Effect of the Credit Crunch on non-life insurance

GIRO Edinburgh
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Who we are

- graham.fulcher@watsonwyatt.com
- Watson Wyatt for 1 year
- ACE Europe Chief Actuary, 6 years
- Cox / Cologne Re 6 years
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- Amlin Group Actuary, 10 years
- EMB consultant, 4 years
- ActEd / Hazell Carr tutor, 5 years
Agenda

- Financial effects (Graham)
- Catastrophe bonds (Graham)
- Effect by line of business (Phil)
- Some possible longer-term effects (Graham)
- Q&A

(Easy: Phil, Hard: Graham, Very Hard: Audience)

Source: Bank of England
August 2009 Inflation Report - (market interest rate expectations, £175 billion asset purchases)
Financials: Share prices

FTSE Insurance/Bank Indices - % change by month

Index: 100 = Sep 2006

FTSE 350 Life Insurance
FTSE 350 Non-Life Insurance
FTSE 350 Banks Index

Data Source: Bloomberg

With thanks to Atlas Partners & Insurance Insider
Financials: Share prices

Financials: MV/BV ratios

With thanks to Atlas Partners & Insurance Insider
Financials: CDS spreads

CDS Spreads - Europe (3 year)

Basis Points

Zurich
Allianz
HannRe
MunichRe

Data Source: Bloomberg

Financials: CDS spreads

CDS Spreads - Other U.S. (3 year)

Basis Points

Chubb Corp
ACE Ltd
Berkshire Hathaway
Liberty Mutual Ins

Data Source: Bloomberg
**Financials: CDS spreads**

CDS Spreads (3 year)

![CDS Spreads Chart]

Data Source: Bloomberg

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**Catastrophe Bonds: Returns and Diversification**

![Catastrophe Bonds Chart]

The Actuarial Profession

making financial sense of the future
Catastrophe bonds: Collateral Issues

Image source: Lane Financial

Catastrophe Bonds: Issuance

Source: Datastream
1. Adjusted for $360m Panther Re sidecar early redemption.
Catastrophe Bonds: Pricing

Source: Indicative secondary pricing matrix on selected ILS from various broker dealers in ILS as of 31st August 2009

Impact on Non-life Insurers

Plan for this bit:
- Several large issues to consider
- Differential impacts on classes

- Start with the Baltic Dry Index
  - Significant for cargo & hull insurers
  - Also leading indicator for investors(?)
  - 94% down
    - 11,793 on 20/05/08 to 663 on 05/12/08 …
Issue 1: Less Activity

Source: bespoke investment group
Issue 1: Less Activity

- Contrast this view from 1985
- Recent fall is dramatic, even in LT view
- But 2006-2008 spike perhaps the real story

- Many insurers haven’t felt it, but there’s been real pain
- Less trade
- (Lots) less finance
- Many companies batten down or fail
  - Especially financial, manufacturing, trading, transport
- Less premium
- Lower exposure (by count, at least)
- Net impact variable across classes
  - Good news where exposure falls faster than premium?!
Issue 2: Lower Prices

- Related issue – dramatic fall in prices of commodities
- Consider Oil price changes
- Key raw material in and of itself
- Proxy for price change other “raw material” items
- Importance of transport costs:
  - Is widespread – impacts most sectors
  - Can be deep – large component in some sectors

Source: wrtg.com
Issue 2: Lower Prices

- Much lower values for commodities
- Reduces exposure value for stocks
- Cuts potential business interruption indemnity

- Beneficial to most insurers in short term
- Previous inflationary bubble burst
  - *Some of us were getting concerned about this*

- More complex effects in medium term

Source: thisismoney.co.uk
Issue 3: Direct Claims

- More insurance claims in some classes, eg
  - Financial Institutions
  - Credit
  - Fidelity
  - D&O
  - E&O
- Impact already huge in some classes
- And “things in the pipeline” for others(?!)

Issue 3: Direct Claims

- Insurers pain is not uniform
  - As always, falls on some heavier than others
- Some are busy surviving
- Others may be salivating about price rises
- Processing delays increase uncertainty
Issue 4: Affordability Pressures

- Lots of insureds are “suffering”
- Can’t afford insurance hikes
- Don’t invest in newer machines
- Also risk management reductions?
  - Maintenance standards lower
- Suppression of some issues
  - Struggle on, ignoring bad news?
- Increased moral hazard
  - “Way out” for pressurised insureds?

Issue 5: Indirect Claims

- Indirect impact on some classes:
  - Bad – repair ship previously too profitable to fix
  - Good – machines work below “breaking” volumes

- Affordability issues are storing up future claims

Reserving actuaries to think about tails again!
Catch-all issues slide

- Inability of insurers to (re)capitalise
  - Is insurance pricing just Supply & Demand?
  - Constraint on some plans (Bermuda but not London?)
  - Even after an active 2009 season, no “class of 2009”
- Domestic insurers defending hard
  - Less good stuff gets to London
  - US and other markets
- Brokers suffering too
  - Tough talking, cut staff & standards?, E&O later?

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But keep perspective

Eg Airline insurance

- Less flights / RPKs
- Load factors might increase (if fewer but fuller flights)
- Minimum premium (if exists) bites
- Capital constraints, but still huge oversupply

- EVENTS will drive results & prices, not the credit crunch
Discuss your favourite class … ?

Debate the net impact on any or all class(es)?

Not now … but at the end, if that’s what you’d like

Medium Term: Capital modelling implications

Changes to economic capital model being considered in light of recent market developments

Source: CRO Forum Survey January 2009
**Longer term effects: Macro-economics**

- Inflation; the slayed dragon returns
  - High and unpredictable
  - Issue for long-tail and XoL
- Other issues:
  - FX volatility
  - Prolonged low returns
- Global Power shift
  - Western/Sino
  - Sovereign Wealth Funds

*Image source: Wiki archives, New Yorker*

**Longer term effects: Regulation**

- Risk of “one-size fits all” policy
- Likely themes:
  - Cynicism and challenge
  - Stress and scenario
  - Conservatism and cyclicality
  - Remuneration and risk
- Supervisory co-ordination:
  - Lacking in the short term
  - Legislated in the medium-term

*Image source: BBC, Le Monde*
Longer term effects: Government Financing

- Spend and tax replaces tax and spend
- The consequences:
  - Increasing taxation burden
  - Recouping costs from insurers
  - Clamp down on tax-havens
- Opportunities:
  - Shift from public to private sector provision of protection (except US healthcare)
  - States ceasing to act as catastrophe insurers of last or even first resort

Image source: newsbusters.org, Reuters

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Longer term effects: Counterparty Risk

- Lessons
  - Repackaging and renaming risk does not remove it
  - Rating agency ratings are fallible
  - Risk may return or be untransferable
- Implications:
  - Re-evaluation of trading books
  - Return to syndication
  - Focus on LOD reinsurance

Image source: BBC
Longer term effects: Other

- Recruitment
  - One-off chance to boost?
- Strategy:
  - Dispersion versus diversification
  - Empowerment versus control
  - Defensibility and adaptability

Image source: BBC