The State of the P/C Insurance Industry

Strength Amid Economic Adversity & Financial Turmoil

> Association of General Contractors Surety Bonding & Construction Risk Management Conference Naples, FL



Download: http://www.iii.org/media/presentations/contractors/ February 10, 2009

Robert P. Hartwig, Ph.D., CPCU, President Insurance Information Institute \$ 110 William Street \$ New York, NY 10038 Tel: (212) 346-5520 \$ bobh@iii.org \$ www.iii.org

iii

Presentation Outline

The Economic Storm: P/C Insurance—Strong & Resilient

- Insurer Performance & Recession
- Banks vs. Insurers
- Financial Strength & Ratings
- Financial Strength & Ratings: A History of Resilience
- P/C Insurance Industry Financial Overview & Outlook
 - Profitability
 - Premium/Growth Trends
 - Underwriting Performance
 - Investment Market Impacts
- Capital & Capacity
- Investment in Mitigation
 - Safe, High-Yield Investment

THE ECONOMIC STORM What a Weakening Economy and Financial Crisis Mean for the **Insurance Industry**

U Designed for Resilience and **U** Strength Despite Adversity





Source: US Department of Commerce, Blue Economic Indicators 1/09; Insurance Information Institute.



* As of February 2009

Sources: National Bureau of Economic Research; Insurance Information Institute.



Unemployment Rate: On the Rise

January 2000 through January 2009



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



Unemployment Rate: A Volatile History

January 1948 through January 2009



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

Premium Growth in P/C Insurance Industry Does Not Follow Economic Cycle



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

Real GDP Growth vs. Real P/C Premium Growth: Modest Association



Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 8/08; Insurance Information Inst.

U.S. \$825B Economic Stimulus Package, By Category



Sources: House Appropriations Committee; Wall Street Journal, January 16, 2009

FINANCIAL STRENGTH & RATINGS **Industry Has Weathered** the Storms Well iii



Source: A.M. Best; Insurance Information Institute

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2007



Source: A.M. Best; Insurance Information Institute

Summary of A.M. Best's P/C Insurer Ratings Actions in 2008*

P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.

Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades





14

Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005

<u>1969-2005</u>



Source: A.M. Best: P/C Impairments Hit Near-Term Lows Despite Surging Hurricane Activity, Special Report, Nov. 2005;

Critical Differences Between P/C Insurers and Banks

Superior Risk Management Model & Low Leverage Make a Big Difference

How Insurance Industry Stability Has Benefitted Consumers

BOTTOM LINE:

- Insurance Markets—Unlike Banking—Are Operating Normally
- The Basic Function of Insurance—the Orderly Transfer of Risk from Client to Insurer—Continues Uninterrupted
- This Means that Insurers Continue to:
 - Pay claims (whereas 34 banks have gone under*)
 - The Promise is Being Fulfilled
 - Renew existing policies (banks are reducing and eliminating lines of credit)
 - Write new policies (banks are turning away people who want or need to borrow)
 - Develop new products (banks are scaling back the products they offer)

Source: Insurance Information Institute.

Reasons Why P/C Insurers Have Fewer Problems Than Banks: A Superior Risk Management Model

• Emphasis on Underwriting

- Matching of risk to price (via experience and modeling)
- Limiting of potential loss exposure
- Some banks sought to maximize volume and fees and disregarded risk
- Strong Relationship Between Underwriting and Risk Bearing
 - Insurers always maintain a stake in the business they underwrite, keeping "skin in the game" at all times
 - Banks and investment banks package up and securitize, severing the link between risk underwriting and risk bearing, with (predictably) disastrous consequences—straightforward moral hazard problem from Econ 101

• Low Leverage

- ➢ Insurers do not rely on borrowed money to underwrite insurance or pay claims →There is no credit or liquidity crisis in the insurance industry
- Conservative Investment Philosophy
 - High quality portfolio that is relatively less volatile and more liquid
- Comprehensive Regulation of Insurance Operations
 - The business of insurance remained comprehensively regulated whereas a separate banking system had evolved largely outside the auspices and understanding of regulators (e.g., hedge funds, private equity, complex securitized instruments, credit derivatives—CDS's)

• Greater Transparency

> Insurance companies are an open book to regulators and the public



*Includes all commercial banking and savings institutions. **Through Jan. 6. Source: FDIC: <u>http://www.fdic.gov/bank/historical/bank/index.html</u>; Insurance Info. Institute

19

P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

Historically Volatile, But Not Because of the Economy

P/C Net Income After Taxes 1991-2009F (\$ Millions)*

*ROE figures are GAAP; ¹Return on avg. surplus. 2008 numbers are annualized based on 9-mos. Actual of \$4.066 billion. 22

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

P/C Insurance Industry ROEs, 1975 – 2008E*

Note: 2009 figure is actual 9-month result. Sources: ISO; Insurance Information Institute.

Investment Performance

Investments are the Principle Source of Declining Profitability

Distribution of P/C InsuranceIndustry's Investment Portfolio

Source: NAIC; Insurance Information Institute research;.

Asset Class Investment Benchmarks, 4Q:2008

Source: Jay Gelb, P&C Insurance 2009/10 Outlook, Barclays Capital Research, January 6, 2009, Appendix B

Property/Casualty Insurance Industry Investment Gain:1994-2008:Q3¹

¹Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain. *2005 figure includes special one-time dividend of \$3.2B. Sources: ISO; Insurance Information Institute.

Capital/ Policyholder Surplus

Shrinkage, but Capital is Within Historic Norms

U.S. Policyholder Surplus: 1975-2008*

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

*Towers Perrin estimate as of 12/31/08

Leverage Levels by Type of Financial Institution (3Q:2008)

Leverage Ratio

Source: Credit Suisse, Financial Services 2009 (Sector Review): "De-leveraging, De-risking, Consolidation & Regulation... Expect More of All," 19 Dec. 2008, p. 3

Underwriting Trends

Financial Crisis Does <u>Not</u> Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

P/C Insurance Industry Combined Ratio, 2001-2009E

Number of Years With Underwriting Profits by Decade, 1920s –2000s

Number of Years with Underwriting Profits

Note: Data for 1920 – 1934 based on stock companies only. Sources: Insurance Information Institute research from A.M. Best Data. 33 *2000 through 2008.

Catastrophe Losses

Impacting Underwriting Results and the Bottom Line

iii

U.S. Insured Catastrophe Losses*

**Based on PCS data through Dec. 31. PCS \$2.1B loss of for Gustav. \$10.655B for Ike of 12/05/08. <u>Note</u>: 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. 35 Source: Property Claims Service/ISO; Insurance Information Institute

States With Highest Insured Catastrophe Losses in 2008

\$ Billions

Source: PCS; Insurance Information Institute.

*PCS estimate as of 12/15/08.

37

Sources: ISO/PCS; AIR Worldwide, RMS, Egecat; Insurance Information Institute inflation adjustments.

Insurers Bad Fortune is Good Business for Contractors

Repairing CAT Losses Likely to Be Big Business

Loss Prevention Has a High ROI: Property Owners, Insurers and Contractors Can All Benefit

Return on Each \$1 Invested in Mitigation

Building Codes Loss Prevention

*According to the Multi-Hazard Mitigation Council of the National Institute of Building Science. Source: Institute for Business and Homes Safety; Insurance Information Institute.

Institute for Business and Home Safety Fortified Homes

Bolivar Peninsula, Texas, after Hurricane Ike

Sources: Munich Re NatCatSERVICE *\$1 billion economic loss and/or 50 fatalities.

Insurance Information Institute On-Line

WWW.JJ.ORG

THANK YOU FOR YOUR TIME AND

YOUR ATTENTION!

Download at:

http://www.iii.org/media/presentations/contractors/