

Globalisation and the impact on reinsurance

As the economic balance of power shifts towards the emerging markets, what does this spell for the “Western” reinsurance players? **Dr Kai-Uwe Schanz** of **Dr Schanz, Alms & Co AG** examines the possible implications.



There is a real possibility that the global reinsurance market, a business that generates US\$200 billion in annual premiums, will be significantly reshaped in the next two decades as the economic balance of power seems to inexorably shift towards the emerging markets. Current global industry leaders could face a major struggle if they want to retain their leading position. And there are the first signs that emerging market countries are prepared to use their rapidly-growing wealth and clout to challenge the dominance of traditional Western players in emerging markets reinsurance and – potentially – beyond.

Power shifting towards emerging markets

There is a new dimension to this trend of a shifting economic balance of power, commonly referred to as “Globalisation 2.0”. Until recently, globalisation was understood solely to mean “Western” companies setting up manufacturing facilities in China or call centres in India. Today, however, emerging markets are investing their vast surpluses in US treasuries and other developed world asset classes; and their corporate giants are making inroads into “Western” markets by acquiring (operations from) prestigious brands such as IBM, Jaguar, Land Rover and Volvo.

Domestic sovereign and non-sovereign investors (such as Dubai Group and Khazanah from Malaysia, which hold the majority of one of the world’s largest Shariah-compliant reinsurance companies), do have the funds to establish new reinsurance entities or beef up existing ones. They develop an increasing comfort and familiarity with the reinsurance sector. In line with this development, the financial strength of “indigenous” reinsurers has improved markedly even though it remains underwhelming from a global perspective.

Moreover, national and regional reinsurers have boosted their technical capabilities, not least by more aggressively taking on board talent from “Western” countries. As a consequence, the traditional “expertise gap” between global and regional players, arguably the most relevant barrier to entry in reinsurance markets, is narrowing.

Preferences of cedants

Local insurance companies are also keen to diversify their reinsurance placements more effectively to mitigate counterparty credit risk. In the past, they may have dealt with just five reinsurers. Nowadays, they increasingly prefer to put their eggs in a larger number of baskets. This development has to be seen in the context of the financial crisis which has demonstrated that corporate size and financial strengths ratings on the one hand and resilience to “Black Swan”-type market dislocations are not necessarily positively

correlated.

The vulnerability of “Western” institutions exposed by the financial crisis has also heightened the sensitivity of regional and local ceding companies to the perceived arrogance and “preaching attitude” of some foreign reinsurers.

A growing number of cedants now feel more comfortable dealing with domestic alternative reinsurance carriers who not only offer acceptable and improving levels of financial strength and technical expertise, but also a larger degree of cultural proximity.

Emerging market players face challenges

There are challenges, of course, for emerging market reinsurers. They need to enhance the international diversification of their underwriting portfolios in order to reap the benefits of improved capital efficiency and to attract and retain the best and the brightest, with a truly global perspective on recruiting talent.

In addition, it is necessary to keep the extent of these changes and their impact on the reinsurance market in perspective. Emerging insurance markets still account for a relatively small share of the global market, compared with their share in global GDP. The reason is that insurance penetration (insurance premiums as a share of GDP) is considerably lower in emerging markets (3%) than in developed ones (9%), according to Swiss Re.

The global share of emerging market non-life insurance markets amounts to 14%, excluding the Newly Industrialised Economies (NIE) of Singapore, Hong Kong, Taiwan and South Korea. In the life insurance business, emerging markets account for just 12% of the world’s total.

Regional reinsurers catching up

However, a strong case can be made that growing economic power and the increasing technical ability will enable emerging market reinsurers to capture a larger share of available reinsurance business. They will be able to do so not just in their domestic and regional markets but also in mature economies – and they may have the potential to follow in the steps of companies such as Lenovo and Tata.

Again, all this is not to say that “Western” incumbents will lose their clout anytime soon. However, as their regional competitors are catching up, they may want to respond to “Globalisation 2.0” by pursuing a strategy of accelerated regionalisation. Such a strategy could see “Western” reinsurers add more value locally (ie, by transferring underwriting authorities) and, potentially, even tapping into local and regional capital sources. **M**

Dr Kai-Uwe Schanz is the Principal Partner of Dr Schanz, Alms & Co AG, Zurich. The original longer version of this article was published in *Quantum – Finance in Perspective*, April 2011. The author can be contacted at kai-uwe.schanz@schanz-alm.com