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## Guest Editorial: Global Challenges and Solutions

By Mike McGavick<sup>+</sup>

This is an extraordinary time for our industry, as we face a number of challenges putting the entire sector under pressure. As I see it, they fit into two separate baskets of challenge: the first, challenges facing everyone in the global economy and the second, those specific to our sector. And though different, they can be solved with the a few key solutions.

### Global challenges

First, technology. With technology advancing, risks mutate rapidly. This is where the problem lies—the faster the rate of change, the more challenged our business model is. We're used to long data sets to gain comfort in a risk, but new risks don't have the same length of data associated.

Second, climate change. Many of the claims we're engaged in, are events that happen due to weather and climatic events. With this in mind, we know that there is a simple phenomenon about human beings: we like to live in places where geology is interesting—where the ocean meets the shore, where the river cuts through, where the mountains are. So we see climate change and other distortions as compounding the already fundamental problem that people like to live where geology is interesting and inherently unstable.

Third, longevity. It's obvious that the basic economics of how pension systems are funded have not kept up with our great success in the sciences and the way we have extended longevity. The population designs of the developed world are creating nearly insurmountable pressures and we're already starting to see signs of the same patterns in developing worlds. We have made great progress over decades in seeing that seniors enjoy a better life and now we're under economic pressure that's suggesting in the future they won't.

### Sector challenges

First, globalisation. Any business can operate globally with the Internet, yet insurance mechanisms are set up on a national basis, making it increasingly difficult to create efficient solutions for global clients. This is a tension that exists for every insurer, and the cost of being global burdens the whole system.

Second, alternative capital. The challenge with alternative capital is that it's bent on hollowing out one specific line: the U.S property cat space. The results of this are that people are now seeking how to use alternative capital in other products and situations, as well as searching for new profitable fields while hoping that the alternative capital won't chase them out. There are so many uninsured challenges—hopefully we can bend this capital to come up with new solutions.

Third, consolidation of the broker community. For insurers, broker community control is a great challenge. Though the insurers service the clients and make the products, the control is weighted more heavily within the consolidated broker community.

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Fourth, analytics. Despite being a data-driven business, most insurance companies have poor data systems—this is something that needs to change, fast. We need to harness what this trend can do for clients, or others who have more modern data will supplant us.

Fifth, regulation. So far, the approach that has been taken hasn't been appropriate to our industry—for banks, maybe, but not insurance. With this in mind, there's going to be a lot of change soon resulting in one good outcome and another that's still up in the air.

The good outcome is that regulators are trying to create greater global collaboration, which would help with the previous challenge of globalisation. Additionally, the promises of Solvency II that there would be regulatory deference to group regulators could be very positive for the sector.

The more uncertain outcome involves regulators requiring capital to be held very dearly. Each of the trends just reviewed demand greater innovation, which isn't possible if the price of capital is too high. The more determinedly capital is regulated and inefficiently it's used, consolidation will be encouraged over innovation.

## Solutions

Now, after noting that this is a very challenged world, I want to shift to how we can get past these with a few key solutions.

First, innovation needs to be at the heart of the industry. We tend to develop products slowly, replicate them swiftly, and the profits erode for decades. That pattern can't continue. So how do we get our rate of innovation up?

Number one, we need to assign our best people to the innovation space, not just our most profitable areas of activity.

Two, we need to harness external data in a useful way, because internal data sets are not going to be up to the challenge. That means an underwriting mentality teamed with actuaries and finding public databases and resources to write and reshape products.

Three, take risks that involve adjacency. If we're willing to set part of our resources aside for something nontraditional, then we can really do some breakthrough work.

Four, we have to entice innovative people to join our industry. We need the people who are experts in complex fields to apply their skills in *our* world; their insight is an important factor to future innovations.

The second solution is rethinking our relationship with society, particularly governments. We have to discuss with them what social outcomes we want and how our products can lead towards that social good. Though we may not be used to it, this is a vital approach.

There are a number of major challenges both in the world abroad and within our own sector; however I think that these imperatives are the right ones for pulling us ahead into a new era of prosperity. We must change our approach to innovation and as we do, we must engage in deeper partnerships with governments to create solutions that are large enough for the challenges we face.