Be positive
AXA’s Henri de Castries focuses on opportunities—not threats

A regulatory paradox
Re/insurers might not like Solvency II but they need it implemented now

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MY ROLLERCOASTER RIDE

Denis Kessler ponders ten years of change and achievements at SCOR
Interview: Denis Kessler
A TIME TO REFLECT

As Denis Kessler quietly celebrates 10 years at the helm of SCOR, he reflects on the remarkable turnaround he instigated at the company, ponders future opportunities and tells Intelligent Insurer that one of his biggest concerns now is that Solvency II will never be implemented.

There cannot be many leaders of reinsurers globally who have been on as much of a rollercoaster ride as Denis Kessler, the chairman and chief executive of SCOR. The French reinsurer is now one of the top five players worldwide, with a truly international presence—it is regarded as part of the reinsurance establishment. Even the SCOR lounge in Monte Carlo seems as though it has been there forever.

That this is the case illustrates just what an incredible job Kessler has done since he took the reins of the company almost exactly 10 years ago. It is remarkable how quickly people have forgotten just what a mess SCOR was in back then.

At one stage, during the 2003 Monte Carlo Rendez-vous in fact, it had been downgraded to BBB- and was teetering precariously close to the brink of collapse. Cedants had lost faith in the company, its shareholders were deserting it and the demise of what had been one of the strongest players in the industry looked a real possibility.

Yet somehow—against all the odds, it seemed—Kessler turned it around. It has not been a short journey—far from it. And the business today bears little resemblance to SCOR back then, but as he marks his 10th anniversary with the company, it is worth reflecting on where he first started as well as where he plans to head next.

“When I arrived in the business we had lost our credibility, our solvency and a lot of money,” Kessler recalls. “We were in a very deep hole. But we somehow kept going and I always believed that if we could do that and gain momentum, we would eventually take off—and we did just that.

“I am very proud of what we have achieved in the past 10 years: it is fair to say that we have changed everything about the company apart from the name. We have changed the underwriting, the financing, the people, the corporate governance. It has been a long ride and it took 10 years to get there, but we have got there.”

Kessler says the most important thing in his early days of leadership at the company was a vision—and the fact that shareholders were prepared to support that vision. “If you have that, anything is possible,” he says. “The vision was to create a genuine flat global group, and we have done that.”

CREDIT WHERE IT’S DUE

SCOR now deals with risks in more than 140 countries around the world and has more than 35 offices. Kessler says that not only has the vision been realised but he sees the company as truly international in every sense.

“We are not a ‘French’ group any more. Through the acquisition of other firms such as Revios, Converium and Transamerica Re, the vision to be truly global has been realised. We have 54 nationalities in the company and we actively look to empower people in local markets. There are no ex-pats from France running our overseas operations, they are all locals with an intimate knowledge of local issues.”

The recent success of the group—its expansion and diversification—has received plaudits of late. All four rating agencies have upgraded SCOR in the past 12 months.
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Fitch was the first to upgrade SCOR in March this year, taking it to A+ from A and citing its strong solvency, moderate debt and ability to expand its business position via external growth and by swiftly integrating operations. The rating agency said its business position and diversification have significantly improved in the past five years.

Moody’s and AM Best were next to act. In May, AM Best upgraded its issuer credit ratings to a+ while affirming its financial strength ratings of A, while Moody’s upgraded its financial strength rating to A1 from A2 on the back of SCOR’s: “enhanced franchise strength, consistent good profitability aligned with very low results volatility, and very good financial flexibility, while maintaining very good business diversification, a relatively conservative investment portfolio and good capitalisation”.

Then in June, Standard & Poor’s upgraded the business to A+. The rating agency noted SCOR’s strong capitalisation, operating performance and investment portfolio at the time and praised the impact the acquisition of Transamerica Re on the business saying it would “give SCOR greater business and geographic diversification”.

SCOR has also posted solid results in recent years—results for the first half of 2012 were strong, gross written premiums grew by 10.2 percent on a pro forma basis to €4.6 billion, and its P&C business specifically grew by 16 percent to €2.25 billion, posting a combined ratio of 93.8 percent. Overall net profit was €206 million, a big increase on the €40 million posted for the same period last year.

Its 2011 results were also positive. SCOR recorded a net profit of €330 million in a year of exceptional natural catastrophes and financial turmoil for the industry and its gross written premiums increased by 13.6 percent to €7.6 billion (8.6 billion pro-forma).

In the Transamerica Re acquisition, announced in April 2011, SCOR bought the mortality portfolio, including the operational assets and personnel, of Transamerica Re, a division of AEGON. The deal was worth $912.5 million and increased the volume of premiums written by SCOR Global Life by around 50 percent. The business acquired represented a gross premium volume of $2.2 billion in 2010, 87 percent of which was underwritten in the US.

INTERNATIONAL OPPORTUNITIES

SCOR’s approach to the global portfolio is interesting, however. Kessler dismisses any notion of discussing the company’s overall geographic strategy in terms of regional priorities, for example, arguing that such language is too simplistic. He says that each individual country must be judged on its own merits—and the reinsurer will never chase growth for the sake of it in any market, wanting only profitable opportunities.
SCOR’s diversification goes beyond its creation of a truly global model. Kessler sees many opportunities to move into new product lines. He says SCOR is looking for example at cyber and data storage liability risks closely, and he also sees big opportunities in longevity risks and long-term care.

“We always see opportunities; demand is strong and rising as long as you keep pace with what clients want. You have to be careful moving into new risks but the opportunities are vast. No-one had heard of longevity risk five years ago yet these are a big problem for pension funds. And long-term care is the same. Whenever there is economic progress that means new risks and new opportunities.”

SCOR has been busy turning these opportunities into tangible business assets. In November last year, the company completed its first longevity reinsurance transaction in the UK. “Entry into the UK longevity market was one of the company’s strategic initiatives for 2010–2013. SCOR Global Life reinsured a significant share of the longevity risk assumed by Deutsche Bank, following the completion of a £3 billion longevity swap transaction between Deutsche Bank and the Rolls-Royce Pension Fund in the UK,” he says.

The strategic plan Kessler refers to was unveiled at an investors’ day in September 2011—it is a slightly updated version of its “Strong Momentum” plan, which covers the period 2010–2013.

The updated version takes into account the group’s new shape following the acquisition of Transamerica Re’s mortality portfolio and the sale of SCOR’s US annuity business. With these two changes, the group expects to achieve gross written premiums of €10 billion in 2013 (compared with €6.7 billion in 2010), corresponding to an annual growth rate of 14 percent.

SCOR made other adaptations including the integration of the latest economic and financial developments; the adaptation of its internal model in the context of Solvency II; a marginal change to its strategic asset allocation; and a new organisational structure of SCOR Global Life. It also confirmed the execution of the four cornerstones of its business model [strong franchise, controlled risk appetite, high diversification and robust capital shield] and the targets set by the original plan—the optimisation of the group’s risk profile; AA level of security; and profitability of 1000 basis points above the risk-free rate over the cycle.

CHALLENGES AHEAD

But for all that he has achieved, and for all the firm’s ambition and the opportunities Kessler believes lie ahead, this also remains a particularly difficult time for the industry generally. The biggest problem is, he admits, that the hurdles all lie in areas that are not core to the expertise of reinsurers.

The concerns of the top players were laid bare in Monte Carlo, the meeting that usually sets the scene for the rest of the renewals season in terms of tone and talking points.
“Each Monte Carlo is different, yet this one was amazing in that reinsurers were so focused on the asset side of things. I don’t think central bankers have ever been mentioned at the event before yet suddenly they have become so important to the industry. Underwriting cycles were barely mentioned at all,” says Kessler.

His main concerns lie on the asset side too, and this is a problem. “For us as reinsurers, this is not our core competency,” he says. “We understand liabilities. When it comes to new risks, we know how to react: to model risks and come up with solutions. But on the asset side, most reinsurers have behaved in roughly the same way. We all have a portfolio dominated by bonds with a bit of equity and real estate and when the returns are not there it is difficult to know where to turn.”

Kessler’s take on this problem is that the insurance industry is suffering because of the need to help banks and governments. While low interest rates and the consequential low yield environment might be the best strategy to solve their debt crisis, insurers are the “collateral victims” of the on-going monetary policies around the world.

“It amounts to a ‘tax’ on us,” he says. “In an average year, our investments might have yielded 200 basis points above today’s return. We are getting nothing like that now—it is like a hidden tax.

“As an industry we can try and improve things by improving underwriting profits but we have to be realistic. We can improve our combined ratios but you can never compensate for the strong decline in the assets contribution to the bottom line.”

His biggest fear is that the economy slips into the same state that Japan’s economy has experienced: ultra-low yields and deflation for as long as 10 years. “That would be a major problem for insurers,” he says. “Life insurers would suffer first but it would be a real challenge for all insurers and reinsurers.”

He also has concerns over the potential break-up of the eurozone. He believes a partial break-up is a real possibility, but qualifies his statement saying: “As reinsurers we work with low probabilities all the time so a 1 percent possibility to me is a real possibility and 10 percent is quite high.”

The important thing for insurers and reinsurers is to be prepared for all possibilities. He says SCOR reacted quickly when there were first concerns four years ago, and decreased its assets in countries at risk including Greece, Italy and Spain. “We only have liabilities there now and in case of a break-up they may devalue their currency. We are prepared,” he says.

In its results for the first half of 2012, SCOR reiterated its prudent strategy on this front. Having identified the risk of sovereign debt as early as 2008, it said, it has constantly reduced its exposure to this risk and still has no exposure to the sovereign debt of Greece, Ireland, Italy, Portugal or Spain, or to the debts issued by US states and municipalities.

Kessler notes that preparation of this nature comes down to a type of risk management. SCOR uses two types: the first does everything to measure and mitigate known risks such as the traditional underwriting risks. The second he describes as strategic risk management, which boils down to seeing the bigger picture and the risks this might present.

“If you place too much emphasis on the first type and not enough on the second you can have problems,” he says. “It means seeing the bigger issues facing the industry and your company. The main risks in recent years have been strategic in that sense. The sovereign debt crisis is a good example of that. Some people lost a lot of money.”

**SOLVENCY II ON THE RADAR**

On top of these problems, Kessler has another great concern: regulation. And the crux of this issue, he says, isn’t the wording or precise nature of the regulation itself but the uncertainty over when it will be introduced. Solvency II is on his radar and he is highly critical of the EU governance for not ensuring more certainty.

“We are already living in a world of great uncertainty. We have uncertainty in our liabilities. We have uncertainty on our asset side. Now, we also have a third uncertainty: regulation. That is a lot of uncertainty. Given all the other problems we face, we might have expected regulators not to have added to the list, but they have.”

Kessler says that many of those now opposing Solvency II on technical grounds are in fact doing so simply because they’re afraid that some companies are not ready or that the economic environment is too difficult for the switch—still proposed for January 2014. This is a frustrating situation for companies such as SCOR that have invested heavily in ensuring they will be ready on time.

“It is a problem for us as a company and for the industry overall,” Kessler says. “We expect Solvency II to create demand for reinsurance so we must look at our capacity levels and plan for that. Yet there is still uncertainty meaning we cannot. This is wrong.”

He goes on to say that although he might disagree with some of the technical detail underpinning Solvency II, overall he is a supporter of the new regime. SCOR has built its own internal model which has been already submitted to the French regulator. The biggest disaster of all, he says, would be that the legislation does not come into effect at all.

“We support it and we believe it will be good for insurance and reinsurance. Risk-based regulation is the correct tool for us as an industry. We have invested heavily in our own model and although we disagree with some elements of it such as the calibration of capital charges on equity and private bonds versus government bonds, for example, the worst-case scenario for us would be if the entire framework were abandoned.

“If some companies are not ready, give them longer to comply. But for those that are ready, it would be awful to be told it will be abandoned or even delayed. We will be ready for January 2014 and we hope it will be implemented and all our hard work recognised. Overall, that would be a major achievement and would be beneficial to the entire industry, which has already been exceptionally resilient since the beginning of the crisis, in terms of showing we’re able to switch to such a sophisticated regulation in order to achieve the best possible risk and capital management.”