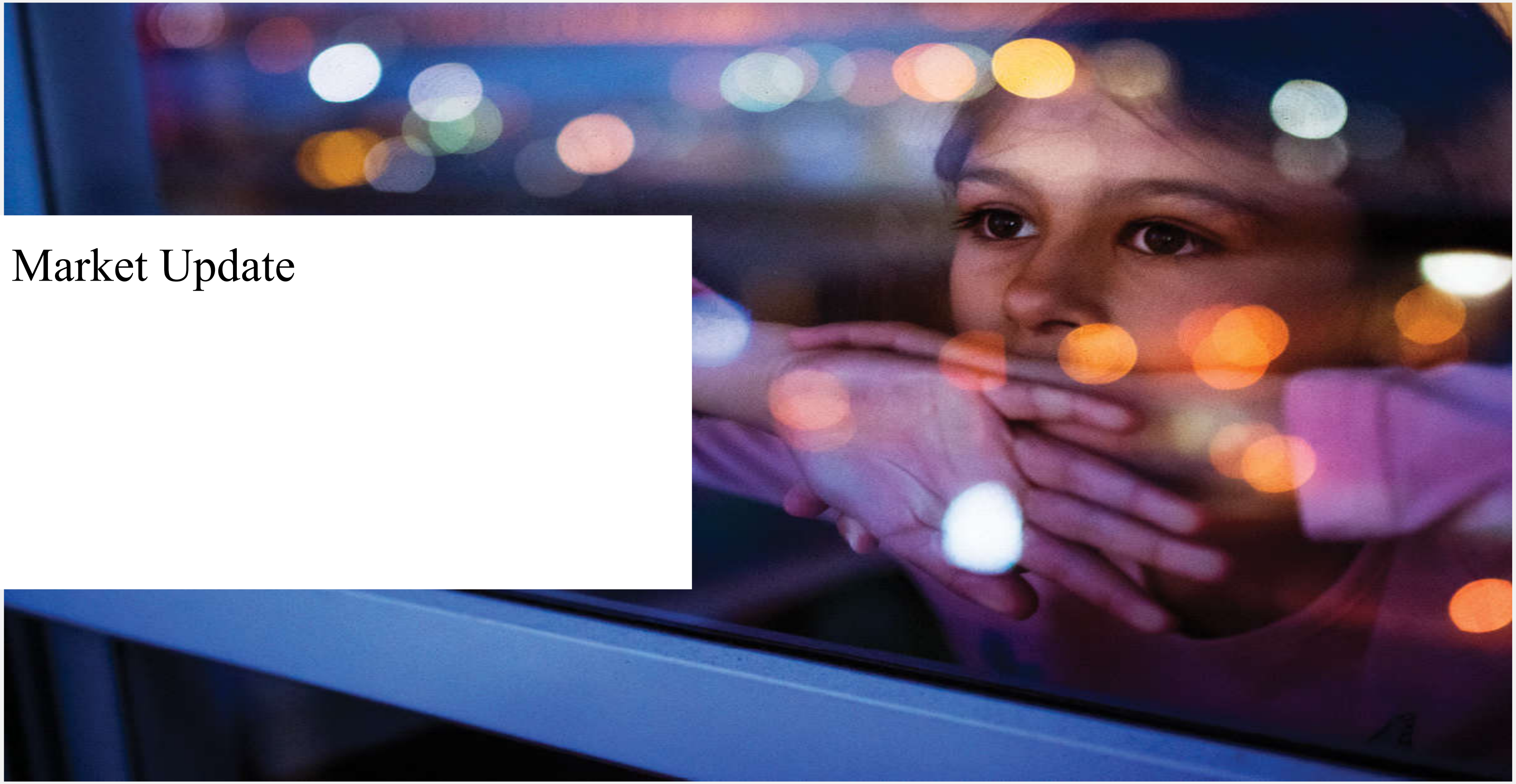
Insurance Market Update

GB Broking

March 2022



Headlines

Geopolitical and economic factors shaping the insurance landscape in the months ahead, with recent events dampening the short term moderation in rates

- Capitalisation and solvency of the large publicly traded insurers at the higher end of their' solvency targets
- Benefits to insurers from rising interest rates, countered by geopolitics, threats to economic growth and increased loss cost trends
- Capital market volatility expected to persist in the short-term
- Ukraine conflict complicated the Federal Reserve and ECB's monetary plans and now walking the tightrope between action against inflation and global growth
- Corporate margin pressures through increased costs of capital and inputs, should remind insurers on 'affordability' as insurance buyers consider procurement strategies and budgets
- View of catastrophe risk being re-appraised as insurers take a forward view and consider the effects of Climate, secondary perils, unmodelled losses and population movement
- Universal return to growth by insurers after several years of portfolio pruning and rating realignment
- Rising loss cost inflation brought about by social inflation, cost of energy, commodities and supply chain constraints support insurers' need for continued technical pricing
- Longer-term 'persistence' of inflation, may lead insurers to re-assess reserving assumptions
- Economic backdrop and lower corporate margins, may lead insurers to differentiate by industry sector and client profile, mindful of affordability after year on year price rises

Ukraine conflict

Uncertainty and nature of events likely to dampen any short-term moderation in insurance rates

- Fluid nature of the conflict may stem the moderating market as insurers assess exposure, consider wider market issues including the effect of sanctions and insurance policy coverage
- Product lines of Aviation, War, Contingency, Cyber, Credit & Political Risk affected
- Insurers assessing exposure and liabilities to Ukraine and surrounding region
- Between $10 – 20 billion of airline hull assets in Russia against an estimated Aviation War premium base of $180 million
- Uncertainty around Cyber Terrorism and how policy coverage interacts with War definitions as well as broader collateral damage in the event of a targeted attack
- Some insurers no longer writing new or renewal business in Russia, Ukraine and Belarus and where contractually possible, issuing cancellation especially for War
- Societal and moral imperative having a profound effect on insurer action
- Increased capital market volatility although the significant asset losses experienced at the height of Covid-19 have not yet been repeated
- Heightened risk of social unrest as staple food prices rise or western brands / ‘unfriendly’ nations become a focal point for future hostility
- Potential for further impact to insurers portfolios if the West contemplates future trading restrictions on ‘neutral’ nations
- Broad and unknown knock on effects including energy transition, inflation, growth and societal issues

Ukraine

Longer-term contagion and knock on efffects

Today | Potential

Today

Credit & Political Risk, Aviation War & Contingency, Marine War, War and Terrorism, Cyber……..

- Less overall exposure to Ukraine following the annexation of Crimea in 2014 and resulting sanctions and changes to insurer appetite
- Non-Russian airline leasing organisations believed to have 515 planes in Russia with a value of between $10 – 20 billion
- Trade Credit exposure concentrated in Oil & Gas export finance in Russia
- State-sponsored or Cyber Terrorism yet to deliver meaningful disruption and market loss but insurers remain concerned about coverage definitions, ‘attribution’, carve-back coverage and collateral damage from targeted attacks
- Cyber insurers looking at ‘standing down’ the market-wide war exclusion and replacing it with a ‘next generation’ war exclusion to address cyber warfare
- War & Terrorism market estimate exposure to Ukraine at $3 - $5 billion
- Uptick in demand for War coverage from European clients alongside renewed interest in Nuclear, Biological and Chemical Radiological
- Aviation / Marine War coverage impacted in the hostility however some downside risk minimised through cancellation provisions
- Coverage, money flow and event triggers are complex and subject to legal interpretation, for example, ‘Five Power Exclusion’ in War & Terrorism policies
- Prohibition to return assets outside Russia enacted in Russian Law
- Ban on Russian insurers ceding risk to “unfriendly states” elevates the issues associated with sanctions and the changing regulatory landscape

Potential

- Increased fears of cyber attacks and targeted actions against the West
- Escalation of hostilities and contagion to other countries
- Capital market volatility affecting asset side of insurers’ balance sheet while simultaneously incurring liabilities through the P&L
- Rising credit spreads, costs of finance and input costs pose a challenge to business especially highly leveraged organisations
- ‘Technical’ default of Russian debt and further credit deterioration
- Rising costs of staple foods and lack of access to basic utilities inflate social tensions
- As the effects of economic isolation increase, crime rates rise with Western institutions a possible retribution target
- Miscalculation by Central Banks as they normalise monetary policy
- Supply chain constraints driving up the cost of repairs and availability of replacement parts
- Changes in demand for insurance as costs of capital rise, corporate earnings are squeezed and growth declines, putting pressure on discretionary spend
- Risk premium and conditions of insuring Russia become onerous
- Need for energy security presents opportunities and threats to the energy transition and commitment to Net Zero

WillisTowersWatson

Solvency and ratings

Strong liquidity, although a high degree of uncertainty about the extent, outcome and consequence of the military conflict remains

- Insurance ratings have been relatively stable over 2020 and 2021 with capital buffers back to pre Covid-19 levels
- Russian insurers downgraded or on CreditWatch due to direct asset and insurance liability exposure to Russia
- Some global multiline insurers, such as Allianz and AXA have operations in Russia, although their exposure is believed to represent a small amount of total adjusted capital, assets and liabilities
- Exposure to Russia for many insurers headquartered outside the country believed marginal, in many cases less than 1% of overall insurance liabilities/assets
- Re-insurers like Hannover Re, Munich Re, SCOR, and Swiss Re have exposure to Russia although their capital positions are considered to be a key strength and defence against asset volatility
- Capital market volatility remains a challenge to insurers given their large position as an investor in the global capital market
- Insurer rating downgrades during the pandemic were less than the historical 10-year average
- Of the insurers rated by S&P in EMEA, 69% have exceptional liquidity, with more than twice the liquidity required to pass S&P's prospective stress scenario

- Solvency II regulation, strong capital buffers and conservative investment profiles are key foundations to avoid a deterioration in credit quality
- Negative rating action taken on insurers headquartered in Russia with downgrades made to several domestic insurers
- For European insurers, direct asset exposures are believed to be limited as Solvency II regulation requires risk assessment under different lenses; quantitatively and qualitatively
- Focus on potential effects of the conflict including dislocated commodity markets, supply chain disruption, inflationary pressures, weaker growth and capital market volatility
- Rising benchmark rates, combined with a widening of credit spreads may end a historic run of favourable financing conditions
- A rapid and volatile market repricing, affecting debt-servicing costs and funding access would hurt lower-rated borrowers

Financial Results

A well-capitalised industry having benefited from improving rates and active portfolio management

- Substantial earnings improvement in 2021 with improved underwriting results, underpinned by stronger investment returns
- Double-digit growth in commercial written premiums as insurers capitalise on a favourable insurance rating environment
- Commercial lines rating environment outstripped loss-cost trends; a substantially different pattern to Personal Auto
- Insurers remain cautious about the risk environment and need for underwriting discipline
- Confidence in the trajectory and continued momentum for rate despite their acknowledgment that the pace of rate increases has moderated
- Life insurance earnings continued to be dragged by Covid-related mortality losses
- Expense ratios slightly lower after increases in top line revenue although acquisition costs, for example MGA distribution, nudged up in certain classes

Loss Ratios

- Significant reductions, with improvements more pronounced in insurance lines than reinsurance
- Notwithstanding heavy Natural Catastrophe loss burden in 2021 (Hurricanes Ida, Winter Storm Uri and European Floods), Combined Loss Ratios are the best since 2016
- Covid-related claims incurred for P&C business had modest impact on 2021 results, in contrast to the substantial toll in 2020
- Commercial insurance loss ratios benefitted from continued reduced frequency of loss in certain lines
- Severity in some casualty lines more subdued ahead of heightened economic and social inflationary risks
- Loss ratios benefited from some reserve releases set aside in prior years, including a contribution from the 2020 accident year

2021 (Re)insurer Financial Results

Insurer		Net Income		Combined Ratio	
		2021	2020	2021	2020
AIG	USD	9,388	-5,944	95.8%	104.3%
Allianz	EUR	6,610	6,807	93.8%	96.3%
Arch Capital	USD	2,157	1,406	85.2%	94.0%
AXA	EUR	7,294	3,164	94.6%	99.5%
Axis Capital	USD	619	-120	97.5%	109.6%
Berkshire Hathaway	USD	89,795	42,521	96.0%	95.2%
Chubb	USD	8,539	3,533	89.1%	96.1%
Everest Re	USD	1,379	514	97.8%	102.9%
Hannover Re	EUR	1,231	883	97.7%	101.6%
Hartford	USD	2,365	1,737	96.3%	96.4%
Liberty Mutual	USD	3,068	758	100.8%	101.8%
Mapfre	EUR	765	527	97.5%	94.8%
Markel	USD	2,425	816	90.0%	98.0%
Munich Re	EUR	2,933	1,211	98.1%	98.3%
QBE	USD	750	-1,517	91.5%	107.4%
SCOR	EUR	456	234	100.6%	100.2%
SwissRe	USD	1,437	-878	95.8%	110.2%
Talanx	EUR	1,011	673	97.7%	100.9%
Travelers	USD	3,662	2,697	94.5%	95.0%
WR Berkley	USD	1,022	531	89.6%	94.9%
Zurich	USD	5,202	3,834	94.3%	98.4%

Investment Returns

Investors prepared for ongoing volatility as Central Banks navigate the changing risk environment

- Higher reinvestment rates for insurers driven by increased risk-free rates
- Increases in interest rates improved the returns from insurers' bond portfolios, particularly for those with shorter durations
- Equity and alternative portfolios provided strong returns in 2021
- 1st rate rise for 10 years by the Fed, with a further seven pencilled during the year
- Duration and scale of commodity price increases uncertain
- Higher risk premiums and interest rates on government bonds in US and Europe
- Swiss Re estimate that the energy price shock from Ukraine could lead to 1-2% lower GDP growth and 1-2% higher inflation in the euro area
- Speed and degree of Central Bank normalisation will vary
- Threat of a stagflation shock created complexity in the interest rate outlook

Euro Area

Annual inflation rate rose to a record high of 5.8% in February from 5.1% in January

US CPI: 7.9%

Largest 12-month change since the period ending August 1982

European Windstorms

Windstorms Dudley and Eunice - €3 - €4.5 billion (RMS estimate)

Eunice

€2.5 - €3.5 billion

Likely to be the costliest European windstorm of the last 15 years

The most damaging European windstorm event since Windstorm Kyrill in 2007

Germany

40%

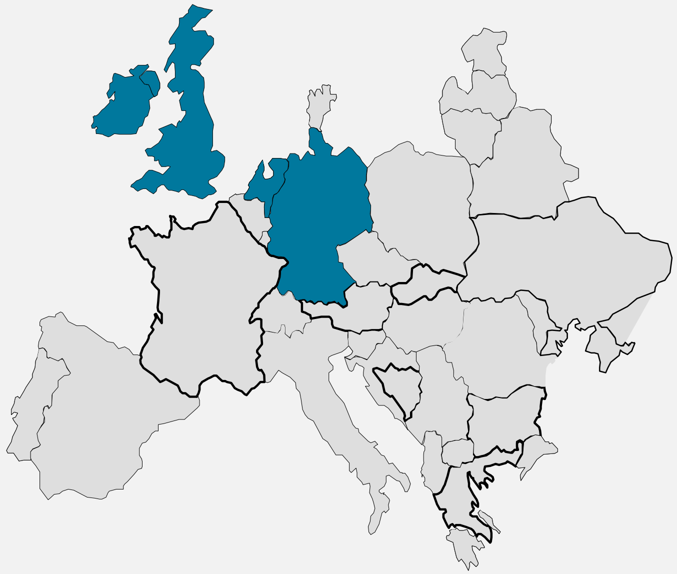
United Kingdom

15%

Netherlands

20%

Wind-only loss estimates include damage to property, automobiles, agriculture, and direct business interruption, but exclude losses from damage to infrastructure, which are expected not to be material



Catastrophe and Climate

- Insurers 'view of risk' being reconsidered as recent loss history necessitates a wider view of risk taking account of earnings as well as solvency
- Forward view of risk incorporating loss frequency, climate scenarios, inflation and unmodelled losses
- Losses have been increasing, influenced by more exposure in riskier locations
- Current trends projecting an increase in Cat Losses requiring strong pricing discipline and realistic capital loss scenarios
- More work required to understand Climate risk properly and put upward pressure on the absolute value of catastrophe losses

Swiss Re

- $2.1bn in large Nat-cat losses in 2021, exceeding Nat-cat budget of $1.5bn
- Increased 2022 Nat-cat budget to $1.9bn

Munich RE

- Increased projected share of Major Losses in its Combined Ratio by 1 point to 13%

SCOR

- 2021 Nat-cat ratio of 12.8% of Net Earned Premium, well above a budget of 8% and ahead of the previous year's 6.8%

AXA

- Cat budget for AXA XL lowered from 6% of premiums to 5% for 2022

LLOYD'S

- Five year Catastrophe Loss business plans average 12% of the Combined Ratio - actual results range 18% - 20%

Lloyd's oversight on Climate

Increased oversight of volatility measures as part of the business planning and capital management process

- Expecting Managing Agents to take a science-led, diligent and structured approach to Climate, thoughtful about the impact of Climate and how this is factored into analytical models
- Asking Managing Agents to understand differences between catastrophe loss ratios submitted as part of annual business planning, the models used and actual experience to ensure future plans are realistic and achievable
- Would like Managing Agents to express their 'willingness to lose' and appetite for risking profits in the near term right through to the capital-burn rate in the extreme / tail
- Continue to support top performing Managing Agents and differentiate the capital management approach and principles for doing business
- Following a 'principles-based' oversight approach
- Sustainable performance is an unrelenting discipline – looking to build resilience in the portfolio for the opportunities and challenges ahead
- Consider Managing Agents plans in the context of their longer-term strategy ensuring that decision-making supports investment horizon
- Increased losses influenced by more exposure in riskier locations

A Changing View of Risk
Over last five years Catastrophe Loss scenarios in Lloyd's business plans averaged 12% of the Combined Loss Ratio, although actual results ranged between 18% and 20%

ESG – The Insurer survey on Lloyd's

- **50%** integrating ESG into investment operations compared to 15% integrating ESG factors into underwriting decision-making
- **85%** do not currently have a compensation policy tying annual remuneration of executives with ESG performance
- **31%** have internal guidelines on sustainable suppliers, a quarter of these policies rolled out within the last six months
- **Almost 75%** have some restriction for risks related to coal mining projects or planning to introduce these, compared to two-thirds who have some form of restriction for coal power projects
- **37%** not contemplating the adoption of a net-zero pledge, at least in the current calendar year
- **81%** claim to have a business ethics policy compared with 70% having a fair remuneration policy
- **Less than 20%** planning to have an executive compensation policy in place by mid-2022
- **66%** plan to identify and develop KPI's to monitor the execution of ESG strategy before mid-year
- **81%** taken measures to adapt their syndicates' product offering to take into account ESG risks
- **63%** have a C-suite executive officially responsible for ESG issues - 1 in 4 at the CEO level

Source: The Insurer

Lloyd's

Risk adjusted rate change continues to be a 'floor' not a target

Demonstrated improved underwriting performance in 2021

Maintaining underwriting and pricing discipline remains vital to ensure Lloyd's is positioned to deal with short- and long-term factors including inflation and Climate

Continue to emphasise importance of achieving appropriate rate for exposure given how quickly inflation can erode recent hard-fought gains during hardening market

On track to deliver the upgraded model for Lloyd's Europe by the end of Q1 2022

To ensure pricing delivers sustainable results, price-adequacy and a focus on technical pricing will be key in managing risk in a more uncertain world

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