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EXCLUSIVE INSIGHT AND ANALYSIS FROM INSURANCETIMES, STRATEGICRISK & GLOBALREINSURANCE

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The (re)insurance market has well and truly woken up with this month. As our detailed coverage of results in the sector demonstrates, capital at the big reinsurance players is fully reloaded and the profits were flying in for 2009. On the flip side, this has pushed back towards a soft market, with a fall in rates at the 1 January renewals; a trend that can be expected to accelerate throughout this year.

Lloyd's, home to many reinsurers, is also performing well, with a robust results season. But the market is not resting on its laurels: its strategic review released this month outlines its plans up to 2012. As we suggest, it may not be revolutionary – but it is smart thinking.

Meanwhile, in the primary market, insurance brokers are looking to start splashing the cash once again. Kwik-Fit is already on the market, and a large number of major brokers are looking to start buying again. As with the reinsurance market, there is cash on the table, and it is now merely a question of when, not if, the buy frenzy begins.

As we conclude the first quarter of 2010, it is clear that this year will be an interesting ride – and hopefully without the white knuckles that characterised 2009.

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in this issue

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Sink or swim?

Risk managers have a choice: stick with compliance or step up to the board

Risk management is at a turning point. Aspiring senior risk professional can either step up as a strategic adviser to the board, or accept that their responsibilities go no further than compliance. But what are the key traits of an effective strategic risk manager? And what do they need to do their jobs properly?

Influence at the top

In the wake of enhanced board, regulatory and shareholder attention, the industry is witnessing an increased demand for risk management professionals in the boardroom. This is driven by an urgent need for informed and accurate risk advice to senior management. In order to do this, risk managers need to be able to convey messages succinctly and effectively.

Risk managers who are uncomfortable in this role may end up sidelined or ignored. Many financial firms are taking senior executives with the business knowledge and training them in risk management. When this happens, career risk managers could lose out.

Skill acquisition

Lack of capability and experience at a strategic level can hold risk managers back. Smart risk managers should look at ways of acquiring sufficient commercial acumen, business knowledge, and strategic vision. If they do not they are in danger of losing relevance.

Clear lines of reporting

In order to operate as a check and balance, risk managers require a clear reporting line to the chief executive. But they should also have a trusted relationship with the audit committee. At the same time non-executive directors need to be prepared to listen to the advice of their risk managers and, in some cases, they may need to become more risk-aware themselves.

Business enabling

Equally, risk management needs to support the business to achieve its commercial objectives. It is no good if risk managers are seen as a stumbling block to revenue and growth. For this reason risk management should not be too conservative or purely focused on reducing threats. By working through scenarios, risk managers may find ways of tightening up processes that make them more agile and effective.

Risk culture

Risk managers can only embed a strong risk management culture within the business if they are seen to be credible and have influence over other people's behaviour.

The emphasis remains on risk professionals themselves to make sure they earn a reputation as credible and influential departments.

Information systems

Finally, risk managers need to have the right information in order to make a convincing case to the board. Technical solutions can help give risk managers some of that assurance.

If the risk manger is raised to a strategic level, and they become embedded into business thinking, then organisations should be able to take certain risks, safe in the knowledge that they have the processes to deal with the consequences. The only question that remains is whether the risk community itself is brave enough to step up?

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Key points

- Risk managers need influence at the top, but in order to get this they require business knowledge and trust
- Lack of capability at a strategic level sometimes holds risk managers back. It is their responsibility to acquire the right skills
- Risk managers should have a good relationship with the audit committee and executive management should not exert unfair influence over them
- If they are seen to be an obstacle, risk managers will be sidelined. They should make sure their work is business enabling, not a hindrance
- Risk departments may need smarter resources in order to present timely, accurate and convincing data to the board

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→ Pension funds need better risk management, 17 December 2009

→ Time to step up, 16 December 2009

→ Walker's final review published, 26 November 2009

→ The way ahead, 11 September 2009

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It's okay to be boring

The Lloyd's strategic review was a bit of an anti-climax. But nobody promised a revolution

Given the media fanfare that surrounded last year's news of a strategic review of Lloyd's, readers of what was finally published last month could be forgiven for being a little disappointed.

On the face of it, the review, conducted by Deloitte and setting market priorities for the next two years, essentially promises more of the same. Lloyd's states that its goals are: to maintain and develop the attractiveness of the market; to ensure London remains a competitive centre for financial services; to improve the operating environment, for example, through claims and electronic reform; and to keep a handle on regulation (think Solvency II).

So far, so much to be expected. But hang on. First, despite the media hype, the management at Lloyd's said from the beginning that they were not expecting any revolutionary change to arise from the study. Last summer, when the review was announced, Lloyd's chairman Lord Levene told *Insurance Times*: "What may come out of this will be fine-tuning. We are not suddenly going to move into banking." Chief executive Richard Ward added: "We're going to stick to our knitting: keep to the basics and remain boring when it comes to investments."

Looking strong

And yet, while the headlines attached to the review may lack the wow factor, dig into the detail and there is some meat to be found.

The bigger picture is that, against the backdrop of a stuttering global economy, reinsurance generally and the Lloyd's market in particular have remained relatively unscathed. Lloyd's is firmly established in the USA and the UK, which combined account for 66% of its business.

As more Lloyd's carriers become multi-platform, and other reinsurance centres spring up, it is increasingly becoming the home of complex and specialist risks. It remains a subscription market, with two-thirds of its business being placed via subscription, and is committed to that continuing. And with 45% of its business coming through the big three brokers, Lloyd's has firmly established the distribution relationships that are fundamental to its survival.

So what next? Well, according to the review, Lloyd's has decided to expand its geographical reach and product diversity but, crucially, it will remain a specialist market and not chase growth in areas where it is already well-established. This means not particularly seeking growth in SME or personal lines, or any further development in the US excess and surplus lines and reinsurance markets, where it is already predominant.

Instead, Lloyd's will be looking to grow in emerging markets, initially through reinsurance rather than primary insurance, through expansion in pre-existing markets such as China, Singapore and Japan. And it will make greater use of coverholder companies to access reinsurance business in established markets such as the USA and Canada.

Closer to home, that "sticking to the knitting" includes tough performance management to protect the central fund and the reputation of the market. There is also a focus on operation efficiencies, including the ongoing electronic reform and claims transformation projects.

No change here

Ward has this to say about the review in its final form: "This is about evolution, not revolution. We have stood up well in the face of the worst recession since the great depression, and we don't see a huge necessity to change direction."

The review should perhaps be seen as an internal audit, an exercise to check, rather than presume, that the market is on the right course. Because, as Ward implies, if it ain't broke, why fix it?

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Key points

- Lloyd's commissioned Deloitte to conduct a review of the market, which was published last month
- Despite much hype by the trade press, Lloyd's said from the start that it was about "fine-tuning"
- Lloyd's will remain a specialist market, but will look to expand its geographical reach and product diversity
- Closer the home, the focus will be on tough performance management and improving operational efficiency

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➔ Storm on the horizon, February 2010

➔ IUA predicts key challenges for London Market, 11 January 2010

➔ The risk takers, September 2009

➔ Lloyd's reveals new North America president, 20 August 2009

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Saxon East • News Editor • Insurance Times

Bargain hunt

The mood is switching back to M&A, but it's likely to be a less frenetic picture this time around

As the broking world battened down the hatches during the recession, acquisitions took a backseat. But now the economy is starting to pick up and banks, under pressure to lend, turn the taps back on for brokers, all the talk is that acquisitions are back with a bang for 2010.

It's a mixed group of players: established consolidators that still have an acquisitive appetite and up-and-coming firms looking to bag some bargains. But how serious are this bunch and what are they looking for?

The likely players

Bluefin chief executive Stuart Reid says: "We would like to do 10 to 15 acquisitions each year for the next three years. I hope that gives you an idea of how seriously we're taking it."

New kid on the block CCV is battling it out with Bluefin for signatures. Its expansion will potentially add value to a float of the Towergate family, planned for 2012. Towergate chairman Peter Cullum recently revealed plans to integrate the smaller company into the main group prior to IPO.

Elsewhere, Charterhouse-backed Giles is still looking for that transformational acquisition as it seeks to boost its flotation prospects for 2012. Less likely to make a mega-deal, but still on the look-out for acquisitions, are Towergate and Oval. But expect a low-key approach.

Oval renegotiated a £115m debt facility for acquisitions with its banks at the end of 2008. Group managing director Jeff Herdman told *Insurance Times* that his company is "definitely on the acquisition trail again" and that three or four deals are planned for 2010.

Favourable conditions

According to Lloyds TSB's managing director for financial institutions, Bill Cooper, concerns over the economy will ensure potential buyers remain cautious. "People are worried about the economy and the performance of their businesses. But if the economy does not take a double-dip, then the activity and the acquisitions will pick up gradually," he says.

CCV chief executive Michael Rea believes there will be plenty of opportunities to buy as brokers look to sell. "There is an ageing population of principals in the broking business. Some will pass on their business to sons and daughters; others don't have a succession plan in place. So there is a kind of age demographic associated with it."

Furthermore, prices have come tumbling down to realistic levels. While it was not unheard of for consolidators to pay 15 times earnings in 2006/07, prices are now down to between five and eight times. One insider says: "Prices are significantly down on where they were, maybe 40% off where they were in the past."

The wait-and-see contingent is likely to include Lark Group, which has access to Groupama funding, and provincial consolidators such as Henderson in Yorkshire and Bollington in Manchester.

"If it looks like businesses can be acquired for reasonable prices, it will become interesting to private equity again," Cooper predicts. "We may see that towards the second half of the year."

But one industry source disagrees, insisting that private equity has dried up and no other brokers with consolidator ambitions are likely to emerge. "I think it will be 10% of the activity talked about. There will be two or three players that go out and buy in a serious way."

For all the industry talk, one thing is clear: this year will involve nothing like the activity pre-2008. There are fewer big operators and, as a result, less money splashing around. It's going to be interesting, but perhaps not quite as exciting as the old days.

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Key points

- As the economy slowly emerges from recession, conditions are ripening for renewed merger and acquisition activity
- Familiar names CCV, Giles and Bluefin will be joined by other brokers as banks begin to lend again
- Reasonable pricing and an ageing population of broker owners will also spur buy-outs, but not at the same pace as seen pre-2008

Archive

→ Return of the M&A market, 25 February 2010

→ Clydesdale Bank to embark on mid-market broker lending spree, 25 February 2010

→ Giles clinches 13th place in buyout track, 8 February 2010

→ CCV completes first deal of 2010, 22 January 2010

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Replenished Re

The reinsurance industry is flying high, so why do the analysts remain so gloomy?

In February, there seemed to be an endless procession of reinsurers unveiling stellar profits for 2009, not to mention excellent takings in the January renewals. Several companies actually posted the best sales figures in their history: Montpelier Re, Axis Capital, Allied World, Endurance, Catlin and Platinum Underwriters all announced record results either for the year or the last quarter. Meanwhile, Hannover Re announced its second-best annual results and Munich Re returned record dividends to shareholders.

So what is the reason for such a buoyant market, and will it continue? For starters, most reinsurers have said an unusually benign cat season enabled them to take pristine balance sheets into 2010. But that alone does not make for such healthy figures; there have been several years in the past two decades when low cat figures did not correlate with high returns.

The reality is that benign loss figures and low attritional losses were important adjuncts to a background of helpful factors, notably extreme caution in underwriting and pricing discipline on the back of the financial crisis. Economic uncertainty also served as a good reason to raise rates.

Then there was an unexpectedly rapid improvement in capital market conditions, including recoveries in equity market prices. Fitch points out that reductions in corporate bond spreads bolstered reinsurers' capital positions significantly in 2009, which have now returned to near pre-crisis levels in 2007.

But it wasn't all plain sailing, and 2009 called for unique manoeuvres by reinsurance bosses and underwriters. PartnerRe boss Patrick Thiele believes the art of reinsurance management is simply better now than it was 15 years ago, with a greater focus on cycle management and product diversification, while modelling, risk management and technical pricing have also advanced. There does appear to have been a common understanding that underwriters had to maintain discipline, as well as prepare for Solvency II and potentially leaner times in 2010.

Reading the tea leaves

With reinsurers' capital at near-historic peak levels, it might come as a surprise to know that rating agencies in particular are not joining the celebrations. Fitch expects that the large release of reserves in 2008 and 2009 (on business done in 2002-2006) will not continue in 2010. This, coupled with a soft rate environment, "will reduce earnings in 2010" says a Fitch statement on Bermuda-based carriers.

Moody's says the continued soft market will place additional pressure on reinsurers' underwriting margins and profitability during 2010. Soft reinsurance pricing, it says, results from both increased capacity and reduced demand. "This soft market could also mean that the credit profile of the reinsurance industry may not be as healthy as current capital levels indicate. Additionally, in the absence of attractive opportunities on the underwriting side, reinsurers may step up share repurchase activity, which could increase their vulnerability to catastrophe losses."

On the demand side, reduced economic activity and the strained reinsurance budgets of primary carriers have had an adverse impact on reinsurance purchases, says Moody's. It voices concerns about excess capacity and slack demand. The rating agency, which has maintained a negative outlook on the reinsurance industry since September 2009, believes such indicators for 2010 could have negative implications for policyholders and creditors of reinsurers.

The final note of warning comes from Lloyds TSB Corporate Markets insurance relationship manager Seb Kafetz, who says investment returns are likely to be much lower, as reinsurers have moved out of equities and hedge funds into bonds and government-backed investments. "In addition, recession-related claims in political risk and specialty classes are likely to increase."

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Key points

- Reinsurers have posted some of the best results for years, due to an unusually benign cat season and unexpected improvement in capital market conditions
- Bosses and underwriters have had to perform some canny manouevres and maintain strict discipline on pricing
- Rating agency Fitch is still pessimistic about the future, saying the soft market will put pressure on profitability
- Moody's voices concerns over excessive capacity and slack demand, and the effects this will have on policyholders and creditors

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→ Munich Re profits soar,
2 February 2010

→ Reinsurer profit oulook pressed by soft renewals,
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