

Insurance Sector New Challenges Ahead

BY ROSS NAISMITH

The insurance industry has fared better than other financial sectors in the recent and continuing financial crisis. With few exceptions, insurers emerged in late 2010 with stronger balance sheets and higher earnings than they had in the pre-crash market.

Despite the return to steady waters, there are lingering effects from the financial crisis:

- General insurance premiums track Gross Domestic Product (GDP), and slower economic activity has led to less demand and reduced volume. People and companies are buying less and building less, and lowering insurance costs is often a key target of financial officers.
- Less demand for and reduced volume in underwriting has led many insurers to rely heavily on their investment portfolios to bolster profits. Some insurers perform better financially through their investments than through underwriting, their core activity. It is now not uncommon for investment activity to account for 70 percent of overall profit.

These two issues have put pressure on insurance businesses to increase efficiency, lower costs, reduce head count, and leverage space use—strategies that greatly impact property portfolios.

PROPERTY PORTFOLIOS

In addition to those mentioned above, a number of factors are reshaping the environment and influencing ways in which insurers use space.

Consolidation

2011-2012 will see the insurance sector experience more merger and acquisition activity. Compared to other major industries, general insurance remains relatively fragmented with more than 10,000 regulated players spread out across the globe. The largest insurance firm only represents about 4 percent of the global market.



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Surplus capital and depressed share prices, along with the traditional view of consolidation as an effective way to achieve growth, may lead to a rash of acquisitions or attempts at acquisition. The sector already has a number of business consolidations pending.

In most cases, these consolidations will result in over provision of property stock and head count. Cuts in head count and real estate holdings may likely soon follow.

Stricter Regulation

Solvency II is the new industry capital regime, emanating from European statutory regulations from 2012 on. It will require insurance companies to have a minimum of solvency capital to protect customers against company defaults. While some details remain unfinished, it is likely Solvency II will trigger further pressure for efficiency and consolidation.

It may also cause market migration to more capital-efficient locations, although other jurisdictions around the world such as Australia, Bermuda, and the Arabian Gulf are also adopting Solvency II-type rules.

Together consolidation and Solvency II are poised to drive very meaningful changes in property occupation.

- Lower margin players will seek to drive down cost in a 'proud to be cheap' movement where insurers seek to outdo each other. These players will trend towards low budget environment buildings in secondary locations.
- High-margin smaller players will locate themselves in prestigious locations and have quality offices to give the impression of power.
- Administrative functions will drift towards secondary, out-of-town, or even offshore locations.
- Shareholders will be less tolerant of waste and expenditure. There is a clear trend of insurance companies following the public sector and frowning on extravagance.

The London Position

London will retain its position as the global centre of insurance sector excellence. Within London, the market will continue to be dominated by the Lloyd's Triangle, with Lloyd's of London at its epicentre, increasing its influence as a magnet to the industry.

The Underwriter/Broker community will seek to maintain prime office locations within sight of Lloyd's of London in order to keep key business interfaces within walking distance of this historic location. As the most sought after real estate, the 'Triangle,' bounded by Leadenhall, Fenchurch, and Bishopsgate streets,



Lloyd's of London, London, UK

will be unable to meet demand due to the limited size of its aging building stock. This will likely drive site redevelopment and lead to increasingly newer, modern architecture woven into the existing historic and geographical contexts.

Pressure on space will increase the temptation to split front- and back-office activities. The reliance on personal interface for business will receive the front-office priority to inner-city locations with support functions moved to cheaper locations.

Front-office interior architectural spaces will also become more sophisticated and appointed, as the limited space available places pressure to provide better communing spaces in the Triangle.

While electronic support will likely become omnipresent, at least for the foreseeable future, the insurance business will continue to rely on traditional Broker/Underwriter face-to-face interaction.

Space in the front offices will be dense and function-oriented and possibly shared. Out-of-town support spaces will become associated with the 'proud to be cheap' aesthetic, though the quality of space may rise due to the need to attract and retain workers.

The New Workplace

As the availability of quality space decreases, high-density workspaces will come to dominate the 'Triangle.' Physical desk sizes currently are veering away from L-shaped toward benching systems. Lengths are frequently only 1600mm, and there will be pressure to go down to 1500mm. In high mobility areas, lengths may go as low as 1200mm.

Density will likely drive an increase in flexible work environments with the insurance industry embracing mobility strategies and universal planning.

Mobility strategies will allow the industry to move to denser occupation than the traditional 1:1 ratio of people to desks.

Universal planning will establish optimum floor layouts balanced between open plan, cellular, and on-floor support spaces, giving permanent layouts but allowing for departmental expansion or contraction. This results in less space and less capital cost.

Workspace will increasingly be balanced by spaces to collaborate, learn, and socialise, alleviating the pressure of density and acknowledging that the restoration of some level of life/work balance should be attained to maintain productivity levels, all while improving employee retention and attraction.

Underwriter/Broker interface space will become decidedly higher end as businesses look to achieve an edge over competitors. When margins are relatively uniform, the environment can be a key differentiator from competitors. External meetings (in restaurants, in bars, etc.) will continue as current practice, but internal meeting space will become more varied, multi-functional, and aesthetically pleasingly. The front door/first impression/welcoming aspect in reception and entertaining spaces will become more acute.

The Lloyd's 'Box' will eventually fall in line with regular financial practices and become more dominant on cyberspace than in-person interchange. But not yet — traditions die hard. Key Underwriter/Broker exchange will continue to be based on strong personal relationships for the foreseeable future.

SUMMARY

- Insurers emerged post-crash, with stronger balance sheets and higher earnings than the pre-market crash. However, there remains pressure on insurance businesses to be more efficient in order to optimize margins.
- The Insurance Sector is poised to experience more merger and acquisition activity, resulting in over provision of property stock and head count. Increased statutory measures may exacerbate this.

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- Consolidation will result, impacting property portfolios.
- London will continue to be the global centre of insurance sector excellence.
- The London market, in the EC3 postal area, will continue to be dominated by the 'Lloyd's Triangle.'
- Lloyd's of London will increase its pivotal position as the spiritual and actual focus point in key Underwriter/Broker exchange.
- High-end specialist firms will continue to seek prime London EC3 office locations.
- Diminishing quality building stock availability within the Lloyd's Triangle coupled with lease expiries will likely lead to site redevelopment.
- Prime real estate premiums and increased staff costs will increase out of town migration of support functions with front office taking priority in the City.
- Workplace strategies will focus on increasing density, but balanced by improvements in space to collaborate, learn and socialise.
- Quality Underwriter/Broker interface space will be provided, as well as a overall improvement of space to facilitate employee retention and attraction.
- Front-office space will become more diverse, but the historic/emotional ties to business exchange associated with 'The Room' and its clones will remain.
- Settlement process will be increasingly technology based, but key Underwriter/Broker exchange will continue to be conducted at a personal level for the foreseeable future.
- The emotional and physical attachment to the Lloyd's Triangle may eventually fade, but not yet.

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