INSURANCE & TECHNOLOGY

SECURITY/RISK MANAGEMENT

Insurers Face Riskier World: WEF's Global Risks 2013 Report

Anthony O'Donnell

JANUARY 15, 2013

Three of the top five risks ranked by 1,000 influential respondents from around the world could have a profound effect on the insurance industry, according to Michel-Kerjan of the Wharton School.

The world is becoming a riskier place in ways that affect the insurance industry, as revealed by The World Economic Forum's Global Risks 2013 report. At least three of the top five risks identified by the report have implications for the insurance industry, whether from an underwriting or a risk management perspective, according to Erwann Michel-Kerjan, managing director of the Wharton School's Risk Management and Decision Processes Center and contributor to the report.

The report identified the top five risks as severe income disparity, chronic fiscal imbalances, rising greenhouse gas emissions, water supply crises, and mismanagement of population aging. The report was produced by the World Economic Forum in collaboration with The Wharton Center for Risk Management at the University of Pennsylvania, Marsh & McLennan Companies, the National University of Singapore, Swiss Re, Zurich Insurance Group, and the Oxford Martin School, University of Oxford.

"Fiscal imbalances, water supply issues, and greenhouse gases all have the potential to affect the insurance industry profoundly," Michel-Kerjan comments. "If Hurricane Sandy is going to be the new normal, then we have an insurability question."

The Global Risks 2013 report is based on a survey of over 1,000 experts from industry, government, academia and civil society who were asked to review 50 global risks. From an insurance point of view, one of the developments in respondents' evaluation of risks was recognition that climate-related disasters are happening, according to Michel-Kerjan. "There used to be debate about whether a new era of catastrophe had arrived, especially after Hurricane Katrina," he says. "Since then massive hurricanes, typhoons, droughts and floods have occurred. And given that the U.S. is the largest insurance market, people are asking about the future of catastrophe insurance in the U.S."

Recognition also has set in among respondents of the persistent risk of terrorism, according to Michel-Kerjan, who testified before Congress in 2012 on the subject of renewing the Terrorism Risk Insurance Act (TRIA). "Many people believe that because we killed bin Laden, the terrorist threat is over," he comments. "The reality is that al Qaeda is evolving."

The report identified cyber risks as a third major concern with implications for the insurance industry, according to Michel-Kerjan. Cyber-threats have moved from being the stuff of action movies to the subject of business executives' discussions, he relates. "When you talk to IT people and boards of directors, many of the discussions are about two things: one is that their company has been hit so many times that they feel a need to reconsider their cyber security position, and the other is that cyber risk is no longer just an IT issue — it is a strategic risk management issue."

An evolving perception of risks has led to broader changes in how companies think about risk management, according to Michel-Kerjan. "Risk management has gone from being dealt with by risk managers alone to being a real topic of discussion at the board level." The World Economic Forum also is looking at risk in a more integrated way, according to Michel-Kerjan. During the previous seven years of its existence, the report has mirrored society in a silo view of risks, he acknowledges. "This time we pushed hard to do two things simultaneously," he elaborates. "We said, 'Let's do probability- and consequence-type analysis for each of the 50 types of risk, but let's go further and try to understand their interdependencies.'"

Considering the way risks affect each other introduces a very different mindset, Michel-Kerjan insists. He recalls an earlier report presented at a World Economic Forum meeting in Davos, where asset price collapse was identified as the top risk, with agricultural food price volatility also on the list. "This was at a time of great exuberance!" he notes. "We were able to anticipate a massive food crisis six months later because we were able to look at the risks interdependently."

"Hundreds of billions of dollars moved from very sophisticated financial products to commodities such as rice and wheat," Michel-Kerjan adds. "The price of food doubles, people die."