

Risk appetite gains momentum in a changing world

2017/2018 Global Reinsurance and Risk Appetite Survey Report

How is risk appetite helping insurance companies make better decisions about reinsurance needs? How effectively are companies using enterprise risk management (ERM) to enhance business performance? Which emerging risk is top of mind? To find out, we asked insurance executives across the globe to weigh in.

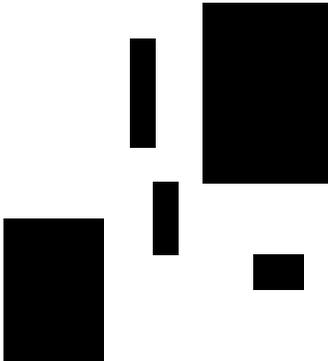


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Executive summary

Willis Towers Watson's latest risk appetite survey has again confirmed that risk appetite is increasingly central to insurers' business decisions.

- The motivation for buying reinsurance has shifted toward earnings protection and volatility reduction driven by investor relation efforts.
- ERM capabilities have improved, as suggested by higher satisfaction with current frameworks; however, it appears progress is still needed to achieve companies' risk culture goals.
- Among different emerging risks, most respondents say cyber risk is clearly their main concern, due largely to the difficulties in defining and managing this serious risk both from underwriting and operational perspectives.

In an insurance industry of increasing complexity and risks, risk appetite and reinsurance are gaining momentum as cornerstones of a successful operation, regardless of geography or size.

Survey highlights

Risk appetite is evolving, dynamic and almost universal

- **Risk appetite statements are among the day-to-day must-have management tools:** Nearly all survey respondents (98%) have adopted or are planning to adopt a formal risk appetite statement in the next three years.
- **Risk appetite is dynamic:** One-third of insurance companies with a formal risk appetite plan intend to make a material change in the coming year, mainly due to regulatory requirements.

Risk appetite guides reinsurance buys, particularly earnings

- **Risk appetite is a strategy optimizer:** Increasingly (80%), risk appetite statements optimize capital and earnings and, hence, reinsurance strategies.
- **Drivers of reinsurance buys:** Earnings protection and volatility reduction are top drivers for reinsurance purchasing. Capital is still very important; however, the advanced implementation of recent regulatory requirements has absorbed this need.
- **Advanced metrics and less tolerance:** Insurers are moving to more sophisticated metrics such as return on equity and economic capital; however, they are becoming less tolerant of missing their earnings targets due to pressure to perform from investors.

ERM satisfaction widespread, but insurers' final vision still far-off

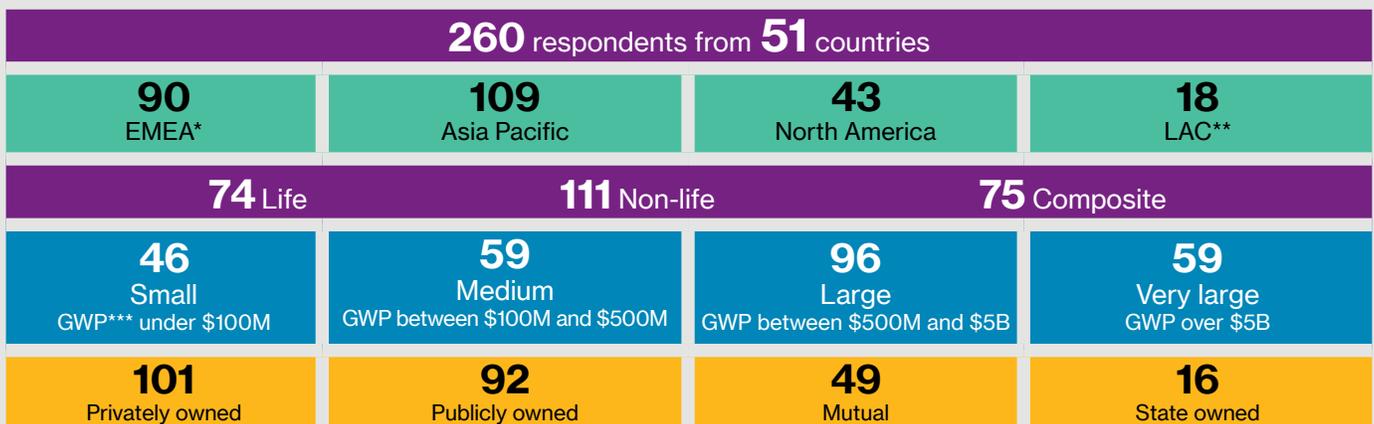
- **ERM front and center:** ERM is increasingly prominent, and regulation most commonly drives implementation.
- **ERM satisfaction overwhelming:** The vast majority of insurers across all regions are satisfied with their ERM capabilities. Compared with 2015 survey results, the proportion of dissatisfied survey respondents was halved – indicating progress in ERM implementation over the period.
- **Risk culture key to ERM vision:** Risk culture was ranked most important to the final strategic ERM vision; however, only 20% of surveyed companies reported significant progress (more than 75%) toward achieving their visions for risk culture.

Cyber risk looms as top emerging risk

- **What concerns insurers?** Unsurprisingly, technology, cyber risk and industry disruptors are prime concerns, while regulatory issues remain central. Climate change, globalization and connectivity also featured heavily in the survey responses.

About the survey

Our web-based survey of 260 insurance executives from 51 countries was fielded June 8 through August 10, 2017.



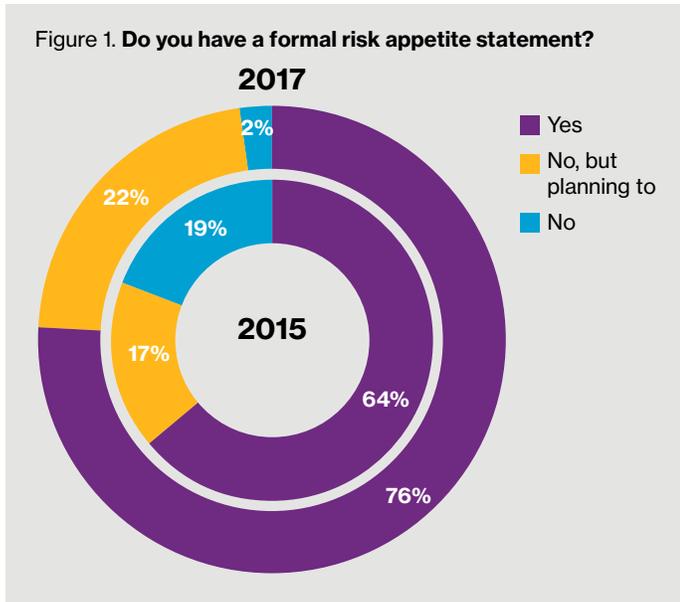
*Europe, Middle East and Africa

**Latin America and the Caribbean

***Gross written premium

Risk appetite in a changing world

Figure 1. Do you have a formal risk appetite statement?



Risk appetite statements are far more than just a regulatory requirement and are almost universally used by insurance companies around the globe. In fact, what may have begun as a way to satisfy regulators and rating agencies is now being given its due as a valuable management tool that can safeguard companies from serious, debilitating emerging risks such as cyberthreats.

Risk appetite statements are now on nearly every insurer's agenda

The concept of a risk appetite framework is not new. Rather, its emphasis and focus have increased globally over the past few years, driven by regulatory pressures and fear of systemic risks that could threaten the financial services industry.

Regulatory requirements are just one driver

In some geographies an embedded risk appetite framework, including formal risk appetite statements, is a regulatory requirement. Where regulatory requirements do not exist, it is common for a company to implement an equivalent framework to compare favorably with peers.

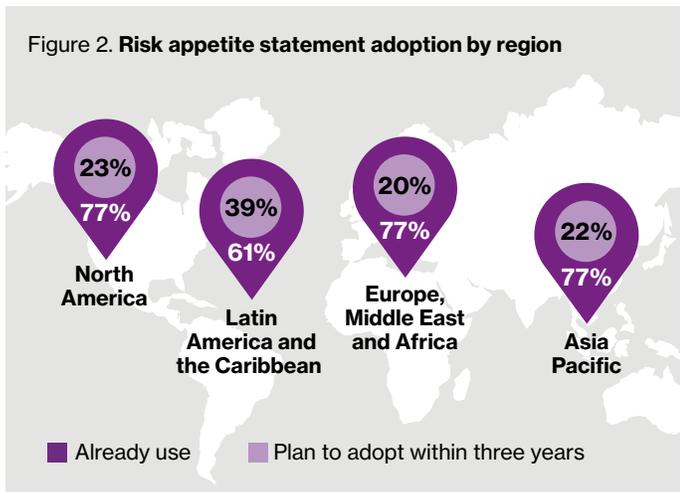
Key survey results:

- Globally, over three-quarters of insurers surveyed have formal risk appetite statements in place, with a further 22% planning to adopt one in the coming three years.
- Only 2% of those questioned have no plans in place to implement a risk appetite statement. (Notably, no life insurance companies surveyed fall into this category.)
- When the survey was conducted in 2015, over 15% of participants had no plans to implement a risk appetite framework. *Figure 1* shows a marked shift in attitude across the market.

Several regions, one trend

Regionally, the adoption of formal risk appetite statements is consistent, with similar take-up rates. Only Latin America and the Caribbean (LAC) reported a lower-than-average adoption rate. That said, all LAC respondents plan to have one in the next three years (*Figure 2*).

Figure 2. Risk appetite statement adoption by region



Risk appetite and reinsurance – linking micro to macro

As we've just described, a risk appetite framework is integral to running an insurance company.

Insurers are increasingly using their risk appetite statements to optimize their capital management and profitability targets. Reinsurance has always been a particularly efficient way to manage these macro-goals and is, therefore, unsurprisingly linked to risk appetite: 80% of insurers surveyed consider their risk appetite statements when optimizing their reinsurance strategies (Figure 3).



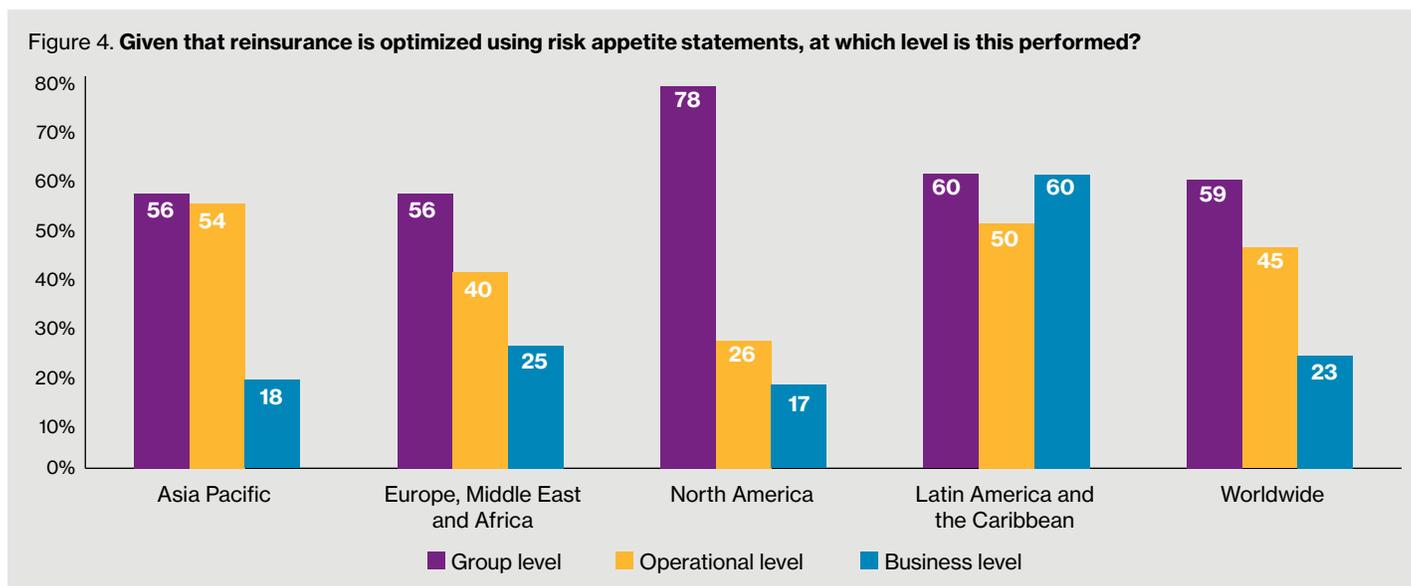
Next we will see how risk appetite and reinsurance targets three business areas:

- Operational use (within various functions of an insurance company)
- Earnings protection
- Capital strategy

Operational use

Group leads general risk appetite use: The degree that companies use their risk appetite statements to optimize reinsurance strategies varies by region. Some of this deviation may be caused by a different mix of business types, group versus individual or the level at which risk appetite is set (Figure 4).

Reinsurance is a visible and flexible part of an insurer's capital management strategy that drives a number of key business decisions, including balance sheet strength, earnings and profitability, dividend policy, business and investment strategy, and company ratings.

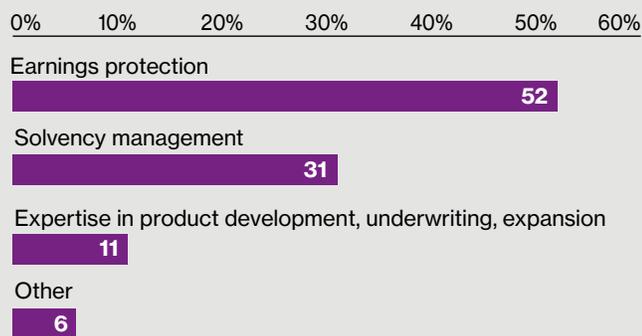




Earnings protection

Survey participants indicated that earnings protection – both earnings results and volatility reduction – tops the list of drivers for evaluating reinsurance strategies (Figure 5).

Figure 5. Which of the following measures/needs are more important to your reinsurance decision?



Metrics are up, targets are down: Managing the volatility of results is of prime importance. This is particularly relevant in public companies where perceived volatility can severely impact share price. When asked which earnings metric is the most important in setting reinsurance strategy, life insurers' responses show that they don't have a clear preference (Figure 6). Some may be closed to new business, which explains the increased spread in responses.

However, it is clear that insurers are increasingly considering more complex earnings metrics such as return on equity. In the 2017/2018 survey, 18% rated return on equity as the primary earnings metric, double the 9% response rate in 2015/2016 results.

Figure 6. Most valued earnings metric for setting reinsurance strategy

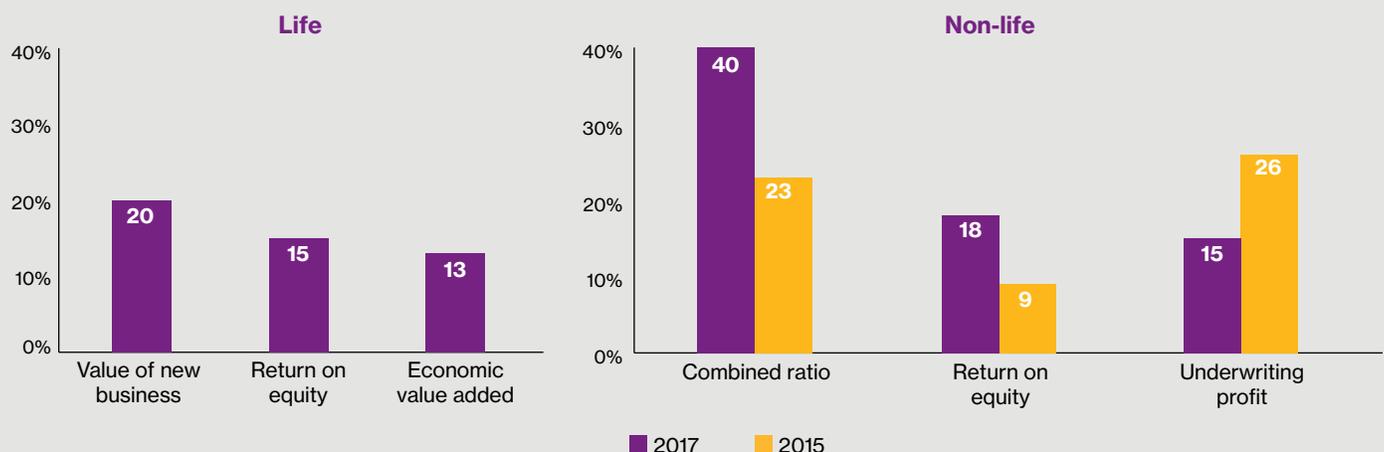
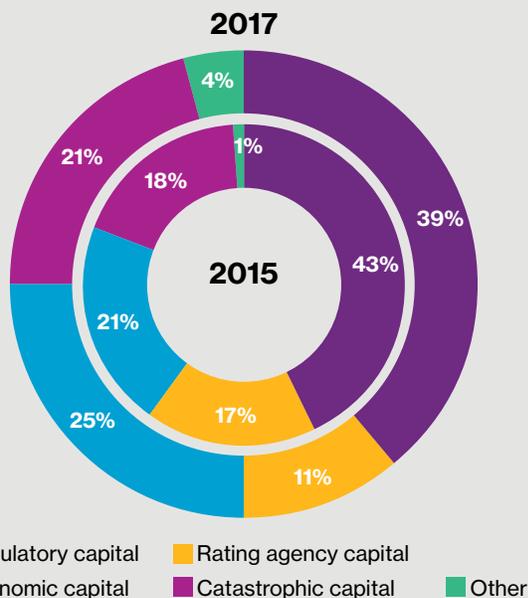




Figure 7. Which of the following capital measures is the most important to your reinsurance decision?

Total



Note: Solvency II and equivalent countries include: Bermuda (full equivalence), European Union (EU) and Switzerland; Australia, Brazil, Canada, Japan, Mexico (provisional equivalence) and U.S. as of Commission Delegated Decision (EU) 2015/2290

Capital strategy

The global regulatory environment continues to develop. Changes and advances in recent years have increased the emphasis on capital measures and targets.

Much of the new wave of global regulation and oversight is now implemented (or will be shortly), with regimes such as Solvency II leading the way. A number of countries around the world are striving for frameworks with similar principles, with the introduction of risk-based capital supervisory regimes becoming the new normal in Asia Pacific and the Middle East.

This focus on capital is not new; however, we are seeing changes in which capital measures are considered most important depending on the maturity of the local regulatory environments.

Regulatory capital dominates – nearly twice as important for life over non-life companies: Although regulatory capital is still the most relevant capital measure (*Figure 7*), economic capital and catastrophe risk capital are gaining momentum. This is because companies are more sophisticated, and indeed the use of internal capital models increased substantially from 33% to 52% between 2015 and 2017. However, recent catastrophic events have reinforced the focus on catastrophe risk capital.

This split is slightly different when considering life and non-life separately, particularly since catastrophe risk capital is not a common concept in the life industry.



Enterprise risk management

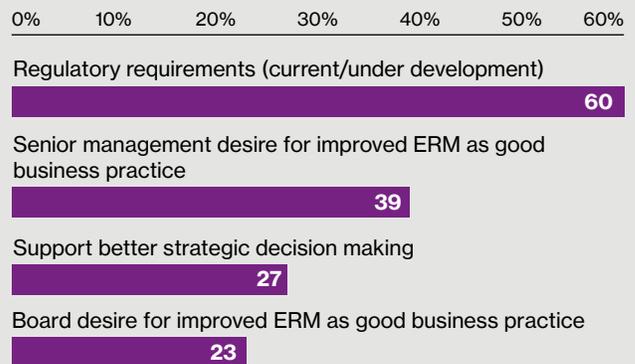
Regulation is the most common driver for those developing their ERM capabilities. However, internal drivers also play an important part, as detailed in *Figure 8*.

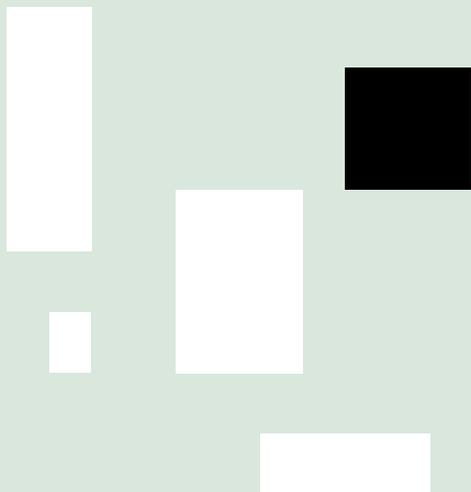
Figure 8 shows the overall picture; however, it is worth noting that there is a slightly different trend in North America where regulatory requirements rank only third.

Only 2% of respondents answered that they had not made changes to their ERM frameworks in the previous 24 months. Interestingly, the negative interest rate environment was listed as a reason for change by a subset of respondents. This corresponds with interest rates featuring in the top 10 emerging risks.

Risk culture was ranked most important to the end-state ERM vision; however, only a fifth of those surveyed reported significant (greater than 75%) progress toward achieving their visions for risk culture.

Figure 8. **What have been the key drivers of change in your ERM framework over the last 24 months?**





About Willis Re

One of the world's leading reinsurance brokers, Willis Re is known for its world-class analytics capabilities, which it combines with its reinsurance expertise in a seamless, integrated offering that can help clients increase the value of their businesses. Willis Re serves the risk management and risk transfer needs of a diverse, global client base that includes all of the world's top insurance and reinsurance carriers as well as national catastrophe schemes in many countries around the world. The broker's global team of experts offers services and advice that can help clients make better reinsurance decisions and negotiate optimum terms. For more information, visit willisre.com.

About Willis Towers Watson

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