

Property & Casualty Insurance

Insurance Insider Conf Takeaways: Reinsurance Price Declines Could Slow; Industry Seeks To Evolve

We attended the *InsiderScope* New York 2016 conference, which brought together executives from reinsurance, insurance and insurance broker companies. Our key takeaways are 1) industry participants are cautiously optimistic that reinsurance price declines will continue to abate as we head into June renewals, 2) industry M&A is expected to continue for the foreseeable future, 3) the industry must continue to prove and enhance its value proposition to remain relevant and grow, and 4) the industry needs to continue to develop new and innovative technologies while attracting younger millennial talent to the industry.

- Many panelists believe the soft reinsurance cycle could be bottoming after several years of price declines. Additionally the accumulation of recent losses (Canadian wildfires, Texas storms and Japanese earthquakes) could result in a further slowdown in reinsurance price declines during the upcoming renewal period.
- Industry M&A is expected to continue for the foreseeable future. Most believe deal prices in 2015 were reasonable with the exception of a few large Asian deals and the deals made strategic sense.
- Panelists indicated that the insurance industry will need to evolve in order to prove its value and that the industry has been slow to adapt to emerging threats such as cyber, intellectual property, terrorism and pandemic risks. For example, industry claims as a percentage of GDP in the U.S. increased through the late 1980s to 3 percent of GDP, but have since declined to around 2 percent of GDP. Meanwhile, insurance premiums have fallen from 4 percent of GDP in the US to 3 percent today.
- Our outlook for the P&C insurance sector is mixed. Near-term the group could benefit from its defensive nature and less interest rate exposure than the rest of financials (although low interest rates still depress returns). Long-term, however, lower P&C insurance prices and slowing reserve releases are headwinds. We prefer companies with growth opportunities outside the soft P&C cycle including AON (where FCF could accelerate), ALL (which we view as a turnaround story) or ACGL (best-in-class insurers that are also growing in mortgage insurance).

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Additional Takeaways from *InsiderScope New York 2016*

- The panelists agreed that the industry must capitalize on growth opportunities in emerging risks, with cyber being at the forefront. Regulators had difficulty defining cyber and now the courts are faced with a similar challenge. Carriers are having difficulty measuring cyber exposure and the risk associated with cyber across multiple policies. In addition, the industry is attempting to achieve national uniformity regarding data security and product liability.
- The industry's aging leadership was also highlighted as a key concern going forward. According to McKinsey, the average age in the insurance industry is 59 with 25% of the workforce scheduled to retire by 2018. McKinsey also estimates that 400,000 hires will be needed by 2020 to maintain the industry's current headcount.
- Additionally, many insurers are not being opportunistic regarding reinsurance purchasing as pricing has declined. However, price declines have enabled them to manage capital and stabilize earnings. There is also a trend towards buying more centralized coverage.
- The industry is addressing challenges as it tries to adopt universal standards for guidelines and regulations. Given that Europe is implementing Solvency II, U.S. regulators are trying to create an equivalent for domestic carriers.
- The conference believes that it's too early to determine the impact of BCAR model changes on reinsurance prices, although it could create some additional demand for reinsurance.
- Panelists noted that the recent surge of non-traditional capital into property catastrophe has resulted in capital slowly entering into specialty lines and negatively impacting pricing. However, panelists cautioned that the skillset required for property catastrophe is not the same as the core competencies needed for specialty lines. This inexperience could result in losses that impact already low margins. That said, the days of operating as a mono property catastrophe line are finished and the race to special lines is the race to necessary diversification.

Companies Discussed in This Report (all prices in this report as of market close on 10 May 2016)

Allstate (ALL/\$67.98/Overweight), Aon (AON/\$106.12/Overweight), Arch Capital (ACGL/\$71.54/Overweight)

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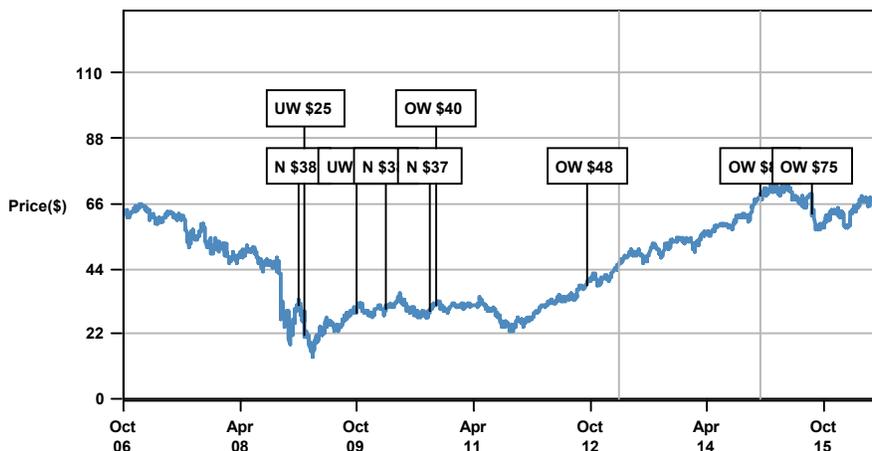
Aon (AON, AON US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
13-Dec-06	N	36.46	-
31-Dec-08	N	45.68	50.00
25-Sep-09	N	40.84	51.00
10-Sep-10	N	37.77	45.00
17-Dec-10	OW	45.10	53.00
04-Oct-11	OW	42.15	54.00
12-Oct-12	OW	53.19	59.00
04-Feb-13	N	56.13	59.00
09-Dec-14	OW	97.60	110.00
13-May-15	OW	99.11	113.00
04-Apr-16	OW	104.85	120.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Dec 13, 2006.

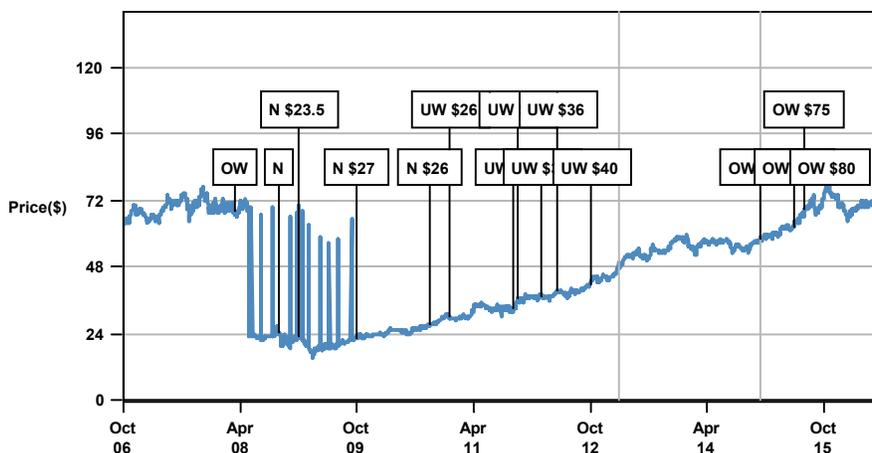
Allstate (ALL, ALL US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
31-Dec-08	N	31.91	38.00
30-Jan-09	UW	21.67	25.00
25-Sep-09	UW	29.15	38.00
16-Feb-10	N	30.52	38.00
10-Sep-10	N	29.45	37.00
04-Oct-10	OW	31.57	40.00
11-Sep-12	OW	38.25	48.00
09-Dec-14	OW	68.83	80.00
03-Aug-15	OW	62.34	75.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Dec 31, 2008.

Arch Capital (ACGL, ACGL US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
07-Mar-08	OW	68.14	-
29-Sep-08	N	24.47	-
31-Dec-08	N	23.33	23.50
25-Sep-09	N	22.16	27.00
10-Sep-10	N	27.08	26.00
06-Dec-10	UW	30.35	26.00
04-Oct-11	UW	32.95	31.00
27-Oct-11	UW	36.67	34.00
15-Feb-12	UW	37.64	35.00
26-Apr-12	UW	39.15	36.00
01-Oct-12	UW	41.64	40.00
09-Dec-14	OW	58.26	66.00
13-May-15	OW	62.50	72.00
01-Jul-15	OW	68.61	75.00
28-Oct-15	OW	77.48	80.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Mar 07, 2008.

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