



The Regulatory Environment and Increasing Global Uncertainty: *Implications for Insurance Finance and Economics*

Eqecat Annual Conference

Miami, FL

March 30, 2011

Robert P. Hartwig, Ph.D., CPCU, President & Economist

Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038

Tel: 212.346.5520 ♦ Cell: 917.453.1885 ♦ bobh@iii.org ♦ www.iii.org



What in the World Is Going On?

**Is the World Becoming a Riskier
Place?**

Uncertainty, Risk and Fear Abound

- Japan, New Zealand, Haiti, Chile Earthquakes
- Political Upheaval in the Middle East
- Echoes of the Financial Crisis
- Housing Crisis
- Sovereign Debt Crises
- Currency Crises
- Inflation
- Runaway Energy & Commodity Prices
- Era of Fiscal Austerity
- Reshuffling the Global Economic Deck
- China Becomes #2 Economy in the World
- Nuclear Fears
- Resurgent Terrorism Risk
- Manmade Disaster (e.g., Deepwater Horizon)
- *Apocalypse 2012: End of the Mayan Calendar on Dec. 21 (11:11PM)*



Are “Black Swans”
everywhere or
does it just seem
that way?



The Global Financial Crisis, Risk and the New World Economic Order

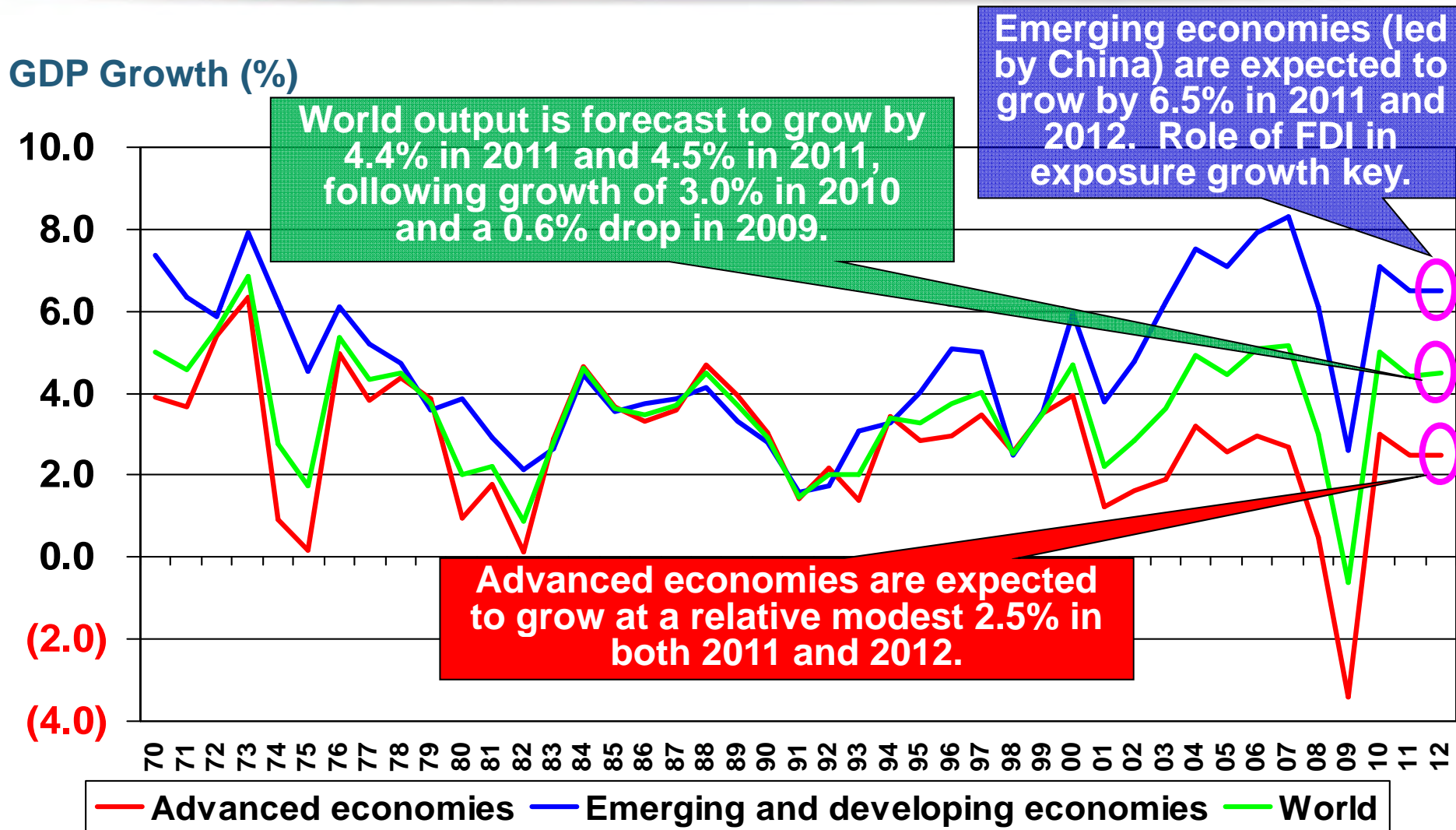
**Aftermath of Crisis Continues to
Breed Insecurity**

***Insurers' Path to Growth Is More
Challenging/Risky***

The New World Order: A New Level of Risk for Business

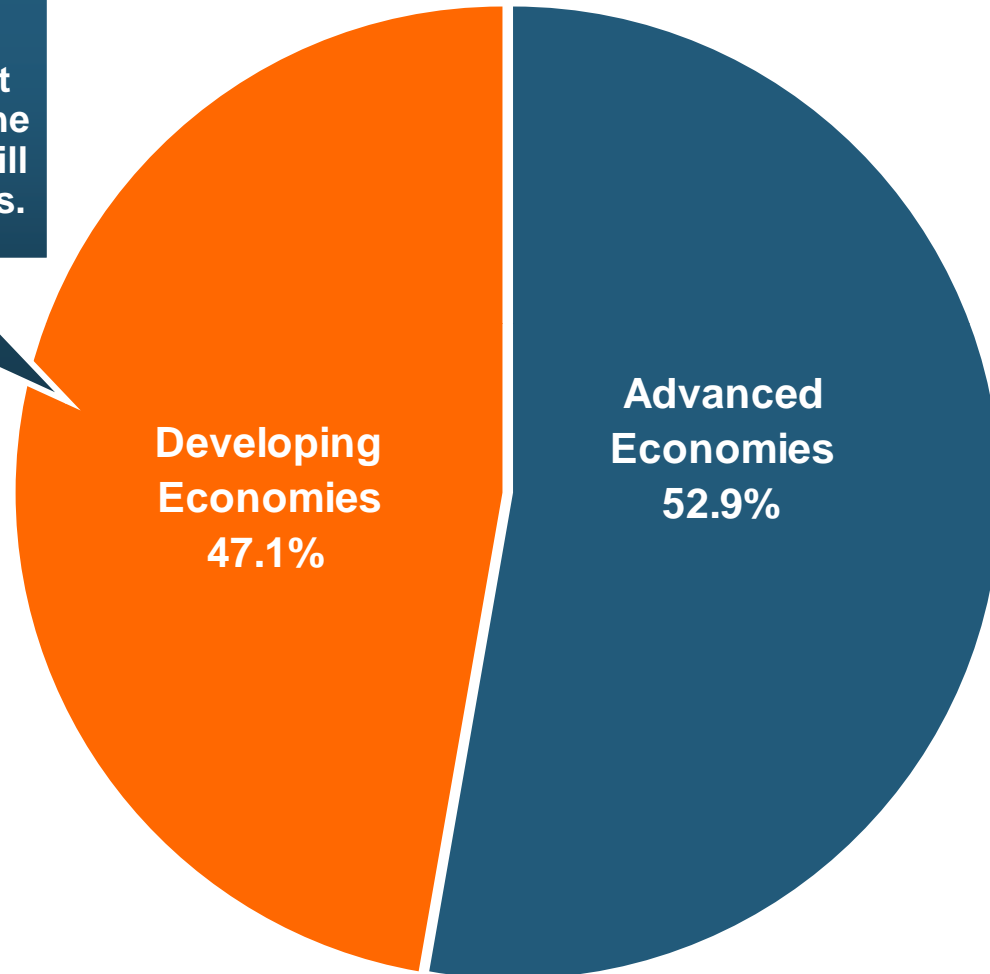
- **Best Growth Opportunities are No Longer in Low-Risk Markets (W. Europe, US/Canada, Japan)**
- **Growth Rates are 2-3 Times Higher in Developing World**
 - ◆ Business investment will remain high, much of it in need of insurance
 - ◆ Investment conditions will remain challenging for decades
- **Unemployment Rates Are Much Lower in Emerging Economies**
 - ◆ Establishment of a middle class and a wealthy upper class
- **Incomes Are Rising Faster in Emerging Economies**
 - ◆ Fueling demand for goods and services
 - ◆ Foreign Direct Investment (FDI) and insurance exposure/demand
- **Immature Institutions Raise Risk/Possible Systemic Risks**
 - ◆ Legal system, financial markets, regulation, infrastructure issues
- **Instability in Emerging Nations Will Remain High**
 - ◆ Political instability; Corruption in some countries
 - ◆ Economic vulnerability (trade, xrt risk, credit risk, commodities, energy)
- **Natural Hazard Risks Are Often Elevated w/Minimal Mitigation**

GDP Growth: Advanced & Emerging Economies vs. World, 1970-2012F

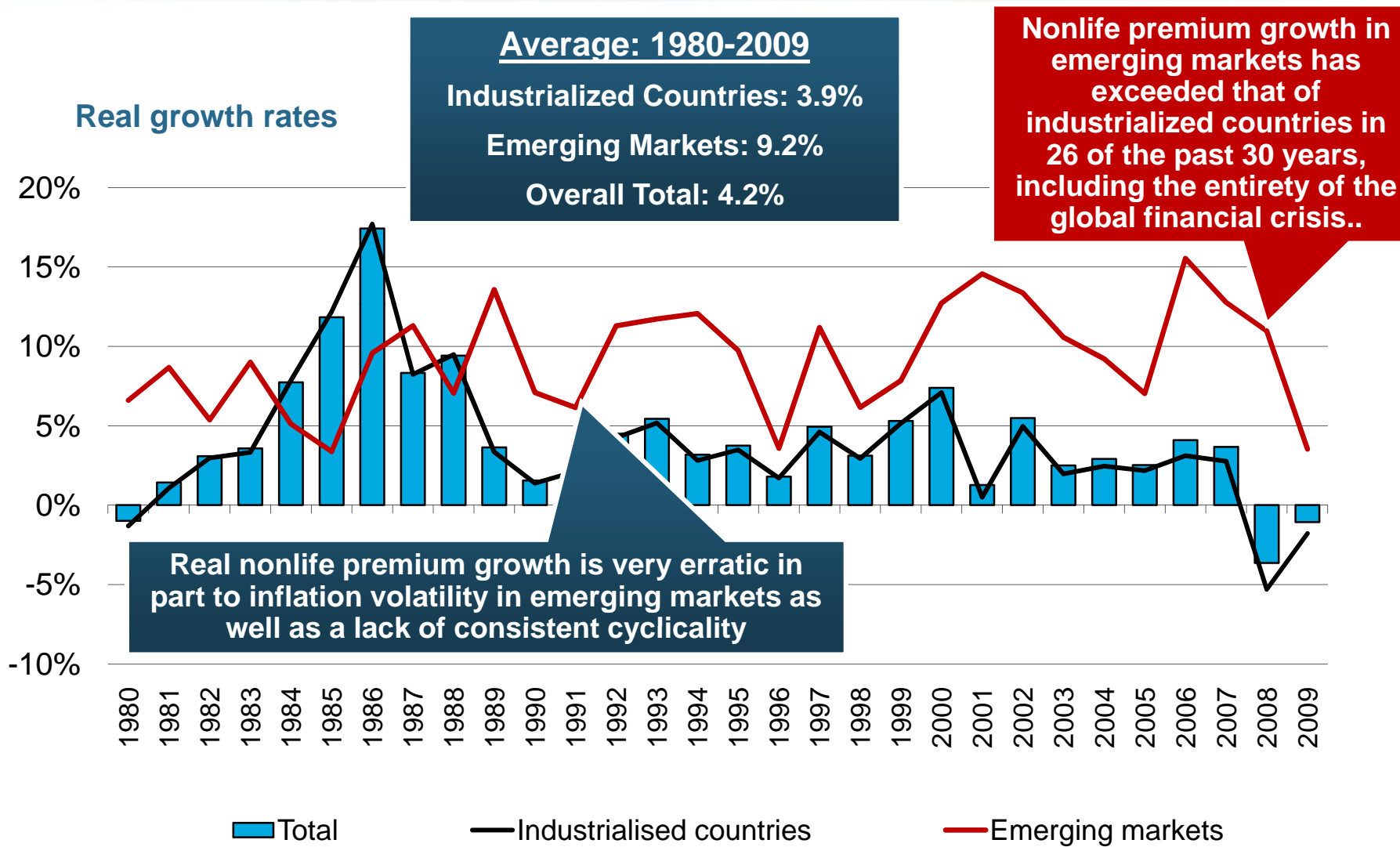


Relative Shares of Global Output, Advanced vs. Developing Economies, 2009

The gap is closing quickly. China became the world's second largest economy in 2010 and before long the developing world's share of GDP will exceed that of advanced economies.



Global Real (Inflation Adjusted) Nonlife Premium Growth: 1980-2009



Source: Swiss Re, *sigma*, No. 2/2010.

Distribution of Nonlife Premium: Industrialized vs. Emerging Markets, 2009

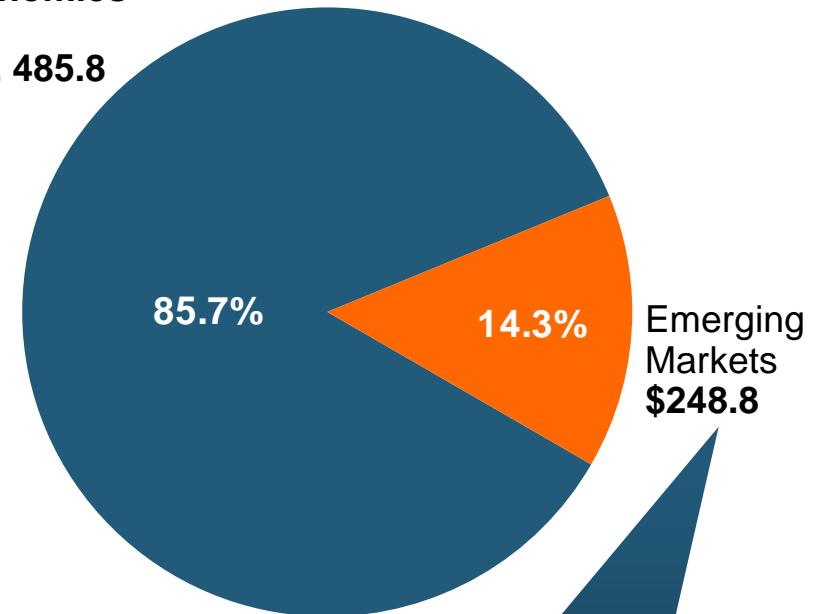
Premium Growth Facts

- Although premium growth throughout the industrialized world was negative in 2009, its share of global nonlife premiums remained very high at nearly 86%--accounting for nearly \$1.5 trillion in premiums.
- The financial crisis and sluggish recovery in the major insurance markets will accelerate the expansion of the emerging market sector

2009, \$Billions

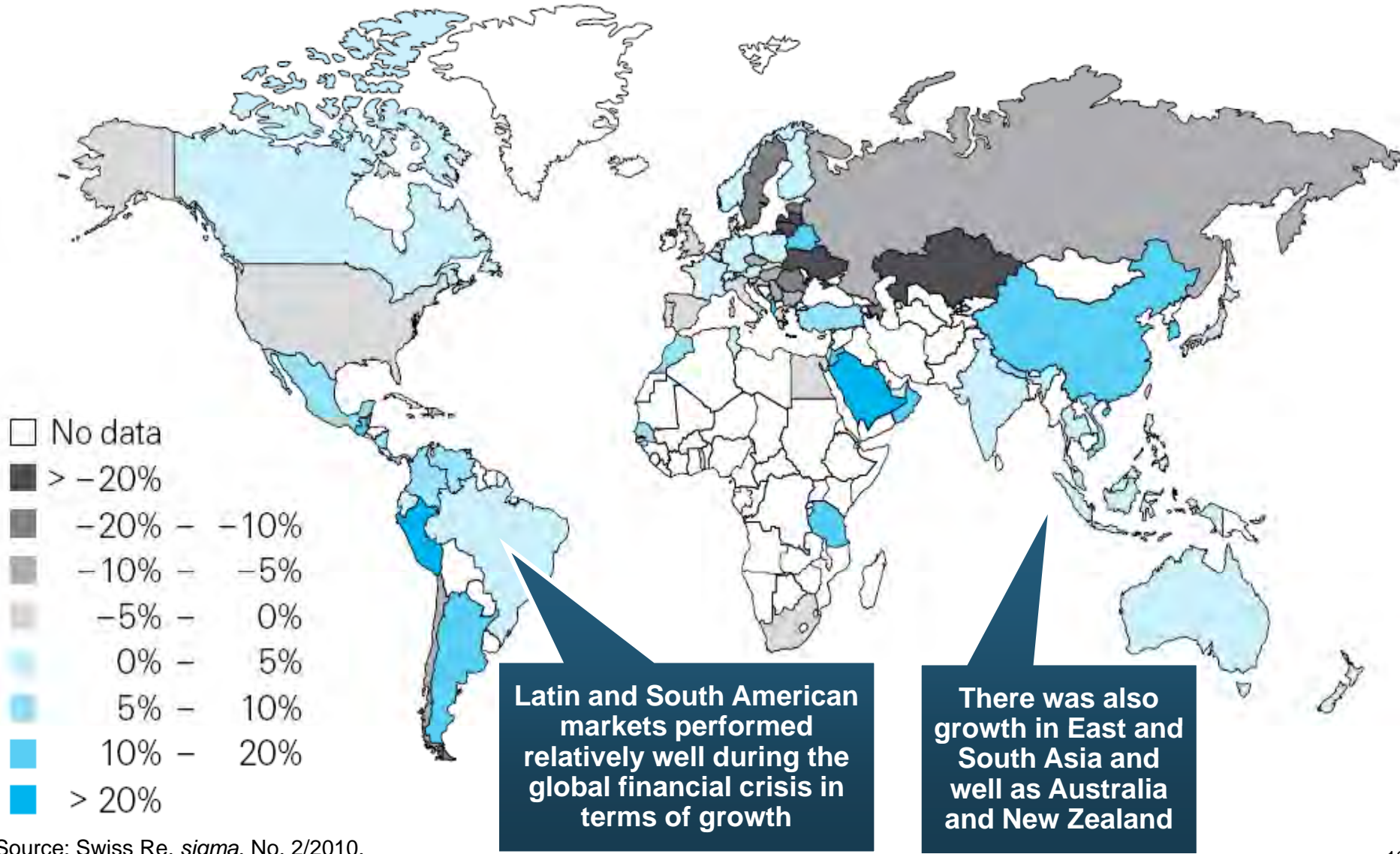
Industrialized
Economies

\$1, 485.8



Developing markets now account for 47% of global GDP but just 14% of nonlife premiums

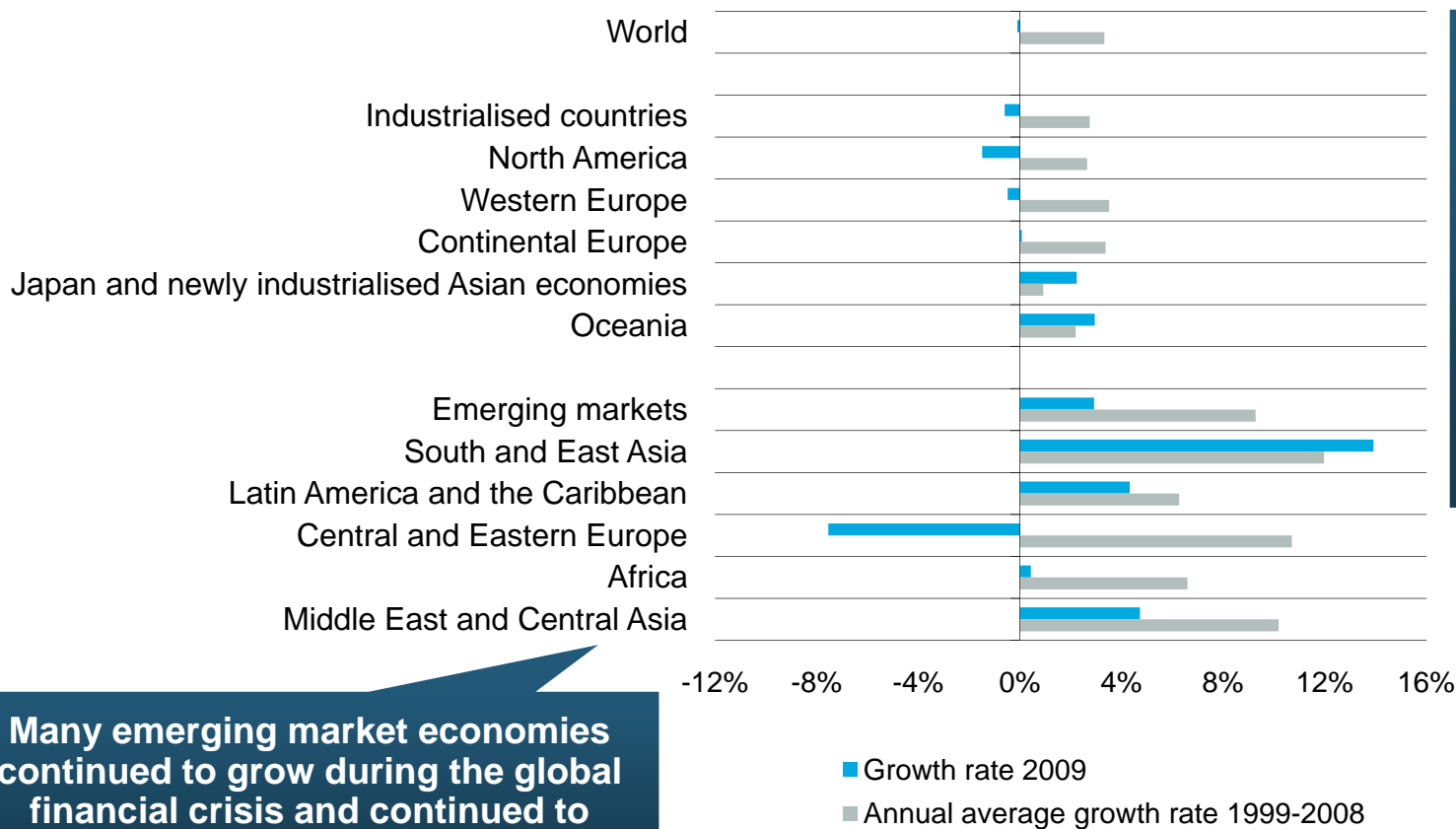
Nonlife Real Premium Growth in 2009



Source: Swiss Re, *sigma*, No. 2/2010.

Nonlife Real Premium Growth Rates by Region: 1999-2008 and 2009

Real Premium Growth Rates



Every emerging market region except Central and Eastern Europe experienced growth during the financial crisis

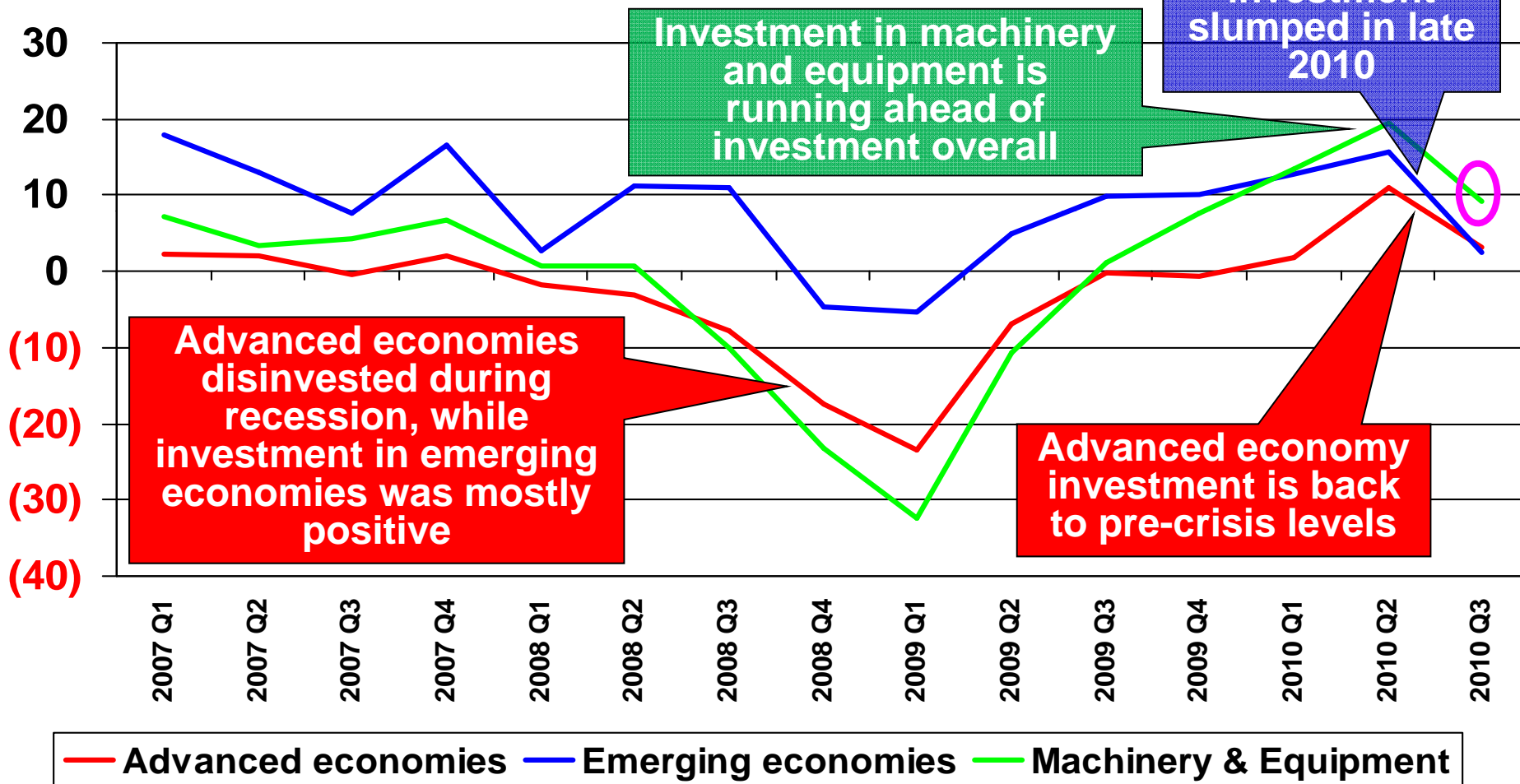
Many emerging market economies continued to grow during the global financial crisis and continued to benefit from foreign direct investment

■ Growth rate 2009
■ Annual average growth rate 1999-2008

Source: Swiss Re, *sigma*, No. 2/2010.

Real Gross Fixed Investment: 2007:Q1 – 2010:Q3

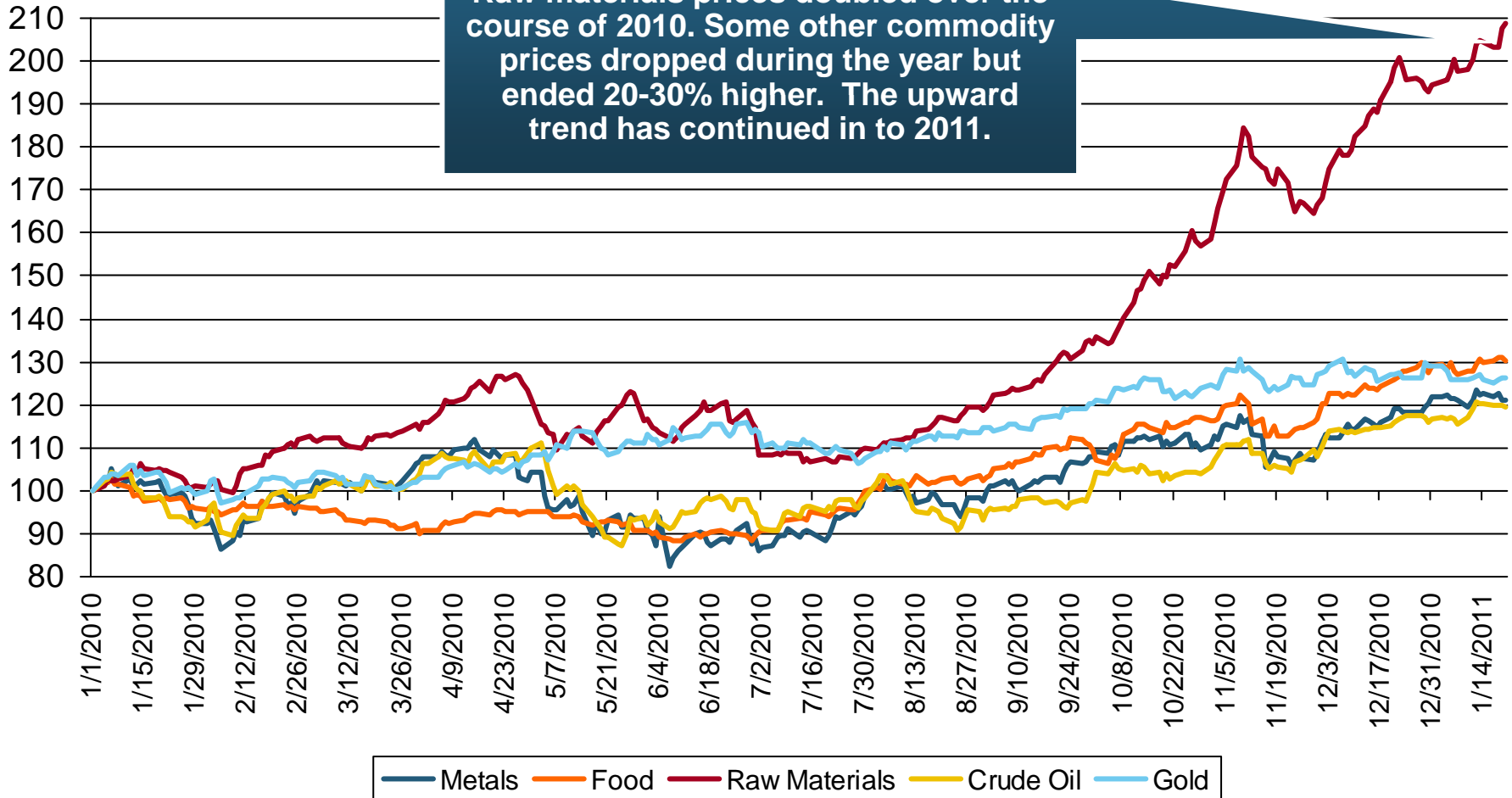
Annualized % Change from Preceding Quarter



Commodity Price Changes in 2010-2011*

Index (Jan 1, 2010 = 100)

Raw materials prices doubled over the course of 2010. Some other commodity prices dropped during the year but ended 20-30% higher. The upward trend has continued in to 2011.

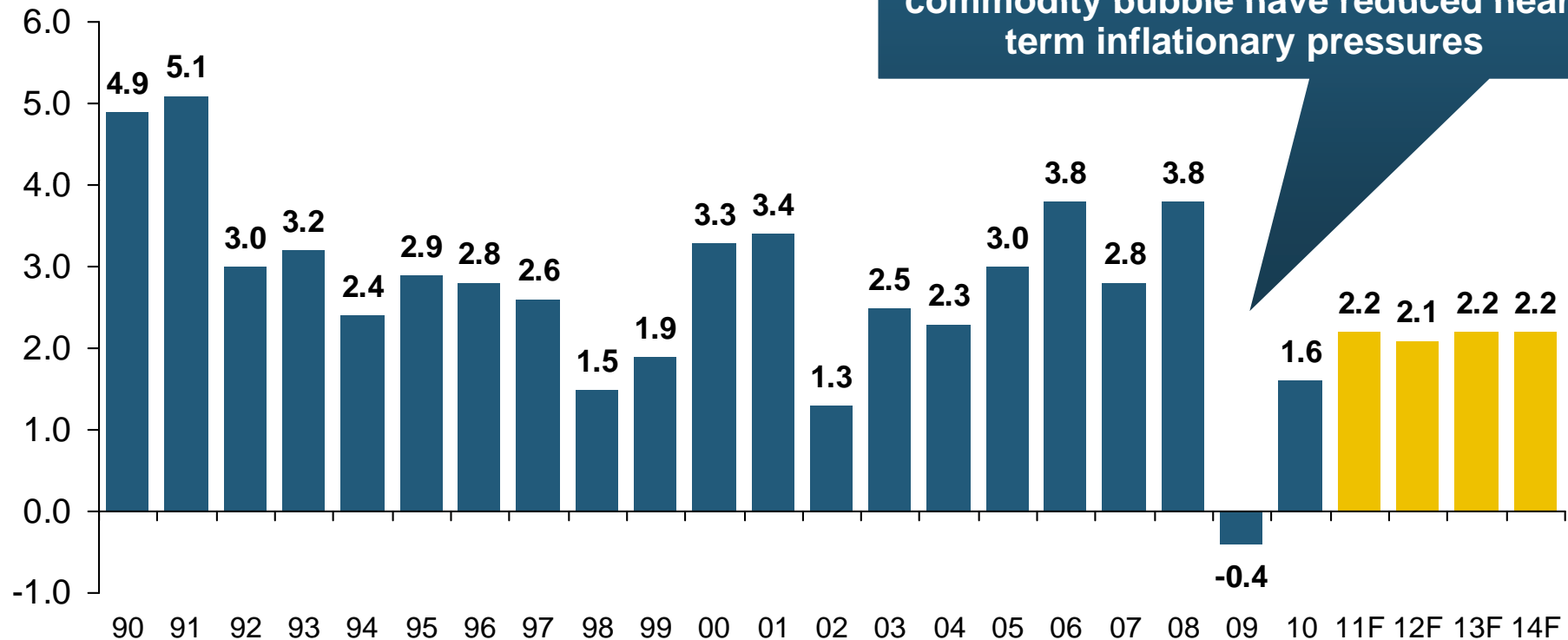


*data are through Jan. 20, 2011

Source: International Monetary Fund World Economic Outlook January 2011 update at http://www.imf.org/external/pubs/ft/weo/2010/update/01/data/figure_2.csv

U.S. Annual Inflation Rates, (CPI-U, %), 1990–2014F

Annual Inflation Rates (%)



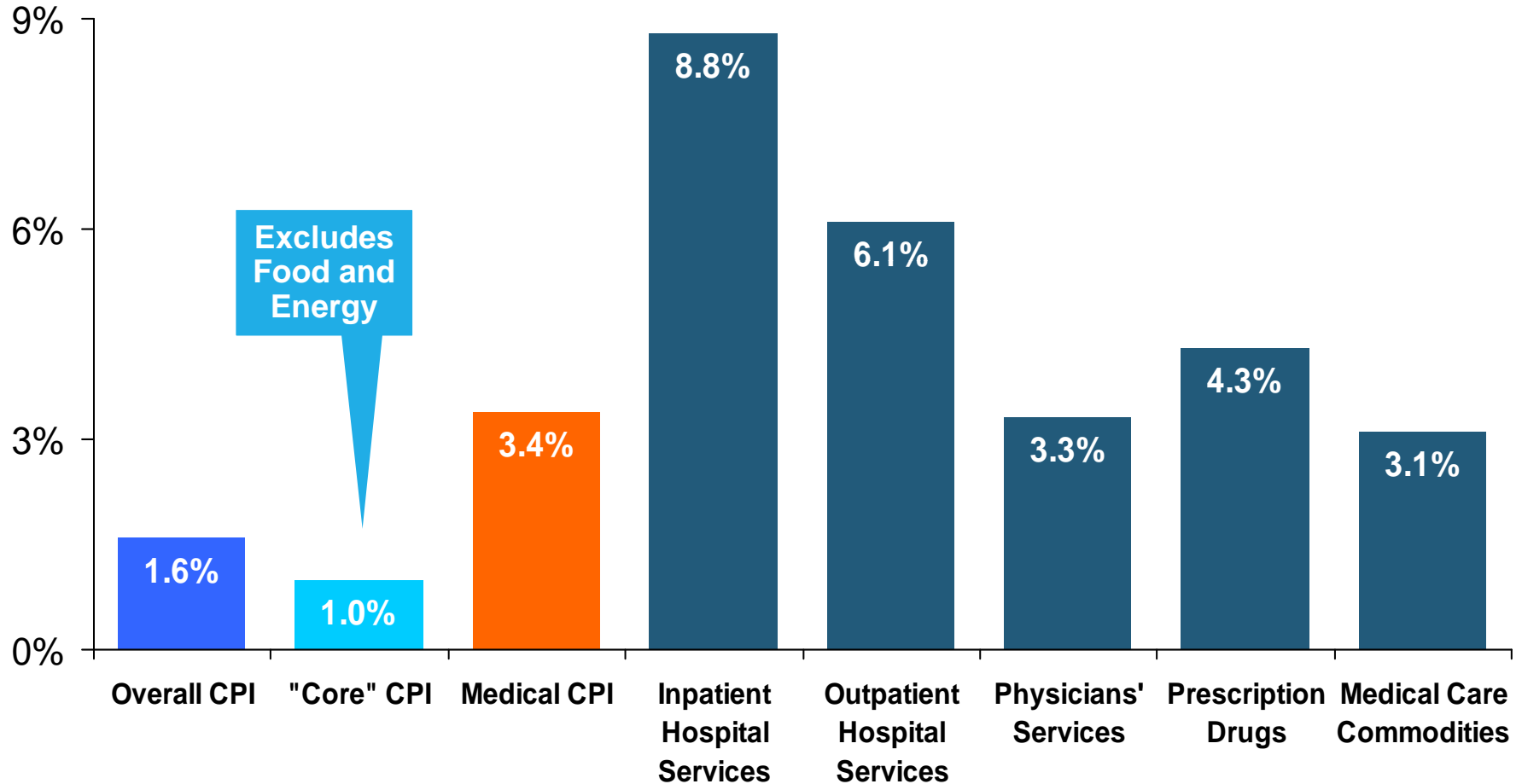
Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble have reduced near-term inflationary pressures

The slack in the U.S. economy suggests that inflation should not heat up before 2012, but other forces (commodity prices, inflation in countries from which we import, etc.), plus U.S. debt burden, remain longer-run concerns

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 10/10 and 3/11 (forecasts).

P/C Insurance Claim Cost Drivers Grow Faster than even the Medical CPI Suggests

Price Changes
in 2010



Healthcare costs are a major liability, med pay, and PIP claim cost driver. They are likely to grow faster than the CPI for the next few years, at least

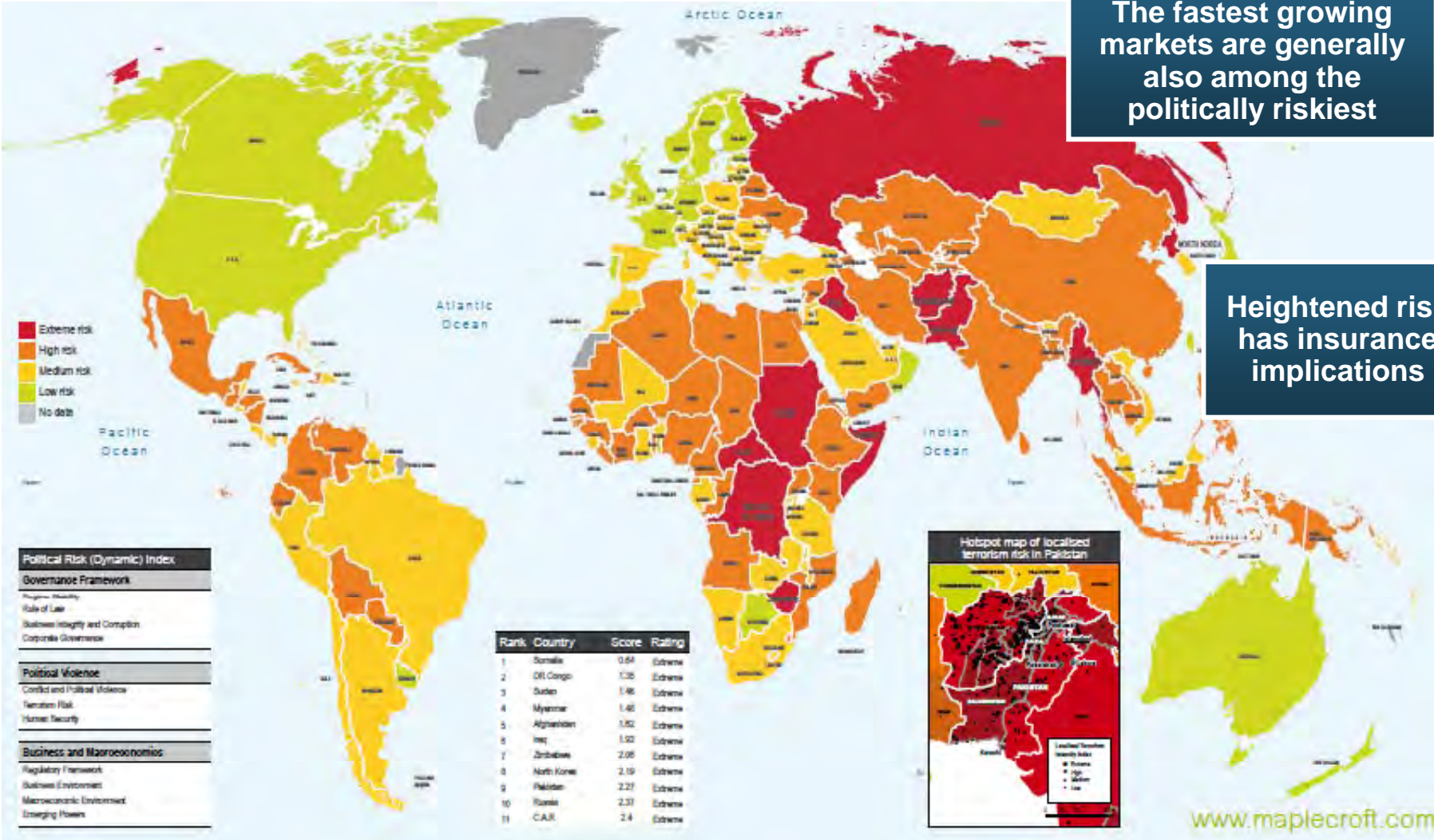
The Unfortunate Nexus: Opportunity, Risk & Instability

**Most of the Global Insurance
Industry's Future Gains Will be
Fraught with Much Greater Risk and
Uncertainty than in the Past**

Political Risk in 2010: Greatest Business Opportunities Are Often in Risky Nations

The fastest growing markets are generally also among the politically riskiest

Heightened risk has insurance implications



Middle East Unrest in 2011: Unanticipated Events Creating Significant Economic & Political Risk with Implications for Global (Re)Insurance Markets

LIBYA

Opposition: Coalition of defected cabinet members, hardened activists and political leaders in rebel territory. U.S. has liaison with opposition council.

U.S. Strategy: Slapped sanctions on regime to push out Gadhafi, supported push for U.N. resolution and played lead role in bombing campaign.

SAUDI ARABIA

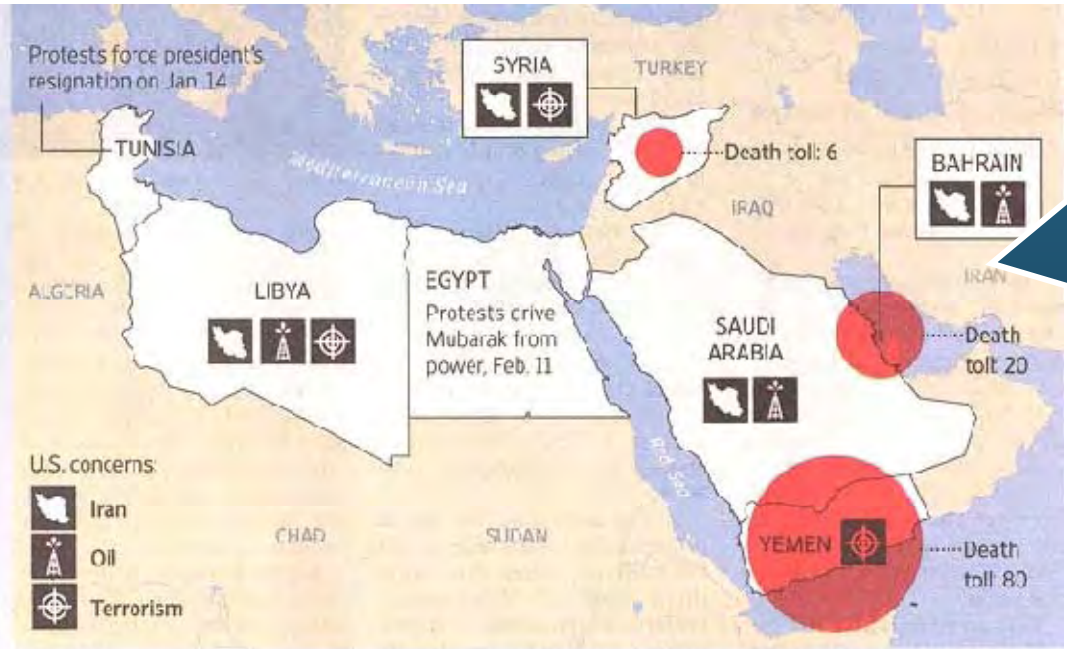
Opposition: Shiite minority, in small protests, demands democratic reforms.

U.S. Strategy: Urges democratic reforms and restraint against protesters.

BAHRAIN

Opposition: Shiite opposition split between demands for reform and regime change.

U.S. Strategy: Urges democratic reforms, argued against Saudi troop deployment.



SYRIA

Opposition: Residents in south voicing local grievances hold days of protests. Anemic opposition groups in Damascus have yet to join.

U.S. Strategy: White House criticizes violence, calls on Damascus to address 'legitimate aspirations of their people.'

YEMEN

Opposition: Pro- democracy coalition of secular and Islamist parties has been joined by controversial cleric, military brass and tribal leaders.

U.S. Strategy: Calls for democratic reforms while asserting support for president.

Most of the countries experiencing unrest are strategic allies of the US and/or major oil producers. Also, does a desperate Gaddafi raise the risk of terrorism (Libya was responsible for the bombing of Pan Am flight 103 in 1988)?

Heightened risk has insurance implications

Note: No deaths have been reported in Saudi Arabia as a result of recent conflict; death toll for Libya unknown. Sources for death tolls: Amnesty International (Yemen); local media (Bahrain); WSJ reporting (Syria)

Countries by Insurance Risk Tier Rating

<u>CRT-1</u>	<u>CRT-2</u>	<u>CRT-3</u>	<u>CRT-4</u>	<u>CRT-5</u>
Australia	Barbados*	Bahamas*	Antigua & Barbuda*	Belarus
Austria	Belgium	Bahrain	Brunei Darussalam	Bosnia and Herzegovina
Canada	Bermuda	<i>China</i>	Egypt	Dominican Republic
Denmark	British Virgin Islands*	Cyprus	<i>India</i>	Ghana
Finland	Cayman Islands*	Israel	Indonesia	Jamaica
France	Hong Kong	Kuwait	Jordan	Kenya
Germany	Ireland	<i>Malaysia</i>	Kazakhstan	Lebanon
Gibraltar*	Italy	Malta	Mauritius	Nigeria
Guernsey*	Japan	Mexico	Morocco	Ukraine
Isle of Man*	Liechtenstein*	Netherlands Antilles*	Panama	<i>Vietnam</i>
Luxembourg	Macau	Oman	Philippines	
Netherlands	New Zealand	Poland	<i>Russia</i>	
Norway	Slovenia	Qatar	Tunisia	
Singapore	South Korea	<i>Saudi Arabia</i>	Turkey	
Sweden	Spain	South Africa		
Switzerland	Taiwan	Thailand		
United Kingdom		Trinidad and Tobago		
United States		United Arab Emirates		

The fastest growing markets are pose a much greater risk to an insurer's stability, strength and performance

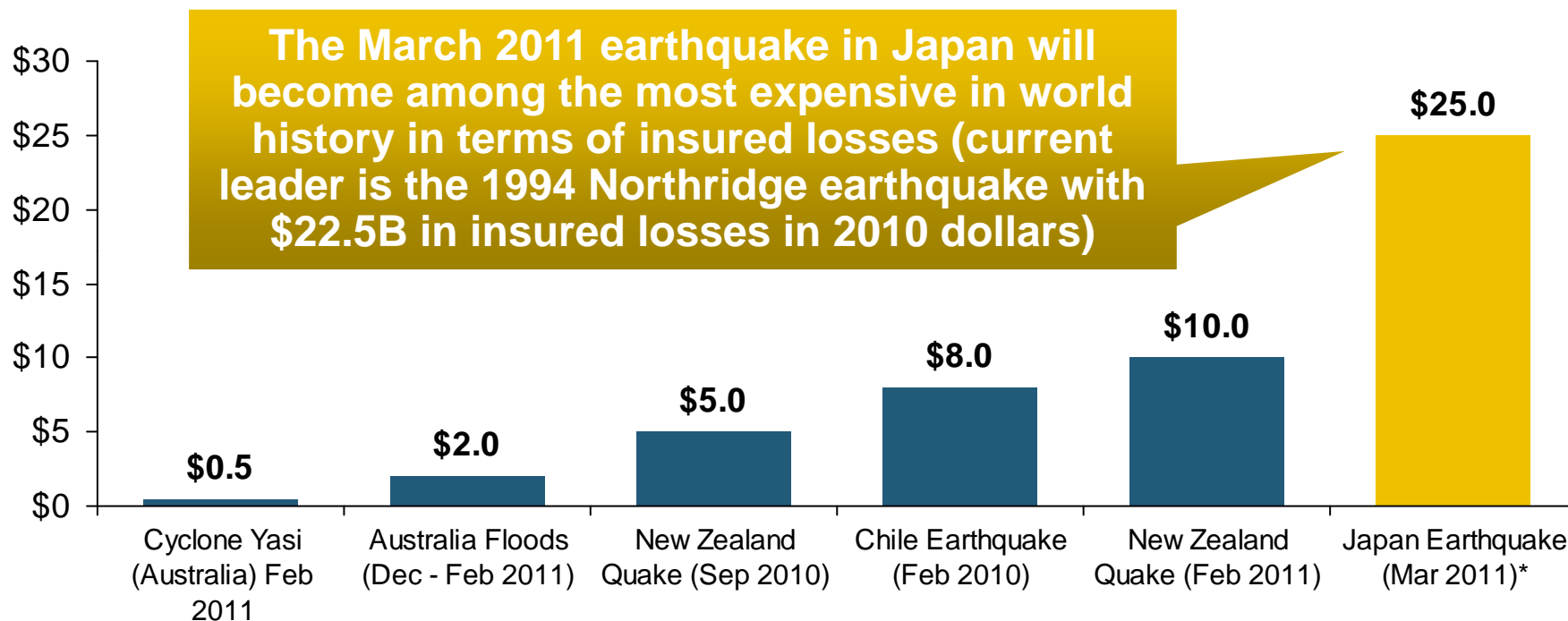
*Denotes countries to be considered "Special Cases" by A.M. Best
 Source: A.M. Best., as of 4/13/10

Catastrophe Risk as a Contributor to Global Uncertainty

**2011: Catastrophes Will Have
Notable Impact on the Global
Economy and Public Policy**

Recent Major Catastrophe Losses

(Insured Losses, \$US Billions)

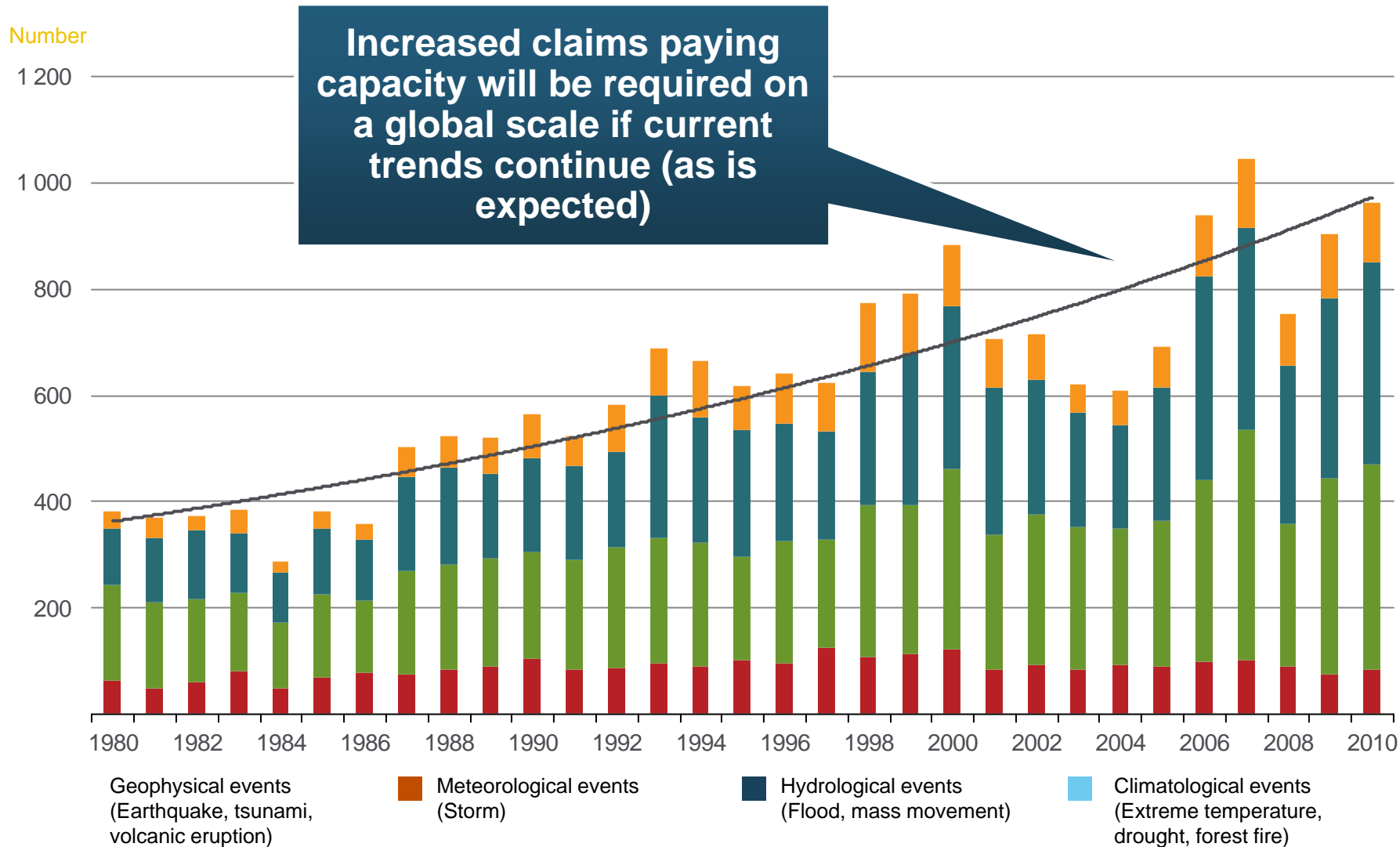


Insured Losses from Recent Major Catastrophe Events Exceed \$50 Billion, an Estimated \$48 Billion of that from Earthquakes

*Midpoint of AIR Worldwide estimated insured loss range of \$15 billion to \$35 billion as of March 13, 2011. Does not include tsunami losses.

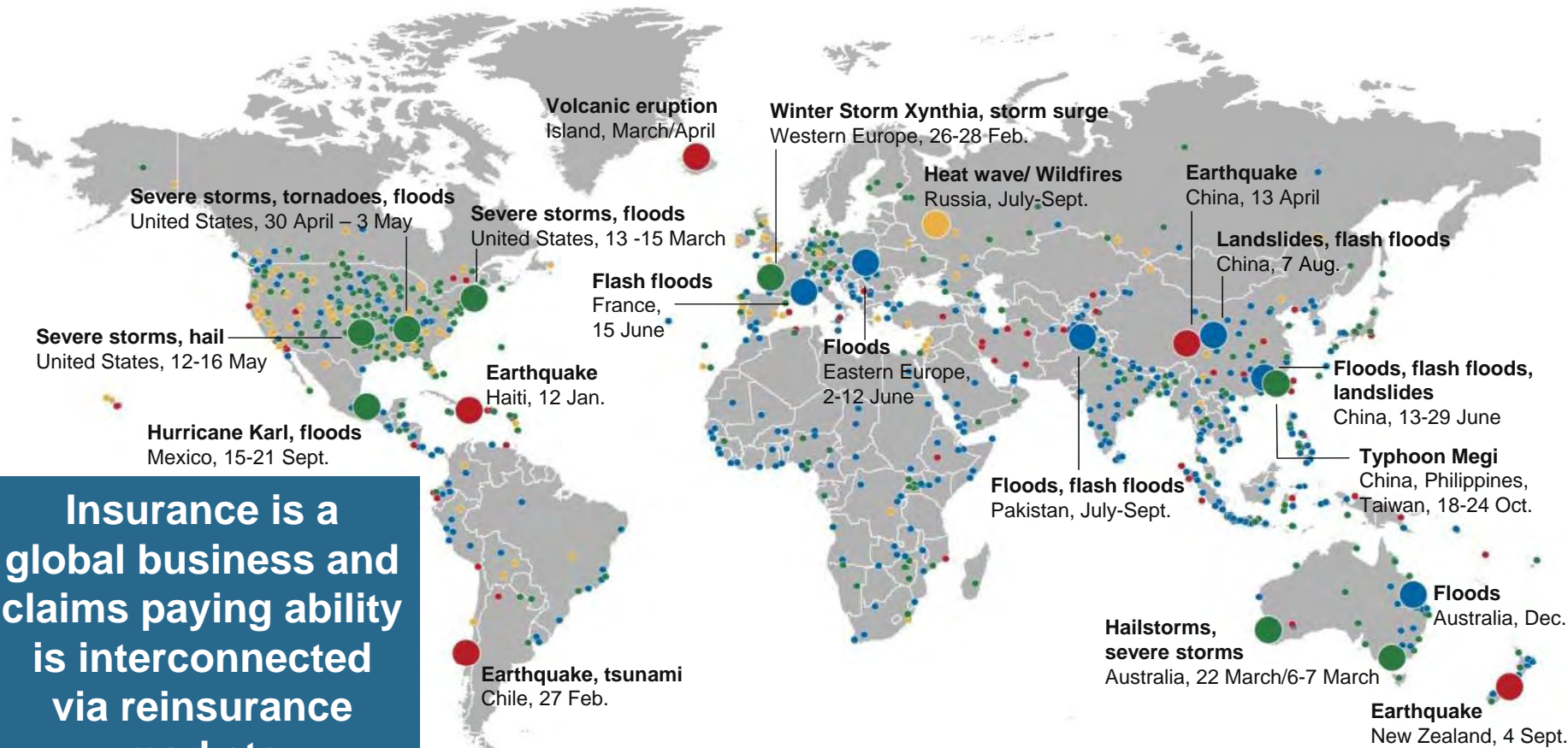
Sources: Insurance Council of Australia, Munich Re, AIR Worldwide; Insurance Information Institute.

Natural Catastrophes Worldwide, 1980 – 2010 (Number of events with trend)



Natural Catastrophes, 2010

950 loss events

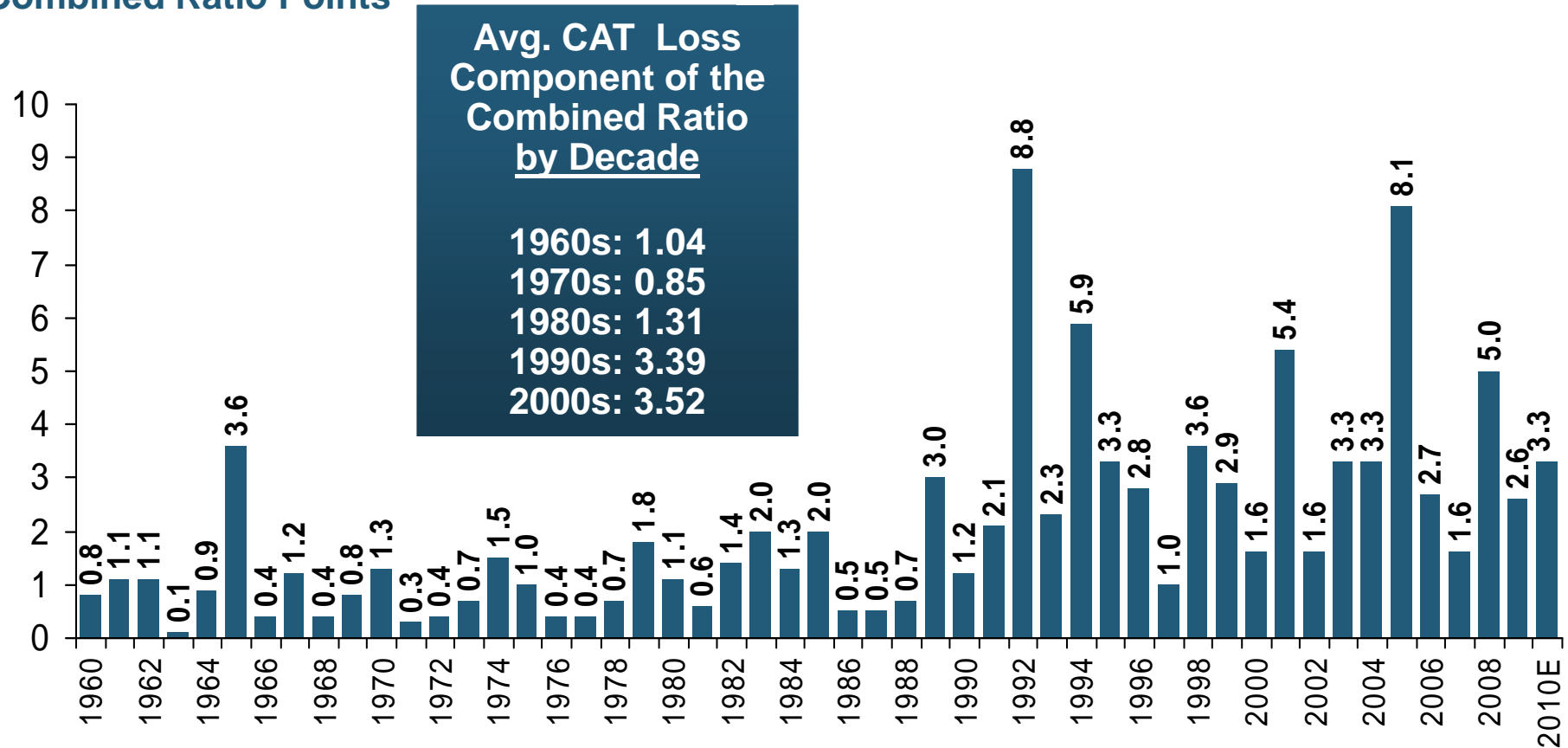


Insurance is a global business and claims paying ability is interconnected via reinsurance markets

- Natural catastrophes
- Selection of significant loss events (see table)
- Geophysical events (earthquake, tsunami, volcanic activity)
- Meteorological events (storm)
- Hydrological events (flood, mass movement)
- Climatological events (extreme temperature, drought, wildfire)

Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2010E

Combined Ratio Points



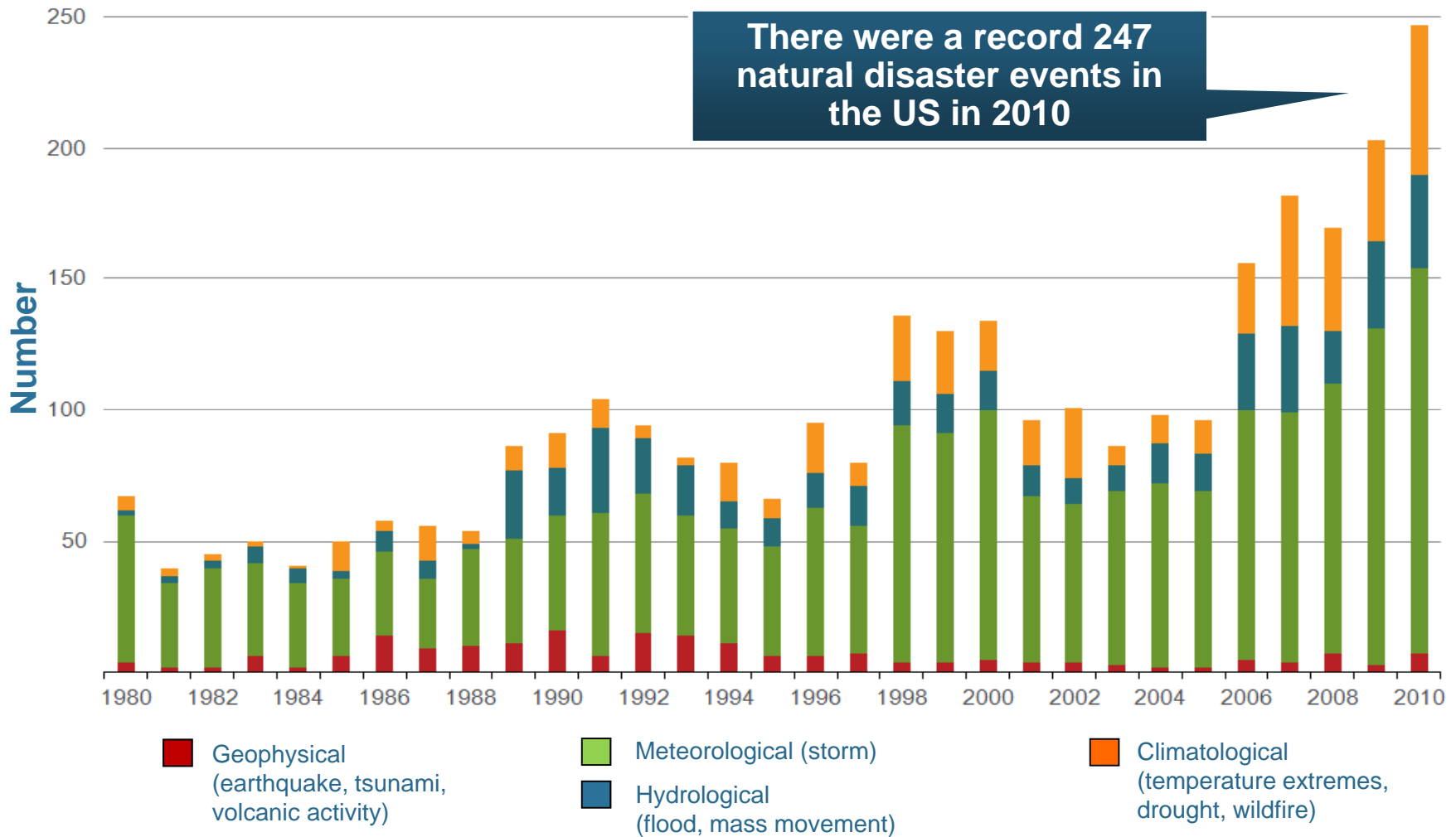
The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

Notes: Private carrier losses only. Excludes loss adjustment expenses and reinsurance reinstatement premiums. Figures are adjusted for losses ultimately paid by foreign insurers and reinsurers.

Source: ISO; Insurance Information Institute estimate for 2010.

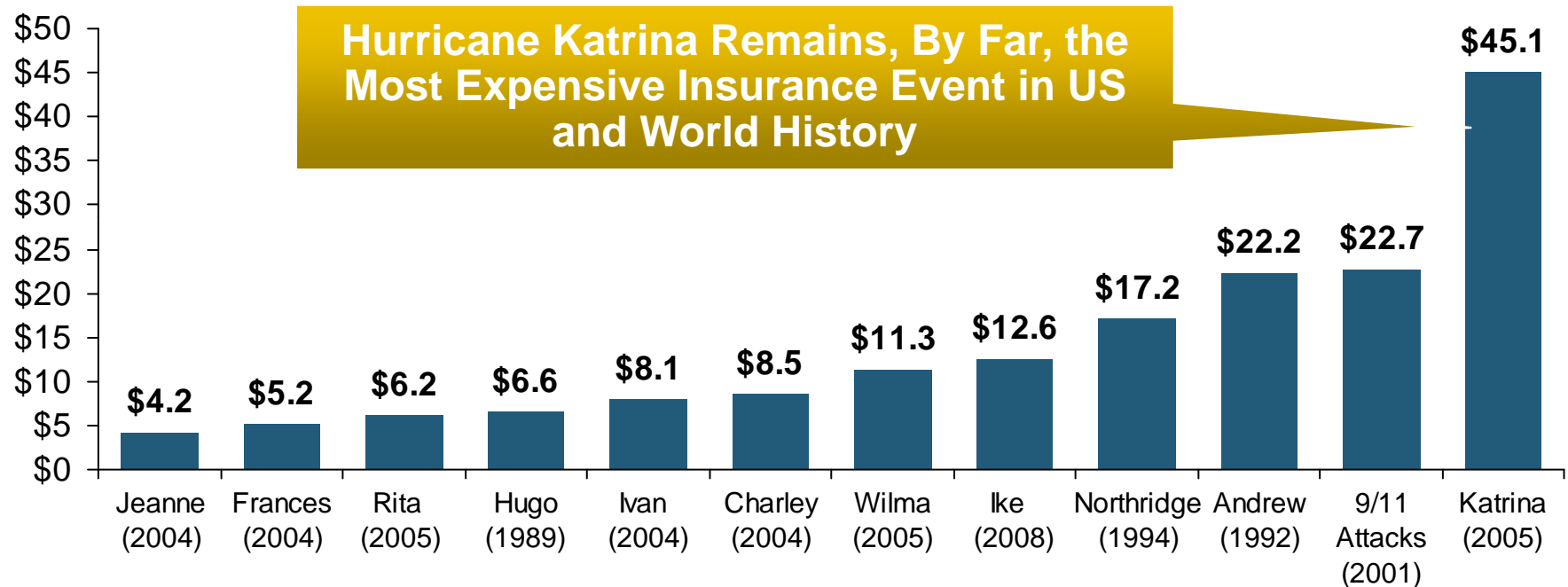
Natural Disasters in the United States, 1980 – 2010

Number of Events (Annual Totals 1980 – 2010)



Top 12 Most Costly Disasters in US History

(Insured Losses, 2009, \$ Billions)



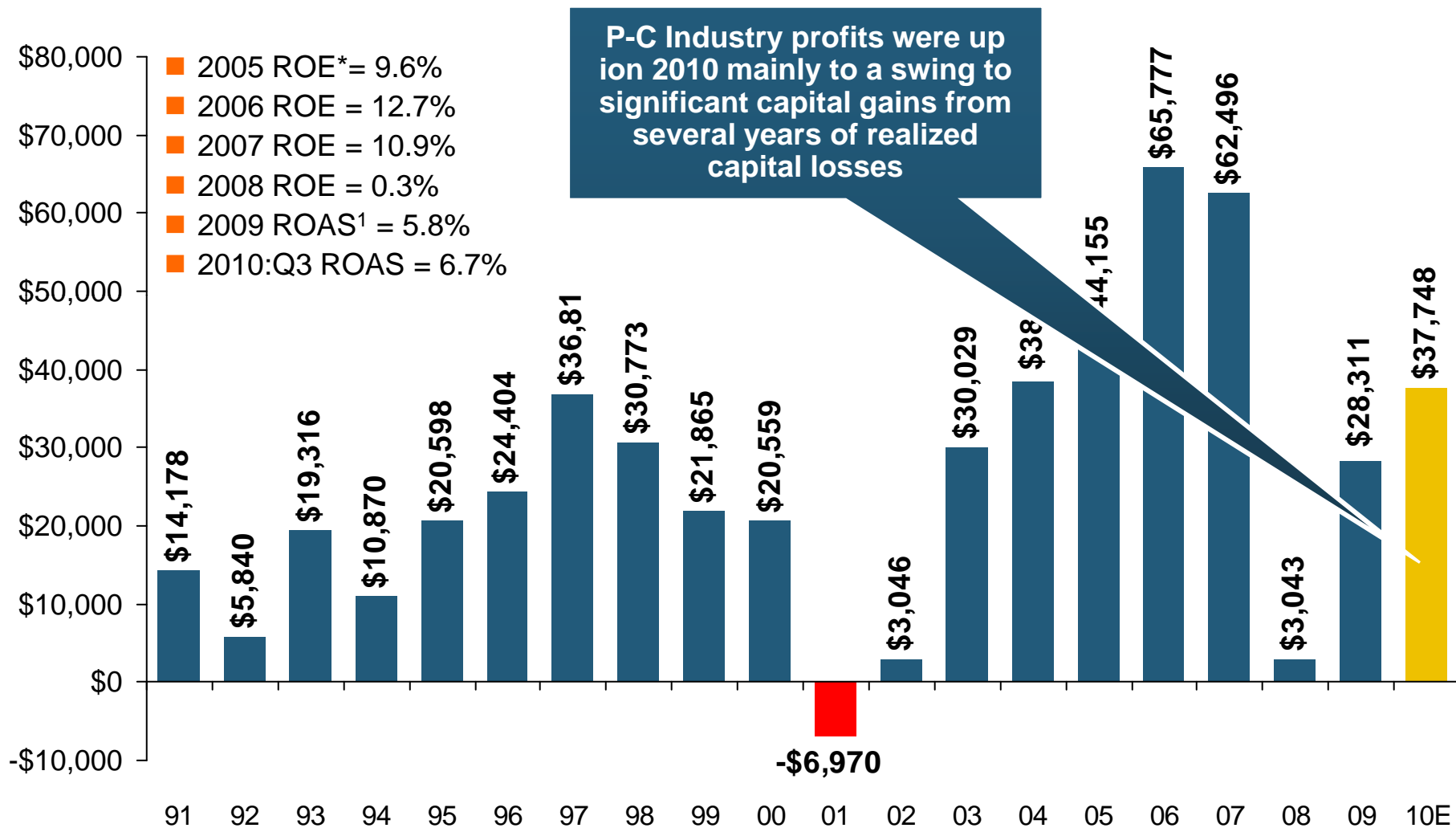
8 of the 12 Most Expensive Disasters in US History Have Occurred Since 2004;



P/C Insurance Industry Financial Overview

**Fitful and Possibly Fragile
Recovery is Underway**

P/C Net Income After Taxes 1991–2010E (\$ Millions)

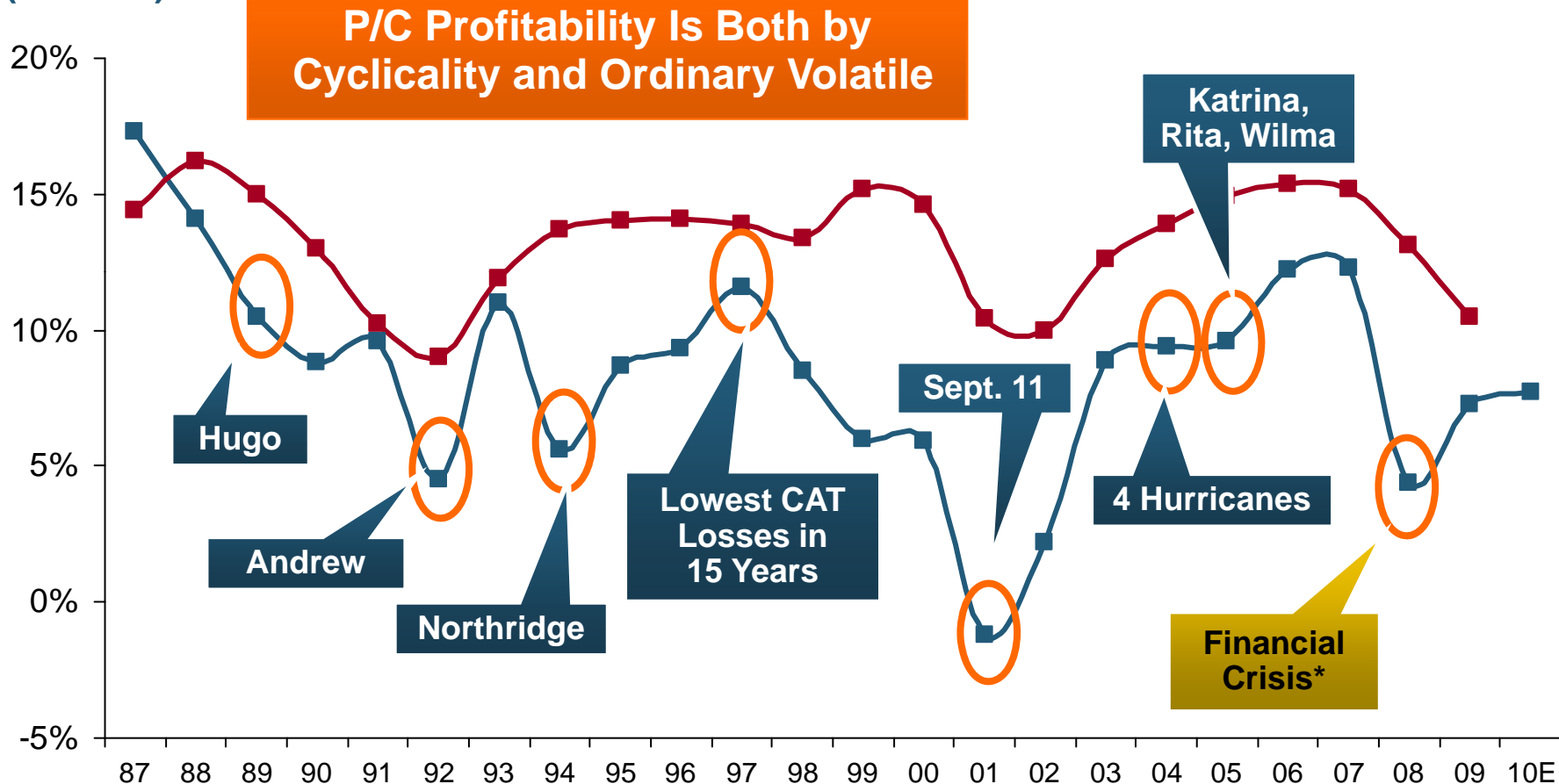


* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.7% ROAS for 2010:Q3 and 4.6% for 2009. 2009:Q3 net income was \$29.8 billion excluding M&FG.

Sources: A.M. Best, ISO, Insurance Information Institute

ROE: Property/Casualty Insurance, 1987–2010E*

(Percent)



* Excludes Mortgage & Financial Guarantee in 2008 - 2010.

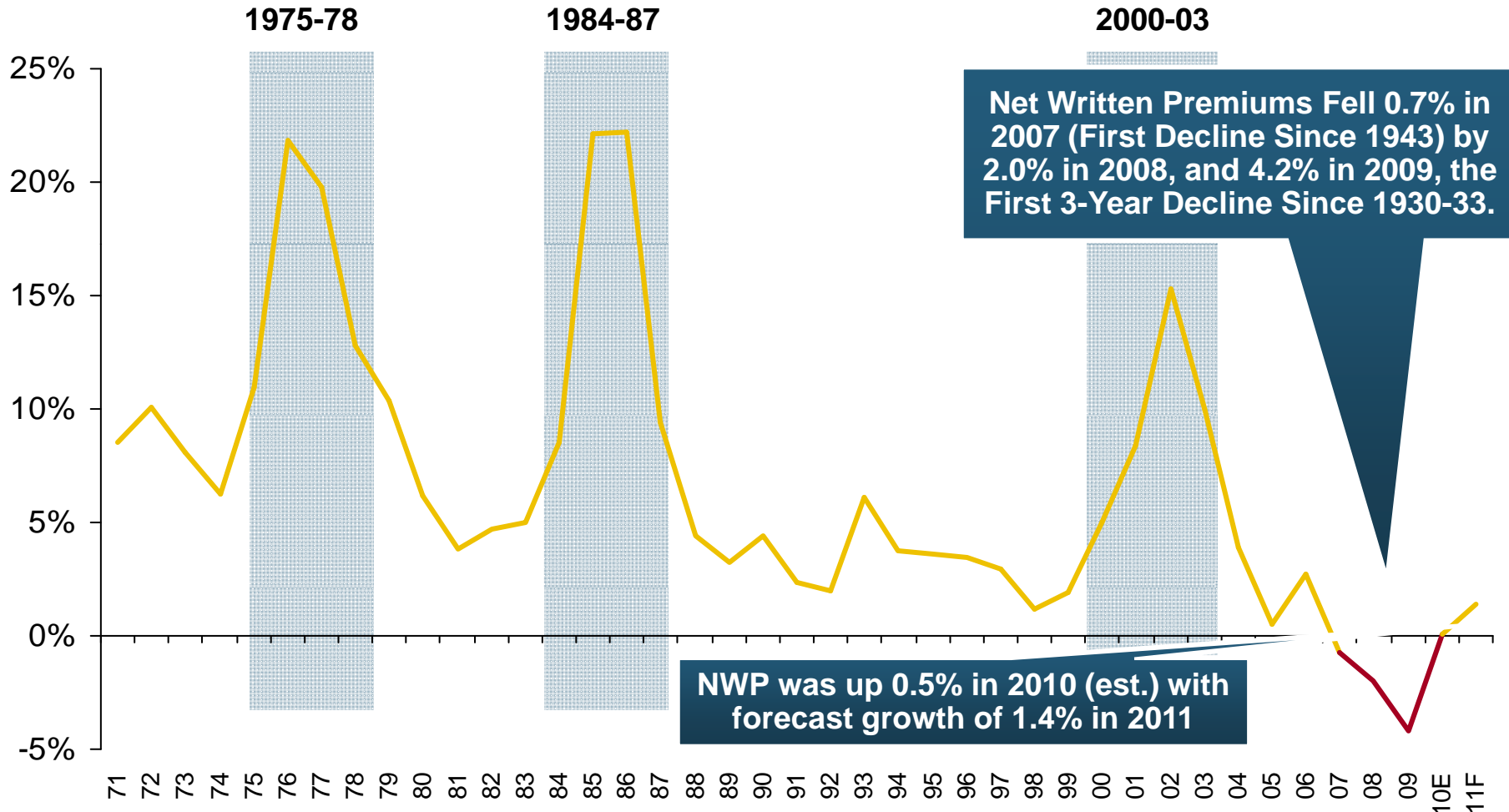
Sources: ISO, *Fortune*; Insurance Information Institute figure for 2010 is actual through 2010:Q3.

PRICING TRENDS

**If Pricing/Reserving Are
Inadequate, History Suggests
Problems Ahead**

Soft Market Persisted in 2010 but May Be Easing: Relief in 2011?

(Percent)

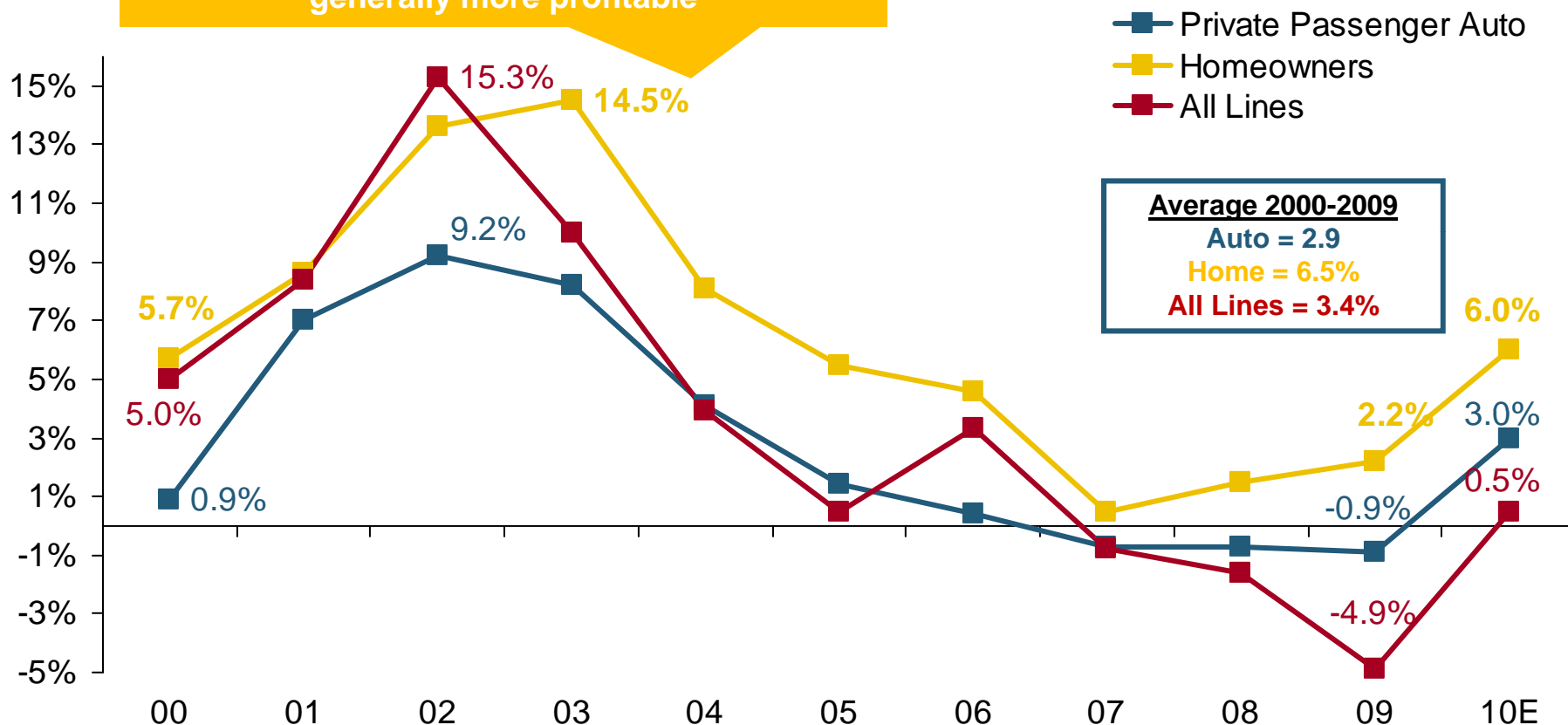


Shaded areas denote "hard market" periods

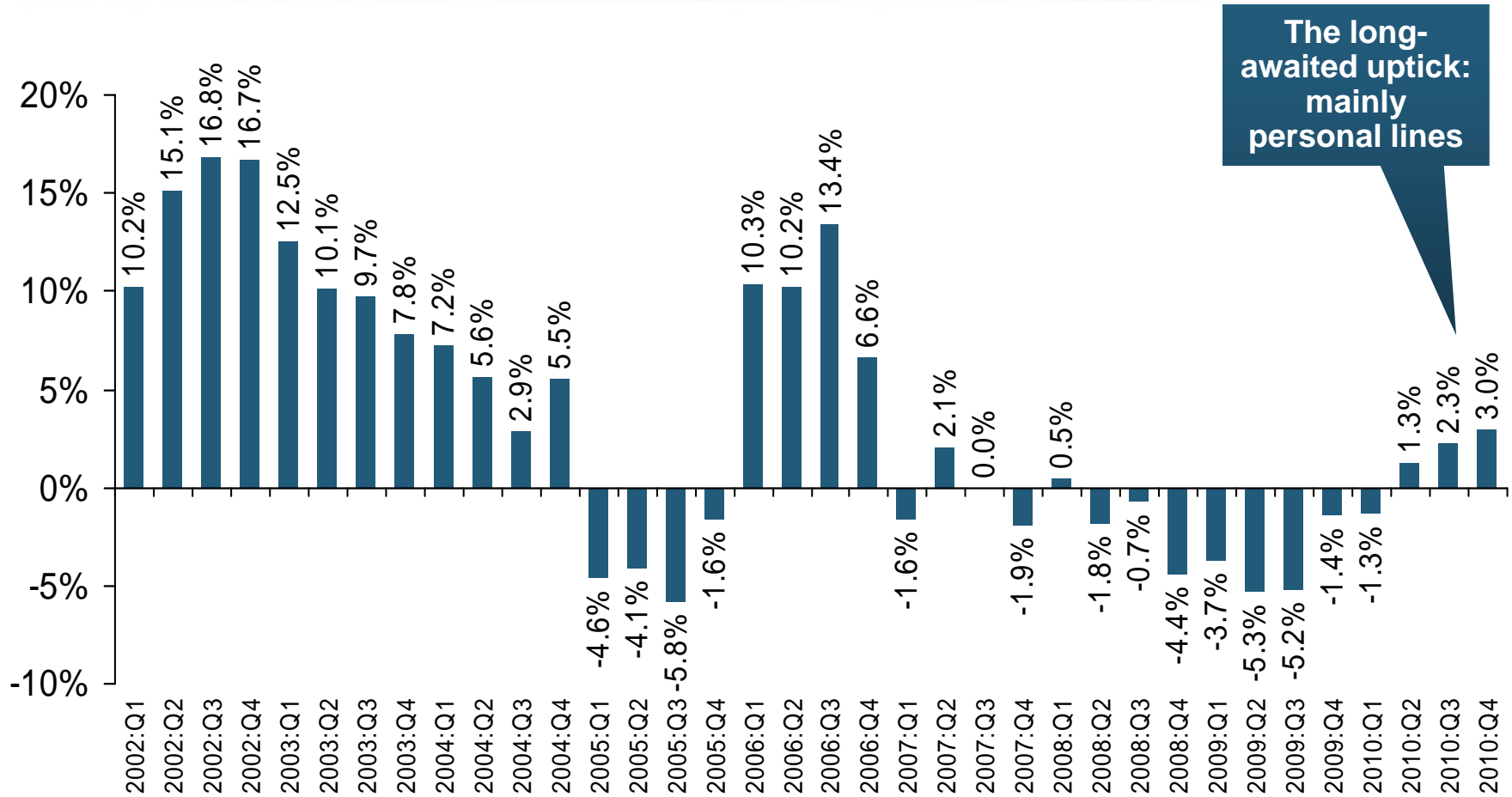
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

Auto & Home vs. All Lines, Net Written Premium Growth, 2000–2010E

While homeowners insurance has grown faster than auto over the past decade, auto is generally more profitable



P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter

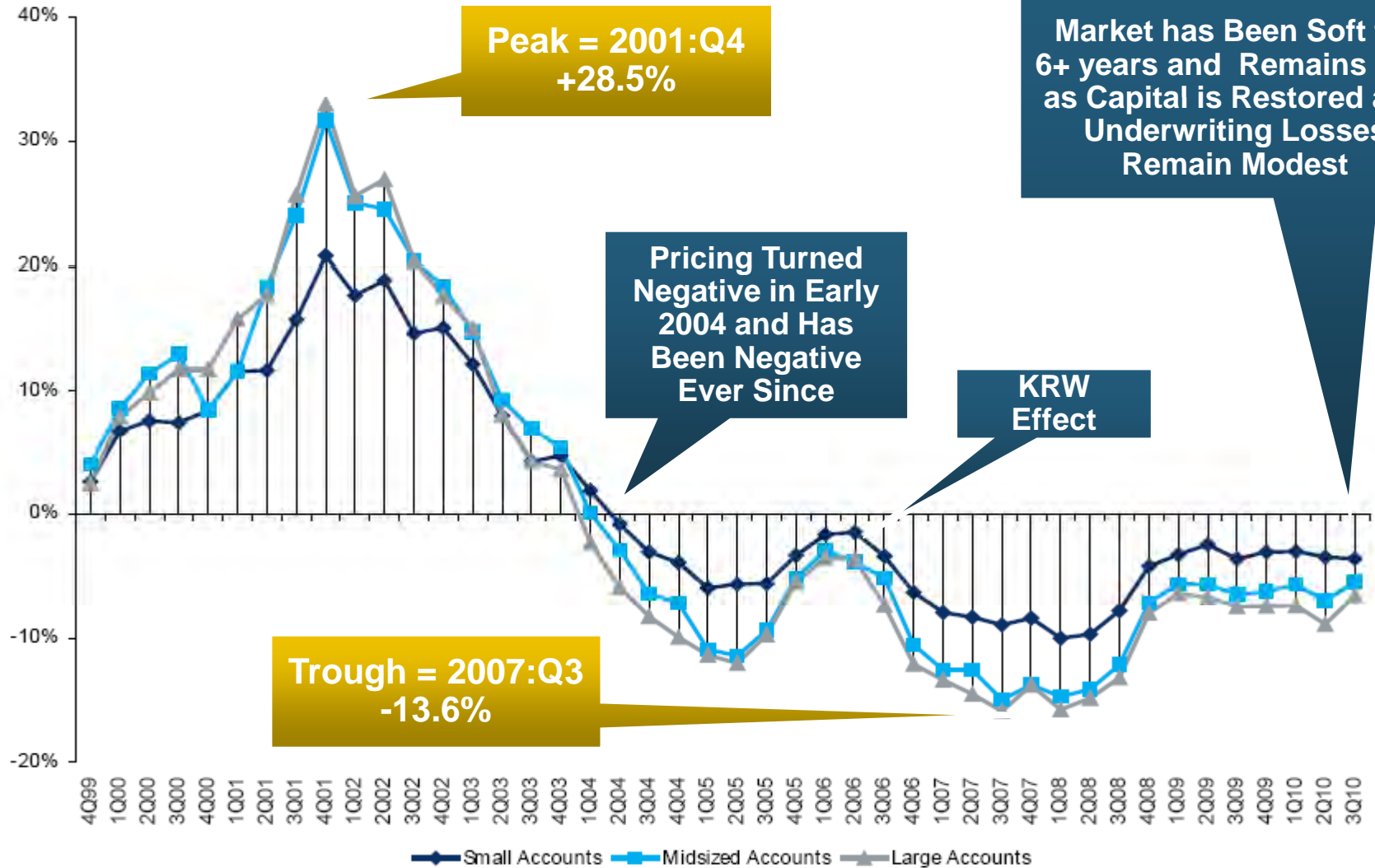


The long-awaited uptick: mainly personal lines

Finally! Back-to-back quarters of net written premium growth (vs. the same quarter, prior year)

Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2010:Q3

Percentage Change (%)

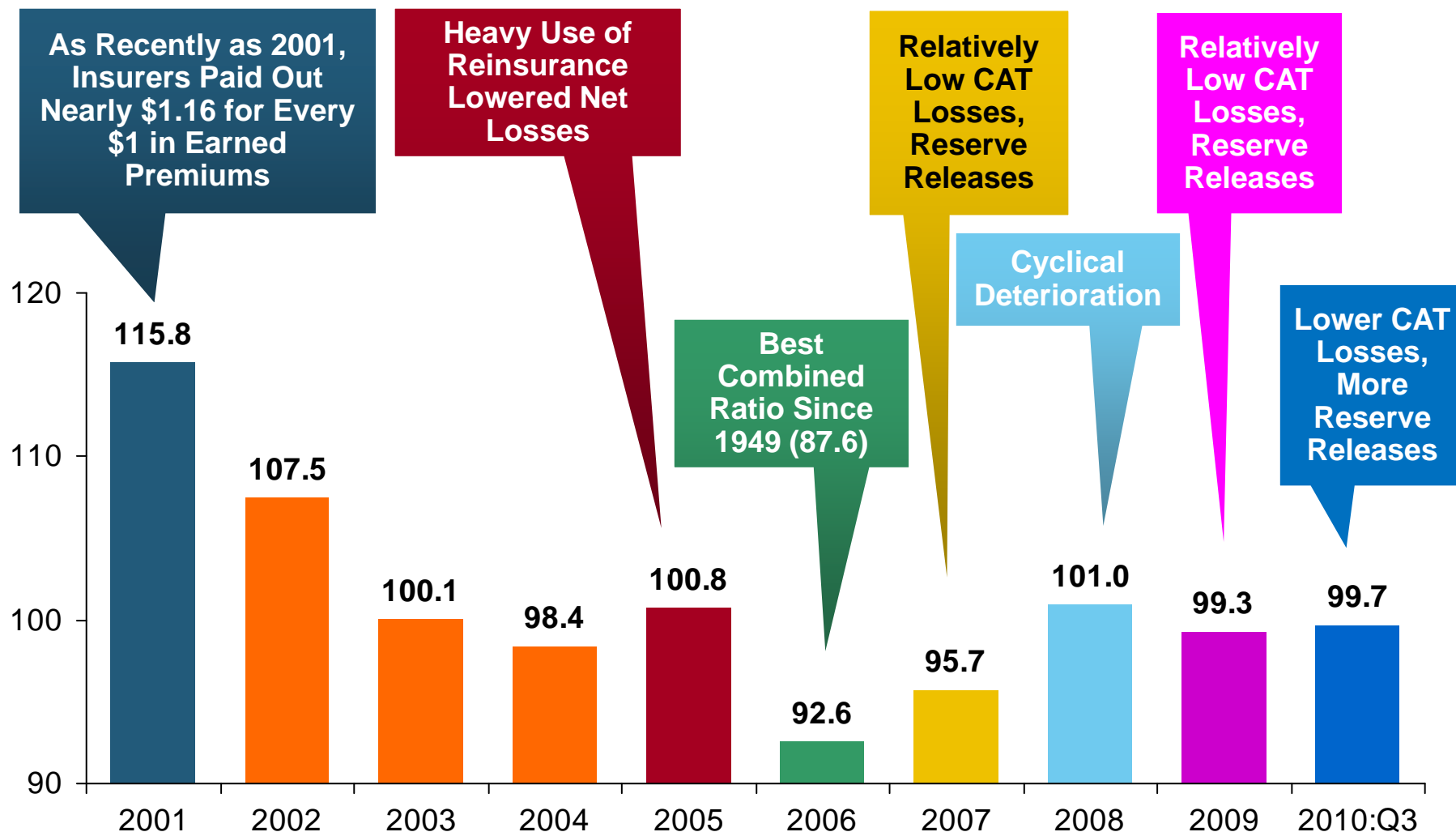


Source: Council of Insurance Agents and Brokers; Insurance Information Institute.

UNDERWRITING

**Cyclicalicity is Driven Primarily
by the Industry's Underwriting
Cycle, Not the Economy**

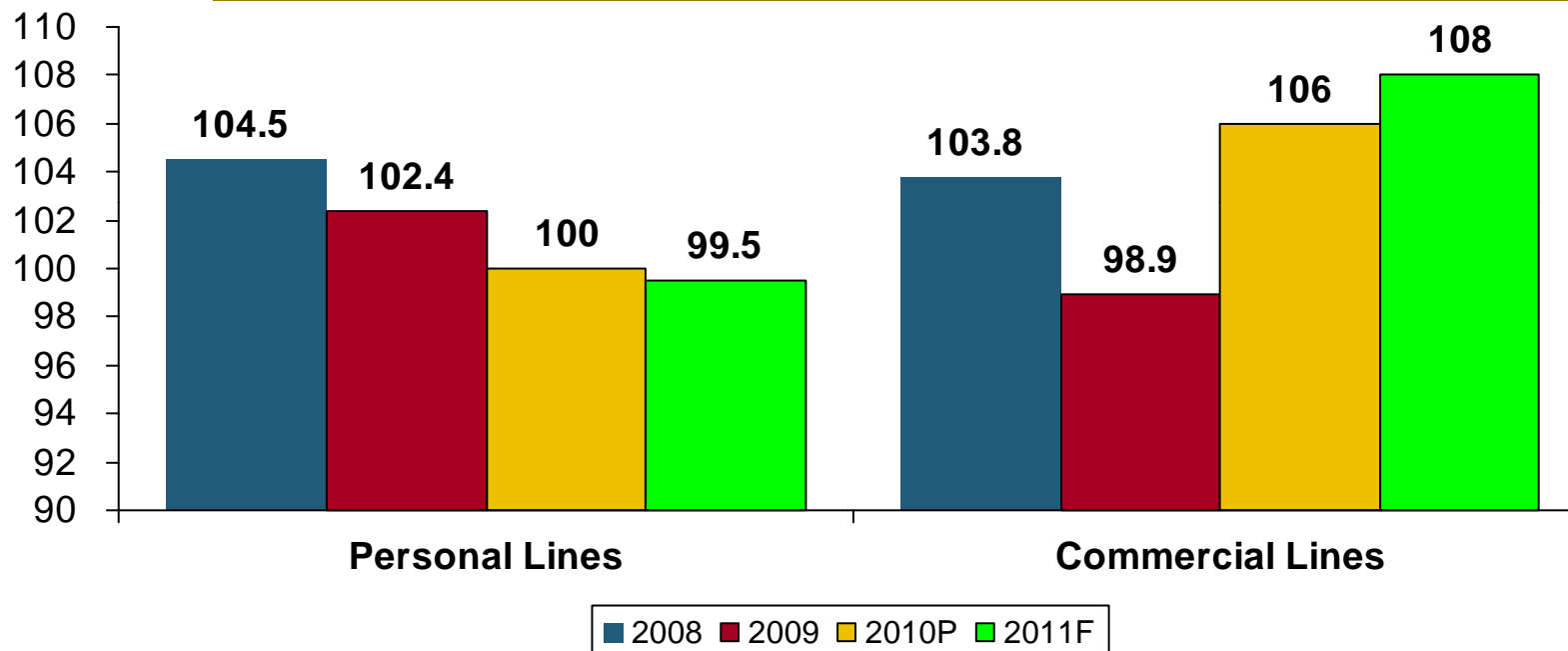
P/C Insurance Industry Combined Ratio, 2001–2010:Q3*



* Excludes Mortgage & Financial Guaranty insurers in 2008, 2009 and 2010. Including M&FG, 2008=105.1, 2009=100.7, 2010:Q3=101.2
Sources: A.M. Best, ISO.

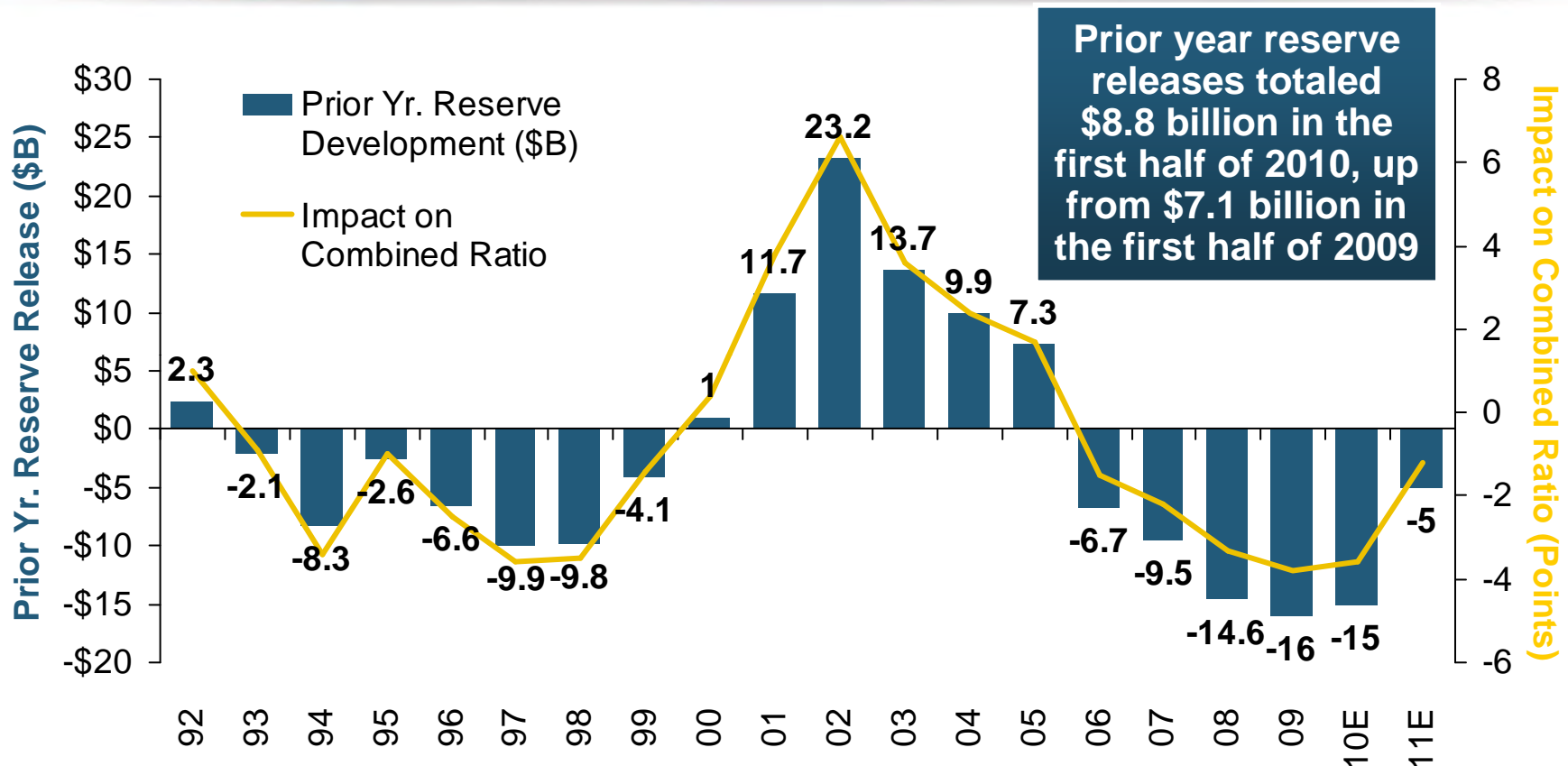
Calendar Year Combined Ratios by Segment: 2008-2011F

Personal lines combined ratio is expected to remain stable in 2010 while commercial lines and reinsurance deteriorate



Overall deterioration in 2011 underwriting performance is due to expected return to normal catastrophe activity along with deteriorating underwriting performance related to the prolonged commercial soft market

P/C Reserve Development, 1992–2011E



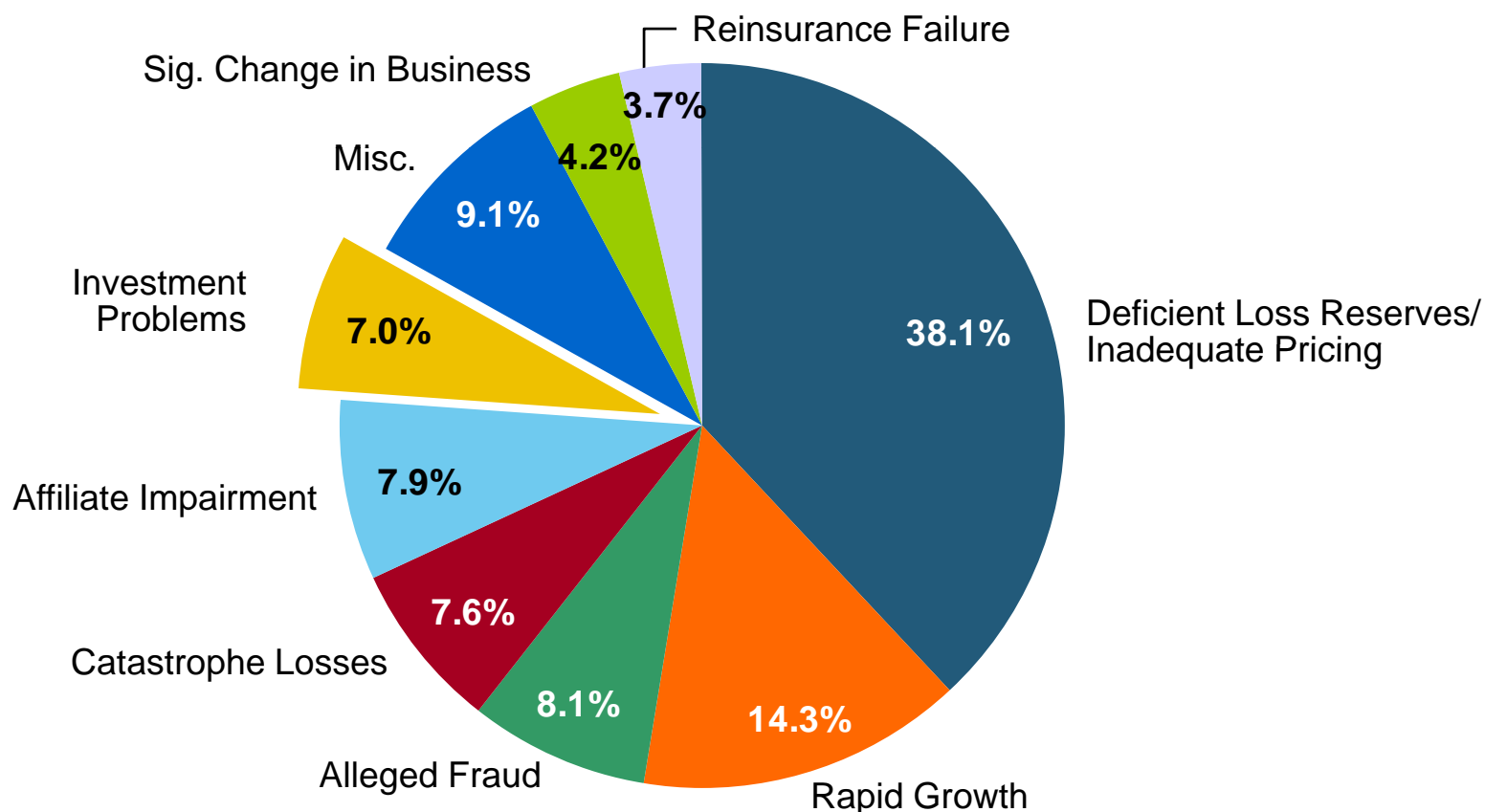
Reserve Releases Are Remained Strong in 2010 But Should Begin to Taper Off in 2011

Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.

Sources: Barclay's Capital; A.M. Best.

Reasons for US P/C Insurer Impairments, 1969–2008

Deficient Loss Reserves and Inadequate Pricing Are the Leading Cause of Insurer Impairments, Underscoring the Importance of Discipline. Investment Catastrophe Losses Play a Much Smaller Role

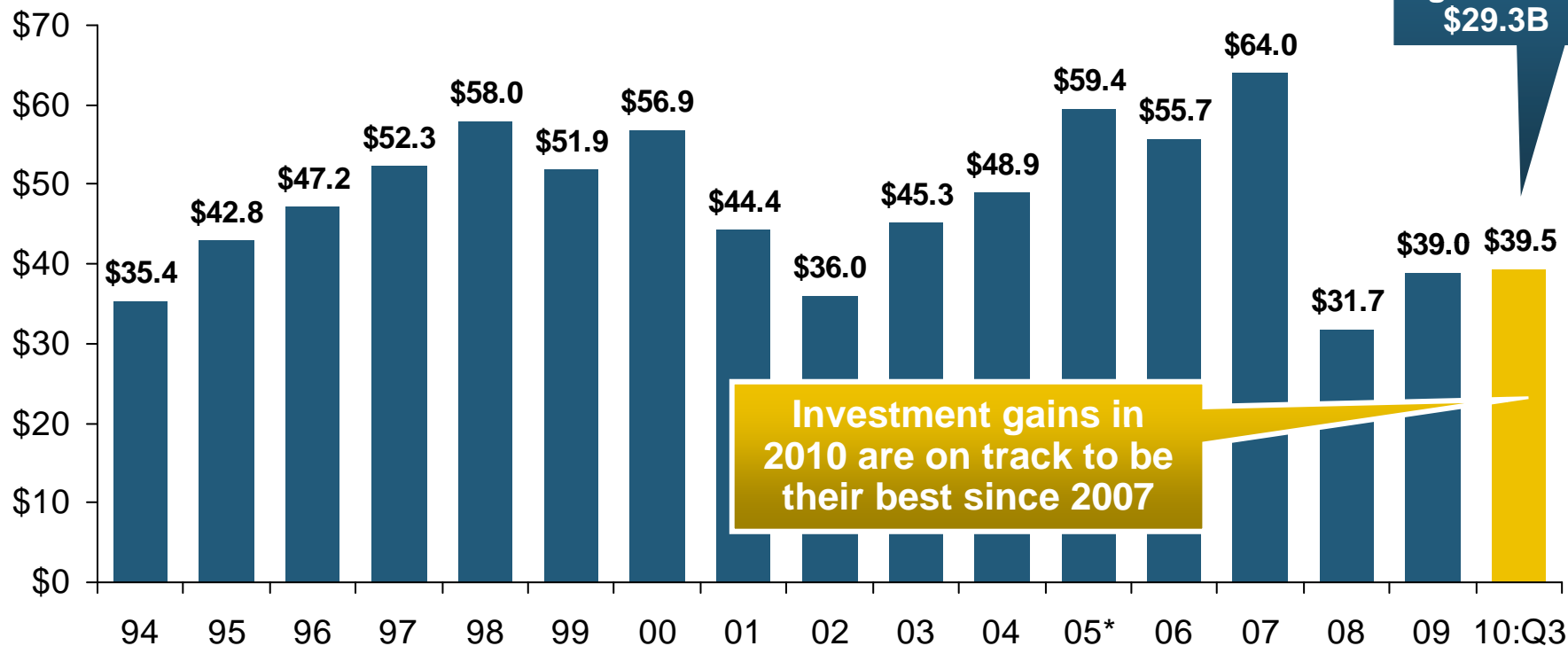


INVESTMENTS: THE NEW REALITY

**Investment Performance is a
Key Driver of Profitability
*Does It Influence
Underwriting or Cyclicalities?***

Property/Casualty Insurance Industry Investment Gain: 1994–2010:Q3¹

(\$ Billions)



2009:Q3
gain was
\$29.3B

Investment gains in
2010 are on track to be
their best since 2007

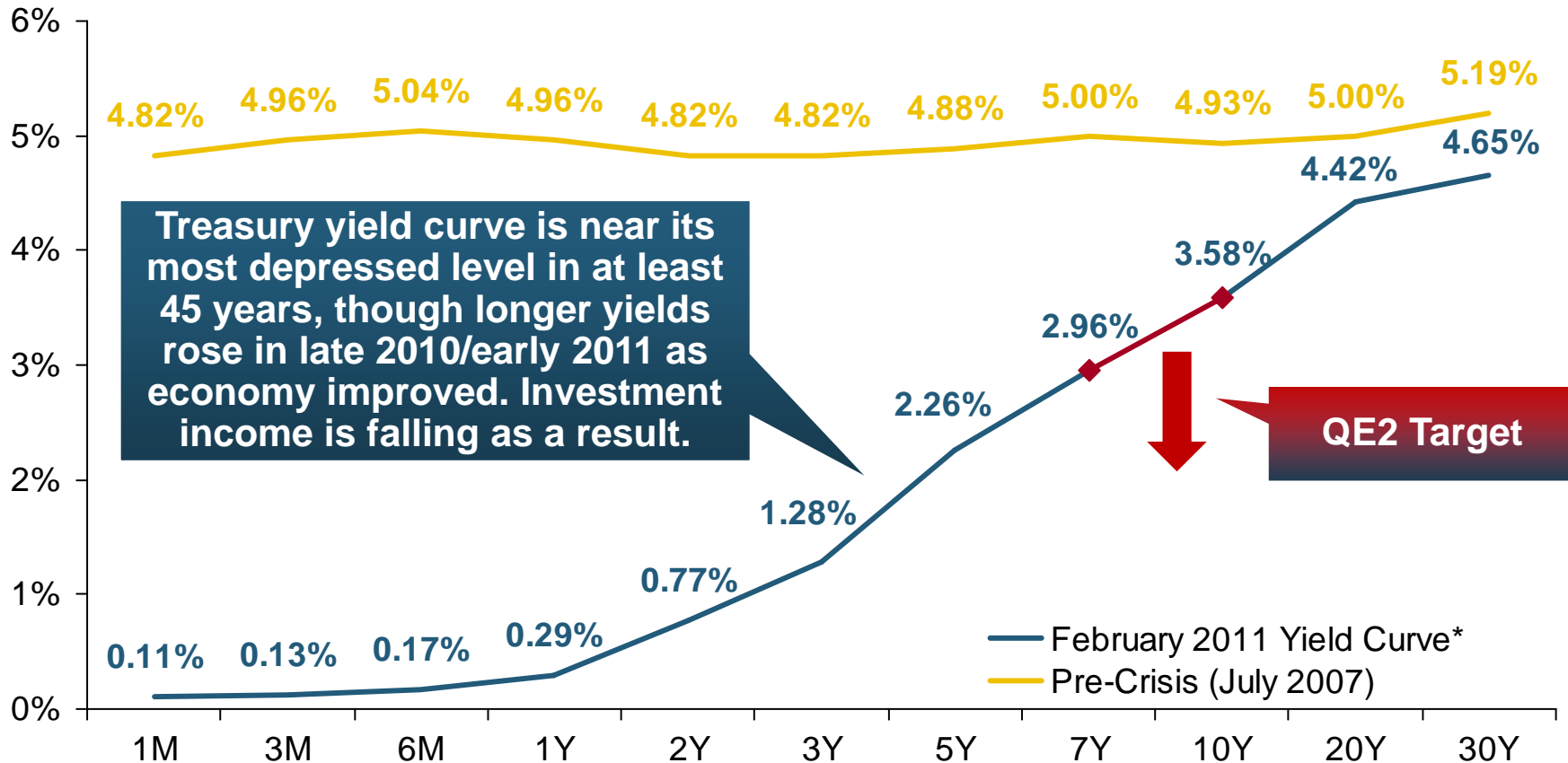
In 2008, Investment Gains Fell by 50% Due to Lower Yields and Nearly \$20B of Realized Capital Losses
2009 Saw Smaller Realized Capital Losses But Declining Investment Income
Investment Gains Recovered Significantly in 2010

¹ Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

* 2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.

Treasury Yield Curves: Pre-Crisis (July 2007) vs. February 2011



Treasury yield curve is near its most depressed level in at least 45 years, though longer yields rose in late 2010/early 2011 as economy improved. Investment income is falling as a result.

QE2 Target

The Fed's Announced Intention to Pursue Additional Quantitative Easing Could Depress Rates in the 7 to 10-Year Maturity Range through June

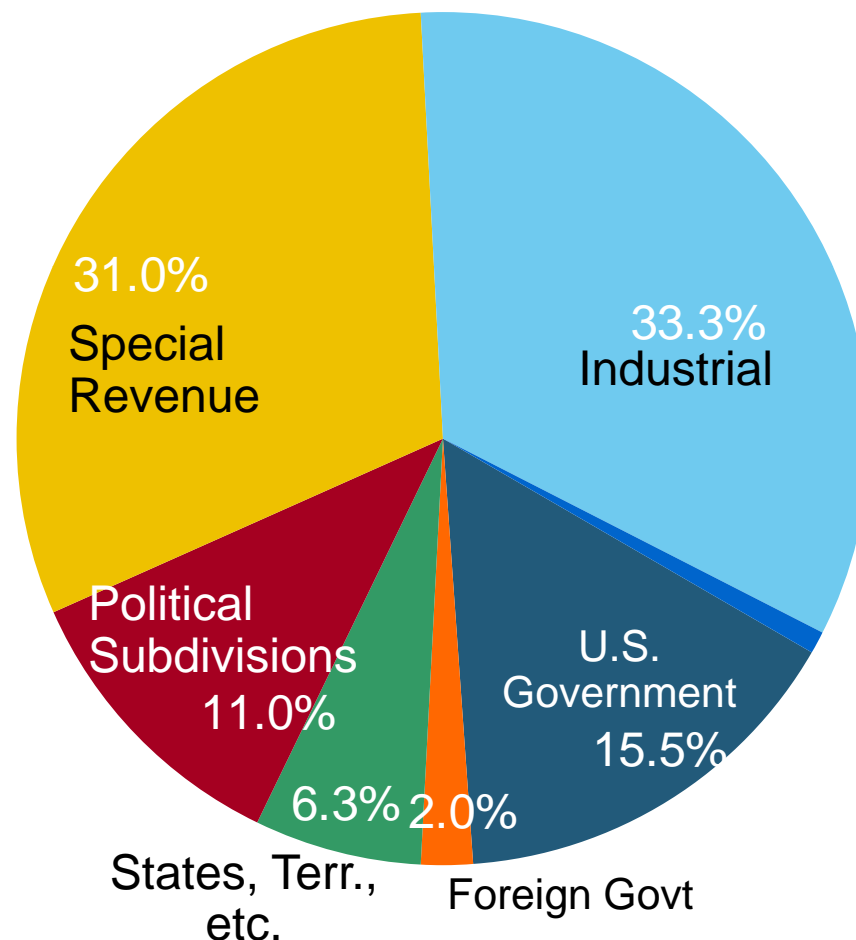
2011 Financial Overview

About Half of the P/C Insurance Industry's Bond Investments Are in Municipal Bonds

Bond Investment Facts as of 12/31/09

- Investments in "Political Subdivision [of states]" bonds were \$102.5 billion
- Investments in "States, Territories, & Possessions" bonds were \$58.9 billion
- Investments in "Special Revenue" bonds were \$288.2 billion
- All state, local, and special revenue bonds totaled 48.2% of bonds, about 35.7% of total invested assets

As of December 31, 2009

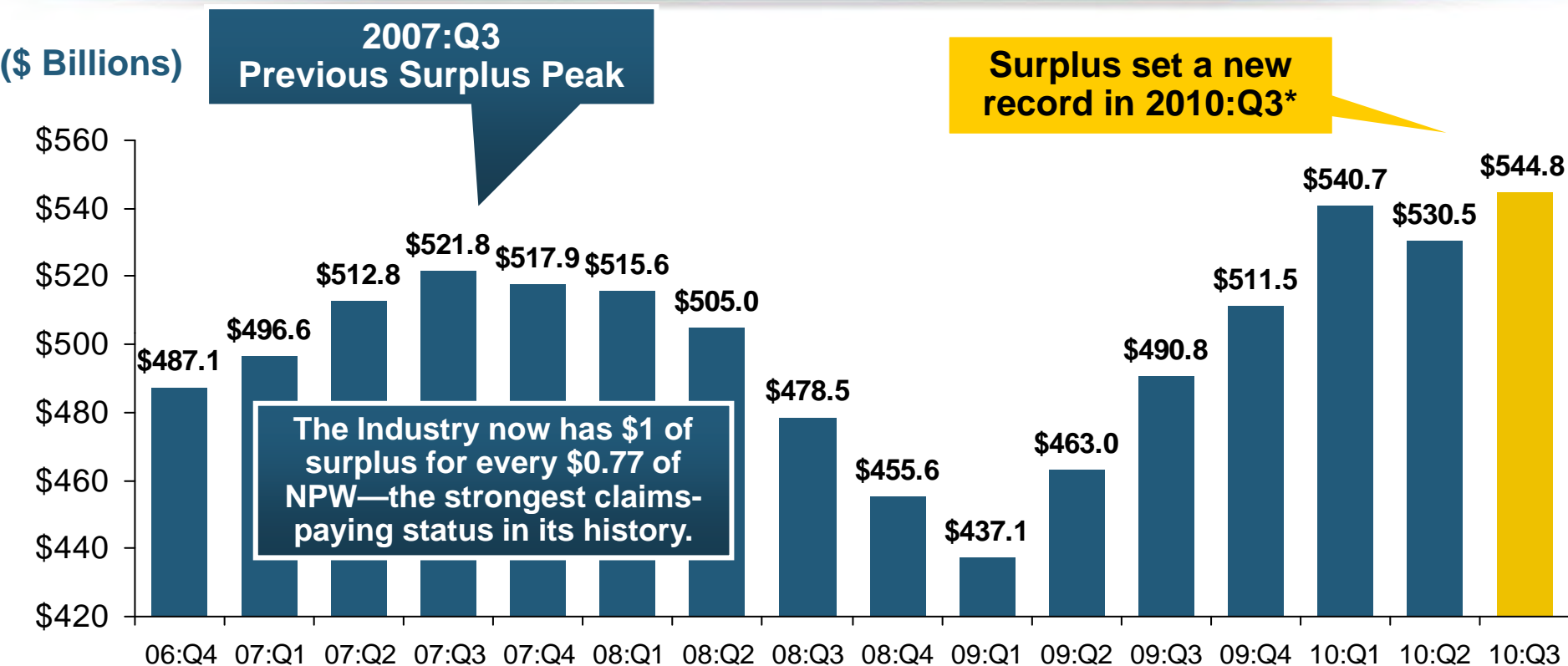


CAPITAL MANAGEMENT & LEVERAGE

**Excess Capital is a Major Obstacle
to a Market Turn;**

**Capital Management Decisions Will
Impact Market Direction**

Policyholder Surplus, 2006:Q4–2010:Q3



Quarterly Surplus Changes Since 2007:Q3 Peak

09:Q1: -\$84.7B (-16.2%)

10:Q1: +\$18.9B (+3.6%)

09:Q2: -\$58.8B (-11.2%)

10:Q2: +\$8.7B (+1.7%)

09:Q3: -\$31.0B (-5.9%)

10:Q3: +\$23.0B (+4.4%)

09:Q4: -\$10.3B (-2.0%)

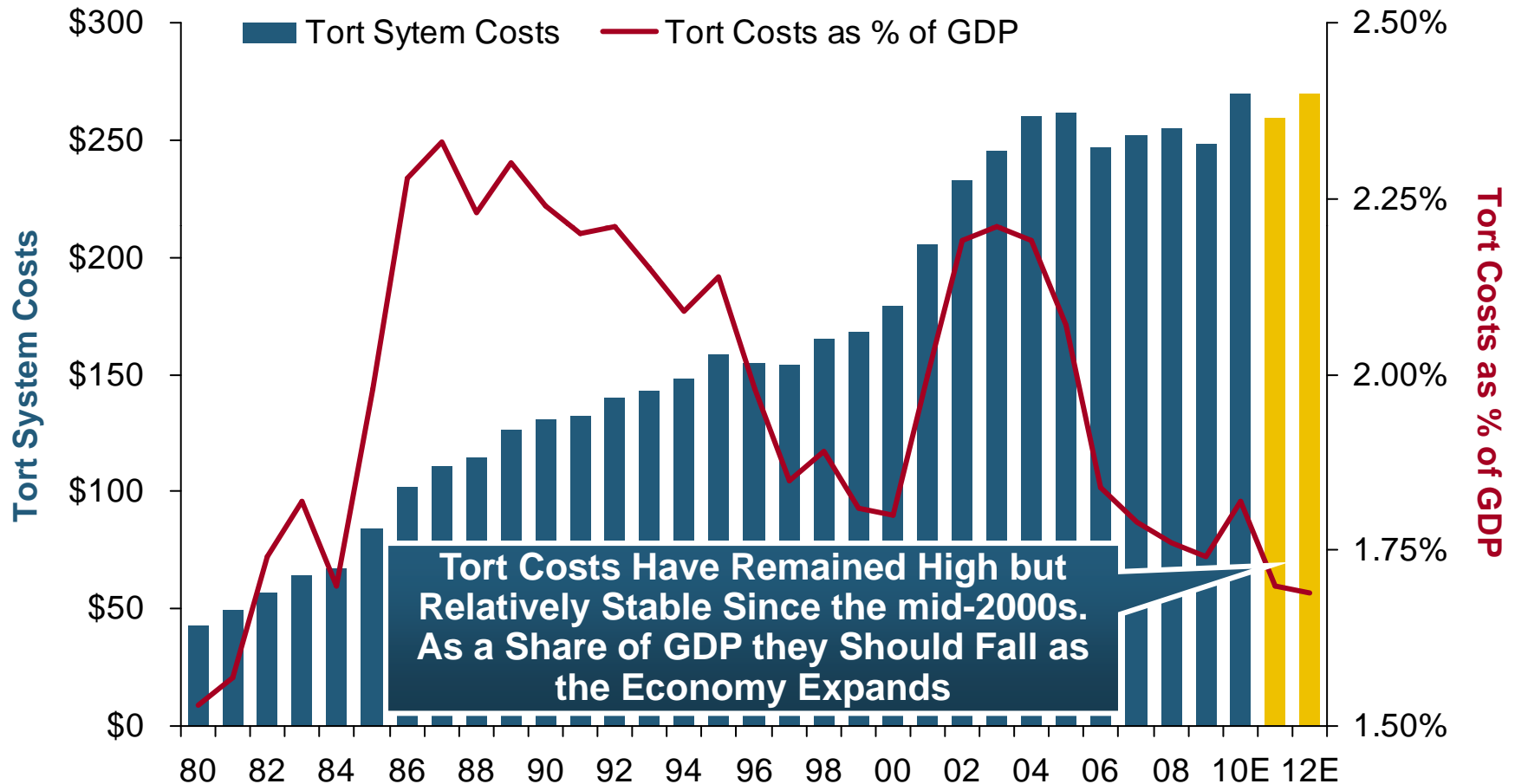
*Includes \$22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business in early 2010.

Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

Over the Last Three Decades, Total Tort Costs as a % of GDP Appear Somewhat Cyclical

(\$ Billions)



Sources: Towers Watson, 2010 Update on US Tort Cost Trends, Appendix 1A

Insurance Information Institute Online:

www.iii.org

*Thank you for your time
and your attention!*

Twitter: twitter.com/bob_hartwig