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The impact of the financial crisis and the recession on insurance/reinsurance

Thomas Hess

Chief Economist, Swiss Re

Head of Economic Research & Consulting

SORS - Sarajewo
18 June 2009

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Agenda

- Capital market and economic situation
- Alternative scenarios
- Prospects for global insurance markets

Sharp drop of equity indices after Lehman default

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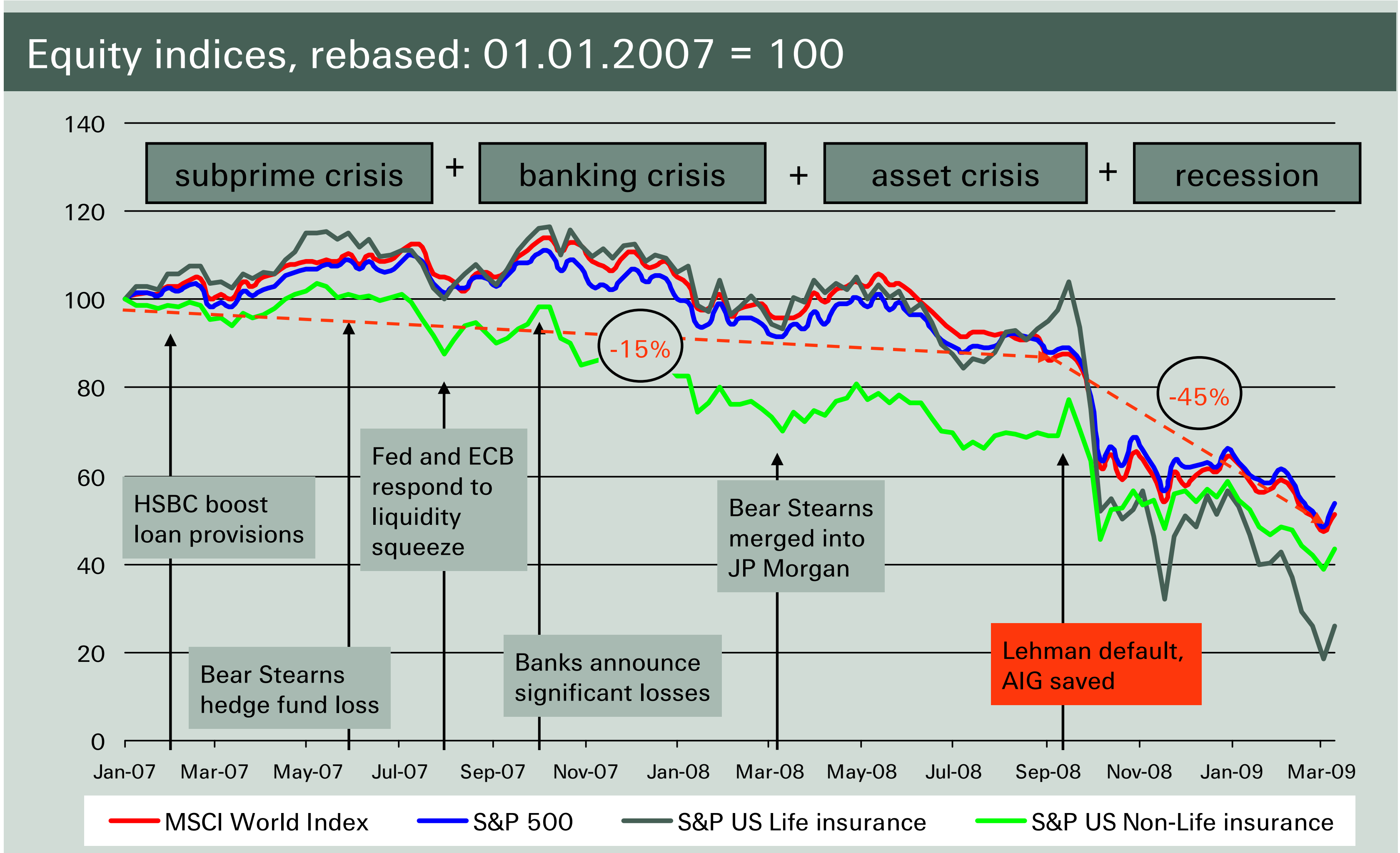

Source: Bloomberg, Swiss Re Economic Research & Consulting

Sharp decline in corporate bond and equity values

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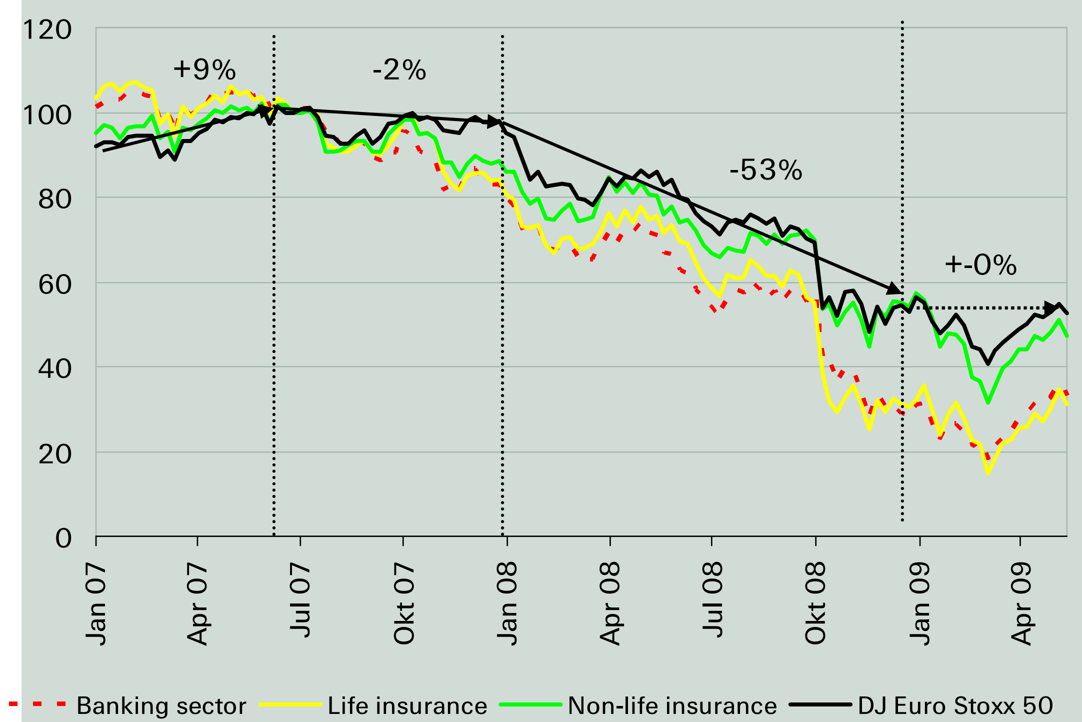
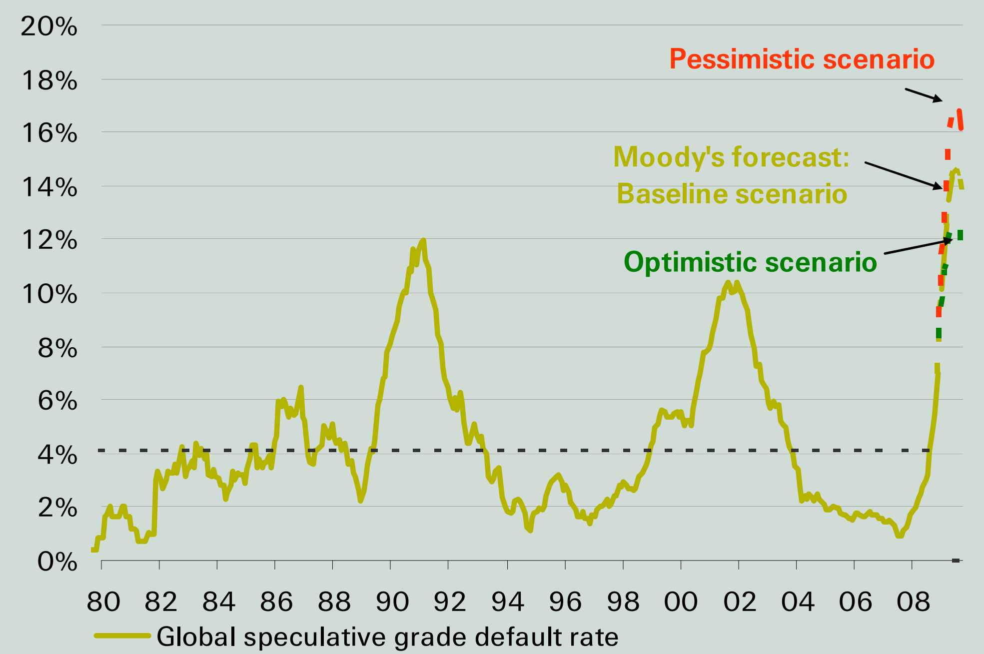
European equities, (June 2007=100)



Source: Bloomberg

Global speculative-grade default rates



Source: Moody's

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Where are the deeper problems?

- Too expansionary monetary policy in the US
- Financial innovation
- Irresponsible underwriting of US mortages
- High leverage of banks (also off balance sheet)
- Insufficient risk management of banks
- Expectations that banks will be bailed out lead to excessive risk taking
- Renumerations schemes
- Problematic role of rating agencies
- Problematic role of supervisors

For many countries, the main transmission channel of the crisis is now the contraction of trade

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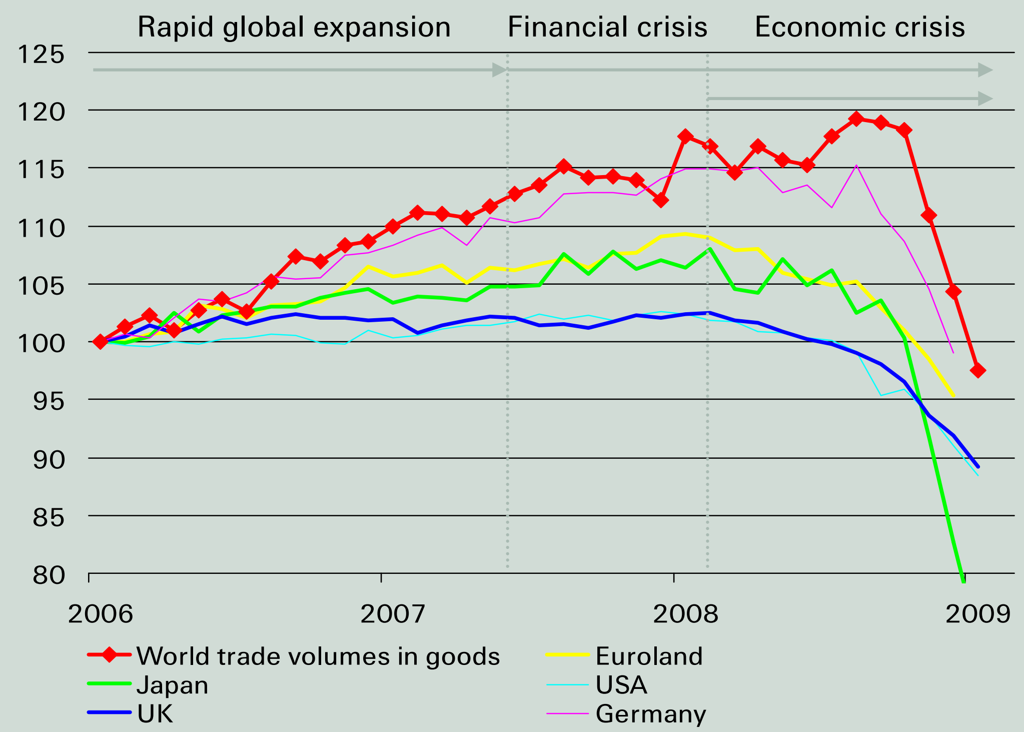
World trade volumes and Industrial Production in selected countries (Jan 2006=100)



Sources: CPB, Datastream

Positive prospects for profits and growth of P%C insurers

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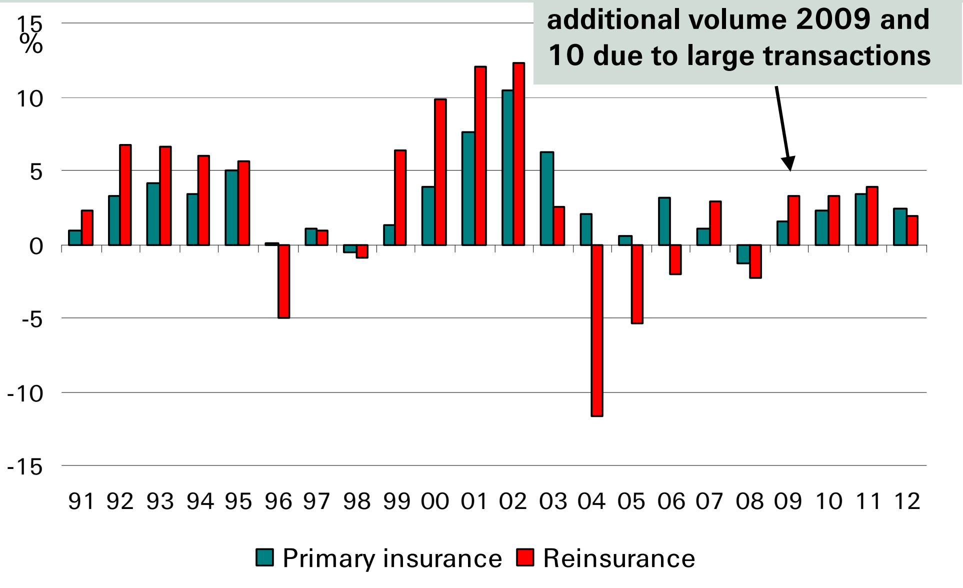
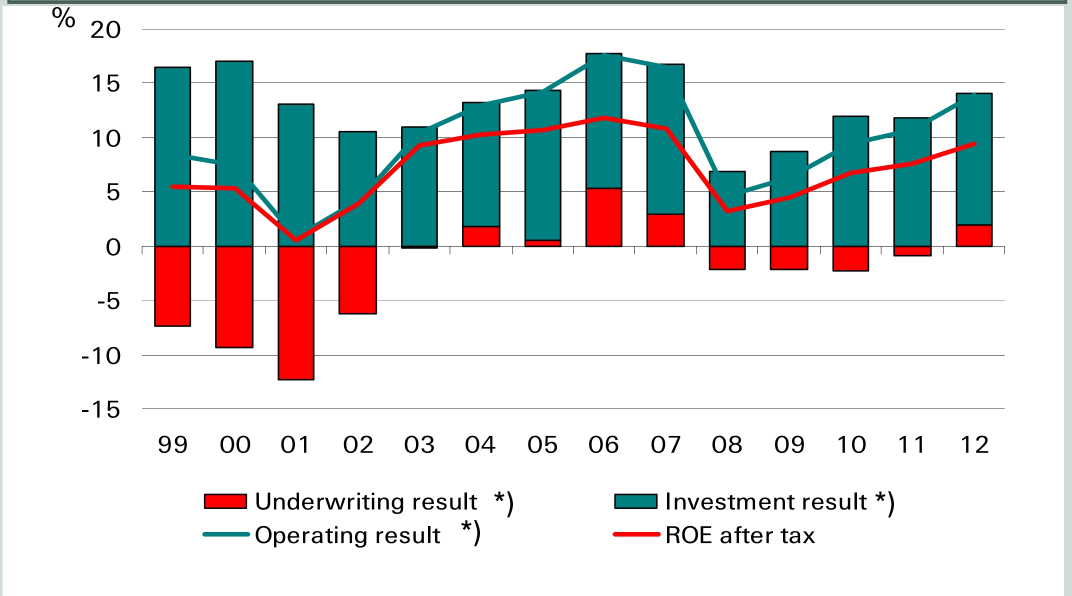
Back to moderate growth (yoy %, infl adj.)



Insurance results improve 2010/ 12



Source: Swiss Re, Economic Research & Consulting, March 2009 forecasts

*) % of premiums

The need to bolster demand makes large public policy actions indispensable…

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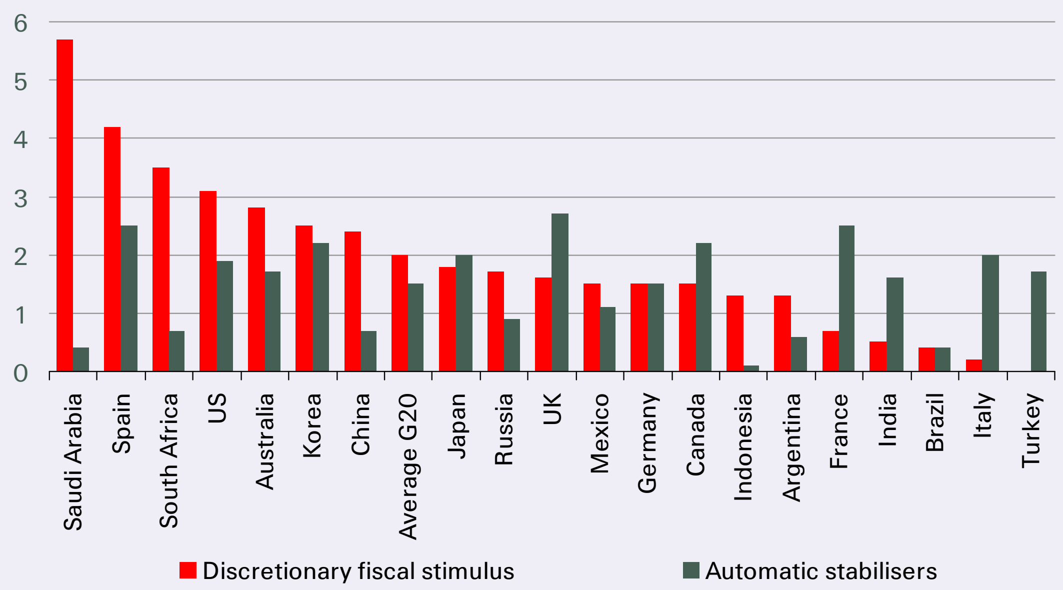
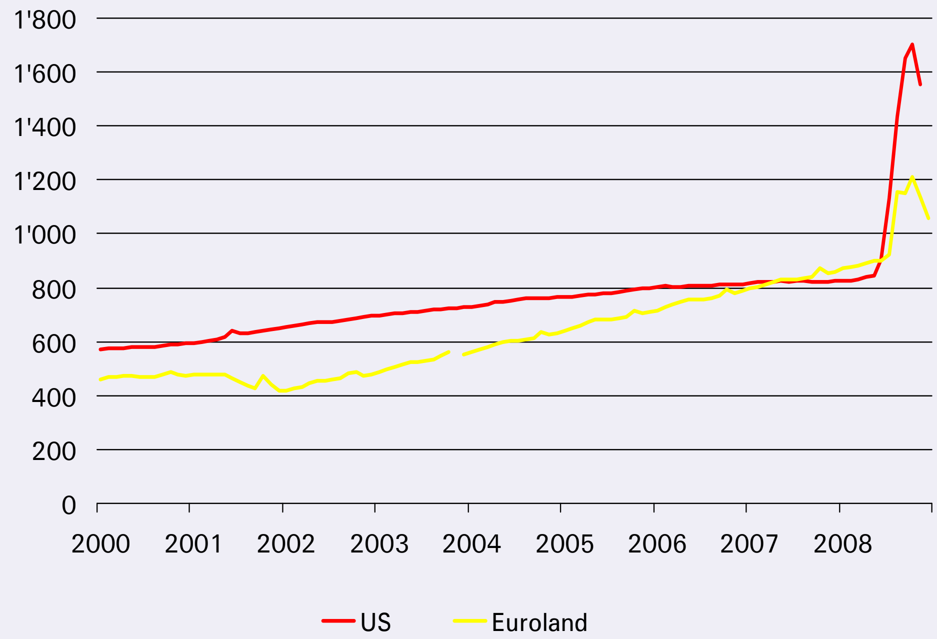
G20: Estimated cost of discretionary measures and automatic stabilisers (% of GDP, 2008-2009)



Sources: IMF, "The State of Public Finances: Outlook and Medium-Term Policies After the 2008 Crisis", Swiss Re ER&C

Monetary base (bn local currency)



Source: Datastream

US Economic Outlook: Key country for global recovery

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	2006	2007	2008F	2009F	2010F
Annual Averages:					
Real GDP	2.8	2.0	1.1	-2.6	1.0
Consensus	2.8	2.0	1.1	-2.6	1.8
CPI	3.2	2.9	3.8	-1.3	0.9
Core CPI	2.5	2.3	2.3	1.4	1.2
End-of-Period:					
Fed Funds	5.25	4.25	0.25	0.25	1.0
5-yr T-note	4.7	3.5	1.6	2.0	2.8
10-yr T-note	4.7	4.0	2.3	2.8	3.6
Baa bond, spread, bp	144	206	492	450	350

Sources: Blue Chips Economic Indicators, Moody's, Federal Reserve Board, Swiss Re Economic Research & Consulting, mid-April forecast

Global overview: Down in 2009, weak recovery in 2010

	2007	2008	2009F	2010F
Real GDP growth				
Euroland	2.6	0.9	-3.4	0.3
UK	3.1	0.8	-4.1	-0.1
Japan	2.0	-0.4	-6.3	0.4
Inflation				
Euroland	2.1	3.3	0.9	1.1
UK	2.3	3.6	1.2	1.0
Japan	0.1	1.4	-0.9	0.5
Policy rates (eop)				
Euroland	4.00	2.50	1.0	1.25
UK	5.50	2.00	0.50	0.75
Japan	0.46	0.10	0.05	0.75
Yields 10-yr govt bond				
Euroland	4.3	2.9	3.0	4.2
UK	4.5	3.1	3.1	3.6
Japan	1.5	1.2	1.3	1.9

Sources: Swiss Re Economic Research & Consulting, mid-April forecast

Global economic outlook

What gets us out of the recession?

- Substantial Central Bank easing, low interest rates
- Fiscal stimulus
- Lower oil/commodity prices, reduced inflation
- US consumers and housing will likely lead the way

What happens in the recovery?

- ***Temporary investment opportunities: Credit and equities***
  - Late in recession, early recovery
- ***Government bond yields likely to remain low***
  - But likely to rise in 2010, 2011
- ***Risk of inflation rises, but low inflation most likely***
  - Risk is low through end-2010, may not be a problem until 2012 or later
  - Fiscal/monetary restraint will keep growth moderate
  - Central banks are familiar with how to tighten monetary policy
  - Risk is essentially political

The crisis will cause medium term trend growth to drop slightly

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Key differentiating issues

- Size and situation of the banking system
- Indebtness of consumers
- Extent of overvaluation of real estate prices
- Importance of the export sector
- Solidness of public finances

Real GDP (yoy %-growth)

	2009	2010	2014
GER	-5.6	-0.4	2.3
FR	-3.0	0.4	2.4
IT	-4.4	-0.4	1.9
Spain	-3.0	- 0.7	2.0
CH	-3.7	-0.3	1.5
AT	-3.0	0.2	2.3

Source: IMF forecasts, April 2009

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What can happen differently?

Baseline 60%

Upside scenario 15%
- recession less deep;
- higher interest rates 2011; credit spreads tighten earlier and better stock-markets

Downside scenario 25%
- deeper recession
- lower interest rates 2010, credit spreads tighten later and worse stock-market

May be combined with different scenarios above!

Bumpy: Overstimulation leads to inflation 2012-14
- recovery stronger and inflation rises to 5% or more for several years
- monetary tightening will cause another recession
- tightening of credit spreads followed by another widening; higher interest rates 2011-2014; stock-markets better then worse

The downside scenario is most severe for companies with elevated asset risks, risks for life companies are substantially increased
The overstimulation scenario provides a window of opportunity to sell risky assets; it is also more positive for life companies, but causes a period of claims inflation

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New April 2009 IMF credit loss estimates

- ***Credit losses have been revised upwards*** to ***4000bn***
- Banks losses are estimated to be 2400 bn, which is 60% of the total
- ***Insurers have losses of 301bn*** (US: 218/ EU: 75bn, Japan 8 bn), which is 7% of the total of credit related losses (***revised downwards!)***
- In addition insurers face losses from equity investments, alternative assets, real estate and participations
- ***ER&C forecasts of 500 bn*** (25%) losses on shareholder capital **is consistent with IMF figures** (total losses on assets are higher as they are shared with life policyholders)

In 2009-2010, a key issue will be the recapitalisation…

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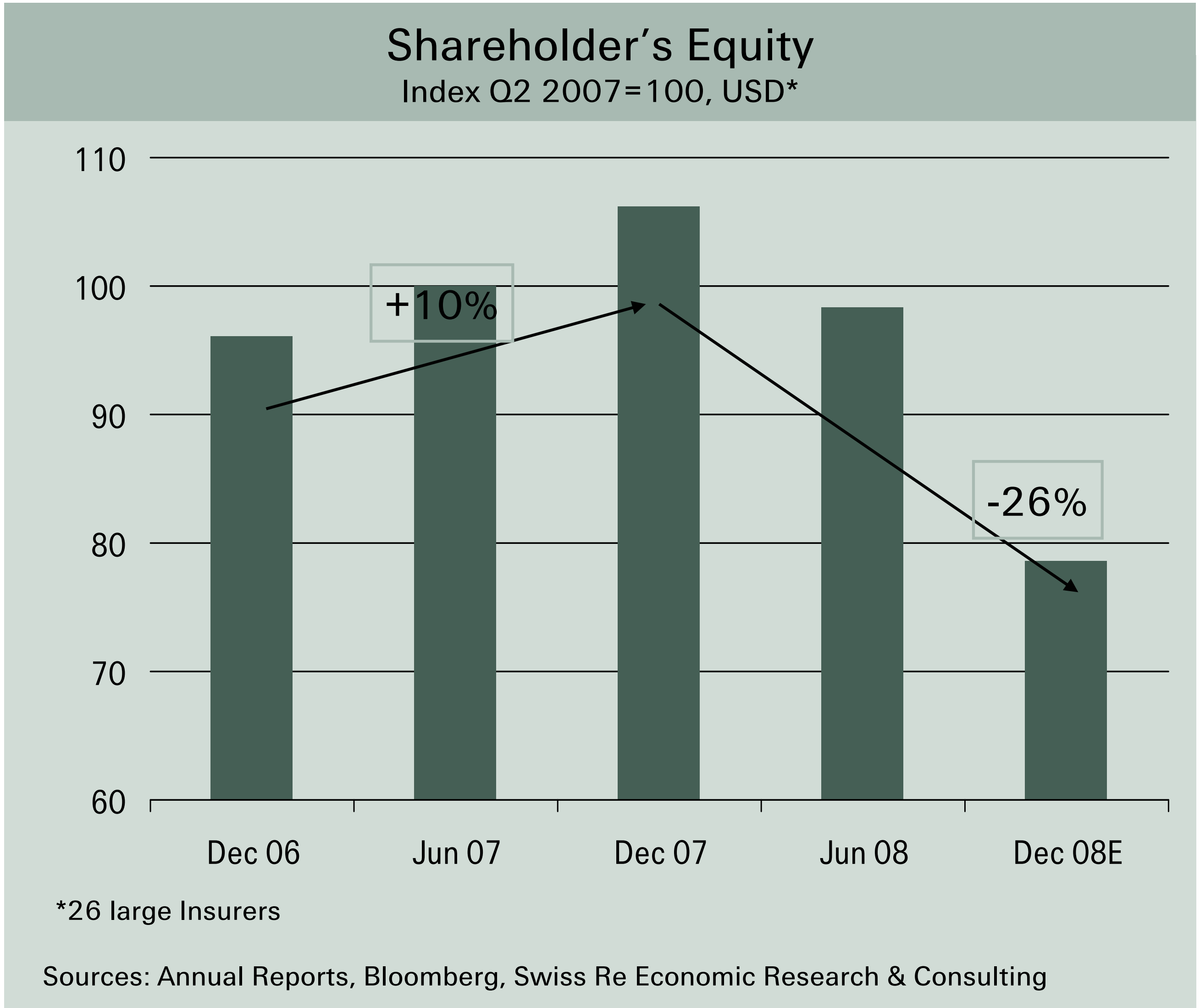
In 2008, the non-life insurance industry lost about 20% and the life insurance industry between 30-40% of the capital base



Key initiatives of (re-)insurers

Key risks are leverage and credit exposure

- De-risk – mainly asset portfolio but also insurance
- Increase profitability – reduce costs
- Find access to funding – (private/government?)
- Use the situation for competitive advantage

→ Survival is no. 1 priority

Baseline: capital & solvency in P&C
(Index 1999=100 for capital)

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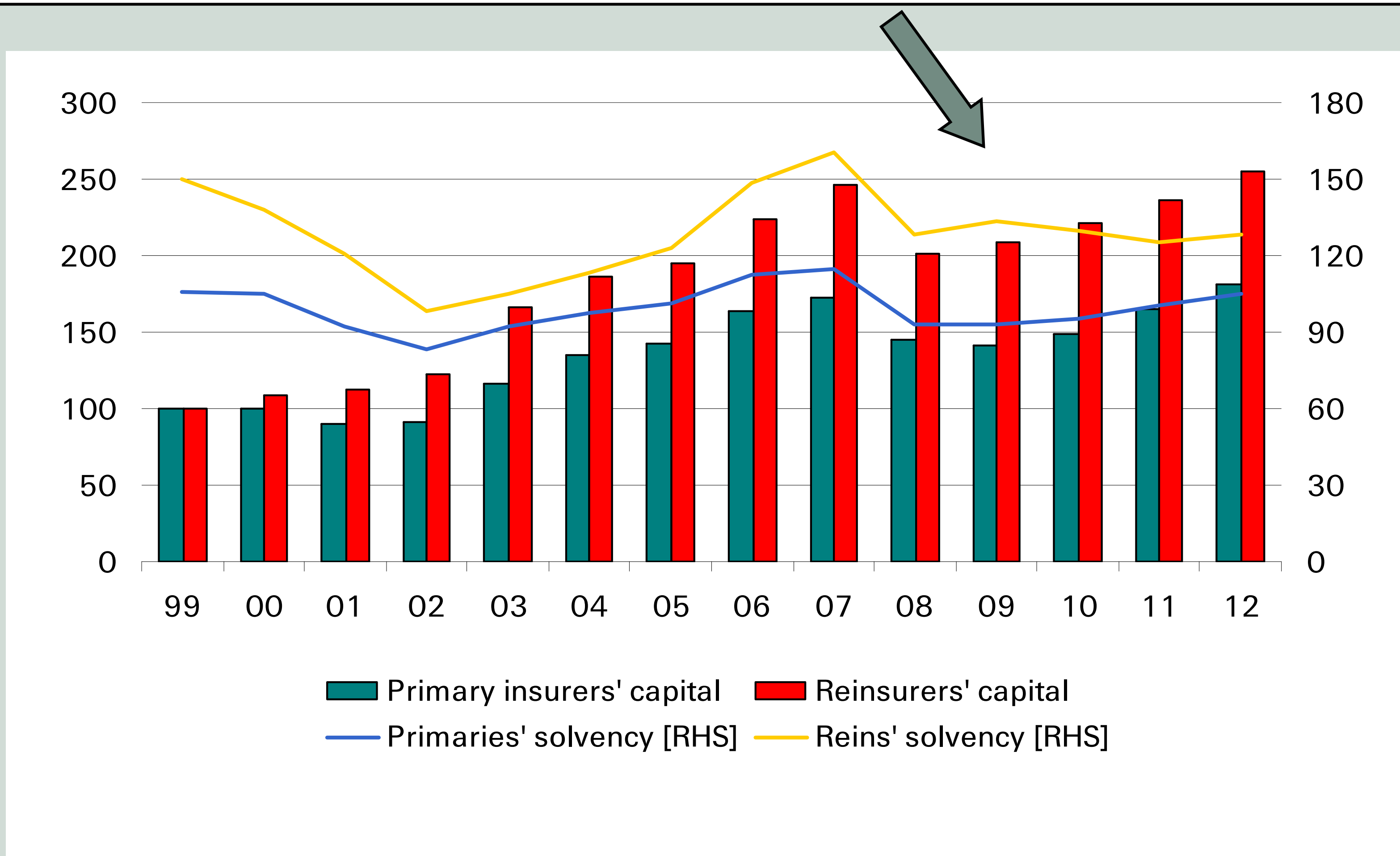

CHANGE 2008 vs 2007

Primary insurers' capital	-17%
Reinsurers' capital	-19%
Primaries' solvency	-19%
Reins' solvency	-20%

Source: Swiss Re, Economic Research & Consulting, March 2009 forecasts

Primary insurers: based on an aggregate of 8 large markets (US, CA, JP, AUS, UK, DE, FR, IT)

Reinsurers: sample of 25 leading P&C reinsurers

Positive prospects for growth and profitability non-life

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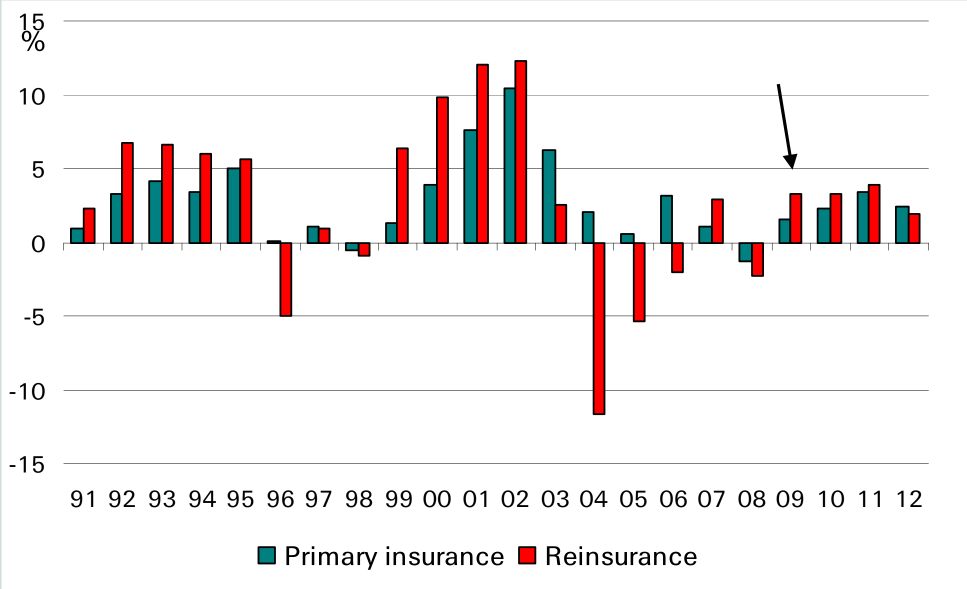
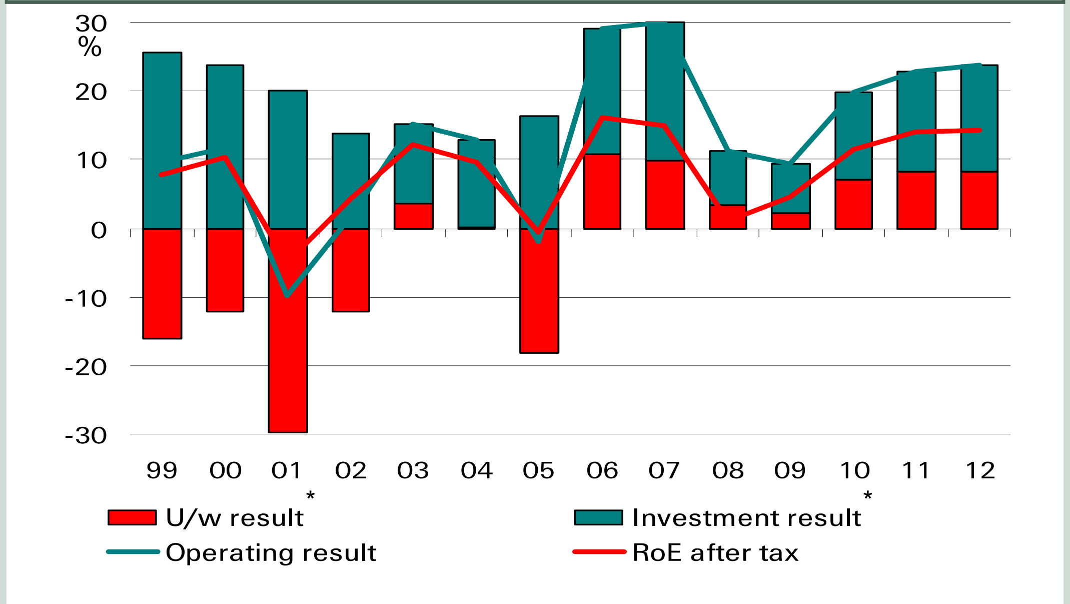
Back to moderate growth (yoy %, infl adj.)



Reinsurance results improve 2010/ 12



Source: Swiss Re, Economic Research & Consulting, March 2009 forecasts

*) % of premiums

Life insurance is heavily affected by the crisis..

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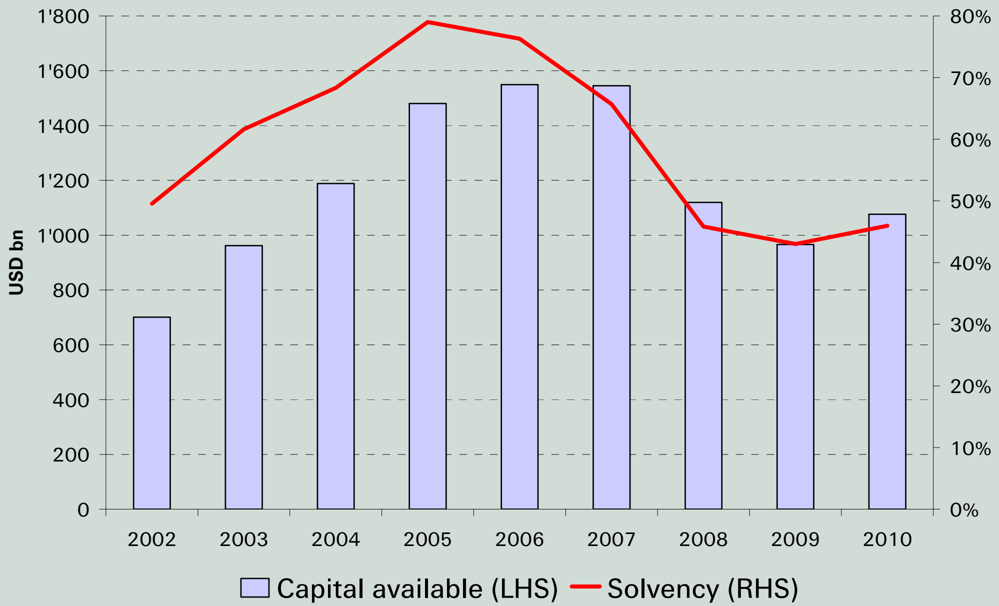
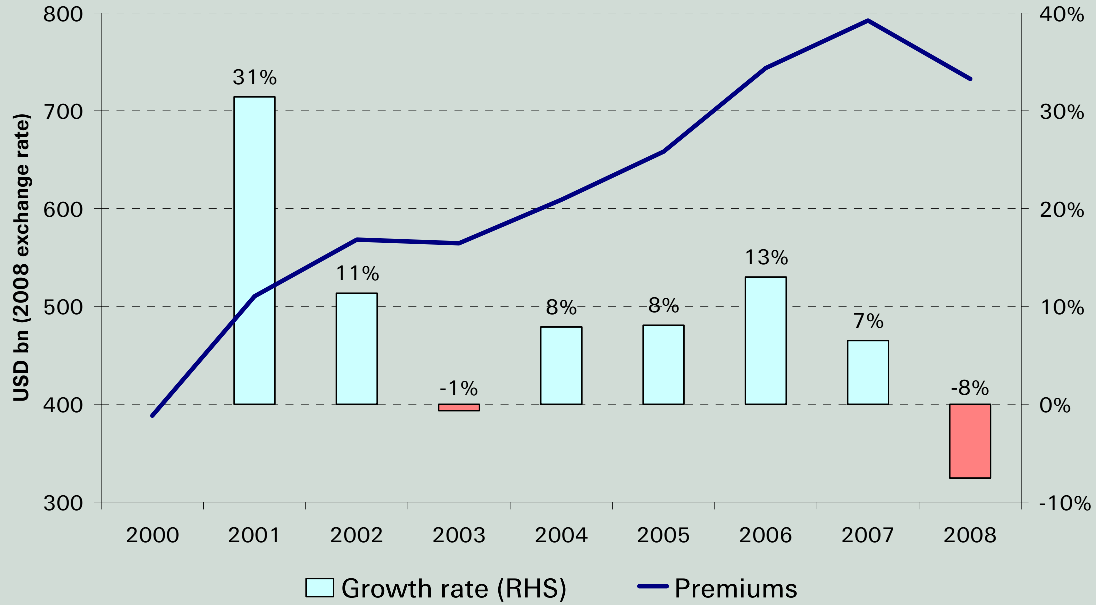
Solvency in life insurance drops sharply, ..



.. new business temporarily down



Sample: US, UK, Canada, Germany, France, Italy, Australia, Sweden, Norway

Source: Swiss Re, Economic Research & Consulting

.. and lots of companies face severe solvency issues

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Life insurers are hit much harder than non-life insurers due to their higher asset leverage

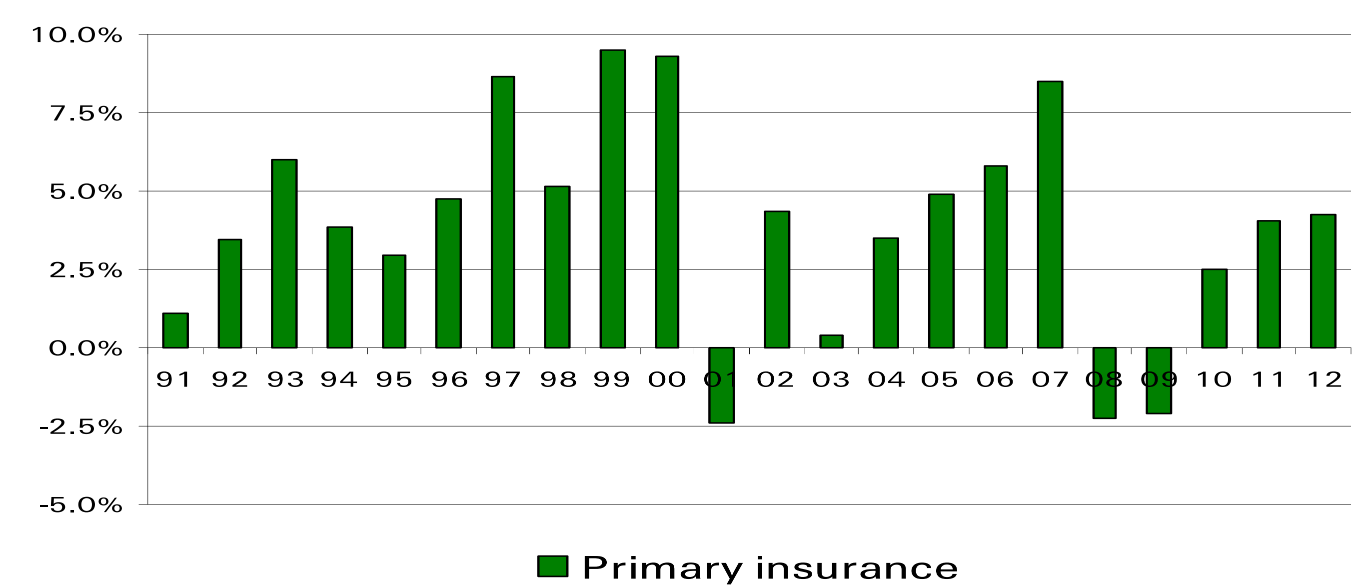
Book value and stock prices end 08/07

	Change in BVPS	Change in Price
Genworth Financial	-33%	-89%
Hartford	-50%	-81%
ING	-24%	-73%
China Life	-12%	-68%
Lincoln National	-30%	-68%
Prudential (US)	-39%	-67%
Principal Financial	-67%	-67%
Protective Life	-69%	-65%
Allianz	-30%	-49%
Sun Life	2%	-49%
Manulife	6%	-49%
Friends Provident	-20%	-47%
Metlife	-37%	-43%
AXA	-20%	-42%
Aviva	-15%	-42%
Prudential (UK)	-19%	-42%
Legal & General	-29%	-41%
Generali	-27%	-37%
Zurich	-24%	-32%
Standard Life	5%	-20%

Source: Bloomberg

Primary life insurance will recover in 2010

Back to trend growth in 11/12 (yoy %, infl adj.)



Source: Swiss Re, Economic Research & Consulting, March 2009 forecasts

Beyond the crisis ..

- ***Growth*** will come back
- ***Risk premiums will be higher*** for some years → opportunity for insurance as an investor
- Non-life and life ***insuranc***e and reinsurance ***model not at threat*** ..
- .. but ***supervisors will question high leverage*** of insurance companies and ..
- .. ***may increase capital requirements***

- ***Globalisation*** of supervision ***will slow down***
- ***Securitisation*** and other alternative capacity ***will come back*** ..
- .. but more – temporarily - ***expensive and difficult access to funding and guarantees will reduce growth*** of embedded value type of securitisation

How to deal with more strict regulation and higher capital requirements?

Reinsurance will play an important role in coping with the crisis

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Huge demand ..

- ***Reinsurance is a superior risk mgmt tool*** (flexible, quickly available and discreet)
- ***Solvency problems*** of companies ***increases need for reinsurance***
- .. but they may ***not afford it***
- ***Lack of alternative*** risk and capital mgmt ***instruments***
- ***.. in*** particular for ***companies hard hit resp. smaller companies***

... may not be fully met

- ***Lack of capacity***, including alternative sources of reinsurance capacity
- ***Risk transfer*** may involve transfer of problematic assets

Reinsurers will play an ***important role in managing the crisis and in the recapitalisation process***

Parts of the alternative risk transfer suffer from the crisis

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- What works?
  - CAT bonds non-life and life
  - ILW (insuance linked warrants)
  - Weather derivatives
- What doesn‘t wirk so well?
  - Embedded value securitisation life
  - Side car capacity

Prospect remain favorable - questions marks regarding embedded value securitisation life

Limited effects of the crisis on (re-) insurance risk transfer ...

- Insurance and reinsurance markets continue to work
- Capacity declined but there is no shortage
- Policyholders kept trust in the industry
- Alternative risk tranfer was affected but will recover
  - ILS
  - ILW
  - Sidecars
  - Insurance derivative markets
  - Embedded value securitisation life (?)

... but credit related activities will be more closly monitiored in future

- Monoliners will hardly provide financial guarantees for capital market products in future
- ALM will get even more important
- Embedded options in Life insurance will get more attention, the same for market risks of investments
- Supervisors will pay more attention to tail risk, liquidity risk and leverage of insurers (also related to derivatives)

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Conclusion

- The economic environment remains challenging and demands for strict risk management
- Low interest rates and the need for recapitalisation ask for solid underwriting results
- As soon as financial markets stabilise profitability will improve; the recovery will be bumpy
- Non-life will do better than life insurance until we see capital markets forcefully bouncing back
- Insurance and reinsurance business model is not at stake