Allianz

Reinsurance: reshaping for a difficult future

Senior executives met to discuss how the industry can rise to the challenge of accelerating change at the Intelligent Insurer and Allianz roundtable at SIRC 2019 in Singapore.

Attendees

Amer Ahmed
chief executive officer
Allianz Re

David Flandro
managing director analytics
Hyperion X

Michael Fung
chief executive officer
TigerRisk Asia

Kenrick Law
regional chief executive officer
Allianz

David Lightfoot,
head of strategic global advisory, Asia-Pacific and Latin America, Guy Carpenter

Hemant Nagpal,
director,
RMS

Siew Wai Wan
senior director, insurance
Fitch Ratings

Hui Yen Tai
regional director analytics
Willis Re

Moderator: Claire Churchard
deputy editor
Intelligent Insurer

The world is in a state of accelerating change, from technology to politics to the changing climate and more. Global reinsurance is at the forefront of these changes, and a roundtable of senior executives met to discuss the forces shaping the future for the industry at an *Intelligent Insurer* roundtable, hosted by Allianz in November at the SIRC 2019 event in Singapore.
Host Amer Ahmed, chief executive officer of Allianz Re, said: "We're in a world of such rapid and significant change on the ground, we need to be considering what implications that may have for us as an industry.

"You can look at it from many levels, from a macro level and in terms of environmental and climate change, societal and political change. Something we underestimate is the influence the re/insurance industry can have in shaping some of how this plays out.

"We've already seen the influx of capital over the last decade from traditional and non-traditional sources, which is challenging us to do things differently and better. That can be in terms of better expense management, bringing more value, making sure that there's not too much frictional cost.

"We are often continuing to fight over the existing pie, while we need to be broadening that pie.

"If we're talking about the protection gap, it's not so satisfying if we see how much of the economic losses around the world are uninsured. One has to ask what are we doing and what should we be doing given our role in society?

"There are some tremendous challenges but also significant opportunities for us to step up. But that means a different approach and mindset for how to approach and address these issues."

David Flandro, managing director analytics at Hyperion X, said: "There are macro fundamental issues that are changing quite a lot, and I would say 2019 is the year in which we have reached something like an inflection point.

"The inflow of capital—we had about $80 billion of capital come into the reinsurance sector between 2012 and 2017—is still there but it seems to have reached some sort of saturation point, at least temporarily.

"That's creating a change in the way that reinsurance is priced and we're starting to see that coming through, at mid-year 2019 and then at the end of the year, driven not least by cession rates going up and reserves getting worse due to social inflation in the US and elsewhere."

Climate change

The years 2017/18 were the worst two years on record when it came to the insured losses paid out by public and private insurers, said Hemant Nagpal, director of model product management at RMS, pointing to losses of more than $220 billion.

He said: "2018 was big for Japan. Jebi was a major event, then there were two events in 2019 as well. Everyone is on the edge even in the insurance-linked securities (ILS) market.

"Climate change is a clear and present danger. The thing to be cautious about is whether the current models can account for climate change. If you go back to 2004/05, four events hit the US in 2004, then in 2005 there were three events.

"RMS introduced what we called the medium-term events which were forward-looking five years rates. Then there was no Florida hurricane for the following 10 years after that, and public memory is short-lived."

Flandro said: We've been talking about climate change for 30 years now. But as Hemant just mentioned, 2017 and 2018 were the largest insured consecutive property catastrophe loss years on record in real terms.

"We're going to have a $300 billion loss year soon. I don't think 2017 was abnormal in any way, I think it was actually a perfectly normal loss year in long-term, statistical terms. So, I'm not sure if it's due to climate change or increased insurance penetration or increased property values, but we are definitely seeing bigger insured and reinsured losses."

On the situation in the first half of 2019, Nagpal said: "We talk about the years with big losses but you have to look at the first half of 2019—it's been the lowest economic loss in 10 years. It was much below the average: you're looking at nat cat of about $40 billion, while the average for the past 10 years is about $100 billion-plus.

"There are different perils which we are already very confident about quantifying the effects of climate change. Something like sea level rise can be measured, then flooding, and increasing precipitation which leads to higher flood losses.

"But if you go down a confidence level, you might have something like severe convective storms. There are various micro and macro factors at play which we are still trying to understand.

"With climate change, what used to be a 100-year event is now a 25-year event. But being in the industry in Asia for so long, you struggle sometimes to explain the return period to people.

"Previously, the question you were asked was 'how can you have two 10-year events in one year?'. Now the question you get asked is 'what is the loss return period on this recent event, and on what basis?'.

"With climate change, products designed for 100 years might actually offer much lower protection. So the market—insurers, reinsurers, brokers and vendor companies—has to realise that we have to bring this into the discussion. Of course there are many properties that could be underpriced or underinsured, and the risk could be too high."

Flandro added that economics are driving a shift in behaviour, particularly around climate change.

"You see investors and funds saying they're going to divest from coal, and that's altruistic. However, I don't think the problem is going to be solved with good intentions because global markets are large and profit-driven, and will offset what they see as inefficiencies.

"For example, reinsurance property catastrophe rates since 2005 have done almost nothing but go down. That is, on its face, contradictory to climate change trends. This being said, one thing we are now being asked by clients is 'can you quantify for us how changes to assumptions, even at the fairly discrete underwriting level, if I have a property that's on the coast and flood-prone, how can I adjust cat model outputs to see how climate change might affect this property under different exposure-based scenarios?'. People are beginning to think about this at a commercial level.

"Another question funds are considering is 'does this affect my return periods, is it in the tail, or is it closer to the middle of the curve than I think?'. Clients and investors with property portfolios, bank portfolios and other types of commercial portfolios, aviation, they're starting to ask these questions.

"If we, as analysts, brokers, and underwriters can quantify that and say 'yes if we make these assumptions about climate change you're more exposed than we thought', then the cost of risk goes up.

"Then the market starts to think about the alternative ways of doing business which are more climate-efficient and not driven by altruistic intentions any more, it's driven by economics and that is where we have to get if we're going to solve the problem in the long term."

Michael Fung, chief executive officer at TigerRisk Asia, said: "With climate change a lot of tail risks for many countries are held by governments. There's a role for the private sector to play here because we as an industry are very good at assessing the risk as well as underwriting it.

"By reducing the amount of exposure to risk, by helping government manage risk, we can contribute to society."

Technology

It is widely acknowledged that technology is transforming the re/insurance sector.

"Looking inwards, I think the industry is going through a period where companies

want to change and are investing in innovation in many areas of their businesses," said David Lightfoot, head of strategic global advisory, Asia-Pacific and Latin America, at Guy Carpenter.

"If we just look at the digital nature of the business, the way we ingest, validate, augment, and consolidate exposure data is all changing as there is new technology for each one of these pieces.

"The industry is investing in tech not only to make processes such as these cheaper, but also to provide better information to management and to its customers.

"Looking outwards, with about 85 percent of total assets of companies in the S&P 500 associated with intangible assets, and our insurance products primarily geared to cover fixed assets, there's not just a protection gap—there's also an insurance gap.

"The good news is the industry is making progress narrowing this gap with cyber, contingent and non-damage business interruption, supply chain and other products.

"Increasingly this gap is going to be addressed not only through financial risk transfer products but also by supporting customers in risk mitigation. So the industry is starting to look forward in a more holistic way that will help its customers protect themselves with respect to the digitisation of their business."

With new technology comes a fresh opportunity to access data, particularly as so much of it is digitised. But, said Flandro, accessing the data is not that simple.

"We need better data in our sector, and we haven't talked about that enough. We have to have more data ubiquity, more homogeneity, it has to be democratised, people need to be able to use it to trade like they do in every other financial sector that I know of.

"I sometimes feel our sector is where the options market was in the 1970s.

"Almost every contract is bespoke, everything is done over the counter. We do have exchange-traded products and ILS but that part of the equation has to grow. This will help us price risk more efficiently and the next frontier could include wildfire and cyber risk, for example.

"But we have to have the underlying data to be able to do that. We've been talking about data and electronic trading in Lloyd's for the last 15 years or so but if we are going to change the way we trade and price risk for the better, we have to build the datastreams.

"The technology exists now where it did not 10 years ago. We will build this with artificial intelligence and algorithms and big data."

Nagpal added: "The insurers have data, we have seen it, but it may not always flow up the chain. Japan is an example, everybody still works on data from the prefecture level of jurisdiction and administrative divisions.

"Given that Japan is so technically advanced why is its data still restricted to prefecture level? That is a question the reinsurers need to ask their cedants, the primaries. It could be because data systems are old, therefore you can put data in but it is much more difficult to take it out."

Lightfoot said: "There are many different ways of using data, so companies are increasingly evaluating the granularity and type of data needed for the decision being supported and then reviewing the cost:benefit of acquiring that data.

"An old example would be after 9/11 when there was an increased understanding of the importance of measuring the risk of casualty cats but more data was needed to better understand this exposure, and companies relatively quickly sought out and found the additional data."

The democratisation of data is another change that could help the industry be fit for the future.

Ahmed said: "We've been doing some work in Vienna where there's a publicly available database of all properties in the city to quite a low degree of granularity. Currently we, as a sector, ask the customer to provide information and it comes back patchy.

"Every insurer is doing it. With the Vienna example, there's a single source where you can go, you can access the data, it's higher quality and validated to some degree, and you hassle the customer less.

"It's quicker and is going to be cheaper and more efficient and standardised. When you start thinking like this you could sit in Vienna and price every property almost with these risk factors, how powerful is that?"

He explained that the system was started by an authority in Austria decades ago. "There are other sources in private companies who are trying to put some of these things together in different markets. It's very interesting, it's harnessing technology and standardisation which will make our jobs more effective."

Lightfoot added: "The use case for investing in tech to democratise data is becoming more powerful. The cost of data storage is down, the algorithms and different software packages to mine data are more understood and many companies are investing in data scientists.

"Where we were 10 years ago is very different from where we are today."

Flandro is also positive about the role of data for reinsurers. "There is a business case for providing the data and it's a commercial business case. In terms of breadth and depth, there are two places where the breadth and depth of data exist where they can be shared.

"Those places are in the brokers and in Lloyd's. That is where it will come from and that there is a good business case," he said.

Siew Wai Wan, senior director, insurance, at Fitch Ratings, said the democratisation of data will help Asian markets in the future.

"I think of the Asian markets as developing markets and developed markets, which face different problems. In the emerging markets which are more catastrophe-prone, there could be companies who are challenged with limitations in gathering comprehensive data to build an appropriate catastrophe model for risk transfer and protection.

"Things have evolved gradually—it takes a lot of resources and risk management initiatives and efforts on the part of the companies themselves to revolutionise the traditional systems they have.

"That's probably a big challenge for at least the developing markets in Asia-Pacific."

In addition to the future role of data, some in the industry have raised concerns about the threat to re/insurance from tech disruptors. But this threat may be overstated, according to Lightfoot.

"Insurance is a hard industry to disrupt with new tech entrants because regulators are in place to support insurance choice and steady capacity at a fair price," he said.

"It seems the insurtech community is realising this and now are often trying to partner more with established insurance companies to improve their operations and products and who, in turn, can work with the regulators to introduce innovation in a collaborative way."

On the development of innovative products, Fung said: "As we've become better with data and technology, capital investors are able to understand climate risk more and they can support our industry to help mitigate this risk.

"The whole distribution of insurance is going to change as well, so technology is bringing the original risk closer to insurers. As brokers and intermediaries that is going to impact our industry. We need to be more innovative as brokers."

The protection gap

The protection gap in re/insurance is widely recognised with many in the industry working to address it, but forces outside the industry, such as governments, regulators and other future concerns are driving greater moves to close the gap.

Willis Re's regional director of analytics Hui Yen Tai said that with the protection gap

there is a lot of thought focused on certain risks such as cyber and climate change and having discipline around them.

"Climate change momentum is really coming through and we may need to frame the whole conversation under this umbrella because of it. With regulators, such as the UK Prudential Regulation Authority for example, having these conversations now and compelling companies, banks, financial institutions, insurers to put a price, or to start that process of putting a price, to the risk and capital associated with it, that could permeate further," she said.

"I would expect other regulators to start having the same conversation. It wouldn't be the first time that regulators in this region watched the development of others and did exactly the same thing.

"Regulatory changes and steps taken by the government compel the industry, beyond insurance, to properly consider end price. And if there is a cost to these risks, then people will start looking at it and change."

Asked what other catalysts are in play, she said: "So much of the discussion comes back to sovereign government and public policy. And that's not an easy conversation, because when we speak to governments and non-governmental organisations (NGOs) it is a different language altogether.

"It's a whole new world, and equally in reverse, re/insurance risk transfer:risk reward is also a whole new language for them. But that engagement is so important to move forward.

"It's only in the last couple of years that I personally have started to see a bit more momentum, and still slowly, but having more players talking about it we could then move faster to bring about change collectively, for example around tech and data.

"There are platforms now, which could benefit from more participation and stakeholders. There are a lot of conversations happening in the UK, and in Europe and the US, but we need to talk about the protection gap in Asia.

"It is the governments in this part of the world that will need to have the confidence and political will to get anything done."

Ahmed said: "In terms of getting government involved, it has to start earlier, engaging with the key actors in terms of planning and government policy. It's not so good if somebody builds on a flood plain and then you come along and say 'we're not going to insure it'.

"That's where the industry has a bigger role to play than we imagine, with what we can do with all the capabilities and analytics we have. We're pretty well placed to help people understand the cost of risk. If they still want to do something that is not smart that's their prerogative, but we should make it clear what the cost is."

Ahmed added that over the last two or three years he had seen much more willingness across the industry for people to put their heads together. "It is vital and shouldn't impact individual intellectual property.

"We have to get this standardisation of data and other tools and assets which make us collectively stronger because some of the issues we have to address are too big for any one organisation in any of the sectors that we operate in.

"Climate change is another area with a lack of focus on the long term. As you go back to your day job, you worry about the short-term things—the next quarter, next renewal, etc—but Rome is burning and we're fiddling on this climate topic."

Ahmed highlighted one of the sessions at SIRC 2019 that made an impression.

"I heard Benjamin Horton, chair of the Asian School of the Environment, Nanyang Technological University, speak. I have rarely heard a more passionate speaker, he was excellent. He was saying that we as a society have maybe 10 or 20 years to stop where we're going.

"We have a role to play which is much bigger than the size of our industry. We have so much knowledge and experience we can bring to the table but it means we have to go

out to the key players and bang on the drum rather than focusing inwardly on ourselves."

Data can help re/insurers drive change, Ahmed said, as people are starting to differentiate between data as a commodity and data that they can use to add value to themselves.

"If we can separate these two things, then we can share and collaborate more actively. The question I have is would this potentially lead to the risk of group-think, for example?"

On the protection gap, Kenrick Law, regional chief executive officer of Allianz, said: "Cyber insurance is a good example. There are products but people don't buy them or understand them and think they're too expensive."

He said that governments can help support change. "It depends on the political system, but it has to be top down and bottom up. It's faster to have a top-down approach, as for example in China.

"Public-private partnership (PPP) is the way around the Asia-Pacific. Government involvement is pretty important because if you look at income level in Asia a lot of countries still have people below the poverty line.

"If you want to get those people properly protected you need to get the government involved because they cannot buy even basic cover. Initiatives in Sri Lanka and Pakistan are working pretty well, but until these people get into the mid-income level you need to have some sort of involvement from the government or a non-governmental organisation."

Fung agreed that PPPs have a role to play. "In terms of PPPs, it makes sense to get the stakeholders together to look at the pre-event finance. These conversations could also look at how a government stakeholder would manage its exposure to the potential risk of climate change, or other risks, and how to mitigate these risks, as well as insurance companies paying loss claims after the event. Everything should be in the conversation between stakeholders."

Returning to the topic of the role of investors, Nagpal said: "We talk about resilience and the protection gap but we have to understand that a lot of this could be a potentially negative return on investment for the private market.

"We have one year re/insurance contracts, governments have four or five years or maybe less depending on how stable they are, and you're looking at your profits and earnings coming out every three months, everybody is so fixated on 4 percent, 3 percent, etc.

"We are all on different time scales here and we have to understand that a lot of it could be a negative return on investment. Who is footing that bill, who is actually paying for it?"

"Ratings could help change government behaviour," suggested Ahmed. "We as insurers buy reinsurance to make ourselves more secure, and that is reflected in our credit ratings, so if governments' resilience were credited with a stronger sovereign rating that would have an economic impact on borrowing costs, etc, in this part of the world at least. Would that not incentivise a different behaviour?"

Lightfoot said: "Climate change is a challenge we need to attack from many fronts. Ultimately, the politics will be important to instigate meaningful change through regulations but so is the work the industry is doing to publicise and quantify the protection gap.

"Five to 10 years ago we weren't talking about the protection gap as much as we are today and it's now a board-level conversation. Fortunately, insurance companies, brokers and other enterprises are increasingly working with governments but it's a different mindset working in the public sector than the private sector as it's a longer conversation."

However, Flandro said: "I don't want to be pessimistic, but if you look at it historically, when did we all get serious about terrorism? After 9/11. When did we all get serious about frequency and severity? After hurricanes Katrina, Rita and Wilma.

“We tend to do it afterwards—not always, but it’s just human nature.”

According to Tai, more can be done from the supply side, and more innovation in products too.

“The demand side has a big issue, I don’t think it is just a case of the consumers seeing and understanding the suite of products and saying ‘that doesn’t work for me’.

“They don’t understand what’s available out there to start with, which is a problem in terms of how the industry is engaging and selling and emphasising these products available.

“However, risk transfer is always just one part of the entire conversation, and as an industry, we are sometimes too fixated on having just that conversation.

“It’s about control and transfer and mitigation. We need to engage consumers and the public sector in terms of the overall piece, the risk itself and the value of risk, then talk about transfer.

“We should focus on the point of insurability. Why are society, and the public and private sectors, not discouraging highly exposed risks to materialise in the first place? Where is that conversation happening?”

Siew Wai said that in Indonesia, where a lot of events have occurred in the past, there is still a wide protection gap.

“People now understand insurance needs reasonably well but a big proportion of the population remains uninsured. This perhaps calls for joint efforts between the government and the industry players to help bridge the gap.”

Asked whether rating government resilience would have an economic impact on borrowing costs in Asia, and whether that could that incentivise different behaviour, he said: “It’s a chicken and egg issue because for a lot of the insurance companies, when it comes to commercial viability, it is a hard battle between do you want to go for a negative return, or do you want to strive more and concentrate on the profitability of your book, so it is a very commercial decision as well.

“As a rating agency covering insurance, we are also looking at it from an additional perspective: environment, social, governance (ESG), which companies are placing greater emphasis on when making investment decisions these days.

“Fitch’s ESG approach fills a market gap by publicly disclosing how an ESG issue directly affects a company’s current credit rating. We are the first credit rating agency to systematically publish an opinion about how ESG issues are relevant and material to individual entity credit ratings.”

Looking to the future, all the roundtable participants agreed that there is a lot more work still to be done, but there was a clear feeling of optimism in the room.

Ahmed concluded, saying: “We don’t have all the answers, but we have a lot of the tools and the will. It’s about working beyond our current scope to engage with many of the stakeholders, and the opportunities are very significant."