GUY CARPENTER

TRENDS IN REINSURANCE FOR SMALLER MUTUALS

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MARSH & McLENNAN COMPANIES

The environment is challenging for insurance
Whilst the particulars differ, mutuals are no exception

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Growth

- Top-line
- Earnings
- Dividend

- Macro-economic
- Return factors
- Risk factors

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Return

- RoE
- RoC
- RoRAC

- Pricing
- Claims
- Expenses
- Investment income
- Capital

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Risk

- Strategy
- Regulation
- Credit cycle
- Market volatility
- Political

- Solvency II
- Conduct
- Spreads
- Asset allocation
- Elections

PERFORMANCE

The trend is for more reinsurance, especially proportional (But all generalisations are wrong…)

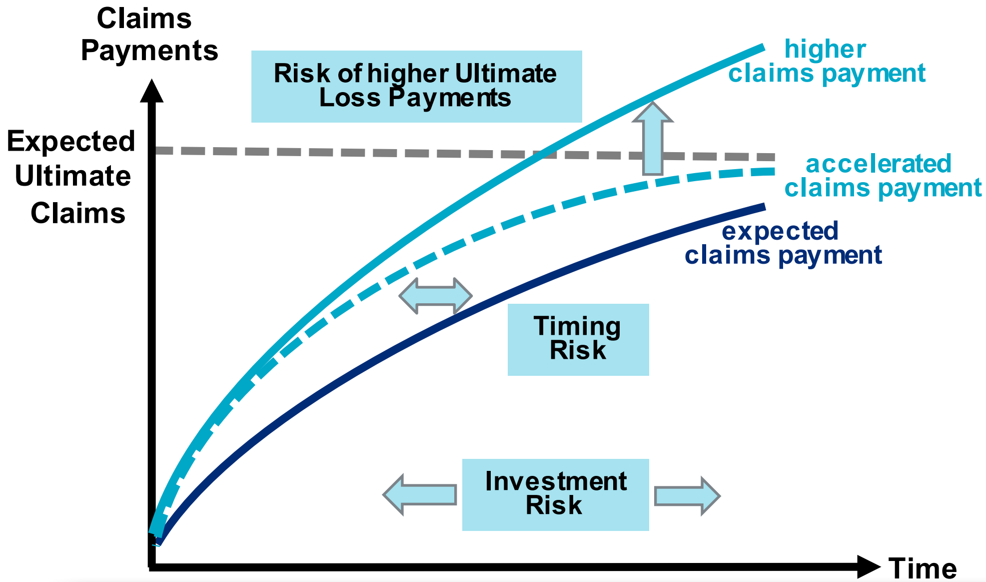
LV=

"During the year we have maintained a strong focus on ensuring we are ready to comply with Solvency II requirements from 1 January 2016 and the potential impact this will have on our capital position.

"The Group has also entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves as at 31 December 2015. The Group also entered into a 20% Quota Share arrangement for 2016 to 2018 (each year treated separately). Whilst the primary driver of these transactions was efficient capital management, the contract also has the effect of reducing the Group's exposure to general insurance concentration risk."

Source: LV Annual Report 2015

Retrospective Reinsurance Solutions
Components to manage Reserve Risk



Risk of higher ultimate loss payments:
Insufficient best estimate reserves, risk of being under-reserved

Timing Risk:
Uncertainty of velocity of payments up to the ultimate loss

Investment Risk:
Reflecting adverse capital market developments (equities, bonds, real estate) on assets covering loss reserves

- **Loss Portfolio Transfer (LPT):**
  The insurance company cedes loss reserves from prior accident years to a reinsurance company. Usually, in exchange the reinsurer receives the assets covering the corresponding loss reserves, and in that case the LPT cover removes the investment risk and the timing risk. Without any limit the LPT covers also the risk of higher ultimate loss payments, but often there are certain limits for the reinsured ultimate claims payment, so the LPT has to be accompanied by an ADC to cover the risk of being under-reserved. The LPT can be managed also with funds withheld solutions, in this case the assets will remain with ceding company.
- **Adverse Development Cover (ADC):**
  The reinsurer pays claims in excess of an agreed reserve level (spot on, above or below best estimate level) in exchange of a risk premium. Actually an ADC cover transfers the risk of higher ultimate loss payments to the reinsurer.

Reinsurance purchase is treating one symptom of Solvency II

Pillar 1 (Quantitative)

S2 penalizes 2 aspects that are particularly relevant to mutuals:

Lack of diversification

- Model driven?
- No credit for niche knowledge

Long-term investment strategy

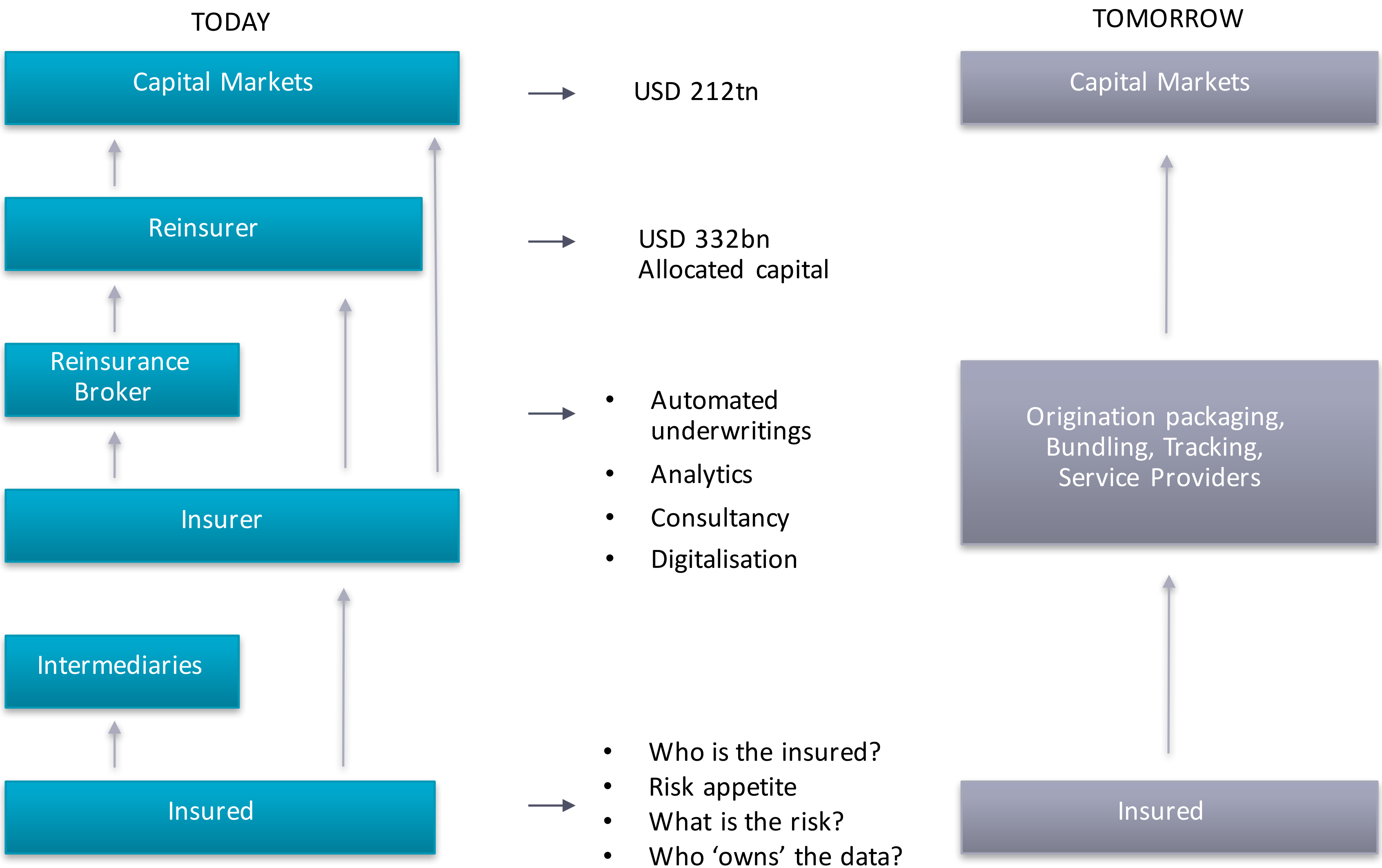
- One year view means high equity risk

Pillar 2 (Qualitative)

The governance requirements are onerous and do not reflect the (often) good flow of information in smaller organizations.

Can be counterproductive as more time is spent managing the process than the business

Will the insurance value chain collapse?



Is mutuality making a comeback?

In 2010, the founders of the **FinTech company**, *Friendsurance*, realized that insurance is expensive and lacks transparency: people pay high premiums each year and get nothing in return. This is why Friendsurance has developed a revolutionary **peer-to-peer insurance concept, which rewards small groups of users with a cash-back bonus at the end of each year they remain claimless**. The claims-free bonus is available on our website www.friendsurance.de.

Source: Friendsurance website

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AFM NED Conference

10 May 2016, hosted by: