Few remarks and questions on the recent developments in the P&C (re)insurance sector

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SCOR Global P&C, Chief Executive Officer

11th Cologne Reinsurance Symposium

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1	**The P&C (re)insurance environment is changing towards a "tiering" ("bifurcation") of our industry**
2	**The historical patterns driving the cycles of our industry seem contested**
3	**New forms of competition have emerged in our industry**
4	**What are the key questions and chosen strategies in this uncertain and unstable environment?**

We have been talking of the "tiering" ("bifurcation") of the reinsurance industry since Monte Carlo 2013 …

Presented in Monte Carlo – Sept 2013

Current issues faced by Insurers	key questions for Insurers	Changing reinsurance purchase policies
	What is at stake?	❑ Reinsurance is still often seen as a cost, but also more and more as a long-term risk and capital management tool ❑ A number of insurers' recent public / high profile announcements have put pressure on others to follow
Depressed macroeconomic environment and persistent low interest rates **Shareholders pressures to improve profitability**	**How and where** do insurers deal with the issues?	❑ Governance is changing: increased centralization, involvement of top managements and boards ❑ Models allow the use of quantitative tools to assess the needs and assist in decision making through sensitivity analysis ❑ Reinsurance programs are being rethought, including as vehicles of corporate policies and controls, like captives for large corporations
Increased regulatory pressures	**With whom** insurers are looking to transact with?	❑ Insurers are increasingly interested in selectively choosing their reinsurance partners and limiting their number ❑ An increasing number of insurers have been and will be measuring performances of their reinsurance partners and ranking them at a strategic level ❑ Opportunities to enter the panels may present themselves only once

More attention on reinsurance

with less counterparties

and

with 5 to 10 - 15 core partners

SCOR Global P&C has to be prepared to timely seize opportunities and position itself early and clearly in clients' and prospects' thinking processes

… and we identified key forces at stake during the January 2014 renewals

Presented for Jan 2014 renewals

Pressure from Brokers

Pressure from competitors

Fierce competition & "tiering" of the reinsurance market

- The business environment proved to be as SGPC had anticipated and communicated in Monte Carlo
  - High level of competition
  - Emergence of a "tiering" of the reinsurance market, where SGPC stands in the first tier as a lead market and a core / preferred partner
- The first group includes 5 to 15 reinsurers (depending on the clients), SCOR being at the forefront

As anticipated

Size and diversification become key advantages

- Larger players benefited from an increasing competitive advantage provided by their improved fit with clients' demands in terms of security, line sizes, global offering and network of local presence and support
- Undiversified small & mid-size reinsurers are marginalized:
  - Loss of access to "sophisticated" clients
  - Much higher pressure on signings for good business, all over-placed
  - Shrinkage of business base

As anticipated, but with a greater impact

SCOR Global P&C

Pressure from Clients

Lower cost and/or optimized reinsurance buying patterns

- Clients improved their capital management and the assessment of their portfolios volatility
- "Sophisticated" cedants made the most of:
  - The improvement of their technical profitability over the past years, driven by the need to offset the decrease in financial revenues
  - The improved understanding of their capital needs and of the effect of their reinsurance purchase in terms of improving their return on capital
- These cedants focused on meeting their budgeted return on capital requirements, even if and when it meant increasing their risk tolerances in certain lines of business

As anticipated, but with a greater impact

Reduction of counterparty risks and related costs

- As a by-product of the financial crisis, "sophisticated" clients want to reduce and limit the number of counterparties in order to minimize the counterparty risks and the related monitoring costs
- These cedants tend to place the bulk of their programme with a restricted number of reinsurers core to them (5-10) and keep on working with a few more (2-5) to keep the flexibility to renew their panels of business partners

As anticipated

Which led us to the following forecasts from the recent developments in the P&C reinsurance sector

	Short-term	Top Line	Profitability (RoE)	Medium-term	Top Line	Profitability (RoE)
1 Small & mid-size reinsurers	❑ Lack of competitive advantages such as long-term relationships, worldwide presence, meaningful capacity ❑ Partner with brokers to provide cheap(er) capacity and wider terms to the market ❑ Forced to concentrate on less profitable business, and take opportunistic shares of sophisticated insurers' programs, if and when any left	→	↘	❑ Business base shrinkage and foreseeable book deterioration in quality and performance ❑ Limited reserves' build-up and potential for releases from past underwriting years to fund short term softening market	↘	↘
2 Opportunistic US-focused reinsurers	❑ Business model predicated on franchise shrinkage when cycle becomes more selective ❑ Combination of capital return and focus on core US (re)insurance markets, more broker-driven than client-focused ❑ Severe competition from ILS funds, hunting on their ground	↘	→	❑ Forced to accept a business base shrinkage and a top line "plateauing" at best ❑ Favor short term capital return to long-term franchise creation	↘	↘
3 Global diversified reinsurers	❑ Allocate more capacities to selected clients ❑ Benefit from a strong franchise and long-term relationships with clients ❑ Focus on portfolio management by increasing business with sophisticated insurers, while reducing exposure to less profitable contracts	↗	→	❑ Can better mitigate softening pockets to maintain overall profitability level and can continue profitable business development ❑ Best positioned to capture emerging markets' growth potential as able to cope with capacity and servicing requirements for the larger ones (China, India, Brazil)	↗	→

2014 **2015** **2016**

The combination of softening operating conditions with prolonged low interest rates and depleting "reservoirs" of potential positive developments of reserves, create an environment increasingly vulnerable to a large, cycle turning event

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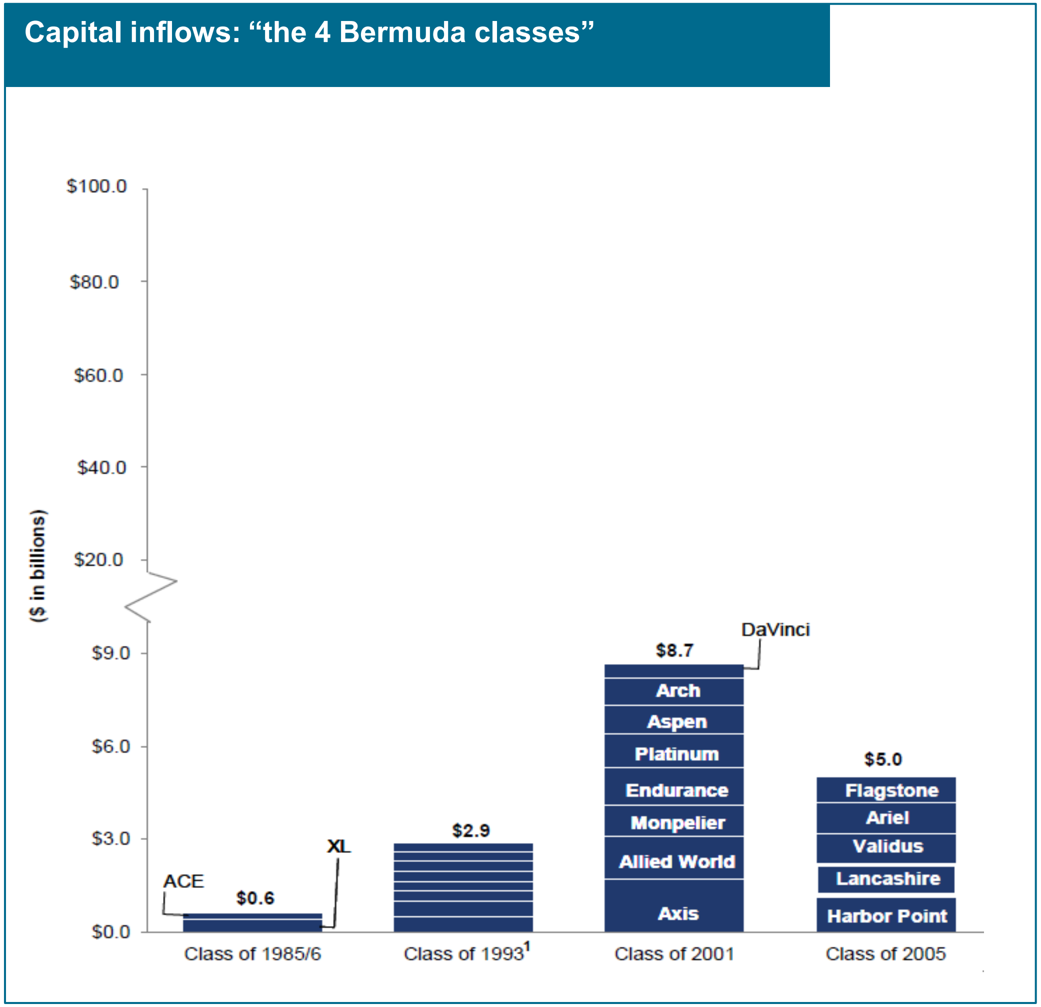
The patterns in the P&C (re)insurance industry have historically followed two “basic principles” that have regularly applied

1. New capacities have entered the industry after large (natural or man made) CAT events

2. The combined ratio and the financial income have been negatively correlated: one compensating the other in varying proportions to maintain the ROE at the target level

   (re)insurers have been adjusting their technical result targets based on their investment return budgets and forecasts, which is also reflected in the cycles of reserve developments

1 Over the past 30 years, new (private equity) capital has entered the industry following large CAT events



- Up until Katrina Rita Wilma in 2005, the reinsurance industry would see new capital arriving on the back of large natural or man made CAT events

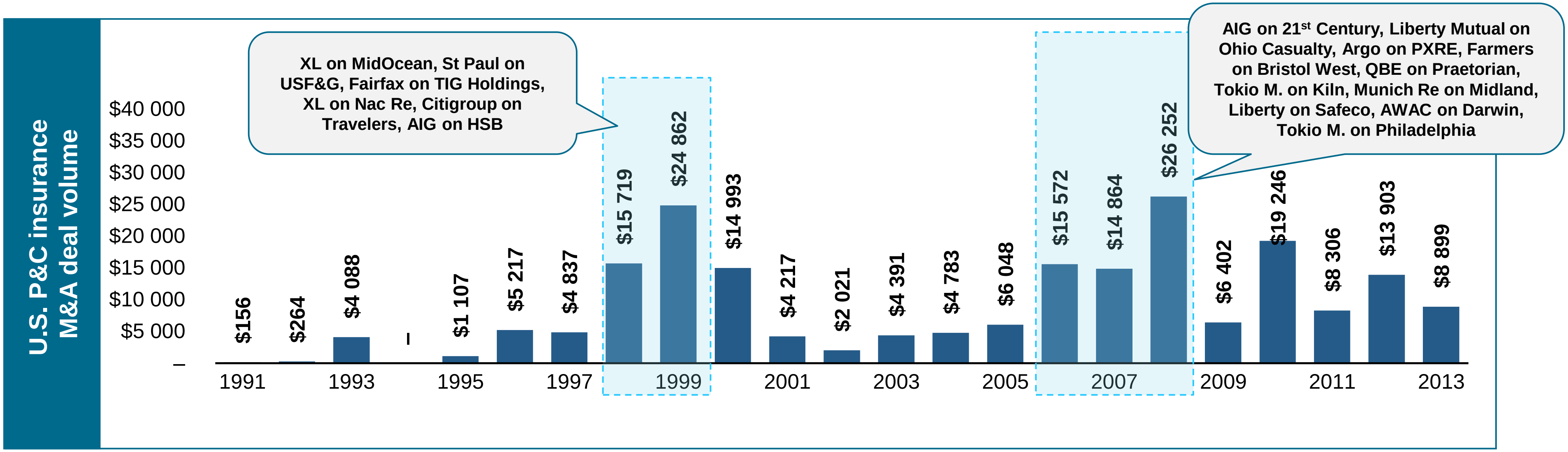
- Private equity investors were the providers of capital with:
  - a higher risk appetite than traditional (re)insurers and investors,

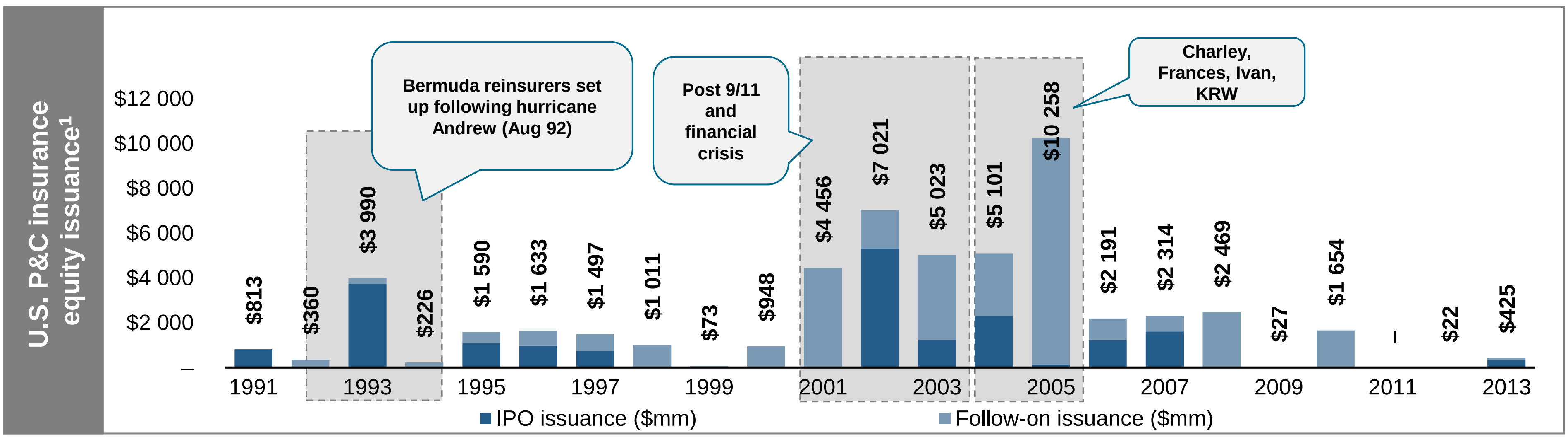
    and

  - clear objectives to enhance their returns by tax optimization through IPOs

Source : Goldman Sachs
1) 1993 new entrants were Partner Re, Mid-Ocean, IPC Re, Global Capital, Lasalle, Tempest, RenRe, Centre Cat.

1 During the market cycles, capital inflows followed the pace of big events

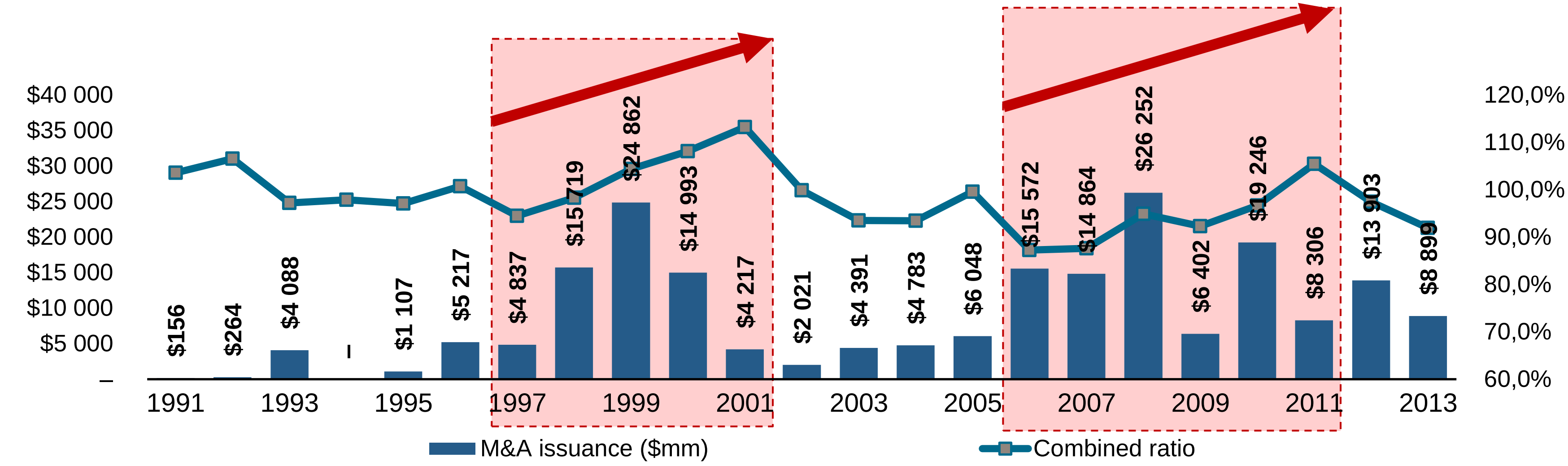




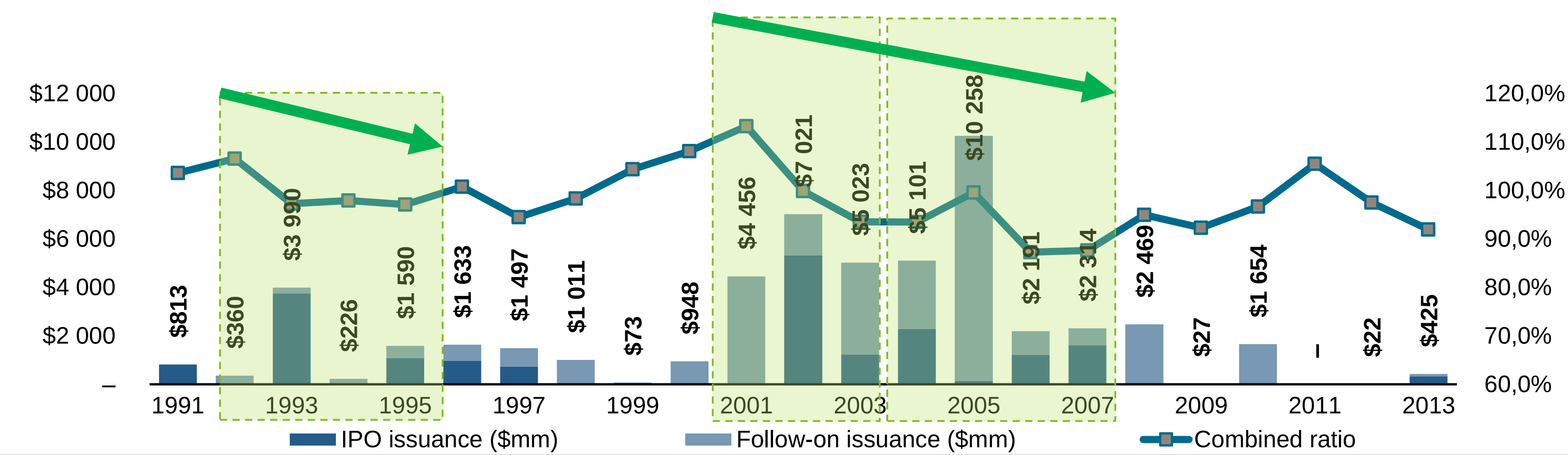
Source: Dealogic, Capital IQ, SNL Financial, FactSet, Credit Suisse, SCOR Global P&C.
Note: Equity issuances based off of U.S. P&C composite.
(1) Equity issuance data for 2008, 2011 and 2012 exclude multi billion worth of follow-on offerings related to AIG

1 And M&A activity has traditionally accompanied an upwards combined ratio trend, while equity issuances translated an anticipation of combined ratio improvement

U.S. P&C insurance M&A deal volume



U.S. P&C insurance equity issuance[1]



Source: Dealogic, Capital IQ, SNL Financial, FactSet, Credit Suisse, SCOR Global P&C.
Note: Equity issuances based off of U.S. P&C composite,
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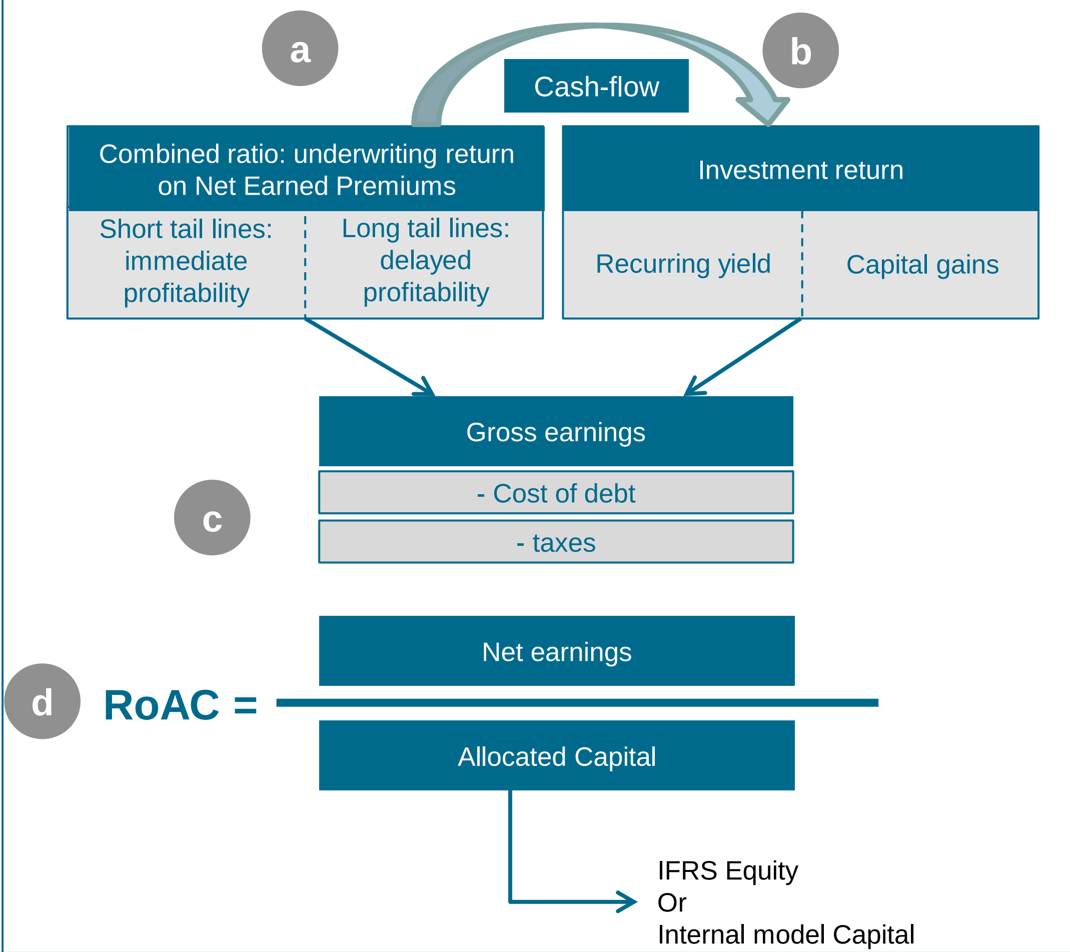
2 The P&C (re)insurer's fundamental profitability equation has led most P&C (re)insurers to focus on the liabilities' side of their business…

Deconstructing Return on Allocated Capital



Comments

a Technical return: Combined ratio, which is a combination of immediate profitability from short tail lines and **delayed profitability from long tail lines**

b Investment income, driven by:

- **Reserves to premiums leverage**
- Invested assets base, comprised of equity and reserves accumulated through cash generation, in particular from long tail lines
- Interest rates' environment producing recurring yield
- Capital gains

c Intermediate items:

- Cost of debt
- Other non-technical admin items (cost of Group infrastructure)

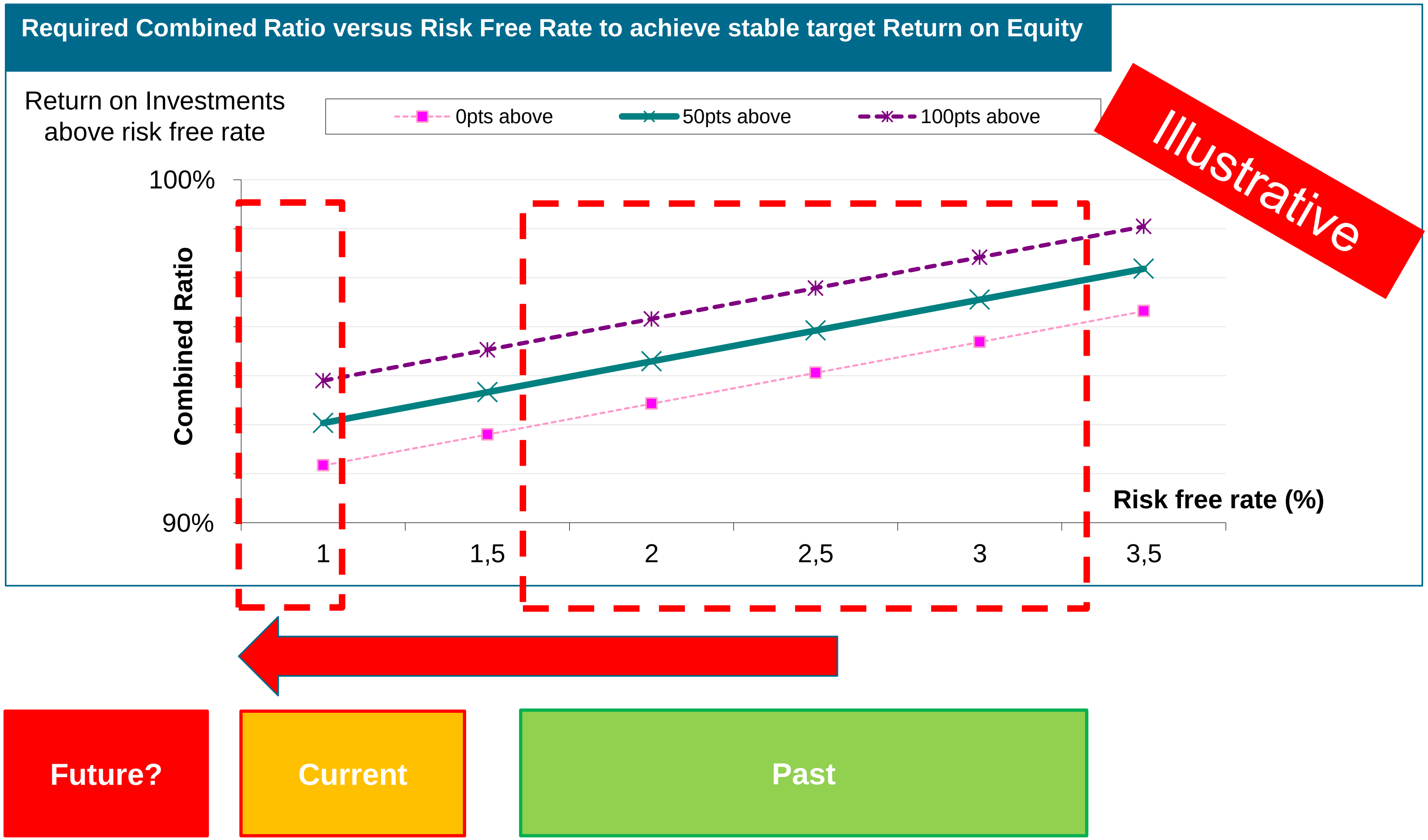
d Return on Allocated Capital: computed on different possible basis:

- IFRS Equity
- Internal model: including or excluding buffer

Source: SCOR

… such that, in a low interest rates environment, (re)insurers have acted on the combined ratio to compensate for lower investment income…

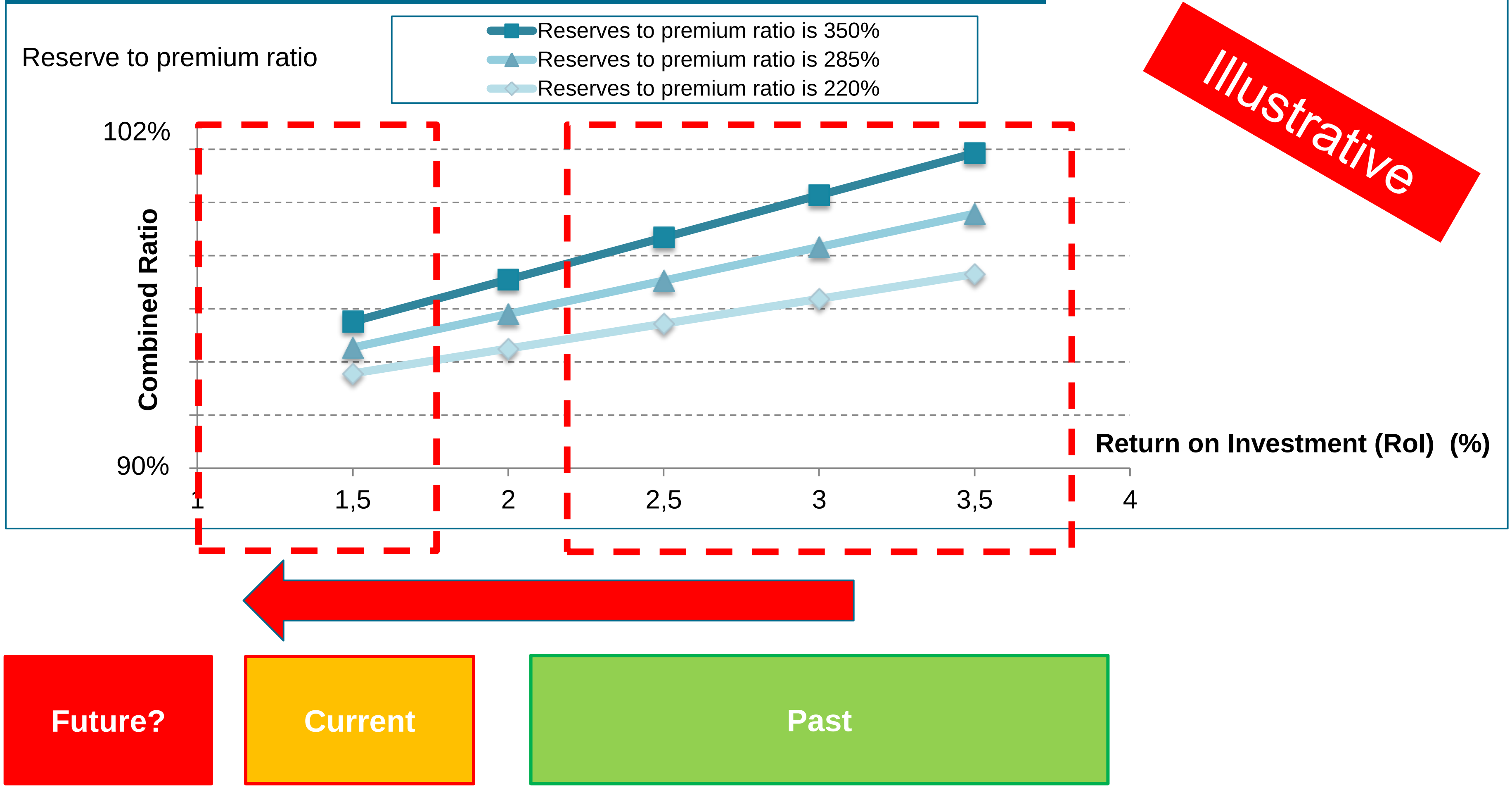
2



Source: SCOR

… leading to combined ratio targets only compatible with shorter tail lines of business

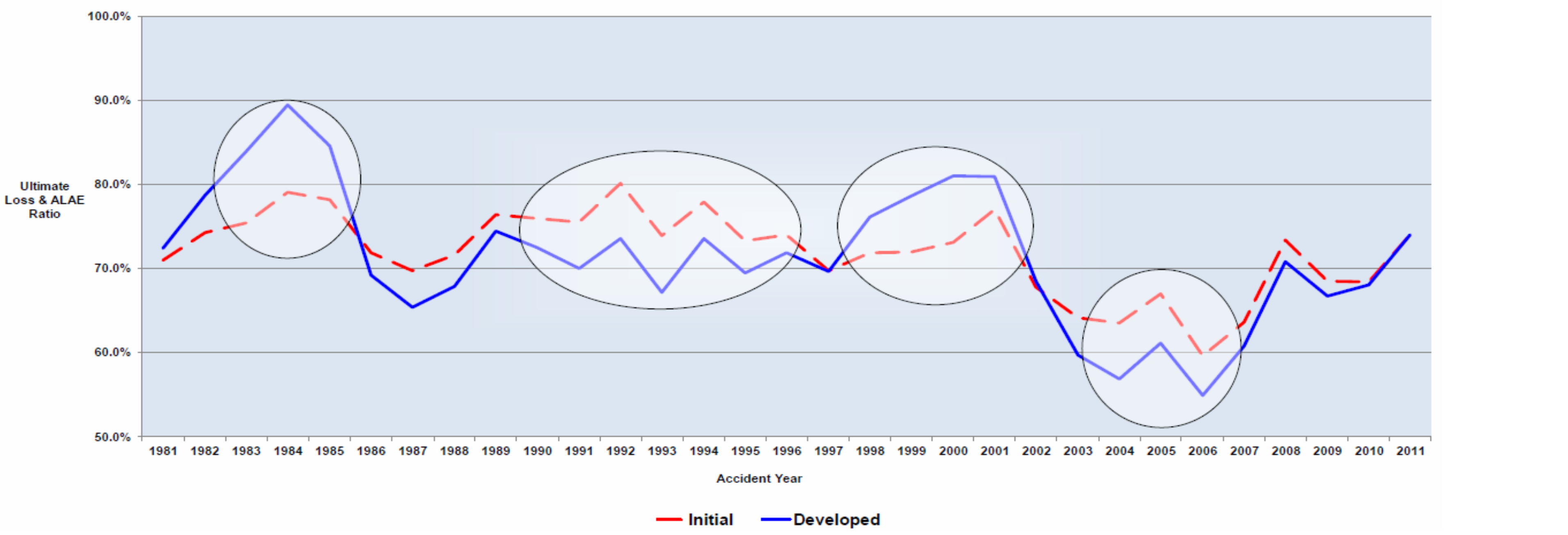
Required Combined Ratio versus RoI rate to achieve stable target Return on Equity



Source: SCOR

2 (Re)insurers have historically managed their balance sheet, and used the flexibility it allows to manage the cycle

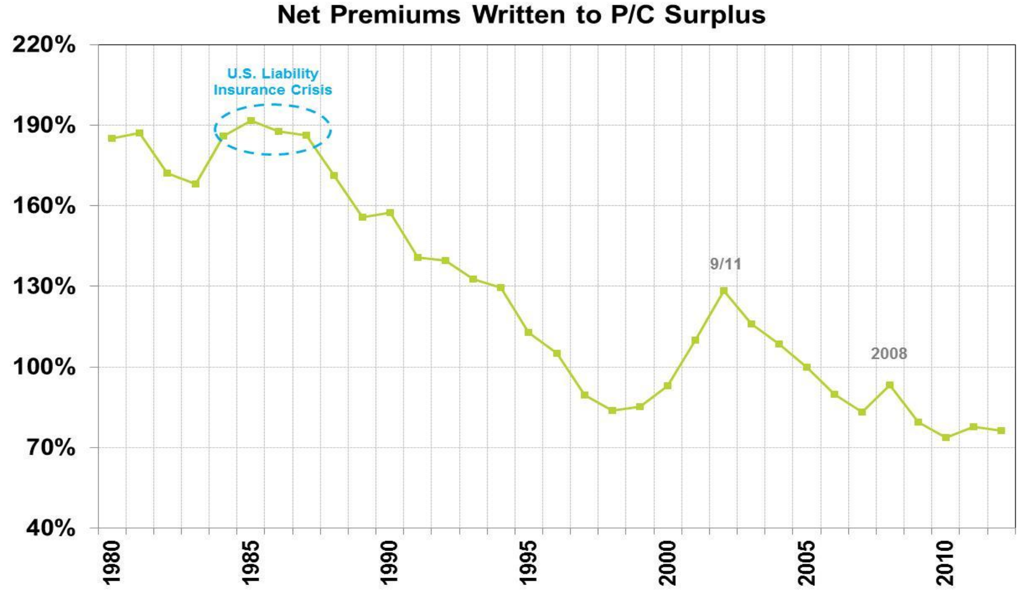
Ultimate Loss Ratio: Initial vs. Developed for US Insurance total P&C Industry



- The US industry offers the best picture of the structural gaps (positive, and then negative) that can be observed between opening and ultimate loss ratios

Source: AM Best, Milliman, November 2012

3 The amount of capital relative to insurance premiums has been growing for over 30 years, and steadily since 2001

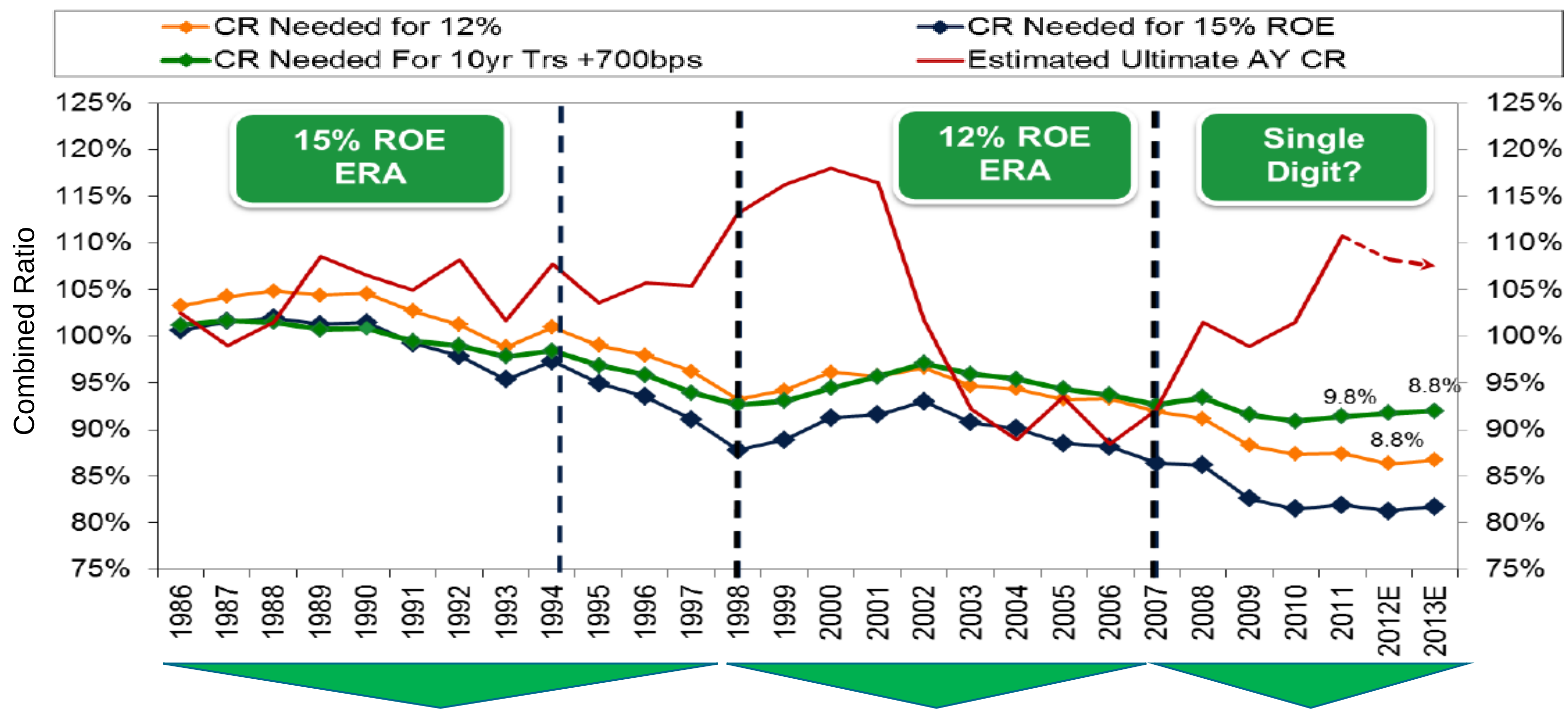


- The capital in the insurance industry has grown faster than the insurance premiums
- This capital needs being remunerated (with shareholders' expectations typically varying between 10% and 15% ROE)

Source: AM Best, Willis

If interest rates and competition pressures remain where they are, it will be difficult for the (re)insurance industry to meet investors' demands

US (re)insurance - Combined ratio needed for adequate return (Accident Year basis)



Risk Free Rate[1]	**6-12%**	**4-6%**	**2-4%**
Excess over Risk Free Rate[1]	**3-9%**	**6-8%**	**5-7%**

Source: VJ Dowling, RAA, SCOR; accident year returns over statutory surplus, excluding National Indemnity
[1] 10 year US Treasury Rate used

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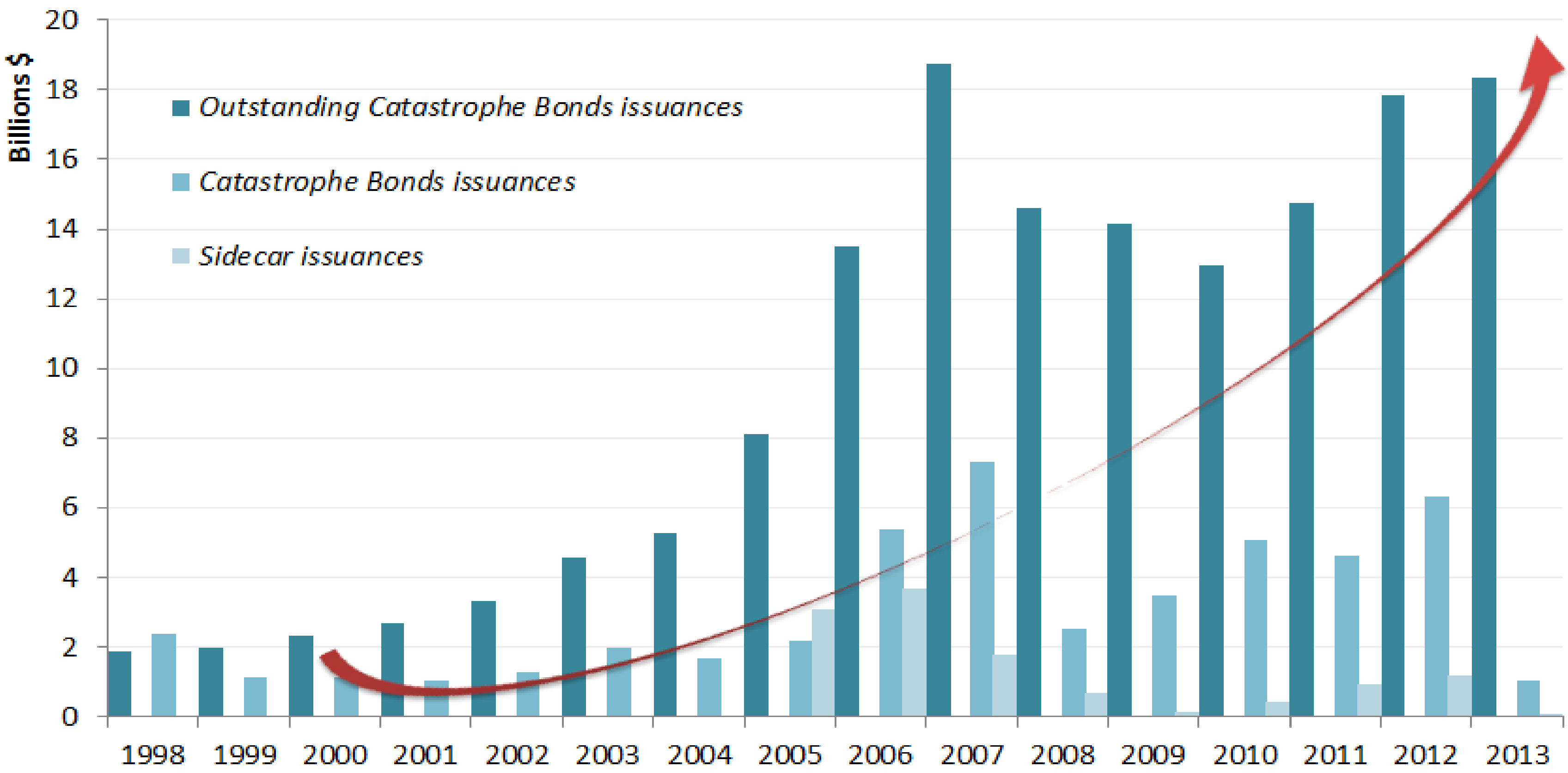
There have recently been a lot talk about (re)insurance and financial markets' convergence: has the industry entered a new era?

- In its April 2014 review, AM Best made some interesting comments:
  - "*It seems ironic that as underwriting opportunities have waned, the reinsurance sector has attracted additional capital to a market already saturated with it.* ***Is this smart money or is it naive****? It's no secret that investors and money managers are enticed by the non-correlating aspects of the property catastrophe business and the tax advantages gained by being an active offshore reinsurer*."
  - "*The insurance business also offers the potential for generating cost-free investment float, which appeals to money managers looking to increase assets under management and reap the lucrative fees that come with that. However,* ***the key to cost-free float is the ability to generate an underwriting profit****, which is not easily achieved and especially difficult in a soft market*."

- In its 2014 letter to shareholders, Warren Buffet commented further:
  - "*Unfortunately, the wish of all insurers to achieve this happy result creates intense competition, so vigorous in most years that it causes the P/C industry as a whole to operate at a significant underwriting loss.*"
  - "*That old line, "****The other guy is doing it, so we must as well****", spells trouble in any business, but in none more so than insurance.*"

Since 2006, the issuance of cat bonds and side cars has completely changed of scale…

- The evolution and growth of the capital markets has been both steady and impressive
- Market intelligence suggests that growth will continue
- Sidecar evolution may however be more cyclical/ opportunistic than catastrophe bonds (post 9/11 and Tohoku)



… and more recently, we saw a second phenomenon: a new reinsurance model based on the partnering of asset managers and liability managers

	1st generation: « brand » Hedge Funds (HF) investing + Reinsurance start-ups			2nd generation: HF investing outsources to 3rd party (re)insurer – permanent		Pension Funds
	Greenlight	**Third Point Re**	**Hamilton Re**	**PaCRe**	**Watford Re**	
Starting date	2004	2011	2013	2012	2014	
Capital	$1.0bn	$1.4bn	$0.8bn	$0.5bn	$1.1b	
AMB Rating	A	A-	A-	A-	A-	
Collateralized	No	No	No	No	No	
Type of reinsurance	High frequency/low severity Some cat	High frequency/low severity	Cat and low severity casualty	Low frequency / High severity cat	Multi-line	?
Investment management style	Hedge Fund Greenlight (Einhom)	Hedge Fund Third Point (Loeb)	Hedge Fund Two Sigma	Hedge Fund Paulson & Co.	Multi Strategy, Fixed income, Highbridge	
Separate Underwriting manager	Yes	Yes Berger	Yes Duperrault / Ward	No **Validus**	No **Arch**	
Public equity traded	Yes	Yes	Not yet	Unlikely	Not yet	

IPO-driven with tax optimization advantages

Long Term Investments?

Watford Re is an interesting example of these latest, much talked about, ventures

March 31, 2014

$1.13bn initial capitalization

WATFORD RE

HIGHBRIDGE PRINCIPAL STRATEGIES — *Investment manager*

Arch Capital Group Ltd.® — *Reinsurance manager*

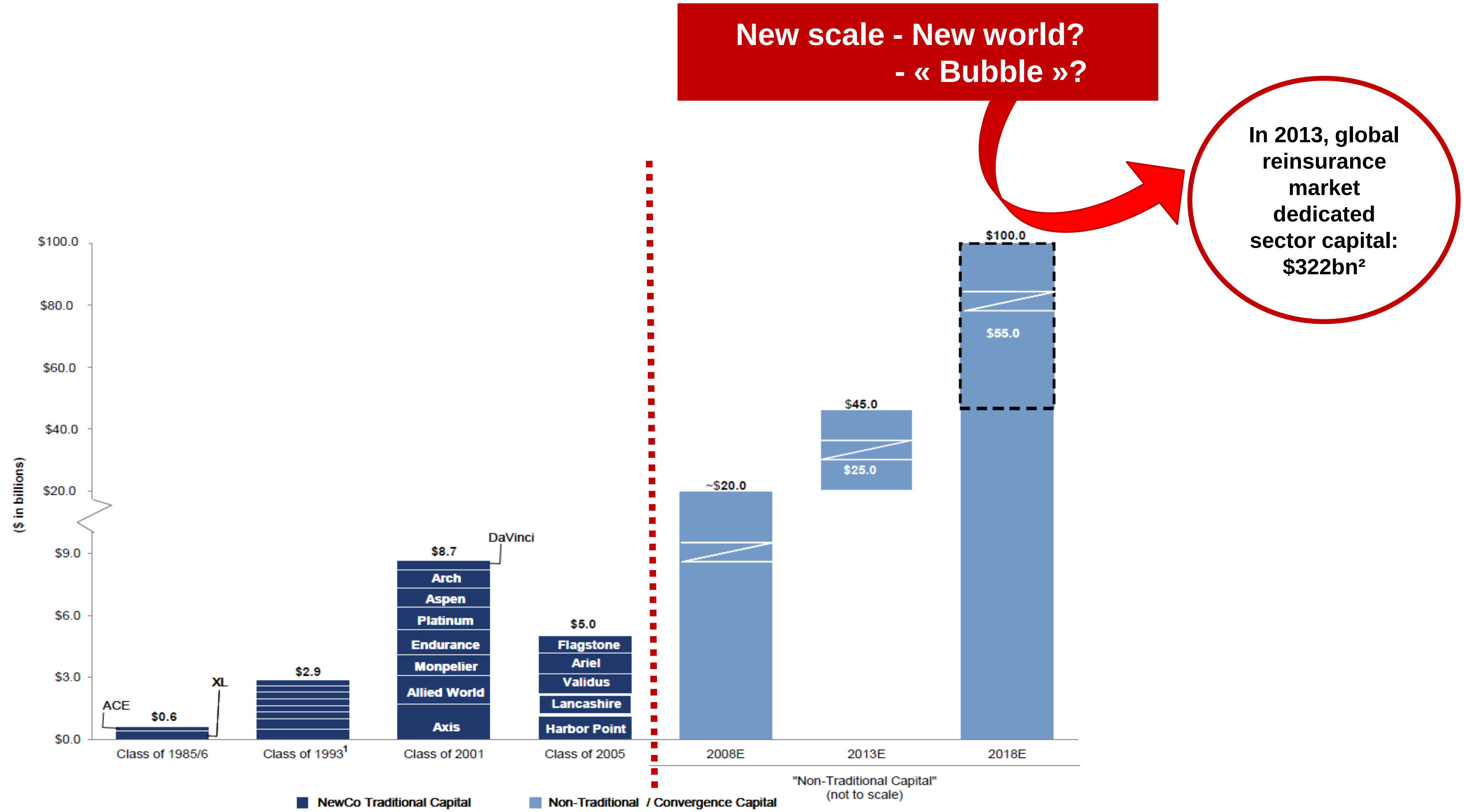
Why is this case particularly interesting?

1. New entrants in the casualty reinsurance space are fairly rare
2. The set up, associating a reinsurer with a hedge fund through long term partnership, is quite unique
3. Watford Re puts a specific emphasis on asset returns in the profitability equation

The concept

- Watford Re is a newly-formed multi-line property & casualty reinsurance company, a Bermuda licensed Class 4 reinsurer with a financial strength rating of A- from A.M. Best
- Arch act as a Reinsurance manager for Watford Re, while JP Morgan's will act as investment manager via the private equity and credit investment platform of Highbridge Principal Strategies. Arch will bring his own underwriters to the new structure. They will work with the same underwriting standards as Arch have
- Watford provides to Arch a vehicle to better compete against lower cost of capital competitors while preserving its clients/broker relationships
- Watford is expected to follow a diversified reinsurance strategy, with some focus on casualty risks and says that its investment strategy will be disciplined and composed primarily of non-investment grade credit assets, which it believes will generate attractive risk-adjusted returns for its shareholders over the long-term
- Lines of business such as Customized Products Reinsurance, Direct & Facultative, International Casualty Reinsurance, Marine and Offshore Energy, Mortgage Reinsurance, Personal Accident and Life Reinsurance, Property Reinsurance (International and US), Specialty Reinsurance, US Casualty Reinsurance

This time, recent inflows of non-traditional capital were not triggered by a “big one”, and scale of capital inflow has dramatically changed



Source : Goldman Sachs, Guy Carpenter, SCOR

1) 1993 new entrants were Partner Re, Mid-Ocean, IPC Re, Global Capital, Lasalle, Tempest, RenRe, Centre Cat.

2) Source: Guy Carpenter

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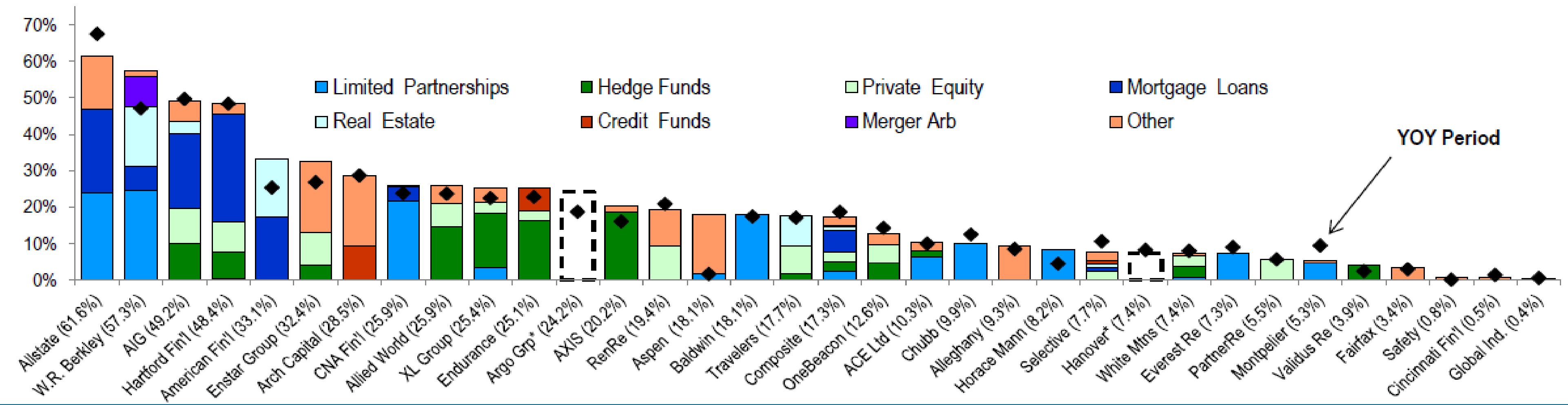
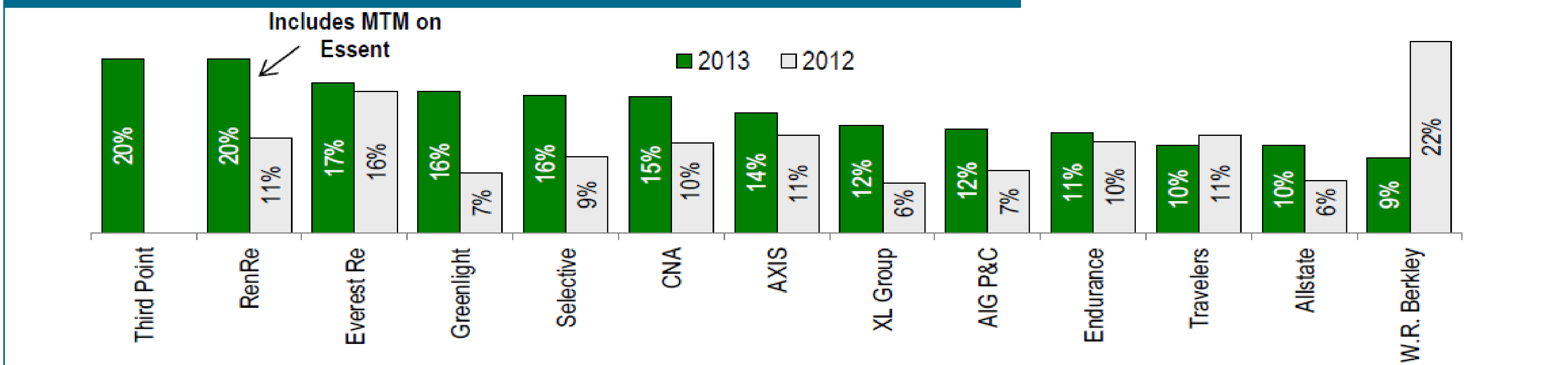
A number of (largely US) players have increased asset risks, putting their capital twice at risk: assets AND liabilities

Alternative Investments as % of Q4 2013 shareholders' equity[1)]



Alternative Investments as % of Q4 2013 shareholders' equity[1)]



1) *Analysis from Dowling & Partners*

More generally speaking, players have adopted different and often multiple strategies: this is characteristic of a stage of maximum uncertainty

Hiring of Convergence Market Executives	Market-Facing Sidecars[1]	Sponsoring Quota-shares	Developing Managed Catastrophe and Insurance-Linked Funds	Purchasing Stake in Existing Funds
Arch Argo Group Aspen AXIS Everest RenaissanceRe Validus Group XL	Alleghany Corporation Amlin Arch Argo Group SCOR Beazley Everest Lancashire Insurance Group Hannover Re PartnerRe Markel Montpelier Re RenaissanceRe Swiss Re Validus Group XL	Aspen Catlin Hiscox Kiln Lancashire Insurance Group Markel Montpelier Group RenaissanceRe Swiss Re SCOR Validus Group	SCOR Amlin Aspen Hannover Re Lancashire Insurance Group Montpelier Group Munich RE RenaissanceRe Validus Group XL	Alleghany Corporation / TransRe Allied World Assurance Company Hiscox

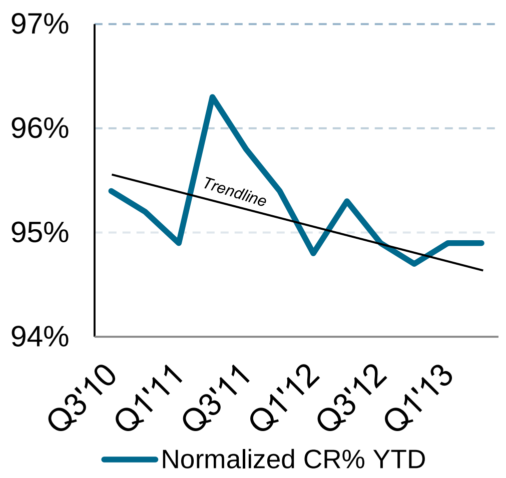
Source : Goldman Sachs
1) Includes market-facing sidecars and Lloyd's Special Purpose Syndicates

We at SCOR have seen a number of these trends in our KPIs

SCOR Global P&C

Down-trending P&C combined ratio

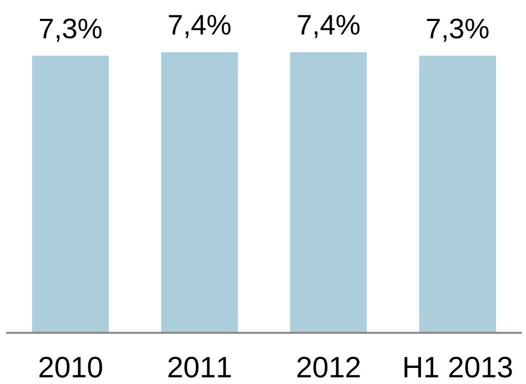
Quarterly normalized net combined ratio



SCOR Global Life

High and stable Life technical margin

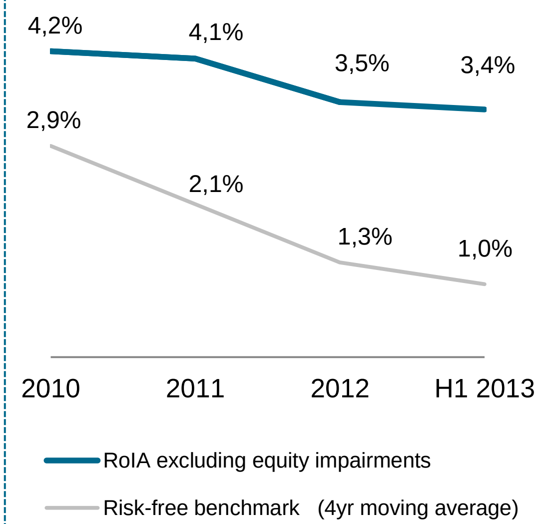
Annual technical margin excl. US indexed annuity business (%)



SCOR Global Investments

Declining returns on invested assets

Return on invested assets before equity impairments



Source : SCOR

Concluding Remarks - There remain a number of key questions and broad uncertainties that could define the future competitive landscape

1. How long will alternative capacities look at (re)insurance risks as "cost-free float"?
   - Or, put another way: What will happen when investors face large-scale losses?
   - And how will they look at (re)insurance returns when interest rates turn?

2. How to fuel the long-term earnings engines and yet drive combined ratio constantly lower

3. Does ILS have a higher propensity to litigate?
   - Short-term focus could contribute to disputes
   - Large share of triggered transactions ended up in dispute

4. By focusing so much on the underwriting leverage, are we not missing the more leveraged part of the equation: investments
   - Are we going to witness a convergence towards a more asset-driven model, whereby investment income will be optimized (if not maximized) given a maximum tolerable underwriting ratio (< 100%)?

5. Do the new interconnectedness with capital markets and the risk of a "bubble" lend credence to the suggestion that:
   - There is a risk of brutal and drastic reversal and market shock correction the day there is a "big one"?
   - Reinsurance is a systemic risky business?

6. Will alternative capital drive consolidation among traditional reinsurers?

Source : SCOR, Insurance Information Institute