Reinsurance Challenges And Opportunities Of The Future

By Marianne Lehnis

As the reinsurance industry enters a new era marked by shifting inner dynamics and fast-paced changes to macroeconomic conditions, industry experts have outlined the unique challenges and opportunities shaping the market of the future, naming key long-term determinants as demographic shifts, government policy decisions, macro-economic variables and technological innovations.

Technology, life insurance and a potential revival of macroeconomic growth represent major growth areas, while growth deterrents include low-interest rates, geopolitical and macroeconomic uncertainty, changing talent requirements, and climate change placing a question on the industry's long-term viability.

New technologies such as blockchain enabled smart contracts, could rewrite entire industry processes and transactions, creating more efficient business models and new platforms for reaching clients.

The full potential of these new integrated ecosystems and technologies is yet to be unleashed, as the industry rolls full-steam ahead into the fourth industrial revolution that is bound to make reinsurance available to an ever-increasing proportion of global clientele.

The global reinsurance sector's IT spending has been steadily increasing in response to the opportunities being unveiled with the rise of AI and blockchain, growing from $132 billion in 2011 to $185 billion in 2016, according to Ernst and Young (EY).

And if AI and blockchain have the potential to exponentially multiply the capabilities of reinsurers, it is emerging markets that hold the promise of a shifting demographic on a scale large enough to grab hold of the industry's improved possibilities.

While the saturated developed markets remain sluggish and intensely competitive, reinsurance growth is being driven by emerging markets with life insurance as the key demand—making this the line of business widely recognized as having the most potential for expansion.

Driving this demand for life insurance is a fast-growing customer base—economic growth means there's an emerging middle class which, EY said, "would open up opportunities for protection, savings and health."

Middle class growth has increased life expectancy—spurring demand for retirement and other longevity products.

In the life sector in 2016, China was responsible for much of the premium growth, contributing 2.4 percent of the global 2.5 percent growth in premiums, with the remaining 0.1 percent coming from all other markets combined, according to Swiss Re Institute's latest sigma study.

"The emerging markets will likely fuel improvement in life premiums in the coming years, with China and India being the main growth drivers. Non-life premium growth is expected to remain moderate, with stronger economic activity in the advanced markets supporting momentum," Swiss Re said.

Slowed growth in advanced economies was the main driver of reduced global insurance premium growth in 2016, although emerging market growth did contract in some areas as well.

It's clear that emerging markets, and in particular China, is driving much of the life and non-life global insurance premium growth as the China "growth engine steams ahead" with the country boasting the world's third largest insurance market in 2016, in terms of total insurance premiums written, compared with a ranking of 16th in the year 2000.

Additional opportunities for reinsurers are expected to emerge as governments come under fiscal pressure and take measures to "reduce social security obligations creating demand for private insurance and wealth solutions," creating a secular bear bonds market as "there are signals of this shift happening, which would open up opportunities for insurers," said EY.

The U.K. may be a prime example of this, with U.K. pension risk transfer to reinsurers predicted to reach £700 billion by 2032, according to Hymans Robertson.

Around one-third of current defined benefit (DB) pension risk schemes are expected to reach self-sufficiency over the next 15 years as UK firms increasingly look to offload this risk.

Demand for bulk annuity buy-ins is expected to quadruple over the next 15 years as defined benefit pension scheme liabilities are increasingly being passed onto insurers.

Cyber insurance has been hailed as one of the largest areas of possibility and growth for the industry, spurred by a growing sharing economy and potential revival of macroeconomic growth.

The recent global ransomware attack impacted 150 countries and was felt across a number of industries, sparking numerous debates about the need for adequate, affordable, and effective cyber insurance and reinsurance solutions.

Insurance industry focused cyber-security firm, Cyence, has pegged the WannaCry ransomware attack economic loss at an estimated $8 billion, although insurance and reinsurance protection is expected to cover just a fraction of this.

The WannaCry attack's global trail of losses demonstrated the real risks of systemic cyber attacks—which are set to become an increasing component of business risks and thus reinsurance cover.

The cost of restoring systems after a ransomware event is said to have tripled since 2016, leaving many businesses and reinsurers still unaware of their true cyber risk.

The General Data Protection Regulation (GDPR) to be implemented across the European Union (EU) next year, will provide a further catalyst for the cyber insurance market.

In the short-term, GDPR is expected to drive higher demand for cyber products as tougher data-breach reporting rules lead to many more reported breaches and greater awareness of cyber risk.

Consequently, as more reliable data on breaches becomes available and reinsurers translate this into more accurate pricing models, A.M. Best believes new products will appear on the market further spurring the supply/demand chain.

The opportunities ahead of the reinsurance world are significant, as they ride the promise of the Chinese economic miracle and the transformative powers of AI and blockchain-enabled technologies.

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They could see it catapulted into a future where reinsurance penetration has spread out across a large proportion of Asia, Latin America, and even into far-reaching corners of Africa.

Within the developed market, massive improvements in speed and efficiency of processes and customer reach could see the market develop and grow into new social sectors and segments.

But the potential roadblocks ahead of industry growth are equally daunting; EY analysts noted that "structural growth is mostly restricted to emerging markets, but accessing it is expensive."

It's clear that the world's greatest opportunities are emerging in China, but also that access to this market is highly restricted for non-domestic players.

Low interest rates remain a major challenge, as well as competition from alternative products.

EY said in its 2016 market trends report, that political risks led by unsupportive regime changes in key markets may "prove to be the biggest inhibitors of insurance growth," adding that "the current macroeconomic uncertainty will continue to impact the sector's growth and profitability.

"The rise of protectionism among newly elected right-wing governments may impact global trade and premiums in certain lines."

In addition to geopolitical risks, reinsurers also risk falling behind if they fail to attract talent with skill sets to match the rise of technology, and cater to rising customer expectations—as people become used to simpler and more user-friendly experiences and products.

And while technology creates opportunities, it also poses challenges to lines of business such as motor—where "autonomous cars would substantially diminish motor premium volumes, transforming motor insurance from a personal to commercial line." Cyber insurance modeling also "acts as a bottleneck to delivering more comprehensive cyber offerings."

And looming above all other growth and impediment factors is climate change: EY analyst's pointed to climate change as an underlying factor set to be a key determinant of the future risks covered.

Catastrophe risk modeller AIR Worldwide compiled the latest findings of climate science on the potential impact of climate change to extreme weather, warning of an overall increase in frequency and intensity of severe weather phenomena globally.

AIR Worldwide said the impact of climate change is most evident for inland and coastal floods due to rising sea levels and changes to precipitation patterns: "There is relatively strong evidence in the historical record that precipitation-related quantities including heavy precipitation events, have been increasing."

Flooding is already one of the most costly perils for the reinsurance community and a recent report by AIR Worldwide shows flooding costs are set to skyrocket; it's the risk with the most evidence from climate science supporting forecasts of an increase in frequency and intensity of both coastal and inland flood events.

2017 has already brought South Asia's worst floods in a decade. In Brazil nearly one-third of Southern and Eastern cities have reported a state of emergency from both droughts and heavy downpours. Texas is still submerged by hurricane Harvey floods while one of the most powerful storms in recorded history, hurricane Irma, blazes across the Caribbean.

Although the vast majority of these losses have been uninsured—the question of how the world responds to climate change and increased severe weather events, and whether this will strengthen or weaken the role of reinsurers, remains a pivotal piece of the future's puzzle.

Climate change both shapes opportunity, but also brings the potential to shake the reinsurance industry's survival as it represents hidden and multi-dimensional challenges, often underestimated by reinsurers. ■

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