

# Financial Risks—International

Market Update Spring 2010



## Contact



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As we emerge from one of the worst economic downturns on record, it is increasingly clear that, despite a good deal of uncertainty in the world, we are seeing the green shoots of recovery. Confidence is returning to the business world, as reflected in the return to profitability in stock markets around the world and an increasing pipeline of initial public offerings (IPOs) coming to market. There is, nevertheless, still latent concern surrounding the property investments that a large number of funds and financial institutions are holding and the valuations of such portfolios.

The financial crisis has driven the beginning of yet more change in the financial services industry across a number of regions, beginning with regulators and advisors that are re-evaluating their roles and responsibilities. They clearly want to avoid a re-occurrence of recent events and ensure that business leaders are held more accountable for their actions.

Laws and local regulations will invariably change. With change we anticipate more litigation, which will drive companies to be more focused on their management team and its ability to navigate through these turbulent times.

In all our product areas, especially the financial sector, claims notifications have increased in the last 18 months, and although D&O class action suit activity from the U.S. remains high, it is interesting to see a large increase in crime claims globally (as quoted by PWC in their 2009 fraud survey) from a wide range of commercial and financial companies—due primarily to recessionary factors.

The financial lines markets generally continue to experience troubled times, due to factors that emanate from the financial crisis and the global recession. This is reflected in claims notification increases that have led many underwriters to focus much more on in-depth underwriting and risk due diligence across their portfolios.

With the above in mind, there continues to be pressure to obtain rate increases, as in the recent past, returns on investment portfolios declined and underwriting loss ratios, most notably in the financial institution sector, increased. This has resulted in a greater underwriting due diligence and allocation of capital to product areas that provide the best return. These factors, together with increased reinsurance costs, have driven the need for greater underwriting profit and increased risk selection. This situation may, however, be short lived as we are seeing a number of new entrants in the financial and commercial markets who are looking for their “slice of the pie.”

### Financial Institutions Markets

The market for financial institutions has changed quite a bit since this time last year, when we saw large increases in premium and a tightening of terms and conditions. Any premium increases are now small with many renewals being flat. What we are experiencing is underwriters being more selective and differentiating between companies’ risk profiles to avoid concentration in any one industry sector. Risk management is the call from the underwriting community to try to return their portfolios to profitability. There is a word of warning here, as we have seen an element of a two-tier market appearing, which we have to be mindful of when renewing customer business, as certain new entrants are hungry for “good” risk income.

### Commercial Risk Markets

The story is somewhat different in the commercial sector—specifically in the directors and officers (D&O) and crime markets. In fact, we have started to see downward rate movement and, frequently, a broadening of terms and conditions. It is not a good time to be underwriting risks in this sector.

There is, however, greater scrutiny of risks and financial conditions in the underwriting due diligence process, with a focus on investment portfolios, debt, and volatility of the industry. Capacity is abundant and competition is rife for D&O and crime products in this sector. Because the financial institutions market opportunities remain challenging, the potential loss of revenue is being made up by more aggressive pricing in the commercial sector; it is, therefore, a good time for customers to benefit from aggressive marketing at renewal, which will reflect optimum pricing and broader terms.

### Warranty and Indemnity

As the economy begins to grow, M&A activity is on the increase—with acquisitions and disposals as a means to bolster company balance sheets allowing them to focus on core business lines. The large investment banks and private equity houses are seeing more deal flow, which will bring about an increase in interest for products such as Warranty and Indemnity, Tax Indemnity, and Residual Gap coverages. These apply to both the buyer and seller side, and there is currently an abundance of capacity in the market.

### General Trend

There continues to be a lot of underwriter movements from one insurer to another. This is healthy for competition in both the commercial and financial institutions sectors, as it means that a lot more capacity can be filled. However, we continue to see the need to partner with carriers that can offer competitive terms as well as service clients who require local policies.

In 2010, on behalf of our clients and prospects, we will continue to monitor local requirements for admitted policies—which is an ever-changing situation. Lockton’s Financial Risks team is at the forefront of advising internal and external customers as to their local policy needs around the world.

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