

The Great Tradeoff: Regulation, Strength & Solvency vs. Profitability & Growth **Can They Co-Exist?** St. John's University School of Risk Management, Insurance & Actuarial Science **New York, NY October 15, 2014** Robert P. Hartwig, Ph.D., CPCU, President & Economist Insurance Information Institute 110 William Street New York, NY 10038

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PART I: PROFITABILITY

A History of Insurance Industry Profitability

- Can financial strength and robust profitability co-exist?
- Supply, Demand and Alternative "Capital"

When Profits Suffer, Who Is to Blame?

• 7 Leading Contenders: The "Fall Guys"

Is the Insurance Industry Becoming Less Risky?

- Since when? Why?
- Comparison with Banks

PART II: GROWTH

- A Global History & Overview of Growth
 - Pockets and Waves of Growth
- Narrowing the "Underinsurance Gap"
- Growth through Consolidation?

Q&A



PART I: PROFITABILITY Has Strength Come at the Expense of Performance?

What Can History Tell Us?



What Is Happening to Insurer Profitability?

What Can We Learn from History? *Déjà Vu: Cycles or Super-Cycles?*

P/C Industry Net Income After Taxes 1991–2014*



•ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.7% ROAS through 2014:Q2, 9.8% ROAS in 2013, 6.2% ROAS in 2012, 4.7% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009. 2014 is annualized H1 data. Sources: A.M. Best, ISO; Insurance Information Institute

RNW All Lines by State, 2003-2012 Average: Highest 25 States



RNW All Lines by State, 2003-2012 Average: Lowest 25 States



P/C Insurance Industry Combined Ratio, 2001–2014:H1*





* 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:H1 = 98.9.

Sources: A.M. Best, ISO.

ROE: Property/Casualty Insurance by Major Event, 1987–2014:H1



* Excludes Mortgage & Financial Guarantee in 2008 – 2014. 2014 figure is through H1:2014. Sources: ISO, *Fortune*; Insurance Information Institute.

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Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2014:H1*





*Profitability = P/C insurer ROEs. 2011-14 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers.

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

P/C Insurance ROE as 5-Year Moving Average



Source: Jessica Weinkle, *Insurance Journal*, "An Average Perspective Based Insurance Profitability Cycles," October 6, 2014, based om I.I.I. data, http://www.insurancejournal.com/magazines/closingquote/2014/10/06/342096.htm.

ISURANCE

P/C Insurance ROE Index (1974-2014:Q1 = 100)





Source: Jessica Weinkle, *Insurance Journal*, "An Average Perspective Based Insurance Profitability Cycles," October 6, 2014, based om I.I.I. data, http://www.insurancejournal.com/magazines/closingquote/2014/10/06/342096.htm.

Back to the Future: Profitability Peaks & Troughs in the P/C Insurance Industry, 1950 – 2014*



*Profitability = P/C insurer ROEs. 2011-14 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers. 2014 figure is through Q2. Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

Average ROE for the P/C Insurance Industry by Decade, 1950s – 2010s



Profitability Has Declined since the highs of the 1970s and 1980s, but is above that of the 1950s and 1960s

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



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

* 2008 -2014 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2014:H1 combined ratio including M&FG insurers is 98.9; 2013 = 96.1; 2012 =103.2, 2011 = 108.1, ROAS = 3.5%.
 Source: Insurance Information Institute from A.M. Best and ISO Verisk Analytics data.

BANK LESSON: Profitability, Capital and Systemically Important Banks



Safer but less profitable

Global systemically important banks* Average:



Global Systemically Important bank Tier-1 capital ratios are up since the global financial crisis, but ROEs are lower

> The Message from <u>Regulators:</u>

Get used to it!

Source: The Economist, "No Respite," September 27, 2014.



Who's to Blame for the Decline in Peak P/C Profitability?

The 7 "Fall Guys"



#1 Mother Nature

Profits in the Age of Mega CATs

Natural Disasters in the United States, 1980 – 2013 Number of Events (Annual Totals 1980 – 2013)



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Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2013*



*2010s represent 2010-2013.

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.

Top 16 Most Costly Disasters in U.S. History

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(Insured Losses, 2013 Dollars, \$ Billions)



12 of the 16 Most Expensive Events in US History Have Occurred Over the Past Decade (2004-2013)

Sources: PCS; Insurance Information Institute inflation adjustments to 2013 dollars using the CPI.



#2 Wall Street

Crashes, Interest Rates & General Volatility

S&P 500 Index Returns, 1950 – 2014*





*Through Oct. 12, 2014.

Source: NYU Stern School of Business: <u>http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html</u> Ins. Info. Inst.

P/C Insurer Net Realized Capital Gains/Losses, 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 13

Insurers Posted Net Realized Capital Gains in 2010 - 2013 Following Two Years of Realized Losses During the Financial Crisis. Realized Capital Losses Were a Primary Cause of 2008/2009's Large Drop in Profits and ROE

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

Property/Casualty Insurance Industry Investment Income: 2000–2014¹



Due to persistently low interest rates, investment income fell in 2012 and in 2013 and is falling again in 2014.

¹ Investment gains consist primarily of interest and stock dividends. Sources: ISO; Insurance Information Institute. *2014 figure is estimated based on annualized H1 data.

Property/Casualty Insurance Industry Investment Gain: 1994–2013¹

(\$ Billions)



Investment Income Continued to Fall in 2013 Due to Low Interest Rates but Realized Investment Gains Were Up Sharply; 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;

Sources: ISO; Insurance Information Institute.



#3 The Federal Reserve

Do Fed Rates Actions Help or Hurt P/C Insurers?

U.S. Treasury Security Yields: A Long Downward Trend, 1990–2014*



*Monthly, constant maturity, nominal rates, through July 2014.

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

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.



#4 The Economy

Do Variability and Volatility in the Economy Make Earning Reasonable ROEs More Difficult?

US Real GDP Growth*





Demand for Insurance Should Increase in 2014/15 as GDP Growth Accelerates Modestly and Gradually Benefits the Economy Broadly

* Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 9/14; Insurance Information Institute.

Impairments vs. Real GDP Growth, P/C & L/H, 1978-2013

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*US P/C and L/H companies, 1977-2013.

Sources: A.M. Best: Best's Impairment Rate and Rating Transition Study—1977-2013, March 31, 2014; Insurance Information Institute.

Downgrade/Upgrade Ratio vs. Real GDP Growth, P/C & L/H, 1978-2013



Downgrades tend to fall relative to upgrades as the economy improves

Increase in

Ratio of Downgrades to Upgrades



*US P/C and L/H companies, 1977-2013.

Sources: A.M. Best: Best's Impairment Rate and Rating Transition Study—1977-2013, March 31, 2014; Insurance Information Institute.

Number of Recessions Endured by P/C Insurers, by Number of Years in Operation

Number of Recessions Since 1860



Many US Insurers Are Close to a Century Old or Older

Sources: Insurance Information Institute research from National Bureau of Economic Research data.



#5 The President (of the United States)

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



*Truman administration ROE of 6.97% based on 3 years only, 1950-52; Estimated ROE for 2014 = 7.8% based on data through 2014:Q2. Source: Insurance Information Institute
P/C insurance Industry ROE by Presidential Party Affiliation, 1950- 2014*



Estimated ROE for 2014 = 7.8% based on data through 2014:Q2. Source: Insurance Information Institute



#6 Ratings Agencies

Quasi-Regulators Must Have Some Impact

P/C Insurer Impairments, 1969–2013



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 "U.S. P/C Impairments Down Sharply in 2013; Alternative Risk Players Faltered," June 23, 2014; Insurance Information Institute.

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2013



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

Reasons for US P/C Insurer Impairments, 1969–2013



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 Special Report "U.S. P/C Impairments Down Sharply in 2013; Alternative Risk Players Faltered," June 23, 2014; Insurance Information Institute.

P/C Reserve Development, 1992–2015E



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: A.M. Best, ISO, Barclays Research (estimates for 2013-2015).

Rapid Growth 'A Leading Cause' of Impairment'

"The leading causes of impairment are deficient loss reserves (inadequate pricing) and **rapid growth**, together comprising more than 50 percent of annual impairments."

- A.M. Best, 2013

Annualized Growth in **Final Years** 45.0% 39.5% 40.0% 35.0% 27.7% 30.0% 25.0% 20.0% 16.2% 15.0% 10.0% 5.0% 0.0% Tower Legion Reliance Insurance (2001)National (2013)(1999)

Source: SNL Financial, Insurance Information Institute.

Top 10 Lines of Business for US P/C Impaired Insurers, 1969–2013

Workers Comp and Pvt. Passenger Auto Account for Nearly 45 Percent of the Impaired Insurers Since 1969



Source: A.M. Best Special Report "U.S. P/C Impairments Down Sharply in 2013; Alternative Risk Players Faltered," June 23, 2014; Insurance Information Institute.

Cumulative Average Impairment Rates by A.M. Best Financial Strength Rating*





*US P/C and L/H companies, 1977-2013.

Sources: A.M. Best: Best's Impairment Rate and Rating Transition Study-1977-2013, March 31, 2014; Insurance Information Institute.



#7 Regulators

Is an Increased Regulatory Burden Reducing ROEs?



Is There Evidence that the (Re) Insurance Industry Is Becoming <u>Less</u> Risky

Is Boring Better?

Policyholder Surplus, 2006:Q4–2014:H1





The industry now has \$1 of surplus for every \$0.73 of NPW, close to 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 . Sources: ISO, A.M .Best.

The P/C insurance industry entered 2014 in very strong financial condition.

US Policyholder Surplus: 1975–2014*



(\$ Billions)



The Premium-to-Surplus Ratio Stood at \$0.73:\$1 as of 6/30/14, a Near Record Low (at Least in Recent History)

* As of 6/30/14.

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

Premium-to-Surplus Ratio: 1985–2014*





The Premium-to-Surplus Ratio Stood at \$0.73:\$1 as of 6/30/14, a Record Low (at Least in Recent History)

* As of 6/30/14.

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

P/C Industry: Loss Reserve-to-Surplus Ratio





The Property/Casualty Industry Adjusted Its Risk Portfolio in Response to Risk-Based Capital Requirements Implemented in 1994.

Source: Calculations from A.M. Best data by Insurance Information Institute.

P/C Industry: Capital Adequacy Is on the Rise







For Every \$1 of Capital Needed to Prevent Regulatory Capital, the Average Insurer Has More Than \$10 – And the Cushion is Getting Larger.

Source: Calculations from SNL Financial data by Insurance Information Institute.



Is There Any Parallel with the Banking World?

Have Banks Gotten Safer?

Commercial Banking: Loan/Deposit Ratio, 1973 – 2014





Lending Has Become a Smaller Part of Commercial Banking Activity Since the Financial Crisis.

Source: Insurance Information Institute calculation from Board of Governors of the Federal Reserve System (FRED) data.

Commercial Banking: Leverage Ratio, 1991 – 2014





Investments in Risk-Free Treasuries Have Helped Strengthened Banks' Financial Status.

Source: SNL Financial LC, Insurance Information Institute.



Is Boring Better for Insurers?

Peak P/C ROEs Are Down, But Impairment Rates Appear to Be Lower As Well

P/C Insurer Impairments, 1969–2013



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 "U.S. P/C Impairments Down Sharply in 2013; Alternative Risk Players Faltered," June 23, 2014; Insurance Information Institute.

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2013



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



SIDEBAR

<u>Secrets of the Ancients</u> The Centenarians: Who Lives to Be 100+ in the P/C Insurance World?

The Ultimate Test of Time

100+ Year Old Insurers as a Share of All P/C Insurers

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About 12% of P/C insurance companies (fewer than 1-in-8) today (2013) are 100+ years old. This is a surprisingly high percentage.



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

Decade of Formation for P/C Insurers at Least 100 Years Old in 2014



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

100-Year-Old Insurers: Independent vs. Part of Group/Holding Company*

INSURANCE INFORMATION INSTITUTE

The number of 100-year-old insurers that are independent vs. part of a more diversified group structure is split almost evenly.



*As of 2010. Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

100-year-old Insurers: Mutual vs. Stock vs. Reciprocal

The vast majority (62.4%) of 100-year-old insurers are mutual insurers, while stock insurers account for 35.9% of the total.



*As of 2010.

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

Premium to Surplus Ratios, "Centenarians" vs. Overall P-C Industry, 1998, 2008 and 2013



Premiums are a rough measure of risk accepted; surplus is funds beyond reserves to pay unexpected losses. The larger surplus is in relation to premiums—the lower the ratio of premiums to surplus—the greater the capacity to handle the risk it has accepted.

"Centenarians" are companies at least 100 years old with positive NWP in 2013. Sources: National Association of Insurance Commissioners' Annual Statements, via Highline; I.I.I. calculations



Is There Evidence that the (Re) Insurance Industry Is Becoming <u>More</u> Risky

Is Boring Better?

Mentions of the Term "<u>Alternative Capital</u>" with "Insurance" or "Reinsurance"



Should the Increased Use of Terms Such as "Alternative Capital," "Hedge Fund" and "Pension Fund" in Conjunction with a (Re)Insurance Be a Concern

* Estimate is annualized figure based on actual data through September 30, 2014. Source: Insurance Information Institute search of Factiva database.

Mentions of the Term "*Private Equity*" with "Insurance" or "Reinsurance"



Should the Increased Use of Terms Such as "Alternative Capital," "Hedge Fund" and "Pension Fund" in Conjunction with a (Re)Insurance Be a Concern

* Estimate is annualized figure based on actual data through September 30, 2014. Source: Insurance Information Institute search of Factiva database.



Does Deluge of "Alternative" Capital Suggest the Industry is Riskier?

Or Has Capital Always Flowed in and Out of this Business?

Global Reinsurance Capital (Traditional and Alternative), 2007 - 2013





But alternative capacity has grown 163% since 2008, to \$50B. It has grown 79% in the past two years.

Source: Aon Benfield Reinsurance Market Outlook, April 1, 2014; Insurance Information Institute.

Investor by Category





Source: Aon Benfield Securities; Insurance Information Institute.

Catastrophe Bonds: Issuance and Outstanding, 1997-2014:Q2





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2014 Issuance Slowed Down Substantially; May Not Surpass 2013 Record

Sources: Guy Carpenter; Insurance Information Institute.

U.S. Wind-Exposed Risk Premium* 2010:Q1 to 2014: Q1

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* Trailing 12-month average SOURCE: Willis Capital Markets, Insurance Information Institute.
Catastrophe Bonds Outstanding, Q1 2014

Catastrophe bonds are heavily concentrated in U.S. hurricane exposures. Twothirds of catastrophe risks outstanding cover U.S. wind risks.



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Reinsurance Pricing: Rate-on-Line Index by Region, 1990 – 2014*





*As of Jan. 1. Source: Guy Carpenter

Questions Arising from Influence of Alternative Capital



- What Will Happen When Investors Face Large-Scale Losses?
- What Happens When Interest Rates Rise?
- Does ILS Have a Higher Propensity to Litigate?
- How Much Lower Will Risk Premiums Shrink/ROLs Fall?
- Will There Be Spillover Into Casualty Reinsurance?
- Does the New Interconnectedness with Capital Markets Lend Credence to the Suggestion that Reinsurance Is a Systemic Risky Business?
- Will Alternative Capital Drive Consolidation?



PART II: GROWTH Has Strength Come at the Expense of Growth?

Obstacles and Opportunities



Will We Ever See Vigorous Growth Again?

Who and What Are to Blame? Soft Markets? "Great Recession"? Regulation?

Net Premium Growth: Annual Change, 1971—2014F



Shaded areas denote "hard market" periods Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.



P/C Insurance Industry's Growth is Influenced Modestly by Growth in the Overall Economy

*Through Q2 2014.

Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 10/14; Insurance Information Institute

Direct Premiums Written: Total P/C Percent Change by State, 2007-2013



Top 25 States



Direct Premiums Written: Total P/C Percent Change by State, 2007-2013



Bottom 25 States



Direct Premiums Written: Comm. Lines Percent Change by State, 2007-2013



Top 25 States



Sources: SNL Financial LLC.; Insurance Information Institute.

Direct Premiums Written: Comm. Lines Percent Change by State, 2007-2013



Bottom 25 States



Sources: SNL Financial LLC.; 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.

Payroll vs. Workers Comp Net Written Premiums, 1990-2013P



Continued Payroll Growth and Rate Gains Suggest WC NWP Will Grow Again in 2014; +8.6% Growth Estimated for 2013

*Private employment; Shaded areas indicate recessions. WC premiums for 2012 are I.I.I. estimate based YTD 2013 actuals. Sources: NBER (recessions); Federal Reserve Bank of St. Louis at <u>http://research.stlouisfed.org/fred2/series/WASCUR</u>; NCCI; I.I.I.

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Average Commercial Rate Change, All Lines, (1Q:2004–2Q:2014)



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



SIDEBAR Advertising in P/C Insurance

Growth in Capacity Spurs Competition

Advertising Expenditures by P/C Insurance Industry, 1999-2013





Source: Insurance Information Institute from consolidated P/C Annual Statement data, Insurance Expense Exhibit (Part I).

Growth in Premiums & Surplus vs. Growth in Advertising Expenditures, 2000 – 2013



Sources: Insurance Information Institute analysis from A.M. Best data.

Growth in Premiums, Capacity vs. Growth in Surance in Advertising Expenditures, 2000 – 2013



Overall Growth in Ad Spending has greatly exceeded growth in capacity (policyholder surplus) or premium growth. This suggests that there are diminishing returns to advertising.

Sources: Insurance Information Institute analysis from A.M. Best data.

Q. How long has it been since you have seen or heard an advertisement for auto insurance?



Four Out of Five Respondents Have Seen An Auto Insurance Ad in the Past Week.

Source: Insurance Information Institute Annual Pulse Survey, May 2014.



Global Insurance Premium Growth Trends

Growth Is Uneven Across Regions and Market Segments

Distribution of Global Insurance Premiums, 2013 (\$ Trillions)



Total Premium Volume = \$4.641 Trillion*



Source: Swiss Re, sigma, No. 3/2014; Insurance Information Institute.

Distribution of Nonlife Premium: Industrialized vs. Emerging Markets, 2013

Premium Growth Facts

- Emerging market's share of nonlife premiums increased to 19.5% in 2013, up from 17.3% in 2012 and 14.3% in 2009. The share of premiums written in the \$2 trillion global nonlife market remains much larger (80.5%) but continues to shrink.
- The financial crisis and sluggish recovery in the major insurance markets will accelerate the expansion of the emerging market sector



2013, \$Billions

Sources: Swiss Re sigma No.4/2013; Insurance Information Institute research.

Premium Growth by Region, 2013



Global Premium Volume Totaled \$4.641 Trillion in 2013, up 1.4% from \$4.599 Trillion in 2012. Global Growth Was Weighed Down by Slow Growth in N. America and W. Europe and Partially Offset by Emerging Markets

Source: Swiss Re, sigma, No. 3/2013.

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Non-Life Insurance: Global Real (Inflation Adjusted) Premium Growth, 2013



Market	Life	Non-Life	Total
Advanced	-0.2	1.1	0.3
Emerging	6.4	8.3	7.4
World	0.7	2.3	1.4

Source: Swiss Re, sigma, No. 3/2014.

Global Real (Inflation Adjusted) Premium Growth: 1980-2013

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Globalization: The Global Economy Creates and Transmits Cycles & Risks

Globalization Is a Double Edged Sword— Creating Opportunity and Wealth But Potentially Creating and Amplifying Risk Emerging vs. "Advanced" Economies

GDP Growth: Advanced & Emerging Economies vs. World, 1970-2015F



Source: International Monetary Fund, World Economic Outlook, October 2014; Insurance Information Institute.

Real GDP Growth Forecasts: Major Economies: 2011 – 2015F





Growth Prospects Vary Widely by Region but the Outlook for 2015 Has Dimmed Except in the US and UK

Sources: Blue Chip Economic Indicators (10/2014 issue); IMF (10/2014); Insurance Information Institute.

Real GDP Growth Forecasts: Selected Economies: 2011 – 2015F



Sources: Blue Chip Economic Indicators (10/2014 issue); IMF (10/2104); Insurance Information Institute.

World Trade Volume: EXPORTS 2010 – 2015F



Growth (%)





The "Underinsurance" Gap

Why is So Much Loss Uninsured and How to Close the Gap

Losses Due to Natural Disasters in the US, 1980–2013





Losses Due to Natural Disasters Worldwide, 1980–2013 (Overall & Insured Losses)



Natural Loss Events: Full Year 2013





• Natural catastrophes

Selection of significant

Natural catastrophes

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- Geophysical events (earthquake, tsunami, volcanic activity)
- Meteorological events (storm)

- Hydrological events (flood, mass movement)
- Climatological events (extreme temperature, drought, wildfire)
- Extraterrestrial events (Meteorite impact)

Source: Munich Re Geo Risks Research, NatCatSERVICE – as of January 2014.

Even as Insurance Coverage Expands, the Insured Share of Losses Is Falling



Total Global vs. Insured Losses as % GDP (1974 – 2013)

Total and insured losses as a share of global GDP have both increased over the past 40 years, <u>but</u> insured losses as a share of total losses has shrunk

Natural Catastrophe Protection Gap (1974 – 2013)



Many emerging market nations have very large insurance gaps. In the US, the gap is about 50%.

Source: Swiss Re Economic Research & Consulting; Geneva Association; Insurance Information Institute.
Gap Between GDP Growth and Reinsurance Limit in Asia-Pacific Region: 2004—2013





Sources: Guy Carpenter, World Bank, IMF; Insurance Information Institute.

Q. If you were to purchase a home today, which of the following summarizes your views on that home's risk of damage from natural disasters . . . and your decision to purchase that home?



More Than Half of the Public Would Be Significantly Influenced by Risk of Damage from Natural Disasters. Close to a Third Do Not Regard Such a Risk To Be a Major Consideration.

Source: Insurance Information Institute Annual Pulse Survey.

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Causes of the Underinsurance Gap and Ways to Narrow/Close It



Contributing Factors to the Underinsurance Gap

- Affordability
- Lack of Awareness
- Limits to Insurability
- Regulatory Deficiencies

Solutions that Will Help Close the Underinsurance Gap

- Compulsory Insurance
- Create a Conducive Regulatory, Legal and Tax Environment
- Build Public-Private Partnerships
- Develop New Products
- Microinsurance
- Enhance Data Collection/Sharing
- Foster a More Strategic Approach to Risk Among Businesses



<u>Growth Through M&A</u> Merger and Acquisition Activity

Will Slow Growth, Excess Capacity Lead to Consolidation? Hasn't Happened—YET

U.S. INSURANCE MERGERS AND ACQUISITIONS, All Sectors, 1989-2013 (1)



(1) Includes transactions where a U.S. company was the acquirer and/or the target.

U.S. INSURANCE MERGERS AND ACQUISITIONS, P/C SECTOR, 2002-2013 (1)



(1) Includes transactions where a U.S. company was the acquirer and/or the target.

U.S. INSURANCE MERGERS AND ACQUISITIONS, LIFE/ANNUITY SECTOR, 2002-2013 (1)



(1) Includes transactions where a U.S. company was the acquirer and/or the target.

Source: Conning proprietary database.



Number of Deals



Source: Optis Partners, "Agent-Broker Merger & Acquisition Statistics: The New Normal?", August 2014; Insurance Information Institute.



Shifting Legal Liability & Tort Environment

(Temporary) "Taming" of the Tort System and Better Risk Management Lack of Recent Liability Crises

Removes Hard Market Catalyst

Over the Last Three Decades, Total Tort Costs as a % of GDP Appear Somewhat Cyclical, 1980-2013E







Insurance Shares Continued to Rise

Sources: Towers Watson, 2011 Update on US Tort Cost Trends, III Calculations based on data from Appendix 4.



Where the Growth Is

Growth Is Uneven Across Geographies, Industries

12 Industries for the Next 10 Years: **Insurance Solutions Needed**



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

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ENERGY SECTOR: OIL & GAS INDUSTRY FUTURE IS BRIGHT

US Is Becoming an Energy Powerhouse; Domestic Demand and Exports Are Key Need Infrastructure Investment

U.S. Natural Gas Production, 2000-2013





Source: Energy Information Administration, Short-Term Energy Outlook (April 8, 2014), Insurance Information Institute.

U.S. Crude Oil Production, 2005-2015P

Millions of Barrels per Day



Source: Energy Information Administration, Short-Term Energy Outlook (April 8, 2014), Insurance Information Institute.

Oil & Gas Extraction Employment, Jan. 2010—August 2014*





*Seasonally adjusted

Sources: US Bureau of Labor Statistics at http://data.bls.gov; Insurance Information Institute.

World Primary Energy Consumption, 1990-2040P



Source: Energy Information Administration, 2013 International Energy Outlook, Insurance Information Institute.



Source: International Energy Agency, World Energy Outlook 2011.



CONSTRUCTION INDUSTRY OVERVIEW & OUTLOOK

The Construction Sector Is Critical to the Economy and the P/C Insurance Industry

Value of New Private Construction: Residential & Nonresidential, 2003-2014*



Remains Well Below Pre-Crisis Peak; Residential Dominates

*2014 figure is a seasonally adjusted annual rate as of June.

Sources: US Department of Commerce; Insurance Information Institute.

Value of Construction Put in Place, June 2014 vs. June 2013*



Overall Construction Activity is Up, But Growth Is Almost 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.



MANUFACTURING SECTOR OVERVIEW & OUTLOOK

The U.S. Is Experiencing a Mini Manufacturing Renaissance That Is Benefitting the US Economy and the P/C Insurance Industry

Dollar Value* of Manufacturers' Shipments Monthly, Jan. 1992—July 2014





Monthly shipments in July 2014 exceeded the pre-crisis (July 2008) peak. Manufacturing is energy-intensive and growth leads to gains in many commercial exposures: WC, Commercial Auto, Marine, Property, and various Liability Coverages.

* Seasonally adjusted; Data published Sept. 4, 2014.

Source: U.S. Census Bureau, Full Report on Manufacturers' Shipments, Inventories, and Orders, http://www.census.gov/manufacturing/m3/ 154



HEALTHCARE

Healthcare Will Consume Ever More of US GDP & Demand More Insurance Solutions

U.S. Health Care Expenditures, 1965–2022F





inflation of GDP growth

Sources: Centers for Medicare & Medicaid Services, Office of the Actuary at <u>http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected.html</u> accessed 3/14/14; Insurance Information Institute.

National Health Care Expenditures as a Share of GDP, 1965 – 2022F*





Sources: Centers for Medicare & Medicaid Services, Office of the Actuary at http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected.html accessed 3/14/14; Insurance Information Institute.



CAT OF THE FUTURE? CYBER RISK

Cyber Risk is a Rapidly Emerging Exposure for Businesses Large and Small in Every Industry

NEW III White Paper:

http://www.iii.org/assets/docs/pdf/paper_CyberRisk_2014.pdf

Data Breaches 2005-2013, by Number of Breaches and Records Exposed



The Total Number of Data Breaches (+38%) and Number of Records Exposed (+408%) in 2013 Soared

* 2013 figures as of Jan. 1, 2014 from the ITRC updated to an additional 30 million records breached (Target) as disclosed in Jan. 2014. Source: Identity Theft Resource Center.

2013 Data Breaches By Business Category, By Number of Breaches



The majority of the 614 data breaches in 2013 affected business and medical/healthcare organizations, according to the Identity Theft Resource Center.



Source: Identity Theft Resource Center, http://www.idtheftcenter.org/images/breach/2013/UpdatedITRCBreachStatsReport.pdf

External Cyber Crime Costs: Fiscal Year 2013

Information loss (43%) and business disruption or lost productivity (36%) account for the majority of external costs due to cyber crime.



* Other costs include direct and indirect costs that could not be allocated to a main external cost category Source: 2013 Cost of Cyber Crime: United States, Ponemon Institute.



Terrorism Risk Insurance

Risk Is Rising TRIA's Future Is Uncertain

Terrorism Insurance Take-up Rates, By Year, 2003-2013



In 2003, the first year TRIA was in effect, the terrorism take-up rate was 27 percent. Since then, it has increased steadily, remaining in the low 60 percent range since 2009.

Source: Marsh Global Analytics, 2014 Terrorism Risk Insurance Report, April 2014 and earlier editions.

Summary



P/C Insurance Markets Remain Profitable

- Peak profitability has declined over the past several cycles
- Lower bound profitability has remained virtually unchanged
- Many factors: economic, market & institutional at work

Quantum Shift or Evidence of a Super-Cycle?

 Profitability patterns today more reminiscent of the pre-1970 era (and back to WW II and even pre-war)

Growth Concerns Are Valid

- Apart from international trade barriers, sound regulation is not a leading driver or impediment to growth
- Economics are a major driver
- Innovative insurance solutions needed for old & new risks



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