

Meeting Global Demand for Insurance

Meeting Global Demand for Insurance--This is the theme that the IIS¹ chose for its 44th annual seminar, held in the Grand Formosa Regent in Taipei on July 13 through 16. This year's conference drew the usual crowd of insurance and reinsurance executives, as well as academics from all over the world. Close to 500 attendees from 36 countries gathered to discuss the pressing issues of our industry with an agenda somewhat reshuffled to accommodate the current development of the sub-prime crisis and its foreseeable impact on the insurance and reinsurance markets. As could be expected, this year's conference saw another increase of the presence of the Asia Pacific region; the BRIC² countries were all present, even if the Russian delegation was reduced to one!

As with all IIS seminars, the major interest of the speakers is to trigger discussions in which a cross-cultural group of industry leaders can exchange ideas in a very relaxed format in which moderators, both academic and industrial, share the leadership of the discussion. In my group this year, we were fortunate to enjoy the transatlantic vision of a Professor of Finance from Swansea University and the leader of the Tillinghast practice in the USA.

Also parts of the Seminar are the presentations by the winners of the Geneva Association/IIS research awards partnership that take place in the afternoon of the last day. The winners this year include three papers written by academics but, as always, with practical implications for the industry. However, the special edition of the Geneva papers³ contains four papers and Andrew Griffin, principal at Towers Perrins, offers a brief response to the first paper. We will reproduce here only a brief summary of the main findings:

- **Mortgage backed securities and capital of life insurers: Was the industry prepared for the credit crunch of 2007 – 2008?** by Etti Baranoff and Thomas W. Sager

Not only were insurers were unprepared for mortgage backed securities (MBS) downgrades, but also that they reduced capital as they accumulated MBS, as though acquiring MBS should raise the overall quality of their investment portfolio. As might be expected, according to the authors' model, the possible adjustments to capital to accommodate the now recognised increased risk of MBS, depends on its MBS exposure. For example, an insurer with median exposure might be expected to increase its capital by 10% to maintain an historical relationship between capital and risk factors, in the event of a moderate re-categorisation of MBS risk.

In his rejoinder however, M. Griffin, stresses that: *“The current development of enterprise risk management (ERM) tools should help life insurers to better anticipate the complex risk patterns that together created the significant risk revealed in the credit crisis – rising interest rates, declining property values, reduced credit underwriting, and more foreclosures by banks pressed to cut their losses.”*

- **The life insurance market's response to aging: Mega or Mini?** by Gustavo Ferro

With the aging population, the life insurance industry should be soon confronted with a massive decumulation of pension funds worldwide. The industry has a well established product, which is the annuity, a unique instrument to cope with longevity risk. But annuity markets remain thin. To promote a more proactive involvement of the industry in the pension business, by addressing the demand-side, the supply-side and regulatory concerns, the author suggests a Multitier Insurance Package (MIP), which combines different insurance products in order to cover longevity risk as well as bequest or long-term care motives.

- **A new paradigm for international insurance comparison: With an application to comparison of seven Insurance markets.** by Wei Zheng, Yongdong Liu and Yiting Deng

Considering the limitations of traditional methods, the authors from Beijing University propose a new paradigm for international insurance comparison. They have conducted the “aggregate analysis” of the “insurance growth level” and the “structural analysis” of the “insurance growth

¹ International Insurance Society

² Brazil, Russia, India, China

³ www.genevaassociation.org or www.iisonline.org

structure” and taken into account the impacts of economic and institutional factors on the insurance growth under different scenarios. They reach three main conclusions:

1. Under their newly defined benchmark-adjusted insurance growth level (BRIP) that measures the relative relationship between the country’s insurance penetration and the world average for an equal level of GDP per capita, the static growth and the mid-term and long-term growth potential should take into account more specific information.
2. As a whole, the insurance growth in the developed countries (mature markets) is mainly driven by economic factors while in the developing countries (emerging markets) it is driven by institutional factors.
3. As the economy develops, the relative role of the institutional factors in driving the growth of the insurance industry decreases whereas the role of the economic factors rises. In emerging countries, after a period of take-off, its growth will be gradually driven mainly by the economy. Therefore, the insurance industry will have to upgrade its growth strategy to attain a sustainable development.

So, going back to the core of the seminar, what were the most important topics of discussion during the three days’ debate? Clearly, the issues of micro-insurance and the delivery of insurance products to Islamic populations were still high on the agenda of many boards. Hello, I’m French live in the US and will be visiting Portland August 1 to 7. However these topics were covered a year ago in Berlin and once again the IIS demonstrated its leadership in uncovering the main issues early and providing its members and attendees a head start in seizing opportunities.

Also highly stressed was the importance of the market in the Republic of China, and in South Korea, with an extremely high penetration, as a percentage of the National Product. Should it prove that way the other Asia/Pacific countries follow, then clearly the future of the industry is in this part of the world. This trend has not escaped the major global players like AIG, ALLIANZ, and AXA, to name but a few, and their Asian operations are rising both in size and numbers. The reinsurance is following with Swiss Re and Munich re stretching from Singapore as well as more modest players like SCOR.

As anyone may guess, the mega brokers tend to lead the pack, and the auditors and notation agencies are aware of market potential with an increasing attention of the regulatory scrutiny. It would have been tempting to mention the issues around the measure of the solvency of the players, but Solvency 2 might be more advanced in 2009, when the European Union will have a chance to come with more detailed information on the implementation of the directive (including specific conditions for the captives domiciled in the E.U.?) and the international association of supervisors (IAIS) may come with its own framework on solvency as they are finalising their own “ERM Guidance.” The Taiwanese Financial Supervisory Commission has clearly elected to develop risk based supervision. In the meantime, clearly the notation agencies are more and more interested in ERM approach in the insurance and reinsurance industry, making it a major project in all players—far beyond the limits of the E.U. where the deadline is already looming close.: Four years for such a project, as banks have learned with Basel 2, is not too much.

The four following questions seem to be essential for any board with a vision for the future:

What impact is the subprime crisis likely to have on the insurance industry?

The sub-prime crisis is still unfolding, and it is hard to predict at this stage what the ultimate impact on the economy will be, let alone on the Insurance industry. There is even a continuing debate among specialists to determine what the final tally will be for the losses; estimates vary from US \$ 1 to 7 trillion!

However, some lessons must be learned from what may well prove to be a turning point for the global economy, after the “defeat” of communism and the great Asia deflation, and with the end of easy cheap money based on loose monetary policies. Several speakers stressed that the crisis’s main origin

was “greed.” In their race to increase short term return, many operators in the financial markets lost track of the underlying equation linking risk and return and engaged in what they saw as a “free ride.”

In the short term, it seems that the direct impact of the crisis should be limited as the “asset side” of the insurance balance sheets did not seem heavily invested in mortgage derivatives. There remains that some companies may be hurt on the “liability side” if they have accepted to cover for losses from the derivative markets.

There remains an ancillary question: although it may be more concomitant than corollary to the subprime crisis, the surge in most commodity prices will have an impact on insured losses when plant and equipment will have to be replaced following an insured event. The impact on the income statement may be limited if the premium takes into account revised value for the insured sites, significant if the soft market currently being experienced prevents increasing premium to follow the “economy of the foreseeable losses.”

In the long run, however, the insurance industry may suffer from a moderate to severe downturn of the global economy. There is a risk of declining standard of living everywhere; hence, solvent demand for coverage in property and casualty may decrease and the savings available for life insurance also. The increased vigilance of the supervisors and notation agencies may increase the solvency of the insurance companies and the public “safety,” but it may have a negative impact on return on assets.

The general mood among the insurance community could be summarized in a phrase by Frank Ellenbürger global head for KPMG: “...*the perception is that the current financial turmoil does not affect the (insurance) industry, which is good.*”

What are the options for a market strategy for the different markets?

“Innovation is the new currency of competition. It is the key to organic growth, the lever to widen profit margins, the Holy Grail of 21st Century Business.” – Business week June 19, 2006

The world economy is going through a period of turbulence accompanied by uncertainties that bring both opportunities and threats. In such an environment, how does an insurance company plan for strategic growth? Clearly, the only course of action that would not be sustainable would be to wait and see! When stressing “strategic” rather than organic growth and/or market expansion, we open a very complex field with a vast array of alternatives, depending of the maturity of the market.

At the IIS seminar, Sun system came up precisely with a list of questions to challenge the status quo that should be addressed in any market, whatever its level of maturity:

- What is the impact of social computing on our future? How do we handle GEN Y?
- Are customers expecting a new channel experience?
- Should we move the customer experience from simply transactional to one of community participation?
- Can we make doing business with the bank/insurer as simple and as seamless as possible?
- Do we really want to do business with our customers on their terms?
- How can we enrich the customer experience?

They summarize the basic question of Marketing 101: What we should hear from our customers provided we listen? However, undoubtedly, mature markets offer different challenges than emerging markets, and there are regional differences that require specific understanding of cultural, legal, economic differences to ensure sound long term planning and strategic development.

In emerging markets where regulatory environments are continuously evolving to catch up with an expanding market and foreign multinational companies are competing for market penetration, the playing field can be somewhat erratic. In the end, if the long term success of any player rests in his

clear definition of tailored growth strategy, it is even more dependent on a precise and careful execution.

One of the speakers went so far as saying: “*insurance is all about execution.*” In fact this is probably mostly true in emerging markets with growth potential in the double digits in the foreseeable future; hence the major importance of quality service and quality staff.

For the mature market, the question is to set reasonable goals, as market share has to be gained over competition, or other financial services. At the end of the day there are a limited number of strategies available in these markets:

- **global player**, if you have reached the size that allows playing in all market segments;
- **scale player**, be the major player in one or two specialties to have a significant impact;
- **diversified player**, (customer segments or geographical) to ensure best portfolio balance and avoid catastrophic losses;
- **niche player**, especially with innovative products and or processes.

What are the insurance needs for an aging population?

Sherry Manetta, director at Conning Research and Consulting, calls for the industry to innovate to answer the needs of the baby boomers entering the retirement era. “*The industry is at an inflection point. There needs to be an emphasis on what impact the impending retirement will have on the marketplace.*”

The industry must address the concern the baby boomers have about the longevity risk of the pension funds, whatever their structure, financing mechanism - repartition or capitalization- and nationality. They want a regular income stream, the ability to leave money to their heirs and the flexibility to have their funds available to pay for other needs such as long term care.

However, the insurers are not just competing with each other for market shares; they are also competing with banks and mutual fund companies. In some respects, the competitors enjoy a favourable competitive environment, at least at the regulatory level in the US, when they can create structured pay out products where the reserving regulations are more onerous for insurers.

Therefore the burden is on the insurer to come up with the right product structure to meet the needs of retirees, sometimes to balance them in that they may prove contradictory. How well they meet those needs will determine the market share they can win from the competing industries. However, it will fall on the legislators to create an optimal regulatory environment and appropriate incentives.

Some changes to guaranteed benefit products in the USA are addressing some of those fears. New guaranteed minimum withdrawal benefits products are being developed that provide the policyholders with the assurance that their ultimate withdrawal will be no less than the initial investment.

The last real evolution for the insurance market seems to have been the introduction of service access in case of an event, rather than a financial compensation for losses. As a baby boomer myself, I would feel far more protected by an assistance-like product guaranteeing my long term care, should I become dependent. Long term care facilities coupled with coverage could prove a more profitable investment for insurance companies than office buildings.

How can the insurance industry attract the competencies it needs in a highly competitive talent hunt?

When considering long run strategies, i.e., a 7 to 15 years horizon, this may prove to be the crucial issue facing the insurance industry as the Y generation will clearly be in hot demand and talents may not find the insurance their first choice when so many industries will try to attract the best.

This issue of human capital remains at the forefront of C'suite and boardroom priorities and constitutes probably the greatest asset in most companies. However, with the pappy boom generation reaching retiring age, and even if we assume that many will work well past the "generally accepted retiring age," they are confronted with the challenge of developing key leadership and a skilled team. If the challenge is more immediate in emerging markets where the demand for proficient distribution teams is fuelled by a tremendous growth in the demand for insurance coverage, particularly in the life sector, the talent squeeze is looming also in mature markets. Specialised and technical talent such as actuaries, risk specialists, underwriters, and claims managers are also in great demand, no matter the level of sophistication of computer based processes.

However, if all the panellists on the topic at the IIS meeting agreed that talent management is a definite priority for CEOs, there was not a consensus on whether retention of existing staff or recruitment of new people should be a major priority in a highly dynamic and competitive environment, especially for the time being in the ASIA/Pacific region or the BRIC countries.

As chair of the panel, M. Michael Magsig, Managing Director of Korn Ferry USA, noted that growth and demographics are driving disparity, especially in Asia, where demand is outstripping supply for talent. This has operated as a swift elevator with younger people landing bigger jobs sooner, but also led to higher premiums paid for experienced staff, and a greater turnover of staff magnetised by a fiercely competitive environment.

Ms. Shikita Sharma, Managing Director, ICICI Prudential Life Insurance, the largest private sector life company in India with close to 30,000 employees and 300,000 agents has stressed that taking into account the high cost of training, retention should be the highest priority. She insisted that most people who leave do so because they feel undervalued. Hence, it is important to let outstanding managers know that they are valued and groomed for a fast track. Furthermore, in a fiercely competitive market, the risk is great to loose not only the manager who quits, but also the whole team with him.

Michael Casella, Managing Director, Asia Pacific, Chubb, proudly heralded a 98% retention rate among those executives that attended the company's action learning and executive leadership program. However he warned against a self-defeating cycle, should the industry allow the bright young sparks to join other industries. In keeping with the new generation expectation, Mr. Casella stressed that it was essential to focus on broad skill development to create a culture that "would sustain and encourage learning, adapting, and executing."

Mr. Martin Parker, Swiss re Asia, had a medium position commenting that retention is just as important as recruitment, and added that Swiss re made a conscious effort to ensure existing workforce satisfaction and engagement. However, as a leading reinsurer, they see some departure as "non-regrettable" when they result in a flow of business from ceding companies with a "friendly Swiss re nurtured leadership."

As far as "Gen Y" is concerned all agreed that they are characterised by their aspiration to be more involved in decision making, to get more responsibilities, and to move up the ladder faster. There is even an urgent need to "re-train" the older managers who are managing GenY as they need more than any previous generation to be individually valued, and get easily bored if things do not move fast enough for them or around them...

After three days of intense debates over pressing issues, the meeting was adjourned until next year, but not without a spectacular final evening at the top of Taipei 101 the tallest building in the world until the completion of the competing towers in China and the Emirate. It is particularly fitting therefore that the 45th Seminar will convene from June 7 to June 10, 2009 in Jordan for the first time of its history in the Middle East, a timely move at a time when this part of the world becomes a main player in the financial markets, due mainly to the boom in oil revenues, and wise investment to insure the future of the local plentiful "Y" generation!

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