Actuaries Institute.

Reinsurance key to providing natural disaster resilience for insurers

Spending an estimated AUD2.5 billion on reinsurance policies saved Australian general insurers from needing to have up to AUD70 billion of capital to cover the cost of natural disasters and other losses last financial year, a new paper published by the Actuaries Institute has found.

The Dialogue Paper*, Reinsurance Explained: A Pillar of Strength for General Insurers, provides an overview of reinsurance – or the insurance that insurance companies buy to protect them against the bulk of costs of major claims events, including floods and earthquakes.

The paper's author Kate Bible, chief actuary and head of capital for Aon's Reinsurance Solutions in Australia and New Zealand, estimates local general insurers spent AUD2.5 billion on reinsurance last year to protect their portfolios against natural disasters, which have become more frequent and severe.

"The industry currently holds AUD34 billion in capital but without reinsurance, general insurers would need to raise an additional AUD23 billion, if they were to meet minimum capital requirements, or AUD70 billion, if they were to meet their current capital levels," Ms Bible said.

"This capital relief that reinsurance provides insurers, along with the stability of returns to their investors, represents the difference between an insurance market that can serve consumers affordably and one that may become inaccessible to many consumers."

Climate change, along with increases in densely populated areas and costs to repair and replace buildings is fundamentally restructuring insurance costs. The paper states that during the past 25 years insured losses from natural disasters averaged nearly USD100 billion a year, globally. But during that time total accumulated annual losses from 'secondary perils' (severe thunderstorms, floods, droughts, wildfires and landslides) have gradually surpassed those from 'primary perils' (less frequent natural disasters such as hurricanes and earthquakes).

Australia and New Zealand are home to some of the largest catastrophe reinsurance programs in the world given their significant exposure to cyclones and earthquakes.

However, unlike their global peers, Australian insurers have less choice when it comes to the range of reinsurance products they can use to gain regulatory credit.

The Australian Prudential Regulation Authority in late 2024 began consulting about ways that could provide insurers greater access to the full range of reinsurance solutions, including alternative reinsurance products. It is due to report by the end of this year.

Ms Bible described the reinsurance market as one that is evolving rapidly, with alternative capital sources such as catastrophe bonds growing to USD115 billion and outstripping growth in traditional reinsurer's capital.

"However, Australian regulations currently limit credit to these potentially cheaper funding sources. Material adjustments to these regulations could help unlock access to these alternative capital sources, leading to improved pricing and terms for some components of reinsurance," she said.

"Ongoing attention to risk mitigation and resilience, as well as regulatory barriers, will still remain crucial to maintaining affordable coverage for Australian households and businesses."

Kate Bible is available for interview.

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As the peak professional body for actuaries in Australia, the Actuaries Institute represents the profession to government, business and the community. Our members work in a wide range of fields including insurance, superannuation and retirement incomes, enterprise risk management, data analytics and AI, climate change and sustainability, and government services.

Actuaries use data for good by harnessing the evidence to navigate into the future and make a positive impact. They think deeply about the issue at hand, whether it's advising on commercial strategy, influencing policy, or designing new products. Actuaries are adept at balancing interests of stakeholders, clients and communities. They're called upon to give insight on complex problems and they'll look at the full picture. Actuaries analyse the data and model scenarios to form robust and outcome-centred advice.

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