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Insurance poised for reforms, standardisation next year

Embedded Value

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AT A RECENT insurance seminar by Lloyd's of London, Jeremy Cox, CEO of Bermuda Monetary Authority, observed that if there was a common thread running through all the deliberations, it was that the insurance industry was never still —it was in perpetual motion.

I think Cox very succinctly defined the spirit of the business of insurance and its dynamic relationship with the national or global economy. The state of a nation's insurance industry is directly proportional to its general condition. Naturally, the density of insurance in the US and Japan is among the highest in the world.

The insurance industry does not move on its own volition. At the core of this business is human instinct and the business imperative to look for tools to transfer risk and to protect one's wealth, assets and even future income from unexpected but probable damages. So as 2014 —with all its highs and lows for the industry — comes to an end, it will be interesting to analyse the trends that may emerge during 2015 for an "industry perpetually in motion".

It is likely that the regulatory framework will get further streamlined and globally standardised. The regulations, along with redefining of boundaries for deployment of insurance funds and capitalisation instruments of companies, have been changing rapidly since 2008. The collapse of AIG — and its subsequent \$182.3-billion bailout by the US government with public money — had sent a strong message to managers and regulators of the industry across the world regarding its vulnerability and indispensability.

Managing this contradiction proved to be a major challenge for all concerned. Very recently, MetLife, the largest insurer in the US by assets, has been declared a "systemically important financial institution" by the Financial Stability Oversight Council as they think the company may pose a serious threat to the US financial system. Similarly, the International Association of Insurance Supervisors thinks the insurance industry must be nurtured and protected as a major source of financial stability. So, 2015 may see greater regulatory activism worldwide.

The focus on emerging markets is likely to continue next year despite the global economic slowdown

Globally, insurers continue to be under pressure due to cyclones and floods. According to Swiss Re's preliminary sigma estimate, economic loss from natural catastrophes during 2014 is estimated at \$113 billion. Insurance claim outgo is estimated at \$34 billion. The estimated loss of lives was 11,000. Around 30% lives were probably covered.

In a recent review of the implications of climate change on the industry, experts in the developed market have underlined the critical role that reinsurers will have to play by involving players of insurance-linked securities (ILS) on a wider scale. They will have to devise innovative solutions for the entities exposed to such risk. Last week, the Association of British insurers and the UK government signed an agreement for a comprehensive flood reinsurance system and 2015 is likely to see a surge in catbonds and the ILS.

The focus on emerging markets is likely to continue next year despite the global slowdown. Saturation at home and poor penetration of insurance in emerging markets will continue to be a pull factor. In fact, John Nelson, Lloyd's chairman, said at the seminar that the insurance market was set to grow to \$2 trillion in just over a decade from the present \$600 billion.

Back home, 2015 may be a happening year in view of the likely passage of the Insurance Bill. But optimists must note that cross-border investments have been experiencing a negative trend since 2008. Cross-border capital flows plummeted to \$4.6 trillion by 2012, from \$11.8 trillion in 2007. The Bill needs to be demystified before expecting benefits to accrue and a sudden turnaround in the domestic market is unlikely during 2015.

The next year may witness reforms in accounting practices and valuation methodologies. This is urgent for smooth mobility of funds across markets.

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