2018's Most Dangerous Risks for Insurers

By Dave Ingram

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Good risk management requires striking a balance between following the wisdom of the market and relying on your own insights. Each year, you need to look at the risks your company is taking and decide if any of them have become more dangerous than they were last year. Also, if there are any new risks coming over the horizon, they should be moved from "emerging" to a place on the list of "presenting" risks.

The following is a version of that process. We provided insurance industry professionals a list of about 70 risks that we had seen on the risk registers of insurers in 2017. Over 230 people responded and ranked over 8,000 pairs. Over twenty percent of the respondents were actuaries and more than half were from U.S. property and casualty insurers. This was the second time that we conducted this survey, so we are able to garner insight into how priorities have changed since last year. The results of last year's survey can be found at *https://blog.willis.com/2017/01/2017-most-dangerous-risks-for-insurers/*.

We found that insurers' concerns have shifted. In 2017, other than the top entry, cybersecurity and cybercrime, most of the concerns were the usual suspects—the traditional risks that insurers have always faced—pricing, IT, competition, underwriting, regulations, investments, and catastrophes.

For 2018, the responses suggest that many insurer managers (those who responded) are concerned that the industry is now closer to becoming the next victim of the modern wave that has emptied out shopping malls and closed countless book stores. Risks in the top ten now include: disruptive technology and customer needs not served by traditional approaches. And, most notably, there is less confidence in management's ability to find its way through these problems; the risk of strategic direction & opportunities missed moved up from 8th place to 3rd.

So here are the top ten risks from the survey. You can use this list and its ranking to challenge your own list of top risks.

1. **Cybersecurity & Cybercrime** (1st in 2017)
   Cyber has appeared at the head of both emerging risk and presenting risk lists in the past year. Risk managers feel that cyber is a major presenting risk and that it has by no means finished evolving. As insurers grow their business operations to become more digitized, they also grow more susceptible to cybercrime and require heightened cybersecurity. In addition, this operational risk may be on the top because of the heavy news coverage of a relatively small number of major incidents.

2. **IT/Systems & Tech Gap** (3rd in 2017)
   Most insurers that we talk to have just completed, are in the middle of, or, are planning a major systems overhaul. There is a fear, however, that all that IT updating requires a constant and expensive effort to keep up. But, if information technology systems are not up to par, insurers run the risk of not being able to satisfy customer service expectations. This is both an operational risk and a strategic risk: the amount of investment in computer systems is the strategic issue while the successful operation of those systems is operational.

3. **Strategic Direction & Opportunities Missed** (8th in 2017)
   Respondents show a lack of confidence that management can get it right. They are afraid that top management will take the company off in a rush—but in the wrong direction, while leaving valuable options on the table. This is, of course, a strategic risk and its position on this list indicates that respondents feel that top management may be too much in the weeds and not enough in the clouds.

4. **Pricing & Product Line Profit** (2nd in 2017)
   Insurance has always been a business where sales are made and prices are fixed before the cost of goods sold (claims costs) is known. The data analytics revolution ties this risk

firmly to the technology issues. This is an insurance risk and if ever it falls outside of the top 10 risks for any individual insurer, it is a clear indicator of impending doom.

5. **Runaway Frequency or Severity of Claims** (19th in 2017)
Nothing like the highest natural catastrophe claims year to bring about a major jump in this insurance risk. Even if prices and underwriting are just right, bad luck can result in more claims or larger claims than anticipated.

6. **Disruptive Technology** (14th in 2017)
No one knows what it will be, but many survey respondents are sure that someone, maybe Alphabet or Amazon are quietly developing the insurance company killer app. This strategic risk is a fear that is tied very closely to the next risk.

7. **Customer Needs Not Served by Traditional Approaches** (New in 2018)
This is perhaps the flip side of the prior risk. For many carriers, the average age of their insureds and agents/brokers increases by almost a full year each year. They fear that the younger generation does not see much value in the insurance products that have been sold for 50 years or more and do not have interest in a sale or claim process that cannot be completed with a few clicks on their smartphones. Another strategic risk that may be linked to aging of insurer management teams.

8. **Emerging Risks** (10th in 2017)
This risk can be read to mean "We do not know what, but something bad is right around the corner." It may have moved up because of an increasing feeling of ill-defined gloom or the opposite. Emerging Risks may have moved up because there is increasing confidence in management's ability to handle the risks that have been identified.

9. **Competition** (4th in 2017)
This year, insurers seem to fear tech-based takeover over pressure from a traditional competitor. But the risk at position 9 on this survey still beat out 65 other risks. Competition is always a major risk for insurers because of the high degree of price sensitivity of most customer bases along with low barriers to entry. Many insurers are seeking diversification via expansion out of their traditional geographic footprint which heightens traditional competition. Competition is the classic strategic risk of a capitalistic system.

10. **Underwriting** (5th in 2017)
Another classic insurance company risk with falling rank. Insurance risks include pricing, underwriting, claims, and reserving. Three of these still fall into the top 10. Reserving does not, coming in 32nd. So respondents still think that it is of high importance to execute the basics of the insurance business. Reserve risk may be seen to be low because of a relatively long streak of reserve releases. That is one of the cyclical parts of the insurance business and it is surprising that insurers do not seem to think that the recent declines in reserve releases is not a sign that the future potential for reserve strengthening is getting closer and closer.

FALLING OUT OF THE TOP 10

Three risks fell out of the Top 10 in 2018:

- **Legislative & Regulatory** (6th in 2017, 11th in 2018)
Recently completed Federal activity on taxes and lack of activity on the ACA may be the reason for decreased concern about this risk.

- **Natural Catastrophe** (9th in 2017 and 17th in 2018)
The position of this risk in 2018 may be an example of the Gambler's Fallacy. High losses from natural catastrophe in 2017 do not actually drive down likelihood of large losses in 2018.

- **Investment Market Risk** (7th in 2017, 22nd in 2018)
This shift in priority for investment risk seems to match with the markets where securities prices are booming and volatility protection is cheap. Sometimes not a great sign, but as JM Keynes said "Markets can remain irrational a lot longer than you and I can remain solvent."

WHAT TO DO WITH THIS INFORMATION?

Think about how this list and the changes from last year compare to your company's thinking. Are there highly ranked risks here that are not even on your risk register or that have a lower ranking? Are you okay with that? ■

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