Macroeconomic Impact on Reinsurance

Presentation to the Casualty Actuarial Society

June 2023
Agenda

1. New Market Realities!
2. First It Was Inflation
3. Reinsurance Market Reset
4. What Happened to the Capital Account?
5. Implications for Primary Insurers
NEW MARKET REALITIES
Insurers Are Adapting to a New World!

Negative Factors
- Investment Values
- Reinsurance Capacity
- Capital
- Reserve Adequacy

Realized and unrealized losses
Dislocation of deployable capital
Down ~ 14% since YE 21
Pressured by inflation

Implications for Primary Insurers
- Higher growth
- Higher risk
- Premium on capital management

Upward Forces
- Inflation
- Reinsurance Prices
- Insured Values
- Interest Rates

Economic, social
+15%, MINIMUM
Higher premiums, higher severity
Higher NII, higher cost of capital

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Risk Transfer Challenged with Capacity Constraints

Functioning Market

Dislocated Market

Risk Transfer

Retro

Reinsurers

Primary Insurers

Consumers and Businesses

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FIRST IT WAS INFLATION
Inflation May Have Peaked, But Far from 2-3% Target!

CPI All Items
Year-over-year % change

M2 Money Supply
$ in billions

5.0% YoY growth in April 2023

40% increase in M2 money supply from 2020-2022

4% decrease in M2 money supply from July 2022

Social Inflation—In the Headlines and Not Going Away

Social Inflation: The increase in loss costs ABOVE the rate of economic inflation

**DRIVERS**
- Litigation funding
- Plaintiff bar tactics
- Propensity to sue
- Societal views on blame
- Fraud
- “Punishment” mentality
- Public distrust
- Media impact on public opinions
- Attorney technology and analytical advances

**% Increase in Loss Costs**

**RESULT**
- Nuclear jury awards
- Pain point for re/insurers

**Recent Comments/Headlines on Social Inflation**

“Two trucking companies hit with $1 billion verdict in death of Jacksonville teenager”
Florida Times-Union, 8/24/21

“Social inflation: The ultimate pain point of US liability insurance”
Insurance Business Magazine, 5/17/21

“The Fallout of High-Value Verdicts - Jury awards have gotten out of hand. Insurers and their corporate customers need to pressure legislators to rein in nuclear verdicts”
A.M. Best, November 2021

“Florida has a social inflation problem that can’t be solved by rate because it is ultimately impossible to know how much to charge to cover fraud.”
RenaissanceRe, 2022Q1 Earnings Call

“The reserve adjustments that we made in 2019, 2018, 2020 through the P&C Re and CorSo, I think reflected our view that the social inflation was an issue and our continued view that it’s not going away, it’s not getting better. It may even be getting worse.”
Swiss Re, 2022Q2 Earnings Call
**Inflation Is Much More Leveraged for Reinsurers**

Suppose a company has a per occurrence retention of $1.25 million:

<table>
<thead>
<tr>
<th></th>
<th>Total Losses</th>
<th>Retained Losses</th>
<th>Reinsurers’ Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sample Claim</td>
<td>$1,500,000</td>
<td>$1,250,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>3% Trend</td>
<td>1,545,000</td>
<td>1,250,000</td>
<td>295,000</td>
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<tr>
<td>Change ($)</td>
<td>45,000</td>
<td>0</td>
<td>45,000</td>
</tr>
<tr>
<td>Change (%)</td>
<td>3.0%</td>
<td>0.0%</td>
<td>18.0%</td>
</tr>
</tbody>
</table>
REINSURANCE MARKET RESET
Hurricane Ian—The Last Straw

Insured Loss Estimates for Hurricane Ian

$ in billions

Catastrophe Loss Creep = Aggregate 29%

$ in billions

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Property Cat Rates Soar at 1.1.2023 Renewals

U.S. Property Catastrophe Reinsurance Rate-on-Line Index

Hurricane Andrew
Hurricane Katrina

+30%

Prepared by Conning, Inc. Source: Guy Carpenter—used by permission

“The Guy Carpenter ROL Index (“Index”) is a measure of the change in dollars paid for coverage year-on-year on a consistent program base. The Index reflects the pricing impact of a growing (or shrinking) exposure base, evolving methods of measuring risk and changes in buying habits, as well as changes in market conditions. The Index provides context for evaluating actual movement in dollars flowing into the system to measure changing views of risk, exposures and other factors. Guy Carpenter & Company, LLC provides the Index only as general information. Specifically, we do not guarantee its accuracy, and it should be understood to be general insurance/reinsurance information. Guy Carpenter & Company, LLC makes no representations or warranties, express or implied or otherwise.”
Recent ILS Performance Leaves Investors on the Sidelines

Annual Insurance-Linked Securities Returns

-10%
-5%
0%
5%
10%
15%

6.4% Average

-1.1% Average

Prepared by Conning, Inc. Source: Artemis [https://www.artemis.bm/eurekahedge-ils-advisers-insurance-linked-securities-fund-index/-used by permission]
Reinsurance Reset: Higher Retentions, Lower Limits, Coverage Gaps

Reinsurance Illustration

### Expiring Reinsurance Tower
- **Layer 3**: Coverage Unavailable
- **Layer 2**
- **Layer 1**
- **Insurer Retention**

### 2023 Reinsurance Tower
- **Layer 3: Coverage Unavailable**
- **Layer 2**
- **Layer 1**
- **Insurer Retention**

- Lower limit available
- Unable to place 100%, retention reverts to insurer
- Higher retention

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WHAT HAPPENED TO THE CAPITAL ACCOUNT?
Fed Rate Hikes to Combat Inflation: Decline in Bond Values

U.S. 10-Year Treasury Yield

FOMC Benchmark decreases in basis points.

FOMC – Federal Open Market Committee of the Federal Reserve
Realized and Unrealized Equity Market Losses

Insurance Stock Indices Compared to S&P 500 January 3, 2022, to January 3, 2023

Prepared by Conning, Inc. Sources: Copyright 2023 S&P Global Market Intelligence LLC and U.S. Department of the Treasury (2023)
Note: Estimated change in bonds = 10% decline since year-end, tax-effected.
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IMPLICATIONS FOR PRIMARY INSURERS
Rates Will Remain Firm Despite Recent Flattening

Average Renewal Pricing, Commercial Lines

Prepared by Conning, Inc. Source: ©2023 MarketScout—used by permission
Leakage from Private Market in FL and from Admitted Market in CA

Citizens Property Policy Count and TIV Trends
Data as of March 31, 2023

- Estimated Citizens’ Losses from Hurricane Ian = $3.8 billion

California Homeowners E&S Premium
$ in thousands

- Average annual growth from 2019-2021 of 40%
- E&S homeowners market share up from 0.6% in 2016 to 1.2% in 2021

Prepared by Conning, Inc. Sources: Citizens Property Insurance Corporation of Florida [https://www.citizensfla.com](https://www.citizensfla.com) and Copyright 2023 S&P Global Market Intelligence LLC
Capital Entered in Prior Dislocations—What About 2023?

$ in billions

- Traditional Capital (left axis)
- Alternative Capital (left axis)
- Worldwide Natural Catastrophe Losses (right axis)

Prepared by Conning, Inc. Sources: Aon Reinsurance Analytics, Aon Securities Inc. and Swiss Re Institute, sigma 4/2021

Reinsurer Formations

Pre-2006: RNR, PRE, AWAC, AXS, Arch, AHL, ENH, VR, TPRE, FGS, LRE, MRH, Platinum, Tempest, Cat Ltd., Mid-Ocean, LaSalle, Global Capital Re, IPC Re, Ariel Re

2006-2017: None

2018-2022: Vermeer, Geneva Re, Conduit, Convex, Vantage

2023: ??
Why No New Capital or Reinsurer Formations?

Ten Factors Limiting New Capital (Isn’t Now the Best Market in a Generation?)

<table>
<thead>
<tr>
<th></th>
<th>Ten Factors Limiting New Capital</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Difficult to Raise Capital</td>
<td>Cost of capital increased, availability decreased</td>
</tr>
<tr>
<td>2</td>
<td>Return Profile</td>
<td>Do investors want enormous volatility for just average returns?</td>
</tr>
<tr>
<td>3</td>
<td>Lack of Franchise Value</td>
<td>Can a new entity be valued at &gt; book value?</td>
</tr>
<tr>
<td>4</td>
<td>Hard Markets Too Short</td>
<td>Short-lived hard markets with new capital and competition driving rates down</td>
</tr>
<tr>
<td>5</td>
<td>New vs. Existing</td>
<td>More attractive to invest in existing companies and sidecar vehicles</td>
</tr>
<tr>
<td>6</td>
<td>Recent Track Record</td>
<td>Investors stung by above-average losses in 5 of last 6 years</td>
</tr>
<tr>
<td>7</td>
<td>Rise of Secondary Perils</td>
<td>Diversifying perils become peak exposures</td>
</tr>
<tr>
<td>8</td>
<td>Inflation and Loss Creep</td>
<td>Accelerating severity with both economic and social inflation</td>
</tr>
<tr>
<td>9</td>
<td>Model Reliability</td>
<td>Too much reliance on models with inherent limitations</td>
</tr>
<tr>
<td>10</td>
<td>Management Expertise</td>
<td>Is there sufficient pool of bankable management talent?</td>
</tr>
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Polling Question

You can only choose one!

A. Over the next 3-5 years the insurance markets will adapt and become less dependent on reinsurance and related capital market instruments.

B. The next 3-5 years will see a (near) continuation of current conditions and represent a golden-era for reinsurers.
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