

CORONAVIRUS AND BEYOND: SECULAR FORCES PERMANENTLY ALTERING THE P/C INDUSTRY

September 2020



Kyle LaBarre

ALL INSURANCE, ALL THE TIME

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Early Q1 Earnings Themes: Commercial Rate Commentary Noticeably More Positive While Loss Cost Caution Remains

The Q1 earnings season is well under way. Beyond earnings, market discussion about rates was noticeably more positive. More companies are following about rates was noticeably more positive. More companies are following about rates was noticeably more positive. More companies are following about rates was noticeably more positive.

Quickies
 It's Not Just Rate: Exposure Can Act Like Rate & Helps Margins...
 Several early reporting lines showed improvement despite a relatively low level of rate improvement across the market. As Travelers highlighted, there is a component of rate growth that "behaves like rate" from a margin perspective. Here's the math. Page 25
 Jabi Loss Development To Watch In Q1: AXIS became the latest (it is in Q1) to increase its loss estimate for the year. While several other carriers added to reserves at year end, it remains an issue for Q1. Page 28
 Not All GAAP Expense Ratios Are Created Equal: We examine 2018 GAAP expenses where not already included. Understanding when "allocations" is important when comparing combined ratios. Page 30
 Markel CATCo Annual Letter Highlights 50%+ Of AUM Is "Trapped" Capital: Though there was limited "new" financial information included in the report, the fund manager did re-emphasize that the publicly traded (in London) CATCo fund will be placed in in run-off. Page 31
 Space First, Now Insurance: Testa Casualty Announces "Launch" Of Insurance Product In "about a month" which follows previous comments from CEO Musk that if insurers fail to recognize the improved safety potential of Teslas, it would offer insurance. We update the subscription plans currently offered by auto manufacturers. Page 35
 Florida AOB Legislation Moves To Governor's Desk: Issues addressed include attorney fees, policy structure and Citizens rates. While positive for the FL market, measuring the extent point at the upcoming Q1 reinsurance renewals. Page 36
 Hiscox Cycles Readiness Survey Highlights Increased Costs & Frequency Of Attacks Over Last 12mos: Small and medium-sized firms are now equally vulnerable to larger ones. Page 38

Other Items of Interest

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THE HALES REPORT

1270 Avenue of the Americas, Suite 930, New York, NY, 10020 | subscriptions@thehalesreport.com | Issue #25, Vol: 2 | Dec 10, 2018

Inside This Issue

- Closer Look At Disarray With Potentially Wide Ranging Market Implications** Pg 1
- Fast Growing Acrisuro Receives \$2B of P&C Industry & Select U/W's** Pg 4
- CoverWallet For Agents... A Solution In Search of A Problem?** Pg 7
- Commercial Lines "Co-Opt" Insurtech To Avoid Disruption** Pg 9
- Liberty Mutual Eyes Top 3 Global Position In Personal & Small Commercial** Pg 11
- Agents & Broker Employment Continues To Lag, Marginally Positive (+0.5%)** Pg 15
- CA Wildfire Losses Likely To Surpass 2017 (\$14.5B): Variance By Company** Pg 17
- Hales Hits 8 Bindable Quotes** Pg 18
- Hales Q4 Deal Diary & Broker Valuations** Pg 19
- Retrospective Market in Disarray With Potentially Wide Ranging Market Implications. ILS Investors Frustrated, Market's CATCo, A Major Player, Under Investigation.** Pg 20

The retro reinsurance market has been in a state of flux heading into the important 1/1 2019 reinsurance renewals. ILS investors (alternative capital dominates the retro market) have been frustrated by (i) ongoing upward loss creep on the \$100B+ of catastrophe losses in 2017 (particularly Irma in Florida), (ii) another year of substantial 2018 reinsurance rate increases were much less than hoped for/promised given a substantial "reloading" of alternative capacity ahead of the 1/1/18 renewals (expecting improved market conditions) dampening the overall rate power across the market.

This year may be different. Last week one of the most significant writers of retro reinsurance worldwide (one of "The Four Horsemen"), Markel's CATCo, confirmed it's being investigated by U.S. and Bermuda authorities related to loss reserving practices in 2017 and early 2018. By our math, Markel CATCo's major 2017 losses have raised by \$930M (or 66%) vs. the \$1.4B booked as of YE 2017. During that period, fund manager raised -\$1.9B of additional investor capital (parent Markel did not 'tuto further funds: "other investors demand for the fund was so great, we did not want to squeeze other people's investments down").

Investigation calls into question potential investor litigation (related to what now / should have known) and **as well as the ability and extent to which ILS should be able to support retro clients at 1/1.**

rates Report | Contact: Feedback@TheHalesReport.com

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TODAY'S SPEAKER



Kyle LaBarre – Speaker

Dowling & Partners

- *Senior Analyst and Partner at Dowling & Partners Securities, LLC.*
- *Member of the Property and Casualty Insurance Research team since 2006, holding various roles of increasing responsibility over the period.*
- *Currently, he has publishing analyst responsibilities for a number of (re)insurance companies, predominately U.S. specialty insurance carriers and U.S. / Bermuda reinsurers.*

Peter Tomopoulos – Moderator

Deloitte Consulting

- *Senior Manager, Deloitte Consulting*
- *ACAS, MAAA*
- *New York City- based*
- *Nearly 25 years of insurance industry actuarial experience*



CORONAVIRUS = A CATASTROPHE UNFOLDING OVER TIME

- **Losses Will Spread Across Many Lines**
- **Many Negatives (Specialty Lines) But Some Positives (Auto)**
- **Never Really Know The Right Answer**

THE PROPERTY / CASUALTY INDUSTRY COVID-19 INSURED LOSS

Known Knowns

(Lines/Coverages Clearly Impacted)

e.g. Event Cancellation



Known Unknowns

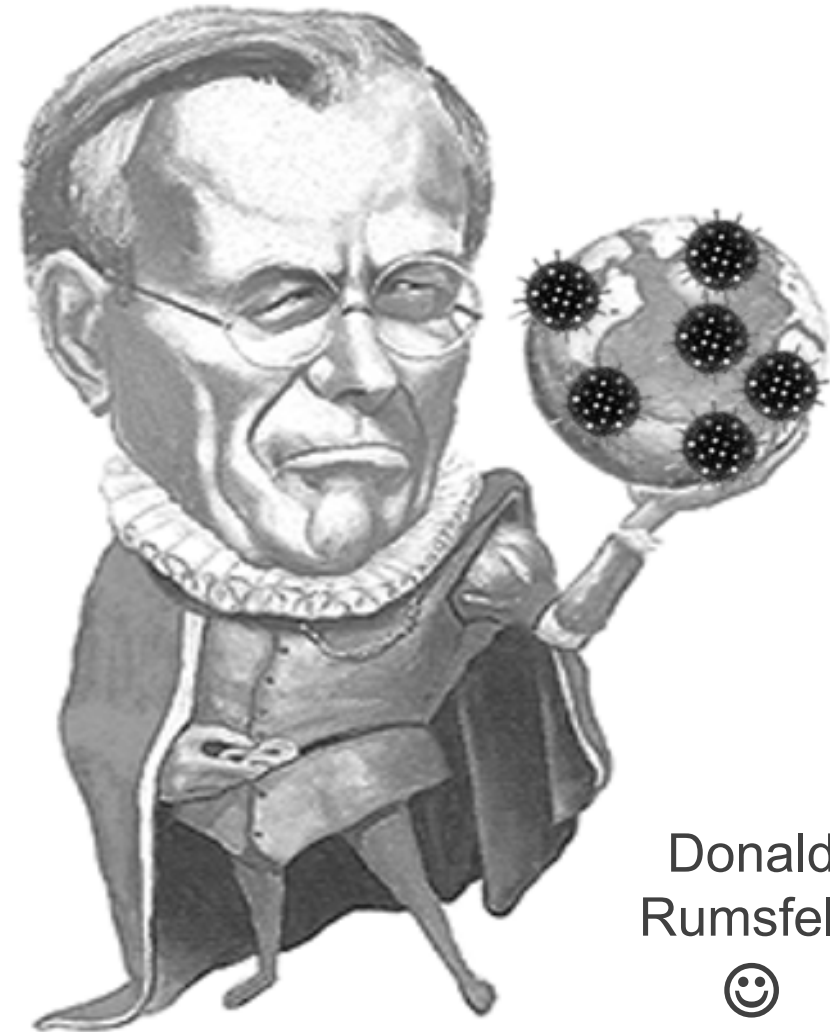
(2nd Derivative Impacts)

e.g. Resulting loss from global battles and court responses around BI policy wording and the other liability exposures



Unknown Unknowns

(One-off From Left Field)



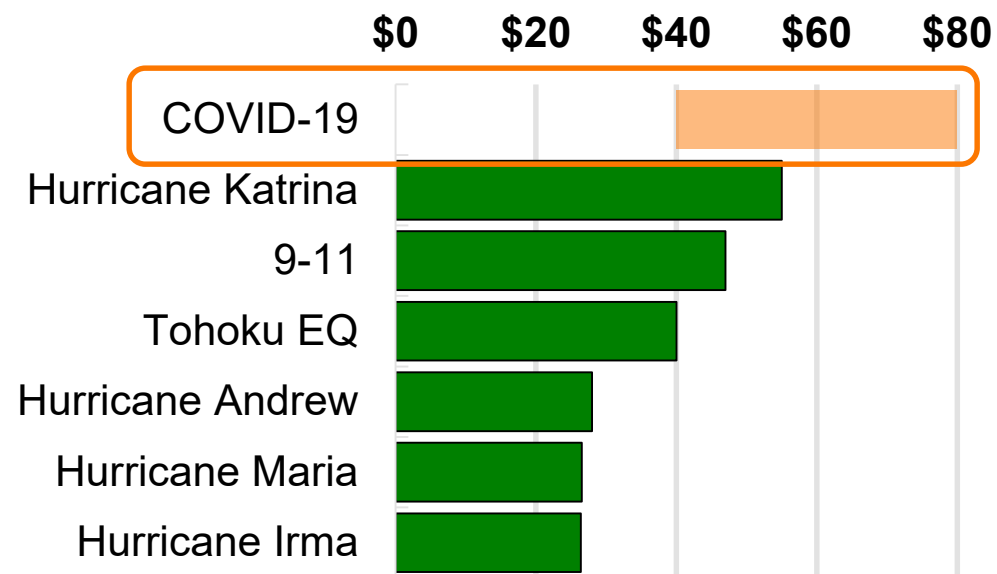
Donald
Rumsfeld
😊

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 In April**

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



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

THE PROPERTY / CASUALTY INDUSTRY COVID-19 INSURED LOSS

The Property / Casualty Industry COVID-19 Insured Losses How Have The Loss "Buckets" Evolved From Mid-April?

Neutral / Positive Trend

U.S. BI (\$5-15B) = Retroactive coverage less likely. Many co's took "belt & suspenders" approach but surprised by amount who didn't.

Credit / Political Risk (\$5-15B) = Gov't backstops may take worst case off table

Event Cancellation (\$5-10B) = More "known" exposure. Trending "in line."

Still Too Early / Less Clarity

Liability Lines (\$5-15B) = Longer tail lines with little clarity yet. Social inflation isn't gone.

Mortgage (Re)Insurance (\$5-10B) = Positive near term trends but long term remains a ?

Unknown Unknowns (\$0-5B)

Negative Trend

Non-U.S. BI / Property (\$12-30B) = Greater prevalence of affirmative coverage and even looser policy wording.

Workers Comp / Other (\$2-5B) = Worst case of W/C reined in but still higher than initial expectations + surety / A&H worse

D&P Industry "Ultimate" Insured Loss = \$40-80B

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

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



HIGH-LEVEL VIEW ON NEARER-TERM IMPLICATIONS FOR U/WERS

COVID-19 / Economic
Shut Down ... **Near
Term / 2020**
Underwriting Impacts

Vs.

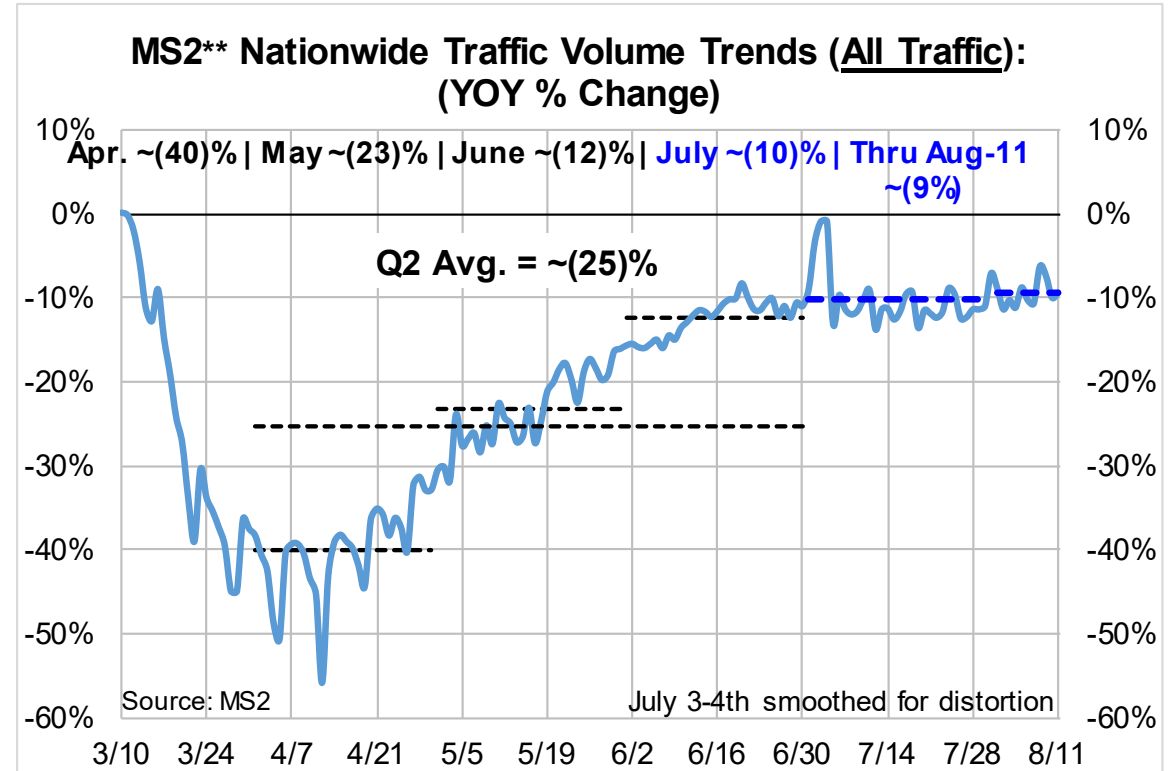
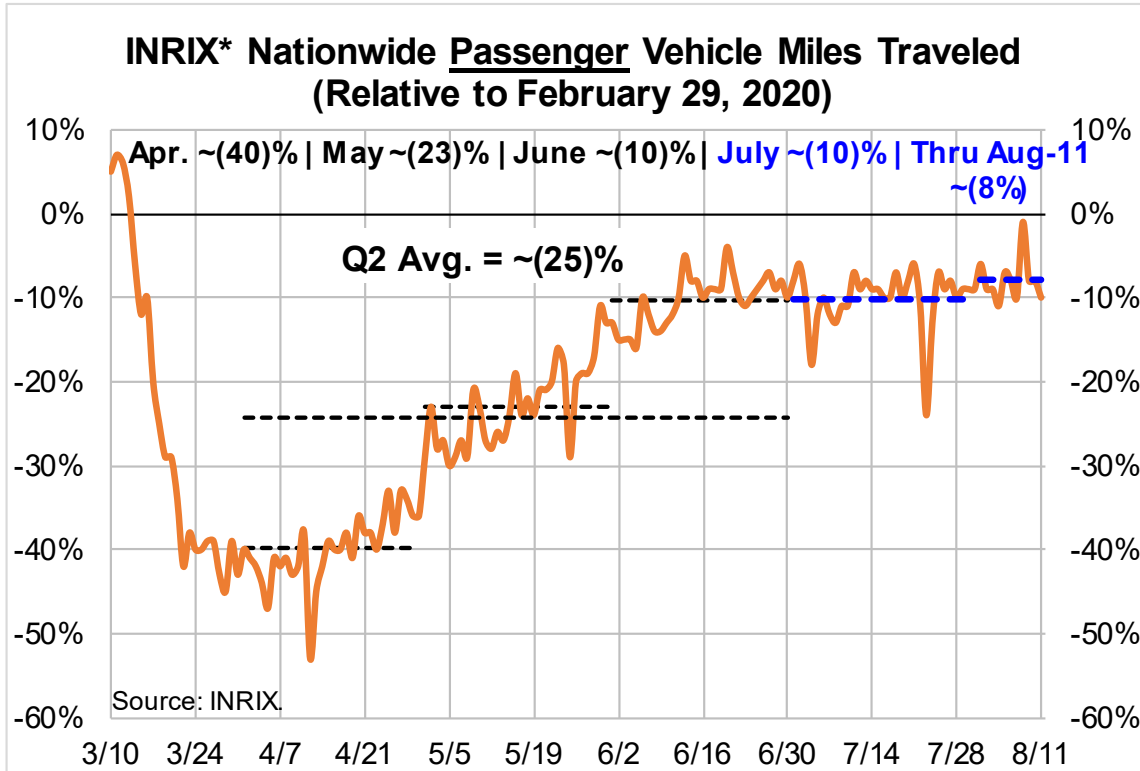
Prior Expectations
(Assuming No Change
In Rate Outlook).

Key Lines Of Business		Written Premiums	Aggregate Losses	Loss Ratio (AY)	Combined Ratio (AY)
U.S. Commercial Lines					
Workers Comp	8%	↓	↑	↑	↑
Cml /CMP Property	10%	↓	↑	↑	↑
GL/Product/ CMP Liab	11%	↓	↑	↑	↑
Mgmt/Prof Liab /Cyber	4%	↓	↑	↑	↑
Cml Auto	6%	↓	↓	↓	↓
Med Mal	1%	--	↑	↑	↑
U.S. Personal Lines					
Auto	36%	↓	↓	↓	↓
Homeowners	15%	↓	--	--	--
SUBTOTAL U.S.	91%	↓	--/↓	--	↑
Other					
XOL Reinsurance		↓	↑	↑	↑
Lloyd's / Specialty lines / Trade Credit		-- / ↓	↑	↑	↑
Surety		↓	--	↑	↑

BUSINESS INTERRUPTION IS THE KEY “KNOWN UNKNOWN”

- ❑ **Business Interruption (BI) remains the biggest “known unknown” due to the historical success of the plaintiff’s bar with some novel coverage arguments / success in expanding coverage.**
 - ❑ **The U.S. standard (“ISO”) wording is strong. Any challenge / reversal would violate contract law.** This will be a long / drawn out battle with the P/C industry already logging some important “wins.”
 - ❑ **International situation is less clear (currently) = several “test cases.”** UK most closely watched.
 - ❑ **The insurance industry simply cannot cover the loss...**, a fact lawmakers must understand or risk bankrupting an industry that is key to economic viability. APCIA (trade body) estimated monthly losses for small businesses of \$220-383B vs. surplus of \$800B for corresponding insurers.

AUTO (PERSONAL & COMMERCIAL) ARE THE LINES BENEFITTING MOST



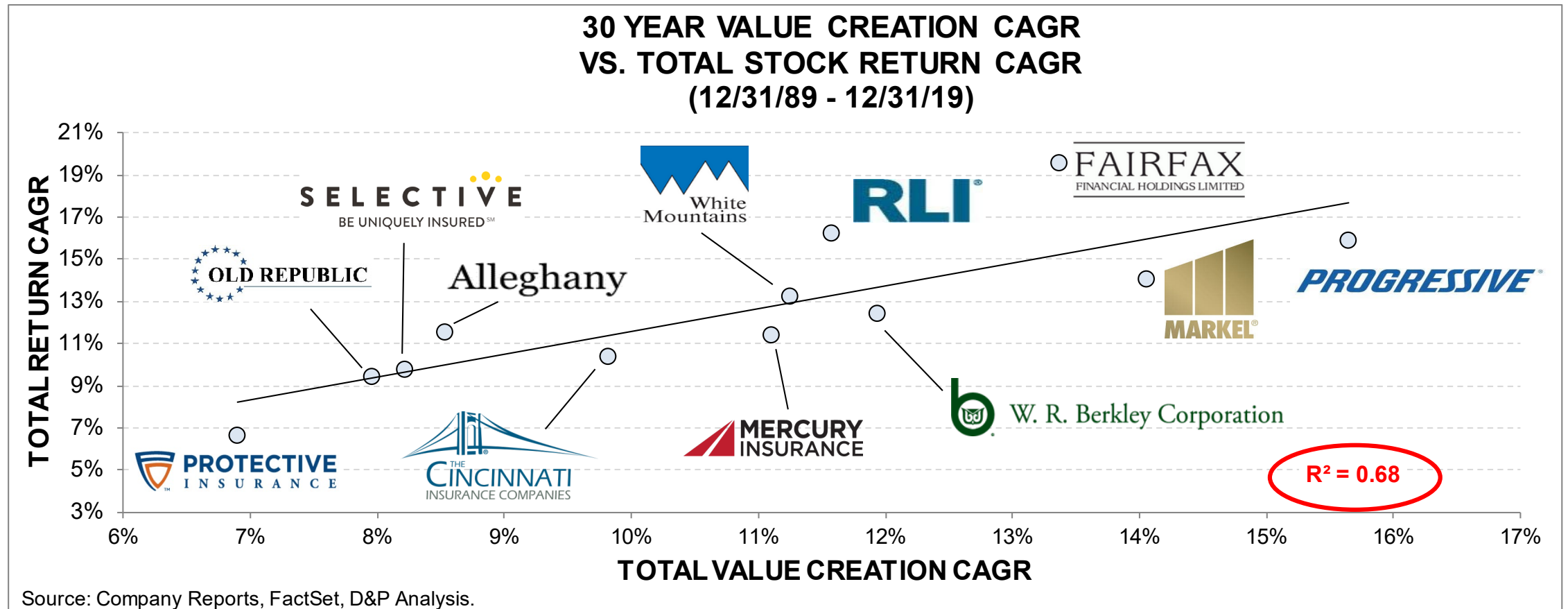
Note(s): *INRIX data is measured primarily with cell phones and other connective data.

**MS2 measures daily traffic volume chg vs. the same day of week in the same month for the most recent year that data is available. The metric is based on data from traffic sensors & smart traffic signals installed by road agencies. Data is collected by either MS2's Autopolling Extension or transmitted by the agencies. The National Traffic statistics include all traffic, including trucks.

LONGER TERM TRENDS SETTING THE STAGE ...

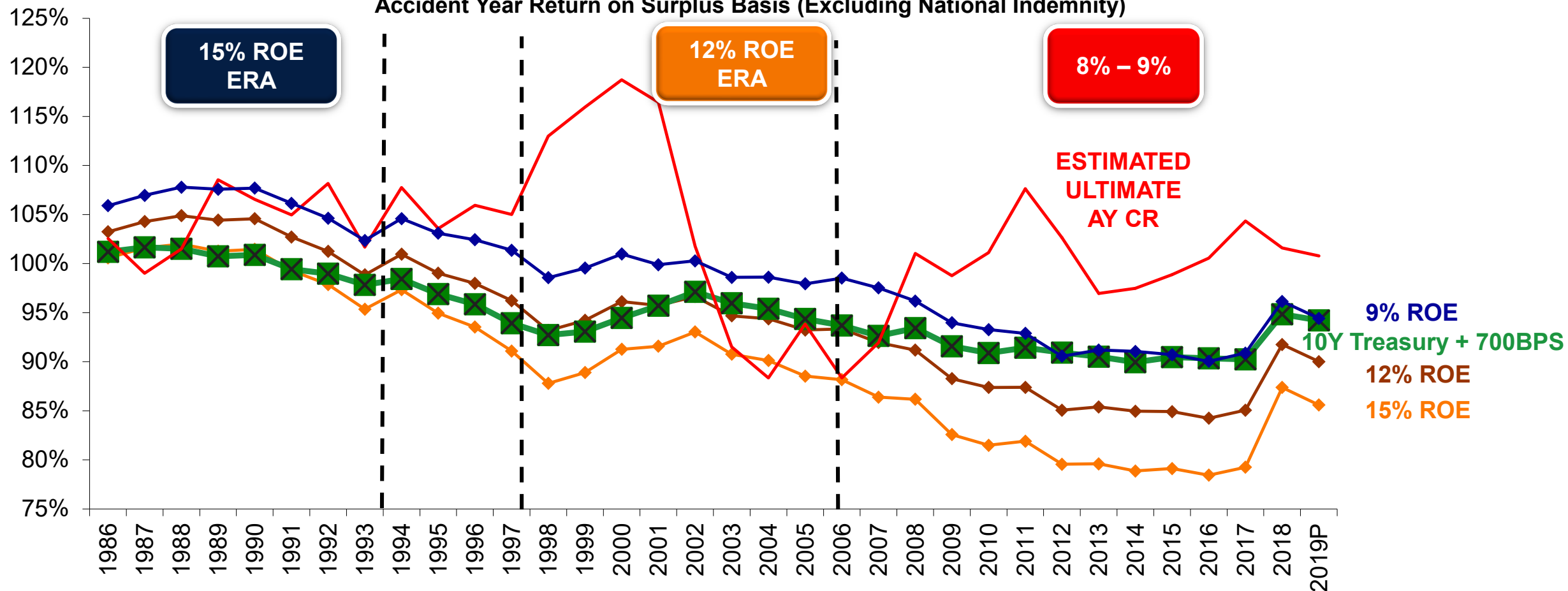
**P/C Insurance Is A “Simple” Business In Theory,
But Very Difficult To Execute Well**

LONG TERM STOCK PRICE TRACKS BOOK VALUE (PER SHARE) GROWTH



COMBINED RATIO REQUIRED TO “WIN” HAS DECLINED WITH LOWER INTEREST RATES & LEVERAGE OVER TIME

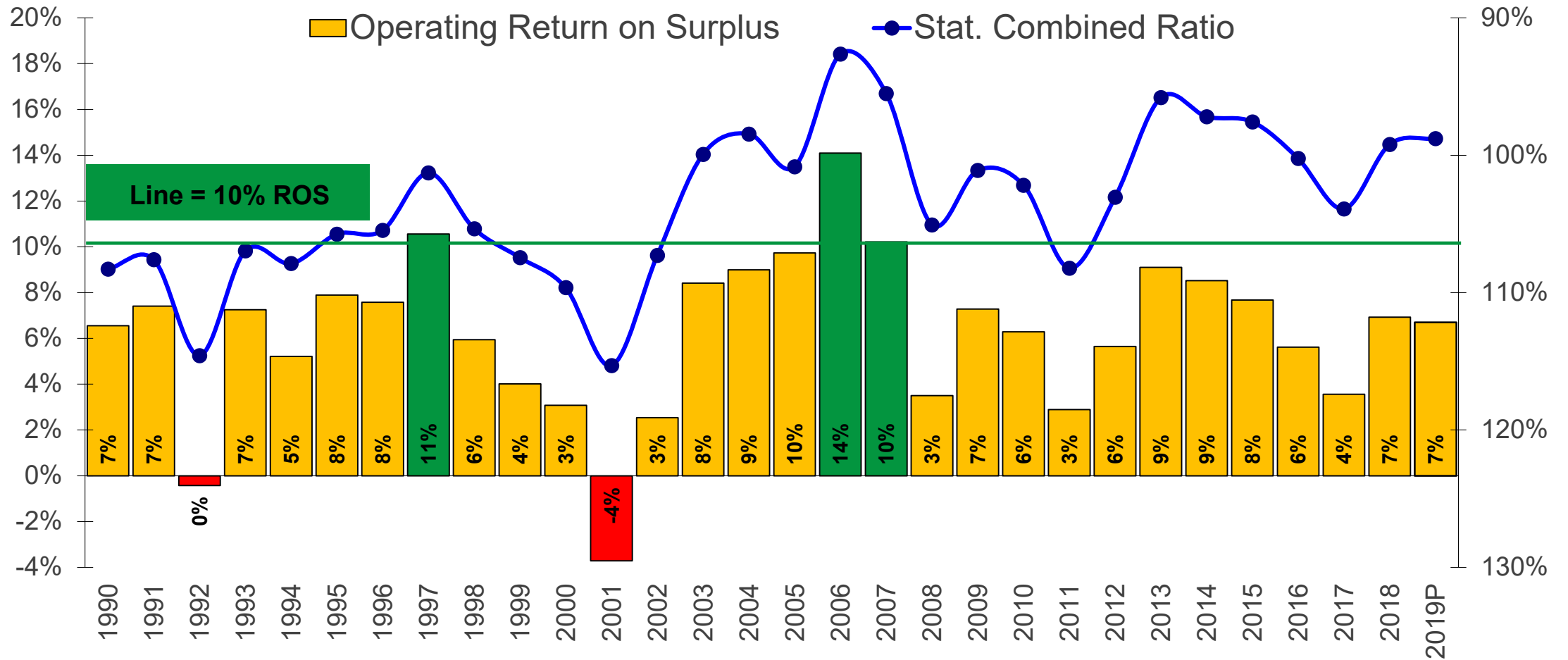
COMBINED RATIO NEEDED FOR GIVEN RETURN VS. HISTORICAL ULTIMATE ACCIDENT YEAR (AY)
 Accident Year Return on Surplus Basis (Excluding National Indemnity)



Source: A.M. Best Aggregates & Averages. 2019P = A.M. Best preliminary results.

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

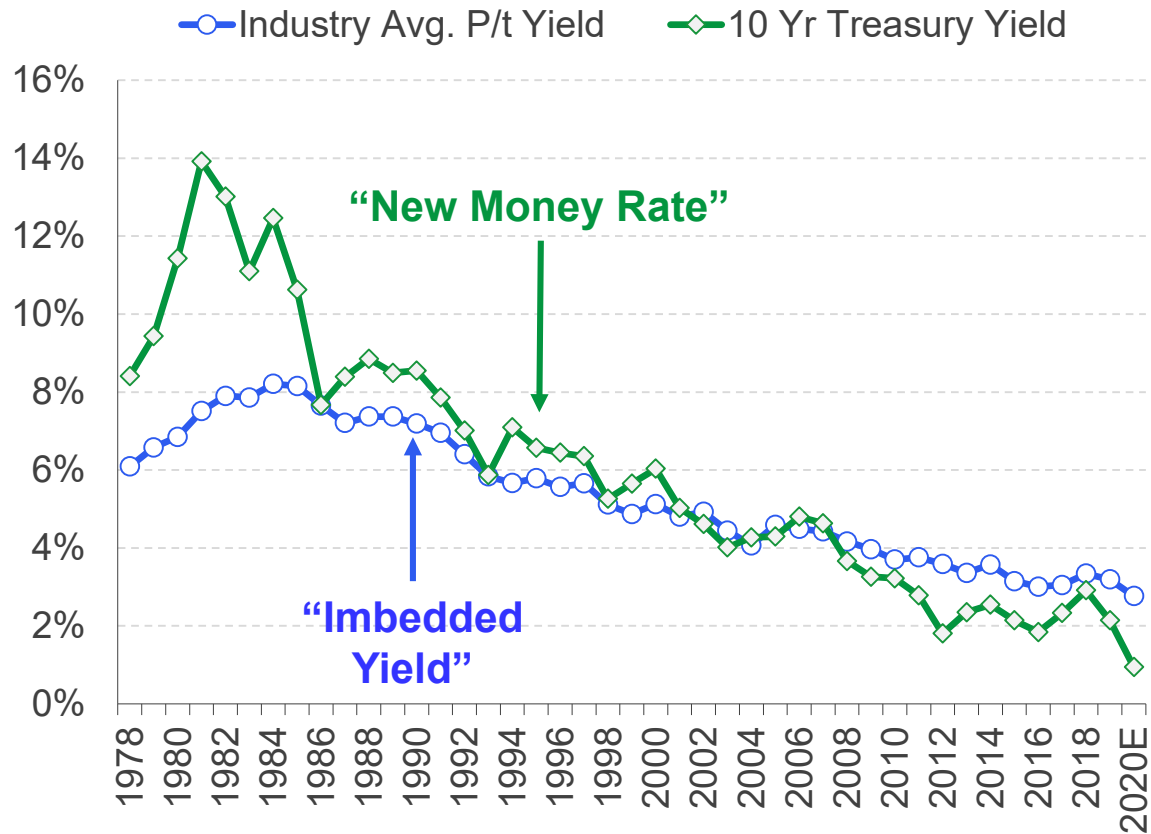
P/C INDUSTRY CALENDAR YEAR RETURN ON SURPLUS & STAT COMBINED RATIO



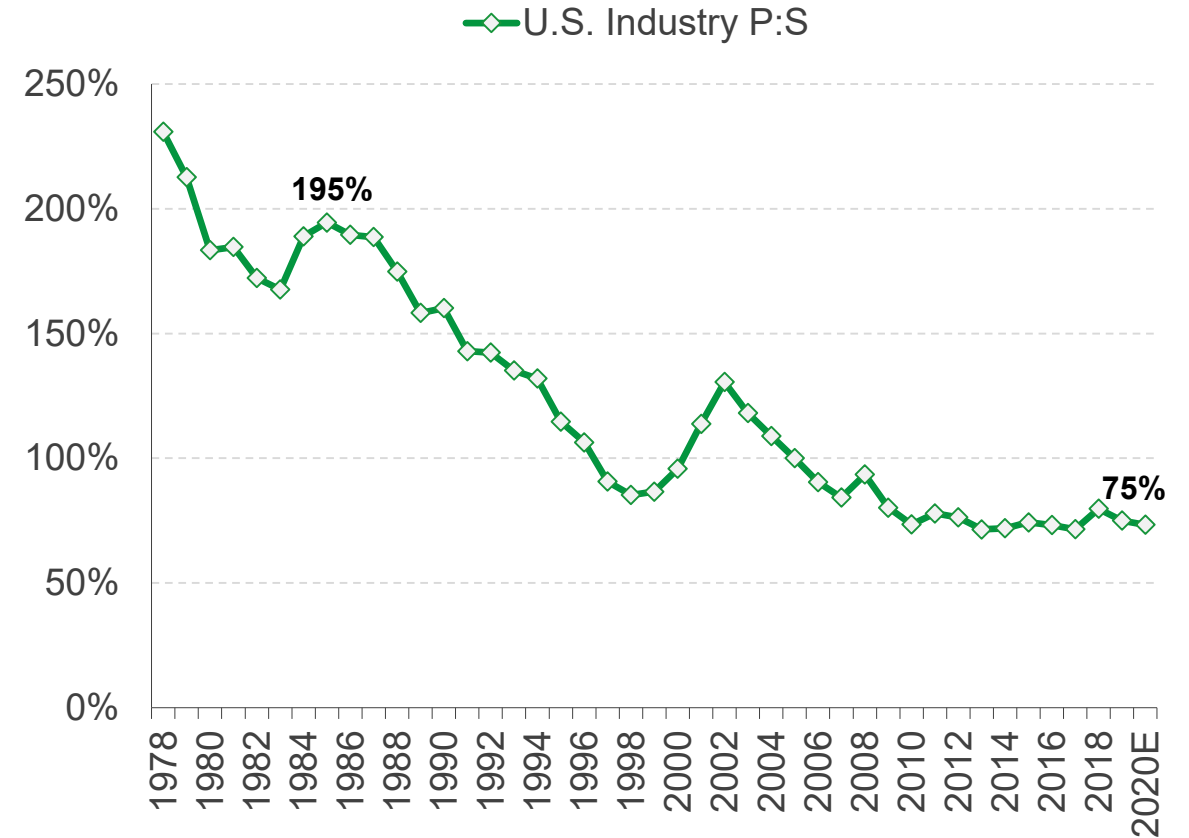
Source: A.M. Best Aggregates and Averages. 2019P = A.M. Best preliminary results.

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

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



NET PREMIUMS WRITTEN TO P/C SURPLUS



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

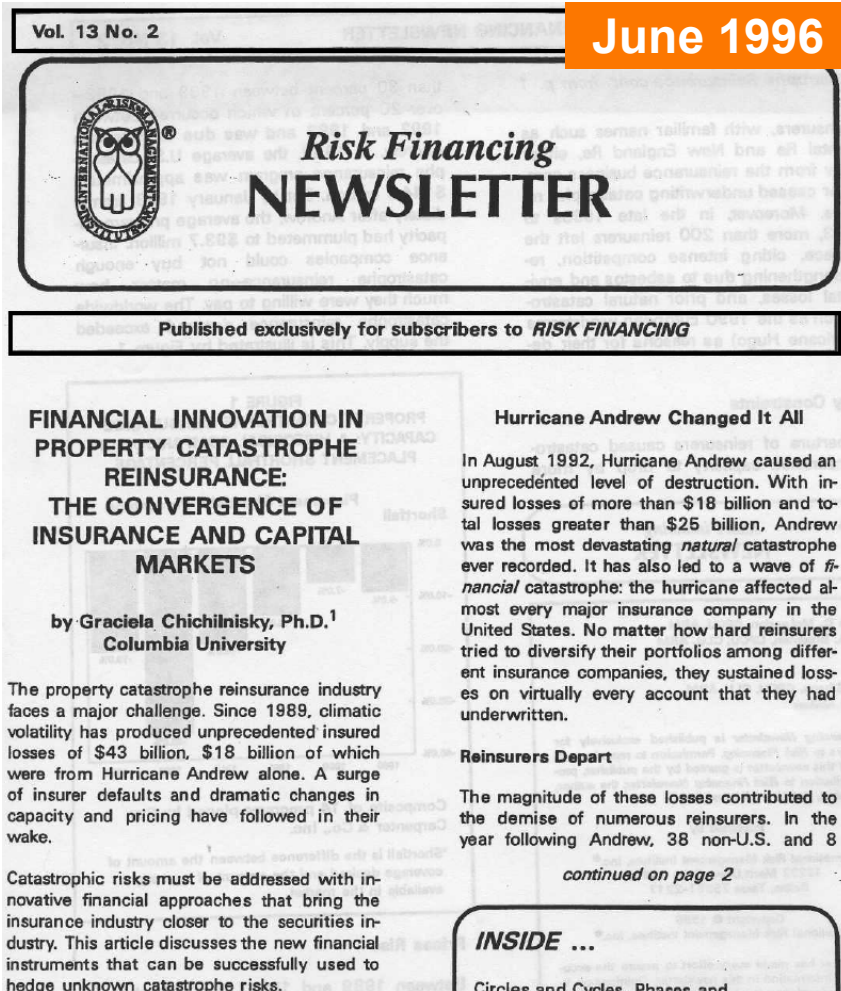
FIVE SECULAR FORCES
PERMANENTLY ALTERING
P/C (RE)INSURANCE

FIVE (SECULAR) FORCES ARE PERMANENTLY ALTERING INSURANCE

1) 3rd Party Capital =
It's Here To Stay

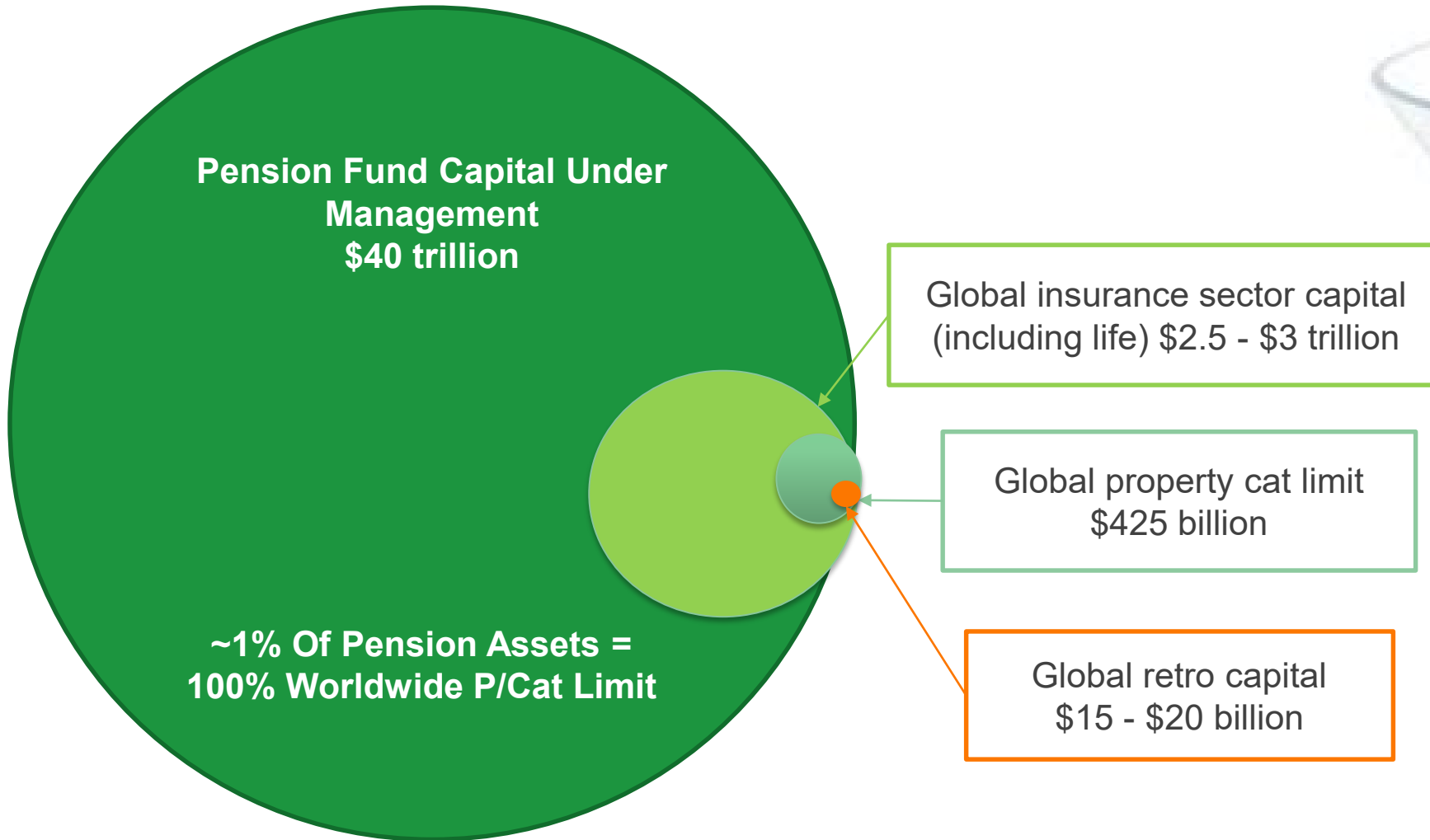
***Permanent Changes To
The Property / Casualty
Insurance Industry***

ILS TOOK 15+ YEARS TO DISRUPT PRICING... ...BUT THE 2012 “TIPPING POINT” ALTERED SUPPLY/DEMAND






























- ❑ USAA Subsidizes Early “Cat Bond” Market
- ❑ J.P. Morgan Vice Chairman, Roberto Mendoza Refers To Cat Bonds As, “An Eloquent Solution In Search Of Demand”
- ❑ Ajit Jain Conducts Guerilla War Against Cat Bonds = Underprices/Kills Large CEA Transaction
- ❑ Absolute & Relative Performance Of ILS Market In 2008-2010 Financial Crisis Was Very Strong
- ❑ June 1, 2012 = “The Tipping Point” = Price Takers Become Price Makers In Property Cat In Florida

THE PENSION FUND “MARTINI”



Source: Guy Carpenter, Willis Towers Watson

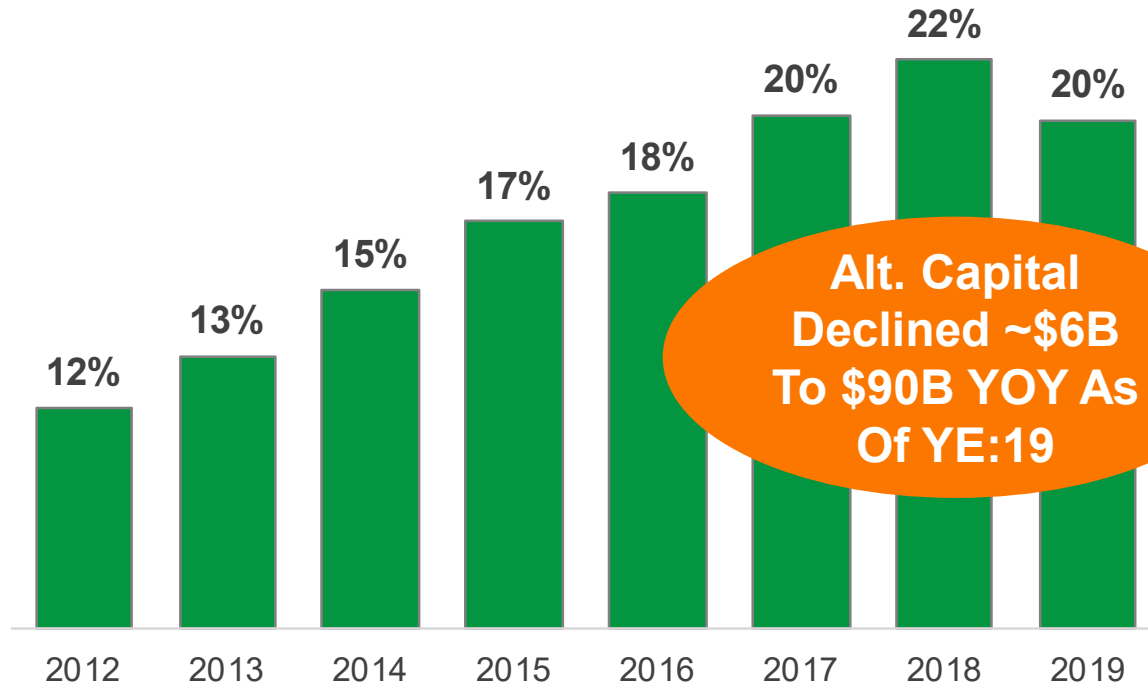
IF YOU CAN'T BEAT THEM, OWN THEM = TOP ILS FUND MANAGERS

ILS Manager	Approximate AUM (\$,B)	Participation in Retro Mkt*	AUM Trend  	(Re)insurer Affiliation	ILS Manager	Approximate AUM (\$,B)	Participation in Retro Mkt*	AUM Trend  	(Re)insurer Affiliation
	~\$11B	Significant (Upsilon Vehicle)				\$5.9	Yes		
	\$9.5	Negligible				\$5.5	Yes	Flat	
	\$7.2	Limited				\$4.3	Significant		
	\$6.8	Negligible				\$4.1	Yes (Sidecars/ Cat Bonds)		
	\$6.8	Limited (Cat Bonds)				\$4.0	Significant		

Latest available AUM figures shown. Source: Artemis; D&P Analysis

SUPPLY: ALTERNATIVE CAPITAL SHOT TOO FAR...

ALTERNATIVE CAPITAL AS % OF TOTAL REINSURANCE CAPITAL (2012-2019)



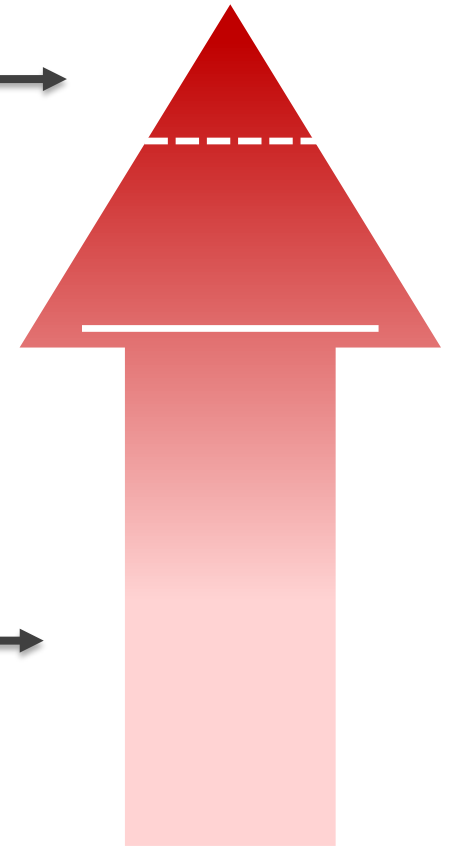
Source: Guy Carpenter; A.M. Best; D&P Analysis

The Property Cat Pricing Spear

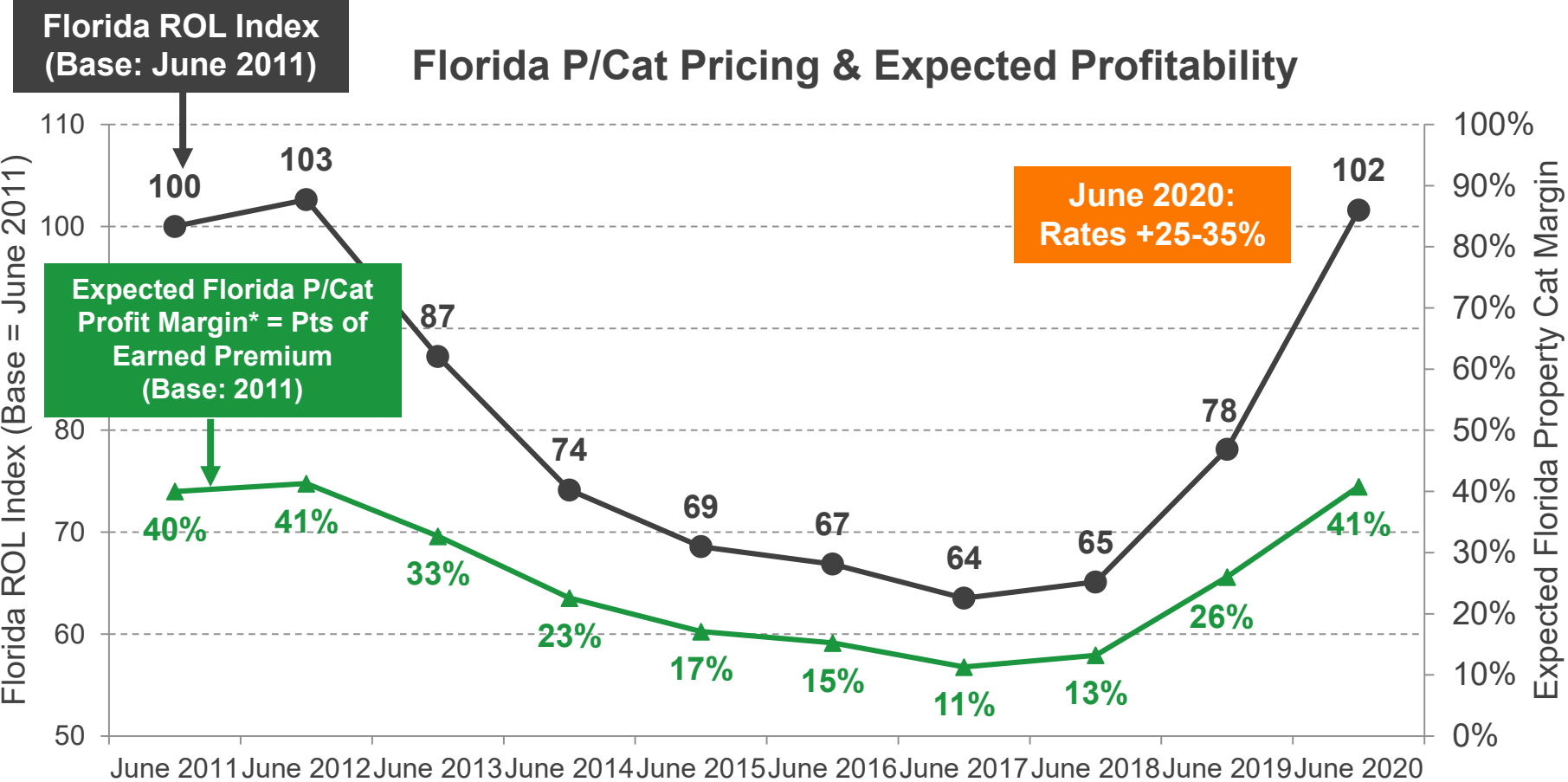
"Direct" Retro / ILW Limits = ~\$15-20B

Global P/Cat Reinsurance Limits = ~\$425B

Global Insurance Sector Capital (Including Life) = \$2.5-3T



JUNE 1ST 2012: PRICE TAKER BECOMES PRICE MAKER = “TIPPING POINT” CHANGED (RE)INSURANCE FOREVER



“While rates decreased by 42%, profit margins eroded 90%.” **

RenaissanceRe

November 2017 (Pre-AOB)

Note: Based on an expected c. ratio base which assumes dollars of loss and G&A expenses are held constant. 2011 base c. ratio considers a 45% loss ratio, 10% commission ratio and 5% G&A. ratio. ** RenRe on Florida reinsurance (2011-2017) per Florida Chamber of Commerce JOK presentation given Nov-17. *Source: D&P Analysis*

NEW SOURCES OF CAPITAL: WHY SHOULD WE CARE ?

- ❑ Capital Markets Size/Potential Dwarfs Traditional (Re)Insurance Markets
- ❑ Lower Return Threshold (Risk Free + 200-300 Basis Points)
- ❑ Places “Ceiling” On Global P/Cat Pricing Post-“Tipping Point” (2012)
- ❑ Accelerates “Unbundling” Of Traditional (Re)insurance Product Offering
- ❑ Expansion Into Other Reinsurance/Primary Markets Will Accelerate

Biggest Threat To Long-Term Growth = “Who Keeps The Tail”?

FIVE (SECULAR) FORCES ARE PERMANENTLY ALTERING INSURANCE

1) 3rd Party Capital =
It's Here To Stay

***Permanent Changes To
The Property / Casualty
Insurance Industry***

2) Evolution of Ajit Jain
/ Berkshire Hathaway

BERKSHIRE HATHAWAY DISINTERMEDIATED AS THE “GO TO” LARGE CAPACITY MARKET (“MEGA CAT”) BY INVESTORS (ILS)

**Berkshire Hathaway
1990s**

Allstate

CEA CALIFORNIA
EARTHQUAKE
AUTHORITY


CITIZENS
PROPERTY INSURANCE CORPORATION



**ILS Markets
2020**

Allstate

CEA CALIFORNIA
EARTHQUAKE
AUTHORITY


CITIZENS
PROPERTY INSURANCE CORPORATION

Biggest Loser

AJIT MOVES TO THE “FRONT OF THE BUS”

Primary



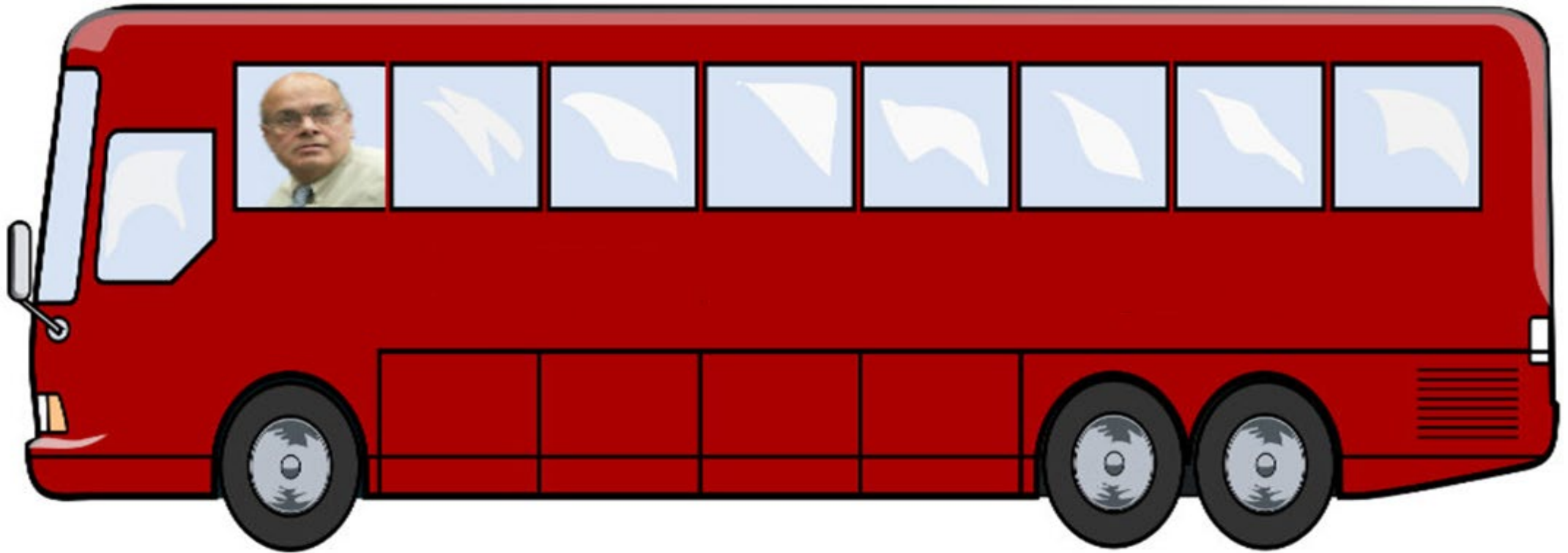
XOL / Retro Writer



Berkshire Hathaway
Specialty Insurance

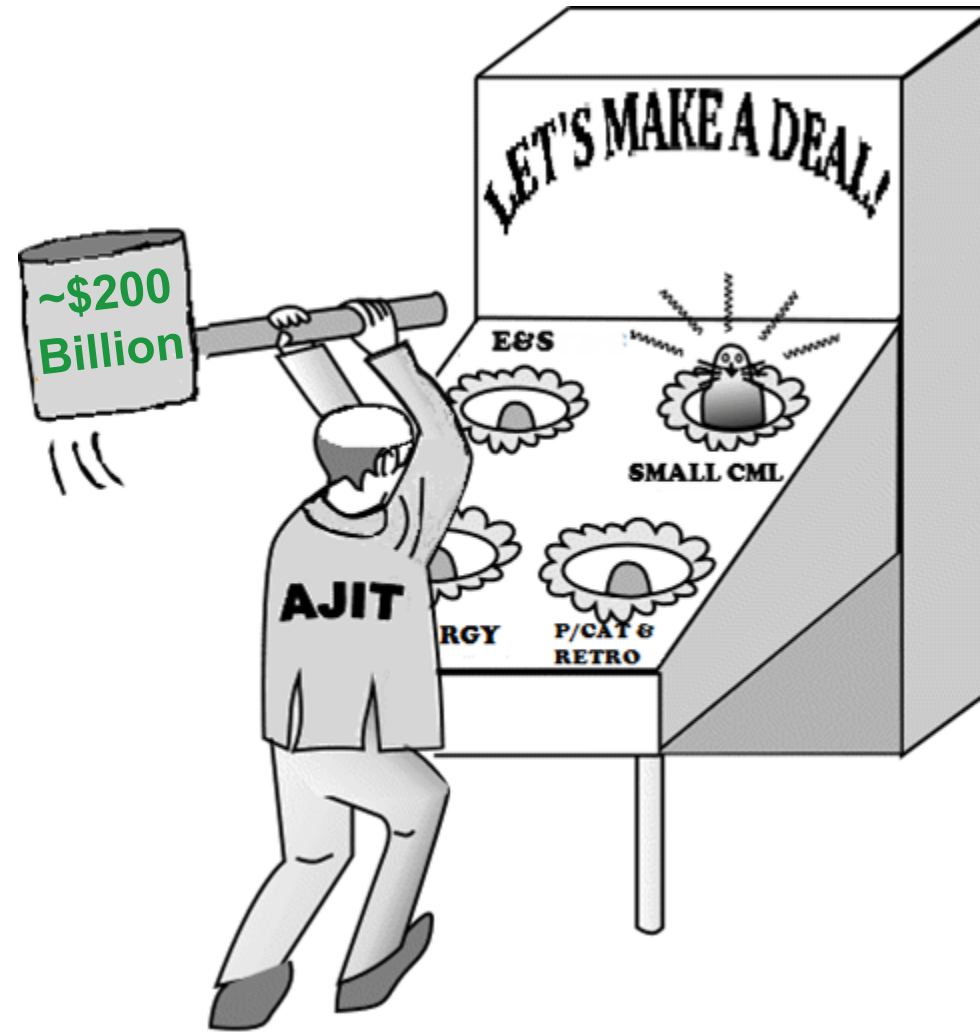
A BERKSHIRE HATHAWAY COMPANY
biBERK
BUSINESS INSURANCE

THREE
BY BERKSHIRE HATHAWAY



AJIT JAIN: PREPARED TO CRUSH PRICING IN ANY IMPROVING MARKET

“Whack A Mole”

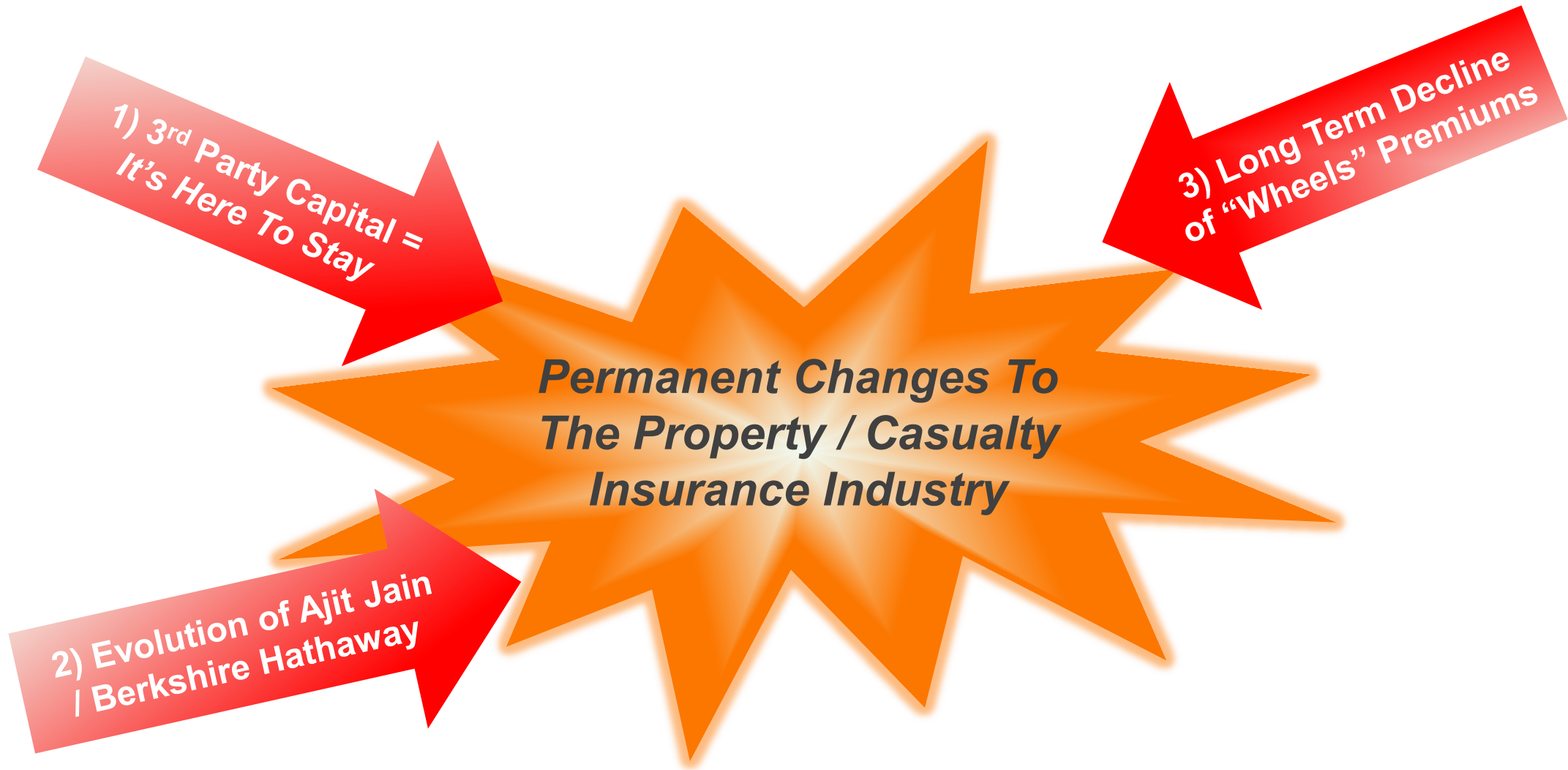


METAMORPHOSIS OF AJIT JAIN: WHY SHOULD WE CARE ?

- ❑ Lower Return Threshold Given “Total Return” Model For “Float” Generated
- ❑ No Fear Of “Channel Conflict” & Mindset To “Do A GEICO” In Commercial Lines = Direct
- ❑ At Over 20% Of Industry Surplus & Under Levered: “Whack A Mole” When Pricing Improves
- ❑ New Emphasis On Primary Commercial Lines = Moves Toward “Front Of The Bus”

A Powerful (Negative) Force On Overall Industry Pricing

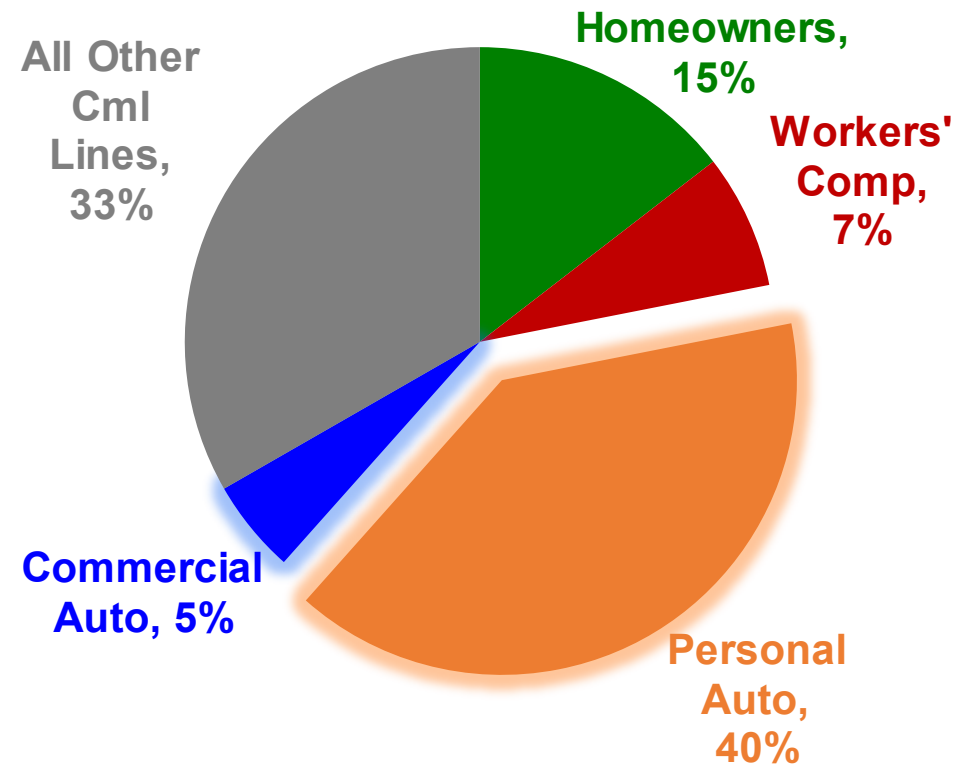
FIVE (SECULAR) FORCES ARE PERMANENTLY ALTERING INSURANCE



WHAT'S EXPECTED TO DRIVE THE PREMIUM DECLINE?

- ❑ Expansion Of Advanced / Autonomous Cars = 90% Fewer Accidents?
- ❑ More Transportation via Rideshare Options (e.g. Uber, Lyft, etc.)
- ❑ Auto Manufacturers Bundle Insurance At The Point Of Sale (The “All In” Subscription Purchase) = Wholesale Replaces Retail Product

**Personal Auto =
Largest Individual U.S. Line**



2019 U.S. Net Premiums Written; Source: SNL

DECLINE OF “WHEELS” PREMIUMS: WHY SHOULD WE CARE ?

- ❑ Reduction Of Premium = Significant Expense Pressure For Underwriters
- ❑ Where Will The Capital Currently Supporting “Wheels” Premium Go?
- ❑ Restructures Personal Lines Buying Patterns = Homeowners Will Be King
- ❑ Permits New Competitors To Emerge?

“Net it will be bad for the auto insurance industry over time if autonomous cars become a big part of the fleet.”

Warren Buffett, May 2018

“We Envision A World Where U.S. Personal Auto Premiums Decline To < 10% of U.S. Industry Premiums In My Lifetime.”





















VJD, Dowling & Partners, September 2013

FIVE (SECULAR) FORCES ARE PERMANENTLY ALTERING INSURANCE
























BROKER CONSOLIDATION = “POWER” OVER UNDERWRITERS

TOP 20 GLOBAL INTERMEDIARIES

1989 Rank	1989* Top 20 Broker	1989* Top 20 (\$, B)	1989* Top 20 Mkt. Sh.
 1	Marsh McLennan	\$2.5	27%
 2	Alexander & Alexander	\$1.2	14%
 3	Sedgwick Group	\$1.0	12%
 4	Johnson & Higgins	\$0.8	9%
 5	Corroon & Black	\$0.5	5%
 6	Willis Faber	\$0.5	5%
 7	Frank B. Hall	\$0.4	4%
 8	Rollins Burdick Hunter	\$0.3	4%
 9	Minet	\$0.3	3%
 10	Jardine Insurance Brokers	\$0.2	3%
TOP 10		\$7.7	86%
 11	C.E. Heath	\$0.2	2%
 12	Arthur J. Gallagher	\$0.2	2%
 13	Bain Clarkson PLC	\$0.2	2%
 14	Hogg Group PLC	\$0.2	2%
 15	Faugere & Jutheau	\$0.1	1%
 16	Jauch & Hubener	\$0.1	1%
 17	Hudig-Langeveldt Group	\$0.1	1%
 18	Gras Savoye SA	\$0.1	1%
 19	Sodarcam	\$0.1	1%
 20	Hilb, Rogal & Hamilton	\$0.1	1%
TOP 20		\$9.0	100%

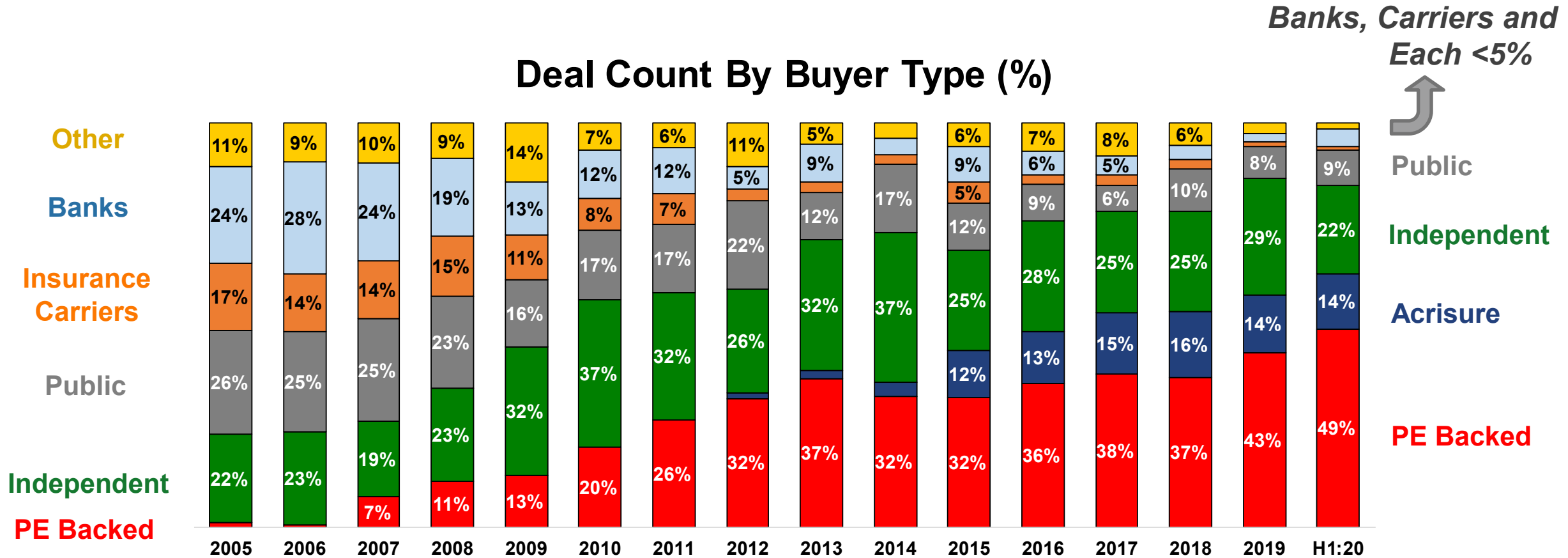
Source: A.M. Best Review; *Brokerage Revenue

2019 Rank	2019 Broker	Ownership	2019 (\$, B)	2019 Top 20 Mkt. Sh.
 1	PF Aon + WLTW	Public (NYSE)	\$20.1	31%
 2	Marsh & McLennan	Public (NYSE)	\$17.0	26%
 3	Aon PLC	Public (NYSE)	\$11.0	17%
 4	Willis Towers Watson	Public (NYSE)	\$9.0	14%
 5	Arthur J. Gallagher	Public (NYSE)	\$5.7	9%
 6	Hub International	Private Equity	\$2.4	4%
 7	Brown & Brown	Public (NYSE)	\$2.4	4%
 8	Truist	Bank / Public	\$2.1	3%
 9	Lockton	Private	\$1.9	3%
 10	USI Insurance Svcs	PE/ Management	\$1.9	3%
 11	Acrisure LLC	Private Equity	\$1.8	3%
TOP 10			\$55.2	85%
 11	Alliant Insurance Svcs	Private Equity	\$1.6	2%
 12	NFP Corp.	Private Equity	\$1.5	2%
 13	AssuredPartners	Private Equity	\$1.4	2%
 14	CBIZ	Public (NYSE)	\$0.9	1%
 15	Hyperion Insurance	PE/ Management	\$0.9	1%
 16	The Ardonaugh Group	Private Equity	\$0.9	1%
 17	BroadStreet Partners	Private Equity	\$0.7	1%
 18	Edgewood Partners / EPIC	Private Equity	\$0.7	1%
 19	Fanhua	Public (NASDAQ)	\$0.5	1%
 20	Risk Strategies	Private Equity	\$0.5	1%
TOP 20			\$65.0	100%

Source: Company Reports, The Hales Report

PRIVATE EQUITY'S INFLUENCE REMAINS STRONG

“LOWER FOR LONGER” CONTINUES TO AID PRIVATE EQUITY ROLLUPS



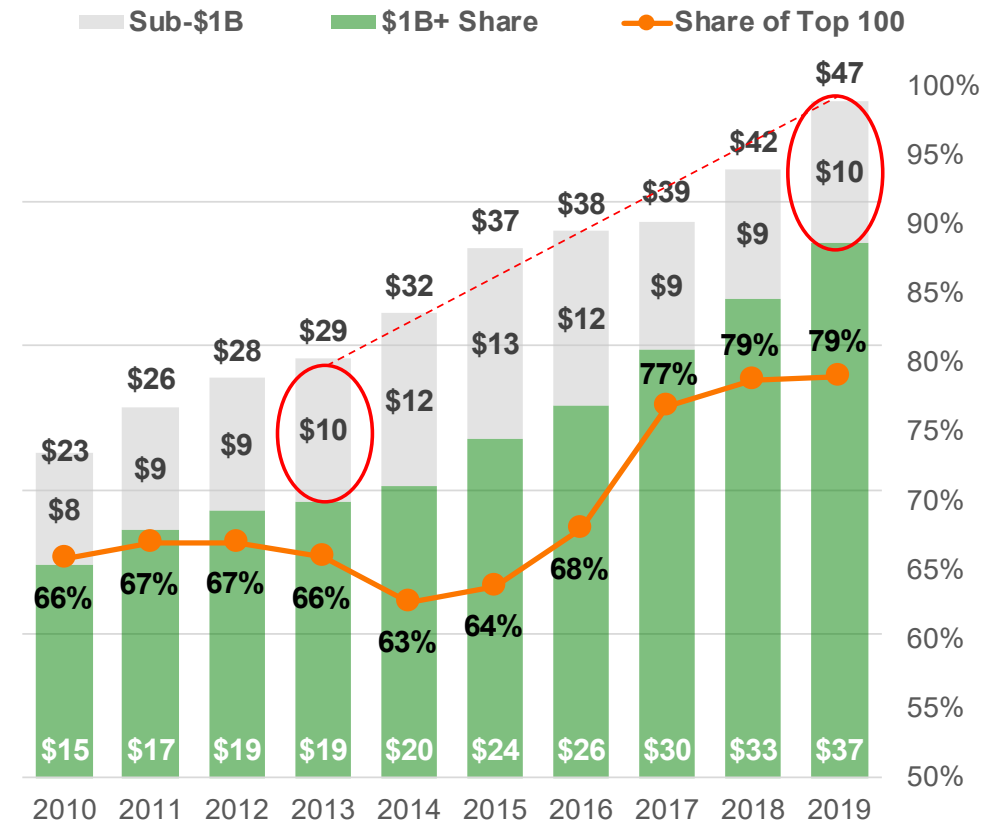
Source: SNL, FactSet, Dowling Hales Analysis. Labels Not Shown If <5%.

BILLION DOLLAR BROKERS INCREASINGLY DOMINATE = LEVERAGE

Hales \$1B+ U.S. Agents & Brokers

Rank		Company	U.S. Revenue (\$,M)			Ownership Type
18	19		2018	2019	% Chg	
1	1	Marsh & McLennan	\$7,219	\$7,840	8.6%	Public
2	2	Aon PLC	\$4,677	\$5,016	7.2%	Public
3	3	Willis Towers Watson	\$3,970	\$4,370	10.1%	Public
4	4	Arthur J. Gallagher	\$3,631	\$4,063	11.9%	Public
5	5	Brown & Brown	\$1,999	\$2,385	19.3%	Public
6	6	BB&T Insurance	\$1,958	\$2,215	13.1%	Public
7	7	USI Insurance Svcs	\$1,795	\$1,894	5.5%	Private Equity
8	8	Hub International	\$1,685	\$1,855	10.1%	Private Equity
10	9	Acrisure LLC	\$1,336	\$1,782	33.4%	PE/ Management
9	10	Alliant Insurance Svcs	\$1,351	\$1,585	17.3%	Private Equity
12	11	AssuredPartners	\$1,223	\$1,429	16.9%	Private Equity
11	12	Lockton	\$1,300	\$1,400	7.7%	Private
13	13	NFP Corp.	\$1,170	\$1,335	14.1%	Private Equity
Total U.S. Revenue			\$33,313	\$37,168	11.6%	

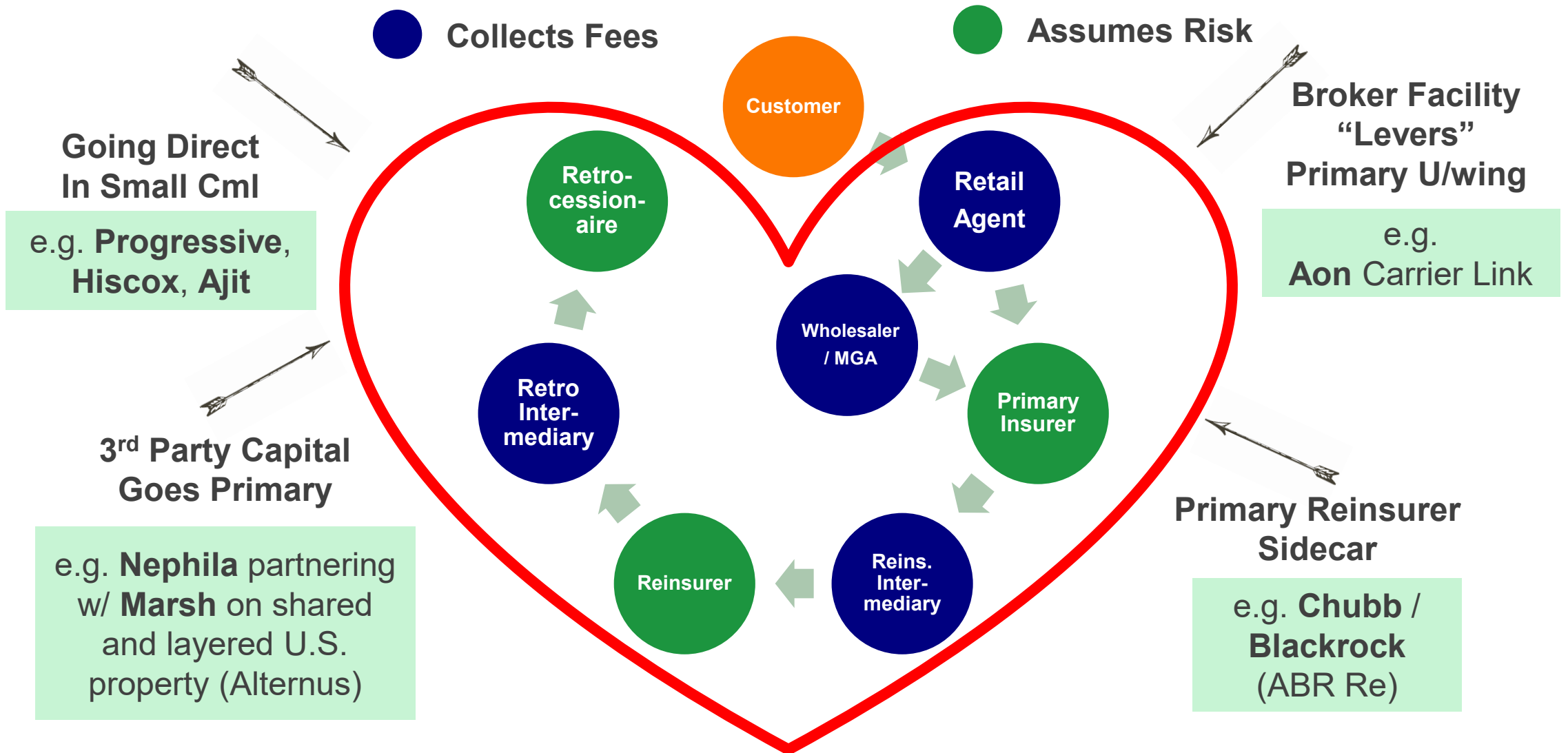
Rising "Share" For \$1B+ Brokers (\$, B)



Graph Source: Hales Top 100 Brokers & Agents (2019 & 2018), Business Insurance, Public Sources

Table Source: Dowling Hales proprietary survey, Company Reports.

DOWLING (RE)INSURANCE “CIRCLE OF LOVE”

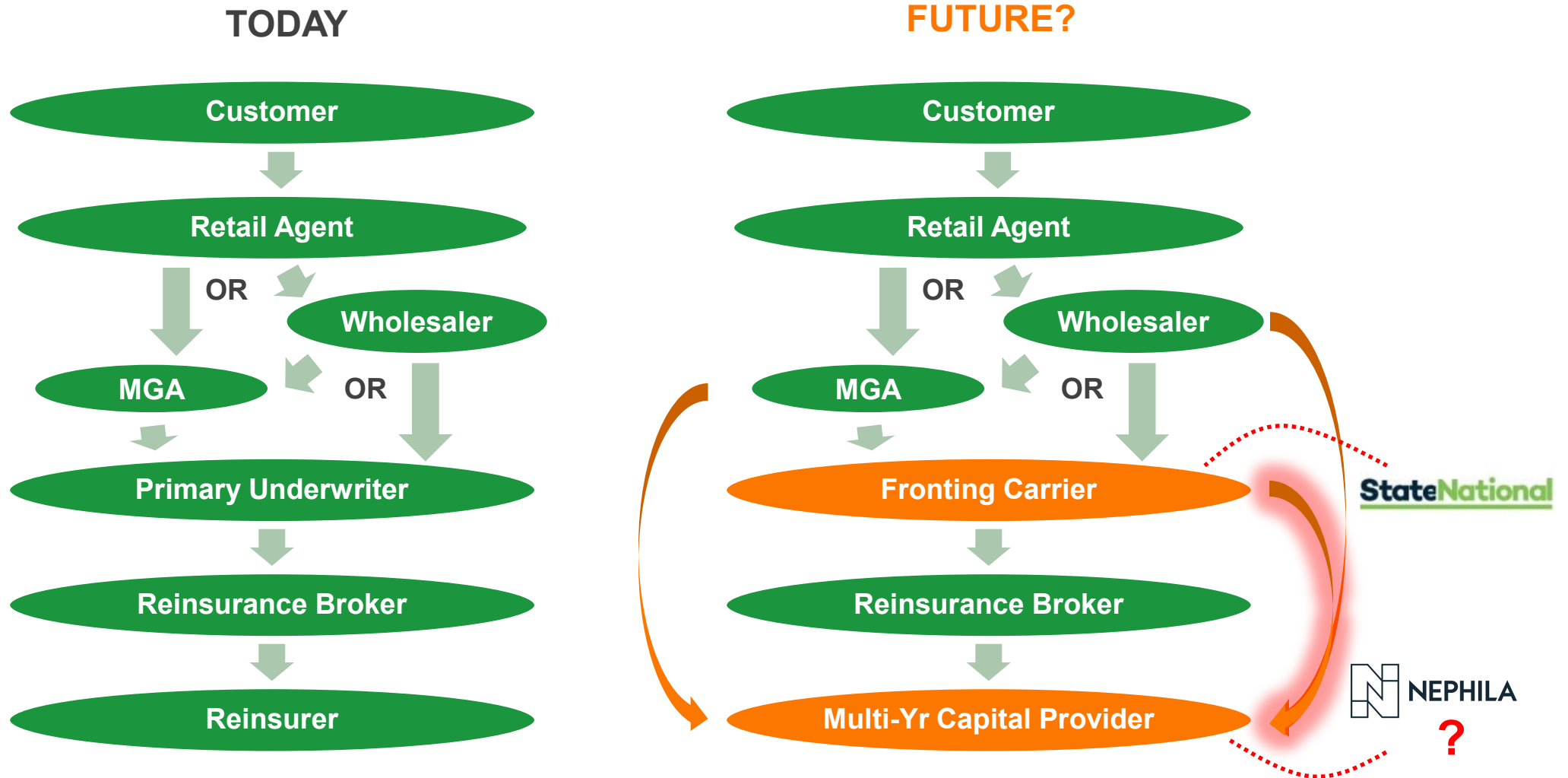


DISINTERMEDIATION OF INSURERS BY “BILLION \$\$” INTERMEDIARY?

*How Will The Billion Dollar Intermediary “Play”?
Are Underwriters At Risk of Disintermediation?*

- Marketing / Sales (Distribution) = He Who Controls The Customer Wins
- Underwriting (Think MGA/MGU Model)
- Claims / Account Service
- Customer Service
- Actuarial / Establishment of Reserves
- Best In Class Investments
- Assumption of Risk = Traditional & Non-Traditional Capital

HAS OUR THEORY BECOME REALITY?: STATE NATIONAL & NEPHILA UNDER MARKET ... POTENTIAL TO “TRUNCATE” THE VALUE CHAIN WITH “NEW” MODEL?



CONSOLIDATION OF BROKERS: WHY SHOULD WE CARE ?

- ❑ Accelerate Disintermediation Of Traditional (Re)Insurers
- ❑ Accelerate Growth Of Alternative/New Sources Of Risk Capital
- ❑ Lowers Overall Profitability Of Risk Assumption

“He Who Controls The Customer Wins”

FIVE (SECULAR) FORCES ARE PERMANENTLY ALTERING INSURANCE



*“The Existing Commercial Distribution
And Underwriting Cost Base Is
Unsustainable Long-term And The
Industry Is At Significant Risk of
Disruption from Outside Players.””*

WHAT'S THE PROBLEM = COST STRUCTURE UNSUSTAINABLE

Pure Losses = 56¢

Loss Adj. Expense 12¢

Commissions & Brokerage 13¢

**Understated Taxes = 2¢
Other G&A 13¢**

Profit 4¢



* 10 Year (2010-2019) Industry Results for Commercial Lines, Source: SNL Data, D&P Analysis

i.e. Loss Ratio

i.e. Expense Ratio

“WEST COAST” SAW INDUSTRY WITH LARGE “TAM” & LOTS OF FAT TECHNOLOGY MUST REDUCE ALL 3 PRINCIPAL “EXPENSE” BASES

1) General & Administrative (13% of Premium)

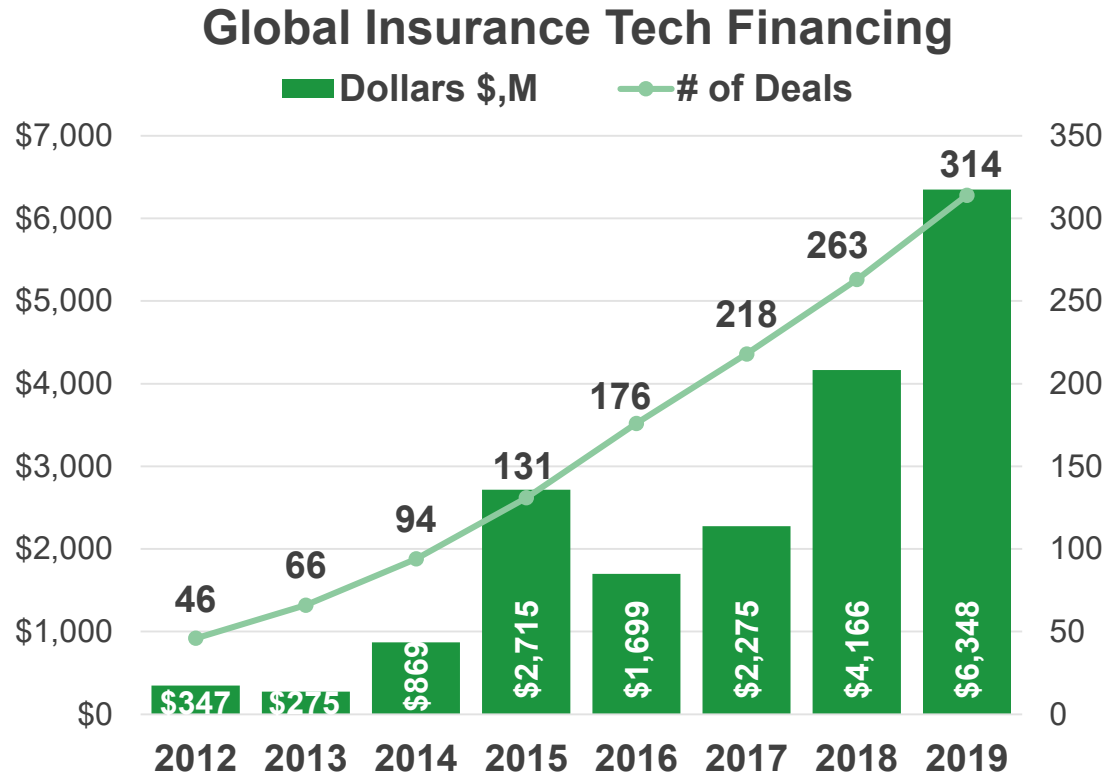
- Overhead
- Underwriting Expense

2) Claims Handling = Loss Adjustment Expense (12%)

3) Distribution = Truncate The “Value Chain” (13%*)

* Understated due to “fee income” paid directly to intermediary by client

INSURTECH FUNDING INCREASINGLY LOOKS TO INDUSTRY FOR \$\$\$ \$\$\$ BILLIONS WILL BE LOST BUT SIGNIFICANT CHANGE WILL OCCUR

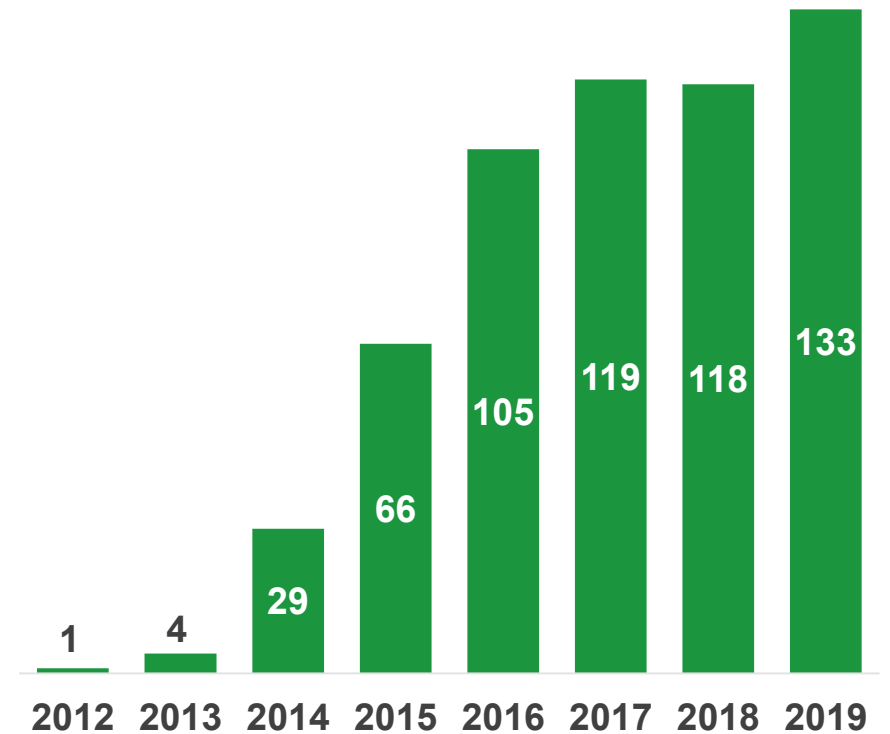


< 50 VC
Investors



500+ VC
Investors

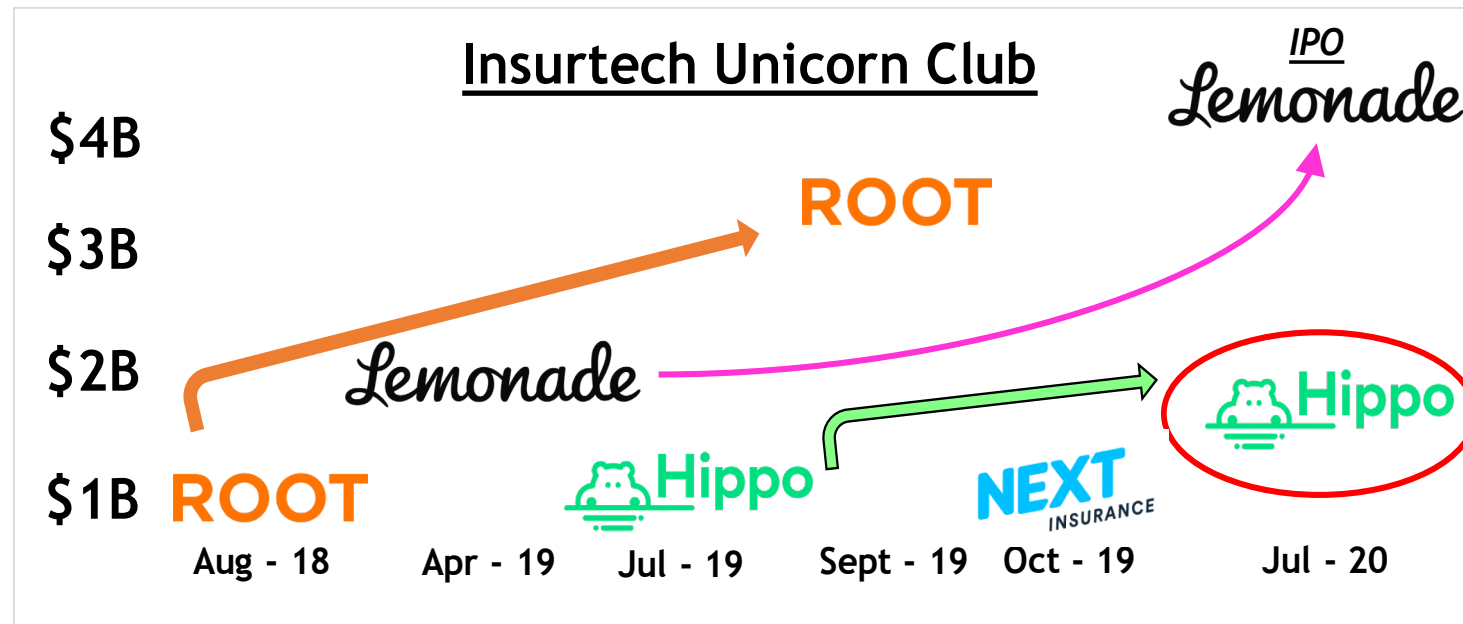
Tech Start Up Investments By (Re)insurers 2012 – 2019



Source: CB Insights, Willis Quarterly InsurTech Briefing

4 P/C INSURTECHS HAVE REACHED “UNICORN” STATUS (\$1B+ VALUATION)

- ❑ In “Tech World,” Valuations Are Based On Growth Potential And Total Addressable Market “TAM”... Rather Than Earnings
- ❑ Next Insurance Became 1st Cml Lines Focused Insurtech To Reach \$1B Valuation
- ❑ Joins Personal Lines Focused Hippo, Lemonade and Root



TRADITIONAL AGENTS WILL REMAIN PART OF CML LINES DISRUPTION...

September 2017

“There is little doubt that the entire insurance process will be direct and online in the future. There will no longer be the need for a mediator (in this case, an agent) between the insurance provider and the customer, as this online system will enable the customer to buy, maintain and handle claims all in one place.”

- Guy Goldstein,
Next Co-Founder and CEO

September 2019

“We recognize that some business owners prefer to work with an agent, so in order to ensure that our product is available to all businesses we launched Next for Agents.”

- Guy Goldstein,
Next Co-Founder and CEO

LEADING P/C INSURERS CHANGE TO MEET INSURTECH CHALLENGE

TRAVELERS 

**Moves From “Agent Centric”
To Multi-Distribution Model**

“[Simple business] is a minimum and long-term strategic action for us. ... It's not just being sure that we're positioned to serve the customer here whenever and from where they choose to engage with us.”

-- CEO Alan Schnitzer, April 2017

Slow Going In U.S.

CHUBB

**Targets 7 Small Business
Questions By Year-end 2019**

“For Chubb over the next eighteen months, we have to do about seven questions. We can't just scrape the carriers from data that is publicly available. We don't need to bother you. Actually, we'll ask you the questions that's your name, what's your address - and we'll be able to figure out the rest.”

-- Chubb CEO Evan Greenberg on CNBC's "Mad Money", July 2018

**Did Not Meet
Year-end Deadline**

PROGRESSIVE

**Expands To Non-Wheel
Direct Commercial Offering**

“We have ambitious plans to add additional partner carriers and small business insurance coverage over the next year as we seek to build the best digital-guided insurance shopping experience for busy small businesses.” “We are aspiring to move into a broader offering on our own paper as well.”

-- Tricia Griffith, Q3-18 Letter To Shareholders, October 2018

Expanded To Direct

DOWLING & PARTNERS CURRENT INSURTECH VIEW ...

Insurtech Is B.S.! = Spreadsheet Was Bigger Impact

- Talk of “Disruption” (2014-17) Largely Replaced By Insurtech Startups Desire For Cooperation/Enabling With Existing Industry Participants = Co-Opt Insurtech Startups.
- Insurtech Accelerates Disintermediation Of Traditional (Re)Insurers Functions As “SaaS” Enables/Accelerates A Larger Trend = 3rd Party Services “By The Drink.”
- Existing Players Not Providing Better/Faster/Cheaper Products & Services Plus Improved Customer Service Will Become M&A Roadkill.
- The Winners Of The Future Will Emerge Largely From Existing Players Who Embrace Significant Change In Customer Experience & Industry-Wide Expense Efficiency.

TECHNOLOGY & CAPITAL CHANGES = NEW BUSINESS MODELS

TARIFF RATINGS

MULTI-LINE ERA

aetnaSM

 **CIGNA**
CIGNA

TRAVELERS

“SPECIALIST”

PROGRESSIVE[®]

 **RLI**[®]
W. R. Berkley Corporation

START-UP (RE)INSURERS

RenaissanceRe

PartnerRe

 **VALIDUS**
GROUP

*“Two Men,
A Dog, A \$1B &
An A- Rating”*

NEW MODELS FOR DISTRIBUTION AND RISK ASSUMPTION

MGAs
Fronting Carriers
Pension Funds

Pre-1950s

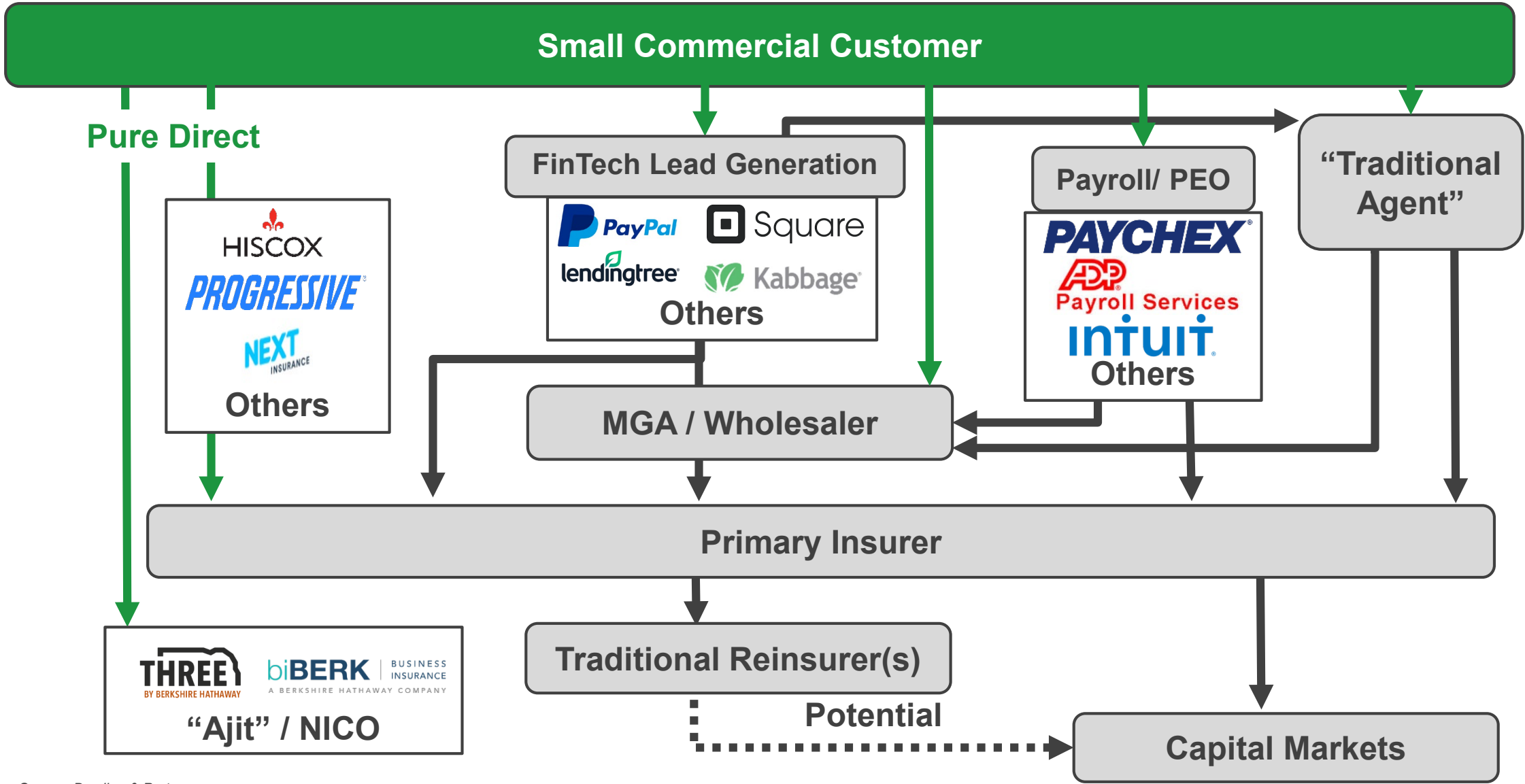
Mainframe
1950 - 1965

Minicomputer
1965 - 1985

Micro P/C Era
1985 - 2010

Cloud Computing, Big Data,
Direct Distribution,
Sophisticated Algorithms





Source: Dowling & Partners

BILL GATES COULD HAVE BEEN SPEAKING TO THE INSURANCE INDUSTRY ...



*"We always **overestimate the change** that will occur in the **next two years** and **underestimate the change** that will occur in the **next ten**. Don't let yourself be lulled into inaction."*

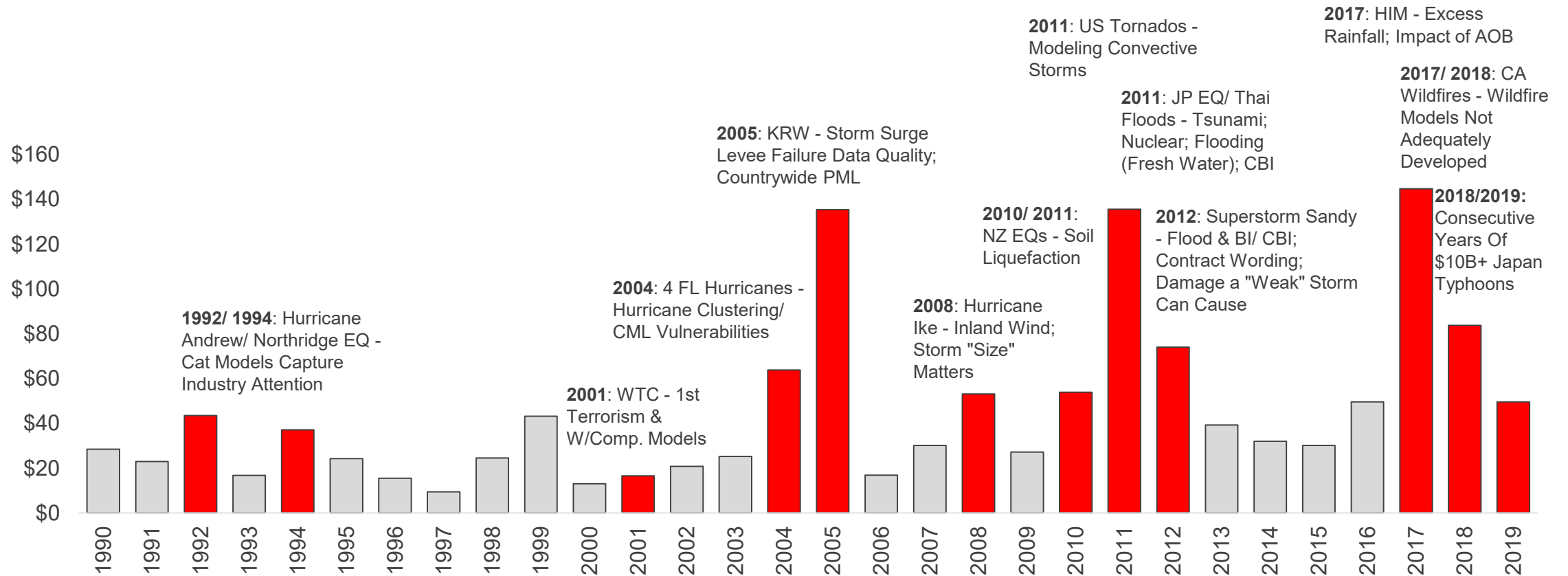
- The Road Ahead, Viking Penguin, 1995

THE PRICING ENVIRONMENT

**Rates Were Moving Pre-COVID-19 ... Uncertainty Accelerating
In The COVID-19 World, Tipping Some Markets “Hard”**

UNDERLYING EXPOSURE GREATER THAN THOUGHT: CAT MODELS

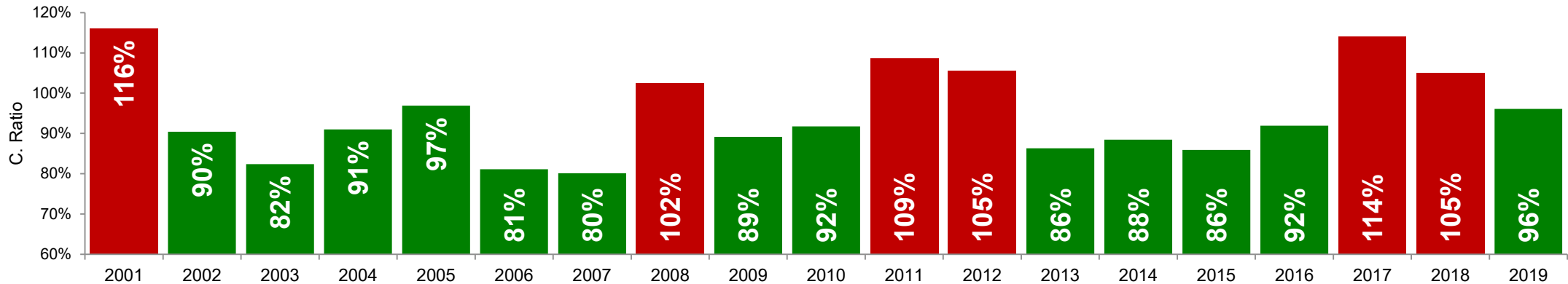
P/C (Re)insurance Annual Cat Losses (\$,B)/ Industry "Learnings"



Source: Swiss Re SIGMA

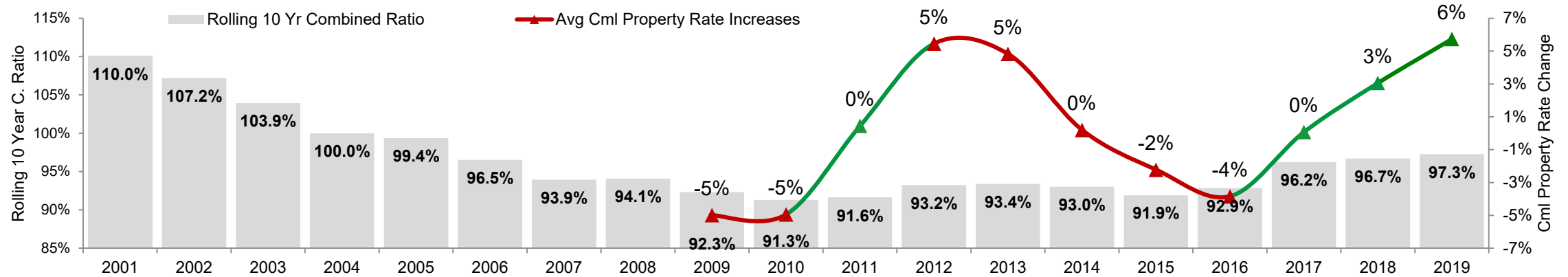
UNDERLYING EXPOSURE GREATER THAN THOUGHT: COMMERCIAL PROPERTY

COMMERCIAL PROPERTY: HISTORICAL CY C. RATIOS



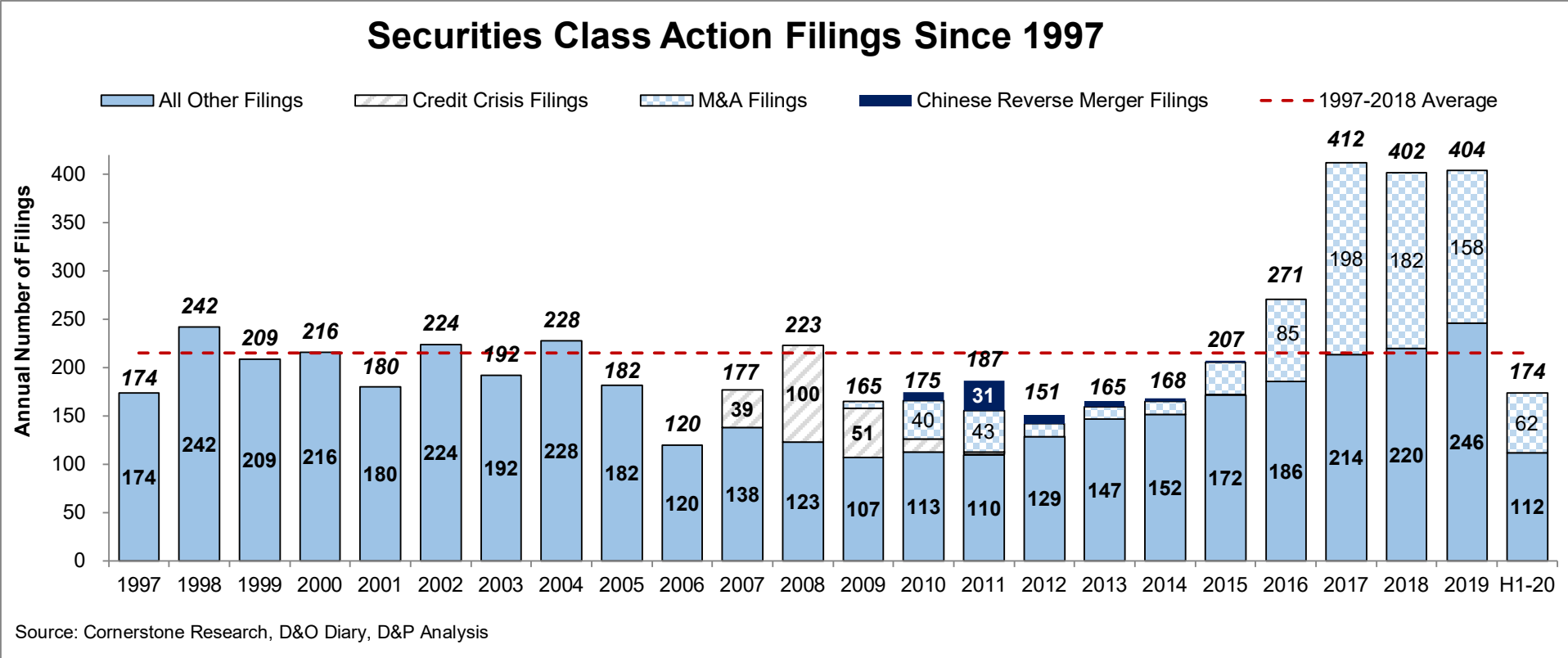
Source: Statutory Filings; D&P Analysis; Commercial Property = CMP (Non-Liab), Fire, Inland Marine, Allied Lines, Boiler & Machinery & EQ

Commercial Property Rolling 10 Yr Combined Ratio Vs. Rates



Note: (1) Cml Property = CMP (Non-Liab), Fire, Inland Marine, Allied Lines, Boiler & Machinery & EQ;
 (2) Cml Property Rate Increases = Average of CIAB, MarketScout. Source: Statutory Filings; D&P Analysis

SIGNIFICANT ↑ IN LAWSUITS = FREQUENCY & SEVERITY ISSUE

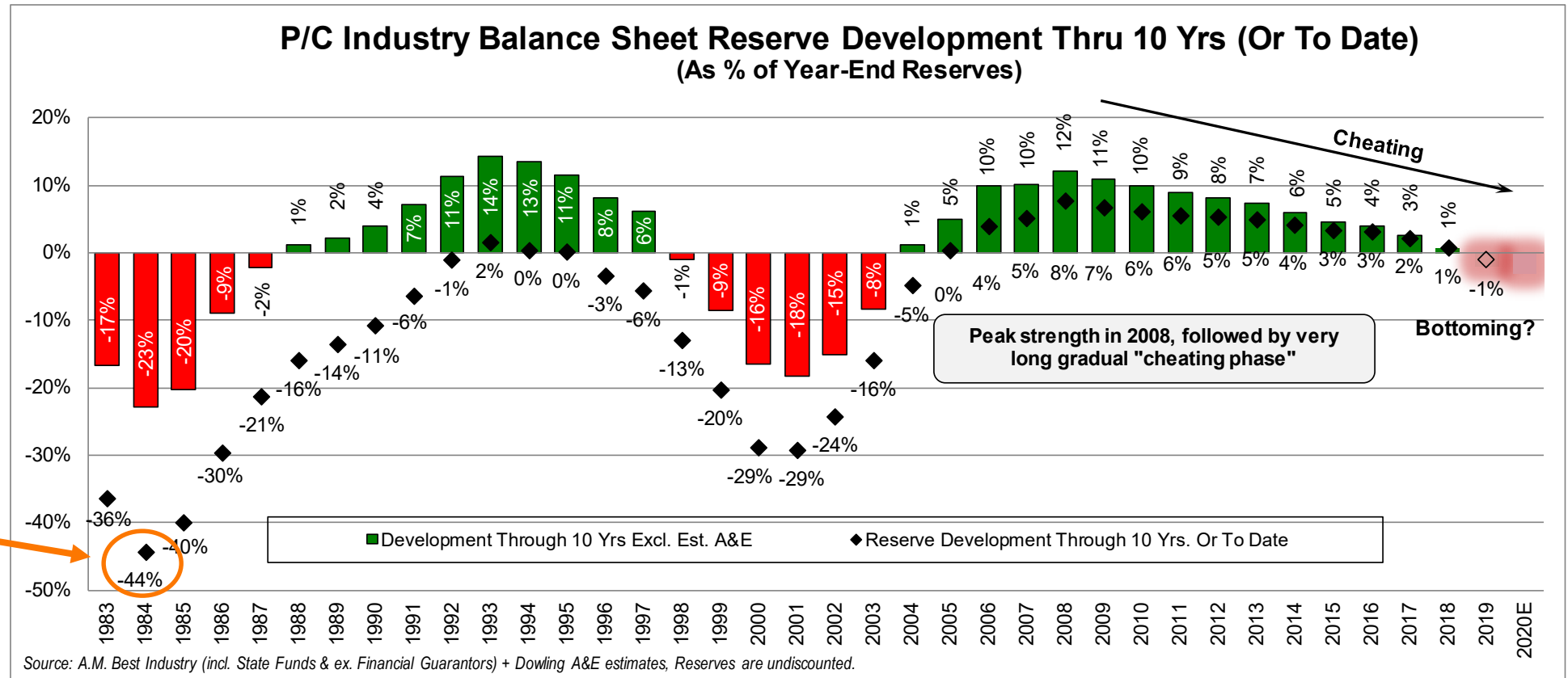


LIABILITY ENVIRONMENT: PRIOR YEAR RELEASES GOING AWAY

Spectacular Loss Experience Post-Financial Crisis Fed Prior Year Reserve Releases

What Happened To The Balance Sheet Reserves In The Subsequent 10 Years At Each Period.

Industry Loss Reserves As Of 1984 Proved Short By Fully 44% 10 Years Later.

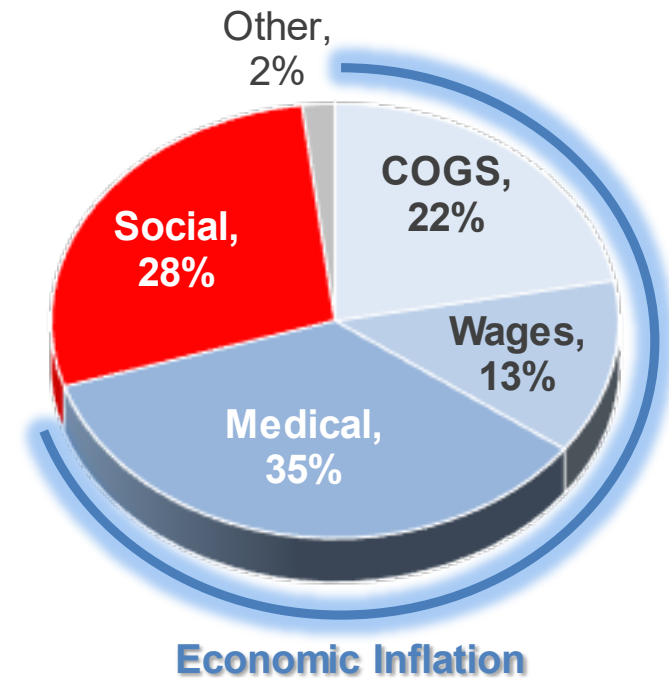


SOCIAL INFLATION IS STILL THERE THOUGH WITH A LIKELY TEMPORARY BENEFIT DUE TO COVID-19 CONDITIONS

- **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."* (Old Republic).

Now Courts Are Closed And Suddenly All Trends Have Shifted

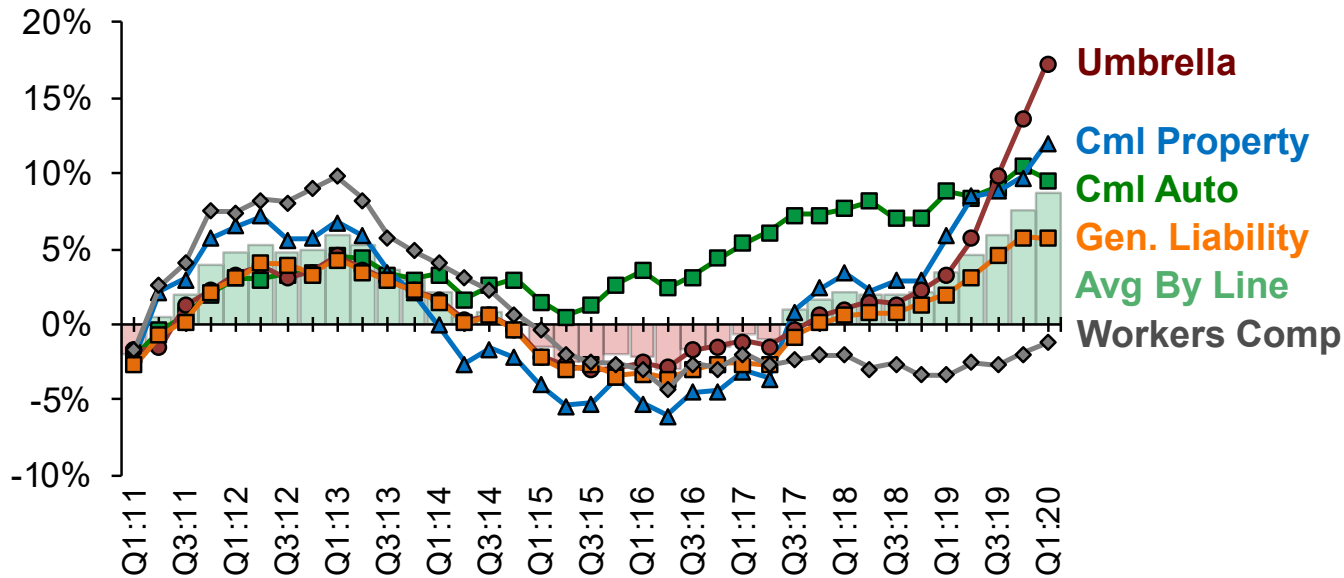
2019 U.S. Loss Reserve Mix By Estimated Inflation Type



Source: Statutory Statements, D&P Analysis

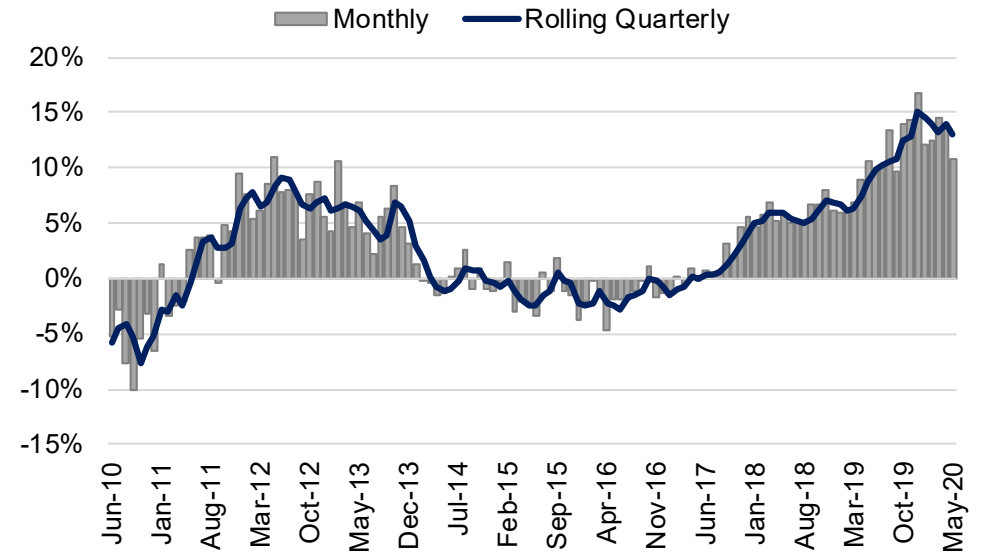
U.S. RATES HAVE INCREASED, BUT SO HAS UNCERTAINTY

CIAB: Average Premium Rate Changes By Major Line Of Business



Source: CIAB; D&P Analysis

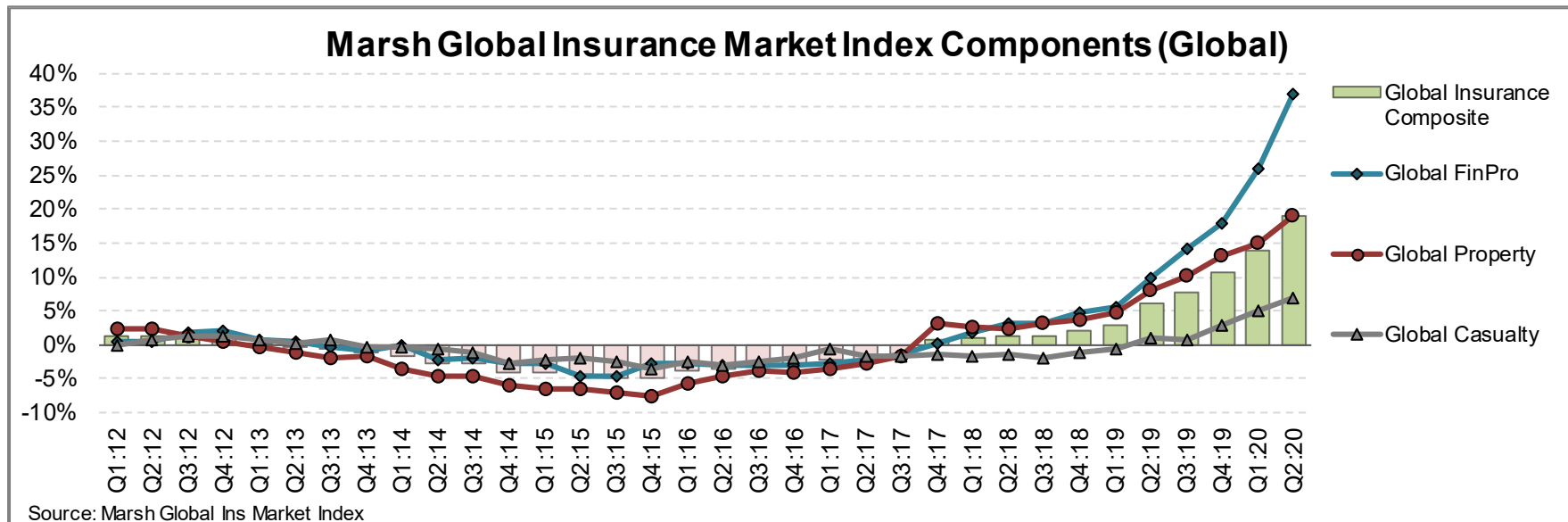
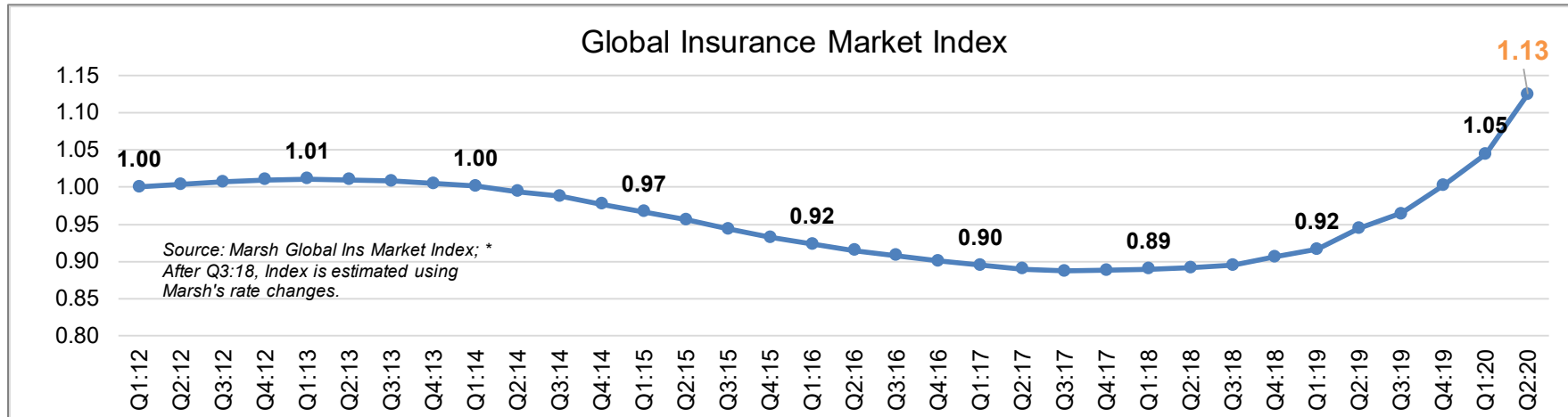
AmWINS E&S Pricing History - All Lines



Source: AmWINS

There Are Clearly Capacity Shortages In Particular Lines Of Business, While Workers Comp Has Served To Offset Somewhat, Given Favorable Results.

GLOBALLY ACROSS ALL COMMERCIAL LINES ...

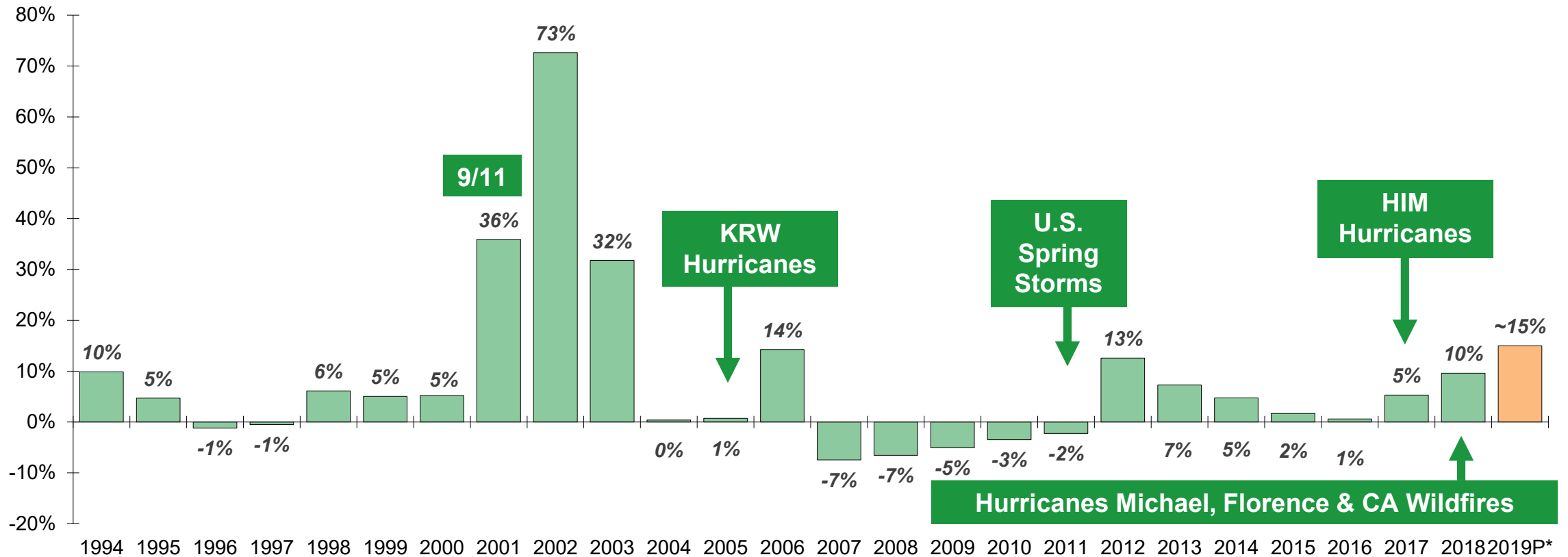


SO ARE WE BROADLY IN A HARD MARKET? NOT YET IN OUR VIEW

		Hard Market Catastrophic Events		
		2001 (9/11)	2005 (KRW)	2020 (Coronavirus)
Leading Up To Event ...				
	Reserve Adequacy	Significantly Deficient (30% of Reserves)	Adequate (0%)	Deficient (-1%)
	Premium:Surplus (Year Prior)	96%	109%	75%
	Interest Rates (10 Yr UST, Event Year @ YE)	5.07%	4.39%	0.59%
	Investment Yield (Year Prior)	5.13%	4.06%	3.19%
	Industry P/BV (Year Prior-To-Event @ YE)	163%	146%	149%
	Industry Operating ROE (Year Prior To Event)	3.1%	9.0%	6.7%
	U/wer Mkt Cap Ex. AIG/BRK (Year Prior To Event @ YE)	~\$170B	~\$260B	~\$410B
	Calendar Year C. Ratio	117.6%	105.5%	
	Initial Accident Year LR	77.8%	66.9%	Assume Deterioration
	Developed AY LR	82.7%	60.7%	
	Casualty Loss Trends	Accelerating	Moderate/Neutral	Accelerating
Catastrophic Event				
	Insured Losses	\$45B+	\$75B+ ex. NFIP	\$40-80B
	Lines Impacted	Multiple P/C lines	Property (Re)insurance	Multiple P/C lines
Post Event ...				
	Reinsurance Pricing (GuyCarp Global P/Cat ROL Index @ 1/1 Following Year)	+25%	+35%	+25% to +35% (as of mid-year renewals)
	Cml Pricing Per CIAB (Following Year)	+25%	-5%	+10% (Q1)
	E&S Premium Growth (Following Year)	+75%	+15%	+20% (Q1)
	Industry P/BV (Event Year @ YE)	154%	156%	119% (June-end)
	D&P U/wer Price Perform (1 Year Period Post-Event)	-1%	+7%	-20% (Since Pre-COVID)
	S&P 500 Price Perform (1 Year Period Post-Event)	-17%	+7%	-4% (Since Pre-COVID)

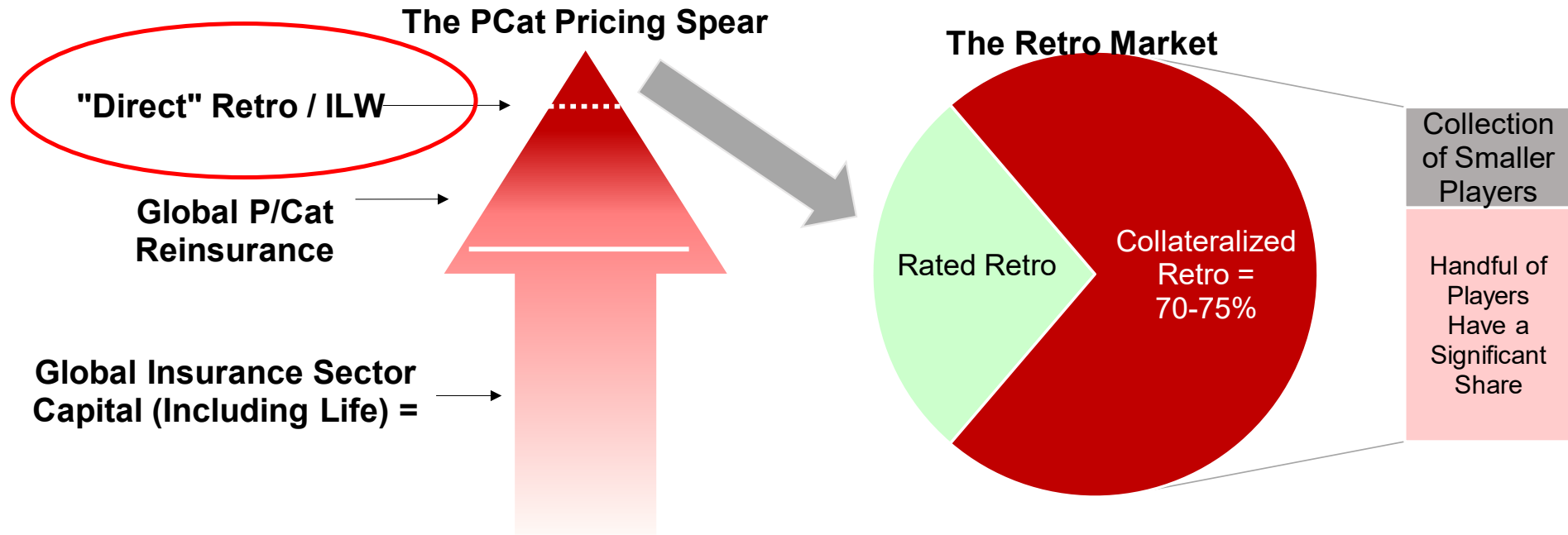
E&S: THE “SAFETY VALVE” FOR THE STANDARD MARKET

U.S. E&S Direct Written Premium Growth







Source: Historical Data = A.M. Best Excess and Surplus Study; D&P Analysis. *2019P = D&P Analysis

PROP. RETRO = LOSSES, TRAPPED CAPITAL & CLIMATE CHANGE



Source: Company Reports, D&P Analysis

PUBLIC COMPANY D&O = MORE FILINGS + SIGNIFICANT CAPACITY ↓

								
	U.S. FinPro	Global FinPro	Primary Public D&O	Public D&O	Financial Services	D&O	EPLI	
Q1-18	0.0%	1.8%	1.5%	1.6%	2.7%	1.0%	1.7%	
Q2-18	0.9%	3.3%	2.6%	-1.5%	3.0%	1.3%	1.9%	
Q3-18	1.1%	3.3%	3.2%	3.1%	1.8%	1.3%	1.4%	
Q4-18	1.5%	4.7%	3.6%	8.6%	2.8%	1.5%	1.8%	
Q1-19	2.8%	5.6%	4.6%	9.4%	3.4%	3.2%	2.6%	
Q2-19	7.0%	9.7%	6.8%	9.1%	5.2%	4.3%	3.2%	
Q3-19	11.2%	14.2%	12.1%	22.6%	6.7%	5.0%	3.2%	
Q4-19	15.2%	17.8%	14.8%	44.2%	7.2%	7.0%	4.6%	
Q1-20	22.9%	26.2%	26.2%	82.9%	7.2%	8.9%	5.5%	
Q2-20	30.0%	37.0%	23.4%	61.2%				

Source: AmWINS, Aon, CIAB, Marsh

QUESTIONS?

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