REINSURANCE

In the quest to deliver value

L-R: Messrs Bobby Heerasing, Mark Morley, Karl Hamann, Ashish Jain, Michel Blanc, James Beedle, Kenrick Law and Benjamin Yeo.

Leading up to Monte-Carlo and the SIRC this year, *Asia Insurance Review* organised its annual reinsurance roundtable discussion with diverse participation from reinsurers, insurers, brokers, a banker and a risk modeller. The theme was how reinsurers can sustain and enhance their relevance well into the future.

Participants felt that with margins compressed in the traditional areas of the business, reinsurers have more impetus to expand their horizons and deliver more value-added services to clients that would further enhance their relevance. But they will have to stay nimble, focused and forge clever partnerships to reap the rewards.

By Ridwan Abbas

Research by McKinsey shows that from January 2012 to June 2017, reinsurers generated a total return to shareholders of nearly 20%, outperforming the insurance industry (13%) and the S&P 500 overall.

The over-performance was partly due to the benign Nat CAT environment during that time; but fast- forward to today and it is telling that many investors view the growth prospects of the sector as rather flat.

In short, the reinsurance sector had a good run for many years but there are doubts as to whether the good times will continue to roll into the future. So one of the main thrusts of the roundtable discussion was how reinsurers can continue to maintain or increase their relevance in the coming years in the face of a rapidly changing environment – both internally and externally.

In taking stock of the present situation, the influence of the capital markets in dramatically altering the dynamics in reinsurance cannot be denied, said Asia Capital Re CEO Bobby Heerasing.

"There is obviously the convergence of capital markets and reinsurance and the blurring of lines. The pressure that has been exerted on traditional reinsurance has been tremendous and that has fundamentally altered the old model," he said.

However, participants recognised that alternative capital is just a fact of life and not necessarily a threat.

PartnerRe Asia CEO James Beedle noted how fast capacity was restored within the industry on the back of the HIM typhoons last year.

"PartnerRe and the class of '93 had physically to build a company in order to deploy capital in the industry. Today there are few physical barriers to the inflow of capital, which happens almost instantaneously," he said.

"Equally, if you look at the areas of the business that consume a lot of capital, such as CAT risk in Florida, that has become very commoditised due to the inflow of capital and consequently returns are no longer as high.

"So as a reinsurer, we certainly look at where the barriers to entry are higher, and where the value-add and expectations are higher, and that is where we can achieve returns and be more relevant," said Mr Beedle.

Diversification and cross-subsidisation

Certainly, the premise for reinsurers has shifted over time and the future is going to look quite different from the past.

Mr Heerasing wondered what the sub-par returns from historically profitable businesses in North America and Europe would mean for strategies in Asia.

"Historically people have been happy to come to Asia and build for the future, because it is strategic, And so we were prepared to take a lower return and we can support it from the margins we are making from the North American and European business. But could that be no longer the case?" he said.

Willis Re Asia Pacific managing director Mark Morley said that reinsurers should critically analyse their diversification strategy, whether it is across regions or lines of business.

"As you move into new business, you need to be careful about moving into low-margin and under-priced business purely in the pursuit of diversification. It has to be quality diversification," he said.

Meanwhile, SCOR Reinsurance Asia-Pacific CEO Michel Blanc believes that reinsurers should build up the non-CAT part of their business.

"I think you can't depend on the CAT line of business to subsidise other parts of the business, so the other lines will become more important too," he said.

Mr Beedle said, "CAT is still very important and remains the biggest purchase for most clients, but are we reaching a point where, for a reinsurer, we are saying CAT has become less important? As mentioned earlier, it's now more commoditised yet it's a class of business which we have to do and which provides access to other lines.

"So will there be some tension there as there's a cost to that capital?" he said.

Diminishing investment returns

Compressed margins for reinsurers have coincided with a sustained period of low interest rates, which has put even more pressure on overall profits.

DBS Bank managing director, global head of insurance Benjamin Yeo said, "We all know that the interest-rate environment has gone significantly downwards, so from a (re)insurer perspective if you don't have underwriting profits you would be hard pressed to use investment income and that would certainly limit options."

AIR Worldwide managing director (Southeast Asia, Australia and New Zealand) Ashish Jain. "One positive thing I've seen, though, is that (re) insurers are proving to be much more resilient against catastrophe risk and to a certain extent credit goes to catastrophe modelling which has helped the insurance industry become more resilient against natural catastrophe risk. You hardly hear about companies going insolvent over the last few years due to catastrophe losses. With investment returns being challenging, the focus is shifting to the underwriting side and companies are looking at optimising portfolios as well as operational efficiencies," said Mr Jain.

A changing landscape

The changing business landscape presents new risks and opportunities for insurers, said Mr Yeo. For one, a lot of traditional business activities have gone online. Also from an Asian perspective, the gravitational push towards China is becoming ever stronger.

"More and more businesses are either setting up shop in China or selling into China, and that would have supply-chain risks that would have to be insured," he said.

In terms of emerging opportunities, cyber remains firmly in everyone's sights, although Mr Heerasing felt that the industry has not fully understood the aggregate nature of the risk.

"If we're honest, all we're doing is catering to the D&O piece of cyber. But how do we manage the increasing connectivity today and the catastrophic nature of what could possibly occur? We may need to look at public-private partnerships or something of a larger nature than our collective balance sheets can provide," he said.

The complexity of some of these risks suggests that the industry has to attract people with more diverse skill sets, suggested Mr Beedle.

"We have to attract people into our industry who are skilled in areas such as cyber, so we will need a recruitment and talent strategy that is different from what we've done in the past," he said.

Meanwhile, Mr Jain believes that having global knowledge about these interconnected risks will be more relevant than jurisdictional expertise.

"There are no geographical boundaries to risks like cyber, supply chain and liability. Given the nature of these risks you are not just talking about one country or continent, and regional reinsurers should take a global view, especially if those lines of business start to grow rapidly."

He said, "Also, I see analytics and modelling not only for managing these risks but to fuel the growth, so that (re)insurers can better understand and have the confidence to write and manage new risks from increasing global interconnectivity."

Staying nimble with a strong value proposition

Given the huge amounts of capital available, it is crucial for reinsurers to develop a strong value proposition beyond that of a capacity provider, said Mr Morley. "You need to know what your value proposition is and you have to be nimble. You need to be able to move capital out of low-margin business into high-margin business."

Mr Jain concurred, saying that "the focus for reinsurers is about value proposition, what non-price value can they add to their customers because having good products and good service is a given these days."

Elaborating on the same point Mr Beedle said, "Clients invariably now want to have a deep relationship with

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five or six reinsurers. The next tier would be another 10 where there is a meaningful relationship, and the rest are just partners seen perhaps once a year. To be successful as a reinsurer, I think you need to be in the top tier where there is a deeper relationship and to get there you need to have a clear value proposition.

"A reinsurer's value proposition has certainly changed over time. How you frame that proposition is an individual choice for each reinsurer, but once you've set it, you have to commit and deliver."

A recent report by Moody's suggest there is more evidence of tiering in the EMEA reinsurance markets, with the gap widening between the top tier, larger, and more sophisticated reinsurers, and the lower tier.

This could be driven by various factors, such as larger cedants preferring large reinsurers who can handle their entire reinsurance accounts across all countries and product lines. In that regard, there will always be room for the larger reinsurers on a panel. For companies outside of that top bracket, the onus is even greater for them to articulate their value proposition to ensure greater relevance, said Mr Morley.

"Clients would want to know to a fairly granular level what your value proposition is, and if the answer to that is capacity, scale and price, then it's going to be a short conversation. What our clients are seeking are partnerships because they are desperately looking for diversified streams of quality income and they know they can't do it on their own.

"One of the ways they can access that business would be through reinsurance partners, and that represents an engagement opportunity for reinsurers who have a well-diversified base," he said.

Synergistic relationship

In the search for a value proposition, Allianz Re Asia CEO Kenrick Law believes that data could potentially be a differentiator going forward.

"Cash won't just be the only king. There is data too. At Allianz, we are trying to centralise our data because we have lots of data around the world and they are not always fully utilised. And so the data and knowledge aspect that reinsurers can provide is going to be important."

Taking up this point, QBE Insurance (Singapore) CEO Karl Hamann said, "Insurers need the scale to build pricing models. When there is no scale, there is perhaps not as much rigour because it's a law of large numbers. So reinsurers hold a lot of data and insurers can leverage that to build more sound and robust pricing models."

Although with some of the emerging risks, there is limited or no historical data, and therefore technology will play an important role to solve some of these data problems, added Mr Jain.

Meanwhile, Mr Heerasing believes that reinsurers are stepping up their engagement with clients a lot more than in the past where it used to be "a very broker-led conversation when it comes to meeting clients' needs".

"Reinsurers are now actively seeking out and building those client relationships, not just meeting them once a year. There is more work being done on the segmentation piece, finding out how can I be more relevant to you and I think we'll see an acceleration of that in the coming years," he said.

Reinsurance to manage volatility

One area where reinsurance may increasingly have a bigger role is as a capital management tool, said Mr Law, citing the example of Allianz leveraging reinsurance capital to bring down its cost of capital.

Mr Beedle said, "We see the appetite for volatility for many of our clients diminishing, which is a good thing because as reinsurers we don't mind taking that on. And that volatility is not just Nat CAT, so the need to understand the broad range of risks within a portfolio, together with a lack of appetite for huge volatility, and you get people buying covers in different ways."

Regulations certainly feature prominently as organisations mindful of conduct risk are simplifying their business, sometimes even withdrawing from certain markets.

"Insurers don't want to show up at the half year mark and tell their board that by the way we have this CAT and it has cost us $250m on our balance sheet. We want to be able to give guidance and with reinsurance where it is we'll be opportunistic and tend to buy more and keep less risk to the balance sheet, and if things change we'll maybe take more risk through the cycle," said Mr Hamann.

Working together

In future, Mr Law said the market was still growing and is big enough for all, although the focus should continually be on expanding the market and getting more risk to be insured.

"We have to work together as an industry to create more opportunities to make it more sustainable rather than fighting over the same pie again and again."

Picking up on the theme of collaboration, Mr Beedle believes building strategic partnerships both within and outside the industry will allow companies to create greater value.

"We have seen a number of industry and non-industry partnerships formed in recent years to establish new carriers and I believe you will see more of these types of partnerships. However, I think insurance companies will still be our client base with partnerships built around them," he said.

The roundtable discussion was sponsored by PartnerRe.