



P/C Insurance in Alabama:

What the Dickens?

Bleak House or Great Expectations?

**Alabama I-Day
Tuscaloosa, AL
October 10, 2012**

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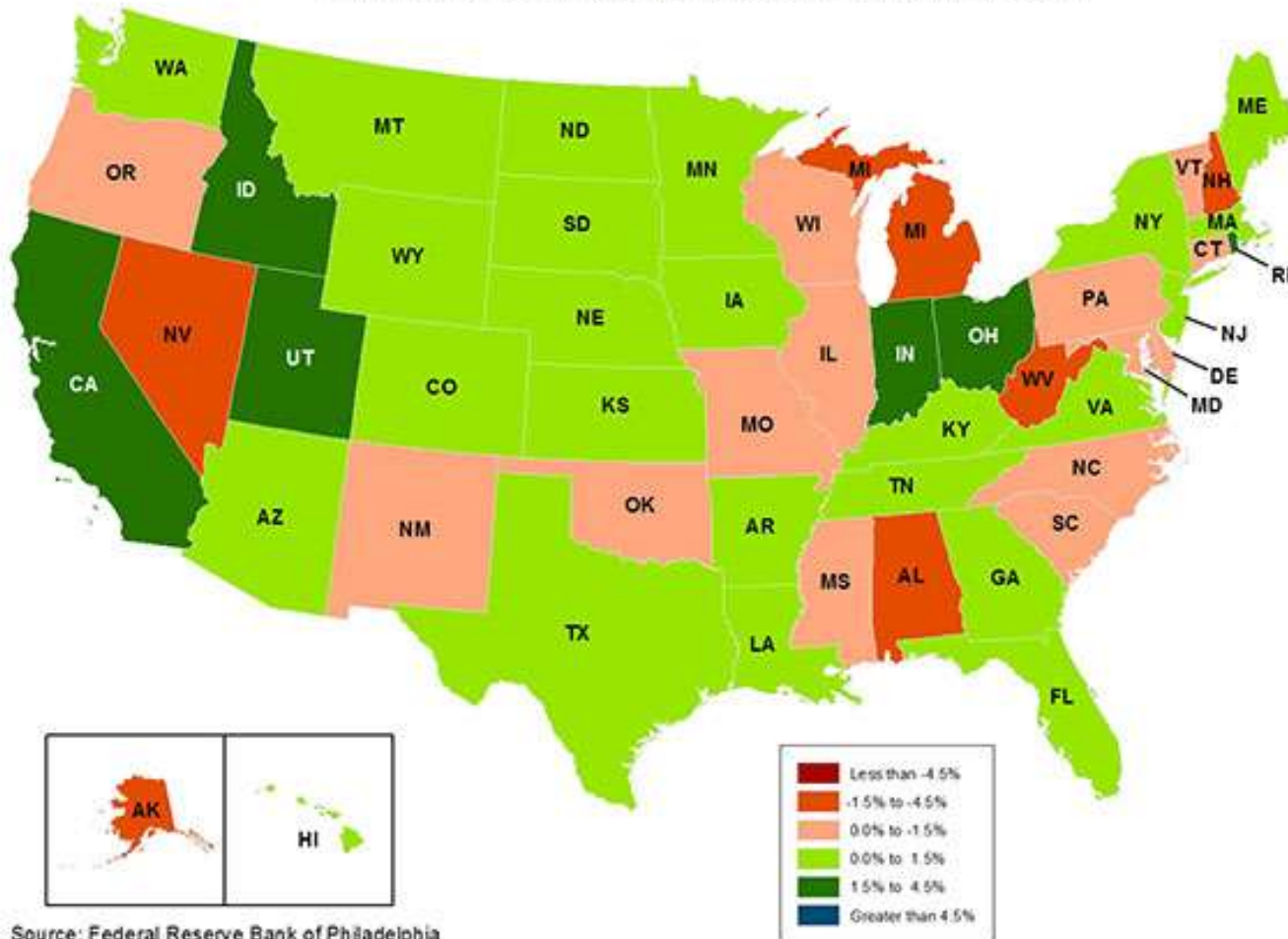
- “Bleak House” and “Great Expectations”
 - ◆ Are two novels by Charles Dickens, written in 1852-53 and 1860-61, respectively
 - ◆ Have ***nothing*** to do with insurance
 - ◆ Were chosen for the presentation’s subtitle merely because they imply opposite outcomes (and give the presentation a literary tone)
- I could have used other Dickens novels instead
 - ◆ “Hard Times” (written in 1854)
 - ◆ The opening lines from “A Tale of Two Cities”:

It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, ... in short, the period was so far like the present period, that some of its noisiest authorities insisted on its being received, for good or for evil, in the superlative degree of comparison only.

- The strength of the economy will influence P/C industry growth opportunities
- Regional differences will significantly affect P/C markets
 - ◆ Recovery in some areas will begin years ahead of others
 - ◆ Speed of recovery in some areas will differ by orders of magnitude from others

State-by-State Leading Indicators for 2d Half of 2012

July 2012 State Leading Indexes: 6-Month Forecast



Source: Federal Reserve Bank of Philadelphia

5 Fastest Growing States

| | |
|--------------|------|
| Ohio | 3.2% |
| Idaho | 2.5% |
| California | 2.4% |
| Indiana | 1.7% |
| Rhode Island | 1.6% |

5 Slowest Growing States

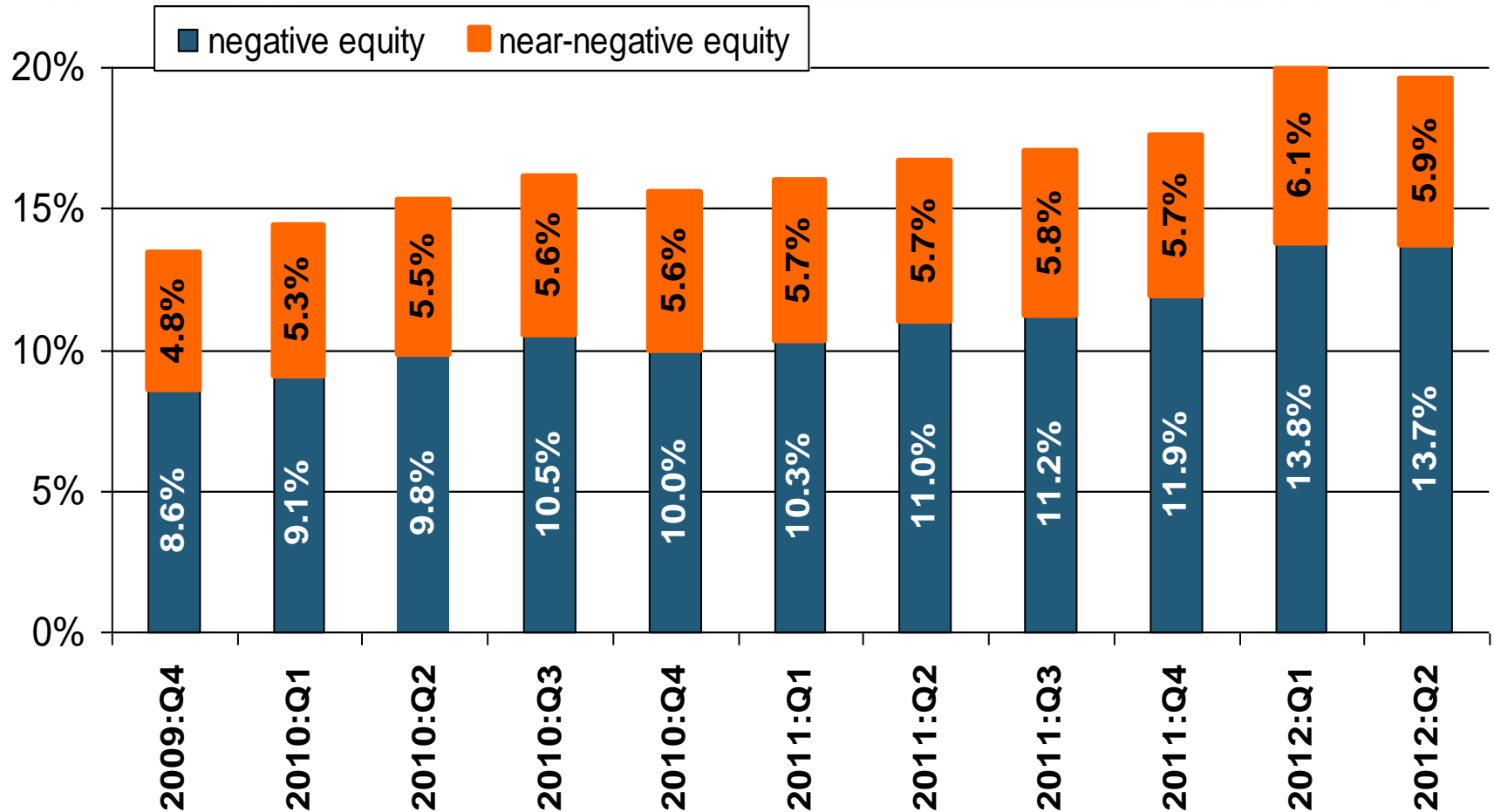
| | |
|----------------|--------------|
| West Virginia | -4.1% |
| Alaska | -3.9% |
| Michigan | -3.4% |
| Alabama | -3.0% |
| Nevada | -2.6% |

Effect of Europe's Economy on Selected US States

| State | Exports to Europe as a % of State GDP | Percent of Total State Exports That Go to Europe |
|----------------|---------------------------------------|--|
| Utah | 6.62% | 43.27% |
| West Virginia | 5.79% | 42.86% |
| South Carolina | 4.88% | 32.78% |
| Louisiana | 4.46% | 20.08% |
| Washington | 3.50% | 19.21% |
| Nevada | 3.38% | 55.19% |
| Indiana | 3.02% | 26.01% |
| Alabama | 2.94% | 28.46% |
| US Overall | 2.19% | 22.21% |

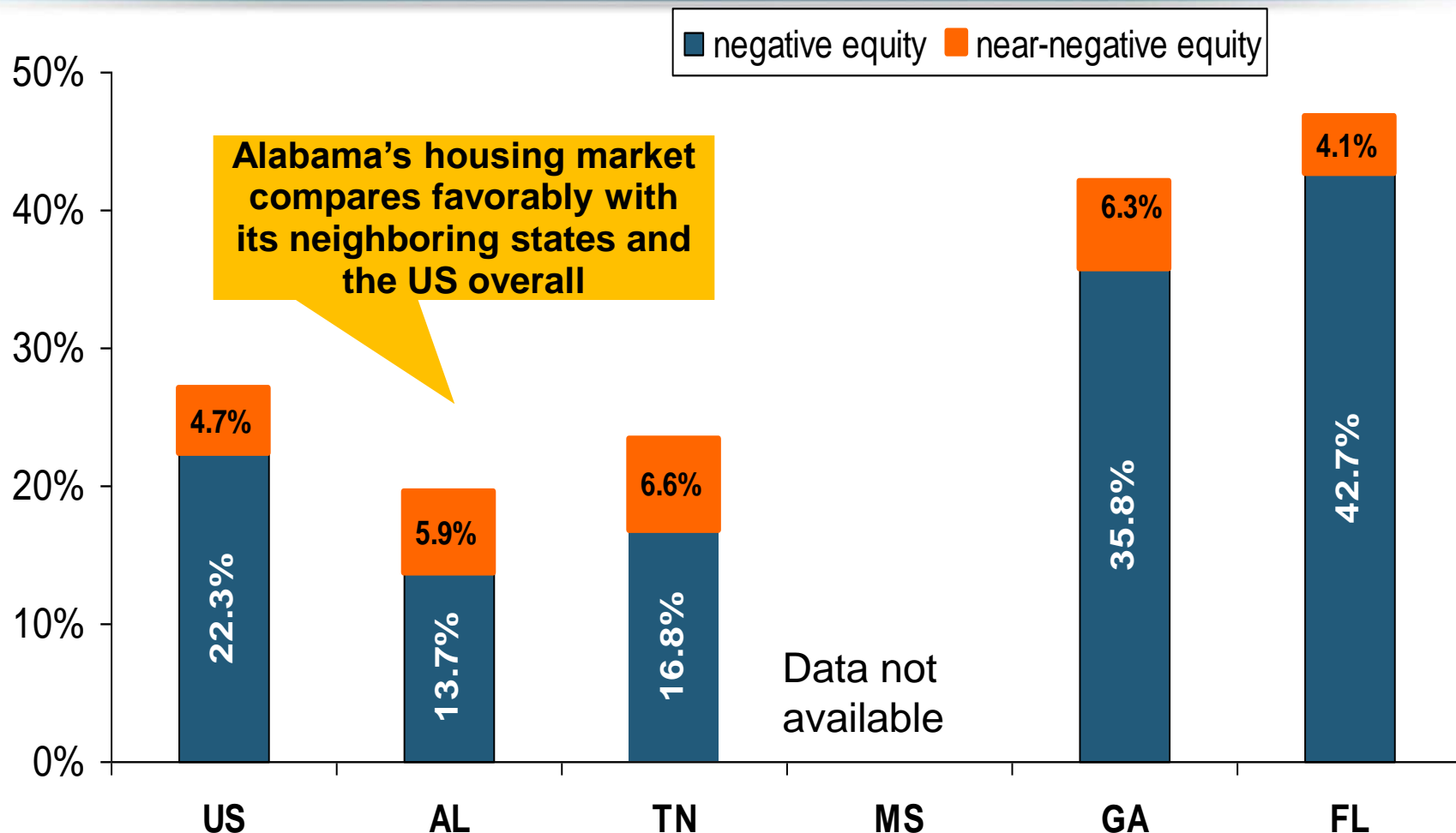
Sources: Wells Fargo Securities, Economics Group, "U.S. States Grapple with Europe's Woes," published July 19, 2012; Insurance Information Institute.

The Alabama Housing Market: Percent of Mortgages with “Negative Equity,” 2009:Q4-2012:Q2



“Near-negative equity” is a position in which the market value is above the mortgage debt, but only by 5% or less.

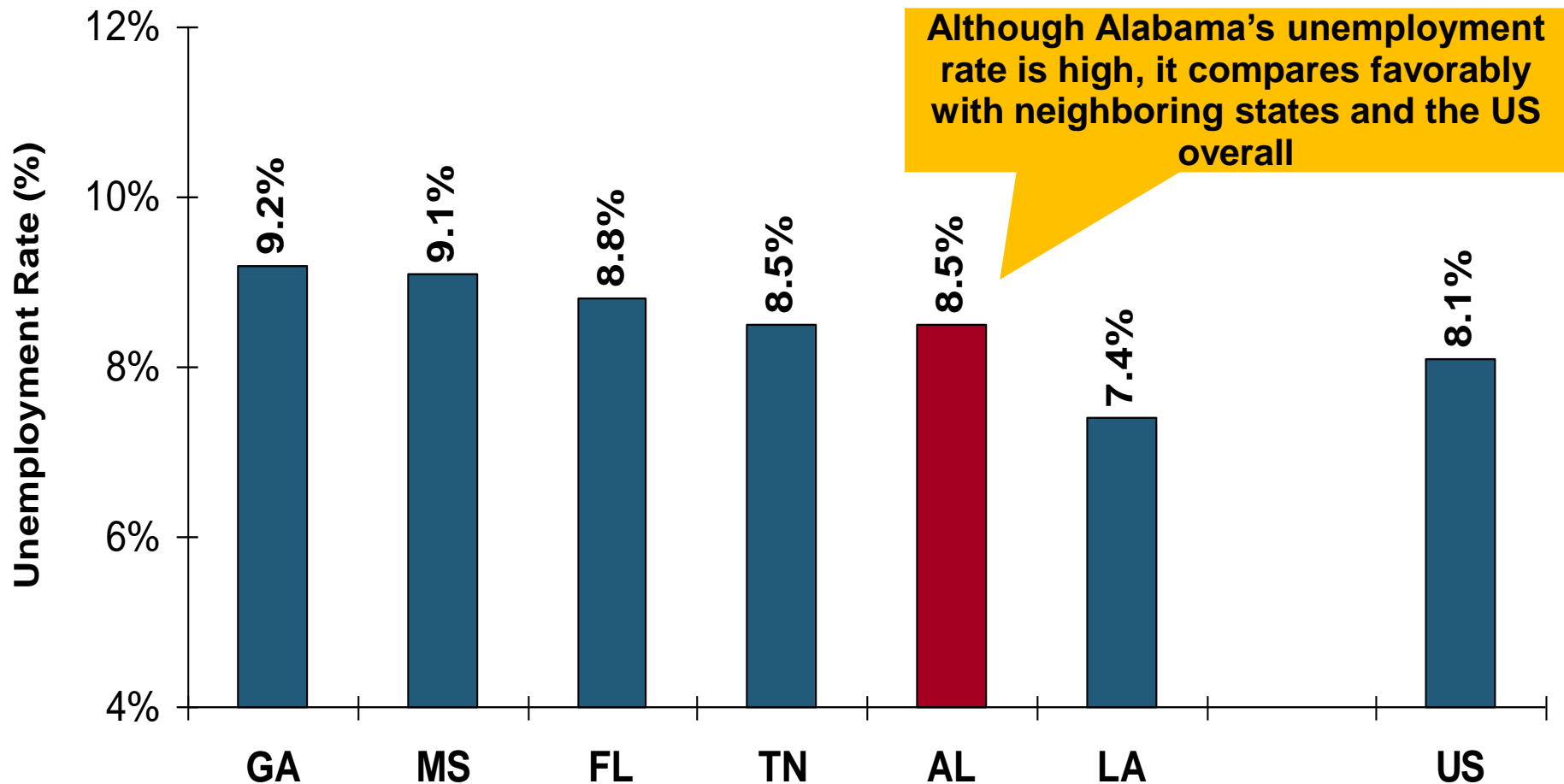
The Regional Housing Market: Percent of Mortgages with “Negative Equity,” 2012:Q2



LABOR MARKET DEVELOPMENTS

Factors Driving Workers Compensation and Other Commercial Insurance Exposures

Alabama & Nearby Southeast States, Unemployment Rates,* August 2012

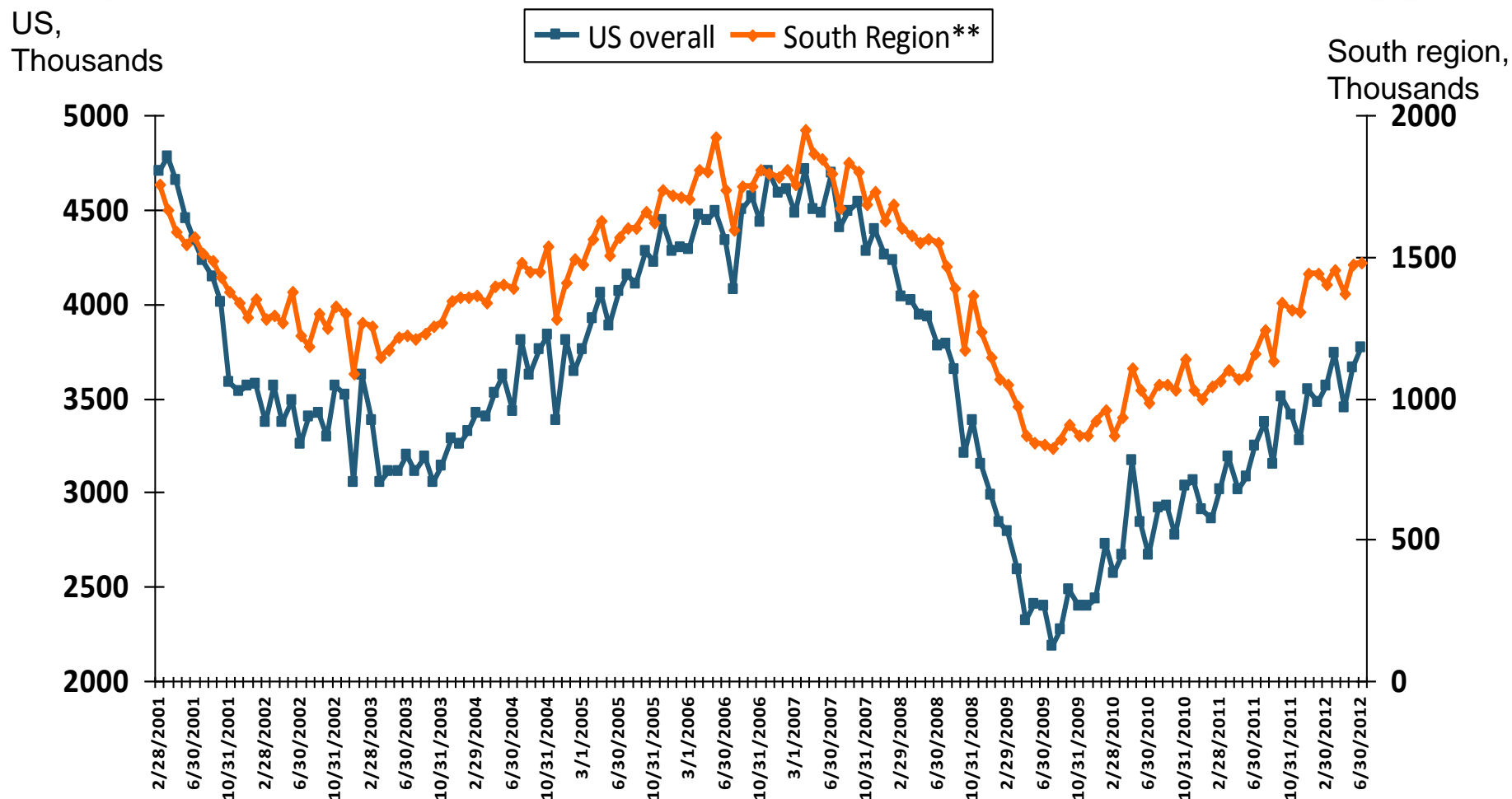


Not a good trend: In the latest month, Alabama's rate rose the most (from 7.8% to 8.3% -- 0.5 percentage points) of any state.

*seasonally adjusted.

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

Job Openings in the South (Not Just AL) Were Stronger than in the US Overall*



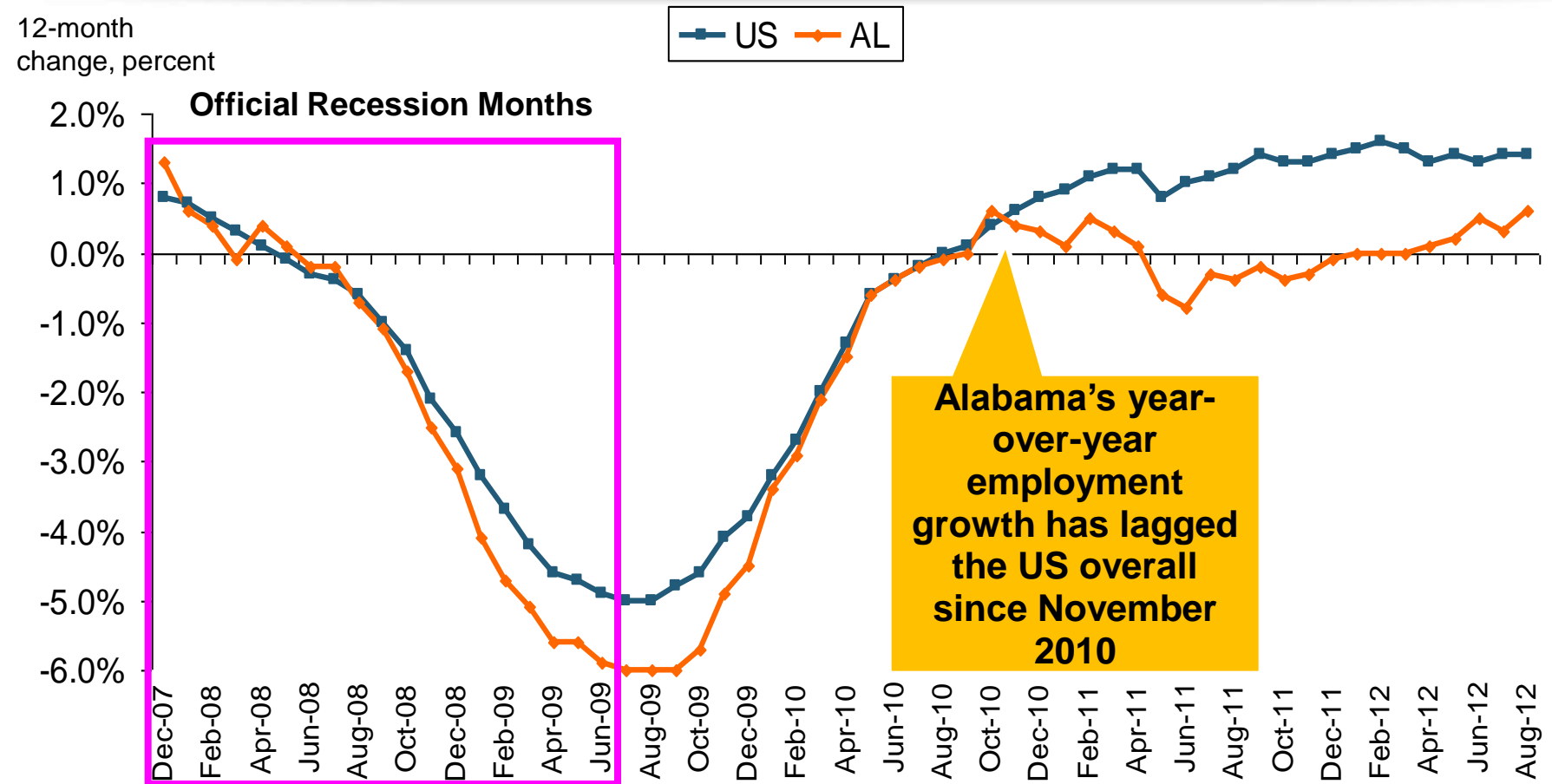
*Total Nonfarm, monthly, February 2001 through June 2012; data published August 7, 2012.

**BLS defines the South region as Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia. BLS doesn't publish data on job openings for each state.

Sources: US Bureau of Labor Statistics <http://www.bls.gov> ; Insurance Information Institutes.

Nonfarm Employment*, AL vs. US

Monthly, December 2007 through August 2012

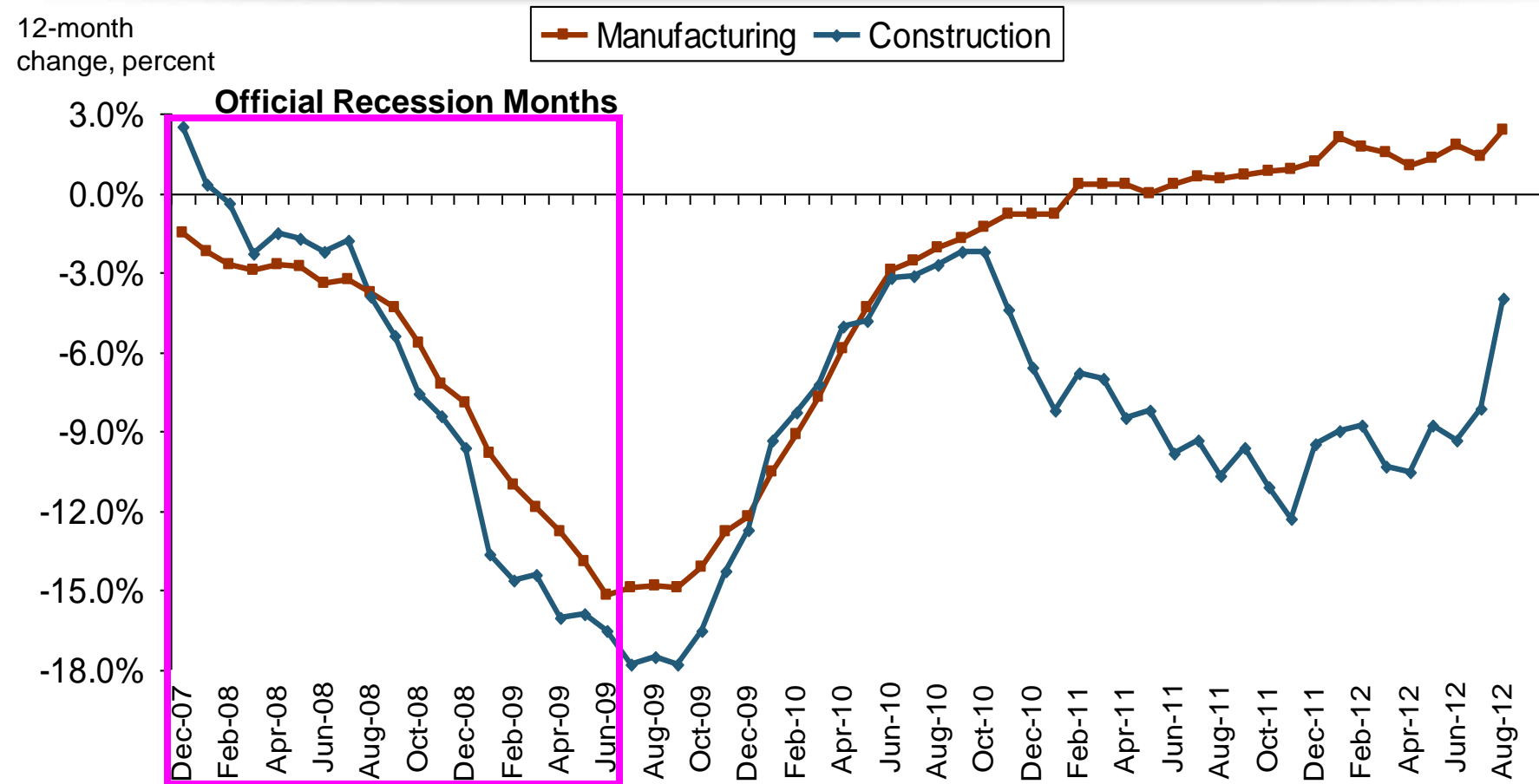


Alabama lost employment in the recession more sharply than the US overall and has recovered less since December 2010.

*seasonally adjusted

Sources: U.S. Bureau of Labor Statistics: <http://www.bls.gov/ces/home.htm>; Insurance Information Institute.

Manufacturing & Construction Employment* in Alabama Monthly, December 2007 through August 2012



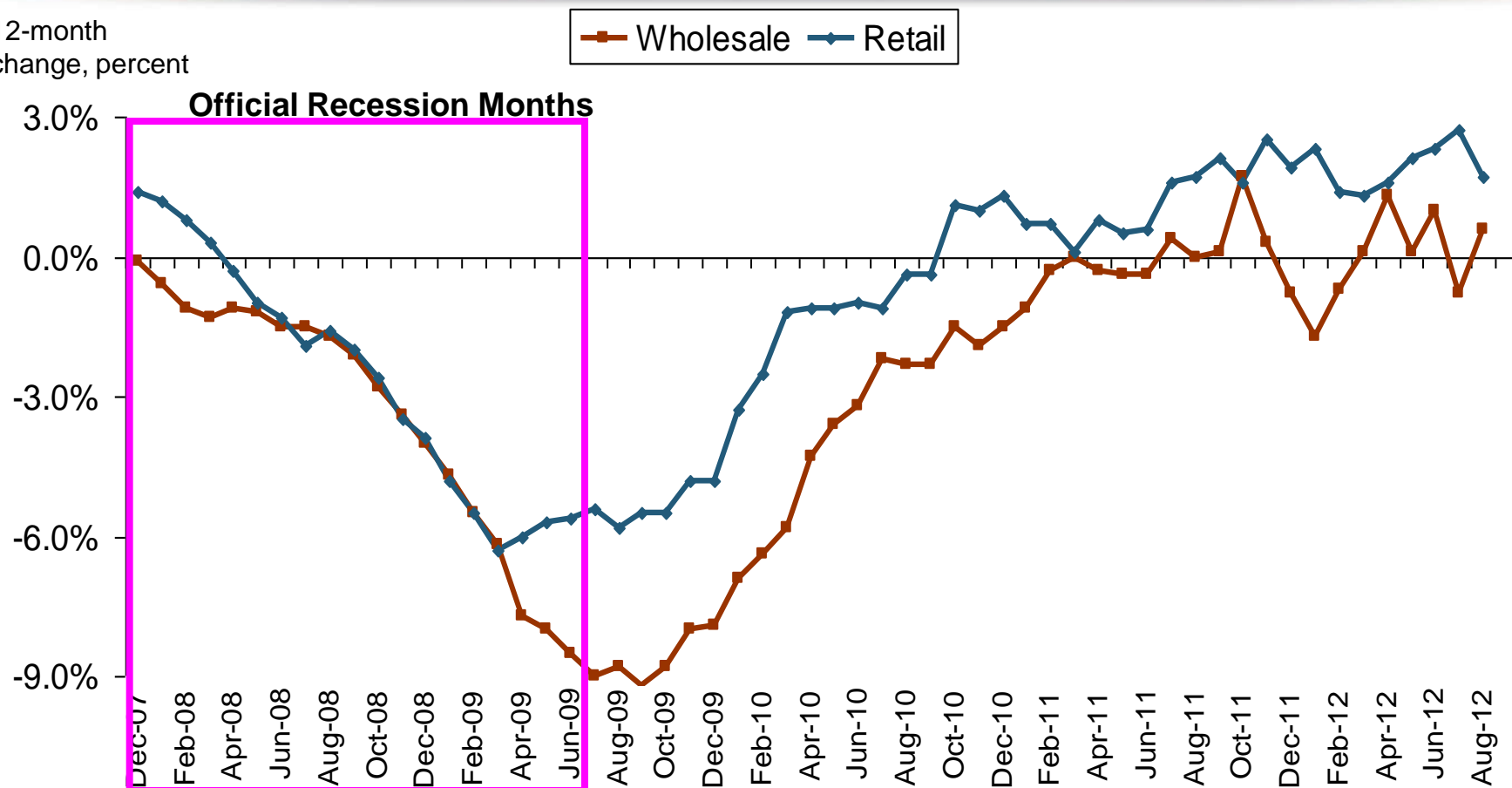
In the Great Recession, construction employment in Alabama slumped more than manufacturing did. Both grew in the second half of 2009 and most of 2010 but since November 2010 construction is shrinking again

*construction data are seasonally adjusted, manufacturing data are not

Sources: U.S. Bureau of Labor Statistics: <http://www.bls.gov/ces/home.htm>; Insurance Information Institute.

Wholesale & Retail Trade Employment* in Alabama Monthly, December 2007 through August 2012

12-month
change, percent



In the Great Recession, retail and wholesale employment in Alabama both slumped, but retail began recovering sooner than wholesale and continued stronger ever since.

*seasonally adjusted

Sources: U.S. Bureau of Labor Statistics: <http://www.bls.gov/ces/home.htm>; Insurance Information Institute.

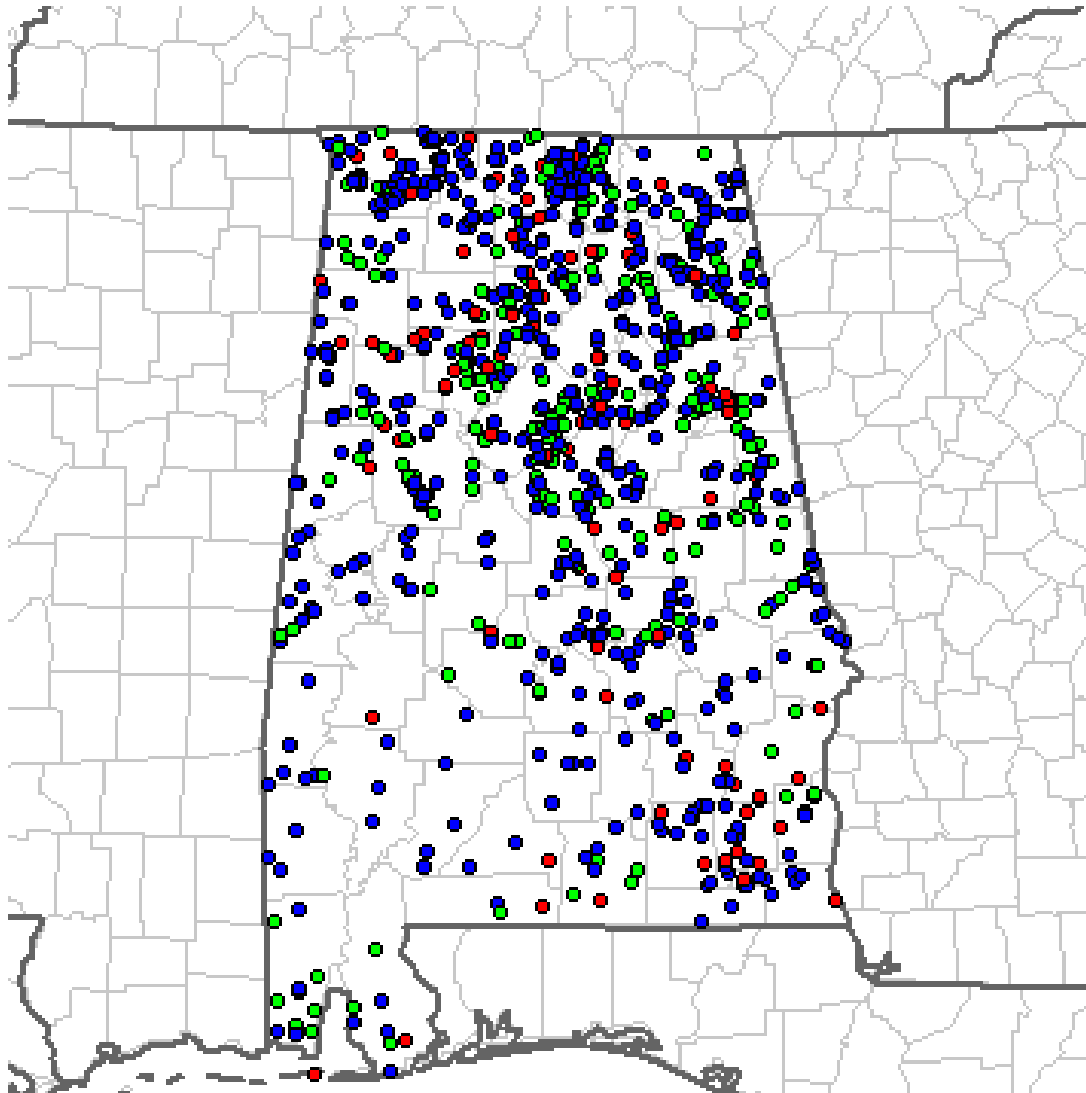
Non-Economic Events Also Affect P/C Insurance

Severe Weather, For Example

Tornadoes & Other Extreme Weather

**A Repeat of 2011 Is Unlikely, but It
(or Worse) Is Certainly Possible**

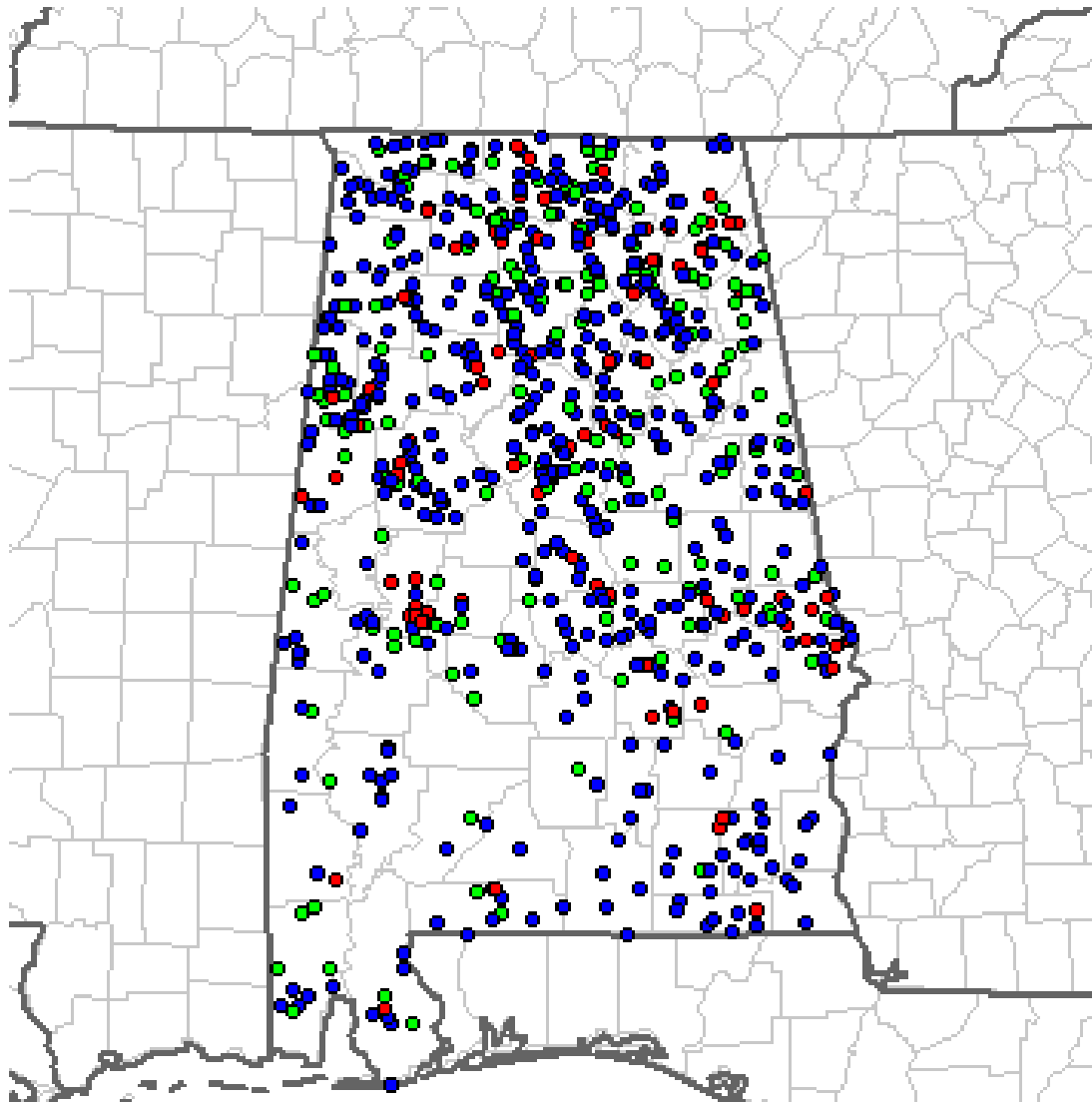
Location of Wind, Hail, & Tornadoes in AL, 2008



2008 AL Severe Weather

| | |
|------------------|-----|
| Wind (blue): | 550 |
| Hail (green): | 284 |
| Tornadoes (red): | 93 |
| Total reports: | 927 |

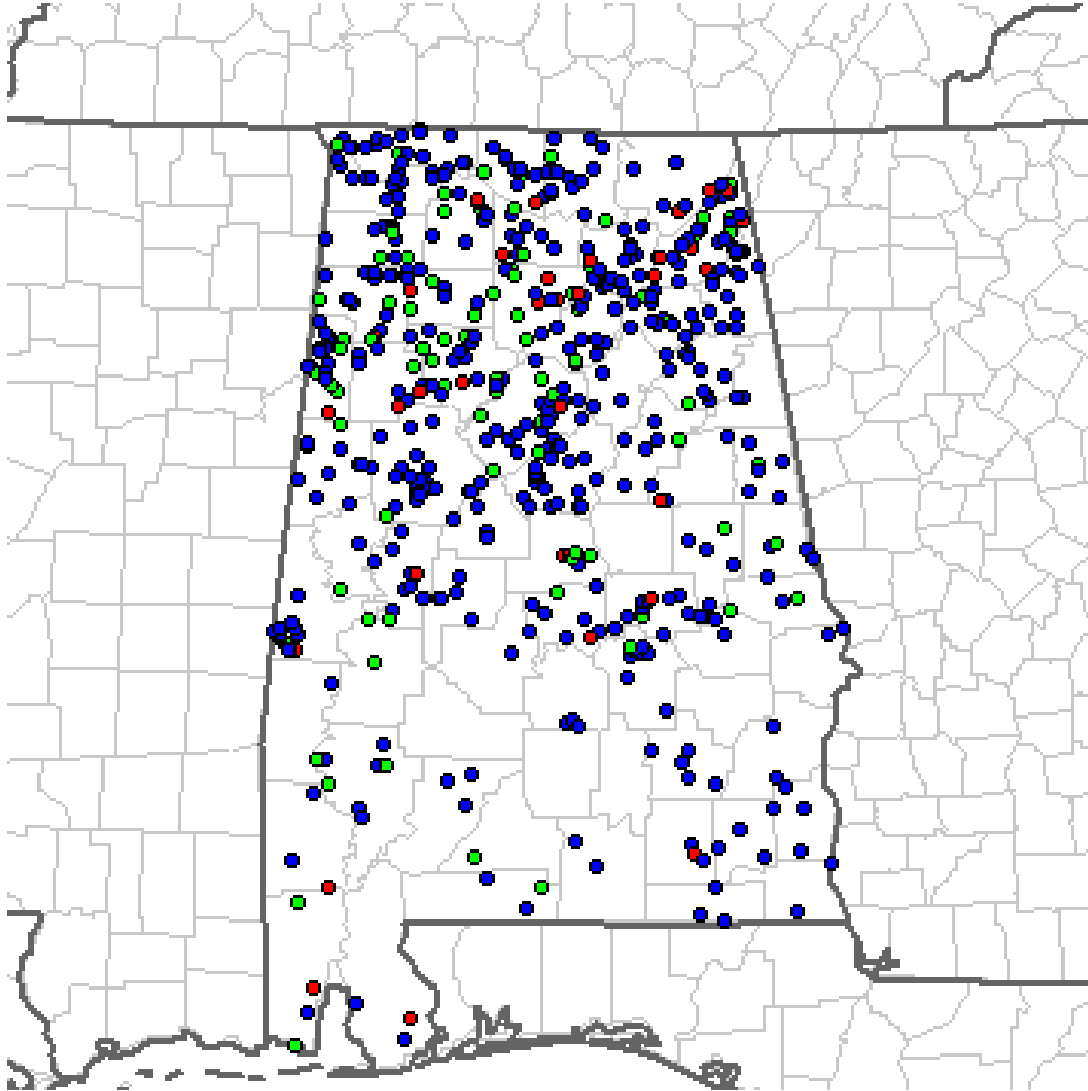
Location of Wind, Hail, & Tornadoes in AL, 2009



2009 AL Severe Weather

| | |
|------------------|-----|
| Wind (blue): | 637 |
| Hail (green): | 245 |
| Tornadoes (red): | 105 |
| Total reports: | 987 |

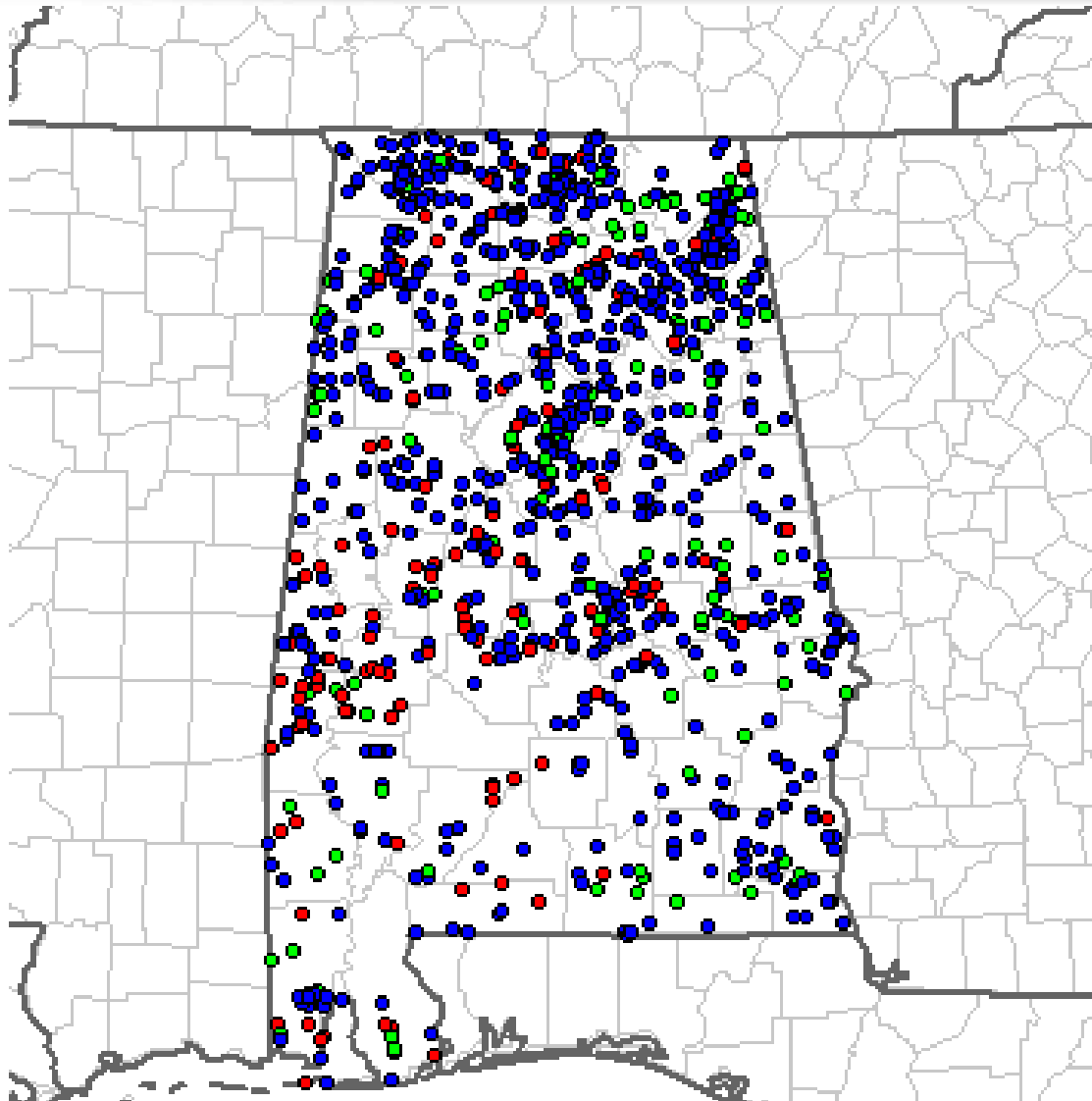
Location of Wind, Hail, & Tornadoes in AL, 2010



2010 AL Severe Weather

| | |
|------------------|-----|
| Wind (blue): | 461 |
| Hail (green): | 123 |
| Tornadoes (red): | 43 |
| Total reports: | 627 |

Location of Wind, Hail, & Tornadoes in AL, 2011



177 tornadoes struck Alabama in 2011—140 of them on April 26 mostly in the Tuscaloosa area

2011 AL Severe Weather

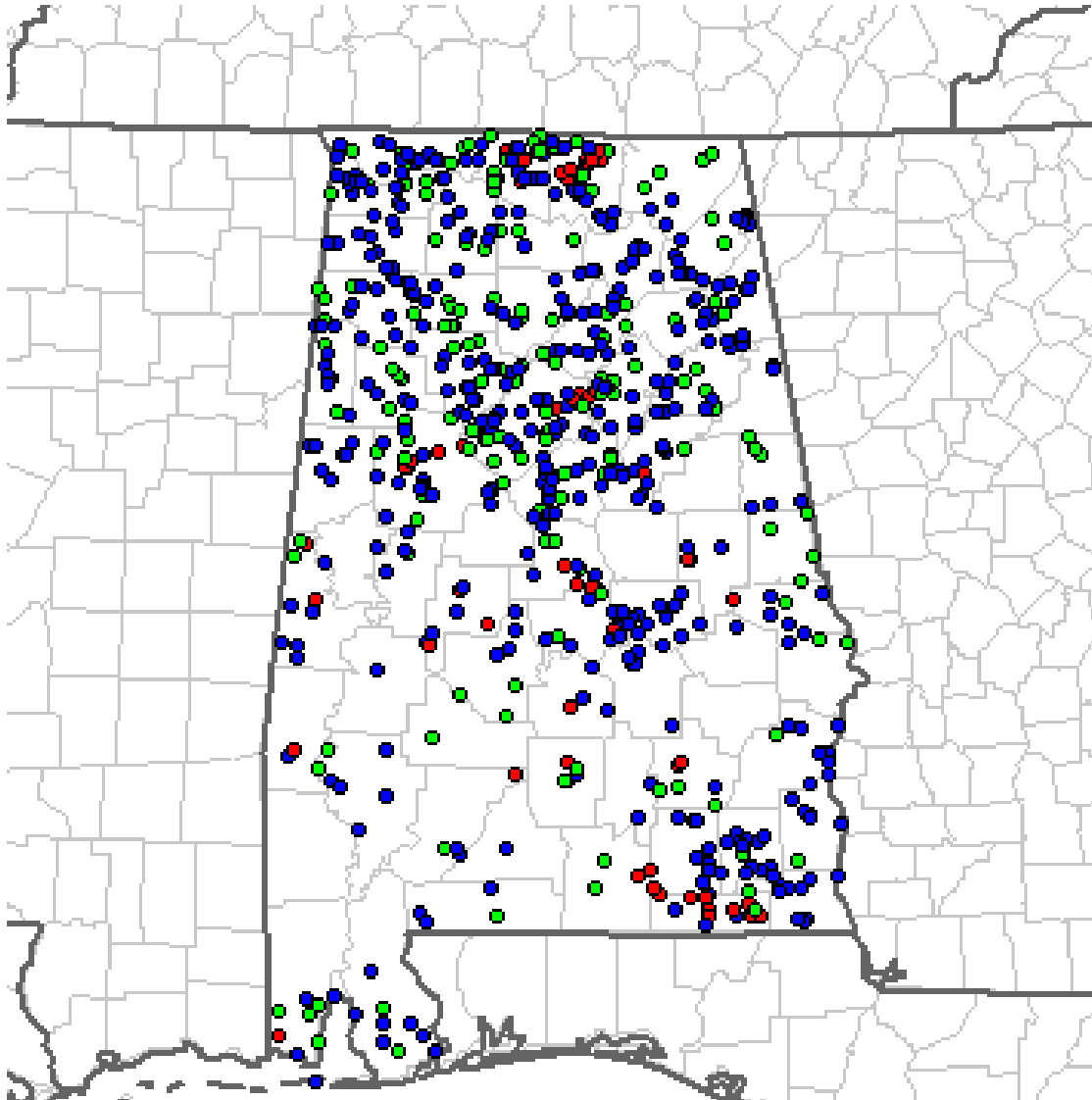
Wind (blue): 917

Hail (green): 217

Tornadoes (red): 177

Total reports: 1,311

Location of Wind, Hail, & Tornadoes in AL, 2012 (through October 1)



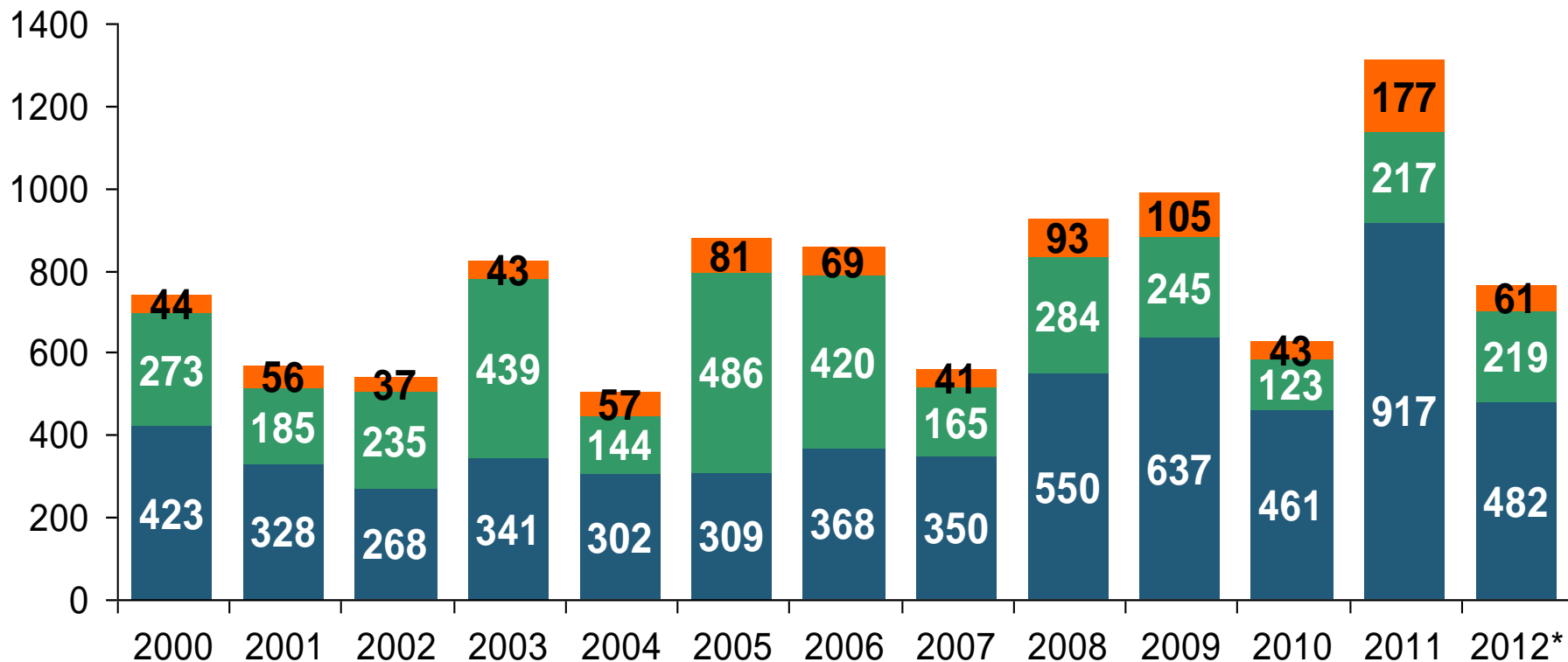
2012 AL Severe Weather

| | |
|------------------|-----|
| Wind (blue): | 483 |
| Hail (green): | 219 |
| Tornadoes (red): | 61 |
| Total reports: | 763 |

Number of Severe Weather Reports in AL, 2000–2012*

Number of
Reports

■ Wind ■ Hail ■ Tornadoes



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

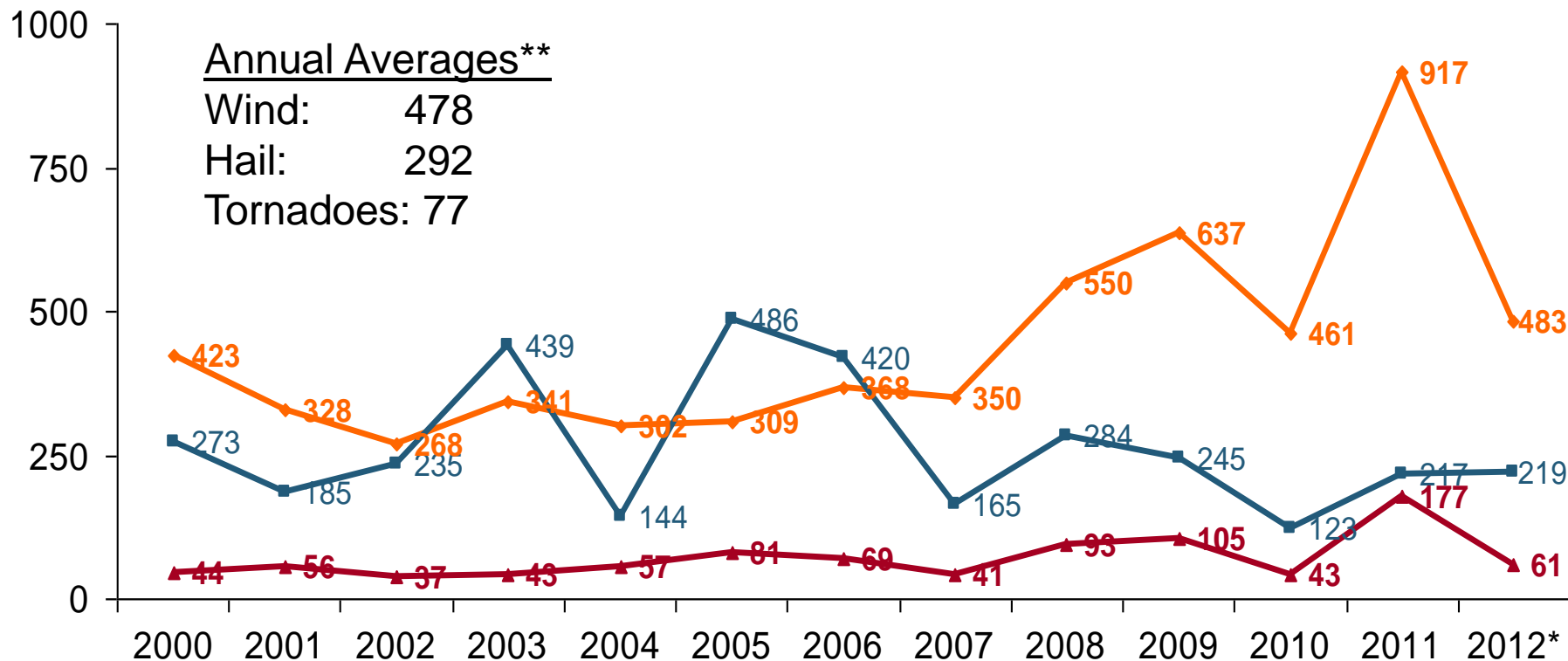
*through September 23, 2012

Sources: NOAA, at http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html# and other years

Number of Severe Weather Reports in AL, 2000–2012*

Number of
Reports

Wind Hail Tornadoes

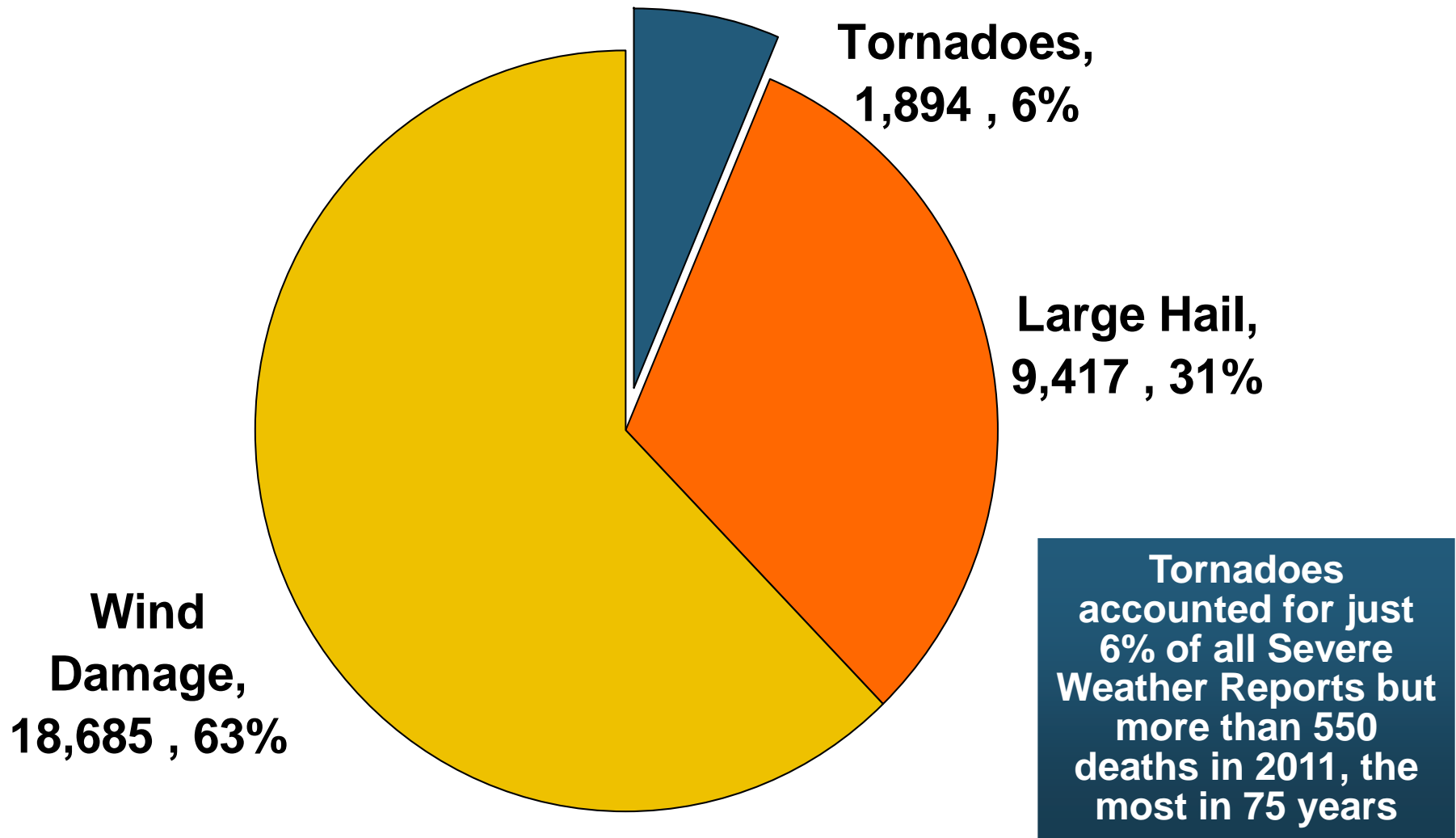


The number of wind and tornado reports seem to have increased—especially since 2008—but not reports of large hail storms.

*through October 1, 2012 **2000–2011

Sources: NOAA, at http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html# and other years

Number of Severe Weather Reports in US, by Type, 2011

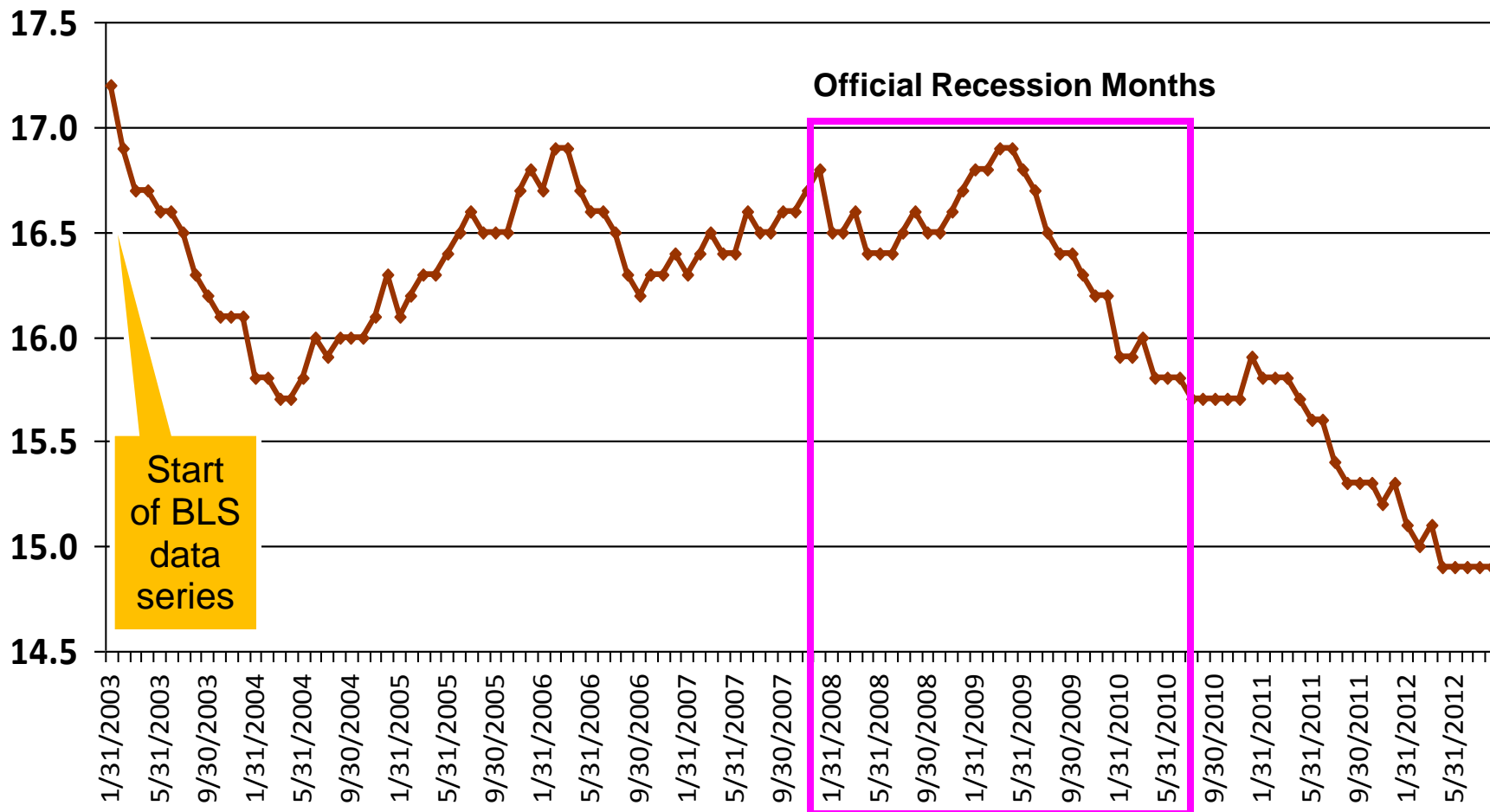


P/C Insurance Financial Performance in Alabama

A Resilient Industry in Challenging Times

AL Employment by Insurance Carriers, 2003–2012*

Thousands

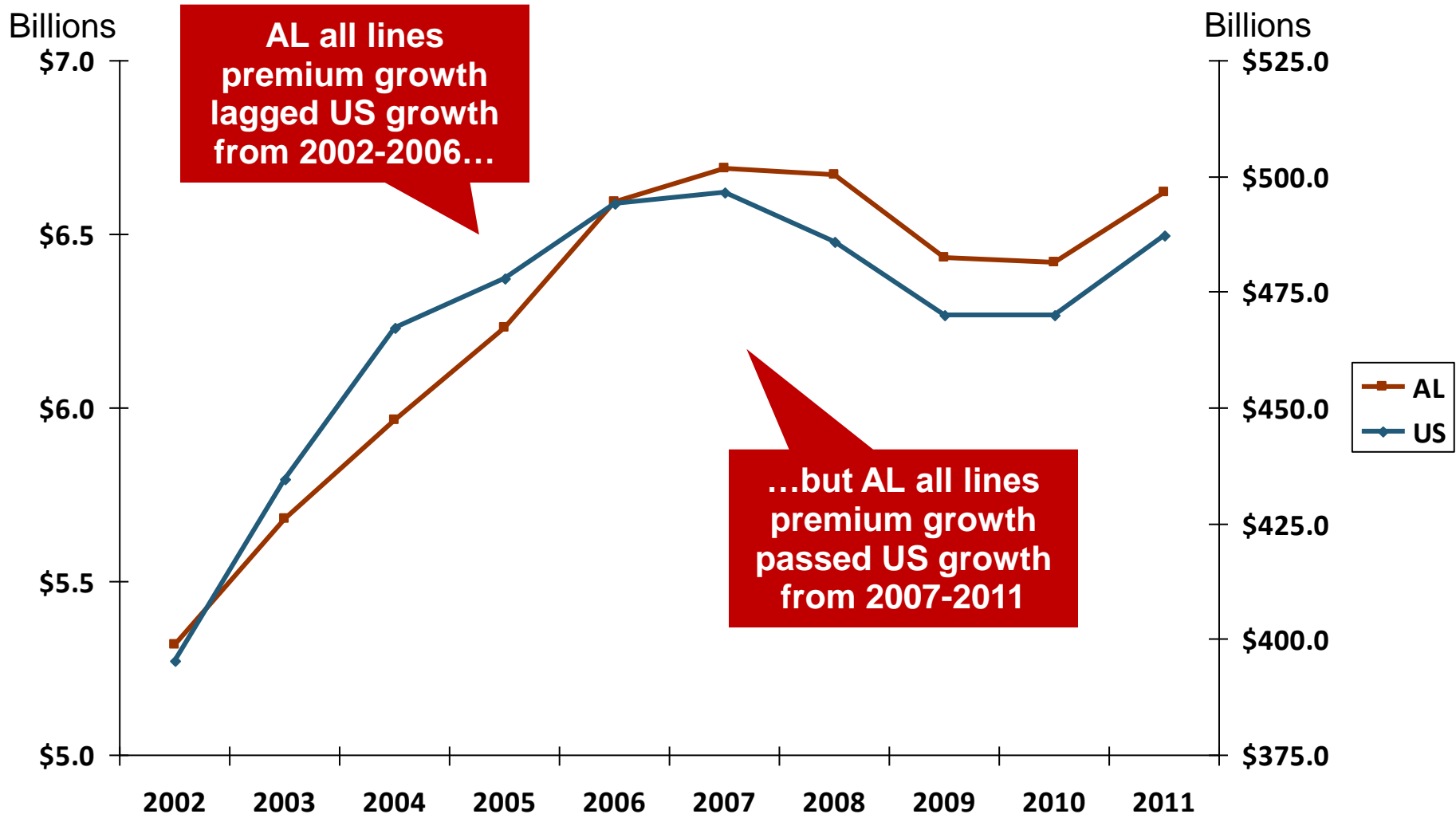


*As of August 2012; Not seasonally adjusted; Does not include agents & brokers.

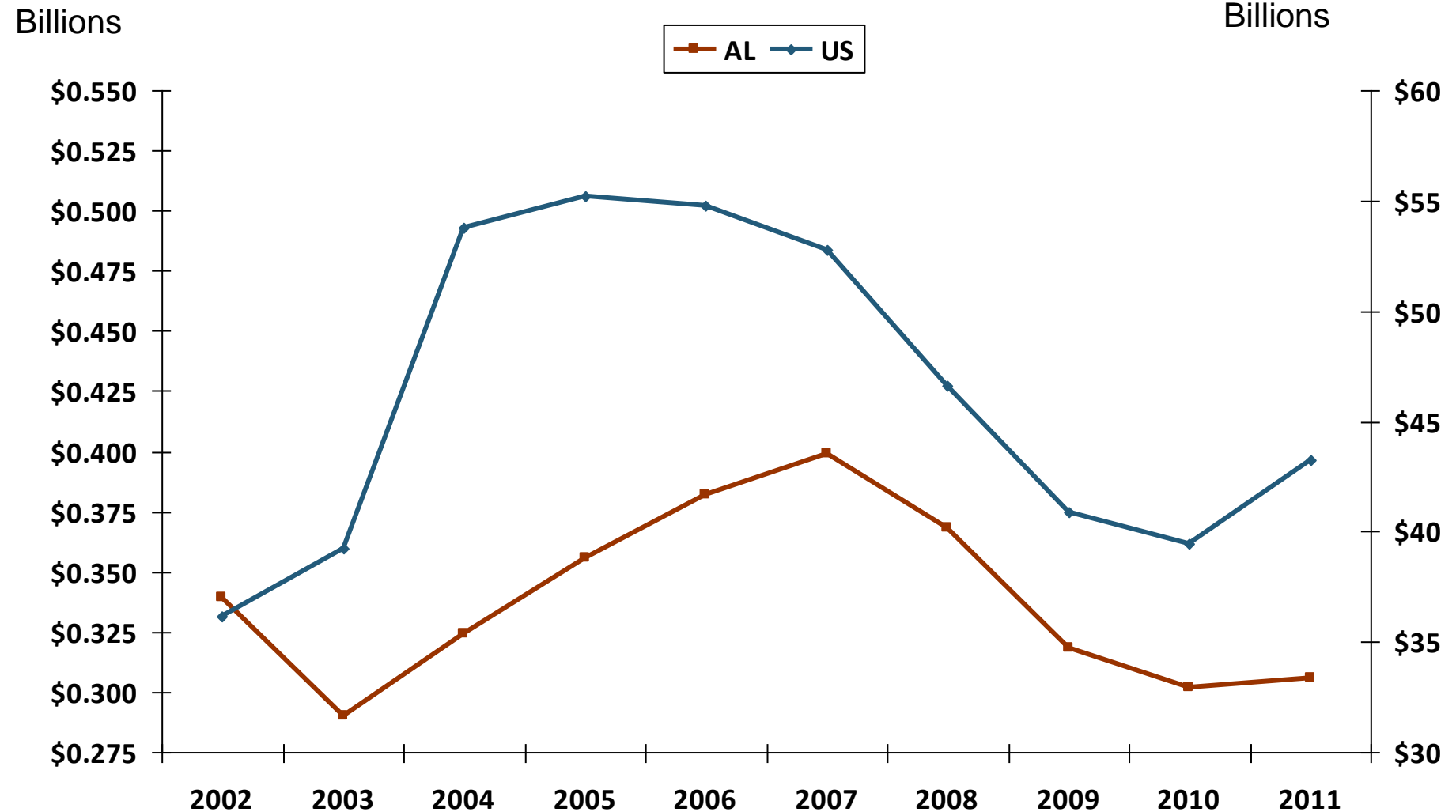
Note: Recessions indicated by gray shaded columns.

Sources: U.S. Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

P/C Industry Direct Written Premiums (All Lines) Alabama vs. US, 2002-2011



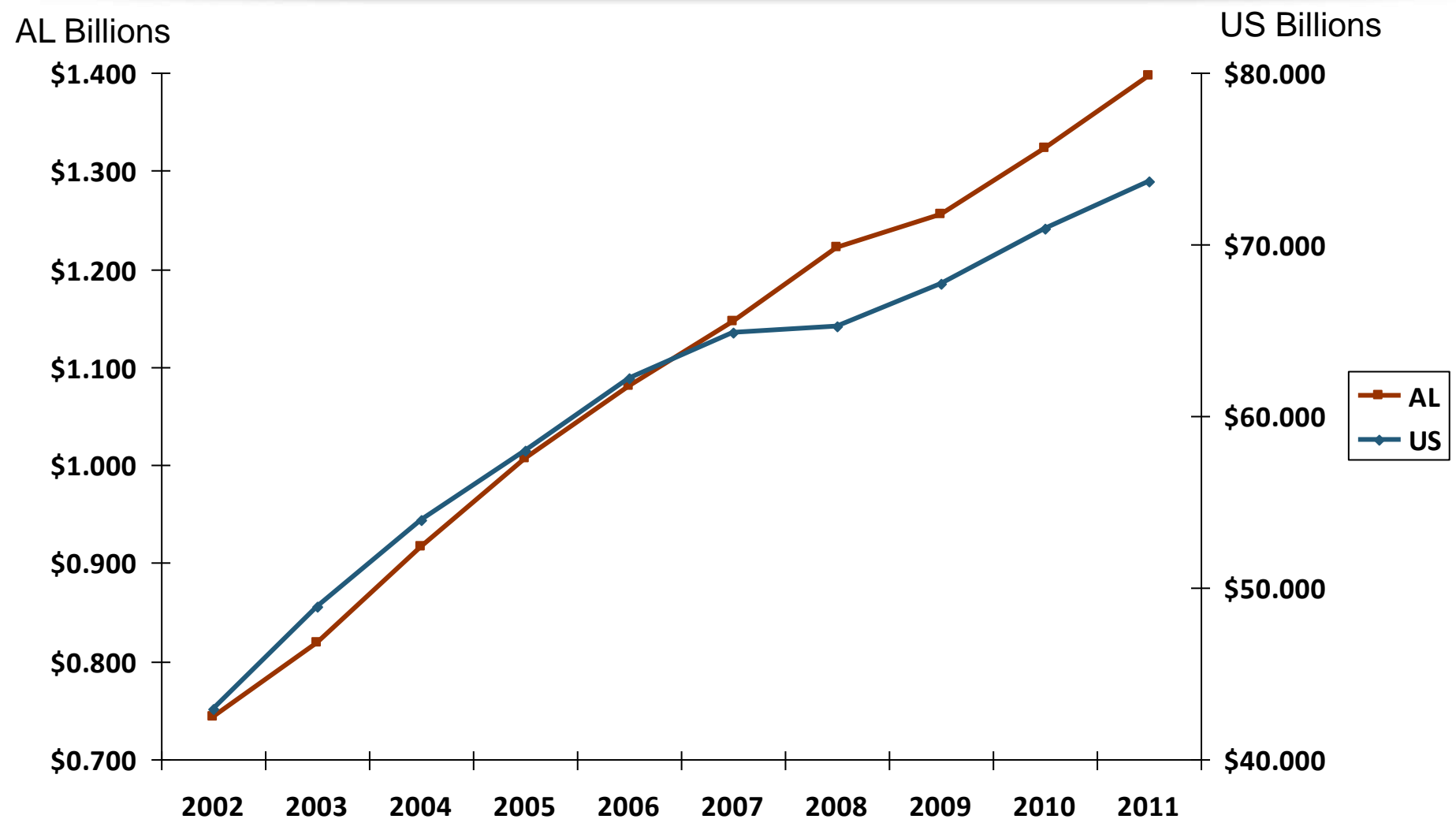
P/C Industry Direct Written Premiums (Workers Comp) Alabama vs. US, 2002-2011



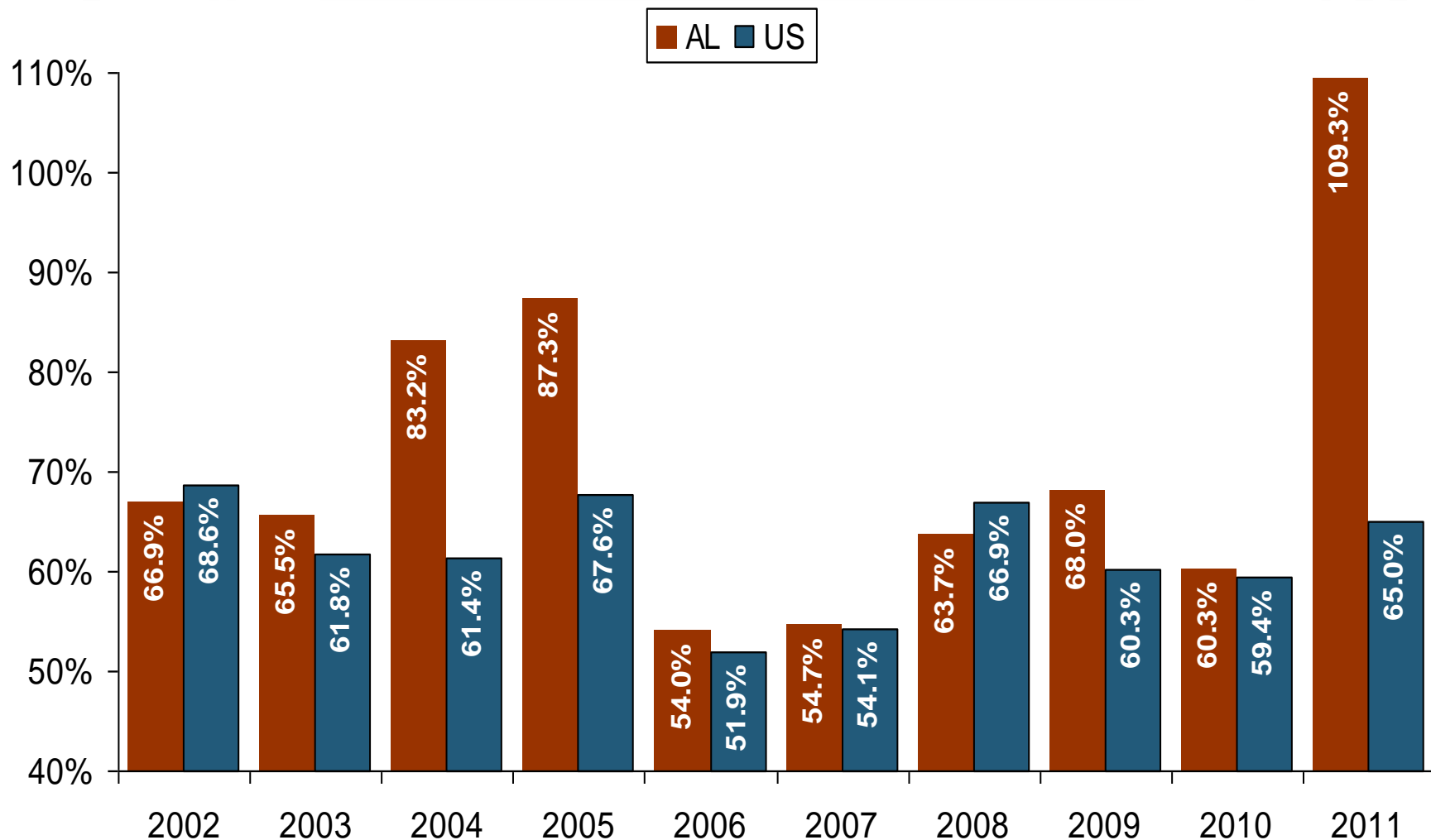
P/C Industry Direct Written Premiums (PP Auto) Alabama vs. US, 2002-2011



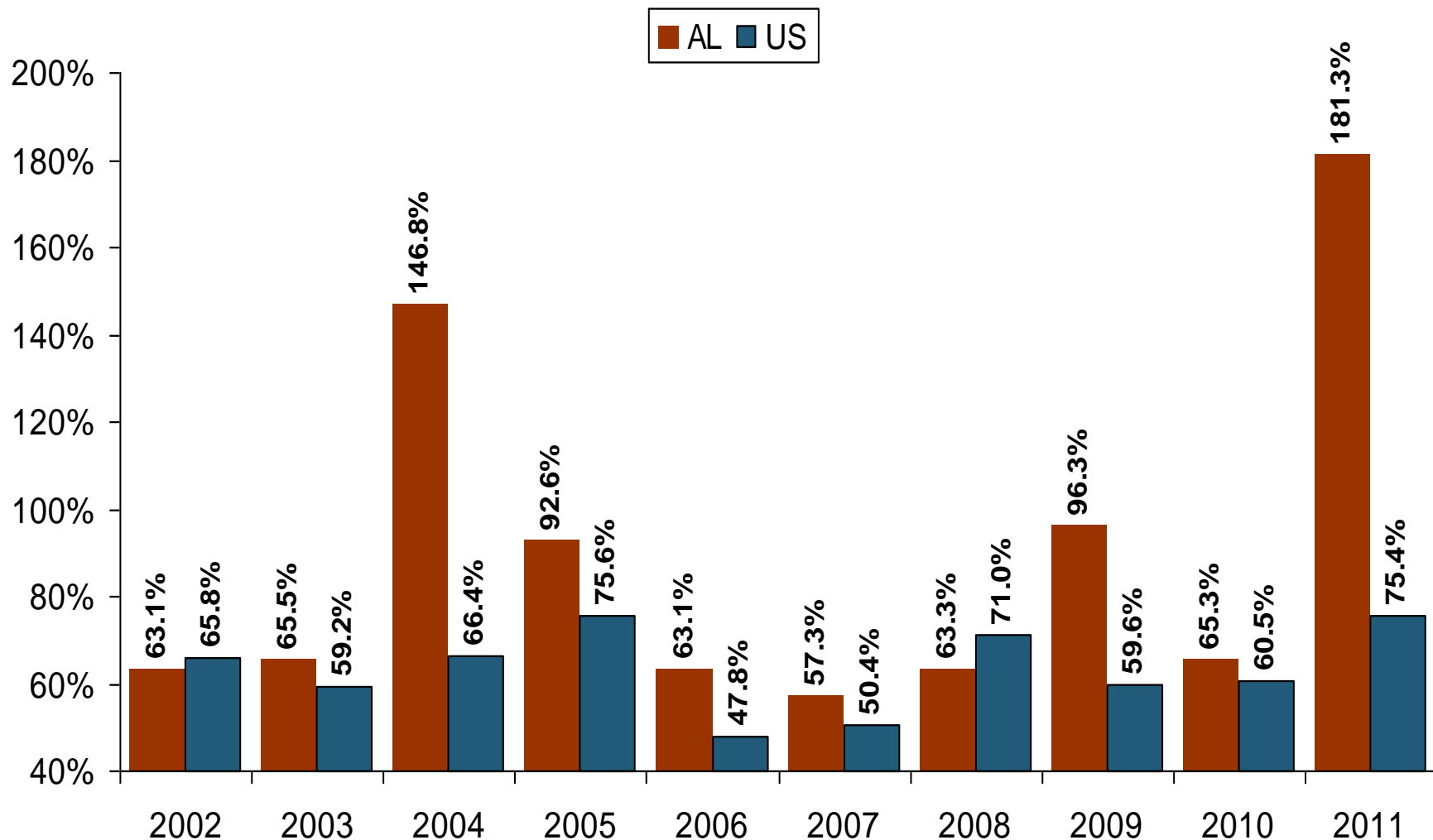
P/C Industry Direct Written Premiums (Homeowners) Alabama vs. US, 2002-2011



P/C Industry Direct Incurred Loss Ratio All Lines, Alabama vs. US, 2002-2011

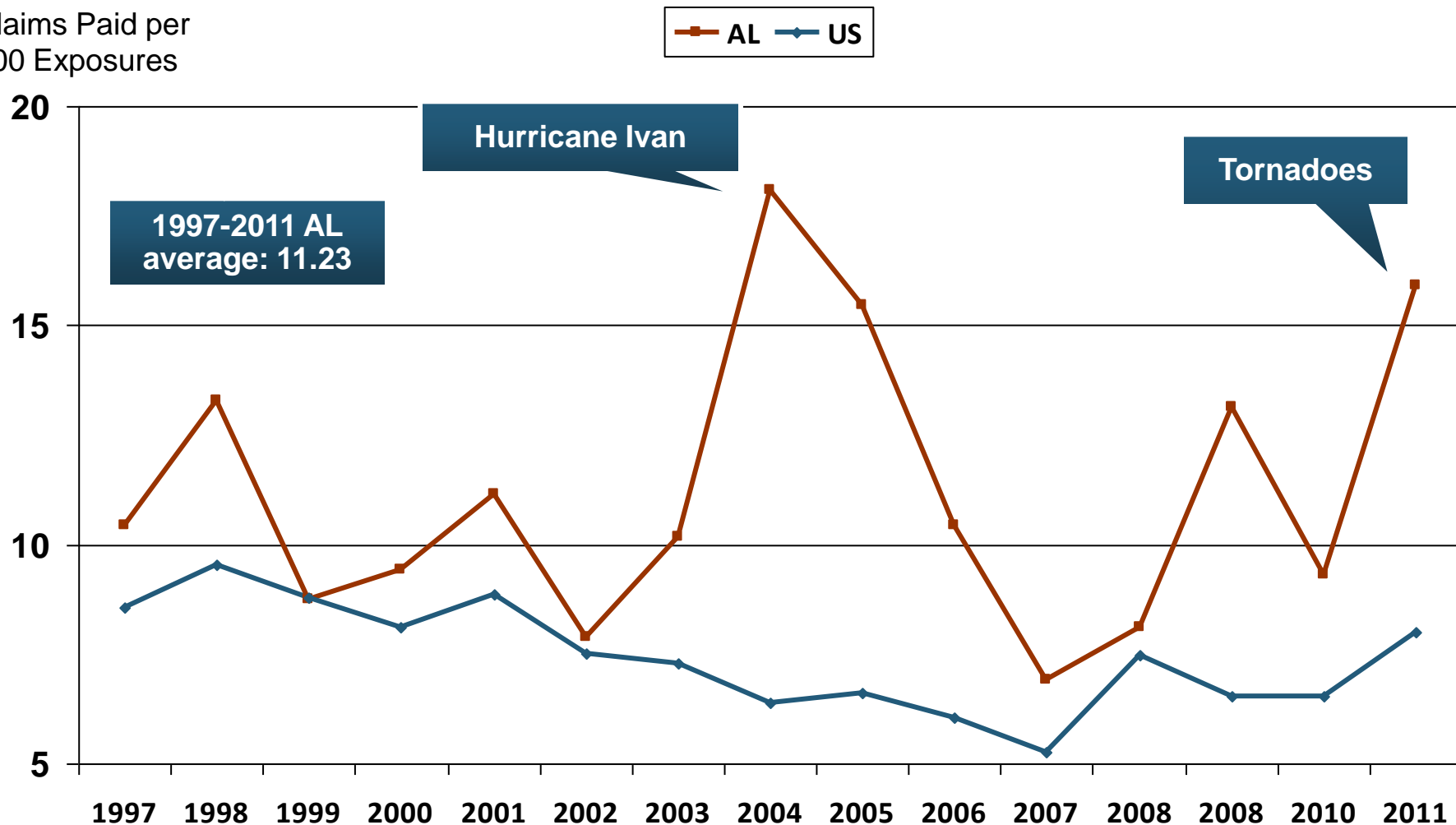


P/C Industry Direct Incurred Loss Ratio, Homeowners, Alabama, 2002-2011*



P/C Industry Homeowners Claim Frequency, Alabama vs. US, 1997-2011

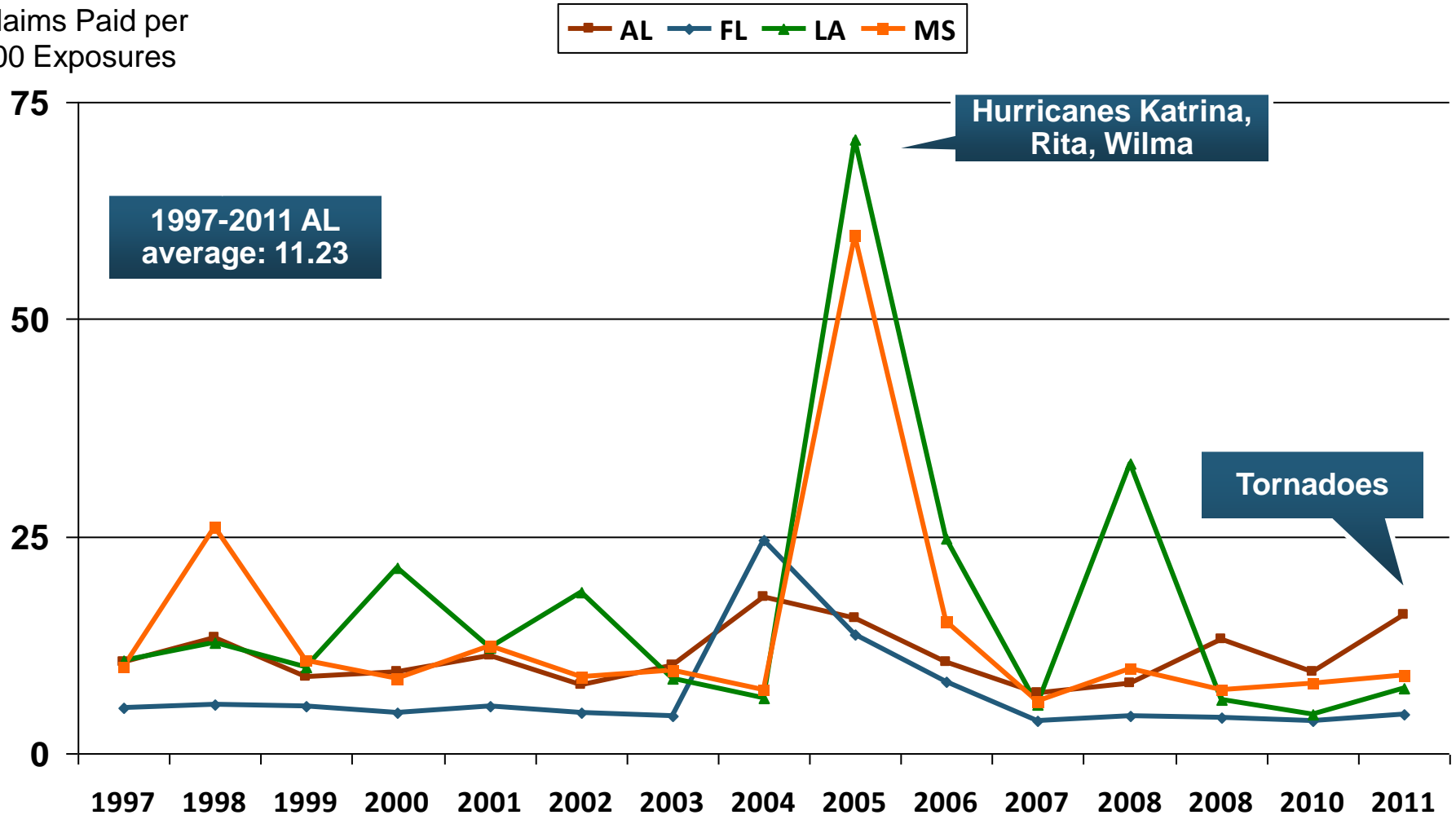
Claims Paid per
100 Exposures



Sources: Insurance Research Council, "Trends in Homeowners Insurance Claims," p. 33 (Alabama) and p.29 (US); Insurance Information Institute

P/C Industry Homeowners Claim Frequency, Alabama vs. Nearby States, 1997-2011

Claims Paid per
100 Exposures



Sources: Insurance Research Council, "Trends in Homeowners Insurance Claims," p. 33 (Alabama), p.52 (LA), p.43 (FL), and p.58 (MS); Insurance Information Institute

Inflation

**Is it a Threat to Claim Cost
Severities?**

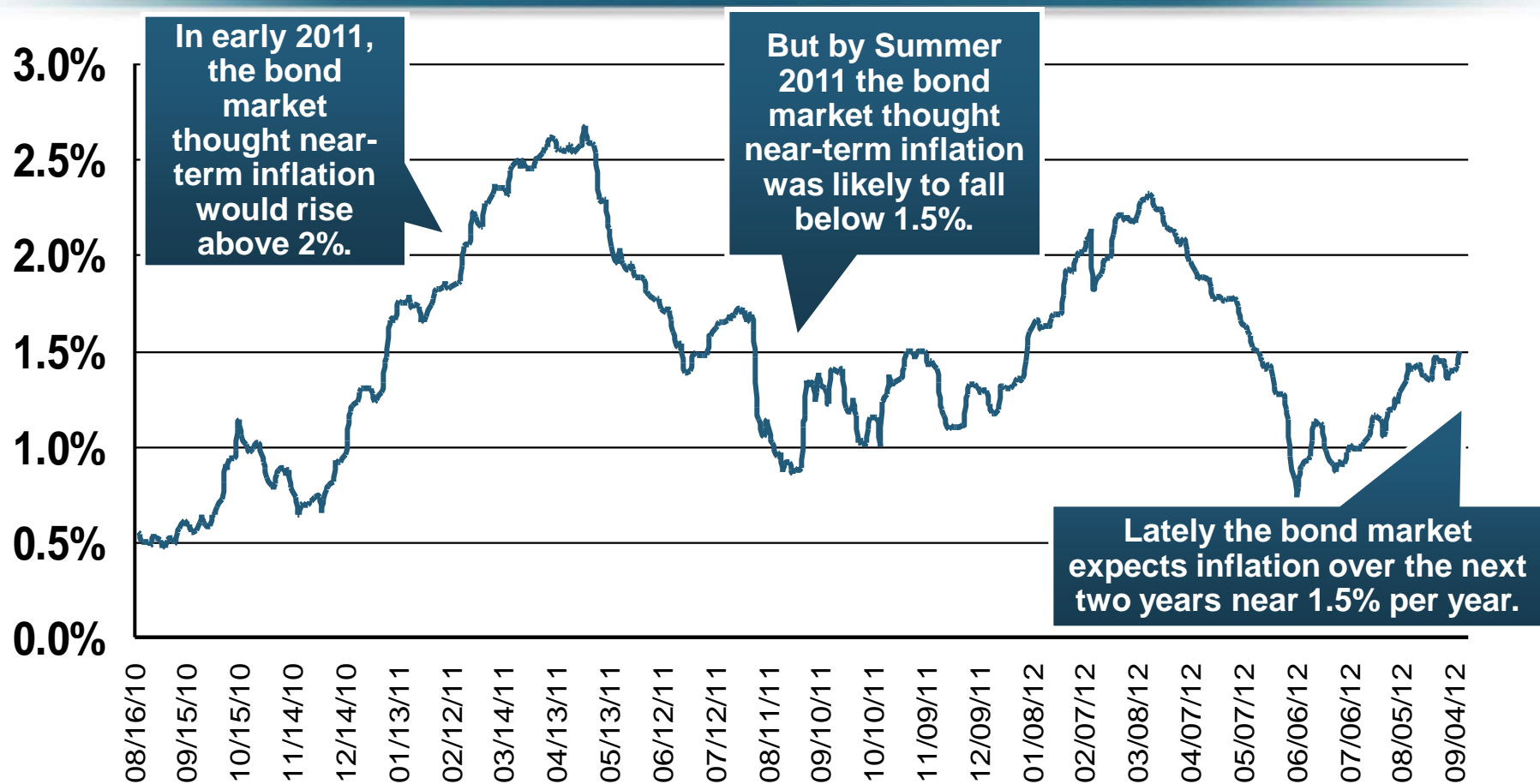
Annual Inflation Rates, (CPI-U, %), 1990–2013F

Annual Inflation Rates (%)



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

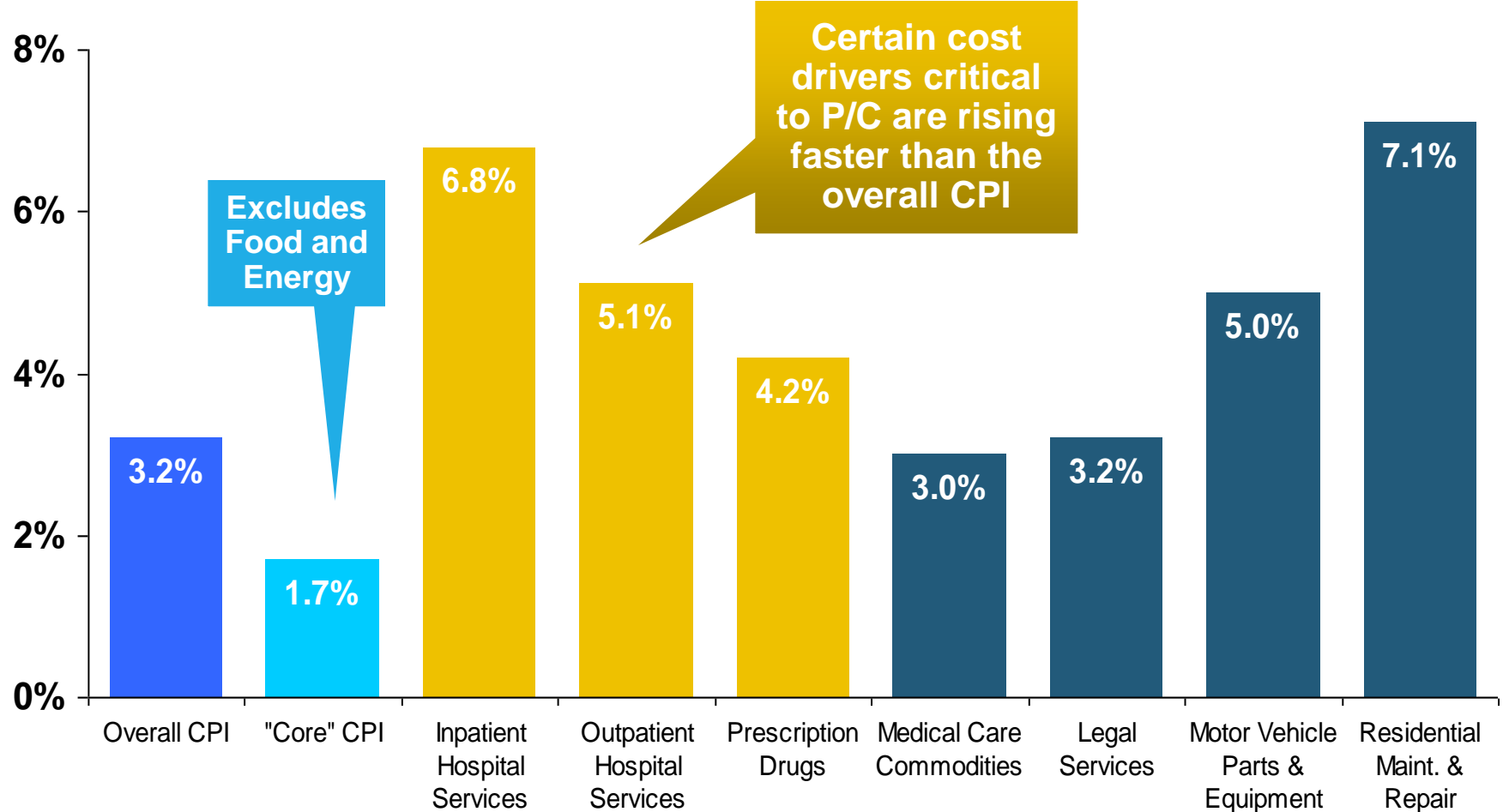
The Bond Market's Recent* Expectation of U.S. Inflation in the Next Two Years



**The rate is calculated by subtracting the real yield of the 2-year TIPS bond from the yield of the 2-year Treasury note.
The result is the implied inflation rate for the next 2 years.**

P/C Personal Insurance Claim Cost Drivers Grow Faster Than the Core CPI Suggests

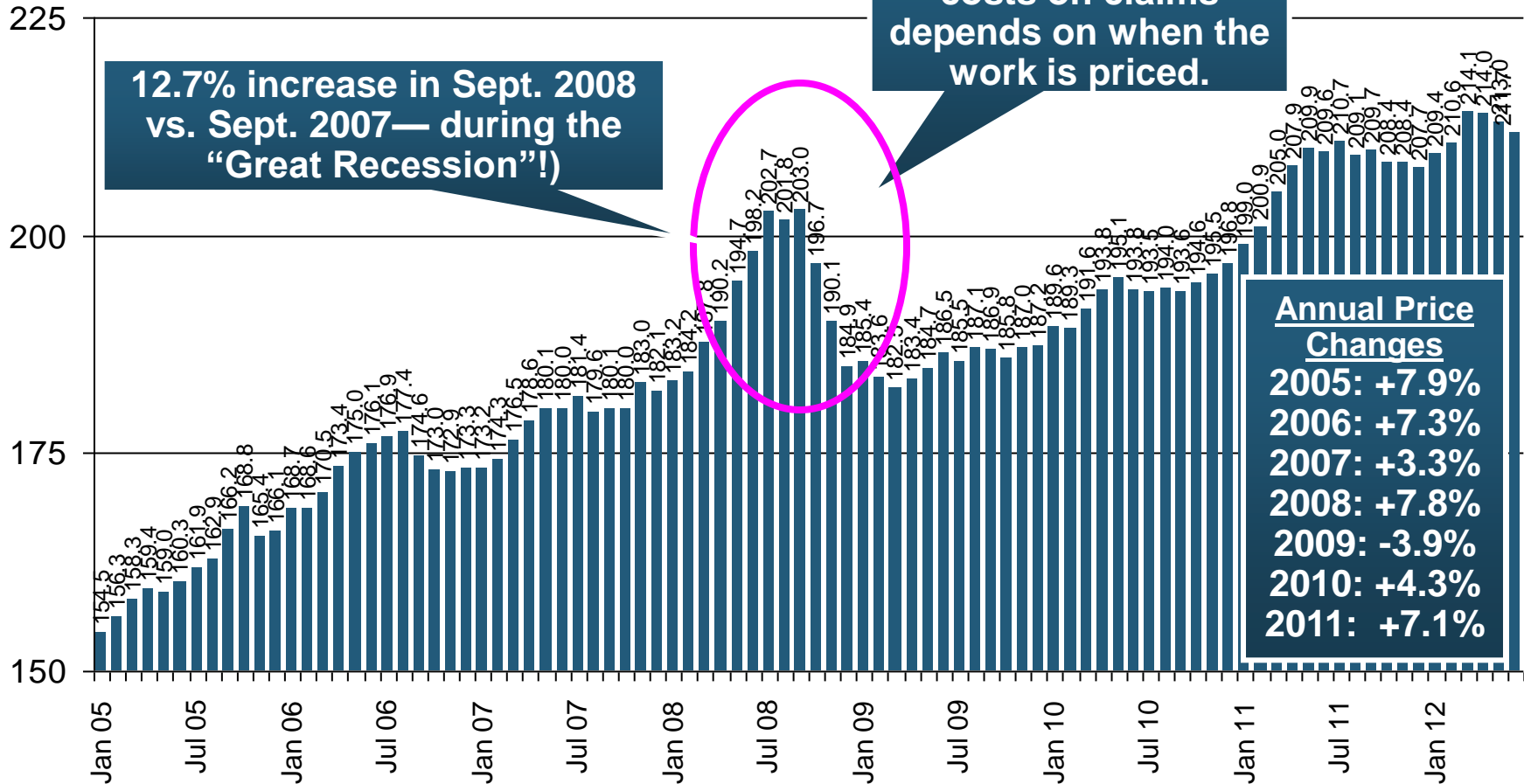
Price Level Change: 2011 vs. 2010



Healthcare costs are a major claim cost driver for WC, liability, med pay, and PIP. They are likely to grow faster than the CPI for the next few years, at least

Price Index for Residential Maintenance & Repair, Monthly, 2002-2012

Price Index

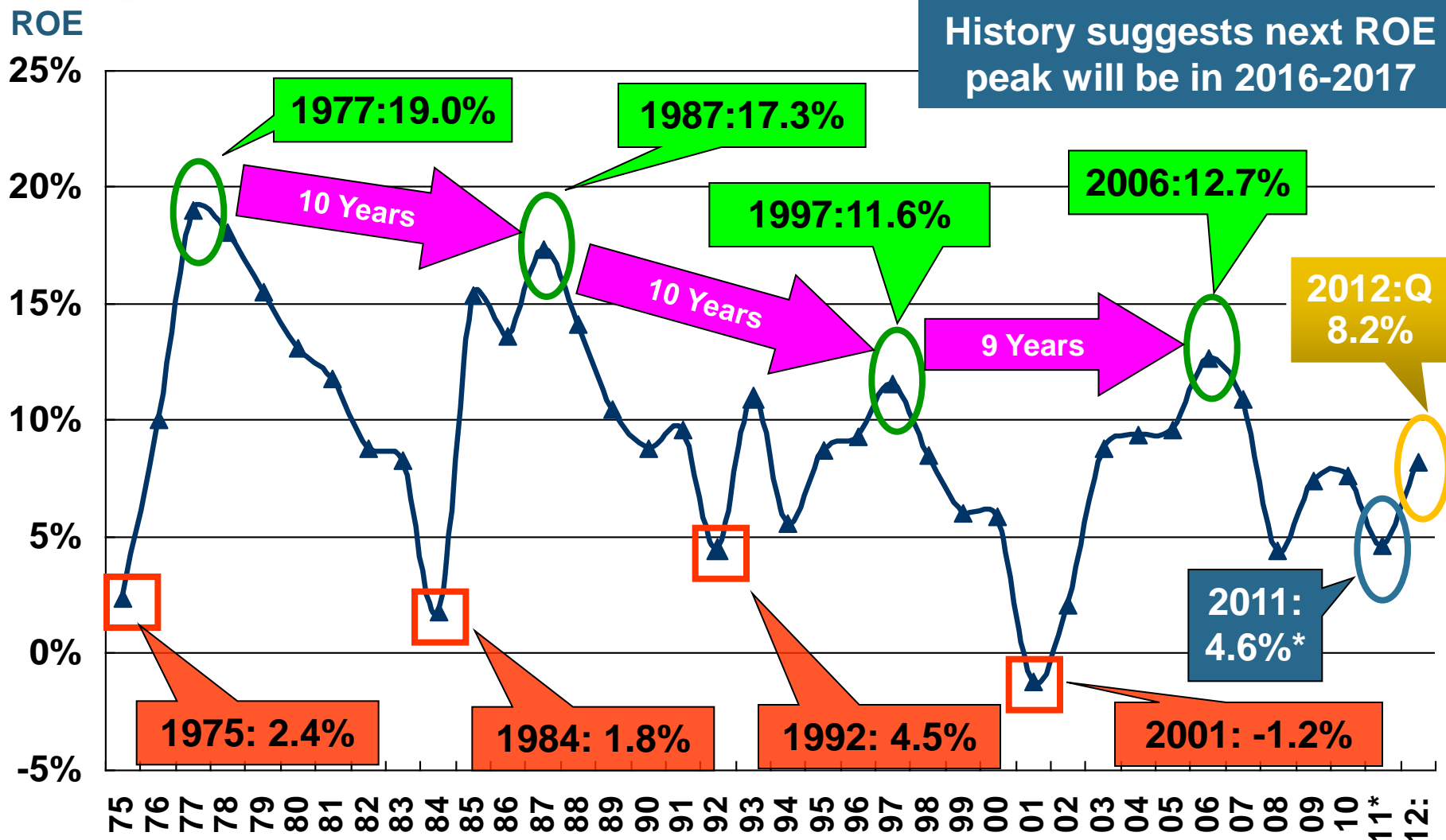


Prices for residential maintenance & repair rose by nearly 40% since December 2004 (through June 2012). Policy limits should keep pace.

P/C Insurance Industry Financial Overview

**Profit Recovery Was Set Back
in 2011 by High Catastrophe
Loss & Other Factors**

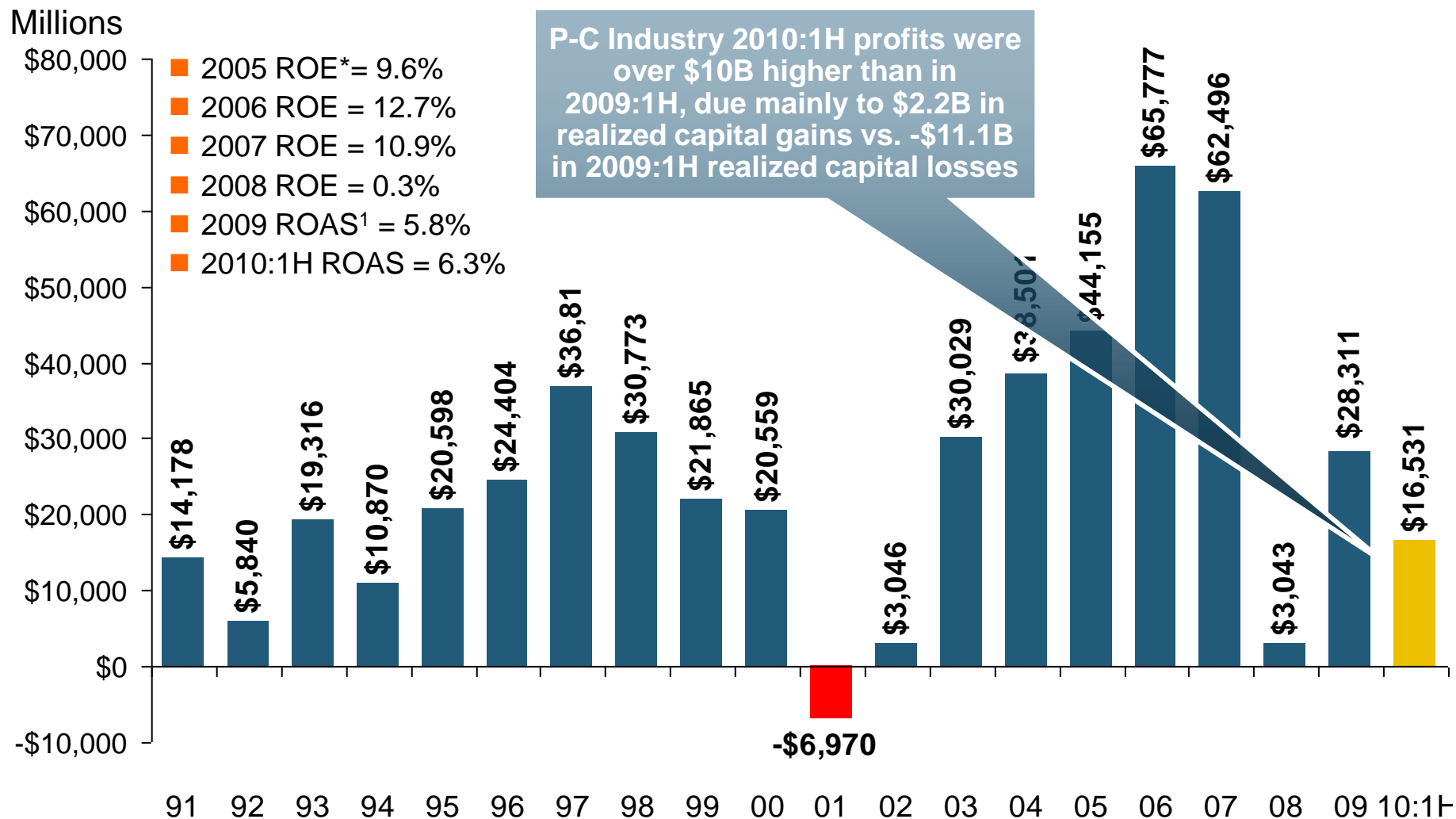
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2012:Q1*



*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:Q1 ROAS = 7.2% including M&FG.

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

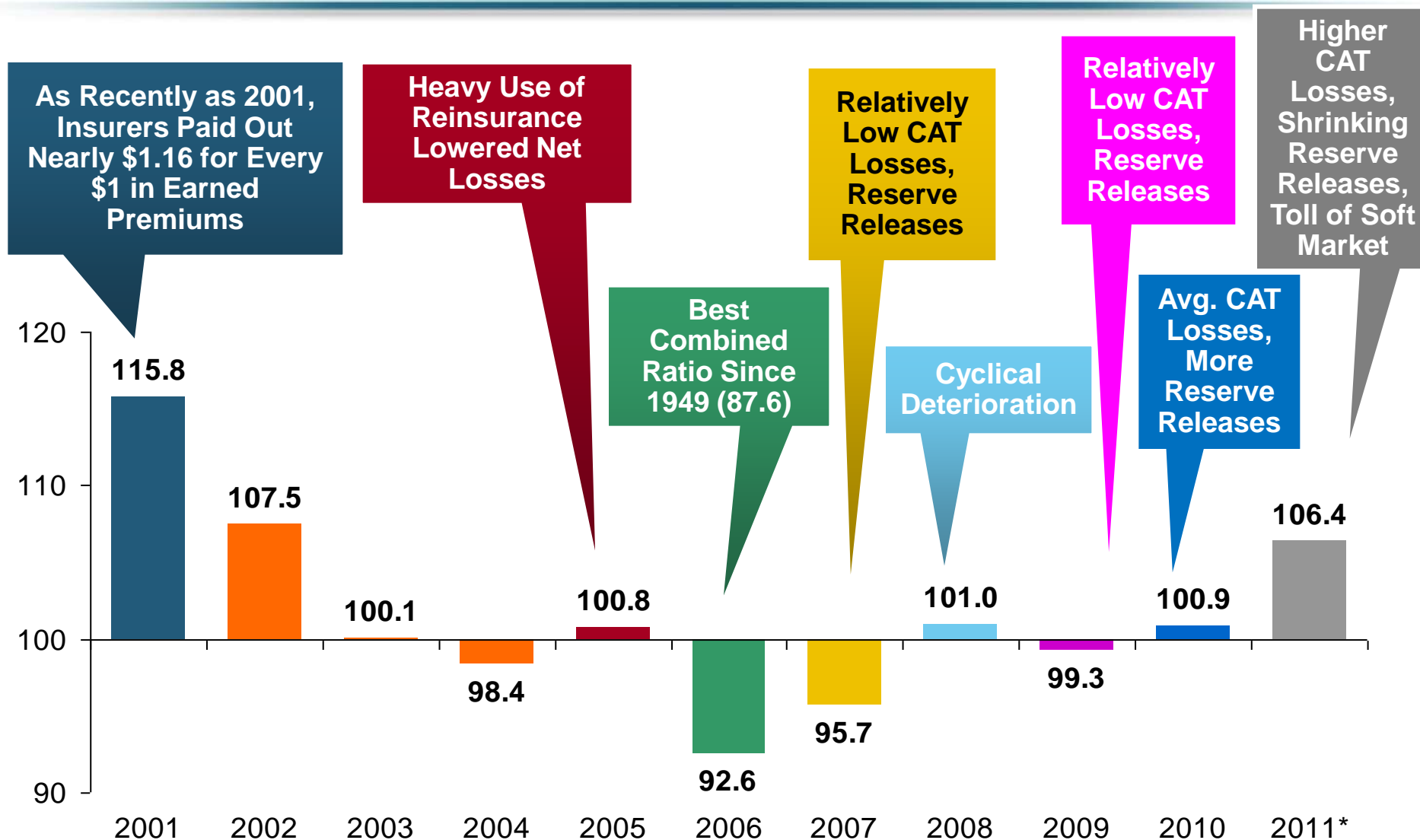
P/C Industry Net Income After Taxes 1991–2010:1H



* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields an 8.3% ROAS for 2010:Q1, 7.3% for 2009 and 4.4% for 2008. 2009 net income was \$34.5 billion and \$20.8 billion in 2008 excluding M&FG.

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

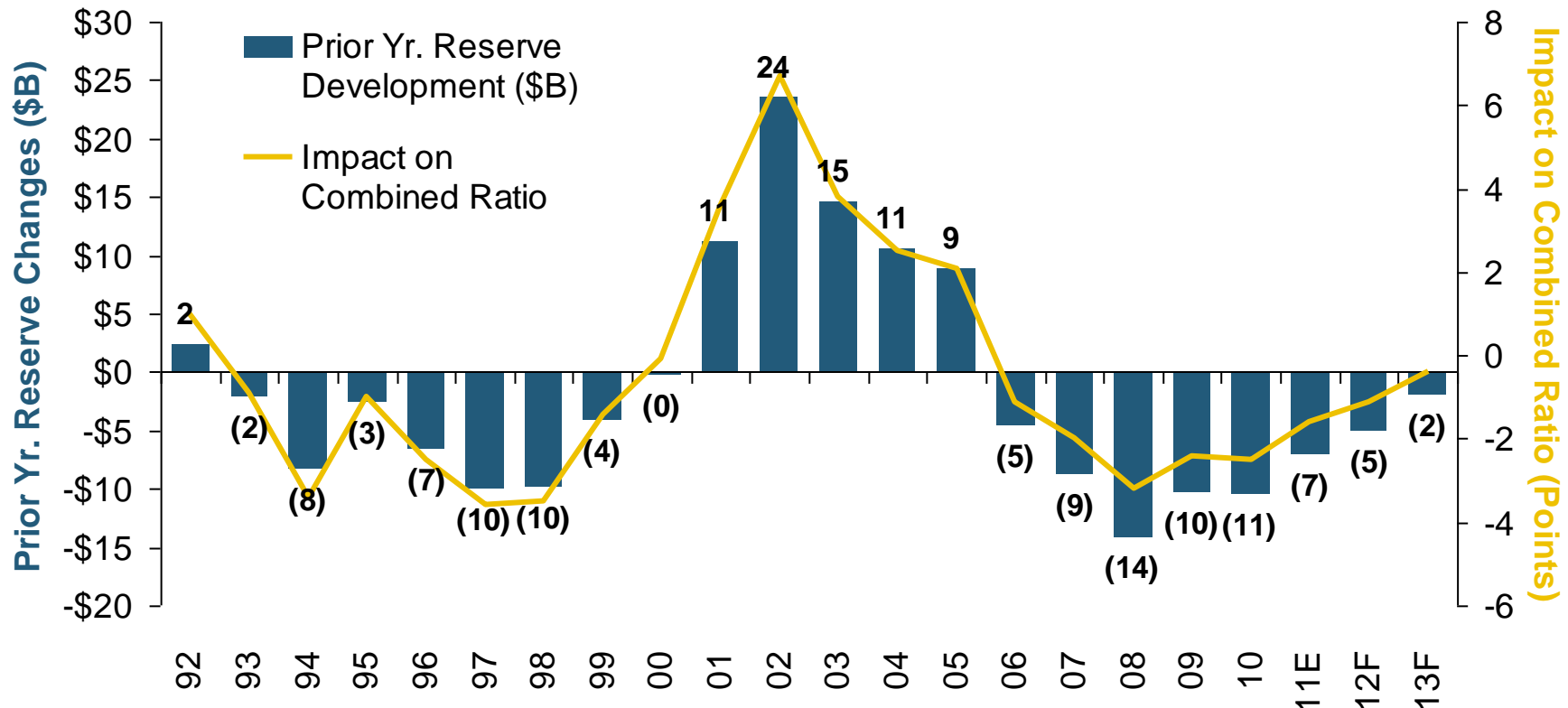
P/C Insurance Industry Combined Ratio, 2001–2011*



* Excludes Mortgage & Financial Guaranty insurers 2008--2011. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=106.4

Sources: A.M. Best, ISO.

P/C Reserve Development, 1992–2013F

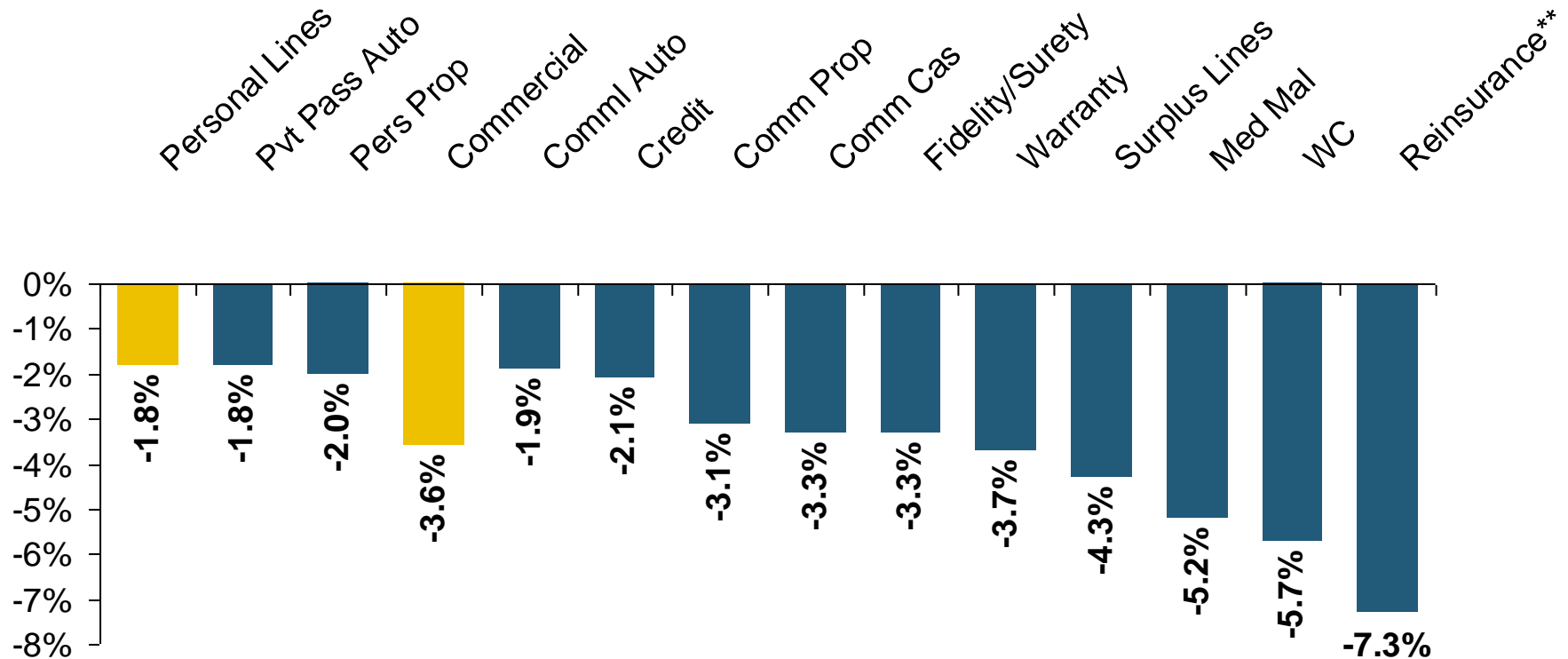


Reserve releases remained strong—over \$10 billion—in 2010 but eased down in 2011 (to \$7 billion). Releases are expected to diminish further in 2012 and 2103.

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.

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

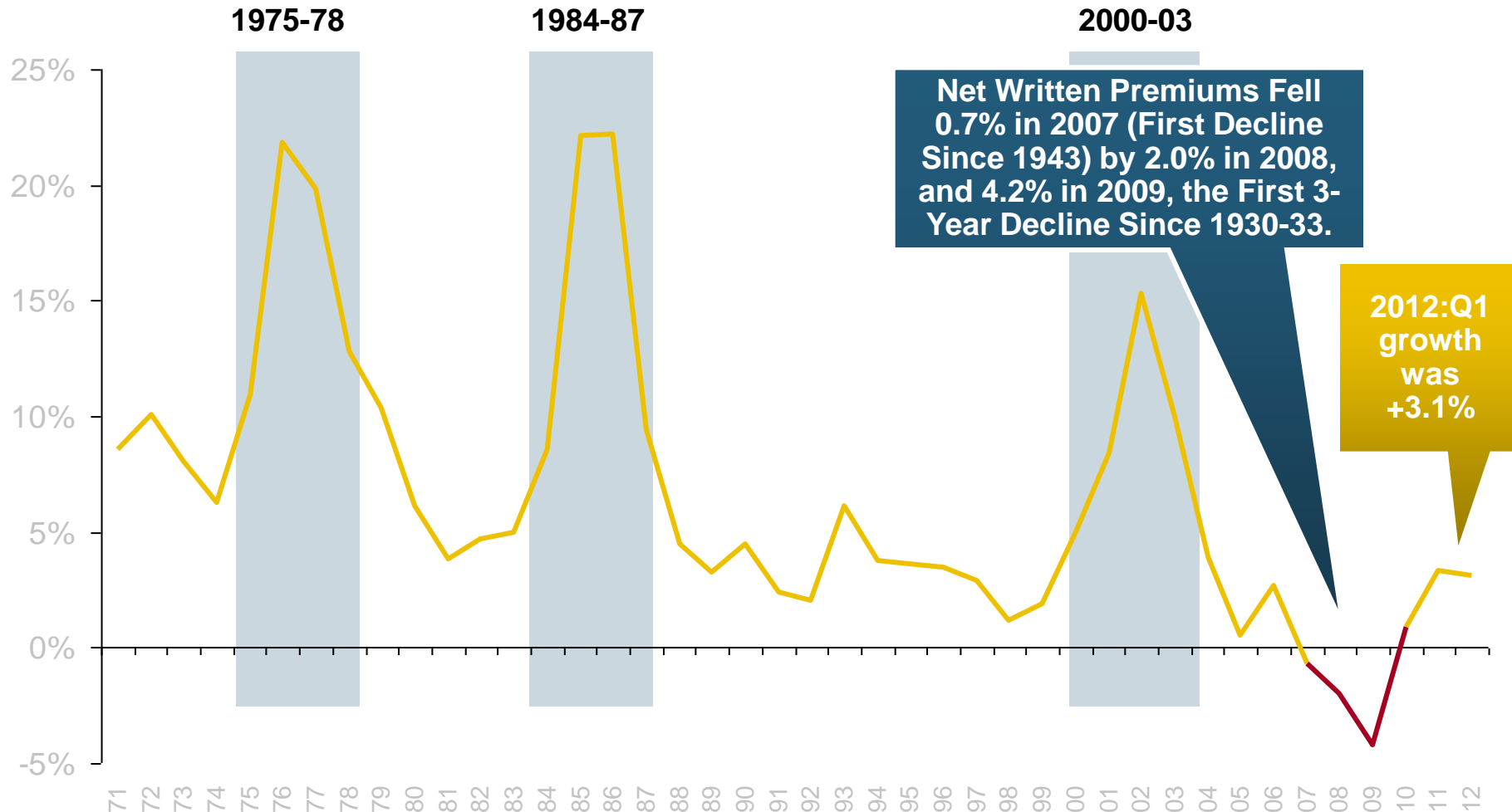
*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

Source: A.M. Best; Insurance Information Institute.

Premium Growth Is Up Modestly: More in 2012?

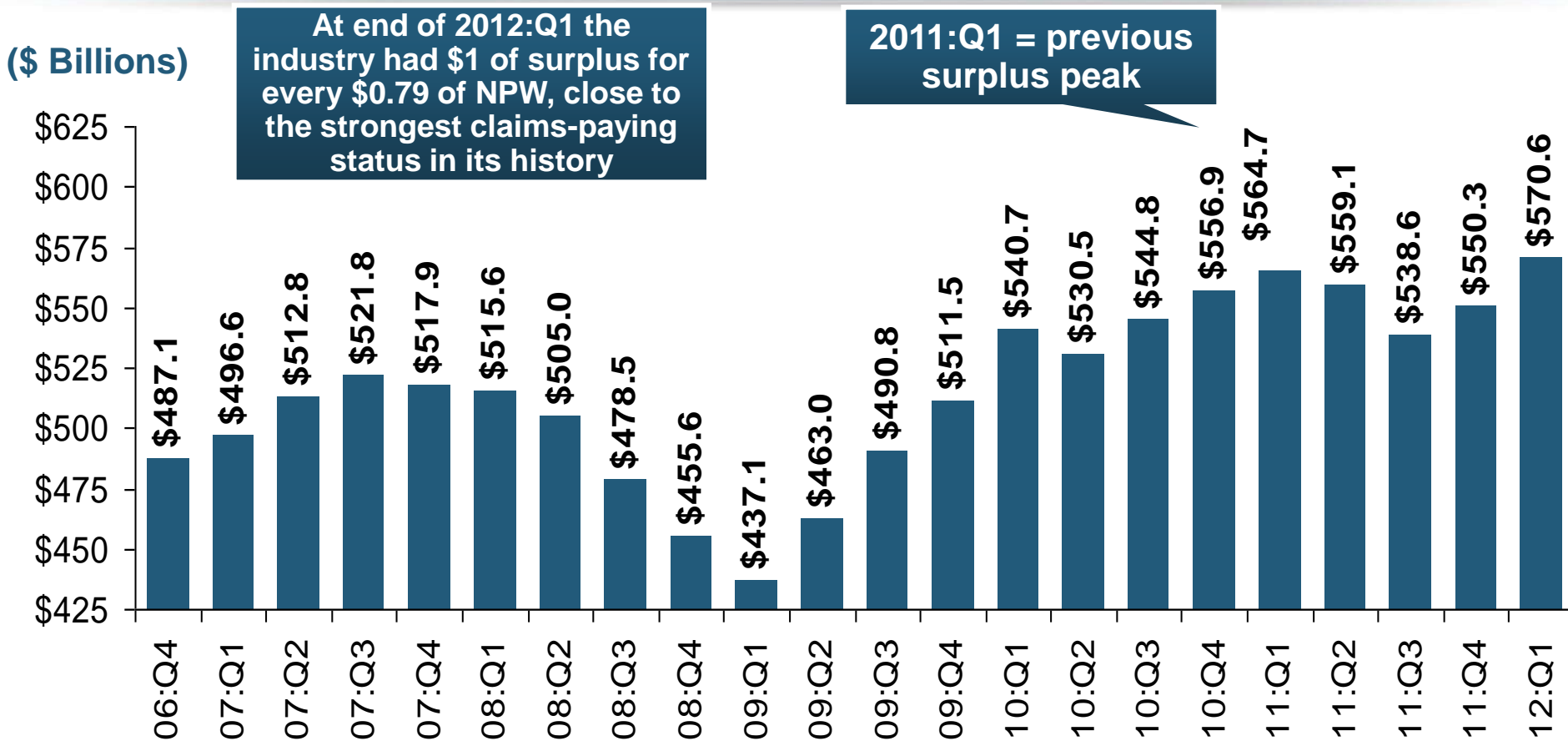
(Percent)



Shaded areas denote "hard market" periods

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

Policyholder Surplus, 2006:Q4–2012:Q1



Note: Beginning in 2010:Q1 figures include \$22.5B of paid-in capital from a holding company parent to a subsidiary insurer. It was a single investment in a non-insurance business.

Quarterly Surplus Changes Since 2011:Q1 Peak

11:Q2: -\$5.6B (-1.0%)
11:Q3: -\$26.1B (-4.6%)
11:Q4: -\$14.4B (-2.6%)

Source: ISO; A.M .Best.

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

| Criteria | Status | Comments |
|--|--|---|
| Sustained Period of Large Underwriting Losses | <i>Early Stage, Inevitable</i> | <ul style="list-style-type: none"> • Apart from 2011 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) • Prior-year reserve releases continue to reduce u/w losses, boost ROEs, though more modestly |
| Material Decline in Surplus/ Capacity | <i>Entered 2011 At Record High; Only Small Decline</i> | <ul style="list-style-type: none"> • Surplus hit a record \$565B as of 3/31/11 • Fell just 1.6% through 12/31/11 from 12/31/10 • Will likely see new record in 2012 • Little excess capacity remains in reinsurance markets • Modest growth in demand for insurance is insufficient to absorb much excess capacity |
| Tight Reinsurance Market | <i>Somewhat in Place</i> | <ul style="list-style-type: none"> • Much of the global “excess capacity” was eroded by cats • Higher prices in Asia/Pacific • Modestly higher pricing for US risks |
| Renewed Underwriting & Pricing Discipline | <i>Some Firming esp. in Property, WC</i> | <ul style="list-style-type: none"> • Commercial lines pricing trends have turned from negative to flat and now positive, esp. Property & WC; • Competition remains intense as many seek to maintain market share |

Key Takaways

Insurance Industry Predictions for 2012-13

■ P/C Insurance Exposures Will Grow Slowly With the U.S. Economy, but there are some bright spots

- ◆ New car buying in 2012 is strongest since 2007; 2013 will be even stronger
- ◆ Hiring will continue and payroll will keep growing
- ◆ Businesses now more aware of business interruption/supply-chain vulnerabilities – opportunities for new/expanded coverage
- ◆ Manufacturing and retail will grow slowly, but construction stalled
- ◆ Growing cost to repair, rebuild, will grow policy limits

■ P/C Industry Growth in 2012 Will Be Strongest Since 2004

- ◆ Industry Capacity Hits a New Record by Year-End 2012 (Barring a Meg-CAT)
- ◆ Premium volume grows but no “hard market” in 2012 or 2013

■ Investment Environment Remains Challenging

- ◆ Interest rates remain low => pressure on rates to achieve profits

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***Thank you for your time
and your attention!***