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Lloyd's of London must follow through on syndicate closure threats, CEOs say

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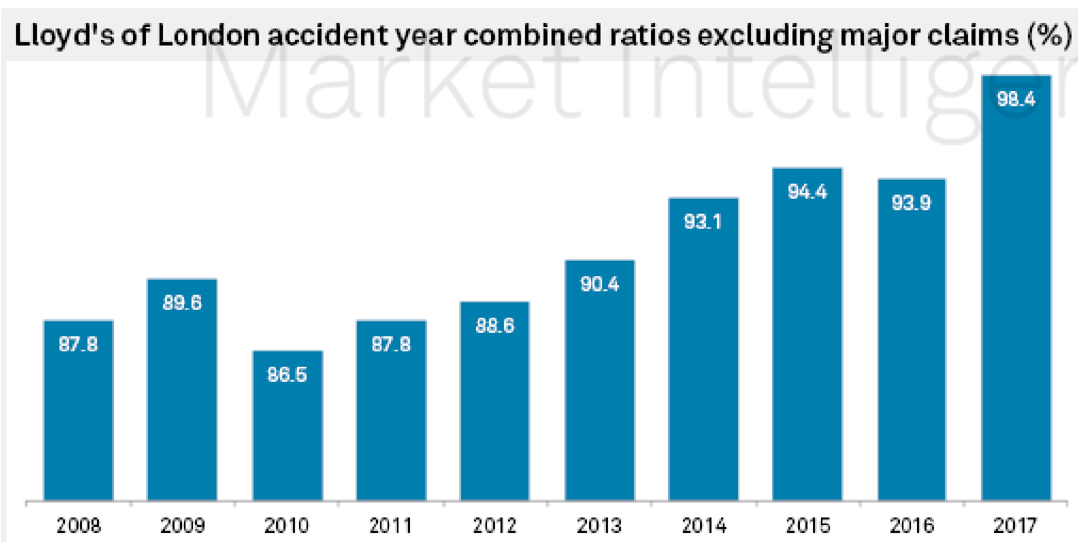
By Ben Dyson

Lloyd's of London should follow through on threats to close unprofitable syndicates if it wants to boost flagging underwriting performance, according to market sources.

Lloyd's insurer CEOs interviewed by S&P Global Market Intelligence broadly welcomed the crackdown, but some warned that it will not be a cure-all for the 330-year-old insurance market's challenges.

Deteriorating performance

The *Insurance Insider* reported June 12 that Lloyd's performance management director Jon Hancock had ordered syndicates that had made three consecutive years of underwriting losses to come up with a remediation plan. Furthermore, all syndicates — regardless of prior performance — will need to submit plans for the worst-performing 10% of their business. Failure to come up with agreeable plans will result in the syndicate or business line being placed into run-off. The *Insider* said syndicates had until June 30 to identify their worst 10%, which is being referred to as "decile 10," and that plans will either be agreed or businesses closed by Aug. 3.

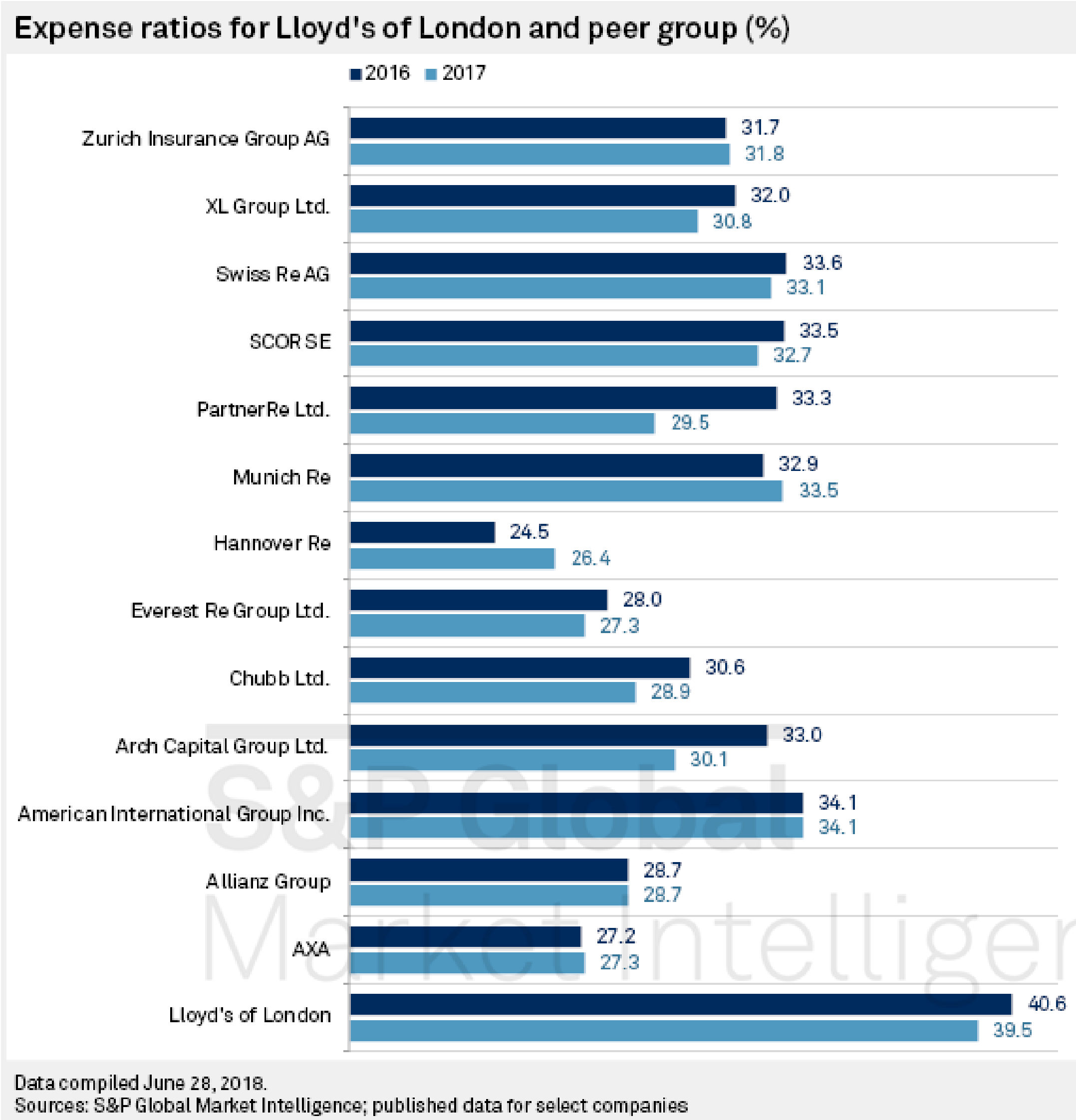


Data compiled June 28, 2018.
Source: Lloyd's of London annual reports

Lloyd's wants to take action because its underlying underwriting performance has been deteriorating. The 2017 natural catastrophes pushed Lloyd's to a £2 billion net loss and a 114% combined ratio, but when the effects of catastrophes and prior-year reserve releases are stripped out, the underlying combined ratio deteriorated by 4.5 percentage points to 98.4% from 93.9%. A combined ratio over 100% indicates an underwriting loss.

The combined ratio is the sum of an insurer's loss ratio and expense ratio, with premiums serving as the denominator. Although Lloyd's often complains that its expense ratio is higher than its peer group, the loss ratio is to blame for the recent deterioration: it increased by 5.6 percentage points year over year to 58.9% in 2017.

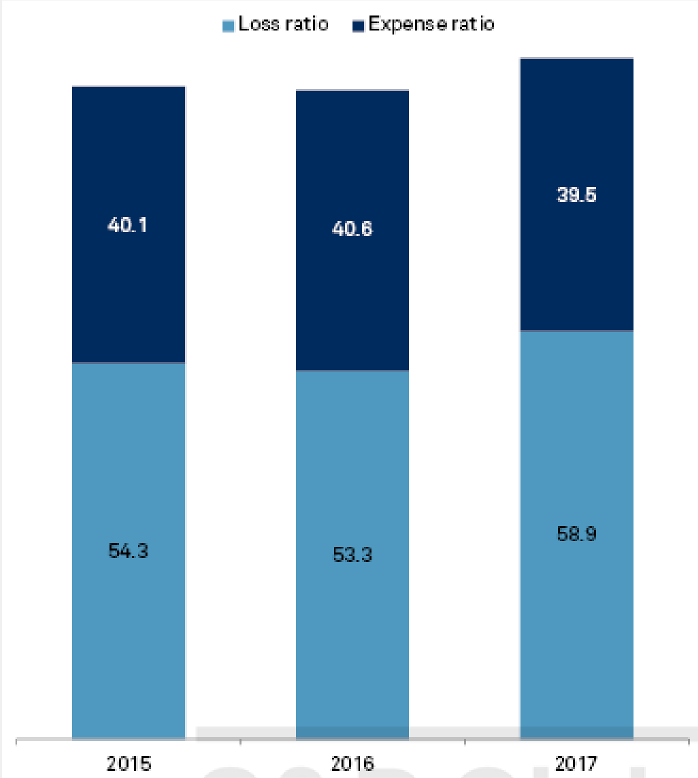
The expense ratio improved by 1.1 points to 39.5%, although it remained 5.4 points above the worst performer in its peer group and 9.2 points above the 30.3% average for the group.



Actions speak louder

Martin Reith, CEO of Neon Underwriting Ltd., backed the initiative, saying in an interview: "Overall, it makes sense. The important thing is [Hancock has] got to follow through now. Having made the threat, I really believe he has to be seen to be taking the action and actually shutting some [syndicates] down."

Lloyd's of London initial accident year underwriting ratios (%)



Data compiled June 28, 2018.
Source: Lloyd's of London investor presentations

Neon's Syndicate 2468 is one of those that has made three consecutive underwriting losses, reporting combined ratios of 138%, 217% and 105% in 2015, 2016 and 2017, respectively. Reith was drafted in by Neon owner American Financial Group Inc. in November 2015 to turn around the business, then known as Marketform.

For some, closing unprofitable syndicates and business is the only way Lloyd's can make a difference quickly. UBS analyst Jonny Urwin wrote in a June 20 research note: "For Lloyd's to regain its outperformance vs. competitor hubs, we believe it must enforce market premium reductions, close syndicates and refocus the business mix away from commoditized lines, whilst cutting cost."

Andrew Horton, CEO of listed Lloyd's insurer Beazley PLC, the fourth-biggest managing agency by 2017 gross written premium, described the crackdown as "a sensible approach," but added in an interview: "The challenge will be for them to make the call at what point do they need to enforce that comment. ... One assumes there are going to be some lines of business or potentially syndicates that go into run-off because it doesn't look like the market is going to improve that dramatically between now and 2019."

Some feel that syndicates should have acted without the push from Lloyd's.

"I find it very disappointing that Lloyd's feels it has to do it, because my own personal view is this is what businesses ought to be doing in any case," said Stephen Redmond, CEO of Qatar Insurance Co. SAQ-owned Lloyd's insurer Antares Managing Agency Ltd. He added in an interview, "I think what they are doing is absolutely appropriate — if only as a reminder to CEOs and active underwriters that that is what they should be doing."

Focus on loss ratio

However, the performance crackdown is likely to have an effect only on the loss ratio. Beazley's Horton said that although it may be possible to shave 1 or 2 percentage points from the expense ratio over the short term, "if you have got a line of business that is trading at a combined ratio of 100% or above, it is not going to materially move the dial. ... I think very much that the focus has got to be on the loss ratio in the short term because that is the only place you can actually improve profitability over the short term."

Efforts to pare underperforming business could also counter the market's need to grow. Horton said: "It is very difficult long term to have a sustainable market if all it does is jettison business. It also needs methods of growing that business."