THE TREASURER'S JOB AT A MAJOR INSURER INVOLVES A RANGE OF DUTIES, NOT THE LEAST OF WHICH IS KNOWING WHICH WAY THE WIND IS BLOWING, SEAN ANDERSON OF KILN TELLS **GRAHAM BUCK**.

Winds of fortune

PHOTOGRAPHER: ROGER HARRIS

The progress of the US hurricane season, which officially lasts from 1 June to 30 November, is monitored closely by insurers. Their attention has become keener since 2005, when hurricanes Katrina, Rita and Wilma collectively cost them over $50bn in insured catastrophe losses. After two relatively benign years, 2008 began less promisingly: greater storm activity was forecast with hurricane Arthur making landfall in Belize even before June got under way.

"As the group writes a lot of US business, we're heavily dependent on which way the wind blows," says Sean Anderson, Group Treasurer at Lloyd's of London managing agent Kiln. "Along with the rest of the market we had a tough time three years ago when it blew the wrong way, and while 2006 and 2007 were very favourable, it's only a matter of time before we get another bad year."

Companies operating in the insurance sector are probably more susceptible than any other to sudden and unexpected events, either weather-related or man made. Anderson recalls his meeting with a representative from Marsh, the world's biggest insurance broking and risk management group, when their discussions were interrupted by news reports of a plane flying into one of the World Trade Center's twin towers. It was an event that completely changed the outlook for the market.

WEATHERING THE STORMS As one of the longest-established operators at Lloyd's, Kiln has weathered nearly five decades of catastrophes. Set up in 1962, it has developed into an international insurance and reinsurance underwriting group and the holding company Kiln Ltd's 10-year listing on the London Stock Exchange only ended in March, with its acquisition by a Japanese insurer.

Growth has been fuelled by specialising in complex and non-standard risks and its underwriting capacity, which this year stands at £842m, makes it one of the largest agencies trading at Lloyd's, with four syndicates. The group's core businesses are property/casualty, accident and health, marine and aviation insurance, plus reinsurance and a smaller but successful life insurance operation.

THE WINDS OF CHANGE Although Anderson worked at other insurers before joining Kiln, his early career signalled a rather different path.

"At university, I did a four-year course in chemical engineering that included a year of hands-on work at a BP chemicals plant in South Wales producing ethylene," he says. "On graduating, I spent three months at Anglo American's South Africa gold mine and experienced the incredibly hot and humid working conditions underground."

On returning to the UK, he joined process engineer Bechtel as a cost engineer in 1987 but had been with the firm only a year when he decided against continuing with engineering. He moved to Deloitte Haskins & Sells and a training contract at the firm's corporate finance department in Birmingham. He was to spend six years with the company, gaining his fellowship of the Institute of Chartered Accountants in England & Wales during this period.

His next job took him into insurance, when he joined Wesleyan Assurance Society in 1994. The group managed its investments in-house and was seeking an investment analyst and deputy fund manager. During his four years there, Wesleyan expanded through a merger with the Medical Sickness Society, an insurer specialising in providing cover for doctors and dentists.

"Wesleyan's prime focus was selecting out-of-favour stocks that it recognised as having good recovery potential," he recalls. "The strategy proved highly successful and its investments have consistently ranked at the top of performance tables." By avoiding technology, media and telecoms stocks, Wesleyan also escaped the boom and subsequent bust of the dotcom era.

GROWTH HAS BEEN FUELLED BY SPECIALISING IN COMPLEX AND NON-STANDARD RISKS AND ITS UNDERWRITING CAPACITY, WHICH THIS YEAR STANDS AT £842M, ALSO MAKES IT ONE OF THE LARGEST AGENCIES TRADING AT LLOYD'S, WITH FOUR SYNDICATES

Next stop, in 1998, was Britannic Assurance, which he joined as an equity analyst. The company, with funds three times the size of Wesleyan's, grew further when it bought Alba Life and asset manager Britannic Asset Management from Britannia Building Society.

Fund management was shifted from the in-house investment team, which was disbanded, to the newly acquired asset manager. Anderson took on the position of Treasury Manager as the group took on external debt for the first time to fund its new operation.

The new decade opened with the dotcom boom at its height. Britannic, which had had minimal exposure to tech, media and telecoms stocks, switched its asset management across to the sector, just before equities were gripped by a three-year bear market. As the equity markets moved lower, the group became more constrained as a result of the high proportion of equities held in investments, and sold off its Britannic Money operation.

"We put a huge hedge in place designed around Financial Services Authority regulations to prevent forced selling at a time when the market had clearly become underpriced. We also looked at pension funds with a view to locking in solvency surpluses. The main difficulty with this was in finding appropriate assets."

Although Anderson had been promoted to Head of Treasury at the end of 2001, Britannic's prospects began to look less promising. The group sold off newer acquisitions such as its mortgage business, bought from Irish bank First Active only three years earlier, and its life business and annuities arm was closed to new business.

"I decided to move on and spent the first half of 2004 over in Spain, living in Segovia. Then the post of UK and European Treasury Manager came along at a subsidiary of General Electric that was being spun off via an IPO [initial public offering]," he says.

The startup, Genworth Financial, had to set up its own treasury system and select its own banks on separating from GE, and Anderson was responsible for 13 different European countries.

He headed a team of six that liaised with a larger US team based in Virginia and recalls how challenging it was to work with the differing treasury cultures of North America and a European country such as Hungary, and to communicate those differences to US colleagues.

"Generally, Europe works more slowly than the US. Each country also has its own different processes, which, in some cases, can appear very different and obscure to outsiders."

OUT OF THE BLUE The opportunity to work at Kiln came "out of the blue" and he joined the group as Treasurer at the start of 2006. What persuaded him? "It was evidently a growing business with a number of startup operations," he says. It also offered exposure to the venerable insurance market at Lloyd's.

"As one of its major players, Kiln has the benefit of individuals who have been in the business for many years and collectively accumulated significant experience," says Anderson. "Many joined the group as graduates and have stayed on."

The 320-year-old insurance market at Lloyd's also offers some unique characteristics, such as mutuality. "You are guaranteeing other underwriters and other companies' liabilities through Lloyd's central fund, a structure that lends itself to a greater degree of scrutiny from the regulator over what and how much you underwrite."

The underwriting capacity for Kiln's syndicates comes partly from Lloyd's names and quota share capital providers; the balance is provided from within the group.

Like its peers, the group has to contend with the insurance market's periodic business cycles. The windstorms that flattened New Orleans three years ago briefly pushed up property/casualty rates for North American risk, but soft market conditions have otherwise prevailed for several years. Kiln's underwriting capacity, which had been steadily rising up to last year when it topped £1bn, was trimmed back this year to £842m as premium rates again moved lower, and will only resume its upward trend once the soft market cycle ends.

"It adds a challenge to how we use our capital most efficiently," says Anderson. "We don't want it lying around providing capacity that isn't going to be used."

THE CORE TEAM Although Kiln announced in March 2007 that its holding company would redomicile to Bermuda and established a small head office on the island, the finance function remains at its City office in Fenchurch Street.

Anderson heads the treasury team of six, with one of the core functions the investment of surplus cash on a daily basis.

"We are very focused on the credit risks of our banks and counterparties. Risk is allocated to the underwriting side and we reduce that attaching to our investments by as much as possible.

"We moved the bulk of our cash to AAA-rated money market funds, with only very small balances left in the banks. The strategy has meant that Kiln's portfolio has performed very well despite the credit crunch, thanks to having the bulk of our money in government bonds and by managing asset and liability matching.

"Over the years, various salesmen have attempted to sell us a variety of enhanced yield products but we haven't been persuaded. So our performance in 2007 and so far this year is on target."

He adds that the crunch reaffirms the importance of understanding the risks in your investment portfolio. Too much volatility from returns could jeopardise Kiln's underwriting capacity. This is coupled with the "best test" of gut instinct. "If the yields or returns just don't look right, you're best advised not to go into it," he says. "Our cash investment spread is across several money market funds, which we monitor very carefully – our view being that the highest yielding are also probably taking on too much risk."

Another area of treasury is credit control. Kiln delegates the collection of premiums from policyholders and cover holders to its brokers and vets them carefully. "Although we haven't cut the number back, a few have needed 'prodding' to disgorge funds. If a broker doesn't pass the premiums he's collected on to us, we're still on risk regardless, so we want to have those payments."

Foreign exchange exposures are influenced by the fact that nearly two-thirds of Kiln's business comes from North America and also by the three-year accounting cycle that all Lloyd's syndicates work on. The US exposure means that profit forecasts in the second half of the year can be dramatically affected by hurricane activity – as in 2005 – so Kiln tries to hedge its exposures at the 18-month stage.

The 2005 year of account only closed earlier this year. Despite Katrina two of Kiln's four syndicates, including the flagship 510, made a profit and the other two made losses less than initially anticipated.

The weakness of the US dollar is another threat to profits – although it becomes a virtue when losses exceed premiums – and Kiln hedges the exposure through a combination of spot trades, forward purchases and vanilla options.

"We're slightly unusual in using the latter, but vanilla options generally provide us with more transparent pricing than the structured products that the banks would like us to use. We also ensure that we review our exposures very carefully."

Over the past two years, a number of Lloyd's companies have been bought by overseas insurers, and Kiln was bought for £442m by Japan's Tokio Marine & Nichido Fire in March.

"The company wants us to continue running the business in the same way that we always have and no longer having any external shareholders helps us in this," says Anderson.

So Kiln will continue its policy of small, bolt-on acquisitions and taking holdings in joint ventures to 100%. Having added Belgium's Belmarine Insurers last May, it picked up South African underwriting agency International Marine in January this year. Anderson says Kiln will probably review more outside opportunities.

"But Tokio Marine regards access to the Lloyd's market as fulfilling one of their key requirements. It certainly fills a gap for them and offers significant opportunities thanks to the many licences that Lloyd's holds."

Graham Buck is a Reporter on *The Treasurer*.
editor@treasurers.org