REINSURING ASIA'S ECONOMIC FUTURE

Strengthening disaster reliance is a prerequisite to Asia's continuing rise. Clarence Y. Yeung, Group CUO & COO, ACR Capital Holdings discusses the role of reinsurance in the rapidly evolving landscape.

Despite the recent mild economic slowdown, Asia's emerging economies are expected to continue growing twice as fast as the world economy as a whole, according to the International Monetary Fund.

If emerging Asia maintains its recent growth trajectory, the region's share of global gross domestic product (GDP) could exceed 50% by 2050, a significant increase from 28% in 2012.

Based on this projection from the Asian Development Bank, Asia would regain its dominant economic position it held until the early 19th century. Some three billion Asians would become affluent by current standards.

In the wake of Asia's economic dynamics, the region's non-life reinsurance markets have grown to a volume of about US$30 billion, more than 15% of the world's total. Asia's prospects, of course, have attracted significant additional reinsurance capacity, which is expected to put pressure on rates in 2014. However, demand is set to remain strong, with most market participants expecting reinsurance premiums to outgrow the region's GDP.

Asia's rise and the advent of the 'Asian Century' should however, not be taken for granted. Super Typhoon Haiyan is a grim reminder of Asia's vulnerability to natural disasters and the (re)insurance industry's still limited contribution to alleviating the humanitarian and economic consequences. Insured losses are not expected to be significant because of the Philippines' low non-life insurance penetration - more than 90% of Haiyan losses are projected to be uninsured. Premiums as a share of GDP account for as little as 0.5%, which is down from 0.9% in 1995. This reflects one of the lowest ratios in Asia. To make matters worse, the Philippines is one of the few countries in emerging Asia exhibiting a declining trend in non-life penetration.

This most recent tragedy highlights one of the challenges Asia's leaders will have to address in order to ensure the region's continued economic growth. The evolving risk landscape is marked by exponentially rising levels of natural catastrophe exposure such as floods, storms, storm surge and earthquakes. Climate risk, rapid urbanisation and an increasing value concentration have dramatically heightened Asia's vulnerability. At the same time, new and unexpected risk hot spots and risk correlations have emerged, as demonstrated by the 2011 Thai floods, for example.

One of the most visible changes to Asia's risk landscape is the transformation of rural areas into cities, as well as the emergence of industrial clusters such as the Yangtze River Delta. From an insurance perspective, higher population density and risk and value concentration present a number of major opportunities and challenges.

Overall, the Asian Development Bank anticipates that the annual infrastructure investment required until 2020 amounts to about US$750 billion. Personal lines are set to receive a boost as demand for housing and private vehicles rises in urban areas. The same can be expected for commercial lines as urbanisation tends to drive industrialisation. Additional commercial insurance business will come from infrastructure projects, especially in power generation and water and waste management where private sector insurance coverage tends to be highest.

However, as urbanisation accelerates, disaster risk exposure also surges exponentially. Mega cities developed around coastal areas are prone to storms and storm surge risks. Cities developed in areas near high-seismic activity zones are also increasingly susceptible to unforeseen disasters. The challenge is exacerbated by a combination of a lack of data and models, sub-standard construction practices as well as a lack of (or non-compliance with) building codes and zoning laws.

IF EMERGING ASIA MAINTAINS ITS RECENT GROWTH TRAJECTORY, THE REGION'S SHARE OF GLOBAL GROSS DOMESTIC PRODUCT (GDP) COULD EXCEED 50% BY 2050, A SIGNIFICANT INCREASE FROM 28% IN 2012

The size, scope and complexity of the challenges ahead require a pro-active and multi-dimensional approach. In a snapshot, these include governments and the private (re) insurance industry, an appropriate mix of non-financing and financing/ risk transfer techniques as well as a combination of pre-disaster and post-disaster measures.

Governments can and should set rules and regulations, which enable (re)insurers to absorb large losses. The introduction of compulsory insurance, for example, can help in deepening and broadening the risk community.

A broad spectrum of non-financing measures can also help in disaster risk prevention and reduction: for example, the natural disaster 'risk maps' released by China in 2011 can aid urban planning. In addition, building codes and their enforcement can also go a long way in improving disaster resilience and response. These measures can effectively complement risk funding and transfer tools.

A broad suite of pre-disaster instruments are available to provide financial relief through risk transfer. These range from public disaster funds, private (re) insurance, micro-insurance, and government risk pools to capital markets-based solutions. Post-disaster, governments can also play a vital role in disaster recovery by reallocating their budgets, raising domestic and/or external credit, or increasing taxes.

In many developing countries, however, total available funds are simply insufficient to cover the full economic cost of a major disaster. Therefore, reinsurers, based on their familiarity with the largest and most complex risks, must and will play a pivotal role in strengthening disaster resilience in Asia. This mission obviously begins with cedants in the local insurance communities. More severe and frequent catastrophes will prompt them to cede more risk to reinsurers for the purpose of risk diversification and financing. In addition, given an abundance of available reinsurance capacity, governments are re-evaluating their roles vis-à-vis catastrophes and are increasingly receptive to transferring such risks to commercial reinsurance markets. This is not only a business opportunity for reinsurers but also, and maybe more important, an opportunity to demonstrate our industry's relevance by narrowing the gap between economic and insured losses. At the end of the day, the continual renewal of (re)insurers' long-term 'licence to operate' is based essentially on their ability to make economies and societies more resilient to the assaults on their sustainability. □