Opportunity realised with strategic management of global volatility

Guy Carpenter's Dean Klisura addresses the macroeconomic challenges and opportunities facing (re)insurers

Today, insurers are facing unprecedented challenges as they navigate a volatile and ever-evolving (re)insurance landscape. The challenges include macroeconomic and financial market instability, the growing complexity and interconnectedness of risk and a shifting geopolitical landscape. While these factors create strategic business challenges, they also represent opportunities for companies to grow and become more resilient.

One of the chief macroeconomic factors is inflation. While global inflation levels are declining, partially owing to monetary tightening, they persist at levels above central bank targets. Multiple supply and demand-side inflation factors remain, including geopolitical uncertainty and tight labour markets. In Europe, the ongoing conflict in Ukraine has heightened volatility stemming from new economic, financial and trade sanctions. The financial effects of the conflict extend beyond Europe, reflected in rising prices for various commodities and products such as food and oil.

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The current inflationary environment is pressuring insurers in multiple areas, including pricing, insured valuations, underwriting margins, reserves and asset values. For example, inflationary effects on materials, supplies and construction costs are increasing property claims settlement expenses. Consequently, if claims reserves were set during lower inflationary periods, insurers may now need to raise the reserve levels, impacting overall profitability.

One way to combat increased inflation is by central banks raising interest rates, which generally leads to slower economic growth. A reduced rate of economic output typically leads to businesses cutting back, which in turn may put downward pressure on insurance rates, slowing premium growth for carriers. This effect adds just one more element of volatility to the (re)insurance market.

Turning risk into return

Insurers can take several actions to manage volatility resulting from inflation and slowing economic growth. Proactive management of insured valuations, adjusting pricing for inflation based on granular data, and modelling risk scenarios and forecasts all help manage balance sheet impacts. Insurance reserving, critical to managing the balance sheet, requires analyses and scenario testing that lead to informed decisions regarding future underwriting and reinsurance buying. Reserve modelling tools provide insights that enable companies to more effectively allocate capital and set strategy.

Companies can enhance capital efficiency by reducing excess, trapped or underperforming capital through customised, structured reinsurance transactions that enable carriers to redeploy capital supporting prior years' underwriting. Another approach is for companies to evaluate risk and reward across their balance sheets and potentially rebalance asset allocation to address increased net retained volatility.

The (re)insurance industry has a history of pivoting to solutions as global economic factors stress the system. The impact of the Ukraine conflict is one example, presenting an opportunity to innovate new approaches to public-private partnerships. Guy Carpenter has worked across all of Marsh McLennan's businesses to propose the creation of a war-risk pool designed to insure the reconstruction work required to rebuild Ukraine's infrastructure and economy. This solution would include the development of a war-risk data platform, to make available the information required to enable actuarial analysis and assessment of war risks in Ukraine. This will be a crucial step in enabling insurance, rebuilding market confidence and unlocking capital.

Dean Klisura is president and CEO at Guy Carpenter

While we are experiencing unprecedented change related to new and increasingly complex risks, this environment presents opportunities for insurance companies that take a strategic approach. The (re)insurance sector is well-versed at navigating volatility, and while past market-defining events may have resulted in a short-term loss of capital and reduced capacity, the market has historically responded through innovation to overcome these challenges.