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News

The Good Life in Non-Life

Non-life insurers in medium-sized markets benefit from improving efficiencies in strong franchises

Ben Leyland Jasmeet Munday

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Non-life insurers in medium-sized markets offer a focused opportunity to benefit from improving efficiencies in strong franchises

A Conversation with Ben Leyland and Jasmeet Munday
Senior fund manager and analyst on JOHCM Global Opportunities and JOHCM International Opportunities

Ben: Financials have a bad reputation for being a low-quality sector full of volatility and gearing. The sector is heavily dominated by banks, particularly large complicated banks, catering to commercial customers with balance sheets that are difficult to interpret. Meanwhile, life insurance companies are very difficult to invest in with confidence. They sell long-term contracts backed by complicated assets, so transparency is not always there, while the size of the balance sheets is a very big risk. But we do like the non-life insurance market, sometimes referred to as general insurance. You have to be selective about the company, the underwriting discipline, the risks they underwrite, the markets they operate in, and who their customers are. But it's more likely that we'll find a high-quality non-life company than a high-quality life company.

Jasmeet: There's only a handful of attractive non-life insurance markets. The consolidated company structure makes markets such as Scandinavia, Canada and parts of Australia attractive. That’s because only a few large players are in control and only one or two key players drive prices through distribution and owned distribution. In the UK and US, price comparison sites drive a lot of traffic. But if you control the broker and the affiliate who sells the insurance, that creates a very different buying behavior. So you're buying from a broker, you're being guided towards what policies to buy and that drives pricing. Plus, bundling policies, for example, home and motor insurance, controls the customer base and helps with retention and renewal.

Ben: Scandinavia, Canada and Australia are all quite small markets.

Jasmeet: Yes, and, because they are relatively smaller, you don't get global capital trying to enter the market. It's a lot more of a localised market compared to, say, reinsurance.

Ben: We also like more fragmented markets where individual players have powerful competitive advantages which allow them to price profitably but still lower than their peers. We've seen it in the US auto insurance market in recent years. Finding the companies that can grow market share because of competitive advantages, broadly relating to cost efficiency in managing claims and processing the administrative costs, is a recipe for strong compounding.

Jasmeet: Scale is a huge and underappreciated advantage because it brings an expense-ratio advantage or even loss-ratio advantage which other companies cannot compete against.

Ben: A lot of financials have done well out of higher interest rates. But the impact has tended to be more front-loaded for banks than insurers. It takes 3-5 years for higher interest rates to feed through into the income that non-life insurers earn on their investment books. So, we are in the middle of that process for insurers, rather than towards the end, as we may be with the banks.
Insurers’ earnings have gone up because of this dynamic but they haven't gone up all the way. Insurers also see a lagged impact of inflation. They have cost inflation first, followed, if you are in a strong, disciplined market, by hardening of premiums.

Premium inflation plays into the hand of those lower cost, higher scale providers. They are better able to cope with inflating costs whilst retaining margins, without pushing all of that inflation onto the customer. So they can win share whilst retaining profitability, whereas the smaller operators have to pass it all through to defend their margins.

Jasmeet: Canadian insurer InTact is one company that we like. It has the leading 18% market share in the Canadian non-life market, and the best direct and broker-led distribution, while the rest of the market is fragmented and has a long tail. So InTact controls the pricing in the market - when it prices up, the market usually follows. The company’s scale allows heavy investment into repair centres and claims management. But it also has specialty insurance through very well-directed M&A, insuring niche small- to-medium-sized enterprises on specific risks. This part of the business has barriers to entry and a huge opportunity to grow.

Ben: We’ve also been looking at the Australian sector which has long been a high margin and very stable market. Here QBE is a potentially interesting player because it has brought a highly regarded management team in to improve the underwriting culture. While its domestic business is very strong, the firm used to be a big flag planter in the US, which has been a thorn in its side. But QBE is solving that problem, exiting certain unprofitable lines, which could sow a lot of seeds for improved profitability in future years.

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