

Quo vadis Industrial Insurance?

This topic entails not to address the current market environment or the unquestionable societal value of the insurance business. Instead I advocate a strategic approach for Industrial Insurers as successful companies do focus on «controlling the controllable factors and not the uncontrollable».

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CURRENT CHALLENGES OF INDUSTRIAL INSURANCE

The first category of challenges I name Homemade Issues and see four aspects:

- **An unfavorable image.** Insurance as a member of the financial services industry cannot isolate itself from the prevailing negative press of the banking sector but also own image issues like certain sales practices, reportedly high commissions or aggressive claims handling practices, all do not really facilitate our business in a multinational company. My only advice here is acting professionally

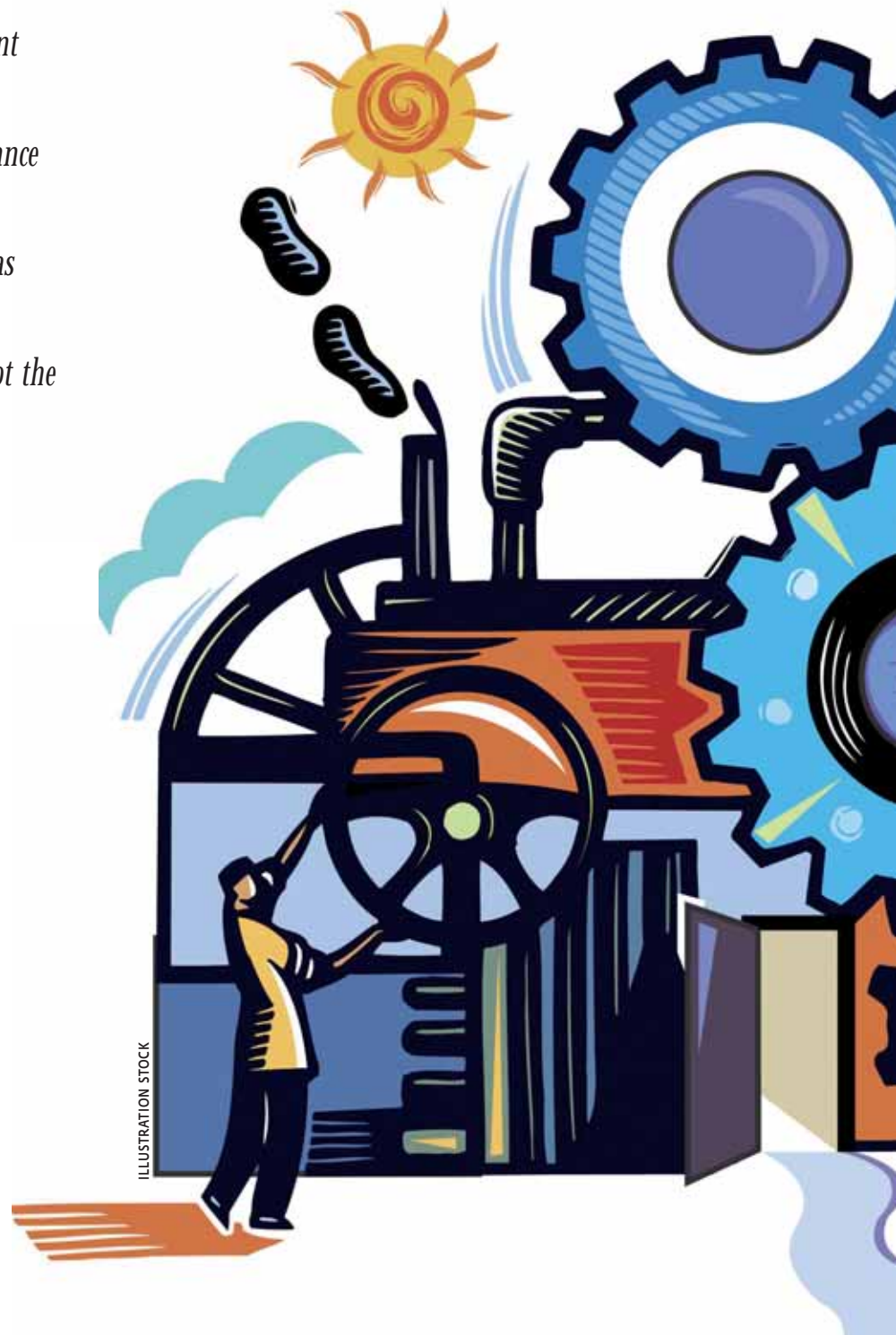
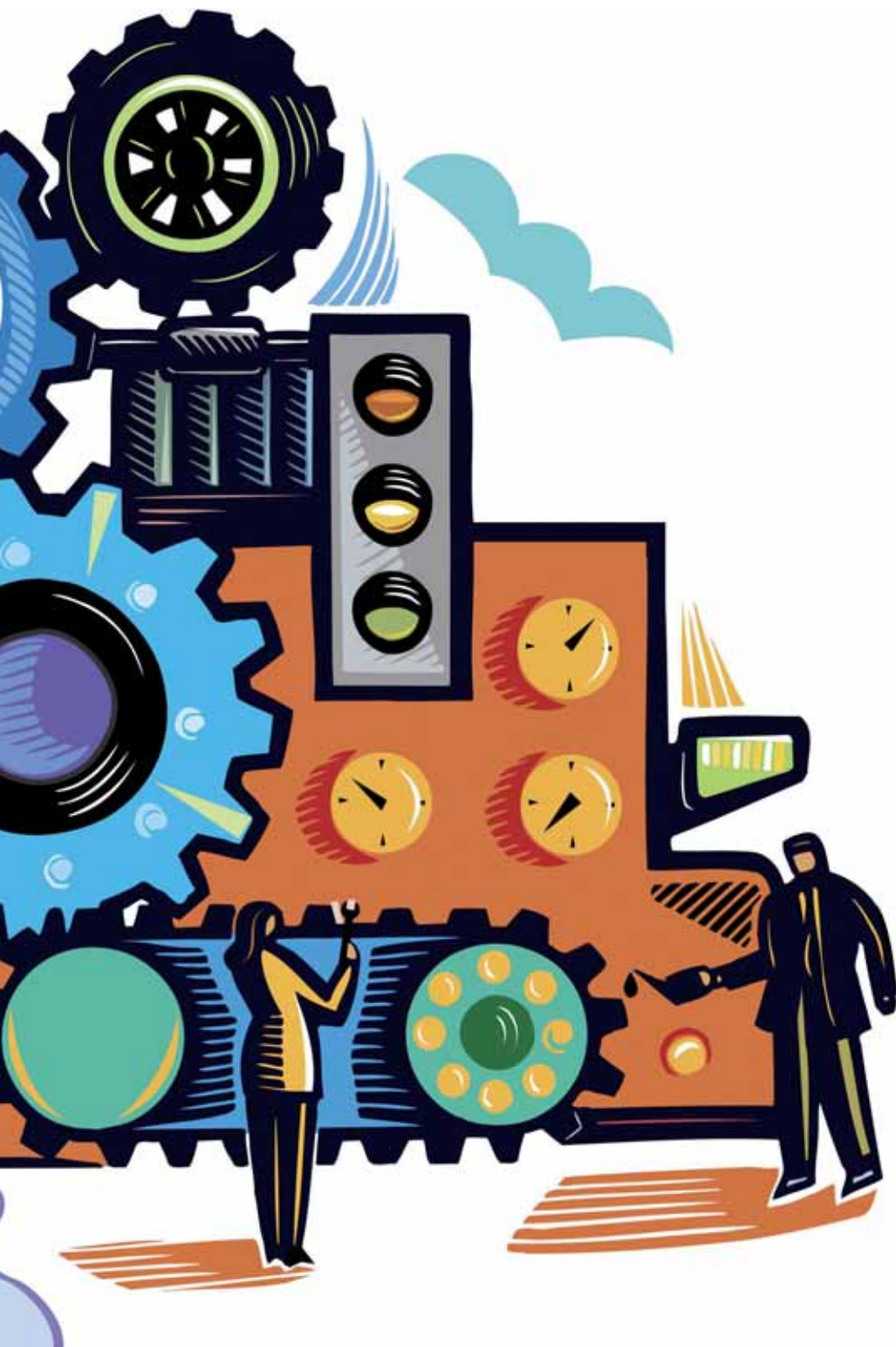


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excellent and compliant as a Risk Manager to gain board room acceptance.

- **A lack of product innovation.** The classical conservative and more evolutionary and underwriting focused insurance business model tends to hinder embarking on a strategic growth path but really should not. At the same time, I see an identical lack of innovation demand by us the Insureds. BASF employs 10% of the work force and spends 3% of net sales on R&D to ensure our business's future and to fulfill the high demands of our customers for technological progress.

- **Lack of IT investment or in a broader sense administrative process deficits.** In our daily transactional life we all deal with an administrative super effort in getting the core of our business, namely the pure risk transfer, commercially managed. And one wonders if the enormous amount of data gathering predominantly serves the assessment of the underlying risk or more check-the-box purposes.

- **Lack of talent.** In the last 15 years buyers and sellers of insurance and intermediaries have not invested

enough in people as their main resource, also in industrial insurance. The retirement of the baby boom generation will present us most likely severe staffing issues.

Herewith I come to the second category, Macro-economic factors:

- We are confronted with a loss in relative importance of insurance over GDP growth. Main reason: new industrial sectors and new business models often do not follow the classical «brick-and-mortar» or in other words a capital intensive production mode. They are more based on «soft» assets such as Intellectual Property that are today in principle not insurable. It appears insurance products presently do not yet adequately accompany the new economy.

- Monetary Policy as the current main macro-economic driver. The historically low and prolonged interest rate environment as a consequence of the chosen monetary doctrine leads in our business to a sharp inflow of so-called Alternative Capital in form of Insurance Linked Securities, Collateralized Reinsurance, Cat Bonds and so on. This provides the system currently with cheap and abundant capacity and facilitates a continuation of the famous «soft» cycle. The same factor is further enforced by a strong growth of emerging insurance players in China and other upcoming markets coupled with the generation of a new



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hub in Singapore assembling this new international capacity.

Regulatory aspects form the third category of challenges:

- **Regulation.** As a consequence of the financial crisis and the resulting negative public sentiment towards the financial sector we saw the pendulum of regulatory supervision almost worldwide swinging substantially to more tightness and in Germany culminating in what the Head of the Social Democratic Party vigorously described as «taming the unbridled entrepreneurial players». For all of us this implicates at the end of the day additional cost for and of compliance.

- **Legislation.** Allow me to be a bit critical in this context ! Our industry tends to entertain extended expert debates if we take the latest dealing in Europe with U.S. sanction clauses in our wordings as one example. To get me right, there is no shade of grey in legal compliance matters and, precisely therefore, our industry would be better advised adopting in such cases an industry standard instead of «shadow boxing» such issues with the hope of potentially gaining a short-term competitive advantage in the market place.

Taking all challenges together, some black painting visionaries appear to see no promising business model and no solid future for industrial insurance. In one article the picture of polar bears fighting for the last not yet melted iceberg was used

to describe this alleged industry survival mode.

But, do we really lack a solution or face a gloomy future? In my opinion certainly NOT ! In the following I will describe the three future trends I see and advocate a strategic approach for the successful participant in the insurance market place.

FUTURE DEVELOPMENT OF INDUSTRIAL INSURANCE

Trend 1. Organizational Adjustments at Insurers

The successful growth oriented Insurer will adjust the following levers of the current modus operandi and thereby apply enterprise specific nuances and adaptations:

- Introducing a line of business overlapping customer segmentation as well as a service and underwriting approach along customer needs and their respective business challenges. While this may sound a bit cryptic or even abstract let's take Cyber as an example of a new risk falling in between many traditional insurance buckets of today that one leading Insurer addressed by setting up what they call Industry Groups or MAPFRE *Wirtschaftssektoren*.
- Providing more transparency in terms of service versus risk transfer. This transparency in pricing together with a more differentiated offering of complete business solutions will lead to higher customer confidence and



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ultimately new business models. The latter also follows recent taxation rulings in the same direction fostering the trend to more clearly distinguish both components in today's «all-inclusive» premiums. Furthermore, I see «trusted insurance products» and eventually ISO certifications of those as helpful to restore a broader product and industry confidence.

- Acknowledging also in industrial insurance an expected commoditization of certain products as they develop into standard solutions off-the-shelf and marketed with different sales channels including the internet based on minimal distribution cost. Other products will be marketed as pure service products based on agreed fees and performance metrics.

- Investing in Professional Excellence by promoting in-house professional expertise and herewith a differentiation from prevailing technical and managerial know how across the market place today.

- Appointing also of *Fachfremde* Senior Executives. While multinational peers, like BASF, growingly appoint non-industry seasoned managers as their Risk Managers, the insurance industry today still operates very much inward bound.



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Trend 2. Pursuing Growth Opportunities

Again, the successful and growth oriented Insurer will be able to tap a number of business opportunities and expand current business revenues:

- Expansion of the Insurance Product Portfolio by developing more products along new emerging business risks through a systematic and rigorous challenge of today's boundaries of insurability. Insurability of «soft» assets like IP, but also CBI, mega catastrophes all represent a challenge to be developed perhaps also by joint R&D think tanks.

- A new approach to insurance R&D as I advocate a higher willingness to test new risks with what we at BASF would call «laboratory» capacity and in a client specific test environment.

- More strategically addressing long-term growth options stemming from commonly accepted global mega

trends such as the expected population growth to 9 billion people by 2025, the associated growth in emerging markets, the respective urbanization trend, the reinforcing single household pattern, the e-mobility and self-driven motorcars, a new energy landscape, and so forth. I expect medium-term to see new insurance solutions focusing on these aspects.

- Pursue growth potentials in emerging insurance markets through a) accompanying globalizing enterprises and satisfying their insurance needs in these markets, and b) investing in own engagements in insurance markets of developing countries. Formation of joint ventures with locally quickly growing insurers may in this context constitute a worthwhile alternative.

- Continuation of the classical what I call MORE approach, i.e. more capital, more capacity, more cover, more risks; I should say regularly at somewhat lower prices per unit. Undoubtedly our core business today will remain crucial and also needs to be fostered but again it will become a – more – challenging proposition if pursued as the sole strategic centerpiece.

Trend 3. A Stronger Market Consolidation

The insurance market will like other maturing sectors or businesses in more mature markets consolidate more strongly in the foreseeable future as a result of two

pain points: a) the mentioned current low and prolonged interest rate environment through the associated severe cost pressure, and b) a Solvency II linked higher future equity requirement. Apart from possible recapitalization needs Insurers will have to streamline their business and consciously elect their specific future business model. I expect to continue to see only a few Service Insurers with a truly global reach able to run international programs and the others – more capacity providers – focusing on particular products, regions, market niches, etc. We should therefore medium-term see a re-organized offer side of our product. To be very clear from my side, we definitely need both types and through some flexibility in terms and conditions to be able aligning them in international insurance programs.

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CONCLUSION

It appears we operate in a basically conservative and evolutionary industry focusing more and speaking still more about a RISK landscape than investing a greater portion of energy on the OPPORTUNITY map.

I am optimistic seeing more opportunities for growth in our industry if all stakeholders contribute their share to the common good:

- Insureds, by more seriously requesting and supporting instead of awaiting product or process innovation.
- Insurers, by more actively spearheading new developments instead of following someone else's pilot when pursuing a new business opportunity.
- Regulatory Supervision supporting the market development, by encouraging a bit more doing business rather than binding management attention rather strongly on monitoring aspects.

Let me then finish with my credo of today: «Let's sharpen our industry's mindset and dare to push the growth button». |

