THE INSURER

Aon-WTW viewed through a different lens

23 November 2020

The conversation in the global insurance village about the pending $70bn+ combination of Aon and Willis Towers Watson (WTW) has inevitably focused on issues important to the parish.

From second-guessing market share concerns of regulators and who gets what job to broker power and choice concerns of carriers – together with speculation about the wave of people moves that typically follows major broker M&A – the transaction is perhaps second only to the pandemic in dominating parishioners' topics of discussions in 2020.

That focus is hardly surprising. After all, we operate in an industry that is largely a people business and where competitors are always looking for opportunities to make gains.

As a publication we too have no doubt been a little myopic in our coverage, looking at the transaction exclusively through this inside-out lens.

And the antitrust regulators – with last week's long-awaited submission to the European Commission and live processes in 17 other jurisdictions – may take the same view and perhaps that will inform the outcome in areas such as market concentration and the potential for divestments, including Willis Re.

We are not party to the innermost thoughts of Brussels regulators, or those in the Department of Justice or any other of the constituents that will make decisions that could change the shape of the transaction over the coming months.

But we would contend that Aon's positioning of its rationale for pursuing the biggest transaction in broking history was likely made from a different perspective: outside-in rather than inside-out.

As such it will try to steer discussions with regulators from that outlook rather than the combination's direct impact on the (re)insurance intermediary space.

Under the leadership of Greg Case there has been a consistent message from Aon on the need to focus on the client, the demands of the client that are not currently being met, and using that as the driver for innovation of products, markets and accessing wider sources of capital to address the risk.

"Insured risk as a percentage of GDP has been decreasing for almost a quarter of a century"

The stark reality for the insurance industry is that without taking that outside-in view, there is a risk of it eventually being a marginalised player, as corporations, governments and individuals turn to alternatives that can address their biggest exposures in a fast-changing landscape of threats.

After all, insured risk as a percentage of GDP has been decreasing for almost a quarter of a century.

This is evidence of a concerning fall-off in relevancy for the sector. At a time when the world has undoubtedly become more volatile with a growing range of emerging threats – some of which bring systemic risk – organisations appear to be turning to the insurance industry less to address that volatility.

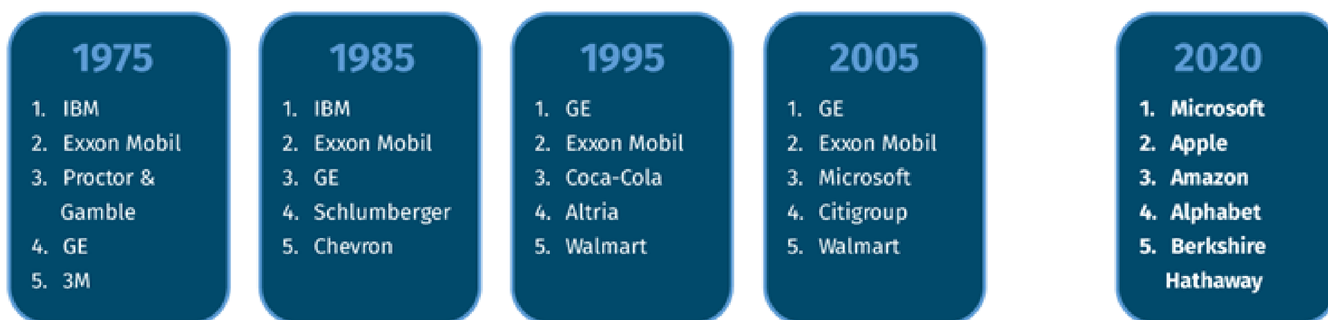
Gap between insured and economic losses at 100-year return period

Source: AIR Worldwide

It's not just the yawning protection gap in natural catastrophe perils – even at times in developed markets – but the emerging risks that are largely uninsured and the demand from businesses to find ways of protecting intangible assets on their balance sheets.

After all, nearly 85 percent of the value of the S&P 500 is now represented by intangible assets. This is highlighted by the largest companies in the world by market cap – it is no longer oil, industry and manufacturing but technology: the top four in 2020 are Microsoft, Apple, Amazon, Alphabet. How much of their operational risks, let alone intangible assets, are insured?

The changing nature of the world's largest companies...



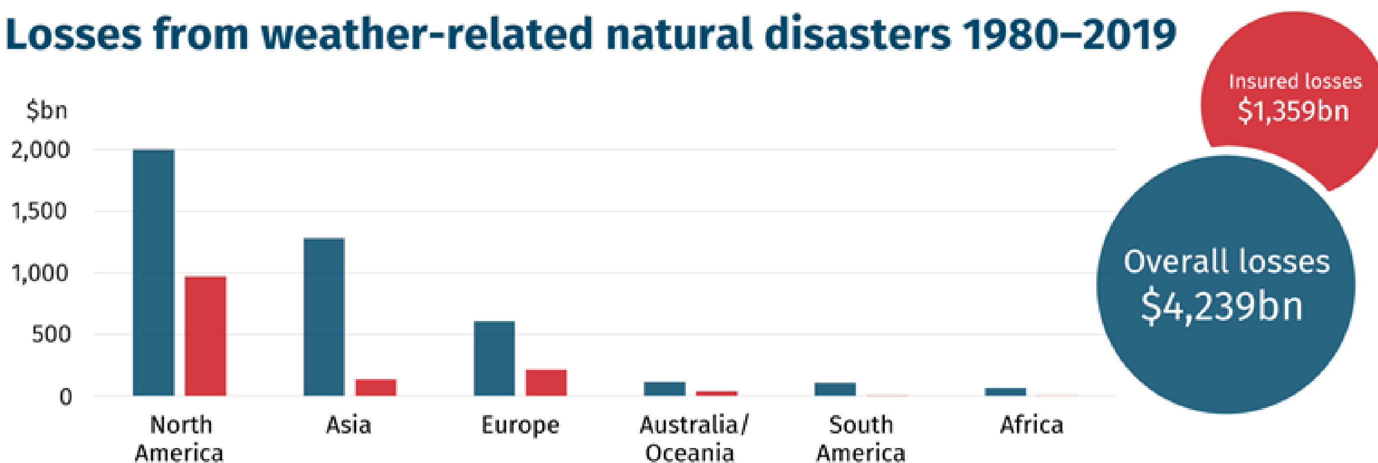
While the bulk of Aon-WTW's regulatory submissions for the transaction address the issues that will drive the outcome of key decisions on potential antitrust and competition concerns, they do also clearly spell out the rationale from that outside-in perspective.

In the publicly available version of the filing with New Zealand regulators there is a section dedicated to the commercial rationale for the companies.

"In short, the parties believe that the economy is evolving and so must the insurance industry. It is the parties' ambition to be at the forefront of that transition, facilitated by the transaction," it says.

The segment – which is likely to be similar across the submissions in other jurisdictions – explains that the strategic and economic rationale for the deal is to combine the two firms' complementary assets "to better address evolving client needs in an increasingly competitive landscape".

It will allow them to accelerate the creation of new solutions that more efficiently match capital with risk "in areas where currently there is either no or suboptimal cover".



These include high-growth areas such as cyber, delegated investments, intellectual property, climate risk and health solutions.

"By combining complementary teams, industry knowledge and data analytics, the combined entity will be able to accelerate innovation to address the industry's most stubborn problems in the form of un- and underinsured risks.

"Many risks that companies face are simply not insurable at present because the industry has been unable to adequately assess risk and apportion risk to capital willing to cover it. Together, the parties will be able to enhance innovation and better address their clients' unmet needs," the New Zealand submission continues.

And a failure to meet those evolving industry needs is also an existential threat for intermediaries – as well as, more obviously, carriers – if the industry as a whole fails to bring value to clients and solve their risk-related problems.

Aon and WTW say that by combining their wealth of resources across their consulting, intermediary and capital markets platforms they can drive innovation to make inroads into that protection gap.

In recent weeks there have been examples of some of those efforts already at play, including a solution driven by Aon to allow companies to borrow against the value of their intellectual property supported by a risk transfer solution, and an offering to bring alternative capital capacity to cyber cat risk.

But events of 2020 have, if anything, demonstrated the scale of the challenge for the insurance industry to stay relevant to its clients' biggest needs.

While a highly active catastrophe year has heightened awareness of the need for insurance solutions to keep pace with climate change, it is of course Covid-19 that has dominated.

The coronavirus has thrown into sharp relief the imperative for the industry to innovate and move quickly to deliver solutions to address the evolving risk landscape.

In the eyes of many outside the sector, its response has been to walk away from pandemic risk rather than towards it.

Of course, the position to only pay claims where coverage is actually in place for the peril is entirely justifiable.

There is, however, a sense in some quarters that the industry is not standing up strongly enough to provide solutions to address the very real threat of future pandemics, as well as other long-tail and systemic risks for which insurance coverage is not currently available.

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Too often, the industry's customers – especially the most deleteriously affected such as SMEs – have had to drag their insurers to court for indemnity. The industry would be naive to think this hasn't affected its reputation in the eyes of some of its customers, as well as governments and lawmakers.

And this is a dangerous position to be in. After all, if the industry cannot come up with solutions, conversations at the board level of leading corporations will not involve insurance companies.

Instead it will be other financial services players building mechanisms to address the risks, and professional services firms being paid the fees to help them, while technology providers bring the modelling capabilities to the table. Or worse, governments just doing it themselves (which they have this year with Covid-19).

Aon and WTW have talked about the steps needed to close the protection gap by first closing the innovation gap.

By coming together, they appear to believe they can get there quicker, and keep the industry sat at the table when clients are looking to transfer risk.

Their case is that a successful execution could help reverse the trajectory of insurance risk/GDP and grow the insurance sector, maintaining its relevance.

But if the industry fails to move from its inside-out view and remains preoccupied with fighting for bigger pieces of the same pie then it risks disintermediation and irrelevance...