Stop waiting for change

In the days before Monte Carlo Rendez-vous, Novae chief executive officer, Matthew Fosh, sat down with Reactions deputy editor Lauren Gow to discuss the finer points of the insurance market's fractious relationship with the capital markets and whose job it is to change the current state of play.

Matthew Fosh has a message for the market: "Get over yourselves." The 57 year-old chief executive officer of Lloyd's insurer Novae is tired of the "endless chats about capital." From his position at the helm of one of the market's most successful insurers, Fosh says the time has come – and swiftly passed – for the market to do something to help itself out of its capital black hole. "Obviously the capital issue is interesting on one level, but what are you going to do about it? What does it mean for the market?"

Fosh, whose firm reported a 92% rise in net profit to £22.6m (H1 2013: £11.8m) in the first half of 2014, says size and scale were once key performance indicators of a broker's or insurer's success in the market. But he is just as quick to point out that those days are long gone and a need for agility has stripped any success from the market's slow-moving behemoths. "Scale is no longer a differentiator. There was a time a few years ago, when Solvency II was starting to come in, and it was all about needing scale to be thought relevant. Now there's plenty of capital, it's less about scale and more about agility. It's more about responding quickly to clients' needs."

The balance of power in the market has shifted from insurers to brokers, says Fosh, but the notion is not something that the market has adapted to quickly enough and it is starting to bite. "The brokers have got lots of options now. They don't need ever-bigger balance sheets. They've got more capital and more markets than they can throw a stick at." Throughout Fosh's interview with **Reactions**, he repeatedly expresses his frustration that insurers seem to be simply waiting for the tide to turn on the balance of power, rather than trying to move the market themselves.

He says the market needs to be more proactive in solving the overcapitalisation crisis through better customer relations. "It's about giving brokers what they want. Are you giving them quick response times? Are you giving them ideas? Are you working with them to solve the problem they've got? This is why it's more about agility now as a market. Size is not the big sale that it might once have been. It's now about responding to them in the way they want you to respond and giving them the service they require and the flexibility they require to get done the way they want to get done."

Because brokers now hold the cards, Fosh says it is up to underwriters to find a way to service their clients without losing out on the deal. "The brokers have got the power line. He who owns the client, owns the business. And in this prolonged soft market that we're playing in, the market has gone to pot. The world is awash with cheap capital so finding capital is not a problem. But people are now desperate to find ways to put capital to work. If the brokers want to do business a certain way, we've got to find ways of underwriting it that works for us. In a world awash with that commodity, how do you differentiate yourself? I think that's much more an interesting debate for the market thinking about the market like that, as it begins to address the issue of how do we respond to this new world."

Fosh reiterates this point again; stronger this time. "This is our new reality, get over yourselves. What might change it? A massive loss? A big change in the macroeconomic environment? Interest rates going up faster than expected? Yes, all these things could suck capital away to play games elsewhere, of course they could, but our reality at the moment is we are awash with capital and it's hard to see it disappearing fast anytime soon."

The very notion that the market is waiting for a cycle change is an out-dated generational issue, according to Fosh, who adds the insurance market has a lot to learn from previous macroeconomic bubbles. "You've got to see what's gone on in the past five years in the context of what's gone on in the last 35 years. The strength, intensity and duration of an economic cycle, like any cycle, is a function of the strength and duration of the cycles that have gone before it."

Speaking about the effect the last five years of macroeconomic issues has had on insurers, Fosh says that while the cause of the financial crisis might have been extraordinary, the subsequent bursting bubble has resulted in a "sort-out phase" that is taking its toll heavily on the industry. "The sort out phase will take a long time because after the party, there is the hangover. And this was a hell of a party so the hangover will be a long one. When it's a really bad one you tend to not go out for a couple of weeks so that's what we're doing. Everyone is very cautious and a function of that is regulation."

The mere mention of regulation is usually enough to rile anyone in the insurance industry, but Fosh believes the combined regulation of banks and insurers is part of his aforementioned "new reality" – and the sooner the market swallows this bitter pill, the better off it will be. "The financial services industry, as distinguished specifically from the insurance industry, has lost the moral high ground in terms of regulation. Every time the FCA, PRA, Bank of England or Lloyd's say they want us to do something extraordinary, we say: 'We don't want to do that, don't be ruddy ridiculous, that's absurd.' And they respond, "You cost us ten trillion dollars, get back in your box and do it'. Fair enough. Politically, the financial industry has got nowhere to go so get over yourself because that's our new reality."

Fosh continues: "That's another part of this post-party economic recovery phase. Everything will be regulated. Some people may not like it, but get over yourselves, work with it and make it your friend. You've got to find a way. Your strategy needs to be born out of what your take is of the next three, five and 10 years. I think, for the purposes of the cycle and what's happening to it, you've got to see it in that context because the idea that something is going to turn the market around and make it hard

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Matthew Fosh, CEO at Novae Group

again, well, I find that quite hard to believe," Fosh adds.

Fosh even goes so far as to say that regulators should be applauded for their work done to improve the solvency of the industry. "Regulation has improved. Our modelling management is much more sophisticated than it was, and for that, regulation must be applauded. It's a bit of a coincidence isn't it? The rise of regulation and suddenly there's relatively few companies go bust."

It is all too easy for the industry to blame regulation for creating a competitive disadvantage, but the sheer size of the market creates a challenge to rise to, says Fosh. "Everybody is trying to work out what this new reality means. How do we carve out our competitive advantage within it? What does it mean for us? What does it mean for us, the management team, and what it means for us individually? How are we going to respond? Yes, there is lots of competition and it means you've got to find your way. Make it work."

Fosh says it is almost laughable that insurers' response to current tough market conditions is to complain about reporting double-digit profits. The time has come to find a way to "just deal with it", he says. "Looking at the results that are coming out of these businesses, I don't see yelps of horror from 3% ROEs and these businesses are still predicting double-digit returns. What's not to like so far? The extent to which 2015 or 2016 is going to get tougher and tougher is still to be seen but the squeeze is on."

Once again, the conversation moves back towards generations and the cycle issue. "This is generational. A cycle is a cycle is a cycle. There's an eternal truth about cycles because cycles are made of people. An economic cycle, or any kind of financial cycle, is made up because it is caused by people behaving like people. But their shape and intensity and duration are completely a function of a situation. It follows that if that cycle goes on and people's returns start coming under pressure people will look for answers."

Looking ahead to the next stage of the market's development, Fosh says waiting for one big market changer could be the wrong tact for the (re)insurance market to take. "I would say it's more likely to be a combination of things than one thing. Of course, a major international loss of big enough scale will do something to move the market but that's just mass. A $250bn loss will be sure to move the needle. I think it's likely to be a combination of changing macroeconomic circumstances and a nasty loss or series of losses. But let's be careful what we wish for."

Fosh then jokes: "You hear it said in the market, 'When underwriters are worried they're not going to get a bonus, they don't really change their habits. When they're worried they're going to lose their jobs, then they do change.'" Once again serious, Fosh says: "I think any changes would need to be from management down. You can't beat the market. If demand is soft, if demand is not growing aggressively then, without economic growth there isn't going to be growth particularly and if supply of the commodity you need to meet that demand is plentiful then not much is going to change."

Summing up the interview, Fosh admits that the difference what the market wants to happen and what will actually happen is still largely in the hands of the capital markets. "Because of the immense supply of money, it will require people to have other opportunities and other places for people to play with their money. At the moment, investors feel they have got no other alternative than this industry. It is now such a common place to come and play. I think it would require a combination of things not just insurance related to change the capital market." ●

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