



# Overview & Outlook for the P/C Insurance Industry *Is the World Becoming a Riskier Place?*

**Society for Insurance Research Webinar**

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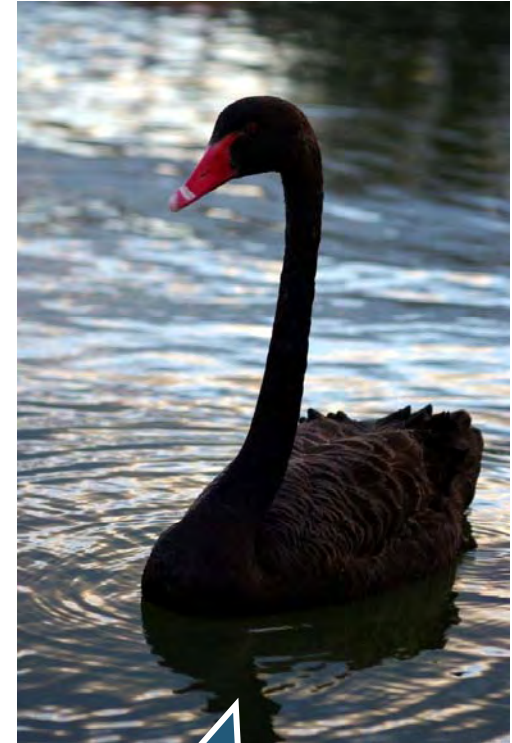
# What in the World Is Going On?

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

***Are We Really Crawling Out of the  
Abyss or Falling Into a New One?***

# Uncertainty, Risk and Fear Abound

- Japan, New Zealand, Haiti, Chile Earthquakes
- Nuclear Fears
- Cell Phone Radiation & Cancer (*WHO Report*)
- Cyber Attacks
- Resurgent Terrorism Risk (e.g., Bin Laden Killing)
- Record Tornado Activity & Flooding in the US
- Political Upheaval in the Middle East
- Echoes of the Financial Crisis
- Housing Crisis
- US Debt and Budget Crisis
- Sovereign Debt & Currency Crises
- Inflation
- Runaway Energy & Commodity Prices
- Era of Fiscal Austerity
- Reshuffling the Global Economic Deck
- China Becomes #2 Economy in the World
- Manmade Disasters (e.g., Deepwater Horizon)



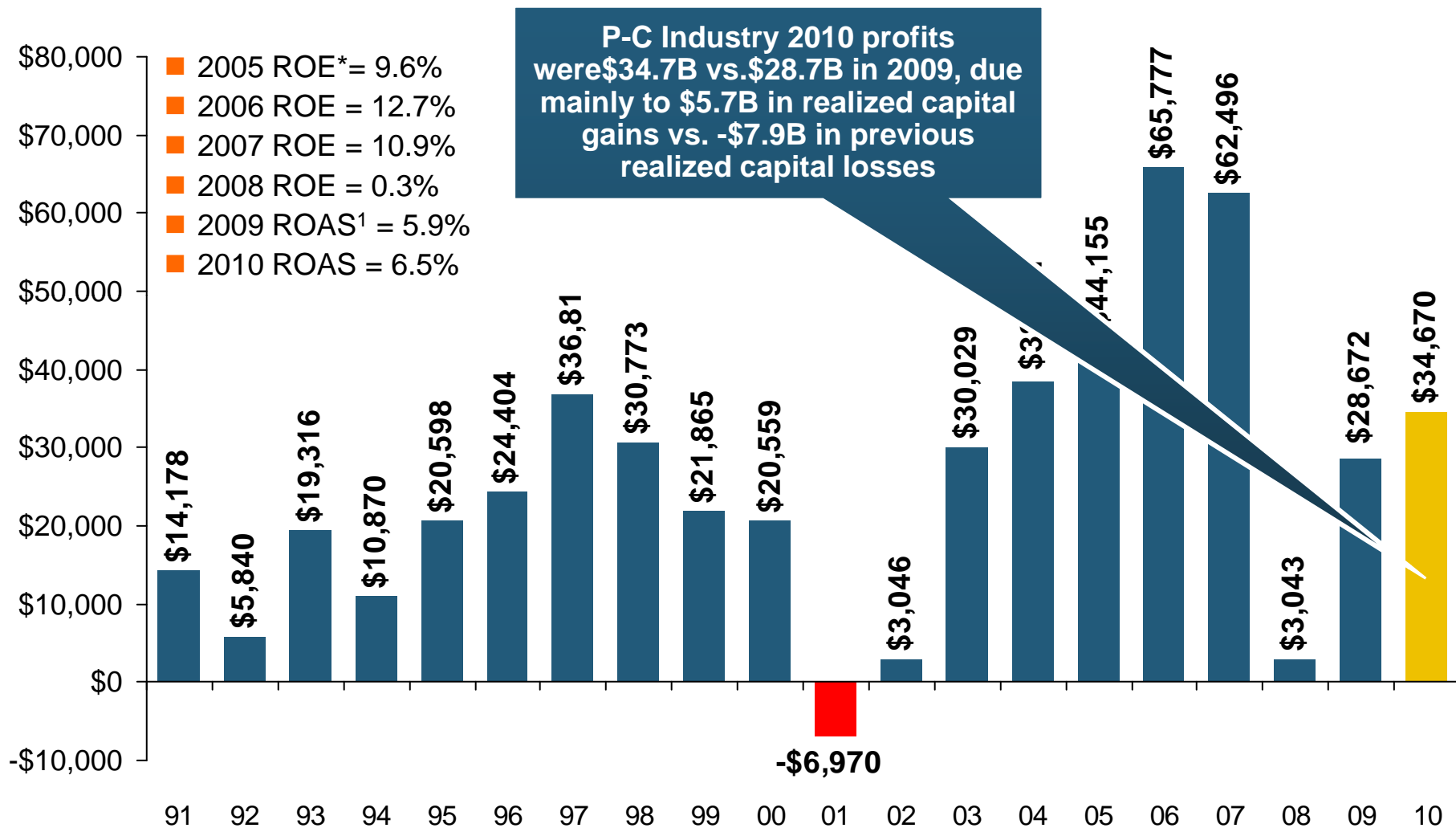
Are “Black Swans”  
everywhere or  
does it just seem  
that way?



# P/C Insurance Industry Financial Overview

**Profit Recovery Continues  
Early Stage Growth Begins**

# P/C Net Income After Taxes 1991–2010 (\$ Millions)

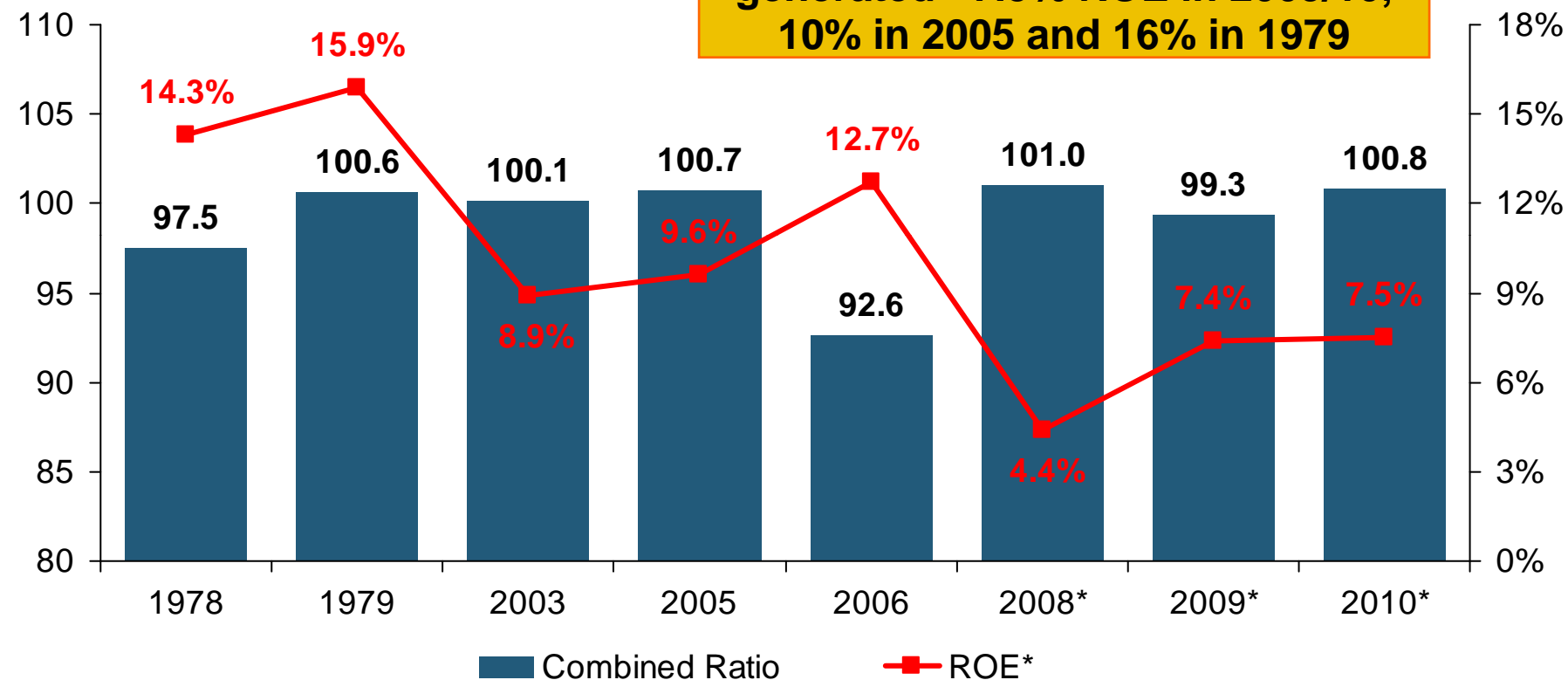


\* ROE figures are GAAP; <sup>1</sup>Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.5% ROAS for 2010 and 7.4% for 2009.

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

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

Combined Ratio / ROE



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

\* 2009 and 2010 figures are return on average statutory surplus. 2008, 2009 and 2010 figures exclude mortgage and financial guaranty insurers

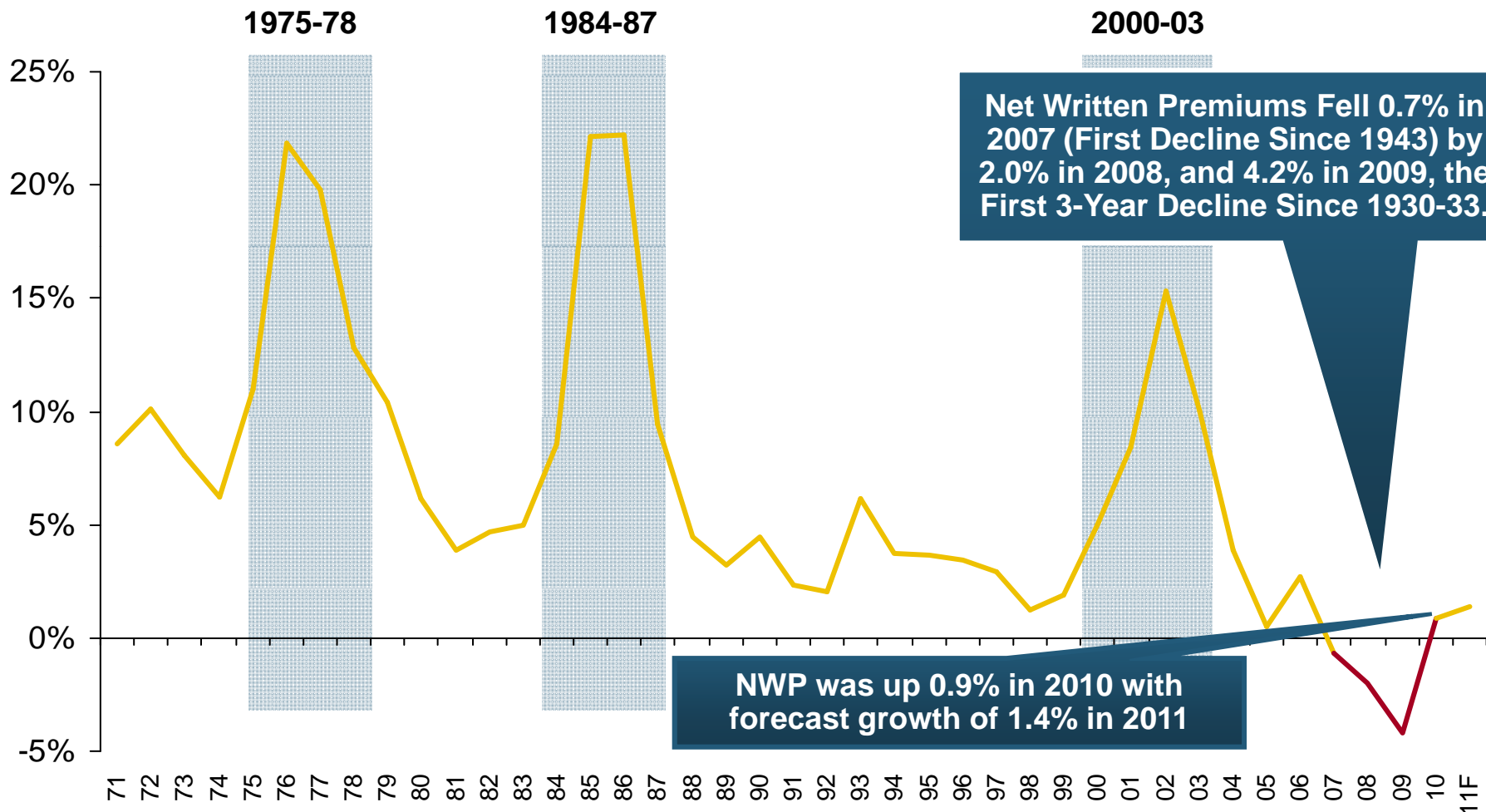
Source: Insurance Information Institute from A.M. Best and ISO data.

# PRICING TRENDS

**Winds of Change or  
Moving Sideways?**

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

(Percent)



Shaded areas denote "hard market" periods

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



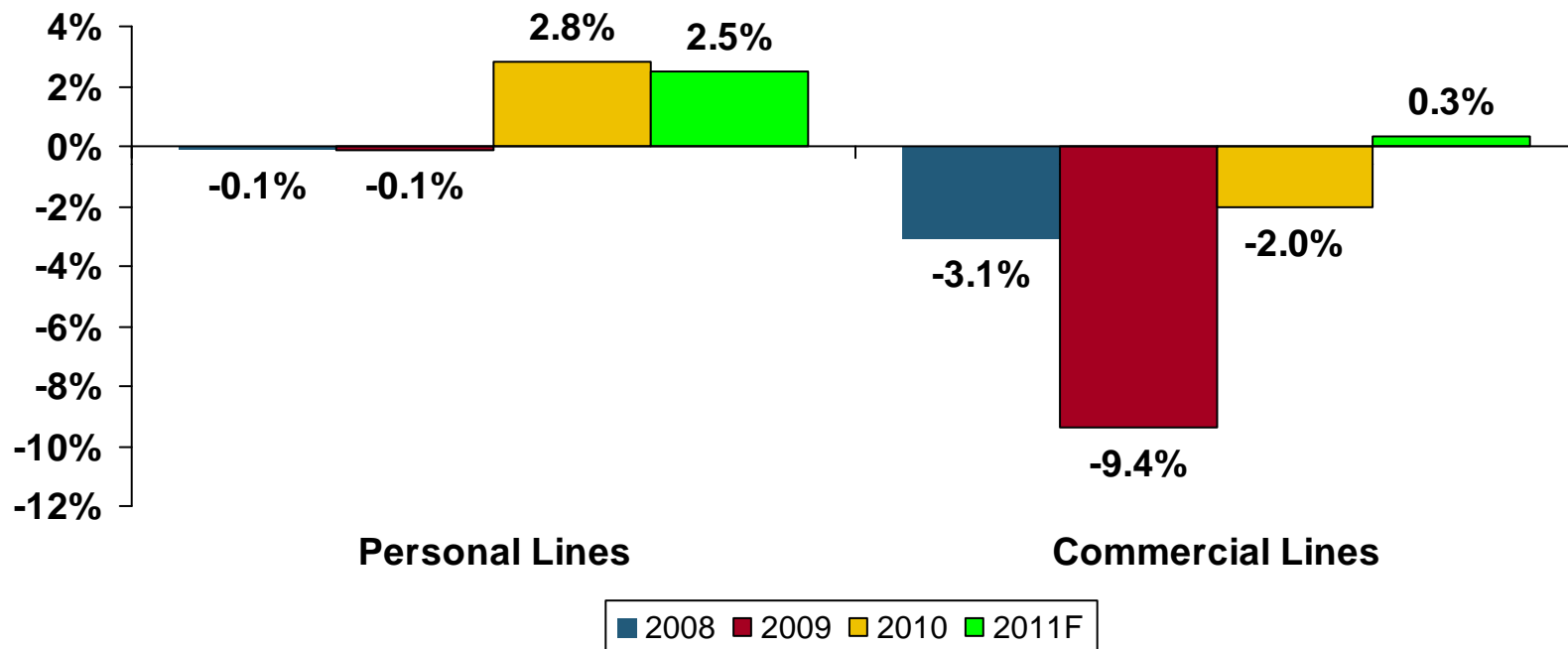
# P/C Net Written Premiums by Line: 2008-2010P

Line of Business	2008	2009	2010P	2009-2010P Change
Personal Auto	\$150.0B	\$156.6B	\$159.1B	+1.6%
Homeowners	\$55.6	\$56.9	\$61.2	+7.6%
Other Liab (incl. Prod Liab)	\$42.0	\$39.1	\$38.2	-2.4%
Workers Compensation	\$33.8	\$30.3	\$29.9	-1.3%
Commercial Multi Peril	\$30.1	\$28.5	\$28.7	+0.8%
Commercial Auto	\$23.7	\$21.8	\$20.9	-4.3%
Fire & Allied Lines (incl EQ)	\$24.2	\$23.4	\$22.6	-3.4%
All Other Lines	\$67.7	\$61.9	\$61.6	-0.5%
<b>Total P/C Industry</b>	<b>\$434.9B</b>	<b>\$418.4B</b>	<b>\$422.1B</b>	<b>+0.9</b>

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

# Net Written Premium Growth by Segment: 2008-2011F

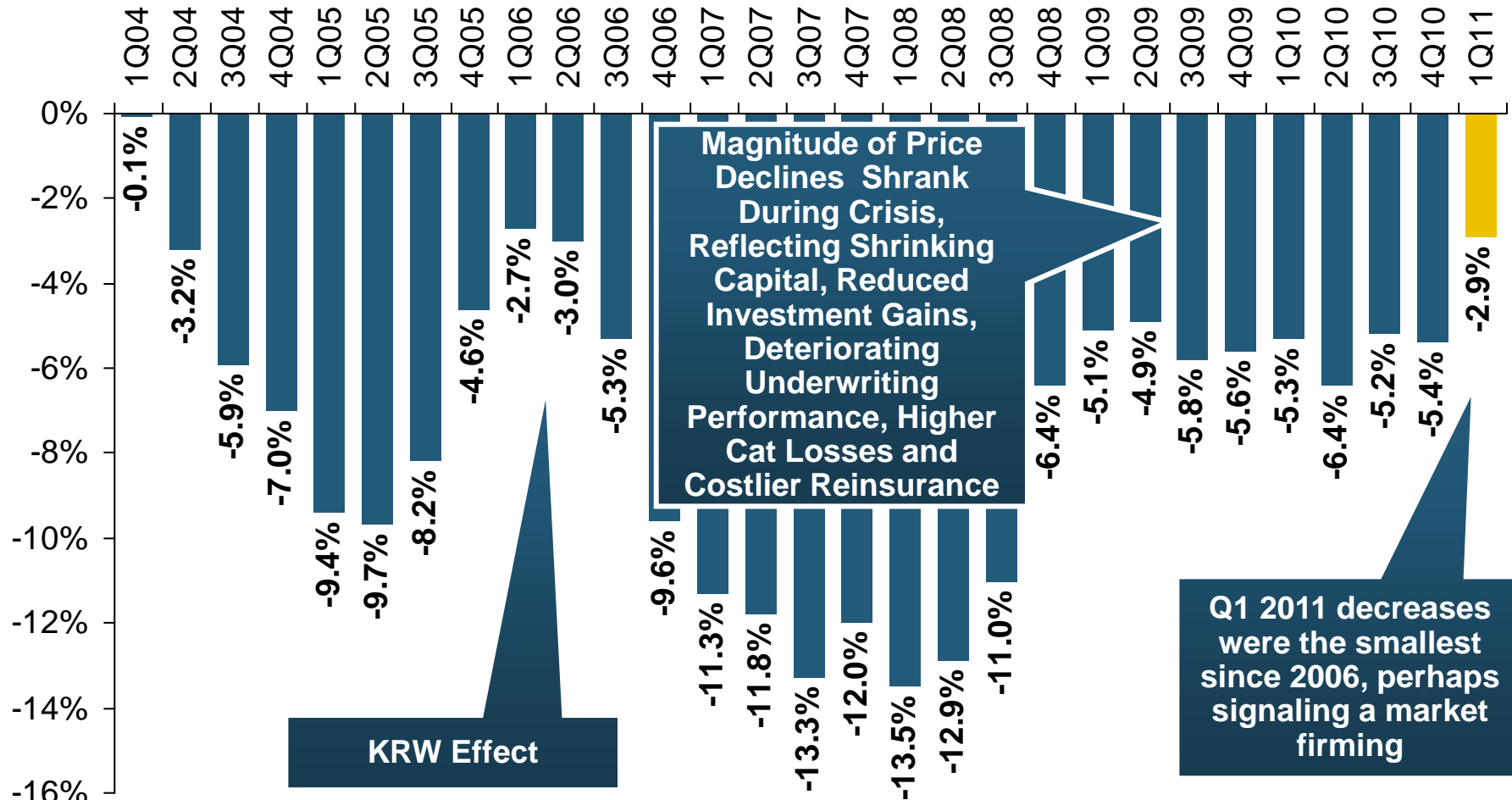
Personal lines growth resumed in 2010 and will continue in 2011, while commercial lines contracted again in 2010 and but will stabilize in 2011



Rate and exposure are more favorable in personal lines, whereas a prolonged soft market and sluggish recovery from the recession weigh on commercial lines.

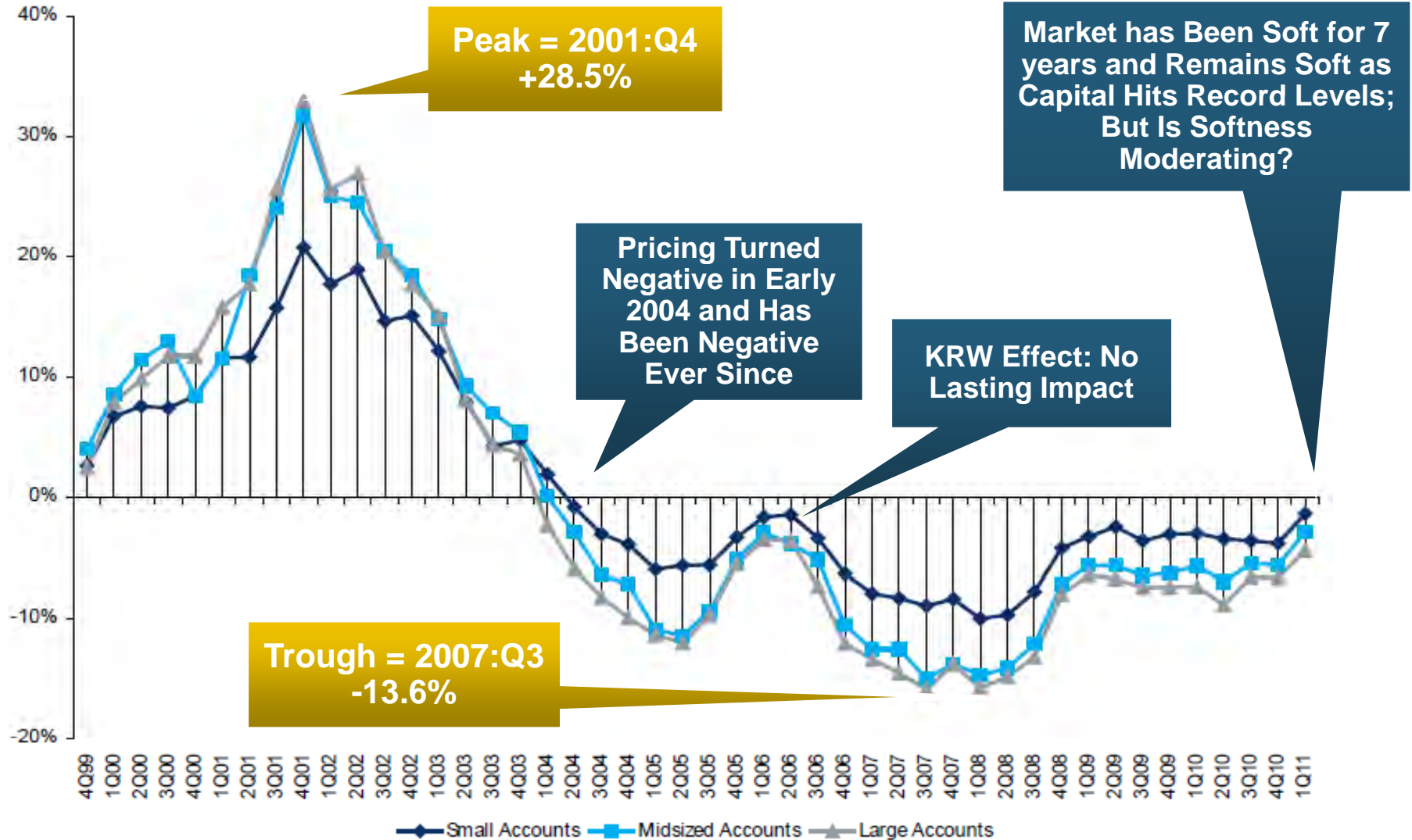
# Average Commercial Rate Change, All Lines, (1Q:2004–1Q:2011)

(Percent)



# Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2011:Q1

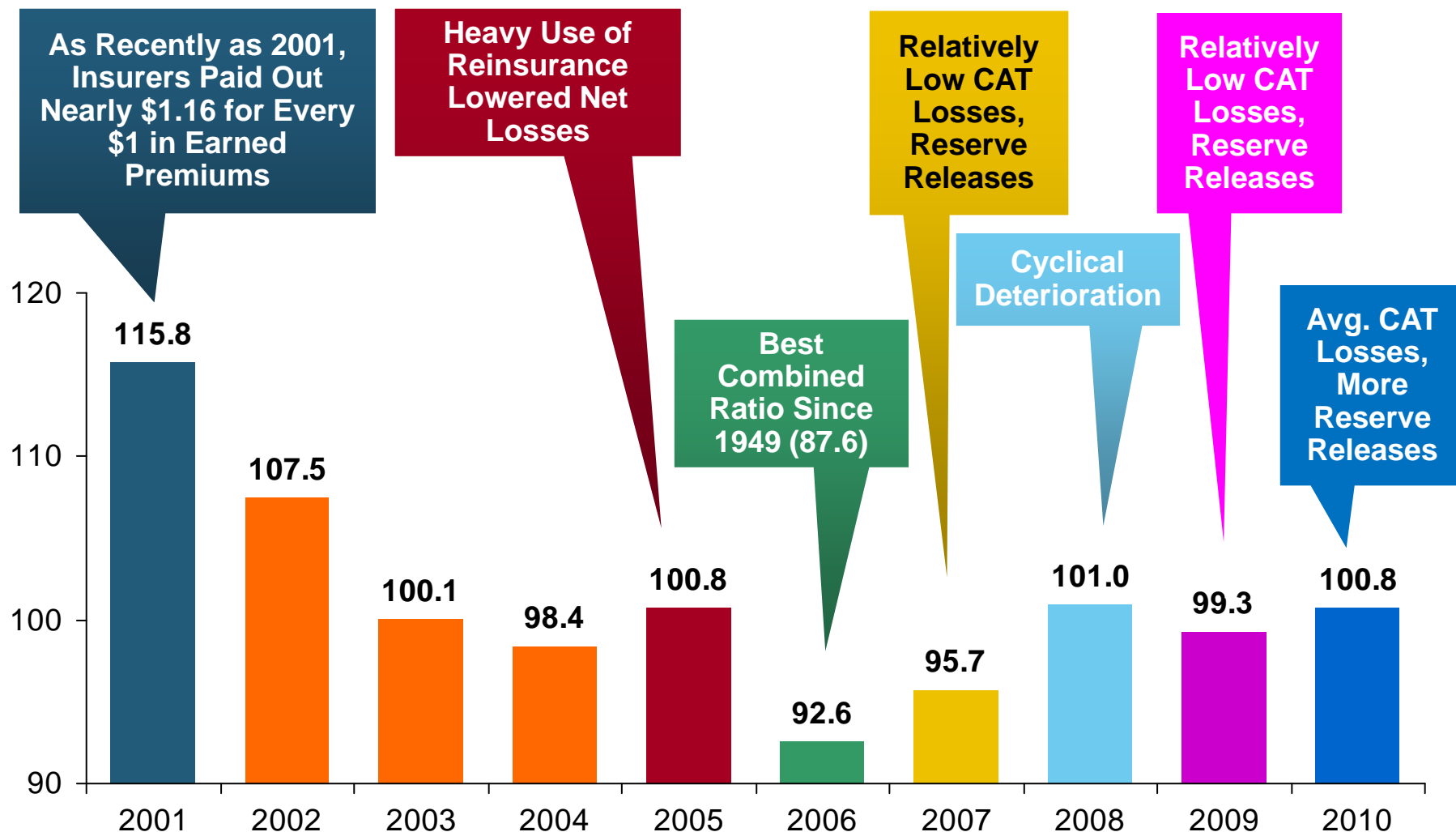
Percentage Change (%)



# UNDERWRITING

**Cyclicalicity is Driven Primarily  
by the Industry's Underwriting  
Cycle, Not the Economy**

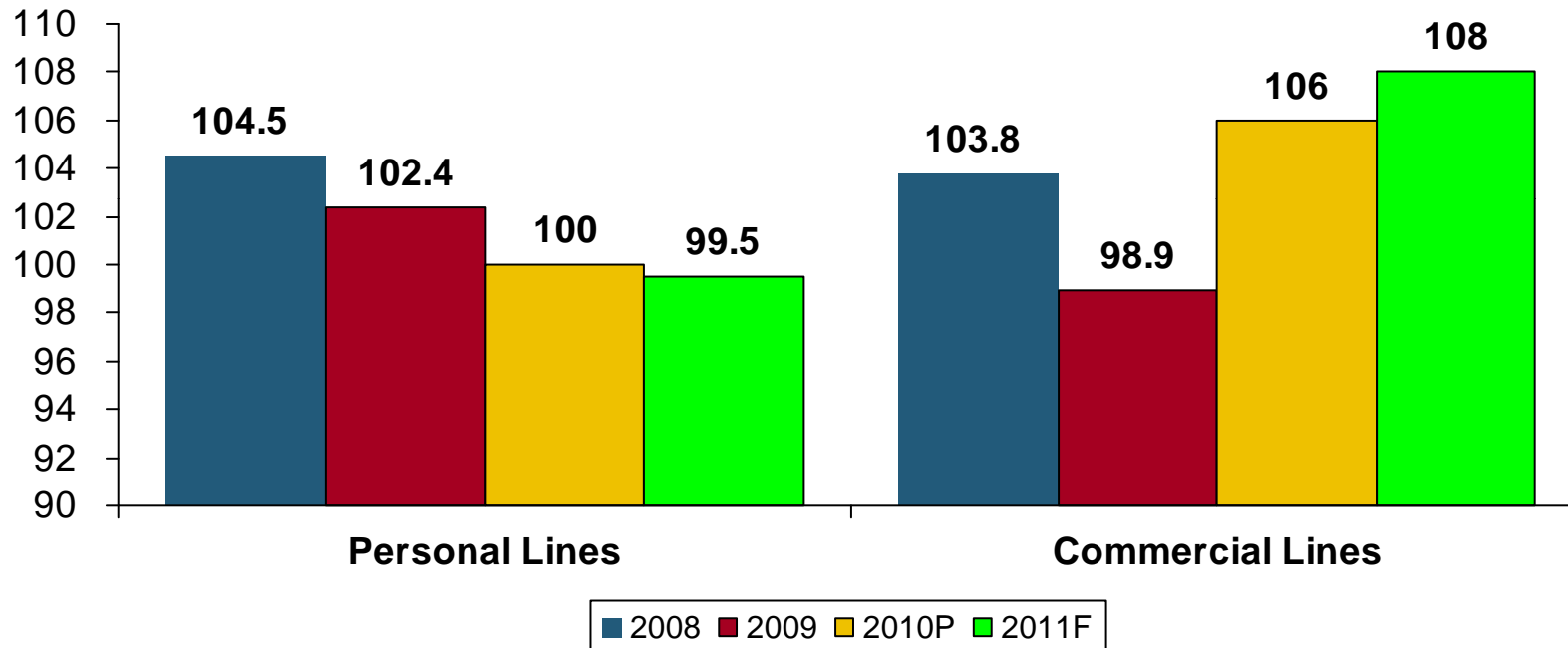
# P/C Insurance Industry Combined Ratio, 2001–2010\*



\* Excludes Mortgage & Financial Guaranty insurers in 2008, 2009 and 2010. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4  
Sources: A.M. Best, ISO.

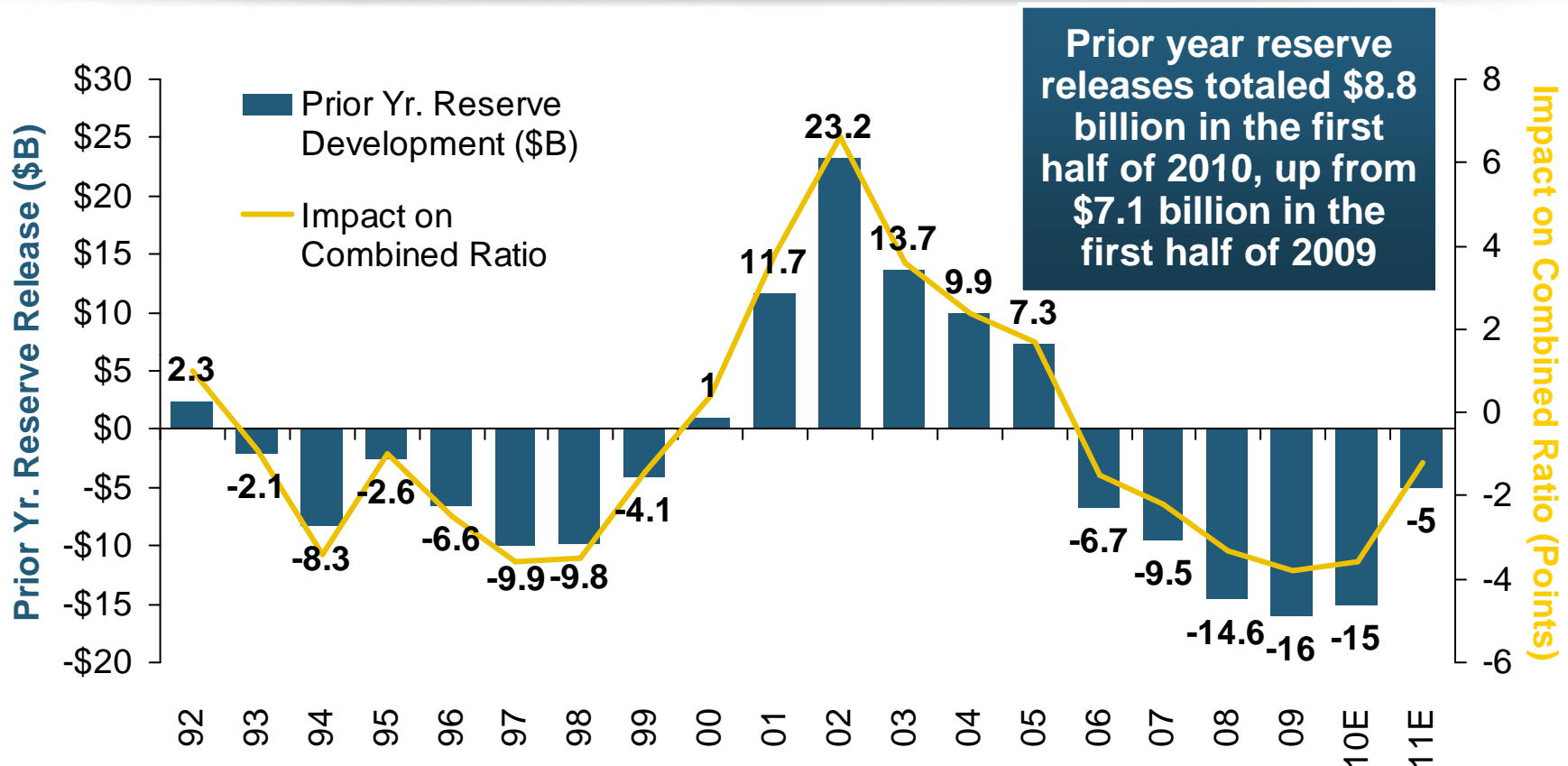
# Calendar Year Combined Ratios by Segment: 2008-2011F

Personal lines combined ratio is expected to remain stable in 2010 while commercial lines and reinsurance deteriorate



Overall deterioration in 2011 underwriting performance is due to expected return to normal catastrophe activity along with deteriorating underwriting performance related to the prolonged commercial soft market

# P/C Reserve Development, 1992–2011E



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

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

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

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

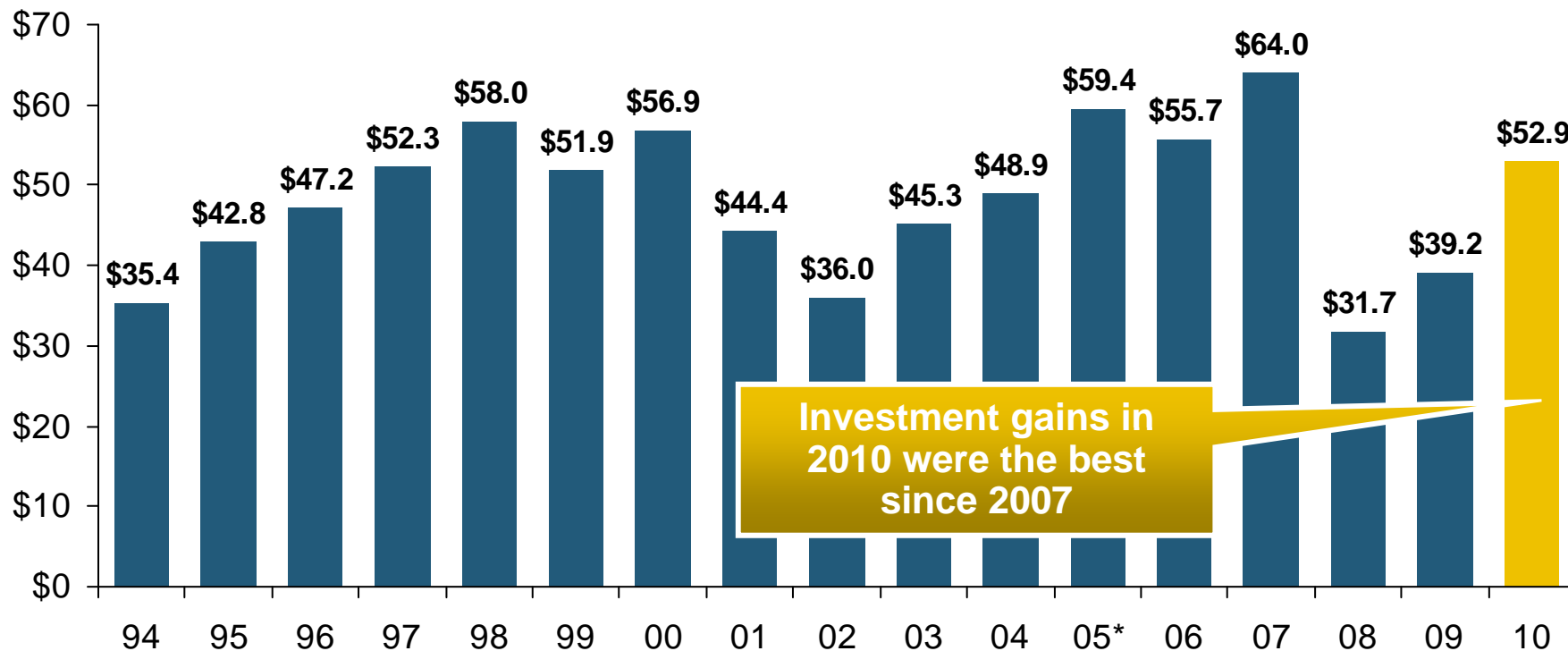


# INVESTMENTS: THE NEW REALITY

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

# Property/Casualty Insurance Industry Investment Gain: 1994–2010<sup>1</sup>

(\$ Billions)



Investment gains in 2010 were the best since 2007

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

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

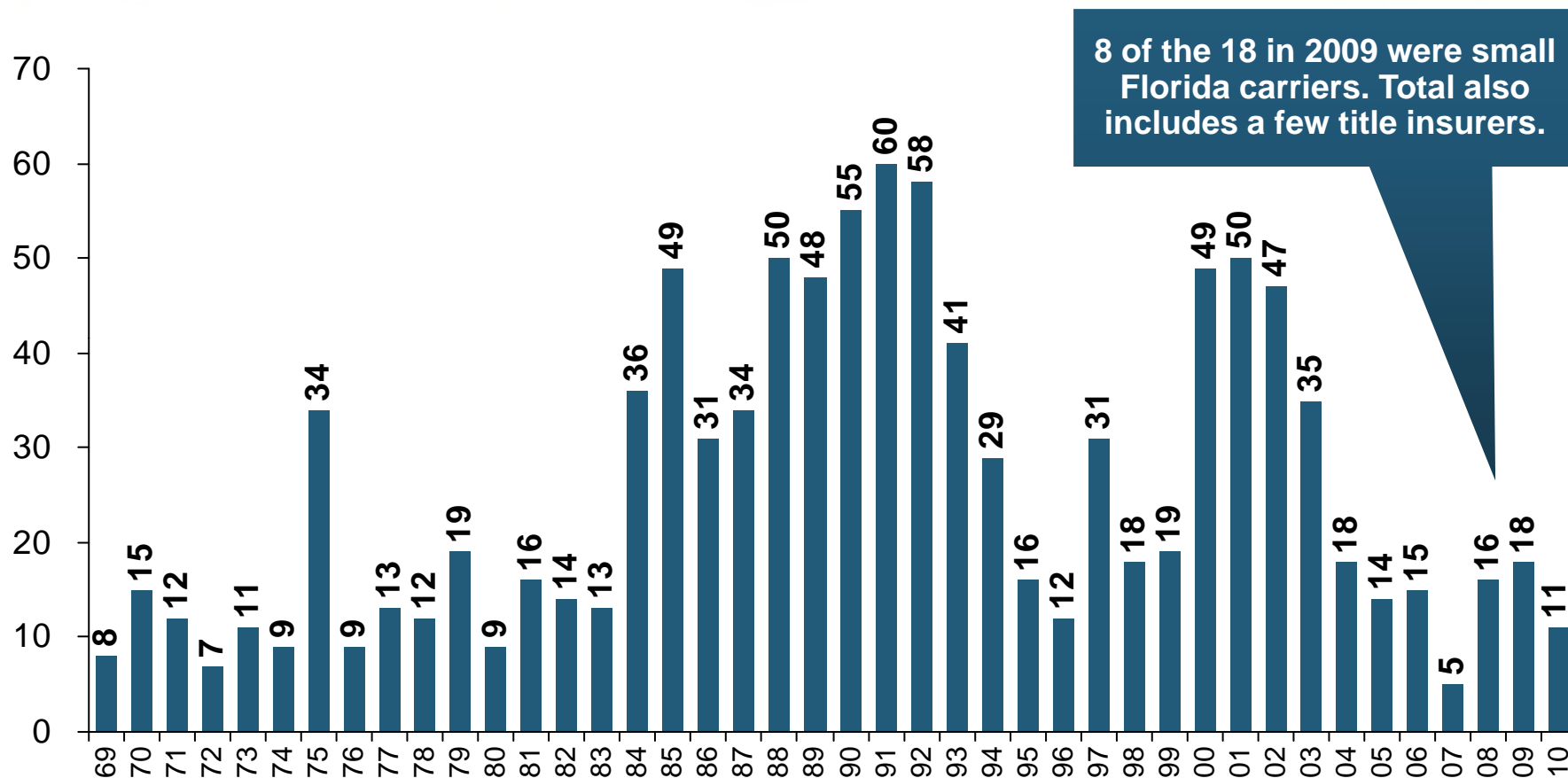
\* 2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.

# **Financial Strength & Underwriting**

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

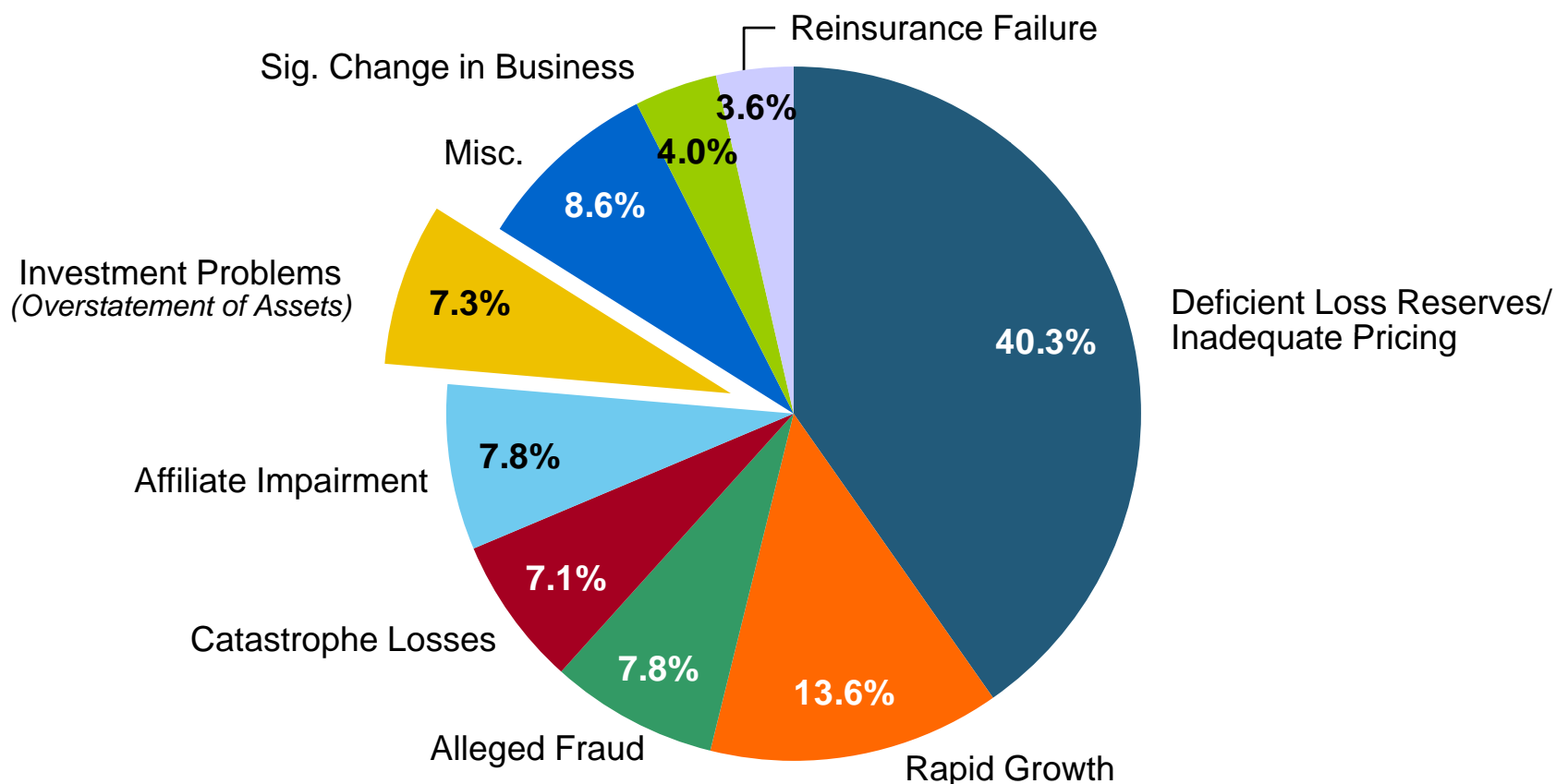
# P/C Insurer Impairments, 1969–2010



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

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

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





# Performance by Segment: Commercial/Personal Lines & Reinsurance

# P/C Underwriting Results: 2008-2010P



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

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

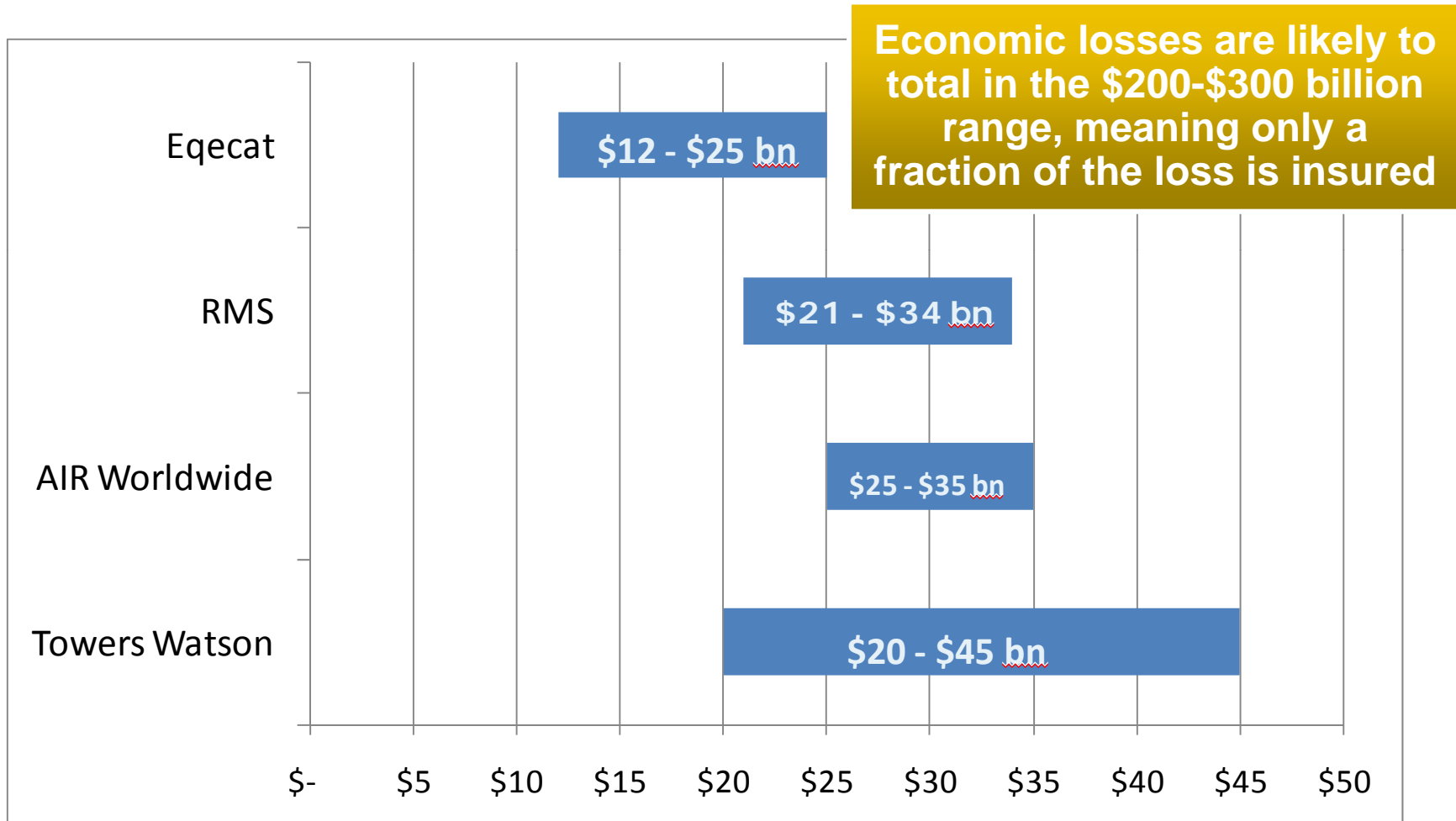
# Potential Impacts of Japan Quake & Other Major CATs on P/C (Re)Insurance Markets

**Impacts Could Be Felt Well  
Beyond Japan**



# Insured Japan Earthquake Loss Estimates\*

(Insured Losses, \$ Billions)

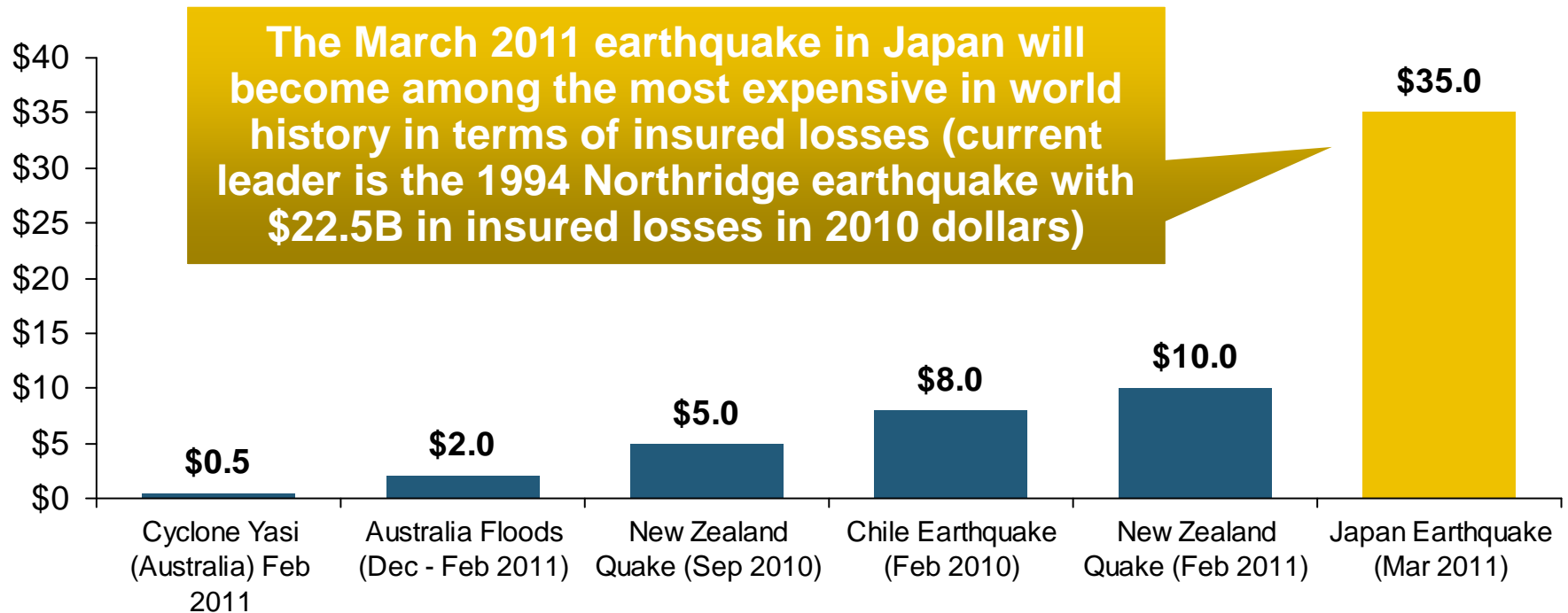


\*As of April 21, 2011. Towers Watson estimate includes \$3.0 (low) to \$4.9 billion (high) in life insurance losses. RMS estimate includes insured life/health losses of \$3 to \$8 billion.

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

# Recent Major Catastrophe Losses

(Insured Losses, \$US Billions)



**Insured Losses from Recent Major Catastrophe Events Exceed \$60 Billion, an Estimated \$57 Billion of that from Earthquakes**

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

- **No Direct Impact for US Domestic Primary Insurers**
- **Primary Insurance: Domestic Japanese Insurers Take Big Losses**
- **Few US/Foreign Insurers Had Direct Exposure to Japanese P/C Market**
  - ◆ Low single-digit market share for a small number of companies
  - ◆ Not a capital event for any non-Japanese primary insurer
- **Significant Absorption of Loss by Japanese Government**
  - ◆ Residential earthquake damage
  - ◆ Nuclear-related property and liability damage
- **Significant Impacts for Global Reinsurers**
  - ◆ Property-Catastrophe covers on Commercial Lines
  - ◆ Business Interruption/Contingent Business Interruption
- **Currently an Earnings Event for Global Reinsurers**
  - ◆ Not a capital event: Global reinsurance markets entered 2011 with record capital
- **Cost of Property/Cat Reinsurance Rising in Japan, New Zealand, Australia**
  - ◆ Up for all; Magnitude of increase is sensitive to size of loss
- **Impact on Cost of US Property-Cat Reinsurance is Possible/Likely**
  - ◆ Market remains well capitalized and competitive
  - ◆ Elevated global cat activity could halt/hike price declines for property/cat reinsurance
  - ◆ FL renewals up 5%-15% according to BDA reinsurer statements (late May)
  - ◆ Offshore energy up 20%-30%; Less onshore.
  - ◆ Casualty—no impact.



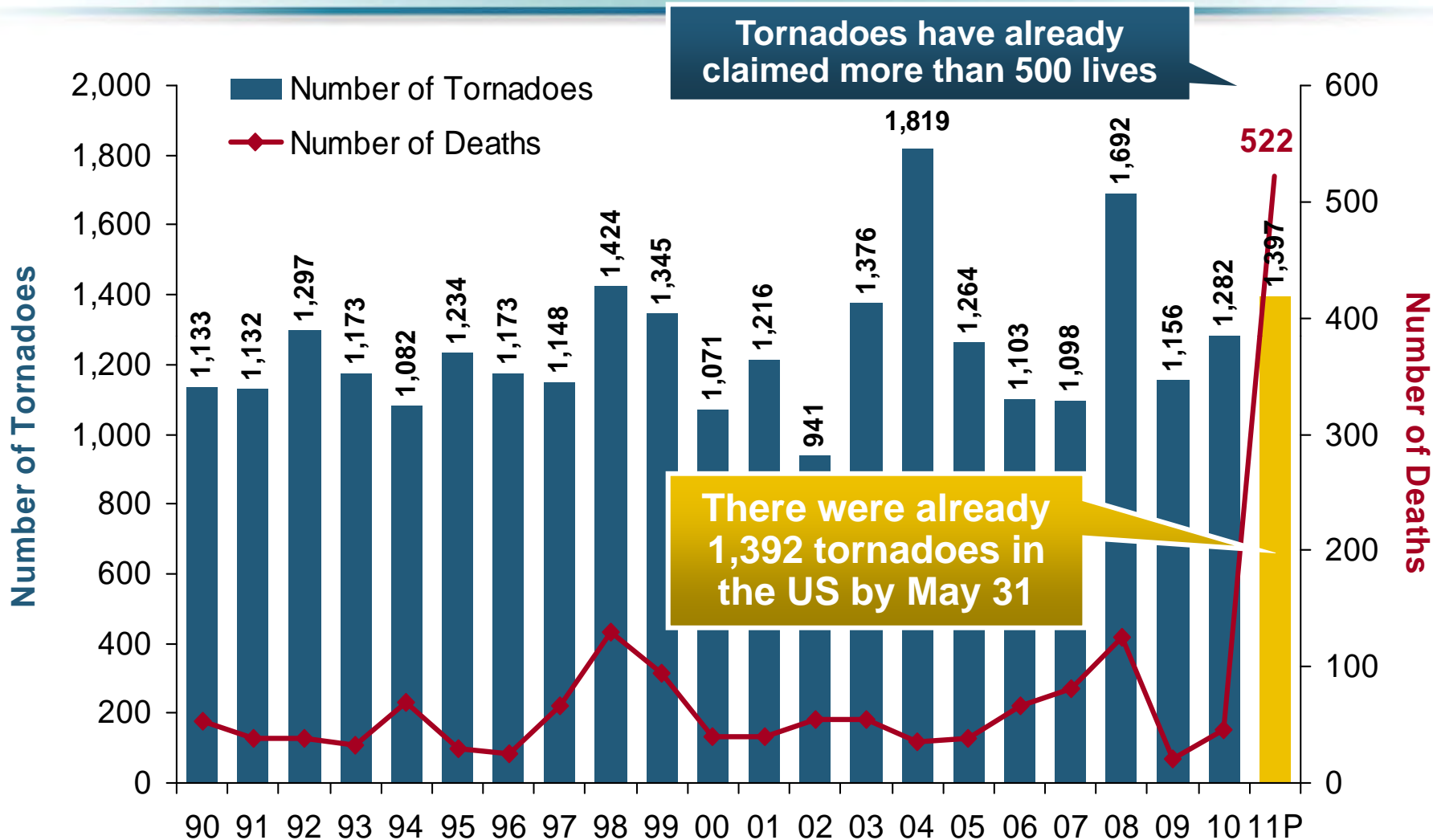
# Summary of April/May 2011 Tornado Outbreaks

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

# Summary of Recent Tornado Activity

- **There Have Been 1,397 Tornadoes Through June 1 in the US**
- **At least 522 People Have Been Killed**
- **The April 27 Tornado Outbreak Killed at Least 342 People**
  - ◆ Now the 2<sup>nd</sup> deadliest outbreak in US history (747 killed in march 1925 event)
  - ◆ States impacted: AR, TN, LA, MS, GA and especially AL
  - ◆ *Insured Losses Estimated at \$2B to \$5B (Eqecat); \$3.7B - \$5.5B (AIR)*
- **Economic Losses Likely in the \$4 Bill to \$10 Bill Range**
- **The May 22 Tornado in Joplin, MO, Killed at Least 130 People**
  - ◆ Largest number of deaths from a single tornado
  - ◆ *Insured Losses Estimated at \$1B to \$3B (Eqecat)*
- **P/C Insurance Industry is Very Strong and Will Encounter No Difficulties in Paying these Claims**

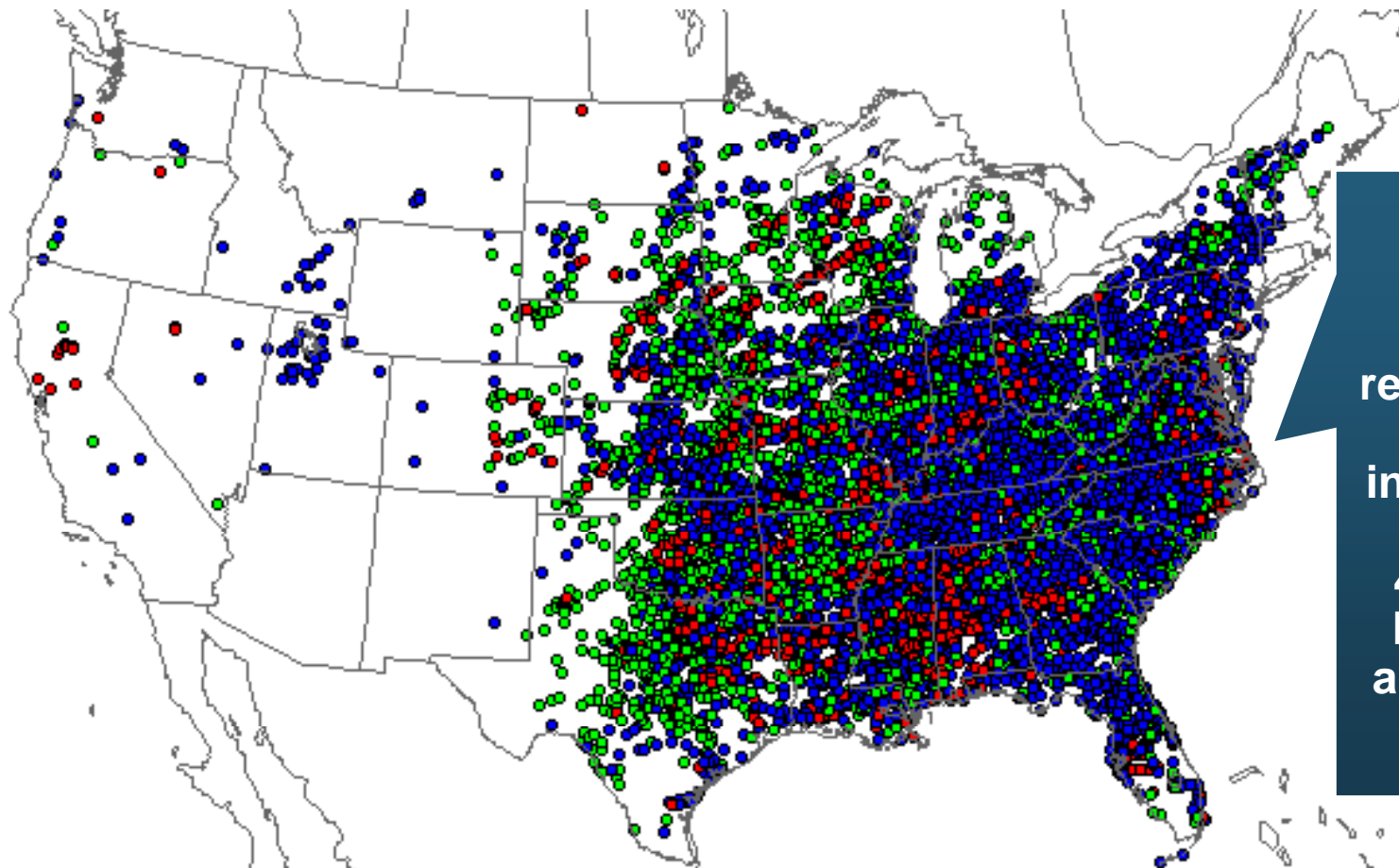
# Number of Tornadoes and Related Deaths, 1990 – 2011\*



\*2011 is preliminary data through June 1.

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

# Severe Weather Reports, January 1—May 31, 2011



There have been 13,295 severe wind reports through May 31; including 1,396 tornadoes; 4,924 “Large Hail” reports and 6,975 high wind events



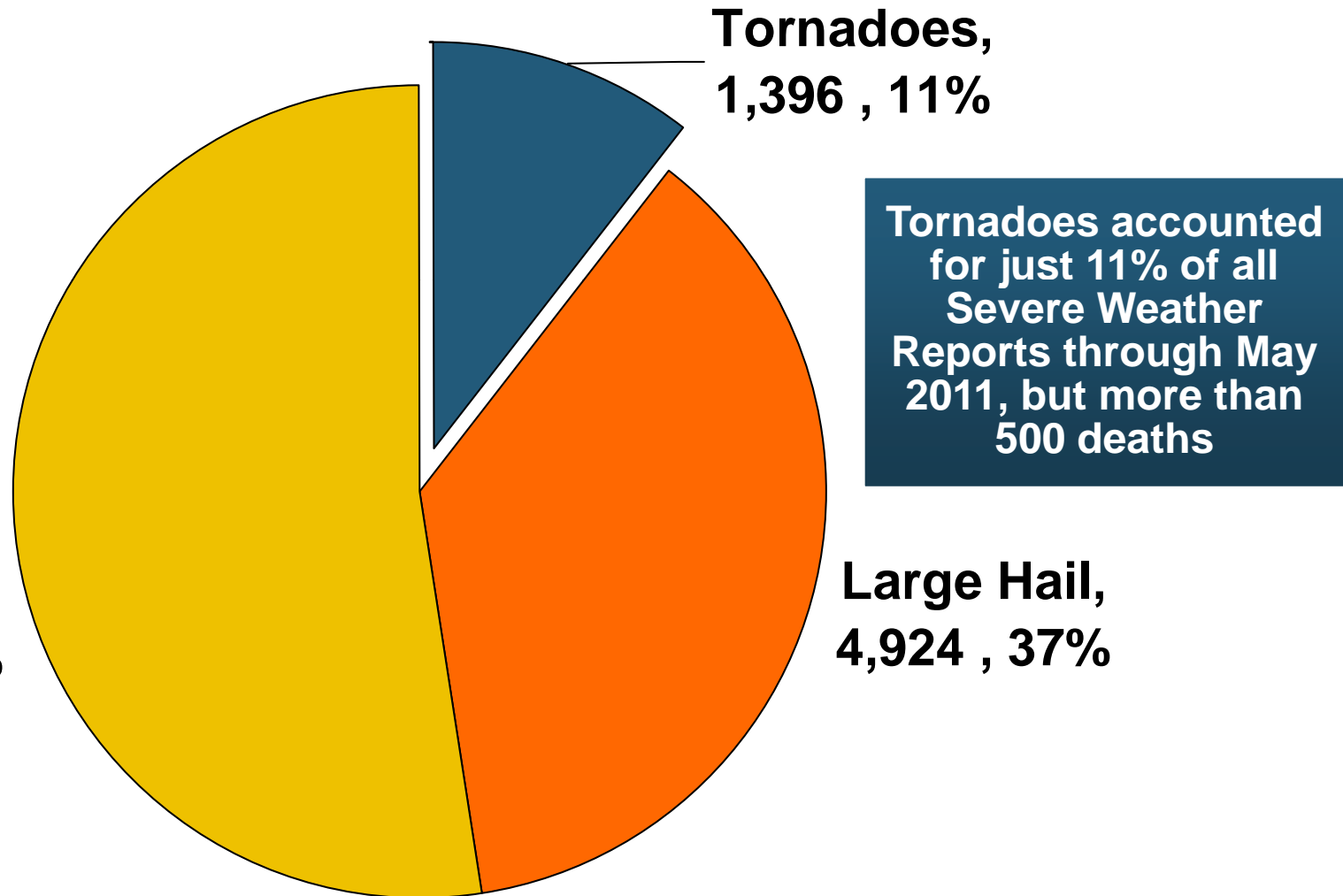
PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Severe Weather Reports  
January 01, 2011 - May 31, 2011

Updated: Tuesday May 31, 2011 08:47 CT

# Number of Severe Weather Reports in US, by Type: January 1—May 31, 2011



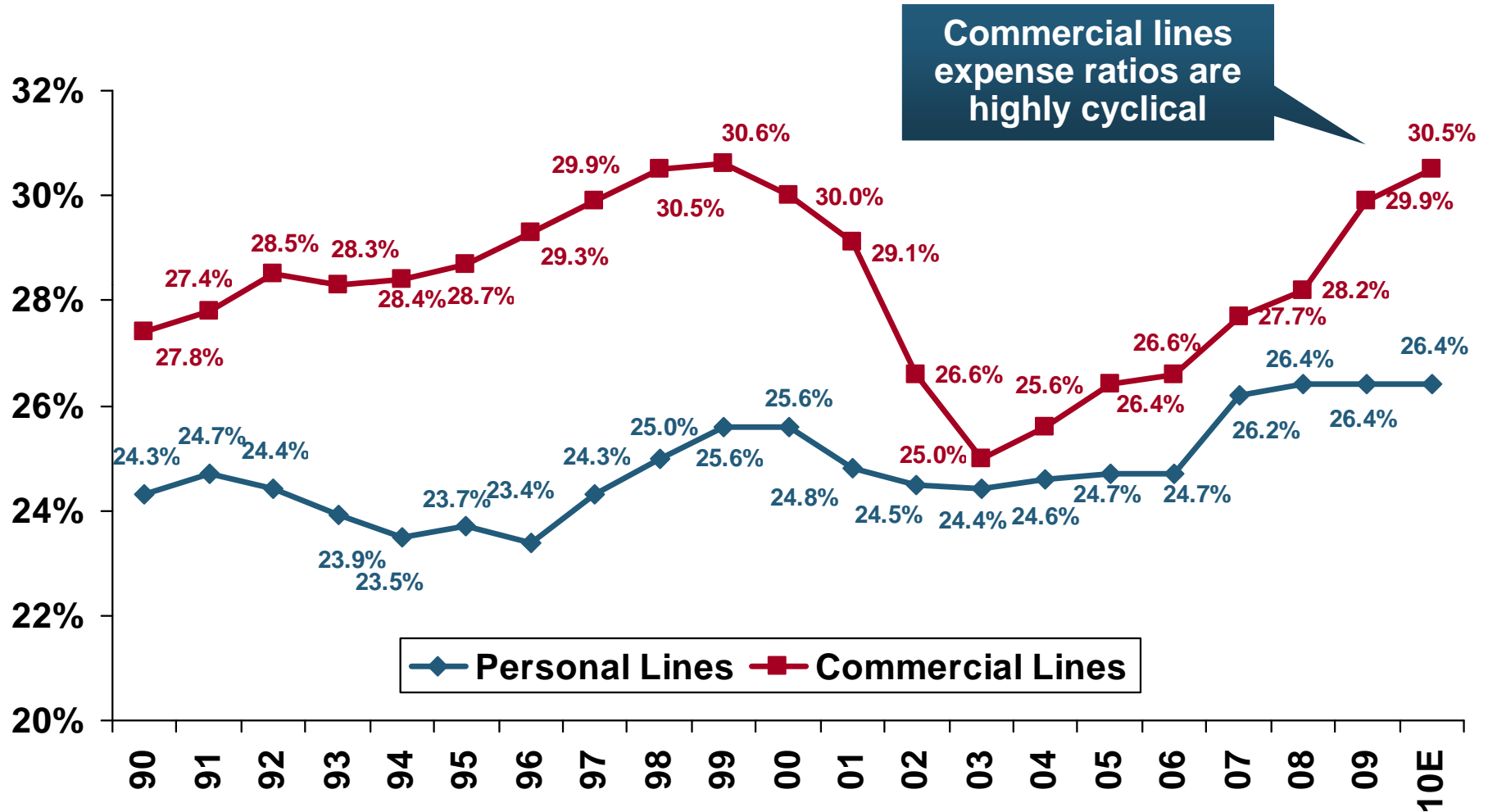


# EXPENSES

**Expense Ratios Are Highly Cyclical  
and Contribute Deteriorating  
Underwriting Performance**

# Underwriting Expense Ratio\*:

## Personal vs. Commercial Lines, 1990-2010E\*\*



\*Ratio of expenses incurred to net premiums written.

\*\*2010 figures are estimates.

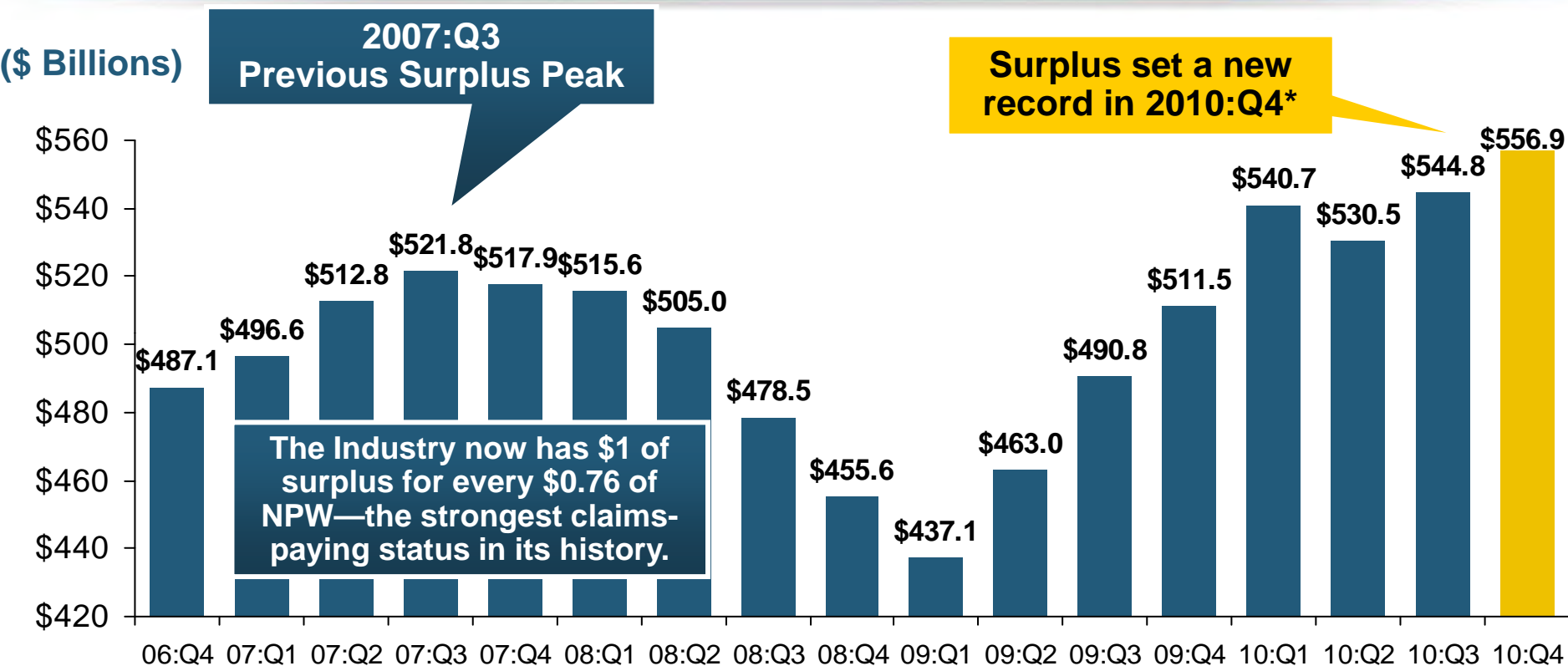
Source: A.M. Best; Insurance Information Institute.

# **CAPITAL MANAGEMENT & LEVERAGE**

**Excess Capital is a Major Obstacle  
to a Market Turn;**

**Capital Management Decisions Will  
Impact Market Direction**

# Policyholder Surplus, 2006:Q4–2010:Q4



## Quarterly Surplus Changes Since 2007:Q3 Peak

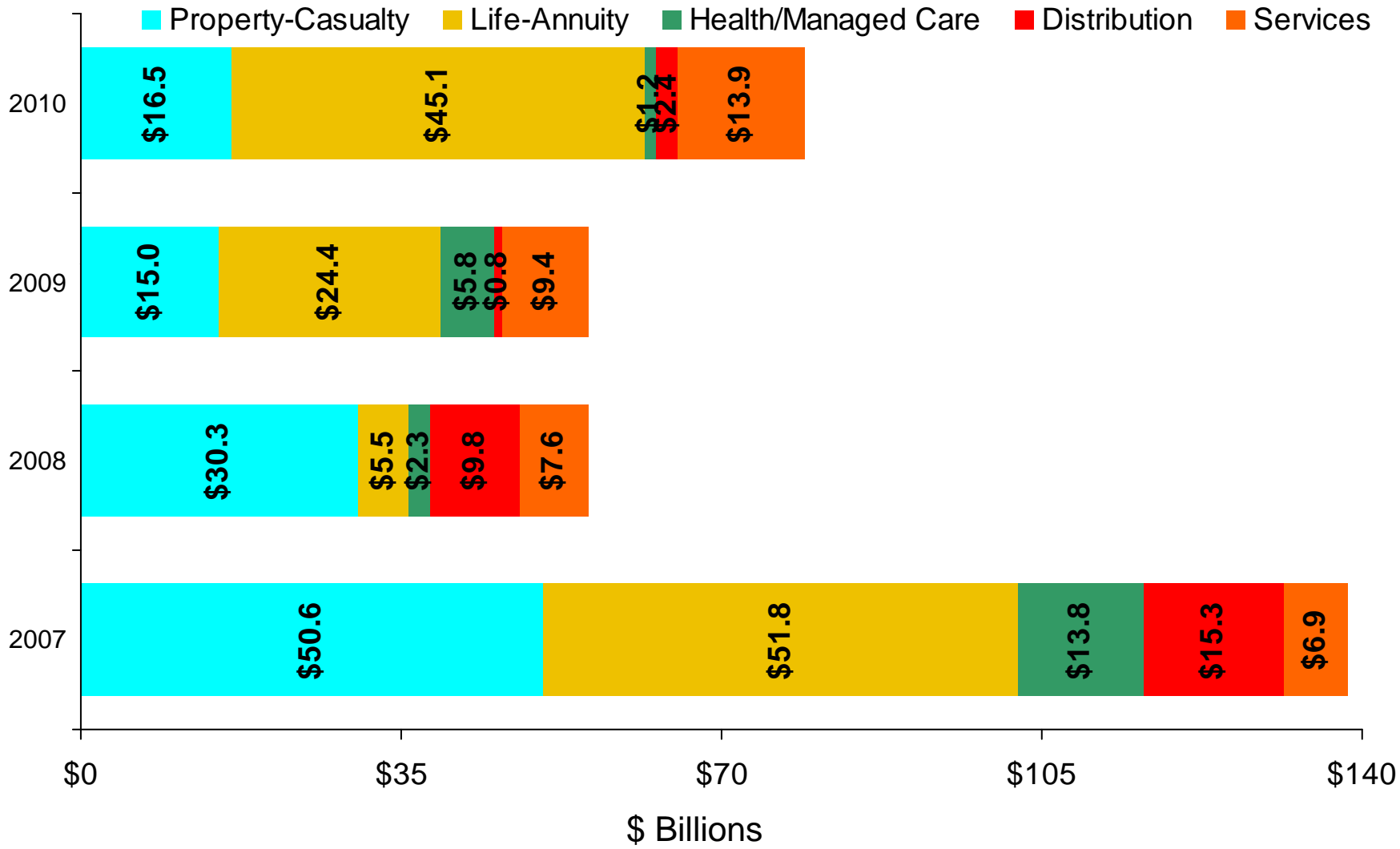
<b>09:Q1: -\$84.7B (-16.2%)</b>	<b>10:Q1: +\$18.9B (+3.6%)</b>
<b>09:Q2: -\$58.8B (-11.2%)</b>	<b>10:Q2: +\$8.7B (+1.7%)</b>
<b>09:Q3: -\$31.0B (-5.9%)</b>	<b>10:Q3: +\$23.0B (+4.4%)</b>
<b>09:Q4: -\$10.3B (-2.0%)</b>	<b>10:Q4: +\$35.1B (+6.7%)</b>

\*Includes \$22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business in early 2010.

# Merger & Acquisition

**Capital Cycles Can  
Drive Consolidation**

# \$ Value of Mergers & Acquisitions, Worldwide: Will Reg Reform Stifle or Boost Activity?



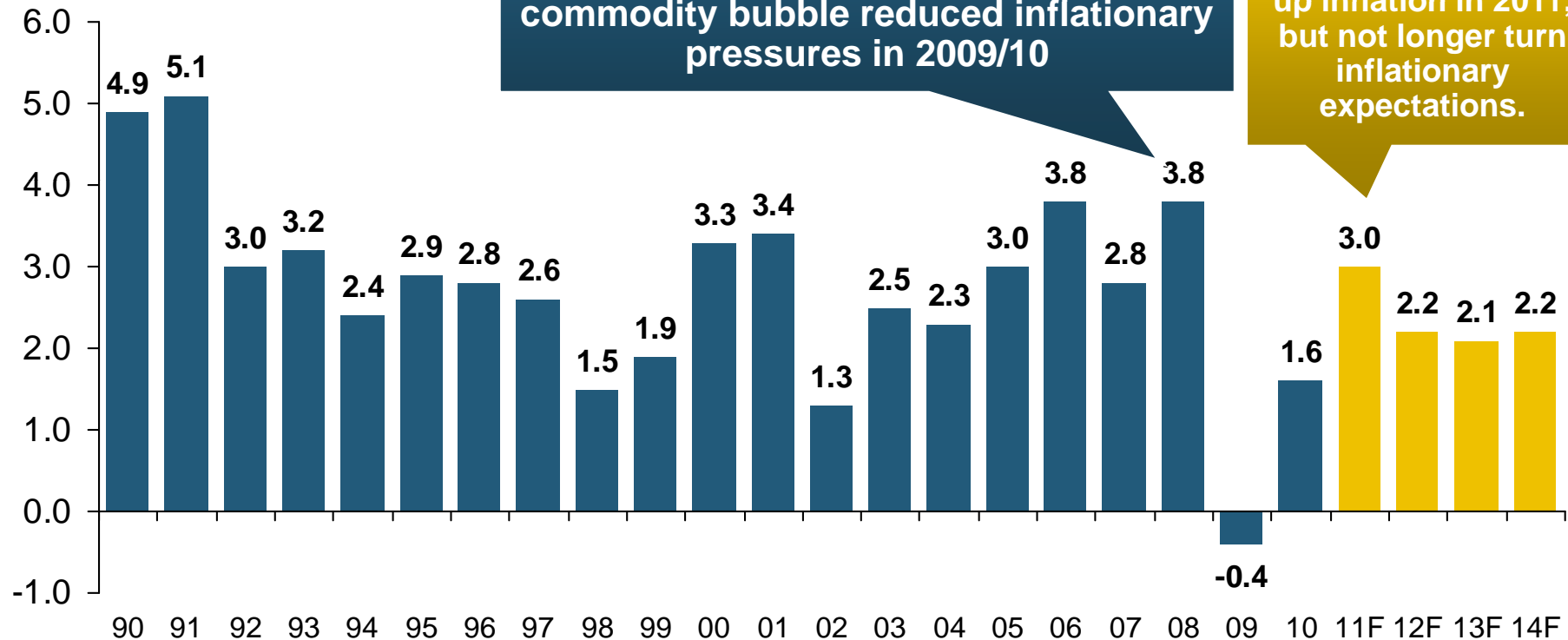
Sources: Conning Research; Insurance Information Institute.

# Inflation

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

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

Annual Inflation Rates (%)



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

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

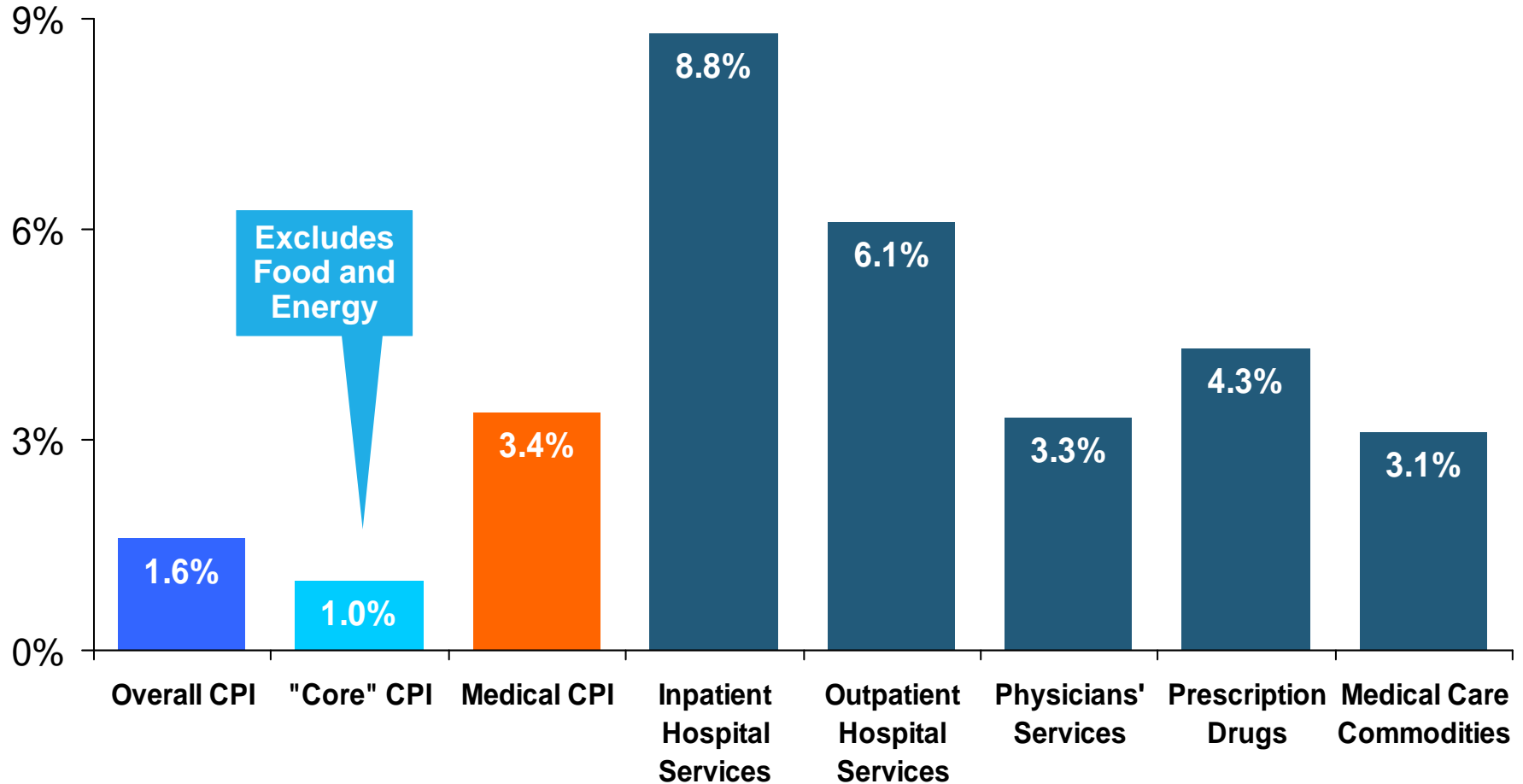
The slack in the U.S. economy suggests that inflation should not heat up before 2012, but other forces (commodity prices, inflation in countries from which we import, etc.), plus U.S. debt burden, remain longer-run concerns

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 3/11 and 5/11 (forecasts).



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

Price Changes  
in 2010



**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**

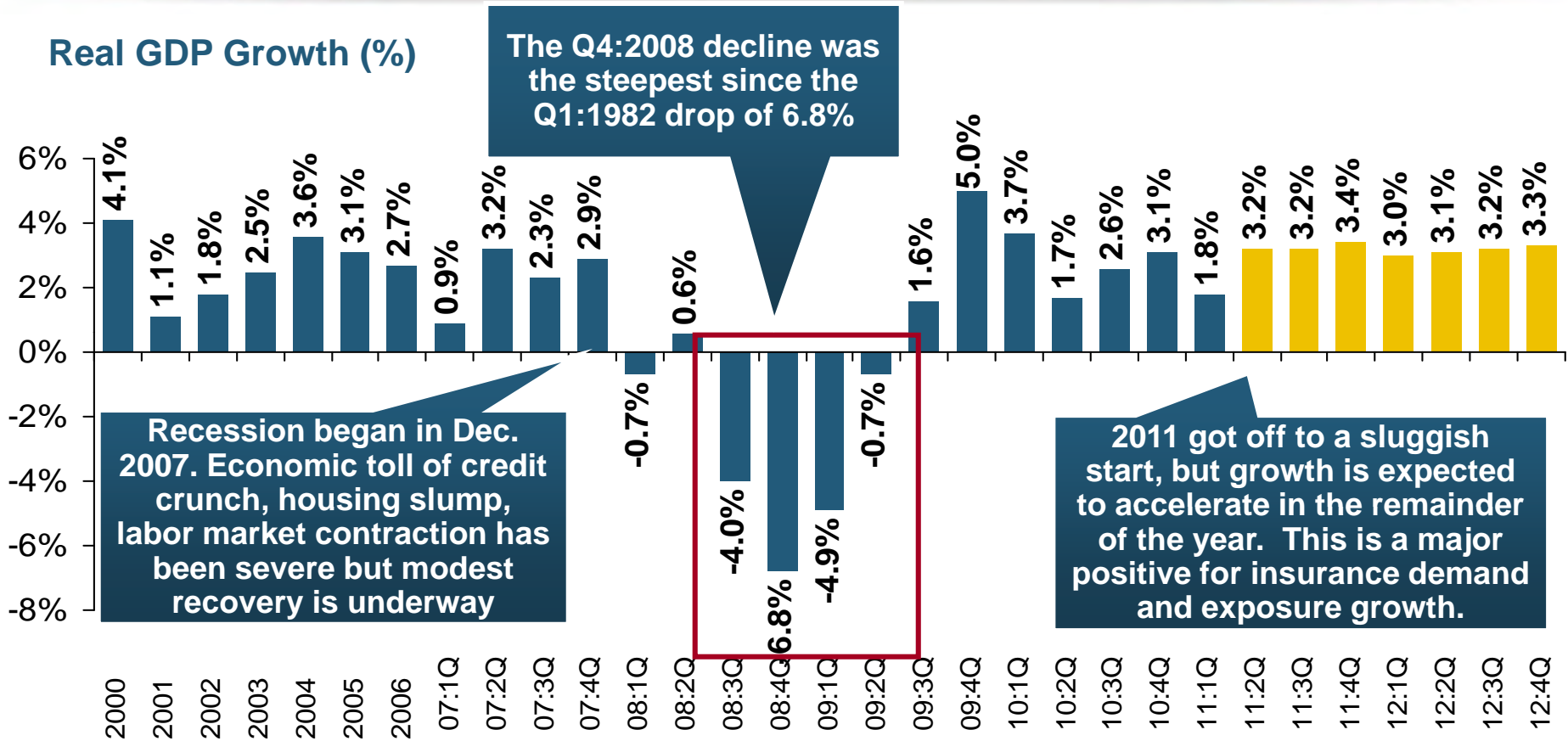


# Economic Issues for the Next 3-5 Years

**P/C Insurance Industry Growth in the  
Wake of the “Great Recession”**

# US Real GDP Growth\*

Real GDP Growth (%)



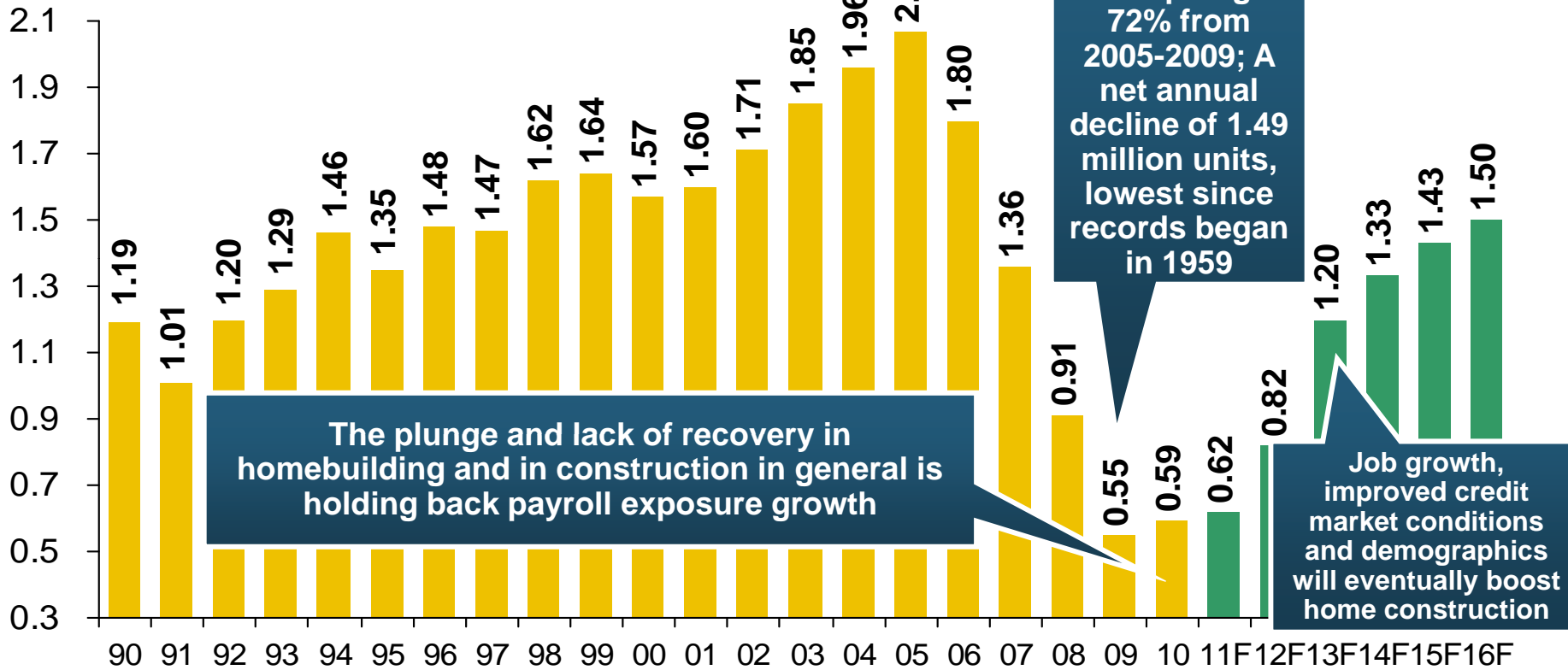
**Demand for Insurance Continues To Be Impacted by Sluggish Economic Conditions, but the Benefits of Even Slow Growth Will Compound and Gradually Benefit the Economy Broadly**

\* Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 5/11; Insurance Information Institute.

# New Private Housing Starts, 1990-2016F

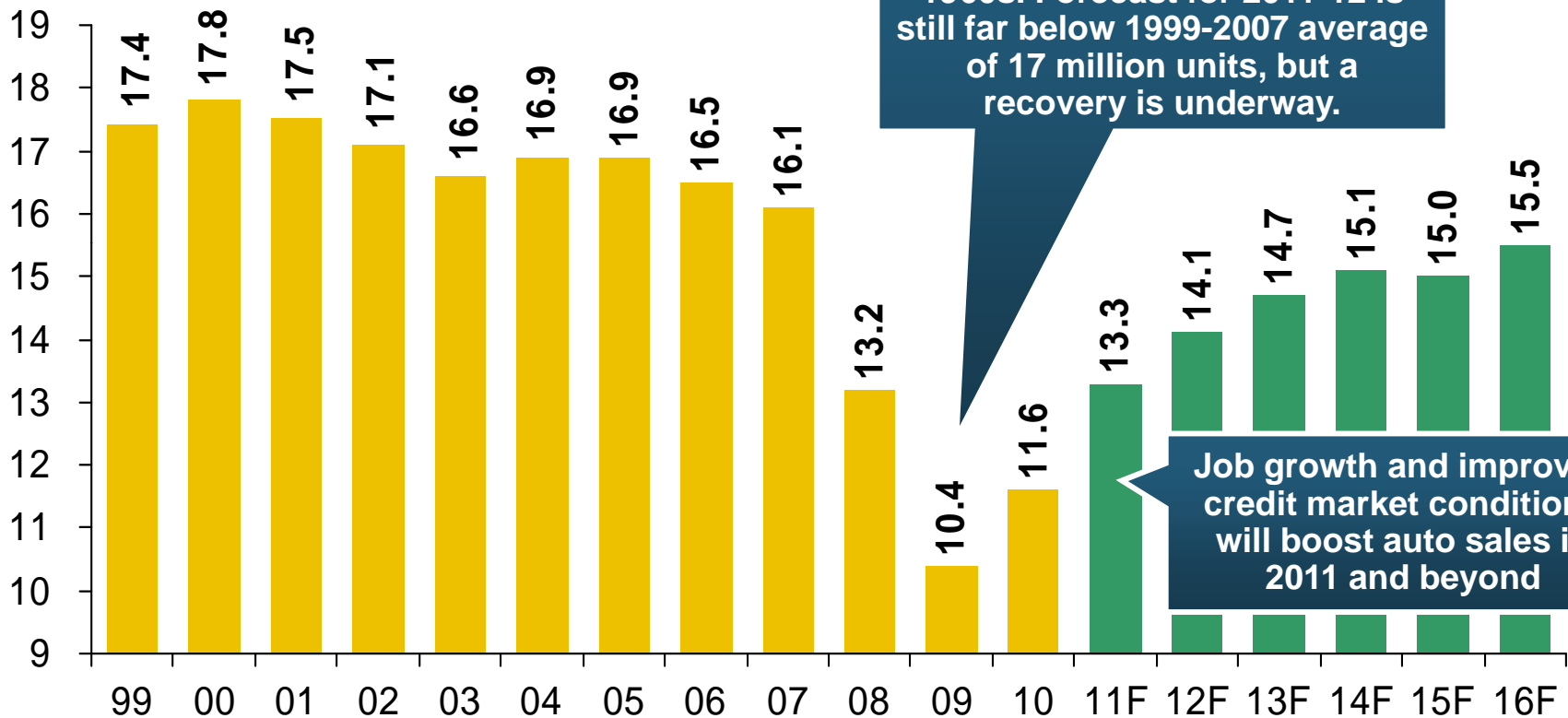
(Millions of Units)



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

# Auto/Light Truck Sales, 1999-2016F

(Millions of Units)

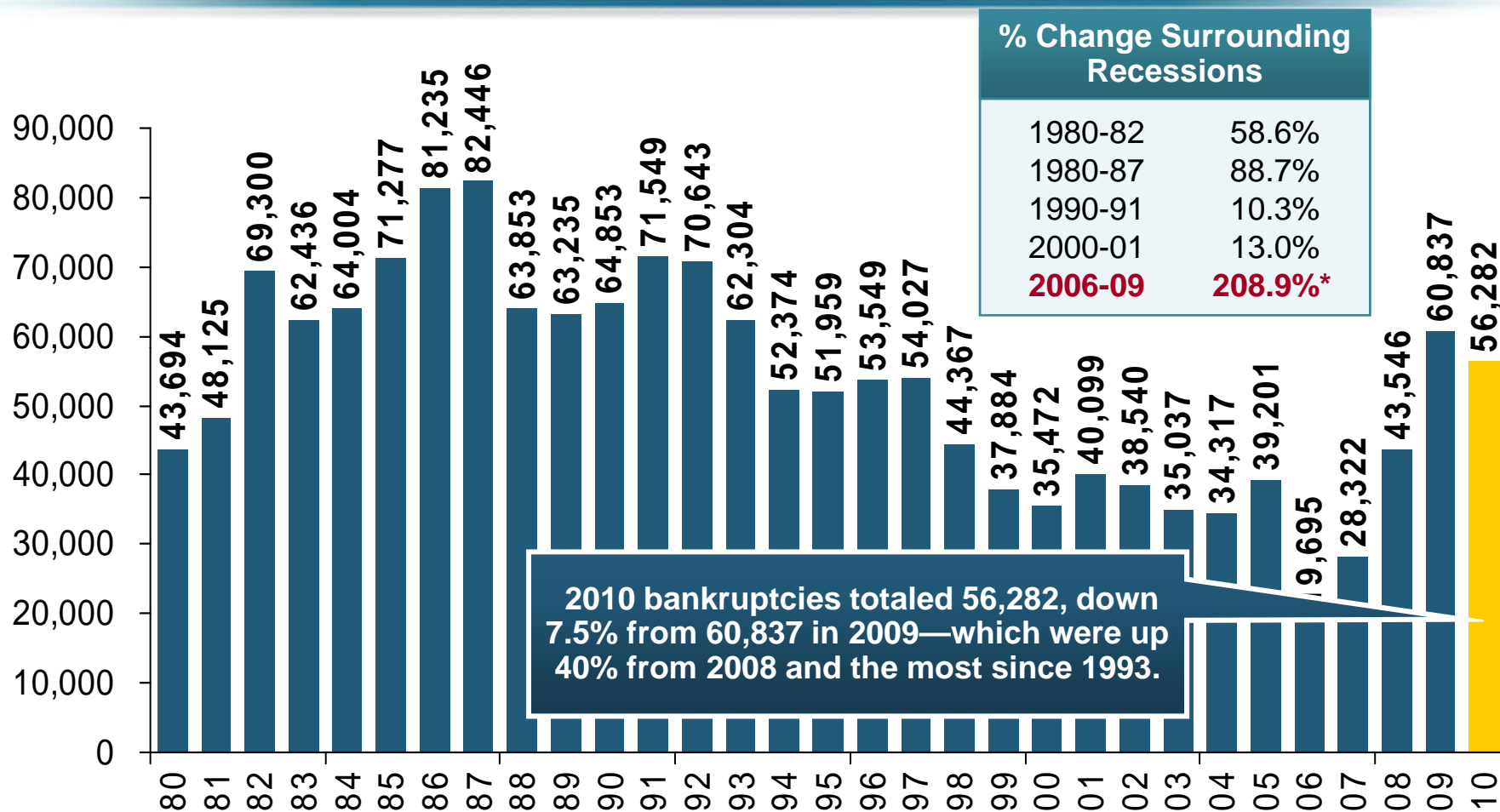


New auto/light truck sales fell to the lowest level since the late 1960s. Forecast for 2011-12 is still far below 1999-2007 average of 17 million units, but a recovery is underway.

Job growth and improved credit market conditions will boost auto sales in 2011 and beyond

**Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point. It is Too Soon to Assess the Impact of Higher Gas Prices.**

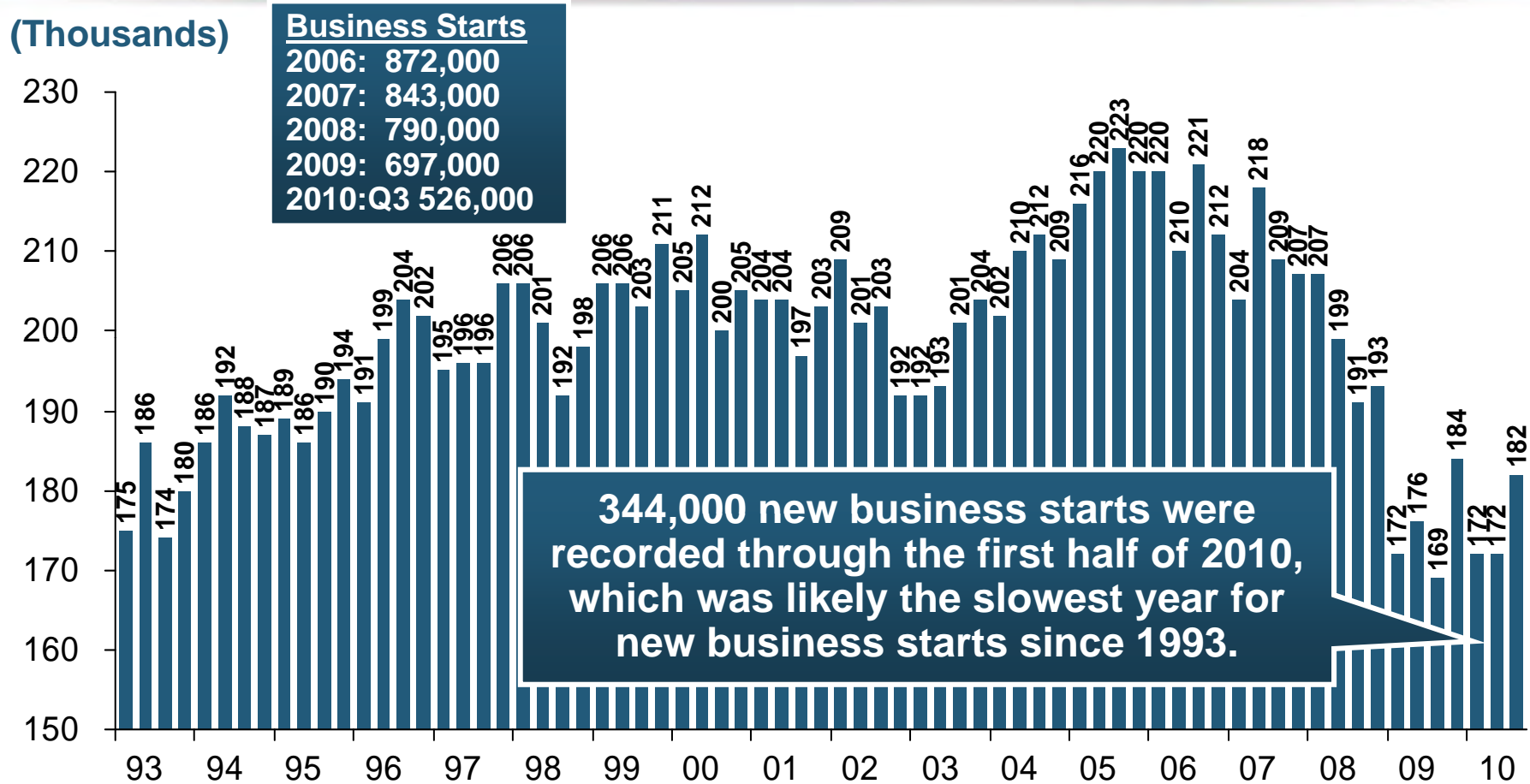
# Business Bankruptcy Filings, 1980-2010



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

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

# Private Sector Business Starts, 1993:Q2 – 2010:Q3\*



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

\* Data through September 30, 2010 are the latest available as of May 3, 2011; Seasonally adjusted  
 Source: Bureau of Labor Statistics, <http://www.bls.gov/news.release/cewbd.t08.htm>.

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

Health Care

Health Sciences

Energy (Traditional)

Alternative Energy

Agriculture

Natural Resources

Environmental

Technology (incl. Biotechnology)

Light Manufacturing

Export-Oriented Industries

Shipping (Rail, Marine, Trucking)



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

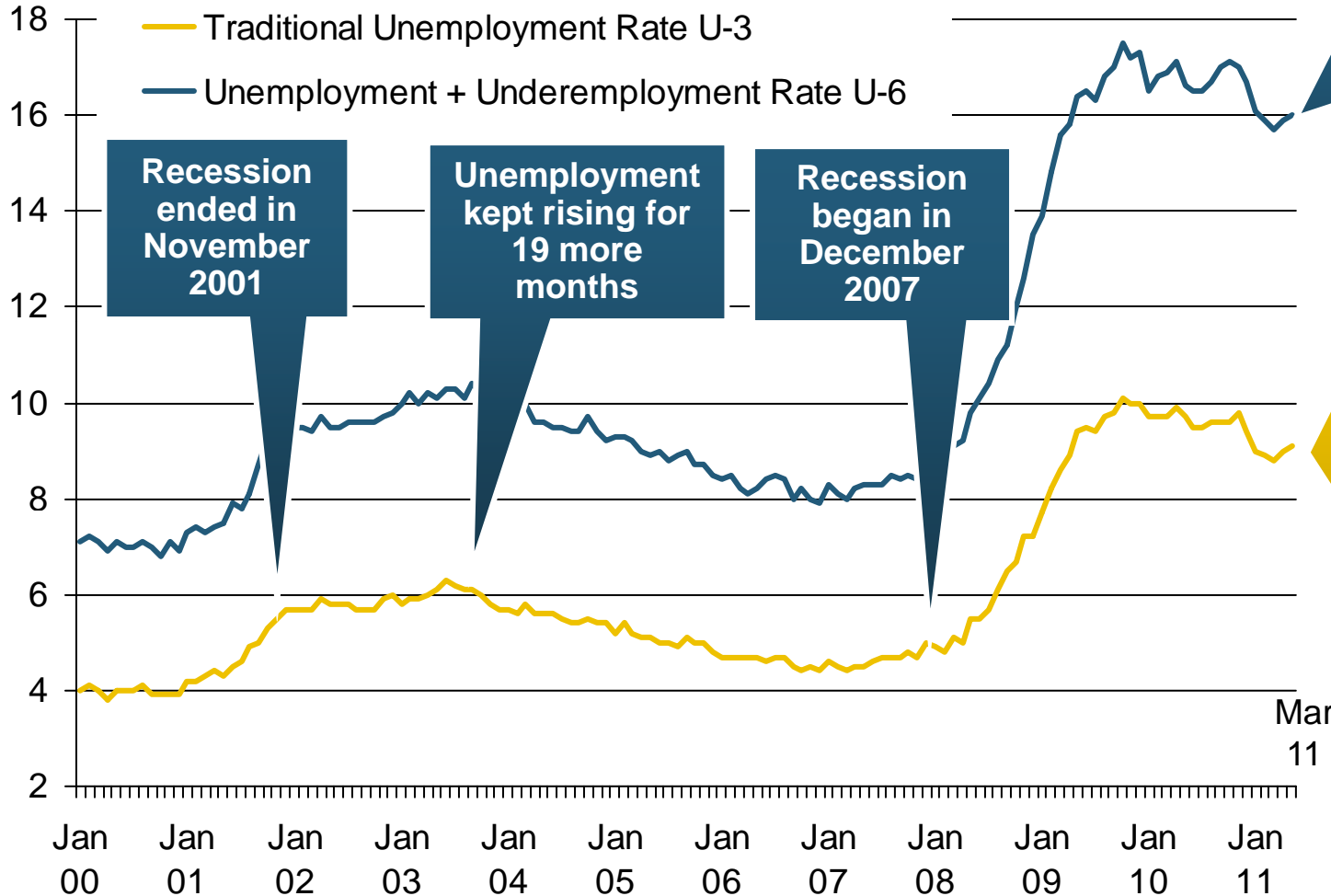


# Labor Market Trends

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

# Unemployment and Underemployment Rates: Falling in 2011

January 2000 through May 2011, Seasonally Adjusted (%)



**Recession ended in November 2001**

**Unemployment kept rising for 19 more months**

**Recession began in December 2007**

**U-6 went from 8.0% in March 2007 to 17.5% in October 2009; Stood at 16.0% in May 2011**

**Unemployment rate rose to 9.1% in May**

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

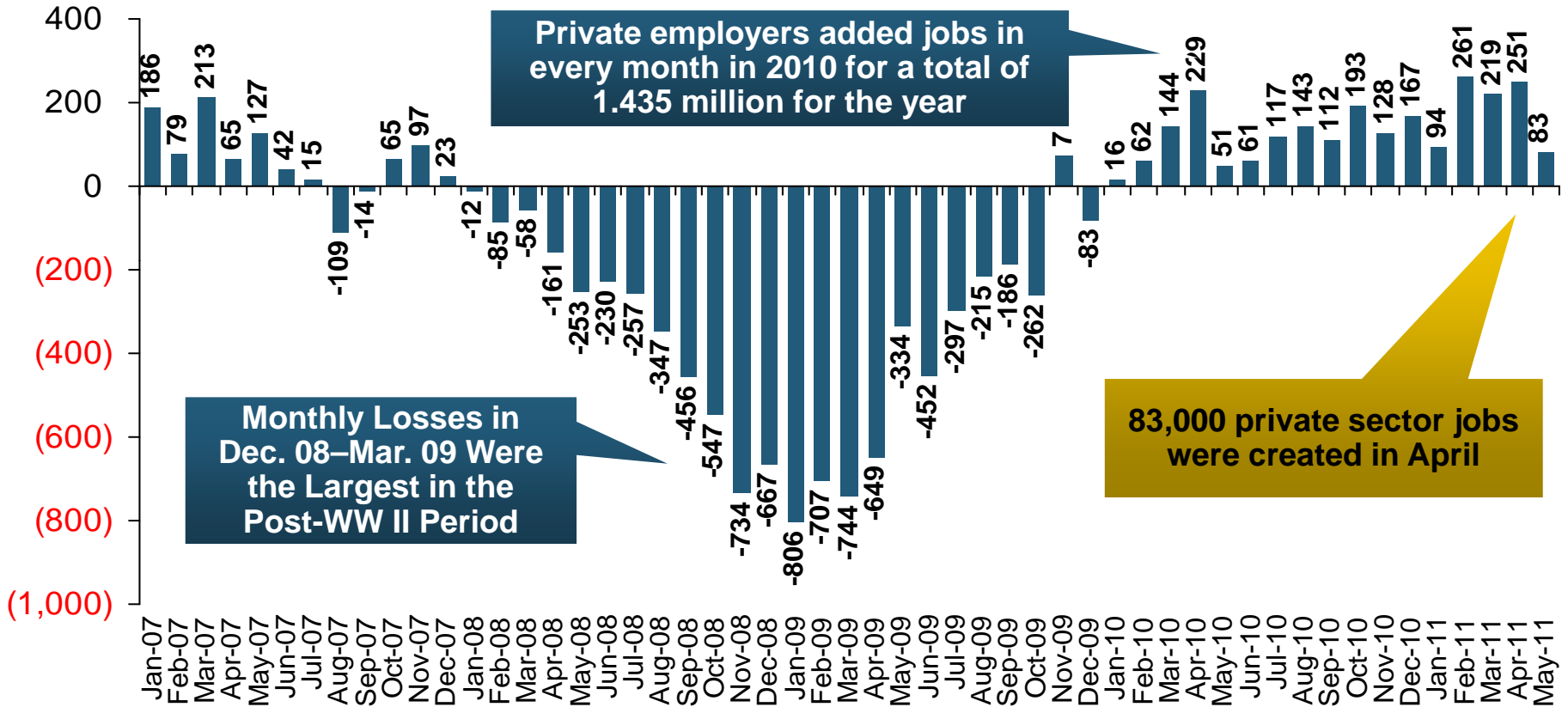
**Peak rate in the last 30 years: 10.8% in November - December 1982**

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

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

# Monthly Change in Private Employment

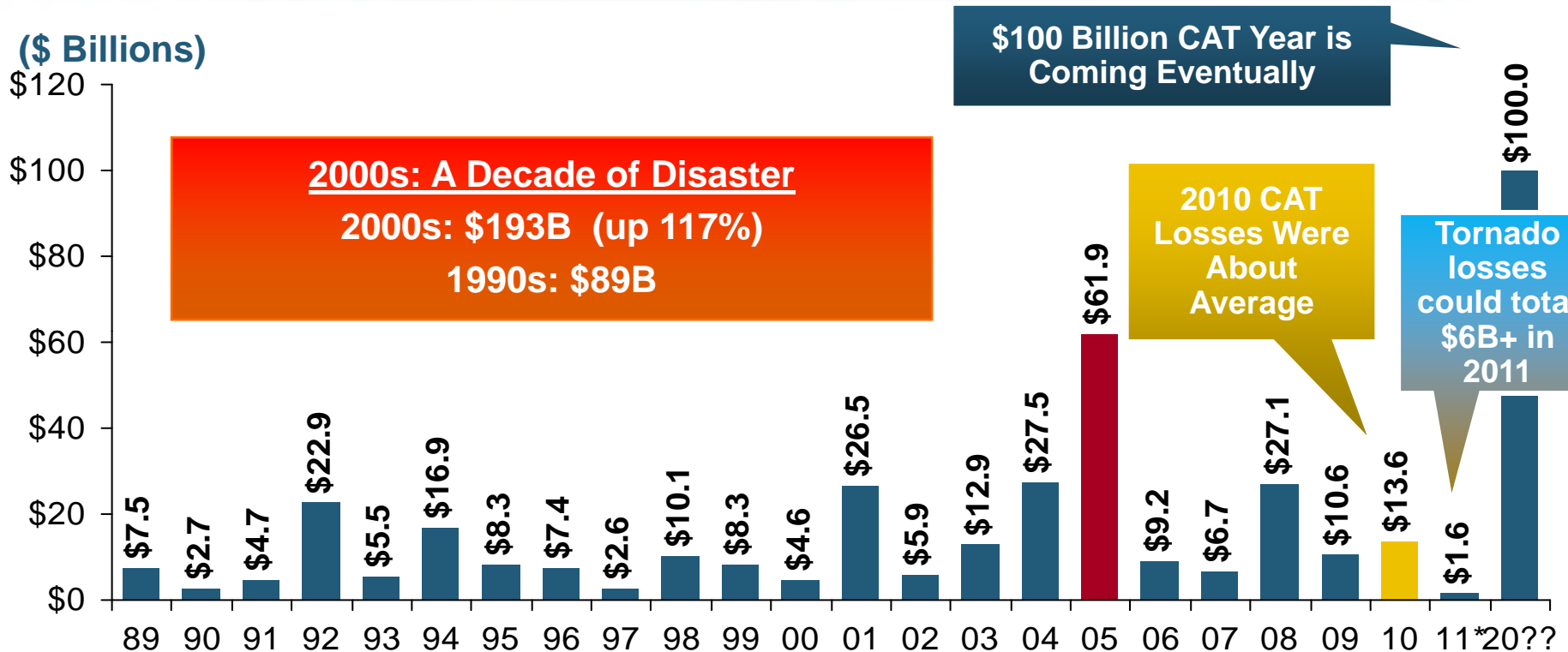
January 2008 through May 2011\* (Thousands)



**Private Employers Added 2.323 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (Local Govt. Employment is Down 416,000 Since Sept. 2008 Peak)**

**Catastrophic Loss –  
Catastrophe Losses Trends Are  
Trending Adversely**

# US Insured Catastrophe Losses



**2010 CAT Losses Were Close to "Average"**  
**Figures Do Not Include an Estimate of Deepwater Horizon Loss**

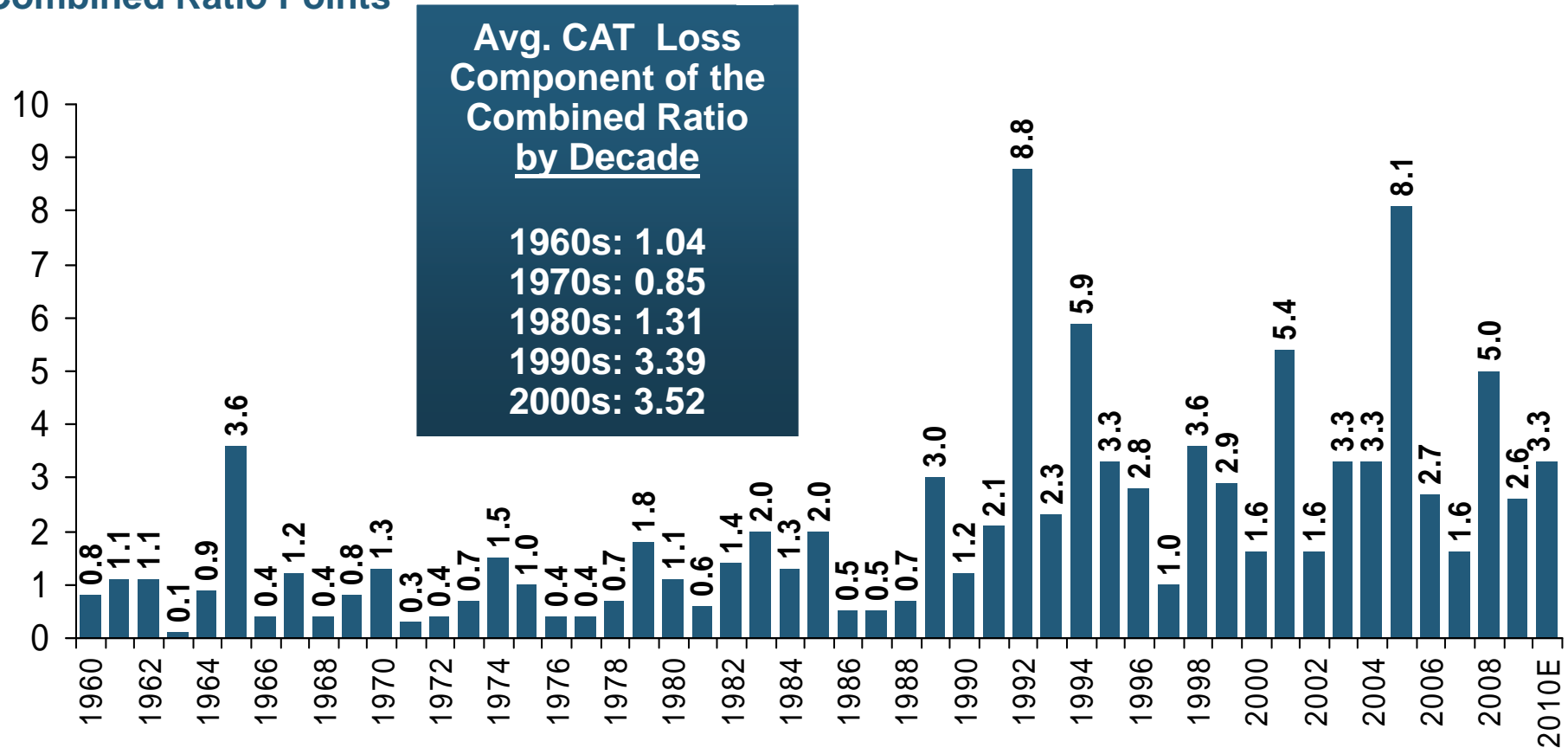
\*First quarter 2011.

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

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

# Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2010E

## Combined Ratio Points



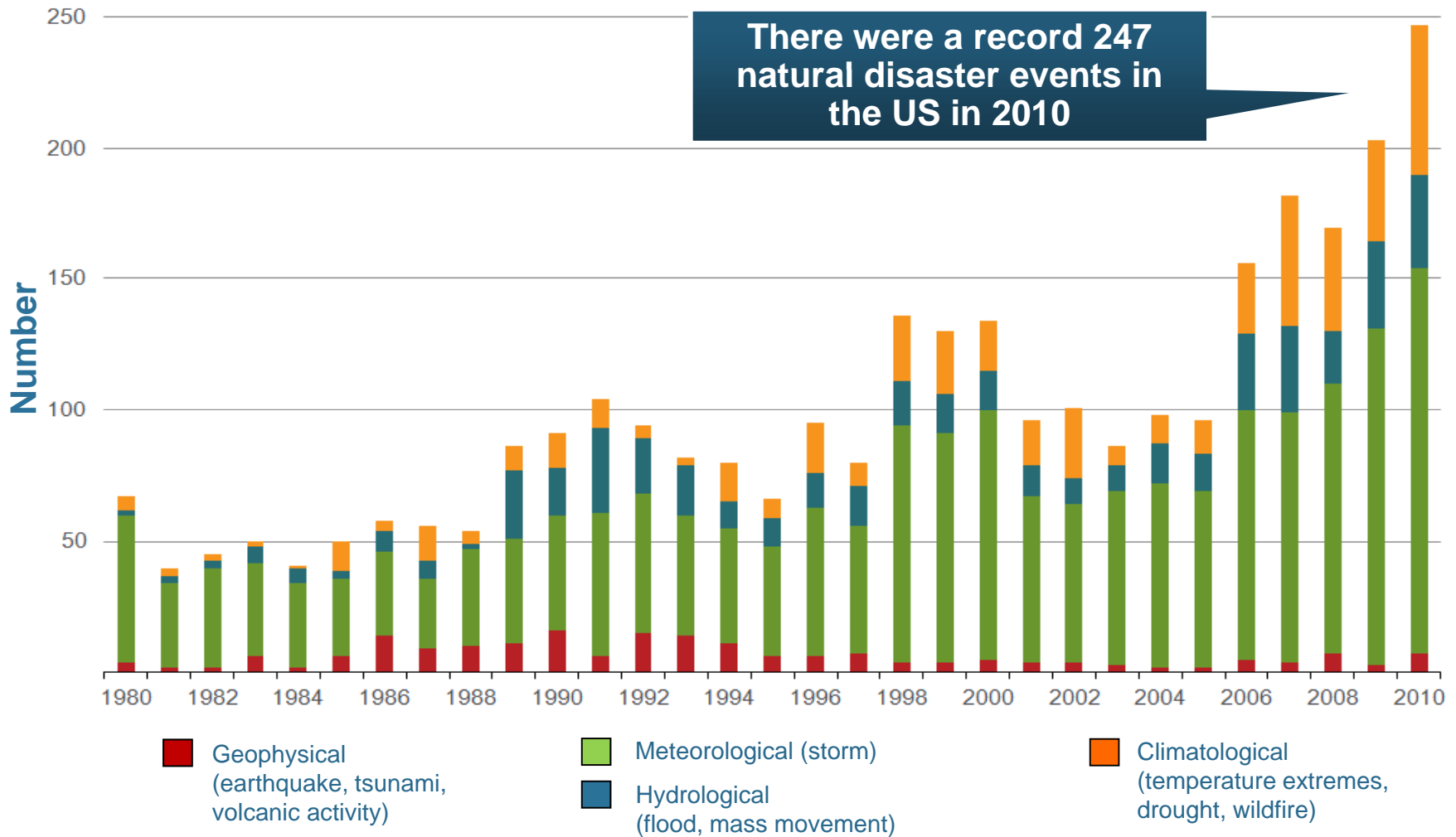
**The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades**

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.

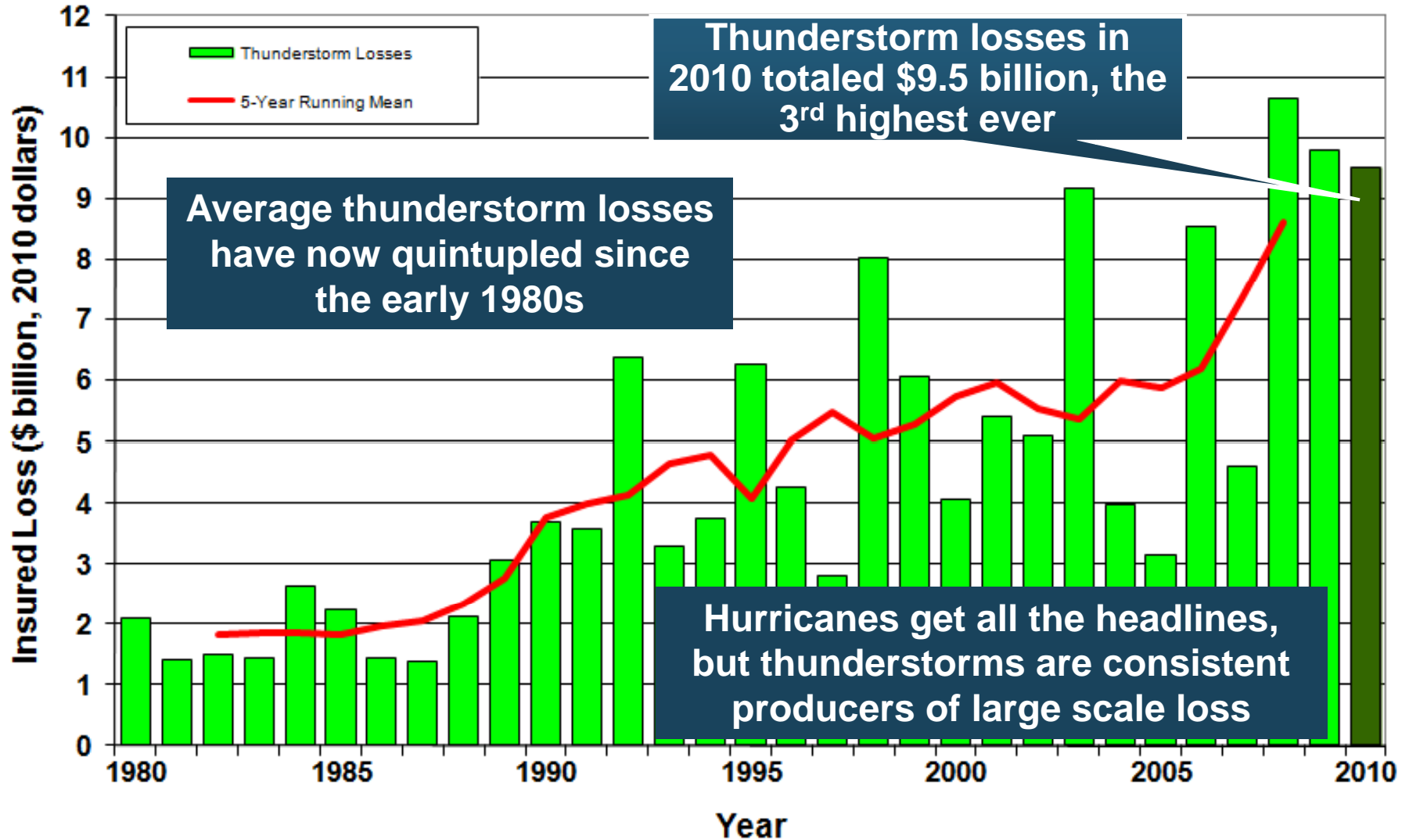
Source: ISO; Insurance Information Institute estimate for 2010.

# Natural Disasters in the United States, 1980 – 2010

Number of Events (Annual Totals 1980 – 2010)

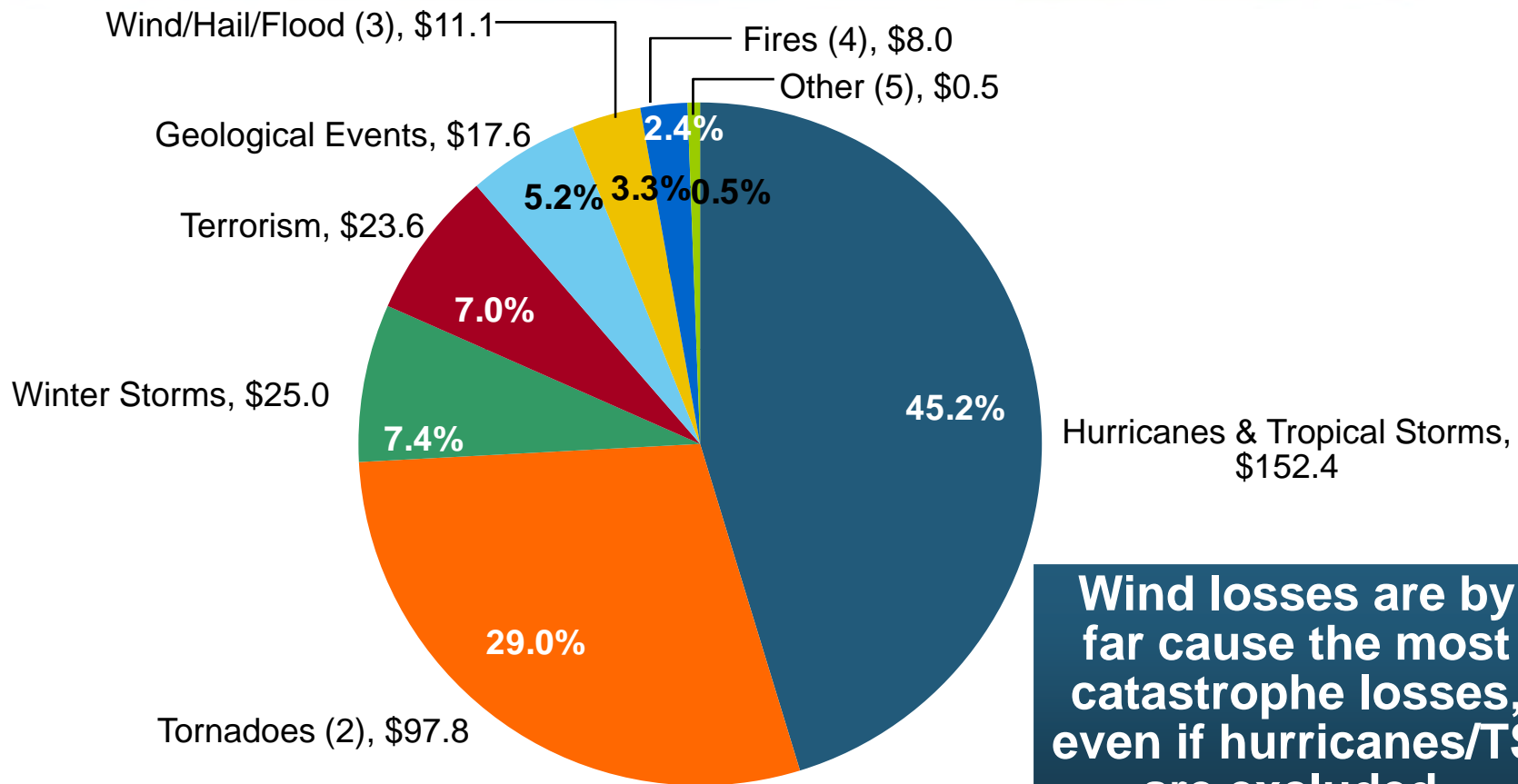


# U.S. Thunderstorm Loss Trends, 1980 – 2010 (Annual Totals)





# Inflation Adjusted US Catastrophe Losses by Cause of Loss, 1990–2009<sup>1</sup>



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

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

Source: ISO's Property Claim Services Unit.

Insurance Information Institute Online:

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

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