

Overview & Outlook for the Workers Comp Market: Growth, Performance & the **Economic Environment Kentucky Associated General Contractors 2013 Information Exchange** February 18, 2013 Download at: www.iii.org/presentations

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A Brief History of Workers Compensation Systems

Social Policy, History, Economics and Politics All Played Important Roles in the Development of Modern WC Systems

Workers Compensation Timeline

Industrialization of US in the Late 19th/Early 20th Century Led to Increasing & Unacceptably High Number of Deaths and Injuries Among Workers

- In 1912, an estimated 18,000 to 23,000 workers were killed on the job (compared to 4,609 in 2011) and approximately 4.7 million (12% or workforce) suffered a nonfatal illness or injury (compared to 3.1 million 2010)
- The 1912 death/injury rates would imply 75,600 deaths and 17 million injuries today
- More awareness of broader impacts on families of injured/killed workers

Workers Could Seek Redress Under Tort Law, But Seldom Prevailed

- Employers usually won suits filed by injured workers by arguing:
 - Contributory Negligence: Employee was at least partially to blame for the accident
 - Assumed Risk: By taking the job, the employee understood the hazards involved
 - Fellow Servant Rule: A fellow worker caused the accident, so the employer was not at fault

European Countries Began to Implement Workers Compensation Programs

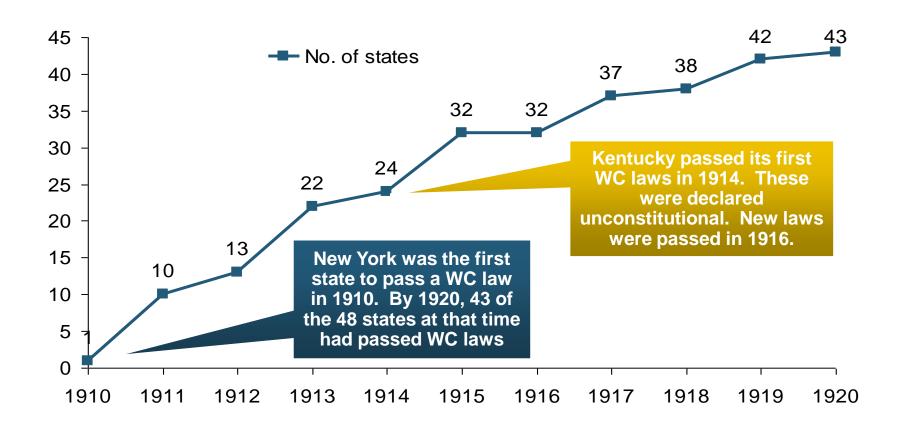
Germany (1884); England (1897)

Insurers Began to Sell Commercial Liability Coverage in the Late 1800s

- Coverage for inadvertent errors became more commonplace
- In the workforce, such policies became the first employer liability policies

Source: Insurance Information Institute.

Cumulative Number of WC Laws Passed, 1910-1920

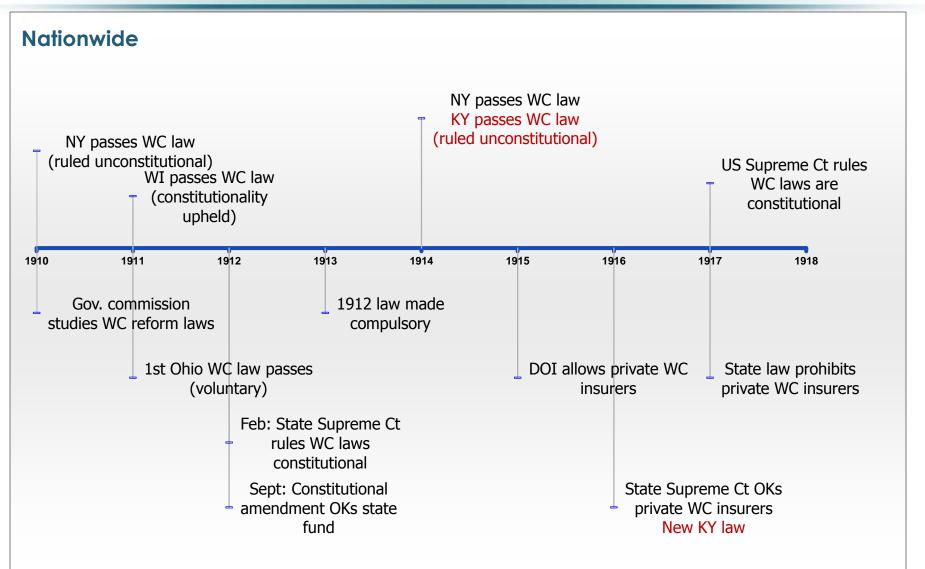


Source: http://eh.net/encyclopedia/article/fishback.workers.compensation; Insurance Information Institute.

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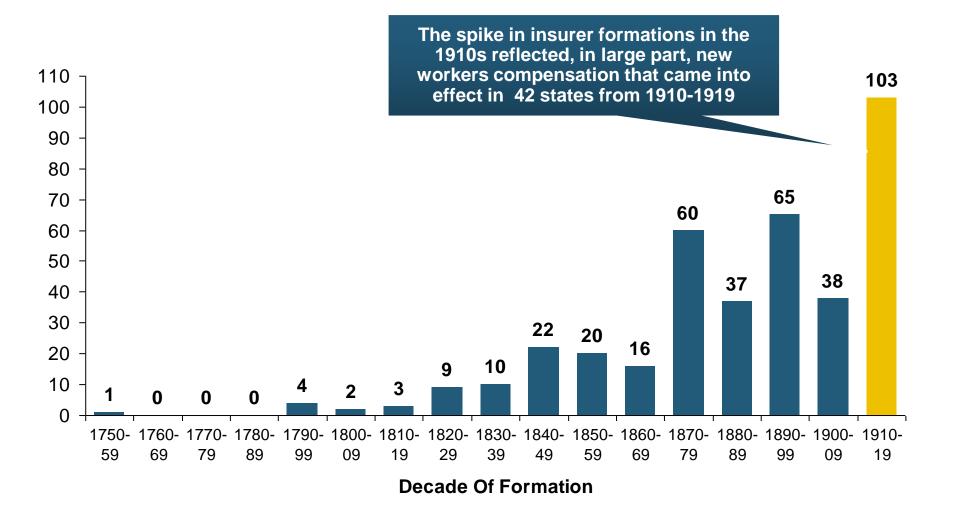
Key Workers Compensation Developments in the 1910s





Source: Insurance Information Institute.

Decade of Formation for P/C Insurers at Least 100 Years Old in 2010



Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

Monopolistic State Funds: Where Are they Today?



State	Date started	Status
Ohio	1911	Still monopolistic
Washington	1911	Monopolistic; referendum sought in 2010
Nevada	1913	State fund privatized in 1999
Oregon	1913	Allowed competition in 1980
West Virginia	1913	Allowed competition in 2008
Wyoming	1915	Still monopolistic
North Dakota	1919	Still monopolistic

Source: Economic History Association, http://eh.net/encyclopedia/article/fishback.workers.compensation, Insurance Information Institute research.

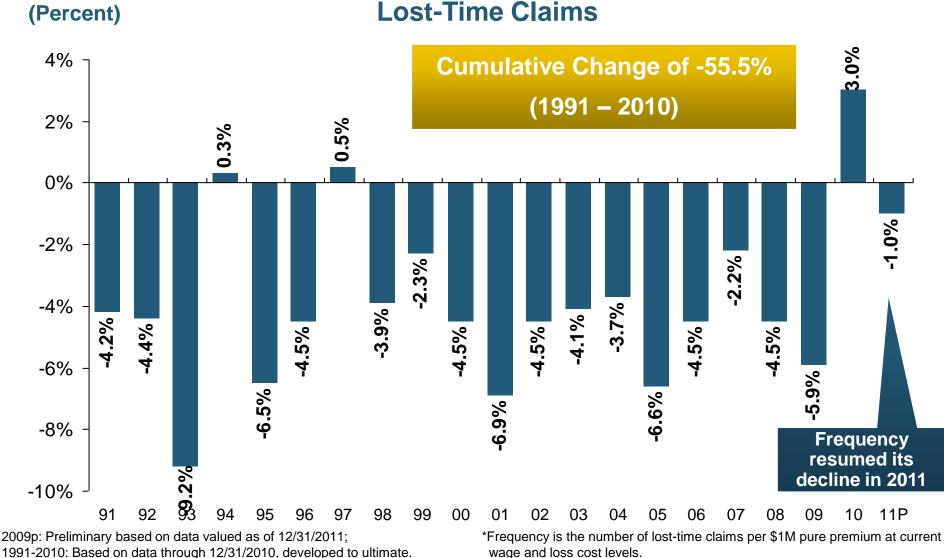


Workplace Safety is the Paramount Concern

Workplace Safety Continues to Improve, in No Small Part Due to the Efforts of Workers Comp Insurers

Workers Compensation Lost-Time Claim Frequency Continues to Decline*





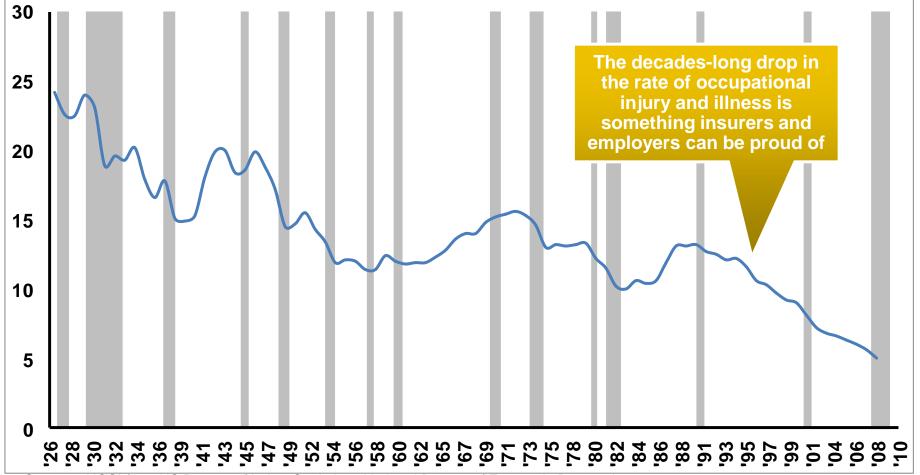
1991-2010: Based on data through 12/31/2010, developed to ultimate.

Based on the states where NCCI provides ratemaking services including state funds; Excludes high deductible policies.

Frequency: 1926–2010 A Long-Term Drift Downward

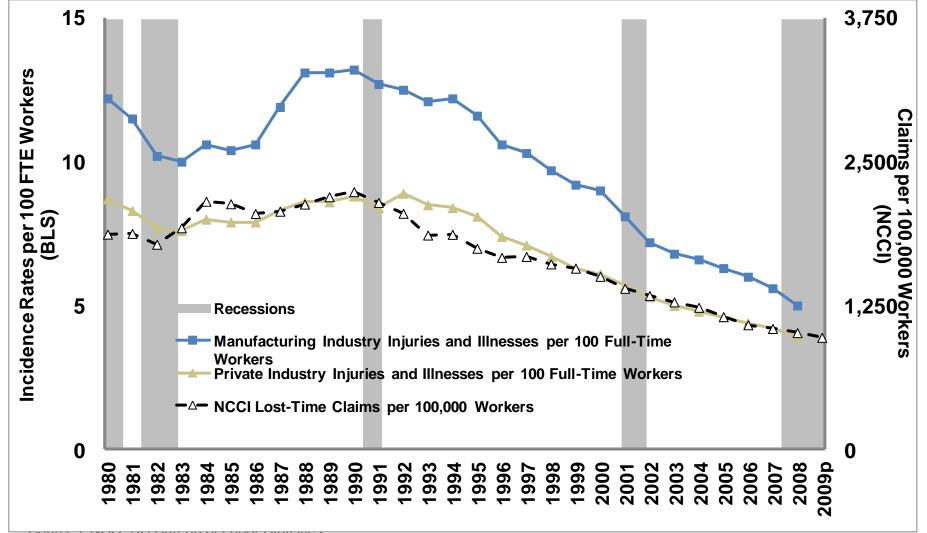


Manufacturing – Total Recordable Cases Rate of Injury and Illness Cases per 100 Full-Time Workers



Sources: NCCI from US Bureau of Labor Statistics; National Bureau of Economic Research.

Workplace Injury Incidence Rates Declined in Last Four Economic Downturns



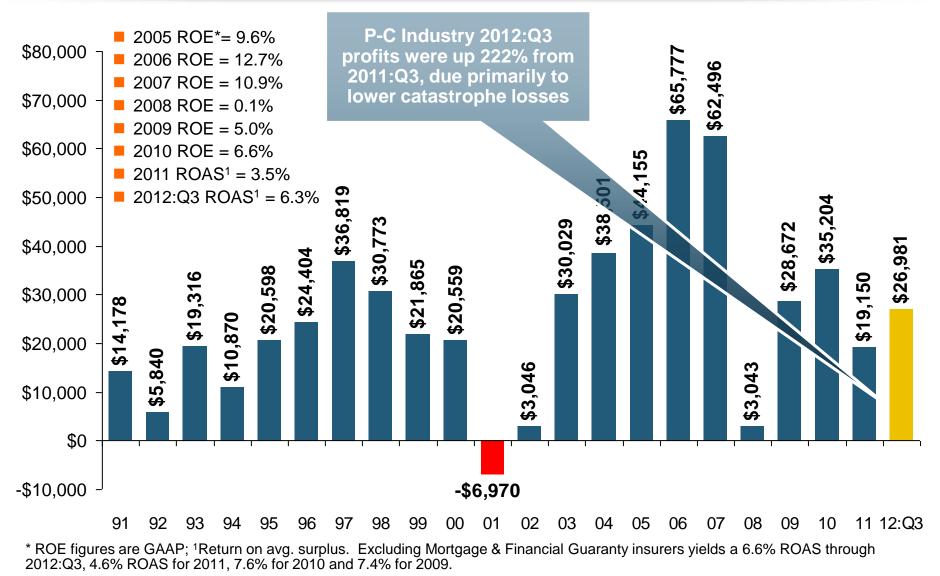


P/C Insurance Industry Financial Overview

Catastrophe Losses Weighed Down Profits in 2012/2011; WC Underwriting Improvements Will Benefit 2013 & Beyond

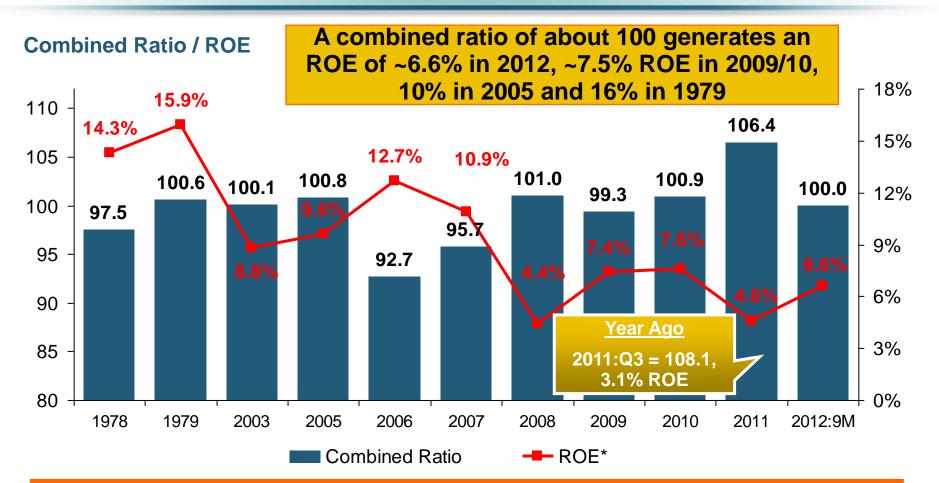
P/C Net Income After Taxes 1991–2012:Q3 (\$ Millions)





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

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



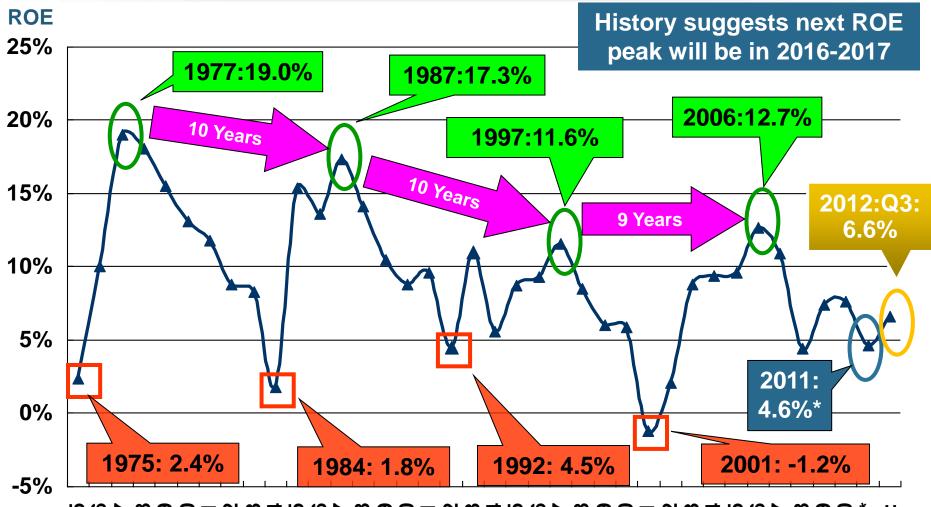
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Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs

* 2008 -2012 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2012:Q3 combined ratio including M&FG insurers is 100.9, ROAS = 6.3%; 2011 combined ratio including M&FG insurers is 108.2, ROAS = 3.5%.
 Source: Insurance Information Institute from A.M. Best and ISO data.

Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2012:Q3*



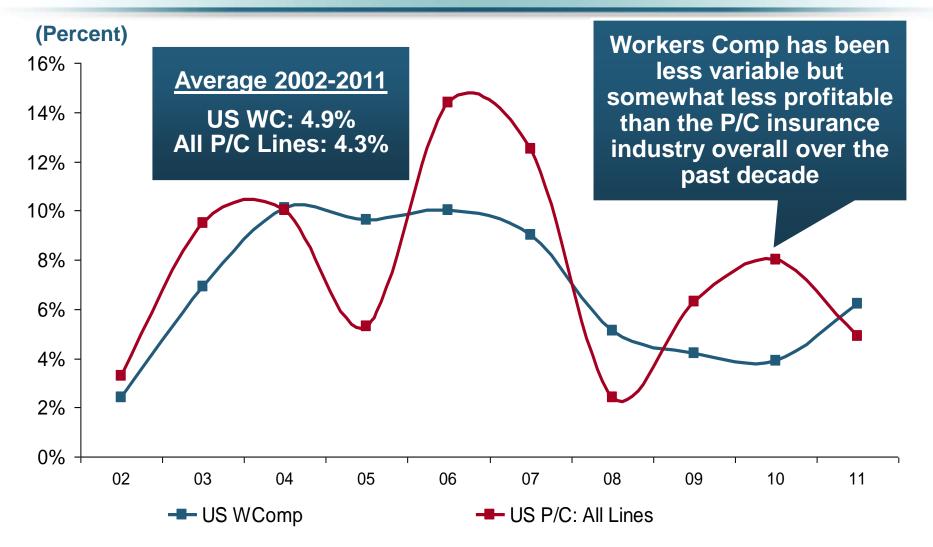


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*Profitability = P/C insurer ROEs. 2011 figure is an estimate based on ROAS data. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. 2012:Q3 ROAS = 6.2% including M&FG. Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

RNW: U.S. All P/C Lines vs. WC, 2002-2011

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Sources: NAIC.



4. RENEWED PRICING DISCIPLINE

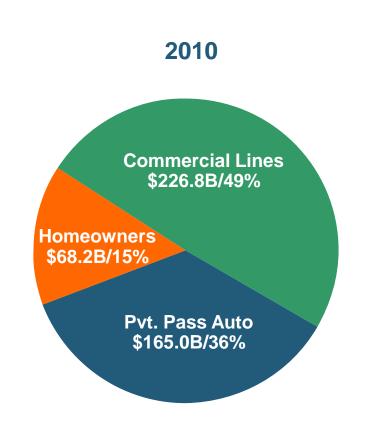
Evidence of a Broad and Sustained Shift in Pricing

Distribution of Direct Premiums Written by Segment/Line, 2010



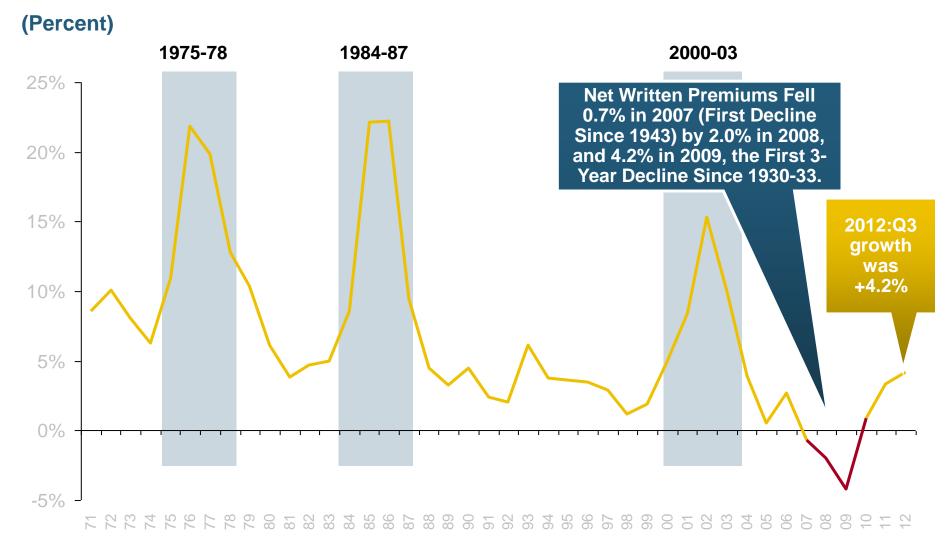
Distribution Facts

- Personal/Commercial lines split has been about 50/50 for many years; Personal Lines overtook Commercial Lines in 2010
- Pvt. Passenger Auto is by far the largest line of insurance and is currently the most important source of industry profits
 - Billions of additional dollars in homeowners insurance premiums are written by staterun residual market plans



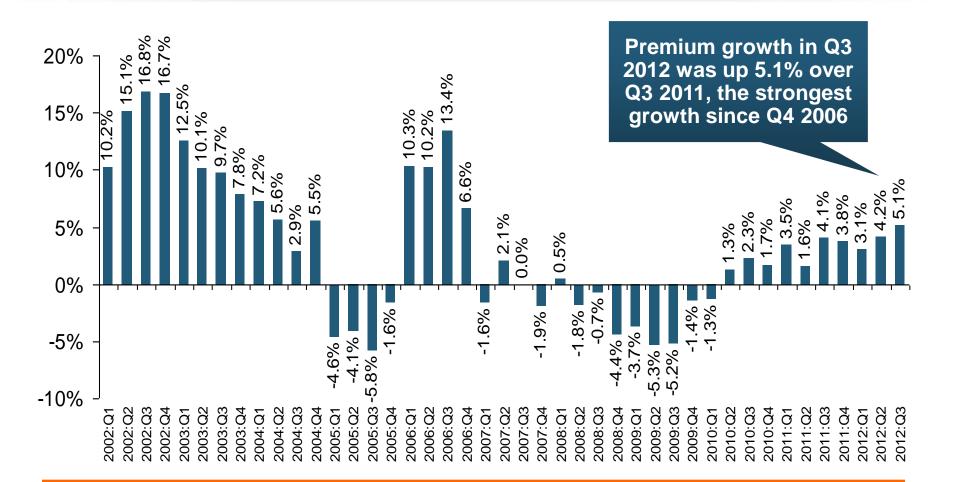
Sources: A.M. Best; Insurance Information Institute research.

Net Premium Growth: Annual Change, 1971—2012:Q3



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

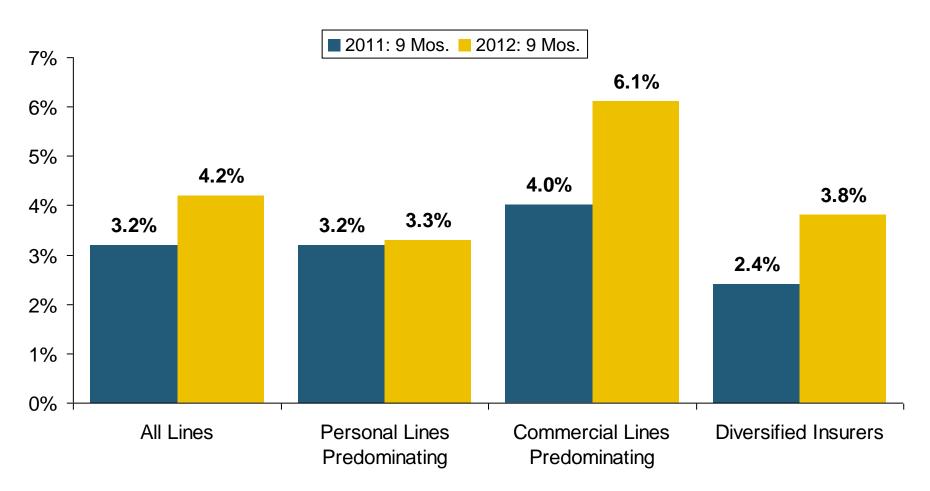


Sustained Growth in Written Premiums (vs. the same quarter, prior year) Will Continue into 2013

Sources: ISO, Insurance Information Institute.

Growth in Net Written Premium by Segment, 2012:9 Mos. vs. 2011:9 Mos.*

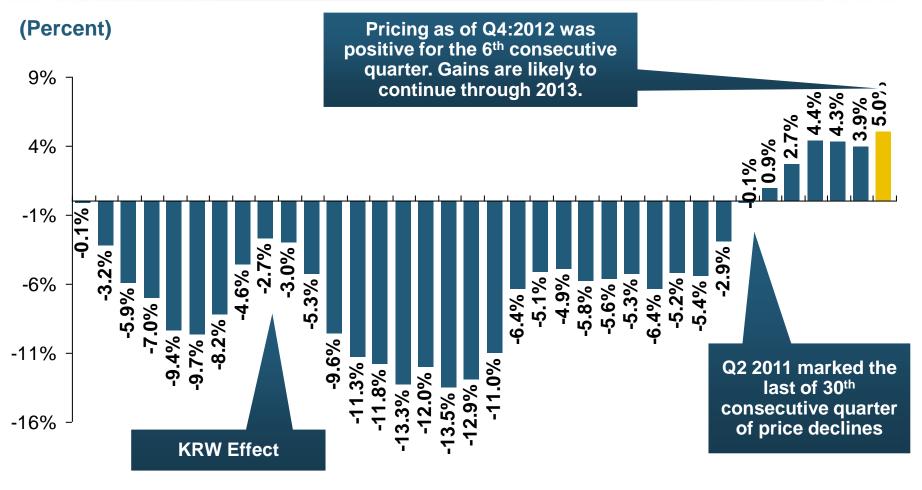




*Excludes mortgage and financial guaranty insurers. Source: ISO/PCI; Insurance Information Institute NSURANCE

Average Commercial Rate Change, All Lines, (1Q:2004–4Q:2012)

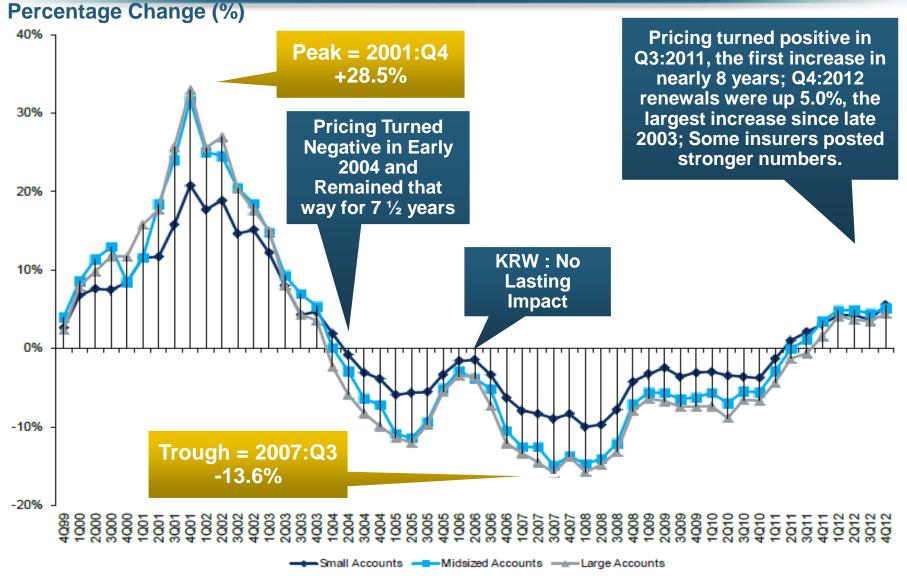




Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents & Brokers; Insurance Information Institute

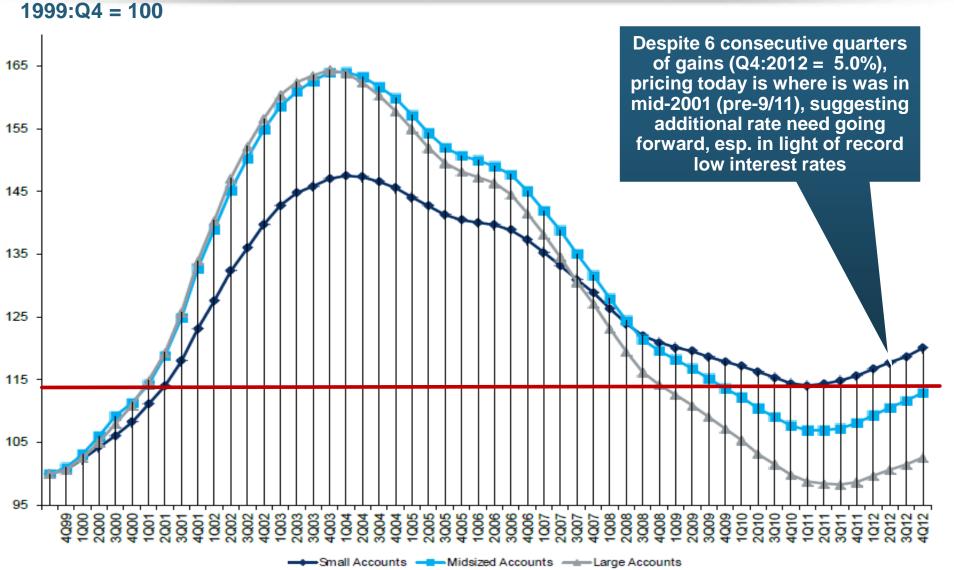
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2012:Q4





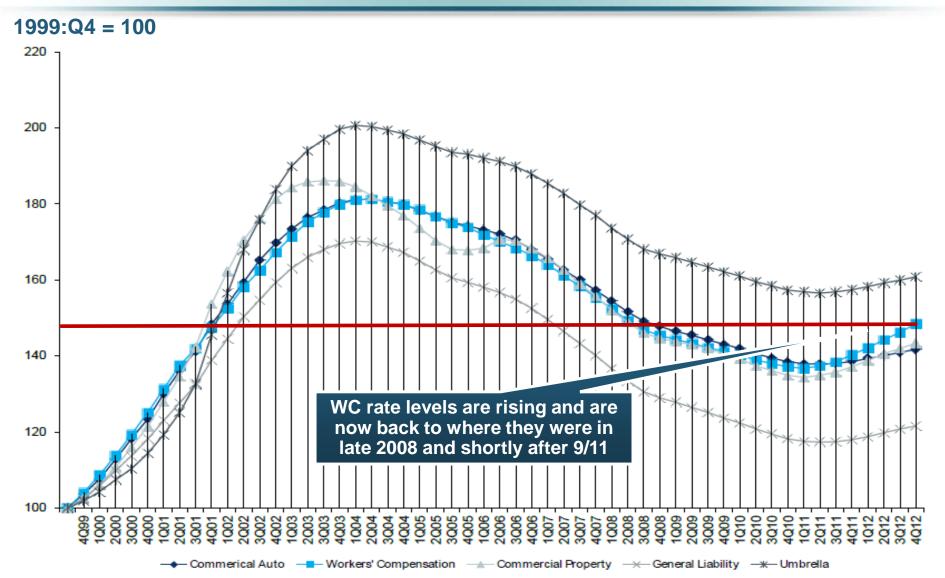
Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Barclay's Capital; Insurance Information Institute.

Cumulative Qtrly. Commercial Rate Changes, **TRUNATION** by Account Size: 1999:Q4 to 2012:Q4



Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Barclay's Capital; Insurance Information Institute.

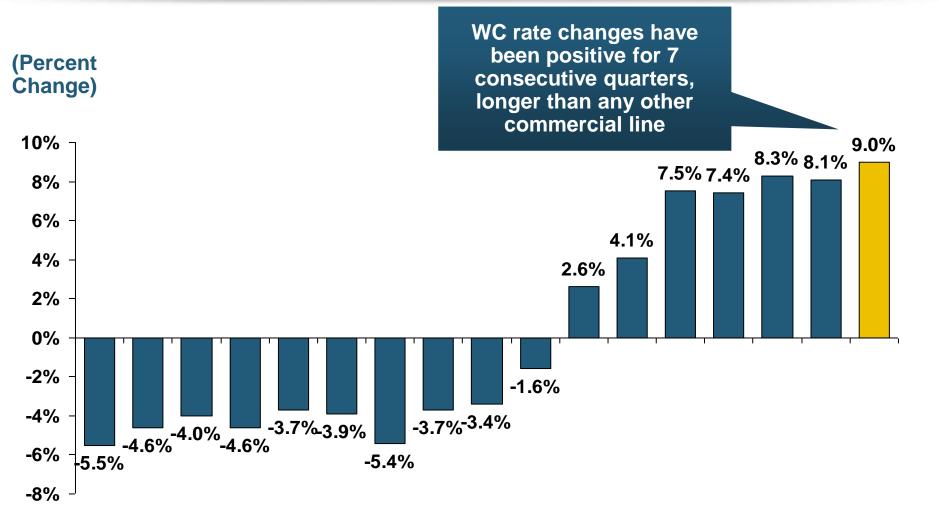
Cumulative Qtrly. Commercial Rate Changes, **The INSURANCE** by Line: 1999:Q4 to 2012:Q4



Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Barclay's Capital; Insurance Information Institute.

Workers Comp Rate Changes, 2008:Q4 – 2012:Q4

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08:Q4 09:Q1 09:Q2 09:Q3 09:Q4 10:Q1 10:Q2 10:Q3 10:Q4 11:Q1 11:Q2 11:Q3 11:Q4 12:Q1 12:Q2 12:Q3 12:Q4

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Information Institute.

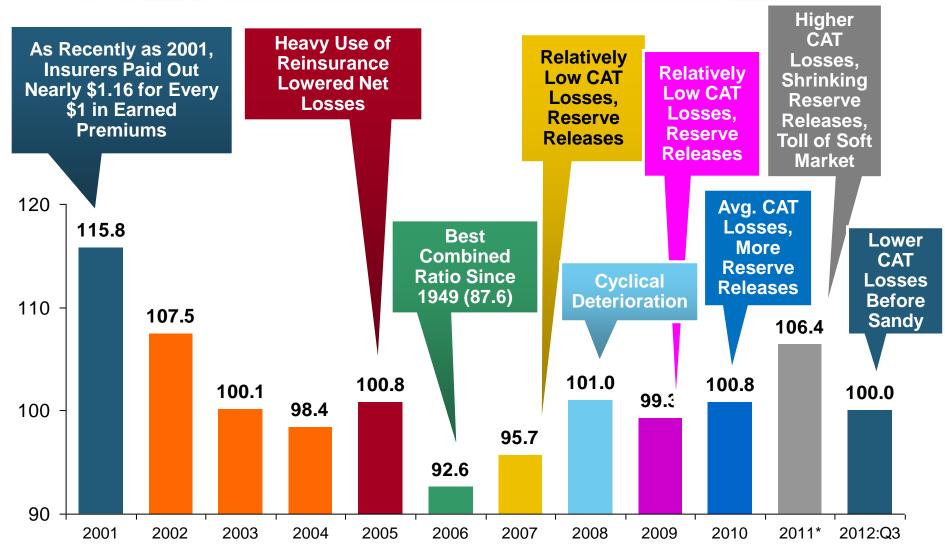


UNDERWRITING

Underwriting Losses in 2011 and 2012 Are Elevated by High Catastrophe Losses

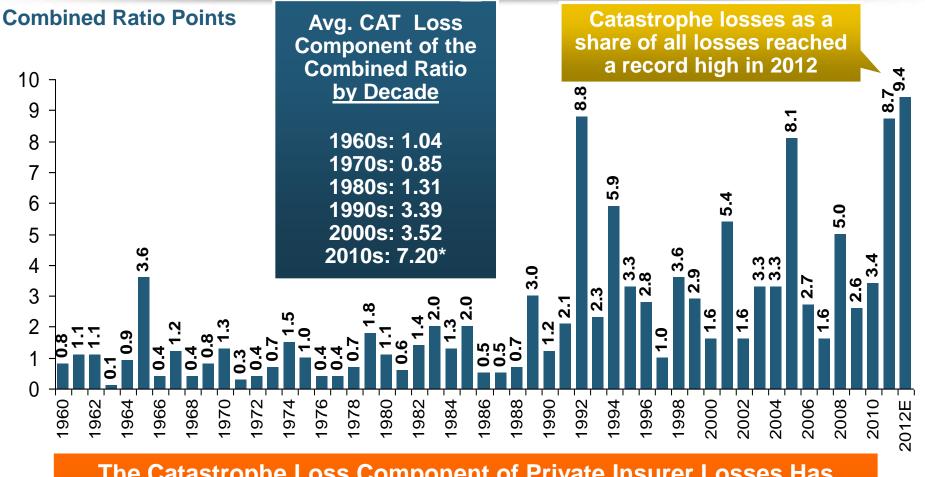
P/C Insurance Industry Combined Ratio, 2001–2012:Q3*





* Excludes Mortgage & Financial Guaranty insurers 2008--2012. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.2; 2012:Q3=100.0. Sources: A.M. Best, ISO.

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

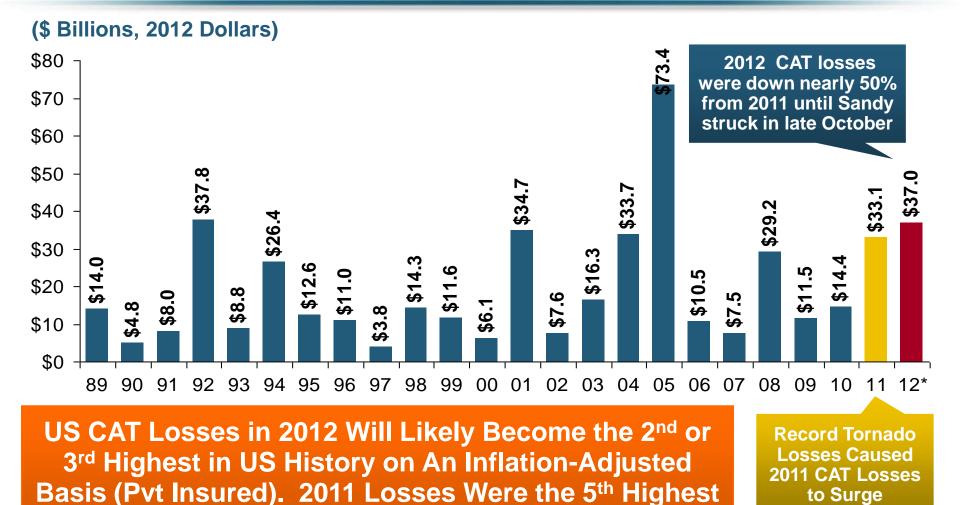


The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

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

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

US Insured Catastrophe Losses

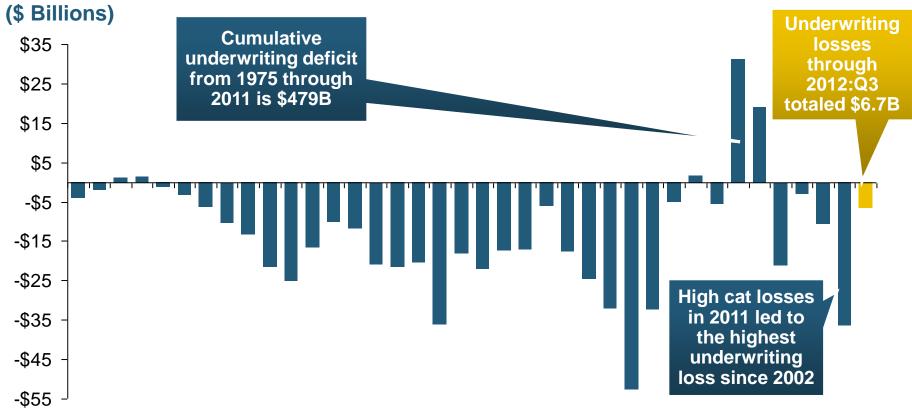


*As of 1/2/13. Includes \$20B gross loss estimate for Hurricane Sandy. Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01 (\$25.9B 2011 dollars). Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B (\$15.6B in 2011 dollars.) Sources: Property Claims Service/ISO; Insurance Information Institute.

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Underwriting Gain (Loss) 1975–2012:Q3*



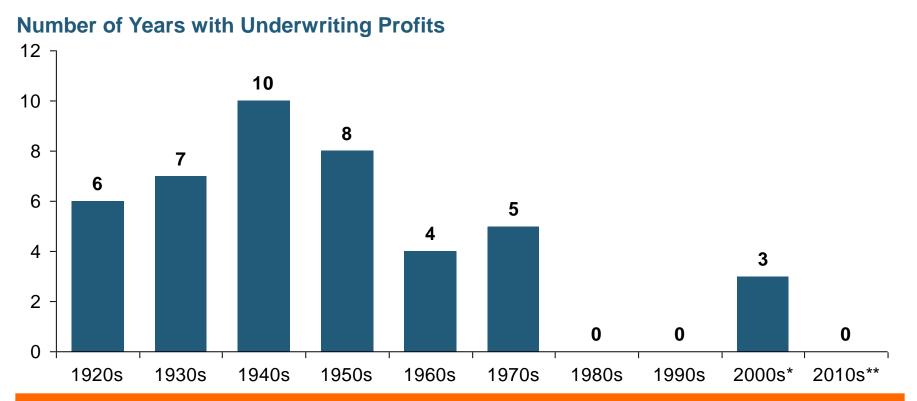


75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12

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

* Includes mortgage and financial guaranty insurers in all years. Sources: A.M. Best, ISO; Insurance Information Institute.

Number of Years with Underwriting Profits by Decade, 1920s–2010s



Underwriting Profits Were Common Before the 1980s (40 of the 60 Years Before 1980 Had Combined Ratios Below 100) – But Then They Vanished. Not a Single Underwriting Profit Was Recorded in the 25 Years from 1979 Through 2003

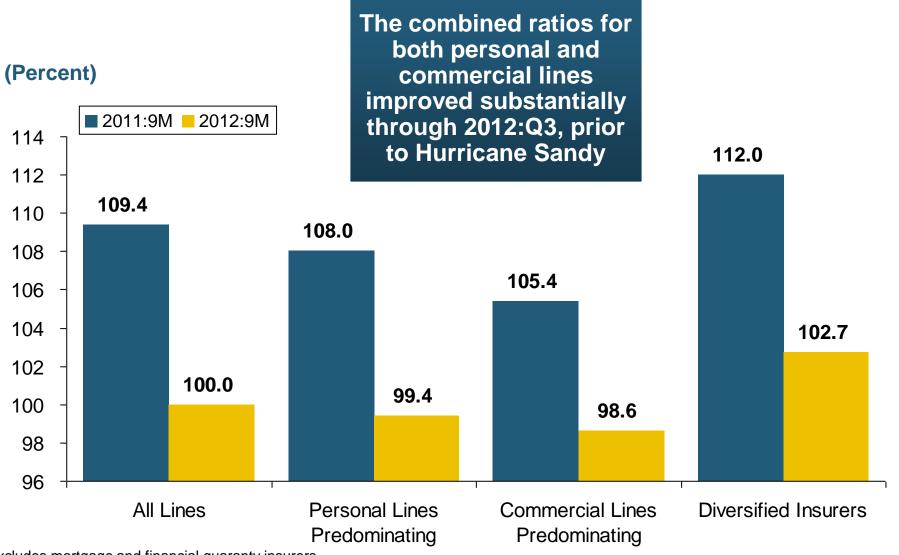
* 2009 combined ratio excl. mort. and finl. guaranty insurers was 99.3, which would bring the 2000s total to 4 years with an u/w profit. **Data for the 2010s includes 2010-2012.

Note: Data for 1920–1934 based on stock companies only.

Sources: Insurance Information Institute research from A.M. Best Data.

Combined Ratios by Predominant Business Segment, 2012:9 Mos. vs. 2011:9 Mos.*



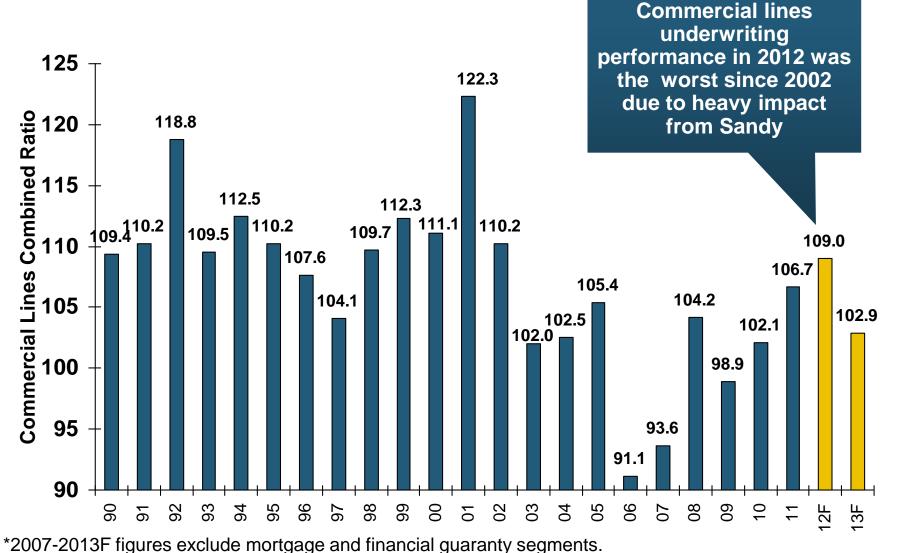


*Excludes mortgage and financial guaranty insurers.

Source: ISO/PCI; Insurance Information Institute

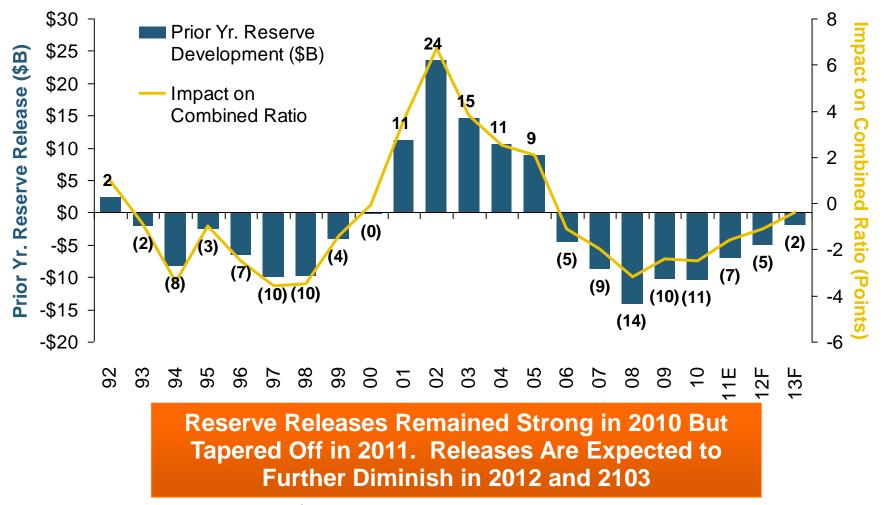
Commercial Lines Combined Ratio, 1990-2013F*





Source: A.M. Best; Insurance Information Institute

P/C Reserve Development, 1992–2013F



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

Sources: Barclays Capital; A.M. Best.

WC Calendar Year Reserve Deficiency Increased in 2011

WC Loss and LAE Reserve Deficiency: Private Carriers \$ Billions **2011 Tabular Discount Is \$5.4 Billion** 33% Percentage of CY **Total Carried** Reserves 10% 1995 1996 2003 2004 **Calendar Year**

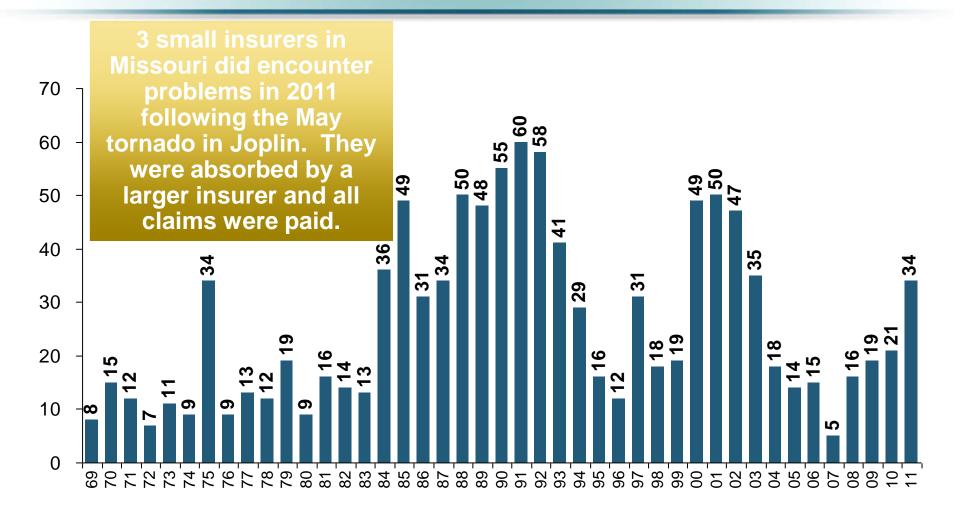
Considers all reserve discounts as deficiencies Loss and LAE figures are based on NAIC Annual Statement data for each valuation date and NCCI latest selections Source: NCCI analysis



Financial Strength & Underwriting

Cyclical Pattern is P-C Impairment History is Directly Tied to Underwriting, Reserving & Pricing WC: The Biggest Challenge

P/C Insurer Impairments, 1969–2011

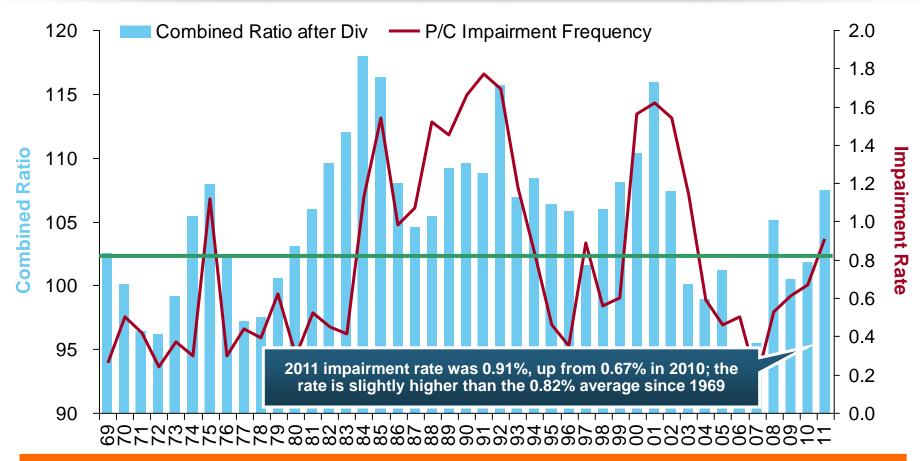


The Number of Impairments Varies Significantly Over the P/C Insurance Cycle, With Peaks Occurring Well into Hard Markets

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

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2011

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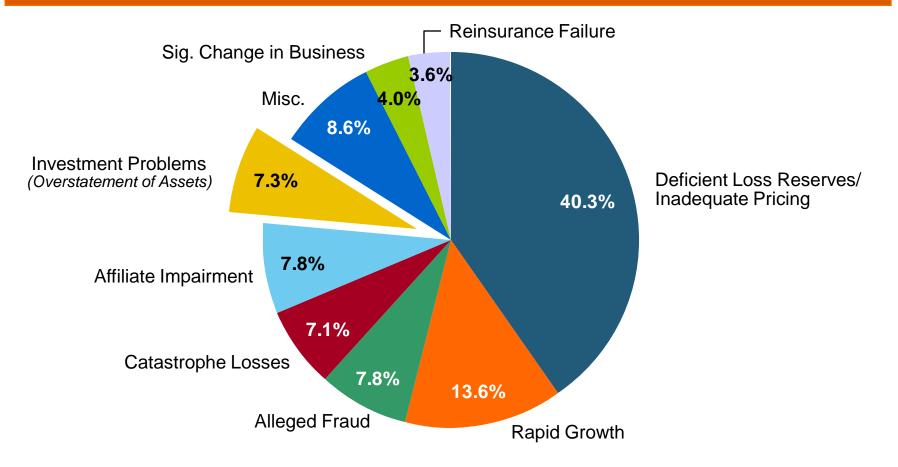
Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007; Recent Increase Was Associated Primarily With Mortgage and Financial Guaranty Insurers and Not Representative of the Industry Overall

Source: A.M. Best; Insurance Information Institute

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



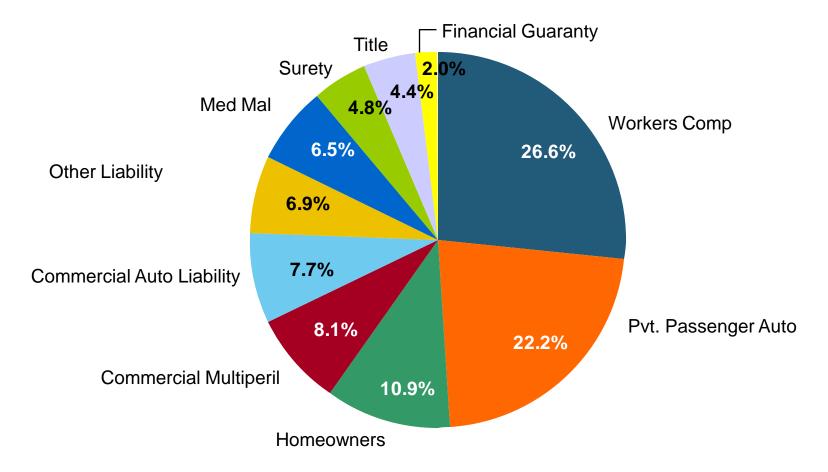
Historically, Deficient Loss Reserves and Inadequate Pricing Are By Far the Leading Cause of P-C Insurer Impairments. Investment and Catastrophe Losses Play a Much Smaller Role



Source: A.M. Best: 1969-2010 Impairment Review, Special Report, April 2011.

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



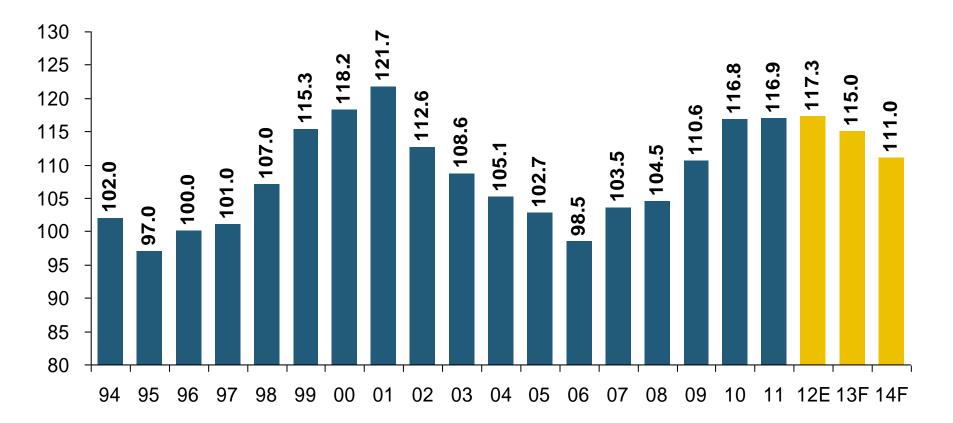
Source: A.M. Best: 1969-2010 Impairment Review, Special Report, April 2011.



Workers Compensation Operating Environment

The Stronger Job Market, Rates Are Major Drivers of Growth; Underwriting Improvements to Come

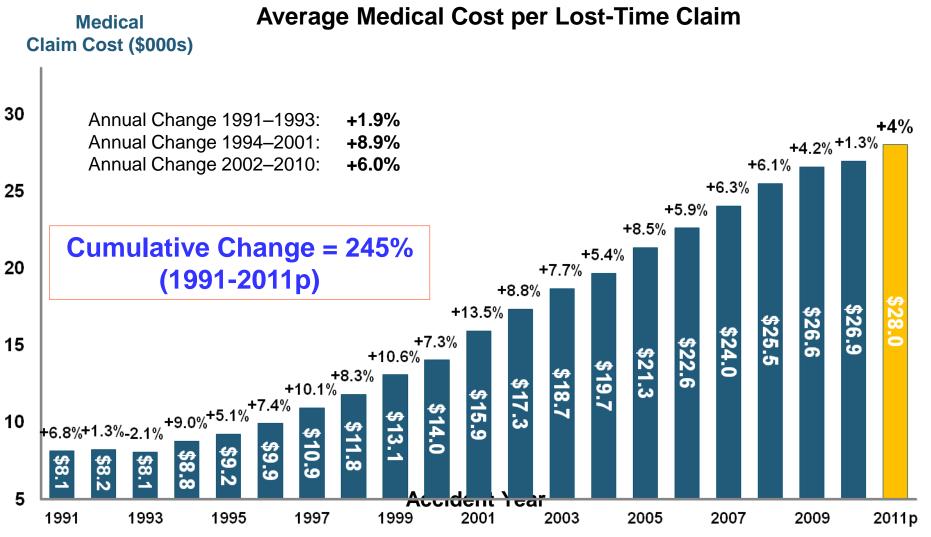
Workers Compensation Combined Ratio: 1994–2014F



Workers Comp Results Should Begin to Improve in 2013. Underwriting Results Deteriorated Markedly from 2007-2012 and Were the Worst They Had Been in a Decade.

Sources: A.M. Best (1994-2013F); Insurance Information Institute (2014F).

Workers Compensation Medical Severity Moderate Increase in 2011

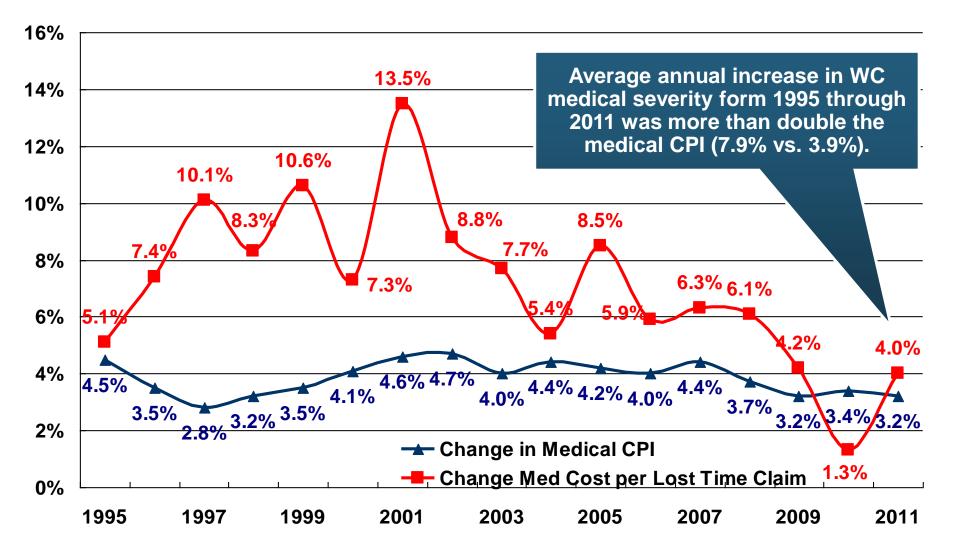


2011p: Preliminary based on data valued as of 12/31/2011

1991-2010: Based on data through 12/31/2010, developed to ultimate

Based on the states where NCCI provides ratemaking services; Excludes high deductible policies

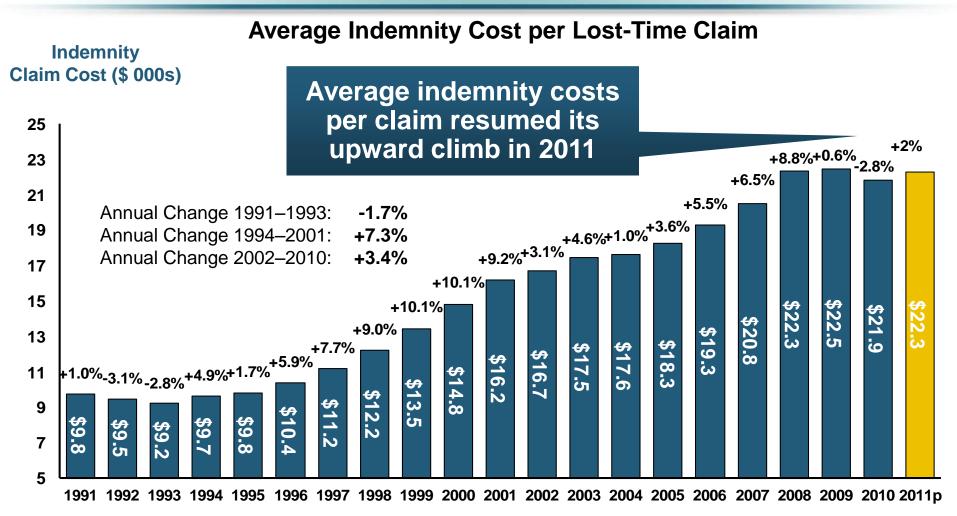
WC Medical Severity Generally Outpaces the Medical CPI Rate



Sources: Med CPI from US Bureau of Labor Statistics, WC med severity from NCCI based on NCCI states.

Workers Comp Indemnity Claim Costs: Modest Increase in 2011

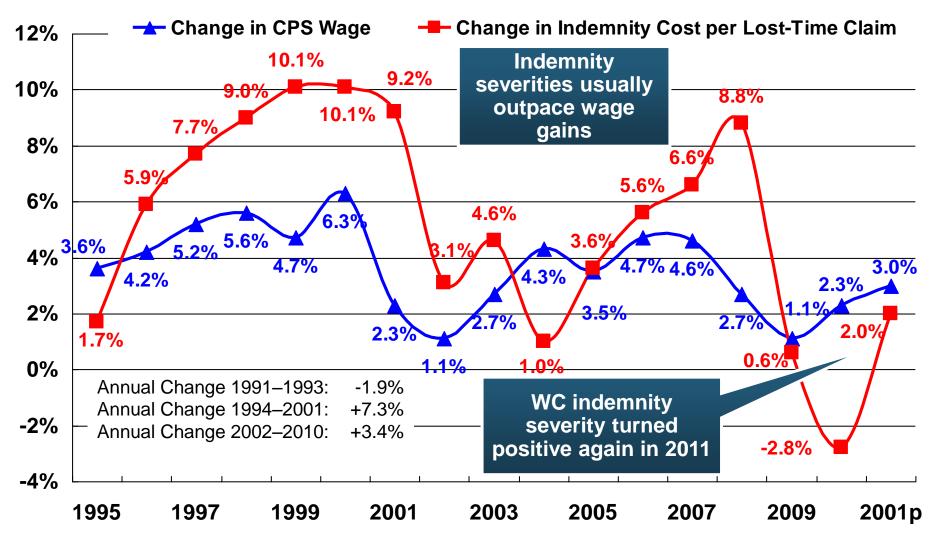




Accident Year

2010p: Preliminary based on data valued as of 12/31/2011 1991–2010: Based on data through 12/31/2010, developed to ultimate Based on the states where NCCI provides ratemaking services Excludes high deductible policies

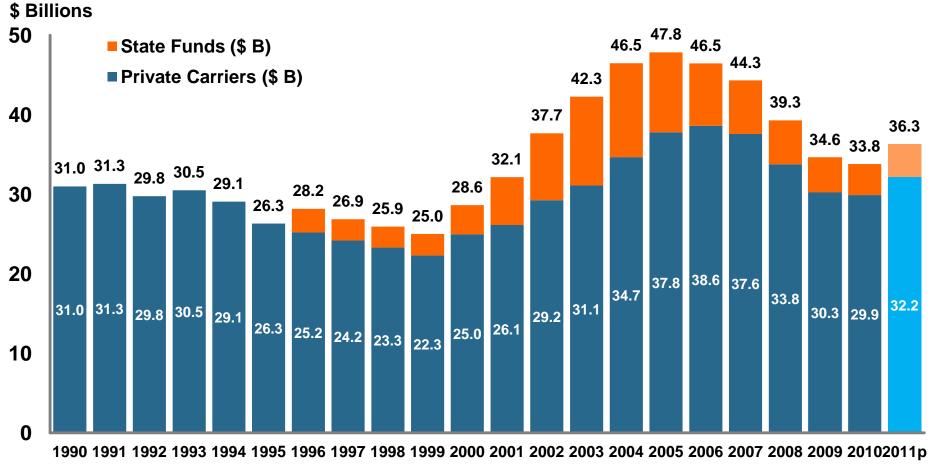
WC Indemnity Severity vs. Wage Inflation, **MINSTITUTE** 1995-2011p



2011p: Preliminary based on data valued as of 12/31/2011; 1991-2010: Based on data through 12/31/2010, developed to ultimate. Based on the states where NCCI provides ratemaking services. Excludes the effects of deductible policies. CPS = Current Population Survey. Source: NCCI

Workers Compensation Premium: First Increase in Years





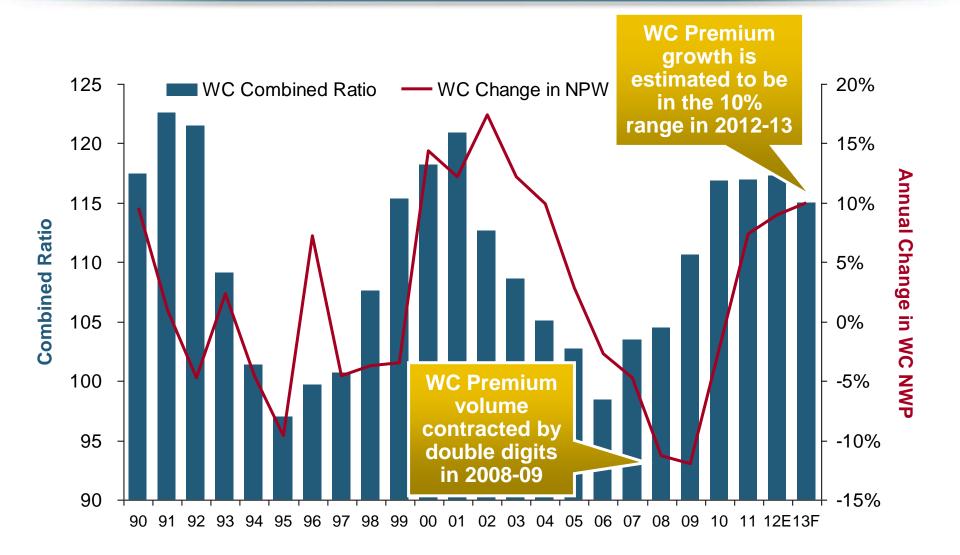
p Preliminary

Source: 1990–2010 Private Carriers, *Best's Aggregates & Averages*; 2011p, NCCI 1996–2011p 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



Fig. 3 Workers Comp Combined Ratio vs. Net Written Premium Growth, 1990—2013F

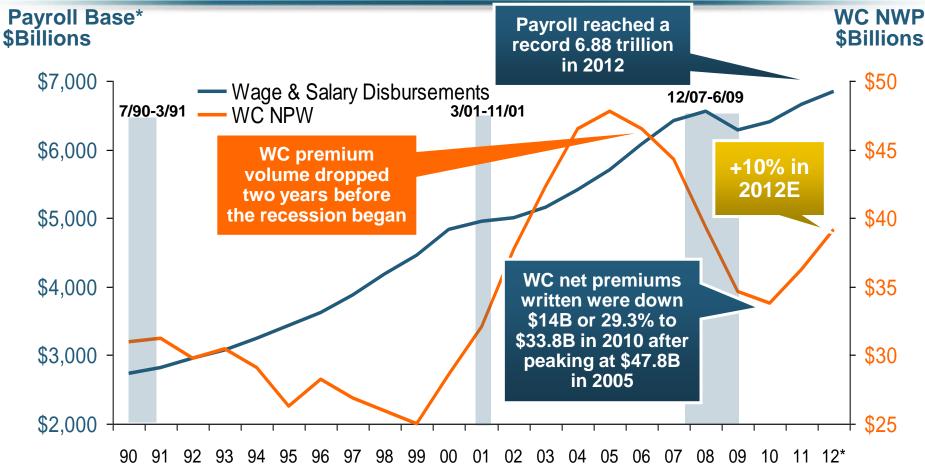




Sources: Combined Rations: A.M. Best (1990-2013F); NWP Growth A.M. Best (1990-2012E); Insurance Information Institute (2013F).

Payroll vs. Workers Comp Net Written Premiums, 1990-2012E



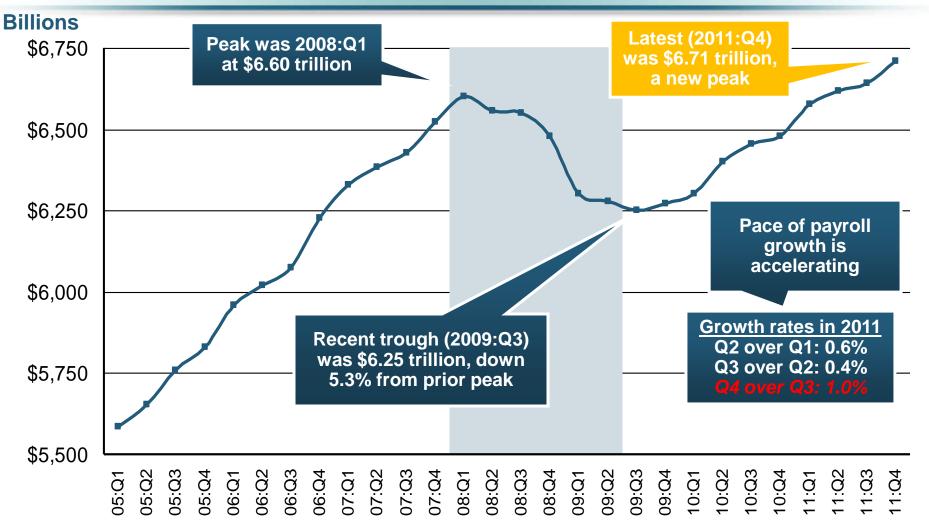


Continued Payroll Growth and Rate Increases Suggest WC NWP Will Grow Again in 2012; +7.9% Growth in 2011 Was the First Gain Since 2005

*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.

Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2011:Q4

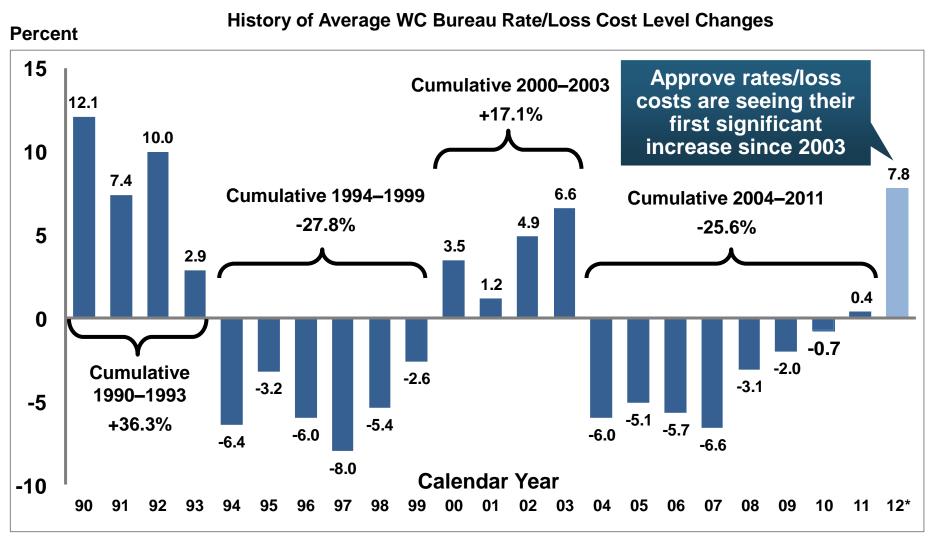


Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

Sources: <u>http://research.stlouisfed.org/fred2/series/WASCUR;</u> National Bureau of Economic Research (recession dates); Insurance Information Institute.

INSURANCE INFORMATION

Average Approved Bureau Rates/Loss Costs

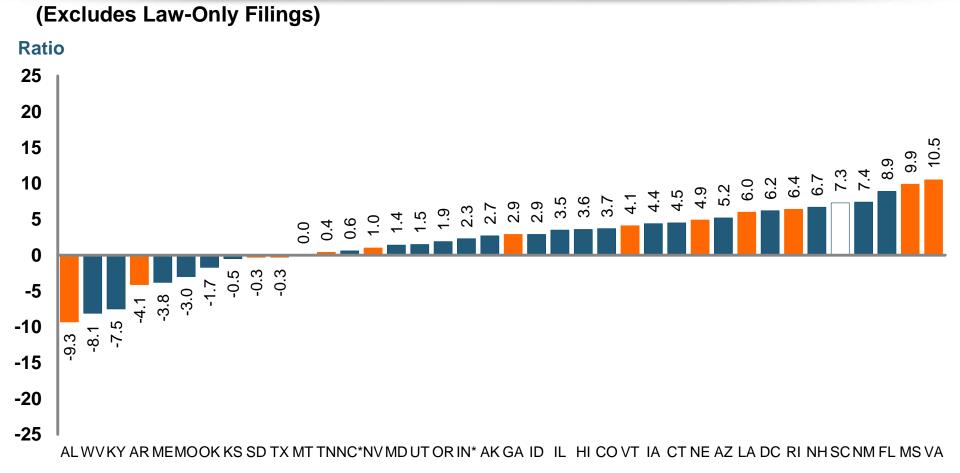


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*States approved through 7/31/12.

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



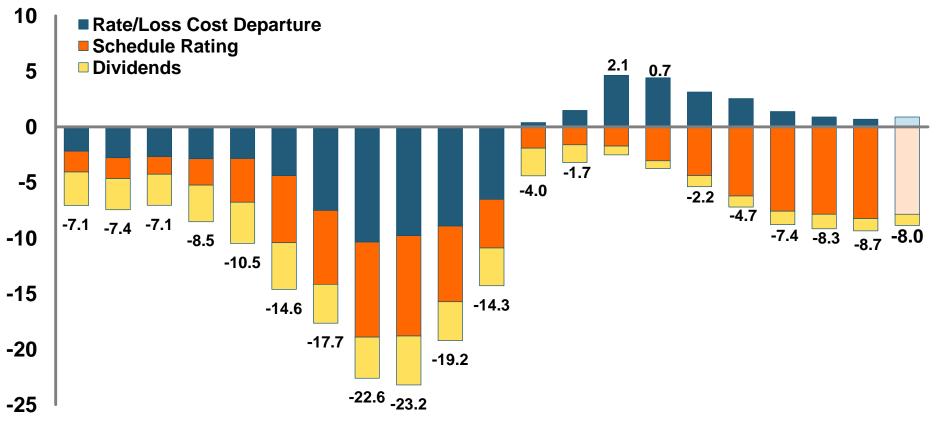
Effective Dates 1/1/2012 and Prior Effective Dates Subsequent to 1/1/2012 Diled and Pending

Impact of Discounting on Workers Compensation Premium



NCCI States—Private Carriers

Percent



1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 20102011p

p Preliminary

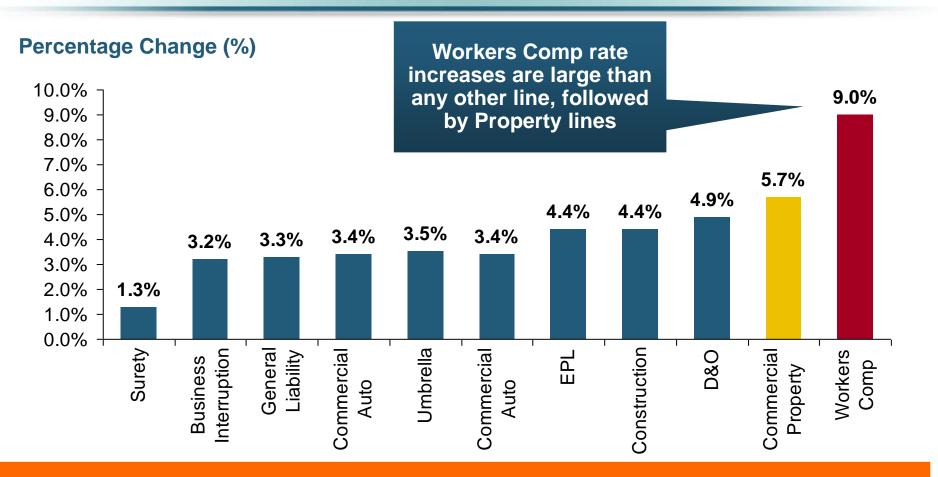
Policy Year

Dividend ratios are based on calendar year statistics

NCCI benchmark level does not include an underwriting contingency provision Based on data through 12/31/2011 for the states where NCCI provides ratemaking services Source: NCCI.

Change in Commercial Rate Renewals, by Line: 2012:Q4

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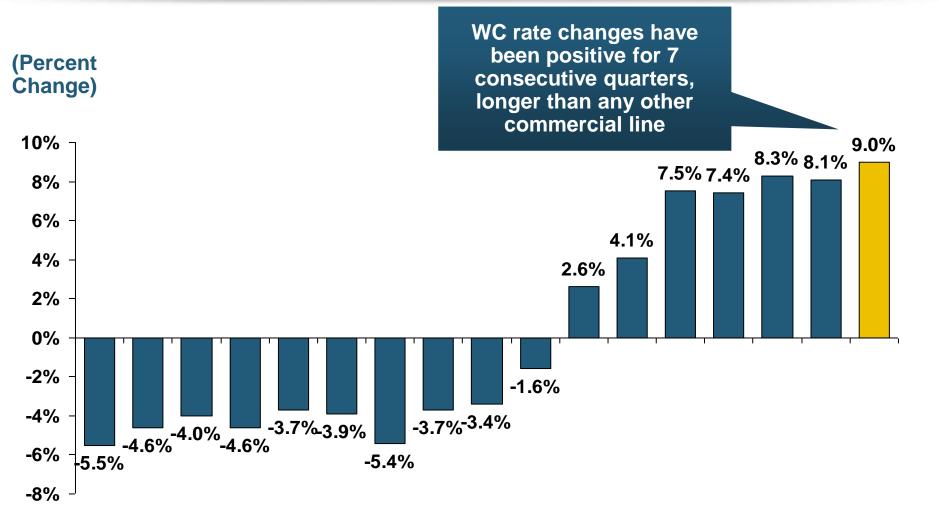


Major Commercial Lines Renewed Uniformly Upward in Q4:2012 for the Sixth Consecutive Quarter; Property Lines & Workers Comp Leading the Way; Cat Losses and Low Interest Rates Provide Momentum Going Forward

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Insurance Information Institute.

Workers Comp Rate Changes, 2008:Q4 – 2012:Q4

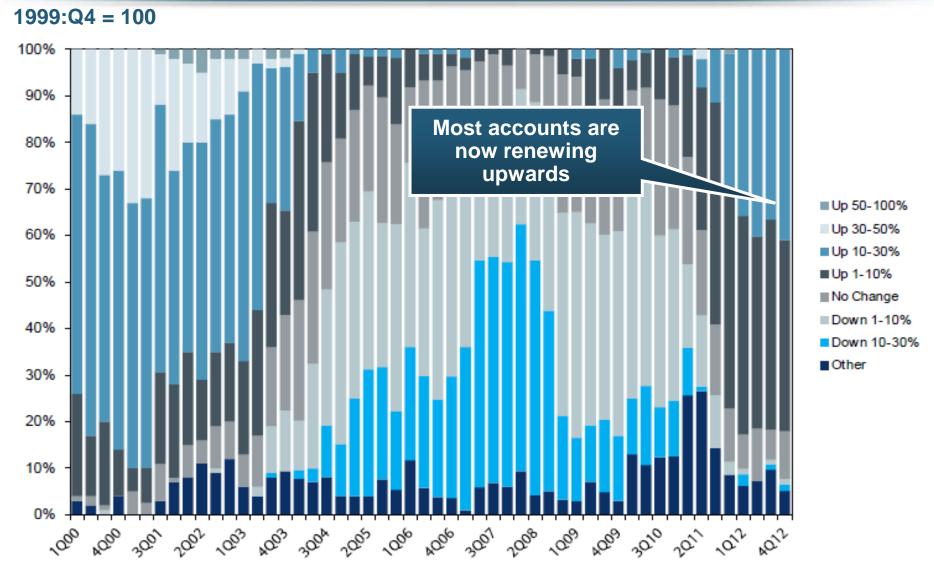
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08:Q4 09:Q1 09:Q2 09:Q3 09:Q4 10:Q1 10:Q2 10:Q3 10:Q4 11:Q1 11:Q2 11:Q3 11:Q4 12:Q1 12:Q2 12:Q3 12:Q4

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Information Institute.

Workers Comp. Quarterly Rate Changes, by Line: 2000:Q1 to 2012:Q4



Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Barclay's Capital; Insurance Information Institute.

INSURANCE

Experience Rating Change: Spit Point Modification

- Experience Rating Was Developed in the Early 20th Century as Method for Adjusting Premium Costs to Reflect Actual Claims Experience
- Current Experience Rating Plan (ERP) Includes a "Split Point" which Allows the Plan to Be More Responsive to the Distinction Between Costs Derived from Frequency and Severity
- Current Split Point is \$5,000 (Hasn't Been Adjusted in 20+ Years)
 - Primary Loss = Amt. up to \$5,000 reflects frequency (given full weight under ERP)
 - Excess Loss = Amt. above \$5,000 reflects severity (partially weighted)
 - Claim severity inflation has tripled since last update, so split point less effective (ERP less responsive to individual claim experience) as ex-mods drifted toward all-average

New Spilt Point Phased Up to \$15,000 Over 3-Year Period

- Year 1 (1/1/13 or later): Split point increases to \$10,000
- Year 2: Increases to \$13,500
- Year 3: Increase to \$15,000

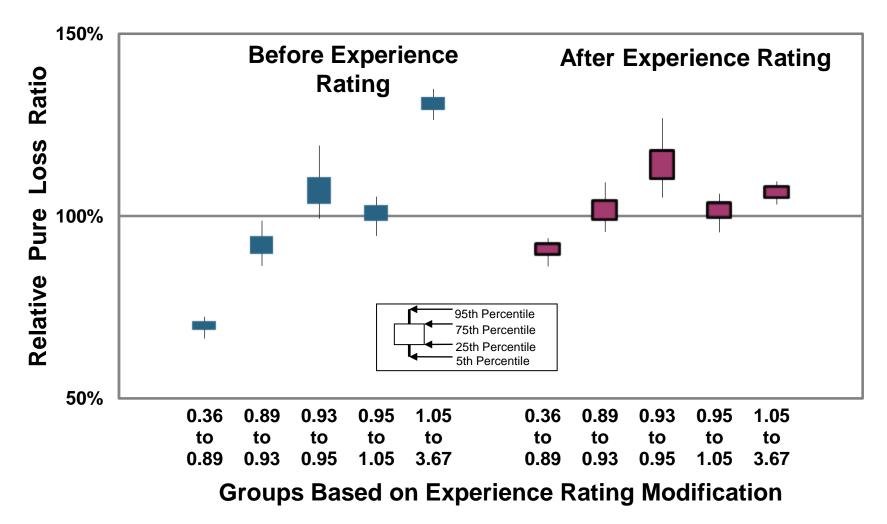
Revenue Neutral in Aggregate

• Insureds running high severity claims will see most significant impact Source: NCCI; Insurance Information Institute.

Quintile Analysis Current \$5,000 Split Point



Policy Year 2006 Under the Experience Rating Plan, Indexed for Severity Inflation

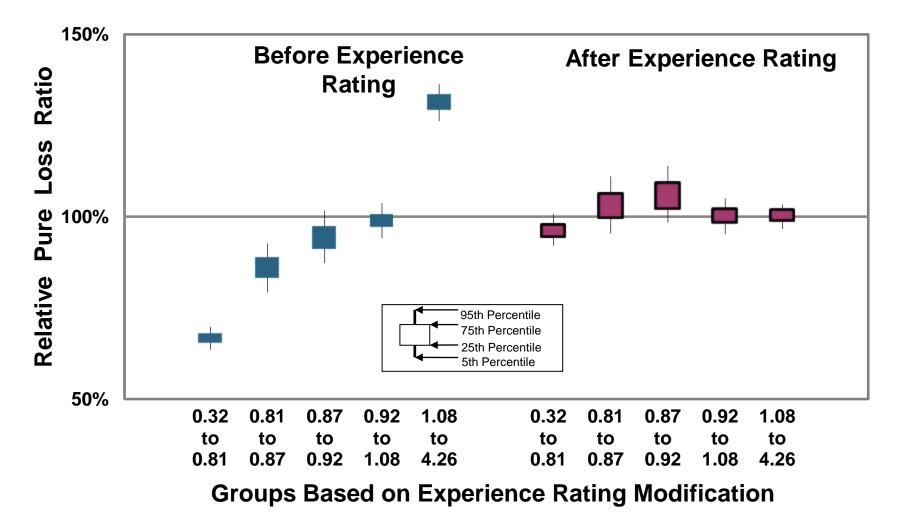


Relative Pure Loss Ratio = Quintile Loss Ratio / Loss Ratio of All Quintiles Combined

Quintile Analysis Indicated \$15,000 Split Point

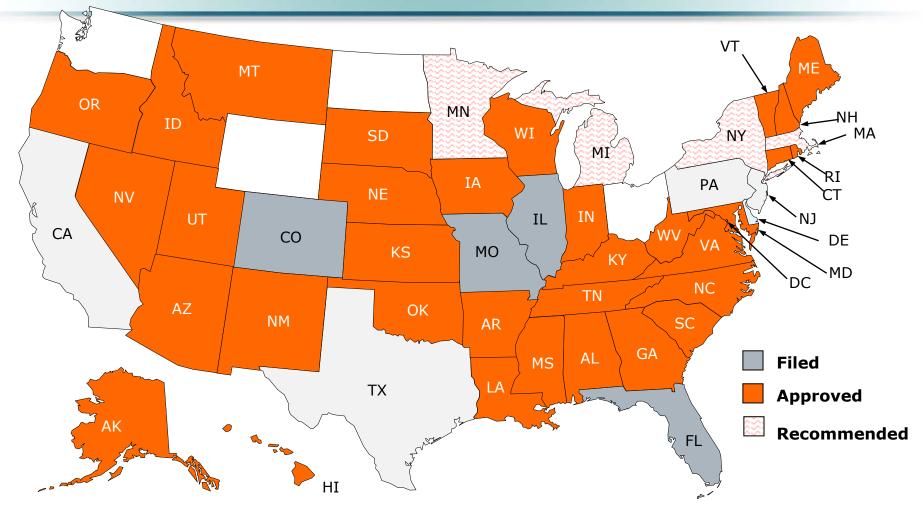


Policy Year 2006 Under the Experience Rating Plan, Indexed for Severity Inflation



Relative Pure Loss Ratio = Quintile Loss Ratio / Loss Ratio of All Quintiles Combined

Experience Rating Plan Primary/Excess Split Point Value Filing



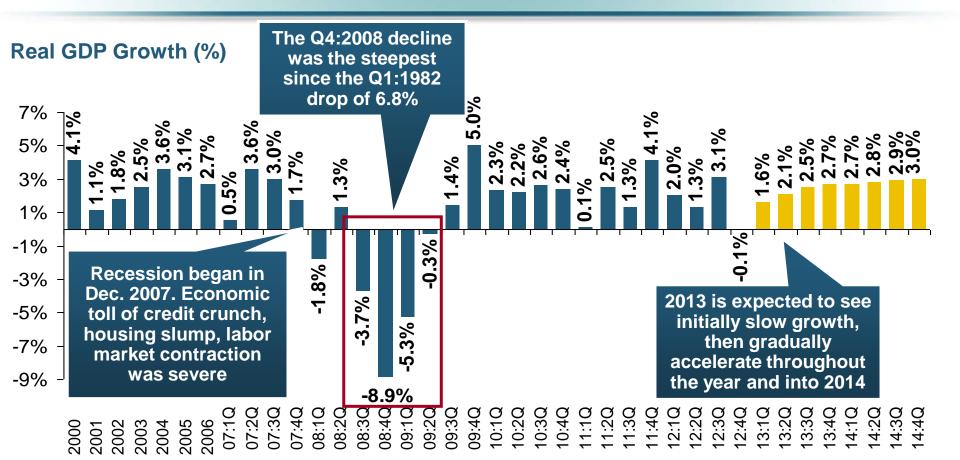


The Strength of the Economy Will Influence P/C Insurer Growth Opportunities

Growth Will Expand Insurer Exposure Base Across Most Lines, Especially Workers Comp

US Real GDP Growth*





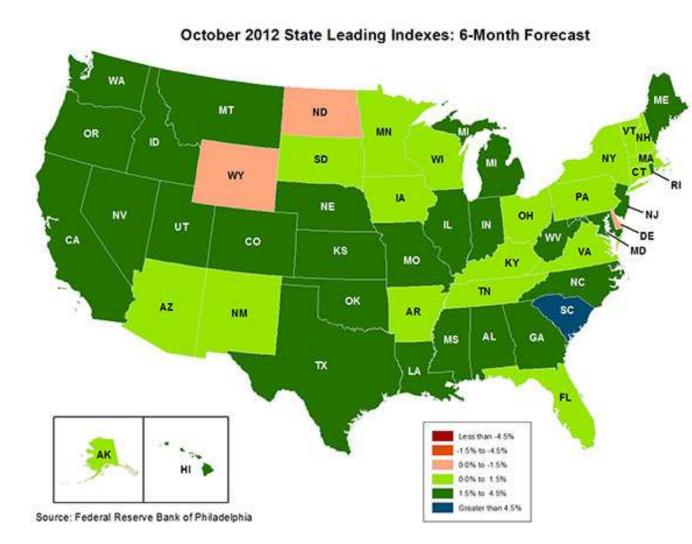
Demand for Insurance Continues To Be Impacted by Sluggish Economic Conditions, but the Benefits of Even Slow Growth Will Compound and Gradually Benefit the Economy Broadly

* Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 1/13; Insurance Information Institute.

State-by-State Leading Indicators through 2013:Q1

INSURANCE INFORMATION INSTITUTE



Near-term growth forecasts vary widely by state

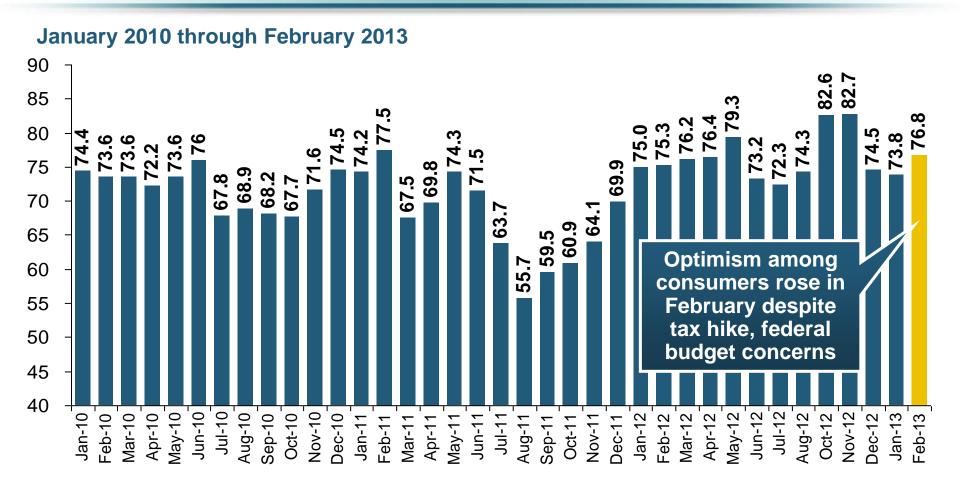
5 Fastest Growing States	
South Carolina	6.97%
Michigan	4.32%
West Virginia	3.59%
Idaho	3.14%
Georgia	3.04%

5 Slowest Growing States

Wyoming	-1.09%
Delaware	-0.24%
North Dakota	-0.19%
Vermont	0.09%
Minnesota	0.18%

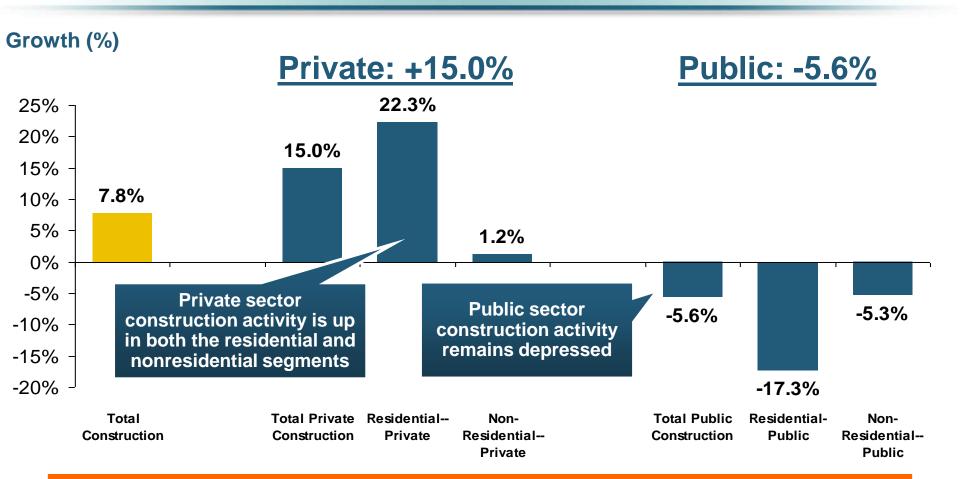
Sources: Federal Reserve Bank of Philadelphia at http://www.philadelphiafed.org/index.cfm ;Insurance Information Institute.

Consumer Sentiment Survey (1966 = 100)



Consumer confidence has been low for years amid high unemployment, falling home prices and other factors adversely impact consumers, but improved substantially in late 2011 and in 2012

Value of Construction Put in Place, December 2012 vs. December 2011*



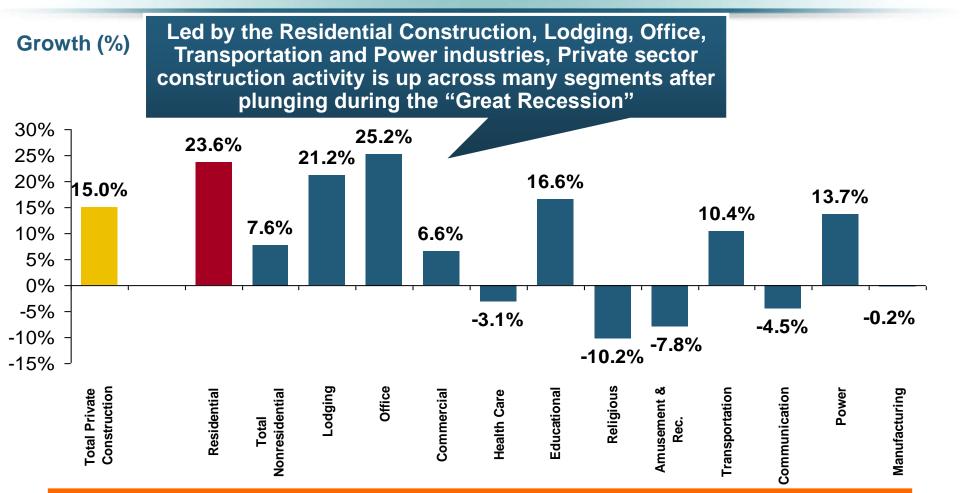
Overall Construction Activity is Up, But Growth Is Entirely in the Private Sector as State/Local Government Budget Woes Continue

*seasonally adjusted

Source: U.S. Census Bureau, <u>http://www.census.gov/construction/c30/c30index.html</u>; Insurance Information Institute.

INSURANCE

Value of Private Construction Put in Place, by Segment, Dec. 2012 vs. Dec. 2011*

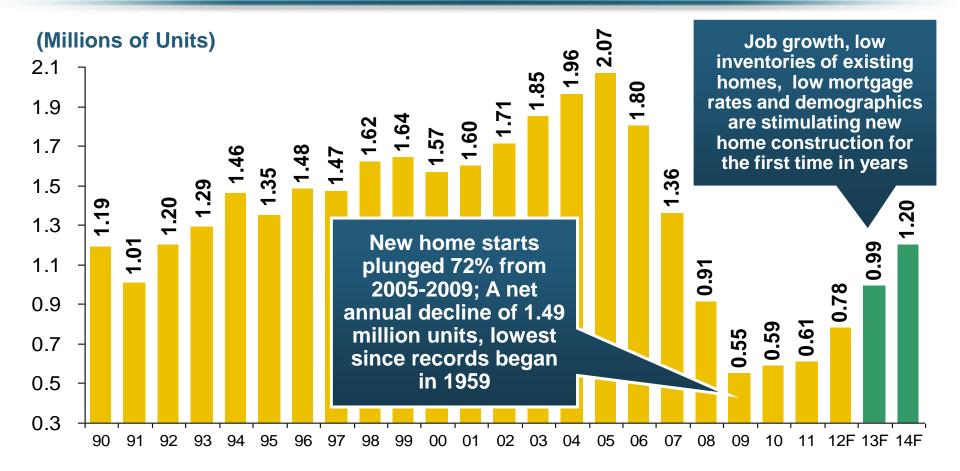


Private Construction Activity is Up in Most Segments, Including the Key Residential Construction Sector

*seasonally adjusted

Source: U.S. Census Bureau, <u>http://www.census.gov/construction/c30/c30index.html</u>; Insurance Information Institute.

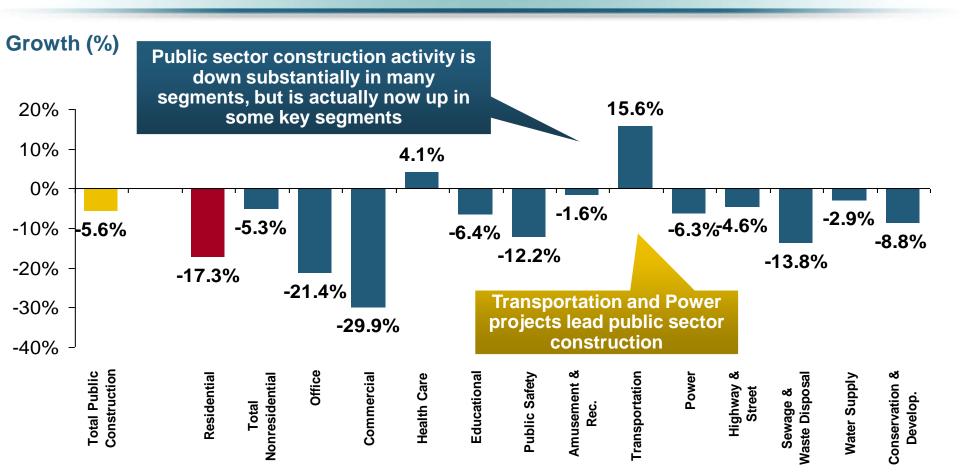
New Private Housing Starts, 1990-2014F



Homeowners Insurers Are Starting to See Meaningful Exposure Growth for the First Time Since 2005. Commercial Insurers with Construction Risk Exposure, Surety Also Benefit

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (2/13); Insurance Information Institute.

Value of Public Construction Put in Place, by Segment, Dec. 2012 vs. Dec. 2011*



Public Construction Activity is Down in Many Segments as State and Local Budgets Remain Under Stress; Improvement Possible in 2013.

*seasonally adjusted

Source: U.S. Census Bureau, <u>http://www.census.gov/construction/c30/c30index.html</u>; Insurance Information Institute.

INSURANCE

Construction Employment, Jan. 2010—January 2013*

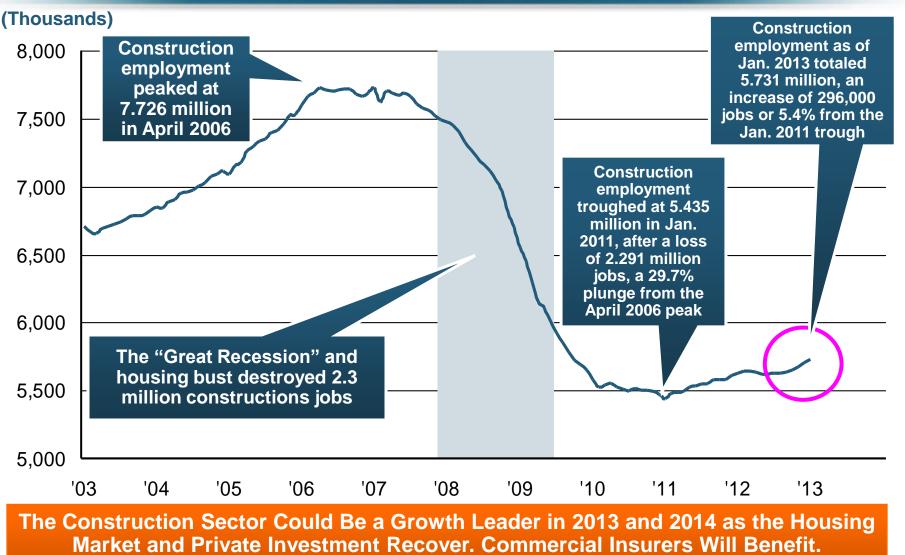




*Seasonally adjusted Sources: US Bureau of Labor Statistics at <u>http://data.bls.gov;</u> Insurance Information Institute.

Construction Employment, Jan. 2003–Jan. 2013



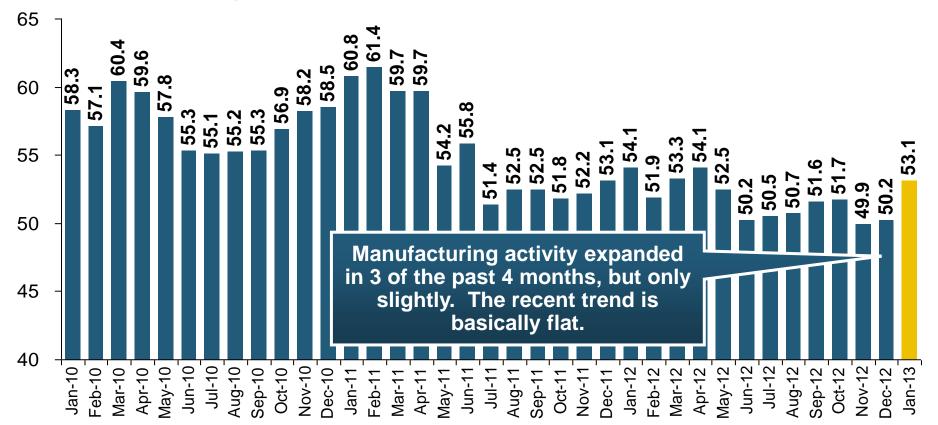


Note: Recession indicated by gray shaded column.

Sources: U.S. Bureau of Labor Statistics; Insurance Information Institute.

ISM Manufacturing Index (Values > 50 Indicate Expansion)

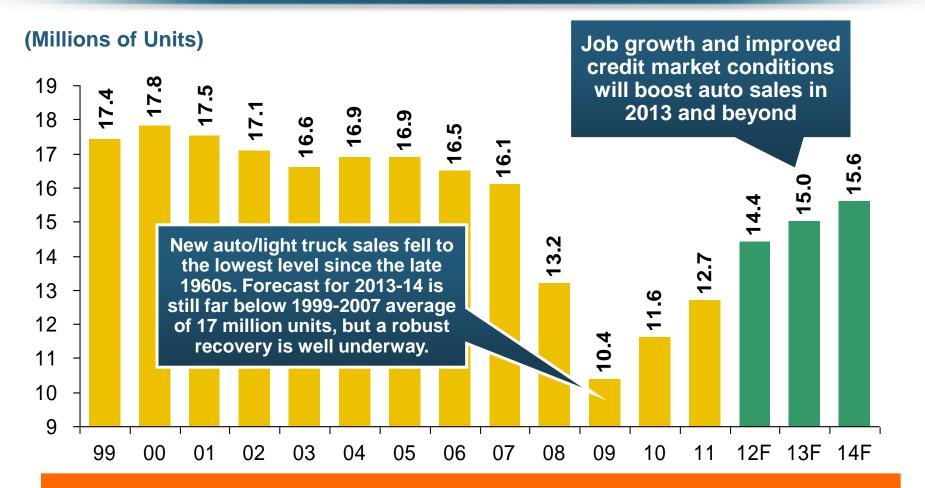




The manufacturing sector expanded for 33 of the 37 months from Jan. 2010 through Jan. 2013. The question is whether this will continue.

Source: Institute for Supply Management at <u>http://www.ism.ws/ismreport/mfgrob.cfm</u>; Insurance Information Institute.

Auto/Light Truck Sales, 1999-2014F



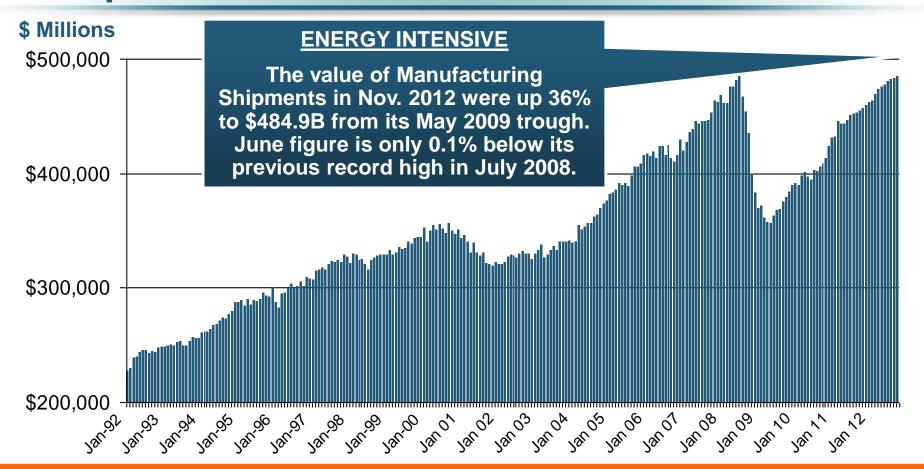
Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, Bolstering the Auto Insurer Growth and the Manufacturing Sector.

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (1/13); Insurance Information Institute.

NSURANCE

Dollar Value* of Manufacturers' Shipments Monthly, Jan. 1992—Dec. 2012



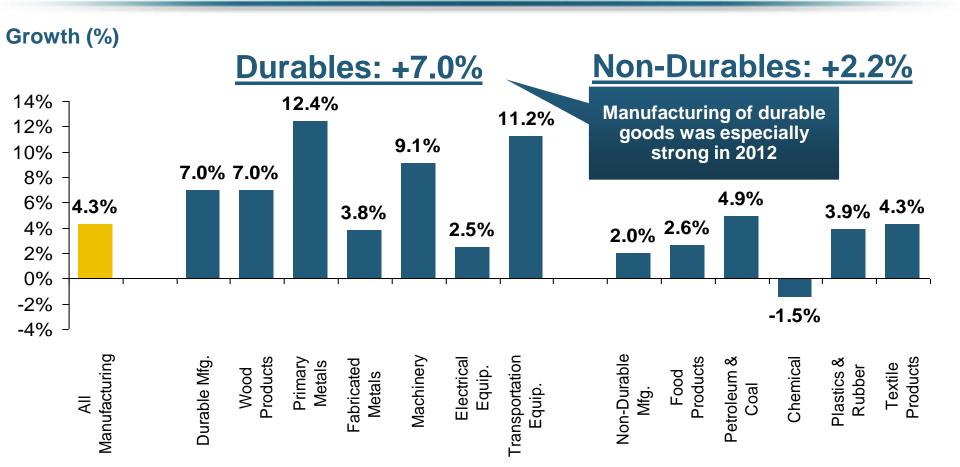


Monthly shipments are nearly back to peak (in July 2008, 8 months into the recession). Trough in May 2009. Growth from trough to Dec. 2012 was 36%. Manufacturing is an energy intensive activity and growth leads to gains in many commercial exposures: WC, **Commercial Auto, Marine, Property and Various Liability Coverages**

*seasonally adjusted

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

Manufacturing Growth for Selected Sectors, 2012 vs. 2011*

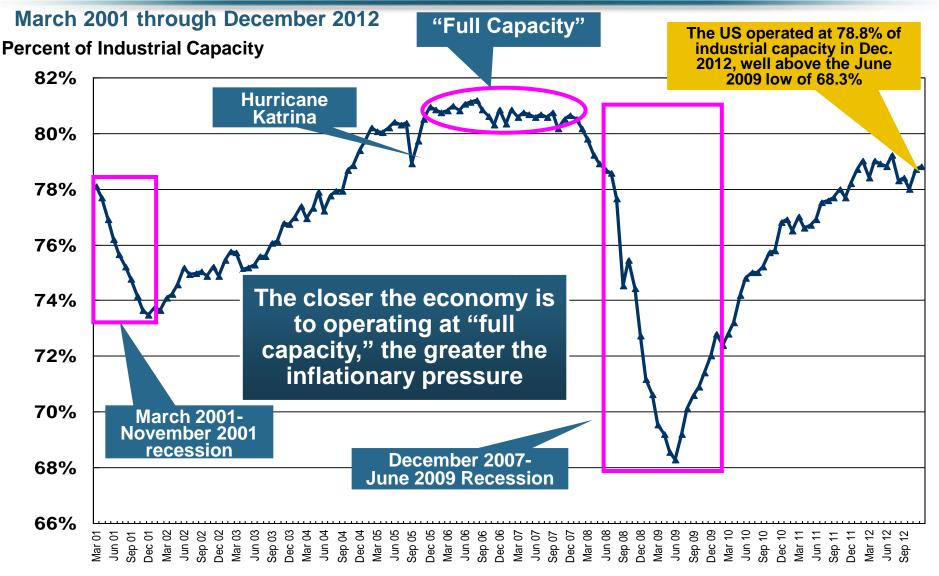


Manufacturing Is Expanding Across a Wide Range of Sectors that Will Contribute to Growth in Insurable Exposures Including: WC, Commercial **Property, Commercial Auto and Many Liability Coverages**

*Seasonally adjusted; Date are YTD comparing data through December 2012 to the same period in 2011. Source: U.S. Census Bureau, Full Report on Manufacturers' Shipments, Inventories, and Orders, http://www.census.gov/manufacturing/m3/

INSURANCE INFORMATION

Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures



Source: Federal Reserve Board statistical releases at <u>http://www.federalreserve.gov/releases/g17/Current/default.htm</u>.

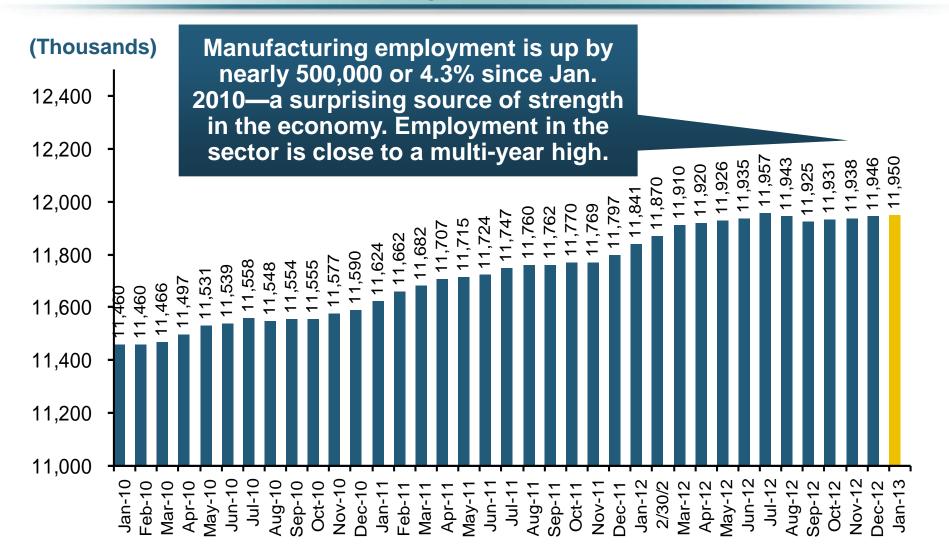
76

INSURANCE

INFORMATION

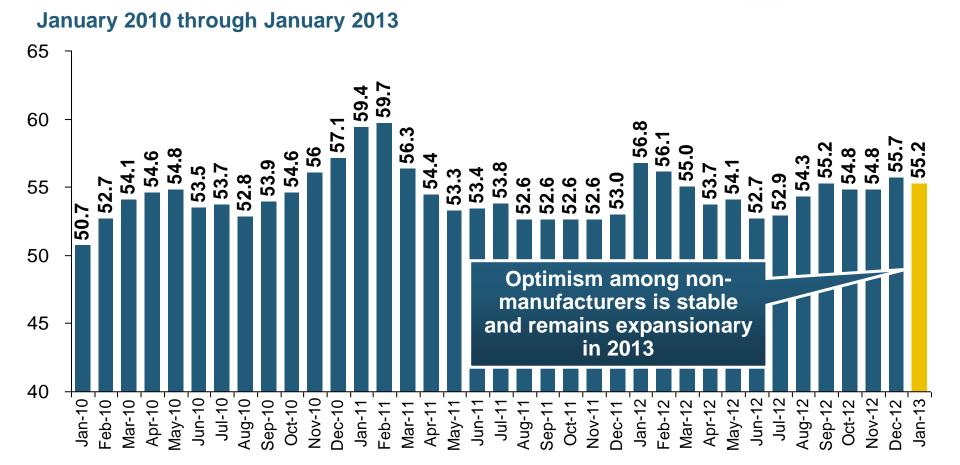
Manufacturing Employment, Jan. 2010—January 2013*





*Seasonally adjusted Sources: US Bureau of Labor Statistics at <u>http://data.bls.gov;</u> Insurance Information Institute.

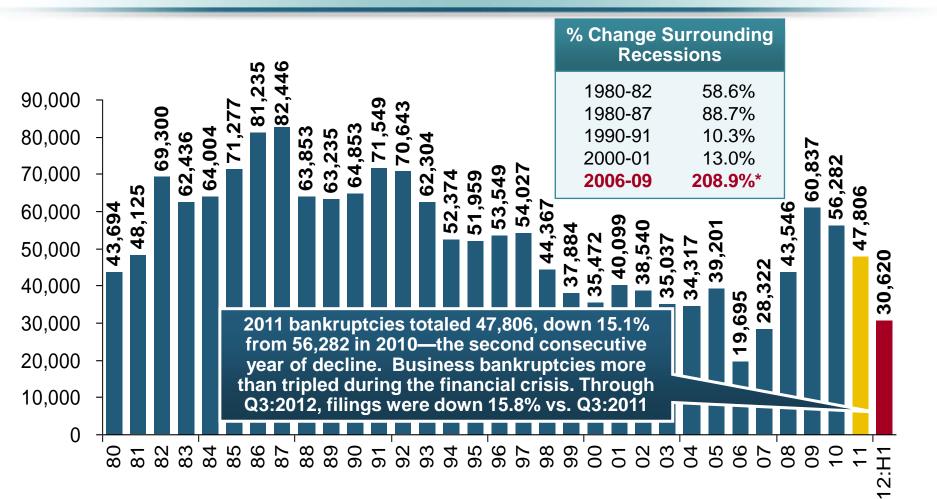
ISM Non-Manufacturing Index (Values > 50 Indicate Expansion)



Non-manufacturing industries have been expanding and adding jobs. The question is whether this will continue.

Source: Institute for Supply Management at http://www.ism.ws/ismreport/nonmfgrob.cfm; Insurance Information Institute.

Business Bankruptcy Filings, 1980-2012:Q3

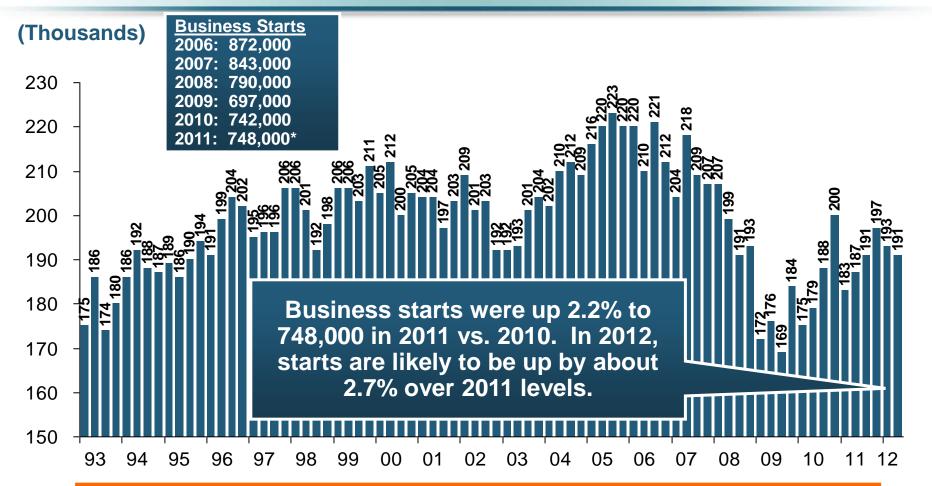


Significant Exposure Implications for All Commercial Lines as Business Bankruptcies Begin to Decline

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

INSURANCE

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



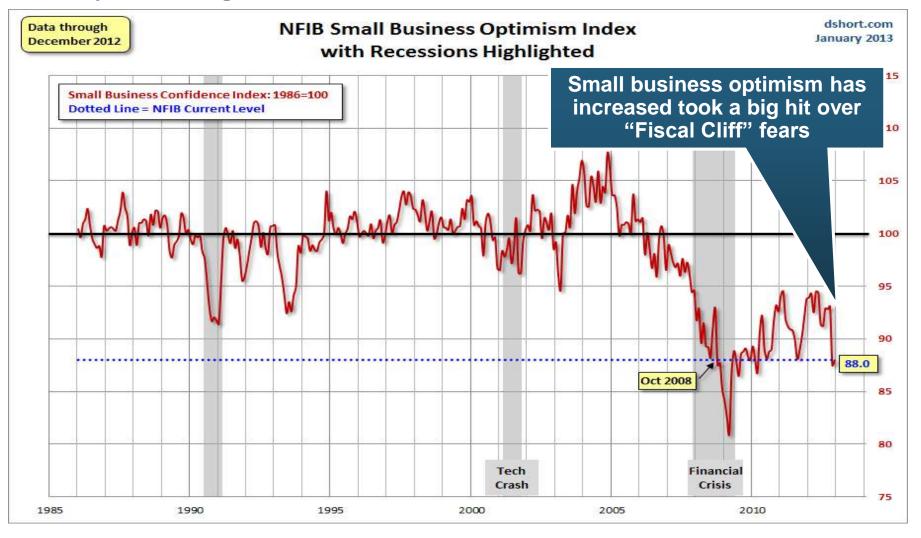
Business Starts Were Down Nearly 20% in the Recession, Holding Back Most Types of Commercial Insurance Exposure, But Are Recovering Slowly

* Data through Jun. 30, 2012 are the latest available as of Feb. 6, 2013; Seasonally adjusted. Source: Bureau of Labor Statistics, http://www.bls.gov/news.release/cewbd.t08.htm.

NFIB Small Business Optimism Index



January 1985 through December 2012



Source: National Federation of Independent Business at http://www.advisorperspectives.com/dshort/charts/indicators/Sentiment.html?NFIB-optimism-index.gif; Insurance Information Institute.

12 Industries for the Next 10 Years: Insurance Solutions Needed



Health Care		
Health Sciences		
Energy (Traditional)		
Alternative Energy	Many industries are	
Petrochemical	poised for growth, though	
Agriculture	Agriculture insurers' ability to	
Natural Resources	capitalize on these industries	
Technology (incl. Biotechnology)	varies widely	
Light Manufacturing		
Insourced Manufacturing		
Export-Oriented Industries		
Shipping (Rail, Marine, Trucking)		

82



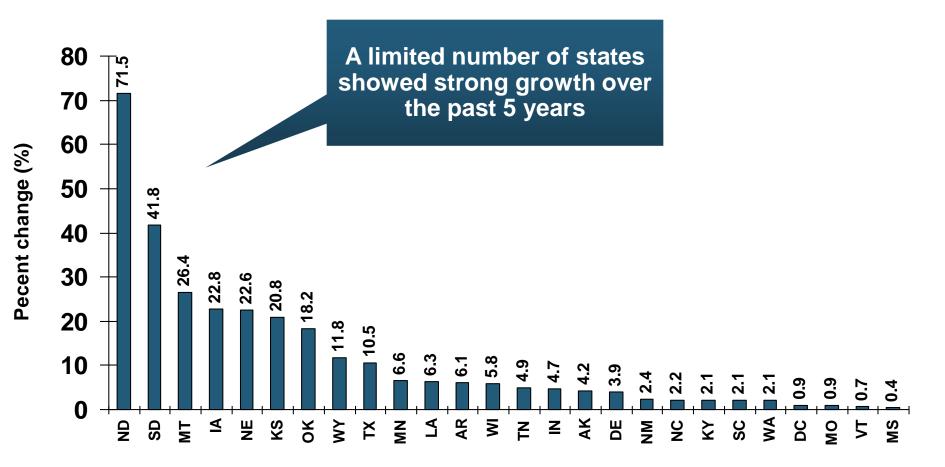
P/C Insurance Growth Analysis by State and Line

Premium Growth Rates Vary Tremendously by State Economy Plays a Big Role

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



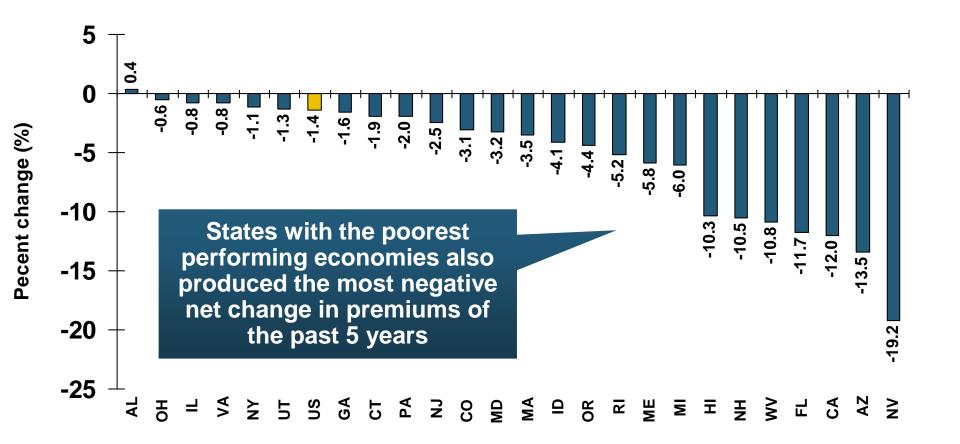
Top 25 States



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



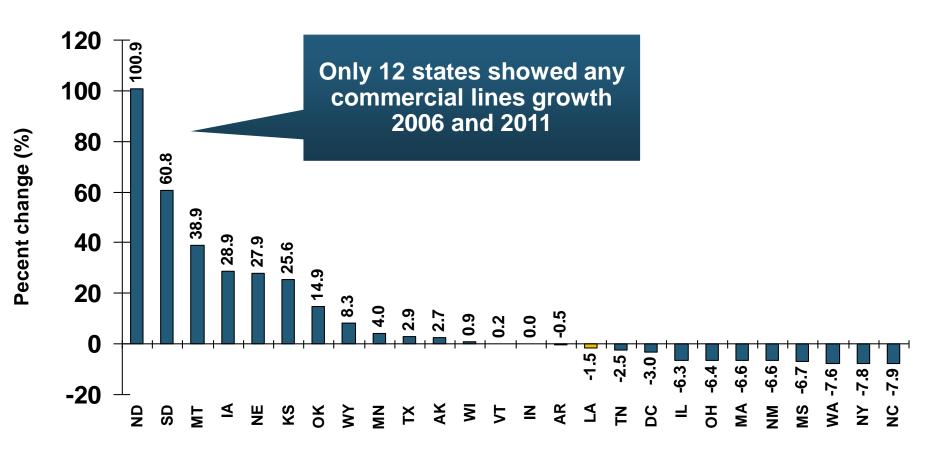
Bottom 25 States



Direct Premiums Written: Comm. Lines Percent Change by State, 2006-2011*



Top 25 States

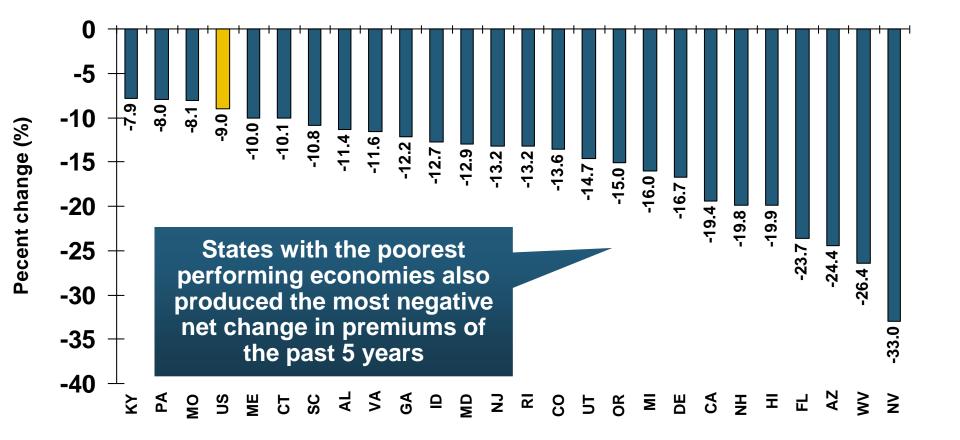


Sources: SNL Financial LC.; Insurance Information Institute.

Direct Premiums Written: Comm. Lines Percent Change by State, 2006-2011*



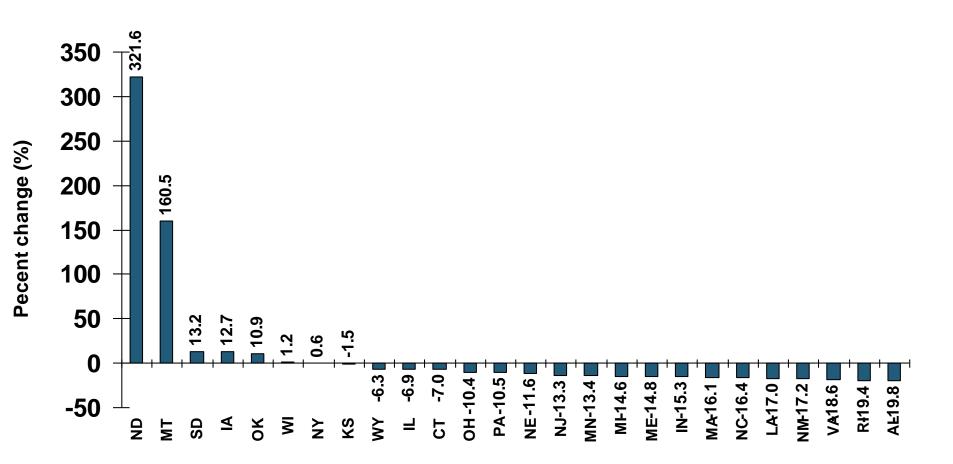
Bottom 25 States



Sources: SNL Financial LC.; Insurance Information Institute.

Direct Premiums Written: Workers' Comp

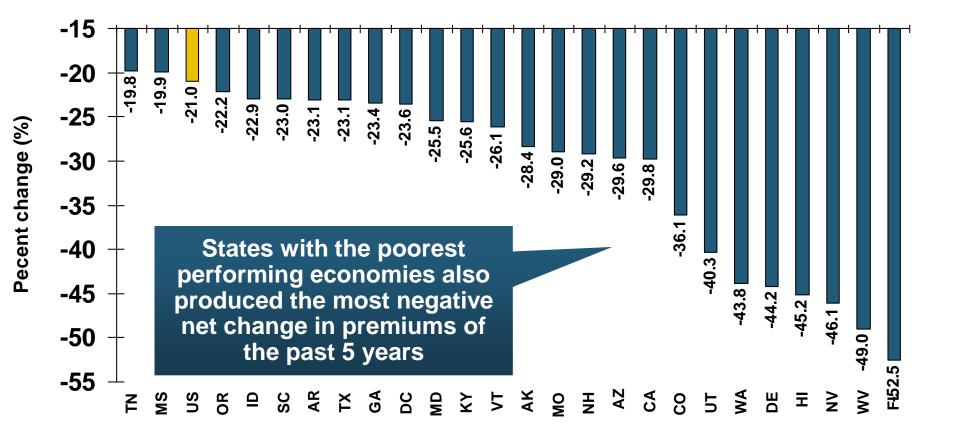
Top 25 States



*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

Bottom 25 States

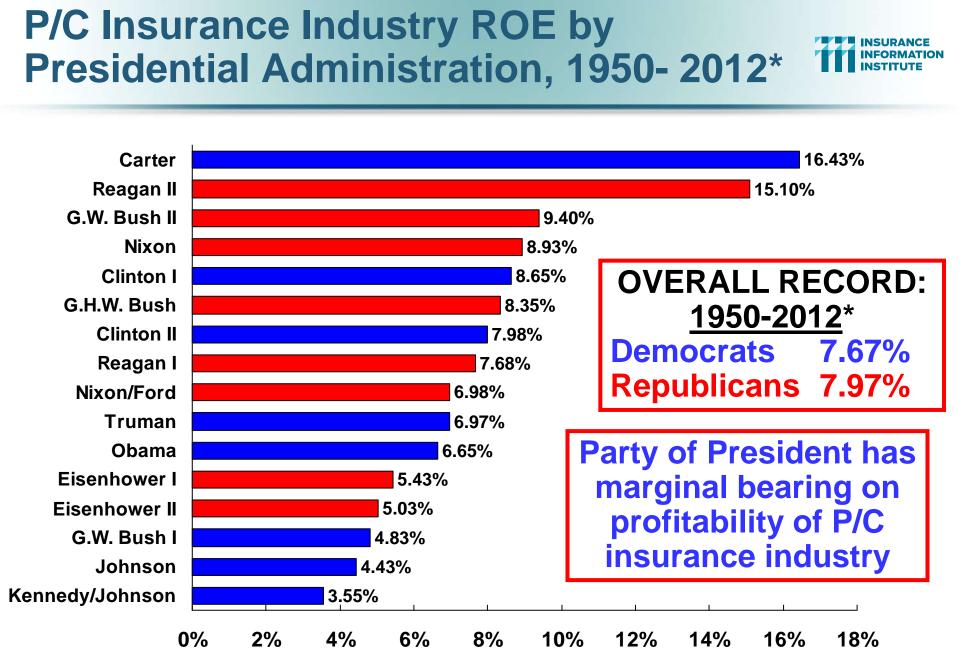


*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period. Sources: SNL Financial LC.; Insurance Information Institute.



Presidential Politics & the P/C Insurance Industry

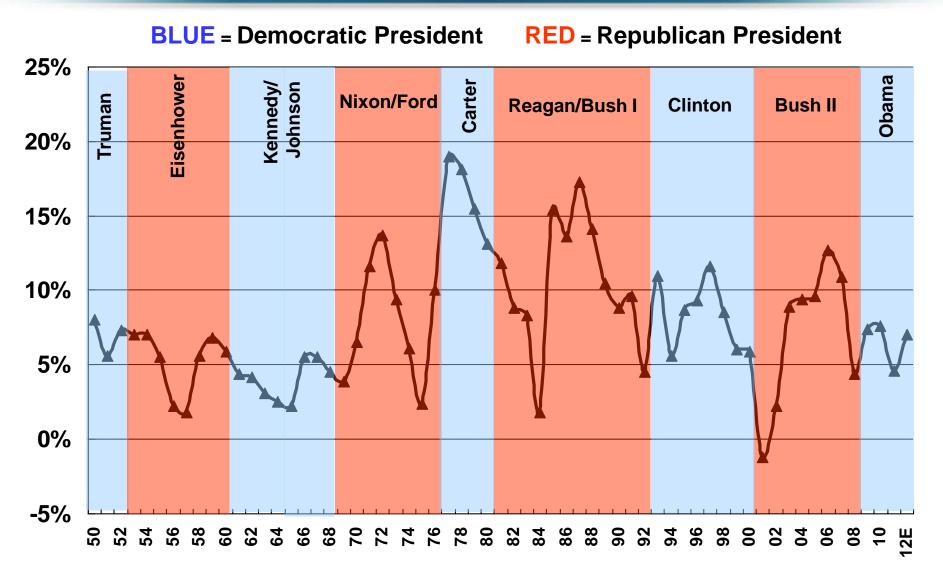
How Is Profitability Affected by the President's Political Party?



*Truman administration ROE of 6.97% based on 3 years only, 1950-52; ROEs for the years 2008 forward exclude mortgage and financial guaranty segments. Estimated ROE for 2012 = 7.0%.

Source: Insurance Information Institute

P/C insurance Industry ROE by Presidential Party Affiliation, 1950- 2012*



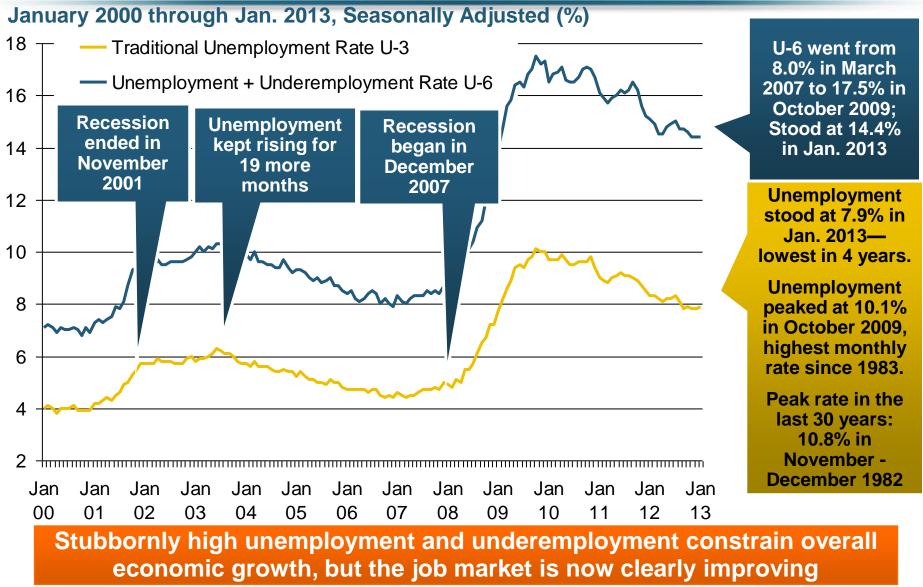
*ROEs for the years 2008 forward exclude mortgage and financial guaranty segments; Estimated 2012 ROE = 7.0% Source: Insurance Information Institute



Labor Market Trends

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

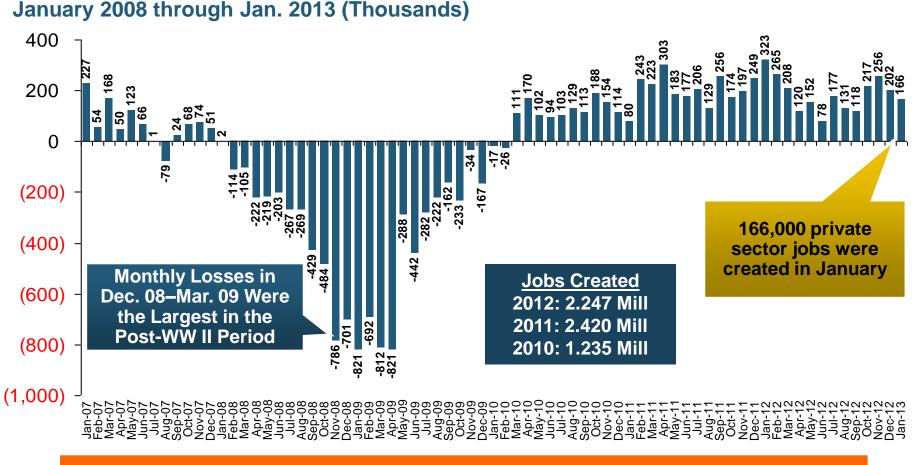
Unemployment and Underemployment Rates: Stubbornly High in 2012, But Falling



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

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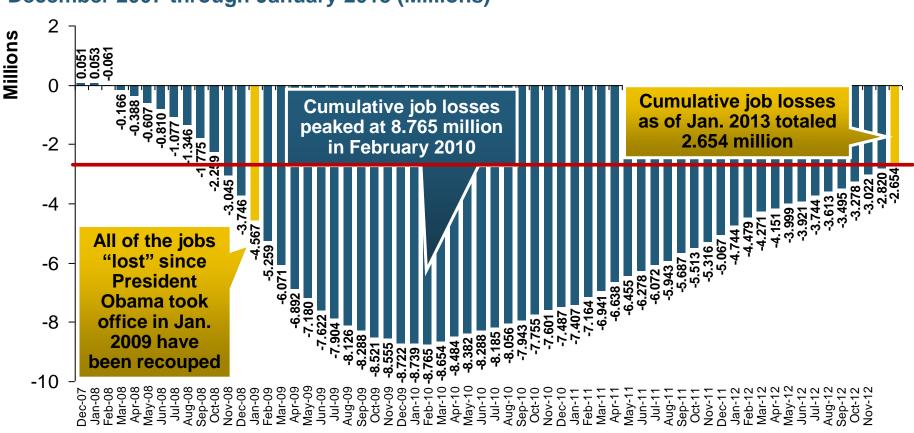
Monthly Change in Private Employment



Private Employers Added 6.07million Jobs Since Jan. 2010 After Having Shed 4.98 Million Jobs in 2009 and 3.80 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)

Source: US Bureau of Labor Statistics: <u>http://www.bls.gov/ces/home.htm;</u> Insurance Information Institute

Cumulative Change in Private Employment: Dec. 2007—Jan. 2013



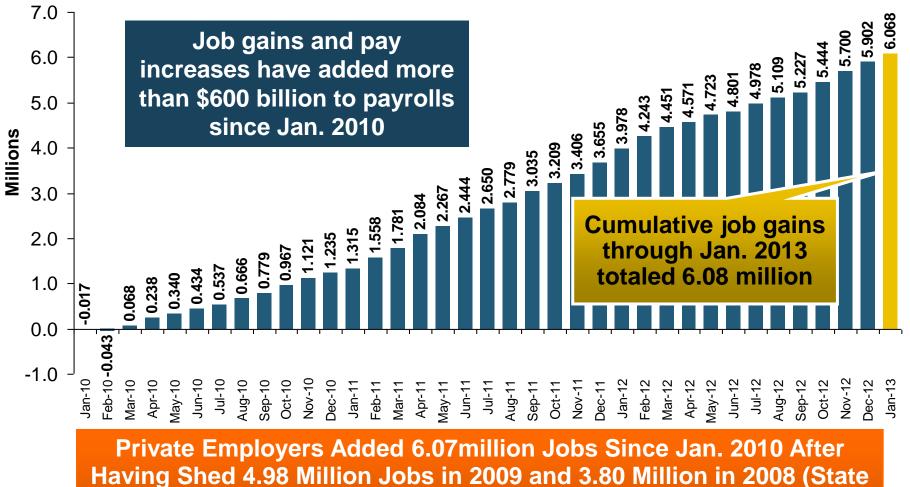
December 2007 through January 2013 (Millions)

Private Employers Added 6.07million Jobs Since Jan. 2010 After Having Shed 4.98 Million Jobs in 2009 and 3.80 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)

Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Information Institute

Cumulative Change in Private Sector Employment: Jan. 2010—Jan. 2013

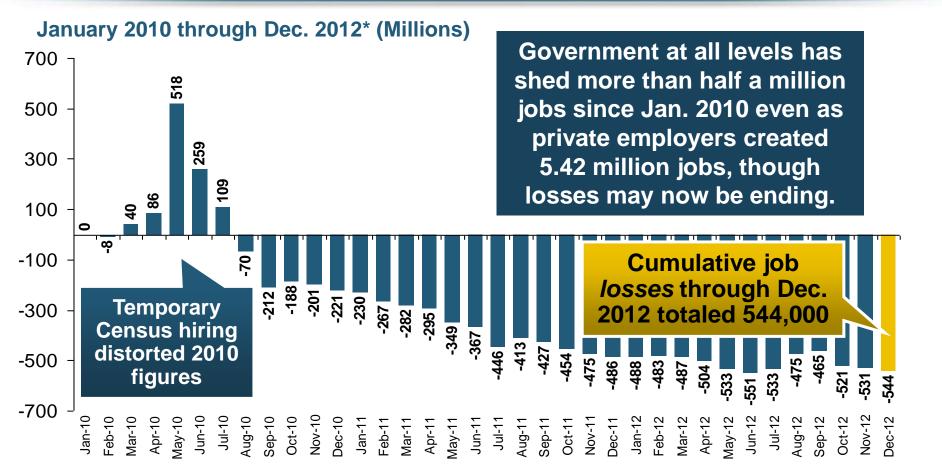
January 2010 through January 2013* (Millions)



and Local Governments Have Shed Hundreds of Thousands of Jobs)

Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Information Institute

Cumulative Change in Government Employment: Jan. 2010—Dec. 2012



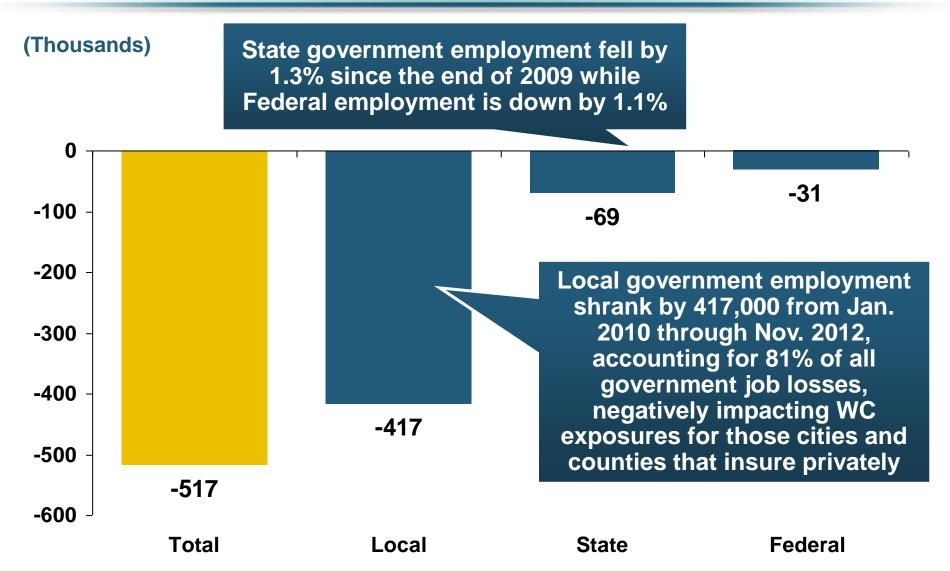
Governments at All Levels are Under Severe Fiscal Strain As Tax Receipts Plunged and Pension Obligations Soared During the Financial Crisis, Causing Them to Reduce Staff

Source: US Bureau of Labor Statistics <u>http://www.bls.gov/data/#employment;</u> Insurance Information Institute

NSURANC

Net Change in Government Employment: Jan. 2010—Nov. 2012*

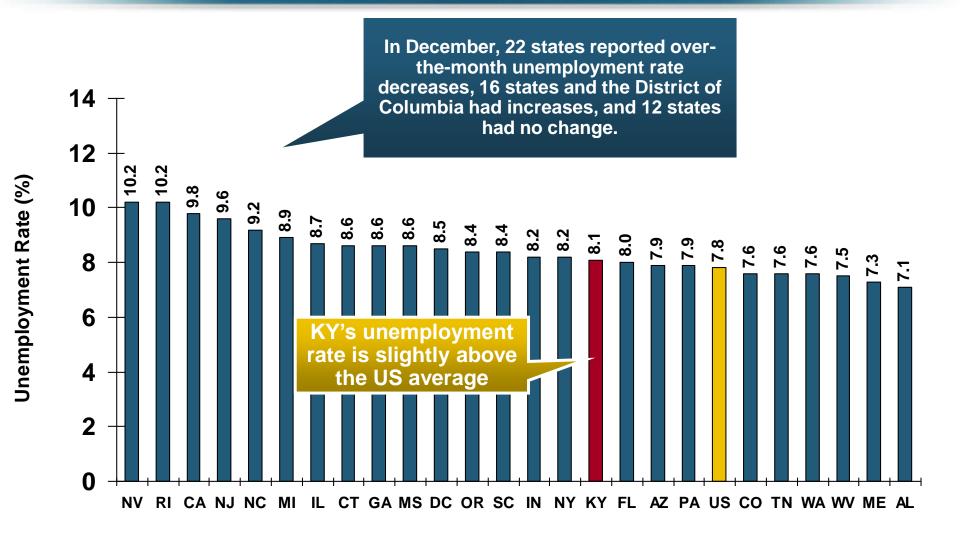




*Cumulative change from prior month; Base employment date is Dec. 2009.

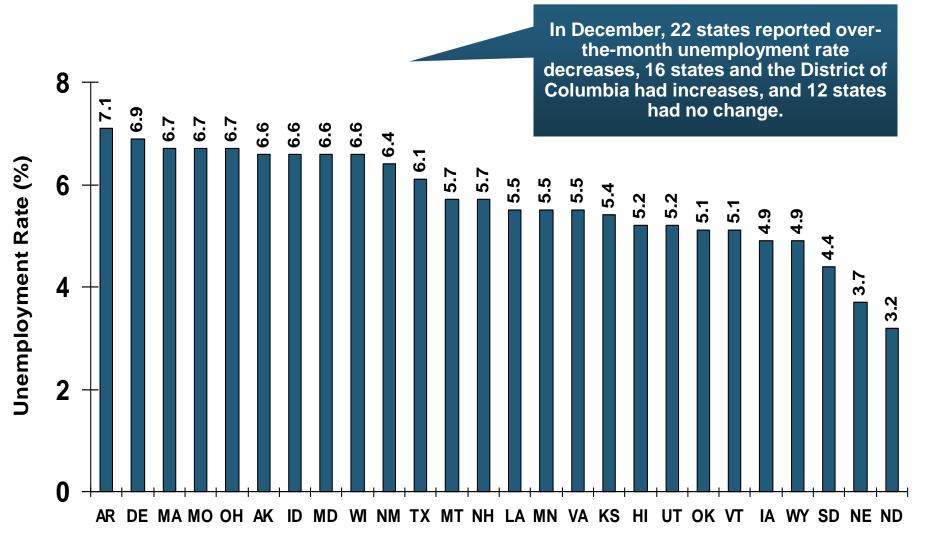
Source: US Bureau of Labor Statistics http://www.bls.gov/data/#employment; Insurance Information Institute

Unemployment Rates by State, December 2012: History Highest 25 States*



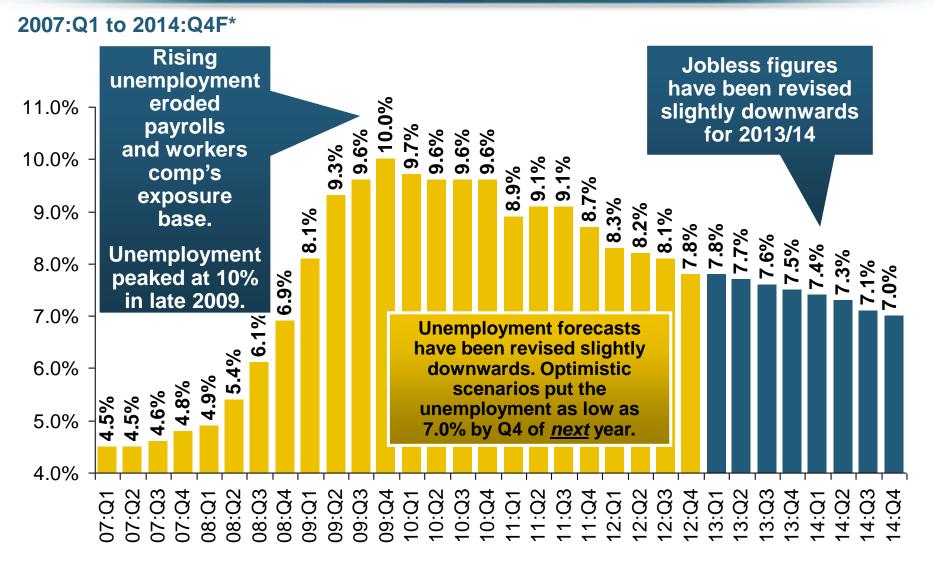
*Provisional figures for December 2012, seasonally adjusted. Sources: US Bureau of Labor Statistics; Insurance Information Institute.

Unemployment Rates by State, December 2012: INSURANCE Lowest 25 States*



*Provisional figures for December 2012, seasonally adjusted. Sources: US Bureau of Labor Statistics; Insurance Information Institute.

US Unemployment Rate Forecast



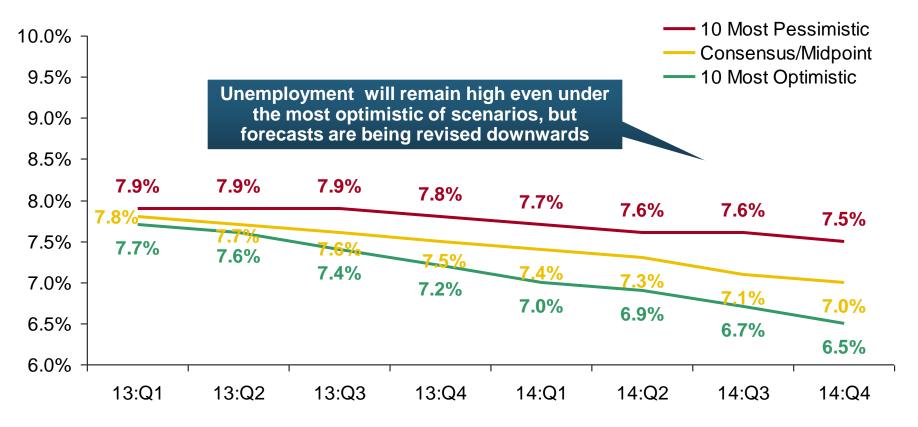
= actual; = forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (2/13 edition); Insurance Information Institute.

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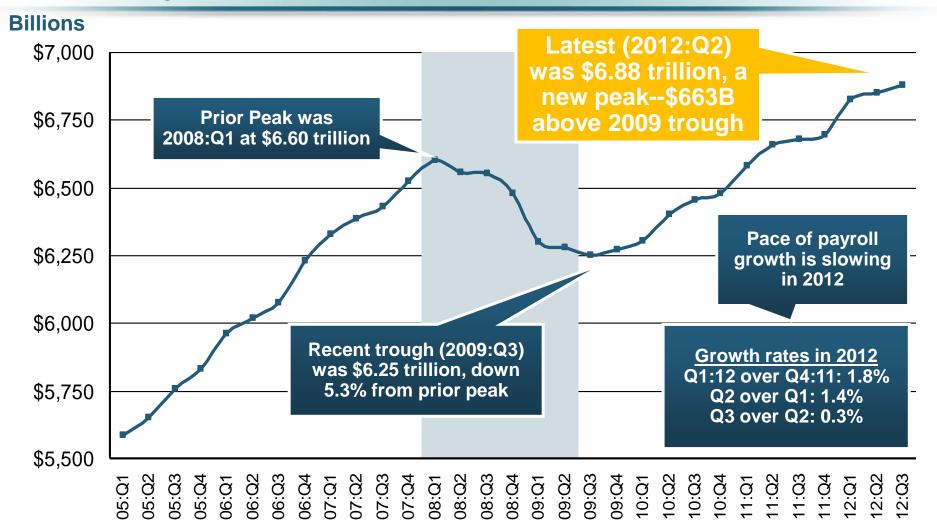
US Unemployment Rate Forecasts

Quarterly, 2013:Q1 to 2014:Q4



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Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2012:Q3

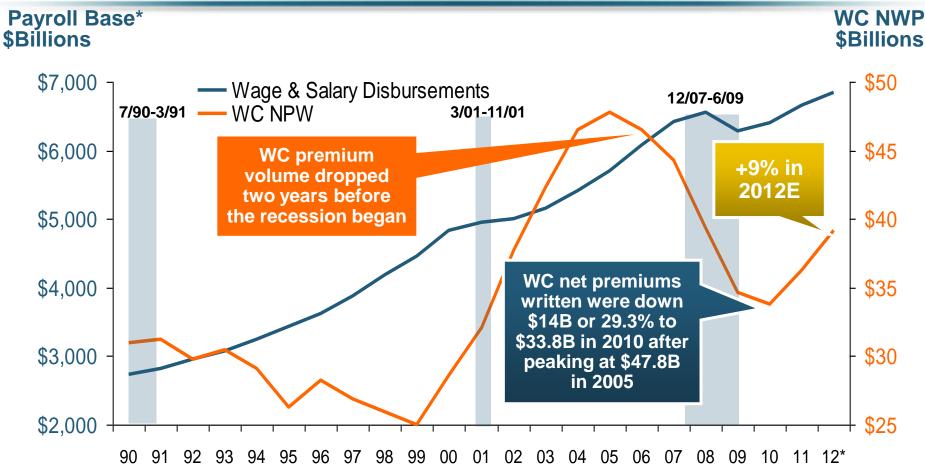


Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

Sources: <u>http://research.stlouisfed.org/fred2/series/WASCUR;</u> National Bureau of Economic Research (recession dates); Insurance Information Institute.

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Payroll vs. Workers Comp Net Written Premiums, 1990-2012E



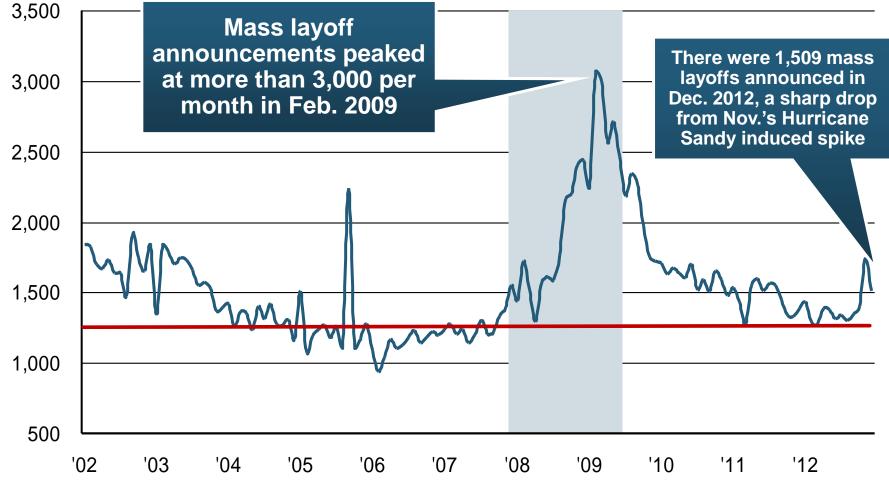
Continued Payroll Growth and Rate Increases Suggest WC NWP Will Grow Again in 2012; +7.9% Growth in 2011 Was the First Gain Since 2005

*Private employment; Shaded areas indicate recessions. Payroll and WC premiums for 2012 is I.I.I. estimate based YTD 2012 actuals. Sources: NBER (recessions); Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR ; NCCI; I.I.I.

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Mass Layoff Announcements, Jan. 2002—December 2012*





*Seasonally adjusted.

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics at <u>http://www.bls.gov/mls/;</u> National Bureau of Economic Research (recession dates); Insurance Information Institute.



The BIG Question: Where Is the Market Heading?

Catastrophes and Other Factors Are Pressuring Insurance Markets New Factor: Record Low Interest Rates Are Contributing to Underwriting and Pricing Pressures

Historical Criteria for a "Market Turn": Low Interest Rates Add New Pressure



Criteria	Status	Comments
Sustained Period of Large Underwriting Losses	Pushed Up	 CAT Losses contributing to higher underwriting losses Apart from CAT losses, overall p/c underwriting losses remain modest Combined ratios (ex-CATs) still in low 100s (vs. 110+ at onset of last hard market); CR= 101.1 in H1:2012 (ex-M&FG) Prior-year reserve releases continue to reduce u/w losses, boost ROEs, though more modestly
Material Decline in Surplus/ Capacity	Small Decline Due to 2011 Cats; Could	 Fell 1.6% in 2011 due to CATs Surplus reached record as of 9/30/12 record \$583.5B Likely drop as of 12/31/12 due to Sandy impact Modest growth in demand for insurance should begin to absorb some capacity
Tight Reinsurance Market	Somewhat in Place	 Ample capacity Market is generally flat except up for cat-impacted accounts Lower prices in Europe
Renewed Underwriting & Pricing Discipline	Sustained,esp.	 Commercial lines pricing is consistently and uniformly across all major lines, esp. Property & WC; Markets remain competitive in most segments

Sources: Barclays Capital; Insurance Information Institute.



INVESTMENTS: THE NEW REALITY

Investment Performance is a Key Driver of Profitability

Depressed Yields Will Necessarily Influence Underwriting & Pricing

Property/Casualty Insurance Industry Investment Income: 2000–2012E¹



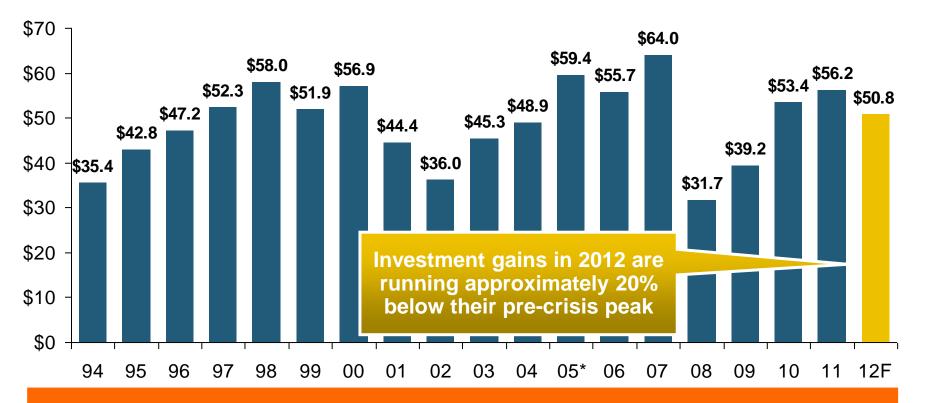
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Investment Income Fell in 2012 Due to Persistently Low Interest Rates, Putting Additional Pressure on (Re) Insurance Pricing

¹ Investment gains consist primarily of interest and stock dividends. *2012F is based on annualized 9M:2012 actual figure of \$35.131B. Sources: ISO; Insurance Information Institute.

Property/Casualty Insurance Industry Investment Gain: 1994–2012F¹

(\$ Billions)



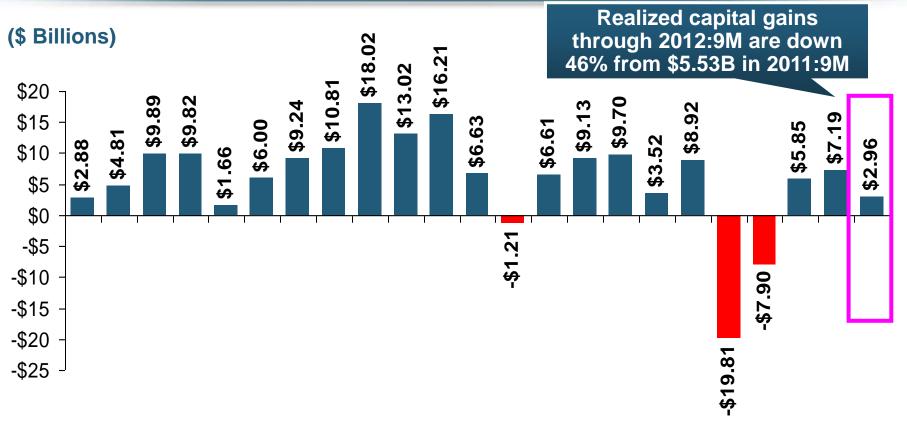
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Investment Gains Are Slipping in 2012 as Low Interest Rates Reduce Investment Income and Lower Realized Investment Gains; The Financial Crisis Caused Investment Gains to Fall by 50% in 2008

¹ Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

* 2005 figure includes special one-time dividend of \$3.2B; 2012F figure is III estimate based on annualized actual 9M:2012 result of \$38.089B. Sources: ISO; Insurance Information Institute.

P/C Insurer Net Realized Capital Gains/Losses, 1990-2012:Q3

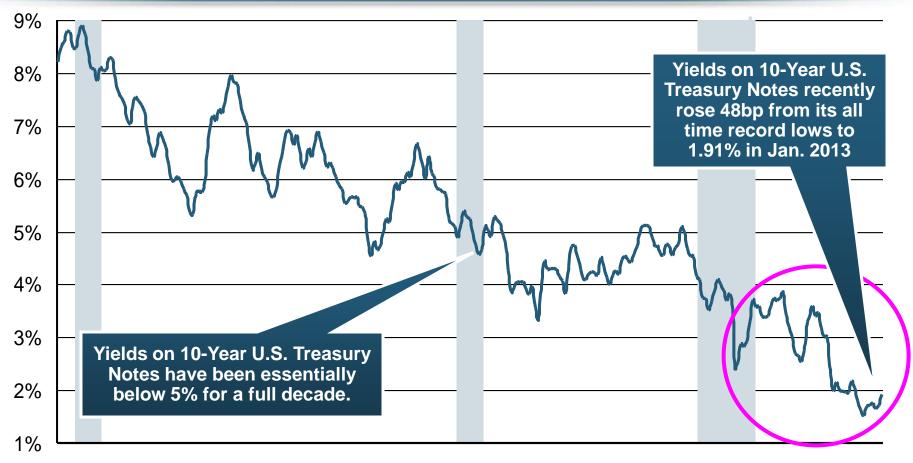


90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 1112:9M

Insurers Posted Net Realized Capital Gains in 2010, 2011 and 2012 Following Two Years of Realized Losses During the Financial Crisis. Realized Capital Losses Were the Primary Cause of 2008/2009's Large Drop in Profits and ROE

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

U.S. 10-Year Treasury Note Yields: A Long Downward Trend, 1990–2013*



'90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '10

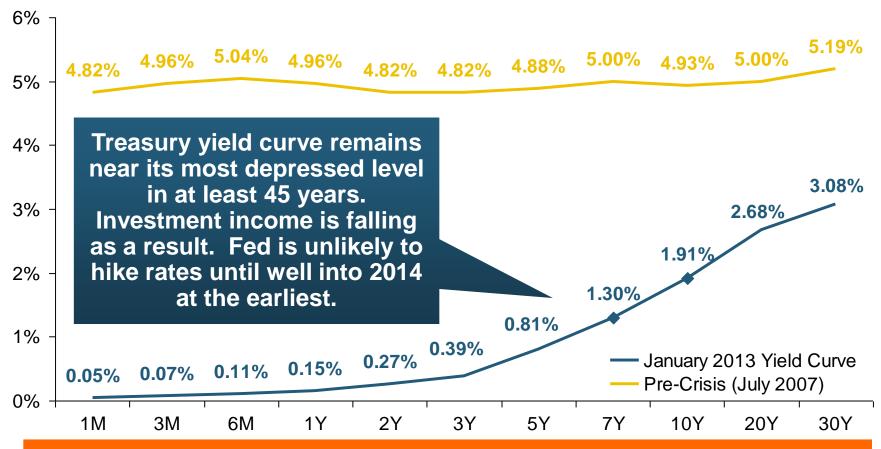
Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

*Monthly, through Jan. 2013. Note: Recessions indicated by gray shaded columns. Sources: Federal Reserve Bank at <u>http://www.federalreserve.gov/releases/h15/data.htm</u>.

National Bureau of Economic Research (recession dates); Insurance Information Institutes.

INSURANCE INFORMATION

Treasury Yield Curves: Pre-Crisis (July 2007) vs. Jan. 2013



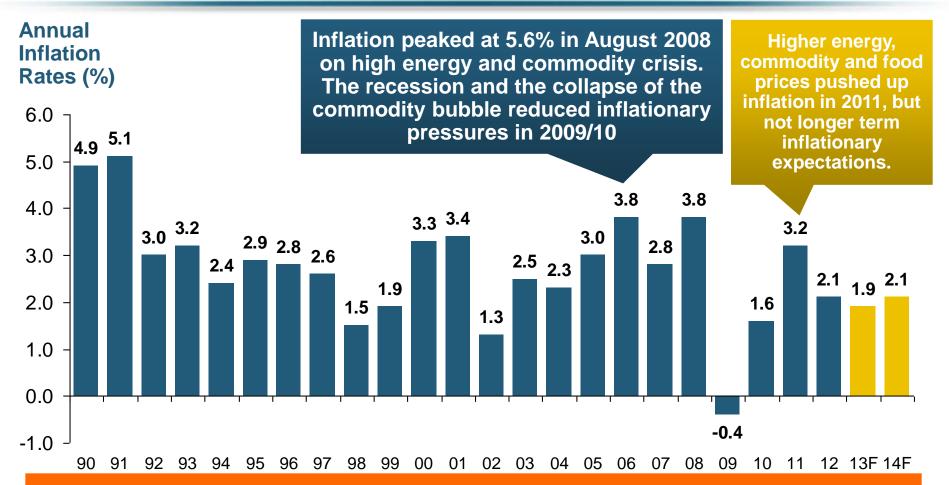
The Fed Is Actively Signaling that it Is Determined to Keep Rates Low Until Unemployment Drops Below 6.5% or Until Inflation Expectations Exceed 2.5%; Low Rates Add to Pricing Pressure for Insurers.

Source: Federal Reserve Board of Governors; Insurance Information Institute.

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

INSURANCE INFORMATION INSTITUTE

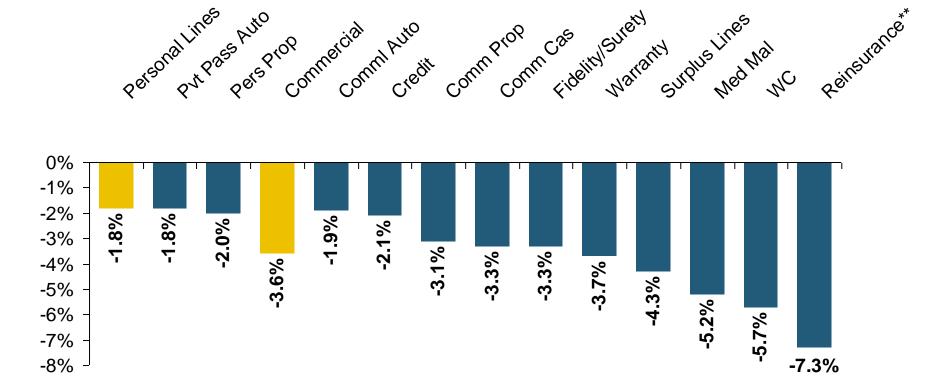


The slack in the U.S. economy suggests that inflationary pressures should remain subdued for an extended period of times. Energy, health care and commodity prices, plus U.S. debt burden, remain longer-run concerns

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 1/13 (forecasts).

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.

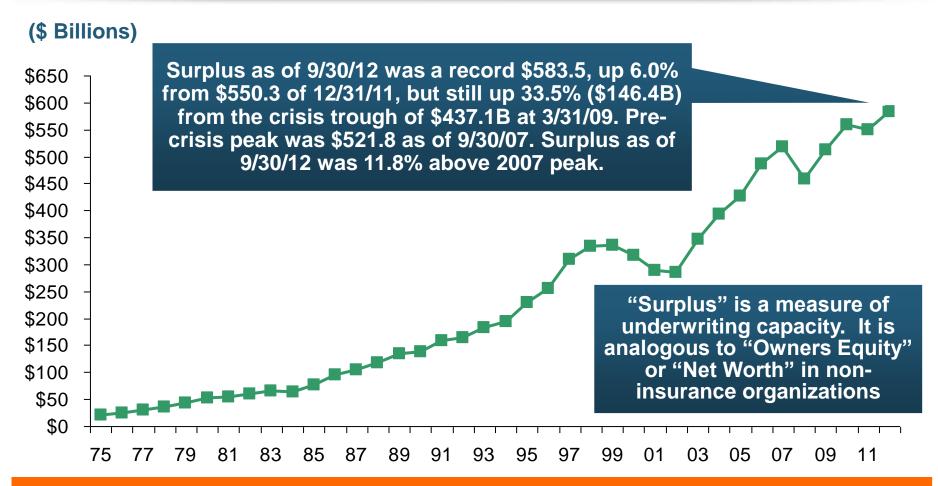


2. SURPLUS/CAPITAL/CAPACITY

How Will Large Catastrophe Losses Impact Capacity?

US Policyholder Surplus: 1975–2012*





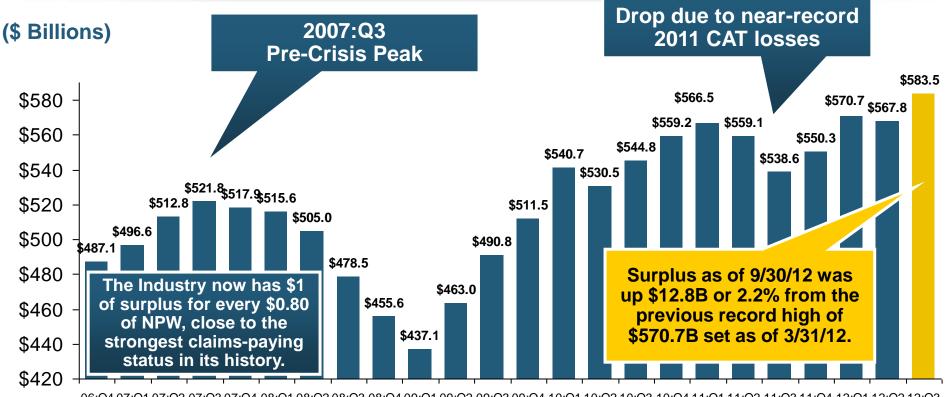
The Premium-to-Surplus Ratio Stood at \$0.80:\$1 as of 9/30/12, A Near Record Low (at Least in Recent History)*

* As of 9/30/12.

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

Policyholder Surplus, 2006:Q4–2012:Q3





06:Q4 07:Q1 07:Q2 07:Q3 07:Q4 08:Q1 08:Q2 08:Q3 08:Q4 09:Q1 09:Q2 09:Q3 09:Q4 10:Q1 10:Q2 10:Q3 10:Q4 11:Q1 11:Q2 11:Q3 11:Q4 12:Q1 12:Q2 12:Q3

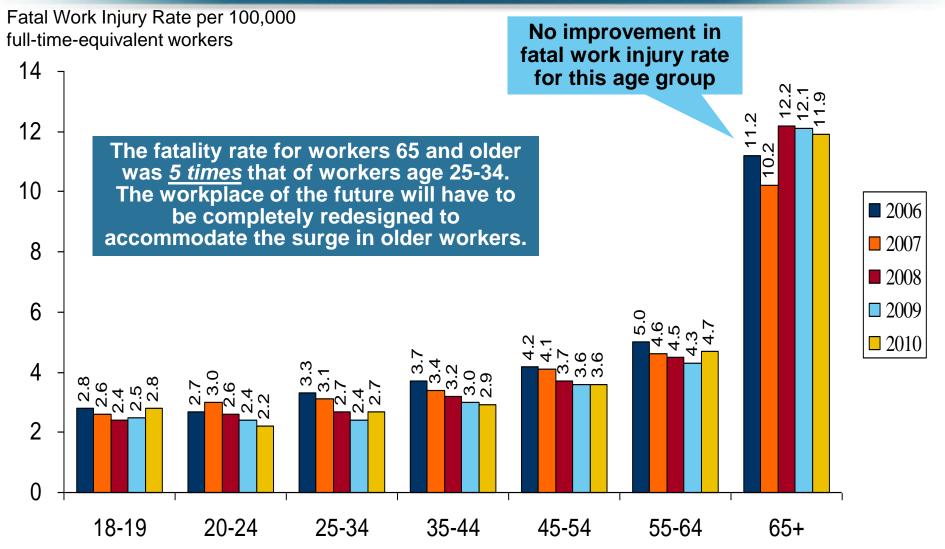
*Includes \$22.5B of paid-in capital from a holding company parent for one insurer's investment in a noninsurance business in early 2010. The P/C Insurance Industry Both Entered and Emerged from the 2012 Hurricane Season Very Strong Financially. There is No Insurance Industry "Fiscal Cliff"

Sources: ISO, A.M .Best.



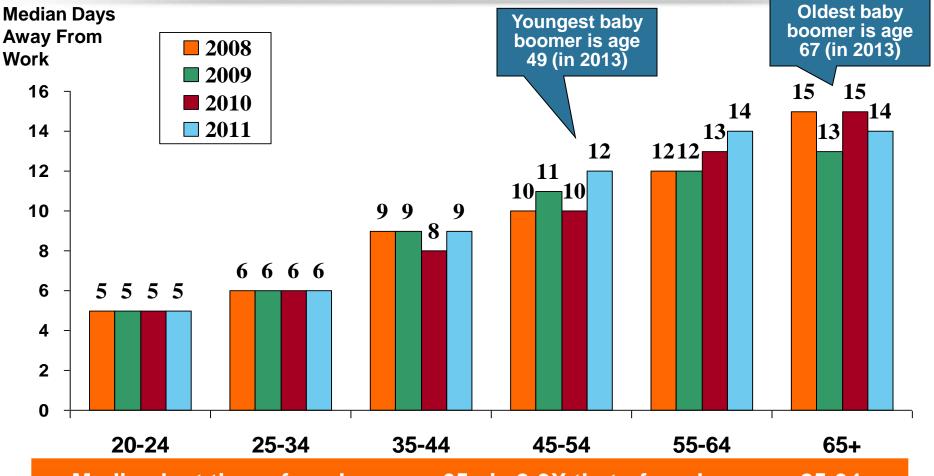
Impacts of Aging and Obesity in the Workforce

Fatal Work Injury Rates Improved Slightly Since 2006 but Still Climb Sharply With Age



Source: US Bureau of Labor Statistics, at http://www.bls.gov/iif/oshcfoi1.htm/#2010

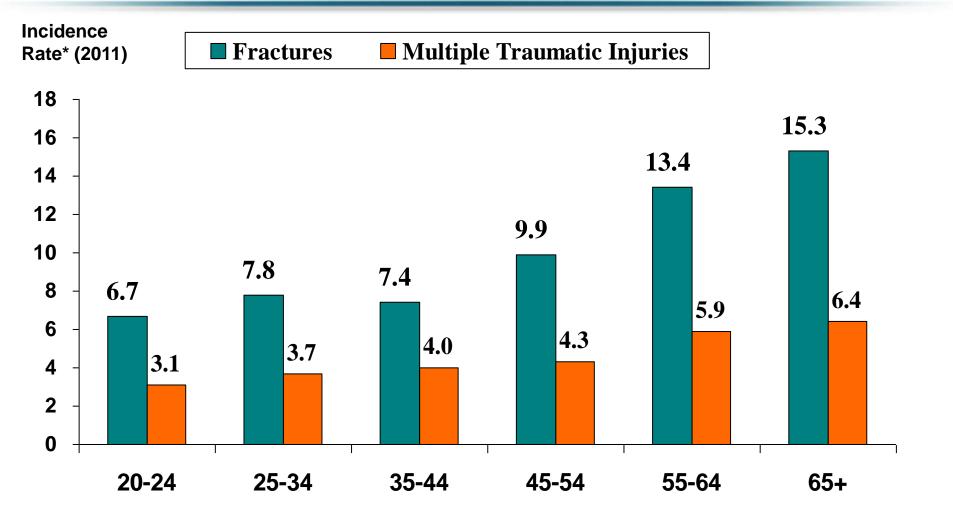
Older Workers Lose More Days from Work Due to Injury or Illness



Median lost time of workers age 65+ is 2-3X that of workers age 25-34. These numbers are pretty stable—they haven't changed much since 2008.

Source: US Bureau of Labor Statistics, *Nonfatal Occupational Injuries and Illnesses Requiring Days Away From Work, 2011* (Table 10), released November 8, 2012.

Older Workers Are Much More Likely to Break a Bone



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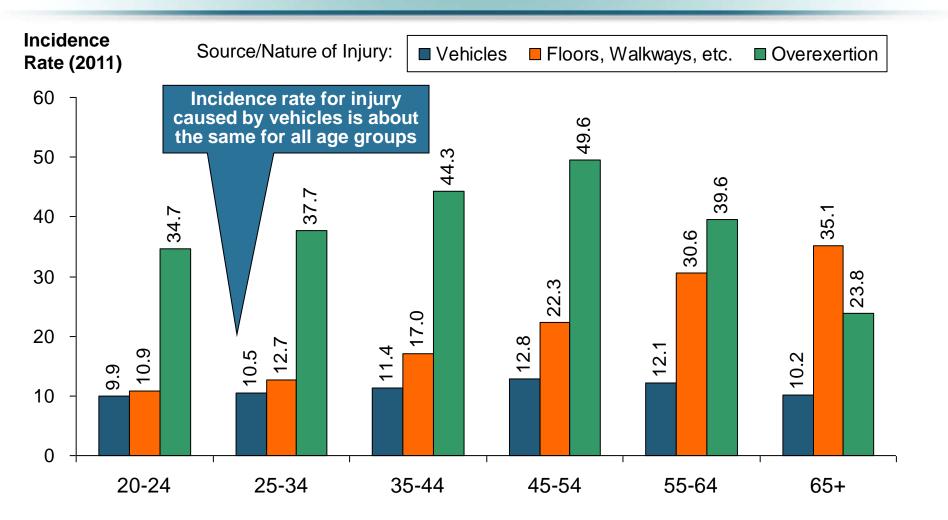
*per 10,000 full-time-equivalent workers

Source: US Bureau of Labor Statistics, US Department of Labor at http://www.bls.gov/news.release/pdf/osh2.pdf Table 14 123

Older Workers Are More Likely to Slip When Walking, but Less Likely to Overexert Themselves

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Source: US Bureau of Labor Statistics, US Department of Labor at http://www.bls.gov/news.release/pdf/osh2.pdf Table 14 124



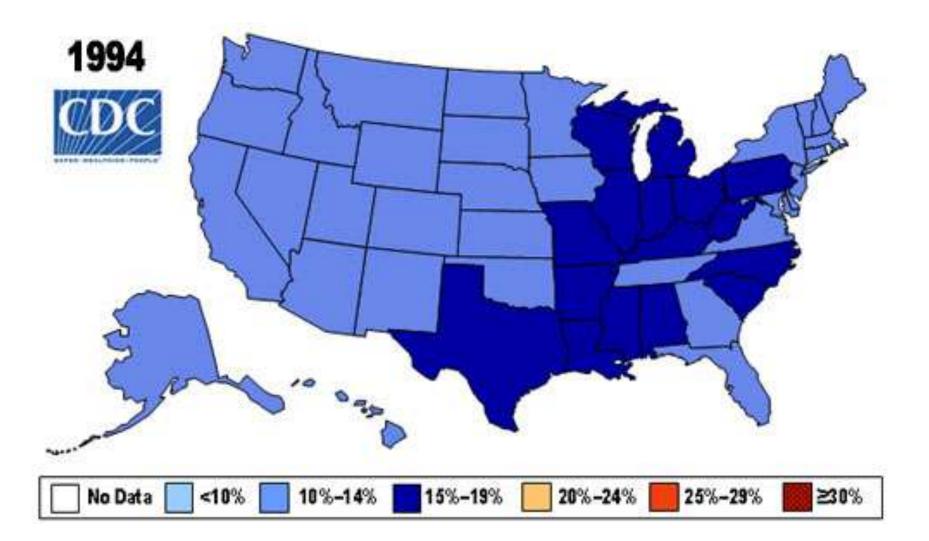
The Obesity Epidemic

In 1994, in no state was the percent of adults who were obese as high as 20%.

By 2010, all 50 states had adult obesity rates of 20% or more. In 12 states, 30% of the adults were obese.

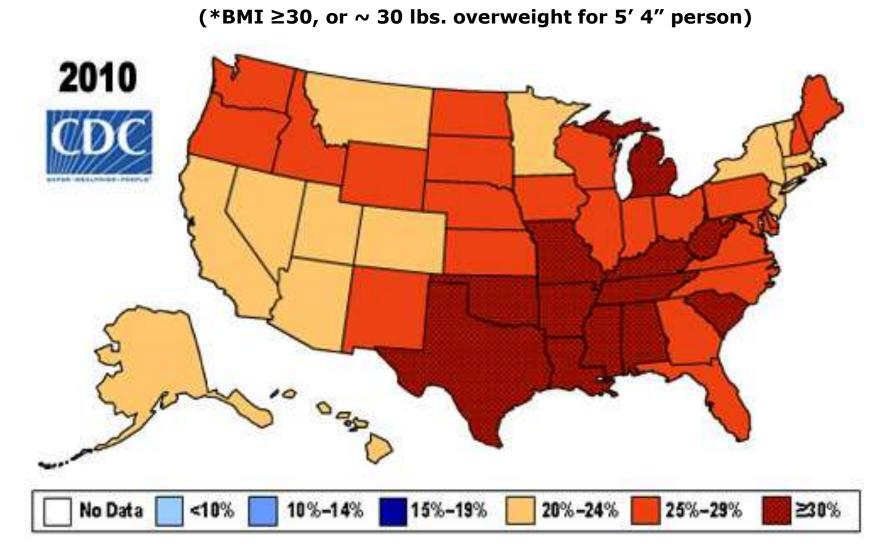
Obesity Trends Among U.S. Adults BRFSS, 1994





Obesity Trends Among U.S. Adults BRFSS, 2010

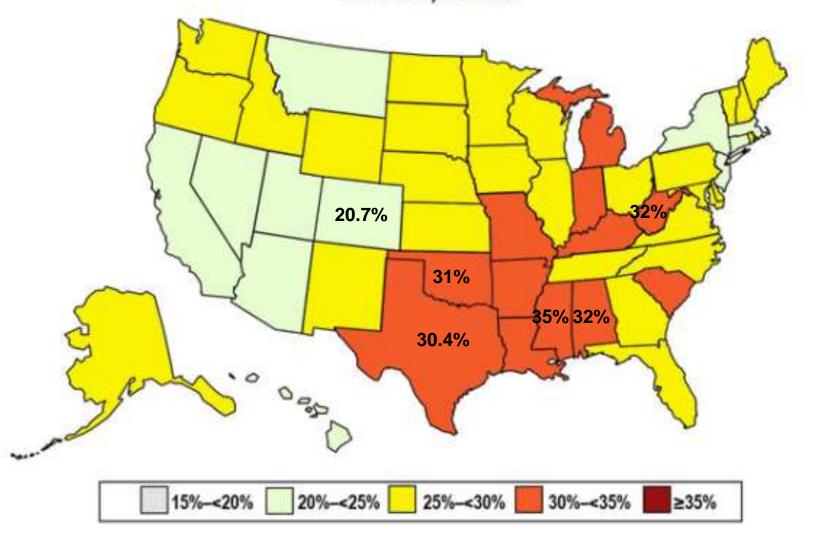




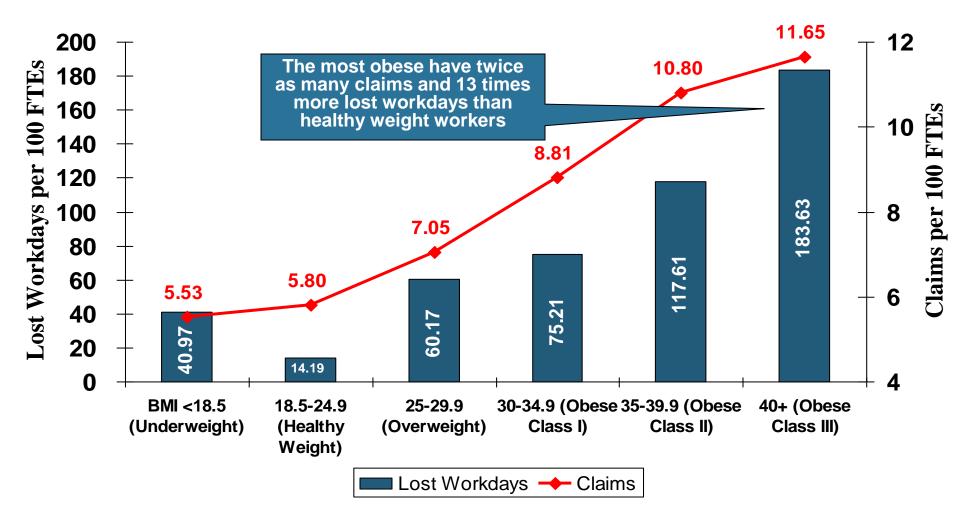
Source: http://www.cdc.gov/obesity/data/trends.html#State



Prevalence of Self-Reported Obesity Among U.S. Adults BRFSS, 2011

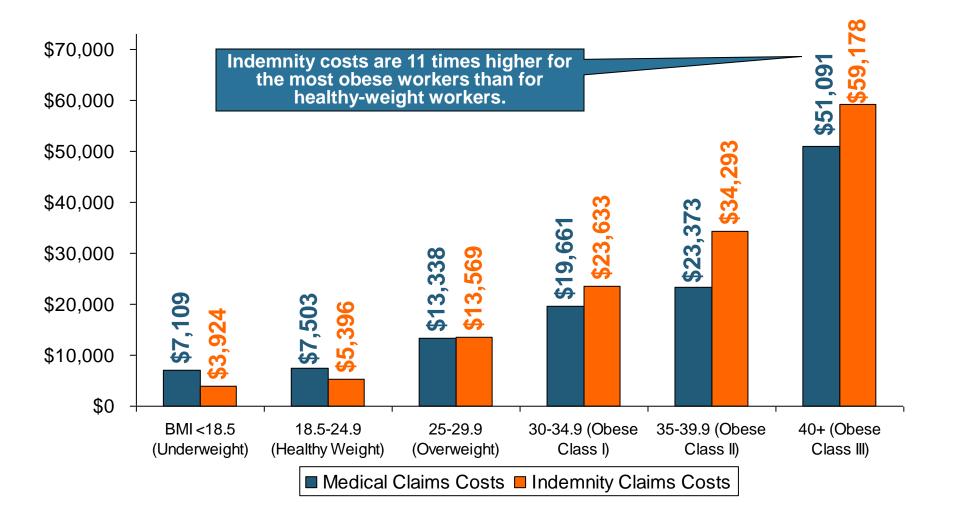


The Most Obese Workers File Twice as Many WC Claims as Healthy-Weight Workers



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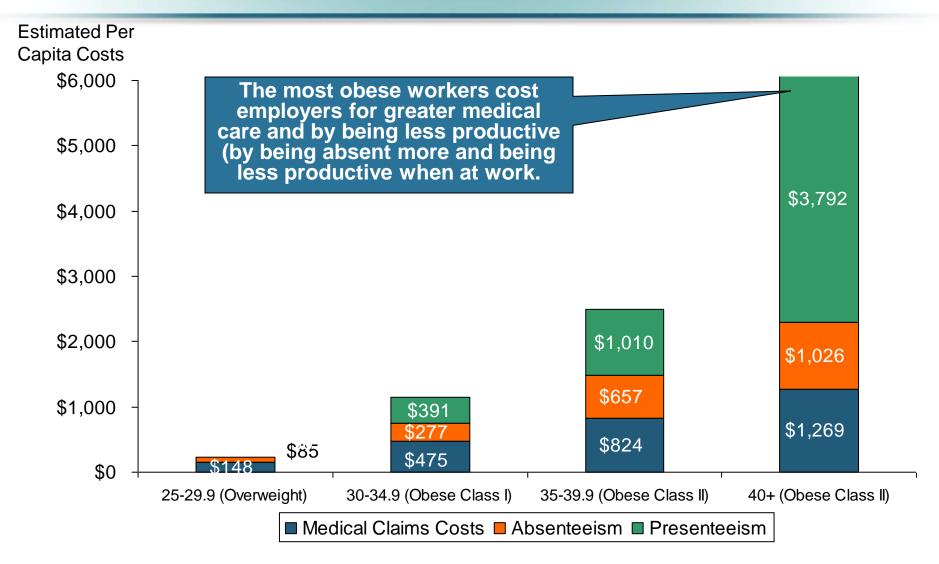
WC Medical Claims and Indemnity Costs are 5-10x Higher for the Most Obese Workers



Source: Ostbye, T., et al, "Obesity and Workers Compensation," Archives of Internal Medicine, April 23, 2007.



Additional (to WC) Costs of Obese Workers



Source: Finkelstein, E., et al, "The Costs of Obesity in the Workplace," Journal of Occupational and Environmental Medicine, Volume 52, No. 10 (October 2010), pp. 971-976.



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