



Challenges and Opportunities for Insurers in the Current Economic Environment

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**Steven N. Weisbart, Ph.D., CLU, Senior Vice President & Chief Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Office: 212.346.5540 ♦ Cell: 917.494.5945 ♦ stevenw@iii.org ♦ www.iii.org**

Four of the Many Challenges Facing Insurers Today

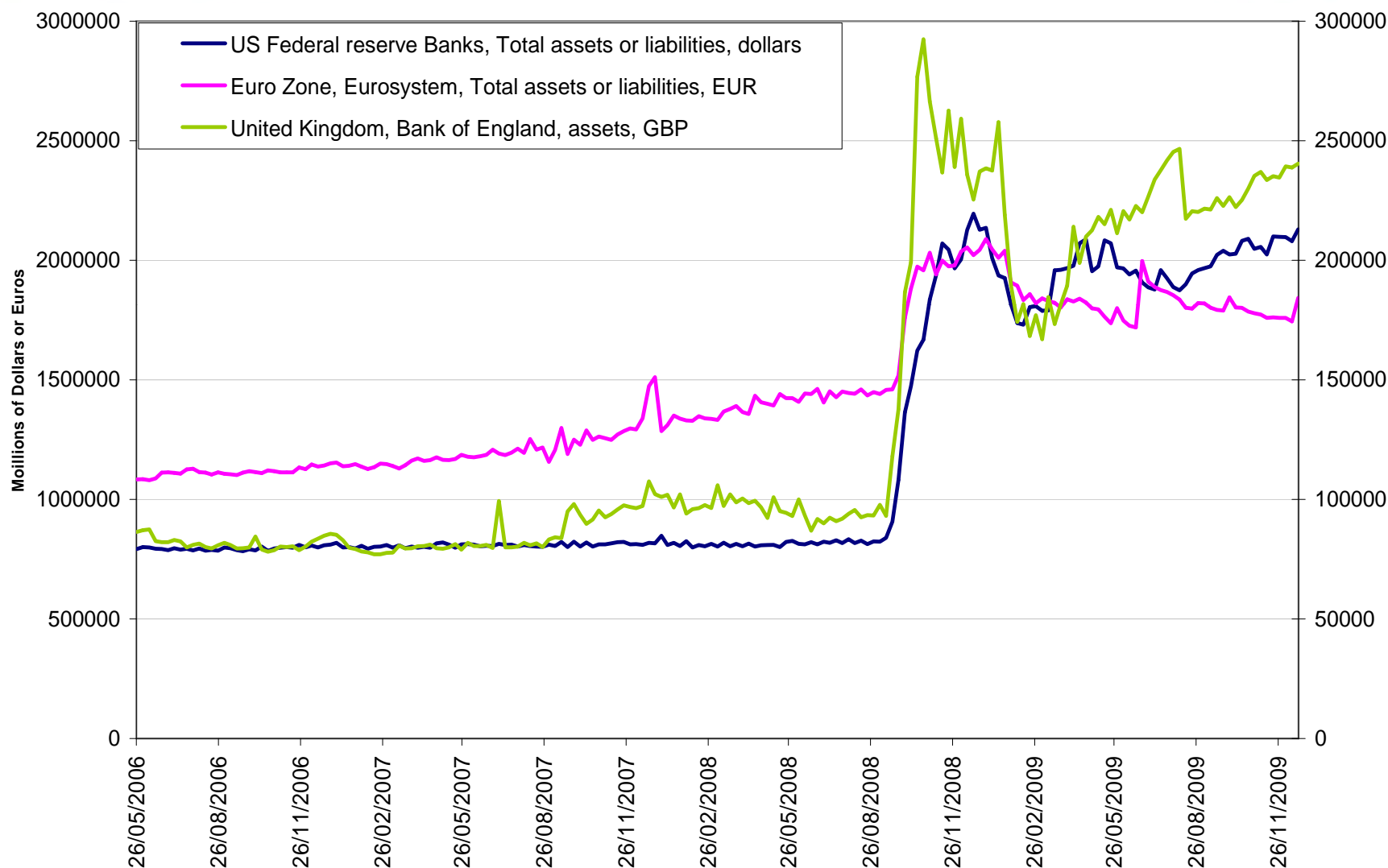
- Pricing, Investing: Will Inflation—As Insurers Experience It—Spike, Stay Low, or be Negative?
- Can Insurers Achieve Target Profits in an Era of Low Investment Returns?
- How Much More Capital Will Regulators, Rating Agencies, and Others Demand That Insurers Acquire and Hold?
- How Best to Prepare for the Next Chapter of the Global Financial Crisis?



Challenge: An Inflation Spike? Low Inflation? Deflation?

The Only Certainty: Broad Ambiguity

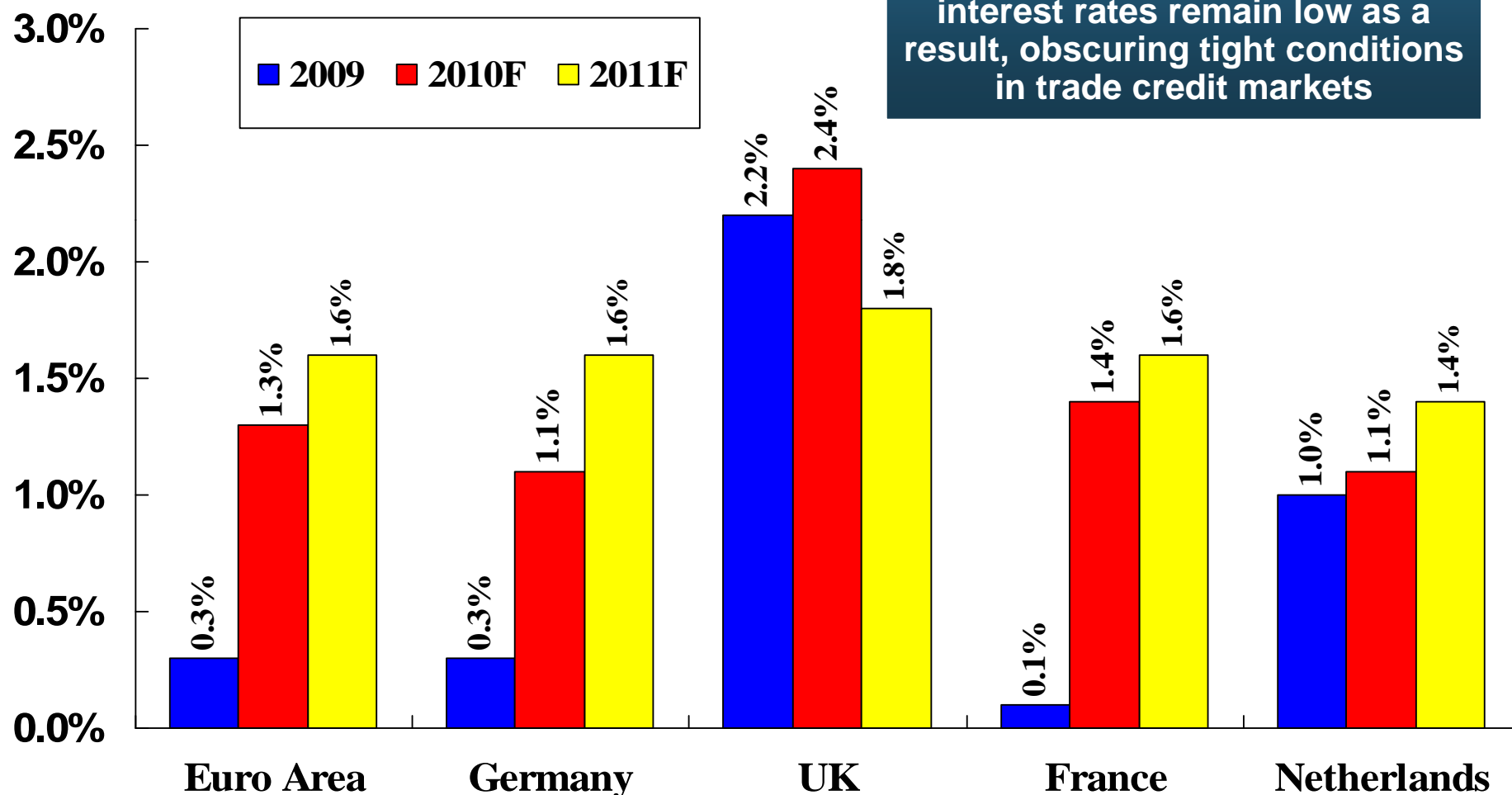
In 2008, Central Banks in Europe, the UK, and the US Dramatically Expanded the Money Supply



Source : Ecwin

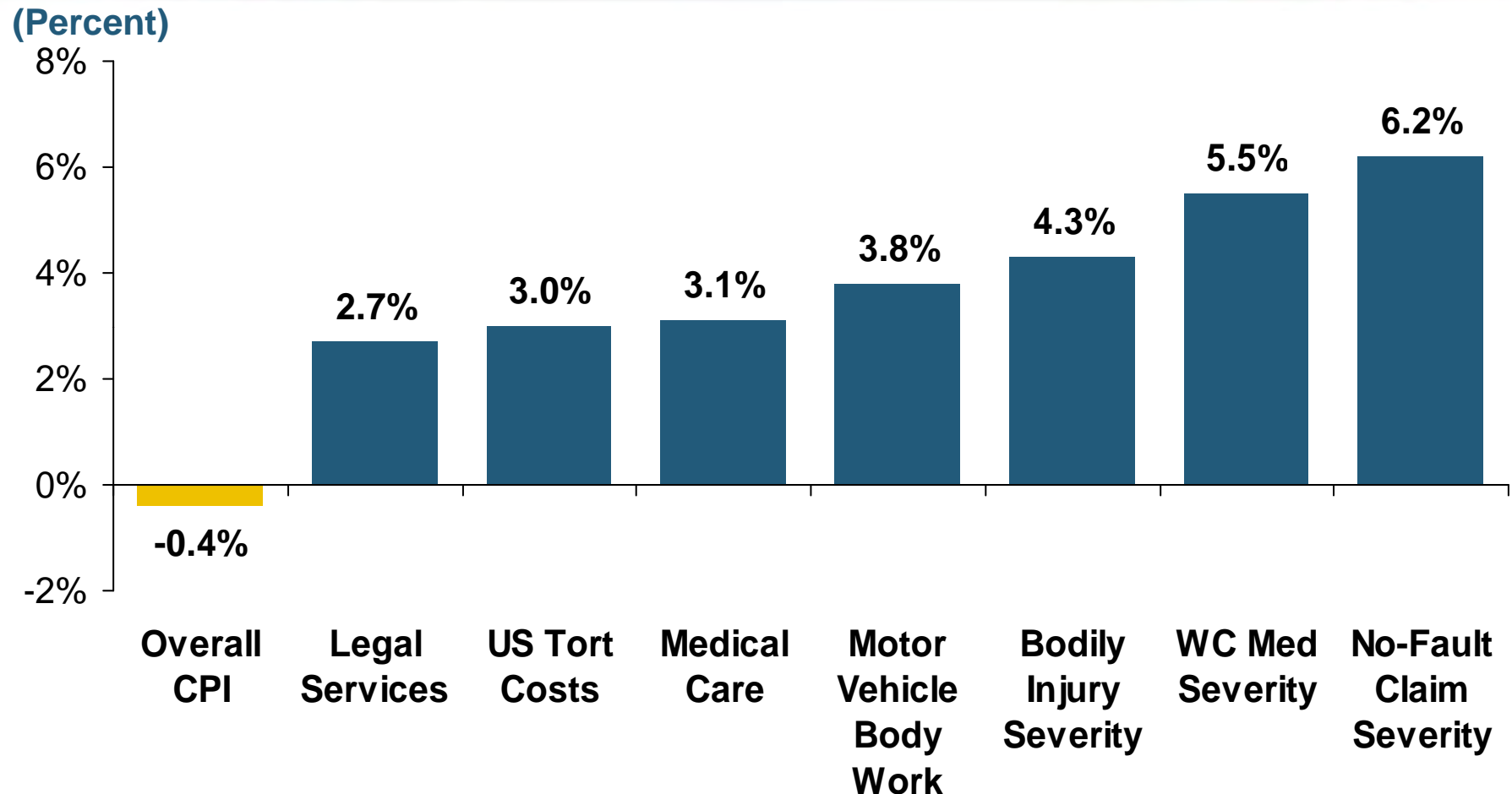
Inflation Rates for Largest European Economies & Euro Area, 2009-2011F

% Change from Prior Year



Inflation is below 1.5% across major European economies and interest rates remain low as a result, obscuring tight conditions in trade credit markets

P/C Insurers Experience Inflation More Intensely than 2009 CPI Suggests

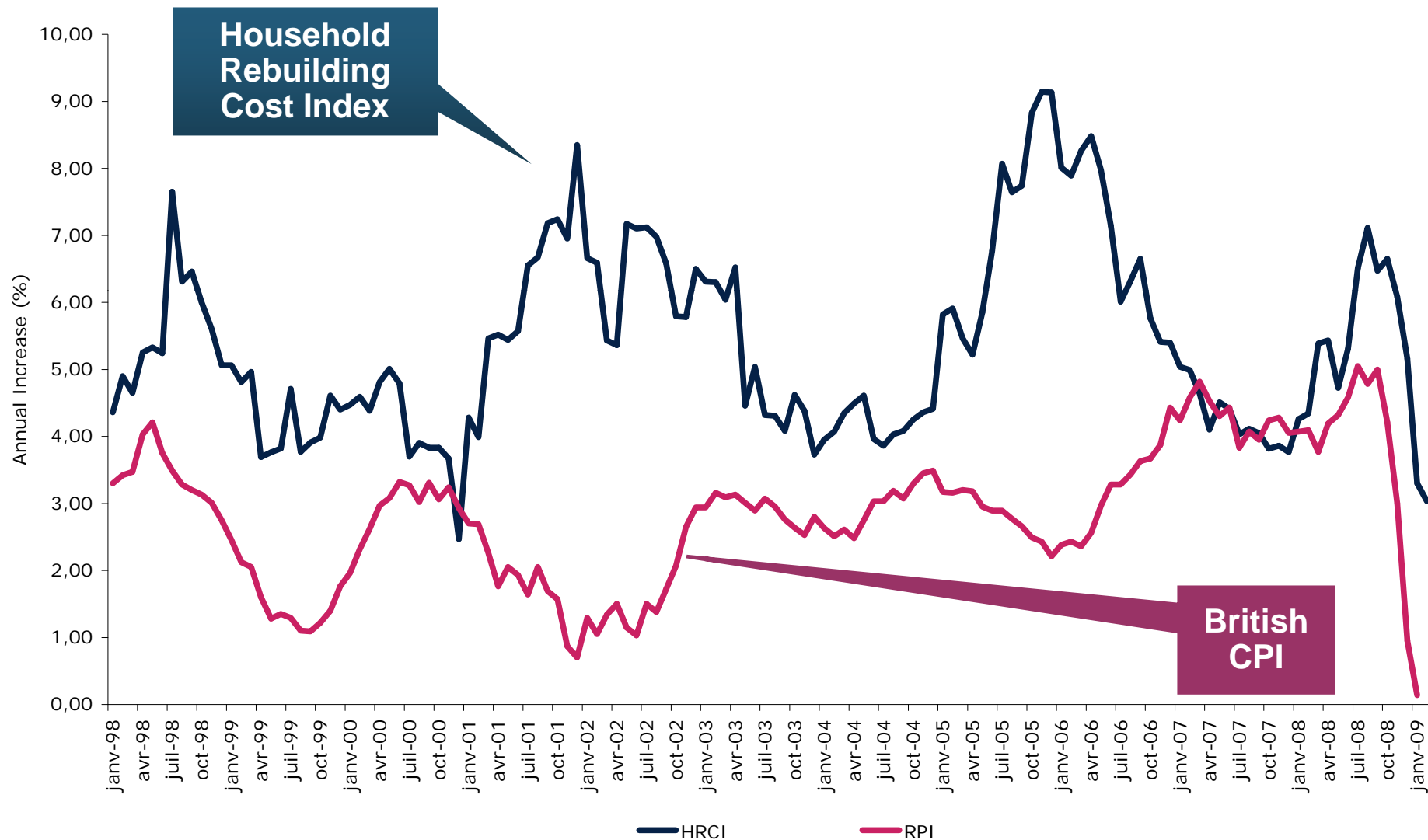


Healthcare and Legal/Tort Costs Are a Major P/C Insurance Cost Driver. These Are Expected to Increase Above the Overall Inflation Rate (CPI) Indefinitely

Source: CPI is Blue Chip Economic Indicator 2009 estimate, 12/09; Legal services, medical care and motor vehicle body work are avg. monthly year-over-year change from BLS; BI and no-fault figures from ISO Fast Track data for 4 quarters ending 09:Q3. Tort costs is 2009 Towers-Perrin estimate. WC figure is I.I.I. estimate based on historical NCCI data.

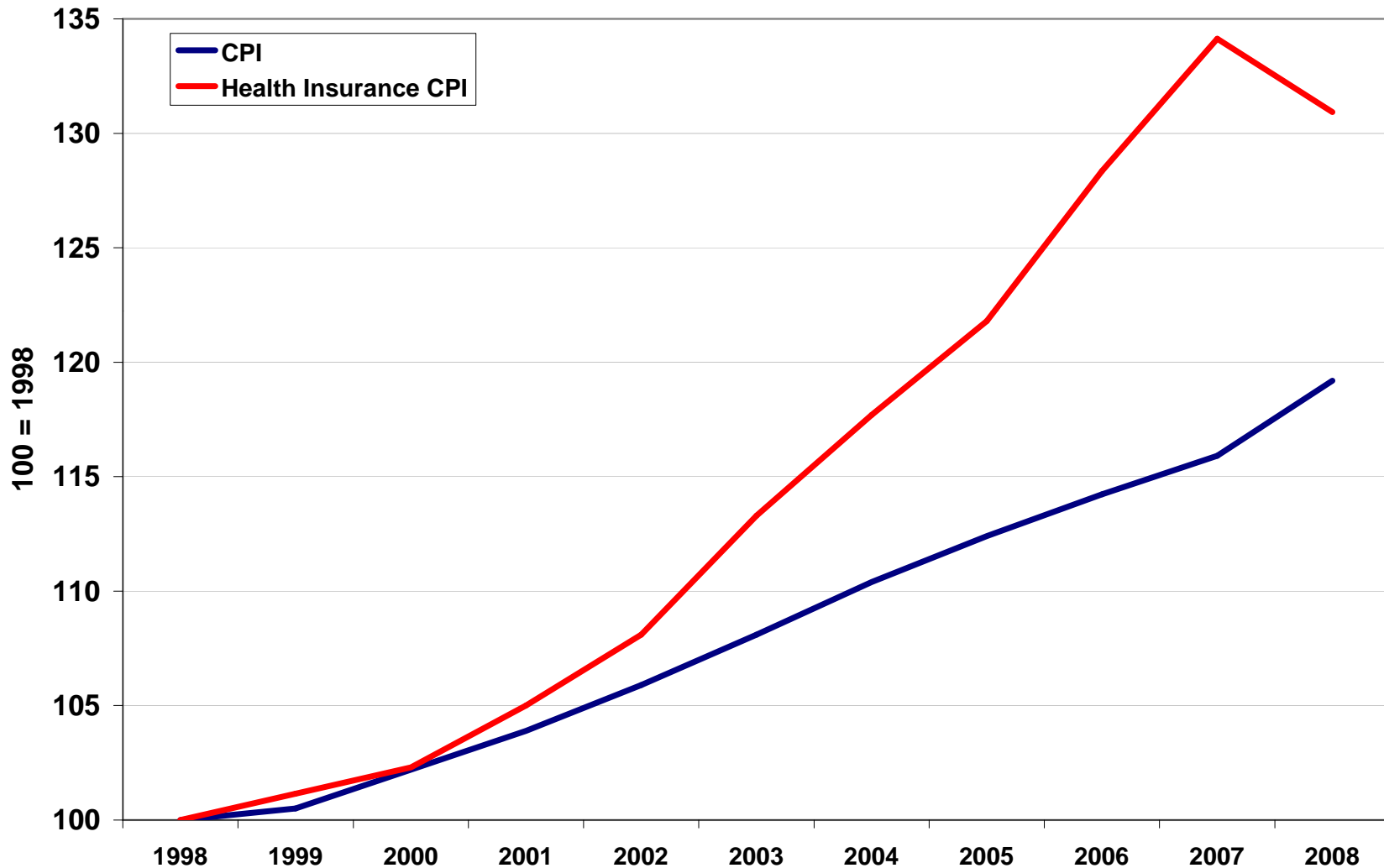
In the UK, the Household Rebuilding Cost Index is Also Higher Than the British CPI

Annual Change in the Household Rebuilding Cost Index and Retail Prices Index



Source : Association of British Insurers

French Health Insurance Tells the Same Story (as Does Many Other Countries)



Source : INSEE

Risks for Insurers if Inflation Is Reignited

■ Rising Claim Severities

- ◆ Cost of claims settlement rises across the board (property and liability)

■ Rate Inadequacy

- ◆ Rates inadequate due to low trend assumptions arising from use of historical data

■ Reserve Inadequacy

- ◆ Reserves may develop adversely and become inadequate (deficient)

■ Burn Through on Retentions

- ◆ Retentions, deductibles burned through more quickly

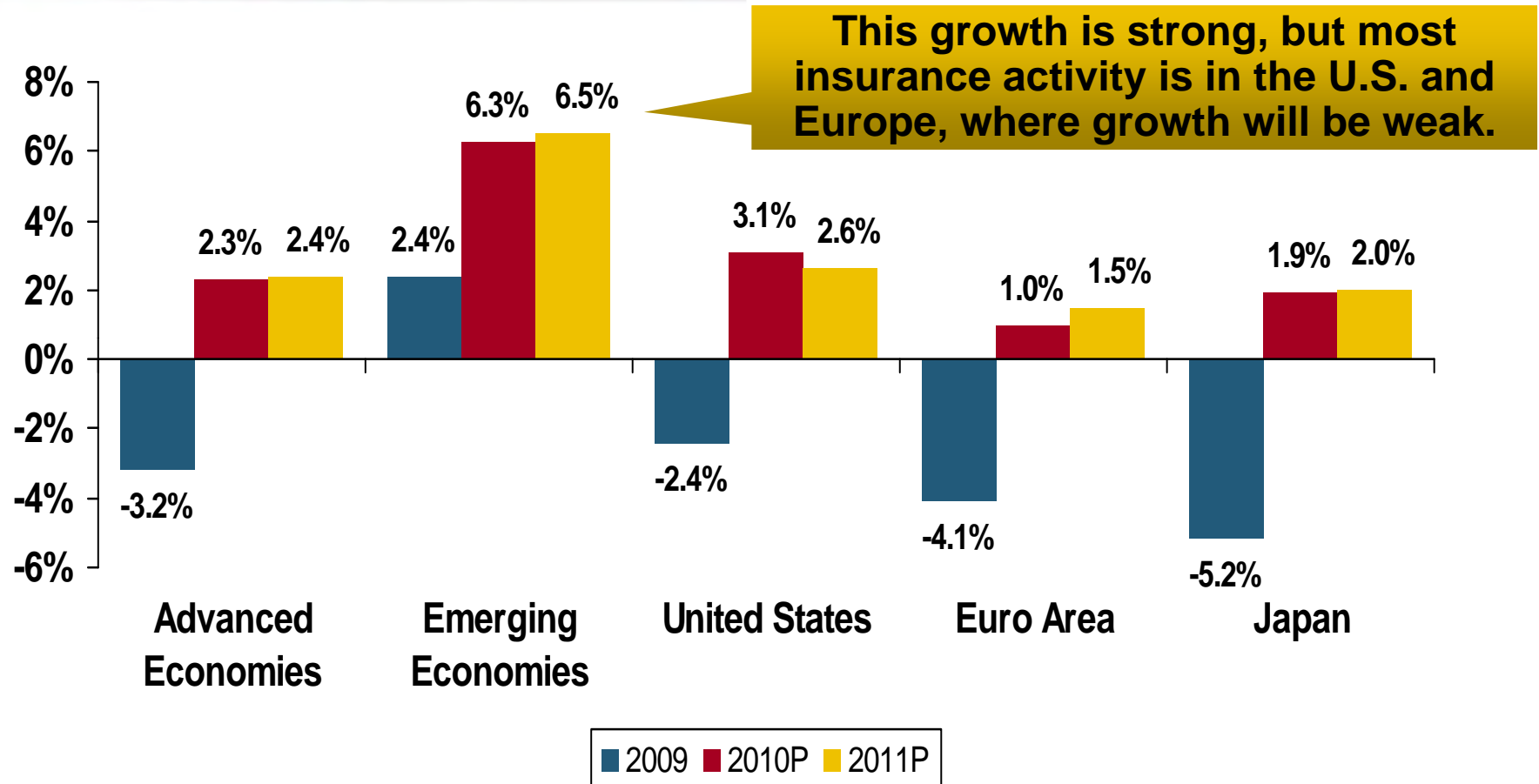
■ Reinsurance Penetration/Exhaustion

- ◆ Higher costs → risks burn through their retentions more quickly, tapping into reinsurance more quickly and potentially exhausting their reinsurance more quickly



Challenge: Low Investment Returns and High Downside Risk

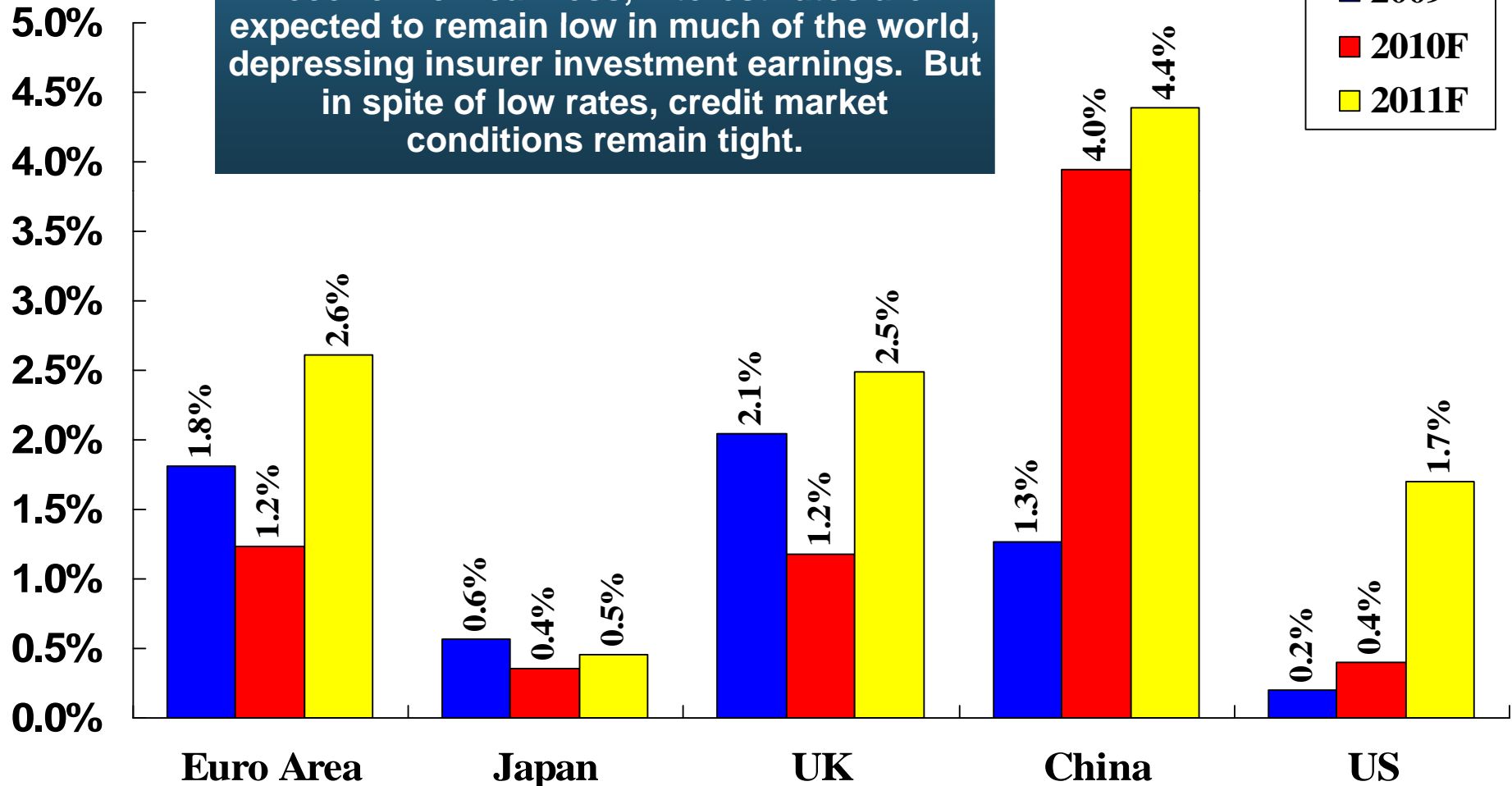
World Economic Outlook: 2009-2011P



Outlook uncertain: The world economy is recovering from the global crisis, but at different speeds in different parts of the world, according to the IMF. Insurance exposure growth will vary regionally and by industry.

3-Month Interest Rates for Major Global Economies, 2008-2011F

Due to central bank action and lingering economic weakness, interest rates are expected to remain low in much of the world, depressing insurer investment earnings. But in spite of low rates, credit market conditions remain tight.



Internationally, Most Short-term Interest Rates Are Still Quite Low

Central Bank	Current Interest Rate	Last Changed
Bank of Canada	0.25%	April 21, 2009
Bank of England	0.50%	March 5, 2009
Bank of Japan	0.10%	Dec 19, 2008
European Central Bank	1.00%	May 7, 2009
U.S. Federal Reserve	0.25%	Dec 16, 2008
The Reserve Bank of Australia	4.50%	May 4, 2010
China	5.31%	Dec 22, 2008
Hong Kong SAR	0.50%	Dec 17, 2008
India	5.00%	Mar 19, 2010
Korea, Republic of	2.00%	Feb 16, 2009

Source: <http://www.fxstreet.com/fundamental/interest-rates-table/>



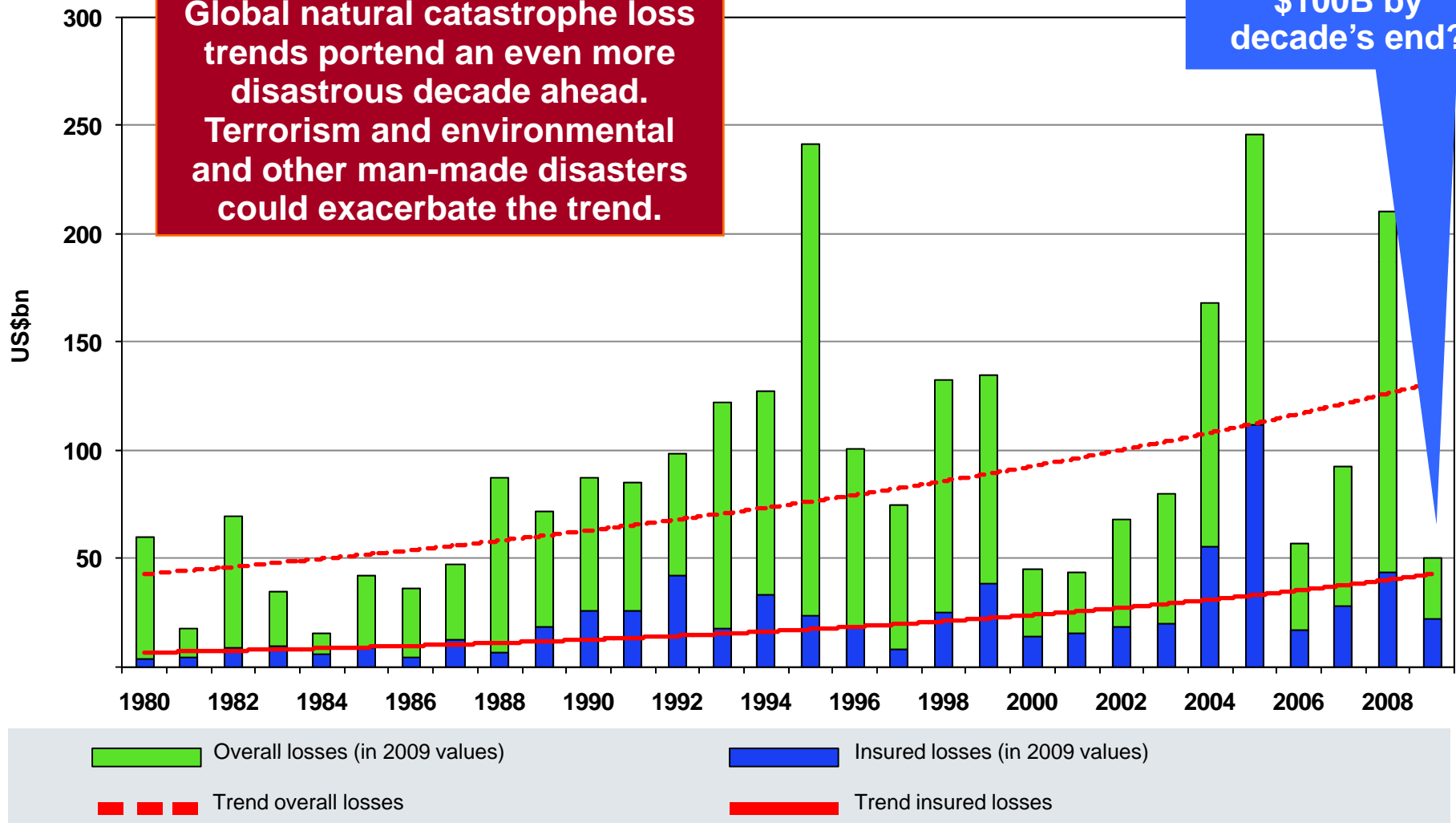
Challenge: How Much Capital is Enough?

Global Natural Catastrophes 1980–2009

Overall and insured losses with trend

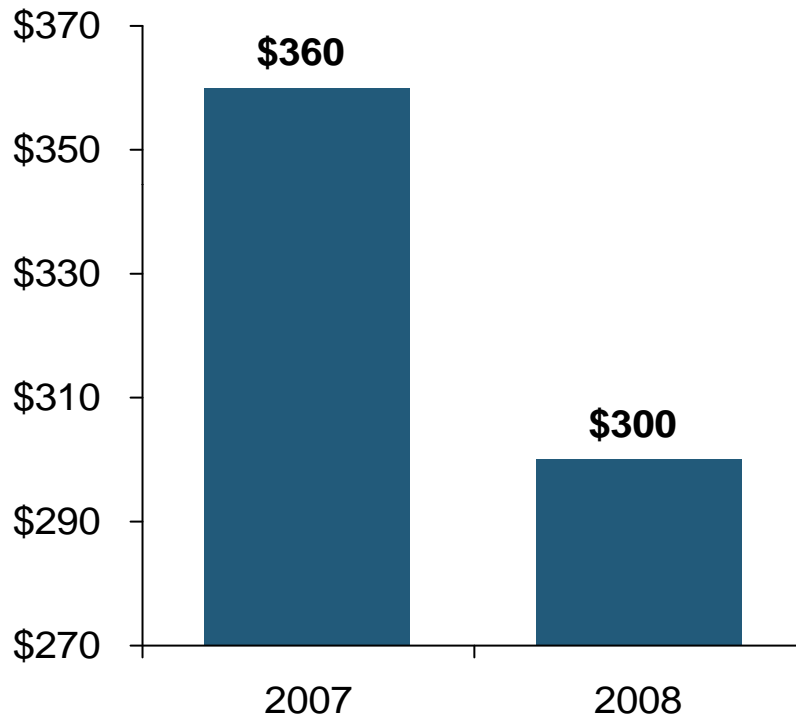
Global natural catastrophe loss trends portend an even more disastrous decade ahead. Terrorism and environmental and other man-made disasters could exacerbate the trend.

Annual insured losses exceeding \$100B by decade's end?

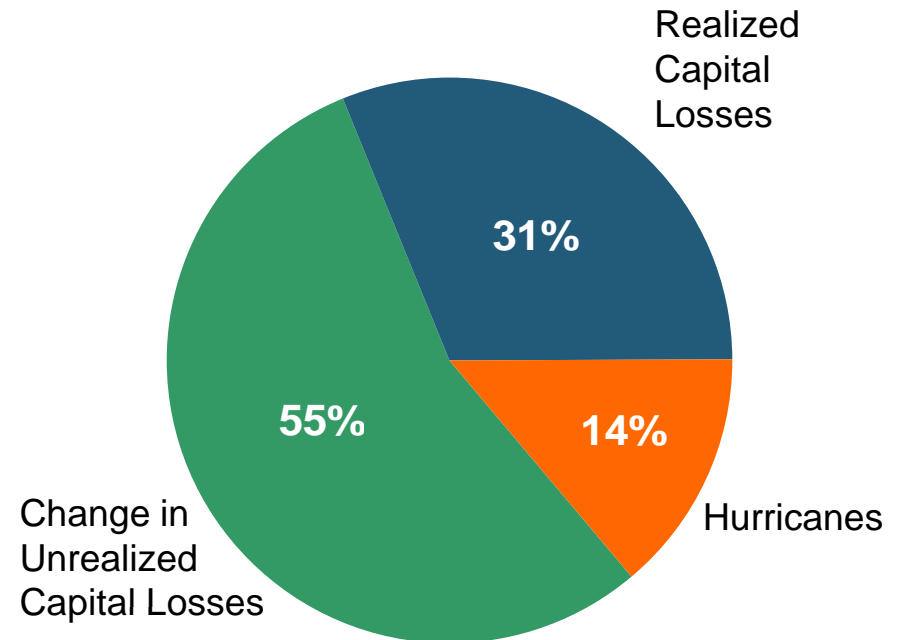


Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

Global Reinsurance Capacity



Source of Decline



**Global Reinsurance Capacity
Fell by an Estimated 17% in 2008**

“Bullets Dodged”

- Being “overcapitalized”—the criticism often leveled at insurers before the financial crisis began—was a good thing
 - ◆ We might have needed some billions of that capital for death and medical benefits if the H1N1 “swine” influenza pandemic—which began in April 2009—had been much worse than it was



Challenge: How to Prepare for the Next Global Financial Crisis?

The Next Global Financial Crisis Might Come Sooner Than We Think

- If fiscal imbalances are not addressed through spending cuts and revenue increases, only two options remain:
 - ◆ inflation for countries that borrow in their own currency and can monetize their deficits; or
 - ◆ default for countries that borrow in a foreign currency or can't print their own.
- Thus, the recent ... global financial crisis is not over; it has, instead, reached a new and more dangerous stage. ... now comes the rescue of the rescuers – i.e., governments. The scale of these bailouts is mushrooming. ...But who will then bail out governments...? Our global debt mechanics are looking increasingly like a Ponzi scheme.

Lessons Learned

- The effects of the crisis on insurance companies varied considerably, depending on
 - ◆ What products they sold
 - ◆ What investments they made
 - ◆ The economic environment in which they operated, and
 - ◆ How strong they were entering the crisis

Insurance LOBs Most Directly Affected by the Financial Turmoil

- Mortgage and Financial Guarantee insurance
- Trade Credit insurance
- Credit Default Swaps (not legally insurance, but functioned that way)
- Variable annuities (unit-linked life insurance products) with downside investment guarantees

Lessons Learned

- The insurance sector's business model is robust and generally able to withstand and conduct normal operations during
 - ◆ a sudden and sharp asset value meltdown
 - ◆ a soft pricing market,
 - ◆ an eroding exposure base, and
 - ◆ a challenging [man-made and natural] CAT environment

All at the same time!

In the Last Crisis, the Insurance Sector Helped Stabilise the World Economy

- “...the insurance sector has arguably helped to provide a stabilising influence in light of its longer-term investment horizon and conservative investment approach.”

***Thank you for your time
and your attention!***