GIRO Conference and Exhibition 2012
Juggling uncertainty the actuary’s part to play
From customer to carrier: where does all the money go?

Robert Andrews, KPMG
Agenda

- Introduction and context
- We know what we’re selling – why are people buying?
- The insurance value chain
- What do intermediaries do?
- Debate:
  - Place your bet – distribute, service or carry risk?
  - Treating customers fairly?
  - Does the market work?
General insurance: Probably the best industry in the world
We know what we’re selling, but why are people buying?
We know what we’re selling, but why are people buying?

Reasons for supply:
• Premiums more than cost of conditional promise to pay and any associated service

Reasons for demand:
• Security against disaster
• Compulsory
• Value add to another good or service
• Enables other activities
We know what we’re selling, but why are people buying?

- Customer value drivers
  - Area of potential consumer surplus
  - Insurer profitability constraints
Insurance value chain

Distribution
- Find and persuade customers to buy
  - Advertising, websites, call centre, financial conduct compliance

Underwriting
- Design product, rate, segment
  - Lawyers, underwriters, pricing actuaries

Policy servicing
- Collect premium, keep records, handle claims
  - Call centres, finance functions, claims handlers, loss adjustors

Risk transfer and capital
- Monitor and manage risk, contract, manage assets
  - Actuaries, lawyers, investment managers, prudential regulators

- Risk selection, retention rate, data, cross selling, compliance risks
  - Strategy, analysis

- Claims control, Legacy issues
  - Tax, ALM, prudential regulation, legacy
### Insurance value chain - examples

<table>
<thead>
<tr>
<th>Phase</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Distribution</strong></td>
<td>Broker – Aon, Marsh, JLT, etc</td>
</tr>
<tr>
<td><strong>Underwriting</strong></td>
<td>Syndicate pricing and negotiation of terms</td>
</tr>
<tr>
<td><strong>Policy servicing</strong></td>
<td>Mainly outsourced – Broker &amp; Lloyd’s market systems, in house claims</td>
</tr>
<tr>
<td><strong>Risk transfer and capital</strong></td>
<td>Syndicate management of capital and risk</td>
</tr>
<tr>
<td><strong>Lead syndicate at Lloyd’s</strong></td>
<td>Lead syndicate at Lloyd’s</td>
</tr>
<tr>
<td><strong>Lloyd’s broker</strong></td>
<td>Core activity</td>
</tr>
<tr>
<td><strong>Virtual insurer</strong></td>
<td>Broker / Affinity relationship</td>
</tr>
<tr>
<td><strong>Direct to market</strong></td>
<td>Core activity</td>
</tr>
</tbody>
</table>
Insurance value chain - examples

<table>
<thead>
<tr>
<th></th>
<th>Distribution</th>
<th>Underwriting</th>
<th>Policy servicing</th>
<th>Risk transfer and capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lloyd’s market 2011</td>
<td>£5.3 billion</td>
<td>£1.7 billion</td>
<td>(£0.7) billion</td>
<td></td>
</tr>
<tr>
<td>Legal expenses 2003</td>
<td>£74 million</td>
<td>£43 million</td>
<td>£151 million</td>
<td></td>
</tr>
</tbody>
</table>
What do intermediaries do?
What do intermediaries do?

✓ Match customers with insurance needs to insurers
✓ Discover new insurance needs
✗ Carry risk

Distribution channels

<table>
<thead>
<tr>
<th></th>
<th>Independent intermediaries</th>
<th>Tied agents</th>
<th>Affinity</th>
<th>Direct</th>
</tr>
</thead>
<tbody>
<tr>
<td>All GI</td>
<td>58%</td>
<td>7%</td>
<td>13%</td>
<td>22%</td>
</tr>
<tr>
<td>Personal lines</td>
<td>40%</td>
<td>8%</td>
<td>20%</td>
<td>31%</td>
</tr>
<tr>
<td>Commercial lines</td>
<td>83%</td>
<td>5%</td>
<td>3%</td>
<td>9%</td>
</tr>
<tr>
<td>MAT</td>
<td>91%</td>
<td>5%</td>
<td>0%</td>
<td>4%</td>
</tr>
<tr>
<td>Personal lines Motor</td>
<td>35%</td>
<td>9%</td>
<td>13%</td>
<td>43%</td>
</tr>
<tr>
<td>Personal lines Property</td>
<td>41%</td>
<td>6%</td>
<td>35%</td>
<td>16%</td>
</tr>
</tbody>
</table>

Source: ABI
What do intermediaries do?

EBITDA - London Market (£k)

- Aon: 125378
- JLT Group: 121585
- Arthur J. Gallagher (UK): 29847
- Cooper Gay & Co: 21426
- Lockton: 19471
- R K Harrison Group: 16302
- Hyperion Ins Group: 12406
- Towers Watson Reinsurance: 11100
- Windsor: 10186
- Newman Martin & Buchan: 9462
- Miller: 9135
What do intermediaries do?

EBITDA - Commercial

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What do intermediaries do?
Treating customers fairly?

“This house believes a low ratio is consistent with treating customers fairly”

Legal expenses market example:

<table>
<thead>
<tr>
<th>Claims</th>
<th>Commission</th>
<th>Expenses</th>
<th>Insurance profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>25%</td>
<td>21%</td>
<td>12%</td>
<td>42%</td>
</tr>
</tbody>
</table>
Distribute service or carry risk?

“This house believes it is better to be a broker than an insurer”
Does the market work?

“This house believes lower barriers to entry would benefit customers”