GUY CARPENTER

Changing Nature of Risk Series

Leading Up to January 2021 Reinsurance Renewals

MARSH & McLENNAN COMPANIES

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Key Takeaways

1. Mid-year reinsurance renewal negotiations were lengthy and complex as insurers and reinsurers cautiously worked to quantify and manage rising levels of uncertainty. COVID-19 compounded existing industry challenges with additional layers of hard-to-quantify loss and economic volatility. The convergence of these factors resulted in market uncertainty reaching an apex through late spring and early summer.

2. Although the midyear reinsurance market had sufficient overall capital, reinsurers adhered to strict guidelines to deploy their capacity. As a result, catastrophe renewals, as an example, experienced the lowest percentage of excess reinsurance authorizations since 2012. This reduction in excess reinsurance authorizations makes clear reinsurers' increased caution.

3. As we look forward to January 1 renewals, there is some good news: primary rates are increasing, asset values are recovering and new capital is entering the market. The market, however, is complex.

4. At the half-year point, dedicated reinsurance capital, as estimated by Guy Carpenter in conjunction with A.M. Best, was down just over 2 percent. Nevertheless, insurance and reinsurance market participants raised USD 35 billion of new capital.

5. COVID-19 loss development continues to be slow and highly uncertain. This will be a factor at January 1 for individual renewals and may potentially affect reinsurers' overall willingness to deploy capital. The average of all public COVID-19 loss estimates tracked by Guy Carpenter is roughly USD 66 billion. The reported losses attributable to COVID-19 through third-quarter earnings announcements to date, in contrast, are slightly over USD 25 billion.

6. Long-tail lines have been a focus of attention in pre-renewal discussions, with increased loss frequency and severity squeezing carriers' margins as social inflation, among other considerations, is driving loss cost trends higher.

7. When reviewing the first half of the year's results, commercial automobile and general liability (occurrence) are evidencing significant adverse development. Medical professional liability and other liability are also showing signs of adverse development in recent periods.

8. Based on these various factors, January 1 renewals and related negotiations are expected to be lengthier and more complex than in prior years.

9. The risk landscape is shifting in significant ways, driven by a number of factors, including demographic changes, the rise of digital technologies, new platform business models, intangible values, cybersecurity and climate change. Insurers are facing new risks, and equally important, new opportunities. The reinsurance sector has a strong track record of responding to periods of change. Putting capital to work to create new coverages and meet evolving demands will be crucial in securing the sector's long-term relevance.

A Time of Unprecedented Change

For the first time since 1918, the world has had to deal with a truly global pandemic. In rapid succession, governments around the world simultaneously imposed quarantines, travel restrictions, business closures and a variety of other measures in an attempt to mitigate the spread of a virus.

While lockdowns and other pandemic response measures helped to flatten the curve, they also created short-term financial turbulence. Equity markets fell over 30 percent in March, forcing governments to respond with stimulus packages and other related solutions. Markets have recovered since then, but we still face the threat of longer-term economic challenges.

If this was not enough, recent events have put a spotlight on the stark reality of social injustice, highlighting systemic inequities and creating an undeniable call for change.

FIGURE 1: MAJOR EQUITY MARKETS' PERFORMANCE: JANUARY TO SEPTEMBER 2020 - VOLATILE EQUITY MARKETS

Source: S&P Global

Where does insurance and reinsurance fit in against this backdrop?

Prior to COVID-19, the industry was already facing a range of challenges. The widespread impact of a global lockdown added to this challenging market and created the potential for even greater volatility. For an industry founded on the principles of diversification, we are now grappling with the implications of the first globally systemic insurance loss.

In trying to assess a loss of unprecedented scope this spring, more than one educated guess put the potential for claims to develop in excess of USD 100 billion, along with financial market volatility wreaking havoc on the asset side of the balance sheet, followed by a lockup of the retrocessional market and widespread trapping of alternative capital.

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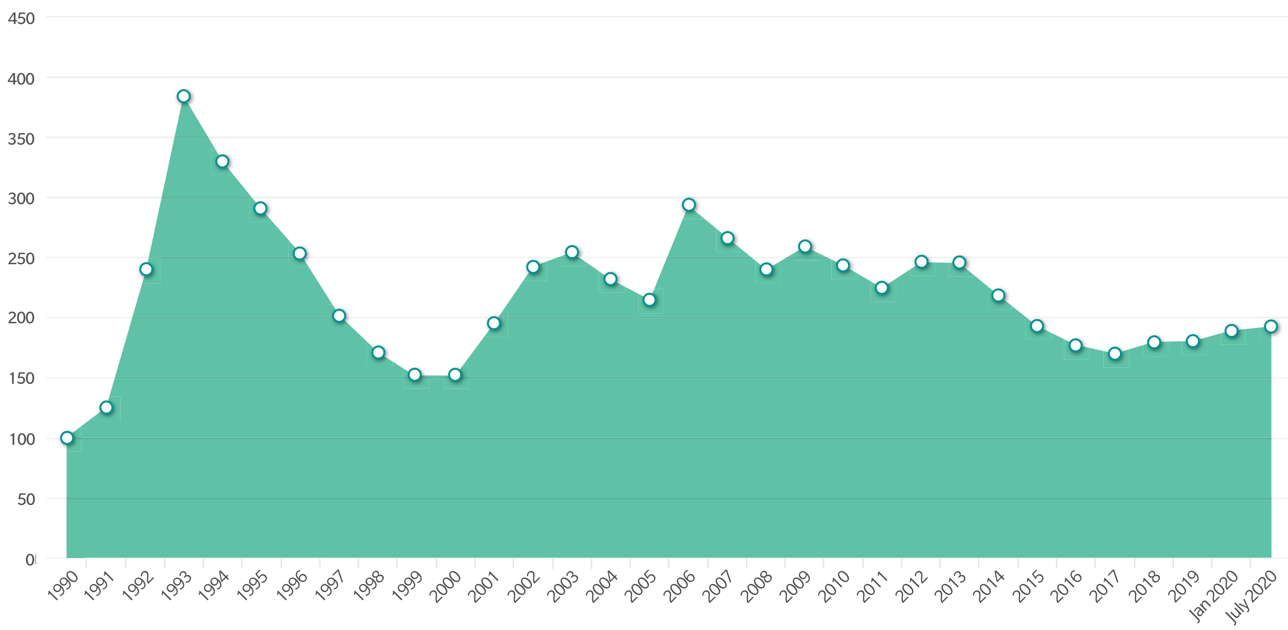
As a result of these initial responses, the mid-year renewals were the epicenter of market uncertainty. Pricing was impacted and capacity tightened. The Guy Carpenter Global Property Catastrophe Rate-on-Line Index increased by 6.2 percent after incorporating mid-year placements, driven by a challenging Florida renewal, loss-affected Japanese pricing and a cautious market environment induced by COVID-19. Despite this environment, all covers were placed and sufficient capacity was available.

As we look forward to January 1 renewals, some areas of uncertainty are diminishing, primary rates are increasing and new capital is entering the market.

The need for primary insurers to generate underwriting returns in a low-interest-rate environment has created a tightening of capacity in certain classes of business and an increase in rates across the board. The Marsh Global Insurance Market Index covering all lines has now shown price increases 12 quarters in a row.

Underlying insurance profitability is critical for a sustainable insurance and reinsurance marketplace.

FIGURE 2: GUY CARPENTER GLOBAL PROPERTY CATASTROPHE ROL INDEX: 1990 TO JULY 2020



Source: Guy Carpenter

Assets have recovered, as evidenced by the S&P 500 hitting a new record high in August after rising over 50 percent from its March low, with similar performance elsewhere in the equity markets.

With regard to direct COVID-19 losses, many market commentators are revising their initial loss estimates downward, particularly in the domain of property business interruption (BI). Based on third-quarter earnings announcements to date, reported losses for COVID-19 reached just over USD 25 billion, much of which is incurred but not reported. At this time, there are many steps still to complete before ultimate outcomes are better understood.

In one highly followed COVID-19-related proceeding, the UK Financial Conduct Authority (FCA) recently concluded its COVID-19 Business Interruption test case. The test case considered English law that governed BI insurance policies with non-damage extensions to coverage, and there were three broad categories: disease notification coverage, prevention of access/public authority coverage and hybrid coverage. On September 15, 2020, in a 162-page opinion, the court reached different conclusions regarding each insurer's wordings but found in favor of the FCA on the majority of issues.

The Supreme Court (the UK's highest court) granted permission on November 2, 2020, for a "leapfrog" appeal (bypassing the Court of Appeal) after the FCA, six insurers and a policyholder action group were granted permission by the High Court in October to appeal the judgment. The appeal hearing will run for four days beginning on November 16, and proceedings will be livestreamed.

The FCA BI test case and the many other cases worldwide are reminders that the insurance industry's policy and treaty wordings require constant care and attention. The construction of thoughtful and well-executed insurance policies and reinsurance treaties is a best practice spotlighted by the industry these last several months.

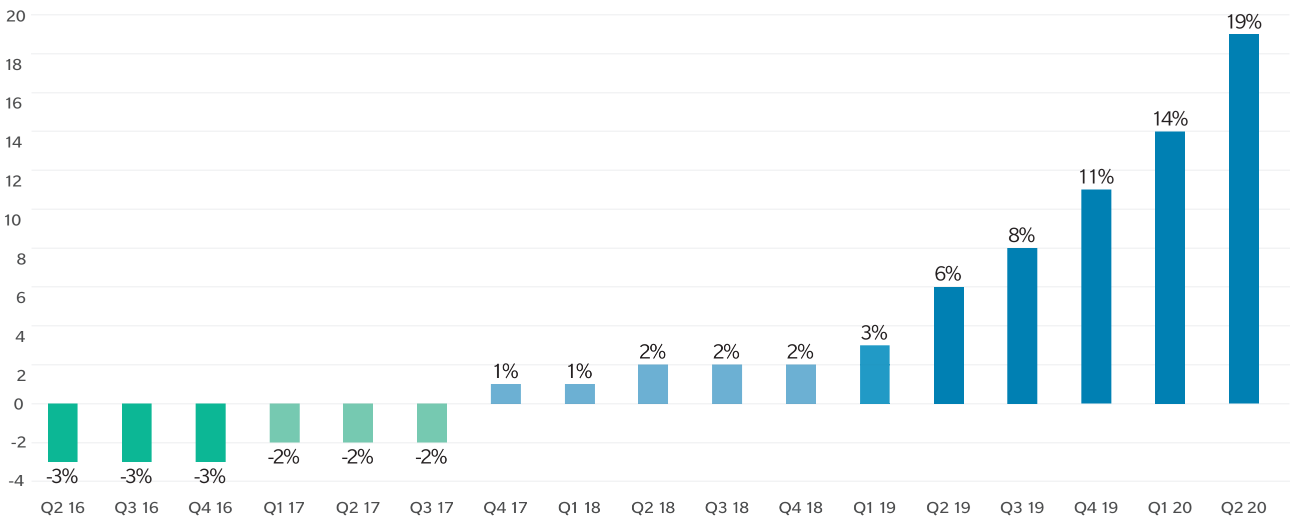
Considering mid-year behaviors and market developments since that point, January 1 renewals are likely to be complex, but the market is signaling that it is ready to respond. At the half year, although dedicated reinsurance capital as estimated by Guy Carpenter in conjunction with A.M. Best was down just over 2 percent, we have already seen USD 35 billion of capital raised by insurance and reinsurance market participants and there is ongoing activity to bring additional capital into the sector.

We expect the alternative capital market to evolve and adapt more broadly as capital seeks new ways to access risk. With specific regard to the retrocessional market, there is increasing activity and interest both from new capital and from existing rated balance sheets looking to deploy new capacity into the market.

Long-tail lines have been a focus of attention, with increased loss frequency and severity squeezing carriers' margins as social inflation drives loss cost trends higher. However, the industry is responding by driving significant insurance rate increases in areas of distress and showing increasingly disciplined risk selection and capacity deployment.

In current market conditions, reinsurance is an effective tool for managing volatility and creating a capital buffer in uncertain times. As a result, we continue to see strong interest in innovative structures and in the legacy transaction and run-off market.

FIGURE 3: GLOBAL INSURANCE COMPOSITE PRICING CHANGE



Note: All references to pricing and pricing movements in this report should be considered averages unless otherwise noted. For ease of reporting, we have rounded all percentages regarding pricing movements to the nearest whole number.

Source: Marsh Global Analytics

The Nature of Risk Is Transforming

Thinking beyond the market dynamics associated with COVID-19, Guy Carpenter has discussed at length the changing nature of risk and the opportunities and challenges confronting the insurance and reinsurance sector as it navigates one of the most significant periods of change in recent times.

The insurability of new risks is going to be one of the key defining issues of the next decade for the sector. Rapid technological changes, digitalization in particular, have already transformed the characteristics of risks assumed by insurers and reinsurers.

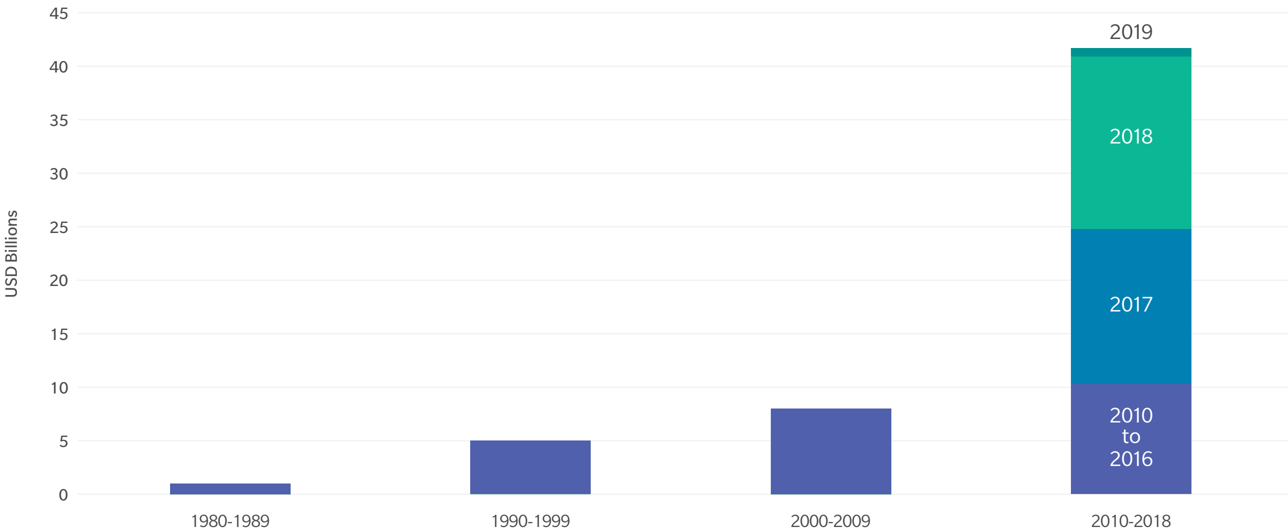
We are now living in the age of intangible assets. Today, around 84 percent of the S&P 500's market capitalization is composed of assets such as intellectual property, trade secrets, brands or data. This shift toward intangible assets challenges insurers but also presents opportunities.

In addition, the global catastrophic losses of the past three years have shown carriers (and governments) that they need to prepare for a more diverse and expensive array of man-made and natural catastrophe losses. New approaches to risk assessment and transfer and application of mitigation strategies are essential.

FIGURE 4: AGE OF INTANGIBLES: NEARLY 90% OF THE S&P 500's MARKET CAP IS INTANGIBLE

Source: EverEdge, Bloomberg, Guy Carpenter

FIGURE 5: GLOBAL WILDFIRE LOSSES



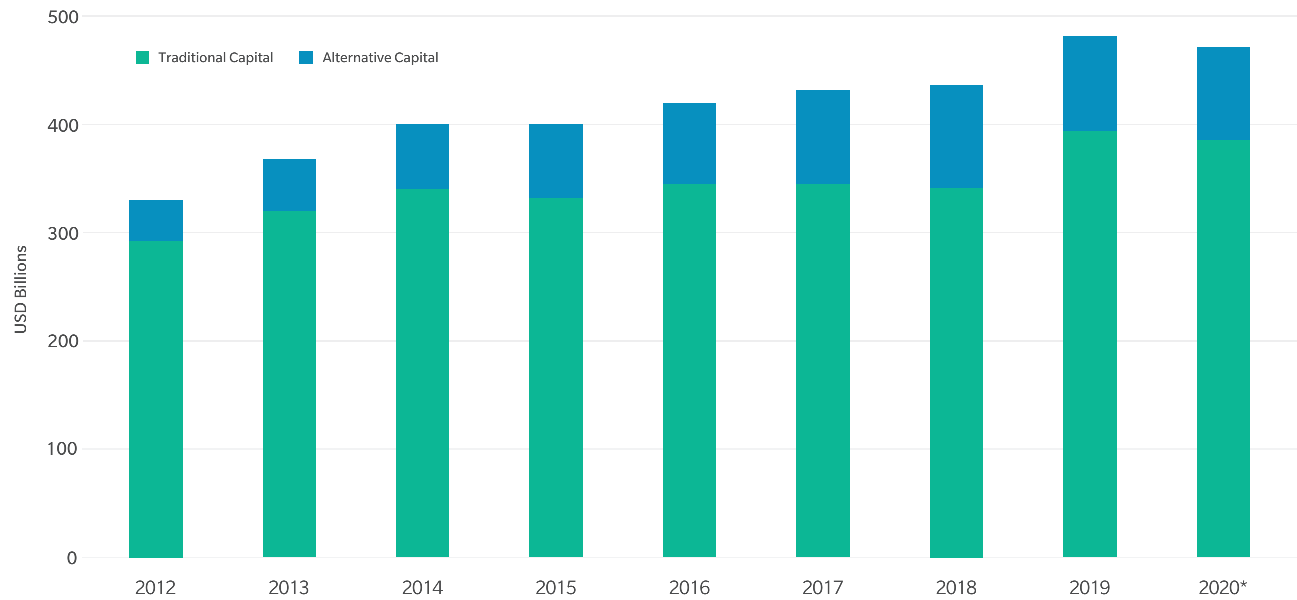
**Losses in 2017/18 do not account for subrogation recoveries in the United States.*

Source: Swiss Re Sigma, Guy Carpenter

The nature of risk is changing, and this change is being driven in part by accelerating and intensifying technological, demographic, environmental and legal trends. Recent losses and a challenging reinsurance market show that not only is the nature of risk changing but how risk is managed and shared is also changing. Guy Carpenter is committed to providing research, insight, guidance and product support through the market evolution ahead, akin to industry channel markers. Maritime authorities place channel markers to identify safe routes, thus leading mariners away from danger. It is our hope that our continued focus on these issues and their solutions will provide a similar service.

For almost 100 years, Guy Carpenter has been providing insurers with "channel markers," warning of risks, mitigating uncertainty, and identifying opportunities. The January 2021 reinsurance renewals will be difficult as market participants seek to reposition themselves to deal with increased uncertainty. We are committed to working with cedents and capital providers to identify solutions and achieve the best possible outcomes at this January 1 and throughout the continuing evolution of risk.

FIGURE 6: DEDICATED REINSURANCE SECTOR CAPITAL: 2012 TO 2020



*Estimated. Source: Guy Carpenter, A.M. Best

The current reinsurance market is uncertain; reinsurers are being cautious; and social inflation, adverse development, extreme weather and Covid-19 are all continuing issues.

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About Guy Carpenter

Guy Carpenter & Company, LLC is a leading global risk and reinsurance specialist with more than 3,100 professionals in over 60 offices around the world. Guy Carpenter delivers a powerful combination of broking expertise, trusted strategic advisory services and industry-leading analytics to help clients adapt to emerging opportunities and achieve profitable growth. Guy Carpenter is a business of Marsh & McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. The company's 76,000 colleagues advise clients in over 130 countries. With annual revenue of $17 billion, Marsh & McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses including Marsh, Mercer and Oliver Wyman. For more information, visit www.guycarp.com and follow Guy Carpenter on LinkedIn and Twitter @GuyCarpenter.

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