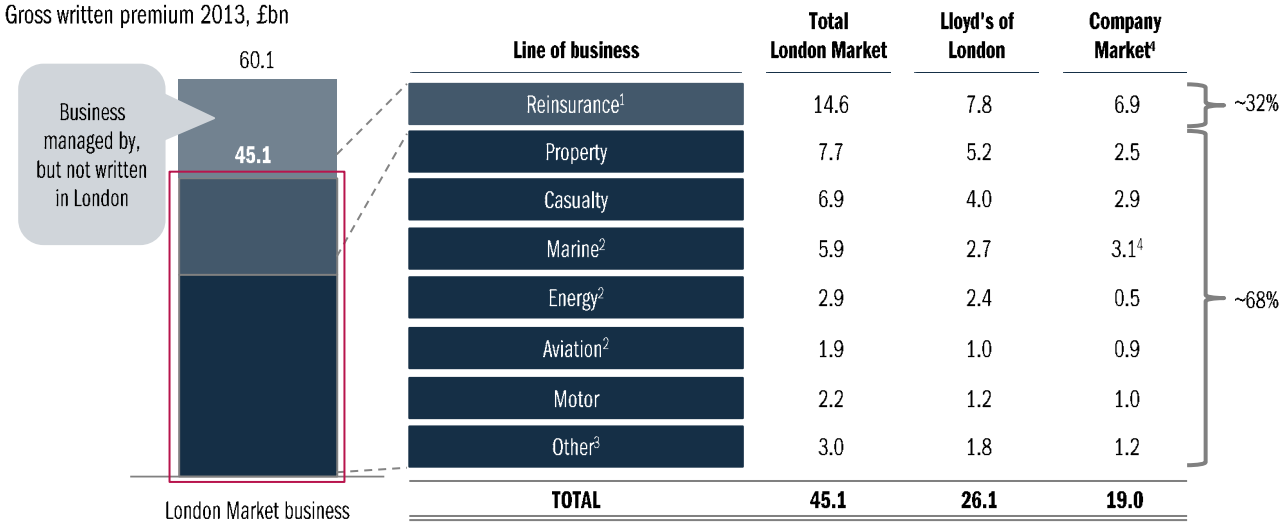
Analysing the Lloyd's premium by physical location of risk (Figure 6), rather than location of the insured, highlights that 42% of Lloyd's business in 2013 covers 'worldwide' risk, a proportion of which has grown since 2010. This mainly includes risk originating in multiple geographies (e.g. a portfolio of factories across different countries) and globally mobile risk such as Marine Cargo and Hull. Please note, we have only assessed Lloyd's data as comparable information for the Companies Market is not available and therefore Lloyd's data serves as a representative sample for the London Market.

Size of the global commercial insurance and reinsurance industry

In 2013 the global commercial insurance market (excluding SME) was estimated at £307bn in gross written premium and the global reinsurance industry at £117bn in gross written premium (Figure 7). The London Market claims a similar share of each, with ~10% of the global commercial insurance market and ~13% of the global reinsurance market respectively in 2013.

Between 2010 and 2013 the global commercial insurance industry grew by 4% and global reinsurance industry grew by 5% annually. The recovery of the global economy and positive economic development in emerging markets were key drivers behind the growth in commercial insurance and reinsurance globally. The reinsurance industry in particular benefited from a lack of specialty underwriting expertise and primary capacity in local emerging market insurers and was able to grow on the back of increasing ceding of premium in these geographies. In addition, despite stable to falling rates in the developed market, the positive rate development in emerging markets driven by the rising cost

Figure 4: London Market gross written premium by line of business

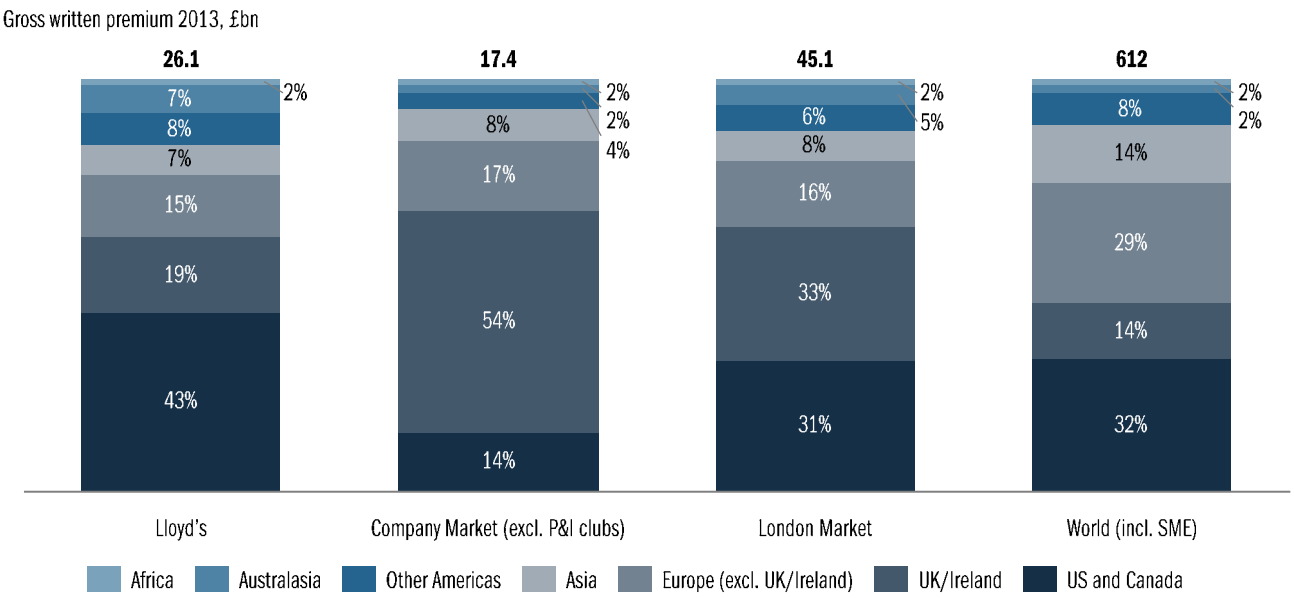


Line of business	Total London Market	Lloyd's of London	Company Market[4]	
Reinsurance[1]	14.6	7.8	6.9	~32%
Property	7.7	5.2	2.5	
Casualty	6.9	4.0	2.9	
Marine[2]	5.9	2.7	3.1[4]	
Energy[2]	2.9	2.4	0.5	~68%
Aviation[2]	1.9	1.0	0.9	
Motor	2.2	1.2	1.0	
Other[3]	3.0	1.8	1.2	
TOTAL	**45.1**	**26.1**	**19.0**	

Figures do not add up due to rounding

1. Includes treaty and facultative reinsurance for all lines of business, except for Marine, Energy and Aviation where only treaty reinsurance included 2.Includes both insurance and facultative reinsurance 3. Accident & health, contingency, surety 4. Includes P&I clubs Source: LMG data request with sample managing agents, Company Market participants and brokers, Source: IUA, Lloyd's of London, BCG analysis

Figure 5: Origin of gross written premium by location of the insured



Source: LMG data request with sample managing agents, Company Market participants and brokers, IUA, Lloyd's of London, BCG analysis

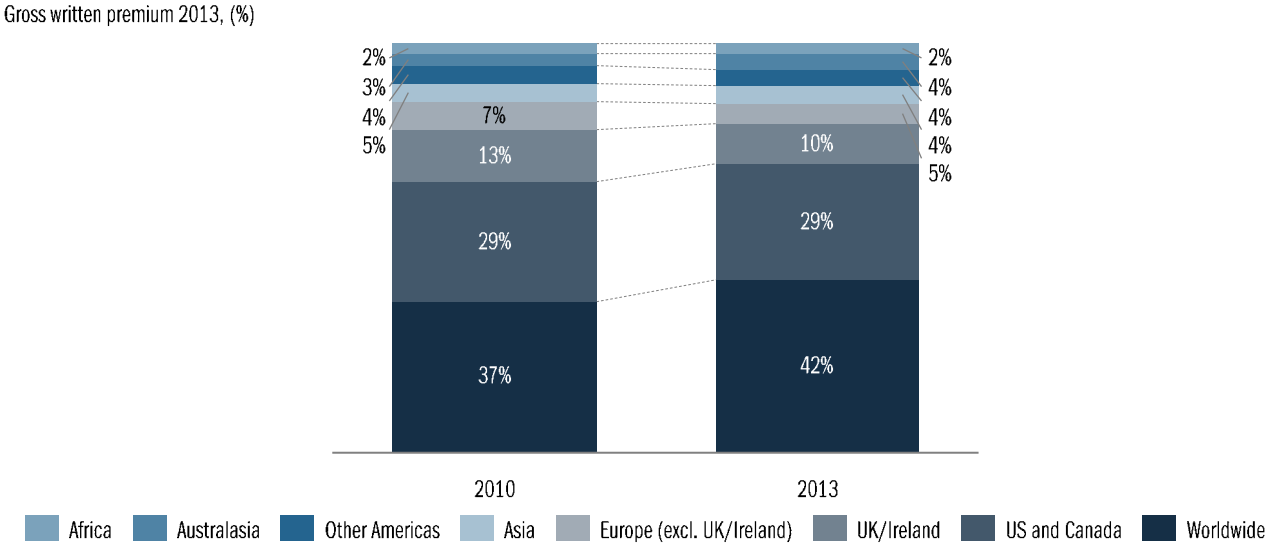
of claims due to natural catastrophes, in particular business interruption events also helped to fuel reinsurance growth.

The UK, including the London Market's global business, accounts for approximately £69.3bn in gross written premium[9]. Bermuda is a leading global hub for reinsurance with an estimated £25bn premium written in 2013, with virtually all premium volume originating outside Bermuda. Zurich and Singapore, other notable insurance centres, also play a role in the global commercial insurance and reinsurance industry, accounting for £19bn and £4bn of total premiums, respectively, in 2013.

In commercial insurance, Europe (incl. UK/ Ireland) has experienced low premium growth (1%) between 2010 and 2013, while North America has grown at 4% emerging markets at 9%. The strong development in emerging market premium is largely driven by GDP growth and increasing commercial insurance penetration.

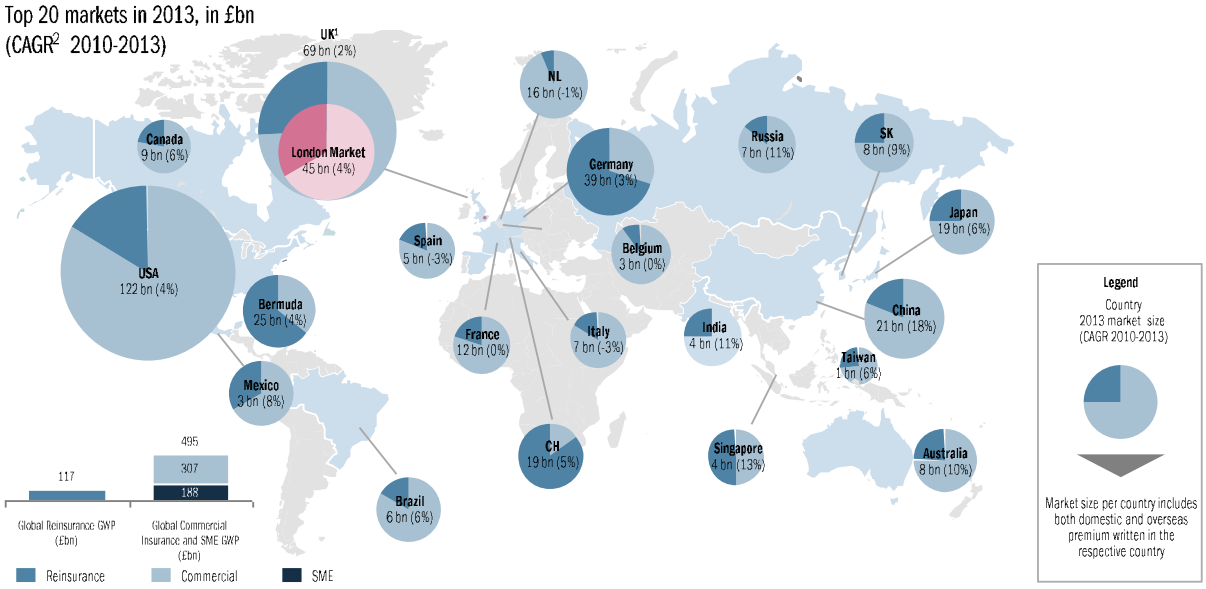
However, Figure 8 shows that the London Market has been growing in the UK, Europe, US and Australasia, with increases in its market share, but was unable to do so in the emerging, markets of Latin America, Asia and Africa. This highlights the London Market's strong distribution and market access capabilities in the US, UK and partly Europe and Australasia, but more importantly it reveals the significant challenges the London Market faces in accessing the emerging high growth markets. With the shift of global risk pools to these emerging markets, the London Market's global leadership in commercial insurance could increasingly become threatened.

Figure 6: Lloyd's gross written premium by location of risk



Source: Lloyd's of London, BCG analysis

Figure 7: Global commercial insurance and reinsurance industry



1. £24.2bn of premium written in the UK (outside Lloyd's and the Company Market), plus £26.1bn premium written at Lloyd's and £19.0bn premium written in the Company Market 2. Compounded annual growth rate; Note: Not all countries displayed, figures do not add up to total industry sizes
Source: Swiss Re Sigma, AXCO, Lloyd's of London, IUA, EIU, IUMI, BCG Insurance Database, BCG analysis

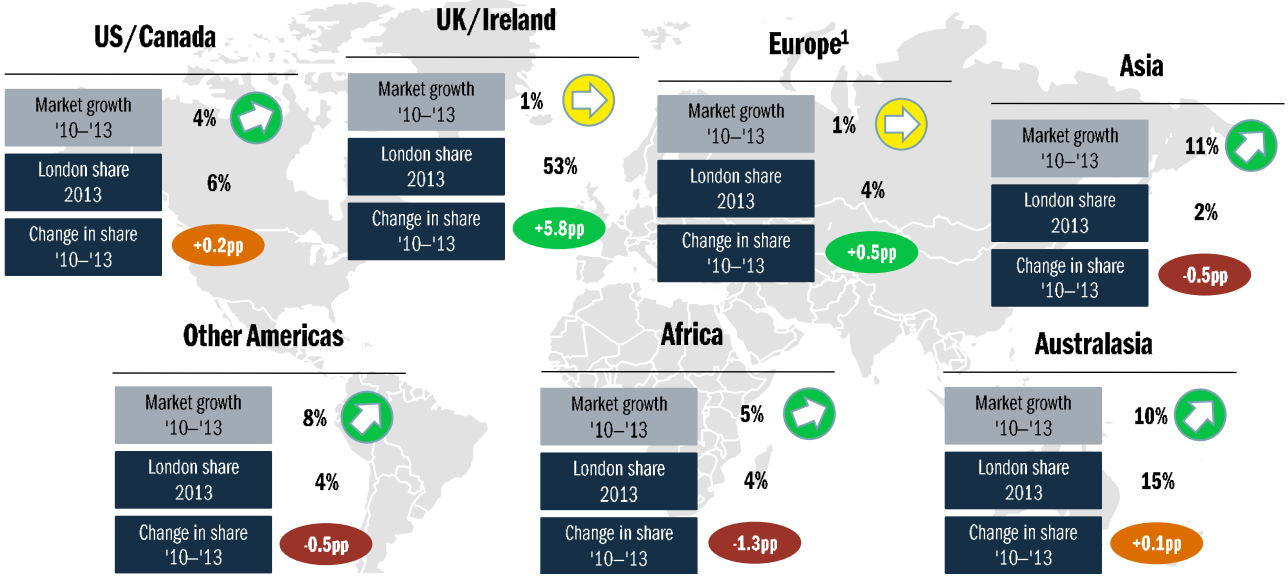
Development of the London Market relative to the global industry

Between 2010 and 2013 the London Market's share of the global commercial industry remained stable at 10% and its share of the global reinsurance industry decreased from 15% to 13%. However, there is variation within individual lines of business (Figure 9). Importantly, one has to bear in mind that these figures represent a snapshot in time and mask long-term trends and continuing challenges for the London Market. The global (re)insurance landscape has been dramatically altered in the last thirty years with the rapid ascent of Bermuda which was virtually nonexistent prior to 1995, the rise of alternative reinsurance such as catastrophe bonds and reinsurance sidecars[10] in the early 2000s and the shift of the largest pockets of growth to Asia, Latin America and Africa. Furthermore, the 2010-2013 data does not yet reflect the more recent challenges arising in 2014. For example in reinsurance, where record reinsurance capital levels have pushed premiums lower than have been seen for a generation. In summary, while these figures might look somewhat positive, they do not fully reflect emerging issues and long-term trends facing the London Market.

Global Commercial Insurance development

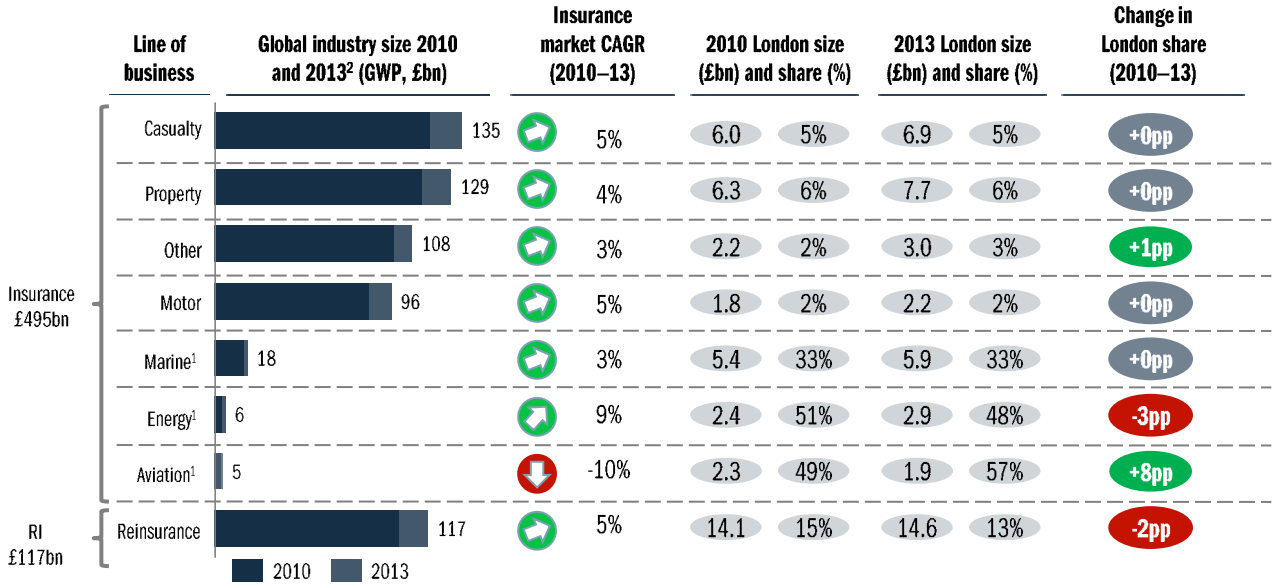
Property and Casualty, the two largest lines of business, have been growing on an industry level at 4% and 5% per annum (2010-13), respectively, driven by GDP growth and inflation. In **Property**, the London Market benefited from being the global specialist for natural catastrophe, terrorism and distressed risk, in particular in the US, and

Figure 8: Development of commercial insurance industry by region



1. Excluding UK/Ireland
Source: Swiss Re Sigma, AXCO, Lloyd's of London, IUMI, EIU, BCG Insurance Database, BCG analysis

Figure 9: Global commercial industry size (incl. SME) and London Market share by line of business



1. Includes insurance and facultative reinsurance 2. Including SME business, light blue boxes represent absolute growth from 2010-13
Note: Unless otherwise stated only insurance counted in line of business, treaty and facultative reinsurance separated under reinsurance
Source: Swiss Re Sigma, AXCO, IUMI, Lloyd's of London, EIU, BCG Insurance Database, IUA, BCG analysis

grew with the overall industry, maintaining its share at 6%. Within property, London has a high share in areas such as mining, but a growing share of business is underwritten locally or in regional hubs.

In **Casualty**, the London Market was not fully able to capitalise on its global reach and underwriting experience, and has only matched industry growth, maintaining a 5% share. The global industry growth is driven by economic development and by increasing penetration of casualty business in emerging markets. The London Market has so far failed to capture its fair share of this emerging market growth. The slow market growth in traditional strongholds of London Market (such as the US and the UK) is reflected in London's growth rate. However, London remains at the forefront of innovation and is actively developing its offer on new types of risk in the casualty space such as cyber risk, nanotechnology and contingent business interruption.

The global **Energy** market has been growing around 9% per annum fuelled by positive development in upstream energy (exploration and production sector) and London has not kept up with market growth since 2010 leading to a decline in share from 51% in 2010 to 48% in 2013. Nevertheless, the London Market and particularly Lloyd's are considered to be the global leader for offshore energy risks with an industry share of 62%[11]. The London Market's expertise in Energy is well established and as the energy industry continues to face large and complex exposures (e.g. Arctic oil exploration, deep-water drilling and fracking) the London Market could be well positioned for growth in these areas.

The global **Marine** insurance sector[12] grew at 3% per annum between 2010 and 2013 and the London Market grew at the same relative rate. Not all Marine segments grew however. While cargo insurance has been growing, driven by an upswing in global trade since 2012, hull insurance continued its trend towards becoming a commoditised product (combined with greater frequency of severe losses globally). Changing trade patterns represent a potential risk to the London Market as Asia continues to gain importance (Figure 10).

The London Market continues to be a leader in Marine insurance with around 33% global industry share. P&I clubs continue to provide the majority share of the world's shipping fleet with insurance cover against legal liabilities to third parties. However, in recent years more local Marine capacity has become available, with several regional hubs emerging close to shipping centres. The global brokers and risk carriers have increased their presence in Rotterdam, Genoa, and other close to harbour locations. Most notably Singapore has established itself as a regional hub for Asian Marine insurance business becoming a clear challenger to the London Market in the region.

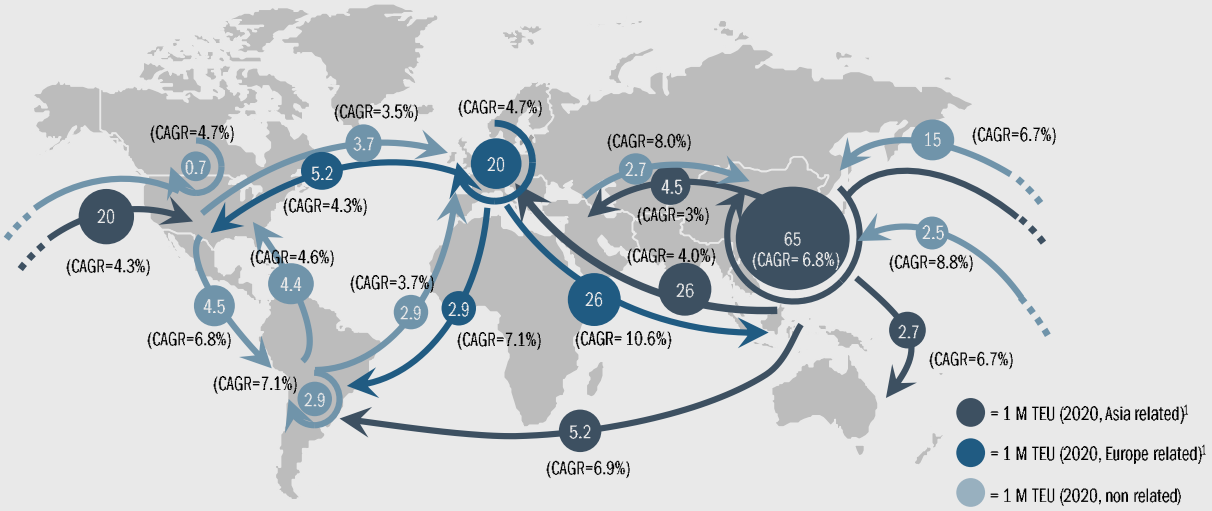
In an overall 'soft' **Aviation** market, the London Market significantly grew its position as the global market place for Aviation insurance (from 49% to 57% market share). This raises interesting questions about London's willingness to write business at lower margins. Nevertheless, with ever increasing air travel across the globe, the Aviation market is expected to return to a solid growth path over the next years. Similar to the Marine market, a significant share of the growth in Aviation, particularly airlines, will be coming from emerging markets and an increasing share of this business will be captured locally or regionally.

Global reinsurance development

The London Market has lost share in the global reinsurance market since 2010, from a 15% share in 2010 to a 13% share in 2013, driven by long-term challenges in the form of competition from overseas hubs, alternative reinsurance capacity and the shift of demand

Example of how the primary sector drives insurance demand: Migration of trade flows to Asia shifts growth pockets for the Marine insurance sector

Figure 10: Global container flows by main trades (2020, in million TEU)



1. Includes exports and intra-regional trade only as these have been identified as drivers of cargo shipments

Note: Twenty-foot equivalent unit (TEU) is unit of cargo capacity based on the volume of a standard 20-foot-long intermodal container. Container flows based on forecasts excluding empties and transshipment but including domestic for intra-regional trade; some trades excluded for display purposes; Turkey and Russia included in Europe; CAGR refers to CAGR 2010–2012

Source: EIU, Eurostat, IHN Global Insights, expert interviews, BCG container flow forecast model

The illustration above shows forecasted global container trade flows in 2020. It outlines how container cargo capacity (in TEU = Twenty-foot equivalents) will be utilized between different regions and within a region. The rapid growth of Asia as a major exporter of goods to Europe and America has shifted trade volumes from Europe and the US to Asia and will continue to do so at an increasing pace. BCG's shipping practice expect >50% of global container flows to be Asia-related by 2020, with intra-Asian flows dominating.

Following the primary market development, Asia will be the largest market for Marine cargo insurance. As cargo is expected to continue to be mostly insured locally, a large share of this business will remain in Asia and is therefore unlikely to reach the London Market. Hence the London Market needs to devise solutions and innovation to gain access to these markets.

to developing economies. Since the beginning of 2014 long-term tectonic shifts in the reinsurance market have gained momentum and have been aggravated by newly arising challenges such as decreasing rates and pressure on terms and conditions. Most notably new capacity, new market entrants, greater retention of reinsurance premiums by large buyers and the increasing tempo of regulatory oversight have contributed to the adverse outlook for the global reinsurance markets. Our interviews highlighted how the reinsurance buying decision is becoming increasingly centralised and how London is not well positioned to meet the needs of centralised reinsurance buyers, who want multi-line, relationship driven deals and often choose to place risk with large global reinsurers who can offer more significant line sizes.

The rapid rise of Bermuda as a global reinsurance hub, with the emergence of four classes of (re)insurers after hurricane events in 1995, has already highlighted the potential for rapid shifts in this market segment. We have also witnessed the increased attractiveness of Zurich as a reinsurance hub, where, based on a lack of Bermudan capacity and attracted by local talent enabling diversification into lines driven by underwriting expertise, 13 Bermudan carriers relocated to or formed major European operations in Zurich. To date more than 30 reinsurers have legal representation and presence along the lake of Zurich.

The supply of reinsurance capacity driven by alternative sources of capital has outgrown demand in recent years to reach more than $44bn in 2013[13]. There are no signs of a rapid reversal of this trend. Competition between traditional capacity providers, such as the London Market, and newer alternative capacity providers is expected to continue. For model-driven property risk, particularly in the US, alternative reinsurance capacity is competing heavily with traditional reinsurers. So far, longer tail casualty risks are less attractive to alternative reinsurers with shorter term investment horizons, but it is unclear how long this trend will persist if the current low interest rate environment remains.

Growth in the reinsurance market is expected to come from Asia, India and Latin America on the back of economic development and increasing demand from local insurers for reinsurance protection. To tap into China, Indonesia and other Asian markets, leading reinsurers are strengthening their presence in the local hubs of Singapore and Hong Kong. In addition, new entrants have been establishing themselves locally in Asia to specifically address Asian reinsurance demand. Miami is still acting as the regional hub through which to access growing demand in Latin America. It remains to be seen whether Brazil, Puerto Rico and other jurisdictions aiming to position themselves as regional hubs will be successful.

4 The importance of the London Market to the UK economy

4 The importance of the London Market to the UK economy

How does the UK benefit from the London Market?

Commercial insurance provides a key underpinning for a market economy. 94 of 100 companies in the FTSE100 index and 100% of the Dow Jones Industrial Average companies are insured within the London Market. Without insurance many public and private investments would be too risky to carry out and companies would be required to carry substantially more capital. Hence only few investments would be made, which would significantly slow down economic development. Commercial insurance plays a fundamental role in supporting and stimulating economic growth through the reallocation of risk. But the London Market provides a more significant role in the UK economy than the provision of risk management products to UK corporates. The London Market, by virtue of its status as a global hub for commercial insurance and reinsurance, attracts jobs and profits to the UK economy, and the assets which back claims paid by the London market insurers are partially invested in UK assets.

We have focused our analysis on four aspects of the London Market's contribution to the UK economy:

1. Employment
2. GDP
3. Investment in UK government debt and corporate debt and equity
4. Payment of claims.

Employment

In 2013, London Market companies employed an estimated 34,000 people (full-time equivalents) in London. We estimate that 21,000 people work in London for London Market risk carriers, Lloyd's managing agents and Lloyd's and that 13,000 people work in London for London Market brokers. In addition, 14,000 people work for London Market companies in the UK, but outside of London.

45% of the London Market's employees are female, which is about the same proportion as the UK average. However, only 3% of executive directors are female compared to 21% at FTSE 100 organizations[14]. Furthermore, around 10% of the London Market employees are non-UK nationals, slightly above the 9.5% of non-UK nationals represented in the overall UK workforce. Meanwhile, 35% of London Market employees graduated from university, which is slightly below the UK average of 38% of the workforce and significantly below the Inner London average of 60%. This highlights the predominance of apprenticeship style learning in the London Market, a model which has favoured training on the job and has been an efficient way to stimulate UK employment without the need for a university education. As the requirement for analytical capability increases in the market, this may however have to change (Figure 11).

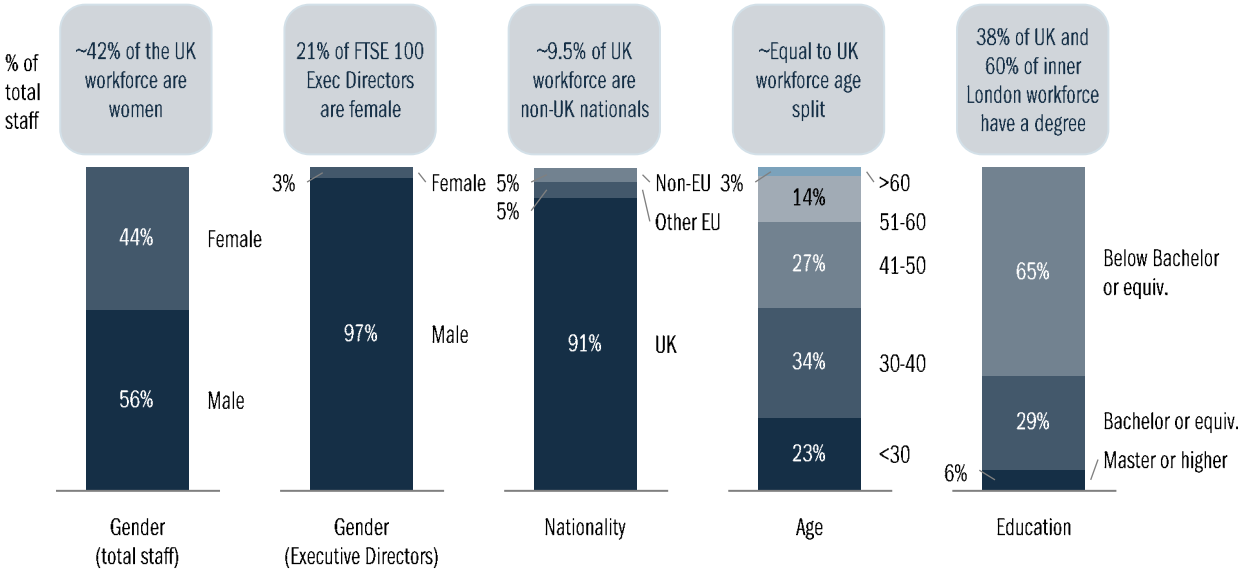
GDP

GDP contribution assessment

To capture the full contribution of the London Market to UK GDP we estimated the direct, indirect and induced GDP contribution of the London Market. The **direct contribution** to GDP measures the value-add of the economic activity of Lloyd's, London Market risk carriers and brokers only.

Beyond the direct contribution, the London Market participants source services and products from other sectors which are required to 'produce' the London Market's economic output. For the London Market this includes most notably ancillary professional services such as claims handling and processing, legal advice, actuarial

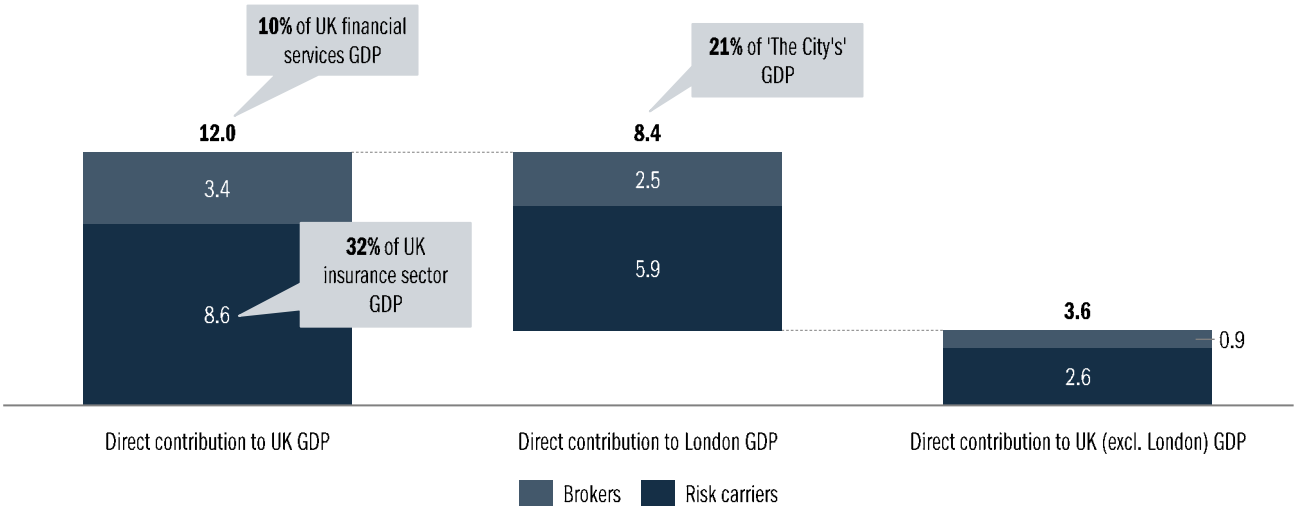
Figure 11: Diversity of London Market workforce



Source: Lloyd's of London, LMG data request with sample managing agents, Company Market participants and brokers, BCG analysis

Figure 12: London Market Direct GDP contribution

2013 economic impact (GDP in £bn)



Source: ONS, TheCityUK, LMG data request with sample managing agents, Company Market participants and brokers, Lloyd's of London, BIBA, BCG analysis

consulting and IT services providers. The London Market's contributions to the local economy via rental payments, facility services and hospitality and retail spend are also counted. All these effects are captured in the **indirect contribution**.

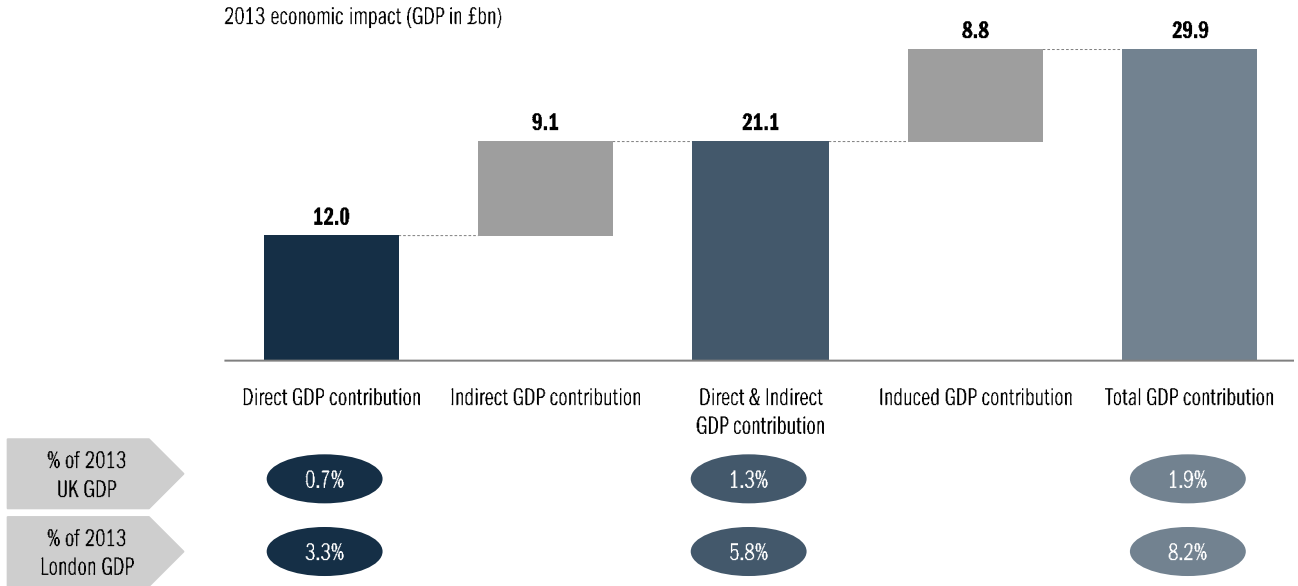
In its widest definition, GDP contribution also includes household consumption by London Market employees. This so-called **induced contribution** captures the effect of increased spending by London Market employees on food, clothing, housing and other consumer goods and services.

In our analysis, the **direct GDP contribution** of the London Market has been assessed based on GDP contribution per employee (for risk carriers) and based on value-add per pound of revenue (for brokers). The **indirect and induced effects** are estimated based on multipliers. These multipliers are an aggregation of all indirect and induced effects of the London Market's economic activity. Details of the methodology used in the GDP estimation can be found in appendix B.

Direct GDP contribution

Using the employment figures presented above and the value add per pound of broker revenue, we estimate that the London Markets' **direct contribution** to UK GDP is £12.0bn in 2013 (Figure 12).

Figure 13: London Market direct, indirect and induced GDP contribution



Source: ONS, TheCityUK, LMG data request with sample managing agents, Company Market participants and brokers, Lloyd's of London, BIBA, BCG analysis

This represents 10% of the total UK financial services sector's direct GDP contribution. The London Market activities in London alone account for an estimated £8.4bn, representing 21% of the direct GDP contribution of 'the City'[15]. While the direct GDP contribution of risk carriers' accounts for 32% of the overall direct GDP contribution of the UK Insurance sector.

Indirect GDP contribution

If we include **indirect benefits**, such as the jobs created in ancillary professional services as well as the London Market's impact on other sectors (real estate, hospitality, services, etc.), we estimate the London Market's contribution to UK GDP rises to £21.1bn, representing ~1.3% of total UK GDP and ~5.8% of London GDP in 2013 (Figure 13).

Induced GDP contribution

Including the effects of household consumption and personal spending by London Market employees on the UK economy, the **induced effect**, the overall GDP contribution of the London Market rises to an estimated £29.9bn in 2013, representing ~1.9% of total UK GDP and ~8.2% of London GDP (Figure 13).

In addition, the London Market is a highly productive sector providing employment to a highly skilled workforce. On average a London Market employee contributes around four times more than the average UK employee to the UK economy (in terms of GDP contribution per employee).

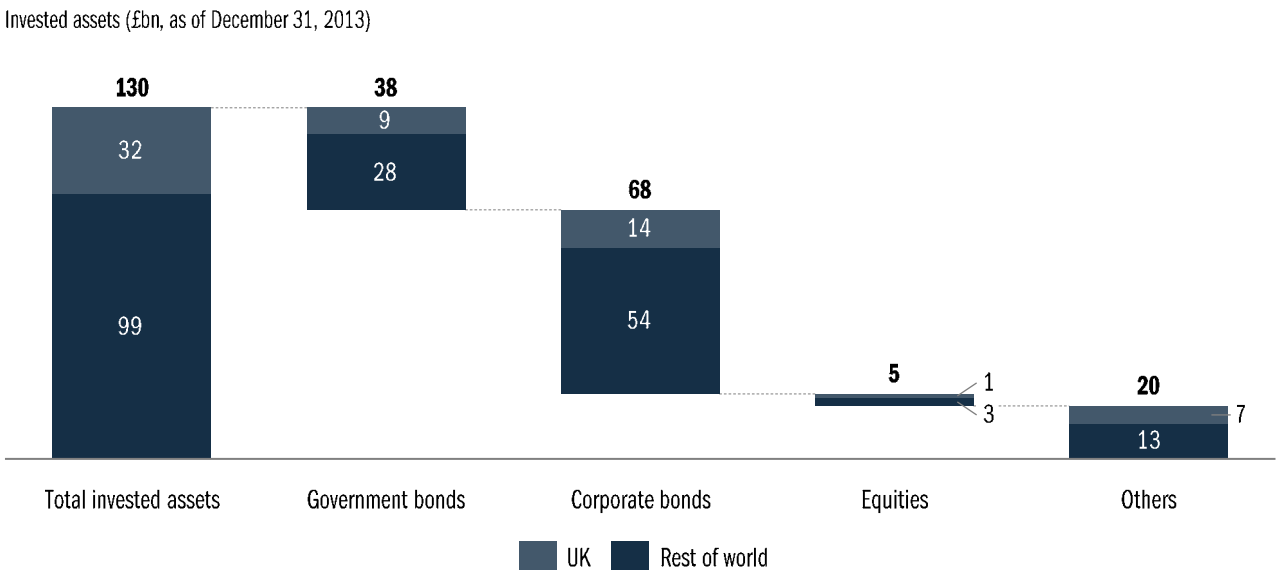
Claims

2013 was a benign year for claims with no major catastrophe losses. Despite this the London Market paid an estimated £23.9bn in claims to its policyholders and cedents. £13.1bn has been paid by Lloyd's syndicates and £10.8bn by the Company Market. While in the five year period from 2009 to 2013, the Market paid more than £140bn in claims in total. These payments, particularly for more specialist risks that would be hard to cover outside of London, underline the role the market plays in supporting the global economy.

Invested Assets

As of December 31, 2013 London Market firms held an estimated £130bn in invested assets. Over £32bn has been invested in the UK, £9bn of which in UK government and £15bn in UK corporate debt and equity (Figure 14).

Figure 14: Invested assets by asset class



Source: ONS, TheCityUK, LMG data request with sample managing agents, Company Market participants and brokers, Lloyd's of London, BIBA, BCG analysis

5 The sources of London's historic competitive advantage

5 The sources of London's historic competitive advantage

In order to understand how the London Market should evolve to protect and improve its competitive position, a more detailed understanding of what drove its historical attractiveness is required. We interviewed 50 of the top executives in the London Market in order to develop a view of what the market thinks of itself, addressing two main questions:

1. What are the key strengths of the London Market?
2. What drove the historical attractiveness of London to market participants?

What did London Market participants think are the key strengths of the market?

Whilst the views of our interviewees were varied, their assessment of London's historic strengths can be grouped into six highly interconnected themes which in combination founded London's historic position as the leading global insurance hub:

Ability to underwrite the largest and most complex specialist risk. London has a history of being the world's leading specialty lines insurance market, where the more difficult, unusual and high severity/ low frequency risks are written. For these lines of business, such as Marine or Aviation, underwriting needs are highly specialised, substantial capital is required and pooling of the risk from around the globe provides diversification. London has historically been seen as the 'natural home' for this business, given its ability to meet these needs and the existence of trading rights allowing it to write the business.

Symbiotic relationship between London brokers and London underwriters. In the past, the London Market was the only market with the appetite to write more complex and large risks. As such, London underwriters historically relied upon London brokers to bring them global business while the brokers were dependent on London underwriters to place the risk, a unique symbiotic relationship. In recent times there has been an increase in the willingness of alternative centres to write these complex risks, coupled with globalisation and consolidation of both brokers and carriers in the London Market. However, London is still a predominantly broker-led market and this relationship will continue to be central to the market's ongoing success.

Unique concentration of market participants. The square mile of the City of London contains the highest concentration of specialty insurance market participants in the world. It makes interaction efficient, generates trust and enables rapid decisions on new and complex pieces of business. While the predominance of face-to-face interaction may be shifting, this concentration of market participants will remain important in the new future.

Global market for excess and surplus capacity from around the world. In instances where locally licensed insurers will not accept a risk because it does not meet local criteria, usually because it is too big, too unusual or too volatile, London has historically had a reputation for providing cover. The pooling of fresh capacity across the market in London acts as a buffer in these instances, a role which is supported by London's position as a wholesale market with strong relationships with its brokers. As an example, a substantial amount of London business (>15% in 2012) is drawn from the US excess and surplus lines market – where London and Lloyd's are the largest non-US writers.

Risk transfer pioneer. The London Market has a reputation for being at the centre of global risk transfer innovation. London Market participants have historically embraced insuring new risks and have been pioneers for new product development. Beyond entirely new risks, London is also an innovator when it comes to being flexible in its approach to policy wording, particularly for more bespoke policies.

Strong capital base able to ride out soft market conditions and large claims. London has a reputation of being a stable, well capitalised market with excellent oversight and ratings. In challenging market conditions, London believes it still has the ability to write profitable business, whilst at the same time paying out claims in a timely and efficient manner. Even after very large losses, London Market participants believe they are more willing to devise cover than their competitors.

What did London Market participants think drove this historical attractiveness?

London's strengths were perceived by our interviewees to be underpinned by a combination of interconnected factors (Figure 15), which were historically unique to London, but may now be under increasing threat from international hubs.

Figure 15: Key factors underpinning London's historic strengths

Underwriting	Underwriting expertise	Concentration of deep, experience based expertise enabling choice of UW
	Innovation/Flexibility	Able to respond quickly & flexibly to new/emerging risks and placement needs
	Breadth of product	Access to a wide range of (re)insurance for global, specialist risk
Distribution	Expert broker network	Expert, local brokers act as a marketing and distribution network for underwriters
	Market access/Licenses	Access to 200+ markets via Lloyd's licensing, coverholders and underwriting offices
Security and Ratings	Capital advantages	Amount, security, flexibility and gearing of "smart" capital available in the market
	Subscription market	Worlds largest subscription market, offering flexibility, choice and diversification
	Claims payment	Reputation for paying all valid claims in a timely and efficient manner
	Regulation & oversight	Proportionate but robust market regulation and oversight: PRA, FCA, Lloyd's
Ecosystem	Central services	Centralised infrastructure estate to enable placement, accounting and settlement
	Network effects	Strong and deep F2F relationships between UW, brokers, (re)insurers & customer
	Professional services	Established local accountants, lawyers, IT outsourcers, claims handlers etc.
	Advantages of London	Stable government, proven legal system, timezone, cultural diversity, schools etc.

6 Trends in placement of insurance risk and the implications for London

6 Trends in placement of insurance risk and the implications for London

We consulted nearly 300 market participants from around the globe and across the distribution chain in order to understand how global insurance trends may be impacting placement decisions and how this may affect London's competitive position. What follows are trends in the placement of insurance risks which have specific implications for the London Market's competitive position.

6.1 Trends in underwriting

Customer preference for local placement of risk and underwriting expertise becoming increasingly globalised

In the past decade, there has been an increasing trend for commercial specialty carriers to open offices around the globe. This push has been in response to end customers' preference for placing business in their local markets, if they can access similar levels of underwriting expertise and capacity to those available in global hubs. Our interviews consistently demonstrated that end customers appreciate local service and local market knowledge.

"Typically, people in the region understand my specific risk and my company better, so assuming they have the required underwriting expertise, authority and capacity I am very happy to place business with them. Only when I can't do that would I go to a global hub" **Latin American Risk Manager**

"For local risks, such as local property catastrophe, the local market provides better terms and conditions and I prefer to deal with someone in region" **Asian Risk Manager**

The future of global insurance hubs is heavily dependent on the degree to which underwriting expertise and authority has a natural home in local markets. Interviews with key stakeholders at global carriers made clear the complex balance that providers seek to strike between meeting local needs and developing global expertise.

"As markets mature, more business is retained within the local geography and we just do not see it if we sit writing business in a global hub, therefore the mindset for us is to be as global as possible, and as local as necessary" **Chief Operating Officer, Global Insurer**

"We place underwriters wherever the global flows of business are, we originated in London and so our natural inclination is to hold underwriting expertise and authority there, until we see a reduction in flows and we need to rethink our strategy." **Chief Operating Officer, London Market, Lloyd's Managing Agent**

"Writing business in regions is a relatively recent development for us. We set up Singapore in 2007 as business was not reaching us here in London. This is in stark contrast to 10 or 15 years ago when business would have come to us in London" **Head of Underwriting Management, Lloyd's Managing Agent**

"The notion that there is a certain type of underwriter or skill which only exists in London is a bit naive, it has more to do with clients and brokers and where they want to place the business" **Deputy Chief Executive, Global Insurer**

Carriers have divergent strategies for the placement of their underwriting expertise, driven by a constantly evolving assessment of what business flows they are or are not seeing, and a trade-off between serving clients locally and developing underwriting expertise. There are, however, common characteristics of business which our research indicates are more likely to be written in a global hub:

- More complex risks which require specialist broking and underwriting expertise
- Higher severity, lower frequency risks which do not require the same level of local service
- Large risks which require significant capacity, often at short notice, where subscription is most relevant

BCG & LMG (Re)Insurance Customer Survey 2014: Key criteria for the placement of risk

Our survey covered 157 insurance professionals involved in the placement of risk, in different geographic regions. Survey respondents were asked a series of questions about the drivers of their placement decisions.

Figure 16: Relative importance of factors driving placement decisions

"When thinking about the (re)insurance 'hubs' that you most frequently use, please rank the following factors in order of importance"

	Risk Managers	Brokers	MGAs	Reinsurance Buyers	Overall
Financial security, e.g ratings	#1	#5	#1	#1	#1
Price	#4	#1	#6	#2	#2
Scope of cover and flexibility of policy wording	#5	#2	#3	#6	#3
Product/risk expertise	#3	#3	#4	#4	#4
Long-term relationship with carrier	#6	#6	#2	#3	#5
Ability and willingness to pay claims	#2	#4	#7	#5	#6
Speed and efficiency of claims payment	#7	#7	#8	#10	#7
Market brand and reputation	#9	#10	#5	#9	#8
Speed of placement/endorsement agreement	#10	#8	#9	#11	#9
Ability to generate capacity quickly	#11	#9	#10	#8	#10
Ease of access to the market (Proximity/Culture)	#8	#11	#11	#7	#11

Top 3 Middle 4 - 8 Bottom 3

Source: BCG & LMG Commercial (Re)Insurance buyer behaviour survey, BCG analysis n=157

Figure 16, asked customers across the distribution chain to rank the factors driving their placement decisions

- The factors driving placement decisions are broadly consistent across the distribution chain
- Overall, financial security, price and scope and flexibility of cover are the three most important factors
- Brokers rank financial security lower than any other groups
- Risk managers rank the ability and willingness to pay claims higher than any other group

Figure 17: Top three factors when placing business, by line of business

"What are the three most important factors for your placement by line of business?"

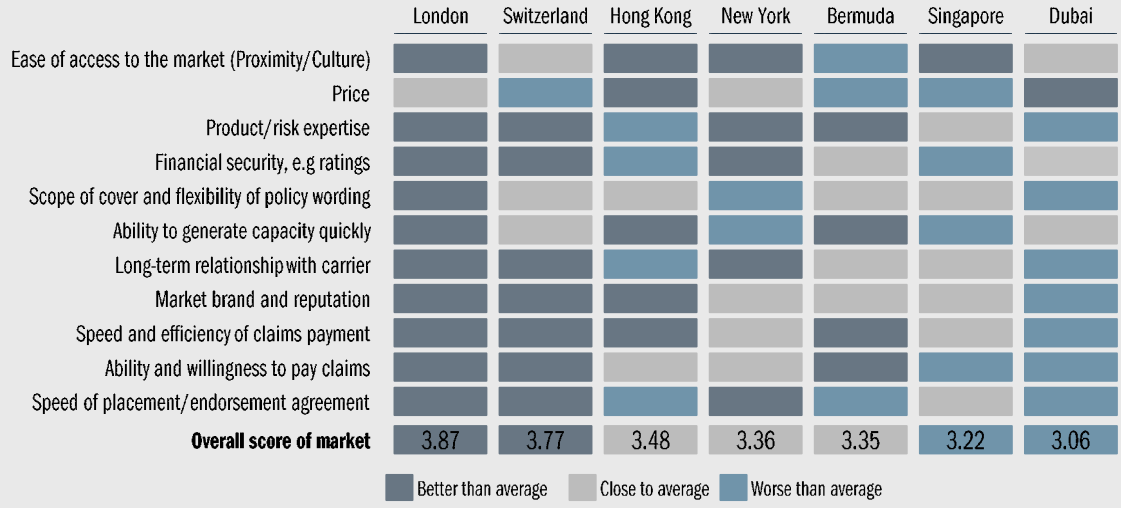
	1st rank	2nd rank	3rd rank
Motor (Direct/Facultative)	Price	Scope of cover and flexibility of policy wording	Speed and efficiency of claims payment
Property (Direct/Facultative)	Price	Scope of cover and flexibility of policy wording	Ability and willingness to pay claims
Treaty RI (All lines)	Price	Ability and willingness to pay claims	Financial security
Other (Direct/Facultative)	Product/ Risk expertise	Financial security	Scope of cover and flexibility of policy wording
Marine (Direct/Facultative)	Product/ Risk expertise	Scope of cover and flexibility of policy wording	Price
Energy (Direct/Facultative)	Financial Security	Price	Scope of cover and flexibility of policy wording
Aviation (Direct/Facultative)	Financial Security	Price	Ability and willingness to pay claims
Casualty (Direct/Facultative)	Scope of cover and flexibility of policy wording	Price	Product/Risk expertise

Source: BCG & LMG Commercial (Re)Insurance buyer behaviour survey, BCG analysis n=157

Figure 17, describes the top 3 most important factors by line of business:

- For the least complex lines, motor, property, and treaty reinsurance, price consistently ranks first
- For the more specialist lines such as marine, energy, and aviation price ranks second or lower.
- For more specialist lines, product and risk expertise is ranked amongst the top three factors
- For lines with high exposure, e.g. aviation, ability and willingness to pay claims becomes more critical

Figure 18: Comparative performance of insurance locations, by line of business



Note: Overall scores ranked from 5 to 1 where excellent = 5, very good = 4, good = 3, fair = 2, and poor = 1

Source: BCG & LMG Commercial (Re)Insurance buyer behaviour survey, BCG analysis n=157

Figure 18, shows the relative ranking of markets for each of the factors driving placement decisions. In order to account for sample bias, we have re-weighted results based on number of respondents by region.

- Overall, London ranks first followed by Switzerland and New York, consistently outperforming for example in financial security, product expertise, and flexibility of policy wording
- Emerging insurance locations such as Dubai or Hong Kong perform better on price than the more established markets in London or Switzerland
- The rankings confirm that London leads the group in the areas expected: security, expertise, flexibility

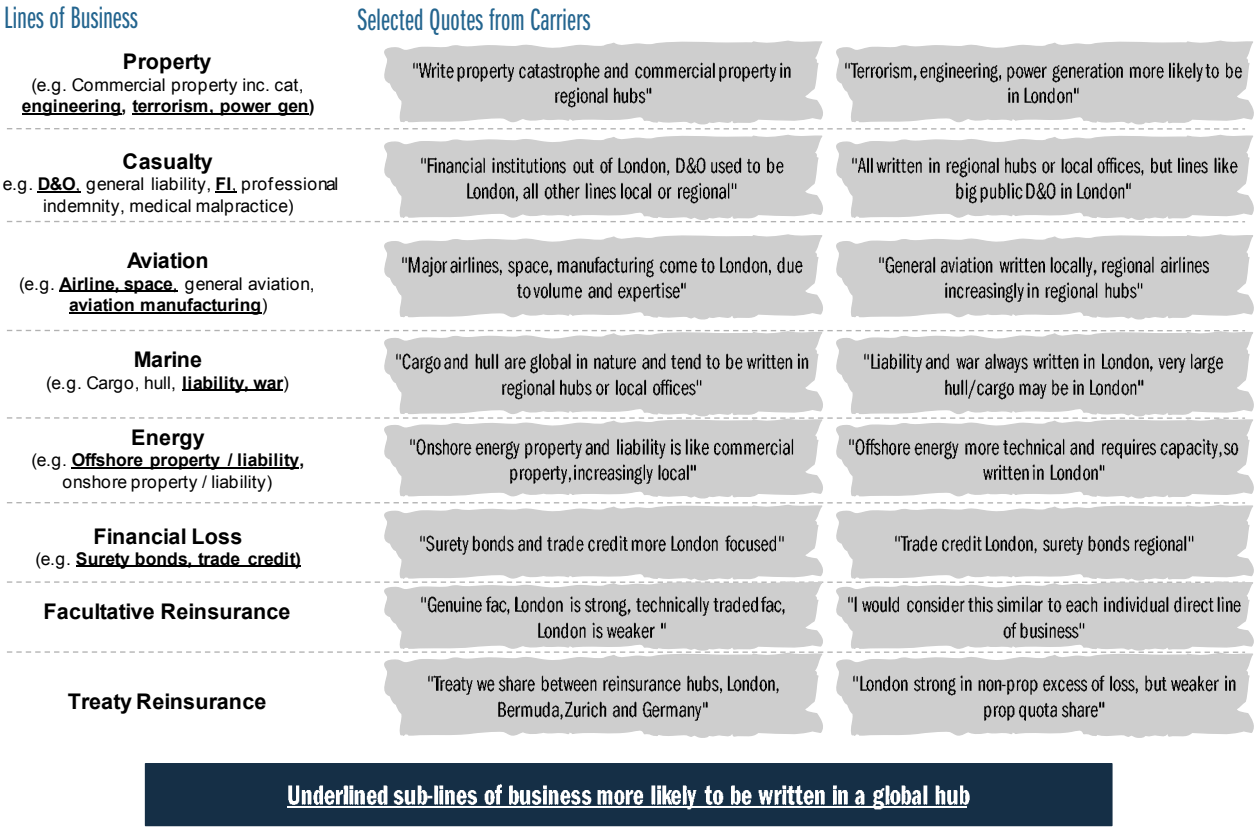
- Excess layers of programmes, which rely on local players to provide primary capacity and service
- Distressed risks where the loss histories are poor and for which the local market has no appetite
- "Niche" risks where pooling across the globe is required to generate enough flow to build expertise

Building on these characteristics, our stakeholders identified lines of business which are more or less likely to be written within a global hub, such as London, in the future (Figure 19).

IMPLICATIONS FOR LONDON

- We estimate that £13–18bn (30–40%)[16] of London Market premiums are in lines of business which are increasingly likely to be written in local or regional hubs, and which London will have to compete hard with local markets on price and service to retain
- London is well positioned as unambiguously the leading global market for certain specialist risks which meet the characteristics defined above, in lines of business such as offshore energy, airlines, terrorism, engineering and marine liability

Figure 19: Lines of business which are more and less likely to be written in a global hub



Source: BCG analysis, interviews with sample carriers and customers, Lloyd's of London, IUA

Analytical underwriting gaining share of commercial business

Advanced analytics have the potential to reshape the commercial underwriting process. Carriers already heavily leverage advanced analytics to inform underwriting decisions within larger, complex commercial classes such as property catastrophe. For more 'specialist' lines of business the use of advanced analytics are less common today, but there are leading players for whom they are core to their underwriting process.

"On our US D&O book we have a pricing tool which sits in the hands of our underwriters and feeds them both internal (claims history) and external (company fundamentals) data. The underwriter can then flex various factors in the model based on their assessment of more qualitative elements such as quality of management and regulatory environment to adjust the price based on their experience"
Lead Casualty Underwriter, Lloyd's Managing Agent

"For political risk and terrorism policies, we have begun to leverage external data sources to generate country ratings which are fed to our underwriters to aid in pricing decisions"
Chief Underwriting Officer, Global Insurer

"Even on our high end airline and airline manufacturing policies we use a series of models leveraging both internal and external data to assist our underwriters with pricing decisions. This has been particularly useful to help our selection of risk in the soft market over the past three years"
Lead Aviation Underwriter, Lloyd's Managing Agent

"For all lines of specialty business we are increasingly marrying analytics with underwriting expertise. Ten years ago we had two to three actuaries, now we have over 100 as well as a team of data analysts doing independent research for us"
Chief Operating Officer, Global Insurer

Importantly, for these larger, more complex risks the goal is to combine analytical underwriting tools with the experience of the underwriter, not to replace the underwriter altogether. Additionally, there will clearly always be risks which are not amenable to analytical techniques alone and for which judgment will remain key.

"A model price is increasingly used by underwriters to ascertain if the market price is within our risk appetite, enabling better selection of risk and improved margins, but it does not replace the requirement for underwriting expertise"
Chief Information Officer, Specialty Insurer

"On the top layers of business in lines such as E&O and D&O for large public companies, I still don't understand how people could ever use analytics to improve pricing decisions"
Chief Underwriting Officer, Global Insurer

As insurers continue to build capability, the use of analytics is extending beyond just risk pricing to focus on operational efficiency and claims handling. For example, data based quote triaging can increase submission handling, especially in high volume lines of business such as marine cargo, while outlier detection on workers compensation can reduce the cost of claims.

The trend for increased use of analytical techniques will continue across lines of business, but, particularly for more specialist risks, it is likely that leading underwriters will increasingly seek to gain advantage from their ability to combine these techniques with judgment. As they do so, with customers increasingly expecting analytical services, there is a real opportunity to provide added value to customers too.

"We expect our brokers and carriers to offer analytical services, actuarial models, and risk mitigation advice off the back of those models in addition to the simple pricing and underwriting of risk"

European Risk Manager

"As I focus more on managing risk, I need increased analytics, knowledge and tools from my insurers and brokers"

US Risk Manager

IMPLICATIONS FOR LONDON

- London's existing expertise base means it is well placed to combine its traditional strengths in judgemental underwriting with more analytically based techniques
- The availability of the historical data required to inform models should advantage London
- The key barrier will be recognition, by senior managers, that skills and capabilities that have made the market successful in the past will not be the only skills needed to be successful in the future
- Offering analytical capability will add value for the customer and help to differentiate London's offering away from pure price competition on more commoditised lines

New product innovation not keeping up with demand

An increasing number of risks which are high on risk managers' risk registers do not have suitable insurance solutions.

"The proportion of the corporate risk map covered by insurance has shrunk to perhaps as little as 10%"

Chief Executive, Risk Management Association

At the heart of the challenge is the fact that a large proportion of the risks faced by companies today are intangible and often linked to soft assets like brand and reputation. For example, cyber, supply chain and reputational risk. These risks are hard to measure and quantify both in terms of severity and likelihood, which, coupled with the strong regulatory and commercial imperative only to accept risks that can be reliably quantified, creates a conundrum for insurers and their customers. The global insurance industry has recently made efforts to provide products for some of these risks, but the take up has been relatively low. This is partly because customers' needs are evolving rapidly, meaning insurers constantly have to play catch up, and partly because in an effort to limit the downside represented by a hard to quantify risk, many policies are too inflexible and have too many exclusions and limits.

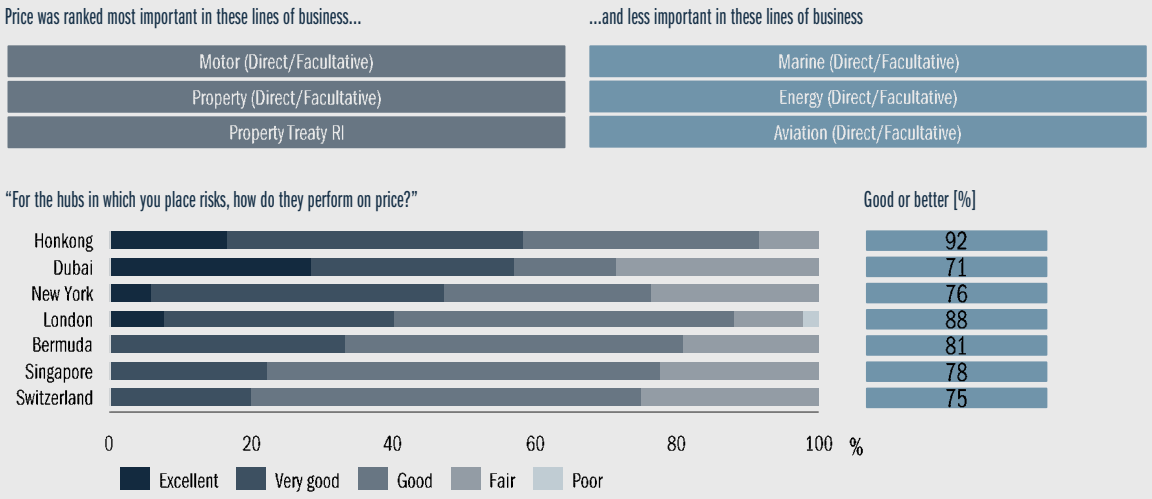
Price and the placement of commercial specialty insurance and reinsurance

Price is an important determinant for placement decisions. Overall our respondents ranked it as the **second most important factor when choosing a market to place their risks**. When asked whether in three to five years from now, "... price will be the major determinant of location of placement for specialty risk", 60% agree while only 14% percent disagree. On the other hand, when asked whether in the same timeframe "... London will have a price advantage in many specialty commercial lines", only 32% agree and now 25% of respondents disagree.

Figure 20, illustrates differences in the degree of importance of price for different lines of business. For those lines traditionally thought of as specialist lines (Energy, Aviation and Marine) price was rated as being of lower importance, versus those lines which are becoming more commoditised (Motor and Property).

Finally, we assessed how well different markets perform on price overall (bottom of figure 20). The vast majority of respondents believed the hubs that they placed risks in are good or better on price. This supports the notion that price is a crucial factor for placement decisions and highlights how only markets which are price competitive capture flows.

Figure 20: Importance of price by line of business and performance of hubs on price



"Insurers need to stop thinking in products and start thinking in individual solutions for each client's needs. This is particularly true for new and emerging risks such as cyber, supply chain and reputational risk, where I need help to understand the risk and want to know exactly what I am covered for" **European Risk Manager**

Providing solutions for these risks represents a significant opportunity for global carriers and the insurance hubs in which they operate. For example, in cyber the recent high profile cases in the US of hackers seizing sensitive customer data from companies has raised the profile of this risk. The US cyber insurance market was estimated to be worth $1bn in GWP in 2013 and could reach as much as $2bn this year, while the European market, worth $150m in GWP in 2013, is growing by 50—100% annually.[17]

Key to developing these solutions will be a partnership approach between risk managers, brokers, and carriers, combined with the need to develop expertise in the underlying risks.

"You can't handle a significant liability claim in the pharmaceutical industry without access to information and sharing of data between the carrier, the broker, and the client" **Head of Exposure Management and Reinsurance, Lloyd's Managing Agent**

"Supply chain is a great example, it is not just about legal risk and insurance, you have to design special coverage and manage the potential exposures of supply chains, which can lead to systemic issues and significant losses. You need a team of experts doing nothing but this and this is what we have created" **Chief Executive, Global Carrier**

IMPLICATIONS FOR LONDON

- London's strong reputation for innovation and flexibility with customers positions it well to address this opportunity

"There is a real opportunity for London to leverage its reputation for innovation and flexibility to deliver some of the products that we all want, cyber, supply chain, reputational risk... the list goes on" **US Risk Manager**

A number of structural advantages of the London Market position it well for innovation:

- Subscription market allows diversification of new risk exposure
- Physical concentration of insurance expertise
- Historical willingness to underwrite "risky" business amongst capital providers

"London's role in the commercial specialty market is contingent upon innovation and flexibility; it is advantaged when there are products which no one else can offer" **European Risk Manager**

Importance of price in decision for placement of specialty risk

Throughout our interviews, price was consistently identified as a key driver of location of placement, both with end customers and the brokers that serve them. In our customer survey, price was ranked as the overall 2nd most important factor in placement decisions with only financial stability ranking more highly. However, most risk managers, particularly those in developed commercial insurance markets, assess price relative to other factors.

"For me, the price I have to pay is traded-off against flexibility, breadth of coverage, and the ability and willingness to pay claims" **UK Risk Manager**

"More than absolute price levels, I care about price volatility. I am willing to pay a 5% higher price to know that it is not going to be hiked at renewal. It is volatility and not the absolute price that breaks my budget" **US Risk Manager**

Based on our interviews and the survey (Figure 20), the degree of importance of price for commercial and specialty risk varies across three key dimensions:

- Region – LATAM, Asia and also Europe are typically more focused on price than the US and UK
- Line of business – more specialist lines such as Aviation, Energy and Marine are less price sensitive
- Experience of risk manager – the more experienced, the less price sensitive

"Many of the local risk managers still need to raise their expertise levels. For them, price is all that matters, but the more experienced risk managers know they need to care about more than just price" **Latin American Risk Manager**

"I always have to fight hard to get companies to consider anything other than price in their placement decisions" **Asian Consultant Risk Manager**

Of course, the importance of price is also highly dependent on the market cycle and the availability of capital for a given line of business, such that in a soft market when there is a lot of available capacity, price is more important. Given the current soft market cycle and the superabundance of available capital, it is of no surprise that there was general consensus amongst our interviewees that price has become more important as competition for commercial specialty business has increased.

"In the current soft market cycle, where I ultimately have a lot of choice on where I place my risk and where I raise capacity, I am probably more price sensitive than I would normally be" **US Risk Manager**

"The extended soft market and increasing competition for my risk places increased focus on price as a differentiator" **European Risk Manager**

IMPLICATIONS FOR LONDON

- London's expense ratio was, on average, 9 percentage points (p.p.) higher versus a non-London peer group in 2013. This was driven by higher acquisition expenses, which were, on average, 13 p.p. higher over the same period[17]
- Acquisition expenses include costs for marketing to and acquiring customers and are at least partly driven by the more complex lines of business which London focuses on. There are also a larger number of processing tasks which fall to brokers in London than with non-London market carriers
- Nevertheless, London will need to work hard to ensure this does not become a price disadvantage

  "There are extra brokers in the chain back to London creating additional acquisition costs, putting London at a possible price disadvantage" **Asian Risk Manager**
- Higher expenses may be off-set by the London Market's expertise, which enable it to price more keenly for certain risks as well as the concentration of market participants and the subscription nature of the market which put downward pressure on prices

  "Due to its subscription nature, London is often keenly priced, however, I sometimes simply use London as a barometer of market price for my risk and then I know what my local carriers have to beat" **European Risk Manager**

  "London is not the cheapest, but offers a good balance between flexibility, breadth of coverage and price" **UK Risk Manager**
- Efforts to improve the London Market's price competitiveness will be increasingly important for London to maintain its position, particularly in more commoditised lines

6.2 Trends in broking and distribution

Globalising broker offices and branch networks for insurers

Brokers' strong relationships with their customers are essential to their continued success, and lead to a desire to be close to their customers. This has in turn driven them to open (or acquire) local offices in markets around the world. As the broking market consolidates and globalises, brokers are increasingly impartial as to the location of placement.

"I have been with my broker for 10+ years, of course they need to have a strong market presence, industry understanding and expertise base, but more than anything it is important they have an in depth knowledge of my business. The only way to get that is through a strong, long term, bilateral relationship and commitment" **UK Risk Manager**

"My placements are increasingly agnostic to specific geographies or markets, my job is to simply place business in the markets and with the carriers who give the best overall offering for my customer based on their needs" **Broker, Asia**

This is propagated by the availability of local commercial (re)insurance expertise and capacity, driven by the globalisation of commercial insurance carriers and development of "local" insurance capability (Figure 21). In the beginning, many of these new offices were viewed as "representative offices", a face in the market that allowed them to access business which was ultimately underwritten back on the company headquarters' paper. However, the degree of underwriting authority bestowed on these offices is increasing.

"When we first opened our Dubai office, it was as a producing office only and most of the underwriting decisions would be made in London. However, over time the underwriting authority in the office has increased, this is because customers want underwriting decisions to be made quickly" **Chief Operations Officer, Lloyd's Managing Agent**

A dynamic whereby local broker and insurance offices get first access to the business is still common. As a result of these allocation processes, customers have relatively little insight into where precisely the business is written and so the notion of a specific market is declining. They are typically selecting a broker and a carrier, rather than a location per se.

Figure 21: Growth in the number of worldwide offices for a sample of brokers and carriers

	HISCOX	CATLIN Underwriting Ambition	ATRIUM	Amlin	Miller	Willis
# Offices (worldwide) 2014	31	56	4	17	9	>400
# Offices (worldwide) 2000	9	4	1	6	1	>300

Note: Growth in office numbers also driven by significant M&A activity over the time period
Source: Named companies data request, BCG analysis

"It's actually quite difficult to understand exactly where the business is written within a carrier, I may deal with someone in region, but the underwriting decision is made centrally and then who knows exactly what paper they write it on" **Latin American, Risk Manager**

"The biggest change in my buying behaviour is the fact that where I geographically place my business is less important, I select the best carriers, not the best markets per se" **US Risk Manager**

As a result, placement decisions are clearly influenced, not only by customers, but by the brokers and carriers that serve them. While these market participants are now focusing even more on securing the best deal for their customers than in the past, our interviews also uncovered that internal barriers to placement of risk outside of the local market still exist.

"I see the internal barriers to placement with our brokers, we don't care where it is placed as long as it is the best proposition, but it seems to be in the best interest of our local brokers to place business in the local market" **European Risk Manager**

"I expect the best brokers to know not only who the right carrier for the risk is, but also which one of the carriers' offices will give me the best price, they are constantly arbitraging themselves" **Asian Risk Manager**

Maintaining an attractive environment for brokers and carriers will become increasingly important in order to be competitive. They will have to market their value proposition to carriers and brokers in order to incentivise the removal of barriers to placement. Factors which affect this include, but are not limited to; tax landscape, regulatory environment, cost and ease of doing business and availability of talent and expertise.

IMPLICATIONS FOR LONDON

- London will increasingly not be able to rely on brokers' and carriers' habits or loyalty in making placement decisions
- London will need to develop a clearer proposition around the lines of business that London is most competitive for and communicate it to brokers and carriers

Emergence of and access to High Growth Markets

High GDP growth in economies such as China, India and Brazil leads to increased demand for commercial insurance. As an example, Oxford Economics and PwC estimate that by 2025, the Asia-Pacific market will undertake approximately 60% of global infrastructure spending, mainly driven by China. During the same timeframe, Western Europe's share will fall to less than 10%.[19] Together with the likely increase in currently low levels of (re)insurance penetration it means "high growth markets" will be responsible for a rapidly growing share of global commercial insurance and reinsurance premiums in the future.

Although, many of these high growth markets have low levels of insurance penetration, a number of their governments have established licence structures designed to encourage the development of local insurance markets (Figure 22). Whether an insurance hub can gain distribution in a high growth market is therefore largely dependent on the hub's ability to work within any regulatory limits to international participation in the market.

"It is not simply a preference for local markets, but a government policy. I couldn't even place my program in London even if I wanted to" **Asian Risk Manager**

IMPLICATIONS FOR LONDON

- Gaining better access to higher growth markets will be key if the London Market is to maintain its share of the global specialty commercial insurance industry
- As insurance penetration for commercial and specialty business in these regions grows, London should be well placed to meet demand for this risk
- Early signs suggest that London is not doing enough to position itself for growth in these markets, given London only captured 0.5% of the absolute growth in premiums since 2010
- This highlights how London will face competition for this business and will need to continue to focus on building relationships in these markets, not simply waiting for the business to come to it. Also the London Market's ability to attract high growth market talent and language capabilities will be key

  "I have found it hard to maintain my relationships with the London Market, they are overly reliant on me going to them versus others who are more willing to come to me" **Latin American Risk Manager**

  "Having a presence on the ground makes a huge difference; I have been to Lloyd's Singapore and met people there. This has allowed me to develop a greater relationship with London" **Asian Risk Manager**
- The London Market, given its unique position and capabilities has an advantage over individual providers and smaller hubs when supporting higher growth market governments in developing their insurance markets. This is particularly true as penetration of commercial specialty business grows

Figure 22: Summary of insurance licence requirements for placing business in Brazil, China and India

Brazil

- **Foreign (non admitted) insurers are not licensed to write direct insurance** in or from Brazil
- The only exceptions are:
  - When there is no insurance coverage available in Brazil
  - Insurances of hull, machinery and liability for vessels registered with REB
- Foreign insurers can apply for **admitted reinsurance status** in Brazil which enables them to write all classes of reinsurance on a cross border basis
- However, Brazilian insurance companies are required to cede **at least 40% of each reinsurance cession to local reinsurers**, unless all reinsurers decline to underwrite
- A **2% remittance tax** is charged to cedants on any premiums paid to non-resident reinsurers

China

- **Foreign (non admitted) insurers are not licensed to write direct insurance**
- The only exceptions are:
  - Marine, Aviation and Transport insurance
  - Where the insured is not a legal Chinese entity or the risk is not located in China
- **Foreign insurers can write reinsurance business,** but the amount of **proportional and facultative** business ceded to any one insurer **cannot exceed 80% & 20%** of insured liability respectively
- Lloyds underwriters are permitted to write non-life direct and reinsurance business in China through **Lloyd's Insurance Company China Ltd (LICCL)**, subject to approval from LLoyd's

India

- **Foreign (non admitted) insurers are not licensed to write direct insurance** in or from India
- The only exceptions are:
  - Marine cargo insurance, which is permitted in accordance with terms of trade
  - Risks situated in Special Economic Zones (SEZ)
  - Risks which have received special approval from the Insurance Regulatory and Development Authority (IRDA)
- **Foreign insurers are permitted to write some reinsurance on a cross border basis,** subject to A) a 5% mandatory cession to the GIC B) no more than 10%, 15% or 20% is ceded outside of India based on insurer ratings C) Indian insurers expected to "maximise retention within the country"

Source: BCG analysis

Importance of Managing General Agents in capturing local flows

A Managing General Agent (MGA) is a firm (often an agent or broker) authorised by an insurer to transact business on their behalf. Depending on the precise terms of the agreement, the MGA may have authority to provide a broad range of services, including underwriting, policy issuance, producer appointment, claims handling and administrative support.

These entities have a number of benefits for the insurer that delegates authority to them. First, they form a distribution channel and allow access to regional markets, under the local markets regulation and capital requirements. Second, these entities become part of the local marketplace and can leverage proximity and cultural awareness, while delivering a local service, issuing documents, collecting premiums and paying claims. Third, they often focus on specialist/niche areas of underwriting in which they have local knowledge and expertise. Finally, they are agents of underwriters, not the policyholder. Meanwhile, for customers, MGAs offer the capacity and the expertise of the delegating insurer with the benefits of local knowledge, underwriting authority and claims payment, building on the preference customers have for placing insurance locally.

"If we want to write more direct business, it's clear the expectation of local regulators is you will do it in their country, you will be capitalised locally and they will want to regulate you. MGAs represent a good compromise here" **Chief Executive, Lloyds Managing Agent**

"MGAs represent and contribute to the strength and diversity of the Lloyd's and London franchise, they should be seen as the focus for local knowledge, local relationships and the local voice for the international London brand" **Head of Business Development, Lloyd's Managing Agent**

As an example of the importance of MGAs to London Market business, the number of delegated authority holders who underwrite business in their respective market on behalf of a Lloyd's syndicate grew from 2,329 to 3,065 from 2007 to 2013. Their growth underlines their role as a vital part of the Lloyd's distribution network. In 2013, these MGAs accounted for 32% of total Lloyd's income, mostly from key international markets the US and Canada (~40%), the UK (~36%19) and Europe (~23%[20]). Meanwhile, the number of MGAs in high growth markets, for example in Latin America and Asia, is more limited, but will likely grow as Lloyd's is expanding into international high growth markets (Figure 23).

For all hubs, growing MGA networks offers a means to establishing a local distribution presence to respond to the trend for localisation of insurance buying and to help conform to local regulation. Ensuring demand from local agents to become an MGA with a specific hub or carrier will therefore be imperative. Our interviews suggested that hubs will need to focus on three key areas to attract MGA business:

1. Offer access to expertise and capacity that is not easily available elsewhere
2. Ensure regulation is proportional and not overly duplicative with local regulation
3. Embrace technology to reduce cost and increase transparency

"MGAs are like water–they seek the path of least resistance. Push them back too much and they will move away because they want to bind risks very quickly. The domestic markets will challenge London if it's too slow and imposes too much regulation." **Chairman, Managing General Agent Association**

"For London to continue to attract my business it must continue to offer things I can't find elsewhere, expertise and capacity for example, while ensuring it is not too costly to do business" **US Managing General Agent**

"I am most likely to want to work with hubs and carriers who reduce the cost of doing business with them. By embracing technology and providing me with things like simple electronic binder platforms, that helps to reduce the cost of doing business" **European Managing General Agent**

IMPLICATIONS FOR LONDON

- MGAs represent an important access point to local markets for the London Market, to offset the localisation of insurance buying and to penetrate emerging markets
- For London to grow its MGA network, it will need to provide MGAs with the right incentives to doing business with London, at a time when capital and expertise is becoming locally available
- Only a strong brand and a clear offering – access to capital, expertise, brand recognition and financial stability not available locally, – can guarantee a strong and stable distribution network
  - Developing London's expertise advantage, particularly for new and emerging risks will be an important part of this proposition
  - London must do what it can to ensure proportionate and non-duplicative regulation, a key concern of the MGAs we interviewed
  - Embracing technology and developing London market infrastructure will be particularly important for MGAs given the disproportionate impact to their business of admin costs
  - There is still work to do to get regulatory recognition for the MGA model in many markets

"I am already regulated heavily in the US. If Lloyd's and London are going to duplicate that regulation then that makes taking my business to London less attractive, despite the relationships I have and the expertise they provide" **US Managing General Agent**

"We operate one of the largest MGA networks in the US, but rather than regulating us as one entity, London insists on regulating each and every one of our MGA offices individually. This adds significant cost to our business model" **Vice President, Wholesale Insurance Holding Company**

6.3 Shifting landscape of capital provision/ capital providers

Commercial (re)insurance customers becoming more sophisticated and retaining more risk

In recent years, there has been a clear trend towards self-insurance and retention of risk on companies' balance sheets. Greater capital availability was an important enabling factor for many firms. In addition, as risk managers have become more sophisticated they are more proactively identifying which risks are strategically important and have moved on from merely sourcing external insurance. Risk managers are increasingly focusing on risk mitigation and the bottom-line impact of their insurance strategy.

"We have used our captive to better understand our own risks and the frequency and volatility of claims, over time we would be willing to insure more on our own balance sheet"

European Risk Manager

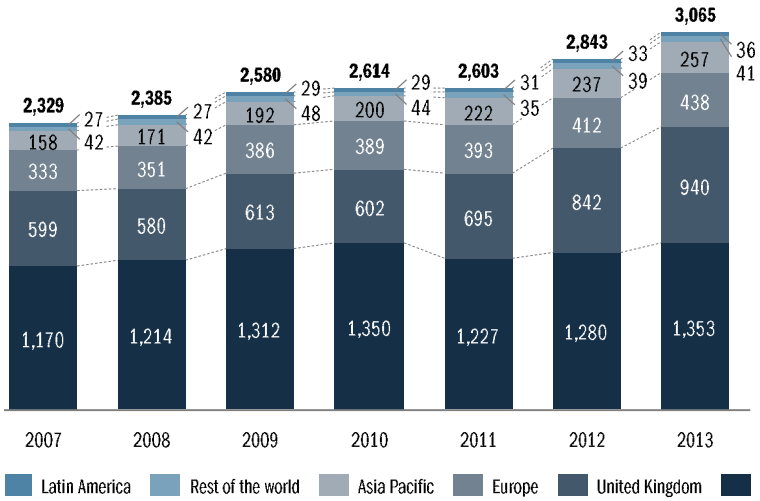
"Our captive enables us to leverage the group risk appetite, take a more holistic view of risk and build our expertise, enabling us to earn some of the risk premium "

US Risk Manager

As an alternative to simply retaining risk on the company's balance sheet directly, an increasing number of companies are setting up captive insurance companies (an insurer that provides risk-mitigation services for its parent company). Today there are over 6,500 captives globally compared to ~1,000 in 1980 and the vast majority of Fortune 500 companies have captive subsidiaries[21]. Captives are overwhelmingly domiciled in low-tax, off-shore locations and typically focus on internalising the primary layers (where losses may be frequent but typically small) of more vanilla, short tail lines such as employee benefits, or risks which are difficult to insure.

Figure 23: The importance of MGAs to Lloyd's premium income

Number of Lloyd's MGAs 2007 to 2013



Growth rates and premium volumes from MGAs

Region	Ann. Growth '07-'13	MGA GWP 2013 [£M]	% of MGA GWP	% of overall business from region
Latin America	7.8%	81.9	1%	4%
Rest of World	2.5%	496.5	6%	48%
Asia Pacific	-0.4%	630.1	8%	20%
Europe	4.9%	918.7	11%	23%
UK	4.7%	1,674.6	20%	36%
US/Canada	8.4%	4,455.5	54%	40%
World	**4.7%**	**8,257**	**100%**	**31.6%**

Figures do not add up due to rounding

Source: Lloyd's London Annual Report 2013, Lloyd's Coverholder Toolkit 2011, Lloyd's Market Intelligence data (for brokers), BCG analysis

"Our captive only takes the primary layers on our risks; the excess layers will always need to be transferred to an insurance company" **Latin American Risk Manager**

"Increasingly more vanilla, short tail, low severity high frequency business is retained in our captive, but the harder to place, high limit and longer tail business goes to the market and often to London" **US Risk Manager**

There is a limit to the range of risks for which direct insurance can be internalised by many large corporations. Risks that will continue to be covered by insurance companies include:

- Risks which require specific expertise which is not cost effective to develop in house and where volumes are not enough to develop the expertise (e.g. aviation and offshore energy)
- When the size of loss is potentially catastrophic (e.g. natural catastrophes) or long tail and therefore has high capital requirements under Solvency II or similar[22]
- Those risks which require specific expertise for the assessment of loss and require significant claims payment processing and administration (e.g. E&O)
- New and emerging risks which are hard to analyse (e.g. cyber and supply chain)

"It is true that we are internalising the lower severity higher volume risks such as commercial property and professional liability, but for more specialist lines and on excess layers we would never internalise those risks " **Asian Risk Manager**

While it appears that for direct insurance there are limits to what can be retained, in reinsurance the risk of volume pressure from self-insurance is greater. Reinsurance buying habits have been changing and there has been a shift towards the use of reinsurance as a tool for managing capital and earnings volatility at a group level, away from trading activity at the level of individual lines of business. This has been further fuelled by the move towards a more risk-based regulatory environment with the advent of Solvency II, forcing explicit assessment of ceded reinsurance and the effect it is having on the company's performance.

"All our reinsurance used to be purchased by the individual line writers in each class of business, however it is now increasingly in the domain of the central reinsurance team under the direct influence of the CFO" **Head of Treaty Reinsurance, European Carrier**

"The advent of Solvency II and risk based regulation has forced us to focus a lot more on the impact of our reinsurance programmes on the company's performance" **Head of Reinsurance, Global Carrier**

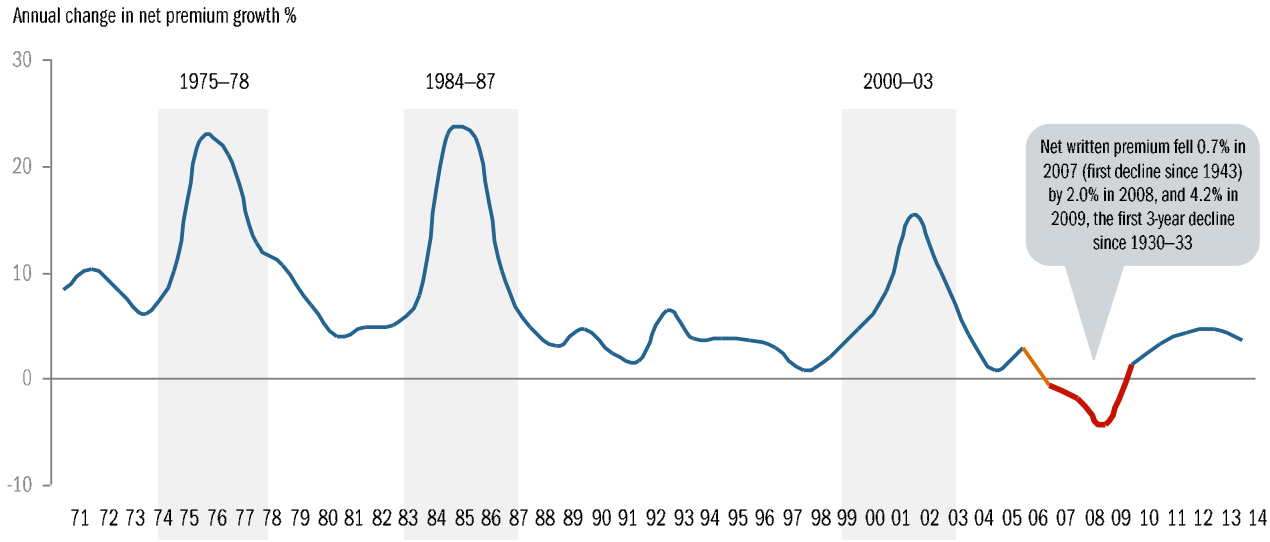
The net result is that insurers have become more confident to adopt a holistic strategy when deciding which programmes to reinsure, internalising a larger proportion of their programmes. Amlin, for example, reduced reinsurance spending by £70 million annually in 2014[23] by identifying gains from diversification in their programme.

"We have purchased a lot less reinsurance from the external market over the past six to seven years, reducing our treaty spend by about €1.5bn" **Amer Ahmed, Allianz Re Chief Executive.**[24]

IMPLICATIONS FOR LONDON

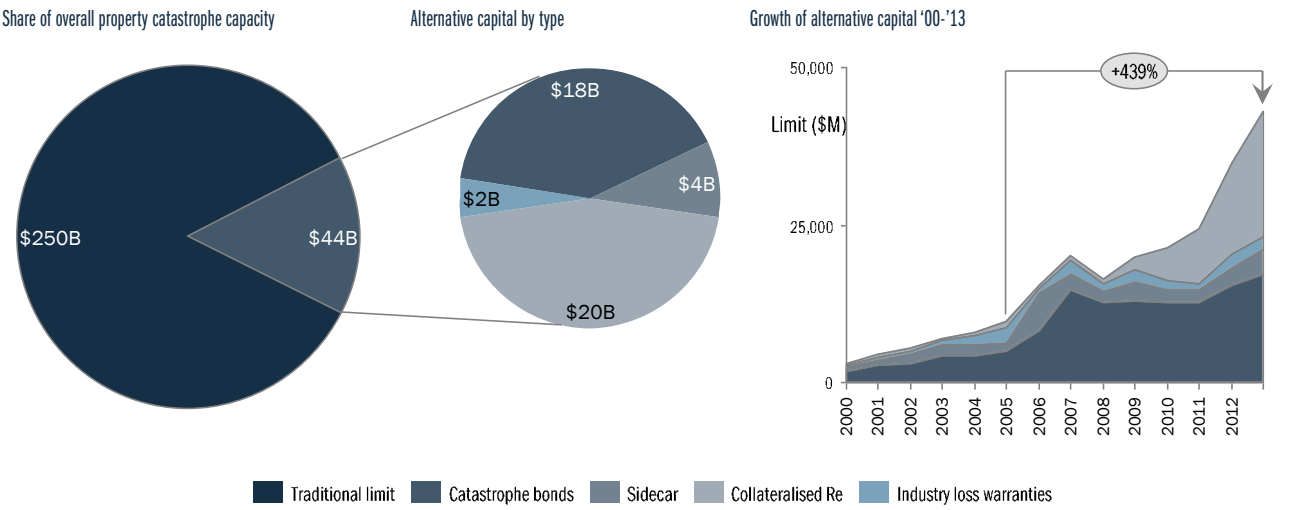
- London is relatively insulated from the trend of increased internalisation of risk by companies and their captives as this typically involves less specialist lines
- However, as the approaches of risk managers are becoming more sophisticated, they expect additional activities from carriers (e.g. the ability to assess and mitigate risk)
- Therefore London will need to evolve its role (e.g. providing more holistic risk management services)
- In reinsurance, the internalisation of risk is more of a concern since insurers have more in house expertise themselves and purchasing decisions are increasingly not held at the line of business level. London's position will be threatened if it fails to adapt to the increasing sophistication of reinsurance strategies and the centralisation of reinsurance purchasing

Figure 24: Historic rate changes in the US Property Casualty industry 1971-Q1 2014



Note: Shaded areas denote "hard market" periods
Source: A.M. Best (historical and forecast), ISO, Insurance; Information Institute, BCG analysis:

Figure 25: Worldwide excess of loss property catastrophe reinsurance – overall capacity and alternative capital



Source: Aon Benfield Securities, 2013, BCG analysis

Market cycles and the impact of an extended soft market

While the insurance cycle has been a historically observed fixture of the industry, the current soft market is particularly prolonged. Some market participants have argued that this indicates that the cycle is distorted. While better pricing models help firms through the prolonged soft market, the increased speed at which capital can enter and exit the market shortens hard periods. A distortion or "reset" of the market cycle could mean that during future hard markets, rates will not climb as high and fast as they did in the past.

Consider the US Property and Casualty Industry as an example:. Net written premium fell 0.7% in 2007, 2% in 2008, and 4.2% in 2009, the first 3 year decline since 1930—33. Six years past the onset of the financial crisis, pricing has only recovered to a point where it was in 2001 — prices fell continuously from their peak in 2003 to 2011 (Figure 24). This flattening in price changes is accompanied by the lowest ever yields on investment income. On 10-Year U.S. Treasury notes, yield has been below or just above 5% for a decade, 2-Year yields dropped to a historic low in 2013 just above 0%, and the industry now holds $1 of surplus for every $0.73 of net premium written, close to the strongest ever claims-paying status in its history.[25] The current soft market cycle could be significantly prolonged. AON Benfield estimate that the loss event needed to "meaningfully disrupt" the market would have to be ~1.6 times larger than the insured losses of Hurricane Katrina, or approximately $100bn.[26]

"It is likely, given the economic environment, low interest rates and high availability of capital that we will be in a soft market for an extended period of time" **Chief Operating Officer, Specialty Broker**

A soft market environment, particularly if accompanied by low investment income in other asset classes, increases competition as investors search for yield. In particular, it poses a threat to London in its role as an excess and surplus capital provider since that relies on a lack of local capacity and appetite for business flows.

"An extended soft market is a problem for hubs like London, when less capacity is needed, this challenges their position as a provider of excess and surplus capacity" **Asian Reinsurance Buyer**

"In a soft market, I don't need to leave the local market for capacity. For example on our medical malpractice policy, there is so much capacity available I no longer need to go to London" **US Risk Manager**

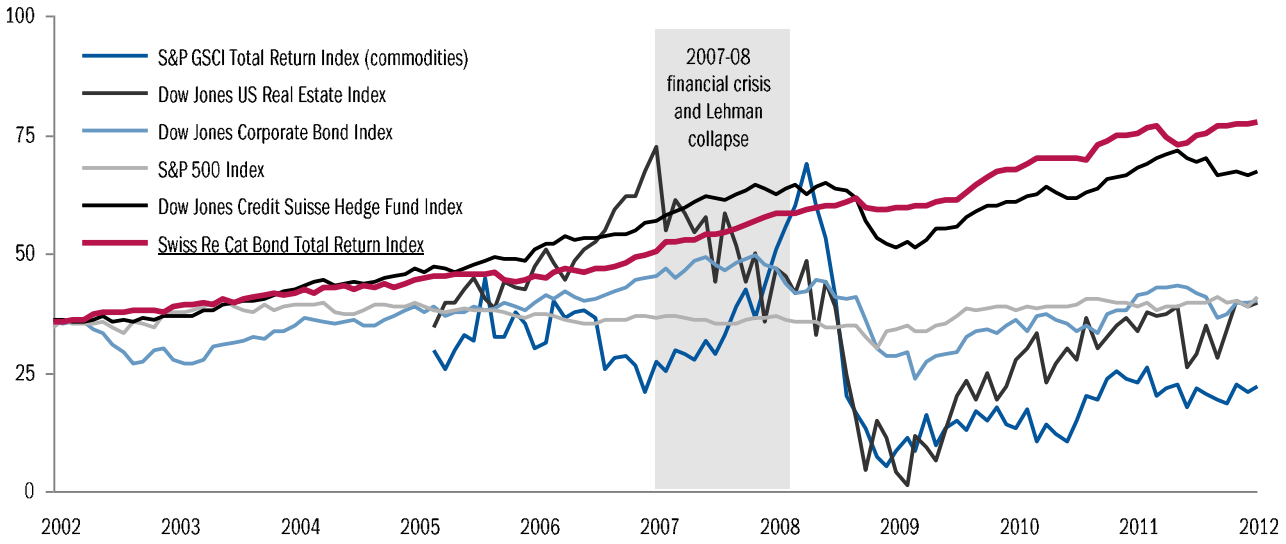
IMPLICATIONS FOR LONDON

- London's position as an excess and surplus capacity provider is challenged by the prolonged soft market, driven by the ready availability of capital
- London will need to increase differentiation and competitiveness in order to maintain share

The rise of alternative capital

Alternative capacity and the securitisation of risk are not new phenomena in the commercial (re)insurance industry. The $26.5bn of losses after Hurricane Andrew in 1992[27] shook the insurance industry and triggered the first attempts at the securitisation of property catastrophe risk. Securitisation involves the pooling and bundling of risks and selling them to investors. Since Hurricane Andrew, alternative risk transfer methods, both securitised and not, have grown dramatically in use. Catastrophe bonds (especially in US and EU Wind and Flood) are the most popular, forming approximately $18bn of $44bn total property catastrophe alternative capacity in 2013 (see Figure 25). Although this represents only 15% of overall property reinsurance capacity, the alternative capital supply has been growing quickly and is 4.4 times larger in 2013 than it was in 2005. Alternative capital providers typically domicile in low-tax locations. Greater than 90% of ILS issuance between 2009 to Q3 2013 was in the Cayman Islands (51%), Bermuda (36%) and Ireland (7%)[28].

Figure 26: For investors, catastrophe bonds offer uncorrelated returns



Source: Aon Benfield Securities, 2013, BCG analysis

It is unlikely that alternative capital is a temporary phenomenon. First, investment returns on ILS have consistently outperformed the stock market with average annual returns of around 8% in the last several years[29]. Secondly, reinsurance capital returns are relatively uncorrelated with other mainstream asset classes, making them attractive to investors (see Figure 26). Third, past loss events such as 9/11 or the 2004/2005 hurricanes have historically spurned more start-ups[30] and the influx of alternative capital, not flight. Fourth, the overall potential for capital influx from capital markets is large. For example, Hurricanes Katrina, Rita, and Wilma resulted in $141bn of losses[31], more than the total equity capital of global reinsurers, but only 0.5% to 1% of US stock and bond market[32]. Finally, many ILS issuers, hedge fund reinsurers and other alternative capital funds, with no rating and smaller overheads, have a cost advantage compared to traditional reinsurers. Hence it seems likely that investors in their search for yield will continue to keep alternative reinsurance in their portfolios. Even if returns in less risky asset classes rise, the extra diversification will continue to add value for investors. So far, the reactions from traditional insurers to alternative capital have been mixed.

"There will never be a situation again where all capital is locked up in traditional models"
Global broker

"We would like to write more business on Lloyd's paper, but they don't seem interested in us. It's an uphill battle working with them." **Investment Manager, Alternative Capital Fund**

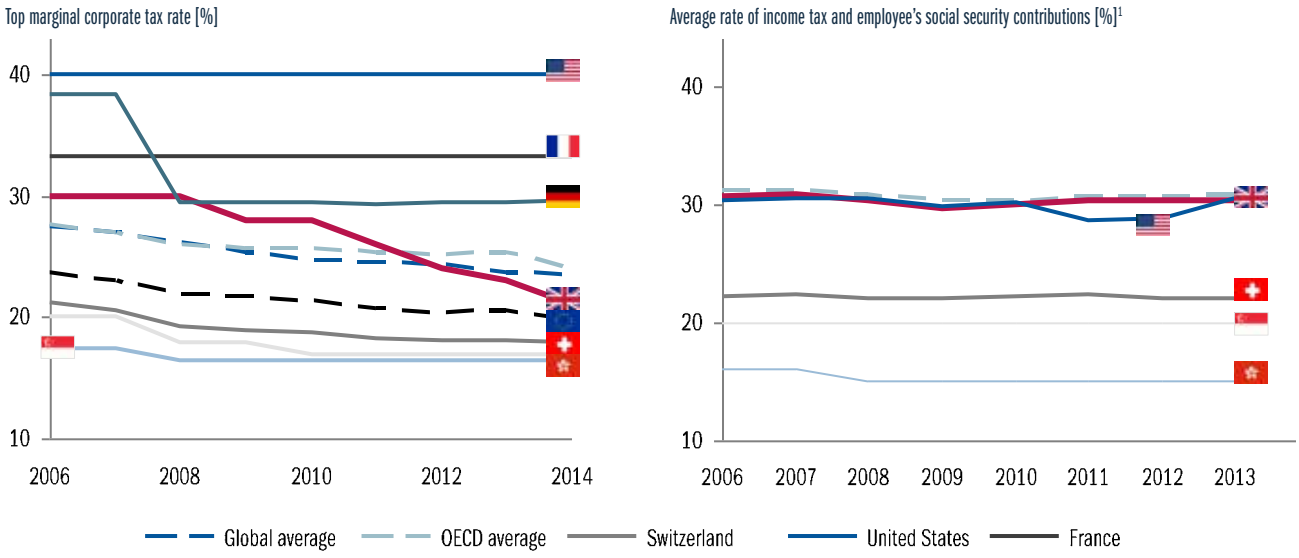
"Sticking your head in the sand and waiting for the alternative capital to leave, as some London market participants are doing right now, is not a sensible strategy."
VP Reinsurance Management, Insurer, North America

IMPLICATIONS FOR LONDON

- Alternative capital settles in the most favourable tax environments, which makes it unlikely that London will be able to attract funds to be domiciled in London
- The additional capacity provided by alternative capital will continue to grow and put downward pressure on prices, especially in property catastrophe business
- London carriers need to find ways to use alternative capital in capital scarce lines where they could use their expertise to meet significant demand (e.g. cyber, supply chain, and catastrophe)
- Some customers report that they would be willing to pay a premium (at least relative to a pure alternative capital provider) if they could receive alternative capital from a (re)insurer with ratings, traditional underwriting expertise and claims paying ability

"There are capabilities which pure alternative capital providers do not provide, such as tried and tested claims handling ability. A blend of traditional insurance capability and alternative capital seems like the most compelling offering" **UK Risk Manager**

Figure 27: Development of corporate tax (left) and labour tax (right) for select countries 2006-14



Notes: 1. Tax rate is calculated for an unmarried, single earner at 167% of average wage
Source: OECD "Taxing Wages", KPMG Tax Database, BCG analysis

6.4 Changing tax, regulation, and government landscape

Tax regimes are competing for globally mobile capital and talent

Tax has played an important role in shaping the post-financial crisis insurance industry, and is a key element of the competition between insurance hubs. Captives are continuously increasing in their importance and often domiciled in tax favourable locations such as Bermuda, Vermont, or Guernsey. A number of insurers and brokers have moved their domicile for tax reasons. When insurance hubs think about how tax influences these events, they need to look at it from two angles: corporate/shareholder taxes and labour taxes.

"The tax position in UK has improved a great deal recently. It is now good compared to other jurisdictions. It is only really the tax free locations which are better, but the number of these is declining"

CEO Europe, Global Carrier

Internationally, there has been a trend towards lower corporate and shareholder taxes. As Figure 27 shows, almost all countries in our selection have lowered their corporate tax rates since the financial crisis. Within the ranking of countries, there still remains a clear distinction between the group of most tax favourable locations such as Bermuda or Hong Kong, and a group of large economies, who also compete on tax but at a higher level. Alternative capital tends to flow to the former group (more than 85% of ILS are located in the Cayman Islands and Bermuda)[33] while traditional market players tend to locate themselves in the latter. Insurance hubs need to consider their relative position as well as the overall trend within their group.

The trend in labour taxation is less clear. Top personal income tax rates within the European Union levelled off in 2014, while they remain comparatively low in hubs such as Bermuda or Singapore. Labour taxation is important for two main reasons. Firstly, it can hamper the ability of a marketplace to attract the talent that it needs to thrive. Secondly, higher labour taxation is a cost pressure for market participants that will eventually feed, at least partially, through into higher prices.

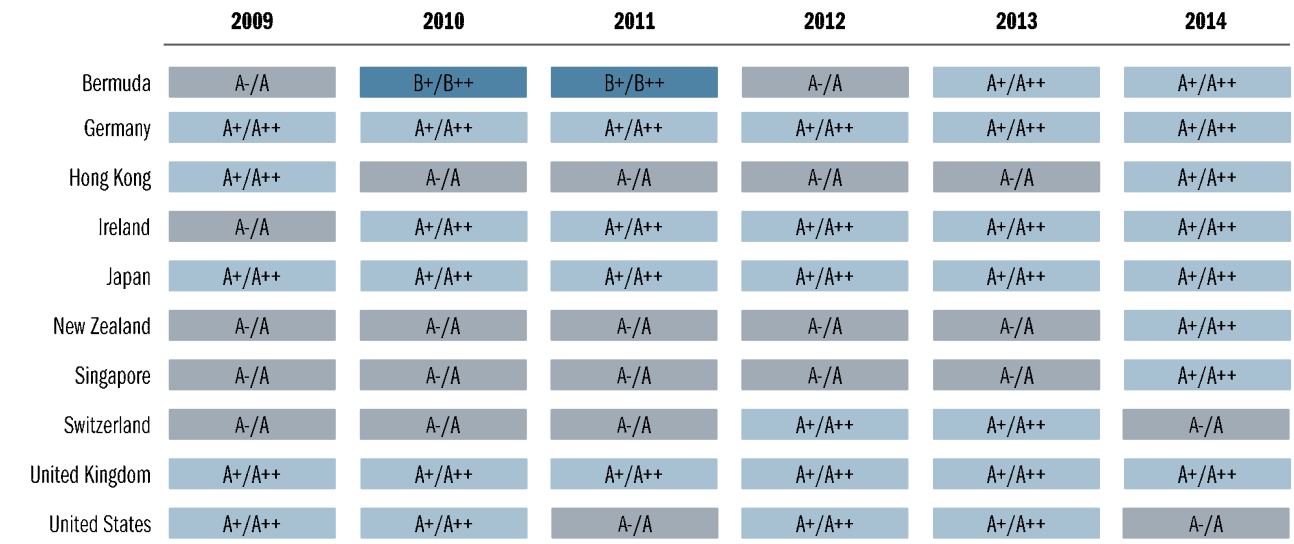
"Personal tax, however, still remains a disincentive in London versus Singapore or Dubai, making it tougher to attract talent"

Chief Operating Officer, Global Broker

IMPLICATIONS FOR LONDON

- Corporate tax and shareholder tax developments have been positive for the UK (joint lowest corporate tax amongst G20 from 2015 onwards)
- In our interviews, market carriers and brokers indicated that in general, they would accept marginally higher tax rates in exchange for certainty over what tax levels will be in the medium to long-term
- Therefore, recent developments, such as the claims equalisation reserves abolishment, suggest volatility in policy, which would impact the attractiveness of London from a corporate perspective.
- On personal tax, London is among the highest income tax jurisdictions in the world, this coupled with the recent cap on tax exemptions for pension contributions and debates over 50% personal tax rates is a concern for London when it comes to attracting top talent to the market
- Insurance premium tax was raised in 2011 to 6% in the UK, but has little impact on global commercial specialty business due to exemptions and taxation based on location of risk

Figure 28: Average AM Best Financial rating of non-life insurers



Source: AM Best Financial Strength ratings database, BCG analysis

Fine line between strong financial regulation and over-regulation

A thriving insurance market needs to attract investors and customers, both of which value financial stability. Approximately 70% of respondents to our online-survey rank financial stability amongst the top three criteria they use to decide on location of placement. A majority of risk managers we interviewed measure financial stability by setting a minimum ratings level for carriers on their placements, for example B++ or higher on AM Best's Financial Strength Rating scale. When looking at the average financial strength rating of non-life carriers by country from 2009—2014 (see Figure 28) we find there is little noticeable variation between established markets, despite different regulatory environments. Notably, only Bermuda has had an average rating below A- in the period 2010—11. Moreover, rankings seem to vary little over time within countries, with some, including the UK, not experiencing any variation in the aggregate rating during the last 6 years. Therefore, to those customers who assess financial stability with ratings alone, there is little differentiation between markets.

"When assessing carriers who participate on my programmes, financial security is really important. I typically use ratings as a proxy for financial security; I wouldn't consider anyone below B+ minimum on AM Best" **Risk Manager, Asia**

"I have a panel of 15 to 20 insurers that we would consider placing specialty risk with. To get on that panel, you have to have a minimum rating of A-" US Risk Manager" **Risk Manager, US**

On the other hand, as noted already, **price** also consistently features on the top three most important factors in our survey, and ranks 2nd overall as a factor driving the decision on location of placement. Costs raise prices, and there has been a reported increase in the cost of regulation since the financial crisis. "Gold-plating" and preparation of Solvency II compliance alone, for example, is projected to cost UK insurers £3bn[34]. Driven by new regulation designed for the banking sector, with the perceived aim for firms to be set up such that they can never fail, there is a risk that cost structures and business development may suffer with little reward for customers, who may not see any changes in ratings.

"Regulation is making business ever more complex and costly; and the regulator seems to put banks and insurers in the same basket" **Chief Executive Officer, Broker**

"The regulator needs to acknowledge that insurance companies are not banks. Our business model is much less short-run focused than theirs." **Chief Executive Officer, Lloyd's Managing Agent**

"Solvency II has gone beyond gold-plating, it is platinum plated." **Chief Executive Officer, Global Carrier**

Of course, while important, not all regulation is prudential or aimed at ratings and financial stability alone. Customers value good conduct, quite separately from financial prudence. When interviewed for a recent IUA member survey, many firms felt that conduct rules have improved their wholesale business operations and enhanced the reputation of the London Market. This illustrates how a well-established legal framework and dispute resolution system can play an important role in attracting business to an insurance hub.

"Regulation, can definitely be a good thing, 20 years ago there was not enough regulation in London, but unfortunately it has now gone too far the other way." **Chief Executive Officer, London Broker**

Effective regulation both prudential and on conduct, can improve market attractiveness. To achieve this, regulators will need to pay close attention to the effectiveness and cost of their rules regimes.

"On the one hand we benefit from firm regulatory oversight providing certainty. But, we can't go too far and make it disproportionate compared to other markets, otherwise the costs of writing business here will be too high" **Chief Operating Officer, Broker**[31]

IMPLICATIONS FOR LONDON

- While levels of prudential and conduct regulation in the UK are widely perceived amongst the strongest in the world, the market will need to pay careful attention to their impact on costs
  - UK brokerage firms estimated the cost of regulation (as a percentage of insurance intermediation fees) as being 2.2% on average in 2013, rising to 4% for smaller brokers with less than £1m annual fees. While the same report estimated that direct regulatory cost in the UK is up to 14 times as high as the average direct regulatory cost across all the other jurisdictions of interest[35]
  - Approximately 50% of our survey respondents agreed with the statement: "Three to five years from now, the regulatory environment in London will make it less appealing for me to place risks there"
  - Given the disproportionate cost of regulation for smaller players, the current regulatory environment in London runs the risk of becoming a barrier to entry to the market

"Burden of regulation and the cost that imparts on carriers is a concern, especially if that means a reduction in the perceived flexibility of London to offer bespoke solutions and to be able to offer competitive prices" **Chief Executive, Risk Management Association**

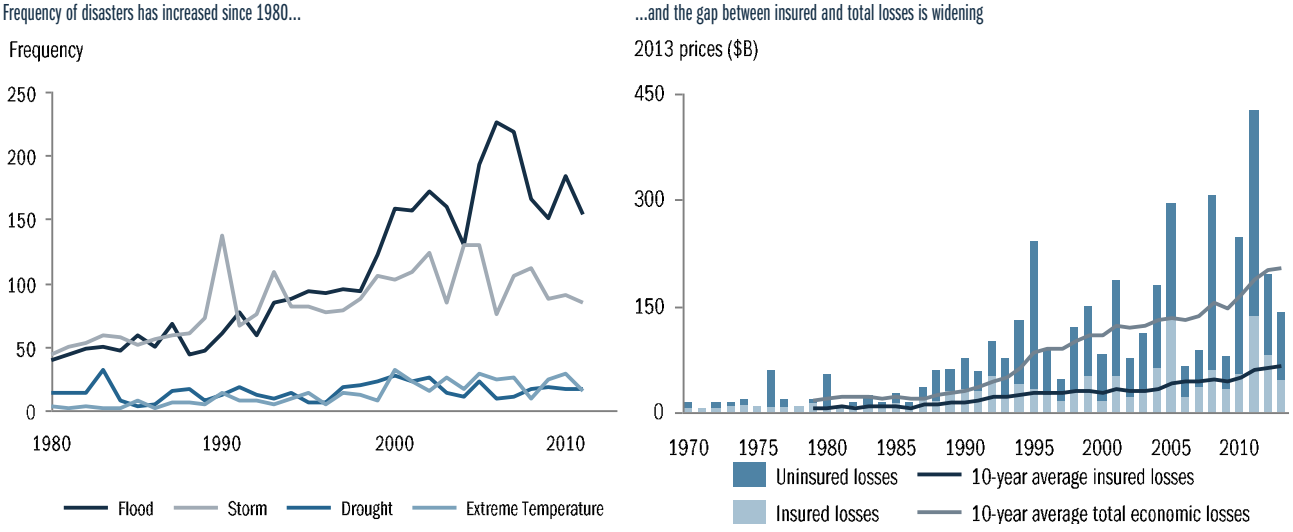
"My firm operates in many, many countries, but London is one of the most difficult from a regulatory point of view. That is a negative that you had better correct, because if you don't there are other countries that would love to have the business that is put into the London Market" **Maurice Greenberg, CV Starr President and CEO[36]**

Role of governments in disaster assistance

In the last 30 years, economic progress has been accelerated for many countries in both the developed and the developing world. Simultaneously, urbanisation has increased dramatically. In China, for example, the urban percentage of the total population was almost 50% in 2010, while in 1982 it was only slightly more than 20%[37]. This means that when disaster does strike, the damages are significantly higher amongst a heavily concentrated population than they used to be in rural, agricultural economies. At the same time, the frequency of natural catastrophes has increased, and climate change is likely to continue to increase this over the next decades. As economies are growing and urbanising, the cost of individual disasters is going up, as is their frequency (Figure 29, left). What is more is that the insurance gap, the percentage of uninsured losses, has widened significantly over the last 30 years (Figure 29, right). Uninsured losses in the developed world are often (partially) post-funded by governments, a fact that is increasingly becoming problematic given the considerable fiscal pressure that many governments face today.

For insurance companies, there are two possible ways to contribute to governments' management of large disasters. The first is direct provision of insurance or reinsurance. For example, the private sectors' cost-efficient risk management, pricing and underwriting expertise may enable it to offer a better deal to taxpayers than government post-funding, which is less insurance but rather redistribution. Switzerland provides an example of the benefits of involving the private sector, by mandating of private earthquake insurance for homeowners and businesses at no cost to the government. Secondly, in many developing countries where insurance markets are less established, because of a lack of demand, data, or

Figure 29: The frequency of natural catastrophes and worldwide catastrophe related losses ($bn)



Source: UNISDR, BCG analysis, Swiss Re Economic Research & Consulting
Note: Economic loss = insured + uninsured losses

expertise, insurance hubs have an opportunity to act as an adviser to governments and to assist in establishing a market for catastrophe risks.

"We need to get everybody to understand that pre-funding is infinitely more efficient and beneficial to society than post-funding; that is the area where we need to do the most work and where, as an industry, we can be the most constructive in the resolution of the issues going forward"

Michael Butt, co-chair of the Geneva Association's climate risk and extreme events working group[38]

It will be a challenge for insurance hubs to convince governments that they can be a valuable partner in disaster assistance, but those hubs that manage to do so stand to help not only the victims of disaster but will gain access to large, hitherto underinsured markets. It is also clear that if traditional (re)insurance markets do not take this opportunity, others will. For example, the alternative capital market is already providing capacity, as exemplified by the California Earthquake Authority who had cat bond coverage of >$600 million in 2012[39].

IMPLICATIONS FOR LONDON

- Government assistance schemes for catastrophe risks, or where they don't exist, the need for them, represent a large, fast growing potential market for London based providers
- London is well positioned to work with governments in this area due to its ability to address governments as a market, rather than as an individual insurer

"Governments and aid organisations should have a propensity to want to work with a market such as London, since it is more politically acceptable than working with a specific carrier in a specific market" **Head of Emerging Risk, Lloyd's Managing Agent**

6.5 Importance of processing infrastructure

Our survey demonstrated that the key drivers of placement decisions are not typically those related to market infrastructure. The ability and willingness to pay claims, speed of claims payment, speed of placement and ease of access to the market ranked below non-infrastructure related factors like financial security, price, scope of cover and product risk expertise (Figure 30).

Nevertheless, our interviews suggested that the whole industry does not deliver on infrastructure and service and that this causes frustration for customers. This is particularly true as a new generation of (re)insurance buyers establish themselves and is reinforced by the fact that the broader financial services industry is perceived as offering a far better service level today.

"It is not that London is terrible in infrastructure and service, it is that the whole industry is terrible, there is an opportunity for London to take the lead here and really harness the power of shared services"

European Risk Manager

"People in our industry want to be able to interact in an efficient and speedy manner, I don't want to have to wait 2-3 months for my policy to arrive after I have agreed a large insurance placement"

US Risk Manager

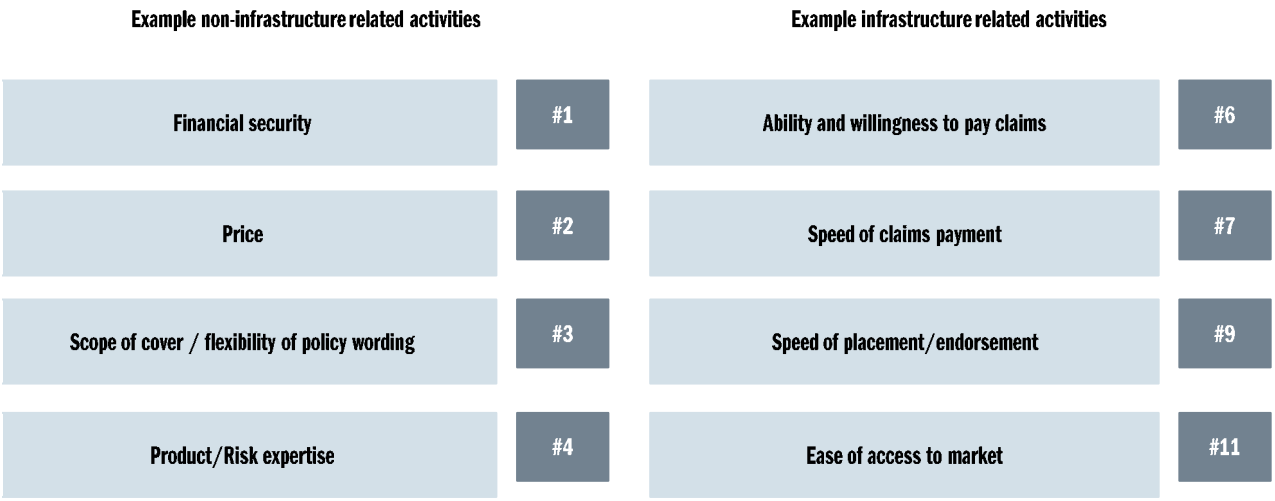
"Commercial insurance is still very old fashioned and not very transparent, insurers could learn a lot from the Banking industry where they have automated a lot of processes. A bond (which in effect is a subscription product) can be issued in two hours, but I have to wait more than two months to place my insurance risk"

European Risk Manager

However, improving on infrastructure and service alone will not be the silver bullet that brings significant premium flows for any market. Additionally, nearly all interviewees expressed a strong preference for face-to-face contact with both their broker and insurer, particularly for more complex specialty risk.

Figure 30: Ranking of infrastructure related factors driving placement decisions

"What are the most important factors driving your placement decisions?"



Source: BCG & LMG Commercial (Re)Insurance buyer behaviour survey, BCG analysis n=157

"Face to Face business is still really important to me, especially on those lines where we are talking about large line sizes, I may want my policy sent to me via e-mail, but I still want to meet my underwriter face-to-face so they really understand my risks and my requirements" **Asian Risk Manager**

"If you think about it, large specialty commercial insurance is like buying a classic car, I don't want to buy that classic car over the internet or without meeting the seller in person, so why would my insurance buying be any different? " **US Risk Manager**

"The driver of people using local markets are nothing to do with efficiency or inefficiency of the policy issuing or claims processes, but rather simple things like local knowledge, language capability and culture" **European Risk Manager**

Finally, there was general agreement amongst the risk manager and reinsurance buyers we interviewed that brokers often bear the burden of poor market infrastructure, in many ways shielding their customers from the pain of dealing with market specific processes. Indeed, many (re)insurance buyers even felt this was a valuable and key activity that their brokers provide. However, nearly all interviewees agreed that if poor market infrastructure had an indirect impact on the price they receive, then that would be a significant disadvantage.

"Given my broker feels most of the pain on market infrastructure I don't really have an opinion" **European Risk Manager**

"Managing the placement process and ensuring claims get paid is a valuable service that I receive from my brokers, it saves me the headache of dealing directly with these issues" **Asian Risk Manager**

"I guess the only time I would recognise or care about poor market infrastructure is if the price I receive is dramatically higher as a result" **US Risk Manager**

IMPLICATIONS FOR LONDON

- Since the pain of market infrastructure is most often felt by brokers and not necessarily by customers directly, the London market should continue to focus its infrastructure improvement efforts on improving interactions with the market, removing specialist process disincentives and limiting the frictional costs of subscription
- London has the opportunity to take the lead on service and market infrastructure, in order to help improve the customer's perception of the overall commercial insurance industry.
- However, this alone will not bring significant premium flows to London; it is simply one of the basic fundamentals on which to build a more compelling London Market proposition for customers.
- While cost and efficiency may be a 'table stake', London will have to continue to compete to ensure it does not become uncompetitive

"The London Market is not a particularly efficient market from a service perspective, The concept of paperless processing just is not happening, whereas it feels like it being embraced in the US and Bermuda" **Latin American Risk Manager**

"London has a perception for poor service amongst the European risk management community, however I am not sure if this is indeed the reality and I am sure this has improved over the last five or so years" **European Risk Manager**

7 Key challenges to the position of the London Market

7 Key challenges to the position of the London Market

1 Customers have a preference for buying insurance in their local market, putting £13-18bn (30-40%) of London premiums at risk of being written locally, where capacity and expertise is increasingly available.

2 London does not have a strong position in emerging markets, and its share of business in these markets declined by more than 20%, from 3.2% in 2010 to 2.5% in 2013.

3 London is losing share in reinsurance (from 15% share in 2010 to 13% share in 2013) as purchasing is increasingly centralised and emerging market growth gains in importance.

4 London's expense ratios were 9 percentage points higher than its peers in 2013, driven by higher acquisition and transaction costs, putting it at a price disadvantage for more price sensitive risks.

5 The comparatively high regulatory burden on London Market participants raises costs and could put London at a further price disadvantage, if it is higher than the value of regulation to customers.

6 The prolonged soft market cycle, propagated by the superabundance of capital and securitisation of insurance risk, challenges London's role as the supplier of additional capacity to meet local needs.

8 Key opportunities for the London Market

8 Key opportunities for the London Market

1

Meet substantial unmet demand for new products & solutions, building on London's reputation for innovation and flexibility in order to offset the commoditisation of more traditional risks.

2

Reinforce London's strength in expertise based underwriting with improved analytical techniques to deliver value to customers, enable better selection of risk and help retain more commoditised business.

3

Invest in marketing the strengths of the London Market, particularly in emerging markets, to stimulate customer demand and encourage brokers and carriers to remove barriers to placement.

4

Break down barriers to (re)insurance and intermediation and develop the distribution network, creating appropriate local presence, to allow London to compete more effectively in high growth markets.

5

Reduce the cost of doing business by delivering on infrastructure activities, removing London specific processes and realising economies of shared service, to increase competitiveness for commoditised risk.

6

Embrace the rise of alternative capital in order to take advantage of deep capital markets, build capacity in capital scarce lines and protect against extended soft market cycles.

9 Questions emerging for the London Market

9 Questions emerging for the London Market

In order for London to address these threats and make the most of its opportunities, there needs to be a wide ranging dialogue about the initiatives required with market participants, regulators and political leaders. The following questions should drive this dialogue. Finding the right answers for the market will be imperative to its future success.

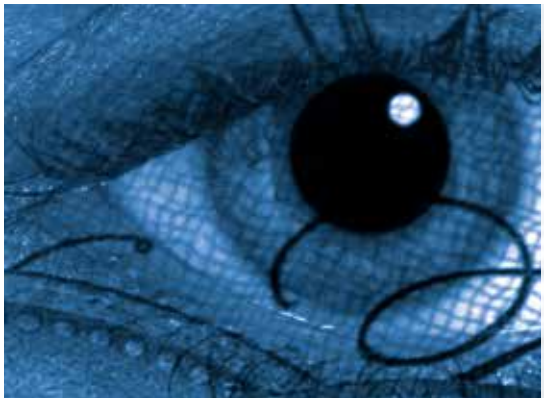
DEVELOPMENT

- How can London encourage product innovation and entrepreneurialism, and the talent required to deliver them?
- How can London supplement its reputation for expertise with analytical capabilities?
- How can London better attract and leverage alternative capital?
- How does London remain relevant to reinsurance buyers centralising purchasing?

COMPETITIVENESS

- How can London enhance the ease of doing business, in particular for brokers?
- To what extent can shared services and infrastructure activity lower costs and improve service?
- How to ensure market regulation is proportional and does not put London at a disadvantage?
- How to ensure tax does not become a material disadvantage for London?

REACH



- What is London's offering to its customers, carriers and brokers?
- What is the best way to communicate that offering?
- How can London best participate in high growth markets?
- How can London increase its local market knowledge and diversity of employees?

10 Acknowledgements

10 Acknowledgements

Authors

London Market Group

Steve Hearn, LMG Chairman
steve.hearn@londonmarketgroup.co.uk

Christopher Croft, Head of LMG Secretariat
christopher.croft@londonmarketgroup.co.uk

The Boston Consulting Group

Pia Tischhauser, Senior Partner and Managing Director
tischhauser.pia@bcg.com

Miguel Ortiz, Partner and Managing Director
ortiz.miguel@bcg.com

Paul Clark, Partner and Managing Director
clark.paul@bcg.com

Paul Hurst, Project Leader
hurst.paul@bcg.com

Communications

Claire Hopkins, The Boston Consulting Group
hopkins.claire@bcg.com

Nathan Hambrook-Skinner, Willis Group
nathan.hambrook-skinner@willis.com

Lisa Hunter, Lloyd's
lisa.hunter@lloyds.com

With thanks to

The authors are grateful to the members of the LMG working group for their participation in shaping this report; Simon Gaffney (Willis Group), Wendy Kilminster (Lloyd's), Sasa Brcerevic and Adam Rushin (Hiscox), Mel Goddard (LMA), Dave Matcham (IUA), Ian Summers (LMG) and James Livett and Chris Buer (LIIBA). Additionally, the authors would like to thank all the firms and individuals who contributed their time and data to the construction of the report.

Appendices

A Class of business definition

Definition of classes of business

Classes of business include direct insurance only for most classes. For Marine, Energy and Aviation insurance and facultative reinsurance are included as the businesses share the same underlying risk characteristics.

Aviation: All aviation business incl. hull, public liability, passenger liability, general aviation and aerospace

Casualty: All casualty business incl. general liability, professional liability, medical malpractice

Energy: All energy business incl. onshore and offshore property and liability (construction, exploration, production, refinery and distribution)

Marine: All marine business incl. hull, cargo, marine liability, art & specie, political risks and war

Motor: All motor business incl. fleet and large single risks

Property: All property business (excl. energy) incl. industrial & commercial and specialist classes incl. terrorism, power generation, engineering and nuclear risks

Reinsurance: All treaty and facultative reinsurance business (excluding Marine, Energy and Aviation facultative reinsurance, which are included in direct lines as per above)

Others: All other business incl. accident and health, contingency and surety

B Methodology

Industry Sizing

For sizing the global industry, AXCO was used as a base source for the country data. Combinations of other sources were used for the overall global sizes:

- AM Best
- Sigma Swiss Re
- IUMI
- Market reports from Aon and Willis

The **commercial insurance** sizes were built from AXCO and aligned using Sigma Swiss Re total market size estimates. This was split by 20 of the largest markets, including the London Market, Bermuda and Singapore (domestic and offshore). Assumptions were made for shares of commercial lines within motor and property insurance, depending on the maturity of the country (measured by GDP per Capita). Where country data was unavailable for 2013, the BCG Non-Life Forecasting Model was used to provide an estimate.

For **reinsurance**, AM Best was used to size the overall industry, made up of treaty and facultative non-life reinsurance. As this data was in net written premiums, a conversion to gross premiums was made. To split premiums by country, ceded premiums from AXCO and other local sources were used to get a total for all of the available countries. This share was then applied to the overall AM Best size. For countries where 2013 data was unavailable, reinsurance forecasts from Sigma Swiss Re were used, which also differentiated between mature and non-mature economies (again using GDP per Capita as a proxy).

Shares of global lines of business were captured from AXCO and applied to the total market size, with the Energy and Marine market estimated using data from IUMI and Willis, and the Aviation market was calculated using Aon and Sigma Swiss Re estimates.

For some comparisons, **SME insurance was excluded** from the total GWP market sizing figures. The share of SME was calculated using a bottom-up approach of estimating insurance spend of companies, in major markets, with turnover of equal or less than £16m (there is no standard global definition of SMEs, so this measure takes into account varying degrees of country development) . The share of companies that fall into this category was weighted by industry and insurance purchasing prevalence and therefore an estimated insurance spend was calculated. For countries where data was unavailable, a weighted average of comparable countries was used to compute to the global figure.

London Market Sizing

The London Market was sized using a bottom-up approach. Data was collected from Lloyd's, the Company market (via the IUA) and P&I Clubs and used to build an estimate for the London Market's total GWP.

The **Lloyd's** figures were built using a combination of Lloyd's Annual Reports, Lloyd's Statistics and other internal Lloyd's data. **Company Market** figures were taken from the London Company Market Statistics Report, published by the IUA. **P&I Club** figures consisted of premium from London-based clubs (Tysers P&I Report) and owned P&I premium outside the clubs (Arthur J Gallagher Marine P&I Commercial Market Review).

The figures were converted from USD to GBP using the annual exchange rates from the Lloyd's Annual Report.

Employment

Employment figures were based on data requests sent out to a representative sample of market participants. The responses were scaled up to approximate the whole London Market, based on their share of London Market premium. Comparisons to the UK economy were made using employment figures from the Office of National Statistics (ONS) and TheCityUK.

GDP

The London Market's GDP contribution was sized based on GDP contribution per FTE for risk carriers (Managing Agents, Company Market participants and Lloyd's) and based on average ratio of GDP to revenues for brokers.

The impact of the London Market to the wider UK economy (e.g. actuarial consultants, legal services, accountants, hospitality, construction, etc.) was taken into account and modelled via Leontief multipliers. Leontief multipliers approximate the indirect and induced effects between different sectors of an economy. The UK Input-Output Table (ONS) was used to calculate the Leontief Multipliers Types I and II for the indirect and induced GDP contributions of the London Market to the UK economy. FTE figures for the London Market risk carriers were taken from the employment sizing model described above.

GDP contribution of London Market risk carriers was calculated using the GVA per sector figures (ONS). The GVA was scaled up to GDP to obtain an estimate of GDP per sector, assuming that the same sector % splits for GVA apply to GDP.

GDP contribution of London Market brokers was calculated by estimating the income of UK based brokering activities of a sample of London Market brokers.

The Leontief multipliers were then applied to the GDP estimates of the London Market to account for indirect and induced effects on the UK economy. The responses were scaled up to approximate the whole London Market, based on their share of London Market premium placed. The GVA contribution was estimated applying an average ratio of value add to revenues for general insurance brokers (estimated by the British Insurance Brokers' Association and London Economics). The GVA was scaled up to GDP to obtain an estimate of GDP per sector, assuming that the same sector percentage splits for GVA apply to GDP.

As the London Market falls across two sectors by the SIC 2007 definition – insurance, reinsurance and pension funds and activities auxiliary to financial services and insurance activities – multipliers were calculated separately for each sector, with Managing Agents, Company Market carriers and Lloyd's falling into the former and brokers into the latter sector.

Claims & Invested Assets

Claims & Invested Assets data was collected by data request of a representative sample of London Market participants. The data was scaled up to obtain a London Market estimate, based on their share of London Market premium.

Endnotes

1. Lloyd's of London 2013 Annual Report
2. Total increase in GWP from 2010 to 2013
3. At Lloyd's, syndicates are the entities who physically underwrite risks. The syndicates are managed and serviced by managing agents who are responsible for appointing and employing underwriters, other management and staff. Managing agents also help to determine the underwriting policy of the syndicate and are responsible for managing capital.
4. Protection & Indemnity clubs are associations of ship owners that have grouped together to insure each other on a mutual non-profit-making basis, for their third-party liabilities.
5. Note, there is a small book of domestic personal and SME business in Lloyd's which may not be internationally mobile
6. Written insurance premium, gross of acquisition and reinsurance cost
7. MGAs in Lloyd's are referred to as coverholders. Today there are 3,065 coverholders, with the largest coverholder markets being the US, UK, Canada, Europe and Australia
8. Local underwriting offices in Lloyd's are referred to as service companies. Today there are 289 service companies, with the majority in the UK, US and Singapore
9. £24.2bn of premium written in the UK (outside Lloyd's and the Company Market), plus £26.6bn premium written at Lloyd's, £17.4bn premium written in the Company Market and £1.6bn premium written in P&I clubs
10. Sidecars are financial structures that allow investors to take on the risk and return of a group of insurance policies written by an insurer or reinsurer and earn the risk and return that arises from that business.
11. According to IUMI (2012)
12. Main classes in Marine insurance include hull, cargo, marine liability and specie (the insurance of valuable property such as art or jewellery), political risks and war.
13. Aon Benfield Securities, Insurance Insider Pre Monte Carlo conference (data from 2013)
14. Women on boards 2014 (Department of Business Innovation & Skills)
15. Defined as the Financial Services in the Cities of London and Westminster and the Boroughs of Poplar and Limehouse (which includes Canary Wharf)
16. Estimate based on a line by line assessment of risks in the Lloyd's and Company Market data. Lines identified in our carrier interviews, which did not originate from the UK were considered at risk of localisation. A 10% range was applied to account for the complexity of analysing premiums line by line in the data
17. Marsh & McLennan Companies estimates
18. Cost analysis based on Lloyd's annual statistics 2013 for all Lloyd's syndicates, a sample of ~15 company market offices based on SynThesys Non-Life PRA returns and a peer group consisting of ~15 predominantly non London, commercial insurance carriers.
19. PWC, "Capital project and infrastructure spending. Outlook to 2025", 2014
20. Represents percentage of overall Lloyd's premiums from the region which come through the MGA/coverholder model
21. Business Insurance, "Captive Managers and Domiciles", 2014
22. The Solvency II Directive 2009/138/EC is an EU Directive that codifies and harmonises the EU insurance regulation. Solvency II is scheduled to come into effect on 1 Jan 16'
23. https://www.insuranceday.com/id/lloyds/amlin-reduces-reinsurance-spend-as-models-reveal-diversification-benefits.htm, accessed on 03/11/2014
24. Speaking at Guy Carpenter symposium and quoted in Insurance Day, 20th October 2014
25. Evercore Partners, SNL data, Bloomberg
26. AON Benfield Analytics, "Reinsurance market outlook June July 2014"
27. NOOA Technical Memorandum NWS NHC-6
28. Fitch, Guy Carpenter, Bermuda Insurance-Linked Securities (ILS) Market Report
29. AON Benfield, "Insurance-linked securities", 2013
30. Insurance Insider - Pre Monte Carlo Briefing
31. Total Economic loss, not insured losses, Source: National Hurricane Center, Tropical Cyclone report Katrina, 2011, NOOA Technical Memorandum NWS NHC-6
32. Dow Jones
33. Fitch, Guy Carpenter, Bermuda Insurance-Linked Securities (ILS) Market Report
34. http://www.ft.com/cms/s/0/9dd1b19c-96ea-11e2-a77c-00144feabdc0.html#axzz3HjaW1x9a (Financial Times, accessed 31/10/2014)
35. Update to the cost of regulation, a report to the British Insurance Brokers Association, London Economics, BIBA, 2014
36. Speaking at Insurance Insider pre Monte Carlo briefing 2014 and quotes in Insurance Insider Monte Carlo day 1 edition
37. http://www.stats.gov.cn/tjsj/Ndsj/2011/html/D0305e.htm, Basic Statistics on National Population Census in China, accessed on 03/11/2013
38. https://www.insuranceday.com/generic_listing/claims/insurance-industry-must-persuade-governments-it-can-take-on-more-climate-change-risk.htm, accessed on 03/11/2013
39. http://ww.artemis.bm/blog/2012/08/01/ceas-third-and-largest-embarcadero-re-catastrophe-bond-in-twelve-months-completes/

LMG

BCG
The Boston Consulting Group