



# Overview and Outlook for the P/C Insurance Industry

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***Download at: [www.iii.org/presentations](http://www.iii.org/presentations)***

Robert P. Hartwig, Ph.D., CPCU, President & Economist  
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038

Tel: 212.346.5520 ♦ Cell: 917.453.1885 ♦ [bobh@iii.org](mailto:bobh@iii.org) ♦ [www.iii.org](http://www.iii.org)

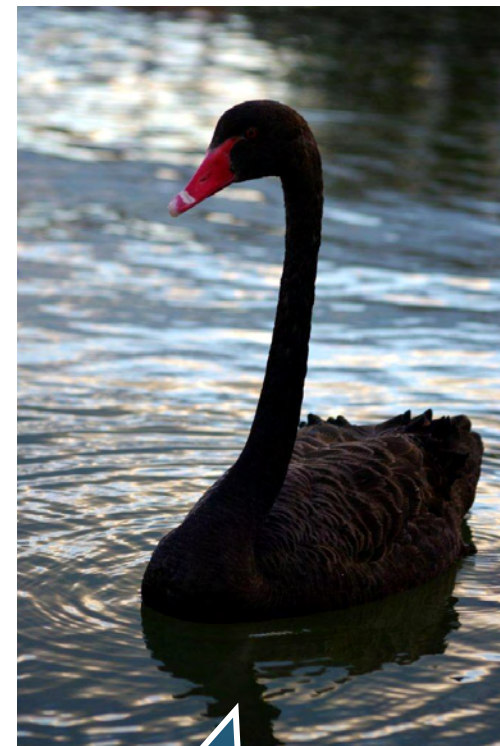
# What in the World Is Going On?

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

***What Are the Implications for  
Insurance and Risk Management?***

# Uncertainty, Risk and Fear Abound

- US Debt and Budget Crisis and S&P Downgrade
- Echoes of the Financial Crisis
- Housing Crisis
- Persistently High Unemployment
- European Sovereign Debt & Currency Crises
- Japan, New Zealand, Haiti, Chile Earthquakes
- Nuclear Fears
- Record Tornado, Flooding in the US, Wildfires
- Cyber Attacks
- Manmade Disasters (e.g., Deepwater Horizon)
- Resurgent Terrorism Risk (e.g., Bin Laden Killing)
- Political Upheaval in the Middle East
- Inflation/Deflation
- Runaway Energy & Commodity Prices
- Era of Fiscal Austerity
- Reshuffling the Global Economic Deck
- China Becomes #2 Economy in the World



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

# Impacts on P/C Insurers of S&P's Downgrade of US Sovereign Debt

- **S&P Downgrade of US Debt Will Have Little Practical Impact**
  - ◆ Solvency, liquidity, claims paying capacity all unaffected
  - ◆ US sovereign debt accounts for 6% (\$80B out of \$1.3 trillion) in invested assets
- **Investors Will Continue to View US Treasury Securities as the Safest Investment in the World**
  - ◆ Other bond raters (Moody's, Fitch) affirmed top credit ratings for US
  - ◆ US bond yields *fell* in the days after S&P issued its initial warning
  - ◆ Evidence suggests that investors' asset of choice during "flight to safety" remains US debt
- **Risk Charge/Weights for US Debt Held by Finl. Firms Won't Change**
  - ◆ Federal bank regulators have already stated risk weights won't change
  - ◆ Extremely unlikely state insurance regulators would do anything different
  - ◆ NAIC (Aug. 7) "*There is no impact on insurer investments in U.S. government and government-related securities from the actions recently taken by the rating agencies. Risk-based capital and asset valuation reserves are unaffected.*"
- **Interest Rates on US Debt Unlikely to Rise Due to Downgrade**
  - ◆ Insurers should see little or no need to mark down value of bonds
- **Market for US Debt Will Remain Largest & Most Liquid in the World**
  - ◆ Downgrade poses no liquidity or solvency issues

# What is Going On in the US and Global Financial Markets?

- **S&P Downgrade Poured Gasoline on a Fire that Was Already Burning**
  - ◆ Downgrade didn't tell us anything we didn't already know about US finances
- 1. **Realization that US Economy is Slowing**
  - ◆ Q1 GDP growth revised downward to 0.4%; Q2 growth was just 1.3%
  - ◆ Job growth has been anemic for several months and unemployment remains high at 9.1% in July
  - ◆ Stock market sell-off was driven by fear and technical factors (e.g., margin calls, hedge fund mass selling)
- 2. **Need for a More Comprehensive Solution to Europe's Debt Problems**
  - ◆ Solution developed for Greece, Italy, Spain, Ireland may be too small
  - ◆ Difficulties in managing multinational institutions and economic policies
  - ◆ ECB and individual member EU countries not all on same page
  - ◆ Solution: Unified strategy similar to TARP; Monetary easing
- 3. **View that Washington is Dysfunctional and "Rudderless"**
  - ◆ Lack of coherent, consistent medium and long term plan to deal with basic structural issues in the US economy (debt, taxes, employment, regulation, etc.)
- 4. **Economic Slowdown in Emerging Markets**
  - ◆ China, other economies less able to stimulate global economy than in 2008

# Déjà Vu? Lehman II?

## Is This 2008 All Over Again?

### Why Today is Not 2008 All Over Again

- The Situation Today is Very, Very Different from 2008
- Credit Markets Are Not Seizing
- Bank Balance Sheets Are in Much Stronger Shape
  - ◆ Capital up, charge offs falling
- We Will Not Experience the Collapses/Near Collapses Like in 2008
  - ◆ No repeat of Lehman, AIG, Washington Mutual, Wachovia, Countrywide
- Some Additional Regulatory Controls Are Now Place

### What Would Be Helpful Now?

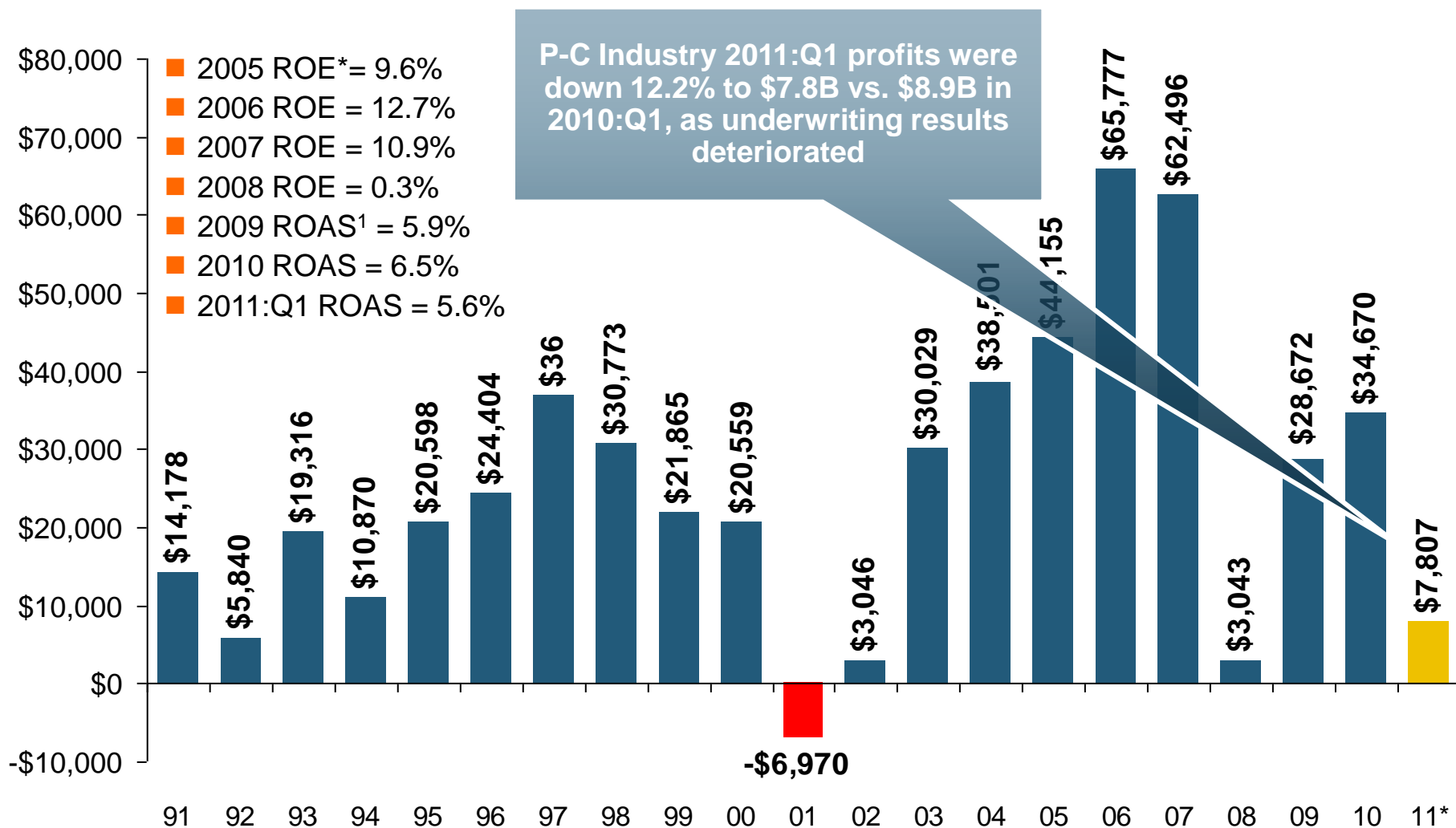
- Long-Term Fiscal and Monetary Policy Direction
- Fed on Aug. 9 stated rates would remain low “*at least through mid-2013*”
  - ◆ This is not only a signal that borrowing costs will remain low over an extended period of time and that inflation will remain muted; Also tells investors that they’ll need to take on risk in order to earn returns in the market. Should be bullish for stocks.
  - ◆ Congress and the Administration need to remove regulatory and tax uncertainty ASAP and drive a pro-growth agenda



# P/C Insurance Industry Financial Overview

**Profit Recovery Will Be Set  
Back by High CATs, Low  
Interest Rates, Diminishing  
Reserve Releases**

# P/C Net Income After Taxes 1991–2011:Q1 (\$ Millions)



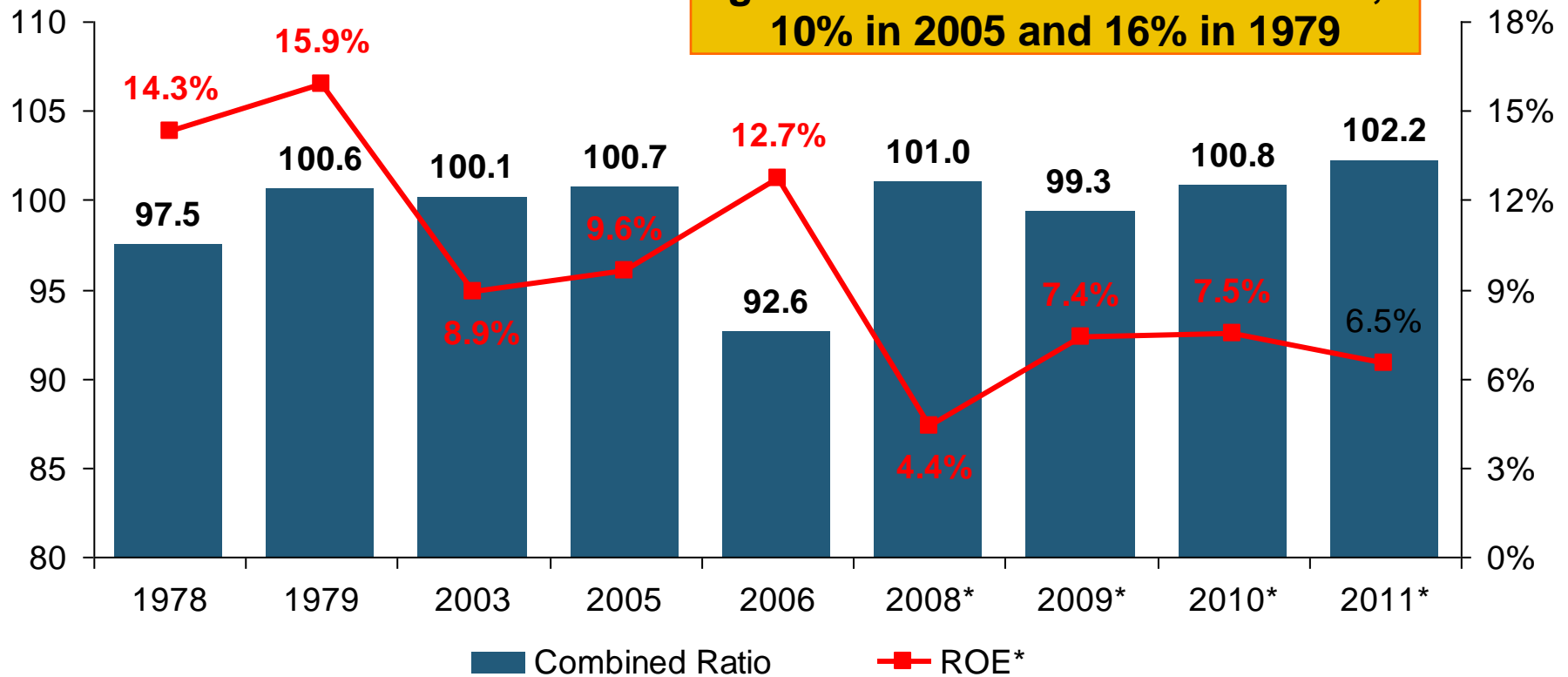
\* ROE figures are GAAP; <sup>1</sup>Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 6.5% ROAS for 2011:Q1, 7.5% for 2010 and 7.4% for 2009.

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



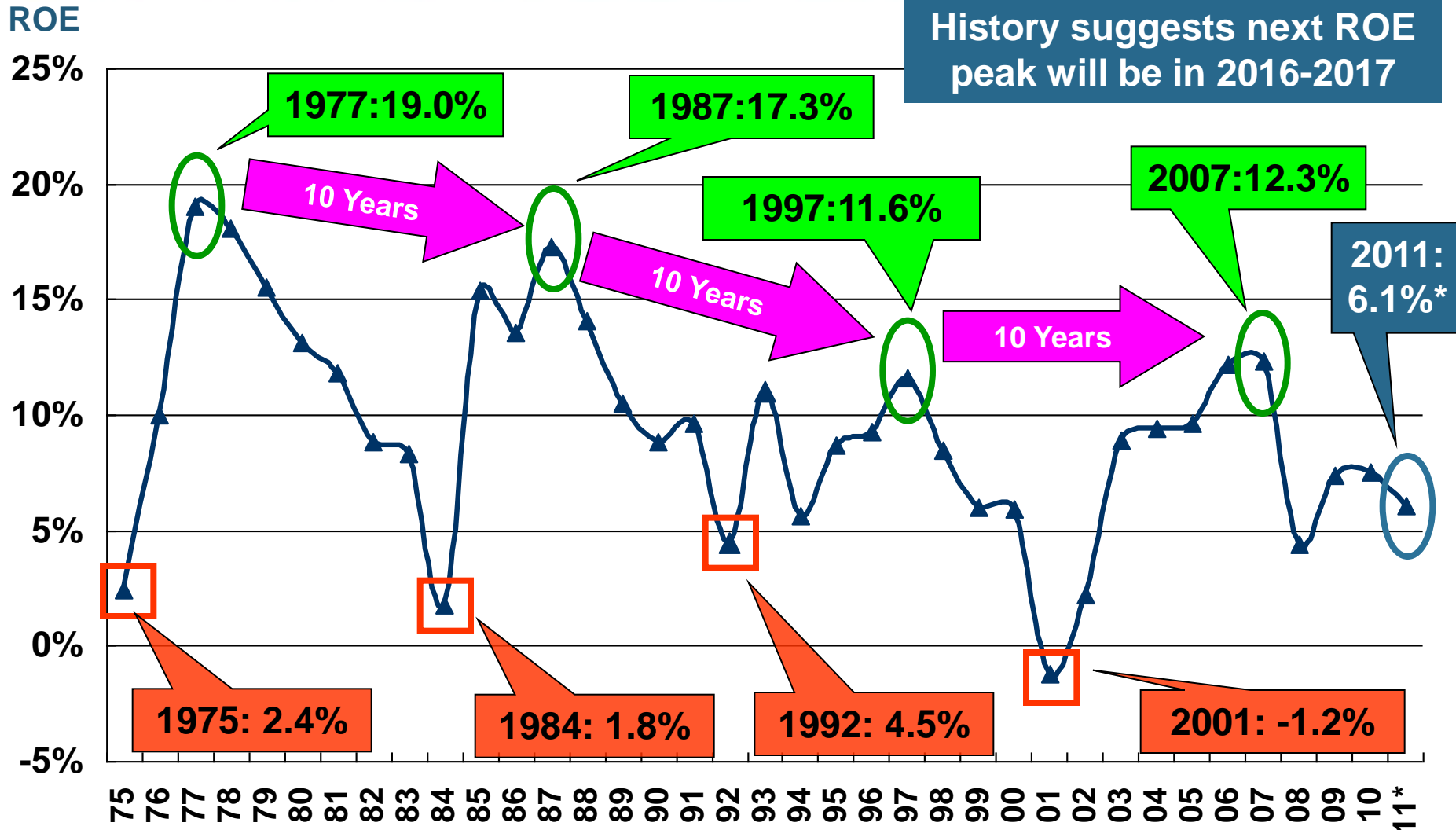
A combined ratio of about 100 generated ~7.5% ROE in 2009/10, 10% in 2005 and 16% in 1979

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

\* 2009 and 2010 figures are return on average statutory surplus. 2008 -2011 figures exclude mortgage and financial guaranty insurers

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

# Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2011\*



\*Profitability = P/C insurer ROEs are I.I.I. estimates. 2011 figure is an estimate based on annualized ROAS for Q1 data.

Note: Data for 2008-2011 exclude mortgage and financial guaranty insurers.

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



# Profitability and Growth in Pennsylvania P/C Insurance Markets

## Analysis by Line and Nearby State Comparisons



# Catastrophe Loss Developments and Trends

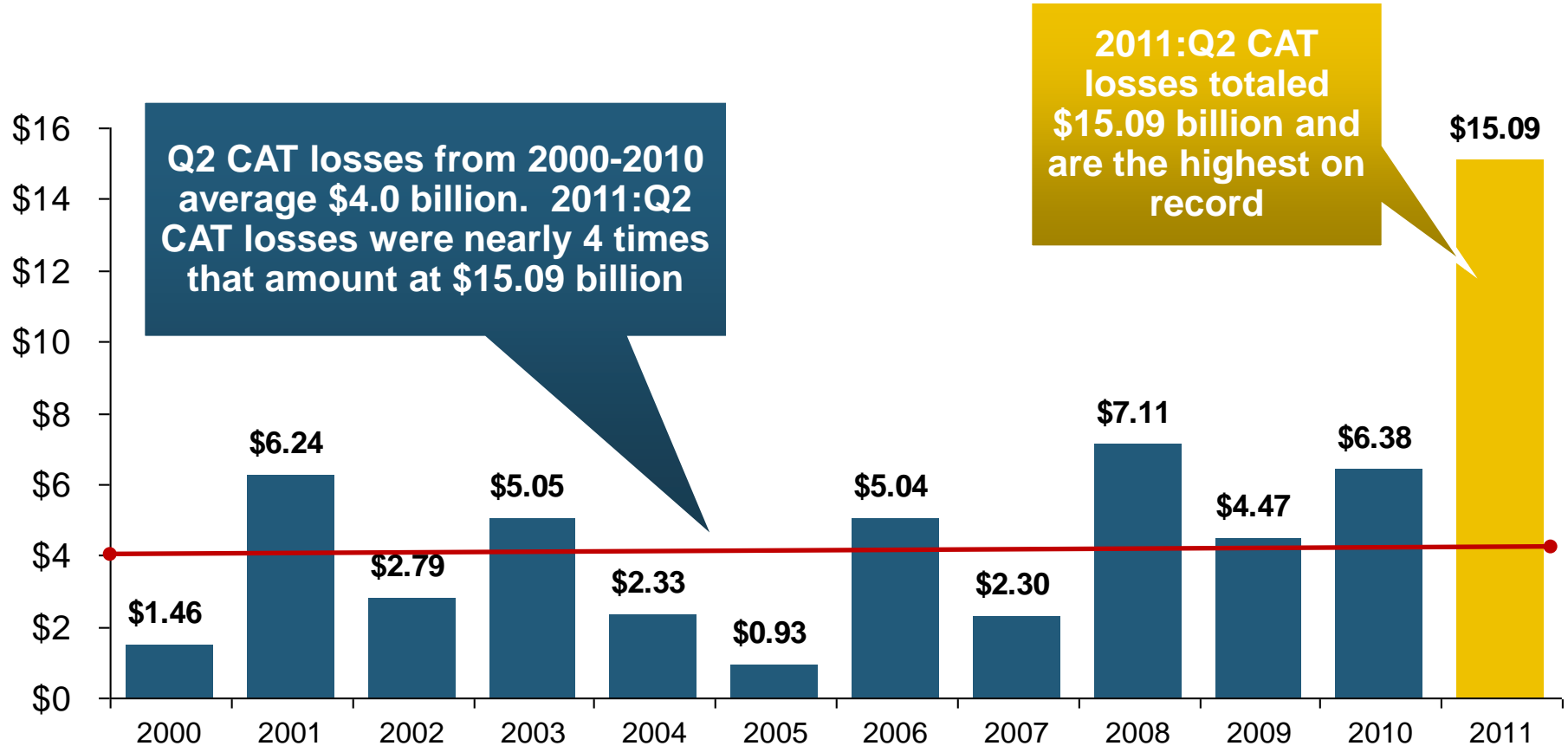
**2011 and 2010 Are Rewriting  
Catastrophe Loss and  
Insurance History**

# Global Catastrophe Loss Summary: First Half 2011

- **2011 Is Already (as of June 30) the *Highest* Loss Year on Record Globally**
  - ◆ Extraordinary accumulation of severe natural catastrophe: Earthquakes, tsunami, floods and tornadoes are the primary causes of loss
- **\$260 Billion in *Economic* Losses Globally**
  - ◆ New record for the first six months, exceeding the previous record of \$220B in 2005
  - ◆ Economy is more resilient than most pundits presume
- **\$55 Billion in *Insured* Losses Globally**
  - ◆ More than double the first half 2010 amount
  - ◆ Over 4 times the 10-year average
- **\$27 Billion in *Economic* Losses in the US**
  - ◆ Represents a 129% increase over the \$11.8 billion amount through the first half of 2010
- **\$17.3 Billion in *Insured* Losses in the US Arising from 100 CAT Events**
  - ◆ Represents a 162% increase over the \$6.6 billion amount through the first half of 2010

# US Second Quarter Insured Catastrophe Losses, 2000–2011

\$ Billions



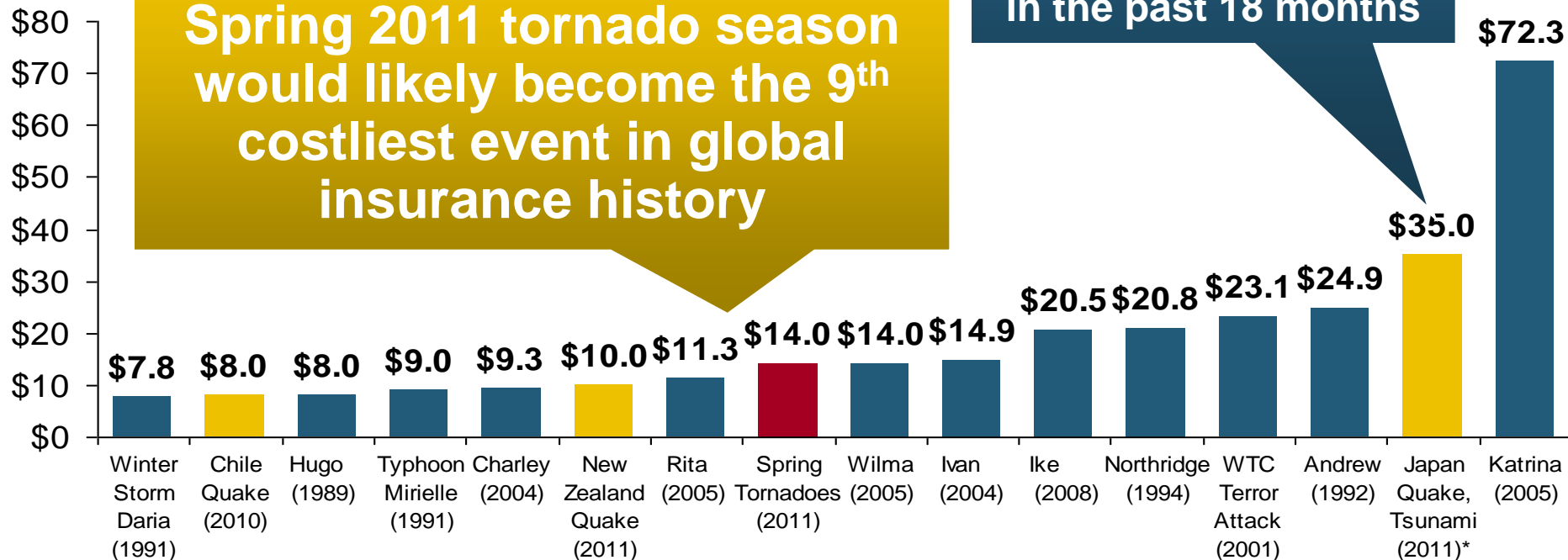
**Record Q2 (and First Half) CAT Losses Will Adversely Impact Insurer Results in 2011**

# Top 16 Most Costly World Insurance Losses, 1970-2011\*

(Insured Losses, 2010 Dollars, \$ Billions)

Taken as a single event, the Spring 2011 tornado season would likely become the 9<sup>th</sup> costliest event in global insurance history

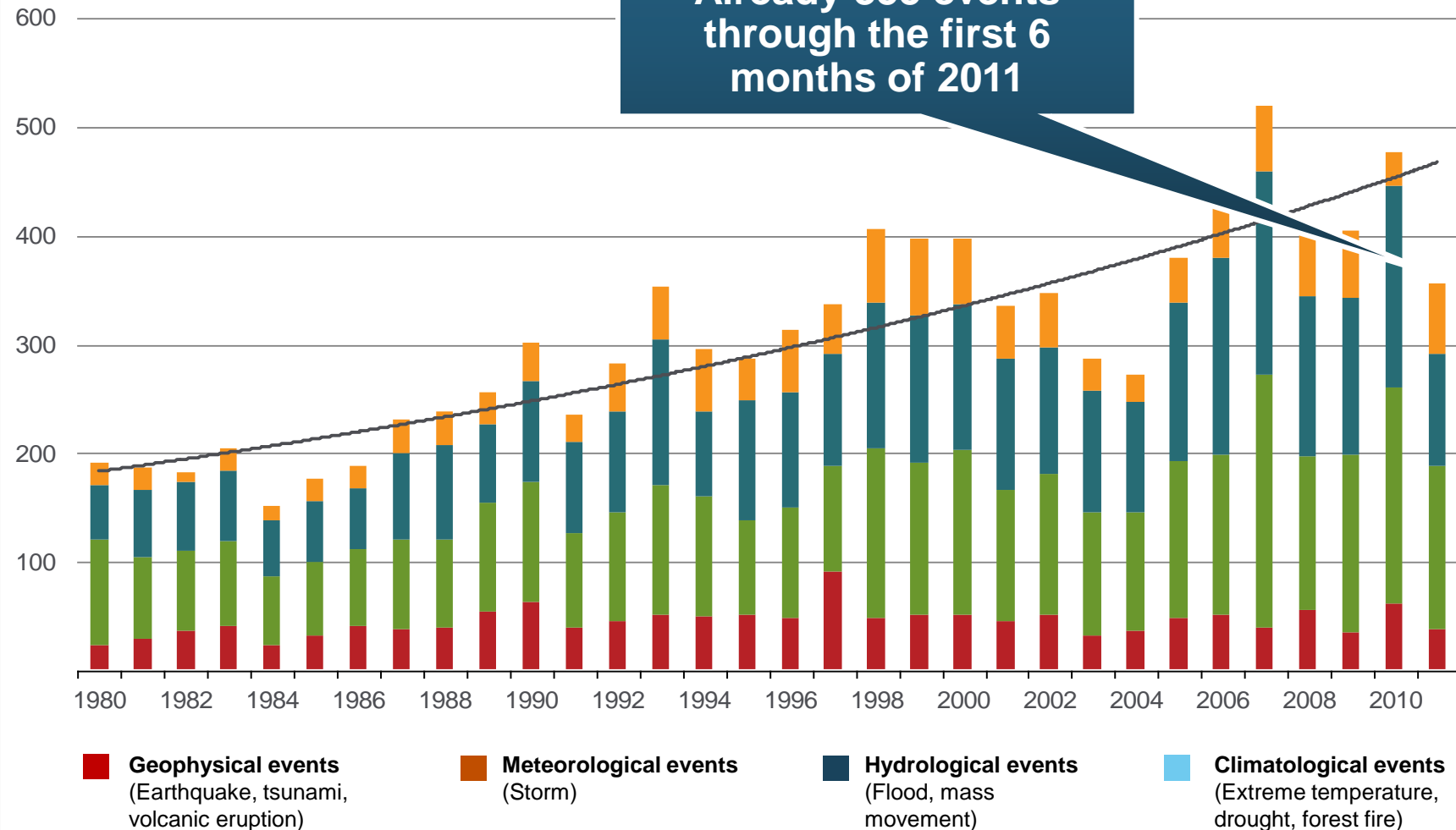
3 of the top 15 most expensive catastrophes in world history have occurred in the past 18 months



\*Through June 20, 2011. 2011 disaster figures are estimates; Figures include federally insured flood losses, where applicable. Sources: Swiss Re *sigma* 1/2011; AIR Worldwide, RMS, Eqecat; Insurance Information Institute.

# Worldwide Natural Disasters, 1980 – 2011\*

## Number of Events

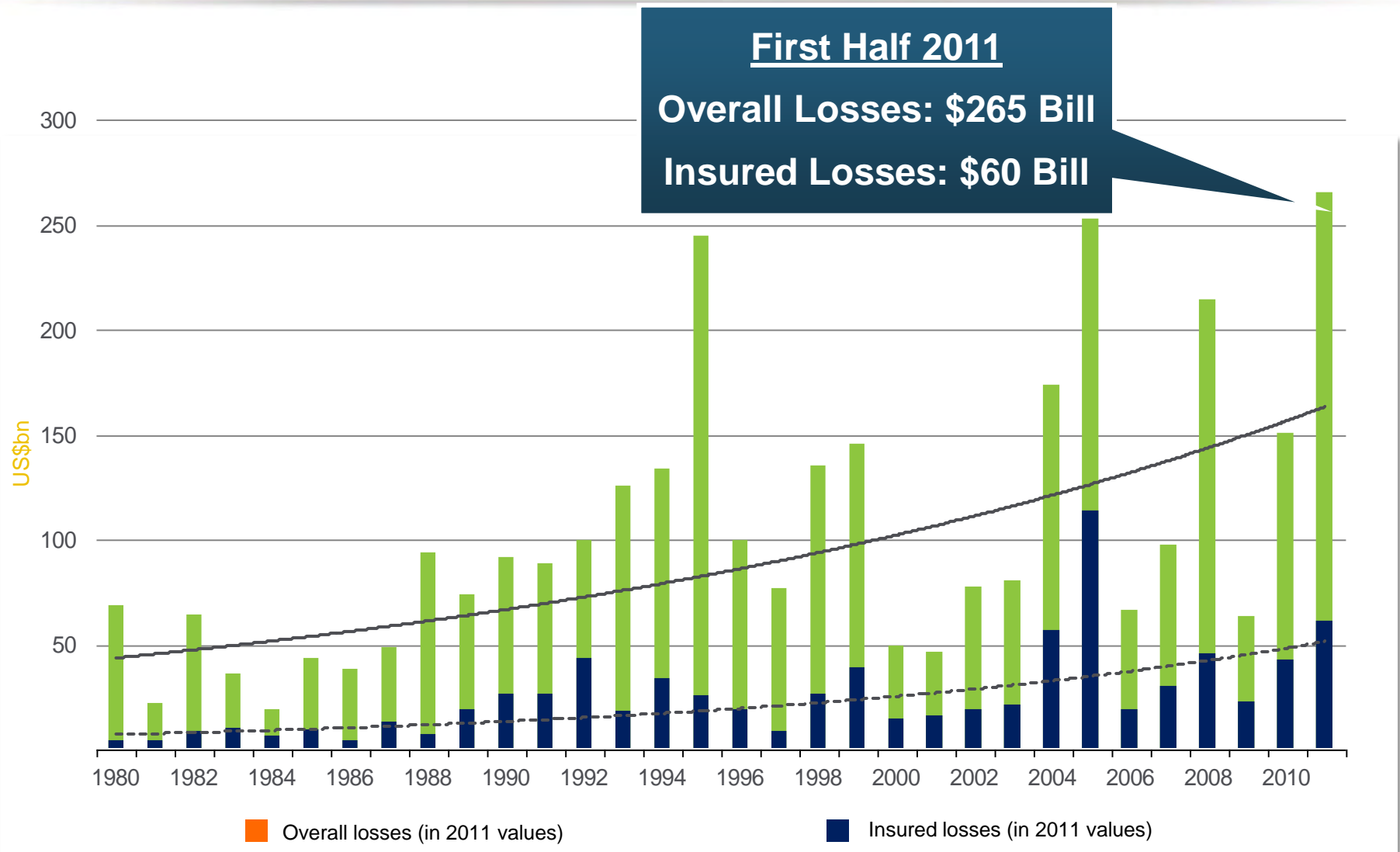


\*2011 figure is through June 30.

Source: MR NatCatSERVICE



# Worldwide Natural Disasters 1980–2011, Overall and Insured Losses\*

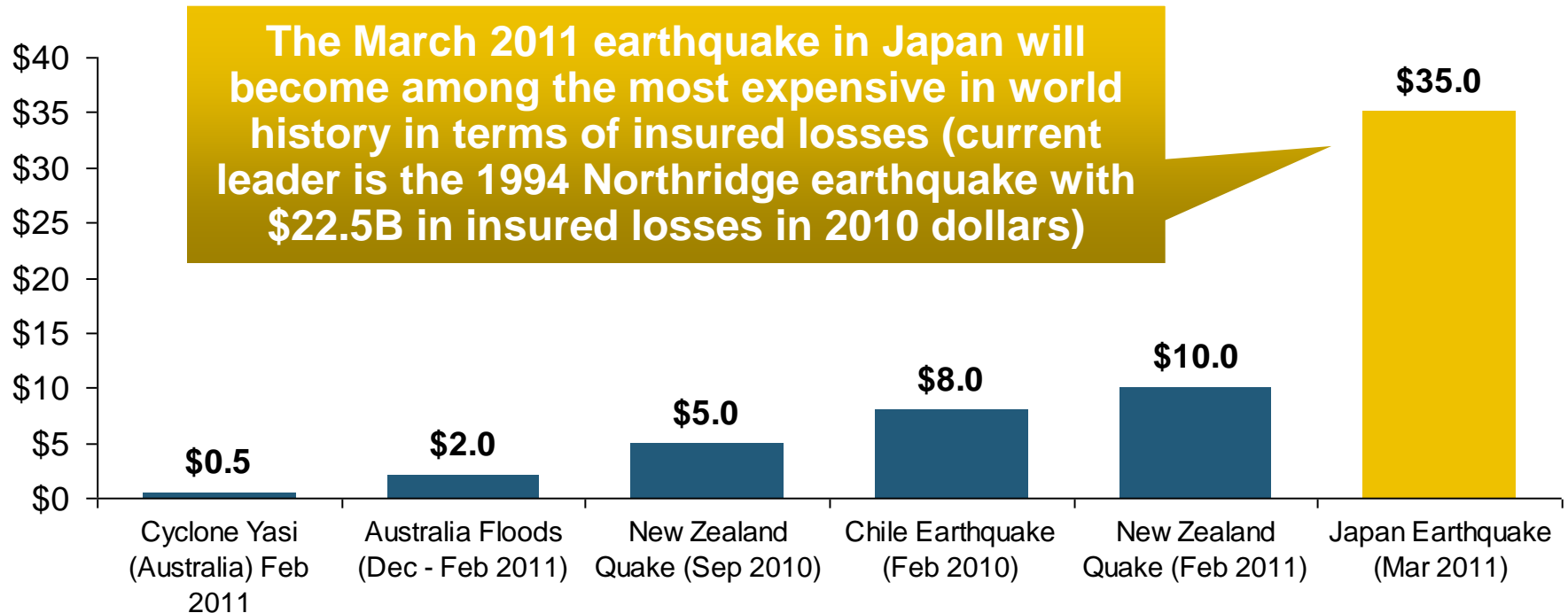


\*2011 figure is through June 30.

Source: MR NatCatSERVICE

# Recent Major Non-US Catastrophe Losses

(Insured Losses, \$US Billions)



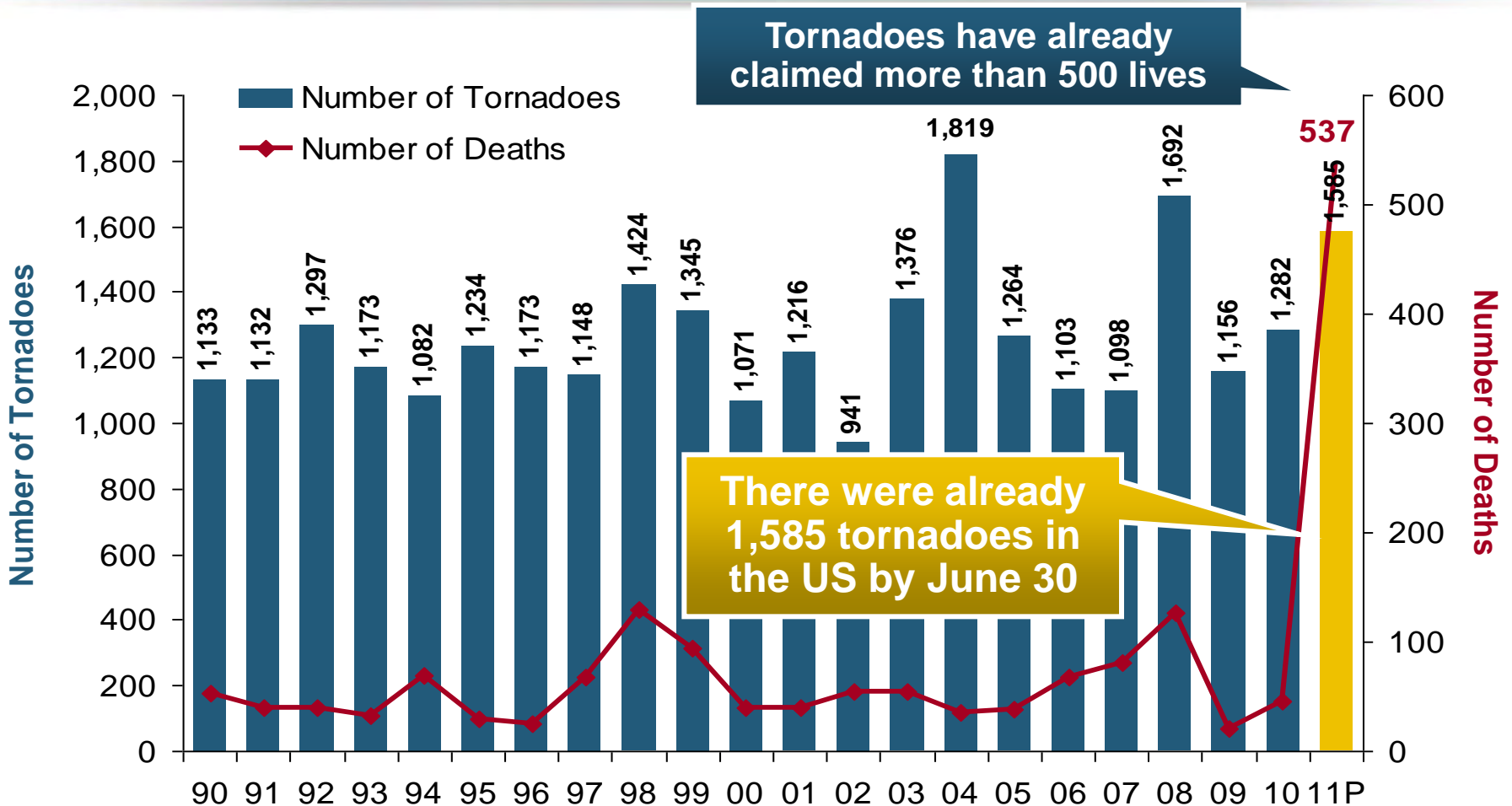
**Insured Losses from Recent Major Catastrophe Events Exceed \$60 Billion, an Estimated \$53 Billion of that from Earthquakes**



# SPRING 2011 TORNADO OUTBREAK

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

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



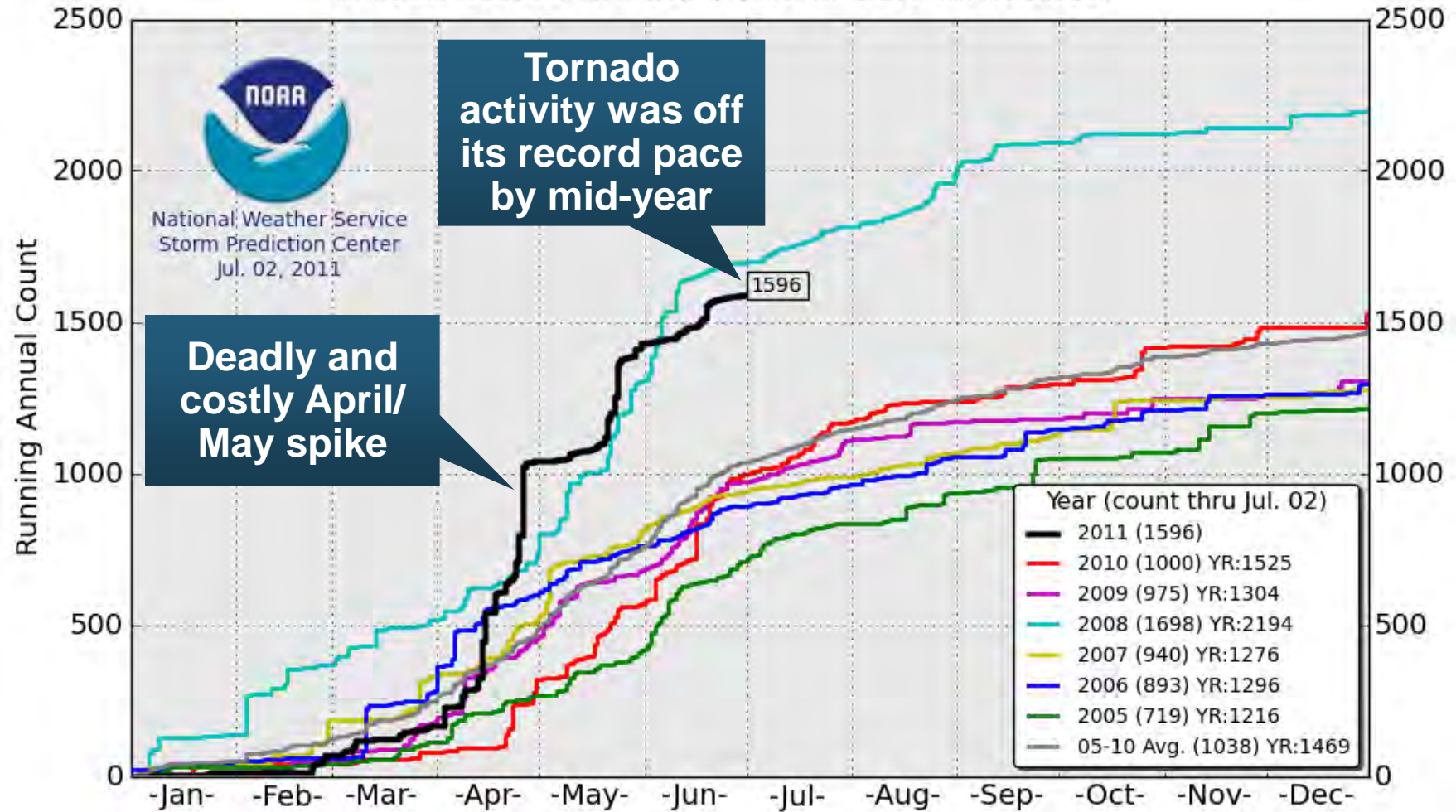
**Insurers Expect to Pay \$2 Billion on 165,000 Claims Arising from the April 2011 Tornadoes in the Birmingham and Tuscaloosa Areas**

\*2011 is preliminary data through June 30.

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

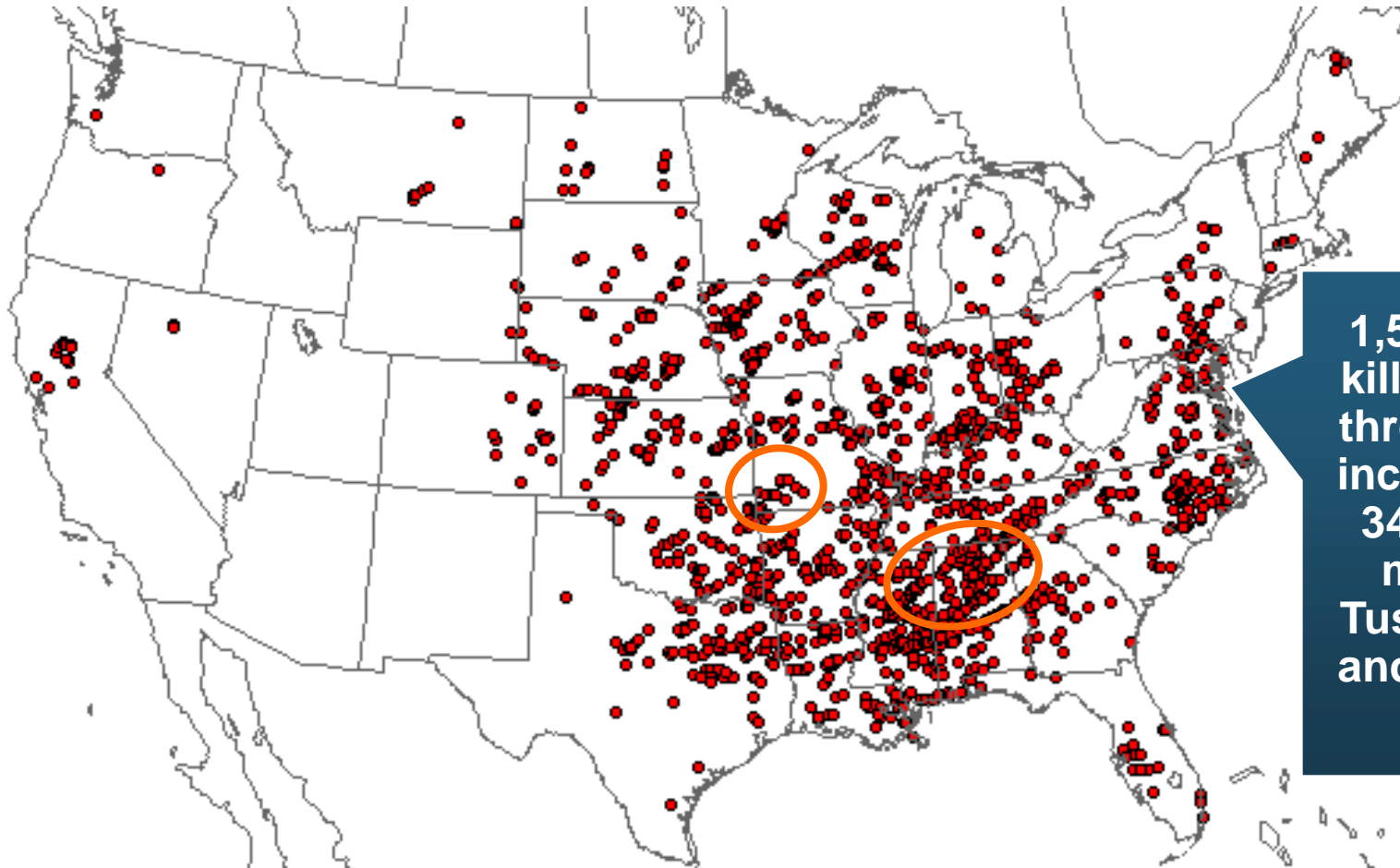
# U.S. Tornado Count, 2005-2011\*

United States Annual Trend of LSR Tornadoes\*



\*Preliminary tornadoes from NWS Local Storm Reports (LSRs)  
Annual average is based on preliminary LSRs, 2005-2010

# Location of Tornadoes in the US, January 1—June 30, 2011



1,585 tornadoes  
killed 537 people  
through June 30,  
including at least  
340 on April 26  
mostly in the  
Tuscaloosa area,  
and 130 in Joplin  
on May 22



PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

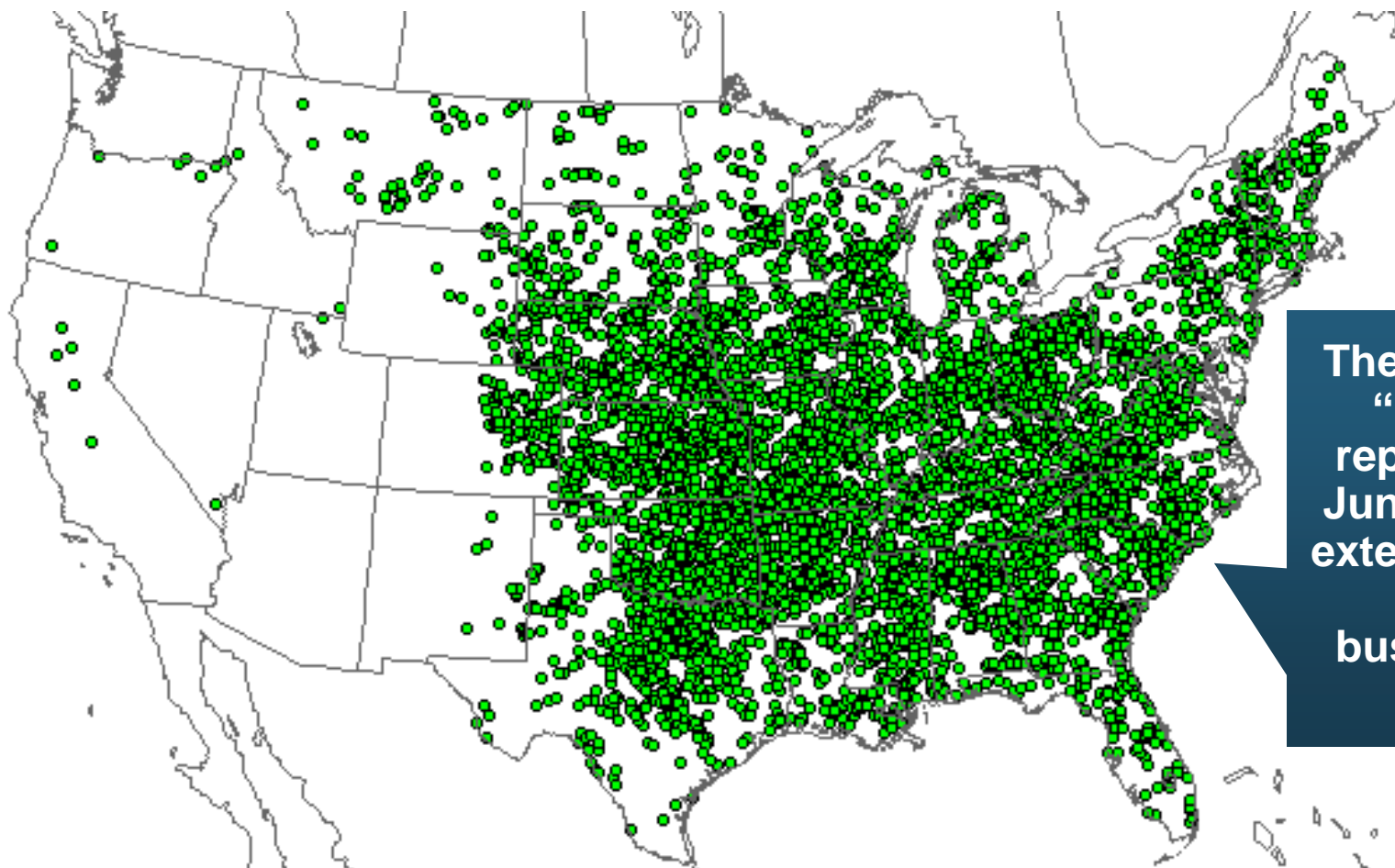
NOAA/Storm Prediction Center Norman, Oklahoma

Tornado Reports  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT



# Location of Large Hail Reports in the US, January 1—June 30, 2011



There were 7,176  
“Large Hail”  
reports through  
June 30, causing  
extensive damage  
to homes,  
businesses and  
vehicles



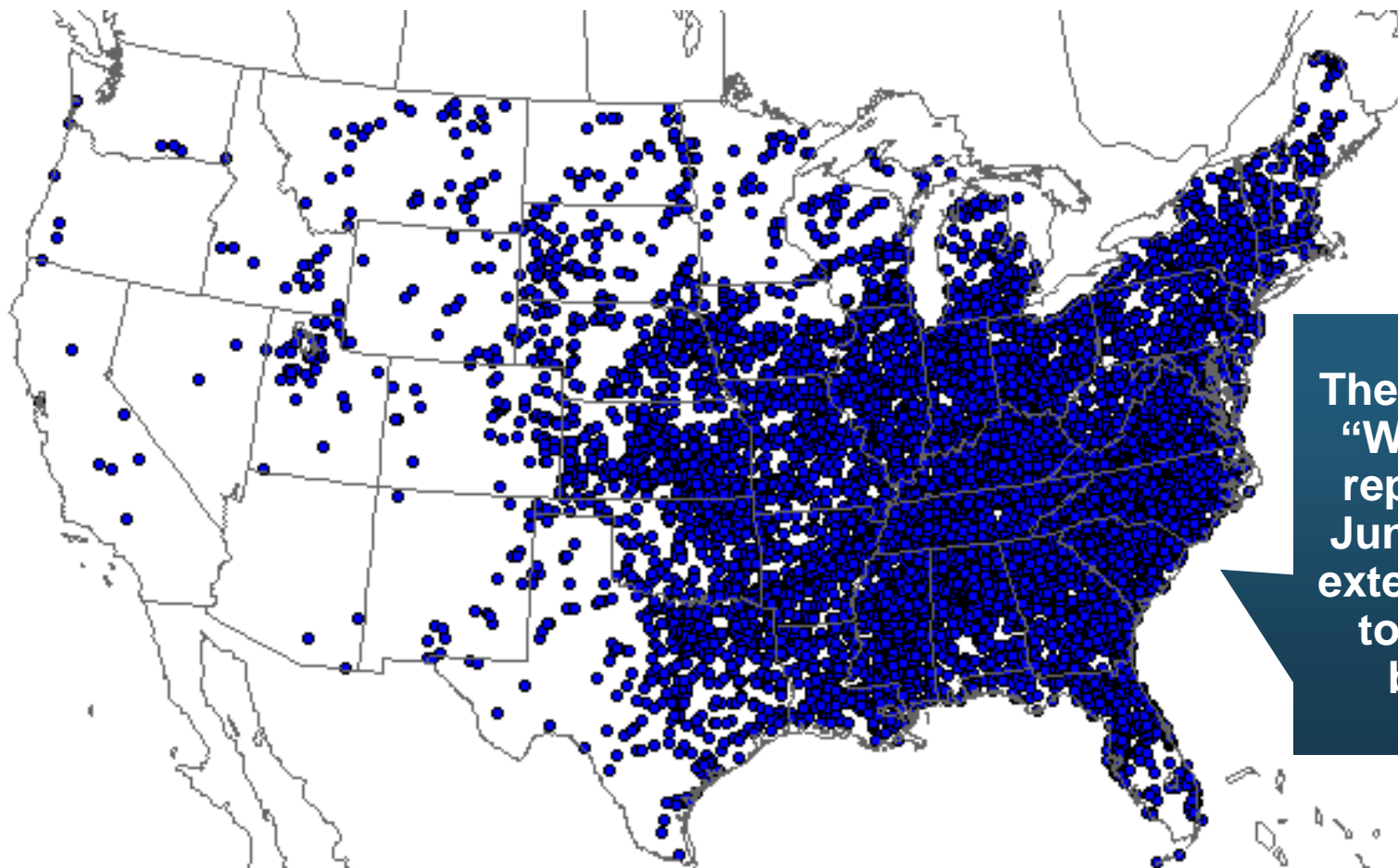
PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Hail Reports  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT

# Location of Wind Damage Reports in the US, January 1—June 30, 2011



There were 11,283  
“Wind Damage”  
reports through  
June 30, causing  
extensive damage  
to homes and,  
businesses



PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

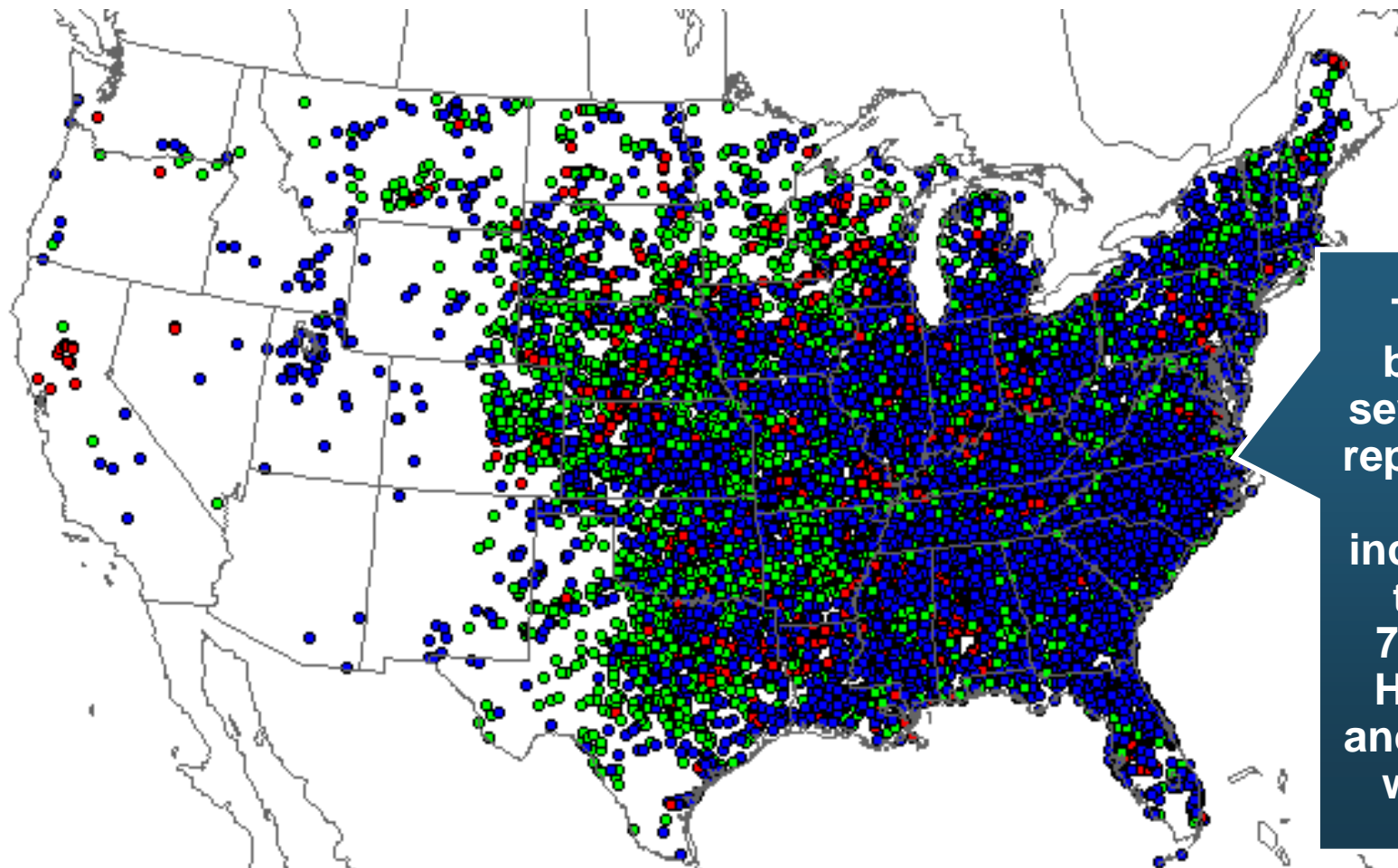
NOAA/Storm Prediction Center Norman, Oklahoma

Wind Reports  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT



# Severe Weather Reports, January 1—June 30, 2011



There have been 20,044 severe weather reports through June 30; including 1,585 tornadoes; 7,176 “Large Hail” reports and 11,283 high wind events



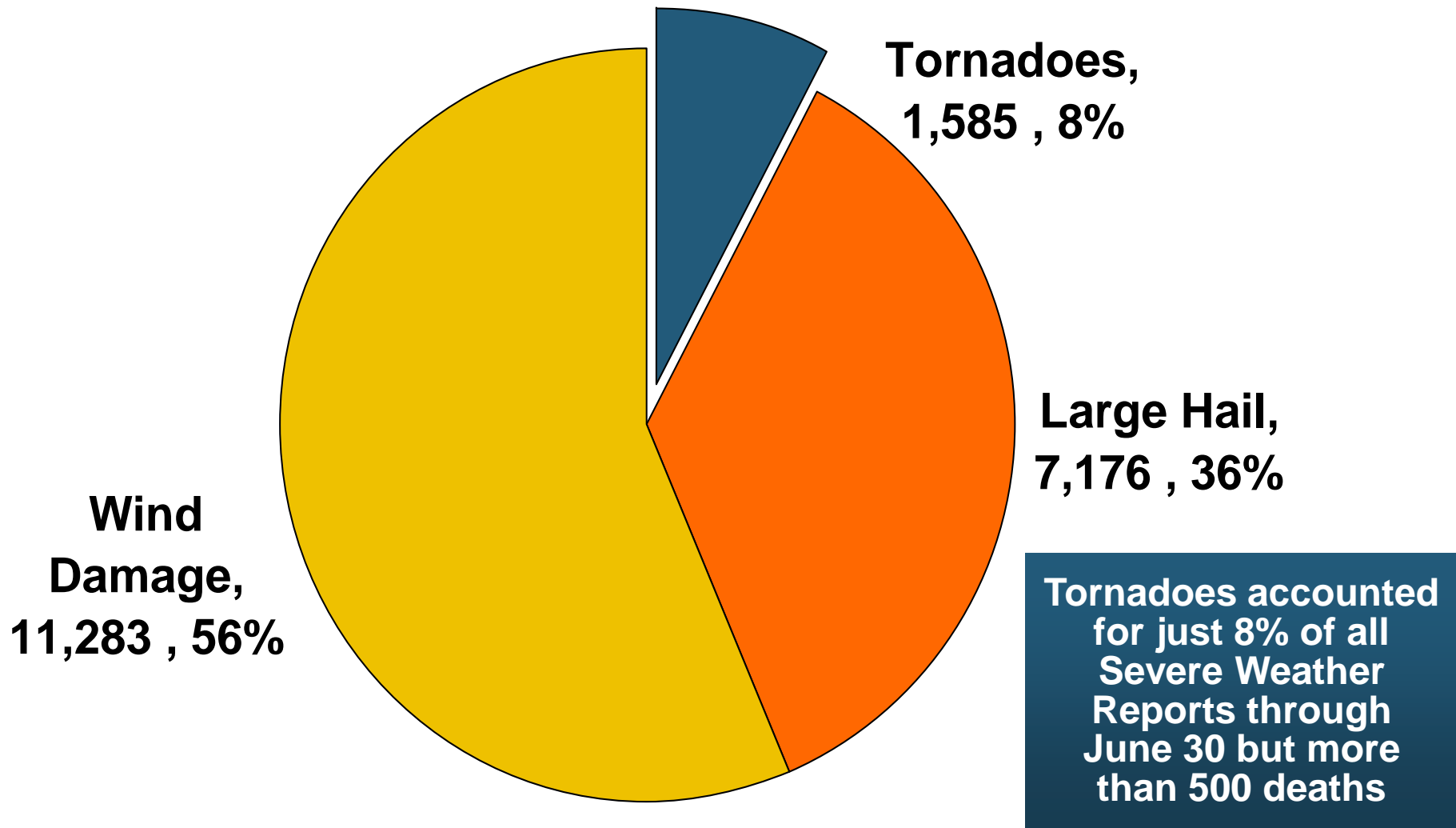
PRELIMINARY SEVERE WEATHER  
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Severe Weather Reports  
January 01, 2011 - June 30, 2011

Updated: Thursday June 30, 2011 11:49 CT

# Number of Severe Weather Reports in US, by Type: January 1—June 30, 2011



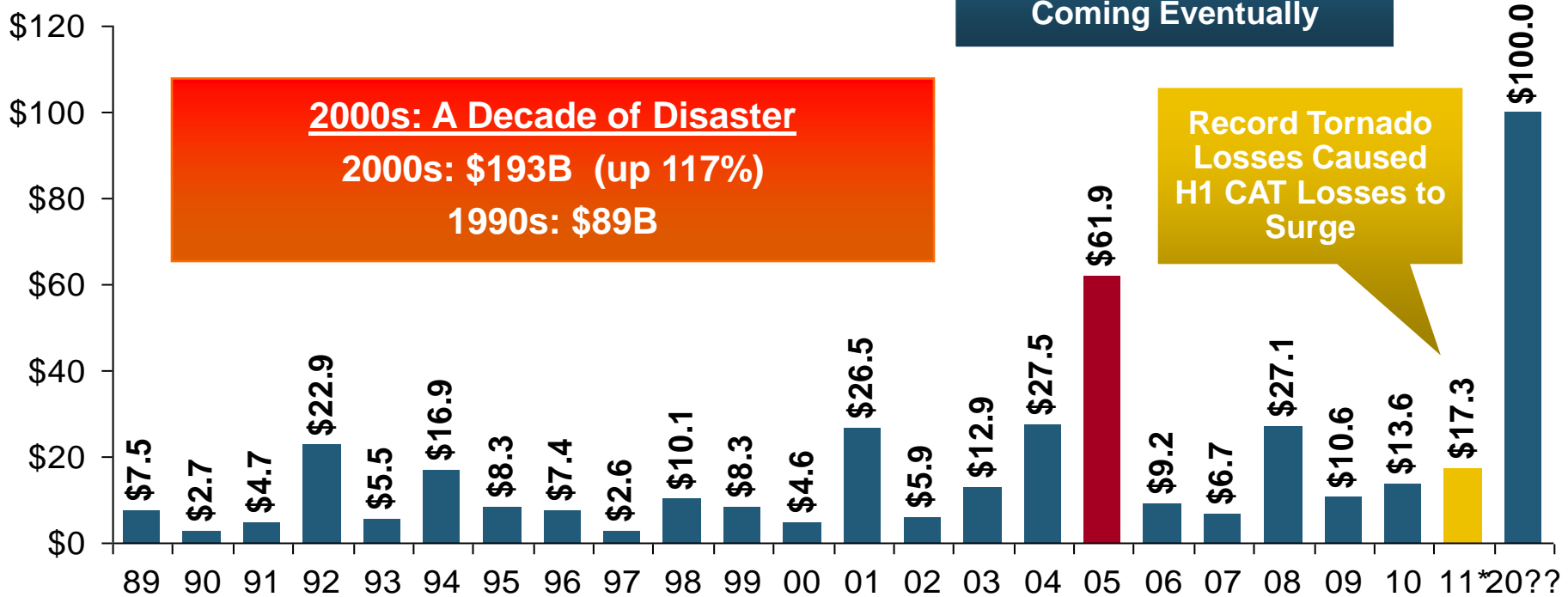


# US CATASTROPHE INSURED LOSS UPDATE

**First Half 2011 CAT Losses Already Exceed All of  
2010 and Could Become One of the Most  
Expensive Years on Record**

# US Insured Catastrophe Losses

(\$ Billions)



**2000s: A Decade of Disaster**  
 2000s: \$193B (up 117%)  
 1990s: \$89B

\$100 Billion CAT Year is Coming Eventually

Record Tornado Losses Caused H1 CAT Losses to Surge

**First Half 2011 US CAT Losses Already Exceed Losses from All of 2010. Even Modest Hurricane Losses Will Make 2011 Among the Most Expensive Ever for CATs**

\*First half 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.

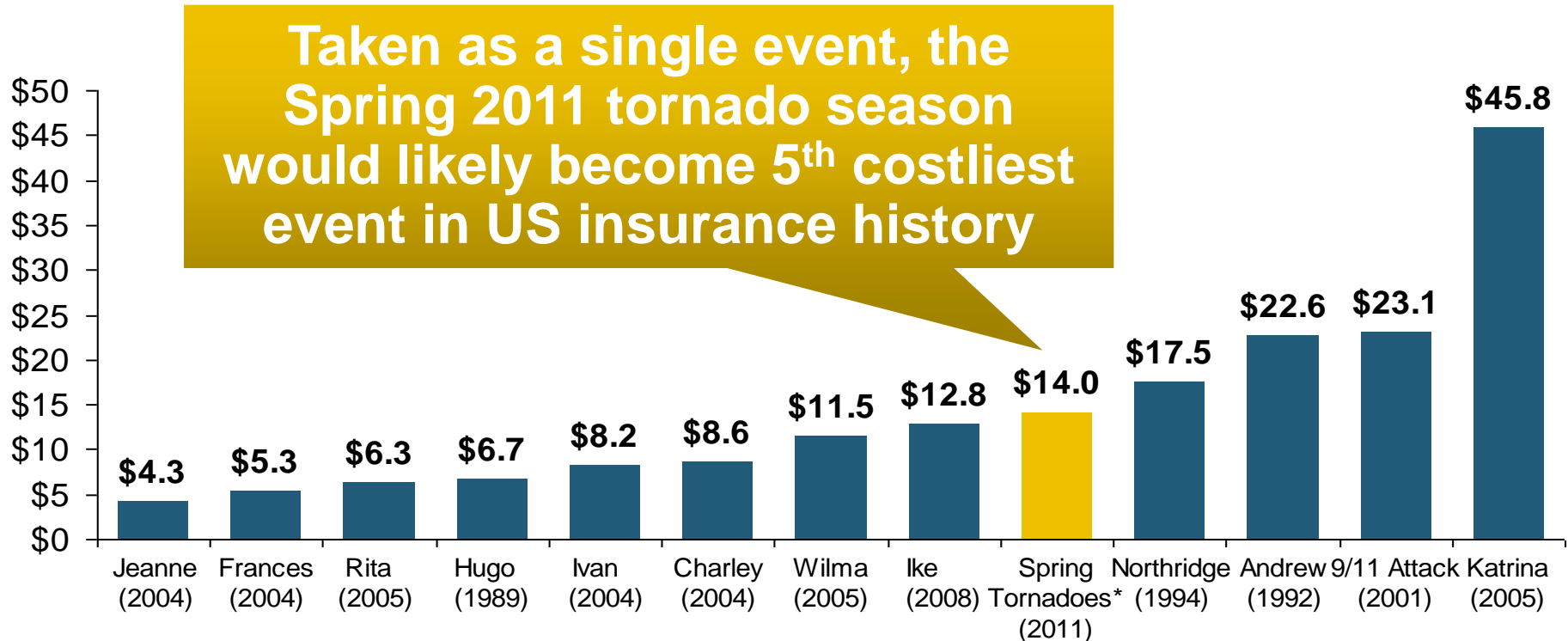
Sources: Property Claims Service/ISO; Insurance Information Institute.

# Natural Disaster Losses in the United States: First 6 Months 2011

As of July 6, 2011	Number of Events	Fatalities	Estimated Overall Losses (US \$m)	Estimated Insured Losses (US \$m)
<b>Severe Thunderstorm</b>	43	593	23,573	16,350
<b>Winter Storm</b>	8	15	1,900	1,425
<b>Flood</b>	8	15	2,100	in progress
<b>Earthquake</b>	2	1	105	in progress
<b>Tropical Cyclone</b>	0	0	0	0
<b>Wildfire</b>	37	7	125	50

# Top 12 (13?) Most Costly Disasters in U.S. History

(Insured Losses, 2010 Dollars, \$ Billions)



\*Losses will actually be broken down into several "events" as determined by PCS.

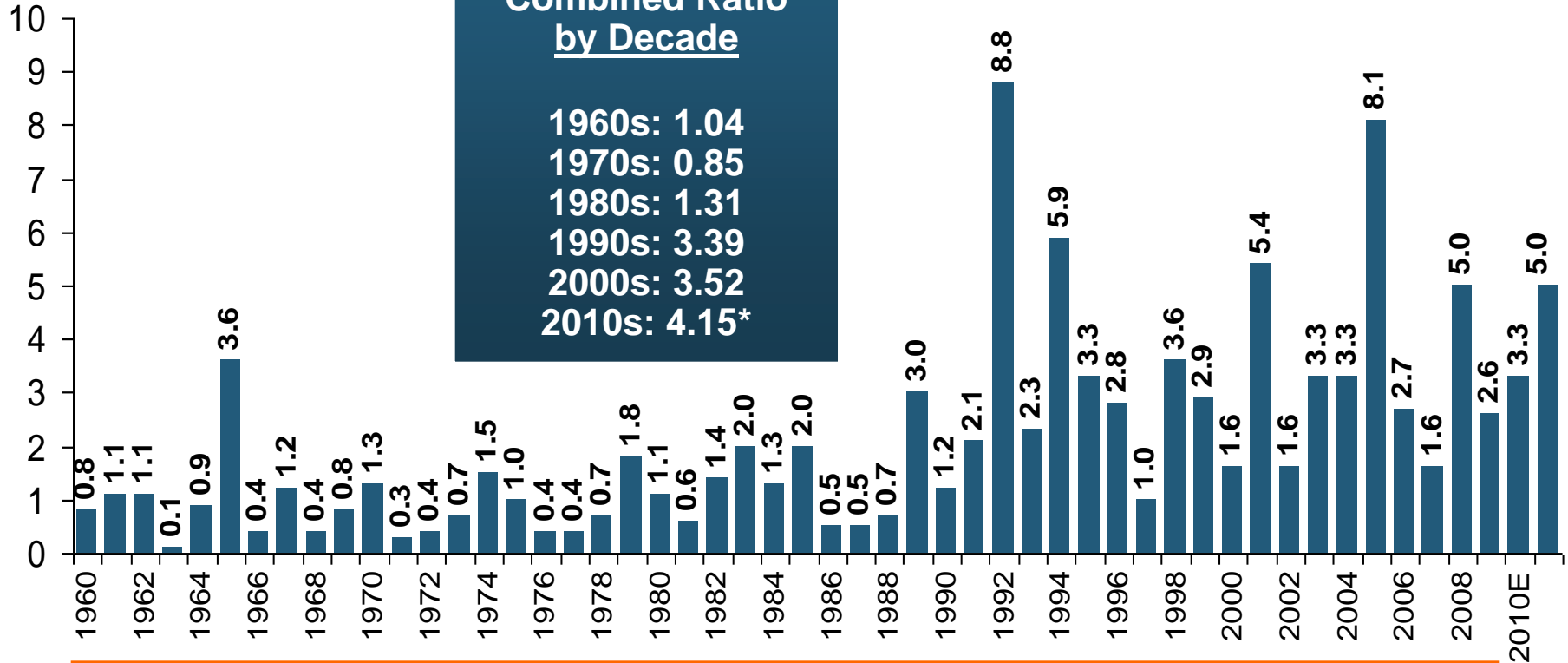
Sources: PCS; Insurance Information Institute inflation adjustments.

# Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2011:H1\*

## 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: 4.15\*



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

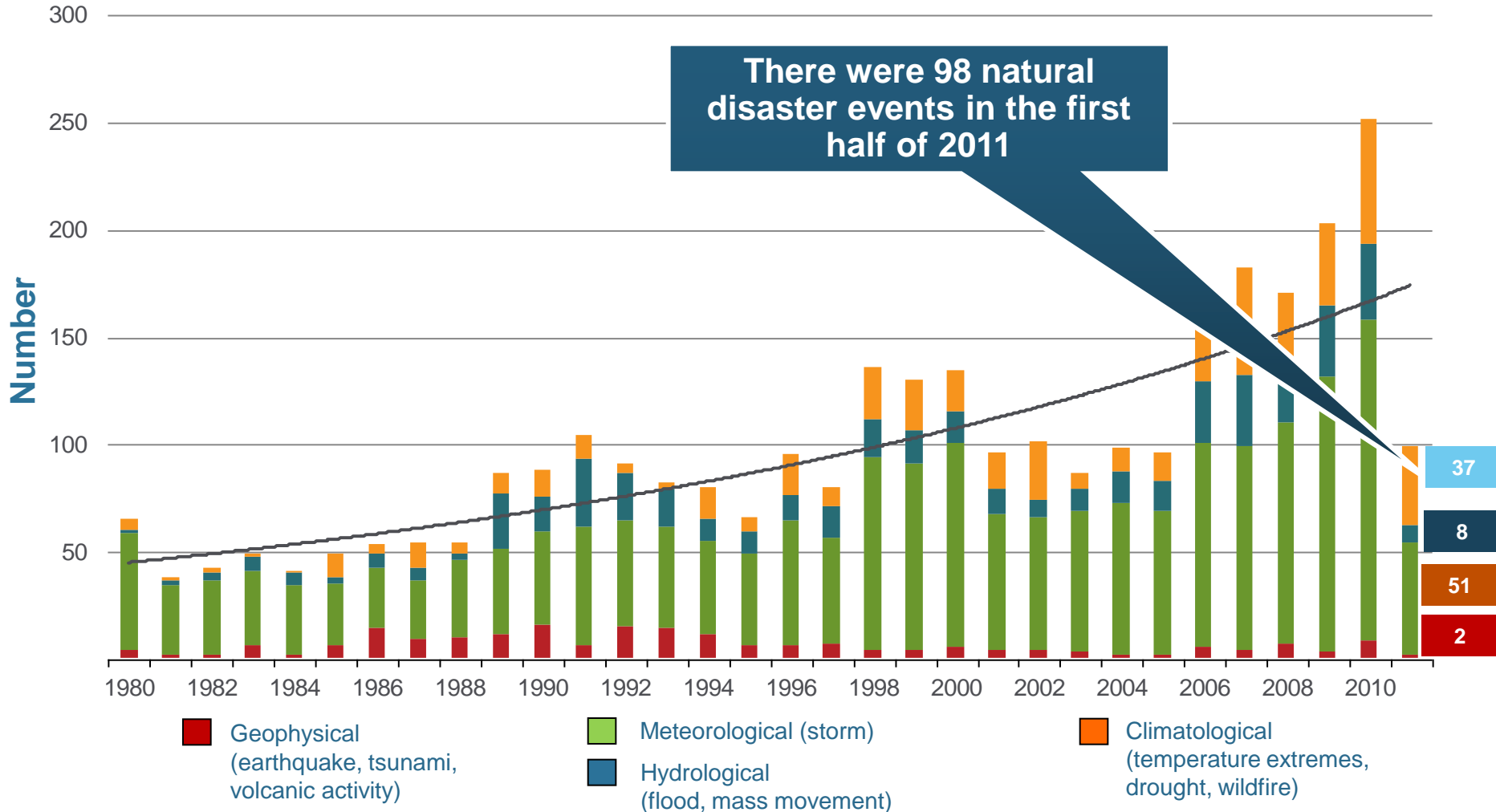
\*Insurance Information Institute estimates for 2010 and 2011:H1

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.

# Natural Disasters in the United States, 1980 – 2011\*

Number of Events (Annual Totals 1980 – 2010 and First Half 2011)

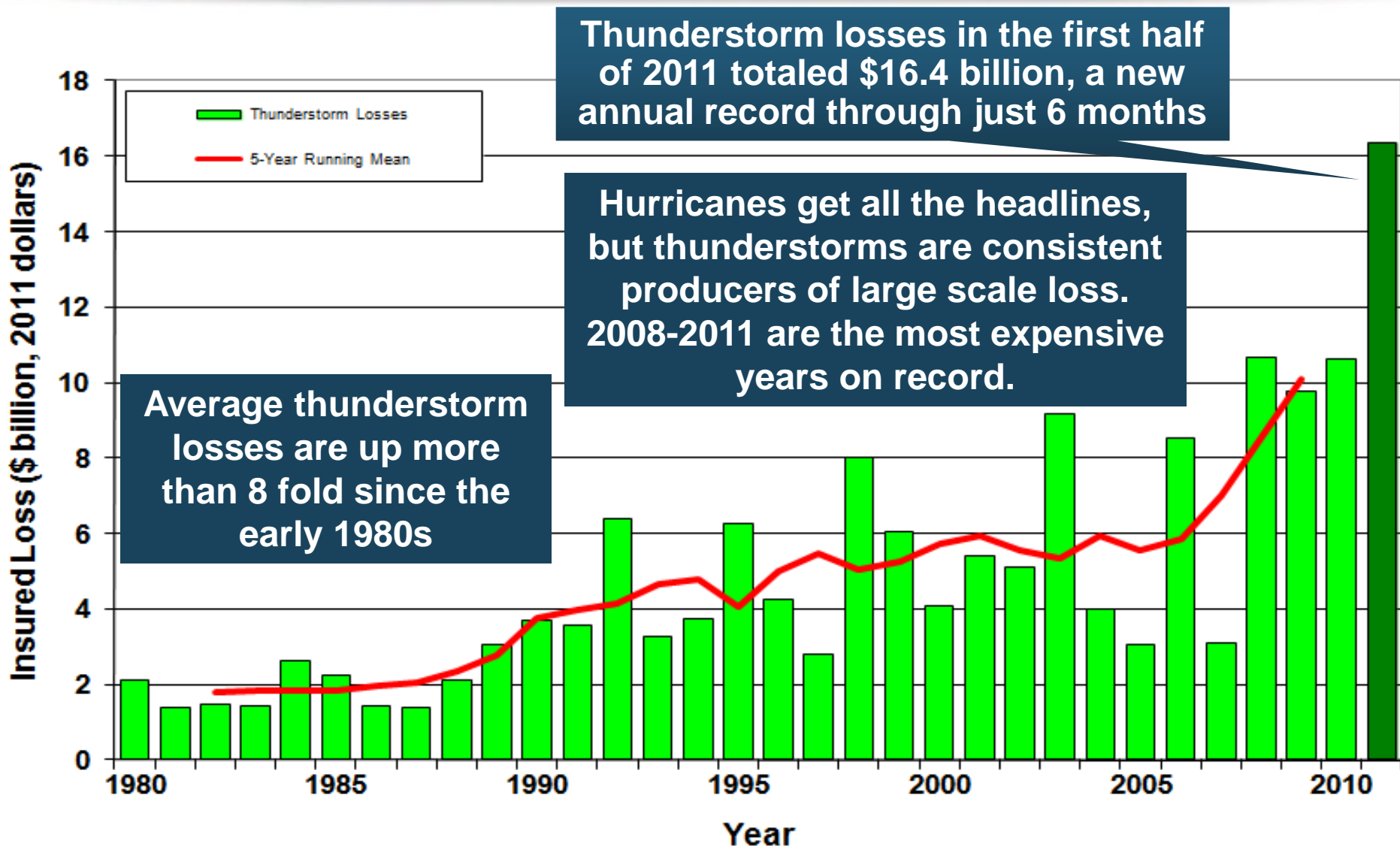


\*Through June 30.

Source: MR NatCatSERVICE



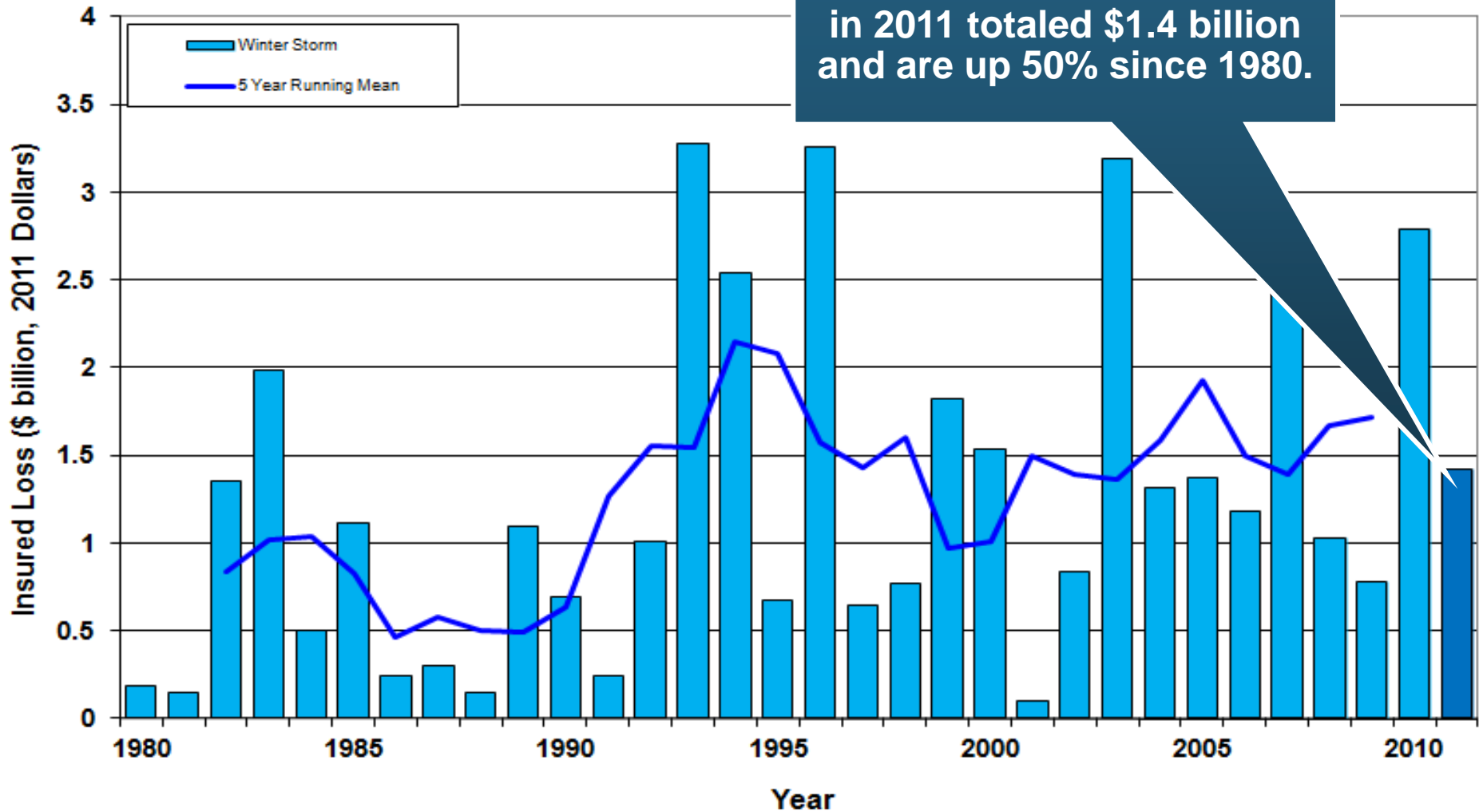
# U.S. Thunderstorm Loss Trends, 1980 – 2011\*



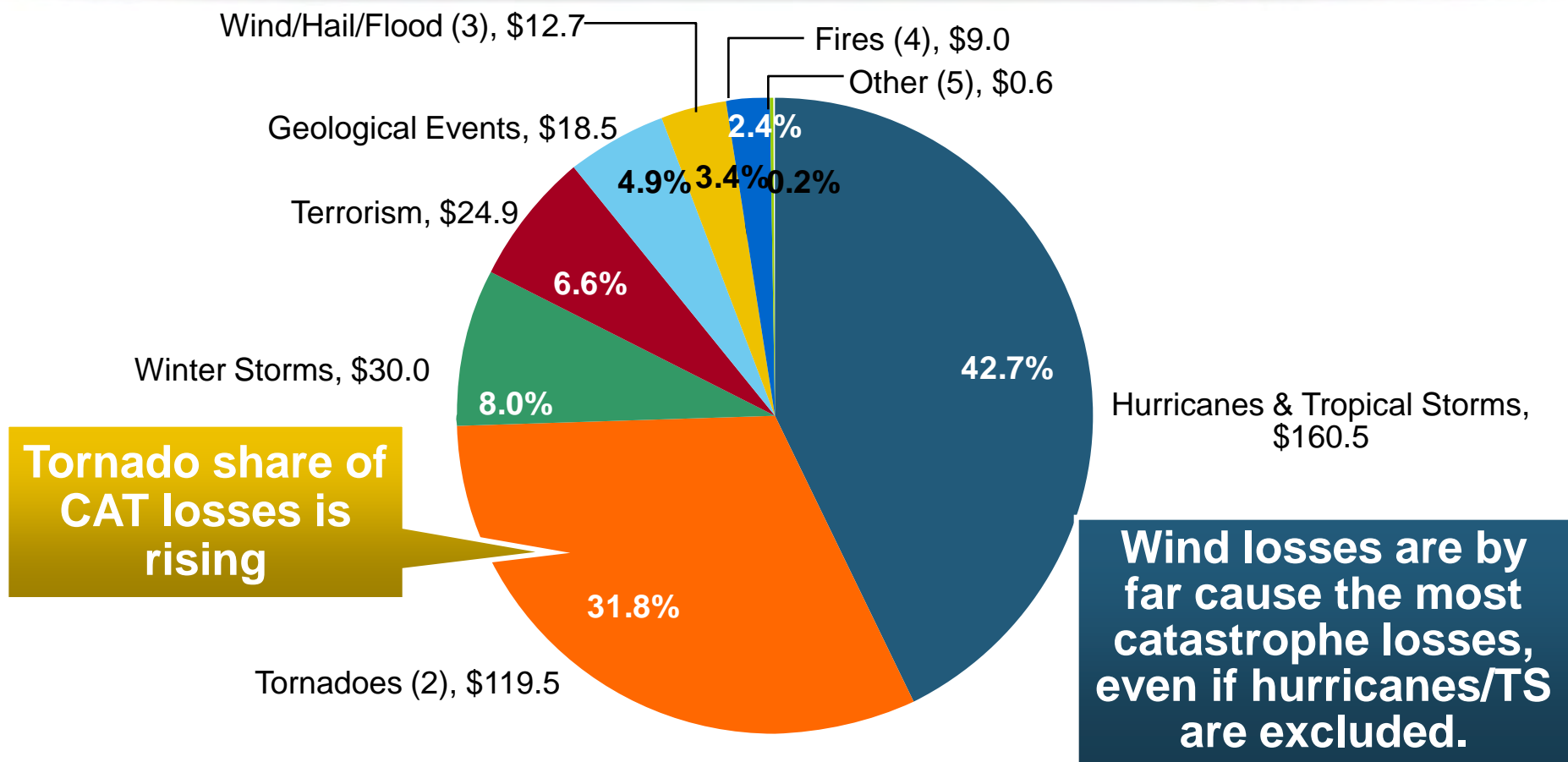
\*Through June 30, 2011.

Source: Property Claims Service, MR NatCatSERVICE

# U.S. Winter Storm Loss Trends, 1980 – 2010 (Annual Totals) vs. First Half 2011



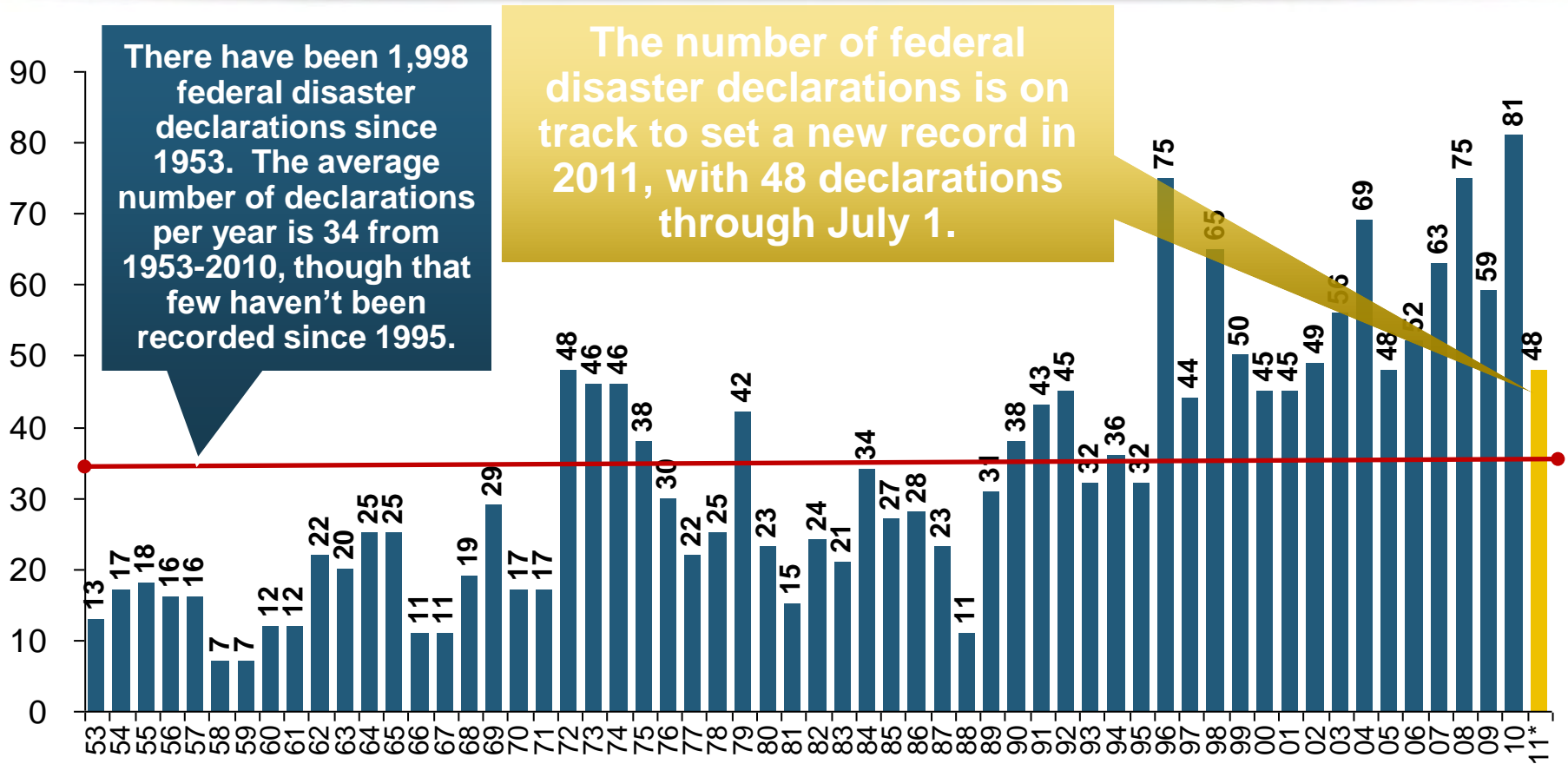
# Inflation Adjusted U.S. Catastrophe Losses by Cause of Loss, 1990–2011:H1<sup>1</sup>



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.

# Number of Federal Disaster Declarations, 1953-2011\*

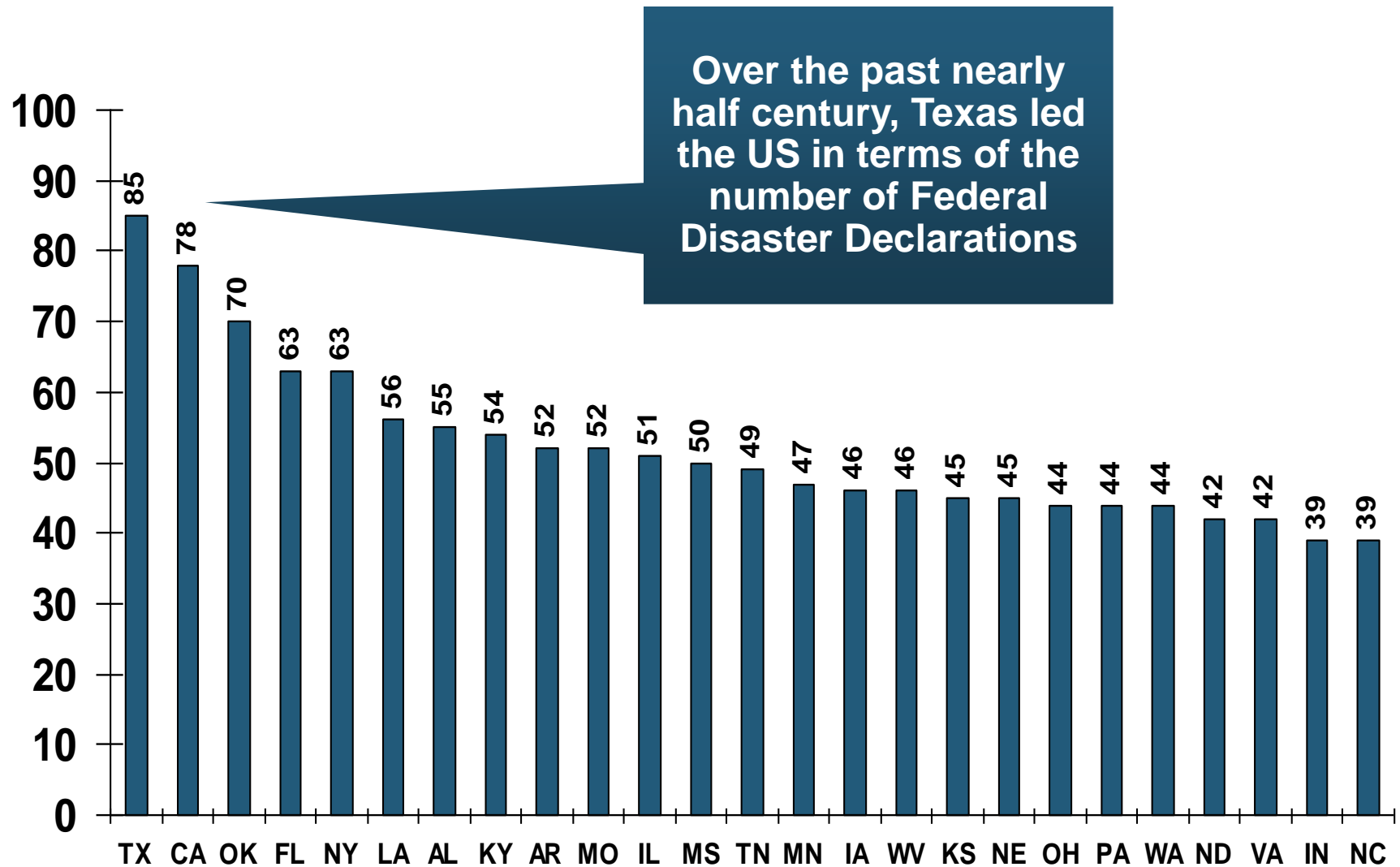


**The Number of Federal Disaster Declarations Is Rising**

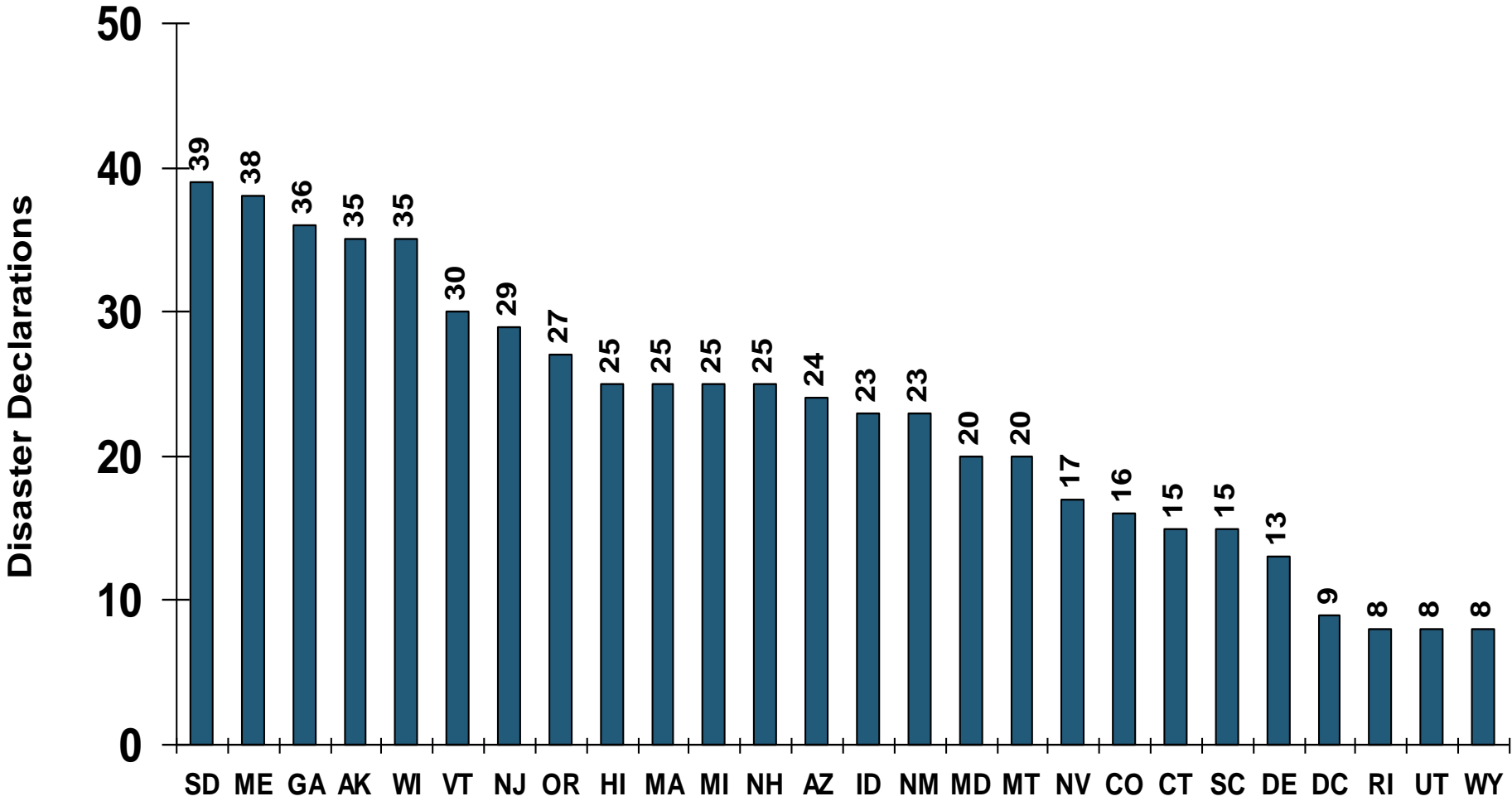
\*Through July 1, 2011.

Source: Federal Emergency Management Administration: [http://www.fema.gov/news/disaster\\_totals\\_annual.fema](http://www.fema.gov/news/disaster_totals_annual.fema); Insurance Information Institute.

# Federal Disasters Declarations by State, 1953 – June 30, 2011: Highest 25 States



# Federal Disasters Declarations by State, 1953 – June 30, 2011: Lowest 25 States



Source: FEMA.



# The BIG Question: When Will the Market Turn?

## Insurance Cycle Dynamics

# Criteria Necessary for a “Market Turn”: All Four Criteria Must Be Met

Criteria	Status	Comments
<b>Sustained Period of Large Underwriting Losses</b>	<i>Not Yet Happened</i>	<ul style="list-style-type: none"> <li>• Apart from Q2:2011, overall p/c underwriting losses remain modest</li> <li>• Combined ratios (ex-Q2 CATs) still in low 100s (vs. 110+ at onset of last hard market)</li> <li>• Prior-year reserve releases continue reduce u/w losses, boost ROEs</li> </ul>
<b>Material Decline in Surplus/ Capacity</b>	<i>Surplus is At/Near Record High</i>	<ul style="list-style-type: none"> <li>• Surplus hit a record \$565B as of 3/31/11</li> <li>• Analysts est. excess surplus of \$75-\$100B</li> <li>• Some excess capacity may still remain in reinsurance markets</li> <li>• Weak growth in demand for insurance is insufficient to absorb much excess capacity</li> </ul>
<b>Tight Reinsurance Market</b>	<i>Somewhat in Place</i>	<ul style="list-style-type: none"> <li>• Higher prices in Asia/Pacific</li> <li>• Modestly improved pricing for US risks</li> </ul>
<b>Renewed Underwriting &amp; Pricing Discipline</b>	<i>Not Broadly Evident</i>	<ul style="list-style-type: none"> <li>• Commercial lines pricing trends remain negative</li> <li>• Competition remains intense as many seek to maintain market share</li> <li>• Terms &amp; conditions—no broad tightening</li> </ul>



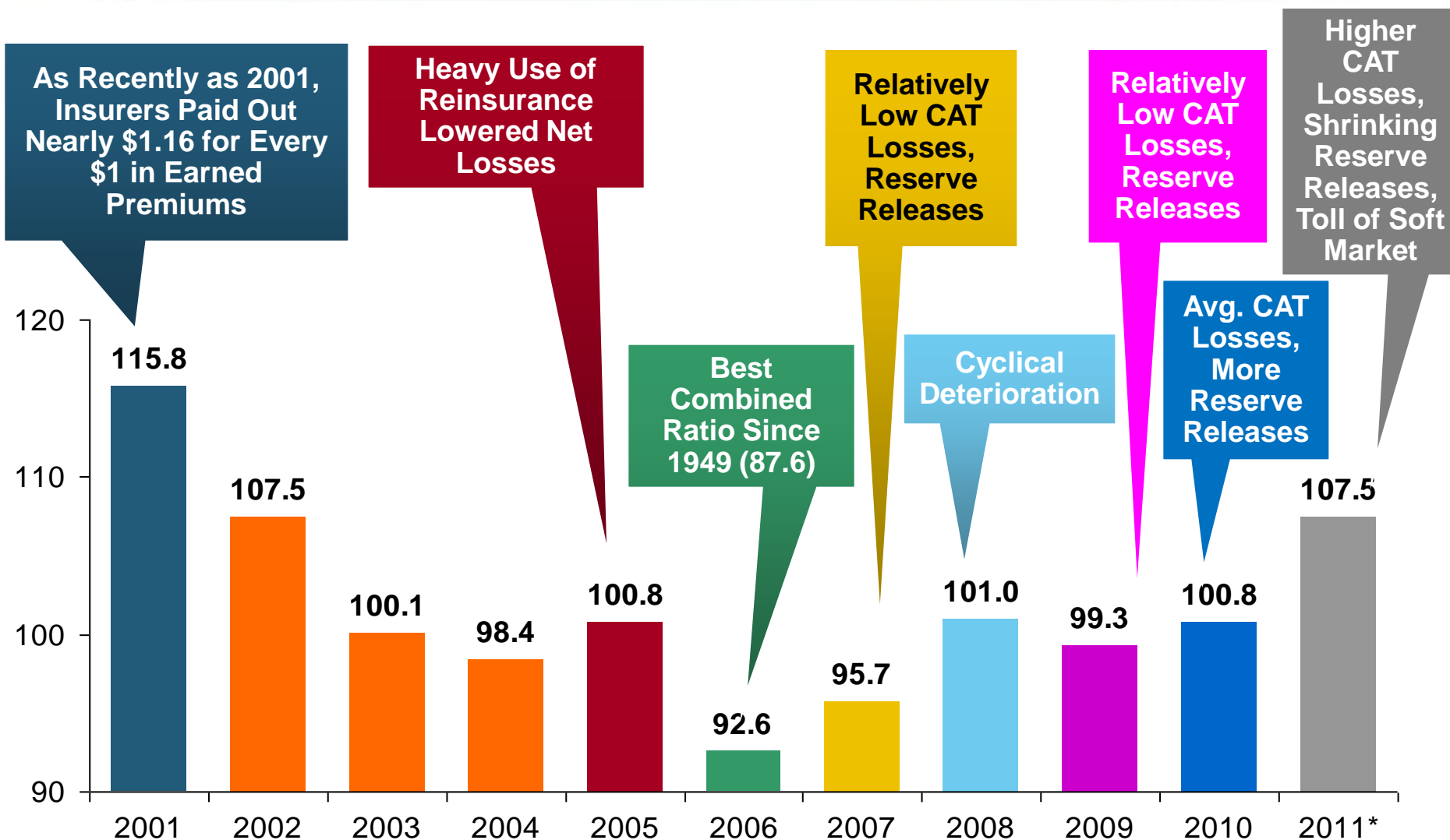
# Do the Property Catastrophe Events of 2011 Impact Casualty Markets?

- **Unlikely that Record 2011 Property CAT Loss Will Impact Casualty Markets in Any Material Way**
- **Global P/C & Reinsurance Industries Entered 2011 w/ Record Capital**
  - ◆ Events so far in 2011 are earnings events, rather than capital events
- **Natural Catastrophe and Casualty Risks Are Largely Uncorrelated**
  - ◆ Risks are different
  - ◆ Geographically, mostly distinct primary carriers: Japan-Australia-NZ-US
  - ◆ Casualty markets generally don't influence property markets
- **Property and Casualty Risks Are Largely Siloed**
- **Record Property Losses in 2004/2005 Did Not Impact Casualty Mkts.**
- **Casualty Markets Have Their Own Issues**
  - ◆ Tort environment
  - ◆ Inflation
  - ◆ Public policy

# 1. UNDERWRITING

**Have Underwriting Losses  
Been Large Enough for Long  
Enough to Turn the Market?**

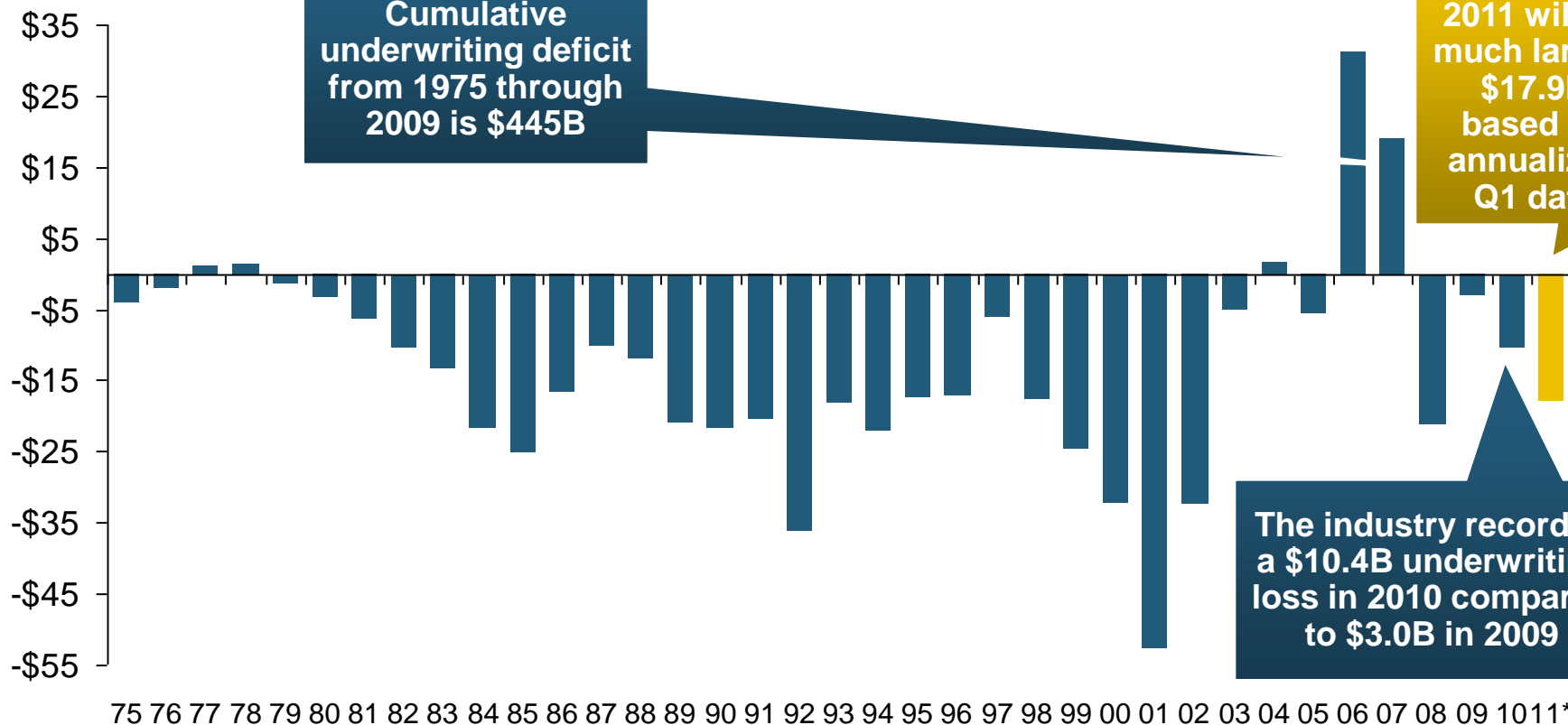
# P/C Insurance Industry Combined Ratio, 2001–2011:H1\*



\* Excludes Mortgage & Financial Guaranty insurers 2008--2011. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=109.1  
Sources: A.M. Best, ISO.; III Estimated for 2011:H1 (Q1 actual ex-M&FG was 102.2).

# Underwriting Gain (Loss) 1975–2011\*

(\$ Billions)

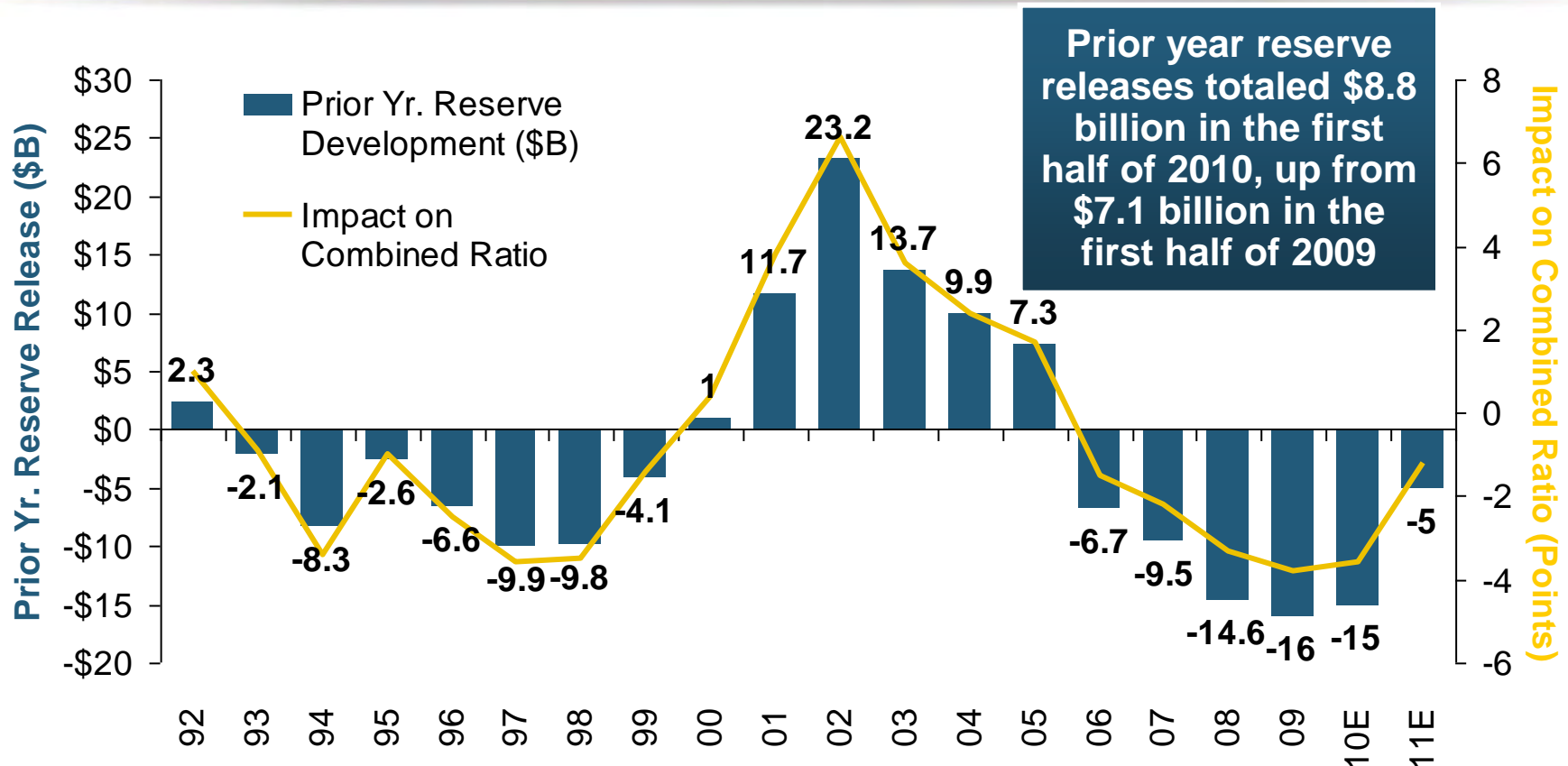


**Large Underwriting Losses Are *NOT* Sustainable  
in Current Investment Environment**

\* Includes mortgage and financial guaranty insurers in all years. 2011 figure is annualized based on actual Q1 underwriting losses of \$4.463 billion.

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

# 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**

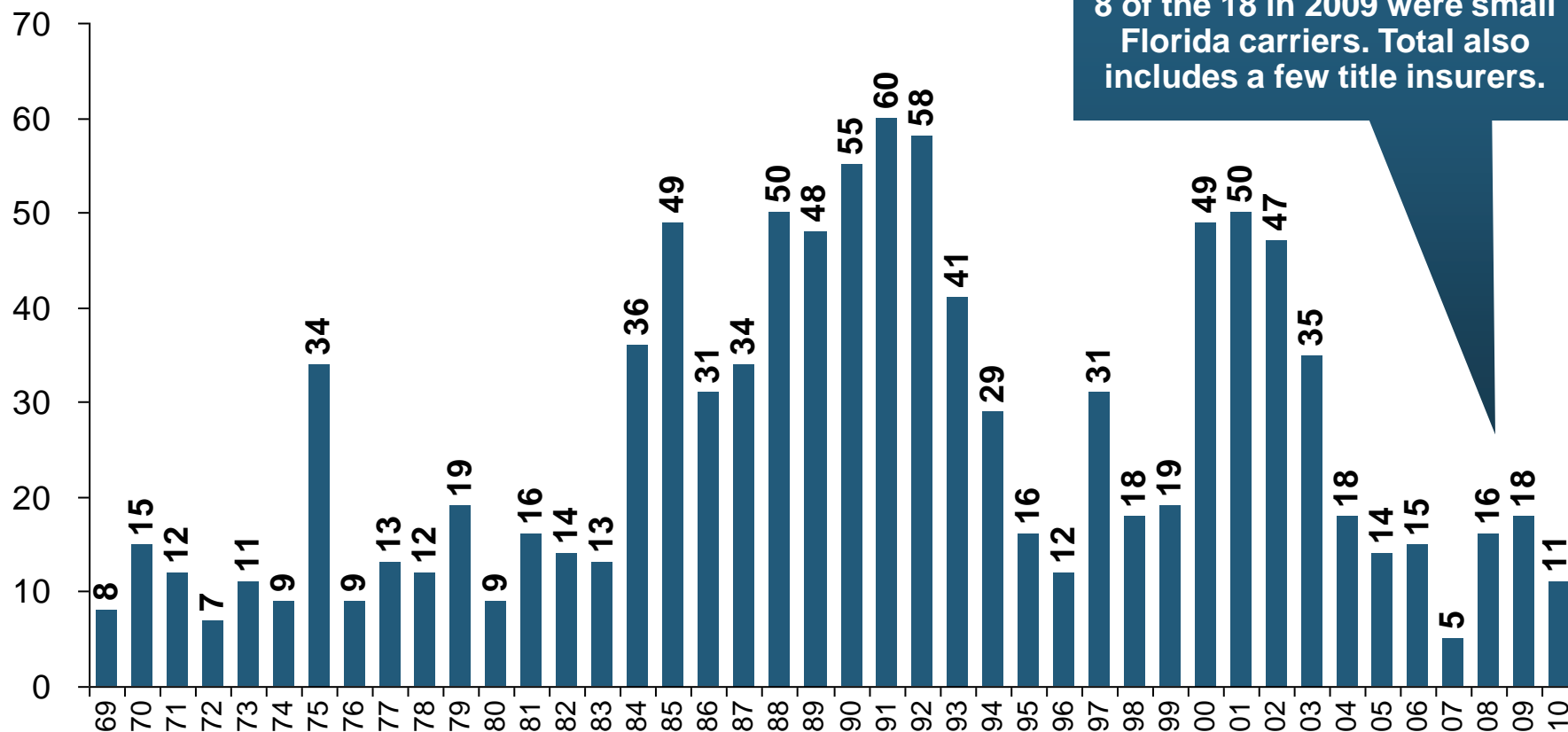
Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage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

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

# **Financial Strength & Underwriting**

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

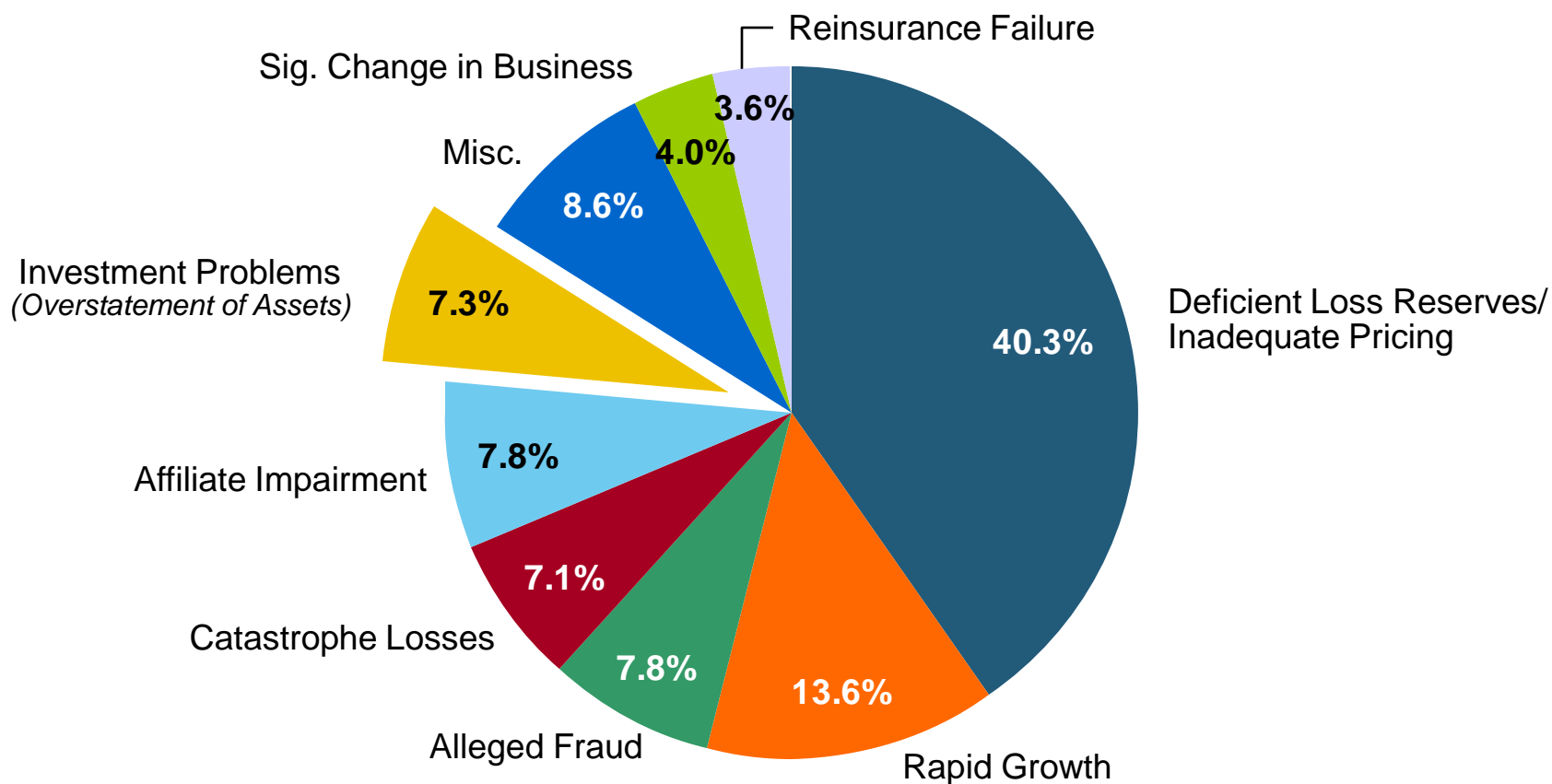
# P/C Insurer Impairments, 1969–2010



**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

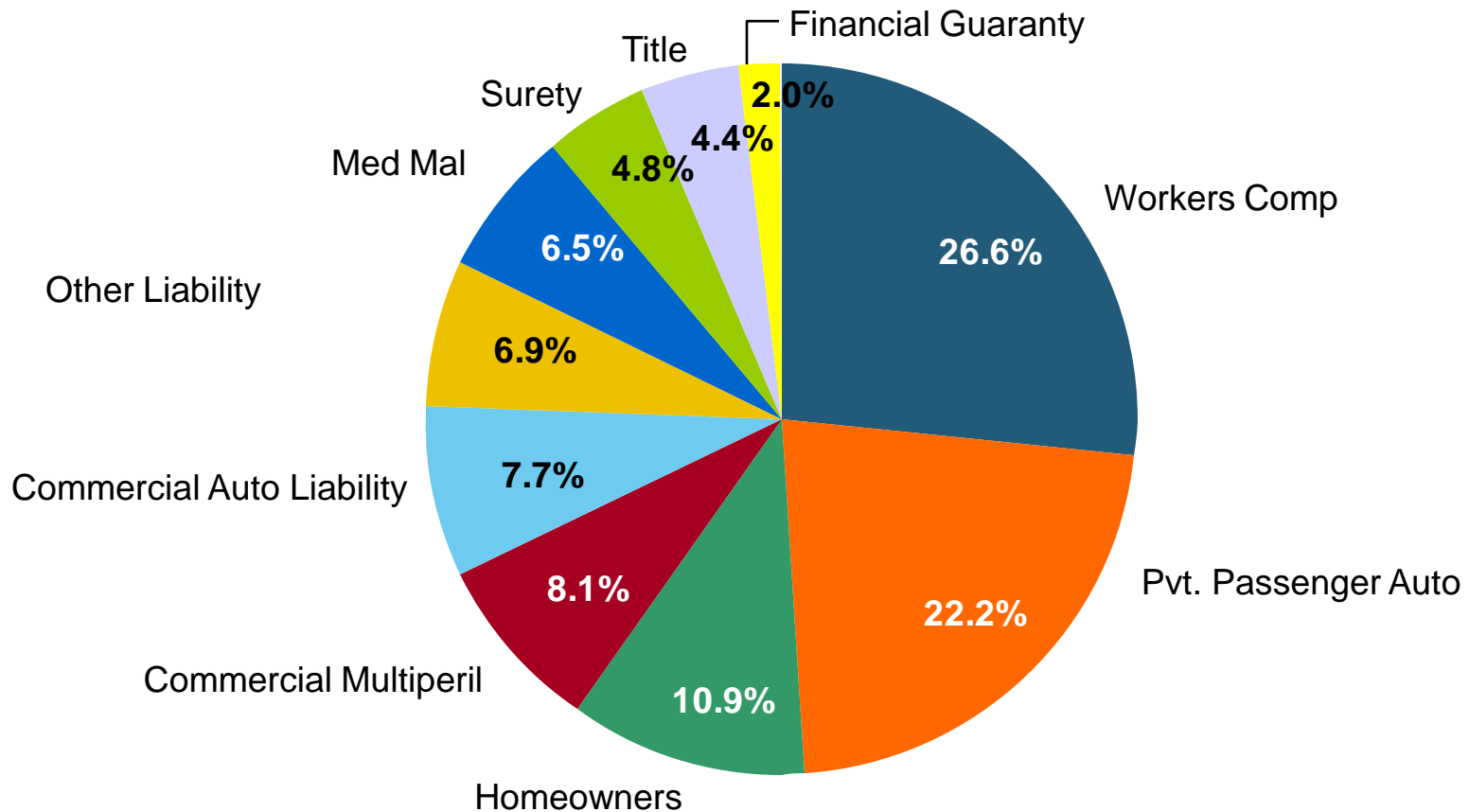
Historically, Deficient Loss Reserves and Inadequate Pricing Are By Far the Leading Cause of P-C Insurer Impairments. Investment and Catastrophe Losses Play a Much Smaller Role





# Top 10 Lines of Business for US P/C Impaired Insurers, 2000–2010

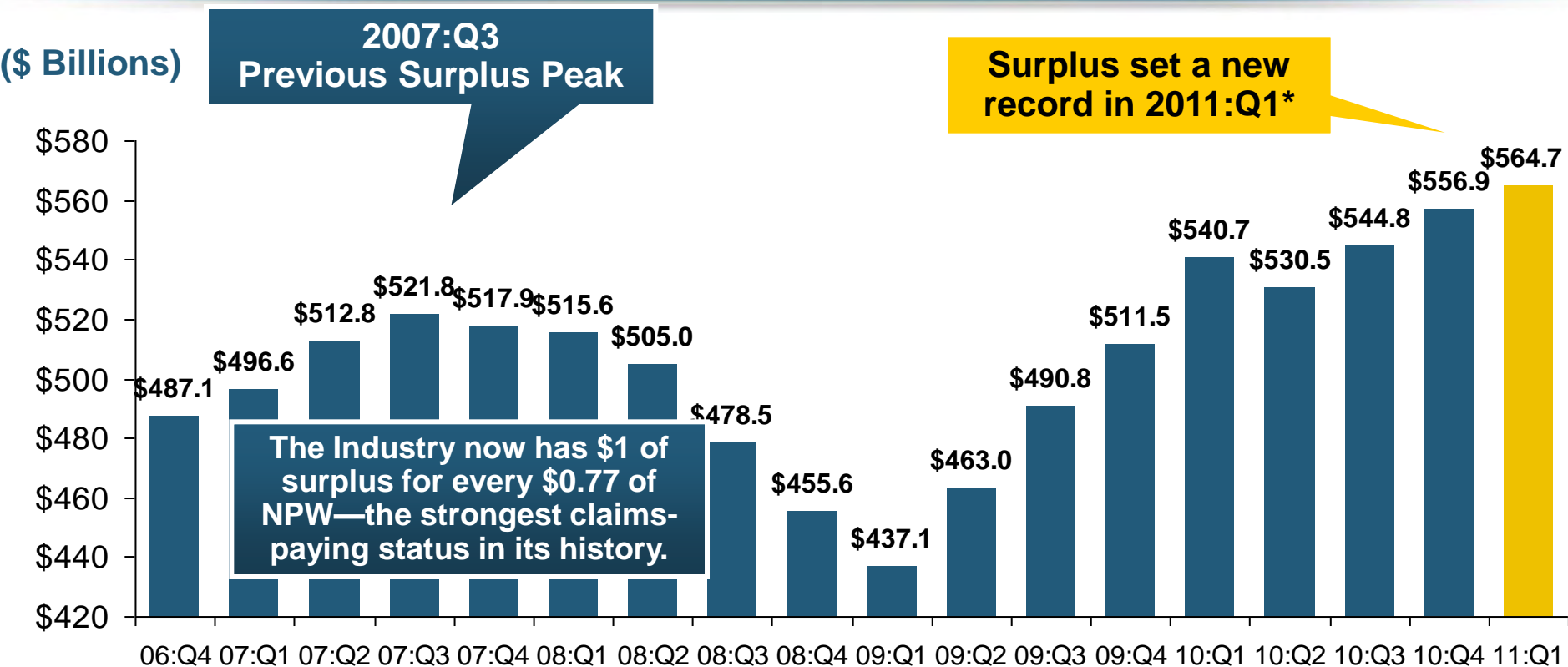
Workers Comp and Pvt. Passenger Auto Account for Nearly Half of the Premium Volume of Impaired Insurers Over the Past Decade



## **2. SURPLUS/CAPITAL/CAPACITY**

**Have Large Global Losses Reduced Capacity in the Industry, Setting the Stage for a Market Turn?**

# Policyholder Surplus, 2006:Q4–2011:Q1



## Quarterly Surplus Changes Since 2007:Q3 Peak

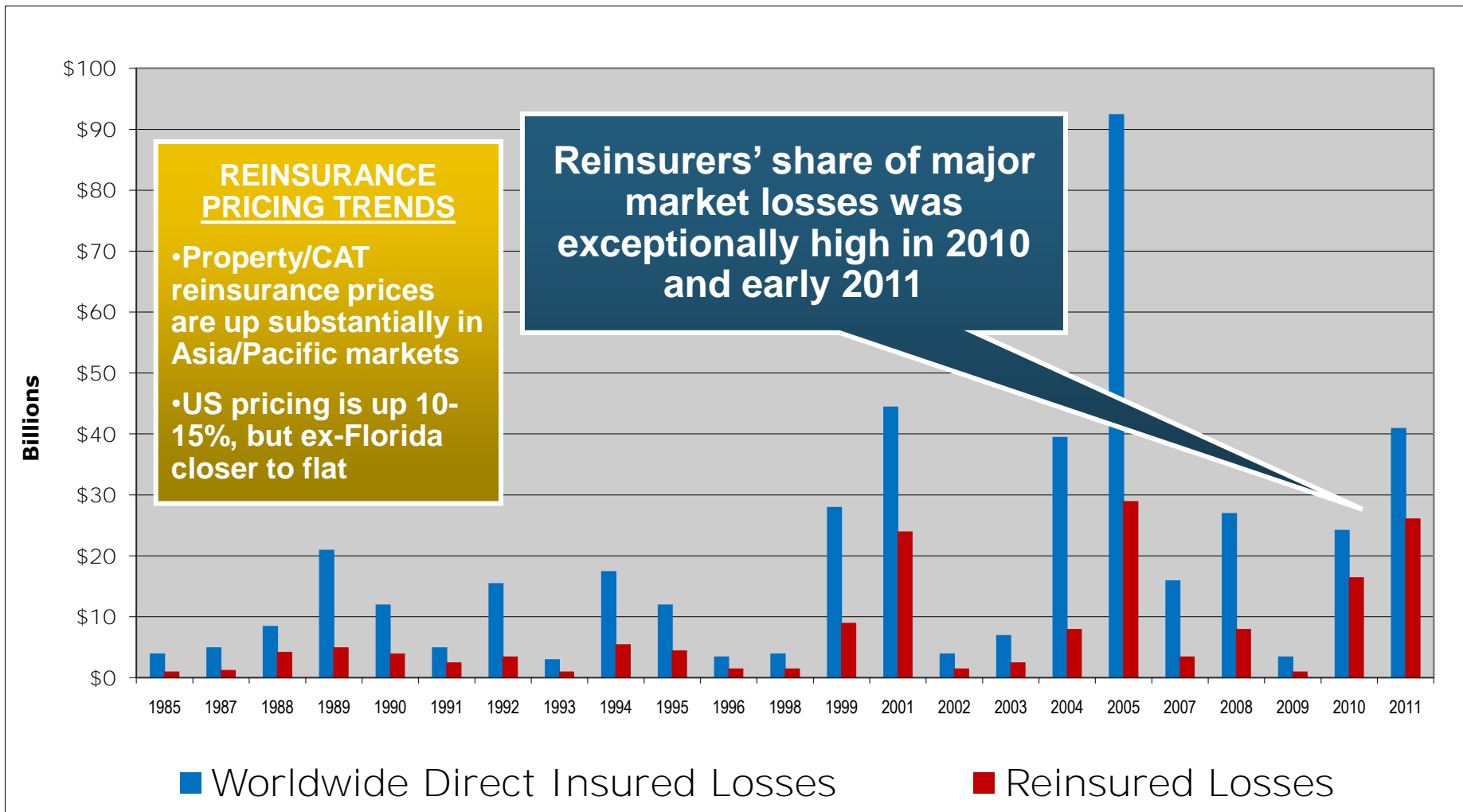
<b>09:Q1: -\$84.7B (-16.2%)</b>	<b>10:Q1: +\$18.9B (+3.6%)</b>
<b>09:Q2: -\$58.8B (-11.2%)</b>	<b>10:Q2: +\$8.7B (+1.7%)</b>
<b>09:Q3: -\$31.0B (-5.9%)</b>	<b>10:Q3: +\$23.0B (+4.4%)</b>
<b>09:Q4: -\$10.3B (-2.0%)</b>	<b>10:Q4: +\$35.1B (+6.7%)</b>
	<b>11:Q1: +\$42.9B (+8.2%)</b>

\*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.

## **3. REINSURANCE MARKET CONDITIONS**

**Has Record Global  
Catastrophes Activity  
Erased Enough Capacity  
to Turn Markets?**

# Significant Market Losses, 1985-2011\*



Source: Holborn; RAA.

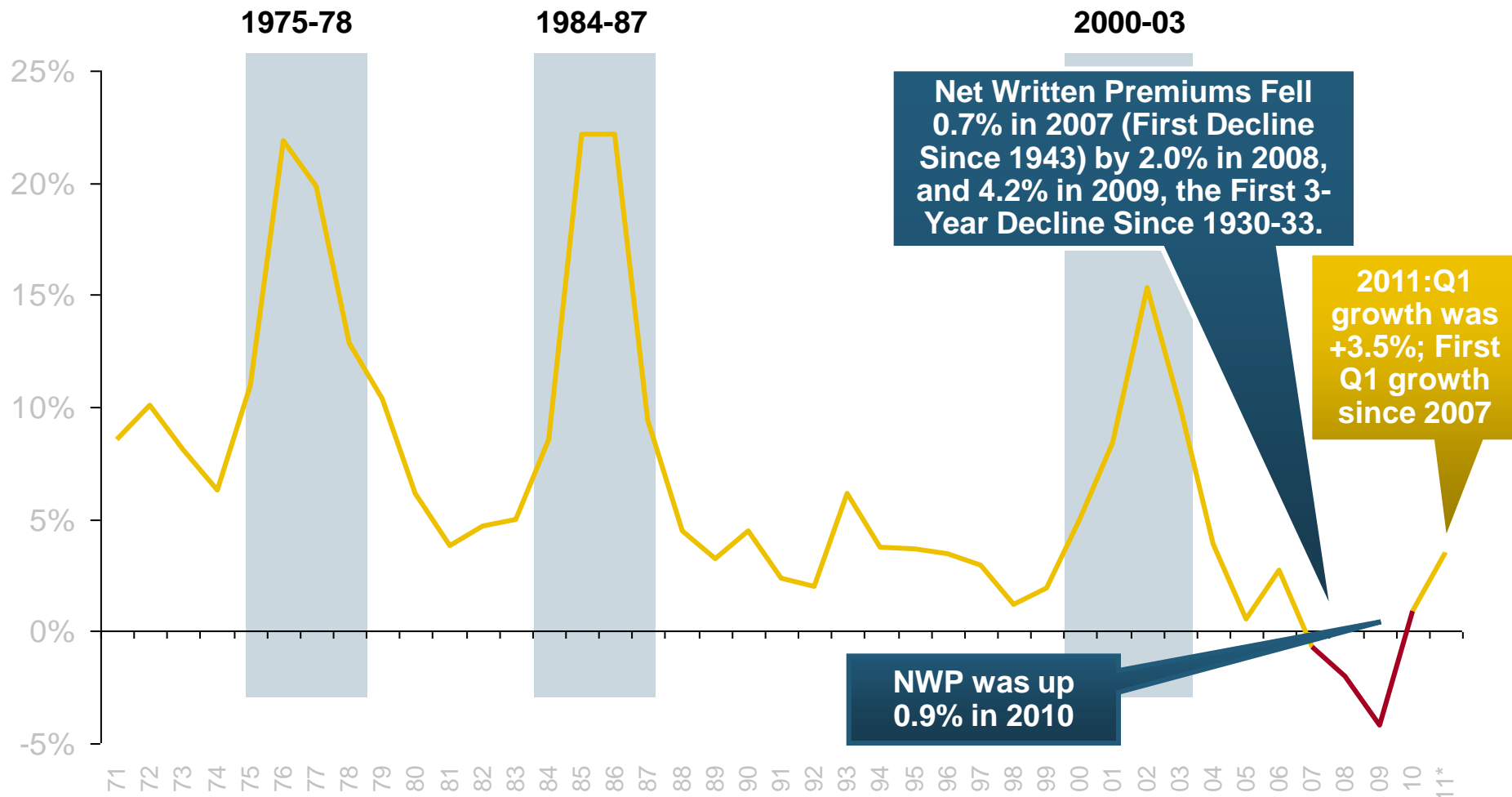
\* 2011 events are as of March 31 and are preliminary and may change as loss estimates are refined further.

## **4. RENEWED PRICING DISCIPLINE**

**Is There Evidence of a Broad  
and Sustained Shift in Pricing?**

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

(Percent)

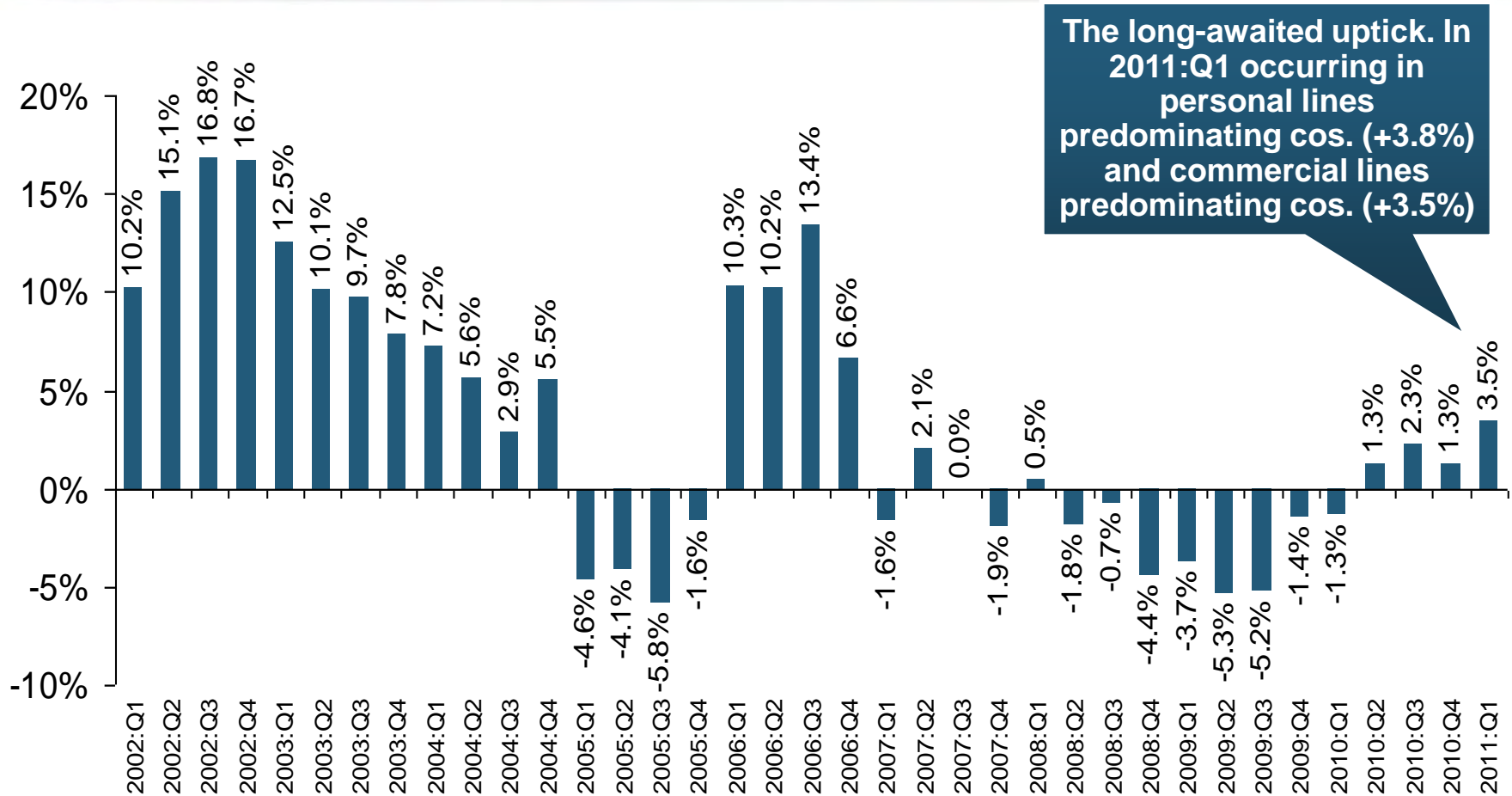


\*2011 figure is an estimate based on Q1 data.

Shaded areas denote "hard market" periods

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

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

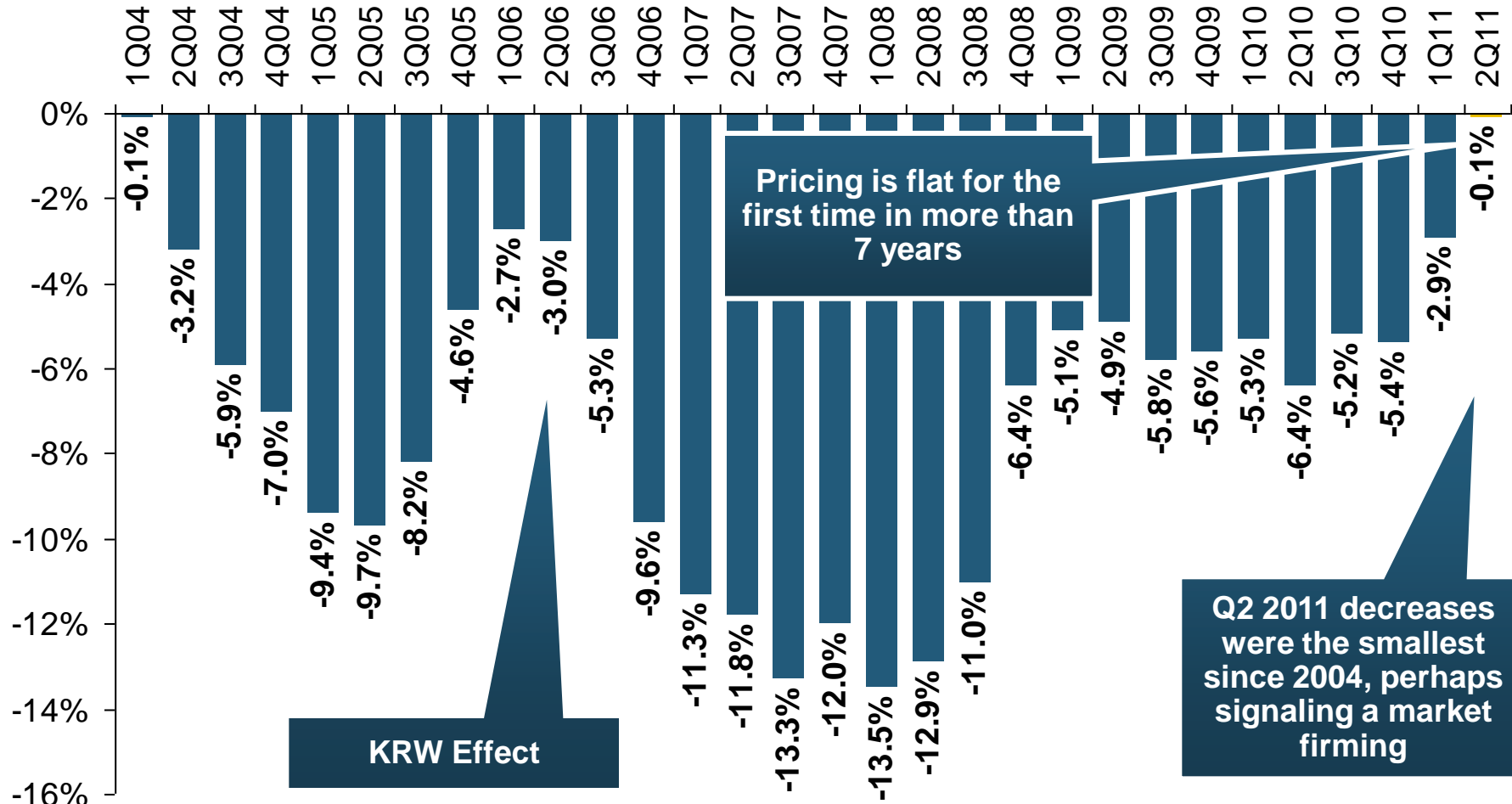


**Finally! Back-to-back quarters of net written premium growth (vs. the same quarter, prior year)**



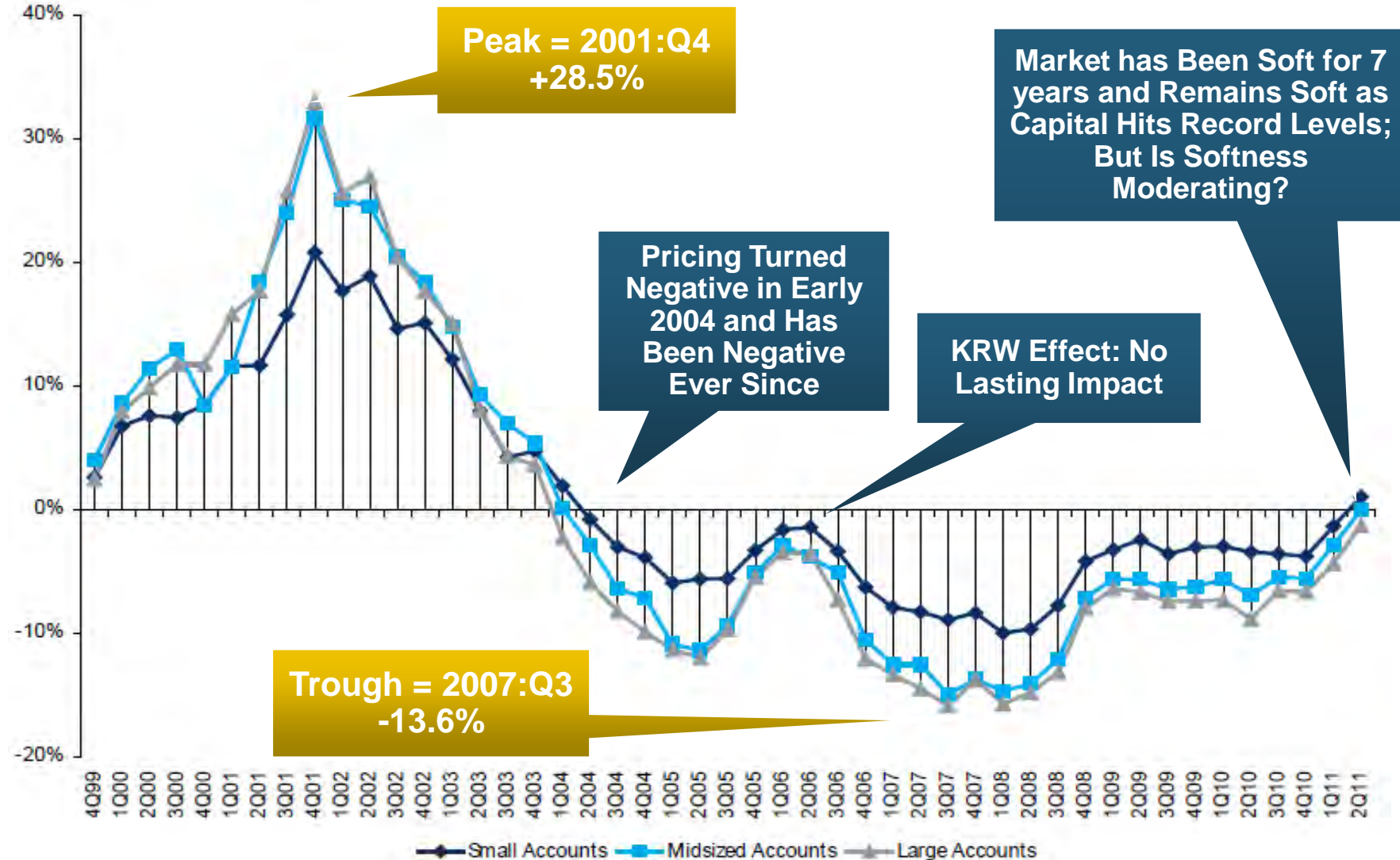
# Average Commercial Rate Change, All Lines, (1Q:2004–2Q:2011)

(Percent)



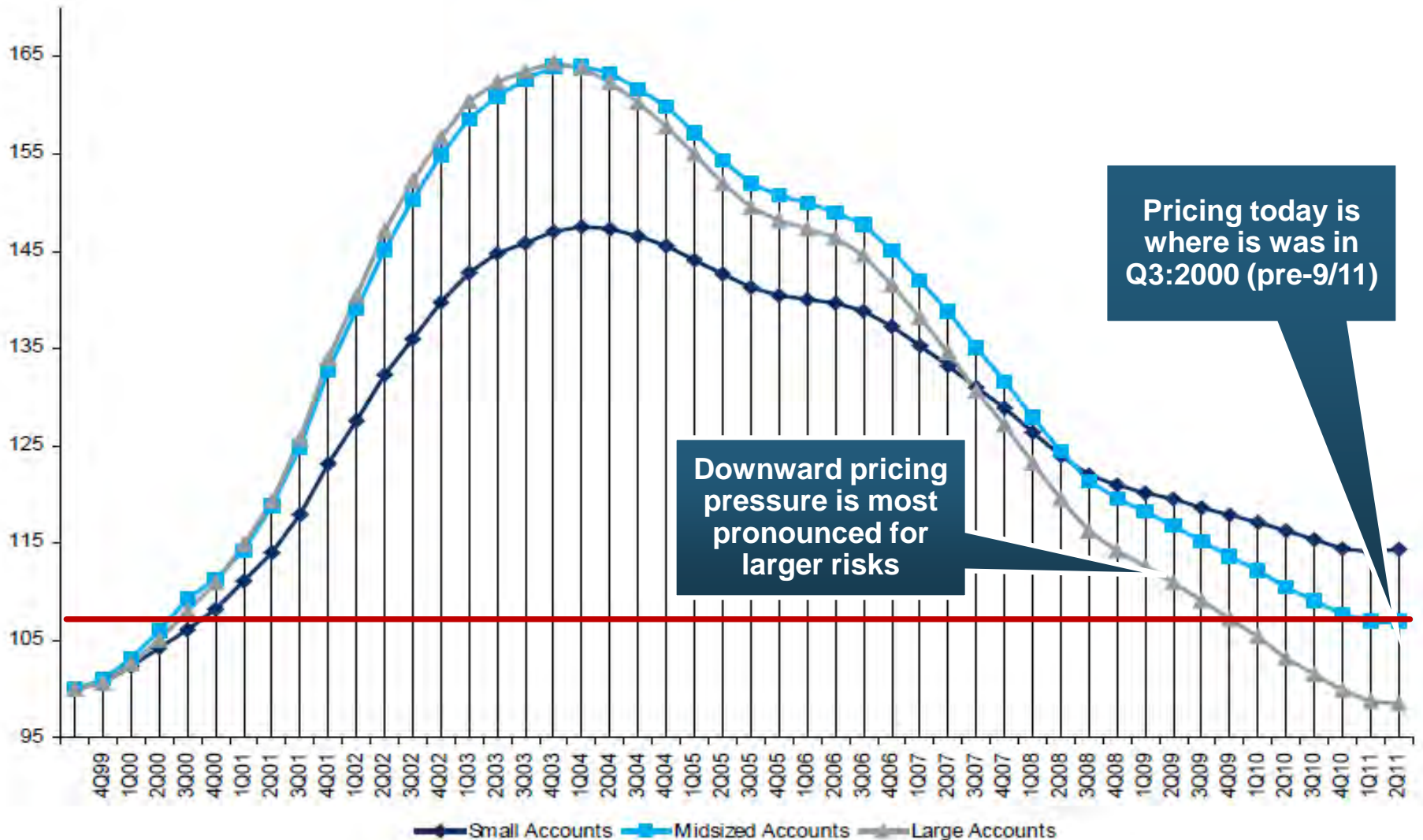
# Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2011:Q2

Percentage Change (%)



# Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2011:Q2

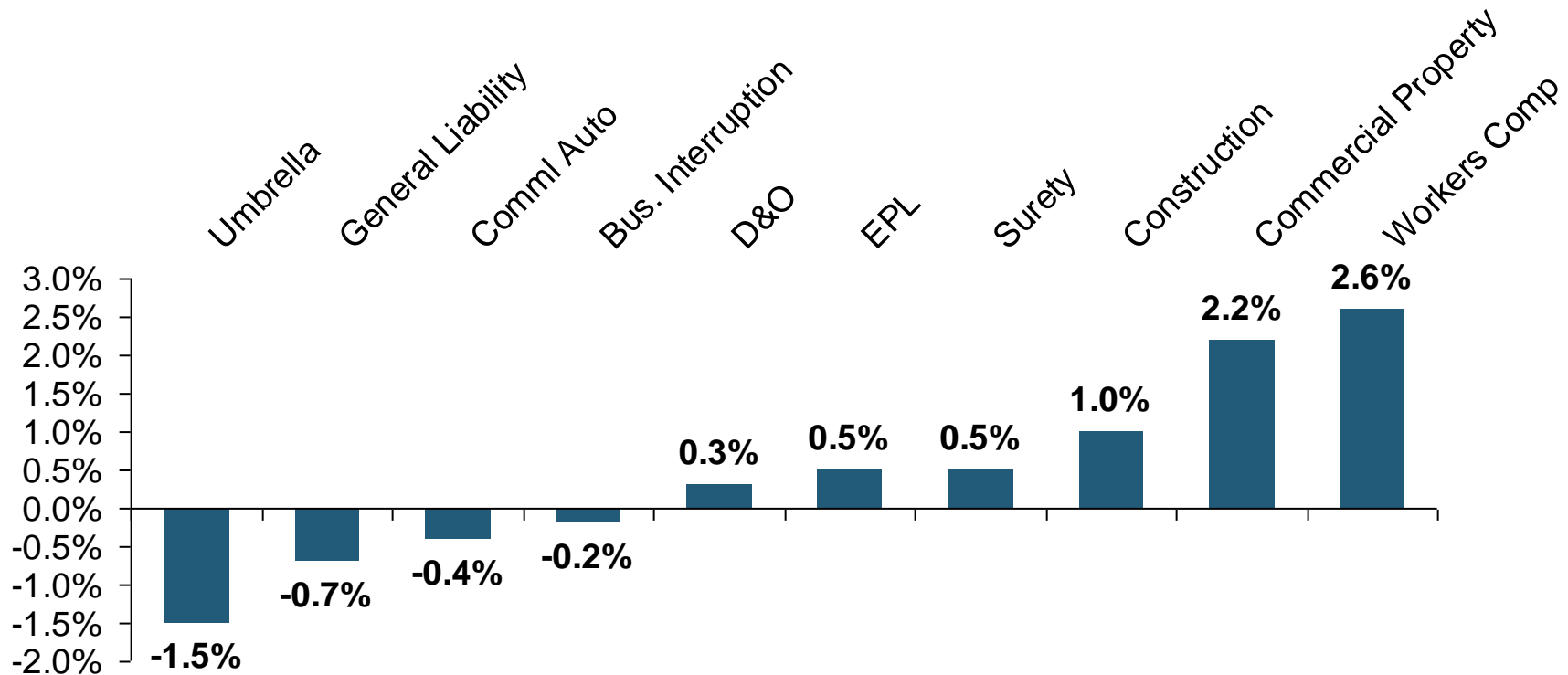
1999:Q4 = 100



Source: Council of Insurance Agents and Brokers; Insurance Information Institute.

# Change in Commercial Rate Renewals, by Line: 2011:Q2

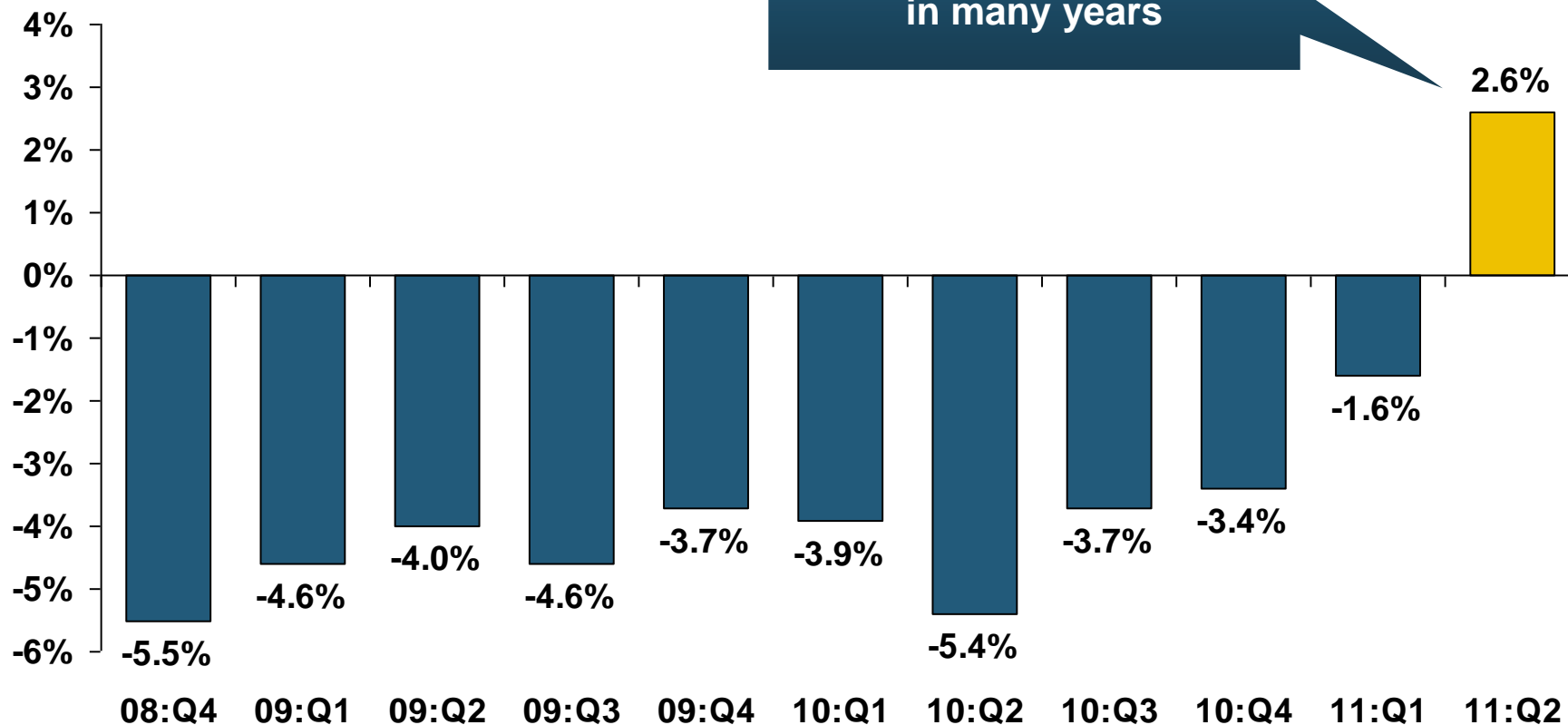
Percentage Change (%)



**Major Commercial Lines Renewed Mixed in Q2:2011, With Workers Up More than Any Other Line**

# Workers Comp Rate Changes, 2008:Q4 – 2011:Q2

(Percent  
Change)



# Other Cycle-Influencing Factors

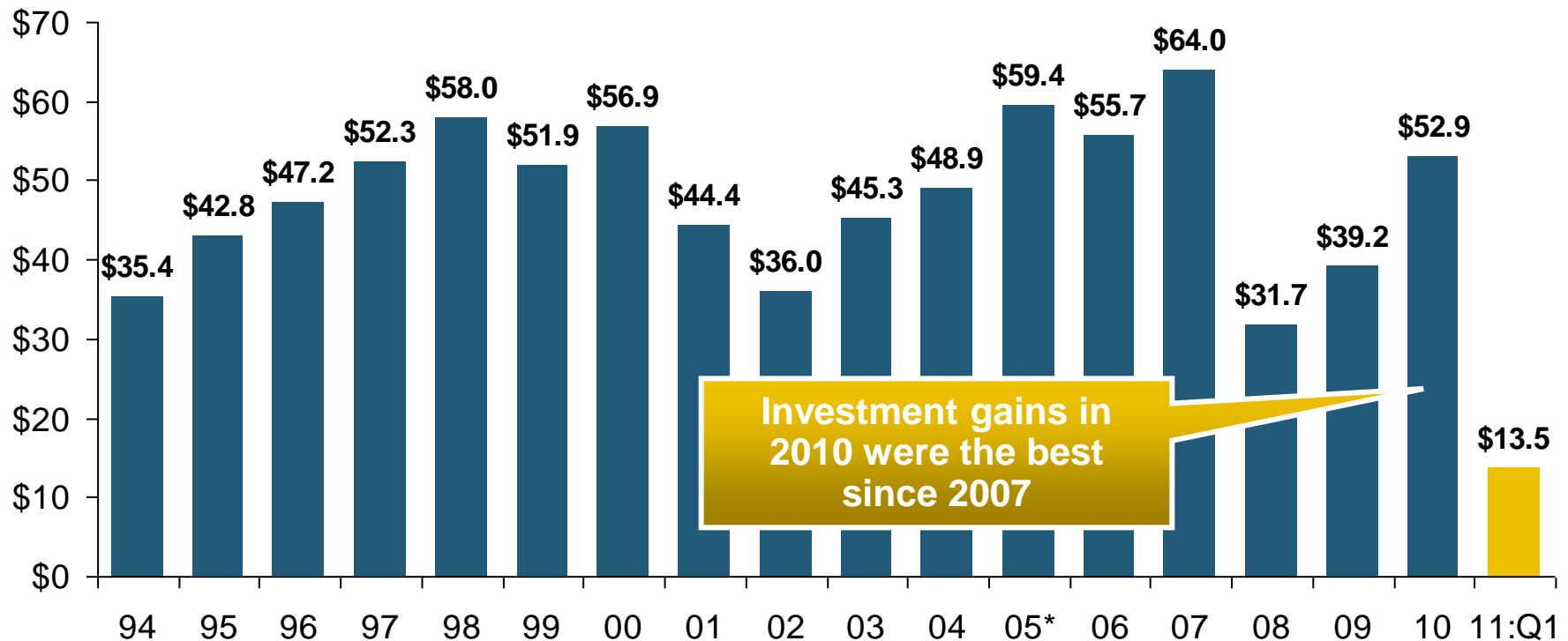
**Could Other Factors Act as  
a Catalyst to Turn the  
Market?**

# **INVESTMENTS: THE NEW REALITY**

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

# Property/Casualty Insurance Industry Investment Gain: 1994–2011:Q1<sup>1</sup>

(\$ Billions)



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

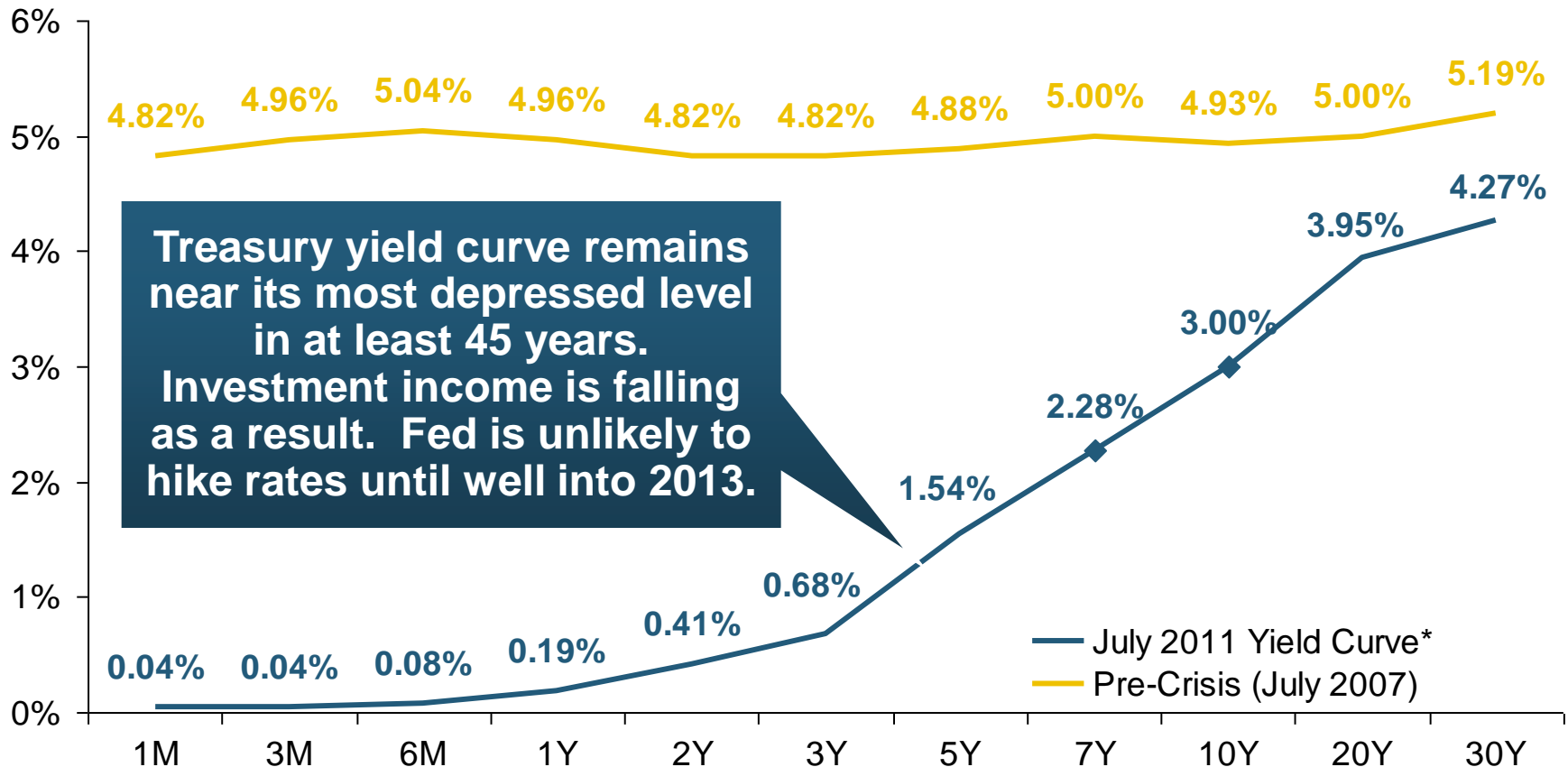
<sup>1</sup> Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

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

Sources: ISO; Insurance Information Institute.



# Treasury Yield Curves: Pre-Crisis (July 2007) vs. July 2011\*



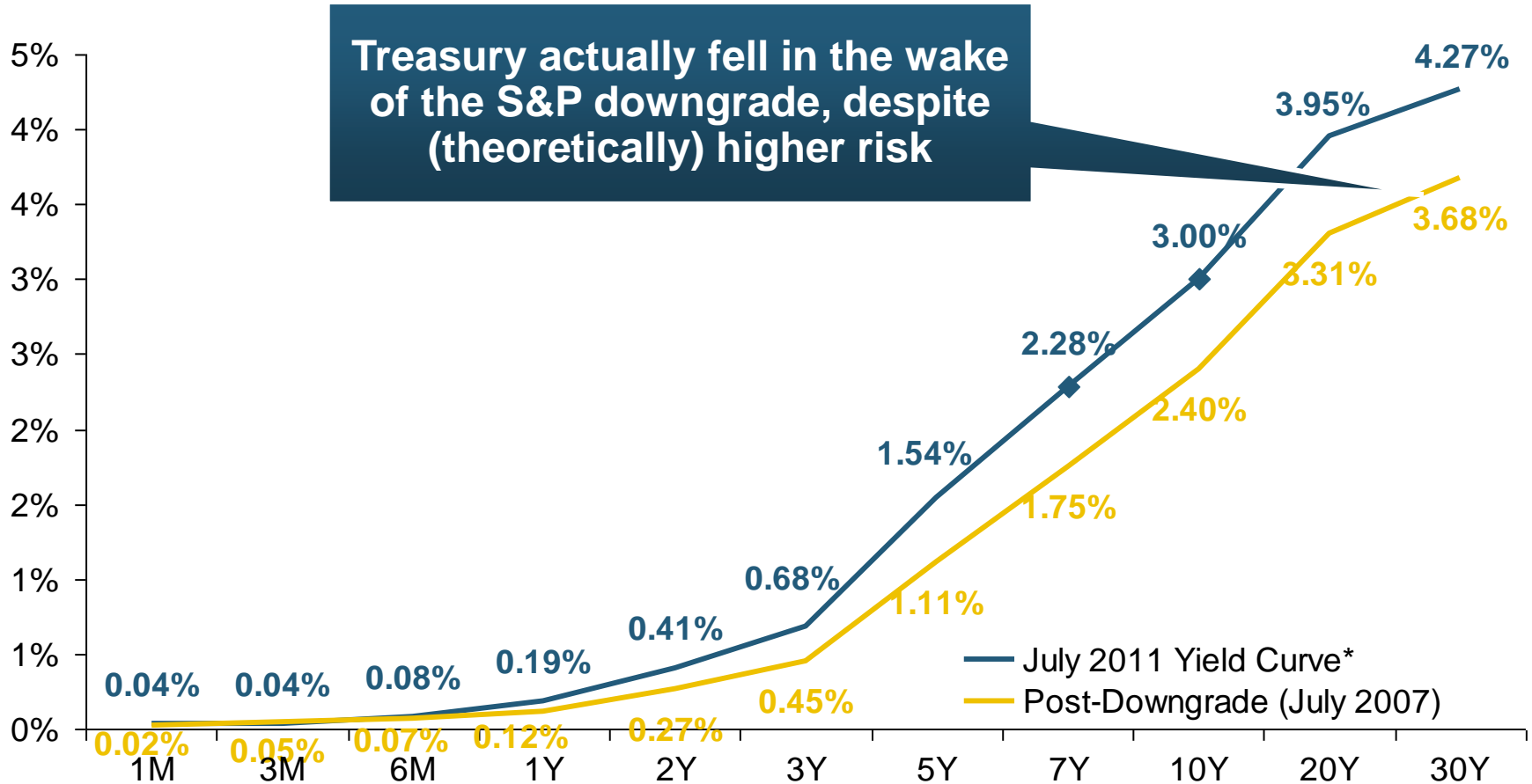
Treasury yield curve remains near its most depressed level in at least 45 years. Investment income is falling as a result. Fed is unlikely to hike rates until well into 2013.

**The End of the Fed's Quantitative Easing Is Unlikely to Push Interest Rates Up Substantially Given Ongoing Economic Weakness**

\*Average of daily rates.

Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.

# Treasury Yield Curves Before and After S&P Downgrade



**The End of the Fed's Quantitative Easing Is Unlikely to Push Interest Rates Up Substantially Given Ongoing Economic Weakness**

\*Average of daily rates.

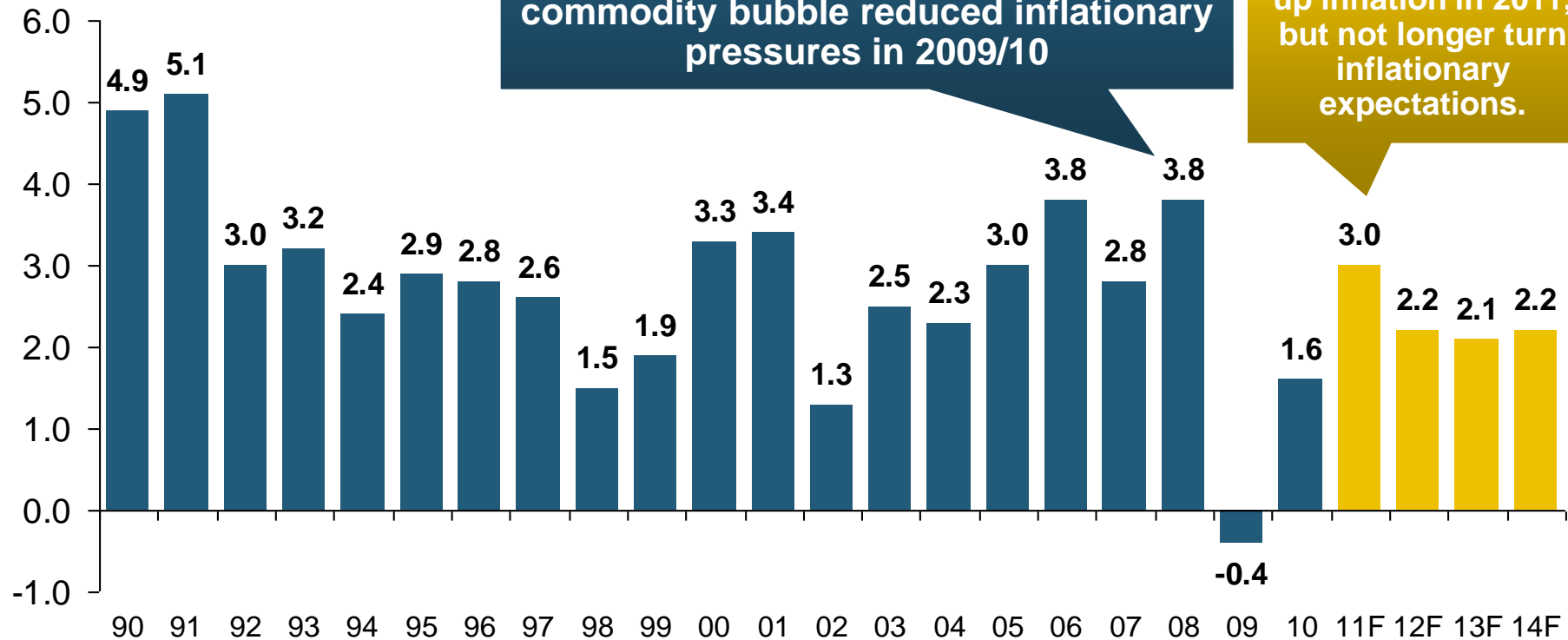
Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.

# 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

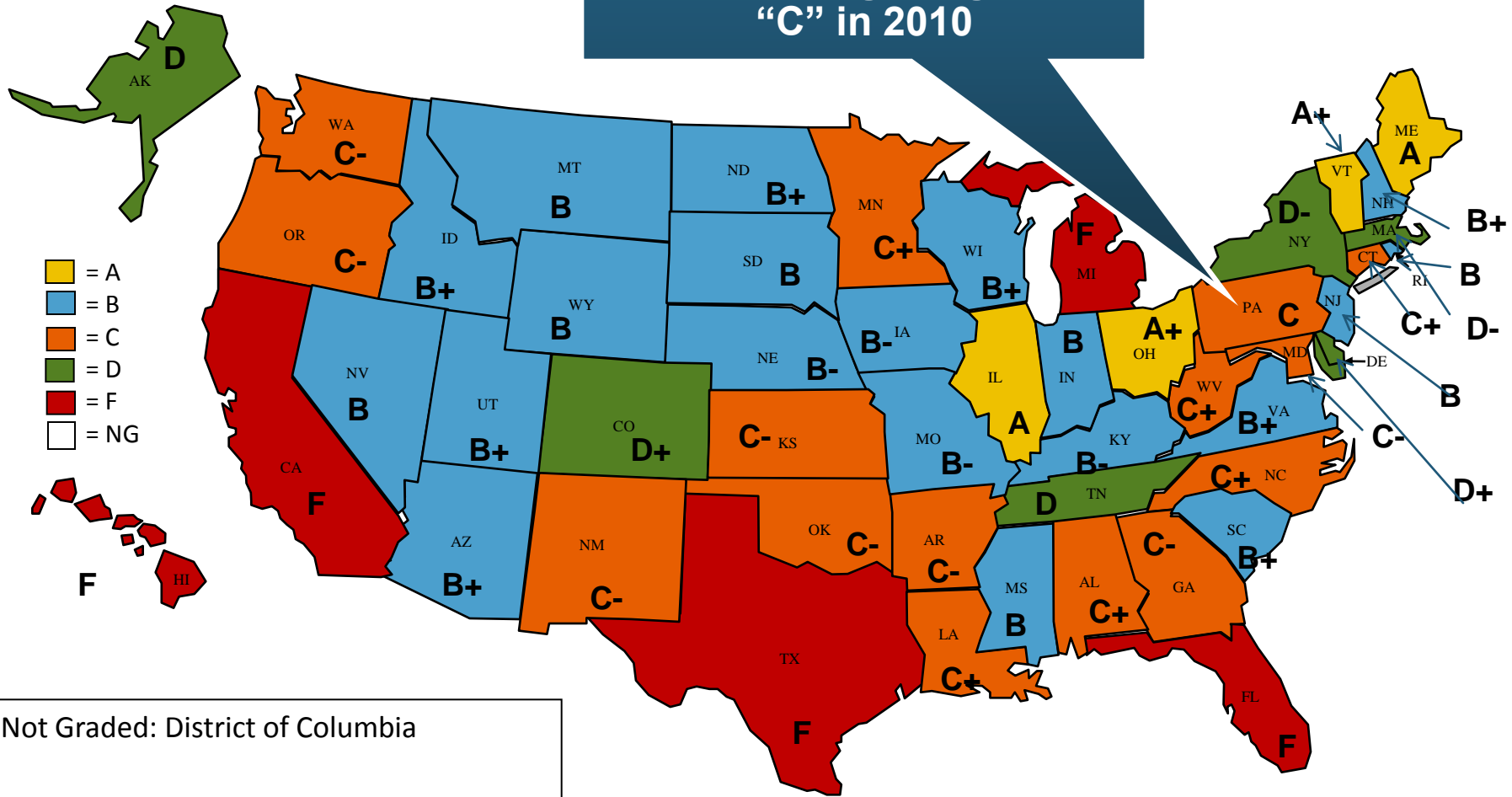


# Regulatory Environment & Financial Services Reform

**Insurers Not as Impacted as  
Banks, But Dodd-Frank  
Implementation Has Been a  
Concern for Insurers**

# 2010 Property and Casualty Insurance Regulatory Report Card

Pennsylvania's regulatory environment got a grade of "C" in 2010



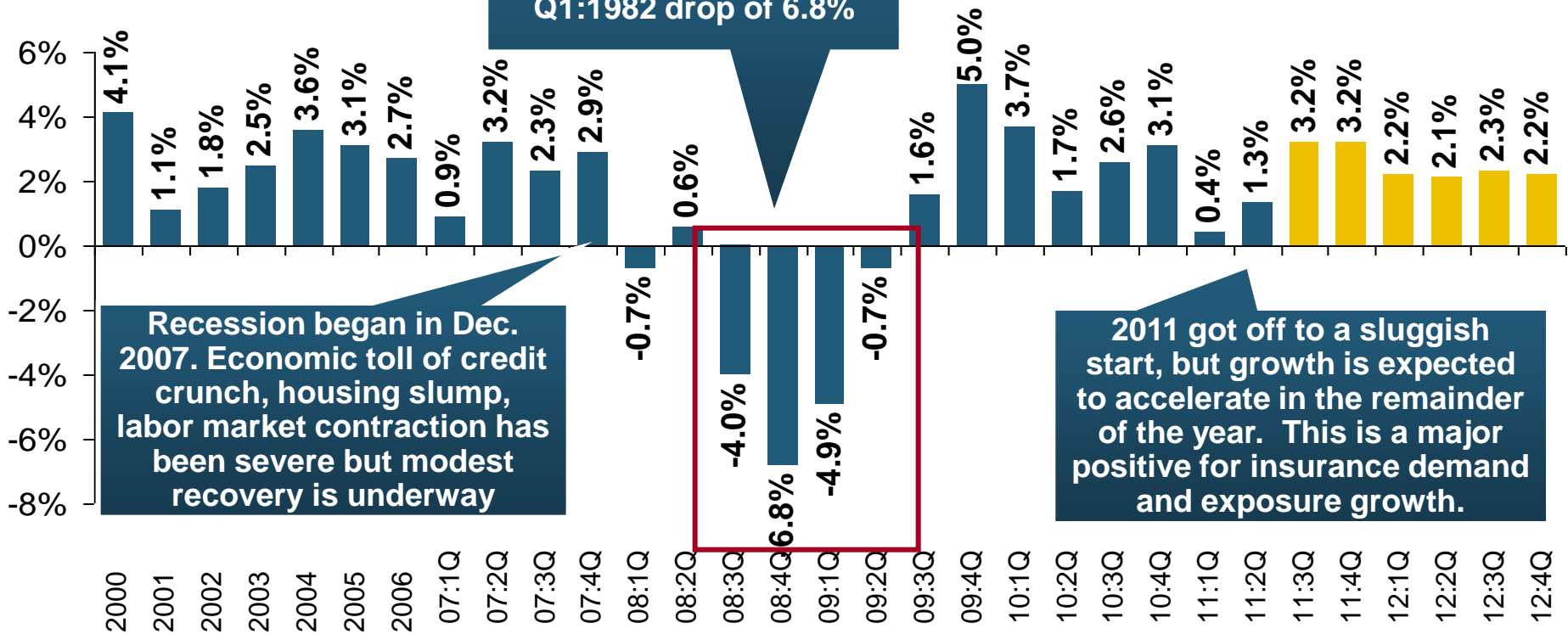
Not Graded: District of Columbia

# **The Strength of the Economy Will Influence P/C Insurer Growth Opportunities**

**Growth Would Also Help Absorb  
Excess Capital**

# 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.

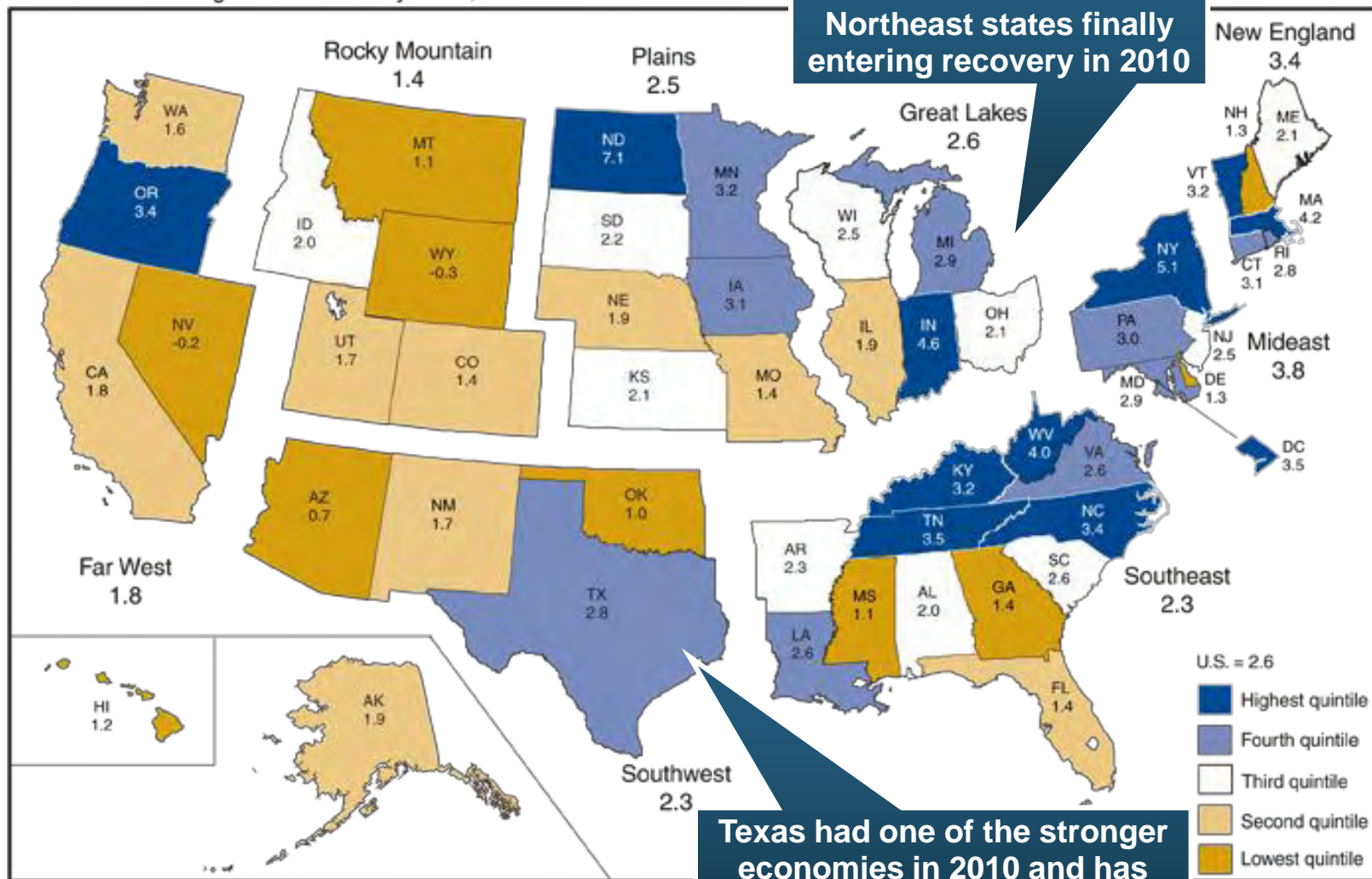
Source: US Department of Commerce, Blue Economic Indicators 7/11; Insurance Information Institute.



# 2011 Financial Overview

## State Economic Growth Varied in 2010

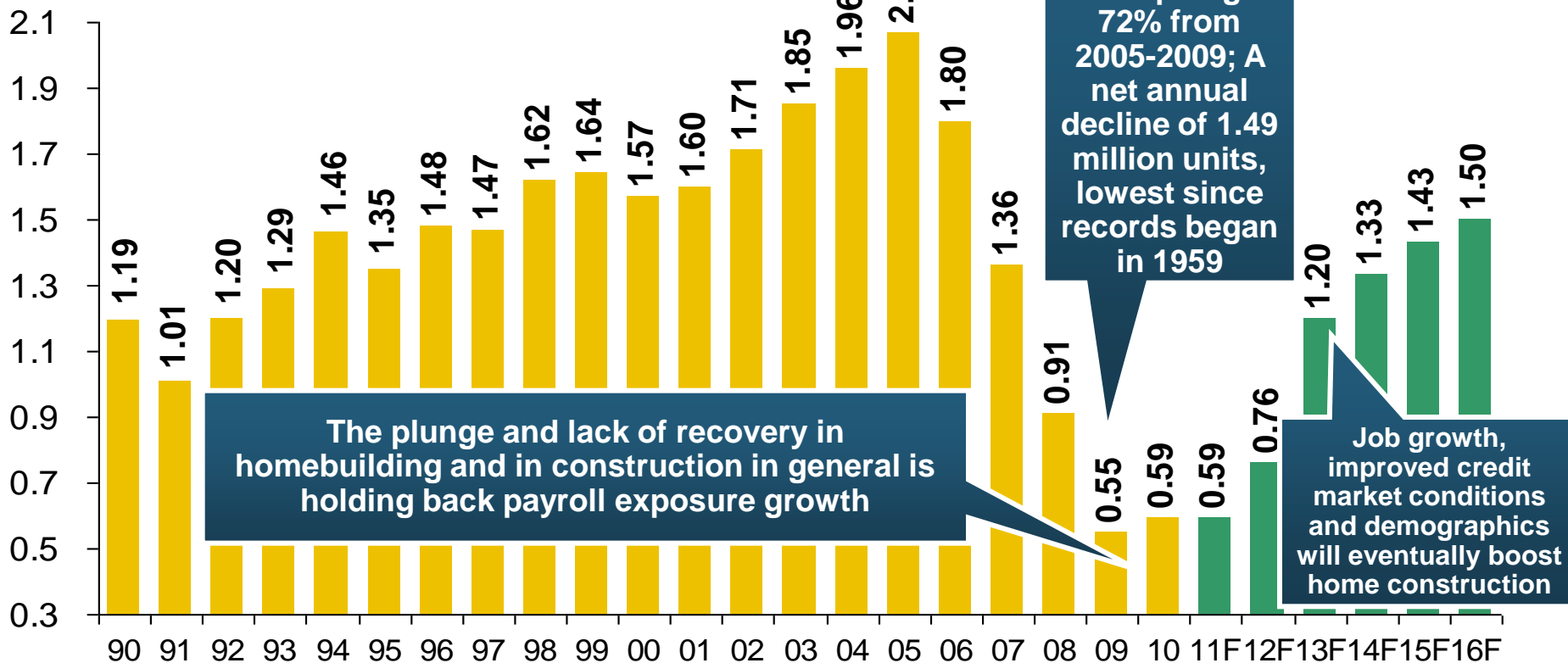
Chart 1. Percent Change in Real GDP by State, 2009-2010



U.S. Bureau of Economic Analysis

# New Private Housing Starts, 1990-2016F

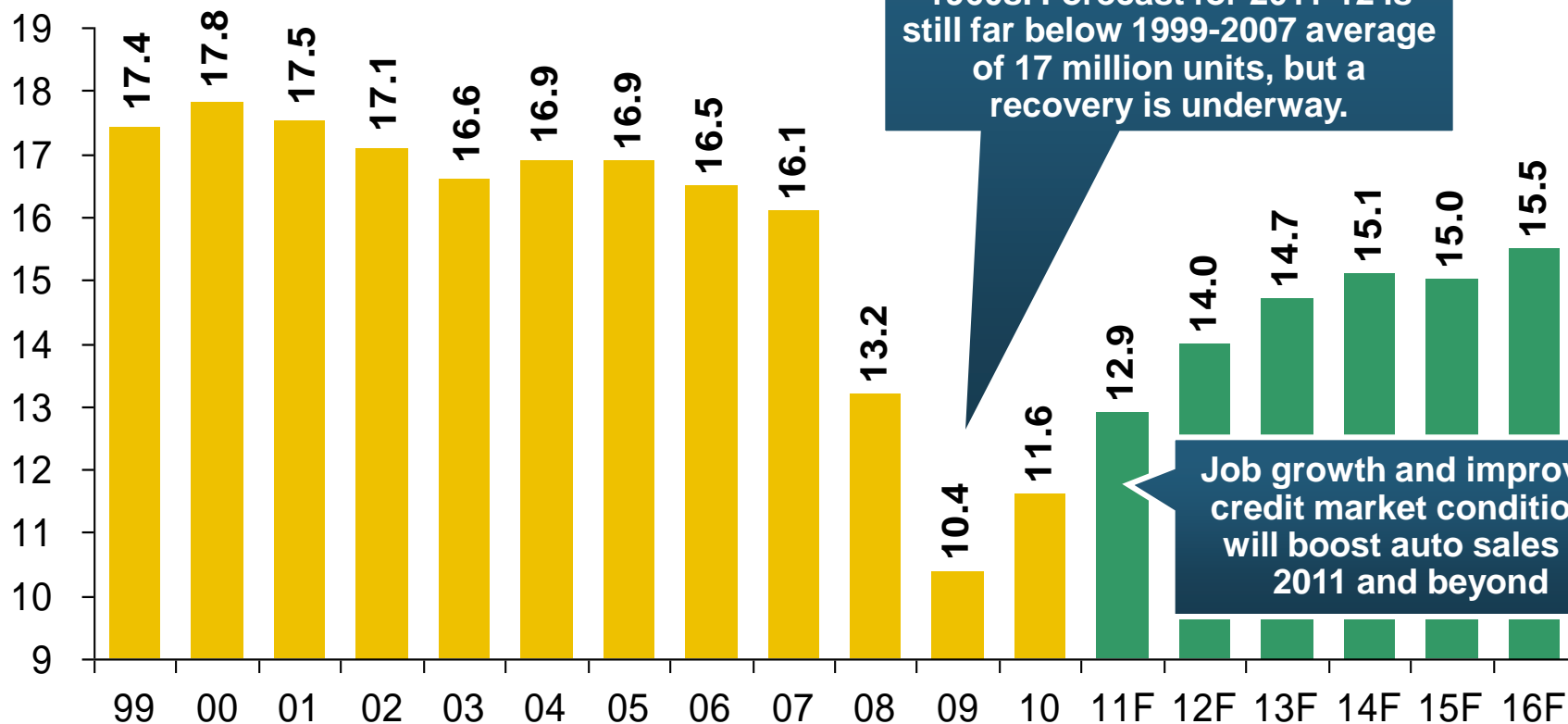
(Millions of Units)



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

# Auto/Light Truck Sales, 1999-2016F

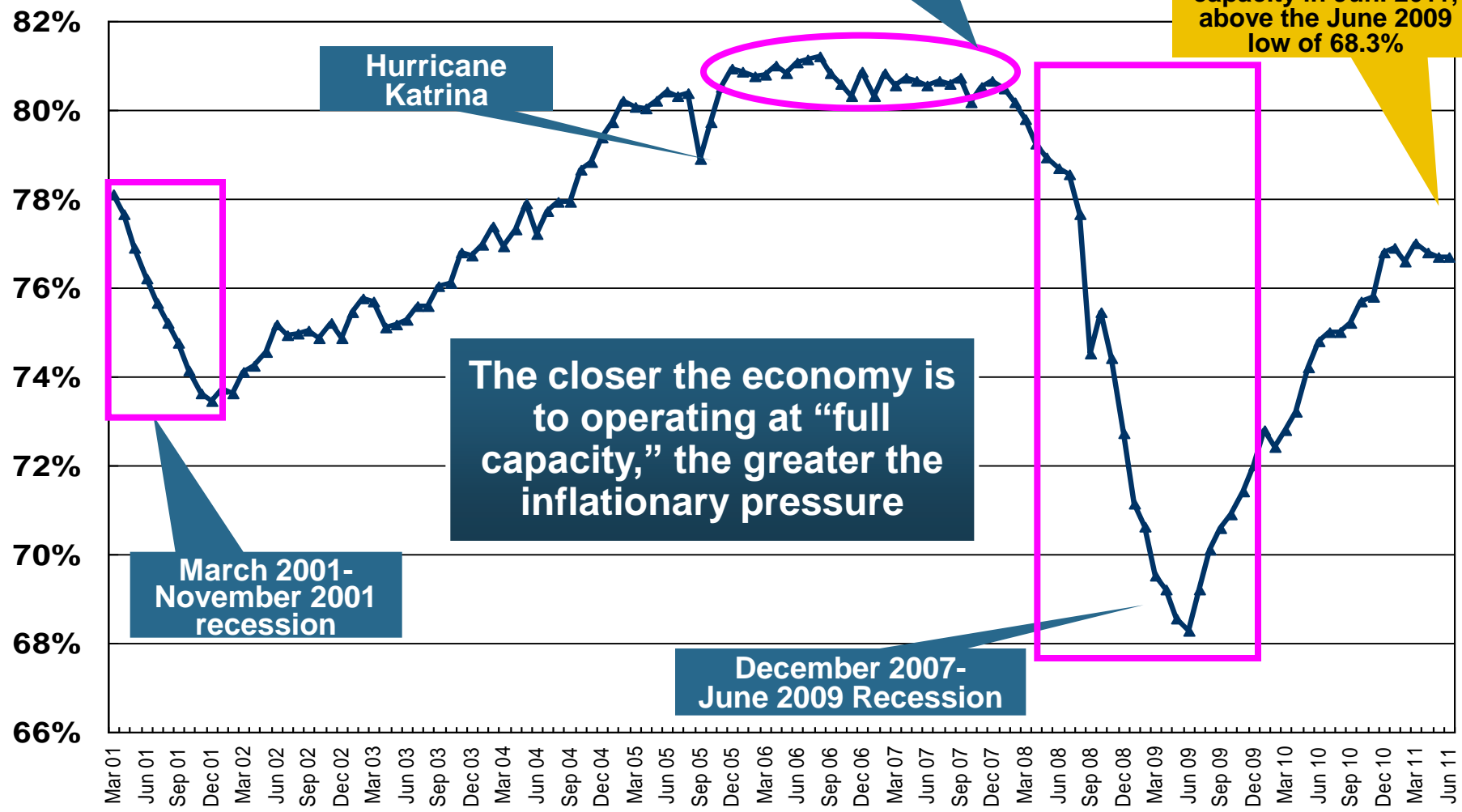
(Millions of Units)



**Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, Bolstering the Manufacturing Sector.**

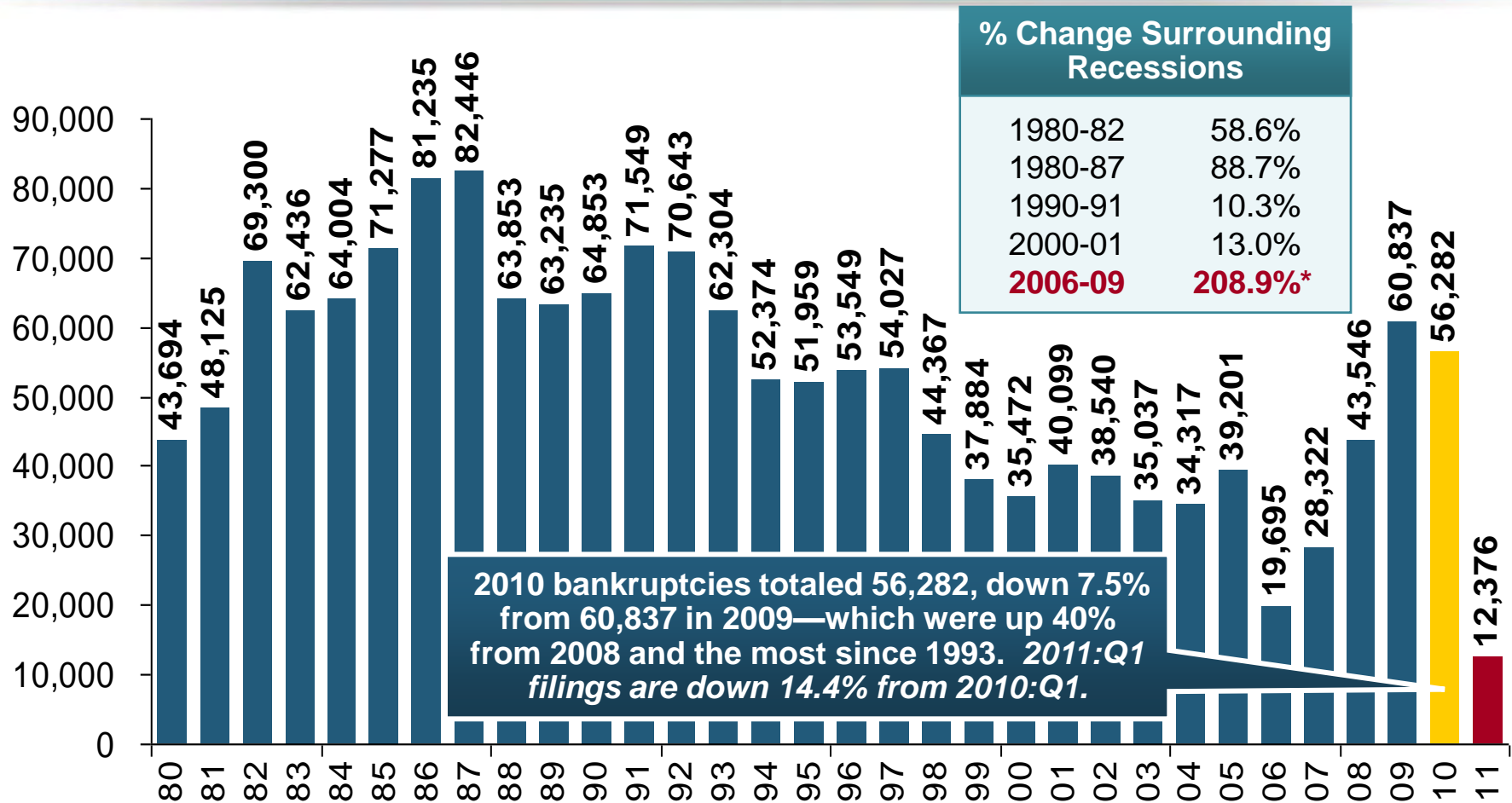
# Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

Percent of Industrial Capacity



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

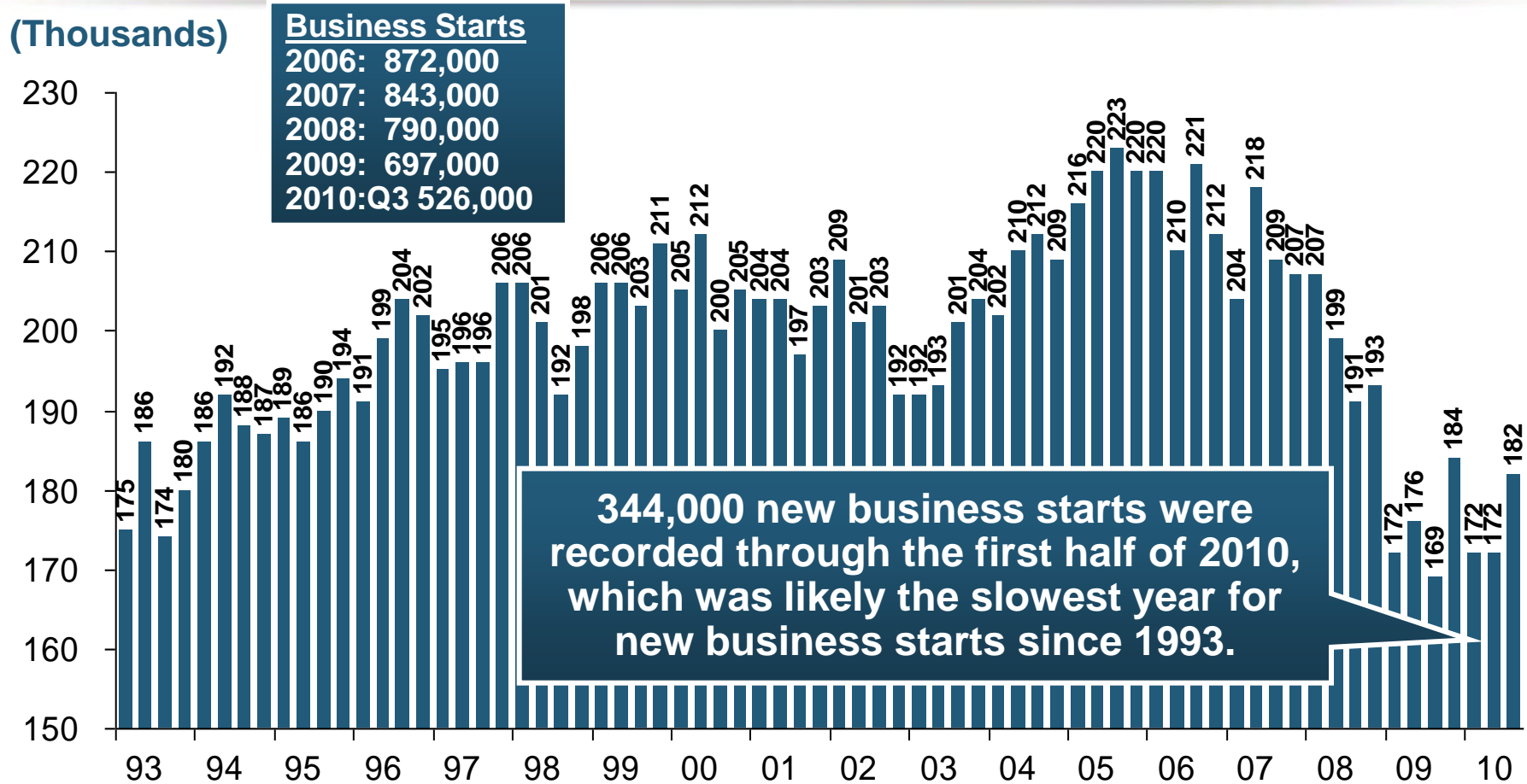
# Business Bankruptcy Filings, 1980-2011:Q1



**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 July 25, 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

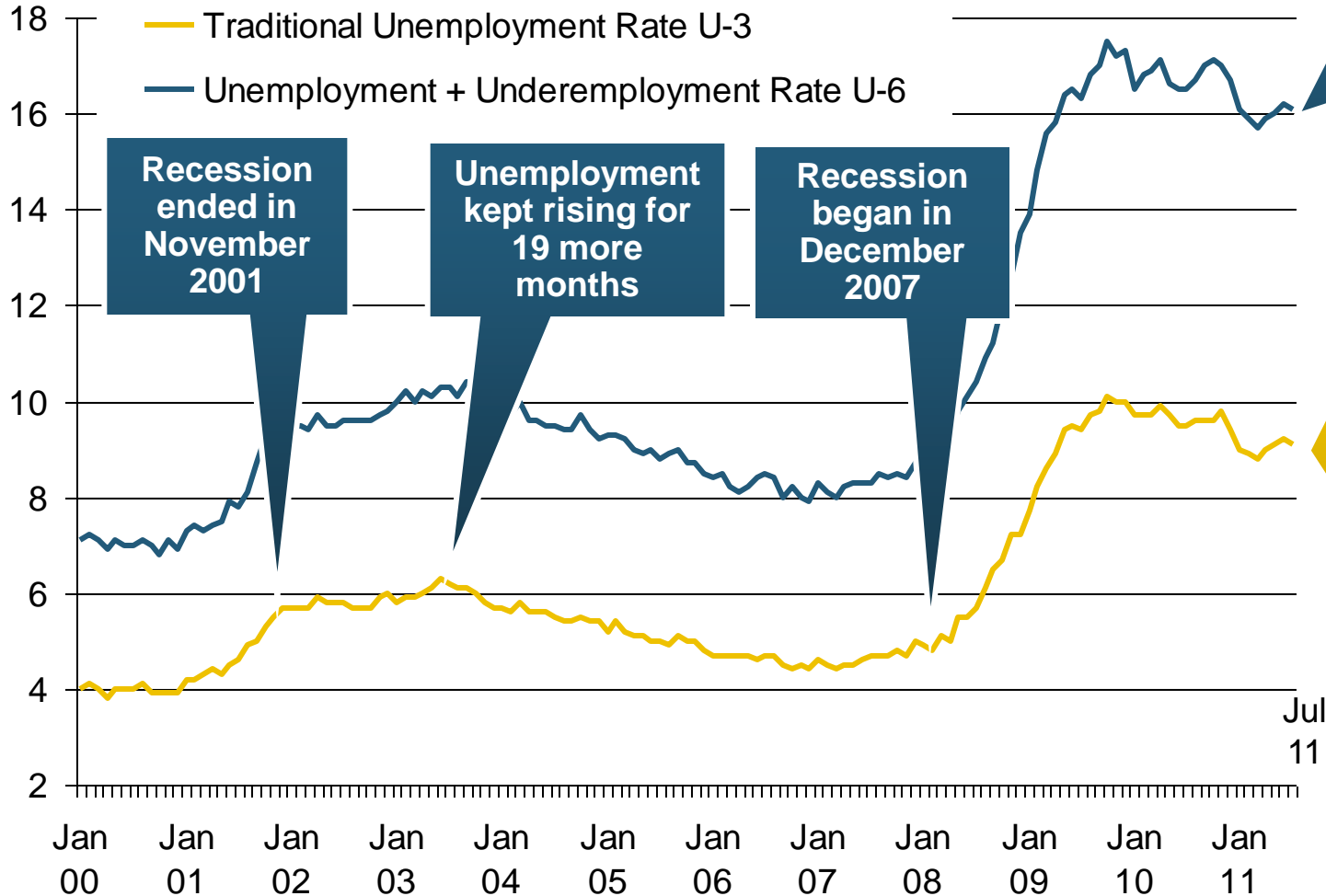
# Labor Market Trends

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



# Unemployment and Underemployment Rates: Stubbornly High in 2011

January 2000 through July 2011, Seasonally Adjusted (%)



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

U-6 went from 8.0% in March 2007 to 17.5% in October 2009; Stood at 16.1% in July 2011

Unemployment fell to 9.1% in June

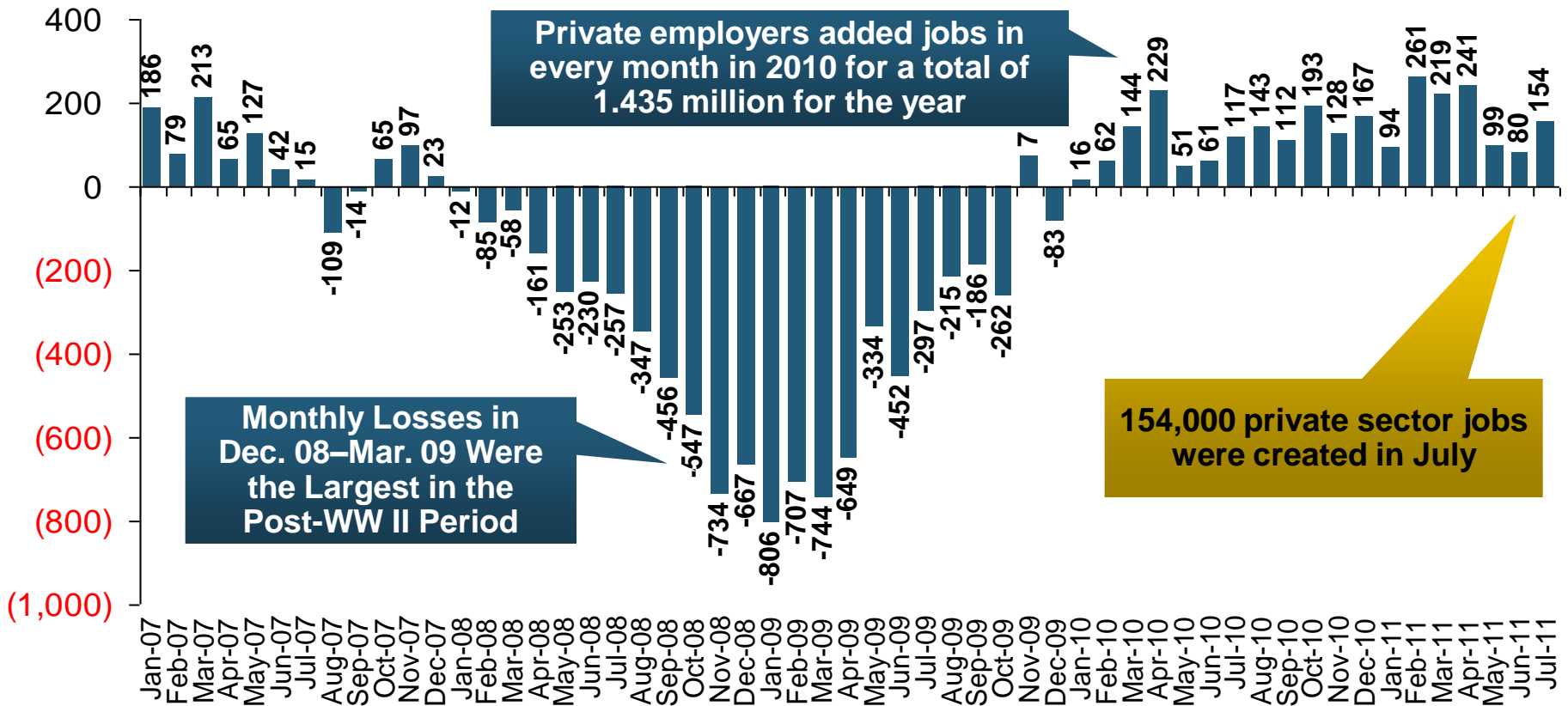
Unemployment peaked at 10.1% in October 2009, highest monthly rate since 1983.

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

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

# Monthly Change in Private Employment

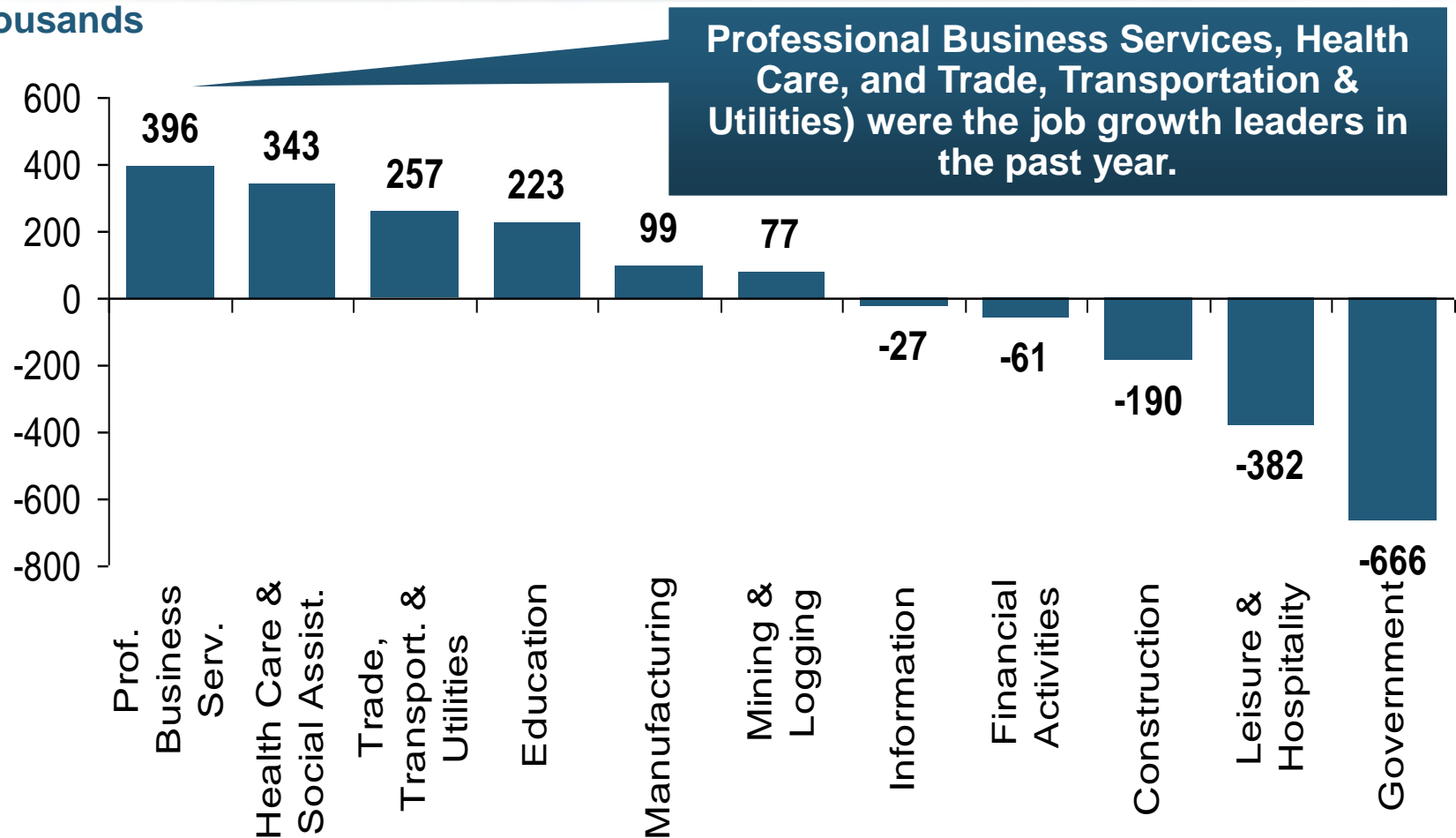
January 2008 through July 2011\* (Thousands)



**Private Employers Added 2.368 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)**

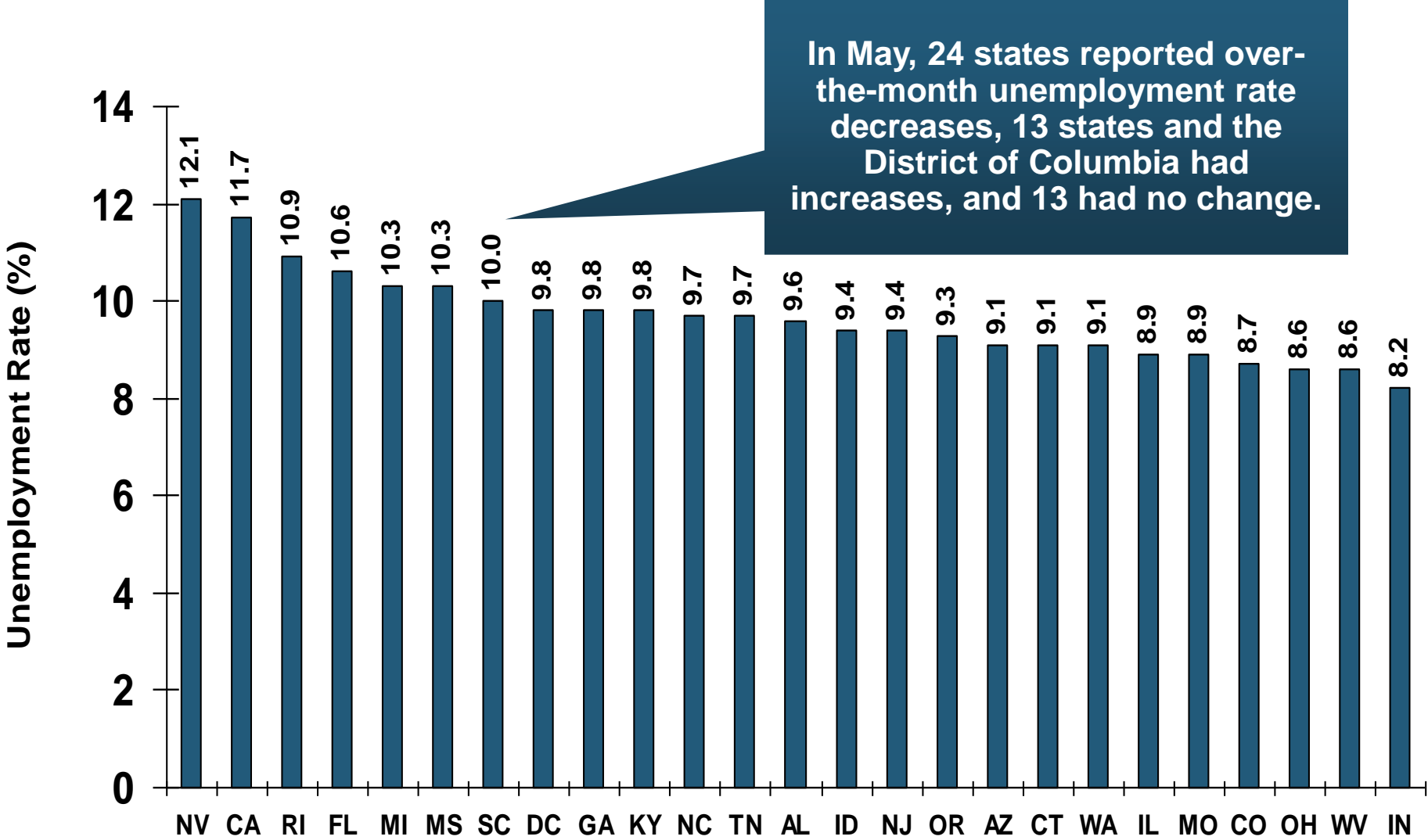
# Change in Number Employed in Select Industries, June 2011 vs. June 2010

Thousands



**There is a great deal of variation in employment growth by industry, indicating a very uneven and slow recovery**

# Unemployment Rates by State, May 2011: Highest 25 States\*



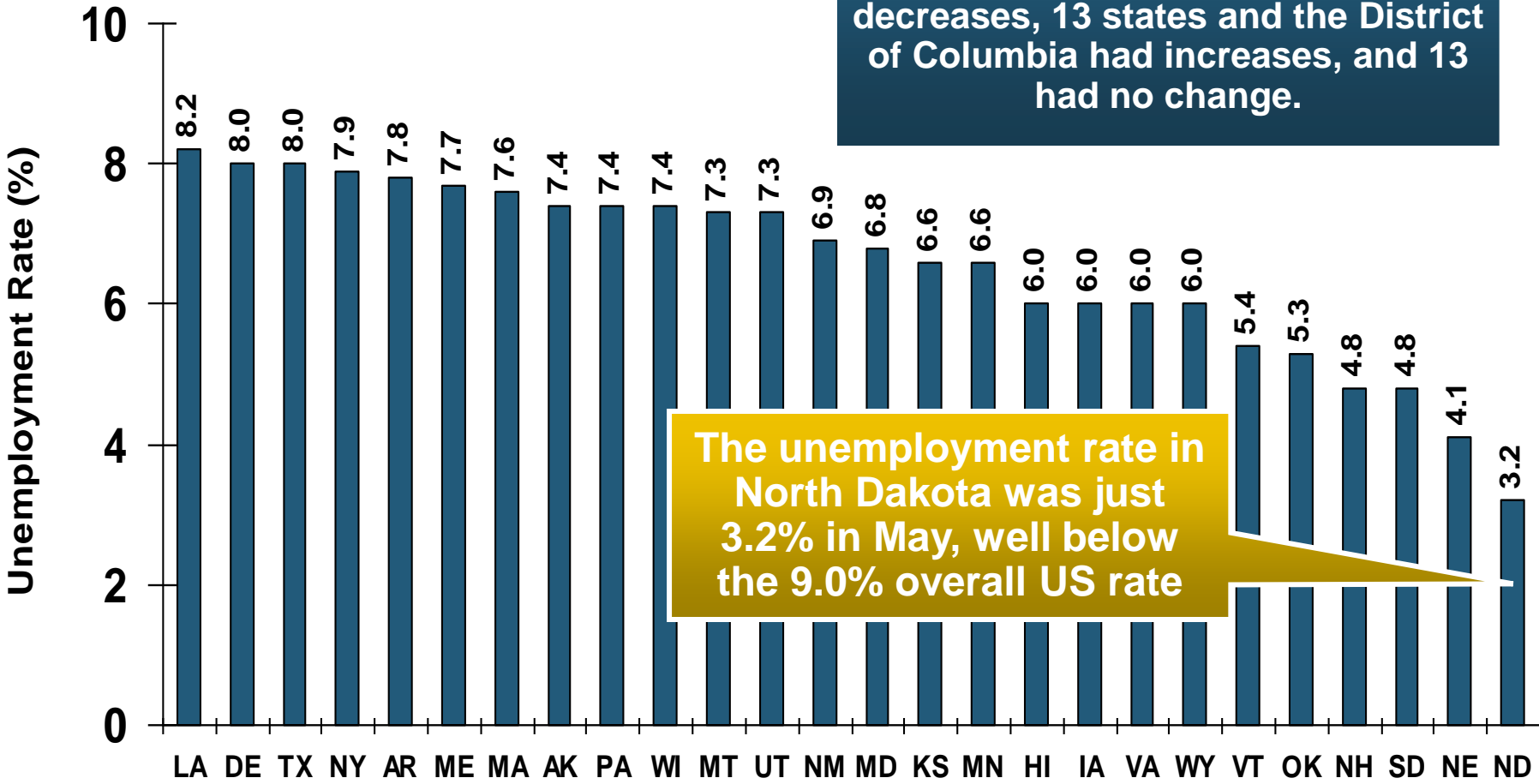
\*Provisional figures for May 2011, seasonally adjusted.

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

# Unemployment Rates By State, May 2011: Lowest 25 States\*



In May, 24 states reported over-the-month unemployment rate decreases, 13 states and the District of Columbia had increases, and 13 had no change.



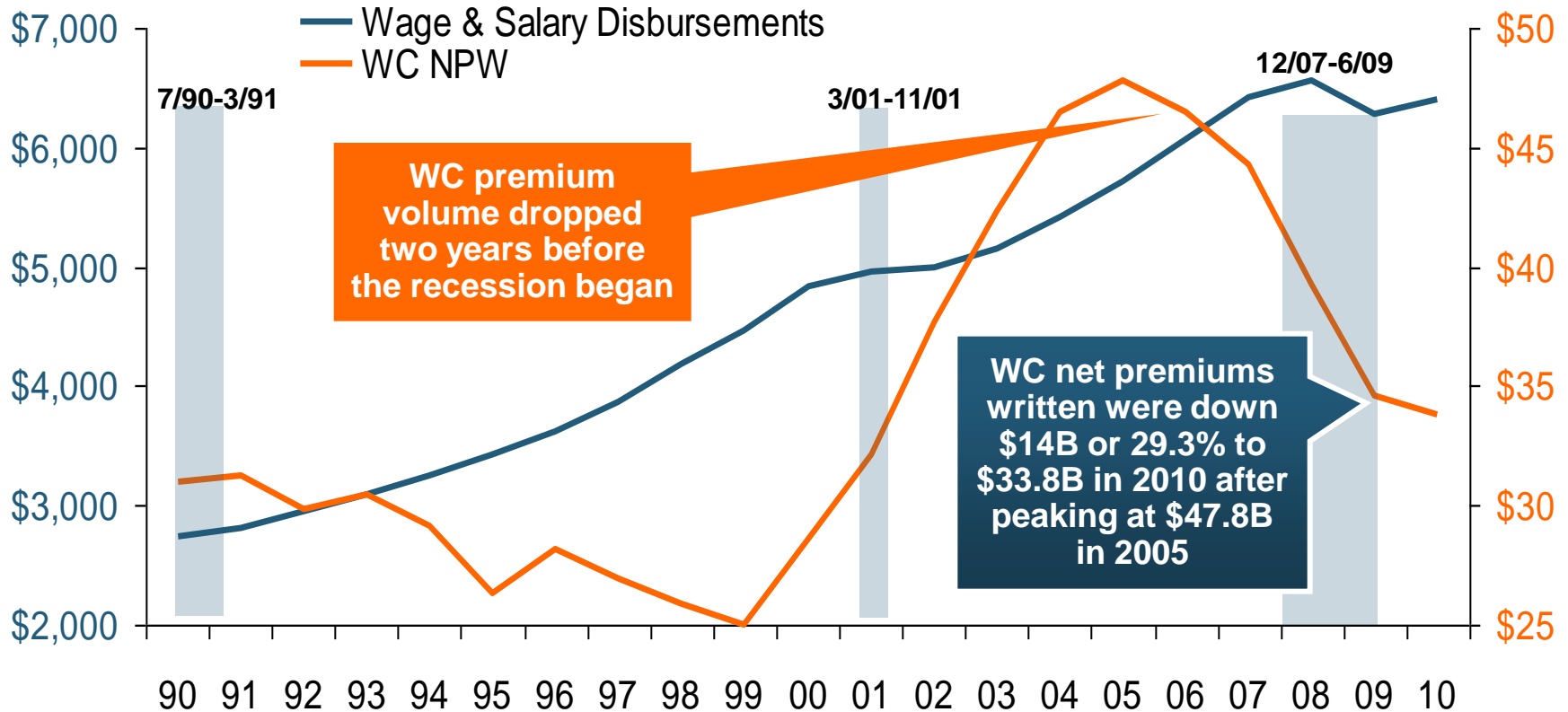
The unemployment rate in North Dakota was just 3.2% in May, well below the 9.0% overall US rate

\*Provisional figures for May 2011, seasonally adjusted.  
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

# Wage and Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums

Payroll Base\*  
\$Billions

WC NWP  
\$Billions



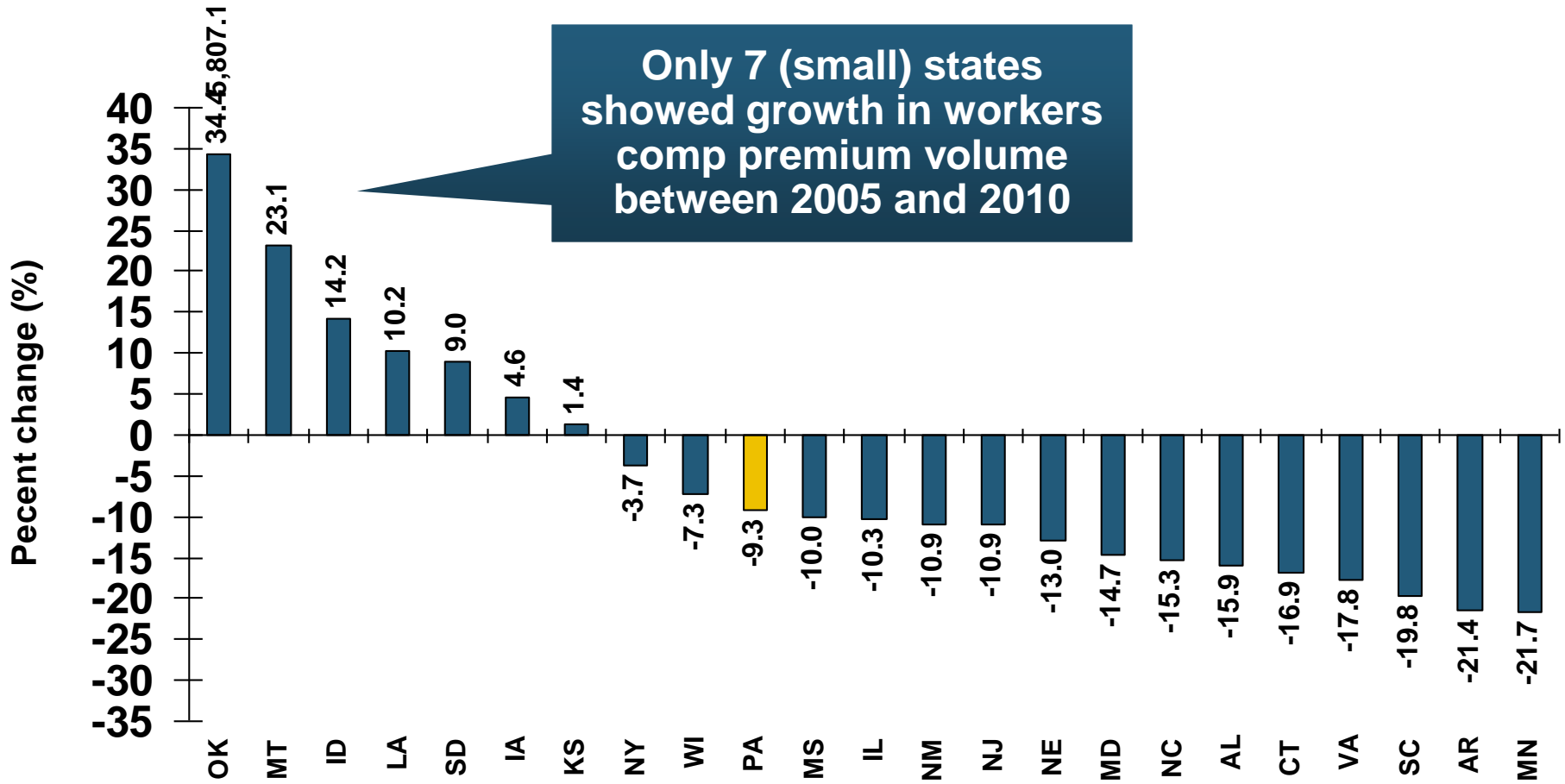
**29% of NPW has been eroded away by the soft market and weak economy**

\*Private employment; Shaded areas indicate recessions.

Sources: NBER (recessions); Federal Reserve Bank of St. Louis at <http://research.stlouisfed.org/fred2/series/WASCUR> ; NCCI; I.I.I.

# Direct Premiums Written: Worker's Comp Percent Change by State, 2005-2010\*

## Top 25 States

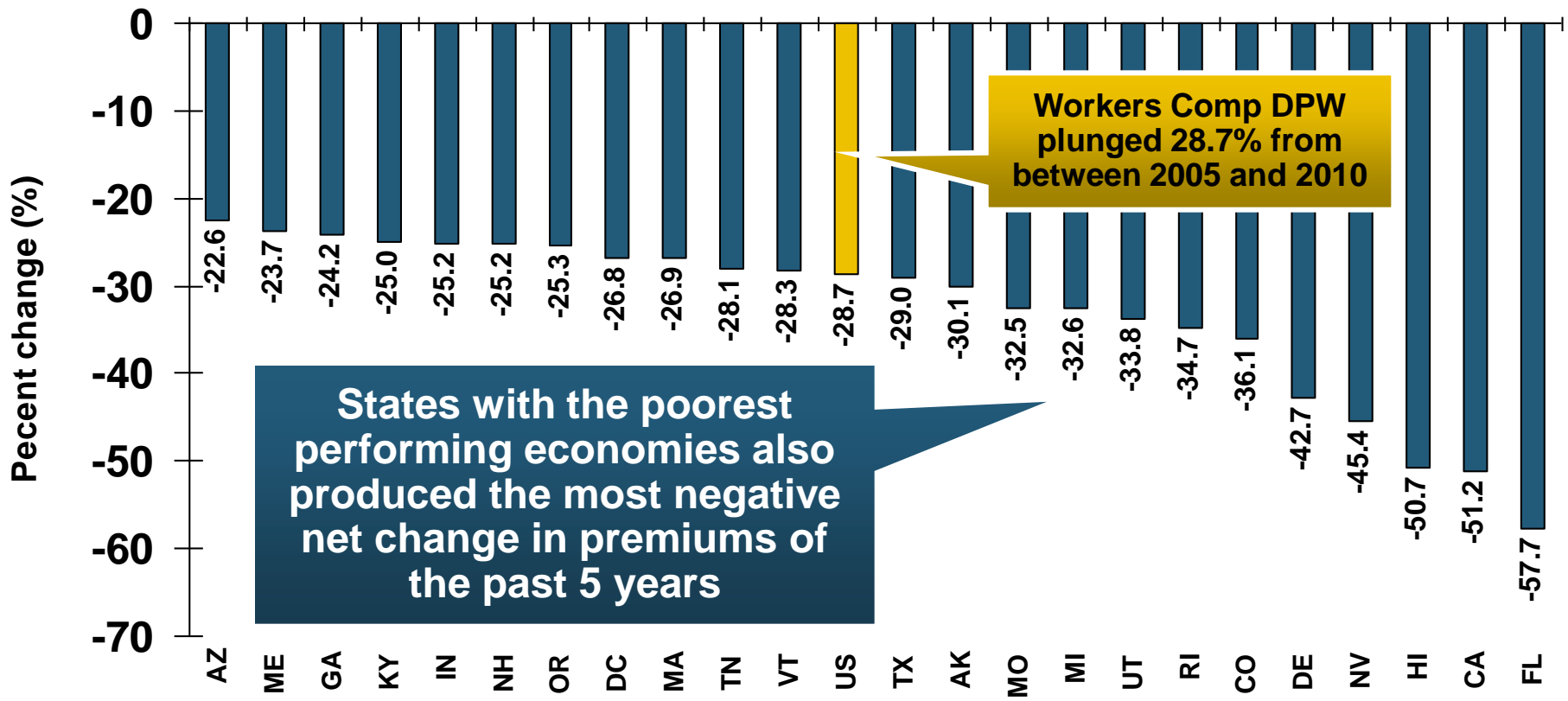


\*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: Worker's Comp Percent Change by State, 2005-2010\*

## Bottom 25 States



\*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.



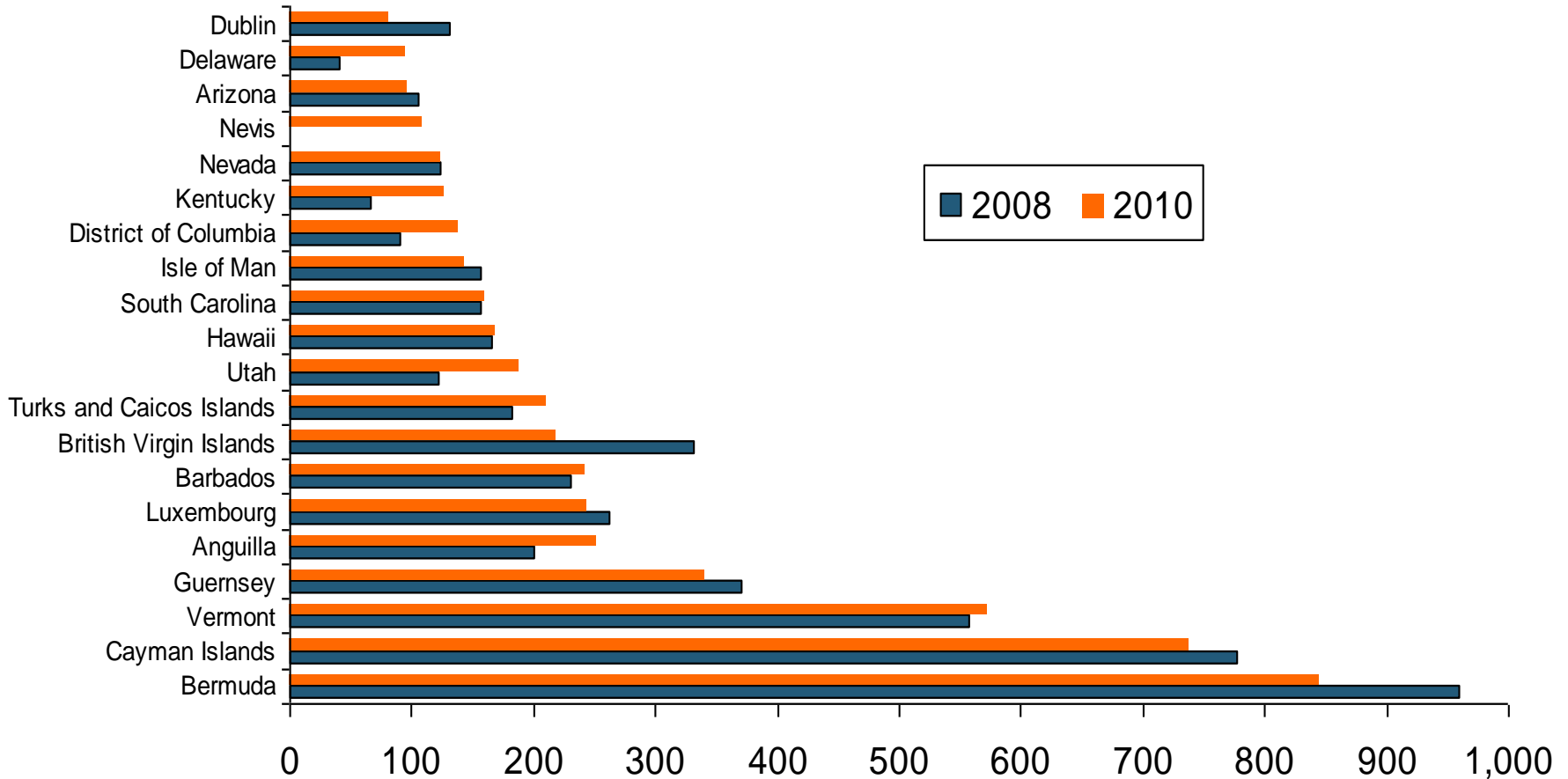
Insurance Information Institute Online:

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

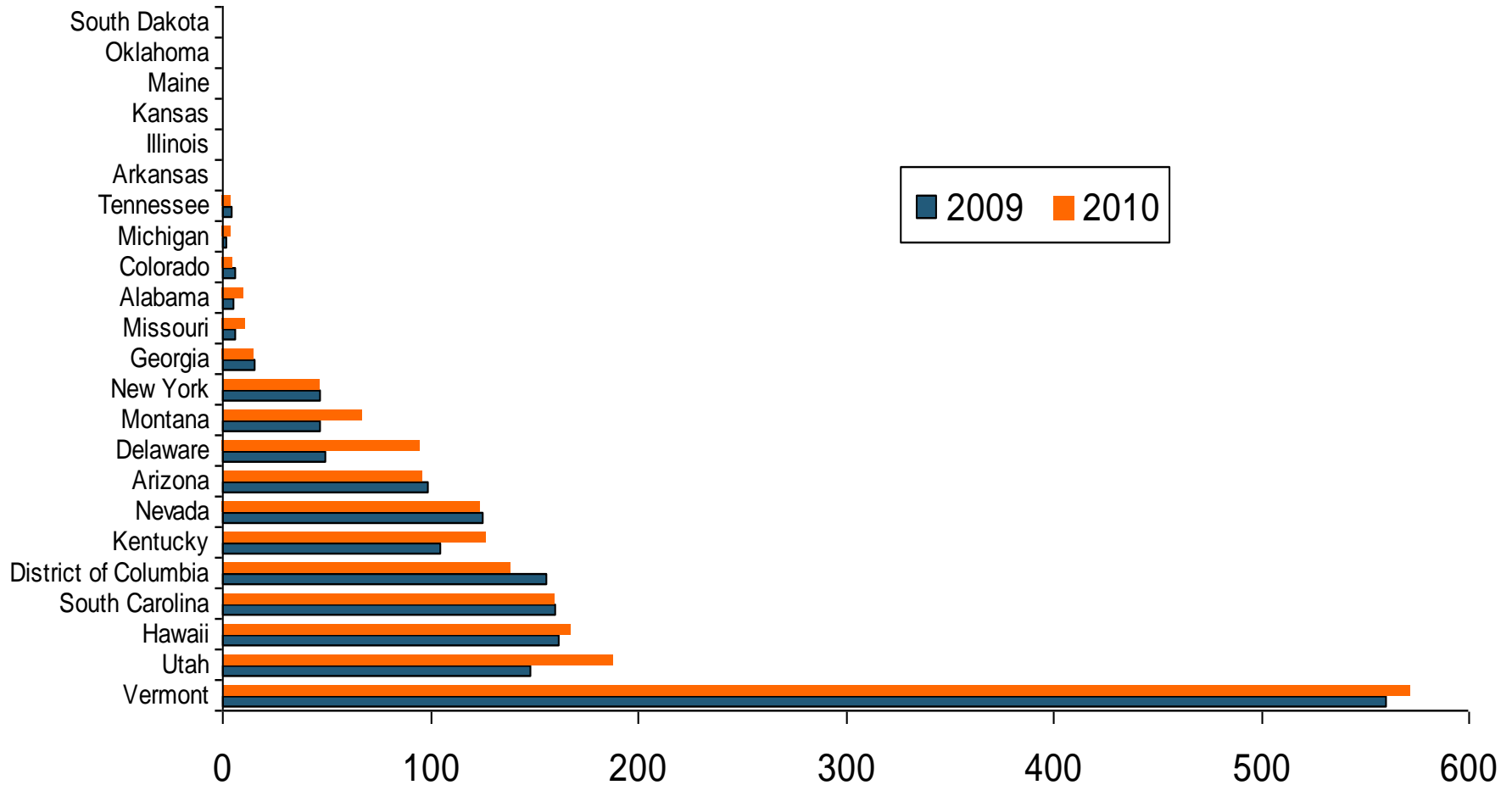
*Thank you for your time  
and your attention!*

*Twitter: [twitter.com/bob\\_hartwig](https://twitter.com/bob_hartwig)*

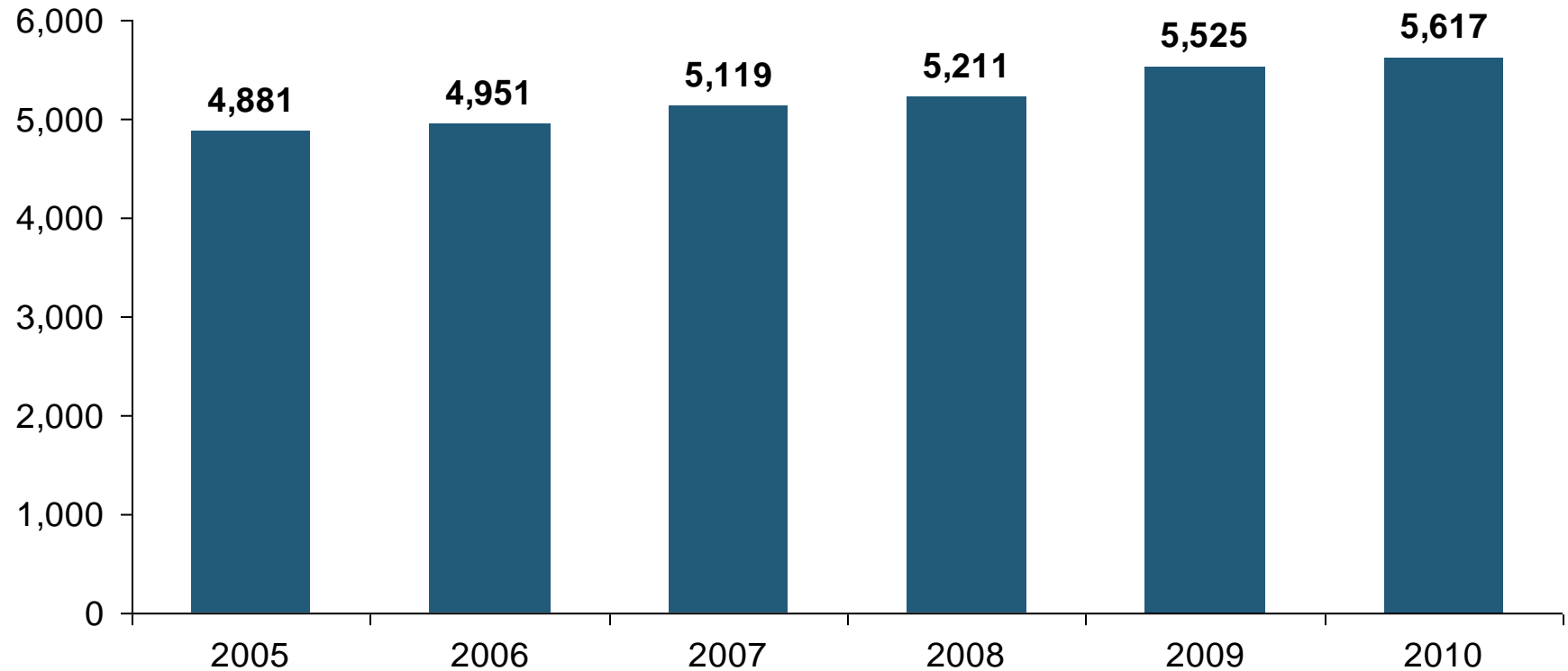
# Leading Captive Domiciles, 2008-2010



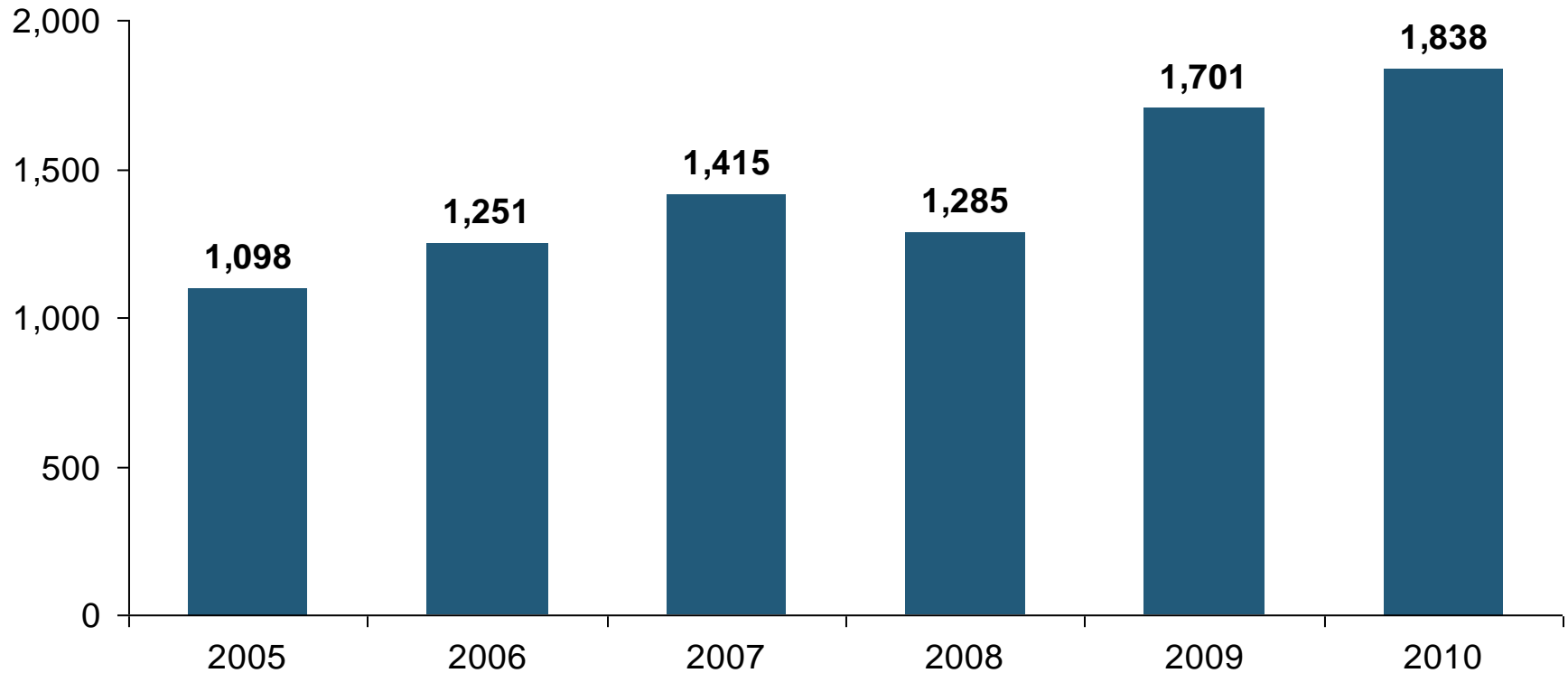
# Captives by State, 2009-2010



# World Captive Growth, 2005-2010



# State Captive Growth, 2005-2010

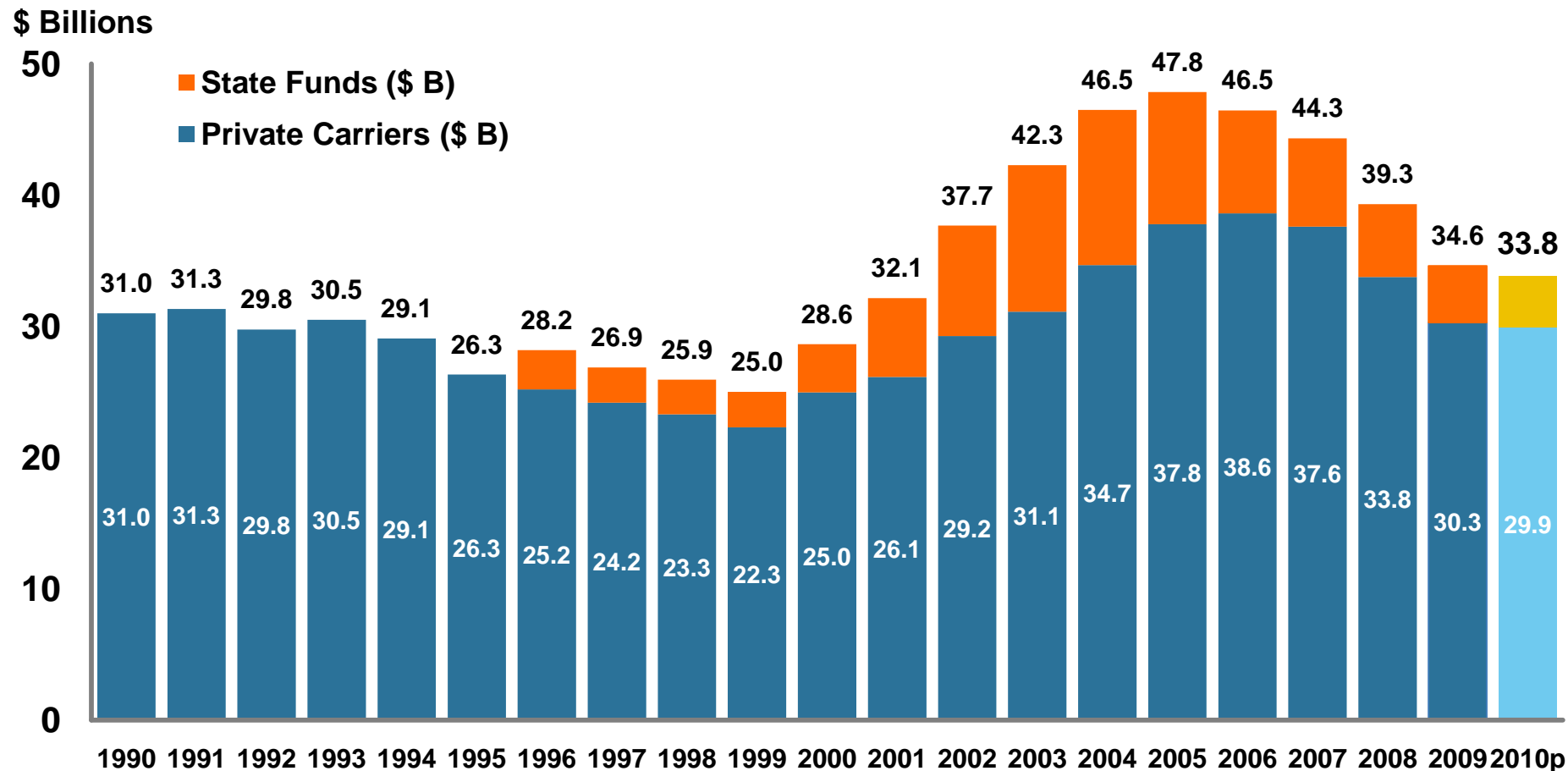


# **Workers Compensation Operating Environment**

**The Weak Economy and Soft Market Have  
Made the Workers Comp Operating  
Increasingly Challenging**

# Workers Compensation Premium Continues Its Sharp Decline

## Net Written Premium



p Preliminary

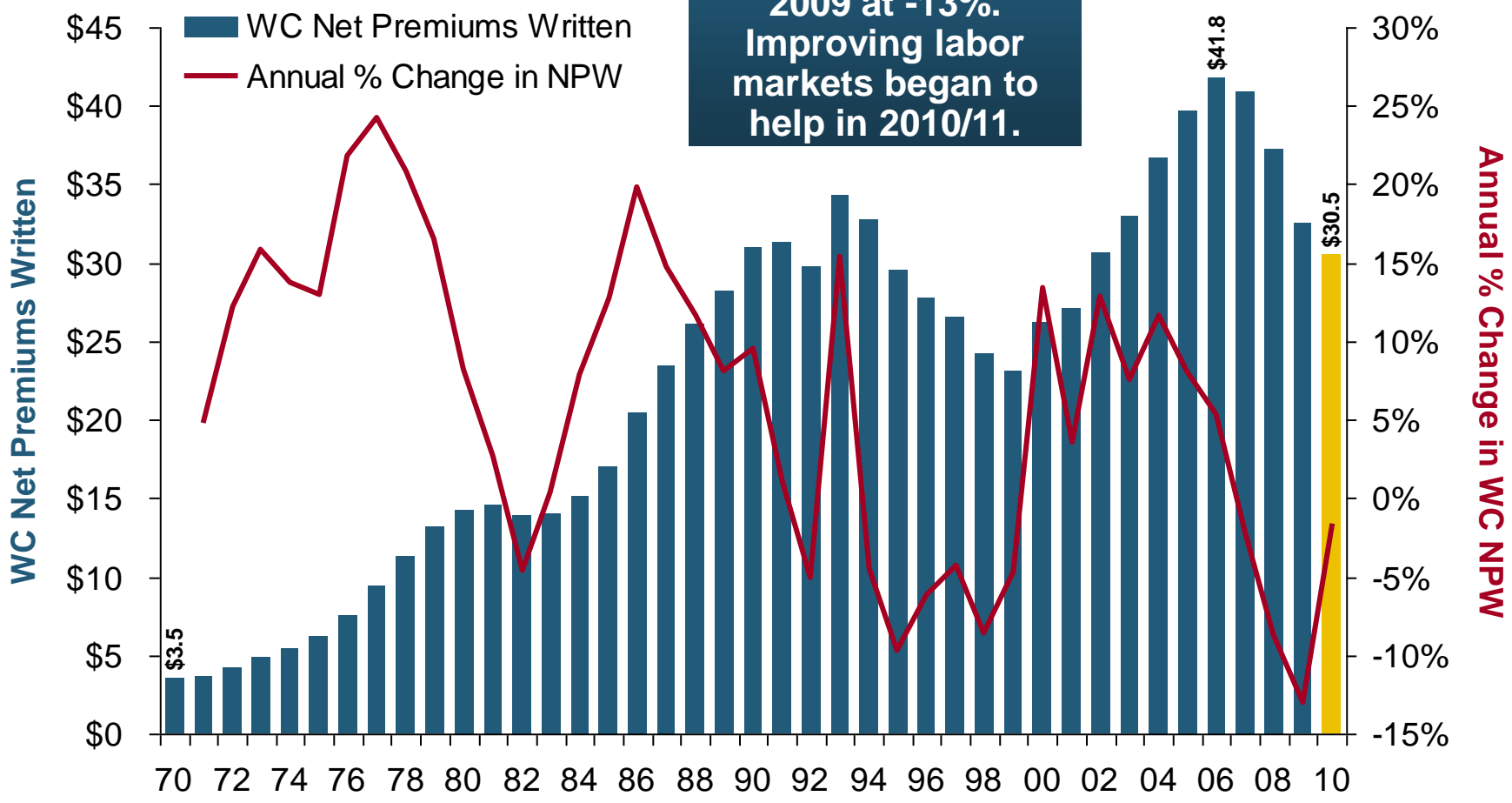
Source: 1990–2009 Private Carriers, *Best's Aggregates & Averages*; 2010p, NCCI

1996–2010p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements

State Funds available for 1996 and subsequent

# Workers Compensation Net Premiums Written and Annual Growth Rates: 1970-2010P

(\$ Billions)



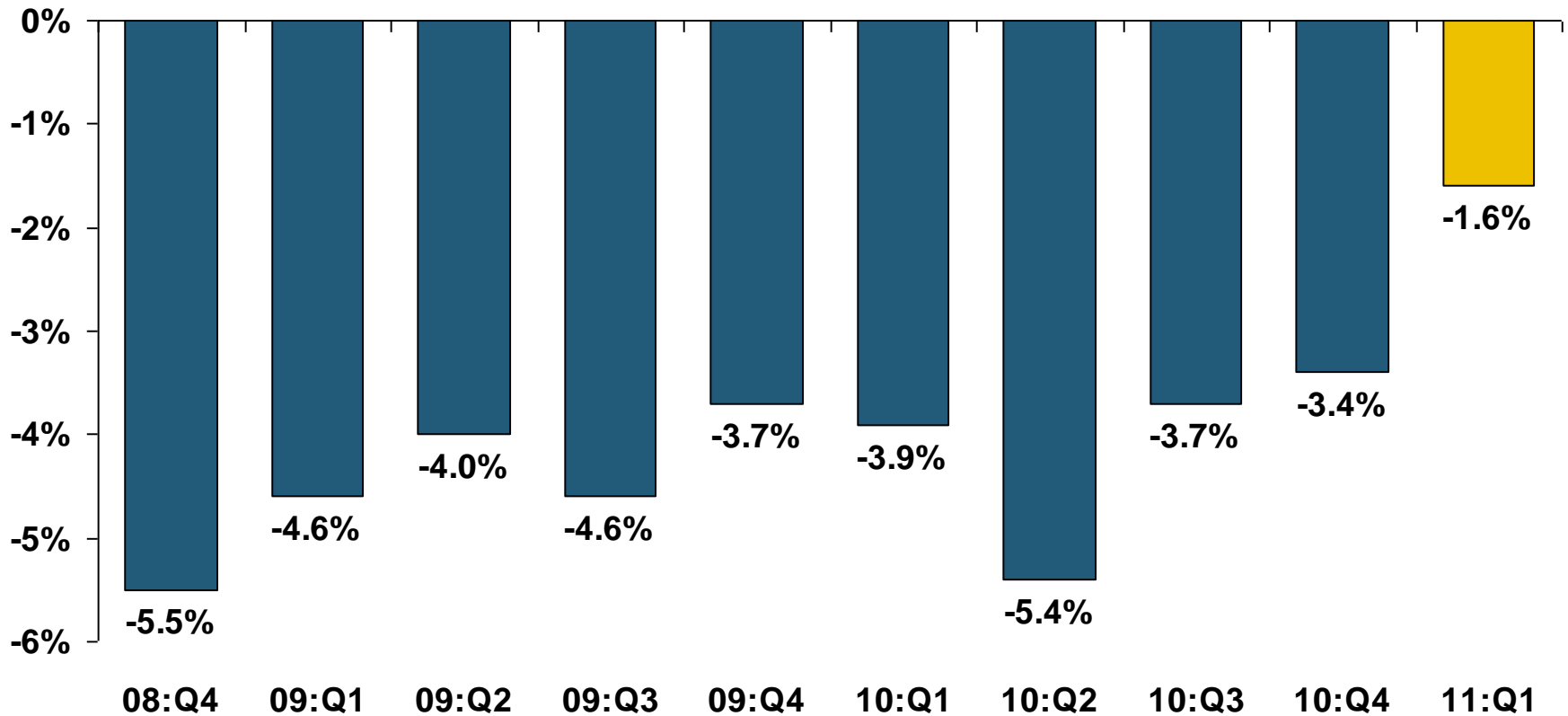
Sources: A.M. Best (1973-2009); Insurance Information Institute calculations and estimates for 2010.



# Workers Comp Rate Changes, 2008:Q4 – 2011:Q1

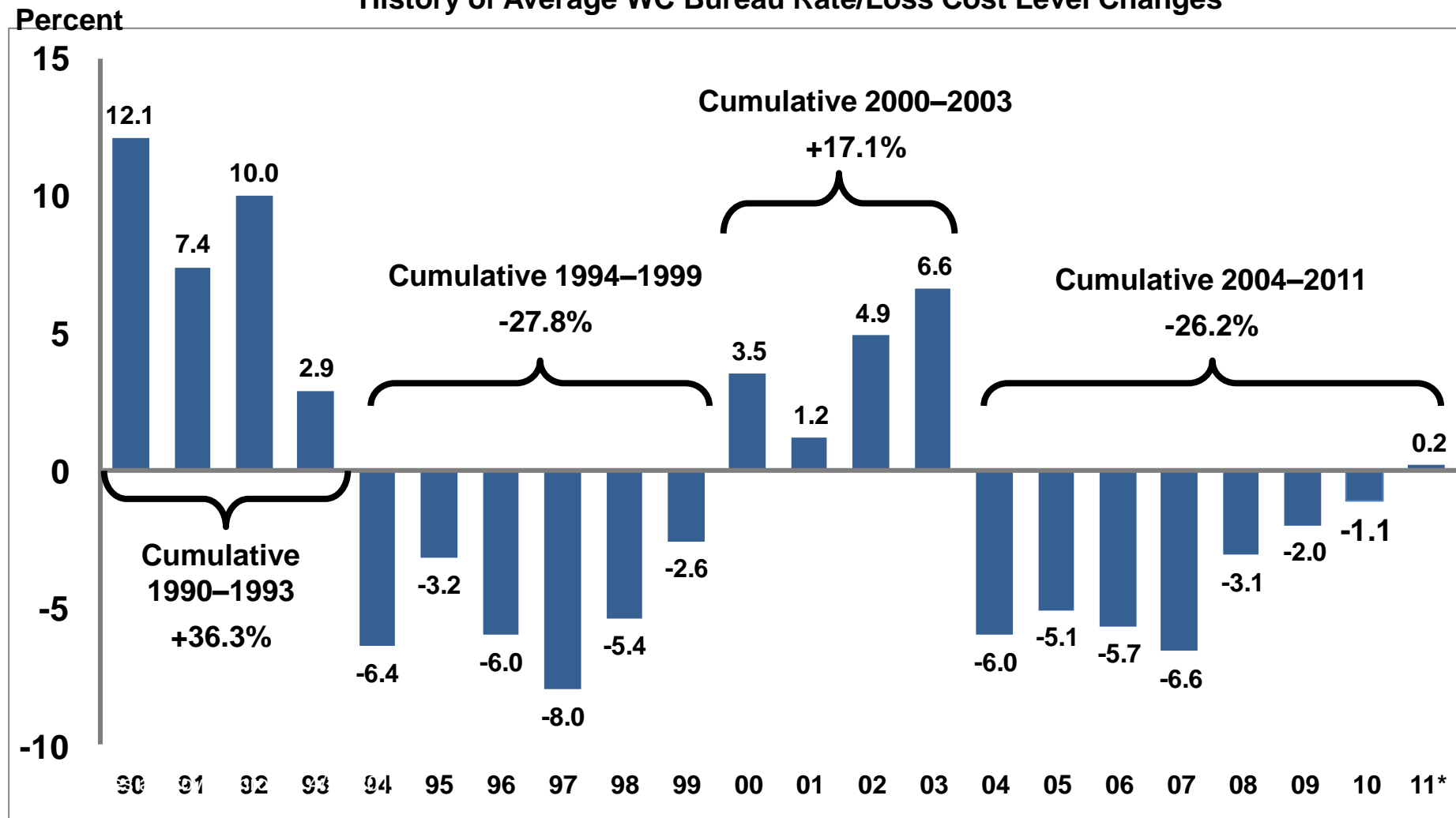
(Percent  
Change)

The Q1 2011 WC rate change was the smallest decrease in many years



# Average Approved Bureau Rates/Loss Costs

## History of Average WC Bureau Rate/Loss Cost Level Changes



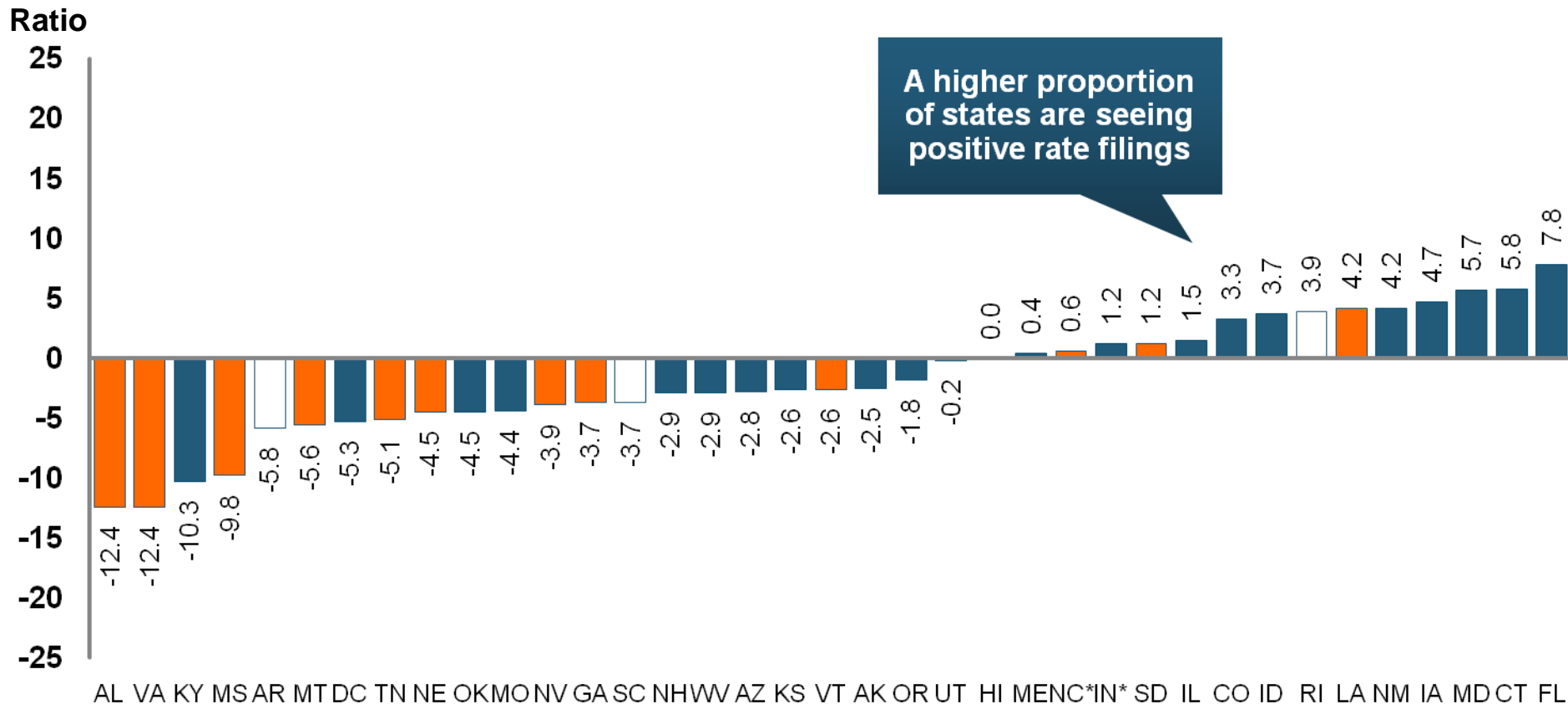
\*States approved through 4/8/11.

Note: Countrywide approved changes in advisory rates, loss costs and assigned risk rates as filed by applicable rating organization.

Source: NCCI.

# Current NCCI Voluntary Market Filed Rate/Loss Cost Changes

Excludes Law-Only Filings



■ Effective Dates 1/1/2011 and Prior   ■ Effective Dates Subsequent to 1/1/2011   □ Filed and Pending

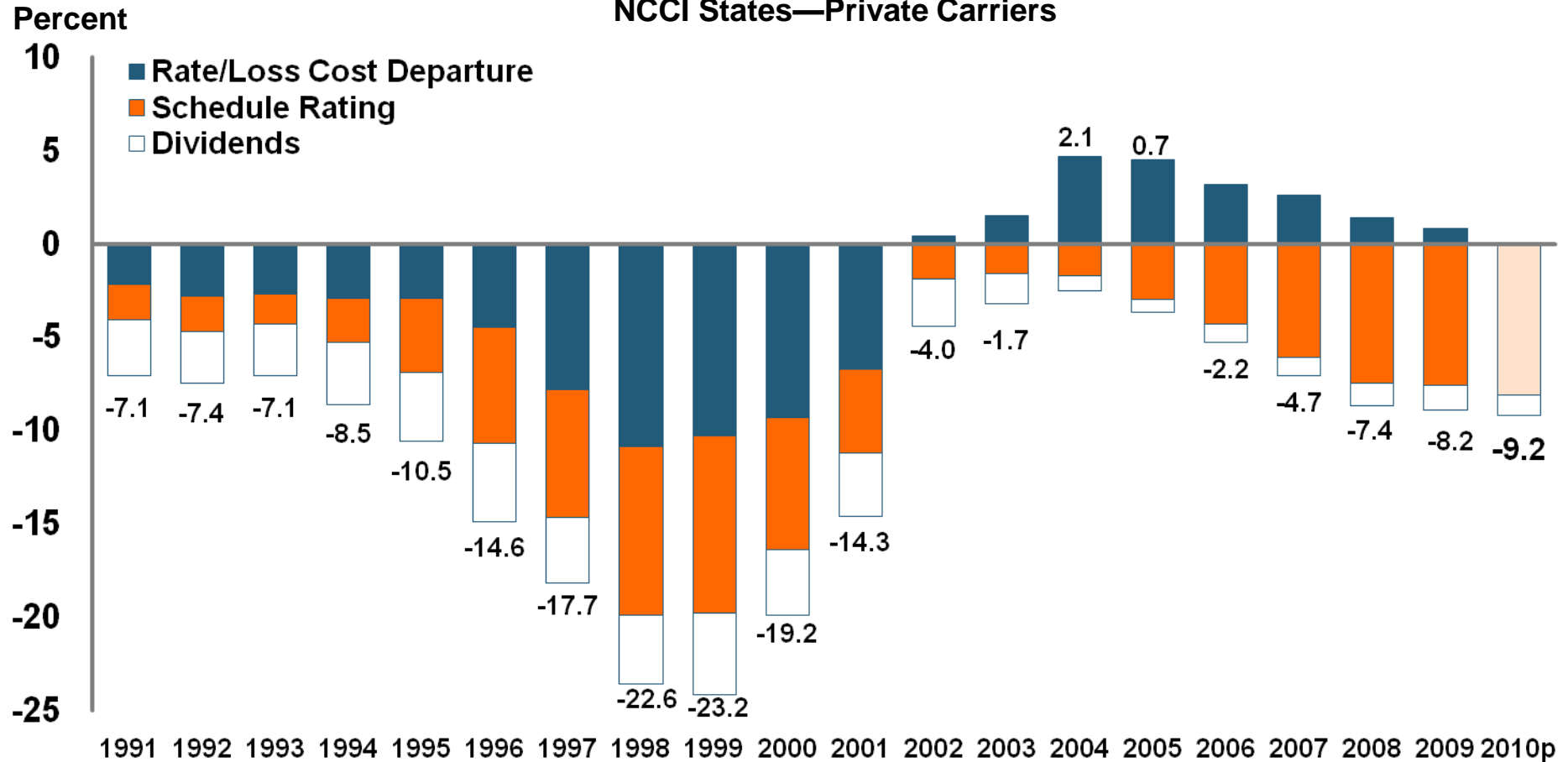
States filed through 4/15/2011

•IN and NC filed in cooperation with state rating bureau

Source: NCCI

# Impact of Discounting on Workers Compensation Premium

## NCCI States—Private Carriers



p Preliminary

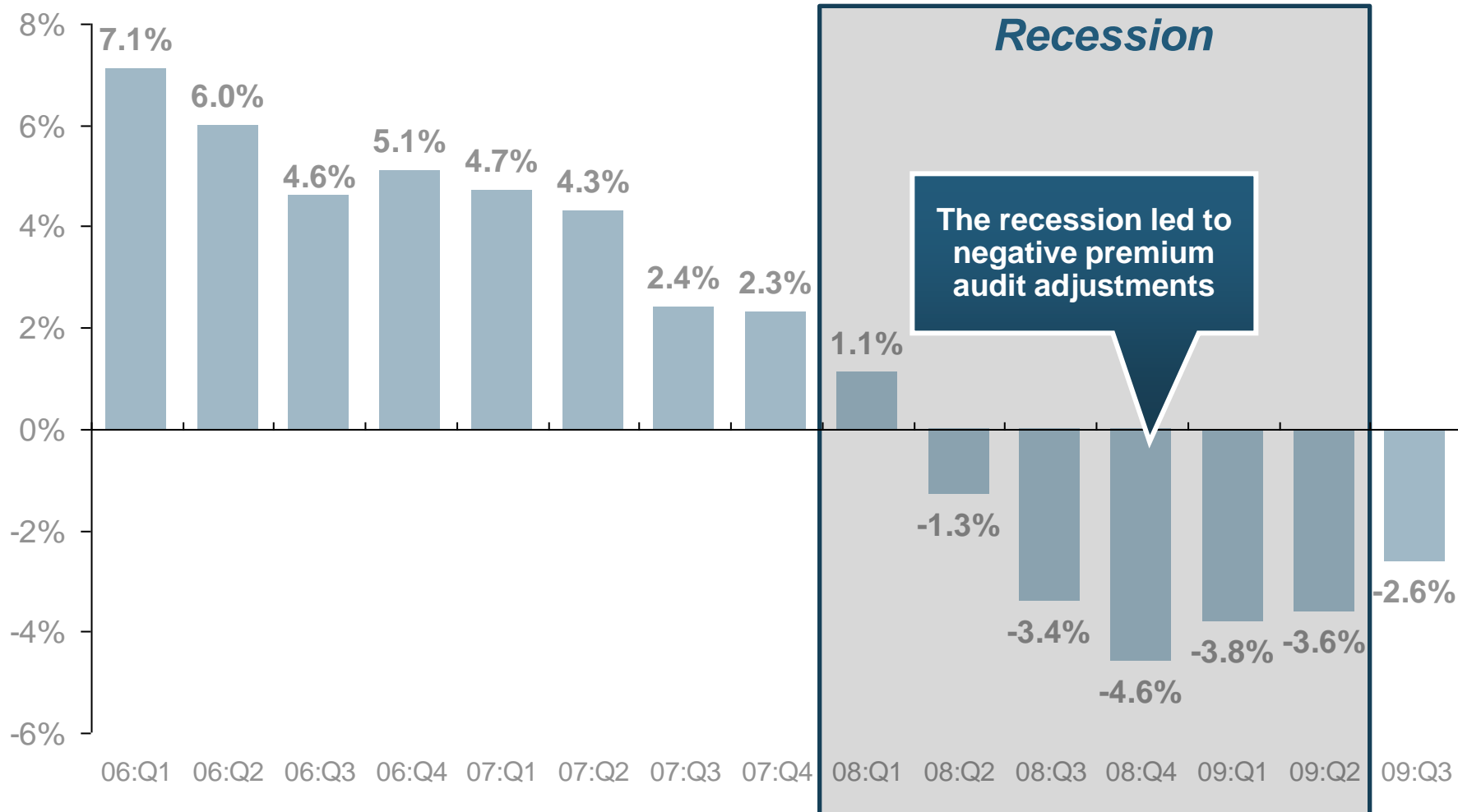
Dividend ratios are based on calendar year statistics

NCCI benchmark level does not include an underwriting contingency provision

Based on data through 12/31/2010 for the states where NCCI provides ratemaking services

Source: NCCI

# Final Premium vs. Estimated Premium by Policy Effective Quarter: 2006:Q1 – 2009:Q3



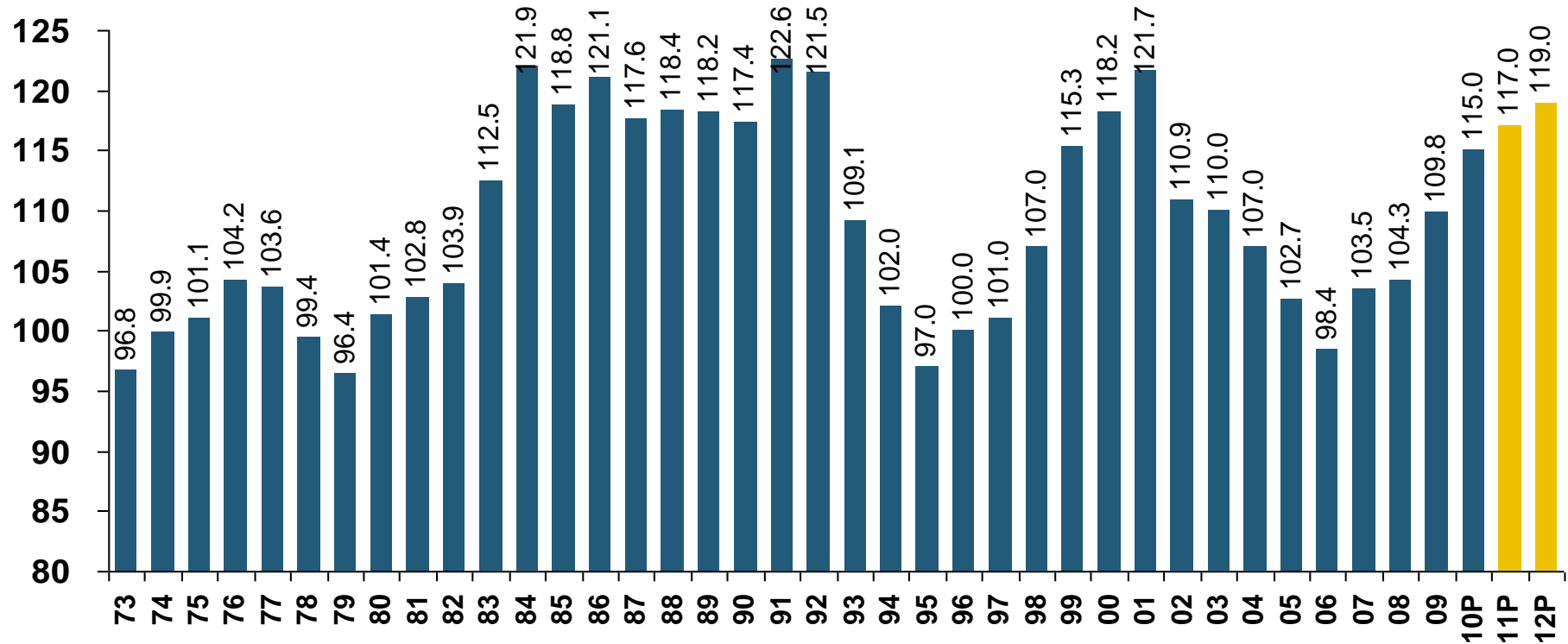
*Recession*

The recession led to negative premium audit adjustments

Note: WC Statistical Plan audited premium compared to policy-estimated premium. Based on states where NCCI provides ratemaking services, including state funds; excludes high deductible policies and mid-term cancellations.

Source: NCCI

# Workers Compensation Combined Ratio: 1973–2012P



**Workers Comp Underwriting Results Are Deteriorating Markedly**