The Future at Lloyd's—The World's Leading Insurance Marketplace

May 16, 2019

Lloyd's of London ("Lloyd's") has often been lauded as the world's insurance center. It has in the past, however, suffered from a reputation for arcane, opaque and sometimes costly structures and processes. Against a backdrop of ongoing M&A and consolidation in the Lloyd's market, a general firming of rates at Lloyd's and general optimism by all participants, this is all set to change.

There has been a flurry of M&A involving Lloyd's participants over the last few years, including:

- Canopius agreeing to acquire AmTrust at Lloyd's.
- Hamilton agreeing to acquire Pembroke from Liberty Mutual.
- China Re acquiring Chaucer from Hanover.
- AXA acquiring XL Catlin (and XL acquiring Catlin).
- AIG acquiring Talbot through its acquisition of Validus.
- CPPIB acquiring Ascot from AIG.
- CenterBridge acquiring Canopius from Sompo.

The Debevoise insurance team has been involved in all of the above transactions, as well as other significant non-M&A transactions in the Lloyd's market. Against this backdrop of major deal activity, we set out our views on the new vision recently unveiled by new Lloyd's CEO John Neal.

On May 1, 2019, John Neal announced a new strategy that is expected to cut the overall cost base by up to 10% and boost business, particularly in emerging spaces such as cybercrime/attacks and reputational risks.[1]

Six key proposals resulting from discussions with Lloyd's market participants and industry experts are highlighted in a prospectus outlining the proposals:

- Developing a platform for complex risk that works end-to-end across quoting, issuing and binding; handling administrative tasks; and carrying out digital analysis.
- Establishing the Lloyd's Risk Exchange—a system that is expected to enable placement of less complex risks in minutes and at a fraction of the current cost.
- Enabling capital to invest in insurance risks, creating a new investment opportunity without needing to be a licensed insurance-linked entity or having to invest in an insurance company.
- Creating an option to work as a "remote" syndicate (a so-called "Syndicate-in-a-Box"). This is expected to create a cost-effective method of entry to the Lloyd's insurance market for new, innovative entrants.
- Developing the Lloyd's Next Generation Claims Service, which is expected to provide a faster and more efficient claims service by way of automated claims processing for many different types of policies (not just parametric ones). Insurance purchased from within the Lloyd's marketplace would be recorded on a database that includes all policies, the assets covered and the coverage limits. Artificial intelligence would be incorporated to process smaller, straightforward claims. By incorporating existing technologies, Lloyd's hopes to create a system that would enable automatic claim validation.
- Creating a new Lloyd's ecosystem, which is expected to be made up of three parts: (i) an expanded Innovation Lab, (ii) a market-leading dataset and (iii) comprehensive partnerships between service providers.

The proposals in the prospectus will be under consultation for around 10 weeks. The prospectus is kept at a very high level, but we expect that greater detail will be forthcoming following the consultation currently underway. Lloyd's plans to start developing its new systems to implement Mr. Neal's vision from October this year. It is hoped that some of these will be operational in 2020.

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[1] https://cdn.foleon.com/upload/31276/lloyds_prospectus_web_-_final.d4fa2f299f05.pdf.

The prospectus, entitled *The Future at Lloyd's*, is based upon the premise that "the world is changing, and Lloyd's is changing with it." In fact, in recent years Lloyd's has come under considerable pressure to modernize its operations and its culture and to control the high costs that can be associated with operations at Lloyd's.

The proposed changes announced last week put a spotlight on the influence that technology will have on the insurance sector, particularly as technology continues to disrupt traditional business models and practices. Indeed, Mr. Neal himself told the *Financial Times* that "[i]nsurance as a sector has got to speed up in a tech-driven world. This is our opportunity to show some leadership."[2]

The prospectus published last week emphasizes how the insurance market is having to not only adapt to the new risks that its customers face but also to update the products that it provides to protect customers' business.

However, technology is not simply affecting the products sold, it is also changing how those products are sold. In the past, Lloyd's has been slow to fully embrace these developments. Yet recently, there has been a drive to transform Lloyd's into a technology-driven marketplace. For instance, the Lloyd's Lab, a new innovation accelerator that seeks to deliver solutions to the key challenges facing the market, opened in September 2018. A report published by Oxbow Partners in September last year found that managing agents at Lloyd's are much nimbler in the insurtech market and can respond and deploy "Supplier Insurtech" much more quickly than larger insurance groups.[3]

Similarly, one of the key proposals in the prospectus—the Lloyd's Risk Exchange—takes further steps towards embracing the opportunities created by technology. Complex or bespoke insurance policies would continue to be arranged in face-to-face meetings in the famous underwriting room, but "standard" insurance contacts would move onto the online system. In addition, the first proposal set out above, the complex risk platform, would create an efficient administrative and analytical framework for issuing complex insurance policies, reducing the time and costs required.

Lloyd's has also come under continual criticism for high costs. The plans contained in the prospectus should allow the market to do business more cheaply, aiming to reduce costs in the premium of up to 40 pence on the pound to 20 or 25 pence.

This is not the only significant step to improve efficiency taken by Lloyd's in recent months. Prior to the round of business planning for 2019, Lloyd's performance

2 https://www.ft.com/content/e9b0a4dc-6b33-11e9-80c7-60ee53e6681d.

3 https://www.oxbowpartners.com/wp-content/uploads/2018/09/Oxbow-Partners-LMA-InsurTech-report.pdf.

management director, Mr. Jon Hancock, required syndicates with three consecutive years of losses to produce a remediation plan, and all syndicates—regardless of their performance—were required to submit plans for the worst-performing 10% of their business. This has become known as the "decile 10" review and has had an immediate effect on the marketplace. The review has resulted in some syndicates exiting certain classes of business entirely as well as an increase in rates for others. According to S&P Global, around one fifth of the market was required to submit full remedial plans, and Hiscox has noted that the whole market has in fact been prompted to take action. Although for some part of the Lloyd's market the decile 10 review has been challenging, many have praised the corporation for taking decisive action in meeting the difficulties facing the market. Indeed, the action taken by Lloyd's has been considered part of a system of "improved underwriting discipline" and should help stand the market in good stead as market conditions strengthen. Mr. Hancock has made it clear that the decile 10 review was not a one-off reaction to immediate circumstances but will continue to form part of the Lloyd's reporting process. For those syndicates that have treated the mandate as an opportunity to increase profitability, they are in fact seeing that small operational improvements can have a big impact.

The prospectus announced by Mr. Neal forms part of a wider approach by Lloyd's to modernize and maintain its market-leading role in the insurance industry. The potential for new and cost effective routes into Lloyd's, including the "Syndicate-in-a-Box" option discussed above, may help to introduce innovative new products to the Lloyd's market and allow Lloyd's participants to take advantage of the new opportunities and markets created by the ever-changing technology landscape. If the proposals discussed are implemented and successful, they have the capacity to enact real change to this 330-year-old insurance market. As such, Lloyd's market participants should be prepared to adapt to these changes, and those who can implement and take full advantage of the changes will be among the best placed participants in one of the world's foremost insurance markets.

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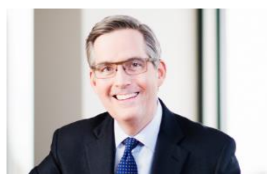

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