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‘There will be gaps in cover’ at 1.1 renewals: Allianz’s Chris Townsend

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by Mithun Varkey

While macroeconomic challenges, hardening markets and capacity constraints point to short-term pain, there is still a world of opportunity in the medium to long-term, according to Chris Townsend, member of the board of management of Allianz.

“If you think about the macro picture overall, it’s obviously a really challenging environment right now – you’ve got this sort of trifecta of low growth now globally, rampant inflation, and fast-rising rates, you couple that with a lot of the geopolitical tensions around the world, and it all underpinned by climate change,” he told InsuranceAsia News.

“Our house view is that it’s going to continue to be a challenging environment, definitely through the northern winter, into the first and second quarters of next year,” said Townsend, who as a member of the board of management of Allianz is in charge of global insurance lines, including AGCS and Euler Hermes (Allianz Trade), Reinsurance, Anglo Markets, Middle East and Africa.

“As you go through this transition, I think there are really good opportunities on the asset side of the balance sheet going forward and there will be opportunities in terms of M&A,” he added.

Townsend thinks that with the upcoming renewals, “there will be gaps in cover because there is an imbalance between supply and demand” and that the renewal cycle will be delayed.

“Reinsurers have been saying, get in early there and get it done quickly, there is only so much capital. But when people come forward, the reinsurers aren’t actually willing to commit now because many of them haven’t got their retro protection in place and it will push to a later renewal cycle,” he noted.

From a macro perspective, the strengthening of the dollar has had an impact, particularly on some of the emerging markets in Asia Pacific. It has put a strain on governments’ balance sheets, which will have an impact as well.

“You’ve seen it in terms of the return periods – some of the insurers have been managing to buy protection for one-year and two-year periods, which is way too low, and it’s appropriate the reinsurers will push up those attachment points now to something more realistic.” Chris Townsend, Allianz

While the dislocation in the market is driven by a lot of these macro factors, there are some nuanced and specific issues on the reinsurance side that are affecting the industry.

“There have been poor reinsurance results for five years, and the inability across the sector to cover its own cost of capital. That’s got to change. Shareholders won’t put up with that in the longer term,” Townsend said.

“So, it’s perfectly fair for reinsurers to be able to ask for a rate that is commensurate with their ability to make a return on their cost of capital,” he added.

Changing dynamics

One key area is that reinsurers will be looking for hard data in terms of how carriers are managing inflation. Insurers will have to show reinsurers how they are amending the structure of their own programmes to deal with it.

"If you can't show by line of business, and by geography, which index you are using, what's driving inflation, and how your prices respond? I think you'll get appropriately punished for it. Because if you have gaps in your data, the reinsurance will make up your own mind. And it won't be pretty," Townsend said.

"So long as you can articulate that clearly and you have an appropriate change in your programme to reflect some of those factors and you can explain it, it will be less of an issue."

Inflation will also push up the attachment point relatively, away from some of the first loss areas, Townsend noted.

"So, you've seen it in terms of the return periods – some of the insurers have been managing to buy protection for one-year and two-year periods, which is way too low, and it's appropriate the reinsurers will push up those attachment points now to something more realistic," he added.

Also, on the retro side, which is a key driver of reinsurance, there's no new capacity, and most of the market is pulling back significantly.

"The ILS market in the last few years has been challenging. It's a brave fund manager who will in this era of climate change deploy new money in insurance. It's really not going to happen at the moment until you can get some consistent and predictable returns," he said.

Meanwhile, (re)insurers also have a challenging environment managing the asset side of the balance sheet. "There was a decade of free money, that's gone, we're done with that," Townsend said.

The positives
However, it isn't all doom and gloom, especially in Asia Pacific, where the underlying factors such as underinsurance remain — with the pandemic in fact highlighting the protection gap.

The transition from government to the private sector is continuing, and dealing with pensions, health, the young population and urbanisation — all those factors are the same as before Covid.

"So, in the medium-to-long term nothing has really changed," Townsend said. "I think there's just a world of opportunity out there. So I'm actually pretty optimistic medium to long term."

Though retro capital is hard to come by, especially with Hurricane Ian expected to trap a lot of the capacity, Townsend said the impact is going to be only in the short term, pointing out that while reinsurance capital is about US$650 billion, insurance companies in the US alone have surplus capital of US$1 trillion and Hurricane Ian is not going to impact that.

"Hurricane Ian, whether it's a US$40 billion or US$50 billion loss, will be an earnings event, not a capital event for most companies," he said.

Evolving market

At the heart of the reinsurance industry's challenges has been climate change. The rising frequency and severity of nat cats is in some ways reshaping the market. With several players pulling out of property, especially the lower layers, reinsurers seem to be content with writing more casualty and specialty business.

Townsend said: "Now you have a situation where reinsurers are willing to trade – they will write some nat cat for you so long as you can give them the liability. Whereas five years ago, it was completely the inverse."

While he is upbeat on the liability market, he noted that some global carriers with US exposure, face issues with social inflation and there have also been large pay outs from some "nuclear judgments" recently as courts get back to work post-Covid.

"I think they are getting the appropriate rate right now, but there is some pain to come in the market from prior years," noted Townsend, adding that "there are some challenges in some of the back books . . . like [the] 2013-18 years, there's some work to be done in terms of how those years will develop".

On the property side, "you're seeing some move to single named perils rather than a blanket cover and they're not picking up some of the secondary perils", according to Townsend. "You see that in any normal market cycle: cover expands in a softening cycle and retracts in a hardening cycle," he added.

Specialty lines, he said, has been a very good play for direct carriers over the last 18 months. A lot of that is driven by the need for energy infrastructure, which has a significant demand for risk capital.

"There will be significant investments in terms of the whole transition through to net zero, literally trillions of dollars being spent around the world, which needs insurance capital to support it. Both of those sectors will rely on the specialty market. So I think there'll be good demand for specialty products going forwards," he added.