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Summary of the 17th ACCE meeting

by Christophe Courbage[+]

On 24–25 March 2015, the 17th meeting of the Annual Circle of Chief Economists (ACCE) took place in Paris, graciously hosted by SCOR. The general theme of the seminar was 'Insurance prospects in a changing risk environment'. The meeting brought together a special group of chief insurance economists and strategists from Members' companies of The Geneva Association to interchange ideas and views on current, relevant economic affairs in insurance. About 15 participants attended the meeting representing Allianz, Hannover Re, Zurich Insurance Group, Munich Re, Generali, SCOR, Swiss Re, the Insurance Information Institute and the Italian Insurance Association (ANIA).

The first speaker was Vincent Lopez, Head of Actuarial R&D at SCOR Global Life, who made a presentation on the theme of pandenomics, addressing the potential consequences of pandemics using the Ebola outbreak as a case study. Ebola is a zoonotic virus, i.e. channelled through animals before being channelled through humans. The virus had huge impacts not only on public health systems, which proved to be highly non-resilient to such crisis, but also on local economies. This calls for the development of universal health coverage, possibly leading to opportunities for the intervention of insurers. Pandemics can be a key concern for insurers and particularly reinsurers, as the weight of stand-alone pandemic risk in reinsurers' balance sheets is particularly heavy. This imposes close risk monitoring and (partial) coverage strategies through mortality bonds. Ebola clearly created protection awareness in regions where institutional investors now count on the private sector to help support the local economy and public health quality development. As demography will be extremely dynamic over the course of the 21st century in these regions, it may be now the right timing for (re)insurers to tackle the need for death/disability/health coverage and associated insurance. This could be done through microinsurance for individuals, group insurance for local firms, and specific group programmes for foreign companies that mostly rely on self-insurance.

The second speaker, Arne Holzhausen, Head of Insurance and Wealth Markets at Allianz SE, addressed the long-term impact of the recent financial crisis on the insurance industry. The legacy of this financial crisis for the insurance industry is fourfold: low yields, secular stagnation, more regulation and a global power shift. Starting with the first issue, nominal interest rates have been falling with trend growth since the mid-70s and recently dropped due to easy monetary policy. High saving (due to an ageing population and an uncertain environment) and low demand for investment (due to risk-averse behaviour, low population growth and possibly the digitalisation of the economy) also explained the fall in interest rates. As a consequence of low yields, the insurance industry needs to look for alternative investment and new product architecture, including those with reduced guarantees. The insurance industry is also confronted with low potential output growth for the time being, which limits the development of insurance markets in many countries and therefore, calls also for innovative and new products, especially in the P&C lines of business. The third issue relates to the rise of regulation whether it concerns risk based capital regimes, conduct of business, globalisation of supervision or convergence amongst the financial industries. This leads to a higher cost of capital, higher barriers to entry, possibly excessive consumer protection and less long-term investment. Finally, a global power shift to Asia and a more multipolar insurance world is developing fast. The outlook for the insurance industry in a few decades could be lower profitability, measured growth, diversified distribution, higher risk and possibly new competitors.

[+] Director, Ageing and Insurance Economics, The Geneva Association.

The third speaker, Roman Lechner, Director of Economic Research & Consulting, at Swiss Re, made a presentation on 'Liability claims trends: emerging risks and rebounding economic drivers'. Due to economic and social factors such as low inflation, low wage growth, tort reform and improvements in medical care costs, liability claims have been lower than expected since 2008. Over the long term, claims growth typically outpaces economic growth, and the expectation is for a return to this more normal growth path, which in turn should push up demand for liability insurance. Redundant claims reserves from prior-year claims have been another factor supporting insurers' profitability in recent years. However, a pick-up in liability claims growth should drain reserves, and an accelerated depletion of reserves in the case of severe claims could erode the profitability of existing books of business. Liability risks are challenging to underwrite and price, due to their long-tail nature, which often results in claims being settled many years after business is written. Insurers need to take advantage of their underwriting expertise to improve pricing. Likewise, they must maintain capital strength to manage the long-tail nature of the business and the rising claims costs, such as those from the growing litigation funding industry. However, new risks and stronger economic growth should increase claims severity and generate more demand for liability insurance. A number of technological, social and regulatory changes will drive liability claims in the near future. Insurers need to innovate to capture market opportunities. With big data and forward-looking models, insurers can perform statistical analysis to better understand the key drivers of risks.

The fourth speaker was André Masson, Research Director at the CNRS, EHESS and Paris School of Economics, who addressed the topic of 'French savers in the current crisis: preferences, financial expectations, and the demand for savings and life insurance'. Mr Masson presented some recent works based on various surveys and scoring methods. He showed that, from 2007 to 2011, there exists an overall stability of risk and time preferences of French households. Preferences are heterogeneous between households and have a significant explanatory power of wealth and portfolio choices. Preferences are formed early in life and depend on the environment, social origins and parents' own preferences. These recent works also showed French households have a lower willingness to take risks in saving and portfolio choices. This is especially due to higher exposure to (background) income risk ('hit by the crisis') and to more pessimistic future income and asset price expectations. The question is therefore to know how to generate more 'enterprising' behaviours, i.e. more risky and long-term saving and investment. It is not easy to change preferences and abilities over the short–medium run. One option is to improve financial education in order to change expectations and understanding, which is limited and often not lasting. Another option is to create a safer and more stable economic environment. This would certainly call for preserving the Welfare State, especially for the elderly.

The fifth speaker, Benno Keller, Head of Research and Policy Development at Zurich Insurance Company, made a presentation on 'Big data in insurance underwriting: boon or bane?'. Big data technologies in insurance underwriting, and especially predictive underwriting, have the potential to become a step change in the understanding of individual risks. The benefit of knowing risk levels is highly valuable in terms of risk mitigation and prevention, as long as the reduction in expected loss exceeds costs for mitigation. Big data is likely to reduce the cost of risk mitigation, e.g. through targeted investments and tailored incentives, and allows for risk-based premiums which provide mitigation incentives. At the same time, there is a regulatory trend towards banning the use of risk information in underwriting. Premium differentiation based on individual risk criteria is increasingly being perceived as 'unfair'. The presentation looked at the effect of banning the use of private information in various insurance markets. Banning the use of gender as a risk indicator for motor insurance is unlikely to significantly reduce welfare, since the cost of adverse selection is low and the benefit of risk mitigation is not gender-related. Banning the use of genetic information in life insurance is likely to involve an increasing social cost, as genetic predisposition may signal high probability and the current cost of adverse selection is low because most individuals do not possess genetic information. Banning the use of geolocation is very likely to be welfare-reducing as the cost of adverse selection is high for non-mandatory insurance and there is large potential from mitigation. Telematics/activity trackers are likely to be welfare-enhancing, as risk is largely driven by behaviour and the cost of adverse selection is low.

Finally, the meeting ended with a presentation from Robert Hartwig, President of the Insurance Information Institute on the topic of 'Alternative capital: impacts on global reinsurance and insurance markets'. The presentation described the many forms of alternative capital, with an overview of the various ways capital enters the marketplace, paying considerable attention to the structure and function of insurance-linked securities, especially catastrophe bonds. It also assesses the impact alternative capital has had on the marketplace. Conclusions are: (i) though the bulk of new capital continues to enter the marketplace through traditional means such as retained profits, alternative structures have become an important source of new capital; (ii) the increase in capital in recent years has contributed to the decrease in reinsurance rates over the past few years, particularly in the property catastrophe business; this may be creating a trickle-down effect into other reinsurance lines; (iii) the emergence of alternative capital appears to be an important factor in a recent wave of reinsurance mergers.

Once again, the ACCE seminar proved to be very useful in addressing the current strategic affairs in insurance and lead to an active exchange of opinions and animated discussions among the participants.