



Overview and Outlook for the Insurance Industry: Challenges and Opportunities

**Insurance Regulatory Examiners Society (IRES)
Career Development Seminar
Portland, OR
July 29, 2013**

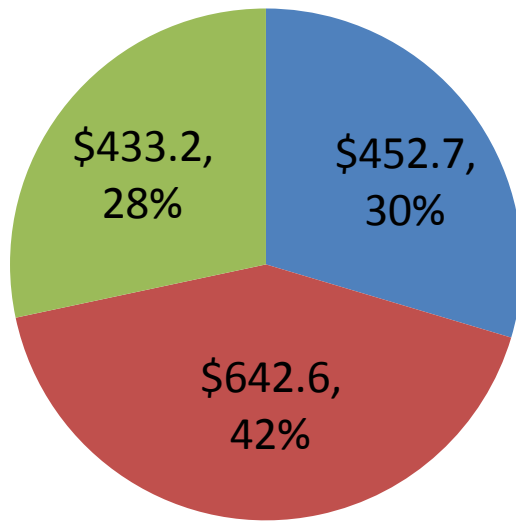
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U.S. Insurance Industry Financial Snapshot as of Year-end 2012

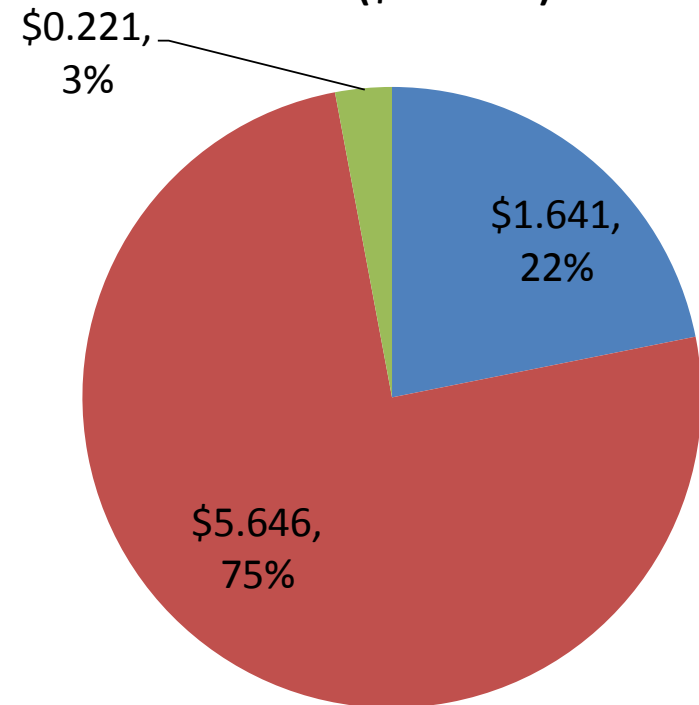
Premiums (\$Billions)

■ P/C ■ L/A ■ Health



Total premiums: \$1.5 Trillion

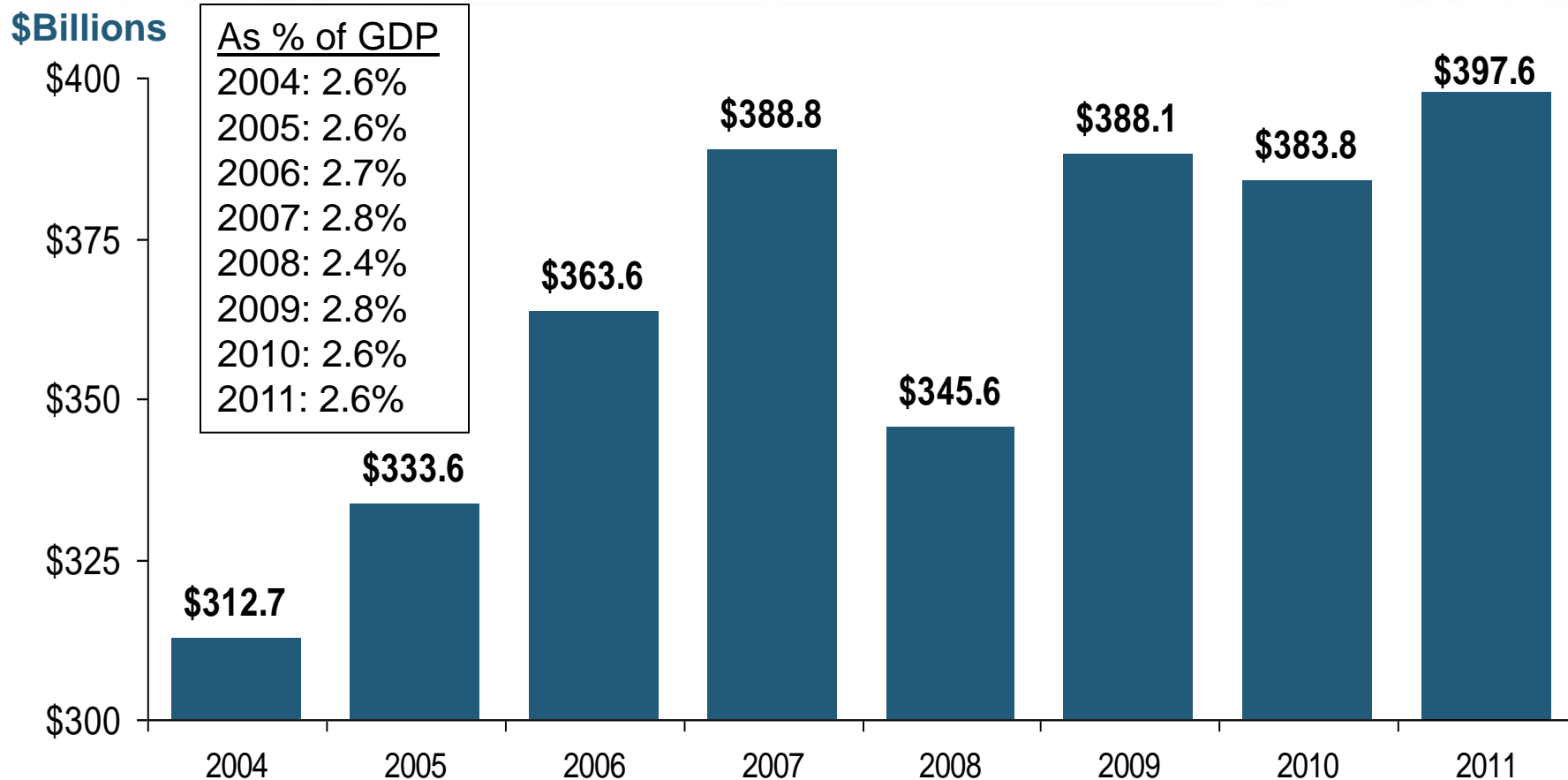
Assets (\$Trillions)



Total assets: \$7.5 Trillion

In terms of assets, the life/annuity sector is over three times as large as the property/casualty sector and both dwarf the medical expense sector. But in terms of premiums, the three are much closer.

The Insurance Industry's* Value Added to U.S. GDP, 2004-2011



For comparison, the banking/credit sector's value added was generally about 3.6% of GDP during this period; for securities and investments, about 1.2%.

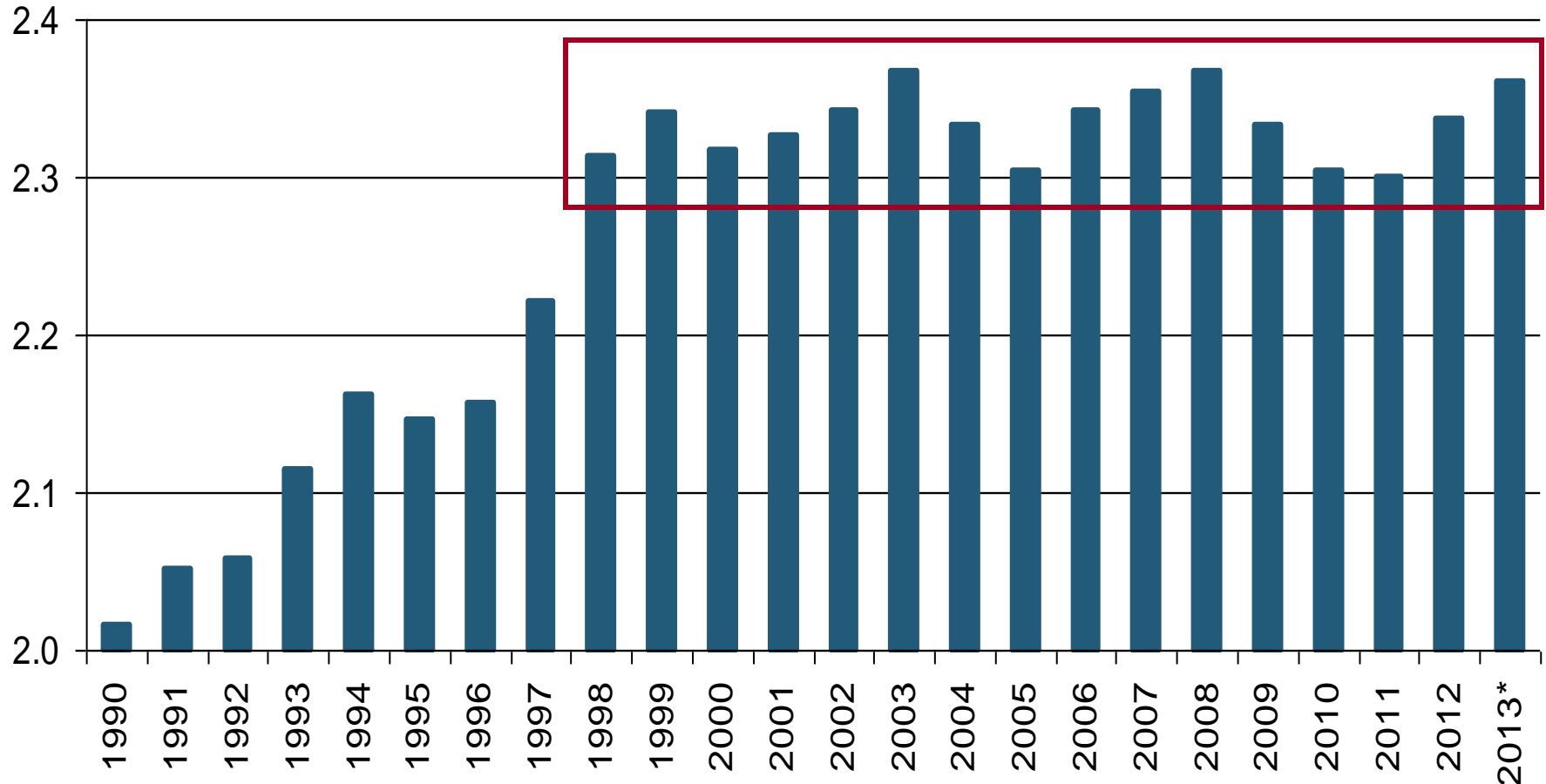
*"Insurance carriers and related activities"

Sources: U.S. Commerce Department, Bureau of Economic Analysis; I.I.I.

- **For the Last 15 Years (Since 1998), Overall Industry Employment Has Stayed in a Narrow Band Between 2.30 million and 2.37 million**
 - ◆ But there have been **dramatic changes** in employment **among the major subsectors**
- **Factors Affecting Industry Jobs**
 - ◆ State of the Economy & the Market
 - ◆ Outsourcing
 - ◆ Productivity Enhancements
 - ◆ Consolidation

Employment in Insurance and Related Activities, Annually, 1990-2013

Millions



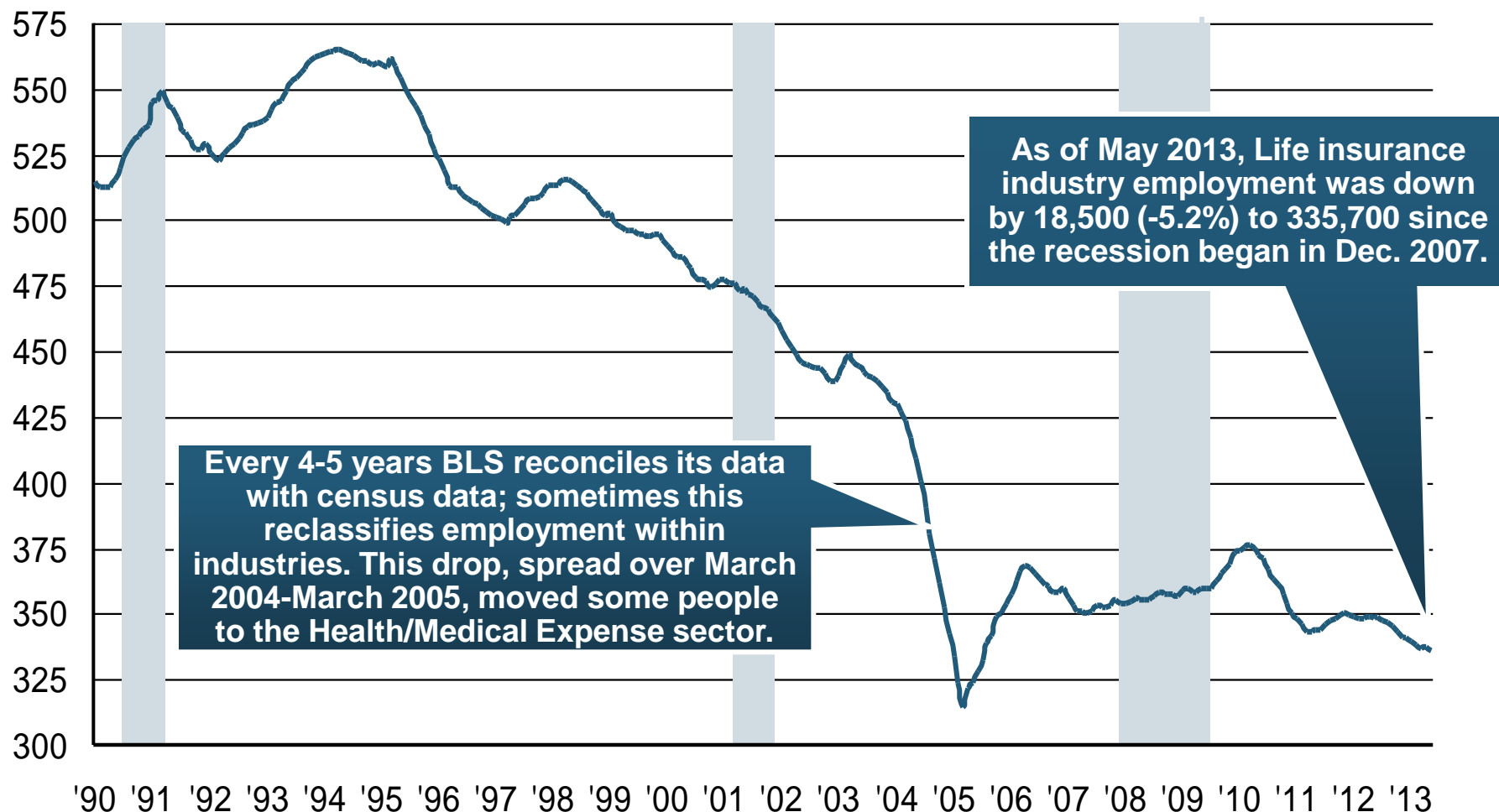
Employment in the overall insurance industry grew by nearly 300,000 (+14.7%) from 1990-1998 but has been virtually flat since 1998.

*Estimated based on Jan-Jun 2013 data

Sources: Bureau of Labor Statistics; Insurance Information Institute

U.S. Employment in the Direct Life Insurance Industry: 1990–2013*

Thousands



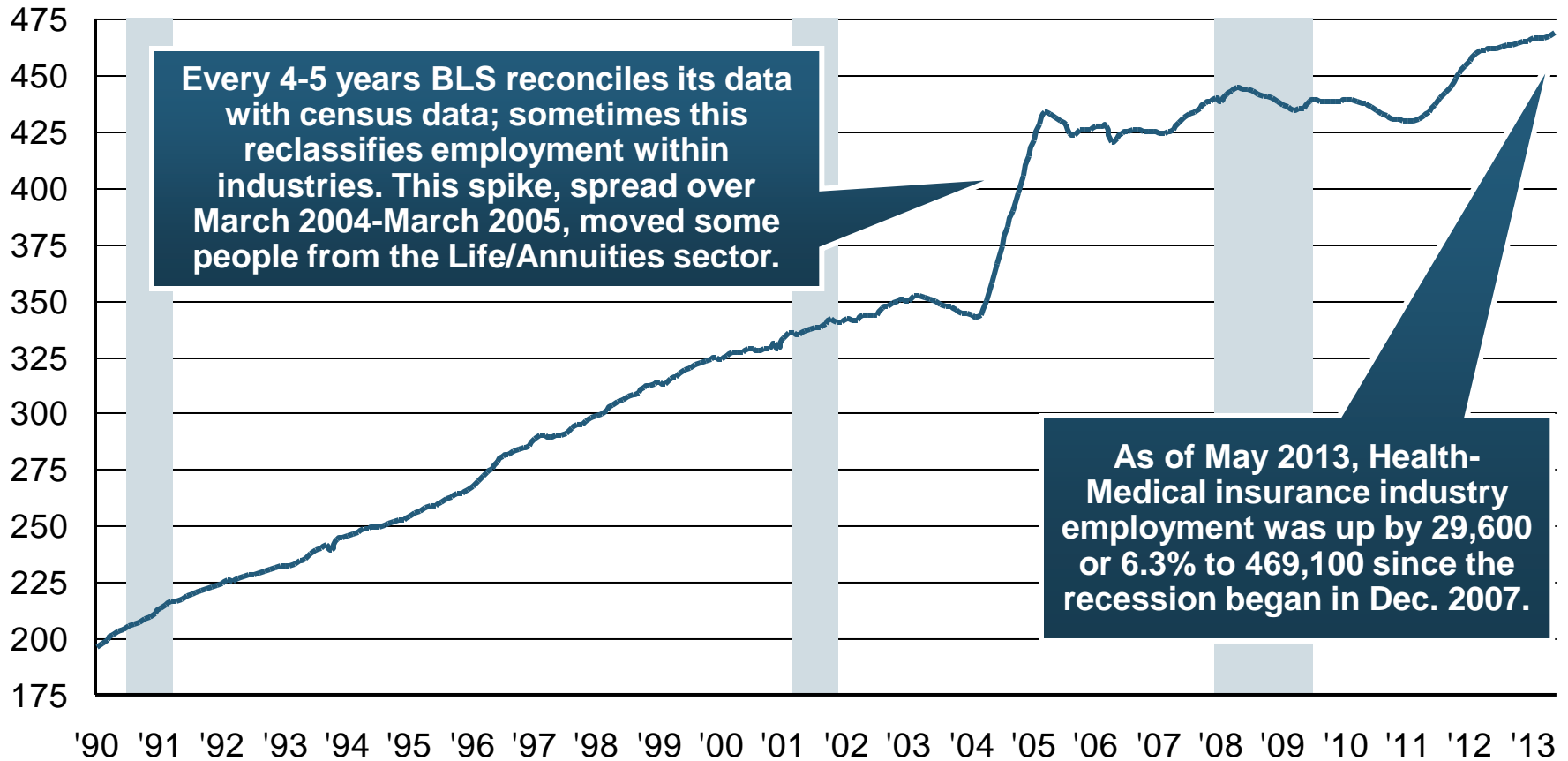
*As of May 2013; Seasonally adjusted; Does not include agents & brokers.

Note: Recessions indicated by gray shaded columns.

Sources: U.S. Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

U.S. Employment in the Direct Medical Expense Insurance Industry: 1990–2013*

Thousands



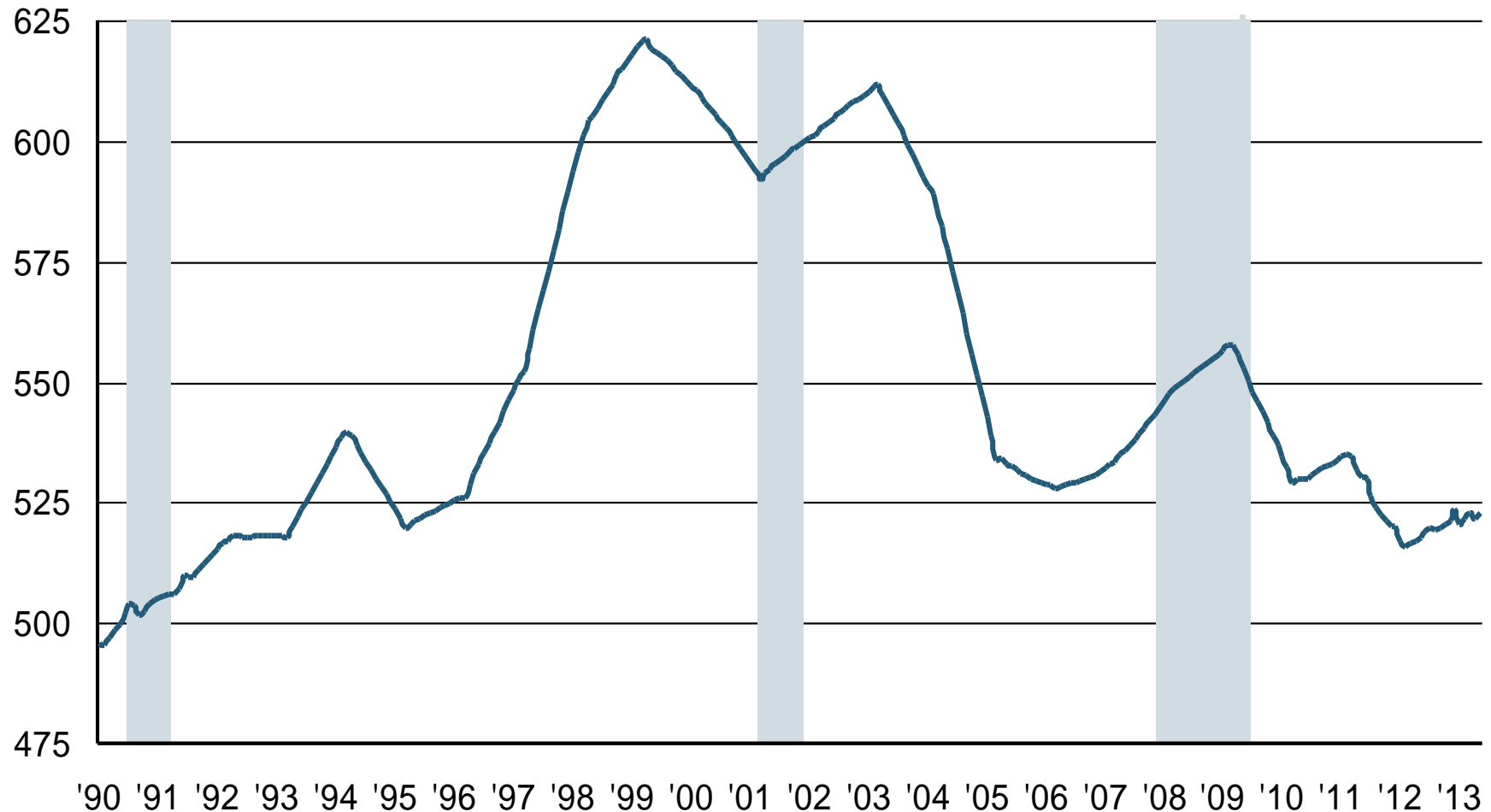
*As of May 2013; Seasonally adjusted; Does not include agents & brokers.

Note: Recessions indicated by gray shaded columns.

Sources: U.S. Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

U.S. Employment in the Direct P/C Insurance Industry: 1990–2013*

Thousands



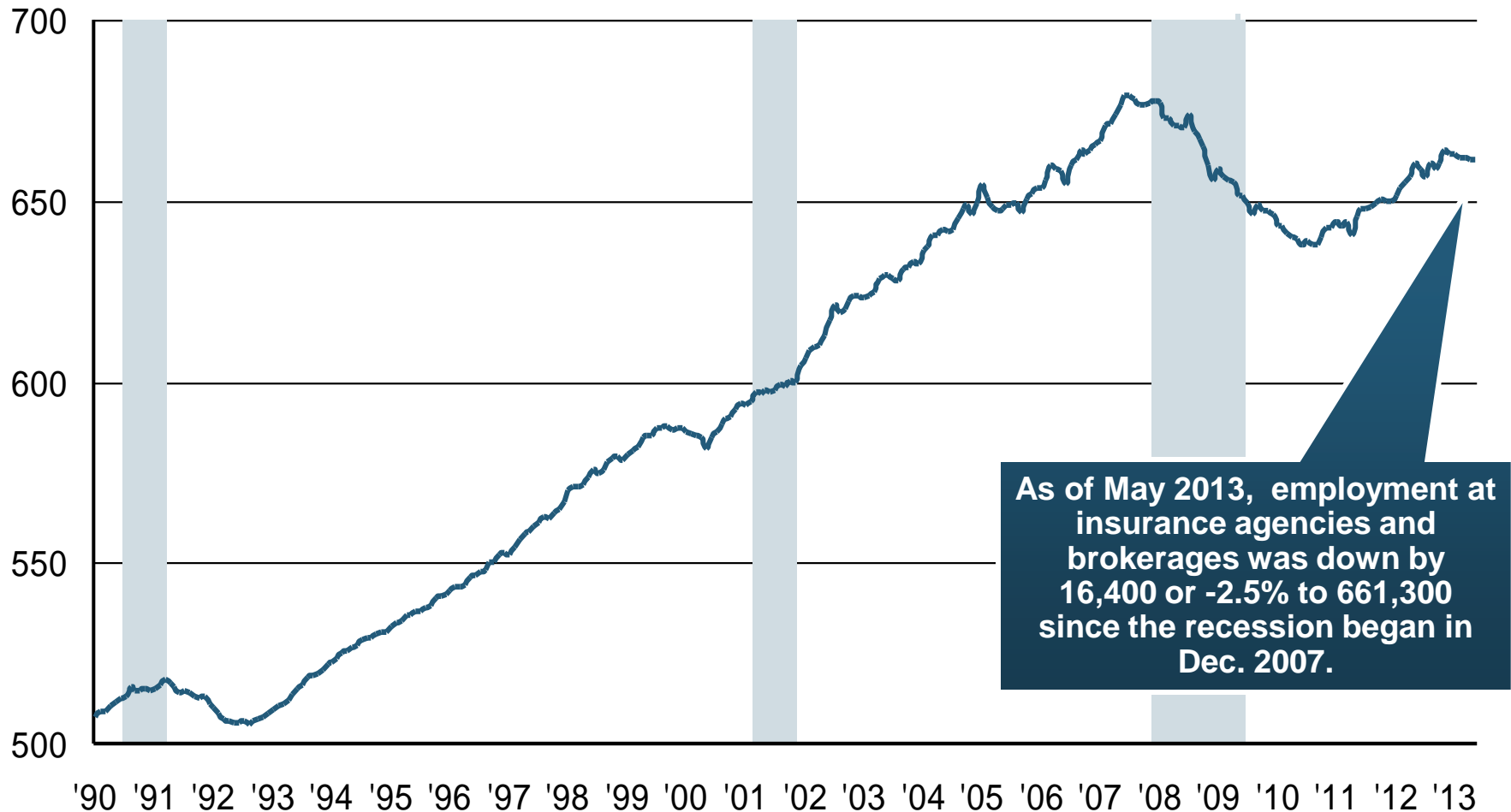
*As of May 2013; Seasonally adjusted; Does not include agents & brokers.

Note: Recessions indicated by gray shaded columns.

Sources: U.S. Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

U.S. Employment in Insurance Agencies & Brokerages: 1990–2013*

Thousands



*As of May 2013; Seasonally adjusted. Includes all types of insurance.

Note: Recessions indicated by gray shaded columns.

Sources: U.S. Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Insurance Industry Brief Financial Overview

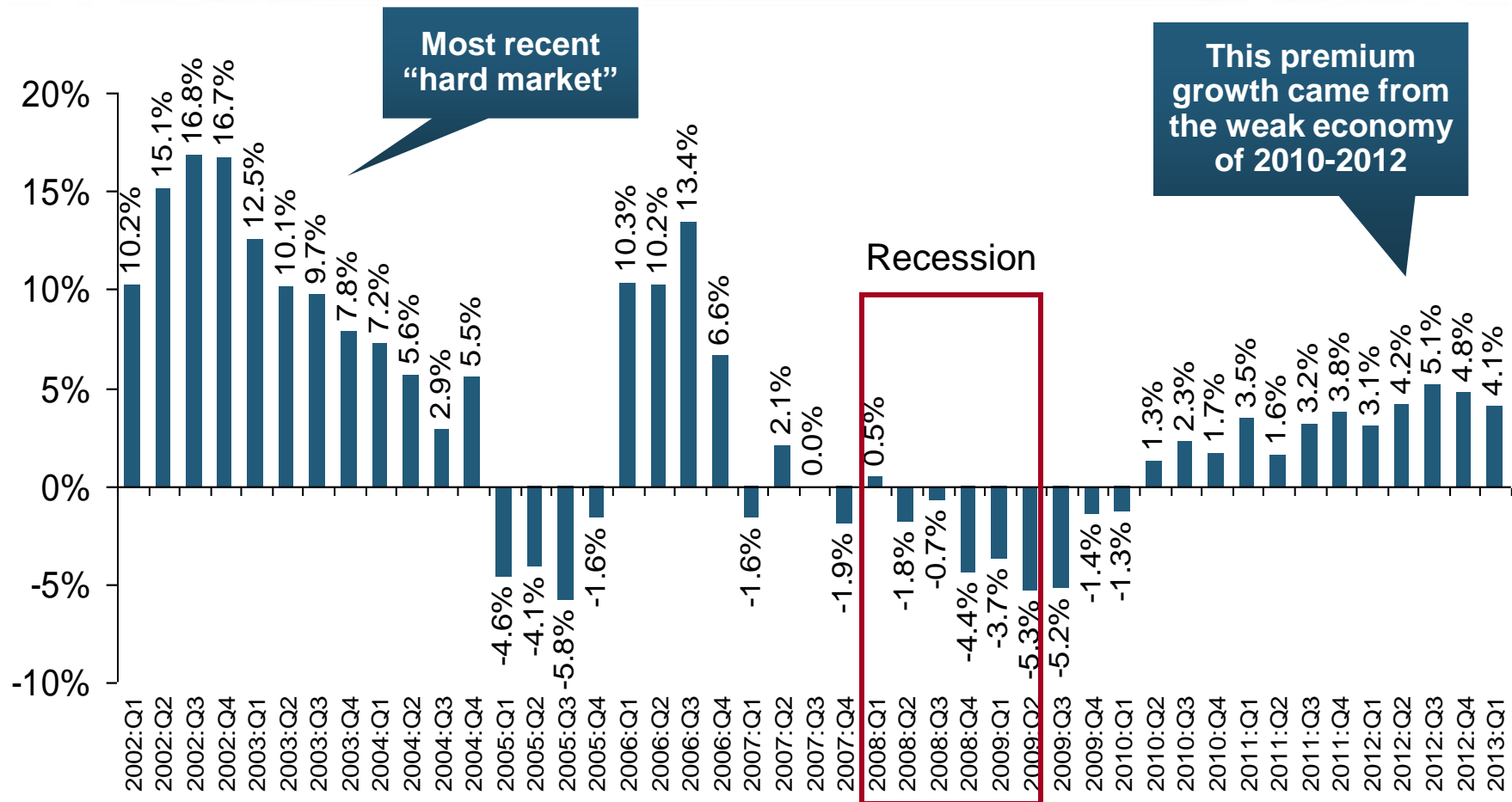
- The Property/Casualty segment
- The Life/Annuities/A&H segment

The P/C segment

Major Segments

- Personal Lines (Auto & Home)
 - Property
 - Liability
- Commercial Lines
 - Property
 - Liability
- Specialty Lines

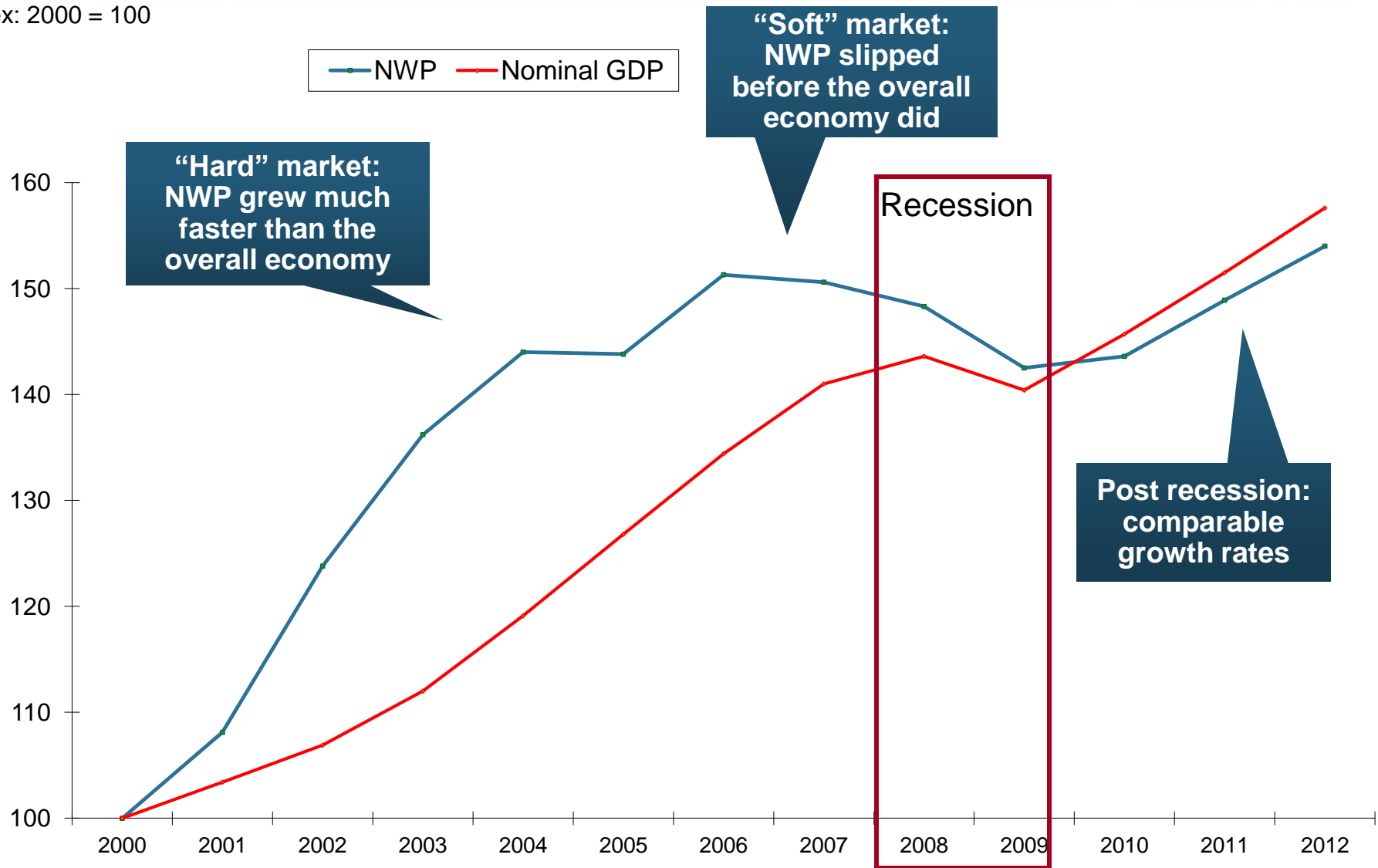
P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter, 2002–2013



Finally! A sustained period (12 quarters) of growth in net premiums written (vs. same quarter, prior year).

Yearly Nominal U.S. GDP vs. P/C Net Written Premiums: 2000-2012

Index: 2000 = 100

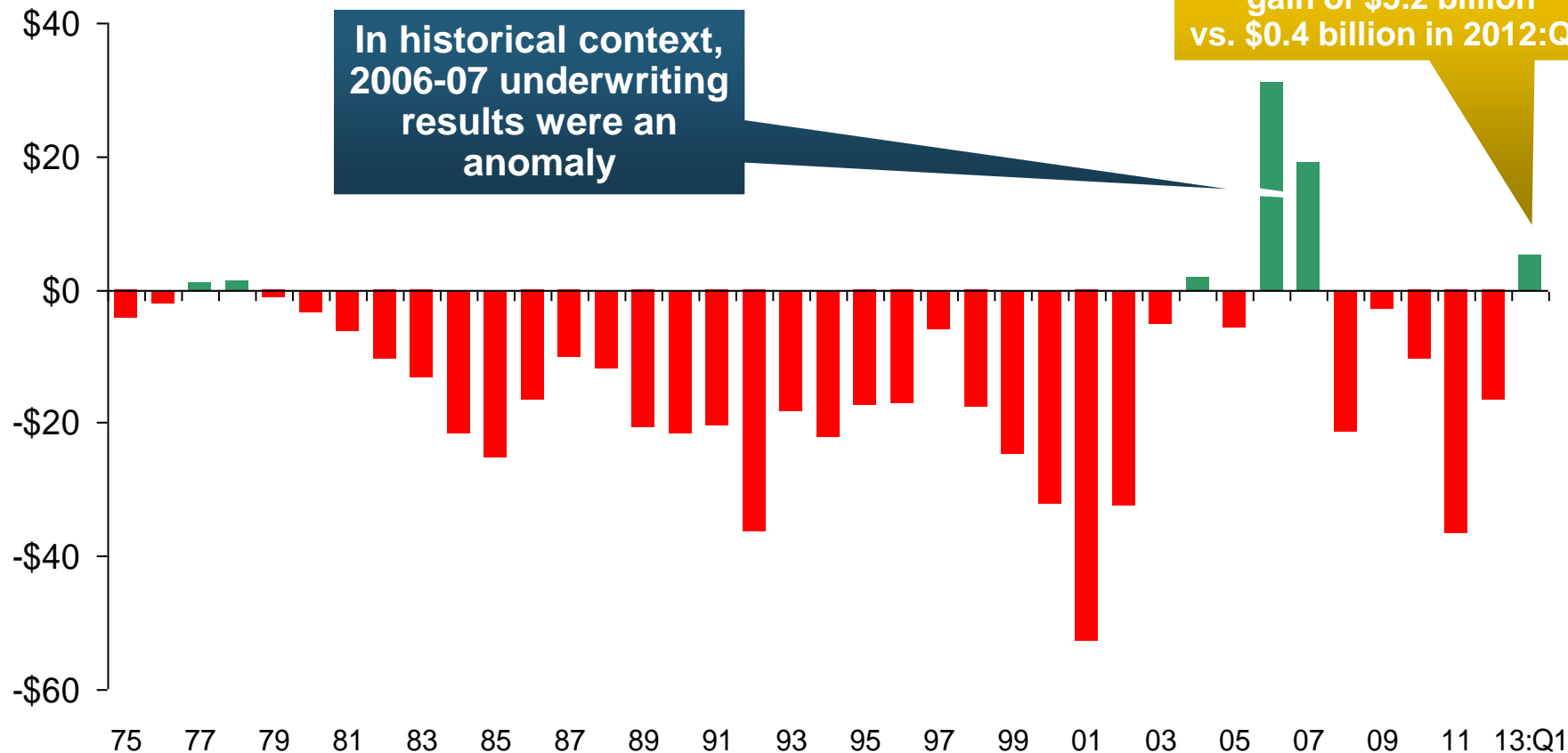


Sources: <http://www.bea.gov/national/xls/gdplev.xls> ; SNL Financial; I.I.I. calculations

Underwriting is Rarely a Profit Source

Gain (Loss) 1975–2013***

\$ Billions

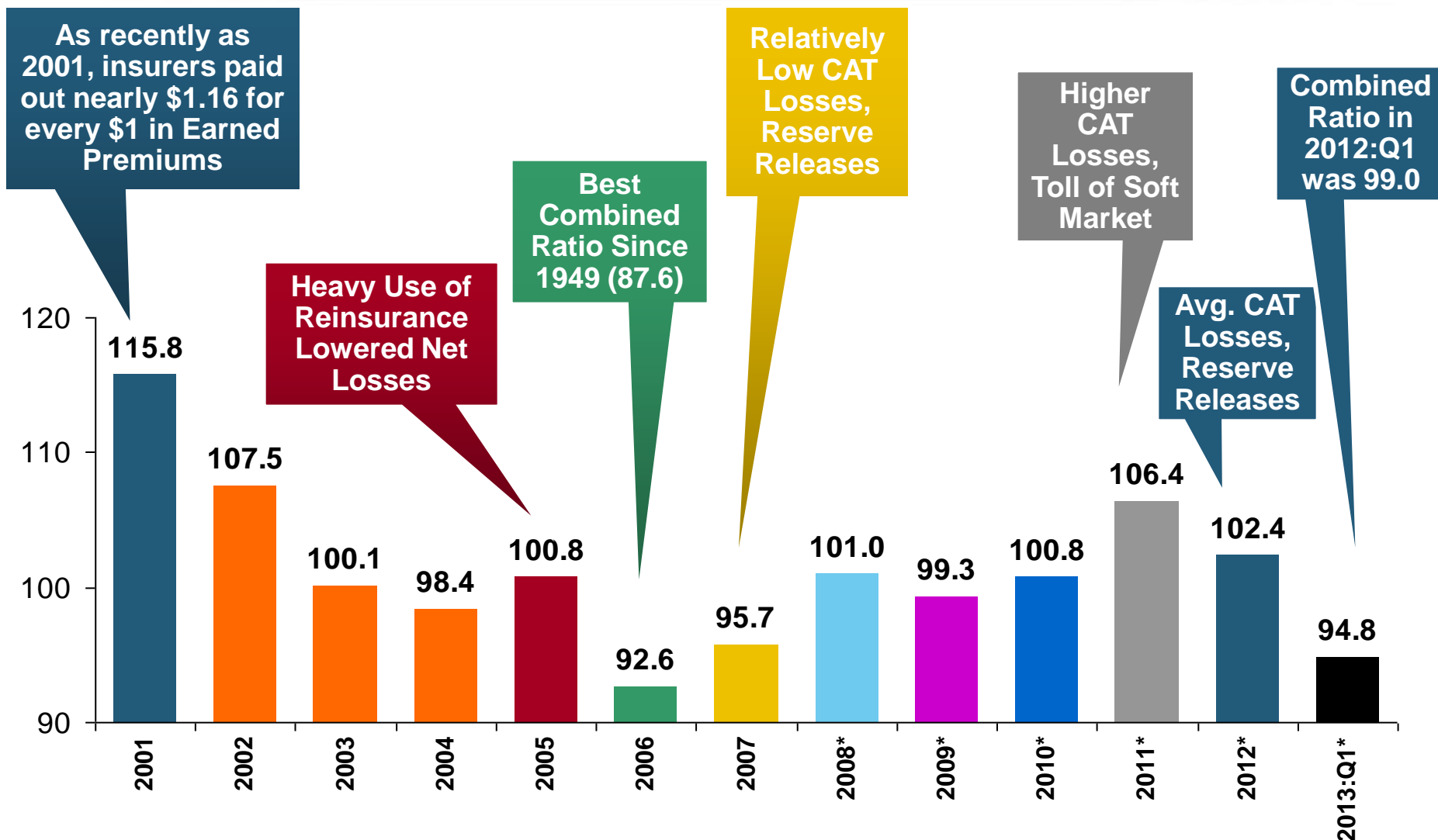


Average yearly underwriting loss in the 2008-2012 low-interest-rate environment? \$17.6B. With interest rates this low, large persistent underwriting losses are not a recipe for success.

*Includes mortgage and financial guaranty insurers in all years.

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

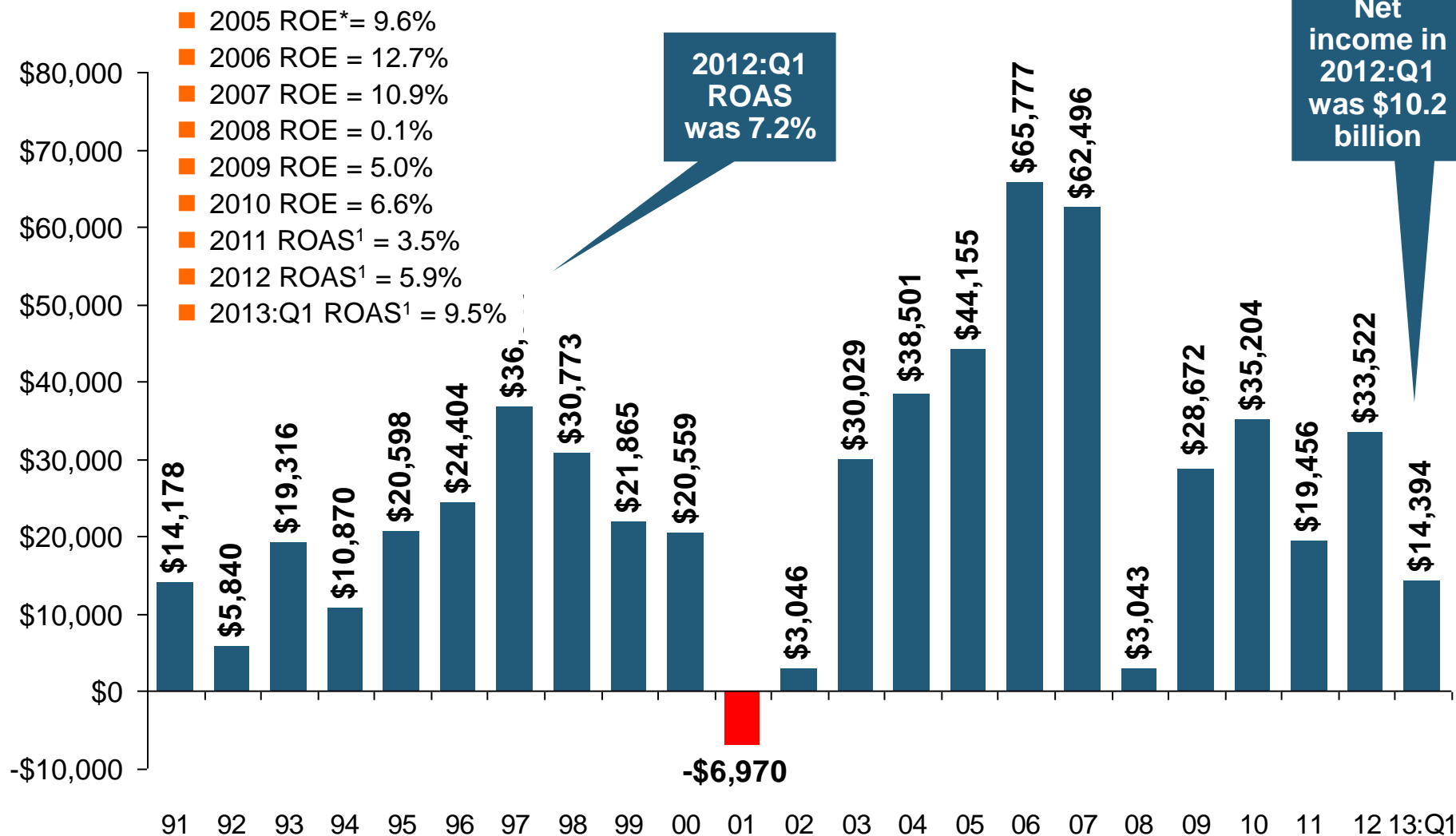
P/C Insurance Industry Combined Ratio, 2001–2013



* Excludes Mortgage & Financial Guaranty insurers 2008--2012. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.2; 2012=103.2.

Sources: A.M. Best; ISO.

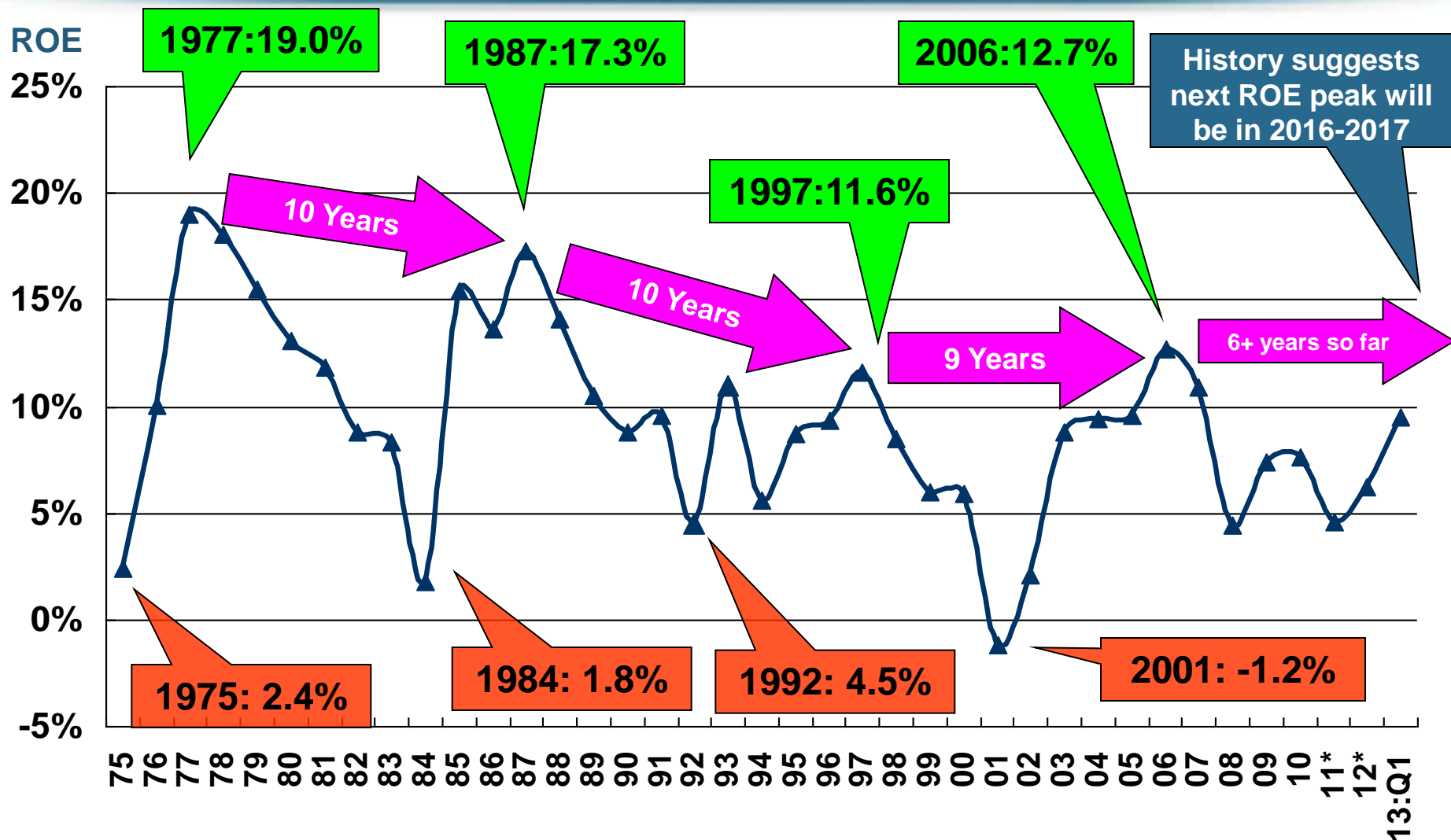
P/C Net Income After Taxes 1991–2013 (\$ Millions)



* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 6.2% ROAS in 2012, 4.7% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

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

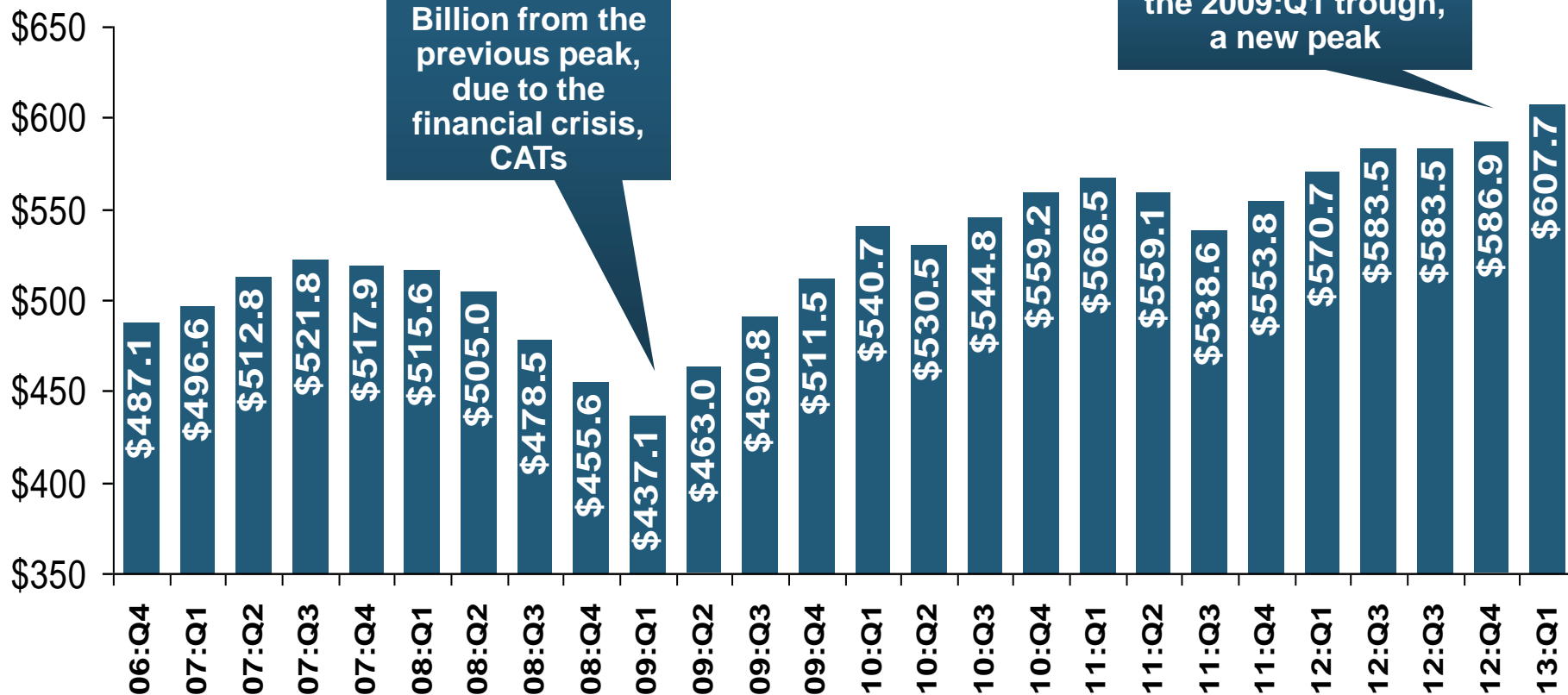
Profitability (ROE) Peaks & Troughs, P/C Insurance Industry, 1975 – 2013



*Profitability = P/C insurer ROEs. 2012 is an estimate based on ROAS data. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. 2012 ROAS = 5.9% including M&FG.
Sources: Insurance Information Institute; NAIC; ISO; A.M. Best.

Policyholder Surplus, Quarterly, 2006:Q4–2013:Q1

(\$ Billions)



The P/C industry at year-end 2012 had \$1 of surplus for every \$0.78 of NPW, the strongest claims-paying status in its history.

Don't Call It the “Life Insurance” Industry

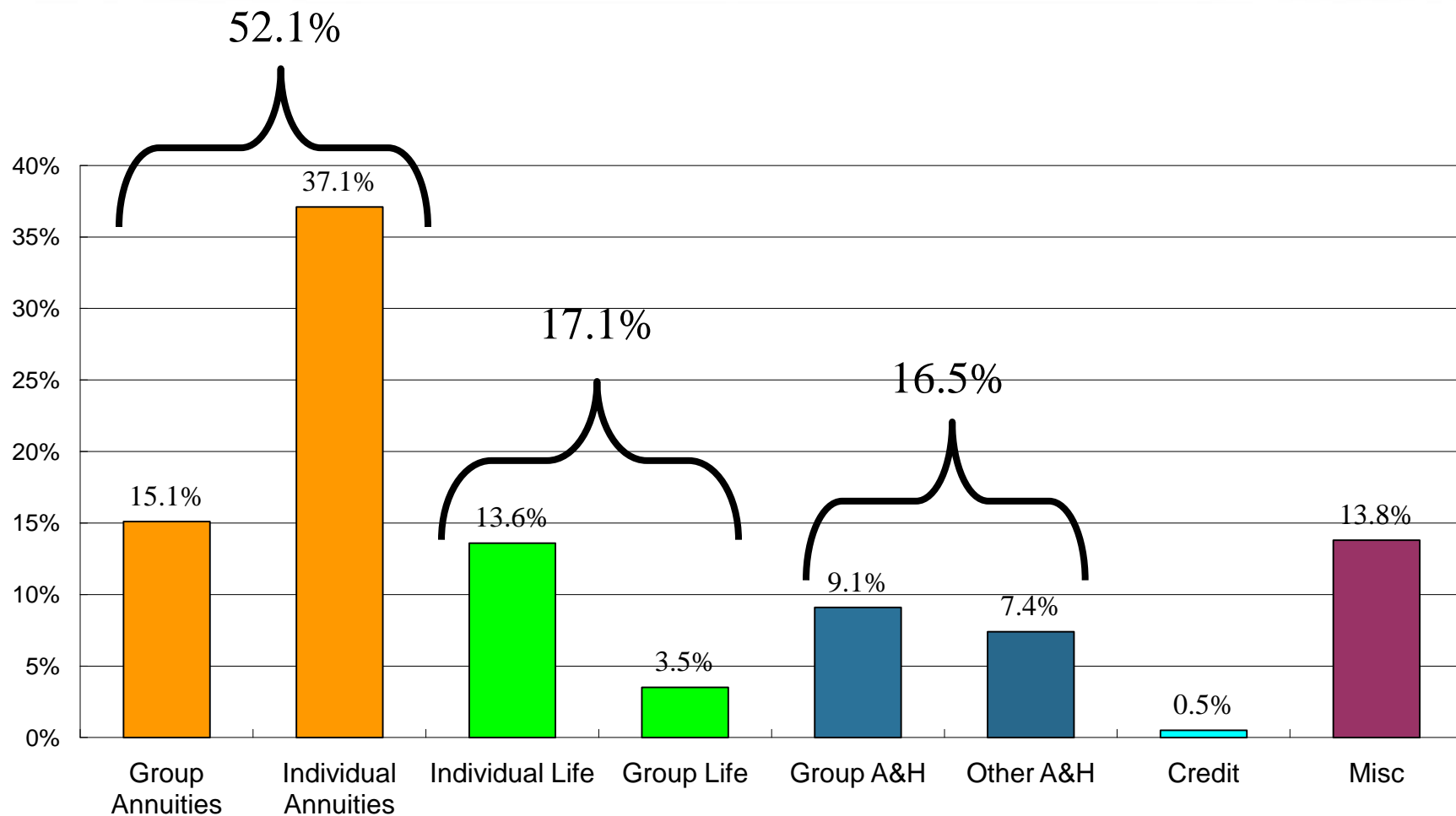
**Annuities Dominate
Industry Premiums and Profits**

The Life/Annuities/A&H segment

Five Major Segments

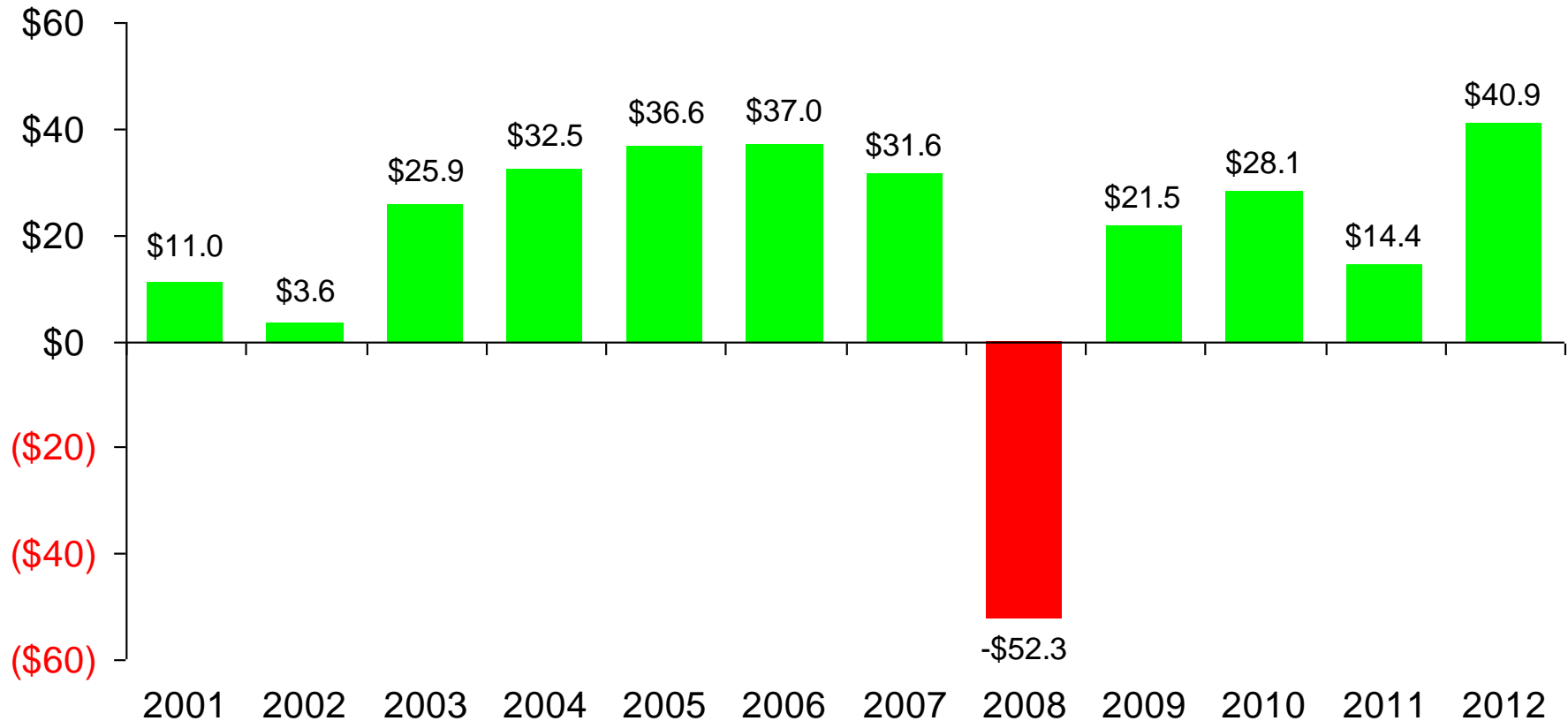
- Individual Life Insurance
- Individual Annuities
- Group Life Insurance
- Group Annuities
- A&H Insurance

U.S. Life/Annuity Insurance Industry Profit Sources, by Percent, 2012



Life/Annuity Industry Profits, 2001-2012

Billions



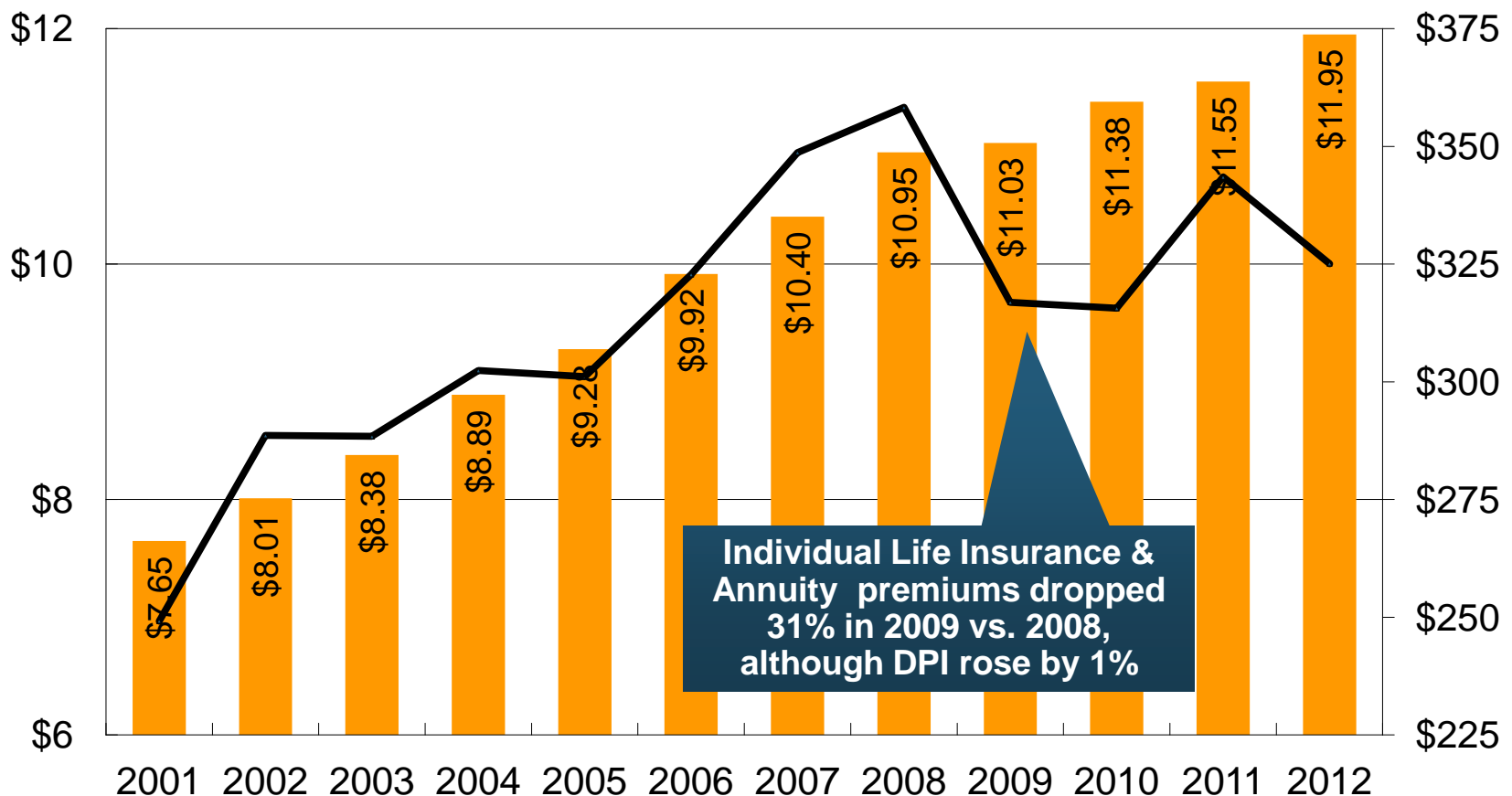
The Life/Annuity industry has produced steady (if unspectacular) profits, except for years in which the industry's investment results produced significant realized capital losses.

Individual Life Insurance & Annuity Premiums Tracked DPI Until 2009

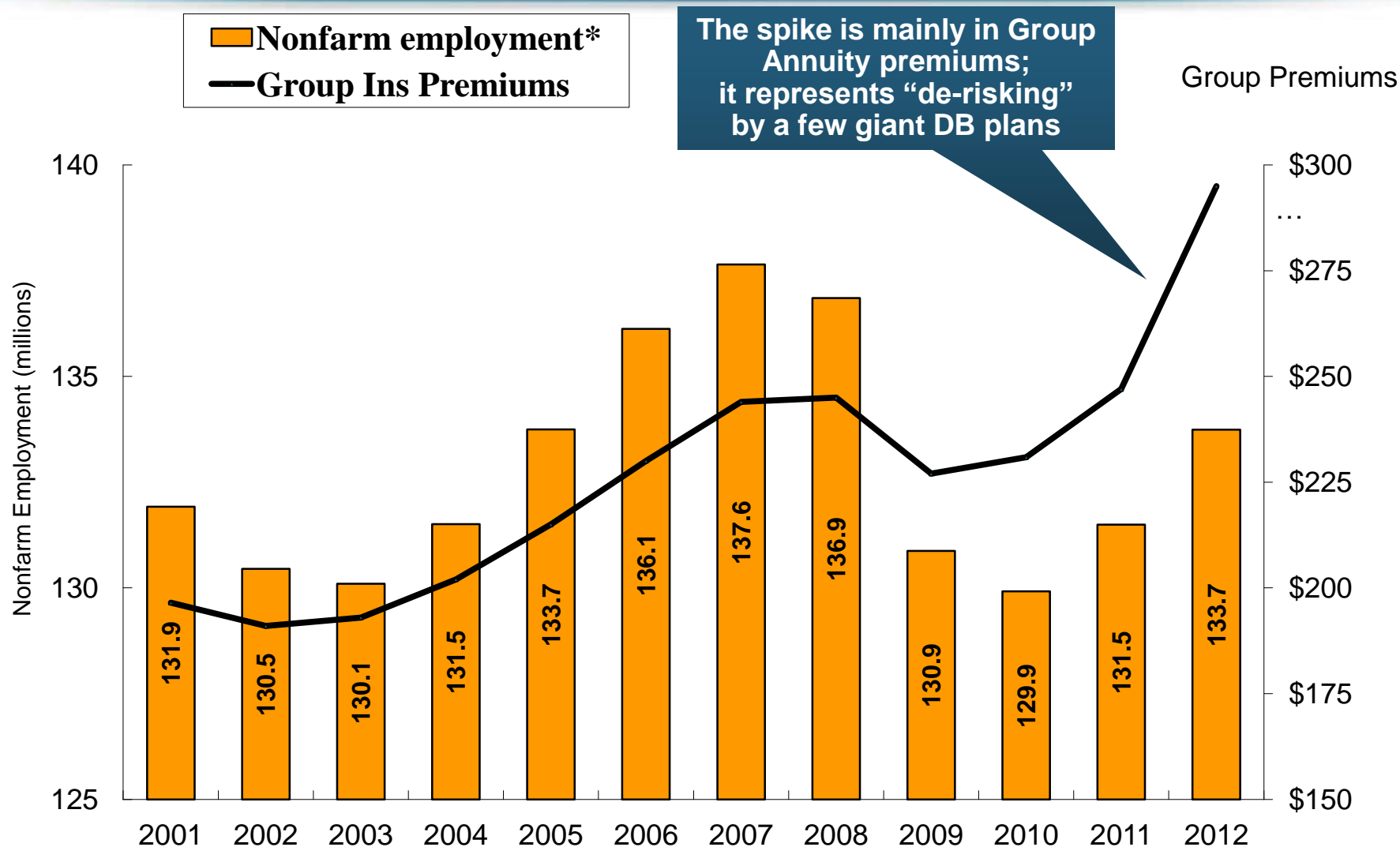
DPI
(\$ Trillion)

■ Disposable Personal Income
— Individual Life Insurance & Annuity Premiums

Individual Life
Insurance & Annuity
Premiums (\$ Billion)



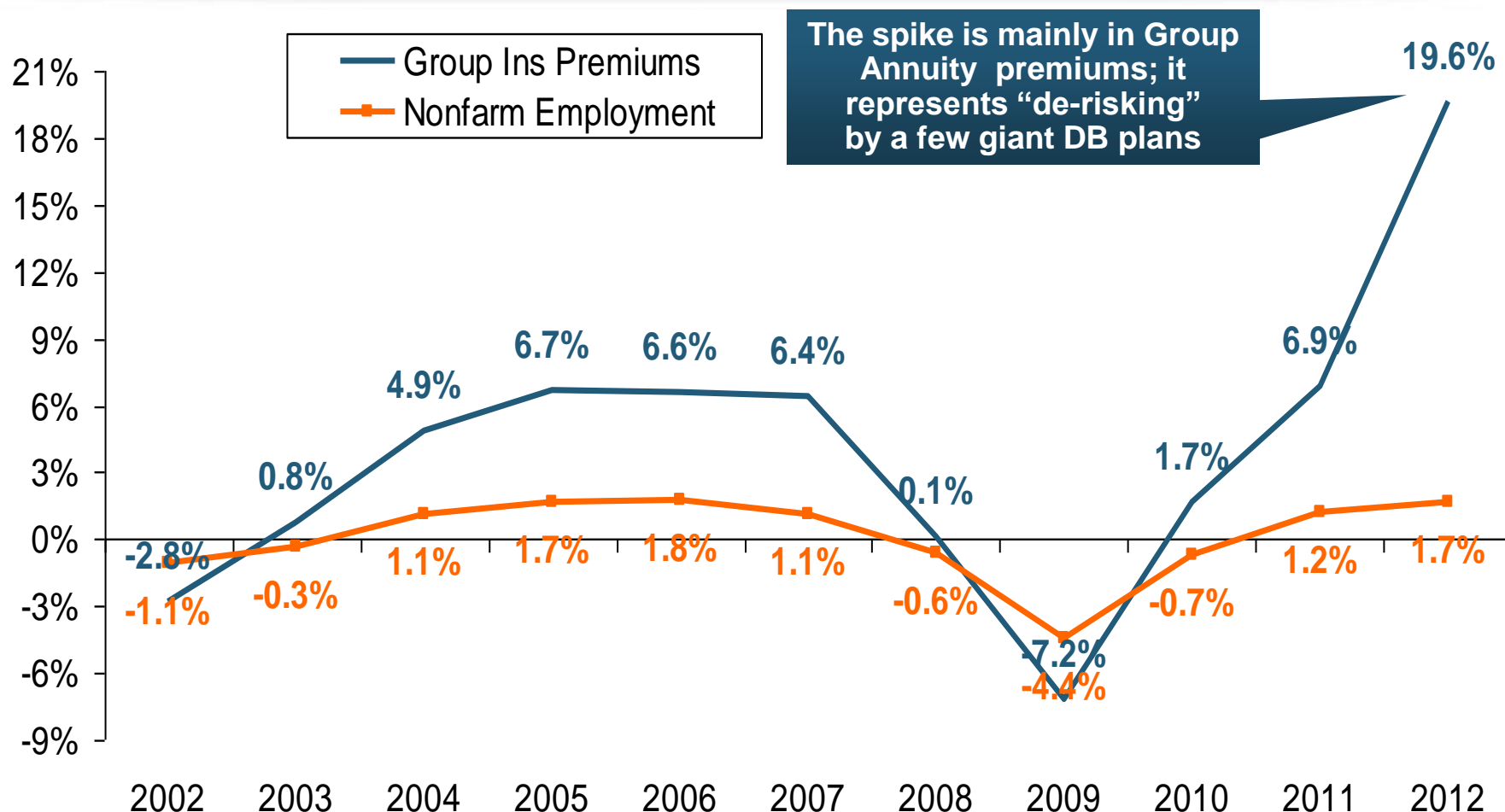
Group Insurance Premiums (line) Track Nonfarm Employment (bars)



*Not seasonally adjusted. Group premiums = group life, group annuities, and group a&h

Sources: NAIC Annual Statements, via SNL Financial; <http://www.bls.gov/ces/>

Pct. Change in Group Insurance Premiums Tracks Nonfarm Employment

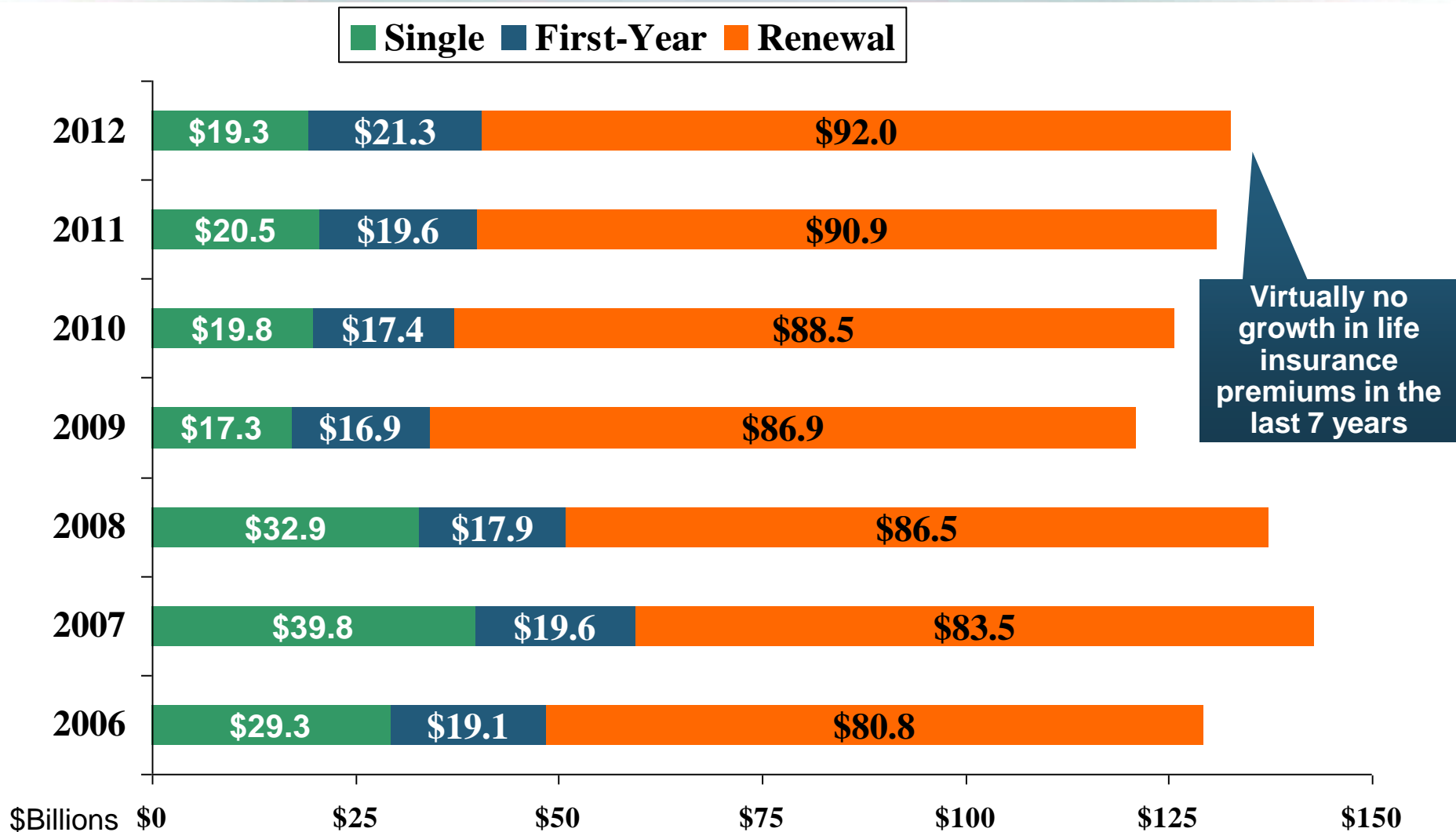


A few employers with large defined-benefit pension plans recently bought group annuities in order to avoid excess longevity risk.

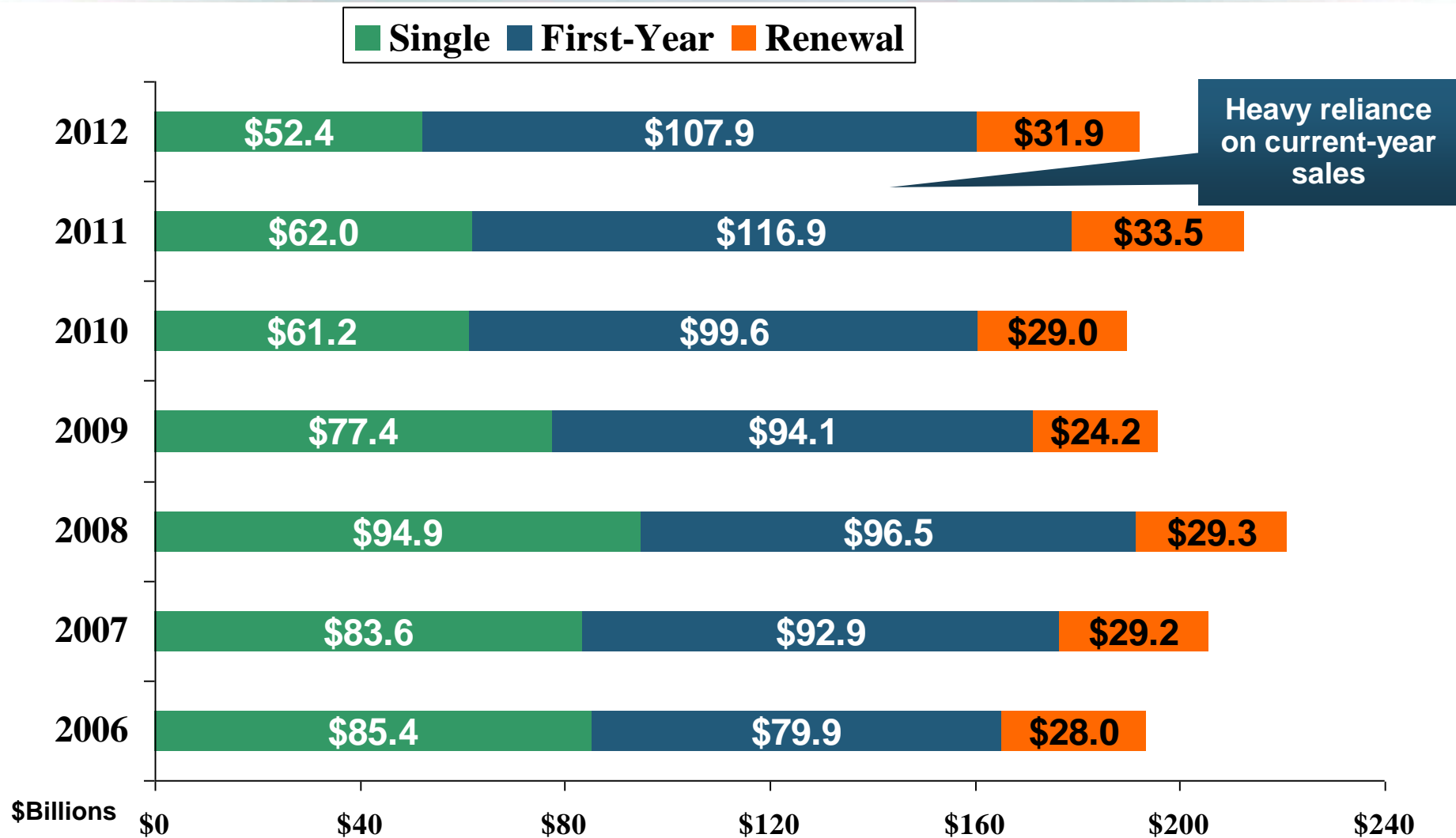
*Not seasonally adjusted. Group premiums = group life, group annuities, and group a&h

Sources: NAIC Annual Statements, via SNL Financial; <http://www.bls.gov/ces/>

Individual Life Insurance: Direct Premiums by Frequency, 2006-2012



Individual Annuities: Direct Premiums by Frequency, 2012

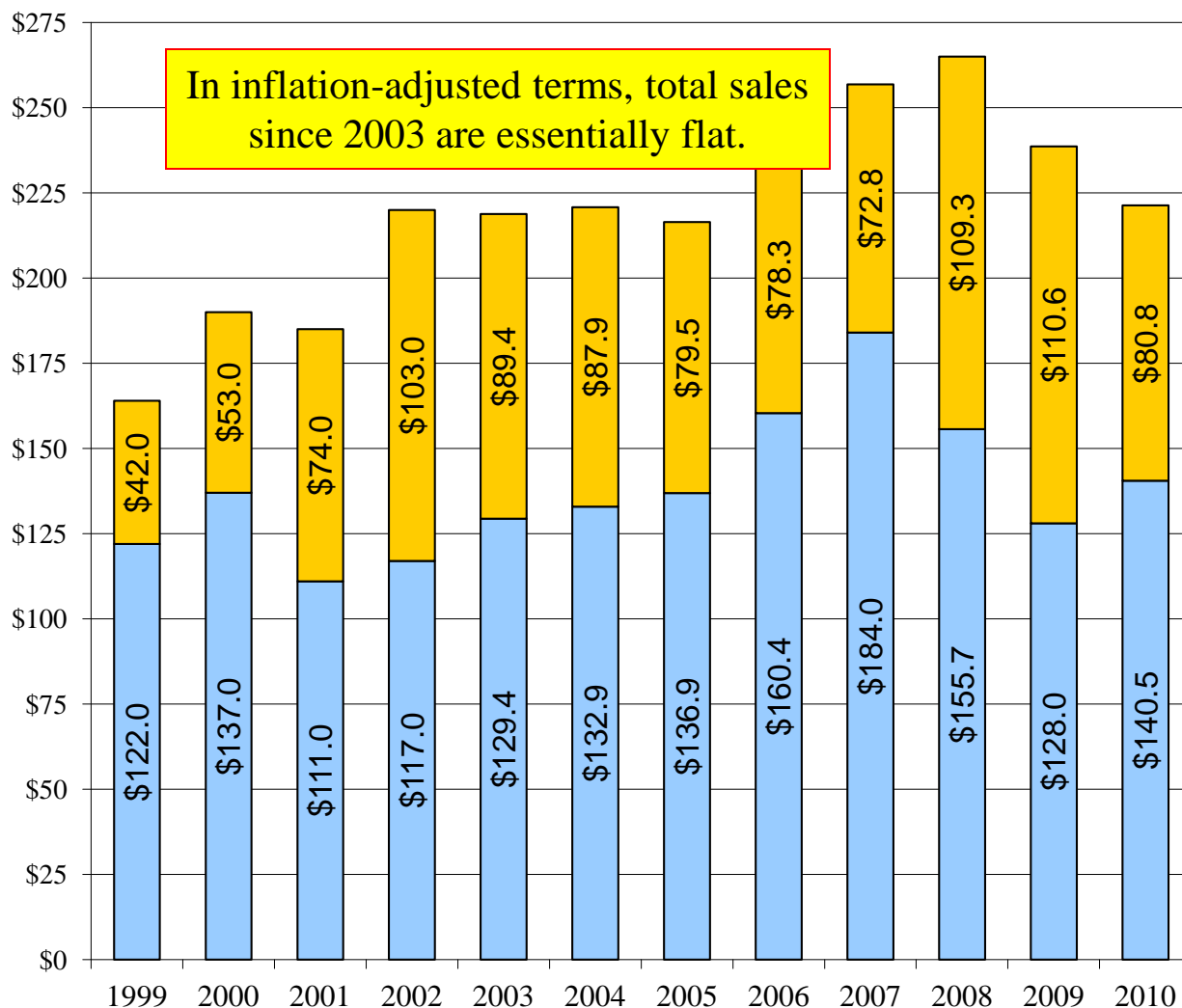


Sources: NAIC Annual Statements, from SNL Financial; I.I.I. calculations.

Deferred + Immediate Individual Annuity Sales, 1999-2010

\$ Billions

■ Variable ■ Fixed



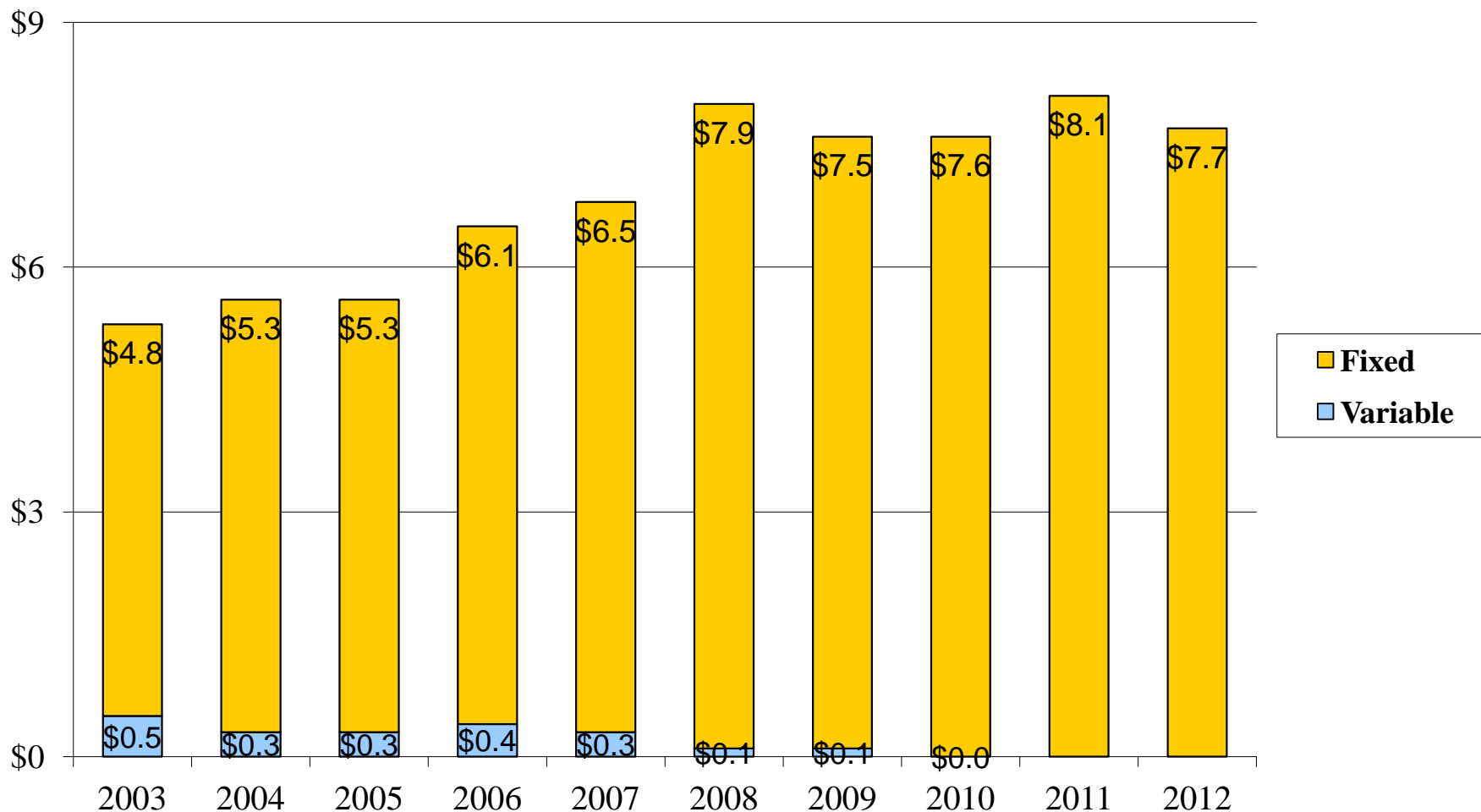
Source: LIMRA International; I.I.I.

Fixed annuity sales spike when the stock market tumbles

Variable sales dropped after the stock market plunge in 2000 but recovered by 2004. 2007 was a record year. 2009 variable sales vs. 2007 dropped by 30.4%.

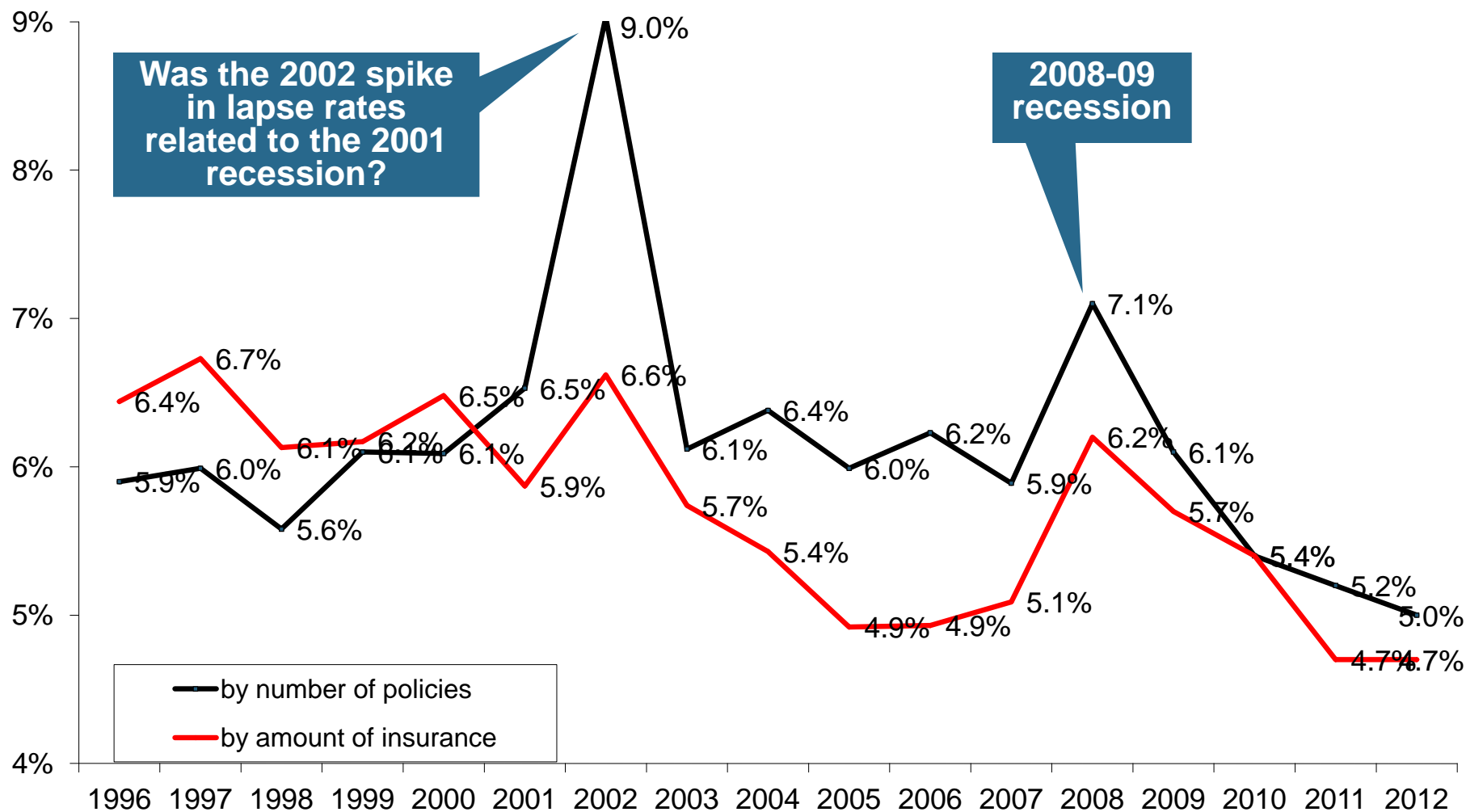
Individual Immediate Annuity Sales, 2003-2012

\$ Billions



Almost no one buys variable immediate annuities or indexed immediate annuities

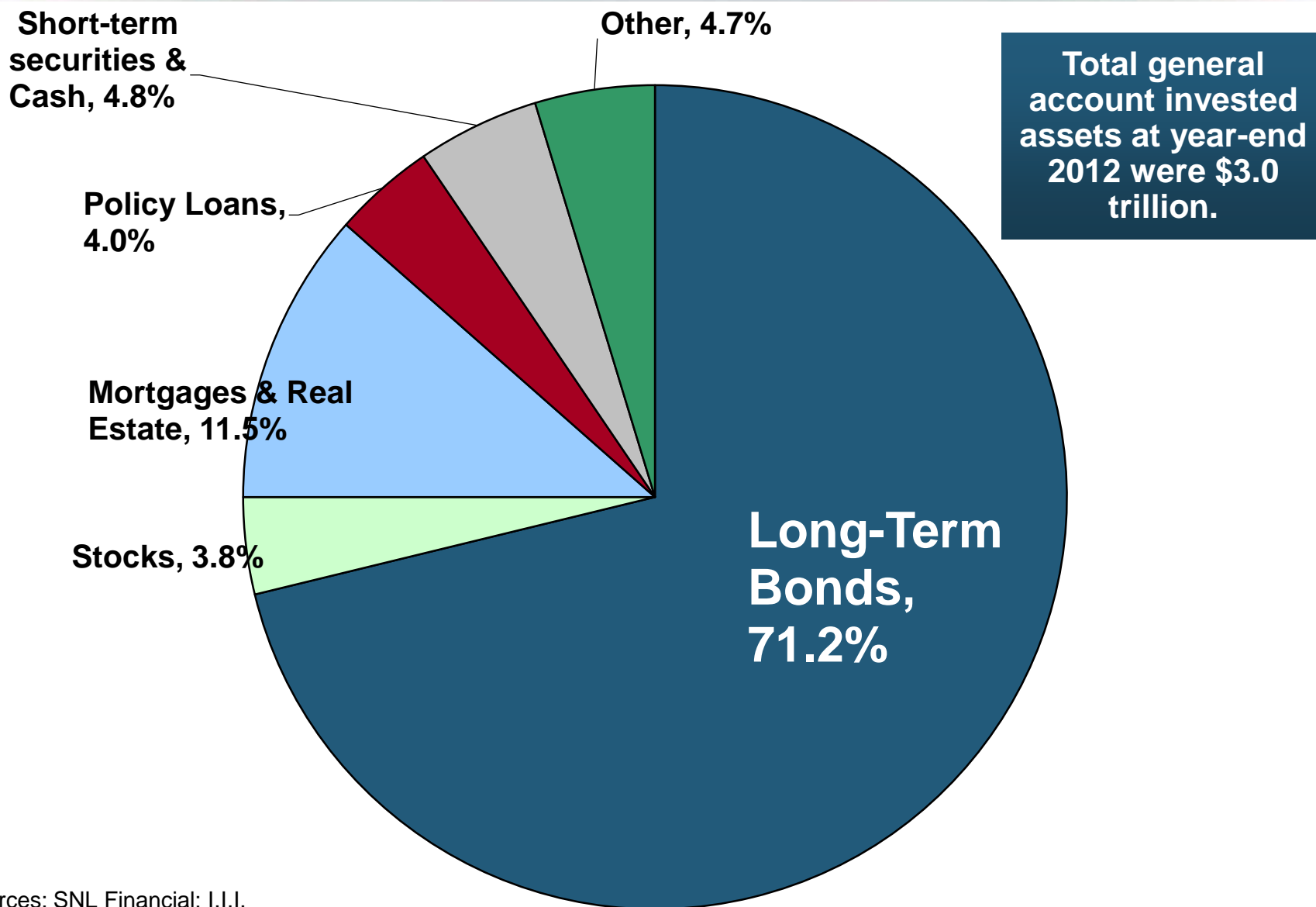
Ordinary Life Insurance Lapse Rates, 1996-2012



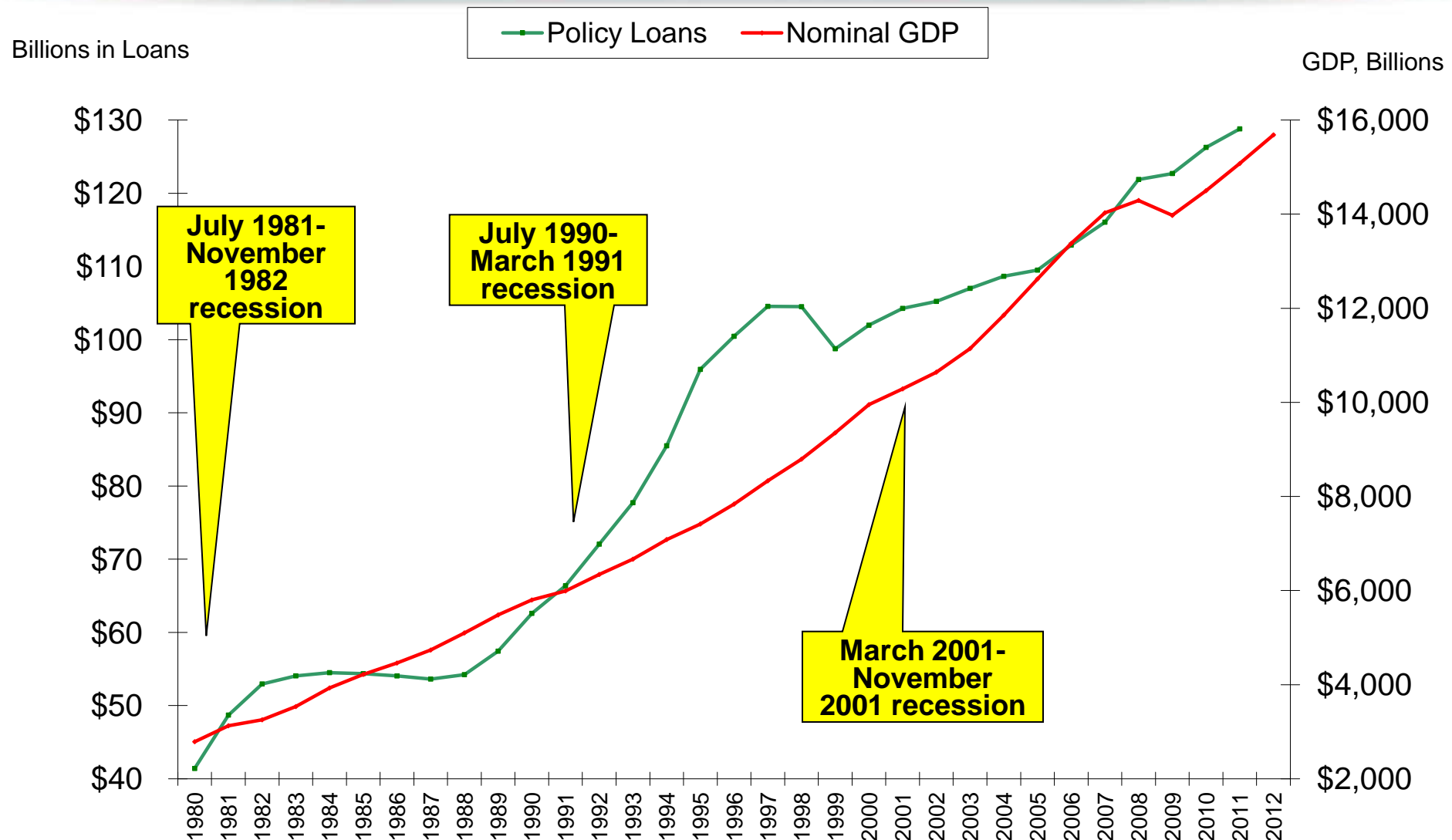
Sources: NAIC Annual Statements, p. 25 line 15 (lapses) and average of lines 1 and 21, from SNL Financial; I.I.I. calculations

Investments

Distribution of L/A Insurer Invested Assets (General Account), 2012



Policy Loans Increase During/Following a Recession, but Also in Boom Times

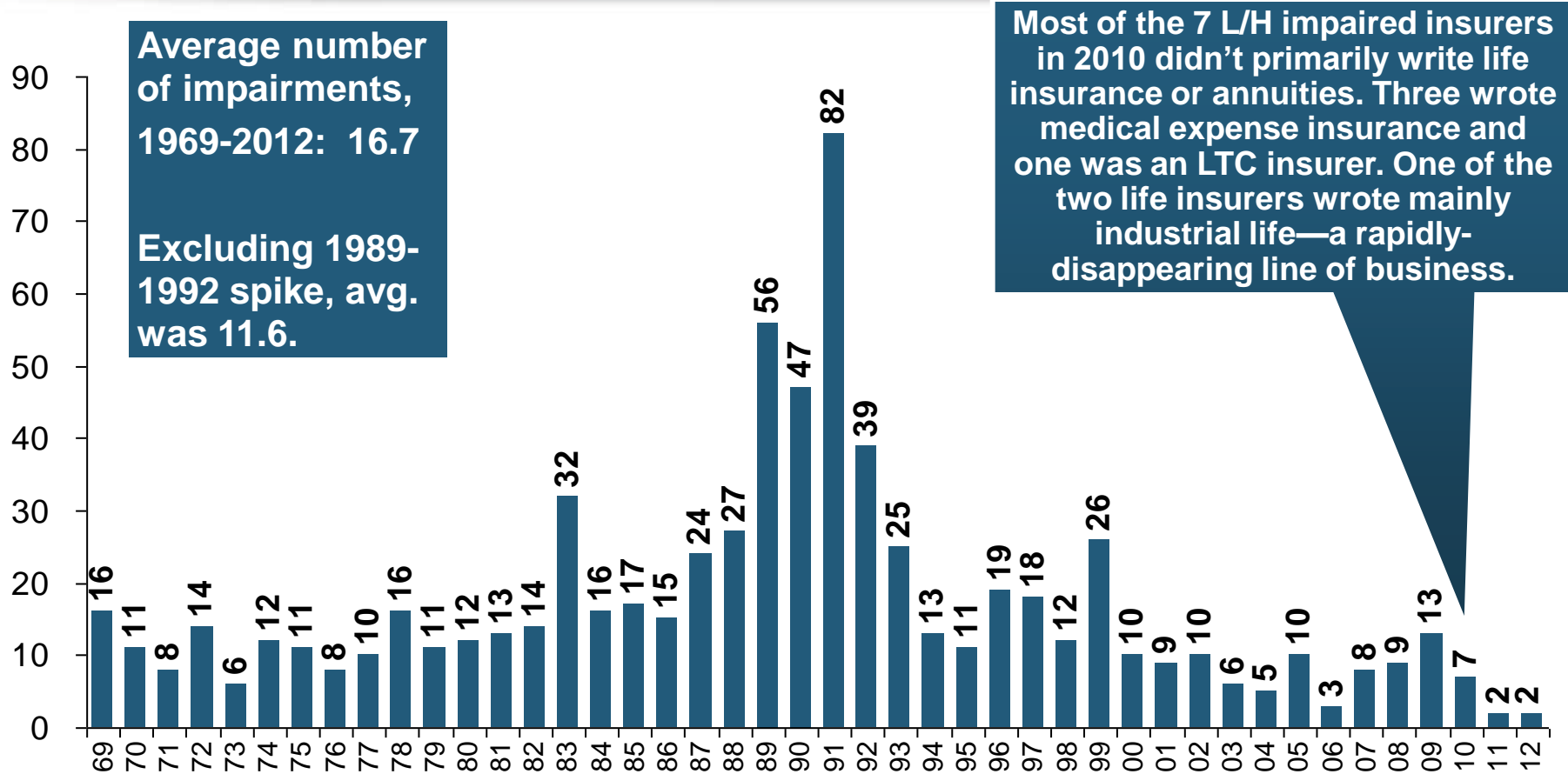


Sources: <http://www.bea.gov/national/xls/gdplev.xls> , ACLI Life Insurers Fact Book 2012, p. 11.

Financial Strength

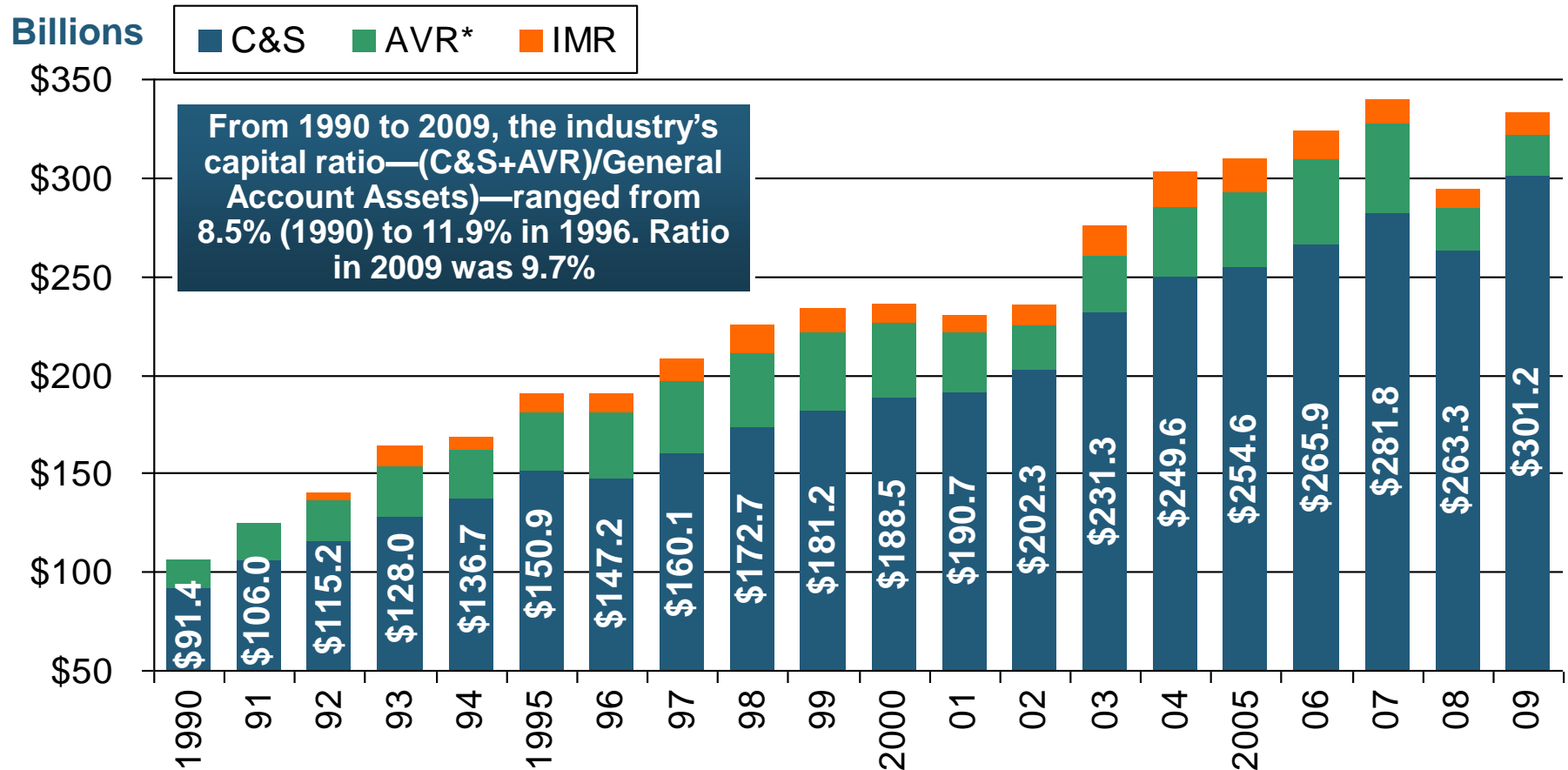
**The Industry Has
Weathered the Storms Well**

Number of Impaired L/H Insurers, 1969–2012



The Number of Impairments Spiked in 1989-92, with Smaller Spikes in 1983 and 1999. But in the Financial Crisis, When Hundreds of Banks Failed, Virtually No Life Insurers Failed.

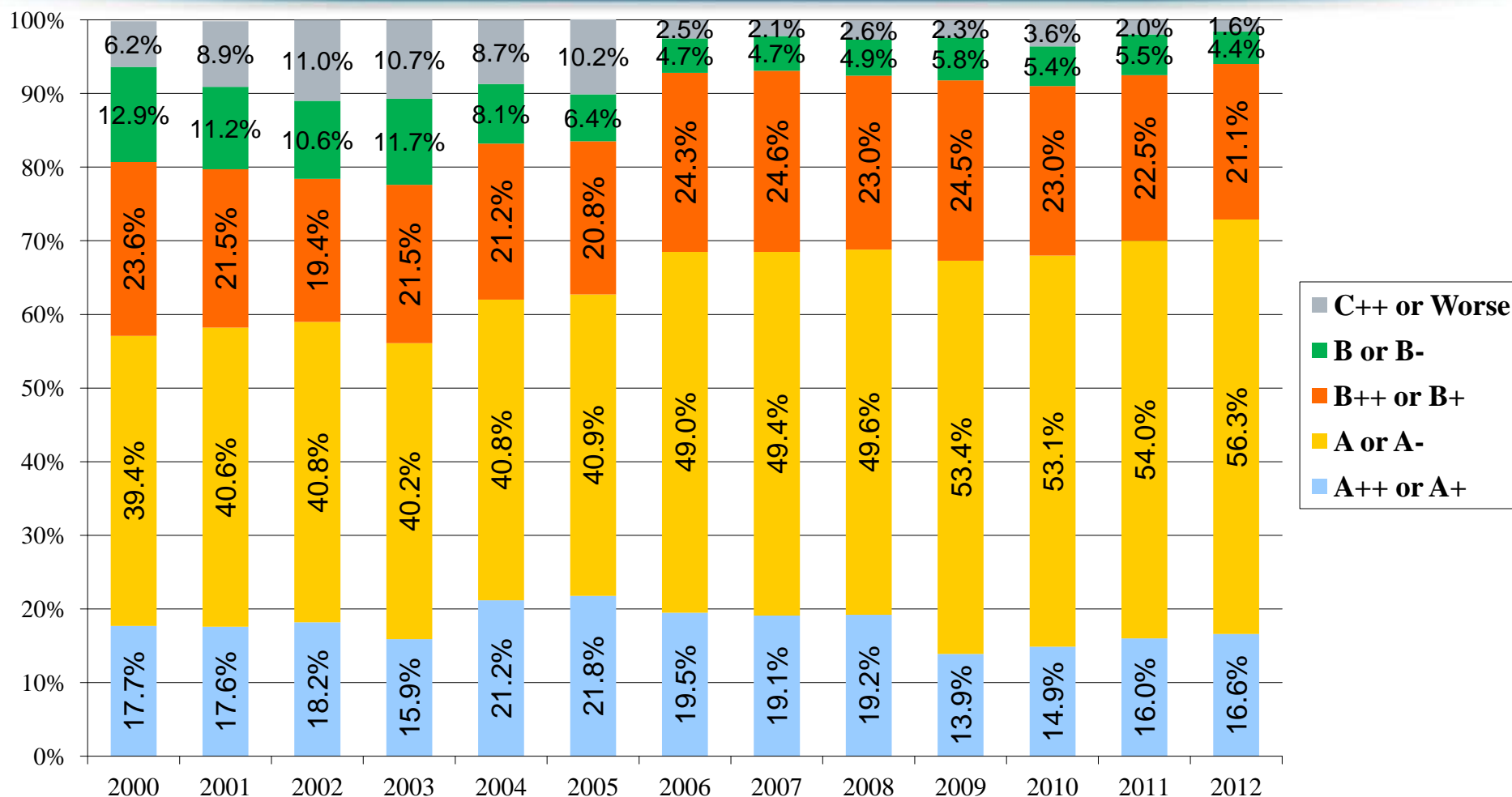
Life/Annuity Industry Capital & Surplus, AVR, & IMR, 1990-2009



Life/Annuity insurers are stronger than the C&S dollars indicate, because the Asset Valuation Reserve (AVR), booked as a liability, is essentially a surplus account to “cushion” asset value drops. The Interest Maintenance Reserve (IMR), another liability account, buffers the insurer’s C&S against drops in investment income.

*prior to 1992, this was the Mandatory Securities Valuation Reserve (MSVR)
Sources: ACLI 2010 Life Insurance Fact Book; Insurance Information Institute.

Distribution of A.M. Best Ratings for L-A Insurers, 2000-2012



The percent of Life-Annuity insurers with A or A- ratings has grown. In 2000 it was 39.4%, but in 2012 it is 56.3%. Today, 94% of L-A insurers have A. M. Best ratings of B+ or better, up from 81% in 2000.

Key Challenges and Opportunities

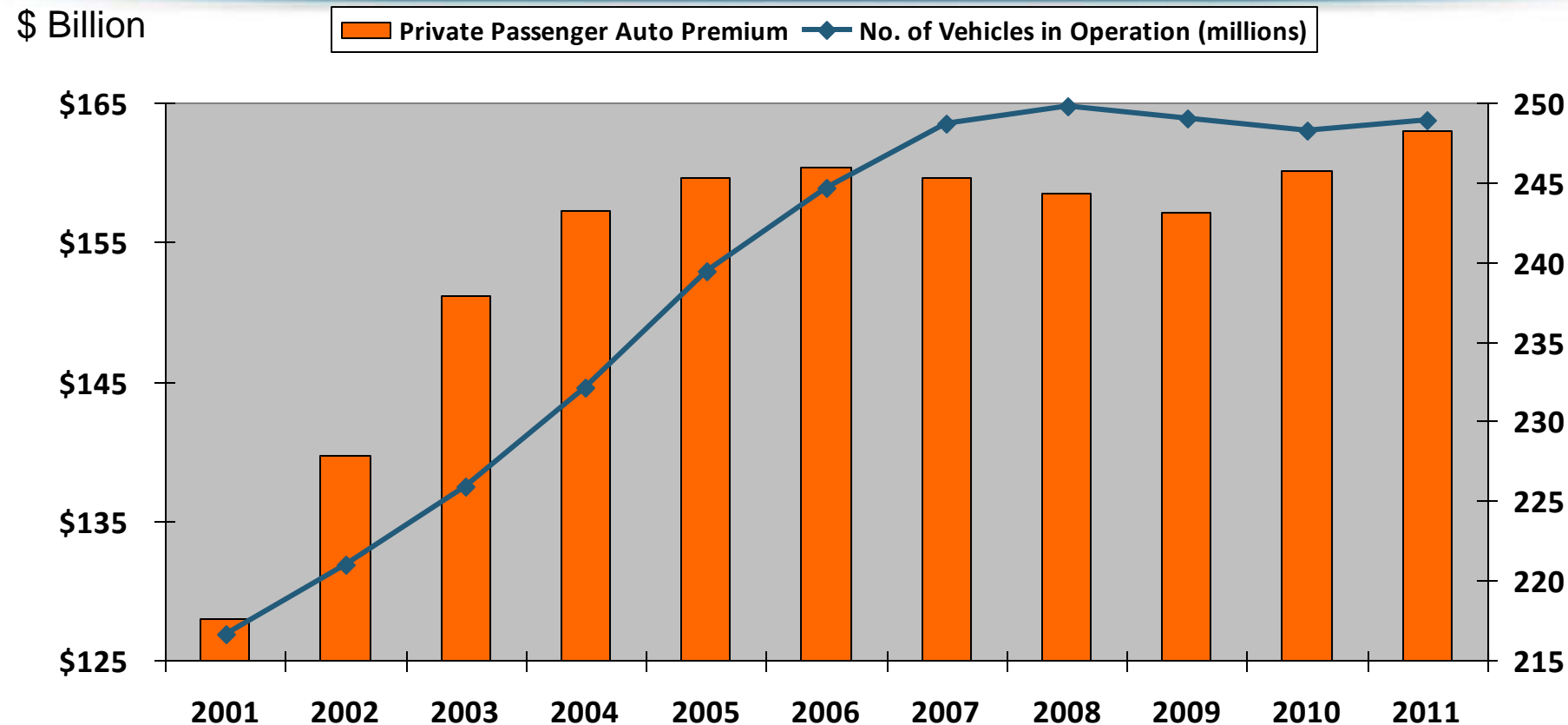
■ Challenges

- ◆ Changing Exposure Mix
- ◆ Persistently Low Interest Rates/Investment Return
- ◆ Increasing Frequency and Severity of Natural Catastrophe Claims

■ Opportunities

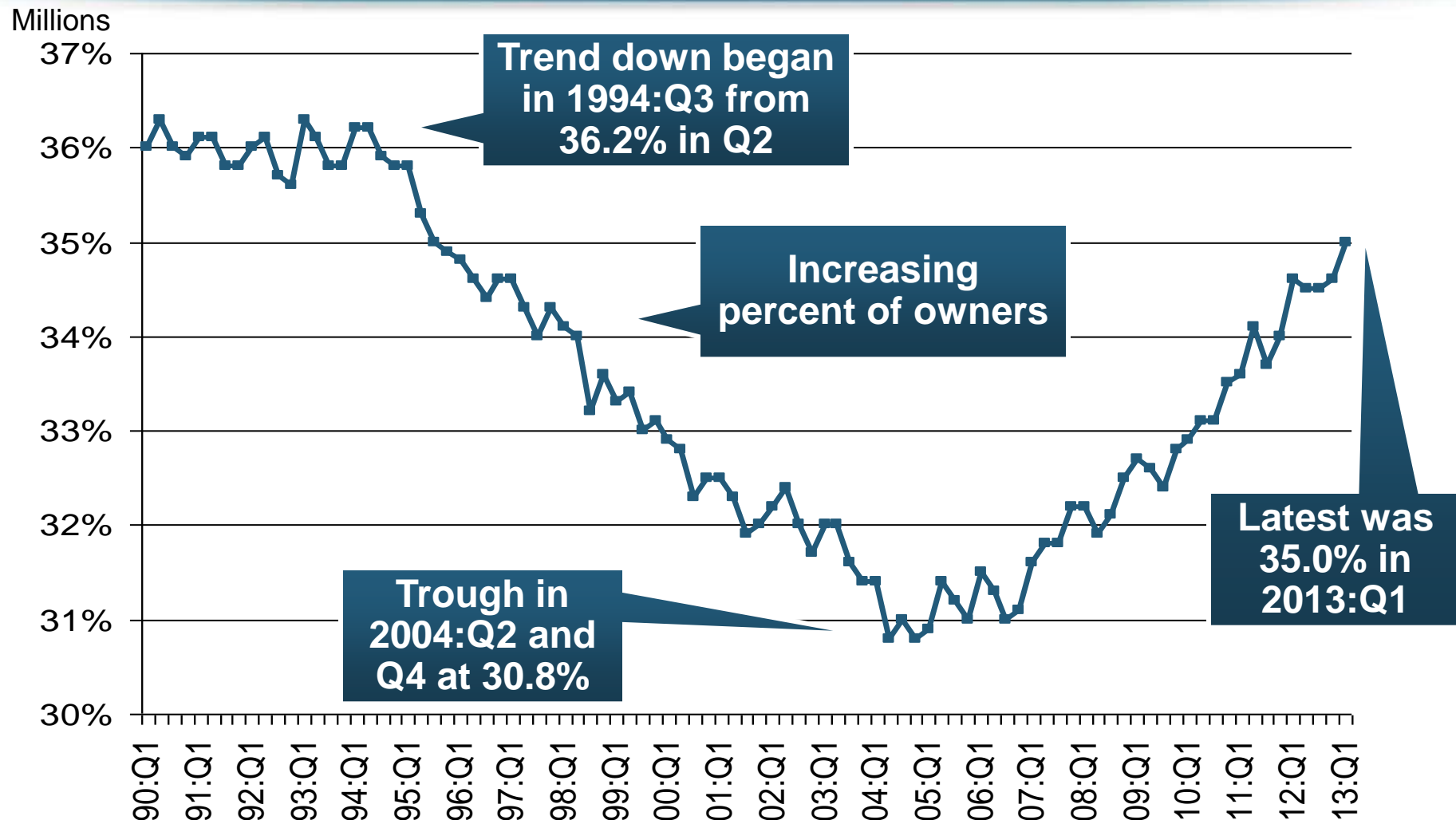
- ◆ New insurance needs being recognized
 - Cyber risk
 - Business continuation

PP Auto NWP vs. # of Vehicles in Operation, 2001–2011



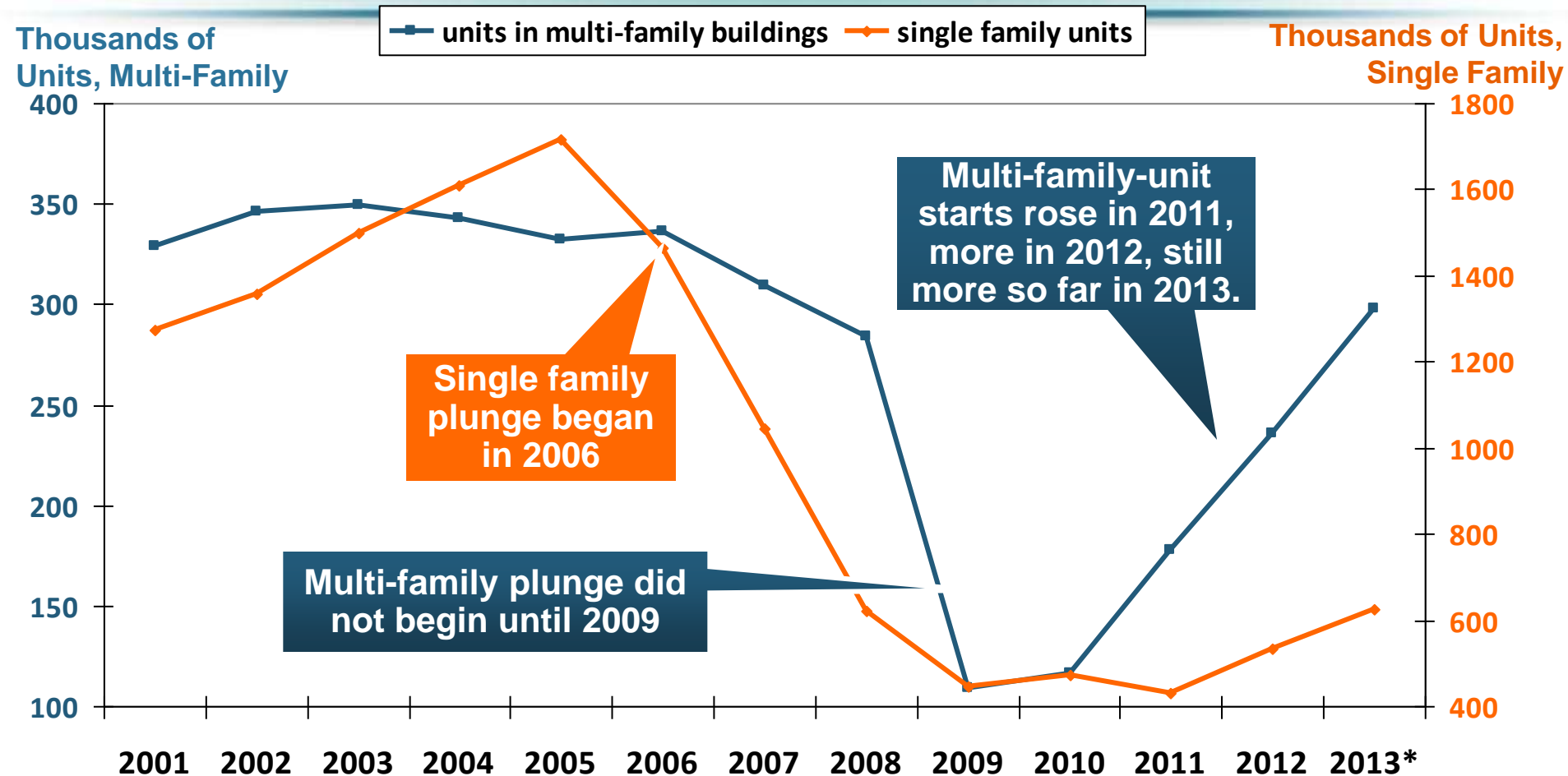
PP Auto premiums written are recovering from a period of no growth attributable to the weak economy affecting new vehicle sales, car choice, and increased price sensitivity among consumers

Rental-Occupied Housing Units as % of Total Occupied Units, Quarterly, 1990-2013



Since the Great Recession ended, renters occupied 3.6 million more units (+9.9%)—outstripping population growth (+2.9%). When will this end?

So Far, the Pickup In Housing Starts is Mostly in Multi-Family Housing

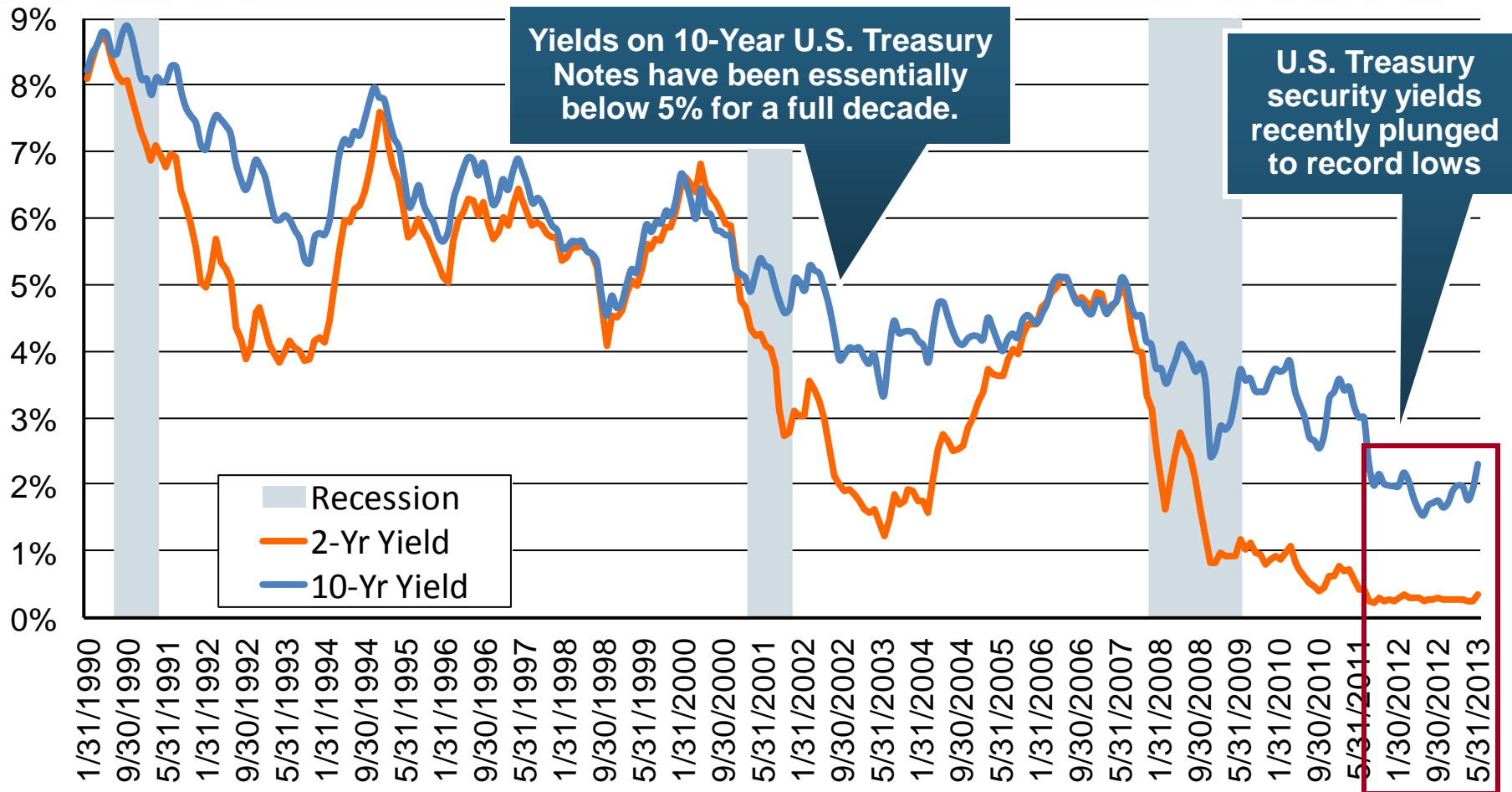


2013:Q1 multi-unit starts at a seasonally adjusted annual rate of 325,000, are nearly back to the average annual pre-recession rate of 339,000.

*average of annualized seasonally adjusted January-April 2013 data; April is preliminary.

Source: US Census Bureau at www.census.gov/construction/nrc/pdf/newresconst.pdf.

U.S. Treasury Security Yields*: A Long Downward Trend, 1990–2013

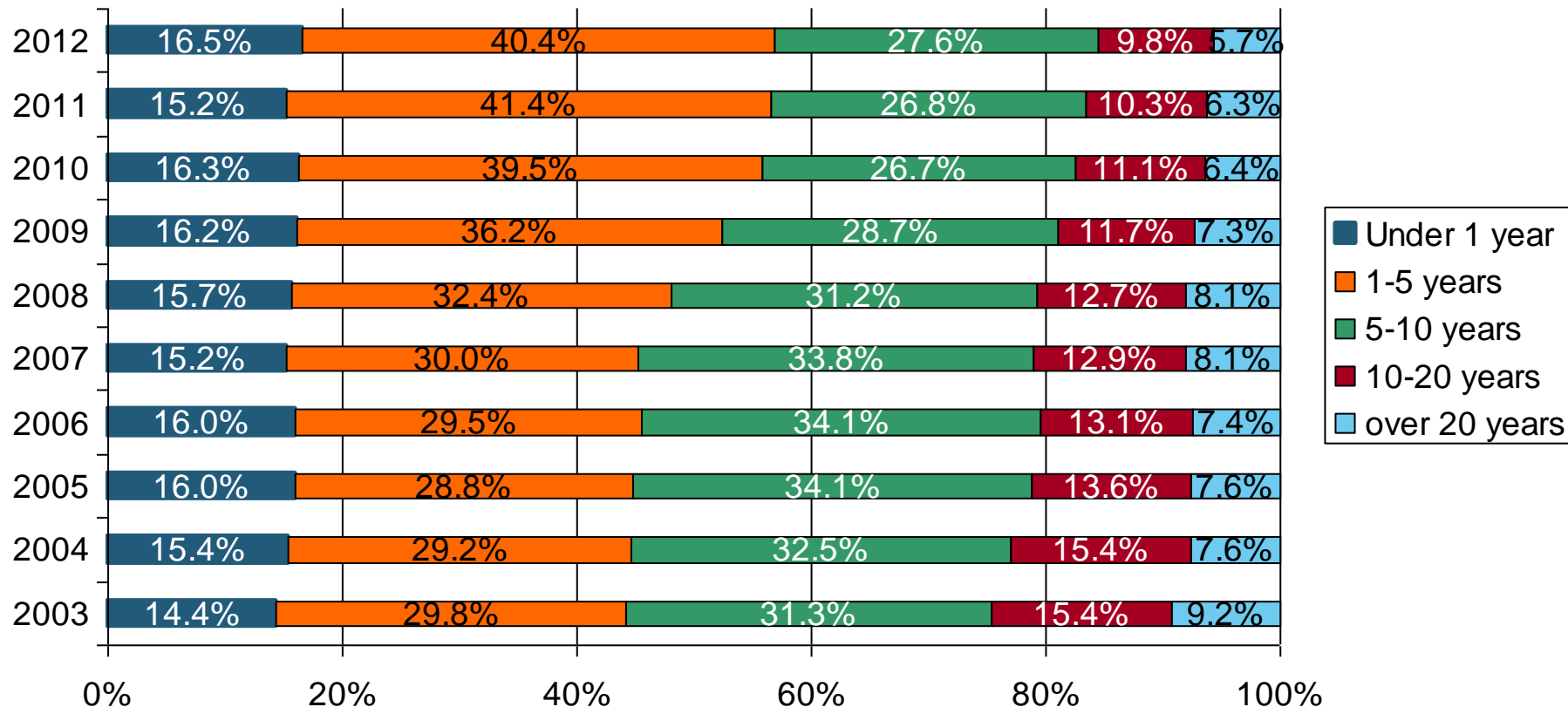


Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

*Monthly, constant maturity, nominal rates, through June 2013.

Sources: Federal Reserve Bank at <http://www.federalreserve.gov/releases/h15/data.htm>.
National Bureau of Economic Research (recession dates); Insurance Information Institutes.

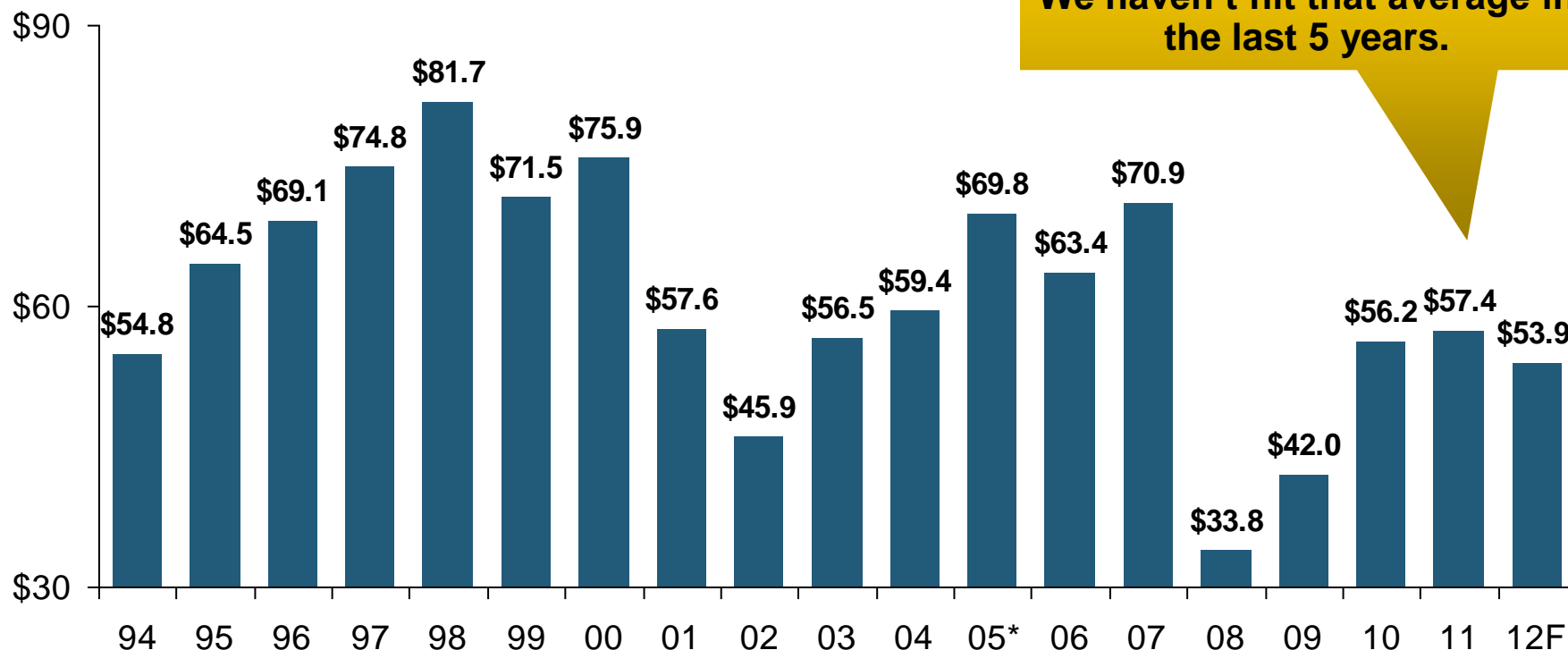
Distribution of Bond Maturities, P/C Insurance Industry, 2003-2012



The main shift over these years has been from bonds with longer maturities to bonds with shorter maturities. The industry first trimmed its holdings of over-10-year bonds (from 24.6% in 2003 to 15.5% in 2012) and then trimmed bonds in the 5-10-year category (from 31.3% in 2003 to 27.6% in 2012). Falling average maturity of the P/C industry's bond portfolio is contributing to a drop in investment income along with lower yields.

Inflation-Adjusted P/C Industry Investment Gains: 1994–2012F¹

(\$ Billions,
2012 dollars)



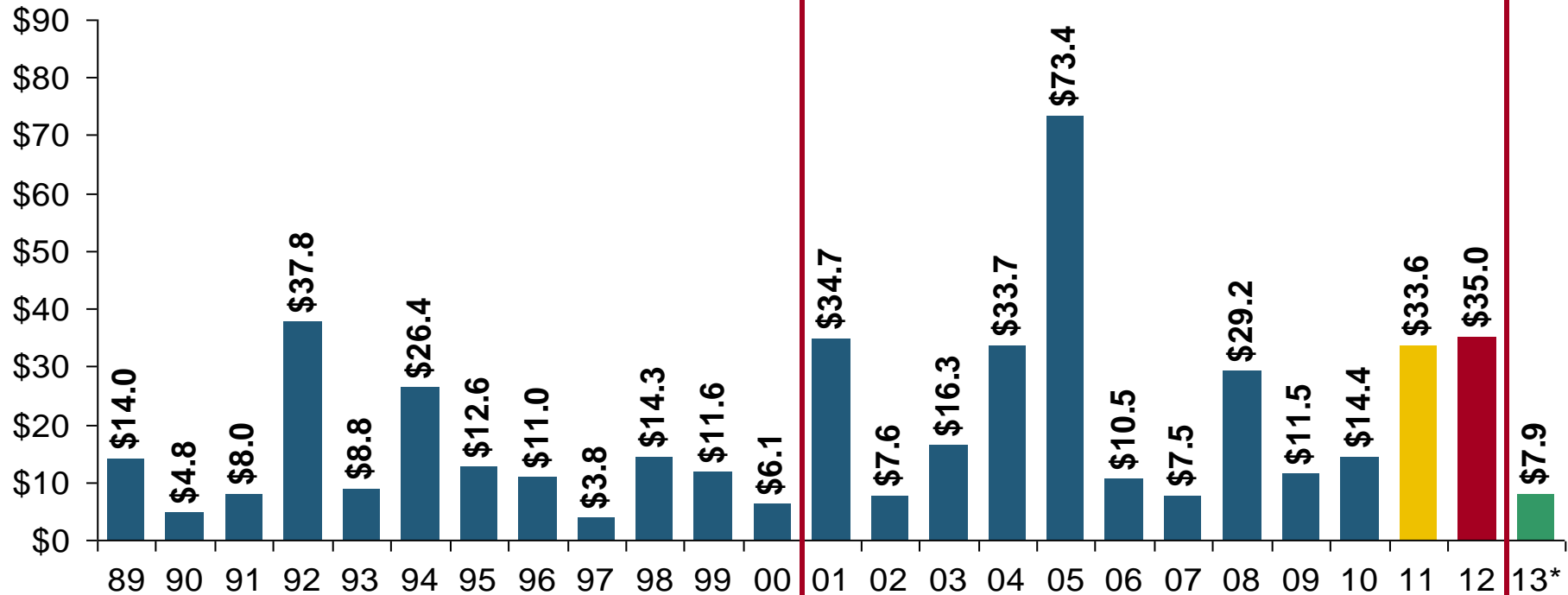
In 2012 (1st three quarters) both investment income and realized capital gains were lower than in the comparable period in 2011. And because the Federal Reserve Board aims to keep interest rates exceptionally low until the unemployment rate hits 6.5%—likely at least another year off—maturing bonds will be re-invested at even lower rates.

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

*2005 figure includes special one-time dividend of \$3.2B; 2012F figure is I.I.I. estimate based on annualized actual 2012:Q3 result of \$38.089B. Sources: ISO; Insurance Information Institute.

U.S. Insured Catastrophe Losses

(\$ Billions, 2012 Dollars)



From 1989-2000, average annual catastrophe losses were \$13.3 Billion. For 2001-2012, average annual catastrophe losses were \$25.6 Billion—double the prior period.

Record tornado losses caused 2011 CAT losses to surge

*Through 6/2/13. Includes \$2.6B for 2013:Q1 (PCS) and \$5.32B for the period 4/1 – 6/2/13 (Aon Benfield Monthly Global Catastrophe Recap).

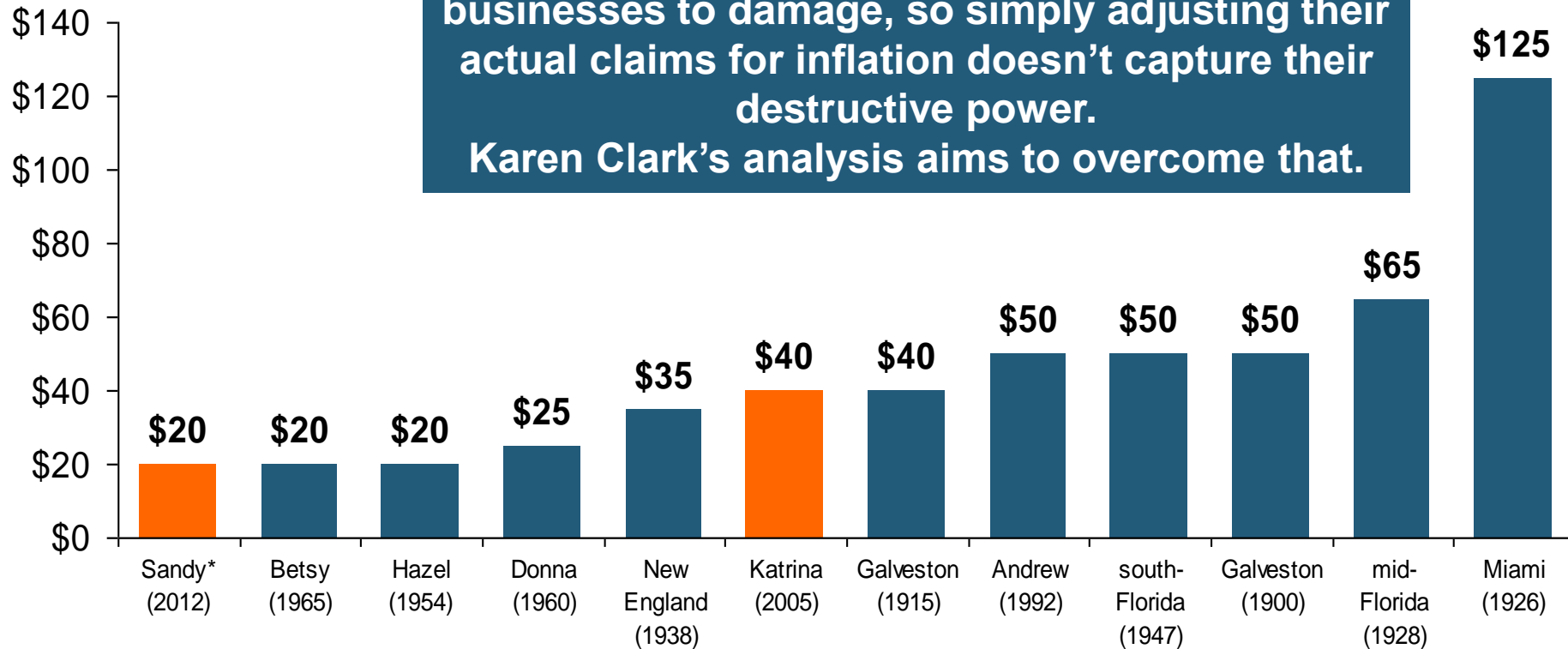
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01 (\$25.9B 2011 dollars). Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B (\$15.6B in 2011 dollars.)

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

If They Hit Today, the Dozen Costliest (to Insurers) Hurricanes in U.S. History

Insured Losses,
2012 Dollars, \$ Billions

Storms that hit long ago had less property and businesses to damage, so simply adjusting their actual claims for inflation doesn't capture their destructive power.
Karen Clark's analysis aims to overcome that.



When you adjust for the damage prior storms could have done if they occurred today, Hurricane Katrina slips to a tie for 6th among the most devastating storms.

*Estimate as of 12/09/12 based on estimates of catastrophe modeling firms and reported losses as of 1/12/13. Estimates range up to \$25B.
Sources: Karen Clark & Company, *Historical Hurricanes that Would Cause \$10 Billion or More of Insured Losses Today*, August 2012; I.I.I.

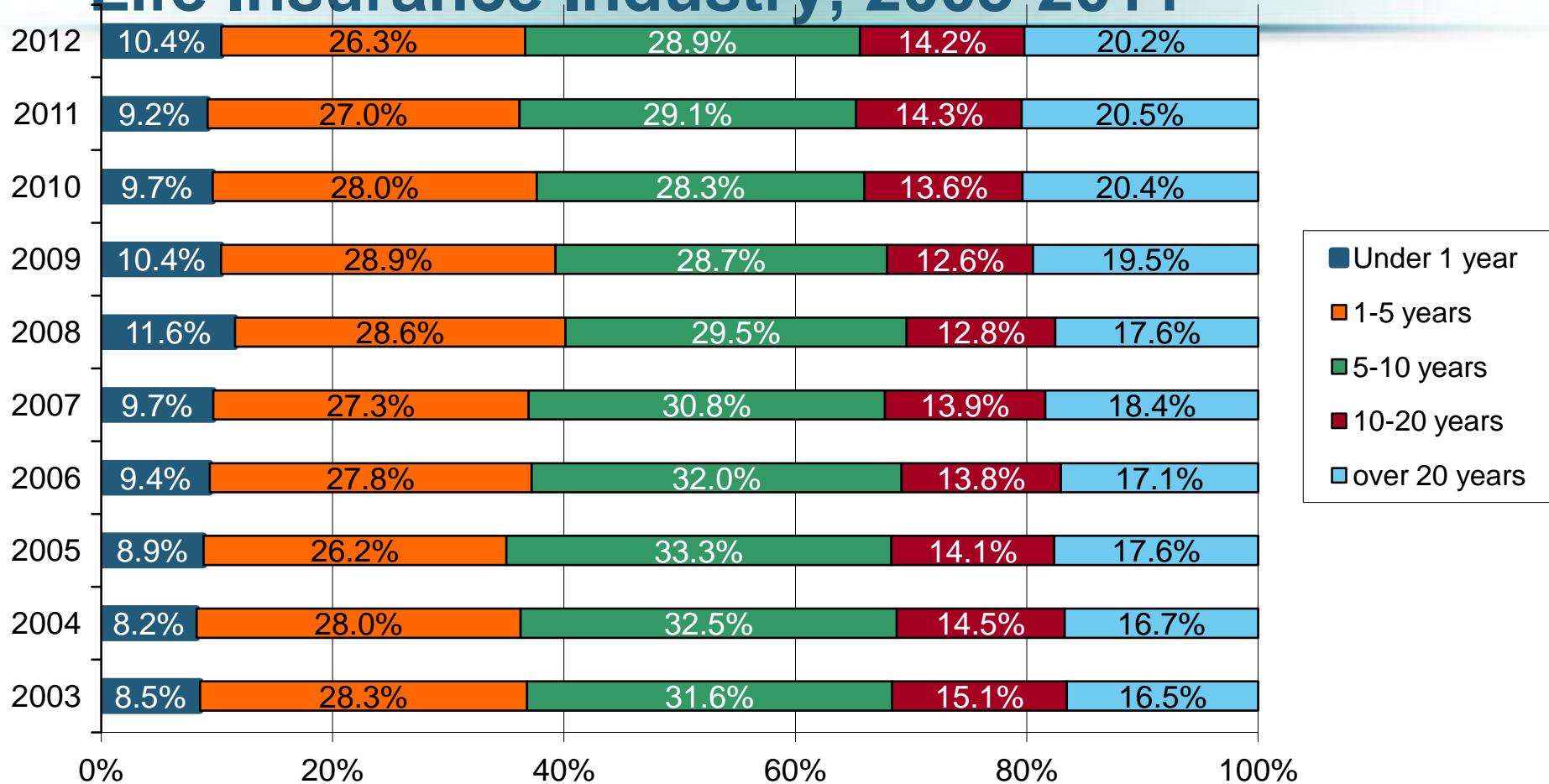
■ Challenges

- ◆ Persistently Low Interest Rates
- ◆ Changing Tendency to Buy Life Insurance
- ◆ Annuity Product Design
 - Guaranteed Living Benefits
 - Fixed Indexed Annuities

■ Opportunities

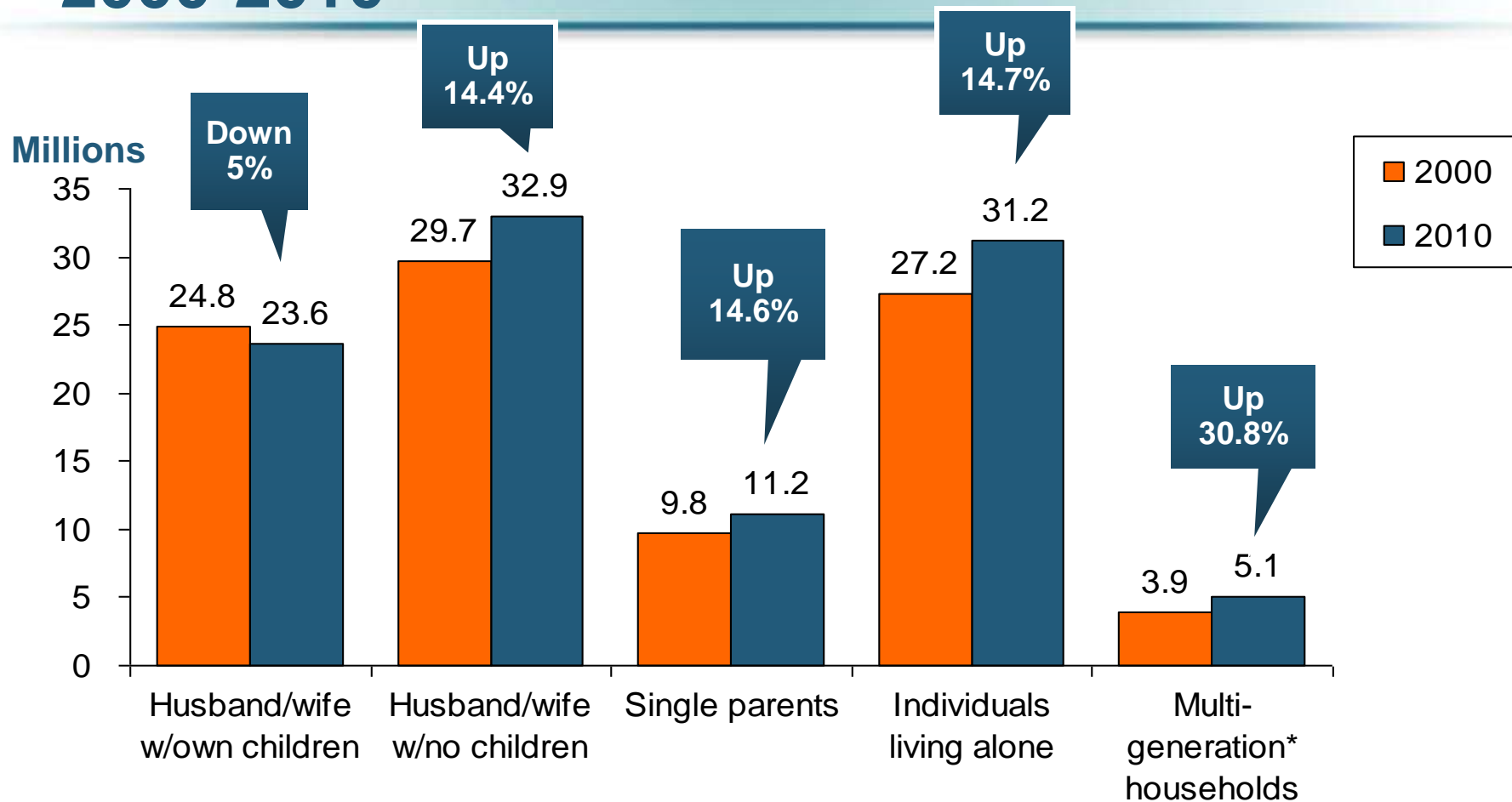
- ◆ The “Baby Boom” generation is reaching retirement age
- ◆ DB pension plans “de-risking”
 - DC-type plans (i.e., 401(k), 403(b), IRA) might also

Distribution of Bond Maturities, Life Insurance Industry, 2003-2011



The main shift over these years has been from bonds with intermediate maturities to bonds with longer maturities. The industry added to its holdings of over-20-year bonds (from 16.5% in 2003 to 20.2% in 2012) and trimmed bonds in the 1-5-year and the 5-10-year categories (from 59.9% to 55.2%).

Changes in Household Composition, 2000-2010



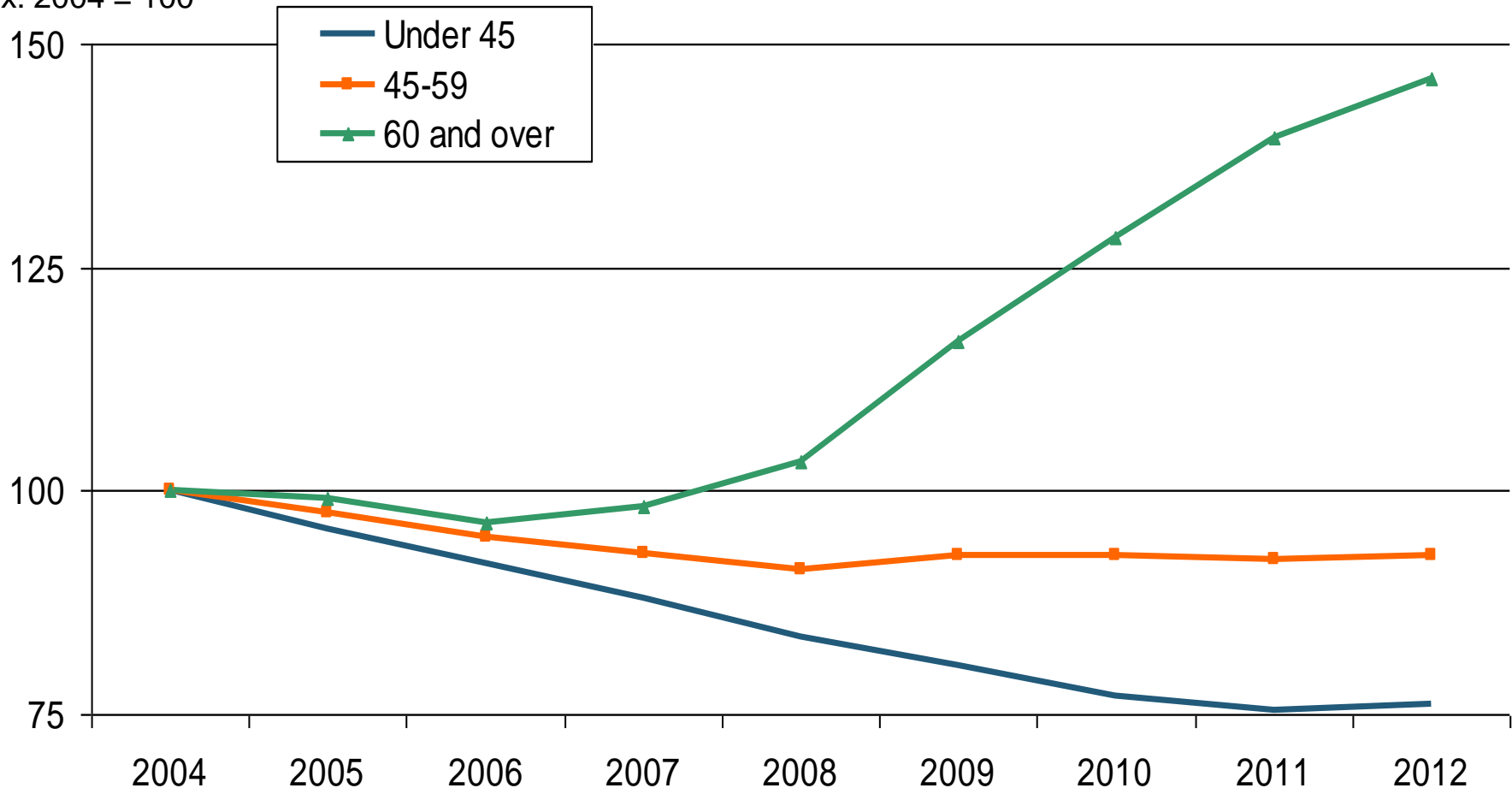
The number of traditional households (husband, wife, children at home) fell by 1.25 million in the first decade of the 21st century. Multi-generation households rose by roughly the same number in that decade.

*defined as three or more generations living in the same household

Sources: U.S. Census Bureau, "Households and Families: 2010," issued April 2012.; Insurance Information Institute.

Change in Life Insurance Applications by Age Group, 2005-2012

Index: 2004 = 100



Since 2007, the only age group buying more individual life insurance is the 60-and-over group. Although this is a growing population segment, can the life insurance industry base its growth on this small segment?

■ Challenges

- ◆ Medical Loss Ratio
- ◆ Coping with a tidal wave of 30+ million new customers
 - Staffing/Training
 - Systems

■ Opportunities

- ◆ A tidal wave of 30+ million new customers

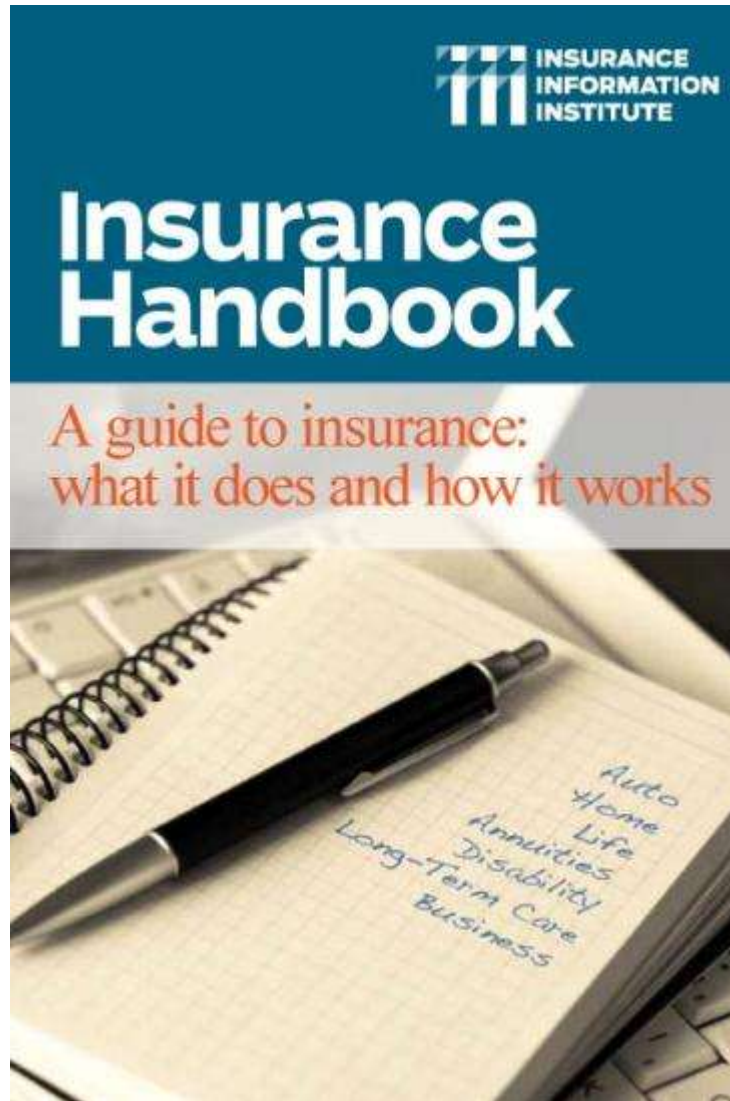
■ Challenges

- ◆ Solvency
 - How to measure each insurer's "enterprise" risk?
 - How much capital is enough for each insurer?
 - How important is it to match international capital and risk-measurement standards?
- ◆ Market Conduct
 - How to regulate social media
 - What is the proper balance between transparency and approval/disapproval?

■ Opportunities

- ◆ Limitless

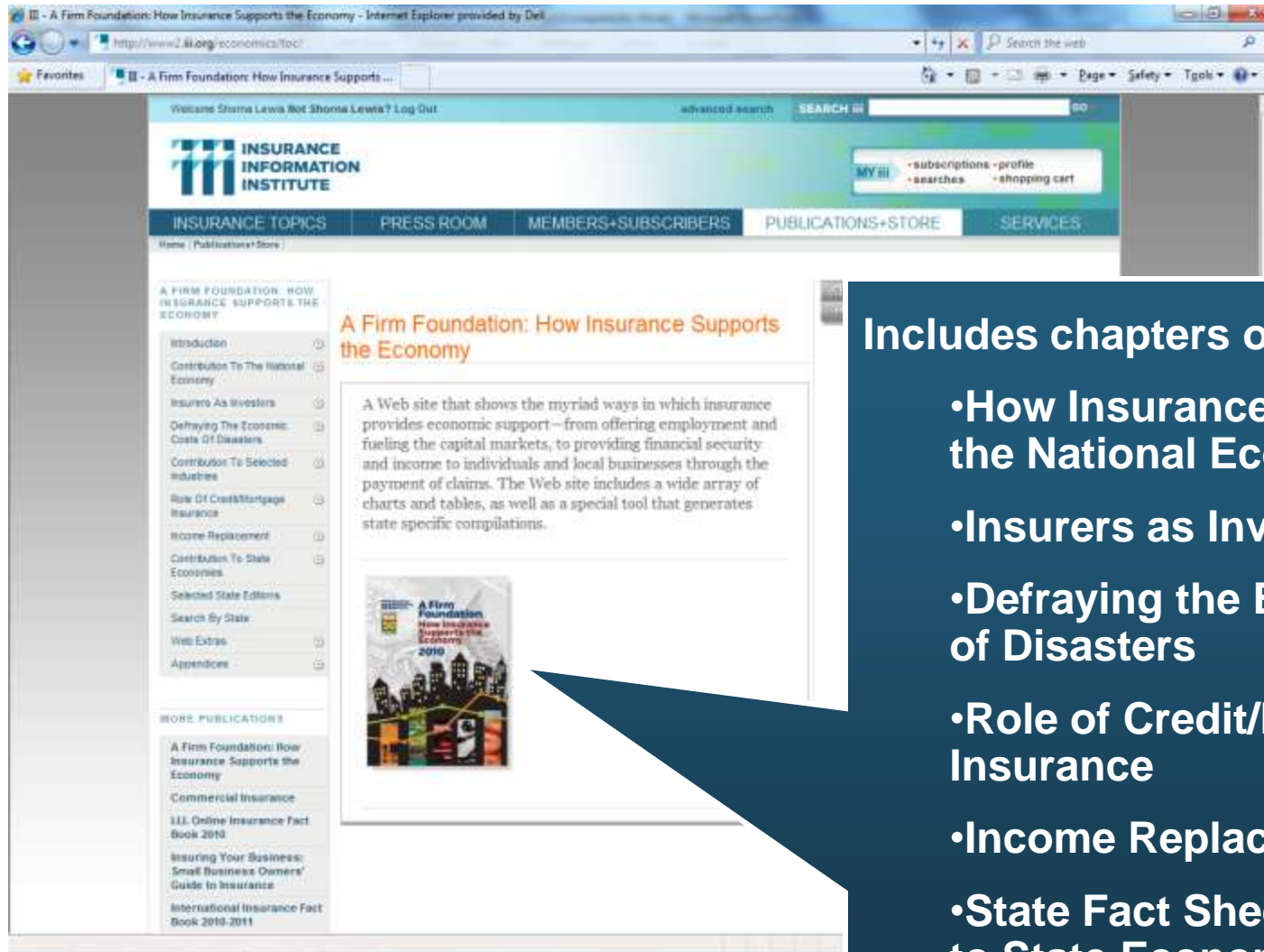
Three Valuable References



The new I.I.I. Insurance Handbook launched in 2010 provides vital information for a wide variety of audiences:

- Public Policymakers
- Reporters
- Regulators
- Students
- Insurance Company Employees
- Academics

A Firm Foundation: How Insurance Supports the Economy



Includes chapters on:

- How Insurance Contributes to the National Economy
- Insurers as Investors
- Defraying the Economic Costs of Disasters
- Role of Credit/Mortgage Insurance
- Income Replacement
- State Fact Sheets/Contribution to State Economies

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