Graham Clarke's Houston Mariner's Presentation
23 September 2003

I have been travelling to Houston for over 25 years, so it is a particular pleasure to be invited to speak at this seminar.

Having been a broker for the whole of my career, that is my topic today and my speech this morning is entitled "London Brokers – the changing landscape."

You will all be aware that although most London brokers act in both a retail and wholesale capacity in the international market, our usual role in the U.S. is that of wholesaler and therefore our primary responsibility is a transactional one – to place and service your business.

However, in order not only to win business but sometimes merely to survive, the London broker has had to adapt to the increasingly tough market and business environment. Some have disappeared altogether, others have merged, grown, or been acquired and I think that although we have had a relatively quiet period from that point of view, this pattern is likely to continue.

Today I am going to track the changes that have occurred over the past three decades, discuss what today's London broker needs to do to succeed, and look at likely developments over the next few years.

Firstly, let's take a look back, and go through a brief history of London brokers and their role.

There have been a vast number of changes since I started, both in the broking and underwriting sectors of the London market.

Since 1970 premium income into London has broadly increased year on year. I will briefly track premium increases into London and look at these numbers compared to the number of brokers, to demonstrate the impact that the changes in the London broking community have had on the market.

What has not changed, however, is that London brokers are still the primary access point into the London insurance market.

Miller

Brokers are facing many challenges, both internally and externally. I will go into some detail about the issues that are currently facing London brokers, and what this means for all of us.

And finally, I will share my thoughts about the future of the London broker with you. At the end of the presentation, I will be delighted to answer any questions that you may have.

So what is the history of the London broker?

The role of the broker has evolved over the last 300 years - from waiting tables in the 16th century, to becoming 'the middle man' who brings buyers and sellers of insurance together, and seeks to add value to both parties.

London brokers, and Lloyd's brokers in particular, have played a major role in the development of the London market, and through their international marketing activities have generally been regarded as a cost effective business production and distribution source. However, the broker's role as agent of the underwriter changed long ago and, and now in most cases brokers have become agents of the client. Due to this, the role has broadened considerably and successful brokers must now possess the following skills:

Marketing – (In the U.S. you would refer to this as "Sales") we must promote our specialist areas in the international marketplace, in order to generate business from around the world.

Client handling – although quoting and placing is our most traditional responsibility, we must equally be able to advise clients on specialist products, wordings and markets, as well as risk management issues, risk financing, captive management and self-insurance.

Technical skills – it is well known that the majority of the business that is placed into the London market is highly specialized and we therefore need to be able to design the appropriate program structure and policy wordings, always ensuring compliance with any local legal requirements for today's more sophisticated buyer.

Processing – having successfully negotiated and placed a piece of business, it is essential for us to accurately and promptly issue cover notes, debit notes and other policy documentation.

Sales skills – we have to be able to broker deals with all the major insurance markets all over the world, not just Lloyd's, and increasingly work to bring together clients and underwriters with like-minded business philosophies.

Claims handling – the prompt collection of claims is vital to the ultimate client and as such, the claims function must be fully integrated with the front-end business team.

And finally Strategic skills – these are essential if we are to manage our businesses in order to succeed in this competitive global environment.

Let's now take a look at the most recent stages of the evolution of the London broking market.

The media often refers to the 'big bang' in the City of London. As you know this concerns a dramatic period of change that took place in the stock broking industry in the 1980's. To a certain extent the London broking market went through its own 'big bang' in the early '90's, when the US 'mega' brokers began their acquisition trail.

When I first started working in the London market in 1974, there were 265 Lloyd's brokers as opposed to 115 today.

If you took a snap shot of the London brokers who were handling marine and energy business at that time, these are some of the major players in the market:

All renowned and established companies of their time - however, in the early '90's the picture started to change dramatically, when the US brokers turned their attention to London.

Pre 1993 you could have selected any one of these brokers to place your business into London. Bain's; Minet's or JFS to name a few

But of course, these all were bought by Aon…

And even the larger brokers like J&H and Sedgwick were targeted:

And you may have guessed, all these became Marsh.

These slides clearly demonstrate the massive impact that US companies have had on the London broking scene.

You might well ask with all that acquisition activity, what effect has it had on the London broking scene today? A recent issue of Insurance Times published a list of the top ten brokers of UK business. If you look at these brokers, who also have a London market presence, the list looks like this:

Miller

Aon is the biggest, followed by Willis, who has just overtaken Marsh in the UK this year.

Jardine Lloyd Thompson, the product of the merger between Lloyd Thompson and Jardine's in 1997 is 4th.

The Heath Group (made up of C.E. Heath, Fenchurch Insurance Brokers and Lowndes Lambert) is next.

You may recall that Benfield was originally Benfeld Lovick, Rees which was established in the early seventies. Acquisitions in the nineties of Ellinger Heath Western, Greig Fester and in 2001 of EW Blanch have resulted in the entity that is Benfield today.

Next is Alexander Forbes, which is listed in South Africa and really came to the forefront of London brokers with its acquisition of Nelson Hurst in 1997.

HSBC Insurance Brokers are of course a member of the HSBC Group, a large banking and financial services corporation. HSBC entered the scene through their acquisition of Gibbs, Hartley, Cooper.

Miller, where I have worked for the last 20 years, is next. We have recently celebrated our centenary and remain the largest completely independent broker on the list.

And finally, SBJ, formerly Steel Burrell Jones, which was established in the late seventies following a defection from Bland Payne.

So as you can see it is a very different picture to that of the 1970s, and in my view, we are about to enter another significant period of change.

Whilst the number of London brokers has almost halved over the past 30 years, during the same period the total premium income into Lloyd's has more than tripled.

Although there are still a significant number of Lloyd's brokers, the balance has changed considerably. Today there is much more business being placed into London by far fewer brokers. In fact the top ten Lloyd's brokers have increased their market share by 27% over the past ten years.

As you know, to access the Lloyd's market you have to go through an accredited Lloyd's broker. Over the past three decades the number of fully accredited Lloyd's brokers has diminished substantially. Whilst there are many reasons for this decline as I have just illustrated the major factor is acquisition.

In 2001, Lloyd's decided it wanted to widen its distribution base within the U.K. and overseas, and announced an initiative to open up the market to provisionally accredited brokers. To date, 49 brokers have been provisionally accredited, nine of which are subsidiary offices of the big brokers, 23 are based in London, six are provincial UK brokers looking for new markets, and only 16 are new overseas brokers. Whilst this can be argued to be a large increase in brokers, the new business generated appears to be minimal.

I think the main reason for this is because, even if a broker gets Lloyd's provisional accreditation it needs to be in a position to forge relationships with each of the 71 underwriting syndicates and every underwriter they want to deal with. Separate, signed terms of business are also required. This is just not feasible if you do not have an established base in London.

So the alternative of continuing to use a London based and established broker continues to be the most cost-effective and practicable option.

In 2003 the role of the broker continues to change, and London brokers are facing a number of major issues that are likely to have a significant impact on their profitability and future success. We, as London Brokers, have to be able to respond not only to a changing insurance market, but also to increasing pressures within our own business.

Let me take you through some of the issues that are top of my agenda as CEO of Miller.

Most of you will be aware that, like you, we are facing a new regulatory regime in the U.K. On 14th January 2005 the Financial Services Authority (the FSA) takes over the regulation of UK brokers. The government backed FSA has real teeth and its impact on the London market is likely to be huge.

The FSA is responsible for:

- Promoting public understanding of the financial system
- Maintaining confidence in the UK financial markets
- Customer protection
- Reducing the scope for financial crime.

For us, this means they will be monitoring:

- Capital
- High level standards
- Client money
- Conduct of business
- And training and competence

The cost of regulation to the UK insurance industry will be tremendous. The FSA has estimated almost £200m up front and then £166m per year thereafter.

Penalties for non-compliance are likely to soar. The FSA has demonstrated already its willingness to fine and penalise. Let's go through a couple of examples:

- ABN Amro was fined £900k for market misconduct.
- The Royal Bank of Scotland was fined £750k for failing to control money laundering.

All in all, FSA regulation will mean brokers will have to become more professional in their dealings with clients and markets. Relationships will have to be formalised, and greater attention will have to be paid to the details, which I believe is good news for our industry.

The talent pool for top quality, experienced brokers is dwindling and there is a lot of competition. I think that as a people industry the big challenge is to retain and acquire quality staff, and it is likely that there will continue to be a lot of personnel changes occurring across the main London brokers over the next year or so. This will result in significantly increased staff costs, as companies inflate prices to either retain or attract key people.

You will have observed that so far, electronic trading systems are not competing with face-to-face broking – especially for the highly sophisticated and complex risks, which come to our market. I think all of us here today will agree that a broker and an underwriter need to thrash out a deal together, and this form of negotiation is virtually impossible over a screen or a telephone.

However, in my opinion, technology is going to be key to London brokers in the future, and will be vital for transferring information quickly and easily around the world, creating transparency between the broker and the markets, and the broker and its clients.

There are a number of London market initiatives underway aimed at supporting the online transfer of risk information and documents needed by brokers and underwriters in analysing and putting a policy together.

Most of you will have heard about the London market principals - LMP – a market-wide initiative designed to achieve a more efficient and streamlined market place with clarity and certainty of coverage, earlier production of polices, and quicker money transfer, ultimately speeding up the claims process. The first phase of introducing LMP slips is well advanced, with nearly 80% complying with this standard in 2003.

Whilst this is welcome news for future efficiencies, the implementation of these systems will require brokers to invest heavily in this area.

The market for writing brokers' professional indemnity and errors & omissions cover has shrunk dramatically. In many cases, it is simply impossible to procure quotes at certain levels.

Due to this, premiums are sky high, even with much bigger deductibles. For the smaller broker, this adds severe financial strain, and for those who do not have large financial reserves, this could prove ruinous.

U.K. companies have typically provided their staff with a generous pension on retirement, which is calculated as a percentage of their final salary, adjusted annually for inflation.

Due to revised actuarial assumptions based upon longer life expectancy and lower future investment returns, coupled with the significant fall in stock market value, pension funds have been left with massive deficits.

U.K. brokers have not escaped this problem. In fact, the top ten brokers referred to earlier have a combined deficit in excess of £1billion against a net asset value of £1.5 billion.

I believe that the challenges outlined facing London brokers are significant, diverse and largely unprecedented. And those who do not address and adapt to these challenges will not survive in the future.

In addition to the challenges facing the broking community, our market is experiencing a period of extraordinary change, and we, the brokers, must also be prepared for this.

Capacity is likely to continue to increase for next year but beyond that it is difficult to predict. Lloyd's capacity for 2003 is £14.4 billion and it is anticipated to increase further for 2004, with many of the Lloyd’s syndicates looking to maximise on opportunities that the current market conditions offer. The expected result of increased capacity, of course, is downward pressure on rates. However, it is clear that corporate capital will not continue to invest in Lloyd’s if there are not adequate shareholder returns, which are clearly a direct function of underwriting profits.

Of course, the London market is not just about Lloyd’s. London has the advantage of being recognized as an insurance centre of excellence, so it is a natural choice for other investors. As you all know, many U.S. companies, including WR Berkeley, Houston Casualty, Chubb, and AIG are committing further investment to London. Bermudan money is also continuing to come to London and many others are investing both in and out of Lloyd’s – these include ACE, Munich Re, Liberty and St. Paul.
Whilst in most cases London brokers would have had access to this capacity overseas, there is no doubt that having decision makers on our doorstep is a real benefit.

In the post 9/11 environment, London has been able to attract quality business at significantly better terms than witnessed for many years.

As I have already mentioned, there is increased capacity for 2003 in the London market, particularly at Lloyd’s.

It remains to be seen whether London will be able to attract new business as some of its peers struggle to compete, or whether this increased capacity will be focused on business already in London, thereby creating competition and driving down pricing.

Barnabus will have addressed this question for you yesterday from an underwriter’s viewpoint. I also believe that underwriters will have to continue to underwrite for profit.

Many of the big insurance and reinsurance companies have lost substantial sums of money in the last few years. Swiss Re recently estimated that the non-life market had lost US$200bn since 2000.

Despite hardening markets and a relatively benign loss year in 2002, the erosion of insurers’ capital bases has been devastating for many.

This has not gone unnoticed by the rating agencies with ten of the world’s top fifteen reinsurers downgraded since 2001, most by several notches.

It is too early to quantify the impact of Maemi, Fabian and Isabel but it comes as a timely reminder of the potential exposures to the underwriting community.

Lloyd's is fortunate in that its losses resulting from 9/11 are consistent with its net and gross loss estimates, and the quality of its outwards reinsurance asset remains strong. Also thanks to Equitas, it has ring-fenced its pre 1993 losses, protecting itself from long tail legacy claims including asbestos and pollution.

Due to Lloyd's requirements, Lloyd's underwriting syndicates typically keep a low proportion of their funds in equities, and their investment portfolios tend to be weighted towards government and corporate bonds and cash, which have fared relatively well.

Insurance companies, on the other hand, have tended to invest a greater proportion of their portfolios in equities and property. This served them well during the bull stock markets, but has made the recent market slump more painful.

The Lloyd's capital base has changed too, and although it remains diverse, it has gone from being capitalized by 30,000 sole traders and individual investors, to being almost entirely funded by corporate capital which you will know is much more risk averse than private capital.

In short, the markets will need to write for profit and not market share.

There is no doubt that this will affect the business that they wish to write, and the prices at which they are prepared to write it. We have, I believe, an interesting few years ahead.

Another major change in the London market is the Lloyd's franchise board that was introduced this year, which has resulted in a major structural change at Lloyd's.

This has created a new governance structure around the franchise concept, to focus attention on the performance of the market, and the well being of the Lloyd's brand. A concept to recognise that the individual businesses in the market share in valuable, financial and brand assets that must be actively, and commercially, protected and managed.

In addition, Lloyd's has introduced annual accounting to replace traditional three year accounting, making the market intelligible and comparable.

The impact for brokers and clients is that the Franchise board, with the benefit of far superior performance data, has the authority to restrict the business that syndicates can write, which may put yet more pressure on certain lines of unprofitable business.

I think that there is going to be a shift in the kind of business that brokers want to handle.

I am certain that more and more generalist and true commodity business will be conducted direct, via the Internet for example.

I suspect the global players will try to cover all bases, as they have the size and resources to do this.

Brokers with a specialist focus will need to become increasingly marketing led and client relationship driven. To do this they will have to really understand their clients' needs in order to provide them with the services they require. In addition, they need to anticipate market and commercial trends and then design specific policy forms to meet the new risks and challenges associated with them. Brokers will have to continue to look to add new services and products, including a range of consultancy on risk modelling, risk management and other industry specific services, if they are to stay ahead of the game, and offer clients a really valuable service.

So what else does the future hold?

There is no doubt that technology will play an increasingly important role and should revolutionise the way business is processed over the next few years. London brokers will have to have good IT systems – both front and back office, and fully integrated online document repositories if they are going to compete and offer the level and speed of service that will be required in the future.

Regulation and compliance will play a greater role, and only the brokers that already have a compliant culture and are committed to it will survive, once we are regulated by the FSA in 2005.

For those of us in the London market, distribution is all-important and networks and books of business are what everyone wants. According to research by a leading UK accountancy firm; there are 46% of UK brokers looking to buy and 36% looking to sell. So who's doing the deals? The prime candidates are the big international brokers and the leading UK groups.

Undoubtedly in the current conditions there will be a number of small generalist and niche brokers who will find the competition and financial burden of doing business in a global environment just too tough. So there are likely to be considerable changes at the smaller end of the market.

The larger UK based brokers are now looking to build their business through acquisition. You will no doubt have read about Benfield's successful IPO earlier this year, and a number of other London brokers are looking to raise capital in this way. This is likely to result in an increase in bigger acquisition deals, as the larger brokers want to consolidate their position in the UK and internationally. In particular, they view the US as a market with huge potential, and gaining distribution sources is crucial.

All the signs are that London will continue to be one of the world's major insurance markets. There are reforms underway which will only make our market stronger and healthier, but there remains a significant amount of work to do in this area. We cannot, for example, afford to have long time lags between achieving full market agreement and the issuing of documentation to our clients.

In conclusion.

The London market has recently experienced an unprecedented period of change.
Our markets have shown resilience in dealing with the losses resulting from the more predictable natural disasters, as well as the inconceivable tragedy of 9/11. It has proven its strength as a market place and it is now crucial that we recognise and plan for the changes of the future.

We are committed to remaining a vibrant and exciting market, offering opportunities to the underwriting community, the brokers and our clients.

Our brief look at the recent history of the brokers has shown that change is the order of the day. We need to prepare for more significant movement in the London broking landscape. It is therefore essential to continue to select your London broking partners with care, in order to provide your clients with uninterrupted top class service.

Your business is incredibly important to London and we know we have to earn it and offer a superior service at all times, providing real value to all of the players in your market: retail brokers, wholesale brokers and, of course, the ultimate buyers.

This is our goal – I am confident that as we learn from the past and work harder at anticipating the challenges that lay ahead, we can provide you with the dynamic, entrepreneurial spirit you have come to expect from your London brokers.

Thank you for listening.