



# Overview & Outlook for the P/C Insurance Industry: *Focus on Hawaii Markets*

Hawaii Insurers Council Annual Meeting  
Ko Olina, HI  
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***Download at [www.iii.org/presentations](http://www.iii.org/presentations)***

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- **Review of Recent Events**
  - ◆ What in the World is Going On?
- **Summary of P/C Financial Performance**
- **Catastrophe Loss Developments & Trends**
  - ◆ Global
  - ◆ US
- **Will the Market Turn? Four Necessary Criteria:**
  - ◆ Underwriting Loss Trends
  - ◆ Capital/Capacity
  - ◆ Reinsurance Markets
  - ◆ Pricing Discipline
- **Other Contributing Factors to the Underwriting Cycle**
  - ◆ Investment Environment
  - ◆ Tort/Casualty Environment
  - ◆ Inflation
  - ◆ Economic Environment

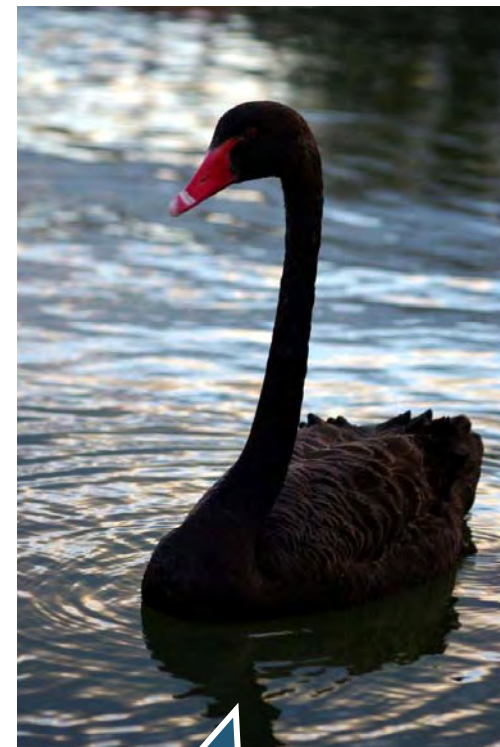
# What in the World Is Going On?

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

***What Are the Implications for  
Insurance and Risk Management?***

# Uncertainty, Risk and Fear Abound

- **Global Economic Slowdown**
- **US Debt and Budget Crisis and S&P Downgrade**
- **Echoes of the Financial Crisis**
- **Housing Crisis**
- **Persistently High Unemployment**
- **European Sovereign Debt, Bank & Currency Crises**
- **Japan, New Zealand, Haiti, Chile Earthquakes**
- **Nuclear Fears**
- **Record Tornado, Flooding in the US, Wildfires**
- **Cyber Attacks**
- **Manmade Disasters (e.g., Deepwater Horizon)**
- **Resurgent Terrorism Risk (e.g., Bin Laden Killing)**
- **Political Upheaval in the Middle East**
- **Inflation/Deflation**
- **Runaway Energy & Commodity Prices**
- **Era of Fiscal Austerity**
- **Reshuffling the Global Economic Deck**
- **China Becomes #2 Economy in the World**



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

# Impacts on P/C Insurers of S&P's Downgrade of US Sovereign Debt

- **S&P Downgrade of US Debt Will Have Little Practical Impact**
  - ◆ Solvency, liquidity, claims paying capacity all unaffected
  - ◆ US sovereign debt accounts for 6% (\$80B out of \$1.3 trillion) in invested assets
- **Investors Will Continue to View US Treasury Securities as the Safest Investment in the World**
  - ◆ Other bond raters (Moody's, Fitch) affirmed top credit ratings for US
  - ◆ US bond yields *fell* in the days after S&P issued its initial warning
  - ◆ Evidence suggests that investors' asset of choice during "flight to safety" remains US debt
- **Risk Charge/Weights for US Debt Held by Finl. Firms Won't Change**
  - ◆ Federal bank regulators have already stated risk weights won't change
  - ◆ Extremely unlikely state insurance regulators would do anything different
  - ◆ NAIC (Aug. 7) "*There is no impact on insurer investments in U.S. government and government-related securities from the actions recently taken by the rating agencies. Risk-based capital and asset valuation reserves are unaffected.*"
- **Interest Rates on US Debt Unlikely to Rise Due to Downgrade**
  - ◆ Insurers should see little or no need to mark down value of bonds
- **Market for US Debt Will Remain Largest & Most Liquid in the World**
  - ◆ Downgrade poses no liquidity or solvency issues

# What is Going On in the US and Global Financial Markets?

- **S&P Downgrade Poured Gasoline on a Fire that Was Already Burning**
  - ◆ Downgrade didn't tell us anything we didn't already know about US finances
- 1. **Realization that US Economy is Slowing**
  - ◆ Q1 GDP growth revised downward to 0.4%; Q2 growth was just 1.0%
  - ◆ Job growth has been anemic for several months and unemployment remains high at 9.1% in August
  - ◆ Stock market sell-off was driven by fear and technical factors (e.g., margin calls, hedge fund mass selling)
- 2. **Need for a More Comprehensive Solution to Europe's Debt Problems**
  - ◆ Solution developed for Greece, Italy, Spain, Ireland may be too small
  - ◆ Difficulties in managing multinational institutions and economic policies
  - ◆ ECB and individual member EU countries not all on same page
  - ◆ Solution: Unified strategy similar to TARP; Monetary easing
- 3. **View that Washington is Dysfunctional and "Rudderless"**
  - ◆ Lack of coherent, consistent medium and long term plan to deal with basic structural issues in the US economy (debt, taxes, employment, regulation, etc.)
- 4. **Economic Slowdown in Emerging Markets**
  - ◆ China, other economies less able to stimulate global economy than in 2008

# Déjà Vu? Lehman II?

## Is This 2008 All Over Again?

### Why Today is Not 2008 All Over Again

- The Situation Today is Very, Very Different from 2008
- Credit Markets Are Not Seizing; Some Contraction in Europe
- Bank Balance Sheets Are in Much Stronger Shape
  - ◆ Capital up, charge offs falling
- We Will Not Experience the Collapses/Near Collapses Like in 2008
  - ◆ No repeat of Lehman, AIG, Washington Mutual, Wachovia, Countrywide Financial
- Some Additional Regulatory Controls Are Now Place

### What Would Be Helpful Now?

- Long-Term Fiscal and Monetary Policy Direction
- Fed on Aug. 9 stated rates would remain low “*at least through mid-2013*”
  - ◆ This is not only a signal that borrowing costs will remain low over an extended period of time and that inflation will remain muted; Also tells investors that they’ll need to take on risk in order to earn returns in the market. Should be bullish for stocks.
  - ◆ Congress and the Administration need to remove regulatory and tax uncertainty ASAP and drive a pro-growth agenda

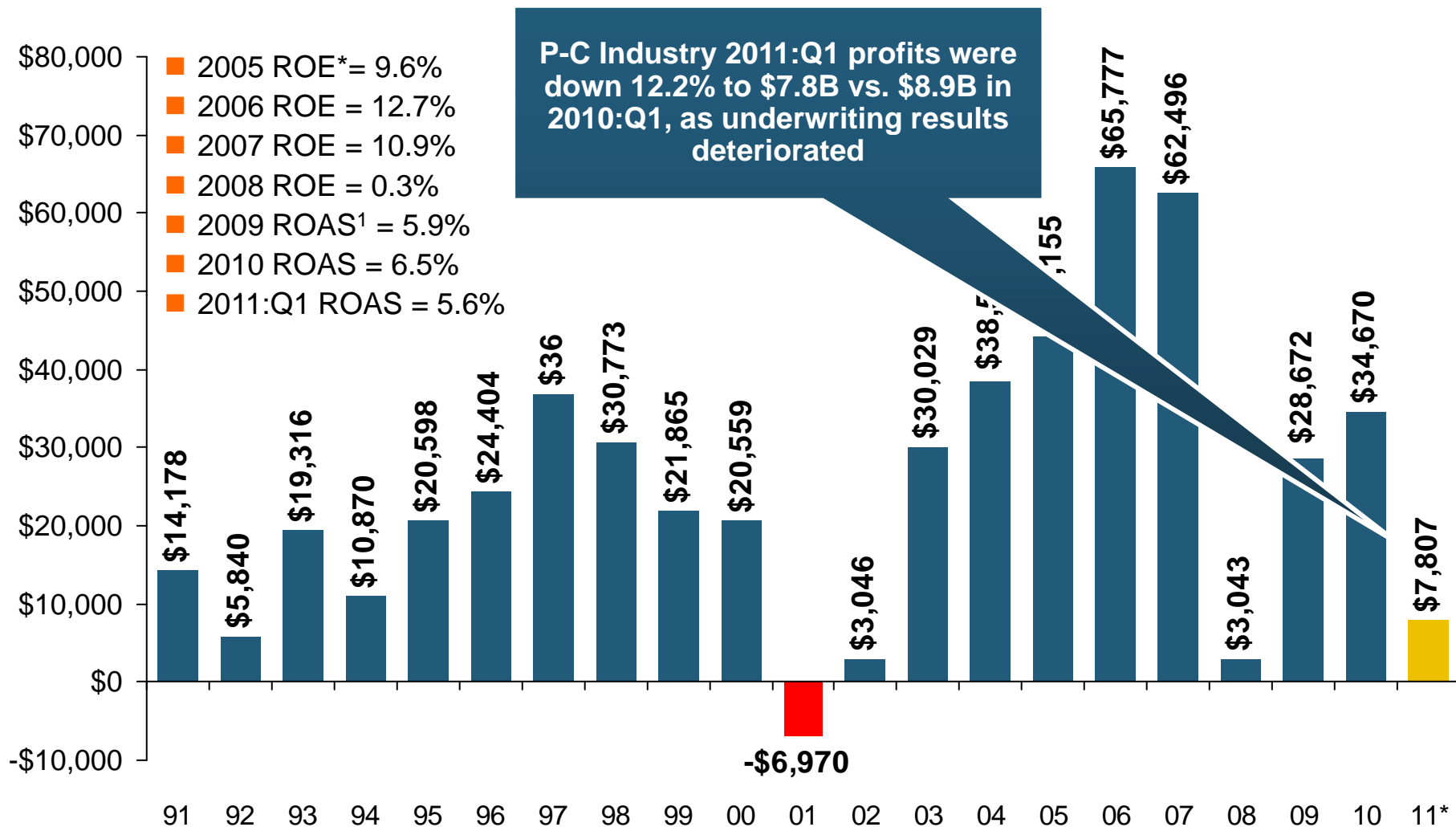


# P/C Insurance Industry Financial Overview

**Profit Recovery Will Be Set  
Back by High CATs, Low  
Interest Rates, Diminishing  
Reserve Releases**



# P/C Net Income After Taxes 1991–2011:Q1 (\$ Millions)



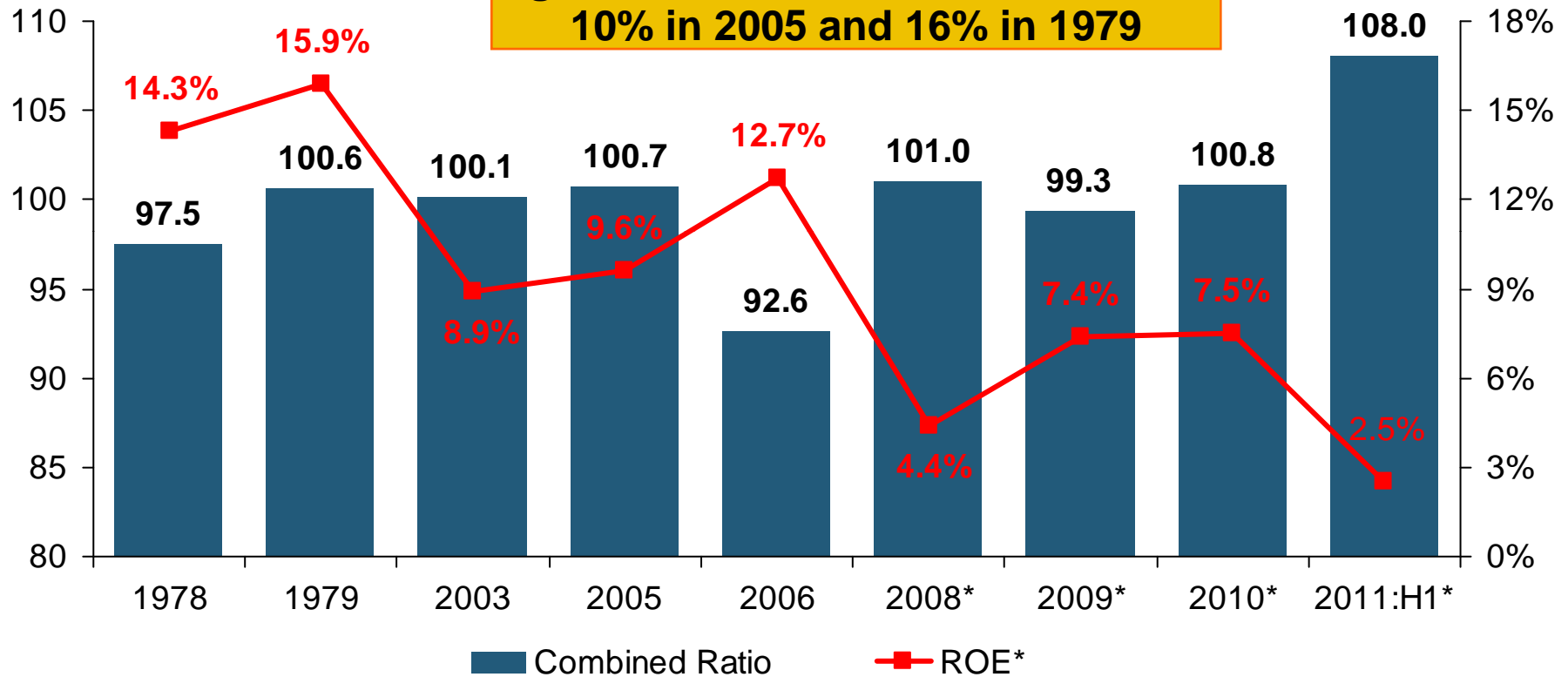
\* ROE figures are GAAP; <sup>1</sup>Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 6.5% ROAS for 2011:Q1, 7.5% for 2010 and 7.4% for 2009.

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

# A 100 Combined Ratio Isn't What It Once Was: Investment Impact on ROEs

## Combined Ratio / ROE

**A combined ratio of about 100 generated ~7.5% ROE in 2009/10, 10% in 2005 and 16% in 1979**

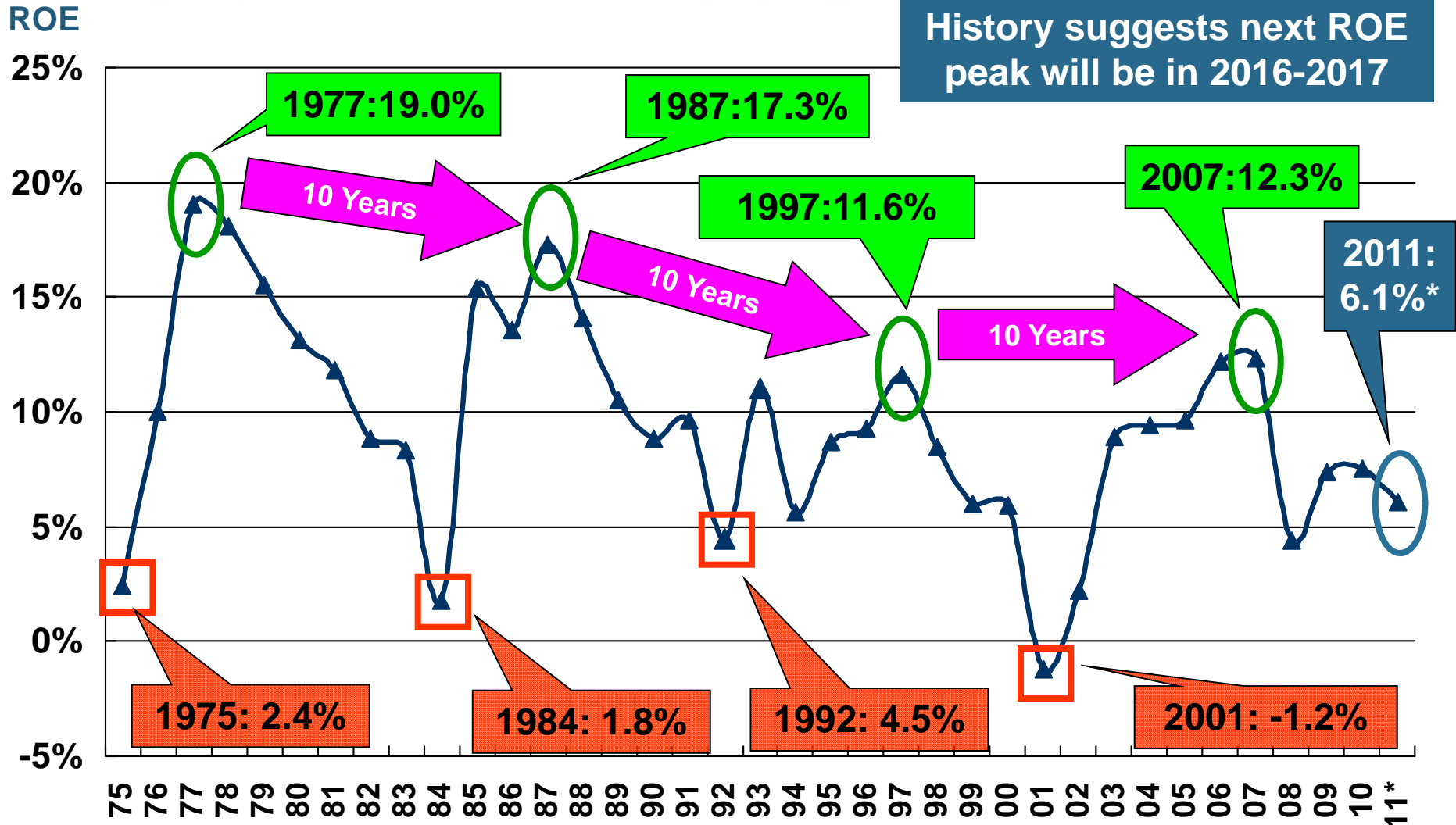


**Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs**

\* 2009 and 2010 figures are return on average statutory surplus. 2008 -2011 figures exclude mortgage and financial guaranty insurers. 2011 figure is estimate through first half.

Source: Insurance Information Institute from A.M. Best and ISO data.

# Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2011\*



\*Profitability = P/C insurer ROEs are I.I.I. estimates. 2011 figure is an estimate based on annualized ROAS for Q1 data.

Note: Data for 2008-2011 exclude mortgage and financial guaranty insurers.

Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

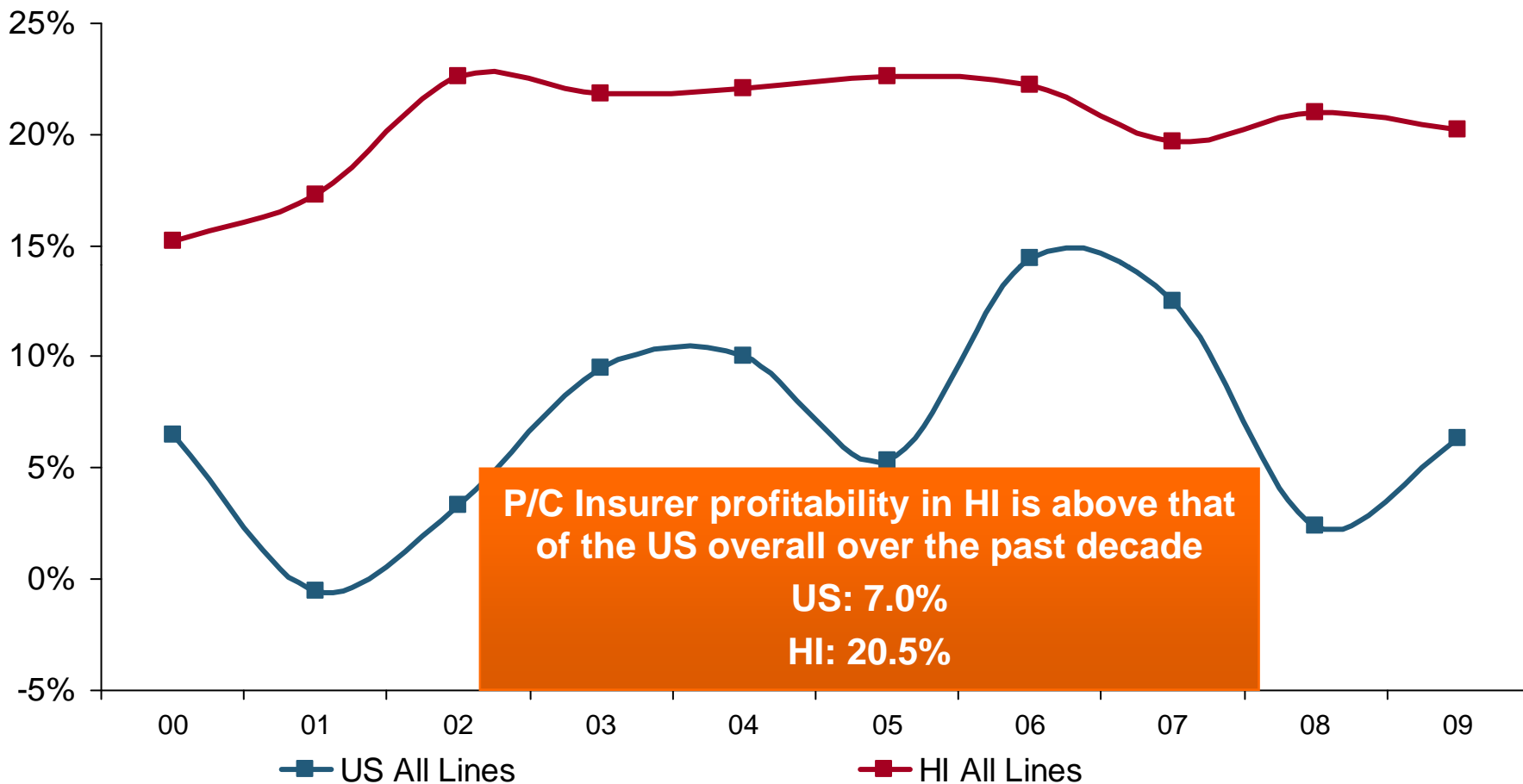


# Profitability and Growth in Hawaii P/C Insurance Markets

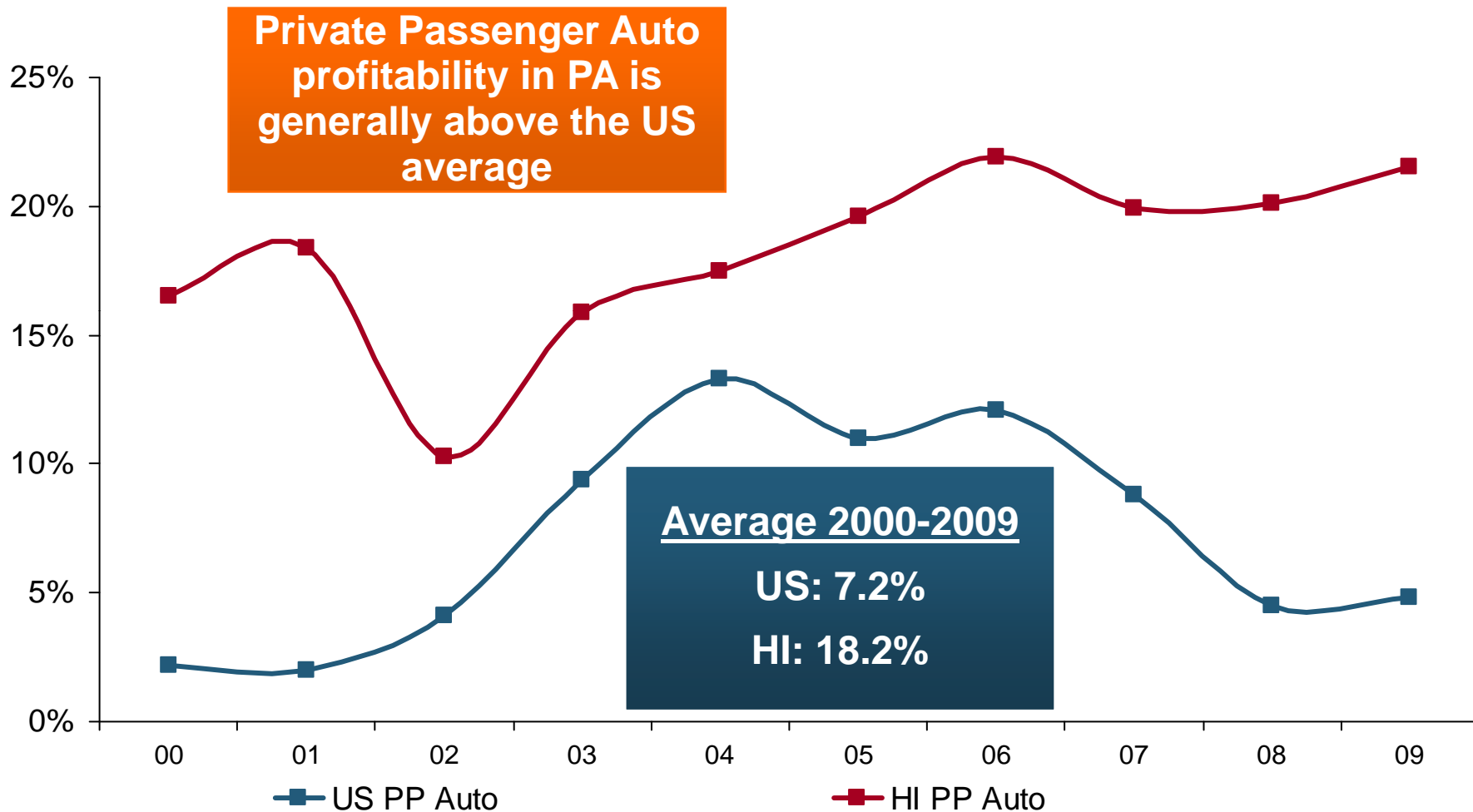
## Analysis by Line and Nearby State Comparisons

# RNW All Lines: HI vs. U.S., 2000-2009

(Percent)

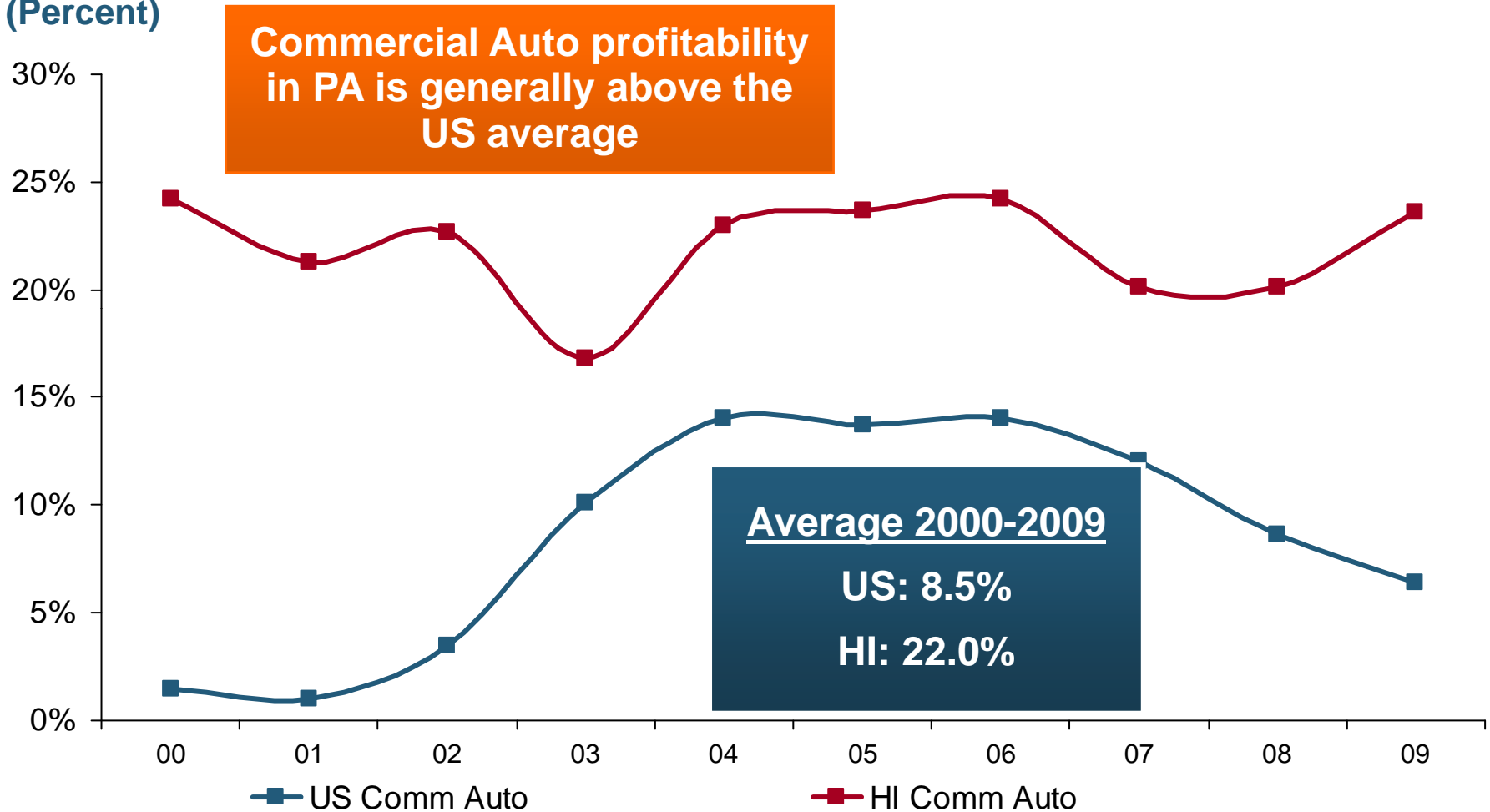


# RNW PP Auto: HI vs. U.S., 2000-2009

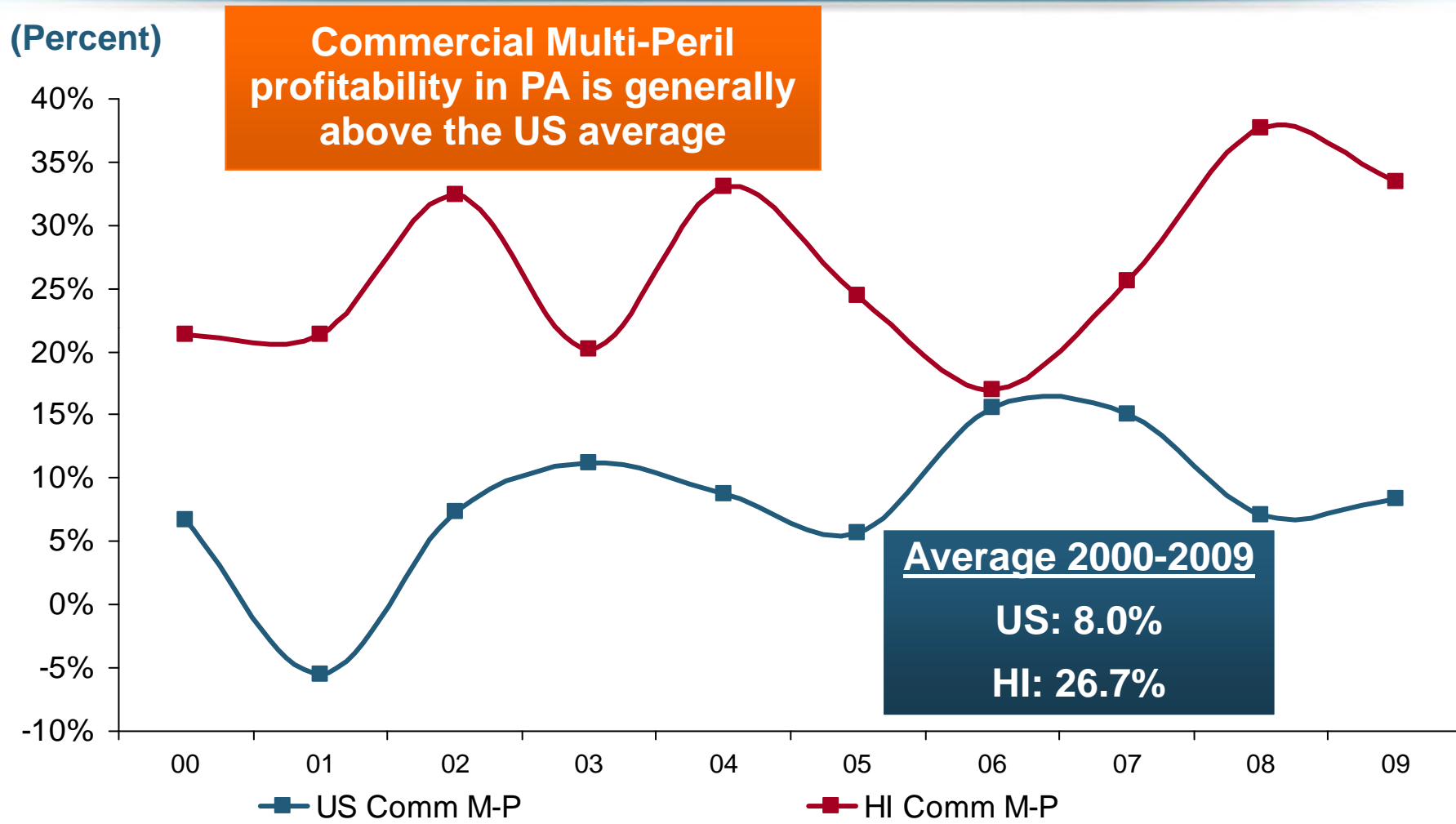


# RNW Comm. Auto: HI vs. U.S., 2000-2009

(Percent)



# RNW Comm. Multi-Peril: HI vs. U.S., 2000-2009





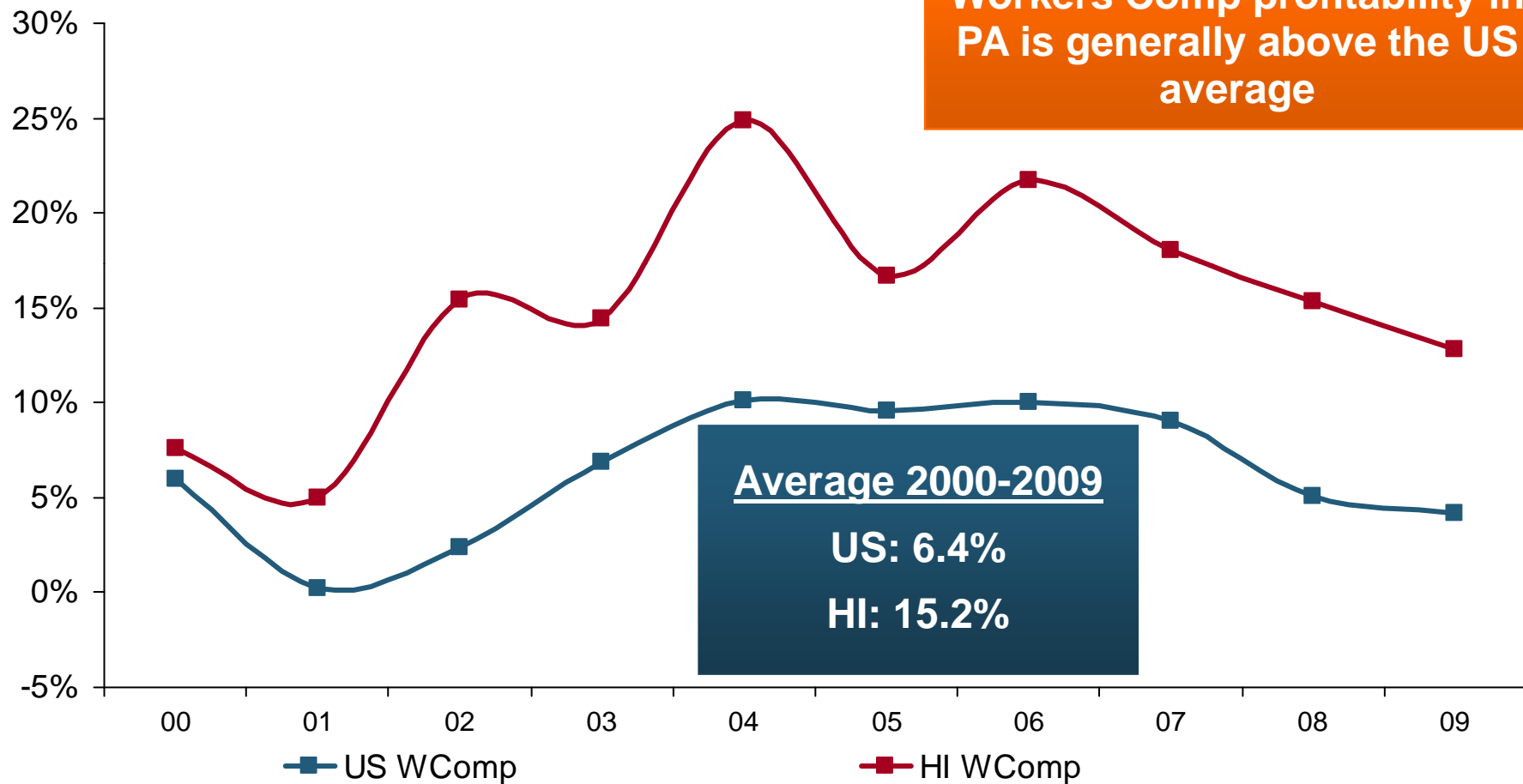
# RNW Homeowners: HI vs. U.S., 2000-2009

(Percent)



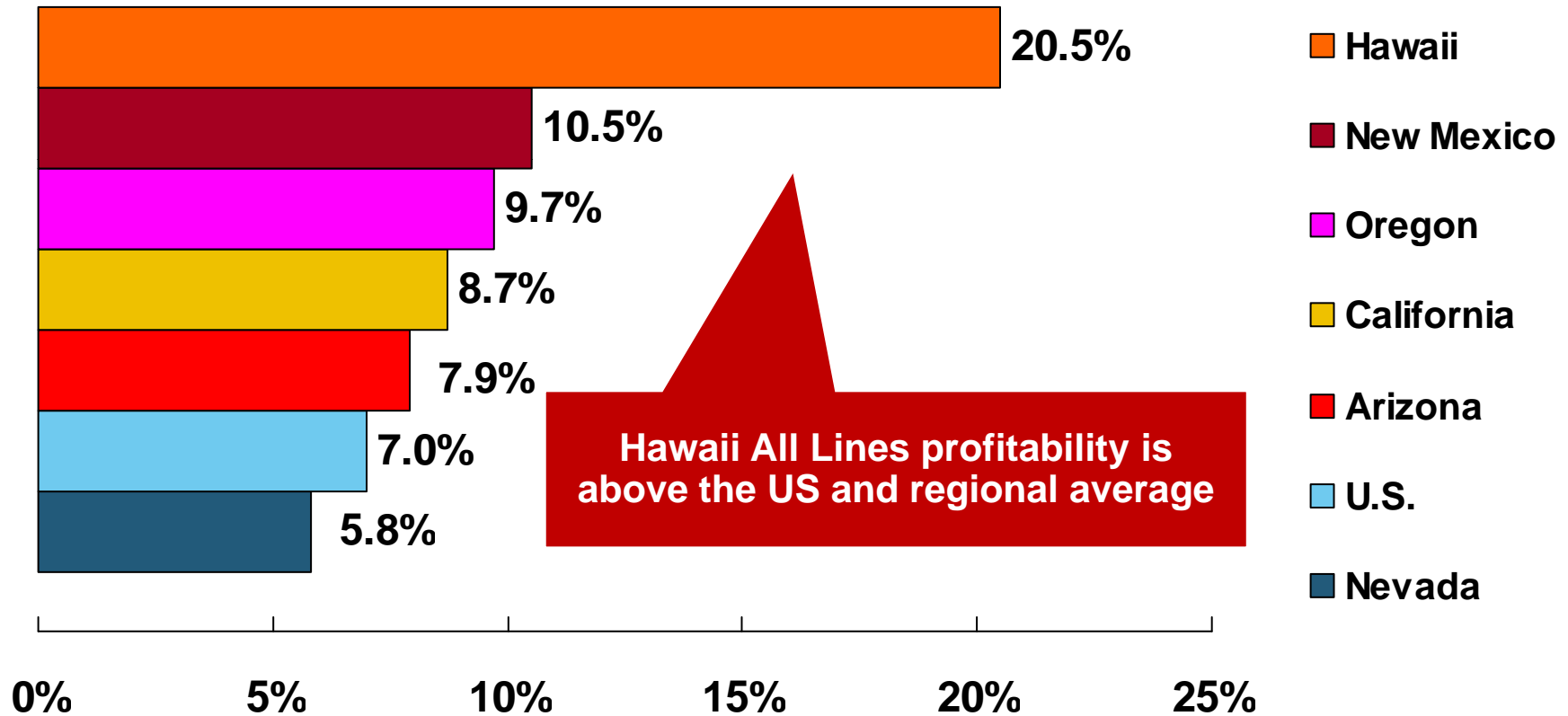
# RNW Workers Comp: HI vs. U.S., 2000-2009

(Percent)



# All Lines: 10-Year Average RNW HI & Nearby States

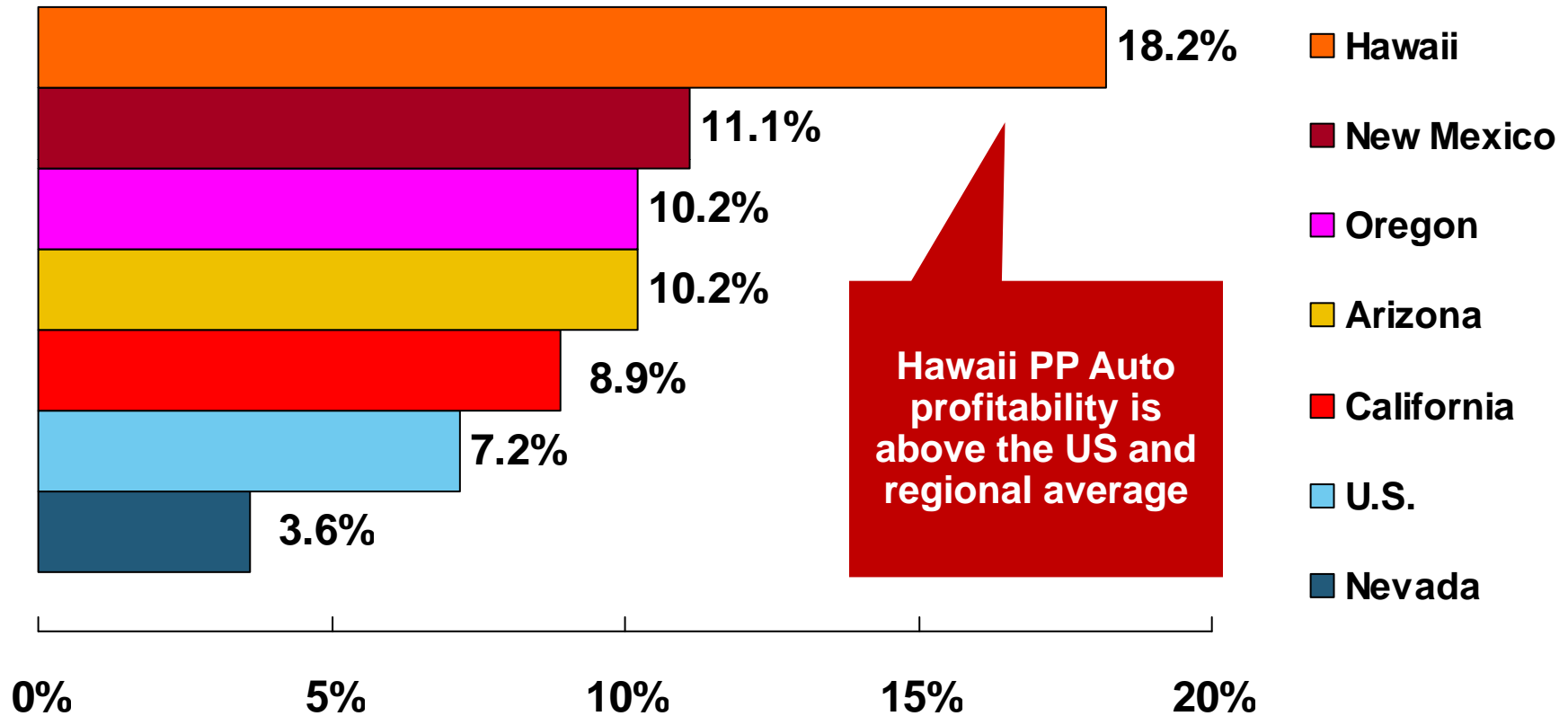
2000-2009



Source: NAIC, Insurance Information Institute

# PP Auto: 10-Year Average RNW HI & Nearby States

2000-2009



Source: NAIC, Insurance Information Institute

# Top Ten Most Expensive And Least Expensive States For Automobile Insurance, 2008 (1)

Rank	Most expensive states	Average expenditure	Rank	Least expensive states	Average expenditure
1	D.C.	\$1,126	1	North Dakota	\$503
2	Louisiana	1,105	2	Iowa	519
3	New Jersey	1,081	3	South Dakota	520
4	Florida	1,055	4	Nebraska	547
5	New York	1,044	5	Idaho	562
6	Delaware	1,007	6	Kansas	576
7	Rhode Island	986	7	Wisconsin	581
8	Nevada	970	8	North Carolina	595
9	Connecticut	950	9	Maine	600
10	Maryland	922	10	Indiana	612

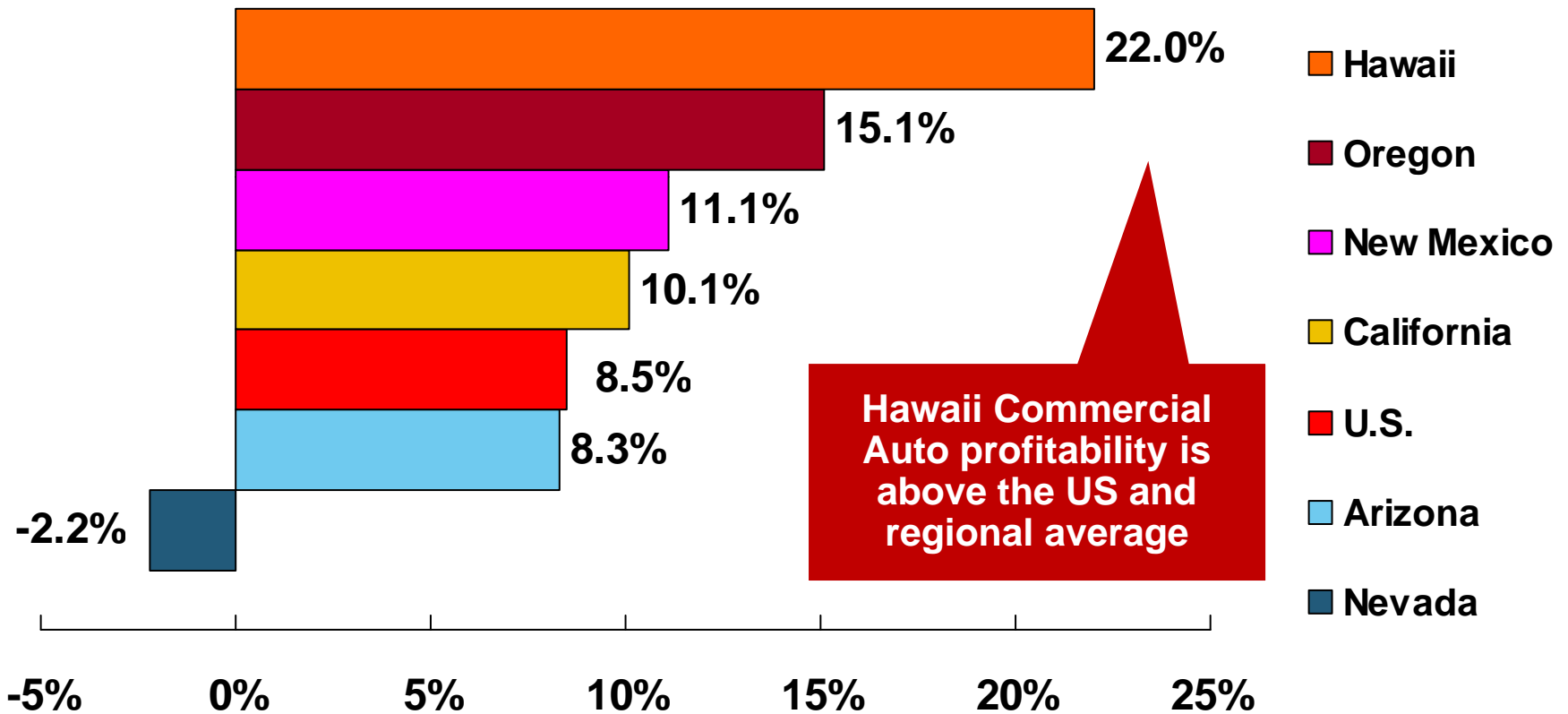
***Hawaii ranked 18th in 2008, with an average expenditure for auto insurance of \$816.***

(1) Based on average automobile insurance expenditures.

Source: © 2010 National Association of Insurance Commissioners.

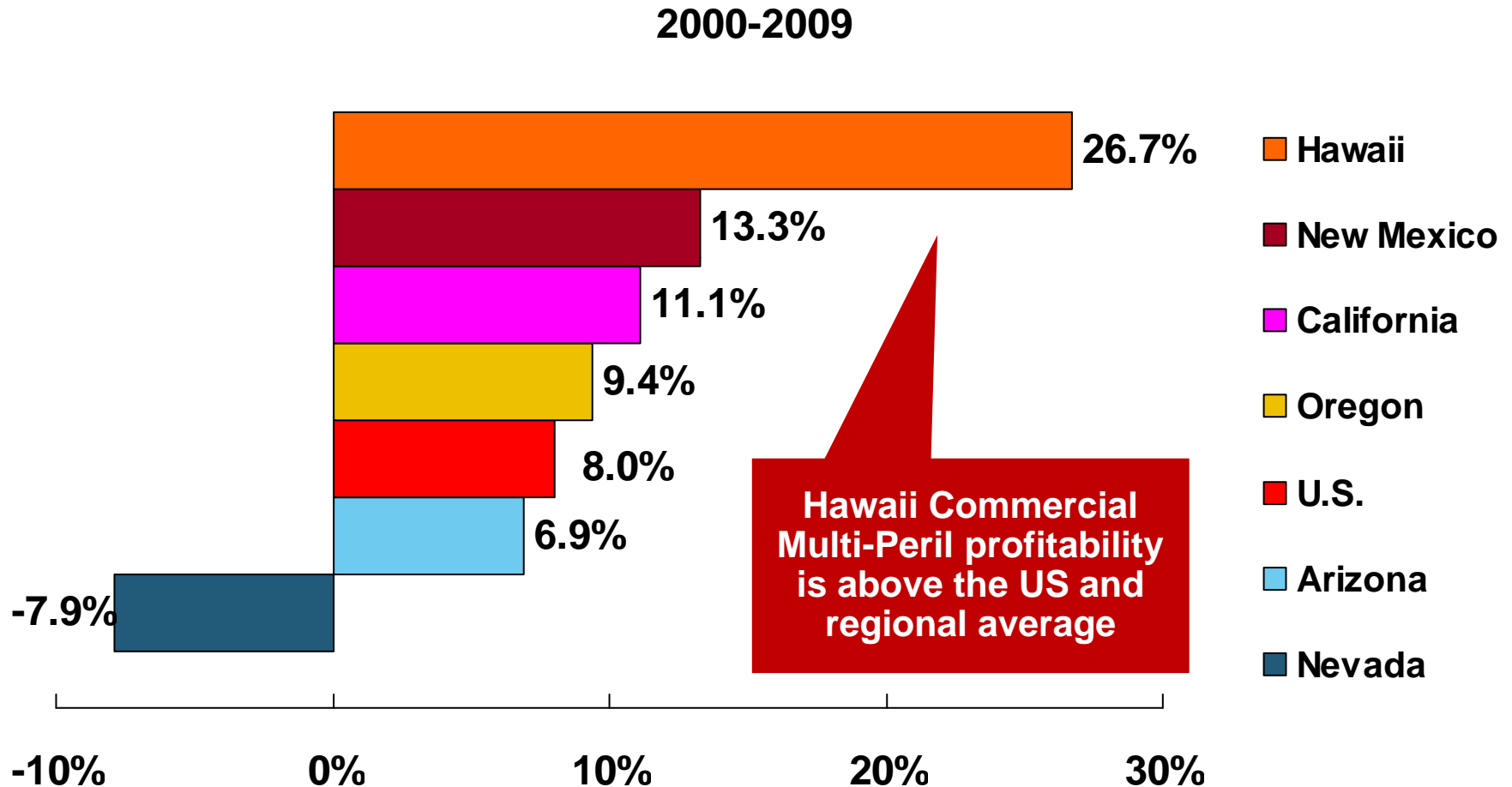
# Comm. Auto: 10-Year Average RNW HI & Nearby States

2000-2009



Source: NAIC, Insurance Information Institute

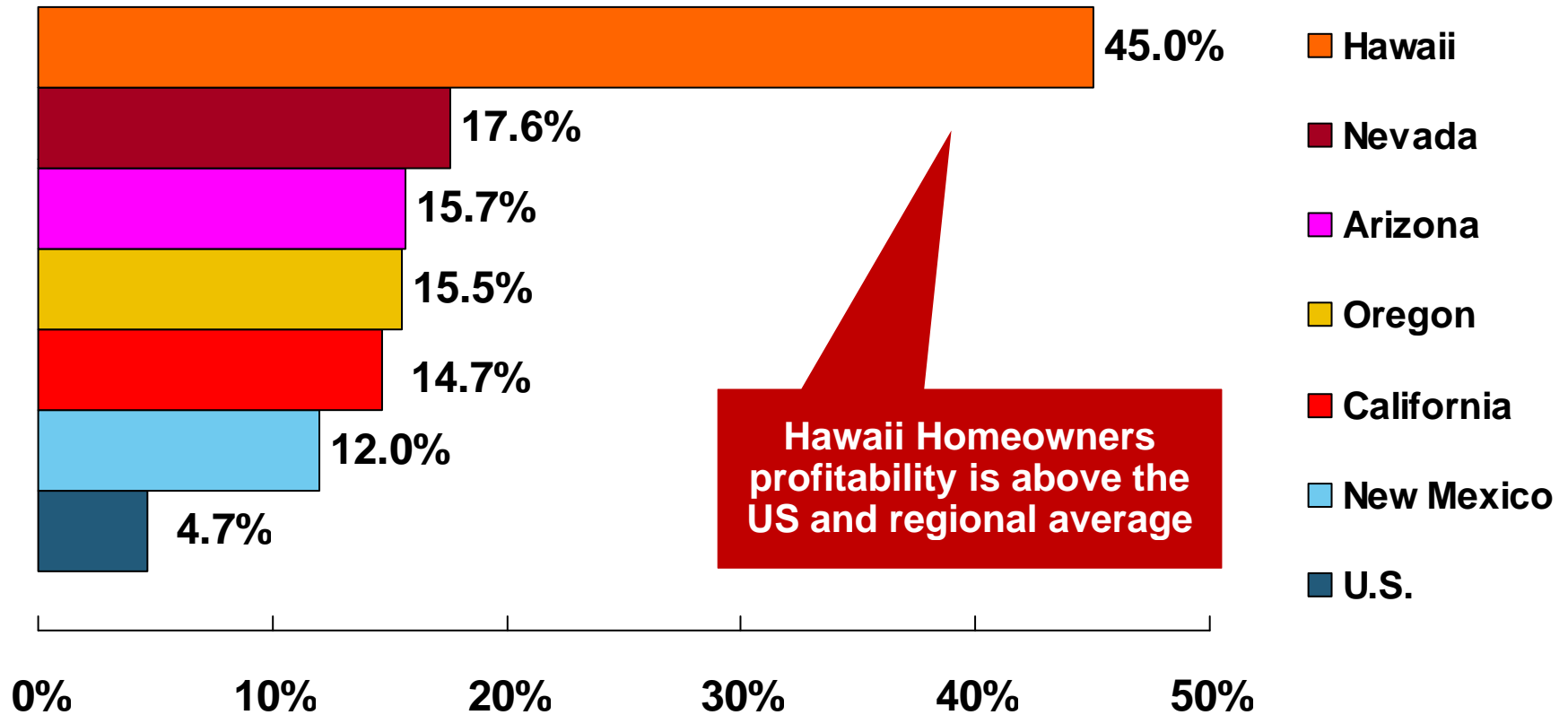
# Comm. M-P: 10-Year Average RNW HI & Nearby States



Source: NAIC, Insurance Information Institute

# Homeowners: 10-Year Average RNW HI Nearby States

2000-2009



Source: NAIC, Insurance Information Institute



# Top Ten Most Expensive And Least Expensive States For Homeowners Insurance, 2008 (1)

**Hawaii ranked as the 12th most expensive state for homeowners insurance in 2008, with an average expenditure of \$862.**

Rank	Most expensive states	Average expenditure	Rank	Least expensive states	Average expenditure
1	Texas (3)	\$1,460	1	Idaho	\$387
2	Florida (4)	1,390	2	Utah	432
3	Louisiana	1,155	3	Oregon	439
4	Oklahoma	1,048	4	Washington	471
5	Massachusetts	1,026	5	Wisconsin	503
6	New York	983	6	Delaware	535
7	Connecticut	980	7	Ohio	565
8	Mississippi	980	8	Maine	572
9	D.C.	926	9	Pennsylvania	586
10	Kansas	916	10	Kentucky	601

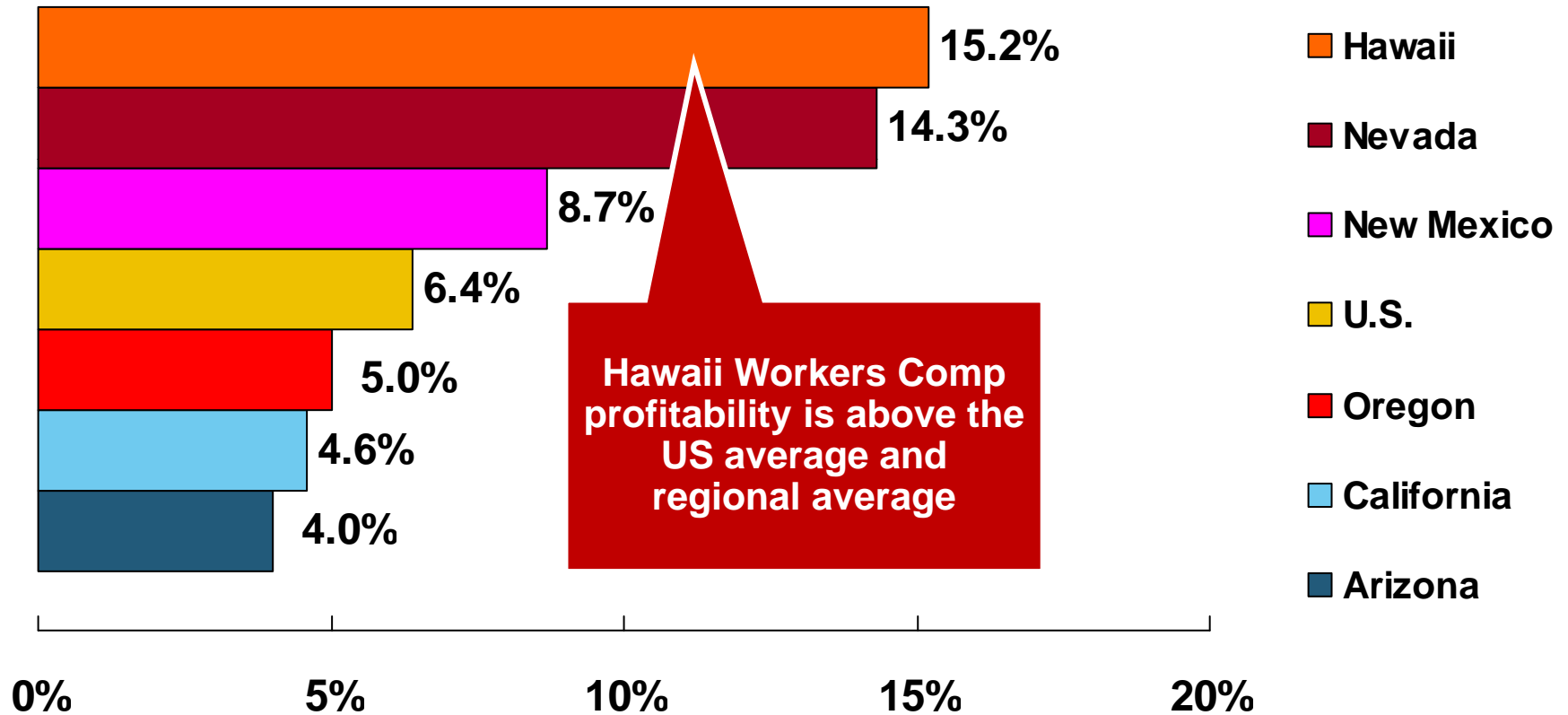
- (1) States with the same premium receive the same rank.
- (2) Based on the HO-3 homeowner package policy for owner-occupied dwellings, 1 to 4 family units. Provides “all risks” coverage (except those specifically excluded in the policy) on buildings and broad named-peril coverage on personal property, and is the most common package written.
- (3) The Texas Department of Insurance developed home insurance policy forms that are similar but not identical to the standard forms.
- (4) Florida data excludes policies written by Citizen’s Property Insurance Corporation, the state’s insurer of last resort, and therefore are not directly comparable to other states.

Note: Average premium=Premiums/exposure per house years. A house year is equal to 365 days of insured coverage for a single dwelling. The NAIC does not rank State Average Expenditures and does not endorse any conclusions drawn from this data.

Source: © 2010 National Association of Insurance Commissioners (NAIC). Reprinted with permission. Further reprint or distribution strictly prohibited without written permission of NAIC.

# Workers Comp: 10-Year Average RNW HI & Nearby States

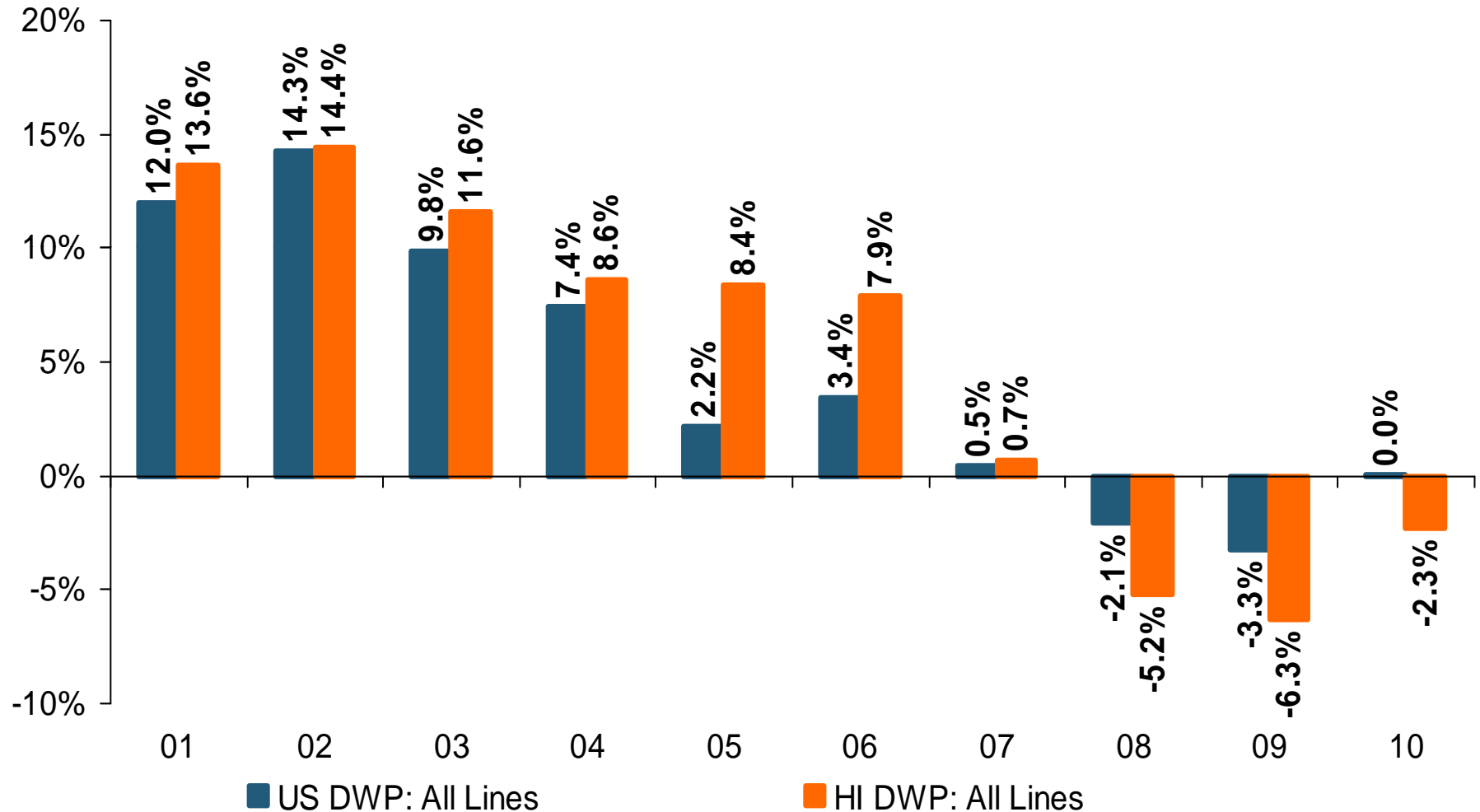
2000-2010



Source: NAIC, Insurance Information Institute

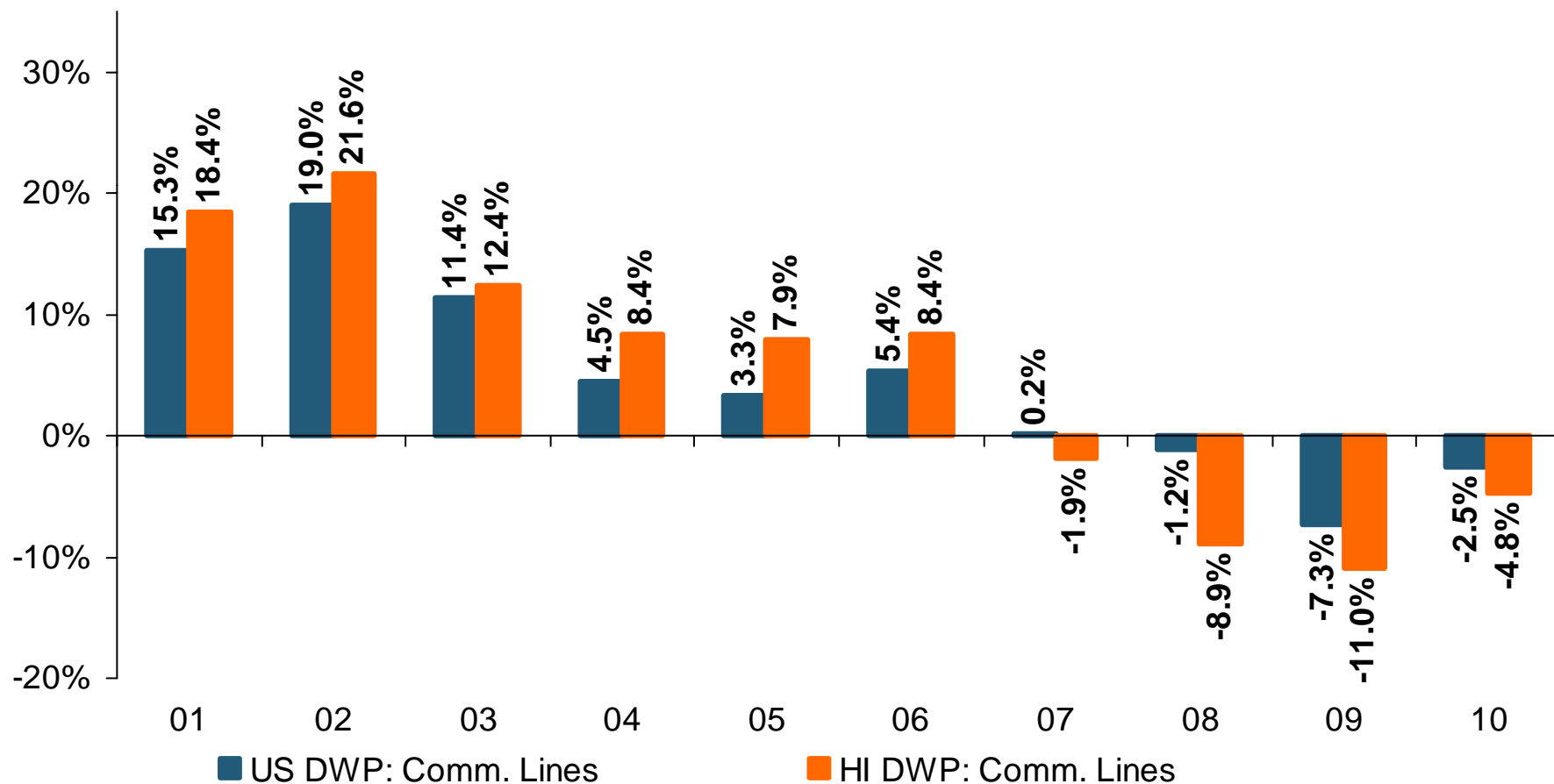
# All Lines DWP Growth: HI vs. U.S., 2001-2010

(Percent)



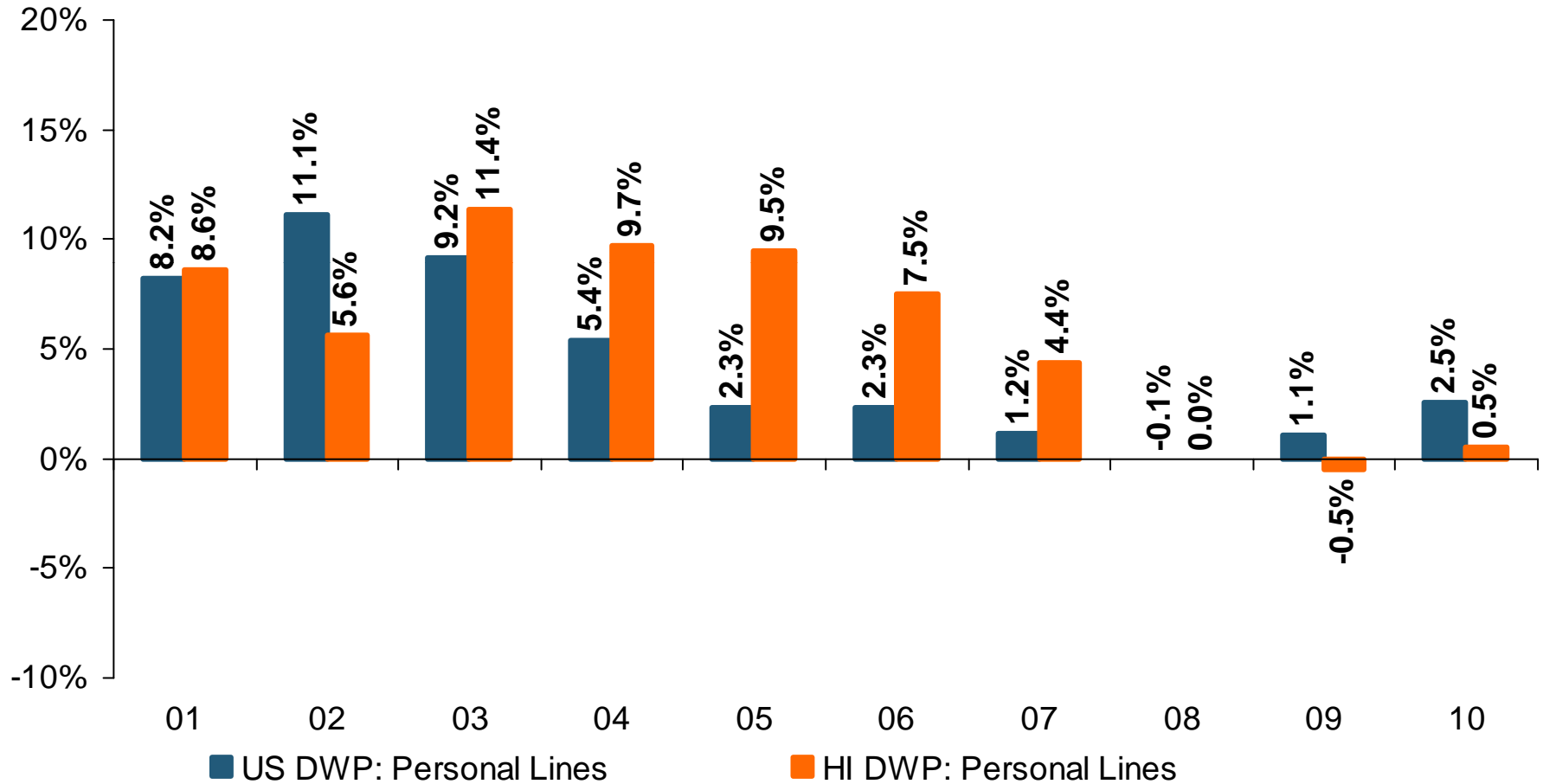
# Comm. Lines DWP Growth: HI vs. U.S., 2001-2010

(Percent)



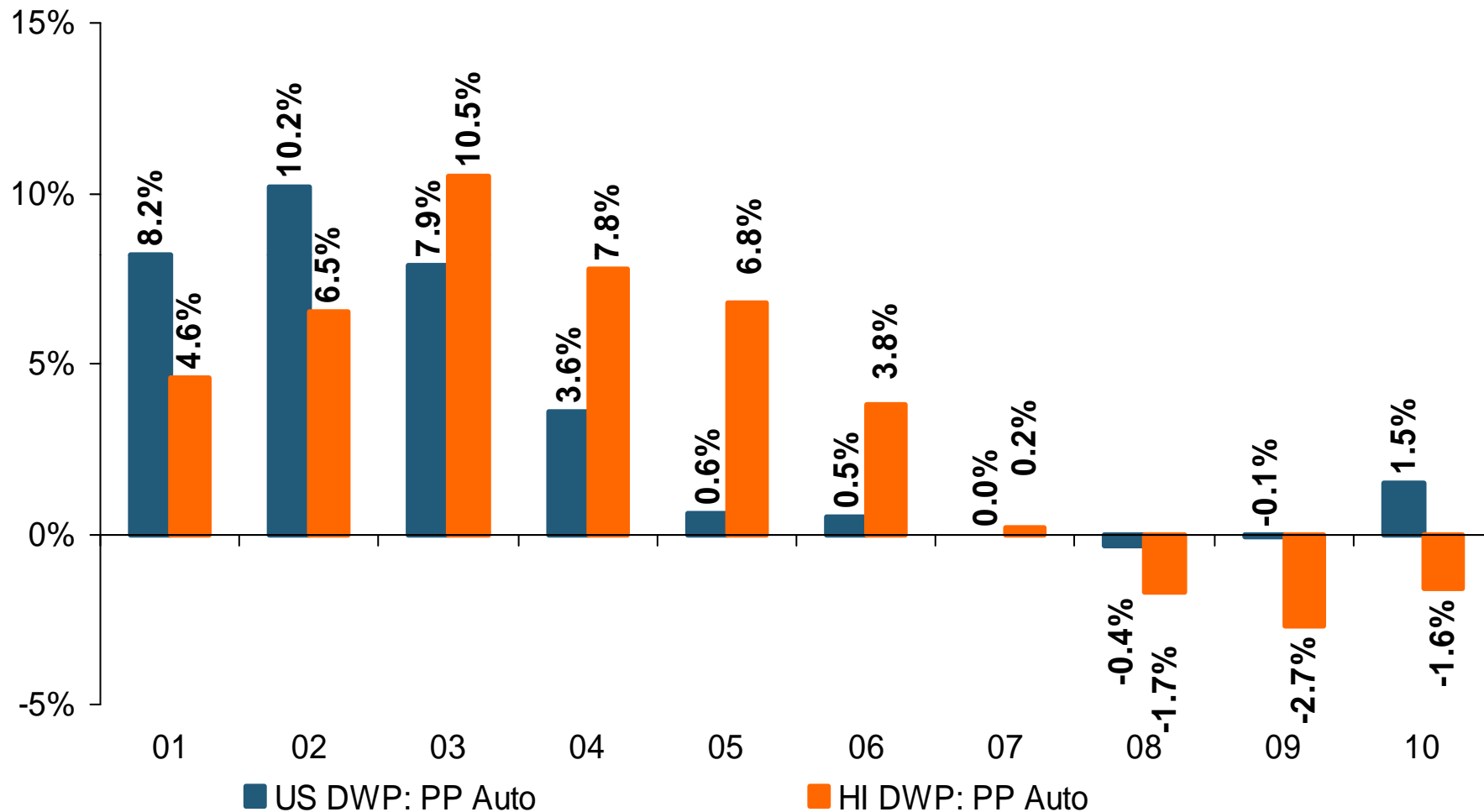
# Personal Lines DWP Growth: HI vs. U.S., 2001-2010

(Percent)



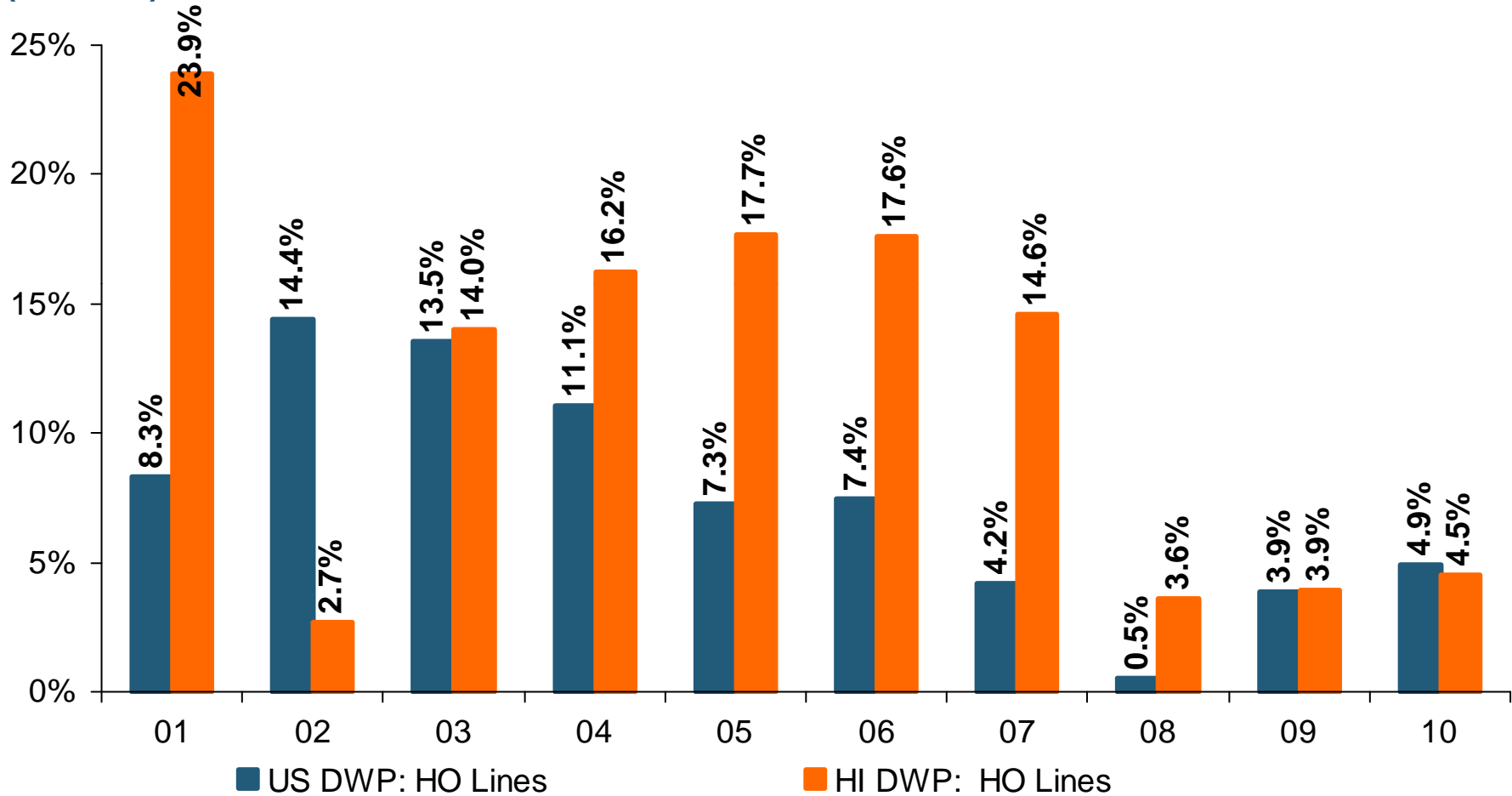
# Private Passenger Auto DWP Growth: HI vs. U.S., 2001-2010

(Percent)



# Homeowner's MP DWP Growth: HI vs. U.S., 2001-2010

(Percent)





# Catastrophe Loss Developments and Trends

**2011 and 2010 Are Rewriting  
Catastrophe Loss and  
Insurance History**

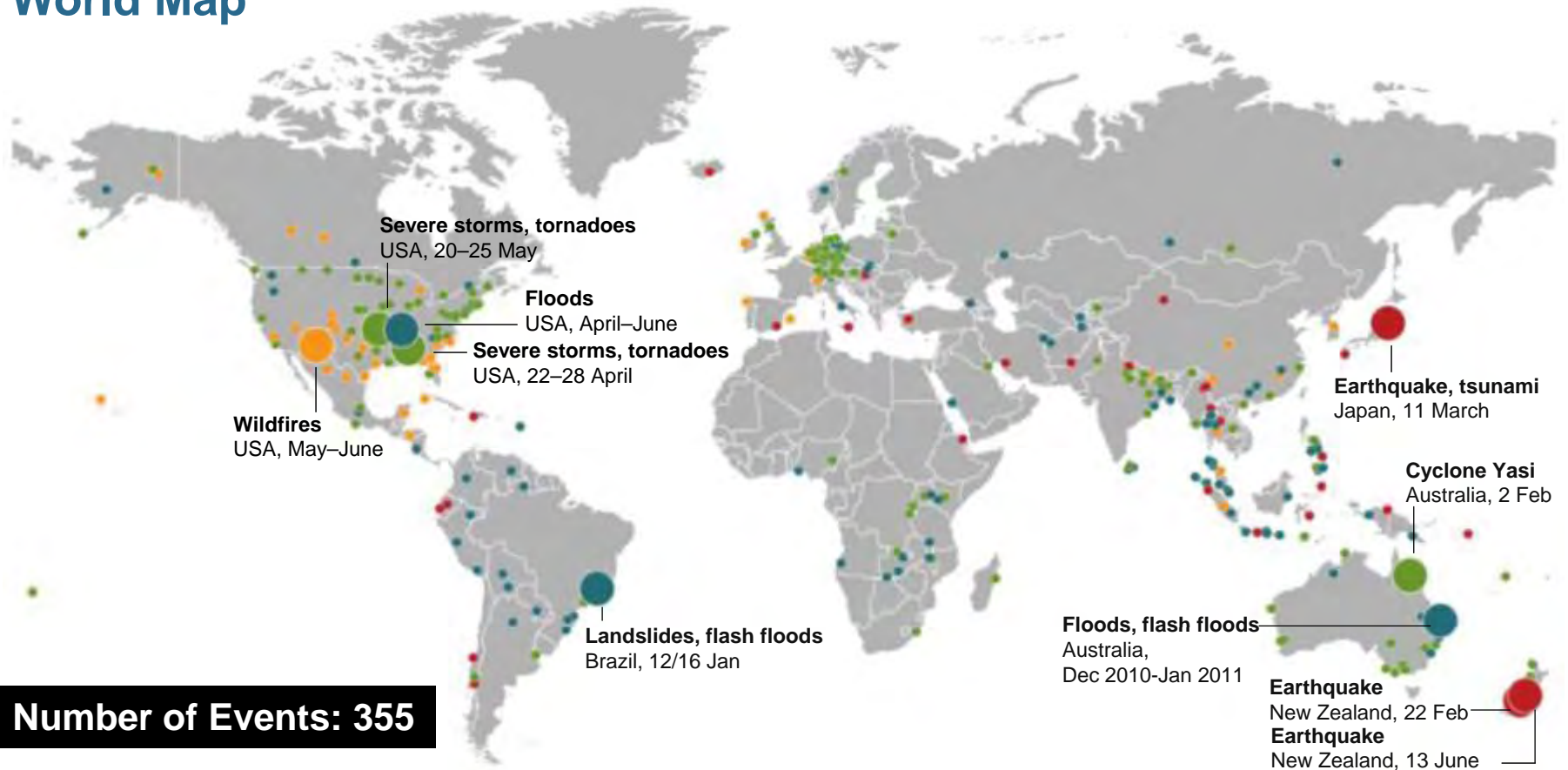


# Global Catastrophe Loss Summary: First Half 2011

- **2011 Is Already (as of June 30) the *Highest* Loss Year on Record Globally**
  - ◆ Extraordinary accumulation of severe natural catastrophe: Earthquakes, tsunami, floods and tornadoes are the primary causes of loss
- **\$260 Billion in *Economic* Losses Globally**
  - ◆ New record for the first six months, exceeding the previous record of \$220B in 2005
  - ◆ Economy is more resilient than most pundits presume
- **\$55 Billion in *Insured* Losses Globally**
  - ◆ More than double the first half 2010 amount
  - ◆ Over 4 times the 10-year average
- **\$27 Billion in *Economic* Losses in the US**
  - ◆ Represents a 129% increase over the \$11.8 billion amount through the first half of 2010
- **\$17.3 Billion in *Insured* Losses in the US Arising from 100 CAT Events**
  - ◆ Represents a 162% increase over the \$6.6 billion amount through the first half of 2010

# Natural Loss Events, January – June 2011

## World Map



**Number of Events: 355**

- 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)

# Worldwide Natural Disasters 2011

## Significant Natural Disasters (January – June only)

### Deadliest Disasters

Date	Event	Area	Deaths
11.3.2011	Earthquake, tsunami	Japan	15,500 (still missing: 7,297)
12/16.1.2011	Landslides, flash floods	Brazil	1,350
22-28.4.2011	Severe storm, tornadoes	USA	350

### Costliest Disasters (Insured Losses)

Date	Event	Area	Insured losses in US\$m
11.3.2011	Earthquake, tsunami	Japan	~30,000
22.2.2011	Earthquake	New Zealand	>10,000
22-28.4.2011	Severe storm, tornadoes	USA	5,050

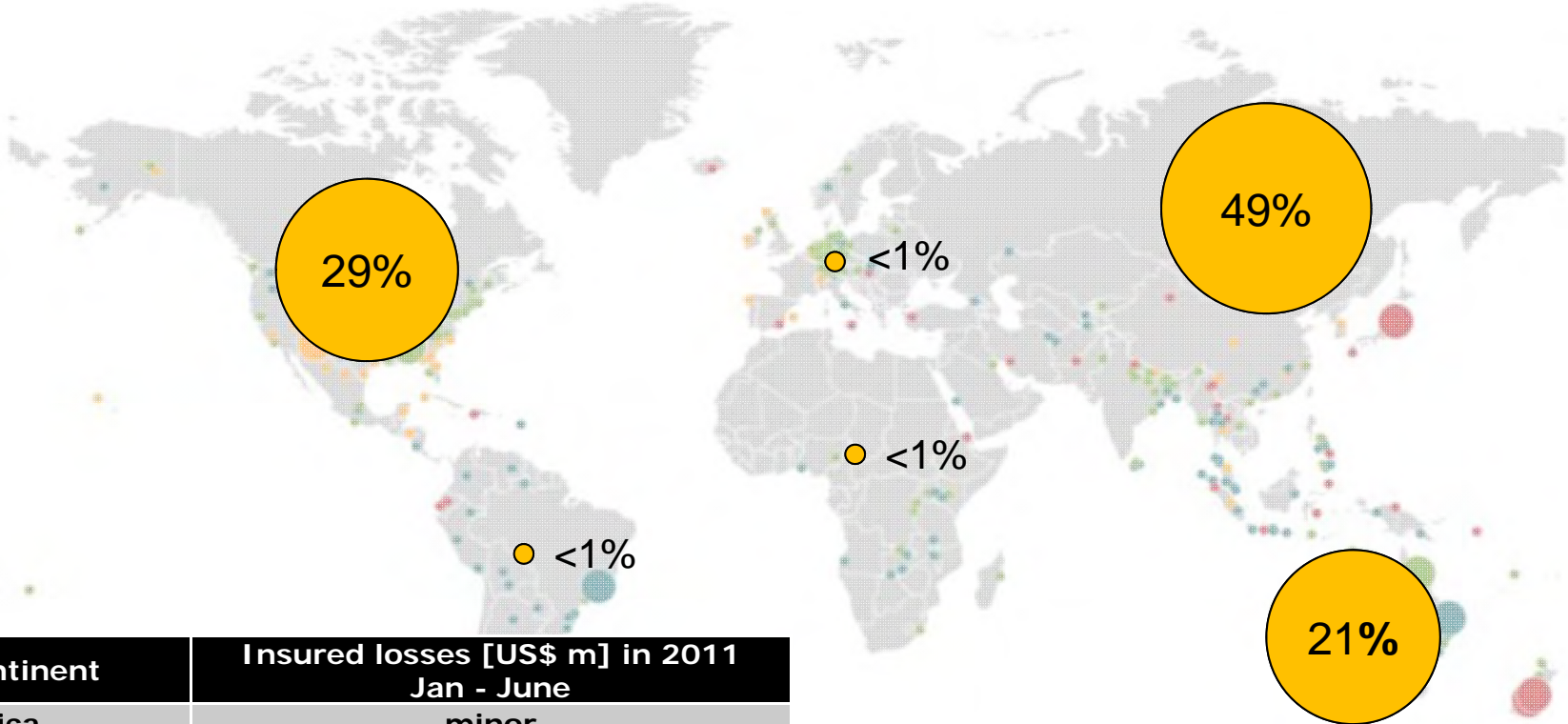
### Costliest Disasters (Overall Losses)

Date	Event	Area	Overall losses in US\$m
11.3.2011	Earthquake, tsunami	Japan	210,000
22.2.2011	Earthquake	New Zealand	20,000
22-28.4.2011	Severe storm, tornadoes	USA	7,500

# Worldwide Natural Disasters 2011

% Distribution of Insured Losses Per Continent (January – June only)

**Insured losses 2011 (January – June only): US\$ 60bn**



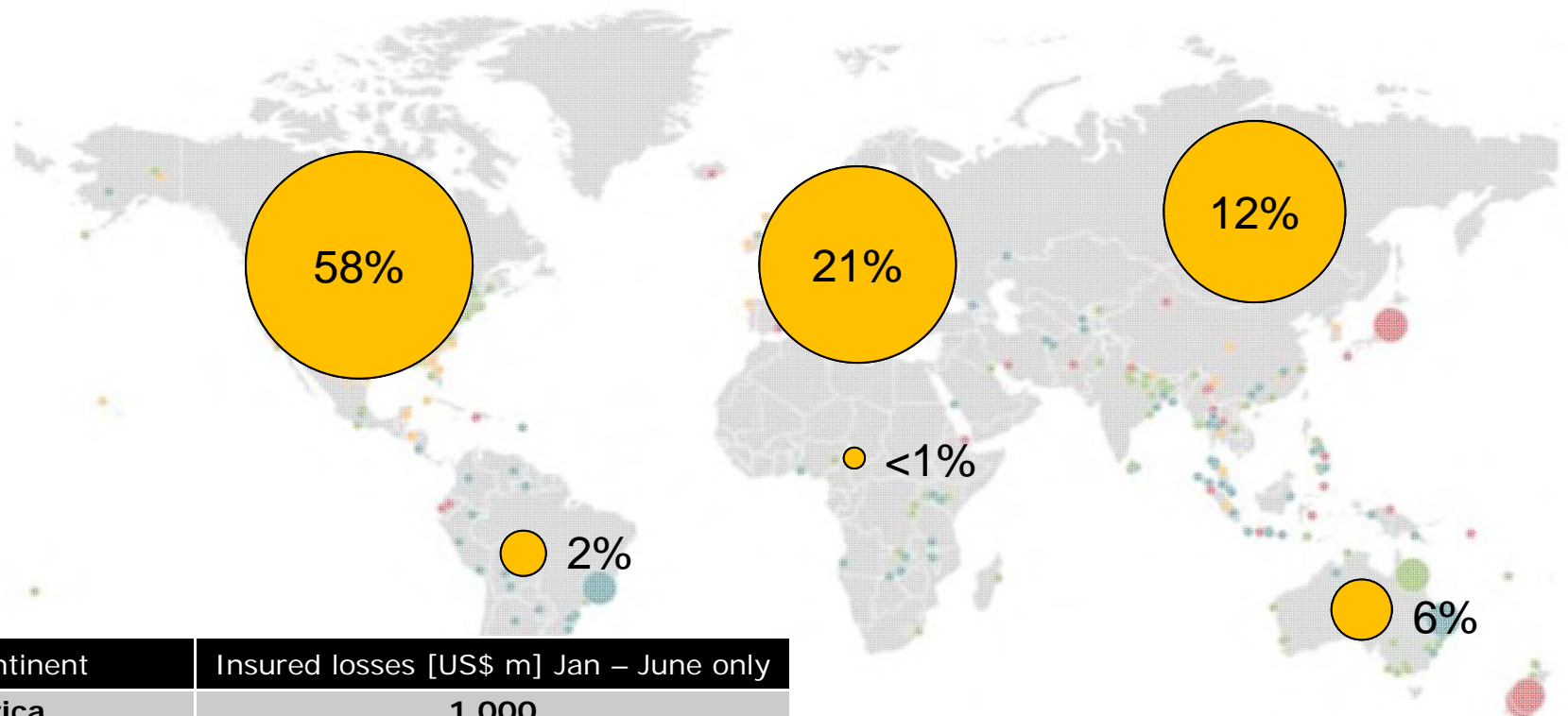
Continent	Insured losses [US\$ m] in 2011 Jan - June
Africa	minor
America	17,800
Asia	30,080
Australia/Oceania	12,900
Europe	100

Source: MR NatCatSERVICE

# Worldwide Natural Disasters, 1980-2011

% Distribution of Insured Losses Per Continent (January – June only)

**Insured losses 1980 - 2011 (January – June only): US\$ 389bn**



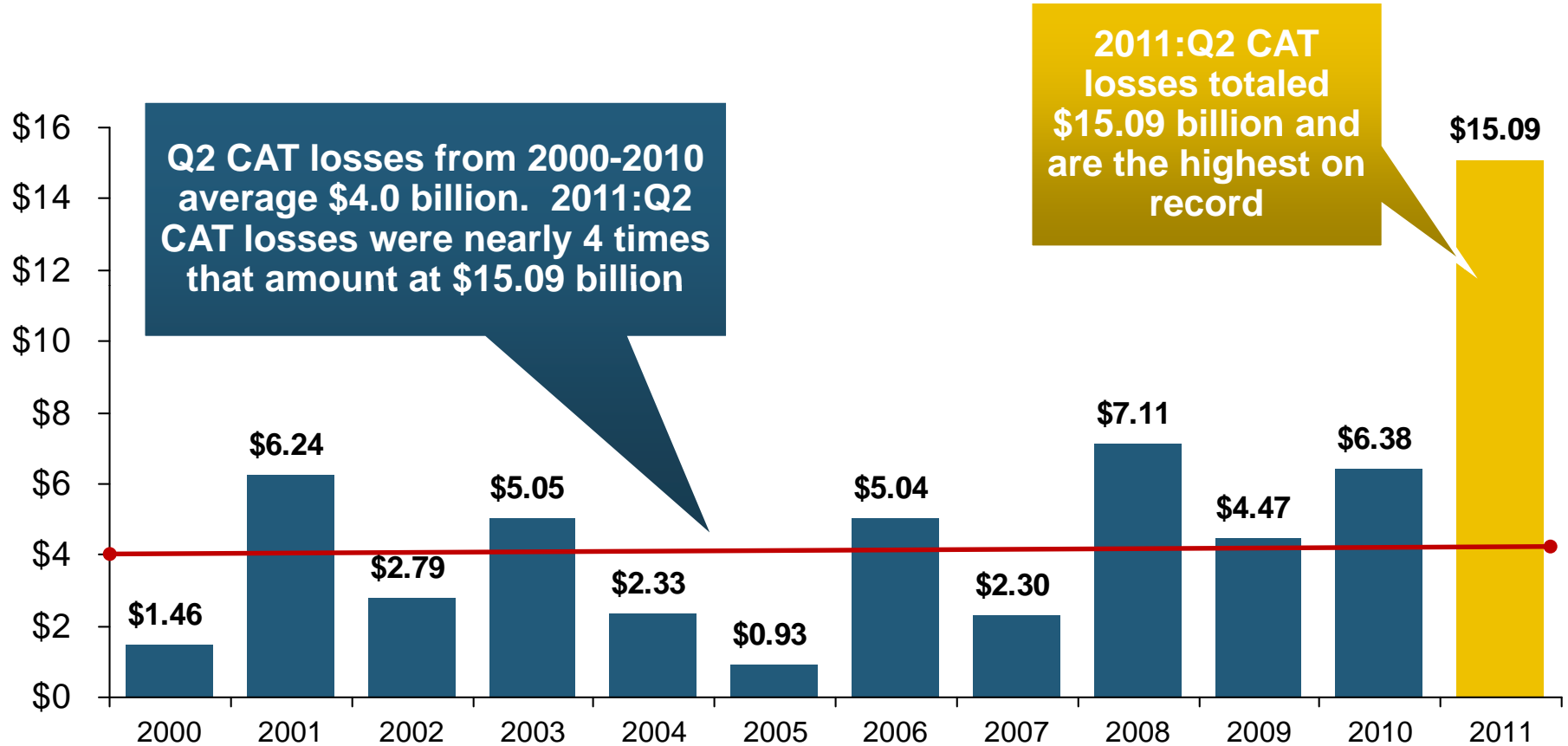
Continent	Insured losses [US\$ m] Jan – June only
Africa	1,000
America	237,200
Asia	45,100
Australia/Oceania	25,100
Europe	80,900

# Insured Loss Estimates for Selected Major Catastrophes in 2011

	<b>Japan Earthquake</b>	<b>April Tornadoes</b>	<b>May (Joplin) Tornadoes</b>
<b>Eqecat</b>	\$22 to \$39 billion	\$5 billion to \$7 billion	\$1 billion to \$3 billion
<b>RMS</b>	\$21 to 34 billion	\$3.5 to \$6 billion	\$2 to \$6 billion
<b>AIR</b>	\$20 billion to \$30 billion	\$5 billion to \$7 billion	\$2 to \$6 billion

# US Second Quarter Insured Catastrophe Losses, 2000–2011

\$ Billions



**Record Q2 (and First Half) CAT Losses Will Adversely Impact Insurer Results in 2011**

# Top 15 Most Costly World Insurance Losses, 1970-2011\*

(Insured Losses, 2010 Dollars, \$ Billions)



\*Through June 20, 2011. 2011 disaster figures are estimates; Figures include federally insured flood losses, where applicable.  
Sources: Swiss Re *sigma* 1/2011; AIR Worldwide, RMS, Eqecat; Insurance Information Institute.

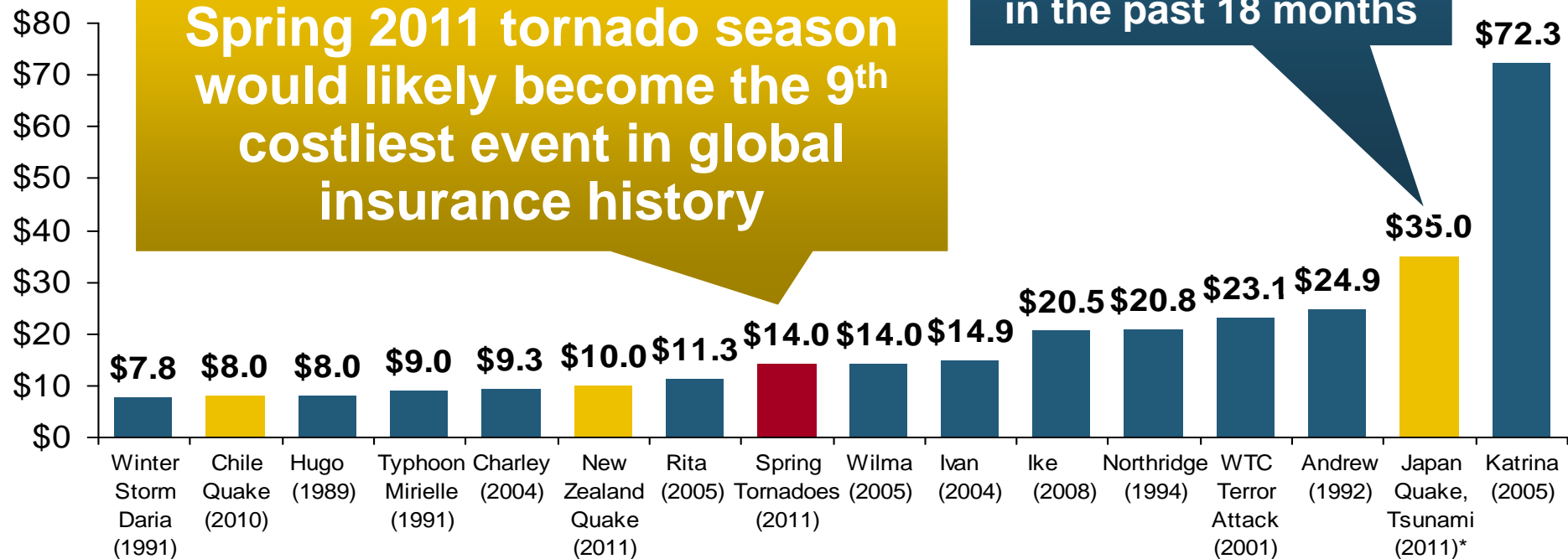


# Top 16 Most Costly World Insurance Losses, 1970-2011\*

(Insured Losses, 2010 Dollars, \$ Billions)

Taken as a single event, the Spring 2011 tornado season would likely become the 9<sup>th</sup> costliest event in global insurance history

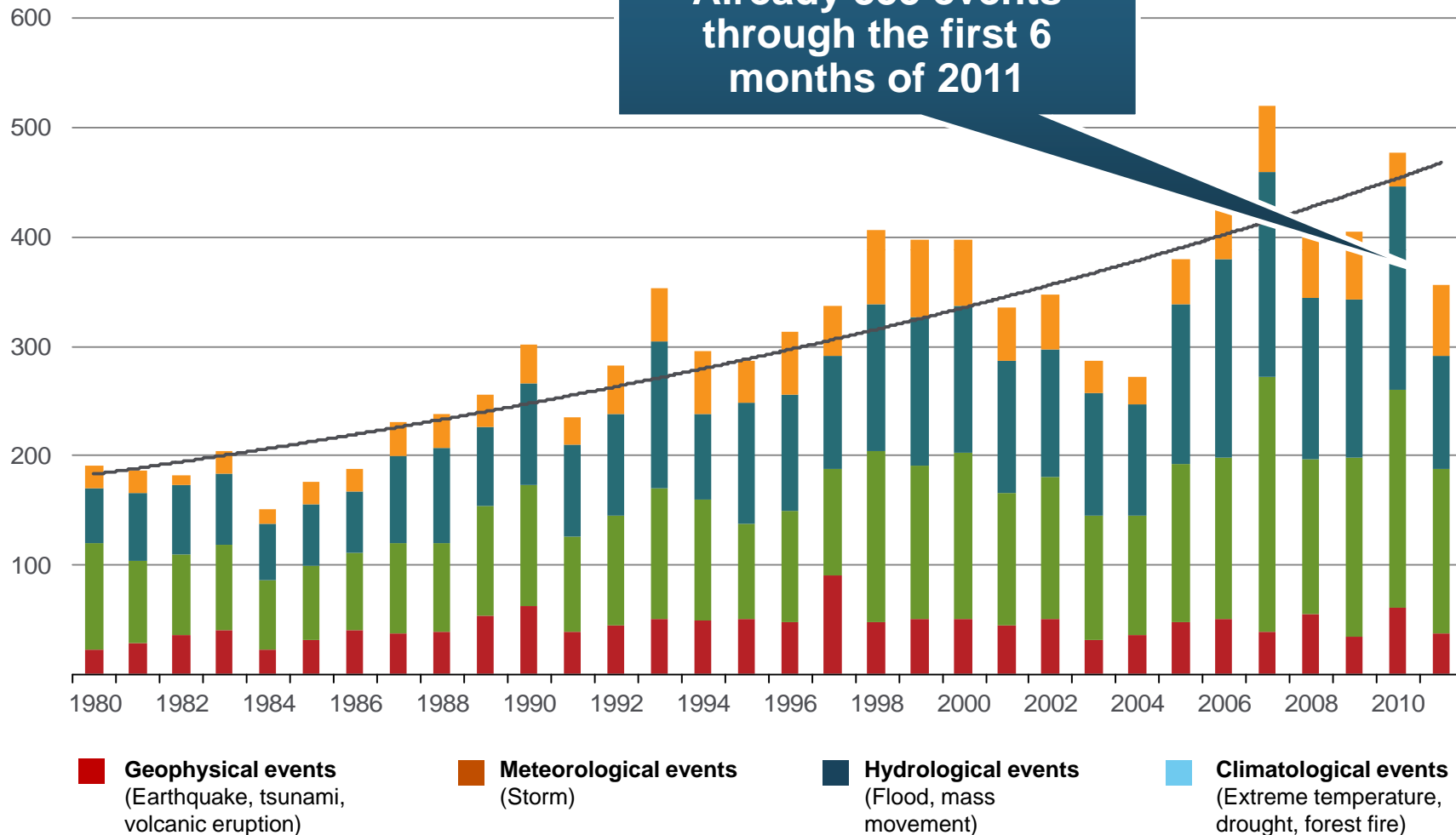
3 of the top 15 most expensive catastrophes in world history have occurred in the past 18 months



\*Through June 20, 2011. 2011 disaster figures are estimates; Figures include federally insured flood losses, where applicable. Sources: Swiss Re *sigma* 1/2011; AIR Worldwide, RMS, Eqecat; Insurance Information Institute.

# Worldwide Natural Disasters, 1980 – 2011\*

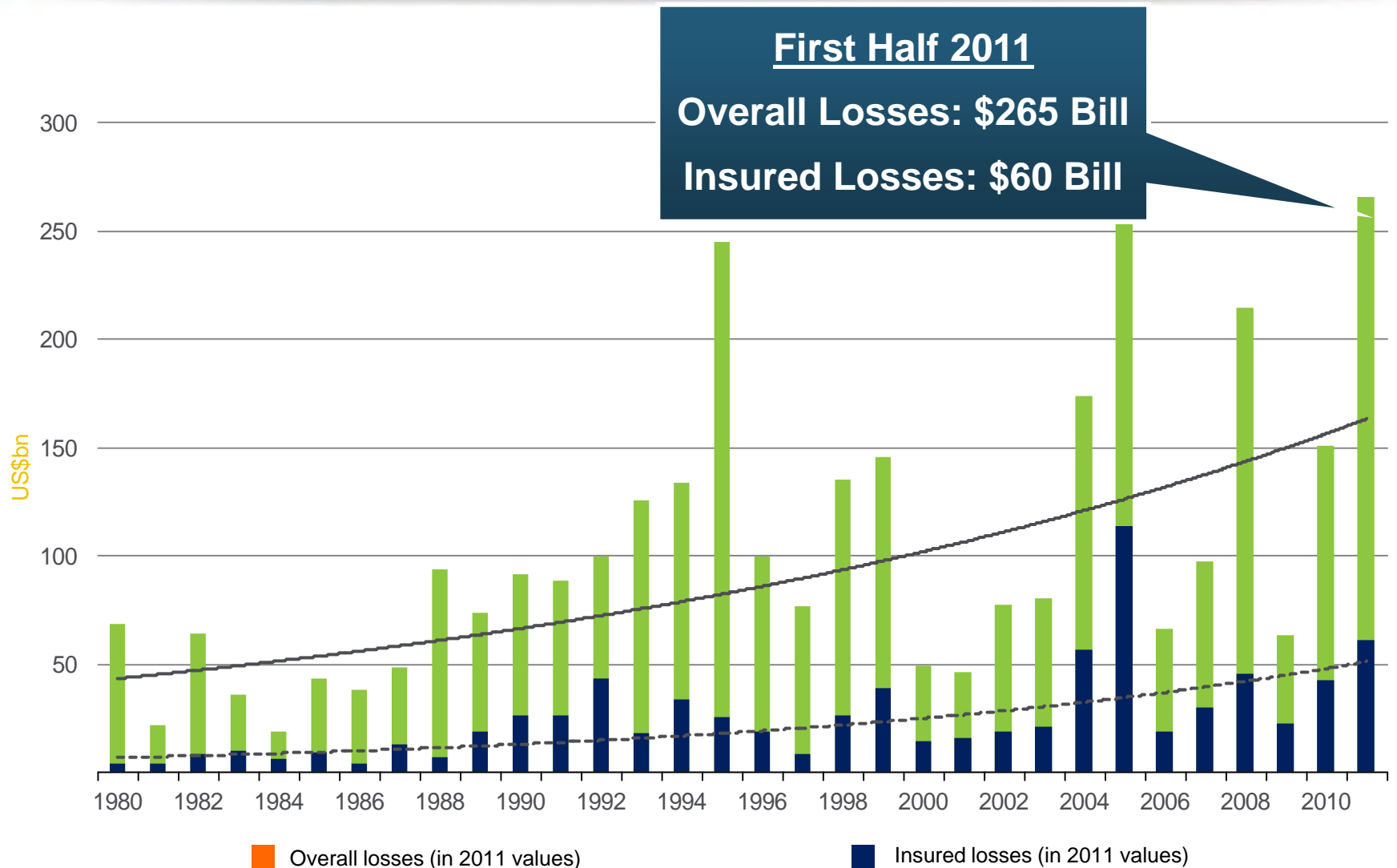
## Number of Events



\*2011 figure is through June 30.

Source: MR NatCatSERVICE

# Worldwide Natural Disasters 1980–2011, Overall and Insured Losses\*



\*2011 figure is through June 30.

Source: MR NatCatSERVICE

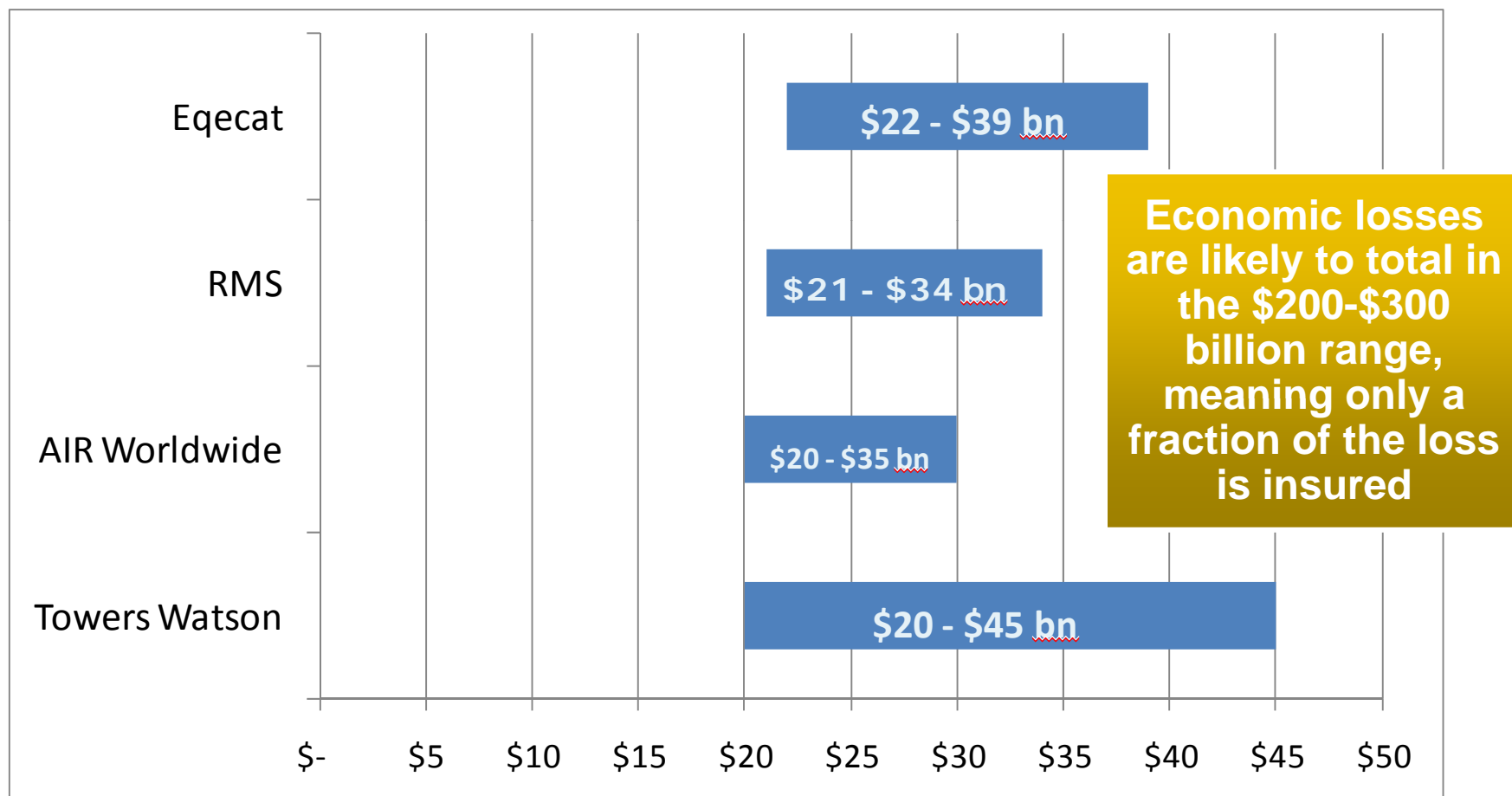


## **JAPAN EARTHQUAKE/TSUNAMI & NUCLEAR DISASTER**

**March 11 Quake/Tsunami Is Just the Most Recent of  
Several Large Global Catastrophe Losses**

# Insured Japan Earthquake Loss Estimates\*

(Insured Losses, \$ Billions)

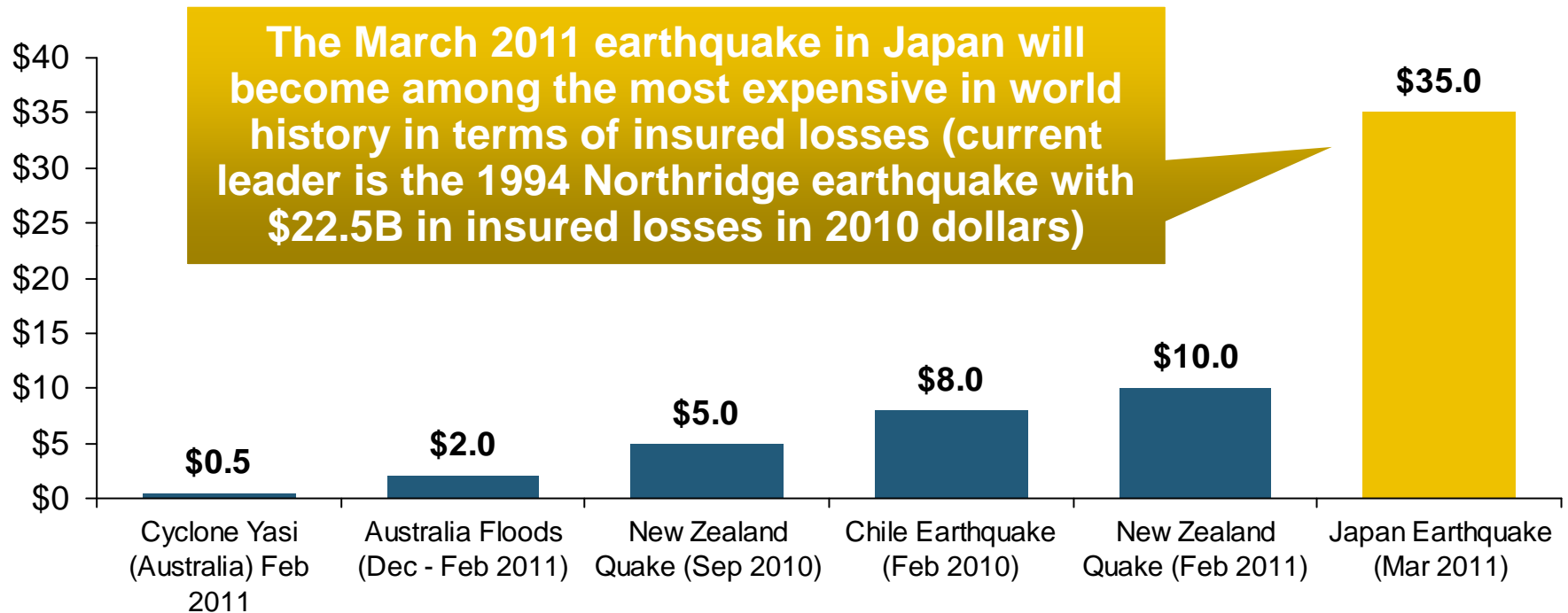


\*As of June 17, 2011. Towers Watson estimate includes \$3.0 (low) to \$4.9 billion (high) in life insurance losses. RMS estimate includes insured life/health losses of \$3 to \$8 billion.

Sources: AIR Worldwide, Eqecat, RMS, Towers Perrin; Insurance Information Institute.

# Recent Major Non-US Catastrophe Losses

(Insured Losses, \$US Billions)



**Insured Losses from Recent Major Catastrophe Events Exceed \$60 Billion, an Estimated \$53 Billion of that from Earthquakes**

# Nonlife (P/C) Insurance Market Impacts of Japan Earthquake

- **No Direct Impact for US Domestic Primary Insurers**
- ***BUT: \$2 - \$5 Billion in Assumed Loss from Foreign Catastrophes Will Wind Up on the Books of US Insurers, Most with No Direct Exposure to Japan/Australia/NZ***
  - ◆ US reinsurers
  - ◆ Retrocessional market
  - ◆ Blanket property insurance covers
- **Primary Insurance: Domestic Japanese Insurers Take Big Losses**
- **Few US/Foreign Insurers Had Direct Exposure to Japanese P/C Market**
  - ◆ Low single-digit market share for a small number of companies
- **Significant Absorption of Loss by Japanese Government**
  - ◆ Residential earthquake damage
  - ◆ Nuclear-related property and liability damage
- **Significant Impacts for Global Reinsurers**
  - ◆ Property-Catastrophe covers on Commercial Lines
  - ◆ Business Interruption/Contingent Business Interruption
- **Supply Chain Disruption Concern (Now Waning)**
- **Currently an Earnings Event for Global Reinsurers**
  - ◆ Not a capital event: Global reinsurance markets entered 2011 with record capital
- **Cost of Property/Cat Reinsurance Rising in Japan, New Zealand, Australia**
  - ◆ Up for all; Magnitude of increase is sensitive to size of loss
- **Impact on Cost of US Property-Cat Reinsurance is Possible/Likely**
  - ◆ Market remains well capitalized and competitive



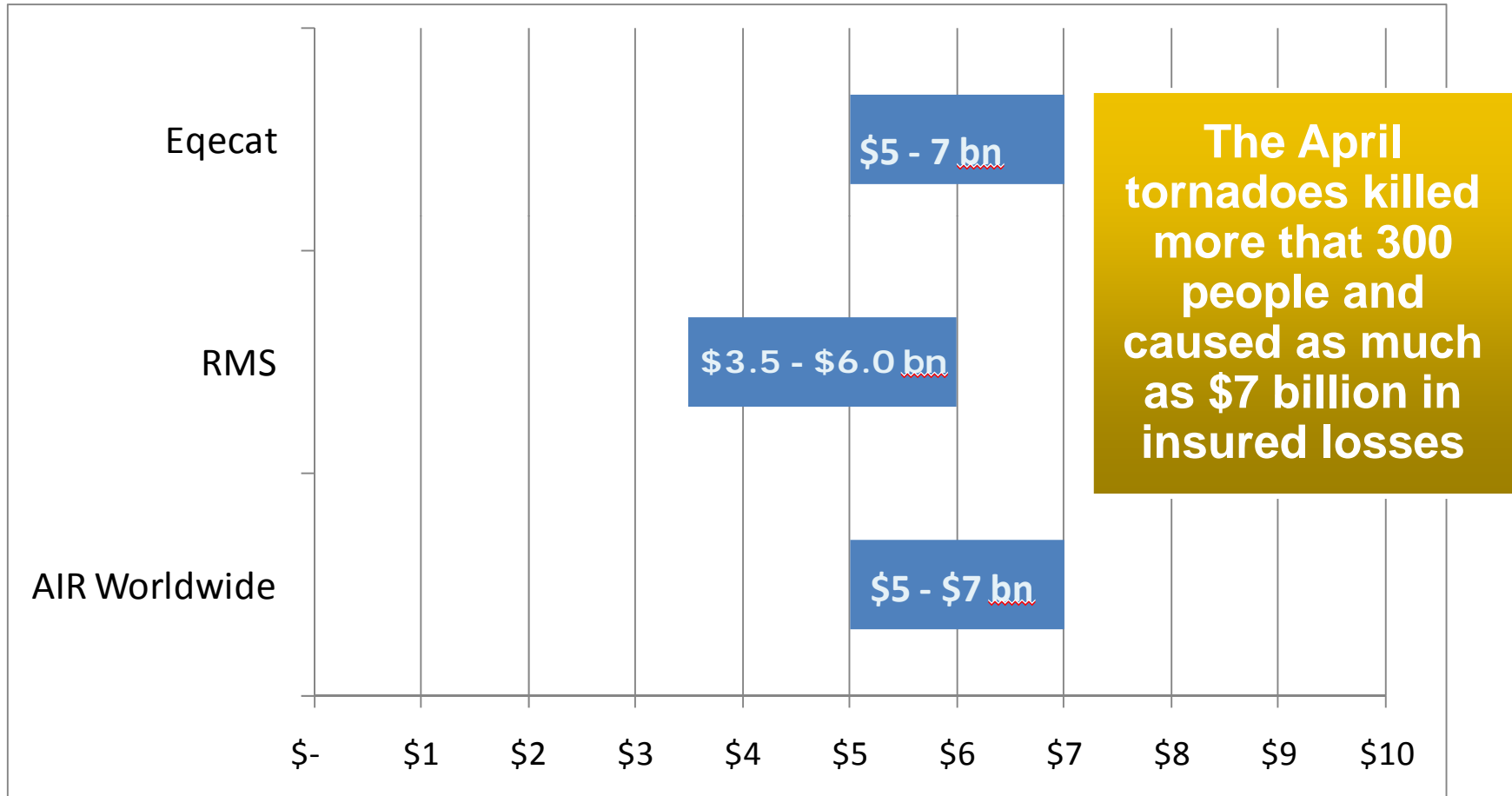
# **SPRING 2011 TORNADO OUTBREAK**

**2011 Will Be Among the Most Deadly and  
Expensive for Tornadoes In History**



# Insured Loss Estimates from April 2011 Tornadoes\*

(Insured Losses, \$ Billions)

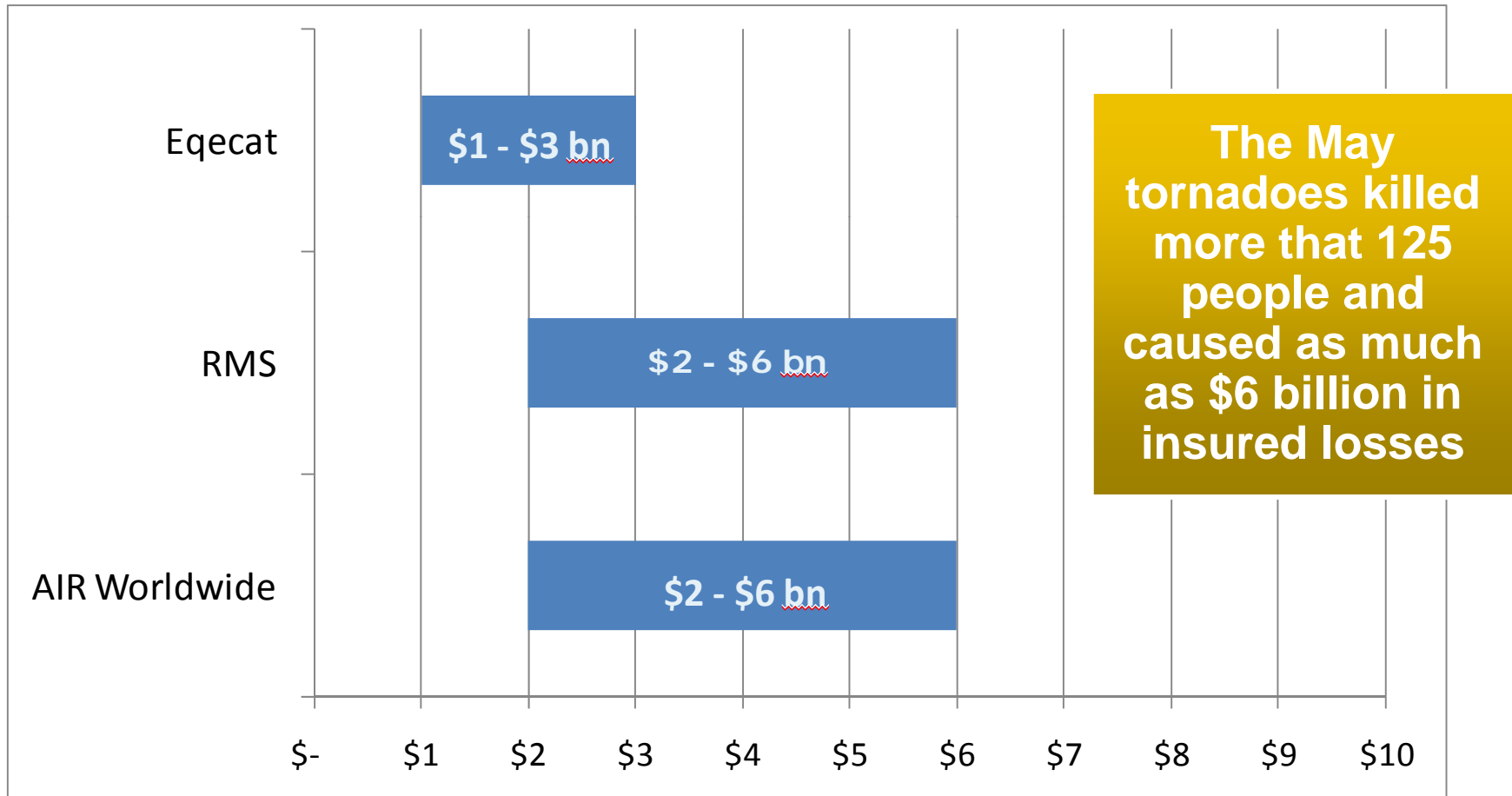


\*As of June 17, 2011.

Sources: AIR Worldwide, Eqecat, RMS; Insurance Information Institute research.

# Insured Loss Estimates from May 2011 (Joplin) Tornadoes\*

(Insured Losses, \$ Billions)



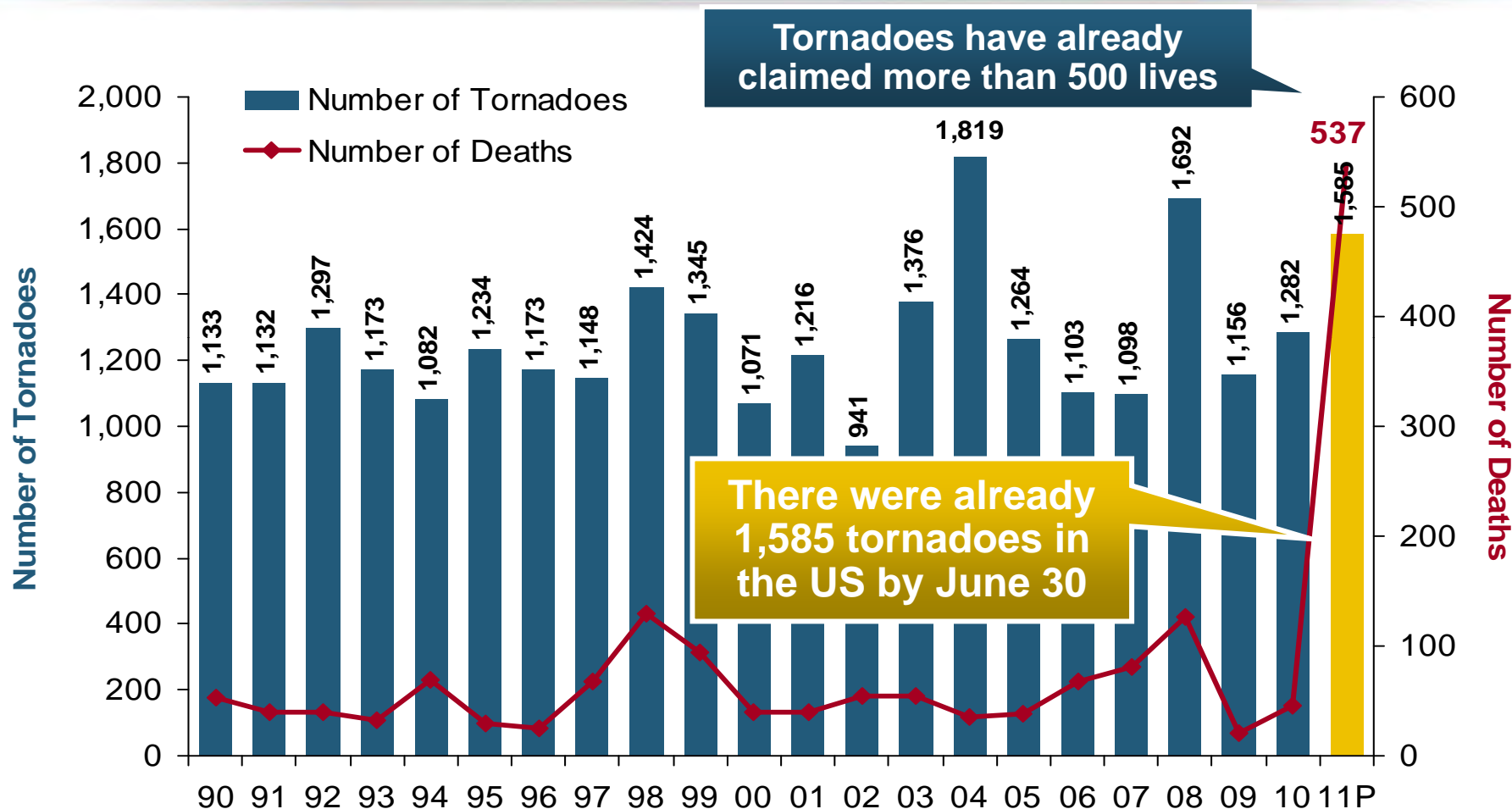
\*As of June 17, 2011.

Sources: AIR Worldwide, Eqecat, RMS; Insurance Information Institute research.

# Summary of Recent Tornado Activity

- **There Have Been 1,585 Tornadoes Through June 30 in the US**
- **537 People Have Been Killed**
- **The April 27 Tornado Outbreak Killed at Least 342 People**
  - ◆ Now the 2<sup>nd</sup> deadliest outbreak in US history (747 killed in march 1925 event)
  - ◆ States impacted: AR, TN, LA, MS, GA and especially AL
  - ◆ *Insured Losses Estimated at \$3.5B to \$7B*
- **Economic Losses Likely in the \$7 Bill to \$14 Bill Range**
- **The May 22 Tornado in Joplin, MO, Killed at Least 130 People**
  - ◆ Largest number of deaths from a single tornado
  - ◆ *Insured Losses Estimated at \$1B to \$6B*
- **P/C Insurance Industry is Very Strong and Will Encounter No Difficulties in Paying these Claims**

# Number of Tornadoes and Related Deaths, 1990 – 2011\*



**Insurers Expect to Pay \$2 Billion on 165,000 Claims Arising from the April 2011 Tornadoes in the Birmingham and Tuscaloosa Areas**

\*2011 is preliminary data through June 30.

Source: U.S. Department of Commerce, Storm Prediction Center, National Weather Service.

# Insurers Making a Difference in Impacted Communities



Destroyed home in Tuscaloosa. Insurers will pay some 165,000 claims totaling \$2 billion in the Tuscaloosa/Birmingham areas alone.

Presentation of a check to Tuscaloosa Mayor Walt Maddox to the Tuscaloosa Storm Recovery Fund



# Insurers Making a Difference in Impacted Communities



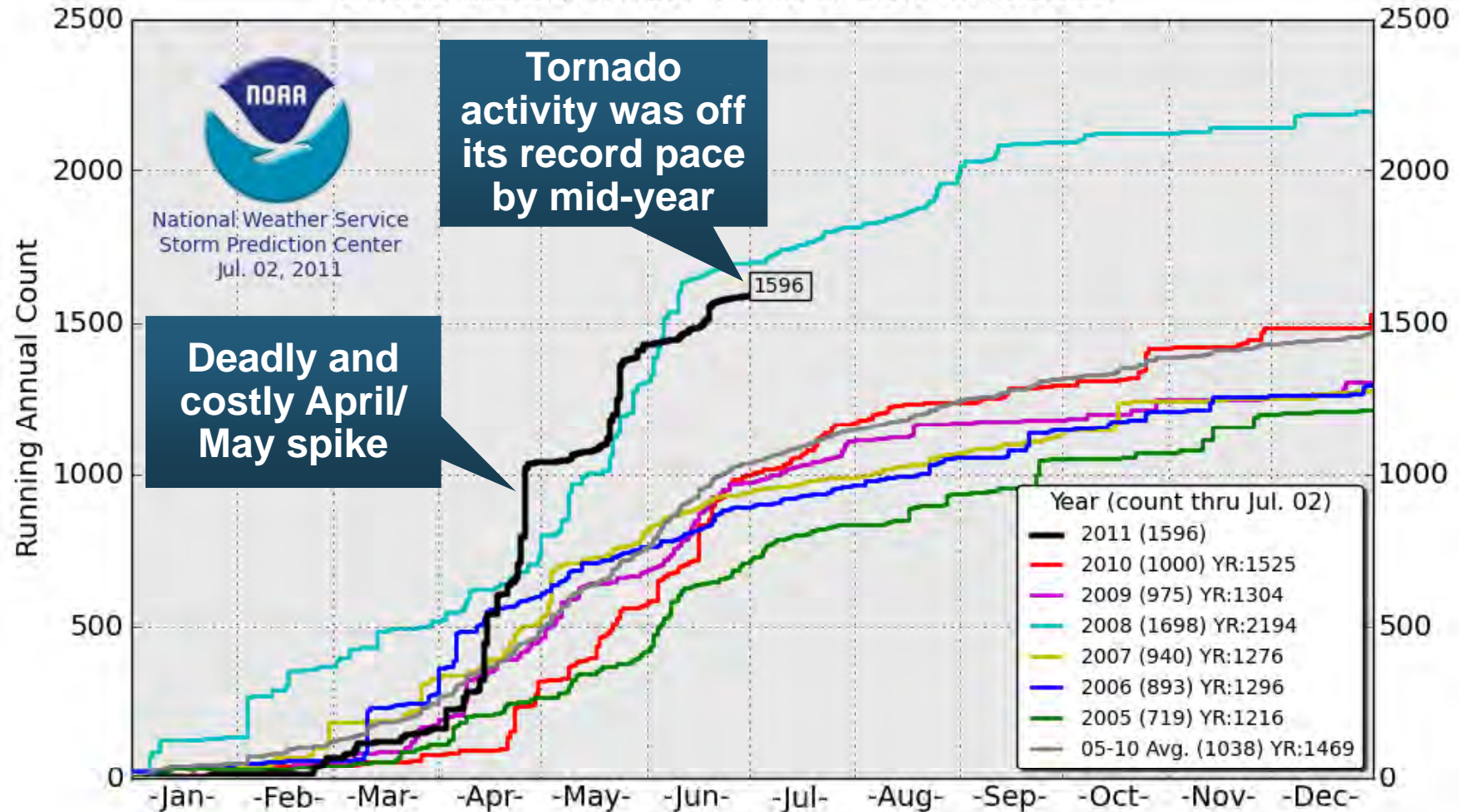
House nearly swept into the East Battenkill River just south of Manchester, VT, after Irene (pic taken 9/7/11)

Closed restaurant on Misquamicut Beach, RI, due to comprising of wooden deck from Irene storm surge. Owner had a NFIP flood policy—business is 50 ft. from water line. (pic taken 9/4/11)



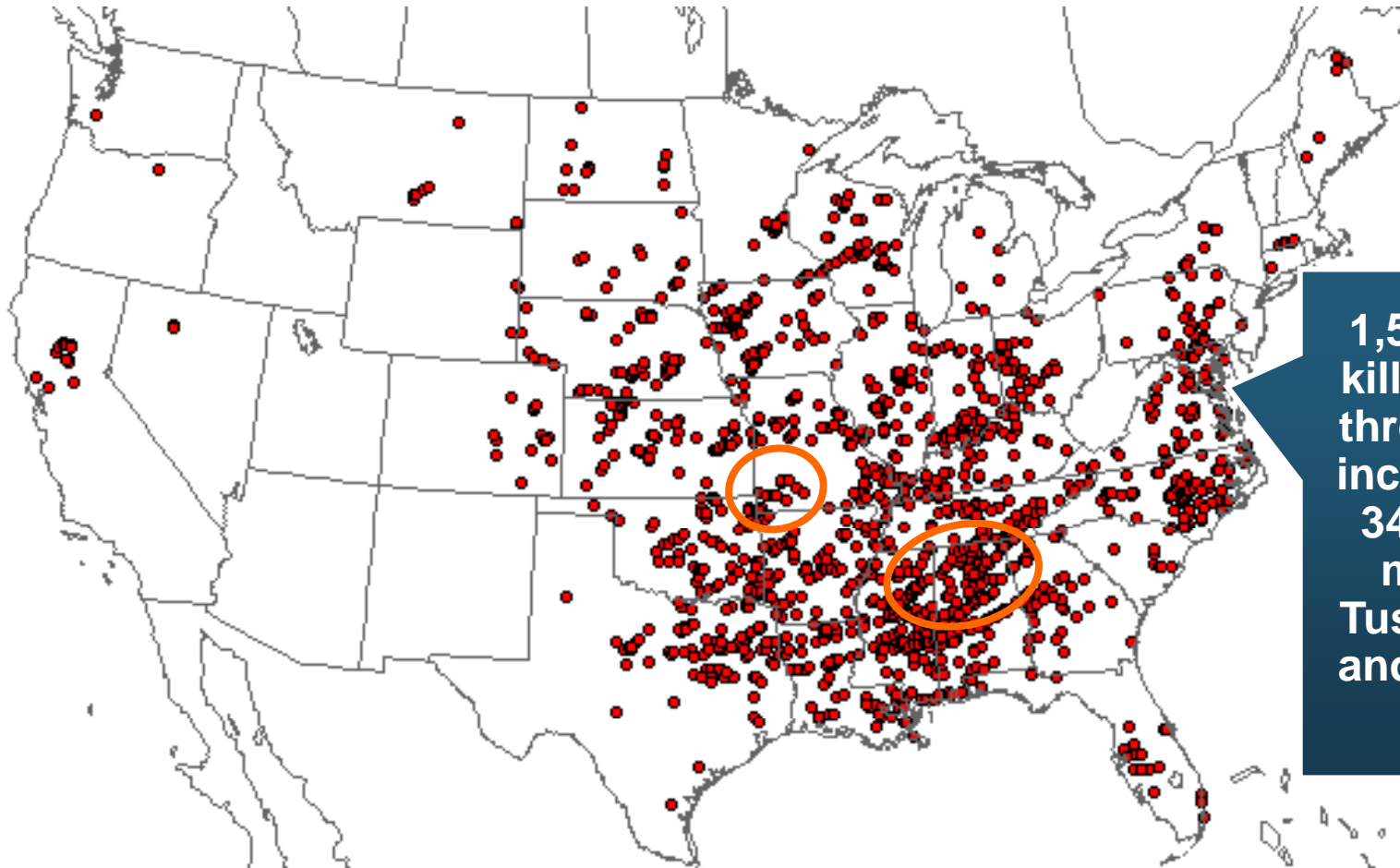
# U.S. Tornado Count, 2005-2011\*

United States Annual Trend of LSR Tornadoes\*



\*Preliminary tornadoes from NWS Local Storm Reports (LSRs)  
Annual average is based on preliminary LSRs, 2005-2010

# Location of Tornadoes in the US, January 1—June 30, 2011



1,585 tornadoes killed 537 people through June 30, including at least 340 on April 26 mostly in the Tuscaloosa area, and 130 in Joplin on May 22

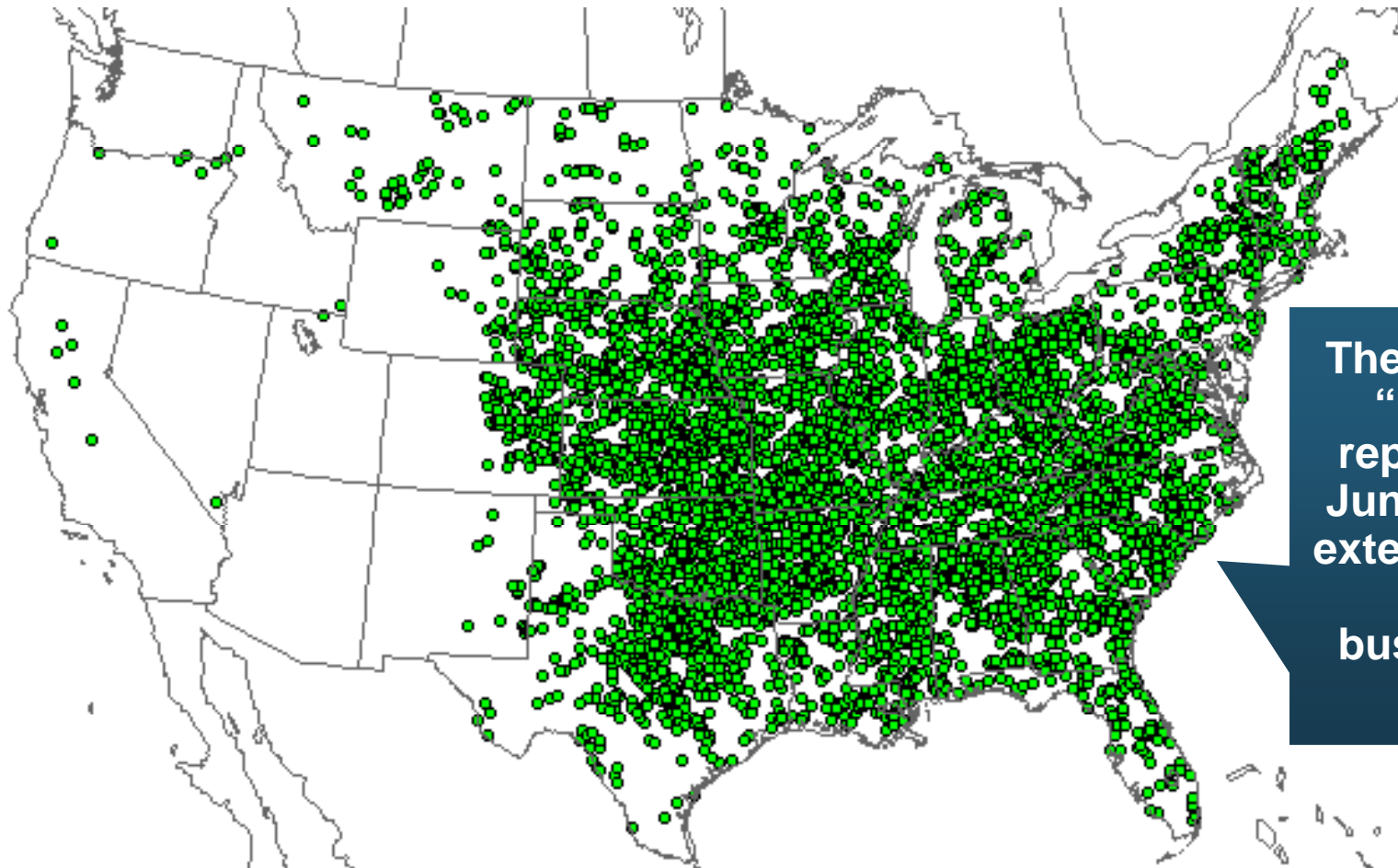
 **PRELIMINARY SEVERE WEATHER REPORT DATABASE (ROUGH LOG)**  
NOAA/Storm Prediction Center Norman, Oklahoma

**Tornado Reports**  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT



# Location of Large Hail Reports in the US, January 1—June 30, 2011



There were 7,176  
“Large Hail”  
reports through  
June 30, causing  
extensive damage  
to homes,  
businesses and  
vehicles



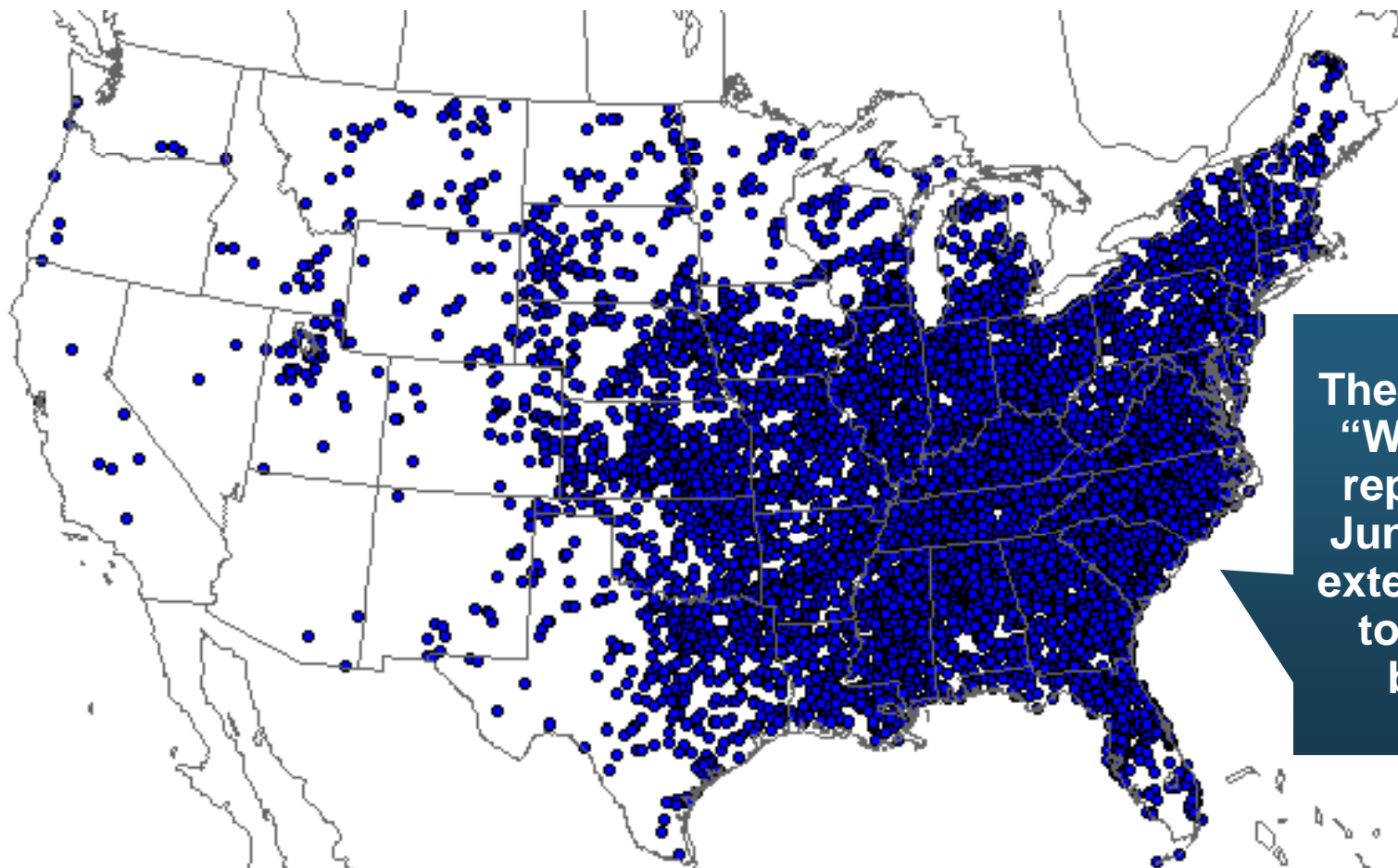
PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Hail Reports  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT

# Location of Wind Damage Reports in the US, January 1—June 30, 2011



There were 11,283  
“Wind Damage”  
reports through  
June 30, causing  
extensive damage  
to homes and,  
businesses



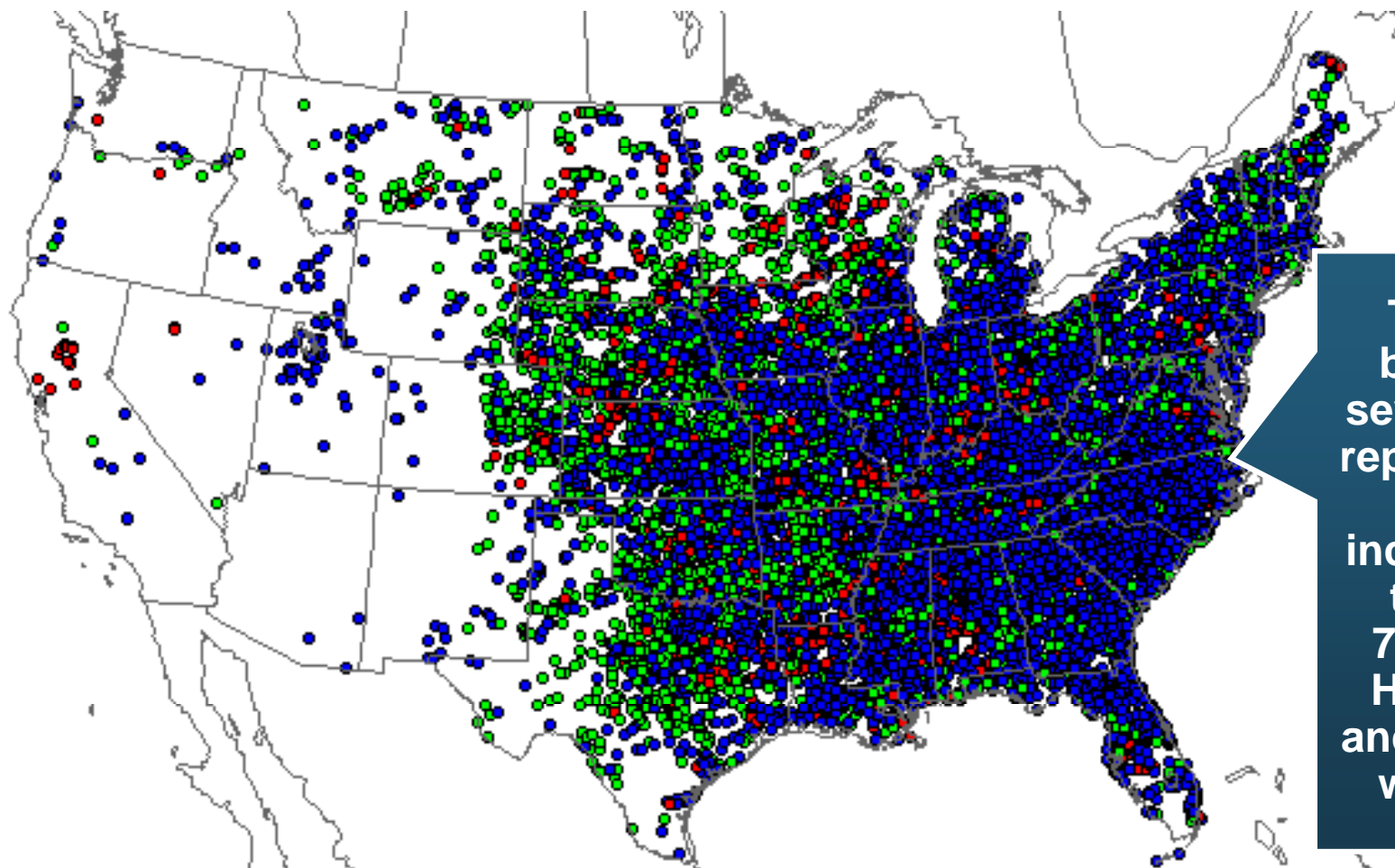
PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Wind Reports  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT

# Severe Weather Reports, January 1—June 30, 2011



There have been 20,044 severe weather reports through June 30; including 1,585 tornadoes; 7,176 “Large Hail” reports and 11,283 high wind events



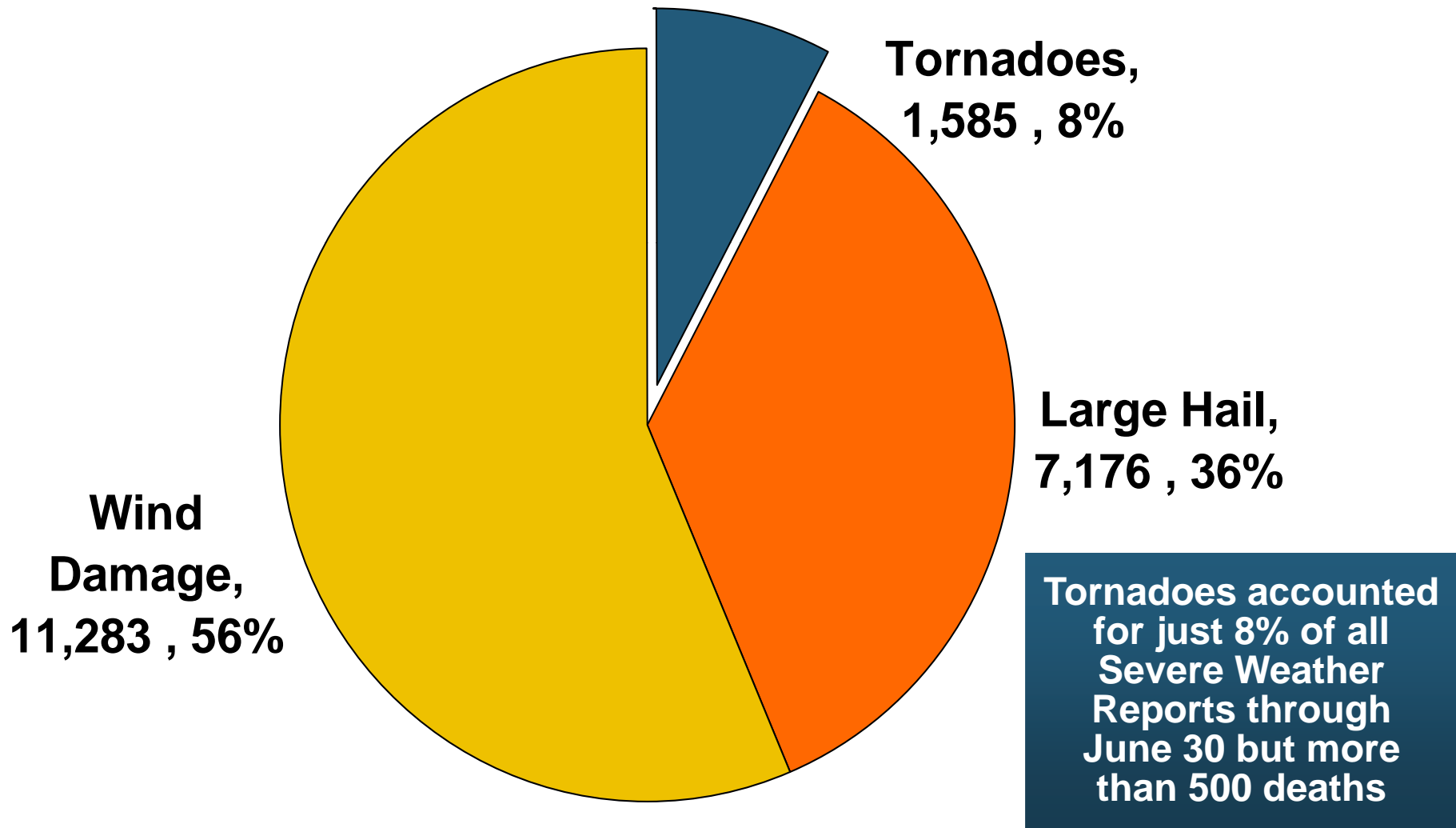
PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Severe Weather Reports  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT

# Number of Severe Weather Reports in US, by Type: January 1—June 30, 2011



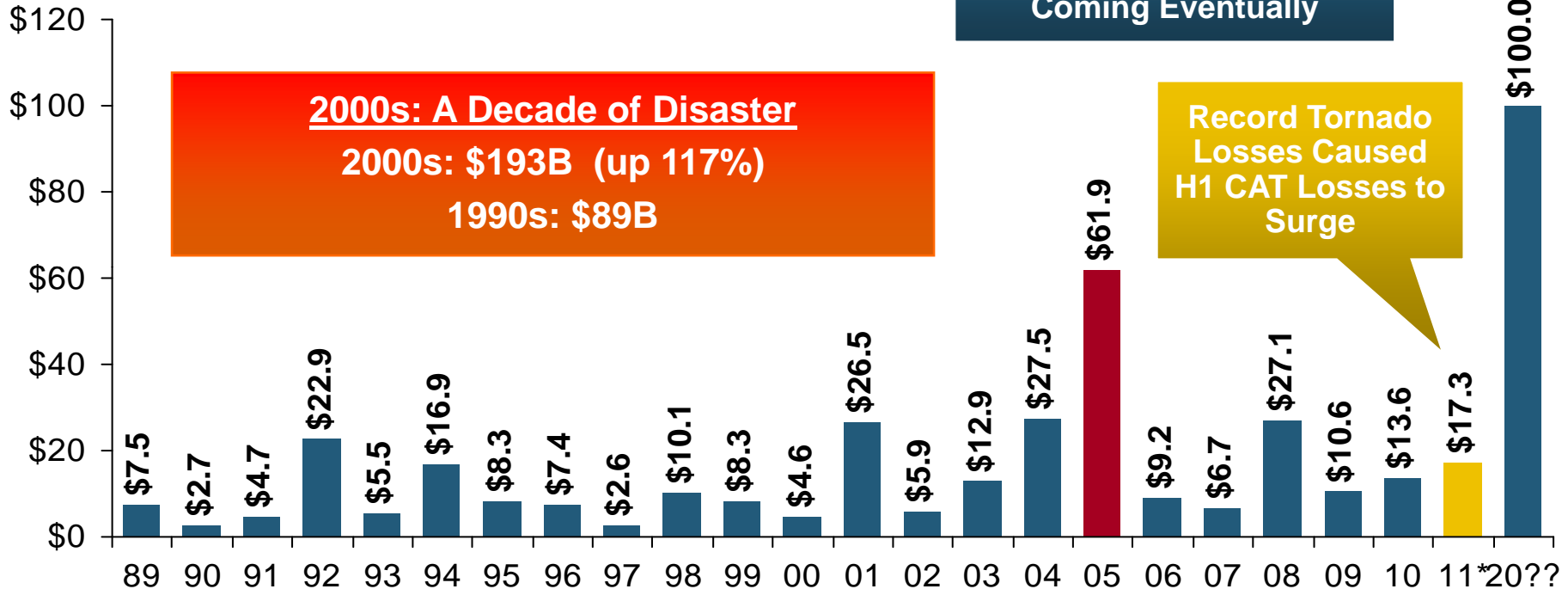


## US CATASTROPHE INSURED LOSS UPDATE

**First Half 2011 CAT Losses Already Exceed All of  
2010 and Could Become One of the Most  
Expensive Years on Record**

# US Insured Catastrophe Losses

(\$ Billions)



**2000s: A Decade of Disaster**  
 2000s: \$193B (up 117%)  
 1990s: \$89B

\$100 Billion CAT Year is Coming Eventually

Record Tornado Losses Caused H1 CAT Losses to Surge

**First Half 2011 US CAT Losses Already Exceed Losses from All of 2010. Even Modest Hurricane Losses Will Make 2011 Among the Most Expensive Ever for CATs**

\*First half 2011.

Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B.

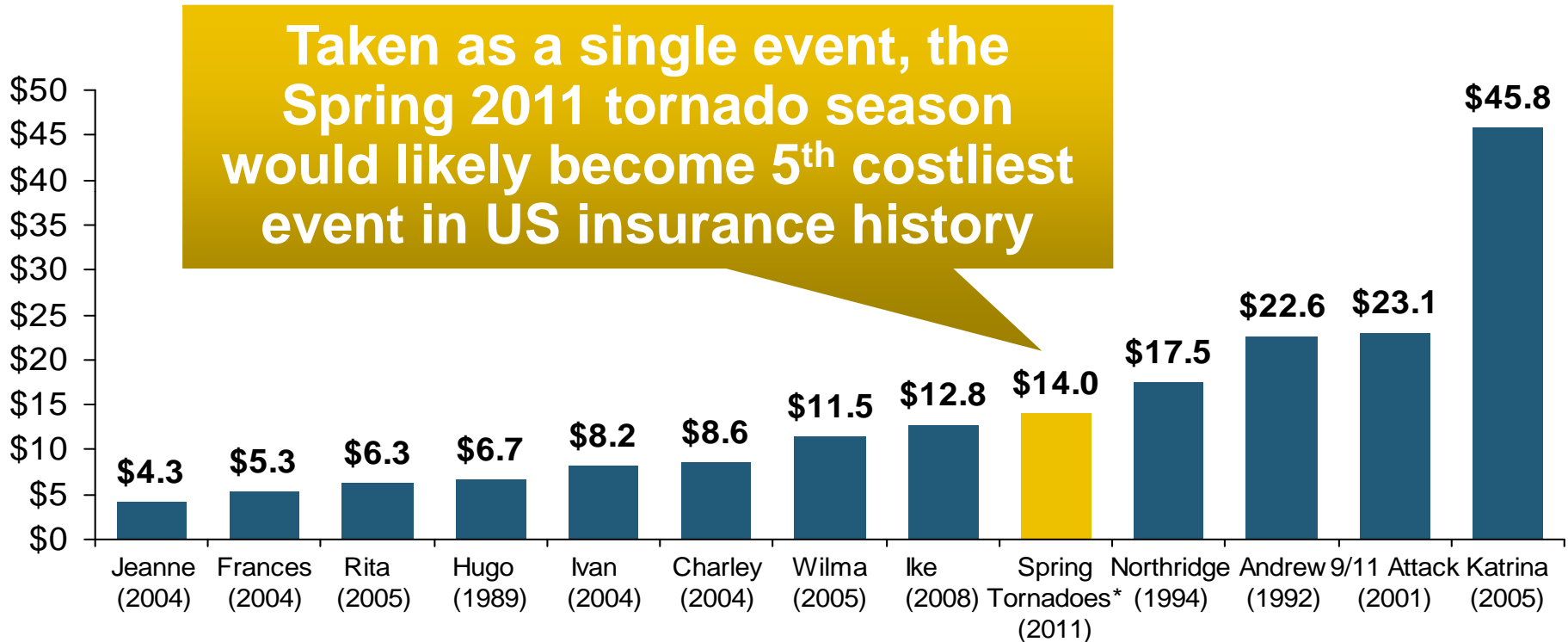
Sources: Property Claims Service/ISO; Insurance Information Institute.

# Natural Disaster Losses in the United States: First 6 Months 2011

As of July 6, 2011	Number of Events	Fatalities	Estimated Overall Losses (US \$m)	Estimated Insured Losses (US \$m)
<b>Severe Thunderstorm</b>	43	593	23,573	16,350
<b>Winter Storm</b>	8	15	1,900	1,425
<b>Flood</b>	8	15	2,100	in progress
<b>Earthquake</b>	2	1	105	in progress
<b>Tropical Cyclone</b>	0	0	0	0
<b>Wildfire</b>	37	7	125	50

# Top 12 (13?) Most Costly Disasters in U.S. History

(Insured Losses, 2010 Dollars, \$ Billions)



\*Losses will actually be broken down into several "events" as determined by PCS.

Sources: PCS; Insurance Information Institute inflation adjustments.

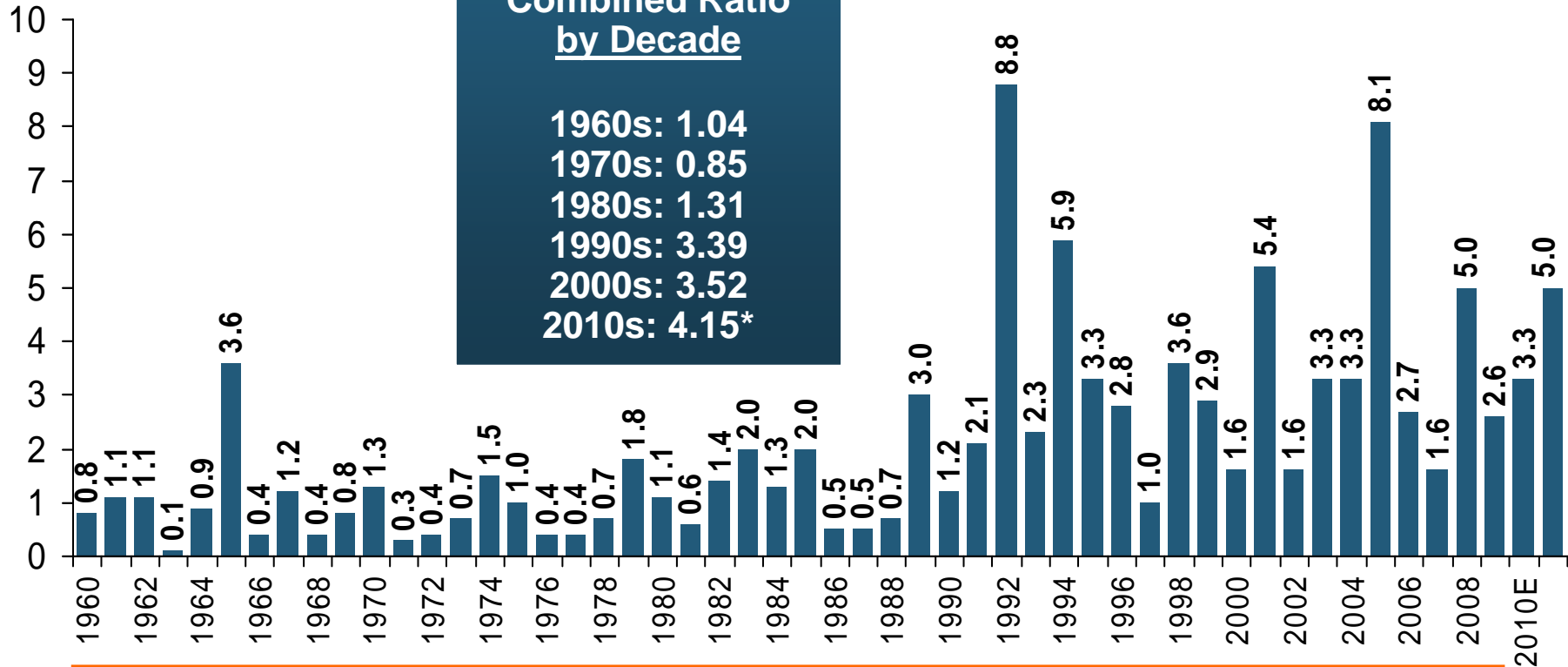


# Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2011:H1\*

## Combined Ratio Points

**Avg. CAT Loss Component of the Combined Ratio by Decade**

1960s: 1.04  
 1970s: 0.85  
 1980s: 1.31  
 1990s: 3.39  
 2000s: 3.52  
 2010s: 4.15\*



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

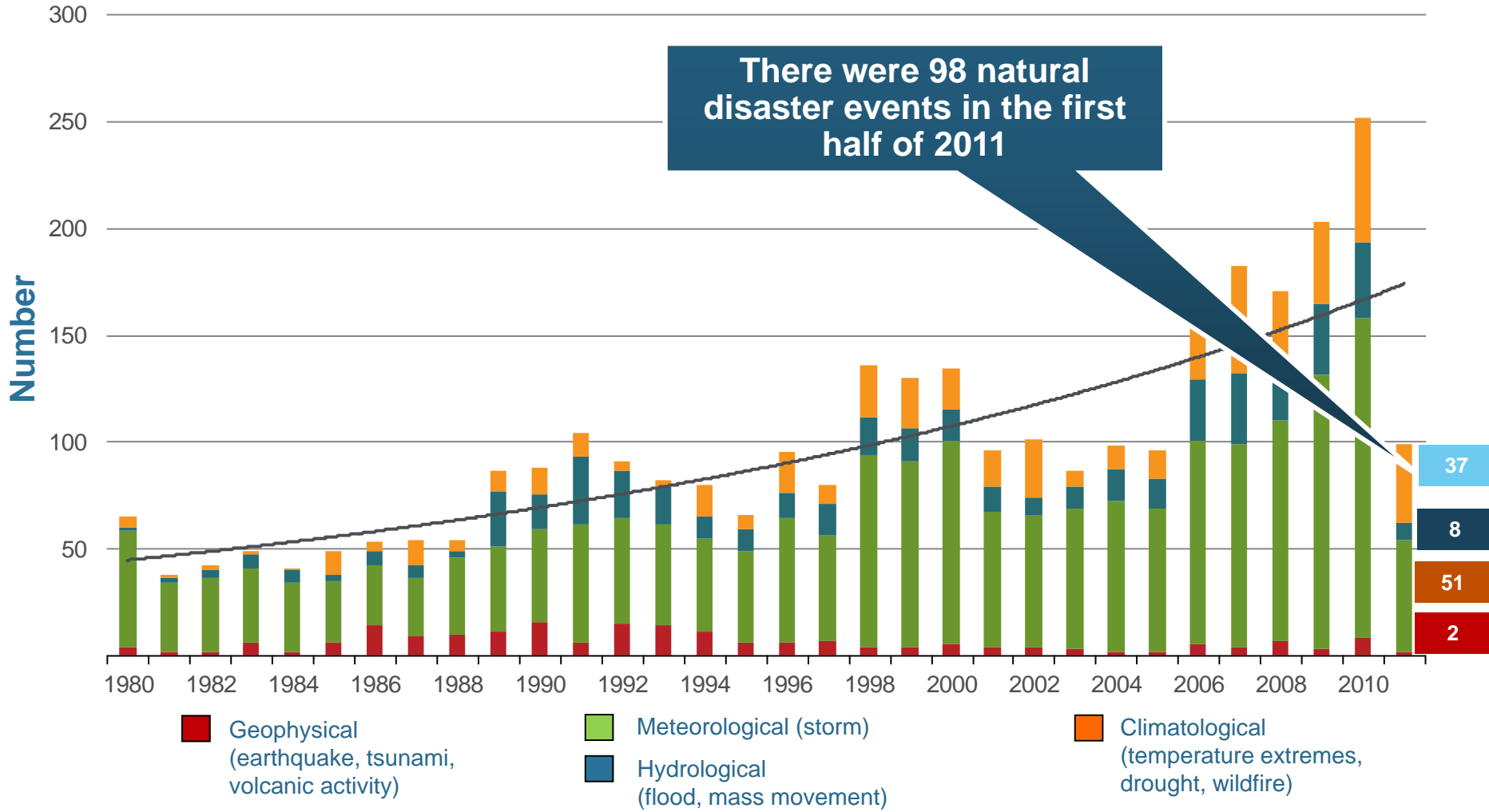
\*Insurance Information Institute estimates for 2010 and 2011:H1

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.

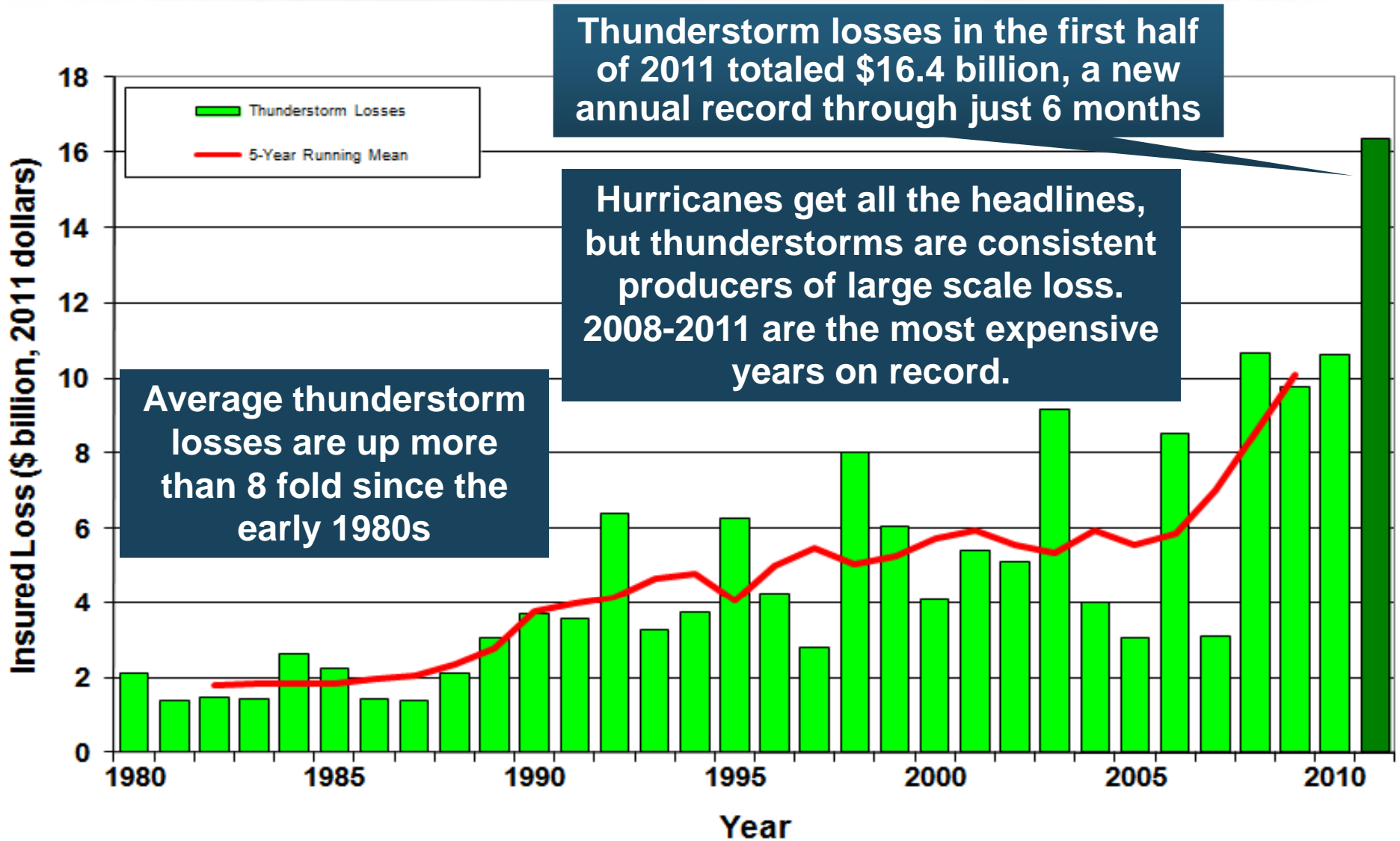
# Natural Disasters in the United States, 1980 – 2011\*

Number of Events (Annual Totals 1980 – 2010 and First Half 2011)



\*Through June 30.  
Source: MR NatCatSERVICE

# U.S. Thunderstorm Loss Trends, 1980 – 2011\*



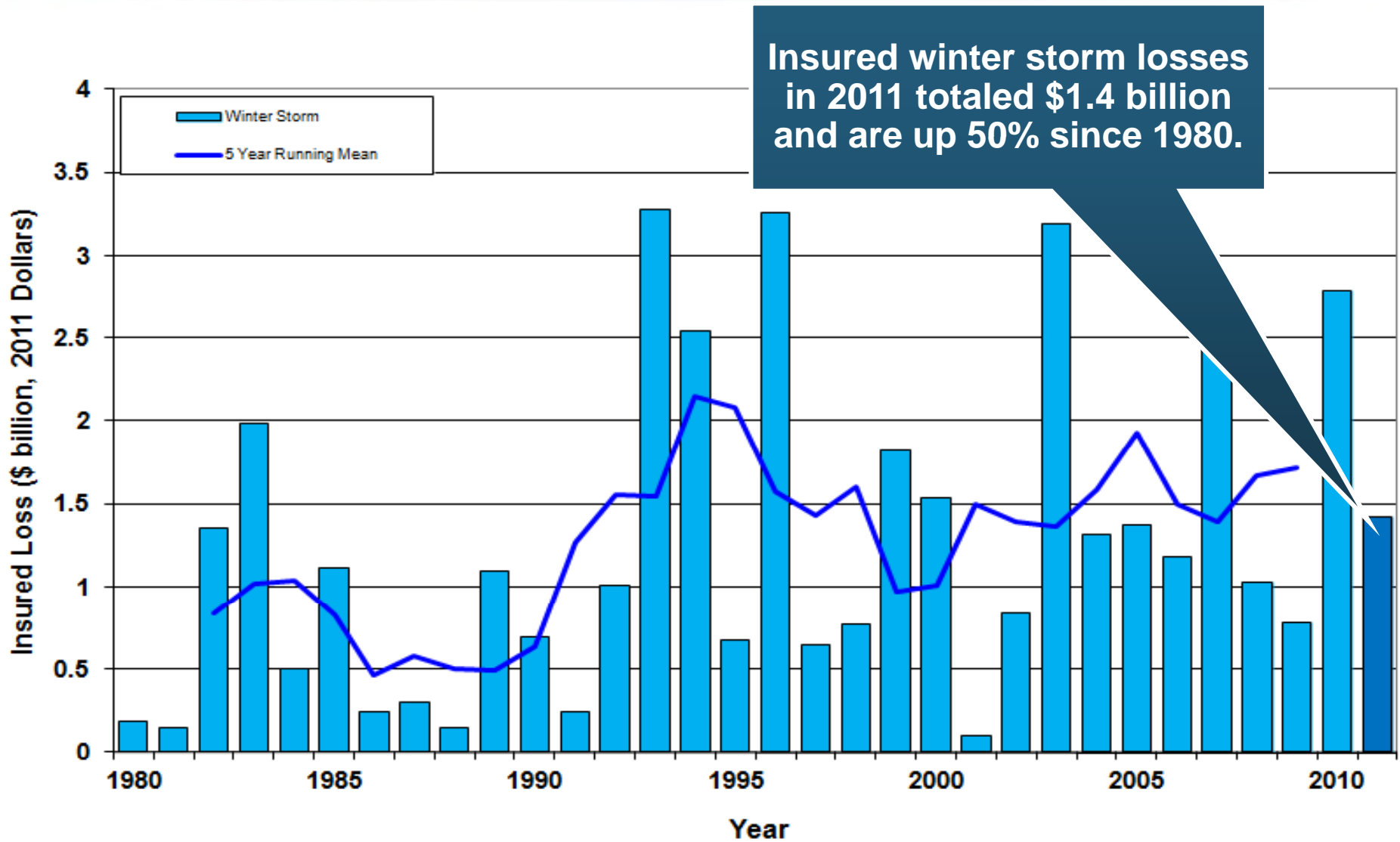
Thunderstorm losses in the first half of 2011 totaled \$16.4 billion, a new annual record through just 6 months

Hurricanes get all the headlines, but thunderstorms are consistent producers of large scale loss. 2008-2011 are the most expensive years on record.

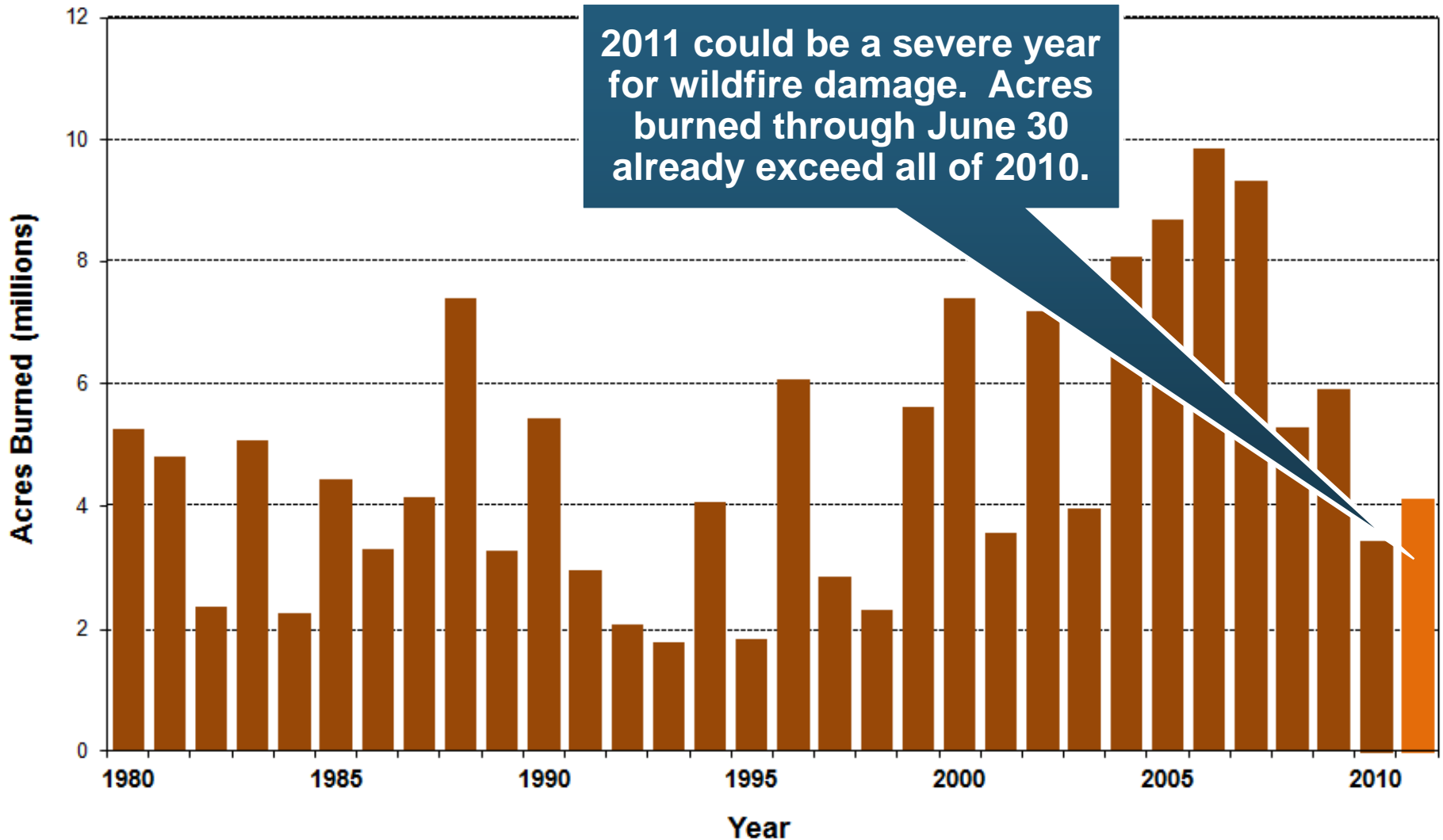
Average thunderstorm losses are up more than 8 fold since the early 1980s

\*Through June 30, 2011.  
Source: Property Claims Service, MR NatCatSERVICE

# U.S. Winter Storm Loss Trends, 1980 – 2010 (Annual Totals) vs. First Half 2011



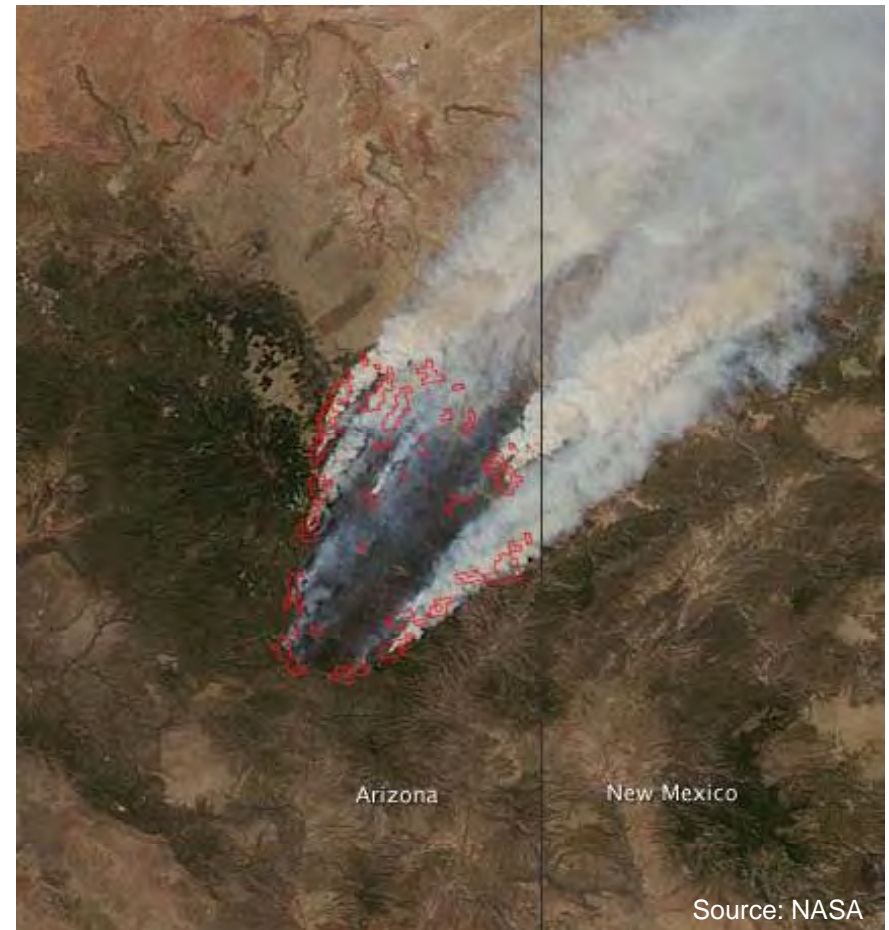
# U.S. Acreage Burned by Wildfires, 1980 – 2010 (Annual Totals) vs. First Half 2011



# Notable Wildfires in 2011

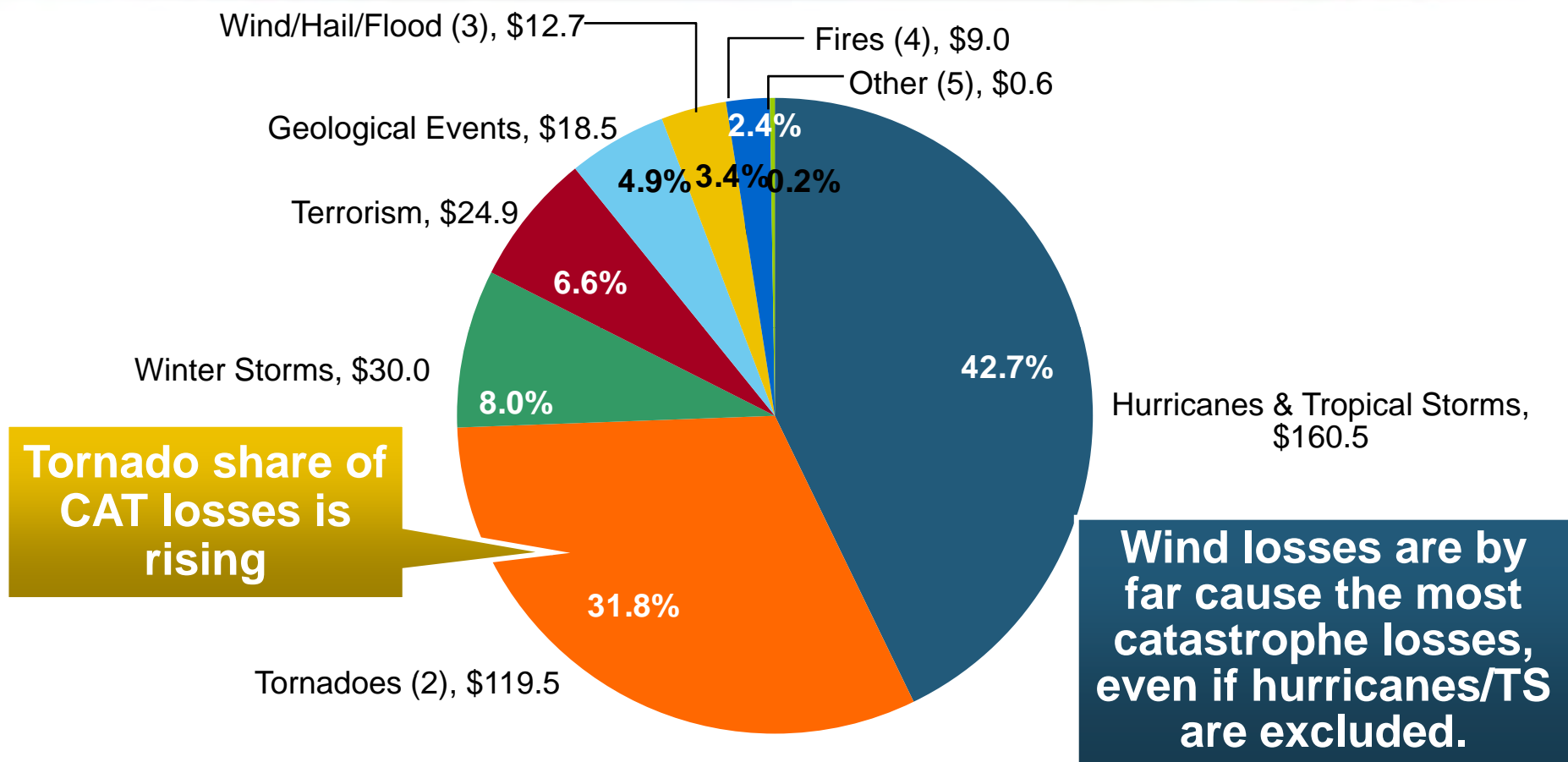
April – June

- ***Texas: Over 3 million acres burned in west Texas from 12 major seats of fire. Over 200 homes and businesses destroyed, \$50 million insured loss.***
- Arizona and New Mexico: “Wallow” fire largest in AZ history at 538,000 acres, Las Conchas fire near Los Alamos, 30 buildings destroyed.



Source: NASA

# Inflation Adjusted U.S. Catastrophe Losses by Cause of Loss, 1990–2011:H1<sup>1</sup>



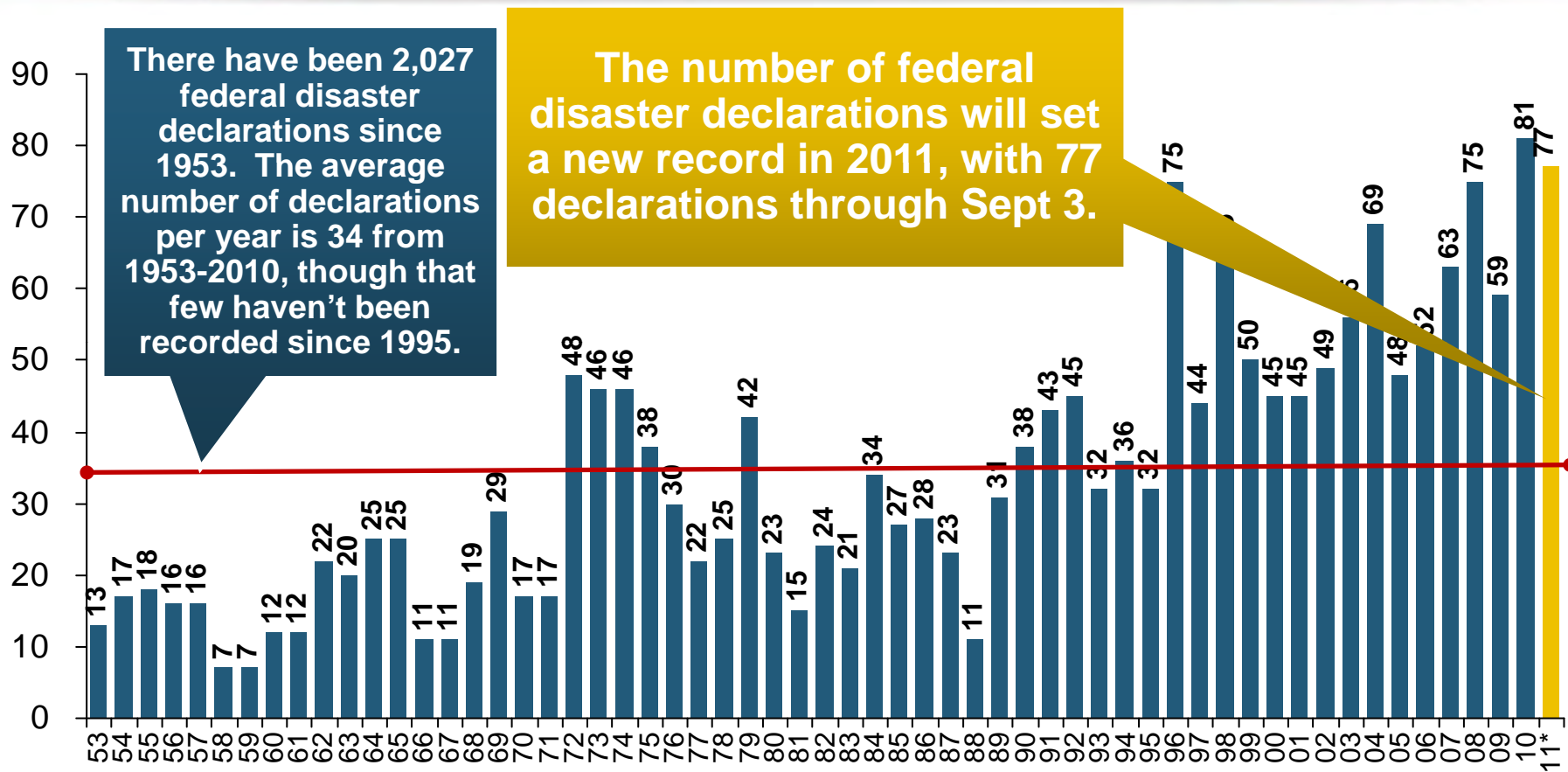
**Tornado share of CAT losses is rising**

**Wind losses are by far cause the most catastrophe losses, even if hurricanes/TS are excluded.**

1. Catastrophes are defined as events causing direct insured losses to property of \$25 million or more in 2009 dollars.
2. Excludes snow.
3. Does not include NFIP flood losses
4. Includes wildland fires
5. Includes civil disorders, water damage, utility disruptions and non-property losses such as those covered by workers compensation.

Source: ISO's Property Claim Services Unit.

# Number of Federal Disaster Declarations, 1953-2011\*



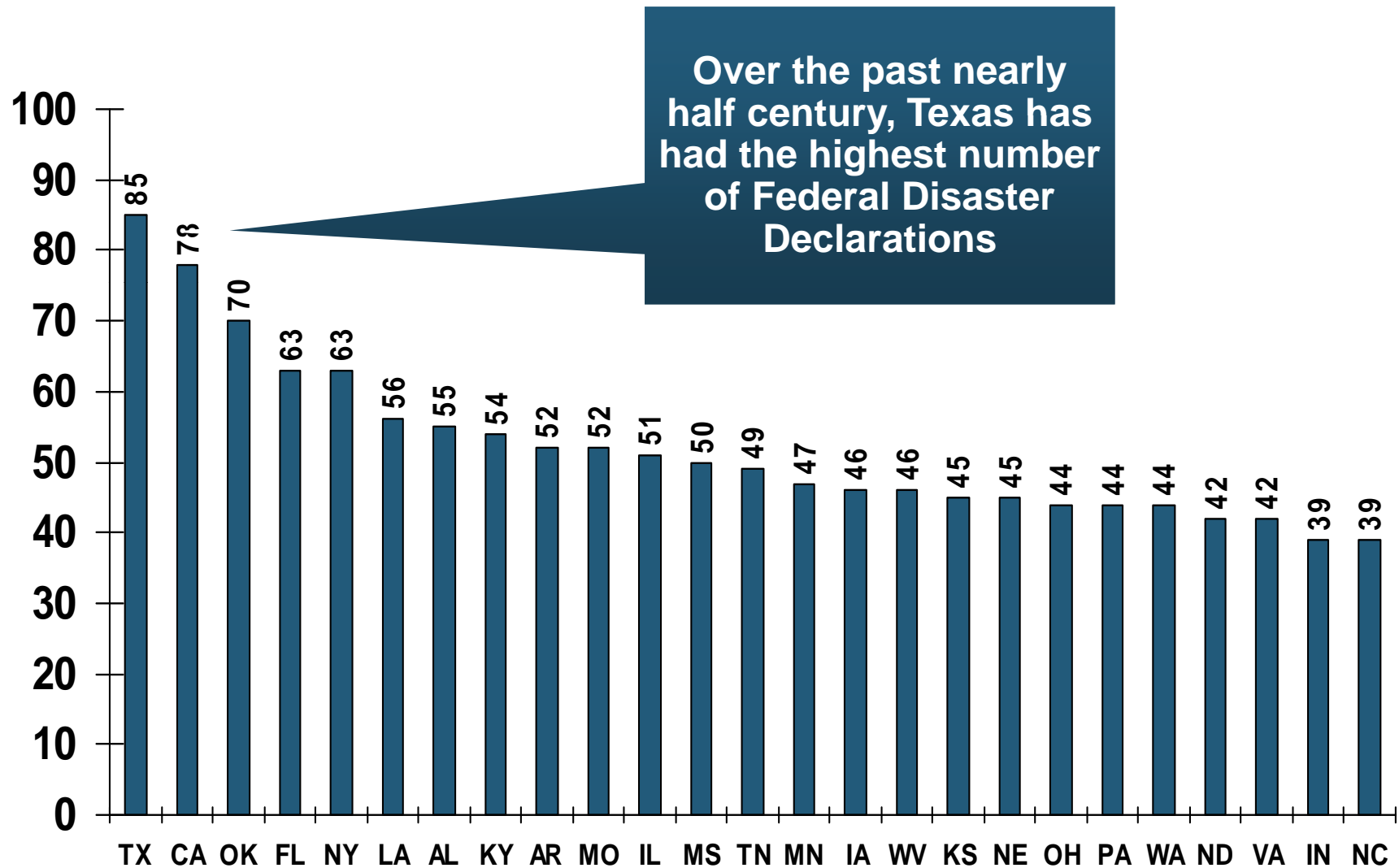
**The Number of Federal Disaster Declarations Is Rising and Will Set a Record in 2011**

\*Through September 3, 2011.

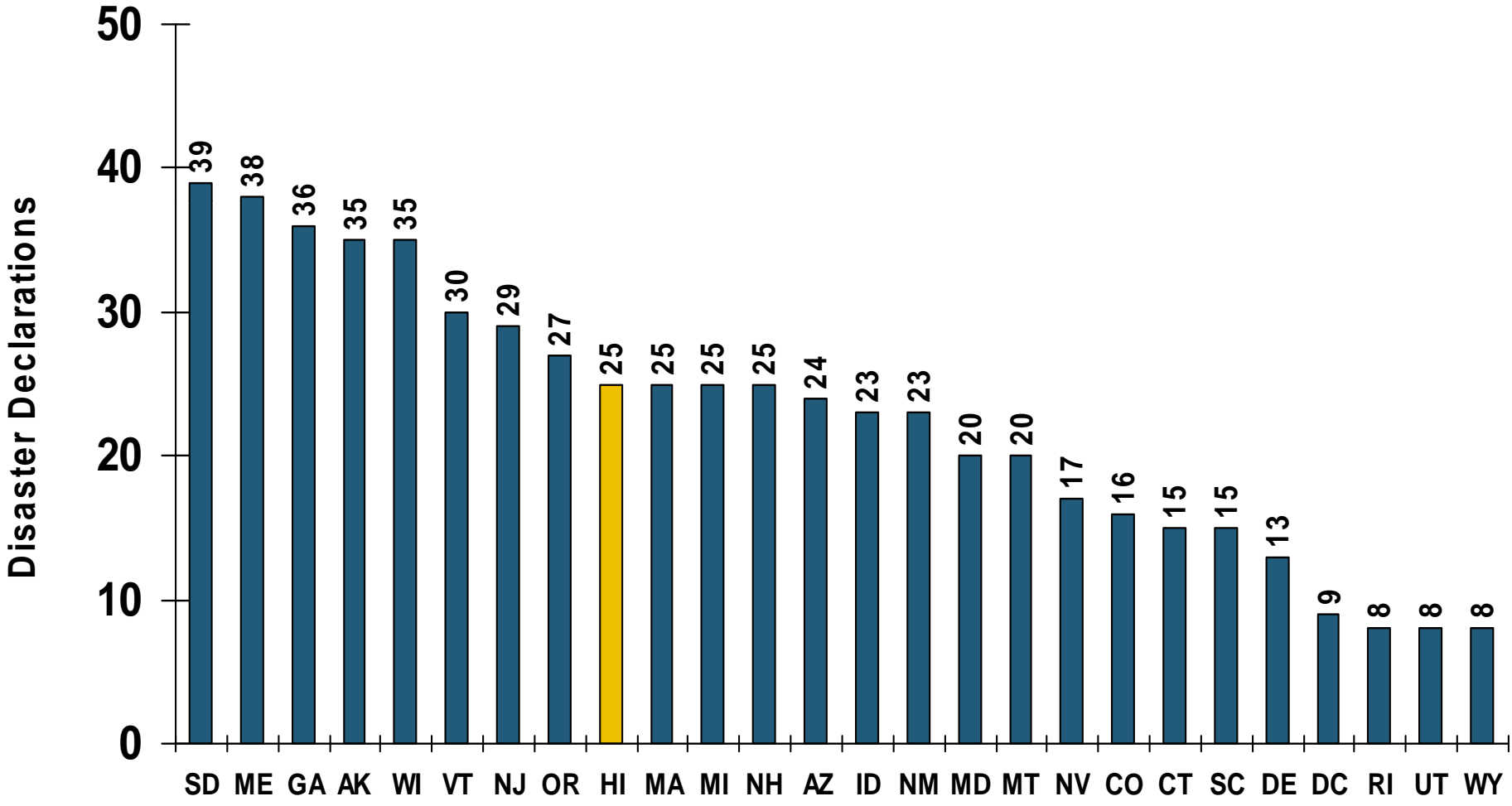
Source: Federal Emergency Management Administration: [http://www.fema.gov/news/disaster\\_totals\\_annual.fema](http://www.fema.gov/news/disaster_totals_annual.fema) ; Insurance Information Institute.



# Federal Disasters Declarations by State, 1953 – June 30, 2011: Highest 25 States



# Federal Disasters Declarations by State, 1953 – June 30, 2011: Lowest 25 States



Source: FEMA.



# The BIG Question: When Will the Market Turn?

## Insurance Cycle Dynamics

# Criteria Necessary for a “Market Turn”: All Four Criteria Must Be Met

Criteria	Status	Comments
<b>Sustained Period of Large Underwriting Losses</b>	<i>Not Yet Happened, But Inevitable</i>	<ul style="list-style-type: none"> <li>• Apart from Q2:2011, overall p/c underwriting losses remain modest</li> <li>• Combined ratios (ex-Q2 CATs) still in low 100s (vs. 110+ at onset of last hard market)</li> <li>• Prior-year reserve releases continue reduce u/w losses, boost ROEs</li> </ul>
<b>Material Decline in Surplus/ Capacity</b>	<i>Entered 2011 At Record High; Since Fallen</i>	<ul style="list-style-type: none"> <li>• Surplus hit a record \$565B as of 3/31/11</li> <li>• Analysts est. excess surplus of \$75-\$100B</li> <li>• Some excess capacity may still remain in reinsurance markets</li> <li>• Weak growth in demand for insurance is insufficient to absorb much excess capacity</li> </ul>
<b>Tight Reinsurance Market</b>	<i>Somewhat in Place</i>	<ul style="list-style-type: none"> <li>• Higher prices in Asia/Pacific</li> <li>• Modestly improved pricing for US risks</li> </ul>
<b>Renewed Underwriting &amp; Pricing Discipline</b>	<i>Not Broadly Evident; Some Firming</i>	<ul style="list-style-type: none"> <li>• Commercial lines pricing trends turning from negative to flat</li> <li>• Competition remains intense as many seek to maintain market share</li> <li>• Terms &amp; conditions—no broad tightening</li> </ul>

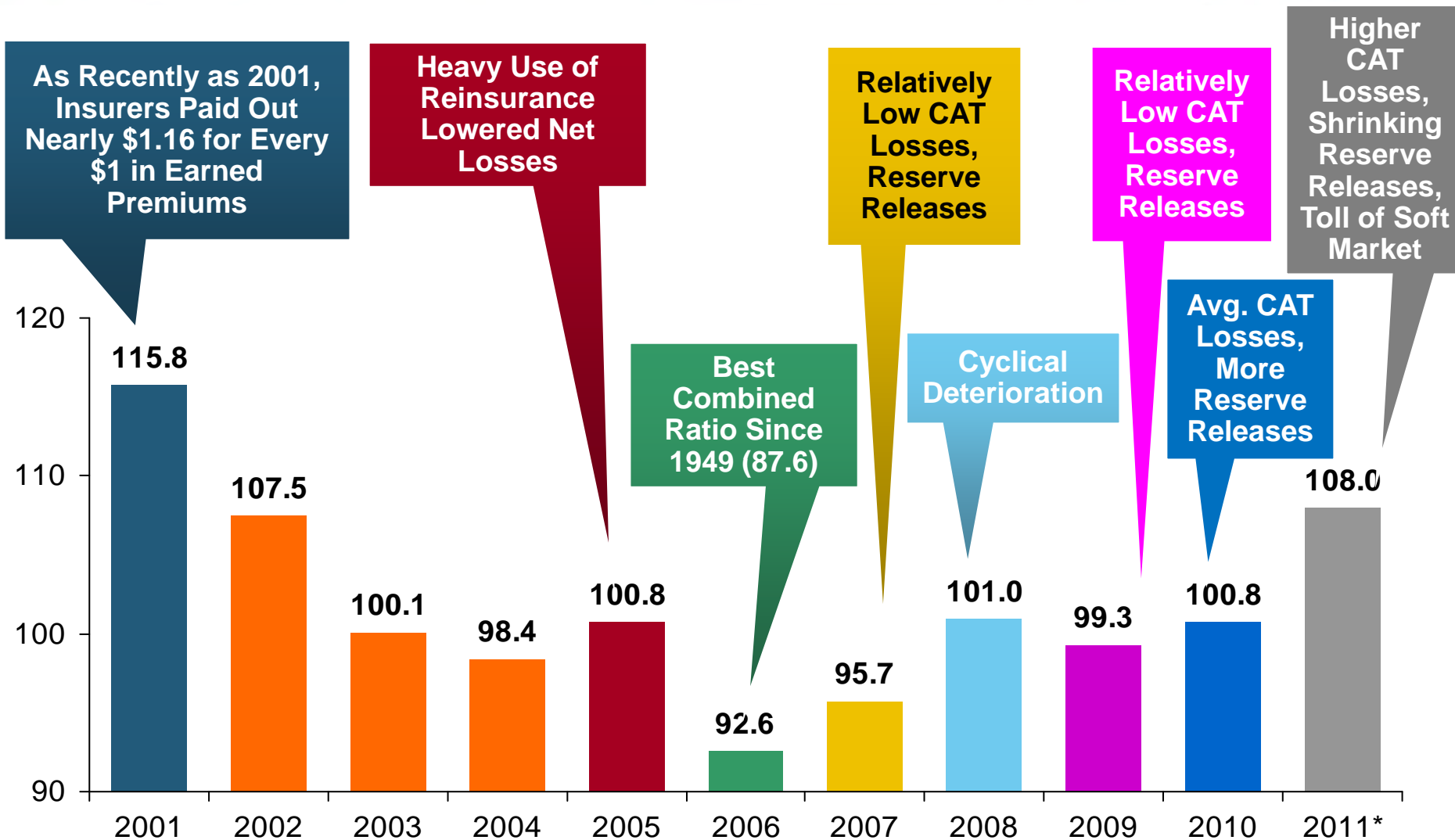
# Do the Property Catastrophe Events of 2011 Impact Casualty Markets?

- **Unlikely that Record 2011 Property CAT Loss Will Impact Casualty Markets in Any Material Way**
- **Global P/C & Reinsurance Industries Entered 2011 w/ Record Capital**
  - ◆ Events so far in 2011 are earnings events, rather than capital events
- **Natural Catastrophe and Casualty Risks Are Largely Uncorrelated**
  - ◆ Risks are different
  - ◆ Geographically, mostly distinct primary carriers: Japan-Australia-NZ-US
  - ◆ Casualty markets generally don't influence property markets
- **Property and Casualty Risks Are Largely Siloed**
- **Record Property Losses in 2004/2005 Did Not Impact Casualty Mkts.**
- **Casualty Markets Have Their Own Issues**
  - ◆ Tort environment
  - ◆ Inflation
  - ◆ Public policy

# 1. UNDERWRITING

**Have Underwriting Losses  
Been Large Enough for Long  
Enough to Turn the Market?**

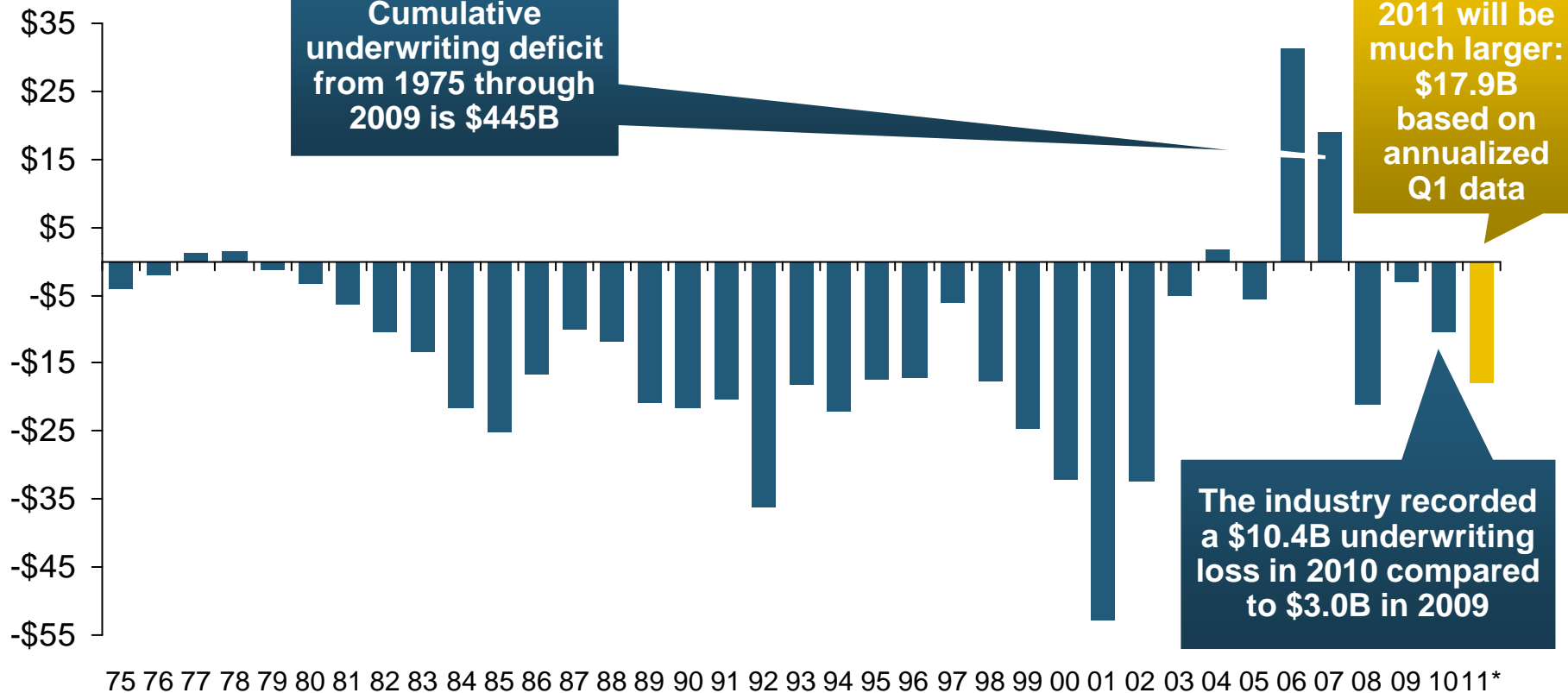
# P/C Insurance Industry Combined Ratio, 2001–2011:H1\*



\* Excludes Mortgage & Financial Guaranty insurers 2008--2011. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=109.1  
Sources: A.M. Best, ISO.; III Estimated for 2011:H1 (Q1 actual ex-M&FG was 102.2).

# Underwriting Gain (Loss) 1975–2011\*

(\$ Billions)



**Large Underwriting Losses Are *NOT* Sustainable  
in Current Investment Environment**

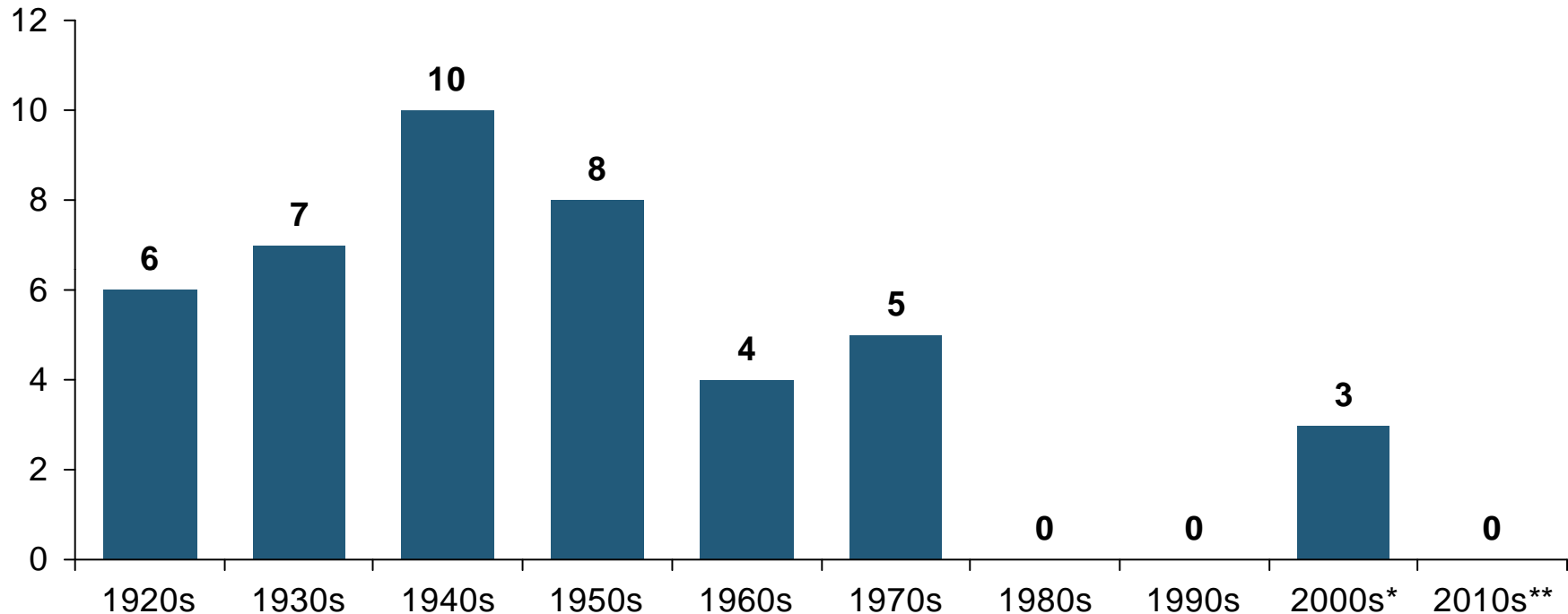
\* Includes mortgage and financial guaranty insurers in all years. 2011 figure is annualized based on actual Q1 underwriting losses of \$4.463 billion.

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



# Number of Years with Underwriting Profits by Decade, 1920s–2010s

## Number of Years with Underwriting Profits



**Underwriting Profits Were Common Before the 1980s (40 of the 60 Years Before 1980 Had Combined Ratios Below 100) – But Then They Vanished. Not a Single Underwriting Profit Was Recorded in the 25 Years from 1979 Through 2003**

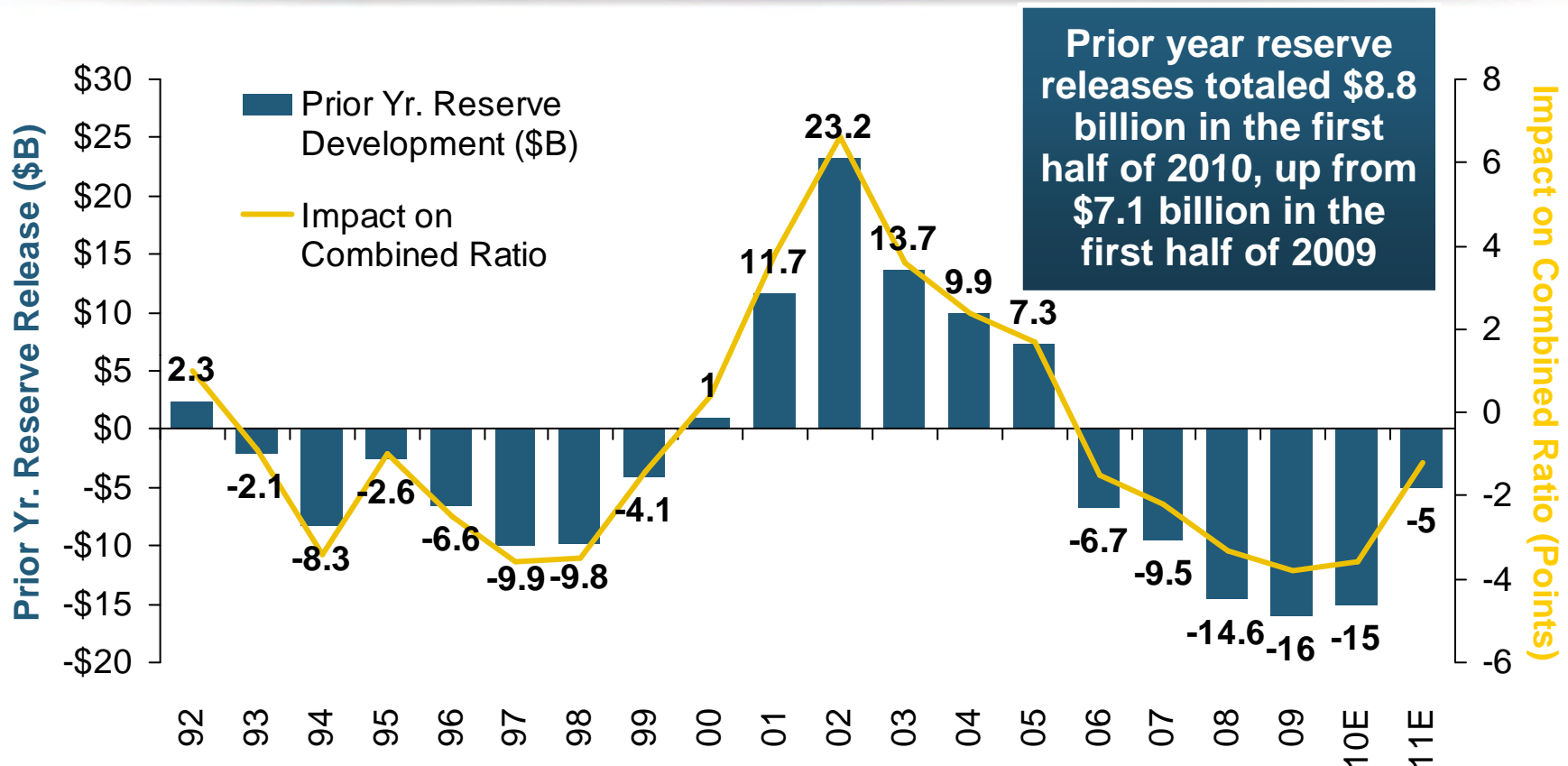
total to 4 years with an underwriting profit.

\*\*Data for the 2010s includes 2010 and 2011.

Note: Data for 1920–1934 based on stock companies only.

Sources: Insurance Information Institute research from A.M. Best Data.

# P/C Reserve Development, 1992–2011E



Prior year reserve releases totaled \$8.8 billion in the first half of 2010, up from \$7.1 billion in the first half of 2009

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

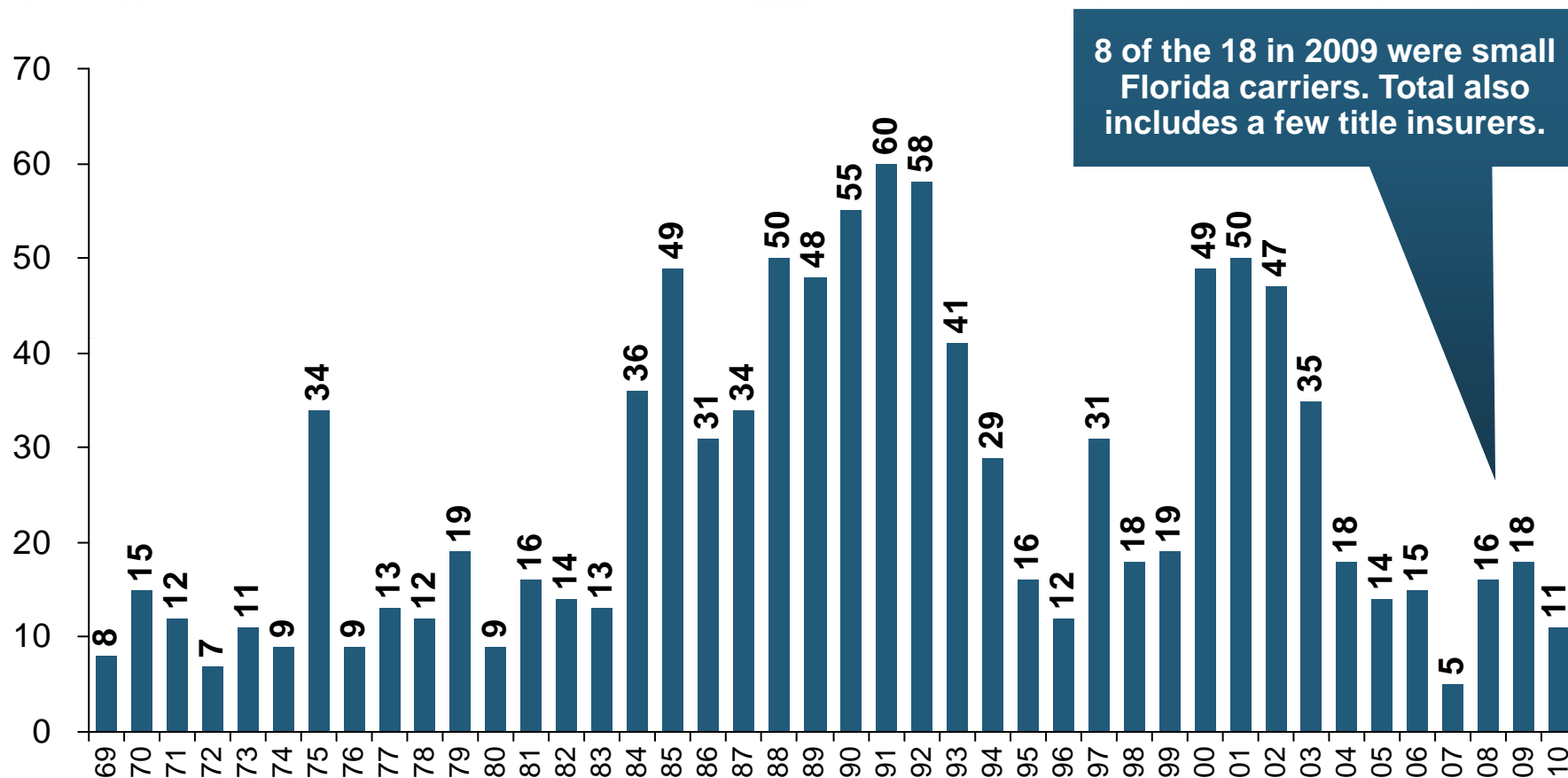
Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage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

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

# **Financial Strength & Underwriting**

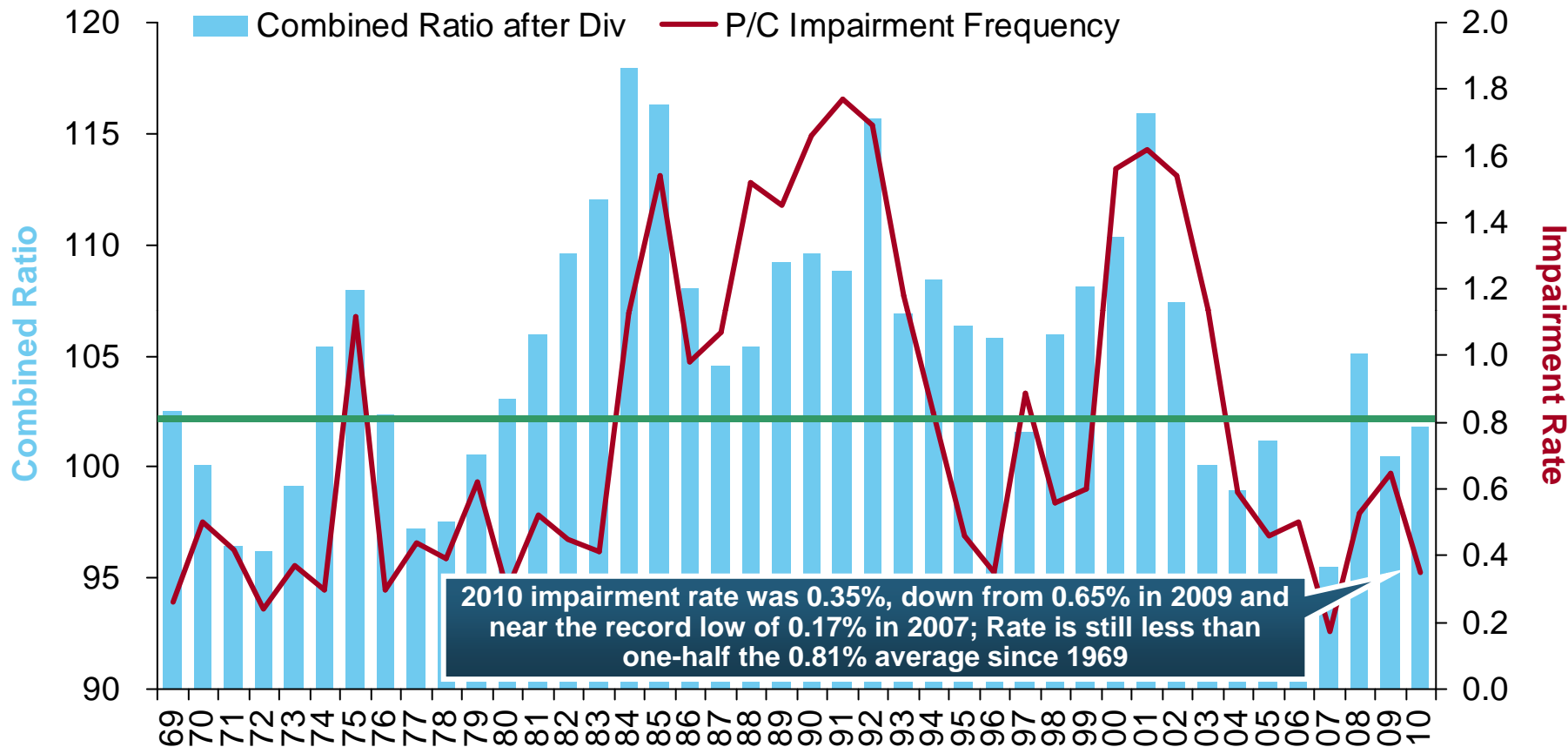
**Cyclical Pattern is P-C Impairment  
History is Directly Tied to  
Underwriting, Reserving & Pricing**

# P/C Insurer Impairments, 1969–2010



**The Number of Impairments Varies Significantly Over the P/C Insurance Cycle, With Peaks Occurring Well into Hard Markets**

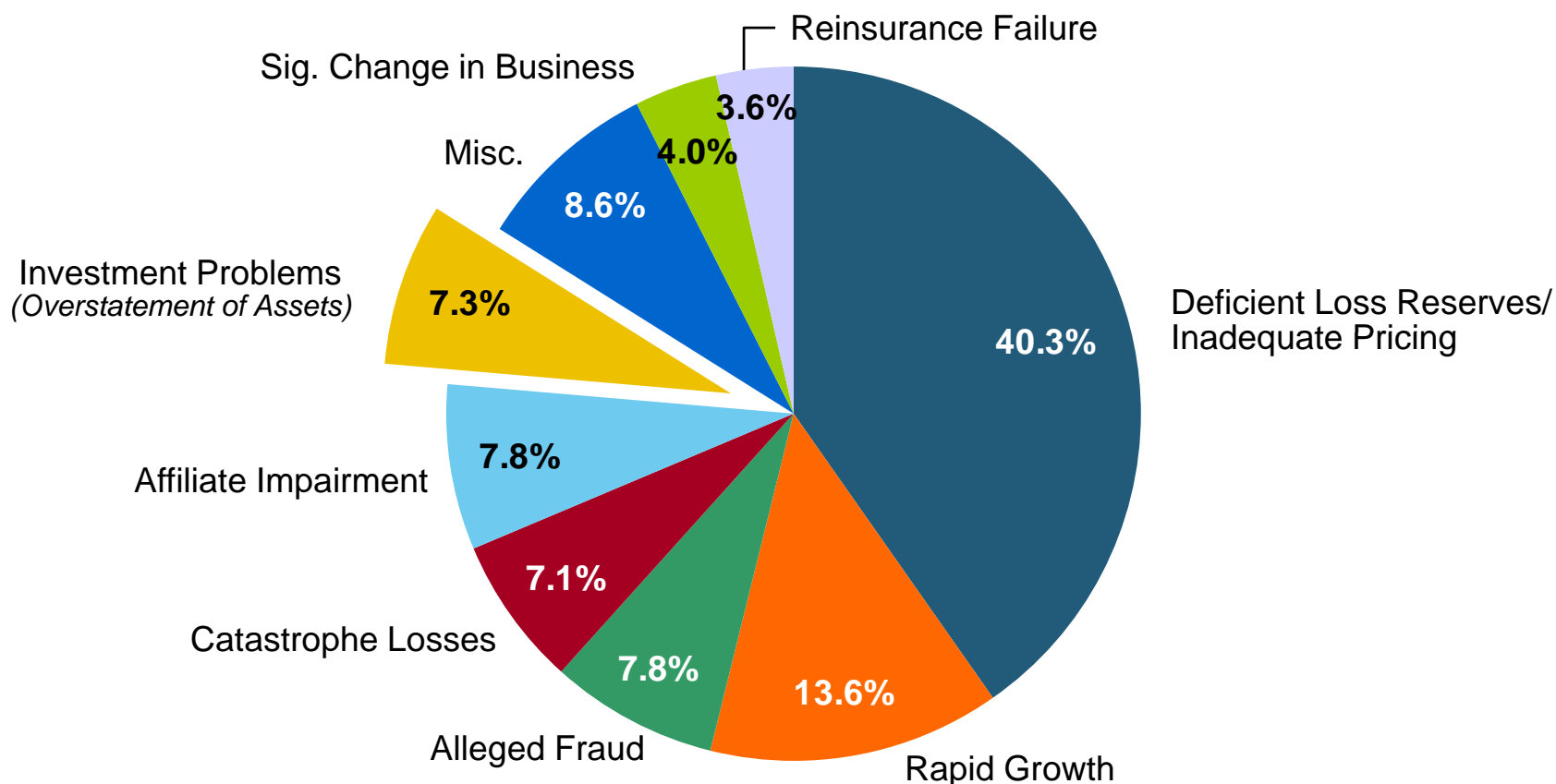
# P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2010



**Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007**

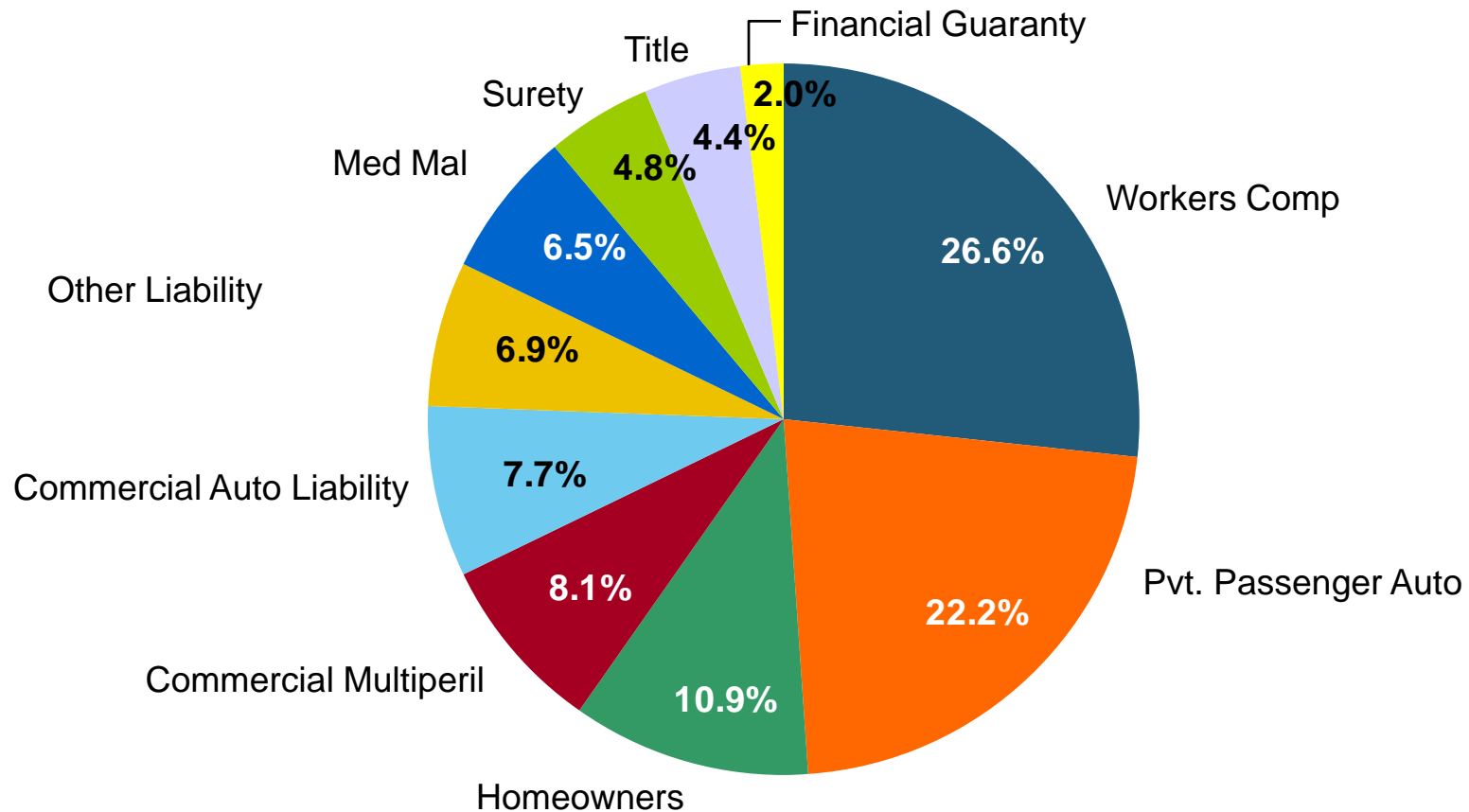
# Reasons for US P/C Insurer Impairments, 1969–2010

Historically, Deficient Loss Reserves and Inadequate Pricing Are By Far the Leading Cause of P-C Insurer Impairments. Investment and Catastrophe Losses Play a Much Smaller Role



# Top 10 Lines of Business for US P/C Impaired Insurers, 2000–2010

Workers Comp and Pvt. Passenger Auto Account for Nearly Half of the Premium Volume of Impaired Insurers Over the Past Decade





# Performance by Segment: Commercial Lines & Reinsurance



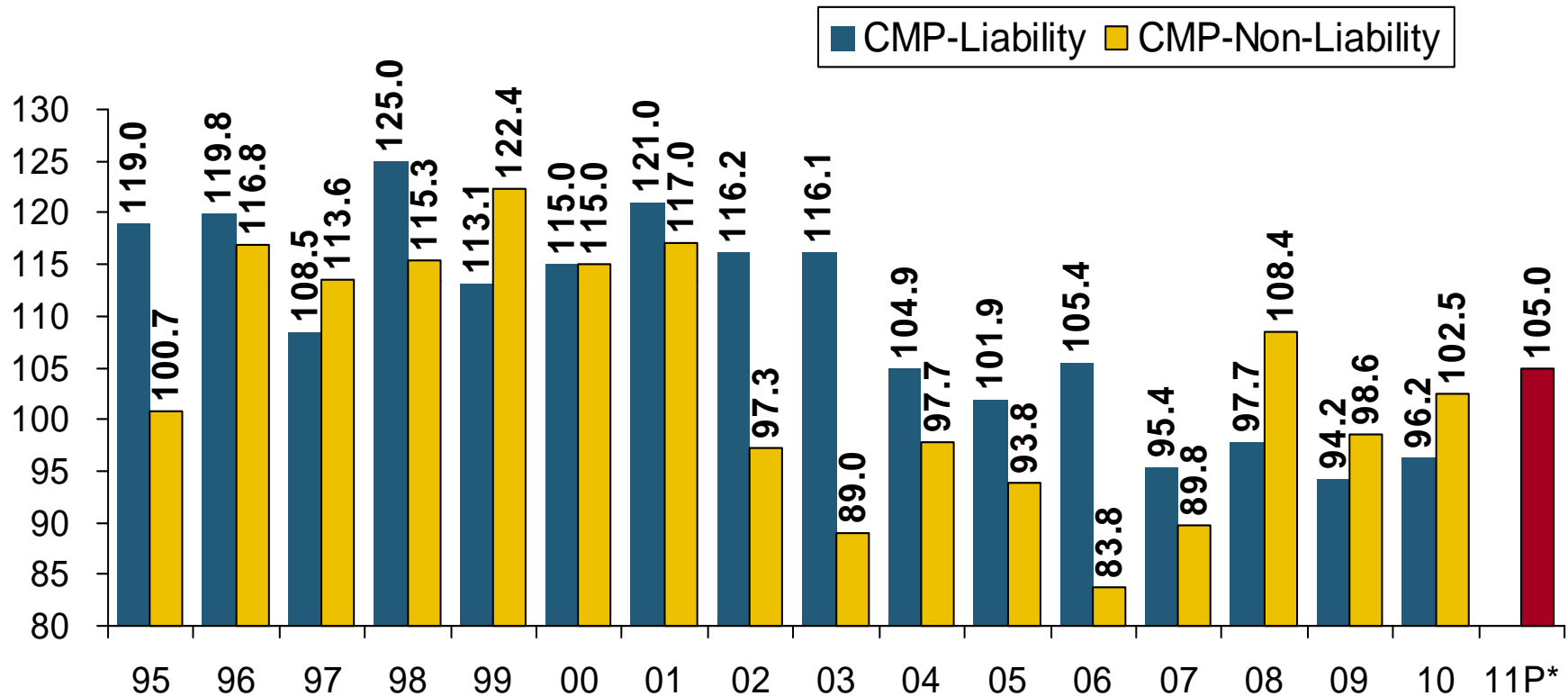
# P/C Underwriting Results: 2008-2010P



Line of Business	2008	2009	2010P
Personal Auto	100.3	101.3	101
Homeowners	117.0	105.6	107
Other Liability (incl. Prod Liab)	95	105	110
Workers Compensation	101	110.5	115
Commercial Multi Peril	104	97	101
Commercial Auto	96.8	99.5	98
Fire & Allied Lines (incl. EQ)	99	80	83
All Other Lines	113	96	101
<b>Total P/C Industry</b>	<b>104</b>	<b>101</b>	<b>102</b>

Source: All lines except WC for 2008-09, A.M. Best; Worker Comp., NCCI; 2010P data, ISO. Private carriers only.

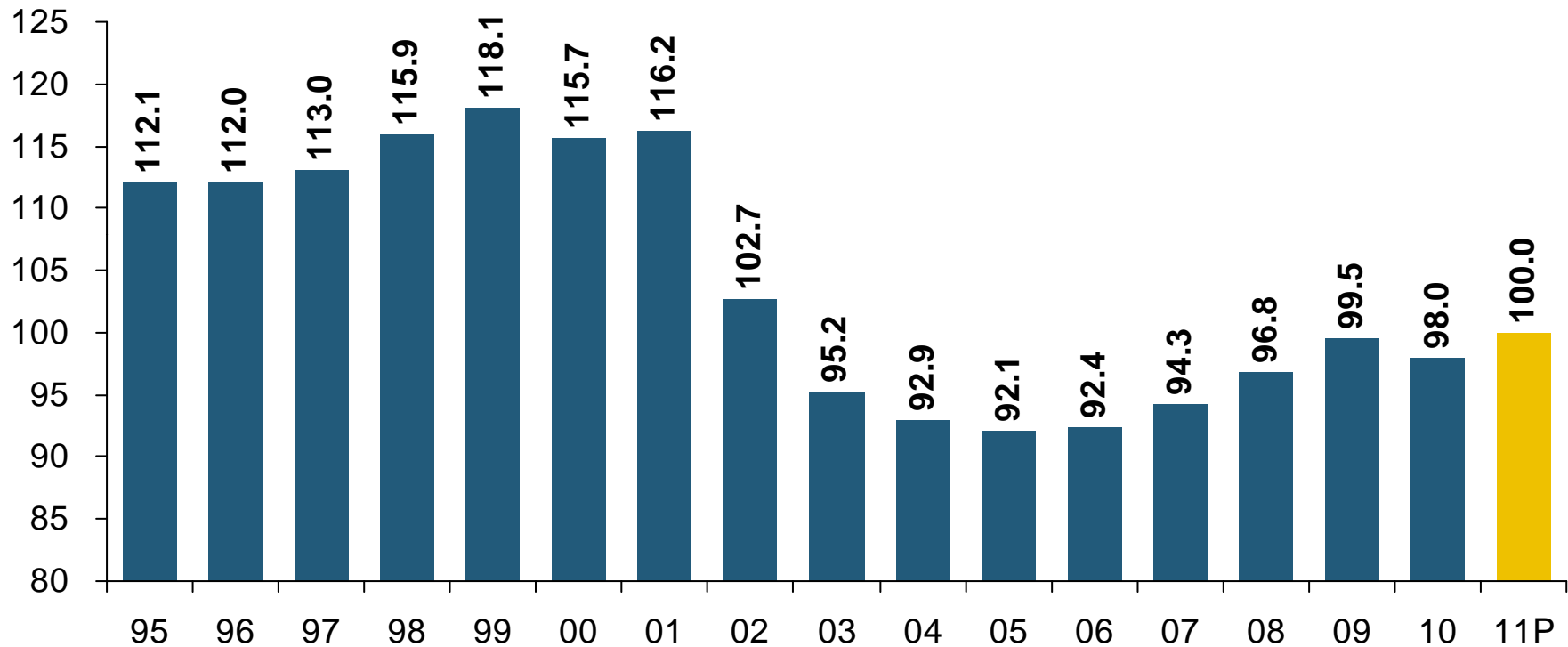
# Commercial Multi-Peril Combined Ratio: 1995–2011P



**Commercial Multi-Peril Underwriting Performance is Expected to Deteriorate Modestly**

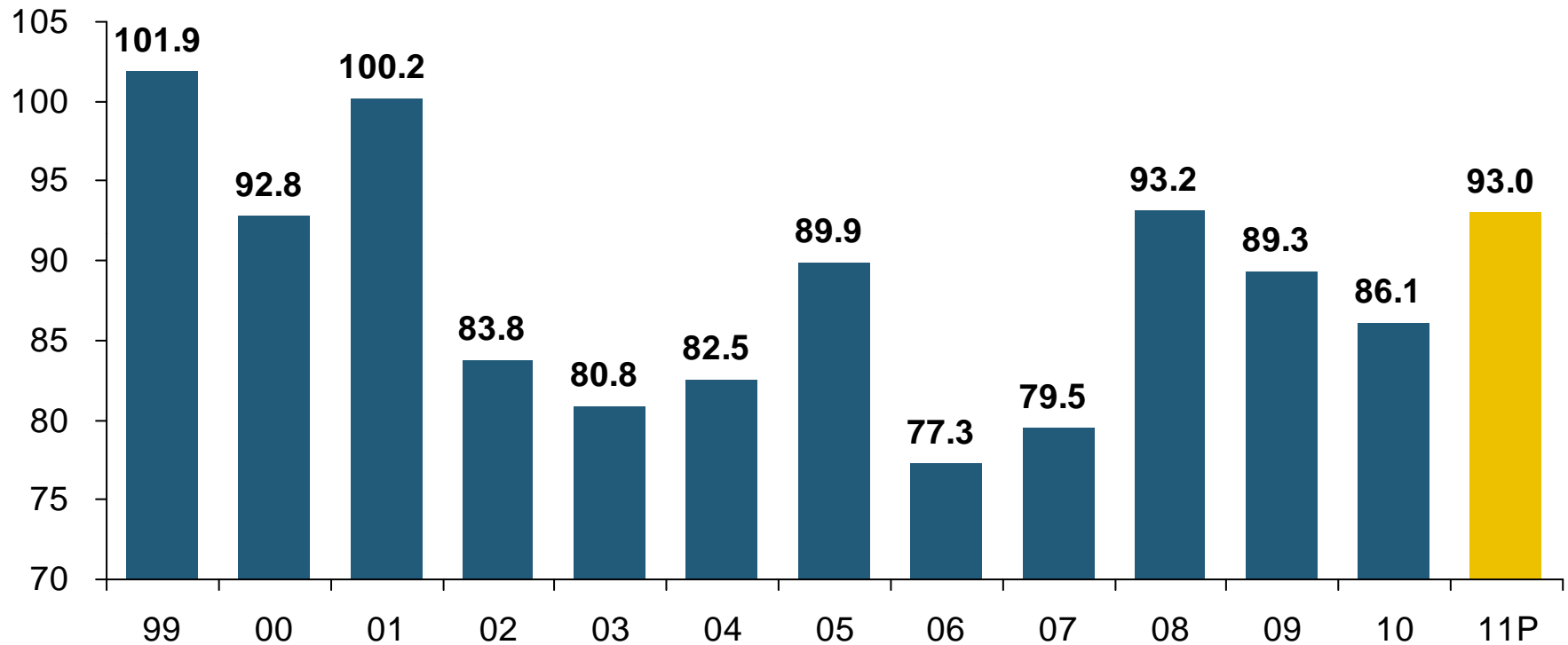
\*2011P figure is III estimate for the combined liability and non-liability components.  
Sources: A.M. Best; Insurance Information Institute.

# Commercial Auto Combined Ratio: 1993–2011P



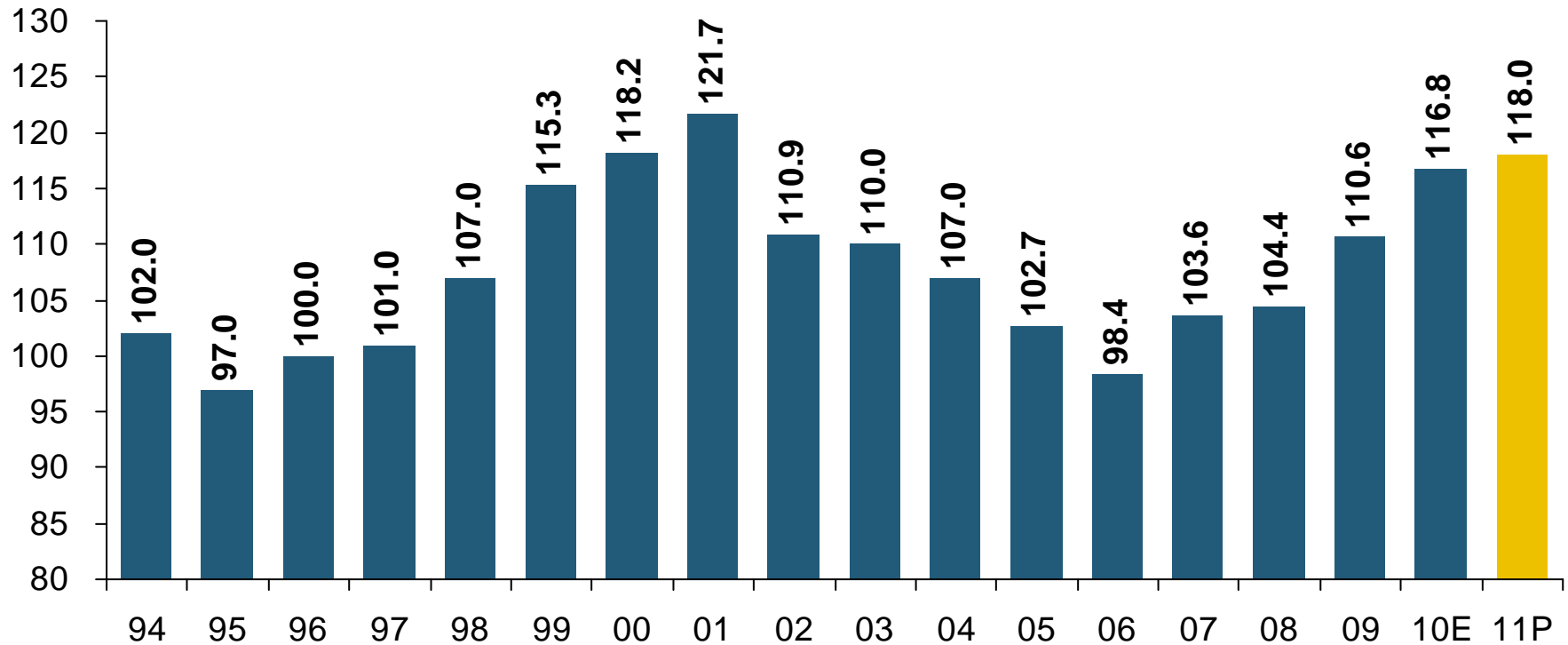
**Commercial Auto Underwriting Performance is  
Expected to Deteriorate Modestly**

# Inland Marine Combined Ratio: 1999–2011P



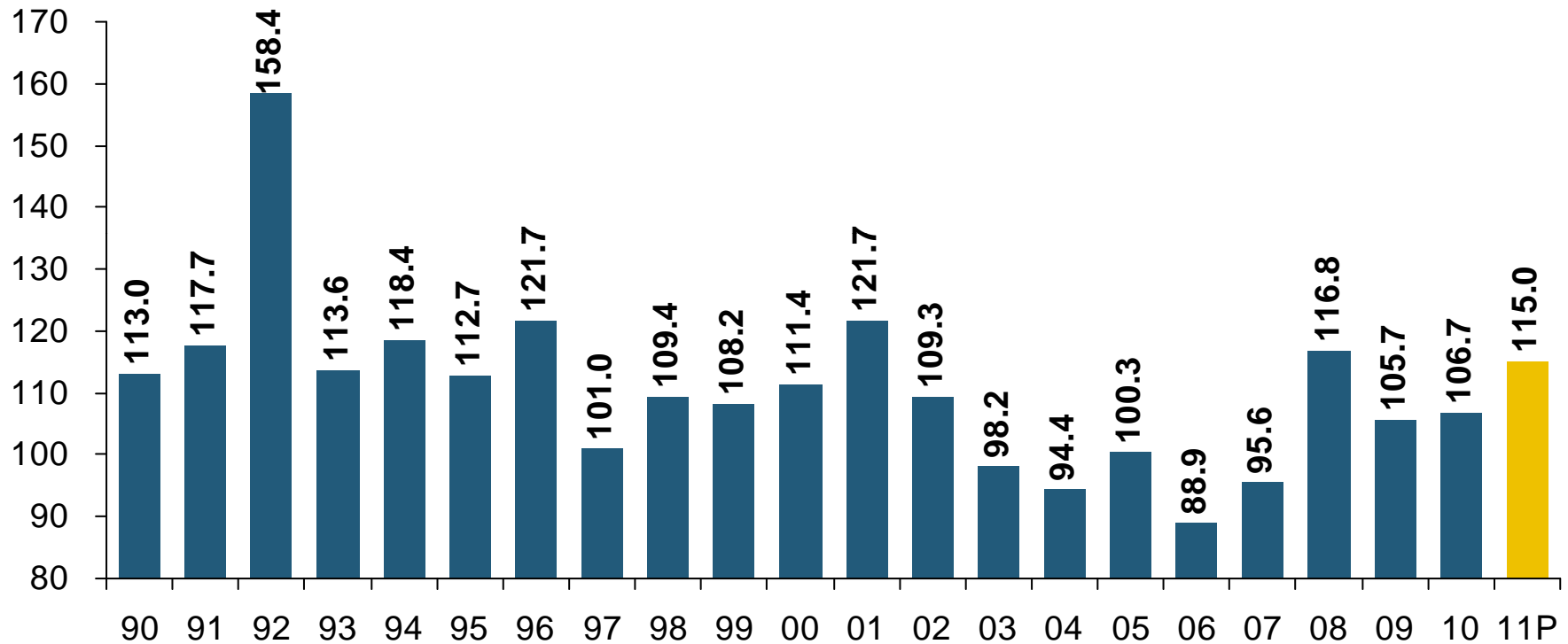
**Inland Marine is Expected to Remain Among the Most Profitable of All Lines**

# Workers Compensation Combined Ratio: 1994–2011P



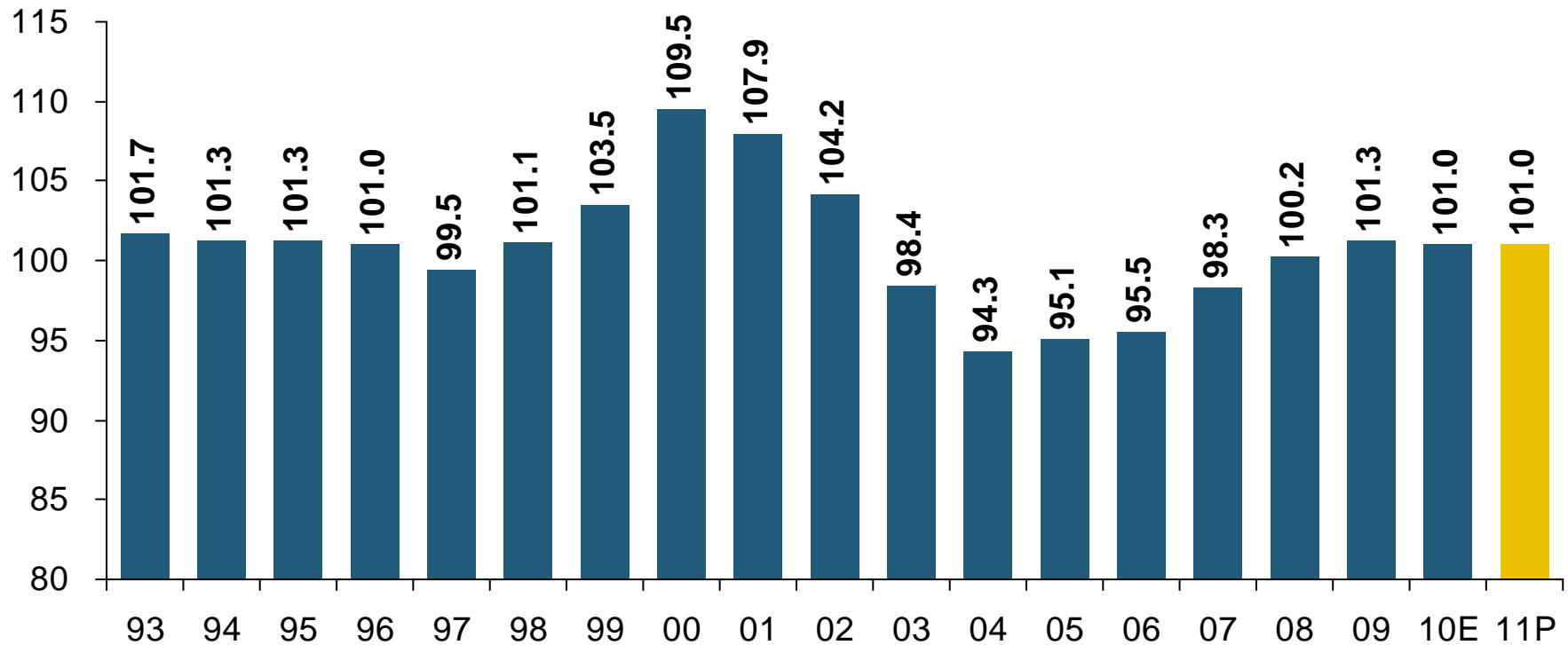
**Workers Comp Underwriting Results Are Deteriorating Markedly and the Worst They Have Been in a Decade**

# Homeowners Insurance Combined Ratio: 1990–2011P



**Homeowners Line Could Deteriorate in 2011 Due to Large Cat Losses. Extreme Regional Variation Can Be Expected Due to Local Catastrophe Loss Activity**

# Private Passenger Auto Combined Ratio: 1993–2011P



**Private Passenger Auto Accounts for 34% of Industry Premiums and Remains the Profit Juggernaut of the P/C Insurance Industry**

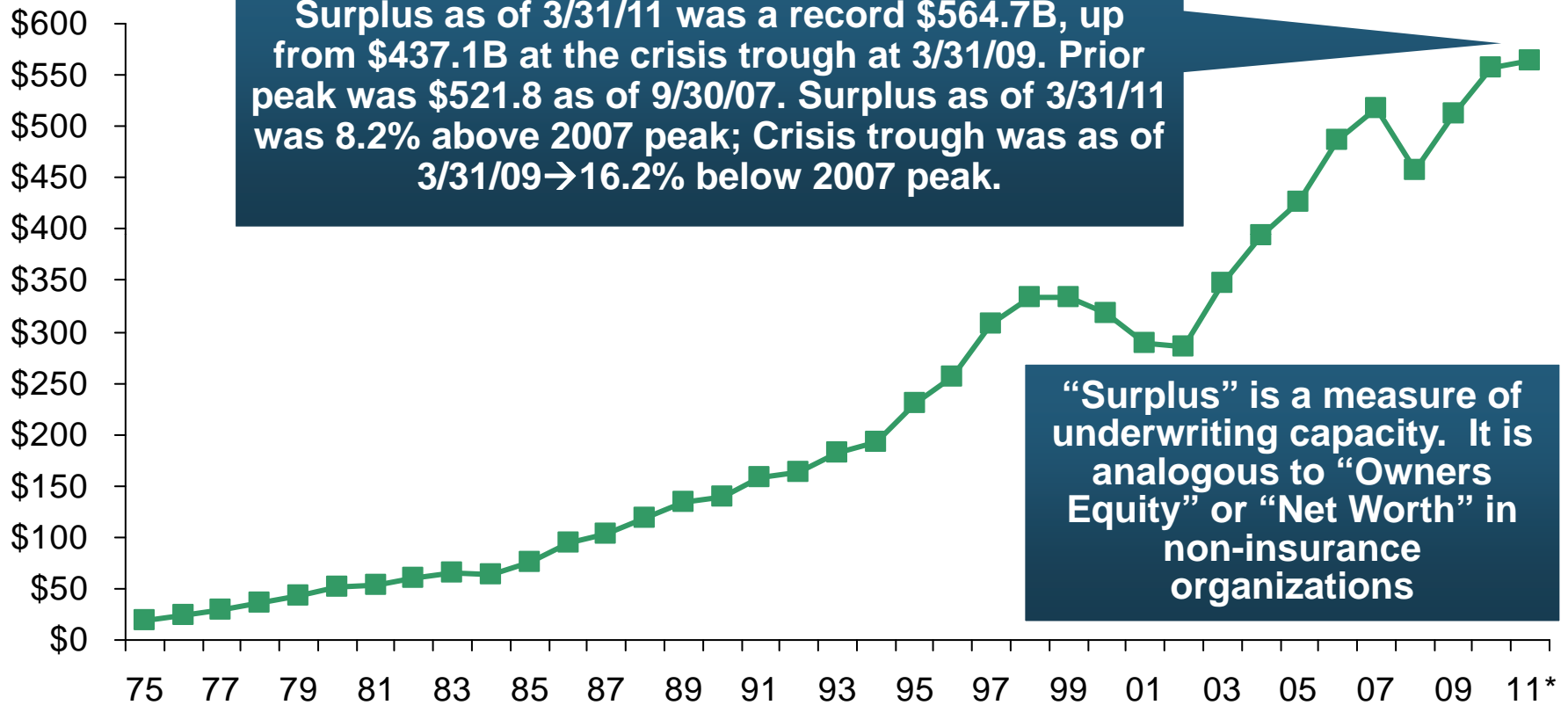
## **2. SURPLUS/CAPITAL/CAPACITY**

**Have Large Global Losses Reduced Capacity in the Industry, Setting the Stage for a Market Turn?**



# US Policyholder Surplus: 1975–2011\*

(\$ Billions)

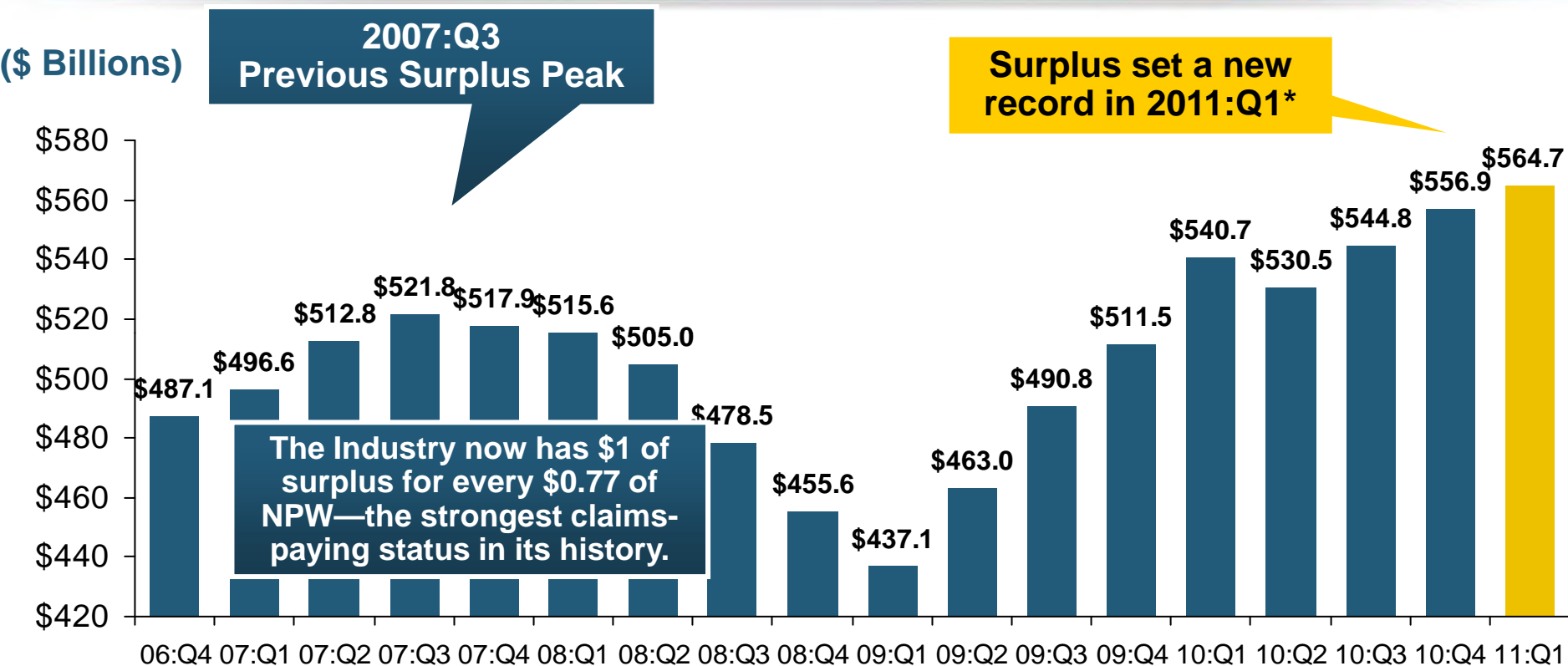


**The Premium-to-Surplus Ratio Stood at \$0.77:\$1 as of 3/31/11, A Near Record Low (at Least in Recent History)\*\***

\* As of 3/31/11.

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

# Policyholder Surplus, 2006:Q4–2011:Q1

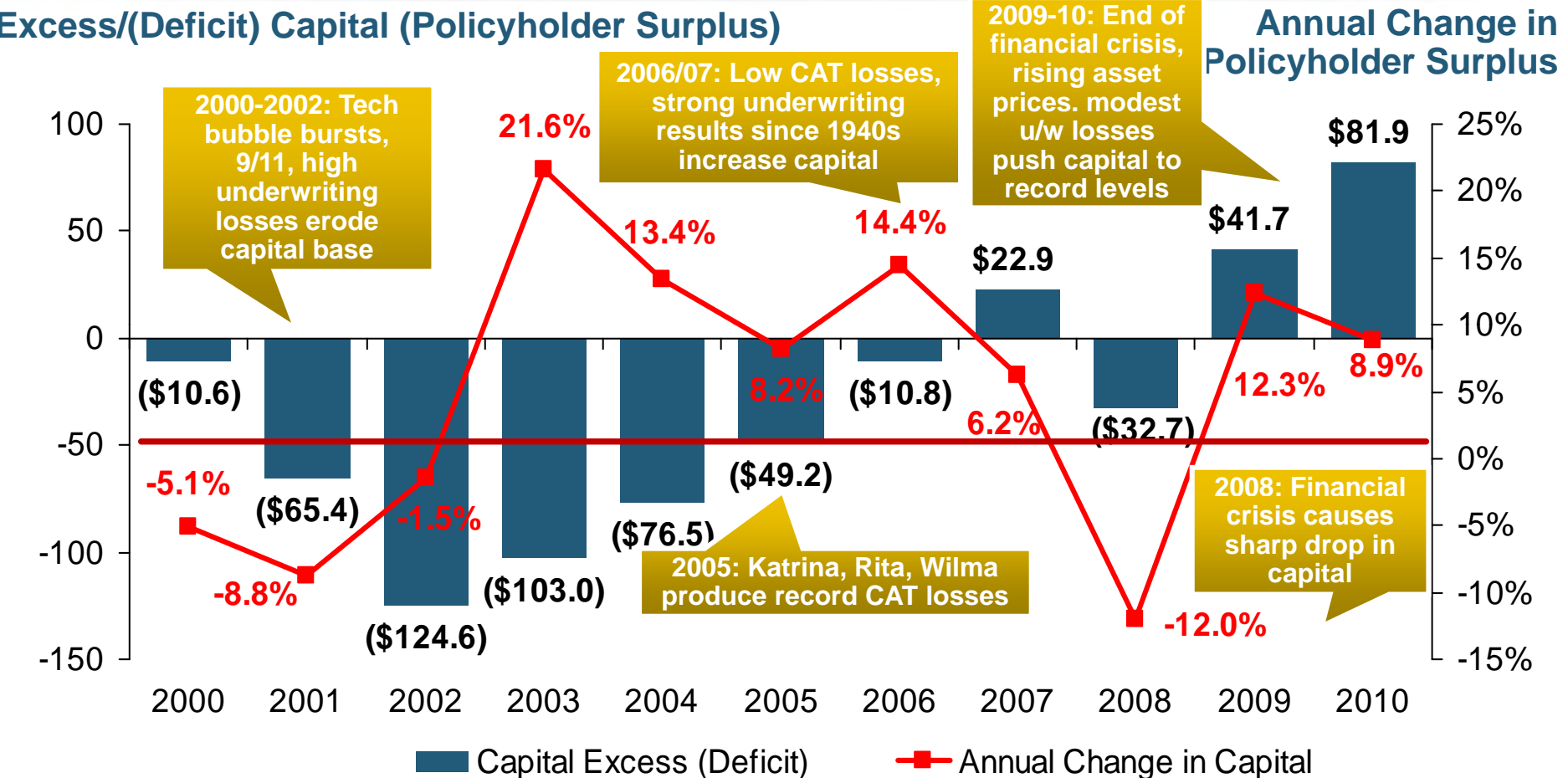


## Quarterly Surplus Changes Since 2007:Q3 Peak

<b>09:Q1: -\$84.7B (-16.2%)</b>	<b>10:Q1: +\$18.9B (+3.6%)</b>
<b>09:Q2: -\$58.8B (-11.2%)</b>	<b>10:Q2: +\$8.7B (+1.7%)</b>
<b>09:Q3: -\$31.0B (-5.9%)</b>	<b>10:Q3: +\$23.0B (+4.4%)</b>
<b>09:Q4: -\$10.3B (-2.0%)</b>	<b>10:Q4: +\$35.1B (+6.7%)</b>
	<b>11:Q1: +\$42.9B (+8.2%)</b>

\*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.

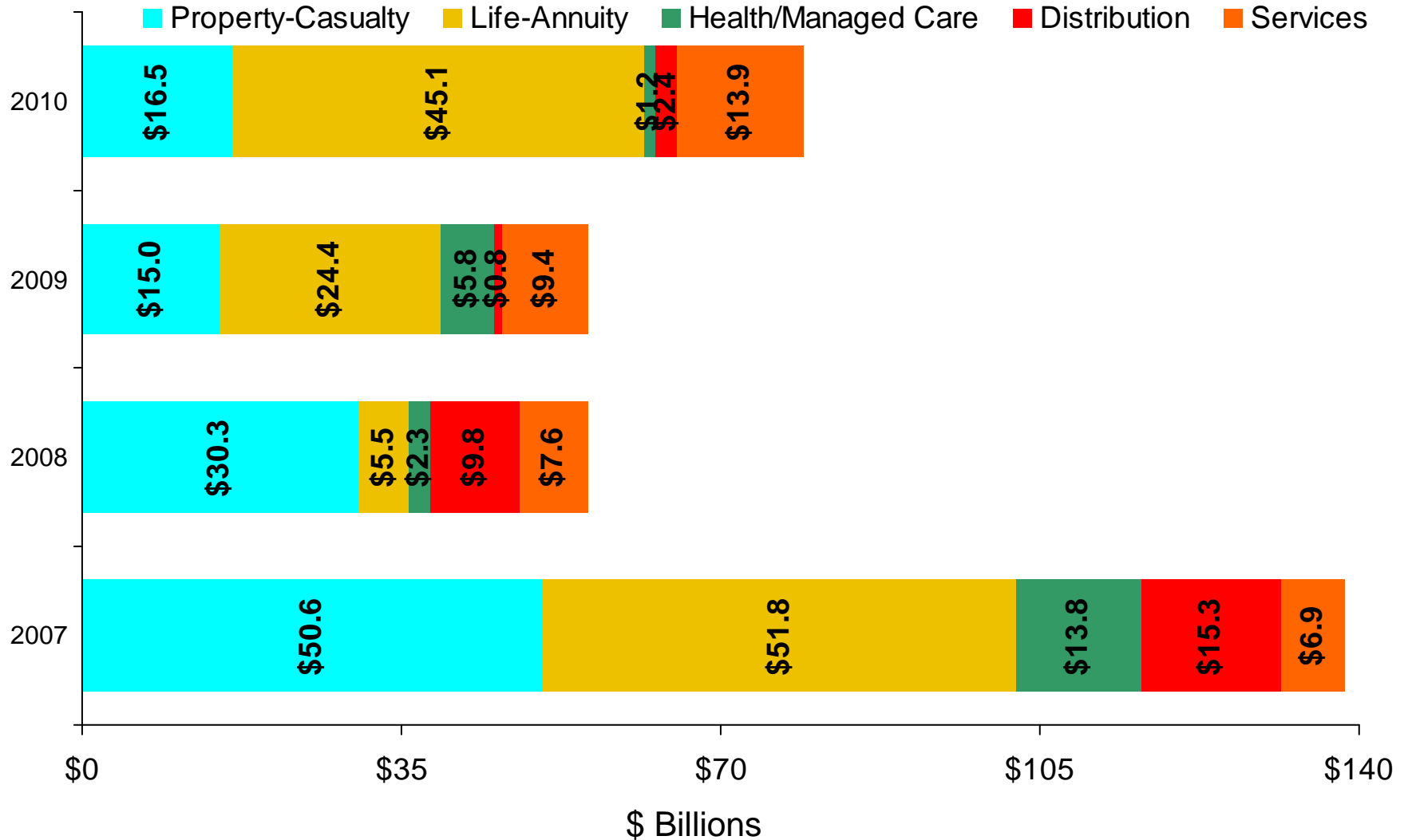
# Implied Excess (Deficit) Capital Assuming Premium/Surplus Ratio = 0.9:1



**Record Policyholder Surplus (Capital) Has Resulted Significant Excess Capital in the P/C Insurance Sector As of Year End 2010. Deteriorating Underwriting Losses, Higher CAT Activity, More Modest Market Returns Will Likely Shrink Excess Capital in 2011.**

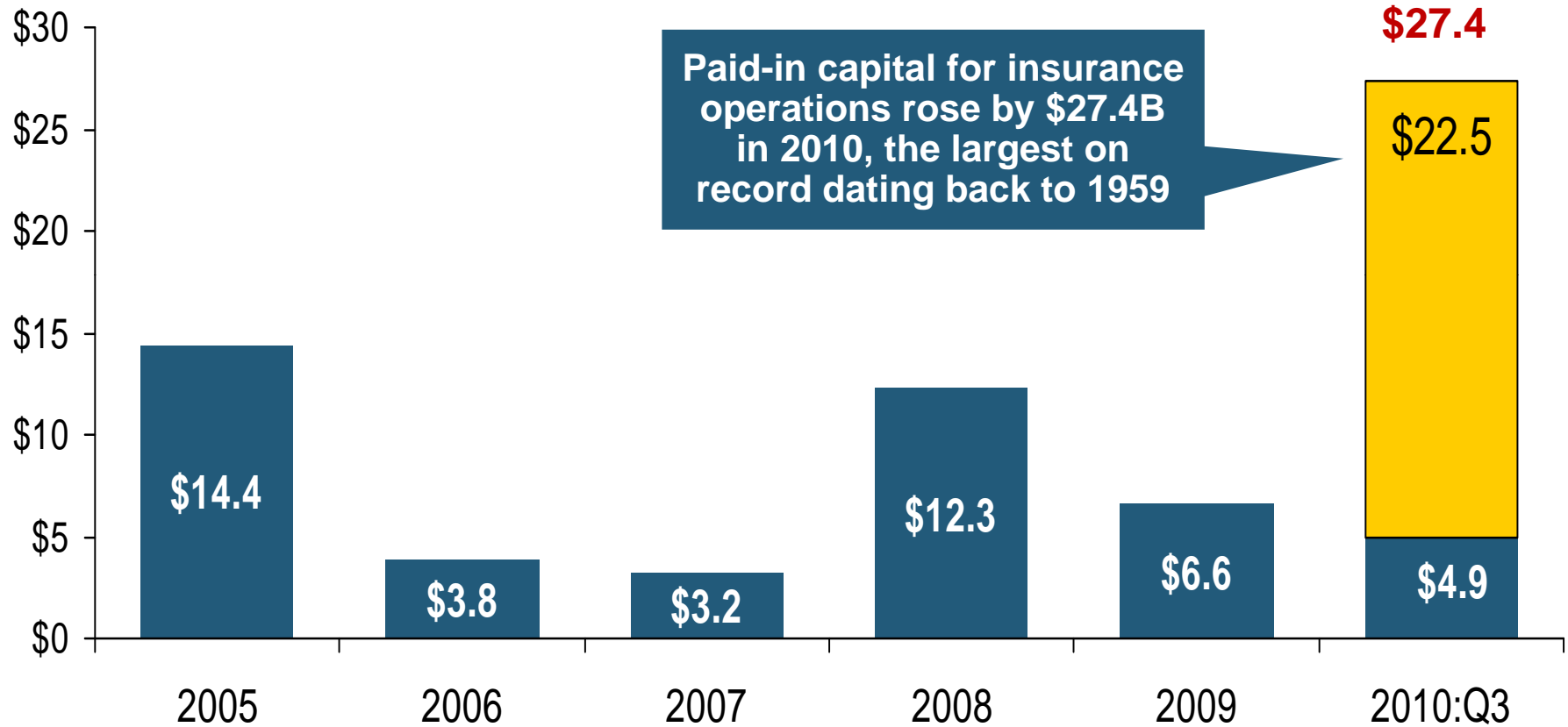
Note: The assumption of a 0.9:1 P/S ratio is derived from a Feb. 2011 announcement by Advisen, Ltd., that the US P/C insurance industry has \$74 billion in excess capital. The implied P/S ratio (calculated by III) is 0.88:1, which was rounded to 0.9:1.  
 Source: Insurance Information Institute calculations from A.M. Best and ISO data. \* Net Premiums Written

# M&A Activity Globally Among P/C Insurers Remains Subdued: Little Capacity Leaving



# Paid-in Capital, 2005–2010

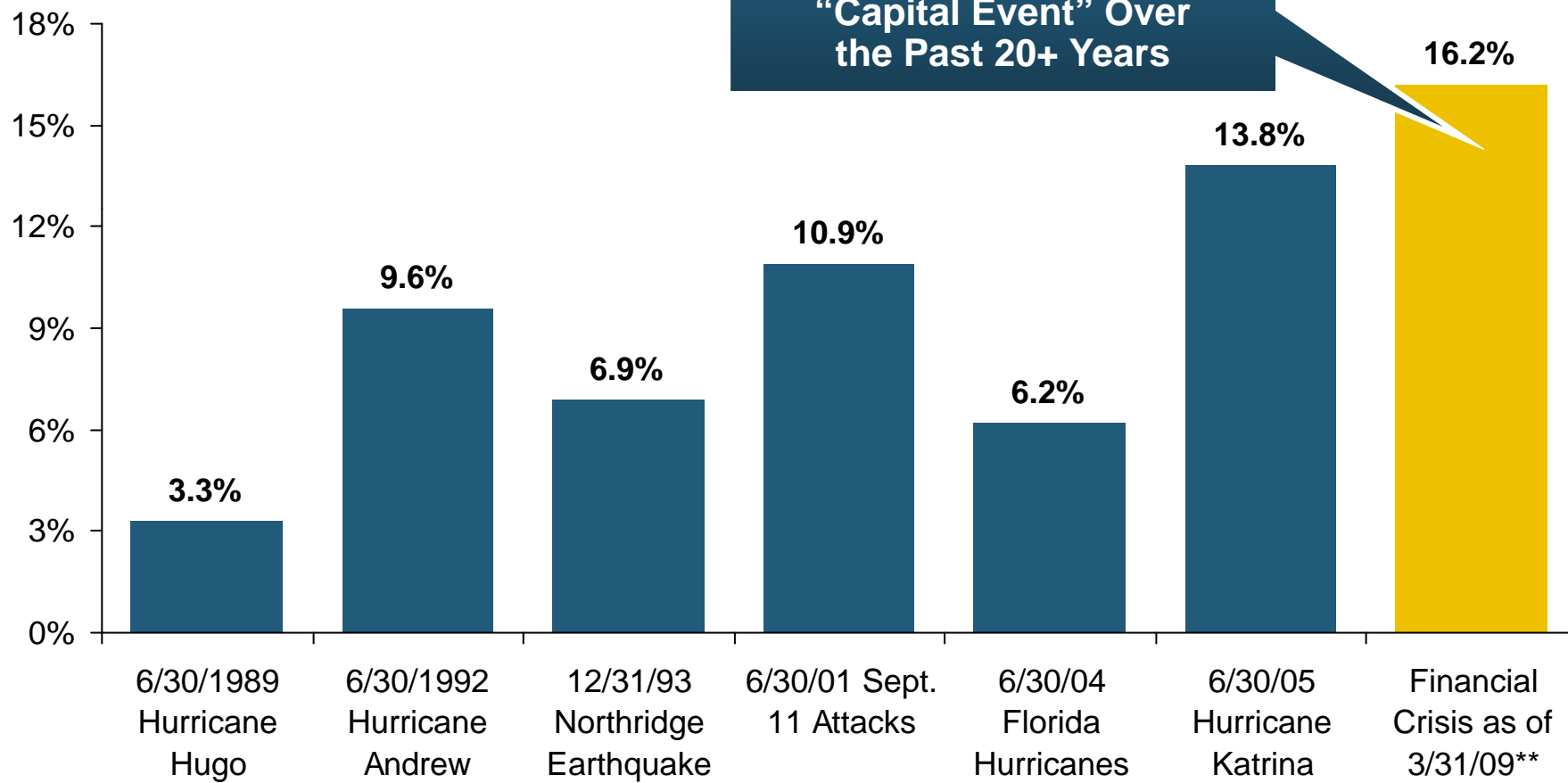
(\$ Billions)



**In 2010 One Insurer's Paid-in Capital Rose by \$22.5B as Part of an Investment in a Non-insurance Business**

# Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989\*

(Percent)



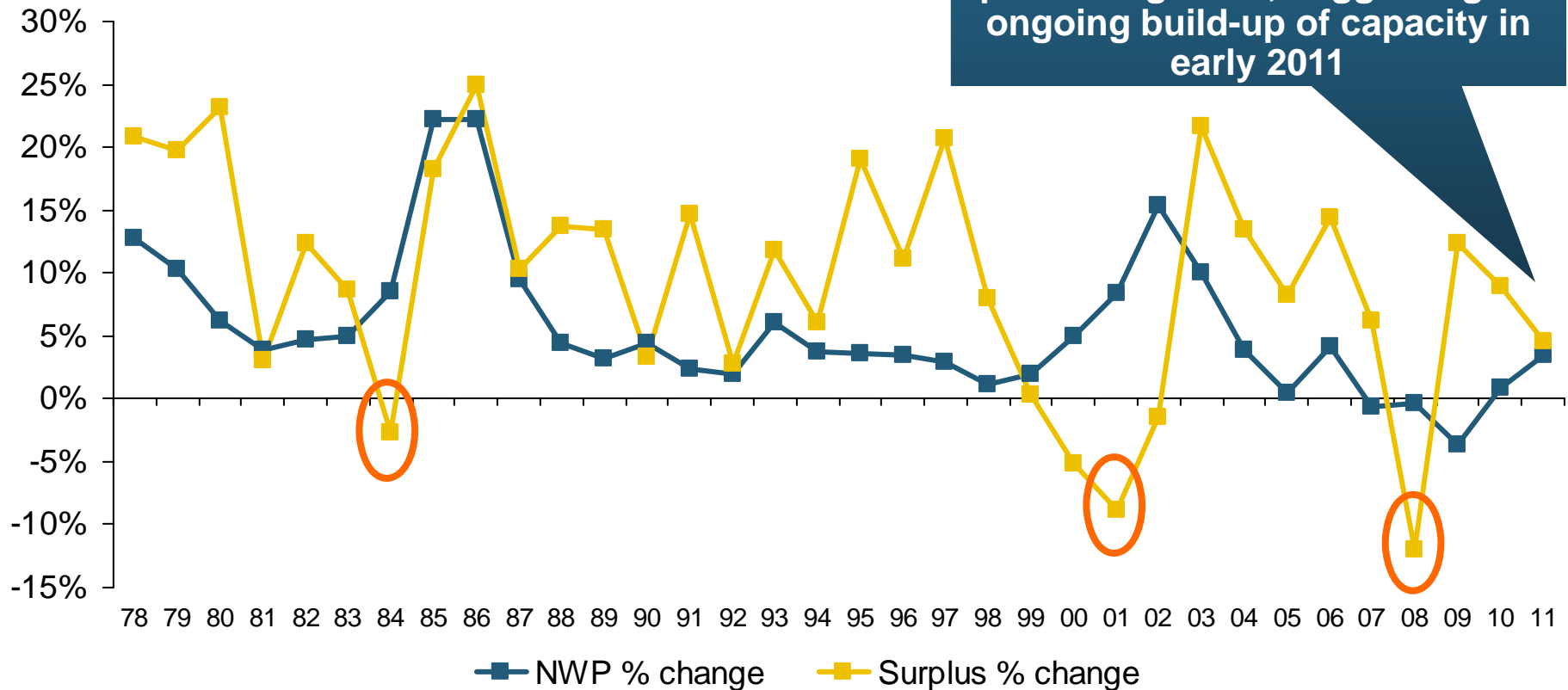
\* Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event

\*\* Date of maximum capital erosion; As of 9/30/09 (latest available) ratio = 5.9%

Source: PCS; Insurance Information Institute

# Historically, Hard Markets Follow When Surplus “Growth” is Negative\*

(Percent)



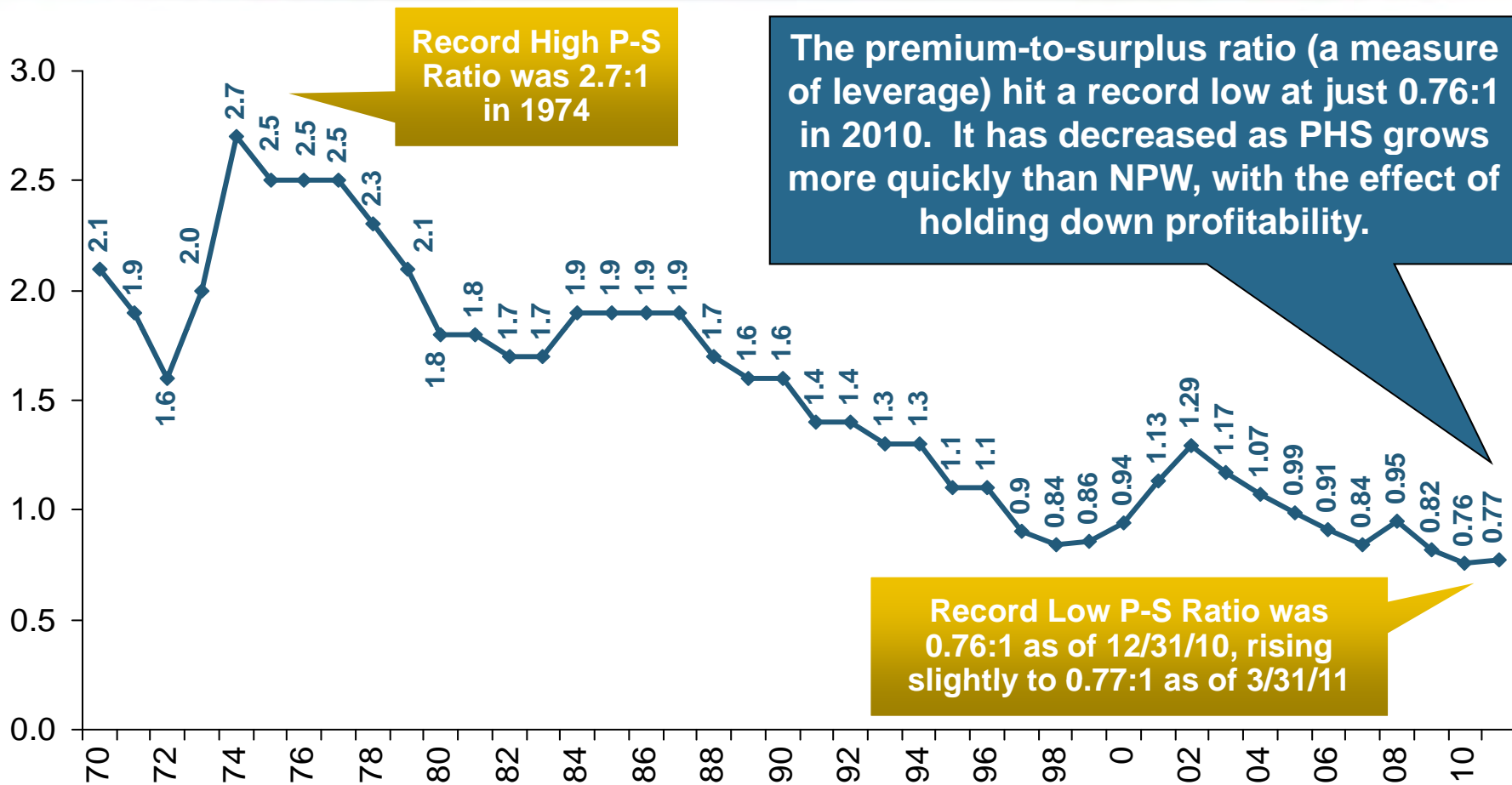
Surplus growth still exceeds premium growth, suggesting an ongoing build-up of capacity in early 2011

**Sharp Decline in Capacity is a Necessary but Not Sufficient Condition for a True Hard Market**

\* 2011 NWP and Surplus figures are % changes as of Q1:11 vs. Q1:10.

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

# Ratio of Net Premiums Written to Policyholder Surplus, 1970-2011\*



Record High P-S Ratio was 2.7:1 in 1974

The premium-to-surplus ratio (a measure of leverage) hit a record low at just 0.76:1 in 2010. It has decreased as PHS grows more quickly than NPW, with the effect of holding down profitability.

Record Low P-S Ratio was 0.76:1 as of 12/31/10, rising slightly to 0.77:1 as of 3/31/11

**The Premium-to-Surplus Ratio in 2011:Q1 Implies that P/C Insurers Held \$1 in Surplus Against Each \$0.77 Written in Premiums. In 1974, Each \$1 of Surplus Backed \$2.70 in Premium.**

\*2011 data are as of 3/31/11.

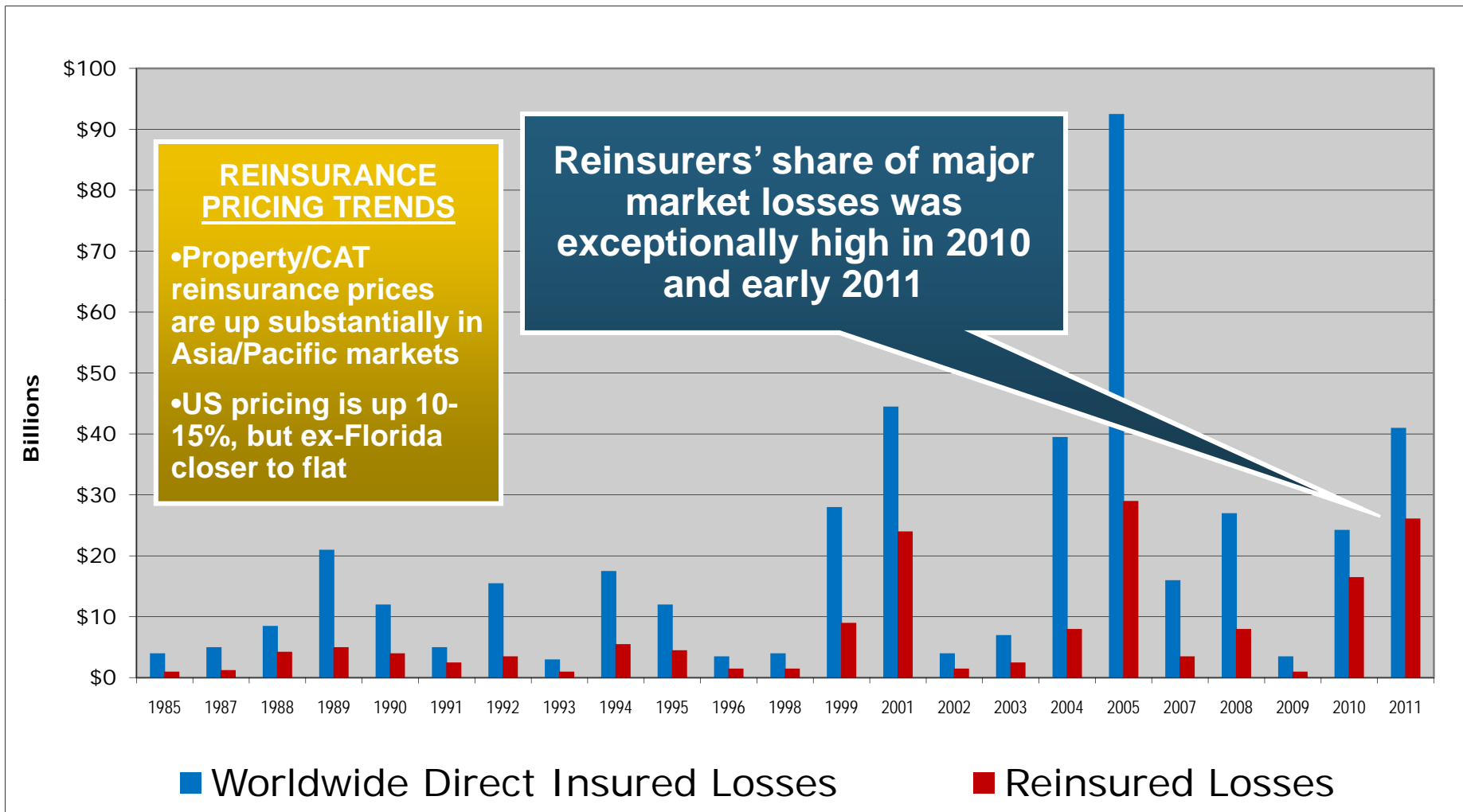
Sources: Insurance Information Institute calculations from A.M. Best data.



## **3. REINSURANCE MARKET CONDITIONS**

**Has Record Global  
Catastrophes Activity  
Erased Enough Capacity  
to Turn Markets?**

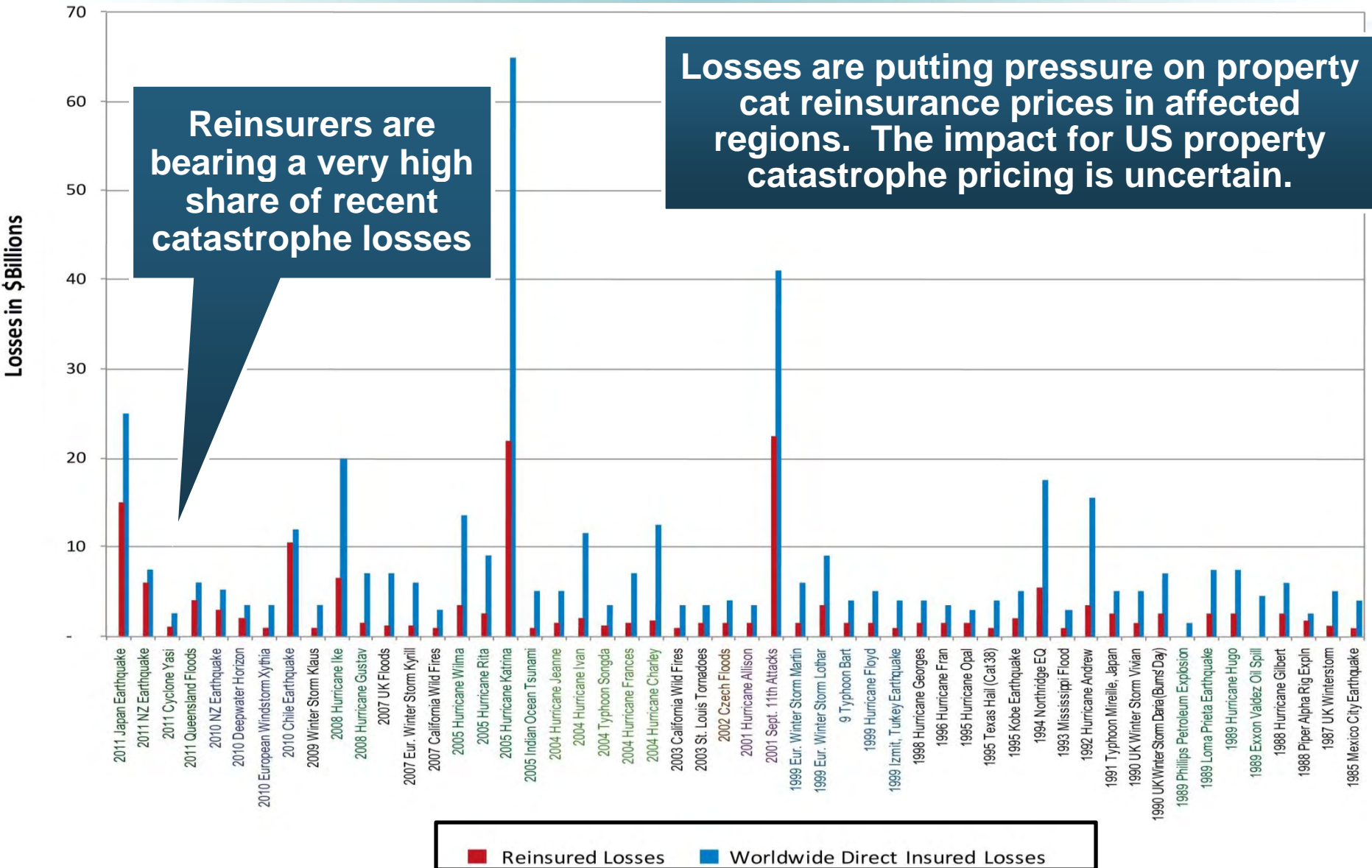
# Significant Market Losses, 1985-2011\*



Source: Holborn; RAA.

\* 2011 events are as of March 31 and are preliminary and may change as loss estimates are refined further.

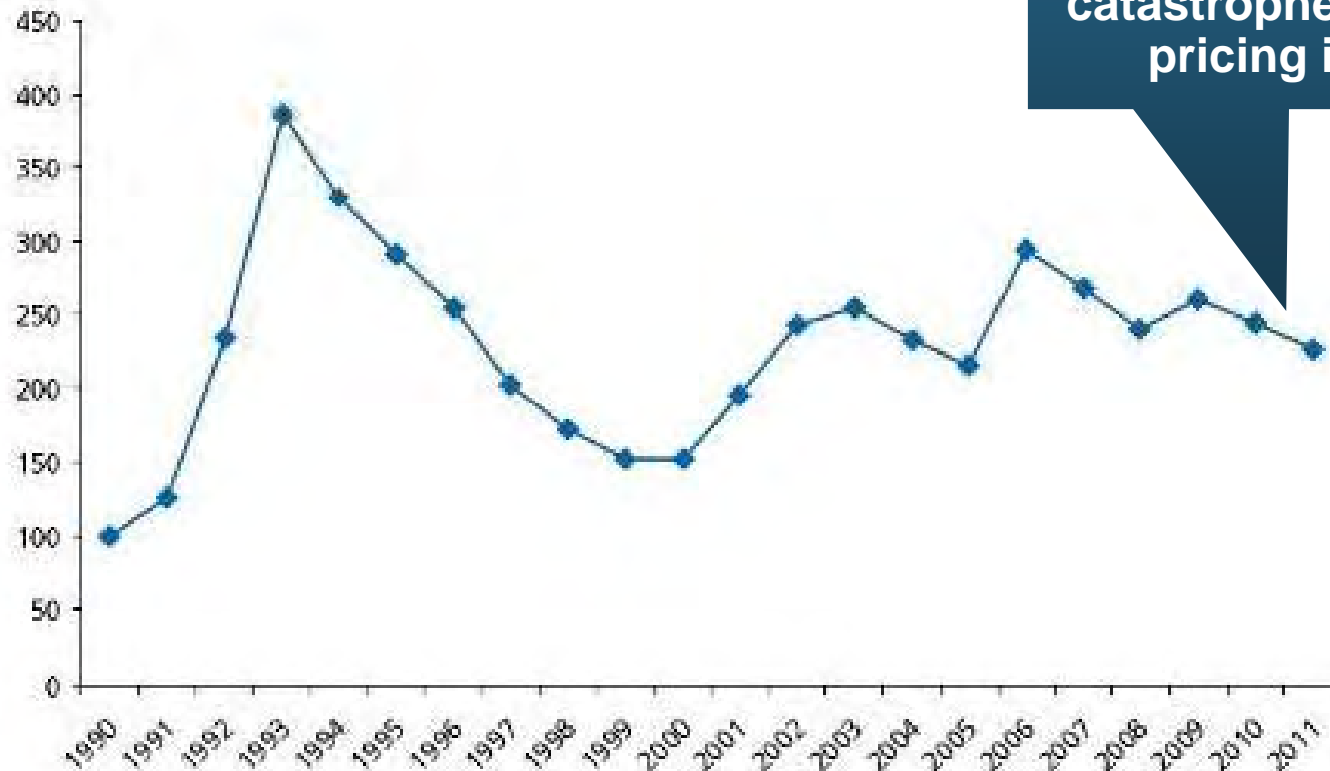
# Significant Market Losses by Event, 1985-2011\*



Source: Holborn, RAA. \*2011 events as of March 31 are preliminary and may change as loss estimates are refined further.

# Global Property Catastrophe Rate on Line Index, 1990-2011 YTD

FIGURE 1: GLOBAL PROPERTY CATASTROPHE ROL INDEX



No sharp increase in global property catastrophe reinsurance pricing is evident

Source: Guy Carpenter & Company, LLC

# **Outlook for the 2011 Atlantic Hurricane Season**

**If Expected Above Average  
Activity Produces Costly  
Landfalls, Reinsurance  
Markets Could Harden  
Significantly**

# Outlook for 2011 Hurricane Season: 75% More Active Than Average

	Average*	2005 (Katrina Year)	2011F
Named Storms	9.6	28	16
Named Storm Days	49.1	115.5	80
Hurricanes	5.9	14	9
Hurricane Days	24.5	47.5	35
Intense Hurricanes	2.3	7	5
Intense Hurricane Days	5.0	7	10
Accumulated Cyclone Energy	96.1	NA	160
Net Tropical Cyclone Activity	100%	275%	<b>175%</b>

\*Average over the period 1950-2000.

Source: Dr. Philip Klotzbach and Dr. William Gray, Colorado State University, June 1, 2011.

# Probability of Major Hurricane Landfall (CAT 3, 4, 5) in 2011

	Average*	2011F
Entire US Coast	52%	72%
US East Coast Including Florida Peninsula	31%	48%
Gulf Coast from FL Panhandle to Brownsville, TX	30%	47%
<b><i>ALSO...Above-Average Major Hurricane Landfall Risk in Caribbean for 2011 (61% vs. 42%)</i></b>		

\*Average over the period 1950-2000.

Source: Dr. Philip Klotzbach and Dr. William Gray, Colorado State University, June 1, 2011.

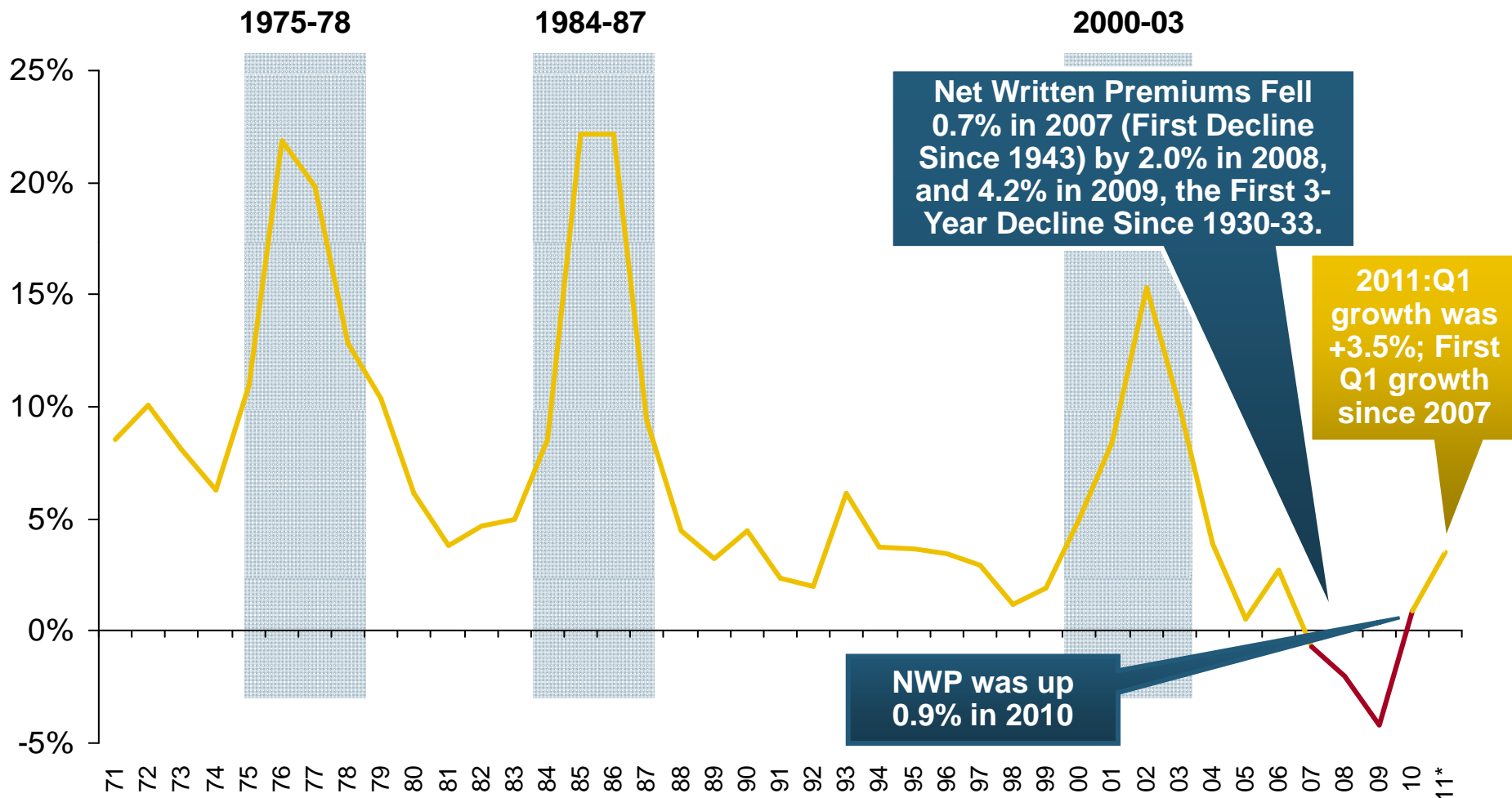
## **4. RENEWED PRICING DISCIPLINE**

**Is There Evidence of a Broad  
and Sustained Shift in Pricing?**



# Soft Market Persisted in 2010 but Growth Returned: More in 2011?

(Percent)

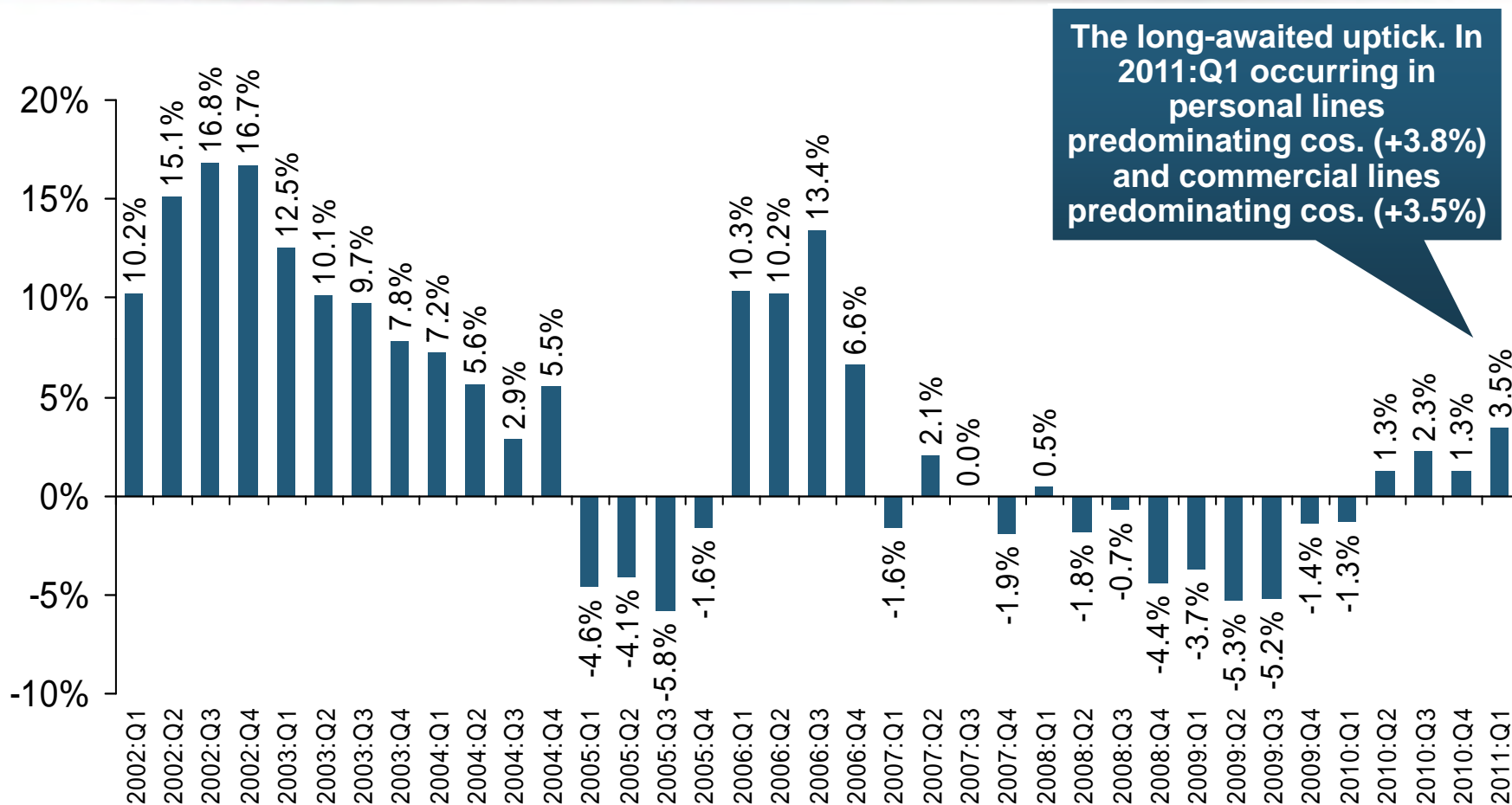


\*2011 figure is an estimate based on Q1 data.

Shaded areas denote "hard market" periods

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

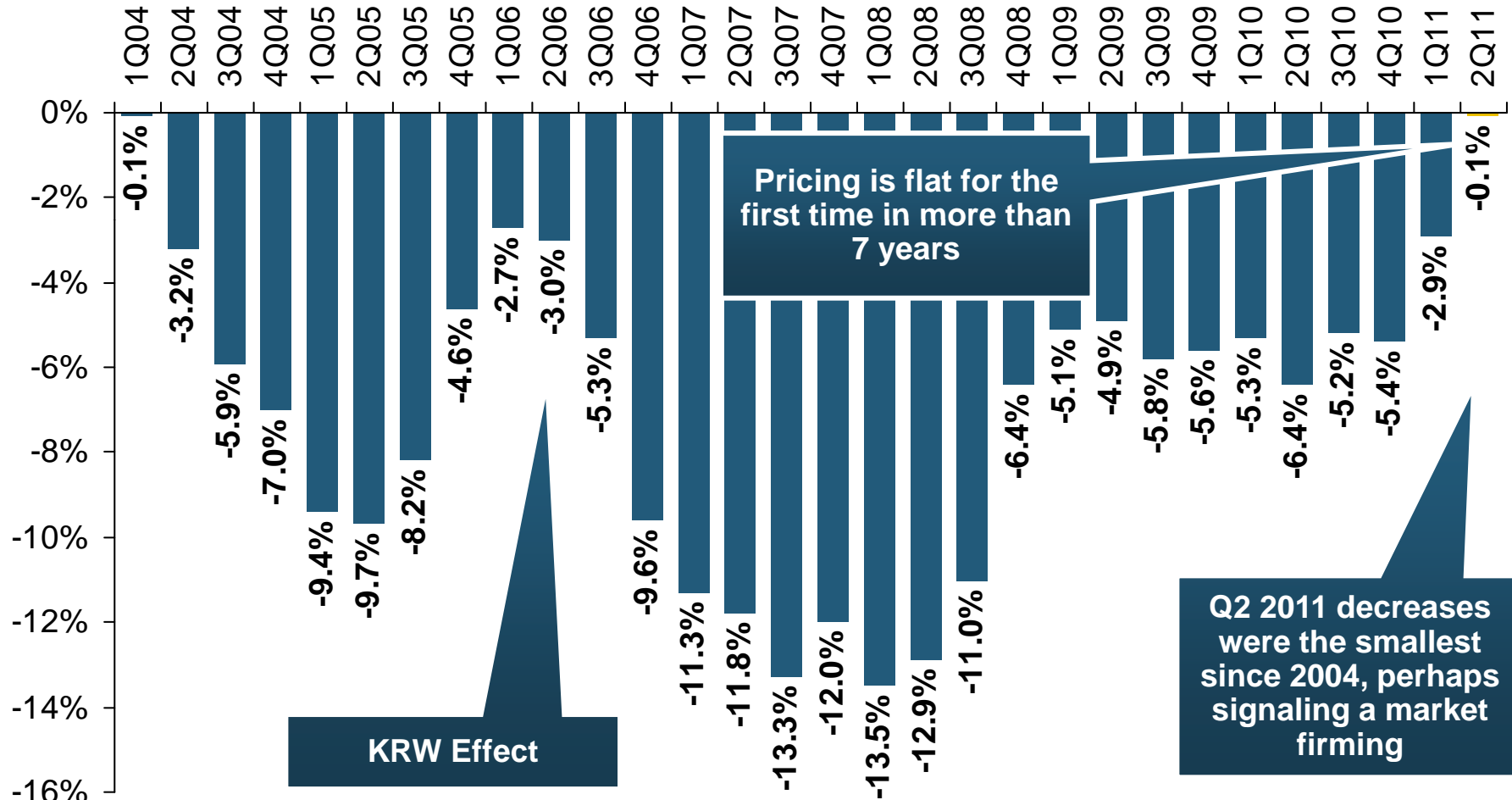
# P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter



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

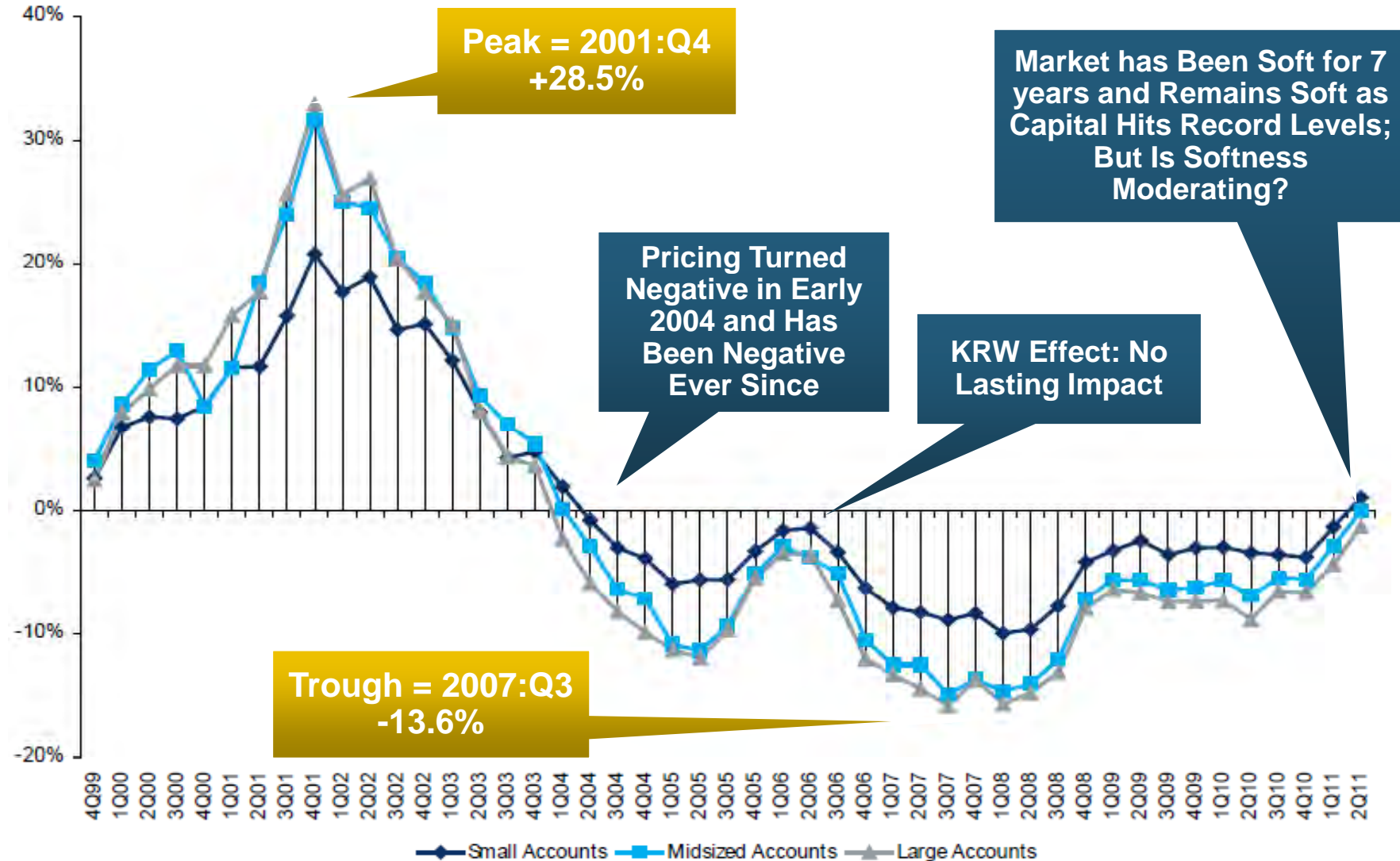
# Average Commercial Rate Change, All Lines, (1Q:2004–2Q:2011)

(Percent)



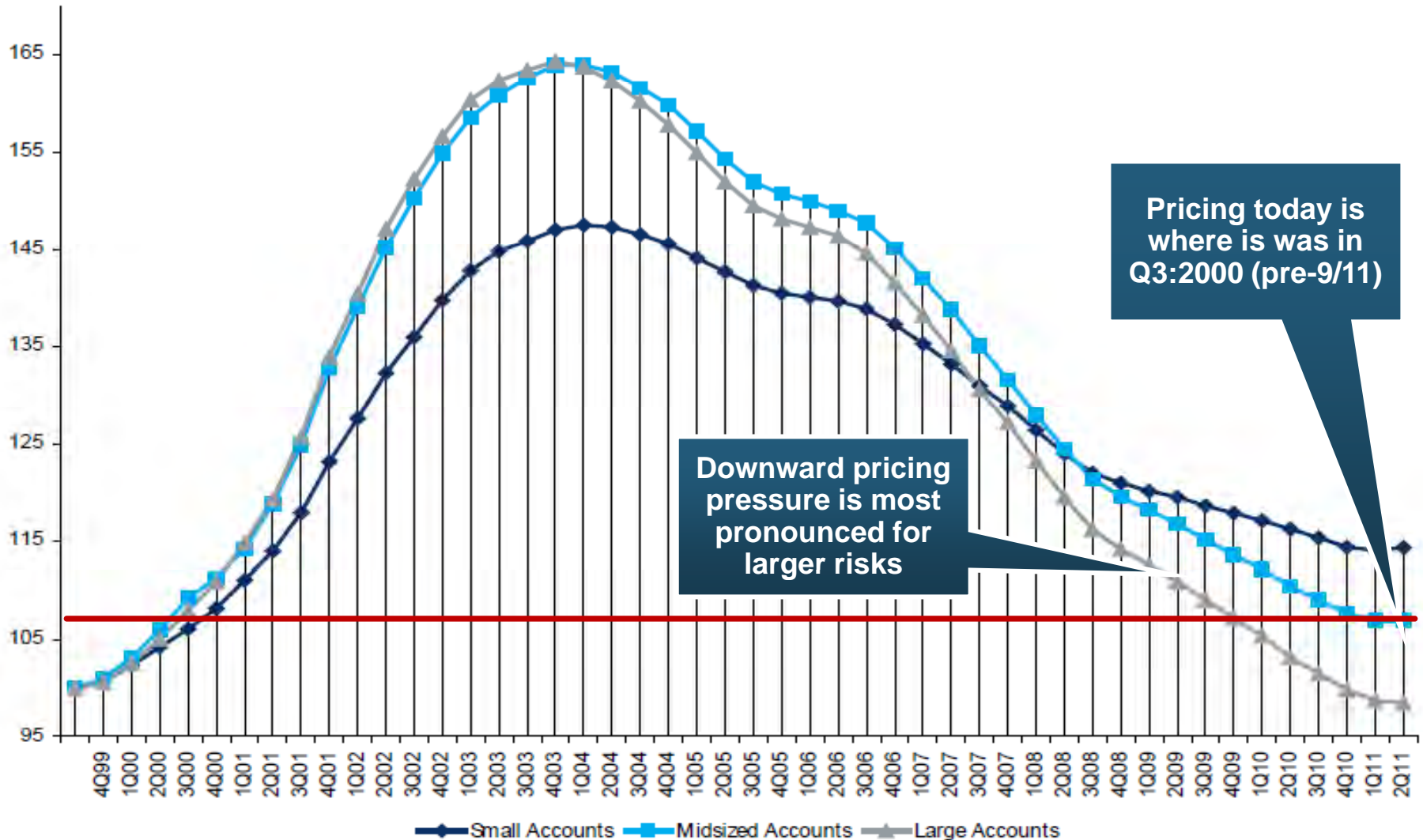
# Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2011:Q2

Percentage Change (%)



# Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2011:Q2

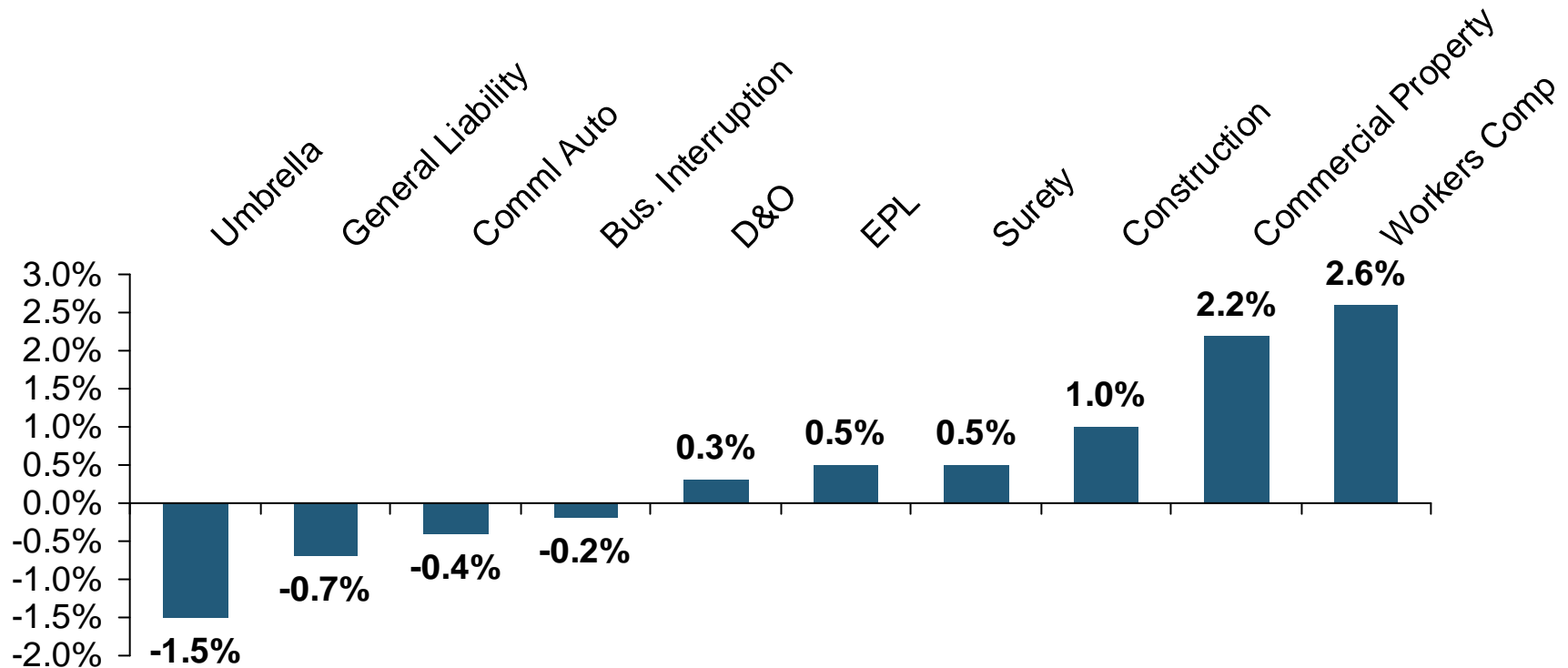
1999:Q4 = 100



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

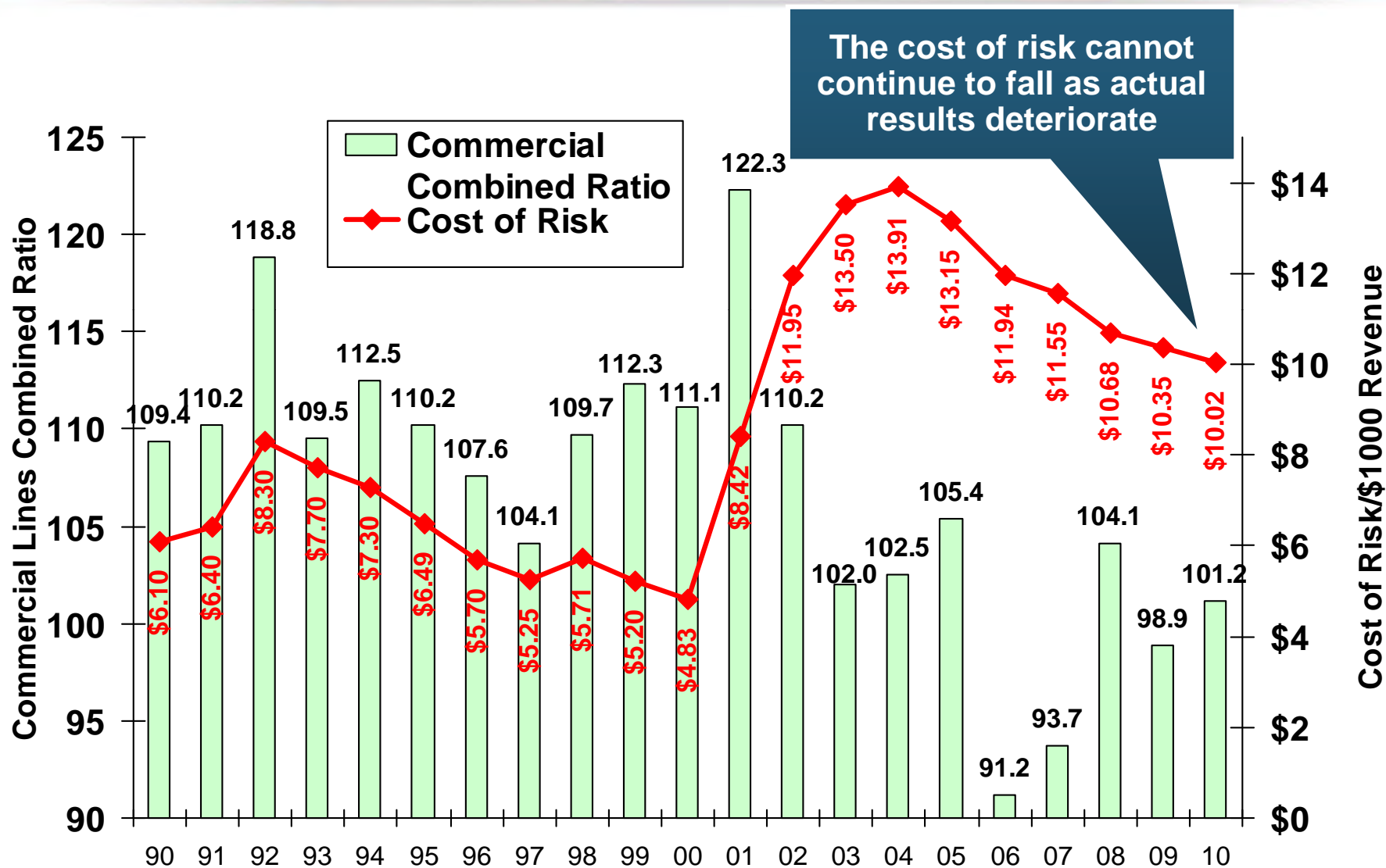
# Change in Commercial Rate Renewals, by Line: 2011:Q2

Percentage Change (%)



**Major Commercial Lines Renewed Mixed in Q2:2011, With Workers Up More than Any Other Line**

# Cost of Risk vs. Commercial Lines Combined Ratio

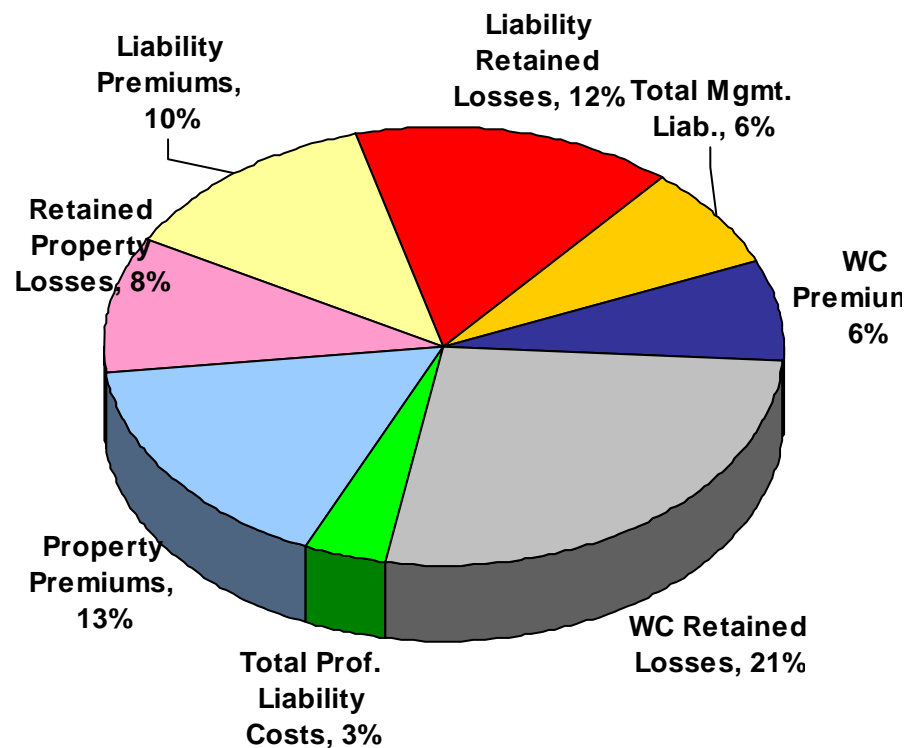
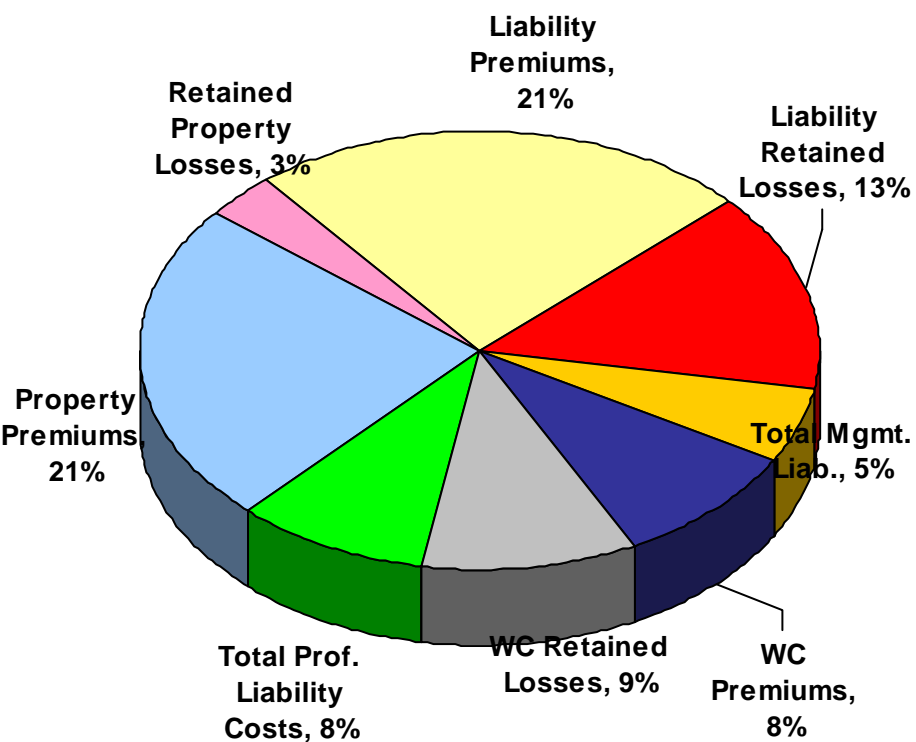


# How the Risk Dollar is Spent (2011)

**Total liability costs account for 35% - 40% of the risk dollar**

## Firms w/Revenues < \$1 Billion

## Firms w/Revenues > \$1 Billion

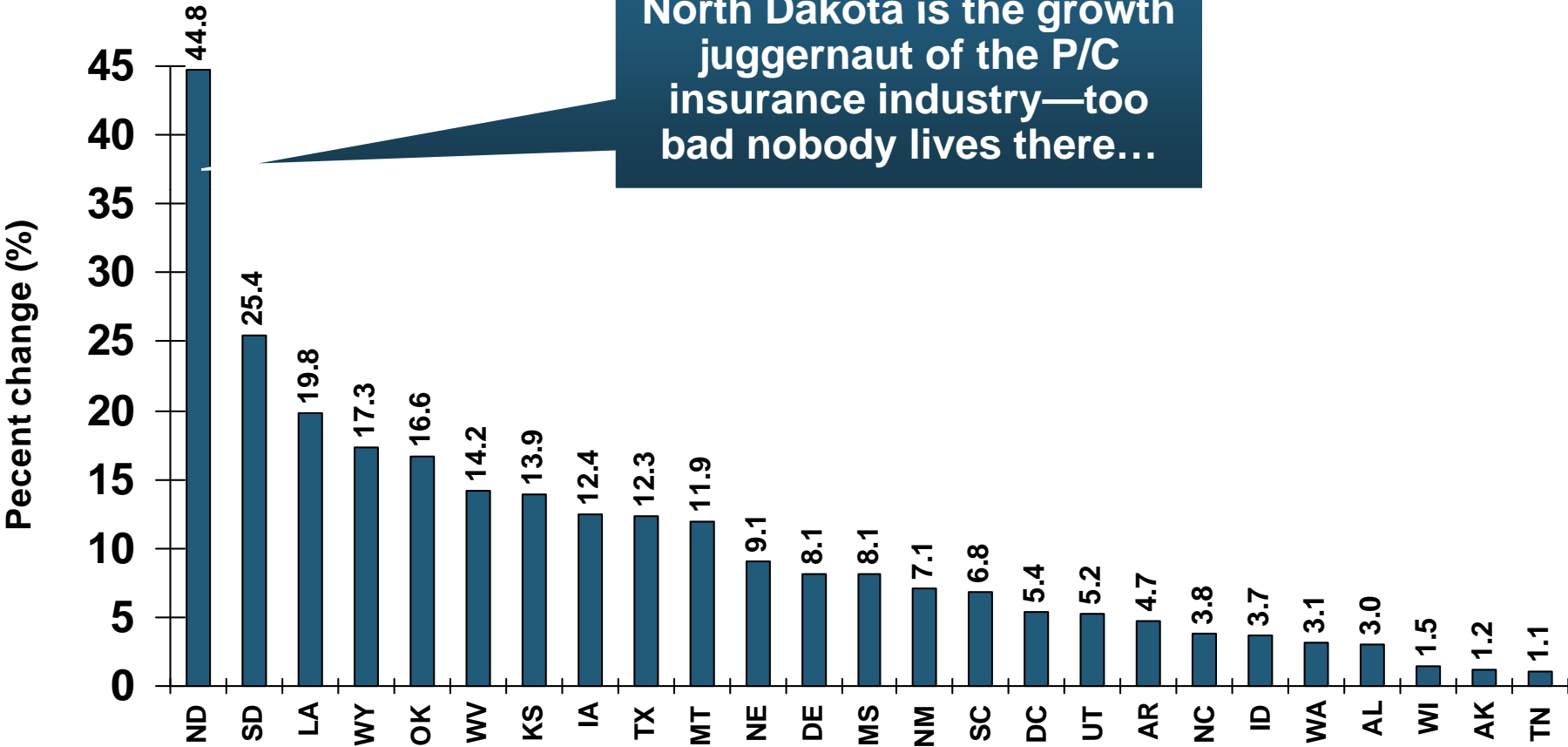




# Direct Premiums Written: All P/C Lines Percent Change by State, 2005-2010

## Top 25 States

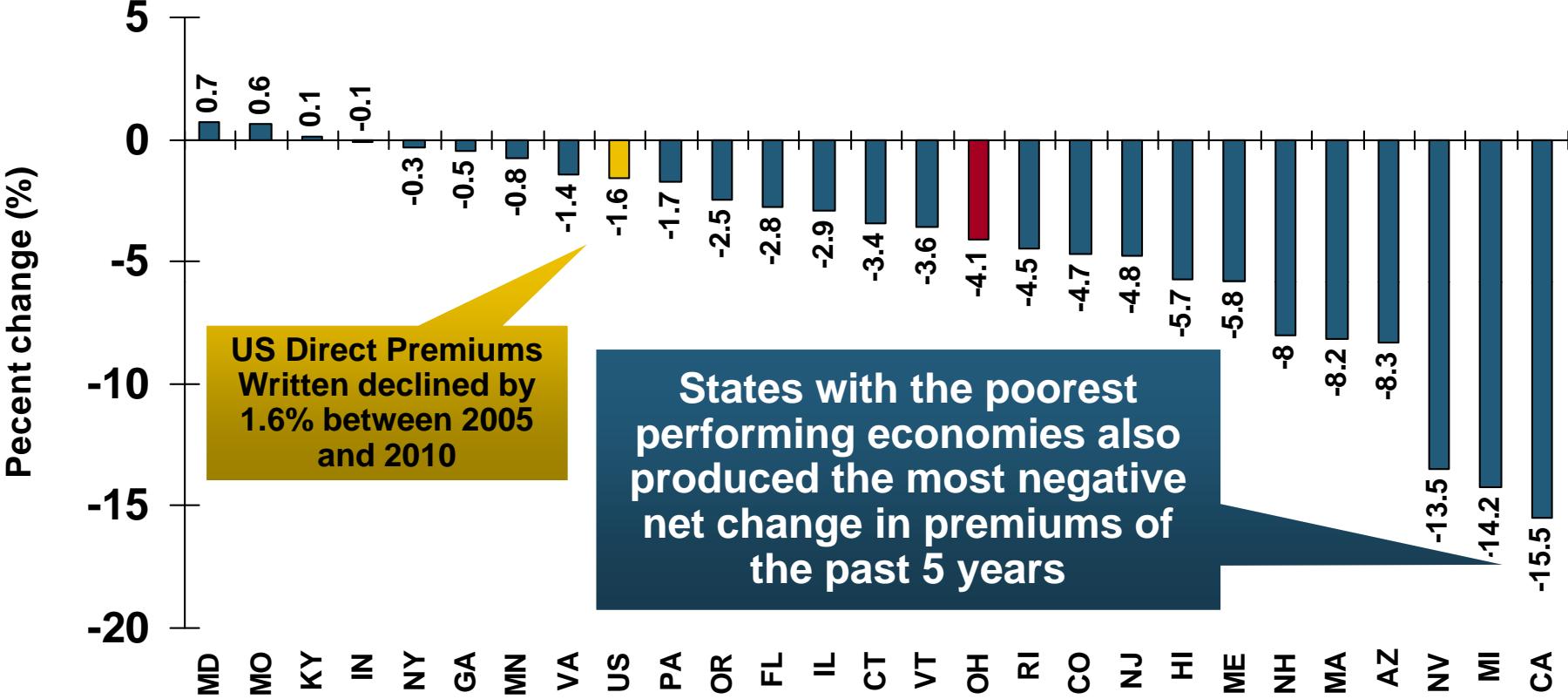
North Dakota is the growth juggernaut of the P/C insurance industry—too bad nobody lives there...



Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: All P/C Lines Percent Change by State, 2005-2010

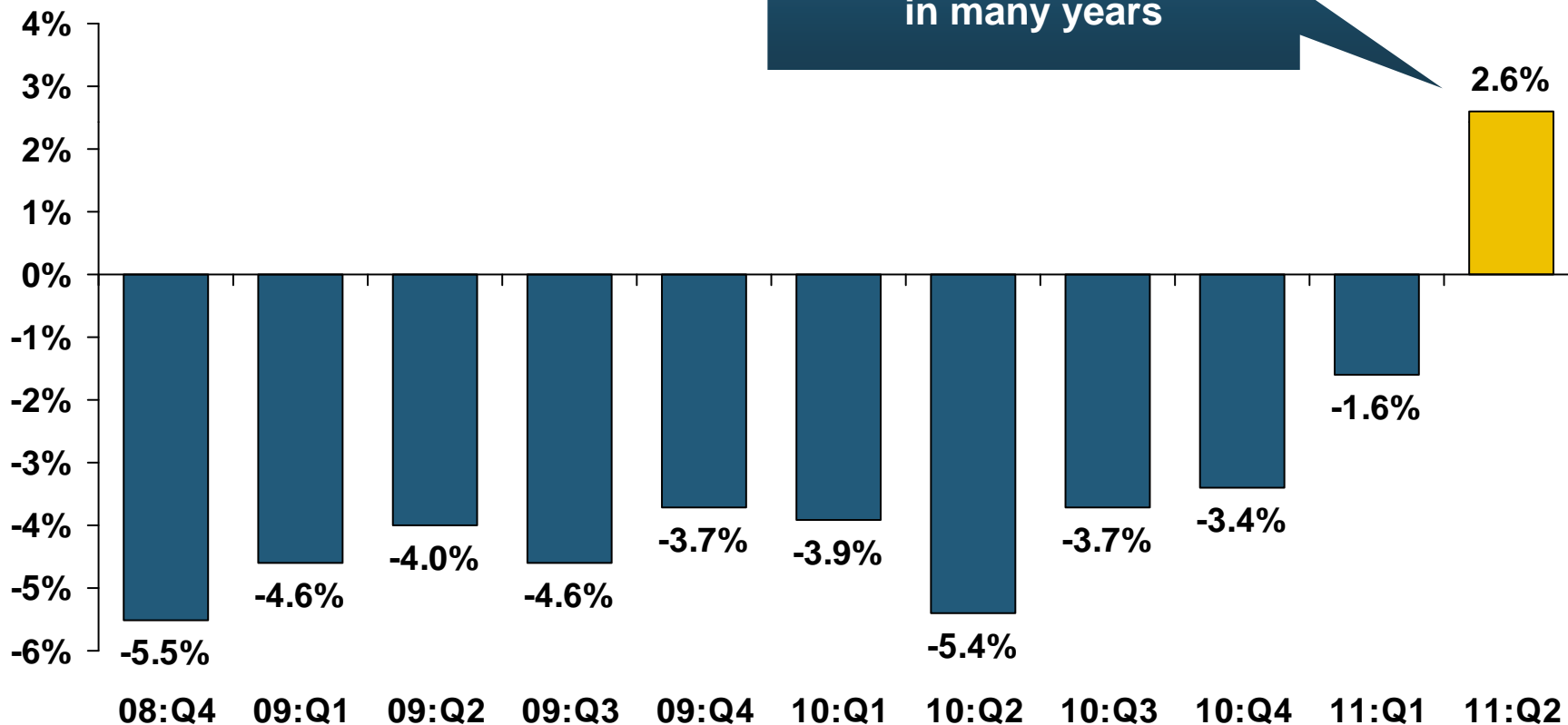
## Bottom 25 States



Sources: SNL Financial LC; Insurance Information Institute.

# Workers Comp Rate Changes, 2008:Q4 – 2011:Q2

(Percent  
Change)



# Other Cycle-Influencing Factors

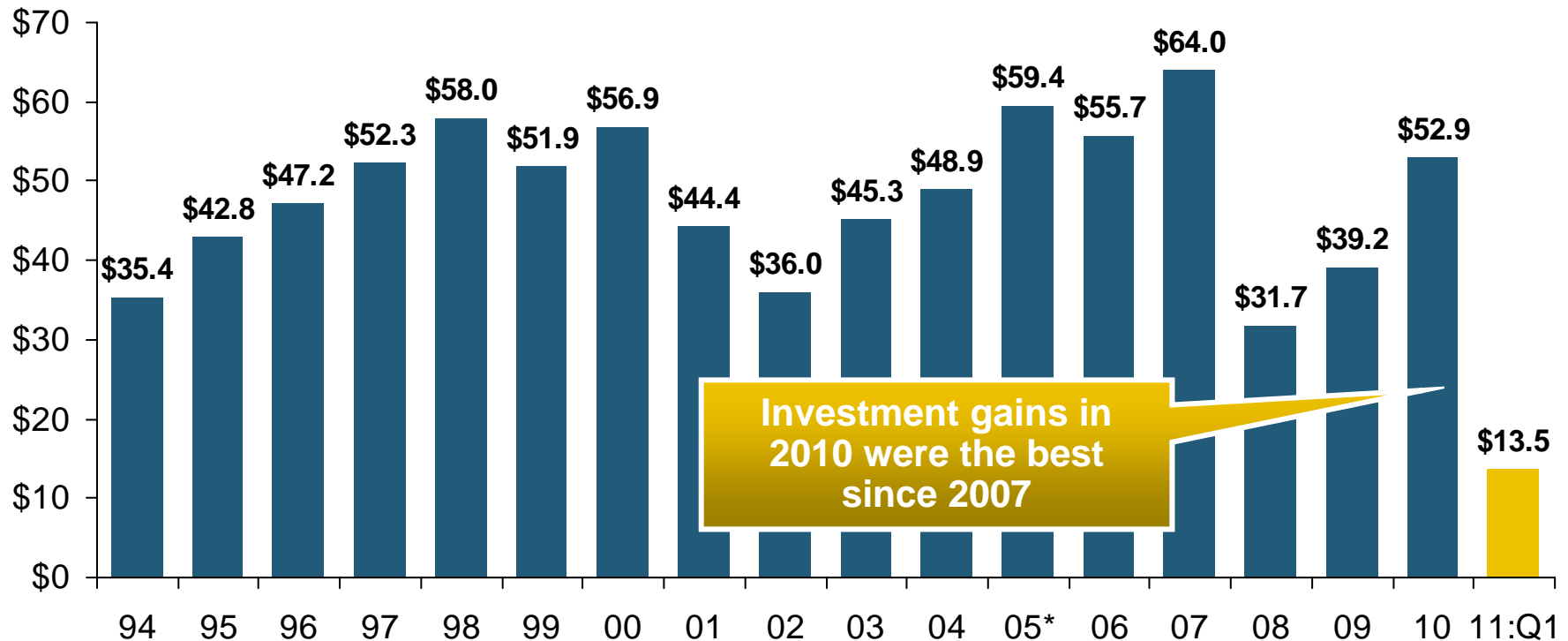
**Could Other Factors Act as  
a Catalyst to Turn the  
Market?**

# **INVESTMENTS: THE NEW REALITY**

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

# Property/Casualty Insurance Industry Investment Gain: 1994–2011:Q1<sup>1</sup>

(\$ Billions)



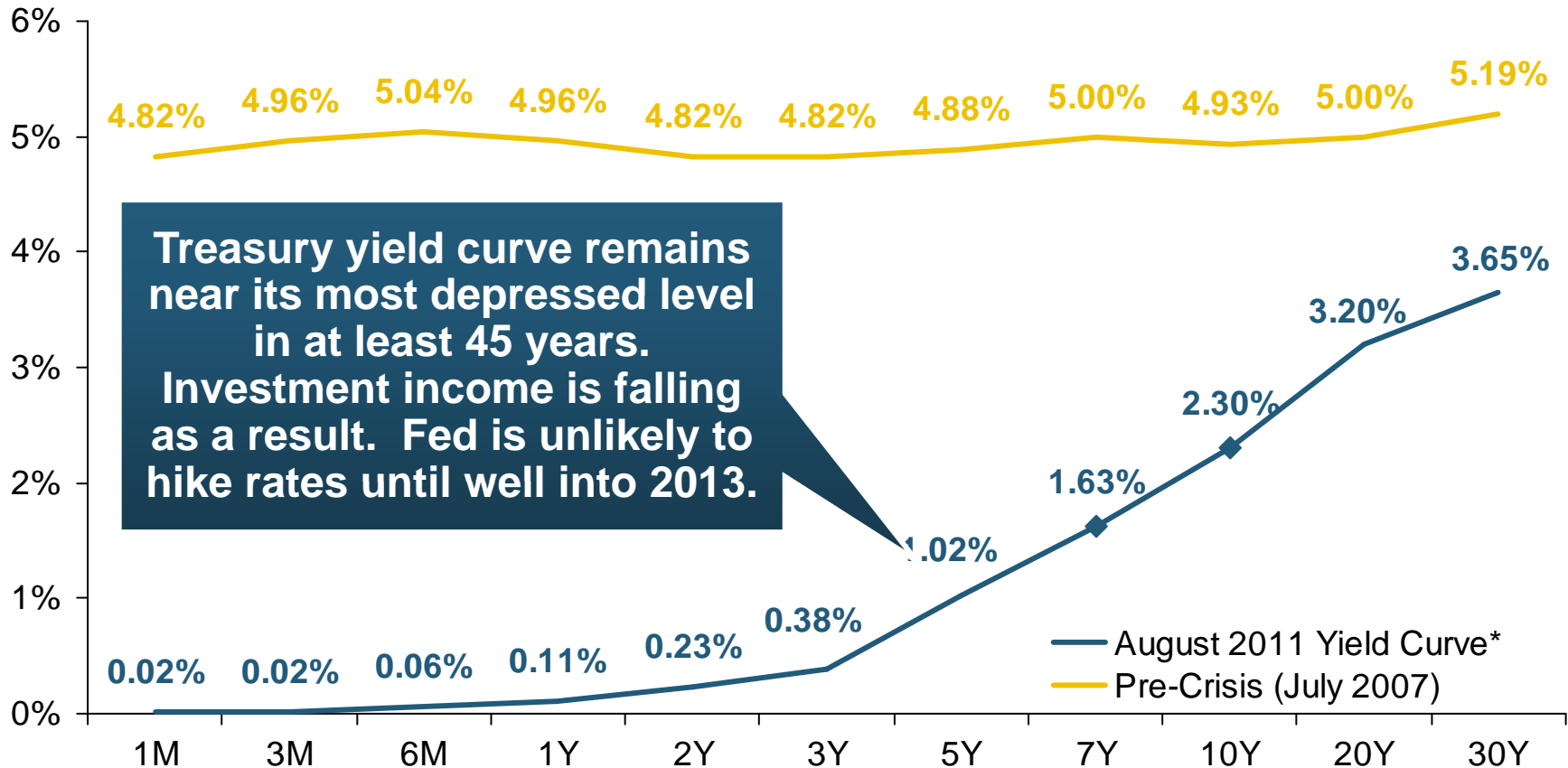
**Investment Gains Recovered Significantly in 2010 Due to Realized Investment Gains; The Financial Crisis Caused Investment Gains to Fall by 50% in 2008**

<sup>1</sup> 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. August 2011\*



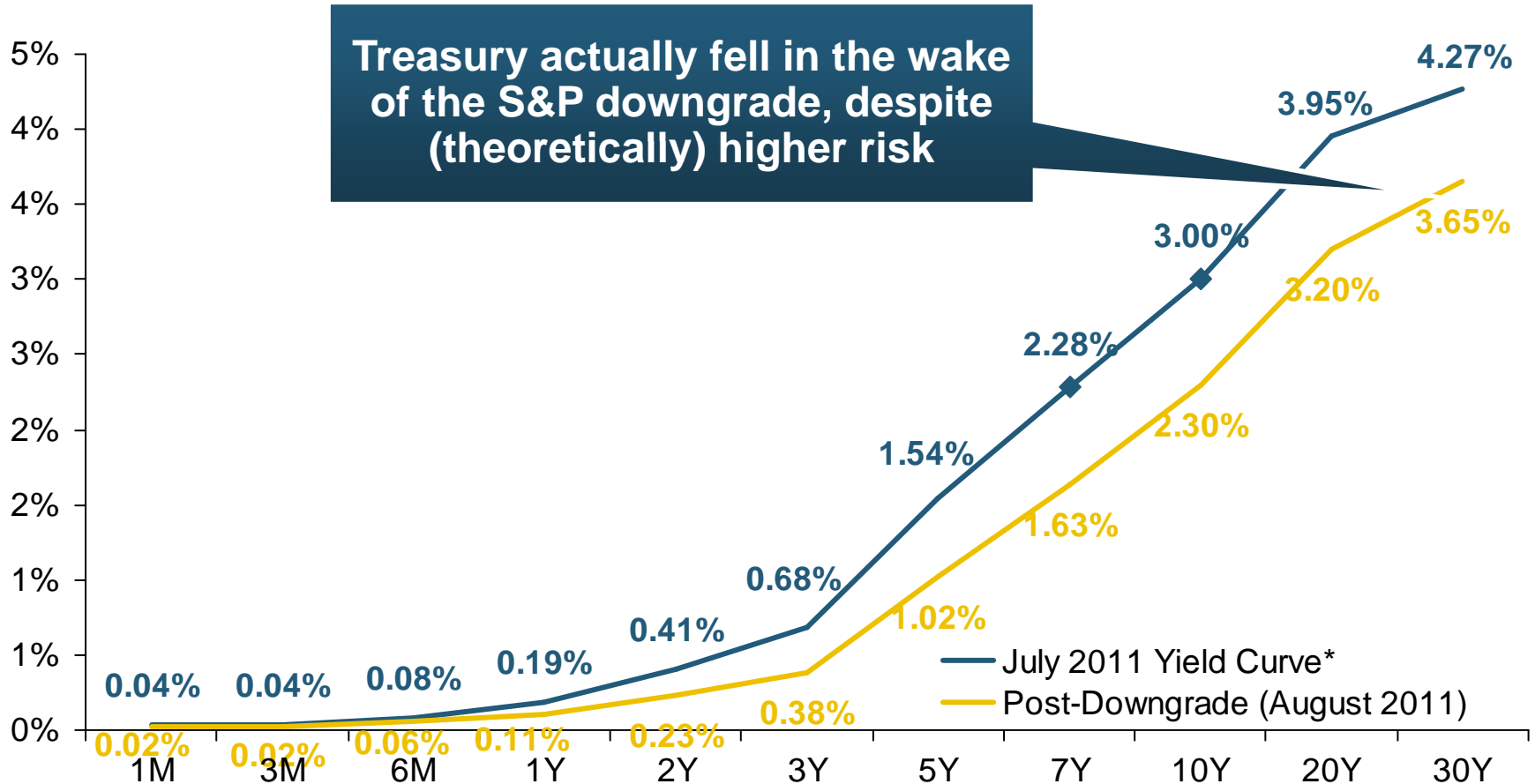
Treasury yield curve remains near its most depressed level in at least 45 years. Investment income is falling as a result. Fed is unlikely to hike rates until well into 2013.

**The End of the Fed's Quantitative Easing Is Unlikely to Push Interest Rates Up Substantially Given Ongoing Economic Weakness**

\*Average of daily rates.

Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.

# Treasury Yield Curves Before and After S&P Downgrade



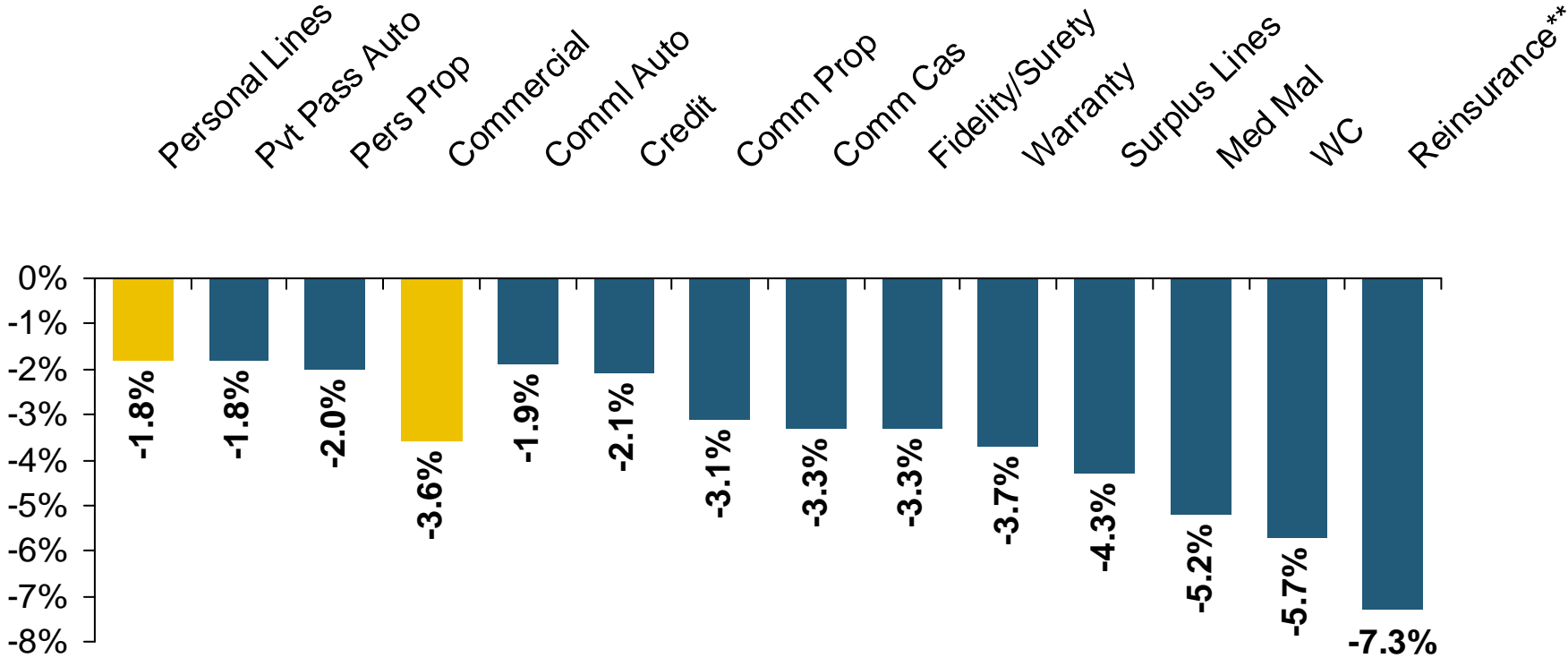
**S&P's Downgrade on August 5<sup>th</sup> Did Not Increase the Borrowing Costs of the US Government. In Fact, Treasury Yields Fell Afterwards**

\*Average of daily rates.

Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.



# Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line\*



**Lower Investment Earnings Place a Greater Burden on Underwriting and Pricing Discipline**

\*Based on 2008 Invested Assets and Earned Premiums

\*\*US domestic reinsurance only

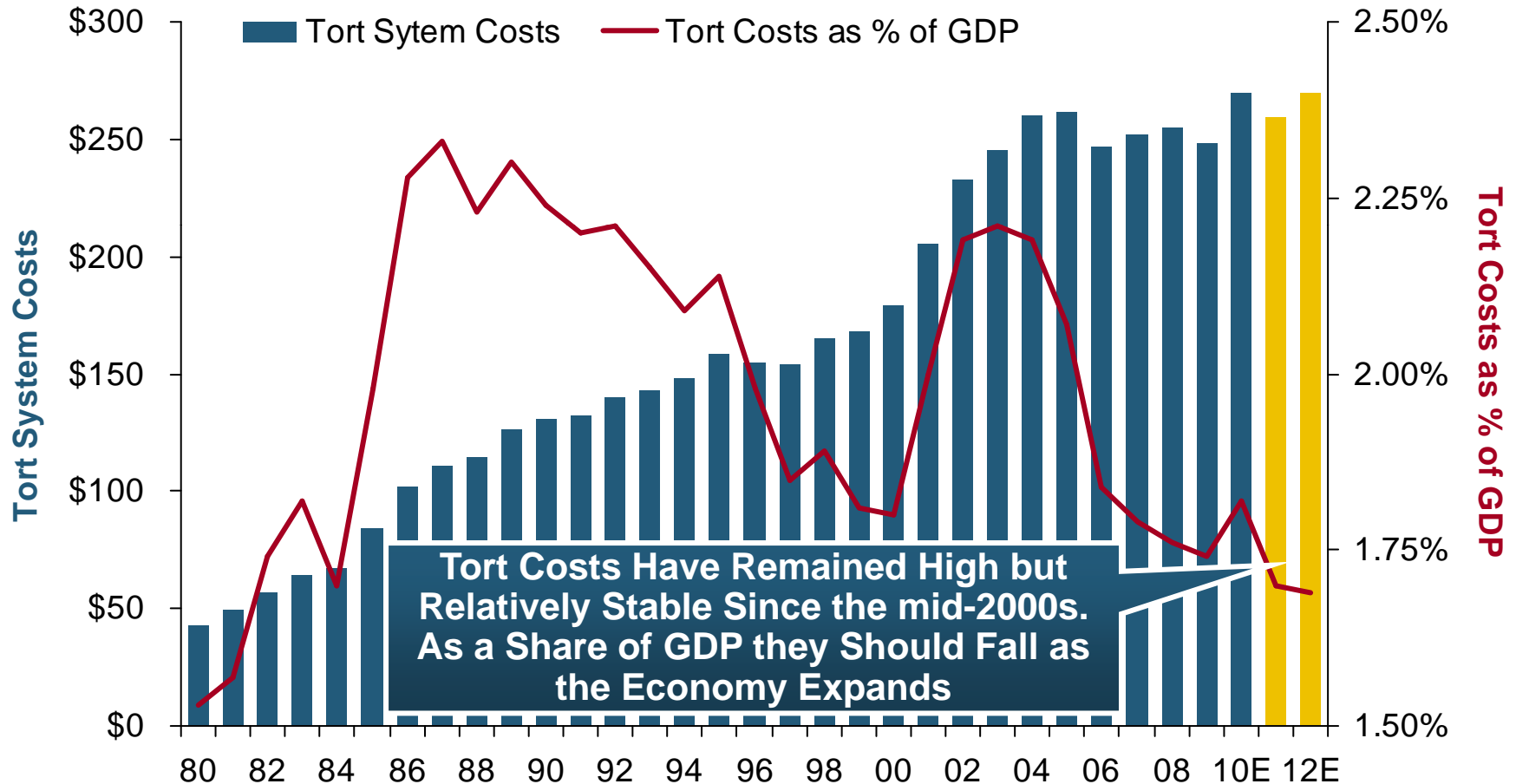
Source: A.M. Best; Insurance Information Institute.

# 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)



# Business Leaders Ranking of Liability Systems in 2010

## Best States

1. Delaware
2. North Dakota
3. Nebraska
4. Indiana
5. Iowa
6. Virginia
7. Utah
8. Colorado
9. Massachusetts
10. South Dakota

### New in 2010

- North Dakota
- Massachusetts
- South Dakota

### Drop-offs

- Maine
- Vermont
- Kansas

Midwest/West has mix of good and bad states.

## Worst States

41. New Mexico
42. Florida
43. Montana
44. Arkansas
45. Illinois
46. California
47. Alabama
48. Mississippi
49. Louisiana
50. West Virginia

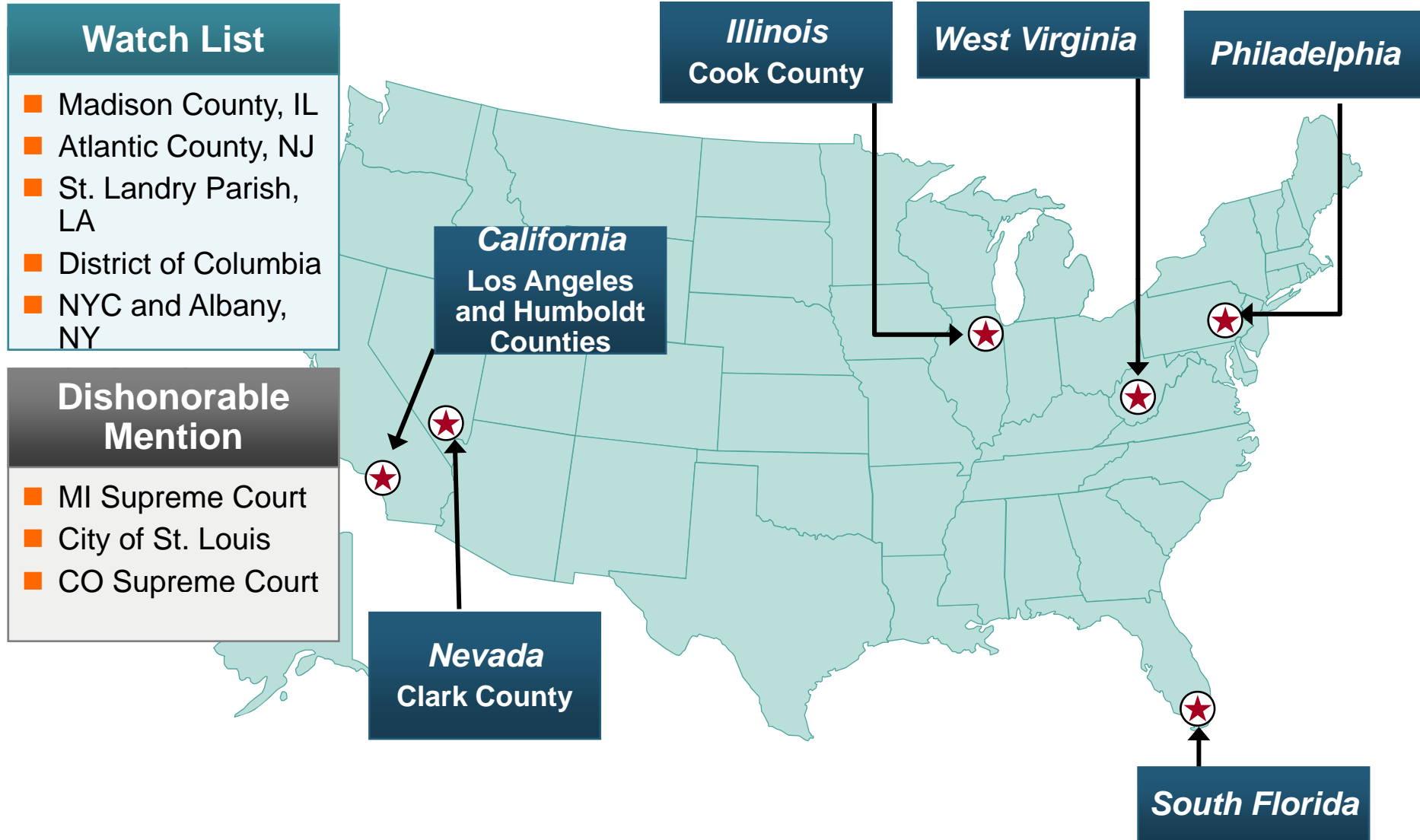
### Newly Notorious

- New Mexico
- Montana
- Arkansas

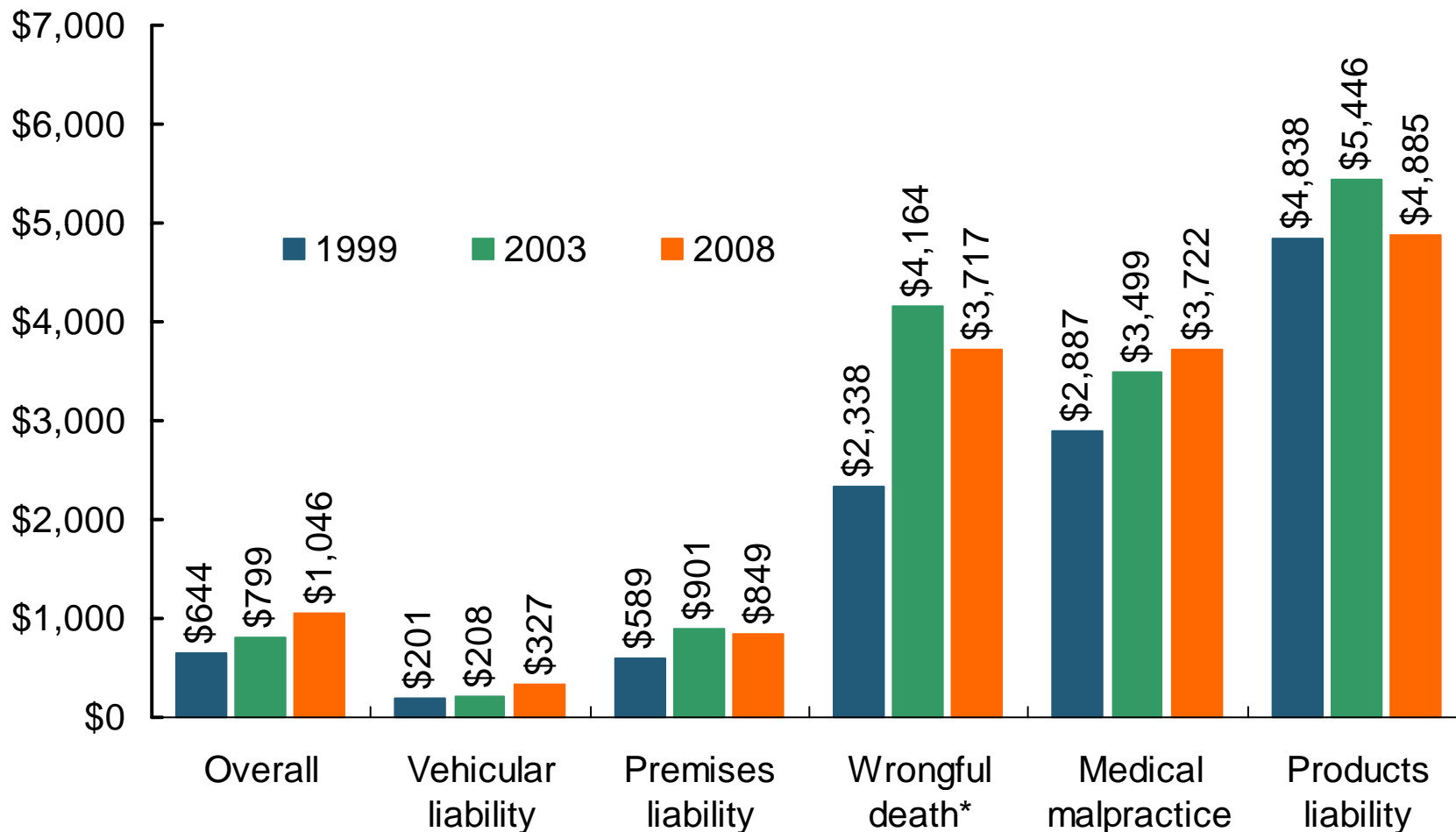
### Rising Above

- **Texas**
- South Carolina
- Hawaii

# The Nation's Judicial Hellholes: 2010



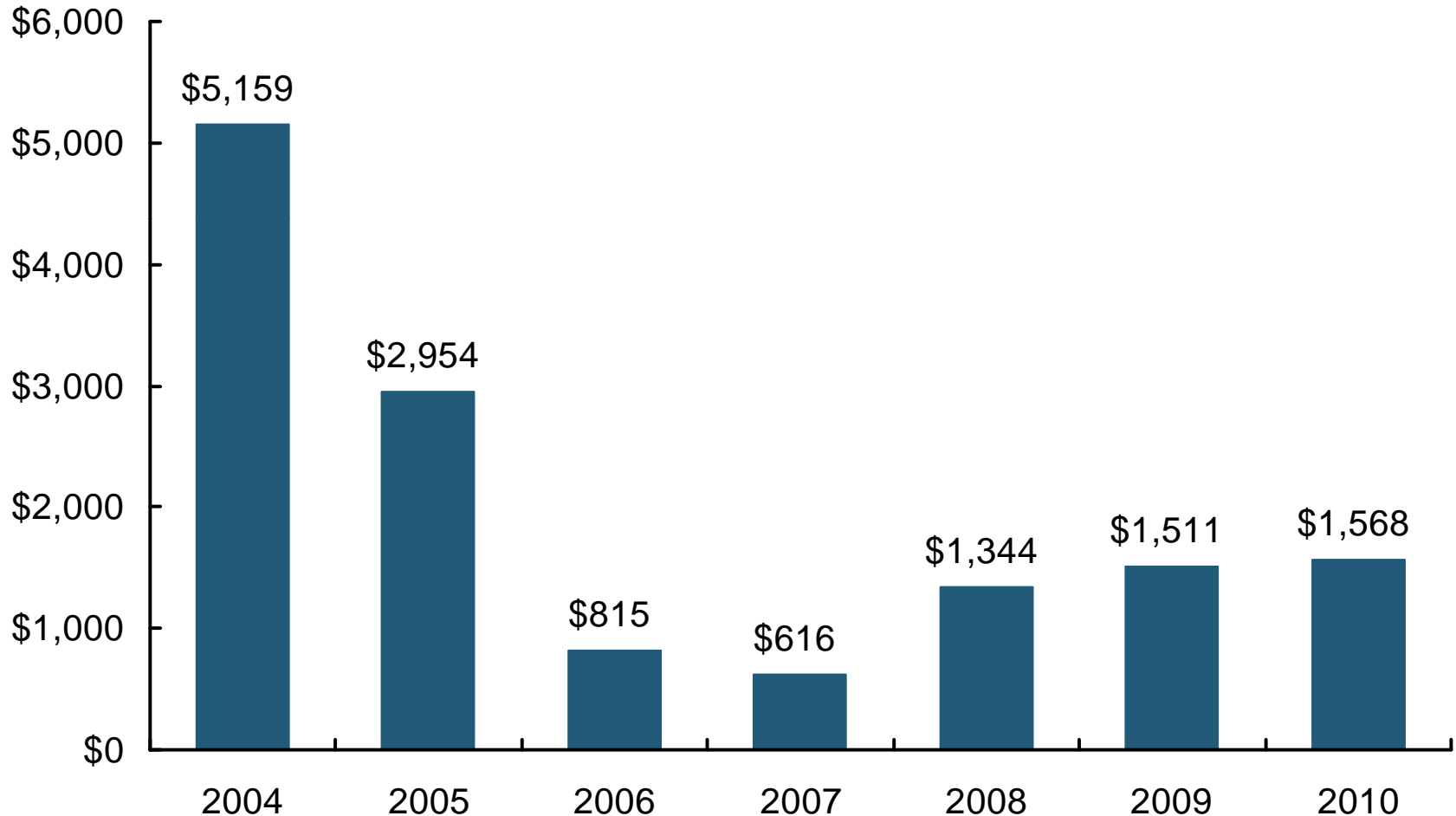
# Avg. Jury Awards 1999 vs. 2003 and 2008



\*Award trends in wrongful deaths of adult males.

Source: Jury Verdict Research; Insurance Information Institute.

# Sum of Top 10 Jury Awards 2004-2010



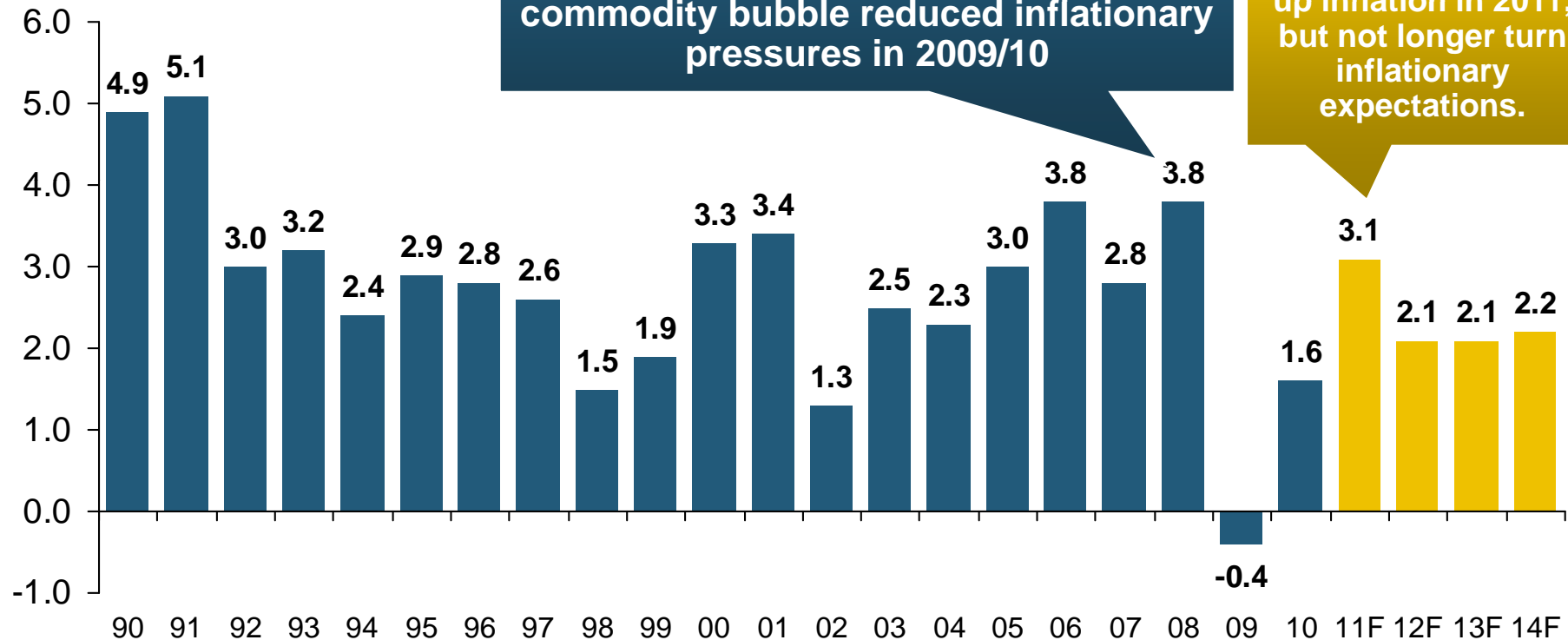
# Inflation

**Is it a Threat to Claim Cost  
Severities**



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

Annual Inflation Rates (%)



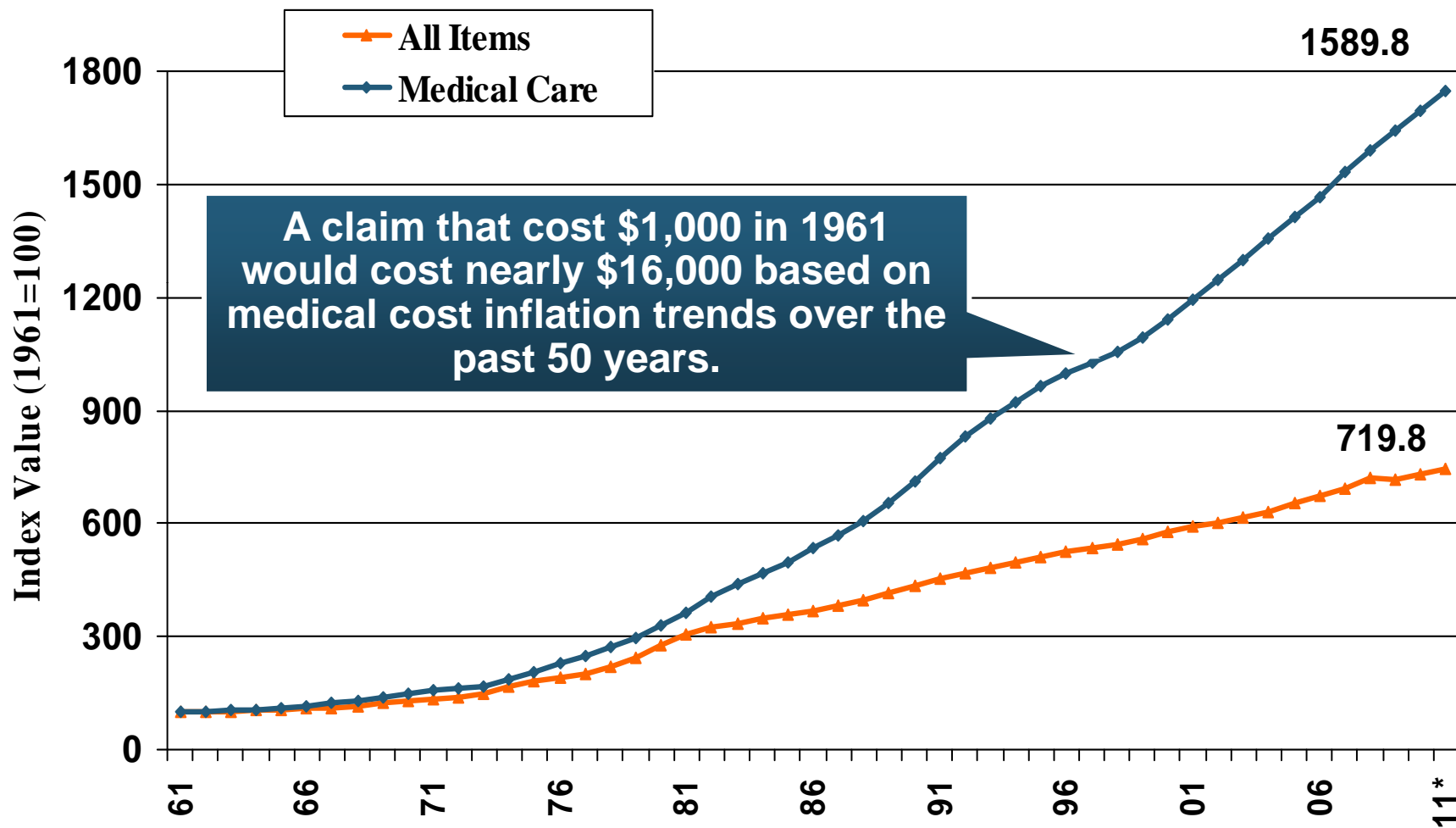
Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble reduced inflationary pressures in 2009/10

Higher energy, commodity and food prices are pushing up inflation in 2011, but not longer turn inflationary expectations.

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, 3/11 and 9/11 (forecasts).

# Medical Cost Inflation Has Outpaced Overall Inflation Over 50 Years



\*Based on change from Feb. 2011 to Feb. 2010 (latest available)

Source: Department of Labor (Bureau of Labor Statistics)

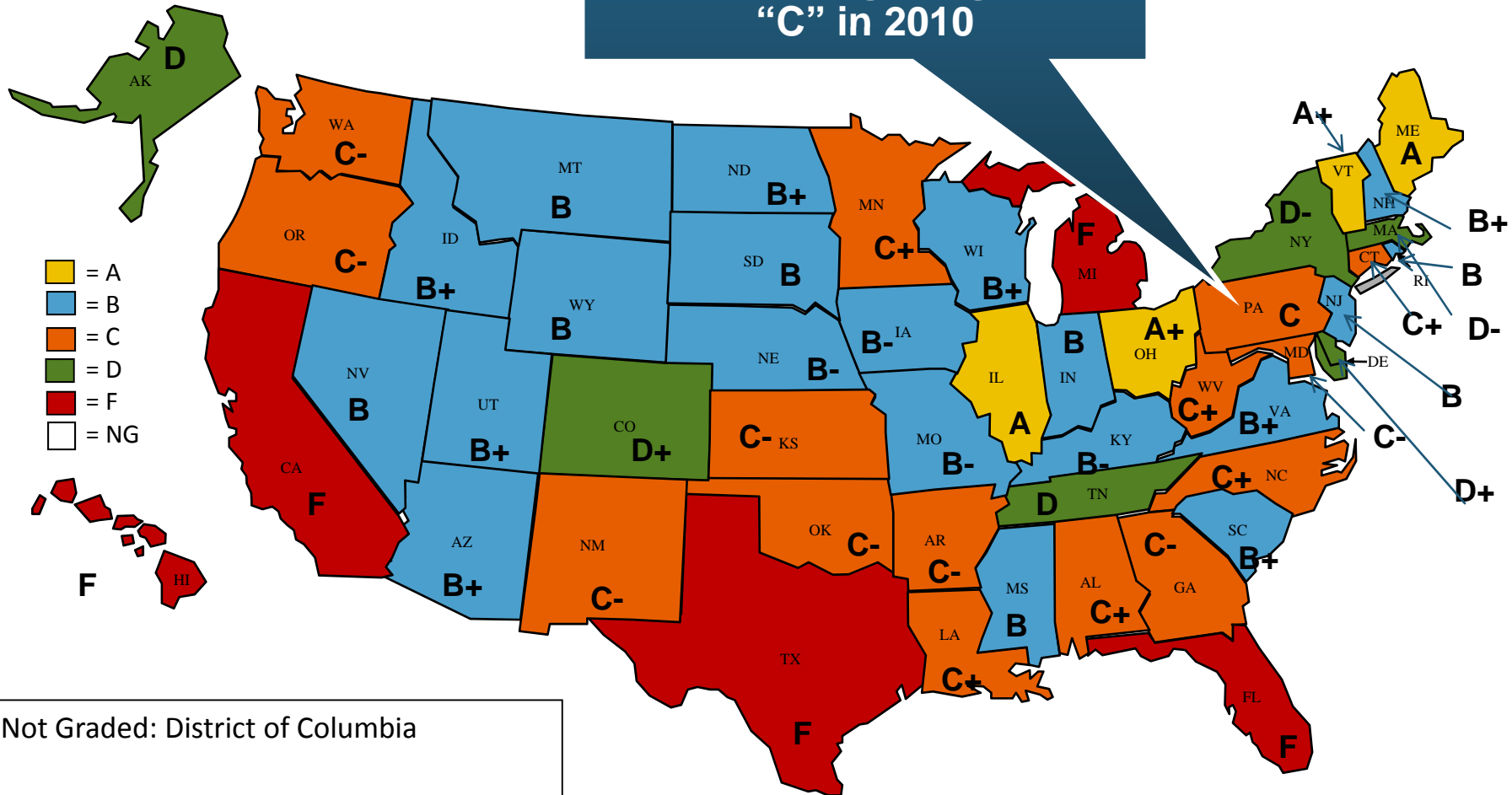


## **Regulatory Environment & Financial Services Reform**

**Insurers Not as Impacted as  
Banks, But Dodd-Frank  
Implementation Has Been a  
Concern for Insurers**

# 2010 Property and Casualty Insurance Regulatory Report Card

Pennsylvania's regulatory environment got a grade of "C" in 2010



Not Graded: District of Columbia

# Financial Services Reform: *What does it mean for insurers?*

## The Dodd Frank Wall Street Reform and Consumer Protection Act

### ■ Systemic Risk and Resolution Authority

- Creates the Financial Stability Oversight Council and the Office of Financial Research
- Regulator representative is MO Insurance Commissioner Huff
- *Roy Woodall, former KY Ins. Comm. & industry executive has been nominated for the insurance industry seat*
- Imposes heightened federal regulation on large bank holding companies and “systemically risky” nonbank financial companies, including insurers
- ***Determination of criteria to identify systemically risky firms is incomplete***

### ■ Federal Insurance Office (FIO)

- Established the FIO (while maintaining state regulation of insurance) within the Department of Treasury, headed by a Director appointed by the Secretary of Treasury
- FIO will have authority to monitor the insurance industry, identify regulatory gaps that could contribute to systemic crisis
- **IL Insurance Director Michael McGraith became first FIO Director on June 1**
- **Creation of Federal Advisory Committee on Insurance to Advise FIO**

### ■ Concern: Will FIO Morph Into a Quasi or Shadow Regulator?

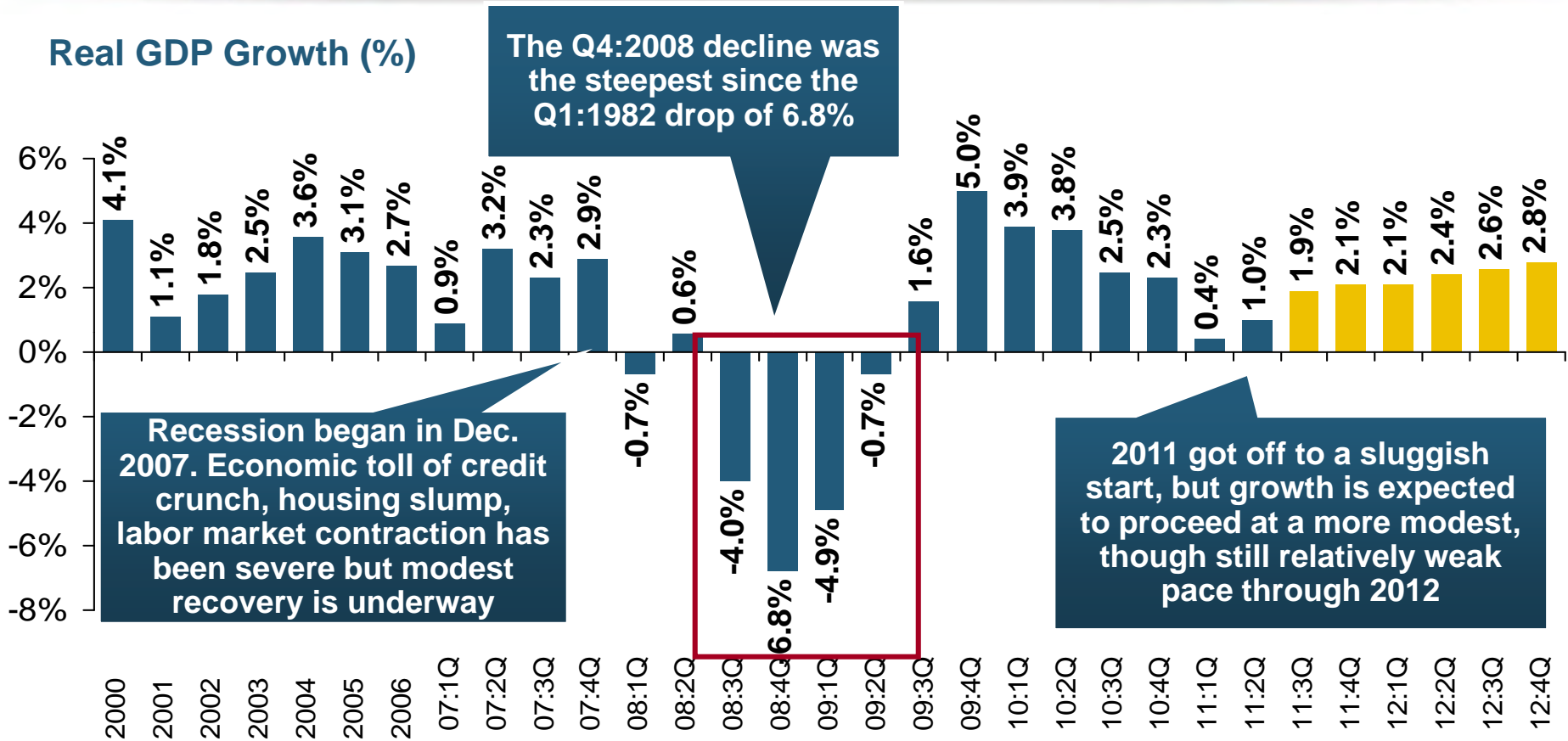


# The Strength of the Economy Will Influence P/C Insurer Growth Opportunities

**Growth Would Also Help Absorb  
Excess Capital**

# US Real GDP Growth\*

Real GDP Growth (%)



**Demand for Insurance Continues To Be Impacted by Sluggish Economic Conditions, but the Benefits of Even Slow Growth Will Compound and Gradually Benefit the Economy Broadly**

\*  Estimates/Forecasts from Blue Chip Economic Indicators.

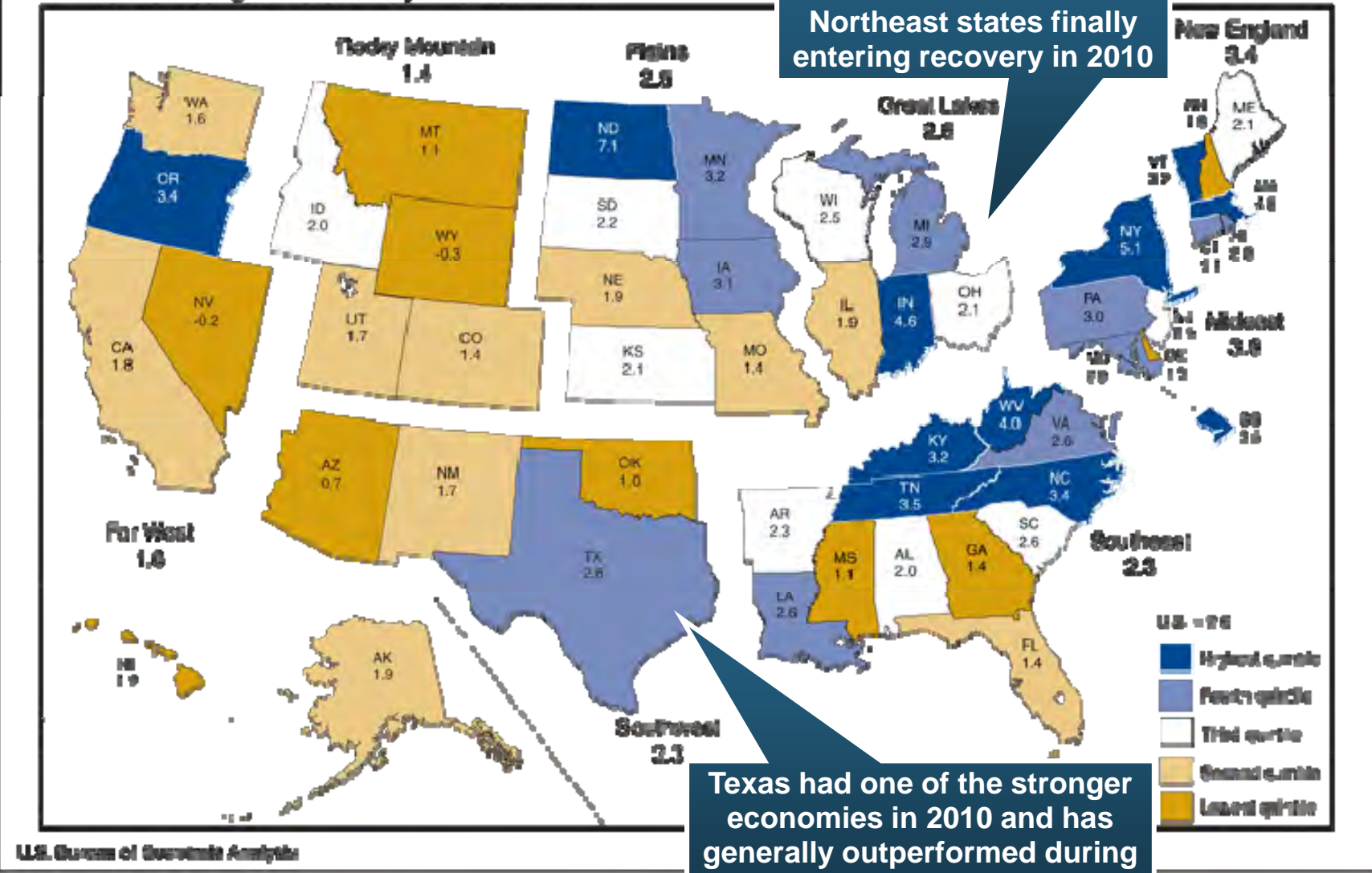
Source: US Department of Commerce, Blue Economic Indicators 9/11; Insurance Information Institute.

# 2011 Financial Overview

## State Economic Growth Varied in 2010

Chart 1. Percent Change in Real GDP by State, 2009-2010

Hard hit Midwest and Northeast states finally entering recovery in 2010

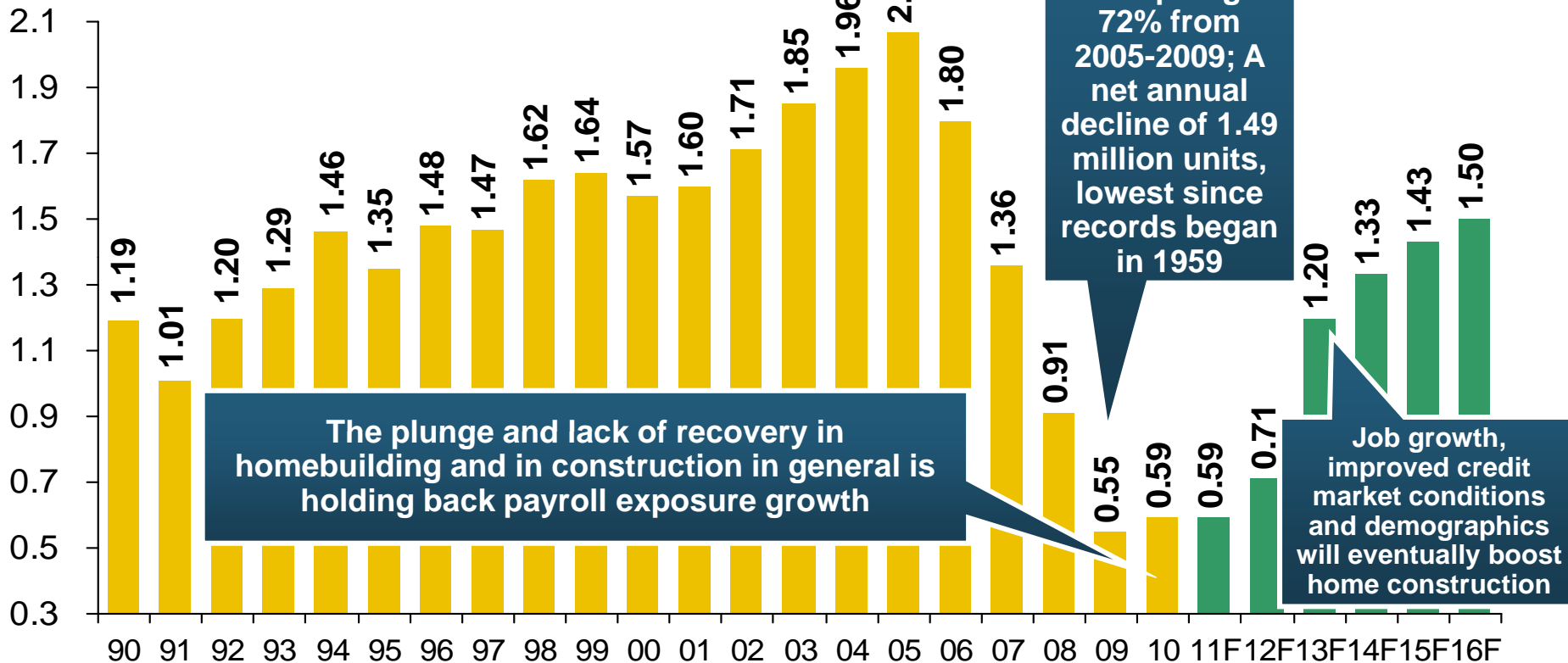


Texas had one of the stronger economies in 2010 and has generally outperformed during the economic downturn



# New Private Housing Starts, 1990-2016F

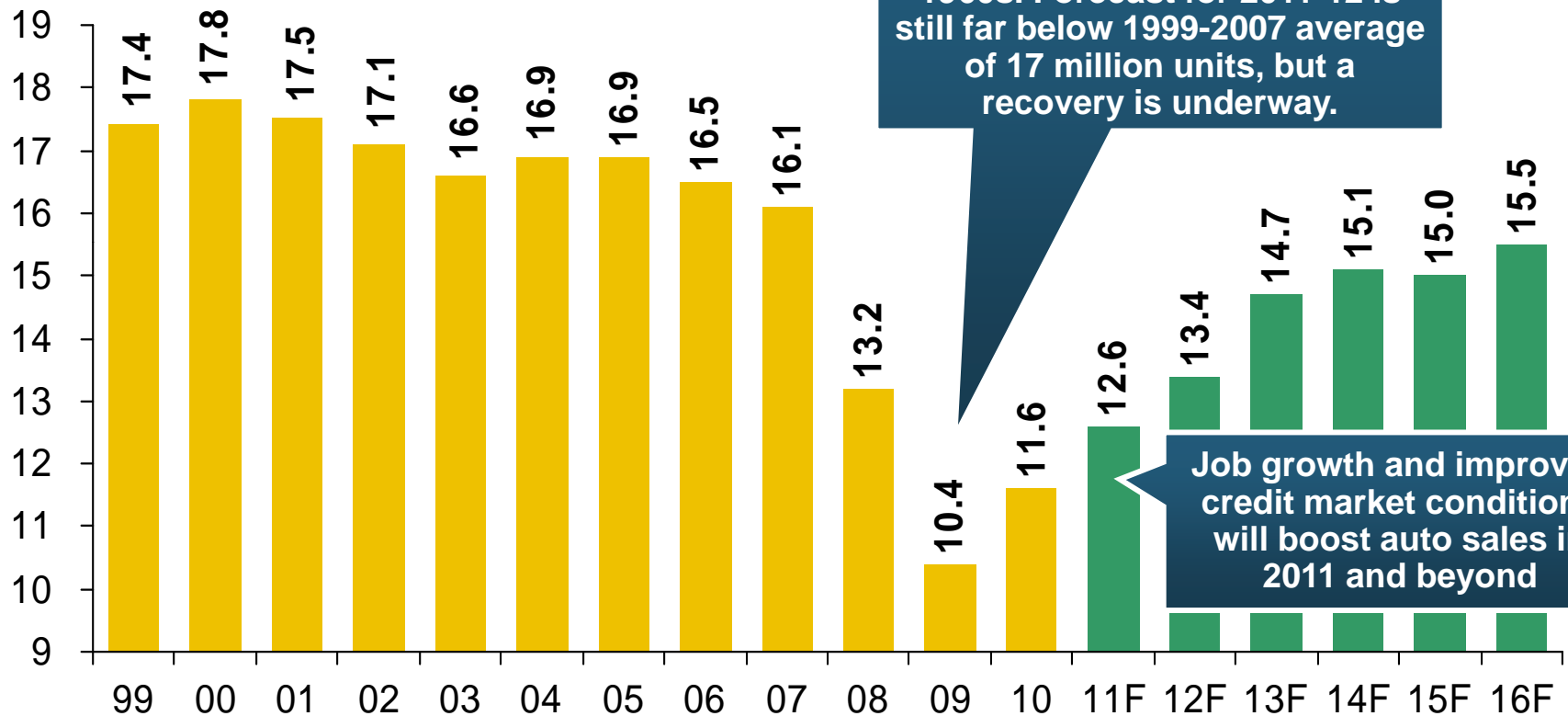
(Millions of Units)



**Little Exposure Growth Likely for Homeowners Insurers Until 2013. Also Affects Commercial Insurers with Construction Risk Exposure, Surety**

# Auto/Light Truck Sales, 1999-2016F

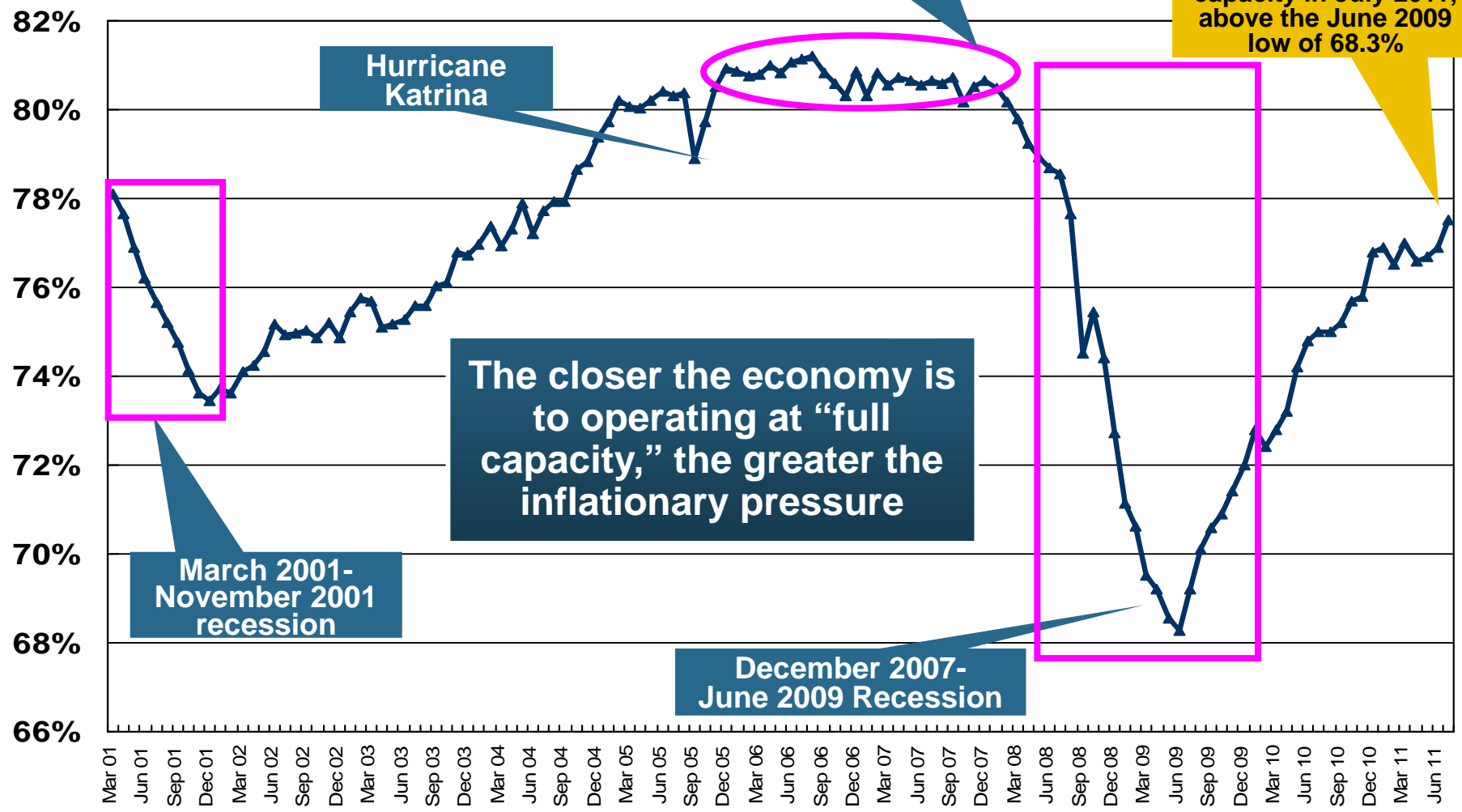
(Millions of Units)



**Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, Bolstering the Manufacturing Sector.**

# Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

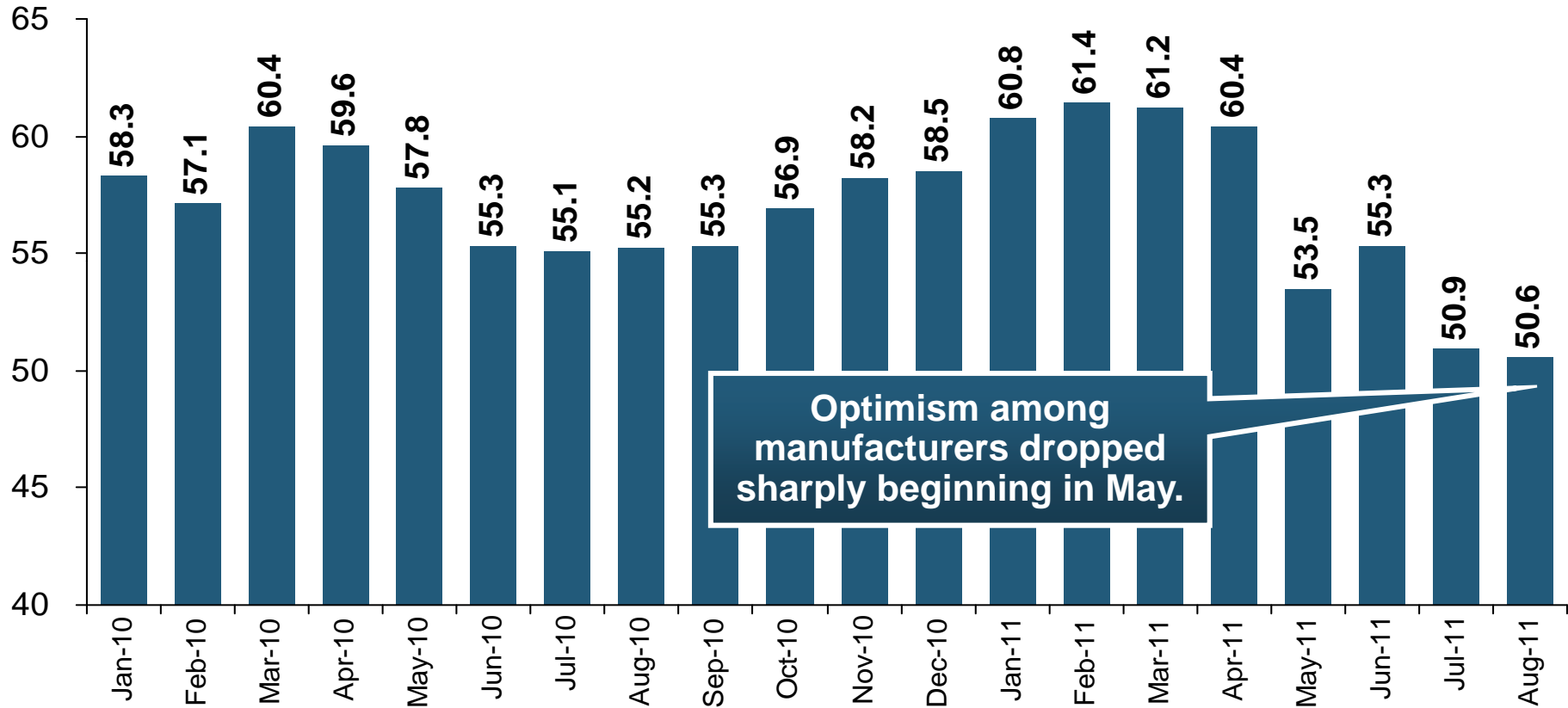
Percent of Industrial Capacity



Source: Federal Reserve Board statistical releases at <http://www.federalreserve.gov/releases/q17/Current/default.htm>.

# ISM Manufacturing Index (Values > 50 Indicate Expansion)

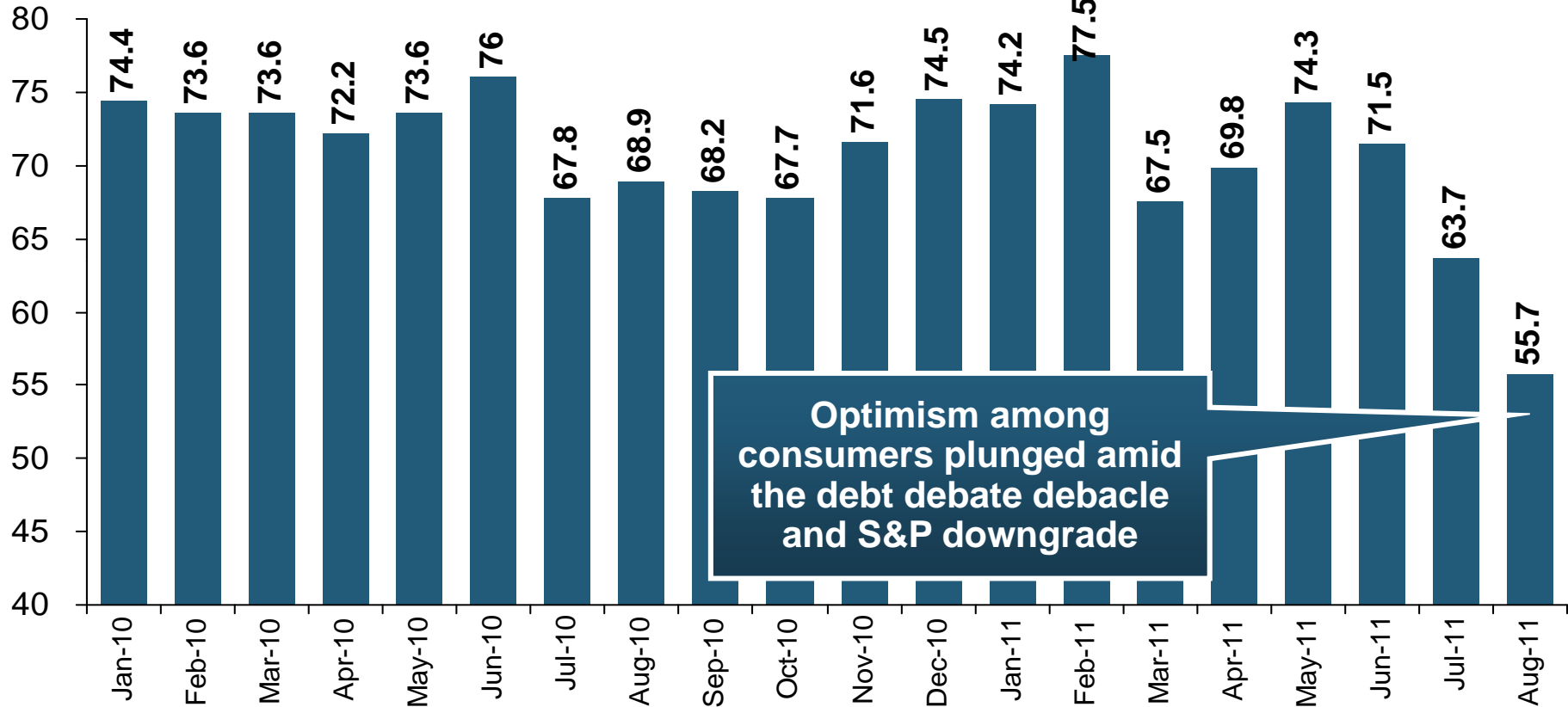
January 2010 through August 2011



**The manufacturing sector has been expanding and adding jobs.  
The question is whether this will continue.**

# Consumer Sentiment Survey (1966 = 100)

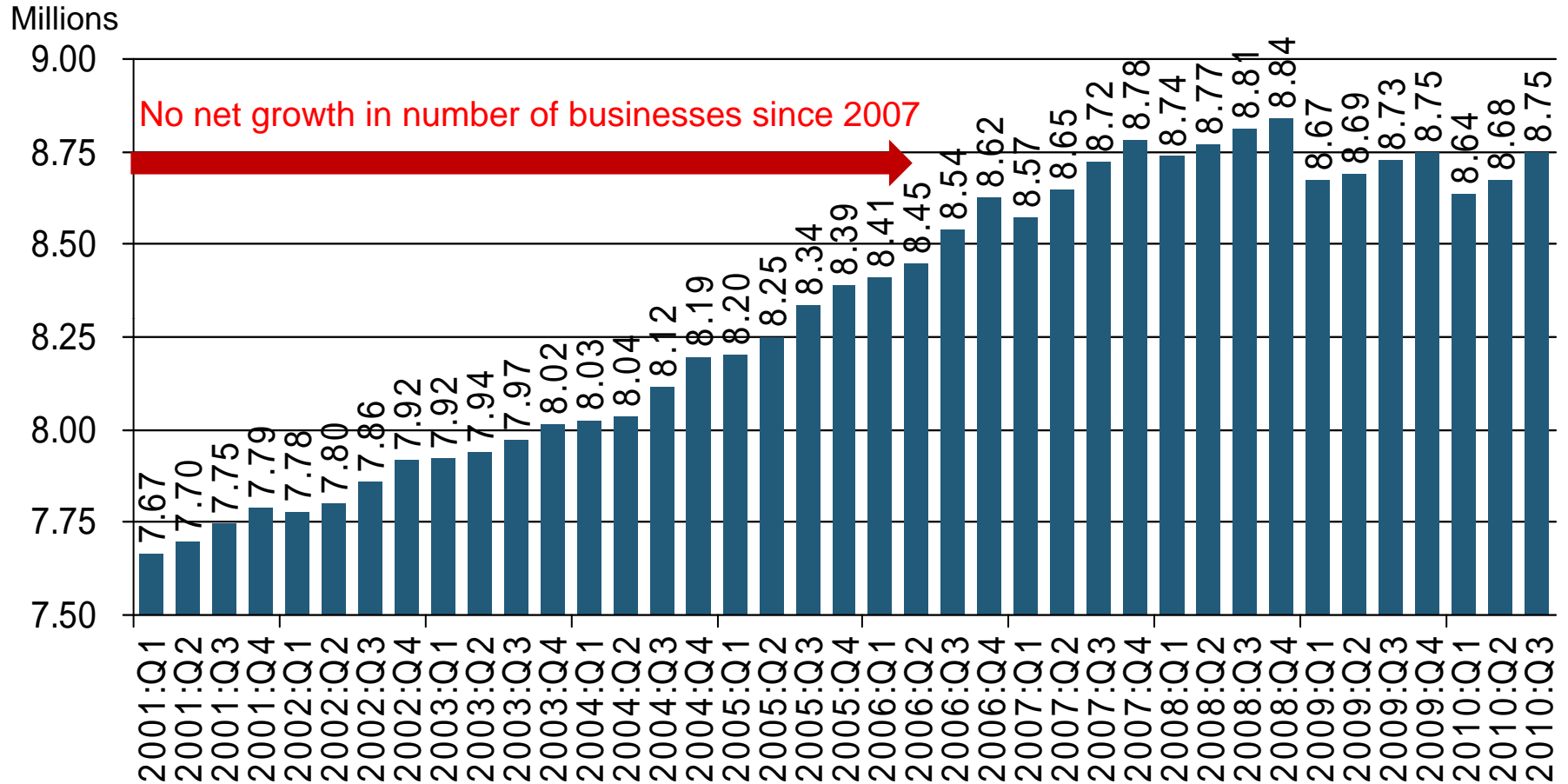
January 2010 through August 2011



Optimism among consumers plunged amid the debt debate debacle and S&P downgrade

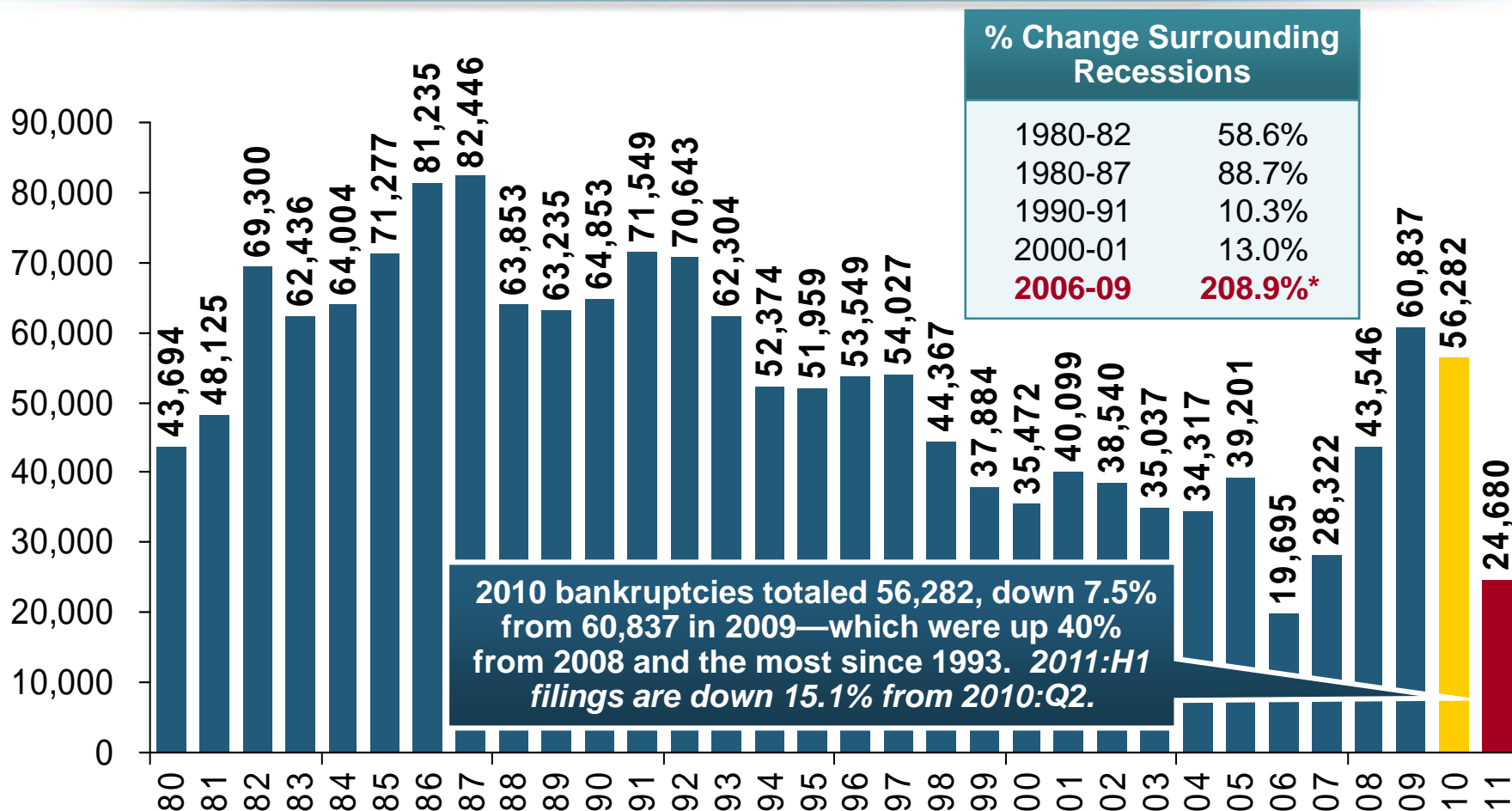
**Consumer confidence has been low for years amid high unemployment, falling home prices and other factors adversely impact consumers.**

# Number of Private Business Establishments, 2001:Q1-2010:Q3



**In 2009:Q1 a net of 165,000 businesses disappeared.  
By 2010:Q3 73,000 new ones appeared,  
returning us to the level first attained three years before, in 2007:Q3.**

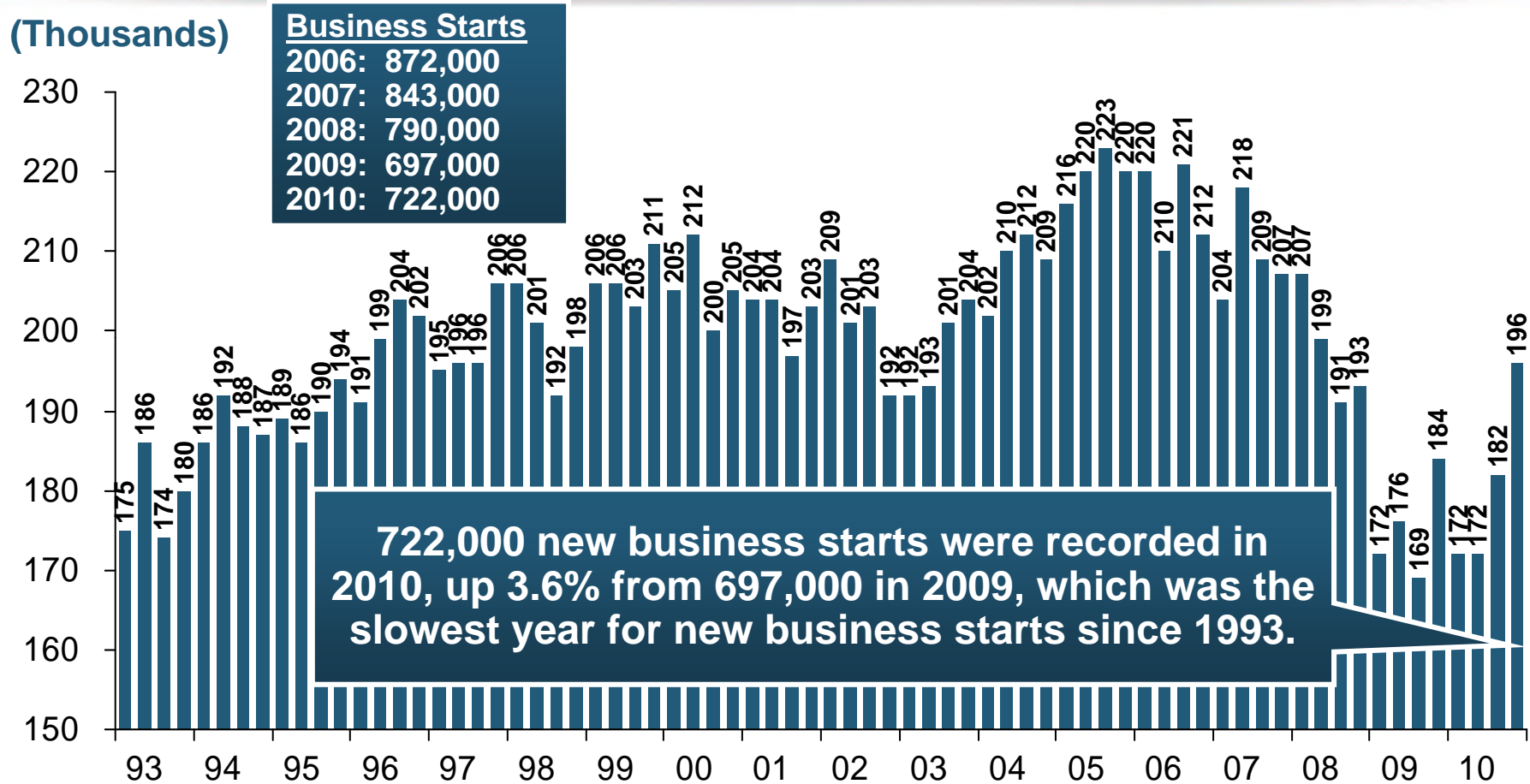
# Business Bankruptcy Filings, 1980-2011:H1



**Significant Exposure Implications for All Commercial Lines as Business Bankruptcies Begin to Decline**

Sources: American Bankruptcy Institute at <http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=61633> ; Insurance Information Institute

# Private Sector Business Starts, 1993:Q2 – 2010:Q4\*



**Business Starts Were Down Nearly 20% in the Recession, Holding Back Most Types of Commercial Insurance Exposure**

\* Data through December 31, 2010 are the latest available as of September 8, 2011; Seasonally adjusted  
 Source: Bureau of Labor Statistics, <http://www.bls.gov/news.release/cewbd.t08.htm>.



# 11 Industries for the Next 10 Years: Insurance Solutions Needed

Health Care

Health Sciences

Energy (Traditional)

Alternative Energy

Agriculture

Natural Resources

Environmental

Technology (incl. Biotechnology)

Light Manufacturing

Export-Oriented Industries

Shipping (Rail, Marine, Trucking)



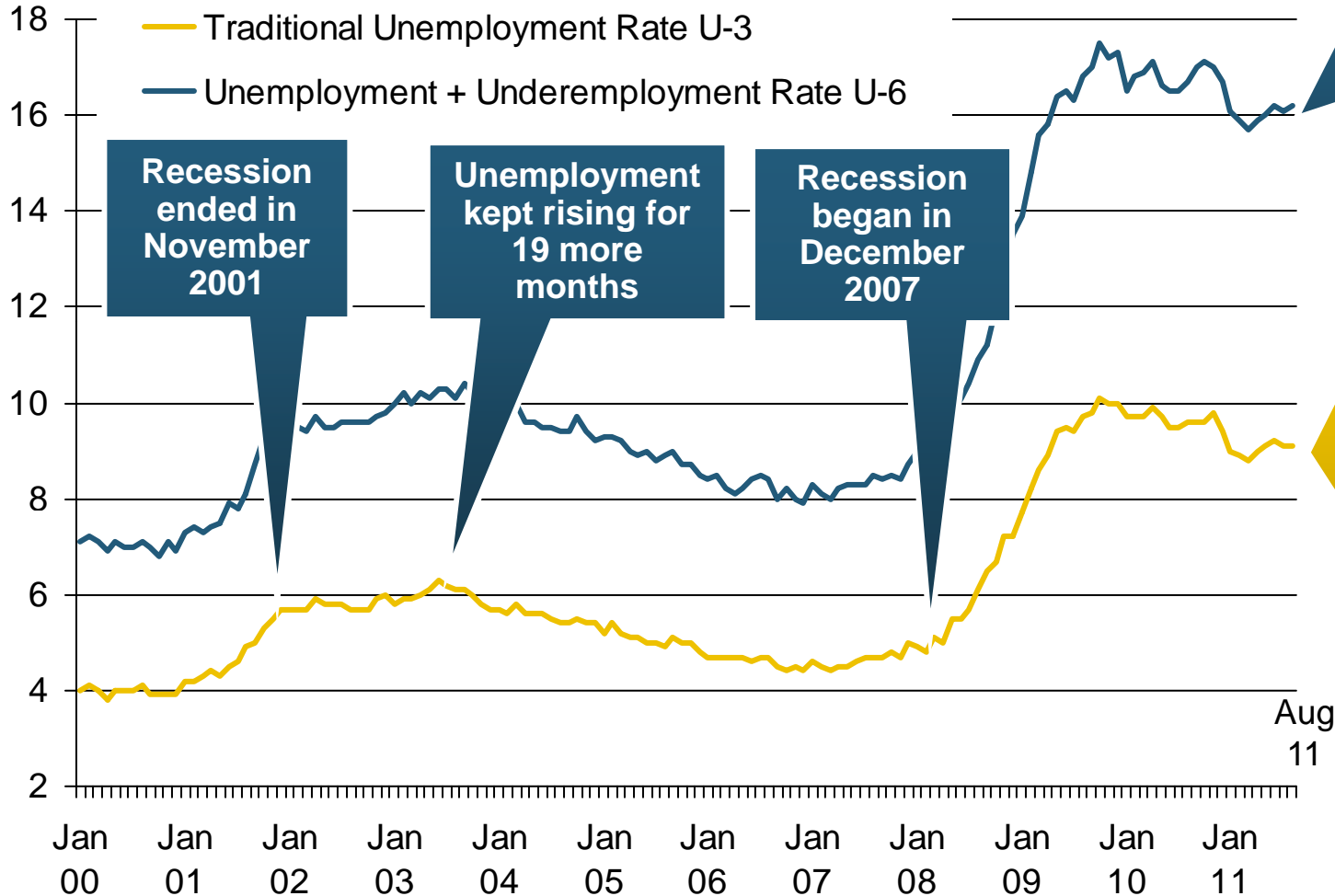
Many industries are poised for growth, but many insurers do not write in these economic segments

# Labor Market Trends

**Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend is Improving**

# Unemployment and Underemployment Rates: Stubbornly High in 2011

January 2000 through August 2011, Seasonally Adjusted (%)



**U-6 went from 8.0% in March 2007 to 17.5% in October 2009; Stood at 16.1% in August 2011**

**Unemployment stood at 9.1% in August**

**Unemployment peaked at 10.1% in October 2009, highest monthly rate since 1983.**

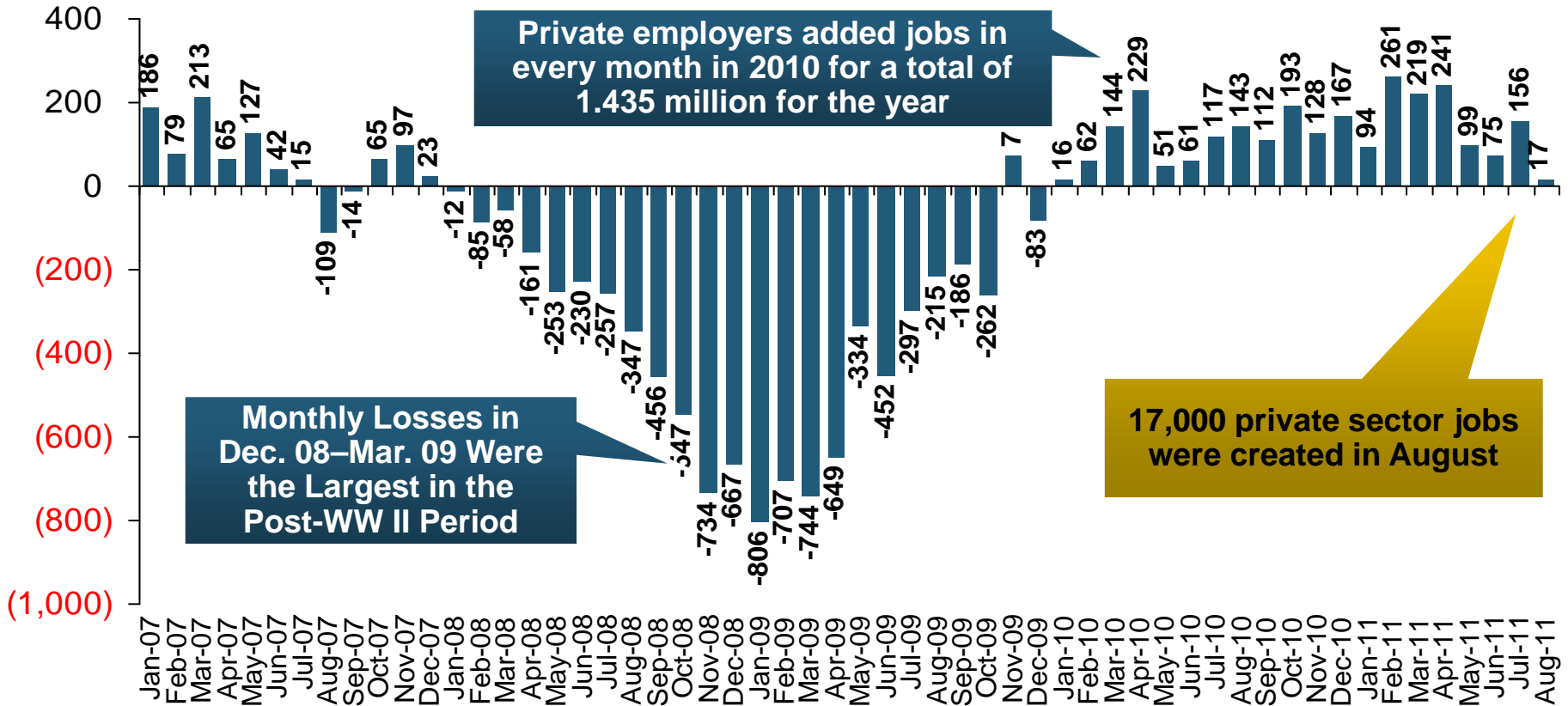
**Peak rate in the last 30 years: 10.8% in November - December 1982**

**Stubbornly high unemployment and underemployment will constrain payroll growth, which directly affects WC exposure**

Source: US Bureau of Labor Statistics; Insurance Information Institute.

# Monthly Change in Private Employment

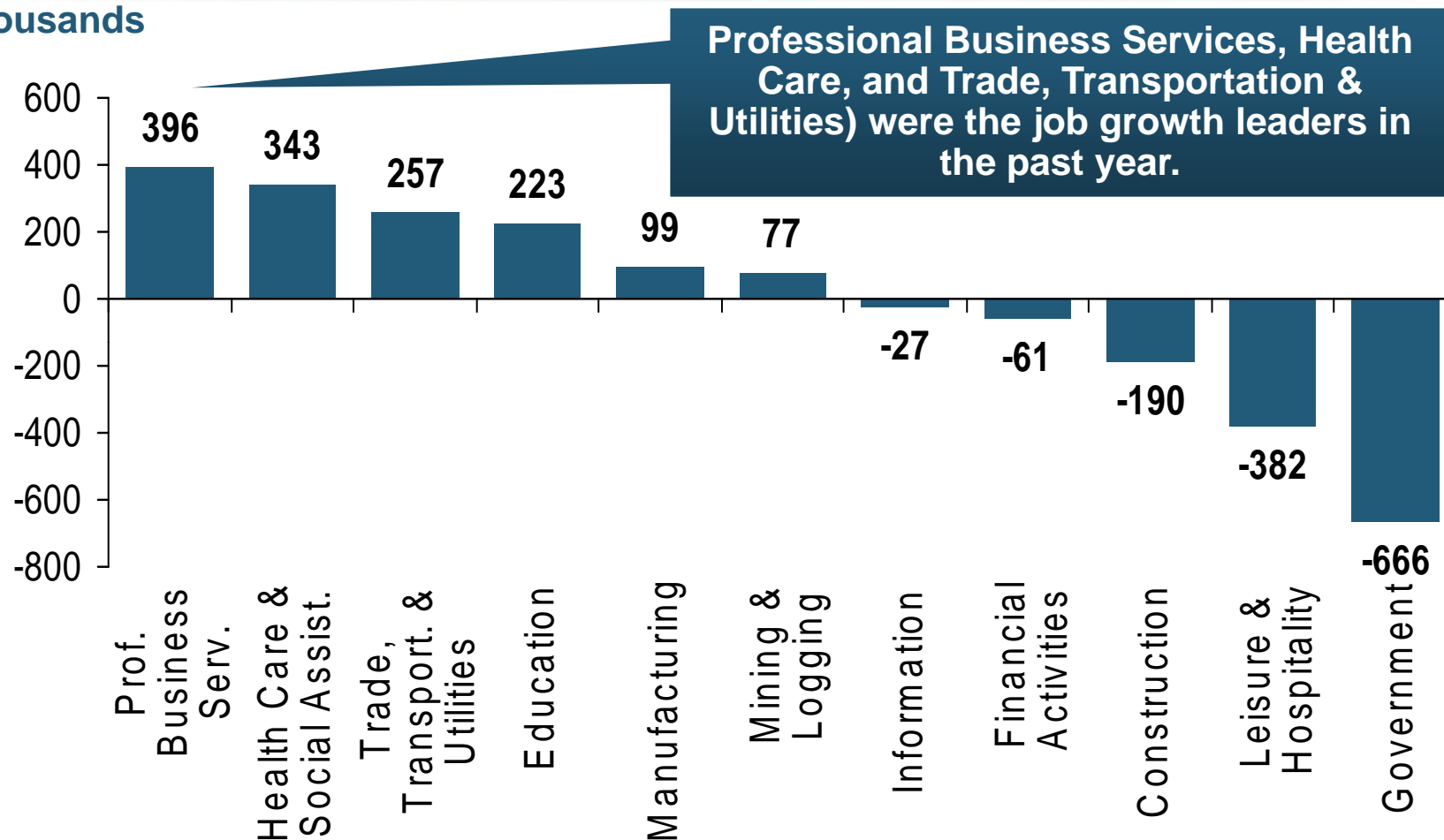
January 2008 through August 2011\* (Thousands)



**Private Employers Added 2.585 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)**

# Change in Number Employed in Select Industries, June 2011 vs. June 2010

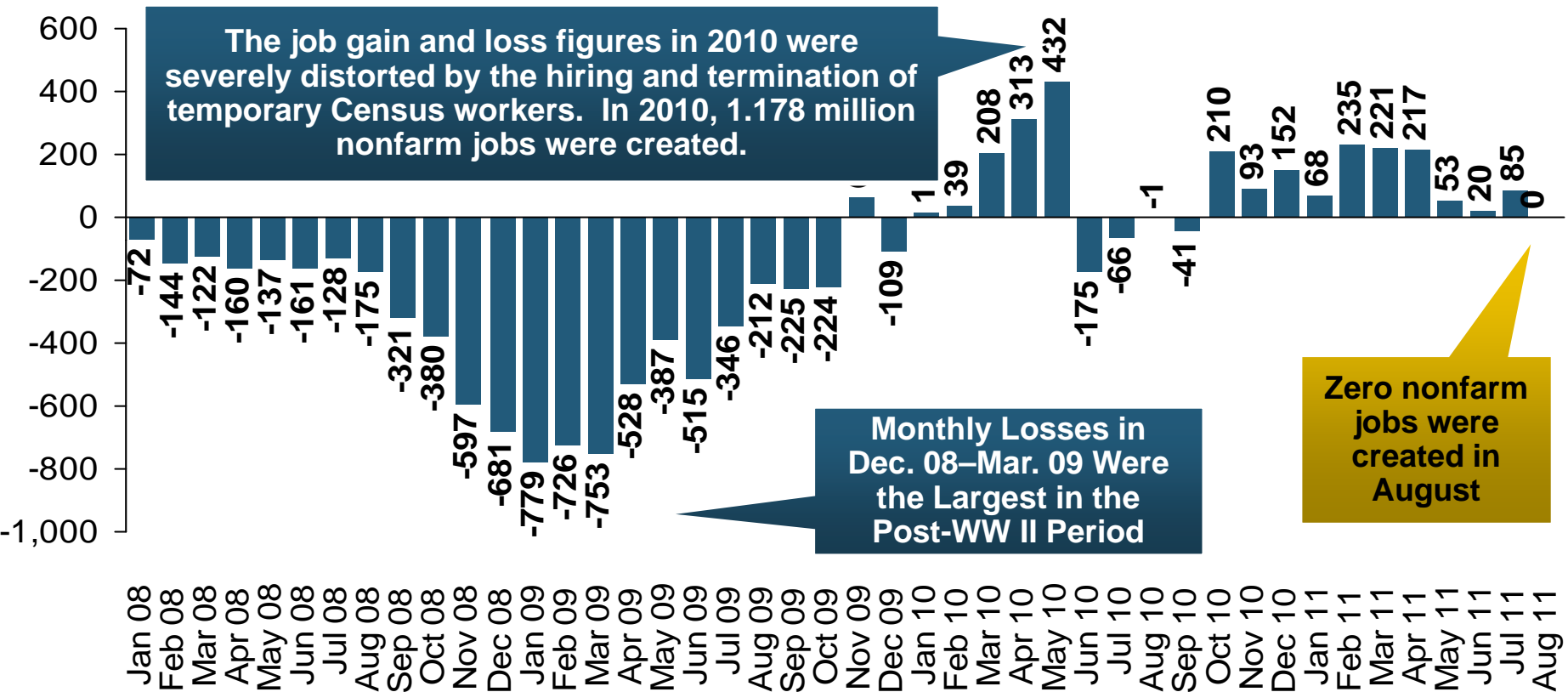
Thousands



**There is a great deal of variation in employment growth by industry, indicating a very uneven and slow recovery**

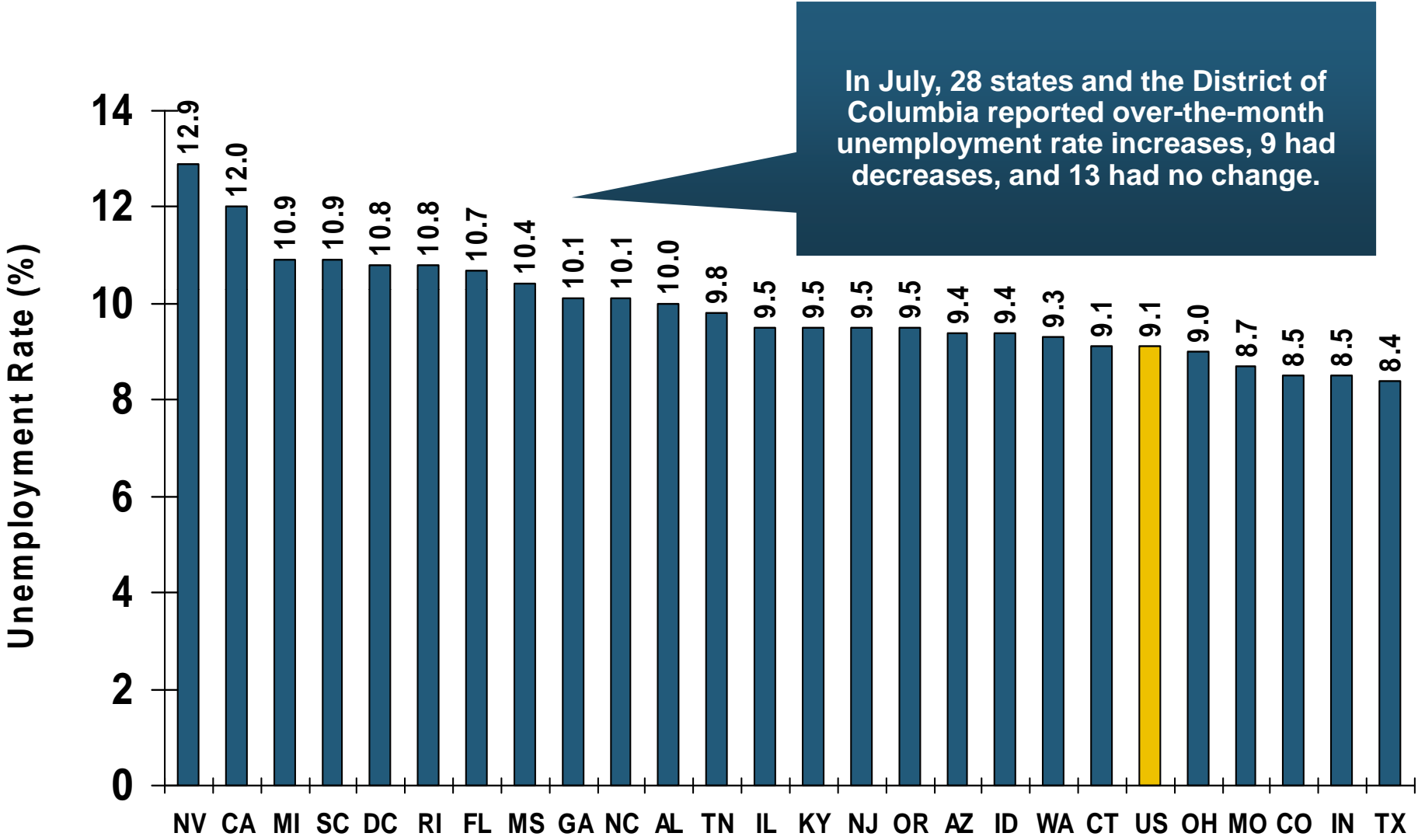
# Monthly Change Employment\*

January 2008 through August 2011\* (Thousands)



**Job Losses Since the Recession Began in Dec. 2007 Peaked at 8.4 Mill in Dec. 09; 14.0 Million People are Now Defined as Unemployed**

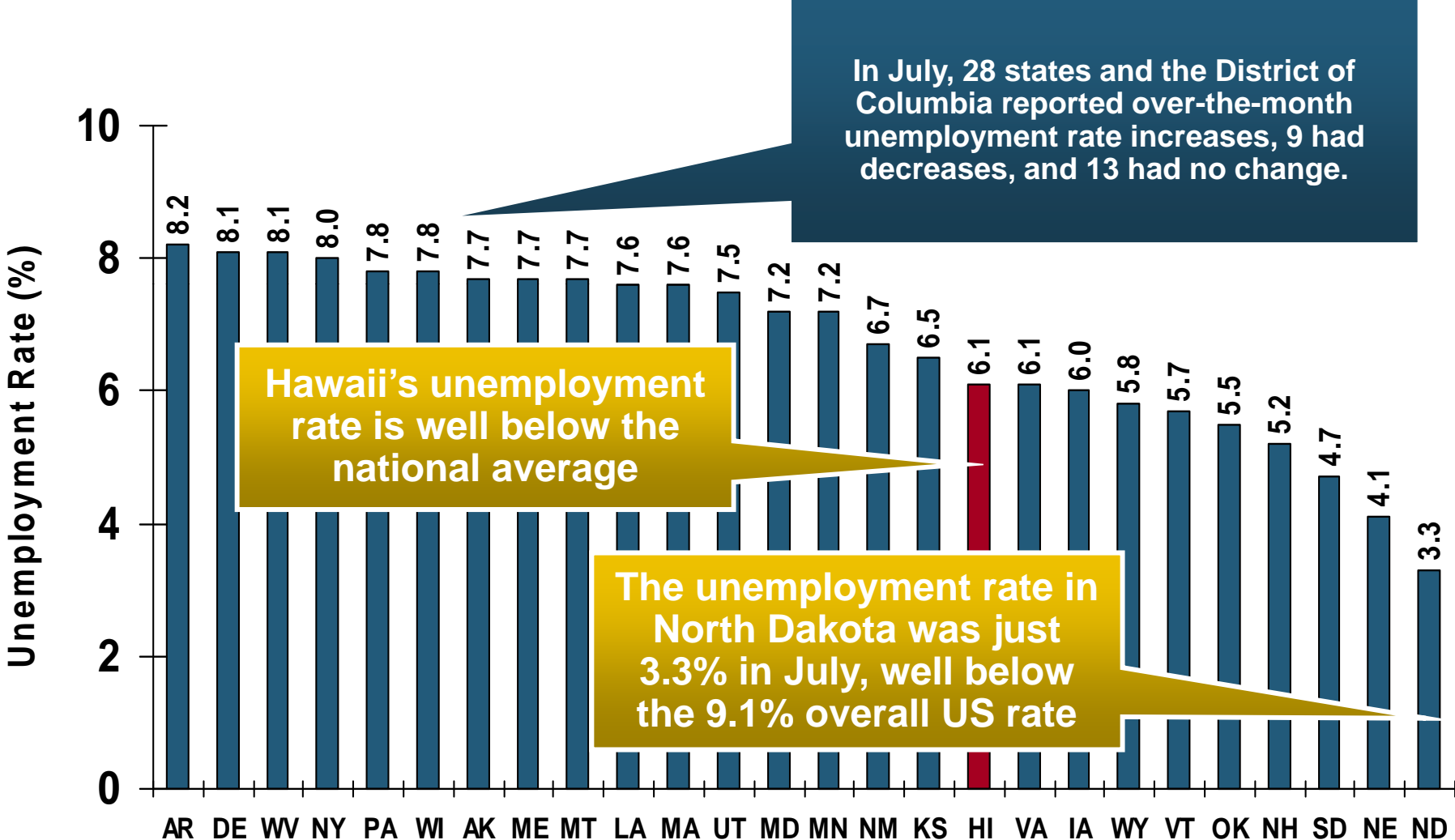
# Unemployment Rates by State, July 2011: Highest 25 States\*



\*Provisional figures for July 2011, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute.

# Unemployment Rates By State, July 2011: Lowest 25 States\*



In July, 28 states and the District of Columbia reported over-the-month unemployment rate increases, 9 had decreases, and 13 had no change.

Hawaii's unemployment rate is well below the national average

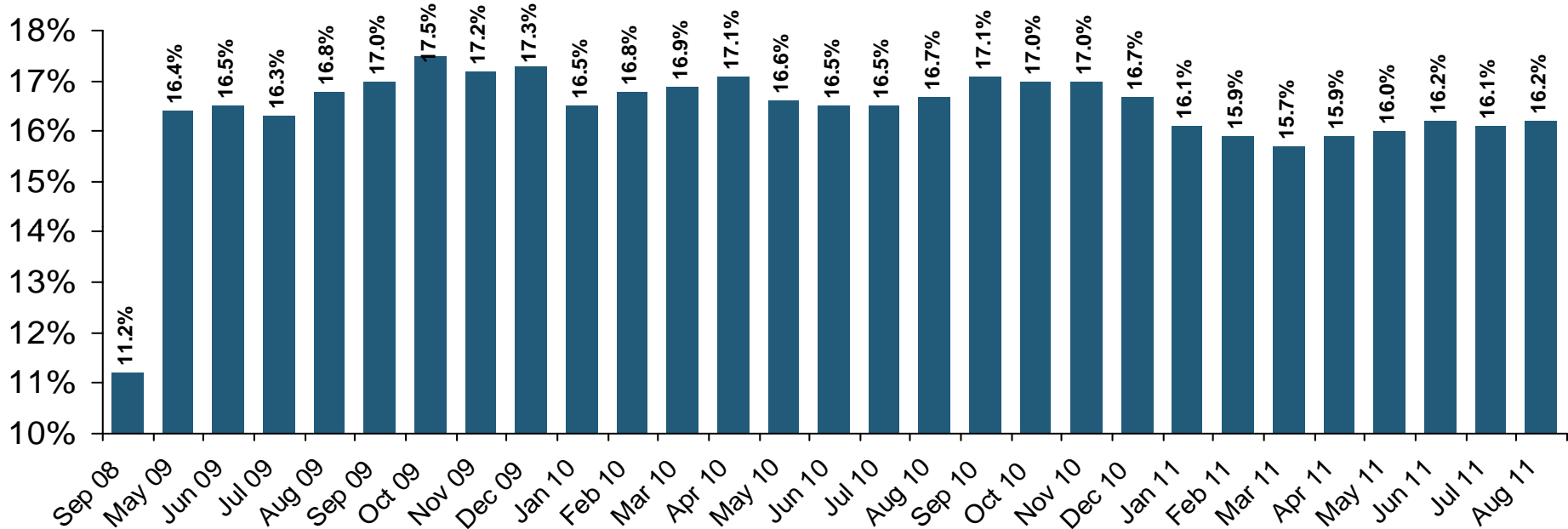
The unemployment rate in North Dakota was just 3.3% in July, well below the 9.1% overall US rate

\*Provisional figures for July 2011, seasonally adjusted.  
Sources: US Bureau of Labor Statistics; Insurance Information Institute.



# Labor Underutilization: Broader than Just Unemployment

## % of Labor Force



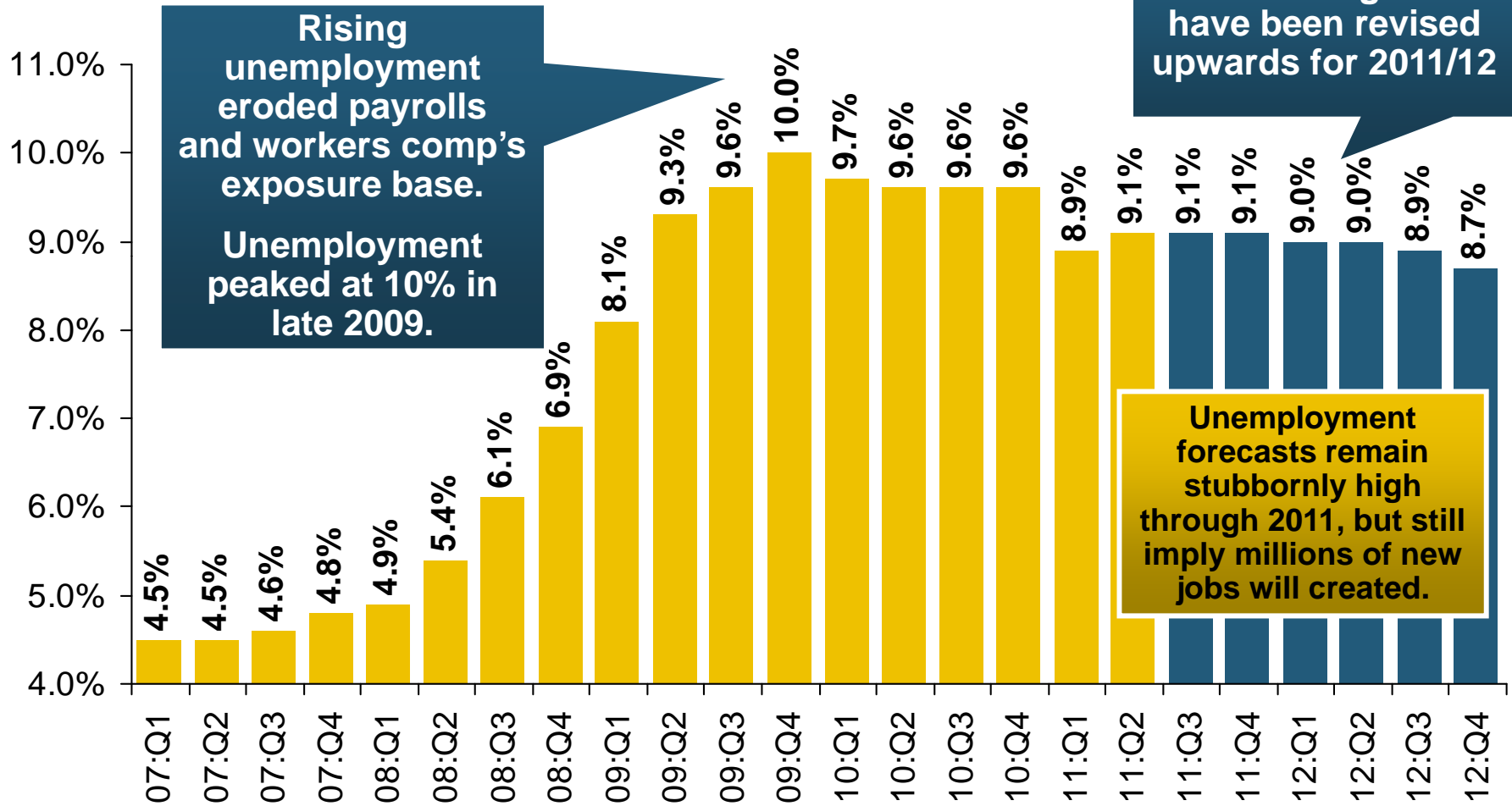
**Marginally Attached and Unemployed Persons Account for 16.2% of the Labor Force in August 2011 (1 Out Every 6.2 People). Unemployment Rate Alone was 9.1%. Underutilization Shows a Broader Impact on WC and Other Commercial Exposures**

NOTE: Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not looking currently for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule.

Source: US Bureau of Labor Statistics; Insurance Information Institute.

# US Unemployment Rate

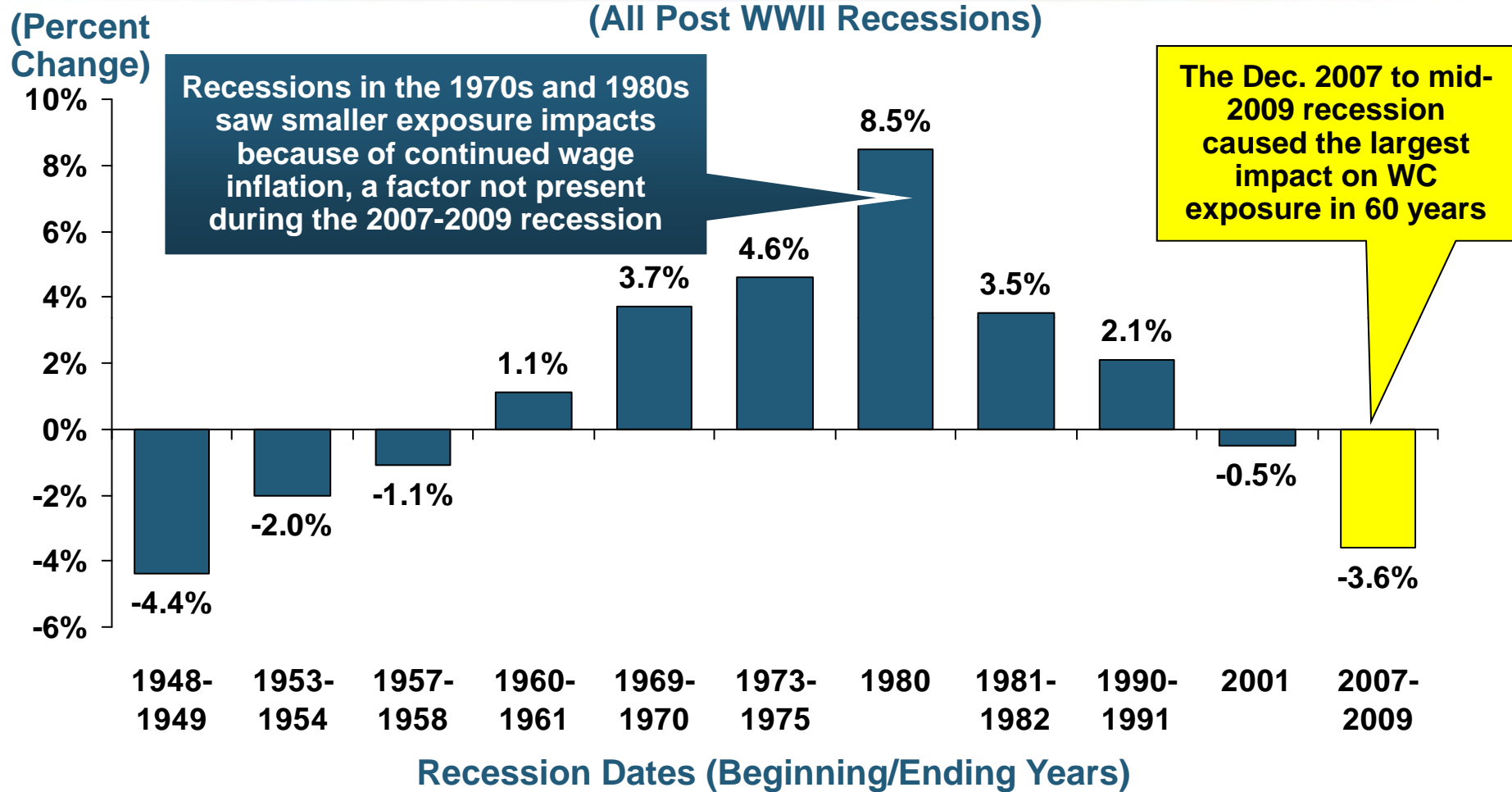
2007:Q1 to 2012:Q4F\*



\*  = actual;  = forecasts

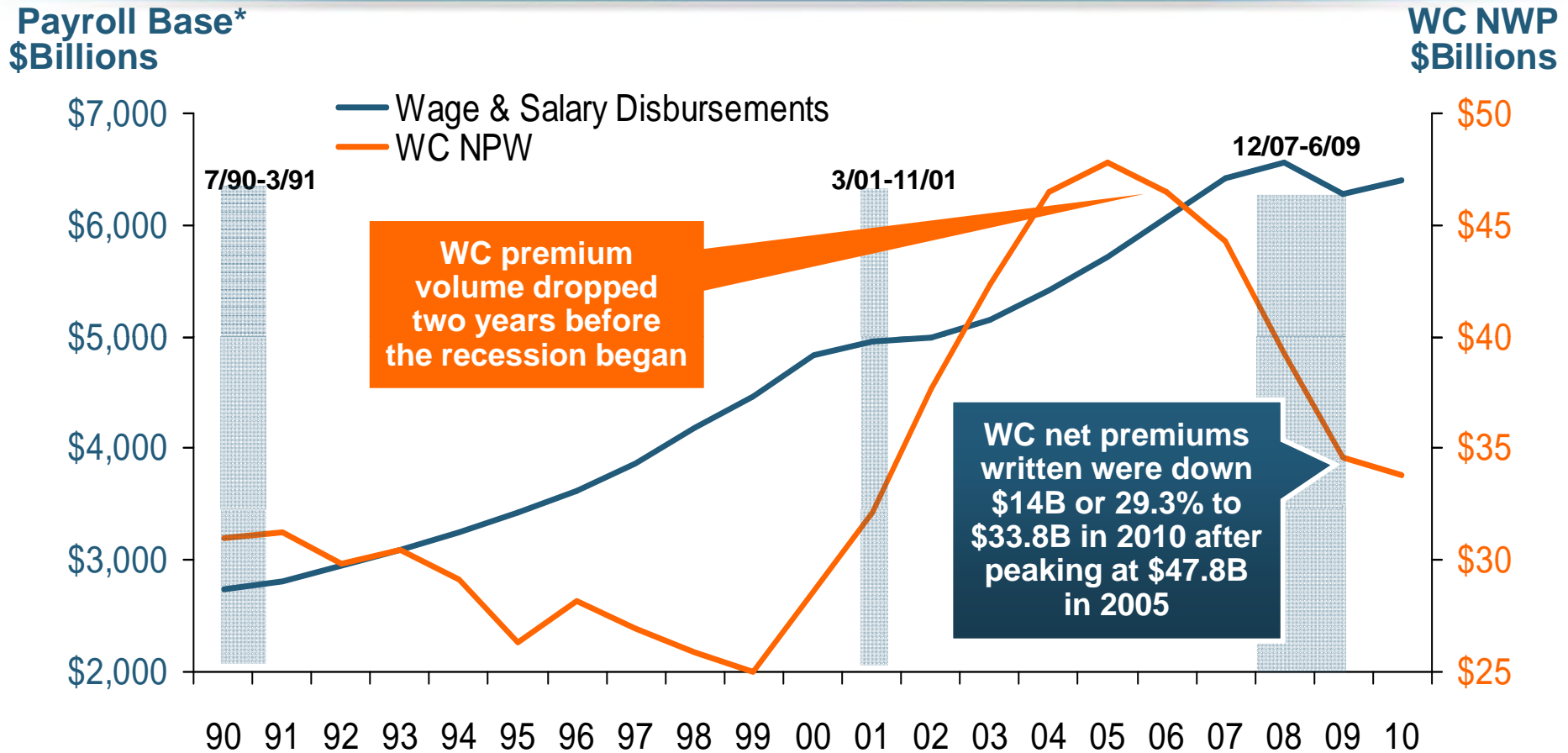
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (9/11); Insurance Information Institute

# Estimated Effect of Recessions\* on Payroll (Workers Comp Exposure)



\*Data represent maximum recorded decline over 12-month period using annualized quarterly wage and salary accrual data  
 Source: Insurance Information Institute research; Federal Reserve Bank of St. Louis (wage and salary data); National Bureau of Economic Research (recession dates).

# Wage and Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums



**29% of NPW has been eroded away by the soft market and weak economy**

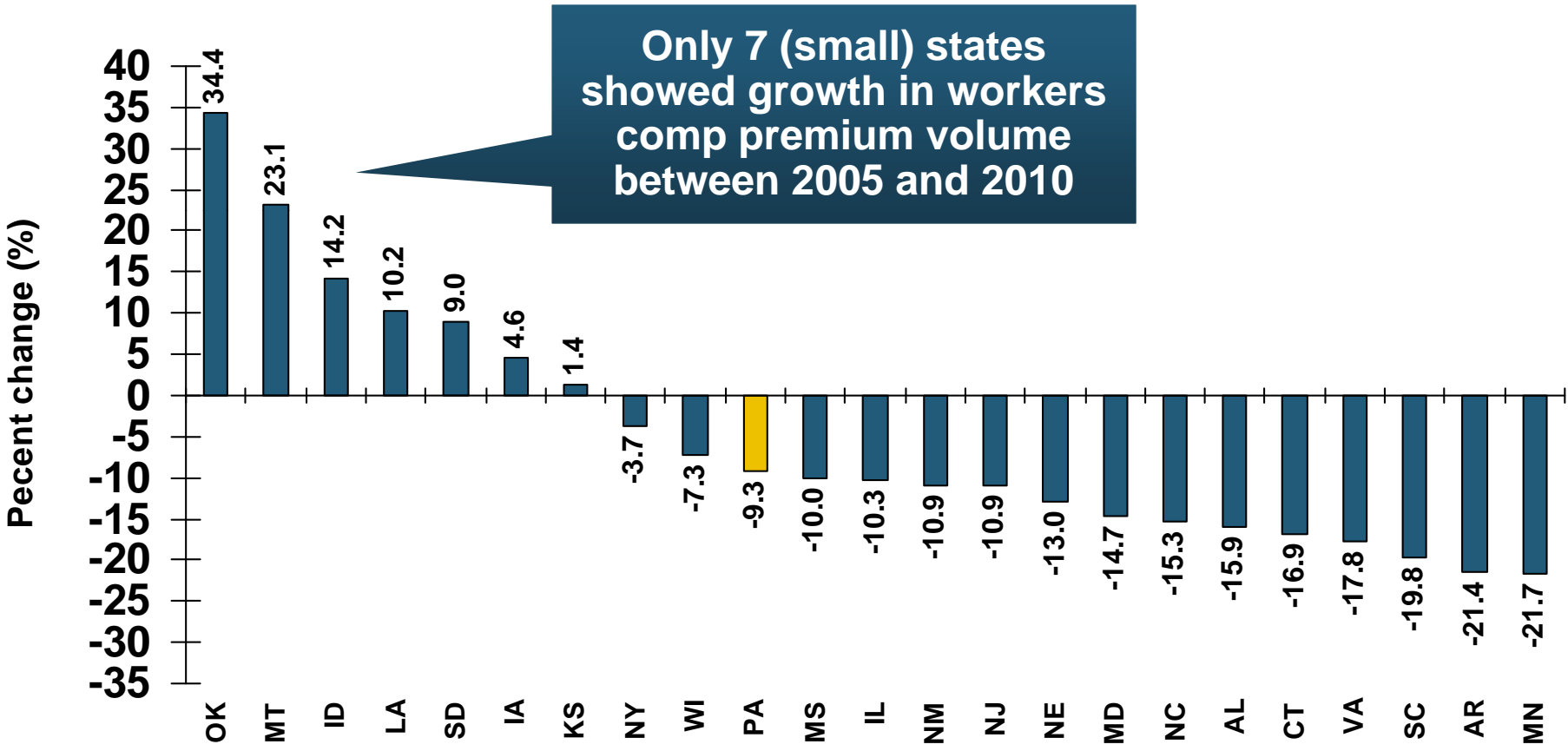
\*Private employment; Shaded areas indicate recessions.

Sources: NBER (recessions); Federal Reserve Bank of St. Louis at <http://research.stlouisfed.org/fred2/series/WASCUR> ; NCCI; I.I.I.

# Direct Premiums Written: Worker's Comp Percent Change by State, 2005-2010\*



## Top 25 States

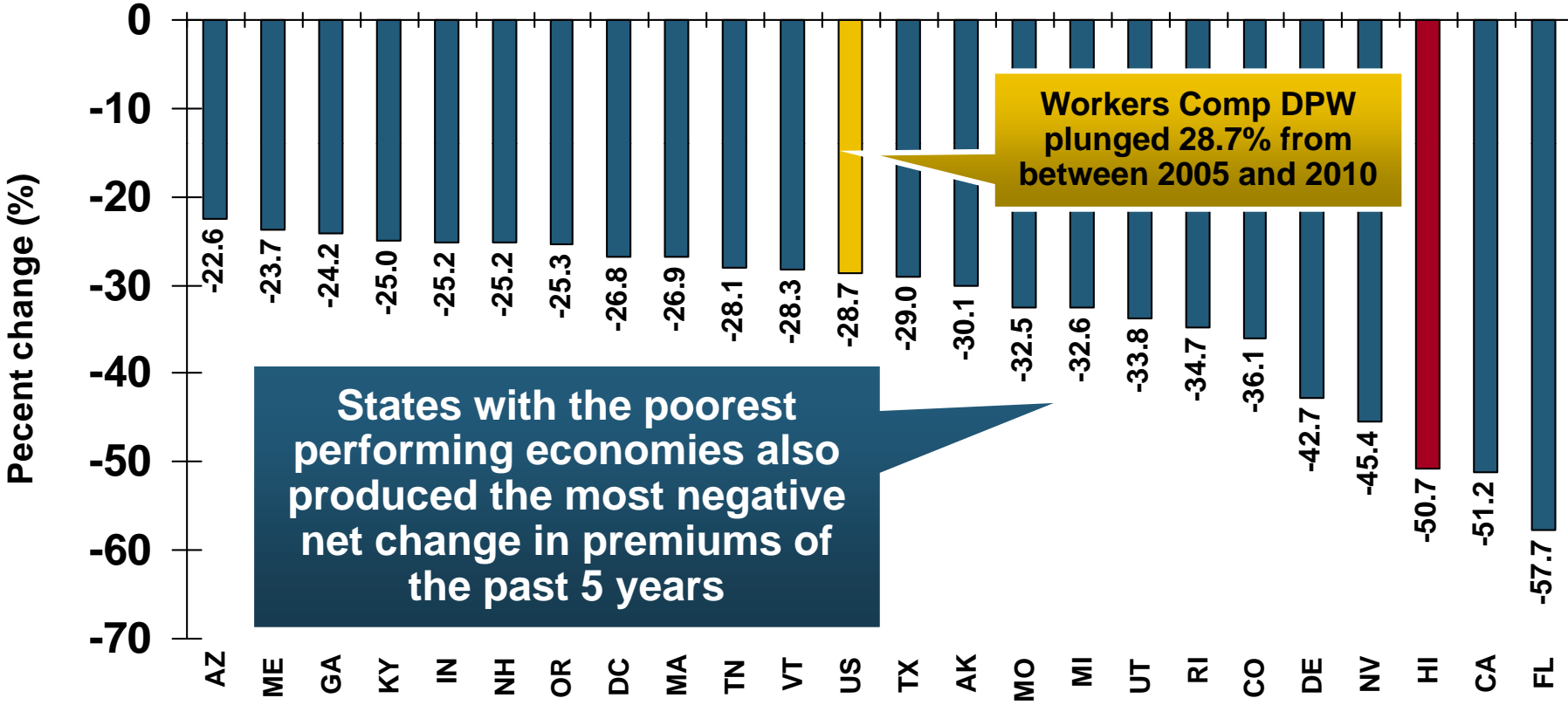


\*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: Worker's Comp Percent Change by State, 2005-2010\*

## Bottom 25 States



\*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.

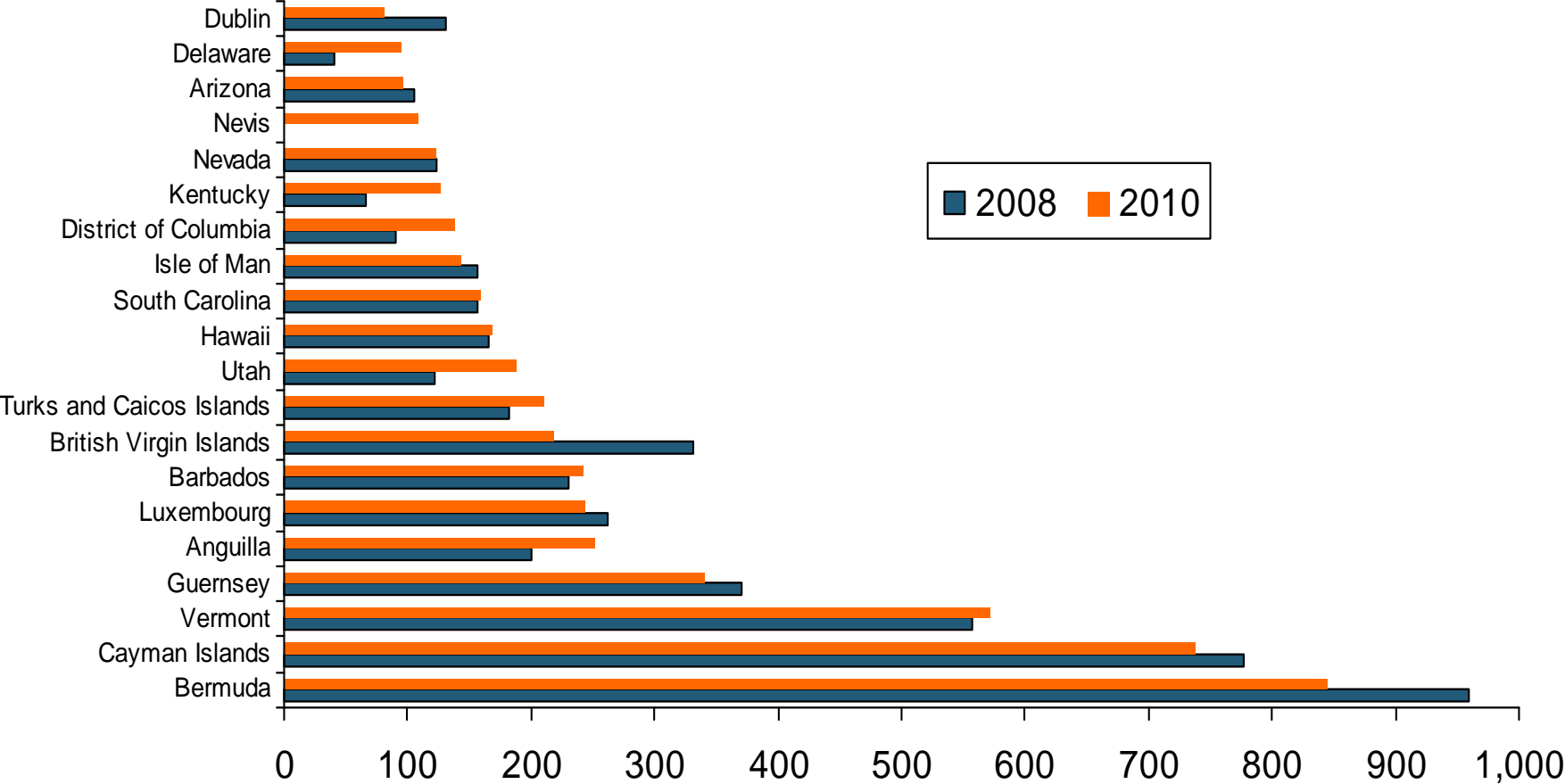
Insurance Information Institute Online:

[www.iii.org](http://www.iii.org)

*Thank you for your time  
and your attention!*

*Twitter: [twitter.com/bob\\_hartwig](https://twitter.com/bob_hartwig)*

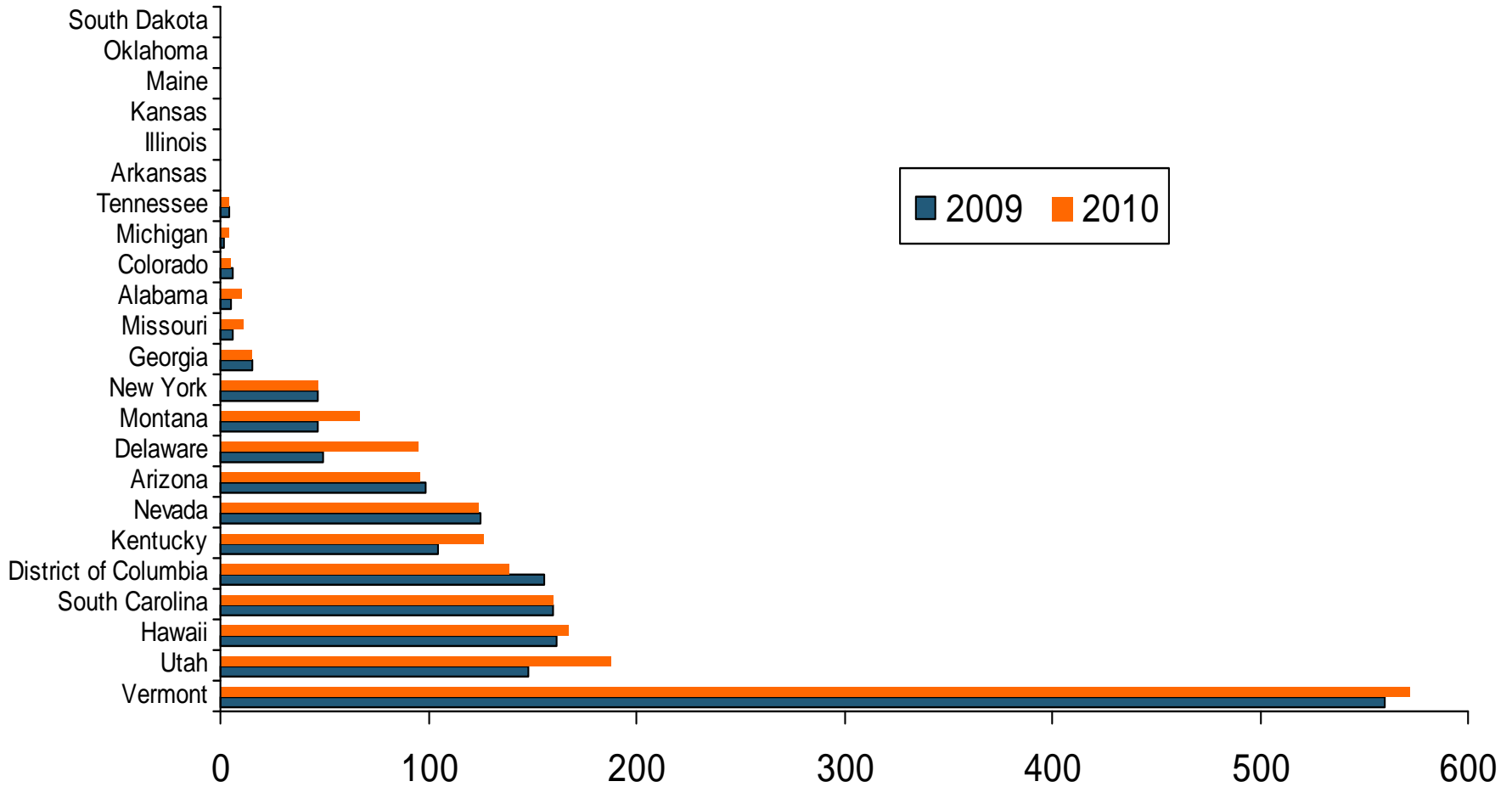
# Leading Captive Domiciles, 2008-2010



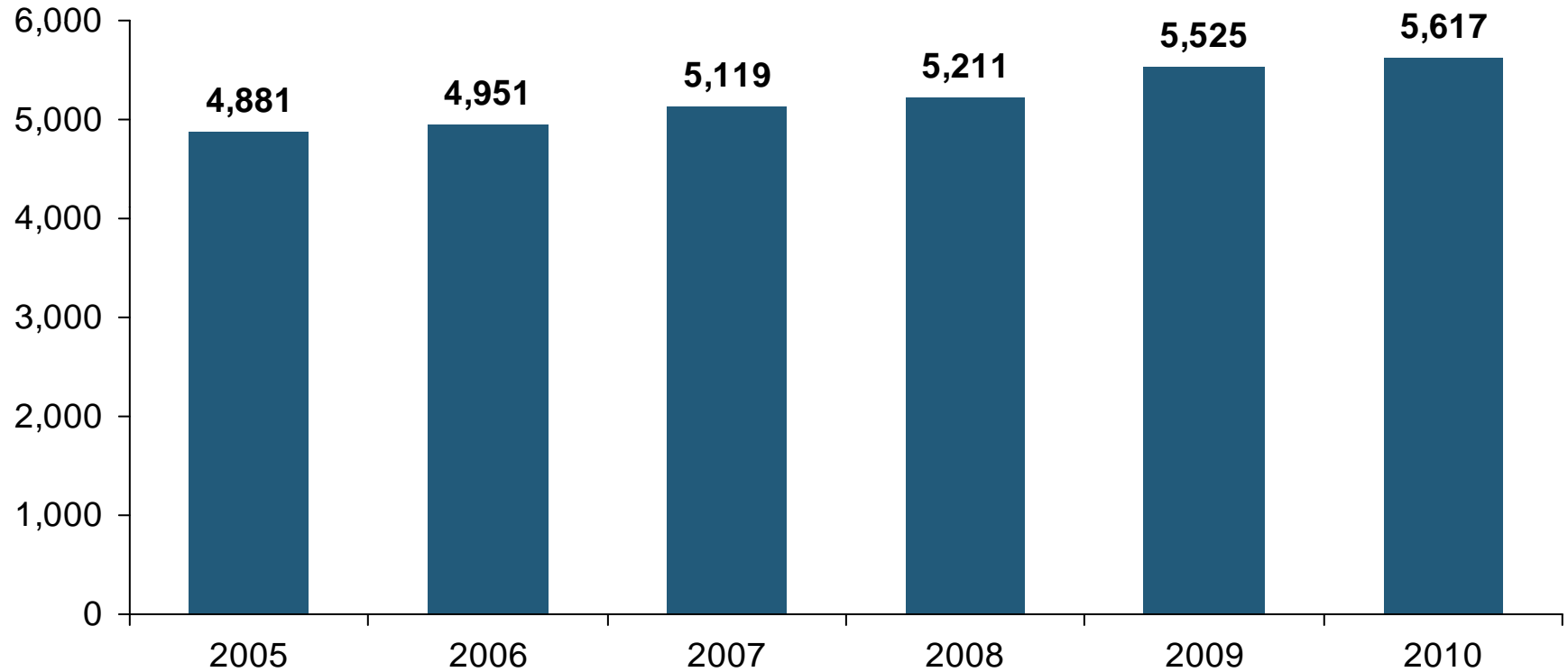
Source: Business Insurance.



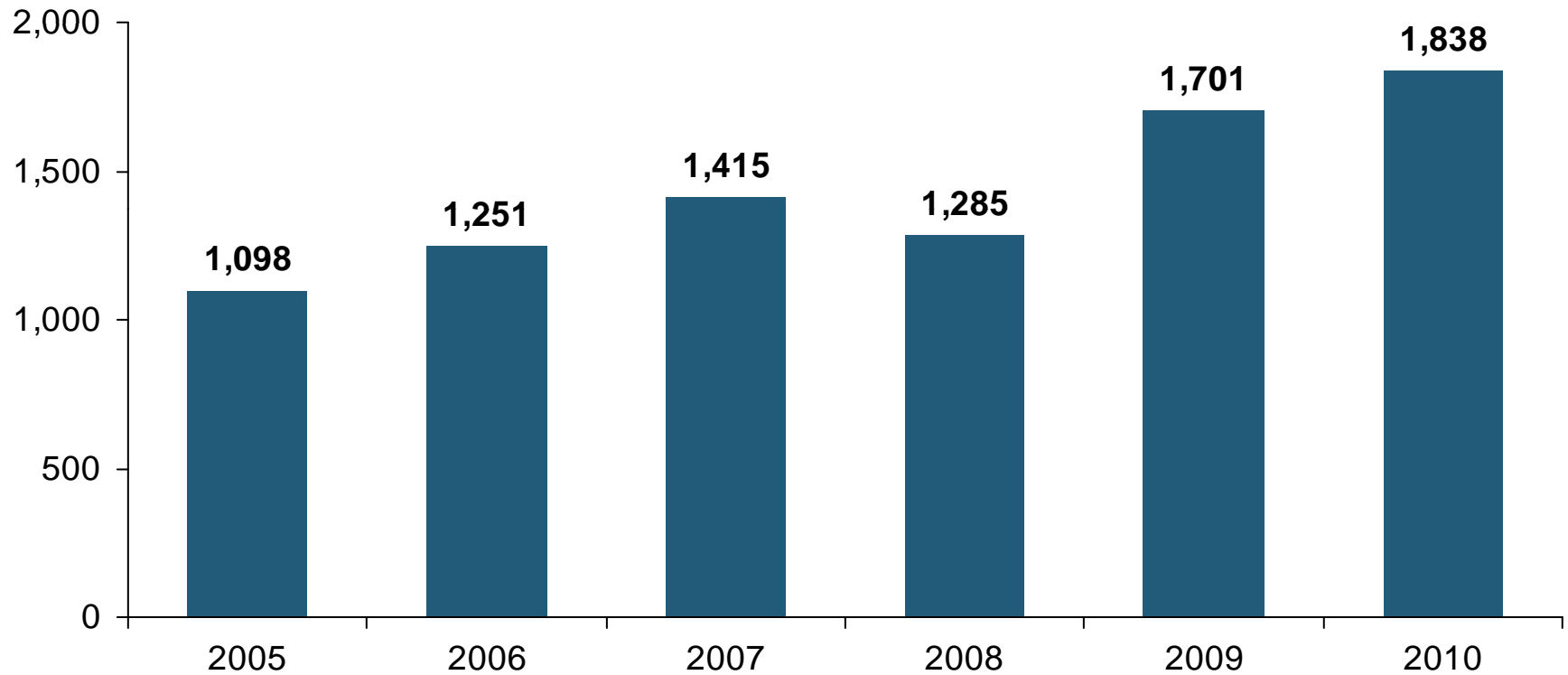
# Captives by State, 2009-2010



# World Captive Growth, 2005-2010



# State Captive Growth, 2005-2010



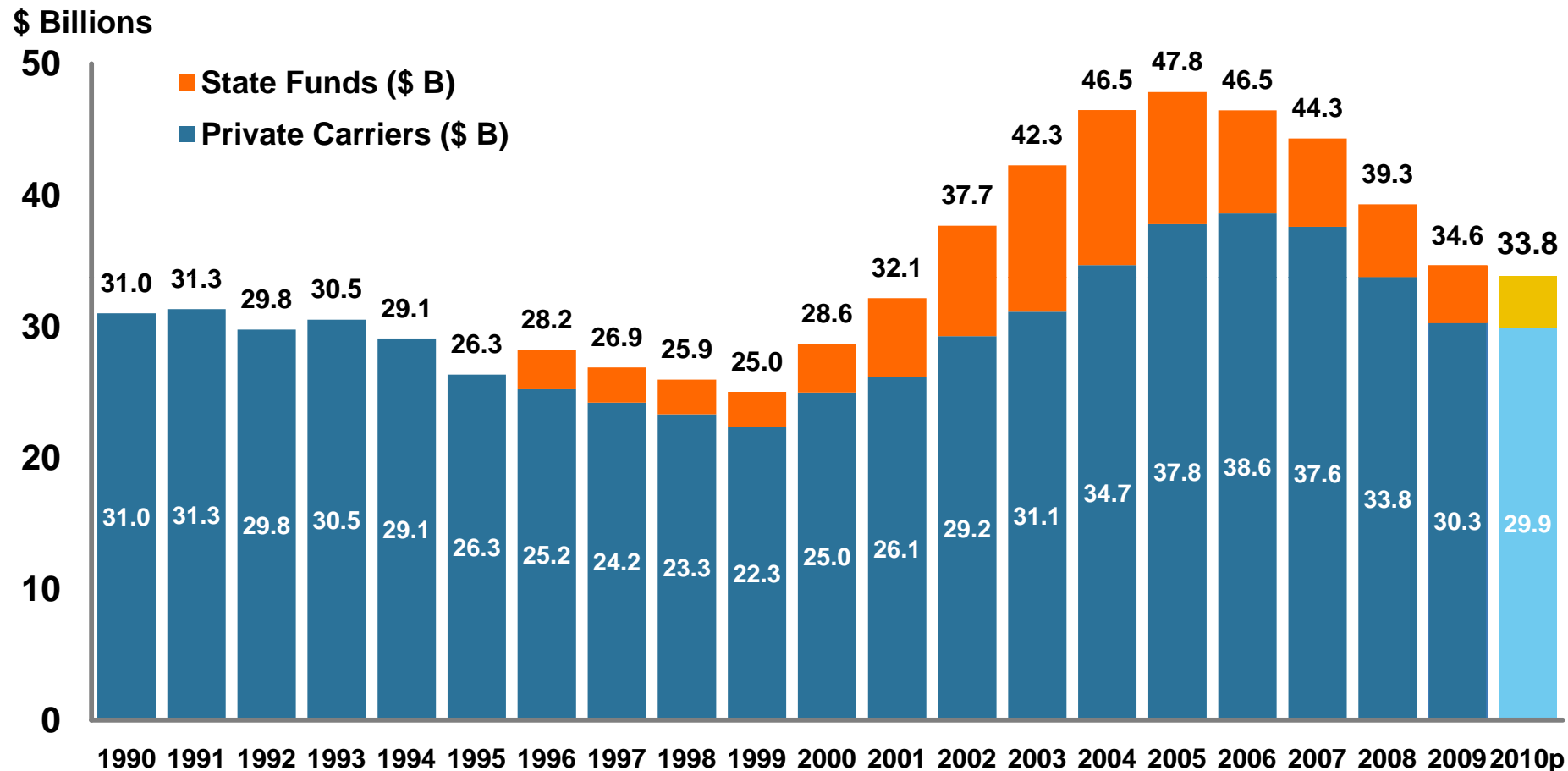


# Workers Compensation Operating Environment

**The Weak Economy and Soft Market Have  
Made the Workers Comp Operating  
Increasingly Challenging**

# Workers Compensation Premium Continues Its Sharp Decline

## Net Written Premium



p Preliminary

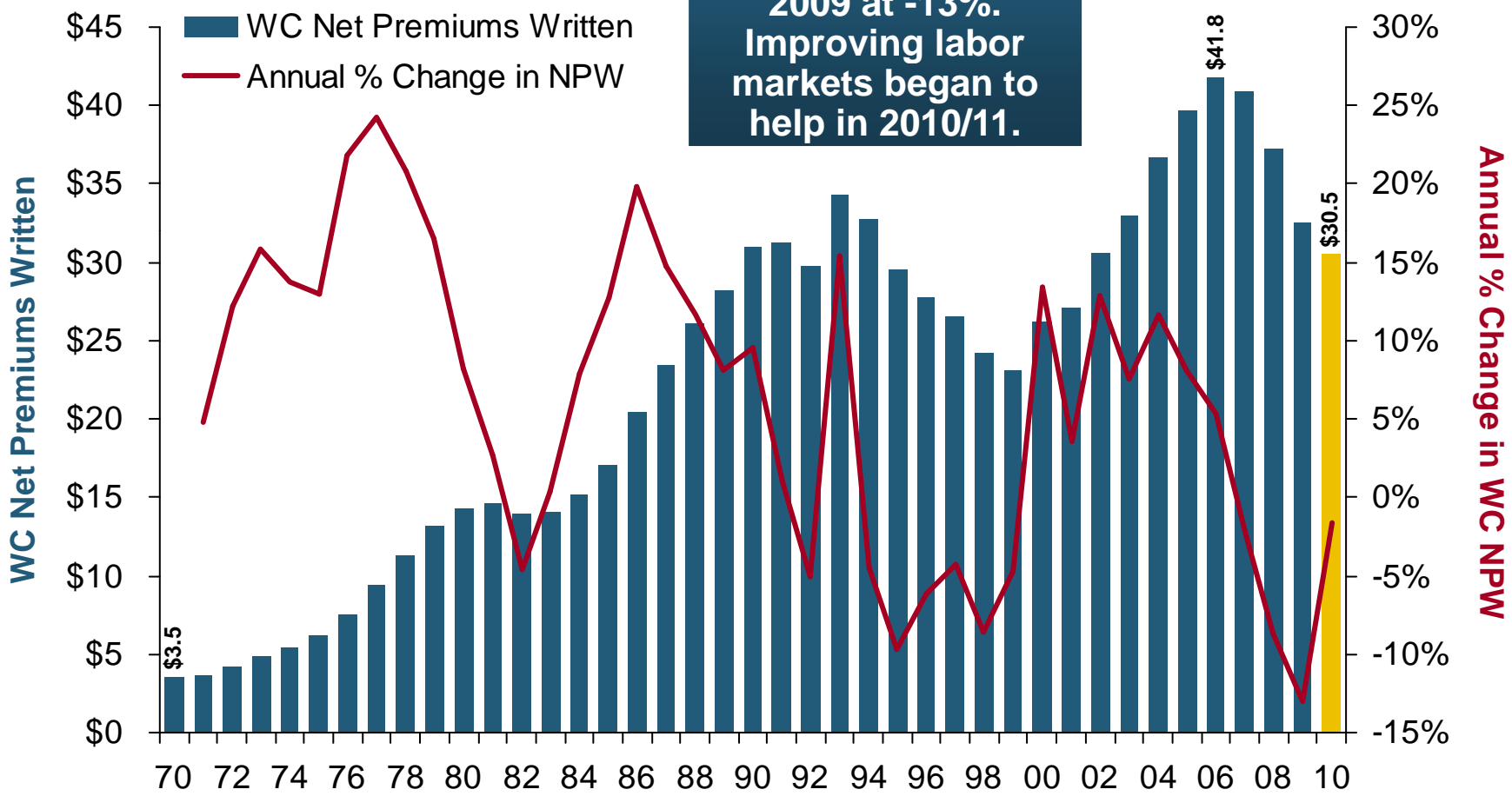
Source: 1990–2009 Private Carriers, *Best's Aggregates & Averages*; 2010p, NCCI

1996–2010p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements

State Funds available for 1996 and subsequent

# Workers Compensation Net Premiums Written and Annual Growth Rates: 1970-2010P

(\$ Billions)

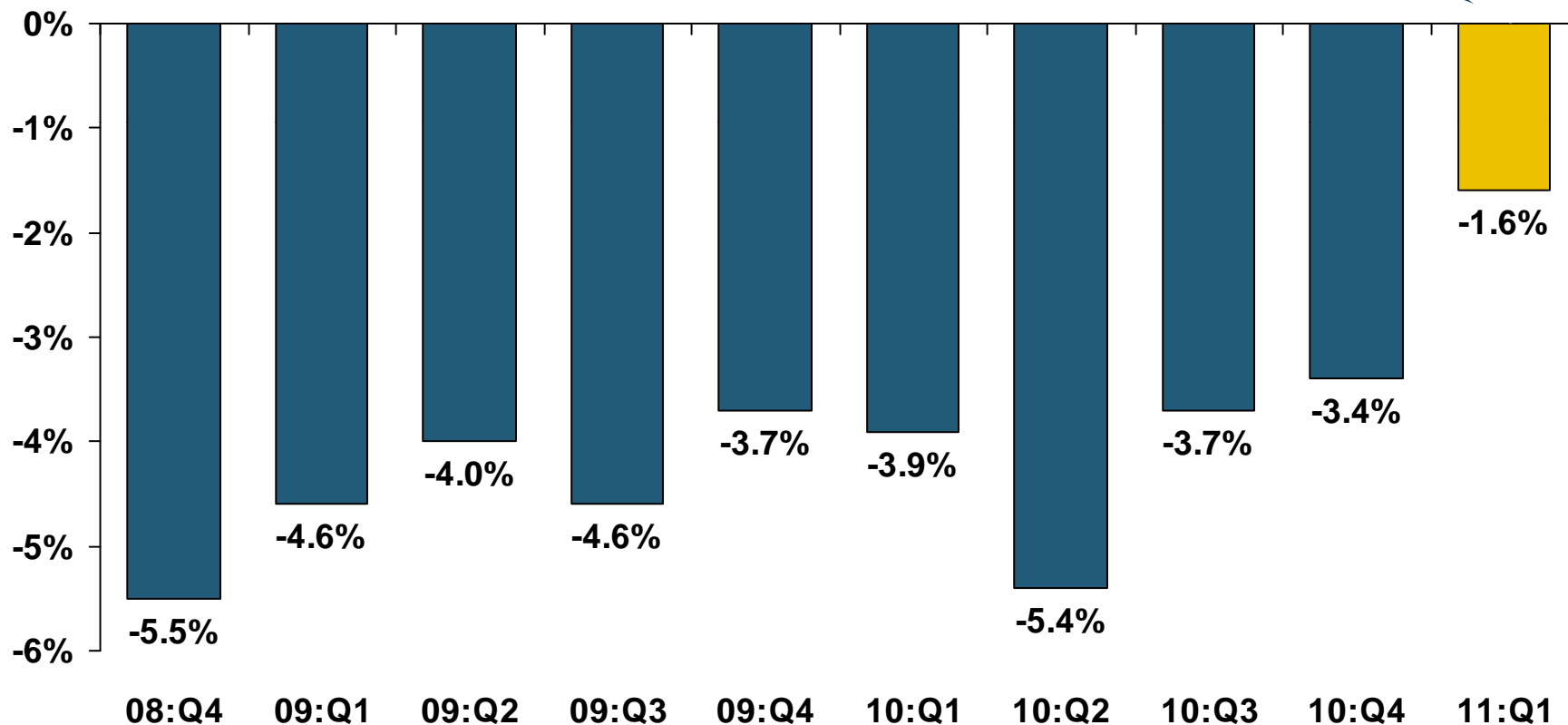


Sources: A.M. Best (1973-2009); Insurance Information Institute calculations and estimates for 2010.

# Workers Comp Rate Changes, 2008:Q4 – 2011:Q1

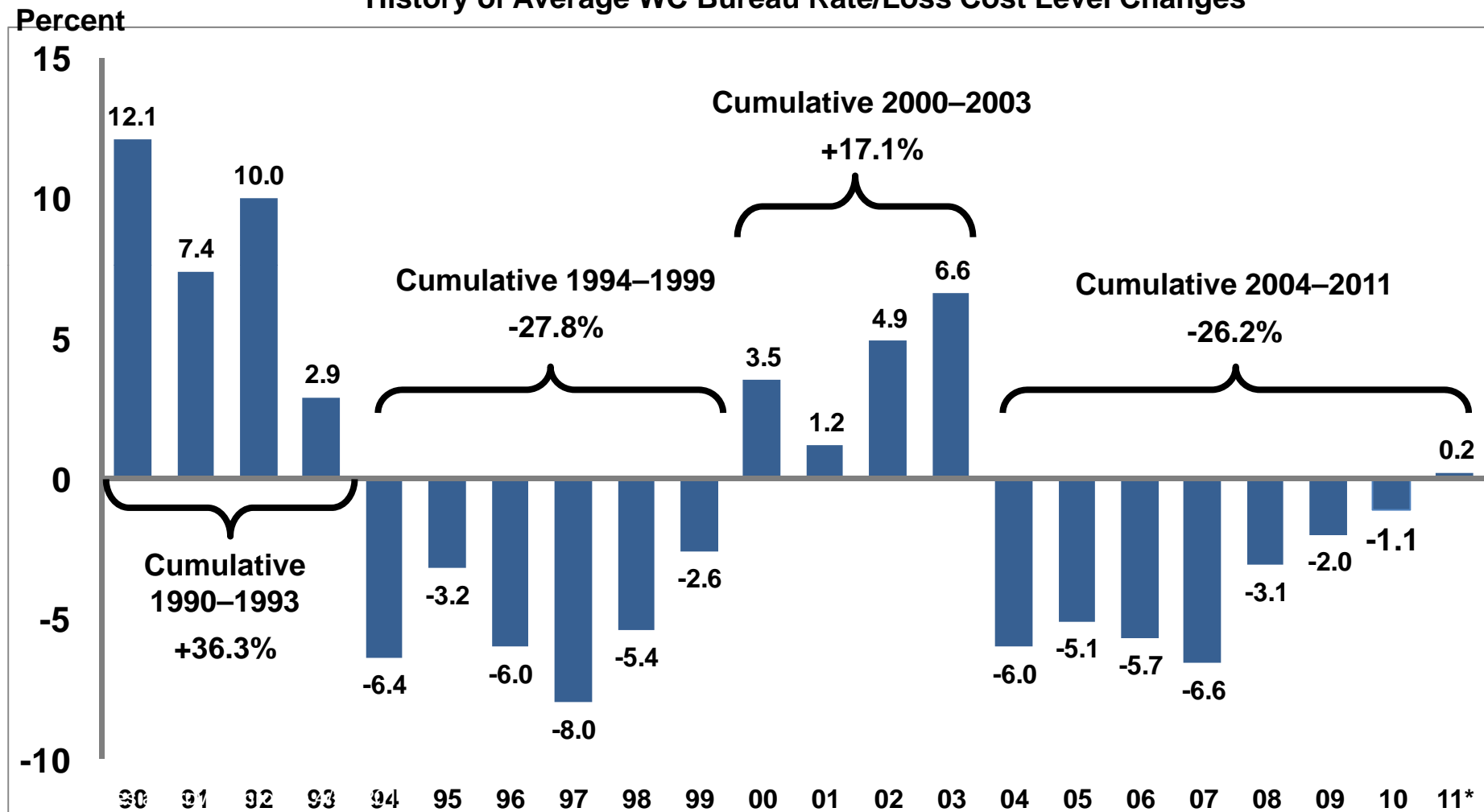
(Percent  
Change)

The Q1 2011 WC rate  
change was the smallest  
decrease in many years



# Average Approved Bureau Rates/Loss Costs

## History of Average WC Bureau Rate/Loss Cost Level Changes



\*States approved through 4/8/11.

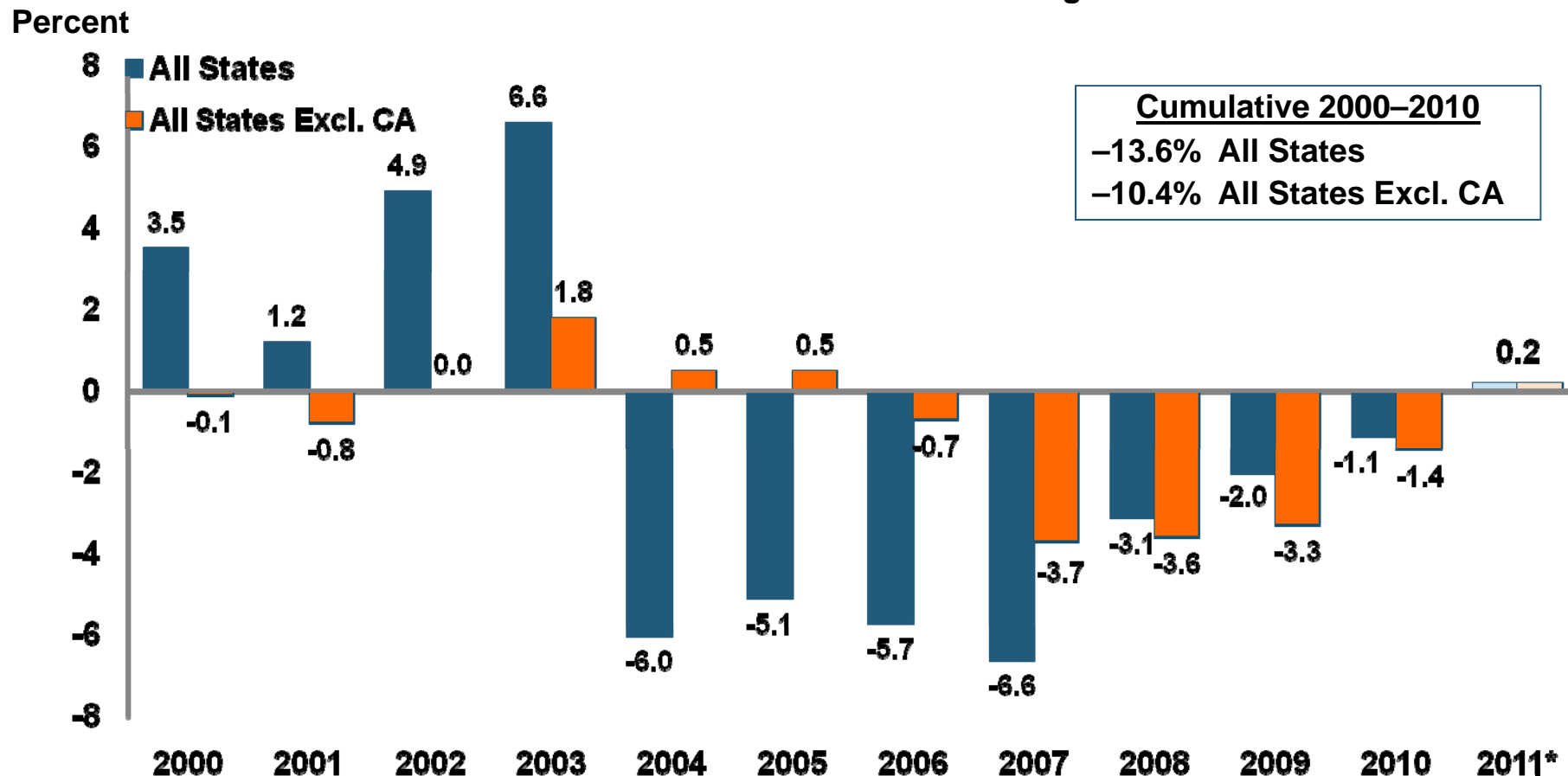
Note: Countrywide approved changes in advisory rates, loss costs and assigned risk rates as filed by applicable rating organization.

Source: NCCI.



# Average Approved Bureau Rates/Loss Costs

All States vs. All States Excluding California



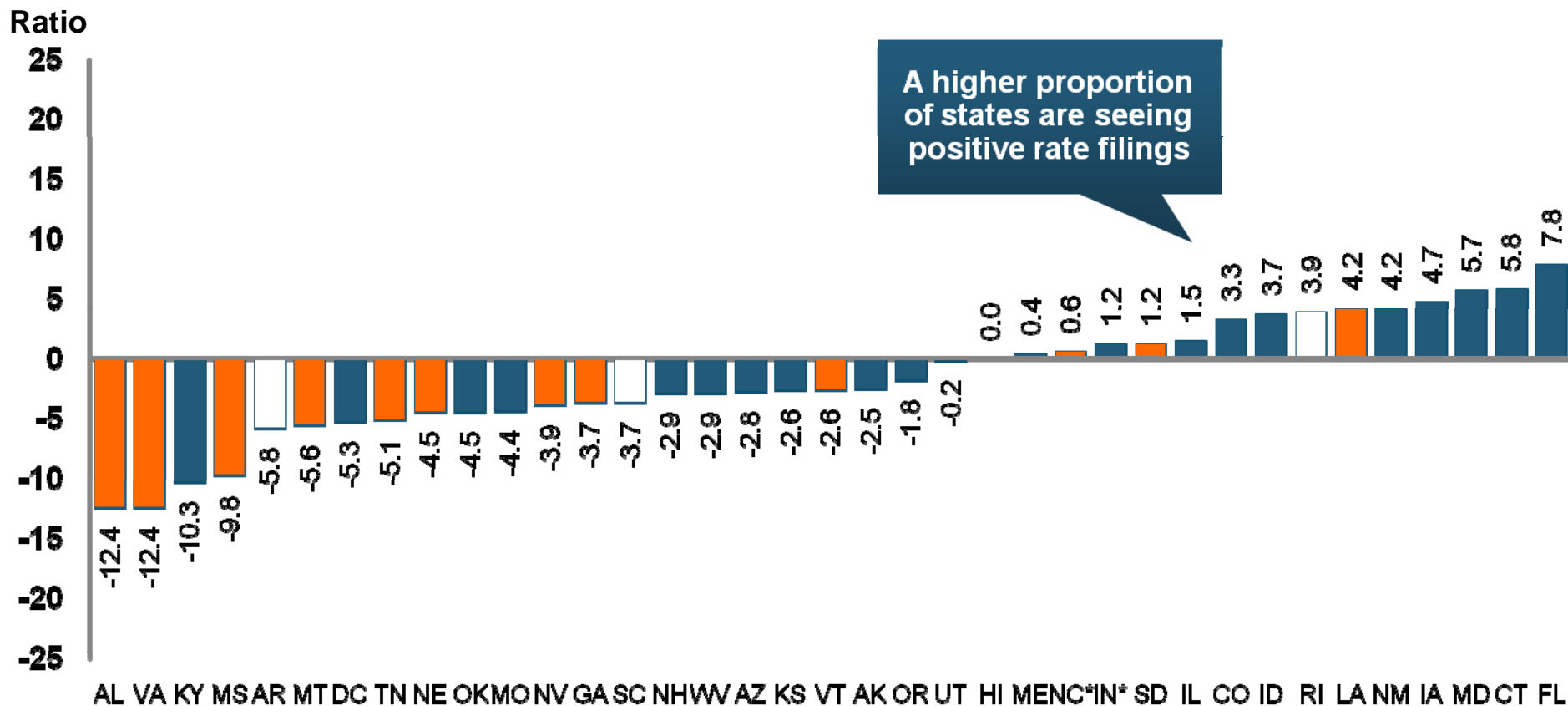
\* States approved through 4/8/2011

Countrywide approved changes in advisory rates, loss costs, and assigned risk rates as filed by the applicable rating organization

Source: NCCI

# Current NCCI Voluntary Market Filed Rate/Loss Cost Changes

Excludes Law-Only Filings



■ Effective Dates 1/1/2011 and Prior   ■ Effective Dates Subsequent to 1/1/2011   □ Filed and Pending

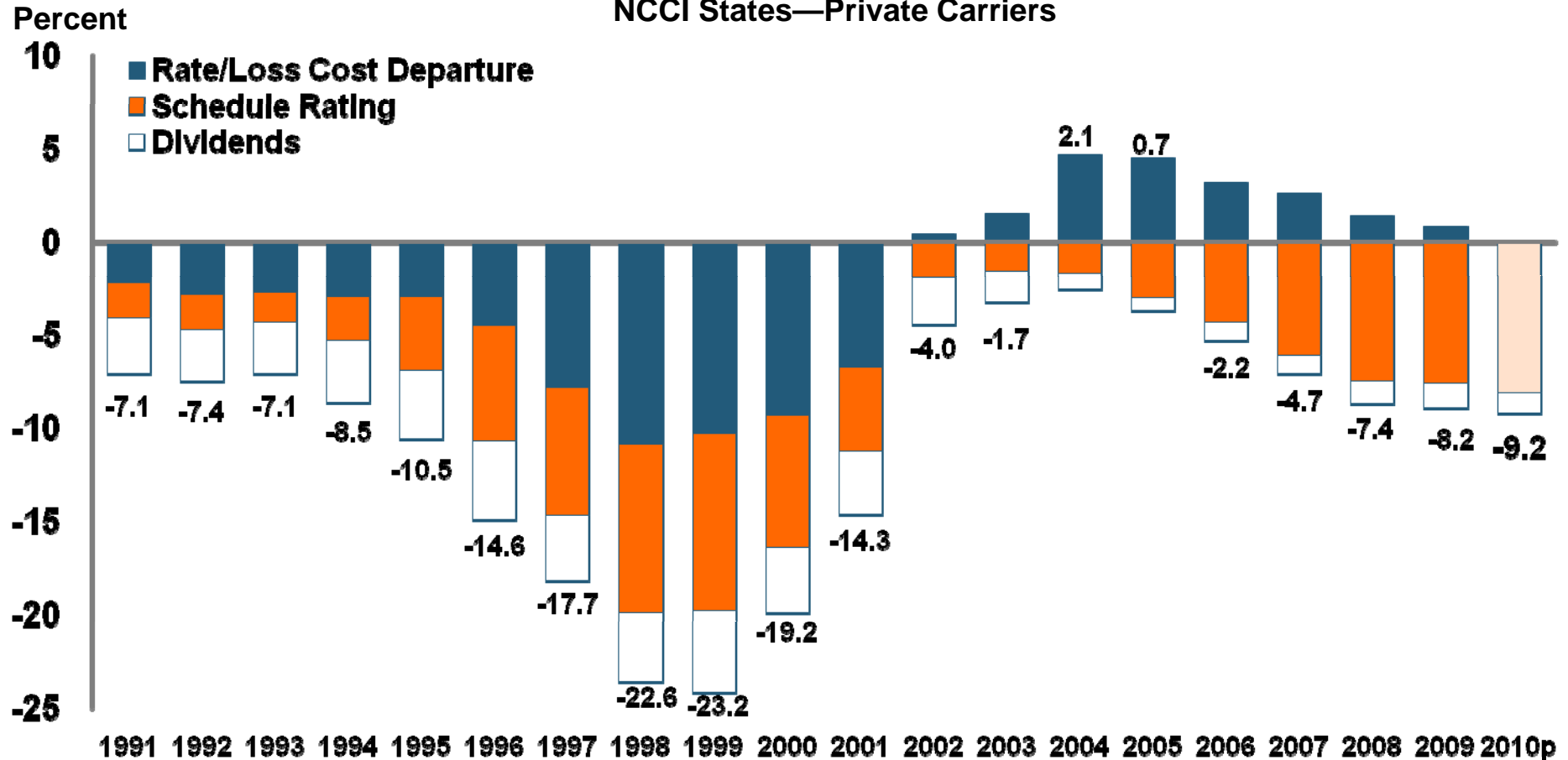
States filed through 4/15/2011

•IN and NC filed in cooperation with state rating bureau

Source: NCCI

# Impact of Discounting on Workers Compensation Premium

NCCI States—Private Carriers



p Preliminary

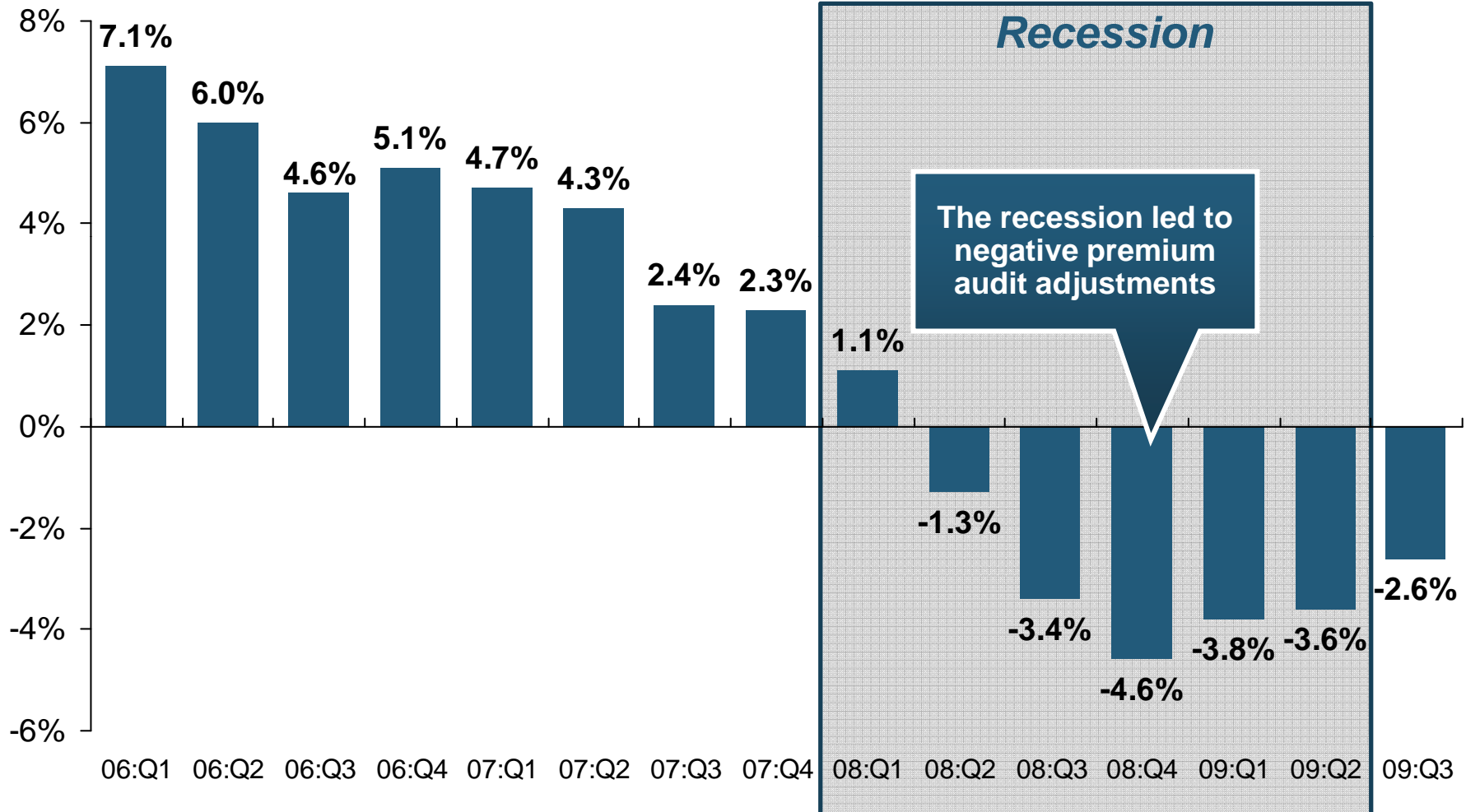
Dividend ratios are based on calendar year statistics

NCCI benchmark level does not include an underwriting contingency provision

Based on data through 12/31/2010 for the states where NCCI provides ratemaking services

Source: NCCI

# Final Premium vs. Estimated Premium by Policy Effective Quarter: 2006:Q1 – 2009:Q3

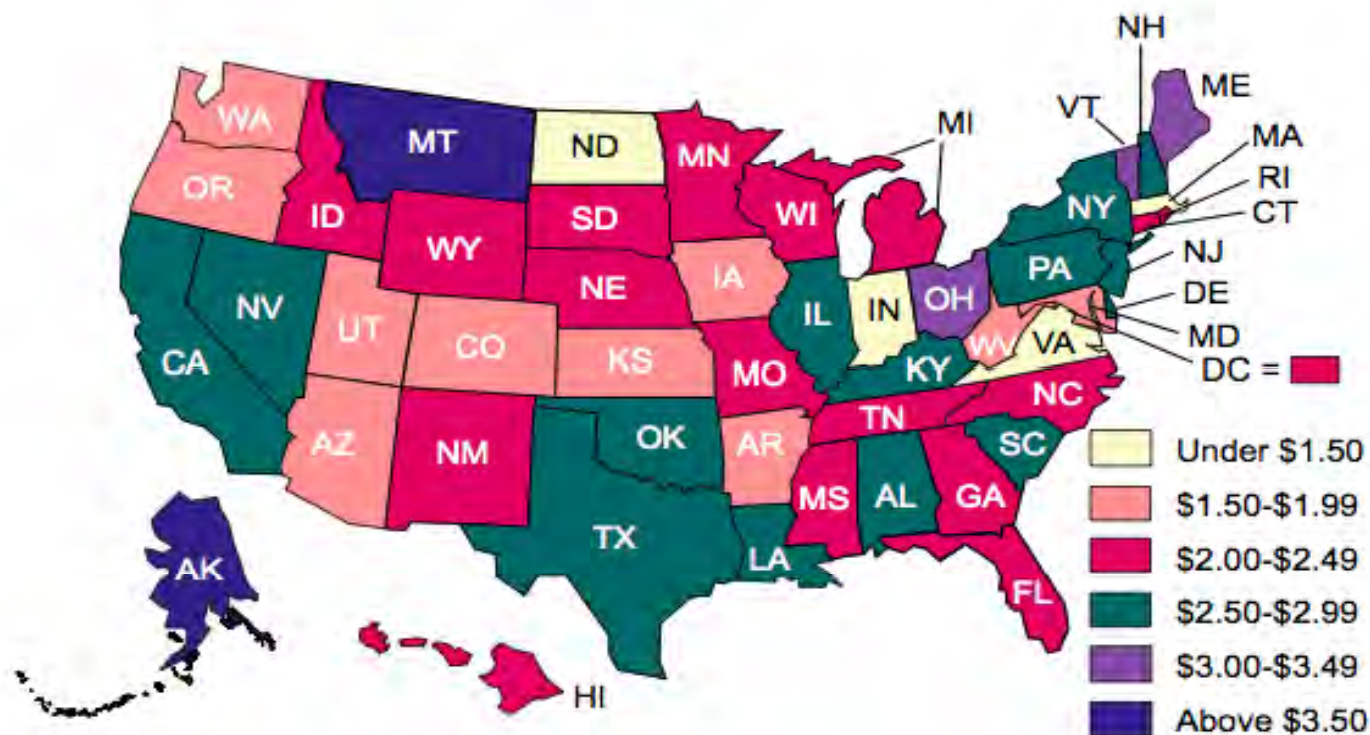


Note: WC Statistical Plan audited premium compared to policy-estimated premium. Based on states where NCCI provides ratemaking services, including state funds; excludes high deductible policies and mid-term cancellations.

Source: NCCI

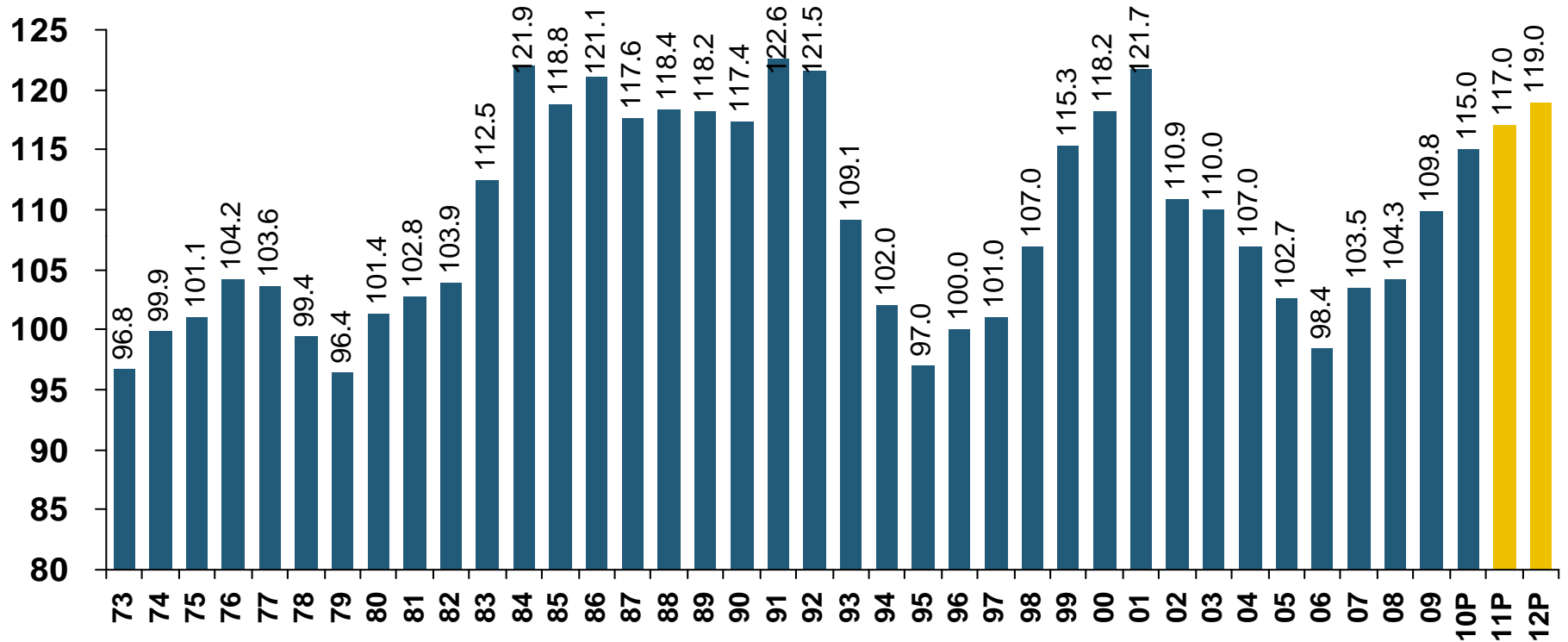
# Comparison of State WC rates

WC rates, on average, do not appear to be significantly higher or lower in states with workers comp state funds



California's WC rates are about average

# Workers Compensation Combined Ratio: 1973–2012P



**Workers Comp Underwriting Results Are Deteriorating Markedly**