

A CUNNING PLAN

ADRIAN LADBURY talked to Andrew Kendrick, CEO and Chairman, ACE European Group, about the group's plans for expansion in Europe



ADRIAN LADBURY: What is your strategy for ACE in the UK, London market and Europe?

ANDREW KENDRICK: Interestingly it is not hugely different between London, the rest of the UK or Europe or even globally for that matter.

Insurance is insurance as long as it is a consistent offering. This is a fundamental point and very important for us. You need a very clear proposition that is well articulated to the broker. You have to clearly define your appetite for risk so that the broker fully understands your position and you can align your skill sets and ambitions. This is essential in order to match your appetite with that of your broker partners. Then you can work together to target the clients, product lines and market segments that you have decided to enter. Through this coordinated partnership approach we have been able to grow profitably in the UK over the last three to four years in what has been a soft market. It is instructive to look back to the way the market developed after 9/11 in 2001 as it shows quite a difference between the US and UK markets versus that of continental Europe. Compared to the US and to a lesser extent the UK, continental Europe is quite different in terms of rating trends. In the US and UK rates took off very sharply after 9/11 but then also fell relatively quickly too. We saw the first price decreases as early as September 2003 in the UK only two years after the event. In Europe the effect was more like an arc because it responded later and lasted longer. As a result, opportunities arose for ACE as the market was healthier for longer in Europe. This was the background for our expansion in Europe and the MENA region over the last few years. Since 2005 we have expanded into 10 new territories in these two regions.

AL: Would you describe this as an opportunistic growth strategy?

AK: This has not been opportunistic growth. We are constantly trying to get additional revenue on stream but we insist on an adequate margin and in this sense we are long-term. We are in this business for the long haul with a well thought out strategy that is based on three pillars. First, you have to be there. By opening an office in a territory you certainly see the business that never leaves a country. Second, you need to empower your underwriters on the ground. Of course you have your platform whether it be London or Paris, you need your underwriting centres of excellence that can deliver the benefit of being part of a global group. But the local underwriters need to be empowered to make decisions and run the business. Third, if you go to any major European country—Germany, France, Italy or Spain—there is a dominant national carrier that customers invariably use. However, there are always opportunities to compete with these national carriers and win business. A company like ACE has a terrific opportunity in this sense because we have a market leading proposition in important specialty lines such as energy, construction, financial lines, environmental, cyber and accident and health. This really does give us the opportunity to offer a credible alternative to the dominant national carrier.

AL: How important is your global spread when you are pitching to win business from these big national carriers in Europe?

AK: Very important. The big national carriers in Germany, France, Italy and Spain do not generally have the global capabilities that we do. We have indigenous representation in more than 50 countries and clients in over 140 countries. Often the big national carriers cannot offer this to customers. Customers with cross-border exposures want and need an insurer with the ability and tools to track premiums and claims payments for example. ACE GPS is the name we use to describe our multinational client proposition. ACE GPS comprises Worldview which is a fantastic and powerful online tool that enables clients to do just that. In reality I think it is fair to say that only ACE and a few other insurers can truly offer this level of service for customers. This is just the kind of capability and level of service that enables you to continue to grow profitably even in a soft market. Because you are able to offer something genuinely different that customers want and need.

AL: So you ride the cycle by using your global capabilities to enable you to not go with the flow? Does this not make it very difficult to compete in a soft market?



AK: ACE's strategy is really very simple, irrespective of soft versus hard market conditions. ACE maintains consistency in its core underwriting strategy, always aiming to achieve a fair margin for risks absorbed. Our combined geographic presence and product capabilities mean we are well equipped to respond to opportunities as and where they arise. This combination, along with our balance sheet strength, means ACE is more than able to compete in a soft market. Underwriting discipline is the key. It is what we are all about. Our role is to transfer other peoples' risk from their balance sheet to ours without damaging our own in the process and I think our performance during this soft market in particular proves that we are doing just that. The upgrade we received from S&P in December 2010 to AA- is a strong validation of our core underwriting strategy and our senior management team. Few if any of our peers have received a ratings agency upgrade in recent times.

AL: There does appear to be a lot of capacity in this market and it just keeps coming and no one says that they are underpricing or chasing volume. Is this correct? Has the cycle somehow been mastered and rates will stay this soft forever?

AK: Unfortunately the cycle has not been conquered and we currently face a highly competitive rating environment. As I mentioned earlier the first decreases after 9/11 came only two years later and we are seven years on from there. So we are absolutely in a cycle and bumping along at the bottom right now. I am not sure we can go any further as a market without eroding margin and ultimately damaging the market. So you have to be smart to outrun the cycle. What we do is give the clear message that our strong balance sheet is at the heart of our proposition.

AL: Size must be an important factor too as you are able to make more efficient use of your capital through diversification and take the hits with less stress?

AK: Yes you have to manage your capital carefully. You only have to examine recently published financials to have a sense of how people are managing their balance sheets. In this sense you do need a big balance sheet as well as adopting very careful risk selection and an appropriate and sensible reinsurance buying strategy. Globally we are one of the biggest P&C companies. Although in countries like Germany, Italy, Spain and France we are not that big in terms of local market share, we are undoubtedly market leaders when it comes to competing with the big national carriers in our chosen fields of business. We are well established in all of the main European economies, we have credibility and a proven track record. We pride ourselves on understanding our clients' business as well as we can, whilst recognising that the broker is the clients' advocate. This tripartite relationship is essential in enabling us to really understand a client's risk before absorbing it within our balance sheet. The level of engagement

and information we seek from client and broker in turn enables us to price the risk appropriately and to make a fair margin. The effects of the credit crunch are still being very much felt. Some clients are still suffering and they do not want the stress on their balance sheets and want to transfer as much risk as possible. However, they can't transfer it all to us because otherwise we become joint ventures effectively.

AL: Is the absence of information and relative lack of transparency between risk manager and insurer the biggest impediment to the kind of product development that the customers are looking for?

AK: New risks may trigger revenue streams that have margins but you have to be sensible. You cannot assume all the risk from the client. You have to choose wisely and carefully. The risk assessment needs to be a rigorous exercise. You have to work out what capacity you are prepared to release and at what price and the relationship with customers has to be as transparent as possible. Without that it can be very difficult to actually price the risk. If we can get really close to the client and better understand their risks and their overall business in depth then there is an opportunity. To do that you need a deep bench, you need the right skilled people behind the business who can carry out the analytics. Once again you do need to be a fairly large insurer because you need a group of people that you can call upon in places like New York and London. In this sense size is perhaps more important than ever before.

AL: Do you think that the stress on capital among some of these smaller players following the recent string of catastrophes will lead to mergers, acquisitions and even failures that could lead to a serious market correction?

AK: It is not easy to say what will transpire over time. I don't think you will see significant change unless there is a major catastrophe over the coming months or large aggregation of events. If it continues as it has been then perhaps there will be a significant change in market conditions for insurance and reinsurance buyers in the next 12 to 16 months. We have seen major insurers fail in the last soft market but this has been less apparent in recent times and I think it is more likely to be smaller companies that exit and there will be an inexorable shift to larger insurance companies with bigger balance sheets, a gravitational pull if you like. We also expect to see M&A activity in the coming months, driven in part by financial results but also by new capital adequacy requirements.

AL: It is often said that the robust performance of the insurance industry during the credit crisis is proof that it has significantly improved its ability to manage its own risk compared with 2001/2002 for example. Would you agree with this?

AK: There is undoubtedly a much sharper focus on risk management today and this has been accelerated by Solvency II. Even the clients want to understand what your risk management strategy is. It helped that the sector performed so well compared to the rest of the financial services sector and withstood the global financial crisis but this is what insurance is all about, avoiding volatility and getting the price right. It is not yet clear what the new RMS 11 catastrophe model will do to the aggregate position. Let's remember that no one predicted the breaching of the levies in Louisiana and something like that could happen again and break through the top of everyone's programmes and have a contagious effect. There is no certainty that any modelling agency would be able to predict these black swan events.

AL: Risk managers may be impressed with the way the insurance industry coped with the financial crisis but they do not seem to be so impressed with the industry's track record with innovation. What is the problem and how can it be fixed?

AK: The insurance industry needs to continue to evolve and to understand more about the risks that its customers face every day and endeavour to transfer more risk. Information is again the key. The industry will be uncomfortable if there is not enough information, enough transparency and exchange of data. Insurance is traditionally built upon historical records, without which it is very difficult to price new risk because of the uncertainty. Also it has to be said that the client is not always prepared to pay the price because if there is a lack of historical track record then there will be a risk premium. EIL is possibly an example of this. Our EIL book is growing but to underwrite this complex business we have to staff up and hire environmental engineers who we then train up to be underwriters. Renewable energy is another area where we have a lot of interest from clients in areas like waste to energy and biomass-derived power generation, solar energy and onshore wind. But this is very recent technology and I, as a non-

expert but insurance man ask: 'How do you repair such a power station?' Therefore it is never easy to assess a new risk but we are willing to try and that is the critical point. For example there is cyber liability. There has been a lot of data exchange on this to help try and understand the exposures and the product capability. This kind of thing takes a lot of research, development time and investment and we need to see a return on that.

AL: What about the brokers, are they doing enough to help the flow of information and help tackle these emerging risks?

AK: The broker is the client advocate. In my experience they are the first one to consider how to manage newer risks such as supply chain or cyber liability and of course play an important part. To help the communication between the three parties we run client advisory boards in the UK and France as we have done in the US and elsewhere and are looking to extend these to other countries. We recently held one in Paris and it was really useful to understand more about client concerns and the risks they are faced with. Dialogue with the client is key.

AL: How could and should the brokers improve their service more generally to insurers and risk managers?

AK: We are a broker company, they are our lifeblood. They need to be very good advocates of their clients. But I see standards slip in soft markets such as now. We have seen cases where underwriters find brokers wandering in with little more than a web-link to the client's home page to provide information about the client. This is clearly unacceptable either from an insurer or client perspective and such behaviour is limited to a minority of brokers. However, I think that standards should slip even less during a soft market because arguably it is even more important that a broker is doing a good job. We obviously do not respond to brokers who walk in with web-links to find out about their clients. It is about upholding standards.

AL: What about the way brokers are paid. Are you happy that they ask for more during such a market when standards may be slipping? Should you be paying the brokers anything?

AK: Clearly it is about the value of the service and what it costs and whether the customer is prepared to pay that cost. In respect of the client, it is down to the broker to clearly communicate the nature of the service they are offering and subject to client agreement, the broker will be paid the commensurate fee for that service. As for insurers, really I would prefer to see the brokers, rather than coming to us for some form of payment, to be paid solely by the clients. It is very simply a relationship in which the broker is acting for the insured. I, as an insurer, should not be paying a broker. It is as simple as that.

AL: And what about the risk managers themselves. We talked about the need for transparency and more information. Do you think it would help if the customers talked more to each other particularly in specific sectors?

AK: Yes but the problem is human nature because each risk manager naturally wants to think that they have a better deal than the risk manager in a rival company. But you could argue

that if they shared more information as a group it would benefit them all and the insurers. The group approach would seem to be a good one because each industry sector has its own continually evolving set of rules and regulations which create new risks and can be difficult to assess on an individual basis. We have research and development people and engineers who can do these assessments but it would perhaps be easier if the market were to cooperate more.

AL: How can insurers make it easier for risk managers to cover their cross-border risks in a consistent way and be sure that they are compliant?

AK: The first thing is that the client needs to be certain that the insurer has a presence on the ground. It needs to be in place in a decent number of territories. We have offices in more than 50 territories and relationships in the others to make sure client needs are met. It is a bit like looking in a mirror. The client has to look at the insurer and ask: 'Does ACE look like that? Does it have the ability to service the business, does it have the products, can it get the tax paid properly, meet the regulations and ensure we are compliant, understand the deductibles and strategy, when we need to use DIC and DIL?' Beyond that the customer has to look for transparency and the one thing

that a client needs to know is that he or she can track a claim and premium spend and provide an overview. ACE has labelled tools to track claims and deliver policies and therefore I think we are ahead of the curve. Generally speaking this is a less price-driven programme you just need to get it right which requires investment on the part of the insurer and client.

AL: What do you think about the idea of an industry database updated by regulators as suggested during our recent Global Programmes seminar to try and at least give risk managers a base point to work from? Would you oppose this because

it threatens your competitive position?

AK: I have to say that this would be useful for the market. It would lessen our competitive position to a degree but when JP Morgan offered their groundbreaking derivatives product in the 1990s they chose to share it because they realised that it would help the market grow. Therefore I agree with the idea to a degree because if the market grows exponentially then we are all better off. So I am generally in favour of sharing information and data but it does worry me that other insurers that are less skilled and resourced than ACE could use it to offer something on which they could not deliver.

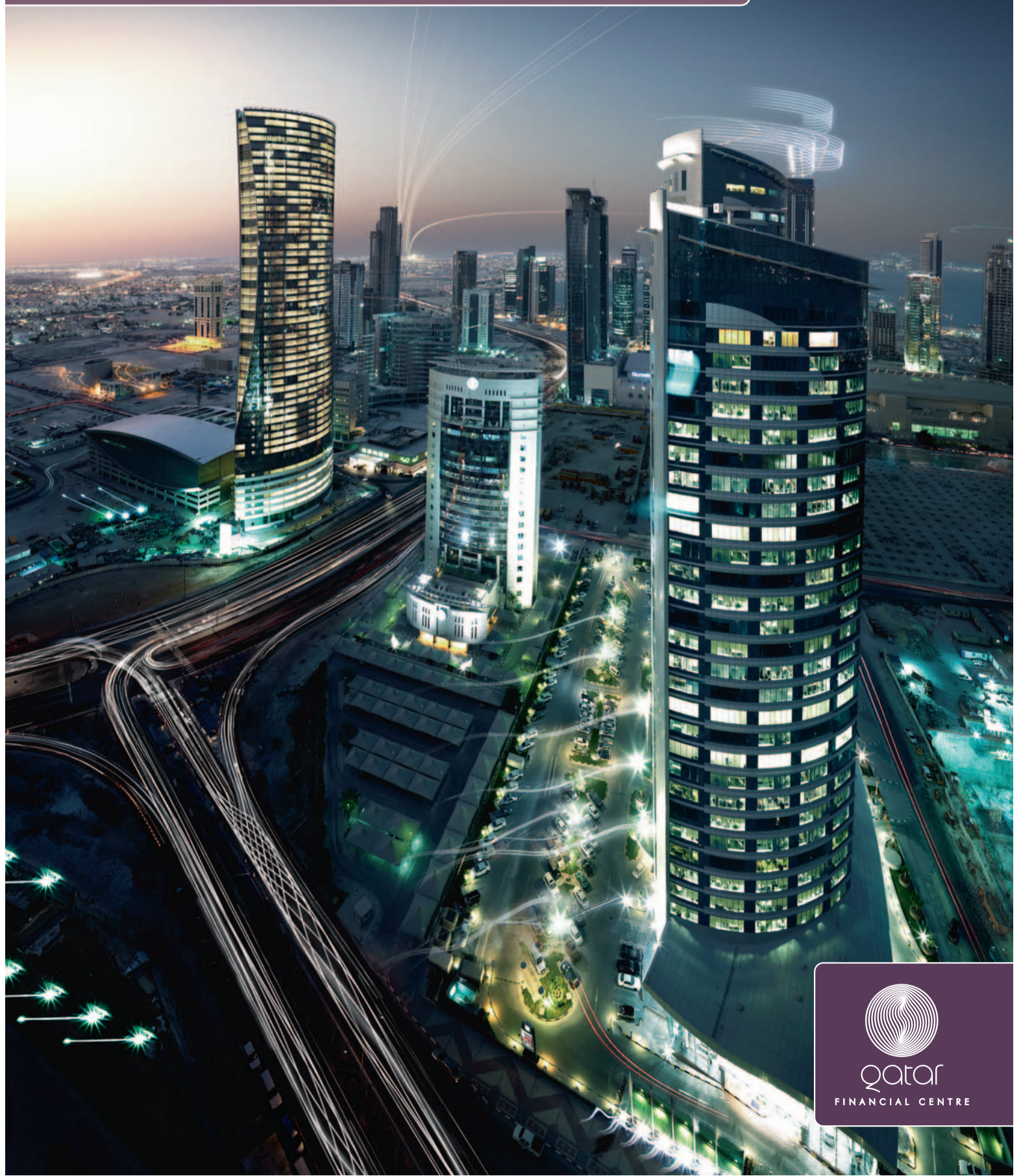
*References the 2008 Forbes Tax Misery & Reform Index

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