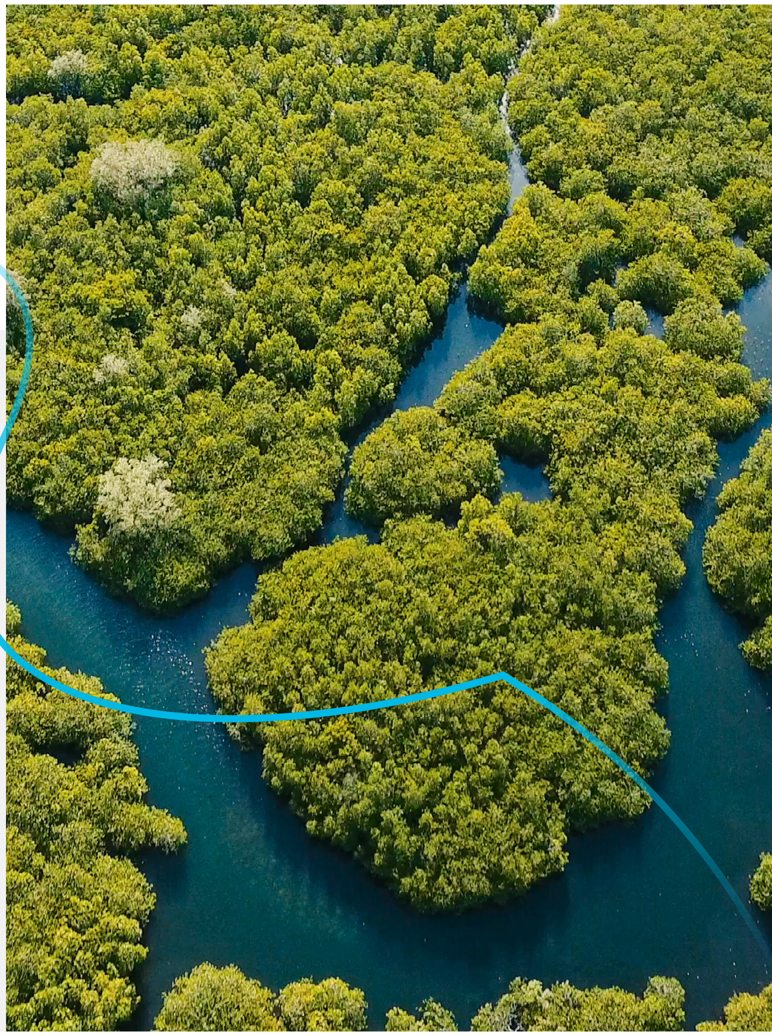
The effect of deglobalization on insurance

Insurers will find resilience amid the chaos by anticipating and responding swiftly to emerging challenges with innovation and resourcefulness.



In brief

- The era of abundant global supply chains is coming to an end. Replacing it is a bipolar or multipolar world shaped by geopolitical conflict, rising nationalism and a multidecade shift to rebuild supply chains near-shore and on-shore.
- The result of deglobalization for insurance companies is scarcity of goods and materials causing increased and unexpected claims severity.
- Insurers can and will respond with more sophisticated pricing, underwriting and capacity models and a stronger focus on risk mitigation, which collectively will stabilize the industry, but customers will feel the effects in the form of higher premiums for years to come.

The property and casualty (P&C) insurance industry is accustomed to weathering storms, both metaphorical and literal. But the industry is facing a particular storm it has never faced before: the change from the last 35 years of globalized mass production of goods and services back to fragmented, protectionist production networks and supply chains.

The winds of deglobalization are gathering strength and threaten to impact our industry in profound ways.

When disaster strikes, whether it be a natural calamity or a man-made catastrophe, the insurance industry is there to provide a safety net and help rebuild what has been lost. The industry does this at speed and scale and (relatively) low cost in part by relying on the distributed and immense global production systems.

But what happens when those global supply chains begin to unravel?

For years humanity has enjoyed the benefits of a sprawling global production network, where materials and labor could be sourced from all over the world at relatively low costs. This era of low-cost abundance is ending.[1] Now, supply chain disruptions are sending shockwaves everywhere, and the insurance industry is no exception. For example, in January and February trade volumes in the Suez Canal experienced a 50% decline compared to the preceding year, while Panama Canal trade saw a 32% reduction.[2] These and like events have a real impact on insurance.

[1] U.S. Bank "How do supply chain issues contribute to inflation?," April 2, 2024.
[2] International Monetary Fund "Red Sea Attacks Disrupt Global Trade," March 7, 2024.

Picture a scenario where a devastating storm ravages a community. It happens often. From January 2013 to January 2023, 88.5% of U.S. counties experienced the declaration of a natural disaster.[3] In those cases, suddenly there is a surge in demand for essential materials to rebuild homes. Yet, what happens when those materials are scarce, either due to local shortages or global supply chain disruptions? What does it mean for insurers when their promise to help is hindered by the inability to procure the necessary resources at a reasonable cost? Simply, the insurers must still meet their commitments and costs go up, losses accumulate, claimants experience long delays. Everyone loses.

The root causes of the changes to supply chains are twofold: demographics and nationalism.

China is grappling with a declining birth rate that threatens to erode its workforce.[4] In 2023 alone, China's population declined by 2 million[5], but China is not alone. South Korea, Japan and Germany also all have rapidly aging workforces and are global manufacturing centers that will experience accelerating trends of reduced working populations and therefore reduced production.[6] Even with large positive immigration flows the U.S. population will hit its peak in 2080 and decline from there.[7]

Meanwhile, the resurgence of nationalism, present-day conflicts such as the war in Ukraine[8] and anti-globalization sentiments in the U.S.[9] have ushered in a new era of geopolitical uncertainty. The once-unquestioned dominance of a global trade network is giving way to a fragmented landscape where protectionism reigns supreme. While some see this as a return to historical economic patterns, it is also a complete reshaping of the supply systems that allowed mass, low-cost replacement of insured goods for the last several decades. It will impact the industry and the industry's customers.

What does globalization mean for your insurance company?

Insurance companies fundamentally structure their business around predictable patterns and manageable risks. Yet, with the rise of nationalism, the change in demographics, the increasing frequency and severity of storms, macroeconomic shifts (such as interest rates), and rapid technology change, insurers find themselves in uncharted territory that is driving rapidly rising costs. The stable foundations upon which insurance companies have built their operations and products for the last three decades are shifting beneath their feet.

Consider a key challenge presented by deglobalization: the **scarcity of replacement goods**. In the wake of a disaster, the demand for essential items like refrigerators or motor vehicle parts skyrockets. However, constraints in production, particularly in regions like China, coupled with logistical hurdles such as shipping disruptions caused by geopolitical tensions, create a perfect storm of supply shortages.

As insureds clamor for swift resolution, insurers face the daunting task of meeting demand that outpaces availability. Families may be forced to seek refuge in hotels while awaiting repairs to their damaged homes; the additional expense of rental cars due to the inability to repair their vehicles accumulates. Prices for goods in a localized area spike, driven by classic supply and demand imbalances. Frustrations mount and costs escalate for the insurance companies that must foot the bill for all of it.

Compounding these challenges are diverging demand for insurance overall versus the ability to supply it. Increasing frequencies of losses are driving increased demand for coverage. These same time losses (and some regulators' unwillingness to allow adequate pricing) reduce insurers' capacity to accept similar risks. Disruptions in the global supply chain exacerbate this imbalance, placing insurers under unprecedented strain. As a result, insurers reduce the risks they will accept while increasing prices, and many potential customers simply cannot afford to purchase what they need.

The insurance industry has survived wide-spread change before; it has the tools to survive this. But operational speed and agility are critical, and that's in an industry not known for either.

[3] Forbes "Natural Disaster Facts And Statistics 2024," June 7, 2023.
[4] The New York Times "Why China's Shrinking Population Is a Problem for Everyone," April 19, 2023.
[5] Council on Foreign Relations "China's Population Decline Continues," January 26, 2024.
[6] World Economic Forum "These are the countries most affected by the decline in working age populations," January 13, 2021.
[7] U.S. Census Bureau "U.S. Population Projected to Begin Declining in Second Half of Century," November 9, 2023.
[8] Harvard Business Review "How the War in Ukraine Is Further Disrupting Global Supply Chains," March 17, 2022.
[9] The Economist "The destructive new logic that threatens globalisation," January 12, 2023.

How does an insurance company adjust?

The solutions are simple, but hard to put into action. To thrive in this evolving landscape, carriers must commit to:

1. Fast, sophisticated changes to pricing and underwriting
2. High-impact, low-cost risk mitigation solutions
3. Negotiated supply chain agreements

Insurance, by its very nature, is a discipline built on evolution. It's not about quick fixes; it's about gradual transformation based on lessons and trends from recent and past events. We have the confidence and the capability to figure this out, just as we have done in the past.

- **Pricing speed**
  If the last few years taught us anything, it is that rapid claims inflation and the slow ability to adjust prices result in large underwriting losses. We need to be much faster to respond to risk changes with price changes. But we also need to be more sophisticated. The data available for pricing is mushrooming and insurers that can't add new highly predictive variables to rating swiftly will suffer adverse selection. The word "swiftly" used to mean years; now it is months, or for leading insurers, weeks.
- **Underwriting speed**
  The combination of supply chain issues, climate change and regulatory roadblocks can make geographic regions or risk segments virtually uninsurable in very short time frames. In those scenarios insurers must be able to see problems and react quickly and precisely with new business restrictions, non-renewals or other "eligibility" actions. Changes to underwriting rules must be based on robust analytics that neither under-restrict nor over-restrict business. Again, insurers need to achieve this with speed.
- **Balanced risk mitigation**
  Risk mitigation is nothing new, but our understanding of the risks and the options to mitigate them continue to expand. In a world with more expensive replacement costs and longer replacement timelines driven by deglobalization, the economics of risk mitigation versus loss replacement is becoming increasingly attractive.
- **Negotiated supply chain agreements**
  Take a proactive approach to managing the claims ecosystem to ensure readiness in high-risk areas and with high-demand items. This could entail innovative inventory management strategies, such as stockpiling critical components to mitigate supply shortages, or it could involve hedging strategies with suppliers of specific types of goods for specific geographies.

In conclusion

The world is changing. For many of us our entire adult lives have been in the context of a globalized world, with all the cost benefits and easy access to production it brings. That era is ending. Insurance (and other industries) have tools to deal with this change, but we need to be focused, thoughtful, proactive and intentional about the steps we will take to address it.

Meet our expert

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Adam Denninger leads Capgemini's global strategy and product management for the insurance industry and manages its relationships with the insurance technology ecosystem. Adam has 20+ years of experience creating and delivering solutions at the intersection of business and technology.

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