



# **NCIGF Economic Update: Implications for P/C Insurance**

**National Conference of Insurance Guaranty Funds  
2013 Annual Conference  
Phoenix, AZ  
April 17, 2013**

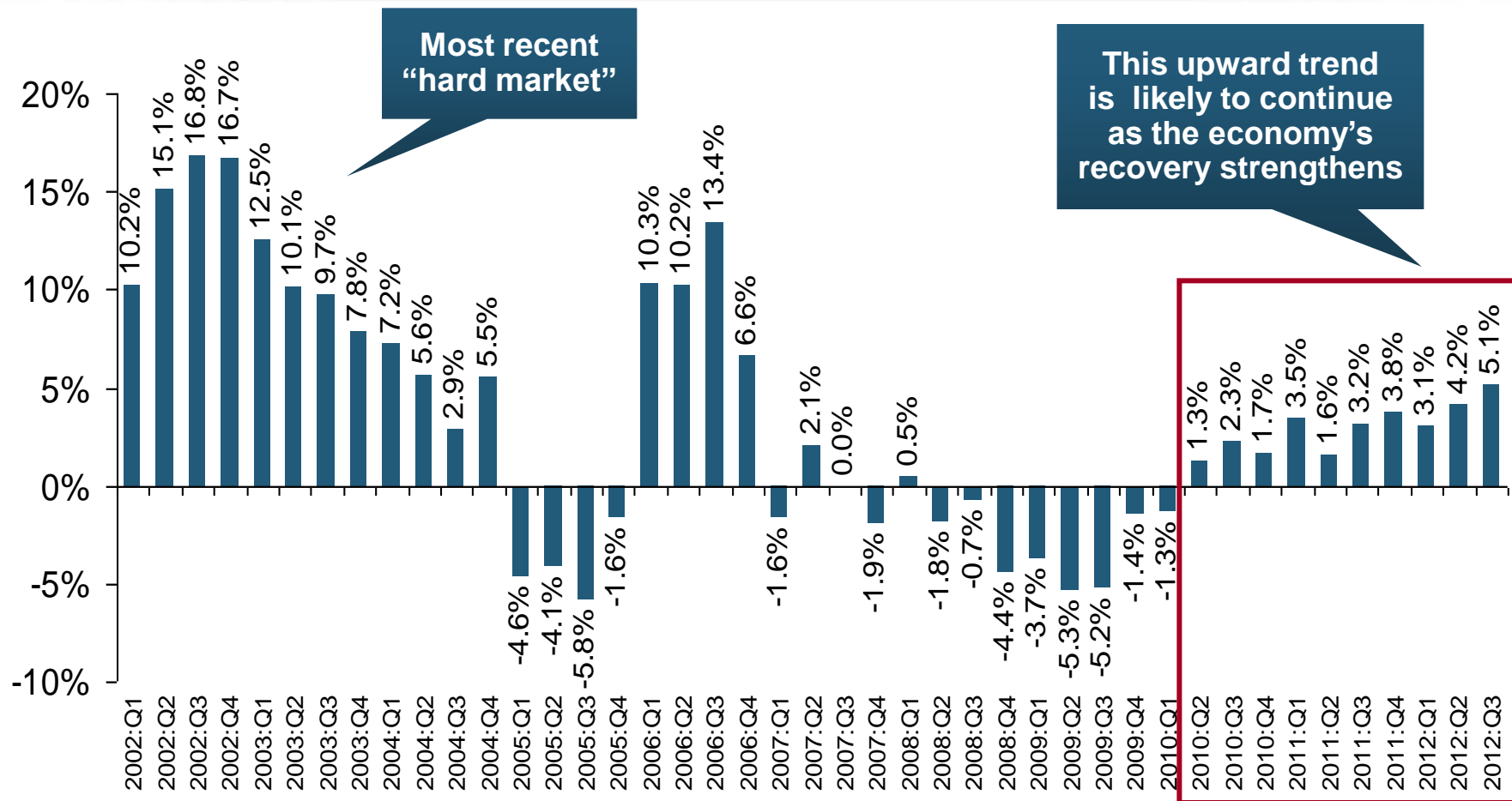
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# **P/C Insurance Industry Financial Overview**

**Profit Recovery Was Set Back  
in 2011 and 2012  
by High Catastrophe Losses  
and Other Factors**

# P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter, 2002–2012

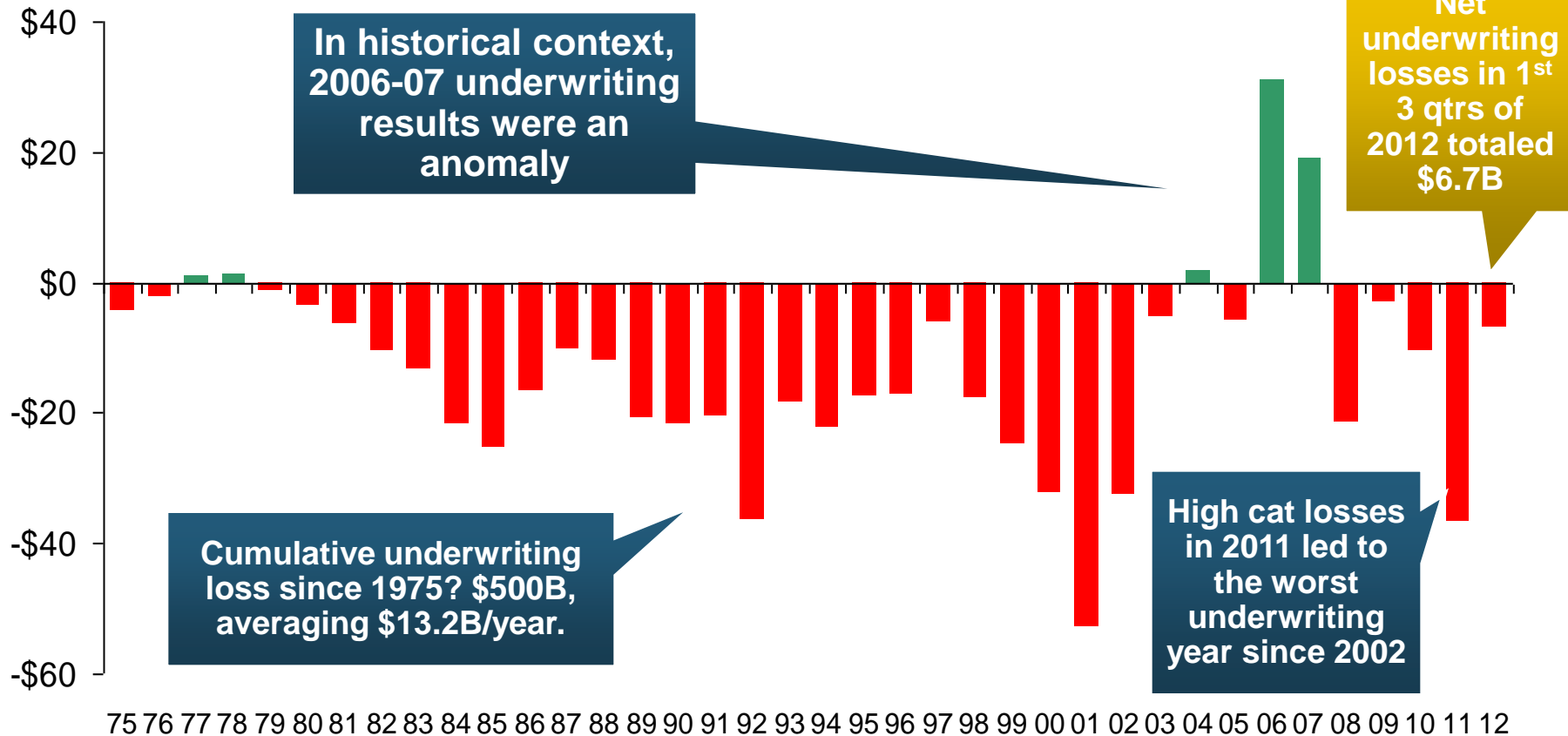


**Finally! A sustained period (10 quarters) of growth in net premiums written (vs. same quarter, prior year), and strengthening.**

# Underwriting is Rarely a Profit Source

## *Gain (Loss)\* 1975–2012\*\**

\$ Billions

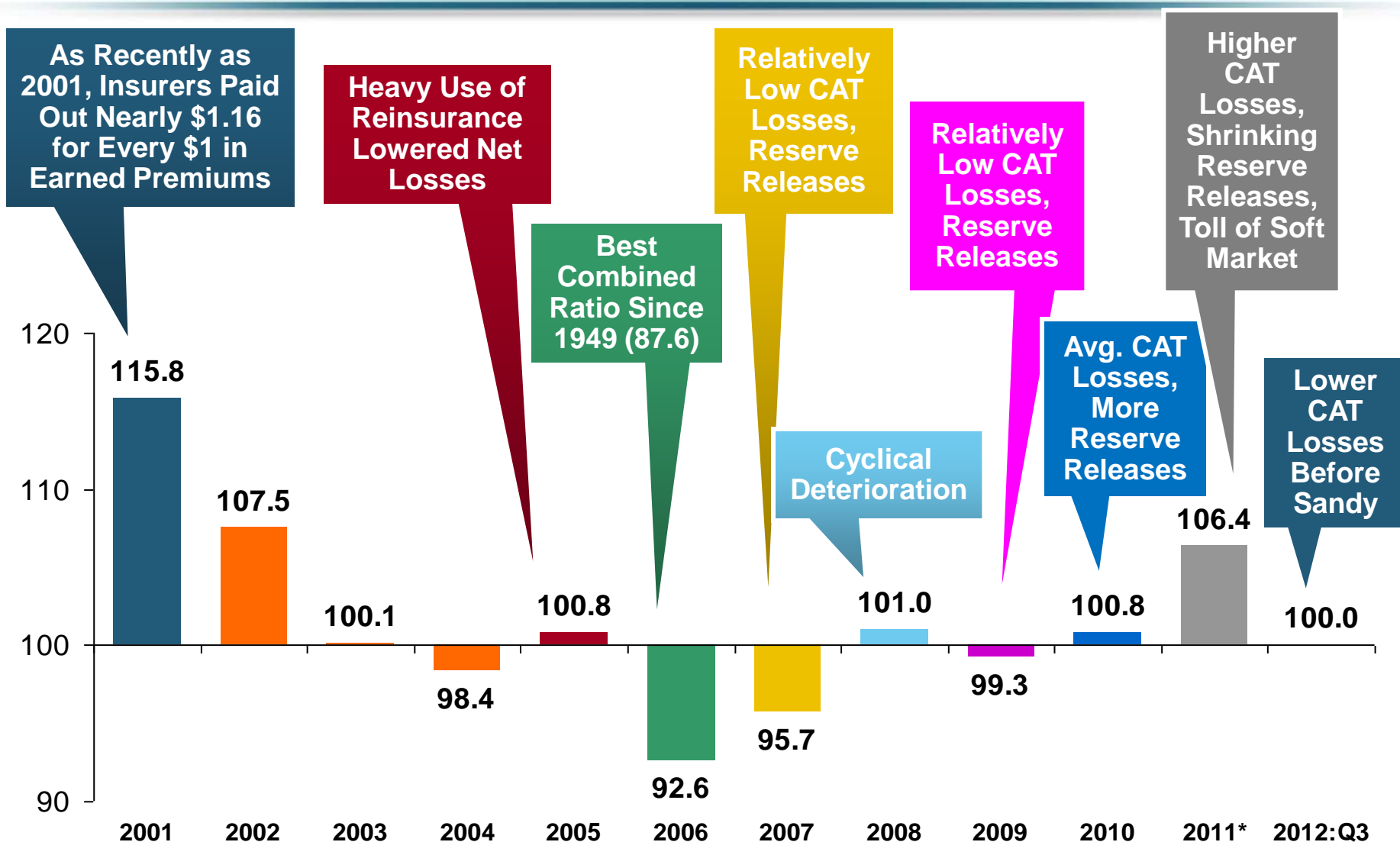


**Average yearly underwriting loss in the 2008-2011 low-interest-rate environment? \$17.8B. With interest rates this low, large persistent underwriting losses are not a recipe for success.**

\*Includes mortgage and financial guaranty insurers in all years. \*\*through first three quarters of 2012

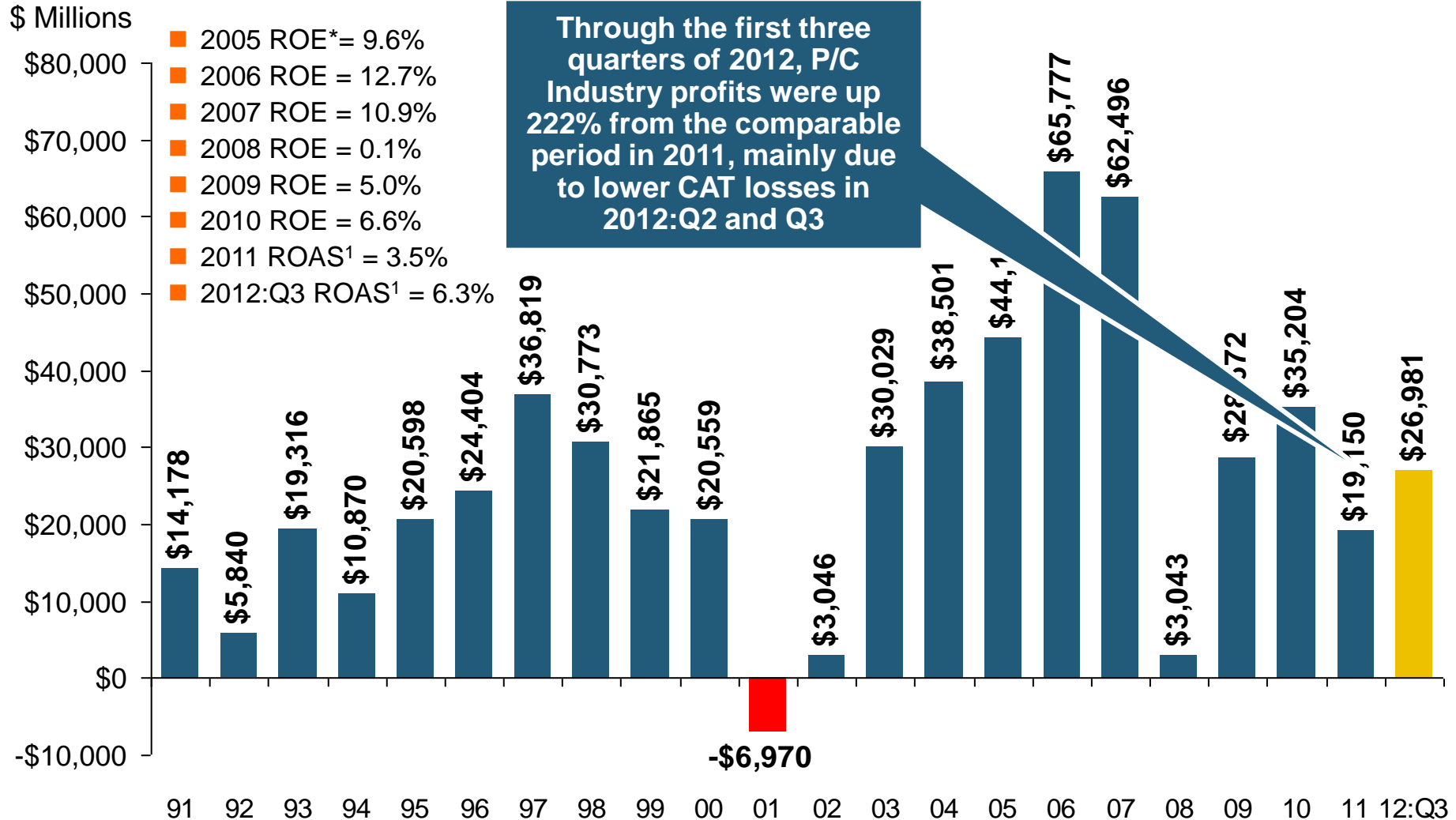
Sources: A.M. Best; ISO; Insurance Information Institute.

# P/C Insurance Industry Combined Ratio, 2001–2012:Q3\*



\* Excludes Mortgage & Financial Guaranty insurers 2008--2012. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.2; 2012:Q3=100.9.  
Sources: A.M. Best; ISO.

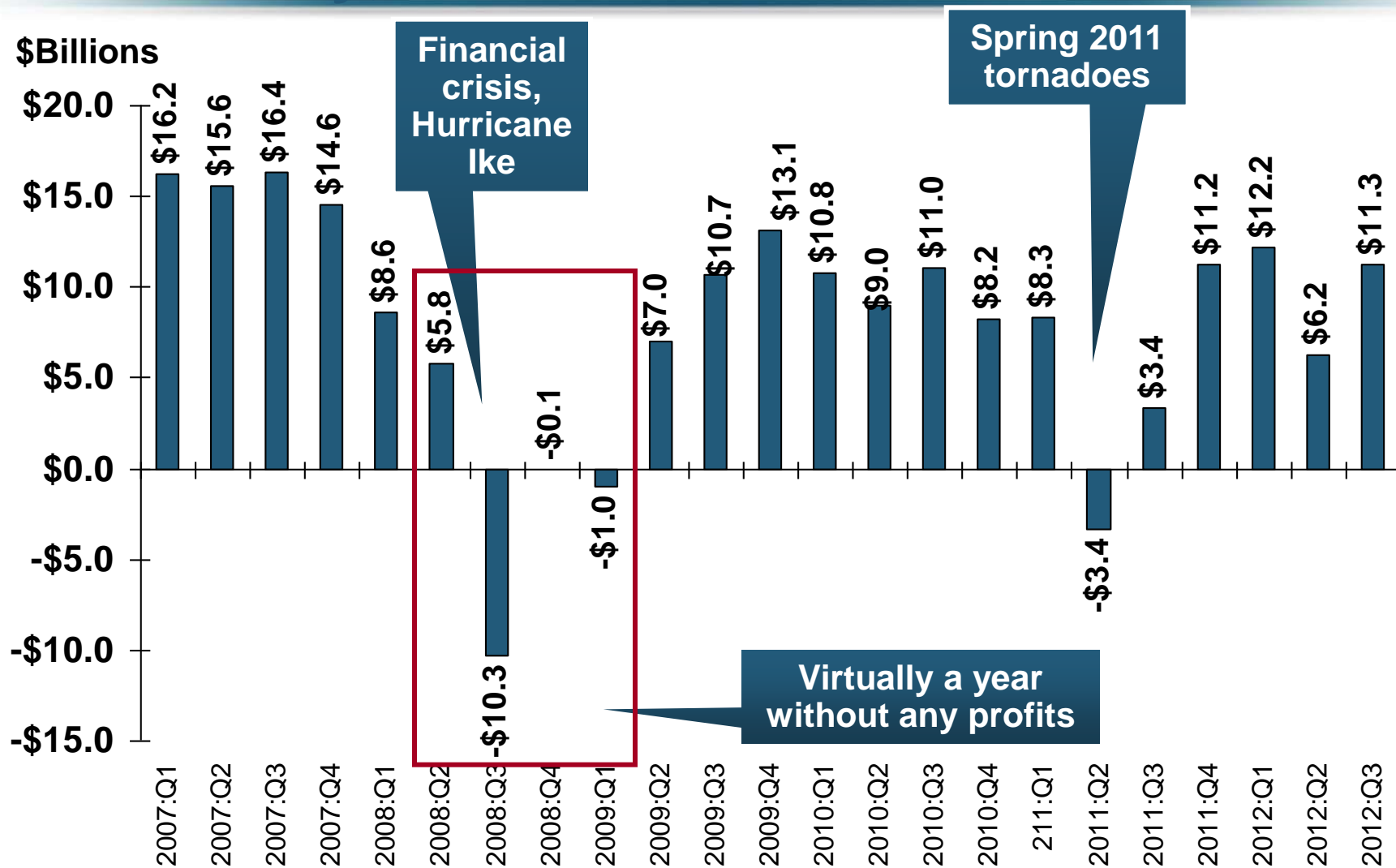
# P/C Net Income After Taxes 1991–2012:Q3



\* ROE figures are GAAP; <sup>1</sup>Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 6.2% ROAS for 2012:H1, 4.6% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

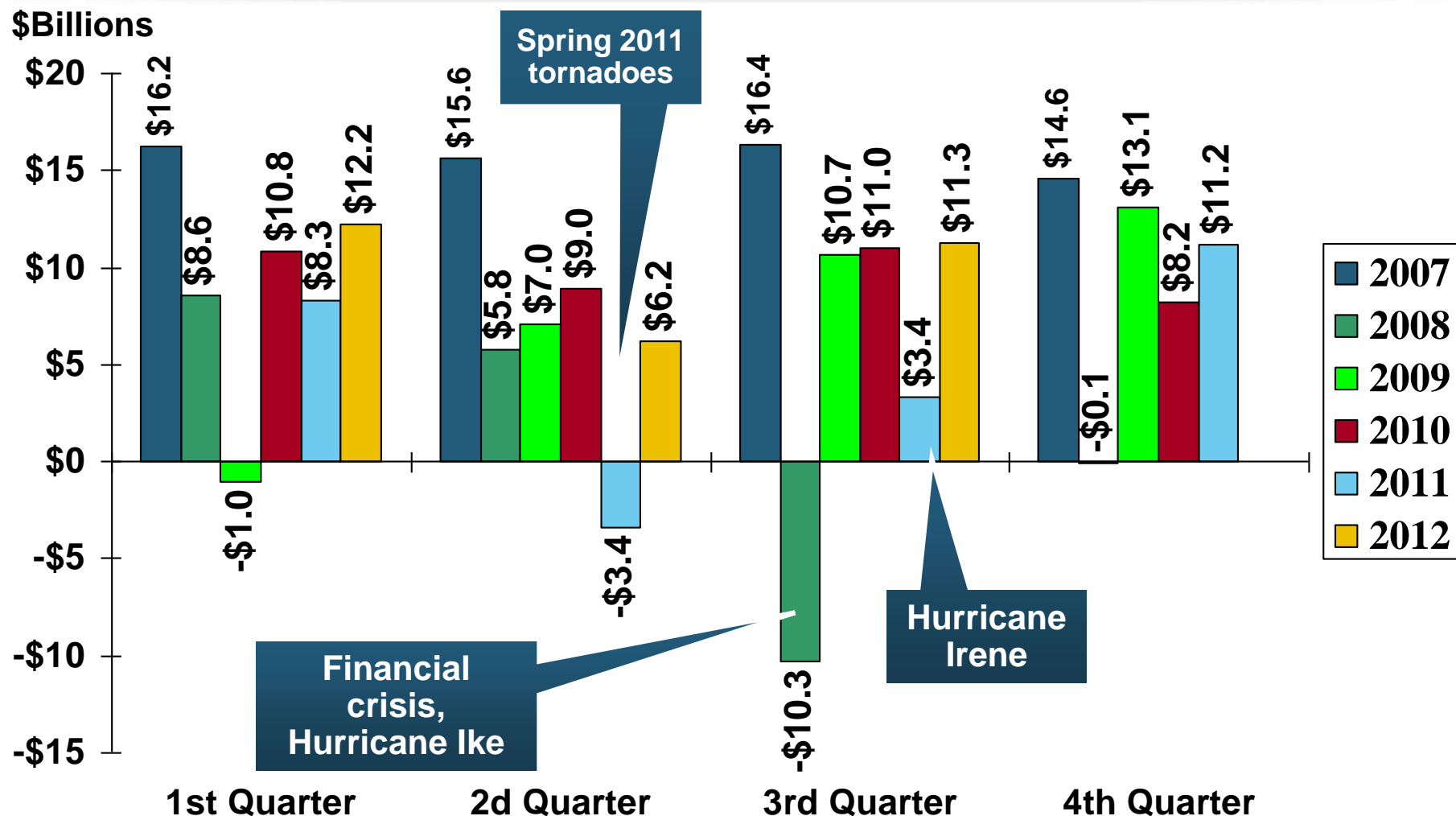
Sources: A.M. Best; ISO; Insurance Information Institute.

# P/C Industry Net Income, Quarterly, 2007:Q1-2012:Q3



Sources: SNL Financial; Insurance Information Institute

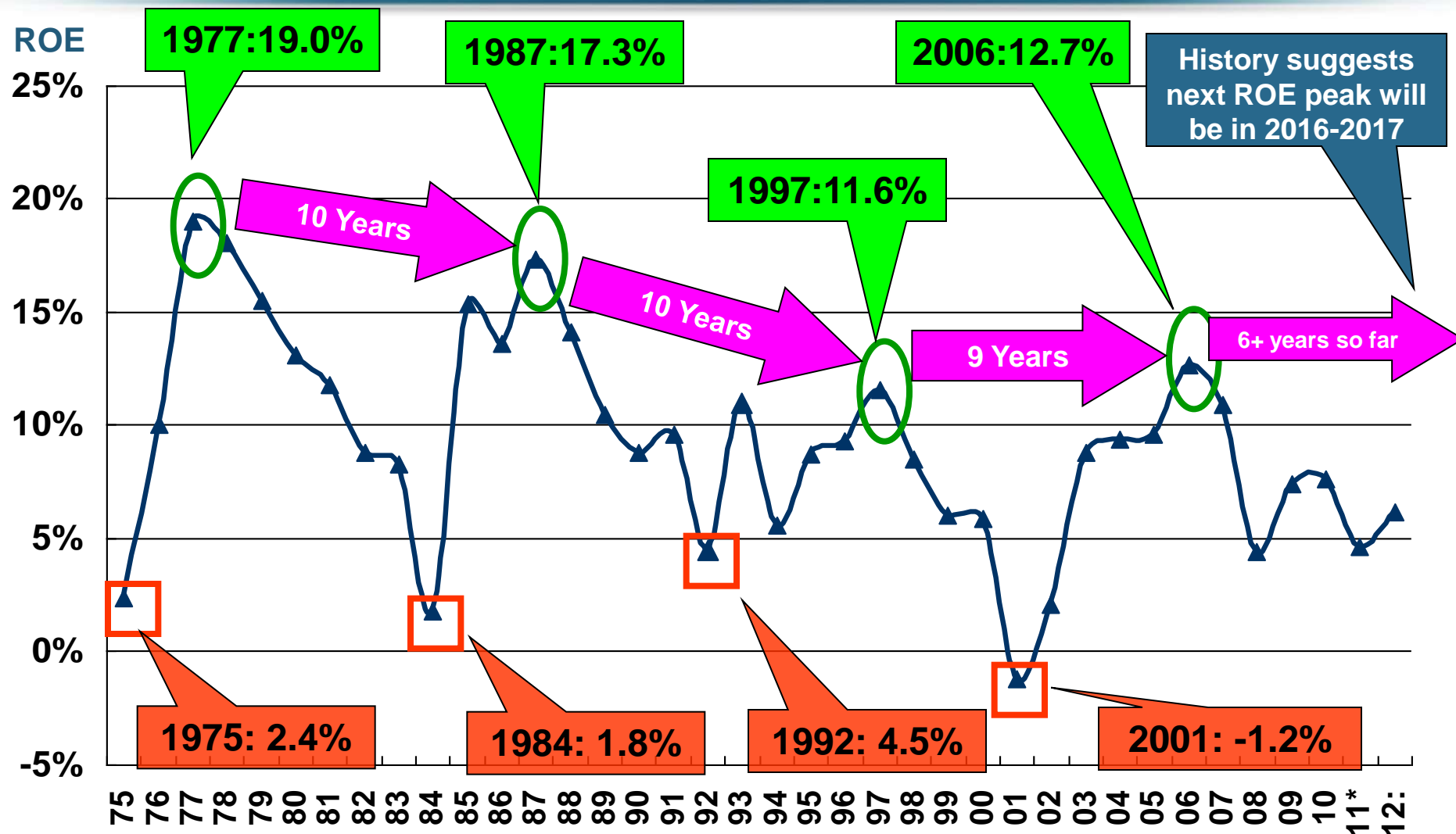
# P/C Industry Net Income, Quarterly, 2007:Q1-2012:Q3



Over the past 6 years, no calendar quarter has been consistently profitable.

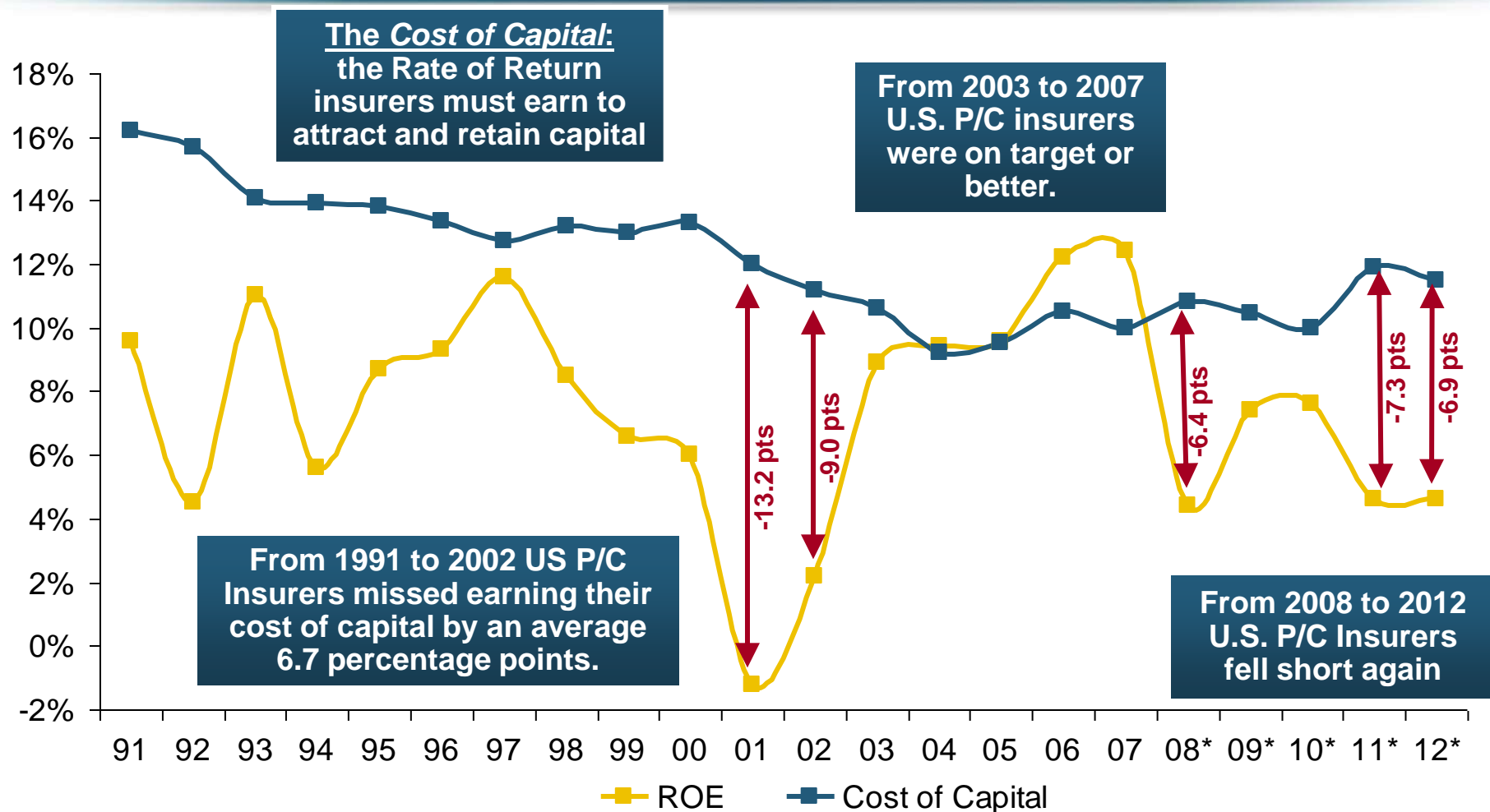


# Profitability (ROE) Peaks & Troughs, P/C Insurance Industry, 1975 – 2012:Q3\*



\*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:H1 ROAS = 5.9% including M&FG.  
Sources: Insurance Information Institute; NAIC; ISO; A.M. Best.

# ROE vs. Equity Cost of Capital: U.S. P/C Insurance: 1991-2012\*

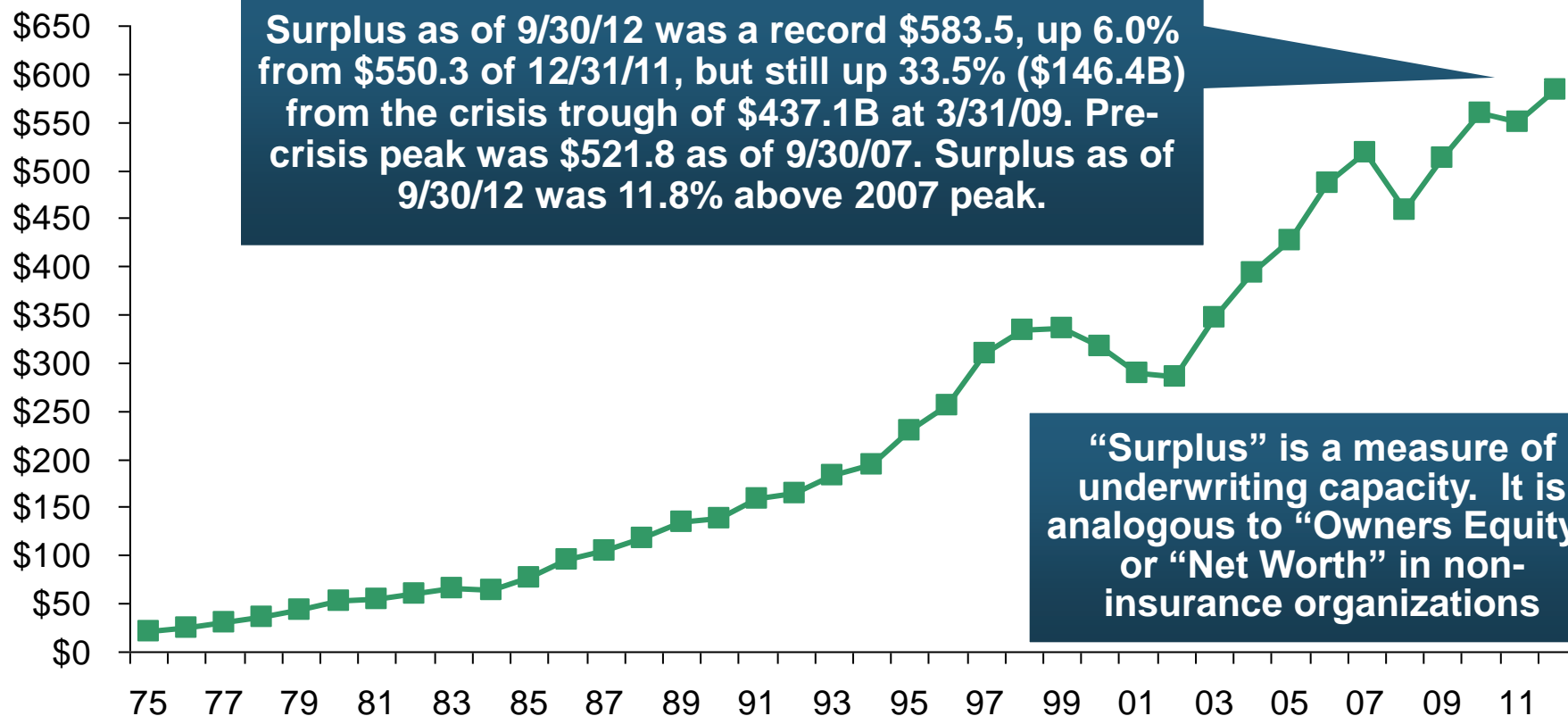


**Over the last 22 years, the P/C insurance industry  
fell well short of earning its cost of capital in all but 4 years**

\* Return on average surplus in 2008-2012 excluding mortgage and financial guaranty insurers. 2012 figures are III estimates.  
Source: The Geneva Association, Insurance Information Institute

# US Policyholder Surplus: 1975–2012\*

(\$ Billions)



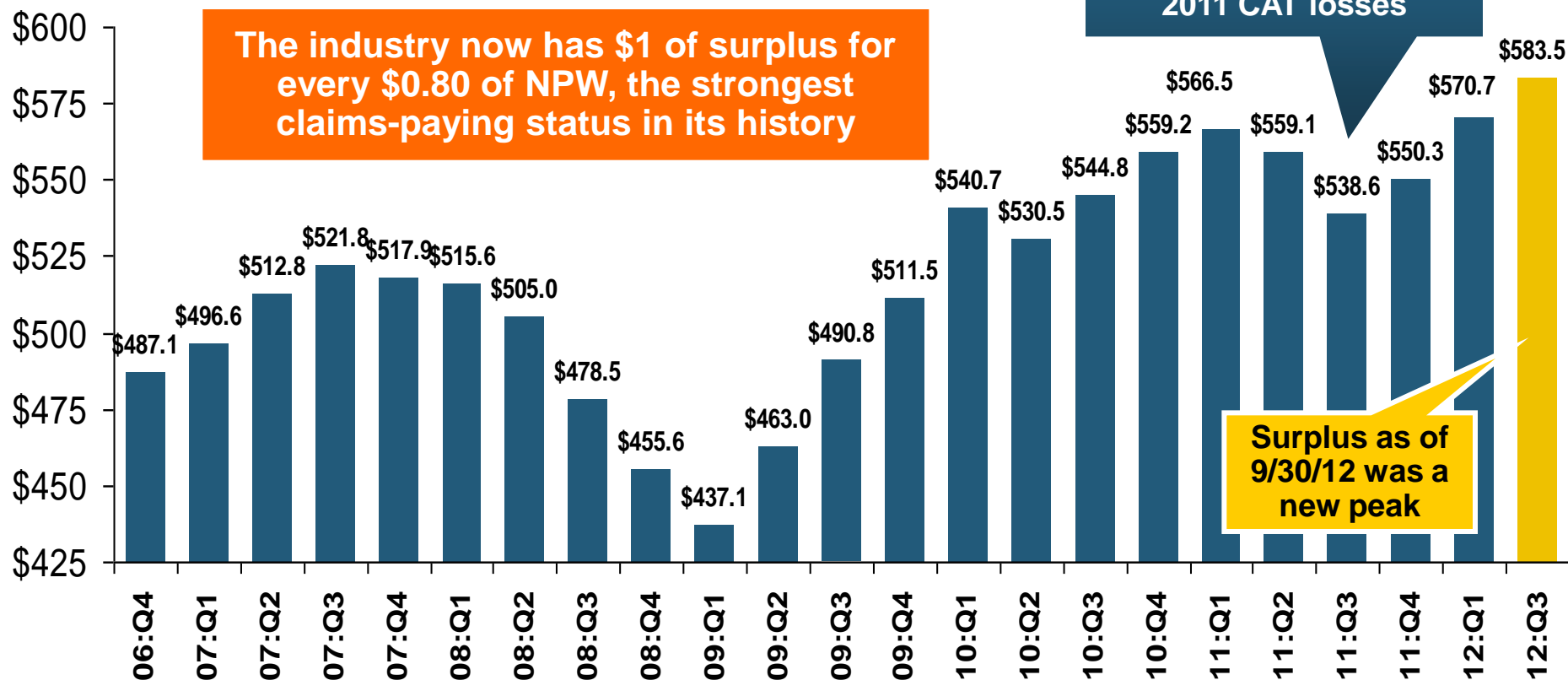
**The Industry's Claims Paying Resources Reached an All-Time Record High as of Q3 2012, Just Before Sandy Struck, A Vivid Demonstration of the Strength**

\* As of 9/30/12.

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

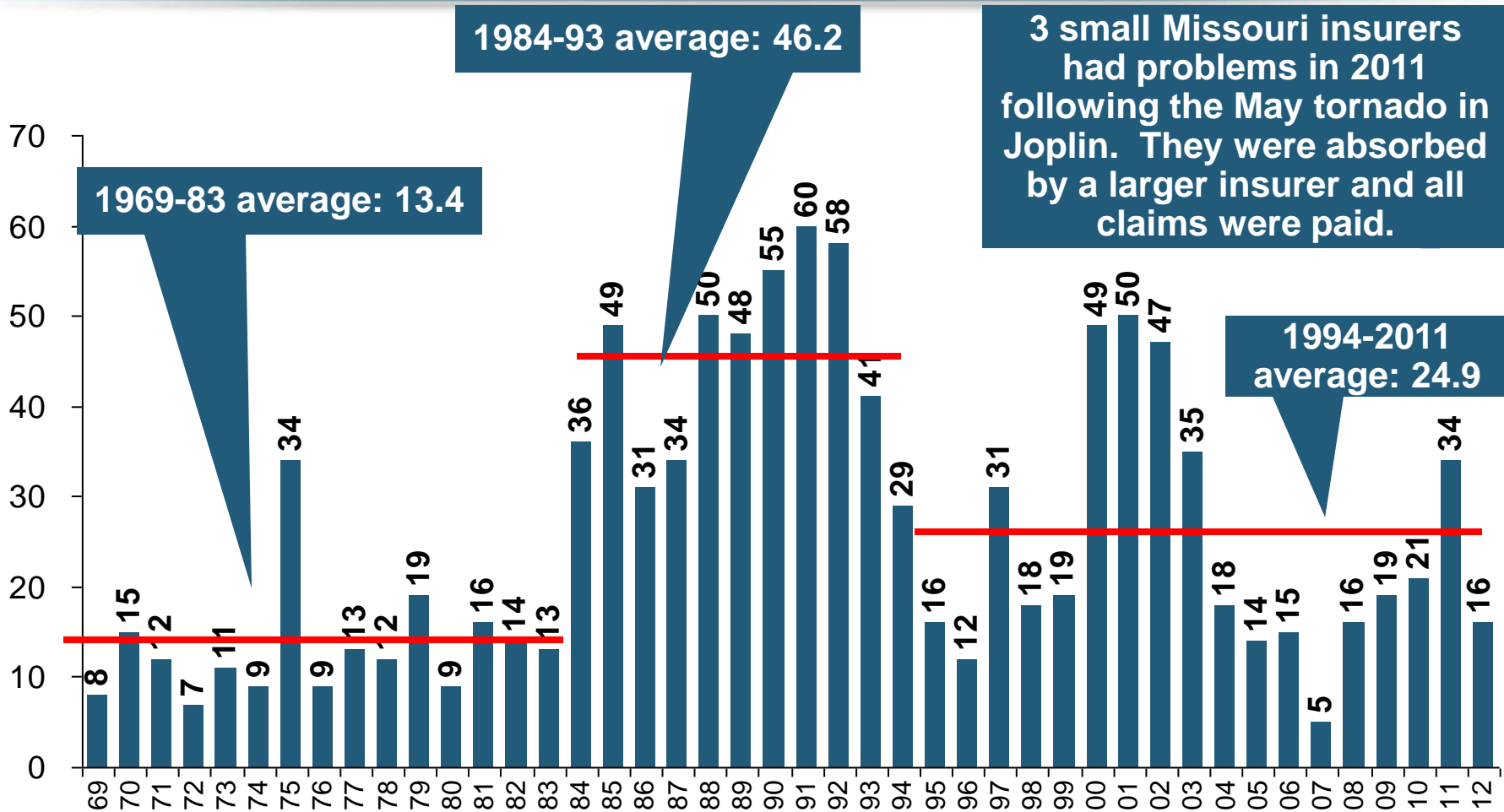
# Policyholder Surplus, 2006:Q4–2012:Q3

(\$ Billions)



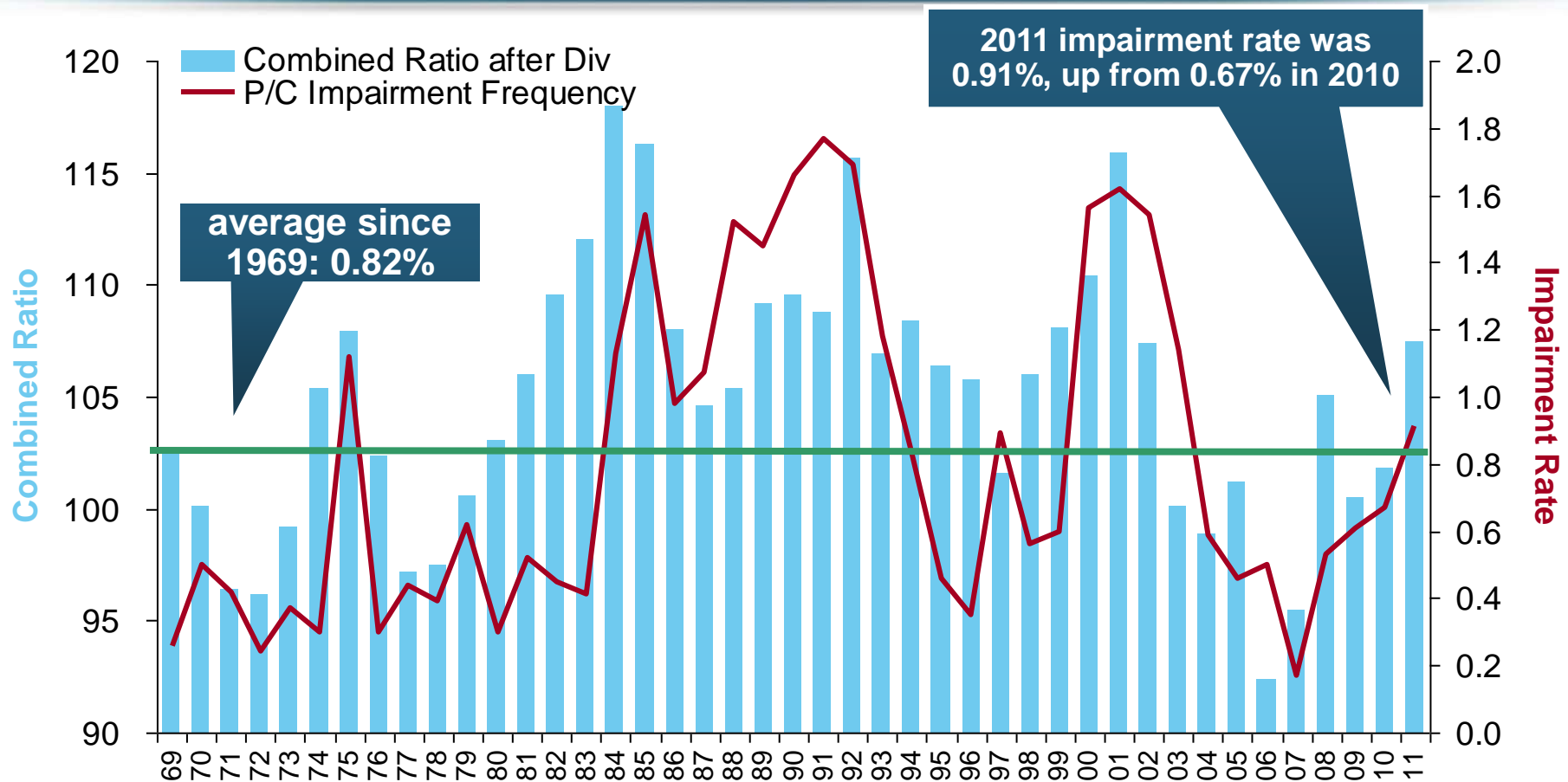
# Impairments

# Number of Financially-Impaired P/C Insurers, 1969–2012



**The number of financially-impaired insurers varies each year, correlated with the P/C insurance cycle. Peaks occur well into hard markets.**

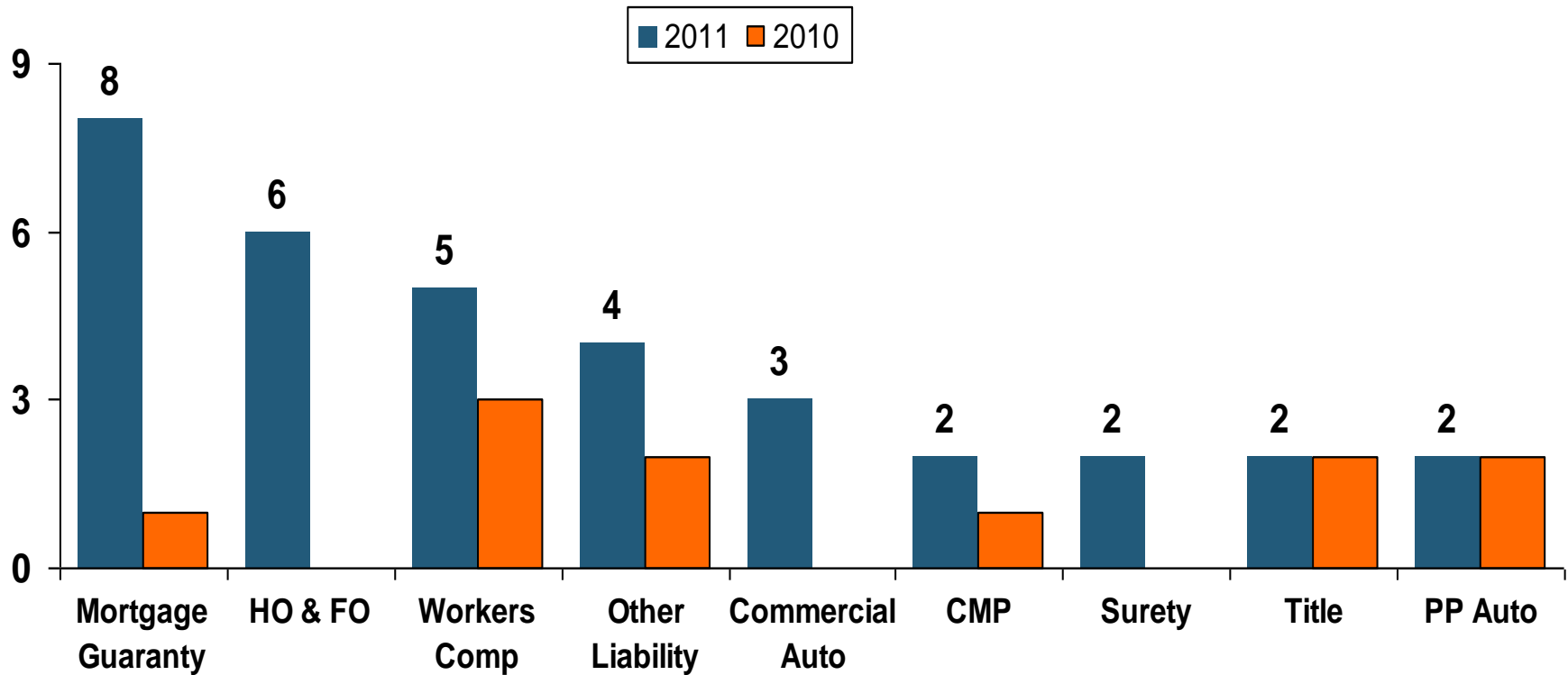
# Financially-Impaired P/C Insurer Rate vs. Combined Ratio, 1969-2011



**Impairment rates are highly correlated with underwriting performance. 2007 was a record low. The recent increase was not representative of the industry overall; it was associated mainly with problems experienced by Mortgage and Financial Guaranty insurers.**

# Number of Financially-Impaired P/C Insurers, by Primary LOB, 2010-2011

Number of  
Insurers

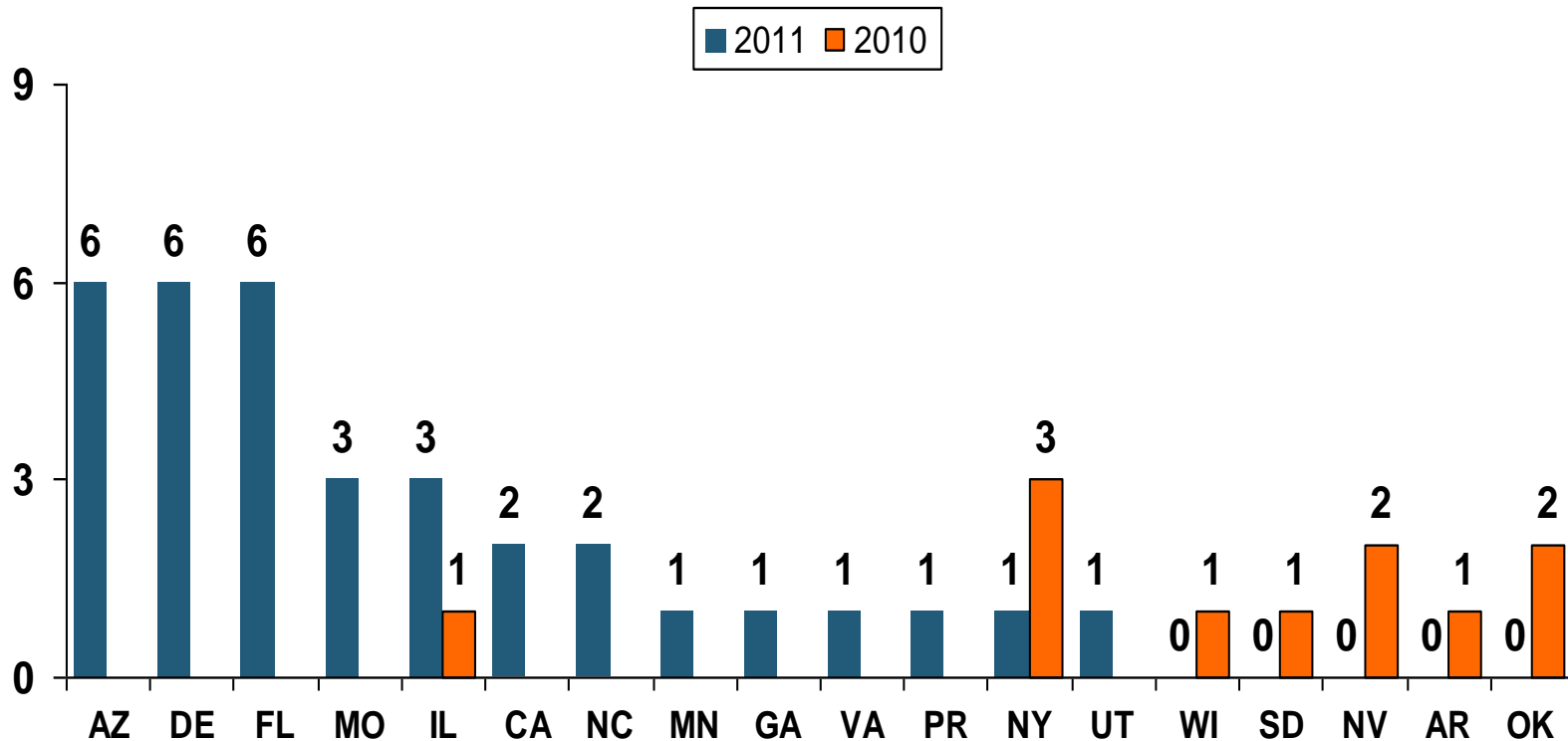


Source: A.M. Best Special Report "1969-2011 Impairment Review," June 2012; Insurance Information Institute.



# Number of Financially-Impaired P/C Insurers, by Domicile, 2010 & 2011

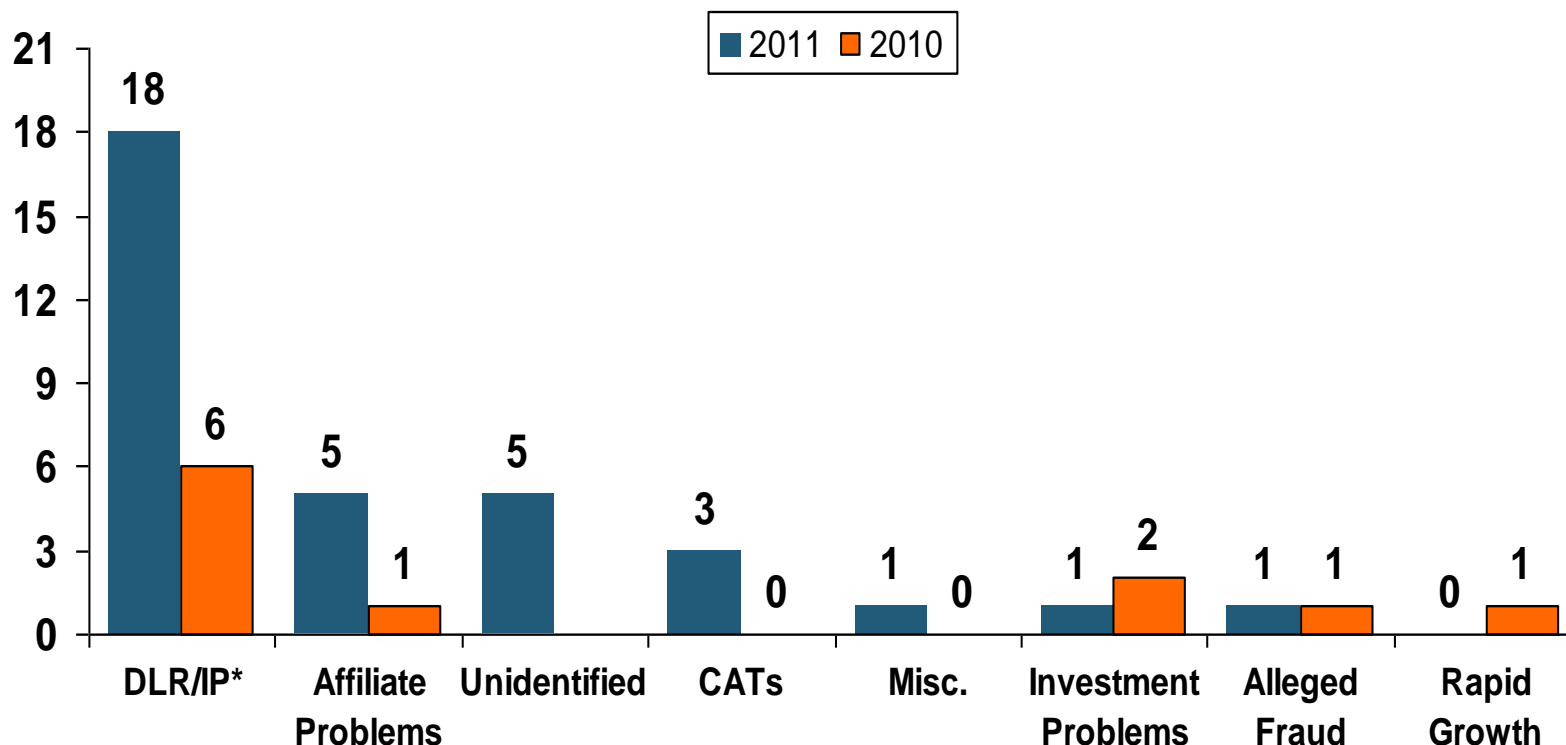
Number of  
Insurers



Source: A.M. Best Special Report "1969-2011 Impairment Review," June 2012; Insurance Information Institute.

# Number of Financially-Impaired P/C Insurers, by Impairment Cause, 2010-11

Number of  
Insurers

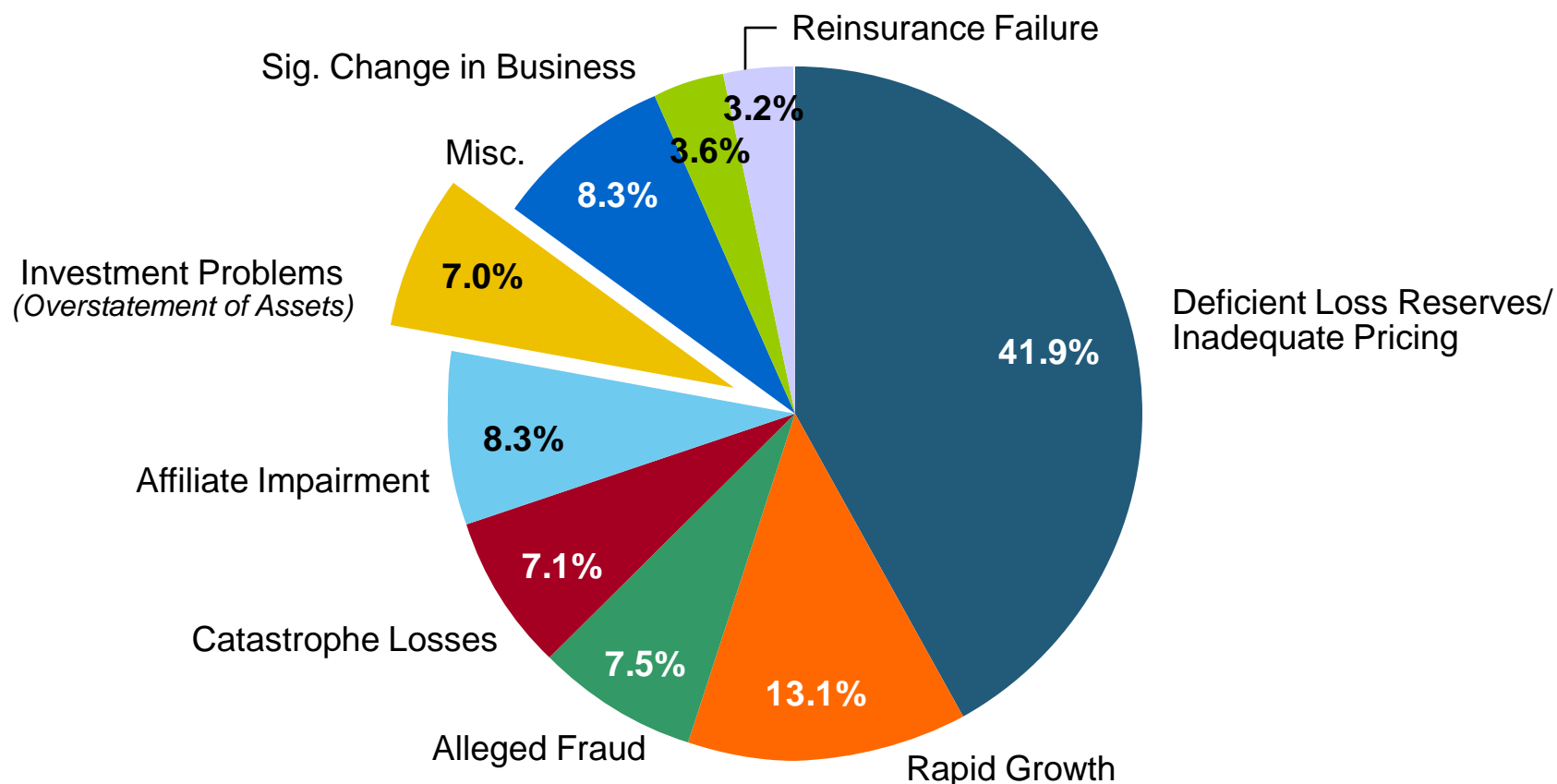


\*Deficient Loss Reserves/Inadequate Pricing

Source: A.M. Best Special Report "1969-2011 Impairment Review," June 2012; Insurance Information Institute.

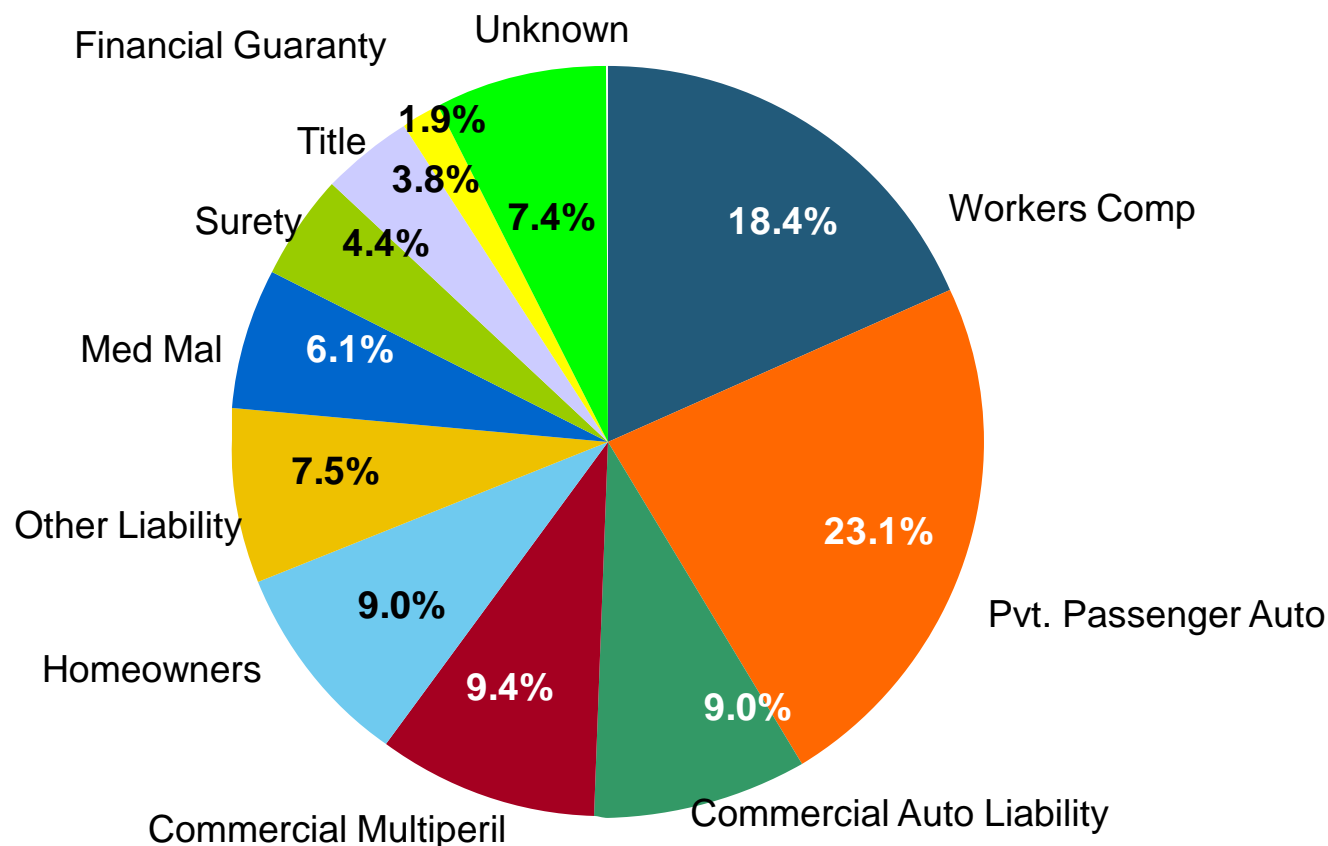
# Reasons for US P/C Insurer Impairments, 1969–2011

**Historically, deficient loss reserves and inadequate pricing have been the leading cause of P-C insurer impairments, by far. Investment and catastrophe losses have played a much smaller role.**



# Top 10 Lines of Business for US P/C Impaired Insurers, 1991–2011

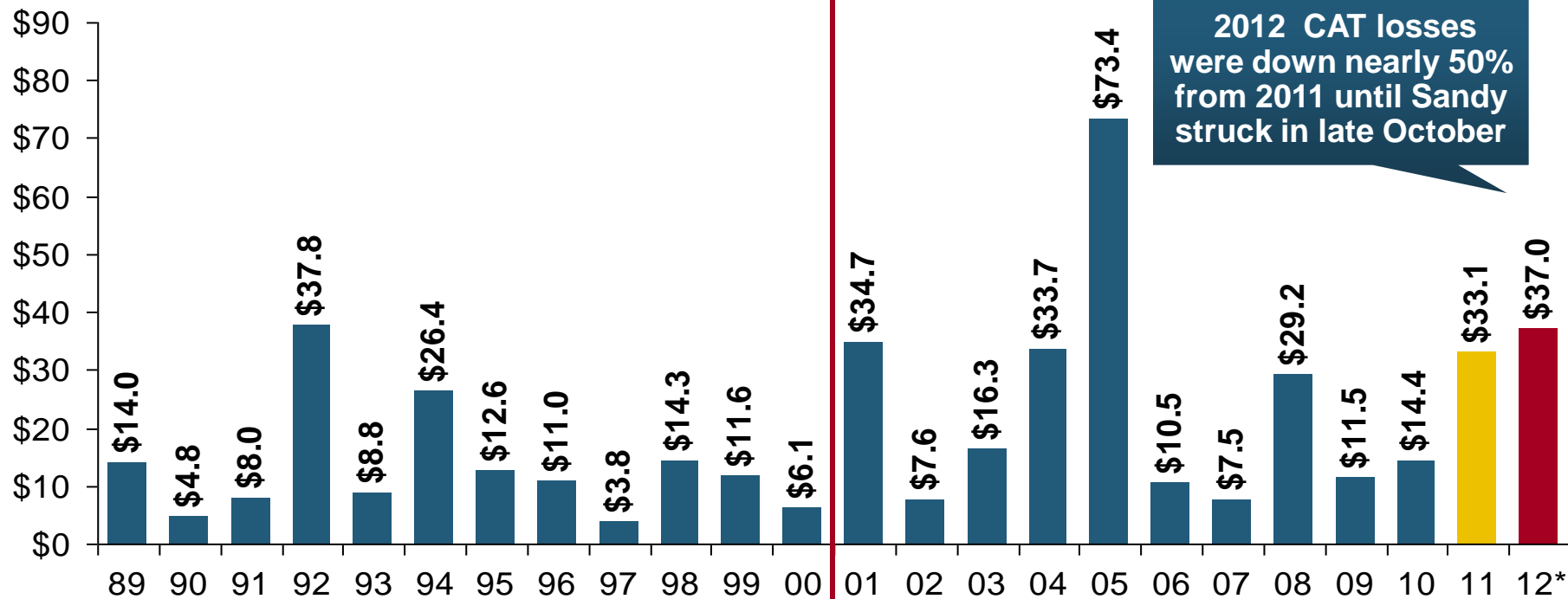
**Commercial lines of business account for two-thirds of the premium volume of impaired insurers over the past two decades, but PP Auto is the single largest line among impaired insurers.**



# Catastrophes

# US Insured Catastrophe Losses

(\$ Billions, 2012 Dollars)



**US CAT Losses in 2012 Will Likely Become the 2<sup>nd</sup> or 3<sup>rd</sup> Highest in US History on An Inflation-Adjusted Basis (Pvt Insured). 2011 Losses Were the 5<sup>th</sup> Highest**

**Record Tornado Losses Caused 2011 CAT Losses to Surge**

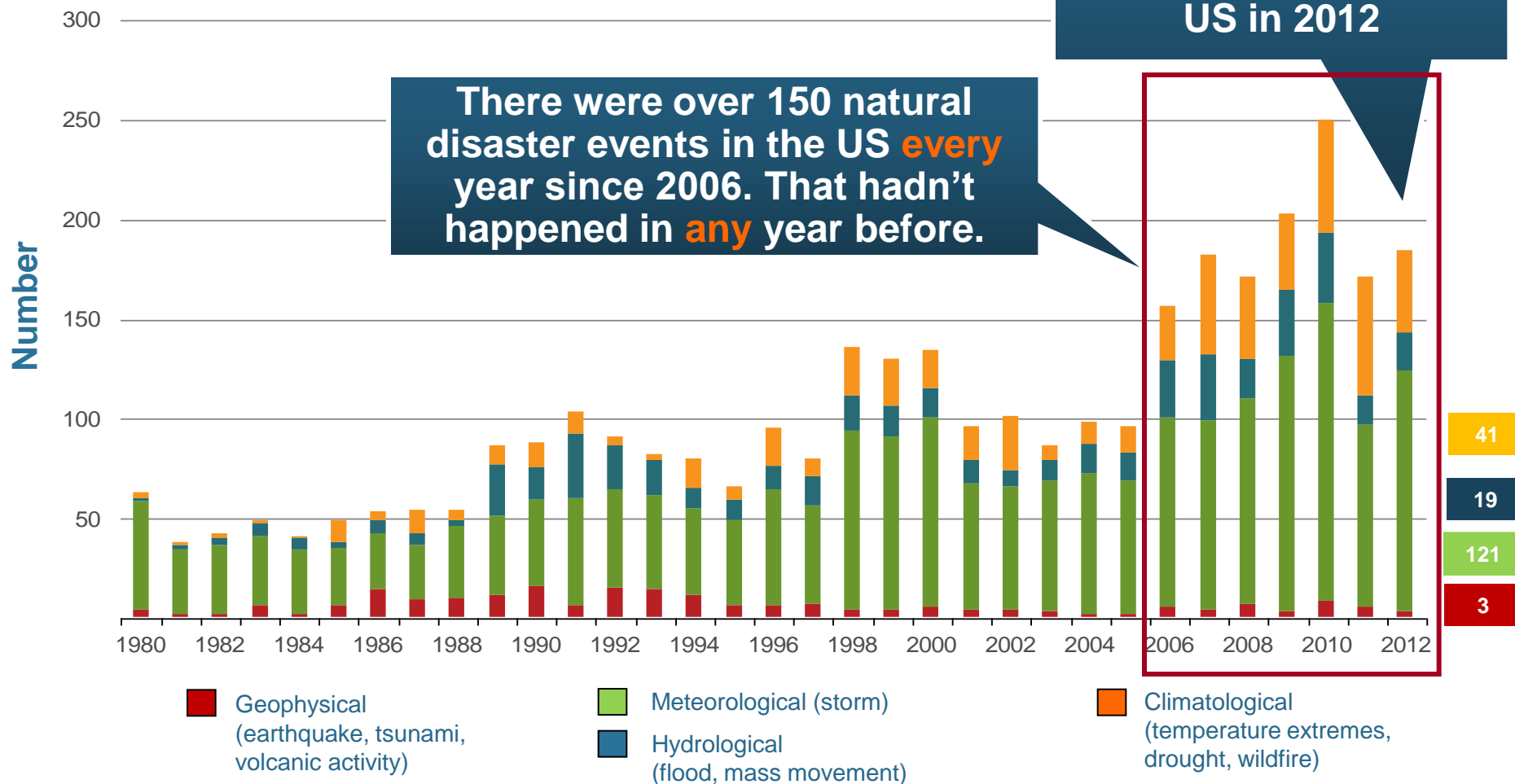
\*As of 1/2/13. Includes \$20B gross loss estimate for Hurricane Sandy.

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.

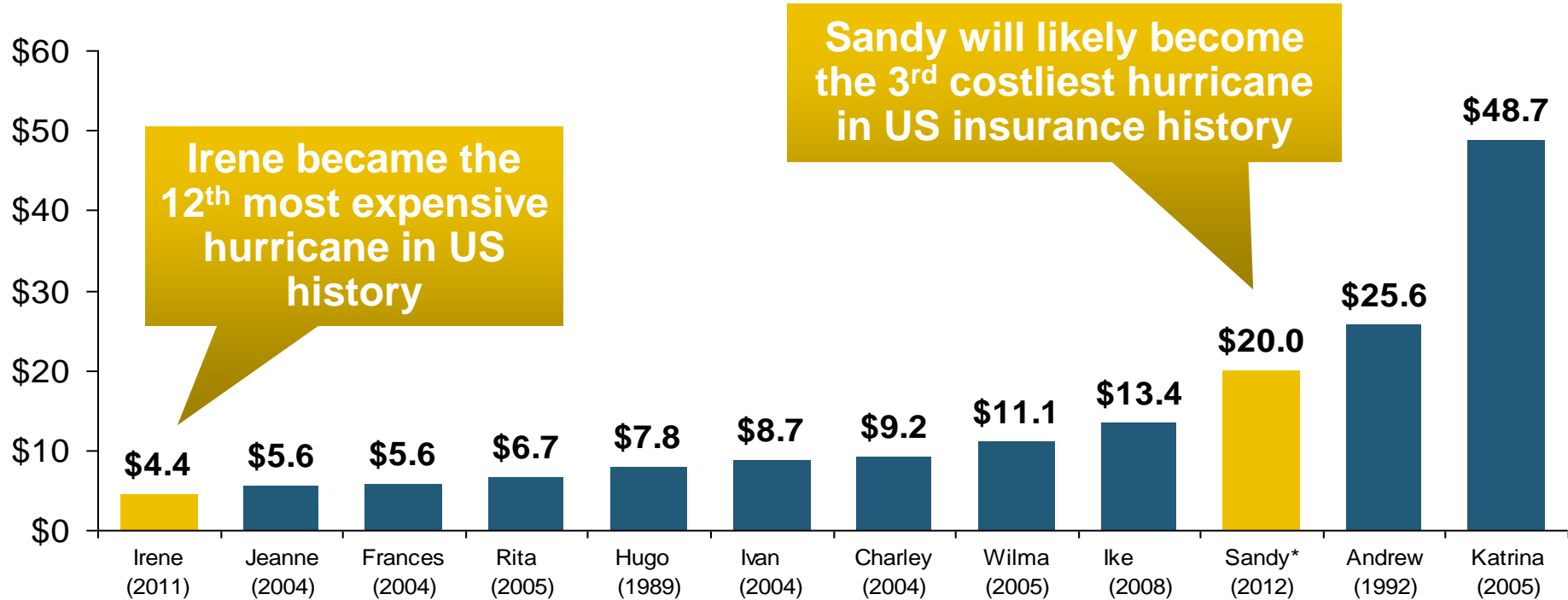
# Natural Disasters in the United States, 1980 – 2012

Number of Events (Annual Totals 1980 – 2012)



# The Dozen Most Costly Hurricanes in U.S. History

Insured Losses,  
2012 Dollars,  
\$ Billions



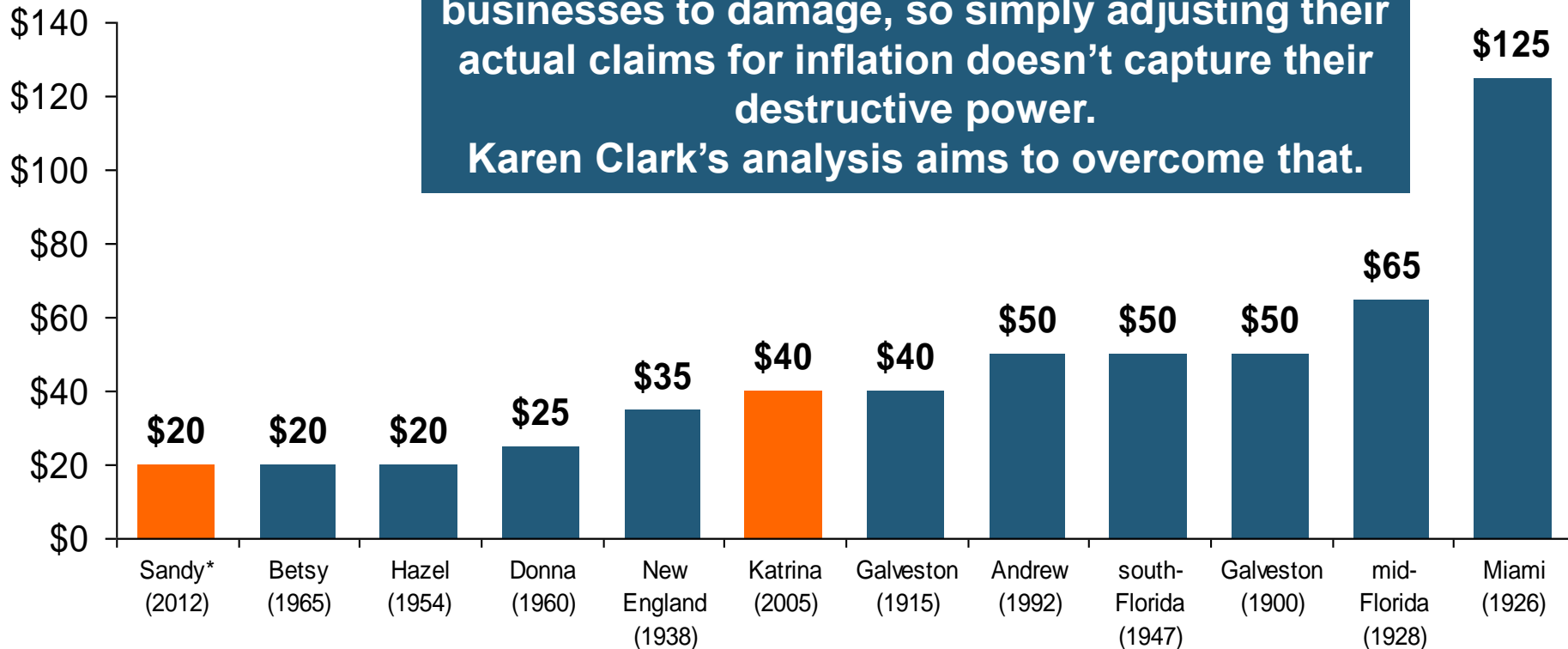
**10 of the 12 most costly hurricanes in insurance history occurred in the past 9 years (2004—2012)**

\*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: PCS; Insurance Information Institute inflation adjustments to 2012 dollars using the CPI.



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

Insured Losses,  
2012 Dollars, \$ Billions

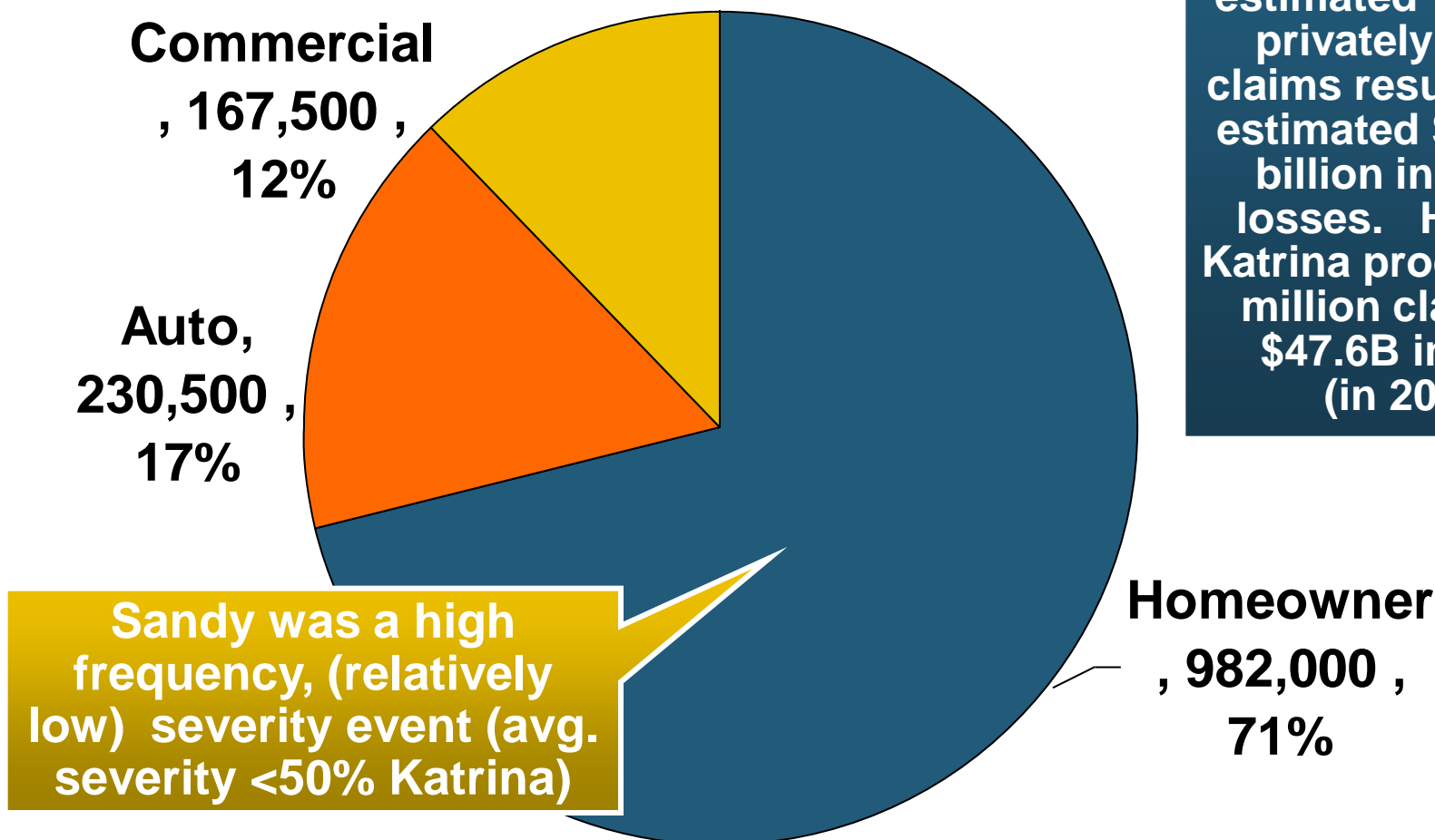


Storms that hit long ago had less property and businesses to damage, so simply adjusting their actual claims for inflation doesn't capture their destructive power.  
Karen Clark's analysis aims to overcome that.

When you adjust for the damage prior storms could have done if they occurred today, Hurricane Katrina slips to a tie for 6<sup>th</sup> 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.

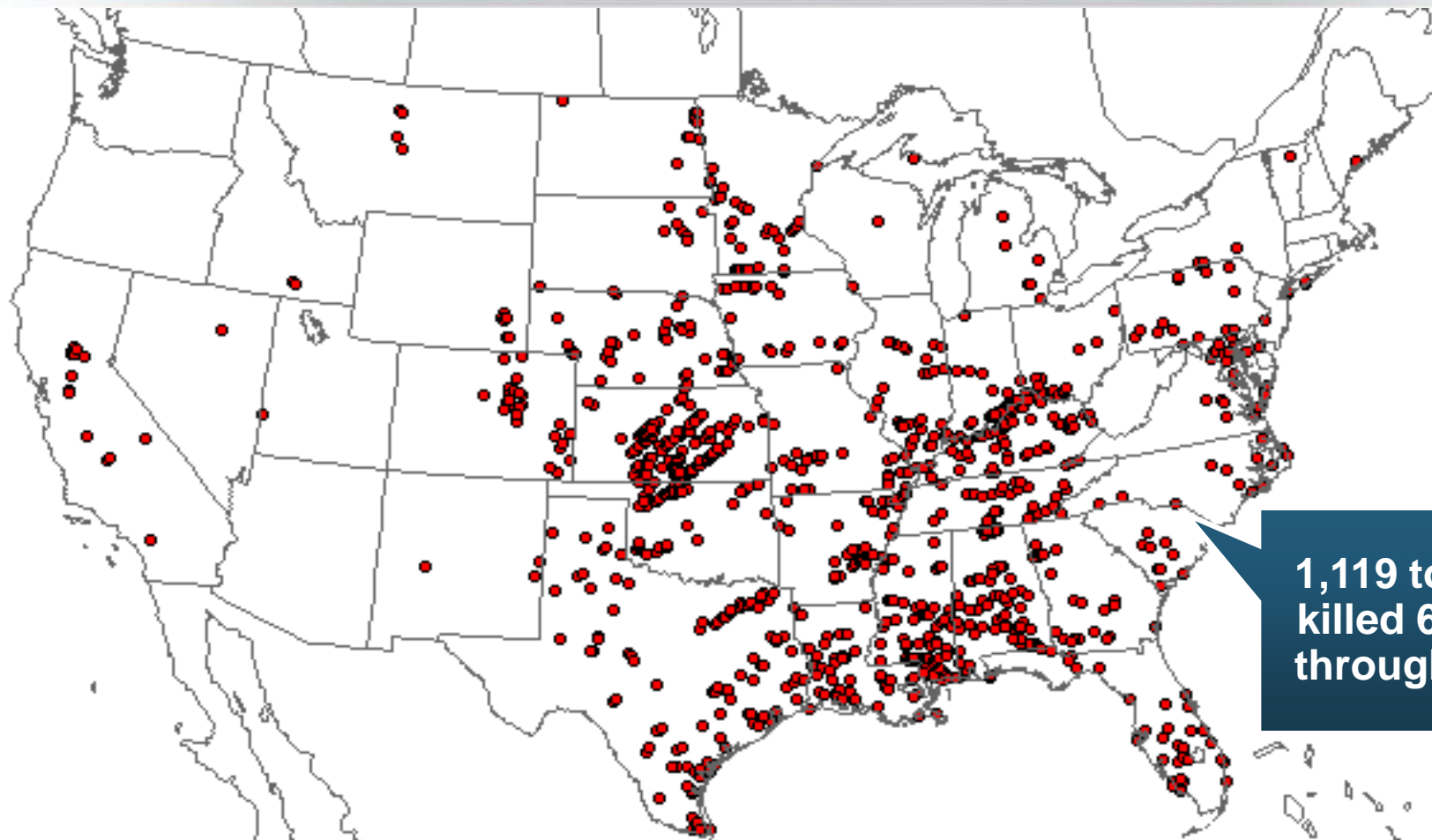
# Superstorm Sandy: Number of Claims by Type\*



Hurricane Sandy resulted in an estimated 1.4 million privately insured claims resulting in an estimated \$15 to \$25 billion in insured losses. Hurricane Katrina produced 1.74 million claims and \$47.6B in losses (in 2011 \$)

\*PCS claim count estimate as of 11/26/12. Loss estimate represents high and low end estimates by risk modelers RMS, Eqecat and AIR. PCS estimate of insured losses as of 11/26/12 \$11 billion. All figures exclude losses paid by the NFIP.  
Source: PCS; AIR, Eqecat, AIR Worldwide; Insurance Information Institute.

# Location of Tornadoes in the US, 2012\*



1,119 tornadoes  
killed 68 people  
through Dec. 31



**PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)**

NOAA/Storm Prediction Center Norman, Oklahoma

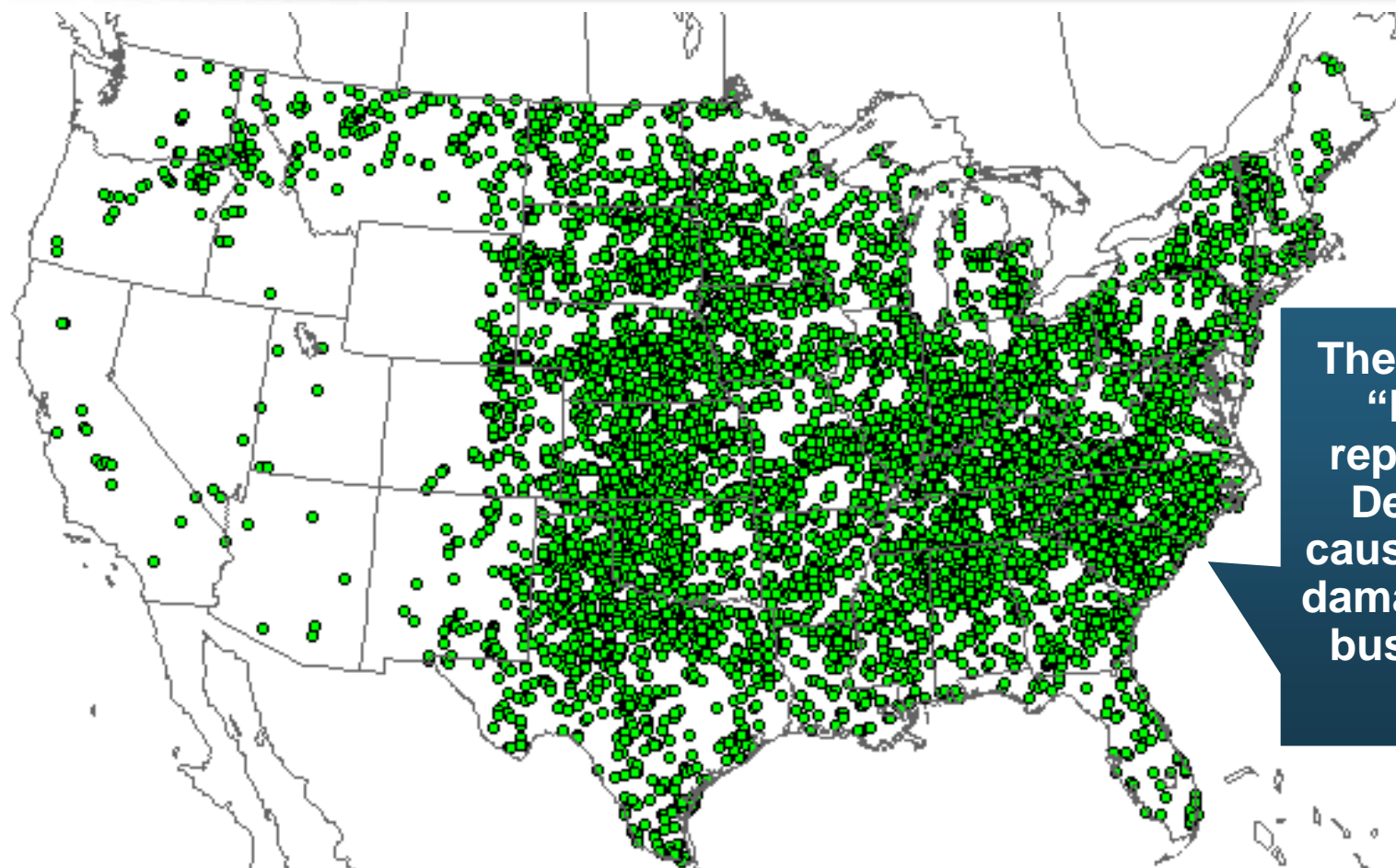
**Tornado Reports  
January 01, 2012 - December 31, 2012**

Updated: Sunday January 06, 2013 02:10 CT

\*Through Dec. 31, 2012.

Source: NOAA Storm Prediction Center; [http://www.spc.noaa.gov/climo/online/monthly/2012\\_annual\\_summary.html#](http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html#)

# Location of Large Hail Reports in the US, 2012\*



There were 7,033  
“Large Hail”  
reports through  
Dec. 31, 2012,  
causing extensive  
damage to homes,  
businesses and  
vehicles



PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

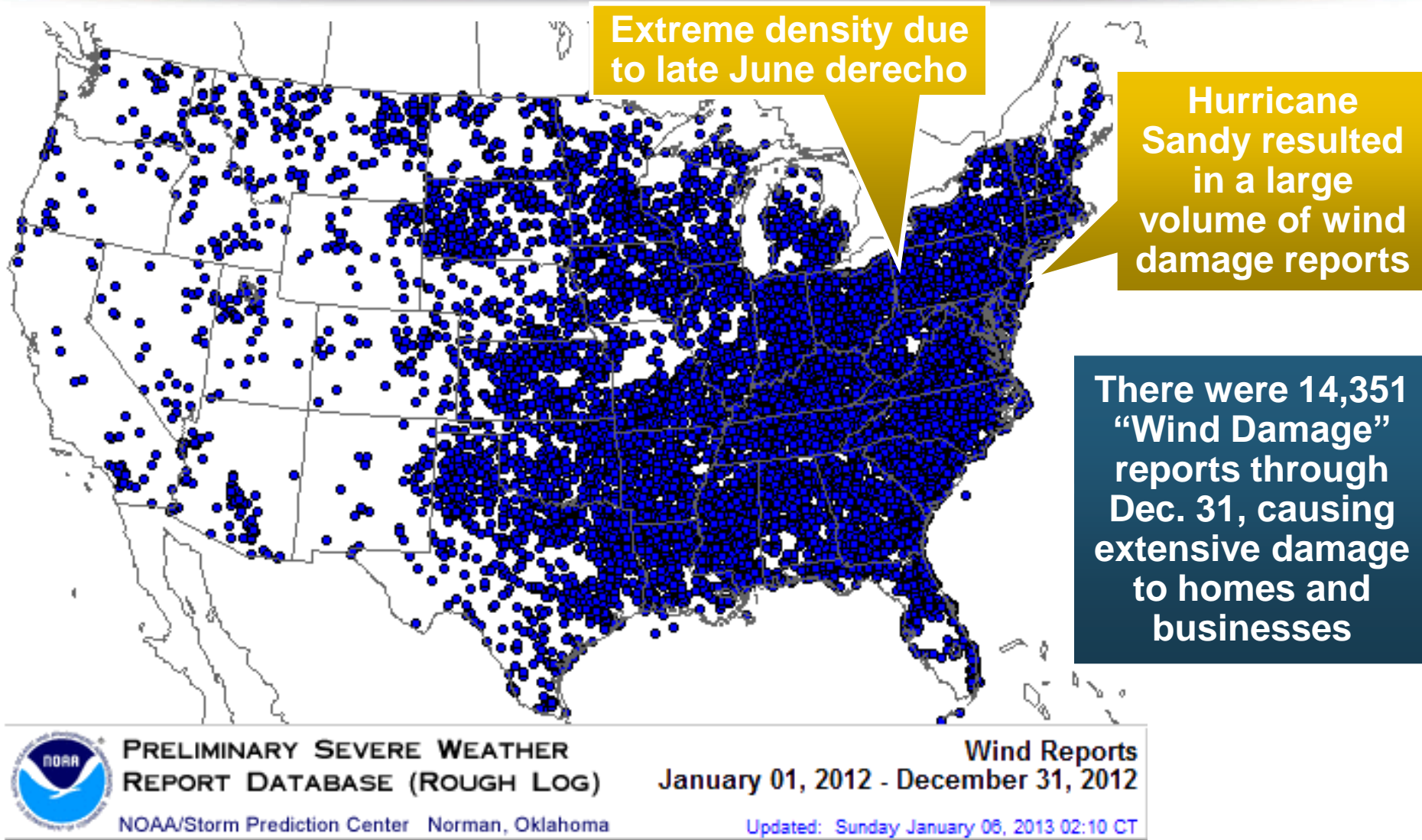
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# Location of Wind Damage Reports in the US, 2012\*

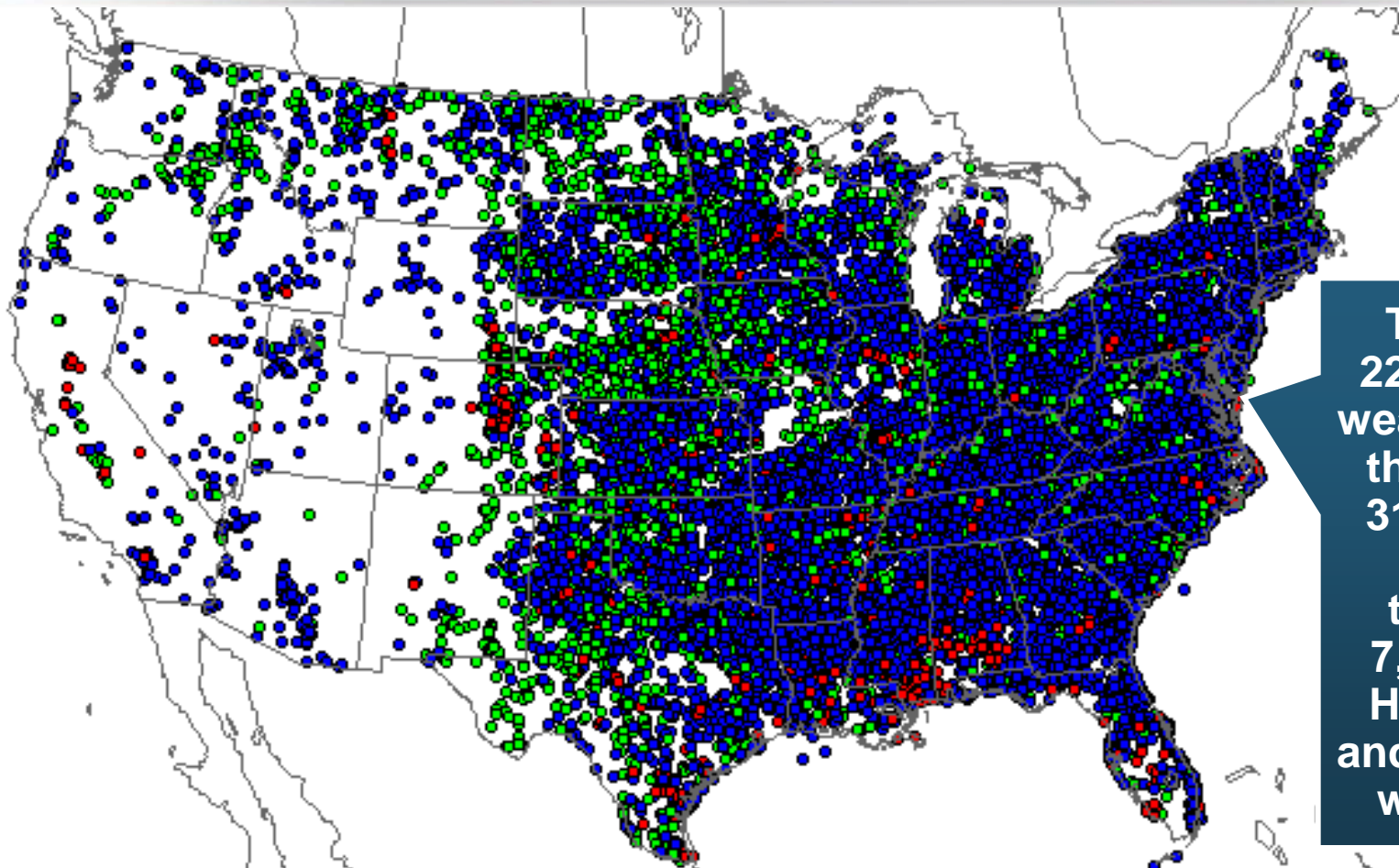


\*Through Dec. 31, 2012.

Source: NOAA Storm Prediction Center; [http://www.spc.noaa.gov/climo/online/monthly/2012\\_annual\\_summary.html#](http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html#)



# Severe Weather Reports, 2012\*



There were  
22,503 severe  
weather reports  
through Dec.  
31; including  
1,119  
tornadoes;  
7,033 “Large  
Hail” reports  
and 14,351 high  
wind events



PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Severe Weather Reports  
January 01, 2012 - December 31, 2012

Updated: Sunday January 06, 2013 02:10 CT

\*Through Dec. 31, 2012.

Source: NOAA Storm Prediction Center; [http://www.spc.noaa.gov/climo/online/monthly/2012\\_annual\\_summary.html#](http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html#)

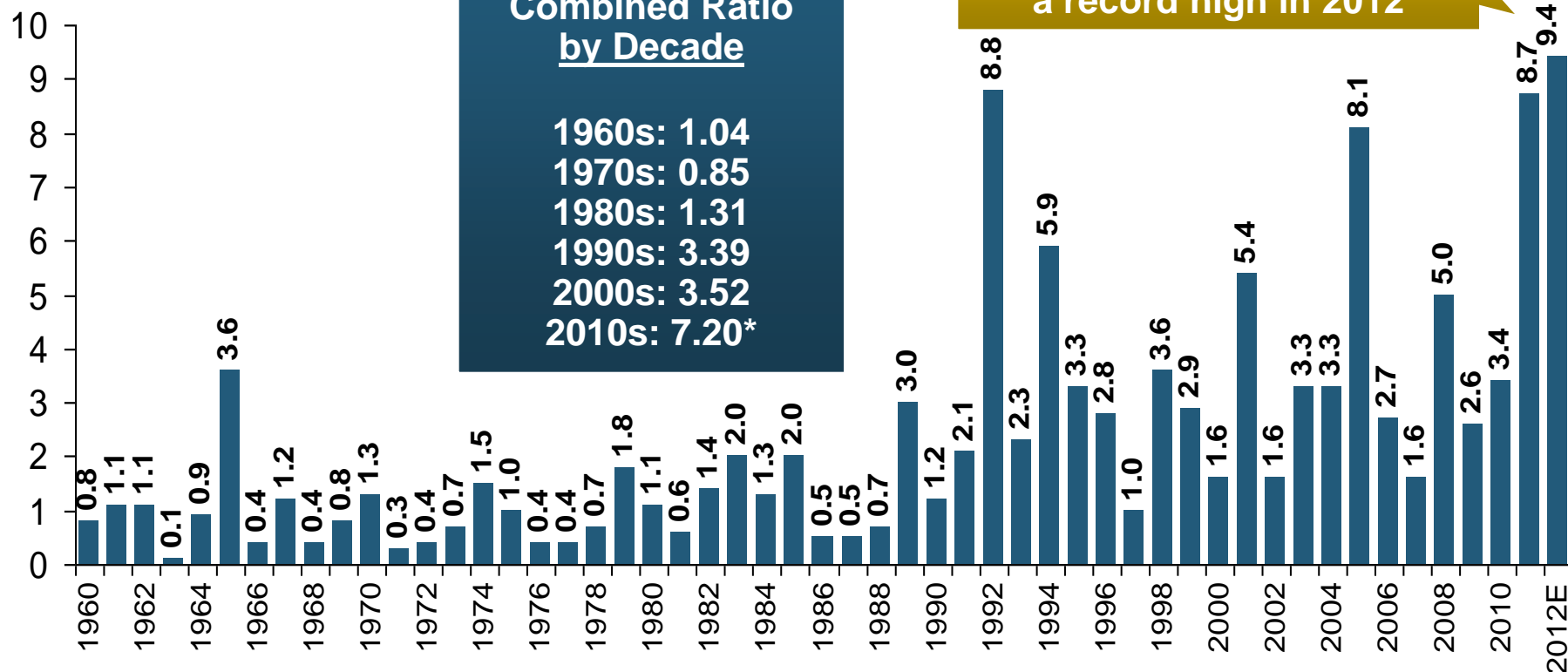
# Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2012\*

## 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: 7.20\*

Catastrophe losses as a share of all losses reached a record high in 2012



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

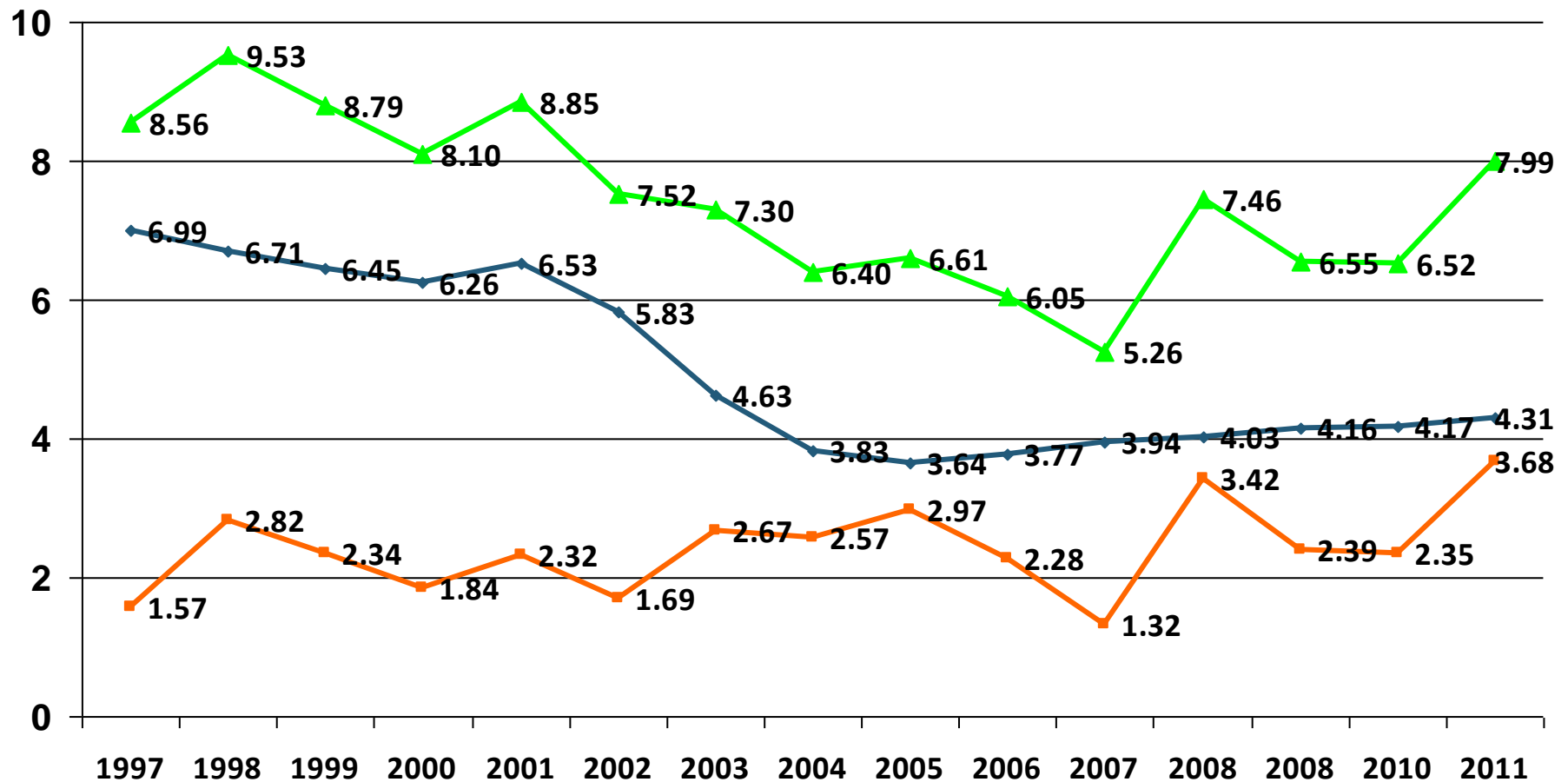
Notes: Private carrier losses only. Excludes loss adjustment expenses and reinsurance reinstatement premiums. Figures are adjusted for losses ultimately paid by foreign insurers and reinsurers.

Source: ISO (1960-2011); A.M. Best (2012E) Insurance Information Institute.

# P/C Industry Homeowners Claim Frequency, US, 1997-2011

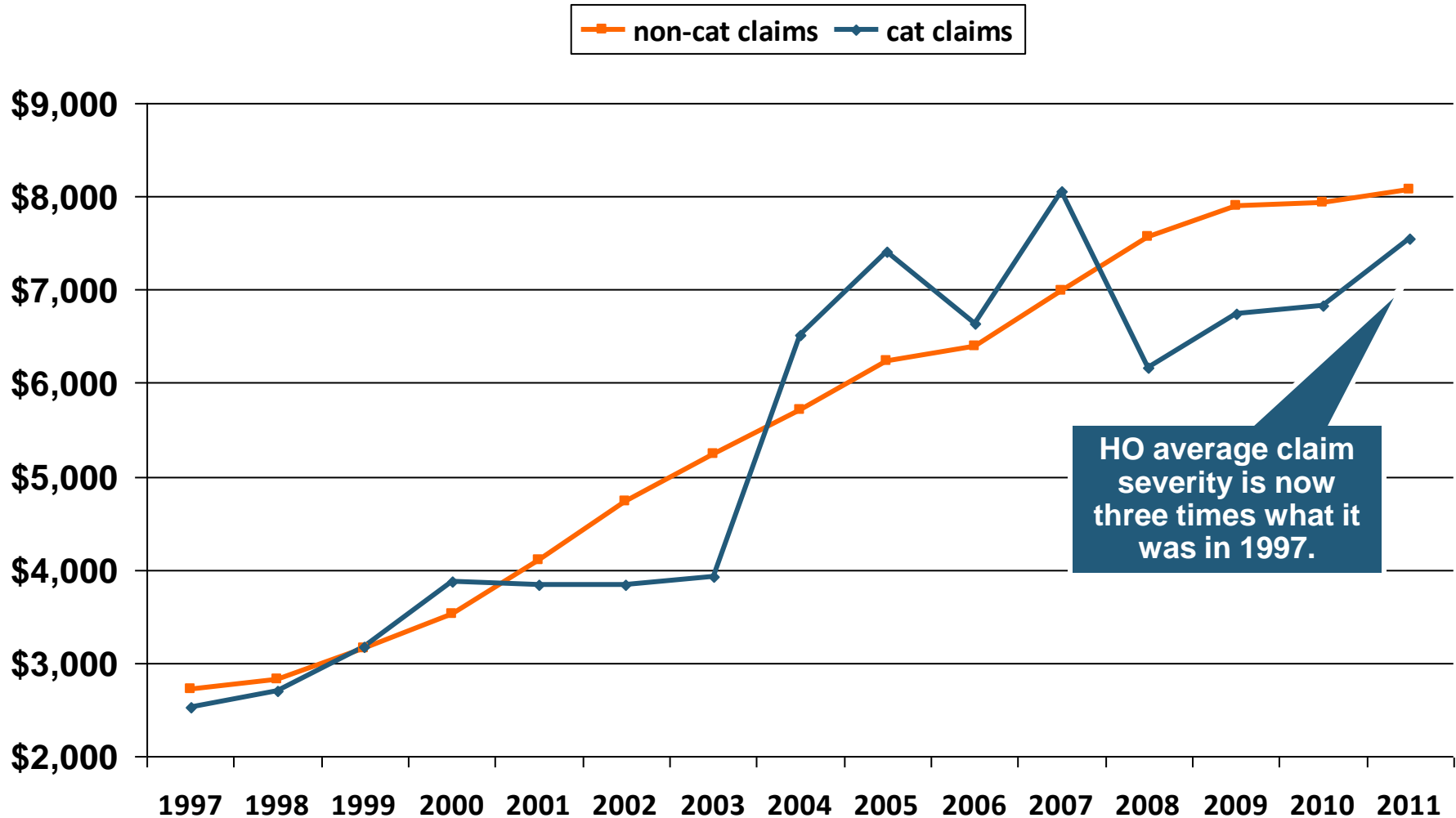
Claims Paid per  
100 Exposures

— CAT-related claims — Non-CAT-related claims — All Claims





# P/C Industry Homeowners Average Claim Severity, 1997-2011

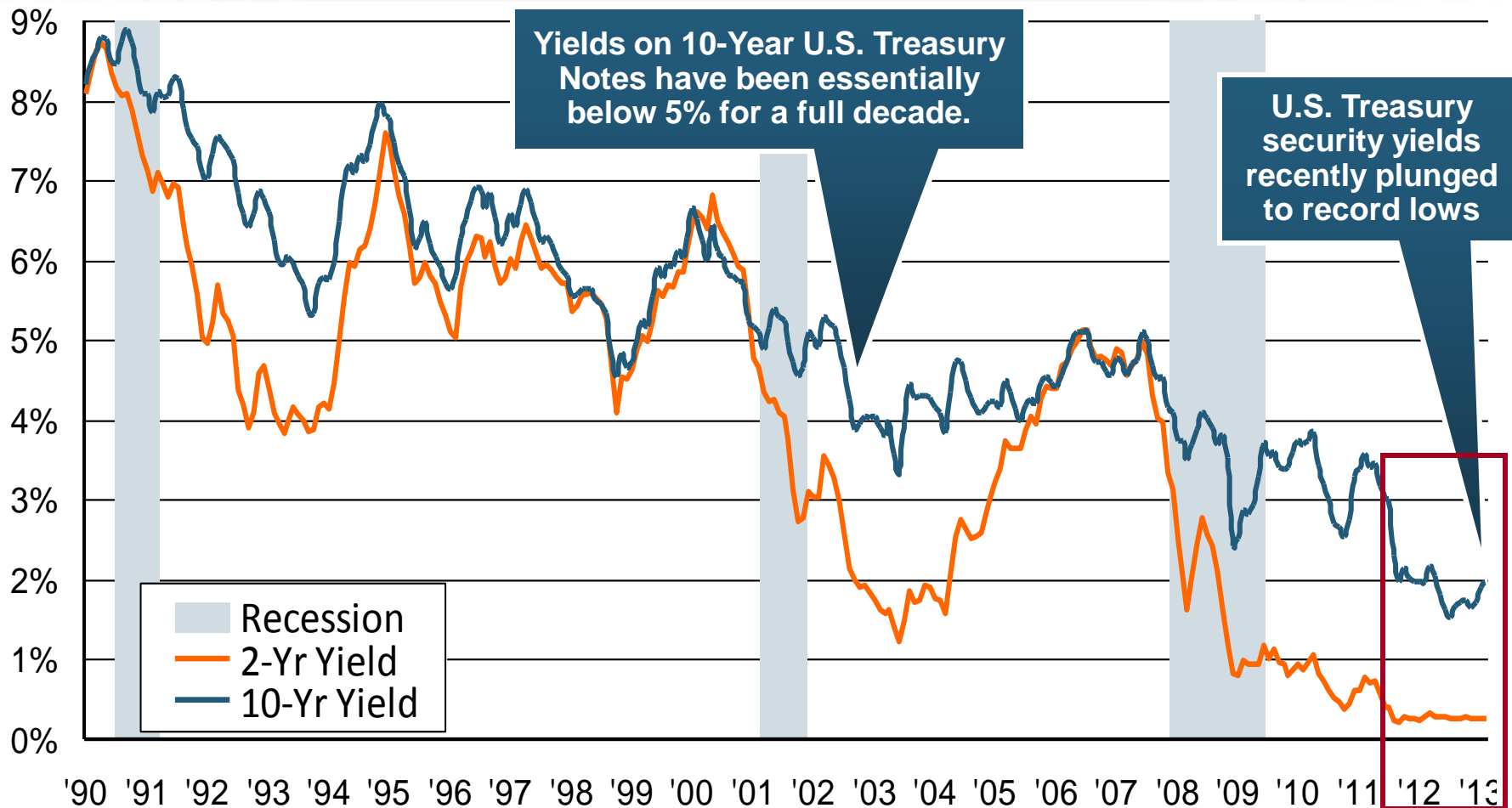


Sources: Insurance Research Council, "Trends in Homeowners Insurance Claims," p. 29, BLS inflation calculator, and Insurance Information Institute

# **Investments: The New Reality**

**Investment Performance is a  
Key Driver of Profitability**

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

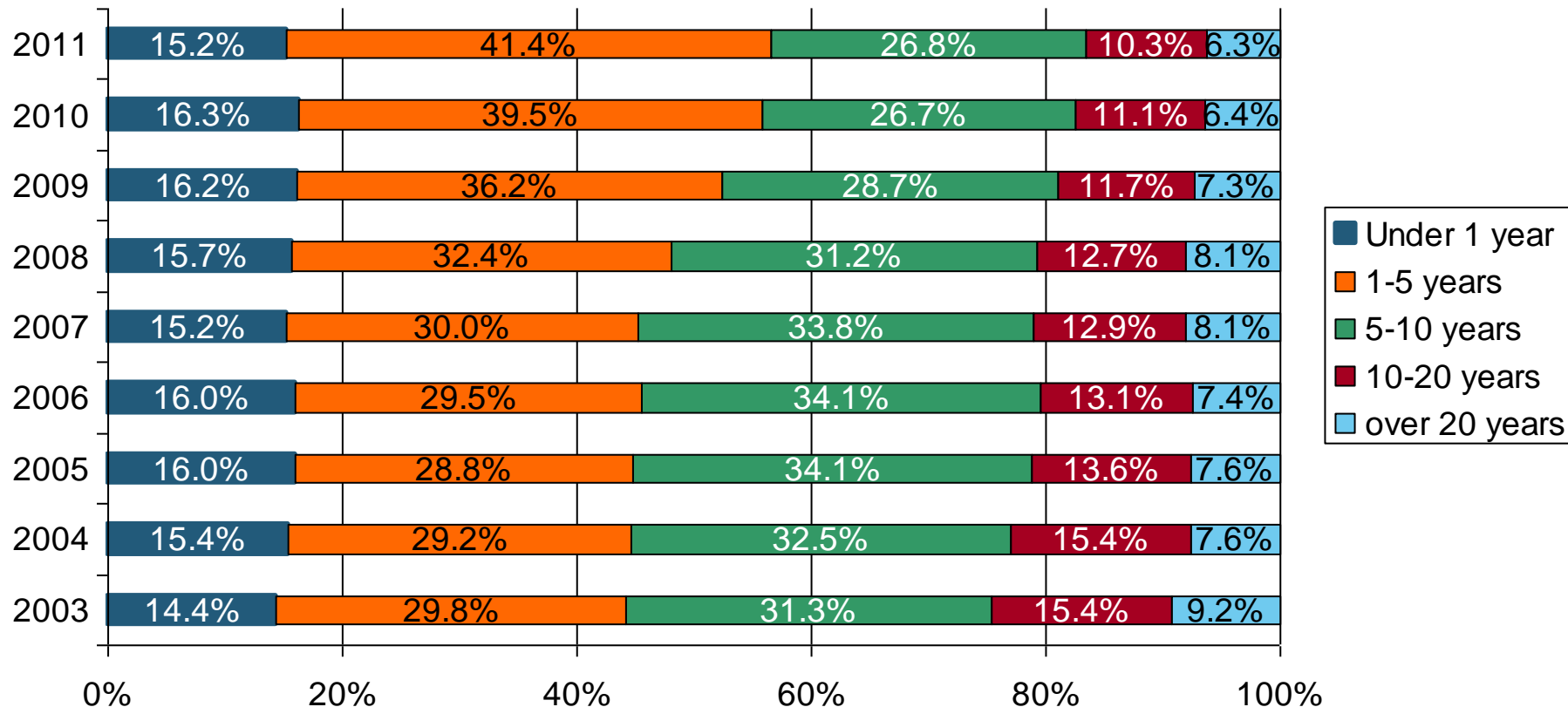


**Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.**

\*Monthly, constant maturity, nominal rates, through Feb 2013.

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

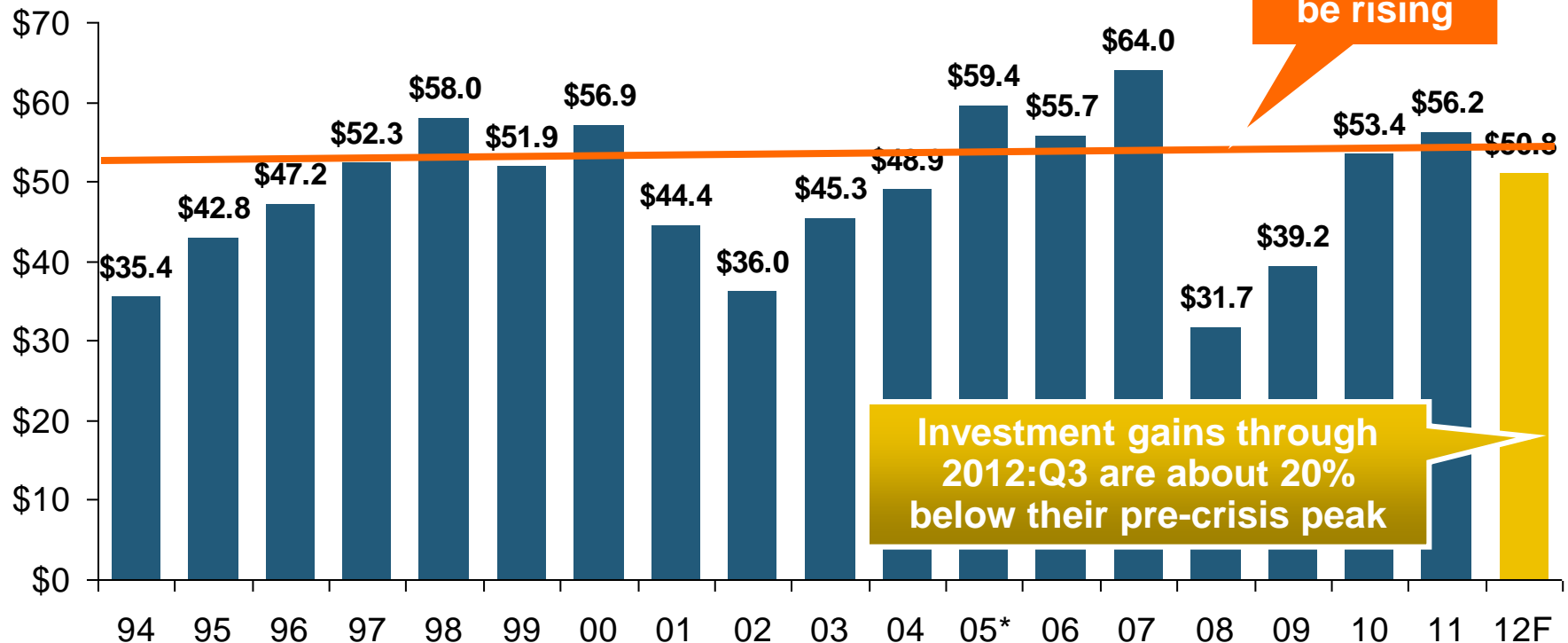
# Distribution of Bond Maturities, P/C Insurance Industry, 2003-2011



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 16.9% in 2011) and then trimmed bonds in the 5-10-year category. Falling average maturity of the P/C industry's bond portfolio is contributing to a drop in investment income along with lower yields.

# Property/Casualty Insurance Industry Investment Gain: 1994–2012F<sup>1</sup>

(\$ Billions)



**In 2012 (1<sup>st</sup> 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 through mid-2015, maturing bonds will be re-invested at even lower rates.**

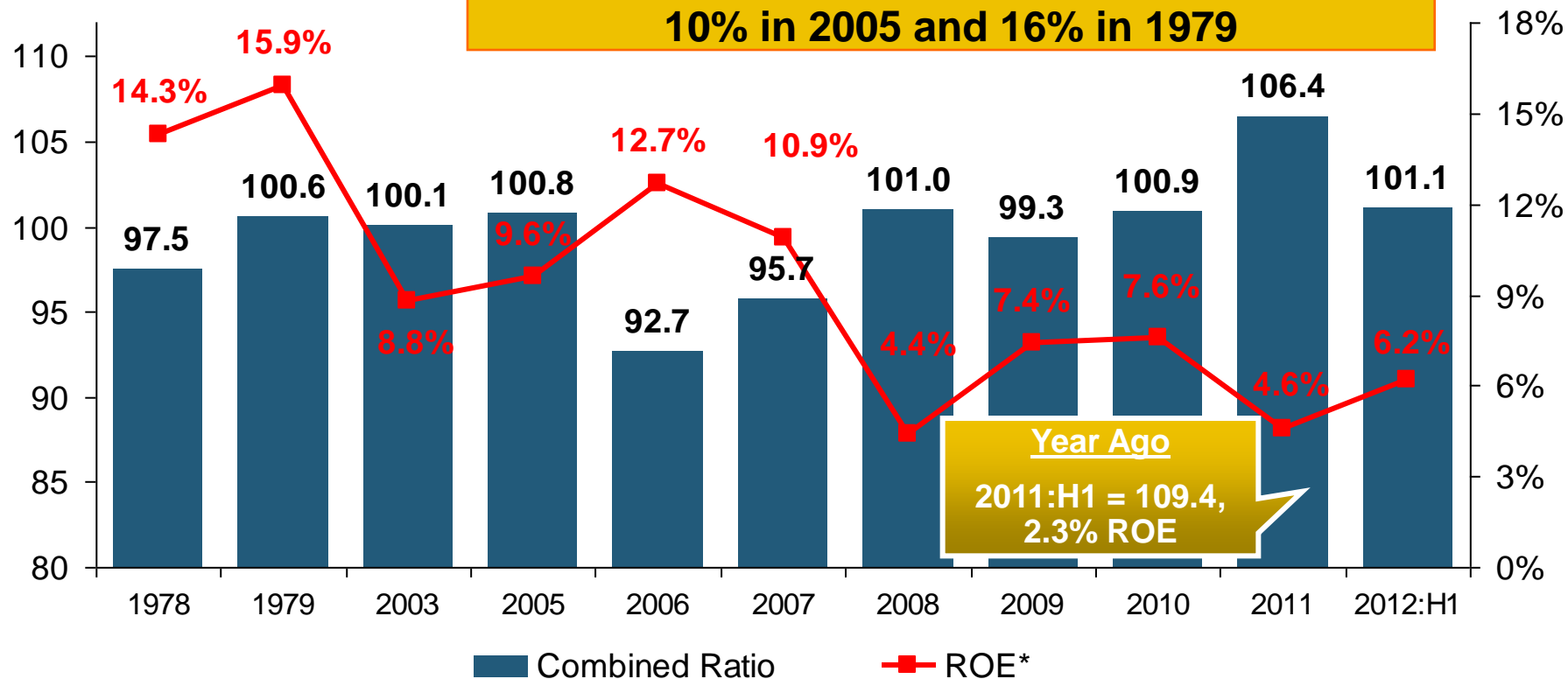
<sup>1</sup>Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

\*2005 figure includes special one-time dividend of \$3.2B; 2012F figure is I.I.I. estimate based on annualized actual 2012:Q3 result of \$38.089B. Sources: 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 generates an ROE of ~7.0% in 2012, ~7.5% ROE in 2009/10, 10% in 2005 and 16% in 1979**

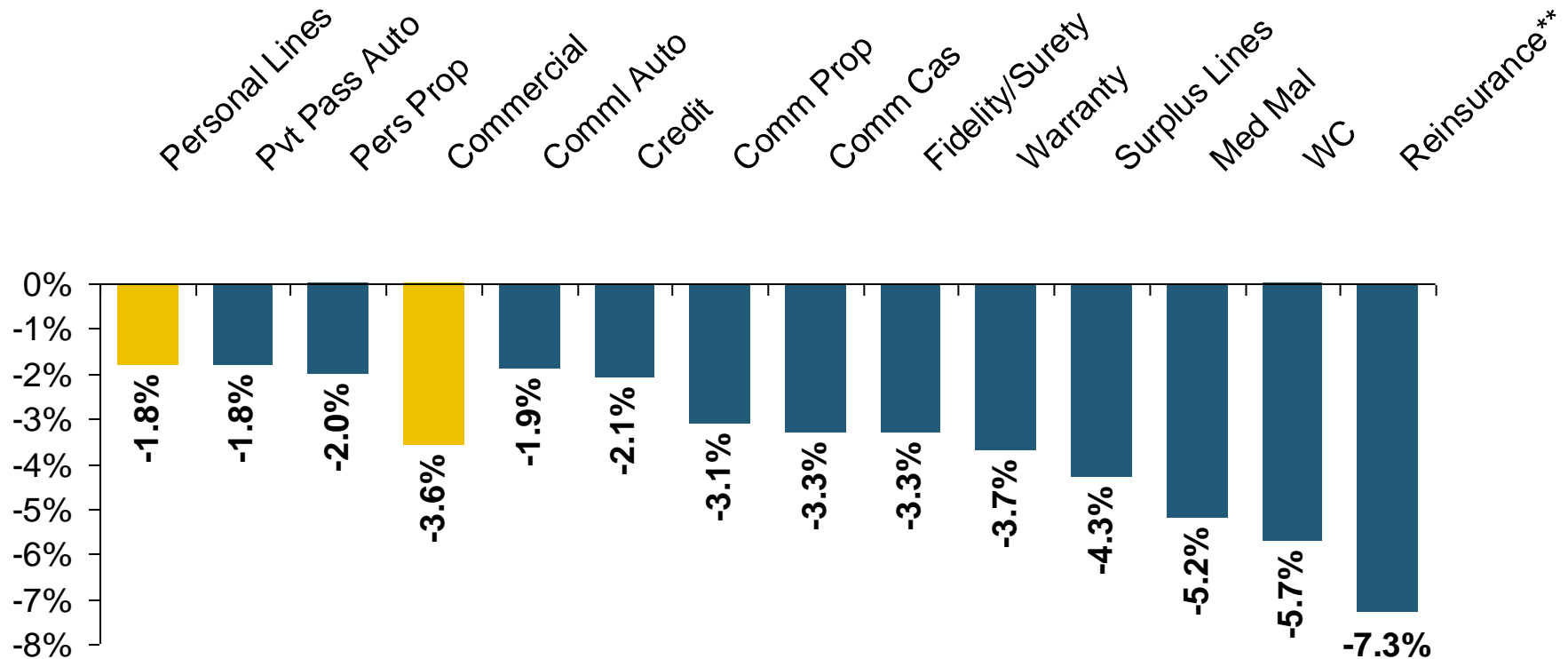


**Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs**

\* 2008 -2012 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2012:H1 combined ratio including M&FG insurers is 102.2, ROAS = 5.9%; 2011 combined ratio including M&FG insurers is 108.2, ROAS = 3.5%.

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

# 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

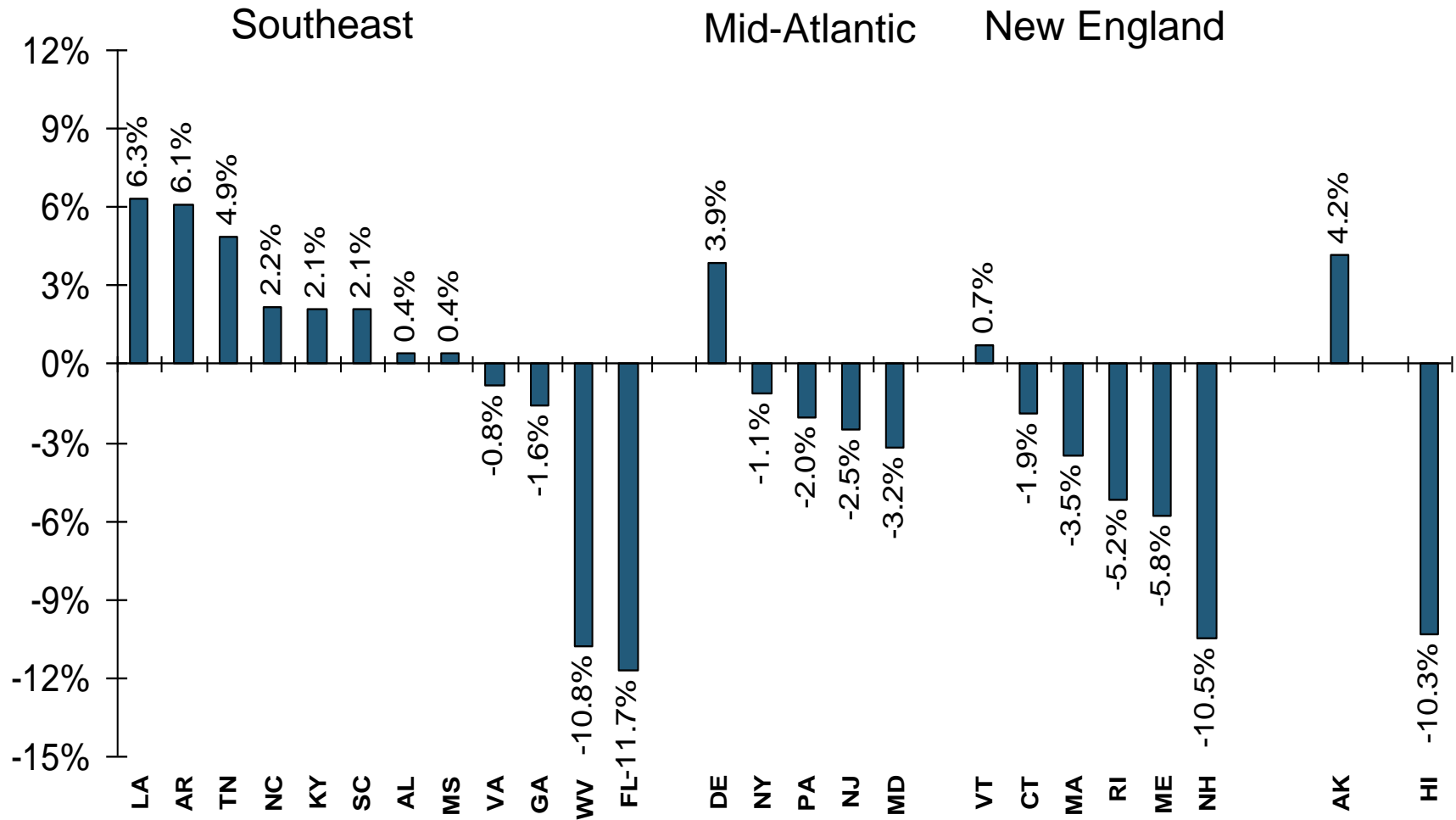
Source: A.M. Best; Insurance Information Institute.

# Perspectives on Premium Growth

**Premium Growth Rates  
Vary Tremendously**

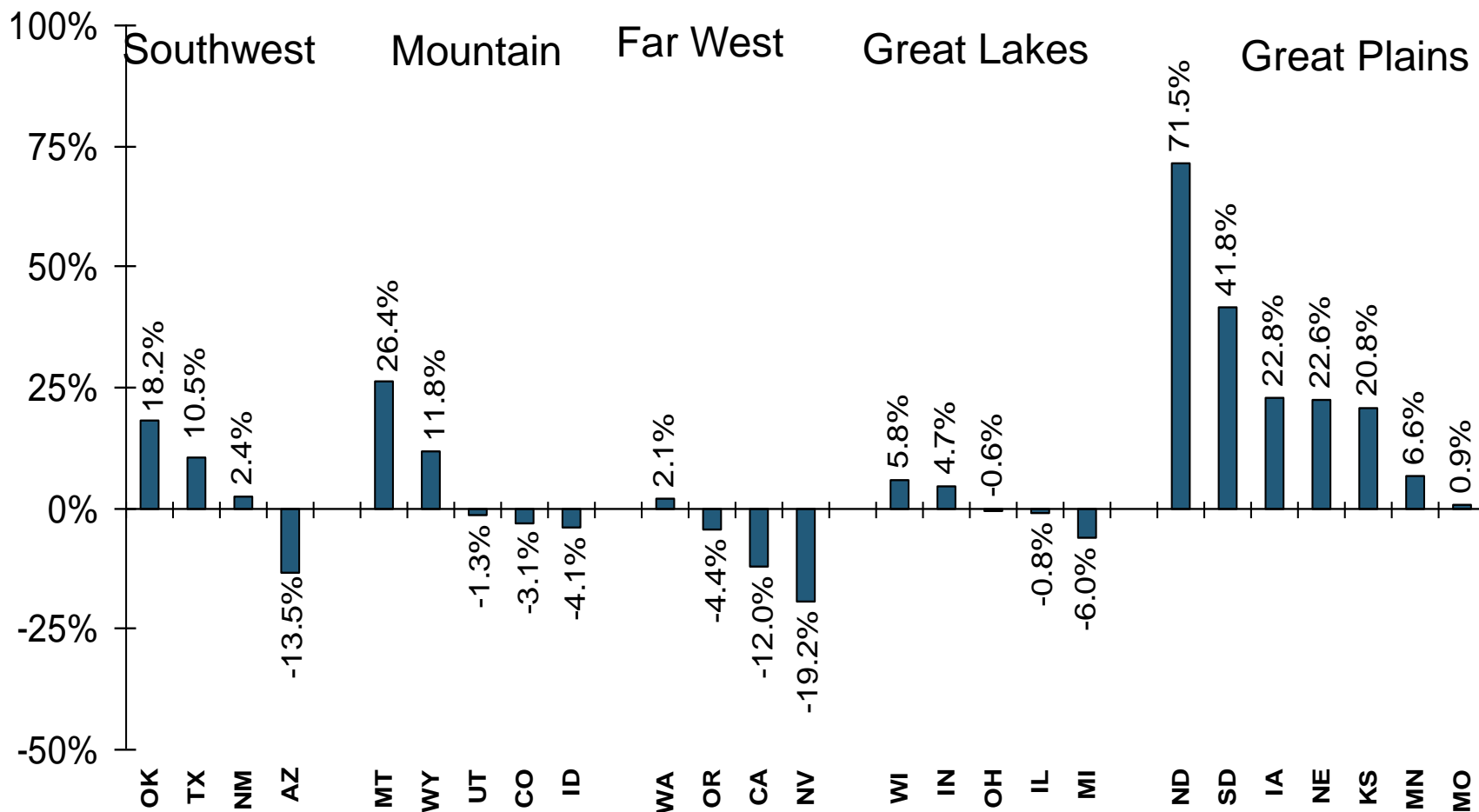


# Total P/C Direct Premiums Written: Percent Change by State, 2006-2011



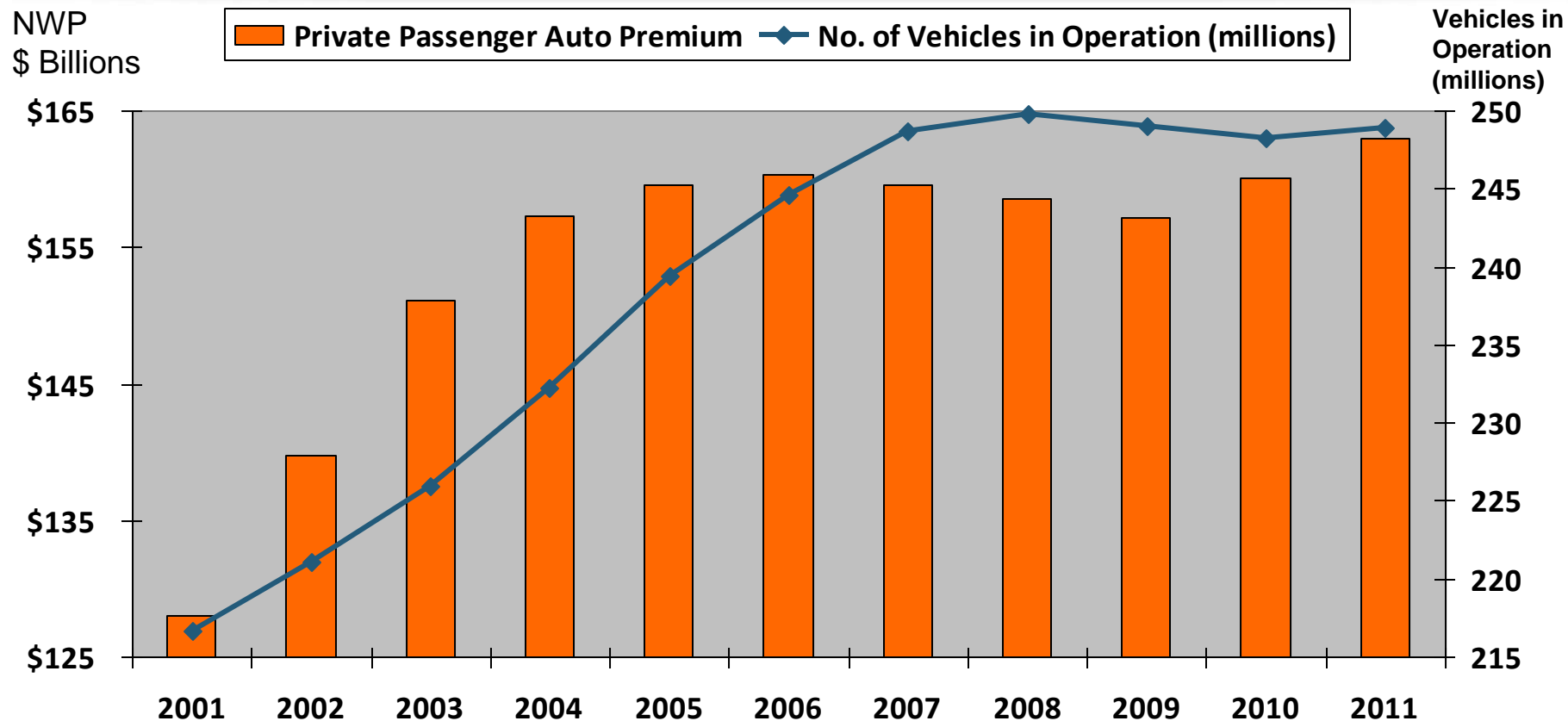
Sources: SNL Financial, LLC.; Insurance Information Institute.

# Total P/C Direct Premiums Written: Percent Change by State, 2006-2011



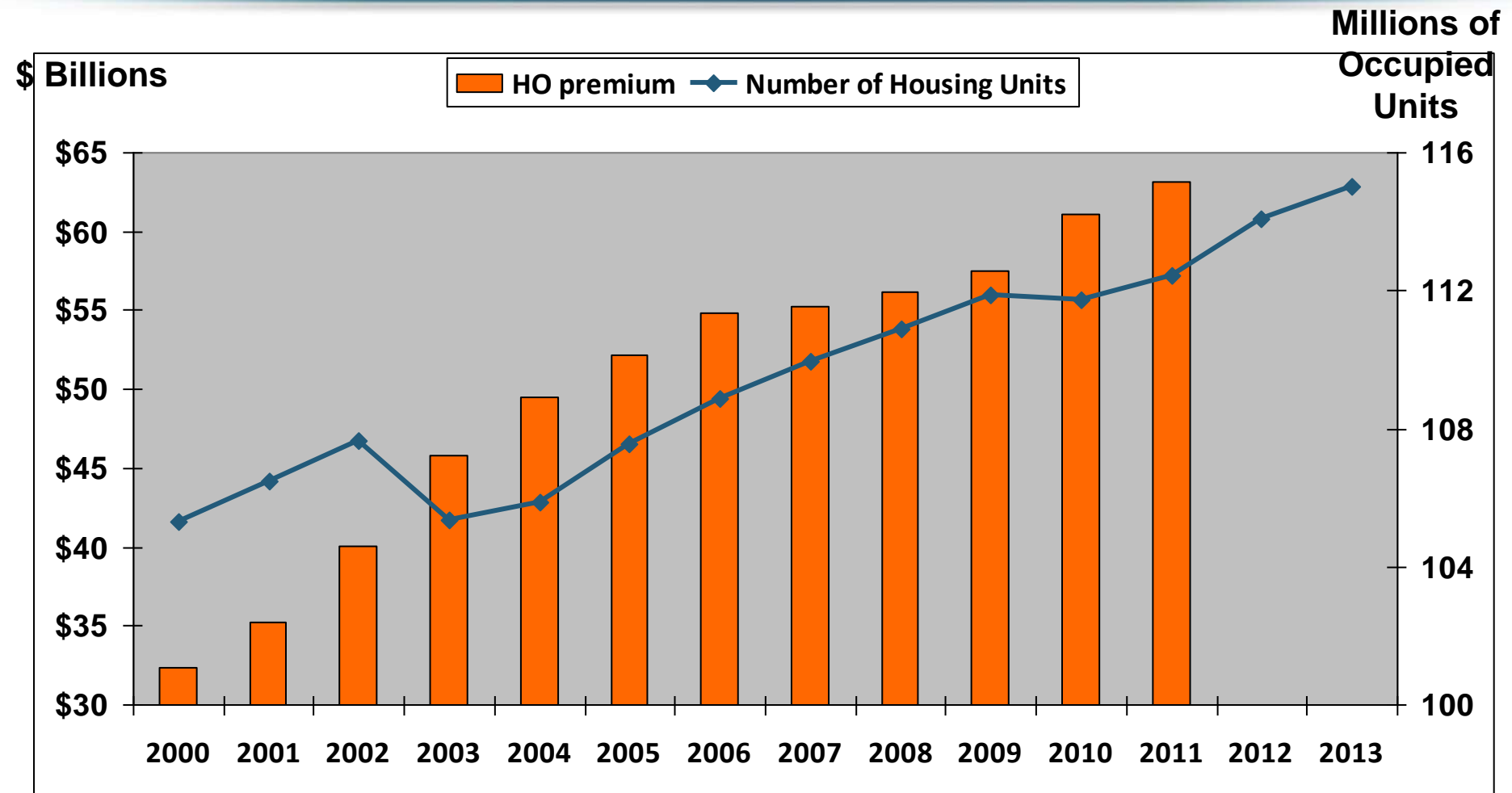
Sources: SNL Financial, LLC.; Insurance Information Institute.

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



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

# HO Insurance Net Written Premium vs. No. of Housing Units\*, 2000–2011



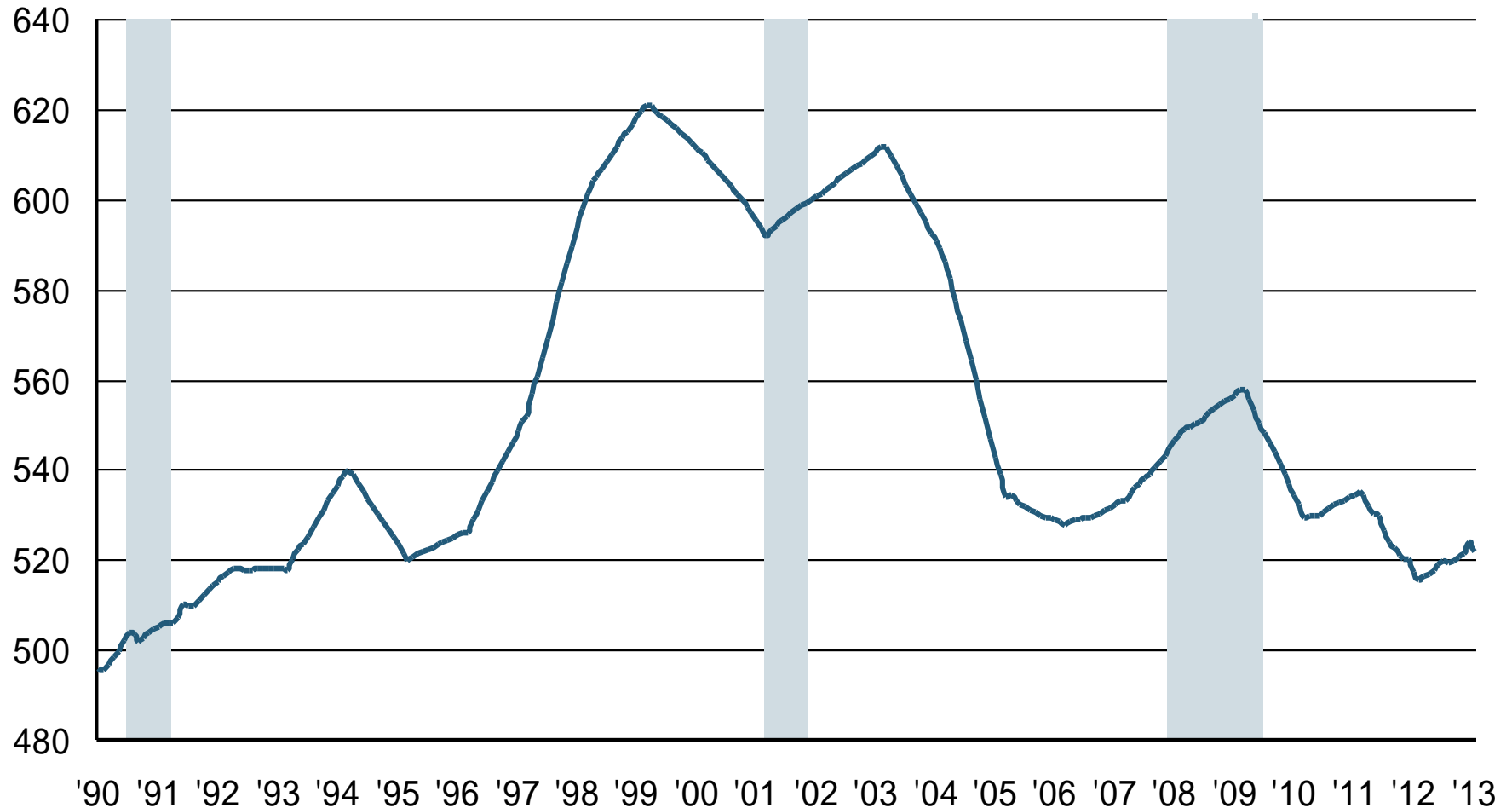
**Homeowners insurance NWP continues rising (up 95% 2000-2011) despite very little unit growth in recent years. Reasons include rate increases, esp**

\*occupied as of start of year indicated  
Sources: A.M. Best; Insurance Information Institute.

# Employment in the P/C Insurance Industry

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

Thousands



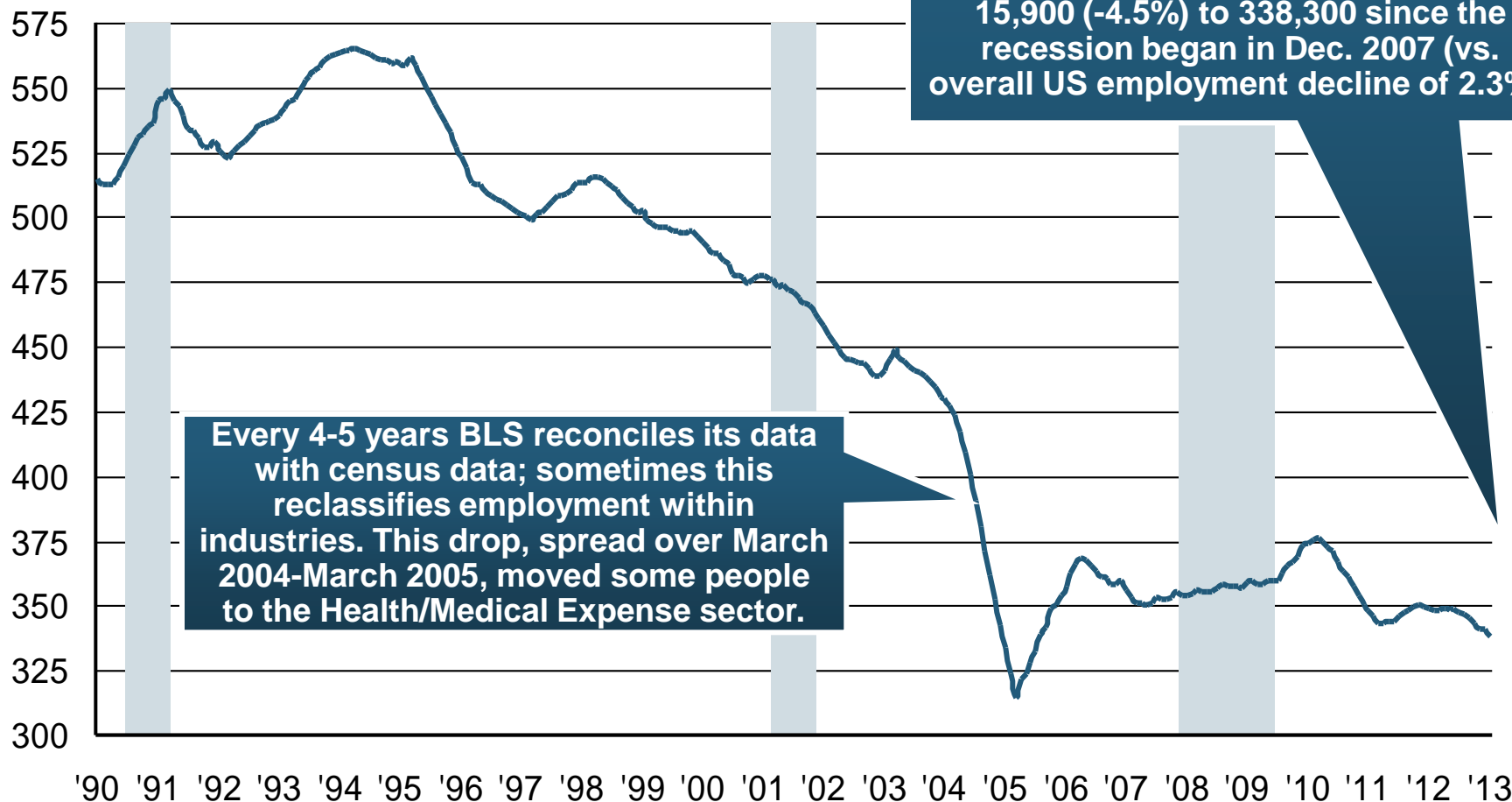
\*As of January 2013; Seasonally adjusted; Does not include agents & brokers.

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 Life Insurance Industry: 1990–2013\*

Thousands



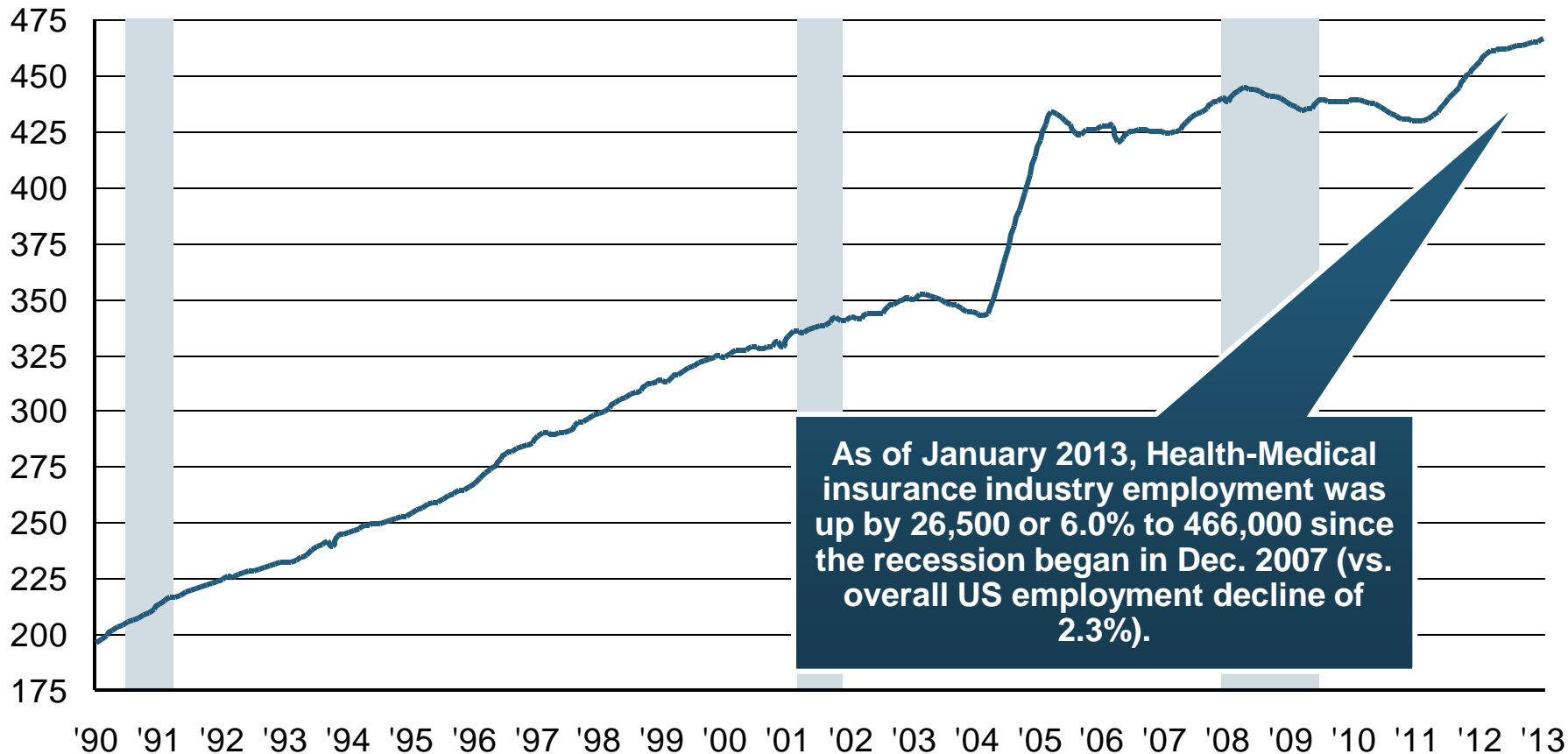
\*As of January 2013; Seasonally adjusted; Does not including agents & brokers.

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 Health-Medical Insurance Industry: 1990–2013\*

Thousands



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

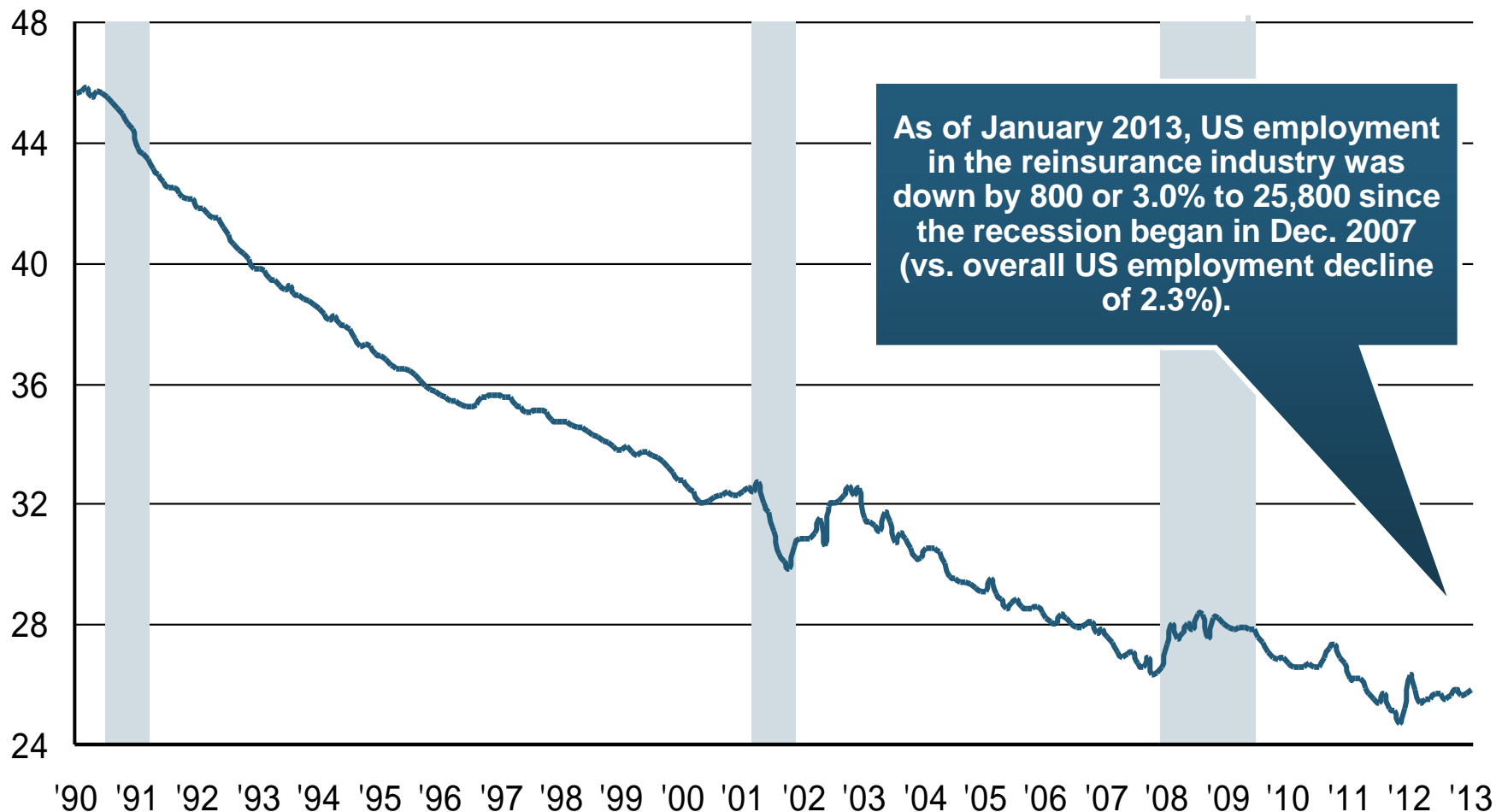
Note: Recessions indicated by gray shaded columns.

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



# Employment in the U.S. Reinsurance Industry: 1990–2013\*

Thousands



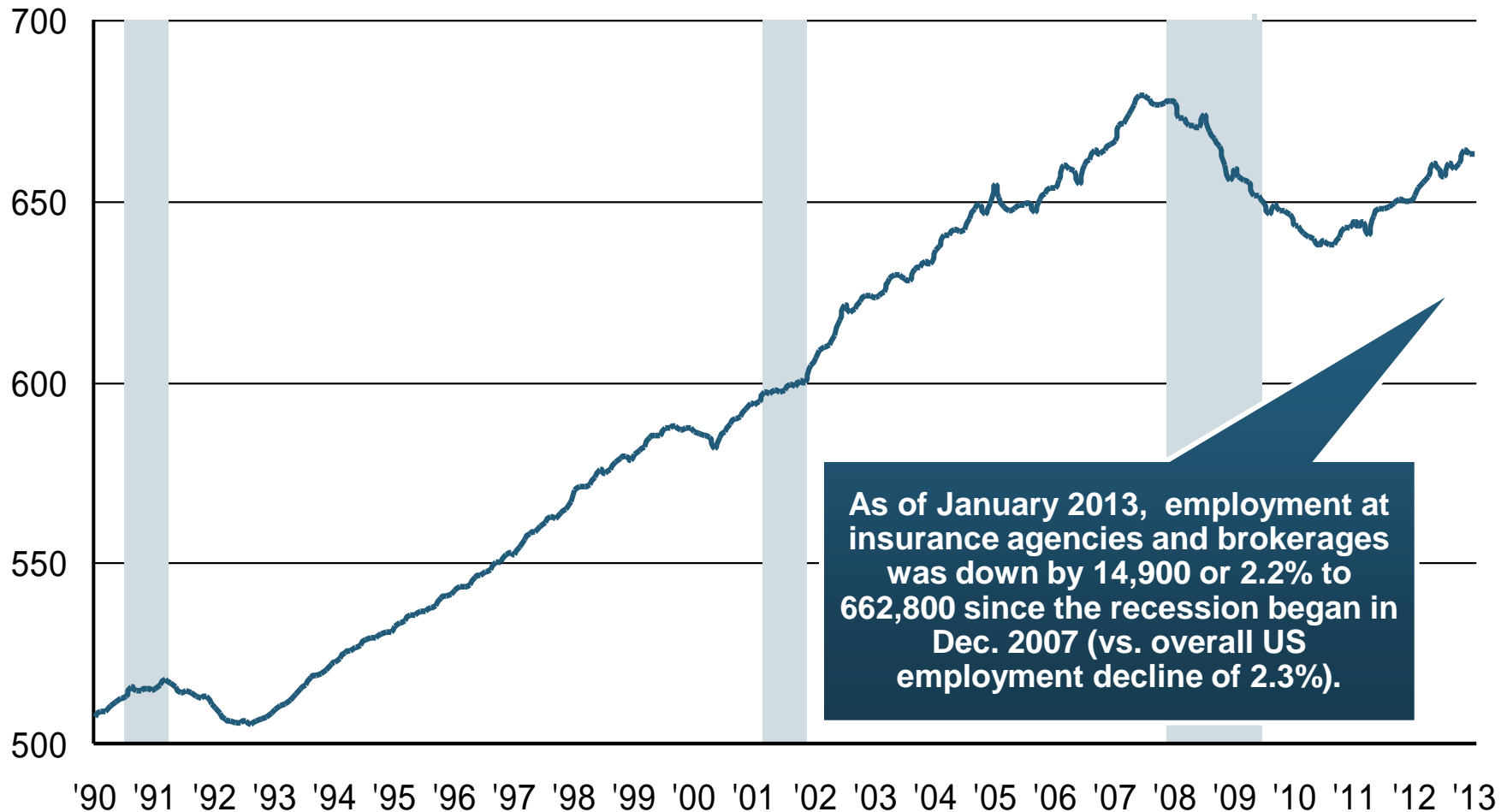
\*As of January 2013; Seasonally adjusted; Does not including agents & brokers.

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



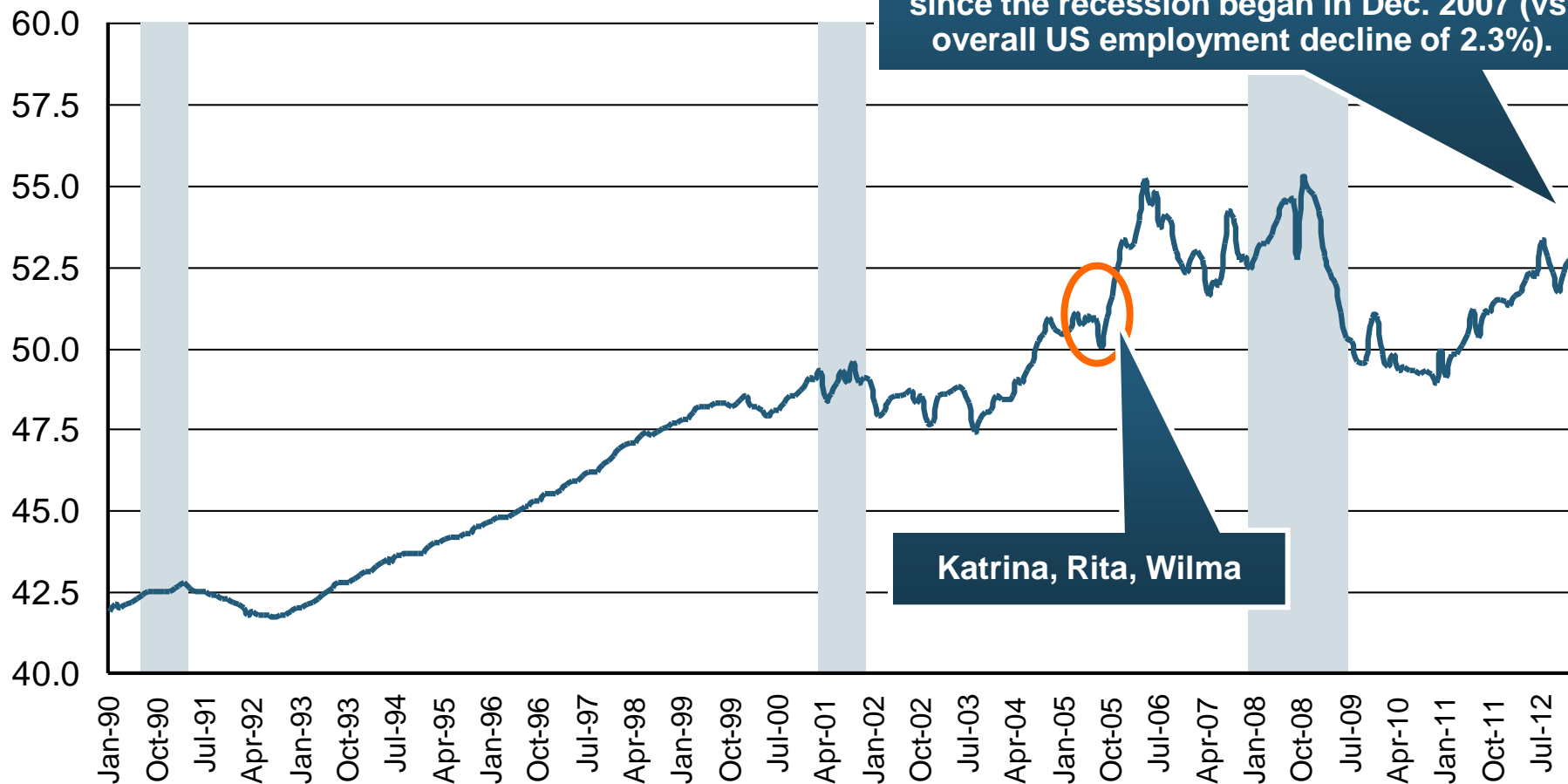
\*As of January 2013; Seasonally adjusted. Includes all types of insurance.

Note: Recessions indicated by gray shaded columns.

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

# U.S. Employment in Insurance Claims Adjusting: 1990–2013\*

Thousands



\*As of January 2013; Seasonally adjusted.

Note: Recessions indicated by gray shaded columns.

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

# Key Take-aways

# Take-aways:

## Insurance Industry Predictions for 2013

- **P/C Insurance Exposures Will Grow With the U.S. Economy**
  - ◆ Personal and commercial exposure growth is likely in 2013
    - But restoration of destroyed exposure will take until mid-decade
  - ◆ Wage growth is also positive and could modestly accelerate
- **P/C Industry Growth in 2013 Will Be Strongest Since 2004**
  - ◆ Growth likely to exceed A.M. Best projection of +3.8% for 2012
  - ◆ No traditional “hard market” emerges in 2013
- **Underwriting Fundamentals Weak But Improving**
  - ◆ Some pressure from claim frequency, severity in some key lines
  - ◆ But WC will be tough to fix
- **Industry Capacity Hits a New Record by Year-End 2013 (Barring Meg-CAT)**
- **Investment Environment Is/Remains Challenging**
  - ◆ Interest rates remain low

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