Moody's
Investors Services

Dowling & Partners

CLRS: Rating Agency and Investor view of the Financial Conditions of P&C Insurers

Sarah Hibler, Moody's, Associate Manging Director

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Polling Question #1

What is the largest threat facing the P&C Industry today?

A.) Social Inflation

B.) COVID-19 pandemic

C.) Low Fixed Income Investment Returns

D.) Technology (e.g., Tech Companies challenging traditional P&C Industry, Driverless cars, etc.)

E.) Other

Polling Question #2

What is your view on the future of the US Economy? Assume 2020 GDP ends the year down 20% or more

A.) Stock market remains strong so everything is great and there are no concerns

B.) GDP in 2021 will be flat with 2020

C.) GDP will bounce back in 2021 with gains of 20% or more

D.) GDP in 2021 will continue to decrease leading to significant recession

E.) There is going to be a trickle down effect and we will enter in a financial crisis in 2021, similar to 2007 - 2008

MOODY'S INVESTORS SERVICE

Access is everything™

CLRS: Rating agency and investor view on the financial condition of P&C insurers

Sarah Hibler, Associate Managing Director

September 2020

Access is everything™

Expertise

A comprehensive view of the global markets through our ratings and research.

Credibility

Over 100 years of experience delivering forward-looking, independent, stable and transparent opinions.

Engagement

Meaningful interactions across multiple channels between our analysts and market participants.

1

Moody’s ratings and P&C scorecard

Moody’s global presence

$72+ trillion
of Total Rated Debt

- **4,700** Rated Non-Financial Corporates
- **4,100** Rated Financial Institutions
- **138** Rated Sovereigns
- **47** Rated Supranational Institutions
- **450** Rated Sub-Sovereigns
- **17,700** Rated Public Finance Issuers
- **11,000** Rated Structured Deals
- **1,000** Rated Infrastructure & Project Finance Issuers
- **213** Rating Methodologies

11,500 MCO employees

1,100+ Analysts

24 Countries

Americas	EMEA	Asia Pacific
32,500 Rated Companies and Structured Deals	**4,600** Rated Companies and Structured Deals	**2,000** Rated Companies and Structured Deals
$34+ trillion Total Debt Rated	**$21+ trillion** Total Debt Rated	**$15+ trillion** Total Debt Rated
19,900 Research Publications	**7,000** Research Publications	**3,100** Research Publications

MOODY'S INVESTORS SERVICE OFFICES

Americas	EMEA		Asia Pacific	
United States	Cyprus	Poland	Australia	Japan
Canada	Czech Rep.	Russia	China	Korea
Argentina	DIFC	South Africa	Hong Kong	Singapore
Brazil	France	Spain	India	
Mexico	Germany	Sweden		
	Italy	UK		

EVENTS

46,000 Global Participants

12,000 Global Outreach Activities, including:

- Conferences
- Teleconferences
- Roundtables

RESEARCH

30,000 Research Publications

- **22,500** Company Research
- **3,100** Industry Research
- **4,400** Other Research

RESEARCH PUBLICATIONS BY SEGMENT

12,300	Non-Financial Corporates
5,600	Financial Institutions
1,700	Sovereign & Sub-Sovereign
5,700	U.S. Public Finance
2,000	Structured Finance
2,000	Infrastructure & Project Finance
700	Cross Sector

Number of MCO employees as of August 2017; all other data as of 31 December 2017 except Events and Research figures which cover the period 1 January 2017 to 31 December 2017. Numbers of rated entities (other than sovereigns and supranational institutions) and structured deals, research publications and event participants/activities rounded to nearest hundred.

Moody’s insurance financial strength ratings

- Ratings are viewed on both an absolute and relative basis
- Globally consistent across geographic regions and industries
- Ratings reflect both the likelihood of default and any financial loss suffered in the event of default (severity)
- IFS rating starting point; debt ratings generally notched down from IFS rating

Investment Grade IFS Rating

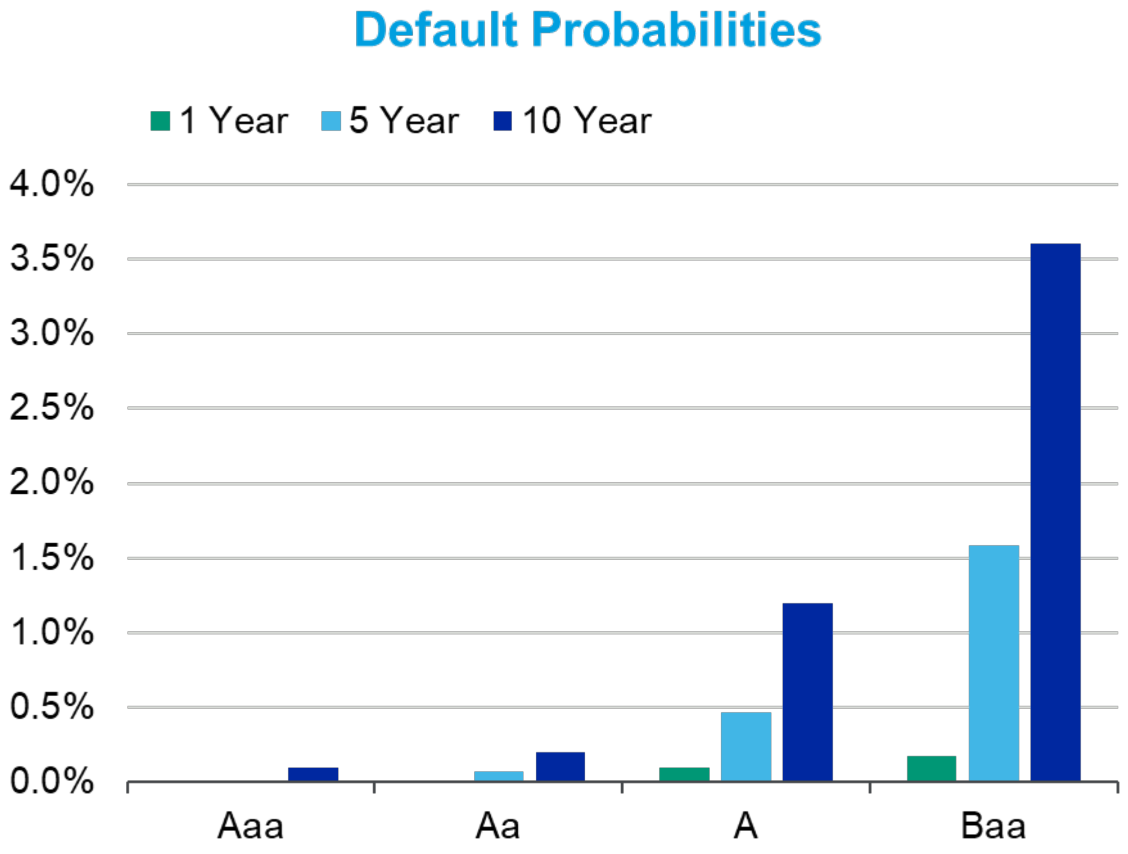
- Aaa
- Aa1, Aa2, Aa3
- A1, A2, A3
- Baa1, Baa2, Baa3

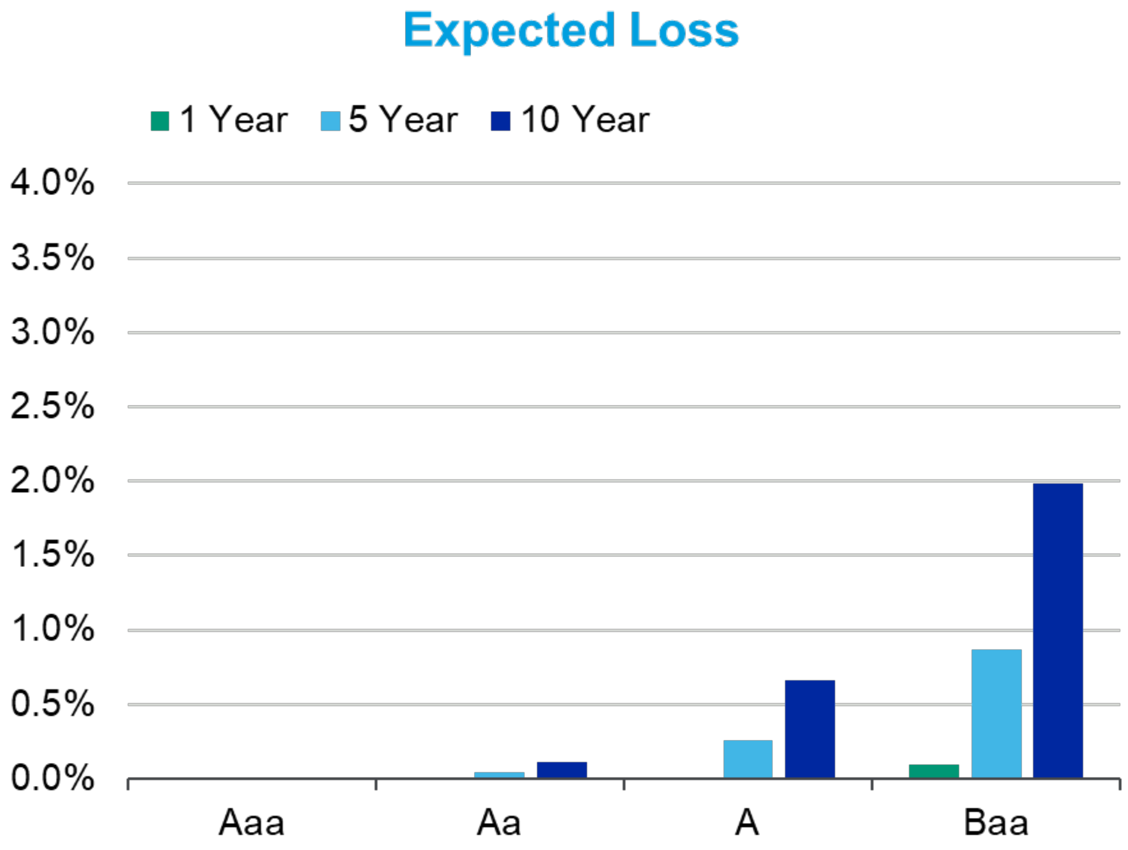
Non-Investment Grade IFS Rating

- Ba1, Ba2, Ba3
- B1, B2, B3
- Caa1, Caa2, Caa3
- Ca/C

Meaning of Moody's ratings

Likelihood of default and expected loss for selected time horizons





The lowest "Secure" rating (Baa) has the annual default probability of a "500 Year" event

Moody’s sample P&C insurance scorecard

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adj Score
Business Profile								Aa	Aa
Market Position, Brand and Distribution (25%)								A	A
-Relative Market Share Ratio			X						
-Underwriting Expenses % Net Premiums Written				31.0%					
Product Focus and Diversification (10%)								Aa	Aa
-Product Risk			X						
-P&C Insurance Product Diversification		X							
-Geographic Diversification		X							
Financial Profile								Aa	A
Asset Quality (10%)								Aa	Aa
-High Risk Assets % Shareholders' Equity		35.0%							
-Reinsurance Recoverable % Shareholders' Equity		55.0%							
-Goodwill & Intangibles % Shareholders' Equity			40.0%						
Capital Adequacy (15%)								A	A
-Gross Underwriting Leverage			3.5x						
Profitability (15%)								Aa	A
-Return on Capital (5 yr. avg.)		8.0%							
-Sharpe Ratio of ROC (5 yr.)			250.0%						
Reserve Adequacy (10%)								A	A
-Adv. (Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd. avg.)			-1.0%						
Financial Flexibility (15%)								Aa	A
-Adjusted Financial Leverage		24.0%							
-Total Leverage		26.0%							
-Earnings Coverage (5 yr. avg.)			7.0x						
-Cash Flow Coverage (5 yr. avg.)		8.0x							
Operating Environment								Aaa - A	Aaa - A
Preliminary Standalone Outcome								Aa3	A1

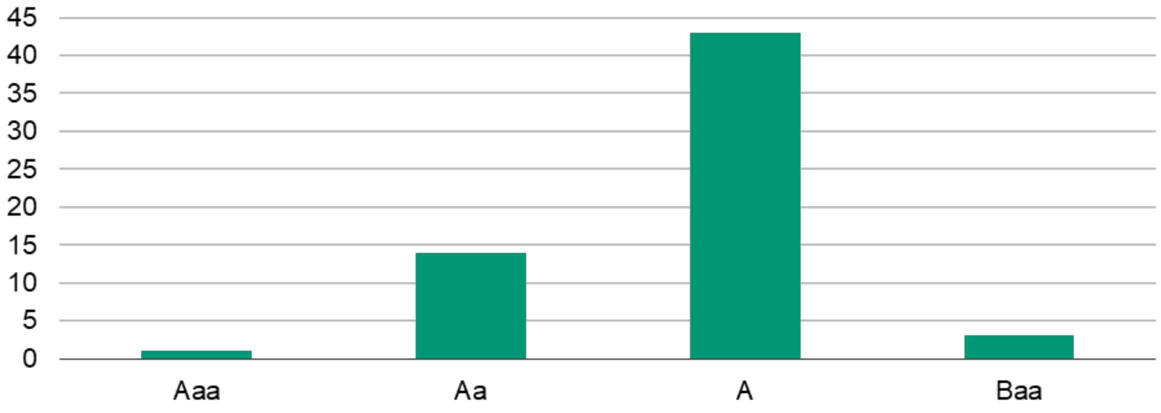
[1] Information based on US GAAP financial statements as of fiscal year ended December 31, 2019.
[2] The Scorecard rating is an important component of the company's published rating, reflecting the standalone financial strength before other considerations (discussed above) are incorporated into the analysis.
Source: Moody’s Investors Service

2

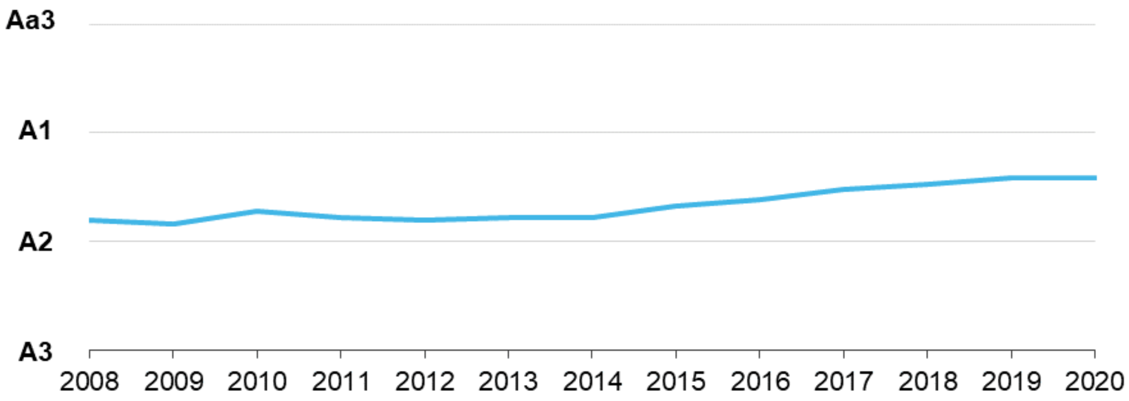
Moody’s rating trends and outlook

Rating trends in North American P&C insurance

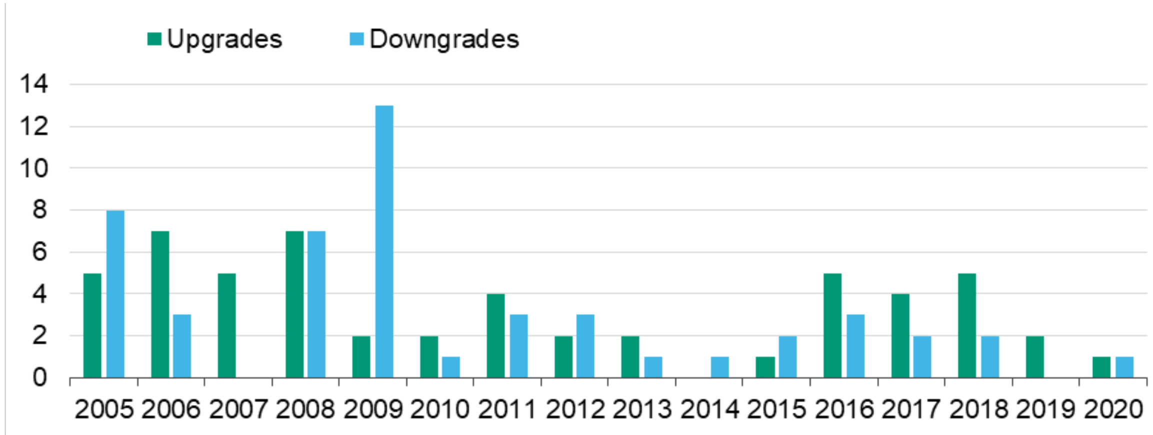
Rating distribution (61 Groups)



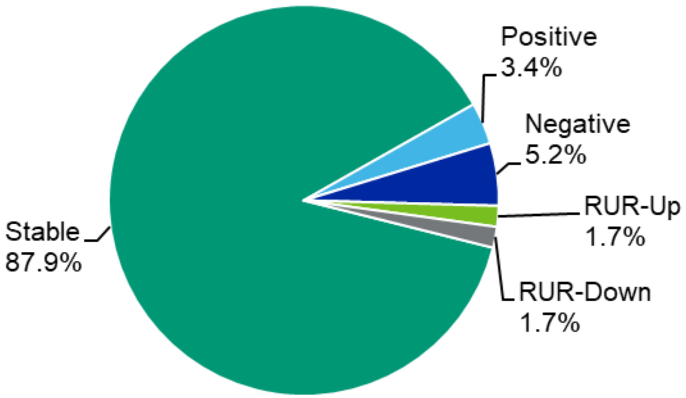
Average IFS rating



Upgrades and downgrades



Outlook distribution



Source: Moody's Investors Service as of August 13, 2020

US P&C insurance outlook – Stable

NEGATIVE

What could change outlook to negative

- Sustained P&C loss cost inflation in excess of pricing trends, leading to weak profitability and reserve deficiencies
- Large increase in catastrophe exposure relative to capital
- Projected 10% decline in P&C industry capital
- Economic recession extending for several quarters

STABLE

Key drivers

- Solid capitalization, with conservative investment portfolios tempered by thinning reserve margins
- Disciplined underwriting, prudent use of reinsurance, good risk management
- Positive commercial lines pricing trends help offset rising liability claims and volatile property claims
- Low investment yields weigh on insurers' profit margins
- Mandatory nature of many P&C products helps industry weather economic downturn

POSITIVE

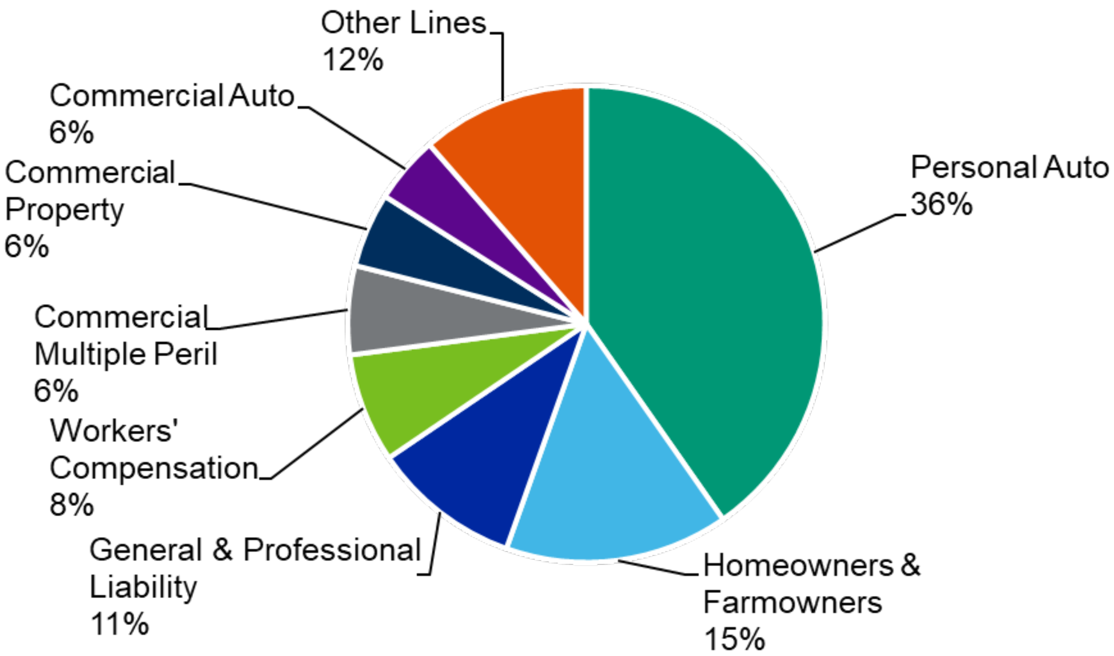
What could change outlook to positive

- Sustained P&C price increases in excess of loss cost trends, coupled with robust capital
- Gradual rise in interest rates, e.g., up 2%-3% from early-2020 levels
- Quick economic recovery, with sustained real GDP growth in the mid-single digits

Coronavirus claims rise; ongoing uncertainty

Loss estimates for the industry are challenging, multiple business lines and geographies affected

US P&C industry direct prems written by line - many coverages are mandatory
Aggregate direct premiums written in 2019: $707 billion



Legal risks
Disputes around BI exclusion clauses

Political pressure
Ex gratia payments

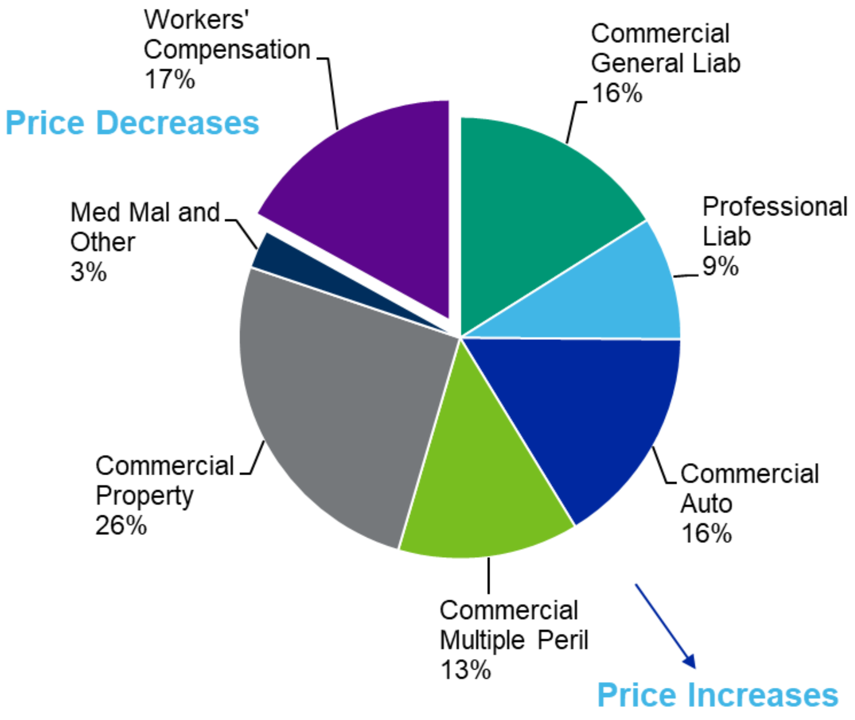
Social pressure
Premium rebates

Sources: SNL Financial L.C. (Contains copyrighted and trade secret materials distributed under license from SNL, for recipient's internal use only), Moody's Investors Service

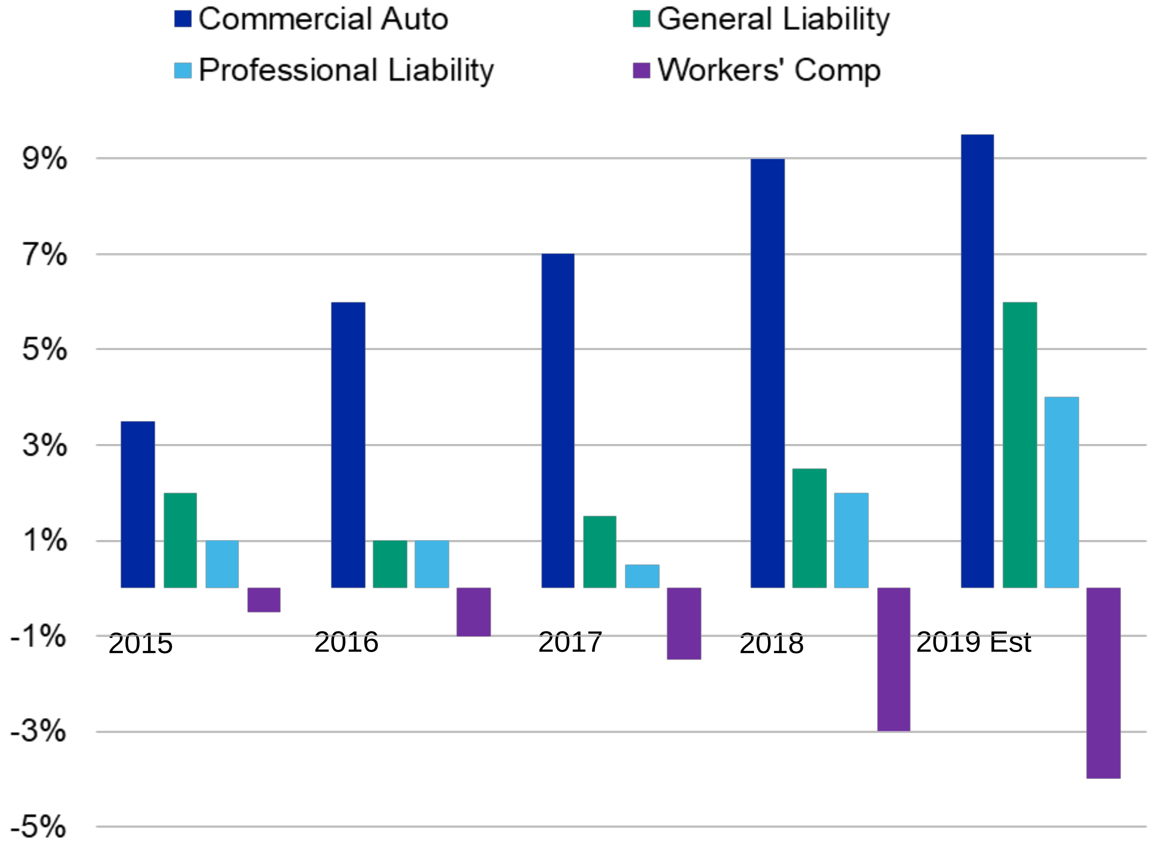
Commercial exposures decline while prices rise

Commercial premium mix by business line

Yearly direct premiums about $345 billion



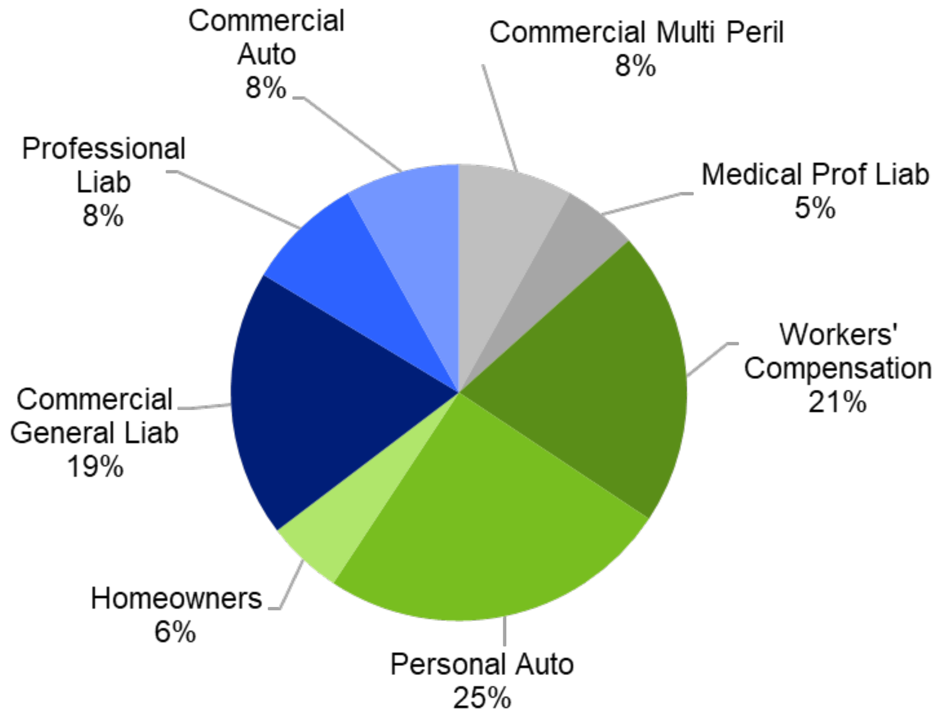
Yearly rate changes by business line



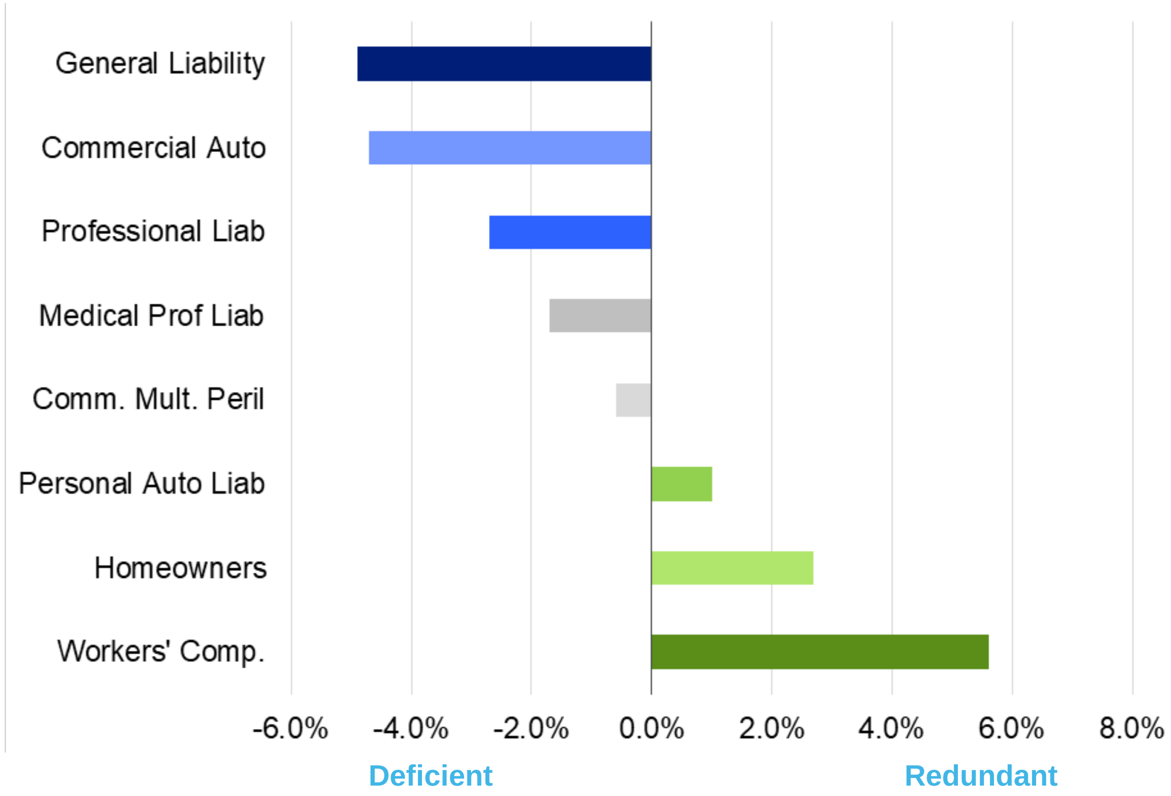
Note: Right-hand chart incorporates Moody’s yearly issuer pricing surveys
Sources: SNL Financial L.C. (Contains copyrighted and trade secret materials distributed under license from SNL, for recipient’s internal use only), Moody’s Investors Service

Reserves adequate, big differences by line

Reserves by line of business



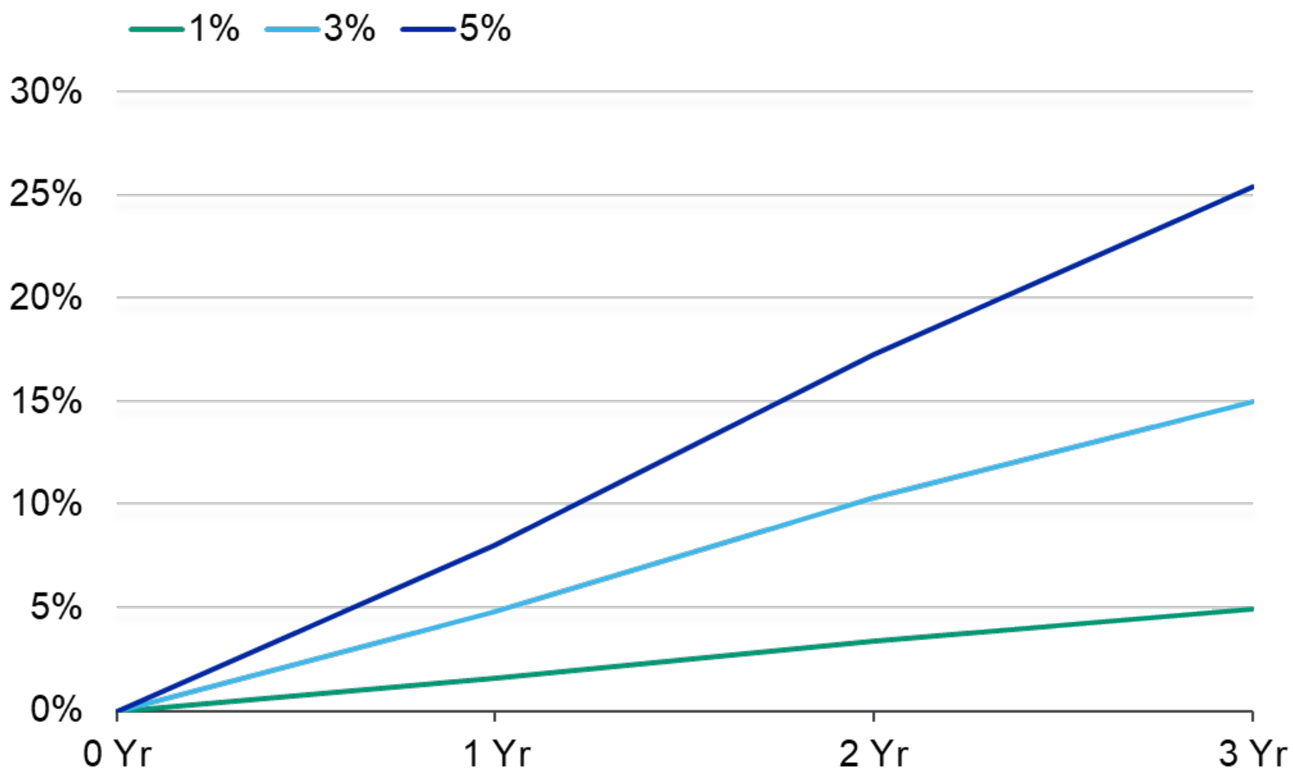
Moody’s reserve estimates as of year-end 2019



Sources: SNL Financial L.C. (Contains copyrighted and trade secret materials distributed under license from SNL, for recipient’s internal use only), Moody’s Investors Service

Commercial insurers exposed to claims inflation

Indicative reductions in surplus (%) from unexpected claims inflation



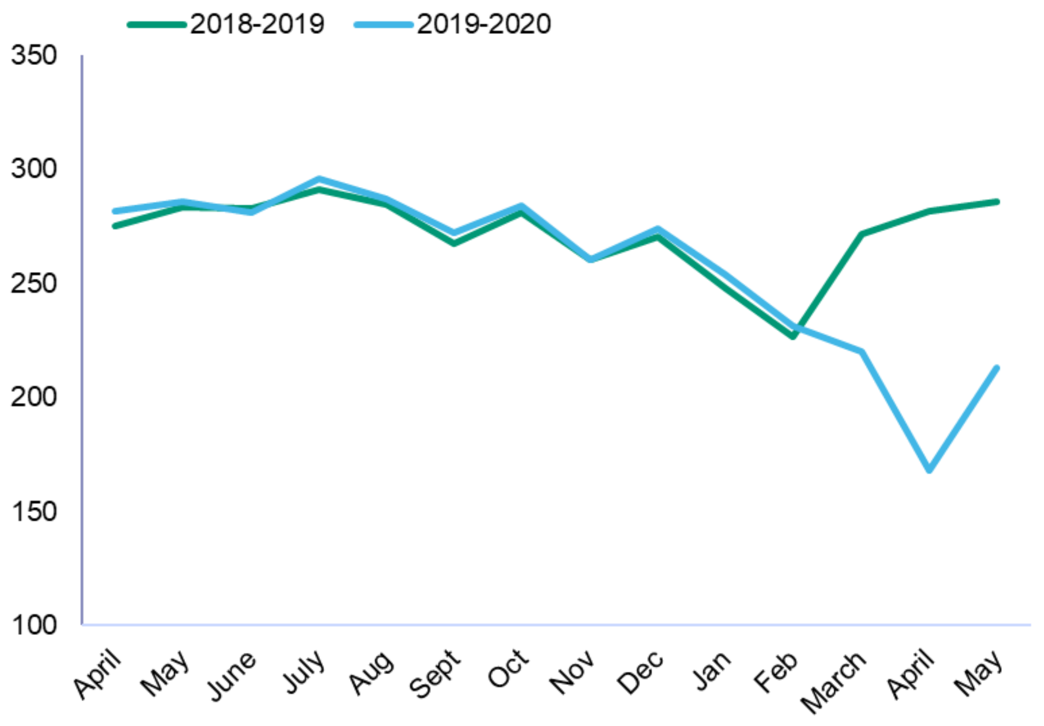
- **Rising loss cost trends**
  - Rising jury awards
  - Litigation financing
  - Forum shopping
  - Securities class actions

- **Emerging risks**
  - Opioids, Roundup, talc
  - Climate change liability
  - Cyber attacks

Note: Chart reflects Moody's estimates of median reductions in surplus for top 20 commercial insurers at 1%, 3% and 5% claims inflation
Sources: SNL Financial L.C. (Contains copyrighted and trade secret materials distributed under license from SNL, for recipient's internal use only), Moody's Investors Service

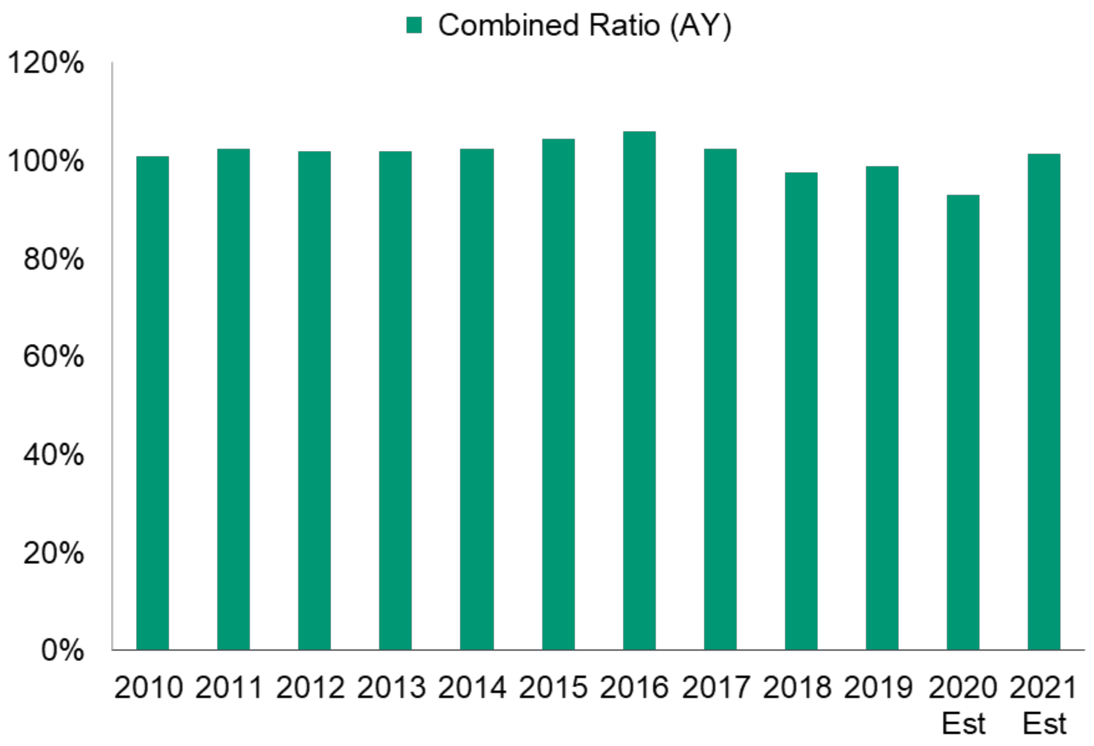
Drop in personal auto frequency drives premium rebates

Miles driven decline significantly in March



US billions of miles driven by month

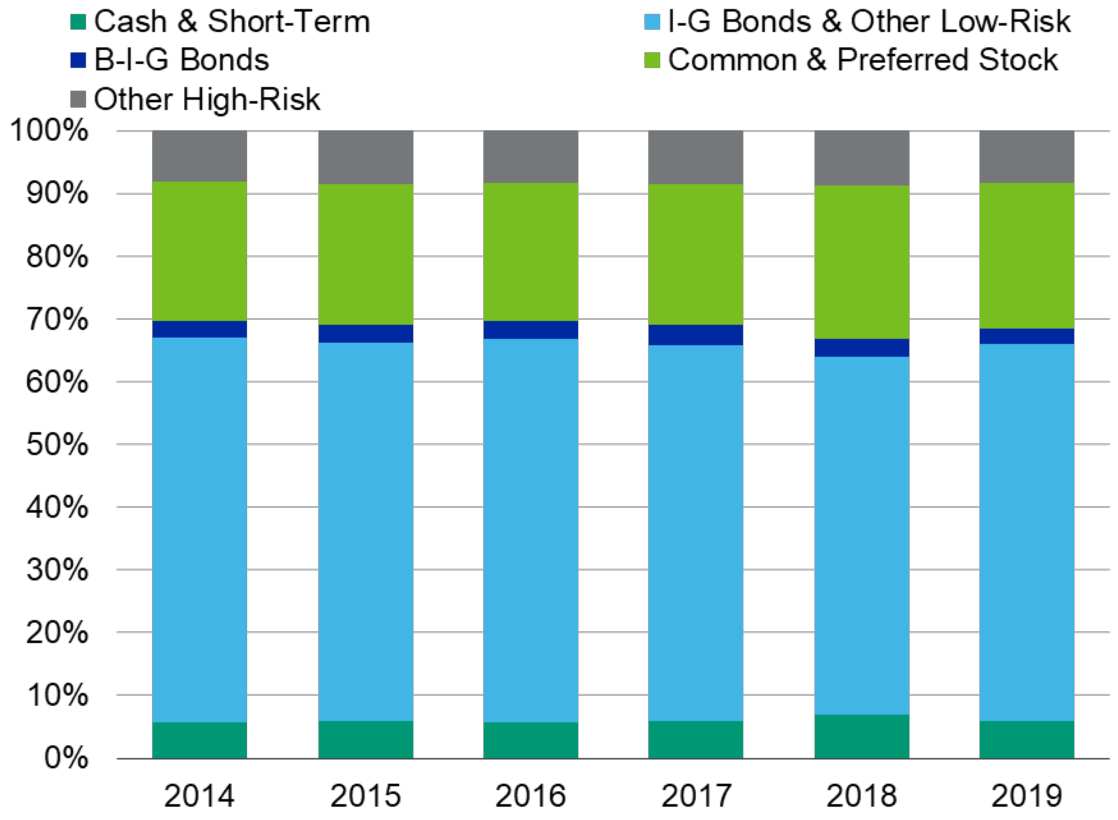
Personal auto combined ratio estimates



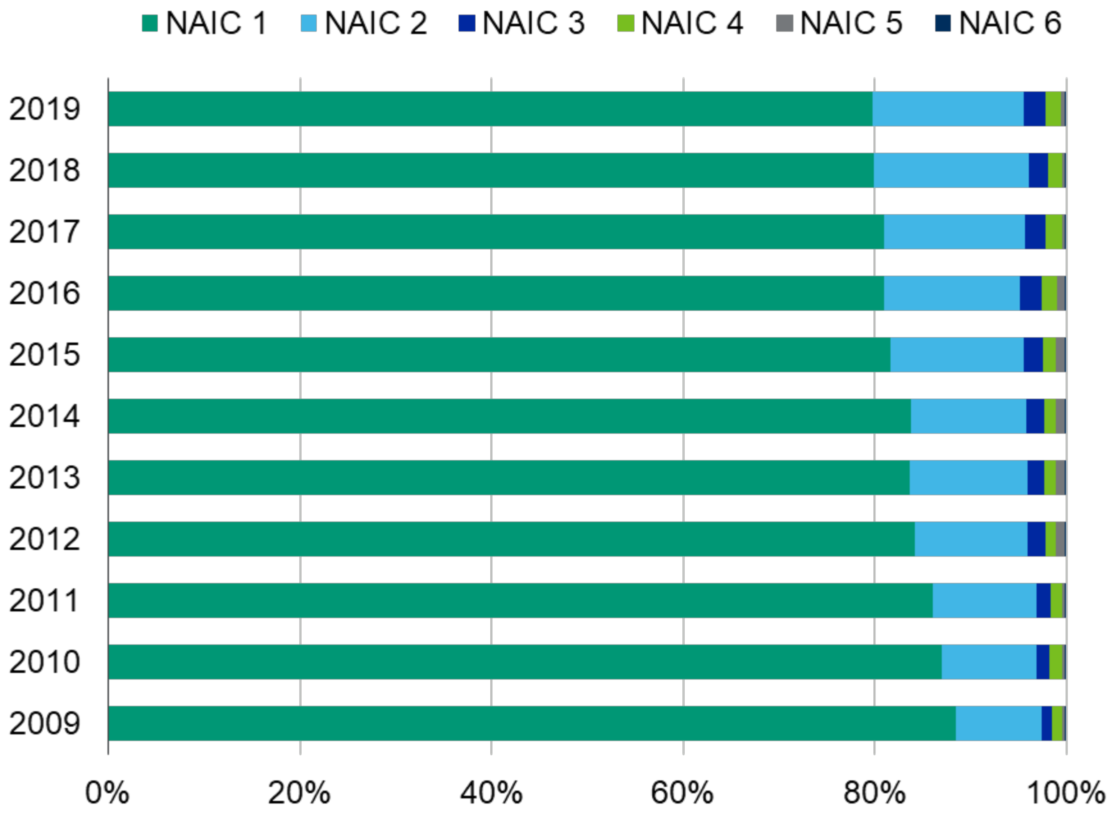
Sources: Federal Reserve Economic Data/St Louis Fed, SNL Financial L.C. (Contains copyrighted and trade secret materials distributed under license from SNL, for recipient's internal use only), Moody's Investors Service

High quality fixed income portfolios, strong liquidity

P&C investment allocation



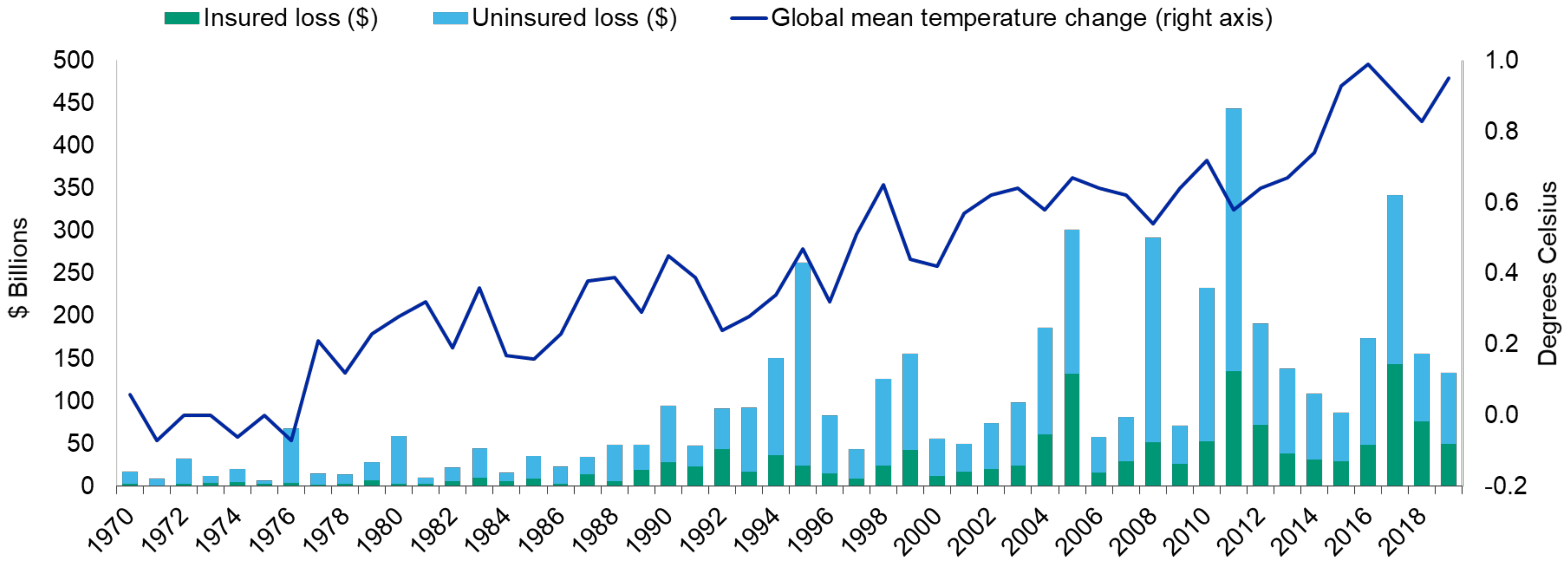
High quality fixed income portfolios



Sources: SNL Financial L.C. (Contains copyrighted and trade secret materials distributed under license from SNL, for recipient’s internal use only), Moody’s Investors Service

Natural catastrophes becoming more costly

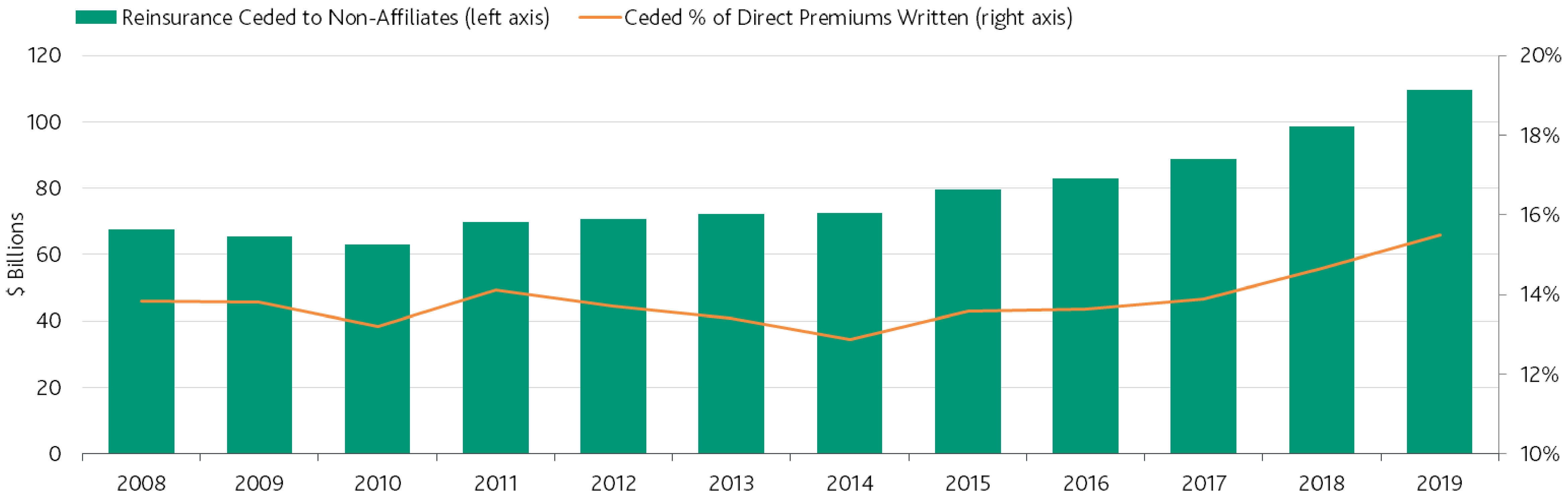
Global insured and uninsured natural catastrophe losses and rising temperatures



Note: Dollar amounts indexed to 2018; global mean temperature variations based on yearly NOAA global land and ocean temperatures relative to 100-year mean for 1901-2000
Source: Swiss Re Sigma, NOAA National Centers for Environmental Information, Moody’s Investor Service

P&C insurers buy more reinsurance

Reinsurance ceded



Source: SNL Financial L.C. (Contains copyrighted and trade secret materials distributed under license from SNL, for recipient's internal use only), Moody's Investor Service

Lasting economic and social impacts

Change in customer behaviors

- Travel
- Use of technology

Partnerships with governments

- Political pressure here to stay

Asset risk

- Risk of stranded assets (commercial real estate?)
- Profitability and capital risks

Economic slowdown

- Lower premiums

MOODY'S
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P/C (RE)INSURER FINANCIAL CONDITION
AN EQUITY ANALYST PERSPECTIVE

September 2020

Dowling & Partners

Kyle LaBarre

SETTING THE STAGE …

P/C Insurance Is A "Simple" Business In Theory,
But <u>Very</u> Difficult To Execute Well

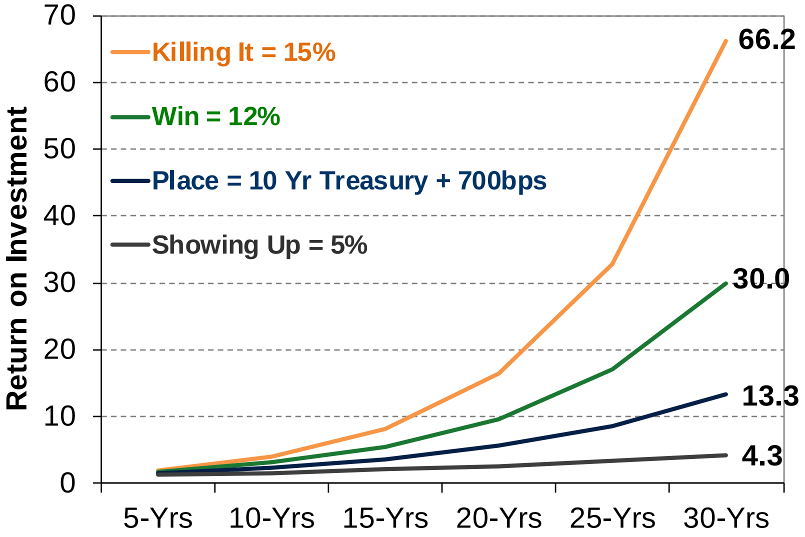
SIX KEY INVESTMENT THEMES …

- Over The Long Term The **Only Measure Of Financial Success For Owners Of A Property/Casualty (Re)Insurer Is Growth In Tangible Book Value (Equity) Per Share.** Share Price Tracks Book Value Over Time. Volatility Matters. So Does Avoiding The "Big Mistake".
- **Underwriters' Reported Financial Statements Are Always Wrong**. Reported Results, With The Income Statement Driving The Balance Sheet, Are Either Too High Or Too Low (Intentionally Or Not) = But Are Always Inaccurate.
- **Rating Agencies = Have Been The De-facto Regulators**
- "**He Who Controls The Customer Wins**" = Intermediaries Capture Outsized Returns Relative To Underwriters On An Absolute & Risk Adjusted Basis.
- **"Bermuda Was a Better Mousetrap"** And Underwriters Operating From The U.S., Paying Full U.S. Taxes, Are At A Distinct Competitive Disadvantage.
- In The Aggregate **(Re)insurance Has Been/Is/And For The Investable Future Will Be A Lousy Business** (Fails To Earn Its Cost Of Capital Over Time).

"SUCCESS" IS GROWING TANGIBLE BOOK VALUE/SHARE OVER TIME

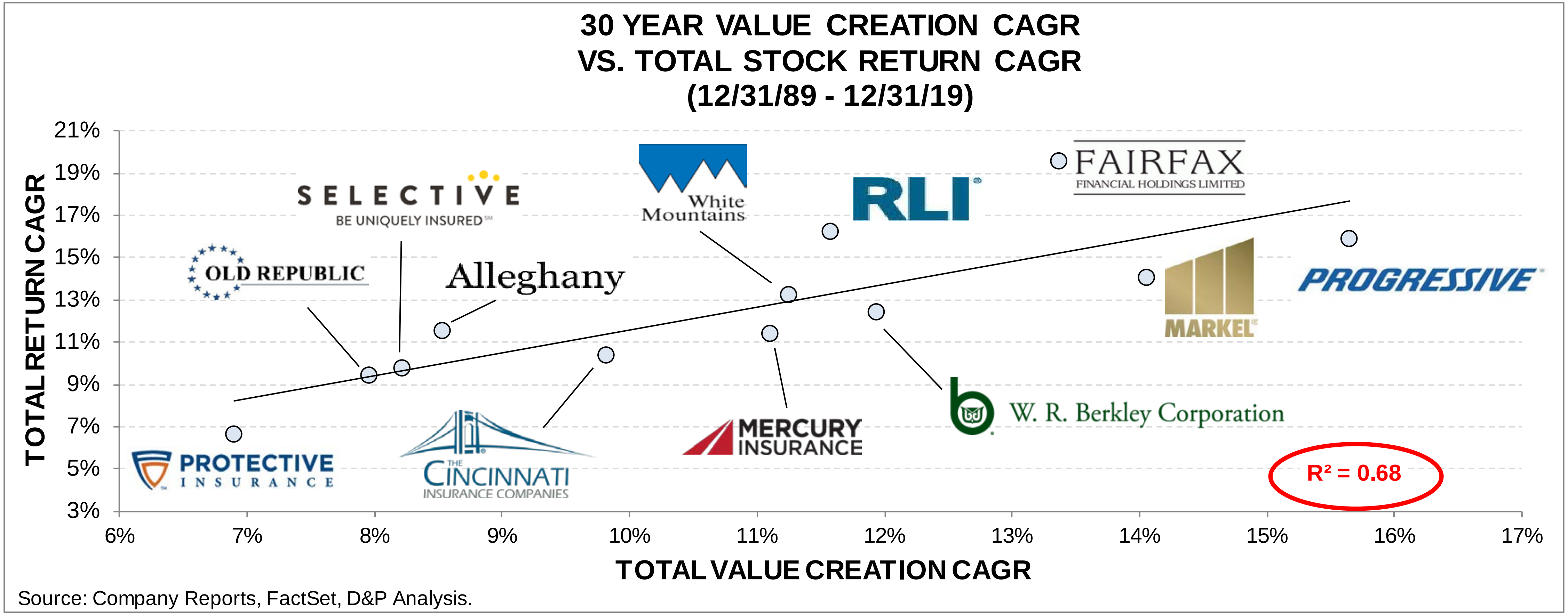
- ❑ Long-term Stock Price Tracks Growth In Book Value Per Share
- ❑ We Think About Companies In 3 Categories:
  - ❑ WIN = 12%+
  - ❑ PLACE = 10 Year Treasury + 700 bps
  - ❑ Just "SHOWing Up" = 5%
- ❑ (Re)insurance Is All About The Magic Of Compounding Returns
- ❑ Compounding Book Value At 12% Per Year = "Double" Every 6 Years

	Win	Place	Show
Length of Time	12%+	~9%	5%
5-Years	1.8	1.5	1.3
10-Years	3.1	2.4	1.6
15-Years	5.5	3.6	2.1
20-Years	9.6	5.6	2.7
25-Years	17.0	8.6	3.4
30-Years	30.0	13.3	4.3



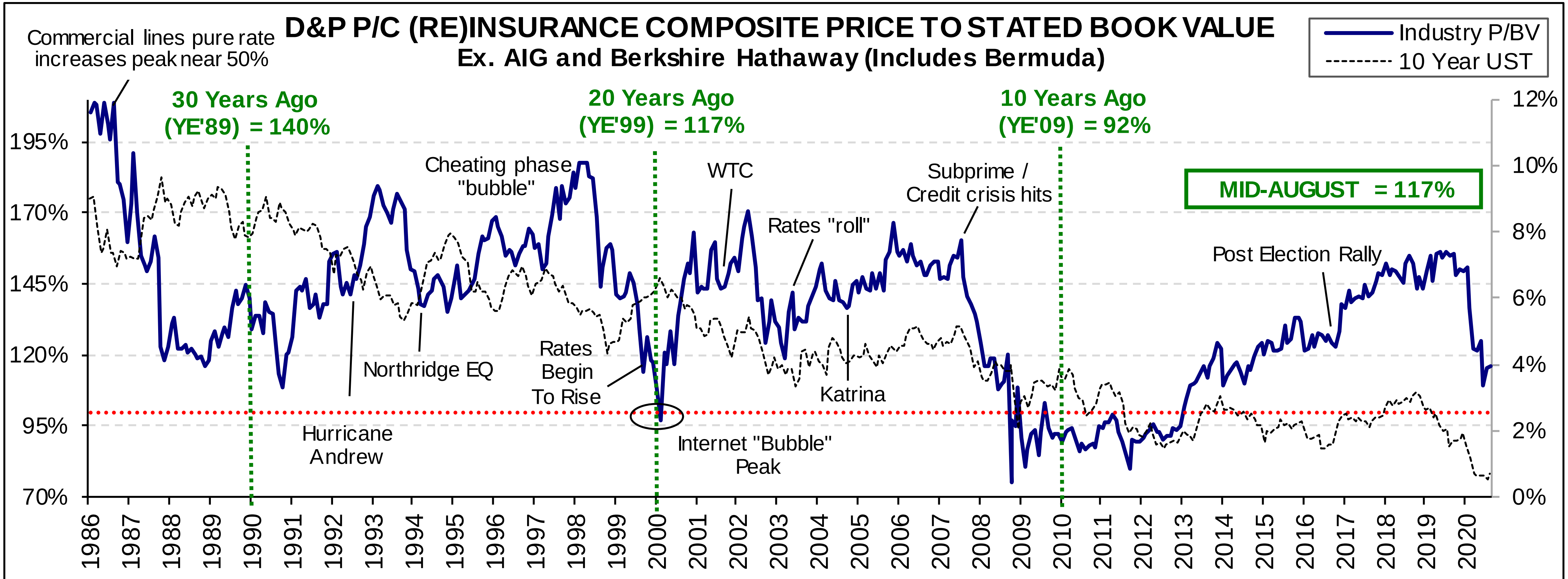
Source: D&P Analysis

LONG TERM STOCK PRICE TRACKS BOOK VALUE (/SH) GROWTH



Source: Company Reports, FactSet, D&P Analysis.

30+ YEARS OF DECLINING PEAK VALUATIONS



Source: FactSet, D&P Analysis. Note: Current P/BV Adjusted For Estimated MTM Impact

5 LEVERS TO BUILD BOOK VALUE PER SHARE:

Underwriting = #1 Driving Force & Price of Entry To “Win”

Investment of “Float” = Loss Reserves/Unearned Premium

Investment of Capital/Surplus

Capital Management

- Capital Structure = Appropriate Use of Non-Equity Capital
- Sale/Repurchase of Common Stock At Opportune Times
- Dividend Policy = “Regular” & Special Dividends

Location of Domicile

HOW (RE)INSURERS MAKE $
OUR "DUPONT" MODEL FOR RETURN ON EQUITY

Underwriting Margin X Underwriting Leverage = U/wing ROE Contribution

(Net Premiums Earned / Shareholders' Equity)

+

Investment Yield X Investment Leverage = Investment ROE Contribution

(Invested Assets / Shareholders' Equity)

+

All Other

= Pre-tax ROE

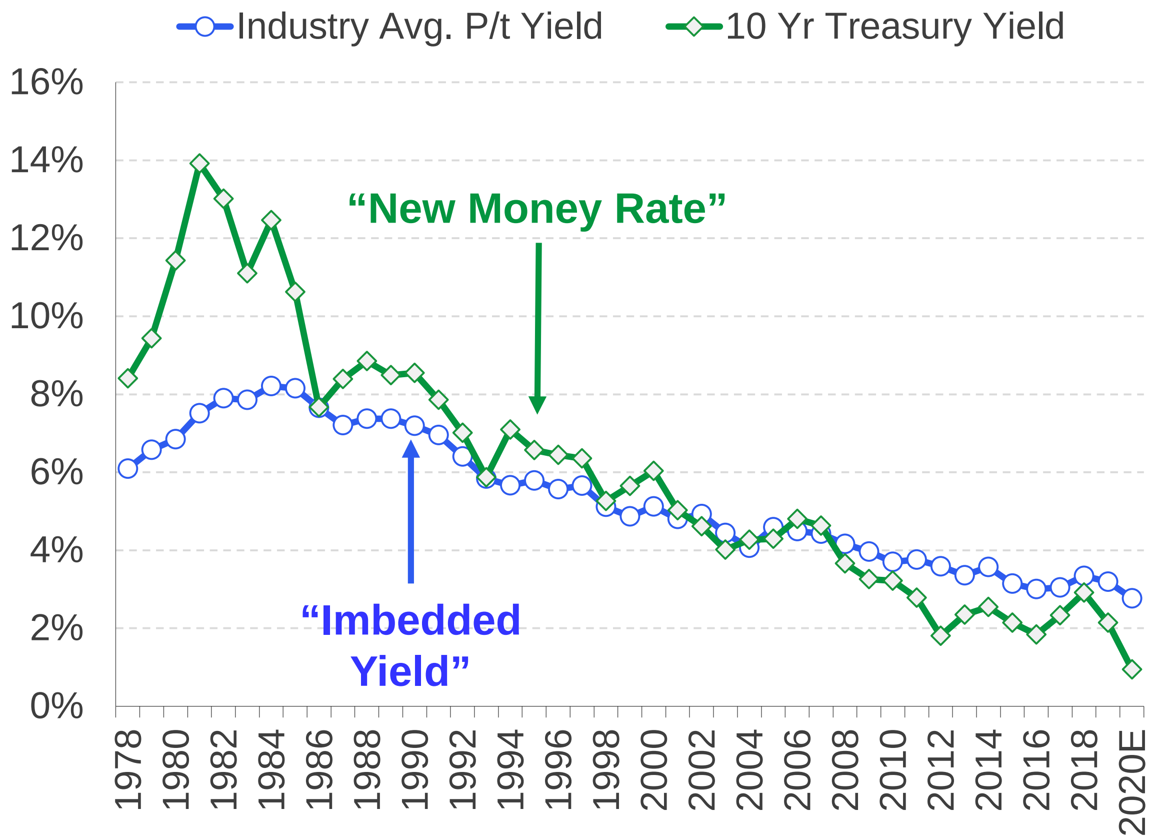
-

Tax

= After-tax ROE

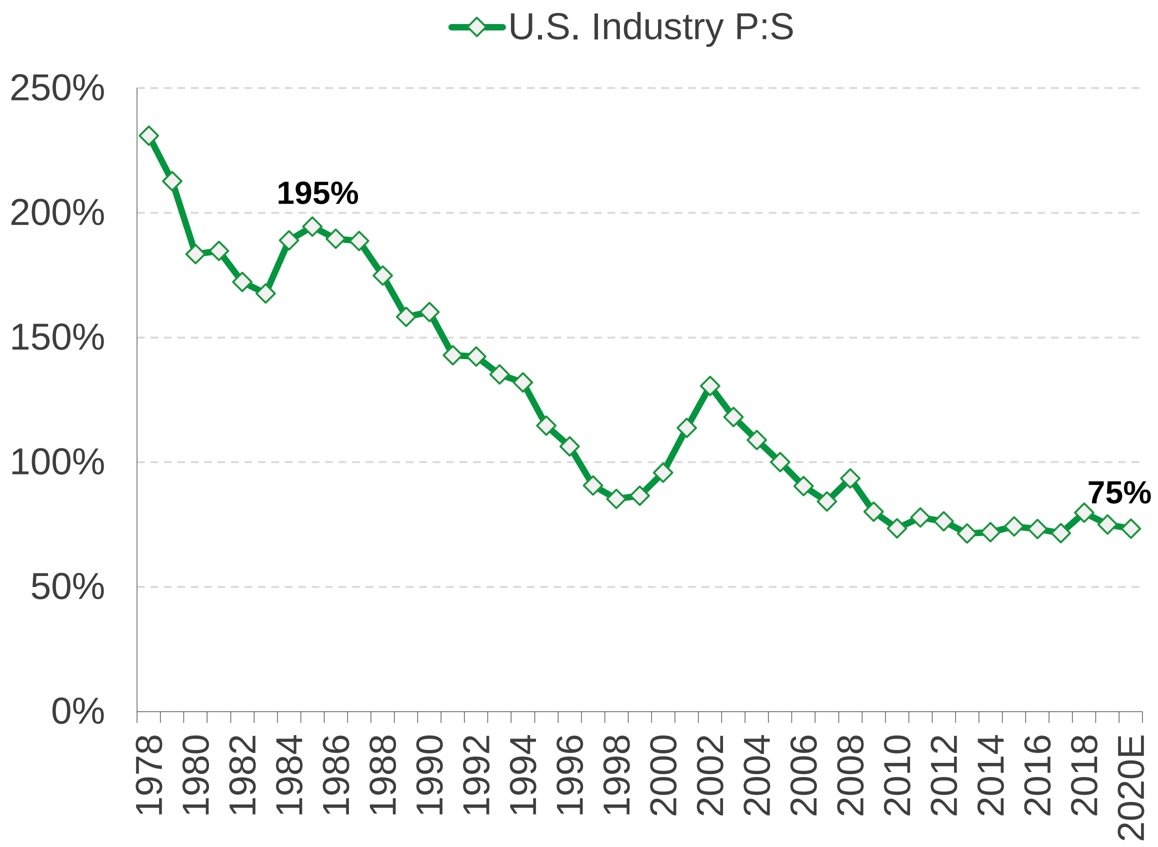
CYCLICAL CHANGES SUPPRESSING RETURNS: 40 YEARS OF BOTH LOWER INTEREST RATES & LEVERAGE

AVG. P/T NII YIELD VS. 10 YEAR TREASURY

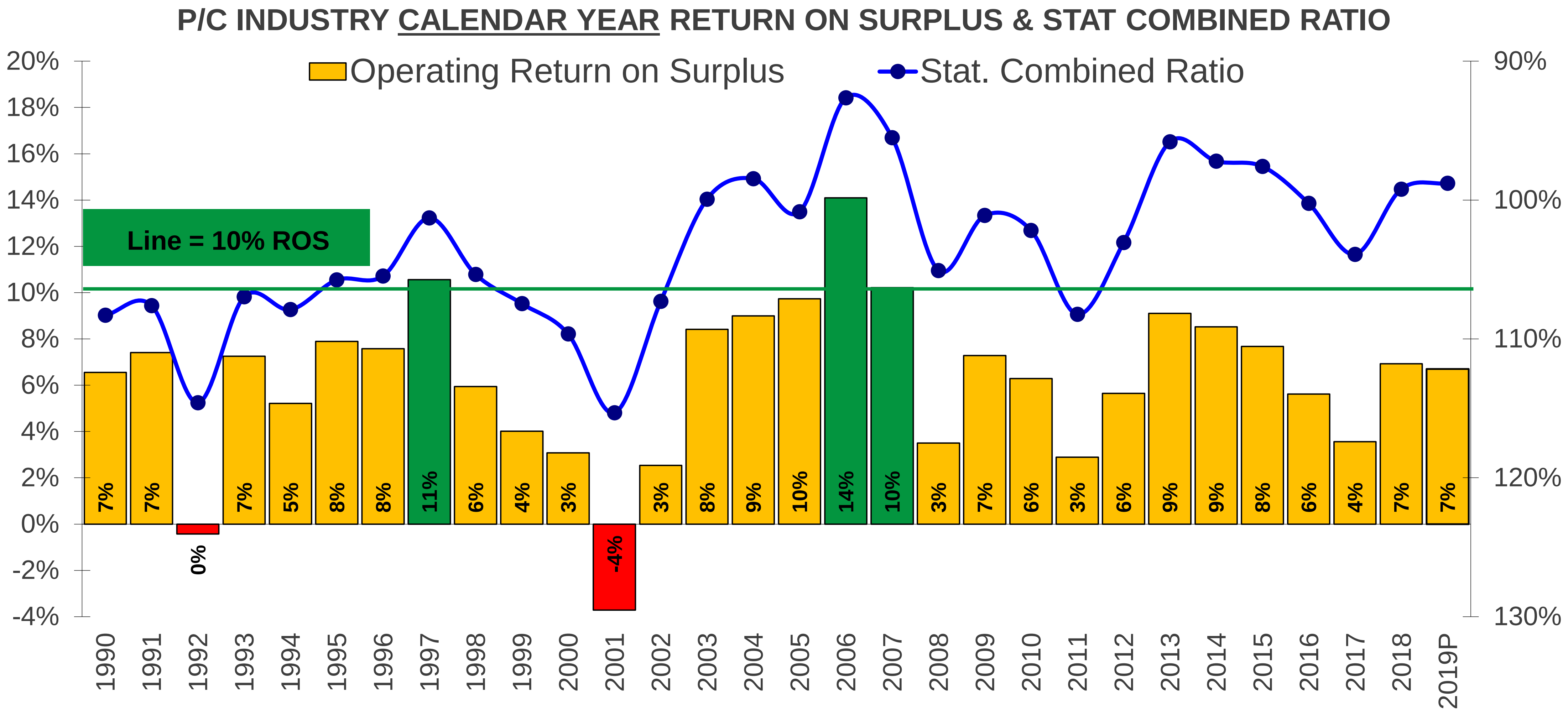


Source: A.M. Best Aggregates & Averages, D&P Estimates, U.S. Department of Treasury

NET PREMIUMS WRITTEN TO P/C SURPLUS



SINCE 1990: ONLY 3 TIMES WAS THE OPERATING RETURN 10%+



Source: A.M. Best Aggregates and Averages

SO WHAT DO EQUITY RESEARCH ANALYSTS LOOK FOR IN EVALUATING THE FINANCIAL CONDITION OF P/C INSURERS?

- Understand Where & How Companies Use Their "Risk Budget" = Cat Risk, Reserve Risk, Premium Risk And / Or Investment Risk.

- Differences In Reserving Philosophies = 50/50 Vs. "More Likely Redundant." Public Information Is All We Have: Schedule P, 10K Triangles, Global Loss Triangles. GAAP Data Is Inconsistent Across Companies.

- People Do What They're Paid To Do = What Metrics Are Used For Management And Underwriters' Compensation?

- Lean Heavily On The Work That The Rating Agencies Already Do.

Remember Investment Theme #1 … The Only Measure Of Success Is Long Term Total Value Creation. P/C (Re)Insurance Is Very Much About Blocking / Tackling & Avoiding The Big Mistake

PUTTING IT IN PERSPECTIVE …

Where Are We Today & How Does COVID-19 Factor In To Our View Of Financial Strength For The Industry

RESERVE POSITION (@ YE-19) CONTINUED TO WEAKEN …

- **U.S. Industry** Reserves Still Appear To Be Worsening And Likely Are Deficient Overall, But Workers' Comp Is Muting How Deep Into Deficiency The Industry Goes.
- **Other Liability** & **Commercial Auto** Lines Remain Weak = Each Line Looks Deficient. OLO And OLCM Weaker Than Last Year, Commercial Auto Similar Deficiency.
- **Workers Comp** Continues To Serve As An Offset = 2019 Reserves Look Weaker But Still Redundant Overall.
- **Personal Auto** Similar Position To Last Year = Adequate To Slightly Redundant.

	D&P YE 2019 "VIEW"		
YOY Chg	Deficient	Adequate	Redundant
Neutral	Commercial Auto Liab.	Personal Auto Liability Homeowners	"All Other" Lines
Weaker	Other Liab. Occ. Other Liab. Claims Made U.S. Industry	Commercial Multi-Peril	Workers' Comp Medical Professional Liability

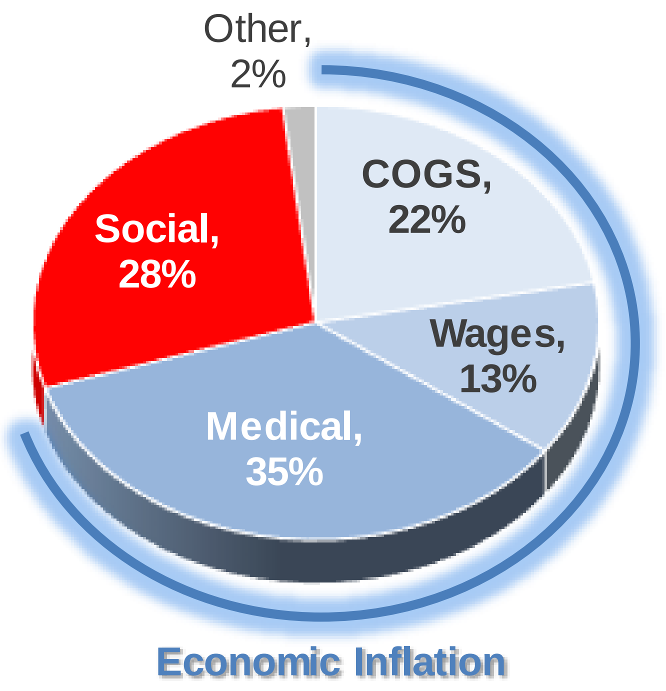
Dowling & Partners

SOCIAL INFLATION IS STILL THERE THOUGH WITH A LIKELY TEMPORARY BENEFIT DUE TO COVID-19 CONDITIONS?

- **Increase In Plaintiff Activity:** Rate of attorney involvement was up, but now many more want to settle: Plaintiffs want cash now.
- **Plaintiff's Bar Is Increasingly Well Funded:** Litigation funding has spread to many different types of suits, but it is an "asset class" for investors and one that must compete with other alternatives.
- **Jury Makeup and Millennials "Social Responsibility" Views:** *"Now there are exogenous forces…that are affecting these loss trends such as millennials on juries and litigation financing, which seems to be an increasing factor in terms of prolonging the life and the cost of claims."* (**Liberty Mutual**).
- **Attorneys Are Leveraging Tech / Sharing Data:** *"…the other things that the plaintiff attorneys are doing is leveraging technology to share tactics on how to approach claims, sharing information on various insurance carriers and their practices so as to be able to more effectively leverage the insurers."*

Now Courts Are Closed And Suddenly All Trends Have Shifted

2019 U.S. Loss Reserve Mix By Estimated Inflation Type



Source: Statutory Statements, D&P Analysis

RATING AGENCIES SCRUTINIZING FINANCIAL STRENGTH

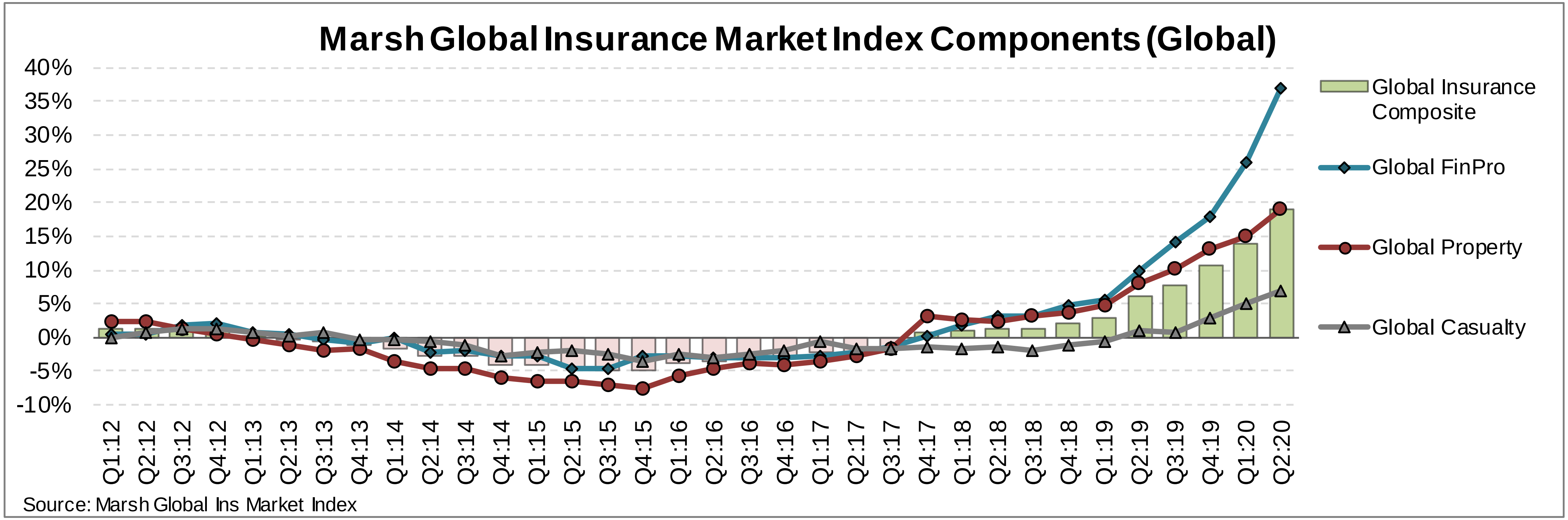
(Re)insurance	A++	A+	A	A-
		AXIS	AXIS	
		Alleghany	Argo Group	Argo Group
		Arch Capital	Fairfax Financial	Greenlight Re
		Everest Re	Sirius Group	Sirius Group
		RenaissanceRe	Lancashire	Third Point Re
				Watford*

Primary	A++	A+	A	A-
	Chubb	Allstate Corp	American Int'l Group	Employers
	Berkshire Hathaway	American Financial	AMERISAFE	Enstar Group
	Travelers	Cincinnati Financial	Assurant	Hallmark*
		Hartford	CNA Financial	HIIG
		Intact Financial	Donegal Group	Kemper
		Old Republic	Global Indemnity	Kinsale
		Progressive Corp	Hanover Group	ProSight
		RLI Corp	Horace Mann	State Auto
		W.R. Berkley	Int'l General Ins.	
			James River	
			Kinsale	
			Markel Corp	
			Mercury General	
		ProAssurance	ProAssurance	
			Protective Ins	
			Safety Ins	
			Selective Group	
			United Fire Group	

Outlook Status:
- Positive Outlook = Green
- Stable Outlook = Black
- Under Review, Developing = Purple
- Negative Outlook = Orange
- Under Review With Negative Implications = Red

*Source: A.M. Best; *HIIG, Hallmark, & Watford Not Covered By D&P But Included For Reference*

GLOBALLY, (RE)INSURANCE RATES ARE MOVING BUT MAGNITUDE AND RATE ADEQUACY VARIES BY LINE / GEOGRAPHY

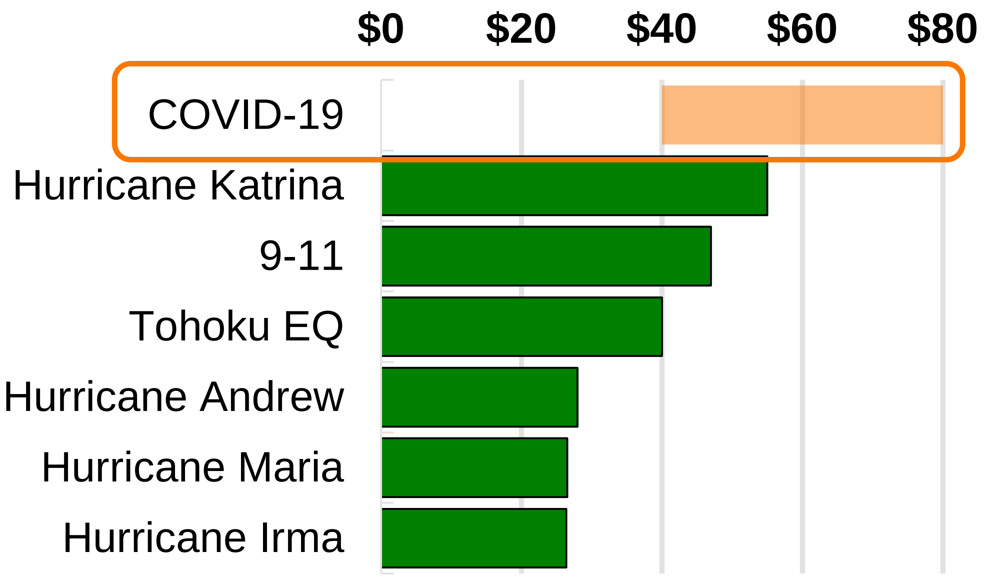


THE PROPERTY / CASUALTY INDUSTRY COVID-19 INSURED LOSS

Loss "Bucket"	Low $,B	High $,B
Property (BI, LAE, etc)		
United States	$5	$15
United Kingdom	$5	$10
Europe	$5	$10
Other Geographies	$2	$10
Liability	$5	$15
"Specialty Lines"		
Mortgage	$5	$10
Event Cancellation	$5	$10
Credit / Political Risk	$5	$15
Workers' Comp / Other	$2	$5
Unknown Unknowns	$0	$5

D&P "1st Cut" At Industry "Ultimate" Insured Loss = $40-80 Billion

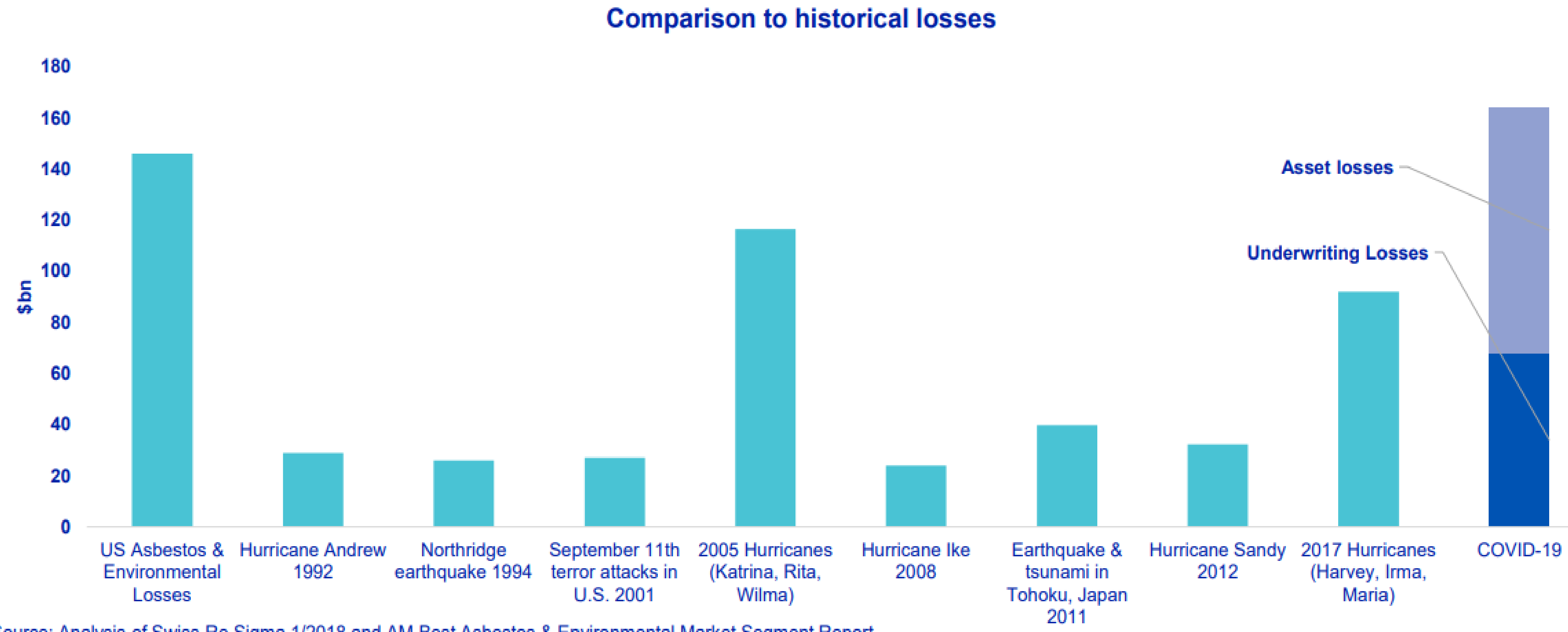
Top Global Cats Of The Last 30 Years ($,B)



Source: iii, Swiss Re Sigma, D&P Analysis = Inflation adjusted insured losses.

COVID-19 IS BIGGER THAN “INSURED” LOSSES = ASSET CONCERNS TOO

COVID-19 is likely to be the largest loss to insurers to date



Source: Analysis of Swiss Re Sigma 1/2018 and AM Best Asbestos & Environmental Market Segment Report
Losses are indexed to 2019 values

SOME OBSERVATIONS ON THE INDUSTRY'S RESPONSE TO COVID-19

- We Remain In The Early Innings Of The Process. To Date We Tally ~$20B Of Recognized (Re)insured Losses.
- Losses To Date Dominated By "The Easy Stuff" = Event Cancellation, Credit, Non-Damage BI, Etc. "Indirect" Exposures Remain A Significant Overhang.
- Reserving Methodologies / Results Appear Inconsistent To Date.
- ~$25B of New Capital Has Been Raised To Date Since COVID-19.
- Near Term Investment Portfolio Pressure Alleviated Somewhat By Q2 Rebound.
- Much Still To Be Decided On A Legal / Regulatory Front.

QUESTIONS?

Please send any feedback, comments or questions to kyle@dowling.com