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What's Driving the P/C Industry?

CAS Webinar, July 27, 2017

Download at www.iii.org/presentations

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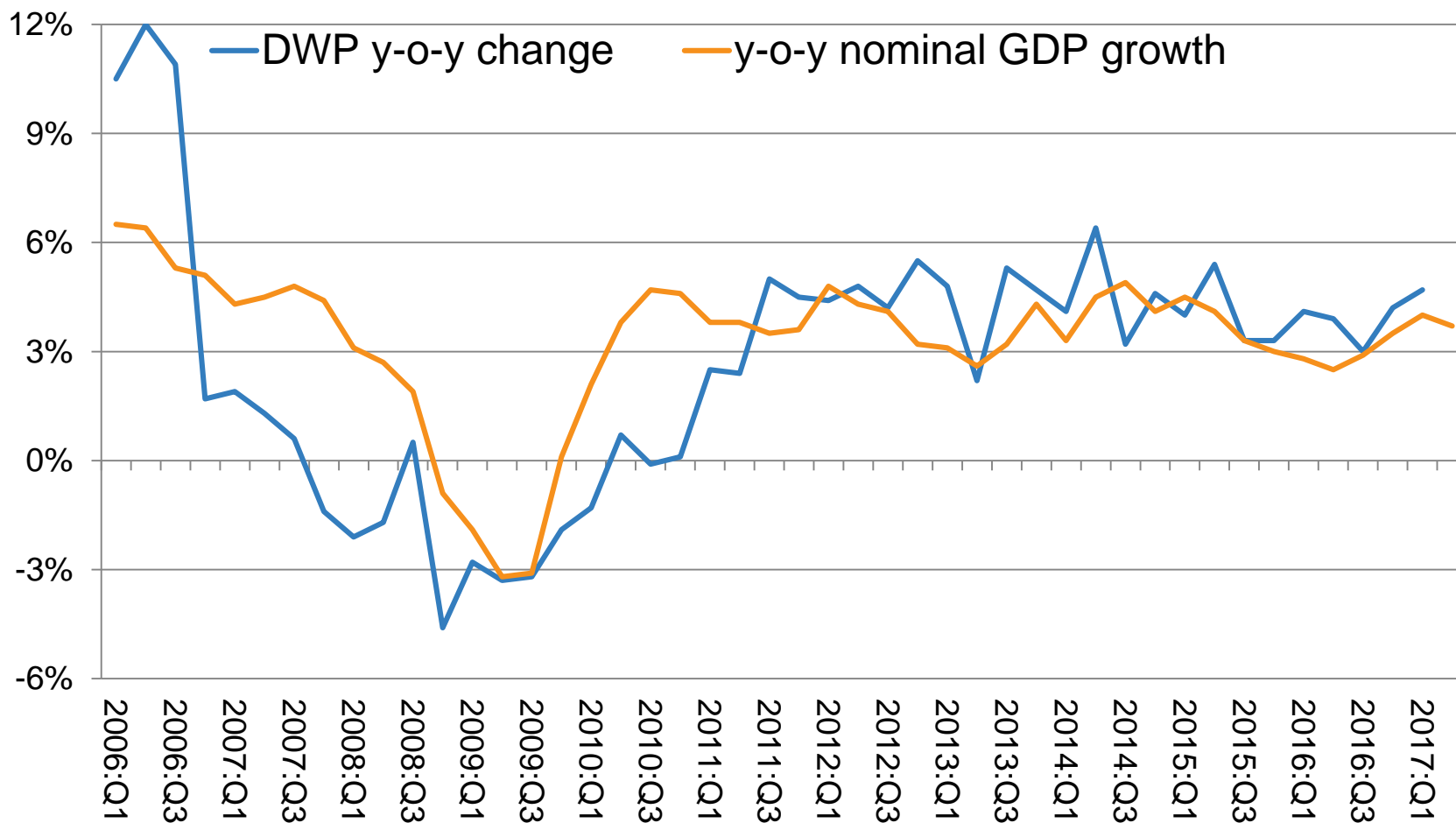
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What's Driving It?
The Economy, for one thing.

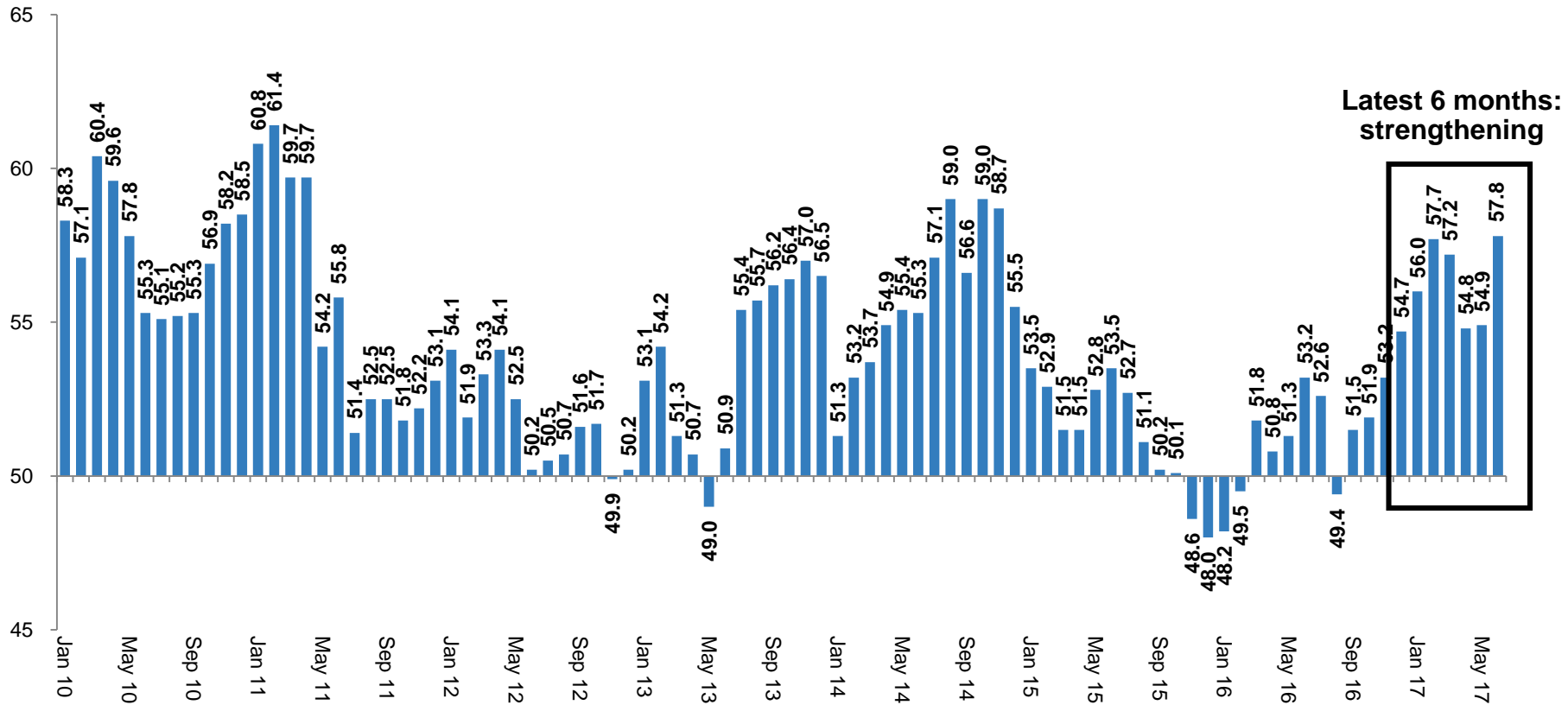
The Economy Drives P/C Insurance Industry Premiums:

Direct Premium Growth (All P/C Lines) vs. Nominal GDP: Quarterly Y-o-Y Pct. Change



Direct Written Premiums track Nominal GDP—not quarter by quarter but overall fairly well.

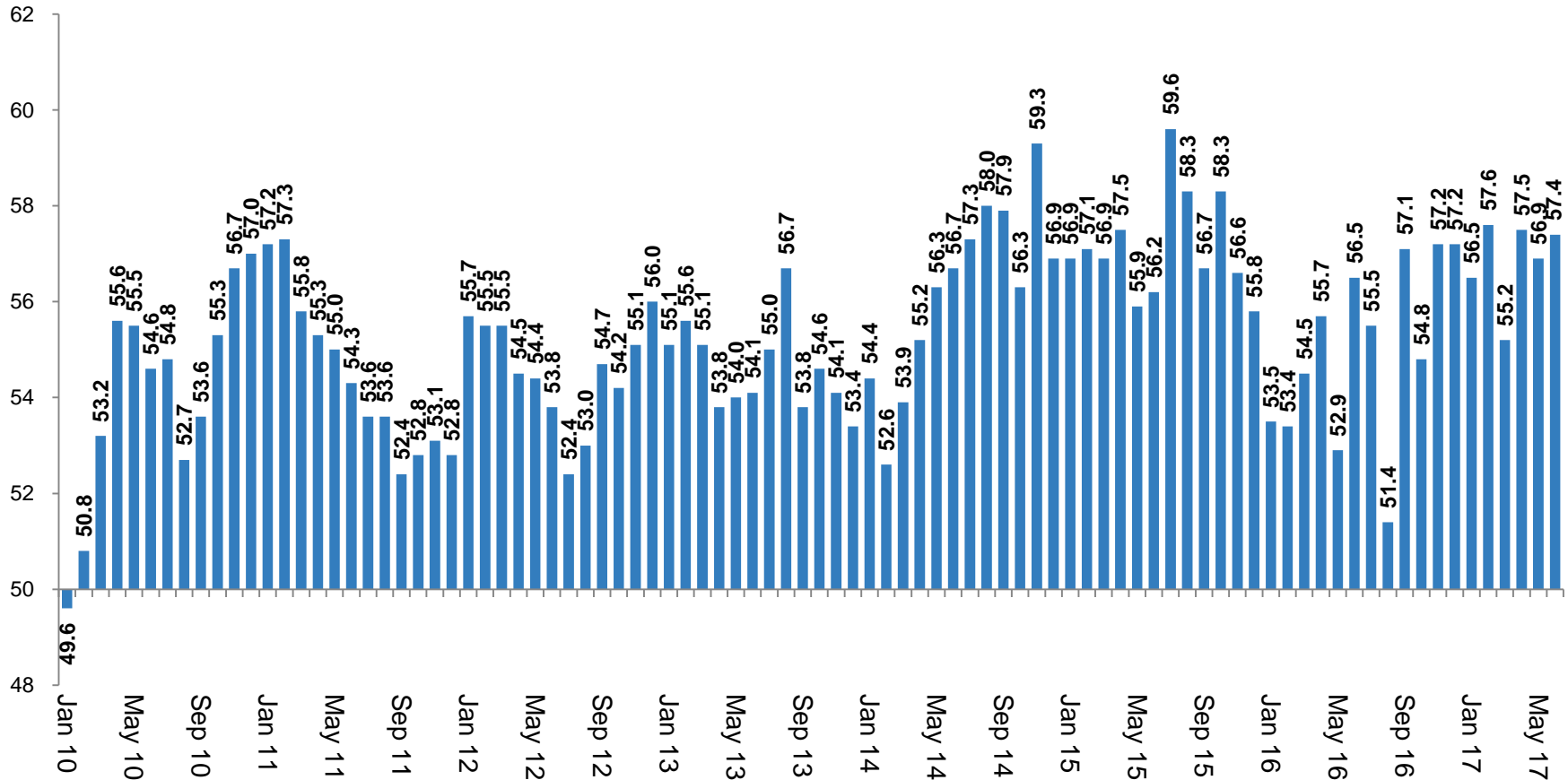
ISM Manufacturing Index (Values > 50 Indicate Expansion), January 2010-June 2017



The manufacturing sector expanded in 67 of the 70 months from January 2010 through October 2015. It contracted in November 2015 through February 2016 and again in August 2016 but is expanding again.



ISM Non-Manufacturing Index (Values > 50 Indicate Expansion), January 2010-June 2017

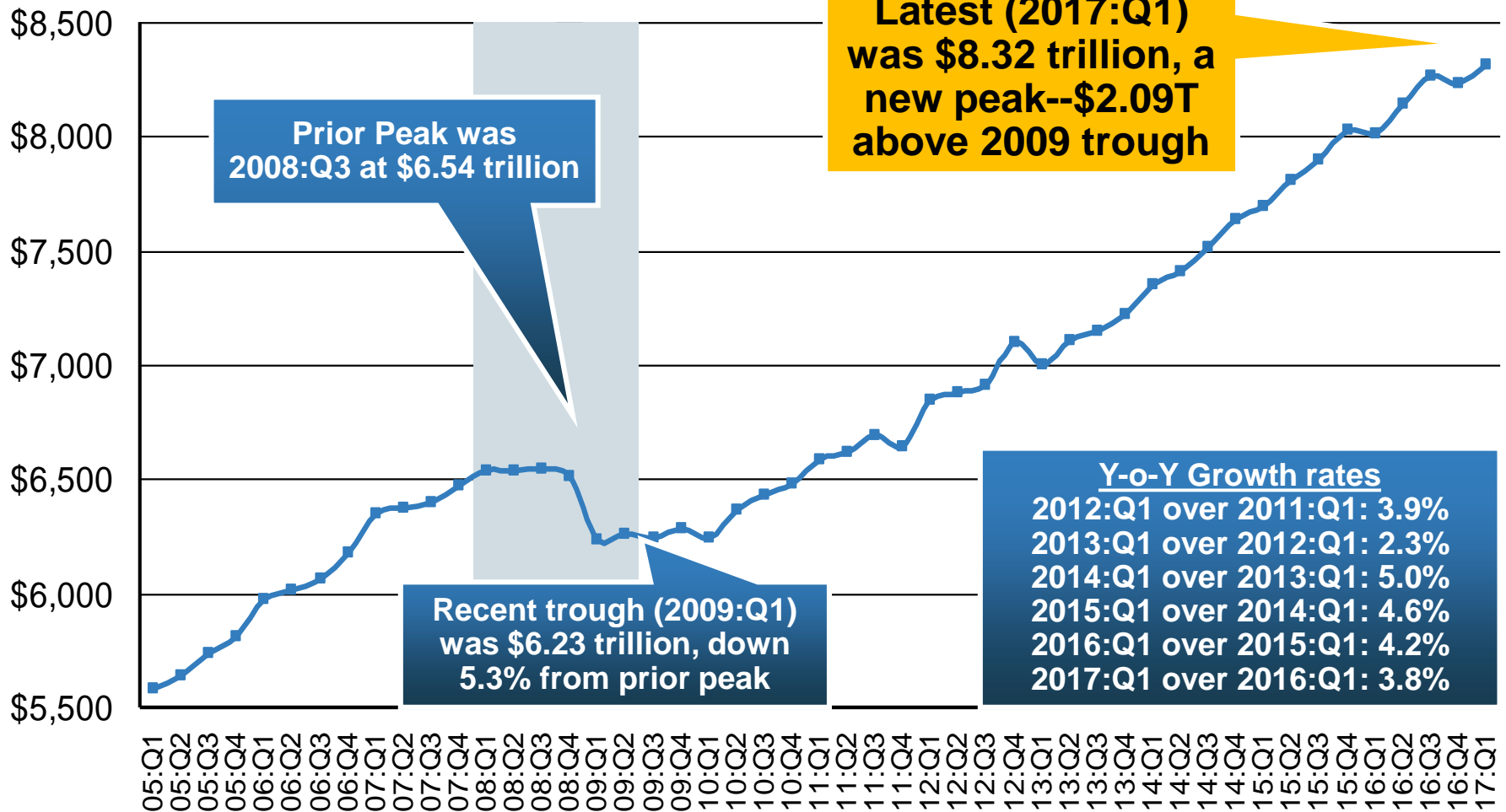


The non-manufacturing sector expanded in every month after January 2010. The pace of expansion roared ahead in 2014-15, slowed a bit in 2016, but ended 2016 and is starting 2017 strong.



Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2017:Q1

Billions



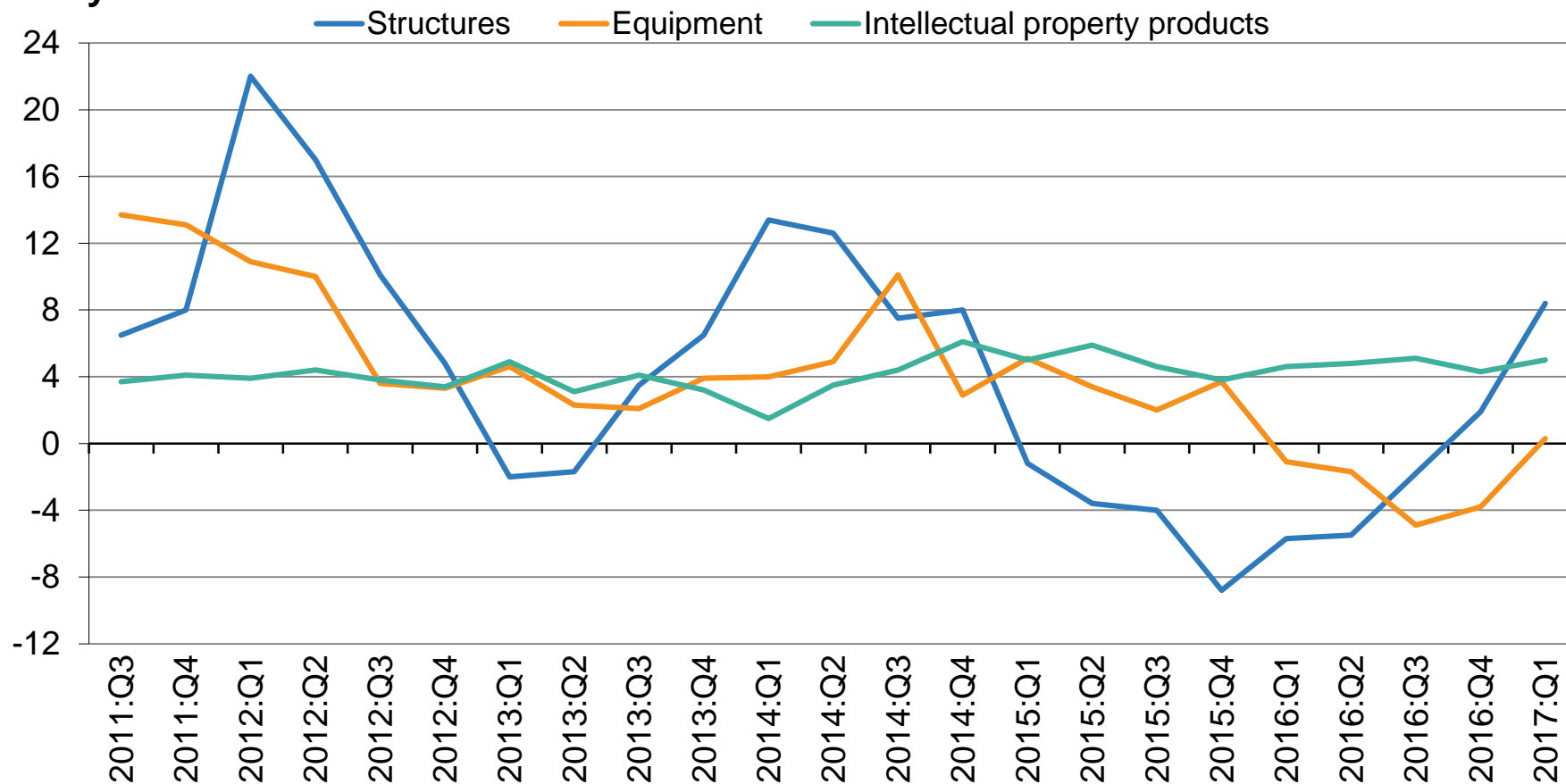
Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

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



Nonresidential Fixed Investment: Implications for Commercial Insurance

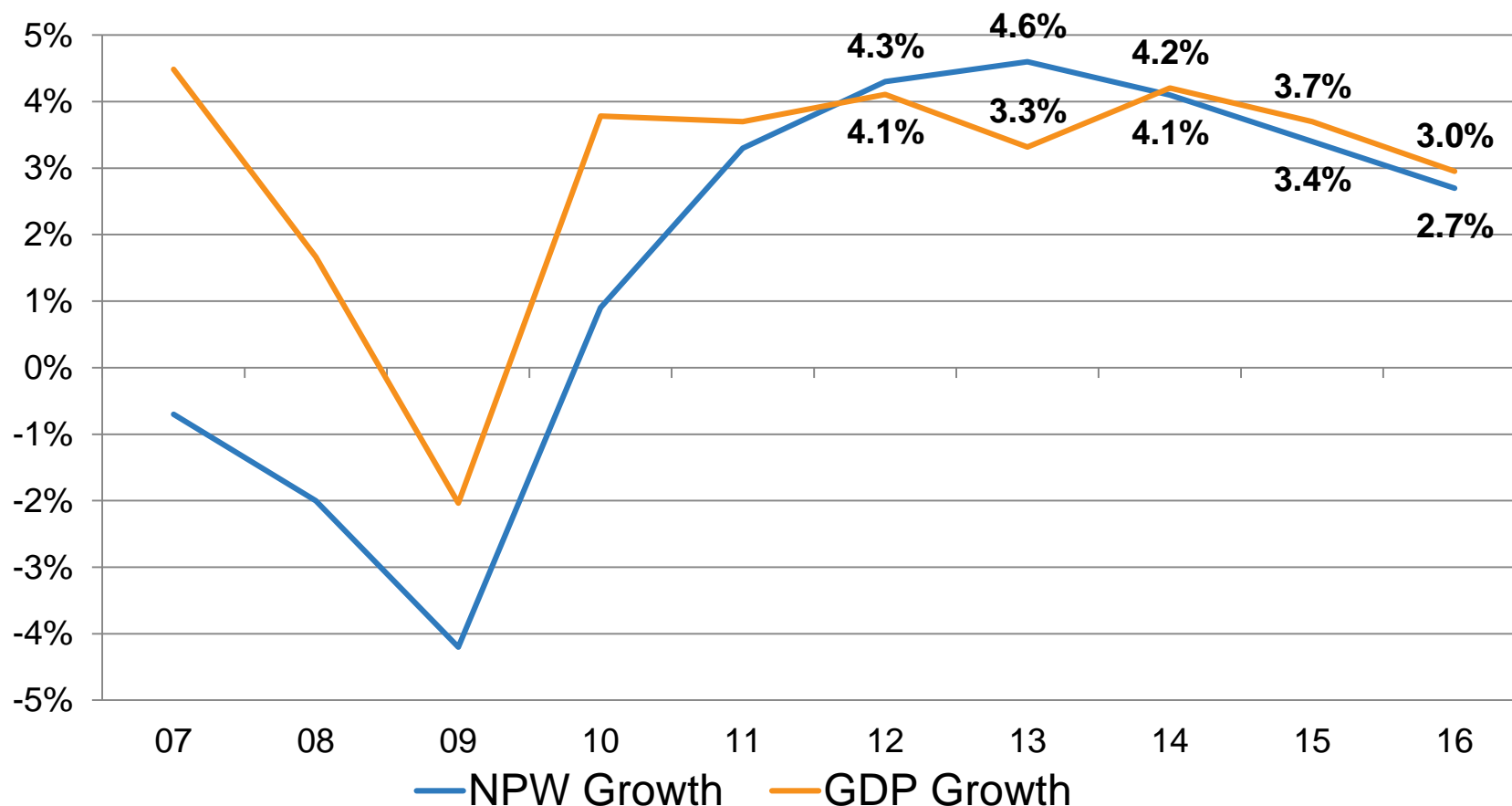
**Percent Change
from same quarter,
prior year**



Sources: bea.gov, news release "Gross Domestic Product: First Quarter 2017 (Second Estimate) and prior releases, Table 8; Insurance Information Institute.

So How is the P/C Industry Doing?

Net Premium Growth (All P/C Lines): Annual Change, 2007-2016



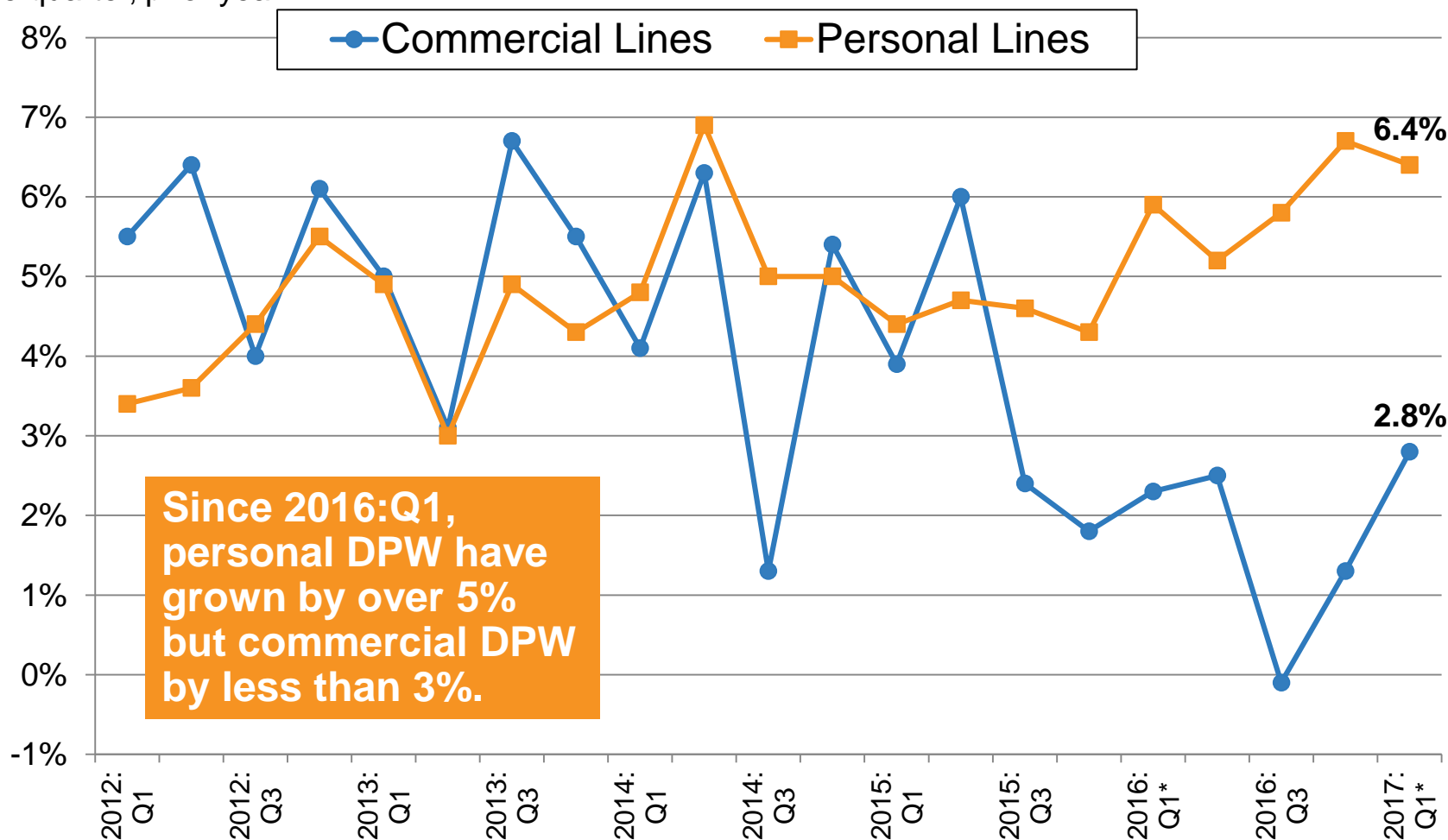
Premium Growth Has Followed Economic Growth, Inflation.



SOURCES: A.M. Best (2007-2013), ISO (2014-16), Federal Reserve Bank of St. Louis (FRED), Insurance Information Institute.

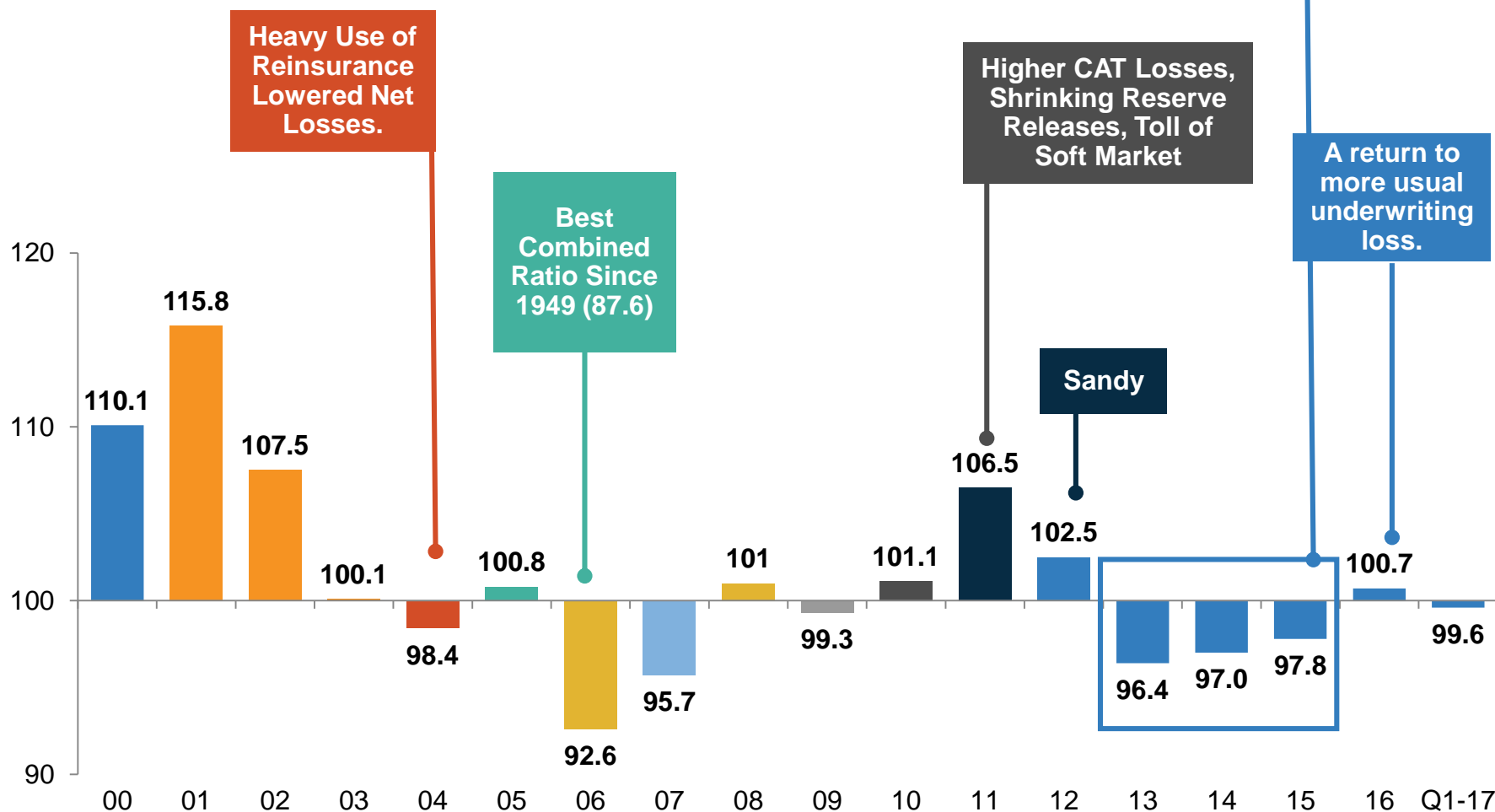
Commercial & Personal Lines Direct Premiums Written Growth, Quarterly Y-o-Y

Percent Change from same quarter, prior year



Sources: NAIC via SNL Financial; Insurance Information Institute calculations.

P/C Insurance Industry Combined Ratio, 2000-2017*



*Excludes Mortgage & Financial Guaranty insurers 2008-2014.

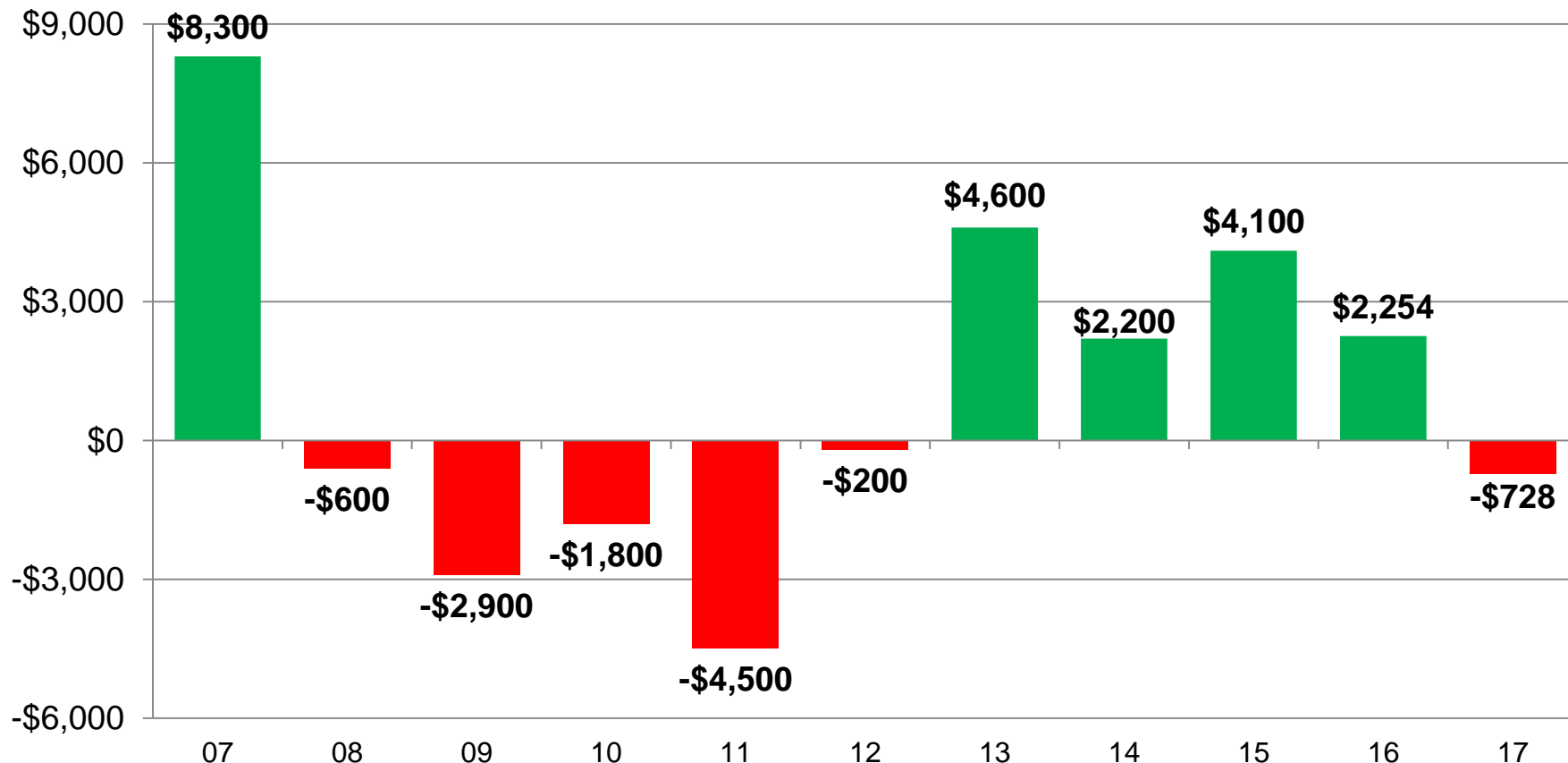
Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.1; 2012=103.2; 2013=96.1; 2014=97.0.

Sources: A.M. Best; ISO, a Verisk Analytics company; I.I.I.



Net Underwriting Gains & Losses, 1st Quarter of Each Year, 2007-2017

\$ Millions

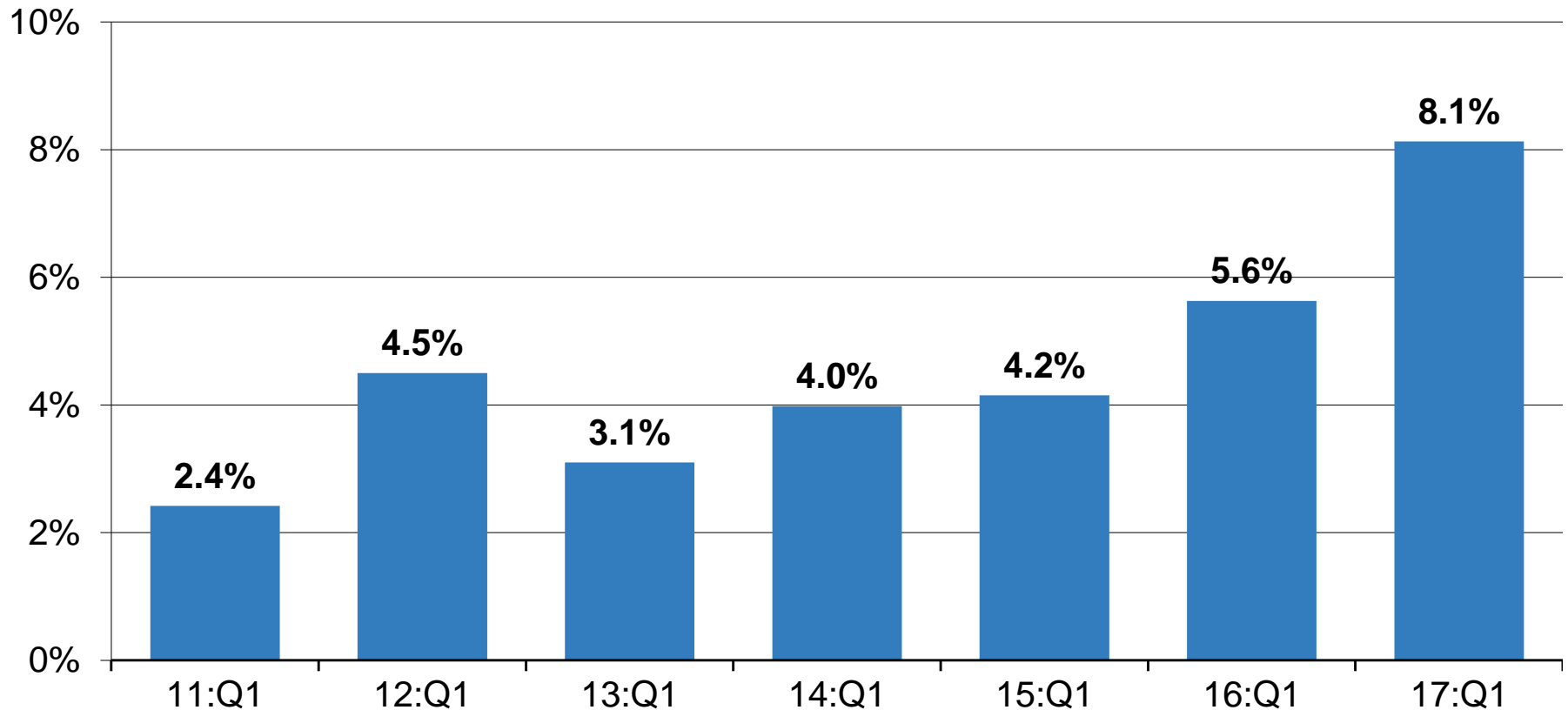


**In the first quarter of the year,
net underwriting results have been quite variable.**



Sources: ISO/PCI; Insurance Information Institute.

CAT Claims as a Percent of Total Claims,* 1st Quarter, 2011-2017

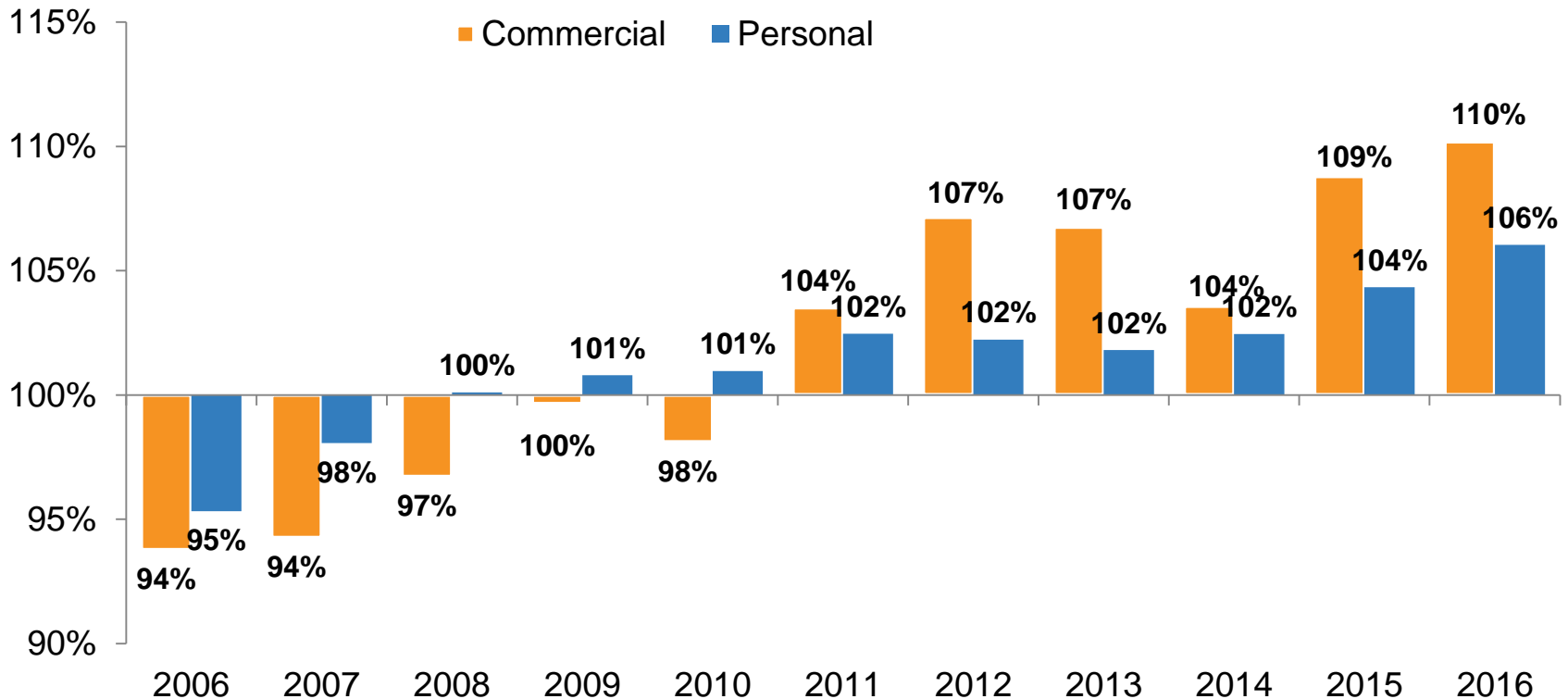


CAT claims are normally a small part of total claims in the first quarter, but that wasn't true in 2017. Moreover, although it's a small sample, the trend seems to be rising.



*Net of reinsurance and include Loss Adjustment Expenses
Sources: ISO PCS; Insurance Information Institute calculations.

Auto Net Combined Ratio, 2005-2016



**Loss Ratios Have Been Rising for a Decade.
2016 Return on Net Worth is Likely Close to Zero or Negative.**



Source: National Association of Insurance Commissioners data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

State Issues

Auto Insurance

Increase in Loss Costs, 2015:Q1–2017:Q1



Bodily Injury

15.3%



Property
Damage

15.0%



Personal Injury
Protection

14.1%



Collision

13.2%

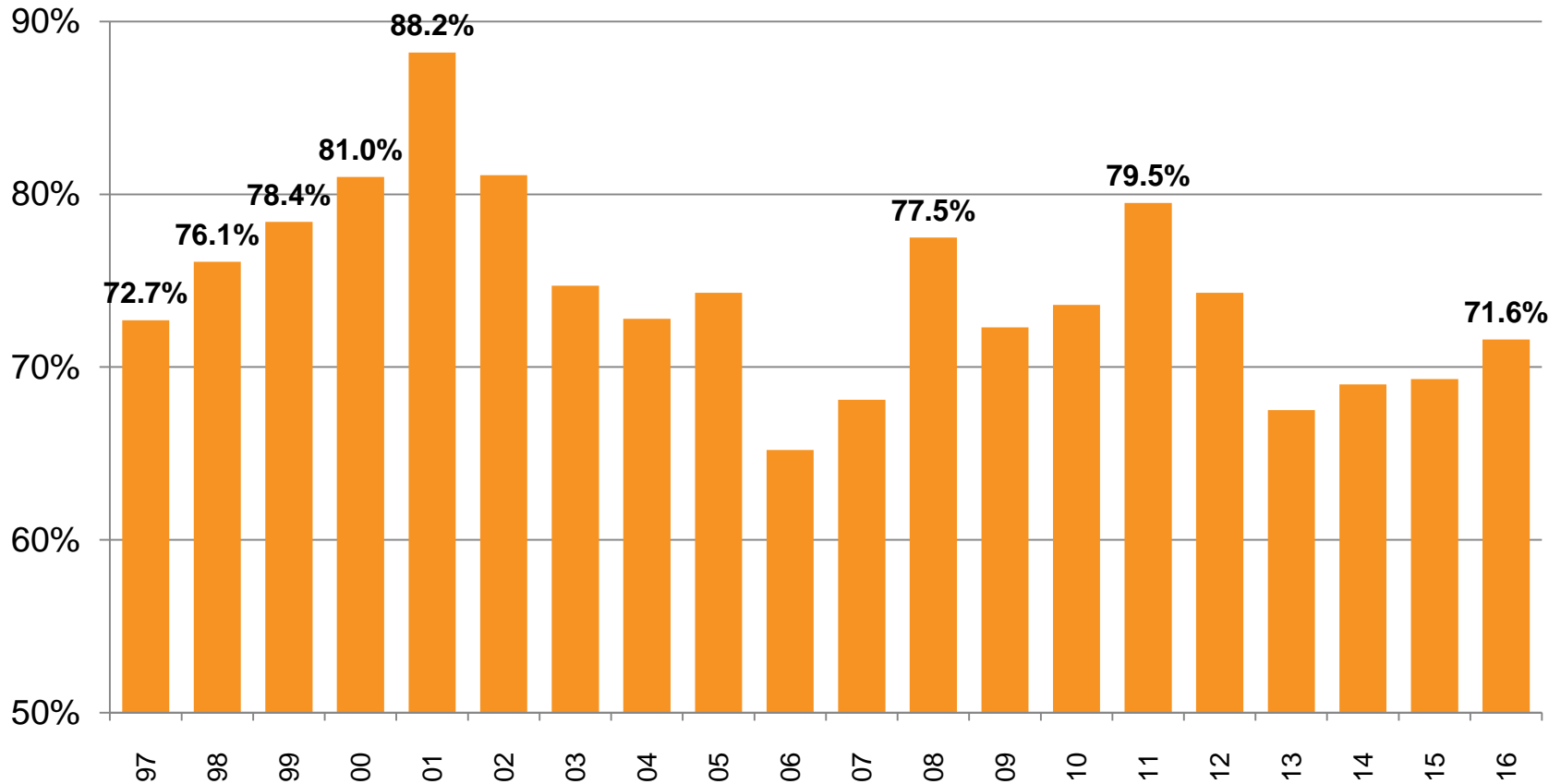


Comprehensive

22.5%

From 2015 to 2017, the cost of accidents has risen dramatically. By contrast, consumer prices overall rose 3.9 percent during 2014 and 2015.

P/C Industry Loss and Loss Adjustment Expenses as Percent of NPE, 1997-2016



The industry tends to make an underwriting profit when this ratio is under 70 percent.

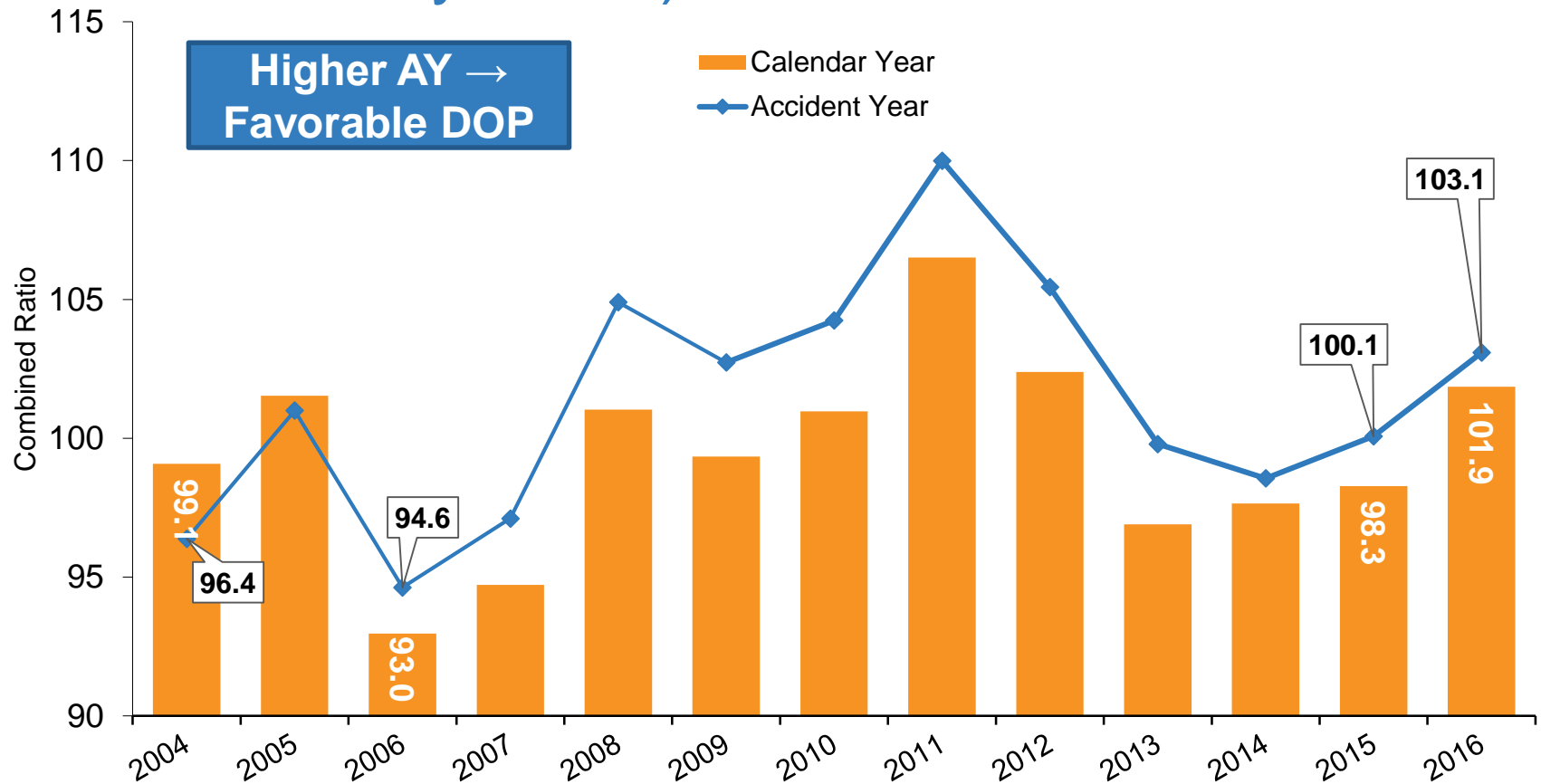


Sources: SNL Financial; Insurance Information Institute. NPE=Net Premiums Earned

Reserve Development

Has the Well Run Dry?

AY vs. CY Combined Ratio, (Excl. Guaranty Lines) 2004-2016

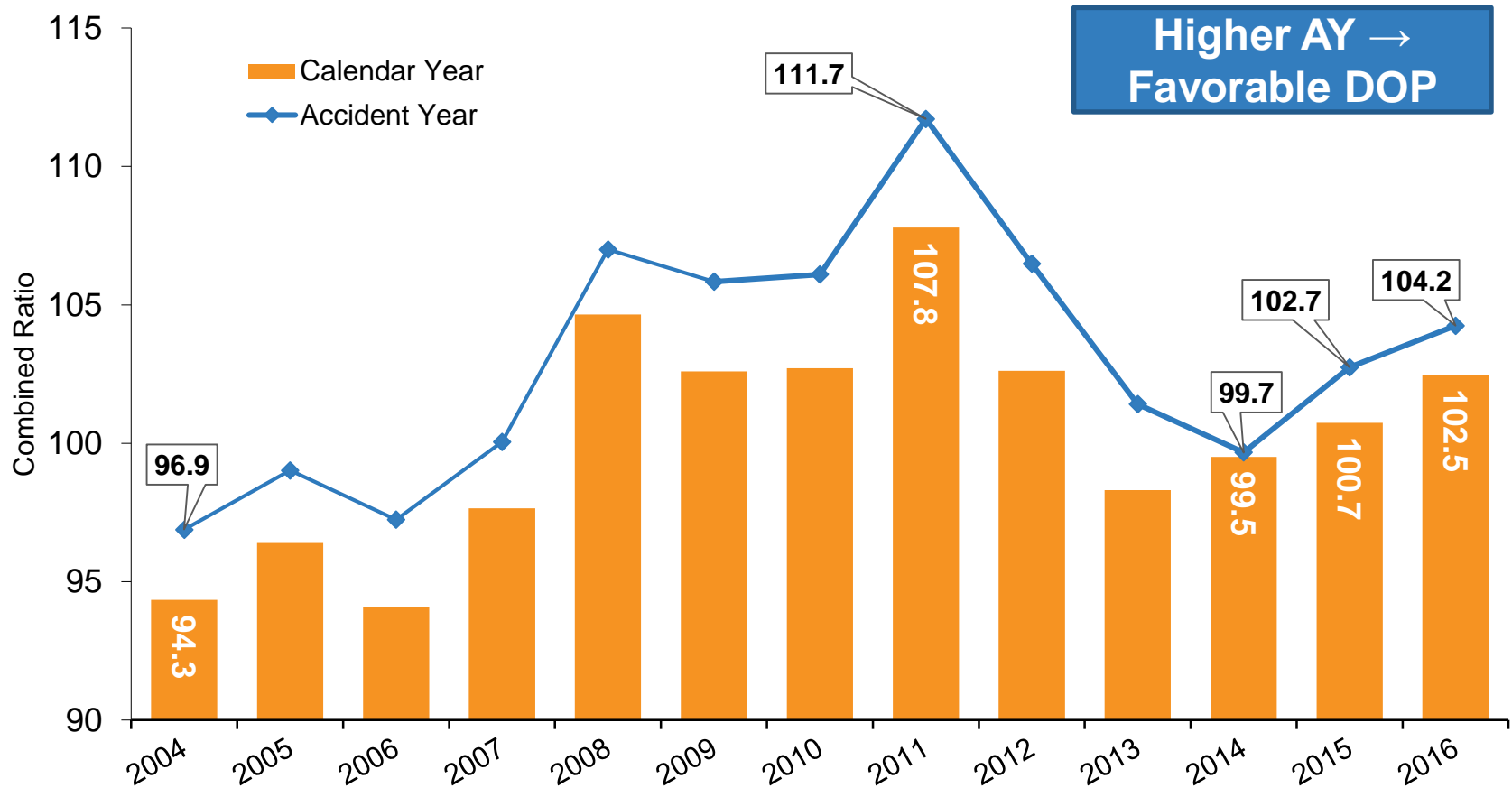


10 Consecutive Years of Favorable Loss Development.



Sources: NAIC data from S&P Global Intelligence, Insurance Information Institute.

Personal Lines Combined Ratio, 2004-2016

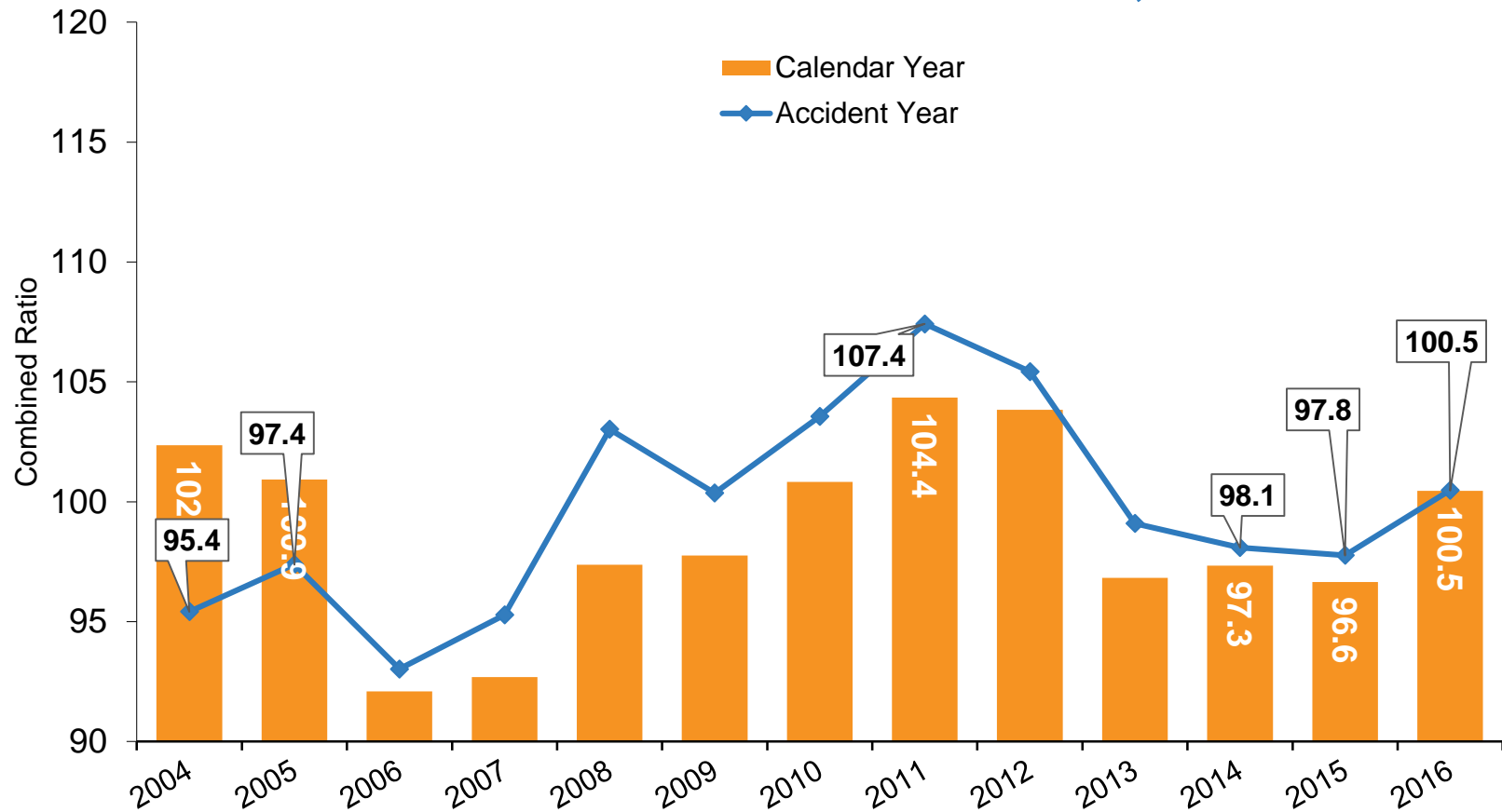


Catastrophes (Matthew, Hail) Drove HO C.R. Higher. Frequency, Severity Dogged Auto Results. 14 Years of Favorable Development.



Sources: NAIC data from S&P Global Intelligence, Insurance Information Institute.

Commercial Lines Combined Ratio, 2004-2016



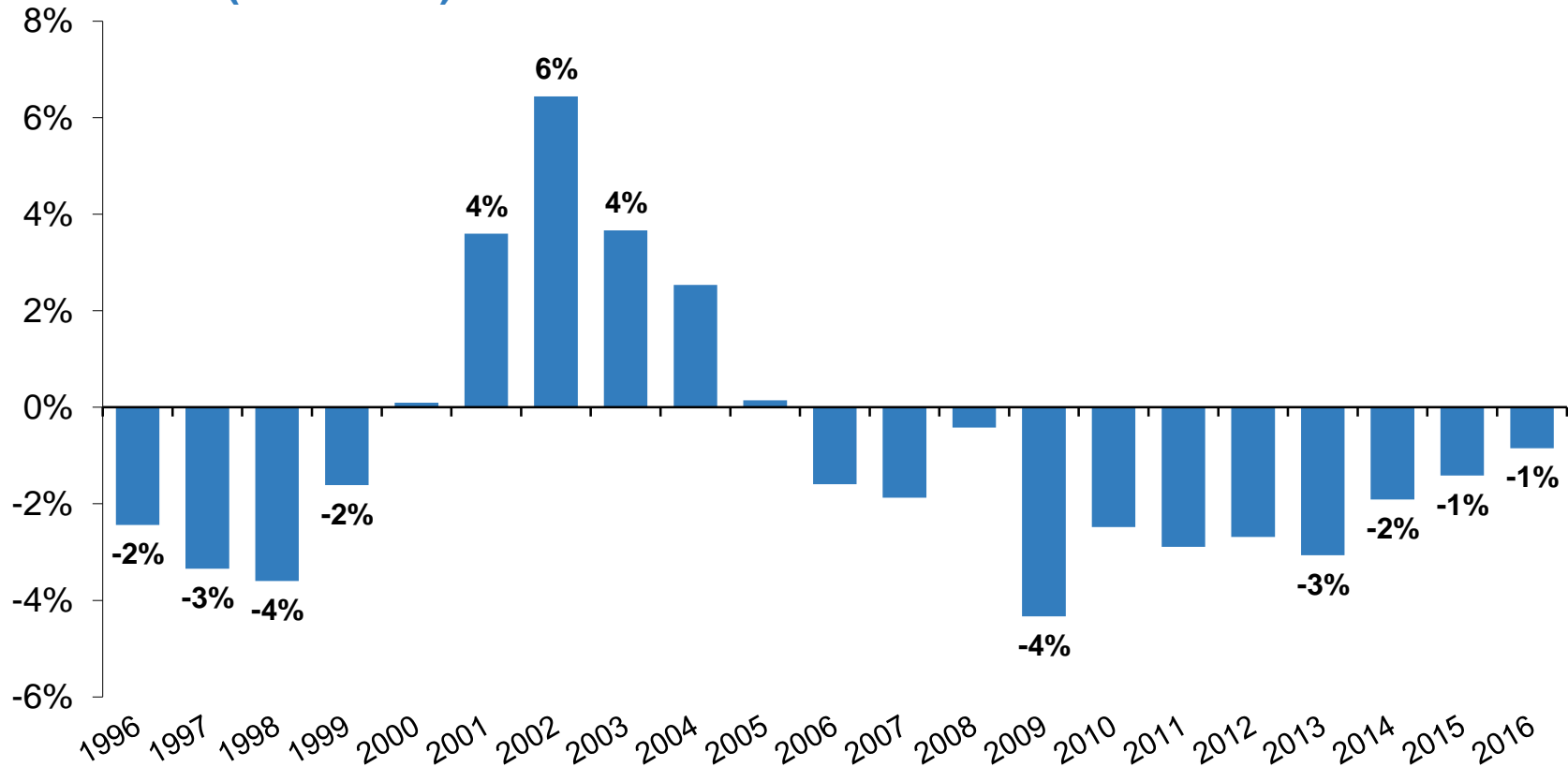
After 10 Years, Has the Well Run Dry?



Sources: NAIC data from S&P Global Intelligence, Insurance Information Institute.

Development on Prior, 1996-2016

DoP (% of NEP)

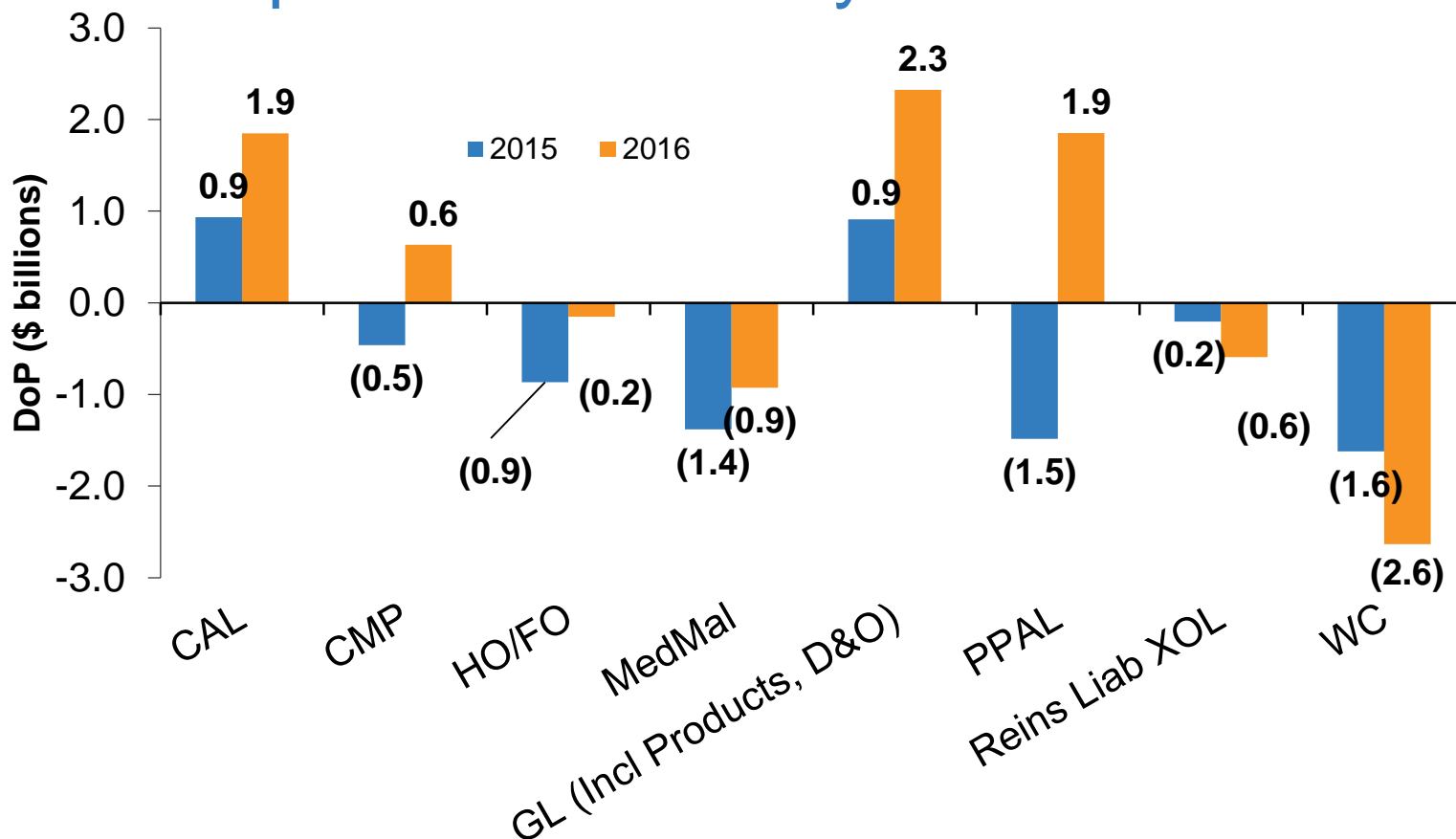


Reserve Releases Keep Getting Smaller.



Sources: NAIC data from S&P Global Intelligence, Insurance Information Institute.

CY Development on Prior by LOB



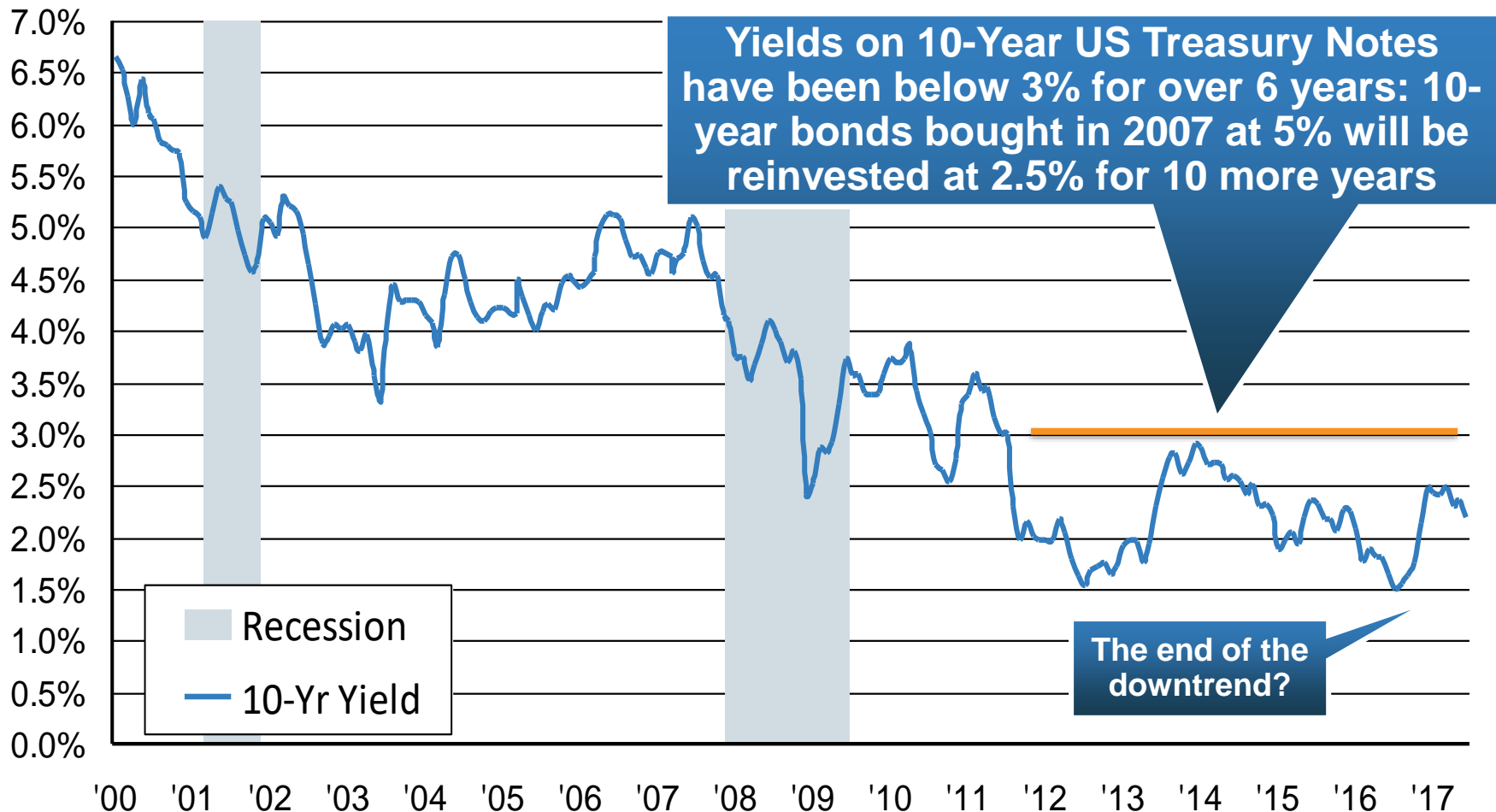
Reserve Deterioration in Auto Liability Lines, Improvement in Workers Compensation.



Sources: NAIC data from S&P Global Intelligence, Insurance Information Institute.

And the Investment Results?

US Treasury Note 10-Year Yields: A Long Downward Trend, 2000–2017*



Since nearly 50% of P/C bond/cash investments are in 5-year or longer maturities, most P/C insurer portfolios will have low-yielding bonds for years to come.

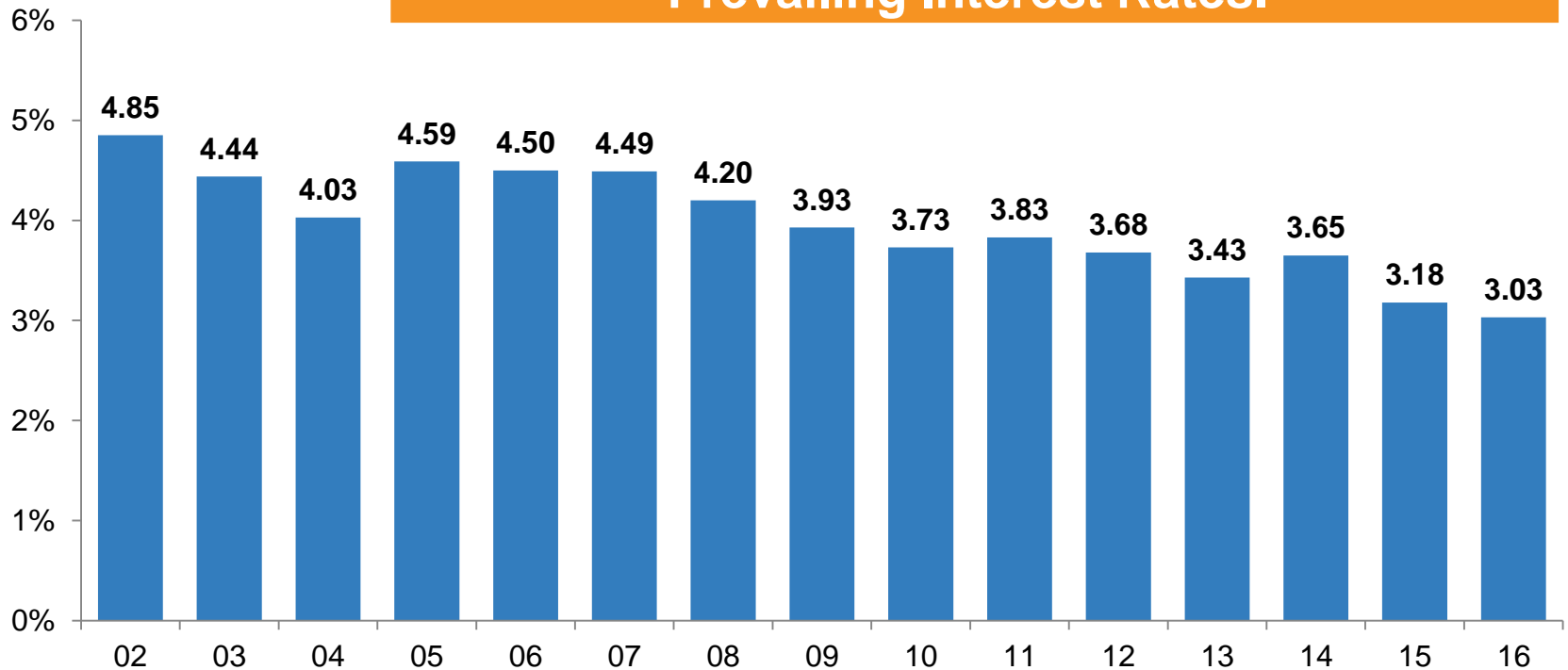
*Monthly, constant maturity, nominal rates, through June 2017.



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

P/C Insurer Portfolio Yields, 2002-2015

P/C Carrier Yields Have Been Falling for Over a Decade, Reflecting the Long Downtrend in Prevailing Interest Rates.

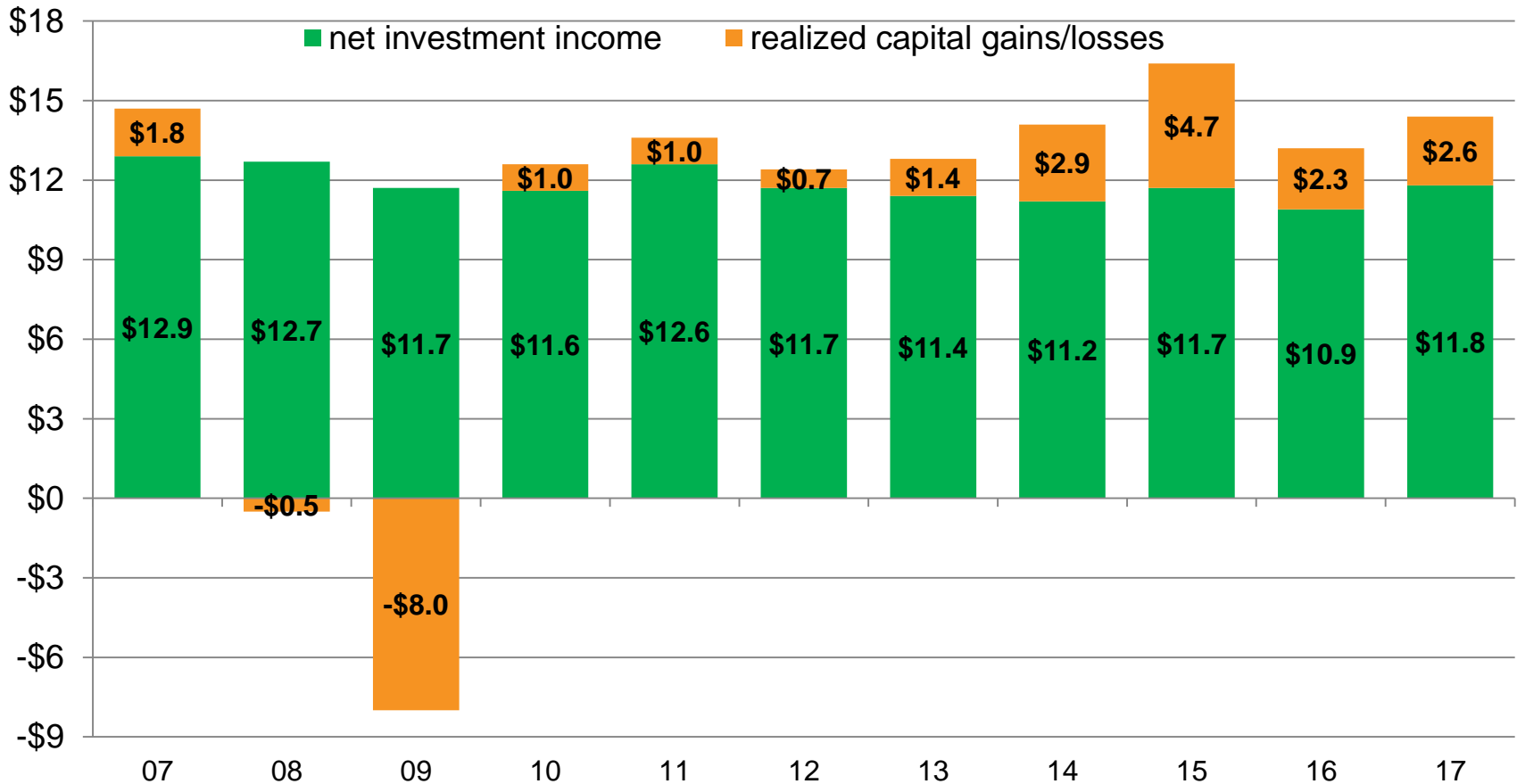


Even as Prevailing Rates Rise in the Next Few Years, Portfolio Yields Are Unlikely to Rise Quickly, Since Low Yields of Recent Years Are “Baked In” to Future Returns.



Net Investment Gains Vary Mainly With Realized Capital Gains/Losses, 1st Quarters, 2007-2017

\$ Billions

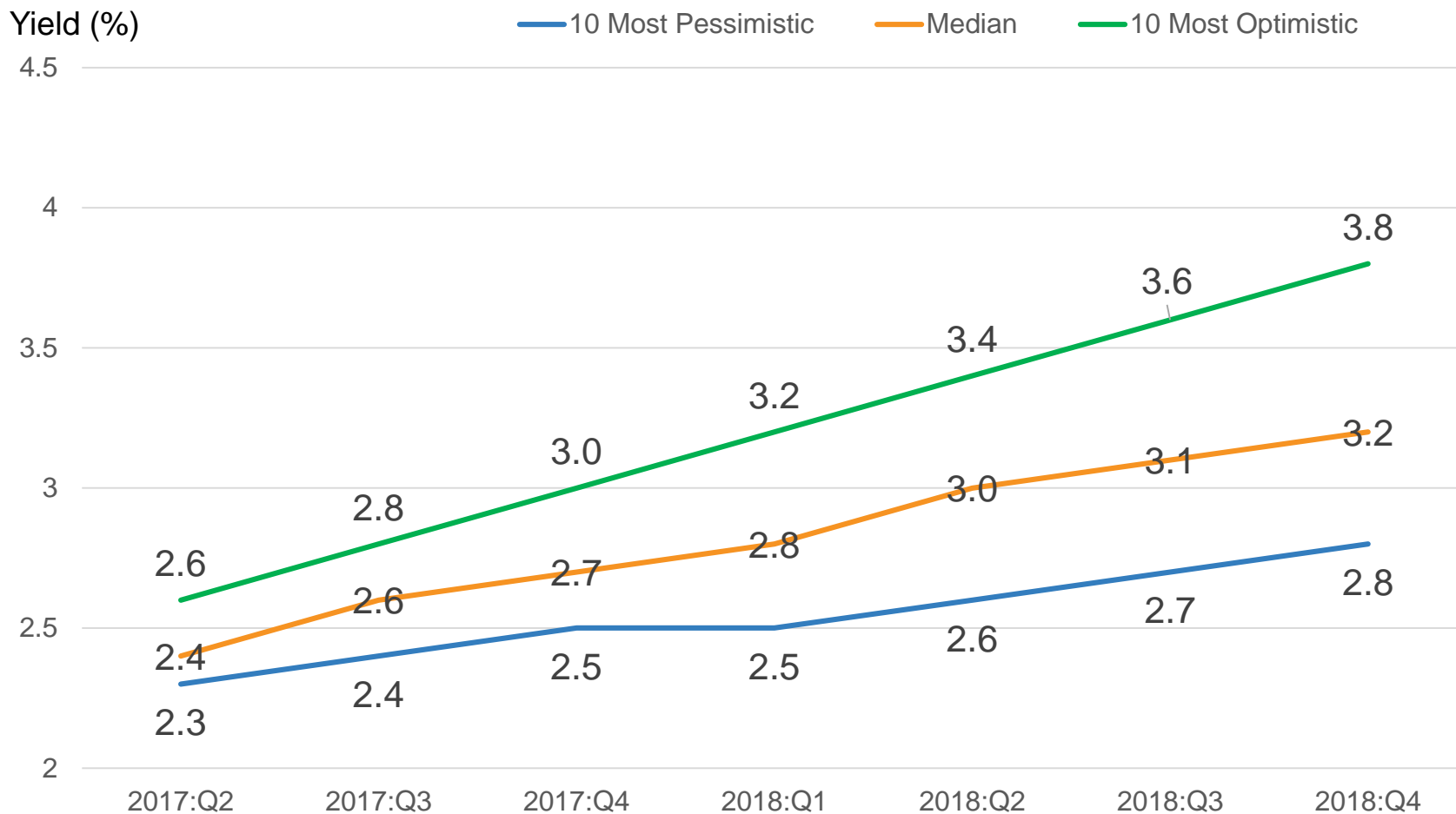


In the first quarter of the year, net investment income has been steady but realized capital gains/losses have been quite variable.

Sources: ISO/PCI; Insurance Information Institute.



June 2017: Quarterly Yield Forecasts for 10-Year US Treasury Bonds in 2017-18



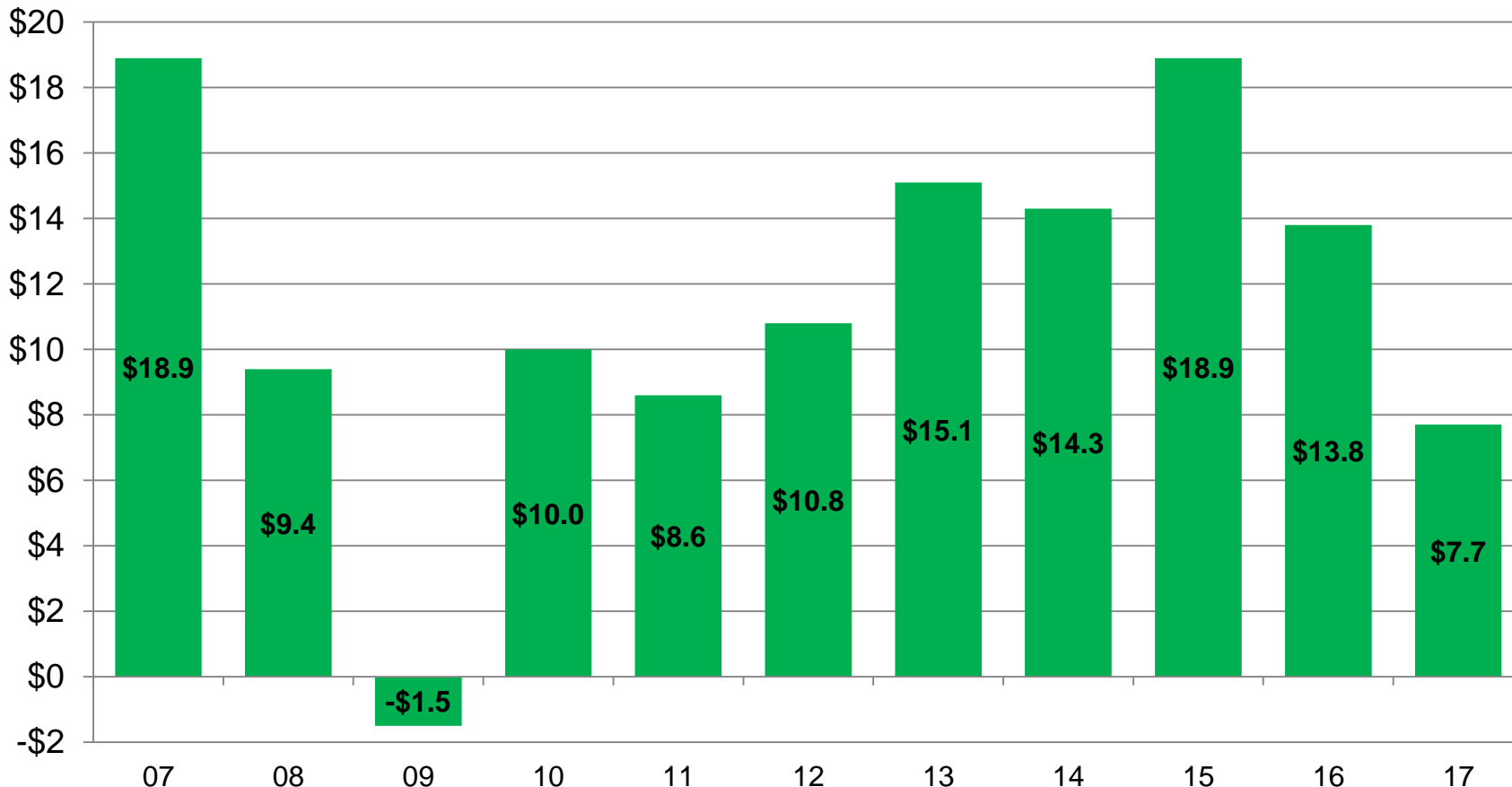
Virtually all of the 53 forecasts in the Blue Chip survey expect continual increases in the yield of 10-year T-bonds in 2017-18.



The “Bottom Line”?

P/C Industry Net Income After Taxes*, 1st Quarters, 2007-2017

\$ Billions,
2017 dollars



**In the first quarters of the year, net income varied.
2017 was the second-lowest profit in the last 11 years.**

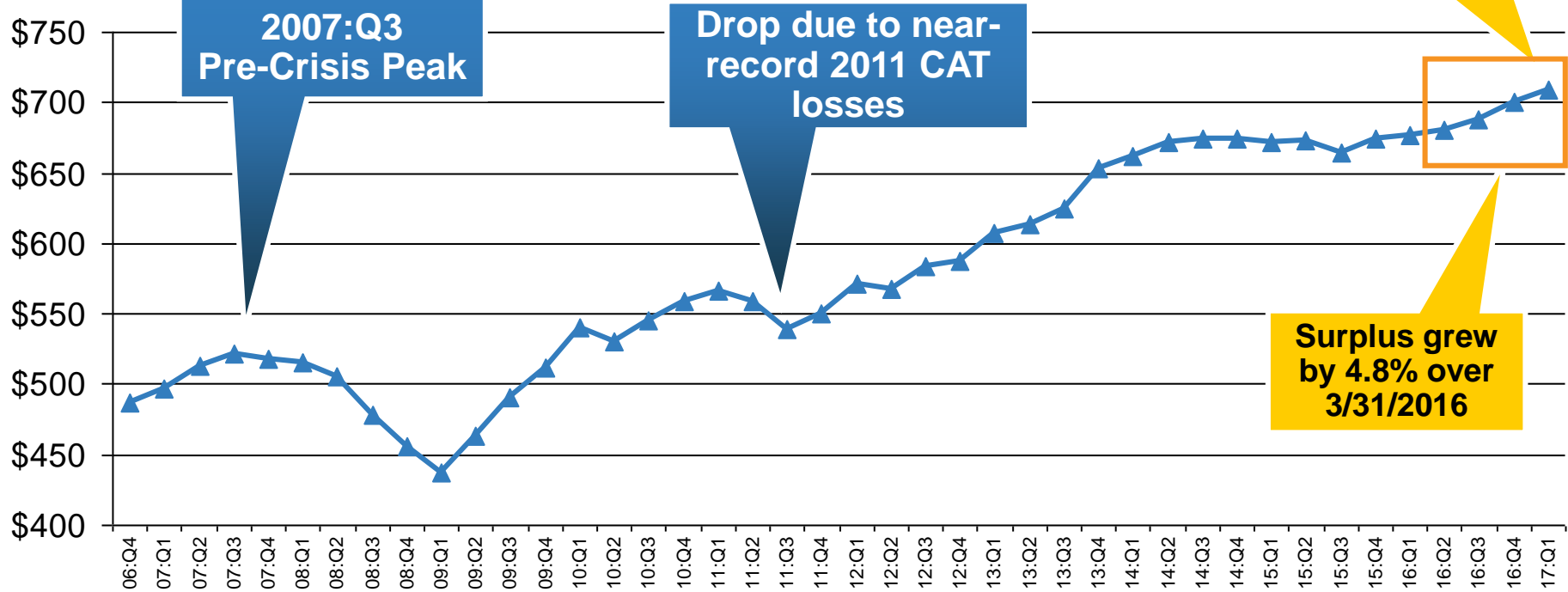


*adjusted for inflation using the BLS CPI calculator, to 2016 dollars

Sources: A.M. Best; ISO, a Verisk Analytics company; Insurance Information Institute.

Policyholder Surplus, Quarterly, 2006:Q4–2017:Q1

(\$ Billions)



The industry now has \$1 of surplus for every \$0.75 of NPW, the strongest claims-paying status in its history.

2010:Q1 data includes \$22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business.

The P/C insurance industry is, in 2017, in very strong financial condition.



Sources: ISO, A.M .Best.

Commercial Rates*

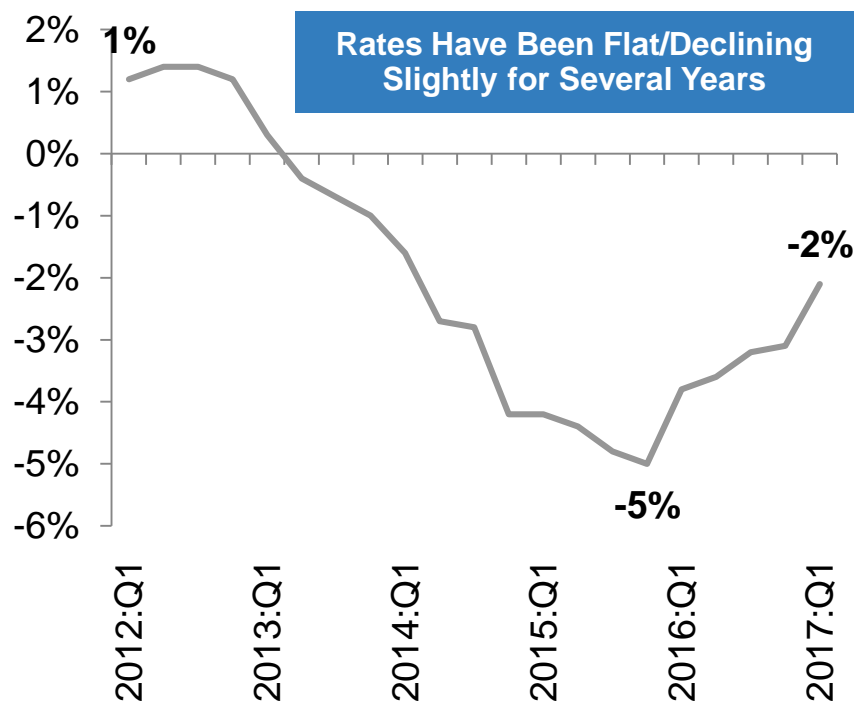
Softening Ahead?

**These Publicly Available Estimates May Differ Substantially
From Events In Individual States and Markets*

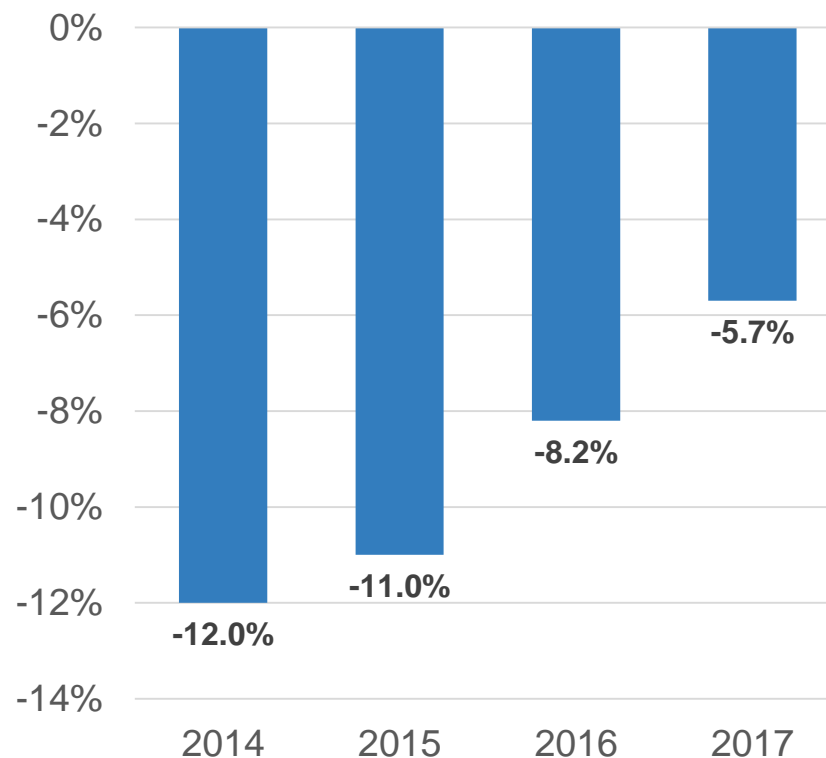
Rate Changes Worldwide

Rates Soft/Flat, Especially in Reinsurance

Global Insurance Rates Through Q1 2017

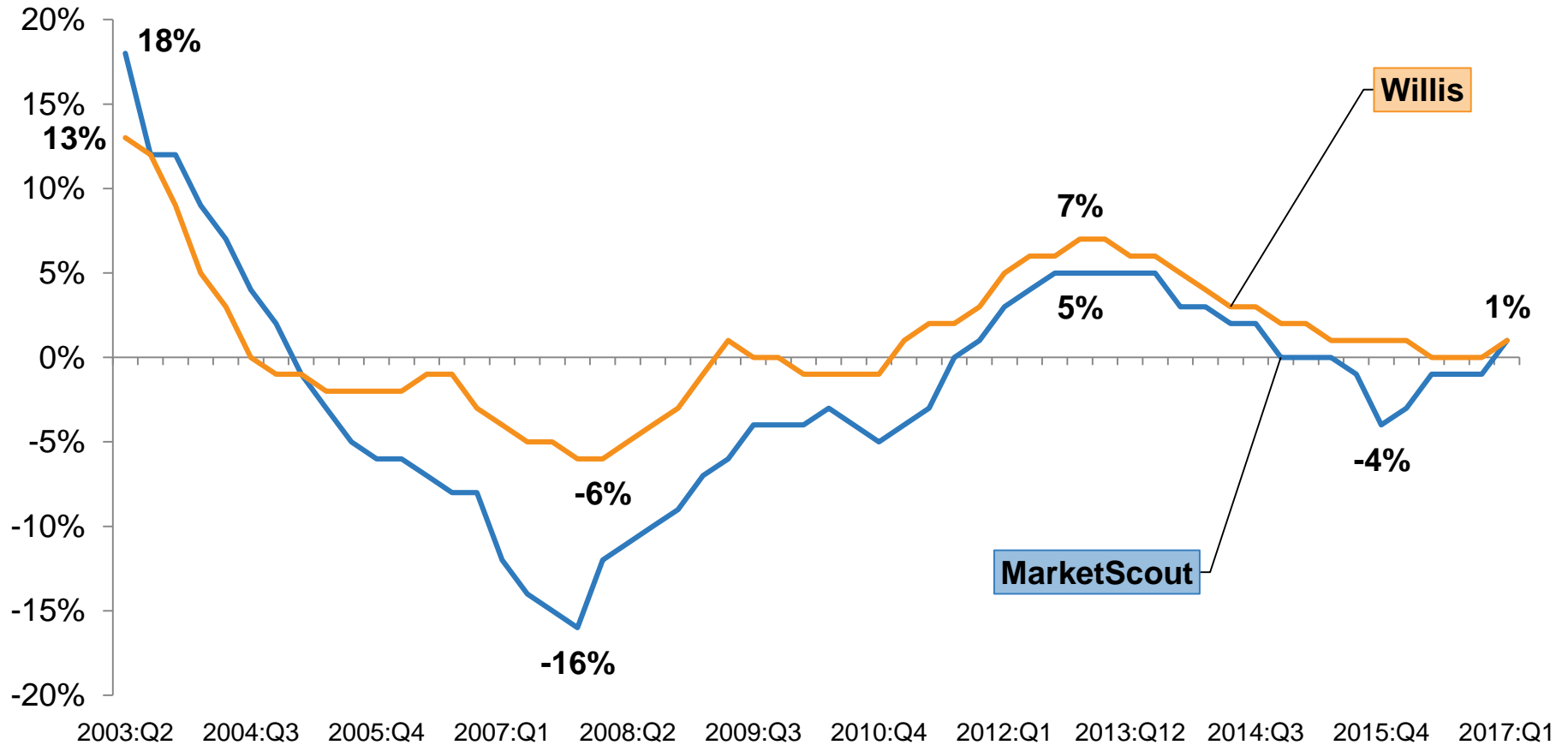


Global Reinsurance January Renewals



Sources: Marsh Insurance Market Index, JLT Re.

Commercial Lines Rate Change



We're in a Long Period of Flat Rates Overall.

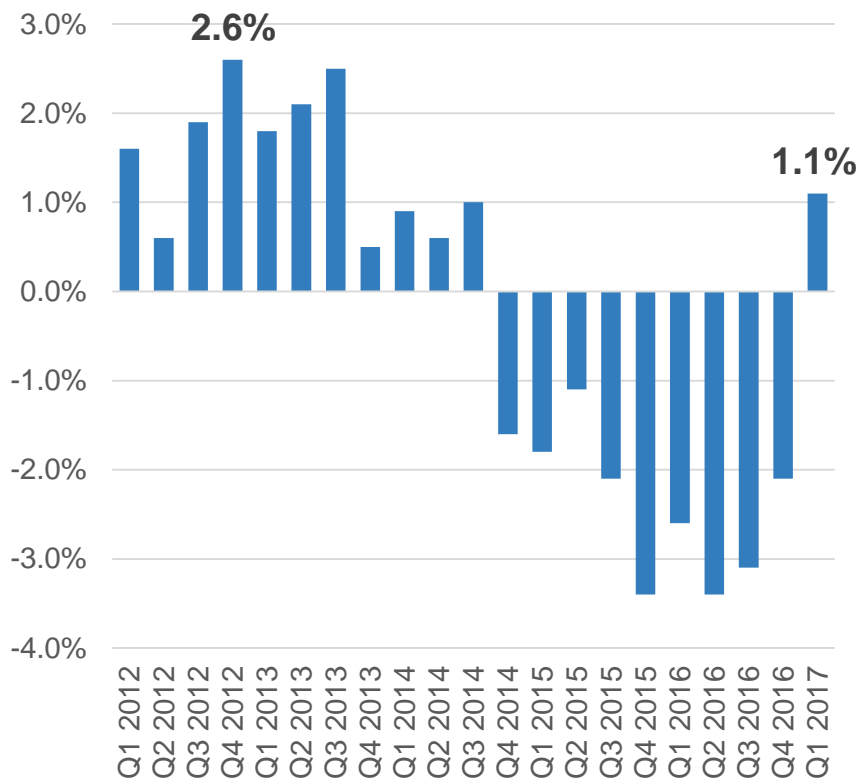


Sources: Willis Towers Watson, MarketScout.

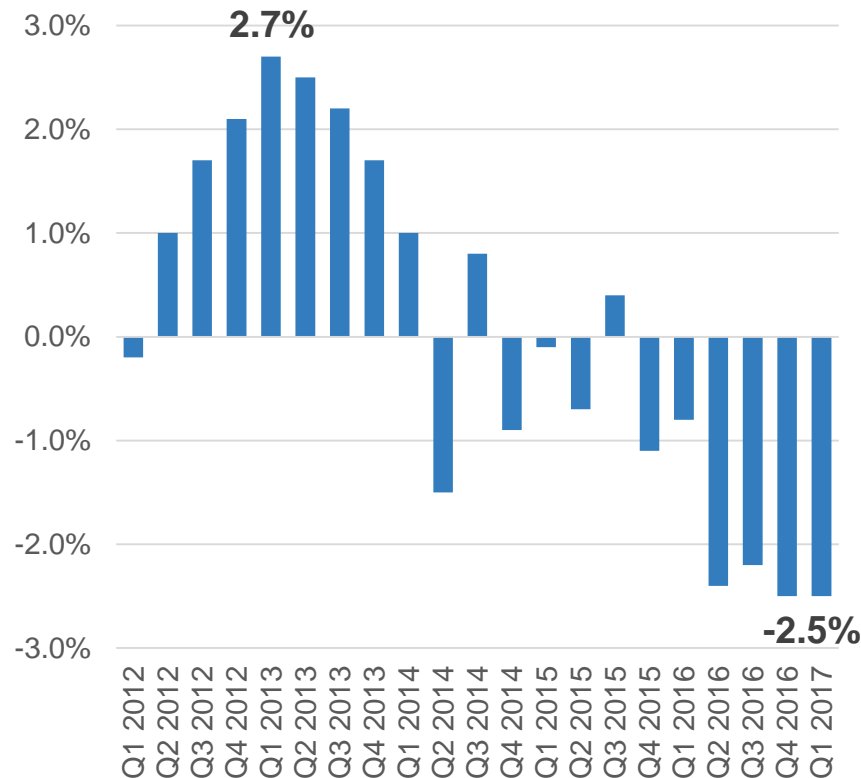
Liability Rate Changes

Slight Softening, Though Local Markets Vary

U.S. Casualty



U.S. Financial and Prof Liab

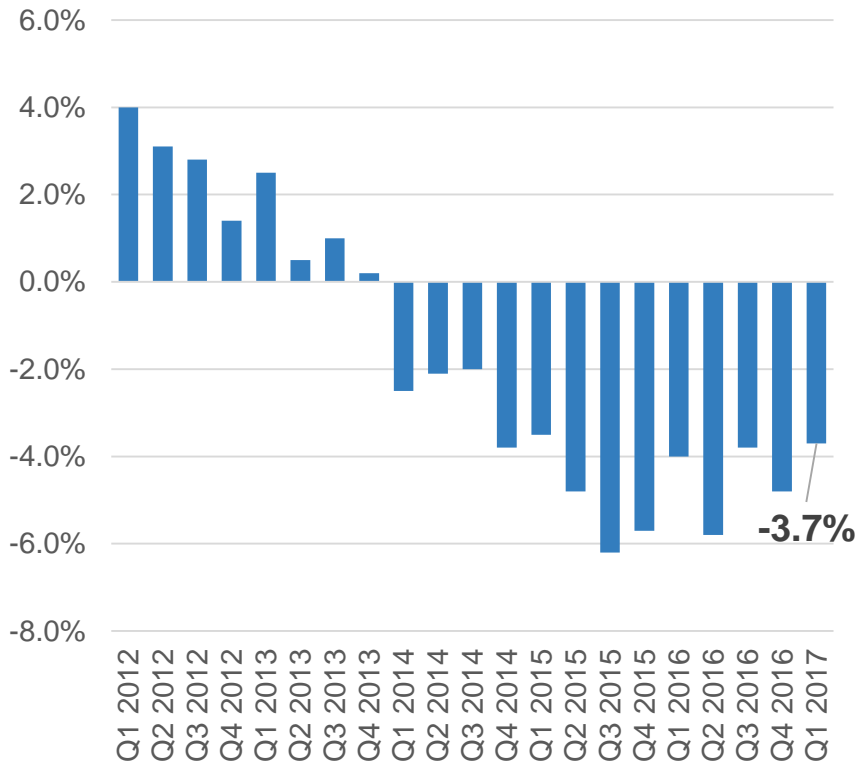


SOURCE: Marsh Insurance Market Index.

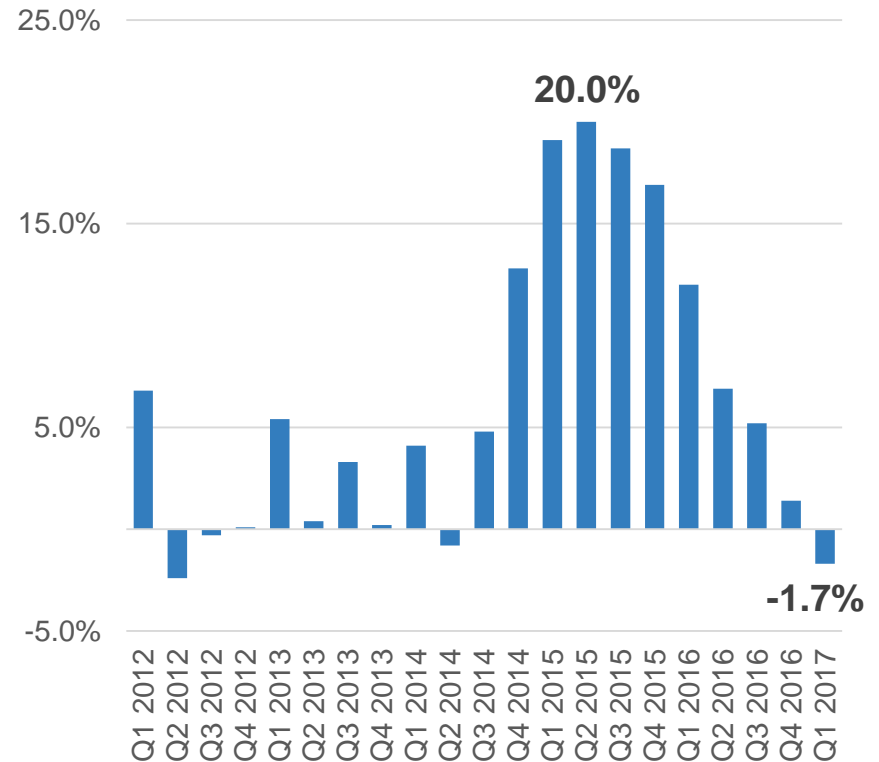
Property/Cyber Rate Changes

Slight Softening, Though Local Markets Vary

U.S. Property



U.S. Cyber



SOURCE: Marsh Insurance Market Index.

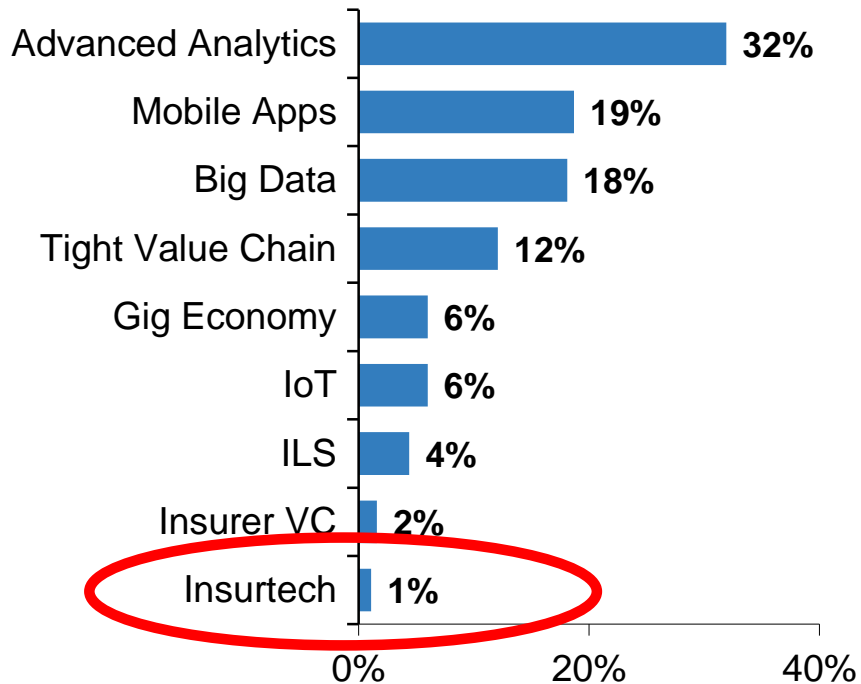
On the Horizon

Sharing Economy and Disruption

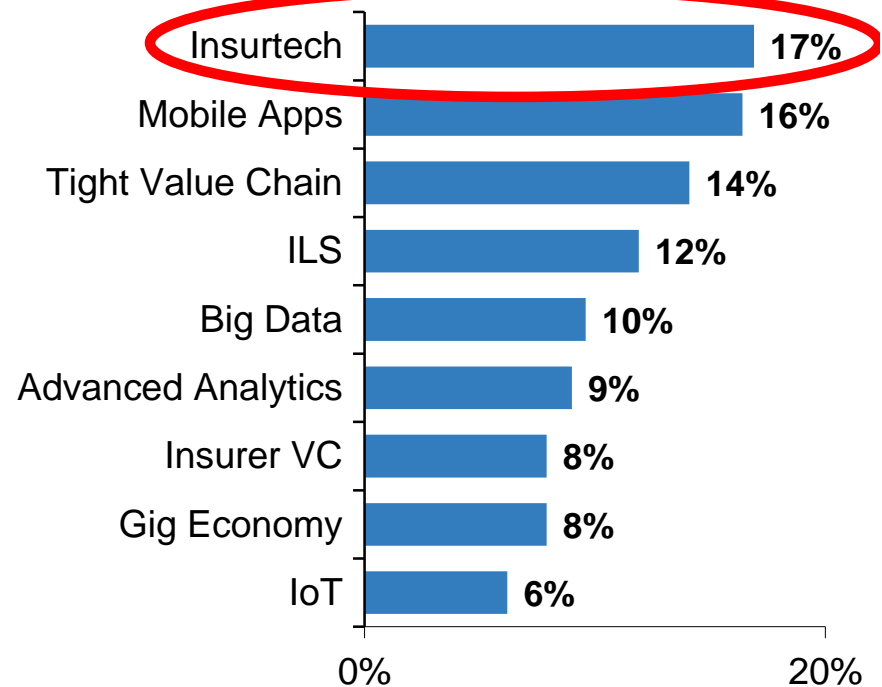
Greatest Threats, Opportunities

Whither Silicon Valley?

Greatest Opportunity

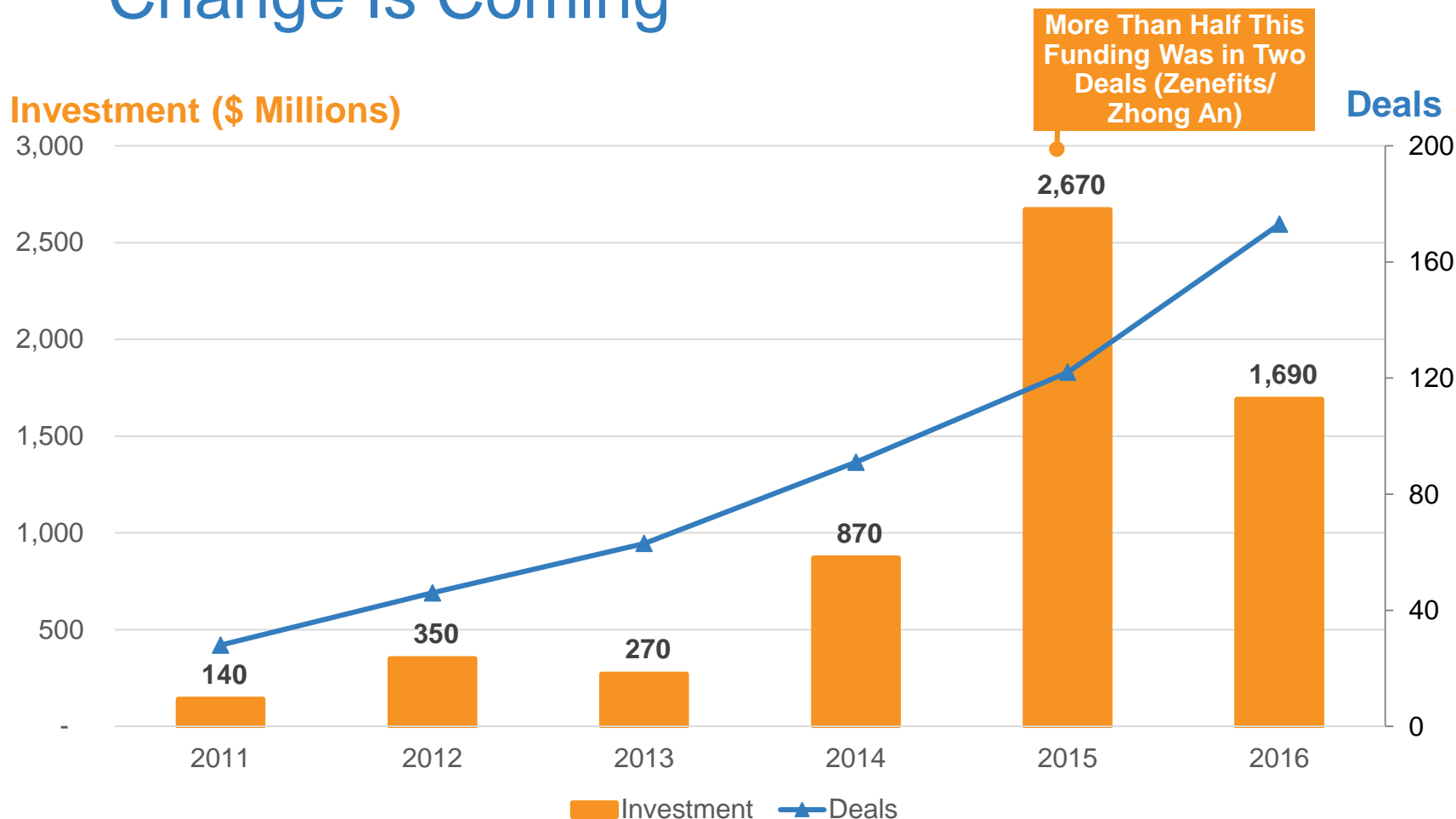


Greatest Threat



SOURCE: A.M. Best Winter 2016-17 Insurance Industry Survey.

Insurance Technology Financing – Change Is Coming



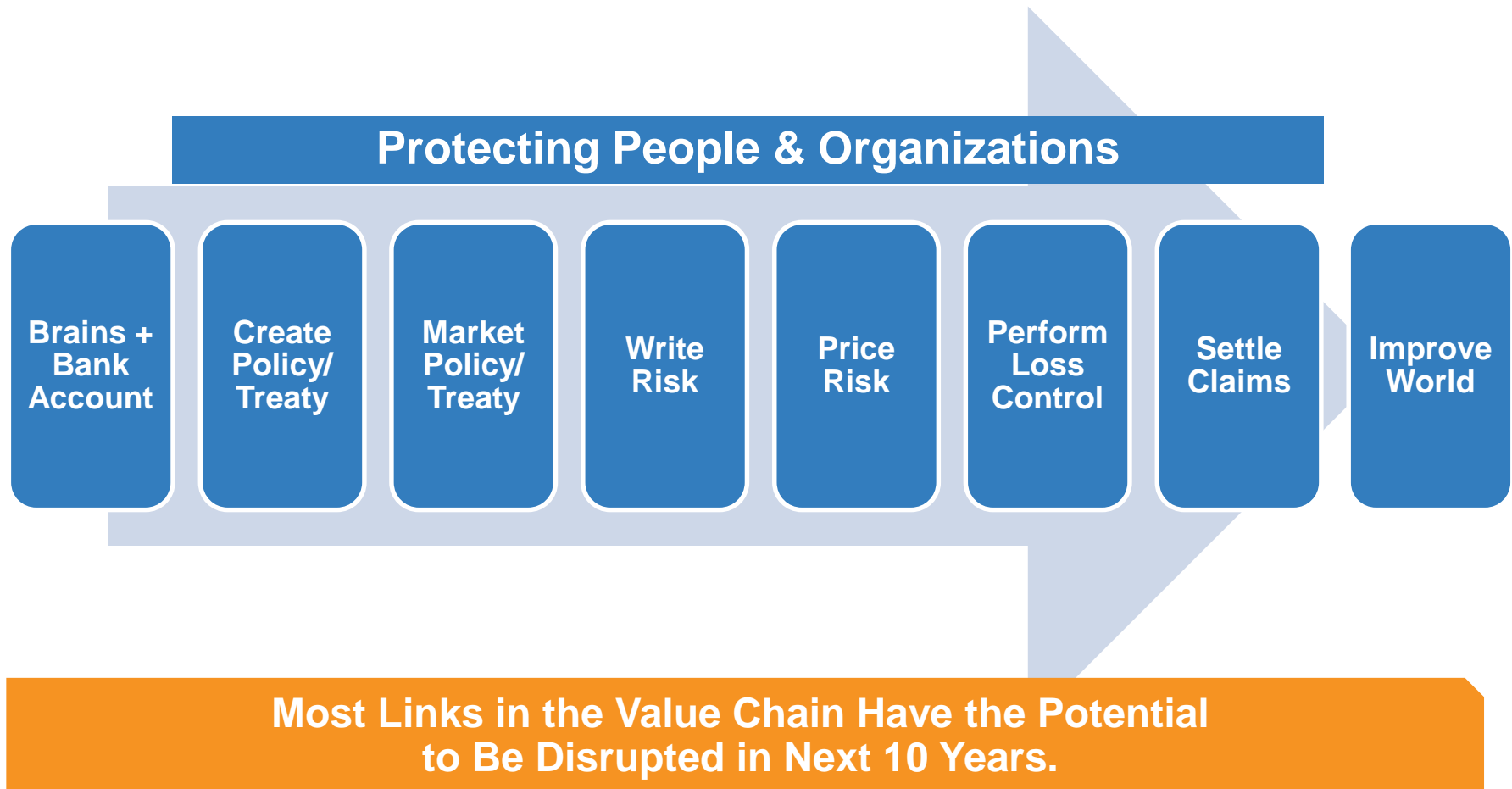
Investment In Insurance Tech Is Rising. Number of Deals Set A Record Last Year. P/C Insurance is Increasingly the Focus.



SOURCES: CB Insights, Insurance Information Institute.

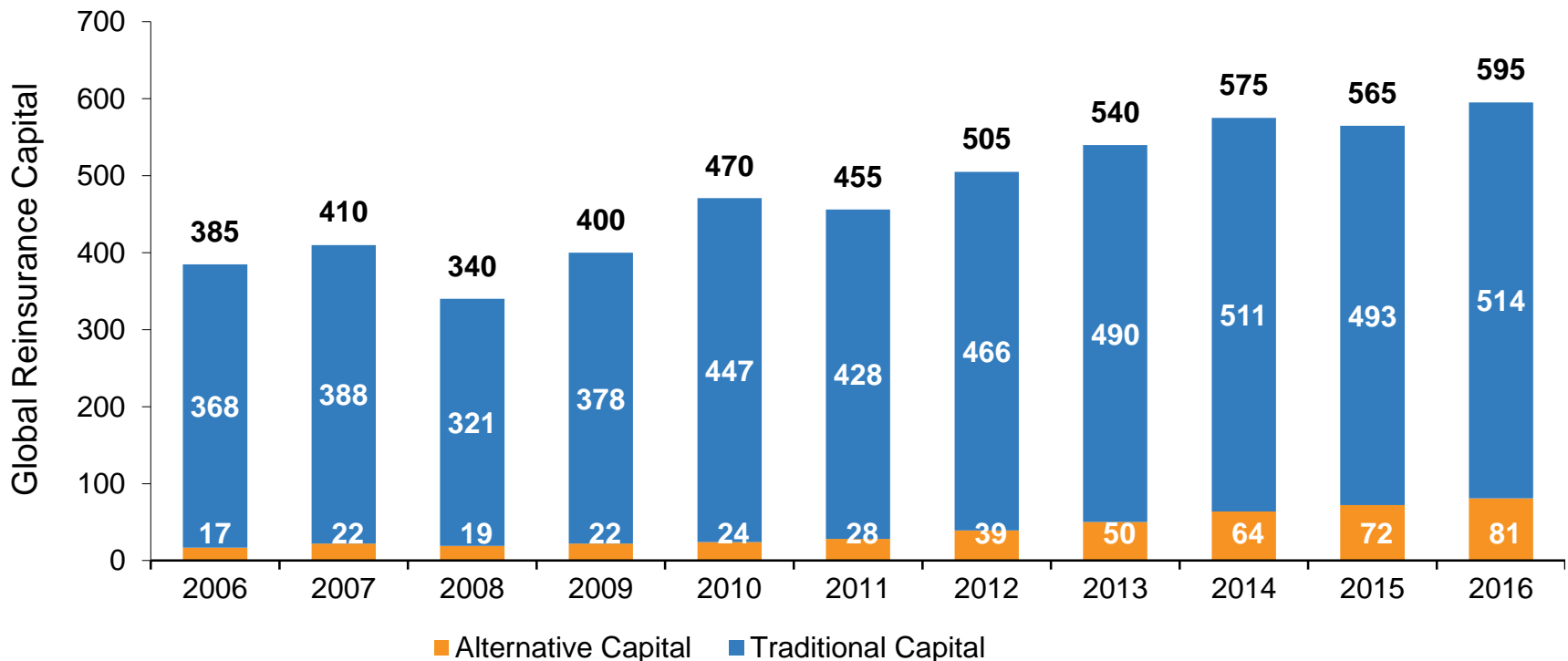
The (Re)Insurance Value Chain

Where Could Disruption Lie?



Alternative Capital Potentially Disrupting the Bank Account

(Billions of USD)



Alternative capacity has grown 350% since 2006. It has more than tripled in the past six years.



Source: Aon Benfield Analytics; Insurance Information Institute.

The Internet

Will It Disrupt Marketing?

▲ Lead Generators

- ◆ InsWeb, NetQuote, Insurance.com
- ◆ Site allows comparison shopping, sells lead to insurer

▲ Call Center Agencies

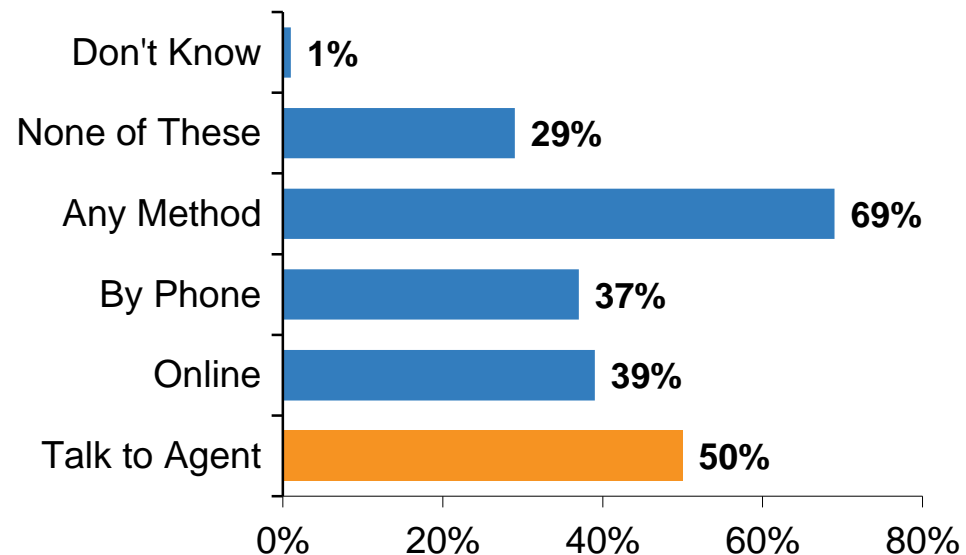
- ◆ SelectQuote, Goji
- ◆ Call center employs agents

▲ Digital agencies

- ◆ Esurance, Policy Genius
- ◆ Quote and buy online

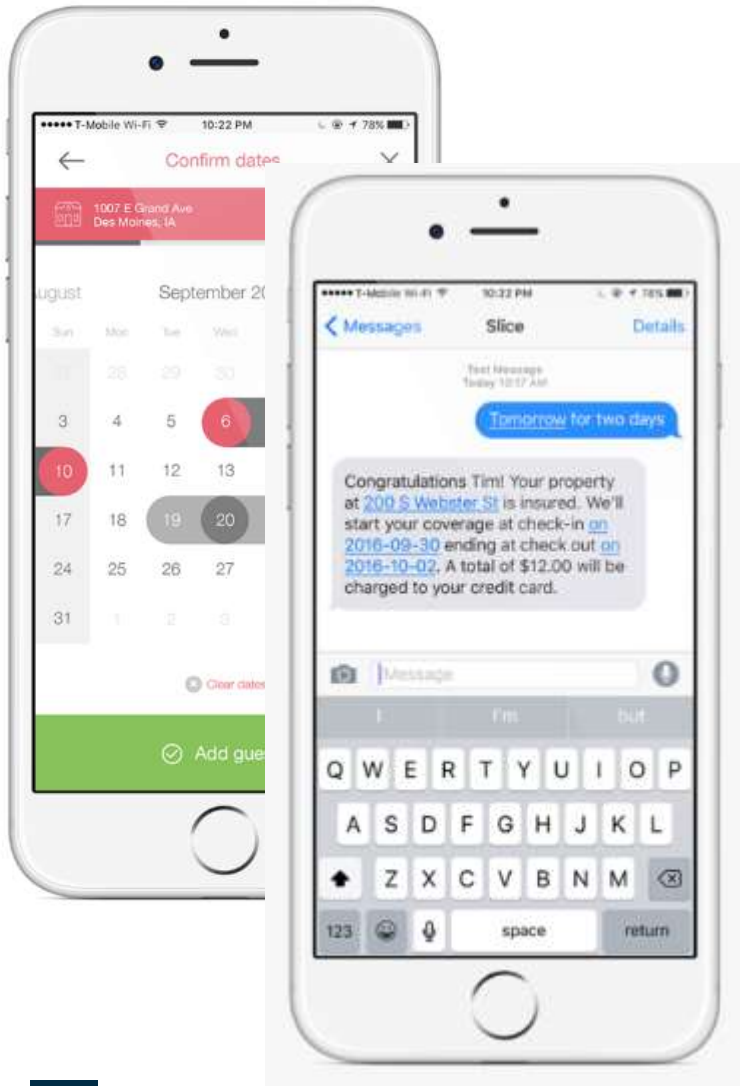
But Customers Still Like Agents

▲ Did You Compare Prices When Your Auto Policy Was Up for Renewal?



SOURCES: The New Age of Insurance Aggregators, <http://insurancethoughtleadership.com/the-new-age-of-insurance-aggregators/>; Insurance Information Institute November 2015 Pulse Survey.

Pricing Disruptor: The Fragmented Risk



One-Day Auto Insurance



Read
QR Code
(agency code
embedded)



Register

- Name
- Birthday
- Address
- e-mail address
- Driver's License No.
- License expiry date



Input

- License plate No.
- Date of driving

Premium is added
on the monthly
mobile phone bill

Loss Control Disruptor

The Internet of Things

Telematics Today



Telematics Tomorrow

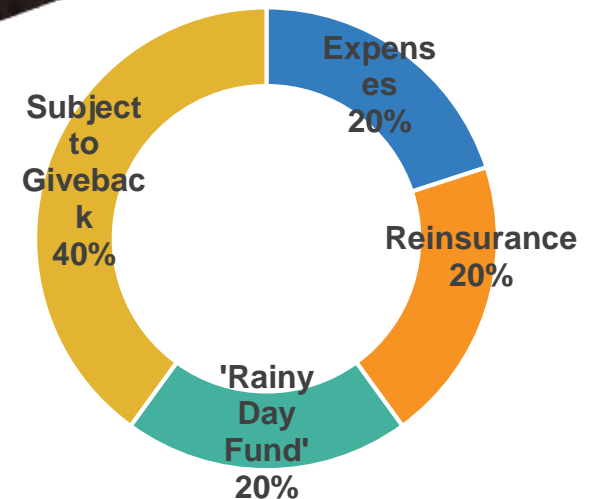
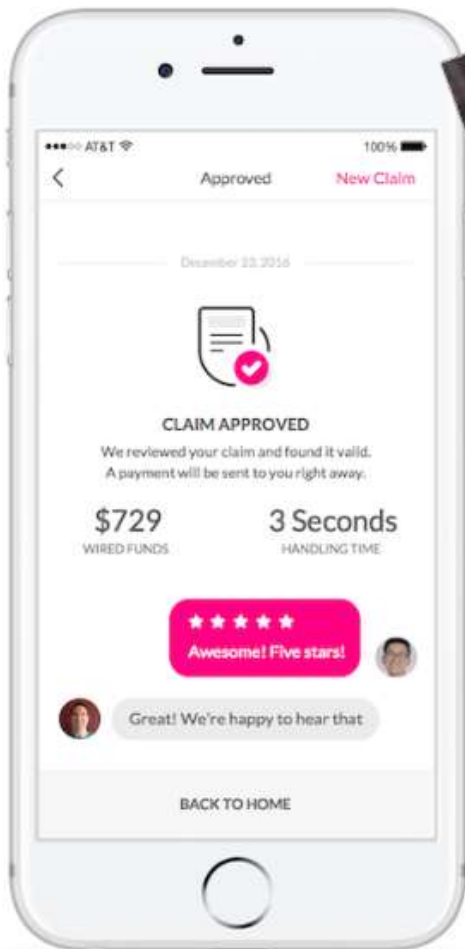


Apple iWatch

Claims Disruptor

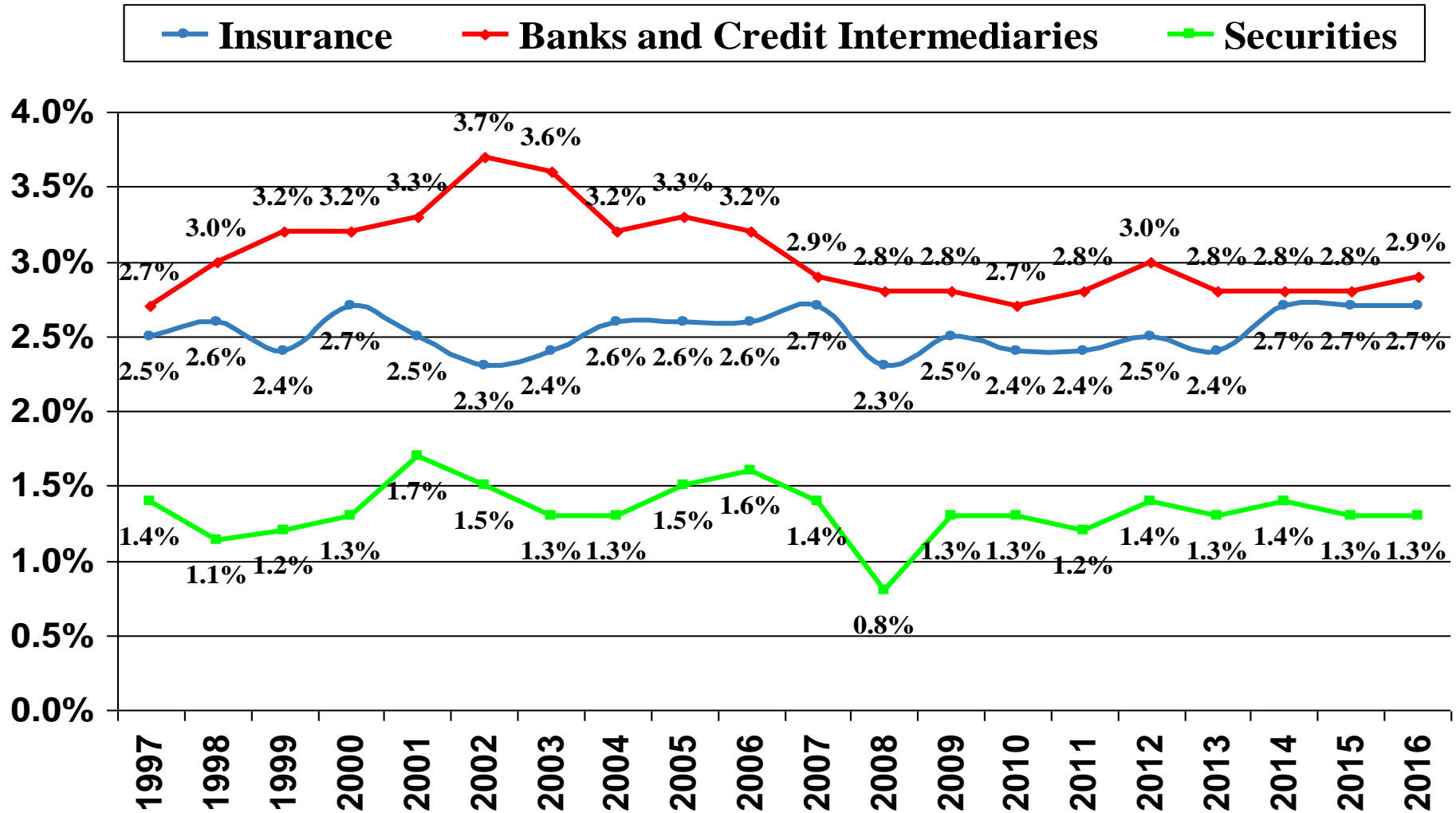
Artificial Intelligence + Behavioral Economics

Lemonade



How Insurance Contributes to Economic Growth

The Insurance Industry's Contribution to GDP Now Nearly Equals Banks



Sources: US Bureau of Economic Analysis; Insurance Information Institute.

Major Construction Projects Don't Start Without Insurance



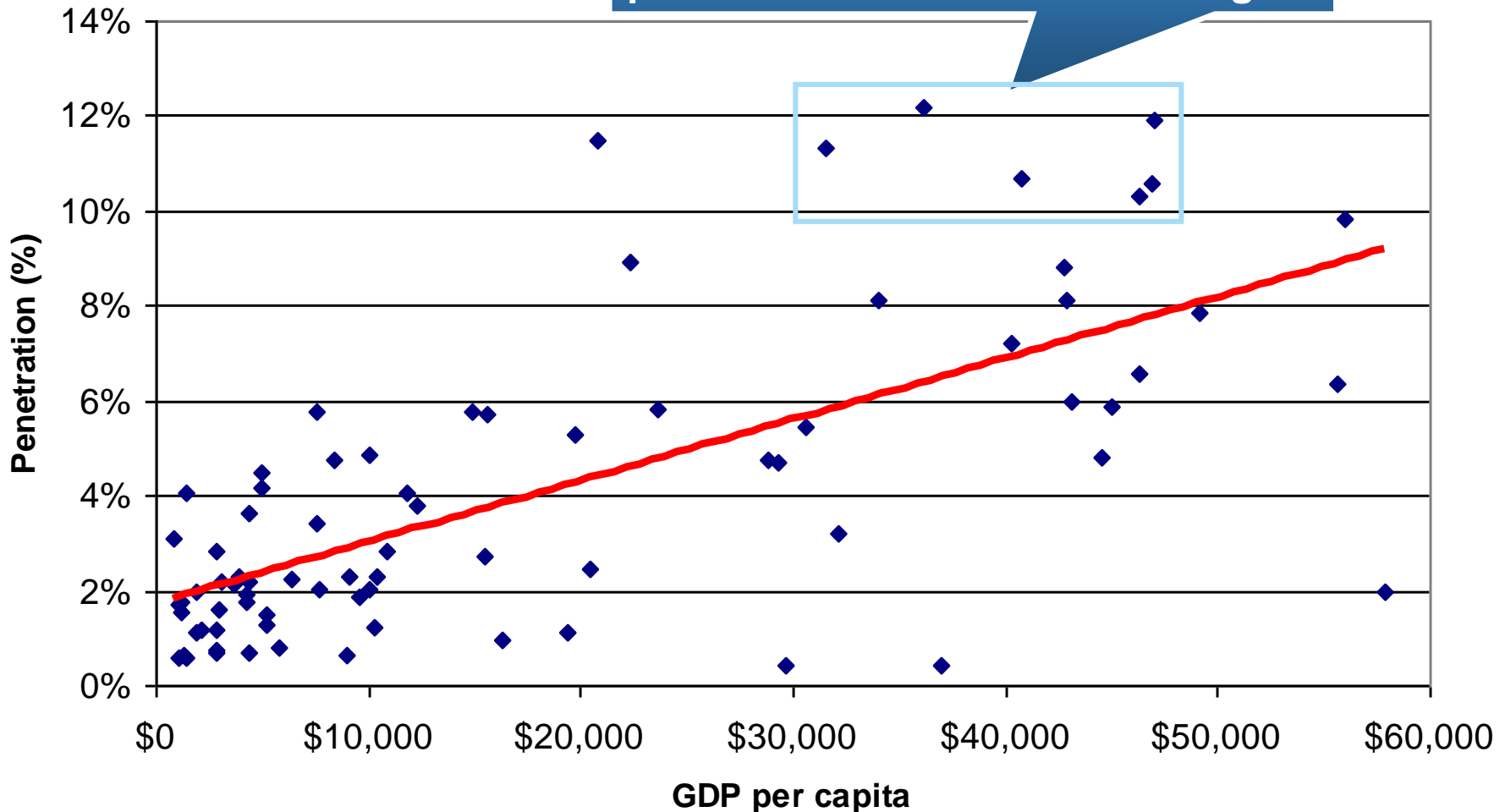
- An example: Boston's "Big Dig." At \$14 billion, the project was...
 - ◆ Larger than the original Panama Canal,
 - ◆ More expensive than the "Chunnel" connecting France and England
 - ◆ Among the carriers who were winning bidders were AIG, Lexington, Zurich-American and Kemper Environmental.
 - ◆ Workforce included 150 general contractors, 600 construction companies
 - ◆ Worst fear: that a building within 50 feet of the excavation would collapse



Source: Mark Hollmer, "The Big Risk: Insuring the Big Dig," Insurance Times, Sept. 17, 2002.

As Economies Grow Wealthier, Insurance Market Penetration (Premium as % of GDP) Also Grows

Some wealthy countries have penetration rates of 10% and higher



Insurance Contributes to Growth by Speeding Recovery

- ▲ Insurers are “financial first responders”
 - ◆ Insurance claims administration and payment is the most efficient way to achieve rapid recovery
 - ◆ Insurers perform this function more quickly and reliably than government or other aid organizations
 - ◆ This effect benefits not just those directly affected but also the wider community
 - ◆ After SuperStorm Sandy, 93% of claims were closed within 6 months



Insurers Sponsor and Promote Knowledge and Activities That Save Lives and Property

Insurers collect and disseminate both financial and non-financial knowledge; for example:



Life insurers

Major longevity
influencers



WC insurers

Injury and fatality
avoidance and
rehabilitation

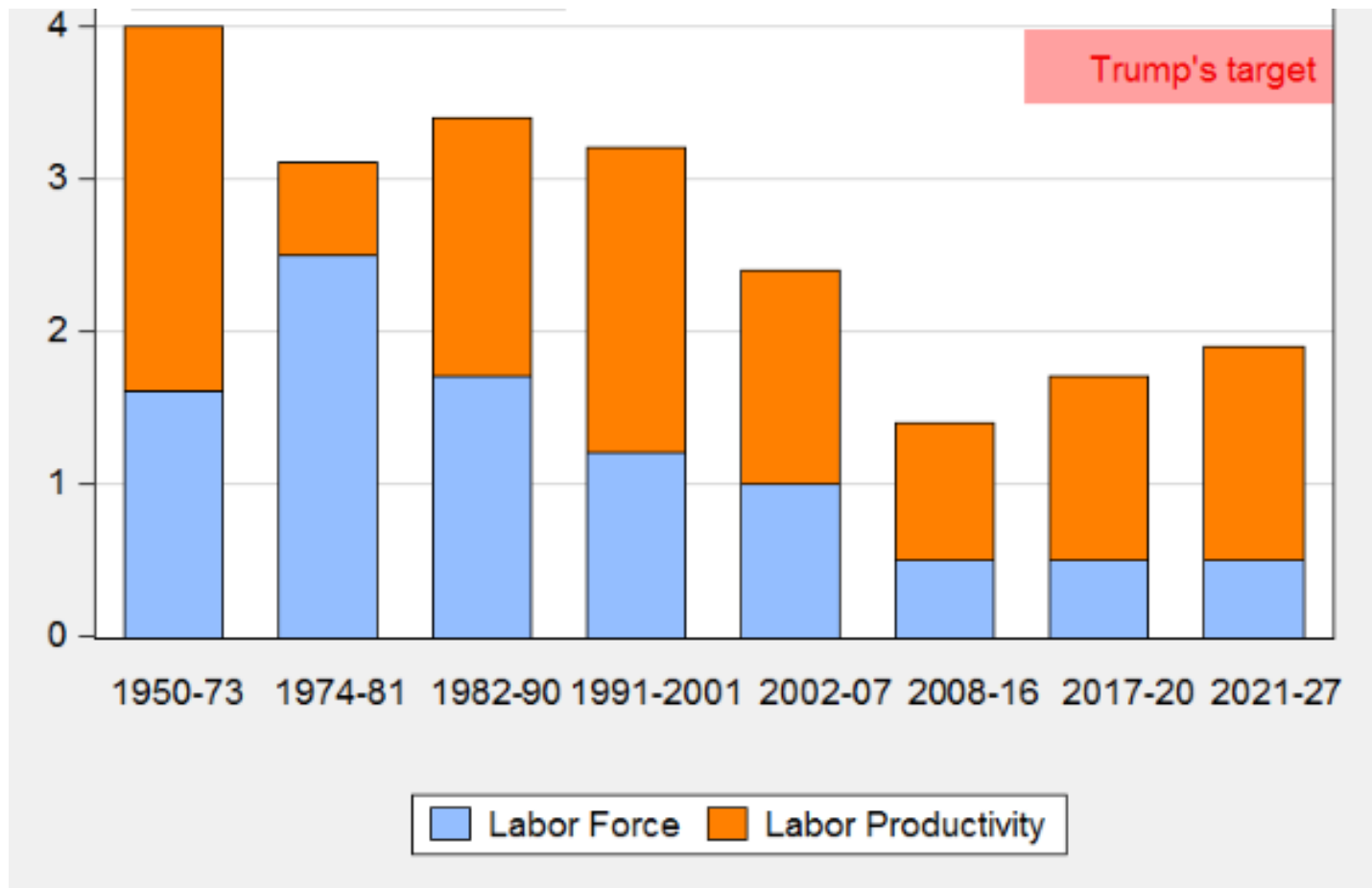


Property insurers

Research and
certification of
fire-resistant
materials

Final Thoughts

Where Would Economic Growth Come From?



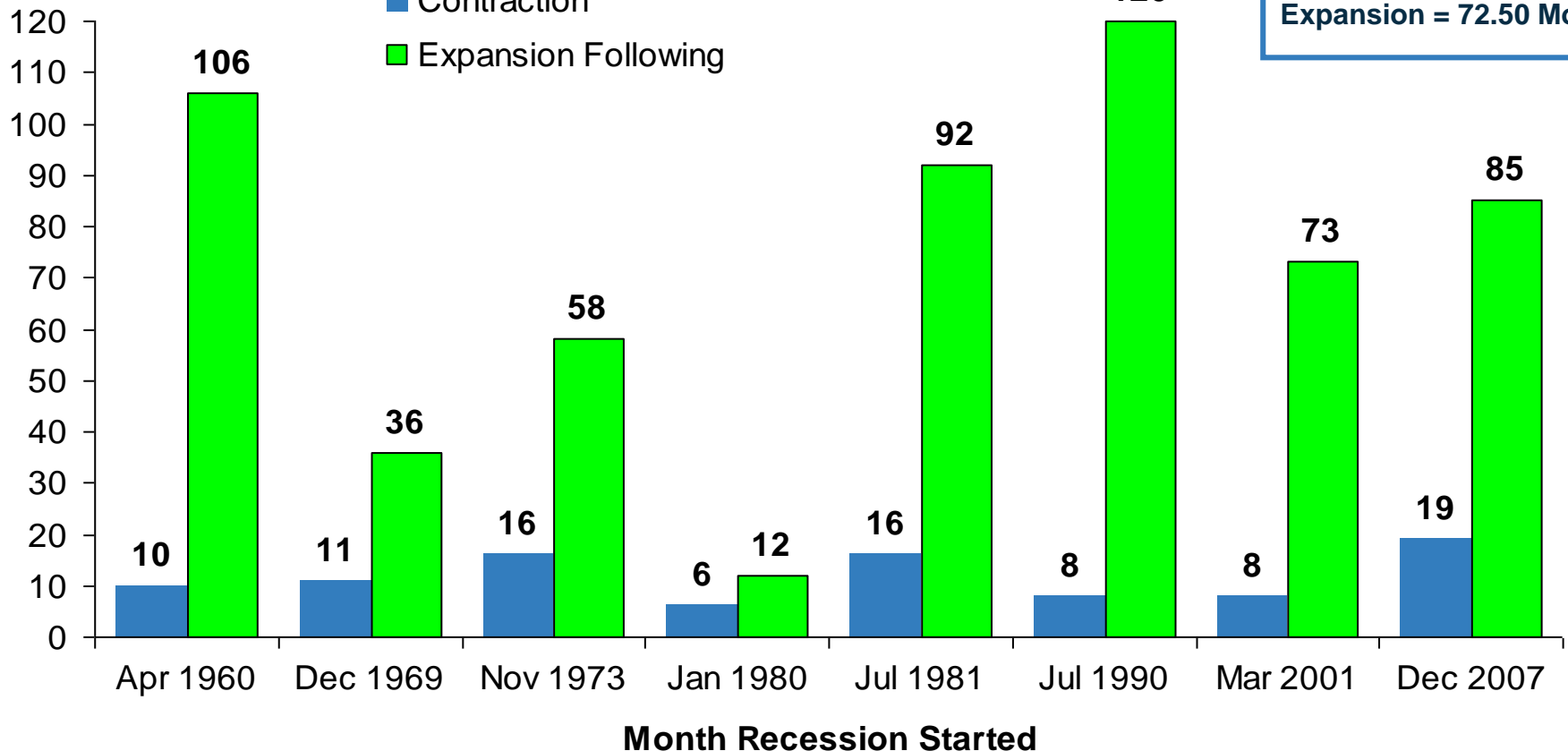
President Trump's goal of a sustained 4% real annual growth rate will be hard to achieve, even if labor productivity reverses its 21st century slide, because the labor force isn't growing as rapidly as before, especially if immigration is curtailed.

Length of US Business Cycles, 1960–Present*

Duration
(Months)

■ Contraction
■ Expansion Following

Average Duration*
Recession = 11.75 Mos
Expansion = 72.50 Mos



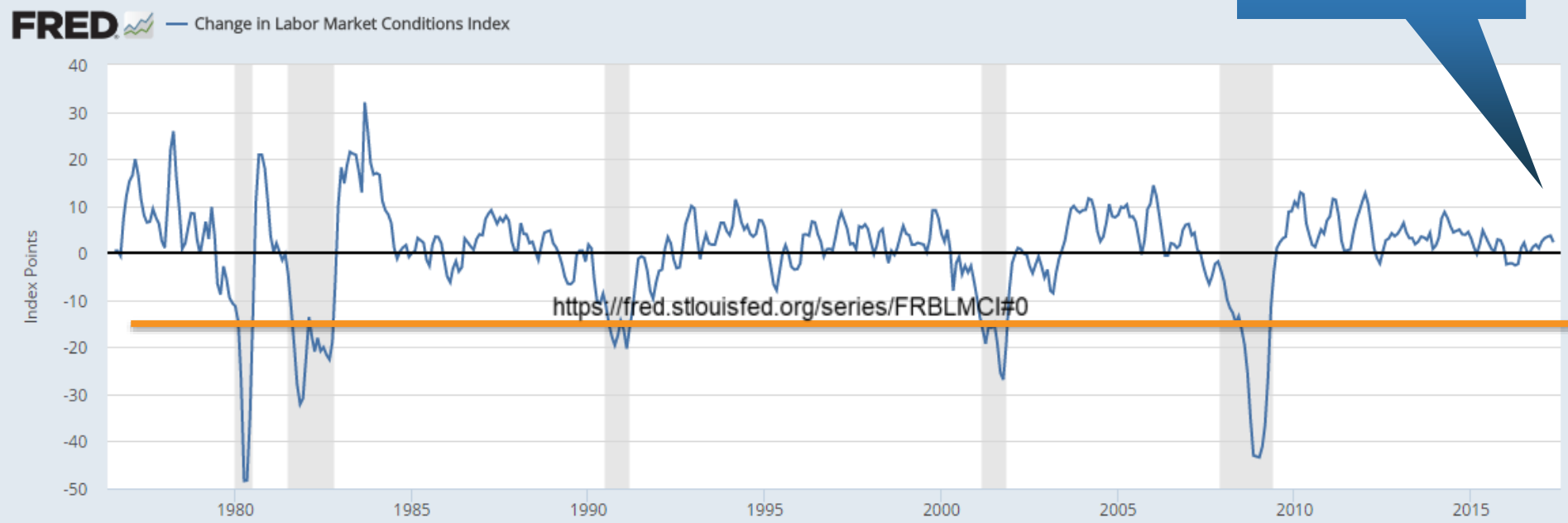
The length of the expansions greatly exceeds the length of contractions (recessions).



*Through July 2017; June 2009 was the “official” end of the recession that started in Dec 2007.
Sources: National Bureau of Economic Research; Insurance Information Institute.

Recession Ahead? The Fed's "Change in Labor Market Conditions Index" is a Good Indicator

Latest value: 1.5
in June 2017.



Since 1976, we've had a recession whenever the Index drops below -15.



Source: <https://fred.stlouisfed.org/series/FRBLMCI#0> , last updated May 8, 2017

Summary

- ▲ The economy seems likely to grow at a modest rate, and property/casualty premiums will grow with them.
- ▲ Catastrophes are an increasing drag on underwriting results.
- ▲ Commercial rates may be entering a soft period.
- ▲ Investment returns continue to be meager; don't expect changes soon.
- ▲ Insurance is a cornerstone of the U.S. economy.





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