Assurances

A Composite Insurer's View of the U.K. Domestic Market

R.K. Bishop

Volume 54, Number 1, 1986

URI: https://id.erudit.org/iderudit/1104479ar
DOI: https://doi.org/10.7202/1104479ar

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Publisher(s)

HEC Montréal

ISSN

0004-6027 (print)
2817-3465 (digital)

Explore this journal

Cite this document

Bishop, R. (1986). A Composite Insurer's View of the U.K. Domestic Market. *Assurances*, *54*(1), 73–83. https://doi.org/10.7202/1104479ar

Article abstract

Si cet article traite du marché des assurances en Angleterre en 1984 et pendant une partie de 1985, nous croyons que les propos de l'auteur sont encore d'une grande actualité. Et c'est pourquoi nous faisons paraître ici sa communication au dernier *Rendez-Vous de Septembre*, qui a eu lieu à Monte-Carlo à l'automne de 1985.

A Composite Insurer's View of the U.K. Domestic Market

by

R.K. Bishop, FCII, FCIS[1]

Si cet article traite du marché des assurances en Angleterre en 1984 et pendant une partie de 1985, nous croyons que les propos de l'auteur sont encore d'une grande actualité. Et c'est pourquoi nous faisons paraître ici sa communication au dernier Rendez-Vous de Septembre, *qui a eu lieu à Monte-Carlo à l'automne de 1985.*

My remit is to describe, from the viewpoint of a direct insurer, the UK domestic non-life market (as opposed to the international and reinsurance market centred upon the City of London), to review recent developments and current performance, and then to use my crystal ball to suggest a pattern of ongoing developments and trends, with particular emphasis on their impact on reinsurers. A daunting task at any time within a paper of 4000 words, but especially so in the present volatile market conditions and with the end of the remaining fire tariffs announced as I strive to meet the Organising Committee's mid-April deadline for submission of this paper.

The UK domestic market

Net non-life premium income in 1983 can be estimated as :

	£m
Fire & Accident non motor	3900
Motor	2100
Marine & Aviation	2250
	8250

[1] M. R.K. Bishop est *Chief General Manager* de Phoenix Assurance et *Chairman* de British Insurance Association, Londres.

Competing for this business are some 500 British companies, Lloyd's and a number of foreign insurers. Whilst the last mentioned normally enter the UK to transact business in the London international and reinsurance market, a few have now established branches in provincial cities and are competing, often fiercely, for domestic insurance. Even those maintaining only London offices provide competitive alternative markets for the national brokers who do not hesitate to use them for such insurance.

Although until the last two or three years this UK non-life market has been relatively well disciplined, this has been a self, not an imposed discipline. With the abolition of the final part of the fire tariffs, there will be no rating agreements, no commission agreements and no general agreements as to form or wordings for any class of business.

There is full freedom establishment in the UK subject only to authorization by the regulatory authority – the Department of Trade and Industry – and 103 new companies have been so authorized in the past 5 years. Applications for authorization are normally processed quite speedily.

Once authorized, companies enjoy what we in the UK have come to call "freedom with publicity" – substantial freedom to transact business and freedom to invest funds without government or other direction or interference, provided we disclose what we do by submission of prescribed statutory returns.

Additionally, the UK recognizes freedom of services, with no restrictions on where insurance cover may be obtained.

The UK insurance market is thus, arguably, the most open and unrestricted in the world – and certainly unrestricted by comparison with most other members of the EEC. Small wonder, therefore, that the presence of the most resourceful and energetic broker force in the world, willing and able to use all available markets, combines with the above-mentioned freedoms to make for highly competitive market conditions.

Current performance

British Insurers are not afraid of competition – even intense competition ; they have lived with it at home and abroad for more than two centuries. The difference over the past few years has been the immense increase in capacity at a time when the low level of world economic activity has meant too little pure new business to satisfy the growth ambitions of insurers. There is no room in this paper to dwell on the detailed reasons for this over-capacity – in any case they are too well known. Included are :

1) High interest rates encouraging cash-flow underwriting ;

2) The creation of captives and their entry into the open market ;

3) A soft reinsurance market (without which the activities of captives would have been greatly restricted) ;

4) The ability and willingness of brokers to use world markets ;

5) The paucity of pure new business mentioned above.

Yet another factor is the rapid increase in the number of insurers operating in the international field, direct and by way of reinsurance. Many powerful companies, previously operating only in their domestic markets, have in recent years sought greener pastures elsewhere, primarily because of intense competition and squeezed profit margins in their home markets, but also because of their vulnerability to local cyclical troughs. What better place for these previously insular companies to dip their toe into the international pool than in London ? Many such companies "gave their pen" in pursuit of premium income and many are now licking their wounds.

I will examine, later in this paper, the extent to which these factors and the resultant over-capacity are still relevant and likely to continue to affect the UK domestic market, but there is no doubt that over the pass two or three years they have combined to undermine market discipline and bring about unwise, sometimes insane, competition. This has culminated in the appalling UK results announced by the major British composites over recent weeks. Every one has announced seriously worsened underwriting figures for 1984, and I doubt whether many have enjoyed a trading profit even after allocating investment income on technical reserves.

Although, pending the issue of the full annual reports, the information is not available as I write this paper, it is probable that this malaise spreads across the industrial, commercial and personal sectors and across all major classes of risk in the UK market.

Initially, the intense competition centred upon the larger industrial and commercial risks and in the fire, consequential loss and liability classes. Rates were cut sometimes up to 50% in the property classes and even more in the liability classes as the traditional insurers tried to hold on to at least part of their porftolios. As disastrous results became inevitable in these classes, and reduction in overall premium volumes brought problems of expense ratio, insurers sought growth elsewhere, and increased their efforts to develop through personal accounts. Unprecedented competition was thus transported into the personal sector, again with direct consequences.

The escalation of competition would itself have been sufficient to produce an unacceptable level of underwriting loss but, unfortunately, other factors were conspiring to make matters worse :

I) Crime losses have increased at an alarming rate – for example between 1979 and 1984 the cost of burglary and theft losses under household policies increased four-fold and for industrial and commercial premises three-fold.

II) The extent and frequency of weather related losses increased dramatically as shown by the following figures, all of which are expressed at January 1984 price levels :

15 years 1963-1978

January	1963	£ 127 m frost and snow
September	1968	£ 64 m floods
January	1976	£ 114 m gales and floods

5 years 1979-1984

January/March	1979	£ 106 m frost and snow
December	1979	£ 39 m gales and floods
Dec. 1981/January	1982	£ 279 m arctic weather followed by floods
Jan./February	1984	£ 175 m gales, snow then floods

III) Increased claims consciousness on the part of personal policyholders, probably due to the influence of the media and consumer organizations, but also due to increasing cost of repairs – this has been especially noticeable in weather related claims and claims for subsidence.

IV) Emergence of numerous and expensive long-tail claims in public and products liability and employer's liability classes, although the problem of industrial diseases has not been so great as in North America.

V) Escalation in the level of court awards in excess of monetary inflation – this "social" inflation has undoubtedly been influenced by knowledge, through media coverage, of awards in North America.

VI) After several years when motor accident frequency had increased only to a small extent, the latter part of 1984 and the opening months of 1985 saw a sudden increase in incidence not yet fully explained. Possibly this was due to unusually wet driving conditions and winter weather, but it may have derived from social and economic changes resulting in greater usage and, therefore, greater vehicle exposure ; if so, this would be cause for concern. For example, a "don't drink and drive" campaign clearly failed over the 1984 Christmas period.

Prognosis

The disastrous overall underwriting experience in 1984 reflected all the factors examined in the previous sections of this paper. What now ? How many of these adverse influences are continuing ones ? Are there any new problems lurking in the shadows ? Any favourable trends ? Just what is the outlook for direct insurers in the UK domestic market and how will this impact on the reinsurers ? Out comes my crystal ball.

With regard to capacity in relation to business available, I have not hesitation in saying that, on the international stage, it is decreasing. There are far more insurers who entered the international market and got their fingers badly burnt, than are admitting it. Some cannot hide it, including a few well known examples amongst the captives, and an outstanding example until recently "over-active" in the London fringe market. But, like myself, readers of this paper will have knowledge of a great many other instances where insurers of many nationalities have pulled back from or pulled out of international and/or reinsurance ventures.

It seems to me that industrial companies will, in the light of what happened to some captives who ventured into the open market, hesitate before encouraging such activity in the future, or before forming new captives. What is more, the soft reinsurance market which made feasible such excursions in the first place, is very much less in evidence. Indeed the hard line now being taken by the major traditional reinsurers – particularly those from Europe – must have a further and significant limiting effect on world capacity.

Pressures on the solvency margins of United States insurers due to past adverse results, negative cash-flow, and the present availability of higher premium rates coupled with the difficulty of non-US reinsurers to provide "surplus relief" because of the strenght of the dollar, will further restrict world capacity.

Lower interest rates combined with very high operating ratios make cash-flow underwriting sheer suicide instead of just the madness it always was, and will be another capacity – shrinker.

There are positive signs of increased economic activity worldwide, which must surely make for increased volumes of pure new business – the other factor in the solvency equation.

Capacity, therefore, must be shrinking against available business. Even if improving conditions bring new companies or capital into the market (and I am somewhat alarmed by the apparent ease with which US insurers currently seem to be able to raise new capital), I cannot believe that this will materially affect the improving balance.

The pertinent question for this paper is whether shrinking international capacity will impact upon and bring discipline to the UK domestic market. I have no real doubts that it will, although I can quite easily devise a scenario in which this would not happen : for example, if too many national and international insurers were to see such splendid opportunities in the UK market that they diverted capacity from elsewhere to exploit those opportunities. But the very heavy 1984 results of most major insurers, a tough reinsurance market, and pressure on solvency brought about by increased premium volumes developed from higher rates, seem to all combine to make this most unlikely.

And so, shrinking capacity should bring improved disciplines, leading to more adequate rates. But will this be on a scale to restore an acceptable level of overall profitability to the UK market ? What other factors may help or hinder recovery ?

First, it is not without significance that despite the heavy underwriting losses (and in many cases uncovered dividends or bottom line losses), reported by UK majors in 1984, all are able to show an increase in net worth because of the excellent performance of the underlying investment portfolio. Even without the examples of extraordinarily imaginative (and to me thoroughly undesirable) accounting which were unveiled for the first time in the 1984 (progress reports) corporate reporting, continuing good investment performance might slow down underwriting recovery, as we have seen to be the case in the past 2 or 3 years in the United States.

Second, it is axiomatic that acceptable results are in the end dependent upon adequate rates. Although we are now seeing significant rate increases in many markets, it must not be forgotten that a rate cut by 50% needs a 100% increase just to restore it to pre-cut level. We thus have a long way to go.

Third, a factor, which has stimulated and facilitated competition and which will not hinder the increasing activity and power of the British brokers. They will, as is their role, continue to seek out competitive markets for their clients. But I believe, because of an imperative for total security, and because of the comparative ease of negotiation and administration, they will prefer and return to the traditional British insurance market as its competitive edge is restored by the favourable trends discussed in this paper.

Moving from the general to the particular, perhaps the greatest uncertainty ahead is in the outcome of the ending of the industrial fire tariff from 1st July 1985. Of course, tariffs have been progressively reduced in range and scope over the past 10 years but, personally, I am sorry to see this last remaining feature of imposed discipline disappear, because there are arguments in favour of retention of a tariff for risks where a very small number of risks in a particular class make the statistical experience of the individual insurer of limited use, but we must respect as is the power of government competition policy and consumerism. Nevertheless, if tariffs had finally to go, perhaps it is best that it should be at a time when other disciplines, recognizing the need to remedy disastrous results, make a reversion to the worst excesses of competition unlikely. I hope and expect that both insurers and brokers will act very responsibly in this regard.

Of the other factors affecting present experience :

I) In regard to crime, I am more hopeful. There seems to be some sign of a levelling off in the incidence of burglary and theft. Although theft claims cost BIA members £ 320 m in 1984, an increase

of 16% over 1983, this was the lowest percentage increase for several years. The public is more conscious of the problem and is taking steps to improve protections. The concept of the "neighbourhood watch" is gaining ground. Accordingly, recent quite massive rating increases in both commercial and personal fields may partially, or even substantially, have taken the measure of the problem.

II) Although it would be wrong to be complacent about the impact of industrial diseases, I do not see problems in the UK on the scale which have surfaced elsewhere.

III) Increased public claims consciousness is here to stay, but again this is a matter of rate adjustment and most insurers have already taken steps to meet this need by increasing household contents rates – but the public will have to be prepared to pay for the service it demands.

IV) Incidence of motor losses has a habit of increasing from time to time and then flattering; we shall have to wait and see whether this happens following the uplift in frequency of the 1984/85 winter. Rates can then be adjusted and at least inflations is currently at a manageable level.

V) One can be much less certain about the pattern of weather losses. While British insurers have commissioned studied in this regard, all that a preliminary report has confirmed to us is that the weather in the eighties has been more changeable than for the rather more settled 10 years of the seventies, and that this more changeable pattern is likely to continue since changeability has been a past feature of the British climate.

Other considerations

Two questions which the organizing committee asked me to address and which I have not so far mentioned are :

1) Is there an underwriting cycle and, if so, can one identify measurable changes in its amplitude, duration, etc ?

In North America during the fifties, sixties and seventies there was a fairly well defined underwriting cycle over periods of 5/6 years. If the business there is still cyclical, the direction has been downward for an unusually long period and so the best one can say is that the present cycle in on an extented time scale.

In the UK over the same three decades, cycles in the sense that periods of profitability automatically trigger a downturn, which is followed by an upturn in a fairly regular time pattern are not easily identifiable. A better description would be that downturns are usually triggered by specific events with a subsequent upturn as the market adjusts itself to the new circumstances – the downturn in profitability of motor business following the abolition of the motor tariff in 1969 is a good example. The advent of over-capacity for all the reasons identified in this paper triggered the present extended downturn. We hope we are in the period of adjustment and change in environmental circumstances which will signal the recovery. This cannot be said to be part of any regular or predictable pattern.

2) What impact is the industry's Ombudsman likely to have on trends in the personal business section ?

The short answer is none. The Ombudsman is essentially a Public Relations safety valve. The concept is working very well and to the full satisfaction of members of the Bureau.

Finally, before attempting to draw a few conclusions as to future patterns of profitability, we are conscious that this paper has dealt with fire, accident and motor to the exclusion of marine and aviation. Much of the marine and aviation business transacted in the London market is international rather than national. National or international, both the marine and aviation markets have gone through an unprofitable period for the same reasons as the rest of the non-life market – namely over-capacity.

Due substantially to the withdrawal of reinsurance support coupled with an early recognition of disappointing trends by a compact market, aviation business has shown signs of improvement in advance of the rest of the market.

Marine hull business is essentially international and evidence of more adequate rates obtained has been seen during 1984. Cargo remains highly competitive and this is the case of the domestic as well as the international account.

82 **Conclusions**

Whilst a number of uncertainties remain which makes it dangerous to be positive as to the restoration of reasonable returns from UK domestic non-life business, and even more so as regards the timing of the recovery, there are sufficient favourable factors in evidence which give cause for optimism. More specifically :

a) Reducing capacity should permit the present trend for significant rate increases in property and liability premiums for industrial and commercial risks to be maintained and hopefully accelerated. This is one of the areas in which international reinsurers have an important participation and the trend should help reinsurance results ;

b) As to personal lines, improving results in the commercial account may take some pressure off the current fierce competition in both the household and the private motor sections. A slowing down in the rate of increase in crime losses should mean that substantial rate increases for household cover will provide improved premium adequacy and better results. Reinsurers will seldom be involved individual personal covers except at the higher levels of bodily injury excesses ;

c) It seems unlikely that such serious losses will arise in the tail of liability covers written on UK risks as have arisen in North America and this must be good news for reinsurers ;

d) The difficulty of forecasting future weather patterns leaves uncertainties for reinsurers on catastrophe covers ;

e) In the fire account, the ending of the fire tariff introduces another element of uncertainty.

On balance, I am optimistic about the UK non-life account over the next few years, not the least because the appalling 1984 results demand the application of remedial measures which the market environment is likely to permit. A continuing hard reinsurance market is, however, a vital factor.

Finally, I am acutely aware that we are in a period of rapid change and by the time this paper is presented in Monte Carlo in September, I may even by then have cause to "eat my words". What is certain is that no insurer or reinsurer will be successful unless capable of responding quickly to changing conditions, environment and markets.

Dictionnaire de gestion financière, par P. Conso, R. Lavaud, B. Colasse et J.-L. Foussé. Dunod-Gauthier-Villars, 3e édition. Nouveau plan comptable. Paris

Voilà un ouvrage fort intéressant, en particulier pour ceux qu'intéresse le vocabulaire financier. Tout n'y est pas, mais on y trouve soit les équivalents des termes employés en Europe, soit la traduction de termes américains. Ainsi, voici comment on définit *blue chip* : terme anglo-saxon, emprunté au jeu de poker. Sur les bourses de valeurs mobilières américaines ou britanniques, on appelle *blue chip stock* les titres émis par des entreprises de bonne notoriété. . . Il y a là, au premier abord, un paradoxe, mais il faut prendre les mots dans le sens qu'on leur donne. Autre expression : *venture capital*, que l'on traduit par capital risque ; ce qui est assez inattendu, puisqu'on dit généralement, au Canada tout au moins, *capital de risque*.

À noter qu'on distingue, au sujet du capital, le capital appelé, la libération du capital, *capital budgeting*, capital circulant, capital engagé, capital fixe, capital social, capitalisation boursière, capitaux flottants, capitaux permanents et capitaux propres. Il y a là une série de distinctions intéressante au double point de vue financier et comptable. Dans l'ensemble, l'ouvrage est fort intéressant.