Current Underwriting Challenges
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Lloyd’s Analysis
7 June 2016
Agenda

► Review of Lloyd’s historical results
► Overview of Lloyd’s approach to challenge underwriting
► Ideas for monitoring pricing and underwriting
► Conclusions
Lloyd’s historical results 1950 - 2015


Source: Lloyd's Annual Reports, Statistics relating to Lloyd's 2001; Lloyd’s data for 1950 – 1999 on three year accounting (assuming written=earned premium and 18% brokerage), and from 2000 onwards on annual accounting basis.
Lloyd’s Underwriting Results since 2000

Source: Lloyd's Annual Reports, NEP = Net Earned Premium
Analysis of Lloyd’s operating expenses

Since 2009 operating expenses increased from 35% to 40% driven by:

- Higher acquisition costs (28% - 30%) by and large due to increased Coverholders business (25% to 32% of Lloyd's income)

- Higher administrative expenses ratio (9% - 11%) driven by
  - Softening market environment, i.e. lower premium income for the same risk exposure
  - Weakening exchange rate (business predominantly sourced in US$, while admin expenses are predominately in GBP£ (2009: $1.61 = £1, 2015, $1.47 = £1)
  - Increased regulatory requirements, e.g. Solvency II

**Source:** Lloyd's Annual Reports, NEP = Net Earned Premium

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Lloyd’s Premium Rate Index

Source: Lloyd’s Statistics (2016 Edition)
Price Leakage: Profits compressed from both sides

- Benchmark price
  - Cost of Capital
  - Bound Profit
  - Expenses
- Expected Loss
  - Claims inflation
  - Regulation
  - Marketing
  - Brokerage / Commission
  - Perils
  - Discounts
  - Limits

T&C price waterfall

Compression

Rising tide of Cost-to-Serve

Price Leakage: Profits compressed from both sides

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BCG Growth-share Matrix

Visit: https://www.bcgperspectives.com/content/articles/corporate_strategy_portfolio_management_strategic_planning_growth_share_matrix_bcg_classics_revisited/
BCG Growth-share Matrix

- **Star** (High Growth, High Share): Invest Profits
- **Question Mark** (High Growth, Low Share):Question Mark
- **Dog** (Low Growth, Low Share): Shrink/卖掉
- **Cash Cow** (Low Growth, High Share): Share

Growth vs. Share Matrix
BCG Growth-share Matrix Life Cycle
Which line of business would you put where?

- Stars
- Question marks
- Cash Cows
- Share
- Dogs
- Growth
Lloyd’s return on capital 1983 - 2015

Source: Lloyd’s Annual Reports, Statistics relating to Lloyd’s 2001; Lloyd’s data for 1983 – 1999 on three year accounting (assuming written=earned premium and 18% brokerage), and from 2000 onwards on annual accounting basis. Capital = Total Net Resources of the Society of Lloyd’s and its members less subordinated debt.
You can only be proven wrong

Black Swans

Karl Popper

*Good tests kill flawed theories; we remain alive to guess again.*
You make money until you don’t
A Lloyd’s syndicate is planning to enter a new class of business, where historically only 15% of the syndicates met its planning loss ratio and 85% failed.

The syndicate has a track record of meetings its business plan loss ratio 4 out 5 years.

How much confidence would you have that this syndicate can achieve its planning loss ratio in the new class of business?
Hit and run … away from your tail

► There are two kinds of casualty underwriters, the skillful ones and the ones who run away from their tails.

► Reviewing the historical market data reveals that only 15% of casualty underwriters are skillful and 85% are running away from their tails.

► A CEO employs a new casualty underwriter.

► The CEO believes that she can identify the skillful underwriter with 80% confidence.

► What is the probability that the CEO actually employed a skillful underwriter?
Performance review cycle at Lloyd’s

- Market submits data to Lloyd’s
- Lloyd’s analyses the data
- Bespoke management information is generated
- Agent specific reports and tools are played back internally and externally
- Lloyd’s and agents use the MI to review and improve their performance
In a nutshell

Predict  Correct
Example: Benchmarks vs. peers and plan

- Underwriting performance benchmarks vs. **notional market** and plan
  - Top performing syndicates or classes sit in the top right quadrant
  - Bottom performers sit in the bottom left quadrant
  - Movements over time highlight changes in performance

Source: Quarterly Performance Information reports from Lloyd’s
Illustrative example for price monitoring

Original diagram by David Bracewell, Deutsche Bank
Signal and Noise
Signal and Noise
Since 2009: Performance Management Data Return (PMDR)

► Monthly data feed from syndicates’ underwriting systems

► Information on premium income by risk, including
  – Price changes for renewals
  – Price comparison against business plans

► Key tool to monitor syndicates’ business plan and performance oversight

<table>
<thead>
<tr>
<th>Past</th>
<th>Present</th>
<th>Future</th>
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<tbody>
<tr>
<td>Quarterly Monitoring Return</td>
<td>PMDR</td>
<td>Syndicate Business Plan</td>
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PMDR in practice

- PMDR highlights potential issues before loss ratios have to deteriorate.

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<th>Syndicate No / COB</th>
<th>PMDR Written Premium (000's)</th>
<th>Current Year PMDR % of Approved Plan</th>
<th>Lapsed Premium %</th>
<th>New Premium %</th>
<th>Current Year Pure Rate Change % (RARC)</th>
<th>Previous Year Pure Rate Change % (RARC)</th>
<th>% of Total Premium with Benchmark Price</th>
<th>Benchmark Price Overall</th>
<th>Plan Loss Ratio %</th>
<th>Loss Ratio % with benchmark price applied</th>
<th>Latest Actual Loss Ratio %</th>
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Calibrating pricing models takes time …
... but can enhance better monitoring of risk appetite
Cycle Management Decision Tree

- Does our current portfolio deliver targeted return on equity over the cycle?
- Can less cyclical (sub-)segments be identified?
- Is focusing on these segments a valid strategy?

  Yes ➔ Follow the cycle
  No ➔ Flexible exit/entry

- Does our business model support a flexible exit/entry?
- Can we gain customers back when re-entering the market?
- Can we preserve underwriting expertise during exit periods?

  Yes ➔ Active price management
  No ➔ Value-maximising exit

- Can an active price management compensate for the expected price decrease over the next cycle?
- Can we establish the required skills/tools for systematic price management?
- Can we align the mindset and behaviour of individual underwriters?

Source: “Three strategic approaches to active cycle management”, Thomas Sepp and Oliver Bäte, Cycle proficiency. Post Magazine, 1 July 2004, pages 22 – 23,
Conclusions

► Underwriting conditions are challenging
► Business planning and monitoring are essential
► Better data and risk modelling should allow for better portfolio cycle management
► Solvency II capital models should allow for better allocation of capital to risk appetite
References

► Directory of data and reports from Lloyd’s:
  - [www.lloyds.com/data](http://www.lloyds.com/data)

► Lloyd’s Statistics:
  - [www.lloyds.com/stats](http://www.lloyds.com/stats)

► PMDR framework and examples:
  - [www.lloyds.com/pmdr](http://www.lloyds.com/pmdr)

► Guidance on claims inflation
  - [www.lloyds.com/claimsinflation](http://www.lloyds.com/claimsinflation)
Thank you

► Questions?

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