GLOBAL PROGRAMME CAPABILITY AND THE SUBSCRIPTION MARKET AT LLOYD'S

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Abstract

The purpose of this paper is to identify and understand the issues surrounding the writing of global programmes at Lloyd's by the subscription market, and to examine if the capability to underwrite and service global programmes at Lloyd's is needed, and assess if it can provide a viable long-term solution. This is an issue which has concerned market practitioners for a number of years and continues to do so; it is one which relates to global development and is very relevant to the strategic objectives of the Lloyd's market. A multinational client needing a global programme must be certain that it fits the legal and tax requirements of its various locations. Lloyds is still dominant in this market but faces increasing competition from other global insurers. Some Lloyds syndicates want to extend their range of global services, through a central global programme, with a working process which enables the subscription market (in which several syndicates and companies each take a share of the risk) to work in conjunction with global programme capability. However, there are obstacles to this, which are examined in this paper.

บทคัดย่อ

จุดประสงค์ของการศึกษานี้เพื่อระบุถึงปัญหาในการรับประกันภัย ความสามารถในการพิจารณารับประกันภัยและการบริการในงานโกลเบิ้ลของลอยด์ พร้อมทั้งการประเมินหาหนทางแก้ไขปัญหาในอนาคต ซึ่งปัญหานี้ได้เกิดขึ้นแก่คนทำงานมาเป็นระยะเวลานานแล้ว และการศึกษานี้ได้สอดคล้องกับวัตถุประสงค์กลยุทธของลอยด์ ลูกค้างานโกลเบิ้ลของลอยด์ ในหลายประเทศมีความต้องการให้งานโกลเบิ้ลของลอยด์เหมาะสมกับกฎหมายข้อบังคับ และระบบภาษีในแต่ละประเทศ อย่างไรก็ตามลอยด์ยังคงครองตลาด แม้จะประสบปัญหาการแข่งขันที่เพิ่มสูงขึ้นจากผู้รับประกันภัยเจ้าอื่น บางสมาชิกของลอยด์ในประเทศต่าง ๆ ต้องการที่จะขยายบริการงานโกลเบิ้ลโดยผ่านศูนย์กลางของลอยด์ที่สามารถรองรับกับการทำงานร่วมกันของลูกค้าและสมาชิกลอยด์ในแต่ละประเทศ อย่างไรก็ตามอุปสรรคในการขยายบริการนี้ได้ถูกระบุไว้ในงานศึกษาชิ้นนี้ด้วย

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INTRODUCTION

Typical buyers of global programmes are multinational corporations (MNCs) who need an insurance product which matches their requirements, including providing coverage for all their subsidiaries in the territories where they are located, with local insurer approved contracts (lACs) which fully comply with local legislation and tax requirements. The pace of development of regulatory and tax authorities requirements has increased over the last ten years, which has impacted clients, and insurers need to be able to provide solutions which address these changed needs.

Lloyd's underwriters used to hold a competitive advantage over their company market competitors, in part because of the number of countries with which Lloyd's held licenses to sell insurance on a direct basis. Over the last twenty years this advantage has been eroded as these competitors have developed into global companies with licensed subsidiaries in many countries. These global insurers can provide a high level of service to MNCs requiring local lACs in multiple territories, as some have developed their own infrastructure to enable the setting-up and servicing of global programmes. They have been able to do this as they have sufficient scale and can allocate resources for longer-term strategic objectives. However, Lloyd's still has a significant and advantageous global coverage as it has licenses and authorisations in more than 75 countries worldwide[1].

These licenses are very beneficial to Lloyd's but do not provide the ability for syndicates to write global programmes on a direct basis across the entire globe. In spite of this ability to provide cover in many countries and territories, Lloyd's syndicates are not considered a true market for primary global programmes as they do not have the capability needed to co-ordinate across the market to issue and administer local lACs. Only a limited amount of global programme business is written by syndicates in Lloyd's, mostly as reinsurance or on an excess basis.

Lloyd's has moved forward significantly, with its wide-ranging international markets web presence containing comprehensive country information, but some market practitioners believe that more could be done to match the global insurers by enabling syndicates to offer a full global programme service.

The establishment of a central global programme service capability at Lloyd's could provide the missing elements that are needed for syndicates to write global programmes on a subscription basis. An implementation to establish global programme capability would require the creation of a working process so that the subscription market model can work in conjunction with global programme capability.

If a central service were to be considered necessary, any proposed solution would have to be a practical, viable long-term solution based on the principle that the syndicates

[1]www.lloyds.com/crystal.

writing global programmes on a subscription basis would collectively pay for the global programme service.

This would be a significant opportunity to develop a potentially large amount of new premium income to the market as a consequence of an improved, competitive, service proposition. Overall potential income which could be derived from insuring global programmes is difficult to identify. However, the insurance premiums paid by the MNCs could generate a significant amount of new income to Lloyd's underwriters. However, there are obstacles and challenges to the creation of a central global programme capability at Lloyd's; the issues are complex and there are many stakeholders with differing views and objectives.

GLOBAL PROGRAMMES

'Global programmes' is a term often used by the large global insurers which refers to an insurance programme, a risk transfer arrangement, provided to a multinational corporation. There are a number of key, inter-related stages and processes involved in the management of a global programme, which are time-consuming and costly to set up and administer. Global programmes can be multi-class i.e. there will be property, casualty and possibly marine cargo, although the larger sections are likely to be either the casualty or the property sections due to the larger amount of premium in these classes.

The solutions implemented for global programmes vary by market segment; for example, the property market handles global programmes differently to the marine market. The MNCs buying property cover require much larger limits than the marine programmes; one insurer cannot take all of the risk so consequently the property brokers use panels of insurers providing coverage on a layered basis, with selection of carrier influenced by capacity. The financial lines directors' and officers' segment is able to write 100% of any one risk shown to them as the limits are lower, so to a greater degree the choice of carrier will be determined by service.

Lloyd's defines a global contract as follows: "A global insurance contract [which] covers risks located in more than one country".[2]

Companies buying global programmes

Typically, companies requiring global programmes are MNCs with operating subsidiaries in multiple territories; many will be Global 500, FTSE 100 and Fortune 1000 companies with subsidiaries operating in overseas territories. These MNCs are from all commercial and industrial sectors; for example, technology and media companies with global operations. The rapid expansion in MNCs operating on a cross-border basis is likely to

[2] www.lloyds.com/the-market.

continue. The list of MNCs is dominated by US, European and Japanese companies, but there are increasing numbers domiciled in developing economies.

"Even with scores of mergers and acquisitions, some 38,000 MNCs internationally control 270,000 foreign affiliates. More than 90 percent of the MNCs are based in developed countries, and about two-fifths of the affiliates are found in developing countries" (Skipper and Kwon, 2007).

Broker solutions for global programmes

Global programmes are handled by brokers, either through owned networks of subsidiaries or through networks of affiliated partners. Global programmes are mostly placed by the global brokers Aon, Marsh and Willis; all three have global networks of offices which they can use to both attract and service business. Global brokers have their own offices worldwide, so if the principle broker is a global broker they will use their local office where possible. Wholly owned global networks have the benefit of uniform IT equipment, standard services and similar corporate values, whereas affiliate networks have flexibility and are easy to expand or change.

Insurer solutions for global programmes

Currently, the major global insurers are the only insurers capable of independently providing global programmes. There are a number of these operating in the London market. The global programme will be written in London with local IACs being issued as required, either by the insurer's local offices or by an affiliated insurer.

THE SUBSCRIPTION MARKET IN LLOYD'S AND GLOBAL PROGRAMMES

"The subscription market describes the commercial insurance and reinsurance market in London by which a single risk is underwritten by a number of underwriters, both at Lloyd's and in the insurance company market, subscribing percentage lines of the risk on a several, not joint, basis ... it typically requires one of the underwriters to act as leader to agree terms of cover and the policy wording, and to make decisions on claims". (Ambereen and Burton, 2008).

The Lloyd's subscription market has not yet developed a solution for global programmes due to a combination of factors, which include the actual number of syndicates making up the subscription market and the legacy of the annual venture when it was difficult to prioritise investment for the long term. The renewal and reconstruction process of the mid-1990s necessitated an inward focus, and strategic planning was not prioritised. These factors have contributed to the situation which Lloyd's is in now where it does not have the necessary, customer-focused market solution required to enable syndicates to underwrite global programmes. In a world with an ever-increasing level of globalisation and continuing development of cross-border companies and trade, it is imperative that the support mechanisms available to the subscription market at Lloyd's keep pace with the rate of development of those insureds who are buying the insurance products sold on the Lloyd's market.

Why is global programme service capability needed?

Over the last fifteen years there has been a dramatic acceleration in the development of the global economy. There have been significant changes to the size and structure of MNCs during this period of globalisation.

"Globalisation refers to growing economic interdependence among countries as reflected in increasing cross-border flows of three types of entities: goods and services, capital and know-how" (Anil et al., 2012).

During this period there has also been a significant increase in the attention focused on compliance and tax issues, by both the countries in which the MNCs are domiciled and the countries in which its subsidiaries are located. Consequently, MNC insurance requirements and global insurer solutions have moved forward significantly over the last decade, the largest global insurers having developed their capabilities to keep pace with this change.

In the insured heading of IACs there is often the terminology 'MNC and/or Associated and/or Affilliated and/or Interrelated and/or Susidiary Companies and/or Corporations'. This very broad wording provides coverage for the insured wherever its subsidiaries are located; consequently, the underwriter could inadvertently provide cover for a subsidiary located in a territory where the insurance was not legal. Taxes may not be paid by the insurer to the local authorities on behalf of the insured, and there could be difficulties in settling a claim if one occurred. The threat of legal and regulatory penalties, along with negative impact on the Lloyd's brand in the event of any non-compliance, are further compelling reasons to create a global programme capability within Lloyd's.

As reported by the Federation of European Risk Management Associations (FERMA), the issues most concerning risk managers are those which involve regulatory, statutory and fiscal compliance. Results contained in FERMA's European Risk Management Benchmarking Survey 2012, showed that 61% of respondents considered that legal, regulatory or compliance requirements were the main external factor triggering risk management in their companies. Also, "the cost of complying with the myriad of new regulations and standards continues its steady increase in most markets worldwide" (2007, Skipper and Kwon).

Awareness of the compliance issues continues to be high for risk managers, and as the cost to implement compliant solutions increasing more efficient solutions will be welcomed by the buyers of insurance.

Lloyd's and global programmes
Within the Lloyd's subscription market there is not currently a true global programme capability, although there are arrangements whereby a proportion of the risk can be underwritten by syndicates - either on an excess basis or as reinsurance. Variations include the global insurer fronting for Lloyd's syndicates, separate standalone locally issued IACs and in some cases one of the Lloyd's overseas office co-ordinating the issuance of a local IAC.

Lloyd's syndicates are able to particpate on market policies which are global programmes, subject to the solution offered by the broker. This can be as reinsurance of global insurance companies, but these insurers charge syndicates for the service and it is probable these charges will be increased.

There is, though, a large potential Lloyd's capacity available for global programmes, as syndicates want to have the ability to participate on these programmes if they are in a class they currently write. There is interest in underwriting global programmes in the marine (marine cargo) and the financial lines (directors and officers) markets at Lloyd's. There is also potential demand from the property, aviation and casualty markets.

There is sufficient capacity in the marine market to provide full limits coverage on most marine cargo global programmes as the limits are well within the line capacity of the market. There are more than 35 Lloyd's syndicates writing cargo business in 2013, with a combined total premium capacity in excess of USD 500,000,000. These syndicates can provide over USD 1.0 billion of line capacity for the very largest risks.

POTENTIAL BENEFITS OF A GLOBAL PROGRAMME CAPABILITY AT LLOYD'S

A central global programme service at Lloyd's would ultimately be of benefit to the insureds; it would provide them with a wider range of solutions to their insurance needs as there would be another potential market participant for their business.

The ability for Lloyd's syndicates to underwrite global programmes would allow existing relationships with clients; for example, Lloyd's syndicates writing just a small proportion of the MNC insurance programme as a reinsurance, to develop further, possibly into a full global programme.

The following are some of the additional ways that a central global programme capability would be of benefit to Lloyd's:

- It would enable Lloyd's to attract more business from a wide range of territories, providing an improved geographical spread of written business which would dilute the impact of the current emphasis in underwriting by syndicates of catastrophe-exposed risks from North America.

- *It would enable the Lloyd's market to attract business which is not currently* written into the market. Placing a value on the potential premium which could result (in addition to the less tangible benefits arising from the service) is difficult. Indications are that it has the potential to be well in excess of USD 100 million of premium.
- Economies of scale could be leveraged by the Lloyd's corporation. Lloyd's International Markets department already provides expert assistance on foreign territory IAC issues; this service could be extended to explicitly include global programmes. In addition to the increased volume of work there would be an extended range of expertise. Familiarity with global programme issues could be developed because of the global programmes being handled. Implementing comprehensive global programme capability would be beneficial as it would increase Lloyd's' international operations.
- If Lloyd's were to develop global programme capability, once global programmes were set up they would have the advantage of the inbuilt competitive nature of the subscription market at Lloyd's. A unique aspect of the Lloyd's market is the combination of sharing of risk and embedded competition. One global insurer providing global programme cover may not be competitive. Once a global programme is set up with Lloyd's syndicates as security, the broker has the option, if required at renewal, to change security but the setup of the global programme would remain. Therefore, the client benefits.
- If the Lloyd's market had the capability to support the writing of global programmes, it would make the Lloyd's market more attractive to foreign insurers as a platform within which to establish their own syndicates. This is because the licenses offered by the Lloyd's platform would enable them to write global programmes for their own domestic market. This would be attractive to foreign insurers as it would improve their service offering. It would also be attractive to Lloyd's as it would potentially increase direct worldwide business as well as developing strategic alliances. It would be mutually beneficial.

A CENTRAL MARKET GLOBAL PROGRAMME CAPABILITY AT LLOYD'S

A centrally provided global programme capability is needed as it would be the efficient use of resources to provide an improved service to the insureds and brokers working on their behalf. Lloyd's Corporation would be the natural choice to establish a central global programme capability as it already manages the Lloyd's market and has many experts working within the wide-ranging International Markets department. Lloyd's also has the Lloyd's Agency department with its global network and expertise in a number of areas, including the managing of electronic certificates.

Certain functions required in the global programme process can be provided by third parties. Any implementation could take workflow systems to provide the structure and process to ensure a succesful initiative.

The Lloyd's corporation controls the market through the franchise board, with a very important part of this activity being financial control and the preservation of the central guarantee fund, which ultimately exists to safeguard the customers of Lloyd's. Collectively, the market has a greater strength than the sum of its individual parts.

Similarly, co-ordinating global programmes centrally can achieve a result which is not deliverable by syndicates operating individually, as managing multiple syndicates' participation on global programmes will be a complicated activity. Centralising the service would spread the costs over a wider base and reduce duplication of effort.

Lloyd's currently performs a number of central functions such as the collection and payment to respective authorities of country tax, so there is existing expertise and making use of the existing talent would be an economical way to further strengthen the subscription market.

Viability for the long term

If a central service was created at Lloyd's it would have to be self-supporting. The very nature of the subscription market at Lloyd's is that there are managing agents who collectively want to out-perform their peers. None of them will be prepared to subsidise their competitors.

Long-term viability will also depend on the use of the most modern systems in order to integrate the different internal and external component parts of a global programme capability service. The successful implementation will require first-class IT and communications to underpin its operations, as good communication between all the parties throughout the global programme life cycle is of paramount importance. Existing workflow systems, similar to those implemented in global service companies, would enable the required degree of corporate connectedness and control required over the flow of data and services.

Electronic messaging can provide a solution to managing these flows of information. Acord reinsurance messaging standards should be incorporated into the system from the planning stage, so that in the future it will be a straightforward process to enable electronic delivery of local lACs. The ability to communicate and control through standard messaging is fundamentally important for the future and will provide for the continued development of the service. Current activities of the London Market Group (LMG) include electronic messaging; this work is progressing and could have application in a global programmes solution.

CHALLENGES TO GLOBAL PROGRAMME CAPACITY AT LLOYD'S

Global programmes are complex and any process to manage them reflects the many issues relating to information gathering, local country/territory compliance requirements, premium allocation, premium payment, tax payment, controlled master programme issues, local policy issues and claims payment.

Local insurer approved contracts

One of the principle challenges to the establishment of global programme capability at Lloyd's is the provision of local lACs. There are many difficulties in arranging local policy documentation in territories where Lloyd's does not hold a license to write business on a direct basis. A practical and acceptable process to provide local lACs which comply with all local regulations is a very important requirement in a potential solution for Lloyd's' global programme capability. In any global programme solution the provision of local lACs needs to be controlled from the centre, unlike facultative reinsurances which are arranged on an ad hoc basis. This is because there needs to be quality control over all local lAC provision in order to ensure that the insureds have fully compliant policies and that they receive a uniformly good service. In time, as Lloyd's International Markets broadens its range of licensed countries and territories, the issue of fronting will reduce in scale.

Lloyd's International Markets works to expand the number of territories in which syndicates are licensed to write (re)insurance business. Managing agents also have the option to join Lloyd's platforms, which have been set up in various territories in order be able to write business in those territories whilst complying with the local regulatory requirements. Here also, is a challenge in that not all managing agents are on the Lloyd's overseas platforms.

Financing issues

Creating a global programme service would be expensive and will need financing. It will be necessary to enhance existing accounting systems; for example, the premium and claims systems will need to be expanded to have wider geographical coverage, the identification of tax payable to countries is dependent on correct allocation of FIL codes. These will need updating to support full control.

If financing the global programme by charging the market on a user-pays basis, the revenue achieved should offset some of the programme's costs, and in time the service should be cost neutral. Ideally, the unit would become a profit centre; however, there are no guarantees as to when the service would be self-funding. There are various financing options applicable to the total programme premium, including a potential additional commission, which could be applied to pay for the service. The charge, being on the total programme premium, would be a small percentage, but it would generate a reasonable income and would be an effective method of charging for the service.

The overall cost of handling global programmes will have to be carefully controlled as there could be an extended chain of charges e.g. placing broker, fronting insurer IAC fee, local reinsurance broker tax management cost (if required) which could, in total, be too high. The long-term viability of global programme capability depends on a realistic and profitable financial model.

Challenges in creating global programme capability for the subscription market

Lloyd's syndicates planning to write global programmes will need to ensure that their underwriters and support teams are all fully trained in overseas territories' insurance requirements. Lloyd's could possibly require syndicates to go through a qualification process to be allowed to lead global programmes; this would still allow brokers a choice of leader but introduce a level of control. However, not all managing agents may decide, or be able, to strengthen their underwriting support teams and so able to lead global programmes in the Lloyd's market.

Global programmes are long-term relationships which take time to establish. Understanding and relationships need to be built up - a difficulty will be to balance competition with stability. A further challenge to providing a global programme service is that the service will need to operate across classes. Co-ordinating this within the subscription market will be a challenge.

There are some underwriters in the Lloyd's market who want global programme capability, but not all syndicates at Lloyd's insure MNC's requiring global programmes. This situation will have to be handled equitably. Underwriters in those classes where insureds buy global programmes will need to convince their managing agencies that they should make the investment. There will need to be consensus regarding the proposed model for achieving global programme capability and there will have to be commitment and successful collaboration to make it a reality.

CONCLUSION

There is a growing need for a central global programme capability at Lloyd's which is increasing in importance as companies continue to globalise, regulators make more stringent their respective countries and territories regulatory requirements and tax authorities worldwide increase their efforts in pursuing tax revenue. Ideally this capability would be centrally organised, as individual syndicate implementations would be inefficient and would not work across the market. Rapid formation of global programme capability could be achieved because it would be a natural development of Lloyd's' existing worldwide expertise.

The particularly rapid growth in globalisation experienced since 2000 is a result of the development of business models of our clients. We can use the tools, including inexpensive communications and global web standards, which have enabled their business model development and subsequent globalisation, to develop a Lloyd's subscription market global programme capability

A viable long-term solution for global programmes can be implemented. There will need to be commitment from the entire market to secure its success - from Lloyd's, managing agents, brokers and other stakeholders. The solution would have to be a combination of systems and organisational collaboration, part process and part structural. Although Lloyd's is currently behind its competitors with regards to co-ordinated global programme administration it does have existing key component parts required for the future which would enable a rapid development of global programme capability. The right foundation for the global programme service, integrating work on messaging being progressed by the London Market Group and utilising the best systems will ensure its long-term viability.

The service needs to be centrally provided but will require demand for it from managing agents, the costs, revenues generated and benefit all being factors. There are a number of services relating to global programmes, some of these are best performed by the broker and others by the insurer(s) so within the solution there should be a division of the process so that there can be an appropriate apportionment of cost. The LMA are ideally placed to identify demand and to help the market reach a consensus on this subject. If Lloyd's can align and utilise its existing resources, add systems as required and successfully implement a global programme capability which matches current global programme provision by global insurers, then it will be able to attract new premium income to the market. Importantly this increase in income to Lloyd's would be the result of an improvement in service.

An equally important point is that there is a potential cost in not developing global programme capability. This would be the business the market could lose to those companies better set up to handle global programme business. Global programme capability is needed within Lloyd's to make it more attractive for those syndicates with multi platforms to write business into their Lloyd's syndicate rather than writing it through their company platform outside the Lloyd's market.

The technological systems available to support a solution are now available. The cost of fast, high bandwidth communication through fibre optics has been reducing steadily so that the cost is now very low. Workflow systems have matured so that insurers can control their business from the centre using common systems and rules. We now have voice over IP (VOIP) and soon video over IP will become more commonplace; there are also web standards which enable the exchange of data between different systems. These and other technological advancements have made global programme co-ordination more easily achievable.

Lloyd's is uniquely placed as a market to collaborate, and as such the market holds an advantage over other insurance hubs. However, as the cost of communications reduce, the advantage the Lloyd's market holds is being eroded. The very low cost of communications is likely to lead to greater competition as geographical barriers diminish. As a market Lloyd's needs to act now to maximise its advantage while it still exists.

There is a need for Lloyd's to add global programme capability to its existing range of market support services. The changes introduced by the rapid advance in globalisation make it critically important, both now and for the future, that Lloyd's succeeds in improving the subscription market's global servicing capability. Future external demand for global programme capability from insureds and brokers is likely to ensure the long-term viability of a central service. With a unified commitment by managing agents to support Lloyd's in its development of global programme capability a solution can be achieved.

There are sufficient compelling reasons to justify the establishment of a central global programme capability at Lloyd's. Furthermore, a central global programme capability at Lloyd's would be fully aligned with Lloyd's' 2025 Vision (www.lloyds.com/vision2025) and it would help fulfill a number of long-term strategic objectives, including potentially improved geographical spread and an increase in attractiveness of the Lloyd's platform to overseas insurers. It would be a natural development for the International Markets department but most importantly it would increase the range of services which the Lloyd's market can offer insureds.

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