

---

# Trading risks - A perspective from the Lloyd's marketplace



Markus Gesmann  
Vario Global Capital Ltd.

SAV Mitgliederversammlung 2016

# Abstract

Lloyd's started famously from trading out of a coffee-shop in London over 300 years ago. Over the centuries Lloyd's evolved into a leading specialist insurance market place and startup incubator for new insurance products and companies.

This talk will give an overview of Lloyd's history and how this £27bn marketplace works today. Trading risks from policyholders to capital providers has always been at the core, from the wealthy individuals, who backed Lloyd's syndicates in the past to the marketplace of today, with many forms of capital providers. The focus of this talk will be about the ideas behind Lloyd's efficient capital management and how they can be translated into company markets.

—

# What is the difference between gambling and insurance?

—

**It's a matter of perspective!**

**Insurance reduces risks.**

**Gambling introduces risk.**

To achieve efficient  
**Trading of Risks**  
we have to bring insurers  
and gamblers (investors)  
around the same table.





## Meet Lloyd's Coffee House

London is the trade centre of the world.

Legend has it that ship owners met at Lloyd's coffee house in London, for coffee, and to exchange news and other pastime pleasures.



The Marquess Wellesley by John Philip Davis ("Pope" Davis).

## Meet William.

He is a shipowner. His ship will sail around the world and is expected to return with goods in three years.

# Meet George.

He is rich. Very rich.

He has an appetite for some riskier investments in his portfolio.





–

**William loses his capital, if his ship doesn't return.**

**George looks for attractive investments.**

# Lloyd's connects William and George.

George is willing to provide capital to underwriters at Lloyd's to insure William's ship for a premium.

It is a win-win situation for all parties.  
Risk is traded.



HOW THE LLOYD'S MARKET WORKS

LLOYD'S

£ \$ € ¥

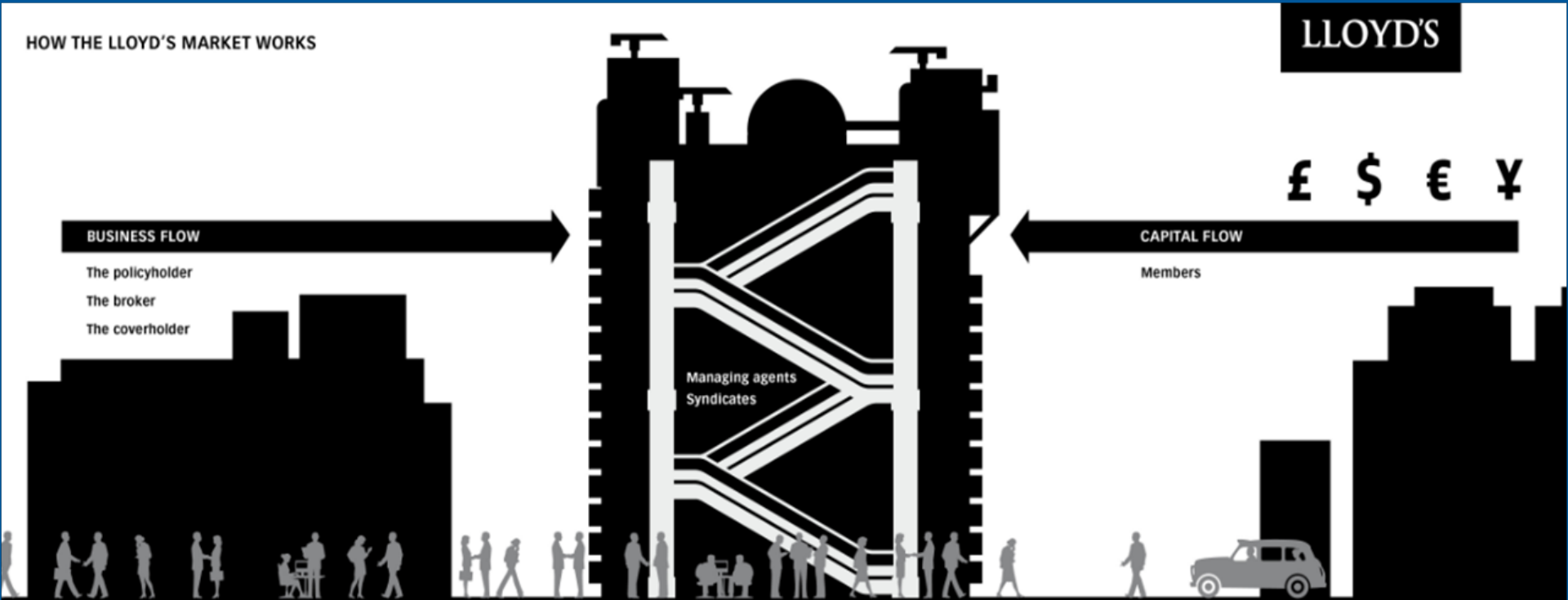
BUSINESS FLOW

- The policyholder
- The broker
- The coverholder

CAPITAL FLOW








































































Members

Managing agents  
Syndicates



Source: Lloyd's

# Lloyd's: 84 syndicates\* managed by 54 agents

							Marketform
						MSF Pritchard Syndicate 318 Underwriters at Lloyd's	Munich RE 
							Novae 
							
							S A Meacock & Company Limited
	Beaufort Underwriting Agency Limited						
							
							
							
							

\*As well as 13 special purpose syndicates, at 31 December 2015. Source: Lloyd's 2015 Annual Report

# Lloyd's Chain of Security

## Several assets

First Link	Syndicate level assets £46,191m
Second Link	Members' funds at Lloyd's £17,840m

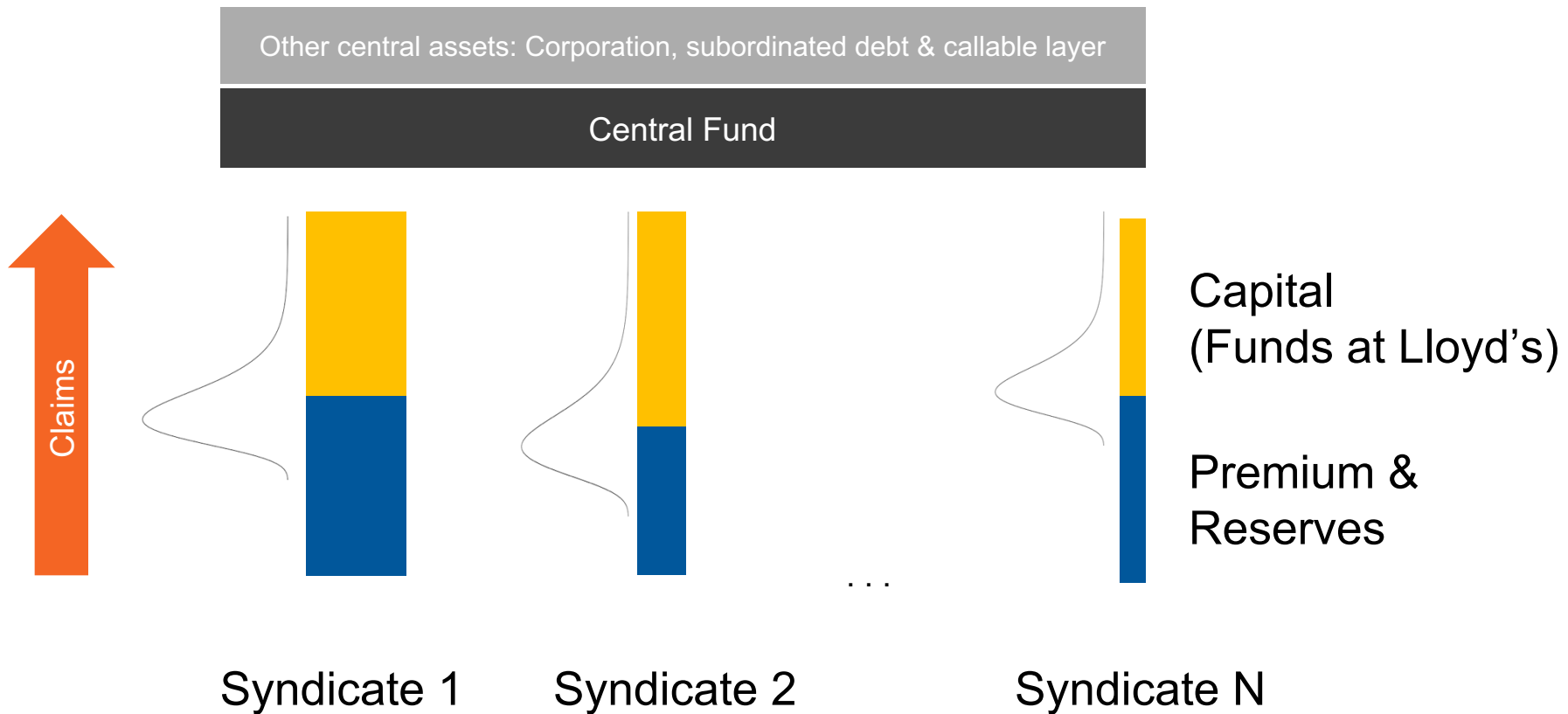


## Mutual assets

Third Link	Central Fund £1,658m	Callable layer £822m
	Corporation £105m	
	Subordinated debt/ securities £882m	

Source: Lloyd's  
2015 Annual Report

# Another view at Lloyd's Chain of Security





## A simple transformation

Underwriters turn risks into investment opportunities.

Building a well diversified portfolio of risks can provide a very attractive asset class.

# Main point

Lloyd's is a marketplace

Trading risks, i.e. sharing risks  
helps society and offers investment  
opportunities



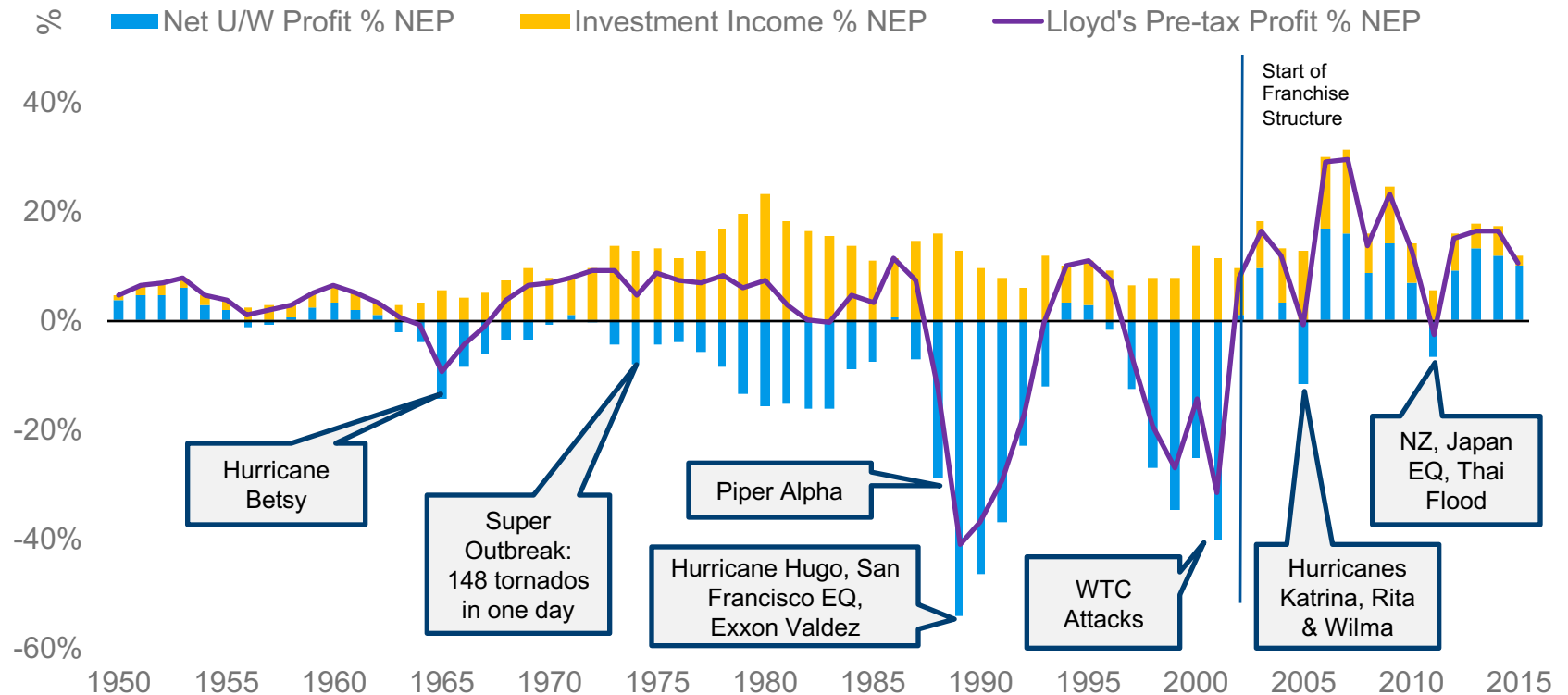
---

# Lloyd's Performance

From a club to a professional marketplace

---

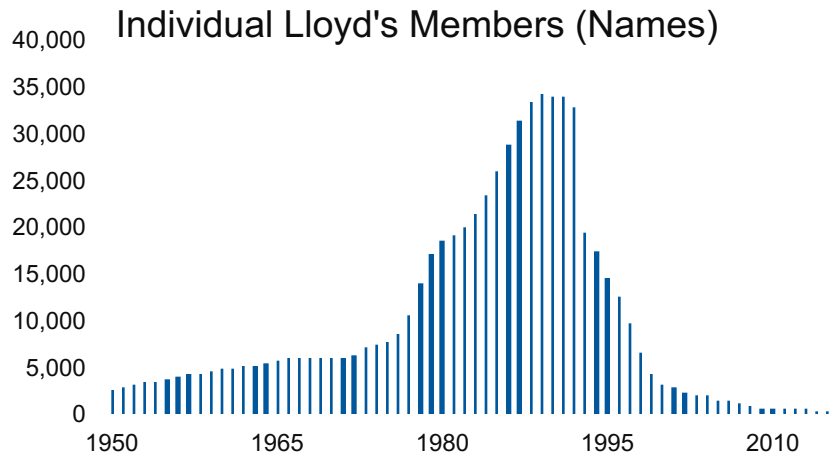
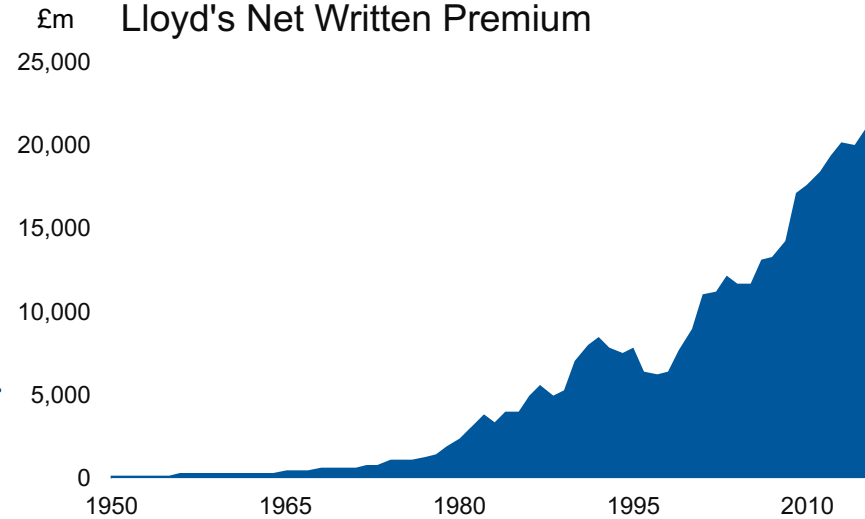
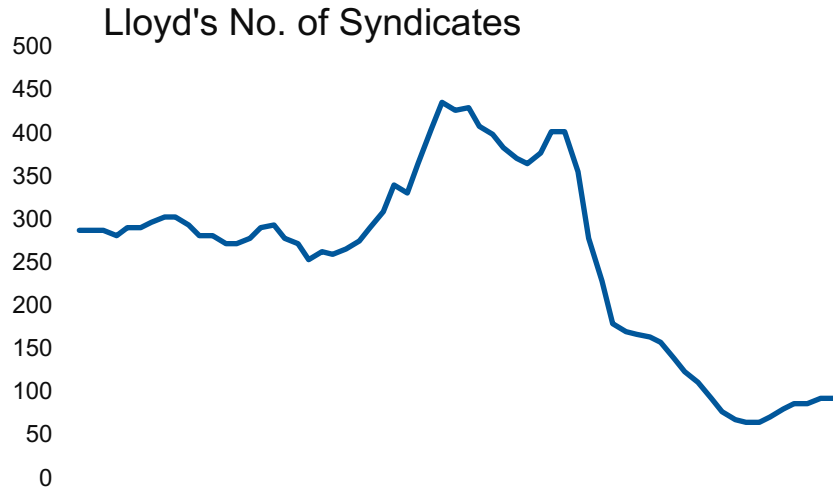
# Lloyd's historical results 1950 - 2015



Major losses: Hurricane Betsy (1965), 1974 Super Outbreak 148 tornados in one day, Piper Alpha (1988), Hurricane Hugo (1989), the San Francisco Earthquake (1989), Exxon Valdez (1989) North European storms (1987 and 1990), Typhoon Mireille (1991), Hurricane Andrew (1992), Northridge Earthquake (1994), WTC (2001), Hurricanes Charlie, Francis, Ivan (2004), Hurricanes Katrina, Rita, Wilma (2005), New Zealand, Chile Earthquake (2010), New Zealand, Japan Earthquake, Thailand Flood (2011)

Source: Lloyd's Annual Reports, Statistics relating to Lloyd's 2001; Lloyd's data for 1950 – 1999 on three year accounting (assuming written=earned premium and 18% brokerage), and from 2000 onwards on annual accounting basis.

# From diversification across syndicates to within syndicates



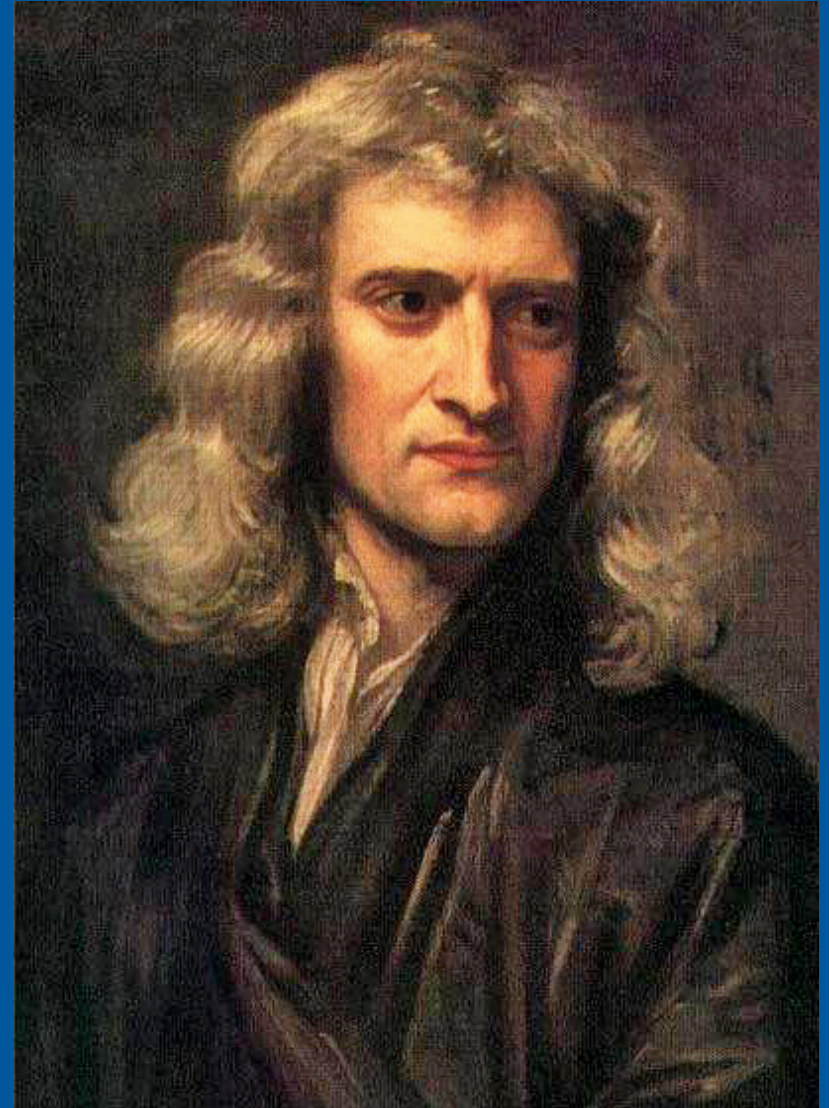
All charts show data from 1950 to 2015

Source: Lloyd's Statistics 2015. Count of Lloyd's syndicates contains special purpose syndicates.

1. Overseas Members commenced underwriting in 1969.
2. Women Members commenced underwriting in the UK in 1970, and overseas in 1971.

# Scientific Method

Models are valid, until they are proven wrong



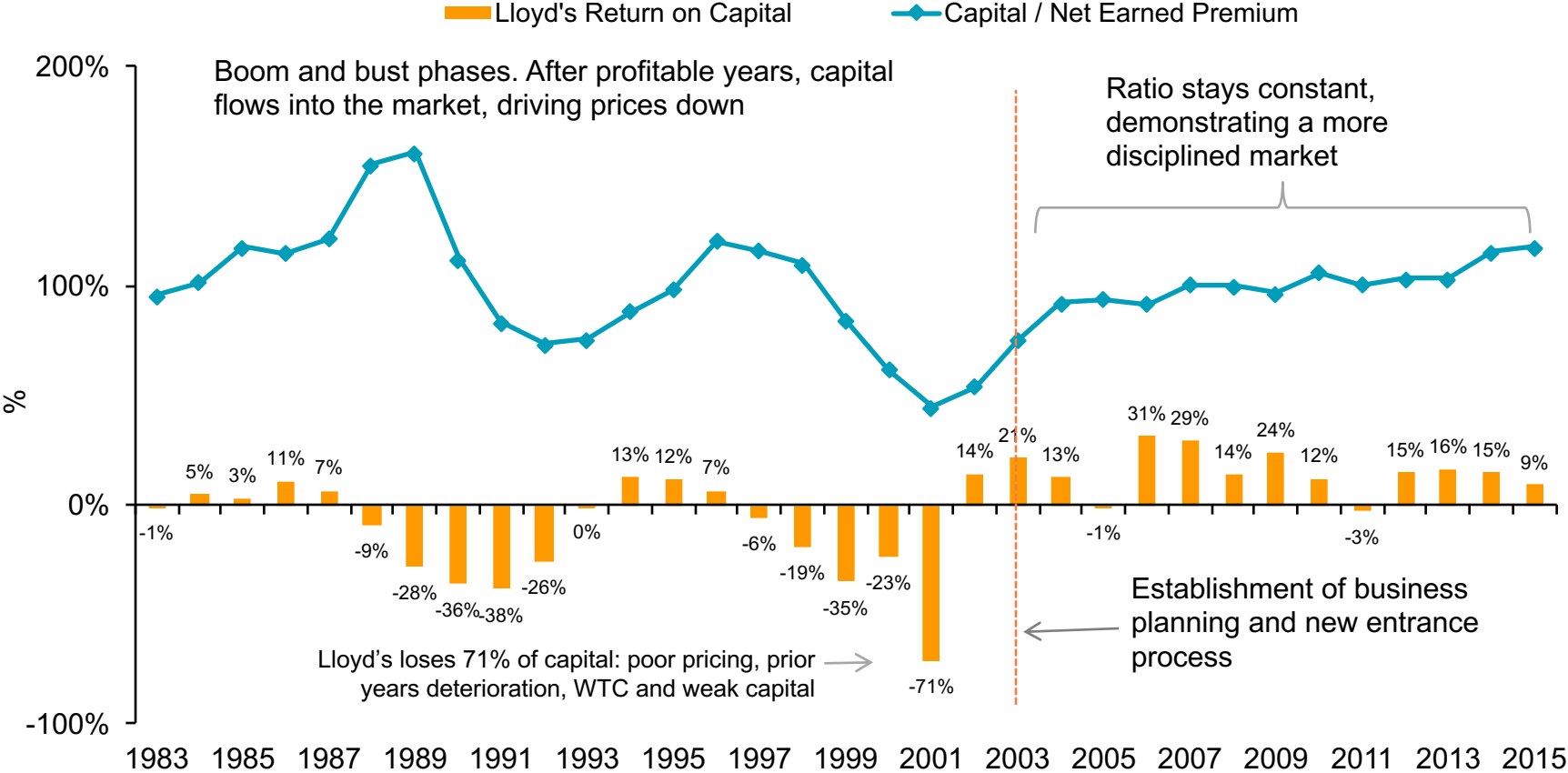
Isaac Newton: This a copy of a painting by Sir Godfrey Kneller(1689). This copy was painted by Barrington Bramley. [Public domain], via Wikimedia Commons

---

# Business Plans are Models

- Business plans are models to make money
- They are built on assumptions
- Assumptions need to be tested
- If assumptions are no longer valid, the plan has to change

# Lloyd's return on capital 1983 - 2015



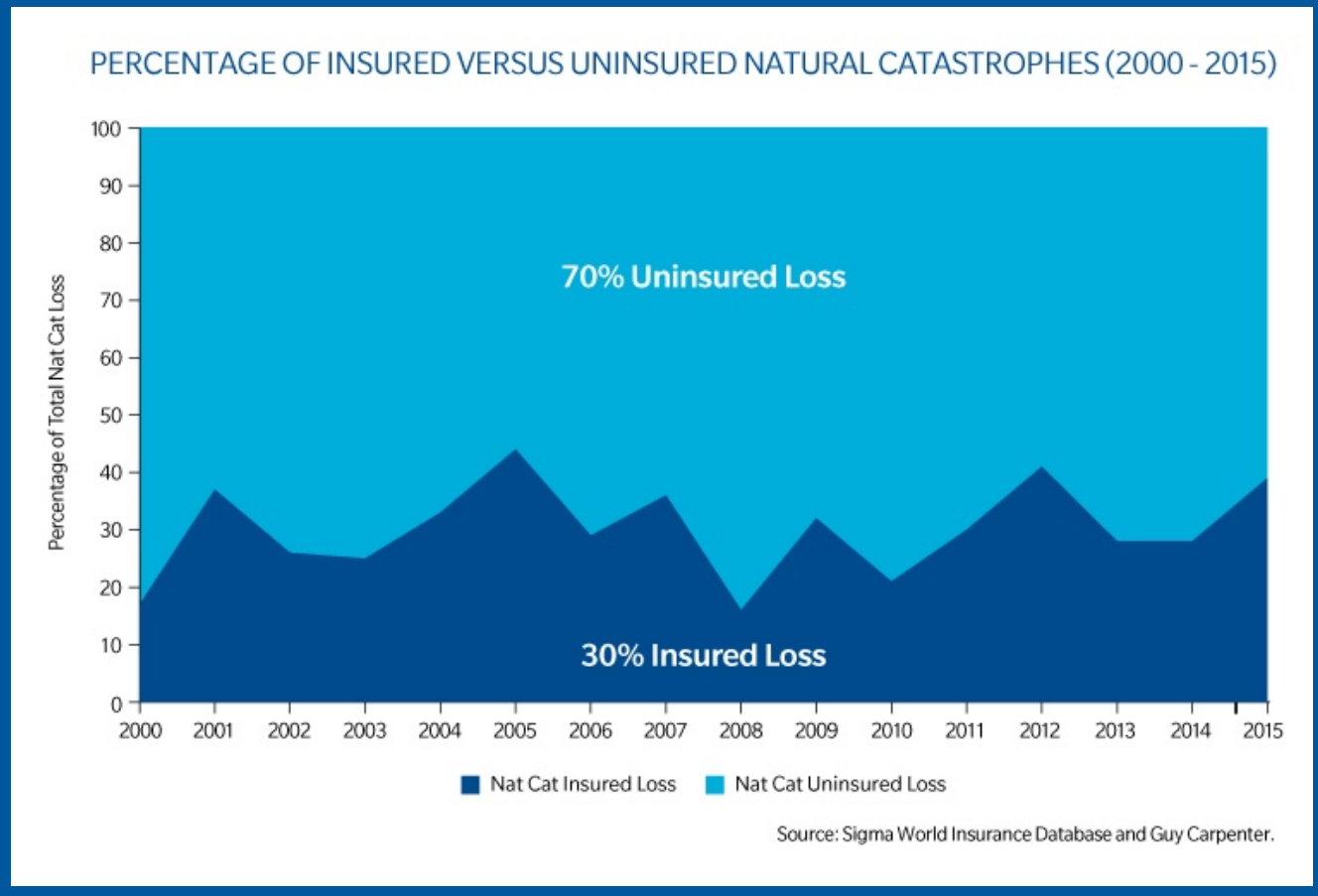
Source: Lloyd's Annual Reports. Statistics relating to Lloyd's 2001; Lloyd's data for 1948 – 1999 on three year accounting (assuming written=earned premium and 18% brokerage), and from 2000 onwards on annual accounting basis.

# Main point

Change, when the world is changing around you.

Plan ahead and write down the assumptions. If assumptions are no longer valid, then the plan is no longer valid either. Change!

# What's next?



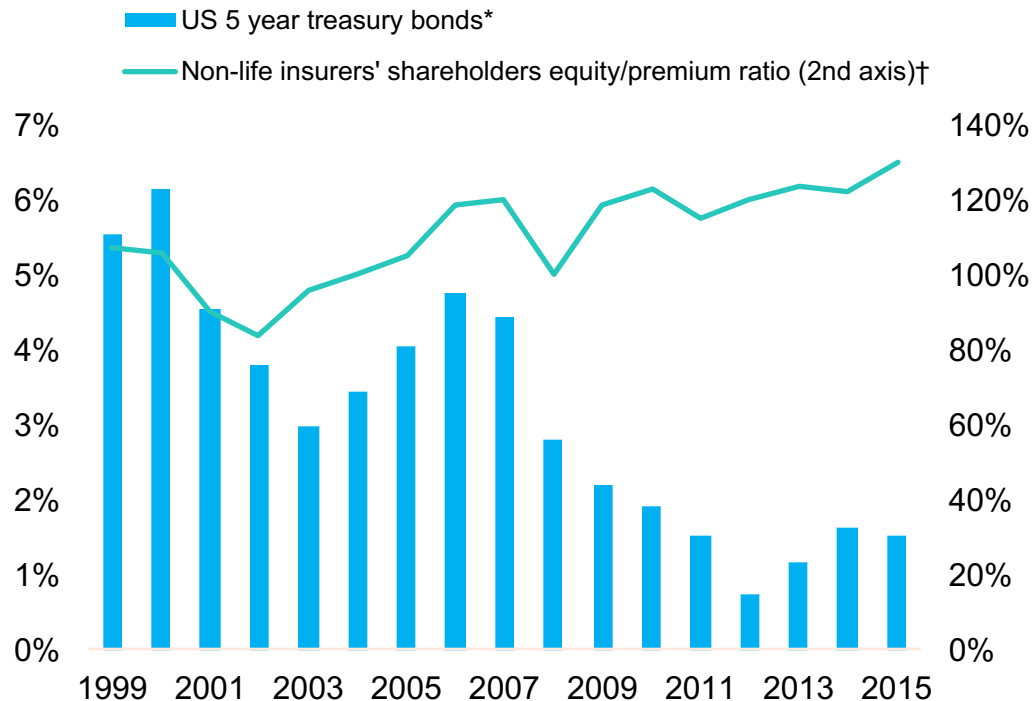


---

# Improve trading of risk

Required: Professional, transparent, regulated, diversified and commoditized

# The opportunity

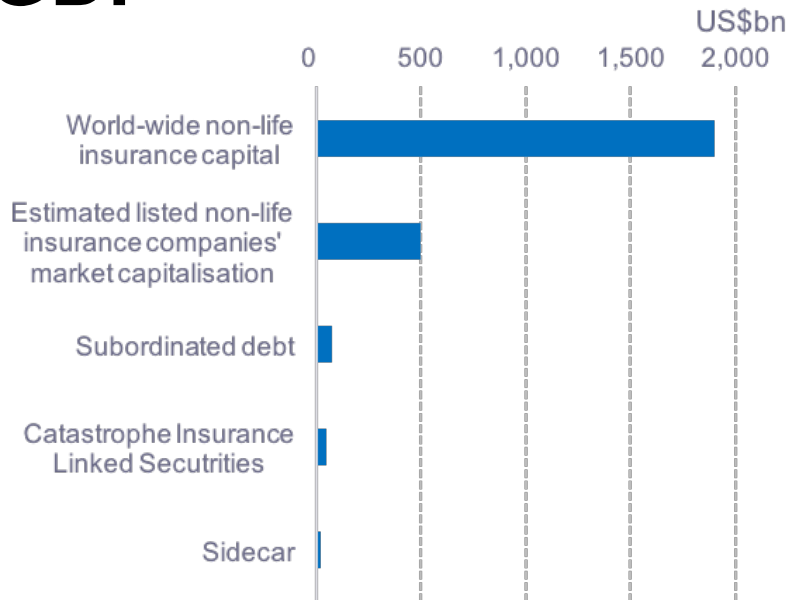


Source: \*US Federal Reserve, †Swiss Re Sigma 2016/3

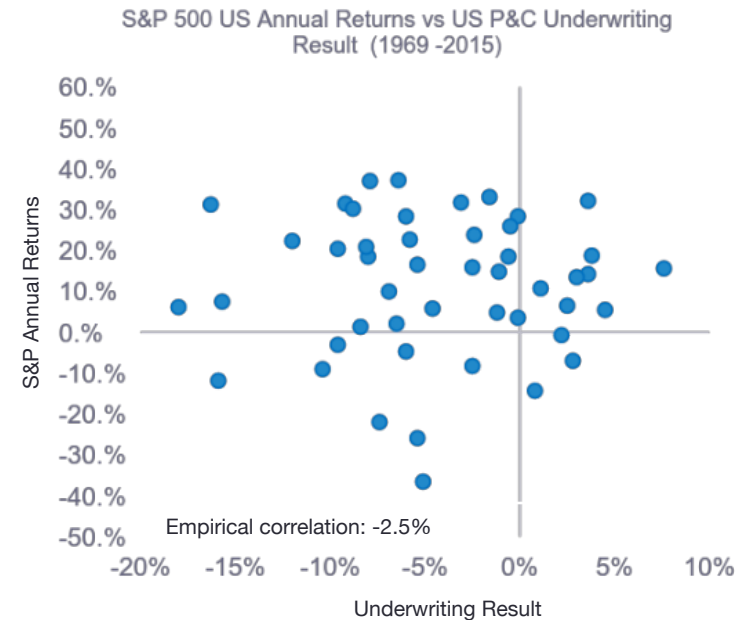
**Insurers and fixed income investors can derive mutual benefit through direct investment in insurance risk**

- Insurers are carrying too much equity capital to generate attractive returns.
- Fixed income markets are accepting historically low yields.
- The old insurer investment model of using solely equity to capitalise the 'float' is no longer effective

# Access to insurance as an asset class is small, much lower than its contribution to GDP



Source: Aon Benfield, Aon Securities, Vario estimates

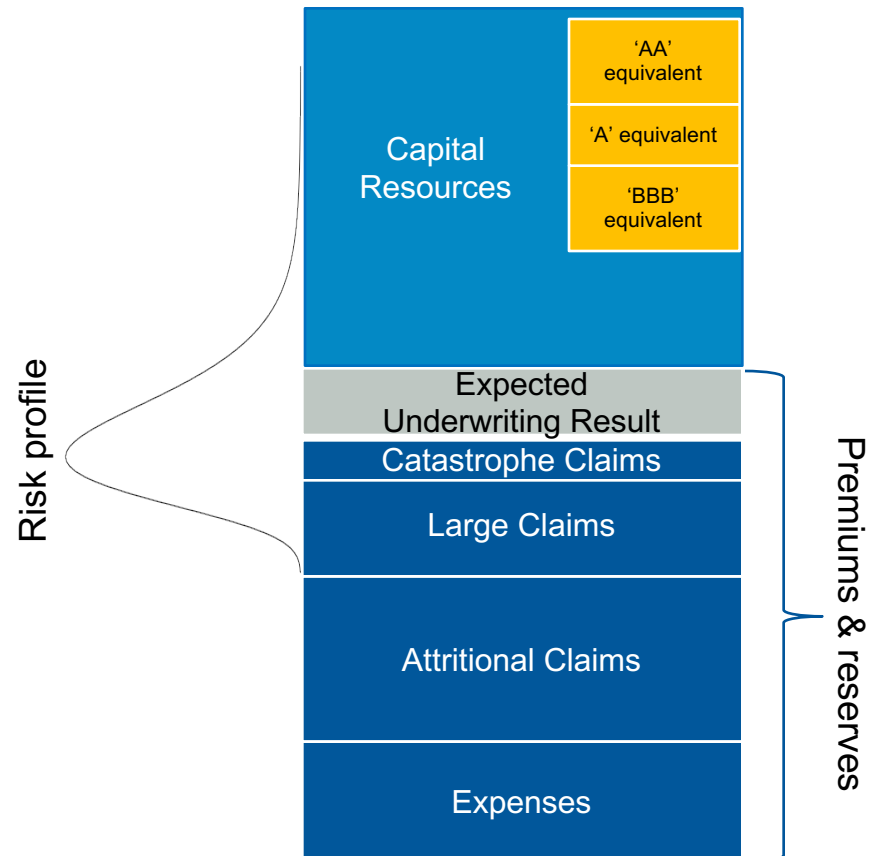


Source: Insurance Information Institute

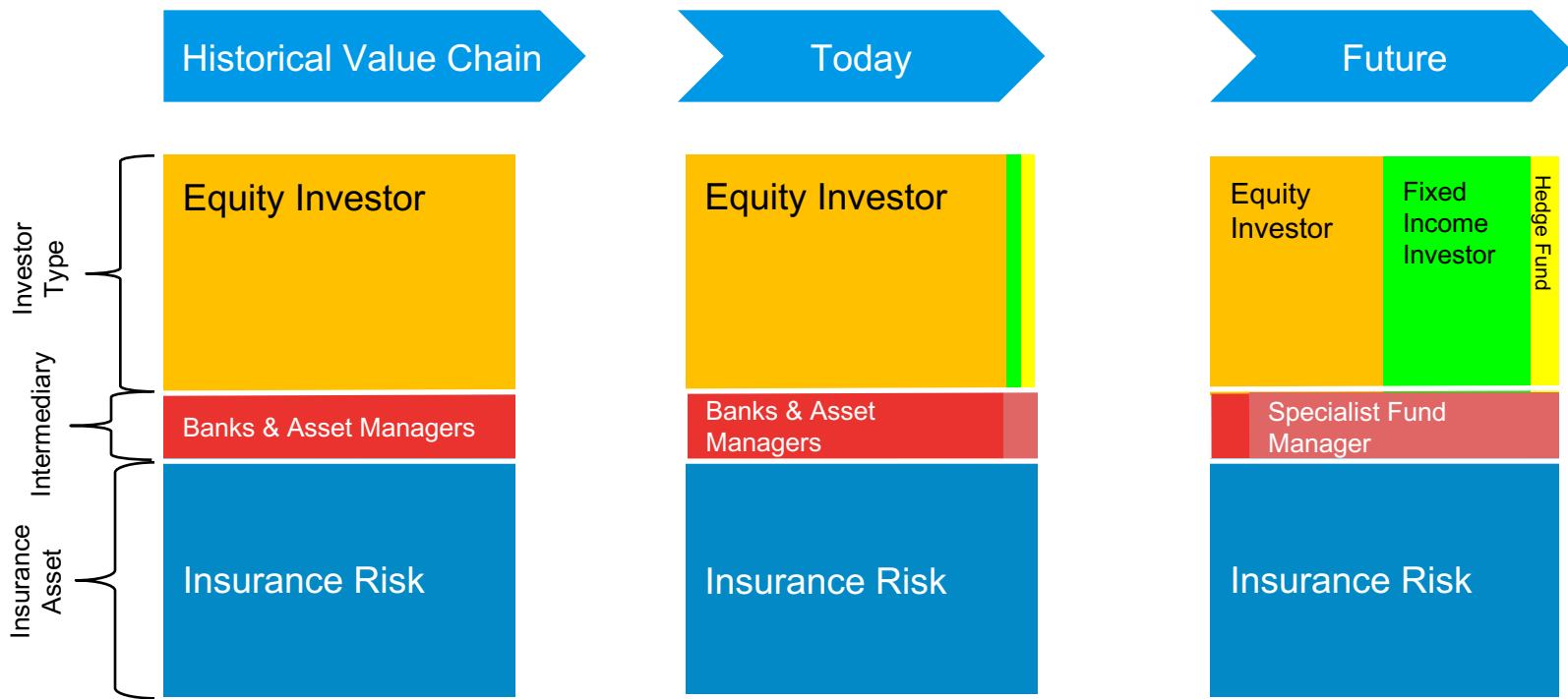
- Investors only have access to a small proportion of the insurance market\*
- Non-life underwriting has no significant correlation with capital market prices

\*according to Aon securities, only 25% of the insurance market is accessible

# Insurance risk as an investment tower



# Better understanding of risk will lead to a transformation in the warehousing of risks



**Opening up all of the insurance risk to fixed income investors brings industry capitalization into line with how other sectors are financed**

---

# Conclusions

## My liability is your asset

- Trading risk has a social imperative
- Embracing professionalism and scientific methods provides the foundations for successful risk transfer
- The old business model of generating 'float' and to live off the investment returns is no longer viable
- Like Lloyd's, syndicating and trading the remote risk improves return on equity

# Thank you

Markus Gesmann

Email: [markus.gesmann@variopartners.com](mailto:markus.gesmann@variopartners.com)

Phone: +44 (0) 7981 006 152

This publication has been prepared for general guidance on matters of interest only and does not constitute professional advice. No representation or warranty (expressed or implied) is given as to the accuracy or completeness of the information contained in this publication. To the extent permitted by law, Vario Global Capital Ltd, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting in reliance on the information contained in this publication.

© 2016 Vario Global Capital Limited. All rights reserved.

Vario Global Capital Limited is a company registered in England & Wales with registered number 10033177.

Registered Office: One Fleet Place, London EC4M 7WS, United Kingdom.