



The Actuarial Profession

making financial sense of the future

GIRO CONVENTION 2008

25 SEPTEMBER 2008, SORRENTO, ITALY

London Market Pricing in the Soft Market

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Agenda

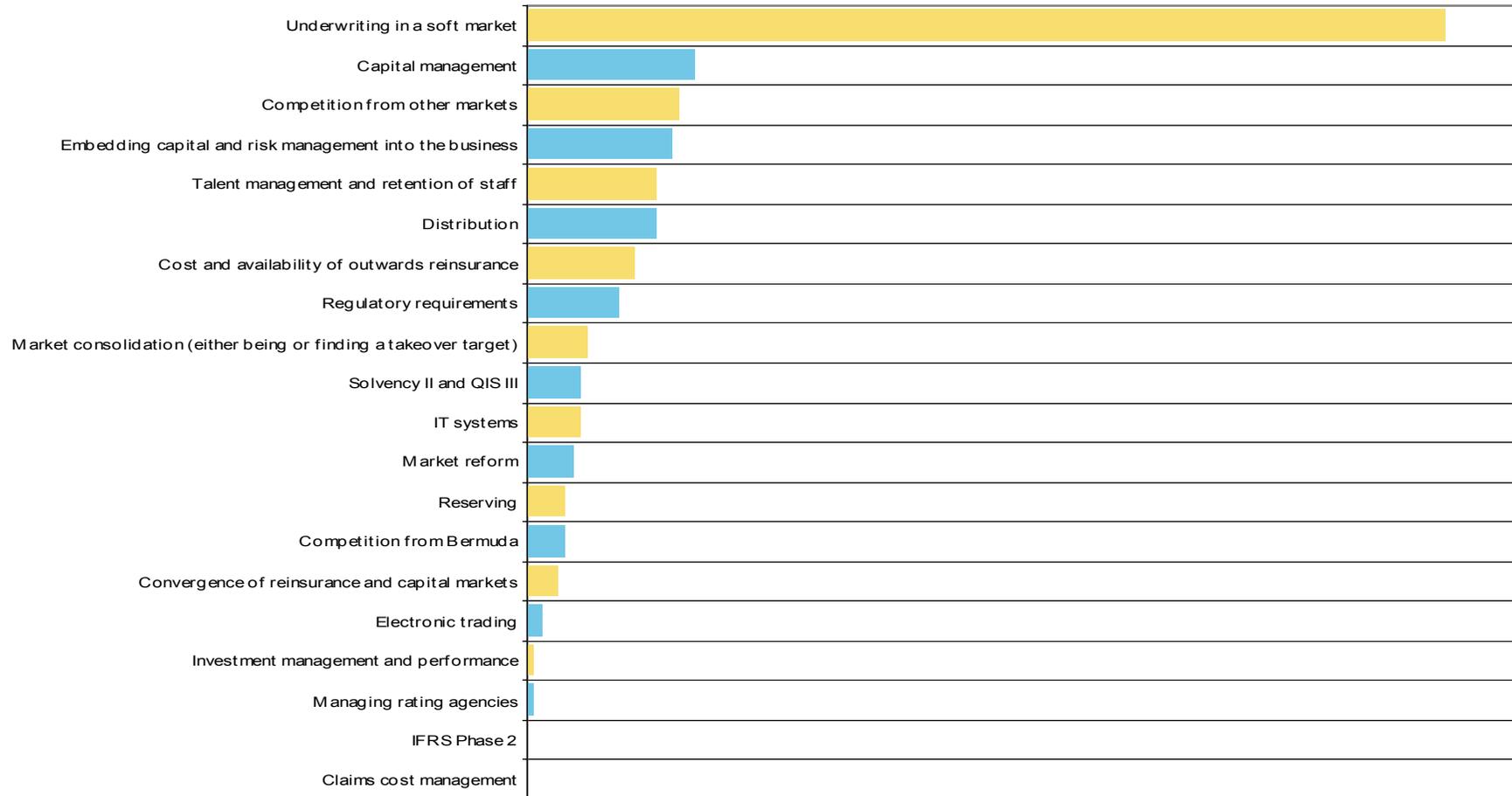
- Extracts from a Watson Wyatt survey
“Pricing and capital management in a softening market”
- Potential improvements to the pricing process
- Summary
- Questions

Current industry issues

- What are the five most important current industry issues for your organisation? (please rank five of the items in order of importance from 1, most important issue to 5, least most important issue)
 - Capital management
 - Claims cost management
 - Competition from Bermuda
 - Competition from other markets
 - Convergence of reinsurance and capital markets
 - Cost and availability of outwards reinsurance
 - Distribution
 - Electronic trading
 - Embedding capital and risk management into the business
 - IFRS Phase 2
 - Investment management and performance
 - IT systems
 - Managing rating agencies
 - Market consolidation (either being or finding a takeover target)
 - Market reform
 - Regulatory requirements
 - Reserving
 - Solvency II and QIS III
 - Talent management and retention of staff
 - Underwriting in a soft market

Source: Watson Wyatt survey “Pricing and capital management in a softening market”

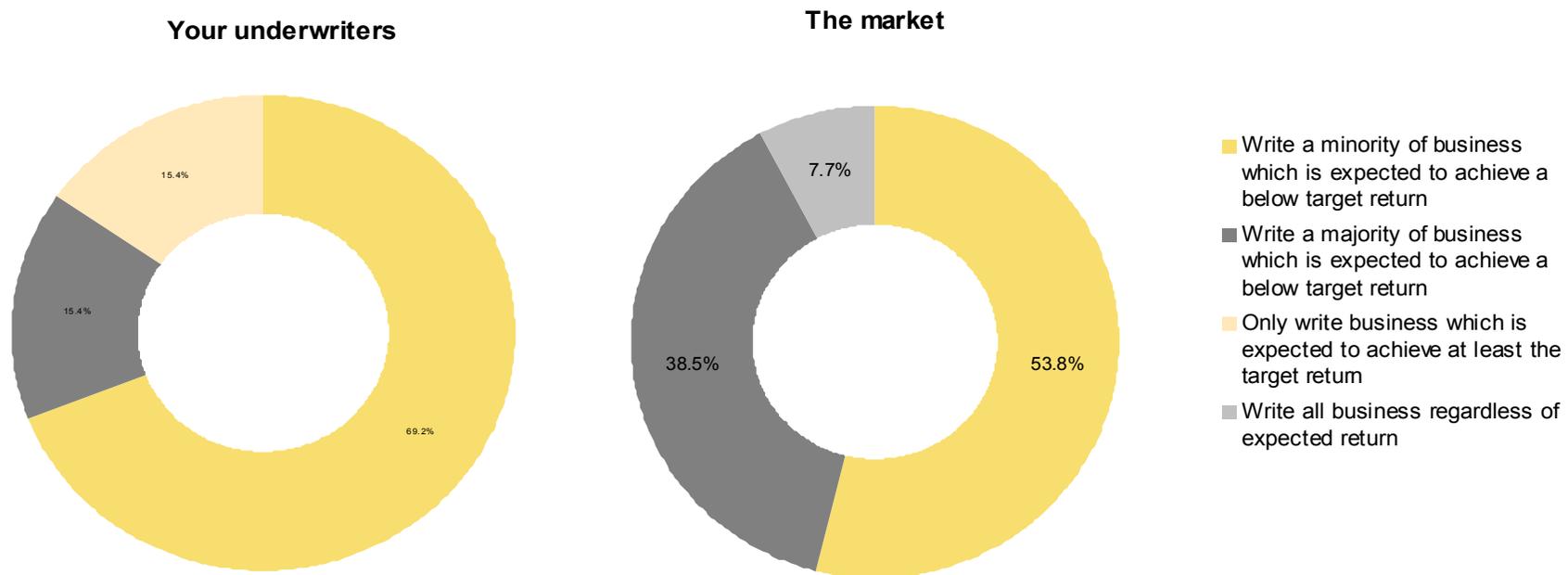
Current industry issues



Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Underwriting in a soft market

How do you believe the following are likely to behave through a soft market?



Source: Watson Wyatt survey "Pricing and capital management in a softening market"

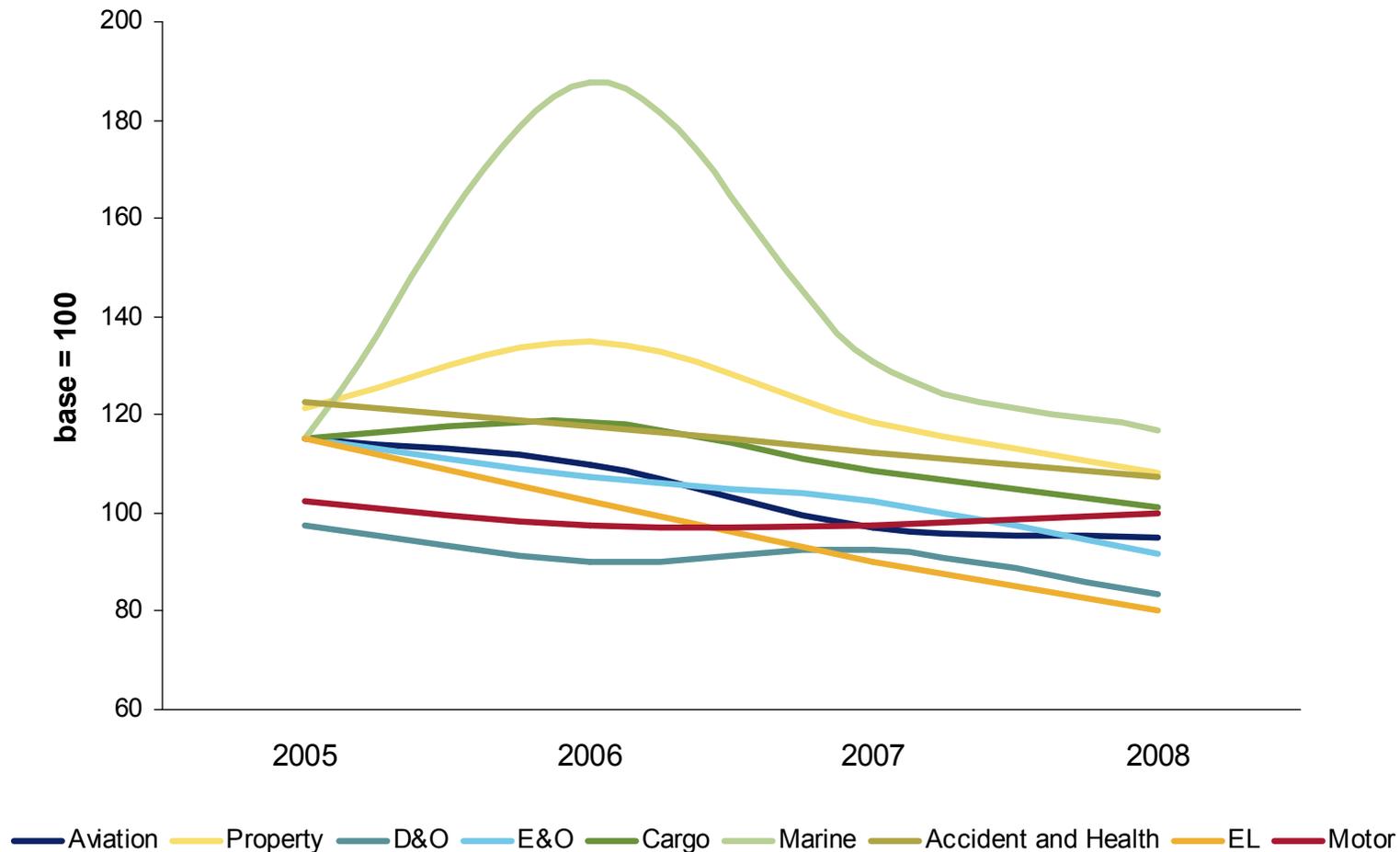
Underwriting in a soft market

- Most respondents expect their underwriters to maintain underwriting discipline better or as well as the market
- None expect to be worse
- *“I’ve never met an underwriter who is worse than the average”*

Survey respondent

Source: Watson Wyatt survey “Pricing and capital management in a softening market”

Recent, current and future underwriting conditions



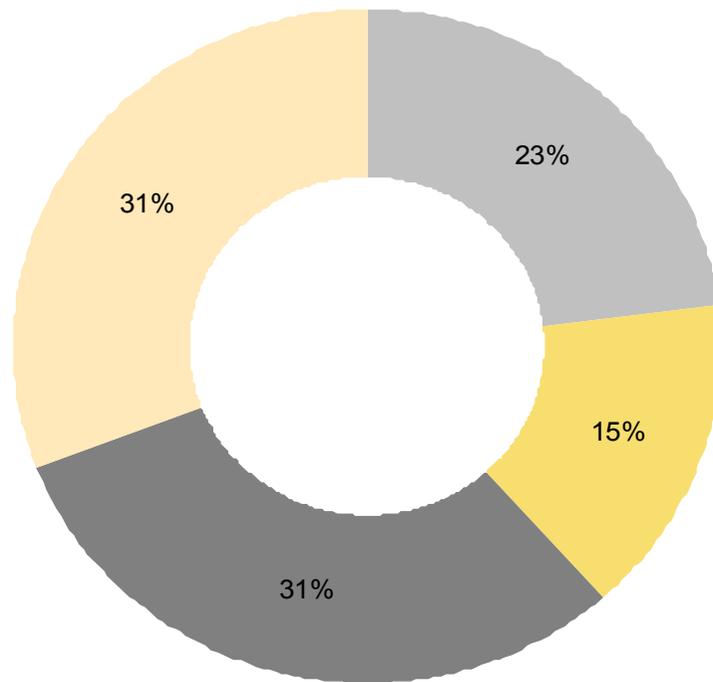
Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Recent, current and future underwriting conditions

- Almost all classes are trending downwards (other than motor)
- Clear distinction between the CAT and non-CAT exposed classes eg marine and property
- Despite softening rates, most classes expected to be profitable (or at worst marginally loss making) well into 2008
- 2009 could be the crunch year rather later than most market commentators expect

Source: Watson Wyatt survey "Pricing and capital management in a softening market"

How will the new Lloyd's syndicates impact the cycle?



- Accelerate the fall in rates (in other words, the trough will not be deeper but will be reached more quickly)
- Make rates fall further (in other words, the trough of the cycle will be deeper)
- Make rates fall further and accelerate the fall
- No impact

Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Recent market conditions

- Amlin
 - Overall down 8%
 - Retreated from US large property risks where rates fell 10.1% in the first quarter
 - US CAT fell 10%-12%
 - Aviation fell 1.5%
- Brit
 - Rates on renewed business down 2.2%

Recent market conditions

- Catlin
 - Average weighted premium rate across in first quarter 2008 decreased 5%
 - Average weighted premium rates for catastrophe classes decreased by 8%, whilst average weighted premium rates for non-catastrophe classes decreased by 2%

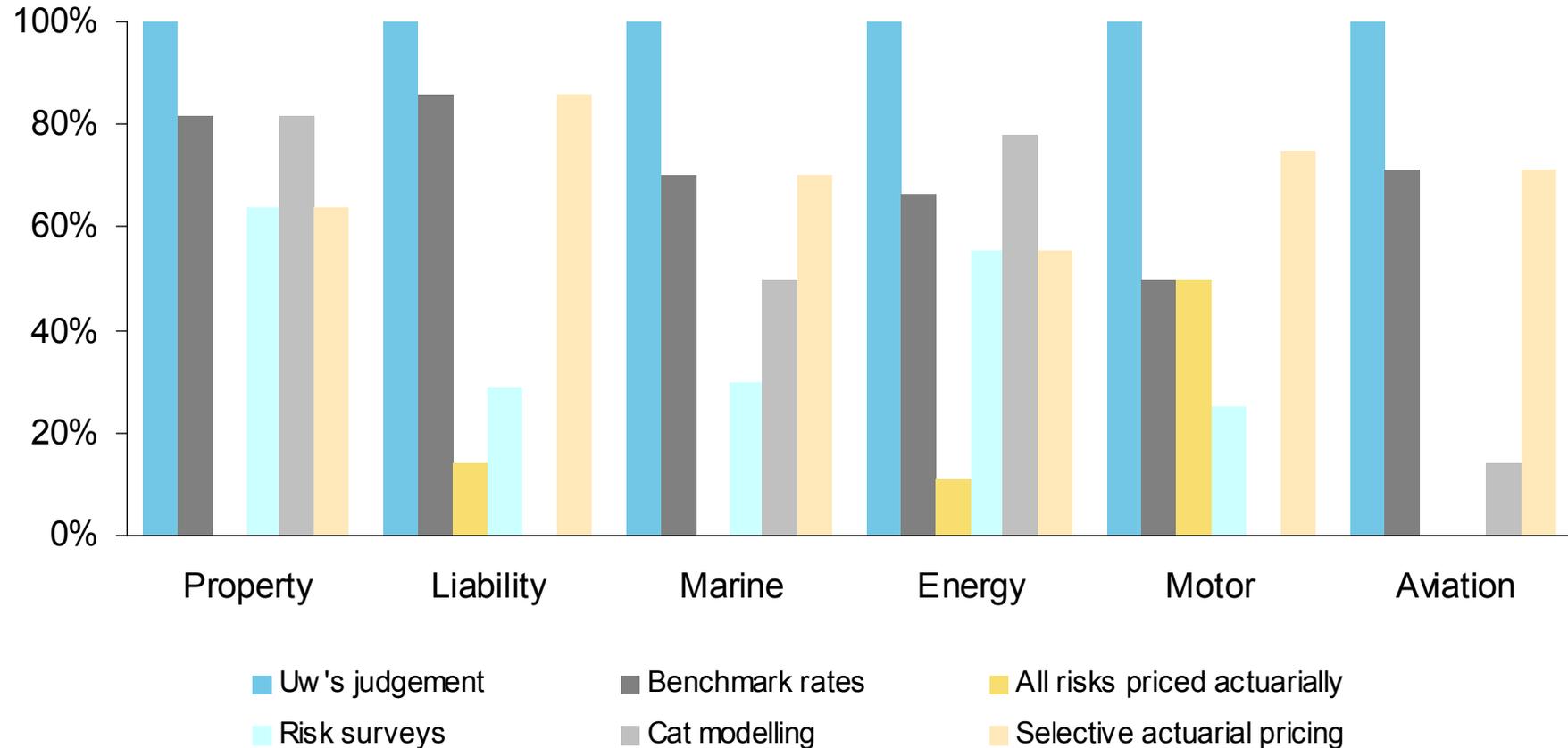
Monte Carlo Rendez Vous 2008

- Munich Re anticipates hardening market
 - Decreasing profits, capital base, investment gains
 - Increasing personal injury claims, claims inflation, exposures to natural catastrophes
- Aon Re Global
 - Credit crisis could halt slide

Monte Carlo Rendez Vous 2008

- Willis – hardening in marine market
 - Market remains predominantly soft
 - Double digit increases in P&I renewal
 - Scandinavian hull markets looking for 10%-15% increase
- Scor – downturn is all hype
 - 2008 rates had not shown massive drops across the board
 - Average drop 3% or 4%

Approaches to technical pricing



Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Approaches to technical pricing

- Approaches vary greatly by class (as one might expect)
- Underwriters judgement applied in all cases!
- Benchmarks used by about 60%-80% of respondents
- CAT modelling used on CAT-exposed classes
- Virtually no class where actuaries price all risks
- Actuaries are used more selectively

Source: Watson Wyatt survey “Pricing and capital management in a softening market”

Software used to support technical pricing

	Aviation	Property	Liability	Marine	Energy
In house	80%	67%	88%	60%	78%
External CAT model	20%	92%	0%	60%	100%
External licensed off-the-shelf	10%	0%	0%	0%	11%
External licensed tailored	20%	0%	0%	0%	0%
@RISK or similar	50%	42%	63%	50%	33%

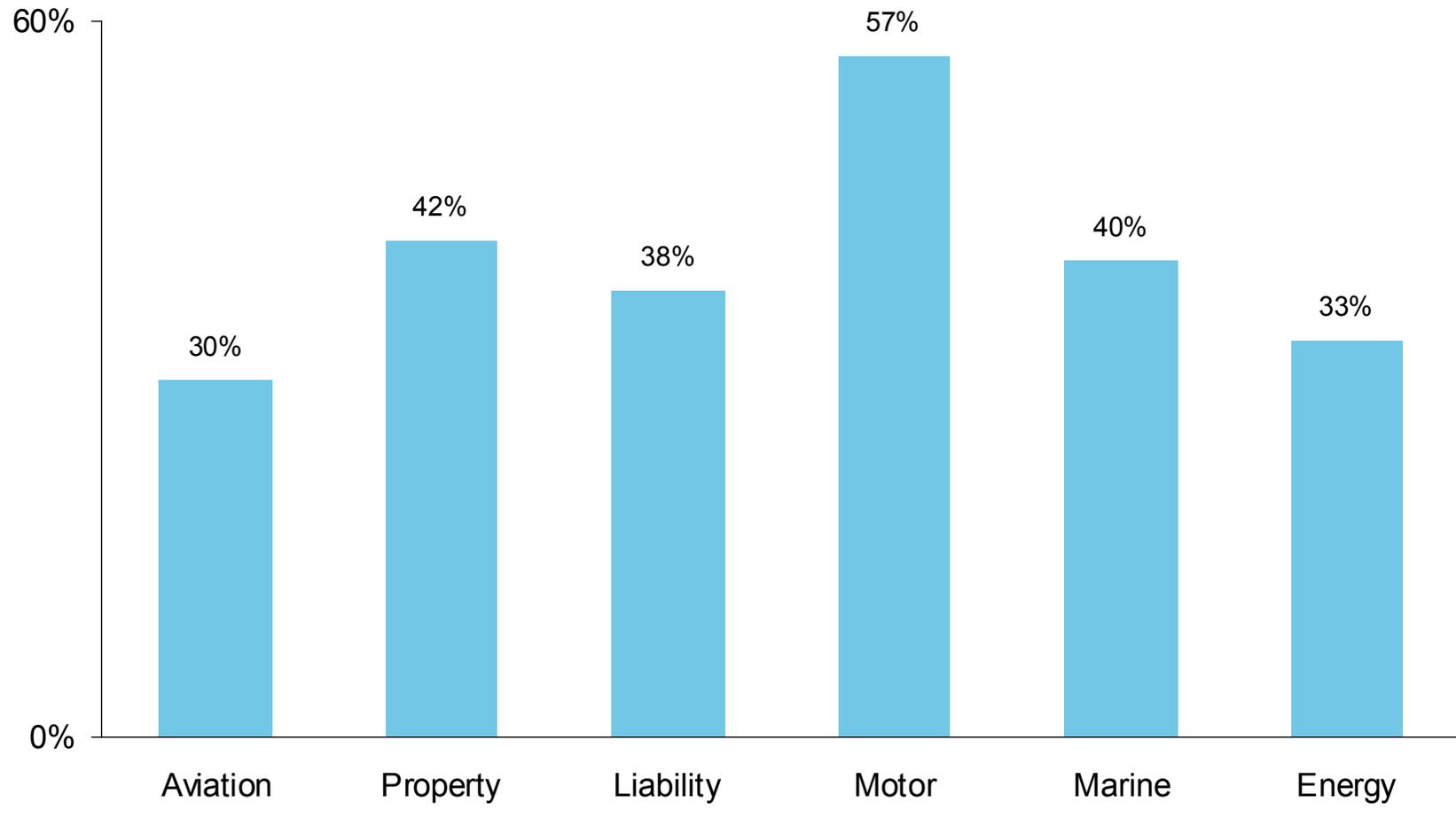
Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Software used to support technical pricing

- In-house developed models are used to a degree in most classes of business
- The CAT exposed classes use CAT models as one would expect
- No other externally provided models are used by the respondents in respect of property, liability or marine
- Simpler applications such as @Risk and spreadsheets are used by about a third

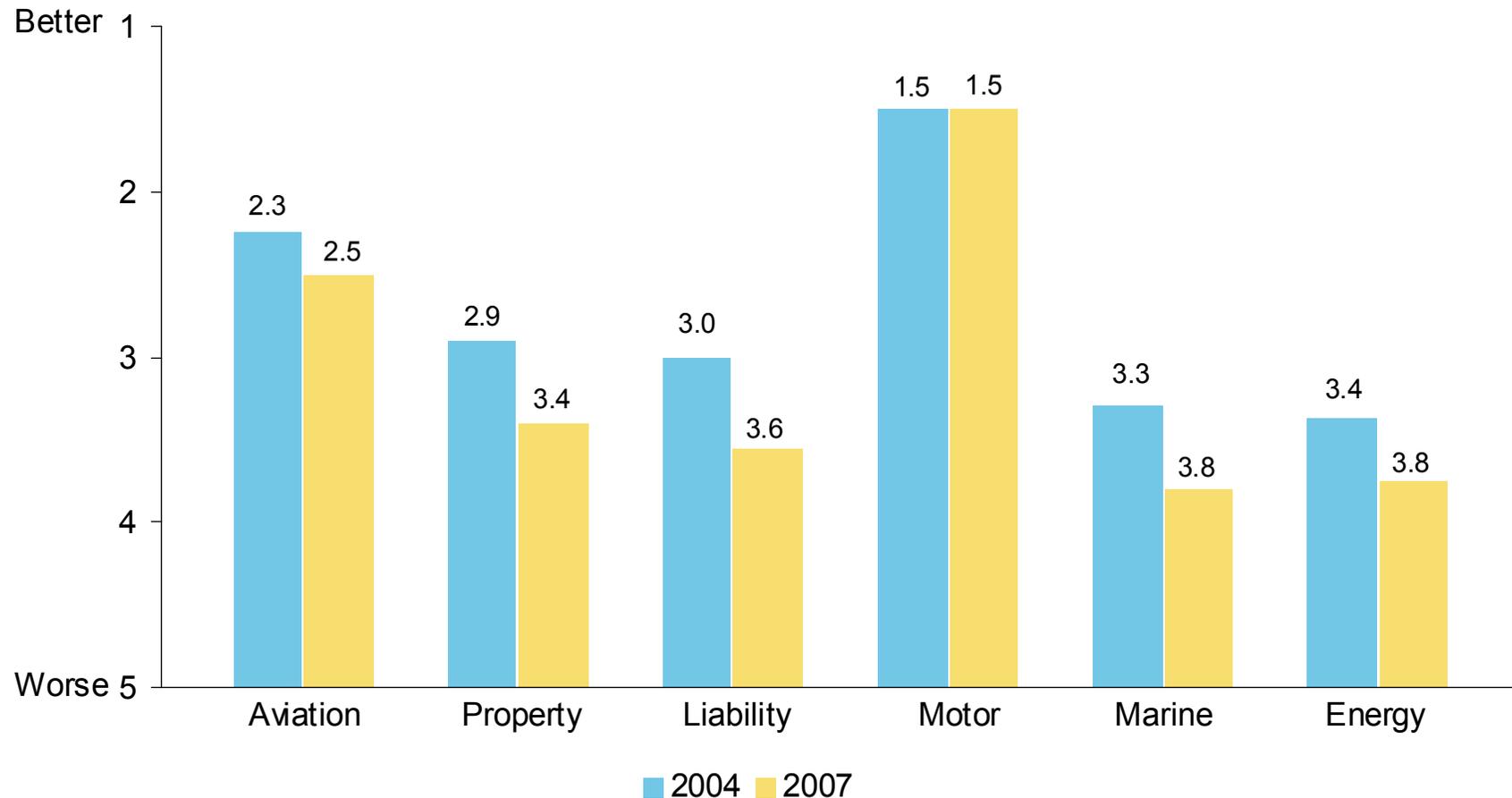
Source: Watson Wyatt survey “Pricing and capital management in a softening market”

Would standardised pricing software add value?



Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Changes in data quality



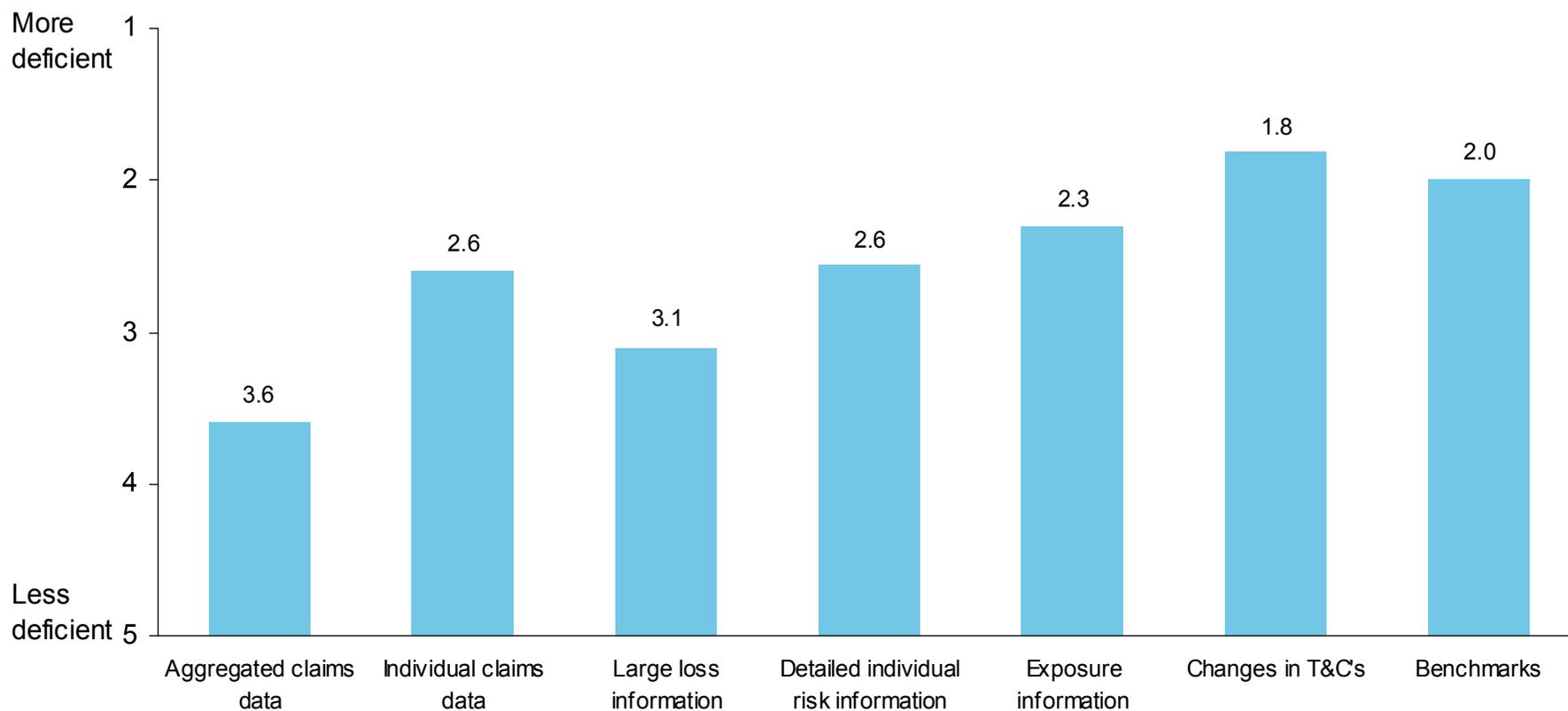
Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Changes in data quality

- Data quality has REDUCED from 2004 to 2007
- Individual responses show no improved scores
- Motor data is regarded as pretty good
- *“Data gets worse the further into a soft market you get. Better data is available in a hard market because brokers are forced to supply it when they can’t find a market.”*
Survey respondent

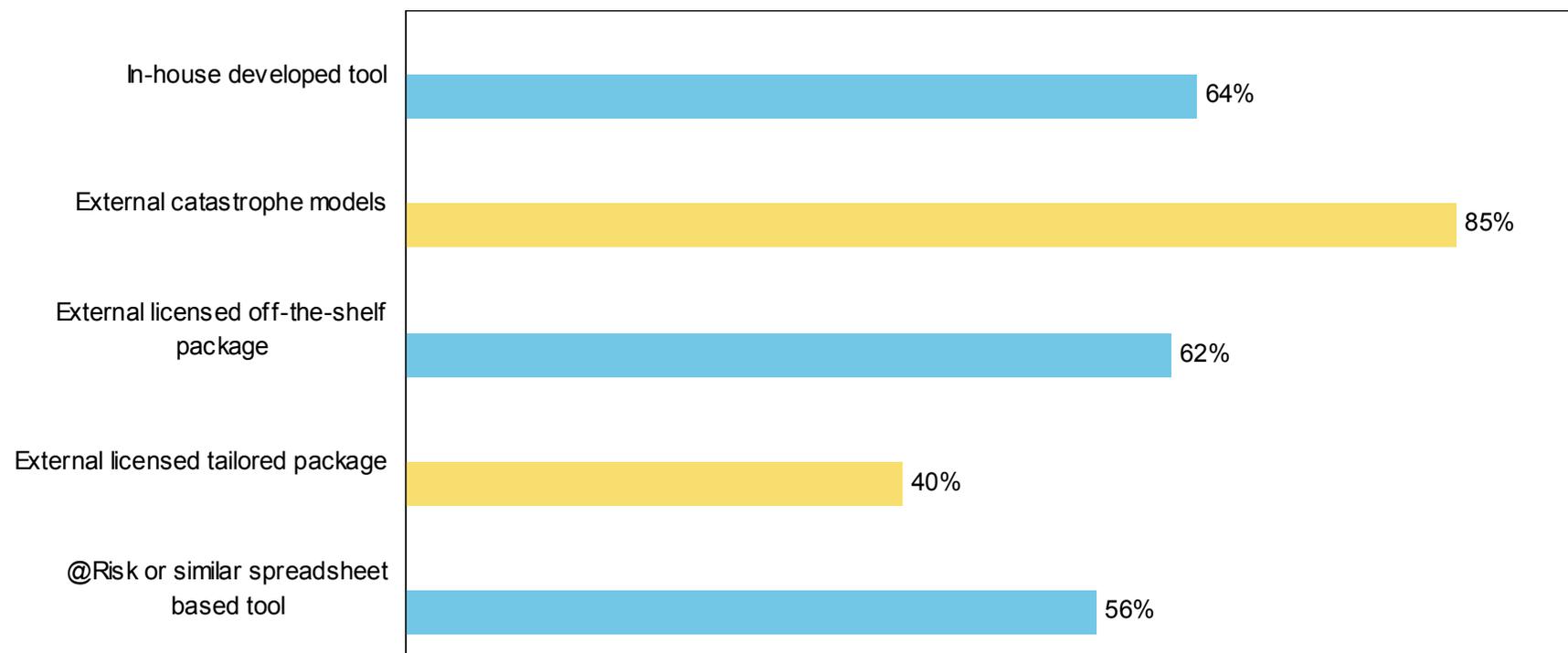
Source: Watson Wyatt survey “Pricing and capital management in a softening market”

Where is the market most deficient in data?



Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Software used to support capital modelling



Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Potential improvements to the pricing process

- Deploy more technical tools to supplement and corroborate underwriter's judgement
- Apply more of the existing techniques to current business
 - eg portfolio analysis
- Research and develop new techniques
- Test GLM techniques on selected classes
 - eg marine or aviation

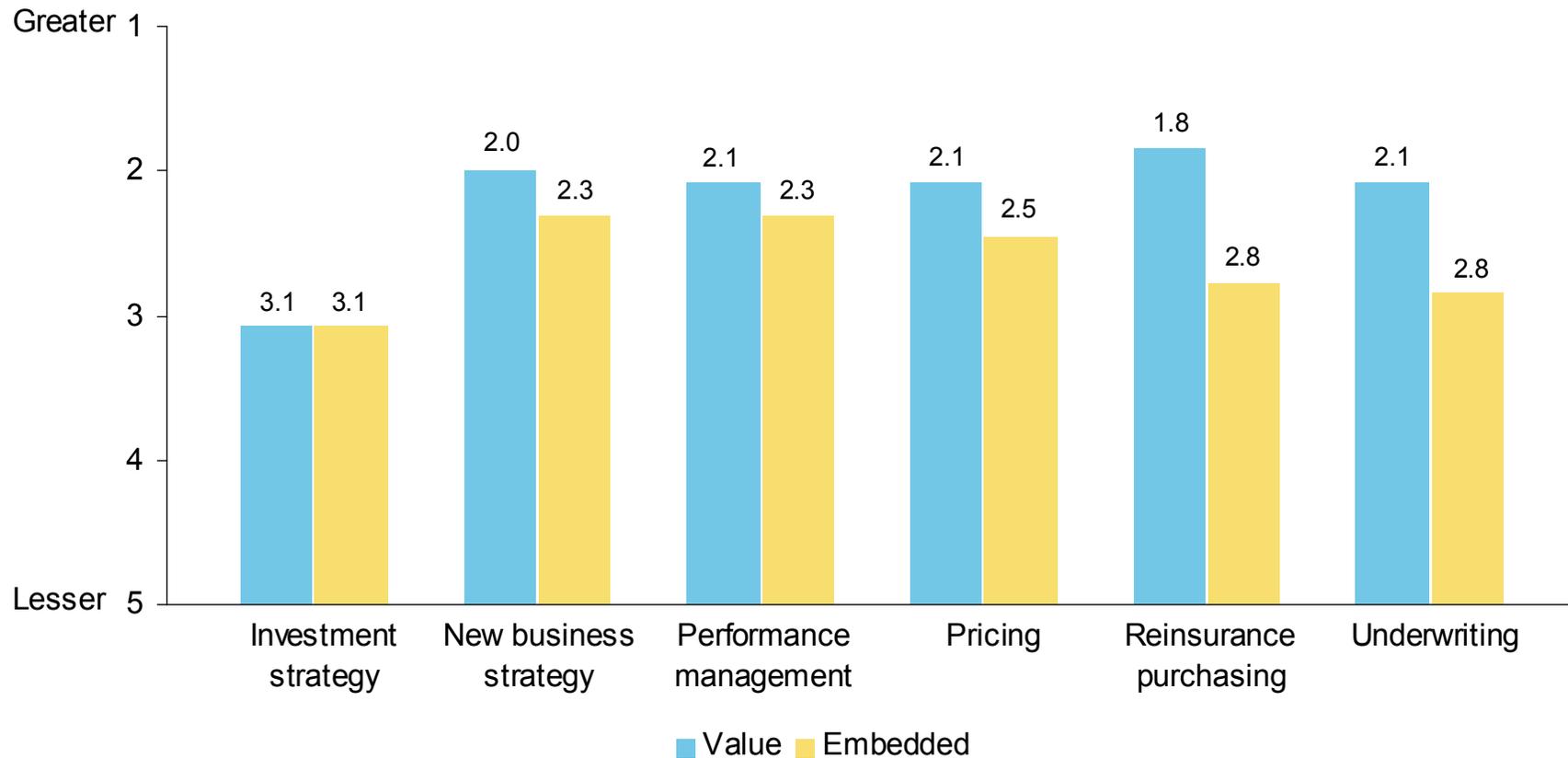
Potential improvements to the pricing process

- Consider use of standardised models to achieve
 - more consistency
 - greater efficiencies
 - better audit controls
- Or, at least, standardised approaches and information across the business
- Improve data quality and coverage

Potential improvements to the pricing process

- Greater use of capital management processes and models in underwriting and pricing
 - More embedded to extract more value (see next slide)
 - Goal could be to understand impact on capital and returns for each additional risk written
 - Helps to satisfy FSA and Solvency II “use” tests

How well is capital management embedded into your business?



Source: Watson Wyatt survey "Pricing and capital management in a softening market"

Summary

- “Underwriting in a soft market” is the number one issue by far
- Most expect their underwriters to maintain underwriting discipline better than their competitors
- Most classes expected to continue to be profitable in 2008 with 2009 expected to be the crunch year
- Key to success will be to maintain underwriting discipline and to deploy more technical tools

Summary

- Underwriters could use more technical tools to support their judgement
- Standardised pricing software could add value but is limited by data quality and sufficiency
- Capital models considered to have added considerable value despite suffering from similar data issues
- Don't get left behind - it is likely that the situation may have advanced considerably in 5 year's time

Summary

- Continue to improve data quality and coverage
- Widen application of existing techniques and research new techniques
- Greater use of capital management processes and models in underwriting and pricing