GUY CARPENTER
MARSH MERCER KROLL GUY CARPENTER OLIVER WYMAN

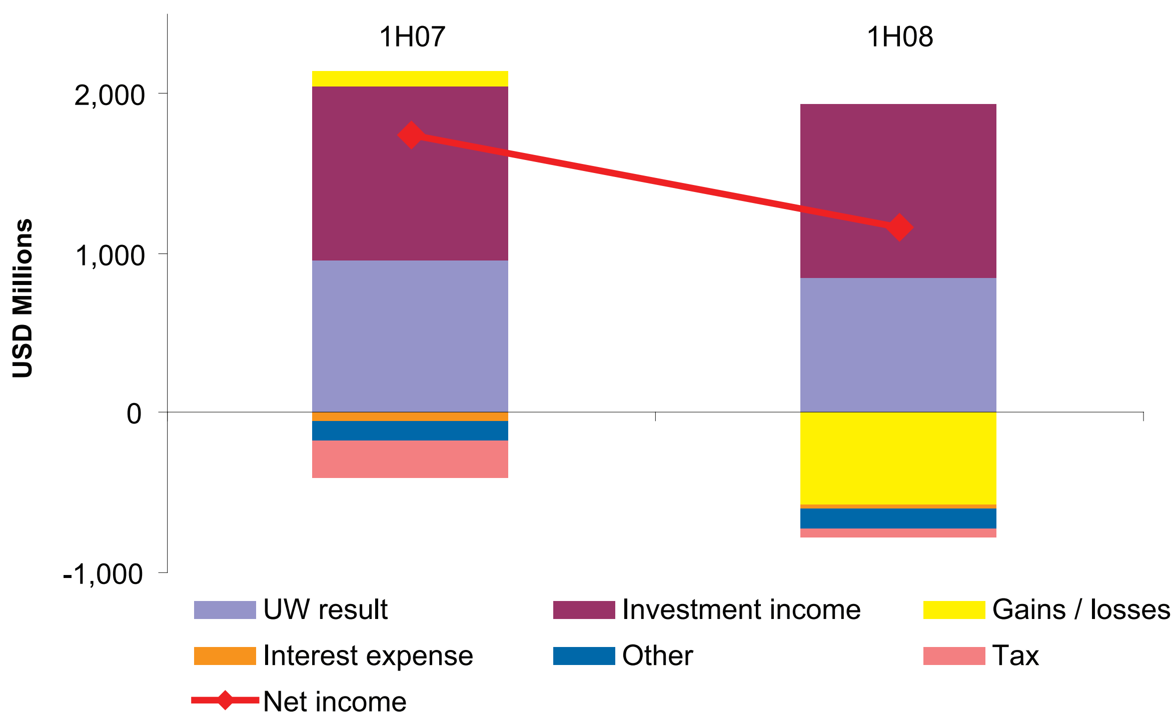
GC Briefing
An update from the Business Intelligence Unit

August 2008

Bag Profits Early
Investment Gains Under Pressure

Asset-driven losses have put pressure on earnings. Investment gains comprise an important part of carriers' long-term profits, and financial markets have shown just how volatile this source can be. With net income off 60 percent from the first half of 2007 to the first half of 2008, carrier profitability will become increasingly reliant on technical earnings.

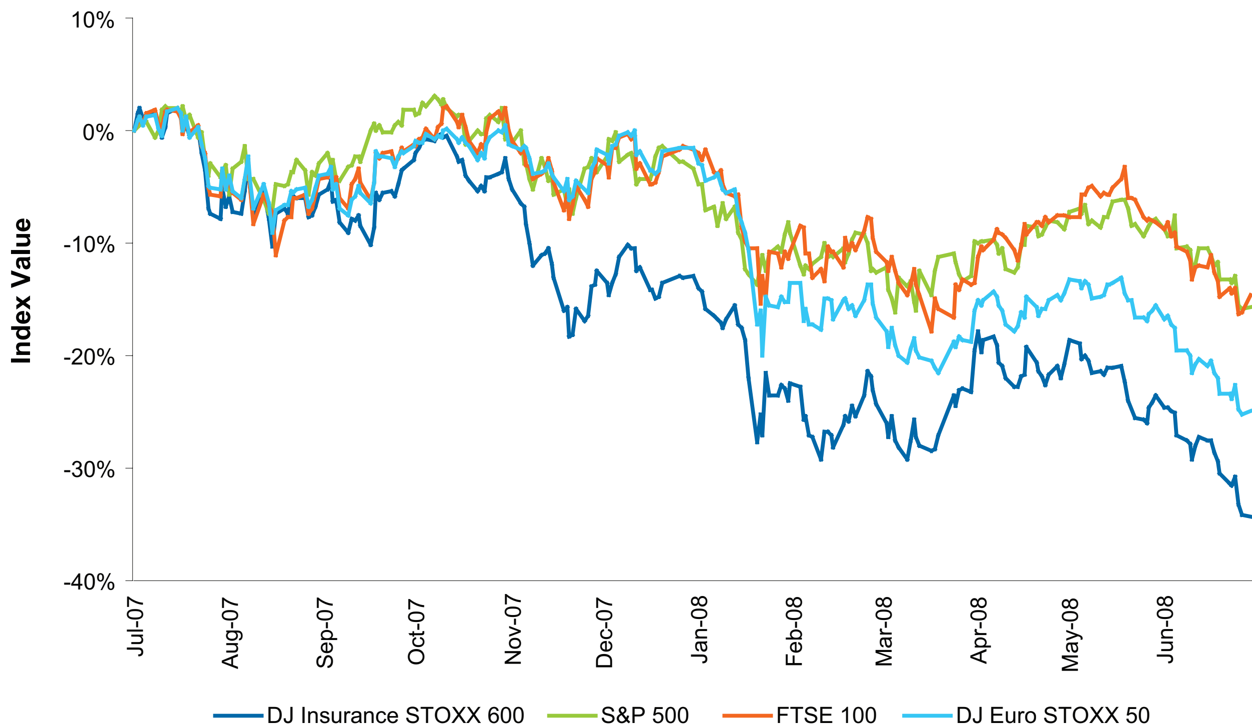
Investment Performance Squeezes Earnings
Several years of relative calm have led to strong earnings growth, but the rate of growth has begun to slow. While there have not been any mega-catastrophes, disasters around the world have impacted (re)insurer profits. There have been market-shifting insured losses in 2008, though distributed across several events on different continents. At the same time, capital markets have had to adapt to the effects of the subprime mortgage market collapse. Equity values, consequently, have been pushed lower. Both investment and underwriting gains have been squeezed, putting (re)insurer earnings at risk.



Source: Guy Carpenter & Company, LLC

A study of seven prominent risk-bearers suggests that investment gains are down profoundly across the (re)insurance industry significant. Investment gains for this group reached an aggregate USD98 million for the first half of 2007. For the same period in 2008, though, the group showed an aggregate investment loss of USD566.2 million, and the majority has been realized. Net income is down 60 percent year-over-year.

Capital markets are still trying to find solid ground. Equity values are depressed both generally and for the (re)insurance industry specifically. The FTSE 100 and S&P 500 indices are down approximately 15 percent year-over-year (measured from 2007H1 to 2008H1). The Dow Jones Euro STOXX 50's decline of 25 percent is more precipitous, but it is not as severe as the 34 percent plunge of the Dow Jones Insurance STOXX 600.



Source: Guy Carpenter & Company, LLC

As investment gains have become less reliable, catastrophe losses have increased, particularly in the United States. The second quarter of 2008 was the second costliest second quarter of the past decade. The increase in insured losses was offset, at least in part, by reserve releases. The emerging environment may be more challenging than it appears. Since reserve releases represent a finite resource for the support and stabilization of earnings, the continuation of catastrophe losses at the current pace could have an even greater impact on profitability.

Impact for (Re)Insurance

To maximize profitability in the coming months, risk-bearers may need to adjust their risk management strategies, as investment gains are unlikely to provide the buffer on which they have relied over the past few years. A large catastrophe loss this year could erode many companies' earnings and capital bases.

Further, Market risk sensitivity in dynamic financial analysis (DFA) and enterprise risk management (ERM) models could also become a factor. Large losses from different sources could call the efficacy of ERM into question. Assessments could be jeopardized in the event of a large catastrophe loss following the significant asset-side write-downs experienced so far in 2008.

For this reason, carriers may consider protecting underwriting earnings booked year-to-date. Reinsurance cover in the form of a "stop-loss" can lock in underwriting profits against potential future catastrophe losses. Unlike excess of loss reinsurance, which is related to single loss amounts, stop-loss covers relate to the total claims incurred in a given underwriting year.

The impact of selecting risks judiciously can be enhanced through increased risk transfer. By locking in underwriting gains now – and reducing retentions – carriers can mitigate the effects of capital market turmoil and protect their bottom lines.

Contcts

Questions regarding this briefing by the Business Intelligence Unit may be directed to:

Christopher Klein, Managing Director,
Head of Business Intelligence
London +44 (0)20 7357 2514

David Flandro, Senior Vice President
London +44 (0)20 7357 3267

continued from the previous page

About Guy Carpenter

Guy Carpenter & Company, LLC is the world's leading risk and reinsurance specialist and a part of the Marsh & McLennan Companies. With 50 offices worldwide, Guy Carpenter creates and executes reinsurance solutions and makes available capital market solutions* for clients across the globe. The firm's full breadth of services includes line of business expertise in Agriculture; Aviation; Casualty Clash; Construction All Risk and Engineering All Risk; Excess and Umbrella; Life, Accident and Health; Marine; Medical; Political Risk and Trade Credit; Professional Liability; Property; Retrocessional; Surety; Terrorism and Workers Compensation. GCFac®, our dedicated global facultative reinsurance unit, provides the placement strategies, information and timely market access that are critical to obtaining strategic facultative reinsurance. In addition, Guy Carpenter's Instrat® unit utilizes industry-leading quantitative skills and modeling tools that optimize the reinsurance decision-making process and help make the firm's clients more successful. Guy Carpenter's website address is www.guycarp.com.

*Securities or investments, as applicable, are offered in the United States through GC Securities which is a division of MMC Securities Corp., a US registered broker-dealer and member FINRA/SIPC. Main Office: 1166 Avenue of the Americas, New York, NY 10036. Phone: (212) 345-5000. Advice on securities or investments in the European Union is provided through GC Securities Ltd., authorized and regulated in the U.K. by the Financial Services Authority. Reinsurance products are placed through qualified affiliates of Guy Carpenter & Company, LLC. MMC Securities Corp., GC Securities Ltd. and Guy Carpenter & Company, LLC are affiliates owned by Marsh & McLennan Companies. This communication is not intended as an offer to sell or a solicitation of any offer to buy any security, financial instrument, reinsurance or insurance product.

Guy Carpenter & Company, LLC provides this report for general information only. The information contained herein is based on sources we believe reliable, but we do not guarantee its accuracy, and it should be understood to be general insurance/reinsurance information only. Guy Carpenter & Company, LLC makes no representations or warranties, express or implied. The information is not intended to be taken as advice with respect to any individual situation and cannot be relied upon as such.

Readers are cautioned not to place undue reliance on any historical, current or forward-looking statements. Guy Carpenter & Company, LLC undertakes no obligation to update or revise publicly any historical, current or forward-looking statements, whether as a result of new information, research, future events or otherwise.

Guy Carpenter Briefing

© 2008 Guy Carpenter & Company LLC