



MegaTrends and MicroTrends: The Past and Future of P/C Insurance

**Midwestern Actuarial Forum
Cincinnati, OH
September 14, 2012**

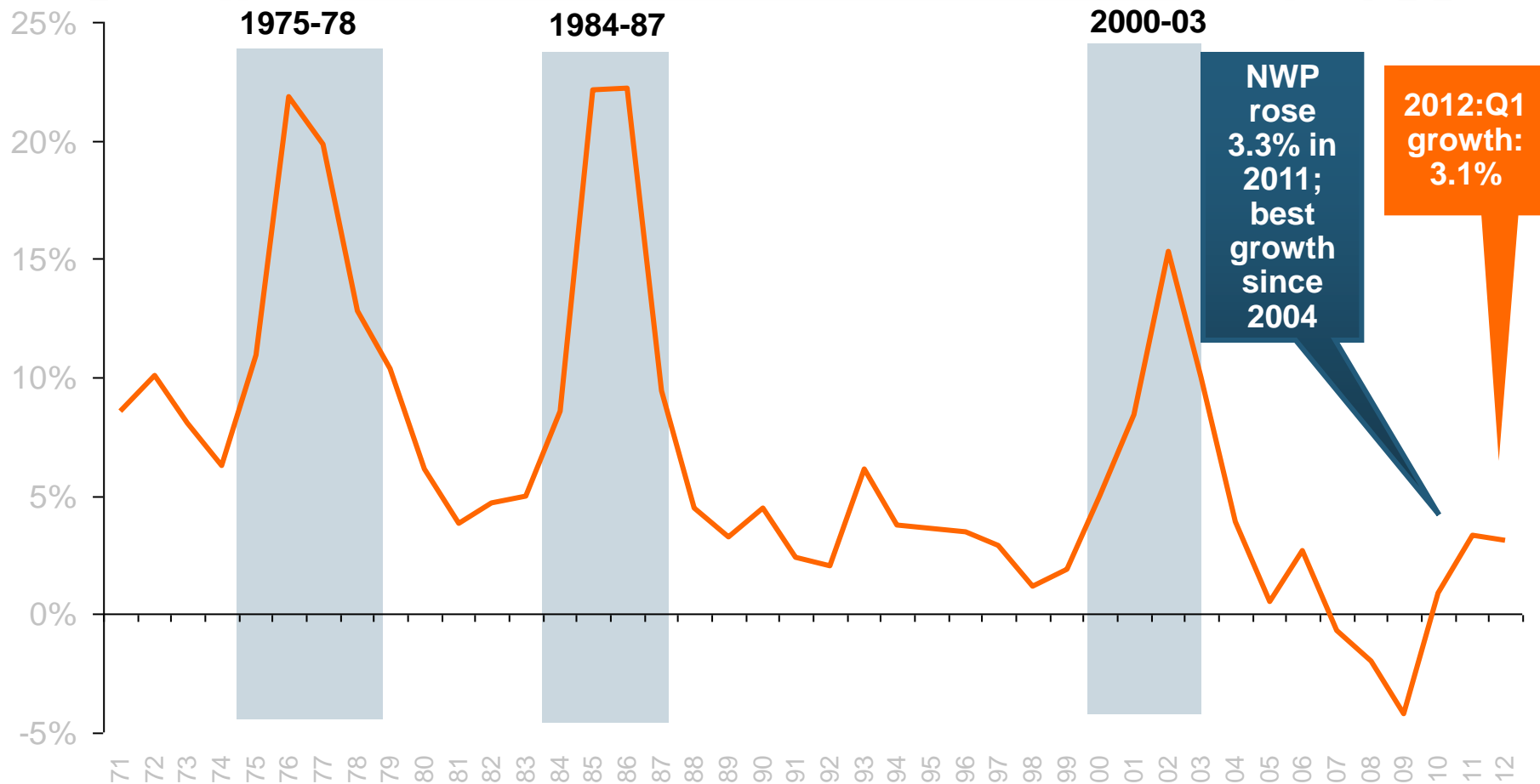
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P/C Insurance Industry Financial Overview

**The Long-Term Past and
Short-Term Future
of the P/C Insurance Industry**

Net Written Premiums: Soft Market Persisted into 2011 but Growth Returned; More in 2012?



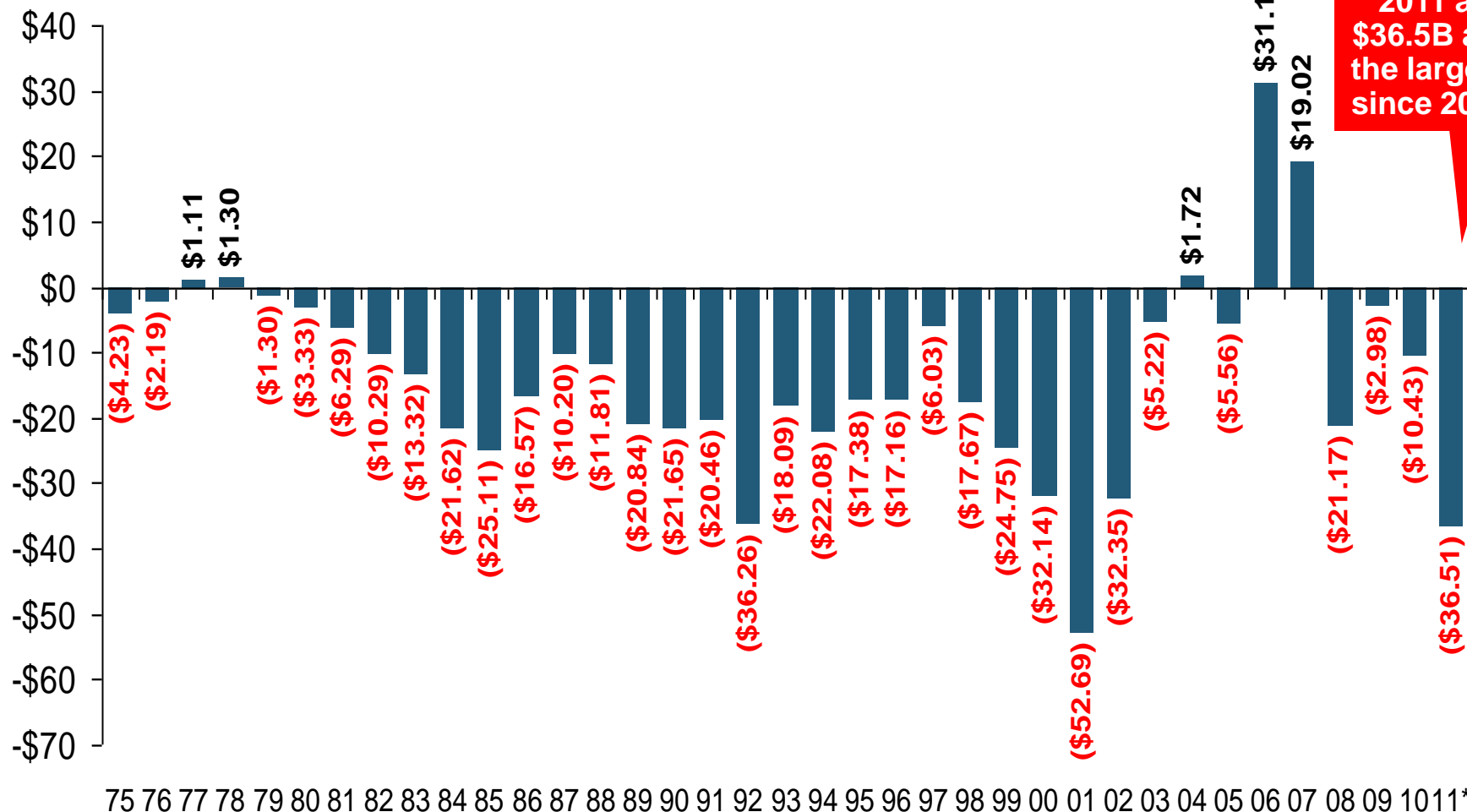
Net Written Premiums fell 0.7% in 2007 (1st year-over-year drop since 1943), fell 2.0% in 2008, and 4.2% in 2009—the first 3-successive-year decline since 1930-33.

Shaded areas denote “hard market” periods

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

Underwriting Gain (Loss) 1975–2011*

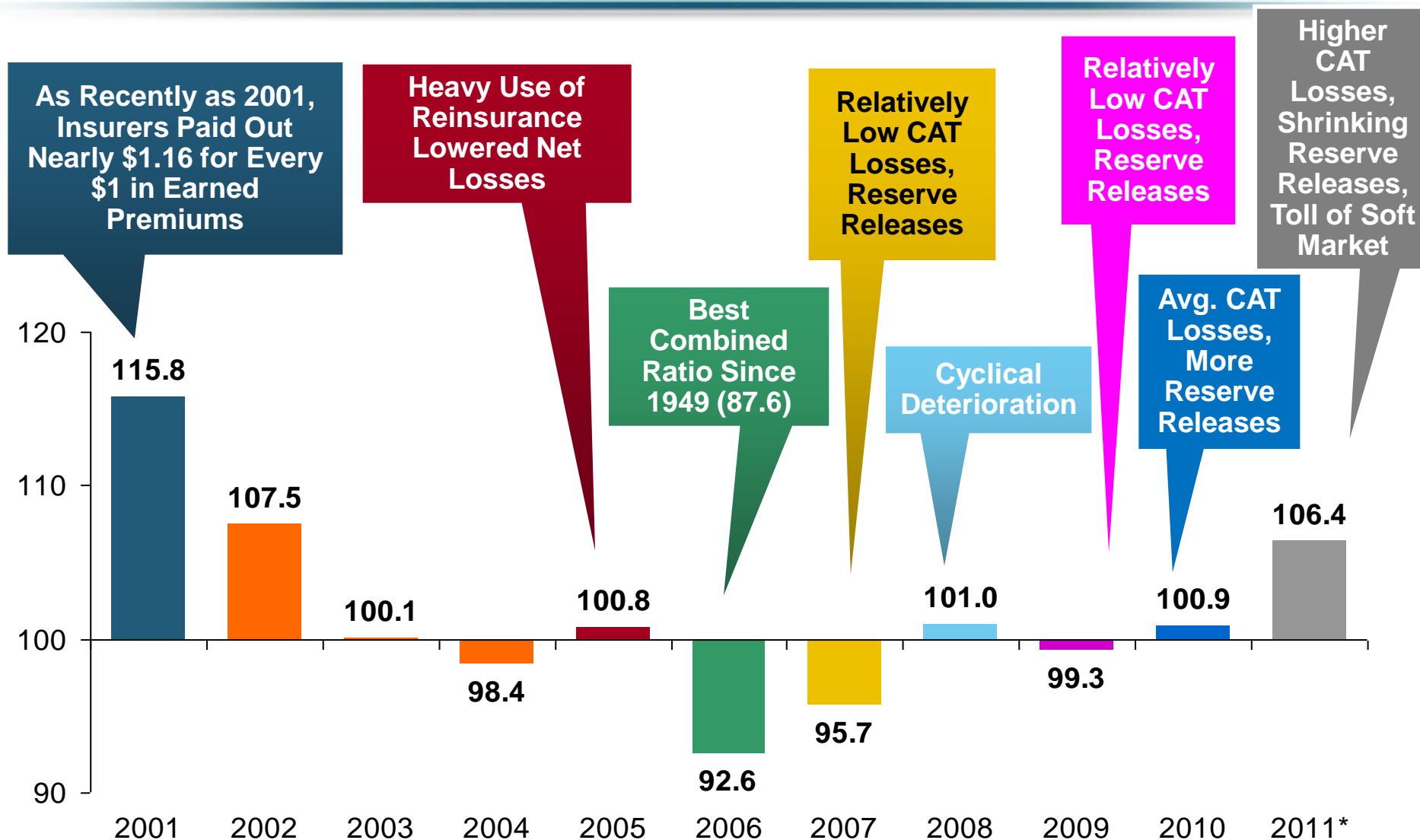
\$ Billions



* Includes mortgage and financial guaranty insurers in all years

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

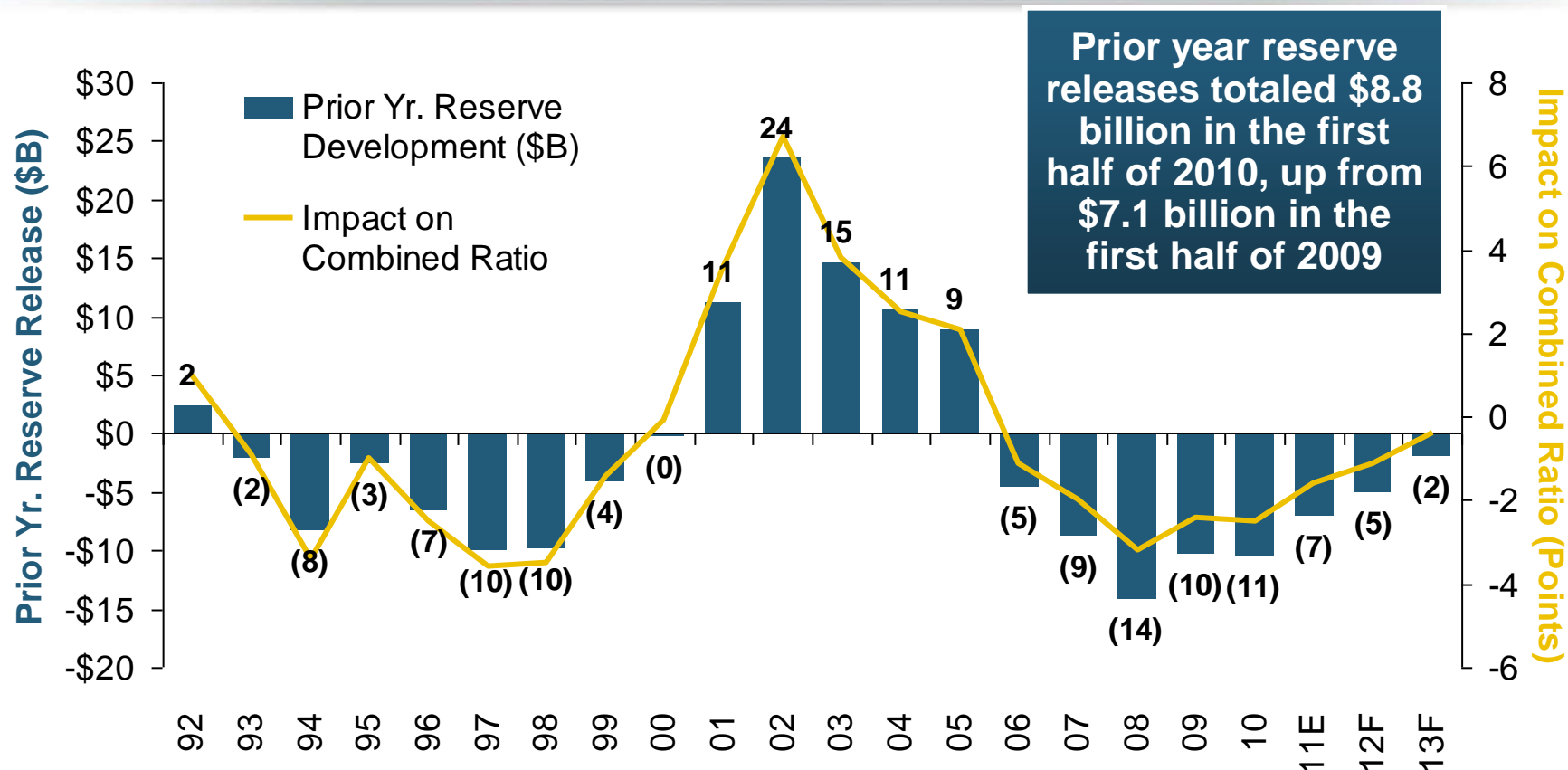
P/C Insurance Industry Combined Ratio, 2001–2011*



* Excludes Mortgage & Financial Guaranty insurers 2008--2011. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=106.4

Sources: A.M. Best, ISO.

P/C Reserve Development, 1992–2013F



Reserve Releases Remained Strong in 2010 But Tapered Off in 2011. Releases Are Expected to Further Diminish in 2012 and 2103

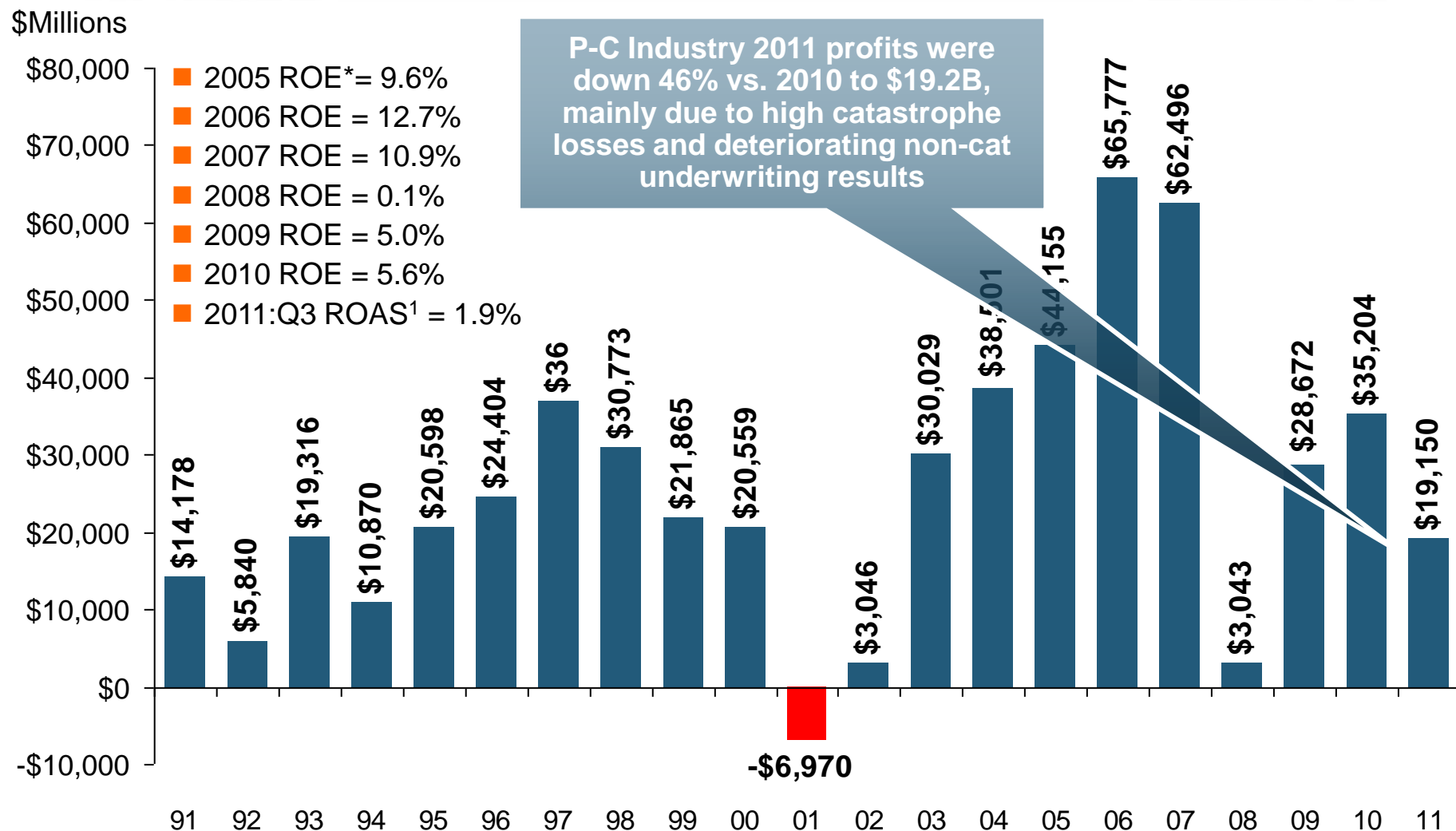
Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage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

Sources: Barclays Capital; A.M. Best.

A “Hard Market” in the Future?

Criteria	Status	Comments
Sustained Period of Large Underwriting Losses	<i>Somewhat in Place</i>	<ul style="list-style-type: none"> • Overall p/c underwriting losses exceeded \$10 billion in 3 of last 4 years • Combined ratios rising, masked by reserve releases (110+ at onset of last hard market)
Material Decline in Surplus/ Capacity	<i>Not Even Close</i>	<ul style="list-style-type: none"> • Surplus hit a record \$565B as of 3/31/11 • Analysts est. excess surplus of \$75-\$100B • Some excess capacity may still remain in reinsurance markets
Tight Reinsurance Market	<i>Somewhat in Place</i>	<ul style="list-style-type: none"> • Higher prices in Asia/Pacific • Modestly improved pricing for US risks
Renewed Underwriting & Pricing Discipline	<i>Not Broadly Evident</i>	<ul style="list-style-type: none"> • Commercial lines pricing trends now modestly rising • Competition remains intense as many seek to maintain market share • Terms & conditions—no broad tightening

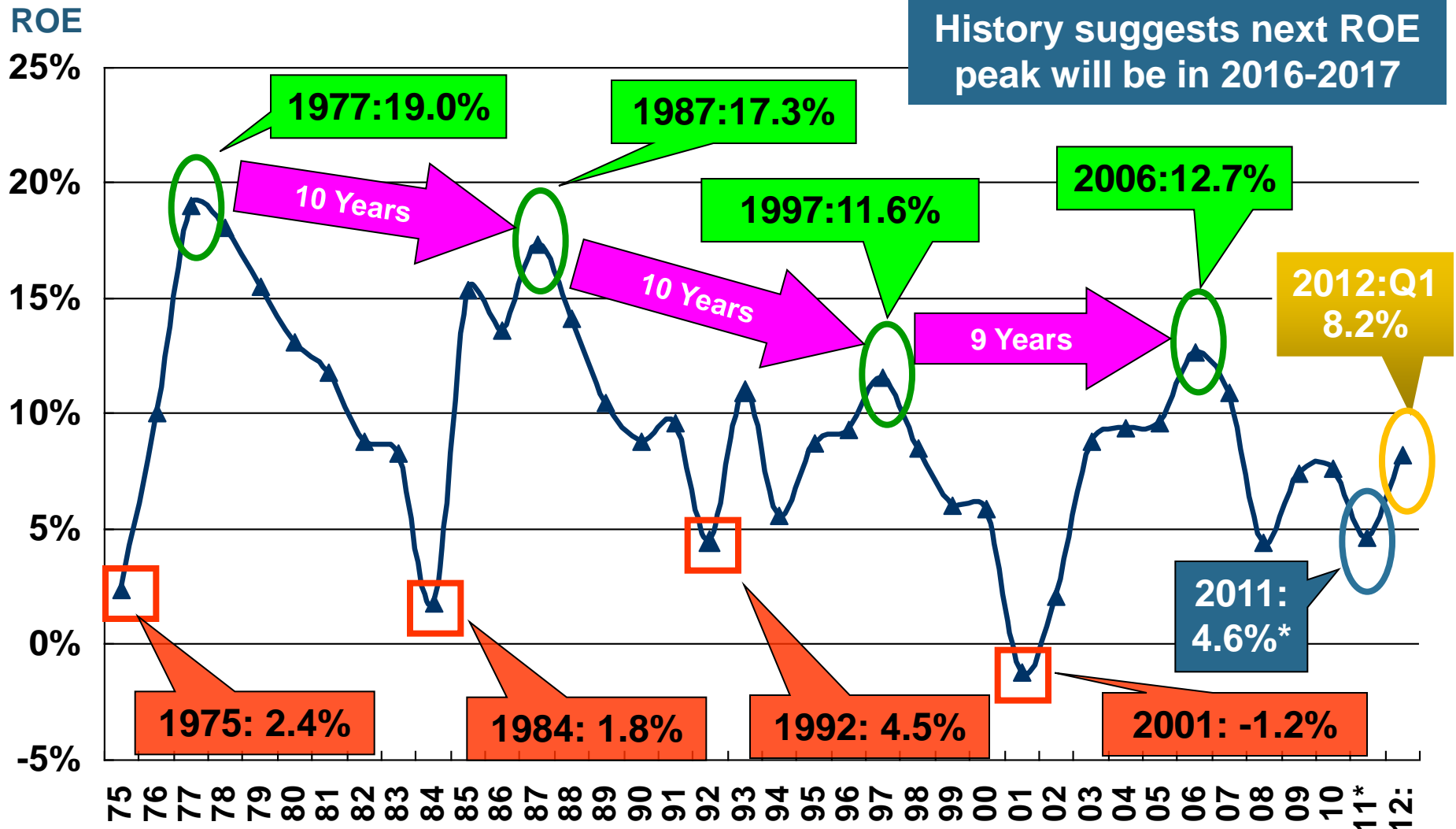
P/C Net Income After Taxes 1991–2011



* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 3.0% ROAS for 2011:Q3, 7.5% for 2010 and 7.4% for 2009.

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

Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2012:Q1*

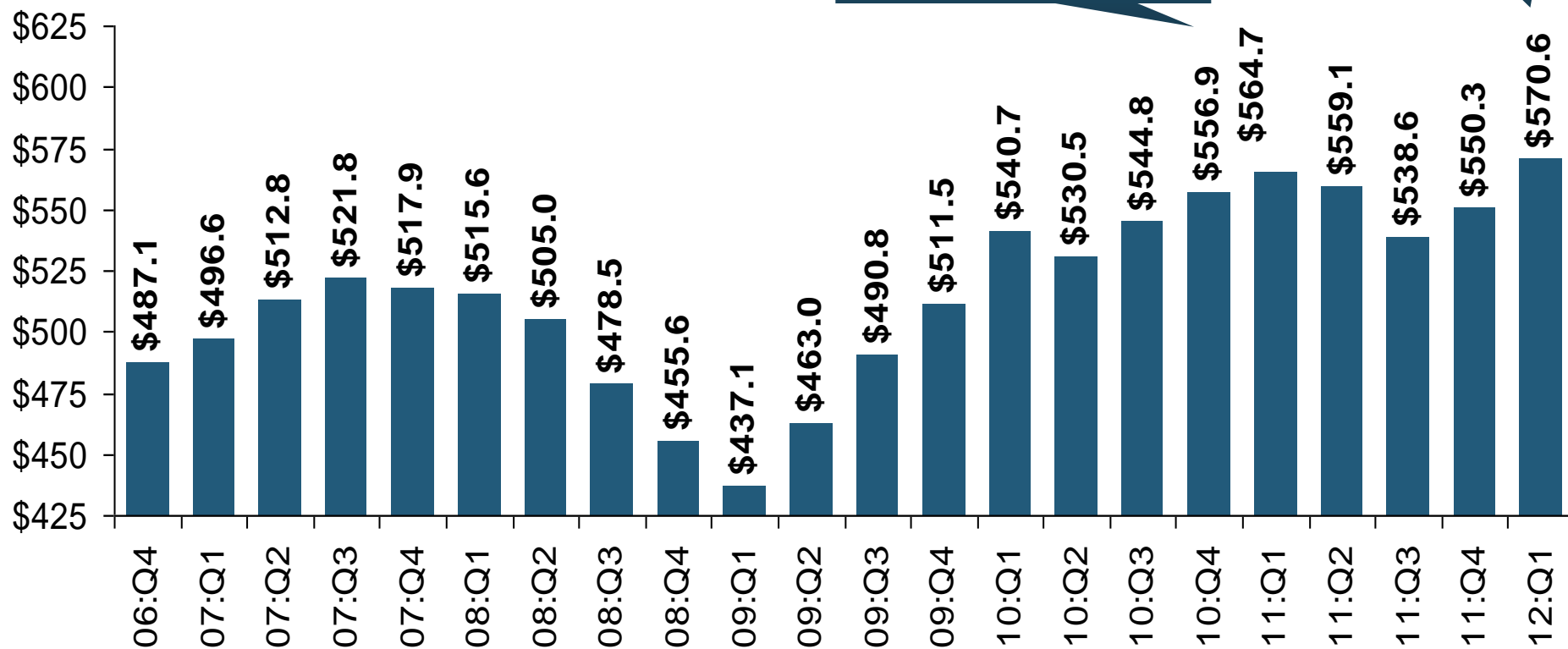


*Profitability = P/C insurer ROEs. 2011 figure is an estimate based on ROAS data. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. 2012:Q1 ROAS = 7.2% including M&FG.

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

Policyholder Surplus, 2006:Q4–2012:Q1

(\$ Billions)



Note: Beginning in 2010:Q1 figures include \$22.5B of paid-in capital from a holding company parent to a subsidiary insurer. It was a single investment in a non-insurance business.

Quarterly Surplus Changes Since 2011:Q1 Peak

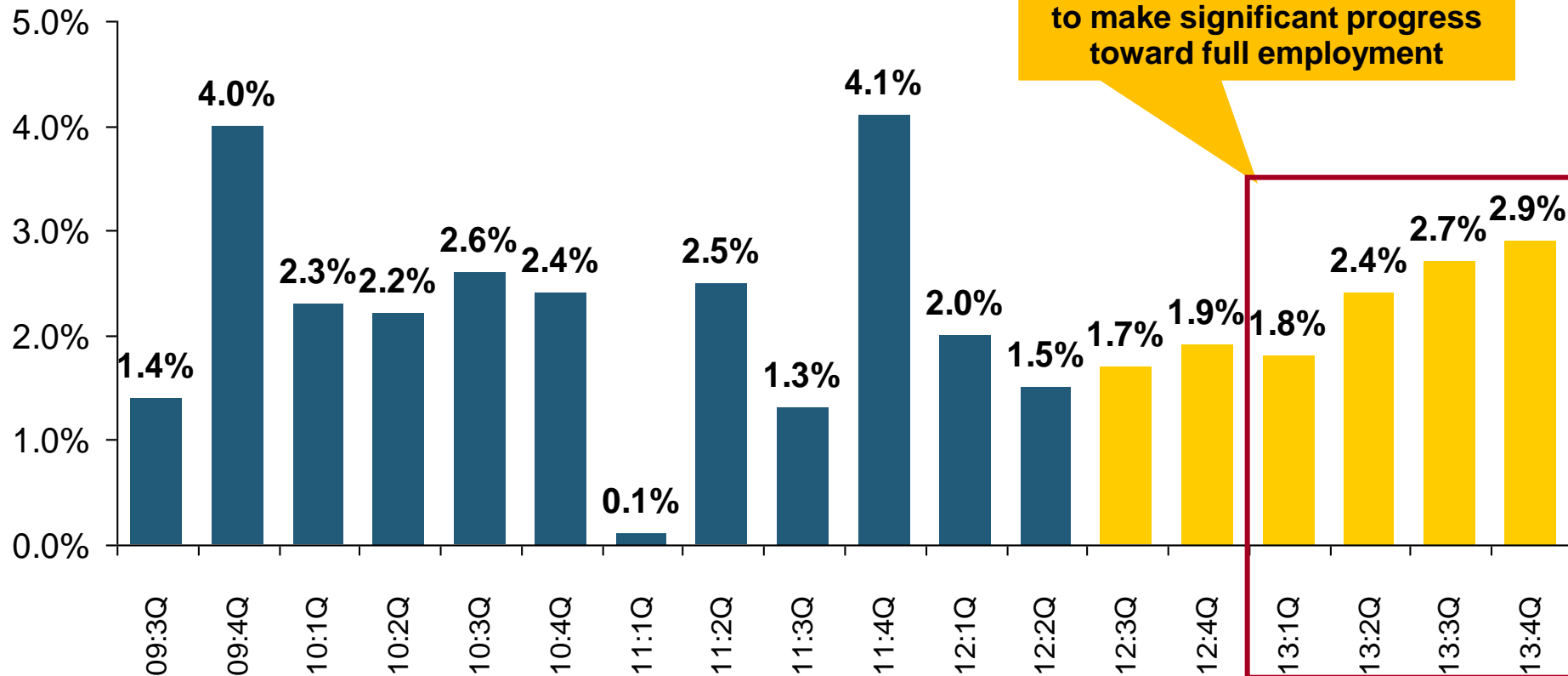
11:Q2: -\$5.6B (-1.0%)
11:Q3: -\$26.1B (-4.6%)
11:Q4: -\$14.4B (-2.6%)

Economic Drivers of P/C Insurance Exposures

**Growth in the Wake
of the “Great Recession”**

The Post-Recession US Economy is Forecast to Keep Growing*, but Slowly

Real GDP Growth at Annual Rate(%)



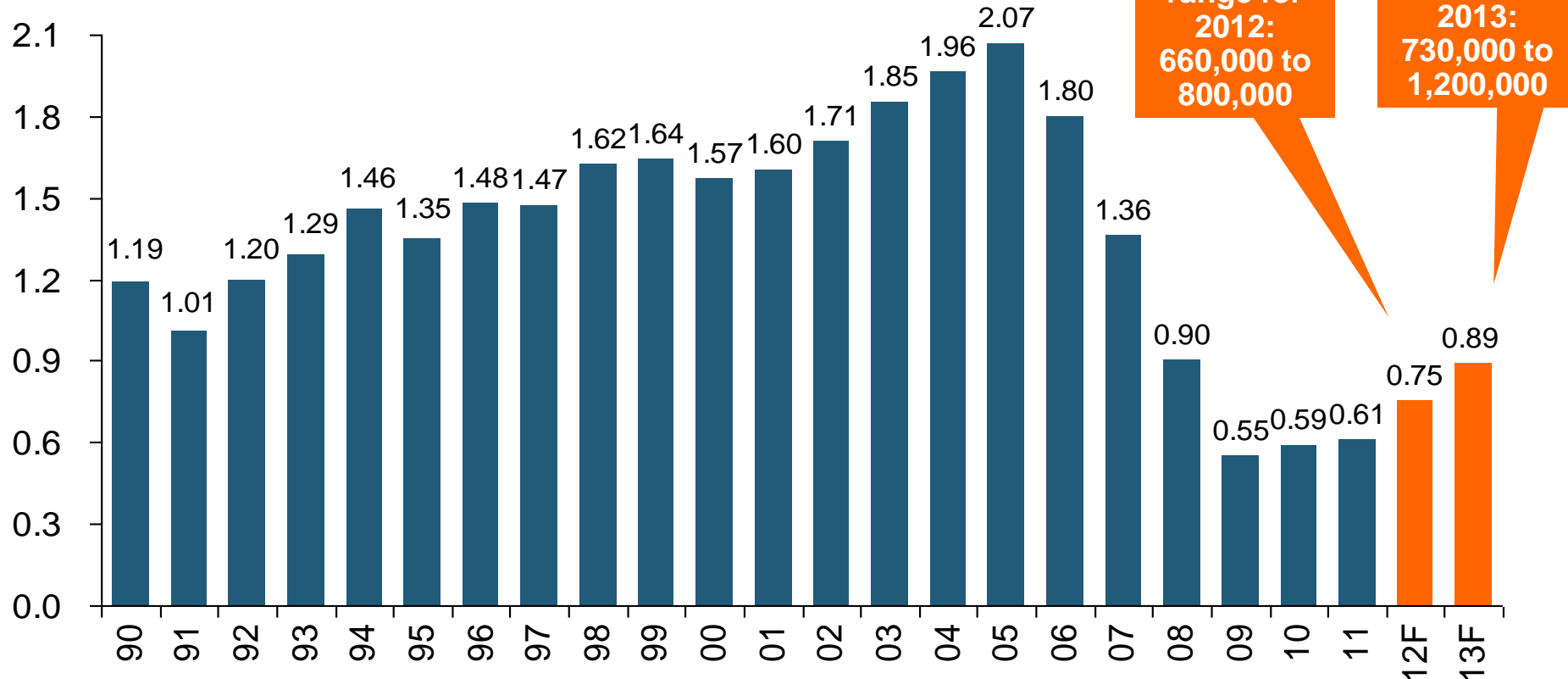
Some economists worry that as of Jan 1, 2013, planned federal spending cuts, the expiration of income tax rate reductions, and the end of some unemployment benefits will sap growth and could trigger another recession in 2013.

* Forecasts from Blue Chip Economic Indicators

Sources: US Department of Commerce, <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm> ; Blue Chip Economic Indicators 8/2012 issue (forecasts); Insurance Information Institute.

Construction of Private Housing Is Picking Up

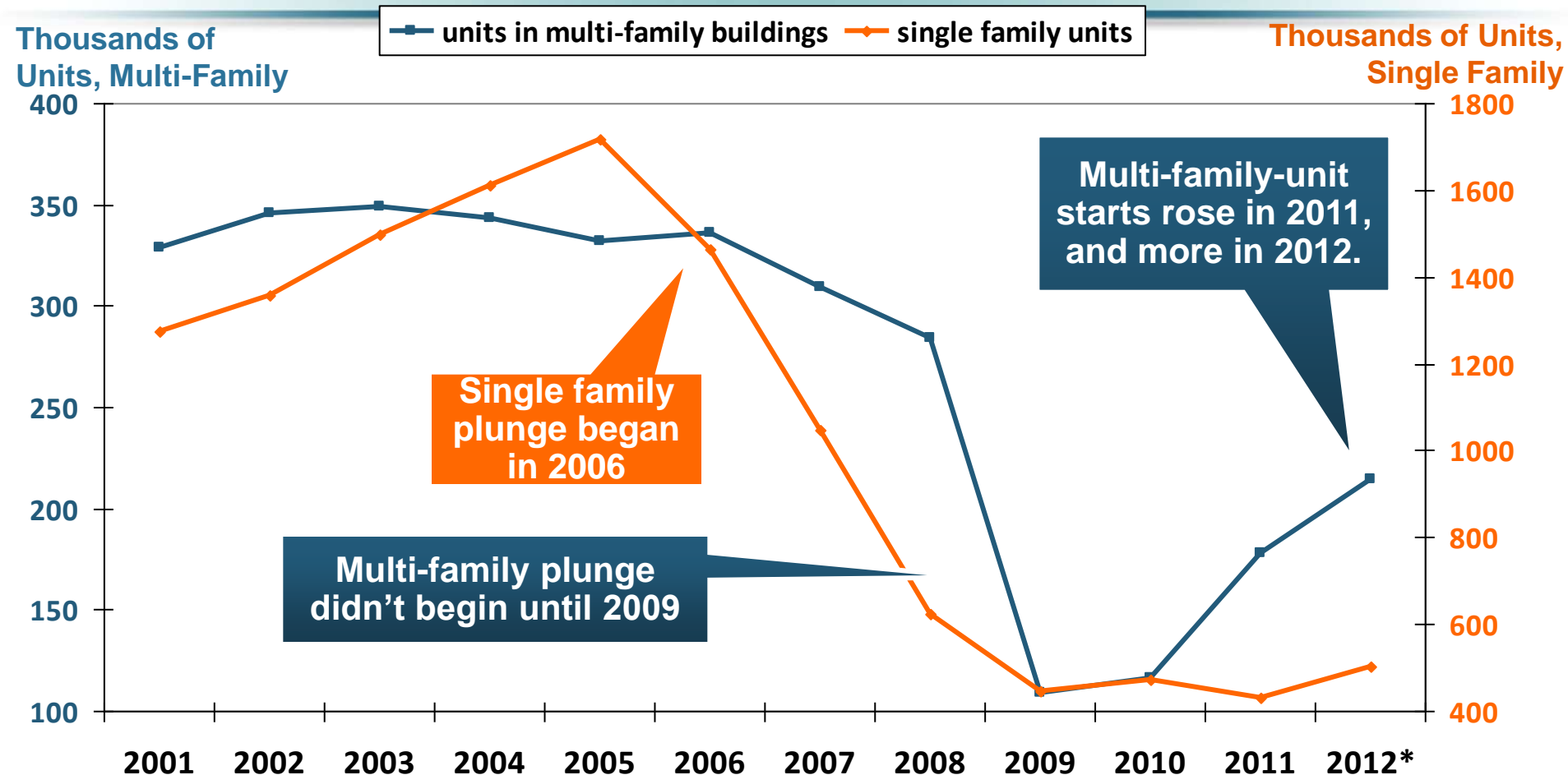
Housing Starts,
Millions of Units



Weak home construction forecast implies little exposure growth likely for Homeowners insurers and insurers with a residential construction book of business for the next few years.

Sources: U.S. Census Bureau and Department of Housing and Urban Development (history) at <http://www.census.gov/const/newresconst.pdf> ; Blue Chip Economic Indicators (8/2012), forecasts; Insurance Information Institute.

But the Pickup is Mostly in Multi-Family Housing Starts



Multi-unit starts, currently at a seasonally-adjusted annual rate of 215,000, are double the 2009 rate. Average annual rate for 2001-2006: 339,000.

*January-July 2012 data, annualized, seasonally-adjusted, preliminary (July)

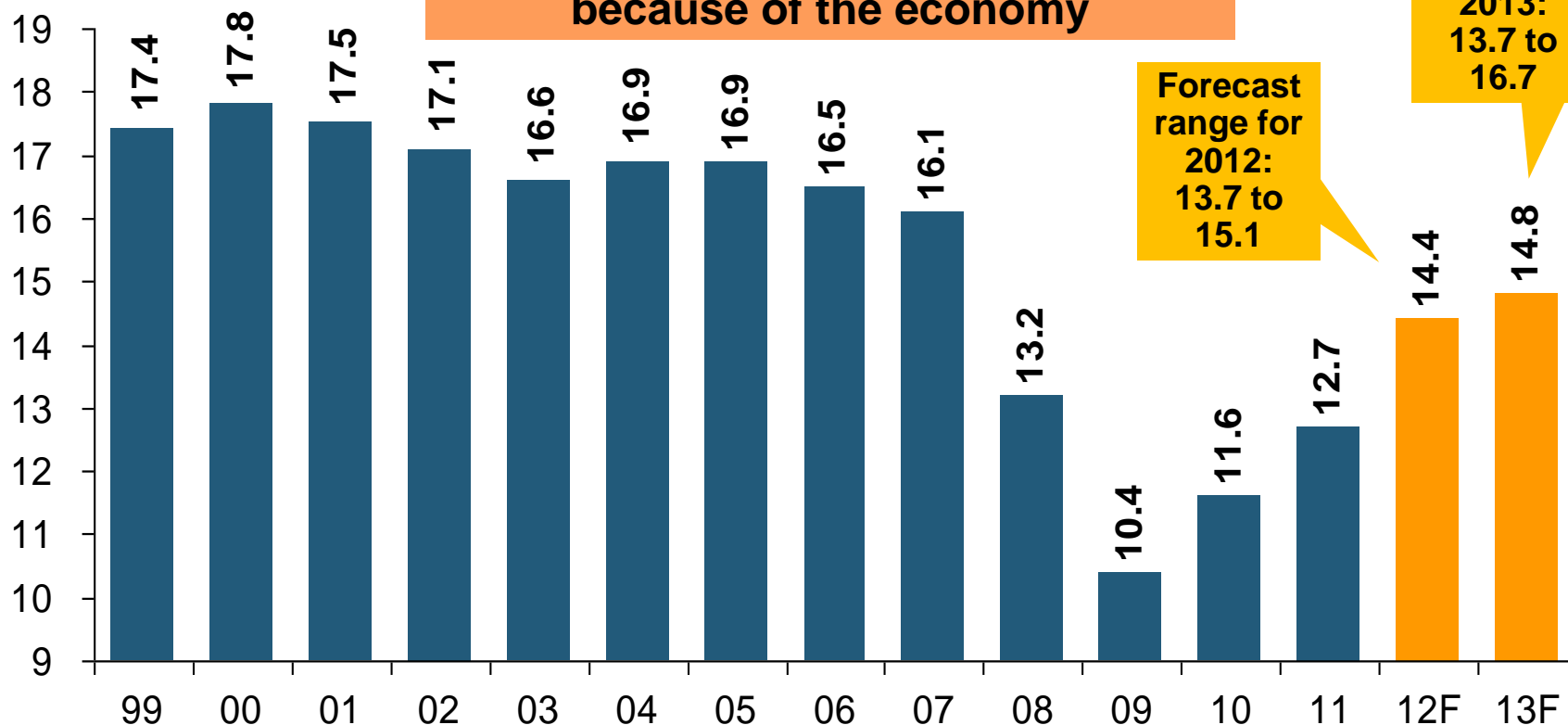
Source: US Census Bureau at <http://www.census.gov/construction/nrc/pdf/newresconst.pdf>

The Auto Insurance Picture

**A “New Normal”:
More Old Cars on the Road**

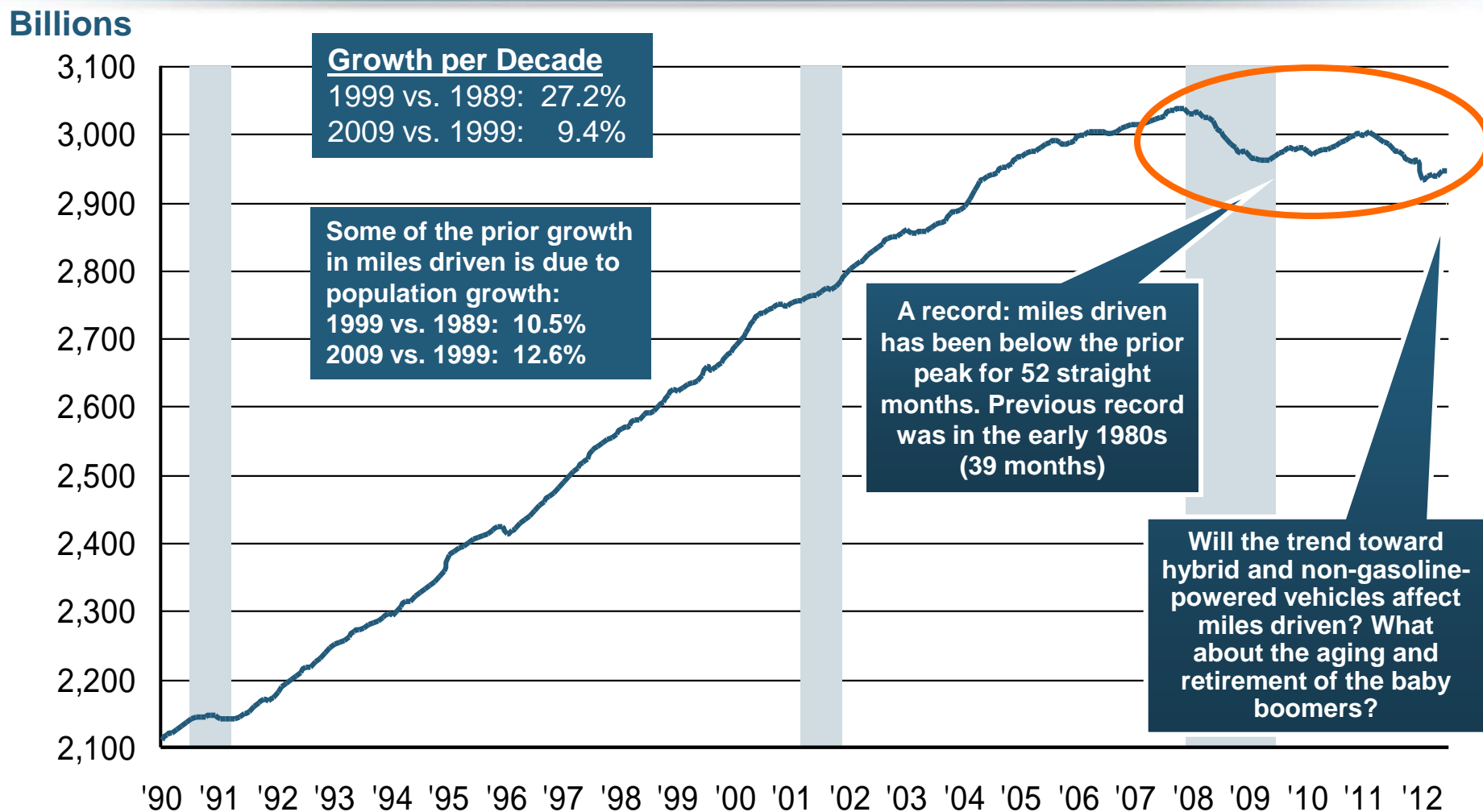
The Car-Buying Slump Is Creating Pressure to Replace Aging Vehicles

(Millions
of Units)



Many more older cars are on the road today than in “normal” times. Previously in a 3-year span, new cars would replace about 35 million old cars, but in 2008-10 only about 27 million old cars were replaced.

But People Are Not Driving More: Miles Driven*, 1990–2012



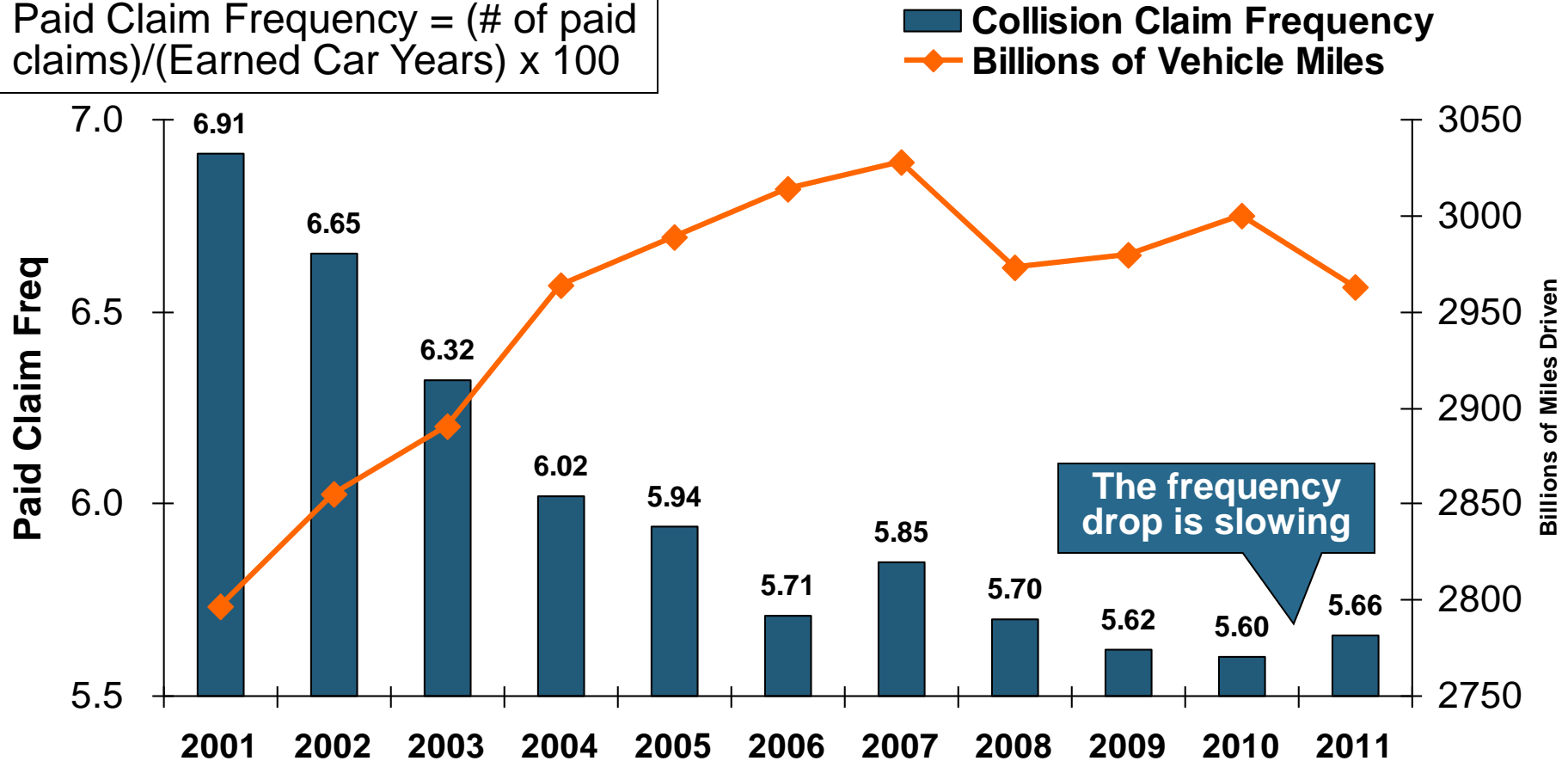
*Moving 12-month total. The latest data is for June 2012.

Note: Recessions indicated by gray shaded columns..

Sources: Federal Highway Administration (<http://www.fhwa.dot.gov/ohim/tvtw/tvtpage.cfm>);
National Bureau of Economic Research (recession dates); Insurance Information Institute.

Do Changes in Miles Driven Affect Auto Collision Claim Frequency?

Paid Claim Frequency = (# of paid claims)/(Earned Car Years) x 100



“Pay-As-You-Go” Auto Insurance: Fluctuations in miles driven will affect exposure

Sources: Federal Highway Administration (<http://www.fhwa.dot.gov/ohim/tvtw/tvtpage.cfm>); ISO Fast Track Monitoring System, *Private Passenger Automobile Fast Track Data*: 4th Qtr. 2011, published April 5, 2012, and earlier reports.

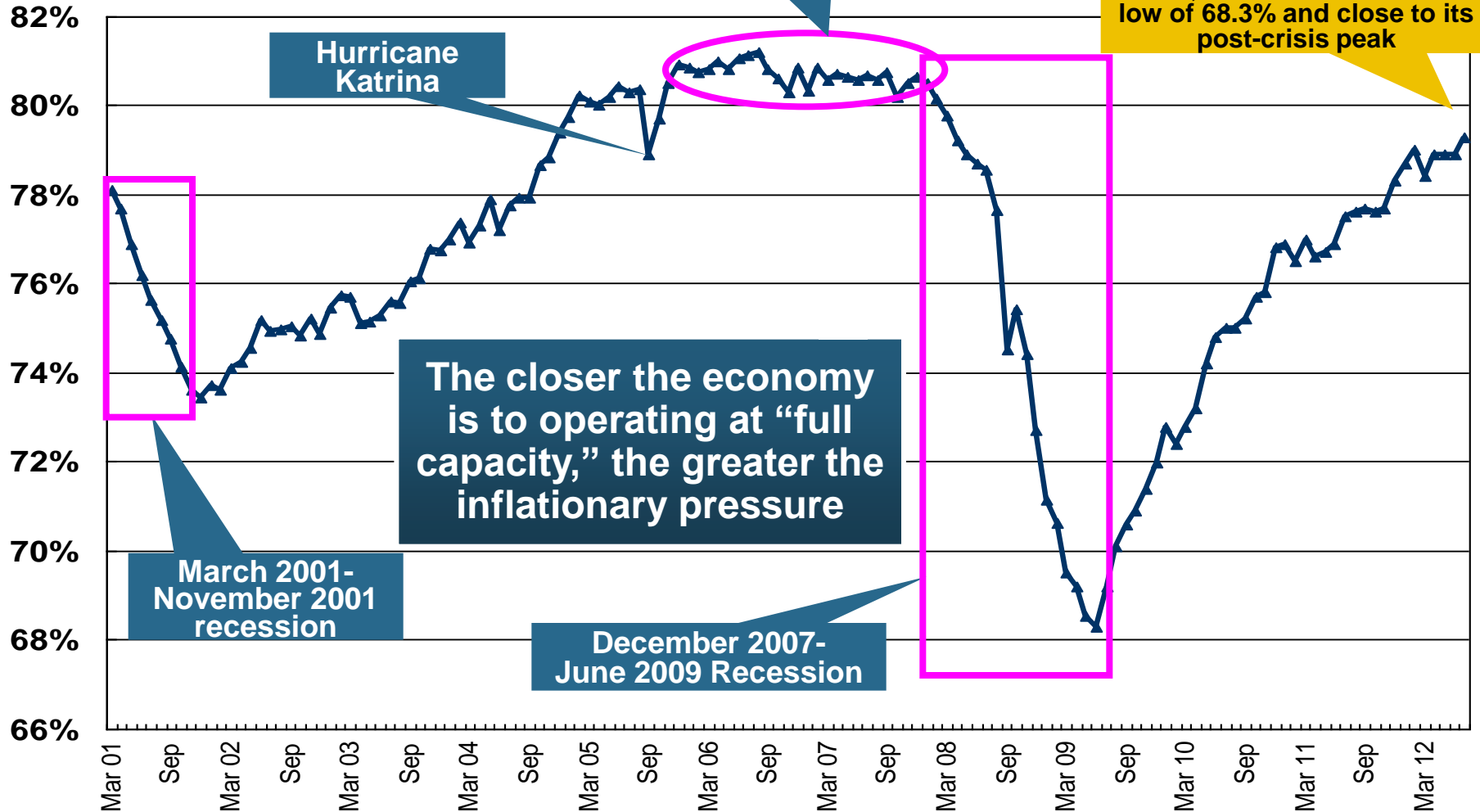
The Commercial Insurance Picture

**The Near-Term Outlook
for Small Business
is Getting Better but isn't Bright**

Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

March 2001 through July 2012

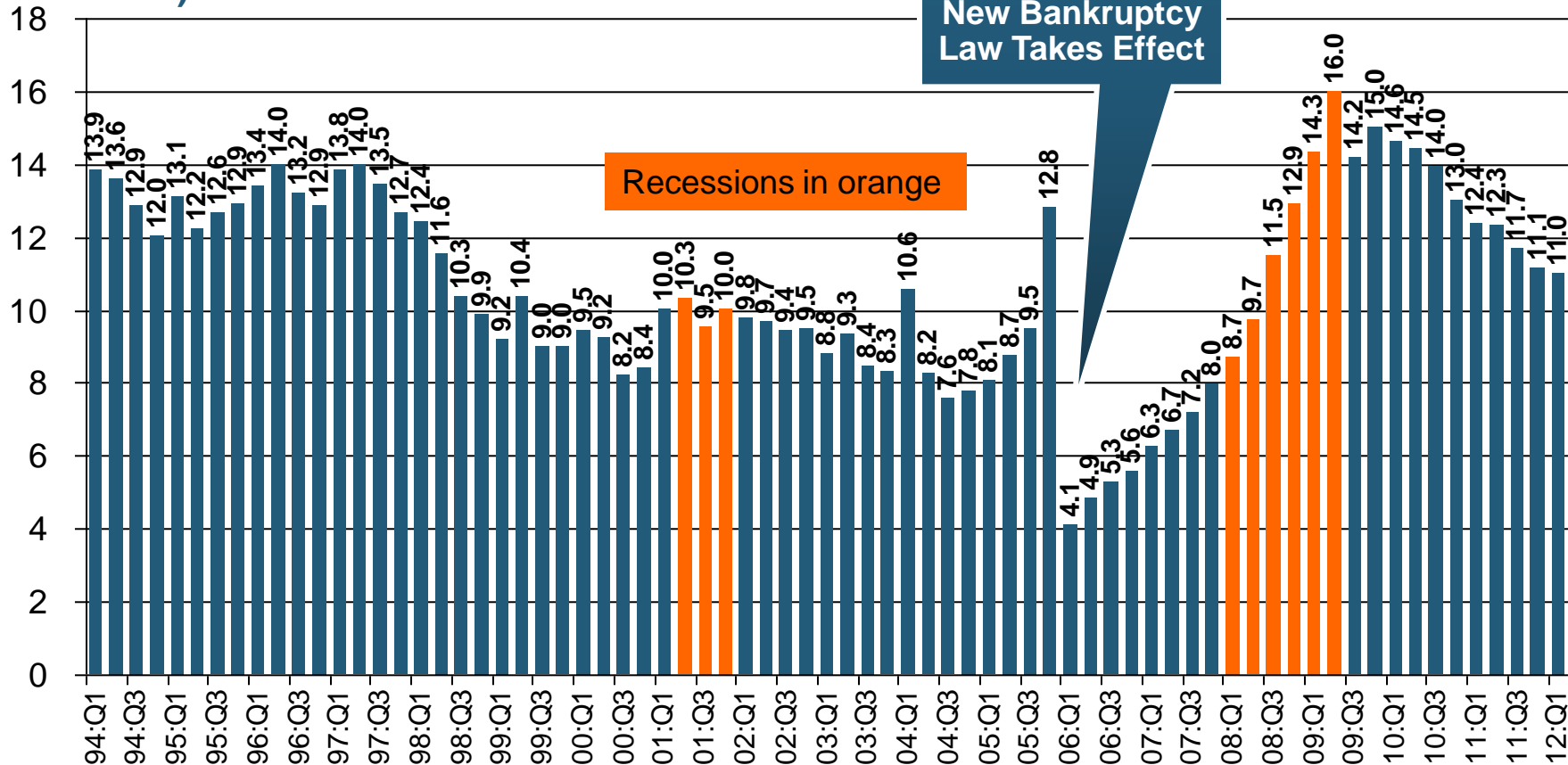
Percent of
Industrial Capacity



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

Business Bankruptcy Filings: Falling but Still High in 2012 (1994:Q1 – 2012:Q1)

(Thousands)



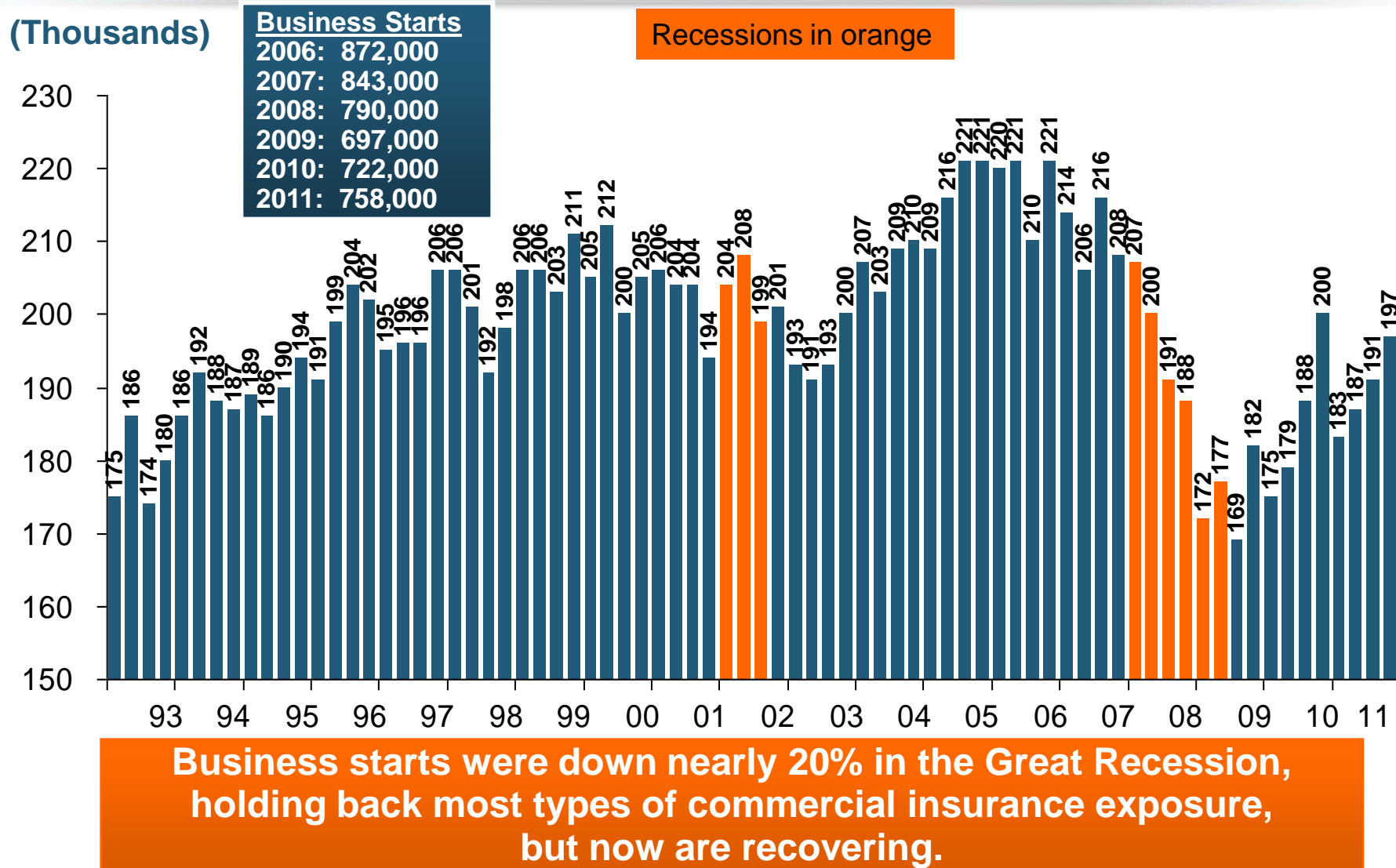
Business bankruptcies were down 46.5% in 2012:Q1 vs. recent peak in 2009:Q2 but were still higher than 2008:Q2, early in the Great Recession. Bankruptcies restrict exposure growth in all commercial lines.

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 – 2011:Q4*



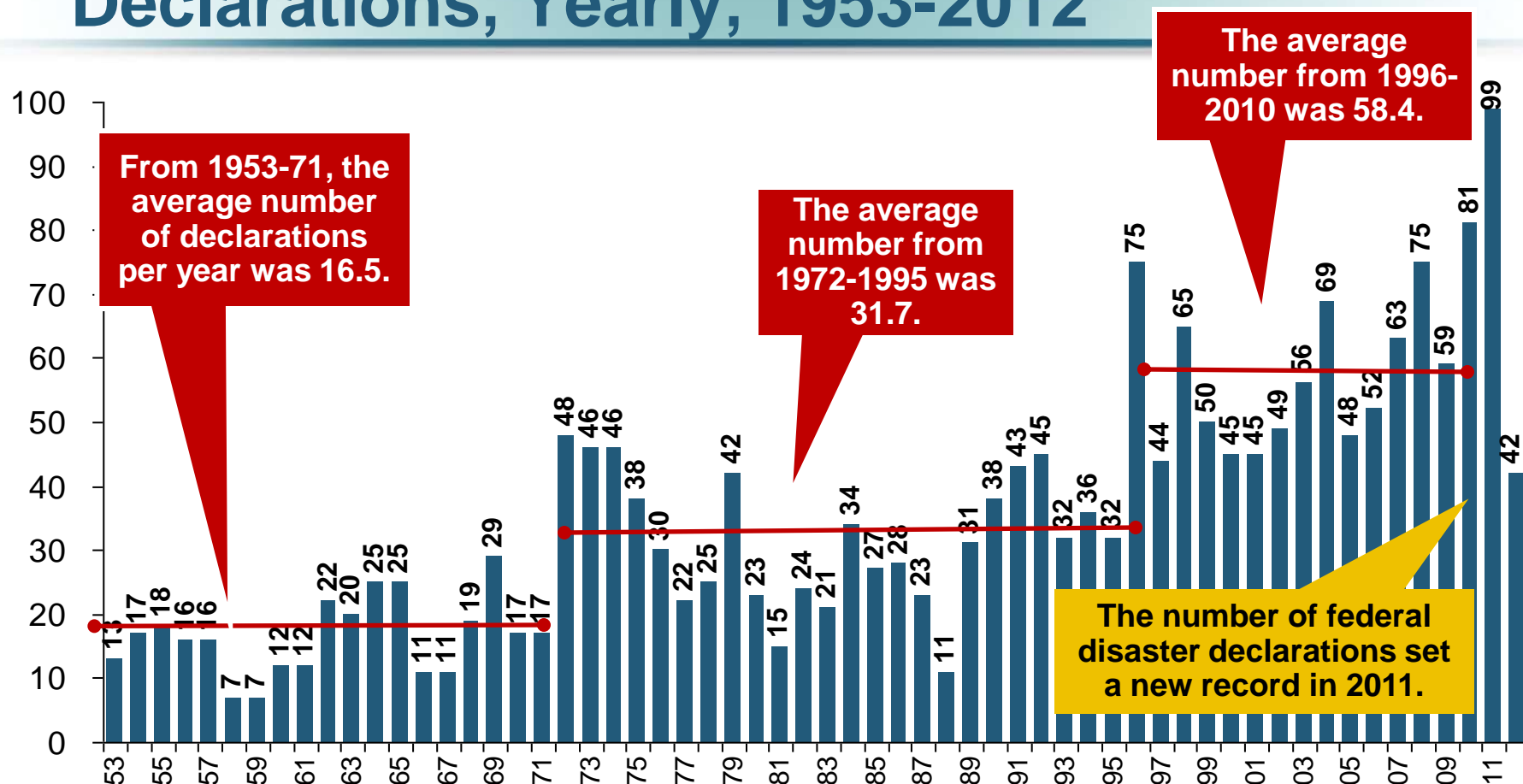
* Data through Dec 31, 2011 are the latest available as of August 2, 2012; Seasonally adjusted.

Sources: Bureau of Labor Statistics, <http://www.bls.gov/news.release/cewbd.t08.htm>. NBER (recession dates)

Catastrophe Loss Developments and Trends

**2011 Rewrote Catastrophe Loss
and Insurance History**

Number of Federal Major Disaster Declarations, Yearly, 1953-2012*

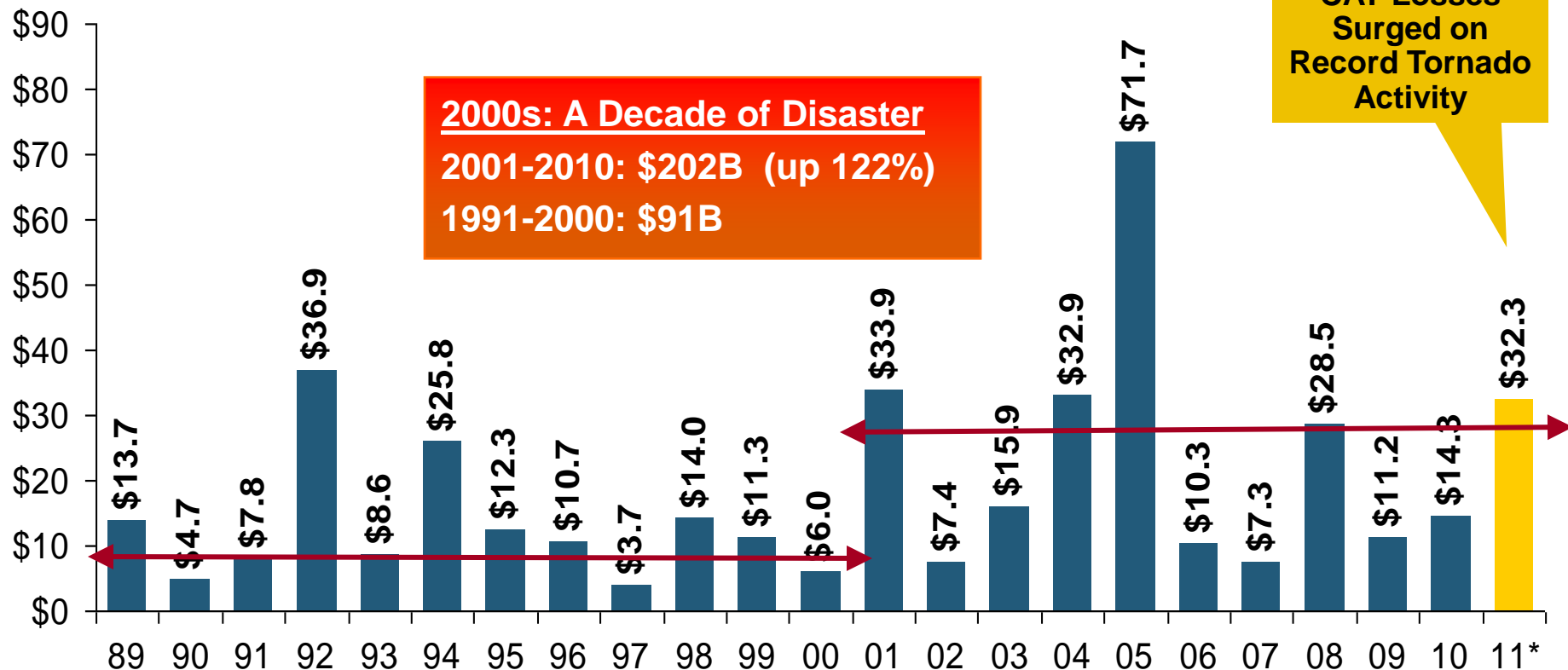


Of the 42 federal major disaster declarations in 2012 so far, 23 were for wildfires, 16 were windstorms, 2 winter storms, 1 tropical storm.

*Through July 27, 2012. Sources: Federal Emergency Management Administration at http://www.fema.gov/disasters?field_state_tid=All&field_disaster_type_term_tid=All&field_disaster_declaration_type_value=All&items_per_page=60&=GO; Insurance Information Institute.

US Insured Catastrophe Losses, Yearly, 1989-2011*

\$ Billions of 2011 dollars



**US insured CAT losses do not include amounts paid
by the National Flood Insurance Program.**

*ISO estimate.

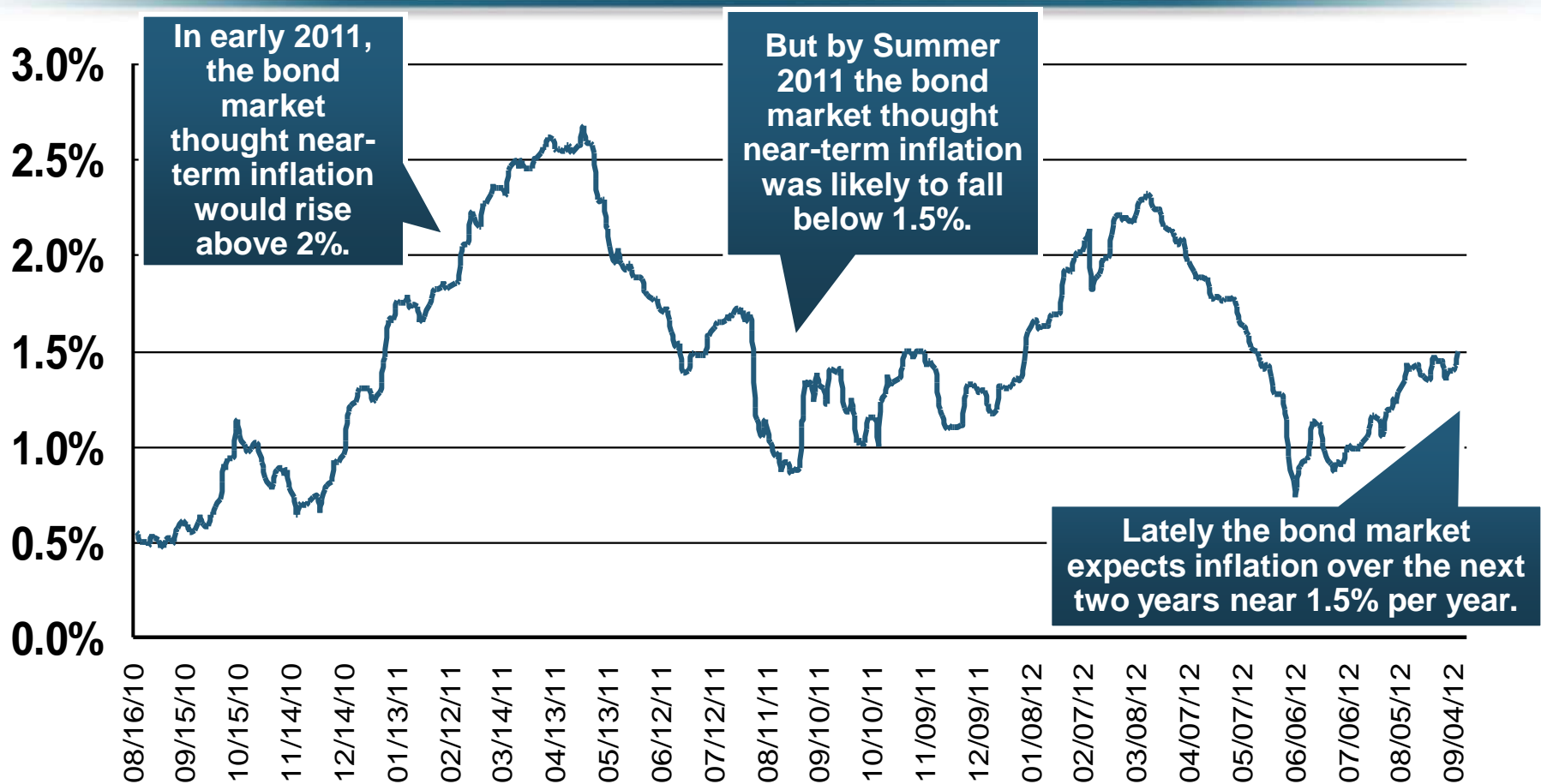
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01 (\$25.9B 2011 dollars). Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B (\$15.6B in 2011 dollars.)

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

Inflation & Price Drivers of P/C Insurance Claims

**P-C Claim Severity Generally
Has Risen Faster than the CPI**

The Bond Market's Recent* Expectation of U.S. Inflation in the Next Two Years

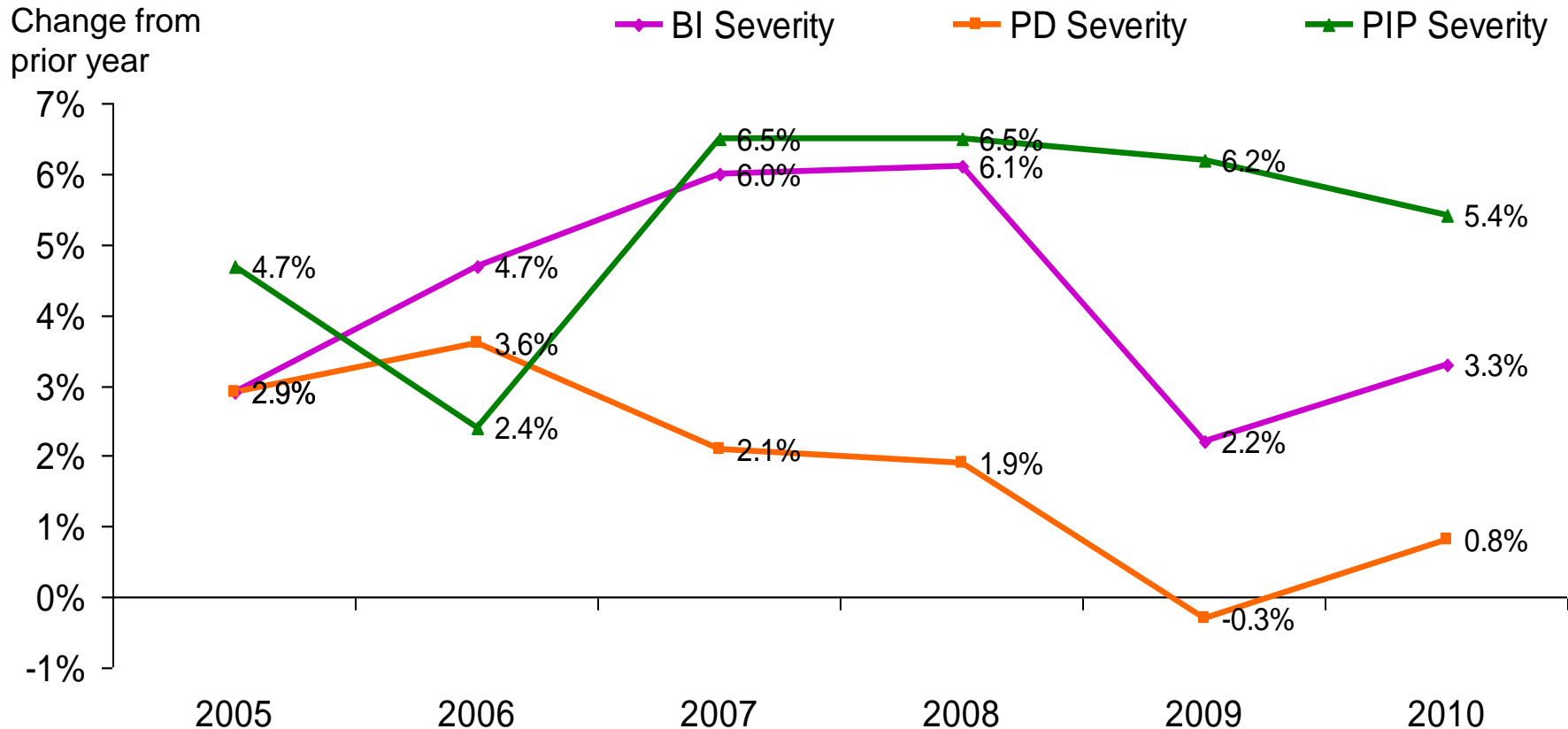


**The rate is calculated by subtracting the real yield of the 2-year TIPS bond from the yield of the 2-year Treasury note.
The result is the implied inflation rate for the next 2 years.**

*Daily, from 8/17/2010 through 9/6/2012

Source: <http://www.bloomberg.com/apps/quote?ticker=USGGBE02:IND>

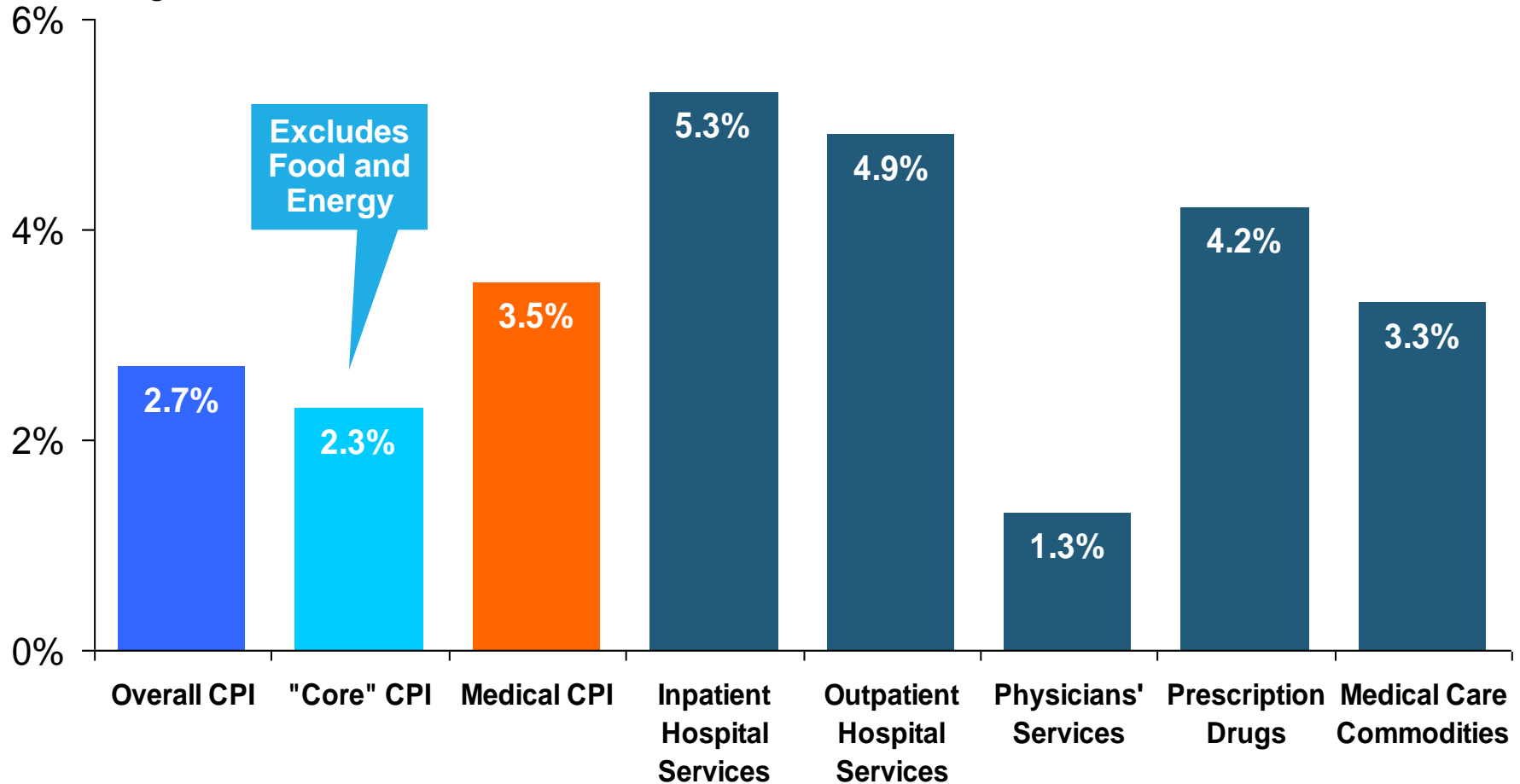
Auto Liability Claims Severity Trends, 2005-2010



The average severity of auto property damage liability claims has grown slightly more slowly than overall inflation. Beginning in 2006, average severity for BI and PIP grew much faster.

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

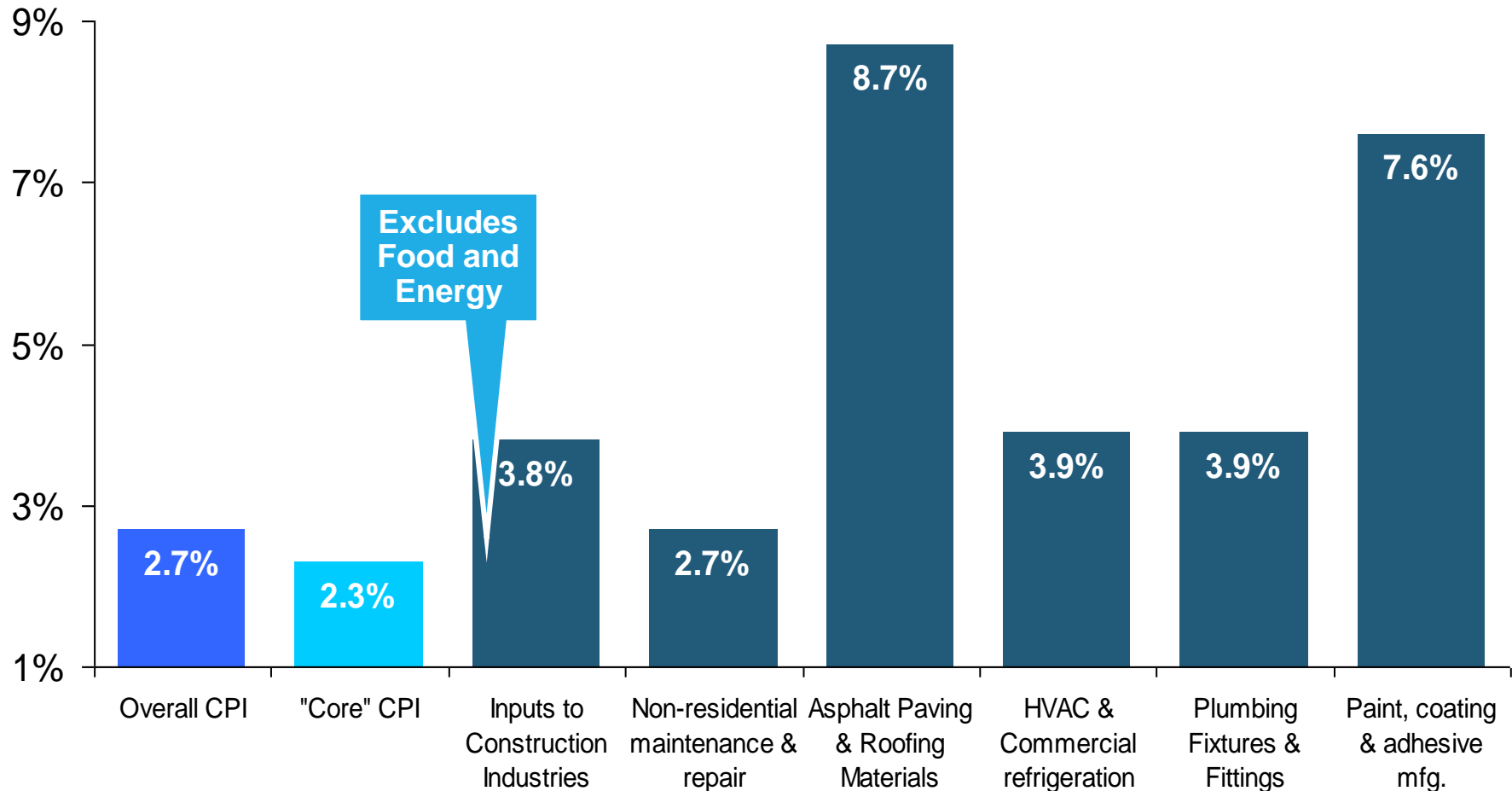
Mar 2012 Y-o-Y
Price Changes



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

P/C Commercial Property Insurance Claim Cost Drivers Grow Faster than the Overall CPI Suggests

Price Level Change: 2011 vs. 2010



Copper prices spiked and retreated in 2011. In July its price was 33% higher than a year earlier; by November it cost 8% less than in November 2010.

What's a “MegaTrend?” What's a “MicroTrend?”

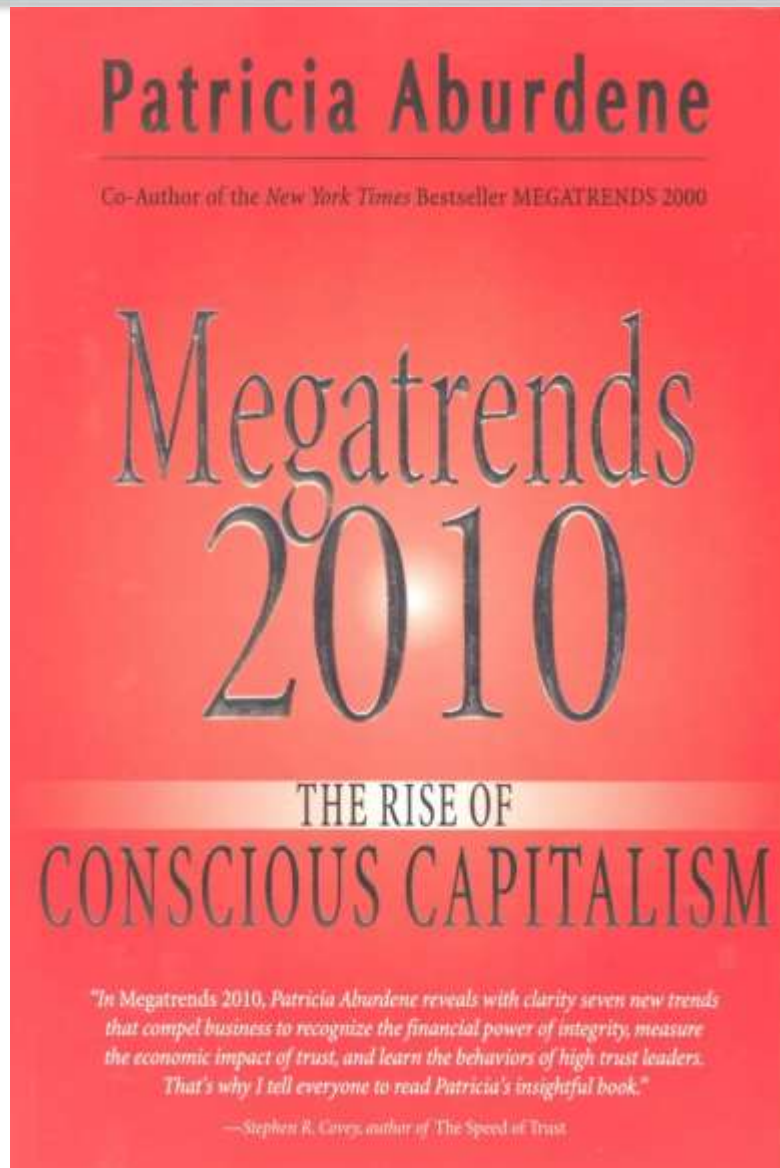
**Looking beyond day-to-day
developments**

***What are the implications for
Insurance and Risk Management?***

A MegaTrend is...

- Something...
- Generally changing the way things get done
- Happening on an enormous scale
- Growing rapidly

Books and Websites Proclaim Various MegaTrends



3 MegaTrends to Watch

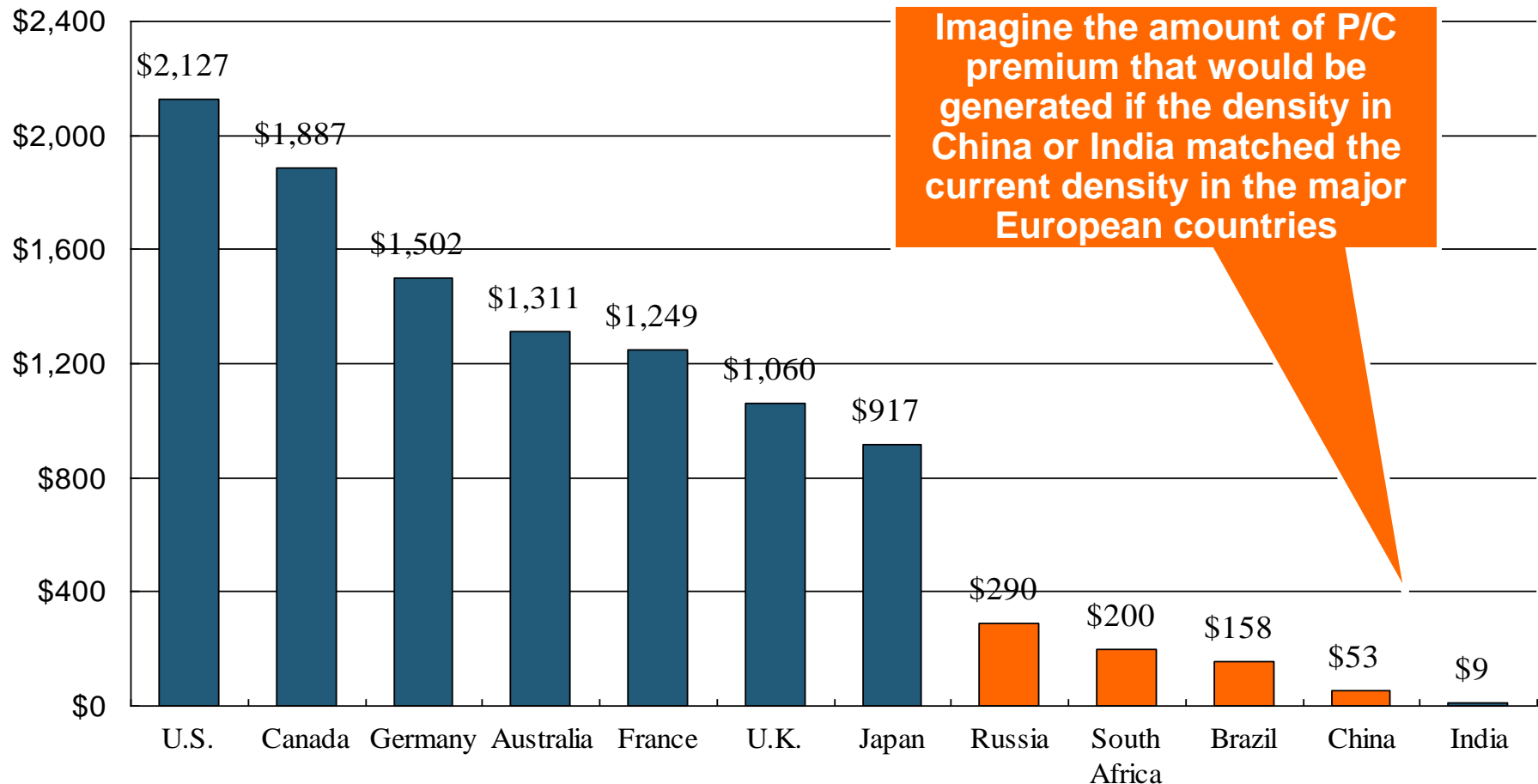
**There are many proclaimed MegaTrends.
These three come from Forbes.com**

<http://www.forbes.com/sites/haydnshaughnessy/2011/12/28/3-megatrends-for-2012-or-why-shared-value-is-indeed-an-answer/>

1. The Global Growth and Transformation of the Middle Class

- A huge market for personal insurance (possibly 1 billion people) is emerging in developing countries
- At the same time, the middle class in “advanced economies” is shrinking
- Selling insurance to the new global middle class will require teaching whole populations
 - what insurance is,
 - how it works, and
 - why one would choose one “brand” over another

Non-life Premium* per capita (Density) for Selected Economies, 2010



From 2002-2010, Insurance Density in India tripled, and in China it grew 5-fold. But the most spectacular Density growth in these years belongs to Russia: in 2010 Insurance Density in Russia was 7 times what it was in 2002!

2. The Growth of a More Individualistic Capitalism

Mass marketing is giving way to...

- Online services—retailers and special-interest community/peer sites—are giving customers/users more control, making the shopping/info-gathering experience more personalized
- The younger generations are leading the way to managing their lives as unique individuals, sharing with friends/peers but not strangers
- Implications for P/C insurance
 - Follow the microtrends?

3. The Rise of the New Business Ecosystem

- The new ecosystem is technology-enabled and works with potentially hundreds of sub-vendors
 - the Apple App store or iTunes
 - Amazon marketplace
- It marries small-firm innovation with large-firm financial muscle
- Implications for P/C insurance?
 - **A radically different “distribution” system?**
 - Will Amazon.com develop a “virtual Lloyd’s”?
 - **A radically different claims apparatus?**

An Insightful Book Published About 5 Years Ago



A MicroTrend is...

- An intense identity group, growing rapidly
- With needs and wants unmet by the current crop of companies, policymakers, and others who would influence society's behavior
- Typical size: $\pm 1\%$ of the population

7 MicroTrends to Watch

**There's More: Mark Penn's book
cites 68 other MicroTrends**

1. Sex-Ratio Singles (Single Women)

- For the first time in America, there are more single women than ever who are likely to stay that way.
- From shortly after birth, women outnumber men, and men are more likely to be homosexual than women are
 - In 2005, single women were the 2nd largest group of home buyers, just behind married couples.
 - They bought 1.5 million homes, more than twice as many as single men.
 - The number of single women bearing/adopting children in 2005 tripled since the early 1990s

2. Commuter Couples

- Dual-career couples who maintain two households
- In 1990: 1.7 million people
In 2005: 3.5 million
- All ages – the number of married people over 50 who live separately tripled between 2001 and 2005

3. 30-Winkers

- The number of people who sleep fewer than 6 hours/night is rising fast
 - 1998: 12%
 - 2005: 16% (34 million people)
- In the 2005 “Sleep in America” poll,
 - 37% said they’ve nodded off or fallen asleep while driving
- Less sleep leads to
 - Less productivity
 - Increased obesity
 - New businesses to help people get more sleep
- **Should sleep be an underwriting factor?**

4. Hard-of-Hearers

- Roughly 1/3 of people over 65 (about 35 million) are hard-of-hearing
 - But many with hearing loss are under 65
 - Hearing loss varies by race, geography, gender
- Occupational/Business Impact: Overcoming hearing loss will be a hot industry in the next few decades
 - New technology (who will lead this? Apple? Bose? Sony? Ford? New entrepreneurs?)
- Public policy/Insurance impact
 - An anti-noise campaign similar to anti-smoking?
 - **Do the hard-of-hearing cause more accidents?**

5. Old New Dads

- Births to men aged 50 or older
 - In 1980: 1 in 23
 - In 2002: 1 in 18
- Births to men age 40-44: up 32%
- Births to men age 45-49: up 21%
- Old dads will likely
 - Work longer
 - Retire later
 - **Drive at older ages**

6. Newly Released Ex-Cons

- 650,000 people (90% men, avg. age 34) released from prison or jail **each year**
- These people generally have little connection with economic society:
 - Little education
 - Few job prospects
 - Many employers won't hire them
- Likely results:
 - Increasing crime
 - Worsening public cost of family support "financial safety net"
- **Are these people insurable in the voluntary market?**

7. High School Moguls

- A dozen years ago 8% of all teens (1.6 million) were making money on the internet
- The top 100 entrepreneurs aged 8-18 in 2001 earned total profits of \$7 million
- In 2006 the U.S. Small Business Administration launched “Mind Your Own Business,” an online resource to help teenagers develop their start-ups
- **How much do teen business owners know about insurance? How well are we reaching them?**

Insurance Information Institute Online:

www.iii.org

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