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Oxford Martin School's Ian Goldin on insuring a new world of systemic risk

By Catrin Shi

Ian Goldin is a professor of globalization and development and the director of Oxford Martin School at Oxford University. SNL Financial caught up with Goldin after he spoke at a Marketforce lecture in London on March 5 about the consequences of rapid globalization and what it means for the insurance industry.

Ian Goldin
Director, Oxford Martin School
Source: Oxford Martin School

As he sees it, faster, more complex technology is not only leading us toward extraordinarily high levels of not only "hyperconnectivity" but also systemic risk. "The capacity to change, enhance and manipulate people, things and objects is growing," he explained. "But we are a long way from understanding this new world of capabilities, the world that man shapes. There is this ubiquitous availability of extremely potent, destabilizing potential, and I believe we are entering for the first time [a stage] where a single individual can destroy all mankind."

Below is an edited transcript of the interview.

SNL Financial: At the lecture, you talked about how the world has become "hyperconnected" and how this increases systemic risk. How do you see this level of connectivity developing in the next 20 years?

Ian Goldin: We are going to keep integrating more tightly. There will be more of us, and there will be more virtual connectivity. At the moment, it is doubling every year at least. Connectivity will go way beyond humans to include objects — so we may have sensors in our bodies, cars or homes. We will be entering new levels of connectivity, and it will also penetrate more parts of the world, parts that are not so well connected now, because they do not have the technology.

Is this good news for insurers?

I think this is both good and bad. There is lots of potential for improvement in terms of real-time understanding of what risk is, the real-time pricing of risk and much better modeling of things like behavior. We will be able avoid risk far better — cars will be able to tell if they are going to crash into each other, or drivers will be able to tell the alcohol content in their blood. There will be many improvements of that nature.

On the other hand, we will be at higher levels of systemic risk. There will be more risk cascading from one place to another, coming across risk borders. Risks happening in one place, which could be very small, can amplify into very large risks in other places very quickly, and that creates a much greater level of uncertainty for insurers. I think the old models of risk are very likely to be thrown out because this new form of risk will overwhelm a lot of the old risk. The pricing of risk will also change fundamentally over the next 10 to 20 years.

Has the insurance industry been good at addressing this type of risk so far?

It is a remarkable industry. I have been to Lloyd's of London and you really get a sense of how it has evolved over time. It has been extremely good at adapting to changing risk environments, and I have no doubt it will continue to adapt.

The world will be very different from the world the insurance industry has come from, and I think there will be very few that will survive the pace of change and the level of shock that will come through. It will be a creatively destructive process. Some will stay ahead of the curve, some will fall by the wayside, and of course, new acts will come up as well.

How do insurers try to build resilience against this? How do you raise awareness of these systemic risks?

First and foremost, one needs to understand that its own knowledge is very important. One needs a mental map of how the world runs and how it is evolving. I think it is difficult to take a systematic approach to managing the strategy of a business or investment and pricing the risk going forward. So an understanding of globalization, the world of finance and its behavior is absolutely essential.

On top of that, one needs very sophisticated and nimble specialists in a business, whether it is on climate change, demographics or other more traditional forms of risk. These are structural types of risk, which are on top of all the previous types of risk. These require a deep level of understanding, the ability to communicate with leading experts and being able to translate what they are saying into this world. That requires a lot of sophistication and skill, which not everyone has. There also has to be an ability to be extremely nimble — to be able to change one's mind and move forward very quickly — because the one thing that is absolutely certain is that the pace of change will accelerate.

What do you think is the most pressing challenge for the insurance industry in terms of risk? Longevity? Climate change? The development of technology?

All of those. One of the new ways of thinking about risk is that you perhaps shouldn't prioritize. You shouldn't say something is going to be a pandemic, or there is going to be a flood or fire, because that implies you know, and you don't. What you have to do is say is that we expect a much higher level of floods, or we expect a cascading effect of risk. We need to understand the fact that we perhaps didn't understand previously.

At Oxford Martin School, you promote the development of cross-disciplinary thinking. How much impact could this have on insurance?

We [at Oxford Martin School] are by far the most joined-up place in the world when it comes to hearing about future trends and the risk associated with them. We are trying to do this because we want to help mitigate the risks. This may be designing competition policies to ensure nothing in the system is too big to fail, or designing insurance policies that can price this risk in a sensible way. We will need vibrant insurance policies so people can survive risk, because there is simply going to be much more of it. The insurance industry has an absolutely vital role to play ensuring that societies are better placed to be sustainable in this world of increasing systemic risk.

What do you think the insurance industry will look like in the future?

We are already beginning to see the emergence of new products such as longevity bonds and cat bonds. These sorts of products will become more significant over time. There needs to be constant innovation in these products due to the nature of the risks — distributing them as widely as possible to as wide an asset pool as possible, because the scale of some of these risks will be much larger than they were in the past.

Reinsurance will continue to play a vital part. It is fundamental to the system that the reinsurance industry is well capitalized and remains solvent. Interdependencies and correlations between the reinsurers should also be reduced, so that an immeasurable set of events — be it another financial crisis or a set of storms — will be survived by the business. We used to think of these as one-in-1,000 years, one-in-700 years, one-in-seven years events, but we know now that that sort of probability is changing.