

Reinsurance – Supply driven Demand

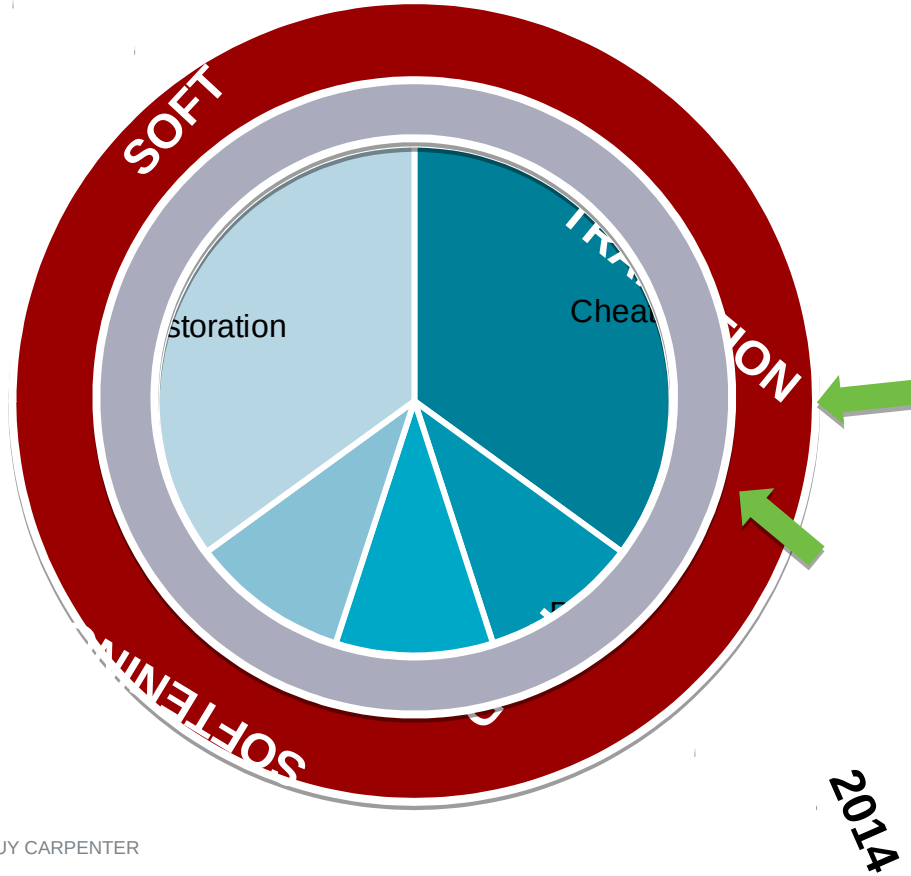
Serbian Insurance Days, November 2018



Mario Baotic
MD, CEE&Turkey

Cycle – Where Are We Now?

Soft Market is the Norm, with Occasional Hard Periods



Source: Adapted from Dowling & Partners, Guy Carpenter

Cycle – Where Are We Now?

Soft Market is the Norm, with Occasional Hard Periods

- **What's changing (Industry dynamics)**

 - 2017 and 1H2018 loss events

 - Supply led demand growth

 - Pricing power

 - Return on equity

 - Reserve movements

- **Macro factors (Implications)**

 - Financial markets

 - Risks

Source: Guy Carpenter

What's changing – Industry dynamics

2017 large loss events

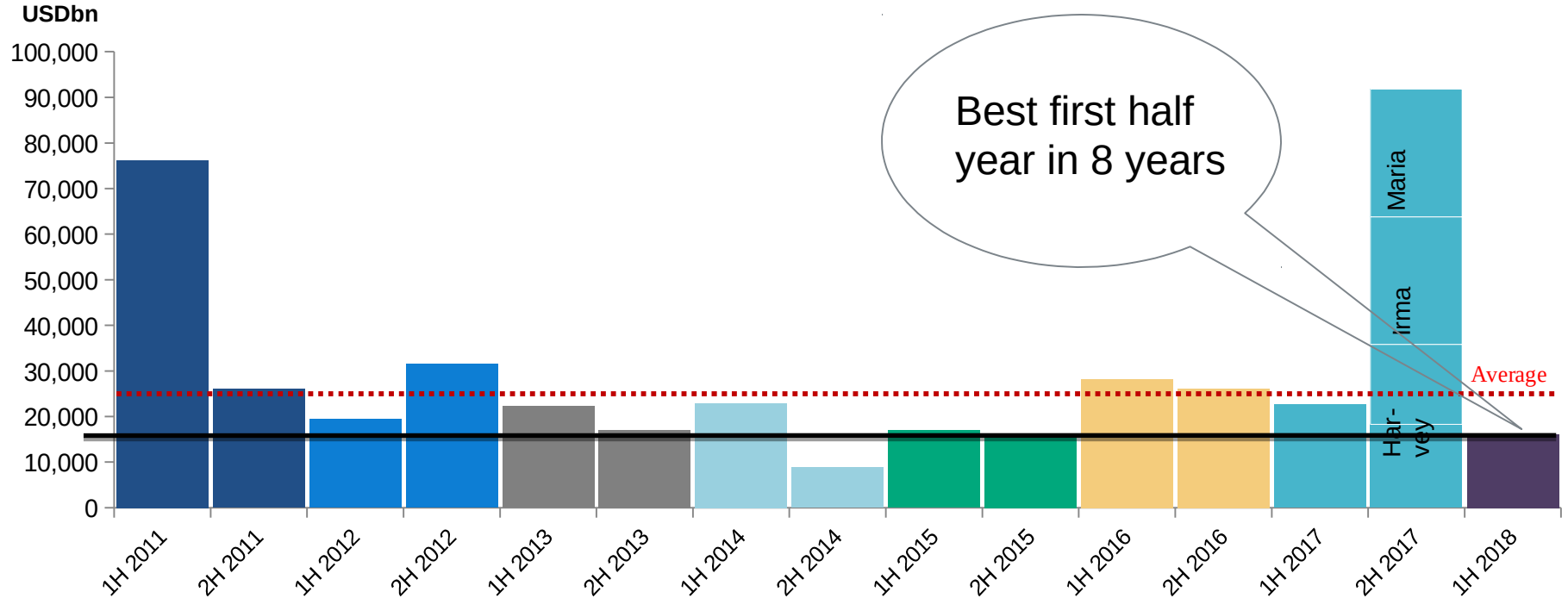
Total insured losses 2017	\$ 114 bn
Reinsurers share of losses	\$ 41 bn
Reinsurers earnings power before tax and cats	\$ 46 bn

So, HIM losses can be characterised as an earnings not a capital event

Source: Guy Carpenter

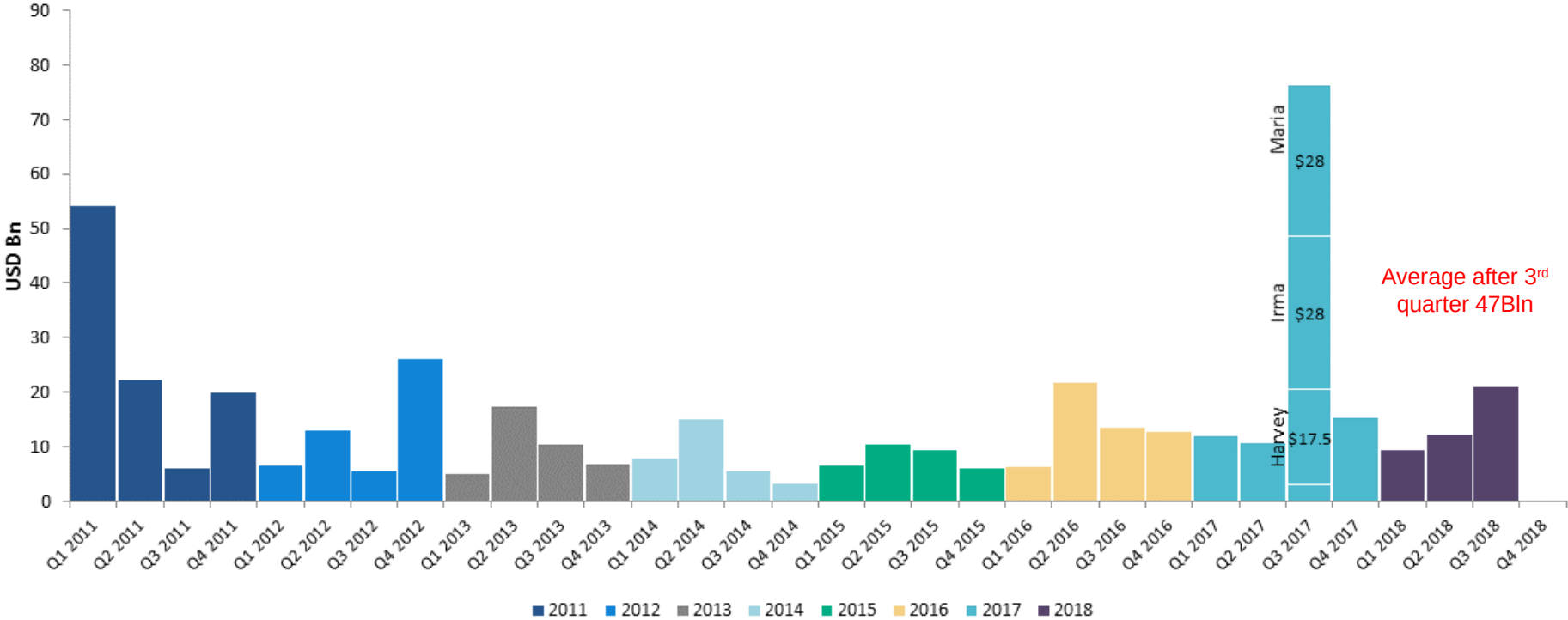
What's changing – Industry dynamics

1H18 large loss events – lowest 1H for past 8 years



Source: Guy Carpenter estimates

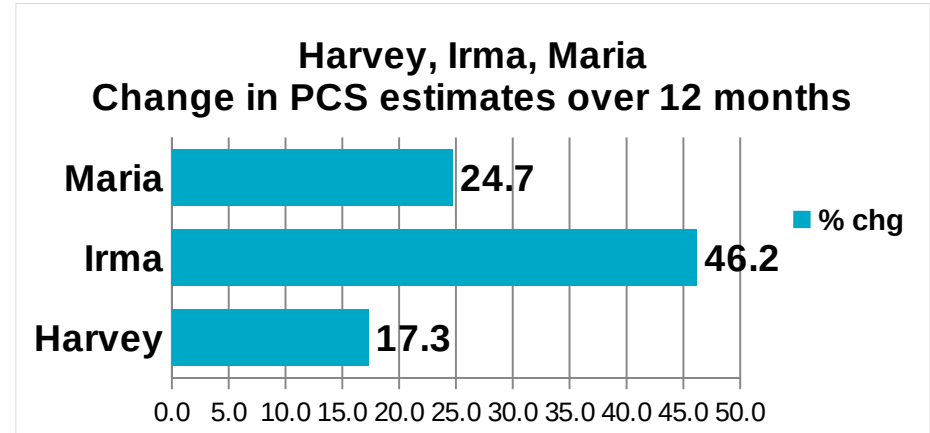
Significant Insured Losses - 2011 to Q3 2018



PCS Development of Reported Losses

Published Updates for HIM

	Harvey	Irma	Maria
2017			
Sep/Oct	15.9	18.0	21.9
Nov/Dec	15.9	15.1	22.4
2018			
Jan/Feb	15.7	17.2	24.0
Mar/Apr	17.1	18.7	25.3
May/June	17.6	19.5	25.7
Jul/Aug	17.6	20.8	27.3
Sep/Oct	18.4	22.0	27.3
% Chg	17.3%	46.2%	24.7%



Percent change calculated from the lowest to the highest estimate for each event.

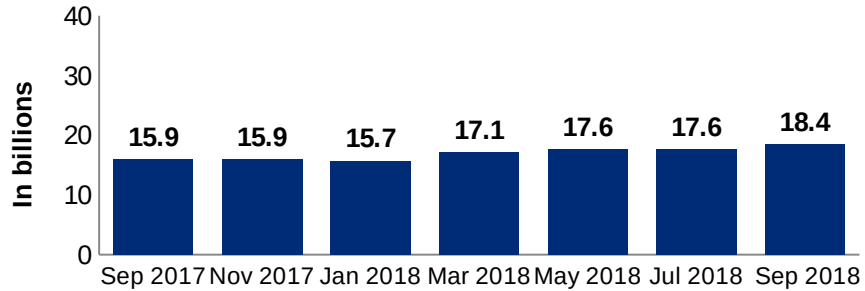
Source: PCS

PCS Development of Reported Losses

Published Updates for HIM

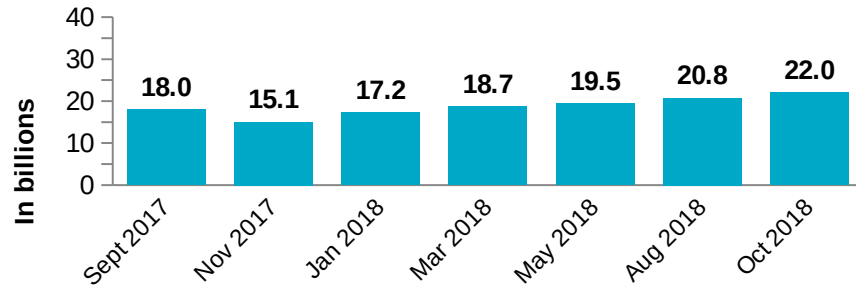
Harvey

16% increase from initial estimate



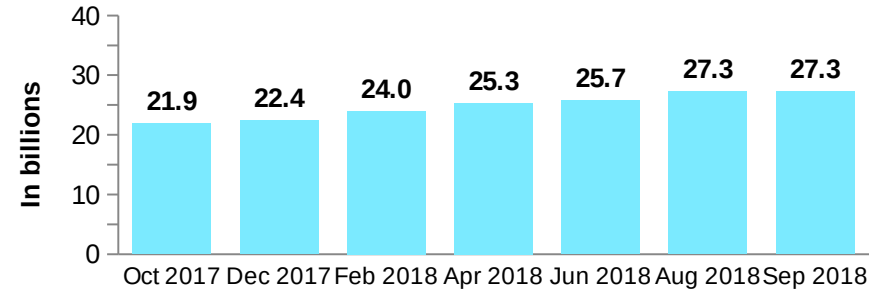
Irma

22% increase from initial estimate



Maria

25% increase from initial estimate



Percent change calculated from the initial estimate to the most recent estimate for each event.

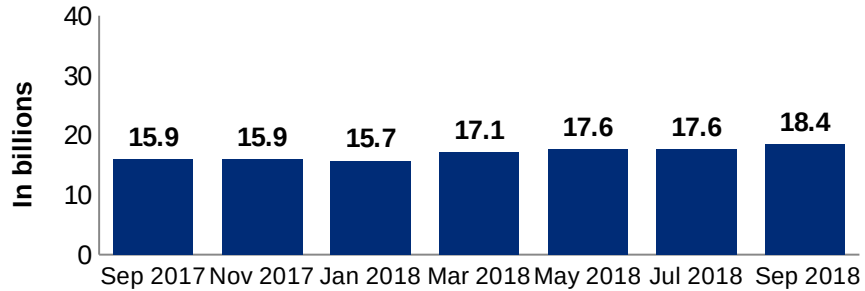
Source: PCS

PCS Development of Reported Losses

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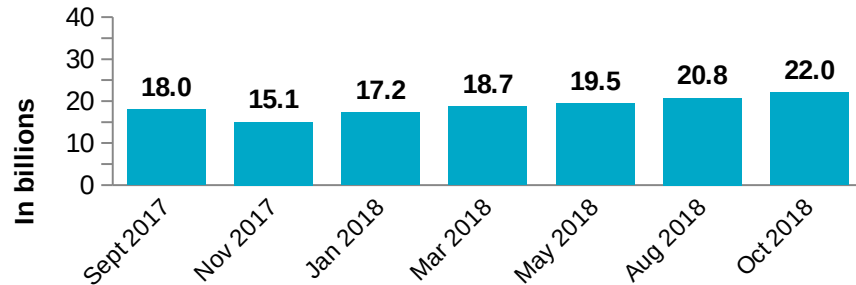
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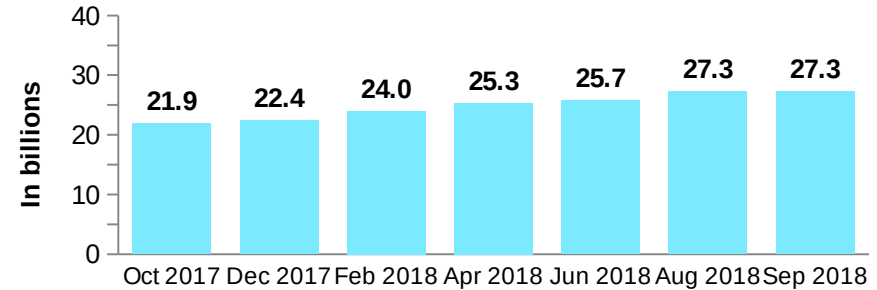
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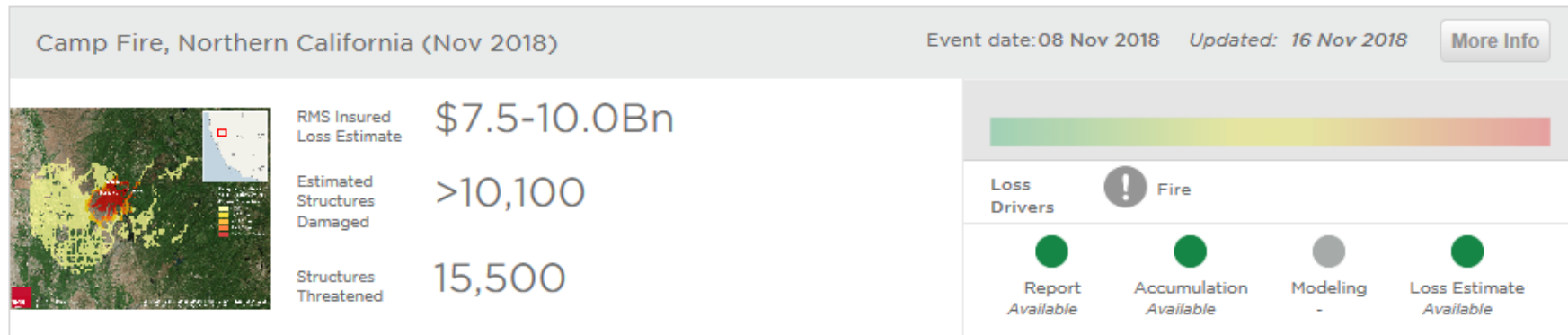
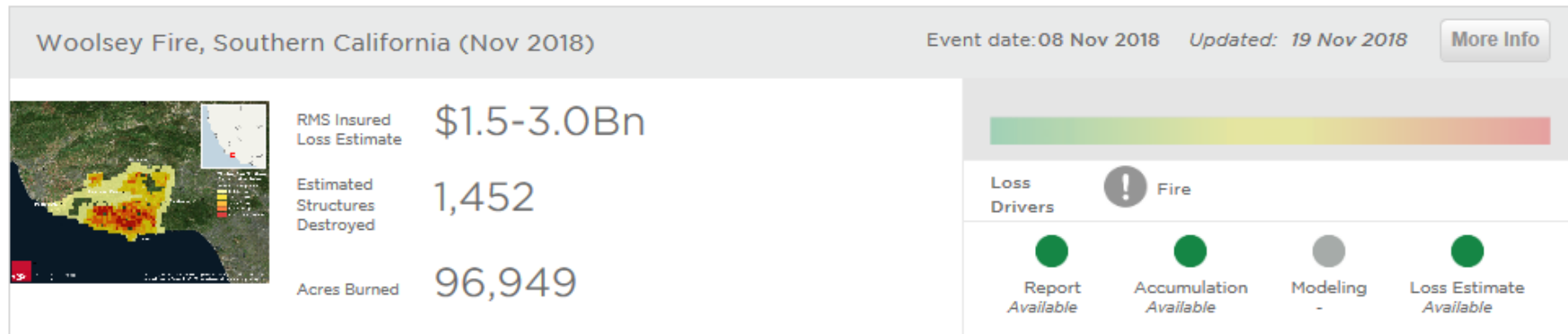
25% increase from initial estimate



Percent change calculated from the initial estimate to the most recent estimate for each event.

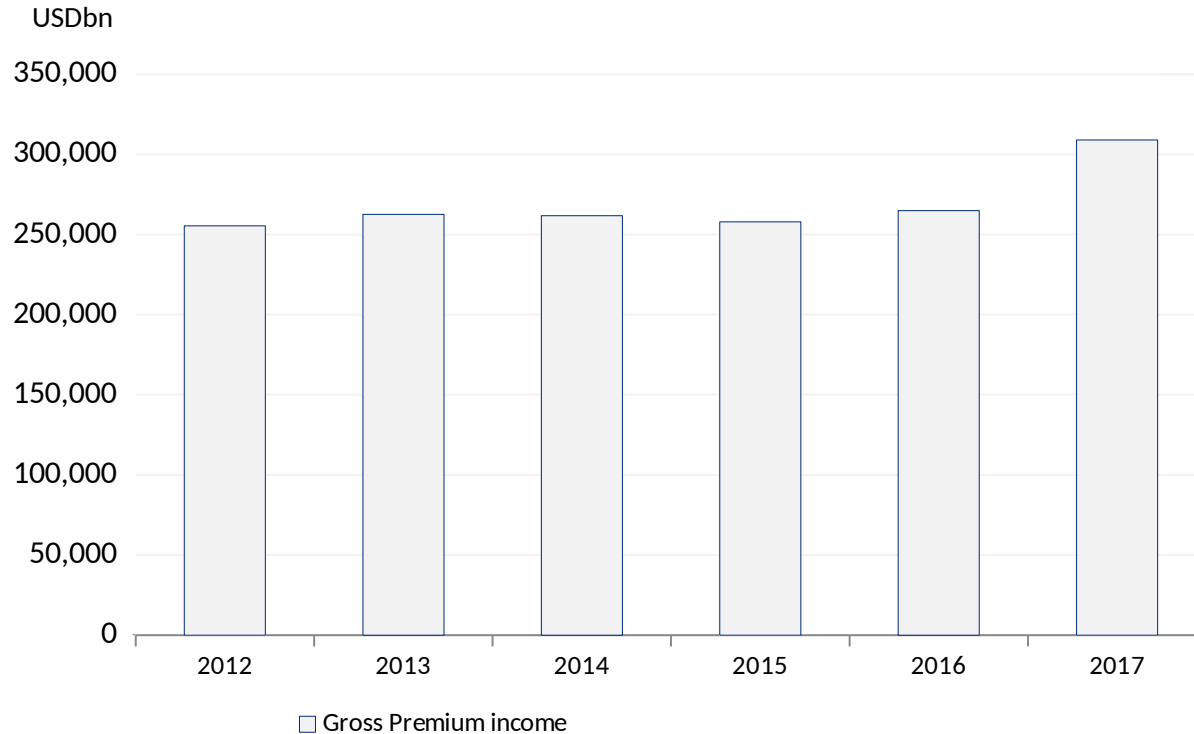
Source: PCS

Californian Wildfire Losses



What's changing – Industry dynamics

Supply led demand growth



Reinsurance premium

- Ceded reinsurance premium 1H18 = +16%
- Reinsurers' cession ratio increased to 17%
- Growth was strongest in:
 - Retro
 - Cyber
 - Casualty
 - Financial lines

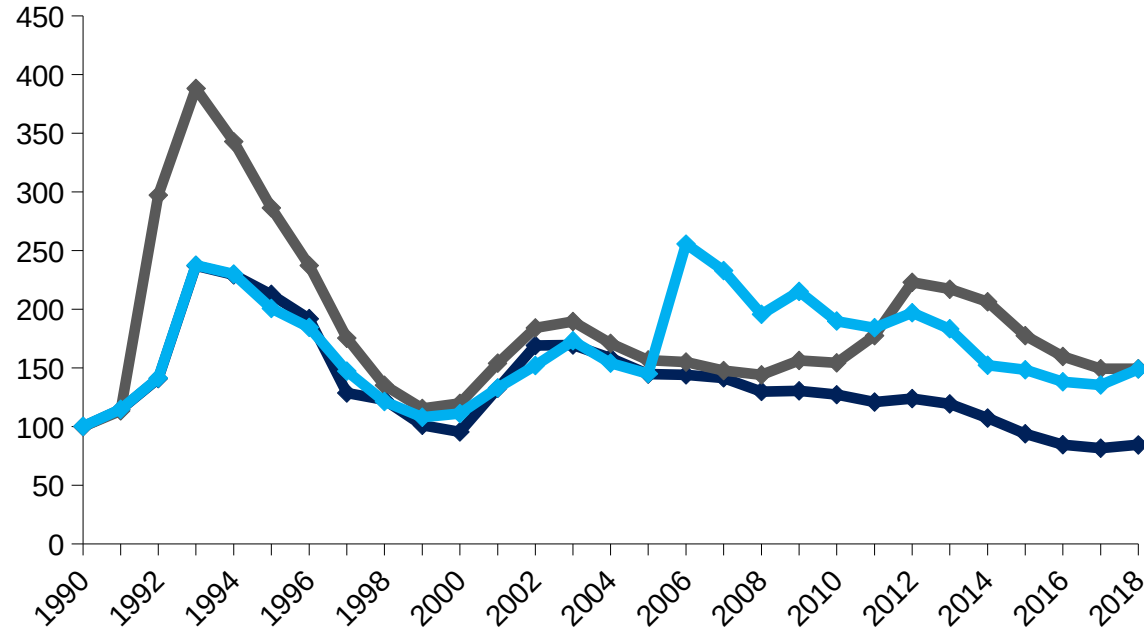
Capital

- 1H18 total capital grew +2% YTD
- Alternative capital +10% YTD
- Side car capacity +40% (to USD8bn)

What's changing – Industry dynamics

A lack of pricing power

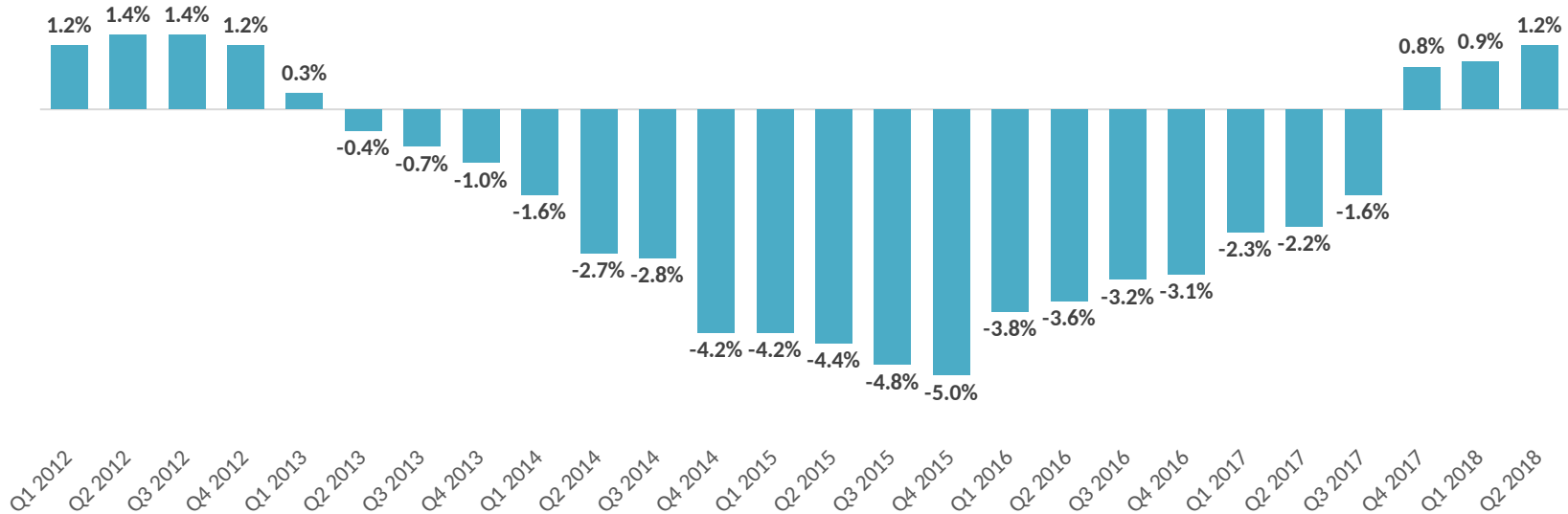
Guy Carpenter Property Catastrophe RoL Index



- Global Cat prices increased at 1/1
- For Jan-Jul renewals the increased slowed considerably
- Future pricing can be influenced by loss experience but more importantly by capital deployment (ILS in particular)

What's changing – Industry dynamics

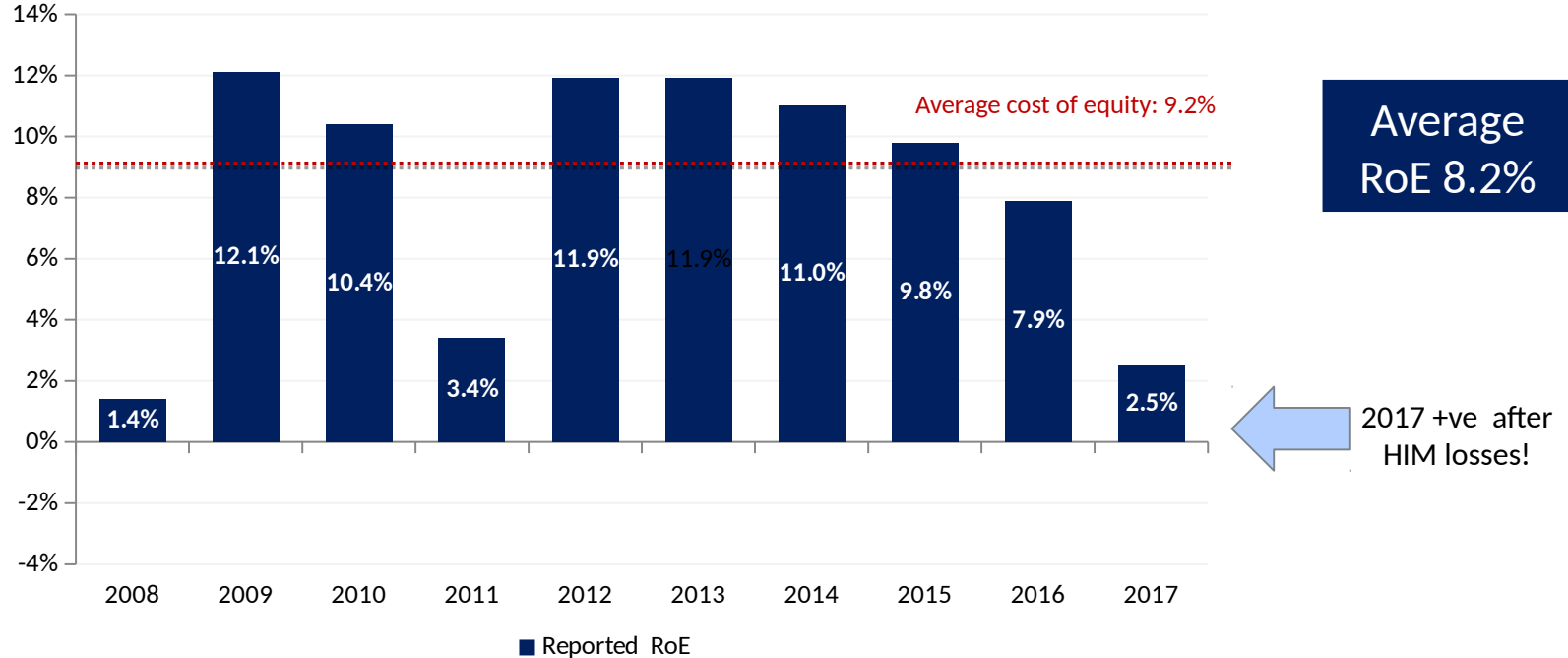
Global Insurance Composite renewal rate change



Source: Marsh

What's changing – Industry dynamics

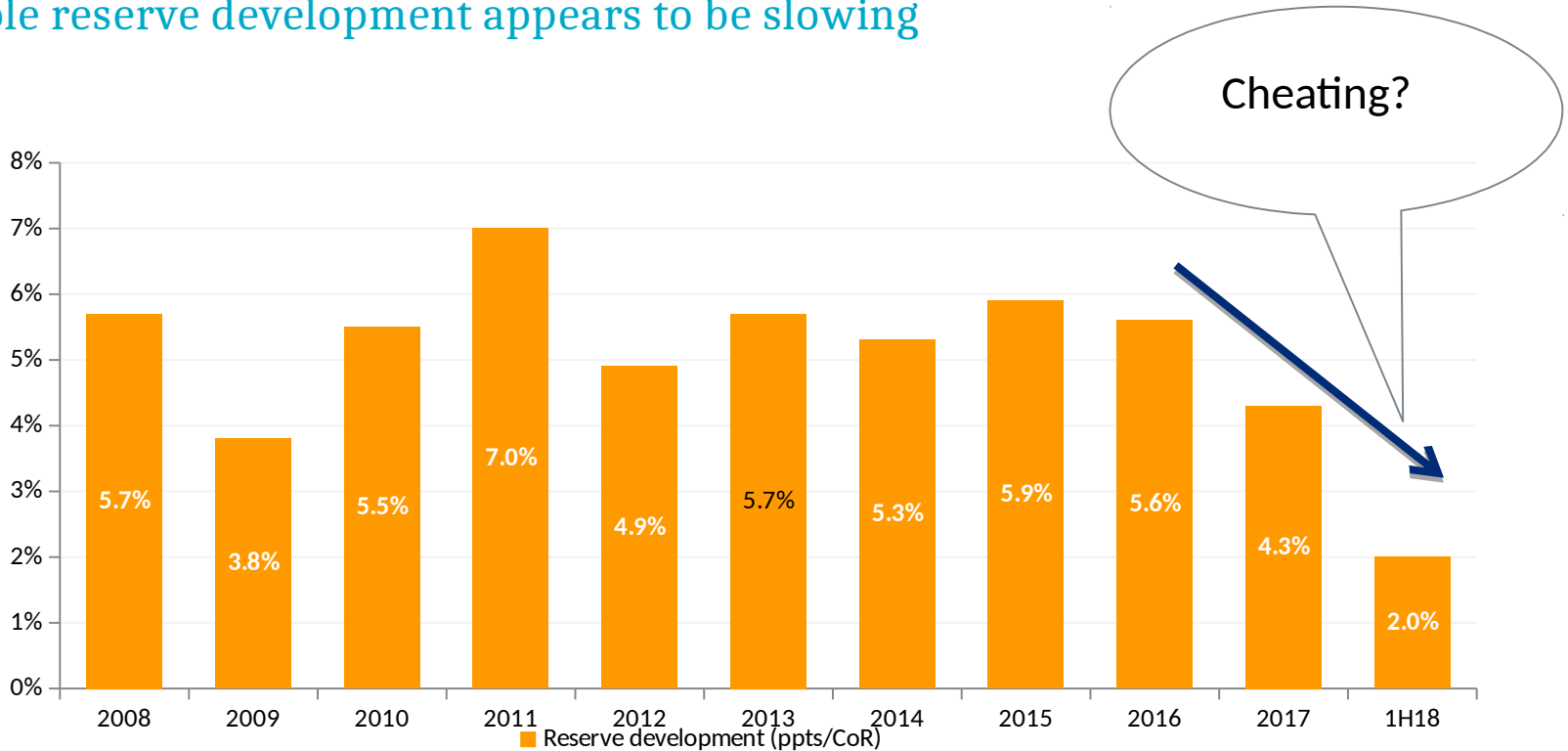
Return on equity - falling but the industry is still making money



Source: GC Reinsurance Composite, Bloomberg, Guy Carpenter estimates

What's changing – Industry dynamics

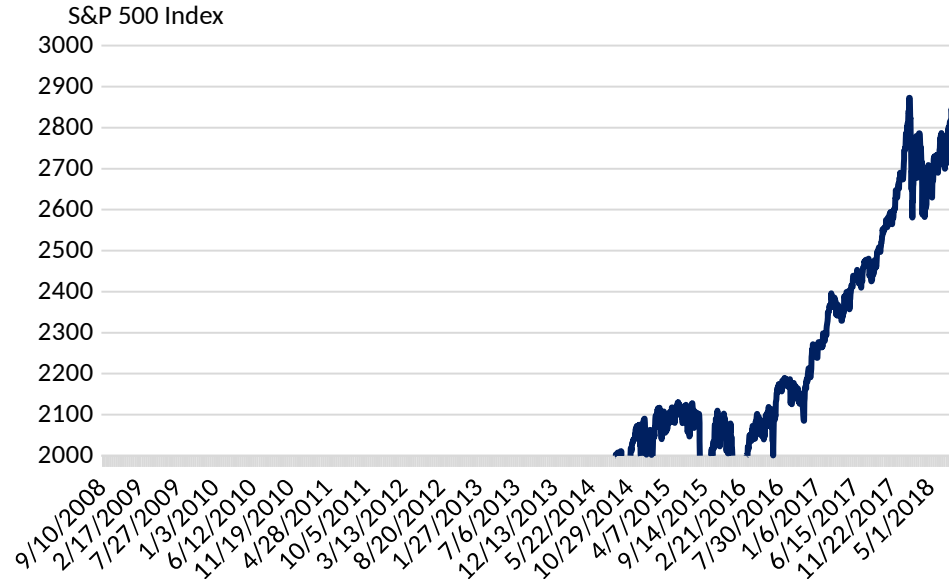
Favourable reserve development appears to be slowing



Source: GC Reinsurance Composite, Guy Carpenter estimates

Macro factors - Implications

The industry has benefitted from favourable financial markets



- **Developed economies grow for 3 years ~3%pa**
 - propelling corporate earnings
 - exposure growth
- **The S&P500 is at a record high**
 - longest bull market in history
- **Bond yields are low**
 - corporate credit spreads are very tight
- **Market volatility**
 - historically low
 - Inflation benign
- **All of these factors have contributed to:-**
 - strong balance sheets
 - favourable reserve development
 - earnings growth

(1) Shiller P/E or CAPE ratio based on average inflation adjusted earnings from the previous 10 years

Source: Bloomberg

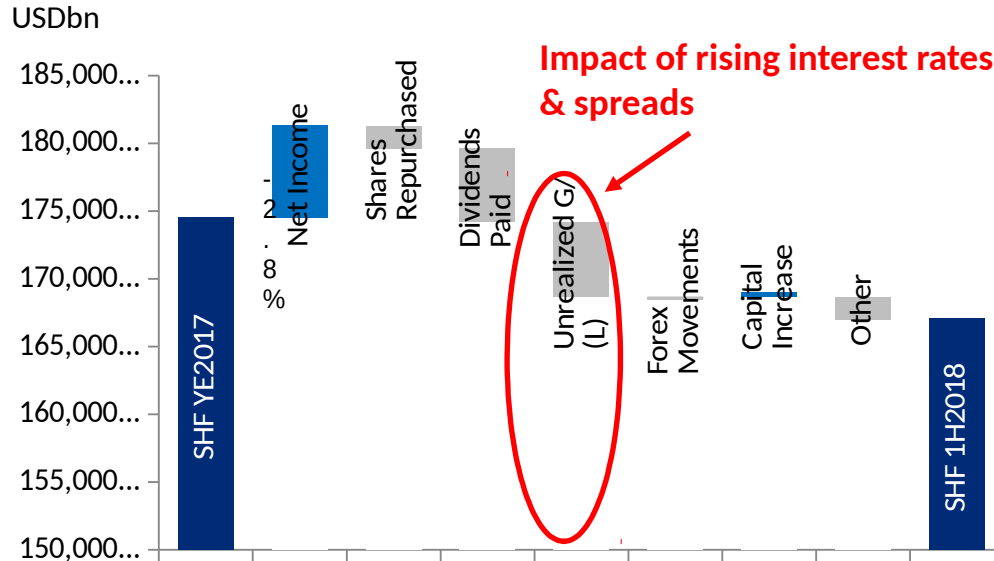
Macro factors - Implications

Storm clouds ahead?

Global economic cycle reaching a peak	= slower demand growth	= lower earnings growth, lower equities valuations
Quantitative Tightening	= higher interest rates & risk premia	= lower book values & capital, higher WACC ILS disruption, higher earnings (maybe)
Globally debt ~+40% since 2008	= wider credit spreads & defaults	= lower BVs & Capital, higher WACC
Stronger USD	= emerging markets distress, contagion	= higher US earnings and net assets for non-USD reporting
Higher inflation	= Central Banks' policy failure	= higher claims cost, reserve additions, lower earnings & BVs
Geopolitical risks	= higher tariffs, BREXIT, EMs	= financial market volatility, inflation, stagflation

Macro factors - Implications

Balance sheets are vulnerable to macro risks



Source: GC Reinsurance Composite

- Even in 2017 the GC Reinsurance Composite achieved net income of USD4.4bn (~USD120bn in the last 10 years)
- In 1H18 the GC Reinsurance Composite had net income of USD6.8bn
- But this was offset by unrealised investment losses as financial markets were affected by “Quantitative Tightening”

Key Takeaways

Speed Read

1. Supply driven demand for reinsurance fuelled by Alternative Capital
- +
2. Strong balance sheets
- +
3. Low loss activity in H1 2018
- =
4. Rating pressure at 1st January renewals

BUT

Macro risks are rising

Key Takeaways

Speed Read

1. Buyers and sellers are open for business
2. Opportunities to solve strategic capital and volatility issues
3. Innovation
4. Assist clients manage the VUCA
 - Volatile, Uncertain, Complex and Ambiguous world ahead



GUY CARPENTER

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