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Column

Daring creativity and independence in risk transfer

In view of the industry's problems to get coverage for new or complex risks, alternative options of risk transfer come more into focus. Reinsurance and capital markets currently offer good framework conditions. Many risk managers are though still afraid to take innovative approaches to insurance.

For some industries it is traditionally difficult to get sufficient cover for their major risks. On the one hand, this is a capacity problem of direct insurers. The worldwide risks of internationally active German chemical companies may for example hardly be covered even by all German direct insurers together. On the other hand, many companies complain that insurers are often not offering adequate products or that some risks are simply uninsurable.

Astonishingly, the industry's disappointment about the insurers has not caused customers to start rethinking their risk transfer strategy. Most risk managers are clinging to traditional industrial insurance. So they miss out on giving sensible options of alternative risk transfer (ART) a chance.

The instruments for this have been ready for a while and the time is right. In financial markets, pension funds and other institutional investors are searching for investment possibilities for high amounts of capital. Instruments of risk transfer such as cat bonds become more attractive. At the same time, the reinsurance market is characterized by high competitive pressure and low premiums.

Why do many risk managers still not use cost efficient alternatives of risk transfer? ART models are complex. They have to be tailor-made for every company in order to provide ideal coverage for the group's risks by means of deductibles, captives, classic insurance, reinsurance and capital market instruments. Also herewith related supervisory law, capital market law and tax law matters of such often multinational programs deter. And last but not least, complex models are more difficult to explain internally than the common insurance contract.

But the effort is usually worth it. Compared with traditional commercial insurance, a combination of ART models and insurance policies by accessing reinsurance and capital markets and thus achieving higher premium transparency is often more cost efficient. It also allows for improved risk management and lower claims ratio, e.g. by incentive schemes aimed at avoiding losses within the group.

The industry may reach greater independence of the traditional insurance market and its products and premiums if companies are courageous enough to make use of new concepts offered by reinsurers and providers on the capital market (as well as by most large direct insurers). Not only the companies would profit thereof. Risk managers could jettison their outdated image of a mere buyer of insurance.

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