A strategic vision for the Asian insurance/reinsurance industry

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Effective (re)insurance can not only bring about great economic and social benefits to the society, but transform the world we live in. While the Asian (re)insurance industry is developing very rapidly, its relevance and prominence is still very limited. Where the Asian (re)insurance industry needs to be is to become a fundamental pillar, driving Asia's economic growth. It needs to transform our society by bringing prominence, prosperity and stability to Asia, as well as the greater region.

Key Strategic Goals: fundamental pillars for the vision

There are four key essential elements to achieve this vision:

Localised understanding with knowledge, experience and analytics

Asia's (re)insurance industry is highly diversified, and is undergoing rapid socio-economic change. It ranges from the Asia powerhouses of China and India, emerging Asia (Indonesia, Malaysia, Philippines, Thailand and Vietnam) and developed Asia (Japan, Hong Kong, Singapore, South Korea and Taiwan). Reliable and relevant data is scarce, and historic experience may be unrepresentative. The desire to quantify risk through analytical means is often not possible. Thus the need to build up local knowledge, experience and expertise in the risk segment is essential. This deep understanding of risk and how it is interconnected and managed will form the foundation of the (re)insurance industry. With this, the need for transparency in the underlying risk, together with strategic client management built upon the fundamental principle of trust means that the (re)insurance industry in Asia will be unique.

Insurance penetration, for greater impact

Eight of the 10 largest megacities are located in Asia. Risks are increasingly more prominent with the industrialisation and urbanisation of Asia. As someone puts it, "mega economies produce mega risks". Goldman Sachs projects that by 2025, at a GDP of around $18 trillion, China's economy will be comparable to America's. India's GDP is expected to surpass Germany's. The emergence of middle classes with considerable spending power suggests that insurance and reinsurance demand will outpace overall GDP growth. Provided localised knowledge and understanding exists, the (re)insurance industry clearly has enormous opportunities.

However, insurance penetration in Asia is currently still very low. The insurance penetration (premiums as a percentage of GDP) for China is 2.8%, compared to 8.8% for the US, and 7.4% for the world (2007). China and Indonesia show greater signs of insurance penetration potential. Insurance penetration is critical to support the socio-economic developments of Asia, especially through the effective and efficient risk transfer mechanism of (re)insurance. Our industry needs to proactively offer new products and services and add values tailored to the specific regions in Asia.

The perception of insurance is also very important. In developing Asia-Pacific, more than one in three customers see insurance as a constraint due to its mandatory / compulsory nature, while that number is about one in five in Europe and North America. Should our industry not meet the needs of the economy and engage our society, our relevance will be diminished. Large corporates in various industries have already gone down the route of self-insurance, while others have set up captives as a form of risk management. Captives, largely domiciled in Bermuda and also Singapore to an extent, may develop quite significantly in the years to come, especially with Asia's growth. With this, our industry should embrace all forms of risk, partner with risk owners and provide affordable / accessible solutions, offering protection to transfer risk, and provide certainty.

Managing the risk or rolling the dice

The unprecedented natural catastrophes that impacted Asia in 2011 – the tsunami / earthquake in Japan and the flooding in Thailand – not only had a great humanitarian and economic impact, but highlighted several important issues. With the industrialisation and urbanisation of Asia, the risk landscape is changing fast, and specific concentrations of risk are emerging. The complexities between the interactions of risks also surfaced when various contingent business interruption claims surfaced as a result of these events. Again, the importance to understand the risk, despite limited data, is highlighted.

The importance of the (re)insurance industry to support and facilitate the economic recovery, redevelopment, and society needs, after a catastrophic event has happened is critical. With increased penetration, our industry would have a much more direct responsibility and involvement to provide support for natural catastrophe. The public sectors, as well as individuals, are currently absorbing most of the economic loss as opposed to the (re)insurance industry. Our industry not only needs to offer such support, but also needs to manage catastrophe risks carefully.

Sustainable life transformation

Asia, comprising over 4.1 billion people, approximately 60% of the world's population, signifies that there is huge potential in terms of the impact that the (re)insurance industry can bring. The economic, social, political, and environmental factors are all interrelated and impacts not only Asia, but more broadly. For example, economic strength will enhance living standards, impact immigration and government policies, as well as contribute to global warming, and thus the food and energy sectors in the long term. Such a chain of reaction can impact the stability of the region. Together with increased population, living standards and medical advancements, aging populations will pose significant burdens to the society and government.

By 2030, according to the Asian Development Bank, 55% of Asians are expected to live in urban areas, up from a mere 25% in 1980. The rapid rate of urbanisation, with increasing infrastructural developments in key areas of housing, power, transportation and telecommunication, is likely to aggravate risk exposure. The OECD estimates that, by 2020, Asia will account for 55% of the global middle class, as compared with its current share of just 30%. As such, sustainability is crucial for the long-term development of enriching lives in Asia. Promoting the knowledge and productivity of the population will not only help with the appreciation and use of the (re)insurance industry, but assist to bring about peace and stability to the region.

Asia's development can be enhanced through facilitated economic growth, and the effective management of risks, which is what the (re)insurance industry is for. The need for affordable, accessible insurance, including all forms of insurance, will have a direct impact of transforming economies, but more significantly, transforming individual lives. This forms the fundamental pillars for our (re)insurance industry.

Strategic thrusts: charting and navigating through Asia

Four key strategic thrusts are shaping the Asian (re)insurance industry.

Technological advancements

Technology has transformed the world we live in. Not only so, technology has also directly impacted the (re)insurance industry. Technological advancements have, in general, reduced the levels of risk in our society. With declining claim frequencies, the (re)insurance industry is challenged to maintain its purpose, scope and relevance. As an example to illustrate this, what would the motor insurance be like when Google Cars fill our roads, and car accidents are effectively reduced to zero. The implication of this is twofold. Firstly, the need for our (re)insurance industry to respond to new risks, especially due to the impact of technology. Secondly, the increased use of the (re)insurance industry to provide for catastrophe related covers.

Risk management capabilities have been enhanced with technological advancements. An example is natural catastrophe modelling which has developed rapidly, aided by computational power. The need for effective management of risk has become the new focus area for risk experts. This is especially with the increased accumulation and complexities of risks in Asia, as highlighted by the significant natural catastrophe losses in 2011.

Capital flow and management

The (re)insurance industry must continue to generate significant value for the economy and society. It needs to provide the necessary return on capital, with stability and predictability, and continue to attract even more capital. The (re)insurance industry has the potential to drive significant changes to the economy, similar to what the technological sector has done. The fact that our industry provides coverage ranging from balance sheet protection to individual health, retirement and individual lives suggests that our (re)insurance industry is of great importance. With greater capital, our ability to manage risks, including those that are emerging, as well as black swan events, will be enhanced.

The increased capital flow into the (re)insurance industry signifies that the industry has further potential for development. Recent start-ups such as Asia Capital Re in Singapore and Peak Re in Hong Kong, dedicated to serving the Asian local reinsurance market, signifies that there are tremendous opportunities in Asia. However, there are also significant challenges with the increased capacity in the (re) insurance market. The industry standard return on equity (RoE) target of 15% has been severely challenged in recent years as a deep soft market has combined with a significant catastrophe loss experience and miserable investment yields to suppress returns. If (re)insurance industries have a long-term vision, can ride out the insurance cycle and add value to the economy, such investments and capital flows will be sustainable.

Regulatory ripples

Through globalisation and the rise of large multinational corporations expanding their footprints across the globe, many have been impacted by legislative and regulatory actions from other parts of the world. The regulatory environment too has changed, with local regulation increasingly being influenced by global regulatory developments. Solvency II, for example, is having a major impact on regulatory developments around the world.

The regulator's aim is primarily to protect the policyholder's interest. However, this generally translates to imposing more stringent requirements and adds to the compliance costs of the industry. Through measures such as holding more capital, additional disclosures, and more frequent monitoring, all this not only increases costs, but increases the barriers for entry for new competition. In addition, innovation for the industry is not something that the regulators is directly promoting and measured on. For example, local regulators are typically not measured on insurance penetration (which is ultimately a reflection of how much protection there is in the community), nor how innovative the (re)insurers are (which is fundamental for the development of the (re)insurance industry).

Societal factors

With the urbanisation and industrialisation in Asia, the average wealth of the middle income class will rise significantly. The need for various forms of (re)insurance such as accident, health and pension product will not only be driven by the increase in demand, but also complement the social security systems in Asia. In addition, trends such as the ageing population and emerging risks such as climate change suggests that there is enormous opportunities for the (re)insurance industry to make a difference.

With all these macro forces together, the (re)insurance industry in Asia will likely see further consolidation, in response to achieve scale, diversify, reduce cost, increase efficiency, and to stay competitive and deliver innovative yet affordable (re) insurance covers. AIG (American International Group), with roots tracing back to

Shanghai, is classified as an insurer that is too big to fail, "a nonbank systemically important financial institution". Perhaps Asia will see more of such conglomerates over the years to come, with some of its own, offering all types of insurance, meeting the needs of our society.

To "The Asian Century": it was once just a vision

To conclude, the Asian Development Bank's publication, "Asia 2050 Realizing the Asian Century" highlights that (italics added for emphasis):

"Asia is in the midst of a *truly historic transformation*. If it continues to grow on its recent trajectory, it could, *by 2050, account for more than half of global GDP*, trade and investment, and enjoy widespread affluence. *Its per capita income could rise sixfold*. It thus holds the promise of making some 4 billion Asians, hitherto commonly associated with poverty and deprivation, affluent by today's standards. By nearly *doubling its share of global GDP* (from 27% in 2010 to 51% by 2050, Asia would *regain the dominant global economic position* it held some 250 years ago, before the Industrial Revolution. Some have *called this possibility the "Asian Century"*.

While this promising outcome, *premised on the major economies sustaining the present growth trajectory*, is plausible, it does not imply that the path ahead is just doing more of the same. Indeed, just maintaining the present growth rates will require *urgently tackling a broad array of politically difficult issues over a long and sustained period*, even though benefits may not"

With this backdrop, it is clear that the (re)insurance industry in Asia plays a significant role, and can fast-track the world we live in. The rapid development in Asia means that new opportunities for the (re)insurance industry must be seized. By responding and adapting to our changing risk landscape and becoming a catalyst to transform the Asia we know of today, it can create new opportunities and promote and facilitate the economic developments of Asia. It will also bring along with it prosperity through wealth creation, stability, and improved standards of living, providing more certainty in a world of uncertainty. All this can be made possible by embracing and developing a deep understanding of risk, and to effectively manage it. One day, perhaps sooner than we think, Asia will become the (re)insurance hub for the world.