London Market Underwriting Survey 2019

Brighter together

Foreword

With excess capacity, low rates, and increased competition from alternative hubs the London Market is operating in an exceptionally challenging environment. In addition, uncertainty caused by Brexit, coupled with a more general regulatory-fatigue, is fuelling a sentiment of apprehensiveness across a market that is in dire need of a revolution. Encouragingly, there are moves underway, such as the recent Future at Lloyd's prospectus, published by John Neal, Lloyds CEO, aiming to radically cut the cost of doing business at Lloyds by 50% over five years. These are exciting times, and we expect Insurers that are able to innovate and harness the power of change, to be the ones who remain relevant and profitable in the London Market.

Key Findings

Increased competition, over capacity, low rates and expense ratios that won't budge

The soft market is the new norm: 70% of survey respondents listed 'Rates' and 'Competition' in their top three challenges both now and over the next three years. It is within this soft-rating context that the market must be viewed; treating these conditions as the new norm, whilst expecting those waiting for the market to harden to be left behind. Insurers need to look for more innovative ways to turn a profit in this environment.

Looking past the low hanging fruit: Unable to grow their way out of poor performance results Insurers are focusing on expense reduction as the next obvious lever to improve results. Of our survey respondents, 95% stated they had an explicit cost reduction programme or target. However, in an environment where everyone is pursuing the same strategy, those that want to lead the pack need to be looking beyond the low hanging fruit and seek creative answers to the ongoing issue of unsustainable expense ratios.

Obtaining share in the shrinking London Market: 65% of our survey respondents believe there is not enough business coming into the London Market to deliver desired growth targets (Graph 1). London Insurers need to focus on new product and distribution strategies, which will make them competitive at home and abroad, in an effort to either expand geographically or make London a more attractive place for business.

70%

of survey respondents listed 'Rates' and 'Competition' in their top three challenges

Customers have a preference for wanting to buy insurance in their local market, putting £12-16bn (30-40%) of London premiums at risk of being written locally, where capacity and expertise is increasingly available

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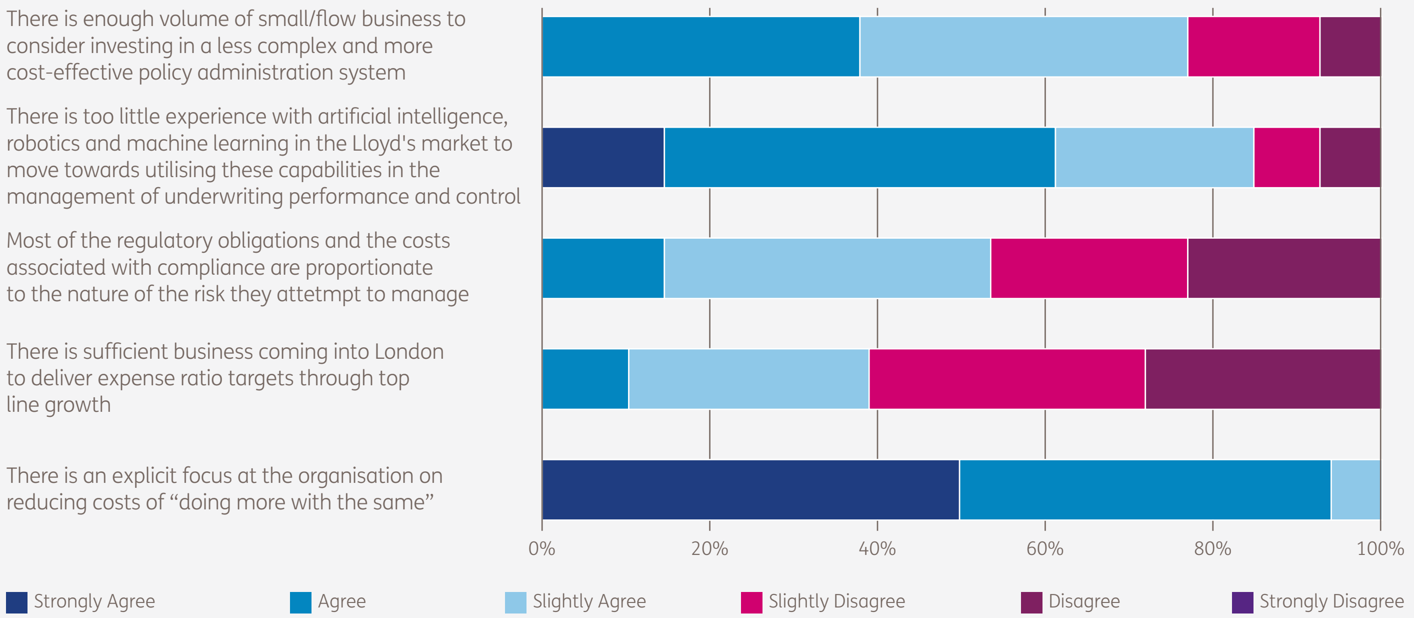
Hiscox London Matter's report

Graph 1: Survey respondents' views on how strongly they agreed or disagreed with the following statements



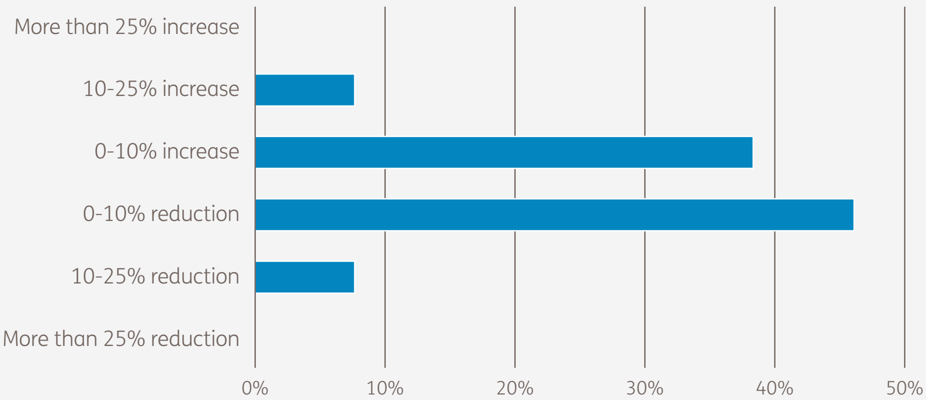
The need to maximise value from Underwriting Management in the short term

From standalone to hybrid: Over 70% of the survey respondents have dedicated Underwriting Management functions. Many organisations have fallen foul of trying to manage risk by forcing all divisions to operate in the same way. Applying a one-size-fits-all framework can be a significant inhibitor to innovation and entrepreneurship. Equally, ensuring an objective review of class performance is essential, measuring the business against an agreed set of common metrics to reduce any subjectivity.

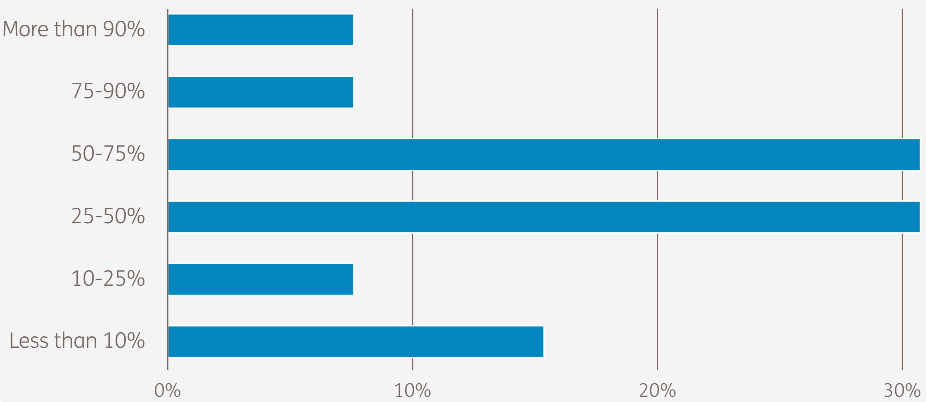
Doing the same, with less: 55% of survey respondents stated they were looking to reduce the headcount of their Underwriting Management function by up to 25% in the coming year. With team sizes reducing, these functions will need fresh approaches to continue to add value. These include automating administrative task in order to allow teams to focus on activities such as strategic Market reviews and underwriting control management. Where activities do not contribute to either value creation or value protection, they should be discontinued.

Aligning Risk, Compliance and Underwriting Management: A majority of survey respondents – 85% – believe that compliance controls are disproportionate to the risk they are designed to manage (Graph 1). Many organisations are overly reliant on capital models for assessing their risk-versus-reward profile and are not exploring how best to engage Risk, Compliance and Underwriting Management functions to derive true added value whilst remaining within the organisation's regulatory strategy.

Graph 2: Survey respondents' views on headcount increases or decreases expected in their Underwriting Management function over the next year



Graph 3: Survey respondents' views on how much additional underwriting data within their business they are unable to access due to availability challenges or formats



Over

70%

of the survey respondents have dedicated Underwriting Management functions

> "I don't want my Underwriting Management team telling me to tick boxes. I want them to challenge my decisions strategically and tell me where I should be investing or paring back"
>
> –
>
> **Survey respondent**

85%

of the survey respondents believe that compliance controls are disproportionate to the risk they are designed to manage

Significant shortage in capabilities, tools, and skillsets to meet the demands of the future

The data is there, it is just difficult to access: Extracting data from within complex legacy estates is still an issue. Over half of our survey respondents stated there is up to 100% more data available that they are simply not able to access. Whilst Insurers might not be maximising the data potentially available to them, they are improving the amount of time spent analysing and driving insights from what they can get. This marks a significant step forward from our London Market study two years ago.

Attracting the right skills into the Market to support emerging technologies: Over 85% of our survey respondents agree that there is too little experience with artificial intelligence (AI), automation (RPA) and machine learning (ML) in the London Market to be able to move towards utilising these capabilities in the management of underwriting performance and control (Graph 1). In order to capitalise on the potential gains to be made from adopting new technologies the Market needs to attract and retain more diverse skillsets, such as data scientists.

Get ahead of the automation curve: Survey respondents ranked automation as the least desirable activity required of the Underwriting Management function in the short term. It appears that organisations see little application within their teams over the short-term, but this does not mean that the focus across the wider business can wait. It will take time for investment in this area to show a return however, Insurers should build a centralised automation capability now rather than doing it ad-hoc over time and risk delivery to different standards.

Graph 4: Survey respondents were asked to rank the activities they would like to do more of in their Underwriting Management function if they had capacity / right skillsets

- Underwriting strategy reviews
- Underwriting control assessment / enhancement
- Mi / reporting enhancement
- Data quality analysis / enrichment
- Portfolio loss modelling
- Reinsurance optimisation
- Market intelligence / benchmarking
- Software / application development
- Underwriting expense modelling
- Process automation/rpa

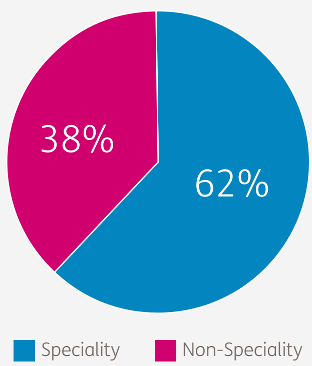
> "Underwriters in the future will have access to huge volumes of data. We need to make sure we're ahead of the curve when it comes to being tech savvy enough to use it and leverage the intelligence it provides"
>
> –
>
> **Survey respondent**

Forward Looking: Creative thinking and innovative ideas to enable Insurers to thrive

Diversity of proposition to build on product innovation: London, and Lloyds in particular, has always been a hub for product innovation. Insurers should focus on diversifying the way current and emerging products are offered as propositions, concentrating on lower cost sales channels for commodity products or bundling covers to better meet client needs. This would open new sales routes to drive growth in the future.

Demonstrating the value of London: When asked what percentage of business written in the London Market could truly be classed as "Speciality business", the average response was just 60%. With many survey respondents also confirming an appetite to invest in simpler policy administration systems to support lower-complexity risks, is it now the time for the Market to come up with more innovative, cost-efficient ways of managing fast flow business?

Graph 5: Survey respondents' were asked what percentage of London Market business they considered to be truly speciality



Section 1: Value Add Underwriting Management

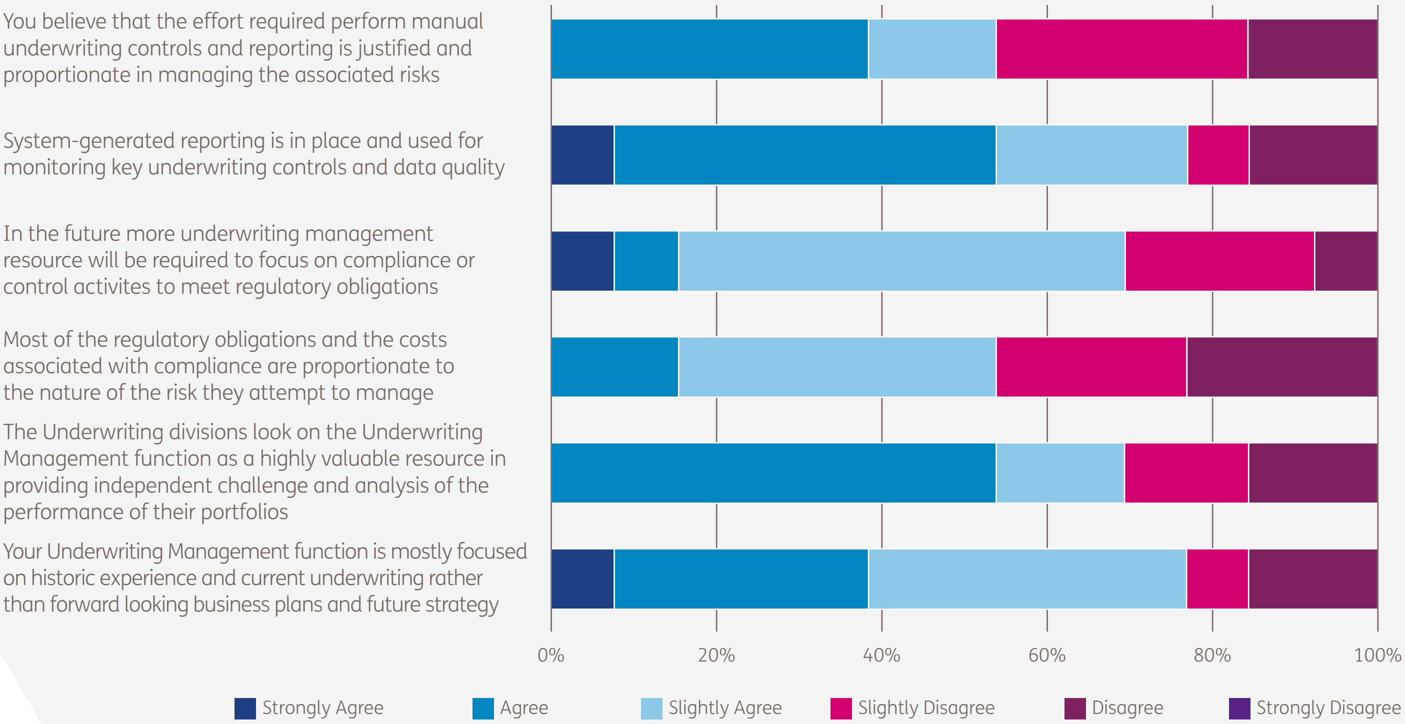
The need to maximise value from Underwriting Management in the short term

Over the past five years a shared-services Underwriting Management function has been the dominating operating model for most teams. Over 70% of respondents to this year's survey confirmed the presence of a dedicated Underwriting Management function within their organisation. This trend was in part driven by merger and acquisition activity, as it became necessary to standardise Underwriting Management controls and practices across the organisation to ensure compliance and common process. Over time however, this model has evolved and we note in our survey responses that a number of Insurers are increasingly adopting a hybrid model whereby control is moved back into specific underwriting divisions, with overall performance continuing to be managed centrally.

This approach is a sensible one given the nature of London Market business. Efforts to apply a standardised framework can be challenging, and so shifting this control back into teams that know the business best is a good approach to ensure they remain relevant. Retaining the responsibility of performance management within a centralised Underwriting Management function can also make sense. This allows class performance to be assessed against a common set of agreed metrics, ensuring product reviews remain effective and that management is aware of areas that are over- or under-performing.

In parallel with the emergence of a new hybrid model for the Underwriting Management function a further trend is looming; the need to do more with less. Over half of our survey respondents confirm that they expect a headcount reduction in their teams of up to 25% over the coming year. A good mantra for Underwriting Management functions looking to understand how to maximise the output from a reduced team is "do less, then obsess". By focusing on genuine value-add activities teams should start to see the perception of the benefit they create increase, and with over 30% of our survey respondents disagreeing with the statement that the Underwriting Management function is regarded as a highly valuable resource, there is clear room for improvement.

Graph 6: Survey respondents' views on how strongly they agreed or disagreed with the following statements



When asked to rate which activities Insurers would like to do more of in their Underwriting Management functions, preference for doing more Underwriting Strategy reviews topped the table followed by an explicit focus on MI and reporting enhancements, and the enrichment of data (Graph 4). This focus on improved data capabilities aligns with many of the investment priorities we are already seeing Insurers make. Investment in Business Intelligence (BI) tooling is up 25% from our previous survey and there is an overwhelming consensus from this year's survey respondents that further investment in data analytics and modelling is expected over the next 12 – 24 months.

Graph 7: The top five areas for investment in the next 12-24 months to enhance Underwriting Management capability, as pick by our survey respondents

TOP 5 AREAS FOR INVESTMENT

1. Mi, dash-boarding and visualisation tools
2. Underwriting data quality and enrichment
3. Data modelling
4. Data analytics platforms / tooling
5. Underwriting management workflow tools

Significant shortage in capabilities, tools, and skillsets to meet the demands of the future

New tools and capabilities will continue to assist the Underwriting Management function and should help reduce time spent on low value activities. When asked how much time as a percentage Underwriting Management function spent on the activities of data retrieval, data validation, data analysis, and reporting and MI most survey respondents noted a largely equal split of time across all fours areas. This is progress from a few years ago when energy was largely directed on retrieval and validation activities, but there is still room for improvement. In order to demonstrate real value from the Underwriting Management function the provision of accurate, data-rich and visually consumable MI is an excellent area to continue to develop capability in.

"We struggle as a firm, and as an industry, to attract the type of skillsets we need to maximise the benefit of emerging technologies. We need to collectively ask ourselves: How can we compete with Google, Facebook, even InsurTech when it comes to attracting the best talent?"

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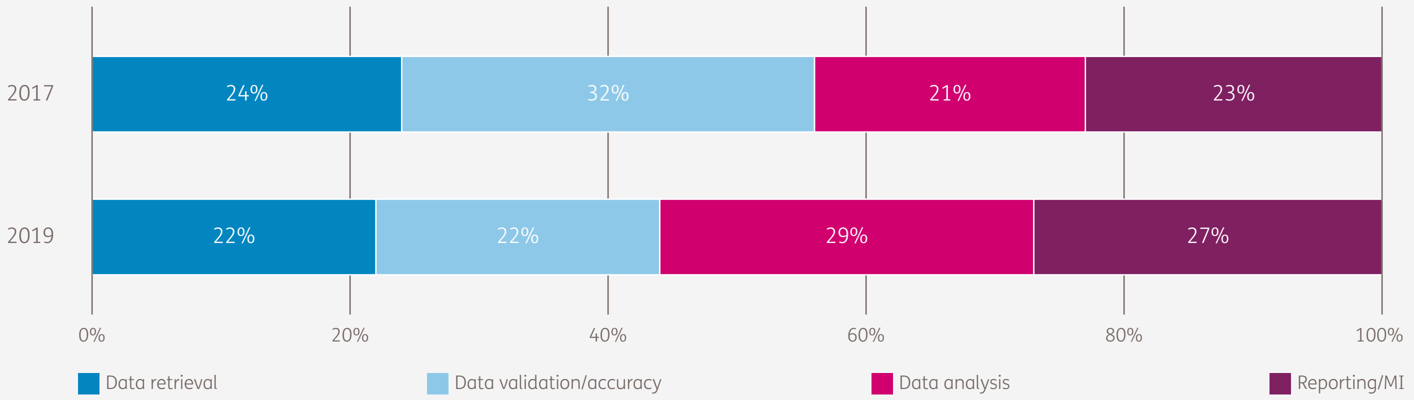
Survey respondent

Graph 8: An overview of where time is spent during the process of generating business intelligence from underwriting data. This has been compared with the results from our 2017 Underwriting Survey



Automating manual controls and low value activities is also an area that Underwriting Management functions should be giving significant focus to. Over three-quarters of survey respondents confirmed that 60% of their existing controls are completed manually and yet investing in automation technologies was not regarded as a key area for teams over the next two years. This reticence to invest in arguably standard technologies (such as RPA) and those that are still emerging (ML / AI) is consistent across all of our survey respondents and is part of a larger issue facing the Market. 85% of survey respondents believe there is too little experience with emerging technologies and this poses a huge issue (Graph 1). The application of innovative technologies has the ability to overhaul the way Insurers manage and price risks and those who fail to capitalise on these emerging capabilities are likely to fall increasingly behind over the coming years.

Many of the themes that have emerged from the survey this year confirm that the Underwriting Management function finds itself in a period of flux. Asked to do more with less, whilst improving the actual and perceived benefit of their team, these functions need to look for new and innovative ways to deliver the service offered if they want to remain a valued component of the underwriting lifecycle. This challenge however, should be viewed through an opportunist lens; with the right investment in tools, technologies and upskilling of resources the Underwriting Management function should find itself back at the centre of underwriting activity. Delivering genuine insights through real-time, accurate interrogation of data, providing valued challenge as a trusted business partner and shedding the 'administrative' image that still clouds opinion of this function.

Section 2: Market Conscious Underwriting Performance

Increased competition, over capacity, low rates and expense ratios that won't budge

There is consensus across the industry that the current soft market is likely to continue for at least the next two to three years. This pressure on rates, combined with increased competition, excess capacity and broker commissions amounted to 30% of all top concerns raised by our survey respondents. This figure increases to 32% when looking over a three year period, indicating little confidence in a market hardening within that timeframe. As such Insurers are slowly beginning to waver in the belief that top line growth will justify their cost base and allow them to grow out of their current predicament. Our survey results showed 63% of respondents do not believe there is enough business coming into London to enable profitable growth through the top-line and there continues to be a focus on cost reduction (Graph 1).

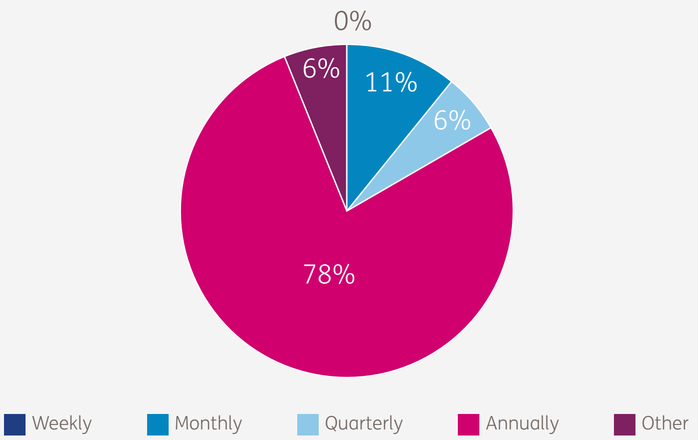
Our survey data shows that 95% of organisations have an explicit programme or focus on reducing costs. This is clearly something that is now at the forefront of the industry's thinking representing a marked change from just a few years ago when organisations targeted revenue growth using existing operating models. Insurers have taken a number of approaches to cost reduction, ranging from straightforward headcount reduction to large outsource contracts. Whilst these approaches have been a step forward they have largely been focussed on 'low hanging fruit' and arguably do not represent the step change in attitude needed to create a lean foundation for the future. Insurers now need to look across the full breadth of their business, not just the back-office, to find a way of delivering sustainable efficiency.

Diversity of proposition and updated ways of working in a traditionally cautious market

There is strong evidence in the survey results that London Market Insurers are holding on to outdated concepts and ways of working. This builds on Insurance's reputation as a conservative industry and that responses to change are slower than in other sectors. However, if Insurers are to survive these difficult market conditions then they need to think differently about how they respond to this changing landscape.

80% of survey respondents confirmed that they reviewed their product suite on an annual basis, offering a limited window to review potential expansion into new areas. However, there is an emerging trend within the remaining 17% of organisations to review their product offerings on a quarterly or even monthly basis. This approach should enable Insurers to be more agile in their decision making either by entering, exiting or modifying product offerings regularly rather than attempting to ride out market cycles or by offering shorter policy lengths.

Graph 9: Survey respondents' were asked how frequently they formally reviewed their product suite for long term growth potential (as opposed to short term targets, i.e. current year business plan)



In addition, only half of the survey respondents stated that they consider complexity when reviewing their product set, suggesting that there is limited thought given to how they deliver their products to market. A simple product should be quicker to process and easier to automate. This issue is compounded by the fact that whilst 40% of survey respondents said they have the ability to segment by complexity and they choose not to, preferring to stick to existing ways of working.

Failure to view product sets through a complexity-lens also manifests itself in other areas. When asked what percentage of business written in the London Market could be truly classed as 'Speciality' the average response was 60%. If we infer the remaining 40% is of lower complexity, thereby requiring less underwriting intervention, then this area is ripe for process and system innovation. Indeed, the majority of survey respondents confirmed an appetite to invest in simpler policy administration systems to support less complex business (Graph 1). However, Insurers need to respond quickly if they are to capitalise on high volume business and not lose out to technology companies or general insurers reaching up the complexity chain who can offer simple digital journeys to service brokers and manage policies.

The question of complexity also reinforces a further important feature of the London Market. One of the primary benefit of London is the unique skillset, contacts and experience provided by having so many underwriters in a small geographic space. Insurers should be reviewing their product portfolios against their processes and assessing where their underwriters are adding value. Every human interaction has a cost. Given the current challenges facing Insurers in the market, these additional touchpoints cannot be afforded. It is time to be ruthless about which classes of business require a human led underwriting route and which require an automated one.

"The m^2 cost of office space in the Square Mile makes it some of the most expensive real estate in the world. There is simply not a business case for retaining teams in these offices if they do not need to be there."

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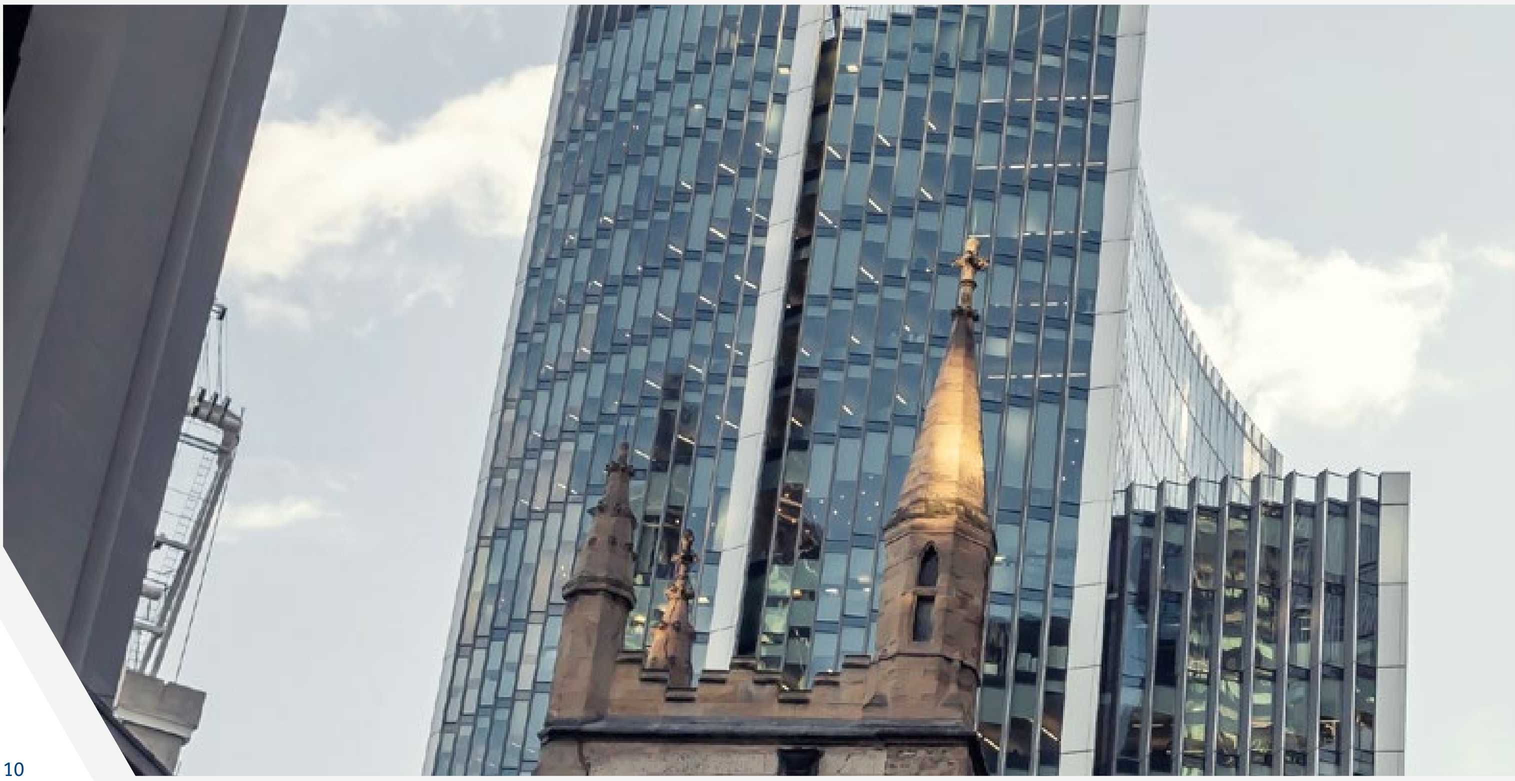
Survey respondent



The London underwriting process adds more value to some areas and products than others

London Market Insurers are still resistant to making bold underwriting portfolio decisions such as exiting classes or fundamentally changing the make-up of their books. Only 20% of organisations stated that they fully consider the cost of underwriting when selecting risks, whilst 50% are prepared to tolerate low margin for volume. 30% of Insurers focus only on the loss ratio. This approach is a typical way of working but not in keeping with the current environment where the cost of doing business is so important. A truly bold underwriter would turn away business if it was not going to be profitable for their organisation. The challenge that most Insurers have in this regard is understanding the full end-to-end cost of a new policy, or even better, the full policy lifecycle. This is where new sources of data such as workflow management, BI tooling and data visualisation can aid the underwriter in making their decision.

Given the constraint on growth in the London Speciality Market there are two areas that we see as particular opportunities for organisations:

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“We are seeing new and emerging risks in Australia and the US. As markets harden, the opportunities there are huge, especially in Intellectual Property, Cyber, M&A, and Terrorism risk cover”

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Survey respondent

1. Emerging Markets

London Market organisations have traditionally been reluctant to expand beyond the English speaking world with a loss of market share across Asia, Africa and Latin America between 2013 and 2015. Various reasons have been attributed to this, including a desire to place business locally, the London brand not being as strong in these countries, and a lack of understanding of local law and or language on the part of the Insurer. Something that organisations may well consider to drive profitability is to make more strategic moves into emerging markets, through either a coverholder model or local branches. Both approaches require an awareness of the cost and complexity of setting up new operations and being able to support across different time zones in a cost effective manner.

2. Diversification of Proposition

London, and Lloyds in particular, has always been a hub for product innovation. This skill in finding correct risk balance for new and niche product lines such as Cyber is built into the DNA of the Market. To build on this, Insurers should be focussing on diversifying the way these products are bundled into propositions, concentrating on lower cost sales channels for commodity products or bundling covers to better meet client needs. This would open new sales routes to drive growth in the future. Based on our survey results the primary reason Insurers are not already doing this is the conduct risk obligations that come with it. However, as technology creeps up the complexity chain the ability to ignore this trend is being reduced.

Conclusion

The Underwriting Function of the Future

Many of the initiatives we see Insurers pursuing are good ones; investing in technology and upskilling resources, continuing to reduce their operating expenses whilst optimising their portfolios to maximise potential profits and utilising Underwriting Management function and Risk and Compliance teams for value-added activities. However, there is no silver bullet to the challenges faced by the London Markets and certainly no one specific solution that will revolutionise the industry. Focus must remain on effective implementation of programmes that drive efficiency and implement innovative solutions for growth.

What is certain is that the success or failure of these initiatives and solutions will largely dictate whether or not an Insurer survives the next five year. However, more interesting is what the outcome of these initiatives and market trends will be. It seems certain that the role of the Underwriter today will not be the same as the Underwriter of the future. Below we offer some high level thoughts on where this role might go in the coming years:

The Relationship Manager

Likelihood: High

What you need to believe

- The face-to-face service and customisable products are, and will remain, the key differentiator for London Insurers
- Automated pricing and binding will extend to all Specialty Underwriting
- Back end processes such as document production will be largely managed through robotics or automated processes

What it means for the Underwriting function	What it means for the Underwriting Management function
• Pricing will largely be conducted via automated models prior to contract completion but with margins for the Underwriter to work within depending on the market environment	• Portfolio analysis more important than ever as the lack of face-to-face interaction means Underwriters are unable to gauge the market. Additional resources will need to be diverted into this area
• Underwriters are enabled with real time data which is accessible via mobile devices at the point of sale	• Controls are built into automated processes reducing the need for manual checks
• Insurers will need to invest in digital back-end systems which allow for customisable product sets depending on the client requirements	• Additional skills required to understand automated decision making processes to assure them against regulatory requirements
• Back-end processes such as document production and delivery are largely automated	• Key controls required around underwriter margins to prevent the writing of unprofitable business

The Data Analyst

Likelihood: Medium

What you need to believe

- Product innovation in the future will come from finding niches in data sets which can be done by Underwriters
- As products are developed dynamically it will be impractical to develop point of sale IT systems resulting in manual sales process support by an automated back end
- Back end processes such as document production will be largely managed through robotics or automated processes

What it means for the Underwriting function

- Fewer Underwriters will be required but they will be geographically mobile to ensure they bring the right products to the right clients
- Underwriters will be responsible for the accurate inputting of data to ensure controls can be administered
- IT departments will need to establish an automation 'command centre' to ensure processes are maintained and a good understanding of the impact of change is created within the organisation

What it means for the Underwriting Management function

- Portfolio and market analysis is the key differentiator for Insurers. Insurers will increase the size of their Underwriting Management function to include increased levels of product development tasks
- Insurers will need to invest heavily in their internal data management and analytics capabilities to be able to utilise it for product development
- This will be supplemented with increased levels of external data from sources such as the 'Internet of Things' to further seek out opportunities
- Controls will continue to be operated manually in some spaces albeit supported by some increasingly automated processes and artificial intelligence

The Robot Director

Likelihood: Low

What you need to believe

- The personal / face-to-face service provided by Underwriters adds little or no value and so clients will prefer to self-serve
- Automated pricing and binding will extend to all Specialty Underwriting, even the most complex
- Clients will be able to manage their policy using a web portal or interface
- Back end processes such as document production will be largely managed through robotics or automated processes

What it means for the Underwriting function

- Underwriters will need the technical skills required to build and maintain automated pricing models similar to those maintained in General Insurance today
- Little or no interaction will be required with either Clients or Brokers
- Insurers will need to invest heavily in digital front- and back-end systems that manage the complex needs of their products
- Insurers will need to invest heavily in robotic and AI automation
- IT departments will need to establish an automation 'command centre' to ensure processes are maintained and a good understanding of the impact of change is created within the organisation

What it means for the Underwriting Management function

- Portfolio analysis more important than ever as the lack of face-to-face interaction means Underwriters are unable to gauge the market. Additional resources will need to be diverted into this area
- Controls are built into automated processes reducing the need for manual checks
- Additional skills required to understand automated decision making processes to assure them against regulatory requirements
- Real time data feeds from automated quote engines to feed into portfolio and pricing analysis

About Baringa Partners

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