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

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

<table>
<thead>
<tr>
<th>Related to</th>
<th>Technical</th>
<th>Walkaway</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Risk/loss Environment</td>
<td>YES</td>
<td>YES</td>
<td>YES (but ...)</td>
</tr>
<tr>
<td>Capital Position of Company</td>
<td>YES</td>
<td>YES</td>
<td>YES (but ...)</td>
</tr>
<tr>
<td>Business Mix</td>
<td>YES</td>
<td>YES</td>
<td>YES (but ...)</td>
</tr>
<tr>
<td>Internal Expenses</td>
<td>YES</td>
<td>YES</td>
<td>YES (but ...)</td>
</tr>
<tr>
<td>Current Position in Market Cycle</td>
<td>NO</td>
<td>YES</td>
<td>YES (but ...)</td>
</tr>
</tbody>
</table>

Business Planning

Risk Preferences  
Market Prices  
Other Constraints

Risk/Return Analysis

Best mix for current year – based on achievable pricing level
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).