

# THE INSURANCE INSTRUMENT, A PILLAR OF SUPPORT FOR THE FINANCIAL INDUSTRY AND SOCIETY

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## **Abstract:**

*Insurance was during the pandemic the fourth most affected sector globally, after sectors such as the HoReCa industry, the banking sector and the energy sector. The pandemic phenomenon made many government institutions decide to reduce interest rates to minimum levels, with the expected effects on investment-dependent industries, which is why these decisions are reflected in the negative results recorded by the financial sector. In this paper, we propose, based on empirical data, to highlight the main challenges of the financial sector with a direct orientation towards the insurance sector and to propose solutions for the recovery of this sector.*

**Keywords:** financial instruments, finance, sustainability

**JEL Classification:** G23, O16, Q56

## **Introduction**

In the latest reports from the Boston Consulting Group, insurance was defined as the fourth most affected sector globally, surpassed only by hotels and leisure, banking and energy. The Boston Consulting Group's 2020 Value Creators Report, a global consulting company, profiles the 97 largest publicly traded international insurers with a market capitalization of more than \$5 billion as of December 31, 2019. Of these 97 insurers, 41 were headquartered in the Americas, 33 in Europe and Africa, and 23 in Asia and the Pacific (APAC).

Over the past five years, insurers have posted a total shareholder return (TSR) of 8.2% on average, slightly underperforming the market by 1.4 percentage points. This return takes into account the evolution of the share price, including dividends. Large insurers, however, performed much better—the industry's top performers delivered a 36% TSR return in 2019 and an average of 20% TSR since 2014.

With the outbreak of the global pandemic caused by the SARS-CoV-2 virus, everything went more difficult. Many governments have cut interest rates to record lows, with the expected knock-on effects on investment-dependent industries. In the financial sector, banks were the most affected, followed by life insurance.

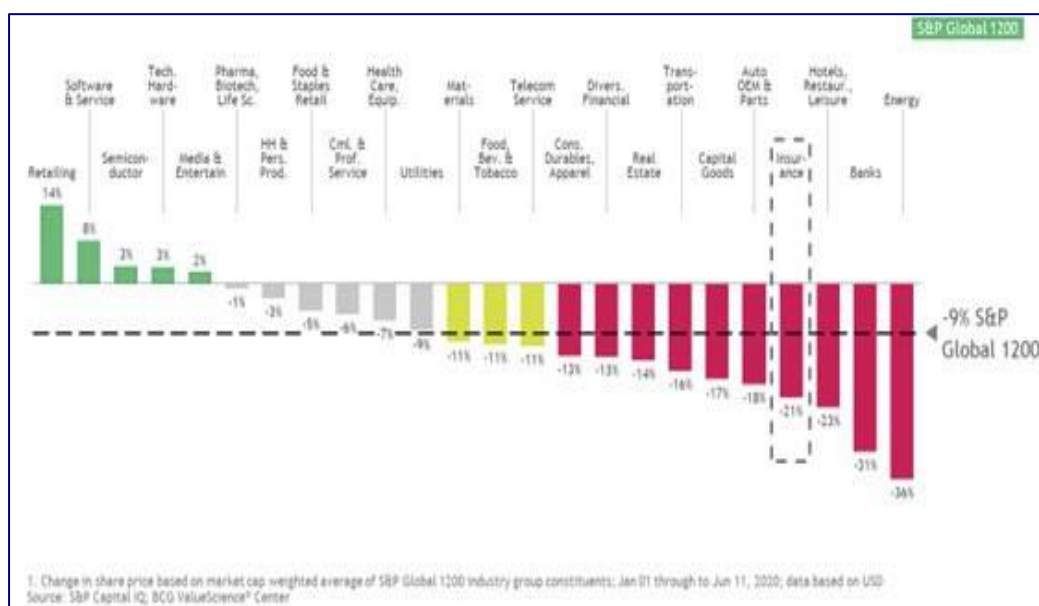
As of June 2020, the insurance industry was down 21% from the perspective of total shareholder return, being the fourth most affected sector in the pandemic, while the S&P Global 1200 stock index had a loss of only 9%, as we can see in the table below.

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### Grafic 1: Insurance sector losing (YTD, S&P)

On the other hand, there are insurers that have significantly outperformed other competitors or



companies in other industries, underscoring one of our fundamental lessons: any company can find its way to creating added value. Moreover, this performance was recorded both in different geographies and in distinct market segments. The top five companies over the past five years, 2014 - 2019, were: South América (Brazil, mainly property, casualty, but also health, annual TSR of 43.6%), Progressive (USA, property and casualty, annual TSR of 25.2%), Ping An (China, multi-line insurance, annual TSR of 23.5%), Hannover Rück (Germany, reinsurance, annual TSR of 23.5%) and Porto Seguro (Brazil, mainly property, casualty and health, annual TSR of 21.9%). The full list is illustrated in the tables below.

Table 1.

### Top quartile insured

Company	5-year average RoE (%)	5-year TSR 2015-2019 (%)	Book value growth (p.p.)	P/B multiple (p.p.)	Dividend yield (p.p.)	Share change (p.p.)	2020 YTD <sup>1</sup> share price change (p.p.)	Region	Sector
Sul América	16	44	12	28	4	0	-24	South America	P&C / Health Insurance
The Progressive	21	25	13	9	3	0	8	North America	P&C Insurance
Ping An	18	24	20	3	2	-3	-9	Asia-Pacific	Multi-line Insurance
Hannover Rück	13	24	7	11	5	0	-5	Europe	Reinsurance
Porto Seguro	16	22	7	9	6	0	-16	South America	P&C / Health Insurance
Primerica	21	21	6	8	1	5	-14	North America	L&H Insurance
Swiss Life	7	20	5	11	4	-1	-24	Europe	L&H Insurance
Kemper	7	19	7	14	2	-5	-16	North America	P&C Insurance
Admiral	49	19	10	3	7	-2	1	Europe	P&C Insurance
Cincinnati Financial	12	19	8	7	4	0	-44	North America	P&C Insurance
Hannover Insurance Group	9	18	1	11	4	12	-25	North America	P&C Insurance
W. R. Berkley	12	18	6	8	3	1	-19	North America	P&C Insurance
American Financial Group	11	17	6	7	4	-1	-44	North America	Multi-line Insurance
Arch Capital Group	9	17	12	6	0	-1	-29	North America	P&C Insurance
Talanx	10	17	7	5	5	0	-21	Europe	Multi-line Insurance
Assurant	8	16	-7	18	3	3	-19	North America	P&C Insurance
ageas	7	16	2	7	4	3	-38	Europe	Multi-line Insurance
RenaissanceRe	6	16	8	10	1	-3	-8	North America	Reinsurance
Erie Indemnity	23	16	10	3	3	0	8	North America	P&C Insurance
Fidelity National Financial	12	16	-2	8	10	0	-30	North America	P&C Insurance
Old Republic International	12	15	8	3	7	-3	-27	North America	P&C Insurance
AIA	13	15	14	0	2	0	-11	Asia-Pacific	L&H Insurance
Globe Life	15	15	10	1	1	4	-29	North America	L&H Insurance
IGA	11	15	10	1	2	2	-48	North America	Reinsurance

1. Year-to-date from 1 January 2020 to 11 June 2020; 2. Here BV of equity and P/B multiple used opposed to other companies for which we use BV of tangible equity and P/TB multiple  
Source: S&P Capital IQ, Refinitiv, BCG ValueScience® Center

Tabel 2.

## Second quartile insurers

Company	5-year average RoE (%)	5-year TSR 2015-2019 (%)	Book value growth (p.p.)	P/B multiple (p.p.)	Dividend yield (p.p.)	Share change (p.p.)	2020 YTD <sup>1</sup> share price change (p.p.)	Region	Sector
Gjensidige Forsikring	20	15	4	5	6	0	-2	Europe	P&C Insurance
First American Financial	13	15	20	-8	3	-1	-15	North America	P&C Insurance
Allianz	11	15	5	3	5	2	-13	Europe	Multi-line Insurance
Münchener Rück	8	15	0	5	5	4	-10	Europe	Reinsurance
Aflac	15	14	10	-2	3	4	-32	North America	L&H Insurance
Tryg	21	14	-14	23	7	-1	0	Europe	P&C Insurance
Intact Financial	10	14	-1	13	3	-2	-7	North America	P&C Insurance
SCOR	7	13	1	7	5	0	-35	Europe	Reinsurance
IA Financial	11	13	8	3	3	-1	-36	North America	L&H Insurance
Tokio Marine	8	13	1	6	4	2	-19	Asia-Pacific	P&C Insurance
Everest Re	9	13	4	4	3	2	-23	North America	Reinsurance
Zurich Insurance	10	12	0	5	7	0	-10	Europe	Multi-line Insurance
Swiss Re	6	12	-5	7	6	3	-25	Europe	Reinsurance
Hiscox	9	12	-2	11	4	-1	-46	North America	P&C Insurance
Allstate	13	12	1	3	2	5	-15	North America	P&C Insurance
Alleghany	5	12	1	8	0	2	-37	North America	P&C Insurance
NN Group	7	12	9	-3	5	1	-15	Europe	L&H Insurance
Helvetia	7	12	4	3	4	0	-30	Europe	Multi-line Insurance
Sony Financial	9	11	4	4	3	0	3	Asia-Pacific	L&H Insurance
Sun Life Financial	11	11	4	2	4	1	-15	North America	L&H Insurance
AXA	6	11	1	5	5	0	-28	Europe	Multi-line Insurance
Markel	7	11	4	7	0	0	-19	North America	P&C Insurance
Bâloise	9	11	3	3	4	0	-15	Europe	Multi-line Insurance
BB Seguridade	61	11	-8	11	7	0	-22	South America	Multi-line Insurance

1: Year-to-date from 1 January 2020 to 11 June 2020  
Source: S&P Capital IQ, Refinitiv, BCG ValueScience® Center

None of the Romanian insurance companies are in this top (in fact, only 3 European insurers are in the first quarter) and only one is in the second quarter.

According to the paper InsurTech financial instruments on the financial market in the current global context (Manta O., Militaru I., Croitoru L, 2021) in which the main trends of the insurtech industry were presented, we appreciate that these models are necessary to mention whenever we have the opportunity, so as to create the conceptual multiplier effect at the level of the markets.

What is the future of insurance? Experts share their opinions

No one will accuse insurance of being the most exotic industry. But it may just be the most important. As technologies shape the future of the world in ways most of us never anticipated, insurers will need to keep up.

Here's what industry insiders see as the future of the insurance industry:

Marina Cvetkovic, VP of Strategy and Chief of Staff to the CEO of Swiss Re

“There is a lot of talk about insurtech, but I would say that the future of insurance is in tech-insurance. Insurance is about data and the big tech companies will very soon, if they haven't already, exceed the amount of data they hold compared to insurance companies. Insurance companies will survive if they turn into service providers, offering insurance products to big tech companies who will own the data and dictate the terms. Tech companies will face insurance end customers.”

Patricia Renzi, Principal at Milliman “Insurance needs to change to be more customers focused. This will require the cooperation of insurers and regulators to change the way we define insurance and the way we communicate with customers. By focusing on customer needs and remembering that insurance is what protects individuals against the unexpected so they can continue to thrive, we can give people the means to escape poverty, to protect their homes and families, to retire for sure, in order not to be bankrupted by a health crisis. We need to better communicate the tremendous value of insurance to society and help people protect themselves and their families. We need to build stronger trust and we can do that through better communication and engagement.”

Karn Saroya, CEO of Cover “In terms of insurance distribution, I think wherever insurable property is sold or managed, it will be embedded through API. Insurance entities will need to look, act and feel like technology companies in the way they use data sets to distinguish good risk from bad risk.”

Samantha Kohn, Communications Manager at Mobiles, Inc.

“With increased competition and market saturation, the future of the insurance industry is utility value. The cost of customer acquisition is extremely high and most insurance companies currently operate solely on transactional value rather than utility value. This means that marketing efforts and resources are spent on attracting and signing new customers, but once the contract is signed, very little effort is put into providing ongoing value, also known as utility value. To compete, insurance companies will need to start focusing on utility value - continuing to offer customers value that entices them to stay.”

Jiten Puri, Founder and CEO of PolicyAdvisor

"Product: Changing consumer preferences, ubiquity of data, and deep learning capabilities will transform insurance from an episodic protection product with a one-time benefit payment to a SAAS-like prevention and enrichment product, with insurers offering continuous services (of e.g. in health and welfare).

Process: The abundance of data will allow carriers to integrate with third parties data

ecosystems to measure “everything at any time,” thereby making better targeting and underwriting decisions. Non-traditional data sources (eg wearable/biometric data, VR-enabled selfies, social media fingerprints) will become embedded in life insurance models.

Pricing: As data latency decreases, life insurance prices will be lower weighted on historical population-derived actuarial models and focused more on insights from personalized and real-time risk assessments. Better underwriting will lead to more accurate and tailored pricing.”

Jayant Lakshmikanthan, CEO and Founder of CLARA analytics

“This may sound a bit abstract and futuristic, but AI advances have already led to a whole new market segment: InsurTech. The rise of InsurTech indicates that the insurance industry is changing profoundly as it modernizes. The ability to analyze countless data points in mere seconds opens up avenues of assessment and prediction that humans simply cannot hope to achieve. This does not mean that people are no longer needed in the industry. On the contrary, Humans still possess higher-order thinking skills that machines are not equipped to acquire. The ability to consider intangibles, judge, sees and interprets what lies beyond the screen - these are human skills that will always be in demand.”

Forecasts and strategic imperatives

The unclear medium-term outlook for the post-COVID-19 period brings a level of uncertainty that most management teams have not faced before. For example, how long will it take to retrieve the request? How will non-life claims evolve? How much opportunistic capital will enter the industry as a result of the price increase? How can insurers cover attractive life and pension products in a world of zero return?

We have identified four imperatives, in addition to the fifth, improving capital allocation, for insurance firms to thrive in the post-Covid world:

- Accelerating transformation to create a Bionic Business Model

Through research, BCG found that most insurance companies are underinvesting in digital initiatives and consistently lag behind the industry's digital champions, companies that are prioritizing these investments and building digital organizations. Insurers should focus on

digitizing five key areas that require it: distribution, customer service, operations, organization and claims management.

□ Increasing productivity through new ways of working

The insurers that will emerge stronger from the COVID-19 crisis will be those that, over the coming months, will address the following critical factors: cost, speed and persistence. Many will need to cut costs without compromising key capabilities. The ability to react quickly to circumstances such as changes in demand will have a major impact on insurers' efforts to reduce claims and make the most of new opportunities. All companies have realized that the critical systems they depend on are very fragile and need resilient operating systems. The ability to operate with agility will be the key to success.

□ Adopting scenario thinking

As they face greater uncertainty about the macro environment, companies must face increasing challenges in a less predictable world. Due to the lessons learned from the unexpected impact of COVID-19, more insurers are moving towards advanced scenario analysis. This approach allows management to explore the effect of strategy and tactics in various scenarios, quickly calculate the impact of deteriorating conditions on the business (such as capital, margins and liquidity), identify risks, concentrations between exposures and re-evaluate existing business assumptions and financial measures.

□ Optimizing the business portfolio through smart mergers and acquisitions

M&A is a key strategy for increasing capital productivity by realigning the business portfolio and improving strategic position. Future-watching underwriters will use this crisis to evaluate and pursue both buying and selling opportunities.

Bottom line: insurers have a tough road ahead. This could become even more difficult if the global economic recovery is long-lasting or if COVID-19 returns in force. But as Albert Einstein said "in the midst of difficulty lies opportunity". Now is a good time for hard-working insurers to act.

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