



The Actuarial Profession

making financial sense of the future

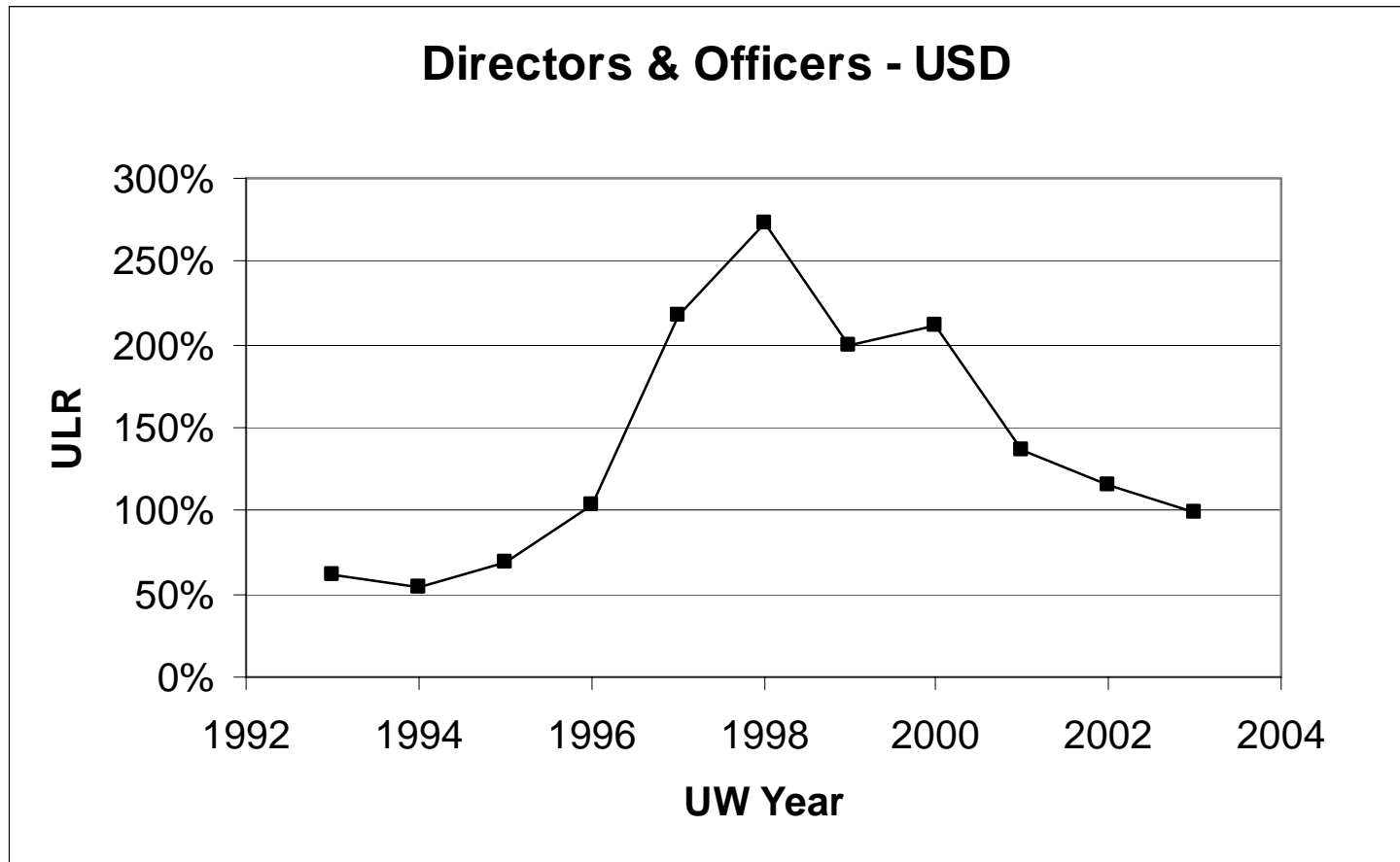
The London Market Pricing Cycle

Nicholas Line
26th April, 2004

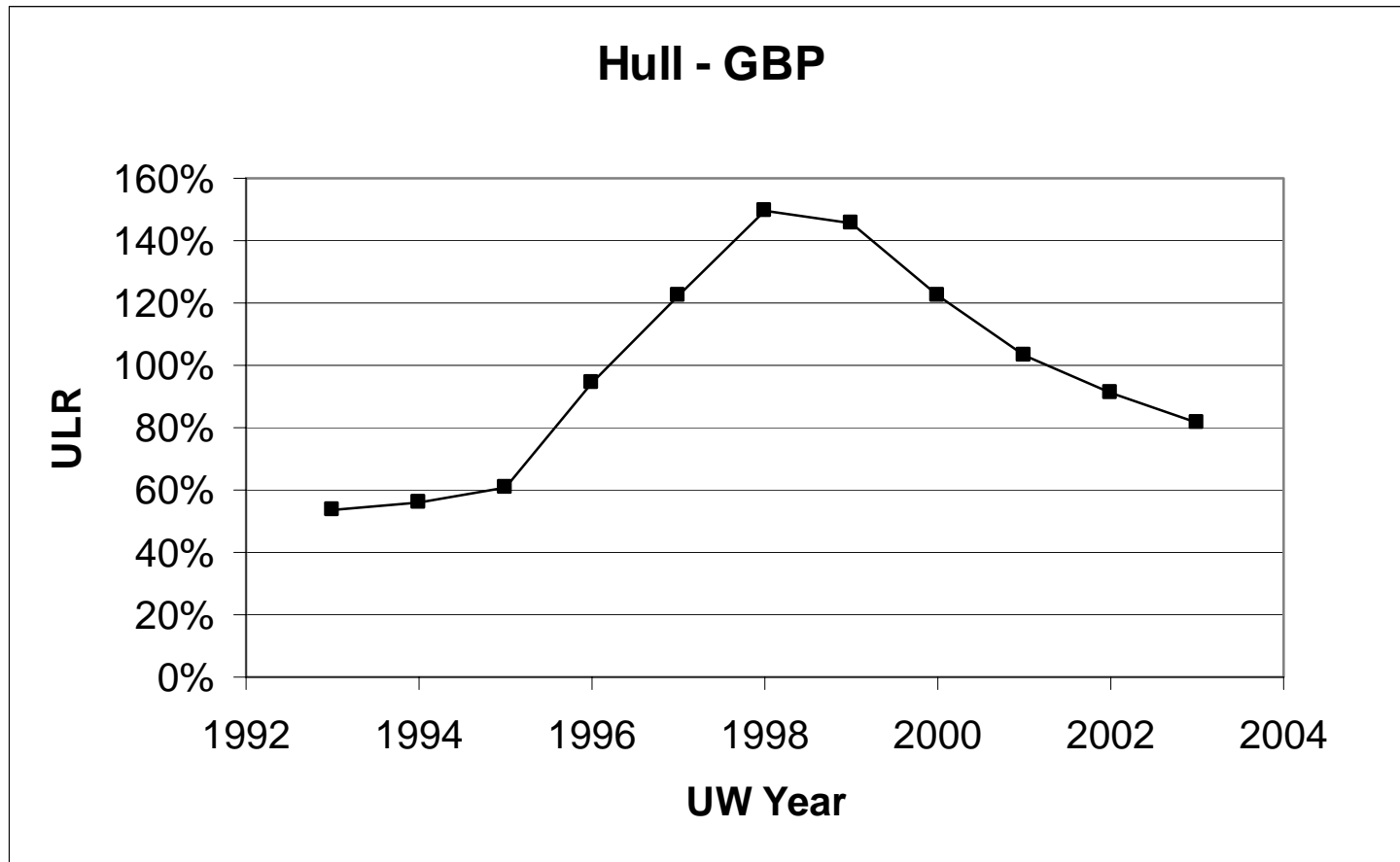
The London Market Pricing Cycle

What I'm not going to talk about:

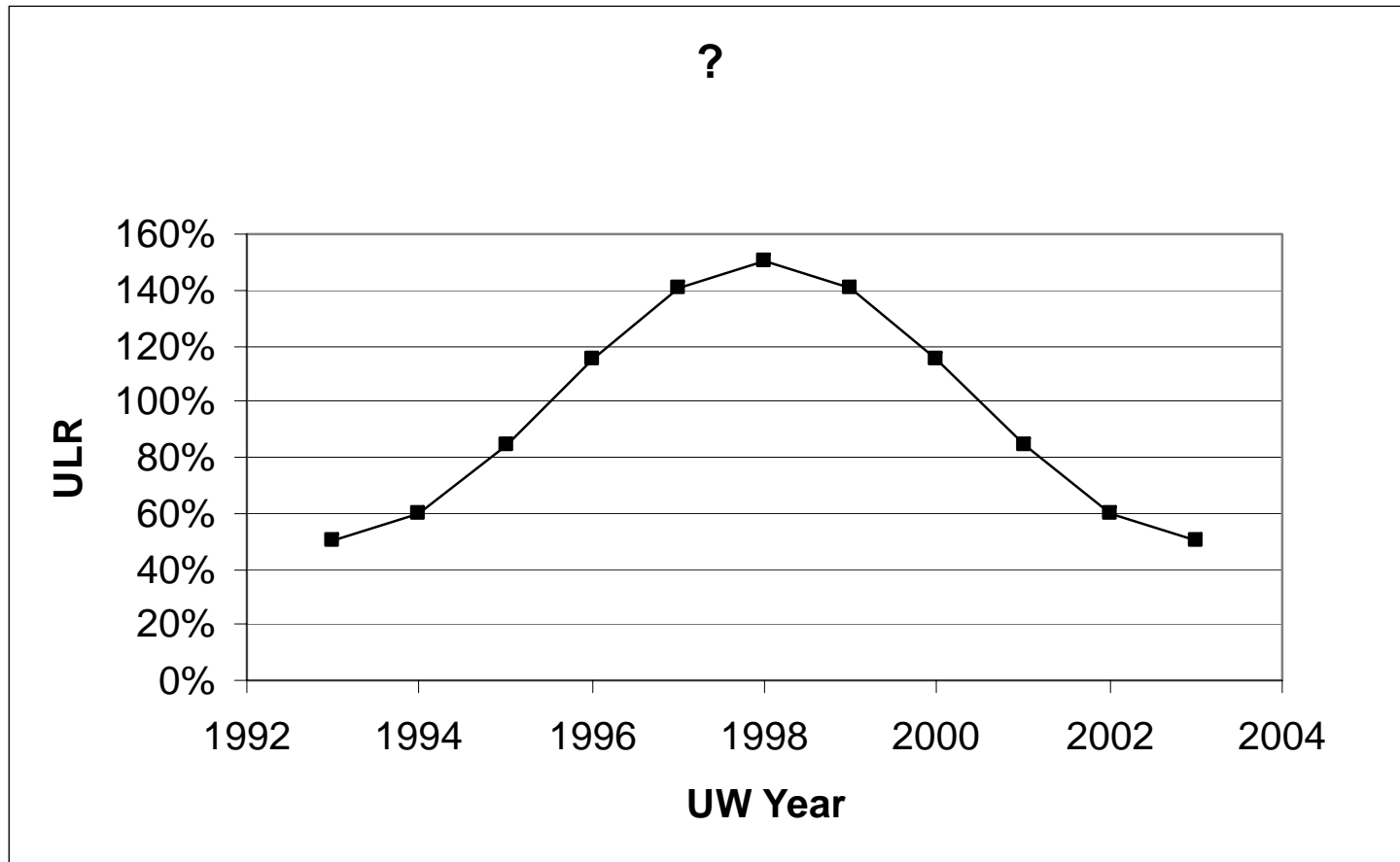
- The London Market = Companies + Lloyd's etc
- The Pricing Cycle = looking at lots of graphs....



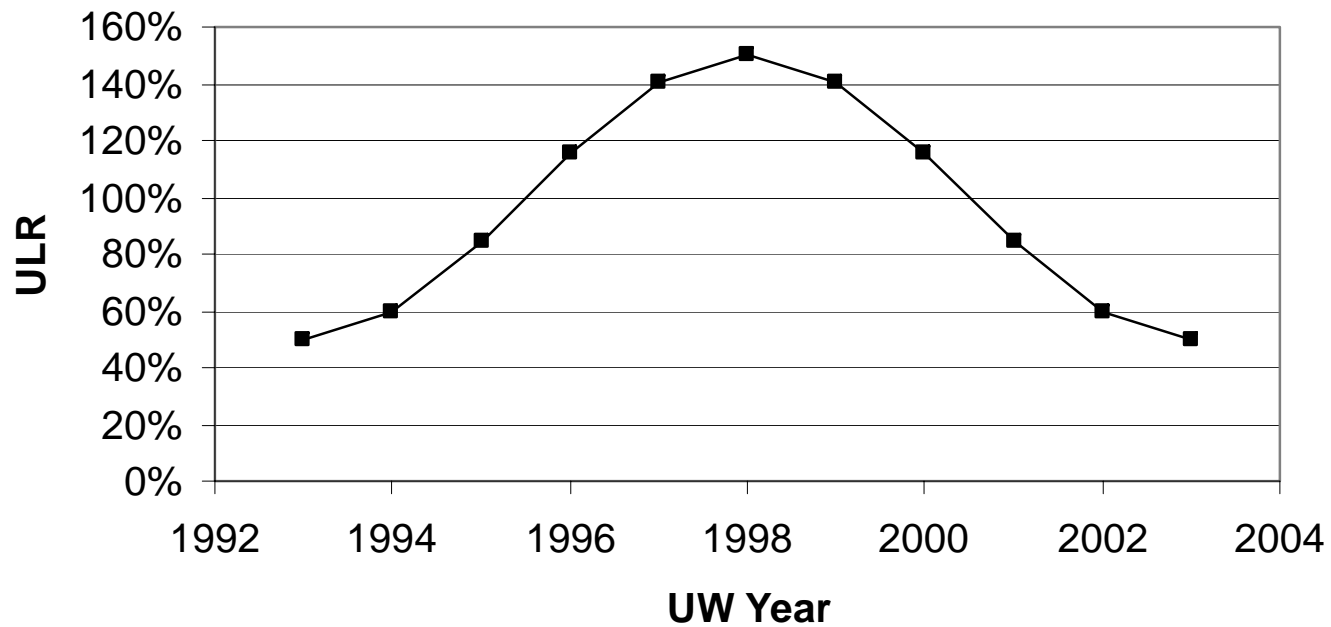
Taken from Reserve Cycle Paper presented to GIRO 2003



Taken from Reserve Cycle Paper presented to GIRO 2003



$$100\% + 50\% \times \cos \left\{ \frac{(t-1998)}{10} \times 2\pi \right\}$$



The London Market Pricing Cycle

What I am going to talk about:

- Summary of 2003 GIRO papers
 - I Cycle Survival Kit
 - II Cynic & Idealist
- What is happening now?
 - Profession
 - Regulators
 - Industry
- The Future

The London Market Pricing Cycle

Why am I here?

Chaired the Cycle Survival Kit Working Party



Did all of the work for the above



Have many years of experience in the London Market
Have seen countless cycles come and go
Am an old hand



Have been a victim of the pricing cycle
Don't want to be so again
Want to know all I can about it



Summary of GIRO Papers I

- The Cycle Survival Kit
 - Reserving Cycle in UK
 - Merits of flattening it
 - Standard actuarial techniques
 - Rate indices
 - More work needed!

Summary of GIRO Papers II

- The Cynic and Idealist (Martin White)
 - The pricing cycle has been well studied, but there is not much on what to do about it
 - Must handle the cycle to operate effectively
- Cynic: 'Companies are unable to cope with the cycle'
- Idealist: 'Companies could cope with the cycle if they could just operate a bit differently'
- This means being unafraid of volatility or of losing market share

The Actuarial Profession

- The Cycle Survival Kit Part II
 - The working party continues in 2004
 - Update and extend work on FSA data
 - Suggest adjustments to reserving methods to deal with the cycle
 - Contact Kevin Wenzel (Allianz Cornhill)
- Reserving Task Force
 - a periodic review of reserving issues by the Institute of Actuaries
 - Set up by the GIB
 - Terms of Reference tbc

The Regulators - Lloyd's Franchise Performance I

Aims

- To maximise returns to all capital providers over the cycle
 - Keep Franchisees well informed about their performance
 - Point out where we are in the cycle
 - Highlight good practice
- ! Lloyd's is not a dominant player in any class
- Have to be realistic about Syndicates influencing the pricing cycle

Advantages

- Unique access to everyone's data, both past and present
 - Access to the management of all agencies/syndicates
 - Can identify best practices and encourage others to follow them
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The Regulators - Lloyd's Franchise Performance II

Actions

- Past: ON or OFF
- Now: Range of powers
- Dialogue: Commercial, not just Regulatory
- Coaching and Improving
- Regulatory returns
- Identify best practice

Examples

- Limited Qualifying Quota Shares to 10% of capacity
- Changes to business plans, line sizes, strategy
- Strengthening and widening of board membership
- Extreme: limit premium volume for a class (to zero)

The Regulators - FSA

Four main aims

- Maintaining confidence in the UK financial system
- Promoting public understanding of the financial system
- Securing the right degree of protection for consumers
- Help to reduce financial crime

Influences

- Monitor companies via Arrow visits and risk assessment
- Must only write business that is profitable....
- ICAS should help dampen the cycle
- New companies seeking approval need sufficient capital
- So it all comes back to capital providers

The Industry I - 2004 Renewals

Reinsurers' Views

- Munich Re
 - 'Conditions for sustainable profitability set'
 - 'Adequate prices across entire portfolio'
 - 'Property rates consolidating at technically adequate level'
 - 'Casualty rates show further increase'
 - Swiss Re
 - 'Encouraged by further development of hard market'
 - Cautionary note on forward-looking statements, 19 caveats, top of the list: 'cyclicality of reinsurance industry'....!
 - Hannover Re
 - 'Most markets in p/c reinsurance still offer very good profit potential'
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The Industry II - 2004 Renewals

Market Views

- Benfield
 - Will the market 'Hold the Line?'
- JP Morgan
 - European Non-Life better than Life (sub-100% combined ratio to 2006)
 - Coverage of Lloyd's initiated
 - 'Lloyd's offers best place for investors to take advantage of the current high rates and low combined ratios.' - February 2004
- RIMS (risk managers)
 - Hard market 'now on its last legs'
- Insurance Information Institute (US)
 - US p/c on course for first underwriting profit since 1979

The Industry II - 2004 Renewals

Market Views

- Headlines
 - Is the market already on the turn? - November 2003
 - This market is not for turning...yet - November 2003
 - Can Lloyd's maintain its momentum? - April 2004
 - *** already planning for soft market -April 2004
- Hull
 - Future grim in Marine hull cover - February 1996
 - “Free Fall” in hull rates to continue - September 1996
 - Marine hull rate fall alert - July 1996
 - Marine in deep water - January 2003
 - Low rates leave hull sector in ‘dire state’ - September 2003

The Industry III - 2004 Renewals

London Market Companies I

- Reported rate increases overall for 2004 renewals
- However some classes showing reductions
- By class
 - Large property -10%
 - Energy & War -10%
 - Hull + 5%
- Some publish rate indices

The Industry III - 2004 Renewals

London Market Companies II

- Quotes from public statements include
 - Favourable market conditions
 - Profit not volume
 - Reinsurance costs and terms improved
 - Growth is not at the expense of quality
 - 2004 rates will exceed 1993 on average
 - Well-placed to cope with softening market
- Likely to produce good 2004 results purely due to unearned premium from 2003

The Future I - Reasons to be Cheerful

- Capital: Intelligent
- Capital: Adequate but not excessive
- Capital: Continues to be eroded by reserve increases
- Investment returns
- Stronger FSA/Franchise Performance Directorate
- More actuaries (pricing)
- Better reserving, so better profitability assessment
- More prevalent rate indices
- Stricter claims control
- Improved Management Information
- Pressure from rating agencies
- Lessons learned.....?

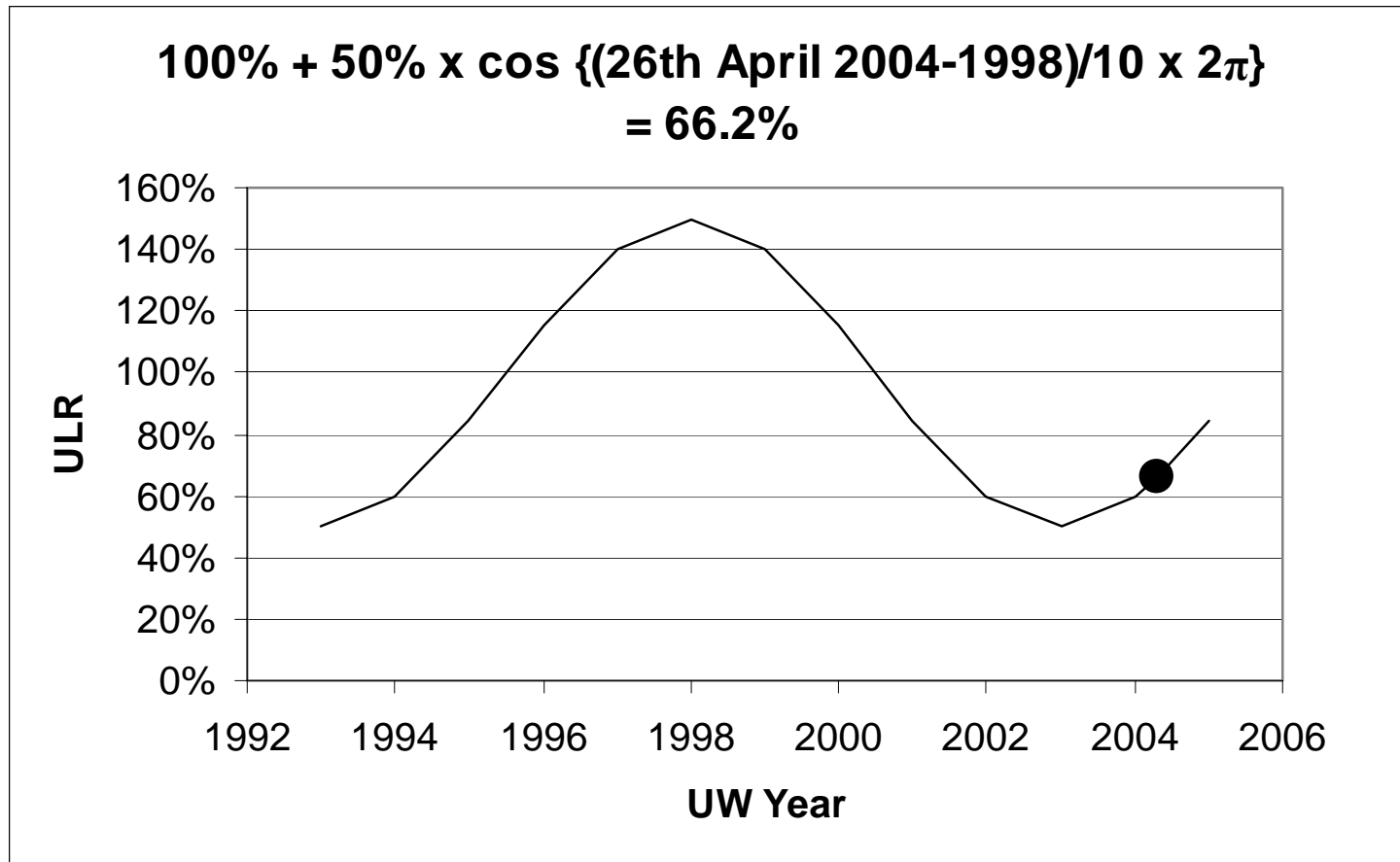
The Future II - Reasons not to be Cheerful

- Weight of history
- Capital: Innocent?
- Capital: Some is unconstrained by prior year problems
- Still not a meritocracy
- Underwriters: Inexperienced?
- Underwriters: Do not know when to stop?
- Underwriters: No incentives to stop?
- Wall Street pressure / CEOs' egos
- Some classes cannot price technically, so no red line
- Cannot measure changes in terms & conditions easily
- Low level of claims activity gives false picture of loss costs
- Currency movements erode written premium for £ reporting

The Future III - Are We Cheerful???

Cheerful 12 - 12 Not Cheerful (L)

Where are we now?



The London Market Pricing Cycle

Questions:

- 1) Have we made enough money in this hard market to pay for the losses in the last soft market?
 - 2) Is it right that rates for some classes should be falling already?
 - 3) Is it surprising?
 - 4) Will these falling rates stop at adequate levels or keep going?
 - 5) Will the amplitude of future cycles be smaller?
 - 6) Will the period be shorter?
 - 7) Is the pricing cycle dead?
 - 8) Have we made enough money in this hard market to pay for the losses in the next soft market?
 - 9) Will Hull ever make money?
 - 10) Does McDonald's have a Franchise Performance Directorate?
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