A unique view of the future

Jardine Lloyd Thompson's Chief Executive Dominic Burke and Commercial Director William Nabarro have an invaluable view of the insurance market. They outline what to expect for 2010 and beyond. By Andrew Cave

After two years in the doldrums the global economy is turning a corner, and the talk has turned to resurgence and renewal. Businesses and sectors that have been fighting fires for so long finally have the opportunity to pause and take stock. At Jardine Lloyd Thompson two of those most qualified for the role of looking ahead to what the future holds are Chief Executive Dominic Burke and William Nabarro, Jardine Lloyd Thompson's Commercial Director.

As head of the world's sixth largest broker, Burke has a canny nose for the health of the insurance sector as well as the wider stock market and the general economic picture, while Nabarro's experience as a mergers and acquisitions banker gives him an insight into the opportunities and challenges that difficult markets pose in downturns.

Meeting Burke, one cannot help but be bowled over by his focus. It is his passion for what he does, coupled with dogged determination, which helped transform the

Dominic Burke (left) and William Nabarro (right) discuss the future for insurance

fortunes of the firm when he became CEO four years ago. Nabarro shares his lively intelligence, and adds his urbane, measured overview of the market. Between them they have a unique insight into what the markets have in store for insurance buyers.

Adding value

Both are looking for ways to differentiate service in what has been a buyers' market for some time. Insurance cycles traditionally run counter to those of stock markets, as capital searches for the best returns. However, the global recession that followed the credit crunch is different. Unlike what happened in the last downturn in 2001, the insurance market has generally not hardened, with a 12 per cent reduction in global domestic product leading to corporate belt-tightening and an extremely competitive market.

That trend is likely to continue well into 2010, with buyers benefiting from softer rates in many classes. Burke says: "We may be through this cycle by the second half of 2010, but then it will be a question of where the growth comes from and how quickly it is going to come. This is going to look and feel like a recession for quite some time." Nabarro agrees. "We've gone through 12 months in which pressure from companies to cut every element of back office cost has just been inexorable," he says. "There's been no tolerance for increased insurance cost to the point that, where markets have hardened, it's generally resulted in higher levels of retained risks or clients not buying certain lines."

Some insurance cover, such as credit risk and financial institution insurance and catastrophe-related exposure in the Gulf of Mexico is bucking the trend and starting to show price rises, while motor insurance rates have also hardened recently in some parts of the world but generally, Burke feels the soft market will continue.

Total aggregate sums insured decreased as buyers shrunk in size and had less money to spend and this has led to a more competitive insurance market as underwriters not wanting to see their books reduced, have responded to the new environment. Burke shrugs off any

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»» potential challenge from a market where demand has reduced. Undaunted, he is focusing on the opportunities to tailor straitened budgets to achieve the best value. "Clients are at least getting the benefit of a lower total insurance cost," says Burke, "and we're working with them to maximise that position for them so that they can eradicate costs from their business."

He is excited about the opportunity in this climate for Jardine Lloyd Thompson to win new clients through a greater depth than its rivals in many sectors. Brokers have to work a lot harder to show clients this differentiation in a soft market but Burke is enthusiastic about the opportunity. "We'll remain focused on being risk managers and understanding risks in their fullest sense for clients because there are exposures on balance sheets today that perhaps none of us saw 18 months ago. The world is a very different place," he says.

The focus remains on serving clients, but Burke is adamant this must be balanced with reasonable broker fees. He says the solution is more effective service utilising initiatives for electronic claims, accounting and settlement to reduce the cost of placing insurance into the markets. "We recognise the challenges clients have," he says, "they're challenges we have too. We have to run our business efficiently, making better use of technology and up-skilling our people. We're obliged in a very competitive market to make sure we're not wasting clients' money."

Burke is speaking from a position of strength. Jardine Lloyd Thompson was one firm to come out of the global recession having gained vigour. The first half of the current financial year saw a 16 per cent growth in fees and commissions. Burke believes the company's business model, current structure and strategy gives it a sound platform for sustainable profitable growth as it continues to work hard to help clients achieve their insurance and risk management objectives. A trading statement in November confirmed that the group's performance for the third quarter of 2009 was in line with expectations and that it remains on track to achieve its financial objectives.

Fiscal strength

Fiscal strength has come from strong organic growth in a sector where some have had to rely on acquisitions for momentum. Nabarro is well-placed to offer his view of recent insurance market consolidation. He points out: "I've spent most of my working life as an investment banker specialising in mergers and acquisitions and I think it's often fool's gold in this industry. It's viewed as a necessity in order to deliver continuing earnings per share growth to shareholders but the risks and some of the damage sustained by companies through the M&A process is very considerable in terms of adverse customer reaction and the fragmentation of businesses involved. It's very wasteful. Deals may work financially in the short term but over time the fallout in terms of good people and important clients could be material. Important industries don't consolidate indefinitely. Customers demand choice."

For Jardine Lloyd Thompson growth is a result of a range of strategies. In his November trading statement, Burke said: "JLT remains well positioned and we will continue to build on our successful strategy of balanced growth – organically, by bolt-on acquisitions and through selective hiring of industry-leading people." When probed for more details he says: "We have a strong balance sheet and the funds to invest in businesses that we can add to JLT. But we'll only do it where the cultures, product skills and knowledge of the people add real value and extend our offering."

One future challenge for the industry is whether there is an opportunity to move away from the cycles that can be so disruptive, to more consistent pricing. Burke is not alone in wanting to see a day where the market "moves away from the arbitrage of pricing to have a long-term cost of risk that clients can embed into their own business model. It will benefit clients who will actually understand what it's going to cost them when they're making investment decisions or entering new geographies, specialities or industries."

The business is therefore in a strong position to face a number of challenges expected to cause some disruption in the next

year. This is not only the current economic conditions but a number of regulatory and structural issues within the Lloyd's and London company insurance markets.

Subscription

Burke is keen to see the continued operation of London as a subscription market, particularly for the placement of large or complex risks. Under the subscription system, brokers negotiate rates, terms and claims management procedures with one insurer, who then agrees to underwrite a substantial portion of the risk. He or she then finds other underwriters to support the leader or quote better terms and conditions.

This practice was protected from scrutiny by the European Union competition authorities by a block exemption, which is due to expire in March 2010. Whilst some elements of the insurance block exemption have been renewed, the authorities have left the co-operation agreement as an open issue – although far from exclusively an insurance issue – as they feel it is covered by existing elements of law. This has created uncertainty and fear that the EU competition authorities may launch some sort of action.

Burke feels this would not be in clients' interests and that the way the market operates encourages competition whilst also providing solutions for clients that might otherwise by unattainable. He supports the subscription market as it believes it operates in the best interests of clients, allowing them to access larger capacity and more competitive terms.

Vertical placement

The European Union competition authority threat may be countered by a growing trend that involves insurers applying their own terms and claims protocols for their share of a risk – known as vertical placement – and this provides some buyer benefits.

Traditional subscription placement requires the broker to place 100 per cent, otherwise terms for the whole risk must be renegotiated. With vertical placements the London broker can place, say, 70 per cent of a risk at advantageous terms, and the balance placed elsewhere in the London or local market.

However, on the down side, while a broker would have gone to great lengths to place 100 per cent at better terms, in this new market some may take the easier option of placing on a vertical basis.

Burke can see the pros and cons of both approaches. The key is providing choice for clients and ensuring the availability of cover and capacity in any single market, he says.

He is optimistic that legislators will see the benefits of maintaining the status quo: "I can't believe legislation will be allowed that would take away or threaten what's still the leading insurance market in the world. The market will evolve and we may see more of the way that the aviation insurance industry operates as a best-terms market, for example, rather than what we've been used to. But it can do that without damaging its position in the global insurance market."

Solvency II

More of a challenge, Burke and Nabarro believe, is the European Union's Solvency II directive, which is due to come into effect in 2012, with experts expecting one of the key outcomes to be risk-based allocation of capital. Nabarro shares widespread industry concerns that Solvency II may raise capital requirements and therefore the cost of capital and premiums for clients.

The worry is that tighter demands on capital could see smaller specialist insurers consolidated by larger groups that may not provide the same cover, resulting in less choice for buyers. In addition, Nabarro says implementation could cause confusion. "This can in some ways be compared to Basel II in the banking sector, which leads me to suggest that during the initial phase of the implementation you could have some quite nasty rigidities as the implications of different insurers' books become apparent later in the day than you would like."

Choice and coverage

However, Burke and Nabarro are adamant the right approach should enable Jardine Lloyd Thompson to maintain choice and coverage for their clients. In a way, they say, the directive makes brokers more essential than ever as they are able to utilise their close knowledge of the market and its participants to source the right cover. In the meantime, the company will continue to work hard on clients' behalf to influence the new regime.

"Clients want to buy cover," says Nabarro. "The fact that the industry is worrying about Solvency II and the subscription market structure shouldn't be their problem. But there are a number of challenges or question marks over the structure of the way that the insurance market operates and we have to make sure they're resolved in a way that benefits the buyers."

From their unique standpoint Burke and Nabarro can see a clear way ahead through the vagaries of the market and legislation. They see opportunities for buyers to get a better service, and ultimately better risk pricing. It's a typically passionate conviction from these two industry heavyweights, and one that their previous form would show they can play their part in delivering. RS

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