The Insurance Institute of London

The London Journal 2013

Barnabas Hurst-Bannister ACII
President
Insurance Institute of London

Ambassadors for the industry

A year at the presidential helm provides the most vivid reminder of the prodigious efforts made on behalf of all our members, not only by the IIL's indefatigable secretariat team but also by a wide range of volunteers.

This is the perfect opportunity to thank everyone who gives their time and effort to enable our committees, lectures, research and social activities to flourish, and the veritable army of wordsmiths who have created this 2013 Journal.

Nearly a quarter of Institute members are also members of the Personal Finance Society, where life after the Retail Distribution Review involves an evolving landscape, as Chris Hannant outlines. Keith Richards has no doubt that there will be an ever-greater need for services to be provided by those with independently validated evidence of professionalism. In Richard Hobbs' view, regulators and practitioners owe it to each other to establish the right framework for conduct.

Key themes

Regulation is a theme that runs through the interview with Robert Hiscox, who looks with undiminished enthusiasm across the London Market in which he has played a major role for many years. In calling for better-educated regulators he calls also for a first line of self-regulation, acknowledging that this would come about more easily under pressure from a (yet to be created) body representing the whole non-life market. On this point Huw Evans underlines the need for that voice to be louder if the insurance industry is to be recognised and valued properly by customers, governments and regulators.

While Robert Hiscox believes that London will continue to attract young people with drive, common sense and a desire to learn, Terry Hayday believes that for independent non-executive directors, ongoing education is equally vital, as has been recognised by the Worshipful Company of Insurers. Derek Atkins and Anthony Fitzsimmons underline this with their observation that the root causes of reputational damage are to be found within a company's leadership team including the board.

We have a host of explanations – Natalie Ceeney, the Financial Ombudsman, on how the PPI story has illustrated not a new compensation culture but a new communication culture; Stuart Willoughby on why claims adjusters can and should act as ambassadors for the insurance industry; Anthony Jefferys on the need, in today's information-suffused environment, for systems and processes that match the ambitions of a modern world-leading market place; Andrew Kendrick with a clarion call to apply tested traditions of product innovation and broking expertise to the reality of a shift in economic power to the East and elsewhere (not that this has deterred the International Union of Marine Insurers from holding their annual conference in London this September); Gina Butterworth on how to manage emerging risks; and Erik Johnson on why and how diversity should be embraced by the London Market.

There is no shortage of information. Sate yourself on Charles Scawthorn's facts and figures – and then prepare for sleepless nights. Dominic Christian tells you all that you wanted to know about ILS but were too afraid to ask. Andrew Bathurst and Andrew Bardot shed light on some of the challenges now facing the P&I clubs.

If there was any doubt about our collective commitment to professionalism it will be dispelled by Graham Clarke's calling for mentoring as the best way to channel experience from one generation to the next; Sian Fisher's championing of the MGAA's role as a professional trade body for the burgeoning MGA world; and Hollie Dearman's inspiring cry to anyone who doubts the value of tackling professional qualifications.

A rich seam of seriousness of purpose has been mined to produce this Journal – please enjoy the output.

Thank you to everyone who gives their time to enable the IIL to flourish

Allison Potts
Secretary
Insurance Institute of London

London – Building on a fine track record

Now tantalisingly close to 20,000 members, the London Institute grew 11% this year, driven by Chartered status for individuals and firms who see it as a way of highlighting their professionalism.

Lectures

World-class speakers attracted bumper audiences at London's lectures. The season opened with lectures by the CEOs of British Airways and Heathrow Airport and the Chairman of Arianespace. The top team at Lloyd's was particularly well represented with addresses by the Chairman, the current CEO and his predecessor and the Director of Performance Management. Also giving lectures were major London Market figures, including the Chairman and CEOs of Ace, Amlin, Catlin and Talbot. Brokers were represented with talks by the Chairman of BIBA, the Group President of Aon and the Chairman and CEO of Willis Global. The reinsurance sector was well served by lectures from the Chief Economist of Munich Re and the CEO of Swiss Re Group. The programme also contained technical lectures highlighting Europe's largest construction project - Crossrail; who pays for civil unrest; and the highly-successful international mining industry. Members also benefited from several law lectures including one from former Supreme Court Justice, Lord Saville of Newdigate.

Reflecting the interests of PFS members, IIL extended its Financial Services lecture programme. It was opened by Pensions Minister Steve Webb MP, and other thought-provoking speakers included the chairmen of the Financial Ombudsman Service and the Financial Services Consumer Panel.

New CPD certificates

Members who missed any of these talks can catch up via the Institute website podcasts and while there can download a CPD certificate.

IIL awarded CPD quality marque

In recognition of the quality of CPD created by the London Institute, we became the first CII local institute to be awarded CPD event accreditation status. This marque signals the quality of both London lecture and educational visit programmes.

More for young members

A stream of lectures designed to appeal specifically to younger members was launched during the year by Russell Higginbotham FCII, CEO of Swiss Re UK and followed up by Inga Beale ACII, Group Chief Executive, Canopius and a presentation on negotiation skills.

In addition, over 900 young members and their guests enjoyed the circus themed party and a charity fashion show hosted by the London Institute at the Big Top, Bloomsbury and Tower of London. The aim of both events was to help make the Institute more appealing and accessible for young insurance professionals and to provide professional networking opportunities.

Research

London has 15 books in print. During the year, together with the Chartered Institute of Loss Adjusters (CILA), we launched the joint research study Business Interruption Policy Wordings. This was the first of London's research studies to be produced in e-book format, which proved highly popular with more than 2,200 full and 24,400 partial downloads.

The London Institute also launched a supplement to its best-selling Construction Insurance Research Study.

Equality and diversity

Another first this season was the appointment of London's inaugural Diversity Champion, Erik Johnson ACII. Through an article in this Journal (page 14) Erik seeks feedback that will help formulate a plan.

Awards for London members

Robert Reid ACII, APFS received the CII's highest honour when he was awarded the Bridgewater Award for outstanding service to the Institute and the Personal Finance Society. Other members recognised for their service included Elizabeth Holton FCII and Paul Maynard FCII. Finally, congratulations to Sunil Parmer FCII, who was awarded the CII Rutter medal for the best Fellowship application.

World-class speakers attracted bumper audiences to London's lectures

Stuart Willoughby
Global Head of Claims and Commutations
SCOR

The shop window is claims

Within the London and the Lloyd's markets, the increase in the profile of claims services in recent years has been notable.

Claims as the differentiator

For any international insurer or reinsurer operating in the London, Lloyd's or any other global markets, the company's claims operation and services are the window display that attracts potential clients to walk through the shop door to purchase your product over those of your competitors. The product advertised in the window is, of course, the *raison d'etre* of our industry – the re/insurance policy. This is, some might say, 'delivering on a promise'.

The client base is wide and varied – an individual purchaser of a simple property cover will have very different expectations to those of a multinational corporate client seeking comprehensive cover for a large commercial risk. Notwithstanding such differences, however, all clients expect the delivery of a service in the form of claims handling in the event of loss. Claims handling is therefore the true test of the service provided, and an indicator of the quality of performance in this context.

Within the London and Lloyd's markets, where I have spent much of my career, the increase in the claims services profile in recent years has been significant. This trend has been particularly prominent in the past 10–15 years, during which the market's recognition of the value of the claims function has seen many more claims professionals appointed to increasingly senior positions within the industry. This underlines the market's growing awareness of the key role of claims, both in the generation and the subsequent retention of business.

Diversification and centrality of claims' role

The greater emphasis placed on claims has been an essential reaction to changes in the market. Thanks to new and better technology, the performance of re/insurance companies has become more transparent and measurable over the years. The introduction of the Electronic Claims Files (ECF) is a good example of the manner in which technology has streamlined the industry and these developments, in turn, have shifted the emphasis on the function of claims as a means by which the business can be further improved.

Claims capability can enhance a business by contributing to product development. Based on the experience of claims practitioners, existing products are often modified and new products developed to cater for clients' needs. Claims teams' input is invaluable in this respect and good communication between claims and underwriting teams ensures effective assessment of product performance through continuous monitoring and evaluation. As a result, a product can be adapted efficiently and expeditiously.

Of course, internal communication does not stop there – the claims team is positioned at the centre of the organisation and must communicate and cooperate with all aspects of the business, including management, finance, actuarial, accounting and risk management teams.

In practice, this means contributing to product and business development as well as to pricing and reserving, in addition to traditional claims responsibilities (claims handling, claims adjustment, litigation, commutation, reporting and procedure).

Claims as the industry ambassador

Given the centrality and the diversity of its role, it is not surprising that the claims team is also expected to function in an increasingly client-facing role. Clients are no longer satisfied to have a promise in the form of the contract wording; they want to know that their claim, if and when made, will be in good hands. Providing clients with such assurance requires quality interaction and a direct client–claims relationship provides an opportunity to demonstrate the company's claims handling philosophy and a good understanding of the client's needs.

The claims function and the people behind it have adapted flexibly to the growing demands of the industry. It has embraced the consequent expansion of its role and stands proud to grace the shop window as ambassador of the industry.

Many more claims professionals are being appointed to senior industry positions

Graham Clarke
President-elect, Insurance Institute of London
Chief Executive, Miller

Mentoring talent

Mentoring, either through structured programmes or on a more informal basis, can be an effective way to channel knowledge from one generation to the next.

At any point in time, most business leaders would broadly agree on the key risks faced by their companies. Many of these risks would apply across various industries, which in 2013 might include the Eurozone sovereign debit crises, availability of credit, increase in regulation, cyber failure, currency fluctuation, and sociopolitical upheaval.

Some of these apply in one way or another to the insurance industry, but for us there is an easily identifiable risk that has remained a constant feature throughout the history of our business – the risk of not being able to attract, retain, train and cultivate talented employees. Although in some of the global firms the focus seems to have shifted from people to process, for most of us our people remain our most valuable asset.

The incalculable value of a highly skilled and ambitious group is not only that these are the people who produce our opportunities, market our business, and service our customers, but also, by virtue of being extensively trained and experienced, they serve to minimise other growing risks to our business, such as more demanding regulation and the ability to manage technological advances.

In most broking and underwriting firms, structuring individual training and career development has evolved from almost non-existent or ad hoc activities to specific and formalised plans to keep employees focused and motivated, and ensure their skills remain relevant and up to date.

For most young people entering our business professional qualifications, formal training programmes, and ongoing tuition will be an integral part of their career advancement. This aspect of personal development is crucial, but in an industry such as ours where much of the knowledge is held in the heads of the current leadership, it is also key that our senior practitioners pass this experience on to the next generation through shadowing, coaching, apprenticeship, and mentoring schemes.

Channelling knowledge

Mentoring, either through structured programmes or on a more informal basis, can be an effective way to channel knowledge from one generation to the next. For the one being mentored, it is reassuring to be able to identify with or be guided by a senior individual within their firm. Today, this industry is littered with challenges that span across a wide spectrum of issues; we all face potential business, ethical, and social responsibility pitfalls on a regular basis and a direct relationship with a senior individual can help our young people pick their way through this minefield. With the ethos of our industry still heavily influenced by the Lloyd's culture and underpinned by the doctrine of utmost good faith, there is a strong imperative for senior leaders to ensure that young people coming up through the organisation understand and are empowered to embody the high standards required of them to operate in the market and by their individual firms.

Our people remain our most valuable asset

A mentoring programme, although primarily intended to enrich the experience of the one being mentored, can have collateral benefits for the mentor and the company as well. One of our biggest challenges as employers is retaining talented young people, and there is demonstrable evidence that investment in career development not only produces a more talented individual, but also encourages company loyalty. The mentor can also benefit from the enthusiasm, fresh ideas, and unique perspectives of our younger generation.

There is no doubt that professional qualifications and rigorous training programmes should remain an integral part of a person's development. However, in order to maintain London's leadership position, it is essential that this formal training is augmented with experience-based guidance to ensure that successive generations are expertly equipped to face the challenges of the future.

Hot topics 2013–2014

The leaders of the London Institute's lecture committees highlight some key issues in their sectors

Accident Committee – Andrew Keefe ACII, Casualty Broker, Marsh

Worldwide volatility continues, featuring chronic fiscal imbalances, energy price shocks, regulatory risk, supply chain disruption, reduced capital expenditure and safety margins, plus possible equity and commodity market bubbles.

The global interconnectedness through trade, finance and technology is unparalleled in history and requires greater global cooperation.

The escalation of state-level cyber attacks on critical infrastructure systems is likely to lead to systems failure, data loss and digital misinformation.

The EU has 9% of the world population, 25% of world GDP and 50% of the world's unfunded pension and end-of-life liabilities, which acts as a fiscal brake.

The unacceptable level of EU youth unemployment has potential to drive increased social disorder.

The pressure to exploit the 5.76 trillion cubic feet of shale gas deposits estimated worldwide may generate new disputes and litigation.

This year will see the biggest change to the civil litigation environment since introduction of the Woolf reforms.

The rise of non-OECD countries will make the management of risk and global programmes more complex.

Aviation Committee – David Sales FCII, Senior Vice President – Aviation, Lockton

We endeavour to include a suitable mix of lecture programme topics to cover the current issues facing the aviation industry and which we hope will both entertain and educate our audiences.

A UK charter airline's managing director will talk about its challenges, including the new Boeing 787 Dreamliner.

Among other planned lectures, the managing director of a major UK aviation engine manufacturer will look at recent changes in civil aviation and the lessons for the future.

On the space side we will hear from a satellite operator on rapid imaging services for commercial applications.

With the push for 'open skies' on the agenda on both sides of the Atlantic, we have an executive director of the European project to talk on delivering the Single European Sky and the modernisation of air traffic management.

Taken as a whole, it will be a great programme of events.

Claims Committee – Jonathan Clark ACII, Claims Manager, Underwriting, Channel Syndicate

Each year our committee deliberates to develop a programme of lectures that reflect some of the key issues facing claims professionals. Two topics that are never far from the claims agenda are clarity of customer proposition around claims service and handling catastrophe claims.

The delivery of the insurance promise centres on claims and more than ever the marketing of an insurer, broker or managing agent is based on claims performance. A few years back it was rare to see an advert promoting claims handling when selling insurance, but now it is the norm. Innovation in communication of claims activities and regular access to the claims teams are key components of the sales process and there will be pressure on us to further develop what we do and how we sell it.

Catastrophe claims handling is a London Market speciality; we can be sure that this topic will continue at the front of debate in the market. Whether it is to consider the latest thinking on wide area damage or to look at satellite technology, we still have much to learn and share.

Financial Services – Roger Sanders OBE, Cert PFS, Managing Director, Lighthouse GEB

Intermediary firms are still bedding-in new post-RDR business models and challenged to ring-fence 'old model' income streams, while managing clients' expectations, so as to derive revenue from advice and transactions. 'DIY clients' are increasing, leaving pure advice models exposed, unless added value can be clearly demonstrated. Many firms are offering whole-of-market and restricted advice service propositions side by side, with development work in delivering fully-regulated advice by telephone. And good old-fashioned life assurance is now considerably undersold.

Pension intermediaries and providers are progressing with automatic enrolment and most will not see target SME market 'take-off' until 2014, when capacity issues will start to surface.

By end 2012, 80% of individual advisers 'made the grade' with the new Level 4 diploma, and continue to offer investment advice. The rest either remain at Level 3, advising on mortgages and/or protection, or are 'retired', many to remain as introducers.

The new regulators kicked-off on 1 April, with emphasis on putting customers first, on having appropriate staff remuneration strategies and the FCA's willingness to intervene in product design if necessary, are early signs of regulatory culture change and of firms' behaviours needing to change.

International Committee – Alastair Evans ACII, Head of Government & Policy Affairs, Lloyd's

Hot topics include:

- Intensifying debates about the UK's relationship with the EU as well as European Parliamentary elections and a change in EU Commissioners in 2014.
- A European Commission review to be undertaken by the end of 2013, of the European system of financial supervision, including the role of EIOPA and whether it should evolve further.
- Ongoing Omnibus 2 discussions between the EU institutions on long-term guarantees and equivalence and the expected publication of the proposed Solvency II Level 2 implementing measures.
- Long awaited publication of the US Federal Insurance Office reports on modernisation and improvement of the US system of insurance regulation and on the US and global reinsurance market.
- The summer publication of the first list of Globally Systemically Important Insurers.
- A final scheduled IAIS consultation paper on the proposed Common Framework for Internationally Active Insurance Groups.

Lloyd's and Market Issues Committee – David Gittings, CEO, LMA and Nick Starling, Director, General Insurance and Health, ABI

Hot topics for the Lloyd's Market include likely further developments in electronic endorsements and placing following the acquisition of Qatarlyst (formerly RI3K) by US software house Ebix; Lloyd's Vision 2025 and the implications of seeking to attract capital and people to the market from developing economies; increasing regulatory pressures following implementation of a Solvency II approach and the creation of two new regulators (particularly in the delegated underwriting area, and its increasing data requests); broker commissions and market service agreements used as ways of maintaining broker income; continuing back office enhancements to improve market business processes; the move away from using Xchanging as a claims agreement party in favour of bringing this back in-house; pressure for insurance law reform, for example in the areas of non-disclosure, the use of warranties, damages for late payment of claims, etc – all could impact the Lloyd's Market; increasing convergence between Lloyd's and company market carriers with platform of choice at the same time as availability of capital market 'hot money' to take risk; and hugely increased market professionalism and an enormous appetite from young new entrants for knowledge.

The year ahead will see the new regulatory architecture bed down, and we can expect the Financial Conduct Authority in particular to be continuing its examination of many aspects of the general insurance market. Solvency II may yet rise from its slumbers. Insurance will continue to be a matter of great political interest, and we can expect plenty of activity on flood insurance and the motor market, especially in the ongoing battle to tackle the compensation culture and address the whiplash problem. Continuing success in countering fraud and more and better use of industry-wide data is expected. The industry needs to remain firm in its defence pricing according to risk, in what is probably the most competitive market in the world.

Finally, we know that somewhere in the world, perhaps in the UK, there will be a major catastrophe, for which insurers will play their part in rebuilding communities and aiding recovery.

Marine Committee – Andrew Bathurst, Director, PWS Gulf Ltd

Hull – Ships that were built in the boom years are now a concern for a perceived lack of quality. Container ships are now so large that it could take years after a casualty to establish the level of loss. The largest could regularly carry a billion dollars of cargo. Class societies are the guardians of the quality of shipping but are increasingly in competition with each other.

P&I – Owners are currently not earning enough from charters to cover operating expenses, thus creating additional pressure.

Sanctions – P&I clubs are forced to apply complicated legislation. Piracy has required the clubs to monitor and assist several industry initiatives to support owners.

Energy – Unconventional oil and gas exploration continues to rise and some economists suggest that the US could be independent within 10 years. Arctic drilling is high risk (but high reward) with huge reserves of oil and gas within Russian territorial waters.

Hot topics 2013–2014

The leaders of the London Institute's lecture committees highlight some key issues in their sectors

Property Committee – Paul Maynard FCII, Chief Placement Officer, Willis

Modern methods of construction will continue to exercise the mind of insurance professionals. Too often, clients use environmentally friendly but highly combustible building materials. While insurers need to respond to clients' needs, there is a risk that in the drive to so-called sustainable construction, they will ignore the vast pool of risk management expertise. The result might be a more limited and less sustainable market for these risks.

We have seen considerable losses from catastrophic wide area damage (WAD), affecting both the insured's property and local infrastructure.

The *Orient Express Hotels v Generali* case examined cover for WAD under business interruption policies, and considered the 'but for' test for causation and the 'trends' clause; the court concluded these operated to restore the insured to the financial position it would have enjoyed before the loss, as opposed to WAD. Opinion is divided on the OE v G decision, but that does not remove the challenge for the market to provide the right cover for clients.

Property Investors Committee – Anna Whitfield ACII, Underwriting Manager Commercial Lines and Personal Intermediary, AXA

Hot topics for property investors' continue to be influenced by the economy and legislation. Metal theft continues to present an issue for both insurer and client loss ratios; pressure on rates, influenced by an increased focus on profit by insurers, is expected to continue; while demand for office space and residential accommodation grows, reflected by an ever-changing and already crowded cityscape in central London. Commission disclosure under IMD2 will have an impact on the segment, although it is too early to determine how this will play out. European investment remains an area of interest with investment remaining strong in western and northern Europe, whereas southern Europe is flat; lack of capital expenditure on existing asset stocks in depressed areas are resulting in increased client loss ratios. Finally, provision of residential property insurance is expected to continue the trend of the last 12 months, with insurers having a reduced appetite for residentially-biased portfolios.

Reinsurance – Adrian Clark ACII, Director, Aon

In the reinsurance world, attracting, nurturing and retaining top quality talent has never been more important. New and creative growth strategies are barren exercises without the right people to implement them.

A company should never consider investment in its people as an expense. Learning, training and development opportunities are as important as standard benefits discussions a firm has with its employees. If the talent side is right, the economic benefits will surely flow:

- Major cedants are increasingly looking to establish a core group of reinsurance partners. While a strong balance sheet is a *sine qua non*, winners are often characterised by a strong cadre of well-trained, motivated staff, empowered to develop offerings that are tailored to clients' needs.

- Successful firms are often those whose people work well together, share knowledge and assist colleagues. Developing and maintaining a strong culture to underpin this requires considerable and continual investment: many examples exist to prove that this pays dividends.

For a preview of the new lecture programme see the list enclosed or go to www.iilondon.co.uk

Gina Butterworth
Risk Officer
Chaucer Syndicates Ltd

Emerging risks – how are they identified and evaluated?

The effective identification and management of emerging risks is an area that frustrates many risk managers.

Emerging risks are somewhat elusive. Few organisations have a framework that efficiently allocates the resource and time required to effectively identify and evaluate emerging risks across the entire organisation against the often questionable bottom line benefit that this brings. By definition, emerging risks are highly uncertain in quality and behaviour, are often not immediately relevant, difficult to quantify and might not ever crystallise.

These challenges have resulted in risk management framework changes on many occasions. Such changes have been made in attempts to more efficiently identify and manage emerging risks because these could influence the strategic direction and long-term future success of the company and are an important aspect of risk management.

Identifying risks

There is no single mechanism for identifying and evaluating emerging risks and firms should adopt a resource-efficient framework that utilises both formal and informal processes within centralised and decentralised activities.

Ownership of emerging risks should always sit within the business and these risks should be included as part of normal risk and control reporting. For example, the compliance function should identify, manage and report on future regulation, such as emerging European data protection legislation. Similarly, underwriting management should identify, manage and report on risks such as climate change and clustering of natural catastrophes.

> Few organisations have a framework that efficiently allocates the resource and time required

Each business area or risk owner should identify its emerging risks, the uncertainties involved, relevant mitigating actions to be taken and report on these in a timely manner as part of normal risk reporting.

The central risk function should review the risks identified by the business and centrally escalate to the risk committee those that may have a wider impact across the organisation or which may present a strategic issue for the company's business model.

Quantifying risks

Emerging risks should be quantified in order to assess importance levels, but this can be challenging because risks often lack hard evidence or data. However, a risk can be qualitatively assessed until such time that it develops further and more data are available. Various methods can be used to help risk assessment, including expert judgement using an Risk Assessment Guidelines rating scale, stress and scenario testing and reverse stress testing.

The risk function will usually be best placed to perform formal desktop research on external emerging risks through systematic scanning of the external environment. Risks are then discussed with internal experts and either dismissed as not significant or can be added to a central emerging risk register for further investigation or monitoring.

It is necessary to formally capture and record emerging risks for regulatory purposes and this can be achieved through the centralised framework operated by the risk function and the decentralised formal reporting of 'emerging risks' by the business to its relevant committee or board.

However, much of the identification and management of emerging risks takes place as part of day-to-day management activities. Managers are continually scanning the external environment and factoring in the implications and potential future changes to strategies and business plans. Quite often, these factors are not separately classified or reported as 'emerging risks' on a central register or within reports but they are actively identified and managed nonetheless. Such informal, decentralised activities are also a key component of an emerging risk framework and are often overlooked.

Firms should have realistic expectations of the challenges and benefits of identifying and managing emerging risks and seek to apply as far as possible a framework that best fits the culture and is integrated with existing processes. There should be a centralised and decentralised element to the framework but it is critical that accountability for identifying and managing emerging risks rests with the business and that the time and resource allocated is proportionate to the level of risk and the benefits.

Andrew Kendrick
President
ACE European Group

How does London keep its competitive edge? How and where to innovate

London has long been known as the undisputed global centre for broking expertise and a place of product innovation.

Having seen the ups and downs of this market over the past 35 years, London's pre-eminence as *the* global re/insurance hub shows how far we've come. Of course, EC3's relative performance compared to the banks in EC2 and Canary Wharf has only helped put an extra sheen on this.

But we can't maintain this position without a battle. Getting our approach right to the world's faster-growing markets – not only BRICs – is the key to winning it and, of course, at the same time we also need to keep ahead of the changing nature of risk itself. By 2050, emerging markets will represent 19 of the world's largest 30 economies, so there's a huge opportunity for London-based insurers and brokers to spread their knowledge far and wide.

Finding opportunities

We've made some steps towards promoting London's expertise in the main markets of Latin America, in China and in South East Asia. Lloyd's, in particular, has made great strides here. Meanwhile, insurers such as ACE are combining local retail presence with the specialist expertise they have in London, to provide essential cover for economies whose industries and infrastructure are growing at lightning pace.

Successful insurers of the future will look at some of the less obvious markets, which include Russia, Poland and others of the former Soviet bloc. This is a huge growth market today, as is its near-neighbour Turkey. Africa has massive potential, from facultative reinsurance opportunities in the Maghreb through to the increasingly sophisticated insurance and reinsurance markets in sub-Saharan Africa.

Understanding cultures

London needs to ensure it understands and respects local cultures when selling its wares. Having operations on the ground, partnering with local brokers and ensuring we have people who speak local languages is key, otherwise these vastly populated countries will turn their backs on London's expertise in favour of a better cultural fit.

We must also bring more overseas experience to London. Lloyd's, with its impressive Vision 2025 strategy, is helping this. There's been a steady influx from the United States and the EU in the past decade, but very few insurance professionals from Asia, Africa and central and eastern Europe.

Of course, London has long been known as the undisputed global centre for broking expertise and a place of product innovation. We're still pretty good at dealing with emerging risks in established territories, but if we don't immerse ourselves fully in these new markets, we won't understand the changing risks they are facing.

For example, the terrorism and political violence market evolved through products shaped by the events of 9/11. But the Arab Spring, upheaval in southeast Asia and even civil unrest closer to home has changed the nature of the risks and kept underwriters on their toes. In an age in which mass demonstrations or violent insurgencies can be organised in hours through Twitter, risk managers are demanding products that cater to a very real threat to their businesses. Risks such as cyber and directors' and officers', for example, are likely to evolve very differently in these new markets than they have done in the West and London is one of the few centres with the technical expertise and global experience to help these markets mature and meet emerging challenges.

Embrace the shift

Let's continue to work together to maintain London's position as the place where companies of all shapes and sizes come to insure their risks. But let's embrace the global shift from West to East and North to South by going out to tomorrow's markets. The world will come to London, so let's do the hard work and go out and get our hands dirty, with an eye to exporting and importing to London the skills we need to stay ahead.

Let's do the hard work and go out and get our hands dirty

Terry Hayday FCII
Chairman, WCI iNED Forum Steering Group
Optimum Consultants

The iNED Forum

In October 2012, the Worshipful Company of Insurers held its inaugural iNED Forum.

Based on the success of that event and in response to feedback from attendees, the Livery Company has formed an eight-man steering group, to deliver high-quality educational activities for independent non-executive directors (iNEDs).

Aimed at existing or potential non-executive directors (NEDs) across the entire insurance sector – life and general / insurance and reinsurance / underwriting and broking / publicly quoted and private – the iNED Steering Group will suggest suitable content for topics, speakers and themes that are of particular relevance to this growing group of important corporate governance practitioners. It will also look to determine the best means of delivery, appropriate venues and the frequency of such presentations. When appropriate, it will organise presentations in conjunction with the Chartered Insurance Institute and, of course, members of its local institute in the City, the Insurance Institute of London.

Increasing demands

Early deliberations have unearthed a wide spread of subjects and interests, ranging from considerations to be understood before becoming a NED to the protection of personal reputation and the significance of directors' and officers' (D&O) insurance. Questions of due diligence will feature prominently, along with a specific session devoted to ethics.

The Financial Services Authority certainly placed considerable demands and expectations upon NEDs in recent years and codes of conduct for all directors have been expanded with relentless zeal. Given the recent changes to the regulatory landscape for financial services, emphasis will be placed on understanding the views of both the new Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) as the Bank of England takes centre stage in overseeing the UK insurance industry. Speakers will be invited from those bodies and from those that offer insurance to boards of directors, covering their onerous responsibilities.

Specific topics for the future are likely to include understanding insurance accounts and statutory reports for non-accountants and, inevitably, sessions on Solvency II and how EU regulations affect NEDs.

Non-executive directors may not be remunerated in the same way as executive directors, but they are constituents of unitary boards under UK law and embrace the same unlimited liabilities as their executive colleagues. Accordingly, the expectations of NEDs in terms of time and duties will be explored fully along with the sometimes contentious matter of remuneration and fee levels. The NED contract will also be explained in great detail and the issues that can confront NEDs under changing circumstances, such as mergers and acquisitions, will also be featured.

The Worshipful Company of Insurers is providing vital training for non-executive directors

Throughout, the emphasis will be on providing practical help and the iNED Steering Group will ultimately look to publish formal guidance in an appropriate format. It is also anticipated that the hallmark of the iNED forums will be a litany of genuine 'war stories' delivered by highly-experienced NEDs.

Hands-on experience

Codes of corporate governance, rule books and best practice manuals certainly have their place, but there is no substitute for hands-on experience. The Worshipful Company of Insurers' iNED Forum will become a focal point for all NEDs engaged in insurance, and, in particular, for those on boards of directors in the London Insurance Market.

Huw Evans
Operations Director
Association of British Insurers

Speaking with one voice

Insurance is at the heart of a functioning society and economy.

Insurance is a vital part of wealth creation and preservation and a silent part of the fabric of our everyday lives. Why then does such a critical industry sometimes struggle to make itself heard and speak clearly with one voice?

I will look at some of the reasons for this problem and suggest some solutions. The answers are about substance, not spin; it is no good speaking with one voice if nothing worth saying is being said. As an industry, we have an extraordinary opportunity in these fast-changing times to turn up the volume and promote our value – indeed, I believe we are already beginning to do so.

Getting our message across

First, what lies behind the problem? At least part of it is historical and cultural; despite its enormous importance to the City of London and the national economy, leading insurers have traditionally neither sought the limelight nor pushed for it, in marked contrast to many bankers and industrialists. Despite the enormous importance of political decision making to insurers' commercial interests, many if not most, have preferred to shy away from political engagement and leave that to their trade bodies and public affairs teams while they run their businesses. While understandable, and in some ways admirable, this modesty has had a cost in terms of the level of understanding politicians have then retained of the industry.

Many if not most have preferred to shy away from political engagement

A second factor is that insurance is easy to take for granted. There is sometimes nothing obvious to celebrate when the industry does its job properly, often because those benefiting from a successful claim are still traumatised by the loss event. When the industry successfully paid out on the 9/11 claims – the largest insurance event in history at the time – it would have been inappropriate in the extreme to have sought favourable publicity. This contrast with other sectors such as aviation, energy and even banking where the delivery of a new product or credit facility is about helping create something new, not repairing the damage after a stressful loss.

A third factor that is sometimes quoted, but with which I don't agree, is that there are too many insurance representative bodies to make our voice heard. These various bodies are a reflection of the breadth of the industry and the range of technical issues needed to be addressed within particular sectors of the market. The industry's principal voice – the ABI – has very successfully fulfilled the vision of industry leaders in the 1980s that merged its predecessor organisations by leveraging its 90% market share to get to the top table of government when it matters.

However, there is much more to be done here if insurers are to maximise the quality and depth of our advocacy and here I set out four key steps I believe we should take:

Insurance is a British business success story and vital to growth

1. *Speak up more on our economic importance*. We are living through the aftershocks of the worst financial crisis since the 1930s with the result that growth is at the heart of political and regulatory agendas. Not only is the insurance sector a major contributor to the economy in its employment levels, tax contribution and export strength, but also its capital investment in the economy through its investment portfolios is a critical source of long-term funding for the economy. We need to become tireless in pointing out this to anyone and everyone who matters; insurance is a British business success story and vital to growth.

2. *Promote our social purpose.* Insurance provides an essential service to society, helping communities recover from flooding, businesses rebuilding after fires and riots, enabling individuals to live fulfilled and productive lives through the accumulation of assets that enrich their existence. These are all essential to the fabric of society, building resilience and developing potential. We need to become less shy about how proud we are of supplying these products and in paying claims when trouble hits. We need to become more confident in working with governments in partnership to tackle problems too; such as the current work with the Department of Work & Pensions to provide support for Mesothelioma suffers unable to claim from an old employer and the ongoing discussions with government to find a way forward on affordable flood insurance for high-risk households.

3. *We need to continue to modernise*. This is not an industry without its faults and it has its share of badly handled claims and reputational problems. To make sure we are heard more effectively, we need to be viewed by other stakeholders, including government, as committed to tackling some of our own problems. The use of voluntary self-regulatory codes through bodies such as the ABI demonstrates this commitment, as does continuing investment in more customer-centric IT and effective complaints handling.

4. *We need to engage more effectively with our regulators*. As Robert Hiscox argues elsewhere in this journal, we need to welcome and work closely with our regulators, especially when we disagree with them. The future is going to see more regulation, not less, as politicians of all persuasions give financial services regulators significant power to prevent consumer detriment and ensure another crisis does not erupt. As a sector that instinctively seeks to work within regulation rather than against it, we should continue to build on the good basis of dialogue that has been established with the PRA and FCA, not forgetting how much vital regulation is now done from the EU and international bodies too.

There is one final advantage worth noting. This is an industry that has considerable coherence and instinctively works together, not something apparent in other parts of the financial services sector, never mind the wider economy. This collective spirit is all the more remarkable given the ferocity of the competition within the UK market but is something I see every week at ABI meetings, in which industry leaders seek to work together to tackle problems and provide governments and regulators with a single position. This is a tremendous asset for the industry and one we take for granted at our peril.

Getting recognised

We have a clear opportunity to speak with one voice more loudly, more effectively and with more relevance than we have achieved up to now. The prize on offer is worth having; to be more fully recognised for the importance of insurance to our world and to be valued more by customers, governments and regulators. Silent partners usually end up being taken for granted. It's time to speak up more loudly.

We need to become more confident in working with governments to tackle problems

Erik Johnson ACII
Diversity Champion and Representative's Committee Member, IIL
Co-Chair, Link – LGBT Insurance Network, Strategy Manager, Lloyd's
Chair, Lloyd's Diversity and Inclusion Steering Committee

Diversity and inclusion in the London Market

To be successful in practice, a diversity and inclusion strategy must be developed with both top level support and grassroots initiatives.

What is diversity and inclusion?

Essentially, diversity is the about encouraging and supporting the mix of people that exist in the real world and recognising that differences can be strengths. Inclusion is getting that mix to work well together. It is not about positive discrimination, lowering standards, or promoting one group at the expense of another. Workplaces that foster respect for, and appreciation of, differences are places where people can be authentic and achieve their full potential, leading to better outcomes for businesses and individuals alike.

The business case – it's strong

The talent crunch – Competition for talent is intense and demographic changes will only create further pressure. While only 1% of students are interested in a career in insurance,[1] nearly 60% of insurance CEOs see shortages of skills as a significant threat to growth.[2] The insurance sector needs to work harder to change the perception of the industry among both students and experienced professionals to attract the best talent out there, regardless of background.

Maximising talent – If an employee fails to perform at their best due to prejudice or the lack of opportunity, that's talent wasted. In an environment where insurers are competing fiercely to attract and retain the best talent, we can't afford this waste.

Time to get proactive – Outstanding companies are not only proactive in attracting the best talent from a wide and diverse pool of candidates, they also create inclusive workplaces. For the London Market to maintain its global pre-eminence in re/insurance, it must tackle these challenges head-on, acknowledging that everyone benefits from working together to create a more diverse and inclusive industry.

The role for the IIL

To be successful in practice, a diversity and inclusion strategy must be developed with both top level support and grassroots initiatives. Working with the CII's Diversity Action Group and other Local Institute Diversity Champions, the high-level role of the IIL's Diversity Champion is to work with the IIL Council and Members to:

- raise awareness of diversity and inclusion;
- provide advice and share best practice on diversity topics; and
- advise on solutions to diversity challenges.

My goal for the next 12 months as Diversity Champion is to work with the IIL Council and interested members to develop plans to ensure that the IIL's work meets the needs of its increasingly diverse membership. That includes supporting wider industry objectives to attract and retain the best talent, with a focus on increasing diversity and inclusion.

The role the London Market can play

There are many ways that members and London Market firms can support this work, including:

- putting issues around diversity and inclusion on the board agenda – and debating them;
- creating and participating in industry-wide, IIL, or company-specific diversity networks;
- publicly stating support for diversity and inclusion, so sending out that message to current and prospective employees; and
- developing recruitment and retention strategies to attract the widest possible mix of talented candidates and help to select, keep, and get the best out them.

How this is done will naturally vary from firm to firm depending on their needs, strategies and size. But it's in all our interests to improve the perception of insurance, attract the best talent, and help create a more diverse and inclusive industry.

As Diversity Champion, I'm keen to hear ideas about how the IIL can support members as well as wider London Market diversity and inclusion initiatives. Please contact me at <iildiversitychampion@cii.co.uk> with ideas and suggestions.

[1] Chartered Insurance Institute, Insuring a better future, 2010

[2] PWC, 15th Annual Global CEO Survey, 2012

Hollie Dearman ACII
Professional Indemnity Claims Handler
Caytons Law

Climbing the ladder with distinction: Exams and career progression

Interviewed by Anthony Jefferys ACII, Chairman, IIL Young Members Committee

The industry has seen a shift in the importance of insurance exams, once an option and now an expectation, and the extent to which they are taken seriously can have an impact on career success and how we distinguish ourselves in an increasingly 'peer-competitive' environment.

The Institute's highest achiever aged under 30, Hollie Dearman, won five awards en-route to completion of the ACII with a run of distinctions, while achieving paralleled successes in her career.

AJ: The majority of graduates entering the market earn themselves a place on a graduate scheme, how did you find your way into insurance?

HD: I somewhat stumbled into the market as I had a choice of going to university or taking a role as a professional indemnity claims broker for Lockton. In truth I simply didn't fancy the student life and, having just been travelling, was tired of being poor! So I took the job whilst not knowing much about insurance. I wasn't sure that I'd still be in the industry six years later but I've no regrets about that decision.

AJ: Were exams a requirement?

HD: I started the Cert CII early on at Lockton. It wasn't a requirement but my boss kept on at me to do the ACII. I appreciated that being inexperienced and without a degree like most other newcomers I would struggle to be taken seriously without the qualification. This was especially so when I joined Mitsui Sumitomo as a claims adjuster. While not compulsory, it became clear that progression to certain higher level roles would be inhibited by the lack of qualification and the ACII would broaden opportunities.

AJ: Completing your exams represents an important milestone for acquiring knowledge and recognition but what led you to complete them to such a consistently high level?

HD: I didn't aim to achieve distinctions; I just had a determined mentality. There was the desire to be more knowledgeable but I had personal motivations that never wavered. A driver for me was to overcome preconceptions in what can sometimes still be a male-orientated market. A strong career goes hand in hand with independence – that's infinitely important to me. The high grades came purely from being committed. It took up my social life, a ridiculous amount of hours and an equally ridiculous amount of caffeine. Focusing on the reasons why I embarked on the ACII is what kept me disciplined. There's a million things we'd all rather do than revise but saying no to a drink after work is a small price to pay as once you've got those letters after your name no-one can take it away from you.

AJ: How has your exam success impacted your career?

HD: The knowledge I've attained is naturally a benefit to the skill I apply to my job but the ACII has given me the credibility that I might not otherwise have had. It's increasingly hard to differentiate yourself and there's no better way to demonstrate commitment. It has changed people's perception of me and undoubtedly the reputation that comes with the ACII has helped me.

AJ: With the ACII and various awards under your belt, what are the next steps in your career and study path?

HD: I have the Fellowship in my sights and I'm now tutoring CII students. Otherwise I remain focused on my career and having accepted an exciting role with Caytons Law, I've much to keep me driven.

Attaining the ACII really is as long and as painful as it sounds. It takes sacrifice but the benefits massively outweigh the long slog getting there and it boosts career progression without question.

A driver for me was to overcome preconceptions in what can sometimes still be a male-orientated market. A strong career goes hand in hand with independence – that's infinitely important to me

Barnabas Hurst-Bannister ACII
President
Insurance Institute of London

Interview with Robert Hiscox by the President, Barnabas Hurst-Bannister ACII

Robert Hiscox, who has enjoyed a very distinguished career at Lloyd's, was the principal guest at this year's President's Lunch at the Mansion House. He recently spoke to Barnabas Hurst-Bannister about the themes he introduced on that occasion.

BH-B: At the Mansion House, you suggested that insurance still has something of a dull image. How do we change that perception?

RH: When I came to the City in 1964 that was certainly true of most insurance companies, with serried ranks of clerks quoting by the book and seeking to attract business at the tariff rate. Even then, Lloyd's was different. We had nourished the innovative spirit of Cuthbert Heath and also 'sailed to the sound of gunfire'.

The whole of the London Market needs to retain something of a buccaneer spirit and rise to the challenges that confront insurers. War, terrorism and kidnap and ransom insurance, for example, have all been developed or refined during my time at Lloyd's. None of that would have happened without embracing creativity. We need to demonstrate a positive attitude and show our customers and their brokers that we can satisfy their insurance needs with a 'why not?' approach to business.

BH-B: But doesn't regulation encourage the underwriter to say 'no' rather than 'why not'?

RH: Only if we don't educate the regulators and don't exercise genuine self-discipline. The insurance industry needs to welcome and work with its regulators. I am convinced that we should second our best staff to the PRA and the FCA, for short periods, to inform the regulators as to how we work and to learn from the regulators about the best and worst performance they uncover. We shouldn't worry about working alongside secondees from our competitors, after all, that's what the subscription market is all about. It's far better to have well informed and supportive regulators. The best people to achieve that are us.

Lloyd's has a proven ability to come together in a crisis … witness Reconstruction and Renewal … but that hasn't stopped us from competing ferociously with each other under the present franchise regime.

BH-B: OK, so how can the entire London Market be encouraged to take this challenge seriously?

RH: We need a strong general insurance body drawn from the Chartered Insurance Institute, the ABI, the Insurance Institute of London and Lloyd's, and maybe the broker bodies as well, to kick start this initiative. We in the business know who the bad guys are, so we should work with the regulators, because bad business ethics or insolvency hurts us all.

The London Market needs to retain something of the buccaneer spirit

The new general insurance body could award 'Approved Status' to insurers and remove it if standards fell. This warns the regulator where to look.

Lloyd's once used market practitioners to regulate, but has moved on to its own professional regulators. They are employed by Lloyd's, not the regulator, and they work with the Lloyd's Market Association. The whole industry could do the same. This would just be a first defence, with the regulators stepping in to anything serious. However, first and foremost we should continue to behave as well as we have for the past decade or so, reducing the need for draconian regulation.

The most important qualities are drive, common sense and commercial acumen

BH-B: Do you think we really could forge a single body that supports the UK insurance industry?

RH: We desperately need one genuinely strong voice for general insurance, including reinsurance, Lloyd's and the brokers. A body that could influence and educate government; that would command the attention of No 10 and No 11 Downing Street; that would be capable of helping the Bank of England with regulation and that might even be able to speak sense to the remorseless regulators in Brussels and avoid gold-plating every EU dictat at huge cost to the UK insurance industry.

BH-B: If EU regulation has been pernicious, what else has damaged the London Market?

RH: We should never have lost our pre-eminent position as a reinsurance leader to Bermuda; a rock 400 miles from anywhere. Its achievement is immense, but we became complacent and remained a market with which it is quite expensive to do business. We weren't helped by high taxation and EU regulations overlaid with domestic gold-plating. If only our government had treasured the UK insurance industry and done everything in its power to help it, instead of snipping and sniping at it … but we are where we are.

I am also concerned that our reward mechanism is faulty. The broker is paid by the wrong party. Somewhat surprisingly, brokers underestimate their own risk assessment abilities and should be prepared to charge their clients for the true value they add on their behalf.

Changes are afoot, with moves to fees rather than percentages of premium, but they are happening agonisingly slowly.

BH-B: Are there any positives?

RH: The London Market is still the overall king of insurance markets. We have the huge advantages of the whole infrastructure of London, the expertise, the culture, the language, the time zone … everyone wants to come to London, but we could do with better airports.

London sees a huge variety of risks … and most of the hairy ones. We are basically a market of last resort as simple business tends to be placed locally, so we see the most interesting risks. This is why the London Market has a wonderful feel about it. You can never be bored if your business is affected by every disaster in the world. Underwriters are decision makers who take the risks from almost every commercial and individual endeavour and their assets all round the world. For people who work in insurance in the City there is still the daily excitement of the 'jungle that is London', still the greatest financial centre in the world.

Transferring risk away from our policyholders is intensely interesting … understanding their needs and offering them what they want is fundamentally satisfying … especially if you can build a business doing just that … and many Lloyd's underwriters have built substantial businesses doing that very successfully in my lifetime. I recall my father tuning in to the news on the radio every day when we were on holiday in Cornwall when I was a child.

I realised at an early age how important it is to have an interest in worldwide events.

BH-B: Is there anything else that you would say to encourage young people to develop a career in the London Market?

RH: Apart from 'go broking first', I would encourage aspiring underwriters to think carefully about the somewhat introverted, highly professional skills that are required to be a good judge of risk. We are basically bookmakers. It helps to have a mathematical mind and a university degree helps train the brain. That doesn't mean that we don't welcome school leavers. For me, the most important qualities are drive, common-sense and commercial acumen, and it doesn't matter if you are 18 or 21, so long as you have those attributes.

Perhaps one of the most satisfying changes that I have seen during nearly fifty years at Lloyd's is that when we advertise, say, eight jobs we receive about 800 applications. The people who want to work, today, for Hiscox, or at Lloyd's or in London's insurance companies or broking firms are getting brighter and brighter and that bodes very well for our market.

Anthony Jefferys ACII
Chairman
IIL Young Members Committee

Empower the next generation: time to modernise

As rates waver on the edge of adequacy, investment returns remain unsympathetic, reserve stockpiles are running dry and underwriting discipline is already a staple value of the operation, focus may turn to expense and seeking greater long-term efficiency through modernisation.

I am reluctant to believe that the elusive 'hard market' will return – at least not in a form experienced in the past. The need to accept diminishing returns on equity and that smarter capital allocation, in-depth portfolio understanding and making the most of data, are today's crucial tasks.

Surviving in good shape is one thing, but to excel and grow profitably in current conditions we cannot rely on extraordinary events to drive up rates. It might be wiser to focus on other factors such as expenses and efficiency, which might benefit by bringing things up to date.

With legislative change diverting focus and funds, it is not the time to reignite and redesign the once-failed replacement and system modernisation projects. But could delaying such changes make matters worse for future generations?

An insurer's risk evaluation strategy is based on its data and its analysis and it is important to capitalise on this by looking more closely at core infrastructure to survive in an increasingly competitive environment and meeting stringent compliance requirements. Many insurers feel that this is no longer an IT-only issue, but a wider business concern.

It may be that some insurers now benefit from more efficient systems and globally collaborative use and analysis of 'big data'. The result is more reliable models, lower expenses, streamlined services and ultimately to be more competitive. In many cases, modern systems and data understanding are strong foundations for long-term sustainable underwriting and optimum expense ratio.

Since the 1970s and '80s, all aspects of the market have developed and become infinitely more complex, but every day skilled insurance practitioners deal with an out-of-date system designed in those years.

Elsewhere, systems and data capabilities are set to grow ahead of ours and some overseas markets have invested heavily in new infrastructure. What becomes of the Lloyd's vision to be 'the global hub for specialist re/insurance by 2025'? – an ambitious but achievable strategy that will require a solid but agile infrastructure and 'cutting edge' support systems.

More easily said than done

The industry has seen some expensive and painful failures, and as a result modernisation remains an industry headache. However, legacy system transformation and the risk associated with wholesale replacement have diminished due to emergence of robust core software packages that support global businesses and which insurers do not necessarily have to design completely from scratch.

Such project costs are significant and require long-term vision upon which to realise any attributable return. A rip-and-replace method is the most costly and might result in the purchase of the next legacy system. Creation of service-oriented architecture and use of 'software as a service' have also been considered. While these alternatives offer a degree of reuse that helps the immediate return on investment, they might not solve the fundamental issue.

Technology, software development and the need to collaborate across value chains is a major factor affecting future success. New processes would save countless man hours spent using legacy systems to rate, bind, issue and maintain policies and it would act as a structural advantage to underwriting and process efficiency. It will offer the underwriters support towards portfolio monitoring and optimisation and there will be long-term availability of IT staff that can adapt the system according to business and legislative needs.

Our business is still a people business, but if we want the next generation to be truly innovative and develop a world-leading marketplace, we need to create an infrastructure and foundation to encourage and make this possible.

New processes would save countless man hours

Keith Richards Cert PFS
Chief Executive
Personal Finance Society (PFS)

What does the future hold for financial planners?

Never has the public needed trusted financial advice as much as it does now.

On 31 December 2012, the majority of PFS members saw the culmination of years of hard work implemented, both in terms of the achievement of higher qualifications and remodelling of their businesses propositions to ensure compliance with new regulatory requirements introduced under the Retail Distribution Review (RDR). The first quarter of 2013 commenced more positively than was predicted by many over the preceding months and the PFS is therefore pleased to report that membership is as strong as ever.

But what does the future hold for the financial planning community going forward? Early signs are positive and the PFS remains quietly optimistic that this will continue, although the true extent of any impact is unlikely to be properly understood until later in 2013. However, if the numerous surveys undertaken in the first quarter can be relied upon, confidence and turnover are both on the increase. Many businesses have invested heavily in new systems to ensure compliance with the new requirements and as a result profit has been hit in some firms but, generally, they too are optimistic about the future.

This said, financial planning firms still face challenges with the implementation of 'adviser charging', the alternative way for clients to pay for services following the banning of commission on investment products. Most of the issues relate to operational matters, which, although time consuming, should disappear as new systems bed in. For the PFS, the changes have caused it to review the services that it provides to members to ensure that it delivers what is relevant and most needed.

Its annual member survey and focus groups help it identify the subject matter most in demand so that it can develop its CPD programme. But the PFS is also aware of the need for diversification. With such a large and varied membership, the PFS board has focused on how best to segment the membership and offer more tailored CPD to the various sectors. This is a strategy that has already been implemented for the chartered members. With over 3,500 chartered financial planners, representing over 10% of PFS membership, the exclusive events and materials developed for them over the past few years have been hugely successful. The PFS is looking to replicate this success by offering targeted services to paraplanners and those members who use discretionary investment services.

Keeping up to date

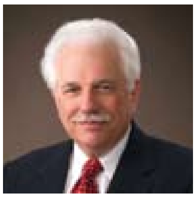
In 2012, the PFS delivered almost 300 events around the country. With a more targeted approach this year, and the need to accommodate increased attendance, it has recognised the value of working closer with local institutes. All PFS members are also members of the CII and therefore belong to a local institute.

The grants paid to institutes include funding that reflects the proportion of each institute's PFS members and it is very encouraging to see an increase in the number of CPD events delivered to the financial planning community by institutes.

In the Lecture Preview insert accompanying this publication you will find details of lectures to be given in London by

- Holly MacKay, Managing Director, Platforum
- Amanda Nelson, Partner, Taylor Wessing
- Kim Stephenson, ACII, DIP PFS, Occupational Psychologist
- Clive Adamson, Director of Supervision and Board Member at Financial Conduct Authority
- Carol Sergeant, Chairman, HM Treasury's Simple Products Working Party
- Natalie Ceeney, CBE, Chief Ombudsman, Financial Ombudsman Service

The UK is still in a period of uncertainty, both politically and economically. Constant changes to tax and welfare benefits, low returns on deposits and nervousness about stock market investment leave many among the general public unsure about their financial future. Never has the public needed trusted financial advice as much as it does now and we need to collectively inspire confidence and trust in our profession.



Charles Scawthorn
SPA Risk LLC
Professor (ret) Kyoto University, Japan

Major catastrophe exposures

The lesson to be learned is simple yet crucial – natural disasters happen.

In recent years there has been no shortage of tragic catastrophe 'surprises', in terms of human casualties the 2010 Haiti (316,000 killed), 2008 Wenchuan China (80,000), 2005 Pakistan (80,000) earthquakes, the 2004 Indian Ocean tsunami (250,000) and 2008 Myanmar Cyclone Nargis (138,000), are the most prominent.

Neither has there been a shortage of insurance 'surprises'. The three largest insurance 'cat' events (2005 Katrina $76bn, 2011 Japan tsunami $36bn and 2012 Sandy $35bn[1]) are primarily due to coastal flooding (hurricane- or tsunami-caused), which doesn't augur well given sea level rise. Despite decades of intense preparation, the 2011 Japan event resulted in 20,000 killed and a loss equivalent to 5% of Japan's GDP, excluding nuclear power plant damage. When nuclear-related losses are factored in, Japan suffered a loss equal to perhaps 15% of its GDP. The 2010–11 series of earthquakes in New Zealand ($16bn[1]) destroyed significant parts of the nation's second largest city, causing losses amounting to 10% of its GDP. The 2011 Thai floods caused about $45bn in damage, one-third of which was insured.

Each of these sudden events were beforehand termed 'low probability' and afterwards 'unprecedented'. They resulted in massive national disruption and required the full attention of the central government to maintain its credibility and authority. Such disasters have been ruinous, typically resulting in massive new borrowing and short-term fiscal crises.

Yet many of these disasters were clearly foreseen and, in some cases, forecast. The Japanese tsunami, which due to its nuclear dimension has had global consequences, was 'unprecedented', yet virtually the identical event occurred one thousand years ago and scientists were on record that a re-occurrence was due. The losses in New York and New Orleans, the Pakistan and Haiti earthquakes and many other such events either had precedent or had been clearly foreseen.

The lesson to be learned is simple yet crucial – natural disasters happen, and a recent history of no such disasters is not an indication that there is little risk. Recent quiescence is more typically a warning of imminent risk.

Notably lacking from recent events has been a major US earthquake. In fact, from an insurance perspective, the United States has only had two significant earthquakes in its history – at San Francisco in 1906 (discussed below), and the 1994 Northridge earthquake, a moderate earthquake on the edge of Los Angeles that nevertheless ranked sixth on Swiss Re's list of most costly insurance losses, at $22bn[1]. Simply put, the United States is overdue for a major earthquake. When it occurs, it will probably result in very high economic and insurance losses. Where might it occur? The United States has perhaps seven potential major earthquake catastrophes:

- *Los Angeles* – the 2008 ShakeOut Scenario examined an Mw 7.8 event on the southern San Andreas Fault, estimating about 1,800 deaths and $213bn of economic losses. A significant fraction of these losses are due to fire following earthquake and therefore insured. The southern San Andreas Fault has generated earthquakes of ShakeOut size on average every 150 years—and on a portion of the fault that ruptures in the ShakeOut Scenario, the last earthquake happened more than 300 years ago. (The San Andreas fault is about 60 km from central Los Angeles, whereas other faults are directly under the urban region and capable of smaller magnitude but comparably damaging events.)

- *San Francisco Bay Area* – the site of the most expensive earthquake in US history – estimates of damage vary from $250m to $500m (1906 dollars), with insurance payouts of perhaps as much as $100m, equivalent to $50bn today (as a fraction of GDP). However, the Bay Area 1906 exposure was that of about 500,000 persons, compared to today's seven million population and $1.5 trillion exposure. The best estimates of damage for a 1906 event repeat only account for shaking, and are about $100bn. No estimates currently exist for an event on the Hayward-Rodgers Creek fault that runs through Oakland and many other East Bay cities. The overall probability of a magnitude 6.7 or greater Bay Area earthquake is 63%, or about two in three.

[1] Insured loss adjusted to 2012 US$
Source: Swiss Re, *Sigma* 2, 2013

A significant fraction of losses are due to fire following an earthquake and are therefore insured

- *Pacific Northwest* – The Cascadia Subduction tectonic plate boundary that runs offshore from northern California to southern British Columbia last ruptured in 1700, with approximate magnitude 9. A large event on this boundary has been estimated to have a 40% probability in the next 50 years.

The remaining US potential events have been less studied:

- *Wasatch Front* is the metropolitan Utah region and includes Salt Lake City and Brigham City, with a total population of about two million. The probability of a large earthquake in the Wasatch Front region is 25% in 50 years.

- *New Madrid, Missouri* has the potential for a large central US earthquake, analogous to the 1811-12 series of earthquakes. Collectively, eight central states are affected, with economic damage in excess of £200bn.

- *Eastern US* has the potential for a large earthquake in a major urban region of the US eastern seaboard. The most prominent historic precedent for this is the 1886 Charleston (c.Mw 7). The 2011 Mw 5.8 Virginia earthquake, which was widely felt, doesn't begin to indicate the impacts a larger event would have.

- *Puerto Rico Subduction Zone* has the potential for a Mw 8 event on the Puerto Rican Trench, similar to the 1787 event, about 120km north of San Juan, Puerto Rico (population 3.8m, about 1.3m of which live in the greater San Juan metropolitan region). Much of the construction in Puerto Rico is seismically vulnerable, and the subduction zone event could generate a major tsunami affecting not only Puerto Rico and the Caribbean but also the southeast US mainland coast.

Two events probably dwarf all others in potential global economic impact and insured losses – a great Tokyo earthquake, and a great central or southern Japan offshore earthquake ('Nankai'), the latter analogous to the 2011 event but placed offshore between Osaka and Tokyo.

In March 2013, Japan's Cabinet Office issued its Second Report on the damage estimation for a Nankai Trough earthquake. The estimates are deeply disturbing – up to 300,000 dead, 9+ million evacuees, and US$2.5 trillion in damage and losses – in all, 10~15 times the 2011 event, not accounting for potential nuclear impacts.

In conclusion, probably the two most pressing questions for any insurance CEO are:

(a) is there an event that will bankrupt our company, and

(b) will our company make a profit?

The latter question is in many ways more easily dealt with, via simulation modelling of the company's portfolio insured exposure and similar simulation modelling of the company's market investments and operations. The low probability nature of extreme catastrophe events tends to minimise impacts in PRA results, except in the extreme 'tails', and profits are pleasingly projected, and usually attained or exceeded.

The first question, however, is what CEOs may lose sleep over. PRA software also tracks the accumulations in hotspots such as Tokyo and Los Angeles, and these are 'controlled' as best as possible, vis-à-vis the lure of profitable underwriting in these markets. However, has all the accumulation been really captured, or are there lines that will unpleasantly surprise us, to the point of possible ruin? Increasingly, techniques such as scenario analysis are being employed to consider this question and identify the potential for risk reduction.

Two events probably dwarf all others in potential global economic impact – a great Tokyo earthquake and a great central or southern Japan offshore earthquake

Natalie Ceeney CBE
Chief Executive Officer and Chief Ombudsman
Financial Ombudsman Service

Complaints – a new era for customer service?

I'm often asked to answer the question that financial services leaders should be asking: 'Why are consumers complaining and what should we be doing?'

Over the past few years, 'complaints' have dominated the headlines, we've seen concerns grow about an emergent 'claims industry', politicians and commentators have worried about the 'compensation culture', and at the Ombudsman Service, the number of new complaints received nearly doubled over the past year.

Behind the headlines

It's easy to focus on large numbers, but as in all aspects of life, headlines make for bad analysis.

Payment protection insurance (PPI) is a case in point. It is by far the biggest area of complaint in our (the financial industry and the Ombudsman's) history. But these complaints didn't come out of nowhere. Over 50 million PPI policies were sold – over more than a decade. In 2010, the FSA very consciously and deliberately chose a 'complaints led' strategy as a redress solution for PPI. It could have asked banks to proactively compensate customers, but it didn't – instead it asked most customers to complain. So, the high numbers aren't a surprise – perhaps it's more noteworthy that fewer than 10% of those sold PPI have so far complained.

Where do claims management companies (CMCs) fit in?

Some argue that CMCs are fuelling complaints, and others assert that they are creating 'fraud'. The conduct of some leaves a lot to be desired, and it is comforting to learn that the claims industry regulator is stepping up its activity against CMCs that breach the rules.

Fewer than 10% of those sold PPI have so far complained

However, we should not equate CMCs behaviour with consumer behaviour. The CMC activity in PPI (and in any area of 'mass-detriment') makes economic sense – and their business model stacks up. Like any for-profit business, CMCs look to the bottom line, and millions of potentially mis-sold consumers provide fertile ground and a ready-made customer base. More crucially, their business model doesn't support their representing individual customers making a very personal complaint, for example about a particular issue in their insurance claim. In our work, outside of 'mass detriment' areas, we are not seeing much CMC activity at all, and don't expect to. And we're not seeing an increase in 'consumers trying it on'.

A more nuanced picture

Stepping outside of areas of 'mass detriment' – and away from CMCs – a more nuanced picture emerges. Over the past year we've seen complaint numbers rise across the board – with banking and credit cases up by around 20% and general insurance cases (excluding PPI), investment and pensions cases up by around 30%.

Why are customers complaining more? There are obvious and some more subtle reasons. The obvious are that trust in financial services is at a record low off the back of recent and high-profile financial scandals – and money is tight.

When something goes wrong – and especially if money can ill afford to be lost – a consumer is that little more likely to challenge the business' response. Volumes might reduce when the economy improves – and even further when consumers feel they can trust their bank and insurers more.
Less obvious, but increasingly observed, is evidence which suggests that consumers are finding new ways to voice their dissatisfaction. They might have 'moaned' in the past, but with the advent of social media, they have ready access to like-minded people. They don't hold back in joining in those 'conversations' and saying 'the service I've had isn't good enough'. It's more comfortable voicing anger if it's been confirmed by peers as valid. The private is finding more opportunities to go public.

That's a key reason why complaints are rising. It's not necessarily that more is going wrong – it's that more people are willing to voice what's going wrong. It's a new culture of communication, but not the 'compensation culture' we keep reading about. We are not seeing more consumers seeking compensation – we're seeing more consumers wanting an apology, and things put right for them and for others. The Ombudsman Service receives 500,000 complaints a year, all of which are reviewed individually – so it probably has the strongest evidence base on the subject!

How are financial institutions responding?

Forgetting for a moment the various rules on complaint handling, it becomes apparent that behind every complaint is usually a customer saying 'you didn't get it right for me'.

Understanding that consumer as a fellow human being – with a family, a life and wants and needs – is the starting point for deeper insight about why things have gone wrong and what it means for them. Complaints are best viewed as a source of insight to help business improvement.

Addressing the issues complaints raise is not about dealing with an individual customer's problems, but an opportunity to improve services across the board. That's not saying that every complaint deserves compensation or is 'right' – but that it is worth listening to. Learning from complaints is about readjusting delivery, or how to live up to the promises in marketing literature. It will also help recalibrate consumers' lowered expectations, create loyalty and ultimately rebuild trust. And there is overwhelming research and evidence that if a complaint is handled well, the customer is more likely to remain loyal – and even more loyal than those who don't have cause for complaint at all.

I've seen many examples of excellent complaint handling, with pragmatic and flexible approaches taken to dispute resolution. I've seen businesses committed to addressing issues that cause complaints. And I've worked with firms in which complaints-handling teams are seen as a valued extension of the marketing and insight function – adding value to strengthen and develop product design.

But also, unfortunately, I've seen appalling practices, including complaint 'factories' miles from other parts of the business, run under the auspices of compliance teams, or separate outsourced functions.

Set-ups such as these don't generate insight, and at worst, they generate defensive box-ticking cultures, unlikely ever to please customers or promote a positive image of the business.

Obstacle or opportunity

How do you see complaints? As obstacles, a cost and a concern – or as an opportunity to improve and gain competitive advantage?

In today's society, if people are unhappy, and if it's not easy for them to complain, they'll tell someone else, and not only their families and friends, but also somewhere potentially much more damaging – the next Twitter campaign?

Complaints should be seen as an opportunity. As a CEO, I want to deliver the best possible service to my customers. Knowing which customers are unhappy and why helps me do my job better – making things better not only for them, but also for everyone who comes after.

With more consumers than ever willing to tell you what they think, there is a bigger opportunity now to learn, and deliver an even better service. So my advice is to step back from the 'complaint volume' headlines, and don't distract yourself by pointing the finger at others or blaming things outside of your control. Instead, treat complaints as an unparalleled opportunity to build an even stronger relationship with customers, by learning from what goes wrong and creating advocates out of those who dare to tell you where you can do better.

Chris Hannant
Director General
Association of Professional Financial Advisers (APFA)

After the Retail Distribution Review

It had been a long time coming, but the Retail Distribution Review (RDR) finally started at the beginning of 2013.

The RDR had cast a shadow of uncertainty over the sector for so long, that most in the sector felt a degree of relief that the preparations were over. Advisers can get on with dealing with it and doing what they do best – looking after their clients.

The initial reaction is a feeling of continuity. Reports suggest that existing clients accept the new arrangements, although the impact on new business remains uncertain. There have been several transitional issues. As a result of the introduction of new rules, there has been some compliance uncertainty for advisers that wish to ensure that everything is right. Advisers have also expressed concern about the reporting requirements for the Retail Mediation Activities Report, how to deal with VAT, and product provider readiness. The Financial Conduct Authority has said it will be taking a tolerant stance on most issues in the first six months, the exceptions lack of appropriate qualification and payment of anything that looks like commission.

When the dust has settled what will the effect of the RDR be on the financial adviser sector?

The APFA has published the first part of its benchmark for the advice sector so that it can monitor change going forward and as a result have an evidence base. The FCA has released data on advisers with the new qualification and these show a significant fall in adviser numbers. There are 31,000 individuals with permission to give investment advice and of these 20,000 are financial advisers.

A near 25% fall in adviser numbers begs the question: is this temporary?

Prior to the RDR, there were about 26,000 financial advisers in 'primary category' firms, that is, those whose main business is advice. The nearly 25% fall begs the question: 'Is this a temporary phenomenon from which numbers will recover or a step change to a smaller profession?'

Who's in

The number of the firms in the industry has oscillated within a fairly narrow range (around 5,000 or 14,000 counting appointed representatives). However, regulatory change has many looking to sell their businesses as they seek to exit the industry and others looking for more support in the face of uncertainty and new entrants looking to buy businesses. So with time, will there be greater concentration in what is a highly-fragmented sector? Or will new firms be created as fast as others are sold into larger entities?

How much of the adviser population will remain independent and how many will opt for restricted? Early signs are that most independent financial advisers have stayed independent. I expect to see some change as people experiment with different approaches to clients and commercial factors might come in to play. And there is a question mark over the concept that the regulator may not have got its definitions right.

There is even a question as to whether the predominant model of face-to-face advice is the future of the profession. Regulatory change has prompted a great deal of consideration of ways to provide financial advice to clients in a cheap and cost effective way. Technology offers new possibilities of communications methods and provision of advice. Several firms are considering new models and options; it will be interesting if these gain mass appeal.

I don't know the answers to these questions but I do believe that the profession will change. The sector in a few years' time will have a different look and feel than today, but it was ever thus. Among the strengths of the sector is that financial advisers have continually adapted to change and the profession's entrepreneurial talents have proved to be resilient, as has the value of the advice that clients have continued to seek.

Richard Hobbs
Director
Lansons Regulatory Consulting

A path to prosperity

A decent period of stable economic growth would make everything better.

Two years ago, I wrote in this journal that we needed a new regulatory approach if consumers were to engage more successfully and more often with financial services. We now have a new approach. We now have two regulators, instead of one, and we have new statutory objectives that emphasise the efficient working of markets and the role of competition in getting good outcomes for consumers.

New relationships

More than that, we have a conduct regulator that intends to employ the somewhat ambiguous lessons of behavioural economics to inform regulatory policy. They are right to try and success would be in the interest of every stakeholder. Inevitably, the early stages of the regulators' journey have been characterised by conflicting messages. The regulator wants a new and more mature conversation with the industry at the same time as it will intervene earlier in markets and with even greater force. Perhaps these messages could have been modulated a little better but the underlying issue is that the new regulators inherit a legacy of whatever conduct practices have gone before. Policies such as those arising from the Retail Distribution Review are only now just beginning to produce observable impacts on the market.

There are two substantial and difficult issues, in particular, for the Financial Conduct Authority to overcome. In recent years the combination of the so-called credible deterrence policy and the joint operations against banks' conduct with the US authorities (for which financial penalties are much higher) has led to a rapid escalation of fines. So much so that the Treasury now collects the fines, instead of the fines helping reduce much higher regulatory fees. One wonders what consumers conclude about the financial institutions with which they are expected to engage if misdemeanours seem to grow bigger every year judged by the fines paid. They could surely be forgiven for mistrust. It is not obvious how higher levels of mistrust improve consumer engagement.

Meeting expectations

This difficulty is compounded by the expectations of politicians and the media that have been fed on a diet of increasingly severe punishment for the financial services sector as a measure of regulatory effectiveness. If the level of punishment diminishes and the regulator is seen to be engaging with the industry in a more sophisticated and thoughtful manner, the immediate accusation will be one of cosying up to the industry. In effect, the non-governmental public body style of regulator is the heat shield ministers use for protection when things go wrong.

> The new regulators have something of a honeymoon period during which they can blame their predecessors until something appears to go wrong on their watch

Photo supplied by Andy Roberts/Getty Images

If the level of punishment diminishes the regulators will be accused of cosying up to the industry

There is no obvious solution in sight to this dilemma. The new regulators have something of a honeymoon period during which they can blame their predecessors until something appears to go wrong on their watch. Whatever that is, observers would do well to consider carefully whether something has been uncovered that occurred before they took up the reins and had a chance to reshape policy. And as one senior regulator observed recently, a decent period of stable economic growth would make everything better.

It will take time to change policy to reflect the new objectives the regulators have been set. They have the same staff as before the change, so new thinking will take a while to establish. Events may, or may not, give them the window to show the benefits of a new approach. They probably only have one shot at it. No pressure then, but they must make some big calls about how they treat the industry and industry would do well to respond to a potential opportunity to secure better regulation.

Sian Fisher ACII
Managing Director
OIM Underwriting Ltd

Why is there a growing trend of MGAs and how are they regulated?

Current estimates suggest around 250 full MGAs now operate across the UK, underwriting around 11% of its £47bn premium income.

Managing general agents (MGAs) are not a new phenomenon in the UK general insurance landscape but the recent surge is curious to some. Whether broker-owned or independent, MGA status as the 'start-up of choice' is simple to explain. Two main drivers exist.

First, historically, any underwriter striking out on their own would go to Lloyd's. Now barriers to entry are high. An MGA is a more realistic option – and one that benefits from backing by major insurers. It offers the attraction of a wide underwriting facility rather than a restrictive traditional binding authority, and the relationship with the insurer is fiduciary, concentrated on achieving underwriting profit. It is a true partnership.

Contraction of bank lending may have made it harder to fund an independent MGA but this has spawned MGA incubator firms – equivalent to the Lloyd's turnkey agencies.

Second, there is significant momentum behind broker-owned MGAs, which are a logical defensive move and response to market need. Insurers have 'gone direct' in personal lines and commercial small and medium enterprises would be next without a coherent response from the larger producing brokers. Professional broker-owned MGAs provide this.

Major consolidation of the retail insurers had also left brokers with a lack of markets, poor service and little innovation. If you are an insurer with a large cost base, SME business is tough to make money from. The insurer solution had been inflexible products sold 'off the shelf' with no underwriting or service component.

Broker-owned MGAs have been a great way to keep a range of insurers in the SME market while giving the sector back its underwriting vibrancy and competitive options. For the insurers, broker-owned MGAs offer a route to SME customers with a more competitive cost base than their own.

Regulation

So with the significance of the sector confirmed and the MGA fiduciary duty owed to the insurer rather than the insured, it seems counter-intuitive that we are regulated in the same category as wholesale brokers. As things stand there is only one regulatory category of wholesale intermediary and MGAs are obviously a form of intermediary. The reality is that our national regulator works within the EU and within the confines of the Insurance Mediation Directive, currently under review.

Despite this, it is vital the market and our regulator understand us. This was a big part of the motivation behind several senior personnel from MGAs getting together to form the Managing General Agents' Association as a professional trade body and voice for the sector.

It is understandable that a specialist part of the market cannot be top priority for a consumer-focused regulator such as the Financial Conduct Authority but it should be able to develop a clear view of what 'good' looks like. We need to work with the FCA to achieve this.

Our insurer partners can play a big part. The regulator will naturally put an emphasis on the principal to ensure appropriate discipline in any delegation of authority to its agent MGAs. Historically, insurers have looked at delegated authorities in quantitative terms as a distribution route, not as an underwriting partnership, and have largely lumped MGAs and brokers together. But thanks to the efforts of the Managing General Agents' Association, and its sister bodies in other major world markets, we get asked much less often now 'aren't you just a broker with a binder?'

Can we persuade the FCA a separate regulatory category is worth exploring? Perhaps. But our primary focus must be on the quality of our offering and defining for the market in general what good looks like for managing general agents.

Can we persuade the FCA a separate regulatory category is worth exploring?

Andrew Bathurst
Director, PWS Gulf Ltd

Andrew Bardot
Secretary & Executive Officer, International Group of P&I Clubs

International Group of P & I clubs (IGA) update

2012 was another difficult year.

The 13 clubs that make up the International Group provide protection and indemnity (P & I) cover for approximately 90% of the world's ocean-going tonnage. The total entered owned tonnage is just under 1 billion tons gross.

It has been another challenging year for ship owners with very few vessel sectors unaffected by the global recession. The ClarkSea Index reflected a downward cycle with the average earnings per day in 2012 20% lower than 2011. This is aggravated by the strong fleet growth that amounts to an aggregate growth of 41% for the world fleet since 2007.

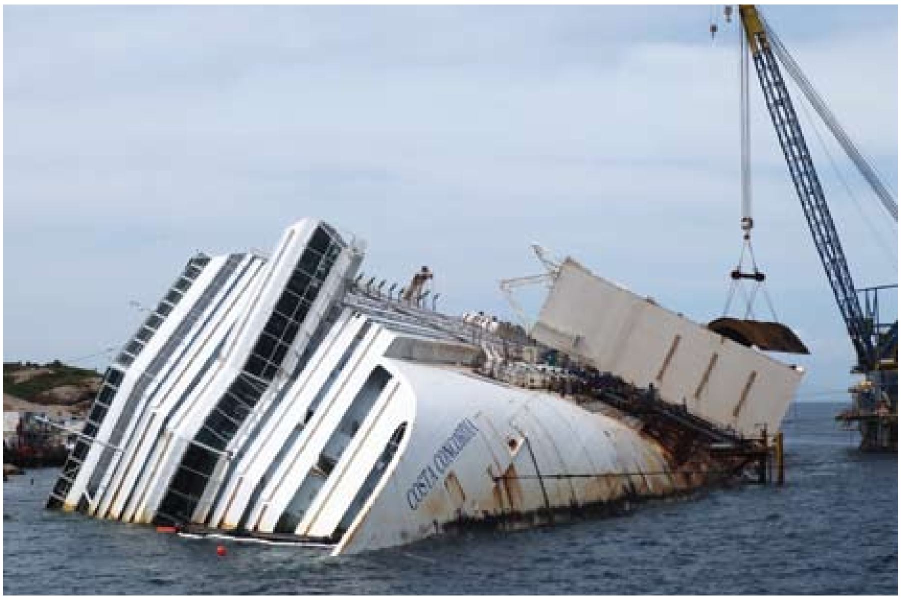


Photo supplied by AFP/Getty Images

27 May 2013: work in progress to remove the Costa Concordia cruise ship wreck

Challenges

From the outset, 2012 was another difficult year for ship owners and clubs with the tragic events surrounding *Costa Concordia* and the significant escalation of costs in responding to the grounding of *Rena*. These have had a significant impact on the group's reinsurance renewals for the 2012–13 and 2013–14 policy years. The member clubs now retain US$9m each club per loss and the upper limit of the pool has risen from US$60m to US$70m. The pooling of large claims between the group clubs dates back to around 1900 and commercial reinsurance arrangements to 1951. Since 2005, the clubs have also arranged their own captive reinsurance company, Hydra, which plays an increasing role in optimising the group's reinsurance.

Sanctions continue to pose challenges for clubs and owners and have taken up considerable time for the clubs.

In particular the increased regulatory focus on sanctions and prohibitions impacting on insurers since 2010 has been of significant concern to clubs and the group.

The year 2012 saw a welcome reduction in the number of piracy attacks and ships/crews captured in the Gulf of Aden/Indian Ocean. However, there have been several incidents off West Africa involving theft of cargo and violence against ships crews. The group supports and contributes to the efforts of the industry to develop guidance for ship owners. The year saw the introduction of the BIMCO Guardcon standard contract for the employment of security on board vessels. The group played a significant role in helping to develop this standard form in an area of complex national and international law issues.

Removal of wreck (ROW) costs are an increasingly significant feature of maritime casualties. The costs associated with ROW continue to grow. These are an increasingly substantial financial burden on clubs, the group pool and the group's reinsurers. A working group was established in August 2012 to review this issue with the aim of identifying factors that have caused this significant cost escalation and to consider whether recommendations or guidance can be provided by the IGA.

The day-to-day operation and administration of the group is based in London and it plays a vital role in helping owners to deal with the complex web of maritime legislation and regulation worldwide and to ensure that adequate and effective insurance cover is available for ship owners' ever increasing liability exposure.

Firas Abi Ali
Head of MENA Forecasting
Exclusive Analysis, recently acquired by IHS

Politics, economies and unrest in the Middle East

Before President Obama's term expires, his administration is likely to offer Iran a deal that sees the United States and the West ending support for Syrian insurgents and hostility to Hizbullah, in exchange for Iran allowing full inspection of its nuclear programme.

We assess the threat of US military action against Iran to be credible. If Iran assesses this to be the case, it would likely accept a deal. If Iran does not see the US threat as credible, the US military would likely strike Iran's nuclear programme, probably leading to up to three weeks' closure of the Gulf Co-operation Council (GCC) airspace and the Strait of Hormuz.

In either event, in the next five years Iran and Hizbullah's strategic priority will probably shift from confronting Israel to confronting Turkey and Saudi Arabia, which are more capable of threatening their strategic interests in Iraq, Syria and Lebanon. The cold war between these countries will likely see the Syrian civil war spread to Lebanon in 2014. The rise of Sunni extremism in Syria and Lebanon will push the Christian, Shia, Alawi and Druse minorities into an alliance to prevent Sunni domination, with the authority of the Lebanese state gradually collapsing. It is unlikely that the civil war in Syria and Lebanon will end in the next five years, because each of Iran, Israel, Turkey and Saudi Arabia will attempt to prevent one another from dominating any future government that emerges in either country. A war in Lebanon will not see the pitched battles seen in Syria, but will likely see militias dominating certain parts of the country.

In the next five years, Saudi Arabia and Algeria would either have seen or still be facing a severe risk of politically destabilising civil unrest.

Both countries' governments are almost entirely dependent on oil revenues and have largely failed to diversify their economies into activities that are not dependent on such income. Both could not create enough jobs to appease rising expectations from their youths, and the political class in both is more concerned with positioning itself for succession than with dealing with the underlying causes of unrest. As such, there is severe risk of mass protests in these countries in the coming five years. The survival of the Saudi monarchy will depend on the ability of the Al Saud to pass the throne to someone younger and seen as untainted by corruption. Unless the Al Saud can maintain a united front and agree the transfer of power to the next generation, discontent over inequalities and corruption will probably come to the fore with destabilising unrest spreading through the Sunni Nejd and Hejaz.

Continuing unrest

North Africa is unlikely to see improvements in its economic situation and sufficient to reduce the risk of politically destabilising civil unrest, especially in Algeria and Egypt, and of labour unrest causing disruptions to cargo and industry. Political power is likely to be divided between labour unions, salafi affiliates and the military in each of Algeria and Tunisia. However, none of these economies is capable of creating jobs and improving living standards at a rate that is sufficient to reduce the risk of unrest.

Photo supplied by AFP/Getty Images

Egyptians salute army as it ousts President Morsi

The popularly backed coup to oust the Muslim Brotherhood in Egypt will probably limit the ability of Islamists to exclusively dominate governments in North Africa going forward. However, as salafis realise that an Islamic state is unlikely to be established through democratic means, some are likely to conclude that the Islamist political parties they have supported were not Islamist enough. They are therefore likely to turn to armed violence against opponents, backed by North African fighters returning from Syria. The paradigm of terrorism is likely to shift from the global approach of al-Qaeda to local and cultural issues, with the aim of ensuring that the salafis' vision of Islamic identities is implemented.

It is unlikely that the civil war in Syria and Lebanon will end in the next five years

Dominic Christian
Co-Chief Executive, Aon Benfield
Chief Executive Officer – International, Aon Benfield

What is ILS?

Insurance linked securities have become very attractive due to the low correlations with mainstream financial markets and high, stable returns.

Insurance linked securities (ILS) are risk mitigation instruments used to transfer re/insurance risk to capital markets. Although taking several forms, the most common and liquid type is catastrophe bonds (cat bonds). Other products include industry loss warranties (ILWs) and sidecars.

The ILS products protect re/insurance companies against high-severity, low-frequency events, acting as a complement to traditional capacity.

Introduction

Capital markets' direct involvement in insurance risk transfer began in the early 1990s and the first cat bond was issued in 1996. Growth accelerated following the 2004 and 2005 hurricane seasons, and resulted in an increase in demand for reinsurance cover and reduction in available traditional capacity.

ILS products

Cat bonds transfer a specified set of risks from a cedant to a group of capital market investors. They are structured via a company established specifically for the transaction – a special purpose vehicle (SPV), which enters into a re/insurance agreement with the cedant and raises capital that is invested in highly secure assets to collateralise the agreement. The capital is raised by issuing a bond that pays a quarterly coupon equivalent to reinsurance premiums and is at risk of impairment or total loss following the occurrence of specified trigger conditions.

Industry loss warranties are a form of risk transfer in which a cedant purchases protection based on the entire industry loss for a pre-defined event in addition to the cedant's actual losses.

Sidecars are independent financial entities that allow capital market investors to take on the full risk/return profile of a reinsurance entity or portfolio as a collateralised quota share agreement between the ceding reinsurer and the sidecar. Investments may be made through debt or equity on the SPV and liability will be capped at initial investment level.

Cat bond market growth

Before the 2008 financial crisis, cat bond market annual growth was 20%. Modest growth followed, but the market returned strongly in 2012 and 2013 will also be a strong year, with about $6–$7bn of new primary transactions.

Over 70% of risks transferred to capital markets relate to US hurricane and US earthquake, which reflects client demand and recognises the embedded nature of catastrophe modelling for these perils.

Expansion and development of credible modelling for non-peak zones will support capital market growth due to heavy reliance by investors on third party modelling.

Recent growth has been driven by several factors, including increased regulatory/solvency capital requirements for cedants, and growing price convergence between ILS products and the traditional reinsurance market.

Spreads have tightened, while the market has witnessed huge inflows of third party capital.

An additional catalyst is the use of main credit rating agencies, which determine bond default probability. This provides investors with additional support and is often a prerequisite for many investors.

Investor base

The investor base largely comprises dedicated funds invested solely in the insurance sector. An inflow of institutional money has resulted in a substantial increase in the size and number of market issuances. Most of this capital has been invested directly with larger dedicated funds but, increasingly, pension funds are investing directly into the asset class. Accompanying this has been a marked shift in the investment time horizon and continued asset class expansion is expected.

Future of ILS

Market conditions favour for continued ILS growth, with new investors attracted by the benefits of ILS investment allocation. The tightening of spreads would encourage more cedants to use the market as a viable alternative to traditional reinsurance.

Conclusion

In a short period, ILS has established a real presence and has become a mainstay that is substantive and integral to the reinsurance market.

Derek Atkins
Visiting professor, Cass Business School, London; partner, Reputability LLP

Anthony Fitzsimmons
Chairman, Reputability LLP

Reputational risk

These risks are as relevant to insurers as they are to other types of firm.

Risk management has a huge blind spot. It does not systematically cover the risks caused by humans involved in organisations. These risks cause crises and are the key drivers of reputational damage. Yet they are missing from most, probably almost all, risk maps.

The first systematic research into this area, *Roads to Ruin*,[1] identified a series of risks that lay at the root cause of about twenty major crises.

Since *Roads to Ruin*, we have more than doubled the cohort of case studies. With over forty companies and pre-crisis assets totalling more than $20 trillion,[2] many companies nonetheless faced bankruptcy. 'Shareholder value' was shredded on a prodigious scale, with shareholders of many companies completely or nearly wiped out. Most of the survivors suffered severe reputational and operational damage. Many leaders lost their jobs as well as their personal reputations.

Following our research, we now classify these elusive but dangerous risks into two main categories:

Behavioural risks – risks from groupthink; inadequate skills, aptitudes, leadership and communication; poor governance, ethos and culture; and undesirable incentives.

Organisational risks – risks from the organisation's structure and strategy, and from complexity.

These are among the most important drivers of both crises and reputational damage. To a great extent, they are not directly covered by insurance.

> What risk manager will be prepared to let their boss know that they are investigating the leadership as a source of potentially catastrophic risk?

The combined conclusions from the research can be summarised in five points.

- Despite disparate natures and industries, the companies studied shared deep-seated behavioural and organisational risks which made them more vulnerable to have crises.
- Once a crisis had struck, the same risks were critical in tipping the crisis into a reputational catastrophe.
- The root causes of these risks lay within the leadership team, including the board.
- These risks, which lie at the root of many, probably most, major corporate disasters, are seldom captured, let alone systematically, by classic risk management techniques. They are beyond the know-how of most risk managers; and they are often taboo or invisible to insiders.
- As a result, these risks pose a hidden but potentially catastrophic threat to any firm, however substantial. Unrecognised, they remain unmanaged and unnecessarily dangerous.

Another factor makes the problem more difficult to solve. What risk manager will be prepared to let their boss know that they are investigating the leadership as a source of potentially catastrophic risks to the organisation?

Special measures are needed both to find such truths and to explain them to corporate leaders.

Lessons for the insurance industry

We offer two insights to the insurance industry.

First, these risks are as relevant to insurers as they are to other types of firm – our cohort of forty includes eight insurers, four of which faced insolvency. Firms should consider whether they are systematically dealing with behavioural, organisational and board risks as assiduously as they deal with other types of risk. Boards should grasp this issue before regulators regard not addressing it as a governance failure.

Second, insurers can develop tools to rank insurance buyers according to whether they are better or worse at managing these risks. Those that are worse are quite likely to be more susceptible to insured events and their escalation into major crises. Particularly important in liability and in directors' and officers' risks, this could apply to many other types of risk.

[1] Professor Derek Atkins, Anthony Fitzsimmons, Professor Chris Parsons, Professor Alan Punter, Roads to Ruin (London: Airmic, 2011)

[2] By way of comparison, the GDP of the United States is $18 trillion

Benefits of membership

Lecture and seminar programme

The Insurance Institute of London offers members a wide programme of lectures. IIL lectures are free to all CII members.

Registration

For lectures held at Lloyd's – all attendees who do not hold a Lloyd's pass must register 24 hours in advance via the IIL website.

For all lectures held at Xchanging and Willis, all attendees must register 24 hours in advance via the IIL website.

Continuing Professional Development (CPD)

If you wish IIL lectures to qualify for CPD purposes, proof of attendance (in the form your registration name badge) must be retained. To obtain this badge you must register via the IIL website.

Lecture podcasts and CPD certificates

Whenever possible we make podcasts of our lectures, which all CII members can download free of charge from www.cii.co.uk. You can also download a CPD certificate.

Educational visits

The Institute's programme of educational visits to a wide range of industrial, commercial and other organisations enables members to view a variety of insurance, safety and fire risks at first hand. Bookings are online via the Institute's website.

Research studies

The Institute's research study groups investigate specialised areas of insurance and produce reports of immense value to practitioners and of importance to the whole industry. Reports can be purchased online via the Institute website and CII members can obtain copies at discounted prices.

Networking events

The Institute hosts a variety of events which aim to give members an opportunity to make new professional and social connections. This year the networking events programme included a lunch at Mansion House, a ball at The Dorchester, a circus themed party and a charity fashion show at the Tower of London. We also arrange a Christmas quiz and a carol service as well as special events designed to appeal to young professionals too. All these events provide an ideal opportunity for companies to entertain clients. Full details of all our events are emailed to members and bookings are welcome online via the Institute's website.

Keeping members informed

Make sure you get the most out of your membership by updating your details at www.cii.co.uk and clicking on My CII.

Website

The Institute's website at www.iilondon.co.uk provides quick and easy access to information about all its events and activities. It also includes:

- an online booking facility for lectures, visits and networking events;
- an online purchase facility for books;
- instant downloads of podcasts, presentations, publications and CPD certificates.

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Annual general meeting

Notice is hereby given that the annual general meeting of the members of the Insurance Institute of London will be held on Monday 30 September 2013 at 5.45 pm at the Insurance Hall, 20 Aldermanbury, London EC2V 7HY. By order of the Council, Miss A V Potts, Institute Secretary.

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