

Best's News Service via Bestwire - June 10, 2015 03:55 PM

Cass Business Professor Describes Evolving Trading Risk for Global Reinsurance Sector

LONDON - As the global reinsurance industry evolves from its historic role of simply responding to disasters, or "CNN events," it is embracing a new form of trading risk, Paula Jarzabkowski, professor of strategic management at Cass Business School, told a London audience.

Reinsurance is moving to a "market for commodities," Jarzabkowski said at Cass, at the release of a book she co-authored, "Making a Market for Acts of God: The practice of risk-trading in the global reinsurance industry." Cass Business School is part of City University London.

"We have a market that has worked over many generations because it has evolved a set of conditions that allow it to do so," Jarzabkowski said.

The market, she said, is now moving toward precise measurement of risk, in which transactions are becoming more important than long-standing relationships, and price becomes the decider.

The consolidation of insurance companies into larger multinationals has attracted regulatory scrutiny, Jarzabkowski said. Reinsurance buyers are now looking more closely at their reinsurance spending, she said.

Emerging purchasing strategies, she said, include the bundling of risk. Jarzabkowski, herself an Australian, cited the decision in 2010 by Australian insurer QBE to buy reinsurance on a global basis. While such a move can make for efficient use of capital, she said, it increases retentions.

These higher retentions, Jarzabkowski said, can create incentives for insurers to understand their risks and control costs. Large buying programs also favor large reinsurers, she added.

"This automatically says big needs to get into bed with big," Jarzabkowski said. "So what we have increasingly is a smaller pool of players taking the majority of the risk."

The global programs have reduced reinsurers' reliance on local knowledge, Jarzabkowski said, while the underwriting cycle has

been undermined by the growing preference of buyers for three-year reinsurance deals. These trends have "changed the way people think about what risk is," Jarzabkowski said.

The picture is further complicated, Jarzabkowski said, by the appearance of "alternative risk transfer products." These are "very good products, if you hit the bulls-eye," she said.

Very specific products are difficult to assess in advance, Jarzabkowski said, before asking if anyone in the audience knew when the San Andreas Fault is going to be hit by an earthquake, or which properties it will affect.

Tom Bolt, director of performance management at Lloyd's, said models have their limitations. He said the Northridge earthquake, which hit California on 1994, "was on a fault that wasn't in the model. And so, while models are incredibly helpful in telling you what your exposures are, they're not so predictive of what will happen in every chance."

Clem Booth, chairman of credit insurer Euler Hermes, said the low level of interest rates is "the main driver" in the growth of securitization in the industry.

"It's nothing to do really with insurance being especially attractive," Booth said. "It's more to do with the fact that putting your money in a bank today is distinctly unattractive," both in terms of return and security.

The question for the reinsurance market, Booth said, will be what will happen after a major event. "I think there is a place" for the new capital, he said. "But I don't see it replacing traditional forms of risk transfer any time soon."

Jarzabkowski described herself and her two fellow researchers who wrote the book as "ethnographers," who spent three years watching people work. This process involved working with 22 reinsurers, three large brokers, and very large and very small insurers.

The book, Jarzabkowski said, described a relationship-based market that is "unpredictable, uncertain and [affected by] increasingly severe losses."

The losses are getting larger "whether you believe in climate change or not," she said, pointing to the effects on risk of increased urbanization.

Huge events, such as the tsunami that hit Japan in July 2011, involve very high values and are difficult to model, Jarzabkowski said. The lack of frequency of the very big events makes it more difficult to learn from them, she added.

(By Robert O'Connor, London editor: Robert.OConnor@ambest.com)

BN-NJ-6-10-2015 1555 ET #