

INTELLIGENT INSURER

OPPORTUNITIES FROM UNCERTAINTY

*Volatility can still offer rewards,
says Gen Re CEO Tad Montross*



EMBRACING UNCERTAINTY

Uncertainty is the common problem underpinning almost every area of the reinsurance business at present. Yet for all the challenges this presents, the most innovative companies will also enjoy the opportunities it will bring to the table, Tad Montross, chief executive of Gen Re, tells Intelligent Insurer.

The greatest challenge facing the reinsurance industry is not soft rates or even volatile investment returns, but uncertainty. The stability of global economies is uncertain, the political situation in many countries is uncertain, regulatory changes specific to the insurance industry are creating uncertainty as are climate change and changes to risk models—something now so critical to the industry.

There are no easy solutions to these challenges. The only option the industry has is to get back to doing what it does best and trying to do it better than ever—assuming risk at fair prices and being vigilant and responsible when doing so.

That is the view of Tad Montross, chief executive of Gen Re, who argues that while inadequate rates and poor investment returns make this disciplined strategy important to the industry, the uncertainty underpinning so many other areas of the market make it vital.

“So many factors at the moment are creating uncertainty for the industry,” Montross says. “The uncertainty about the health of the global economy, unprecedented volatility in financial markets around the world and a fundamental rethink about what is a ‘risk-free rate’ based on the sovereign debt issues in so many countries, all create numerous challenges on the asset side of the balance sheet,” he says.

“This high level of uncertainty demands vigilance in underwriting and resilience in assuming risk. This means that you must stick to what you know. For Gen Re, we continue to focus on understanding our clients’ needs, being responsive and managing the risks we assume prudently.”

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This disruptive uncertainty has been compounded by an exceptionally difficult first half of the year in terms of the frequency of catastrophe losses in various parts of the globe. He says that the high number of natural catastrophes, including increased earthquake activity in the ‘Ring of Fire’ and the severe storms that have hit the US in recent years must “force a reassessment” of pricing among reinsurers.

Montross notes that while the long-term average annual loss stemming from US windstorms has been around \$6.5 billion, the annual bill has exceeded \$10 billion for the past three years in a row. He believes that this year, 2011, the cost could top \$20 billion. He argues that rates must reflect these increased exposures. When you add in the loss of investment income and other uncertainties, the case for rates increasing becomes irresistible.

“Rates will continue to go up where either exposure has gone up, frequency is positive or severity is increasing,” he says. “Lower interest rates and a rethink on what is a ‘risk-free rate’ will also drive rates higher. We need to get paid for the exposures we are assuming.”

Some reinsurers have cited the recent changes to RMS’s US hurricane model, which has adjusted the modelled exposure upwards, as a reason for rate hikes. But Montross dismisses this as being just one factor in the way Gen Re prices this business.

“Our assessment of the underlying exposures and any resultant changes definitely impact our business. We sell a product that we don’t know the final cost of when we sell it. The pricing is based on estimates, and when

we have better data or new information about exposures, our estimates and resultant prices change.”

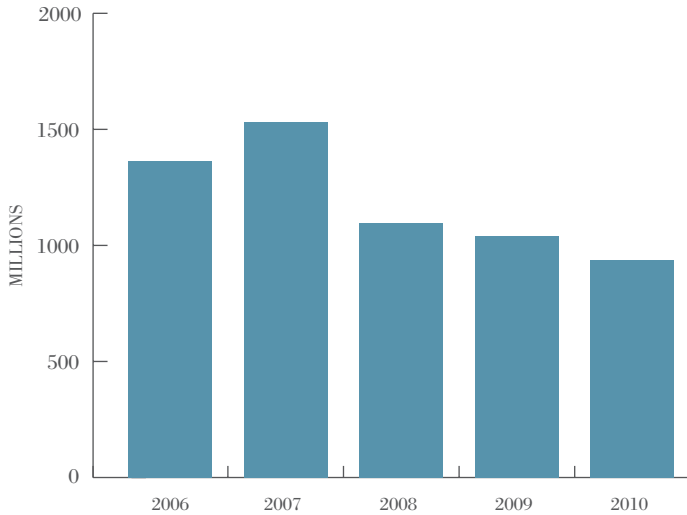
But despite his tough stance on the need for rate increases and underwriting discipline, he does not believe that negotiations at this year’s renewals will be any more difficult than usual. He believes that “good honest communication will be the critical component in any negotiation” and that “all the posturing and market banter is a sideshow”.

He argues that insurers and reinsurers instead need to concentrate upon the real issues. “For Gen Re, an emphasis on our strong technical skills and treating our clients fairly will continue to be our way of doing business,” he says.

The Gen Re chief is also sceptical about some of the changes being imposed on the industry by external forces. He believes that the impending implementation of Solvency II and IFRS4 is creating “additional uncertainty” because they both require significant investment from the industry.

Not only is Montross clear that the industry now needs stability more than anything, he also argues that the long-term benefits of some of the most fundamental shifts are not necessarily clear and bemoans the costs associated with them. “Regulatory changes are requiring large investments of both time and money to be compliant. Yet it is not clear that a greater emphasis on quantitative models will improve risk management for the industry,” he says.

GEN RE NET INCOME



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Another important trend he predicts is that the role of brokers will change in the coming years. “The role of the broker will continue to evolve, ultimately becoming that of a risk consultant paid on a fee-for-services basis. There will be continued consolidation in the broker market segment and I think ultimately fewer reinsurance markets,” he says.

This view is also interesting when taken in the context that he regards his proudest achievement since undertaking his role at Gen Re as maintaining the company’s commitment to a direct business model. “This makes us different and underscores our unique value proposition for clients,” he says. “We will work hard to earn opportunities with clients and prospects in a competitive market. In a world dominated by three brokers, we offer an alternative, a different perspective, a choice.”

Montross also expresses some unconventional views about the future strategy of reinsurers in the future. For many years, diversification has been the watchword of the industry—both in terms of geographical reach and product range. Rating agencies rewarded it; investors looked favourably upon it. It could protect against sharp local market cycles and trends, and position companies well to take advantage of opportunities wherever they might emerge, it was thought.

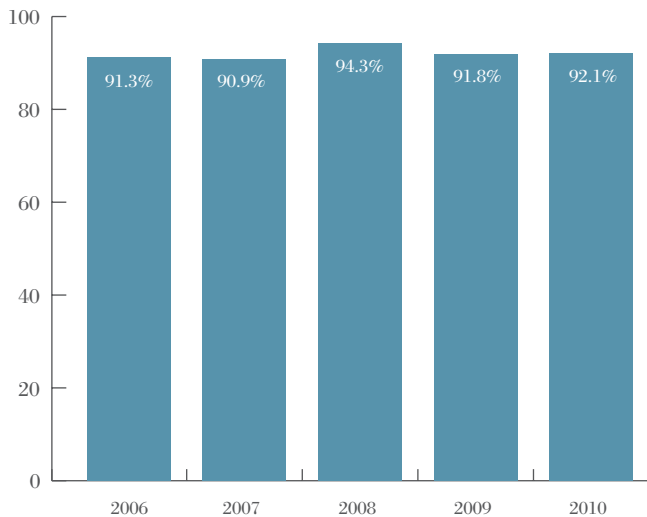
But the Gen Re chief believes that these theories are no longer valid. “Diversification as a strategy has been discredited,” he says. “Also, the mismatch between investors’ 18 to 36-month time horizons and their subsequent ‘exit strategies’ will increasingly be seen as incompatible with a business which has liabilities that will be around for many years, if not decades.”

Yet for all the uncertainty surrounding the industry and its future direction, he also admits that some of the apparent challenges also present opportunities. “Greater uncertainty, changing cat models, increasing cat exposures and regulatory change could increase demand for reinsurance,” he says.

He adds that it will be the reinsurers that allow innovation to flourish that will be best positioned to take advantage of this. “Innovation in the risk assumption business is about doing things smarter and more efficiently, while maintaining a keen focus on risk management,” he says. “The products, exposures and wrappers may change, but the fundamental principles of risk underwriting and risk management always apply.”

Montross says he gears his own approach in terms of how he runs the business to ensure this happens by getting the best from his people. He wants everyone to contribute to concise company goals. “I’ve tried to nurture a more collaborative culture, but with crystal clear objectives. I want our people to believe in and live our strategy—not just follow it,” he says. □

GEN RE COMBINED RATIO



GEN RE PREMIUMS EARNED

