Letter from the Field

Chubb: Strategic Insights from the CFO of Chubb, Peter Enns in ZRH **Zurich, July 2024**

Dear client,

We initiated a position in Chubb, a Global insurance company, in the Focused Equity Strategy in the second half of 2023. We had the chance to meet with Peter Enns, CFO of Chubb, last month.

The most interesting discussion points revolved around the Chubb "way" of approaching the insurance business, which is fundamentally different from the rest of the industry and has produced best-of-breed underwriting profitability.

Chubb's way to superior profitability

The mainstream approach used by most insurance companies is to underwrite risk at low price to conquer new businesses. Insurance companies calculate that the claims will occur sufficiently far in the future to generate enough investment return on the "float" (sum of customers' upfront payments) to offset the losses. The nature of the insurance business allows to push that strategy pretty far – you are handed cash right now in exchange of a piece of paper that binds you to do something at a much later stage.

The common strategy in insurance is to **underwrite risk at low prices**, relying on investment returns from the "float" to offset losses, leveraging the time gap between receiving cash and fulfilling obligations.

The poor underwriting terms (taking too much risk for not enough money) typically show up eventually in the form of large losses that management of insurance companies are keen to designate as "exceptional" and exclude from their combined ratio calculation (standard calculation to measure operating profit of insurance). That generally hurt their balance sheet and triggered a retreat of the market which subsequently rebalances the market and leads to an improvement in insurance prices.

Insurance's **poor underwriting terms** lead to **significant losses,** damaging balance sheets and prompting market corrections, **driving up insurance prices.**

Chubb turned that rationale upside down. It requires a minimum target ROE commensurate to the risk it takes on each underwritten contract (usually around 15% vs 0% or sub 0% for some of its peers). The company does not hesitate to shrink its underwriting activities whenever the price in a particular insurance line does not allow to meet that strict ROE target.

In contrast, Chubb upended traditional strategy by **demanding a minimum target on ROE** for contracts and **reducing underwriting activities** when prices **fall short**.

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The temporary market share losses that result from such retreat are unacceptable to most organizations and managements, which usually tick on a quarterly basis; by contrast, in our meeting, Enns outlined that Evan Greenberg's (CEO) perspective was "generational."

On the other hand, while most organization focus on short term metrics and accept market share losses, **Chubb stays away and adheres to their prudent practices**.

Quality of management and its corporate culture of risk taking

In many industries where competition is fierce, a sharp focus on profitability might come at the expense of long-term growth. But in the insurance business the opposite is true because your balance sheet determines how much risk you can sustainably underwrite.

In the insurance industry, **focusing on profitability** supports long-term growth, as **a strong balance sheet** determines the sustainable underwriting capacity**.**

With its strong profitability and its conservative assessment of adequate reserves, Chubb is able to maintain a fortress balance sheet. It is equipped for the shocks that any insurance business has to handle at some point. As these shocks leave its peers struggling and force them to revise their contracting terms, Chubb can deploy capital in a contra-cyclical way and grow its market share over time.

Chubb's **strong profitability** and **conservative reserve assessment** enable a **fortress balance sheet**, allowing it to withstand shocks and **grow market share counter-cyclically** as peers struggle.

The management, its mindset, and the culture of the company are particularly important in a business that boils down to calculating and managing risk. The role of Evan Greenberg in Chubb's success has been central. In addition to crafting a long-term winning strategy and infusing a conservative mindset, he shaped an organization that made bureaucracy its foe (reflected in the company's low administrative expense) and is able to assess risk proactively as worldwide events unfold. When most peers rely only on actuarial calculation factoring historical data, the line managers of Chubb and its top management adjust their reserves and prices based on micro and macro evolutions they foresee could hurt them in the future. That shorter chain of command has led to better risk matching. Enns highlighted how the fitness of the organization has abled Chubb to recognize how claims would swell in a post-Covid world as inflationary pressures could be less transient than commonly recognized at the time.

Evan Greenberg's pivotal role in Chubb's success lies in **crafting a long-term winning strategy**, instilling a **conservative mindset**, and fostering a culture that prioritizes proactive risk assessment over bureaucracy, **resulting in better risk matching** and readiness for global events like post-Covid inflationary pressures.

An underappreciated giant lying in plain sight

While lamenting that Chubb's stock price does not reflect its intrinsic qualities, Enns touched upon another strength of the business, its breadth. The company covers many areas of the non-life insurance market both in the US and internationally. That competitive advantage is overlooked by analysts that generally have a single focus on the US business of Chubb. The breadth of playing fields

Enns highlighted Chubb's **global market presence** and strategic advantage in **allocating balance sheet capacity** for optimal returns, often overlooked by analysts fixated on its US operations.

means Chubb is able to allocate its balance sheet capacity to underwriting risk in the segments that generate the best return.

Meanwhile the low stock multiple (11/12x) allows Chubb to return excess capital by way of buybacks at terms that are very favorable to the shareholders that decide to hold their stocks. Management remains very disciplined and repurchases shares when Chubb is undervalued in light of their 5 years plan.

The **very low stock multiple** allows Chubb to execute **shareholder-friendly buybacks**, leveraging disciplined management decisions aligned with their long-term plan.

Management touched with us upon the broad direction of travel of the business. The US insurance market continues to be filled with opportunities (reinsurance, cybersecurity insurance, special risks, …) but they have clearly deployed more capital overseas in the recent past.

They see long-term growth opportunities emerging, especially in Asia with a large pool of assets not yet properly insured and the value of these assets rising rapidly. Chubb also sees a potential in developing a life insurance franchise in the region, as most countries there do not offer to their citizens a social safety net that is sufficient (especially in China).

As a result, Enns said that in 10 years Chubb should be less US centric than what it is now. More importantly to us as owners, besides the natural volatility of the claims (inherent to the insurance business), Chubb should continue to be a resilient and profitable business that compounds its earning power and increases its returns over time.

Management outlined Chubb's evolving business trajectory, emphasizing increasing international capital deployment, particularly in Asia, driven by emerging growth opportunities in underinsured asset markets and the potential for developing a life insurance franchise, **aiming for a less US-centric profile** in the next decade, while maintaining resilience, profitability, and **compounding earning power** for shareholders

Sincerely yours,

Cedric Jacque

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