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Overview of the 10th IF Seminar—Today's Issues and Opportunities

By Etti Baranoff[+]

The 10th Insurance and Finance (IF) Seminar was hosted by Prudential plc on 4 November 2014. The main topics discussed were the challenges faced by the industry such as low interest rates, alternative capital, regulatory risks, creditors' risks, longevity risks, climate risks and more. Against this backdrop of challenges, the participating CEOs, CFOs, CIOs, CROs, chief economists and outside speakers provided ideas of opportunities for growth. The main features were creativity, innovation, use of technology and benchmarking on the industry's expertise in handling risks.[1]

After welcoming remarks by Anna Maria D'Hulster, Secretary General, The Geneva Association and Nic Nicandrou, CFO, Prudential plc, Mike McGavick, CEO, XL Group and Chairman of The Geneva Association, provided a powerful keynote speech delineating the main issues and opportunities of the insurance industry. His keynote presentation is provided in this newsletter as a guest editorial on page 2.

McGavick's address on the issues continued during the CEOs' panel that was led by Geoffrey Bell, Executive Secretary, Group of Thirty. The panel included—in addition to McGavick—Nikolaus von Bomhard, Chairman of the Board of Management, Munich Reinsurance Company, and Michael Butt, Chairman of AXIS Capital Holdings Ltd. Summarising briefly McGavick's presentation, which centred around the financial sector's challenges and opportunities in general such as technology, climate risk and longevity risks. He provided a drill down into the challenges unique to insurers: globalisation vs national regulation, the rise of alternative capital, consolidation of brokers, big data and analytics, and regulations. The unique challenges for the insurance industry require bigger innovation and encourage and trigger consolidation. As noted in the article, the opportunities lead to innovation in product development and efficient reliance on experts. The discussion of the industry's fundamental rethinking about its role in society flowed into the CEOs' panel discussion.

Continuing the keynote speech, Nikolaus von Bomhard added his perspective regarding issues on the asset side of insurers as relevant investors. He noted that a different challenge is the lack of protection of investors, since "everything is done to protect the debtor, but not to support the creditor these days—rules have changed and tax systems are changed". There is an extraterritorial reach—national governments stretch their reach. These issues complicate the operations of insurers. In addition, he discussed the "re-assessment of behaviour with the benefits of hindsight" in order to prevent the next crisis is a complex challenge for insurers.

Michael Butt added that "finding areas of growth is difficult and giving the shareholders proper return is tough". He believed that a normalisation of interest rates would be helpful. In the area of alternative capital, he expressed concerns about "too much supply against the current demand." Butt emphasised long-term vs short-term capital; economic losses vs insured loss and the fact that only 30 per cent of the losses are insured in the developing world. Even in the U.S., the losses from Sandy were not fully insured; when there is no insurance, coverage is provided by governments.

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[1] The one-day seminar included three keynote addresses and three panels beginning with the view from the CEOs' perspective, followed by more technical views of CROs and CFOs. The afternoon was devoted to views from outside beginning with the intriguing keynote speech by Davide Serra and concluding with a panel of outside experts.

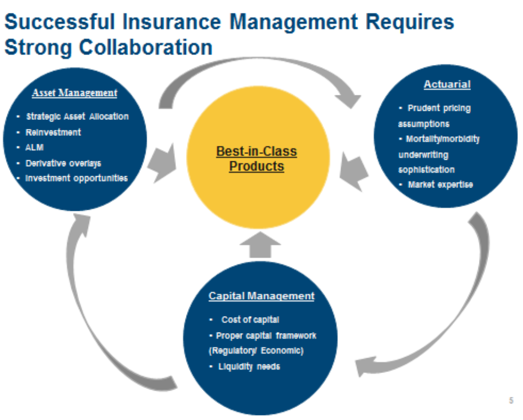
The discussion centred around the enormous pressures on being innovative, since mergers and consolidation are only the third choice when an insurer can no longer find means for growth. The CEOs were in agreement in putting more emphasis on the liabilities side: “Focus on underwriting profits must be number one under the current market conditions and smoother cycles.”

A light discussion ensued about the reach to society via TV on national levels. On a more serious level, von Bomhard addressed the importance of communication on a political level and the fact that now is a good opportunity to gain attention when governments are interested in applying the industry’s expertise in infrastructure and risk management.

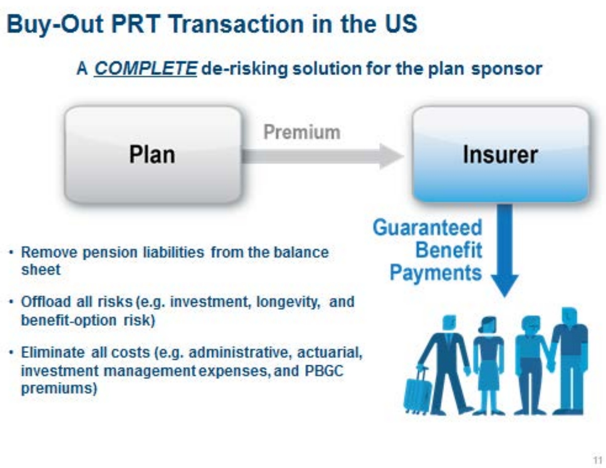
The key lessons learned were “that the art of underwriting is important and is the mainstay of the industry.” All CEOs agreed that now is the moment of opportunity for the industry to provide its unique expertise to governments and, through investments in infrastructure, to create social partnerships.

Following the CEOs session, Pierre-Olivier Bouée, Group CRO, Prudential plc gave the host company address and provided the background to the second session by noting the low interest rates and the fact that being a G-SII was driving unintended consequences for all stakeholders. He too saw the same opportunities with technology and exporting risk management expertise.

The second session of CFOs’, CIOs’, chief economists’ and CROs’ views delved more into the technical aspects of “today’s issues and opportunities.” The session began with Timothy Schmidt, CIO, Global Portfolio Management, Prudential Financial as the first speaker. Schmidt discussed the issues from a portfolio management point of view. For him, the number one risk is the asset/liability matching risk.



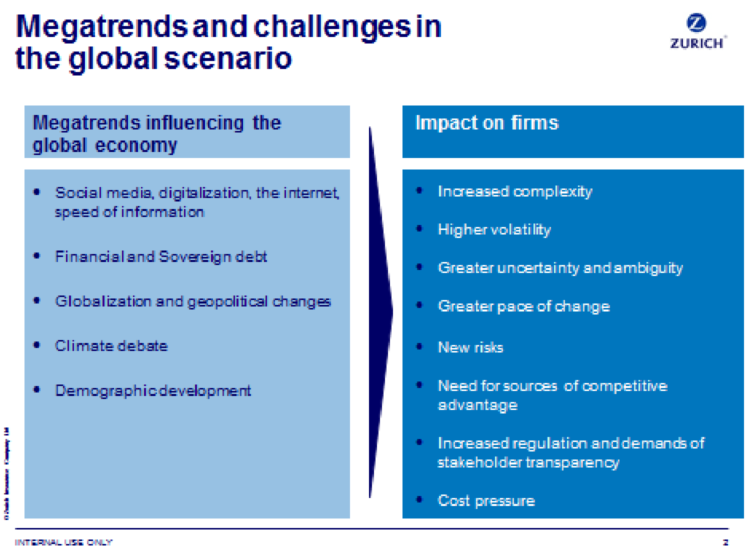
Schmidt noted that “when you get down to risks in the assets originations, work very closely with the products side—understanding the products and product development.” Key is to structure portfolios around the products. The challenge and opportunity is to create the best in class products under the key issues of “treasury rate in the U.S. and low interest rates.” Those have not taken the industry down. In the area of new opportunities, Prudential is in the pensions risk transfers or PRTs with about 4–5 mega deals where the pension provider transfers its liabilities to the liabilities of the insurer.



These PRTs include already retired workers such as from General Motors. The design requires the correct duration profile and asset transfer. Fundamentally, the investment assumptions need to be correct to accommodate the tightness between assets and liabilities.

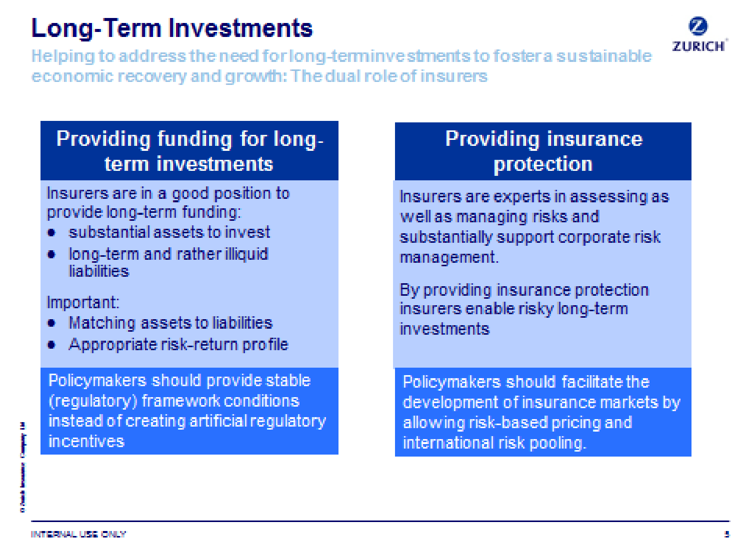
Schmidt also related to Prudential Financial's designation as a G-SII. The company is in discussions with the U.S. Federal Reserve about the designation and the capital needs for higher loss absorbency (HLA). They argue that the regulators should take the reserves into account as they are not marked to market and as long-term liabilities do not require liquidity.

Axel P. Lehmann, Group CRO, Zurich Insurance Group, followed and emphasised transparencies. His central talk was about risk as an opportunity. He covered key challenges with systemic risk designations; new forms of cash flow matching; opportunity in cyber risk, the ageing population and investment challenges. The following slide provides his summary of the megatrends:



The readers are invited to view his full presentation at www.genevaassociation.org/media/908326/ga_10th_if_seminar_lehmann.pdf

In the area of investment, Lehmann called on policymakers to ensure no interferences in insurers' contributions to growth as shown in the following slide:



Kurt Karl, Managing Director, Chief Economist, Head of Economic Research and Consulting, Swiss Re followed with a discussion of alternative capital; claims development on the p/c side was very benign and caused a drop in pricing. His evaluation was that on the casualty side, the industry was in good shape. Such was not the case for the property side with low interest rates and benign U.S. hurricanes. A complete article by Karl is available on page 10. Briefly, he noted that there are expectations for an increase in interest rates. His assessment was that hedge funds would stay and reinsurers would keep providing larger services with the capacity and support in the underwriting, side since the collateralised capital was not providing the expertise. Since loss ratios kept going down, it was difficult to forecast adverse outcomes. As a chief economist, he concluded that "there will be more pricing power in the next 2 years …. as alternative capital reached a limit on the pricing."

Closing the panel was Benjamin Meuli, CFO, Catlin Group Ltd who provided a few insights from his career and his work at Catlin (now merging with XL). The text of his presentation is provided on page 13.

Briefly, he discussed alternative capital and projected that "pension funds will stay". He indicated that "with alternative capital, there is a one-way correlation between catastrophe risk and financial markets … What gets people into trouble is not lack of capital, it is lack of liquidity and those are not twin sisters."

The afternoon was devoted to views from outside. Beginning with the provocative and inspiring keynote speech by Davide Serra, founding and managing partner, Algebris Investments, who gave ideas on two main topics: technology and regulation.

On the technology side, he pointed out the low actual insurers' spending for technology by insurers, while telematics proved to reduce loss costs (see pages 4 and 5 of Mr Serra's presentation).

Serra showed that the "possibilities of reducing claims or losses are massive, and telematics is strong in the U.S." He discussed examples about young drivers in the U.K. and the reduction in claims costs. Insurers are investing only 3.2 per cent of revenues in IT, while banks invest twice as much. Insurers' investments are two-thirds in legacy and one-third in innovation. This system is absolute, since there is no connection to risk management and sales force. Serra noted that Allianz and AXA are far ahead in the EU in investing in technology for analytics and big data. For driverless cars, Allianz is ahead of the game.

Serra's next intriguing challenge was in the area of growth despite regulatory limitations. He called for insurers to become small hubs of venture capital for innovative small firms that are too leveraged and would benefit from equity investments. With such equity, insurers would be giving money into the real economy for growth (see pages 9 and 10 of Mr Serra's presentation).

Serra recognised the limitation of Solvency II on equity investments in the EU and asked "Are EU regulators acting against shareholders/the economy?" and answered that, compared to the U.S., regulators are restricting such investments that are so necessary to grow the EU economy. Serra noted the following:

1) Balance sheets in the EU all look identical; all stress tests are the same; Basel III and Solvency II act as if they have nature on their own.
2) No one is financing their neighbours; everyone is financing the same large companies; insurance should be supplier of capital; insurance should finance more equity in SMEs with local management team or by setting up their own team.

Since everything that is private investment has a 25 per cent risk charge, Solvency II is a barrier to investing in EU SMEs. Serra called for differentials in regulatory charges for investing in local small and medium-sized enterprises (SMEs). (see pages 12 and 17 of Mr Serra's presentation)

The last session was devoted to "Views from outside: Industry's Positioning, Challenges and Opportunities". Mark Button, Senior Director, Standard & Poor's Financial Services Rating, gave a thorough overview of the insurance sector from a rating organisation point of view which is shown in details in his article contribution on page 14.

Bob Hartwig, CEO, Insurance Information Institute followed, and delved into the issues of alternative capital and its ramifications. His presentation is available in the Geneva Association web site. Hartwig entitled his presentation "Capital Punishment? The Challenge of Profitability and Growth in an Industry and World Awash in Capital" and explained how "the global hunt for yield pushed institutional investors into countless new areas—(re)insurance being one of them". During his talk, Hartwig analysed how the combination of accumulation of capital on a global scale and low yields impacted the reinsurance pricing environment. The presentation included many detailed slides that showed profitability patterns and challenges to the non-life industry.

Peter Gallanis, President, National Organization of Life & Health Insurance Guaranty Associations, U.S. (NOLHGA) enlightened the participants with the Choice Theory and the impact on regulations. The seminar concluded with the academic point of view by Martin Eling, Professor and Director of the Institute of Insurance Science, St. Gallen University, who pointed out added topics: 1) the return of the euro debt crisis; 2) managing under the new regulations; 3) adapting the insurance business model. Eling's contribution is available on page 18.

In conclusion, this short overview of the IF seminar provides only a brief and high-level description of the richness of the presentations and the content. For those presentations not included in this newsletter, the readers are invited to consult The Geneva Association web site.