Asia Insurance Review's

EAIC Daily

Day 1

Tuesday • 30 October 2012

Published by: Asia Insurance Review

Media Partner: Middle East Insurance Review

Sponsors: Aon Benfield, Endurance, Swiss Re, Trust Re – Reinsurer of Choice

With the East Asian insurer tempest-tossed by the chaotic changes:

The CEO is the Buoy

In the transformation of the East Asian insurer, who is the driver? Are CEOs making an impact? Or is the industry just being led by the tide of catastrophic events, be they natural, man-made, or regulatory?

The East Asian insurance landscape is changing. Insurers are hit by competition, not only from within but outside the industry; M&As; the severity and frequency of natural disasters; rising middle class; ageing population with increased longevity; technology and social media; rising cost of distribution and channel mixes; regulatory pressures; and the sophisticated consumer with the threat of his complaint over a delayed or denied claim going viral.

Be different

Hence, the East Asian insurers have to transform, as the theme of the EAIC indicates. But they have to change as individual entities and not en masse as a regiment.

Our survey among management consultants and experts suggests that it is the Chief Executive who has to lead the company to be different and ahead of the change game. An effective CEO can make a company the game changer in the marketplace. He cannot hide behind the excuse that because of their unique specificities and extreme technicalities, insurers must act in concert.

Heroes needed

Luckily, charismatic leaders are emerging in the insurance scene. The Chartis/AIG saga with its leader Bob Benmosche is just an amazing success story. Any senior Chartis man in the know will tell you that he is a folk hero who saved the company. Despite coping with a cancer treatment, Mr Benmosche gave AIG people back their professional pride and dignity. In a widely televised speech, he thanked America for the US$182 billion support and joyously returned it with a $15 billion profit. Armed with the belief in the core values of AIG, he revived the dying company and turned it around to see multi-billion profits again and brought back the name AIG. So AIG it is, Always in Gear. Can a CEO do more?

So who are these heroes in our backyard? Look around you. Spot them for us!

Be the change force

The time has come for CEOs to stand out in the transformation process. They have to challenge every assumption and anyone resistant to change with a million reasons to keep policies that do not hold up anymore. The leader, not manager, must be armed with knowledge and wisdom but not get overburdened by excessive data and information. As Nobel Laureate Herbert Simon said, "A wealth of information creates a poverty of attention".

Steer away from being a dictator to whom no real feedback ever comes, say my consultants. Be armed with the mettle of ERM with a positive passion. Enterprise risk management will ensure that even a CEO who stands tall and makes his imperious mark will stay within the limits. He will never be naked.

And that is the CEO who is the steady buoy of the company in any tempestuous change, no matter which ugly wind blows.

DID YOU KNOW?

This is the 3rd time Kuala Lumpur is hosting EAIC – the 1st one was in 1972 and the 2nd in 1988.

More than 1,000 delegates are here for this year's EAIC, with the host city boasting the largest contingent of more than 230.

EAIC has a total of 1,033 corporate and 626 individual members as at 31 August 2012 – with Hong Kong having the most corporate members at 175 and Singapore the most individual members at 127.

Kuala Lumpur will receive US$30,000 this year from the EAIC board for a CSR activity under EAIC's auspices.

This year marks the first time Phnom Penh is participating in EAIC as member.

Royal Palace complex, Phnom Penh

Among the EAIC markets…

- **Japan**, ranked **2nd** globally, recorded the highest premium volume in **2011** at **$655.4 bln**.
- **Taiwan** boasts the highest **insurance penetration** at **17%** in East Asia and the world.
- The **Philippines** grew the most in **total premium** volume: **22.16%** to **$2.88 bln**.
- **Singapore** grew the most in **non-life premium** volume: **22.4%** to **$8.18 bln**.
- **Korea** posted the highest **non-life insurance density** at **$1,045**.
- Host country **Malaysia**'s 2011 **total premium volume** stood at **$14.2 bln**:
  - Life: $9.3 bln
  - Non-life: $4.9 bln
    - It is the world's **33rd** largest insurance market with a **0.31%** market share.
    - Government targets to raise industry's contribution to **GDP** to **4%** by 2020, from currently around 3%.

Sources: Swiss Re sigma World Insurance in 2011, EAIC, Asia Insurance Review

Reinsurance market swift in rebuilding capital

The reinsurance market has swiftly rebuilt its capital following the major losses in 2010 and 2011 – proof that reinsurance is indeed an effective product, says **Mr Malcolm Steingold**, CEO of **Aon Benfield Asia Pacific**. He notes though that more restrictive treaty terms have made the placement of certain risks more challenging.

Despite the significant reinsurance losses in 2010 and 2011, insurers were able to renew required reinsurance capacity at terms and conditions that remained accretive, and reinsurers were able to rebuild capital quickly. "By the end of the first half of 2012, reinsurance capital stood at a record US$480 billion," said Mr Malcolm Steingold.

This continued availability of capacity, coupled with timely claims payments, has confirmed that reinsurance is indeed an effective product and a highly accretive form of capital for insurers that ceded record losses in Asia Pacific in 2010/2011, he said.

A stark contrast to 2005

Although there are only small differences between the reinsurance capacity in 2012 and that in 2011, he said that looking at the underlying dynamics, the 2011/2012 capacities contrast starkly to those seen following Hurricane Katrina in 2005.

"While the proportion of losses paid by reinsurers was higher for the series of losses in 2011/2012 compared with the 2005 losses, post-event capital raising following the 2010/2011 losses was relatively low, and the market has seen approximately one tenth of the capital that was raised following Hurricane Katrina," he said.

Some risks are difficult to place now

However, the more restrictive treaty terms resulting from the record losses of 2011 have made the placement of certain risks more challenging. "For example, contingent business interruption cover is now sub-limited and a greater transparency of exposures is required," said Mr Steingold, adding that any cover provided will generally encompass only named suppliers and customers.

Cover for flood is also severely sub-limited, and some specific, less desirable risk types, such as food risks and textiles, are also more difficult to place – even when they are being placed without flood protection.

CAT bonds and ILS to grow in Asia Pacific

Outside Asia Pacific, markets in the West have witnessed this year a surge in capital markets solutions and demand for collateralised cover. While he expects this trend to be replicated in Asia Pacific, Mr Steingold noted that of the 30 catastrophe bond transactions/insurance-linked securities that closed during the 12-month period ending 30 June 2012, only three issuances came out of the region. And all the three – Kizuna Re Ltd, Kibou Ltd and Akibare Ltd – emanated from Japan, representing only US$490 million of the $6.4 billion total issuances.

"While this trend is symptomatic of the ample conventional reinsurance capacity in the region, there is no doubt that ILS solutions are playing an important role in the global marketplace," he said, adding that over time, there is likely to be more of such products covering Asia Pacific risks.

China still offers most growth potential

Looking at the opportunities in the region, he said that they exist across the whole of Asia Pacific, even in mature markets such as Japan and Australia, and that emerging economies like Vietnam, Indonesia and Thailand all offer high-growth potential. China, though, still offers the most potential.

The recent liberalisation of Myanmar, with its population of around 50 million and rich natural resources, will also offer substantial opportunities to the industry. "However, each opportunity has to be qualified in terms of the extent of time it will take a company to begin to realise value from the opportunity," he said.

As far as lines of business are concerned, the high-growth potential remains in the areas of property catastrophe reinsurance, specialty lines, and agricultural reinsurance, he said.

Facing the interest rate challenge

In this abstract of Swiss Re *sigma* 4/2012 "Facing the interest rate challenge", **Mr Clarence Wong**, **Swiss Re**'s Chief Economist Asia, explores how interest rates affect insurers, and explains why a rapid rise in or sustained low interest rates can be a challenge. He notes that life insurers are more impacted than non-life insurers, but that even within life insurance, interest rate sensitivity varies by product.

Over the last 20 to 30 years, interest rates have been trending downwards in many markets. Ten-year government bond yields in the US, the UK, and Germany have fallen below 2%, and Japanese ten-year yields have been below 2% for more than a decade. Interest rates in Asia have also fallen in recent years as central banks resorted to loose monetary policies to support economic growth.

While the current levels help over-indebted borrowers (mainly in advanced markets) deleverage their balance sheets, not everyone benefits from these low rates. Insurers – and life insurers in particular – are institutional savers that suffer from low investment yields. It is estimated that about US$25,000 billion of funds (or some 12% of global financial assets) are managed and invested by the global insurance industry. Thus, a reduction of one percentage point in interest rates results in lost investment income of about US$250 billion per year – or about 6% of global premium income.

How interest rates affect insurers

Impact on premium rates

Insurance companies typically operate in a competitive environment and share investment income with policyholders through product pricing. In non-life insurance, premium rates need to be increased if interest rates decline, because the discounted value of claims is higher, assuming that lower interest rates do not also mean lower inflation and claims costs.

Impact on demand

In general, lower interest rates make insurance products more expensive or, in the case of life insurance products, reduce their benefits. However, declining interest rates do not always have a negative impact on insurance demand. For example, some types of insurance, like motor liability insurance, are mandatory, and price has no influence on demand.

Impact on the balance sheet

From an economic perspective, changing interest rates do not impact the value of an insurance company (ie its equity position), provided that the duration of assets and that of liabilities are perfectly matched. In reality, there are often duration mismatches when, for example, the duration of an insurer's assets is shorter than that of its liabilities. Accordingly, a decline in interest rates reduces the economic value of the company because the value of its liabilities increases by more than the value of its assets.

Impact on investment income

Because insurers are savers and typically invest most of their premium income in high quality bonds, they suffer from low interest rates. Falling interest rates translate only slowly into lower investment results for insurance companies, but profits, in turn, only improve slowly as interest rates rise. This arises from the fact that only current premium income is invested at market yields.

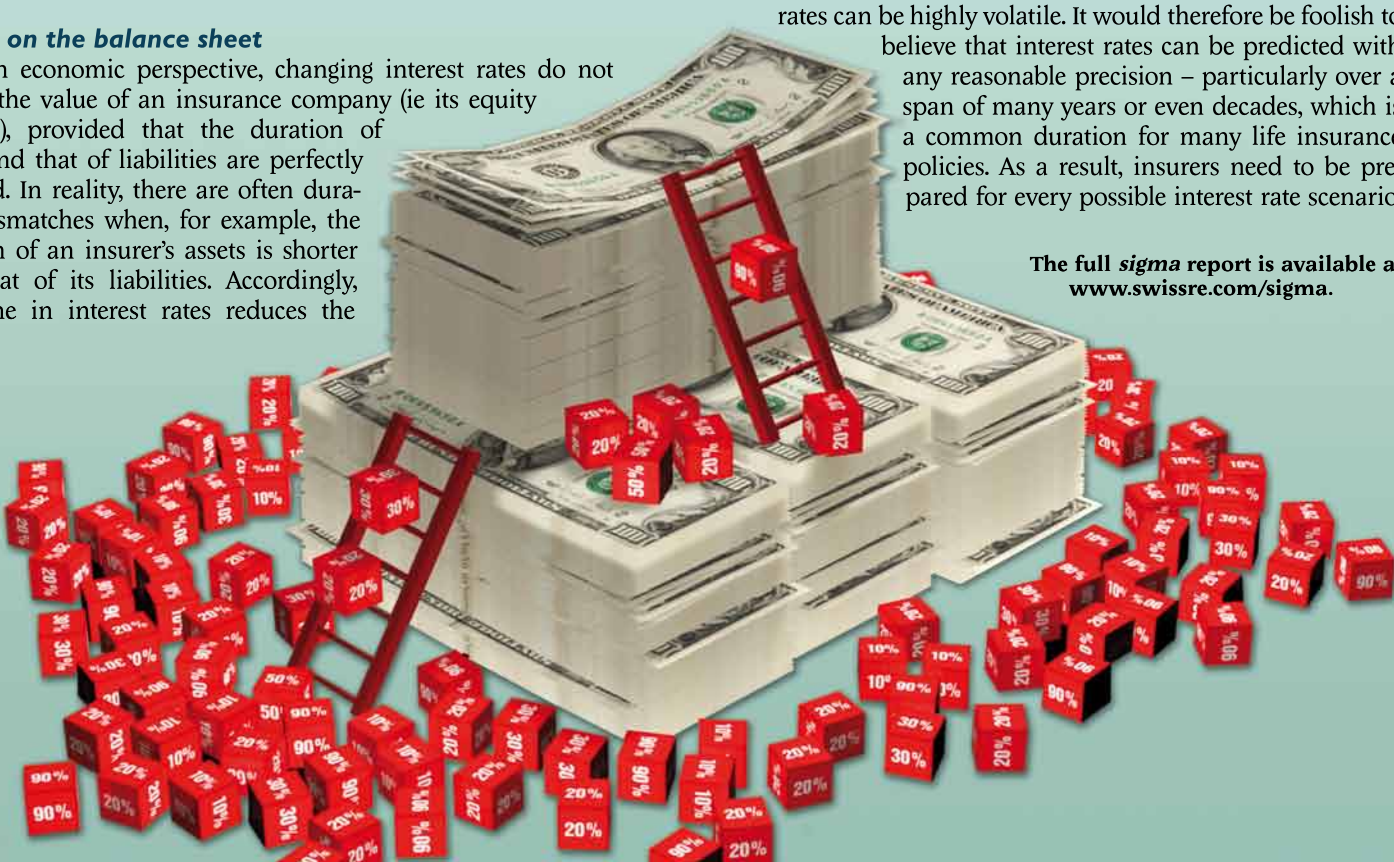
In sum, declining interest rates generally result in higher prices and lower demand for insurance products, lower investment income, and often a decrease in the economic value of insurance companies. The impact on short-tail lines of non-life business is smaller, but can be more significant for long-tail lines.

Managing and mitigating interest rate risk

Non-life insurer interest rate risks seem to be manageable. Short-term business can usually be re-priced on an annual basis, thereby making its sensitivity to interest rate fluctuations marginal. By contrast, interest rates have a huge impact on long-term lines of business where investment income is a major source of earnings. However, even the interest rate risk inherent in long-tail lines of non-life insurance (such as casualty) can be dealt with by prudent management of assets and liabilities, although such business remains vulnerable to unexpected increases in claims inflation, which are often related to interest rate increases.

The biggest threat to non-life business, however, is unexpected claims inflation, which is often related to changes in nominal interest rates, and renders claims reserves insufficient. While a rise in interest rates to levels that are more comfortable for insurers appears unlikely over the short term, history reminds us that interest rates can be highly volatile. It would therefore be foolish to believe that interest rates can be predicted with any reasonable precision – particularly over a span of many years or even decades, which is a common duration for many life insurance policies. As a result, insurers need to be prepared for every possible interest rate scenario.

The full *sigma* report is available at www.swissre.com/sigma.



16th Asia Insurance Industry Awards

Standing tall in testing times

Fourteen industry players have emerged as winners in this year's Asia Insurance Industry Awards, a testament to the resilience of the region's insurance industry as it came out of 2011's series of catastrophes.

All ready for the big day

Led by EAIC President Teddy Hailamsah, the EAIC Executive Board held its meeting yesterday to decide on the venue for the next Congress and to discuss budgetary matters and membership status, marking the first official activity of the event's opening day.

6th India Rendezvous

Theme: *"Back to Basics"*

21-23 January 2013,
Mumbai, India

13th CEO Insurance Summit in Asia

Theme: *"Changing threats to profits"*

20-22 March 2013,
Bangkok, Thailand

Backing Bali with Basics

The 2010 EAIC in Bali made a clarion call for the industry not only to go back to the basics of the insurance business – but also to redefine and spell out these basics amidst a wave of changes facing the industry. Calls for greater collaboration among EAIC members and for innovation also stood tall among the flurry of other concerns addressed at the Congress.

Published by: ASIA INSURANCE REVIEW www.asiainsurancereview.com

Media Partner: MIDDLE EAST INSURANCE REVIEW www.meinsurancereview.com

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