THE OPINION OF DORIS HÖPKE

Tackling pandemic exposure holistically

Dr Doris Höpke was appointed to the Board of Management of Munich Re in 2014 and since August 2018, has taken over responsibility for the Europe and Latin America division including Financial Lines. She completed her law studies at the universities of Osnabrück, Hannover and Leiden and during her early career worked in industrial liability insurance at HDI Haftpflichtverband der Deutschen Industrie. Dr Höpke has been with Munich Re since 1999, so is ideally placed to tell De Actuaris how the business works and her predictions for the future.

Munich Re has a strong position in all lines of business, both life & health, and non-life. The COVID-19 crisis has an effect on many of them. How does Munich Re manage its pandemic exposure?
"Managing a very well diversified business is a key part of our business model. Munich Re benefits enormously from the diversification between life & health and non-life, between property and casualty, between reinsurance and primary insurance, and from the geographic spread of our business. You are right, though, for an extreme pandemic scenario like COVID-19 there is no diversification benefit.

FOR AN EXTREME PANDEMIC SCENARIO LIKE COVID-19 THERE IS NO DIVERSIFICATION BENEFIT

We are steering our pandemic exposure holistically across all business lines as well as across both sides of our balance sheet, liabilities and assets. This explains why we can permit only a significantly lower risk appetite for pandemic exposure in our non-life business compared to our nat cat exposure. Therefore, in our non-life business, and especially in non-damage business interruption policies, pandemics are usually excluded. We offer specific coverage through our Epidemic Risk Solutions Team with tailor-made products, risk-adequate prices and transparent limits."

The non-life catastrophe market has gradually softened, especially in Europe, over past decades. According to the Guy Carpenter catastrophe rate-on-line index, catastrophe reinsurance premiums are half the levels of 2002. What are your expectations for the future?
"European cat rates have indeed fallen over time to very low levels when compared to other regions. There are numerous reasons for this development, such as the expansion of collateralised reinsurance and its knock-on effects, or the strategic aim of some reinsurers to increase their market share in Europe.

The most significant factor in the continuous decline in rates must be seen in the absence of major catastrophes in Europe since storms Lothar & Martin in 1999. While in the US, Australia and the Far East, multiple very significant catastrophic events have established rates at a different level, the absence of these in Europe has led to the continuous slipping of rates.

Currently COVID-19 severely impacts all our lives, the economy and the capital market. Inevitably, the insurance industry will also be impacted

significantly – on the asset side, but also on the liability side. I expect the crisis will have an influence on the supply and demand side of reinsurance, leading to increased prices. We already received requests from clients seeking to increase their reinsurance protection in order to avoid additional volatility and losses. At the same time, I would expect a reduction of capacity due to the losses on the asset and liability side.

For Munich Re, I can say that the probable short and longer term costs of the pandemic are substantial, but will stay financially well manageable. With our strong balance sheet, we remain a reliable partner for our clients in these times."

The alternative market for reinsurance (like catastrophe bonds and other insurance linked securities) has grown. Do you expect this trend to continue?
"Alternative forms of reinsurance have been growing, but still focus on providing nat cat covers for the most risk prone areas like the US. This reflects their major role in the reinsurance market, which is to offer cash collateral-backed capacity in zones that represent material risk accumulations on most traditional balance sheets. Besides offering cat bond services for our clients, Munich Re has been quite active in utilising this capacity for managing our own peak exposures.

Triggered by the crisis, this market might grow into a different direction in the midterm: while most of the more recent growth was driven by investors participating in mostly illiquid forms like 'collateralised re', liquidity might become more important after the current crisis. This might drive more interest in cat bonds as one of the few alternative investment classes that offer some form of liquidity."

Munich Re is not only active as a reinsurer, but also as a primary insurer. So for some clients Munich Re is not only their partner in risk management, but also their competitor. How do you manage this conflict of interest?
"The traditional boundaries between insurance and reinsurance have been blurring for a long time. Similar to how reinsurers are more active in primary insurance primary insurers have started to act as reinsurers.

TECHNOLOGICAL PROGRESS IS FUELING INNOVATION COMPETITION AT ALL STAGES OF THE VALUE CHAIN

Within the Group we ensure strict application of ethical walls between the two organisations. We also gear our primary insurance activities on selected markets and segments. However, these no longer new activities are only a part of the bigger transformation the insurance industry is undergoing. Above all, technological progress is fueling innovation competition at all stages of the value chain. A modularisation of the value chain can be observed, which facilitates the entry of new market participants from other sectors as well.

High regulatory requirements protect the core activity of the insurance industry as well as the requirements for risk management and compliance. And yet, in their own interests, insurers will want to protect their business by taking advantage of the new opportunities offered by advancing digitalisation."

DUTCH INSURERS COULD BENEFIT EVEN MORE FROM REINSURANCE

Munich Re dominates the global reinsurance market together with Swiss Re. These two companies are by far the largest reinsurers and both are almost double the size of number three in the market. Is the market sufficiently competitive?
"Competition is fierce and established, and new players in the industry are feeling the effects of this, not least in terms of rates. Munich Re operates globally and in almost all types of activities. It is thus in competition with a number of successful players in each of these specific business fields and regions. In the Dutch market, for example, many other large and medium-sized reinsurers have gained significant shares over the last fifteen years.

Competition looks even fiercer when considering property, in particular nat cat business. Many players and also capital markets providing alternative capital are involved. Size alone is not decisive: to remain at the top, combined solutions of outstanding specific know-how and financial stability are needed so that clients in turn can compete successfully in their markets."

What are your expectations for new lines of business, e.g. cyber insurance? The market growth in the Netherlands isn't very strong at this moment.
"Studies show that cyber is one of the most critical risks in the eyes of risk managers. Furthermore, cyber risk as well as potential for cyber insurance continues to grow due to more digitalised business models and stricter data protection legislation. Munich Re has recently seen strong growth in Germany and in the Asian markets. The current pandemic situation contributes to a sharp increase in the use of digital technology and thus possibly also to higher vulnerabilities.

Cyber insurance volume in the Netherlands is below the level of other European markets, but we expect strong growth over the next years here as well. Especially as the cyber risk is quite high: The Netherlands account for one of the highest numbers of reported cyber incidents in Europe. From our experience, cyber insurance growth is not linear, cyber incidents can suddenly and massively increase the demand for cyber insurance."

Which opportunities do you see for Dutch insurers with respect to reinsurance?
"Not only Dutch insurers, but the whole industry faces some challenges, ranging from persistently low interest rates and cost pressures, the introduction of IFRS 17, the requirements of emerging technologies, and competition from new players. There is quite a spectrum of fields where reinsurers could be of help to tackle those. I believe, Dutch insurers could benefit even more from reinsurance in order to achieve advantage with regard to capital management."

What are the differences between the Dutch and other markets?
"The Dutch primary insurance market is one of the most saturated insurance markets in the world with widely optimised (re-)insurance solutions and products – for both larger players as well as most small insurers. Distribution channels in many cases involve brokers or underwriting agents, with the strong position of underwriting agents bearing the risk of comparatively high cost ratios for insurers.

For many years Dutch insurance companies focused on commodity business regarding both private lines and SME – leading to fierce competition and price pressure. At the same time, the dominance of large international players in the industrial market has increased.

From my perspective, opportunity and threat are two sides of the same coin. In a highly saturated and competitive environment, differentiation is essential. I strongly believe that data and technology are the most important factors for differentiation, for example in product development, portfolio steering, customer experience, but also in many other areas."

What are important trends and developments in your view for the insurance industry?
"For the insurance industry, I see the power of data and digitalisation as the key to future success. For us this comprises streamlining processes, improving our client's risk exposure, and delivering superior customer experience. Let me give an example to illustrate the possibilities offered by data and digitalisation: water pipe leakage and the escape of water is a major and growing loss driver in property insurance in many countries. With data science we are able to improve risk assessment and prevent losses by making use of data obtained by sensors detecting water leakage.

One of the most important and powerful developments is climate change. I strongly believe that we as an industry have to address the effects and opportunities of it. We need to improve our products to meet clients' future demands and promote the required transition process, e.g. covering risks from renewable energy and new technologies. We must also adjust and reflect climate change in our risk assessment of severe weather events or droughts. Our responsibility in this matter affects all parts of our business activities. Munich Re has joined the Net-Zero Asset Owner Alliance and has committed itself to decarbonising its asset portfolio until 2050. This is an ambitious target that requires significant effort and we aim to promote the transition process in our industry and beyond." ■