

Talking Business Article - Express & Echo Oct 08

Jonathan Cox, Director of the Devon based insurance broking company Pavey Group, offers comment on the recent events in the worldwide financial markets and how businesses will feel the effect. The fundamental point of insurance is to swap uncertainty (i.e. the possibility of a loss) for certainty (the premium you pay). The last minute rescue of American International Group Inc. (AIG) with a deal from The Federal Reserve Bank of New York – a \$85 billion loan in return for 79.9% stake in the Company – certainly created uncertainty in the market.

There is no reason to panic. The practical effect of the situation for those of us with businesses in the West Country is that we are immediately unaffected. AIG UK Limited is a UK registered insurance company, regulated by the Financial Services Authority. Under FSA rules, all assets held for solvency purposes to pay policyholder claims cannot be used for any other purpose. Indeed during the week of uncertainty surrounding their parent companies solvency AIG UK Limited paid £18.6million in claims.

I think this event does, however, give us cause to consider the implications on availability of cover and price of premiums over the medium term. The insurance industry continues to make profits, albeit at a much reduced level from last year. Lloyds of London half year results just out show profit before tax of £949 million (June 2007 was £1,807 million).

Whilst the industry has coped well with recent losses, the volatility in the capital markets combined with any notable natural catastrophes may now be enough to mark an increase to pricing. Separately from this, if AIG UK Limited is sold by their parent company as an asset to contribute to paying off the loan, inevitably premiums will increase through the removal of this, a significant insurer in the UK market. AIG Inc's new Chairman & CEO, Edward Liddy, stated recently that the insurance operations are core to AIG's future, this provides some reassurance that the status quo may be maintained in the immediate future at least.

Of course, whilst the attention has been on the issues arising from the economic effect of the fall in the US housing market, credit default swaps, the related issues in the UK banking sector etc. the usual trends affecting insurance have continued, exposures continue to increase driven by trends in legislation and litigation. Inevitably there will be a rate correction and insurance prices will rise; this should be gradual, but only if tempered by a lack of significant natural catastrophes and by reasonable investment returns for insurer.

Regardless of the factors affecting the macro insurance environment that govern the overall pricing parameters there are certain consistent features. Accurate and detailed information allows underwriters to provide appropriate cover at a better price. The way in which your business is presented to the insurance market is as important as the features of the business you are in.

The world continues to change and creates constantly changing risks for us all. The fact is that we like taking risk otherwise we would not be in business. The thing that we generally try to do is ensure that the risks we take are well understood, controlled as much as they can be and do not leave us overexposed to risk the failure of our business. Manage, monitor and review in all that you do. Take advice to assist you in these endeavours and, as is human nature to do so, leave a little to chance! Nothing stands still. If you only get what you've always had you may never get what you might now need. For more information, Jonathan can be contacted at enquiries@paveygroup.co.uk