OPINION

We must expand the market to put increased capital to work

Bermuda is incubating start-ups and promoting underwriting innovation, but what happens next is not entirely predictable

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As the industry digests the convergence of alternative capital with traditional capital in the re/insurance business, let's focus on Bermuda's role in putting capital to work to benefit consumers in insurance markets.

First of all, Bermuda is doing what it does best. It's putting capital to work quickly, it's incubating start-ups, and it's promoting underwriting innovation. However, what happens next is not entirely predictable.

The famed economist, Joseph Schumpeter, described what we are all witnessing as the essential process of "creative destruction". It is an inevitable, incessant process of revolutionising, mutating and destructing (his words) economic structures – the process of creating a better mousetrap – in this case, one process devoted to managing risk.

Today, there are those who focus on areas such as: the turmoil surrounding mergers and acquisitions; the angst about driving a new soft market; regulators having trouble keeping up with rapid change; and the uncertainty created by the quickly changing conditions.

In the long run, however, all these challenge areas are about putting capital to work. Investors want to take on insurance risk and this is an important part of evolving insurance markets to handle current demands.

Our goal has to be geared towards expanding insurance markets to put this capital to work – both in the developed world and the developing world. In the long run, insurers, reinsurers and their customers will all be beneficiaries of an economy that increases insurance penetration to better manage risk.

In the UK, there are two great examples of increasing private sector risk transfer through reinsurance purchasing, in the form of Pool Re (for terrorism risk) and Flood Re (for flood risk).

Announcements indicate Pool Re has just signed a deal to purchase £1.8bn ($2.6bn) in reinsurance – for the first time ever – and a Flood Re consultant had previously told me that it would purchase up to £700m in reinsurance in its early years, with that amount potentially tripling as exposures grow.

In the US, we have excellent examples in the Florida Citizens Property Insurance Corporation, which has now depopulated itself by successfully transferring 56% of its policies to the private sector and reducing potential debt burden with an expected $4bn risk transfer purchase. This risk is being moved into the Florida domestic home insurance market and into the reinsurers that support that market, which in itself is an additional example of boosting private sector risk bearing.

All that stands in the way of putting this new capital to work in order to manage current and new risks in both developed and developing countries is the self-interest of incumbent players, the myopia of regulators and the inertia of policymakers

Bermuda: doing what it does best
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Also in the US, the new extension of the government terrorism risk program does create an opportunity for incremental growth in reinsurance markets. Similarly, the US National Flood Insurance Program affords a great opportunity to transfer as much as $10bn in risk to reinsurance markets – if the policymakers can get their heads around this opportunity.

In the developing world, Stephen Catlin said it all: "In China, there are at least 10 cities which, in 10 years' time, will each have an economy of a similar size to Florida's and are prone to both wind and earthquake risk. These will need re/insurance support and the reality is that extra capital will be needed over such emerging risks."

Governments throughout Asia and Africa have expressed an interest in growing either or both crop insurance and property insurance markets.

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Market forces – as Schumpeter said – will triumph in the end. But it will require all of us working in this market to focus our attention on regulators and policymakers so they see alternative capital as the opportunity that it is.

Increased insurance penetration for natural disaster risk, through the capital pools exemplified above, protects consumer assets, builds consumer wealth, and speeds economic recovery – as the Bank of International Settlements/International Association of Insurance Supervisors study has found.

As for Bermuda, kudos to the Bermuda Monetary Authority for creating a regulatory structure that can speed reputable capital to market and to the ABIR members' executives who excel at innovation in managing insurance risk.

Speaking of excel, let me close with a quote from XL Group's chief executive, Mike McGavick: "I'd rather work in an industry where capital was attracted than one where it was not."

It seems that Catlin and McGavick are on the same page, in more ways than one! ■

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