# propertytimes

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# EllenBennett

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These are tough times. The property industry is facing its biggest challenge since the crash of the late 1990s. The credit crunch has hit the market at the lowest point in its cycle, at its most exposed. Demand for new commercial property has plummeted, giving investors serious jitters. Residential is not far behind in the slowdown, with major housebuilders saying they will have to stop building new properties, and doomsayers suggesting house prices could fall by as much as 25% in the next two years.

But what does this mean for the insurance market? For an industry that specialises in risk, a downturn is not always bad news. Amid the flames, there are opportunities.

In this supplement, *Insurance Times* examines the pros and the cons of the current economic climate. We look at:

- The rise in fraud as the housing market cools off, and the consequences for contents, buildings and buy-to-let insurance products. (P 7)
- The collapse in commercial property values. How can insurers and brokers help their business partners in property, and will the market ever harden? (P12)
- It may be all doom and gloom now – but what does the future hold? We asked three key players to predict the shape of the market over the next 12 months. (P17)
- Aon's Bill Gloyn is bringing the worlds of property and insurance together through his chairmanship of the City Property Association. He outlines his vision. (P23)
- The market is still suffering the aftershock of last summer's floods, but how has the supply chain adapted? (P 27)
- The first quarter of 2008 saw the worst single risk property losses since 9/11. What were they, and what does it mean? (P33)

**➔ See www.insurancetimes.co.uk for all the property news.**

**propertytimes**

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# NIGHTMARE in HOMESVILLE

**The combination of tumbling house prices and the squeeze on credit has created a raft of problems for insurers. Katie Puckett explains.**

When Bradford & Bingley joined Northern Rock in the doldrums earlier this month, it drove home the fact that the British housing boom is over. Between them the two banks had spearheaded the growth of buy-to-let and cheap property-plus mortgages respectively, contributing to soaring house prices – and a fluid, and lucrative market in household products for insurers. Now the insurance industry must deal with the knock-on effects of the collapse.

One inevitable consequence of a downturn in the economy is a rise in fraudulent claims across the residential market, particularly in easy-to-fake areas like accidental damage or arson. Insurers say they've already noticed ➔

# Residential property

> **"When people are scrimping and saving they might be tempted to cut back on insurance. But in times of economic uncertainty you're even less able to cope with the financial side."**

➔ a rise in this kind of claim coming through, and fear the impact on their already stretched accounts. "Underwriters are making provision for significant fraudulent claims," says Karen Brown, director at broker Lockton. "When the economy falters, some individuals become overstretched and find they can't make their payments, which leads them to act in ways that are not entirely honest. Some people steal from their clients, others commit fraudulent acts, and this can rebound on the employer or their professional adviser who fails to spot the fraud, leaving them open to PI claims."

Recession also uncovers fraud that went on before. Brown's colleague Steve Holland, executive director at Lockton, predicts the downturn will shine a light into shadowy corners of mortgage fraud that have lain undiscovered until now. "We are seeing an increase in mortgage fraud, ranging from application fraud where people say they have a higher salary than they do, or for buy-to-let, where they declare a higher rental income than they're getting."

There's also valuation fraud where a surveyor and a solicitor conspire to defraud a lender, and the more complex and ingenious, split-title fraud. This is where a property has a large piece of ground attached, which is split away from the property legally and borrowed against. Holland adds: "They get a mortgage on what the lender thinks is a property, but it's nothing more than a backyard."

Solicitors and surveyors will see rises in their professional indemnity (PI) premiums as lenders and investors turn to their professional advisers for recompense, and insurers take evasive action. Mortgage brokers will also struggle. "Brokers have seen increases in their PI premiums, and in some cases they're unable to get cover at all," says Holland.

Insurers may find themselves caught in an uncomfortable pincer movement between higher claims from the kind of extreme weather conditions we saw last summer and defaulters calling on mortgage protection policies at one end, and more competition for new business on the other.

For a start, while the size of the potential market for household and buildings insurance will remain the same, homeowners struggling to pay their mortgages might choose not to spend any of their precious disposable income on insurance. Ian Clark, insurance partner at Deloitte, says: "As and when recession hits there are questions around whether people still get buildings insurance and whether contents insurance is a discretionary spend, and volume goes down sharply."

Philip Bird, underwriting director of non-motor and SME at Groupama, believes the market will certainly stagnate. "There'll be less movement in the market because people aren't moving house, so the flow of new business will dry up. There'll be a small downward effect on rates because people want to keep renewals. But at the same time, some upward effect because of results last year. That's two contrasting forces in my mind."

The ABI believes that more than ever, insurers will have to convince the public that cover isn't a luxury item but a necessary safeguard. "When people are scrimping and saving they might be tempted to cut back on insurance. But in times of economic uncertainty, should the worst happen, you're even less able to cope with the financial side." He points out that one in four households still doesn't have contents insurance. The ABI is trying to rekindle interest in a scheme to encourage take-up of insurance among people on low incomes, and is in talks with local authorities about offering insurance bundled in with rent for tenants of councils and housing associations.

Insurers will no doubt be facing pay-outs on mortgage protection policies too, as interest ➔

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# Residential property

➔ rates rise and fixed rate deals come to an end – it is estimated that 1.5 million householders will find themselves on the wrong end of their lender's standard variable rate this year. "There will certainly be more claims there if recession starts to take hold," says Bird. Again, there's a question over whether with greater risk of unemployment people will be more attracted to the security blanket of insurance or whether they simply won't be able to afford it. Either way, Bird believes "premiums will definitely go up".

There's likely to be worse news for people living in those flood prone areas this summer though, and not least because they fear a repeat of the torrential rains that drowned swathes of the Midlands and the North and caused more than £3bn worth of damage. According to the ABI, two million homes, a tenth of the UK total, are at risk from coastal or inland flooding. It predicts that, without a change in government policy, climate change could increase the number of properties at risk to 3.5 million.

The ABI is reviewing its agreement with the government to provide cover in flood prone areas, and with government action on flood prevention still falling short, those homeowners may be left up a creek without a paddle. Bill Gloyn, chairman of real estate at Aon and president of the City Property Association, is concerned that in the worst areas, homeowners could be left with no insurance at all. "If flood insurance stops, property owners could find themselves in breach of their mortgage contracts. They have an obligation to arrange insurance. If they can't, what's going to be the outcome of that? There could be a severe risk if the bank says, 'you're not insuring, give us our money back'. The knock-on effects could be even worse, with mortgagees in default and repossessions. There's a massive potential impact," Gloyn says.

The revised statement isn't due out until later in the summer, after Sir Michael Pitt's report on the lessons to be learned from last year's deluge. But as Gloyn says: "I can't see it's going to result in cheaper premiums and wider cover."

As for the buy-to-let market itself, the forecast is more mixed. Biba technical services manager Steve Foulsham suspects the boom in buy-to-let insurance products may be at an end: "The market has grown over the past few years, with lots of people with spare cash buying second properties and renting them out to pay the mortgage. I would suspect that because mortgages are a bit harder to come by now, that part of the market will begin to dry up."

But despite the collapse of the market for new buy-to-let mortgages, the rental market could still be a promising hunting ground for insurers offering products for landlords or contents insurance aimed at tenants. Deloitte's Clark says: "People can't afford to buy or choose not to buy, so the big tenant referencing businesses like Homelet and Letsure are seeing significant increases in volume. There's also the level of inward migration from, for example, the Polish community. They're not going to be buying, so that's a straight influx into the lettings market."

## Specialist area

Buy-to-let is a much more complex product than traditional household policies and treated as a specialist area by insurers and brokers. There is a Biba scheme for property investors, brokered by EIS Solutions – formerly part of Erinaceous – and underwritten by Groupama. Matthew Wiles, EIS' customer relationship manager believes the market will continue to grow. He says: "House prices are still too high and first-time buyers still can't get mortgages, so a lot of people are still renting and they will do so for another two or three years. The market has grown massively over the past few years. There are lots of people who sold property a few months ago, the clever ones are sitting on a massive investment fund to invest again if house prices are dropping."

Landlords not only need insurance for their buildings but for a range of other hazards including malicious damage by tenants and help with legal costs should things go wrong and they need to carry out evictions. Many small investors are unaware that their household policies won't cover lettings because they have restrictions on tenants living in a property. Some of the supposedly tailored products don't cover malicious damage caused by tenants or loss of rental income. EIS is now looking into a policy to protect buy-to-let owners against the tax implications of their investments, aimed at the smaller end of the market.

All of which indicates that it's not only going to be homeowners praying that the market recovers quickly. But insurers would do well to remember that, like the property market in a downturn, there is money to be made if you look in the right places. IT

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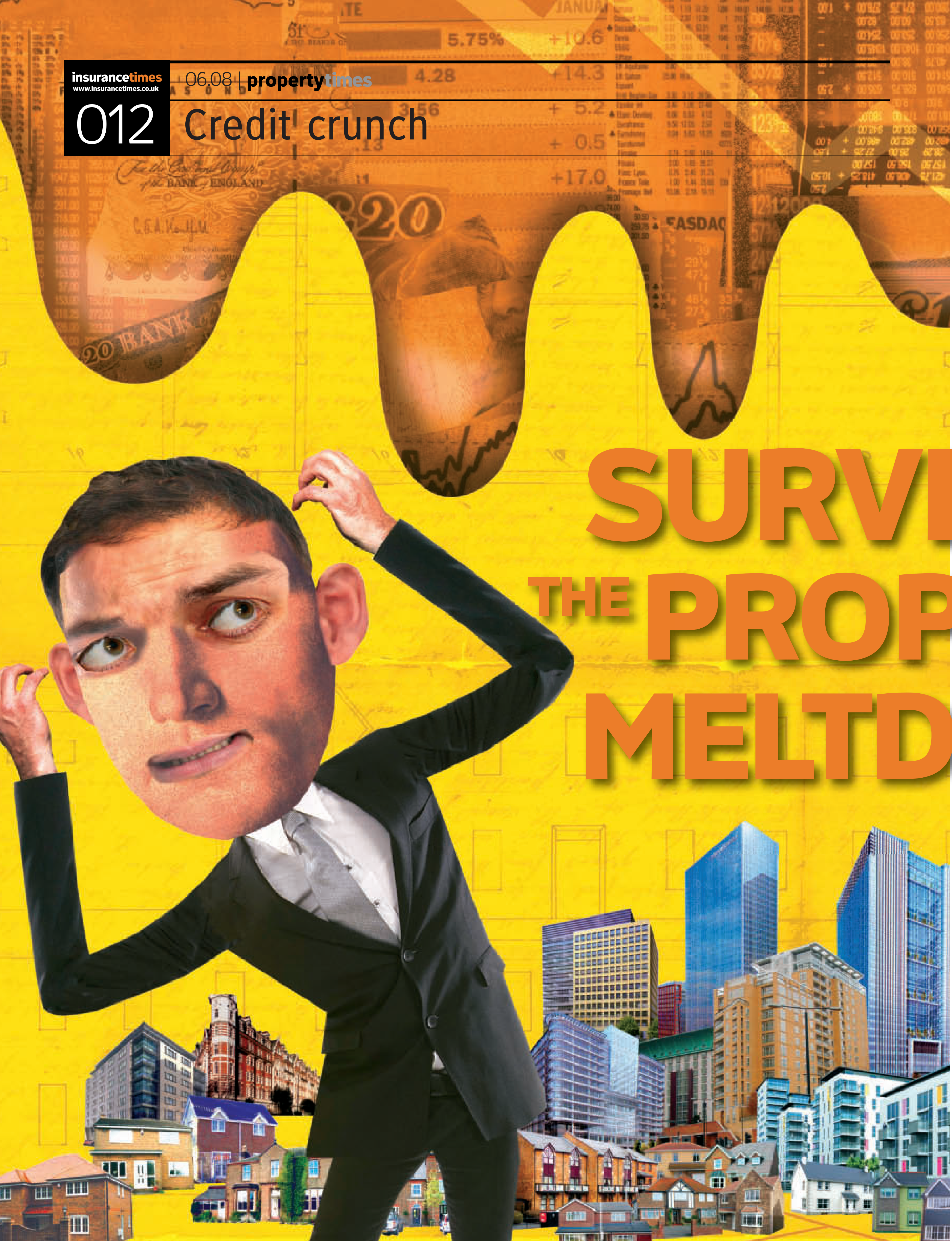
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The outlook for the UK property market is increasingly grim with falling rates and low confidence levels. But Katie Puckett says that it is not all doom and gloom for property insurers.

# VING PERTY OWN

Another day, another depressing headline on the state of the UK property market. Every new set of data only confirms what many had been predicting – and an equal number trying to play down – since the US sub-prime crisis brought the London stock market to its knees last August.

In the first quarter of this year, the Royal Institution of Chartered Surveyors said demand for commercial property had fallen at the fastest rate for more than six years, to its lowest level in eight years. And there was worse to come. Demand for new offices dropped by a third as confidence in retail property dropped to the lowest level on record. Declines in rents are expected to double in some sectors in the next quarter.

But it's not all doom and gloom. As Julia Abrams, director of account management for property investors at RSA, points out: "One person's crash is another's opportunity. Some investors are struggling but others are waiting in the wings with cash to move in at the right point."

The same goes for insurers. Against all the odds, the market for property-related insurance has stubbornly refused to harden in recent years, so the downturn offers some hope of an end to unsustainable rates. But not yet.

"At the moment, the market still seems to be quite soft," says Bill Gloyn, chairman of real estate at Aon and president of the City Property Association. "Everything says it should be hardening already, but it's not. Around the world it is, but not in the UK. The claims don't get any smaller and the numbers don't get any smaller either."

Last summer's widespread flooding hit insurers with more than £3bn worth of claims, a blow the industry is still reeling from, as recent results have shown. While everyone admits the current rates are unsustainable, it seems property is still too attractive a market to reverse the supply-demand relationship.

"Property is seen as a very good performing sector," says Mike Colmans, underwriting manager at Norwich Union. "It tends to perform better when other sectors maybe aren't, and enables insurers to delve into other areas."

Abrams agrees: "This sector has always been seen as profitable. But the commercial property market has gone through a period of very large losses with three or four years of rising claims costs and premiums are unsustainable. The general opinion is that prices have to rise."

## Blanket cover

Almost all the main players offer some property-related insurance – one reason why the market is so soft. Property owners tend to buy a blanket policy for their entire portfolio, which is then amended as they add or dispose of assets. It will cover standard damage through perils such as fire, flood or earthquake and protect rental income. They also have liability insurance in the event of a tenant tripping up and sustaining an injury as a result of the landlord's poor maintenance. The executives may have directors' and officers' cover to protect them from the wrath of shareholders in the event of a bad decision. There's also cover for the legal expenses of evicting squatters from residential properties, and engineering cover for the lifts and escalators in a shopping centre.

As the credit crunch puts new building projects on hold, there will clearly be less call →

### Professions hit by claims: surveyors

When property values dip and investors start losing money, they naturally turn to the professionals that advised them during the sales process for recompense. Surveyors who value properties for mortgage purposes are right in the firing line.

"Notifications of possible claims against surveyors and valuers are already coming in," reports Gary Horswell, managing director of professional indemnity (PI) broker Ntegrity. "This is already translating into a reaction from insurers."

PI brokers are reporting some nasty surprises for surveying practices renewing their policies. Hardest hit are firms that focus purely on mortgage surveys and valuations, without an estate agency business attached, as these are seen as the highest risk for claims. Similarly, firms attempting to expand their geographical or service remit will struggle to find competitive premiums.

Horswell says the market for surveyors' PI cover is certainly hardening. "Virtually the whole of the market is saying, 'we don't want to quote too much surveying and valuation work'. One major insurer is already declining to renew surveyors' policies."

Horswell is fresh from a fruitless search to find a new insurer for one such firm, which focuses entirely on valuations. Its current insurer doubled its renewal premium, and an increasingly desperate search across more than a dozen insurers found no takers. Firms with no history of claims have had premium quotations of 10% of their turnover, up from 1%-2% for general surveyors.

At specialist PI broker Lockton, director Karen Brown has also seen insurers trying to triple the premiums, but she's not convinced there'll be a repeat of the claims against valuers seen in the last recession. "There were more basic and fundamental problems in valuing property in the past, and I don't think we're facing the same problems now. I don't necessarily see claims starting to happen, but underwriters are clearly concerned and the market is hardening for these products. We will be resisting proposed increases from insurers, and have already had some success in keeping these increases to a minimum using sound broking arguments."

Horswell says: "It's a big concern for the surveyors. With PI insurance going up so steeply, it's not a great time to be a surveyor."

# Credit crunch

➔ for construction risks insurance. For other property-related products, the impact will be more indirect but no less significant. Buildings will have some degree of insurance whoever owns them, though the owners may cut back on the sums insured, which reduces insurers' income.

"The amount of property in the UK is still the same, it's still there to be insured," says Mike Phillips, head of specialist markets at AXA. But he also points out that as companies go into liquidation the pool of potential tenants for commercial buildings is reduced. As the occupiers would usually be paying the premiums, empty buildings mean a double strain on property clients deprived of rental income and footing the bills for cover themselves.

At Biba, head of technical services Peter Staddon points out that higher fuel and materials prices coupled with the inflationary pressure on living costs and higher interest rates combine to deal a heavy blow to all sorts of companies. "The credit crunch bites in little bits, but when you put it on business and add it up it has quite an effect. Something has to give – normally insurance is one of those things."

The tougher property market is also likely to mean fewer companies are around to buy cover. "The property investor market could shrink, or that market might turn to invest outside of the UK," says Graham White, Zurich's head of property and strategic exposure. He has noticed that property investors are looking across Europe for higher returns, particularly in Germany, Scandinavia and the East European countries, and even Russia. "We are beginning to see current customers changing their portfolio investment strategies, and offloading parts of their portfolios. And we're beginning to see fewer new portfolios coming on to the scene in the UK."

A common misconception about property insurance is that the sum insured relates to the value of a property. In fact, it only need cover the cost of rebuilding, which may be considerably less because it doesn't include the cost of land. Alternatively, for listed properties or mid-terrace houses it may be quite a bit more.

Even if property owners do understand what they're insuring, they may still use the property's value as a benchmark. In any case, with the cost of construction materials and labour fluctuating, often increasingly wildly, there's a greater risk that owners may be underinsured.

## Accurate valuations

At Norwich Union, Mike Colmans argues that in a tougher market, it's more important than ever for investors to get it right. "If they had a situation where they needed to raise some cash, they might buy or sell a property or get some finance. But with the credit crunch there's a lack of buyers and sellers, and also the difficulty of getting access to lenders. We will pay only the amount insured, so property owners must make sure they are insured for the right amount, because where else are they going to get the money for repairs?"

As a direct response to the credit crunch, nine months ago Norwich Union launched a valuation service to make sure clients are insured for the right amount. Colmans says: "There shouldn't be any reason to go for smaller sums here. In the vast majority of cases the tenant is paying the insurance cost. In other areas where people are paying it out of their own pocket, people think if I slightly underinsure, I'll save money. But it doesn't work like that with property owners."

There is also a risk that cash-strapped owners will try to save money by cutting back on upkeep, with a resulting rise in damage or liability claims from poorly maintained buildings. Insurers should also expect a rise in that other recession favourite: fraud. The links between arson and an economic downturn are well known to insurers, as Zurich's White explains: "There could be people whose business is not doing well and they decide the only way out is to raze their buildings to the ground. Or it could be because you've got more people on the dole kicking their heels in the poorer parts of society. There has always been a connection between arson and a downturn." Zurich has already detected a slight increase.

Norwich Union is launching another new service that it hopes will cut claims on both. "We're trying to help landlords to manage unoccupied buildings," explains Colmans. "We have a management company that will go round to make sure buildings are locked up and that the gas or electricity isn't left on. It gives you more confidence in the property owners if they're prepared to take out an added-value deal like that – you know they care about their buildings."

## Too much capacity

With a dwindling client base with less money, it's not looking good for a hardening market for property-related insurance. "We have a market that is extremely soft, but if there's less business to pick up, that would suggest that it will continue to soften," say White. "Despite all the things thrown at it like last year's flood losses, it doesn't seem to have the appetite to harden. There's still too much capacity."

Norwich Union, AXA and Groupama all say they've been trying to raise rates for commercial property products with some success. "We've hit the bottom of the cycle and what should be acceptable to us," says Philip Bird, director of non-motor and SME at Groupama. "There's a real need to push prices up. We are trying to do that at the moment on commercial property and commercial liability, but it's not always possible to sustain. We're seeing some improvement on renewals and we're trying to do the same with new business. But with lots of insurers battling for premiums, I don't think the rating environment looks good this year either." He's crossing his fingers for 2009.

At Deloitte, insurance partner Ian Clark puts it even more bleakly: "At the moment, there's too much capital chasing too little premium. It won't harden until there's a catastrophe of some magnitude in the US."

Even if 2009 does bring a much-needed hardening of the market, it may be the silver lining to a very black cloud. **IT**

### Professions hit by claims: solicitors

Solicitors renew their professional (PI) indemnity premiums annually on 1 October, so the impact of the credit crunch is yet to be felt. But no one expects it to be good.

Conveyancing solicitors are first in line when it comes to negligence claims in a downturn, partly because of the prominent part they play in the sales process, and partly because the wording of their PI policies is unusually loose.

"Insurers are seen to have deeper pockets when it comes to solicitors," explains James Jack, business development manager at Zurich professional and financial lines. "Their PI policy wording is the broadest there is, and the minimum terms and conditions set out by the Law Society are a lot broader for solicitors than they are for, say, accountants."

The other problem is the compromise of standards in conveyancing as the property market ballooned and with it demand for solicitors' services. "There has been a commoditisation of the housing market over the past 10 years," he adds. "With that comes business practice that can fall down when held to the light. Claims are beginning to become visible. If solicitors have provided watertight conveyancing, they have nothing to worry about. But not all have been so rigorous."

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# A LOOK INTO THE FUTURE

What does the future hold for the property market? Helen Groom asked three experts to gaze into their crystal balls and predict the 12 months ahead.

"The immediate future for the property market does not look rosy, says **Willis UK & Ireland, property team executive director Richard O'Keeffe**. "The UK market has been softening steadily over the past few years. It will remain soft through 2008, and there are likely to be further reductions," he says.

The extent of the reductions depend on the type of business, but he expects rates for 2008 to vary between flat and 20%.

Overcapacity in the market is a key factor in this. "There is a wealth of capacity in the market which will continue to encourage price-based competition. The market is saturated and people are writing for chunks of business."

In addition, lack of underwriting discipline and an abandonment by insurers of their technical pricing are contributing to the continuing soft property insurance market, he says. The only area to show some resistance to rate reductions will be food processing property risks, due to its claims history. "That really is the only area where people are being cautious. That's the one sector that has delivered most of the losses outside the floods."

O'Keeffe says that beyond the sheer damage of the past 12 months' floods, they may prompt insurers to further scrutinise their forecasting models for property risks over the coming year.

"The models that they use to forecast are more tuned to wind events and are a bit less skilful in terms of flooding. ➔

# Property perspectives

➔ So that has to be looked at carefully," says O'Keeffe.

The soft market conditions and the extremes of competitiveness are forcing insurers to be more innovative in the way they attract new business, with longer deals set to feature more prominently over the coming 12 months. "Several insurers are looking at providing long term deals with increased rates in year two and three. Clients and brokers are pushing for cancellations and rewrites in order to secure the current competitive terms for a longer period."

So when will the market begin to turn? "Several insurers claim to be actively looking at their books which could be a sign that the market could turn," says O'Keeffe. "But they are not going to adjust their business until it starts to bite."

" Insurers expected the market to harden faster than it has, says **Mark George, director of client development at Cunningham Lindsey.** "Competition in the market is keeping rates lower then anticipated," he says. "Clearly the 2007 floods were the most significant events in the last 12 months, and the most significant weather event in many years if you look at the pure cost of the damage."

Given the scale of the event and the cost to the industry, George is surprised that rates have not responded to the floods. "It is a surprise that the property world has not been able to harden its rates given the £3bn of expenditure on the floods. If there is another event, it just might happen."

A side effect of the continuing soft market within property is an increased focus on cost management within the supply chain – another trend likely to continue. "The question is how can you be even more innovative, more resourceful and also better at managing claims," says George. "It's not just cost, although cost is a significant element in a soft market. What it means for the supply is more competition, and perhaps being more willing to try out things that might offer more cost savings."

In other words, the continuing soft market conditions are driving innovation within the property sector. With them set to continue for the foreseeable future, the next 12 months could be a period of significant developments within the market.

"All our clients have been saying 'come on, what's your next idea then'; there's no breathing space, it's just constant."

Changes within the insurance market, with the rise of broker consolidators and insurance aggregators, could see the next 12 months being key in the new battle for commissions within the property market, says George.

"The growth of new distribution channels is shifting power from the insurers to the distributors. These business models are coming to fruition and now seem to be driving the technical benefits that they bring," he says.

The large consolidating brokers have been pushing insurers on commission levels on property business, with the coming year set to be a key period for that battle.

"The next 12 months is going to be an interesting situation as to where the commission will come back to and where the balance of power is going to lie. The composite insurers are girding themselves for this, but there are probably some people who are prepared to buy their way into the market. It's an interesting dynamic."

Looking further ahead, this time next year could see it on the point of change. "Beyond the end of 2008, insurers expect to see the market improving in 2009. Another year of sustained underwriting pressure, and an event, or a series of events and the rates will inevitably have to harden," says George.

The property market remains ultra competitive, says **Graham White, head of property at Zurich**, with the floods of 2007, having had little ➔

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# Property perspectives

➔ impact on rates. The appetite for business, he says, means the next 12 months will be tough.

"The market appears to have ignored all of these factors [from the floods] in that it continues to steer an ever more energetic path of new business at any price," says White.

"The overall market is writing at a rate that we see as unsustainable. The outlook for the next 12 months is quite negative unless the market changes and people realise that they can't sustain that pricing very long. But I don't get that impression from what I see and hear in the market," he adds.

The harsh financial lesson provided by the 2007 floods appears to have had surprisingly little impact on the property market, says White.

"Property is still one of the most competitive parts of the market today. I would wonder why that is, as our losses [from the floods] have been reflected across the industry. I would have expected companies that were not as well placed for those losses to have repositioned."

White adds: "It seems to me that they are working on a gamble – saying we had a bad year but it can't happen again this year, and are still trying to meet their new business targets. It will be a very soft market over the next 12 months. I don't think the market will turn until 2010."

Abandoning the discipline of technical pricing is again listed as one of White's key concerns over the next year. "In certain ways I don't think people understand it. I don't see the industry underwriting for or putting processes in place for a catastrophic event, and that's a concern," says White.

"The one area that people need to understand is the technical price, and I think a lot of people think the technical price is the market price, which is the price that you need to get something on to your books, and that's wrong," he adds.

White predicts that another feature of the property market over the forthcoming 12 months will be a rise in the number of two to three-year deals being offered. "There has been a re-emergence of writing long term deals. People in a soft market are looking for different ways of doing business. Brokers are thinking that the market will turn in a couple of years so are protecting their clients and their business," he says.

The SME property market will also move towards light touch underwriting over the next year. "It's pretty automated, and the SME market will become more automated," he adds, adding that it is a means of keeping costs down.

Environmental concerns may also increasingly make a mark on the property market as building regulations are changed to reflect more environmentally-friendly trends, such as new construction techniques and increased insulation.

"The immediate impact is that it is pushing up the costs on rebuilds. As the regulations increase there will be issues with reinstatement costs." But as time goes on, being carbon neutral and reacting to the changing environment will come more to the fore.

From a regulatory point of view, the agreement between the insurance industry and the government on the provision of flood insurance was last updated in 2005. "We are discussing directly with the government and agencies about what we could do and what needs changing," says White.

The result of those discussions, especially in the light of the 2007 floods, could have a major impact on the property market.

"It's by no means a done deal," he concludes. IT

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# HOT PROPERTY

**New chairman of the City Property Association , Bill Gloyn tells Ellen Bennett of his plans to bring the worlds of insurance and commercial property closer together and his flood fears for the City.**

It's no coincidence that Bill Gloyn was appointed chairman of the City Property Association (CPA) in the year that the commercial property industry squares up to its biggest risk in more than a decade, as values tumble. Following in the footsteps of property giants such as Mike Hussey, managing director of Land Securities, Gloyn, Aon's chairman of real estate, Europe, was the first representative of the insurance industry to be appointed to the post, at the end of April.

Gloyn, who says being awarded this post is the highlight of his career so far, believes the insurance industry should have a greater profile in the world of commercial property. In his role as chair of the association representing City landlords and occupiers, he also plans to lobby London's mayor and other public organisations over the vital issues of transport, security and flooding – all risks that property owners and insurers share.

"The general council took the conscious decision that it was a particularly good time for someone of my background to come along and do something different," says the bearded Gloyn proudly at Aon's Devonshire Square headquarters. "It was considered the right time for a man who has focused most of his working life on the risks surrounding commercial property to take the helm with a view to highlighting some of the big issues that are facing the business and attempting to garner some solutions." Though Gloyn, in his friendly, avuncular manner, freely admits: "Some of the problems facing the world economy at the moment may be beyond me to solve."

So putting the economy to one side, what does Gloyn hope to achieve? First up is transport. "Any major financial centre is critically dependent on its transport system and most of us who travel in and out of London know that its transport is not the best – indeed, it could sometimes be called the worst," he says. This is more than a nuisance – it is a major risk which the capital must manage. Gloyn continues: "We have enormous numbers of people from around the world working in London because they like being in London. If just two or three of those organisations decide this is not where they want to be, then that starts to have an impact."

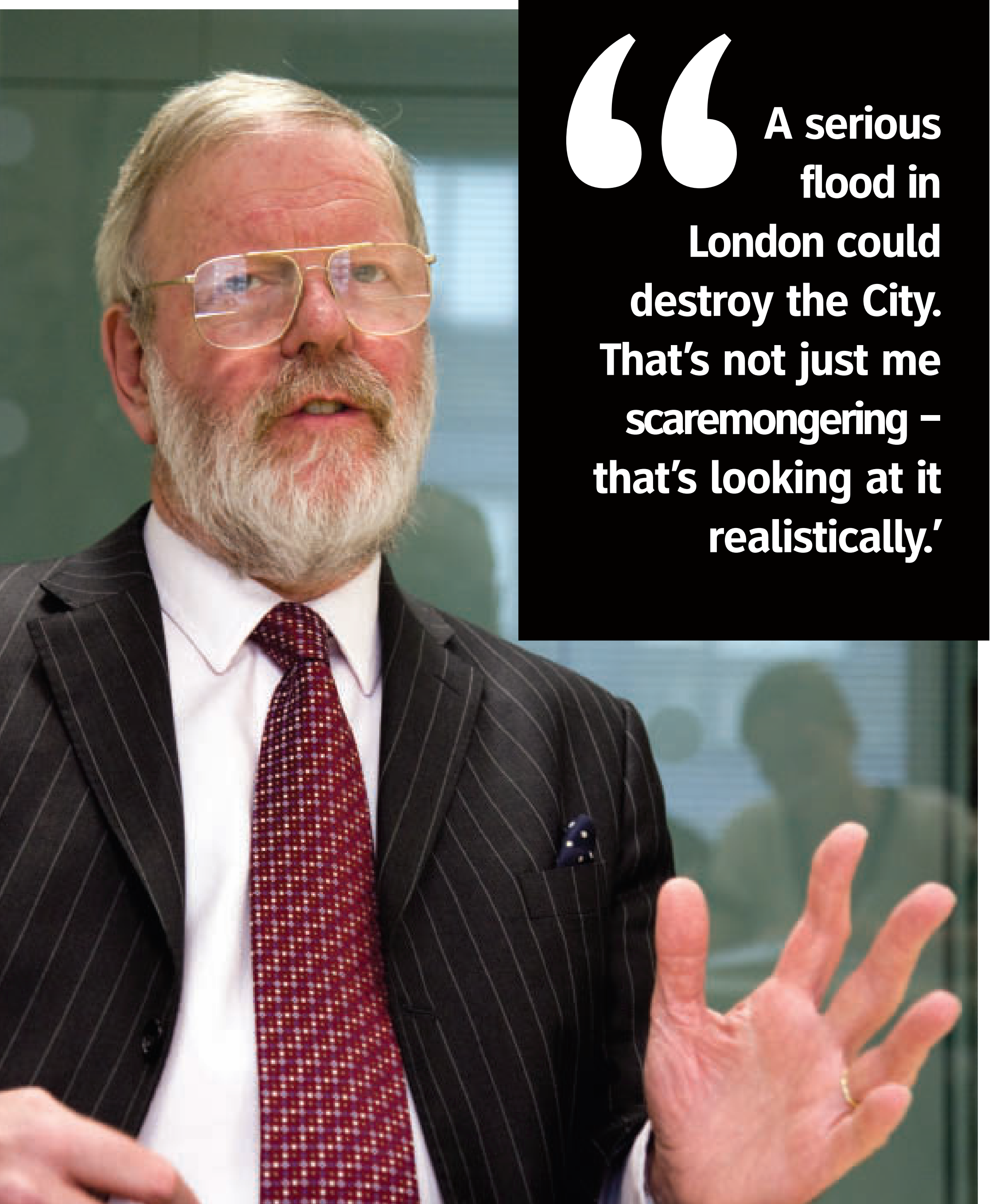
Allied to transport are ongoing concerns about security which, since 9/11, has been at the top of the City's list of worries. But those attacks were many years ago now, and the security measures that were put in place at the time are beginning to look outdated, as are those left over from the days of the IRA. "It has been a long time since there was a public re-examination of some of those security issues," says Gloyn, who like any good risk manager believes that talking about risk at the earliest opportunity is the best way of mitigating it. "If you try to avoid the risk, you can reduce it," he adds.

But these two issues, important as they are, pale next to Gloyn's passionate advocacy of the need for better flood defences. The former risk manager, who arranged the insurance for the development of Canary Wharf, has already written to the new mayor, Boris Johnson, pleading for his help in convincing the government to improve the capital's flood defences. He ➔

➔ has made quite a name for himself in property circles with his outspoken views.

"A serious flood in London could destroy the City," insists Gloyn repeatedly. "That's not just me scaremongering – that's looking at the thing realistically." So what should be done? Gloyn believes that all the information available to the government on flood risk should be immediately shared with business leaders. "Someone somewhere knows the answers," he says. "For example, what is the expected life span of the Thames barrier? And we don't just want some PR, spin doctor answer, but some real facts. That's the classic risk management cycle – first of all, you need to understand the risk. The second step is to reduce or remove it, and the third is to transfer it to someone else – which is where insurance comes in."

But perhaps not for much longer, in this instance. The insurance industry is currently renegotiating its agreement with the government over the provision of insurance for homes in flood prone areas. It has threatened to withdraw cover unless the government stumps up the extra millions needed to improve flood defences. Gloyn warns that this could lead to banks foreclosing on mortgages for uninsured homes, and eventually leave people homeless.



> "A serious flood in London could destroy the City. That's not just me scaremongering – that's looking at it realistically.'

And, while the agreement with the government does not cover insurance for commercial property, it is likely to influence it. So the CPA, with Gloyn at the head, has been furiously lobbying for action. "We wrote to the government in the lead up to last year's Comprehensive Spending Review demanding more money and the government effectively came back with a very negative response," he recalls. "I have written to Michael Pitt [who is conducting a review of flood management on behalf of the government] suggesting that more has got to be done – not just spending more money, but actually looking at the whole risk more seriously with a more analytical mind and trying to come up with some solutions."

### Working together

Turning to the state of the economy, Gloyn admits that there are limits to the protection insurance can offer. Could insurers develop a product that would offset the risk of a crash in the value of a building? Probably not, he thinks. "The response from any realistic underwriter would be, if I wanted to take the business risk of commercial property, I should be a commercial property owner or developer."

However there is one important insurance aspect to be considered – the adequacy of business interruption (BI) cover. If a tenant moves out and the owner is not able to re-let the building at the same rent because the market has gone down, will his BI cover it? "It all comes back to the need to focus the attention of commercial property people a bit more on insurance."

That's not always an easy thing to do. In his characteristically jokey manner, Gloyn acknowledges that the warnings of insurers are not always welcomed. "I don't get invited to parties because no one wants to talk about risk over a gin and tonic," he chuckles. "Property people don't want to talk about risk because the road to property development is strewn with an awful lot of carcasses."

Which comes back to Gloyn's ultimate purpose in taking the chair of the CPA. "I've had lots of highlights in my career but the presidency of the CPA is the absolute pinnacle," he says. "To have melded in such a visible way the worlds of insurance and commercial property is for me a matter of immense personal satisfaction and I hope I can help both businesses work more closely together." **IT**

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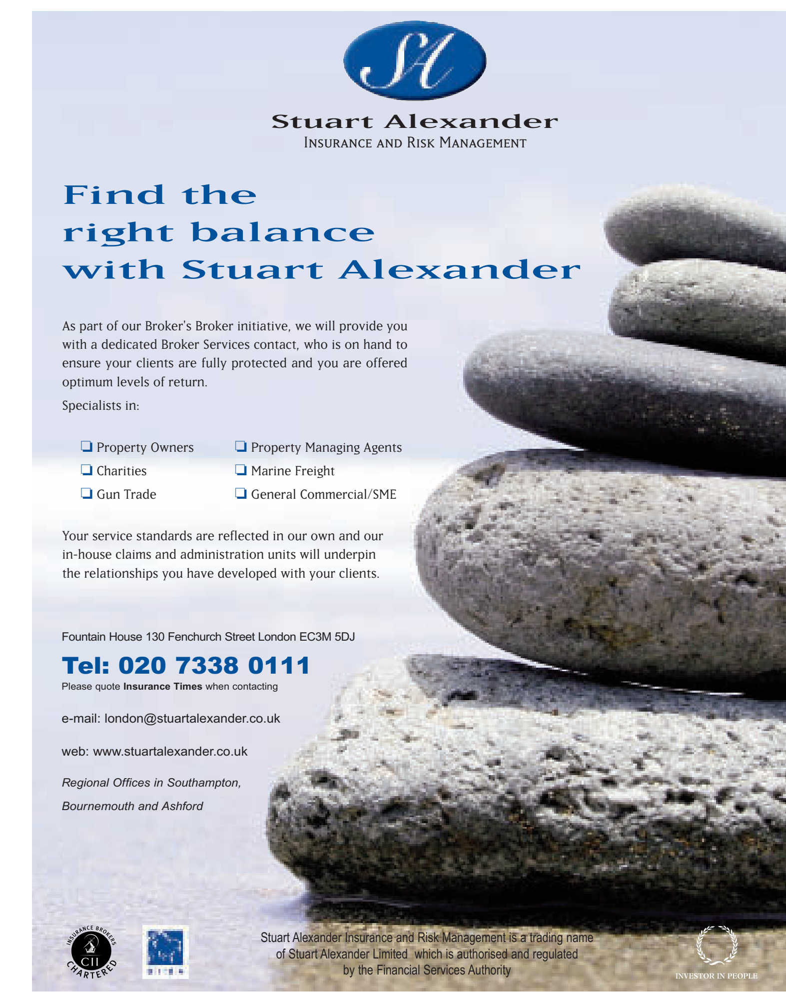
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# Drying out

A year on from the floods, Helen Groom asks insurance insiders to judge the industry's response to the crisis and outlines the lessons that have been learnt.

Twelve months ago, the insurance industry was faced with approximately 180,000 claims from the floods that hit the UK. Not only was the damage devastating for householders and businesses, but the total cost of claims is estimated to be around the £3bn mark.

The 2007 floods put an enormous strain on the insurance industry, which dealt with an estimated 130,000 domestic, 30,000 commercial and 20,000 motor claims, according to the ABI.

Dealing with any major claim involves many people and companies, all part of an established supply chain. The floods generated a deluge of claims, but with many links in a complicated chain of claims management and suppliers, did the system stand up to the pressure, and what has the industry learned since?

"The industry did a tremendous job in how it coped with an unprecedented event," says Biba technical services director Steve Foulsham. "When you think of the number of claims the insurers and brokers had to deal with in such a short space of time, that's especially true." And by May this year, around 96% of people who were affected by the floods were back in their own homes, he adds.

Foulsham's positive outlook on the response to the floods is broadly shared by others within the industry. "The service provided to commercial clients and household clients was outstanding," says Broker Network managing director Mark Wood. ➔

### In the front line

Loss adjusting was naturally one of the front line elements of the supply chain. With adjusters often the first face of the insurance industry a claimant would see, co-ordination between them and insurers and other elements of the supply chain was paramount in successfully and efficiently resolving claims.

Norwich Union supply chain manager David Eldridge says: "One of the first things we implemented was conference calls with our loss adjusters, so that we could understand what resources were available, and where and what they were doing to set up offices to communicate with local communities." In doing so, the insurer made sure that communication with people on the ground was at the forefront of its supply chain management strategy.

Some however, thought that the unique scale of the event presented difficulties for the loss adjusting element of the chain. Broker Network's Wood says: "When the loss adjusters went to the personal lines clients in particular, there was such an overwhelming number. They didn't want to say to the policyholders that it could take up to a year. The managing of the message to the client could have been better, and it could have been that they didn't want to upset the client."

# Supply chain

## Repair and replacement

"There were areas of Hull that were devastated and there was a problem with the sheer number of contractors required. Some of the delays were due to no builders being available," says Biba technical services director Steve Foulsham.

Mark George, client development director for Cunningham Lindsey, says: "There was definitely a case of demand outstripping supply. Policyholders had to make their own arrangements probably more than the insurers would have liked.

"The lack of contractors was keenly felt in the reinstatement stage of the supply chain. There were issues surrounding getting properties stripped out quickly enough so that the drying process could begin," he adds.

"We were quite comfortable with clients using their own contractors for repairs," says Eldridge. "But we felt that if they had allowed us to introduce our contractor networks we would have been able to resolve their claims faster."

However, there were suggestions that some contractors were taking advantage of the demand by increasing their rates, says Foulsham. "The industry could try to agree in advance a rating standard to ensure a level playing field."

➔ The geographical spread of the flooding caused some problems for all elements of the supply chain, with resources initially moved to the Hull and Sheffield area to cope with the first floods, and then shifted to the west of England to cope with the second event. Resources were very tightly stretched in all areas, with many operators bringing in additional equipment from other European countries to help cope with the strain.

"Had the second event not occurred, there wouldn't have been an issue in terms of resources at all. All of us in the supply chain had to move resources away from the first area to react to the second event," says Mark George, client development director for Cunningham Lindsey.

"Fundamentally there were too many claims," says The Revival Company managing director Graham Orriss. "I don't think there was any restoration company that could have handled that without extra staff."

So while the industry coped admirably in challenging circumstances, what could be done better next time the rains come? "We could do things slightly differently in terms of the way we reinstate buildings after they have been flooded," says Foulsham.

"Clearly if the homes are in an area where there is likely to be flooding again, you can do things like build concrete floors and put the electric sockets higher up the wall. But the overarching thing is that we really feel that the government needs to take action on the amount of spending on flood defences.

"More could also be done in encouraging SMEs to take out business interruption cover and to put contingency plans in place," Foulsham adds. Given the fact that some of the areas affected in 2007 had never been considered a flood risk, that is a lesson the industry should try to communicate to its clients.

At an understandably emotional time for homeowners knee-deep in water, maintaining ➔

## Disaster recovery

Getting a grip on the claims was an issue for many of the contractors in the supply chain. The Revival Company managing director Graham Orriss says: "It got to the point where we couldn't process the claims. We couldn't log them into our computer fast enough.

"The sheer number of claims coming in meant that organising the information was key, with time needed to make sure that staff were not just sent to claims in the order they came in, but that logic was applied in having them deal with claims in a compact geographical area."

Many disaster recovery companies were on the panel of more than one insurer and loss adjuster. Multiple cases were coming in from these multiple firms and, in addition, insurers which might not have usually used them, were ringing up to ask them to accept more work.

"We had to turn them down and by doing that we managed to support our partners," says Orriss. "A lot of people kept taking claims on and couldn't handle them."

Recruiting more office staff more quickly, and having good contingency plans in place for sourcing extra equipment from Europe are two of the lessons to take forward, says Orriss.

In addition, flexibility and responding to suggestions from people on the scene, such as using drying machines on multiple properties in the same location, was important.

Most claims were dealt with within eight to 10 weeks for stripping and drying out properties, meaning that recovery for that area of the supply chain was relatively quick.

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# Supply chain

➔ a good communication channel was paramount. Many people had never been flood victims before and had no idea of the timescale needed to resolve their claims properly. Explaining to them from an early stage that it could be a lengthy process, with multiple contractors involved, was key to ensuring customer satisfaction.

"The customer is so traumatised by the event that what you say on day one or day two needs to be repeated on a regular basis," says Norwich Union supply chain manager David Eldridge.

"The consistency of communication to policyholders didn't work so well," admits George. "You have a large number of people involved in the chain. There are the insurer and loss adjuster, and then a disaster recovery firm, so consistency and continuity of communication was a problem."

Part of this issue was managing the expectations of policyholders about when they would be able to get back into their properties. "Flooding can be a pretty horrendous event, particularly if the flood has come above the skirting board level," says George. "You have to manage expectations, as you're really talking about more than six months to repair."

The competitive nature of the insurance industry, with each insurer having its own service standards and contractors, is another area of friction. Foulsham says: "We would like to see more co-ordination between the insurers and the loss adjusters."

In an ideal world, a single loss adjuster could act for multiple insurers in resolving all the cases on one street, meaning standardised communication with homeowners and uniformity in claims management. But it is difficult to make this happen when insurers are intensely competitive in securing both commercial and personal lines policyholders.

"We could have done better in working together with the insurers as a community as opposed to working in individual company silos," says Wood.

But not everyone agrees. "I don't see how it is possible," says Orriss. "Every insurer has different practices, operating standards and service levels, and if you give one street to one company people might not be getting what they expected from their insurer."

If an event on the scale of the 2007 floods hit the UK again, would the industry respond successfully to the challenge? The recommendations from the forthcoming Pitt Review on flood defences and management will shape the thinking of the government and the industry for future events, hopefully for the better, and those within the sector seem confident of its ability.

George says: "Should another event of that magnitude occur, we as part of the supply chain, and the insurers and brokers will be better prepared. A huge amount of work has gone into things like having better relationships and plans, more robust systems and more understanding of what is going to happen."

Eldridge says: "I think the industry would cope, but it would cope more effectively. Every event like this produces lessons that we can take forward." **IT**

### Supply chain management

**If implemented properly the lessons from the 2007 floods will ensure that best practice is maintained, claims costs controlled, and the supply chain is managed smoothly next time round.**

**"In an unprecedented event like this there are resource issues, which means that it takes longer than we would have liked to get out to see people," says NU's Eldridge. "We tried to assess those people in the most need and get to them as quickly as possible."**

**NU has responded by putting more formal agreements in place with its second tier of suppliers, which will be able to commit resources to them in the case of a large scale event.**

**Many in the industry feel that the switch over between different elements of the supply chain could also be smoother and more efficient. Minimising the delay between one piece of the process ending and the next beginning, as well as letting the claimant know what is going on is vital. "We want to make the change almost invisible to the client," says Eldridge.**

**Insurers are putting pressure on all elements of the supply chain to be more efficient in their resolution of claims, and are being very demanding of their loss adjuster partners for innovative solutions to control the cost of claims.**

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# DOWN IN FLAMES

It has been the worst quarter for single losses since 9/11, but property rates are still in the doldrums. Andrew Wragg reports.

Following two years of relatively healthy loss experience, the property industry seems to have encountered a spell of bad luck in 2008. According to Lloyd's insurer Advent Capital, the first quarter of this year dealt the industry the worst single risk property loss since the third quarter of 2001 – a period which was dominated by the 11 September terrorist attacks.

"Others in the industry are saying that this has been the worst start to a year in 20 years," says Michael Papworth, team leader at broker Benfield's facultative solutions division.

Analysts have suggested that the first quarter property losses could be as high as $6bn (£3.1bn), and while one might expect such a figure to have a market-altering effect, this seems not to be the case.

"Other than mining there is no change to the softening market, due to the massive oversupply of capacity," adds Papworth.

Charles Coyne, an analyst at investment bank KBC Peel Hunt, agrees that capital is easy to come by.

"There's plenty of capacity out there, especially in the US," he says, predicting that, despite the events of the first quarter, the broad trend of the US and international property and catastrophe cycle is still set to be down until well into 2010 in the absence of any major events.

Coyne's sentiments are echoed by Al Tobin, managing director and leader of broker Aon's property practice, who believes that rates could be on the slide for the next 18 months. In Tobin's opinion, it would take a claim of more than $10bn to turn the market. Some of his peers have suggested that figure may be nearer $20bn. ➔

## How first quarter 2008 losses hit profits

Hardy Bermuda has borne a portion of both the BHP Billiton and Severstal claims, after providing cover on an excess layer basis. It recently described the first quarter of 2008 as "the most significant loss making quarter since the World Trade Center disaster", which involved "an unprecedented number of high profile large losses in the direct and facultative property market". Lloyd's insurer Advent said major property losses, such as claims connected to BHP Billiton and Severstal, had caused its profits for the quarter to plunge. And Munich Re's first quarter profits declined 19% in its reinsurance division due to the spate of major losses hitting the market in the period.

➔ Tobin says: "Insurers warn of hurricanes hitting the east coast of the US and there is the ongoing threat of earthquakes, but if there are no single events above $10bn, the market will continue to be in the clients' interest for the rest of the year; $10bn is the minimum."

According to Property Claim Services (PCS) data, US property and casualty insurers will pay out an estimated $3.35bn in first-quarter property losses, resulting from nine catastrophes, their largest first quarter pay-out for a decade (see box).

The wave of setbacks in early 2008 does not appear to have dented the market as a whole – capacity is still rife, thanks to the stellar returns of the past two benign US hurricane seasons. However, perhaps not all players are willing to digest the possible extent of their first quarter losses.

"There is somewhat a 'head in the sand' mentality," says Papworth. "Results take a while to come through. By 2009 there will be an impact, which will be shown in the way reinsurance is purchased."

## Business interruption

While the market globally saw rate reductions in property lines of up to 20% over the past year, the high profile and highly expensive floods in Australia in January have managed to slow the speed of decline in the domestic market. Looking at the official figures, it is easy to see why the flooding was, and still is, a business interruption nightmare. According to the Queensland Resources Council (QRC), most of the 33 coal mines in the Bowen Basin – where 40% of the world's steel-making coal originates – lost production as a result of the deluge.

The QRC says the export coal industry is worth more than A$18bn a year to the Queensland economy, and is a huge source of income for the regional authorities. In the last financial year, the coal industry paid $1.15bn in royalties to the Queensland government.

Mining giant BHP Billiton is estimated to have suffered a $1.6bn insured loss in the floods, but even a claim of this magnitude has not halted a slide in property insurance rates in the Australian market.

However, Papworth believes that the flooding has at least managed to slow the decline – to around 5%. He points out that there are signs that the sector may now be reaching the bottom of the cycle.

"In Australia, long-term agreements (LTAs) are coming through," he says. "Insureds are being tied into two to three-year contracts, which tend to happen at the bottom of the market.

"When we begin to see three-year LTAs, it means it is about as cheap as it is going to get."

Is the trend towards LTAs being seen elsewhere globally?

"These LTAs don't exist that much in the rest of the world," Papworth continues. "We have seen them mainly in Australia and Germany. Nothing has appeared in the US yet."

According to London market brokers, claims arising from the Australian floods have hit most of the global multinational cedants to varying degrees. Papworth believes that both insurers and reinsurers have taken a significant hit.

"A lot of the primary companies buy plenty of facultative cover which will impact the traditional fac reinsurers," he points out.

After surveying 20 US property and casualty reinsurers, the Reinsurance Association of America (RAA) reported that combined ratios had worsened to 95.2% from 89.8% in the first quarter of 2008 compared to the same period last year.

According to Benfield, the first quarter losses could focus insurers' attention on the value of fac reinsurance to assuage a series of shock losses.

Meanwhile, Papworth says the Australian flood claims have made mining risks more difficult to place, but outside this particular sector it is still business as usual. But he does add that certain capital-rich players are prepared to seize opportunities in the mining sector, taking advantage of the rates, which are relatively robust compared to the rest of the market.

"Post 9/11, we couldn't place anything," he adds. "But at the moment, we can still do something, which is testament to the amount of capacity that is currently out there."

Aside from the mining claims, Russian steelmaker Severstal came into the spotlight in January following an explosion at its Michigan steel mill, resulting in an estimated $500m insured loss. Just weeks later, the company suffered another setback with an explosion at one of its Russian operations, resulting in an estimated $25m claim. Papworth says these loss estimates could rise still further.

"These claims are ongoing," he adds. "The physical damage can be resolved quite quickly, but business interruption takes much longer to assess."

Spiralling commodity prices have added to insurers' misery in business interruption claims in the energy and manufacturing sectors. So is it time for the industry to rethink the way it structures its policies, or is this variability simply part and parcel of the service it offers?

"The way business interruption is offered is a hot topic right now," adds Papworth. "Especially when the underlying risk is commodity-based. Aspects of the cover are being reviewed, and I have no doubt that Munich Re and Swiss Re will have a team of business interruption experts working away on this." **IT**

### The cost of US claims

According to figures from the Property Claim Services (PCS), a unit of the US Insurance Services Office, the nine events that have landed US insurers a $3.35bn bill for the first quarter include a workers' compensation loss in connection with an explosion at a sugar refinery in Georgia in February. The remaining eight catastrophes, which generated 615,000 claims in 22 states, were caused by severe weather including wind, large hail, flooding, and tornadoes, and one was caused by a winter storm.

Of the 22 states, the five with the largest insured property losses were Georgia ($610m), Tennessee ($535m), California ($360m), Texas ($270m), and Arkansas ($223m).

The costliest event of the quarter, at $955m, was caused by an outbreak of severe weather that spread from Texas to Ohio in early February, which caused about 120,000 losses in the eight affected states.

The first catastrophe of the year, a winter storm in January, affected 13 states and caused an estimated $745m of insured property damage. It also inflicted damage to 177,000 personal and commercial properties and vehicles.

Claims in personal lines produced 56% of the total $3.35bn loss for the quarter, or nearly $1.9bn. The commercial property loss was 31% of the total, or just over $1bn. The loss involving insured vehicles amounted to almost $500m, or 13% of the total.

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