ADAPTING TO ASIA'S EVOLVING INSURANCE LANDSCAPE

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Adapting to Asia's evolving insurance landscape

While the world has recovered from Covid-19, global economies have yet to shake off the pandemic blues. A number of the EU countries falling into a technical recession, US economy, while stable is still fragile, and core inflation remains stubbornly high, risks of interest rate hikes cannot be written off yet. While the grass seems greener in Asia Pacific, the region is not entirely without its fair share of risks.

The challenges facing businesses and the global economy have impacted insurers too, to add to that the past year saw the market turning from prolonged softening to significant hardening, while climate change and extreme weather events have continued to impact carriers across the world.

In light of these challenges, InsuranceAsia News joined hands with Fitch Ratings to assemble a panel of experts from the region to understand and evaluate the state of the (re)insurance market in the region.

The discussion, themed Adapting to Asia's evolving insurance landscape, brought together practitioners and thought leaders from the industry to explore how companies can navigate the present challenges to make the best of the opportunities offered by the fast-growing economies in the region and help close the protection gap.

Broadly, there have been four themes that have had an impact on (re)insurers globally and in Asia Pacific – macroeconomic realities, hardening reinsurance markets, climate change and regulatory developments, most notably the transition to IFRS 17 reporting standards.

Big picture

Kicking off the discussion with an evaluation of the global macroeconomic realities, Clarence Wong, chief economist of Hong Kong reinsurer Peak Re, said that globally, the economic growth momentum is slowing. From a growth of around 3.4% we are seeing it is slowing down to slightly below 2%. Some of the Western markets are already in a so-called technical recession with the risk of the US slipping into a recession later this year.

"I believe the good news here is that the emerging markets are still doing good. We are still expanding with growth of around 4% for the whole emerging universe. And amongst the emerging markets, I think emerging Asia is also doing particularly well, seeing a lot of resilience. Even though the growth of China is slowing, we still expected that for emerging Asia as a whole, we could expect growth above 5% this year," he said.

The IMF said earlier this year that around 70% of the global growth will be coming from emerging markets and around 50% of the growth will be coming from India and China, and China alone will generate 30% of the global growth this year. A view Wong seemed to endorse.

However, the concerns are really from inflationary pressures. Wong said it is still difficult to gauge it accurately and added: "The general impression is we will probably experience a longer period of inflation before it really falls back to the level central banks are comfortable with. Even though the Federal Reserve may or may not hike interest rates immediately, there will still be a long time before we see the peak of the interest rate, or they just really start to com down."

Inflation is still very difficult to gauge accurately because as we have seen, yesterday's the US headline inflation has fallen to 4% but it is still among the targets of the Federal Reserve. And more worrying is the core inflation, which is 5.3%, which is still very high. The general impression here is we will probably experience a longer period, before inflation really falls back to the level central banks are comfortable with. Even though the Federal Reserve might or may not hike interest rates after today's deliberation, there will still be a long time before we see the peak of the interest rate.

Worries around inflation are shared by Jeffrey Liew, head of APAC insurance for Fitch Ratings. He pointed out that Inflation and interest rate trends are quite varied in the region depending on the countries.

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"If you look at China and Japan, the interest rate levels are not as high as Korea, and also inflation in China and Japan is relatively low compared to other markets like Korea," he said.

Inflation and interest rates affect life insurers and non-life insurers differently, Liew noted. While life insurers tend to benefit from a high-interest rate environment because of better interest margins, investment returns, and reserve computation, non-life companies can take a hit due to claims inflation and unrealised losses from investments can lead to capital issues.

"Inflation and high interest rates have to be actively managed," said Liew.

Market correction

The past few renewal cycles have seen significant hardening due to macroeconomic conditions, and elevated losses and that has changed the landscape for (re)insurers globally and especially in Asia, where the market is price-sensitive and catastrophe-prone.

Bringing in a practitioner's perspective, Victor Kuk, Head of P&C Reinsurance for SID, Swiss Re, pointed out that the challenge has been that exposure is going up worldwide as well as in Asia but the premium rate has not gone up as quickly as exposures and there is the impact of inflation too.

Meanwhile, the capital deployed to support the exposures has dropped and has failed to keep up with the exposures, which is a function of the return that the capital providers see, he pointed out.

"We see hotter summers, colder winters. The weather patterns have become more extreme. So the entire market is very sensitive and very nervous. As we went into 1.1. and 1.4, rates have increased a lot, particularly in property cat, where rates increased at least 30%, and in some cases, it has more than doubled," Kuk said.

The market demands a lot more return for the capital that they provide to support the exposures, he emphasised.

One of the main drivers of rate hikes globally has been the catastrophe risk accumulation in the US. The Hurricane Ian losses last year from Florida was a game changer as it trapped significant retro capital and forced reinsurers to demand higher rates.

Christopher Au, Director, Climate & Resilience Hub, said: "What happens in the US has such a big impact on prices and rates. With some of the events recently, we have had a difficult period. Our view certainly is that the loss history and performance recently in the US causes concern, with reinsurance globally, that's fed through into pricing."

But we're entering an environment where risk is increasing… we do need the industry to sort of enter into the risk management process a little earlier, he added.

Retro squeeze

While a market hardening was in the making, what has made things worse for the industry is the lack of retro capital. It was a double whammy for unrealised losses in company portfolios that have forced reinsurers to post mark-to-market losses, while on the other hand increase in catastrophe losses has meant that fewer investors are willing to put up more capital for the industry.

While the first two renewal cycles saw very little new retro capital enter the market, things seem to be picking up as we near the July renewals.

Retro markets are still tight, said Wong of Peak Re. "Capital providers are very much focusing on absolute return, they would like to see some actual indicators of improved profitability, rather than just a promise of better pricing going forward. It might still take some time for capacity or capital to kind of return to the retro markets, particularly since the interest rate outlook is still very uncertain," he said.

Swiss Re's Kuk said: "Going to 1.7, we're seeing a little bit of capital re-entering the market," said Kuk, adding that "concerns in terms of the return, as well as the profit made, continues to be the main focus for a number of players, particularly in the retro sense."

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High prices are a signal to the markets that there are more opportunities. And eventually this will kind of bring in more capital to the retro markets and also to the reinsurance markets, according to Wong.

Au, however, is more optimistic, “we do see it as a little bit of support. Hopefully some good news on the horizon for those seeking financial protection.”

In terms of the dynamics in the US, Au said that in the past couple of months, there’s been an increase in capital and in players and he thinks that it is going to feed through the rest of the markets in the next 12 months.

One of the potential sources of retro capital is the ILS market, which Wong described as quite vibrant.

“For example, the among of cat bonds issued so far this year is US$8.6 billion compared with US$10.5 billion for the whole of 2022. I think that interest in this area is still very strong,” said Wong.

“Yields from the bonds so far has been in the low teens, so it is very attractive to institutional investors. Increasing varieties of risks that are being packaged under bonds are also becoming more interesting,” he said.

Weather woes

There is no doubt that climate change is at the heart of problems faced by property insurers. The increasing frequency and severity of cat events has been a challenge and especially so in Asia Pacific, where protection gap continues to be problem.

As Kuk pointed out, the size of the problem is enormous, the size of the protection gap is huge. In one of our research papers, we said there were about 285 cat events globally, 32% of that is in Asia. In dollar terms, economic losses in Asia last year was around US$50 billion. And only 6% of that is protected.”

This raises the question of whether insurers can continue to sustainably offer protection against catastrophes. The answer though is quite emphatic and unanimous.

“At Swiss Re we believe that nat cat is insurable. The question of how much do you charge for it? And how much return do you get for it? I think that’s a much bigger question for us,” said Kuk.

Wong also agrees that nat cat is insurable.

“The (re)insurance industry is pretty good at kind of advancing the insurability of different risk categories. And particularly with the use of technology, or like with parametric insurance, we can improve the kind of affordability of this product and make it simpler to reduce transaction risk, transaction costs, or frictional costs,” he noted.

While Au also believes there isn’t another industry in the world that is able to price catastrophe risk better than the insurance industry, he argues that the ambition to protect 100% of property damage, business interruption and other risks from nat cats is probably not viable.

“That’s probably not the direction I want to go. But I think the industry has enormous capabilities and does need to be a bit bolder in terms of innovation, moving into the risk management chain a bit earlier on,” he added.

We probably have to think beyond just risk transfer and try to see how reinsurance expertise can support other risk management techniques like risk mitigation, and climate adaptation.

“If we just level ourselves, using our models, our data or risk transfer, and not considering the other measures, it might not be the most optimum use of our resources and expertise,” Peak Re’s Wong said.

One thing is clear, as Au said, some hard choices have to be made as there will be some areas that will not be insurable due to the change in hazard risks, and we need to have a plan for those and understand them.

The alignment of modelling isn’t too far as Kuk pointed out and we need to look at better models in terms of how we model risks as well as the solutions to address the exposures.

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