



ALIRT
INSURANCE RESEARCH

TMPAA Webinar

Covid-19: Potential Impacts on P&C Insurance Carriers and Your Program

Thursday, April 30, 2020

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ALIRT INSURANCE RESEARCH, LLC

- Provides private credit analytics on the life, property & casualty, and health industries
- Located in Windsor, CT
- Years in Business: 21
- Principals have worked together providing credit oversight on insurers for the past 30 years
- Produces quarterly financial analyses on approximately 500 Life, 1,700 P&C, and 450 managed care insurers (U.S.); foreign analyses includes Bermuda, Lloyds, and London Market insurers.
- Analysis generated by running statutory and GAAP financials through a proprietary model that screens for relative financial strength
- Clients: distributors of insurance products, end users of insurance products, asset managers, boards of directors, insurers
- Purpose 1: to “get below” the public ratings in order to more accurately determine the *relative* financial strength and weakness of insurers
- Purpose 2: Act as the outsourced due diligence staff for our agency/broker clients.

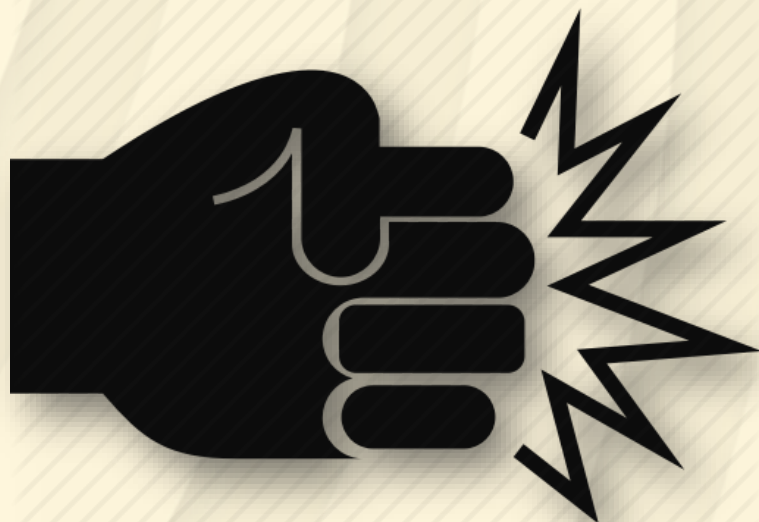
Credit Analysis: What Is It?

Credit Analysis is the study of whether an entity can make good on its financial obligations. Such obligations can include Bond Interest/Principal, Mortgage Loans, Business/Personal Loans, as well as the payment of insurance claims.

Credit analysts pay close attention to an entity's balance sheet as an expression of its relative financial health or 'solvency.'



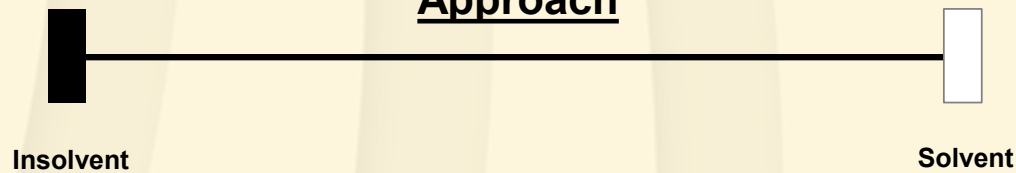
Credit Analysis: Special Considerations



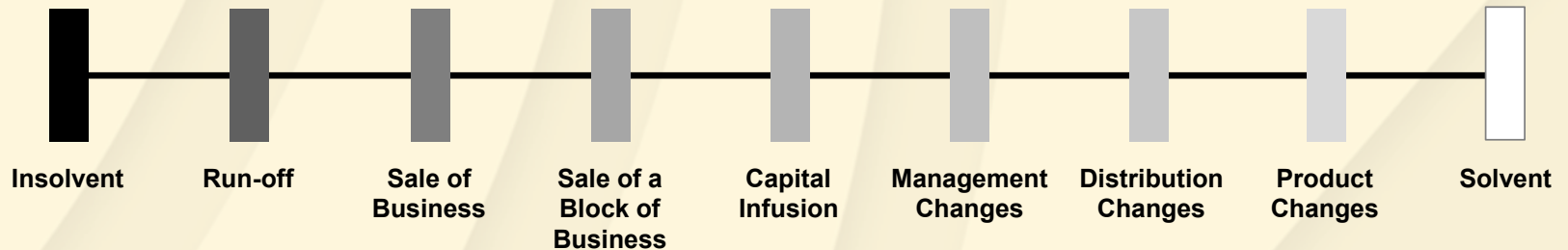
- *Because the future is to a large extent unknowable, credit analysts focus on the relative financial strength of an individual or entity.*
- *In the context of insurance analysis, ALIRT concentrates on the ability of an insurer to “take a punch” and remain standing.*
- *“Punches” can include losses arising from a cyclical deterioration in the industry’s pricing/profitability, shock losses, investment losses, or the adverse impact of economic downturns.”*

Credit Analysis: Special Considerations

From A Binary Approach



To A Spectrum Approach



Per the National Conference of Insurance Guaranty Funds:
600 U.S. P&C insolvencies since 1969 = on average $\frac{1}{2}$ of 1% point each year

Credit Analysis and the Current Environment

“And I think this event is very likely -- more than very likely, I think this event will be the largest event in insurance history, when you add it all up, both asset side and liability side of the balance sheet.” (Evan Greenberg, Chubb Ltd. CEO – 1Q2020 Analyst Call)

“This pandemic was no doubt the largest insurance challenge the industry has ever faced, I think by some way. The chances of the market making anything other than a notable loss in 2020 are zero.” (John Neal, Lloyd’s CEO – Financial Times interview)

Four Periods of Financial Stress - 1990 - 2020 **Degrees of Severity**

Years	Cause	PC Market Cycle	Catastrophes	Capital Market Disruption	Economic Downturn	Impact on U.S. P&C Industry
1990	Oil Price Shock	Low	Low	Med.	Med.	Low
2001	Tech Bust	High	Med.	Med.	Med.	High
08-'09	Mortgage Bust	Low	Low	High	High	Low
2020	Coronavirus Pandemic	Low	High	High	High	???

Balance Sheet of the U.S. P&C Industry - 2019

Assets

Invested Assets	85%
Premiums Receivable	9%
Reinsurance Recoverable	2%
Other Assets	4%
<hr/>	
Total Assets	100%

Liabilities and Surplus

Loss Reserves	26%
Loss Adj. Expense Reserves	5%
Unearned Premiums	13%
Other Liabilities	17%
<hr style="border-top: 1px dashed black;"/>	
Policyholders' Surplus	39%
<hr/>	
Total Liabilities & Surplus	100%

U.S. P&C Industry figures per S&P Global Market Intelligence (as of 12/31/2019)

Assets = \$2.2 Trillion

Loss & LAE = \$680 billion

Total Surplus = \$865 billion

The Balance Sheet: Asset Issues



Largest Asset Classes **(% of Invested Assets – YE2019)**

- Bonds (57%)
 - BBB
 - Non-Investment Grade
 - MBS/ABS
 - Privately Placed
 - Longer Maturity
- Affiliated Stocks (5%)
- Unaffiliated Stocks (21%)
- Cash/ST Inv. (6%)
- Alt. Investments (8%)

Issues

- Duration and Severity of Shut Down
- Degree of Government Support
- Insurer Exposures
- Treatment of Realized Losses
- Treatment of Unrealized Losses
- Impact of Losses on RBC
- Impact to Investment Income

The Balance Sheet: Asset Issues



Premium Receivables

- In Course of Collection
- Deferred Premium Not Due
- Accrued Retrospective Premium

Issues

- Usually Not an Issue, But ...
 - State Governments Have Decreed Forbearance
 - Will All Premiums Be Collected?
-

Reinsurance Recoverables

- On Paid Claims

Issues

- Credit Quality of Reinsurers – Can They Pay
- Coverage Issues – Will They Pay?

The Balance Sheet: Asset Issues



Parlor Game: Potential Investment Loss Impact to U.S. P&C Industry Surplus from Current Pandemic Crisis

	As a % of Surplus									Total
	Investment Grade Bonds			BIG			Stocks		Sch. BA	
	Class 1	Class 2	Class 3-6	MBS/ABS	Privates	Munis	Affiliated	Unaffil.		
As % of Surplus	105%	21%	6%	31%	22%	44%	11%	46%	17%	
% Impairment (?)	0.4%	1.1%	15.0%	5.0%	2.0%	2.0%	5.0%	15.0%	5.0%	
Total % Impaired	0.5%	0.2%	0.9%	1.5%	0.4%	0.9%	0.6%	6.9%	0.9%	12.8%
Surplus Decline (\$BB)	3,982	1,979	7,443	13,279	3,714	7,570	4,900	59,713	7,375	109,955

U.S. P&C Industry Surplus Declines: U.S. P&C Industry 2019 PT Operating Earnings = \$52.2 billion

2001 = -7.7%

2008 = -12.7%

2020 = -13.7? (surplus impairment on investments and loss reserves, less last year's net income)

The Balance Sheet: Liability Issues

Loss Reserves
LAE Reserves



Surplus



Lines of Business At Risk **(% of Loss & LAE – YE2019)**

- BI – (CMP, Fire & Allied – 9.0%)
- Workers Compensation – (21.4%)
- Other Liability – (20.2%)
- D&O (Other Liability)
- Medical Malpractice (4.1%)
- Event Cancellation (Inland Marine)
- Cyber Insurance (Other Liability)
- Media & Entertainment Coverages
- Surety
- Trade Credit Insurance (0.1%)
- Travel Insurance (Inland Marine)
- Accident & Health
- Mortgage Insurance (0.5%)

Issues

- Insurer Exposures (By Line/Geography/ Bus. Sector)
- Severity & Frequency of Loss
 - “Offsets”
- Coverage Disputes
 - Legal Costs (Litigation)
- Regulatory/Legislative Actions
 - Forced Coverage
 - Blanket Immunity
- Reinsurance Disputes
 - 14% of Gross Premiums Ceded to 3rd Party Reinsurers in 2019

The Balance Sheet: Liability Issues

Loss Reserves
LAE Reserves



Surplus



Parlor Game: Potential Reserve Loss Impact To U.S. P&C Industry Surplus from Current Pandemic Crisis

	As a % of Surplus			Total
	Reserve Liabilities		Reins. Recov.	
	Loss	LAE		
As % of Surplus	65%	14%	13%	
% Impairment (?)	8.5%	8.5%	2.0%	
% of Surplus Impaired	5.5%	1.2%	0.3%	7.0%
Surplus Decline (\$BB)	47,606	10,165	2,237	60,008

Initial Industry Loss Estimates:

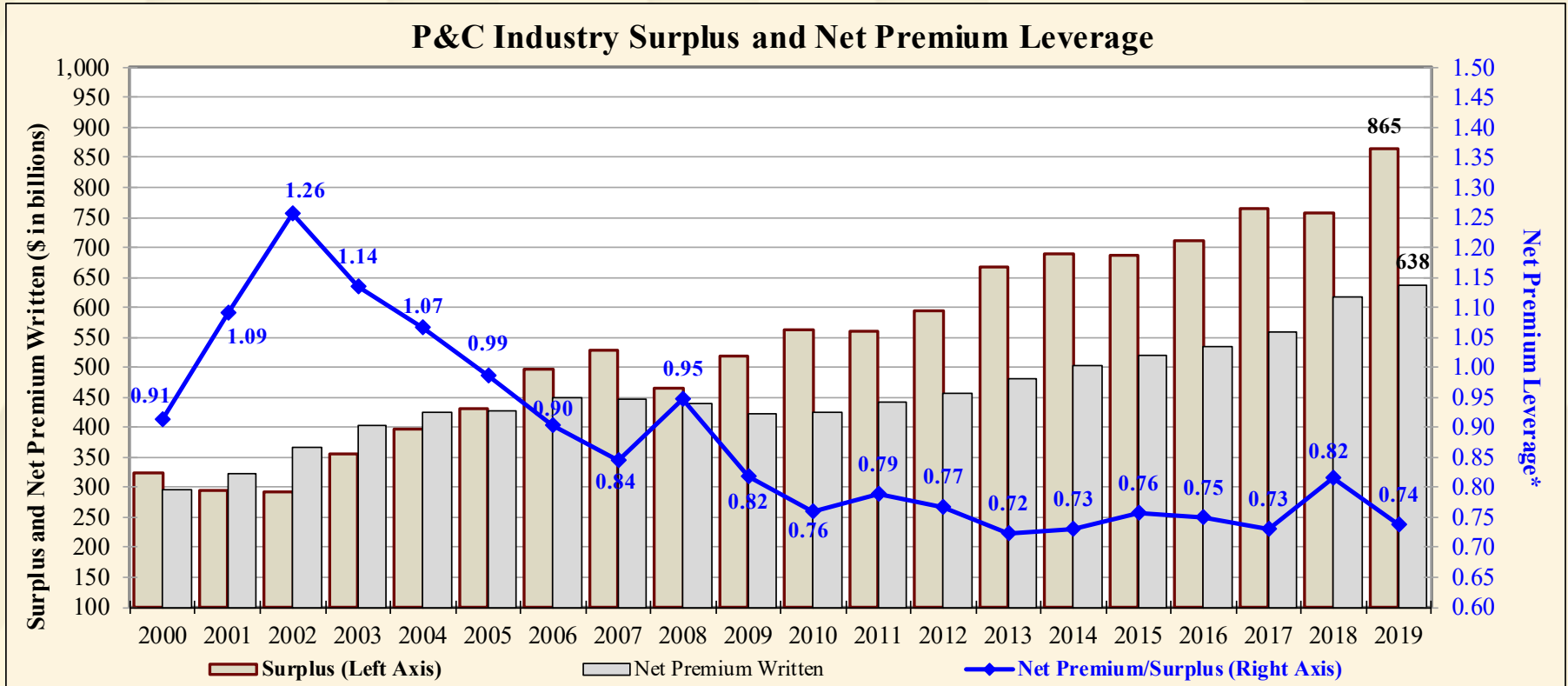
1. \$40 billion - \$80 billion in claims (Dowling & Partners)
2. \$60 billion (UBS)
3. Evan Greenberg – “Tens of billions in claims”
4. John Neal – “Tens of billions, if not hundreds of billions.”

U.S. P&C Industry Surplus Declines:

2001 = -7.7%
 2008 = -12.7%
 2020 = -13.7? (surplus impairment on investments and loss reserves, less last year's net income)

U.S. P&C Industry 2019 PT Operating Earnings = \$52.2 billion

The Balance Sheet: Surplus

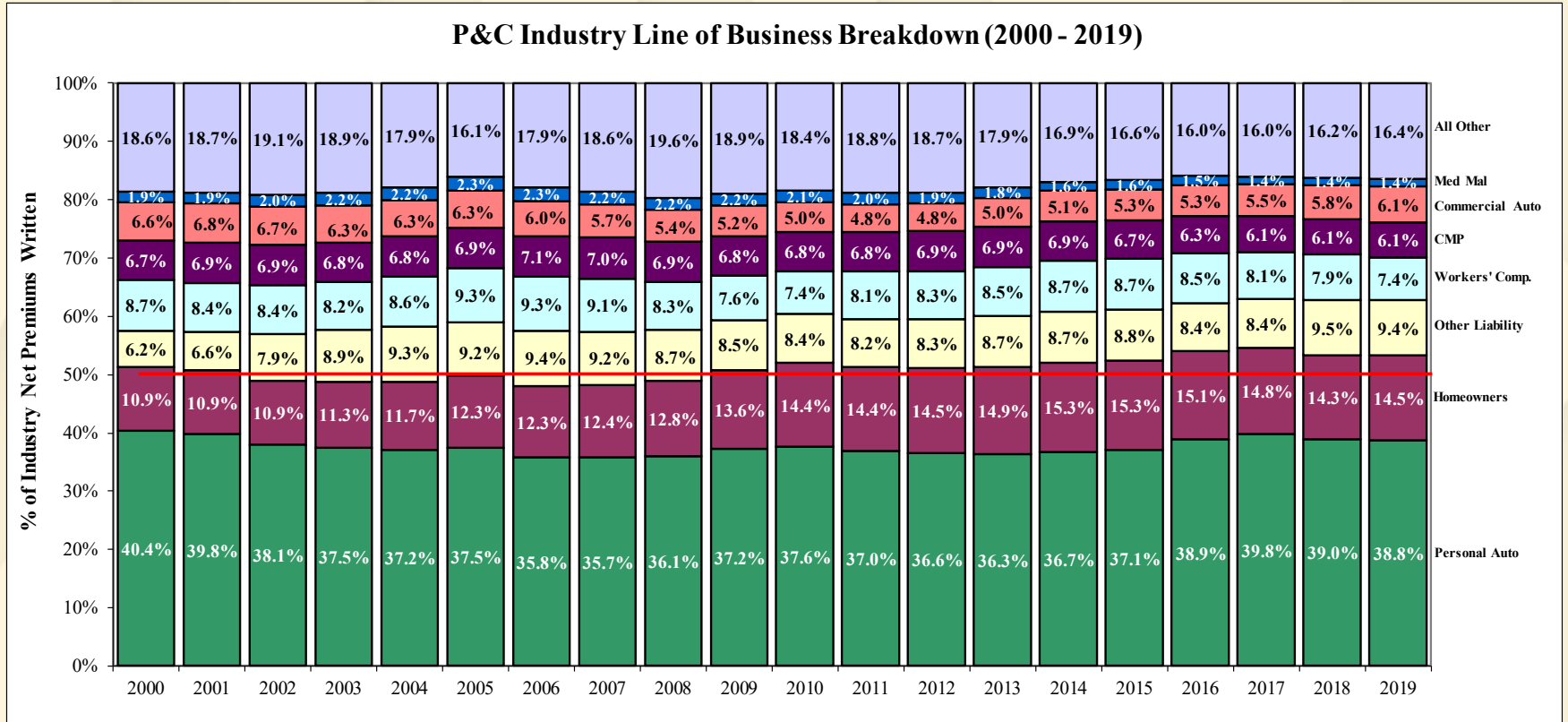


CHANGE IN SURPLUS



- Net Income
- Unrealized Capital Gains/Losses
- Surplus Paid In/Paid Out

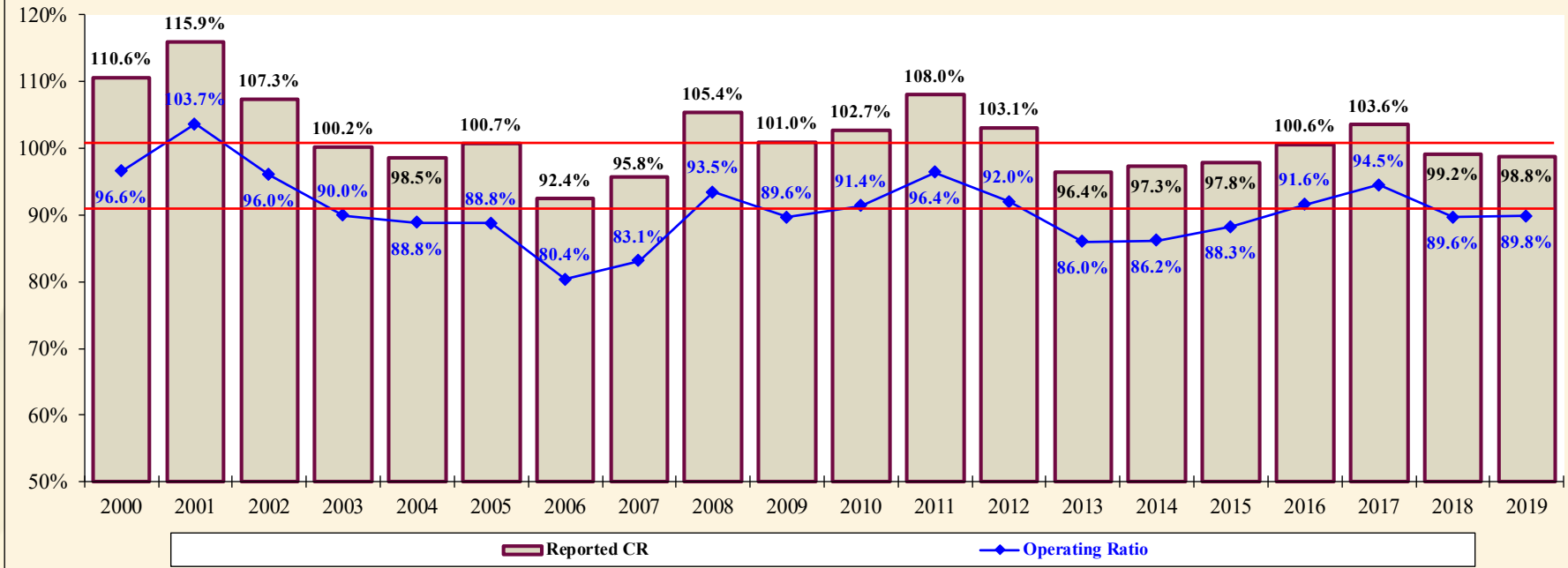
Income Statement – Net Written Premiums



Per S&P Global, U.S. P&C industry net written premiums were \$638 billion for 2019, up 3.2% from 2018. 15 Year Avg. Mix is 51% PL / 49% CL

Income Statement – U/W & Operating Profitability

P&C Industry Reported Combined Ratio vs. Operating Ratio

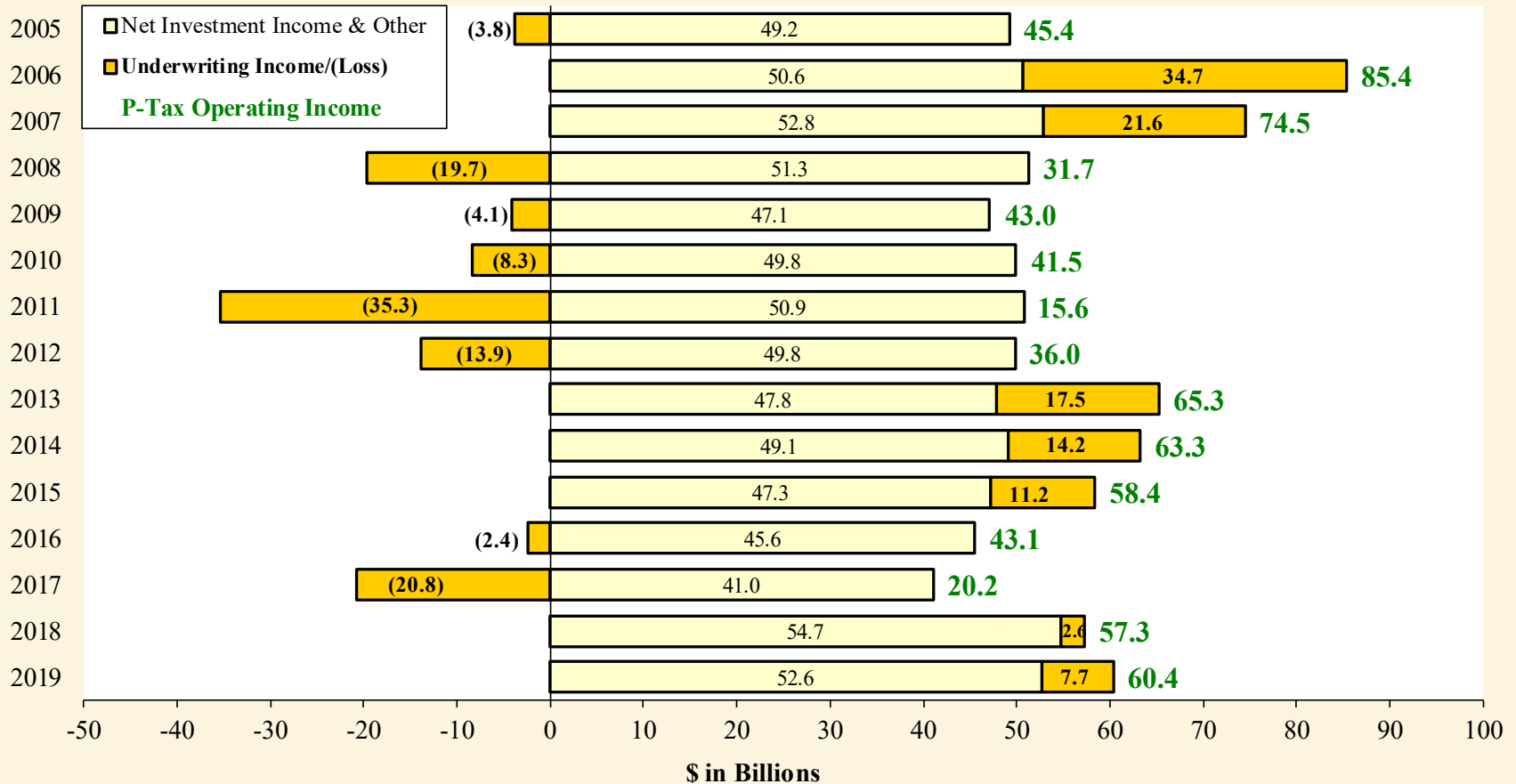


15 Year Average Reported Combined Ratio = 100.2%; 15 Year Average Operating Ratio = 89.4%

15 Year Average Benefit of Net Investment Income = 10.9 points; range = 9.0 – 11.6 points. (2019 = 9.0 points = a cyclical low)

Income Statement – Operating Profitability

P&C Industry Components of Income



Key Takeaways:

Underwriting profits in 7 of the past 15 years. 2004 was the first year of underwriting gain since the mid-1970s.
Investment income still represents the vast majority – if not all – of industry operating profits.

Income Statement: Near Term Impacts

- Premiums Fall (or are Returned/Reduced), but Losses Also Decline Due to Lack of Economic Activity
- Loss Ratios Should Not Be Severely Impacted In the Short Term
 - It will take time for some potential claims to be litigated
 - Insurers do not yet know what type of strengthening may be needed, if any
- Insurers Will Closely Watch Expenses
- Investment Income Will Continue to Be Under Pressure
- Chubb's Greenberg calls the present crisis an "earnings event" (not surplus event) for his company.

Insurer Actions

Actions to Bolster the Income Statement and Balance Sheet

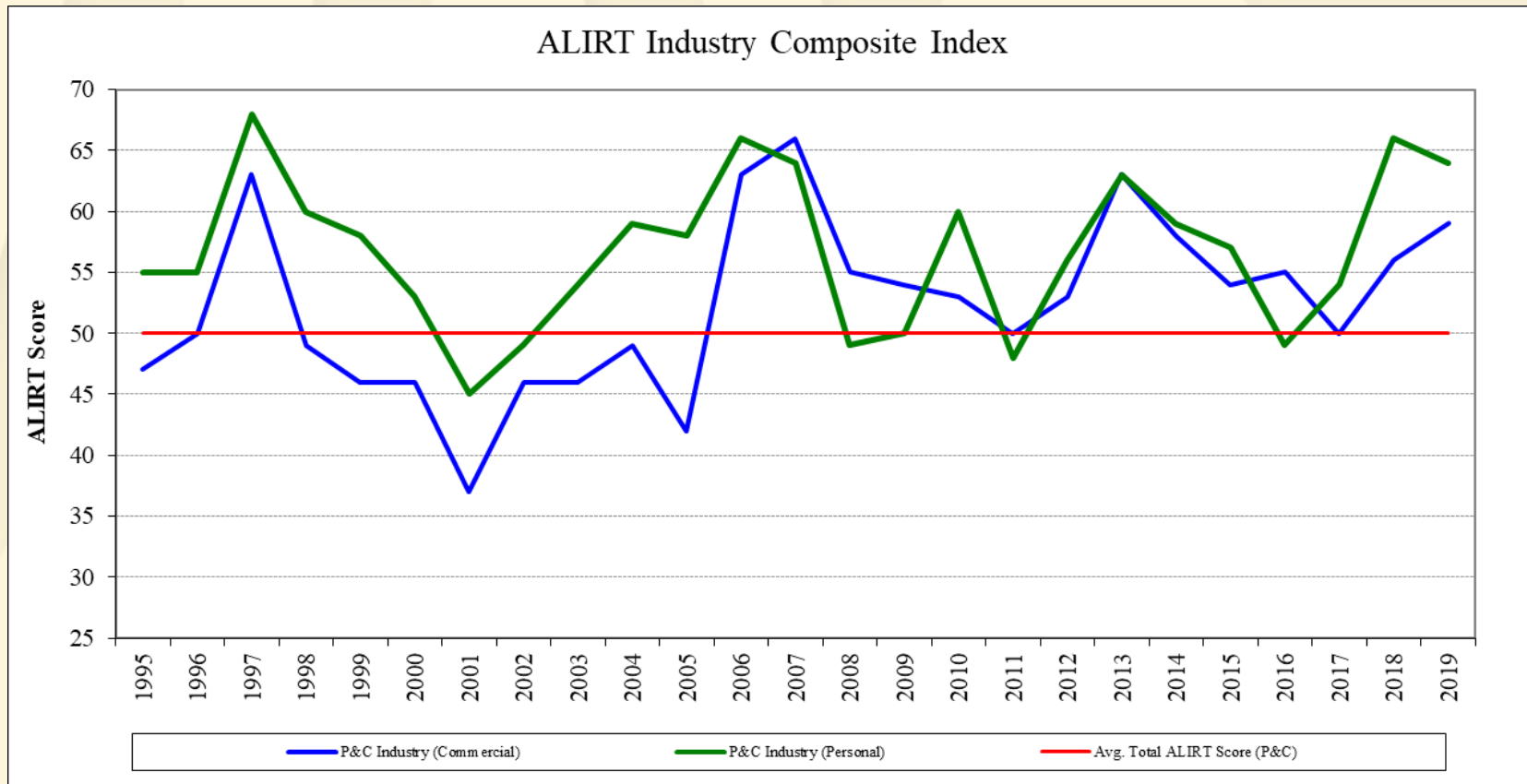
- ***Underwriting Changes***
 - Higher Rates (if possible)
 - Business Lines Exits
 - Lower Limits
 - Tighter Terms & Conditions

- ***Utilize More Reinsurance***
 - Quota Share
 - Excess of Loss/Catastrophe
 - Loss Portfolio Transfers

- ***Capital Raising***
 - Equity
 - Debt

- ***Draw Down Bank Lines of Credit***

Industry Results: ALIRT Composite



U.S. P&C Industry came into the current crisis with a relatively strong financial profile.

The 2008-2009 Great Recession did not severely impact the P&C Industry as it did not coincide with the fall-out from a soft market cycle.

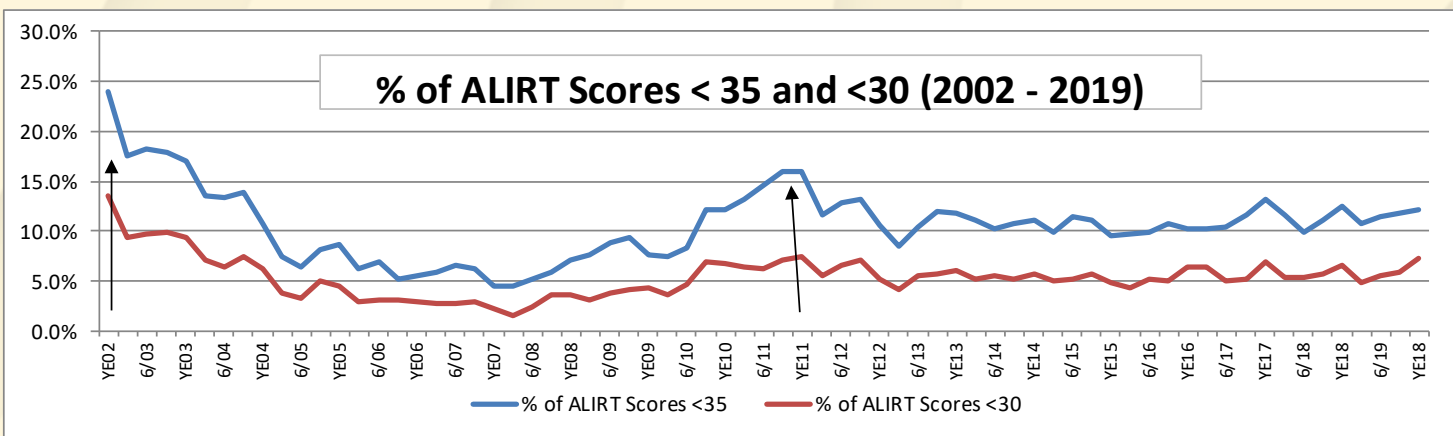
The recession of 2000-2001 coincided with the end of a deep and protracted soft market.

Industry Results: ALIRT Composite

Exhibit 4
US P/C Impairments Through the Period, 2000-2018

	2000-2005	2006-2010	2011-2015	2016-2018	Total
Workers' Compensation	52	16	20	6	94
Personal Lines	43	23	30	10	106
Commercial Lines	35	14	22	7	78
Medical Professional Liability	17	1	4	6	28
Title	3	7	4	0	14
Warranty	1	4	5	0	10
Financial / Mortgage Guaranty	0	2	6	0	8
Surety	6	1	4	2	13
Other	4	4	5	1	14
Total	161	72	100	32	365

Source: AM Best data and research



Program Insurers ALIRT Results – Break Down

<u>Ownership Type</u>	<u># in TMPAA Universe</u>
U.S. National Groups	5
Large U.S. Specialty	9
Small/Medium U.S. Specialty	14
Bermuda	7
Lloyds	13
Reinsurer-Owned	7
Fronting	3
Other	2

Total	60

Program Insurers – Sample ALIRT Analysis

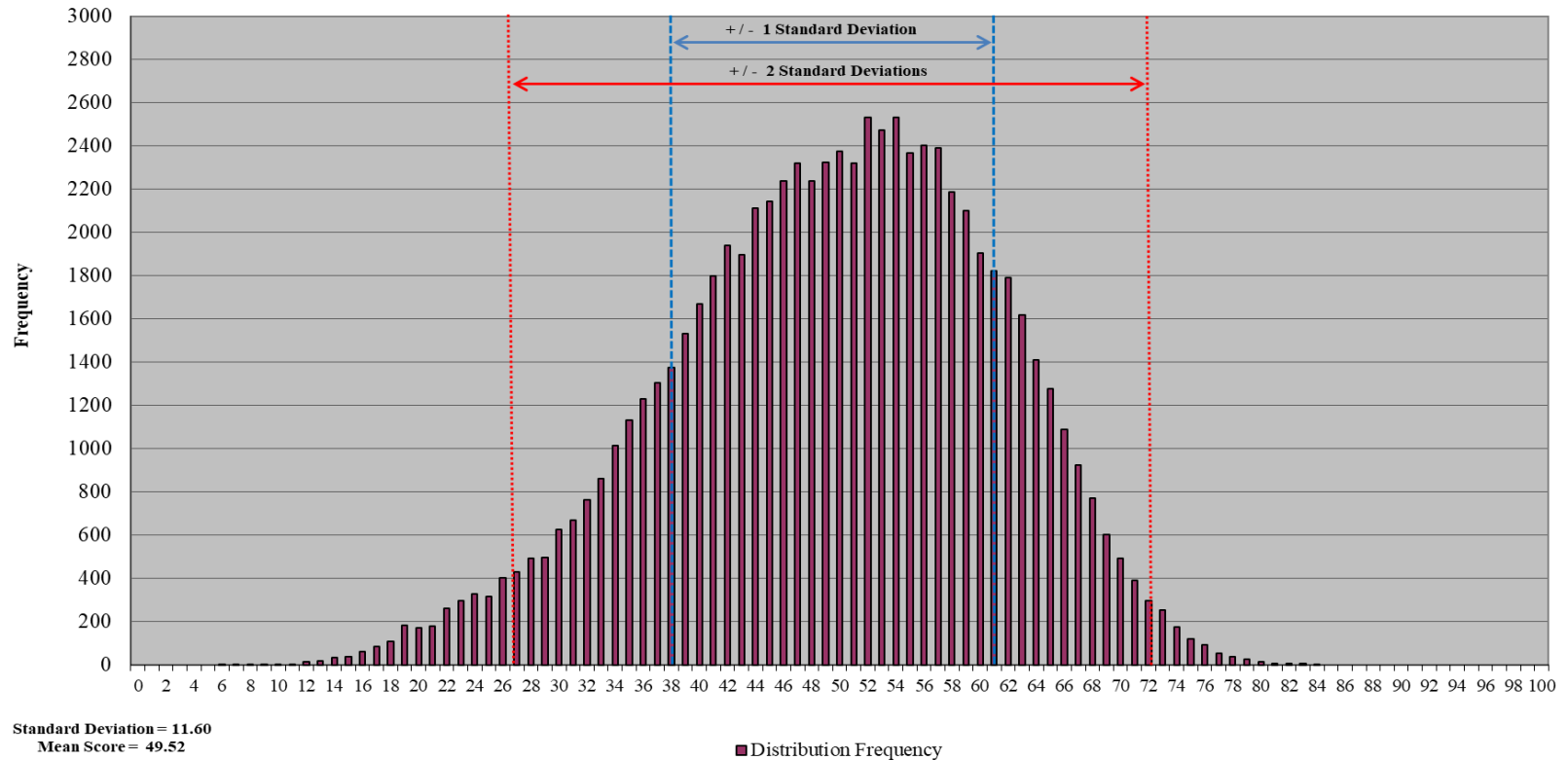
ABC Property Casualty Insurance Company						Time Series = Five Years and Current Year Period						ALIRT																																			
2002						2003						2004						2005						2006						9 Mos. 2007																	
TIER 1 - OPERATIONAL PERFORMANCE																								TIER 3 - GROUP PERFORMANCE																							
Max Score: 16																								Max Score: 2																							
◆ CAPITALIZATION AND LEVERAGE COMPANY: 6 6 7 7 9 COMML LINES COMP: 7 7 8 8 12 13												COMPANY AS % OF GROUP COMPANY: 2 2 2 2 2 COMML LINES COMP: 1 1 1 1 1 1												REVENUES & LIQUIDITY COMPANY: 1 2 2 2 4 COMML LINES COMP: 3 3 4 4 4 3												FINANCIAL LEVERAGE, COVERAGE AND PROFITABILITY COMPANY: 1 1 2 1 4 COMML LINES COMP: 3 3 4 3 3 4											
■ UNDERWRITING PROFITABILITY AND EARNINGS COMPANY: 6 2 6 5 7 COMML LINES COMP: 7 7 7 4 12 14												TIER 3 ALIRT SCORE (Maximum Score = 11) COMPANY: 4 5 6 5 10 COMML LINES COMP: 7 7 9 8 8 8												TIER 4 - SIZE & RATINGS MOODY'S: A3 A3 A3 A3 A3 A3 S&P: A- A- A- A- A- A- FITCH: A A A A A A WEIGHTED COMPOSITE: A+ A+ A+ A+ A+ A+												TIER 4 ALIRT SCORE (Maximum Score = 14) COMPANY: 8 8 8 8 8 8 COMML LINES COMP: 9 9 9 9 9 9											
▲ REINSURANCE COMPANY: 2 2 2 2 3 COMML LINES COMP: 3 3 3 3 6 6												TOTAL ALIRT SCORE (Maximum Score = 100) COMPANY: 41 35 39 39 47 COMMERCIAL LINES COMPOSITE: 46 46 49 42 63 62												TIER 1 ALIRT SCORE (Maximum Score = 55) COMPANY: 21 18 20 18 23 COMML LINES COMP: 23 23 24 18 37 38												TIER 2 - INVESTMENT PERFORMANCE Max Score: 12 INVESTMENT RISKS COMPANY: 4 3 3 4 3 COMML LINES COMP: 5 5 6 6 7 6 Max Score: 4 INVESTMENT RESULTS COMPANY: 4 5 2 4 3 COMML LINES COMP: 2 2 1 1 2 1 TIER 2 ALIRT SCORE (Maximum Score = 20) COMPANY: 6 5 5 8 6 6 COMML LINES COMP: 7 7 7 7 9 7											

Every score is compared against an industry composite average

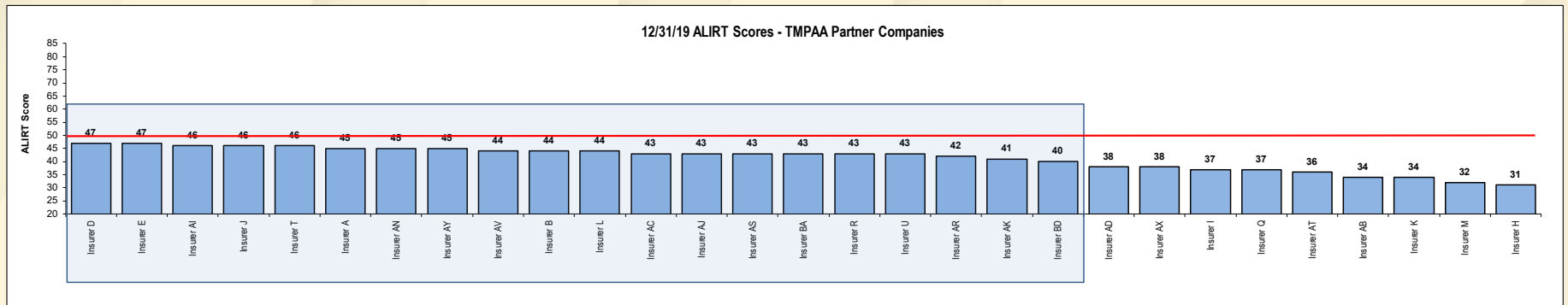
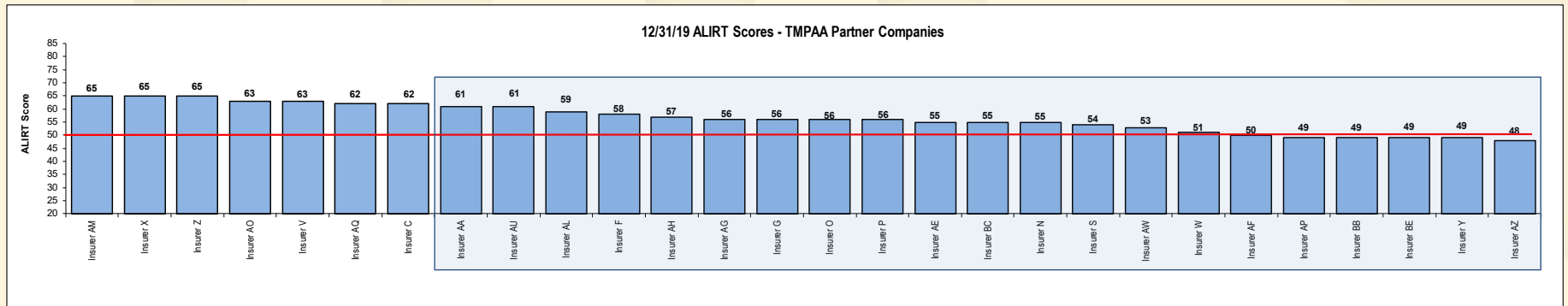
ALIRT INSURANCE RESEARCH P&C FINANCIAL STRENGTH RATIOS																								
ABC Property Casualty Insurance Company																								
TIER 1 - OPERATIONAL RISK																								
◆ CAPITALIZATION AND LEVERAGE												■ UNDERWRITING PROFITABILITY AND EARNINGS						▲ REINSURANCE						
YEAR	TOTAL SURPLUS (\$ MNS)	5 YR SURPLUS GROWTH	RISK BASED CAPITAL RATIO	SURPLUS STABILITY TEST	GROSS PREMIUM LEVERAGE	NET PREMIUM LEVERAGE	LOSS RATIO	EXPENSE RATIO	COMBINED RATIO	ACC YEAR COMBINED RATIO	OPERATING RATIO	PRETAX RETURN ON EARNED PREMIUMS	BUSINESS DIVERSIFICATION	UNAFFLATED COS. ONLY RECOVER / OF GROSS SURPLUS	NET INC. SEC'D AS % OF GROSS PREMIUMS									
2002	5,116	-5%	169%	52.3%	1.73	1.38	76%	28%	105%	109%	59%	33.2%	2.5	156%	16%									
2003	6,046	2%	146%	58.1%	1.77	1.22	117%	31%	149%	109%	123%	-37.7%	3.0	169%	30%									
2004	6,815	2%	170%	53.0%	1.35	1.03	78%	27%	106%	102%	89%	5.2%	3.0	143%	15%									
2005	6,743	6%	165%	60.6%	1.31	1.00	94%	29%	124%	107%	92%	5.2%	3.5	113%	13%									
2006	7,939	69%	156%	54.7%	1.11	0.86	81%	28%	109%	106%	83%	13.3%	3.0	75%	11%									
9/2007	8,246	63%	N/A	53.1%	1.06	0.79	82%	29%	111%	104%	78%	19.3%	N/A	N/A	N/A									
COMML LINES COMP	1,235	113%	241%	19.2%	1.21	0.61	64%	27%	82%	92%	75%	22.8%	2.0	37%	9%									
TIER 1 - OPERATIONAL RISK (continued)												TIER 2 - INVESTMENT RISK												
◆ RESERVES						◆ REVENUE VITALITY AND LIQUIDITY						INVESTMENT RISKS						INVESTMENT PERFORMANCE						
YEAR	COMML LINES	# OF YRS OF RESERVES/ LAST 5 WITH TOTAL RESERVE	ONE YEAR RESERVE DEVELOP	OPERATING CASH FLOW RATIO	UNDERWRIT. CASH FLOW RATIO	ANNUAL % CHANGE EARNED PREMIUMS	TOTAL LIQUIDITY	UNAFFL STOCKS/ SURPLUS	AFFL INVEST/ SURPLUS	NON-RV GRADE BONDS/ SURPLUS	CMO'S & OTHER ABS/ SURPLUS	WEIGHTED TRAD. BONDS (YEARS)	GROSS YIELD ON BONDS	NET YIELD ON INVEST ASSETS	TOTAL RETURN ON INVEST ASSETS									
2002	79.4%	1	-4.1%	235.1%	159.2%	98.4%	91%	11%	49%	38%	81%	11.61	5.8%	14.41%	3.14%									
2003	83.4%	1	38.6%	120.3%	101.4%	2.5%	95%	7%	52%	21%	94%	12.58	5.3%	6.26%	6.50%									
2004	81.6%	1	3.7%	118.4%	105.9%	12.1%	96%	6%	58%	24%	86%	11.55	5.24%	4.02%	8.24%									
2005	81.4%	1	15.3%	171.2%	133.5%	-6.5%	79%	10%	49%	29%	167%	15.20	4.89%	6.71%	5.64%									
2006	82.6%	1	2.4%	152.0%	121.7%	-2.1%	82%	25%	50%	31%	149%	12.95	5.58%	5.06%	7.01%									
9/2007	N/A	0	5.0%	133.8%	100.4%	-3.2%	N/A	30%	46%	36%	N/A	N/A	N/A	5.68%	4.62%									
COMML LINES COMP	81.2%	0	-0.4%	141.2%	114.5%	1.8%	144%	30%	51%	4%	34%	7.64	4.31%	4.40%	7.02%									
TIER 3 - FINANCIAL RISK - HOLDING COMPANY ANALYSIS																								
STRATEGIC VALUE						FINANCIAL FLEXIBILITY & LIQUIDITY						LEVERAGE, COVERAGE, AND PROFITABILITY						TIER 4 - SIZE & RATINGS						
STATUTORY INS CO. AS A % OF TOTAL ORGANIZATION						ANNUAL % CHANGE IN REVENUE						ANNUAL % CHANGE IN DEBT EQUITY RATIO						IN 9 MNS.						
YEAR	ASSETS	SURPLUS	TOTAL REVENUE (\$ MNS)	OPERATING REVENUE	OPERATING CASH FLOW	STOCK MARKET VAL	LIQUID ASSETS AS % OF TOTAL ASSETS	DEBT EQUITY RATIO	PRETAX OPERATING EARNINGS	INTEREST COVERAGE	PRETAX OPERATING ROE	NET PREM'S WRITTEN	NET PREM'S EARNED	TOTAL ASSETS	WEIGHTED COMPOSITE RATINGS									
2002	41.0%	54.4%	12,298	-6.9%	8.5%	60.0%	57.0%	24.4%	N/A	1.9	3.8%	7,073	5,783	25,312	A+									
2003	50.5%	67.6%	11,716	-4.6%	15.0%	60.2%	56.1%	21.3%	N/A	-17.3	-25.6%	7,403	5,929	34,589	A+									
2004	54.7%	74.0%	9,930	-15.2%	16.2%	74.4%	60.2%	24.5%	N/A	3.3	5.5%	7,028	6,645	34,212	A+									
2005	61.1%	75.3%	9,862	-0.7%	22.0%	93.6%	64.5%	18.9%	-67%	1.1	1.8%	6,753	6,212	35,913	A+									
2006	63.4%	81.3%	10,376	-5.2%	21.7%	112.0%	69.7%	22.1%	88%	9.1	17.1%	6,889	6,079	38,188	A+									
9/2007	67.2%	81.5%	9,960	-4.0%	9.5%	106.6%	69.2%	21.3%	-16%	7.2	13.6%	6,537	5,997	40,375	A+									
COMML LINES COMP	5.3%	24.2%	4,439	1.9%	20.0%	123.4%	59.0%	23.0%	7%	10.2	22.3%	896	845	3,625	AA-									

Program Insurers – Historical Distribution of Scores

P&C ALIRT Score Distribution (2002 - 2019)



ALIRT Scores – Program Universe – U.S.

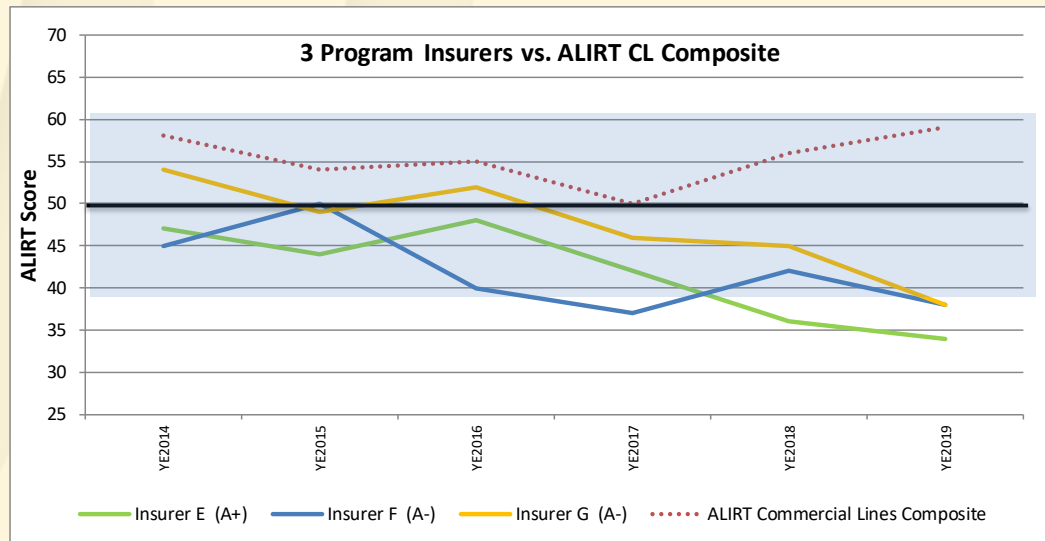
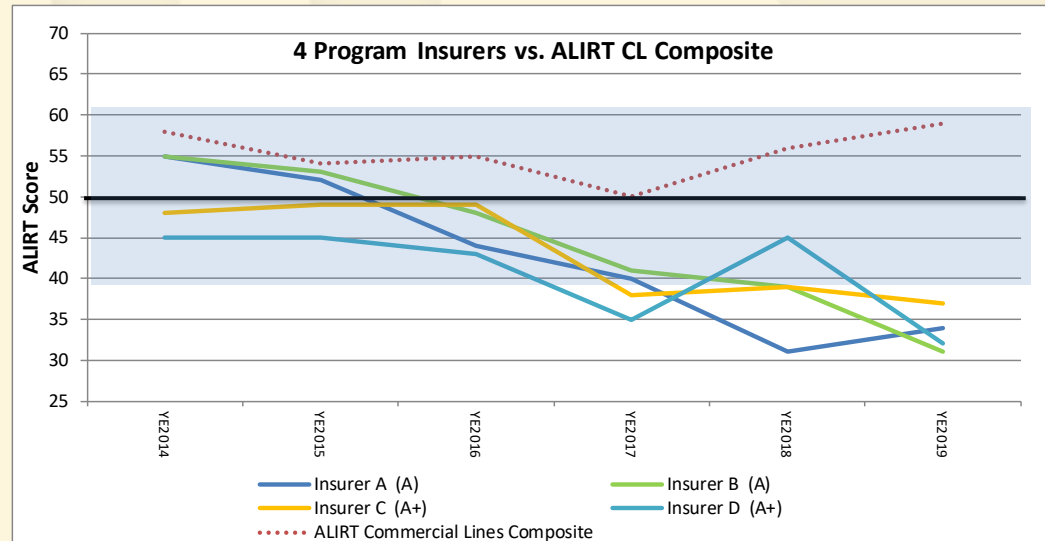


ALIRT Scores – Select Program Carriers

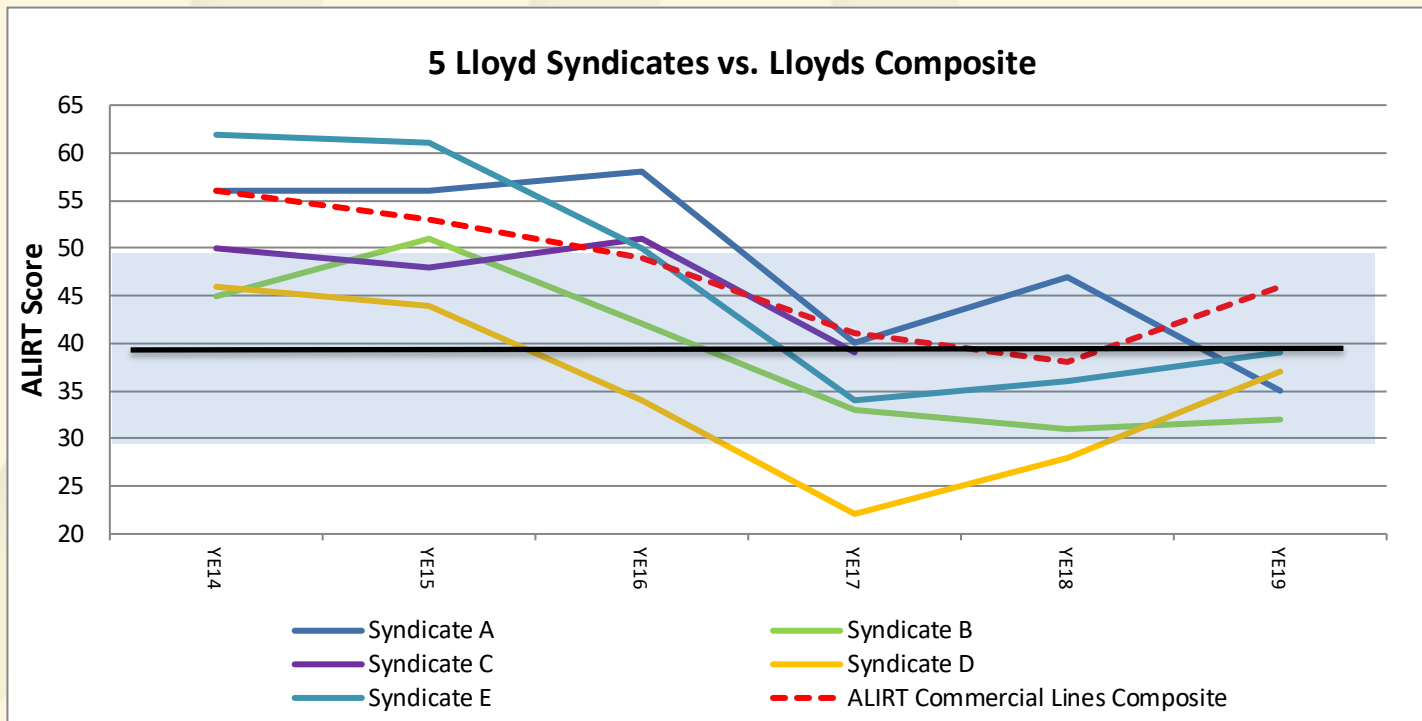
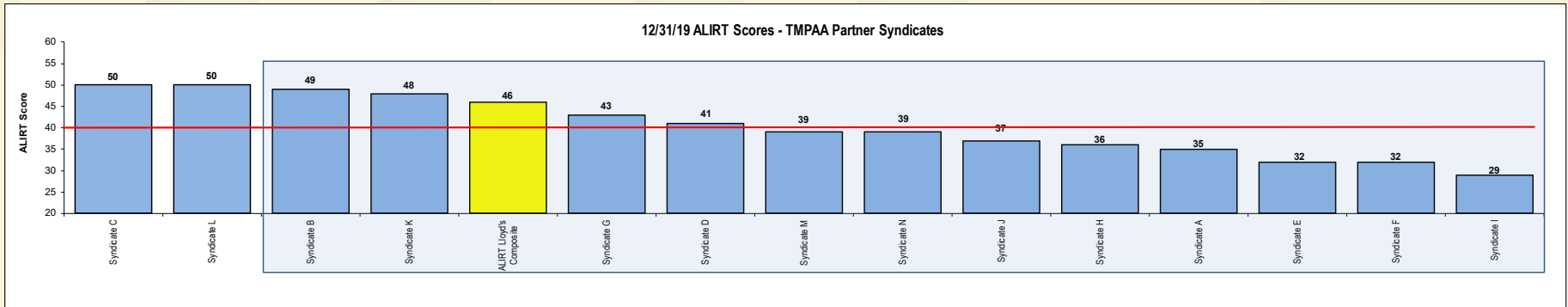


“Heed the tale of the proverbial statistician who drowns in a lake that is three feet deep on average”

Credit analysts do not just look at averages, but more importantly at the outliers



ALIRT Scores – Program Universe – Lloyd's



Conclusions

- Credit Analysis is about tracking an entity's ability to make good on its financial obligations, including an insurer's payment of claims.
- The pandemic has led to a substantially depressed economic activity globally, leading to concerns about the impact on the property & casualty industry.
- The depth and reach of this current crisis will lead to adverse impacts on the U.S. P&C industry's balance sheet, including investment losses and deterioration of loss reserves. If substantial enough these can lead to a reduction in industry surplus.
- Wild cards include potential government mandates on insurers for unexpected claims payments.
- While these losses may be large in aggregate, the industry comes into the period with a strong balance sheet and a decade of decent underwriting and operating performance.
- The financial profile of most insurers in the Program Market, including Lloyd's syndicates, fall within ALIRT's "normal solvent" range.
- While the overall U.S. P&C industry should be able to handle this pandemic shock in stride, individual program insurers entering the crisis with compromised financials should be more closely monitored.



ALIRT
INSURANCE RESEARCH

TMPAA Webinar

Covid-19: Potential Impacts on P&C Insurance Carriers and Your Program

Thursday, April 30, 2020

*Presented by:
David Paul
Principal, ALIRT Insurance Research*

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