Swiss Re AG Chief Economist Media Briefing Conference Call

Company Participants

- Astrid Frey, Unknown
- Dan Ryan, Unknown
- Kurt Karl, Unknown
- Unidentified Speaker, Unknown

Other Participants

- Unidentified Participant, Analyst

Presentation

Operator

Ladies and gentlemen. Good morning. Welcome to the Swiss Re's Chief Economy Media Briefing Conference Call and the live webcast. I'm Sarah, the Chorus Call operator. (Operator Instructions)

At this time, it's my pleasure to hand over to (Alexa). Please go ahead madam.

Unidentified Speaker

Hi. Welcome everyone to our annual global insurance review and outlook. As mentioned, my name is ((inaudible) in touch with me. But I'm in the (Swiss Re) Media Relations and Corporate Reporting department. Welcome everyone this morning. For today's presentation, we of course have Kurt Karl, the Global Chief Economist, who will be, during the presentation, focusing primarily on trends in the property and casualty sector. We have Astrid Frey , our Chief Economist, EMEA, who will be giving the macro picture. And we have Dan Ryan, who is Head of Research of Swiss Re Institute. And he will be focusing on trends, primarily in life and health.

Many of you -- I think you already have taken the (packets from) outside. But if you have not, please take them on your way out. And as the webcast operator just said, we will have a discussion and comments will be provided by our speakers. But hopefully we'll then launch into a lively Q&A session. We really urge everyone here to participate. So without much further ado, I'll hand it over to Kurt.

Kurt Karl {BIO 1758723 <GO>}

Yes, I think you can hear me, right, yes. So welcome everybody. I have a few things to announce before we get started. And then I'll -- by way of introduction. So as (Alexa) mentioned, we are all part of the Swiss Re Institute, it's a new entity in Swiss Re, it's a merger of 3 different parts, the old Economic Research and Consulting, the Center for Global Dialogue Event group and some research and training people from that. And Dan's former digital analytic catalysts group. So we're delighted that Dan came in, because we were a little short on life expertise and he's been with Swiss Re about 10 years and has really great strength in life insurance. So that's a delightful addition to the staff at the Swiss Re Institute.

We are -- for those that have -- I think (inaudible) everybody already. I am retiring at the end of the year. So I'm looking forward to that. And we have a successor named and that's Jerome Haegeli, sitting over here. Jerome comes to us via our asset management section, he was the head of investment strategy. He will be the Group Chief Economist, replacing me in that role. There would be another role as Head of Sigma and that's more Dan's area, who will be heading the research part of the Swiss Re Institute.

So Jerome, we have a press release on this today, he has been at the IMF, he's been with the Swiss National Bank, UBS, Julius Baer, he is on many committees, certainly, Institute of International Finance, the World Economic Forum. He has a Ph.D. from Basel and a M.Sc. from the local LSE. So we welcome him. And he will be available for comments afterwards about his appointment, I'm sure, as well as market indicators.

And without further ado, I'll let Astrid go into the macroeconomic background for our outlook.

Astrid Frey

Thanks, Kurt. Welcome everyone. So I will start with the global economic environment. And the global economic environment is quite a favorable one currently. So the cyclical upswing in the major economies continues. This positive environment is also reflected in the financial market environment. The S&P 500 in the U.S. reaches a new all-time high almost every week and volatility has dropped to the pre-crisis level. But we shouldn't be complacent about this environment, because there's a number of risks that could derail our outlook and I'll address these in turn.

So while the global economic outlook is quite a favorable one, it's also not an overly exciting one at the same time. I think, you can see from this chart here with the blue bars representing the growth estimates for this year and the bars further to the right reflecting our projections for the next two years. Global economic growth is expected to remain steady and in fact in most economic regions of the world, we see either stable growth or a slight deceleration with the notable exception of Latin America, which is, however, mainly due to Venezuela, Argentina, Brazil. So key markets emerging from recession.

So what does that global environment, which is quite a positive one for inflation and interest rates -- actually inflation has remained surprisingly moderate, given this continued economic expansion, economies recovering. There's a variety of reasons for that. But over the long run, or over the medium term, we'd expect then inflation to pick up. And as a consequence, we'd also expect the U.S. Fed to continue hiking interest rates. We expect 3 more rate hikes next year and another (3) in 2019. Europe is a little bit further behind. So we don't expect any rate hikes by the ECB before the end of 2019 -- sorry, we expect the ECB to hike rates at the earliest in 2019 and probably rather towards the end of the year. The Bank of England is a bit of a special case here. The interest rate outlook in the U.K. is quite uncertain. Somehow, we expect 1 rate hike each this year and next. But that's very, very much dependent on the outcome of the Brexit negotiation. So big uncertainty there. We also expect global yields to rise a bit, although from still very moderate levels. And that rise is expected to happen on a global scale. So not only in the U.S. but also and to a somewhat lesser degree in Europe.

So I've already mentioned that we shouldn't get complacent by the low financial markets volatility and this positive economic environment, because there's a number of risks out there. On the more negative side, many people are worried about QE tapering. So about central banks reducing some of the stimulus. That's a risk we're not overly worried about, because central banks have been very diligent in communicating any changes. Also they have adopted very gradual approaches.

Another risk that we're not overly worried about is the risk related to the euro area. But we have to recognize that not all of the issues have been solved that contributed to the global debt crisis a few years ago. Nevertheless, I think, it's fair to say that risks facing the Eurozone are currently very much lower than at the beginning of the year. And that assessment did not change by the uncertain election outcome and the failure of forming a new government in Germany.

Now still remaining in Europe. But crossing the channel, I think it's also fair to say that the risk of a disorderly Brexit has probably increased over the last few months, given the lack of significant progress in the Brexit negotiations. A disorderly Brexit would likely have a negative impact from the U.K. economy. But obviously that depends very much on the assumptions of that disorderly Brexit scenario you take. It would probably also have a negative impact on the rest of the European Union. But to a much lesser degree.

A risk we're much more worried about is -- comes from the U.S. administration and it's very protectionist (inaudible). If the U.S. administration becomes much more aggressive in its protectionism and in an extreme scenario that could result in a trade war, that then will be a scenario that could derail our global growth outlook, not only in the U.S.. But really across the globe.

Another risk that we have been monitoring for quite a long time is a risk of a hard landing of the Chinese economy. That risk mainly relates to the fact that corporate debt burdens have increased quite dramatically since the onset of the financial crisis. Now admittedly, recently there has been some progress or success in at least containing the further buildup of corporate debt. But that risk is rather contained and by far not resolved completely.

And finally and to conclude with a negative risk, I think, it's also a fair assessment to say that geopolitical risks have increased since the start of the year, although the implications for the global economy are very, very hard to quantify.

Now bearing all these negative risks in mind, we shouldn't neglect the fact that there are also quite a few positive risks on the horizon, the most prominent one probably stemming from U.S. fiscal policy, with some progress recently when it comes to U.S. corporate tax reform. But there is also upside risk from Europe, for example, the cyclical upswing in Europe could turn out to be much stronger, even stronger than we currently assume.

So with that fairly positive economic outlook. But also a few risks out there, I'd like to hand over to Kurt -- or hand back to Kurt and what this means for the P&C industry.

Kurt Karl {BIO 1758723 <GO>}

Thanks, Astrid. So I'll be going over the property/casualty outlook. Just the U.S. briefly. You see on the far right the combined ratios, a little over 110% for the personal lines. And the commercial about 103%. Similar to the 2011. But the reversal of who's doing worse of the 2 segments. So 2011 was last large cat loss year, about ($130 billion) insured losses, similar to 2005. And this year, it's turning out to be about the same, in that range of $130 billion losses, maybe a bit more, maybe a bit less. So it's a little painful profitability-wise on the underwriting side.

So that's with the U.S. Here is Europe. You can see the U.K. not doing so well. This tick upwards, probably, mostly due to the Ogden. So you had to pull in a lot of reserves to set aside for those extra losses from the change in the discount rate for lump-sum payments on liability. But still quite high by Europe standards, which is typical of a country that has higher proportion of casualty lines. But Europe done pretty well, not bad at all, down here with profitability in general for the European combined ratio about 94%.

It's been a long period of softening rates. This just shows you that we have pretty good data from our friends at Marsh on commercial lines profitability -- not profitability -- pricing and the progress of it, not so much the levels, because it's hard to get out. But you see it's been declining at an accelerating rate through the end of 2015. But declining at a decelerating rate since then, which is better than accelerating. But still prices are down through the middle of this year on the commercial lines. We do have the evidence from different set of -- slices of the data. The U.S. casualty is a little bit up. So there is a little bit movement towards higher prices prior to the catastrophes. And of course, we think there will be a significant change going into next year.

For the primary industry, overall, you have a return on equity this year of about 3%, not exactly exciting. Going up a little bit, we expect for the next couple of years. But that's with assumptions of average catastrophe losses, as well as -- of course, it's dampened by smaller amounts of reserve releases each year. Profits over the last five years have been generated from low cat losses and reserve releases.

Growth prospects are good. So part of it is the economic outlook that we just saw from Astrid. A stronger growth, a little bit more vehicles, houses, commercial activity, buildings. And you get global growth premiums following up a little bit from extra economic activity. And in addition, we expect some price movements, particularly in the reinsurance lines, because of the exposure to catastrophe, which brings me to this one, where you see the profits in -- in the reinsurance, in the negative territory, about minus 4% return on equity expected this year, because of the high cat losses, looks like about 112% combined ratio, maybe even 115%. So not a fun year for profitability in the reinsurance industry. We expect from this quite a bit of hardening and I'll get into that in the summary slide. But here you see again the global growth will be pushing up and some price movements will be pushing up the cession rates reinsurance premiums globally. Very strong in emerging markets. But picking up in advanced markets on the economic activity, as well as some price changes, particularly in the U.S.

So from our point of view, this was a capital event, it was not just an earnings event, meaning that capital was so depleted, given the low prices that we'll have a general price increase in insurance lines and reinsurance on average. And the loss affected areas are going to be very, very high -- significant gains. So U.S., in the Gulf area, Mexico earthquake , very high price increases.

So that's it for me and I'll hand over to Dan. We're doing -- we're trying to do 5 minutes each. So we get to questions.

Dan Ryan {BIO 20559660 <GO>}

So life insurance, obviously a challenging time for many companies. And in terms of the growth in insurance premiums around the world, on average about 3% expected going forward. And that clearly breaks down very clearly into what's happening in the advanced markets and the emerging markets, particularly China. And the growth that we're seeing there continues to be high, although, the expected year-on-year change it's a little bit down.

And that challenging situation for life insurance is reflected by the ROE. Obviously, the rebalancing from savings business to protection, as savings products continues to prove difficult to be attractive, given the low interest environment. But as you see, it's a feature that affects all regions in terms of the ROE.

Then when we talk about how it is that we try and maximize our returns, been clearly the use of high-yielding assets, particularly in Asia, on the right hand side, you see the desire for different insurance companies to try and explore high yielding assets and the relative balance of those (inaudible) consider that versus others. And that opportunity is obviously related at the same time to the changes in terms of the risk-based capital and particular cost of business being heavily hit. And that -- if I go to medical expenses for a second before we kind of return back to the impacts that has on particular (chunks) of the business.

When we talk about medical expenses, then clearly there are major drivers here, which relate to, first of all, the increasing use of technology in health care. And particularly the difficulty there maybe, in terms of ensuring the alignment between health care providers and the long-term drive in health care costs. We see, particularly when it comes to North America, changes related to Affordable Care Act and the difficulty in terms of trying to ensure, going forward, a middle ground in terms of maintaining insurance coverage. But at the same time the impact on potential classes of products when things (like the CS) are stopped. So that's a challenge clearly going forward.

When it comes to the emerging markets, one of the key issues here is understanding what the drivers to that growing expectation is. Now clearly that's related to increased middle-class. But also trying to get a better understanding of what the underlying drivers. We at Swiss Re have done number of studies which look at willingness to pay. This particular one here relates to India. Previously we did willingness to pay, are related to term insurance in Germany and brick loans in China. And in essence, by using that kind of price/asset discrete choices, we're actually not seeing what people do. But putting them in a situation, or simulating what they might do in that reality. You can see, first of all, the desire for longer-term contracts , the desire for contracts which effectively cover more critical illnesses. And particularly when it comes to choices in (different) categories, we see significant differences between younger and older policyholders.

As premiums grow and as we kind of consider changes in terms of accounting principles and changes in terms of the overall environment, we expect some limited increase in terms of global cessions, offset against, obviously, experience in 2016, which was dominated by 1 transaction in the opposite direction.

Then when it comes to this issue in terms of the capital charges made against longevity business and also potential changes in the way that we view long-term trends in mortality improvements, then there is a closer link between those that would like longevity business and those that currently have it. And we've seen in the first half -- we've seen in 2017, (a large) increase in the number of longevity risk transactions, whether they be swaps or reinsurance. And an increased involvement of reinsurers and also back-to-back arrangements, where insurers can effectively provide that advice, that expertise whilst maintaining their balance sheet. And this transfer that we see clearly has not just risk moving from the pension schemes to insurance and reinsurance. But also has a number of those who were the first movers in taking some of these longevity risk from pension schemes, now reinsuring part of that longevity risk with the wider market and interested clients.

Unidentified Speaker

So yes, we have questions from all of you. First, we'll start in the room. And we'll go to the online people when we get a chance.

Questions And Answers

Operator

(Operator Instructions)

Q - Unidentified Participant

(inaudible)

A - Kurt Karl {BIO 1758723 <GO>}

So we need to have the microphone. So that people online can hear you.

Q - Unidentified Participant

The impact of U.S. tax reform, it's highly non (redistributionist), does that make sense, it's extremely weighted towards the 1% and everybody else tends to pay more. And what impact does that have on the U.S. economy as whole? I mean is that a big driver of growth?

A - Kurt Karl {BIO 1758723 <GO>}

So I think -- sorry I'm the U.S. guy so -- and I've been the macro economist. But I think -- we've been back and forth on this. But I've been dealing more with the U.S. side lately. The tax reform, I think there are a few issues. One, it may not go through, I mean remember that. Two, it will probably be changed, if it does go through, compared to what it is right now. It is a bit regressive, it starts of progressive. So that middle and lower income gets some tax cut. But that disappears after five years, as I understand it. So -- and then at the end of the 10 years, they don't have enough money to balance the budget, which is part of their rule. So the personal disappears and the corporate continues. So it's not just wealthy people, it's also from personal incomes over to tax cuts for the corporate sector, which is also for wealthy people, because most of the corporate sector is owned by wealthy people, of course. So not a lot of growth from what I've heard of analysis from this. You will get some -- particularly initially, one would expect, because there will be a punch early on with respect to the general populace. The consensus forecasters has (0.3%) extra growth next year and nothing after that, for whatever comes through. It's not a huge (package as) expected, not the large one that they're talking about. So I've heard other people think that interest rates will go up so much that they will choke out whatever growth you get from lower corporate and lower personal taxes. So I think it's an open question, is an empirical question ultimately, how the economy reacts. But we're not expecting much from our economic analysis and that seems to be the consensus from economists also. So we have 2 in the front.

Q - Unidentified Participant

(inaudible) You mentioned that non-life insurance premiums are set to rise in emerging markets by up to 6% or 7%. I wondered what factors you see behind that, is it largely due to the middle-class or tech innovation?

A - Kurt Karl {BIO 1758723 <GO>}

Yes. In the emerging markets, it is true on the life side, even more so. often. So it might be useful for Dan to comment on the life side after I finish the P&C. It's the middle-class growing. And the growth is really quite rapid in Asia. So a lot of what we see on these charts, when we say emerging markets is really very strong economic growth in Asia, driven by the rising middle-class. But economic activity in general. So as you get more wealthy, you buy a car, you get a house, you want to protect yourself and your family and insurance goes up. There is a push in China to raise the penetration rates, premiums divided by nominal GDP, from 3% to 5% by (20, 25 years) out or something compared to when they started it. So China is getting like 20% premium growth in some business -- some lines.

A - Dan Ryan {BIO 20559660 <GO>}

So I'll just to add to that. Clearly -- as well as the kind of rising middle-class prosperity, there is also greater awareness and greater innovation on the part of insurance companies. So 2 items there. One, in terms of those products which are effectively dealing with cancer or other critical illnesses. But also going forward the possibility of products which are bringing in new types of data. So whether that's related to variable prices. And clearly the CIRC has -- it is not only to increase and promote digital products. But also to remove any geographical restrictions there might be in terms of the distribution of such products. That's clearly a Chinese relation, that's the clearly middle-class piece. We saw the willingness to pay when it comes to India, greater awareness of the risks and greater awareness of the products that are available, these are 2 opportunities for insurance companies.

A - Kurt Karl {BIO 1758723 <GO>}

And John, you had a question?

Q - Unidentified Participant

Yes, (inaudible). The question I was going to ask you, you took quite a positive (spin) on the potential for premium increases to the reinsurance market. But you speak to the brokers and their view is, unless there is an affected area, they're still quite bullish about the fact that the (resolve by the) reinsurers to drive (inaudible) evenly in the face of some pressure from the seasons to (turn around), because the other issue is, of course where in the primary market, they are turning around and saying, we've got to -- (ought to sell) to some of our clients, who are obviously nowhere near the Gulf of Mexico, as to why they should be paying more for insurance. So how confident are you that the reinsurance market can deliver -- can harden their premiums across the board, rather than just on those -- yes, the sort of cat-exposed areas?

A - Kurt Karl {BIO 1758723 <GO>}

Obviously, we're talking about the future, we don't know. But our expectation, given the low premium rates that we've seen is that we'll have a turning in general. So the way we look at it is, we refer to a technical pricing where you have profitability is equal to the risk-based return that you would expect given the risk. It appears that the risk may be actually up. So there was a lot of things that happened this year with earthquakes, fires; fires also in Europe, not just California. And of course 3 storms. So it's a loss of capital. But the pricing is so low and it's below the technical rates, that implies to us that we are in a situation like 2011 when prices turned quite dramatically after a big loss towards the end of the year. So it's -- I think even three years ago, maybe it wouldn't be a general price increase, because prices were still relatively high. But for the last couple of years we've been below technical pricing in our estimation and as a consequence, we expect a general price rise from this. It's not so much that it's a huge loss. But it's the getting back to a fair pricing situation, which we haven't had for a couple of years.

Further questions? Anybody online?

Operator

There are no questions from the phone.

Q - Unidentified Participant

(Oliver) from the Financial Times. I am just interested in life and health reinsurance and whether you see a much -- quite a pick-up of long-term in the number of transactions?

A - Dan Ryan {BIO 20559660 <GO>}

So I think we put forward with a growing (inaudible). So in terms of the overall (inaudible) I think clearly segments very clearly between the different regions. And we see significant opportunities when it comes to China and the emerging markets. When it comes to the more advanced markets, then clearly individual changes in terms of regulation lead to particular opportunities, when it comes to individual companies, individual insurers wishing to offload or consolidate particular positions. And I think what we're seeing increasingly is more and more life insurers trying to investigate the ways of making existing books more profitable, greater attention in terms of efficiency rates and greater engagement between the life insurer and the insured in terms of data and how that improves understanding of the true risk. Clearly for reinsurers, they have the opportunity, given their knowledge base, to be more involved in sharing their insights, sharing their research with insurers and that would be expected to be rewarded by increased shares in some of the areas of business where there is greater uncertainty. And shall we say, a reduction in those where there is more certainty. But the general shift from savings to protection that we see everywhere, I think, gives greater opportunities to the life reinsurance market .

Q - Unidentified Participant

One for you, Astrid. What would you define -- obviously, given where we are, what would you define as a disorderly Brexit? I mean, what do you see as sort of a Brexit that threatens sort of the harmony of the current status quo?

A - Astrid Frey

So the way we look at the disorderly Brexit scenario is for there to be no new deal by the end of March, 2019. And there will also be no transitional agreements between the U.K. and the rest of the European Union. That will have a negative impact mainly for the U.K. economy. But obviously you could think of a very, very extreme scenario where you really fall off that cliff edge that's usually mentioned, that would also be quite significant, probably for the rest of the European Union. We don't think such a severe scenario -- such a cliff-edge scenario is likely, because obviously what you see is that companies are preparing. The way we define this disorderly Brexit scenario is that companies, yes, they are preparing. But obviously you can never fully prepare for a situation where all of a sudden there is no -- the kind of the framework disappears overnight.

Q - Unidentified Participant

(inaudible) When do you think the alarm bells would start to ring? Do you think whether we need to see some sort of positive noises coming out of Brussels and Downing Street by the middle of next year in terms of future trade? I mean, sort of when do the economies sort of start thinking we need to start heading to the hills here, because -- is there a sort of a date, where if there doesn't seem to be a bit of harmony, you have to start looking at the sort of scenario where this could well be quite a hard landing, because it is clear that the time has run out for any substantial progress?

A - Astrid Frey

I think there are various answers to that -- or aspects to that question or the answer to the question. The first aspect being that it takes a couple of months for also the rest of the European countries to agree on -- to ratify certain agreements. So yes, there is a certain period. The other aspect being, that it is quite likely in my view that any agreement would probably the of the last minute type that we have so frequently seen during crisis in relation to the European Union. So while it cannot be at (1 to 12), may be (5 to 12) would be a realistic assumption.

Q - Unidentified Participant

(inaudible). I have a question on the P&C industry. Do you think that because of the large losses we have seen in the Third Quarter, we are going to see like a speed-up of M&A activity, especially because some of the players might be weakened more than others. And that could then either trigger them to look for acquirers or the other way around that those ones that think they are strong would look to maybe bought by one of the weaker ones?

A - Kurt Karl {BIO 1758723 <GO>}

Sure, very possible. Couple of years ago, we did a Sigma on M&A activity. And we thought things were beginning to take off and they didn't. So expectation then was quite a bit of M&A from these kinds of stresses, low interest rates, regulatory changes, etc. Now we have catastrophe losses and some of them are really quite weak. But we haven't had a huge swell of M&A activity. So I'm a little hesitant to say it's likely after this. Some of the players have been weakened significantly. But as you know, there is alternative capital available to retrocession through collateralized reinsurance, for example, or other ways to protect the balance sheet for that weaker players. So it'll be interesting 18 months while we see who positions in what way. We've thought, perhaps, because we are a large player that large players would be very well positioned in this market, I think we are. But we thought the smaller players would get together and merge quite a bit, because it's just very useful to have more diversification and a larger capital base in this market with very low interest rates, you're not making it on the investment side. So it's definitely the underwriting. You see the combined ratios of some of these smaller players going to 150% or whatever it is, because they are so mono-aligned " they are not totally mono-aligned". But so concentrated on cat risk.

A - Astrid Frey

Are there any more questions in the room? Online, do we have any questions?

Operator

There are still no questions from the phone madam.

A - Unidentified Speaker

Okay. Last chance. All right, well thank you everybody for joining us today. And for those who have any views, please exit out here and be in the lounge and we will begin those. Otherwise, help yourself to more coffee and pastries.

A - Kurt Karl {BIO 1758723 <GO>}

Pastries, don't forget the pastries, very important.

A - Astrid Frey

I wouldn't forget the pastries. And thank you.

Operator

Ladies and gentlemen, the conference is now over . Thank you for choosing Chorus Call and thank you for participating in the conference. You may now disconnect your lines. Good bye.