Beware the Bigger Picture

Intelligent Insurer speaks to Marc Beckers, head of Aon Benfield Analytics for Europe, the Middle East and Africa, who explains that economic factors and new regulation may present the greatest challenges to re/insurers' operations.

Q What are the biggest threats facing reinsurers over the next couple of years?

A The economic situation across Europe will feature highly. Another challenge is regulation, specifically IFRS phase 2 and Solvency II, which will present hurdles for insurers and reinsurers alike. Reinsurers will almost definitely have to use an internal model under Solvency II, because the standard formula is not adapted to their business model. Pillar Two and Pillar Three will be more challenging in comparison with Pillar One, where at least insurance and reinsurance companies are in control. In Pillars Two and Three, the regulator is in control and it remains to be seen how regulators in different countries will enforce the new rules.

Interestingly, of the top five risks listed by the European Insurance and Occupational Pensions Authority (EIOPA), not one is an actual insurance risk. There is the sovereign debt crisis, corporate and private household credit risk, equity risk, prolonged low interest rates followed by a sharp rise in interest rates, and a fall in bond prices—only after those do you have natural catastrophe risk, currency risk and liquidity risk. Clearly we live in interesting times, allowing insurers and reinsurers to distinguish themselves from the pack.

Q Looking at Solvency II in general, what kind of issues have clients been reporting and what kind of support can Aon Benfield Analytics offer?

A Whether clients are large or small, Solvency II is a big issue. Everybody has teams focusing on it, and it is a big drain on expenses.

Some clients have been primarily focusing on Pillar One, arranging their capital needs and internal model calculations. For those insurers where the standard formula shows largely sufficient solvency ratios under QIS 5, the standard formula is fine. Others will have to revert to internal models. Although internal models can be more insightful and identify more appropriate capital requirements, this route is also more challenging because it requires excellent data quality and it involves a long approval process with six different tests. This is then compounded by the fact that companies do not even know whether their internal model will be approved, as there are still a number of questions to be answered by the legislator.

This implies that many insurers require assistance, which Aon provides through Aon Benfield and Aon Global Risk Consulting, advising on capital modelling through ReMetrica and Pillar Two support on areas such as model validation and documentation.

Marc Beckers, *head of Aon Benfield Analytics for Europe, the Middle East and Africa*

Q How do European countries differ in their reinsurance buying strategies?

A You have to make a differentiation between those buying property-catastrophe coverage and those buying casualty reinsurance. If you look at property-cat, in Germany, for example, there is still a number of proportional treaties and a lot of aggregate treaties that have been in existence for a long time. They are partly dealt with through reinsurers and partly through an intermediary such as ourselves.

Then there are countries such as France where there is hardly any proportional business remaining and we see a steady increase in aggregate covers. The aggregate covers are essentially to cope with uncertainty around frequency risk. In my opinion, frequency risk remains harder to estimate than severity risk which benefits from a lot of research on hazard and vulnerability.

However, despite years of research, there can still be much variation in catastrophe model output when a new model is released. For example, in Greece we see one modelling firm increasing its expected loss by between 50 percent and 100 percent and another company decreasing it by 50 percent. As the world of cat modelling evolves, it continues to have a big impact on the way people buy reinsurance across different countries.

We observe more discipline in the reinsurance market than in the past and pricing will remain relatively stable as long as the capital availability of reinsurers is abundant.