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Understanding and hedging natural catastrophe risk in a changing environment, a (Re)Insurance perspective

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Relatively low frequencies of major atmospheric catastrophic events have left insurers and reinsurers in profit over the last decade despite increasing competition, falling insurance rates and climate change. Namely reinsurers i.e. those companies that globally diversify risk and insure insurers have enjoyed 1) an unprecedented drought of landfalling hurricanes, 2) low activity in devastating extratropical storms in Europe and 3) low loss activity from Japan Typhoons. This last decade of moderate losses was only interrupted by this year's hurricane activity with HIM (Harvey, Irma, and Maria) creating insured losses of around USD 100bn - less than half of the losses that were expected over the last decade. Fuelled by low dividends in the capital market and high non-correlating returns from insurance, investors decided to participate directly in the reinsurance market i.e. changed their earlier strategy by pushing capital into insurance risk rather than insurance companies. This ILS (Insurance linked securities) market has exploded recently by adding a growing amount of currently 20% to the existing reinsurance capital. Investors for these ILS products include pension and hedge funds, fund managers, private capital, among others. 2% of the assets managed by pension funds alone could replace the global insurance/reinsurance capital herewith making it possible, if not very likely that natural catastrophic insurance and reinsurance risk will be managed differently in the foreseeable future.

This contribution gives insights into insurance risk assessment, hedging, and risk management and offers visions of how this market thinks and how it might need to change in order to transform rather dull (re)insurance products into exciting new deliveries.