

Target, Technical and Walkaway Pricing in the London Market

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Some Working Definitions

- **Technical Price:**
 - Price required to meet long term return targets and contribution to expenses, on average.
- **Walkaway Price:**
 - Minimum price beneath which deal is thought to be destroying value of company.
- **Target Price:**
 - Required price to enable the underwriter to meet current business plan targets for the planned volume and mix (subject to random error).

Some Relationships

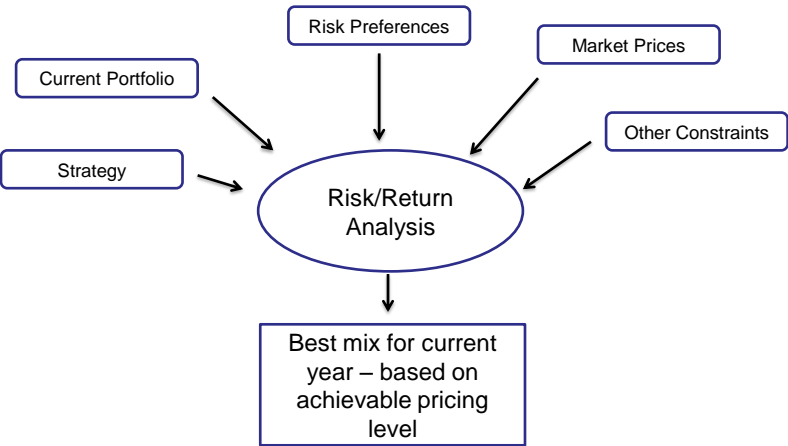
- **Target > Walkaway (Always)**
- **Technical > Walkaway (Usually)**
- **N.B.** If you write a large proportion of deals at the walkaway price it is unlikely you will make plan. (**Some** underwriters will need this explained.)

Some Properties

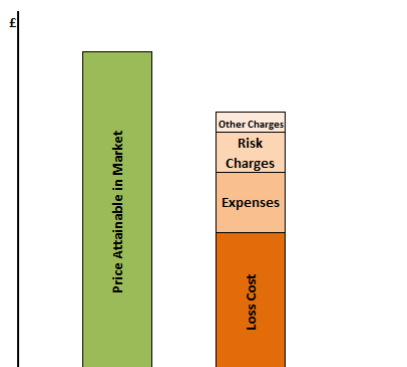
Related to	Technical	Walkaway	Target
Current Risk/Loss Environment	YES	YES	YES (but ...)
Capital Position of Company	YES	YES	YES (but ...)
Business Mix	YES	YES	YES (but ...)
Internal Expenses	YES	YES	YES (but ...)
Current Position in Market Cycle	NO	YES	YES (but ...)

- But the effects of each feature differ on each “price”

Business Planning



What are we trying to maximize?



- Want to maximise the difference across (realistically) possible portfolio selections.

Revision – Marginal / Standalone / Allocation

- **Marginal Basis:**
 - Considers the incremental costs of a block of business when it is added to the portfolio last.
- **Allocated Basis:**
 - Considers the costs if the business is given a “fair” allocation of all charges.

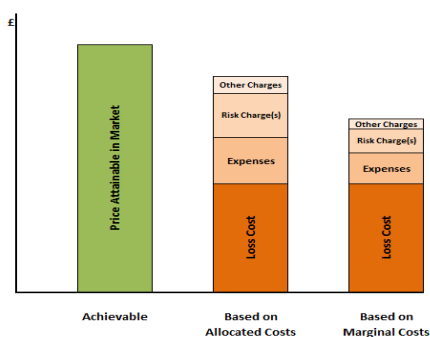
Allocations are always subjective (there are plenty of “wrong” ways but no “right” one).

Revision – Marginal / Standalone / Allocation

- At the business planning stage we are predominantly concerned with marginal comparisons.
- For a “class” to be adding value must cover the required marginal contribution to risk and expense. But some business units must be covering more.

Now Look by “Class”

- For each class we can get:



- This is the basis of the pricing framework. (Target, technical, walkaway).
- Allocated basis is subjective.

Deal by Deal Targets

- We now have a basis for pricing targets by “class”.
- Deal by deal?

But some practical issues

- Variation within “class”.
- Aggregating deals.
- Different levels of uncertainty (e.g. high layers).
- When looking at “marginal” costs what is the appropriate block of business?
- Varying the risk charge with the cycle.
- Which expenses are fixed and which are variable?
- Ceded reinsurance.
- Market risk.
- When to re-balance.
- Soft issues and referral.

And some really difficult issues to deal with

- Decision making time horizon.
- Modelling time horizon.
- Long tailed business, reserving risk and the Market Value Margin.
- Error.
- No Year Zero.

Summary

- Need to start with a robust framework linked to business planning and modelling.
- Outline of target, technical and walk-away framework can be driven from these.
- But lots of major issues in practice.
- But we can start to address these (and we have to deal with similar issues in pricing all the time).