Global Reinsurance Masterclass Series

Strategic Thinking for the Reinsurance Industry

Masterclass 1
Re-think reinsurance
How to shape your future through a strategic understanding of global market forces

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Executive Summary

The reinsurance industry is experiencing intensified competition and regulation.

This Masterclass:
- Analyzes the ‘big picture’ of the reinsurance industry through Porter’s Five Forces model of competition;
- Examines the key players aligned with these Five Forces and their impact on competition and industry profitability;
- Customizes the model to cover special features of the reinsurance industry, especially the roles of brokers and modelling companies;
- Explores co-opetition, the simultaneous competition and collaboration of players, in a subscription market;
- Suggests strategic responses to competitive pressures in the reinsurance industry.

It is the first in a series of seven such Masterclasses.

Up until 2010 reinsurers ‘had it good’. But only three years later, it already seems like a golden age is vanishing.

Reinsurance executives at their late-2009 rendezvous in Monte Carlo were quietly optimistic about the coming year. Granted, there had been relatively few natural disasters in 2009, and following the time-honoured pattern, the buyers of reinsurance – the primary insurance companies, and their brokers – would therefore argue for rate reductions. But those buyers had few alternatives to traditional reinsurance products. The main substitutes, securities-based products like Cat bonds or ILWs, had been given a bad name in the 2008 financial crash, and they were now a no-go area. The Monte Carlo executives were a bit anxious about investors like Crédit Suisse, and others, pumping a lot of money into reinsurance. Increased capital – perhaps even an over-supply of capacity – now that would put reinsurance rates under pressure. But no, those big investors were still finding lucrative investments elsewhere, as the financial markets had recovered quickly from the crash. No problem: 2010 was going to be just fine.

It all looks so different now. Reinsurers paid out on an unprecedented series of natural disasters – the Chile earthquake, Queensland floods, Japanese tsunami, Christchurch earthquakes, Thai floods... yet the ‘payback’ for those losses – the traditional higher premium next time round – wasn’t forthcoming. Those buyers, the insurance companies, are bigger and meaner all of a sudden – huge consolidated global firms with enough capital in reserve to cover quite a lot of their own risk. They need less reinsurance. When they do need it, they come to market with huge, bundled ‘super-risks’ that are hard to analyze, and beyond the capacity and capability of a lot of smaller reinsurers. To add insult to injury, Cat bonds are back: a popular and growing alternative to reinsurance, even a natural substitute when buyers are in ‘super-risk’ territory. Brokers have consolidated too, and invested heavily in analytical expertise, so they now know more about the various lines of business and the overall picture than some reinsurers. They are driving their own agenda more, not just connecting buyers and reinsurers. Capital has come flooding into reinsurance, an abundant commodity now that investments elsewhere don’t look so good. So reinsurers can’t charge so much for it. Even the regulators are getting in on the act, forcing reinsurers to make costly changes to the way they operate and making it ever-harder for anyone to stand out on anything but their rates.

No wonder reinsurers are fighting each other tooth and nail to get into emerging markets like Brazil and China. What other future is there?
Executive Summary (cont.)

The risk business is getting riskier. From 2010 to 2012, almost every trend in the markets has conspired to systematically squeeze reinsurance profits and pressurize traditional practices. And those markets are increasingly volatile.

Rather than working from risk to risk, from deal to deal, while market forces close in, these ‘Masterclasses’ show how reinsurers – senior and junior – can take charge of their future. We offer reinsurers a strategic understanding of the ‘bigger picture’ beyond their individual specializations.

Armed with this understanding, reinsurers can:

- make strategic choices about the kinds of business to pursue;
- manage appropriately the relationships on which they depend;
- build the competences which are needed now and for the future, and use them more effectively.

The present Masterclass I sets the framework for the subsequent Masterclasses II–VII.
1. Competitive forces in reinsurance

1.1 Industry structure

Michael Porter’s “Five Forces” model is a widely-used managerial tool for analyzing potential industry margins and for classifying features which affect the competitive environment.

According to Porter:

- Industry structures are determined by the interplay of five forces: bargaining power of buyers, bargaining power of suppliers, threat of new entrants, threat of substitute products, and intensity of industry rivalry. The strength of each force is specific to each different industry.
- The interaction of these competitive forces determines the intensity of competition and associated profit margins of an industry.
- All competitive forces and their interactions are governed by a regulatory framework that sets the ‘rules of the game’ for all participants.

Figure 1.1 shows these five forces in their regulatory context, and the industry-specific players that apply them in the reinsurance market. The following subsections 1.1.1–1.1.5 discuss these types of players, along with the ways in which they affect reinsurance profitability. Section 1.1.6 then looks at how regulatory change may threaten reinsurance profitability, or provide new opportunities.

This model is a useful starting point to explain why reinsurance profitability has been systematically squeezed so hard since 2010. We can also use it to suggest ways in which reinsurers can fight back against this squeeze.

However, later in this Masterclass (see section 2) we will customize the model to include some special features of the reinsurance market – and explore the possibility that it may benefit competing forces to collaborate, as allies, to counteract some of the competitive pressure.

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1. Competitive forces in reinsurance (cont.)

1.1.1 Buyer power – how changing cedent behaviour is squeezing reinsurance profits

In reinsurance terms, insurers pay to ‘cede’ or transfer risk to reinsurers, and these insurance-industry buyers are therefore known as ‘cedents’.

The general trend for insurers is strongly towards consolidation (see Masterclass II), and a relatively small fraction of reinsurance spend remains with small insurers. As cedents consolidate, becoming larger ‘super-cedents’:

• they can bundle risk more effectively and thus decrease their reinsurance spend;
• they are more able to walk away from the market and retain risk internally, covered by their own large capital reserves, when they consider the market price unattractive;
• there are fewer overall buyers of reinsurance, increasing their comparative power as reinsurers have fewer places to go for reinsurance volume.

Of course, buyer power is not uniform across all cedents. It remains true that smaller insurers, and insurers in emerging markets, remain highly reliant on reinsurance as a proxy for capital, freeing up internal capital reserves to fund growth. But considered as a group, cedents have been bulked up by consolidation into ‘heavier hitters’ in their negotiations with reinsurers. They are reducing the amount of cover they buy, and using their buyer power to lower the rates they pay for it – both of which reduce reinsurance profits.

The good news for reinsurers is that to some extent, there is a balancing force built into the rise of the ‘super-cedent’. The more complex their risk programmes, and therefore the more technology-intensive their risk analysis, the fewer reinsurers are left for those super-cedents to consider. The pool of possible reinsurers is artificially limited to a few select heavyweights with sufficient analytic capability. These reinsurers can then take a firmer stance on their rates. In this way super-cedents are limiting their own buyer power when it comes to certain products.

In general: consolidation of cedents is a dominant, and ongoing, trend in most markets, which is squeezing reinsurance profits. This struggle over profit is, of course, central to the relationship between cedents and reinsurers, yet forces for co-operation also exist. Used strategically, these may offer reinsurers a way of mitigating the squeeze on their profits. Such co-operation is examined in section 3.2.

1.1.2 Threat of substitute products – taking premium out of the reinsurance industry

Substitutes are dangerous if they offer a better price-performance ratio than the core products in an industry. Getting the same value cheaper, or better value at the same price, is always attractive! In many segments of the global market, cedents have had over a decade of experience in using Cat bonds as a cheaper substitute for traditional reinsurance products. Cat bonds are securities whose returns depend on the occurrence of a specific insurance event. They are not normally considered part of the core reinsurance market, as they are not generally offered by reinsurers. Yet Cat bonds need to be on every reinsurers’ radar screen, as they can absorb ceded premium that would otherwise have gone to traditional reinsurers. In fact, since 1996, the Cat bond market has seen US$ 44bn of cumulative reinsurance issuance.

While Cat bonds, together with hedge funds and pension funds that write them, took a hit in the financial crisis, they have since bounced back and, by 2012, reached their highest level for new issuances and outstanding volumes in four years.3 All of this is money which is not going to reinsurers. So to understand the levels of competition and potential profits in the reinsurance industry, reinsurers should look further afield than their traditional rivals.

So far, substitutes like Cat bonds have mainly hit reinsurance rates by competing on price, but little attention has been paid to value beyond sheer risk coverage. A better understanding of the value provided to cedents enables a much more strategic positioning of traditional reinsurance products relative to potential substitutes. It may even justify a price premium for a traditional reinsurance product, if it can be seen to offer something not found in the substitute, such as a long-term relationship and reliability, which cedents value sufficiently (see Masterclass V).

Another important form of substitution is internal retention on the part of cedents – simply doing without the reinsurance product. In all, increased consolidation (as described in 1.1.1) enables cedents to retain and cover more of their own risk as a substitute to ceding it on the reinsurance market. In particular, casualty and property-per-risk retention are increasing after a decade of declining frequency. Cedents increasingly consider this a risk they can carry more of.3

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1. Competitive forces in reinsurance (cont.)

“They went from buying proportional to non-proportional and stopped ceding treaties from local operating entities. A lot of meat from the bone was gone for us, we lost 50% of our premium just due to this.” (Reinsurer)

**In general:** Use of substitute products, and internal retention, both of which deprive reinsurers of premium, are increasing as a result of consolidation in the insurance industry (see Masterclass II). One way for reinsurers to push back may be to educate their clients about the superior value of their products, or to liaise with brokers to do so on their behalf (see Masterclass VI).

1.1.3 Supplier power – how supply of capital, and cost of resources, are squeezing reinsurance profits

“What you would expect now is a hardening in the market, after this gruelling year [2011] …however at the moment the investment community sees reinsurance as a nice alternative: there’s not enough investment opportunity in other[financial] sectors. So at the moment too much investment capital flows back into reinsurance.” (Reinsurer)

Reinsurers are reliant on suppliers of capital, suppliers of analytical and other services, and on the general supply of human resources – well-trained, highly-skilled staff. If the cost of services or human resource goes up, it eats into reinsurance profitability.

Following the law of supply and demand, an abundant supply of capital means that reinsurers cannot charge as much for it, because it is no longer as scarce. Broadly speaking, an increasing availability of capital reduces reinsurance rates and, unless somehow counteracted, reinsurance profits. Thus, when thinking about **suppliers of capital**, as with potential substitutes, it is important to keep an eye on adjacent markets and what their development may do to capital supplies in reinsurance.

The year 2011 provides a good illustration: pay-outs on the second-worst year on record in terms of reinsured disasters drained capital from the industry and should have provided the basis for rate increases the next year. Typically, large losses in one year and the prospect of rate increases the next attract new capital to the industry, which then moderates the extent of rate increases. In 2012, though, an extraordinary US$ 6bn of capital entering the market overcompensated for the 2011 pay-outs, taking reinsurance capital to an all-time high during the first half of 2012. This was because such peaks in supply of capital are not only connected to reinsurance events, but also to the return on capital which is available in other financial markets. Low interest rates there (such as one might expect during a banking crisis) create a surge of interest in the high risk/high return property catastrophe market.

The **modelling companies** which reinsurers rely on for vendor models form another important group of suppliers to the reinsurance sector. Even if reinsurers have their own internal models, they are reliant on three big modelling companies due to the widespread usage in the industry of just a few select models. Modelling companies are suppliers for the industry as a whole, providing a framework which brokers and cedents – as well as a reinsurers competitors – also use, which sets technical boundaries for the market’s collective pricing of risk. The power of these modelling companies has increased as the industry, with the help of these suppliers, has become increasingly technical in the last decade. Partly this is a response to the demands of regulation; partly also to cedents’ bundling of analytically-challenging ‘super-risks’ (see 1.1.1 on p4).

The supply and training of **human capital** into reinsurance has also become more important as reinsurance has become more technical. For example, in the past, underwriters were largely trained internally on the job, whereas now, reinsurance is largely reliant on individuals with prior actuarial training.

Reinsurance firms must therefore develop new recruitment strategies that meet the expectations, in terms of career benefits and opportunities, of the employees they will need in the future. This may not appear to be an imminent requirement in 2013, because recruitment in other financial sectors is still lower in the wake of the banking crisis, but it is bound to become a more urgent problem once competition for talent picks up again.

**In general:** low returns in many financial markets have increased supply of capital, which squeezes reinsurance prices and profits. Increasing technical sophistication is giving more power to suppliers of analytical models, and to potential reinsurance employees with rare technical skills; both drive up the cost base for reinsurance operations.

Reinsurance-market-has-more-capacity-than-at-start-of-2011-with-6bn-of-new-funds-Moody-s/
1. Competitive forces in reinsurance (cont.)

Unfortunately, these trends are largely out of reinsurers’ control. Reinsurers, therefore, must ensure that the value created from inputs like models, human resource, and financial capital outweighs their cost. They can achieve this by tailoring reinsurance products to the current market life cycle (see Masterclass II), sharpening their strategic profile (see Masterclass III), or effectively using highly-skilled staff (see Masterclass IV).

1.1.4 Threat of new entrants

Like substitute products, new entrants compete on the basis of price-performance ratios, but as industry outsiders (at least initially) they have to overcome barriers to entry. The threat of new entrants depends on the nature and ‘height’ of those barriers.

In reinsurance, close, longstanding relationships between reinsurers and cedents (see Masterclass V) have traditionally posed a barrier to entry, but recently their perceived value to cedents seems to have waned a little. The regulatory environment represents another such barrier to entry due to its (increasingly) stringent nature. For instance, new entrants must be able to build and maintain a sufficient capital base: this capital intensity of reinsurance is increasingly heavily regulated. Entrants must also invest heavily in building a high level of prior knowledge and human resources expertise, especially concerning risk modelling, ahead of participation.

While these barriers offer some protection for incumbent reinsurers, they are far from insurmountable. New entrants do find their way into reinsurance, particularly from among hedge funds and insurers. These are companies that can more easily scale these barriers, using their prior knowledge and resources.

Hedge funds have been providing Cat bonds (as described above) in the reinsurance market and have also quickly expanded into providing traditional reinsurance products. With their established pools of investment capital, they jump the barriers to entry represented by the capital intensity of reinsurance. In particular there was strong growth in such new entrants to take advantage of rate increases following the 2005 hurricane season (which included Katrina) when rates were at a historical high, a phenomenon referred to as the ‘new Bermudian market’.

“Hedge funds – we see them as a threat because they take the steam out of our market. Smart money knows when there is money to be made. So when profitability is high, “Money” goes and starts a new Bermuda entity, and that takes a little bit of the steam out of our market.” (Reinsurer)

In 2011/12 several well-known hedge funds continued to announce the formation of reinsurance companies in response to fickle investment opportunities elsewhere, and because they wanted to use reinsurance premium as a captive pool of capital to reinvest in the hedge fund itself. Examples include two $500 million dollar Bermudian reinsurance companies, TP Re and SAC Re, set up by hedge funds in 2012.6

Insurance companies already operate within the same regulatory framework as reinsurers and are thus able to jump most of the above barriers to entry. Examples include Allianz Re which diversified from insurance to become one of the largest reinsurers in the world, and Atradius, which used its specialist credit and surety knowledge to become a key reinsurer in that space through Atradius Re.

Brokers (see section 3.1) might help new entrants gain a foothold in the market, but they can also help incumbents defend their turf by more intelligent matchmaking with suitable clients (see Masterclass VI). This is a complementary role for brokers which potentially adds value to reinsurance services.

In general: there was a surge of new entries from hedge funds in 2012, due to forecast rate rises after the many disasters of 2011, and also connected to poor returns in financial markets.

1.1.5 Rivalry with other reinsurers

The forces of industry discussed in the above analysis, such as new entrants, growth of Cat bonds and the supply of reinsurance capital have led to intense rivalry between reinsurers, because their core business is under attack from all sides. In particular, the growth of reinsurance capital – from $342 billion in 2008 to $480 billion in 2012 – has meant increased competition for a comparatively static amount of reinsurance premium in traditional markets. In non-Cat lines of business the demand for reinsurance is actively declining.7

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1. Competitive forces in reinsurance (cont.)

While emerging markets are still growing, the premium on offer there in 2012 remains comparatively tiny compared to the likes of North America. Some territories do have the potential to counteract the general trend of declining total premium. Foremost among them is China, where unlocking the local market could disrupt the traditional frontiers of the reinsurance business. Brazil is another attractive emerging market. Most lines of business in Brazil experience an annual increase in insurance penetration of around 10% and, consequently, cedents are purchasing more and more reinsurance capacity in response to their growing exposures. In response, major brokers and reinsurers are developing local offices in such emerging territories, and new business models to enable them to compete on a global base. Competition between reinsurers for reinsurance profit and premium is therefore no less fierce in emerging markets than in the traditional ones.

However, reinsurers can to some extent choose their competition, by carefully defining their strategy. Despite the increasing connectivity of the global reinsurance market, ‘the market’ is not monolithic. Most players have strong preferences for the business they seek – or don’t seek (see Masterclass III). In consequence, not everyone is everyone’s rival, and rivalry in some segments is more intense than in others.

A reinsurer’s strategy must depend on how they perceive the competition in their segment of the market. So reinsurers must be clear about the different segments they perceive and the criteria by which they defined them (see Masterclass III). Any market can be made to look attractive, if it is defined narrowly enough, but reinsurers must beware that the boundaries they perceive may not actually be barriers. As markets converge, competitors from other market segments, or even other capital markets, may become new entrants in another and take market share from the incumbents. Take for example the rise of ‘Zurich start-ups’: eleven new reinsurers have entered Europe since 2011, increasing competition and driving down margins. Yet many of these entrants were Bermudian firms, which might not previously have been thought to be competitors in Europe, because of their historic focus on the US catastrophe market segment.

In general: rivalry has strongly increased over the last four years, both as a consequence of the increasing power of buyers and suppliers, the availability of substitutes and new entrants, and as a consequence of incumbent reinsurers’ own growth ambitions. Simply put, if the market is no longer growing, any growth by one incumbent has to be achieved at the expense of another’s market share.

1.1.6 Regulation – the rules of the game

The EU’s forthcoming Solvency II directive and Standard and Poor’s recent economic capital model (ECM) reviews are changing the reinsurance landscape. These are (or will be) relatively stringent requirements, aimed at safeguarding reinsurers’ liquidity even in the case of large payouts for catastrophic events. They are increasingly focusing the industry on internal capital modelling, sophisticated quantification of risk, and strict boundaries around risk appetite and tolerance.

In themselves, these increasing demands cut into industry profits, as compliance with new standards is always costly. More profoundly, though, regulatory changes are also sharpening some of other forces in our model. For instance, Solvency II is likely to create an even more technologically-focused environment than previously, because those who can demonstrate effective internal capital modelling will be advantaged in this new, more stringent regulatory environment.

A regulation-driven technology focus further increases the bargaining power of the suppliers of those vendor models that are used for the more stringent risk quantification. There is a further side-effect of the standardization that is inherent in the stipulated use of models: it becomes increasingly difficult for reinsurers to differentiate themselves based on the quality of their analysis. Direct rivals, new entrants and brokers can offer very similar services, which allows cedents greater freedom in shopping around for those services and increases their buyer power.

Finally, regulatory rating agencies provide cedents with information about reinsurers’ risk profiles and financial positions. As a result, while market transparency increases with increased scrutiny, the room for reinsurers to differentiate themselves is further constrained, because the agencies ‘even up’ information asymmetries that reinsurers could previously exploit. Thus, in the absence of strong differentiation, competition increasingly hinges on price, which heralds further rate reductions.

Still, some local variation remains, as every regional market has to meet its own local regulatory system setting out the rules of the game. These local

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Source: http://thoughtleadership.aonbenfield.com/Documents/20120910_ab_analytics_evolving_criteria.pdf
1. Competitive forces in reinsurance (cont.)

Regulations may be very different from each other: for instance Bermuda is recognized as having less stringent capital requirements than Lloyd’s syndicates operating under the UK regulation administered by the Financial Services Authority (FSA), which is stricter than in most other markets. Reinsurers’ planning for the future needs to differentiate which markets are likely to benefit or suffer from specific regulatory changes.

In general: forthcoming regulatory change will cost reinsurers via changes in working practices and greater technological focus. However, stricter regulation could also provide opportunities for reinsurance companies as some cedents may demand more capital (via reinsurance) to comply with the new standards.

1.2 The cumulative impact of Porter’s Five Forces on reinsurance profitability over recent years

From our analysis of the ‘Five Forces’ in section 1.1, we can see from our ‘In general’ summaries that every one of the five forces has increased its pressure on reinsurance profits over the past couple of years, as shown in figure 1.2.

“Solvency 2 could throw up opportunities where people just need more capital in certain areas. And then we’d hope we’d be in position to give maybe quota share type solutions, so that they’ve got somewhere safe to park some of their premium and it takes the capital strain off their own balance sheet.” (Reinsurer)

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 Suppliers have hugely increased the pool of capital invested in reinsurance, driving rates down.
 Increased use of substitutes such as Cat bonds have diverted premium away from traditional reinsurance products.
 New entrants, diversifying from Hedge Fund or Insurance company activity, have divided the reinsurance pie ever more thinly.
 Buyers have consolidated and gained power to drive down rates by bundling risk, or by retaining it.
 Rivalry between reinsurers has intensified as more incumbents are competing over a smaller pie of ceded premium.
 Regulation has driven standardization, transparency and technicalization and, in doing so, has reduced the ability for reinsurers to differentiate themselves on criteria other than price.

Figure 1.2 Changes in market forces (Porter’s Five Forces) and their cumulative effect on reinsurance margins, 2009-12

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1. Competitive forces in reinsurance (cont.)

These five forces, embedded in a regulatory context, collectively define an industry’s average profit potential. Over time, the strength of any individual force may wax or wane and some fluctuations may even cancel each other out. It is unusual when all five forces change in lockstep, however, and industry profits come under pressure from all sides.

In these circumstances, a strategic understanding of those trends is critical. Because even though industry profitability is under pressure, any individual company can beat the trend and maintain organizational profitability by managing the situation more astutely. Some special features of the reinsurance industry, if employed strategically, can actually help achieve this goal.

In the following sections we will first look at those special features of the reinsurance market which are not covered by the Porter’s Five Forces model. We will then customize the model to include players who may compete, but also might also collaborate with reinsurers – to return value and profit to the reinsurance product.

Study Question 1

(a) Relate Figure 1.1 to the market(s) you operate in. List at least three firms or players in your market(s) who fit into each of the categories in the diagram.

(b) In your market(s), can you identify any particular player among suppliers, recent entrants, or substitute products, which has a particularly powerful effect on profitability in your market? Are you especially affected by this player, or are the effects felt more by other players in your market?

(c) In the same market(s), describe any recent change in local or global regulation and identify consequences you have seen across several different deals.
2. ‘Porter Plus’ – a new customised approach to competitive forces in reinsurance

Porter’s theory is a good starting point for our ‘big picture’ of the reinsurance industry. However, it needs modifying because of certain special features of the industry.

2.1 Complementors

Porter’s model does not consider ‘complementors’, industry players who provide complementary products or services which add value to existing reinsurance products.

Brokers are a hugely important type of complementor in the reinsurance industry. They offer analytic services that help cedents structure their programmes, and they channel programmes towards reinsurers with a commensurate risk appetite (which can save reinsurers a lot of work in finding business). Masterclass VI addresses this matchmaking role of brokers in greater detail.

At the same time, though, the risk-modelling services that brokers provide were previously the domain of large reinsurers. These complementary services do more than facilitate the placement of reinsurance programmes. They also, in a way, encroach upon reinsurers’ service territory, as substitute services. Where brokers provide strong modelling services to their clients, highly-technical reinsurers have less room to distinguish themselves, which increases competitive pressures.

In short, brokers act as complementors, but also as providers of substitute services, so we can see that brokers play an especially complex role in the market. We cannot place them within any single group in the original Porter scheme, so we will put them in a category of their own. The role of the broker will be examined in detail in section 3.1.

2.2 Co-opetition

First, Porter’s model frames business relationships as solely competitive. As we have just seen in 2.1, this is not true for brokers, and possibly not for some other industry players, either. In fact, different players may combine competitive and co-operative strategies. Such co-opetition allows the players involved to increase the size of the ‘pie’ through collaboration before competing over their share of it. Especially when the size of the market ‘pie’ is under pressure from many angles, co-competitive strategies may work to everyone’s advantage.

Thus, when applying Porter’s “Five Forces” framework to reinsurance, it is also important to extend it through the concept of co-opetition. For instance:

- relationships between reinsurer and cedents cannot be understood in solely competitive terms, as they involve collaborative elements of mutual learning and trust. Sometimes, greater collaborative transparency on the part of the cedent can help settle on favourable terms, as reinsurers are more comfortable that they fully understood the risk;
- in their role as complementors, brokers collaborate with reinsurers by feeding them business that fits their declared risk appetite, even while they try to drive reinsurance prices down for their clients;
- despite their rivalry, reinsurers rely on each other to evaluate risk and set appropriate terms for subscription.

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2. ‘Porter Plus’ – a new customised approach to competitive forces in reinsurance

2.3 Porter-Plus

If we add these two extensions to Porter’s framework, we arrive at the following expanded model (Figure 2.3), which we will refer to as ‘Porter-Plus’.

Study Question 2

(a) Are you aware of instances where brokers have encouraged cedents to take their programmes outside of the reinsurance industry, by buying substitute products? Or of the opposite, where the cedent has been persuaded to place their premium with a reinsurer rather than a substitute?

(b) Can you describe an instance in which greater transparency between a cedent and a reinsurer resulted in a better deal than would otherwise have been the case, for either or both parties?
3. Collaboration and co-opetition strategies in the reinsurance industry

As we explained in section 2, reinsurers naturally find themselves in competitive relationships with other reinsurers, cedents, and – to some extent – brokers, all of whom may exert or moderate one of Porter’s Five Forces on reinsurance profits. But there is also potential for collaboration with each of these players which can add value to the reinsurance business. In the following sections we examine these opportunities.

3.1 The complex role of the broker

Brokers have always played a central role in the reinsurance industry – naturally, as they are intermediaries who connect buyers and sellers. Yet the nature of this role has evolved over time, into multiple roles. Figure 3.1 outlines the evolution of brokers’ roles from competitor to substitute to complementor (examined below in 3.1.1–3.1.2).

It should be noted, though, that these roles are played to different extents in different reinsurance markets. European reinsurers have a history of bypassing the role of the broker and have traditionally been more likely to see brokers as competitors. The role of brokers as complementors is more established among reinsurers in Lloyd’s.
3. Collaboration and co-opetition strategies in the reinsurance industry

3.1.1 The broker in competition with the reinsurer
Brokers work as competitors to reinsurers as they try to gain the best price possible for the reinsurance buyers: they work for their clients not reinsurers. On cedents’ behalf, they drive down prices by restructuring programmes so as to obscure year-on-year comparability, negotiating favourable deductibles and retention levels, plus terms and conditions, and generally through the breadth of their distribution channels. In Porter’s terms, they strengthen buyer power and shift margin from reinsurers to buyers.

As brokers have evolved into more sophisticated service providers in their own right, offering analytic services and structuring advice, their relationship with reinsurers has changed to that of a provider of substitute services. These services used to be provided by reinsurers. It used to be the case that a cedent who was actually unsure of the level of risk they were handling could go to a very expert reinsurer to get the risk analyzed – at the cost of a higher premium. Nowadays, a broker might do this for them, enabling the cedent to go with a lower reinsurance premium.

This shift reduces margins, but also deprives reinsurers of an opportunity to distinguish themselves in the eyes of the cedents. The provision of analytical capabilities and training, high-powered computing capacities which individual insurers don’t possess, or wording/legal advice used to help differentiate high-quality from low-cost reinsurers. Without this opportunity for differentiation, price competition is yet further emphasized, intensifying rivalry within the industry.

3.1.2 The broker as complementor to the reinsurer
Despite the various ways in which brokers have reduced profitability in the reinsurance industry, reinsurers must not overlook their role as complementors. Unlocking the value of this role depends more strongly on reinsurers’ collaborative attitude, though. For example, new reinsurance entrants into particular markets again and again highlight their reliance on brokers to both 1) sell their particular brand to cedents; and 2) show them the available risk in those markets. In this sense, brokers can act as a distribution channel for both insurance risks and reinsurance capacity.

In their function as a distribution channel, brokers not only help cedents access risk capital, they also help reinsurers access quality risk/clients. In this sense, reinsurers work with brokers to access the type of risk they are targeting, to fill in gaps in their own knowledge (for example, when assessing clients in new markets, where the reinsurer lacks the background knowledge and experience) and to supplement their own resources (such as via brokers’ local offices). These types of benefits, however, are often overlooked by reinsurers while they deplore the rise of brokers and cedent power.

In general: brokers now perform much more varied services than in the past. Understanding the value they can create for reinsurers, via intelligent matchmaking with cedents, can relieve some of the competitive pressure reinsurers face through strengthening buyer power (see Masterclass VI).

3.2 Co-operation between buyer and seller of reinsurance
Standard operating procedure is still for cedents (and their brokers) to obscure year-on-year changes, complicate comparison and make their risks less intelligible. This is the very opposite of a co-operative approach. Cedents aim to make their deals look more attractive – but instead, reinsurers are instinctively likely to charge a higher premium for a risk they feel they do not fully understand.

Instead, we would argue that both buyer and seller, cedent and reinsurer, can benefit from a long-term relationship built on transparency and trust. The reinsurers can add greater value for their cedents when they are able to understand the cedent, their strategy and risks, while gaining access to the information they need to be confident in their risk assessment. In a more collaborative approach, a cedent gains a partner who truly understands their risk profile, who can be trusted to pay their claims promptly, and who is able to assist them through free consultancy services.

Many relationships between buyer and seller in reinsurance have traditionally been based on the idea of ‘payback’: if a reinsurer wears a loss with a cedent, there is enough continuity in that relationship for the reinsurer to reap the benefits of the consequent rate rises. The tradition of payback is de facto a collaborative strategy; pure competition might suggest that the cedent avoids payback and simply shifts to another reinsurer to access cheaper rates. The ‘payback’ tradition has been a tacit recognition of the two-way benefits of longstanding relationships, mentioned above. Maybe it is time for reinsurers to emphasise more explicitly these benefits, gained via learning and information quality, to counter a drift away from long-term relationships (see Masterclass V).
3. Collaboration and co-opetition strategies in the reinsurance industry

3.3 Reinsurers: collaboration

As reinsurance is a subscription market (whereby all reinsurers take a share of a particular risk at the same market price) there is widespread realization among reinsurers that they rely on having good competitors. That is, competitors who will not undercut on price and share certain standards of risk assessment. This is taken to the extreme in Lloyd’s where collaborative efforts have seen the establishment of a single market voice, sharing of resources and setting standards of appropriate practice between reinsurers.

“...There is a community nature to the market where different syndicates don’t purely see each other as competitors, but also refer business between them to keep it within the Lloyd’s market.” (Reinsurer)

Reinsurers must not lose sight of this distinctive nature of their market, in which it is vital to balance competition and collaboration. An appreciation of strategic groups in reinsurance (see Masterclass III) will show which players are more natural competitors or collaborators.

Study Question 3

(a) List the roles played by brokers for both insurers and reinsurers. In what ways can you make better use of these?

(b) Identify a specific recent example in your market of co-operation (i) between reinsurers (either bilaterally or as an association) (ii) between reinsurer and cedent, which benefitted both or all parties. Was the benefit to you one of profitability, or something else?
4. Conclusion: the squeeze on reinsurance margins – and ways forward suggested by our strategic analysis

As we showed in section 1, between 2009 and 2012 every one of the market forces we have identified – exerted by the groups of players as a whole, rather than individual buyers or brokers or investors – has intensified its pressure on reinsurance margins.

For reinsurers to fight back and grow against these concerted forces, there are three main options. All of them require the strategic understanding of the industry which we have developed in this Masterclass – an understanding framed in terms of co-opetition, a mix of competition and collaboration.

1. **Refine competitive strategy in both traditional and emerging markets.** This is the focus of Masterclass II, which seeks to understand and predict types of cedent behaviour, and of Masterclass III, which goes on to develop the idea of ‘strategic groups’ of reinsurers each based on a different business proposition, suited to different types of cedent.

2. **Improve the internal effectiveness of reinsurance operations.** This is especially the subject of Masterclass IV, which examines the strengths of old and new approaches to the risk appraisal process, the way they can be blended, and the new capabilities they require.

3. **Develop collaborative strategies to benefit both reinsurer and any of: buyers, brokers and/or the reinsurance community in general.** Masterclass V investigates the links between relationships, information, and three different kinds of trust in business relationships, all vital to reinsurance deals. Masterclass VI focuses on the roles of brokers, and the skills they can contribute to create competitive advantage for both reinsurer and cedent.

The reinsurance industry finds itself in a situation of extreme flux. The current industry structure might be radically shaken up, soon. New regulations could erect greater barriers to entry in fiscally strict countries, leading to greater competition in so-called tax-havens. More accurate technical models for a particular territory could boost the bargaining power of the modellers. A lack of significant ‘payback’ from events in 2011 might easily challenge some traditional assumptions of collaboration. There are so many “what if...?” scenarios which could unfold...

In Masterclass VII, the last in our series, we demonstrate how strategic understanding of the reinsurance industry could help you plan for scenarios you may soon have to face – enabling you to shape your future, not just react to it.

**Study Question 4**

The balance of competitive forces and collaborative will is always evolving. In your market, what changes to these elements are you seeing that are not already part of our analysis above? How do they fit into the categories we have described? Or – are they a new force to be added to ‘Porter Plus’?
List of Global Reinsurance Masterclasses

- **Re-Think reinsurance**: How to shape your future through a strategic understanding of global market forces
- **Fit for purpose?**: How to tailor reinsurance products to insurance industry lifecycles
- **Winning the game**: How to identify reinsurance rivals and spot growth opportunities
- **Be a better reinsurer**: How to align structure, knowledge and roles for operational excellence
- **Strategic reinsurance relationships**: How to evaluate information and build trust
- **Intelligent matchmaking**: How to maximise value from broking
- **Imagining the future**: How to stay ahead in the reinsurance game through scenario planning

The aim of the Global Reinsurance Masterclass Series is to support (re)insurance and broking companies in analysing their position and improving their competitiveness during a period of global change. They are based on in depth analysis of a global reinsurance data set, supplemented with analysis of secondary data and findings from complementary industries.

Each masterclass functions as a standalone module that can be used on its own or in conjunction with other masterclasses.
Cass Business School
In 2002, City University's Business School was renamed Sir John Cass Business School following a generous donation towards the development of its new building in Bunhill Row. The School's name is usually abbreviated to Cass Business School.

Sir John Cass’s Foundation
Sir John Cass’s Foundation has supported education in London since the 18th century and takes its name from its founder, Sir John Cass, who established a school in Aldgate in 1710. Born in the City of London in 1661, Sir John served as an MP for the City and was knighted in 1713.
Global Reinsurance Masterclass Series

Strategic Thinking for the Reinsurance Industry

Masterclass 2
Fit for purpose?
How to tailor reinsurance products to insurance industry lifecycles

Professor Paula Jarzabkowski
Dr Adriana Allocato, Dr Rebecca Bednarek, Dr Michael Smets
The Global Reinsurance Masterclass Series is sponsored by ESRC, WCI and IICI
Executive Summary

Consolidation in the insurance industry is driving new trends in reinsurance buying.

This Masterclass:
- Shows consolidation of key insurers is grounded in industry life cycle dynamics;
- Develops a framework to explain the impact of consolidation on reinsurance buying behaviour;
- Applies product life cycle analysis to explain changing trends in reinsurance buying;
- Describes how competition is shifting premium towards a new class of reinsurance products.

It is the second of a series of seven such Masterclasses.

In late 2012 a rumour spread that Berkshire Hathaway was in discussion with QBE about their huge global Cat reinsurance programme that had recently been affected by Hurricane Sandy. With 80% of the programme already placed with three large reinsurers on a three-year basis, the eventual 15 percent share to Berkshire Hathaway across most of QBE’s programmes denied many smaller reinsurers payback on the Sandy loss. This was no small amount of premium income, with QBE being one of the largest insurance companies in the world with turnover of AUD$101 billion. Consequently, for many reinsurers, even losing a small share on these global programmes meant going without a significant amount of important business premium.

As recently as 2010, QBE had struggled to gain market acceptance for such a centralized approach to buying reinsurance. They had found it hard to place a unique per-risk global cover, and had been forced to revise their expectations of multi-year coverage across the reinsurance market. As one Underwriter stated publically the issue was “not about price, but about the global nature of cover.” However, by 2012 QBE was seen as just part of a broader trend. While QBE was the first, others were following with AIG streamlining its property per risk coverage into a single $1.5bn programme for the 2013 renewal.3

In the market there was consensus about what was behind the demand for such programmes. Industry leaders at the Standard & Poor conference in London reflected on the fact that consolidation was driving the trend towards more centralized reinsurance buying. QBE’s own history highlights this point: they acquired seven companies in 2010 alone, operating in countries as far ranging as Argentina, Ecuador, Colombia, Belgium, and the United States. There were many similar stories of industry consolidation and its implications at Baden Baden in 2012. Headlines from Day One of the conference included Generali’s continued drive to centralize its reinsurance spend and ACE’s second significant acquisition of a Mexican firm (worth $865mn) in just over a month.4 Global insurers such as QBE, centralizing their reinsurance purchasing into huge globalized reinsurance programmes, were now just ‘business-as-usual’ for the firms providing them with reinsurance.

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2 “QBE fills programme on one-year terms after reinsurer rejection”, Insurance insider, 5 January 2011
3 “Consolidation fuels centralised reinsurance buying trend”, Insurance Insider, 28 November 2012
4 Baden-Baden Newsletter, The Insurance Insider, Sunday 21 October
1. A time of rapid change in the insurance industry

The reinsurance industry is a secondary industry. It exists to serve the needs of a primary insurance industry: so trends in insurance are likely to change the kinds of products which insurance companies need from reinsurers. This Masterclass focuses on the buyers of reinsurance - the primary insurers, whose world is rapidly changing - and shows how reinsurers need to position themselves to continue to attract insurers’ premium.

1.1 Trends in the primary insurance industry

The primary insurance industry is consolidating. Through mergers and acquisitions (M&A), large players have sought to enhance their product, geographic reach, client base and operating efficiency. As these powerful players have grown, smaller insurers have protected their bottom lines by divesting non-core or underperforming business and subsidiaries, while withdrawing from foreign markets where they lacked sufficient scale.

The impact of such consolidation is evident, with large players dominating insurance markets. Their presence is felt through their size, as evidenced by their massive market capitalization, and their scope in operating across multiple markets. Over the last 10 years, on average, leading insurance companies increased their total revenues by 37% and Axa Group grew by 47% percent during this period. Generally, 22 of the top 25 companies increased their asset size in 2011. Such large companies shape trends in reinsurance products, simply because they dominate the total spending on reinsurance.

Large insurers have become dominant through their global presence in the main markets. For instance, Axa Group – the second world’s largest insurer by total asset value - owes its global industry position to past acquisitions in the US, European, Asian and Latin American markets over the last decades. It aims to become the first general insurer and in the top-three life insurer globally by 2015.

The development of such large dominant players is the outcome of a global trend of M&A activity which has subsumed many smaller players. Indeed, both the number and the value of M&A activities have increased in the insurance industry over the last decade, with a reported 75 deals worth a total of US$18.25bn in December 2012 alone.

This trend for consolidation is primarily driven by the search for economies of scale. Mid-to-smaller insurers have merged with competitors to extract synergies. Another driver is the need for geographic expansion, because the insurer’s domestic markets are ‘mature’ (a term we will explore in section 1.2). One example is the acquisition of (among others) the Lloyd’s (re)insurer Kiln by Tokio Marine & Nichido Fire Insurance, a large Japanese insurer which seeks expansion outside the static domestic Japanese market.

Such growth in leading insurers correlates with a decrease in the overall number of players in mature markets. For example, the number of companies in Europe fell by almost 3% in 2011, with the number in some more crowded markets such as the UK dropping by as much as 8% in a single year.

The ‘lost’ companies either failed in the face of competitive pressure, merged, or were acquired.

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2. Such percentage has been calculated considering the total revenues growth of leading companies reported in Datamonitor in 2002 and 2012. When the specific data was missing, it was read on the investor relations section of the company website.


4. Top 20 global insurance organizations ranked by A.M. best Co.


1. **A time of rapid change in the insurance industry** (cont.)

### 1.2 How industry life cycle theory illuminates trends in the primary insurance industry

The current, on-going consolidation of the insurance industry, and the simultaneous shake-out of smaller players, provide strong evidence of an industry heading towards maturity (Figure 1.2). While in some developing markets – such as those in parts of Asia, Latin America and Eastern Europe – the number of insurance companies is growing, the overall trend is one of consolidation into a small number of key players.

These key players increasingly move into the more profitable of new emerging markets through a range of organic growth, joint venture and M&A activity. The world stage is increasingly dominated by this group of multinationals as the insurance industry enters the maturity phase.

This global consolidation of insurers changes their strategies for buying reinsurance. In the following sections, we will discuss how industry life cycle effects cascade from the primary insurance industry to affect the product life cycle of the reinsurance industry. We will also discuss how reinsurers can predict these trends and respond strategically.

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**Figure 1.2. The standard industry life cycle**

<table>
<thead>
<tr>
<th>Industry Revenue</th>
<th>Introduction</th>
<th>Growth/Shakeout</th>
<th>Maturity</th>
<th>Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CONSOLIDATION, AS MANY SMALL FIRMS ARE UNABLE TO SURVIVE, EXCEPT THROUGH M&amp;A</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>THE MARKET IS DOMINATED BY A FEW LARGE/GLOBAL FIRMS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Key: The shaded area indicates the point at which growth in industry revenue is accompanied by a shake-out in the number of firms in the market.
1. A time of rapid change in the insurance industry (cont.)

THEORY GUIDE: Industry life cycle theory (See Figure 1.2)

Industry life cycle (ILC) theory shows how the nature of an industry changes over time. The theory, which identifies four phases of introduction, growth, maturity and decline, provides insight into industry dynamics and the most appropriate strategies for firms in each phase.

- **Introduction.** The lack of competition and potential for innovation provide an abundance of opportunities that attracts many firms. Firms experiment with new approaches to the market, tend to be entrepreneurial, and focus on serving narrow geographic areas that are specific to their expertise and backgrounds.

- **Growth/shakeout.** Entry of new players is discouraged because recognised brands and products which are already in place satisfy the needs of buyers. Production techniques become refined and the volume of sales grows dramatically. However, as some business models are more successful than others, shakeout begins for less successful firms. As there is more product standardization, firms that are large enough to be able to benefit from economies of scale will be forced to exit or will be acquired by competitors.

- **Maturity.** Sales keep growing, but at a slower rate than previously. The industry becomes centred around those few large dominant players that were able to gain market share during the growth/shakeout phase. Industry consolidation proceeds through mergers and acquisitions as on-going operational efficiency and market share is sought.

- **Decline.** Some of the existing product base becomes obsolete and some industries may move into decline.

Study Question 1
To what extent is the evolution of the insurance industry in your area following the pattern of the industry life cycle model?

(a) In your area of the market, identify two examples in the last two years of insurance company consolidation. How have these two consolidations affected you, if at all?

(b) Are you aware of any insurance companies in your area which are operating in ways characteristic of the introductory period of an emerging market – i.e. are entrepreneurial, innovative, and/or perhaps narrowly focused? Do they require a particular type of reinsurance product?
2. Implications of life cycle effects for reinsurance buying

What insurers want from their reinsurance provider has evolved as part of the industry lifecycle. As a result, insurers have clustered around a small number of different strategies for reinsurance buying.

Different groups of cedents can be identified by three dimensions that emphasize their different priorities in the purpose, products and organization of reinsurance buying. Cedents differ in their:

- degree of capitalization;
- need for central coordination of buying across multiple locations
- bundling of the products purchased.

We can draw a cube that uses these three dimensions as the three axes. This is how Figure 2, below, is organized. Any individual cedent will occupy a position in the 3D space of the cube: for instance a cedent may have low capitalization, little geographical spread and therefore low need for central coordination, but may need to bundle a number of lines into one reinsurance product. This would place it at the front lower left-hand corner of the cube.

In the sections which follow, we will first discuss these three dimensions - which characterise the ways in which cedents buy reinsurance (section 2.1). Then we show how cedents are not evenly distributed throughout the 3D cube, but tend to form two clusters, each containing two identifiable groups. These two clusters represent two different sets of needs for reinsurance: different types of reinsurance product will be appropriate to the two clusters (section 2.2). Finally we show how the growing maturity of the insurance industry is driving reinsurance buying away from one cluster, towards the other, as the firms that have survived the growth/shakeout phase get bigger (section 2.3).
2. Implications of life cycle effects for reinsurance buying (cont.)

2.1 The dimensions which characterise cedents’ reinsurance buying

**Capitalization.** The purpose of reinsurance is to support risk transfer from the insurer to the reinsurer through capital provision. In general, the more insurance coverage an insurer writes, the more capital they need to hold to cover potential payouts to clients. (They can make their capital go further by holding highly diverse risks, which are unlikely to be triggered by a single social trend, or change in business conditions, or environmental catastrophe. For instance, marine risk in Thailand is highly unlikely to be connected to a catastrophic event in Europe, so the chance of payouts on both at once is relatively small.) Reinsurance transfers some of the primary-insurers’ risk so that they can cover more clients - or free up some of their capital to invest in infrastructure/human resource to further their growth ambitions. Effectively the insurer is buying potential access to more capital from reinsurers, in the event of having to make big payouts.

Hence, the level of capitalization in insurers influences their reinsurance needs. Well-capitalised insurers, particularly those with high capital efficiency arising from well-diversified portfolios, do not need reinsurance to either grow or to transfer some of the risk from their portfolio. Rather, they require it to cover peak risk - those ‘Armageddon scenarios’ where a single event, such as a hurricane, or the asbestos scandal, wipes out a major part of the portfolio, and the company is flooded with claims.

By contrast, less well-capitalized players require reinsurance as a source of affordable capital, enabling them to grow or to cover greater risk for their clients.

**Need for coordination.** The need for coordination is a function of the insurer’s size and scope. As firms grow into new markets, they need to shift from allowing local operating companies (LOC) to purchase their own local reinsurance cover to coordinating the buying centrally across all LOCs. Coordination of reinsurance buying enables capital efficiency through diversification, avoids duplication as a firm acquires more LOCs, and ensures that a group has oversight of, and is adequately hedged for, risk taken in LOCs. Global purchasing of coordinated reinsurance is also a more efficient and less costly working practice. High levels of formal coordination are particularly necessary for bundling homogeneous risks across multiple LOCs, such as aggregated catastrophe covers.

Smaller companies have fewer opportunities for capital efficiency and less need for formal coordination of reinsurance buying.

**Product Bundling.** The extent to which reinsurance products are bundled and the form that bundling takes are a feature of an insurer’s size, complexity and capitalization.

At one end, small insurance firms bundle different lines into a single reinsurance product, the bouquet, as they have some small risks that would not be worthwhile for reinsurers as stand-alone programmes. These can instead be traded as a bundle with other different types of risk (for example, marine combined with property). As insurance firms become larger, they tend to ‘un-bundle’ their products. Such programmes are typically single territory, or combine a few similar territories, for the cover of a single type of risk, such as a third party motor liability product, or a Cat cover.

At the other extreme, large insurance companies with accumulations of a particular type of risk favour bundling this into a multiple territory (or even global) programme reinsured through a ‘super-risk’ product. These super-risks are popular with large insurers because they enable capital and resource efficiency.

2.2 Groups and clusters of cedents with similar needs

Based on the above dimensions, insurers can be clustered into four groups, identified by their different strategic needs for reinsurance: emerging markets, local, regional and global insurers. Figure 2 (on page 5) shows how they differ on the three related dimensions.

- **Emerging market insurers** are those that operate in a single emerging market territory or in a small number of similar territories and require reinsurance for access to capital and to alleviate overall portfolio volatility.
- **Local insurers** are those that, while well-established within well-known territories, still practice largely within their country or state of origin.
- **Regional insurers** are those that have extended beyond their domestic market to include surrounding regions.
- **Global insurers** are at the peak of all three dimensions, as they operate in diverse territories and cover different lines of business through their complex multidivisional structure.
2. Implications of life cycle effects for reinsurance buying (cont.)

Figure 2, on page 5, shows that there are two main clusters of strategic groups. On the one hand, there are emerging and local market companies, with a low degree of capitalization and less need for centrally coordinated buying because of their relatively small geographic spread. Due to their lower capitalization, they require reinsurance for access to capital and to alleviate volatility (i.e. transfer some risk). They bundle different lines into a single product (bouquet) or, if sufficiently large, separate different risks into traditional stand-alone products covering a single territory.

On the other hand, there are the regional and global players. These have a high degree of capitalization (and thus ability to retain their own risk). They also have a high need for coordination, which prompts them to centralize reinsurance buying decisions, centralize retention of risk, and bundle homogeneous risks, such as catastrophe risk, into single ‘super-risk’ products, to increase efficiency in reinsurance buying. For instance, the resurgent American International Group (AIG) is undertaking a significant consolidation of its property per risk reinsurance by buying a single US$1.5bn global treaty, further demonstrating the trend of major insurers streamlining their own risk transfer.12

2.3 The progress of the insurance industry life cycle is changing the types of product needed

The industry life-cycle trend we have identified, towards fewer but more dominant global players, can be clearly seen in the 3D representation of Figure 2 to be generating a corresponding trend in reinsurance buying. The consolidation and shift towards Global Buyers means that their programmes, which are few in number but of high premium volume, will increasingly provide a greater share of available premium for reinsurers. In this sense, Global Buyers, who are increasingly dominating the insurance industry as a whole, will also dominate the product set that the industry is buying.

Increased industry maturity thus has implications for the products reinsurers need to provide to their clients, as we will investigate in section 3 overleaf.

Study Question 2

(a) Take one of your major primary insurance clients and work out where they stand on the three ‘dimensions’ of our cube. Are they low, medium or high on each of these axes (capitalization; need for coordination; need for bundling)?.

(b) Can you identify another of your clients which stands in a distinctly different part of the 3D cube?

12http://www.insuranceinsider.com/consolidation-fuels-centralised-reinsurance-buying-trend/
3. The reinsurance product life cycle

The changing reinsurance buying behaviour of insurers, described above, is driving changes in the reinsurance product life cycle: as some existing products mature or decline, new products grow, and potential competing products emerge.

In this section we use Product Life Cycle analysis, to show how products also go through a life cycle in terms of their sales and profitability. Specifically, the reinsurance product life cycle can be divided into sequential stages: introduction, growth, maturity and decline (Figure 3).

3.1 Major reinsurance product types and their position in the product life cycle

For ease of explanation in this analysis, we do not distinguish between Excess of Loss (XL) and proportional products but rather refer to overall trends in the product types we have previously described:

- **Bouquet** (single territories, multiple types of risk);
- **Stand-alone** (single risk-type single or similar territories)
- **Super-risks** (covering multiple, or even global territories)

We will also refer to a relatively new class of product, alternative risk transfer products (ART), such as Insurance Linked Securities (ILS).

**Bouquet** products are declining in popularity but may remain in demand for insurers that are small and unlikely to grow. In particular, they are in demand in some emerging markets, where firms have risks that are too small to be attractive to reinsurers on a stand-alone basis.

Unbundled **stand-alone** products are a mature product, and are under threat from new products that are growing. Specifically, as global players acquire local companies, stand-alone reinsurance products disappear from the market, and are being replaced by their new parents’ bundled ‘super-risks’.

**Super-risk products** are thus growing, indicating the effects of consolidation in the primary insurance industry upon the reinsurance product life-cycle. Dominant insurers centralize their buying and develop regional or global catastrophe and per-risk products. These products then replace the stand-alone local products of the companies that they have acquired.

<table>
<thead>
<tr>
<th>Product Type</th>
<th>Introduction</th>
<th>Growth</th>
<th>Maturity</th>
<th>Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bouquet</td>
<td>new product’s commercialization</td>
<td>successful new products experience high growth in sales; unsuccessful ones are shaken out</td>
<td>product’s sales slowdown</td>
<td>steadily decreasing sales until a product’s demise</td>
</tr>
<tr>
<td>Super-risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stand-alone</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Art</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 3. The standard product life cycle, showing the positioning of the three major types of reinsurance product (and of a product which substitutes for some functions of reinsurance)
3. The reinsurance product life cycle (cont.)

**ART (alternative risk transfer) products** are not traditional reinsurance products (i.e. not generally offered by reinsurers). Instead they are securities whose returns depend on the occurrence of a specific insurance event. For instance, a Cat bond will be triggered only if the issuer loses more than a specified amount, due to a specified catastrophe. If nothing happens, the investors in the Cat bond (typically pension funds or hedge funds13) make money; if the bond is triggered, they lose it, as the issuer is not obliged to repay the principal. From an insurer’s point of view, such ART products can be a partial substitute for traditional reinsurance (the term substitute was explored in our discussion of market forces in Masterclass I.) From a reinsurer’s point of view, ART products compete with traditional reinsurance products: they reduce the total premium available to reinsurers.

3.2 Super-risk programmes as the driver of change in reinsurance

The main driver of change in the reinsurance product life cycle is the growth of the super-risk product. There are four main implications of this growth, which will force reinsurers to adapt.

3.2.1 Pressure on smaller reinsurers

From the reinsurer’s point of view, there is a shift from multiple stand-alone products each yielding smaller, territory-specific premiums, to fewer, larger multi-territory reinsurance products each yielding large premiums. The distribution of global premium thus also shifts towards these super-risks - forcing more and more reinsurers to find ways to offer such products. It also puts pressure on smaller players in the reinsurance industry, who may be ignored, or squeezed out of such deals: they struggle for relevance because they could only write a tiny fraction of the overall deal. For example, the majority of QBE’s global programmes are placed with three large reinsurers.

3.2.2 Change in reinsurance operations and resources

Super-risks are a complex product, covering multiple territories and perils. This has destroyed the direct link between the origin of risk and its cover that is prevalent in stand-alone products. They are thus grounded in more complex financial modelling than existing products, and so require different competencies in analysing risk and return from their reinsurers. As super-risk programmes increase, fewer and fewer reinsurers can actually handle the level of analysis required. If reinsurers are to re-position themselves to offer super-risk products, they need to acquire these new competencies, change their operating structure, and acquire the skills to manage the different organization required. These issues are covered in Masterclass IV.

3.2.3 Growth of ART products that compete with reinsurance

Super-risks have provided the basis for competition from a new set of products. The function of super-risks for large insurers is to provide capital to cover peak risk - a major event which catastrophically affects a large part of the portfolio. Insurance-linked Securities (ILS) are also designed to work at this portfolio-wide level, not at the level of individual stand-alone programmes. ILS (which include Catastrophe bonds, Cat bonds) are partial substitutes (see Masterclass I) for traditional reinsurance, whose use looks likely to grow, and further eat into the premium available to reinsurers. For example, 2012 saw the second highest level of Cat bond issuance on record14 and the premium that fuels this growth no longer fuels the reinsurance market.

These partial substitutes further alter the reinsurance product life cycle in ways that threaten existing stand-alone and bouquet products: as more premium goes into super-risks and ART, a declining share is left for stand-alone and bouquet products.

3.2.4 Super-risks alter the reinsurance product life cycle in emerging markets

Super-risks provide bases for imitation as insurers grow in emerging markets. In larger emerging markets with high growth potential, insurers may move quickly to acting like big players in their demands for more centrally coordinated and capital-efficient reinsurance products. Firms that learn from industry leaders are likely to jump straight to a requirement for large bundled super-risks without passing through an intermediary stage of unbundled products. China and India are examples of emerging markets that, due to their size and the potential for a few large nationwide players to dominate the market, can move quickly to buying bundled super-risks that cover their whole regional market. For example, three main players currently dominate the Chinese market due to their significant assets.15

Reinsurers have to follow the insurers through every phase of their industry life cycle, providing different products as insurers’ demand changes. This may force the reinsurer to make changes in company strategy, or in its operational practices. Such changes are explored in Masterclasses III and IV.

*Ping An Insurance with RMBm 2,844,266 million, PICC with RMBm 290,424 million, and China Pacific Insurance with RMB 570,600 million assets.
Study Question 3

(a) To what extent has your area of the insurance industry encountered and embraced super-risk products? Have you been affected, directly or indirectly, by this aspect of the evolving product life cycle and, if so, in what ways?

(b) Identify a typical example of clients demanding each of the following: 1) bouquets; 2) stand-alone products, 3) super-risks, and 4) ARTs. What do you think is behind the differentiated product needs of those clients? Which product is the most difficult for you or your organization to supply?
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Each masterclass functions as a standalone module that can be used on its own or in conjunction with other masterclasses.
Cass Business School
In 2002, City University's Business School was renamed Sir John Cass Business School following a generous donation towards the development of its new building in Bunhill Row. The School's name is usually abbreviated to Cass Business School.

Sir John Cass's Foundation
Sir John Cass's Foundation has supported education in London since the 18th century and takes its name from its founder, Sir John Cass, who established a school in Aldgate in 1710. Born in the City of London in 1661, Sir John served as an MP for the City and was knighted in 1713.
Global Reinsurance Masterclass Series

Strategic Thinking for the Reinsurance Industry

Masterclass 3
Winning the game
How to identify reinsurance rivals and spot growth opportunities

Professor Paula Jarzabkowski
Dr Laure Cabantous, Dr Adriana Allocato
The Global Reinsurance Masterclass Series is sponsored by ESRC, WCI and IICI
Reinsurance providers have typically avoided head-to-head competition by occupying different strategic positions, according to their different perspectives on what constitutes attractive business. However, industry evolution is generating greater rivalry that is eroding some of these distinctions and driving reinsurers towards new strategic positions that have different implications and demands for success. In this Masterclass, you will explore how to:

- identify strategic groups (subsets of firms that adopt similar strategies) within the reinsurance industry;
- critically assess the strategic positions and business models that differentiate groups of reinsurance companies from each other;
- analyze the strategic moves that reinsurance companies can undertake in order to grow and the mobility barriers that constrain these moves.

This is the third of a series of seven such Masterclasses.

In 2009, Bermuda-based company Partner Re became a top-five reinsurer worldwide, following the acquisition of Paris Re, a French-listed, Swiss-based diversified reinsurer. Similarly, in 2010 Amlin announced its plan to establish a reinsurance company in Switzerland to provide European reinsurance buyers with its security and service delivery. Catlin, similarly following these competitive moves and using $1bn in internal capital, established a reinsurance platform in Zurich to underwrite reinsurance business from European markets. These moves, loosely referred to as ‘the Zurich start-ups’, arguably led by Axis’ establishment of a Zurich subsidiary in 2003, reflect a growing reinsurance orientation towards European business. Hence, beyond its existing domiciled global player, Swiss Re, Zurich is emerging as key reinsurance hub. Supported by a regulatory framework that is seen as closer to Europe’s new capital regime, and competitive tax rates of its own, Zurich is providing an attractive alternative to Bermuda for reinsurers and there have even been propositions that it may overtake the Bermuda-London duel of the past few decades. While the evident returns of a hard market drove successive waves of start-ups in Bermuda, what has led the charge to Europe? In the last five years the global market value grew by only 1.2%, reflecting a quite static premium. Such marginal growth has increased competition and prompted some reinsurers to look for alternative markets where they have previously had little access to business. Bermudian reinsurers have therefore assessed the possibility of increased demand in Europe. During the past decade, the European insurance market has experienced strong consolidation, which, supported by the recent turbulence in global financial markets, has prompted reinsurance buyers to diversify their insurance risk and spread their counterparty risk. In addition, the new capital adequacy rules which are expected to be introduced via the EU’s Solvency II directive would be likely to increase insurers’ demand for reinsurance cover to reduce earnings volatility. These factors suggest that the European market might provide an attractive opportunity for new and strongly capitalised reinsurance entrants to offer improved choice to existing European insurers.

In this context, trading from Zurich enables reinsurers to access European business through enhanced client proximity, both in cultural and geographic terms. For companies domiciled in Bermuda, but looking to diversify outside their dominant US-focus, Zurich offers a large pool of qualified staff and location advantages for language. “Continental European reinsurance buyers usually look to establish long-term, continuous relationships with their reinsurers and often prefer to be served by someone capable of speaking their own language. Reinsurers domiciled in Zurich tend to meet these criteria since most of their staff have the same cultural background as their clients”, as the Head of Operations of a broker firm stated. A further advantage is the geographical proximity to the growing Eastern European markets, which provide a promising productive field for the reinsurance industry.

In this dynamic competitive landscape, firms investing in new reinsurance subsidiaries have an interesting strategic choice to make: whether the subsidiary should continue the parent company’s strategy, or whether it needs a different strategy to compete in its particular market conditions. We pose the following questions, in order to help firms better think through these competitive issues: i) What strategic positions are currently seen in the reinsurance industry? ii) Do these strategic positions make sense, or could they be improved? and iii) How could reinsurers successfully adopt (and integrate) a new strategic position?

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1. Selective rivalry in the reinsurance business

The reinsurance industry comprises more than 200 reinsurers worldwide, accounting for a total market value of $217.5 billion. An individual reinsurance company, however, does not compete directly against all the other companies in the industry. Indeed, while large reinsurers like Munich Re and Swiss Re might be competing against each other as they both operate globally and offer a large range of reinsurance products, it is unlikely that they would consider Maiden Re – which is one of the smallest US reinsurers specializing in property and casualty with only 141 employees – as a main competitor. Rather, managers within reinsurance companies might consider a subset of rivals that are competing on a similar basis and have adopted similar strategies or business models; these are their primary competitors or competitor reference group, known as their strategic group. Rivalry is likely to be higher among reinsurers within a strategic group, because they display similar strategies.

What similarities and differences should we consider to distinguish strategic groups in a useful way? Traditionally the reinsurance industry has been segmented according to geographical/cultural criteria of reinsurance firms in Bermuda, Lloyd’s and Continental Europe. But even though Lloyd’s syndicates, European and Bermudian reinsurance companies have different histories and traditions, this indicator tends to perpetuate stereotypes that are not necessarily helpful in understanding the most important strategic commonalities and differences between firms.

In fact, focusing on the country where a company is domiciled obscures the global nature of the reinsurance industry. Most companies, whether they are based in Europe, Bermuda or Lloyd’s, have access to and write global business, including deals in regions as diverse as North America and Japan. Whether or not they have a local subsidiary, the largest reinsurers are often able to write business from a country with a completely different culture.

In addition, most reinsurance providers are also global in product scope as they provide a range of reinsurance products, and write a variety of classes of risks, ranging from non-life property and casualty risks to life risks. Munich Re, a leading player in the global reinsurance market, for instance, offers non-life, life and health reinsurance solutions and claims that it covers “the entire value chain of the global insurance industry in life and non-life businesses.”

In this truly global context, it is not relevant to cluster companies based on either their geographical scope or their product scope. We will suggest more useful distinctions for reinsurance in the following section 1.1.

To make these distinctions, we will follow a widely-used business-modelling tool which is known as ‘strategic group analysis’. The main premises of this analysis are summarized in the ‘Theory Guide’ box on page 3.
1. Selective rivalry in the reinsurance business (cont.)

THEORY GUIDE: Strategic group analysis

A strategic group analysis usefully complements industry analysis by identifying different groups of companies that follow similar strategies within the same industry. Its basic pillars are the following ones:

- A strategic group is a group of firms in an industry following a similar or identical strategy regarding relevant dimensions. It includes firms that occupy similar positions in the market, offer similar goods to similar customers, and may also make similar choices about production technology and other organizational features.

- Strategic groups are commonly defined based on dimensions that relate to the scope of activities, such as product range, geographical scope, and choice of distribution channels, and dimensions that refer to resource commitment, such as level of product/service quality, technological leadership, and size. The dimensions can be used to generate a strategic group map that captures the strategic differences and similarities between the firms that populate a particular industry. To gain proper insight into groups, the same industry can and probably should be mapped several times using a variety of strategic dimensions.

- Strategic groups are stable over time because of mobility barriers that prevent firms from easily modifying their competitive position. Mobility barriers are the factors which deter or inhibit the movement of a firm from one strategic position to another and, more generally, the expansion of firms in one group to a position held by another group. Therefore mobility barriers effectively limit imitation. They act like entry barriers (see Masterclass 1), but at the level of the group rather than at the level of the industry. Mobility barriers confer persistent advantages to some groups over others within the industry, resulting in greater potential profitability for advantaged groups. Therefore firms within a group have strong incentives to invest in collective barriers.

1.1 How reinsurers can usefully be grouped according to their strategies

Our analysis of the reinsurance industry suggests that it is more helpful to think about strategic differences and commonalities in terms of companies’ priorities in selecting appropriate business to write.

In particular the following three dimensions help to identify the strategic position of a reinsurer:

Line-integration: Does the reinsurance company adopt a mono-line or multi-line approach to diversification? This dimension is related to a reinsurance company’s approach to diversifying the business it is writing.

The lowest level of line-integration is the mono-line approach. A mono-line company has a highly specialized workforce that predominately writes one particular type of business, which would usually be property Cat business, the largest segment of the global market. Its only sign of line-integration is the geographic origin of the business, for example writing property Cat from a number of territories, such as Asia-Pacific, Europe and North America, in order to diversify risk by region.

A mid-level of line-integration is the multi-line approach. A multi-line company writes multiple lines of business, such as property Cat, casualty, and speciality lines. It thus believes in diversification not only by territory but by types of risk. However, even where it writes such lines across client accounts, it makes trading decisions on each line separately, according to the value of that particular risk within the diversified portfolio, rather than according to the value of the client.

Finally, the highest level of line-integration is the whole-account approach. A whole-account company writes all lines of business and integrates their related decision making process around the value of the client. The decisions related to one line are integrated with the decisions related to all the other lines written for that client. Such firms diversify across most lines of business, and do so in partnership with the diversification of their clients.
1. Selective rivalry in the reinsurance business (cont.)

**Mono-line** approach: “Bermuda is a Cat market, it mostly covers a small segment of the reinsurance world.” (Reinsurer)

**Whole-account** approach: “Things are looked at as a whole ball of wax. You can write lines of business which, in isolation, nobody in their right mind would ever do. That particular line might even be loss-making, but you accept it for the value of the whole package.” (Reinsurer)

**Analyzability: Does the reinsurance company focus on highly analyzable business or does it also accept less analyzable business?** This dimension refers to the extent to which there is reliable information about particular lines of business. Highly analyzable lines of business are characterized by the existence of strong vendor models and the high availability of historical data allowing computation.

North American property risks are an example of highly analyzable business; they are typically technical risks, grounded in vendor models that make use of widely-available historical loss data and fine-grained and relatively stable zip code data about property values. Not surprisingly, such highly analyzable business represents the largest class of business, with property accounting for 38.7% of the market’s total value, while the Americas are the largest geographic area of the industry, accounting for 51.3% of the global reinsurance market’s value.9

At the other end of the analyzability scale are risks in emerging markets like Asia and Latin America. These countries, which have expanded robustly by 11% per annum in real terms over the last decade,10 are unmodeled or inadequately-modelled because of the data volatility occasioned by rapid growth, low technological infrastructure for data capture, and little historical loss information. Hence, these risks require different tools and strategies to analyze and underwrite.

**Low analyzability:** “You could write some unprofitable business but you balance it across the lines. The relationship with the client is the key driver.” (Reinsurer)

**Relationships: Does the reinsurance company invest in long-term relationships with its cedents?** This dimension refers to the extent to which there is a real commitment to retain continuity of cover with core partners over the long-term, through the lows and highs of the cycle. Traditionally, business relationships in the reinsurance industry were built on strong social ties, in which the personal relationship between reinsurer and client enabled the business relationship to endure, even as profitability might have waxed and waned over the duration of the market cycle. In particular there was a tacit obligation for payback; that is, in the wake of a loss, a client would ‘make good’ the loss to their long-term partners by ensuring that they received rate rises. Hence there were business advantages to remaining in long-term relationships, despite lower profitability in some years.

At the other end of the spectrum, some reinsurers privilege short-term profitability over relationships. Hence, they assume that every deal must pay, every year, and will not write less profitable business for the sake of the relationship. Such firms do not base their business on the tacit obligation for payback in long-term relationships, but on the assumption that profitable business will always be available from those firms that need capital.

**Long relationship emphasis:** “It’s multi-year, it’s a partnership with the client without any end.” (Reinsurer)

**Short relationship emphasis:** “‘Here’s the price, here’s the capacity’; and it’s more or less ‘take it or leave it’.” (Reinsurer)

**High analyzability:** “There’s lots of maths. They’re doing all this clever stuff and if it spits out a number, then that’s the price they’ll charge.” (Reinsurer)

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10 http://reinsuranceasiaonline.com/articles/future-growth-will-be-tough-emerging-markets
1. Selective rivalry in the reinsurance business (cont.)

1.2 How reinsurers cluster into strategic groups according to these three dimensions

The three dimensions we have identified in section 1.1 can be summarized in short as: line-integration, analyzability, and relationships.

Reinsurance companies are not evenly distributed along these three dimensions. According to the emphasis that they place – which end of the spectrum they stand – on these key three dimensions of selecting business to underwrite, reinsurance firms occupy distinct strategic positions, which cluster into five main strategic groups. These are labelled and illustrated in Figure 1.2, and discussed subsequently.

1.2.1 Descriptions of the five strategic groups which characterize most reinsurance business preferences

**Price-taking Profiteers** aim for deal profitability, choosing programmes such as US property Cat, which has a high Return on Equity (RoE). In selecting business, they privilege: i) a mono-line approach to accounts; ii) technical and highly analyzable business; iii) a transactional approach, where they are not willing to leverage low return deals for better ones. Typically, competitors in this strategic group spring up in a hard cycle and cannot sustain this approach in softer cycles unless protected by the capital structure of a corporate parent, which enables them to increase and decrease capital with the market cycle.

Their strategic proposition is to provide capacity where it is needed on those classes of business that are perceived as higher-return and more analyzable, such as US property Cat, even where this is detrimental to line-integration.

**Deal-making Partners** aim for discrete deals with good returns, with a high RoE, such as big US property Cat deals or those requiring tailored solutions and private deals, where they can put down big lines (i.e. provide a significant amount of capital to support the insurer’s risk) or write close to the risk (i.e. take a particularly high return on equity, because it is calculated against relatively high exposure to loss). In selecting business, they privilege: i) a mono-line approach to the account; ii) very technical and highly analyzable business; iii)
business relationships where there is potential for lock-in because of high capital investment to meet the cedent’s capacity need.

Their strategic proposition is to develop deals for cedents looking for tailored capital solutions.

**Patchwork Partners** are structured as line underwriters, even where they write multiple lines of business. They aim for flexibility in moving along different dimensions of the cube. In selecting business, they privilege: i) the evaluation of each line on its own merits, rather than an integrated evaluation of the multiple lines written across a particular cedent; ii) moderately technical business, using other factors, such as knowledge of the market or cedent to make a judgment call when the deal falls below the technical price; iii) continuity of relationships, but with a tendency to scale up or down their commitment according to the deal profitability in any given year.

Their strategic proposition is to be flexible in assembling a portfolio of typically smaller lines and deals.

**Portfolio Partners** take portfolio diversification seriously by writing multi-territory (scale), multi-line (scope), and short- and long-tail business (i.e. having shorter- or longer-term commitment to payout). They leverage across the cedent portfolio to gain preferential terms or access to better business. In selecting business, they privilege: i) a ‘whole-account’ approach to the business written with a cedent, either through account metrics, or considering the whole relationship across individual deals; ii) strongly technical approaches to evaluating the account as a whole over multiple years, not just writing the most analyzable or technically-priced lines and regions; iii) continuity in business relationships.

Their strategic proposition is to generate capital efficiency and stable long-term returns through diversification.

**Blanket Partners** also take portfolio diversification seriously by writing multi-territory (scale), multi-line (scope), and short- and long-tail business. In selecting business, they privilege: i) ‘whole-account’ and ‘bouquet’ programmes including writing an even share across all lines of business; ii) underwriter knowledge of the cedent and market rather than technical analysis; iii) continuity in business relationships.

Their strategic proposition is to develop deep, long-term relationships with the best clients in any particular market, write across those clients’ portfolios and ride the fortunes of the market with them.

## 1.2.2 How individual reinsurers blur the boundaries of strategic groups - or even jump them

The strategic types described above are ideal types, and any specific company may vary a little around these ideals. A number of firms, such as Catlin and Amlin, operate in different strategic groups simultaneously out of their different London, Bermuda and Zurich subsidiaries; for example tending towards a Patchwork Partner, Portfolio Partner or even Price-taking Profiteer in their different subsidiaries.

However, as the theory box (see p3) suggests, moving from one strategic group to another is not so easy because of mobility barriers. In the following section we will discuss the mobility barriers that firms have to face to enter a new strategic group. In addition, we will show the potential growth trajectories of strategic types and how they change their strategic positions, modifying the competitive landscape of the industry.

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**Study Question 1**

(a) Take the reinsurance company you work for, or are most familiar with. You may even need to consider just one subsidiary. Identify its position on each of the three axes we’ve defined: line-integration, analyzability, and relationships. It is possible that not all the business occupies the same position: can you identify a position that characterizes the majority of the business?

(b) Based on your answer to (a), which strategic group would you consider that this company/subsidiary occupies?

(c) Can you identify another company in which different divisions or subsidiaries occupy different strategic groups?
2. Mobility: why and how reinsurers might change strategic position

Changing strategic position may be the only way to remain profitable and competitive in a dynamic market. But there are three reasons why moving from one strategic group to another, or accessing another strategic group simultaneously, is extremely challenging.

First, firms that want to move into a new group are like potential new entrants in an industry. They have to align their resources and capabilities with the different strategic propositions that they decide to pursue. This is time- and resource-consuming, as they don’t know much about the strategic landscape they have to face, compared to the existing players in the group.

Second, they don’t know how to reach a superior level of profitability because they are new to the group. As they change their strategic position, they also have to generate new knowledge about what constitutes profitable and strategic behaviour in the new group.

Third, moving into an attractive strategic group will increase the level of competition in that group, as it becomes more crowded. Each reinsurer will be left with a smaller premium or some reinsurers may not be able to survive. As new entrants may be those least adapted to the competition in that group, they may be those least likely to survive.

2.1 Barriers to mobility - in each dimension

We now identify the specific challenges and barriers posed by each of the three dimensions we used in section 1 to map strategic groups of reinsurers.

**Line-integration.** Mobility in this dimension, between mono-line, multi-line and whole-account approaches, requires a new way of thinking about the business lines the firm wants to write. For example, a mono-line firm, specialized in a particular line of business, has to consider how to get the necessary expertise to underwrite new lines of business, and how the company must change in order to manage a mixture of lines. Such change may require systems and space resources, new team-based communication and new management expertise. While technical expertise could be purchased by hiring skilled underwriters, it is a new skill to evaluate the profitability or appropriate return on risk from multiple lines of business, or to evaluate what percentage of the portfolio each should comprise.

Hence, it is hard to shift from mono-line to multi-line or, particularly, whole-account approaches to business. Similarly, those that take a multi-line or whole-account approach may struggle to reduce their line-integration and relinquish lines of business even if it is clear that the benefits should eventually outweigh the costs. The struggle may impact on morale - the company may have to let go of staff or close divisions in order to stop writing lines where they have relationships with an existing customer base - and there are almost always technical difficulties in changing the operational structure of a company.

**Analyzability.** Moving toward more analyzable business requires some investments in qualified workforce (such as risk modelling expertise). In principle, new entrants could hire qualified risk modellers. However, buying the expertise might not be sufficient, as new entrants would also need to adapt their organizational structure and decision processes to integrate the expertise of such a highly qualified workforce, which would require time, as well as cultural and process change. Another option would be to develop in-house expertise, which also takes time.

This means that acquiring a high level of proprietary knowledge on risk modelling is not easy. It can act as a mobility barrier, preventing some companies from shifting along this dimension even when they wish to become more technical. Yet, the opposite movement, away from analyzability towards more judgment-based business, would also be difficult, because of the bias towards ‘rational’ decision making in the firm. For example, it is hard to evaluate un-modelled emerging market property risks against highly-modelled US property risks. In this case, the barrier is the difficulty of evaluating business without the support of technical models.

**Relationships.** The relationship dimension requires high levels of trust in relationships with clients and rests on a long-term history. New firms cannot easily and quickly develop such a relationship emphasis, simply because it requires time to build a long-term partnership based on business continuity. A relationship-focused strategy therefore rests on resources such as trust and longevity that are more intangible than risk modelling, or line-of-business expertise, which might be bought. In particular, they cannot be immediately imitated because they are distinctive of the firm in which they reside.11

2. Mobility: why and how reinsurers might change strategic position (cont.)

Hence the relationship dimension presents a particularly high mobility barrier because trust and continuity are slow to build - and quick to destroy! However, it is possible in today’s reinsurance landscape that this ‘barrier’ is becoming less significant. Industry dynamics seem to be moving towards more opportunistic business relationships, since it is unclear that the resources invested in generating long-term relationships continue to generate higher value through privileged access to business.

2.2 What strategic moves are the most feasible?

As we have just seen in section 2.1, there are specific barriers to mobility in each of the three dimensions. But when evaluating strategic dynamics, reinsurance companies also need to consider the combined effect of the multiple mobility barriers together. When a firm decides to move into a new strategic position; it automatically has to shift its priorities according to two or three dimensions.

However, while moving from one strategic group to another is complex because of the existence of multiple mobility barriers, some moves are still possible. The following are some typical trajectories that firms might consider as they evolve.

**Price-taking Profiteer:** Price-taking Profiteers set up in a hard market will at some point encounter a soft market. Without a capital structure that allows aggressive cycle management they often evolve into Patchwork Partners. This decision can either be strategic (‘we will accept a lower RoE on business that is less volatile’) or merely reactive. A second viable option is to retain a focus on highly analyzable catastrophe business and attempt to become Deal-making Partners, focusing on a few select clients with larger capacity needs that suit the reinsurer’s technical approach to business. This second option may be particularly attractive to those Price-taking Profiteers that have reached a critical mass in terms of capacity.

**Deal-making Partners:** Deal-making Partners may come under pressure from ratings agencies to diversify. One option is to branch out into other lines as Patchwork Partners, maintaining a focus on catastrophe capacity based on their deal-making legacy, but offering additional lines of business on a selective basis. Alternatively, they could also evolve into Portfolio Partners (stretch their relationships into other lines and leverage their technical infrastructure to provide a full service to their clients). Another option is to set up a subsidiary, operating separately as a ‘start-up’ in a different reinsurance segment. This is potentially a good way to ‘experiment’ with excess capacity in soft markets or respond to pressure for diversification.

**Patchwork Partners:** The flexibility of this strategic group means that many Patchwork Partners can maintain their position in the ‘centre’ with minor shifts along different dimensions to adjust for market cycles. However, this approach also has an optimum size. If a Patchwork Partner grows to the extent where it provides significant capacity and also writes multiple lines for a cedent, it will face pressure to become more of a whole-account or relationship provider. Similarly, investors are likely to expect some bold strategy to increase returns on their investment, which may curtail the ability to ‘pick-and-choose’ as Patchwork Partners attain critical mass. They may thus choose to grow towards the Portfolio Partner approach with select clients, or to build more significant catastrophe lines with other clients, in a bid to become Deal-making Partners.

**Blanket Partners:** As one of the original strategic types, many traditional Blanket Partners have evolved into Portfolio Partners with the growth of technology and modelling. Given their strength in managing relationships and understanding line-integration, this may be the main trajectory for Blanket Partners to capitalise on their knowledge of clients and markets.

**Portfolio Partners:** Portfolio Partners experience the greatest ‘lock-in’ of any strategic type. It is hard to step away from an ingrained approach to whole-account relationships, as cedents are sensitive to any ‘wavering’ on the part of their key account providers, while competitors hover, ready to move into any openings made by a breakdown in these relationships. Thus, the sunk costs in technical and market infrastructure, distribution channels and relationships tend to establish a level of strategic inertia with existing business. Nonetheless, such players may be able to operate differently through different offices (for example, some of their offices in emerging markets may operate as Blanket Partners). Similarly, because of their depth of resources and infrastructure, such players are well positioned to experiment with new product development.
Study Question 2

(a) In your reinsurance company, or one you know well, is there a type of deal which is avoided? What shift(s) along which axis or dimension (line-integration, analyzability, or relationships) would the company have to make in order to consider such deals?

(b) Are such deals appropriate to a company in a different strategic group? If so, which group - and can you give an example of a company in that group, making such deals?

(c) Continuing to think about the kind of shift considered in (a), what are the barriers to mobility involved in this company making that shift?
3. Implications of strategic group analysis: how reinsurers can take charge of their future

There is no ‘best’ strategic type and no best strategic position, as each is based on different perceptions of profitability, has a different risk appetite, and competes for different priorities.

Today’s reinsurance industry is a highly concentrated market, where the four largest firms capture a 47.3% share of the market’s value, in terms of the gross written premium ceded. The amount of total premium written has remained relatively static: in the last five years it has grown by only 1.2%.

The vignette which opened this Masterclass pointed out that firms are moving to Zurich as they hope for profitable opportunities in the European market. Right now, however, Europe is in decline. Ten years ago (2002), North America accounted only for 27.2% of the market value, while the largest percentage of premium ceded, 55%, was concentrated in Europe. Today, the landscape has been turned upside-down as only 37% of premium ceded is concentrated in Europe, while the Americas, with a total percentage of 51.3% of the market value, are the largest geographic reinsurance market. By moving to Zurich, firms are increasing the number of reinsurance competitors in a declining market. Such moves do not typically make good competitive sense. These companies’ hopes are based on projections of growth in an emerging market - Eastern Europe - and on increased requirements for reinsurance as a result of Solvency II regulation - which has been much delayed.

Whether or not reinsurers gamble on future sources of premium, they have two alternatives: (i) stay in their current strategic group and focus on honing their strengths, in order to be the best within their group; (ii) move towards other strategic positions in order to minimize weaknesses, thereby improving competitiveness.

Our analysis of strategic groups and mobility allows us to hypothesize why each strategic type would like to move. In today’s market with its scarcity of new premium:

- A Blanket Partner would move because it recognizes the relevance of technical analysis in an increasingly model-driven market.
- A Portfolio Partner would consider divesting some lines of business as part of reducing exposure to business of relatively low profitability, as opportunities for significant premium appear to be concentrated in only a few regions and lines of business.
- A Patchwork Partner would decide to emphasize one of the three dimensions to establish a more defined strategy in the hopes of increasing access to business.
- A Deal-making Partner would consider greater line-integration as a way to satisfy ratings agencies and generate more opportunities from their existing long-term relationships.
- A Price-taking Profiteer would move towards more relationship-focused business to remain competitive in softer cycles.

A reinsurer wishing to make any of these changes in strategic position has to evaluate both the benefits and the costs of the move. In particular, they should consider where they stand on any of the three strategic group dimensions and the resources they can apply to a shift along these dimensions. To succeed and survive, firms have to consider how to manage the mobility barriers and how to integrate their business model with a new one.

Study Question 3

(a) Can you identify a company which has made a strategic shift over the time you have been involved in reinsurance? What dimension and/or change of group was involved? Why was the shift necessary?

(b) Within your company, or one you know well, what shifts of strategic group would be possible, or even necessary? Why? What barriers would inhibit that shift?

List of Global Reinsurance Masterclasses

- Re-Think reinsurance: How to shape your future through a strategic understanding of global market forces
- Fit for purpose? How to tailor reinsurance products to insurance industry lifecycles
- **Winning the game:** How to identify reinsurance rivals and spot growth opportunities
- Be a better reinsurer: How to align structure, knowledge and roles for operational excellence
- Strategic reinsurance relationships: How to evaluate information and build trust
- Intelligent matchmaking: How to maximise value from broking
- Imagining the future: How to stay ahead in the reinsurance game through scenario planning

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Global Reinsurance Masterclass Series

Strategic Thinking for the Reinsurance Industry

Masterclass 4
Be a better reinsurer
How to align structure, knowledge and roles for operational excellence

Professor Paula Jarzabkowski
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The Global Reinsurance Masterclass Series is sponsored by ESRC, WCI and IICI.
Executive Summary

Changes in the global reinsurance industry are having a profound impact on the internal operations of reinsurance firms. Competitive success in this environment increasingly relies on a firm’s ability to coordinate diverse pockets of specialised knowledge to write different types of reinsurance deals.

This Masterclass:

- Classifies four main pools of knowledge within reinsurance firms that must be coordinated when making reinsurance decisions;
- Assesses the challenges for reinsurers involved in coordinating this diverse knowledge base;
- Identifies three critical capabilities needed by reinsurance companies to coordinate and combine this knowledge for operational excellence;
- Provides key recommendations for the application of these three capabilities through highlighting ‘triage’ points for their implementation;
- Discusses how these various capabilities can be combined to align with a firm’s particular strategy.

This is the fourth of a series of seven such Masterclasses.

John, a catastrophe (Cat) underwriter with GlobalRe, receives an email from the Account Executive, Ingrid, asking him to analyse a ‘super-Cat’ deal and assess an appropriate level of participation for GlobalRe. John has been preparing for this deal to arrive in his inbox for a while now. He knows it will be the most time-consuming and largest deal he will analyse this renewal season.

Because this client, MegaCedent, is very large and important, with complex deals such as the super-Cat, they have been allocated an Account Executive and John is required to liaise with Ingrid throughout. The Account Executive role is fairly new in the company, but Ingrid has quickly started to grow the relationship with MegaCedent. As she told John: “by getting close to them we learn about deals we wouldn’t otherwise know existed.” She has indeed managed to access to some highly profitable business by making a few concessions on some other deals. Ingrid is now keen to increase the participation on the super-Cat deal, as it is MegaCedent’s top priority.

Not too long ago John was able to analyse and make most decisions on the various deals in his portfolio himself, running some basic models and drawing on his own understanding of the territory to guide him. Today, things are often more complex. First, John works with the analysts to model the super-Cat deal. He is all too aware that the complex nature of this programme requires a deep level of specialist technical knowledge to model it efficiently and effectively; knowledge he does not specialise in. Once the modelling has been done, John liaises with other Cat underwriters responsible for each of the major different territories – e.g. United Kingdom, Asia-Pacific, South America and so on – to price each component of the deal based on their understanding on the various perils in those territories. Beyond the screens of emails, the firm has a Cat team devoted specifically to MegaCedent’s global deal. By drawing on the specialist knowledge of these territory underwriters, and the analysts, John arrives at an overall price for this large global risk.

Once the deal has been analysed, John arranges a meeting with Ingrid. He begins by telling her that the profitability has not improved since last year. Ingrid nods but, based on discussions with the client and her knowledge of what else is in their portfolio, she tells John: “but there are additional smaller deals this client will give us access to, if we can increase our participation on this deal – even by 1%.” John points out that a small increase on this super-Cat deal edges them closer to their prearranged capacity limits in certain territories, and GlobalRe’s overall risk-exposure and strategy need to be factored in. John and Ingrid agree that this is a decision for senior management, and that they should take the deal to the firm’s Chief Underwriting Officer. Ingrid is frustrated as she has wanted to get approval for this additional capacity months ago and that would have saved them time now. However, John states that he himself would not have given the authorisation: “look, I take your point about this deal being a way to access additional client business, and it’s not for me to know whether there’s justification on strategic grounds to adjust our capacity limits to increase our participation here. All I can do is reassert my team’s assessment, which is that this deal’s profitability remains marginal and doesn’t merit an increase.”

John is aware that a deal like this super-Cat requires a team approach. However, as he returns to his desk after the meeting he is also relieved that not all deals require this level of iteration between multiple different people in the organisation. Indeed, sitting in his inbox is a small single-territory deal which he is now has the time to focus on. He knows the client well and will not need to consult widely. Indeed, he should be able to get the modelling done and have his answer back with the client that day. Meanwhile, it will be a good couple of days before he hears back from Ingrid regarding Management’s decision on the ‘super-Cat’ deal.
1. Introduction: Coordinating pools of knowledge to deliver operational excellence

Increasing competition in the reinsurance industry is forcing reinsurers to try to outmanoeuvre competitors in their strategic groups, and to steal market share from rivals in their strategic groups, and to steal market share from rivals by entering new strategic spaces. Many multinational firms have entered new markets outside their traditional base to exploit opportunities for growth in new territories and classes of business. The scramble for opportunity in China, or the wave of Zurich start-ups are prime examples. At the same time, these firms are underwriting more complex arrays of reinsurance deals to meet the evolving needs of large global clients. Many now encompass everything from stand-alone deals, to complex multi-line or multi-territory programmes, to exceptional covers that are unprecedented in size or complexity.

Such diversification creates significant operational challenges for firms. The technical, client and contextual knowledge which is so essential to evaluating complex deals no longer sits with one professional group, the underwriters, but is often distributed across analysts, modellers, account executives and senior management who sit in different parts of the organisation – sometimes in different countries! To succeed in this environment, firms will need to:

- Identify which knowledge pools are needed for particular types of deal – and which are not needed;
- Be able to combine efficiently whichever knowledge pools are needed to analyse the deal;
- Be able to prioritise what these different knowledge pools say about the deal, in order to align final decisions with the firm’s strategy;
- Assess, develop, and integrate any new knowledge needed to access new strategic opportunities.

This Masterclass highlights three critical capabilities to integrate different pools of knowledge. Firms will need to develop all three capabilities, to ensure that they direct knowledge and resources to where they are most needed, while avoiding wasting valuable time and money putting knowledge where it is not needed. They will use these capabilities as needed to write different types of deals, from the small and routine, to the large and exceptional.

The three capabilities also need to be aligned with the firm’s overall strategic priorities and product offerings. For example, Bermudian reinsurers, whose basic strategic proposition was to provide capacity to support US catastrophe programmes, need to be excellent at combining in-depth contextual and analytical expertise. However, as these mono-line reinsurers diversify into new European markets in an attempt to access risk, they will need to find capabilities which can inform a whole-account approach to underwriting.

To explore how firms can develop the three capabilities, and achieve operational excellence, we draw on the knowledge-based view (KBV) of the firm, the main premises of which are summarised in the Theory Guide overleaf.

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See Masterclass III for a detailed discussion.
See Masterclass II for a detailed discussion.
1. Introduction: Coordinating pools of knowledge to deliver operational excellence (cont.)

THEORY GUIDE: The knowledge-based view (KBV)

The KBV takes seriously the proposition that knowledge is the most strategically significant asset a firm possesses. When knowledge assets are effectively developed and combined, they can generate superior operational performance and provide a basis for sustained competitive advantage.

- **The coordination problem.** The KBV suggests that a critical operational challenge for multinational firms is effectively coordinating and combining diverse knowledge assets to make decisions and exploit business opportunities when they arise. Because knowledge coordination comes at a cost, firms must be selective and flexible in how they organise and combine this key resource.

- **Appropriate coordination.** The KBV states that organisations need to develop and match knowledge assets to strategic priorities and situations. In reinsurance firms, for example, deals often vary in complexity and strategic importance. These deals must therefore be assessed so that appropriate combinations of knowledge are brought to bear on the decision-making process – the challenge for firms of course is to work out what those combinations are, and when they should be applied!

- **Dynamic coordination.** The KBV stresses that knowledge should be coordinated dynamically so that firms can adapt to environmental shifts and exploit new market opportunities. Developing dynamic capabilities to adapt and switch between different knowledge configurations is particularly relevant in an reinsurance industry where client buying patterns are changing, deals are becoming more varied and change is becoming a daily reality for small and large firms alike.

Study Question 1

The Theory Guide suggests that reinsurance deals vary in complexity and strategic importance, requiring different combinations of knowledge. Identify two deals known to you which are at opposite ends of the ‘complexity’ or ‘strategic importance’ spectrum. How do they differ in terms of the elements of knowledge required to assess them?

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2. Knowledge and power in reinsurance firms

2.1 The knowledge base of reinsurance firms

Reinsurance firms occupy distinct strategic positions in terms of the type of business they go after, their risk appetites, and their client management (see Masterclass III). Nevertheless, they all rely on four main pools of knowledge, to a greater or lesser degree, to analyse reinsurance deals and make capital placement decisions. These can be defined as: (2.1.1) contextual line and market knowledge; (2.1.2) analytical knowledge, (2.1.3) client knowledge, and (2.1.4) knowledge of the reinsurance firm’s own portfolio and risk appetite.

2.1.1 Contextual knowledge

Reinsurance cover is often classified according to lines of business, for example, property, casualty, aviation; or by ‘market’, for example Germany, Florida, or Caribbean. Experienced underwriters, in particular, possess in-depth knowledge about specialist lines of business or particular geographic markets and contextual conditions associated with them. This might include knowledge about:

- Market trends;
- Industry rumours;
- Local laws and regulation;
- Programmes where pay-outs are anticipated;
- Cedents in a market (e.g. ratings, market share, financial strength);
- Nuances associated with particular types of risk (such as planes or boats).

All these elements, and more, form the context within which any deal must be judged. Experienced underwriters are, therefore, the professionals best placed to apply line and market knowledge to decisions, ensuring that deals of a similar type (e.g. German property risks) are assessed comparatively, and in the context of points such as those above.

No-one’s going to know the business in infinite detail across all the lines of business being reinsured. So what you want to be sure of is that the people doing the reinsureance of each of the lines of business are really smart people, who really know their area. (Reinsurer)

2.1.2 Analytical knowledge

As the industry has developed finer-grained information and models, underwriting decisions have been increasingly supplemented by the specialist knowledge of analysts (actuaries and modellers). These skilled professionals use mathematically-derived models to analyse specific perils, using historical data and programme metrics – such as total insured values, territorial scope, estimated losses, and predicted returns by programme and layer – to establish relative ‘technical’ prices.

These prices are then used to support risk appraisals (i.e. the comparison of risks within and across regions), client or broker negotiations, and placement decisions. But they need careful interpretation, because they strongly depend on:

- The accuracy of the underlying data (how trustworthy is the source?);
- The level of detail of the underlying data – in some territories or lines it can be sketchy;
- The approximations inherent in the models themselves.

These limitations mean that the outputs from modelling are used more for comparisons and benchmarking than to set an absolute price. The limitations also create a spectrum of ‘model-ability’:

One example of a completely unmodellable risk would be a political risk, based on a prediction of political circumstances in a country in several years’ time. There it is down to ‘the art of underwriting’ – using experience to come up with a price. (Underwriter in London)

2.1.3 Client knowledge

Client knowledge has always been central to reinsurance underwriting. Traditionally, line and market underwriters, who underwrote single territory, local or regional programmes year-after-year, developed in-depth understanding of various clients and their books of business. In this traditional sense, client knowledge overlaps with contextual knowledge: it helps the underwriter to judge – and therefore price – the risk through ‘soft’ factors which go beyond the data. (It also helps the underwriter to judge the accuracy and trustworthiness of the data which will be fed into models.)

However, widespread consolidation of cedents, and the increasing prevalence of complex bundled reinsurance programmes incorporating multiple lines of business and spanning multiple territories, has elevated the importance of specialised, in-depth client knowledge. The appointment of account executives by many firms is a manifestation of this development.
2. Knowledge and power in reinsurance firms (cont.)

I’m the central steering point for all things ‘Client A’. That’s the easiest way to look at it. So if someone at Client A has a grouse with our organisation in Chile, he or she may well call me first here in London. (Account Executive)

The role of account executives is to ‘know the client’ across the array of their business; to know, as far as possible, their true needs and the complexity of their combined programmes; to make the most accurate possible estimate of their overall potential; as well as knowing practical aspects such as their preferred ways of buying cover. Clients benefit because the reinsurer understands their complex programmes, so that the client receives product offerings that are better tailored to their requirements. In return, reinsurers get more business and potentially preferential terms. This holistic knowledge can then be used in numerous ways:

- To sell (e.g. on-selling reinsurance capital across an insurer’s whole book of risks);
- To inform (e.g. making line and market underwriters aware of the broader implications of their assessments and decisions);
- To evaluate deals (e.g. taking a holistic view of a cedent’s portfolio, perhaps writing business where an underwriter’s purely deal-level assessment suggests otherwise).

2.1.4 Knowledge of the firm’s own portfolio and risk appetite

Finally, knowledge of the overall firm portfolio and aggregate exposures across clients, regions and markets is continuously incorporated through capital allocation and exposure management parameters set by CFOs and CUOs. These senior executives set the governance rules and policies on risk management, and use their ‘big picture’ knowledge to ensure that underwriting judgments are consistent with the risk appetite and exposure of the firm.

2.2 The location of decision-making power within reinsurance organisations

Multinational reinsurance firms live and die by the quality of their underwriting, and underwriter judgment has always been at the heart of this process. These skilled professionals have traditionally been the ‘point-of-sale’ decision-makers for their companies, using their contextual, analytical and client expertise to make deal decisions relatively independently.

However, powerful industry trends, and organisational adjustments, are taking some of the decision-making authority away from underwriters and sharing it with technical staff, middle management and corporate executives. This increased need for team underwriting challenges the notion of the “empowered” underwriter with whom decision-making power is vested. As a result, different roles within reinsurance firms jostle for position, creating structural ‘pulls’ which are illustrated in Figure 2.2 (overleaf), and discussed in the subsequent sections 2.2.1–2.2.3.

2.2.1 The pull towards numbers

There has been a general pull towards technicalisation – towards ‘number-crunching’. The increasing prevalence of vendor models and mathematically-based approaches, used for analysing property Cat business and other types of risks, has led to the creation of a stronger technical function within reinsurance firms (bottom left of Figure 2.2). While the growth of more sophisticated analytical knowledge has many advantages, it also encourages the standardisation of judgments around common analytic tools and techniques. Thus, the numbers generated by technical staff, such as actuaries and modellers, constrain underwriter judgment by providing increasingly tight parameters within which decisions must be made.

2.2.2 The pull towards middle management

A second key development has been the consolidation of cedents into a number of key global players, and the trend towards centralised, global reinsurance purchasing of large multi-territory programmes. The increasing size of clients, and the complexity of their deals, requires more collective work: knowledge from many underwriters and analysts is coordinated at the client level across many territories and/or lines of business. While individual underwriter knowledge remains an important input, decision-making power – and even authority – has shifted towards middle managers such as Account Executives. This again represents a challenge to the notion of the empowered underwriter.

We Account Executives are the ones in the organisation who will carry the decision upwards and outwards. ‘We’ve the ones who say we will support something, rather than the pricing underwriting side. That’s because we’re the ones who take the view of the whole client and say ‘Well okay, we could do that because of this, this and this’. Whereas if we viewed it as a separate deal, it probably wouldn’t fly. (Account Executive)
2. Knowledge and power in reinsurance firms (cont.)

2.2.3 The pull towards corporate executives

As middle management layers grow, there is also a pull up the organisation hierarchy towards centralised decision-making. More complex product bundling and special deals such as QBE’s global programmes – which are three-year deals, not the normal one-year, for their lead reinsurers – also means that corporate executives are becoming more involved in making deal decisions. Such deals often need to be considered in light of the firm’s risk appetite, strategic priorities and the overall balance of the risk portfolio.
2. Knowledge and power in reinsurance firms (cont.)

2.3 Managing the coordination of knowledge and decision-making power

These ‘pulls’ are not in any sense negative. Indeed, these different pools of expertise are all essential for the underwriting process, and for strategic success. However, heightened structural complexity, and shifts in decision-making authority, can generate several tensions and trade-offs that need to be managed.

First, reinsurers must ensure that the unique expertise of experienced line- and market-underwriters is fully utilised, no matter who has the final decision or how many people are involved in getting there. Situations will arise (as in the vignette at the start of this Masterclass) in which there is a tension between an underwriter’s evaluation of a particular deal, and an account executive’s view that it can be ‘traded off’ against other elements of a client’s whole account, or a corporate executive’s need to balance the portfolio. It is vital that the final decision-maker can recognise the full weight of the underwriter’s expert view in this balancing act, because not doing so will result in poorer (and therefore costly) decisions.

Second, reinsurers must direct knowledge and resources to where they are most needed. Unnecessary knowledge coordination – i.e. “getting everyone involved” in each and every underwriting decision – wastes valuable time and money by calling on pools of expertise (such as portfolio knowledge) where it is not needed.

In a sense reinsurers need to become ‘strategic chameleons’ in their client management, and develop triage points in their underwriting processes that enable them to treat different types of deals and clients differently. Some deals will need input from all four of the knowledge pools we have identified; some perhaps only two (analysis from the technical staff and context from the underwriter). Reinsurers need to develop a system of criteria, based on the nature of each particular deal or client, which allows them to:

- Identify the correct combination of knowledge, and who should apply it;
- Identify where a deal should enter and exit the reinsurer;
- Avoid confusion or tension over roles and decision-making authority.

The capabilities required to combine knowledge appropriately, and the process of triage, are outlined in the following section.

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**Study Question 2**

**Identify the primary pools of knowledge in your organisation.**

(a) Who controls them and where are they located – physically/geographically, and in the company structure?

(b) What is the nature of the interdependencies between them? Considering them two by two, do they always need to be combined, sometimes need to be combined or rarely need to be combined?

(c) What difficulties does your organisation face in combining these pools of knowledge?

3. Coordinating processes: capabilities for combining knowledge

Operational excellence requires the development of capabilities which coordinate knowledge in different combinations to suit specific deals and clients.

Here we identify three critical capabilities that reinsurers need (section 3.1); we then examine the process of triage – how the appropriate capability can be identified to match up with deals and clients (section 3.2); and finally we show how capabilities can be aligned with the firm’s strategic priorities (section 3.3).

### 3.1 Three capabilities for combining and coordinating knowledge

The three central capabilities are depicted in Figure 3.1 below. They are represented by three lines, in red, blue and grey, and the capabilities are discussed in the following sections 3.1.1–3.1.3.

As a deal is processed in time (time is represented along the x-axis) it is considered by different roles within the firm (shown in horizontal bands) so that when a deal passes from, say, an underwriter to an analyst, the line travels across from one band to another. As you move from left to right, the number and breadth of interactions between roles increases. This increases the time and resources involved in making decisions – which means that reinsurers cannot respond as quickly to their clients.

![Figure 3.1 Three capabilities for combining knowledge](image-url)
3. Coordinating processes: capabilities for combining knowledge (cont.)

3.1.1 Rapid-response capabilities

Rapid-response capabilities have traditionally dominated the reinsurance business. Reinsurance deals enter and exit the reinsurer via the underwriter, with whom decision-making authority is vested. Rapid-response capabilities take the numbers generated by technical analysis, and filter them through the underwriter’s vital understanding of context, to make a decision (the red line in Figure 3.1). Put simply, rapid-response capabilities empower underwriters: this empowerment ensures that underwriter quality is supported and maintained.

Reinsurers should retain rapid-response capabilities as they are the most efficient underwriting process and frequently the most effective, prioritising the contextual knowledge of empowered underwriters. These capabilities also allow reinsurers to respond and react promptly to clients where appropriate to the deal, using minimal organisational resources to do so. The central elements to be managed in this process are: (1) ensuring that decision-making authority remains with the underwriters, not the analysts, no matter how technically-minded the reinsurer (because models are flawed and the numbers they generate must always be interpreted in context) and (2) maintaining the ability to vary the degree of analytical involvement depending on the complexity and size of the deal.

3.1.2 Complex-coordination capabilities

Complex-coordination capabilities coordinate a wider variety of knowledge across a greater number of roles to inform reinsurance decisions. These processes (shown in the blue line in Figure 3.1) include the same activities as rapid-response, but they incorporate more interactions and iterations to combine knowledge about key clients, different lines of business (e.g. property and casualty) and multiple geographical territories. This capability often relies on a coordinating middle management role which can bring together all this knowledge; it is most often formalised in the account executive role.

By integrating knowledge from different underwriters (who will also have elements of client knowledge), complex-coordination capabilities can also provide a more holistic view of a client and/or the various elements associated with a complex deal. While they consume more resources and take more time, the explicit integration of account-level client knowledge for those deals where it is appropriate helps the reinsurer to clarify the best approach to satisfy important global clients.

3.1.3 Escalation capabilities

Escalation capabilities (as shown by the grey line in Figure 3.1 on page 8) are required to deal with exceptions that demand portfolio management oversight and control. These capabilities have become more important as the reinsurance environment, and the deals that reinsurers encounter, have become more and more ‘exceptional’.

Taking 30% on QBE’s global per-risk covers is an example of an exceptional deal. No matter how well an organisation’s complex-coordination capabilities work, the reinsurer will need to incorporate an additional component of portfolio-knowledge – via senior executives – within the underwriting decision itself.

Escalation capabilities require a clear pathway to portfolio knowledge and clear decision rules about what does, and does not, need it.

There are two main ‘traps’. Organisations which fall into the first trap are constantly managing by escalation. That would mean that decisions – such as small shares on, say, complex multi-territory deals – are unnecessarily and consistently landing on senior executives’ desks. This, we would argue, is an inadequate development of escalation capability, rather than an example of it. Such a situation might arise where organisations have not adequately developed the necessary complex coordination capabilities (see 3.2) to manage such deals. The three capabilities need to be developed alongside each other.

The underwriter has their in-depth view of different deals, whereas we bring our view of client expectations... how we feel this fits into our jigsaw with that client. So it’s bringing all that into one sort of little space and deciding where we pitch our offer price; that would be the base process. (Account Executive)

Formalising complex-coordination capabilities helps organisations decide where a deal should enter and exit the reinsurer. Decision-making authority is naturally skewed towards the entry or exit point, but should this be with the Account Executive or the Underwriter? This decision obviously depends on organisational priorities and the primacy given to client knowledge (see section 3.3.1). Whichever is chosen, the process should be made clear to all involved to avoid undue tension over authority.
3. Coordinating processes: capabilities for combining knowledge (cont.)

The second trap ensnares the organisations which do not utilise escalation capabilities at all or enough. This may occur if the route for senior executives’ involvement in decision-making in exceptional cases is ambiguous or poorly defined. This might mean that organisations miss out on valuable deals due to a lack of clarity around when senior executives should be involved. For example, a client manager or underwriter might assess a particular deal as too capital-intensive – or ‘strange’ – and thus not assess a deal further, if there is little precedent for escalating such decisions upwards.

3.1.4 Why should a reinsurer bother developing these multiple capabilities?

There are at least four reasons not to rely solely on one way of doing things:

- **To avoid inefficiency.** Rapid-response capabilities are retained for the appropriate deals, rather than being unnecessarily replaced in all cases by complex-coordination. This avoids wasting organisational resources (time and expertise), and provides clients with swift responses.

- **To avoid undervaluing underwriter expertise.** Retaining rapid-response capabilities ensures organisations allow underwriters to make decisions on deals where their expertise and experience are the vital element in the assessment.

- **To be able to assess, and access, the whole range of opportunities in the external environment.** Complex-coordination and escalation capabilities mean that organisations can understand increasingly complex deals. They also ensure that they do not miss out on opportunities; for example, an organisation that always underwrites strictly on a line-by-line basis (via a rapid-response process) may well find it difficult to access the business of clients with whole-account expectations. Indeed, they may even be unaware that additional attractive deals with such clients exist!

- **To avoid constant management by escalation.** Of course, reinsurers need to be able to identify and access the right capabilities for the right business, as discussed in section 3.2.

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**Study Question 3.1**

In your organisation can you think of three typical deals where the above three capabilities would be usefully applied?

Which of these three capabilities does your organisation do particularly well?

Do any of these capabilities require further development?
3. Coordinating processes: capabilities for combining knowledge (cont.)

3.2 Triage – matching the capability to the deal

To apply knowledge appropriately, organisations need clear triage processes to match each deal to the correct capability. Many underwriting teams have weekly meetings during renewals, which can summarise incoming business and incorporate a triage process. A simple ranking system (Levels 1, 2 and 3 for example) could be used to channel business toward different capabilities, and enable speedy communication and collective clarity. Weekly summaries can be emailed to managers and relevant account executives as a reference in case of queries or ambiguities.

Here we provide recommendations for triaging capabilities primarily based on ‘deal-type’ (sections 3.2.1–3.2.3) and, more broadly, by client segmentation (3.2.4).

3.2.1 Stand-alone deals and rapid-response capabilities

Stand-alone deals that are clearly defined by specific line of business and/or market territory boundaries (see Masterclass II) – should trigger a rapid-response capability. Even if a client sends such a deal to an account executive, this should be swiftly passed on to the appropriate underwriter.

For example, a moderately sized stand-alone UK motor deal should draw on the contextual knowledge of an underwriter who understands the intricacies of motor risks within that market, in conjunction with the analytical support. Adding additional process (i.e. complex-coordination capabilities or referrals to corporate executive) to such a deal would be needless and inefficient. Likewise, placing decision-making authority elsewhere, such as in ‘models’, would mean the deep contextual knowledge the underwriter has about this type of business, and their informed assessment of the risk, would be undermined or not fully utilised.

3.2.2 Bundled products and complex-coordination capabilities

More complex ‘bundled’ products should be a triage point for implementing complex-coordination capabilities. These products are likely to require the expertise of several different underwriters, and possibly also someone with client knowledge, like an account executive. Specifically, these products may be bundled either across:

- Multiple territories (e.g. SuperRisks such as global Cat programmes, but quite possibly even a ‘Euro-wind’ or nationwide US Cat cover). Even the most experienced line- or market-underwriter is unlikely to have enough expertise in all the territories covered;
- Multiple lines of business (e.g. Motor, Property, Cat). Many European clients, both large and small, present their deals as a bouquet or package to be considered together in this way, and they are likely to need input from several line-underwriters.

The large clients often associated with such deals are usually important to reinsurers, because of the amount of premium volume available from them; and they can be difficult to understand, due to their size and complex array of needs. Therefore the integration of underwriter assessments may be usefully done by an account executive – who has the requisite in-depth client knowledge.

3.2.3 Exceptional deals

While multi-territory and multi-line deals should be ‘routinely’ amenable to analysis using complex-coordination capabilities, an increasing number of non-standard deals falls outside normal parameters. Triggers can include:

- **Deal size**, such as when an opportunity arises which is outside pre-defined capacity limits. The size of capacity being put down on a single deal is a common indication of when portfolio knowledge should be triggered. For example, in response to Japanese Earthquakes it might have become apparent to underwriters that there was potential for large capacity deals at high-profit margins. Such major deals, falling outside standard capacity limits, should have triggered escalation capabilities to re-evaluate capital allocation for that market, based on exposure management limitations and profitability assessments.
- **Anything outside the typical renewal cycle.** For example, participating in a three-year deal, rather than the standard one-year. Such deals are exceptional as they do not allow the normal price adjustments in relation to market events: they therefore demand a high level of commitment to the reinsurer-client relationship, and involve a longer duration of exposure to the risk.
- **Innovative products** which the organisation, or indeed the market, has not underwritten before.
For example, new terrorism covers were devised post 9/11. Inevitably, as a new product, they were not already well-understood, and had to be considered as 'high-risk'. Decisions to participate in such products therefore required portfolio-level oversight, as the overall risk of the rest of the portfolio needed to be balanced against these extra-risky products. Another example of an unusual product which the organisation has not previously underwritten would be the opportunity to participate in a private deal.

An organisation can define its own parameters for 'exceptions' within its formal underwriting guidelines, being careful to ensure that those parameters do not result in over-referrals.

### 3.2.4 Formalised client segmentation

Client segmentation is an important means of simplifying deal-level triage. Client segmentation should identify:

- Important clients, alongside whom the reinsurer wants to grow across all of their business (rather than a specific line or product area) e.g. due to the client’s premium size;
- Clients with particularly complex needs who are more difficult to understand, e.g. large global cedents with programmes spanning multiple territories, who nonetheless have strict whole-account expectations.

Such clients require complex-coordination capabilities. In this connection, the structural process of allocating an account executive to specific clients is itself a form of client segmentation, and a clear triage indicator that the client’s deals will require complex-coordination. Very few reinsurers will allocate account executives to all clients; instead they will be allocated to important or complex clients like those above, and especially to global giants such as QBE, Allianz, or Axa.

A smaller client, by contrast, might not merit formal complex-coordination despite having a bouquet deal, due to the minimal capacity and exposure involved. Such clients can remain within the preserve of a single underwriter.

The central benefit of client segmentation is that the triage process can be partially achieved prior to the busy renewal period, and in a more comparative way as the reinsurer looks at all their clients together.

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**Study Question 3.2**

What mechanisms for triaging deals exist in your reinsurance firm, or in a firm known to you?
3. Coordinating processes: capabilities for combining knowledge (cont.)

3.3 Applying capabilities to fit your strategy and structure
Every firm needs the three capabilities to overcome coordination challenges, integrate knowledge and write different types of deals. However, not every company will need to apply these capabilities in equal measure.

Each firm will have its own unique strategic priorities as they target different opportunities and attempt to steal market share from rivals. They will also differ structurally in size and geographical dispersion. These factors all impact how the capabilities are applied.

3.3.1 Deal versus whole-account underwriting
As Masterclass III outlined, certain reinsurers are predisposed towards assessing each deal in isolation, and less inclined to assess profitability of a collection of deals at ‘client level’. A Bermudian firm, focused on US property catastrophe business, would be typical in this regard. Such reinsurers will primarily use rapid-response capabilities.

By contrast, some firms, typically continental European reinsurers, prefer to assess client portfolios holistically (the ‘whole-account’ approach) – as their unique selling point to the client. They need to evaluate all the client’s lines of business simultaneously, and therefore lean towards complex-coordination capabilities.

3.3.2 Target deals
The type of deal a reinsurer is targeting is another important consideration. If a reinsurer wants to be, or is, a major global player, who writes very large or unique deals at the forefront of industry innovations, they will require highly-developed escalation capabilities.

However, if a reinsurer is a smaller market follower, who can generate most of their premium volume through focusing on more simple stand-alone deals, they are likely to rely more on rapid-response capabilities and have less need for escalation capabilities. Organisations focused on a narrow product range will also be line-focused, rather than client-focused, which will favour underwriter-led rapid-response capabilities.

3.3.3 Strategic opportunities and strategic trajectories
Even if a reinsurer strategically specialises in deals which require one particular capability, the increasingly competitive reinsurance environment still requires the ability to shift between capabilities, for opportunistic, or evolutionary reasons.

- **Opportunistic shift:** for example, a reinsurer may not be a whole-account underwriter, but may wish to underwrite in this way with a small subset of the very best clients, as a way to grow business. The core business model is not fundamentally changed. This is also a way to “steal” deals off existing competitors as a new player, profiting from situations where clients are not completely satisfied with existing providers.

- **Evolutionary shift:** reinsurers may consciously evolve their business models to access new forms of business, especially when their core area gets ever more competitive. The Zurich start-ups, set up by Bermudian companies to access European risk, required a shift away from line- and deal-focus towards a whole-account approach. Firms must link such changes in their strategic priorities to building the appropriate internal capabilities.

3.3.4 Structural considerations
Structure plays a part in the way these capabilities are implemented within organisations. The greater the size and geographical dispersion of a reinsurer the more likely that formalisation of the various capabilities will be required and that coordination itself will be more difficult. For example:

- The analysis of a large global risk might rely on expertise residing in different offices;
- In larger firms it is likely that some underwriters will not know that a client is simultaneously engaging with their organisation over other deals, or through other contacts.

Smaller firms can often rely on less formalised coordination mechanisms. Analysts and underwriters may share a common workspace, so that they can more easily access the expertise of colleagues from other lines of business who sit close by through informal means. Similarly, underwriters in such firms might informally coordinate together to analyse complex deals without the need for an account executive role.

However, there remains a danger of ambiguity and potential for confusion in all but the smallest firms, unless clear processes and associated triage points are agreed, as discussed above.
Study Question 3.3

(a) Is there a predominant capability used in your firm (or one known to you)? Does it fit well with the strategic position of the firm? Why/why not?

(b) If possible, describe a shift in capability required (in the past, or in the future) in your firm or another. The shift might be temporary or permanent. Why was/is this shift needed? Does it involve more, or fewer, interactions between knowledge pools?
4. Coordinating for operational excellence: conclusions

Table 4 below summarises the triage points for appropriately applying capabilities by deal (such as stand-alone or bundled) and by client. It also suggests how reinsurers can fit capabilities to their strategic priorities (their target business and underwriting approach).

<table>
<thead>
<tr>
<th>Target deals</th>
<th>Rapid-response capabilities</th>
<th>Complex-coordination capabilities</th>
<th>Escalation capabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Stand-alone</td>
<td>• Super-risk</td>
<td>• ‘Special’ or new deals (e.g. 100% deals, large capacity)</td>
</tr>
<tr>
<td>Clients</td>
<td>• Stand-alone</td>
<td>• Important (e.g. large or high-quality) clients</td>
<td>• Complex clients</td>
</tr>
<tr>
<td></td>
<td>• Smaller clients</td>
<td>• Complex clients</td>
<td>• Special relationship clients</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(e.g. multi-year relationships)</td>
</tr>
<tr>
<td>Underwriting</td>
<td>• Mono-line approach</td>
<td>• Whole-account approach</td>
<td>• Targeting a greater variety of more complex &amp; innovative business</td>
</tr>
<tr>
<td>approach</td>
<td>• Analysis driven</td>
<td>• Relationship driven</td>
<td></td>
</tr>
<tr>
<td>Summary: Strategic</td>
<td>• Patch-work Partner</td>
<td>• Blanket Partner</td>
<td></td>
</tr>
<tr>
<td>type (MC III)</td>
<td>• Deal-making Partner</td>
<td>• Portfolio Partner</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Price-taking Profiteer</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

As Table 4 suggests, the most appropriate blend and configuration of internal knowledge varies from firm to firm. It depends on such factors as the profile of the firm’s client base, the type of business it is targeting and general underwriting approach.

In a world where large deals and large clients are becoming increasingly prevalent, rapid-response capabilities, involving efficient bi-lateral coordination between empowered underwriters and analysts, are no longer sufficient to handle all decisions. It is even possible that, as insurers consolidate even more, and as reinsurance deals become more and more complex (see Masterclasses I and II), deals suited to rapid-response become a small minority – certainly for some reinsurance firms. Over a very short period of time, far less than a working lifetime, underwriters are having to shift from being the key decision-maker on the vast majority of deals, to a ‘team-player’ whose contextual knowledge is a piece of a jigsaw – albeit an indispensible piece for the finished picture to make sense.

So: underwriters’ knowledge, for many deals, already requires complex-coordination. However, firms must not end up applying elaborate coordination mechanisms in a wholesale fashion to all deals; this wastes valuable economic and human resources, and unnecessarily disempowers underwriters in the process. To help reinsurers avoid such traps, this Masterclass has highlighted that while reinsurers will have a propensity for a certain way of underwriting, the operationally excellent reinsurer draws on a range of different knowledge-integration capabilities as and when needed.

Masterclass III shows what type of business a reinsurer should specialise in if they are, or want to be, a particular strategic type. This Masterclass builds on Masterclass III by describing the capabilities they need to develop in order pursue this strategy, but also how to shift between capabilities to make the most of opportunities outside of their traditional focus.

Study Question 4
Identify a trend in the kinds of deals and clients handled by your firm (or one known to you).

What implication does this trend have for the future knowledge integration capabilities of this firm?
List of Global Reinsurance Masterclasses

- Re-Think reinsurance: How to shape your future through a strategic understanding of global market forces
- Fit for purpose? How to tailor reinsurance products to insurance industry lifecycles
- Winning the game: How to identify reinsurance rivals and spot growth opportunities
- Be a better reinsurer: How to align structure, knowledge and roles for operational excellence
- Strategic reinsurance relationships: How to evaluate information and build trust
- Intelligent matchmaking: How to maximise value from broking
- Imagining the future: How to stay ahead in the reinsurance game through scenario planning

The aim of the Global Reinsurance Masterclass Series is to support (re)insurance and broking companies in analysing their position and improving their competitiveness during a period of global change. They are based on in depth analysis of a global reinsurance data set, supplemented with analysis of secondary data and findings from complementary industries. Each masterclass functions as a standalone module that can be used on its own or in conjunction with other masterclasses.
In 2002, City University's Business School was renamed Sir John Cass Business School following a generous donation towards the development of its new building in Bunhill Row. The School's name is usually abbreviated to Cass Business School.

Sir John Cass's Foundation
Sir John Cass's Foundation has supported education in London since the 18th century and takes its name from its founder, Sir John Cass, who established a school in Aldgate in 1710. Born in the City of London in 1661, Sir John served as an MP for the City and was knighted in 1713.
Global Reinsurance Masterclass Series

Strategic Thinking for the Reinsurance Industry

Masterclass 5
Strategic reinsurance relationships
How to evaluate information and build trust

Professor Paula Jarzabkowski
Dr Michael Smets, Dr Adriana Allocato, Dr Gary Burke
The Global Reinsurance Masterclass Series is sponsored by ESRC, WCI and IICI
Executive Summary

Changing reinsurance buying behaviours and cost pressures require a smarter approach to managing increasingly diverse client relationships.

This Masterclass:

- Examines how different types of information can reduce your need to rely on trust and goodwill in business relationships;
- Shows how you can use concepts of ‘economic value’ and of ‘information value’ as key parameters to select clients and manage your client relationships;
- Systematises four types of client relationship, and shows how these types can help you choose the most appropriate forms of client engagement;
- Helps you to manage large and diverse client portfolios more efficiently.

This is the fifth of a series of seven such Masterclasses.

To Latin America? In December? Geoff knew that everyone he worked with thought he was mad to go on a business trip in December. Just weeks away from their biggest renewal deadline, Lloyd’s was heaving, brokers were queuing all day to see Geoff and his colleagues, and analytics were running all night. Still, he had made good headway on his renewals so far, so he could just about manage the time away, and he was convinced it was going to pay off. First, because he would be able to attend a conference while over there, with the opportunity to meet many potential Latin American clients; and second, because Rob, his broking contact in the region, had lined up a full schedule of engagements.

Yes, that would include the usual business dinners, schmoozing with some of the big clients, and some formal client meetings to kick off the renewals in April. But then – and this was his personal favourite – he would make a trip to see the Paraguayan soy fields he underwrote last year. Not only was this fun, he thought it was really important to get a ‘feel’ for the stuff he wrote. For him, it made a difference to look people in the eye, discuss how they viewed their job, understand how they go about it, and see the risk itself.

Some of his colleagues would happily write risks purely based on the data, vendor models and the qualitative information provided by the broker. However, this was not so easy in Latin America and some of the other emerging markets. The models were not very accurate and the data was often patchy and unreliable. Getting a better feel for what he was underwriting would give him more confidence when putting down his line back in London.

The other benefit was that his clients felt he genuinely cared. For the big clients in the region, as with big clients everywhere, that was really important. For Geoff’s Latin American clients, who were big in the region, but not big on a global scale, meeting Geoff over dinner would probably be enough to build this sense of personal care. It was very different for those of his colleagues who were trying to engage the big US players: for those sorts of client, contact with underwriters or even account executives wasn’t good enough, they wanted contact with their reinsurer at the very top level – and getting them onto the CEO’s agenda wasn’t easy. Those big US clients were the guys for whom you pulled out all the stops: tickets to Wimbledon, Silverstone or a yachting trip, those guys were worth it, given the amount of premium they paid. His Latin American clients weren’t quite in that league yet, but maybe some day...

What Geoff could never understand was why the firm generally treated all its clients alike. Why do we take anyone who comes to London for dinner and drinks? As much fun as wining and dining was for a while, it was really starting to take a toll. Why do we have to bend over backwards to meet everyone, literally everyone who turns up at Baden, Monte Carlo or PCI? Conference meetings just aren’t right for some clients. But you clog up the three days of meeting time you have, meeting people you’ve recently met, whose submission is already on your desk or who you just know so well, there is really nothing new you could say in 30 minutes. Why didn’t the firm differentiate more clearly who they wanted to meet, for what, and in what form? Surely, there had to be a better way of doing this...
Building and managing client relationships involves a significant investment of time and resource. As we have seen in previous Masterclasses, increased competitive pressures are forcing reinsurance companies to target new clients, either in new territories or through new and different products. They are therefore having to forge new relationships, maintain more of them, and do so across more diverse client portfolios. “One size fits all” relationship management is less and less likely to work.

In this Masterclass we show how reinsurers can manage their clients strategically, so that the valuable time and resources invested support the business strategy and ‘pay off’; either directly, in the form of profitable business deals, or indirectly, in the form of increased goodwill, or access to information, the lifeblood of the reinsurance business.

Here we investigate how information in business relationships is tied up with the concept of ‘trust’. We draw on theories of inter-organisational trust to demonstrate three distinct types of information and trust.

We then develop a framework that enables managers to distinguish clients based on their economic value and the value of the information they can provide. The framework identifies four distinct client relationship types, each of which justifies different levels of investment in relationship management and suggests different forms of client engagement.

Finally, we examine how the different types of information and trust are generated in different forms of engagement with clients, such as ‘road-show meetings’ or social events. Matching up client types with the appropriate forms of engagement will ensure that the investment in relationships ‘pays off’.
In an ideal world, all business decisions would be taken with perfect information. Transacting parties would have absolute certainty that the good is valid, the price appropriate, and their counterparty committed to paying the agreed price at the agreed time.

Unfortunately, perfect information is a myth. In reinsurance, losses are never predictable; risk and claims management are difficult to monitor; and ‘payback’ is beyond the scope of a legal contract. For centuries, however, the reinsurance industry has managed to trade risks on the basis of imperfect contracts, relying on elements of trust in long-term relationships between cedents and reinsurers. These relationships therefore underpin what is essentially a ‘gentleman’s agreement’ supported by mutual trust.

To trust in the absence of information is akin to a ‘leap of faith’. Having more and better information turns that leap into a smaller, and less risky step. So trust and information actually lie on a spectrum. At one end lies ‘hard’ information specific to a particular transaction; at the other lies ‘trust’ – an expectation of behaviour in this instance, based on past experience or information about other similar instances. Wherever possible in business transactions, it is preferable to make decisions based less on trust and more on specific information.

So why not be smarter in using these business relationships to get more and better information, and rely on trust less?

1.1 The three dimensions of trust and information

We can distinguish three different dimensions of trust/information, as described in the Theory Guide overleaf. Trust and information lie on a spectrum in personal, process and institutional dimensions. We will see that, just as it is important to move towards information wherever possible, it is also important to operate not only within the personal dimension, but to incorporate the process and institutional elements of trust and information.

Interestingly, our trust is also based on information – of the kind we might call ‘background information’. Personal trust derives from knowing how your counterpart has acted in the past, knowing their attitudes, knowing that they understand your needs. Process trust comes from knowing how the counterparty’s firm is organised, what its policies are. Institutional trust comes from knowing that the law, or trading standards, or reputation will deter the counterparty, or their firm, from misbehaving.
1. The roles of information and trust in business relationships (cont.)

THEORY GUIDE: The role of trust in inter-organisational relationships

Inter-organisational relationships – such as long-term exchange arrangements or strategic alliances – involve complex interactions, often in situations that are not anticipated and not covered by contractual agreements. In such situations, neither organisation has formal authority over the other. The partners are often co-dependent, but their actions are voluntary and unmonitored. Can they be trusted?

While everyone invests and experiences some level of trust in their personal relationships, it is important to take a more differentiated view when it comes to business relationships. In particular there are three different forms of trust:

- **Personal trust** generally refers to people and is dependent on personal commitments which are echoed in concrete interactions. In short, people build those ‘positive expectations’ of each other’s future behaviour by acting upon their promises. Colloquially, this form of trust is often equated to personal ‘goodwill’ or likeability. To evaluate the level of personal trust in a relationship, you might ask yourself: Will this person act with honesty and integrity? Will they value our relationship sufficiently so as not to ‘cheat’ for their own personal gain?

- **Process trust** usually refers to an organisation’s willingness and capability to deliver on their promises. The focal point of this form of trust is no longer the individual, but the operating standards, governance, controls and policies of the organisation in which the individual works. Often, these may interfere with delivering on personal or organisational promises, because these are simply beyond the capabilities or processes of the organisation. A simple question to assess the level of process trust is: can this person/organisation actually deliver on their promise?

- **Institutional trust** refers to the confidence that legal and political systems, professional standards or reputational networks would discourage dishonest behaviour. The key question, thus, is to what extent broader societal structures would keep organisations and their representatives honest. You can check your level of trust in these systems by simply asking: what would be the consequence of dishonest behaviour?

Importantly, while personal relationships typically exclusively rely on personal trust, business relationships have to take into account process and institutional trust as well. They may inspire confidence in a faithful business relationship even where you don’t perfectly trust the direct counterpart you are personally dealing with.

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1. The roles of information and trust in business relationships
(cont.)

1.1.1 Personal trust
Personal trust has historically been considered vital to client relations, particularly in markets such as Continental Europe or Lloyd’s, where long-term relationships and personal advocacy are part of expert judgment. Through their various meetings, often over many years through social activities such as dinner, drinks, or golf, individuals gain an impression that they ‘know’ each other. When these evaluations are positive, they are often expressed as: “I know him”; “He’s a good guy”; “I trust him”. As relationships solidify over time, we develop more confidence in our counterparts’ intentions and behaviour and ‘trust’ that they will consider the good of the relationship when making decisions, rather than exploiting opportunities to profit at our expense. But note that there is often very little in business relationships to ‘test-drive’ this kind of personal confidence in another’s actions.

However, belief in a person’s goodwill, integrity or likeability is not, on its own, sufficient for a good business relationship. ‘Getting along’ helps to lubricate business, but it is entirely possible that the firm’s internal processes may not allow your counterpart to deliver on a promise. In general, reinsurance buying has become more corporate, decided in teams or committees, and people are audited more, which greatly discourages ‘backscratching’ and favours. It is also the case that there is more mobility in the workplace, and that the personal relationship you build up may increasingly often be consigned to the dustbin when another employee takes over.

As a result of these changes in the workplace, the personal dimension of trust/information is losing value relative to the process or institutional dimensions. Reinsurers may by all means enjoy relating to clients as ‘mates’, but should recognise that this is not the same as a business relationship. Personal trust in a business relationship is only a proxy for information about the individuals concerned. Much more pertinent information can be gathered about the client’s business practices and broader institutional context, as we see in 1.1.2–1.1.3.

1.1.2 Process trust
Process trust addresses two fundamental questions. First: ‘does the organisation actually have the capability to deliver on the commitment that the individual made on its behalf?’, and second: ‘if the individual was inclined to cheat, or to over-promise in the relationship, how likely is it that organisational policies or structures will protect against that?’ By asking these questions, organisational characteristics such as governance, financial management and control come into view.

For example, in business meetings, reinsurers typically ask prospective insurance partners about their underwriting procedures, claims management practices, strategies for growth and financial security. Indeed, some enlightened reinsurers use this information to grade firms on the quality of their organisational practices:

“We want to understand the company, understand how they make decisions, get inside how they underwrite, how they select risks, how they adjust claims, what risks they’re taking on and how they’re taking those risks on.” (Chief Underwriting Officer)

Such information can be obtained through personal contact, but not necessarily through social events, such as dinner or drinks. Rather, relational activities such as site visits – encompassing a detailed discussion of the current firm position and any recent loss history, and some auditing of the prospective partners’ books – are more likely to provide information that supports process trust. Where this information suggests trustworthy practices and procedures, there is less need to base business decisions on the personal qualities of your counterpart; you can put your faith in the company’s processes to deliver good results.

1.1.3 Institutional trust
Lastly, to predict current and future behaviour, you can zoom out further and look at the institutional context in which your partner organisation operates. ‘Institutional trust’ in a relationship would be based on the judgment that legal and political systems, professional standards or reputational networks would provide confidence in the viability of a business, its practices and expected behaviour.

Sources of institutional trust/information include:

- **Regulatory policies** that provide reasonable standards of assurance about business practices – preferably in countries with stable political systems! Ideally regulatory systems will subject companies to scrutiny and exact retribution from those that fail to comply;

- **Professional regulation.** One of the key insurance markets, Lloyd’s of London, derives much of its reputational assets from the strong financial and regulatory assurance that underpins membership in Lloyd’s. An insurance company cannot operate out of Lloyd’s without meeting these standards;
1. The roles of information and trust in business relationships (cont.)

- **Public information**, of good quality and easily available. Many countries of North America and Western Europe have government databases with consistent, fine-grained, independently-verified information on insured properties;
- **Ratings** produced by agencies such as Standard & Poor’s. An example would be ‘financial strength’ ratings which estimate the ability of companies (or other entities) to meet their financial obligations – which could be cedents’ premium payments or loss payments by reinsurers, so that both parties to reinsurance deals can gain trust from such ratings. S&P rate entities that offer life insurance, property and casualty insurance, annuities, health insurance, title insurance, mortgage and bond insurance – and reinsurance.

People prefer to do business with partners whose activities are underpinned by some or all of these factors.

1.2 Information/Trust in reinsurance: a summary

Managers need to consider jointly all three dimensions of information and trust: personal, process and institutional.

While personal trust is an important part of the client management process, increased employment mobility is making such trust less reliable, as key contacts move on to other jobs. Such trust is based on knowledge of the person’s past actions, their attitudes and abilities – as well as the likelihood that they will behave consistently in the future – and such assessments take time. There is also more evidence for process and institutional trust – policies, standards, laws, or, more broadly, any documents that could be used in court if necessary. At the base level, personal trust is a ‘gentleman’s agreement’.

Therefore not only should we move from reliance on trust to obtaining and using more specific information wherever possible, but also away from reliance on personal trust towards process and institutional trust whenever possible. Process and institutional information/trust are often easier and less expensive to generate, particularly in the short-term, and ideally reinsurance companies should target both in their business relationships.

This ideal is not always possible. An example of a business area with very high levels of ‘institutional’ information and trust would be US Property Cat, where there is publicly-available, long-term, historical, and extremely fine-grained data (street-by-street) and a very robust regulatory system. At the other end of the spectrum, in some emerging markets political instability, or perhaps corruption, could mean that institutional information may be absent and the institutions themselves not wholly trustworthy. In such situations, sufficient information and trust in a business must be built using other means.

Developing a sound knowledge of some specific insurers’ organisational processes would help with selecting the best clients in such markets and learning how best to operate within that market.

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**Study Question 1**

Identify a reinsurer-client relationship – either one of your own relationships or one known to you – in which there is a strong element of trust.

(a) If possible, identify an element of a deal which relied on trust in this relationship. What specific information could have improved decision-making, and reduced the need for trust?

(b) Trust that the client will ‘do the right thing’ on a specific transaction is an expectation – a leap of faith – based on ‘evidence’: e.g. knowledge of past actions, or organisational systems, or regulatory pressure. For this relationship, list some of the evidence which generates each of the three dimensions of trust: personal, process, and institutional. Could any be improved, and if so, what new information would be needed?
2. **Relationship types**

Looked at strategically, relationships should be managed not only to facilitate business transactions themselves, but to serve the purpose of harvesting very specific kinds of information (some of which will generate trust). How should we assess clients to discover what kind of relationship we should pursue? We will discuss two valuable client parameters (section 2.1) which allow us to identify four different groups, for whom different kinds of relationships are appropriate (as discussed in 2.2).

## 2.1 Client dimensions for assessment of relationships

There are two key dimensions reinsurers need to consider when assessing clients: *information value*, and *client economic value*.

### 2.1.1 Information value

Information is valuable, both in itself, and for the generation of different types of trust. Therefore the information clients can provide is an important indicator of those clients we should choose and how we should manage the relationship. The information available has value when it increases the reinsurer’s potential for profit. Examples of such information might allow the reinsurer to:

- Produce more accurate estimates when modelling risk, or provide context to evaluate the results of modelling;
- Understand a client’s processes and their regulatory and reputational context;
- Trust that a client has motives for prioritising the mutual benefit in the relationship, rather than profiting at the expense of the reinsurer;
- Understand the evolution of markets, thus informing strategic planning and future decisions.

For simplicity, information value can be measured on a ‘low-to-high’ continuum. If information is only accessible through personal contact, for instance, it forms the low-point. The availability of detailed, independently verifiable information, along with first-hand information about an organisation and its processes, in addition to the personal, would comprise the maximum on the scale.

For example, in emerging market countries like South Africa, information is held by local brokers who do not share it very widely, so personal contact is crucial for access to information. Furthermore, in many rapidly-growing emerging markets, such as China, historical data are not publicly available, which makes it difficult for reinsurers to plan any expansion. By contrast, the ready availability of quality historical data in countries such as Australia and New Zealand makes it easier to formulate opinions and decisions on a deal, even without close personal contact.

“I met an Albanian client at the conference and then visited them in Albania three weeks later, my first visit to that country ever! When I was there I had a closer look at their organisation, their products, and how they analyse policies; I also gained an understanding of regulatory topics such as how insurance premium is taxed.” (Underwriter)

### 2.1.2 Client economic value

Business relationships have to ‘pay off’. Where pay-off is likely to be limited, firms should avoid over-investing in personal relationships, or other expensive relational activities.

Client economic value, here, means the expected financial return to be generated from a client relationship, typically measured as a combination of return on equity and revenue volume. As with information value, client economic value can be assessed on a simple continuum from ‘low’ to ‘high’, but it is important to consider both current and potential client value. Every company, for example, will have some large economically significant clients in their portfolio where they have an established relationship and a proven financial track-record. However, reinsurers also need to team up with customers who may not to be valuable today, but in the future: good indicators might be the client’s recent growth rates, their business prospects and strategic orientation, and the overall potential of their market (such as an emerging territory).

“I’ve radically cut back my engagements with some clients. However, they’re still on our list as a key strategic partner for future growth. It’s just that for now, the types of deals that they provide are simply not profitable.” (Underwriter)
2. Relationship types (cont.)

2.2 Four types of relationship based on information value and client economic value

Our analysis can be summarised as a simple matrix – the information/economic value matrix – shown in Figure 2.2 below. It suggests that client relationships can be divided into four different types which we call Watching, Maintaining, Investigating, and Nurturing, discussed in sections 2.2.1–2.2.4.

![Information/economic value matrix](image)

Figure 2.2 The information/economic value matrix. The quadrants represent different types of client relationship.

2.2.1 Watching relationships (Quadrant A, Figure 2.2)
Watching relationships are appropriate for clients of lower value, in particular for those that operate in regions where institutional information is of poor quality and it is hard to assess the quality of the company’s practices or its longer term viability – that is, there is little process transparency. Many insurance firms in emerging markets fall into this bracket. People may know that these regions will develop, but it is hard to generate sufficient information to select particular firms to partner with, and the size of current and potential business is not sufficient to invest in a closer relationship that could overcome information deficits.

The aim of ‘watching’ relationships is to gather enough information to spot those companies with potential to grow into one of the other quadrants. In particular, if they can learn to improve the quality of the information they provide – and therefore its value in terms of immediate decision-making or future strategic planning – they can move towards the right-hand side of the matrix.

2.2.2 Maintaining relationships (Quadrant B, Figure 2.2)
‘Maintaining’ relationships are oriented towards clients that are economically important today, but are unlikely to provide major information value. These clients are often situated in relatively stable markets that are not expanding; they therefore offer little growth potential, and their business portfolio does not change much from year to year. This is particularly the case in mature Western European and US markets. As a European Market Manager explains:

“We have a very long history with [Client] so over time we’ve reached some kind of optimal portfolio. I mean give and take, it depends on some market cycles but we are already more or less where we want to be in terms of size. Perhaps we would like to have better results but overall we get what we want.”

(Underwriter)
2. Relationship types (cont.)

Within ‘maintaining’ relationships it is important to spot new conditions which could change the relationship. If the client diversifies into a new area which shows potential for growth, instead of the current, merely stable, economic value, then they might need to be moved into a ‘nurturing’ relationship (2.2.4). Relationship change is covered further in section 2.3.

2.2.3 Investigating relationships (Quadrant C, Figure 2.2)

‘Investigating’ relationships are suitable for potentially valuable clients where there is a lack of publicly available information, but the relationship could potentially generate quality information. They might be clients who deal with unusual lines of business that are less ‘knowable’, such as credit, terror or nuclear risks; or who operate in an unknowable market place, where it is difficult to get quality public information.

It is also possible to use an existing client relationship in this way, when a known client is becoming more established in a new growth area, perhaps expanding in new international markets such as Eastern Europe or Turkey, which are not well understood. This new business does not yet have economic value, but the client is known – and trusted, in one dimension or another – and exploiting that relationship offers potential to gain knowledge of that new market with the client.

Once the firm has gained information about new markets (product or territory) through one client, the knowledge can be leveraged to expand to other clients in those markets.

2.2.4 Nurturing relationships (Quadrant D, Figure 2.2)

In any industry there are some leading clients that are of high economic value and offer rich knowledge generation possibilities. These are often global clients whose business spans multiple territories and product lines, and who are often at the forefront of industry developments. As such, they are highly sought after; there is typically considerable competition to do business with these clients. Reinsurance firms therefore invest a lot of time and resource in nurturing or ‘cultivating’ these relationships to exploit their value. Such a nurturing relationship is focused on gaining client-specific knowledge, building the personal dimension of trust and information, and protecting the relationship from encroachment by competitors.

2.3 Relationship development pathways

Clients’ economic value and information value will change and evolve. Information value in particular also depends on context, and on the (changing) knowledge needs of the reinsurer: it may be that the requisite knowledge can be generated from another client or public source.

The critical point for managers is to avoid inertia within client relationships. Problems can arise where historical traditions and widely accepted practices propagate the myth that “relationships are always good.” This can lead to an unreflective, interpersonal approach to client management. As one manager put it:

“Some people want to prolong relationships. You get to know them quite well and there becomes this sort of bond and almost friendship. There’s an element of potential protectionism in there of one’s mates.”

(Chief Underwriting Officer)

Reinsurance firms need to be able to ‘shift a gear’ in relationships, in response to environmental shifts and changing strategic objectives. Here we consider some illustrative examples of typical pathways.

2.3.1 Information value trajectories

An information value trajectory could connect, for example, watching and investigating strategies. While ‘watching’ a large pool of clients – at low cost per client – it might become clear that one particular client could fill an information deficit. That client’s information value has shifted, and it should be investigated. The classic example of this trajectory occurs when a reinsurer wants to explore new growth opportunities, and needs to learn more about an emerging market. More intensive client engagement – see section 3.2.3 – might follow as the firm moves from watching to investigating clients in this market.

A similar trajectory can exist between nurturing and maintaining strategies. Nurturing strategies are appropriate when there is both high value information and high client economic value. However, for certain clients, these relationships may stabilise and become routinised as the reinsurer reaches its optimum growth with that client. The information available within the relationship is unlikely to lead to further growth, so the relationship may move toward the ‘maintaining’ category, requiring a lower degree of engagement.
2. Relationship types (cont.)

2.3.2 Client economic value trajectories
Firms must be aware of and sensitive to shifts in client economic value. Some shifts are extremely obvious, such as a situation of financial mismanagement on the part of the client. A more subtle example is when the knowledge gleaned from an investigative relationship suggests new, potentially lucrative, economic opportunities, which may warrant a nurturing relationship strategy.

Of course, an economic value trajectory can also be triggered by changes within the reinsurer, for example, when the reinsurance firm reduces its appetite for business in a particular market in order to focus on opportunities elsewhere with different clients.

Study Question 2
Identify a short list of maybe 8 to 10 reinsurer-client relationships known to you.

(a) ‘Mark’ each relationship in the list ‘high’ or ‘low’ according to ‘economic value’ and ‘information value’.

(b) Use figure 2.2 to identify the type (watching, investigating, maintaining, nurturing) of each relationship.

(c) Has any of these relationships changed category at some time in the past? Which parameter – economic value or information value – changed and why?
3. Matching the right engagements to the right relationships

The next step is to consider the most cost-effective types of engagement – meetings, conferences, social events, etc. – that will generate the most valuable mixture of personal, process and institutional information and trust. It is important to realise that ‘cost’ must also include the valuable time of the staff who engage in events, meetings, and their organisation, and not just the bottom line of the invoices submitted to Accounts.

3.1 Forms of engagement

The reinsurance industry provides many opportunities for reinsurers and client representatives to meet, do business, exchange information and develop personal relationships. These include:

- **Conference meetings** at annual global conferences in Monte Carlo, Baden-Baden and across the USA, as well as more regional events;
- The so-called **road-show meetings** during which clients make a formal presentation to their key reinsurers, typically at their premises. For example, a Japanese client might meet key reinsurers in London and across Continental Europe to discuss current or future deals. During these meetings, both partners provide business updates, query business developments and may push for changes in their terms of engagement. Such meetings are often followed by lunch or dinner, to deepen social connections as well;
- **Site-visits** where the reinsurer physically visits the client’s premises, sometimes for days at a time, to inspect the client’s books, learn about their work practices and visit some of the properties being insured;
- **Social events**, encompassing anything from corporate golf days, to sporting events, to wining and dining, to chartered sailing trips. While these events are expensive, they foster relationships and can provide a more nuanced understanding of their client’s business pressures, goals and aspirations.

To date, though, there seems to be little discrimination between the purposes that different forms of engagement serve and, therefore, the types of clients they should be applied to. In the following section (3.2) we examine appropriate forms of engagement for the four relationship types outlined in section 2.

3.2 Appropriate engagement with clients of different types

Business relationships serve the ultimate purpose of collecting information, building trust, and – in reinsurance – facilitating placements at the time of renewal. Hence, in a first instance, they should generate the information and trust needed to make business decisions.

3.2.1 Client engagement in ‘watching’ relationships

A low-engagement strategy that enables reinsurers to watch from a distance would be appropriate to explore the potential of clients in ‘watching’ relationships. Meeting at one of the annual industry conferences is usually sufficient to stay appraised of the client’s business development without committing serious resources.

> “I went to a Latin American insurance conference. It was a useful fact-finding trip. Every client appreciated that we were there. Many of them don’t travel to the big industry conferences because of financial constraints.” (Underwriter)

Regional conferences allow a reinsurer to signal its potential interest in that market, which can flush out possible clients who could then proactively make contact – some of whom might have potential to grow in information or economic value. The knowledge of the general market conditions gained from such meetings might also facilitate small deals with other clients, providing a small additional payoff from the small investment of time and resource.

> “In a lot of emerging markets, I don’t see many prospects currently in the short to mid-term... So in China, for instance, we only deploy a small amount of capacity. Okay, with that small resource, we go out and make a footprint, get to know the people, and in the process we get a feel of the sandbox we’re playing in... It’s a taster of that market.” (Account Executive)
3. Matching the right engagements to the right relationships (cont.)

3.2.2 Client engagement in ‘maintaining’ relationships

These relationships are important to a firm’s overall client portfolio because their current or future economic value is high, and they yield steady and predictable rents. They are nonetheless relatively easy and low cost to ‘maintain’, largely using the standard channels for annual meetings at conferences, or in the ‘road shows’ where insurance companies visit their main reinsurers once a year to explain their business portfolio and attract future reinsurance funding. In addition, there might be an invitation to an industry dinner. The reinsurer should be careful to maximise the value of information arising from these meetings by sharing it internally, to inform operational activity.

There is little additional value to be gained in applying higher levels of relationship management, such as CEO-to-CEO contact, or expensive and time-consuming social engagements, such as golf weekends. Deeper personal engagement is inefficient:

“It’s an hour of talking about the business, what they’ve been doing in the last year, what is important in the next renewal. But if it’s a client I know I don’t want to grow further with, I avoid the dinner.” (Chief Underwriting Officer)

So long as any change in circumstances is carefully monitored – such as new and interesting diversifications by a client – the main threat to this relationship strategy would be competition from other reinsurers, who attempt to ‘seduce’ the client with more lavish engagement.

In fact, in this kind of relationship, where each party’s position, needs and strategy are well understood, it is more effective to develop other ways of locking the client into a good business relationship rather than relying on corporate entertainment and other expensive strategies to make the client feel ‘wanted’. Deepening relationships by co-developing reinsurance structures, devising tailored products, or granting access to sought-after skills and competences might actually prove more effective here.

“It’s two-way. We need to understand them; they need to know that we’re partnering with them. We’re getting to that level of dialogue which isn’t one-way; ‘it’s come and help me with my business plan. Does it look sensible? What are the risks that I can run?’ That sort of dialogue is superb. That’s where we want to be.” (Account Executive)

3.2.3 Client engagement in ‘investigative’ relationships

Significant close engagement is needed either to probe existing relationships for new opportunities, or to develop new investigative relationships. As these forms of engagement are expensive and the relationship does not yet offer significant economic value in itself, the levels and forms of engagement need to be carefully tailored. The aim is to exploit the information value dimension of the relationship, so engagement will typically be at a granular and detailed technical level – ‘kicking the tyres’.

Reinsurers would need to visit client premises and investigate their work practices, potentially using audits or at least looking through the books, and asking people at various levels what the client is doing, where it is going, and whether there are opportunities to support the client for mutual future economic benefits.

3.2.4 Client engagement in ‘nurturing’ relationships

Nurturing relationships involve multiple points of contact at both executive and professional levels to service clients and extract value. CEO-to-CEO contact is obviously the highest form of engagement and, due to the commitments of senior executives on both sides, should be used selectively to consolidate important client relationships and/or explore new strategic opportunities.

“We try to have more high-level meetings, where we talk about global issues, global interests... It’s not so much about these single product issues.” (Chief Executive Officer)

High-level meetings are typically accompanied by dinners and other social events, such as a visit to the opera or a golf day. Keeping in touch in a non-business environment is an important signal of willingness to invest in a relationship, but such engagements should be more than simply a ‘corporate junket’. As one senior underwriter explains:

“We’ve just spent a whole day with a client going up Mount [X]. It was a beautiful day, a wonderful day... we’re having interesting discussions, we’re getting insights into how they think, how they operate, what are the pressures in the US market these days. There’s more value than just expressed in financial terms in such interactions.” (Underwriter)
These social events provide the necessary setting for the reinsurer to spend longer with a client than can be justified during a simple conference meeting or a roadshow. This extra time gives the opportunity to talk over many aspects of the client’s needs and establish a reinsurer as the partner of choice in a client’s mind:

“You’re working with them, with the client, on new ideas and new products... you try and tend to have at least two discussions a year with each client on new ideas that are reflective of their business goals and what they’re trying to do.”
(Account Executive)

Finally, it might be thought that, as with ‘maintaining’ relationships, some of this expense might be better directed to attempts to ‘lock in’ these clients – i.e. protect the relationship from predatory competitors – by more purely commercial/business means. The problem is that with these very large clients, the reinsurer typically does not have a large enough share of their business to ‘lock them in’ – and there are many predators!

Study Question 3
Take a close look at the contacts you (or a colleague) typically meet at Baden-Baden, Monte-Carlo or PCI.

(a) Which of the short meetings genuinely generate new information?
(b) As you did in Study Question 2, identify the appropriate relationship type for each and all of these client contacts.
(c) Based on the appropriate relationship type, which contacts could you more beneficially engage differently? Which clients are you engaging in a way that does not match their economic value? Or their information value?
4. Conclusions: implications for relationship management

Despite industry trends of increasing technicalisation, regulatory constraints, and changes in reinsurance buying, relationships are still important – but they have to be strategic. They are not just a tradition and not just a nice way of connecting with personal contacts.

4.1 A client assessment diagnostic

We have outlined a framework, and a set of generic strategies – watching, investigating, nurturing and maintaining – that can be used to manage different types of client according to their economic value, and the information value they can provide.

We suggest that managers need to address the following core questions:

- What is the economic value of this client?
- What is the information value available from this client?
- How do we meet this client?
- How frequently do we meet this client?
- Is the assessment of this client relationship (economic value and information value) consistent with the relationship strategy we are applying (nurturing, maintaining, investigating, watching)?

The client assessment tool in figure 4.1 provides a diagnostic for managers to implement the framework. While deceptively simple, this exercise can help organisations to reflect continually on their relationship management, and thus to ensure that scarce resources are not wasted on lower-value clients, while also ensuring that higher-value clients are effectively utilised.

![Client Assessment Diagram]

Figure 4.1 Client assessment checklist for deciding appropriate forms of engagement with clients
4. Conclusions: implications for relationship management (cont.)

4.2 General recommendations

- ‘Don’t shoot cannons at sparrows’: make sure you match your relationship management expense to the expected payback, in economic terms. Your relationship management strategy should be as differentiated as the portfolio of relationships you maintain;
- Make sure you have the right people connecting, both in terms of the scarce human resources you are willing to devote, and the information you are planning to gather;
- Reinsurance buying is increasingly located in purchasing departments or allocated to different executive functions and there is more mobility in the industry. You don’t want your organisation to lose a relationship because the key contact is moving (either in your organisation or in your partner’s), so make sure you strike relationships at the organisational, rather than personal level. The more people know each other across different parts of both companies, the better;
- Communicate clearly how you manage your relationships and explain who you are meeting, how, and why.

Study Question 4

Ideally you should run all your contacts through the decision tree in Figure 4.1.

(a) Identify relationships and engagement types which need to change. What are the obstacles to that change? How can they be overcome?

(b) In section 1 we demonstrated that it is best to move towards the process and institutional dimensions of information and trust wherever possible. To do this, what new information do you need to generate from your engagements with these contacts?
List of Global Reinsurance Masterclasses

- Re-Think reinsurance: How to shape your future through a strategic understanding of global market forces
- Fit for purpose? How to tailor reinsurance products to insurance industry lifecycles
- Winning the game: How to identify reinsurance rivals and spot growth opportunities
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The aim of the Global Reinsurance Masterclass Series is to support (re)insurance and broking companies in analysing their position and improving their competitiveness during a period of global change. They are based on in depth analysis of a global reinsurance data set, supplemented with analysis of secondary data and findings from complementary industries.

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Executive Summary

Changes in buyer needs and behaviours are making a profound impact on the operations of brokerage firms. Consolidation in the broking industry has been one outcome, yet further change will be needed for brokers to meet the challenges of current industry trends.

This Masterclass:

- Outlines the traditional sources of brokers’ value and remuneration, and explores how current industry dynamics challenge the traditional model;
- Shows how changes in the industry mean that brokers have to devise new business models, with new links between services and remuneration – with implications for their internal structure and operations;
- Identifies opportunities for brokers to mediate with cedents both in terms of new products (such as Alternative Risk Transfer) and new capital providers;
- Highlights further implications of the changing landscape of broking for reinsurers and mid-tier brokers, and explores their strategic options.

This is the sixth of a series of seven such Masterclasses.

Even 15 years ago, the reinsurance industry could be adequately described by dividing it into two categories of business: brokered or direct. Markets like Lloyd's were fully brokered, providing opportunities for multiple small and medium-sized broking firms to generate revenue from placing their clients’ programmes. Meanwhile, the big continental reinsurers largely remained in direct relationships with their clients. At the time, insurers were looking to buy relatively simple reinsurance products, based on the direct transfer of risks in a specific line of business or geographic region. The brokers were their advocates, helping to structure and place the programmes. In their role as matchmakers, looking to provide their clients with good diversification of quality capital at competitive prices, brokers rapidly followed the rise of any new capacity. For example, they took their clients and their programmes to Bermuda as it became a thriving reinsurance hub. Working for their clients, brokers expanded their networks anywhere that they could help broker a deal between capital suppliers – historically, overwhelmingly reinsurers – and their clients.

Today, the picture is vastly different. From the pool of many small- and medium-sized brokers, three main broking firms have expanded their networks globally, in the process taking 85% of the market share. Big brokers with large networks were indeed able to respond rapidly to cedents’ demand, and to bring new reinsurers to reduce the price of capital for their clients. In addition, as they were leading the way with substantial investment in analytics, these big brokers were able to meet insurers’ growing demands for modelling and analytics. Ultimately, these big brokers put the remaining small- and medium-sized brokers under threat, and many merged with the big three, or increasingly began to operate only in small market segments.

At the same time, as reinsurers set up new divisions to operate in new markets, they turned to brokers to help them get even a small share of the business in those markets. As a result, brokers have been able to penetrate markets that were formerly largely ‘direct’. Furthermore, although brokers were originally set up around a model of advocacy for their clients’ programmes, capital suppliers of various kinds (not just reinsurers) have begun to consider brokers more seriously as a sales force, helping them to increase their share of the reinsurance market. Examples of this trend include the sidecar set up between big capital supplier Berkshire Hathaway and global broker Aon, to give Berkshire 7.5% of Aon’s book of Lloyd’s business, and the subsequent reported move by Willis to effect a similar deal, called 360 Global, to offer 20% of its Lloyd’s business through a partnership with capital providers. While these deals are not purely for reinsurance, they show the shift in understanding in large broking firms. Brokers are intermediaries able to effect deals for buyers, but also able to help suppliers to reach attractive markets.

It seems, therefore, that big is best and that the power of the global broker is unstoppable. However, size is only one element of success in an increasingly dynamic market...

1 http://www.holborn.com/%5CData%5CSites%5Cen%5CClientReview%5CBestsReview-HoldingTheirOwn.pdf
2 This estimation has been made by Insurance Insider. http://www.insuranceinsider.com/?page_id=1245145
Introduction: The new competitive landscape for reinsurance brokers

Traditionally, reinsurance brokers have been hired by cedents to help determine their reinsurance requirements, develop these into reinsurance programmes, and place shares of these programmes across multiple reinsurers globally. They therefore provide value for cedents seeking to buy reinsurance, by acting as advocates for those cedents.

However, as an intermediary in the cedent-reinsurer value chain, brokers also provide value to reinsurers: they help reinsurers to find a suitable set of reinsurance programmes to suit their risk appetite.

It is clear, therefore, that reinsurance brokers provide multiple services to the reinsurance market, but their major source of revenue primarily and typically still comes from just one – their placement service. This Masterclass shows that, due to changes brought about by consolidation in the primary insurance industry, this traditional source of broker revenue is being eroded. The broking industry has responded with a corresponding consolidation, but size on its own is only one part of the solution for brokers in the new competitive landscape. This Masterclass therefore addresses changes in brokers’ business model that can allow them to add value, and to reap returns, in the new reinsurance market place.

THEORY GUIDE: Transaction cost economics and the resource-based view

Brokers are market intermediaries, engaged as independent contractors to arrange transactions between a buyer and a seller.

- Imperfect markets generate profit opportunities for brokers. Reinsurance brokers add value as intermediaries because the reinsurance market is imperfect. In a perfectly competitive market, information would flow freely between reinsurance suppliers (reinsurers) and buyers (cedents). Transaction cost theory, however, shows that real markets suffer from many imperfections. Markets are fragmented, obstructing perfect information flow, so that contracts are difficult to monitor and ‘best’ decisions are not possible. These market imperfections generate ‘transaction costs’ such as search costs, coordination costs, and costs of monitoring contracts. Market imperfections thus generate profit opportunities for intermediaries who can help suppliers and buyers to make transactions. Buyers and suppliers have to pay for the services that brokers deliver, but they also economise on often invisible transaction costs that may be expensive to incur.

- Brokers create value through their specific resources and capabilities. Transaction costs may be invisible because they often involve a social dimension. Brokers are able to generate value in imperfect markets because they have invested in valuable resources and capabilities that other market players lack. For instance, reinsurance brokers create value for reinsurers and cedents because they are at the centre of trading networks, which allow them to access a wide range of organisations. This access allows them to collect knowledge and information useful when executing transactions, and foster the circulation of trades in local and global networks. Brokers can add value during contract negotiation by playing a ‘bridging’ position and arbitrating between counterparties.

- The existence of brokers is based on a subtle ‘make-or-buy’ equilibrium. The decision to rely on intermediaries such as reinsurance brokers is based on a comparison between the value and costs of the services that brokers deliver and the value and costs of performing these services in-house. Buyers and/or suppliers can decide to perform the work that they previously outsourced to brokers internally if that is either less costly, creates more value, or minimises the risk of information leakage. Alongside this cost-benefit analysis, market players will consider their resource-base, before deciding whether to buy services from brokers. Brokers therefore continuously need to re-evaluate and renew the value of the services that they deliver, as market players may substitute these broker services by developing their own in-house services and skills.

References
1. The traditional broker service and revenue model

Historically, the way that brokers provide their services and are remunerated has been through a single process, from developing the programme, to placing the programme, to providing managerial support to finalise the process. Hence, as the following description shows, charging for placement has traditionally been an efficient way to generate remuneration for the entire suite of broker services provided.

1.1 The traditional brokering process

The traditional brokering process consists of the succession of phases described in (1.1.1–1.1.4).

1.1.1 Develop the programme

In helping their clients to develop the programme for reinsurance, brokers have to help identify what level, amount and type of risks to cover, and how to structure the programme. This involves deep analysis and development of the technical structure that might best protect the cedent for different levels and types of risk in the portfolio.

“We have had some successes on brokered business; brokers come up with different solutions. They work on the structure, propose something new, and maybe there is a line of business that is not properly covered where they have ideas for a complementary aggregate cover.” (Cedent)

1.1.2 Standardise the programme

Brokers package the information on the programme into a standardised submission pack, to ensure that all reinsurers wishing to supply capital are able to evaluate a particular cedent’s reinsurance requirements on an equal basis. Standardisation is an important technical service that facilitates matchmaking, because it provides a bridge between fragmented reinsurers and their collective evaluation of the cedent’s programme.

1.1.3 Place the programme

Brokers help cedents to access a diverse panel of good quality reinsurers (meaning those reinsurers with sound security and capital reserves to cover losses). Cedents acting alone may struggle to access sufficient quality capital to cover their reinsurance requirements. This may be because:

• They are particularly large and capacity is genuinely limited;

• They do not have a good understanding of reinsurers’ specific risk appetites in order to target them directly;

• Placing a programme across a large number of reinsurers requires an unfeasible or prohibitively expensive amount of leg work to be done by the cedent.

Brokers are specialists in the last two points on this list: they have built a wide knowledge and understanding of the reinsurance market and a lengthy list of contacts. Brokers use this distribution channel to visit, telephone and email reinsurance underwriters around the world to explain the programme. They support the programme’s analysis by acting as a go-between with the client in responding to any queries that the reinsurer has in generating quotes. They then collect the quotes that reinsurers want to offer. Good brokers maximise their distribution channel to ensure that the cedent’s programme can be offered to the widest possible set of suitable reinsurers, which helps to ensure pricing competitiveness.

“I need capacity and price is very important. This is why the broker is important; because the broker has a wide relationship with several markets. The broker knows Lloyd’s markets, the broker knows Bermuda and the broker has the contacts with continental capacity. So this means you can get the best security and the best price: this is the added value of the broker.” (Cedent)

1.1.4 Advise and negotiate

When quotes have been received, the broker advises clients in their decisions about which quotes to accept, and how to allocate shares of their programme to reinsurers. During this process, brokers use their know-how and relationships to help smooth any final negotiations about prices and shares.

1.2 Broker resources and capabilities

Successful broking requires the broker to have a suite of capabilities and resources that are valued by cedents, typically because cedents either do not have those resources themselves, or cannot afford to deploy them to the development of their reinsurance programme.

The technical, distribution and knowledge resources and capabilities expected from brokers are detailed in 1.2.1–1.2.3.
1. The traditional broker service and revenue model (cont.)

1.2.1 Distribution capabilities
Brokers who lack extensive, high-quality distribution channels across a variety of lines of business and territories will naturally struggle. Matchmaking is at the heart of brokers’ intermediation. It requires them to select the most appropriate contacts for every transaction, and negotiate between them in order to match cedents with their counterparties. Programmes can originate anywhere in the world, while the supply of reinsurance capital is fragmented across a number of reinsurance companies in different parts of the world. Brokers therefore usually need a global distribution network, covering most lines of business, in order to both find suitable cedents and also present these cedents to a wide enough selection of reinsurers.

1.2.2 Knowledge resources and capabilities
The success of a reinsurance broker is also linked to a capability to maintain relationships with both clients and reinsurers, and use them to develop a deep knowledge of the primary market and of the reinsurance marketplace. For example, many reinsurance programmes cannot be fully modelled, so contextual knowledge of the primary market is vital for preparing information, structuring the programme, and broking the deal to reinsurers. Knowledge of the reinsurance market is critical in selecting who to approach, where to find extra capacity in the market and how to leverage current market cycles to the benefit of the cedent. Brokers who under-perform in these critical knowledge capabilities, because they are not at the centre of extensive social networks, put their clients at risk, either by overpaying for their cover or ending up with a shortfall.

1.2.3 Technical capabilities
The increasing emphasis on analytics and risk modelling has prompted brokers to develop analytic expertise with an increasingly sophisticated set of tools, to assist in developing reinsurance solutions for their clients. As cedents have become more technically capable, they no longer simply delegate such analysis to brokers. Rather, they want brokers to work alongside them and test the assumptions that they make about their portfolios and the amount of risk cover they need.

“Fifteen years ago, we spoke to clients about market trends and pricing, and about retentions, and based on that, transactions were concluded. Nowadays, clients’ reinsurance buying departments are full of actuaries and analytical people. There is an interaction between what clients are doing and what we must do, so we beefed up our technical and analytical capabilities.” (Broker)

1.3 Remuneration for broking skills and processes
In the traditional broking business model, all the processes (1.1.1–1.1.4) and deployment of skills and resources (1.2.1–1.2.3) are ‘bundled’ into achievement of one outcome – the placement.

Remuneration traditionally only relates to this final placement stage. The final prices paid by cedent to reinsurer contain a percentage for brokerage, which will then be remitted to the broker as their payment for the entire service (as described above). Aspects of the broker’s work such as programme development, or of the broker’s ‘overheads’ such as development of technical capability, are not rewarded directly or costed separately.

As long as there is a symbiotic relationship between all the processes and the placement/payment stage, this remuneration system ‘makes sense’. However, in the following sections we illustrate how the traditional brokering process (described above) is evolving due to changes in client demand. This evolution is disrupting the connection between broker services and remuneration, so we will proceed to suggest how the remuneration model might be adjusted, the better to reflect the full range of skills and services offered by brokers.

Study Question 1
Consider the capabilities required by brokers, outlined in 1.2.1–1.2.3.

(a) Which of these capabilities might (a) brokers, (b) reinsurers, and (c) cedents value the most?

(b) Will a small cedent value the same capabilities as a large one?
2. Implications of the changing reinsurance landscape for brokers

Masterclass II showed that, due to consolidation, the primary insurance industry is increasingly dominated by a group of large multinational insurance companies. These global insurers have different reinsurance needs compared to their predecessors, and they also purchase that reinsurance differently.

Specifically, in these large companies, a central division at corporate headquarters purchases reinsurance for the entire, diversified group book of business. To optimise the capital efficiency arising from their diversification, they have raised their levels of retention of risk: they need less overall reinsurance cover because their capital enables them to cover more of their own risk internally. In addition, globalised cedents have shifted to buying bundled homogenous reinsurance products that provide complex multi-territory, multi-peril covers, discussed in Masterclass II as ‘super-risks’. These changes have altered the competitive landscape in ways that require new resources and capabilities from brokers.

In sections 2.1–2.2 we explore the impact of these changes on the broking industry, leading to ‘the broker’s dilemma’ (2.3).

2.1 Bundled products change demand for brokered distribution

The value of brokers as distribution channels to match fragmented buyers and sellers is altered by market concentration. Quite simply, there are fewer small-to medium-sized cedents looking to partner with small- to medium-sized reinsurers. Rather, there are some very large cedents looking for large reinsurance partners to support their bundled programmes – as well as a range of other substantial capital solutions to offset their risk. Hence, the matchmaking services they require from brokers have changed.

Specifically, global cedents are less reliant on brokers’ distribution services for placing the volume of their reinsurance purchase. The bundled ‘super-risks’ (see Masterclass II) that these cedents offer do need to be placed across the reinsurance industry, so they still require the broking distribution channel to reach a relatively fragmented group of small- to medium-sized reinsurers. However, the majority of their reinsurance purchase is not going to these smaller reinsurers. Rather, the biggest shares of their bundled super-risks are being placed with a handful of the largest reinsurers in the world, through a direct (not brokered) placement.

Distribution through brokers does remain important for global cedents; after they have completed their major transactions themselves, it is not in their interests to develop an extensive distribution channel to place the remaining small proportion of their reinsurance cover across a fragmented market. However, from a broking perspective, the volume of business from these global cedents which goes through the placement service is reduced, so decreasing the overall financial returns to brokers of maintaining such a large distribution channel.

2.2 Global cedents have different requirements of brokers

As large cedents have centralised reinsurance purchasing, it has been financially viable for them to build up the in-house technical skills needed to develop their own reinsurance programmes. Smaller firms, often with a single reinsurance buyer, found it convenient and cost-effective to work with a broker to determine their reinsurance needs and structure their reinsurance programmes. However, large multinational cedents often have a substantial internal reinsurance division, perhaps even operating as a captive to reinsure their own local operating companies. As such, they have grown a significant internal skill base that enables them to develop their own reinsurance programmes.

At the same time, investment in technology has altered the way global cedents can access their suppliers. For example, AXA’s online platform allows them to engage with reinsurers directly from their corporate headquarters, performing the standardised distribution of their reinsurance programmes in-house rather than through a brokered process. Hence, in terms of ‘make-or-buy’ decisions, large cedents have come to a size where investing in their own resources to develop reinsurance programmes has altered their relationship with brokers about buying those services.

Global cedents still require, as their smaller predecessors did, superior technical resources from brokers. However, they need those resources not to determine or develop their reinsurance programmes, since they already have such capabilities in-house – and often at a substantive level that is well beyond the in-house capacity of many reinsurers and smaller brokers. Rather, these global cedents need a very technical broker to help them ‘stress-test’ the programmes they are developing in-house. The broker in this role provides a set of external eyes to help cedents think through their issues, and also potentially offers wider industry knowledge about what peers are doing.
2. Implications of the changing reinsurance landscape for brokers (cont.)

In sum, such a broker must have equal or better technical skills to those that the cedent has developed in-house, and these must be underpinned by a substantial global knowledge base that can match the global profile of the cedent. The broker is cast in more of a consultancy role, with high requirements for the technical and knowledge resources that they can bring to that consulting.

2.3 The broker’s dilemma

Table 2.3 summarises the changes in the industry landscape described above, and their impact on brokers.

<table>
<thead>
<tr>
<th>Change in the industry landscape</th>
<th>Cedent’s rationale for the new strategy</th>
<th>Impact on Brokers’ resources &amp; capabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cedents centralise group reinsurance divisions</td>
<td>Developing their own in-house technical capabilities (versus outsourcing them to brokers) is cost-efficient for large cedents.</td>
<td>Technical capabilities. Brokers have to invest in their own technical capabilities in order to provide advice to these large cedents. However, the financial value of these technical capabilities is less clear as it does not lead directly to placement and associated brokerage.</td>
</tr>
<tr>
<td>Cedents shift to purchasing bundled 'super-risks'</td>
<td>Large cedents can place the majority of their programmes and associated premium directly with a few large key reinsurers.</td>
<td>Distribution capabilities. Buyers and suppliers are less fragmented; hence the value of the broker’s distribution capabilities is reduced. Brokers place (and are remunerated through brokerage) the smaller remainder of the programme. Hence distribution capabilities remain necessary but are not as well remunerated as they once were.</td>
</tr>
<tr>
<td>Cedents have a global subsidiary base</td>
<td>Large cedents require brokers to have a global knowledge base that matches the cedent’s global profile</td>
<td>Knowledge resources and capabilities. Brokers are expected to have a global network. However, the financial value and remuneration of these knowledge resources and capabilities is less clear as it does not lead directly to placement and associated brokerage. Further, many brokers have not themselves fully integrated their global resources and made that knowledge easily accessible.</td>
</tr>
</tbody>
</table>

Table 2.3 Changes of cedent strategy, and the impacts of these changes on the value of brokers’ traditional resources and capabilities
2. Implications of the changing reinsurance landscape for brokers (cont.)

In the new, global, consolidated landscape, brokers have a dilemma.

- On the one hand, they have to grow their technical capabilities to match those of their biggest clients, requiring continuous investment. Indeed, without strong technical capabilities, brokers cannot remain in business.
- On the other hand, they are not typically remunerated for these technical capabilities *per se*, but for their placement services – and the volume of business going through placement services is waning.

The new competitive landscape is dominated by large global players, who are able to place the majority of their reinsurance purchase directly with a few key reinsurers. This means that the core competence of brokers – the placement of business between fragmented buyers and sellers – is less important for global cedents. While large cedents still clearly value brokers’ abilities to provide an external set of eyes, to smooth negotiations, and to offer a level of regulatory transparency to the large deals done between counterparties, these functions do not lead to brokers getting ‘brokerage’ through the placement of the bulk of the programme.

Yet brokers have always been rewarded for placement, without distinguishing and being separately remunerated for their other skills (for example, consultancy support or advice on product development). The broker’s dilemma – as the proportion of reward from placement declines with global cedents, while the demand for technical skills remains high or increases – is how to get an industry to value, and pay for, services and skills that have always been provided for free.

**Study Question 2**

(a) In the new landscape dominated by global cedents, what has happened to demand for each of the different capabilities of brokers (outlined in section 1)? Which of the four elements of the traditional brokering process (in 1.1.1–1.1.4) now form a greater part of the broker’s workload, and which have lessened? Are there new demands on brokers?

(b) Following your analysis in (a), how have changes in the needs of cedents undermined the traditional business model of brokers and brokerage?
3. What should brokers do?

In response to cedents’ consolidation, brokers have also consolidated – a process we describe in section 3.1.

Size, however, cannot be brokers’ sole response to all the massive changes that have occurred in the reinsurance industry in recent years. Some of the changes indeed threaten reinsurance brokers’ traditional way of creating, delivering and capturing value, suggesting that brokers’ existing business model is under increasing pressure and may, perhaps, even become obsolete. In section 3.2 we suggest new possibilities to generate a better link between services, competences and remuneration.

In addition, brokers should also consider the organisational consequences of their new business models (including growth by consolidation). In section 3.3 we suggest how they must adapt the configuration of their resources and competences to their new size and their clients’ new needs. Finally, in section 3.4, we explore how brokers might extend their role beyond traditional reinsurance.

3.1 Consolidation as the broker response to the changing landscape

The primary response of the main brokers has been to consolidate alongside their buyers, so attaining global scale and scope. As a result, three main global brokers, Aon Benfield, Guy Carpenter and Willis, now have 85% market share of the industry. These changes have resulted in a largely oligopolistic broking market.

Meeting consolidation with consolidation in this way can add value in various ways. Consolidated brokers have rationalised and centralised many of the services from their acquired firms, such as claims processing. Their size in itself gives market share and market power. But size can also increase access to, or provide, critical mass in resources. For example:

• Global brokers have invested heavily in their technical capabilities, growing substantial analytics divisions in order to provide advice to clients who themselves have invested in increasingly sophisticated in-house technical ability;

• Global brokers also have access to knowledge of multiple markets, and can generate wider social networks, which are critical to their potential matchmaking skills. Provided that the consolidated global brokers can retain knowledgeable staff and integrate the knowledge flows arising from their acquisitions, they are well-placed to provide advice and support for multi-territory, multi-peril product bundling.

Essentially, global brokers have the scope to provide global cedents with a global service.

However, size on its own is insufficient to meet the changing demands of the market in ways that increase the bottom line. In particular, large brokers with a relatively singular revenue stream are prone to the price competition effects of oligopolistic markets. That is, in order to protect their market share, or take market share from rivals, the big three reinsurance brokers have resorted to price-based competition in order to retain large or valuable clients.

Such price-based competition comes through discounting the brokerage charged. Discounting is particularly fierce when cedents invite tenders for ‘locked-in’ services, known as Request-for-Proposals (RfPs), in which the successful broker that wins the tender will have the cedent’s program to place for some three years. In such cases, there is fierce competition to demonstrate the wealth of technical, distribution and knowledge resources that the broker will bring to the cedent, and, in order to ensure that they are the favoured candidates, this is often provided at a reduced brokerage.

Brokers have thus increasingly competed on the price for which they provide their distribution skills, throwing in their other skills – which are expensive to acquire and maintain – as a ‘sweetener’, to close the deal. This has had the effect of devaluing or at least making it difficult to cost the value of those additional skills that are not part of the placement service.

3.2 Getting remunerated for what brokers actually do

Reinsurance brokers’ historical business model, as outlined in section 1, consists of offering a bundle of services to their clients through the placement process. The cost of each service (for example analytics) is not explicit, as payment for all services is received through brokerage. This approach has traditionally been an efficient way to be remunerated, but it currently limits brokers’ ability to be paid for the new technical services that they provide to cedents.

As brokers increasingly act like consultants, it might ‘pay’ to get remunerated, in part, as a consultancy firm would – though a fee-for-service model, complementing brokerage. Two approaches are outlined overleaf.

*http://www.holborn.com/%7D\Data%2FSites%2F%2FContent%2F%2FClientsReview-HoldingTheirOwn.pdf
3. What should brokers do? (cont.)

- **Adopt an itemised approach to services.** One solution is for brokers to unbundle the services that they deliver to cedents. Instead of offering a ‘package’, in which all services are provided in return for brokerage, brokers could offer an itemised list of services from which cedents could pick. For example, assessing reinsurance exposure, advising on and structuring the reinsurance program, developing and distributing the submission pack, collecting quotes, and so forth. This itemised menu would encompass brokers’ technical, distribution and knowledge capabilities and break them down into specific parts that could be priced individually.

- **Differentiate between a range of bundled services.** Given that many services are connected, full itemisation in the manner described above may be difficult. Another option would be to differentiate between a range of bundled services. Reinsurance brokers could mimic telecoms companies and provide a set of three or four standard packages, tailored to the needs of three or four types of clients, with different forms of remuneration. For example, smaller clients could opt for the full (traditional) development, placement and management package, which would be paid for in brokerage. Larger cedents, meanwhile, might opt for a technical advice and partial placement bundle, with a different remuneration structure involving both a fee for advice, and a proportion of the placement in brokerage. Finally, some cedents may choose a consultancy and claims management service, which would involve a fee, potentially indexed to the number of hours worked, rather than brokerage.

In summary, brokers need to be multi-faceted in the way they generate revenue from their clients. They might have made some small steps in this regard, but they remain largely trapped in old business models.

3.4 Extending the broker’s role beyond traditional reinsurance

Brokers’ value depends on exploiting market imperfections in order to offer resources in which others are not willing to invest. Here we suggest that brokers exploit their role as intermediaries to match cedents with a range of counterparties and products beyond those of traditional reinsurance.

3.4.1 Brokering the substitutes

Global cedents are increasingly looking for a range of cost-effective sources of capital. As shown in Masterclass I, the competitive dynamics of the reinsurance industry are affected by growth in Alternative Risk Transfer (ART) products, such as catastrophe bonds. These products are usually perceived as substitute products for traditional reinsurance, yet they provide brokers with opportunities; helping them to innovate and reinvigorate their business model. Reinsurance brokers need to capitalise on substitute products.

From a broker’s perspective, ART products are less labour-intensive to distribute because they do not require a traditional broking service. They do require a distinct skill set, but brokers who do not yet have the specific capabilities required to broker ART products can acquire them on the market at a reasonable cost. Nonetheless, there are a number of regulatory and organisational issues that brokers need to take into account before being able to distribute ART products. In particular:

- Any player dealing with ART products is separately regulated, and needs to have passed requisite exams. This type of regulation currently limits the ability of brokers to distribute ART products, and puts small brokers particularly at a distinct disadvantage;
3. What should brokers do? (cont.)

- Brokers will need organisational structures that foster cooperation between advisory teams, those specialising in ART and traditional products, in order to share knowledge and enable a combined approach to clients;
- The brokering of ART products might be an opportunity to develop or ‘test’ a more comprehensive fee-for-service model.

3.4.2 Brokering new entrants to the market – new capital providers

Brokers could also direct their attention as intermediaries to other parties, beyond their traditional network of insurance and reinsurance companies. For example, a broker could also become the key intermediary for providers of capital who are tempted to enter the reinsurance market but lack the technical skills and market knowledge to do so. The broker could partner with these potential entrants to lower their cost of entry to the reinsurance market by simply providing them with access to the broker’s book of placed business.

By becoming the natural gateway for non-traditional capital providers wanting to enter the reinsurance industry, brokers can further maximise the value of their distribution channel. Recent examples of innovative partnerships with capital providers include Berkshire Hathaway’s deal with Aon Benfield, through which it is allocated a 7.5% quota share of all business which Aon places in Lloyd’s; or Willis’ similar, proposed 360 Global deal5. In such deals, the broker’s primary focus has turned away from relationships with cedents towards the capital supplier. These deals allow brokers to capitalise on their investment in technical skills and distribution networks, albeit in ways that seem to compete with traditional reinsurers.

The changes in business model that have been discussed in sections 3.2 (regarding revenue streams) and 3.4 (regarding product innovation and diversification) are summarised visually in Figure 3.4 below.

Figure 3.4 Changes in brokers’ business model: product diversification and revenue streams

Study Question 3

Sketch out how a broker might divide its operations into a few separate profit centres, charging both internally and externally for services.

(a) What difficulties might have to be overcome in such a separation?
(b) What particular capabilities are required in each of these profit centres?

4. Conclusions: Future trends

4.1 Erosion of mid-tier brokers
The leading global reinsurance brokers have increased in scale and scope, and invested heavily in technical resources and capabilities, in order to be able to meet the expectations of their cedents. These large established reinsurance brokers are now in a position to develop collaborations with new market players (e.g. new providers of capital), and to offer new services to existing market players (e.g. reinsurance companies). This is not possible for small brokers who do not have the technical infrastructure or global reach to ‘match’ the demands of large global cedents, reinsurers or new market players.

One viable solution for such smaller brokers would be to compete on quality, rather than price. To do so, they will need to develop a clear niche strategy and focus on a narrow subset of clients (most likely with products that are more geographically local in nature), where their high-quality specialised services are valued. Specialisation could be based on line-of-business or on geography.

Alternatively, as already evidenced with the sale of Towers Watson, these brokers are ripe targets for acquisition as part of further industry consolidation.

4.2 Implications for reinsurers
As Masterclasses I and III showed, reinsurers are under considerable threat from changes in cedent buying behaviour, and from increased competition from substitute products and new entrants. Indeed, some of the responses from brokers which are suggested in this Masterclass – such as assisting new capital suppliers – are likely to exacerbate these challenges for reinsurers.

However, in meeting these challenges, traditional reinsurers need to see brokers as a sales force for their capital, helping them to best deploy it to the actual need in the industry. This might include helping reinsurers to:

- Expand into ART products;
- Innovate with traditional reinsurance products to make them more attractive in the face of substitutes;
- Penetrate new markets.

Here global brokers could provide both consultancy and practical services to develop new products and to access new markets. These are functions for which small and medium-sized reinsurers lack in-house resources and capabilities, and yet which they cannot justify developing under their current revenue models.

In general, the impact of current and future change in the broking industry needs to inform reinsurers’ strategic thinking and forecasting regarding their own future. Masterclass VII will consider the implications of the rapidly changing landscape – in broking and in many other areas – through a scenario planning exercise.

Study Question 4
Historically, brokers have been cedent-focused; this Masterclass has outlined some ways in which brokers’ might find value in stronger relationships with players on the other side of the deal – capital suppliers. Reinsurers are of course the traditional capital supplier.

(a) In what new ways, not covered by the ‘traditional’ broking model, can brokers operate as a ‘sales force’ for reinsurance capital?

(b) What capabilities of brokers might a medium-sized reinsurer wish to use?

(c) How might such partnerships differ depending on the size of either the broker or the reinsurer?
List of Global Reinsurance Masterclasses

- Re-Think reinsurance: How to shape your future through a strategic understanding of global market forces
- Fit for purpose? How to tailor reinsurance products to insurance industry lifecycles
- Winning the game: How to identify reinsurance rivals and spot growth opportunities
- Be a better reinsurer: How to align structure, knowledge and roles for operational excellence
- Strategic reinsurance relationships: How to evaluate information and build trust
- **Intelligent matchmaking**: How to maximise value from broking
- Imagining the future: How to stay ahead in the reinsurance game through scenario planning

The aim of the Global Reinsurance Masterclass Series is to support (re)insurance and broking companies in analysing their position and improving their competitiveness during a period of global change. They are based on in depth analysis of a global reinsurance data set, supplemented with analysis of secondary data and findings from complementary industries.

Each masterclass functions as a standalone module that can be used on its own or in conjunction with other masterclasses.
In 2002, City University's Business School was renamed Sir John Cass Business School following a generous donation towards the development of its new building in Bunhill Row. The School's name is usually abbreviated to Cass Business School.

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Sir John Cass's Foundation has supported education in London since the 18th century and takes its name from its founder, Sir John Cass, who established a school in Aldgate in 1710. Born in the City of London in 1661, Sir John served as an MP for the City and was knighted in 1713.
Global Reinsurance Masterclass Series

Strategic Thinking for the Reinsurance Industry

Masterclass 7
Imagining the future
How to stay ahead in the reinsurance game through scenario planning

Professor Paula Jarzabkowski
Dr Gary Burke, Dr Laure Cabantous, Dr Efstathios Tapinos, Dr Konstantinos Chalkias
Executive Summary

Developments in the global reinsurance industry mean that firms are facing ever-increasing levels of uncertainty.

This Masterclass:

- Analyses the reinsurance landscape to identify some of the key uncertainties confronting the reinsurance industry;
- Uses scenario planning techniques to cluster these uncertainties and generate three alternative future scenarios;
- Assesses the impact of these alternative futures on reinsurance industry incumbents;
- Explores how firms in the reinsurance industry can stay ahead by integrating scenario planning into the development of their business strategies.

It is the final Masterclass in our series of seven.

“You see... I can live with doubt, and uncertainty, and not knowing. I think it’s much more interesting to live not knowing than to have answers which might be wrong. I have approximate answers and possible beliefs and different degrees of certainty about different things. But I’m not absolutely sure of anything, and there are many things I don’t know anything about” (Richard Feynman, Nobel Prize, Physics, 1965)

John, the Chief Executive of GlobalRe arrives at the board meeting with Martin, GlobalRe’s Underwriting Director. As they sit down they start to discuss Super Typhoon Haiyan in the Philippines and their exposure. John says, “It was one of the strongest cyclones ever to make landfall.” Martin nods, adding, “I know, these severe weather events seem to be getting worse – and harder to predict. The tornados in the Midwest last November were unexpectedly late in season. It’s happening everywhere. Even the UK has had some of its worst flooding on record in the past two years!” Alan, GlobalRe’s Finance Director says, “The whole world is just more uncertain. Look at the problems in the Eurozone with the sovereign debt and continuing recession. Heaven only knows when that will get resolved.” As the discussion continues, the executives point out yet more uncertainties in the reinsurance environment. Martin is especially preoccupied with the rapid growth in emerging markets and what this will mean for the industry and, especially GlobalRe. He is convinced this will generate unprecedented opportunities for them, which they should target aggressively. But others are more circumspect: “We don’t know. Yes, these markets are growing, but where is the premium going to go and what role will the governments play?” This leads to a general discussion about regulation. The executives are somewhat relieved that Solvency II finally seems to be coming to a resolution, but there is also growing concern that regulation is now a ‘continuously shifting set of goalposts’. Martin talks about how nine of the largest insurers have been designated ‘too big to fail’ and so face more stringent capital requirements.

Julia, GlobalRe’s Operations Director, then takes the conversation in a new direction when she reports on a recent conference she attended, which highlighted how cyber-risk and systemic risks may increase in the next five or so years.

These conversations paint a swirling mess of uncertainty. The executives start to talk about the robustness of the strategy in light of these unknowns. John says, “We need to get our heads out of the short-term and start thinking how these things may be shaping the industry of tomorrow. It is no good looking at one thing in isolation: we need more systematic thinking, and we need to start preparing for an unknown future today.” Alan summarises the feeling in the room: “I wish we had the newspaper for 2025 in front of us today.”

Excerpt from an interview given to BBC Horizon programme, 1981
1. Introduction

1.1 Into the unknown
The risk business is becoming more uncertain. Without a crystal ball, we cannot predict with any certainty how emerging markets, political instabilities, the financial crisis, climate change and new technological developments will all conspire to affect the reinsurance industry over the coming years. This uncertainty is uncomfortable, precarious but, of course, inescapable. As Donald Rumsfeld famously remarked, we are confronted with both ‘known unknowns’ (things we know we don’t know) and ‘unknown unknowns’ (things we do not know we don’t know). This does not mean, however, we are powerless to prepare for what lies ahead.

This Masterclass shows how reinsurers can take charge of their destinies and keep winning in the reinsurance business. Although sophisticated techniques for forecasting and risk modelling are continuously being developed, perceived uncertainties that cannot be addressed with probabilities have to be examined with a different approach. We offer reinsurers a way to address the problem of uncertainty through scenario planning; a foresight technique that can significantly enhance strategic decision-making.

1.2 Introduction to scenario planning
Scenario planning is a practical managerial tool that enables companies to assess external uncertainties and develop more attuned strategies. While the origins of this approach can be attributed to the work of Herman Kahn in the RAND institute, its use by Royal Dutch/Shell in the 1970s popularised the method. Scenario planning encourages managers to scan their environments, pinpoint areas of concern and construct plausible images of the future. Scenario planning is not about trying to predict the future; rather, it is about preparing and readying the business for what may or may not unfold. By ruminating on alternative futures, in a very systematic and disciplined way, scenario planning significantly enhances levels of anticipation and provides management with a varicoloured backdrop against which they can stress-test strategies and plan for the future.

As Figure 1 shows, the scenario planning process involves four main steps: (i) identifying key external trends and uncertainties, (ii) assigning potential ranges of values to the uncertainties, (iii) developing alternative scenarios and (iv) evaluating the strategic implications of scenarios. In the following subsections we discuss each of these steps and show how they can be applied to the reinsurance industry to inform strategy planning. We also suggest how firms can customise this model to suit their own particular needs and use the central ideas discussed in previous Masterclasses to respond to different reinsurance scenarios.

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Identify key trends and factors of uncertainty using the STEEP framework

Determine potential ranges of values for key trends and uncertainties

Develop alternative scenarios around key themes by writing narratives

Evaluate the strategic implications of each scenario for the business

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Figure 1. Scenario planning process


*The scenario planning process in the Masterclass follows Shell’s approach, as outlined in van der Heijden, K. 2005. Scenarios, the art of strategic conversation. 2nd edition, Chichester, UK: Wiley. We also draw on Tapinos, E. 2012. Perceived Environmental Uncertainty and Scenario Planning. Futures, 44(4): 338-345.
2. Scenario planning step 1: Identify external uncertainties in the reinsurance industry

In this step managers use research, brainstorming and discussion to tease out key areas of uncertainty in the reinsurance landscape. Before beginning, however, it is important to agree the planning horizon and define the scope of the exercise. The planning horizon we work to here is 12 years, looking towards 2025. In terms of scope, we are concerned with external macro-level forces, trends and uncertainties that might be of critical concern for the reinsurance industry in the future. The STEEP (Social, Technological, Environmental, Economic and Political) framework provides a useful system for classifying these macro-environmental factors.

Our analysis of the reinsurance industry reveals at least nine STEEP factors (see Table 3, p6) that need to be considered in a reinsurance industry scenario planning exercise. These are explored in ‘brainstorming’ fashion in sections 2.1–2.5. The aim is to be aware of the various ways in which these factors could alter by 2025. Later, when we come to write scenarios, we will choose and weave together some of these possible future developments.

2.2 Technological trends and uncertainties

2.2.1 Big data
Big data is not yet a major priority for many reinsurance firms, which rely on traditional data analytics and vendor models to support underwriting decisions. However, the growing volume of real-time data, coupled with rapid technological advancements, will enable businesses to capture, store and analyse ever-larger volumes and varieties of sophisticated data in the future. Indeed, some estimates suggest that data production will be 44 times greater in 2020 than it was in 2009. According to the Google Chairman, Eric Schmidt, “(Re)insurance is the most obvious industry about to explode with uses for big data” and new technologies have the power to transform the industry. What impact will these trends have on competitive dynamics and operations in the industry?

2.2.2 Cyber risk
There is growing concern about cyber risk and the vulnerability of technological infrastructure to hackers, viruses, cyber terrorists and data thieves. As cyber-crime becomes more sophisticated, making it harder to combat, detect and mitigate, the threat of destabilisation, disruption and data misappropriation grows. A report by Rohini Tendulkar (International Organisation of Securities Commissions Research Department), for example, showed that more than half the world’s securities exchanges experienced a cyber attack in the last year (53%). Earlier this year the Federal Reserve and major Wall Street banks simulated a large-scale cyber attack (called Quantum Dawn 2) that would have resulted in the closure of the US stock market. If cyber risk grows, we could see major disruption to the reinsurance industry over the coming years (see Table 3, p6).

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5Alloway, T. & Massoudi, A. Simulation highlights risk to Wall St from cyber attack. Financial Times 21 October 2013
2. Scenario planning step 1: Identify external uncertainties in the reinsurance industry (cont.)

2.3 Environmental trends and uncertainties

2.3.1 Changing climate
Global environmental trends are creating new risks and opportunities for the reinsurance industry. Rising losses related to extreme weather and catastrophic events, both natural and man-made, have already had a big impact. Ten of the 12 most costly hurricanes in insurance history (adjusted for inflation) have occurred in the past eight years.\(^{10}\) Likewise, inland flooding in Europe, Asia and Australia has caused huge losses for reinsurance firms. The 2010-2011 floods in Australia, for example, resulted in more than $350 million in claims to Munich Re.\(^{11}\) More extreme weather patterns could have significant implications for the industry (see Table 3).

2.4 Economic trends and uncertainties

2.4.1 Growth of emerging markets
Advanced economies still account for nearly 85% of the global insurance market, but average growth in these economies was only 1.5% in 2012 compared to 8% for emerging markets.\(^{12}\) Reinsurers are fighting each other tooth and nail to get into emerging markets like Brazil and China, as growth in mature markets slows and emerging markets become increasingly important in long term growth plans.

How will the reinsurance industry respond to this trend? Will existing industry players increase their revenues through penetration in emerging markets, or will competition increase as new well-capitalised firms in emerging markets move in and compete in developed markets?

2.4.2 Interest rates and capital supply
In recent years, the relationship between capital markets and the insurance industry has evolved. Low interest rates in other financial sectors have resulted in an increasing influx of new capital and capital providers into the reinsurance space. Capital accumulated by reinsurers stood at $510 billion on June 2013 of which $44 billion (8.6%) is coming from alternative capital.\(^{13}\) The reinsurance industry attracted $10 billion of new alternative capital the past year and it is estimated that more than $100 billion will enter the market over the next five years.\(^{14}\)

While the short-term growth of alternative capital is more certain, we do not know what will happen if this trend continues. What will be the strategic position that traditional reinsurers and alternative capital providers will employ in the new era? Will there be coexistence in the market or not? What will their respective roles be?

2.4.3 Global reinsurance market convergence
Globalisation has generated widespread consolidation in the reinsurance industry as players have come together to expand their competitive offerings, broaden their geographic reach and strengthen their bargaining power. The degree to which this trend continues is likely to have far reaching implications for (re)insurance industry structure, profitability and risk trading. For example, if reinsurance cedents (buyers) continue to consolidate, their power will grow as they have the option of retaining more risk, instead of ceding it on the reinsurance market. Additionally, larger cedents are likely to want to use bundled, global or multi-territory products such as super-Cats, rather than use local programmes.

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\(^{10}\) Frank Nutter, President, Reinsurance Association of America. Speaking December 14, 2012 at a Environmental and Energy Study Institute (EESI) organised briefing on insurance industry perspectives on recent extreme weather events

\(^{11}\) Gardiner, D. & Associates, LLC. 2012. Physical Risks From Climate Change: A guide for companies and investors on disclosure and management of climate impacts.


\(^{13}\) “New capital reinsurance industry could reach $100B in 5 years.” Insurance Journal, September 2013.

2. Scenario planning step 1: Identify external uncertainties in the reinsurance industry (cont.)

2.5 Political trends and uncertainties

2.5.1 Financial regulation, state intervention and global governance

With the recent financial crisis, some voices are calling for increased financial regulation. General trends towards tighter solvency regulations have already imposed higher capital requirements on firms, and the need for a more structured and transparent approach to risk management. If such types of regulation become more stringent, the structure and growth of financial markets can be significantly affected.

However, consistent global financial regulation is difficult to achieve, as it requires tight cooperation between states. Disjunctures between different local financial regulations may prevail over global regulation. With respect to non-financial markets, the voice of ‘anti-globalists’ – who call for reforms in governance of institutions that govern globalisation – also is gaining power. There is some doubt as to whether some countries will increasingly rely on non-tariff barriers (such as licensing rules, limits on foreign ownership, mandatory joint ventures) in order to hamper market penetration.

State regulation and intervention could evolve in a number of ways. For example, we may see a growing role of the state as financial power shifts. That is, Brazil, Russia, India and China could overtake the G7 countries as early as 2017 in GDP growth terms. Many of these countries and other emerging markets can be challenging regulatory spaces for business activity because they have economic policies in place that blur distinctions between public and private.

Between the growing empowerment of the state in western economies due to the financial crisis and the historic preference of some of these rising economic powers for state control and investment regulation, we may see more disjointed regulation and greater state restrictions on foreign investment. Alternatively, global markets might become more connected, with regulatory harmonisation and decreasing national-specific restrictions, which would further enable free trade.

2.5.2 New global players and the changing geopolitical landscape

For many commentators of international relations, the 21st century will be the century of Asia, with the economic and political rise of the two most populous countries in the world: China and India. There is little uncertainty that both countries’ population will reach 1.3-1.4 billion (each) by 2020 and that their GNP will continue to grow, to approach (or even exceed in the case of China) the GNP of most western economic countries. But, how these two countries will exercise their growing economic power to play in the political field is more uncertain. Will these two countries cooperate with western countries during international crises? Will China continue to strengthen its military, and overtake Russia; or will it embrace a more democratic society?

The rise of other countries, such as Brazil, also threatens many of the fundamental categories that structure current political thinking, such as the north/south and the developed/developing categories. The USA is likely to see its power position eroded, but the extent to which the world in 2020 will have a more non-western face, with new countries playing in the international political field is unclear. Will Washington remain the central pivot for international politics and if so, for how long?

Study Question 2

In section 2 we have given examples of some broad trends that will be of obvious interest to most companies in the reinsurance industry. Nonetheless, there may be others that are also very important for your business. Think about other broad trends over the next 12 years. Can you identify three other areas of uncertainty that might be important for your business?

3. Scenario planning step 2: Determine potential ranges of values for uncertainties and trends

The next step for those involved in the scenario analysis process is to consider potential ranges of values for each external factor.

As Table 3 (below) illustrates, this is a largely subjective process, but it encourages participants to engage in dialogue about the uncertainties, imagine potential upsides and downsides and think through possible implications.

<table>
<thead>
<tr>
<th>Trends and uncertainties</th>
<th>Low value by 2025</th>
<th>High value by 2025</th>
<th>Possible implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changing population</td>
<td>World population growth slows and reaches less than 8 billion. The proportion of people aged 60+ rises, but only in developed economies; life expectancy remains lower in the rest of the world.</td>
<td>World population grows faster and exceeds 8.1 billion. Proportion of people aged 60+ exceeds 1.2 billion and is expected to grow rapidly.</td>
<td>Labour market, pension systems, social security reforms, tax increases, pressures on economic growth. Demand for healthcare, life insurance and retirement funding. Pressures on natural resources and the creation of new environmental risks and new reinsurance products.</td>
</tr>
<tr>
<td>Big data</td>
<td>The volume of information generated overwhelms firms. Most fail to turn big data into meaningful patterns, concentrating its use into the hands of a few key players.</td>
<td>Analytic technologies become increasingly sophisticated, and thus powerful computing systems are available for people to access and use big data within firms.</td>
<td>Opportunities for innovations in data analytics, risk appraisal and pricing. Enormous technological and competitive challenges. Investment in big data infrastructure to ensure firms have the technological capacity to competitively leverage big data.</td>
</tr>
<tr>
<td>Cyber risk</td>
<td>Technology develops in ways that make online transactions secure.</td>
<td>Cyber attacks become more sophisticated and increasingly infiltrate online networks and technological infrastructure.</td>
<td>Security threats lead to less willingness to trade online. Demand for insurance to cover cyber risk increases. New regulations to mitigate cyber risks, possibly raising compliance costs.</td>
</tr>
<tr>
<td>Climate change</td>
<td>No substantive change in the frequency of extreme weather and catastrophic events.</td>
<td>Dramatic increase in the frequency of extreme weather and catastrophic events.</td>
<td>Market growth due to increased event frequency. Risk of big losses increases. Some firms struggle to survive loss events. Pressing need to develop new risk models and underwriting capabilities.</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>Existing firms penetrate in emerging markets to boost their growth and profits.</td>
<td>New well-capitalised firms move from emerging markets to compete fiercely with existing firms in developed markets.</td>
<td>Emerging markets become increasingly important, but it is unclear where new markets will yield their reinsurance premiums. Implications for business models and global competition.</td>
</tr>
<tr>
<td>Interest rates and capital supply</td>
<td>Alternative capital suppliers face losses in the industry and so exit the market to allocate capital on investments/markets with higher returns.</td>
<td>Returns remain low in financial markets and so new alternative capital keeps entering the market, marginalising traditional players.</td>
<td>Declining demand for reinsurance. Increased supply of capital, squeezes reinsurance prices and profits. More intense rivalry between reinsurers. Increase in mergers and acquisitions activity.</td>
</tr>
<tr>
<td>Global reinsurance market convergence</td>
<td>The trend towards industry consolidation slows.</td>
<td>The trend towards industry consolidation continues or increases.</td>
<td>Buyer consolidation deprives reinsurers of premium and squeezes profits. Greater use of bundled ‘super-risks’ is beyond the capacity and capability of a lot of smaller reinsurers. The pool of possible reinsurers is limited to a few select heavyweights with sufficient analytic capability.</td>
</tr>
<tr>
<td>Financial regulation, state intervention and global governance</td>
<td>A more favourable regulatory environment with greater regulatory harmonisation and decreased national restrictions.</td>
<td>A challenging regulatory environment with more disjointed regulation and increased national restrictions.</td>
<td>Potential for higher capital requirements. More disjointed regulation and increased nationally-specific restrictions would affect the standardisation of products and processes.</td>
</tr>
<tr>
<td>New global players and the changing geopolitical landscape</td>
<td>BRIC countries increase their political and economic power to become equal ‘partners’ with Europe and the US in global governance.</td>
<td>BRIC countries gain enough political and economic power to lead in global governance and re-arrange the global system to their advantage.</td>
<td>The rise of emerging global players hurts traditionally powerful national players. New global competitive dynamics lead many companies in the industry to adjust their business models.</td>
</tr>
</tbody>
</table>

Table 3. External trends, associated uncertainties and possible implications
3. Scenario planning step 2: Determine potential ranges of values for uncertainties and trends (cont.)

**Study Question 3**

In Study Question 2 you looked forward towards 2025 and identified three areas of uncertainty that might be important for your business.

Now define the range of potential minimum and maximum values for the uncertainties you identified.
4. Scenario planning step 3: Develop alternative scenarios

Armed with the knowledge, ‘best guesses’ and projections which have been researched and discussed in the first two steps, managers start to compose compelling and integrative scenarios of alternative future environments.

The process begins with participants engaging in extensive discussion to select the main scenario themes; usually by identifying the most critical forces. The scenario theme is like the eye-catching newspaper headline written in 2025. When writing the scenario narrative, other trends and uncertainties among those identified in the earlier steps are then woven into the storyline in ways that feel plausible. By doing this, managers avoid composing one-dimensional scenarios that are too simplistic. Rather, the factors are woven together to form a much more complex tapestry. To illustrate this process, we have constructed three scenarios for the reinsurance industry in 2025.

4.1 Scenario 1: An increasingly polarised world in 2025

Staggering economic growth in China, India, South Korea, Brazil and elsewhere mean the world is collectively richer than it ever has been, but the flow of economic wealth to lower-growth Western countries is drying up. More international trade is now being conducted within geographical clusters. Economic giants in Asia and Latin America not only generate more wealth, they are also retaining more wealth. Estimates in 2025 suggest that the new Asia pact, for example, will trap 16% more wealth in Asia using regional trade agreements and protectionist measures. Similar developments are occurring in Latin America around Brazil. These are worrying times for many western companies who are increasingly finding themselves locked out of the world’s most lucrative markets. While the World Trade Organisation, western politicians and industry lobbyists continue to rail against these protectionist policies, it seems they are powerless to fight against the strong current that is carrying us towards a more polarised economic world.

Reinsurer Times

This week China overtook Japan to become the second-largest primary insurance market in the world in terms of premium income (€850bn).

The last decade has seen the meteoric rise of China, huge premium growth in India, South Korea and Brazil, and strong growth in emerging markets of Africa and the Middle East. These developments have been accompanied by a dramatic shift in power in the reinsurance world, as the long-established giants of the industry, based in its traditional heartlands of Europe and the US, have failed to penetrate the new markets, as they must have hoped.

Regulation – on a scale which European reinsurers in particular have often denounced as ‘protectionism’ – and the increasing dominance of state-owned reinsurers have seen these geographically-defined markets yield more and more premium to themselves. Western companies, used to working with high-quality information, were slow to gamble on risks in Asia, Africa and the Middle East. which did not come with equally-detailed, historic information needed to run big data analytics. But especially from 2014–2019, when these markets were exploding, local reinsurers such as China Re and India Re showed a much greater willingness to underwrite these less-modellable risks. As a result these two companies have become globally-powerful giants, based on major strength in their ‘home’ markets.

Perhaps too late, European reinsurers have started to underwrite some of these risks in their efforts to grab more Asian premium, but many have been burnt by loss events.
4. Scenario planning step 3 : Develop alternative scenarios (cont.)

4.2 Scenario 2: Extreme weather, extreme prices

Scientists claim that significant rises in greenhouse gas emissions, especially in Asia, along with warming oceans and rising sea levels are causing the dramatic increases and intensity of weather around the world. Withering heat waves, floods in coastal cities and island nations, disruptions to agriculture and drinking water, storms and droughts in tropical areas, tornados and hurricanes in residential areas are now far more common than they were 10 years ago. This is causing untold damage as people migrate from affected areas, rainfall patterns jeopardise crops and food supplies and most major global cities suffer constant disruption.

In 2023 there were nearly 300 individual events generating insured losses in excess of CNY 533 billion (USD138 billion) – a new record.

Insured losses increased by very close to 3% in real terms for each of the previous seven years, in line with damage to human life, urban infrastructure and ecosystems, but the rise recorded in 2023 has been much steeper at 4.3%. While demand to cover natural catastrophes has been especially high in high-growth markets over the past decade, extreme weather patterns are now generating noticeably increased demand in mature markets.

Fears are growing about the potential for market failure, as global insurance and reinsurance markets increasingly struggle with growing demand, higher capital requirements and greater exposure to catastrophe claims. In the last year, the collapse into insolvency of nine of the top 100 reinsurers, led of course by the shock failure of top-twenty company OmegaRe, has only underlined the general decline in reinsurers’ stock prices.

Governments are under increasing political pressure to step in to protect country interests. Industry experts, such as leading academic Paula Jarzabkowski (in her keynote speech at last month’s Singapore Meeting), and Virat Bhattarjee of the Federal Indian Reserve, predict we may be moving towards a new partnership model between state regulation and private providers to prop up infrastructure.
4.3 Scenario 3: Towards a finance society

In 2025, the post-industrial society is definitely behind us, and no-one remembers the golden age of the post war period when large organisations were the pillars of western societies. Large corporations still exist, but they are organised around the model of network organisations, with long chains of suppliers located all over the world and with their headquarters predominantly located in Asia.

The dominant measure of performance for these organisations is the shareholder value model, but because corporate ownership is increasingly concentrated in the hands of a few large mutual funds, only a very small fraction of the world population actually benefits from the financialisation of societies.

Moreover, major players in these financial markets remain very passive in corporate governance. While the nation-state remains the dominant category to think about international politics, globalisation puts it under severe threat.

Power is actually in the hands of the 20 top hedge fund managers, whose earnings are 20 times the earnings of all 500 CEOs of the biggest worldwide corporations, and far above the GDP of many small countries. Indices of wealth inequalities are at their highest levels in all OECD countries and the population is increasingly ageing. The dollar has been replaced by the Chinese currency and China is leading the world, not only from an economic perspective – it is by far the largest economy of the world – but also from a political viewpoint.

The face of the reinsurance industry has changed profoundly within the last ten years.

In 2015 the major players were essentially conglomerates based on long-established European and American companies; now all the major reinsurers are located in Asia and most of them are state-owned. In addition, the financial markets have become very strongly connected, so that ‘non-traditional’ reinsurance capital providers have injected massive amounts of capital into the reinsurance market. While in 2015 the insurance industry was really only beginning to exploit ‘non-traditional’ sources of capital, which supplied less than 20% of global reinsurance needs, by 2025 such capital is so well-established that it is itself considered to be ‘traditional’ reinsurance, supplying just over 50% of risk transfer capital in the industry.

As a consequence, those long-established, traditional western reinsurers have struggled to find their way in a market dominated by new players. Last month GlobalRe was subject to a hostile take-over and we have seen a string of companies – previously highly-profitable industry leaders – go bankrupt.

Study Question 4

Develop two additional scenarios, using the factors particular to your own position in the reinsurance industry which you identified in Study Question 2.
Each scenario has painted an alternative picture of the future. The next critical step is to consider the strategic implications of these scenarios and to use the insights generated to examine the appropriateness of existing strategies and plans. This exercise needs to be carried out on a firm-by-firm basis. Strategic implications will, of course, vary according to the following characteristics of any particular firm:

- Position in the supply chain as cedent, broker or reinsurer;
- Business area;
- Strategic type (see Masterclass III);
- Geographical dependencies;
- Strategic plans.

Changes in emerging markets, for example, will have very different implications for insurers and reinsurers. Different types of insurers (emerging market, local, regional, global) and reinsurers (price-taking profiteers, deal-making partners, patchwork partners, portfolio partners, blanket partners) will be affected in different ways.

In the following sub-sections 5.1–5.6, therefore, we develop a general template that any type of business can use. The subsections consider how any future scenario might affect: competitive forces (5.1); product portfolios (5.2); the business model and strategic positioning (5.3); organisational capabilities (5.4); client relationships (5.5); and broker intermediation (5.6).

In developing our template, we draw on lessons from previous Masterclasses to help firms respond and position themselves for alternative futures.

5.1 Analyse impact on competitive forces

In Masterclass I we stressed the importance of understanding five key industry forces, in particular:

- Bargaining power of buyers;
- Bargaining power of suppliers;
- Threat of new entrants;
- Threat of substitute products;
- Intensity of industry rivalry.

The interaction of these competitive forces determines the intensity of competition and associated profit margins of an industry. As a first step, industry incumbents should analyse these five forces under each scenario to consider future impacts on competition and profitability in key markets.

For example, in scenario 1, increased polarisation is likely to intensify competition and squeeze reinsurance profits. Global reinsurance players will face higher barriers to entry in Asia, which may stifle growth and profitability in these key markets. Reinsurers may furthermore face new competition in existing markets, as new entrants such as China Re, India Re and Latina Re leverage their scale and capital to woo large western clients. At the same time, those reinsurers who have predominantly pursued a strategy based on US property Cat (see Masterclass III) could be impacted by increased capacity and competition from alternative risk transfer products and providers.

Of course, this future would equally affect cedents and brokers. Insurers, for example, with a global presence in Asia and Latin America will face more intense rivalry in their primary markets, but also potentially reduced reinsurance bargaining power. Western brokers, by contrast, are likely to face more intense competition from new brokers in China and elsewhere as these markets become more dominant and localised.

The key task for managers is to understand how the five competitive forces will affect their business under each scenario. Armed with this knowledge managers can then consider what kinds of business they should pursue and what kinds of competences might need to be developed for the future. Masterclass I offers several useful suggestions for how firms might analyse and respond to changing competitive forces by, for example, carefully positioning the firm so it can defend itself, investing in markets where the forces work in their favour, or combining competitive and co-operative strategies to mitigate competitive threats (see Masterclass I, page 10).

Study Question 5.1

(a) How might the five competitive forces change in your area of the market under one of our scenarios, and one of the scenarios you generated in Study Question 4?

(b) What opportunities and threats do these changes present for your business?

See Masterclass III for an explanation of these strategic types.
5. Scenario planning step 4: Consider strategic implications (cont.)

5.2 Is your business fit for purpose?

In Masterclass II we showed how consolidation in the primary insurance industry is changing insurer demand for reinsurance products. Emerging and local market insurers, for example, use reinsurance to access capital and alleviate volatility, whereas the dominant regional and global insurers are increasingly retaining more risks and using more bundled ‘super-risk’ products. These changes have had, and continue to have, a profound impact on reinsurer and broking businesses and their products. How could our future scenarios further reshape insurer demands, and with what consequences for product portfolios?

Subsections 5.2.1–5.2.2 present just two partially worked examples. In practice, companies will need to go much deeper in thinking through each scenario to derive implications for their business. These insights can then be used to consider the fitness of existing product offerings, competencies and strategic plans.

5.2.1 Scenario 2

In scenario 2 the demand for catastrophe cover increases exponentially as weather patterns become more extreme and more dispersed. All cedents in this line of business will be confronted with more exposure to claims and higher capital requirements. There may also be more demand for larger bundled multiple territory products as the number of transactions and scope of cover increases.

Managers should think through the implications for their business. These trends may mean that cedents align well with Portfolio Partners who have high capital efficiency and who are highly proficient in using strongly technical approaches to write multi-territory business. However, the same scenario could represent a major threat for smaller reinsurers, particularly those who predominately write mono-line property Cat business (see Masterclass III).

Thinking through these implications will sensitise managers to future choices. For instance, to counteract higher capital requirements and greater exposure, firms in this space may need to consider taking steps to increase capital efficiency by holding more diverse risks to offset the demands from environmental catastrophes.

5.2.2 Scenario 3

Scenario 3 presents a very different challenge. Greater convergence between financial markets and capital from mega-corporates could well threaten demand for traditional reinsurance products. Growth in China and Brazil will see domestic insurers become larger, lessening their need to use reinsurance as a proxy for capital. Moreover, rapid growth may further move demand away from smaller bouquet products (single territories, multiple types of risk) towards larger bundled super-risks.

Again, managers should think through the implications for their business. While this future may suit some larger reinsurers, it will put great pressure on smaller players who may be ignored, or squeezed out of such deals. Brokers will also be affected as more bundled risks start to bypass the intermediary stage.

Masterclass II provides a useful framework for cedents, reinsurers and brokers to begin thinking through these issues. Reinsurers could, for instance, try to develop new types of products that align with changing cedent needs. They could try forming alliances with new types of capital providers or even diversifying into new markets, perhaps targeting market positions where scale is not necessarily a major advantage.

Study Question 5.2

(a) How might your business’s product portfolios need to change under one of our scenarios, and one of the scenarios you generated in Study Question 4?

(b) What opportunities and threats do these changes present for your business?
5. **Scenario planning step 4: Consider strategic implications** (cont.)

5.3 **Critically assess strategic positions and business models**

In Masterclass III we illustrated how reinsurance firms can position their business to exploit growth opportunities, hone strengths and minimise weaknesses. These same lessons apply here. Greater competitive rivalry and new strategic threats raise the stakes in all three of our scenarios. Reinsurers must consider the robustness of strategic plans and business models in the light of anticipated threats and opportunities in each scenario.

At the moment many firms are fighting each other tooth and nail to get into emerging markets like Brazil, China and elsewhere. Many of the major reinsurers, cedents and brokers have set up local offices in these markets or have established positions using joint ventures or mergers and acquisitions. But what are the strategic implications in an increasingly polarised world (Scenario 1)?

Those operating in such markets are likely to face stronger competition from domestic firms, more state interference and possibly inequitable trade agreements that could restrict growth. If this were the case how might your firm respond? Options might include forming closer ties with state-owned companies, taking steps to reduce market dependencies by diversifying or perhaps developing exit plans.

For western companies that are not already established in Asian and Latin American markets the strategic implications are very different. Growing entry barriers will mean many of these companies will be effectively locked out. Such mobility barriers raise profoundly important strategic questions that need to be explored. Should entry into these markets be accelerated now, perhaps through more local alliances, to establish early positions before it is too late? Should reinsurers look elsewhere for long-term growth, perhaps moving more aggressively into Africa and the Middle East to gain early-mover advantages? How will they compete in existing markets that are becoming increasingly mature?

Masterclass III provides a useful framework to begin thinking through these positioning issues, in particular, considering mobility challenges and those strategic moves that may be the most feasible for different types of reinsurers. The key point – as ever – is that managers should work through each scenario systematically to consider strategic options for their business, and devise plans for each of those possible future worlds.

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**Study Question 5.3**

(a) What strategic moves would your business need to make to maximise success under one of our scenarios, and one of the scenarios you generated in Study Question 4?

(b) How far do these moves depart from existing plans?
5. **Scenario planning step 4: Consider strategic implications** (cont.)

### 5.4 How could we align structure, knowledge and roles for maximum operational effectiveness?

In Masterclass IV we showed how competitive success relies on a firm’s ability to develop and coordinate diverse pockets of specialised knowledge to write different types of reinsurance deals. The preceding steps in this scenario planning exercise should have given you a greater appreciation of potential new competitive landscapes, the robustness of current strategies and possible strategic moves the business may need to take. Key questions for companies to consider are: what demands would each of the future scenarios make on the way the company configures internal knowledge; and what new knowledge might they need to acquire?

For example, in scenario 1 risks in Asia, Africa and the Middle East are less-modellable because of data volatility, lack of technological infrastructure and of historical loss information. Hence, writing these risks is reliant on local contextual knowledge, which gives local incumbents a significant advantage. This raises an important strategic question for western reinsurers. Should these companies maintain a strong focus on highly analysable business, which represents a significant proportion of the market’s total current value, or should they develop the resources to write less analysable business now, to try and penetrate critical emerging markets for tomorrow?

This decision point has different implications for different types of firm. For example, Price-taking Profitiers and Deal-making Partners privilege very technical and highly analysable business. As such, they have strong technical functions and a great deal of analytical expertise. To move towards less analysable business would be a major jump for these firms. They could possibly use a ‘start-up’ company structure and spare capacity to ‘experiment’ with less analysable business, but this would require the development of new contextual and client knowledge and new complex-coordination capabilities to inform reinsurance decisions. For other types of company such as Blanket Partners, less analysable business is already part of the portfolio, and so would be less of a stretch for knowledge and resources. The challenge for these companies would be to select the right clients and develop deep long-term relationships with them (see 5.5 overleaf).

Scenario 2 also suggests some important implications for the blend and configuration of internal knowledge. For example, dramatic increases in the frequency of extreme weather and catastrophic events may generate a pressing need to develop new risk models and underwriting capabilities. This raises several questions that firms need to think through. For instance, will significant investments in big data infrastructure be needed? How will firms manage and coordinate the information generated? If big data becomes more important to a firm it will generate a pull towards technicalisation, shifting more power and decision-making authority to technical staff.

Senior managers need to think about how they will design their organisations to accommodate these shifts and combine knowledge in ways that suit specific deals and clients. Masterclass IV offers several frameworks that can be used to start thinking through these issues.

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**Study Question 5.4**

(a) Look back at the strategic responses you planned in Study Question 5.3, for two scenarios (one of ours, and one which you generated for Study Question 4).

(b) How will your planned responses to each scenario change the priorities given to different forms of knowledge in your company?
5. Scenario planning step 4: Consider strategic implications (cont.)

5.5 Implications for client relationship management

Masterclass V stressed the importance of managing client relationships strategically, so that the valuable time and resources invested support the business strategy. Reinsurers should use the insights from this Masterclass to consider how each scenario might alter the nature of their client portfolios and think through the implications this has for both valuing and engaging with clients. For example, reinsurance firms may increase the number of ‘watching’ relationships (see Masterclass V) with clients in emerging markets in order to have a broader base of opportunities for shifting into these markets as their potential profitability becomes clearer.

Managers need to judge how each scenario raises (or decreases) the future value of clients and start to adjust their engagement strategies accordingly. For example, in scenarios 1 and 3 current emergent markets assume greater levels of importance. At the same time, mature markets with (currently) high-value clients may yield less and less revenue, particularly for smaller reinsurers. This could significantly alter the ‘pay-off’ from client engagement in terms of both economic and information value. So, a Blanket Partner (see Masterclass III) wanting to write more business in Latin America, which still lags in analysability, could consider increasing the number of ‘investigating’ and ‘nurturing’ relationships in these key markets; this would allow them to target potentially valuable insurers, cultivate relationships and generate local information to enable them to be successful (a useful tool to help managers consider implications for relationship management is the client assessment diagnostic in Masterclass V). At the same time, the Blanket Partner could invest in greater knowledge of the Latin American market, thus developing its capabilities to become a leader in technical analysis as the region matures (see Masterclass IV).

Study Question 5.5

(a) Using the client assessment diagnostic in Masterclass V, evaluate the economic and information value of existing client groups under one of our scenarios, and one of the scenarios you generated in Study Question 4.

(b) How might your client engagement strategies need to change in the future?
5. Scenario planning step 4: Consider strategic implications (cont.)

5.6 Implications for broker intermediation

Brokers play a vital role as intermediaries in the cedent-reinsurer value chain. Masterclass VI showed how recent changes in the reinsurance industry mean that brokers have had to devise new business models and reconsider the link between services and remuneration. A critical question for broking companies, and for users of these services, is how each scenario might alter the landscape of broker intermediation?

In scenario 3, for example, rapid growth in Asia and Latin America will present both opportunities and threats for broking companies. These markets are likely to become dominated by fewer, larger insurance companies who will use more bundled super-risk products. While these larger insurers will still need brokers to place across the reinsurance industry, an increasing proportion of this business may bypass the intermediary stage as large insurers place more of their business directly with key reinsurers arising from their own domestic markets, or with alternative capital providers. At the same time, Asia and Latin America are huge markets and even a small proportion of this business could provide very profitable opportunities for brokers to place reinsurance cover across a global market.

Broking firms need to think through how they will match and package their competencies and product offering to clients in these future worlds. In particular, there are two critical questions they should answer for each scenario.

First, what technical, distribution and knowledge resources and capabilities will they need to develop to add value to their clients in this new world? For example, in scenario 1 one of the underlying drivers of the polarised world is that information available in Asia, Africa and the Middle East is of relatively poor quality, not easily analysed with models. Broking firms may see this market imperfection as an opportunity and ask: could we develop the global networks, technical capabilities and knowledge resources to help western reinsurers write more of these risks; thereby offering an alternative to insurers in these countries?

Second, brokers should ask, how can we get industry players in this world to value, and pay for, this customised service offering? For example, brokers may consider moving towards a more consultancy-based model where they are remunerated on a fee-for-service basis. Masterclass VI offers more detail, explanation and guidance.

Study Question 5.6

(a) What technical, distribution and knowledge resources and capabilities will we need to develop to be successful under one of our scenarios, and one of the scenarios you generated in Study Question 4?

(b) How would we profitably package and sell the new service offering?
Looking to 2025, it is clear that firms in the global reinsurance industry face many unpredictable trends. Rapid technological advancements, sweeping global economic changes, unprecedented weather patterns and other developments are conspiring to spin a web of uncertainty that makes accurate prediction nearly impossible. Nonetheless, to stay ahead in the reinsurance game, companies must prepare themselves now for what lies ahead.

This Masterclass provides managers with a practical tool they can use to ready themselves for future challenges. Using scenario planning, managers can scan their environments, pinpoint areas of concern and construct plausible images of the future. By contemplating alternative futures in a systematic way, businesses can make themselves more sensitised to possible futures and strategic implications. This learning can then be used to stress test strategic plans, resources, and competencies.

When doing these exercises managers should construct the scenarios in groups. Once written, each scenario should be taken to be accurate; this really ‘is’ the future. With that mind-set, the scenarios are interrogated to draw out strategic implications i.e. the impact on competitive forces, the business model, product portfolios, client relationships, organisational design and knowledge management. Similarly, the results of this analysis should show the company which of their existing core competences need to be protected, developed and invested in.

Armed with these insights, companies then have three main options:

- **Wait and see.** Recognising that scenarios are not predictions, organisations may consider that for certain strategic implications the best option is to ‘wait and see’. The scenario planning exercise will have sensitised managers to environmental trends which can be formally monitored before deciding if a specific course of action is appropriate or warranted.

- **Take preparatory steps.** Other strategic implications may be firmer, perhaps because they are deemed important under more than one scenario. In this case managers may start to prepare the ground now by investing time and resources to build important capabilities for the future. This often involves incremental steps, for example, adapting recruitment policies, scoping new projects, building new partnerships etc.

- **Implement immediately.** Organisations may find that whichever scenario they consider, the strategic implications are similar and important. For example, regardless of which events unfold, the business may need to establish a stronger foothold in China; preferably sooner rather than later. This realisation may prompt managers to take more decisive action now to gain a favourable position, or to reinforce the appropriateness of existing short- and medium-term strategies.

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**Scenario 1**
Anticipated trends, developments, competitive forces (see MC I)

**Scenario 2**
Anticipated trends, developments, competitive forces (see MC I)

**Scenario 3**
Anticipated trends, developments, competitive forces (see MC I)

**Business implications for:**
- Product portfolios (MC II)  
- Strategic positions (MC III)  
- Structures/knowledge (MC IV)  
- Client relationships (MC V)  
- Intermediation (MC VI)

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**Figure 6. A basic decision model for strategic action**
6. Conclusion: Looking to the future (cont.)

Figure 6 summarises these options and how they might be deployed as part of a scenario planning exercise. We suggest that managers consider two core questions:

- Are the implications unique to one scenario, or common across multiple scenarios?
- Are these implications likely to have a major or minor impact on our business?

Answering these two simple questions will help organisations to exploit opportunities to develop a sustainable competitive advantage.

Lastly, scenario planning is not a ‘one-off’ exercise. For organisations dealing with increased levels of uncertainty, we recommend an annual scenario-planning workshop be undertaken. In this way, a ‘future-sensitive’ organisation can be nurtured.

- This workshop will sensitise managers to important developments and create a ‘strategic-radar’ for detecting the most important trends and uncertainties.
- These key uncertainties can then be cascaded and shared with divisions and other parts of the organisation to encourage greater sensitivity to external signals or developments.
- Knowledge gained in this way can then be fed back into future workshops, where scenarios and plans are regularly updated and reworked in light of environmental developments.
List of Global Reinsurance Masterclasses

- Re-Think reinsurance: How to shape your future through a strategic understanding of global market forces
- Fit for purpose? How to tailor reinsurance products to insurance industry lifecycles
- Winning the game: How to identify reinsurance rivals and spot growth opportunities
- Be a better reinsurer: How to align structure, knowledge and roles for operational excellence
- Strategic reinsurance relationships: How to evaluate information and build trust
- Intelligent matchmaking: How to maximise value from broking
- **Imagining the future:** How to stay ahead in the reinsurance game through scenario planning

The aim of the Global Reinsurance Masterclass Series is to support (re)insurance and broking companies in analysing their position and improving their competitiveness during a period of global change. They are based on in depth analysis of a global reinsurance data set, supplemented with analysis of secondary data and findings from complementary industries.

Each masterclass functions as a standalone module that can be used on its own or in conjunction with other masterclasses.
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In 2002, City University's Business School was renamed Sir John Cass Business School following a generous donation towards the development of its new building in Bunhill Row. The School's name is usually abbreviated to Cass Business School.

Sir John Cass's Foundation
Sir John Cass’s Foundation has supported education in London since the 18th century and takes its name from its founder, Sir John Cass, who established a school in Aldgate in 1710. Born in the City of London in 1661, Sir John served as an MP for the City and was knighted in 1713.