



Where Do We Stand? Changes and Challenges in 2013 and Beyond

**PCI's Marketing & Underwriting Professionals
Seminar
Fort Lauderdale, FL
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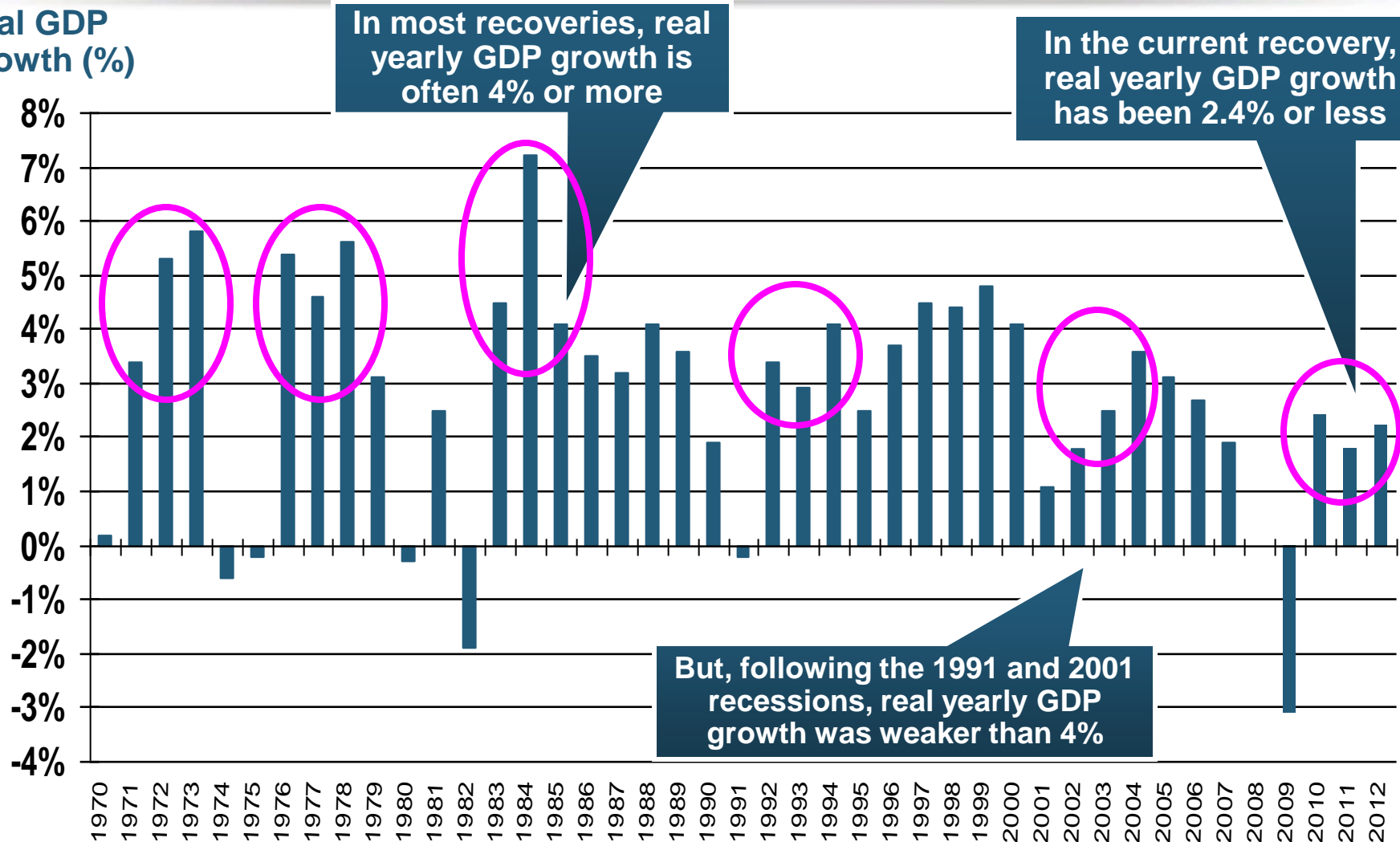
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Challenge #1: Slow Exposure Growth

**Most forecasts see the U.S. and
world economies continuing to
stumble along**

Real GDP Growth: Past Recessions and Recoveries, Yearly, 1970-2012

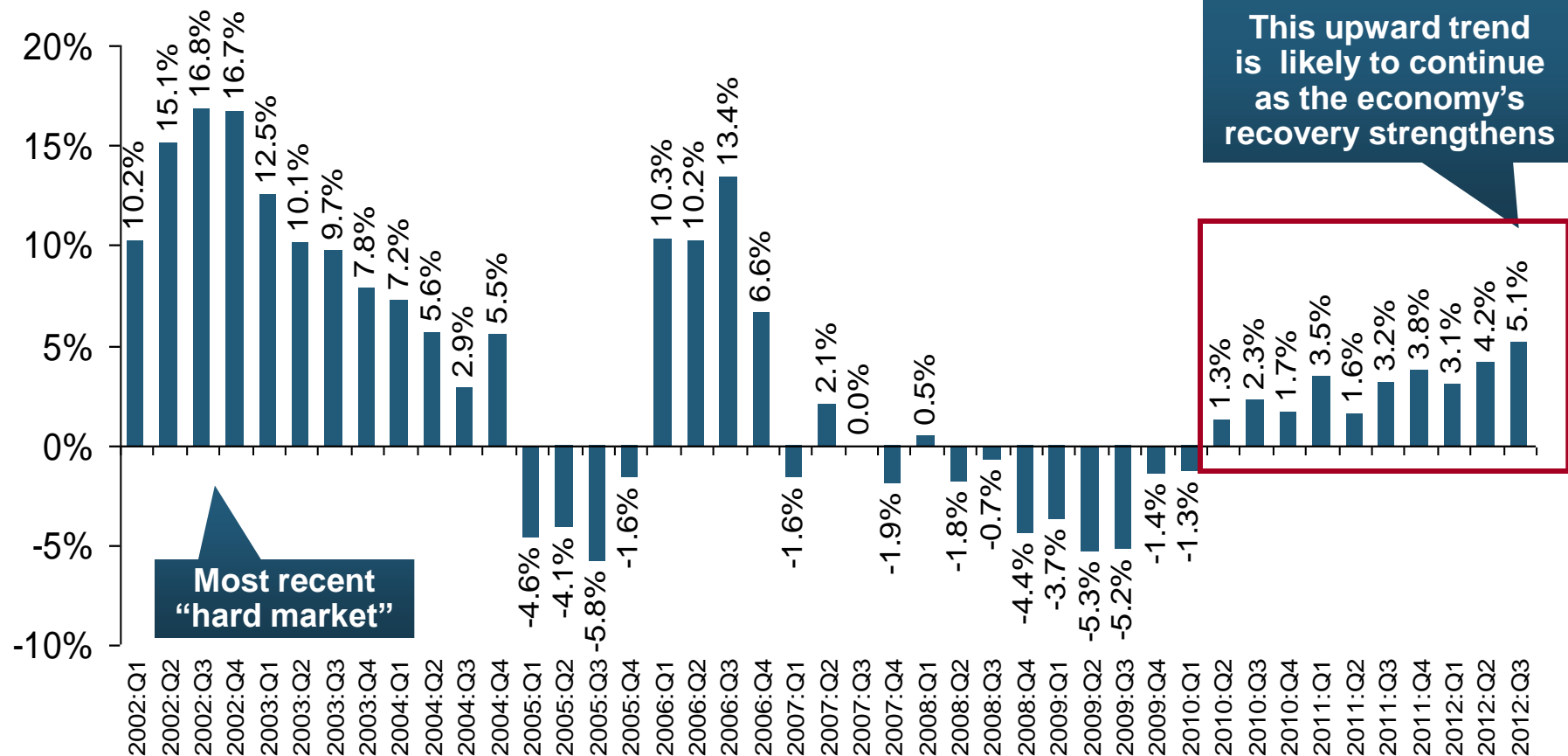
Real GDP
Growth (%)



Source: (GDP) U.S. Department of Commerce at <http://www.bea.gov/national/xls/gdpchg.xls>.

But Overall, Since 2010:Q2, P/C Net Premiums Written Are Growing

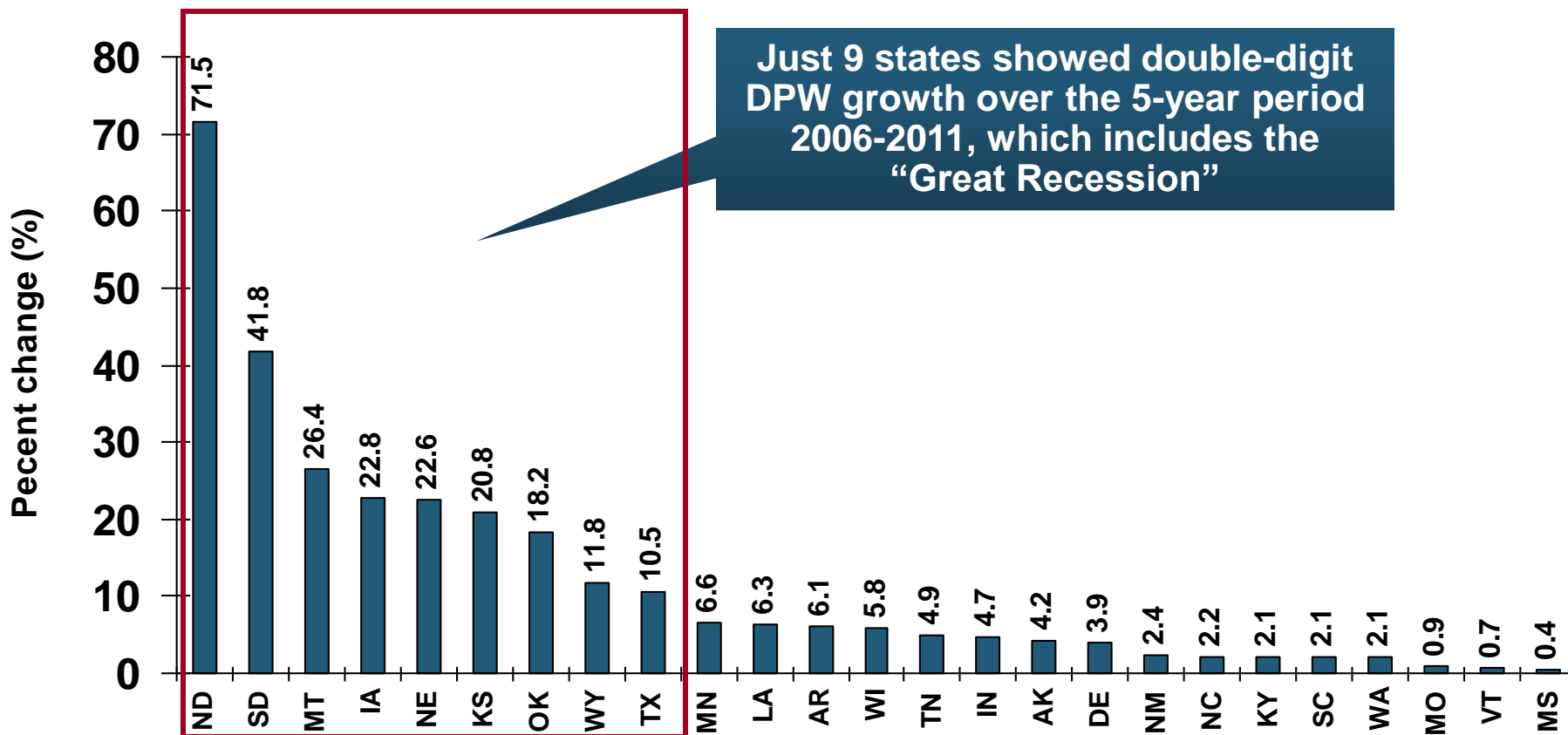
P/C NPW: % Change,
Quarter vs. Year-Prior Quarter



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

But the Growth Is Uneven: Wide Variation by State (DPW: Total P/C Percent Change for 2006-2011)

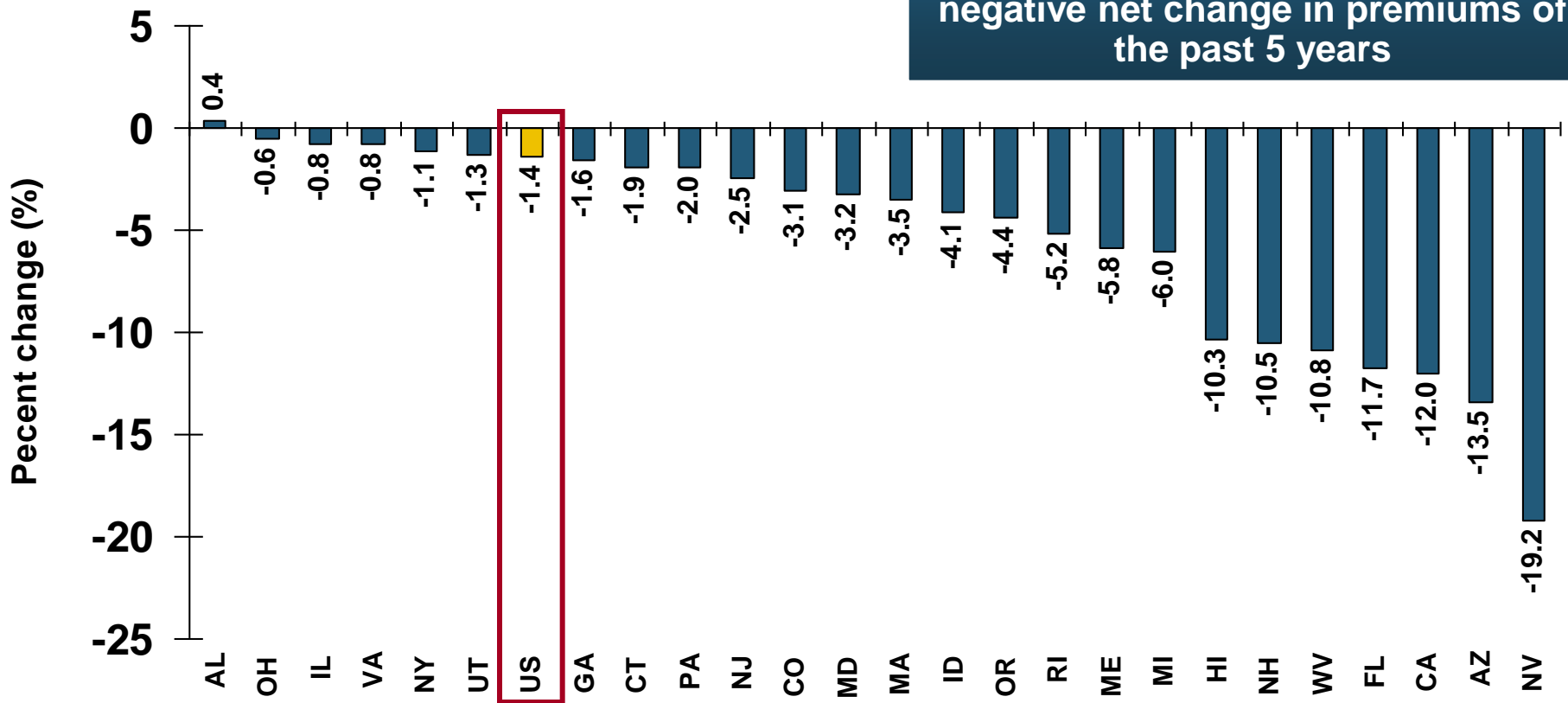
Top 25 States



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

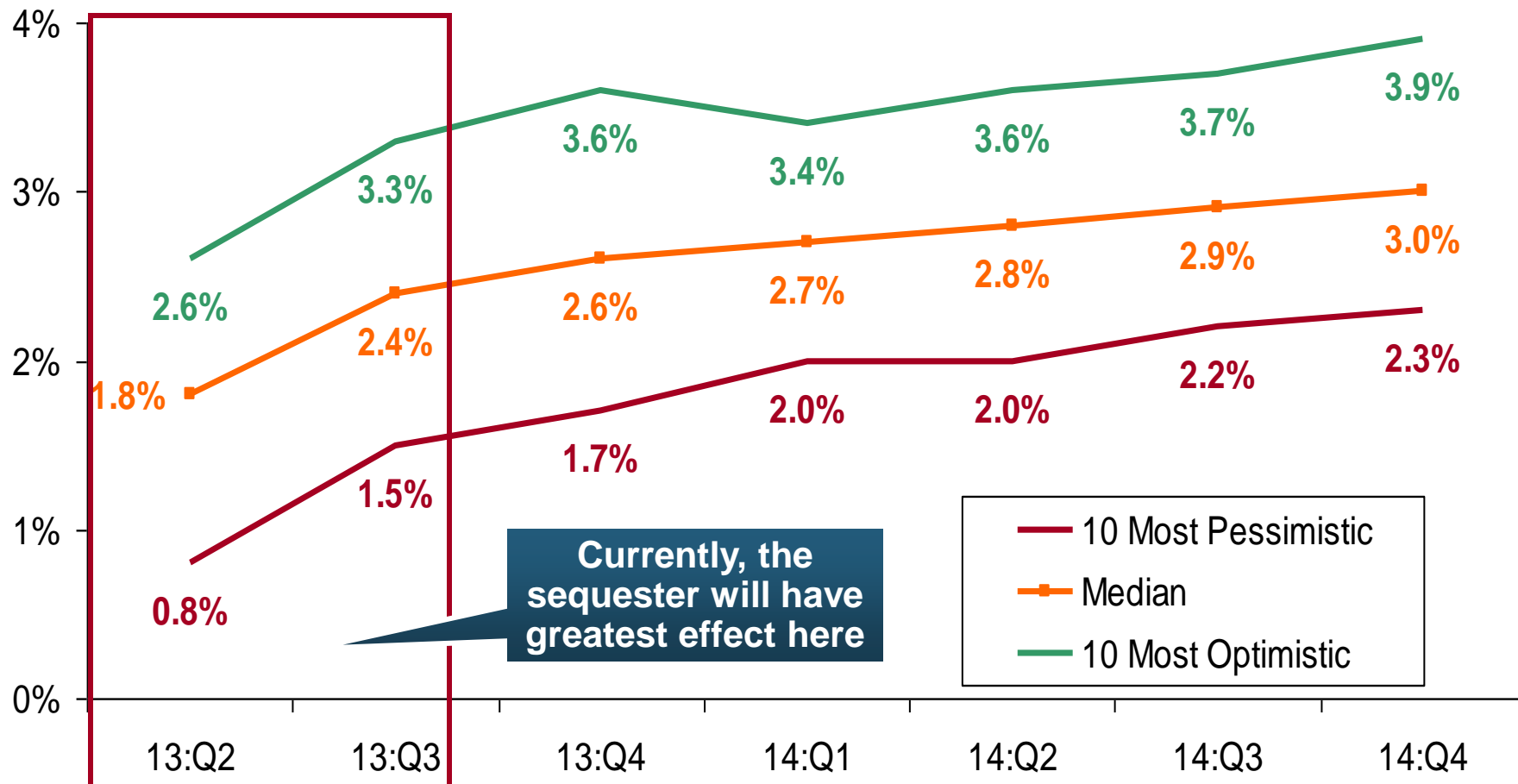
Bottom 25 States

States with the poorest performing economies also produced the most negative net change in premiums of the past 5 years



April 2013 Forecasts of Quarterly US Real GDP for 2013-14

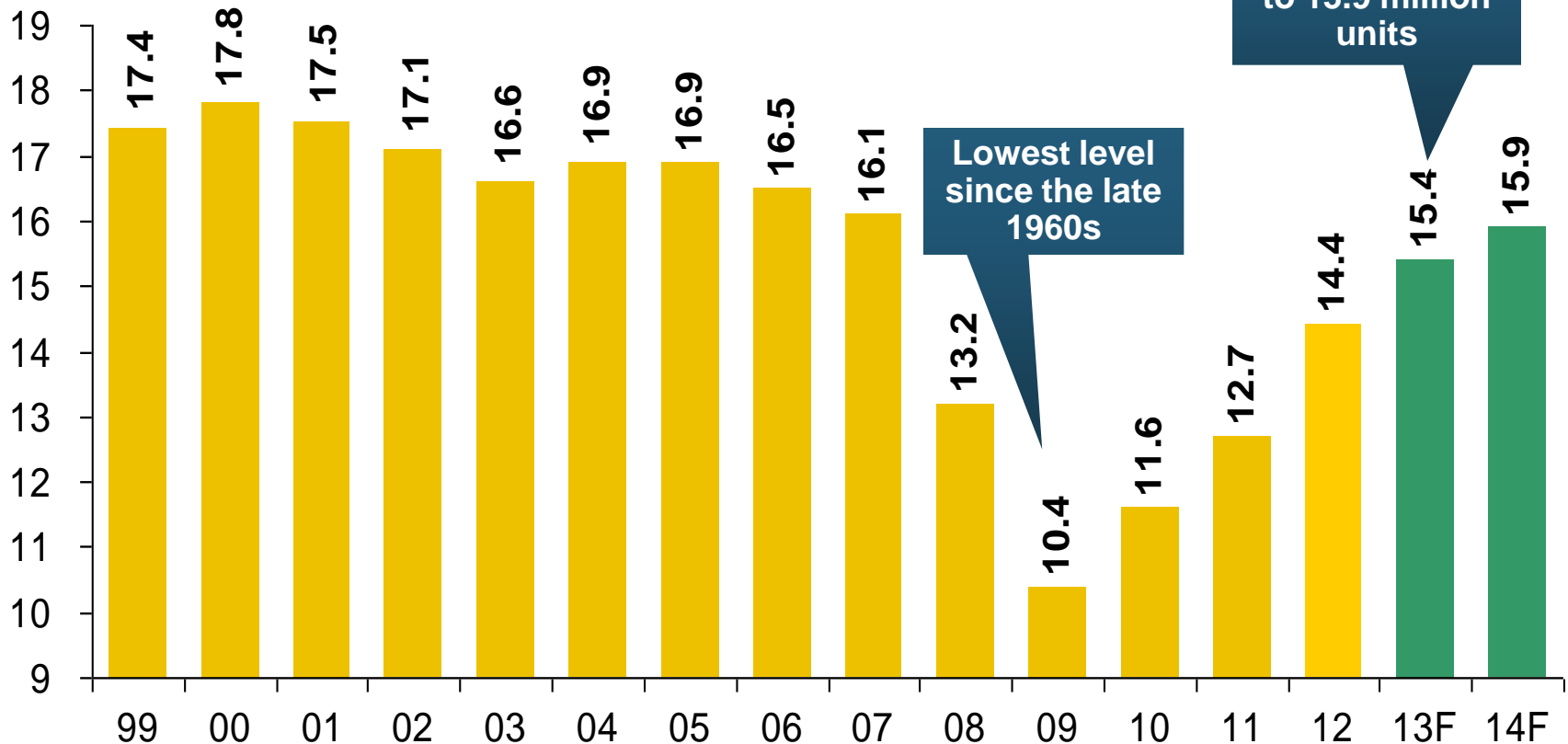
Real GDP Growth Rate



Despite the sequester and other challenges to the U.S. economy, virtually every forecast in the Blue Chip universe in early April sees improvement ahead

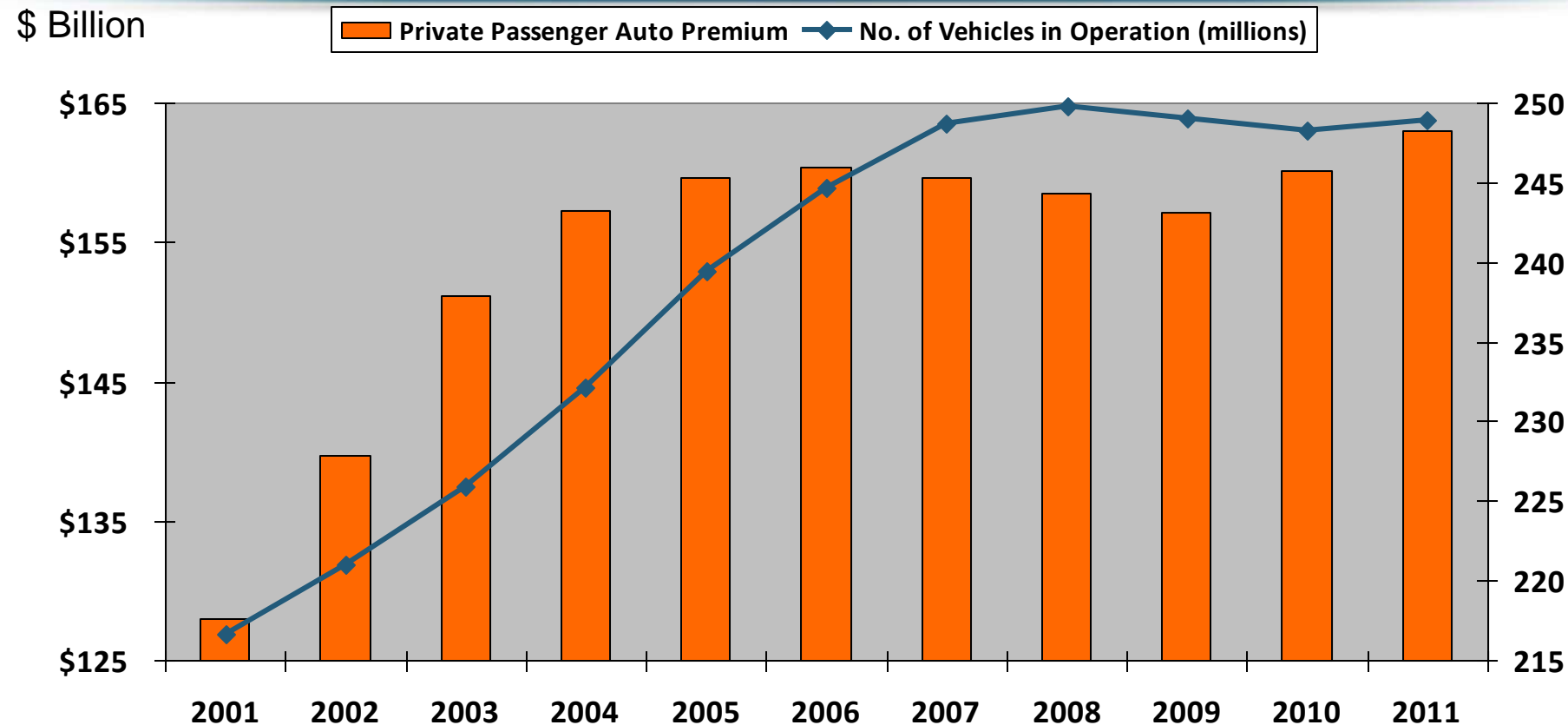
Auto/Light Truck Sales, 1999-2014F

(Millions of Units)



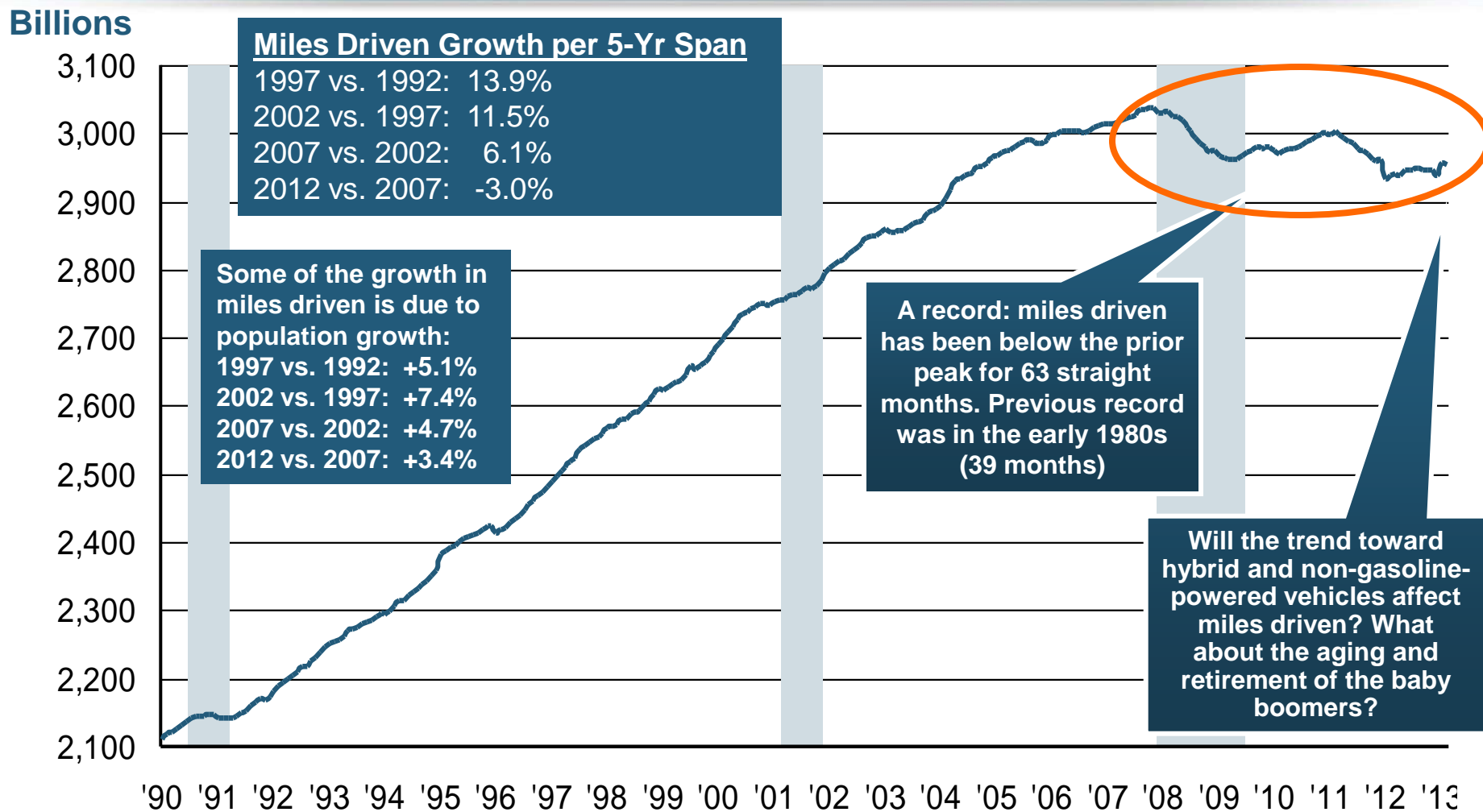
Job growth and improved credit market conditions will boost auto sales in 2013 and beyond, bolstering the manufacturing sector and the economy generally.

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

Something Unusual is Happening: Miles Driven*, 1990–2013



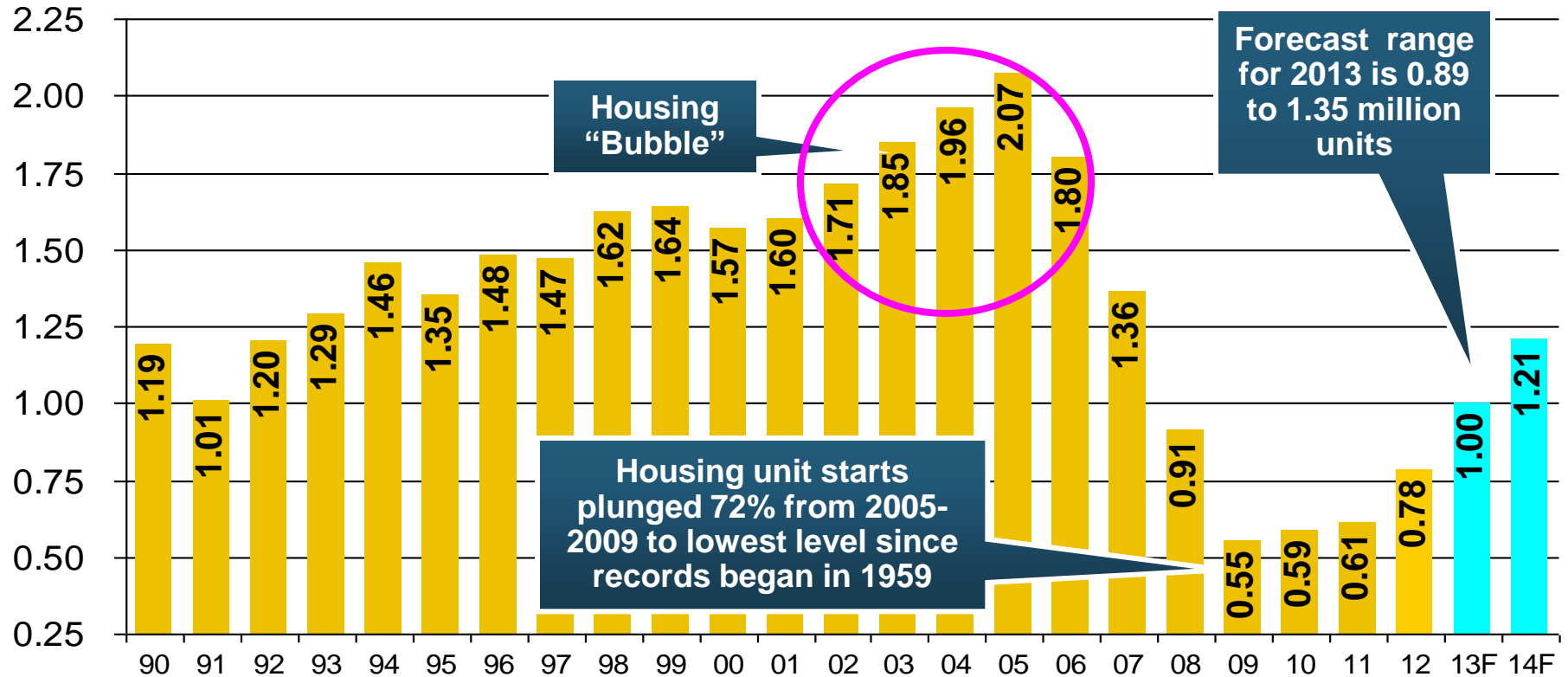
*Moving 12-month total. The latest data is for February 2013.

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.

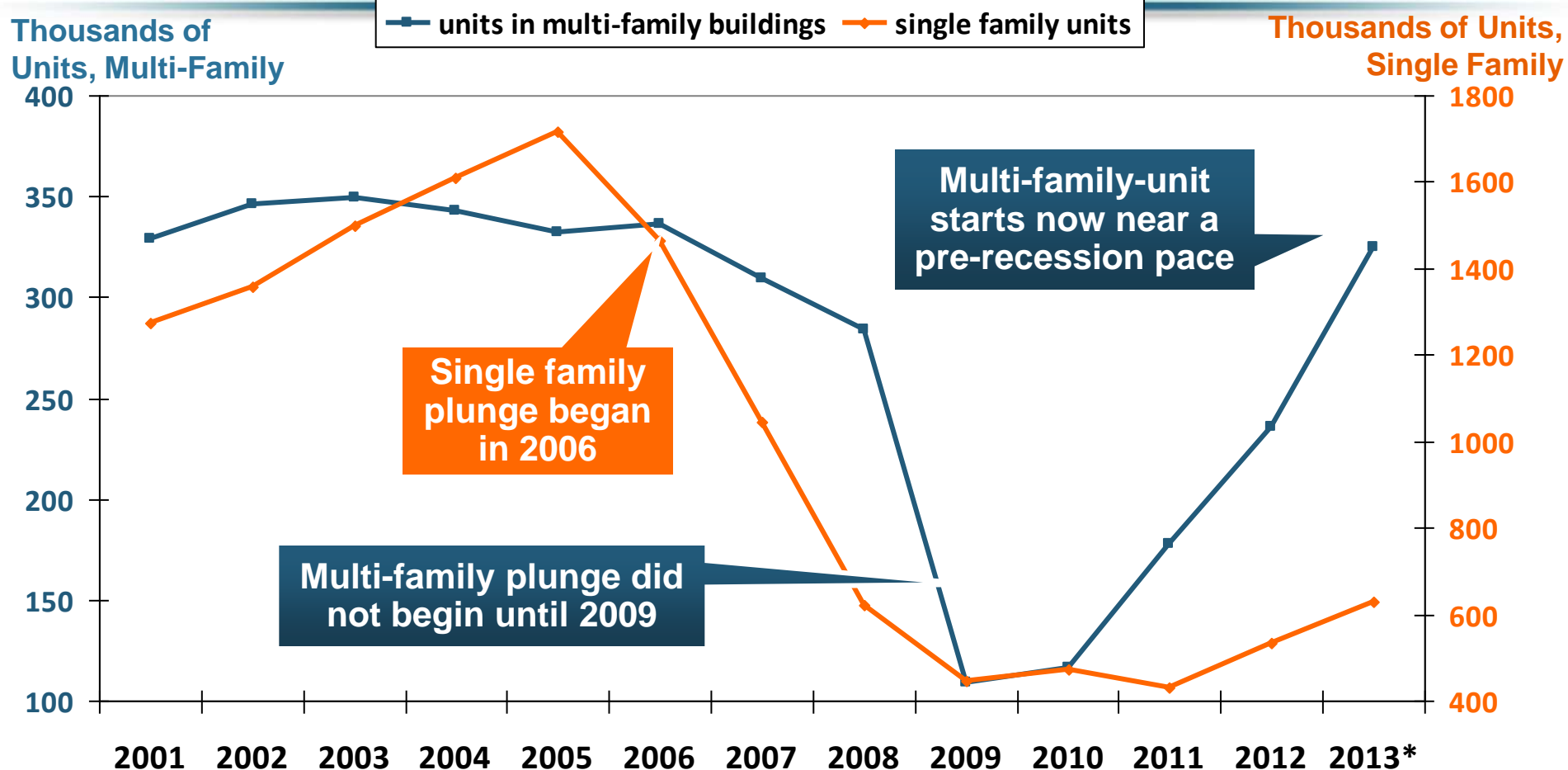
Private Housing Unit Starts, 1990-2014F

Millions
of Units



Homeowners insurers are starting to see meaningful exposure growth for the first time since 2005. Commercial insurers with construction risk exposure, surety also benefit.

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



Multi-unit starts, in 2012 at a seasonally adjusted annual rate of 235,000, are double the 2009 rate. Average annual rate for 2001-2006: 339,000.

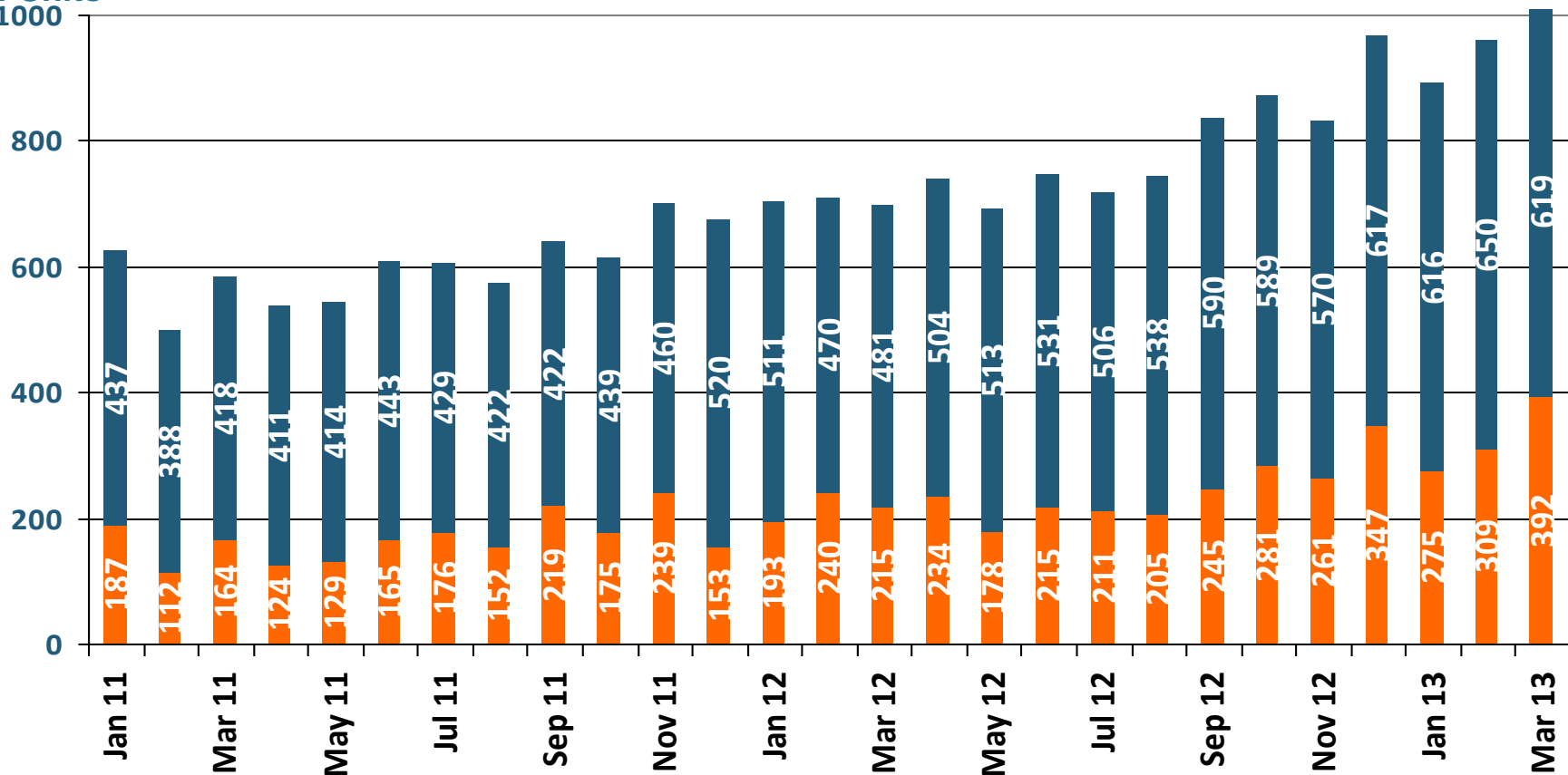
*January-March 2013 data, annualized, seasonally adjusted; March is preliminary.

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

Housing Unit Starts: Building Momentum, Monthly, Jan 2011-Mar 2013*

Thousands
of Units
1000

■ units in multi-family buildings ■ single family units

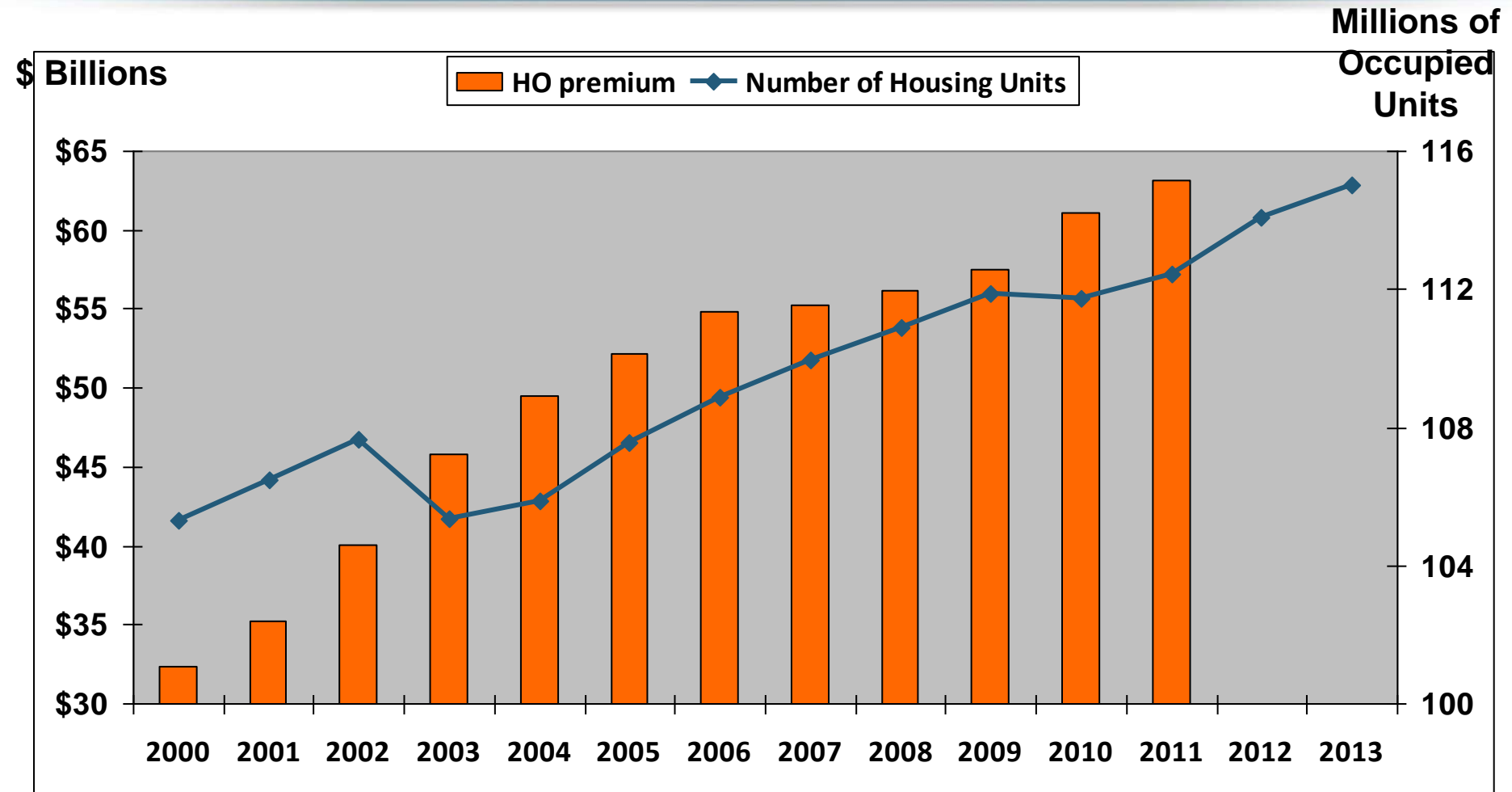


The number of units in multi-unit starts more than doubled from Dec 2011 to Dec 2012. Single family start rose nicely, too.

*at annualized rate, seasonally adjusted; Mar2013 numbers are preliminary.

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

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

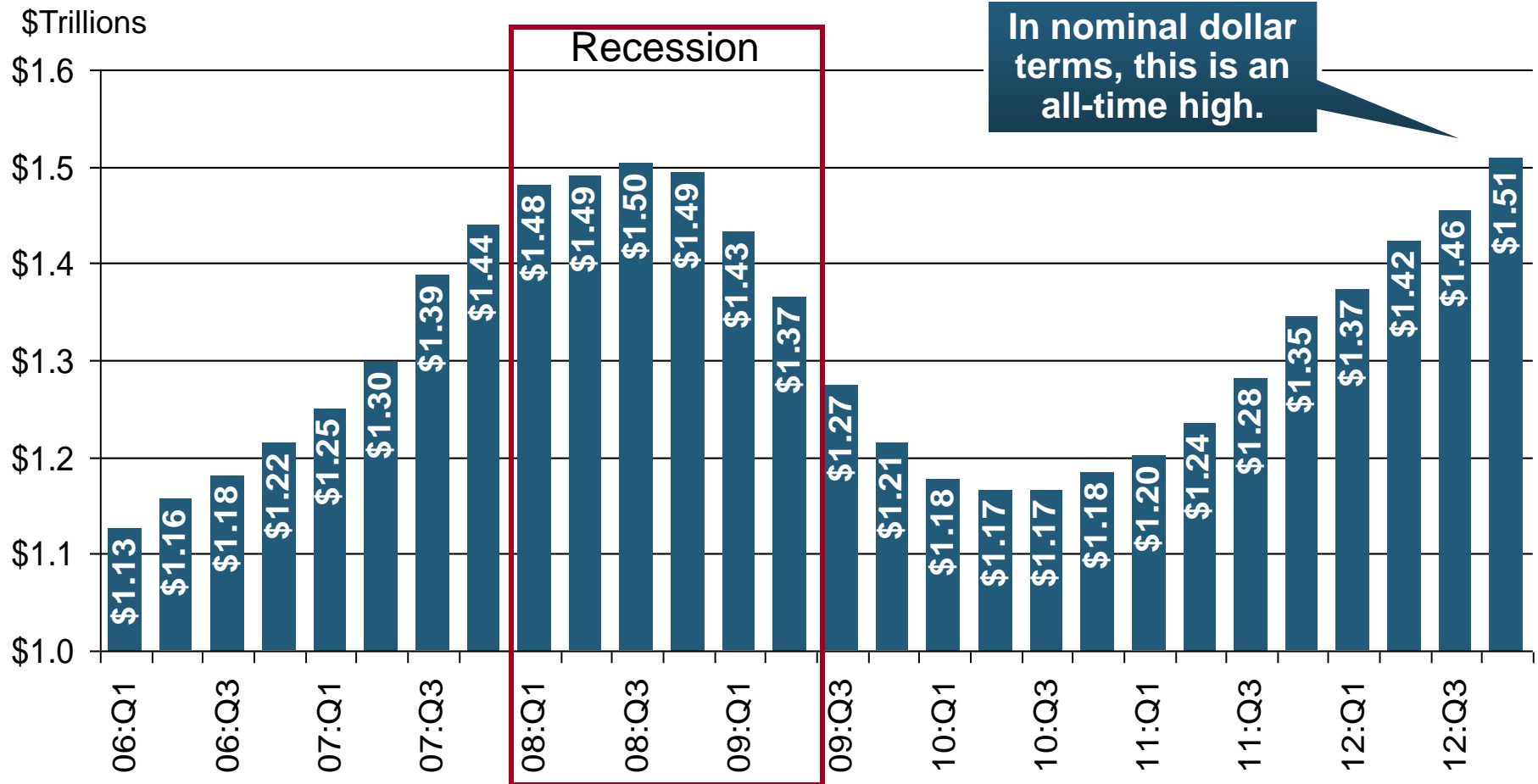


Homeowners insurance NWP continues rising (up 95% 2000-2011) despite very little unit growth in recent years. Reasons include rate increases, esp

*occupied as of start of year indicated

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

Commercial & Industrial Loans Outstanding at FDIC-Insured Banks, Quarterly, 2006-2012*

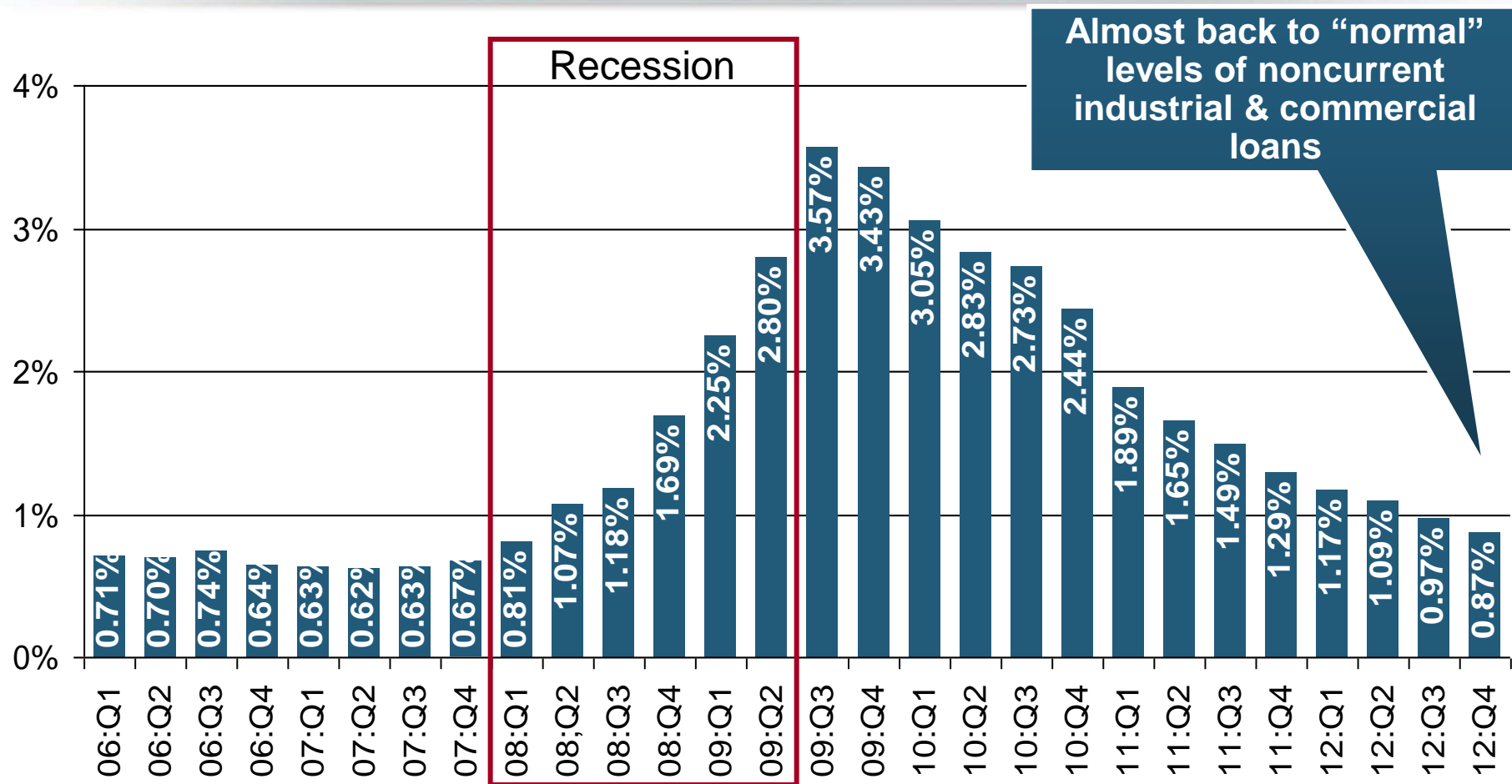


Outstanding loan volume has been growing for over two years and (as of year-end 2012) surpassed previous peak levels.

*Latest data as of 4/19/2013.

Source: FDIC at <http://www2.fdic.gov/qbp/> (Loan Performance spreadsheet); Insurance Information Institute.

Percent of Non-current Commercial & Industrial Loans Outstanding at FDIC-Insured Banks, Quarterly, 2006-2012*



Non-current loans (those past due 90 days or more or in nonaccrual status) are back to early-recession levels, fueling bank willingness to lend.

*Latest data as of 4/19/2013.

Source: FDIC at <http://www2.fdic.gov/qbp/> (Loan Performance spreadsheet); Insurance Information Institute.

Dollar Value* of Manufacturers' Shipments Monthly, Jan. 1992—Feb. 2013

\$ Millions

\$500,000

The value of Manufacturing Shipments in Feb. 2013 rose 37.5% to \$489B from the May 2009 trough

\$400,000

\$300,000

\$200,000

February 2013 surpasses previous record high in July 2008

Jan-92 Jan-93 Jan-94 Jan-95 Jan-96 Jan-97 Jan-98 Jan-99 Jan-00 Jan-01 Jan-02 Jan-03 Jan-04 Jan-05 Jan-06 Jan-07 Jan-08 Jan-09 Jan-10 Jan-11 Jan-12 Jan-13

Manufacturing is energy intensive. Growth leads to gains in many commercial exposures: WC, Commercial Auto, Marine, Property and various Liability coverages.

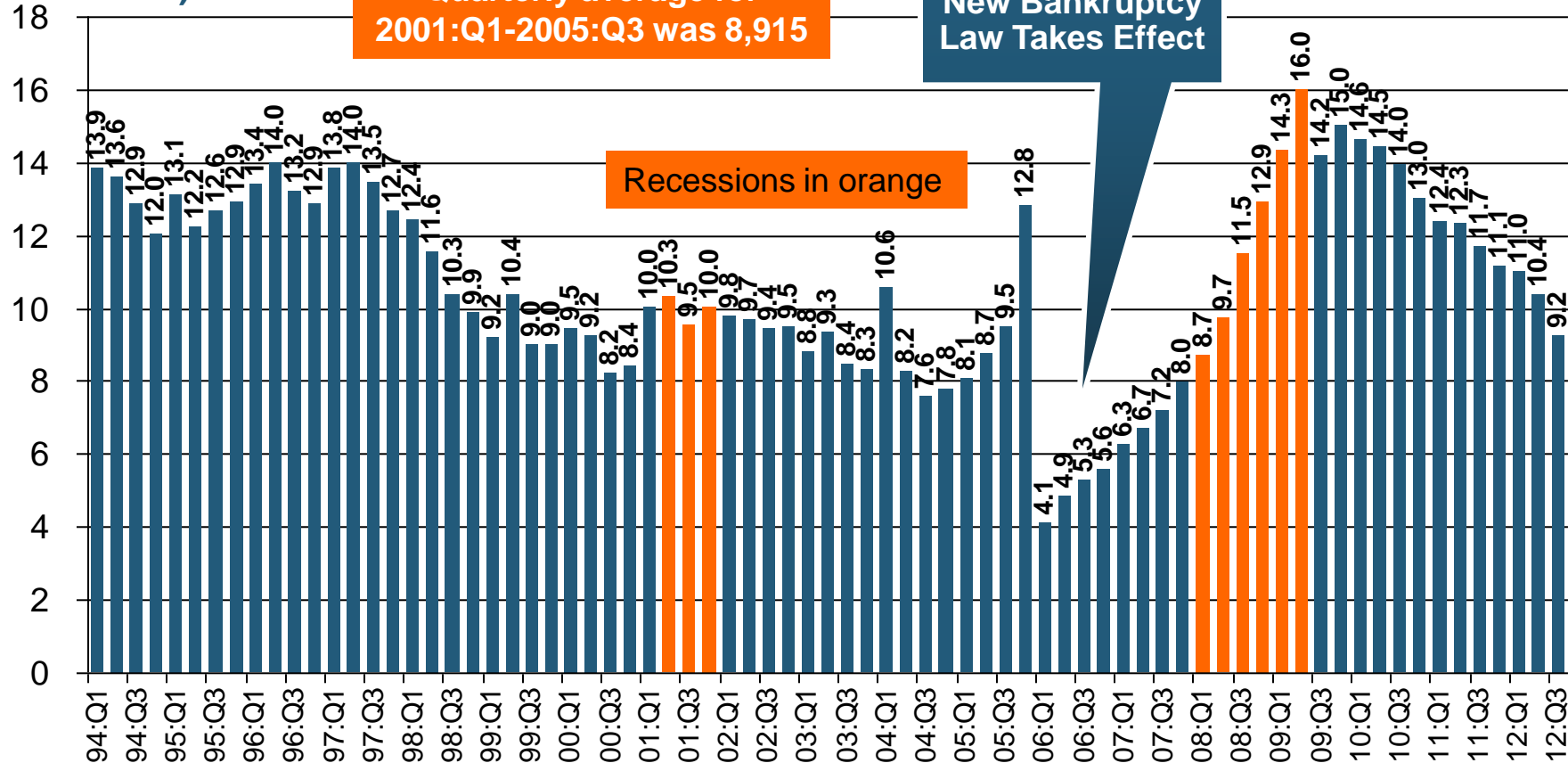
*Seasonally adjusted; Feb. 2013 is preliminary but is from the Full Report for February.

Source: US Census Bureau, *Full Report on Manufacturers' Shipments, Inventories, and Orders*, www.census.gov/manufacturing/m3/.

Revised historical data, based on benchmark revisions, will be released on May 17, 2013.

Business Bankruptcy Filings: Falling but Still High in 2012 (1994:Q1 – 2012:Q3)

(Thousands)



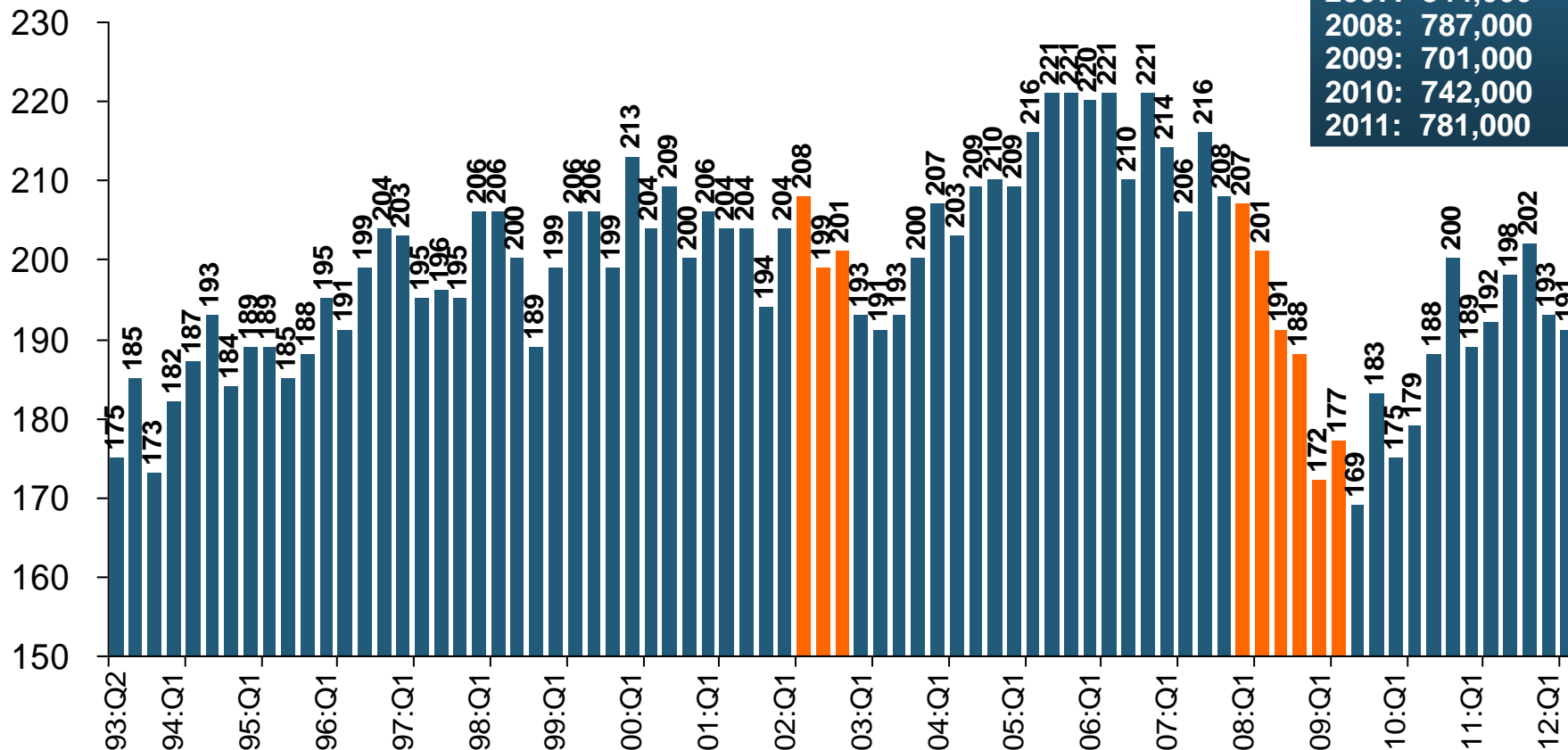
Business bankruptcies were down 42% in 2012:Q3 vs. recent peak in 2009:Q2 but were still higher than 2008:Q1, the first full quarter of the Great Recession. Bankruptcies restrict exposure growth in all commercial lines.

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

Private Sector Business Starts, 1993:Q2 – 2012:Q2*

(Thousands)

Recessions in orange



Business Starts

2006:	861,000
2007:	844,000
2008:	787,000
2009:	701,000
2010:	742,000
2011:	781,000

Business starts were down nearly 20% in the Great Recession, holding back most types of commercial insurance exposure, but now are recovering.

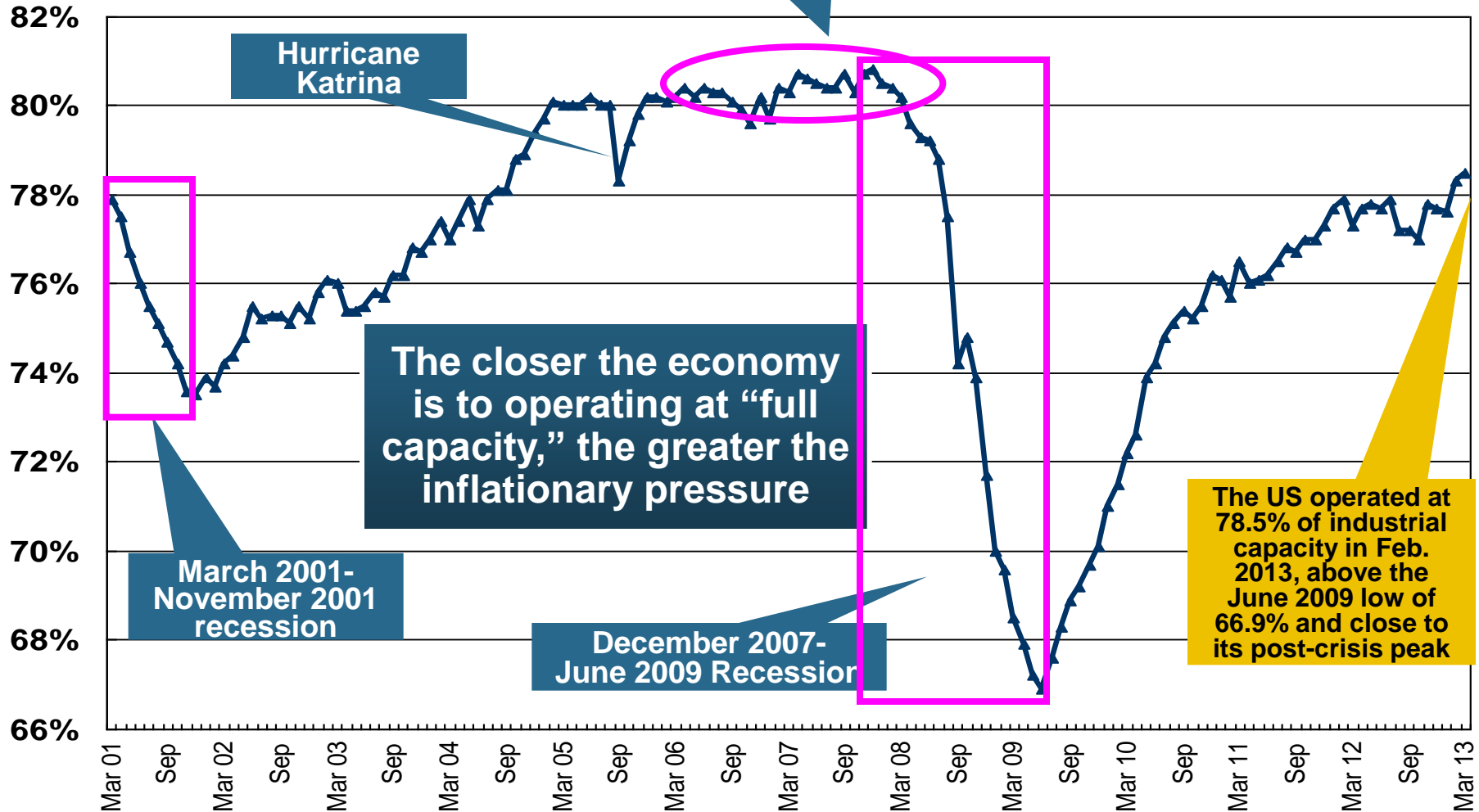
* Data through Jun 30, 2012 are the latest available (posted Jan 29, 2013); Seasonally adjusted.

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

Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

March 2001 through Mar. 2013

Percent of
Industrial Capacity



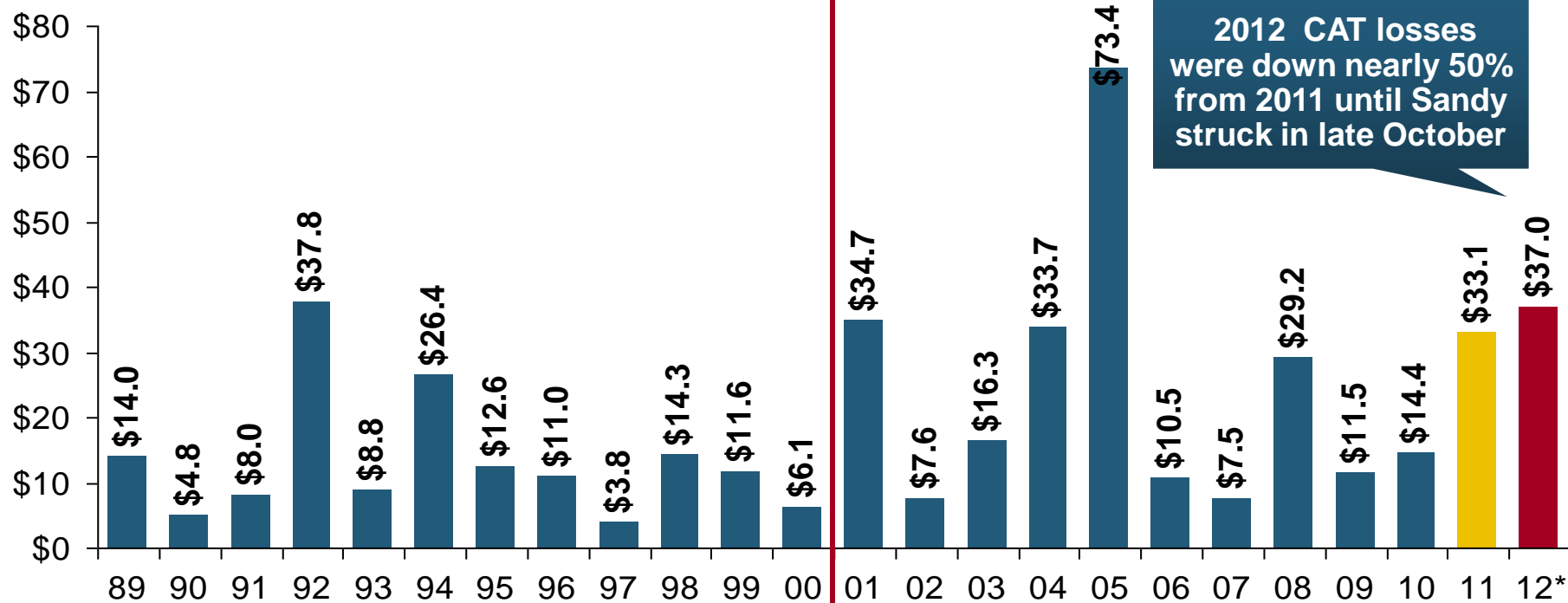
Source: Federal Reserve Board statistical releases at <http://www.federalreserve.gov/releases/q17/Current/default.htm>.

Challenge #2: Dealing with Catastrophes

**Are they more frequent and more
severe?**

US Insured Catastrophe Losses

(\$ Billions, 2012 Dollars)



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

Record Tornado Losses Caused 2011 CAT Losses to Surge

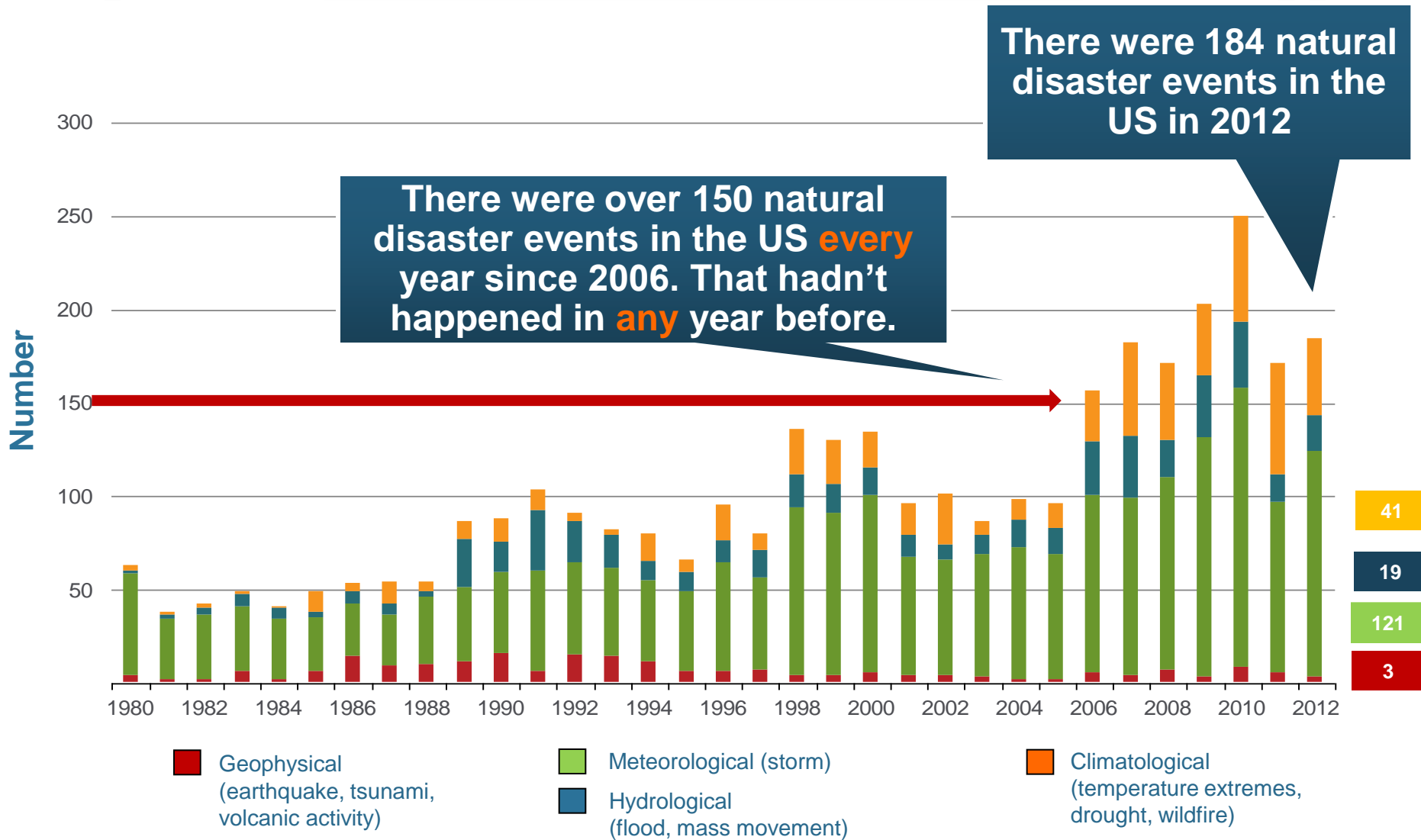
*As of 1/2/13. Includes \$20B gross loss estimate for Hurricane Sandy.

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.

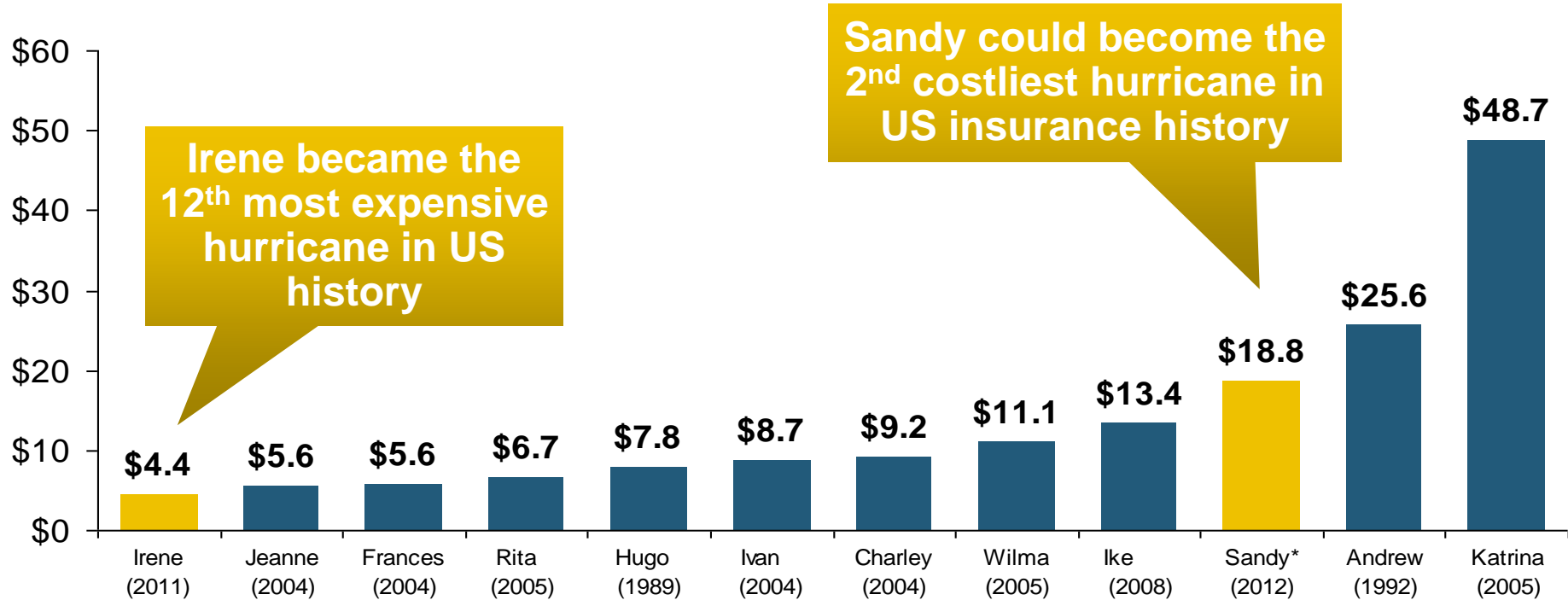
Natural Disasters in the United States, 1980 – 2012

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 costliest hurricanes in private 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.

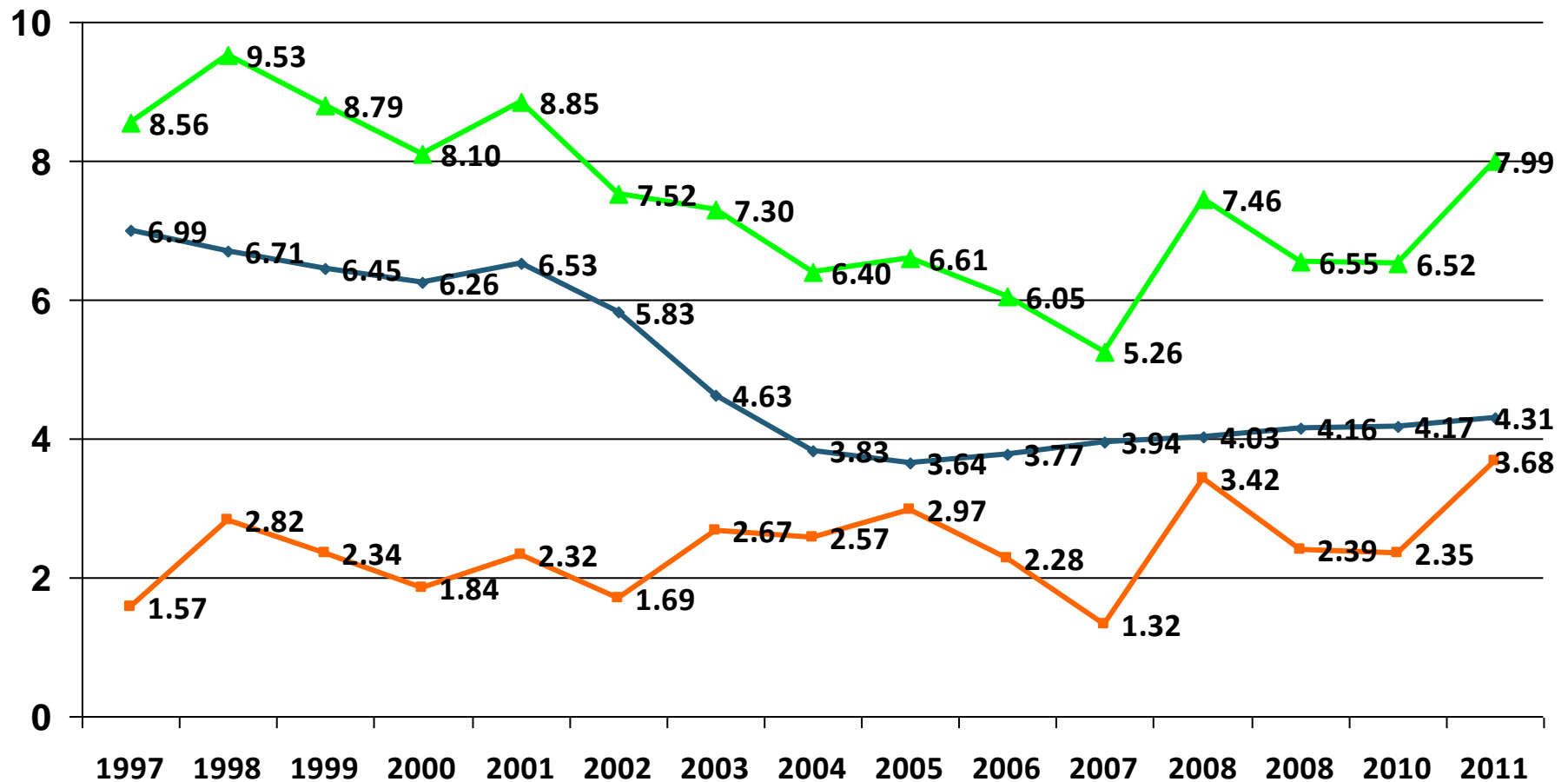
When you adjust for the damage prior storms could have done if they occurred today, Hurricane Katrina slips to a tie for 6th among the most devastating storms.

*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.

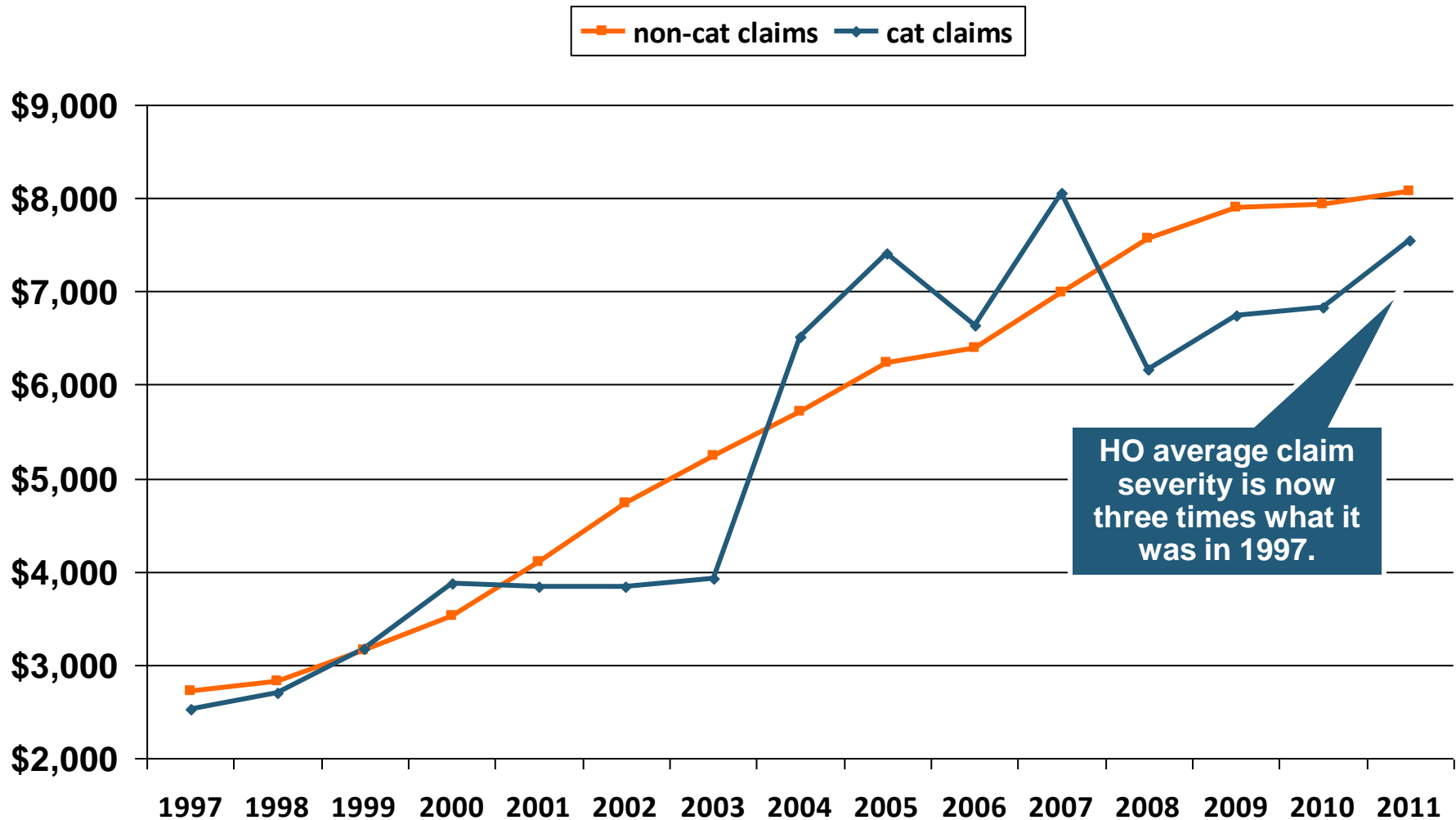
P/C Industry Homeowners Claim Frequency, US, 1997-2011

Claims Paid per
100 Exposures

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

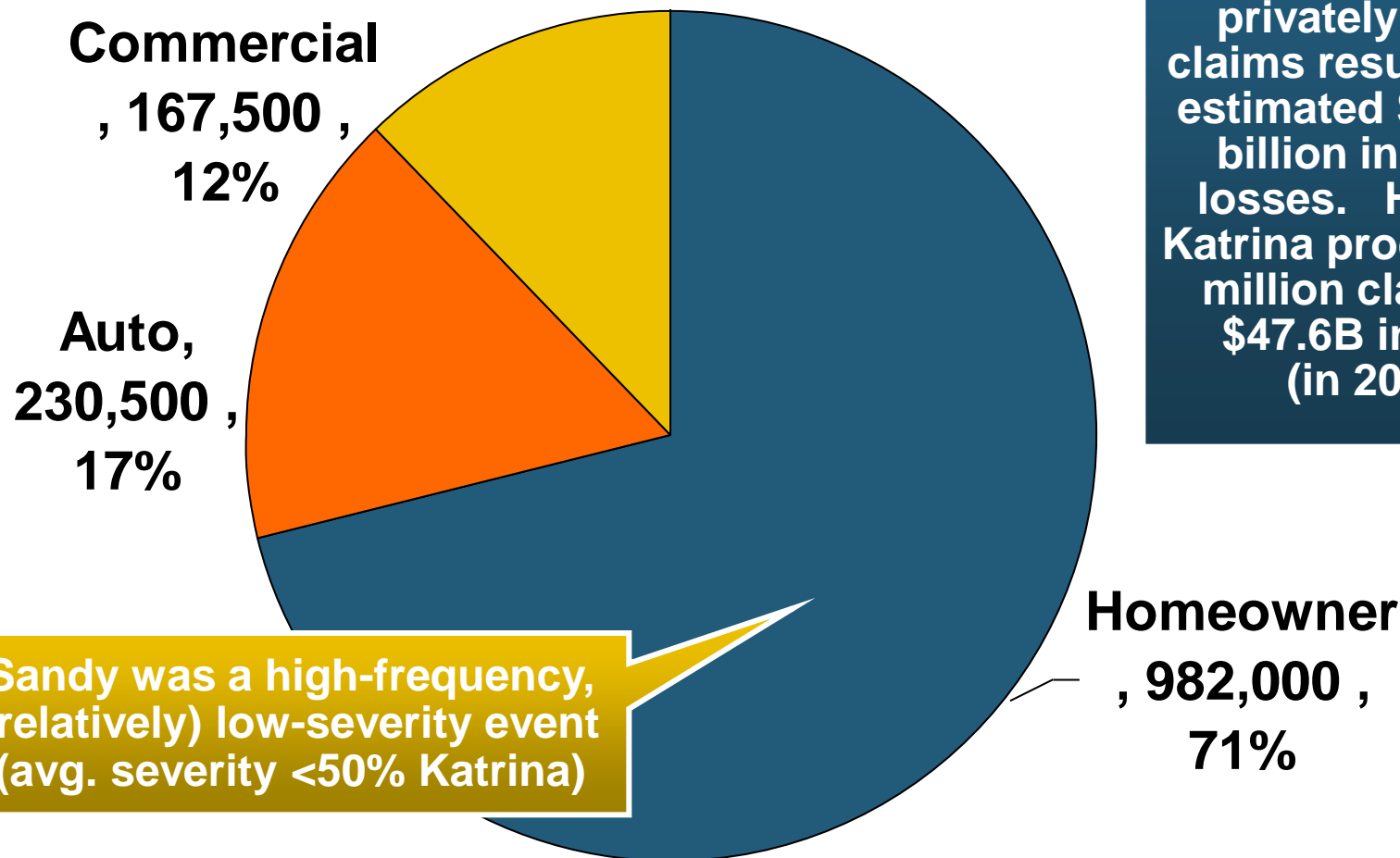


P/C Industry Homeowners Average Claim Severity, 1997-2011



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

Superstorm (barely a CAT 1) Sandy: 1.4 million Claims, by Type*

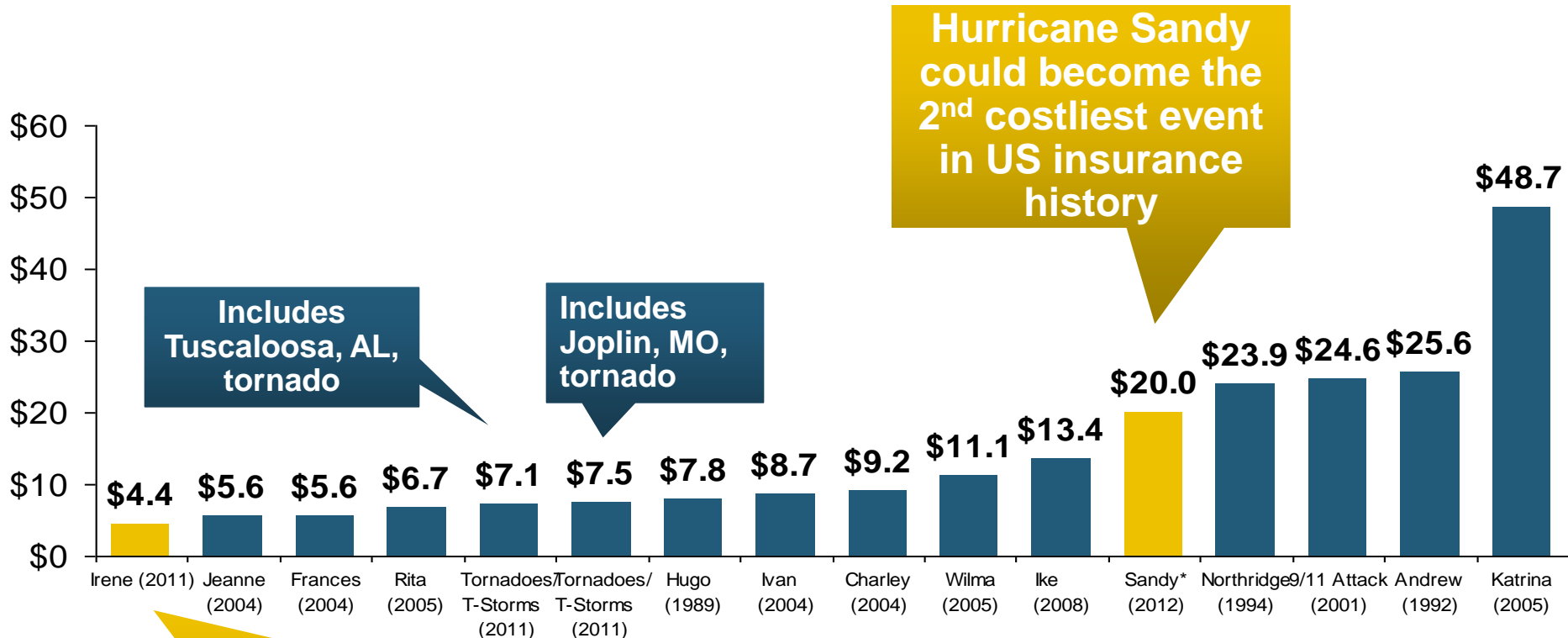


Sandy caused an estimated 1.4 million privately insured claims resulting in an estimated \$15 to \$25 billion in insured losses. Hurricane Katrina produced 1.74 million claims and \$47.6B in losses (in 2011 \$)

*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.

Top 16 Most Costly Disasters in U.S. History

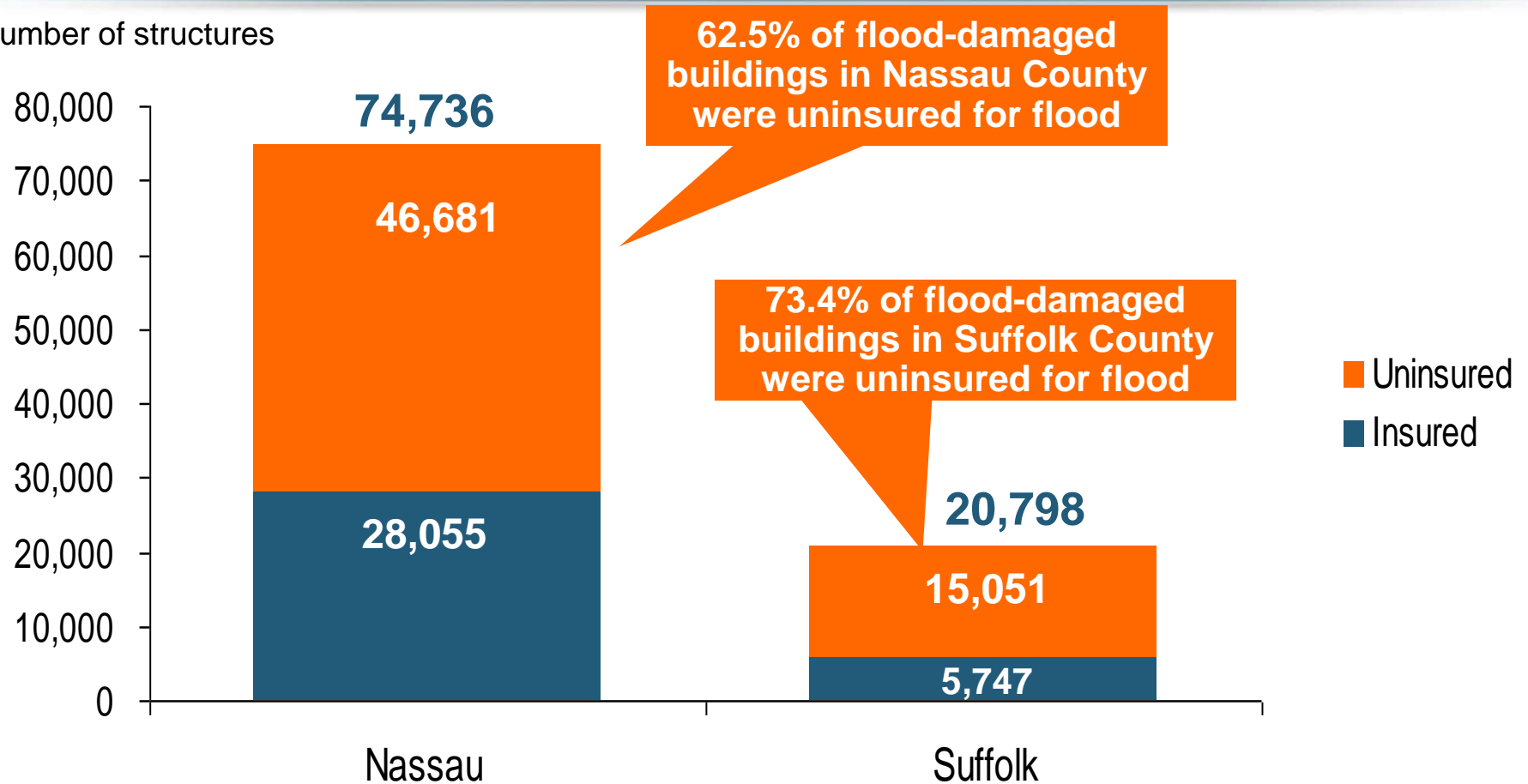
(Insured Losses, 2012 Dollars, \$ Billions)



*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.

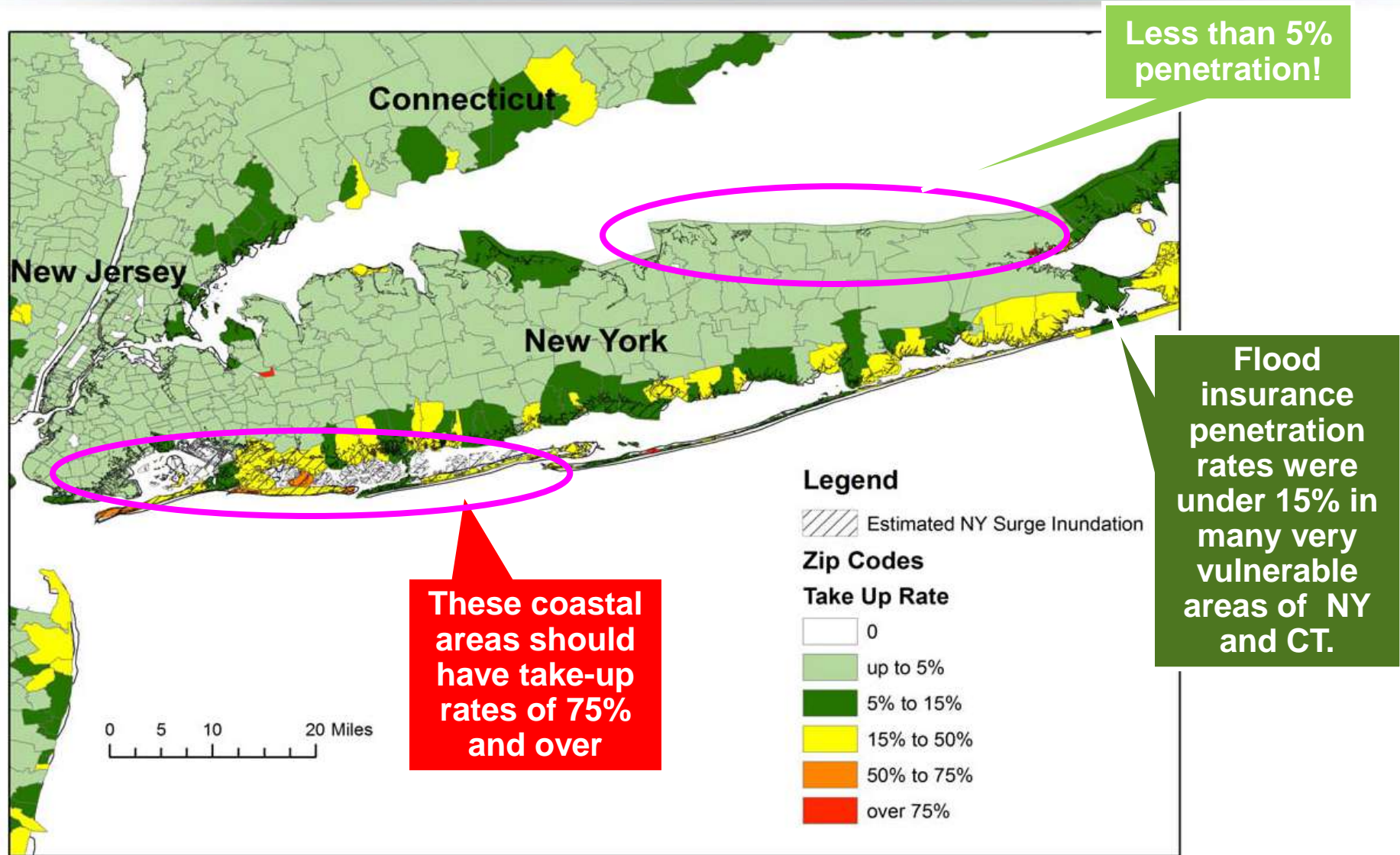
Flood-Damaged Structures with/without Flood Insurance: Long Island NY

Number of structures



Here's a marketing challenge. Most people who live on the coast in Long Island didn't buy flood insurance.

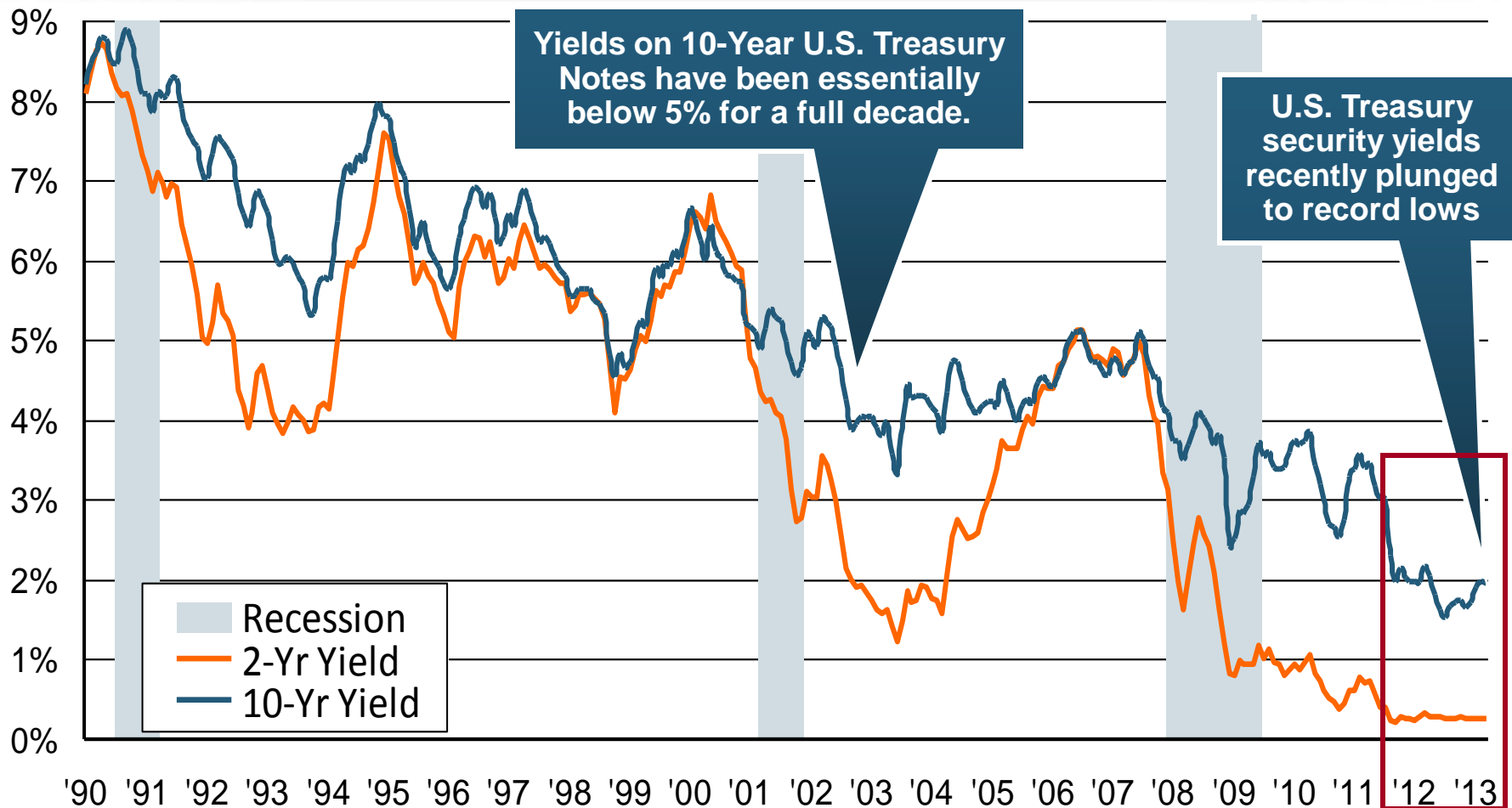
Residential NFIP Flood Take-Up Rates in NY, CT (2010) & Sandy Storm Surge



Challenge #3: Prolonged Low Investment Gains

Investment Performance is a Key Driver of Profitability

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

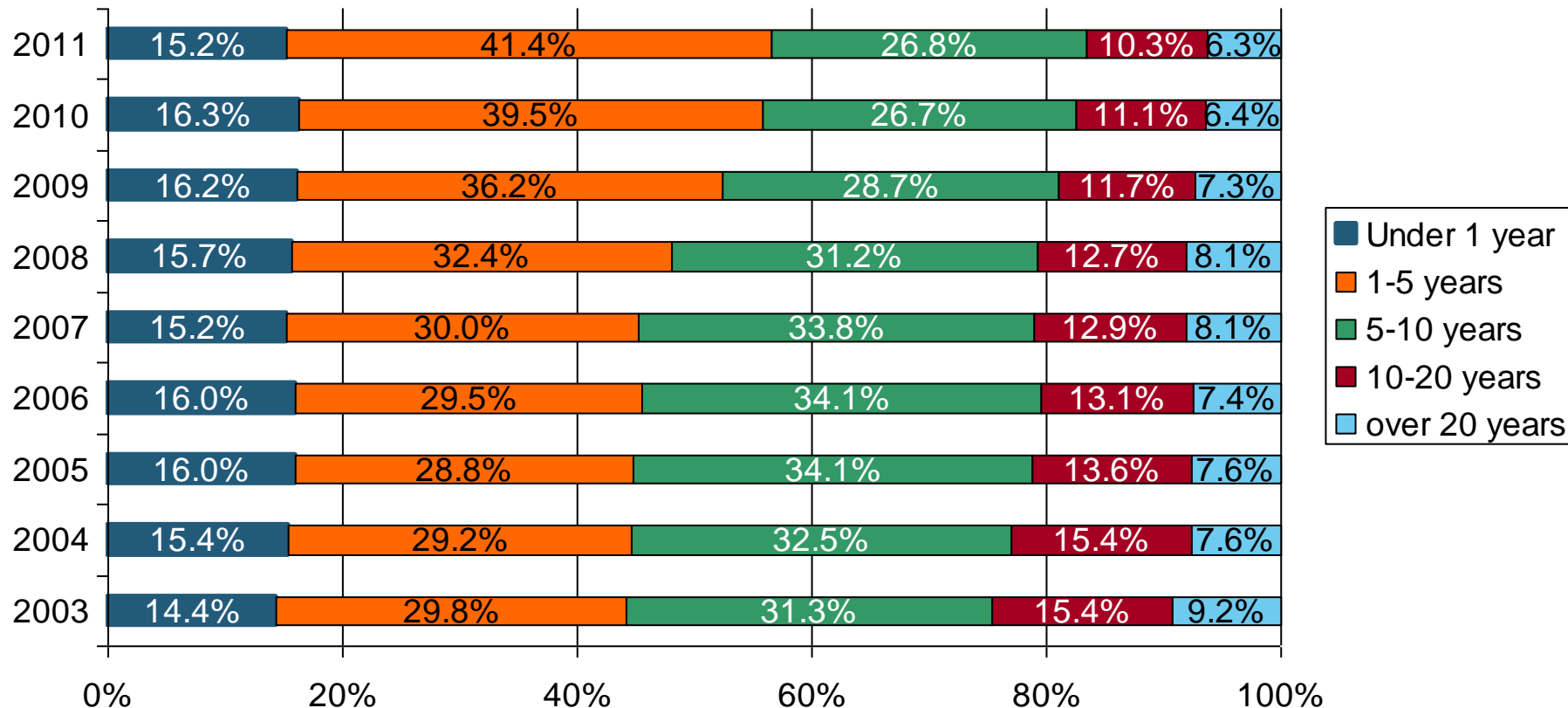


Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

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

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

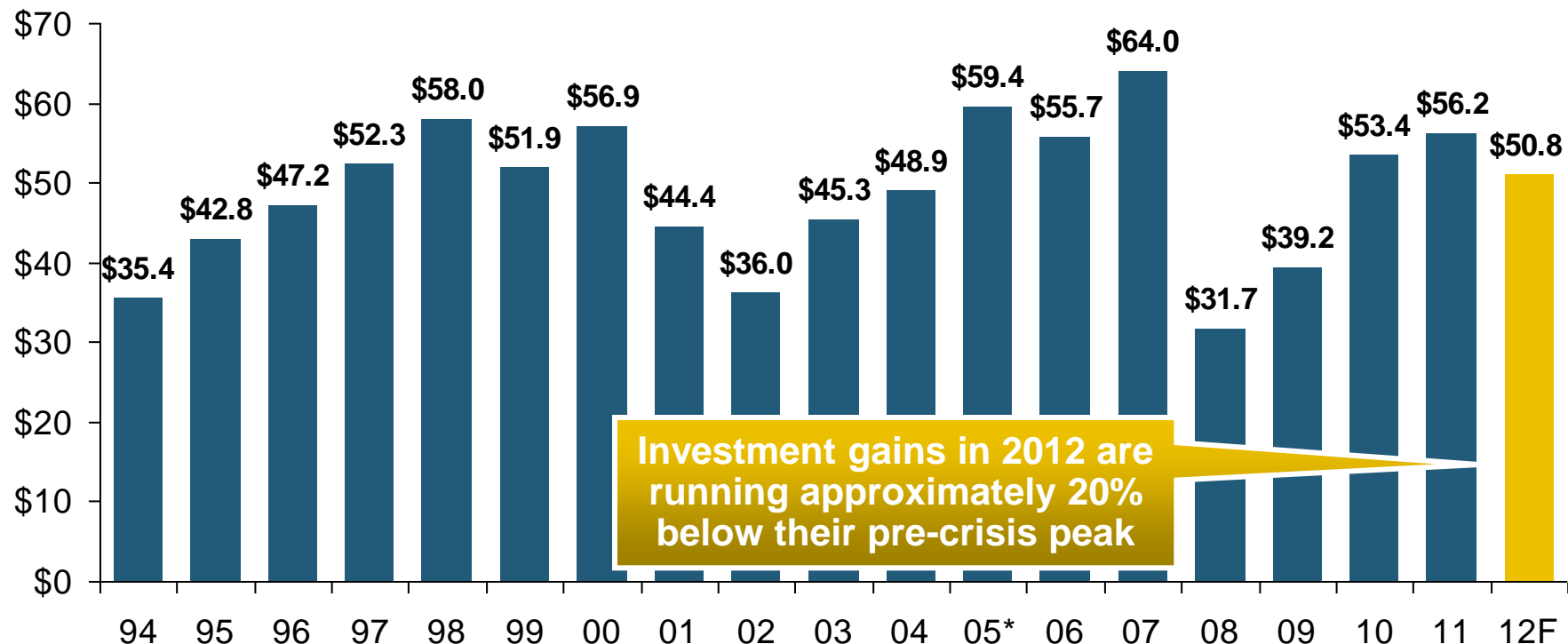
Distribution of Bond Maturities, P/C Insurance Industry, 2003-2011



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: 1994–2012F¹

(\$ Billions)



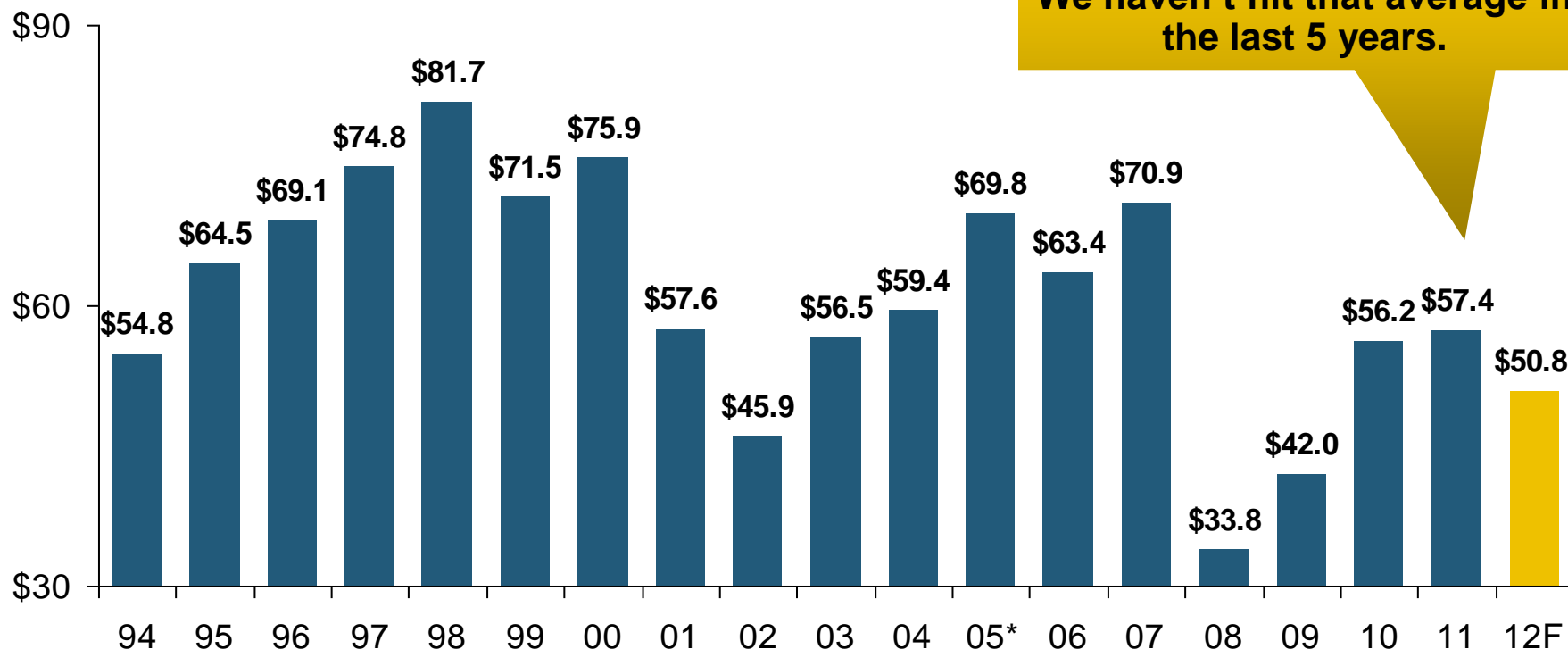
In 2012 (1st three quarters) both investment income and realized capital gains were lower than in the comparable period in 2011. And because the Federal Reserve Board aims to keep interest rates exceptionally low until the unemployment rate hits 6.5%—likely at least another year off—maturing bonds will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

Purchasing Power of P/C Industry Investment Gains: 1994–2012F¹

(\$ Billions,
2012 dollars)

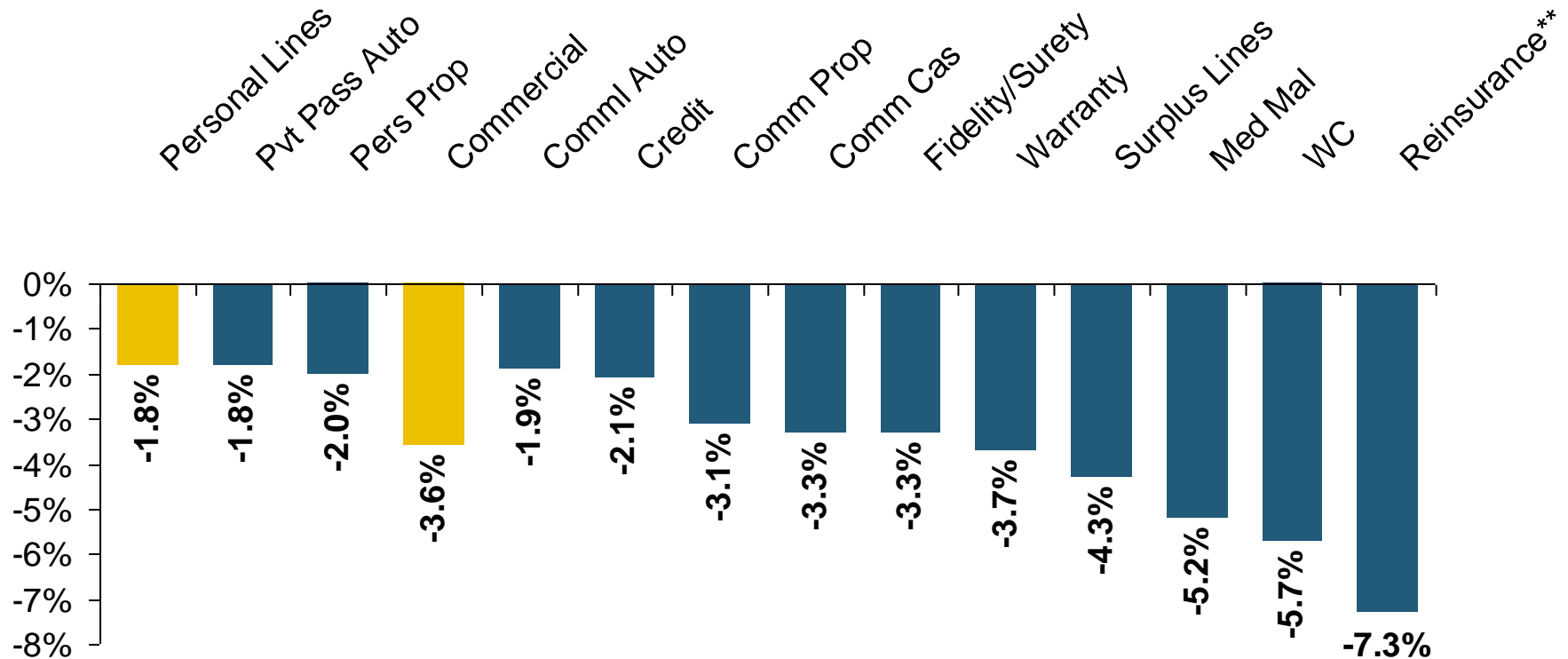


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Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line*



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

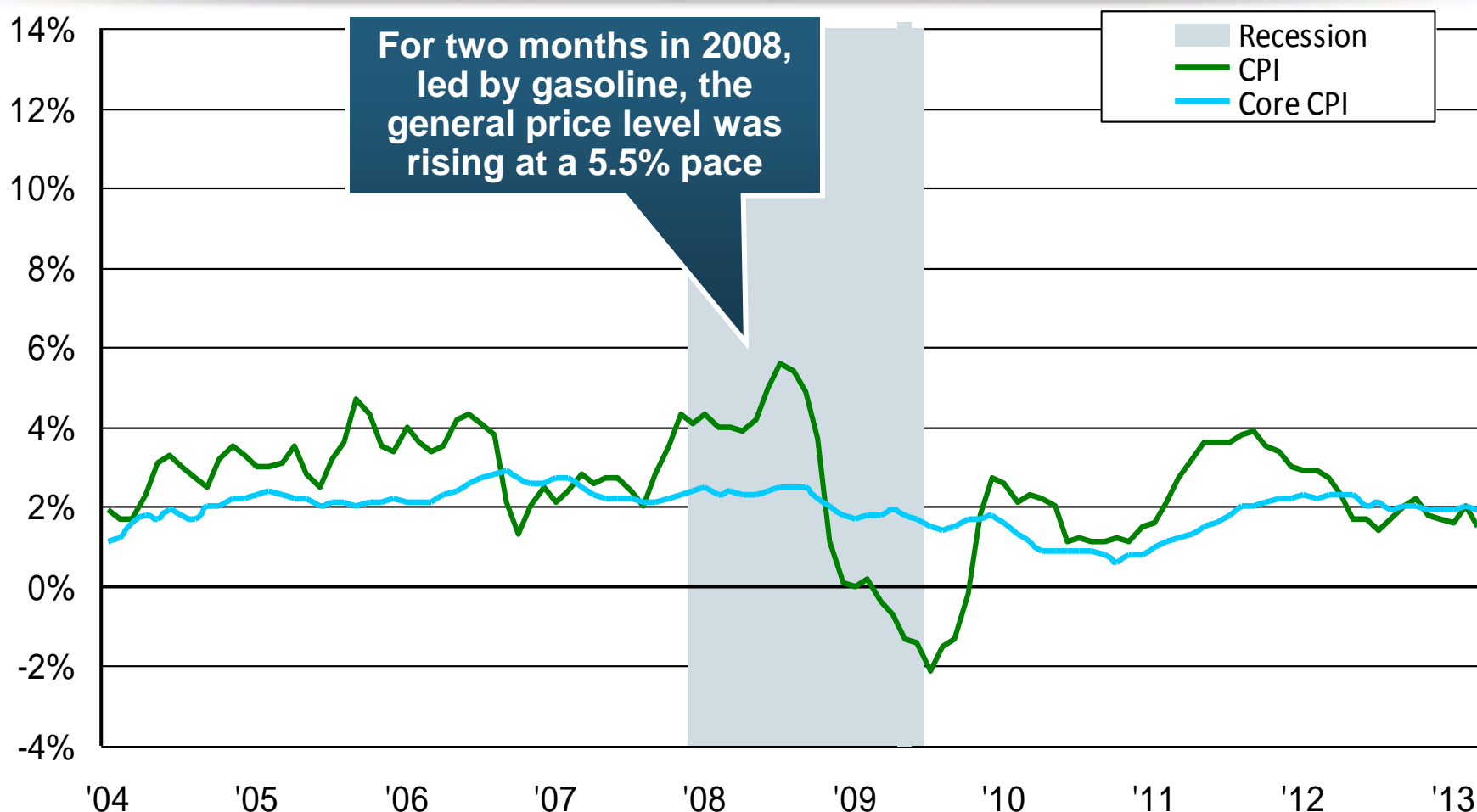
*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

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

Challenge #4: Inflation and P/C Claims

Change* in the Consumer Price Index, 2004–2013

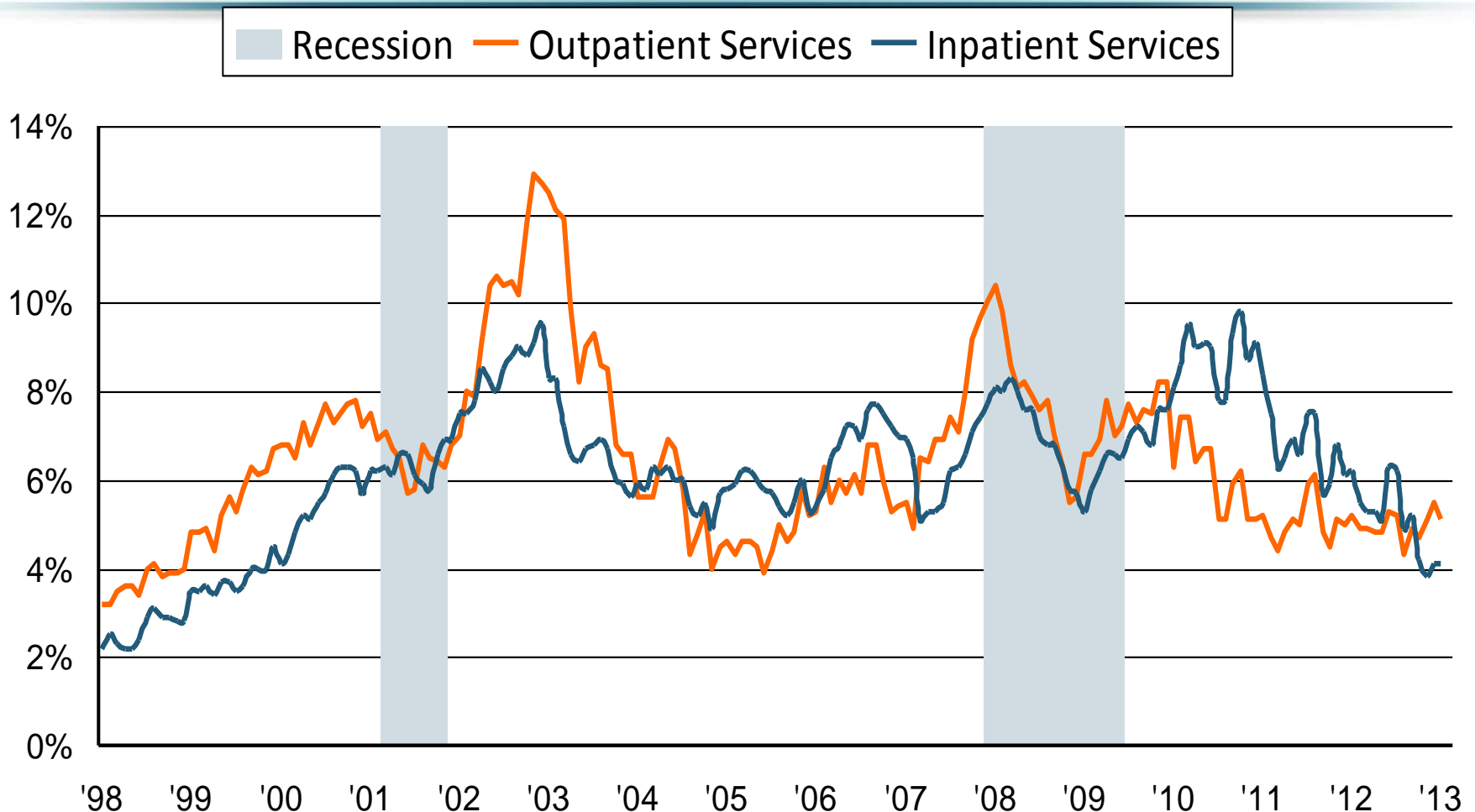


Over the last decade, prices generally rose about 2% per year.

*Monthly, year-over-year, through March 2013. Not seasonally adjusted.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Prices for Hospital Services: 12-Month Change,* 1998–2013

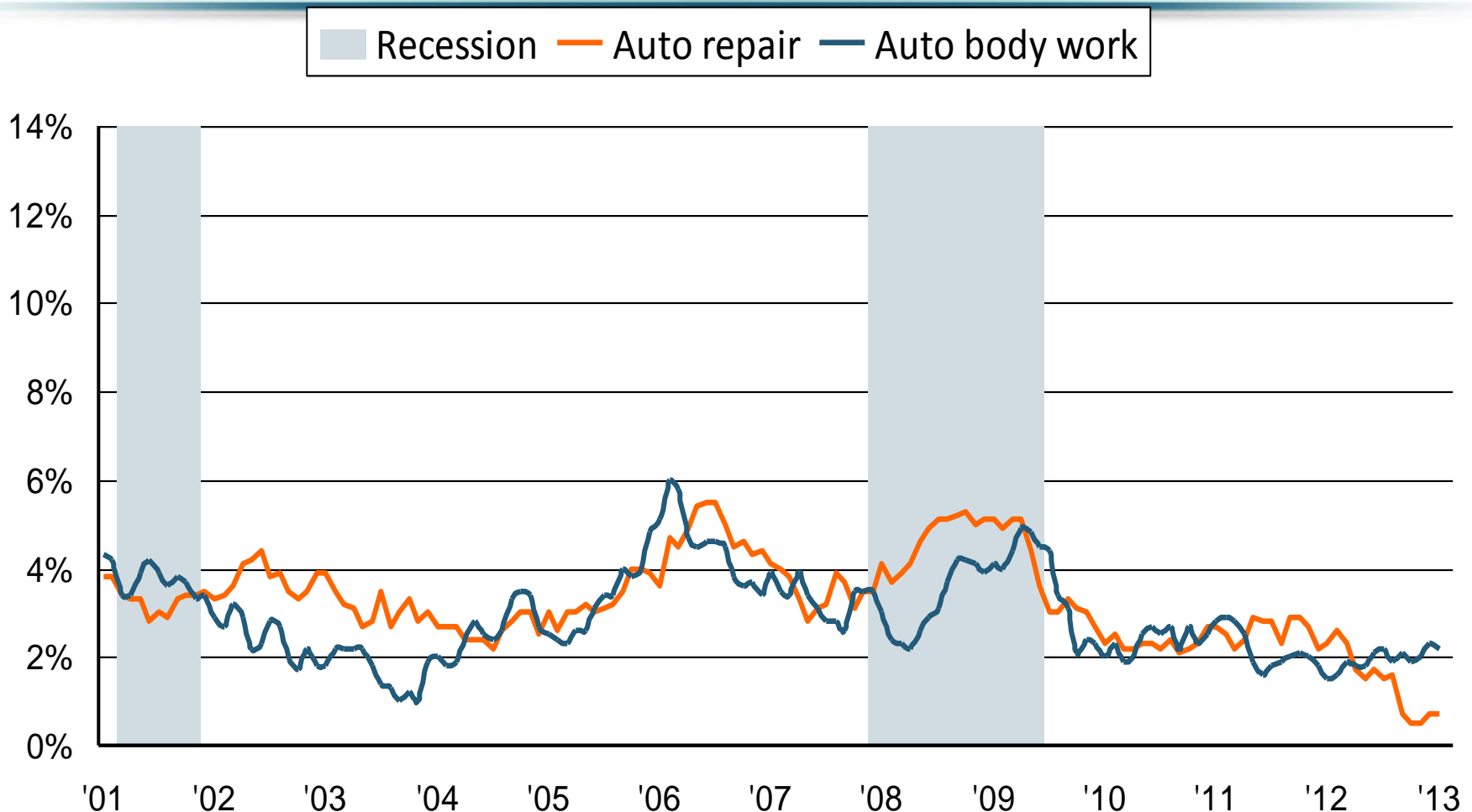


Cyclical peaks in PP Auto tend to occur approximately every 10 years (early 1990s, early 2000s, and possibly the early 2010s)

*Percentage change from same month in prior year; through January 2013; seasonally adjusted

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

Forces that Drive Car Repair Costs: 12-Month Change,* 2001–2013

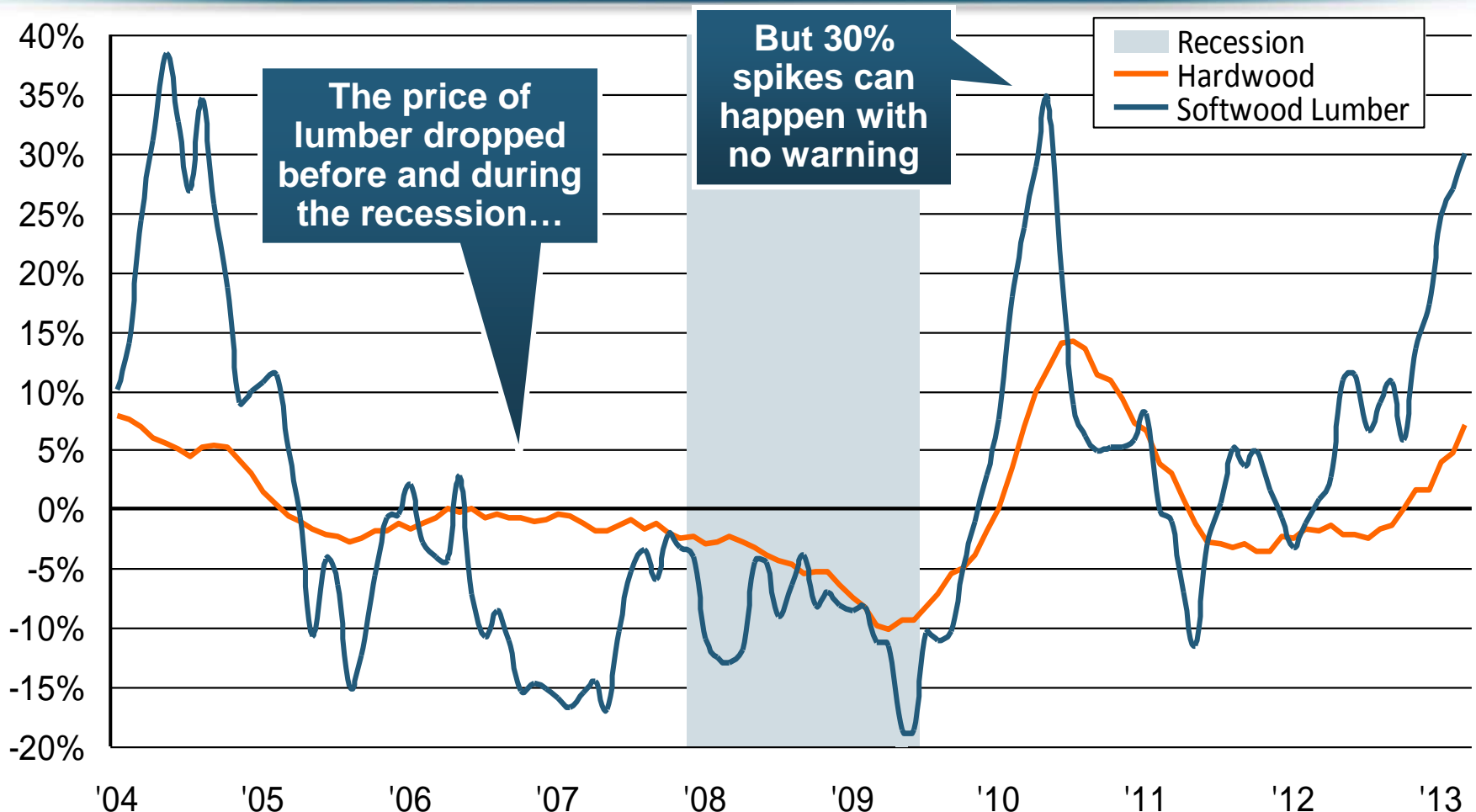


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Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

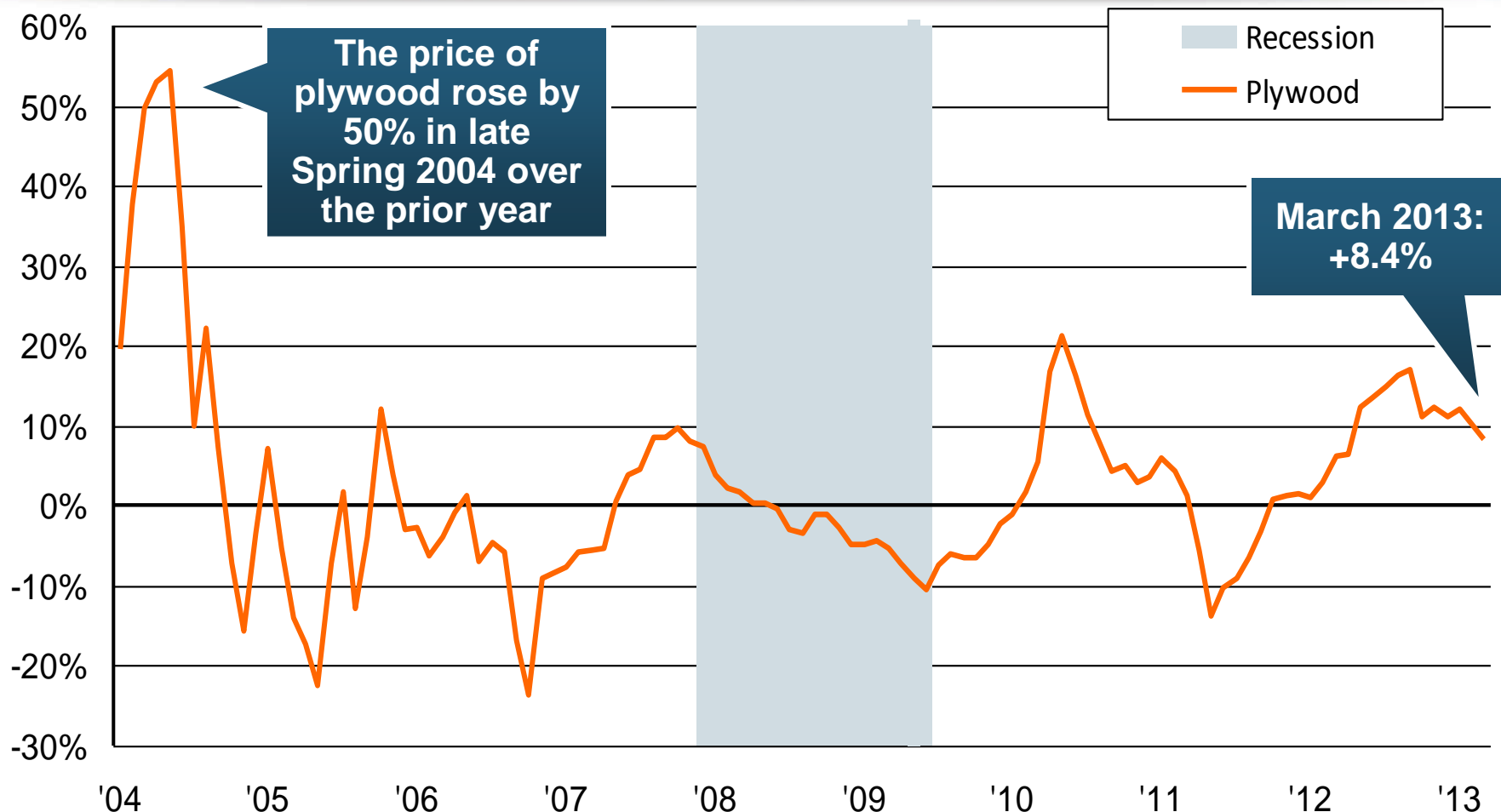
Change* in Price Index for Lumber: A Downward Trend but Sudden Spikes, 2004–2013



The prices of building materials vary wildly and change levels rapidly. Prices for hardwood have been much less variable than softwood lumber.

*Monthly, year-over-year, through March 2013. Not seasonally adjusted. Dec. 2012 and Jan., Feb., and Mar. prices are preliminary. Sources: US Bureau of Labor Statistics, Producer Price Index series WPS0811; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Change* in Price Index for Plywood: A Downward Trend but Sudden Spikes, 2004–2013



From the end of the recession (June 2009) to March 2013, the effect of the ups and downs of the price of plywood has resulted in a rise of 25.6%.

*Monthly, year-over-year, through March 2013. Not seasonally adjusted. Dec. 2012 and Jan., Feb., and Mar. prices are preliminary.
Sources: US Bureau of Labor Statistics, Producer Price Index series WPU083; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Challenge #5: Regulatory Pressure?

**From Congress (TRIA), HUD, CFPB,
FSOC/Federal Reserve (SIFIs),
the NAIC's SMI, etc.**

I.I.I. Congressional Testimony on the Future of the Terrorism Risk Insurance Program

TRIA at Ten Years:

The Future of the Terrorism Risk Insurance Program

House Financial Services Subcommittee on
Insurance, Housing and Community
Opportunity

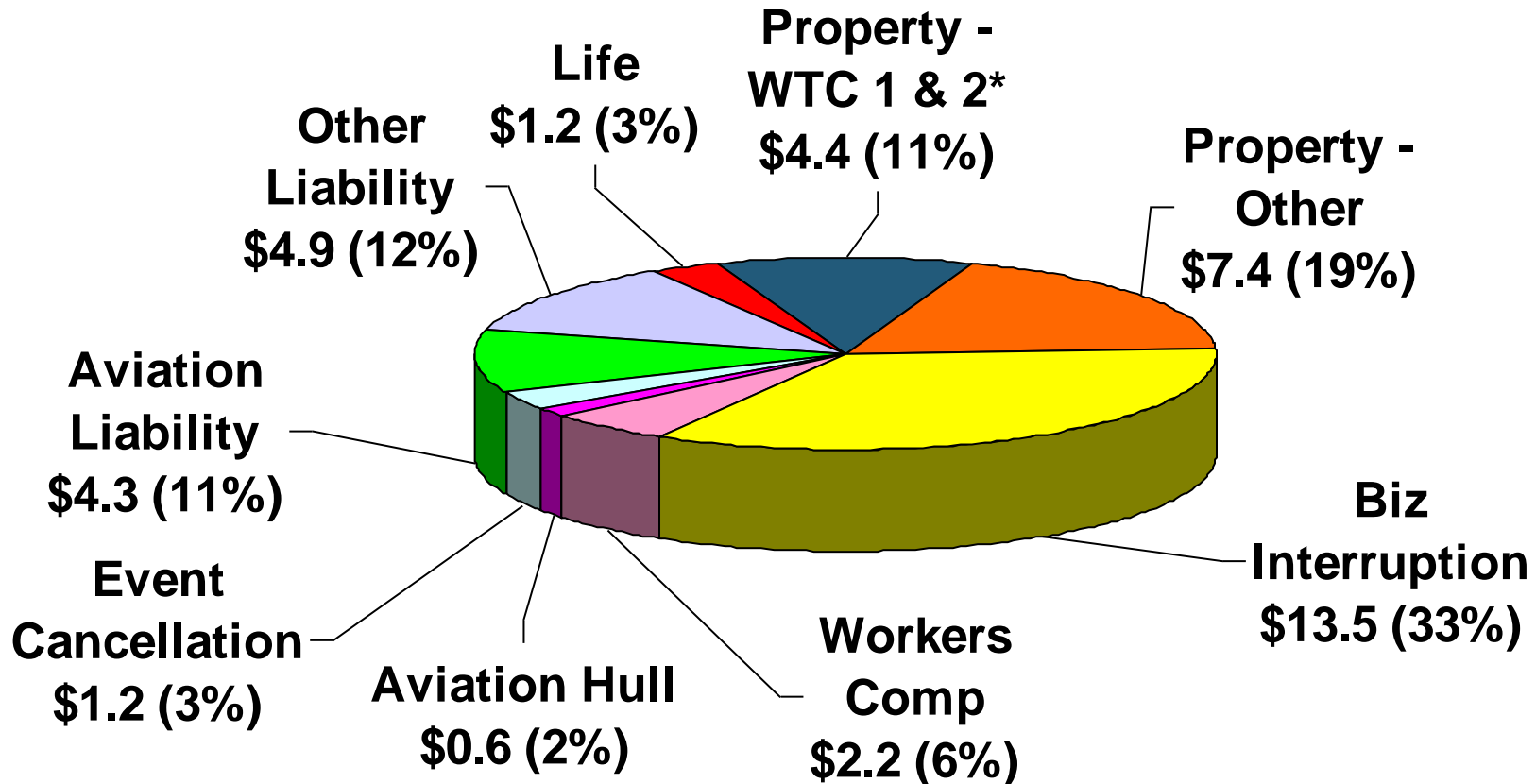
Testimony of
Robert P. Hartwig, Ph.D., CPCU
President & Economist
Insurance Information Institute
New York, NY

September 11, 2012
Washington, DC

- **Issue:** Act expires 12/31/14. Insurers still generally regard large-scale terror attacks as fundamentally uninsurable
- **I.I.I. Input:** Testified at first hearing on the issue in DC (on 9/11/12) on trends in terrorist activity in the US and abroad, difficulties in underwriting terror risk; Noted that bin Laden may be dead but war on terror is far from over
- **Status:** New House FS Committee Chair Jeb Hensarling has opposed TRIA in the past; Obama Administration does not seem to support extension; Little institutional memory on insurance subcommittee
- **Media:** Virtually no media coverage yet apart from trade press; WSJ will likely editorialize against it.
- **Objective:** Work with trades, risk management community and others to help build support

Loss Distribution by Type of Insurance from Sept. 11 Terrorist Attack (\$ 2011)

(\$ Billions)



Total Insured Losses Estimate: \$40.0B**

*Loss total does not include March 2010 New York City settlement of up to \$657.5 million to compensate approximately 10,000 Ground Zero workers or any subsequent settlements.

**\$32.5 billion in 2001 dollars.

Source: Insurance Information Institute.

Terrorism Violates Traditional Requirements for Insurability

Requirement	Definition	Violation
Estimable Frequency	<ul style="list-style-type: none"> • Insurance requires large number of observations to develop predictive rate-making models (an actuarial concept known as credibility) 	<ul style="list-style-type: none"> • Very few data points • Terror modeling still in infancy, untested. • Inconsistent assessment of threat
Estimable Severity	<ul style="list-style-type: none"> • Maximum possible/ probable loss must be at least estimable in order to minimize “risk of ruin” (insurer cannot run an unreasonable risk of insolvency though assumption of the risk) 	<ul style="list-style-type: none"> • Potential loss is virtually unbounded. • Losses can easily exceed insurer capital resources for paying claims. • Extreme risk in workers compensation and statute forbids exclusions.

Terrorism Violates Traditional Requirements for Insurability (cont'd)

Requirement	Definition	Violation
Diversifiable Risk	<ul style="list-style-type: none">•Must be able to spread/distribute risk across large number of risks•“Law of Large Numbers” helps makes losses manageable and less volatile	<ul style="list-style-type: none">•Losses likely highly concentrated geographically or by industry (e.g., WTC, power plants)
Random Loss Distribution/ Fortuity	<ul style="list-style-type: none">•Probability of loss occurring must be purely random and fortuitous•Events are individually unpredictable in terms of time, location and magnitude	<ul style="list-style-type: none">•Terrorism attacks are planned, coordinated and deliberate acts of destruction•Dynamic target shifting from “hardened targets” to “soft targets”•Terrorist adjust tactics to circumvent new security measures•Actions of US and foreign govts. may affect likelihood, nature and timing of attack

Source: Insurance Information Institute

The New HUD Ruling

HO Underwriting vs. Disparate Impact

What Did HUD Rule?

- The Fair Housing Act prohibits discrimination in the sale, rental, or financing of dwellings on the basis of race, color, religion, sex, disability, familial status, or national origin.
- HUD's rule says Plaintiffs may use statistical analysis to show that certain insurer/lender/municipality behavior had a disproportionately adverse effect on the sale, rental, or financing of housing for minorities
 - ◆ Under the rule, this showing violates the federal Fair Housing Act **even if the insurer/lender/municipality did not intend to discriminate**
 - ◆ Defendant can prevail if it shows the practice was needed to achieve one or more substantial, legitimate, nondiscriminatory interests
 - ◆ But plaintiff may win by showing that another practice with a less discriminatory effect could achieve this interest

Potential Impact on Property Insurance Underwriting

- Why does this affect property insurance?
 - ◆ Insurers don't use race, religion, sex, etc. to underwrite property insurance
 - ◆ But they *do* use credit-based insurance scores, neighborhood, and other factors that could be the basis of a “disparate impact” conclusion
- Isn't this a federal government agency's intrusion into state regulation, against McCarran-Ferguson?
 - ◆ HUD says M-F says federal laws/regulations that “specifically relate to the business of insurance” supercede state law
- But how can insurers defend themselves if they don't have data on race (which they're prohibited from collecting)?
 - ◆ HUD says plaintiff have the same problem, so it's fair

Potential Impact on Property Insurance Underwriting (cont'd)

■ Higher Rates for Homeowners Insurance?

- ◆ Might result if carriers can't use credit-based insurance scores in underwriting
 - This might worsen conditions for lower-income people with good scores, some of whom are minorities
 - Insurance pricing becomes less accurate => better risks subsidize worse risks
- ◆ Could also increase costs to monitor compliance and defend suits alleging discrimination

■ Potentially Changes State/Federal Regulatory Balance

- ◆ Not necessarily by itself, but in the trail of
 - Federal Insurance Office
 - FSOC
 - CFPB

Other Regulatory Challenges?

- Designating Some Insurers as Systemically Important?
 - ◆ Creating a two-tiered, “unlevel playing field”
- Extending the “Reach” of the Consumer Financial Protection Bureau?
 - ◆ The CFPB is now proposing regulations for mortgage servicers regarding property insurance on homes with mortgages
 - ◆ Will it deal with insurance offered with credit cards?
 - ◆ Bank marketing of insurance products?

Key Takaways

Takeaways:

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 Deteriorate Modestly**
 - ◆ 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!***