



MegaTrends and MicroTrends: The Past and Future of P/C Insurance

**PCI Joint Marketing & Underwriting Seminar
San Diego, CA
April 23, 2012**

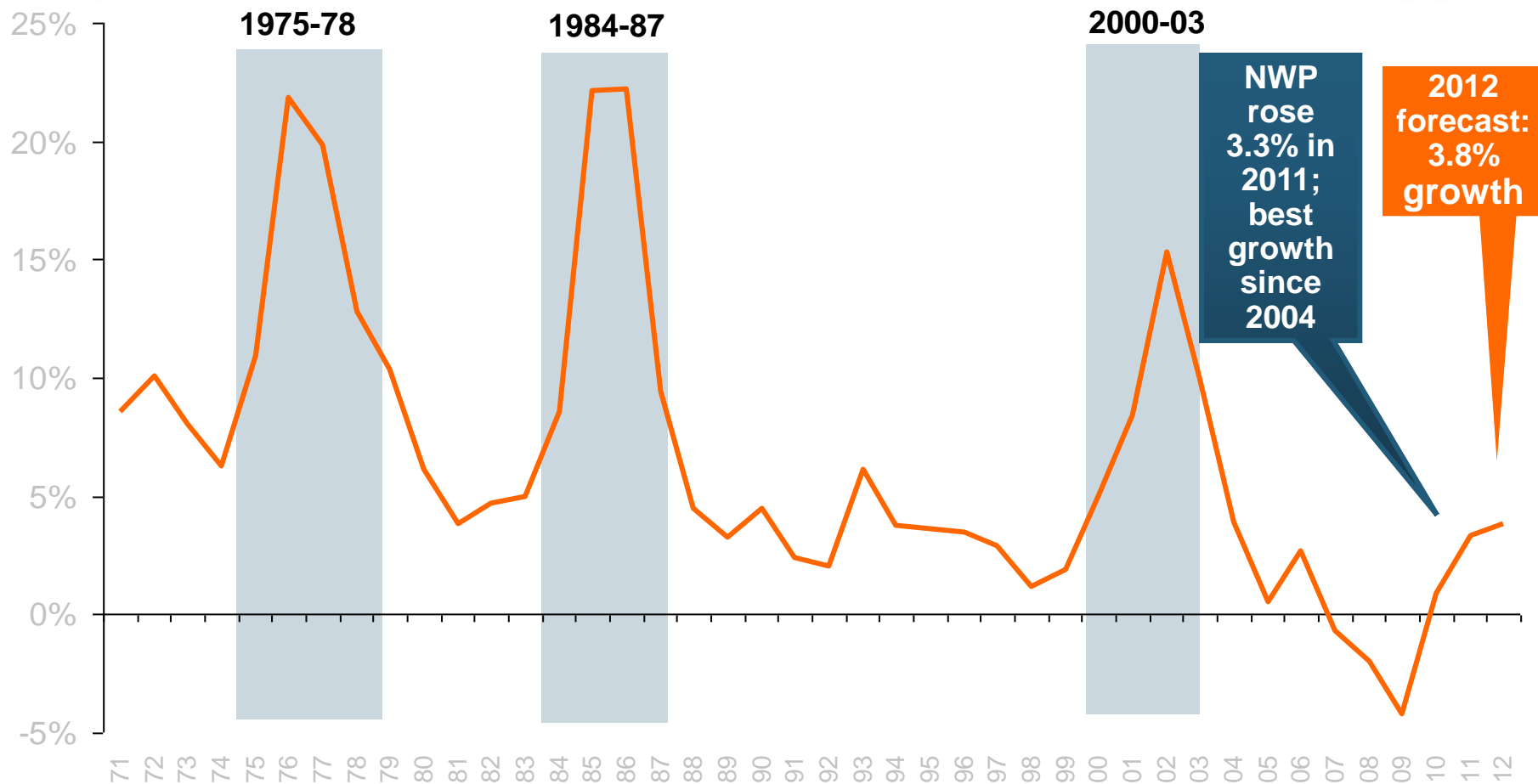
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P/C Insurance Industry Financial Overview

**The Long-Term Past and
Short-Term Future
of the P/C Insurance Industry**

Net Written Premiums: Soft Market Persisted into 2011 but Growth Returned; More in 2012?

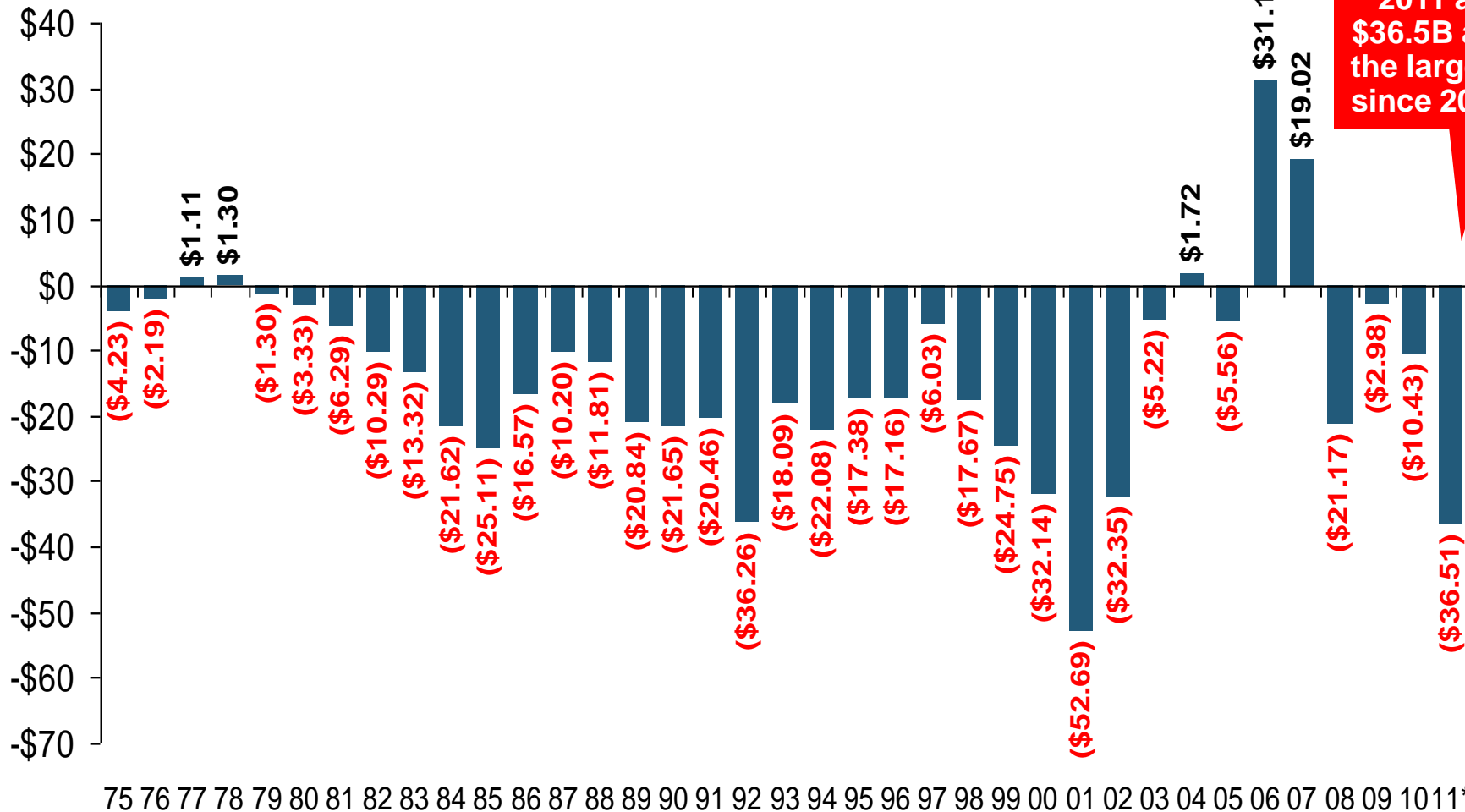


Net Written Premiums fell 0.7% in 2007 (1st year-over-year drop since 1943), fell 2.0% in 2008, and 4.2% in 2009—the first 3-successive-year decline since 1930-33.

Note: 2012 figure is A.M. Best Estimate Shaded areas denote “hard market” periods
 Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

Underwriting Gain (Loss) 1975–2011*

\$ Billions

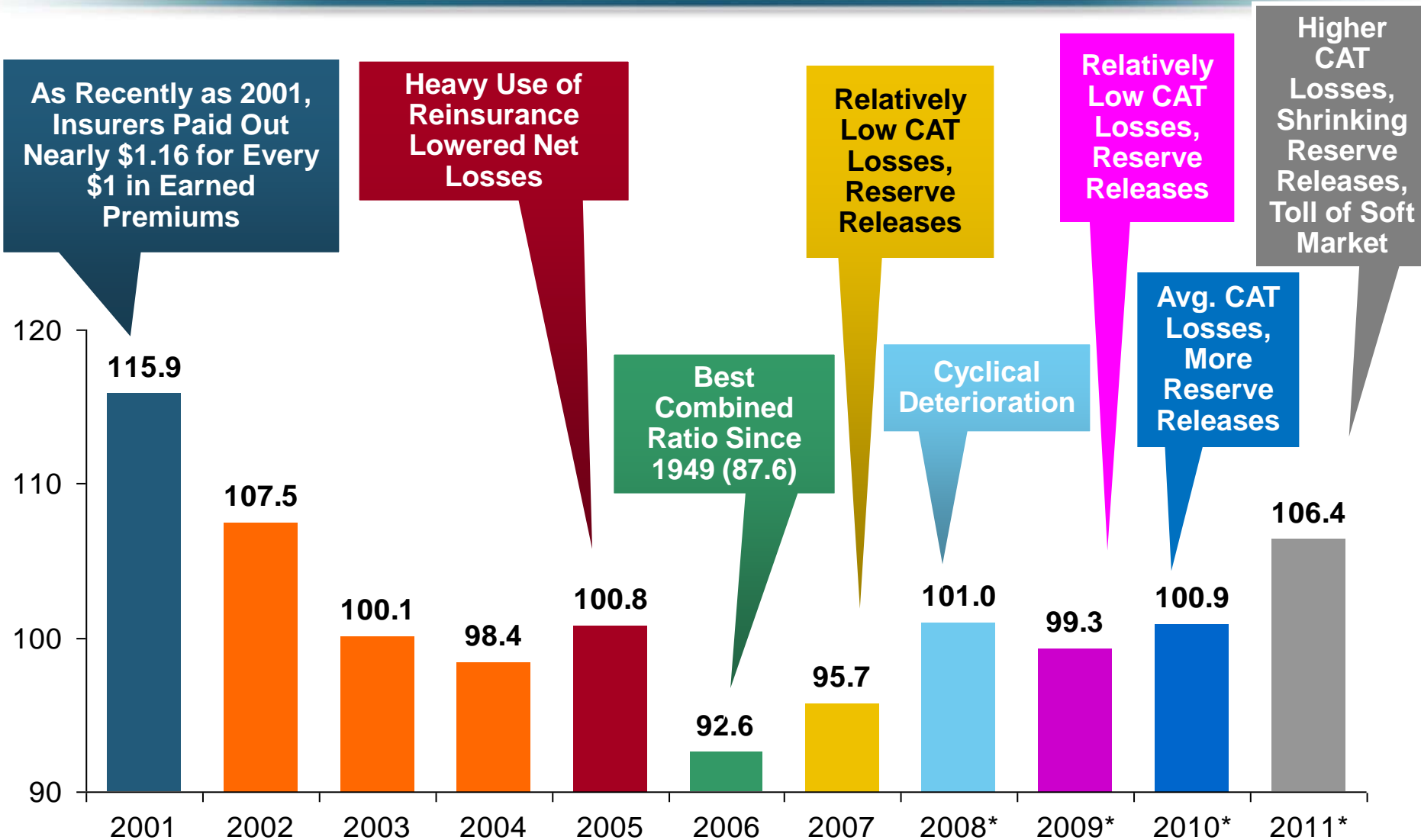


U/W losses in 2011 at \$36.5B are the largest since 2001

* Includes mortgage and financial guaranty insurers in all years

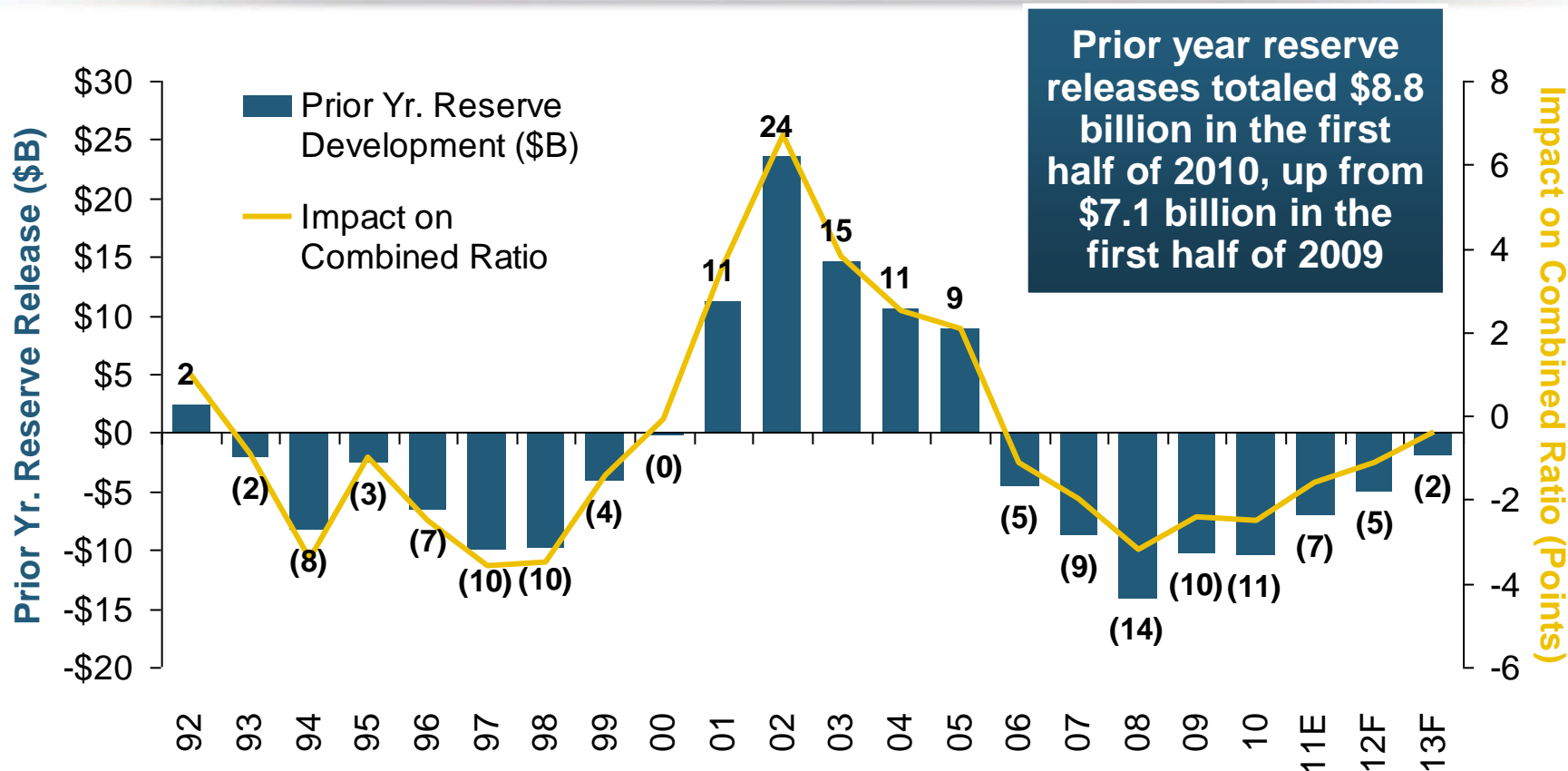
Sources: A.M. Best, ISO; Insurance Information Institute.

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=108.2
Sources: A.M. Best, ISO.

P/C Reserve Development, 1992–2013F



Reserve Releases Remained Strong in 2010 But Tapered Off in 2011. Releases Are Expected to Further Diminish in 2012 and 2103

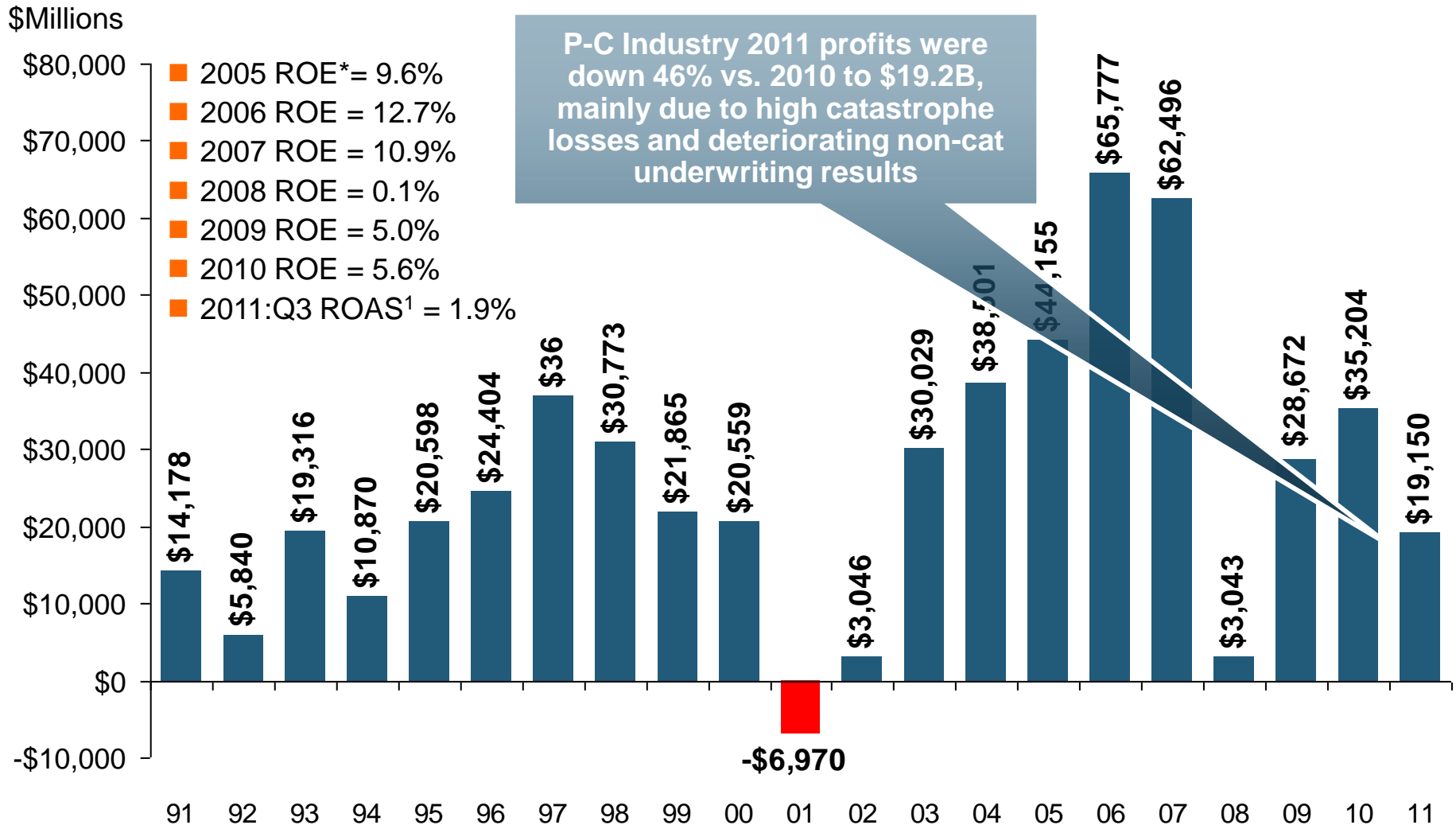
Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage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

Sources: Barclays Capital; A.M. Best.

A “Hard Market” in the Future?

Criteria	Status	Comments
Sustained Period of Large Underwriting Losses	<i>Somewhat in Place</i>	<ul style="list-style-type: none"> • Overall p/c underwriting losses exceeded \$10 billion in 3 of last 4 years • Combined ratios rising, masked by reserve releases (110+ at onset of last hard market)
Material Decline in Surplus/ Capacity	<i>Not Even Close</i>	<ul style="list-style-type: none"> • Surplus hit a record \$565B as of 3/31/11 • Analysts est. excess surplus of \$75-\$100B • Some excess capacity may still remain in reinsurance markets
Tight Reinsurance Market	<i>Somewhat in Place</i>	<ul style="list-style-type: none"> • Higher prices in Asia/Pacific • Modestly improved pricing for US risks
Renewed Underwriting & Pricing Discipline	<i>Not Broadly Evident</i>	<ul style="list-style-type: none"> • Commercial lines pricing trends now modestly rising • Competition remains intense as many seek to maintain market share • Terms & conditions—no broad tightening

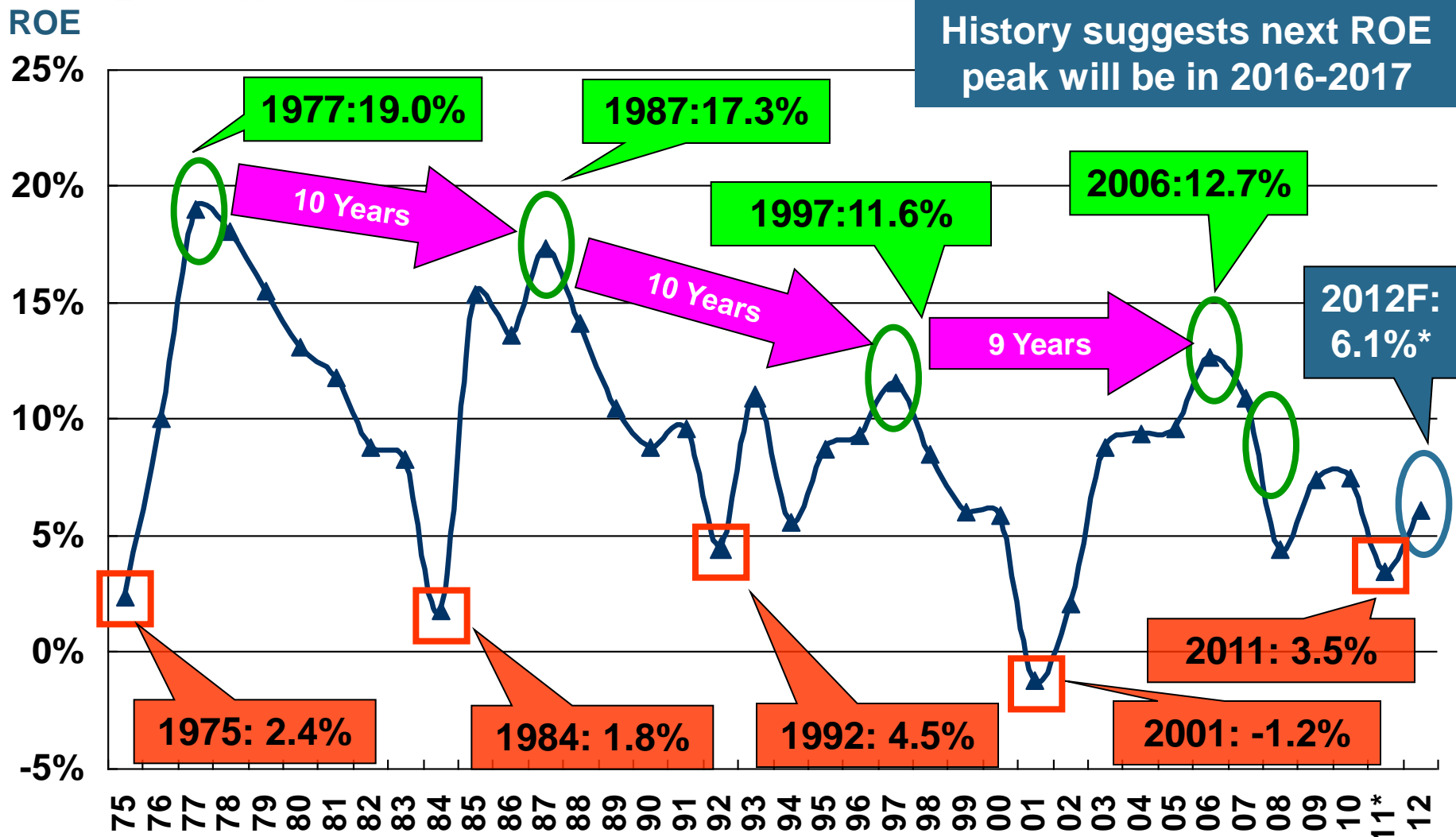
P/C Net Income After Taxes 1991–2011



* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 3.0% ROAS for 2011:Q3, 7.5% for 2010 and 7.4% for 2009.

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

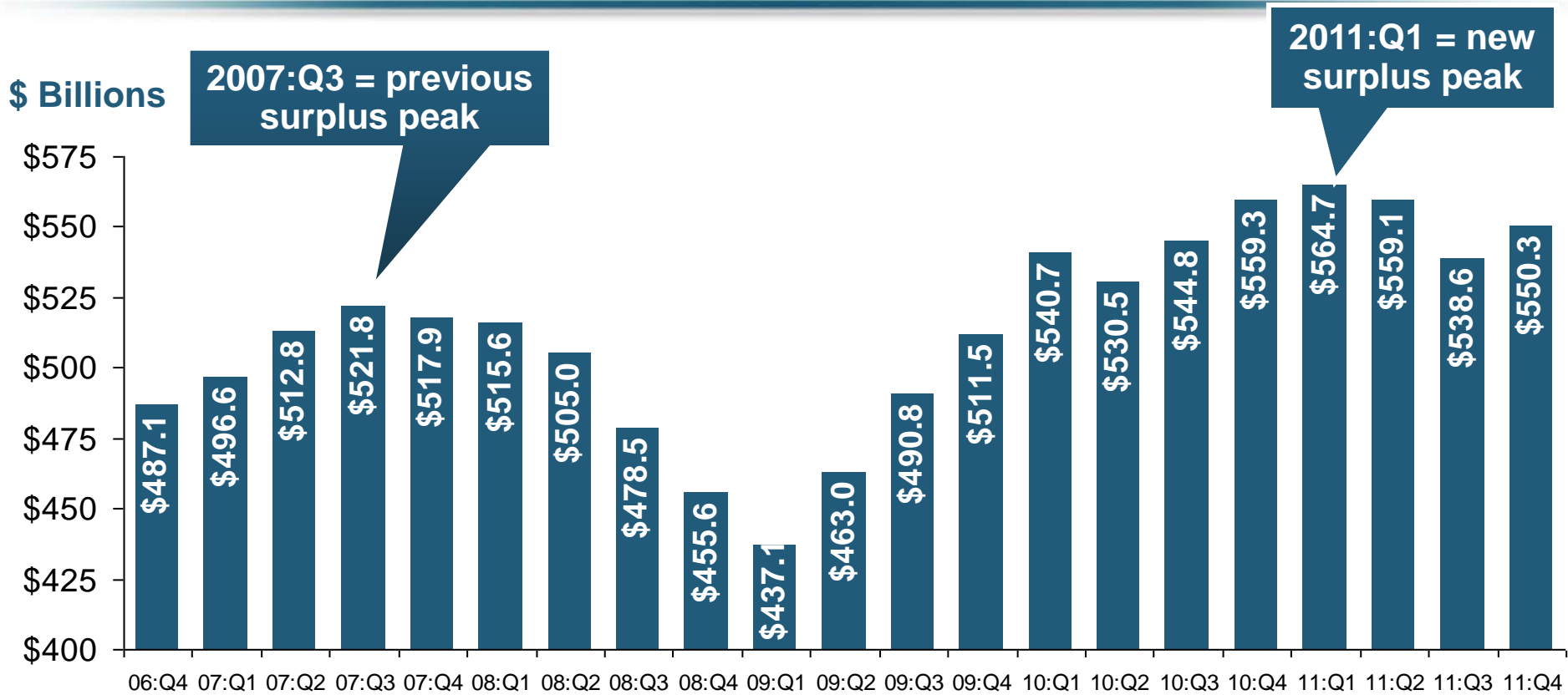
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975–2012F*



*Profitability = P/C insurer ROEs. 2011-12 figures are A.M. Best estimates. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. For 2011:Q3 ROAS = 1.9% including M&FG.

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

Policyholder Surplus, 2006:Q4–2011:Q4



2007:Q3 = previous surplus peak

2011:Q1 = new surplus peak

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.

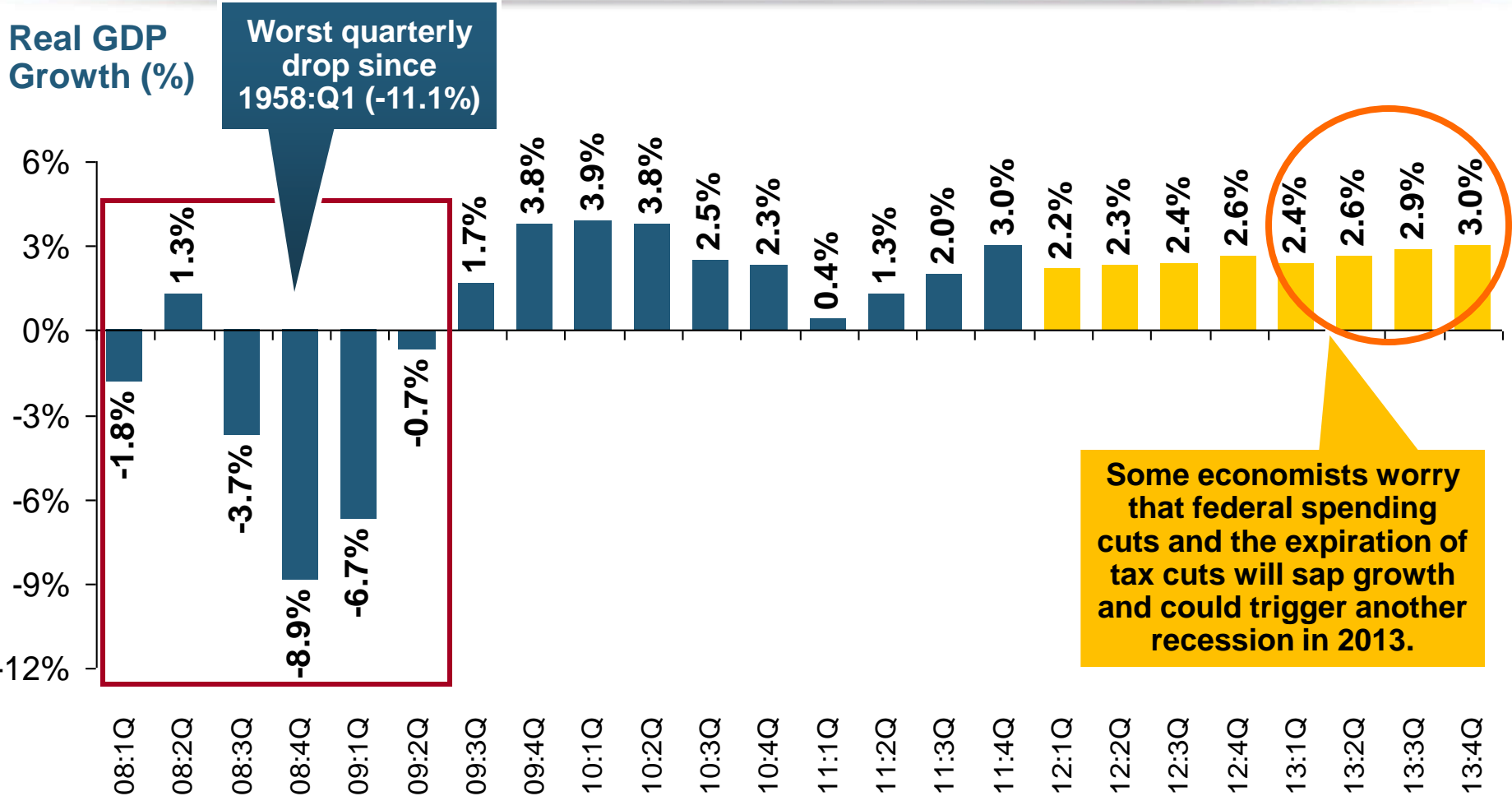
Quarterly Surplus Changes Since 2011:Q1 Peak	
11:Q2: -\$5.6B (-1.0%)	The industry now has \$1 of surplus for every \$0.80 of NPW, close to the strongest claims-paying status in its history
11:Q3: -\$26.1B (-4.6%)	
11:Q4: -\$14.4B (-2.6%)	



Economic Drivers of P/C Insurance Exposures

**Growth in the Wake
of the “Great Recession”**

US Real GDP Growth, quarterly*



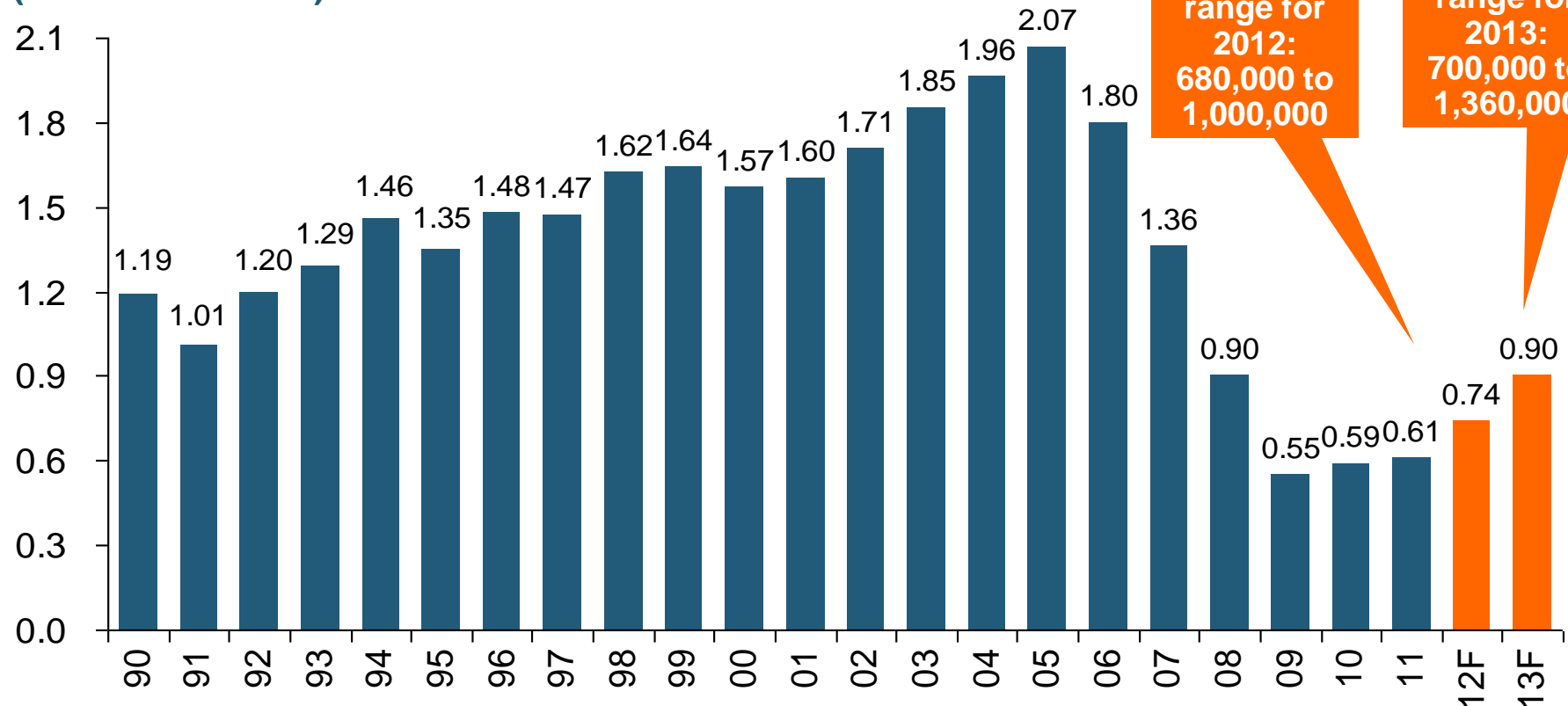
Demand for insurance continues to be affected by a sluggish economy

* Median of range of Estimates/Forecasts from Blue Chip Economic Indicators

Source: US Department of Commerce, Blue Economic Indicators 4/2012 issue (forecasts); Insurance Information Institute.

Private Housing Starts, 1990-2013F

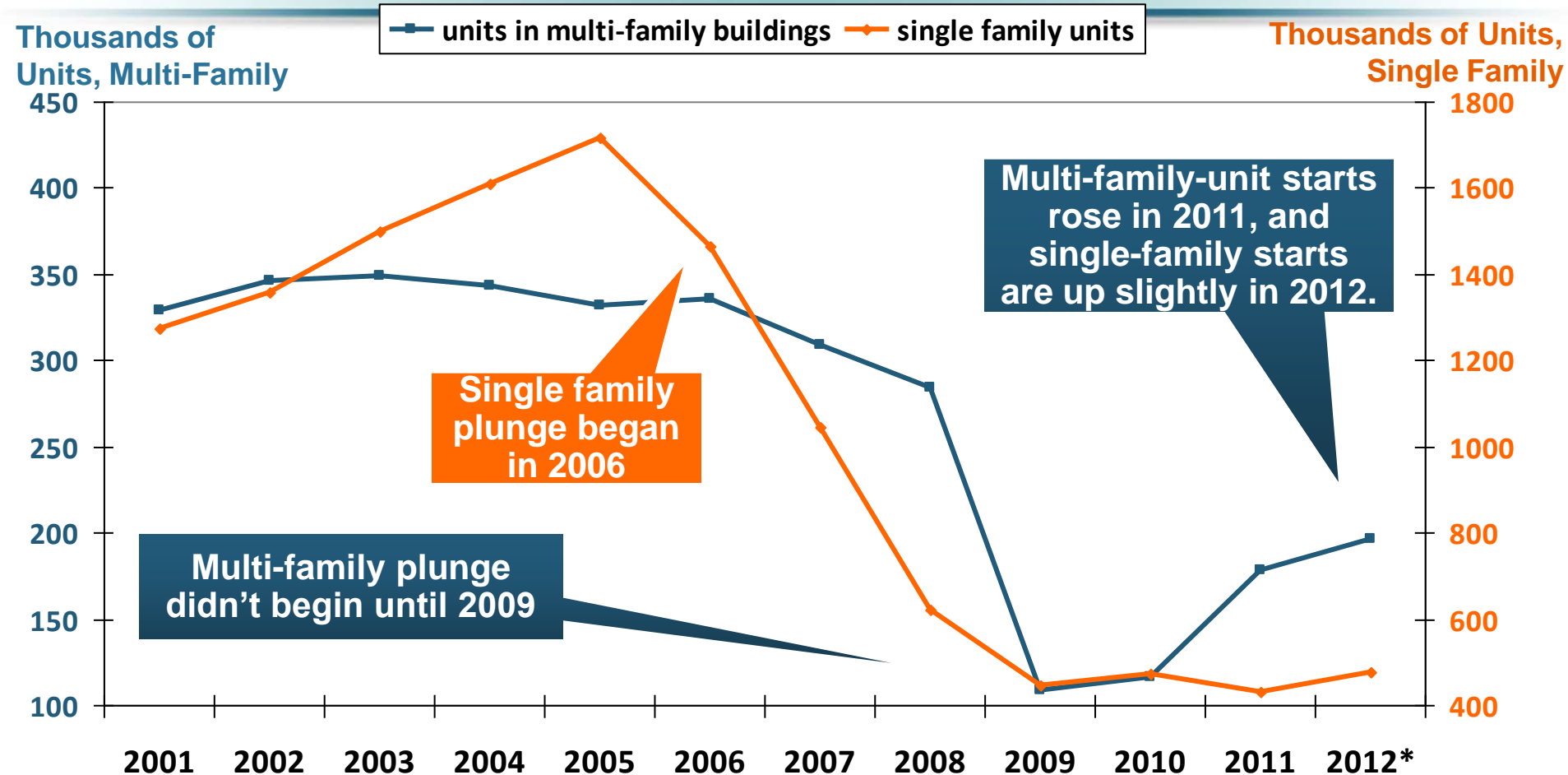
(Millions of Units)



Weak home construction forecast implies little exposure growth likely for Homeowners insurers for the next few years, but homeowners might fortify homes to mitigate storm and other damage.

Sources: U.S. Census Bureau and Department of Housing and Urban Development (history) at <http://www.census.gov/const/newresconst.pdf>; Blue Chip Economic Indicators (4/2012), forecasts; Insurance Information Institute.

Single vs. Multi-Family Housing Starts, Annually, 2001-2012*



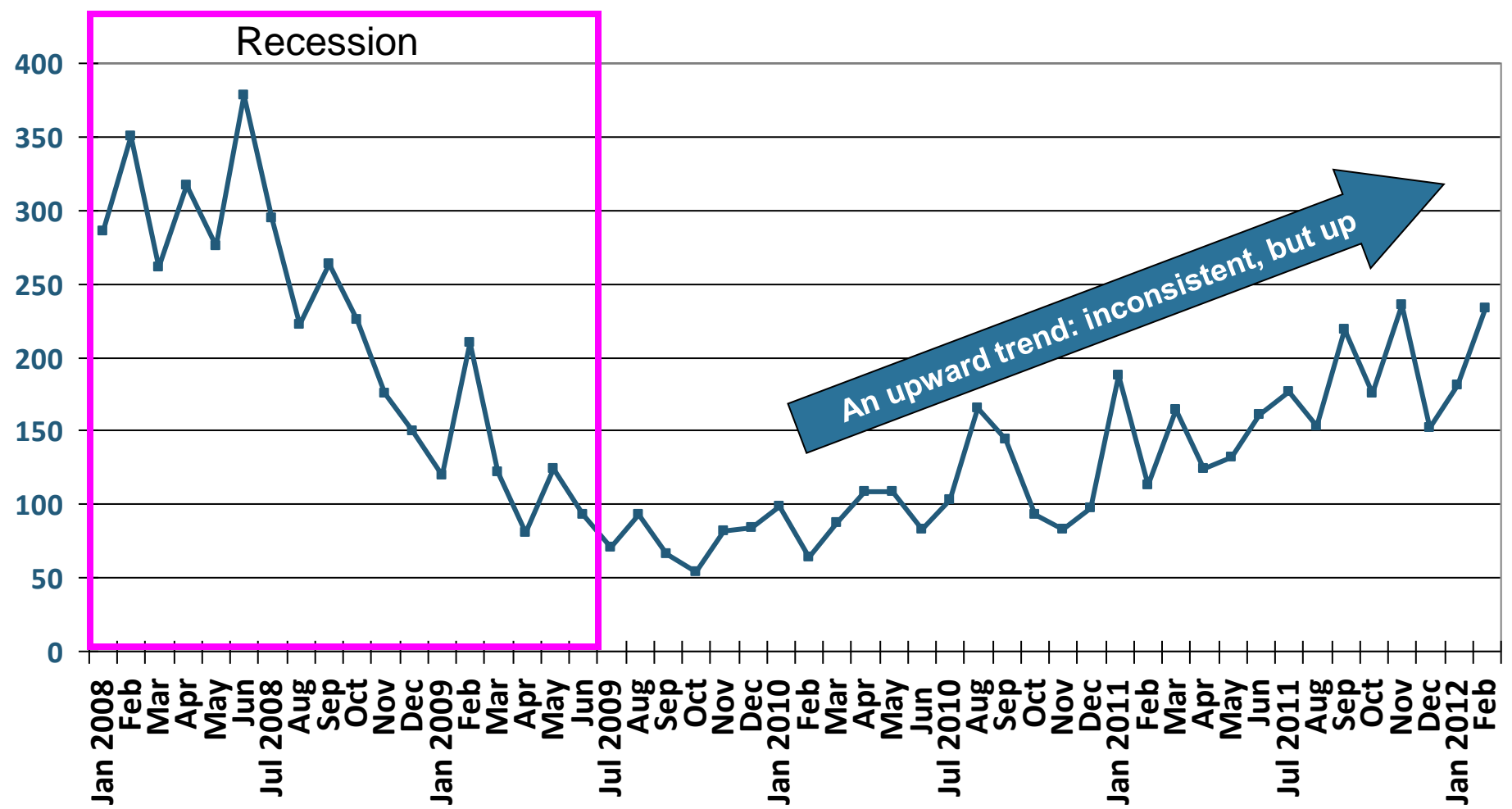
The slump is mainly in single-family housing, but starts of multi-family units also plunged in 2009-10.

*January-March 2012 data, annualized, seasonally-adjusted, preliminary

Source: US Census Bureau at <http://www.census.gov/construction/nrc/pdf/newresconst.pdf>

Number of Units in Multi-Family Housing* Starts**, Monthly, January '08-Feb '12

Thousands of Units

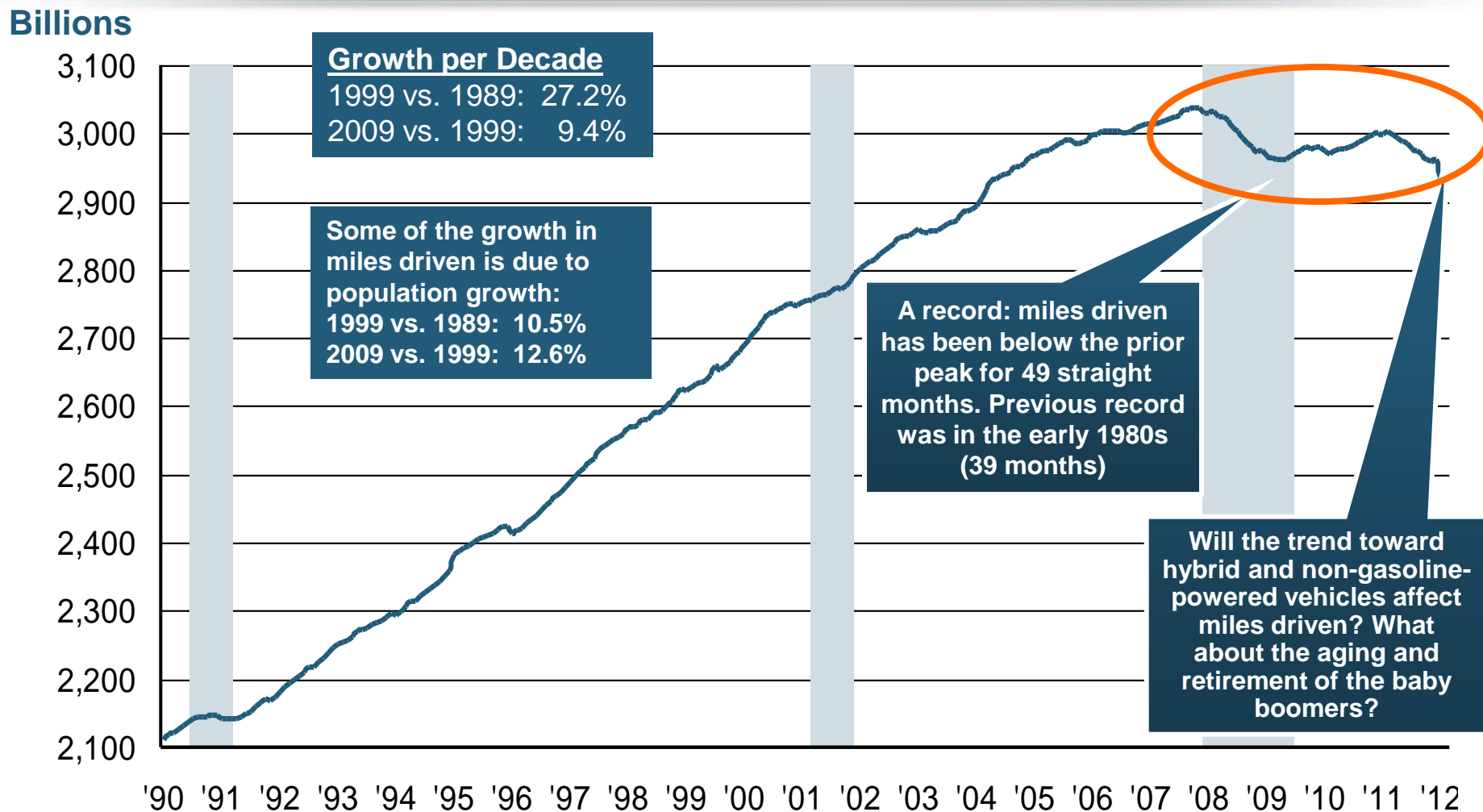


*5 units or more **seasonally-adjusted annual rates
 Source: US Census Bureau at <http://www.census.gov/const/newresconst.pdf>

The Auto Insurance Picture

**A “New Normal”:
More Old Cars on the Road**

Miles Driven*, 1990–2012

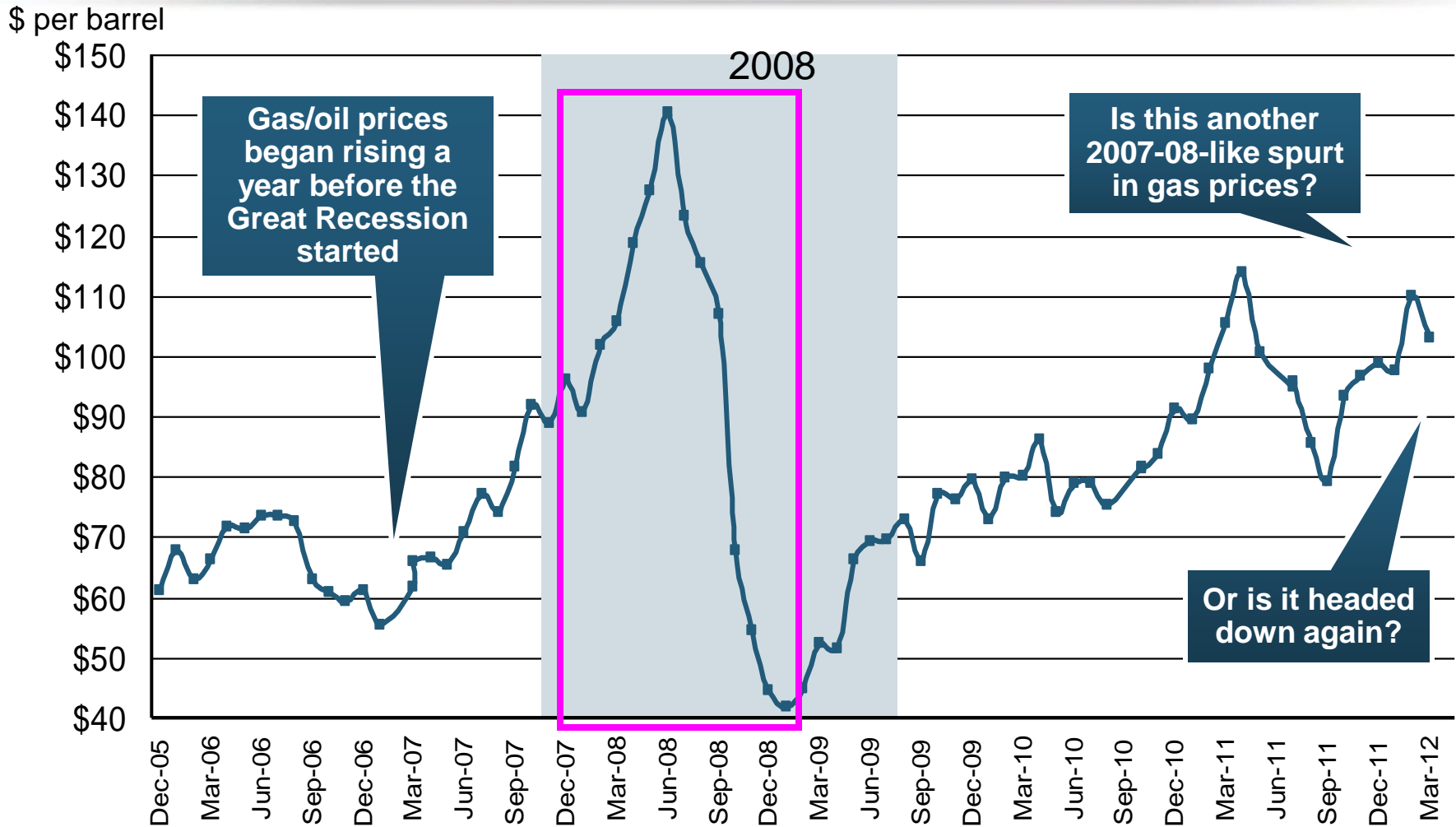


*Moving 12-month total. The latest data is for February 2012.

Note: Recessions indicated by gray shaded columns..

Sources: Federal Highway Administration (<http://www.fhwa.dot.gov/ohim/tvtw/tvtpage.cfm>); National Bureau of Economic Research (recession dates); Insurance Information Institute.

Recent History of Crude Oil Prices* Monthly, 2006-2012



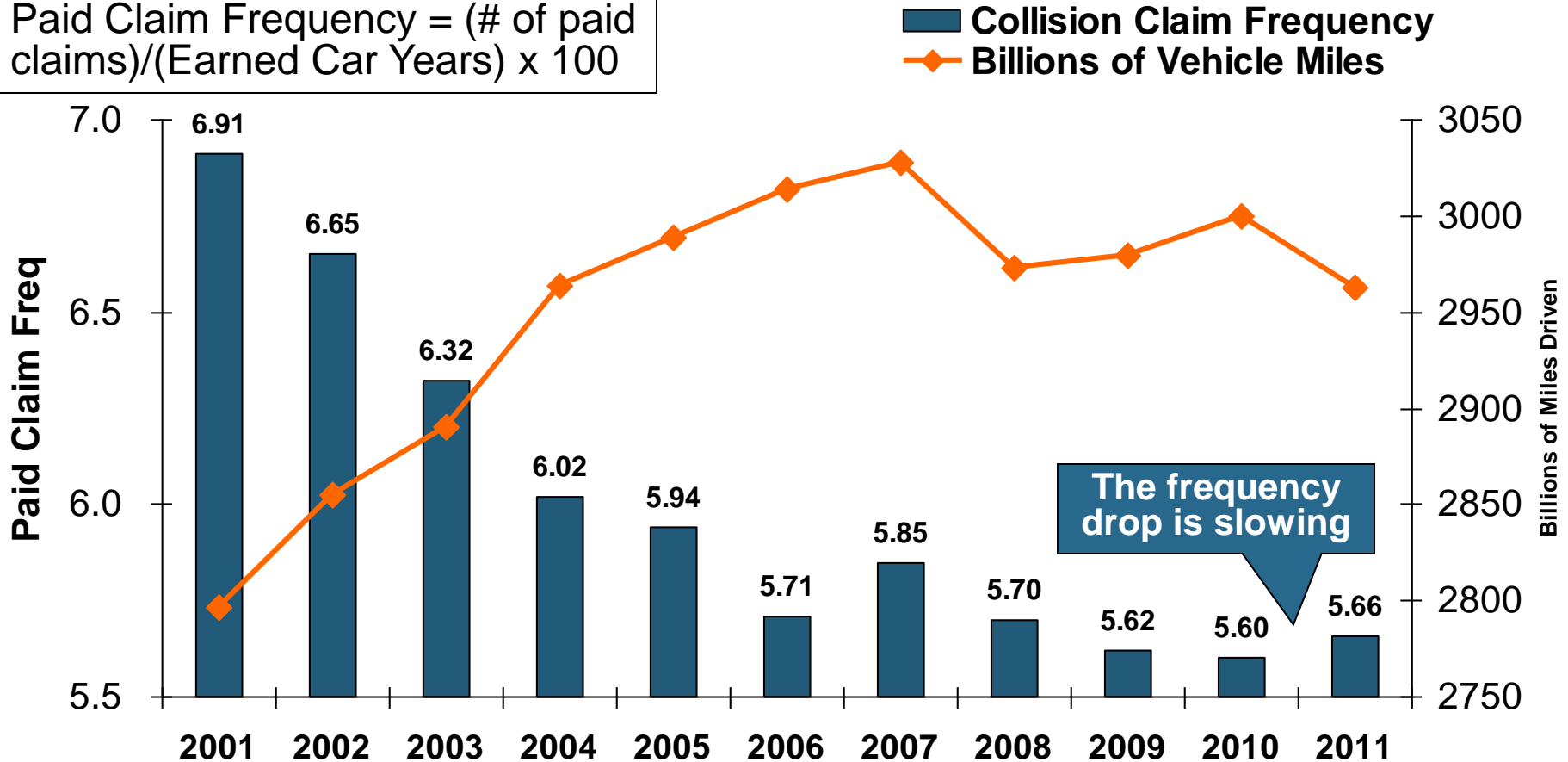
Note: Recession indicated by gray shaded column.

*per barrel of light, sweet crude oil for future delivery as traded on the New York Mercantile Exchange (NYMEX); last weekly close in each month, except Decembers (which are 12/31 closing prices)

Sources: NYSE at <http://www.nyse.tv/crude-oil-price-history.htm> NBER (recession dates)

Do Changes in Miles Driven Affect Auto Collision Claim Frequency?

Paid Claim Frequency = (# of paid claims)/(Earned Car Years) x 100

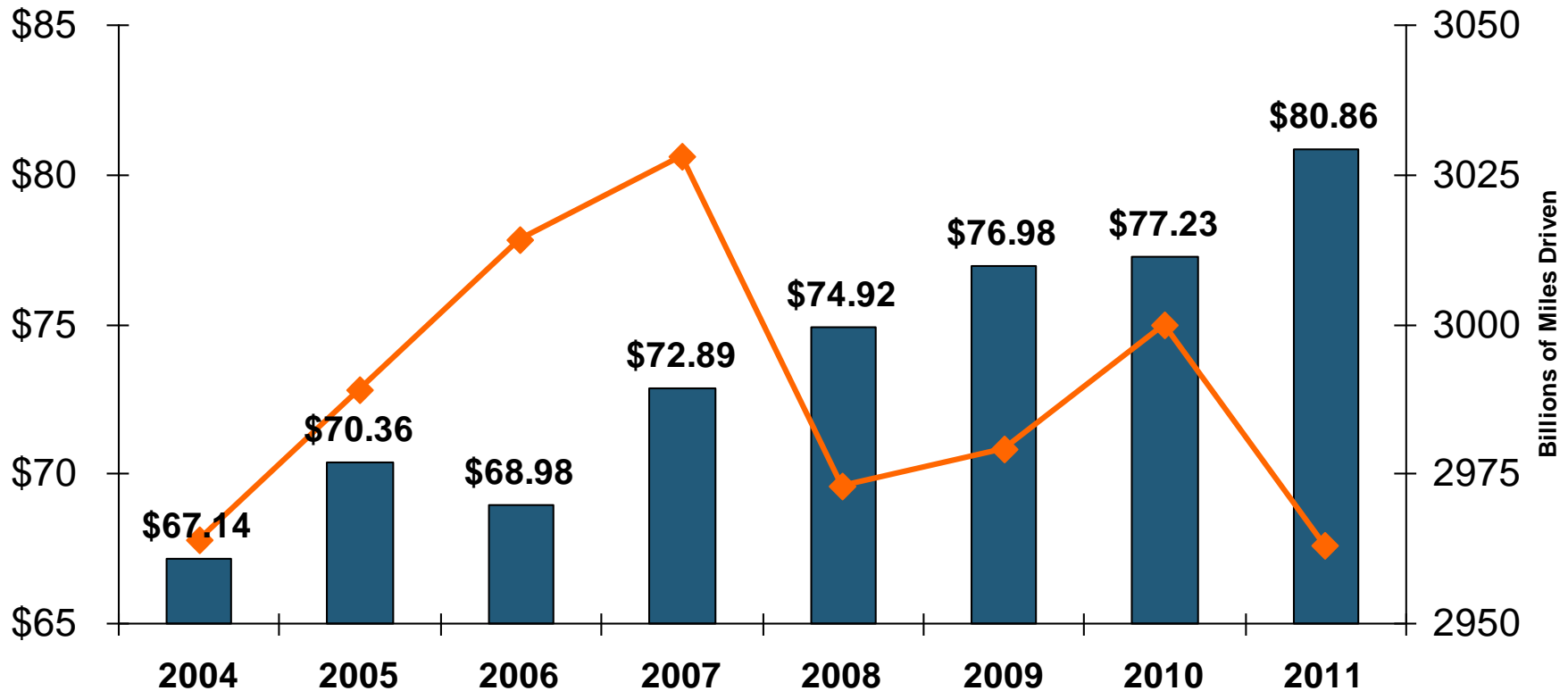


“Pay-As-You-Go” Auto Insurance: Fluctuations in miles driven will affect exposure

Do Changes in Miles Driven Affect Auto Claims Payments (BI+PhysDam)?

Incurred Losses
(\$ Billions)

■ Incurred Losses
◆ Billions of Vehicle Miles

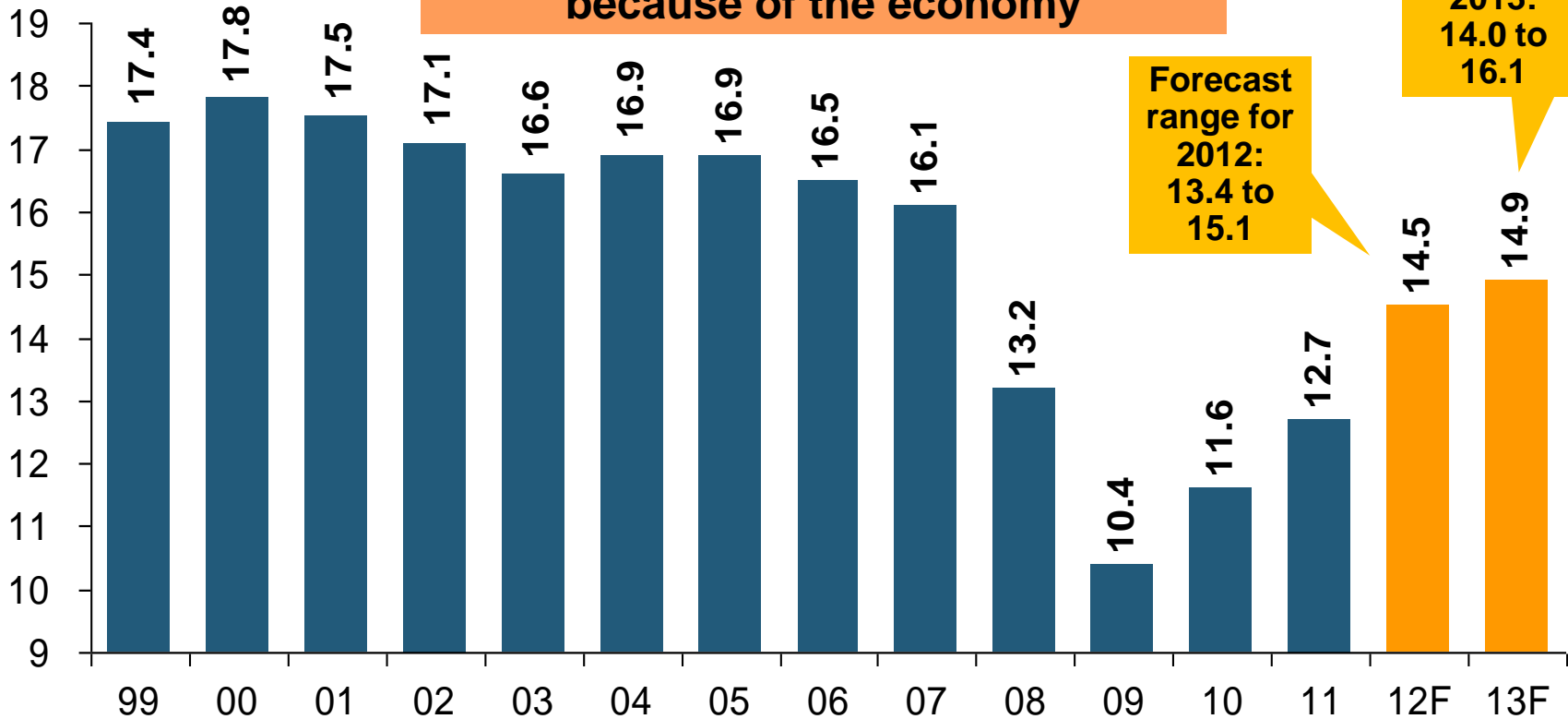


The sharp drop in miles driven in 2008 and the smaller drop in 2011 didn't slow the growth of auto insurance incurred losses

The Car-Buying Slump Will Create Pressure to Replace Aging Vehicles

(Millions of Units)

2011 AAA Survey: 1 in 4 drivers have neglected repairs and maintenance because of the economy



Forecast range for 2012: 13.4 to 15.1

Forecast range for 2013: 14.0 to 16.1

Many more older cars are on the road today than in “normal” times. Previously in a 3-year span, new cars would replace about 35 million old cars, but in 2008-10 only about 27 million old cars were replaced.

Sources: history--U.S. Department of Commerce; forecasts (including 2011 preliminary--Blue Chip Economic Indicators (4/2012); Insurance Information Institute; USA Today 8/10/2011 edition (AAA Survey).

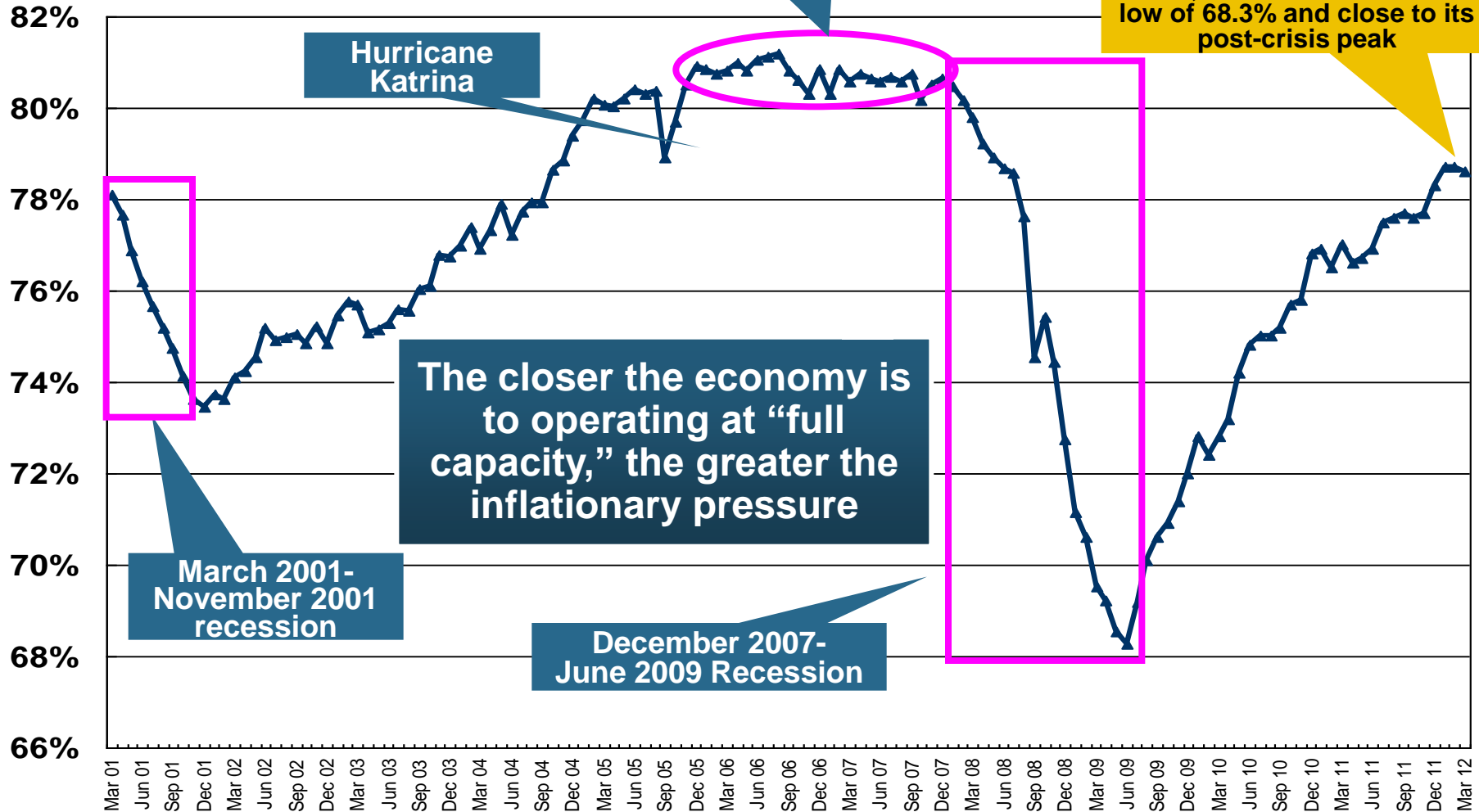
The Commercial Insurance Picture

**The Near-Term Outlook
for Small Business
is Getting Better but isn't Bright**

Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

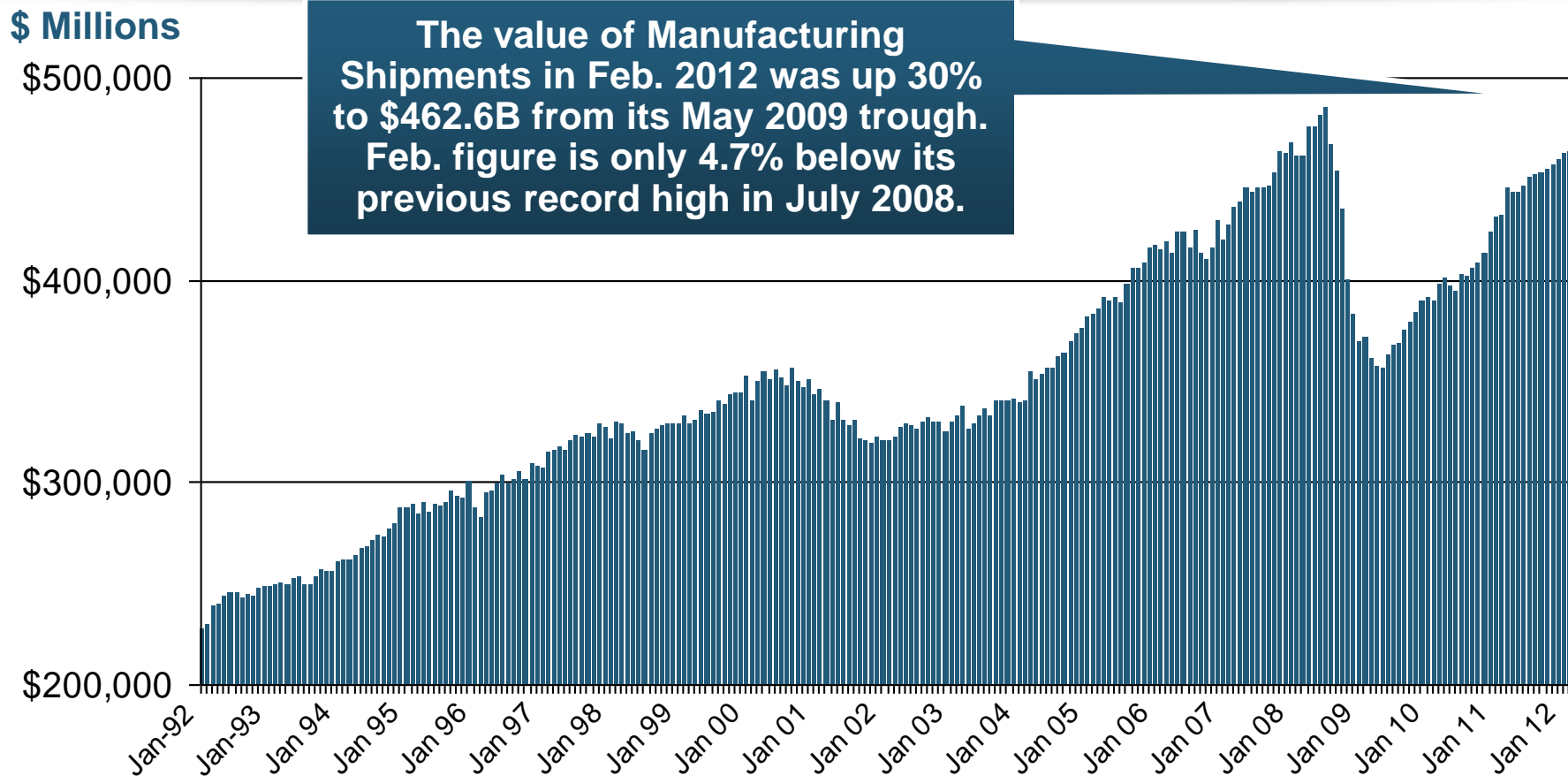
March 2001 through March 2012

Percent of Industrial Capacity



Source: Federal Reserve Board statistical releases at <http://www.federalreserve.gov/releases/q17/Current/default.htm>.

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

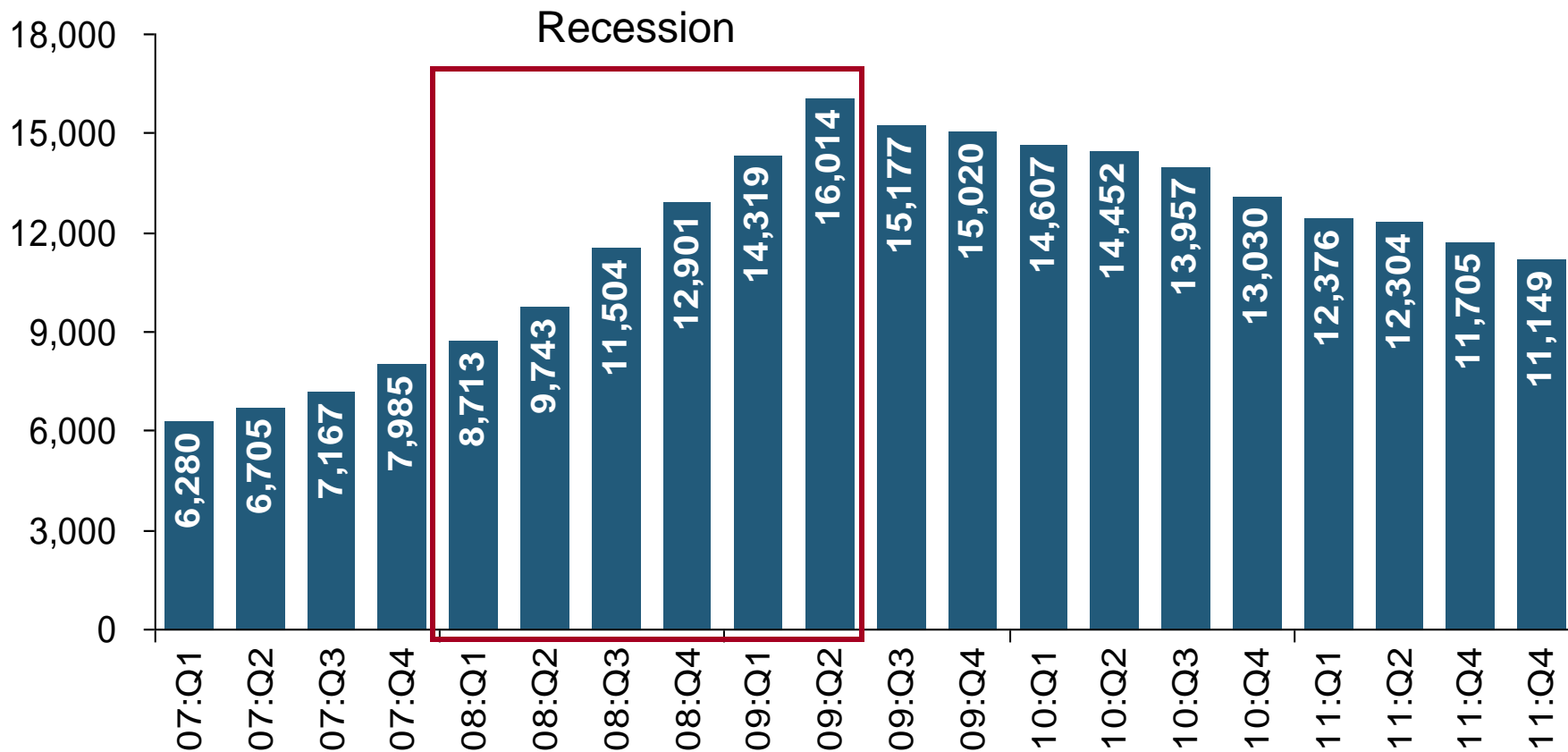


Monthly shipments are nearly back to peak (which happened in July 2008, 8 months into the recession). Trough in May 2009. Growth leads to gains in many commercial exposures: WC, Commercial Auto, Property and Various Liability Coverages

*seasonally adjusted

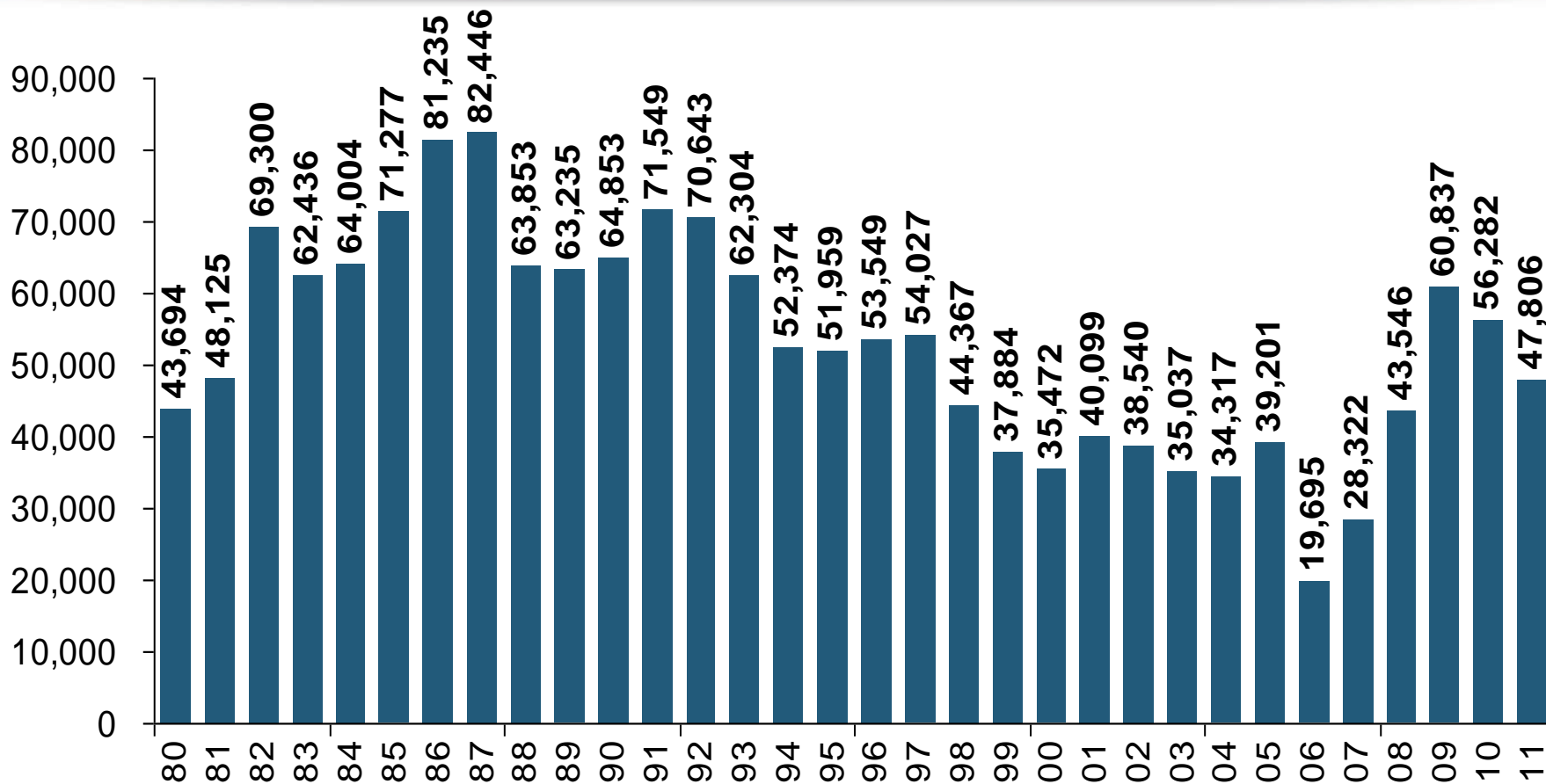
Source: U.S. Census Bureau, *Full Report on Manufacturers' Shipments, Inventories, and Orders*, <http://www.census.gov/manufacturing/m3/>

Business Bankruptcy Filings, Quarterly, 2007-2011



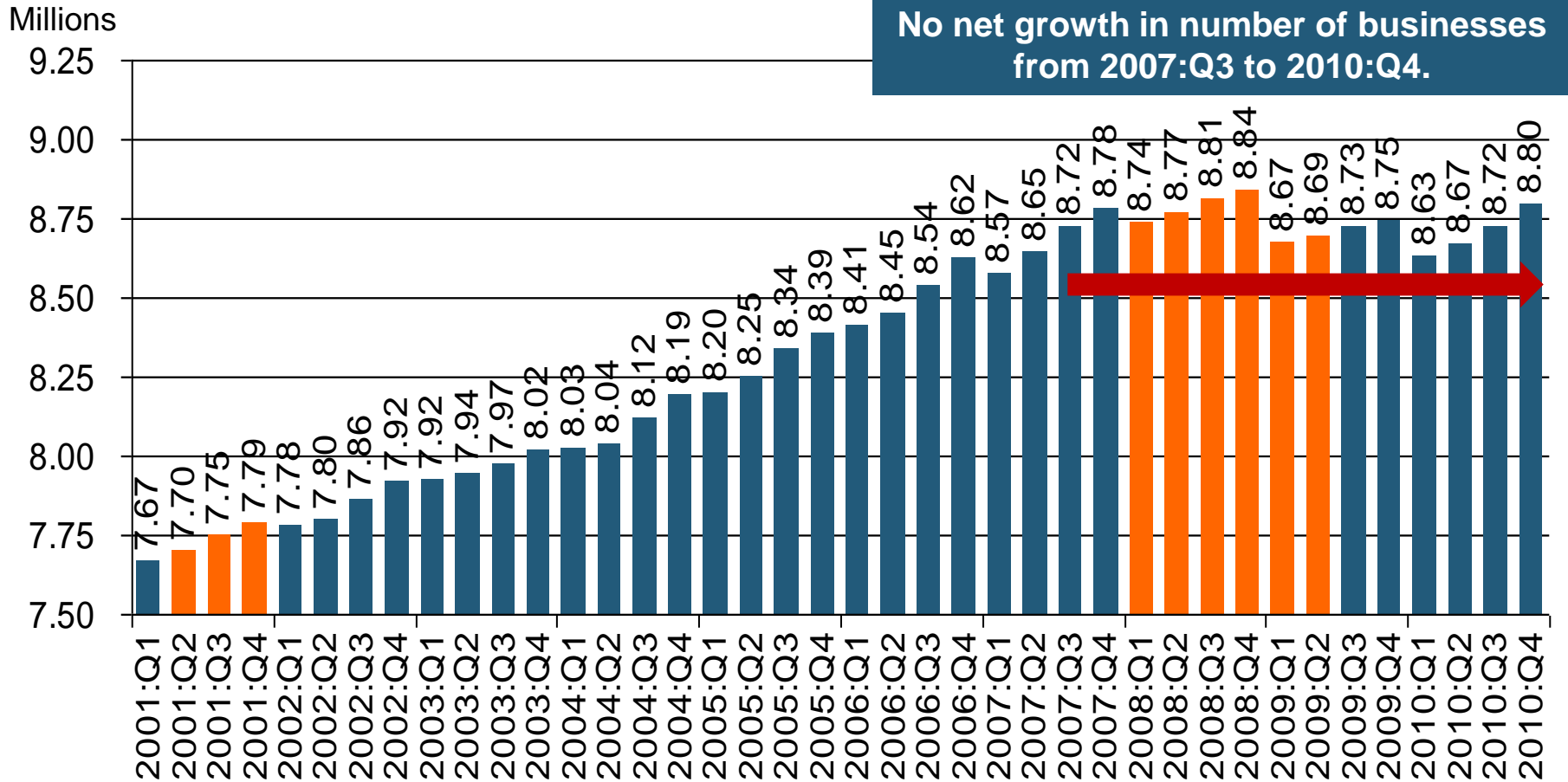
Business bankruptcies were down 15.1% in 2011 vs. 2010 and down 21.4% in 2011 vs. 2009, but were still higher than in any pre-recession year since 1997. Significant exposure implications for all commercial lines.

Business Bankruptcy Filings, Annually, 1980-2011



Business bankruptcies were down 15.1% in 2011 vs. 2010 and down 21.4% in 2011 vs. 2009, but were still higher than in any pre-recession year since 1997. Significant exposure implications for all commercial lines.

Number of Private Business Establishments, 2001:Q1-2010:Q4*



The number of employees in new businesses is typically lower than the number in formerly-operating businesses that closed.

*data for 2010:Q1-2010:Q4 are preliminary

Sources: U.S. Bureau of Labor Statistics

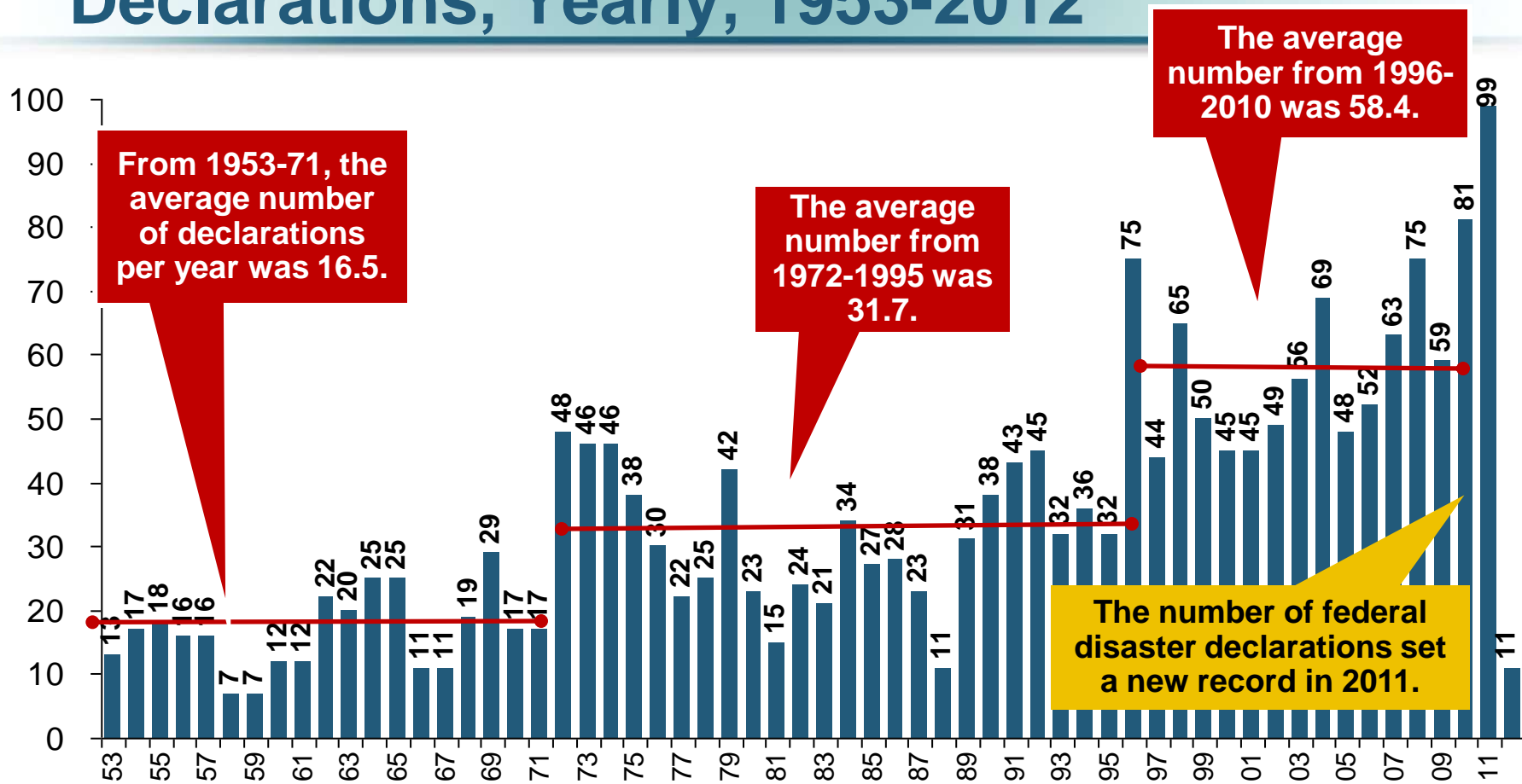
Note: quarters when the economy was in recession are indicated by orange bars

“Quarterly Census of Employment and Wages”; Insurance Information Institute

Catastrophe Loss Developments and Trends

2011 is Rewriting Catastrophe Loss and Insurance History

Number of Federal Disaster Declarations, Yearly, 1953-2012*

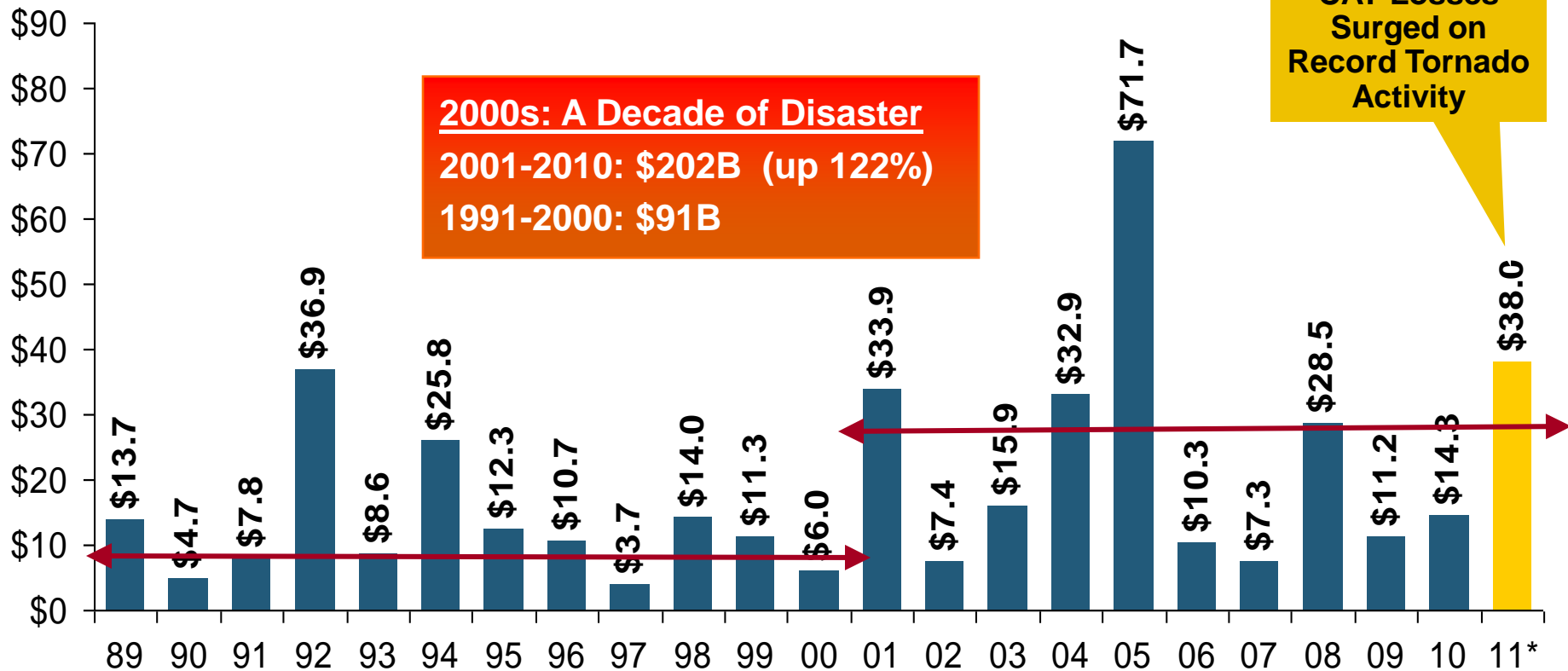


There have been 2,060* federal disaster declarations since 1953. Note that 2005 was a relatively low year for number of disaster declarations in the 1996-2010 period, but that year included Hurricanes Katrina, Rita, and Wilma.

*Through April 12, 2012. Sources: Federal Emergency Management Administration at http://www.fema.gov/news/disaster_totals_annual.fema ; Insurance Information Institute.

US Insured Catastrophe Losses, Yearly, 1989-2011*

\$ Billions of 2011 dollars



2000s: A Decade of Disaster
 2001-2010: \$202B (up 122%)
 1991-2000: \$91B

CAT Losses Surged on Record Tornado Activity

US insured CAT losses do not include amounts paid by the National Flood Insurance Program.

*ISO estimate.

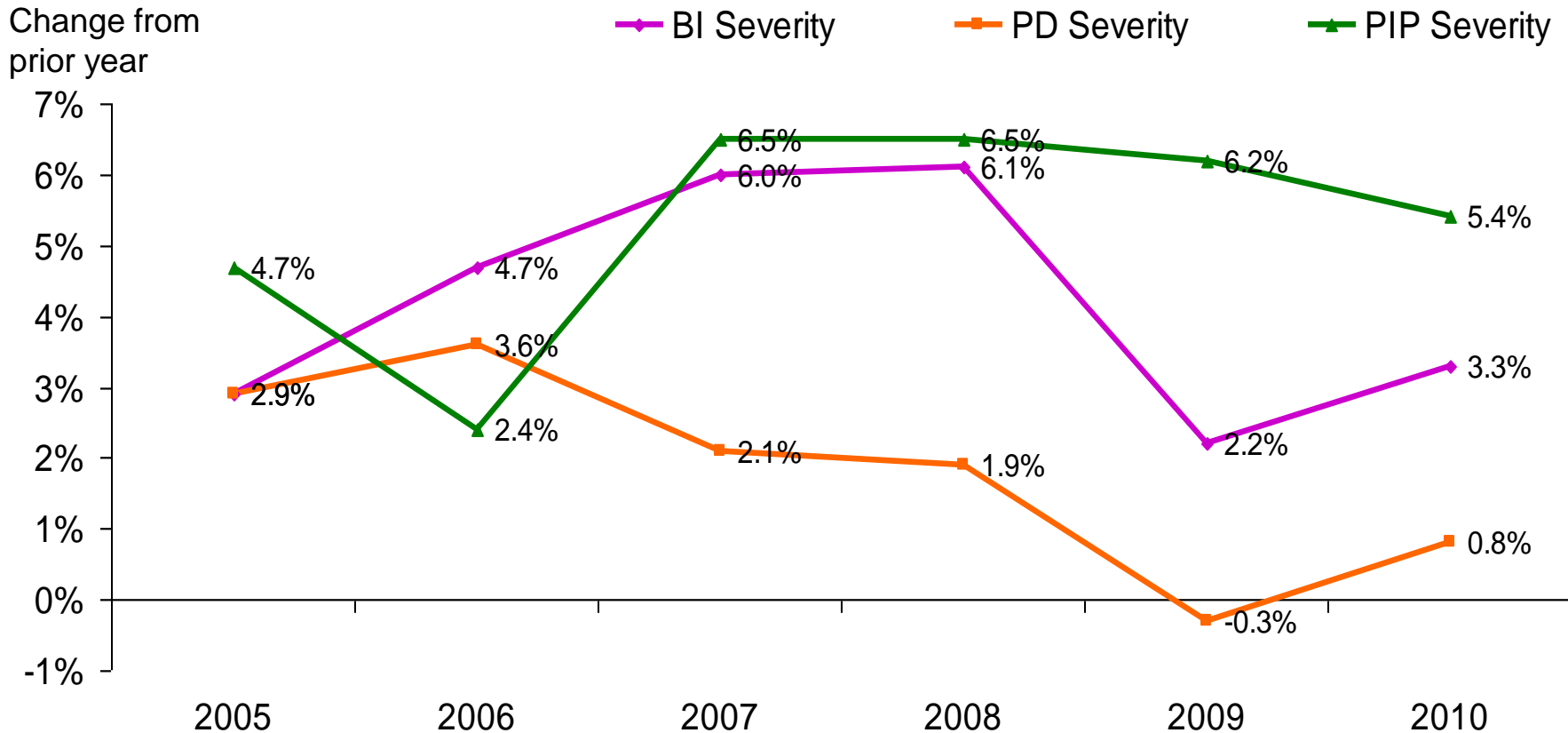
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01 (\$25.9B 2011 dollars). Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B (\$15.6B in 2011 dollars.)

Sources: Property Claims Service/ISO; Insurance Information Institute.

Price Trends of P/C Insurance Claims

**P-C Claim Severity Generally
Has Risen Faster than the CPI**

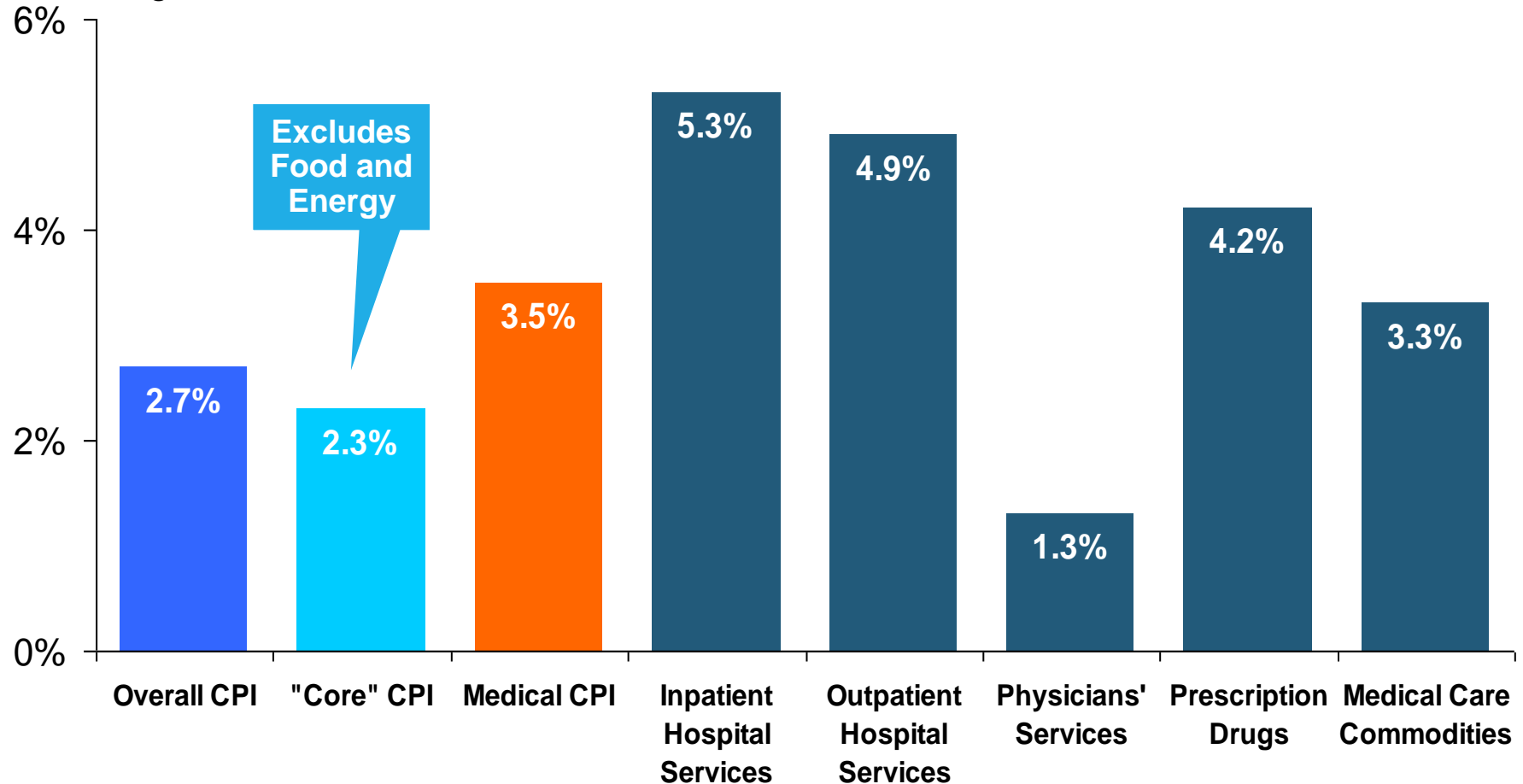
Auto Liability Claims Severity Trends, 2005-2010



The average severity of auto property damage liability claims has grown slightly more slowly than overall inflation. Beginning in 2006, average severity for BI and PIP grew much faster.

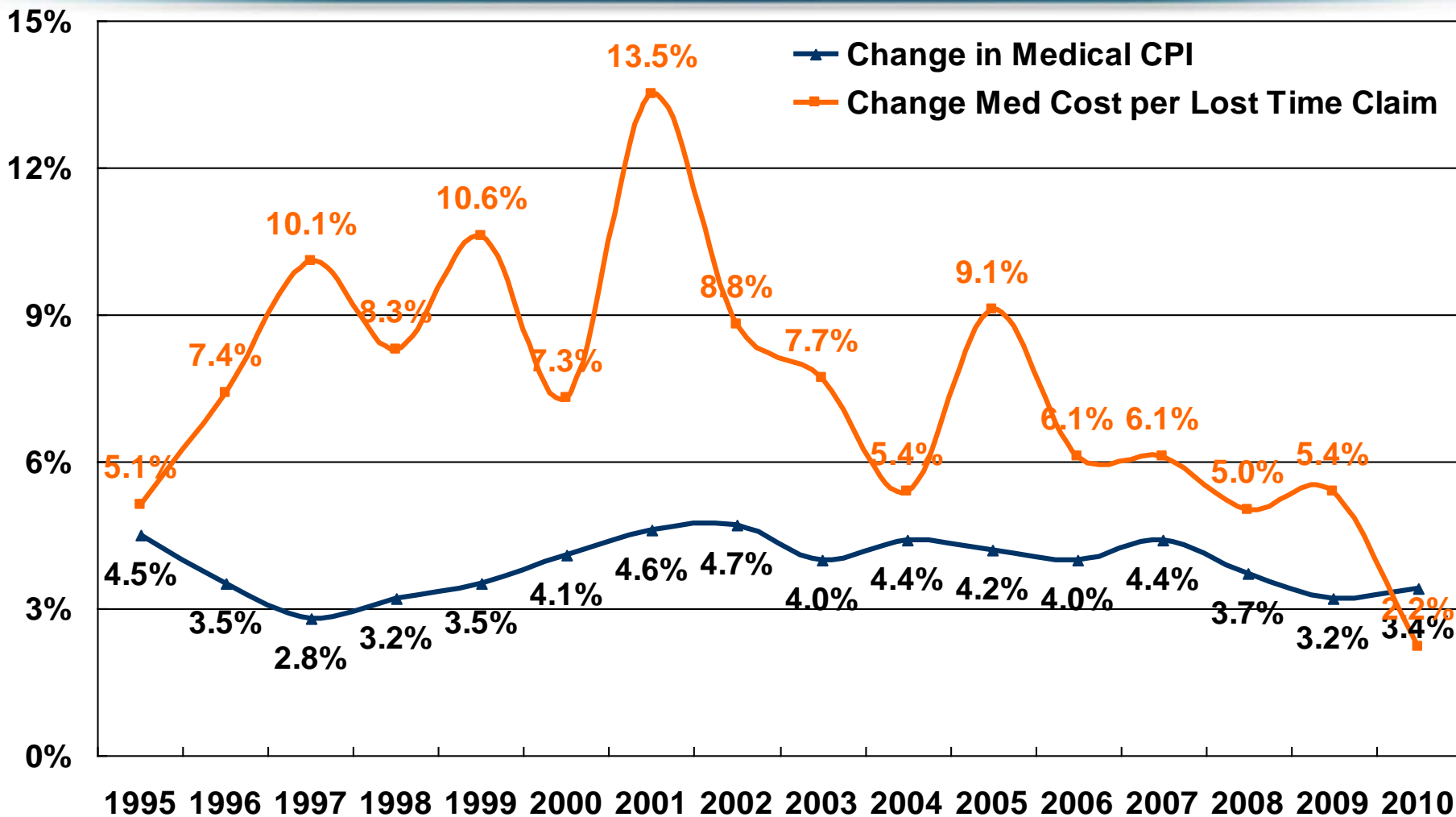
P/C Insurance Claim Cost Drivers Grow Faster than even the Medical CPI Suggests

Mar 2012 Y-o-Y
Price Changes



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

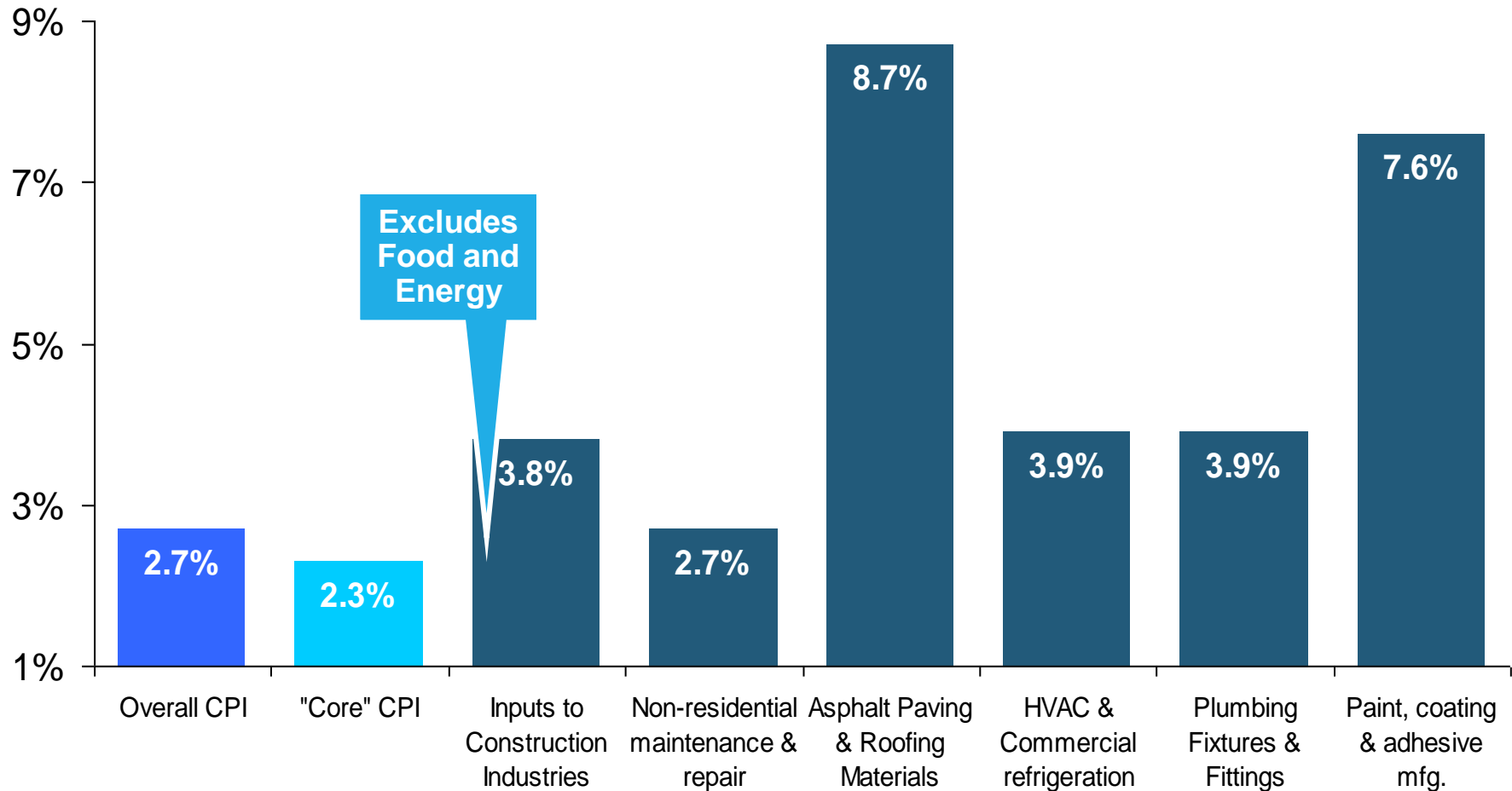
WC Medical Severity Rising at Twice the Medical CPI Rate



The average annual increase in WC medical severity from 1995 through 2009 was nearly twice the medical CPI (7.6% vs. 3.9%). Will healthcare reform affect this gap?

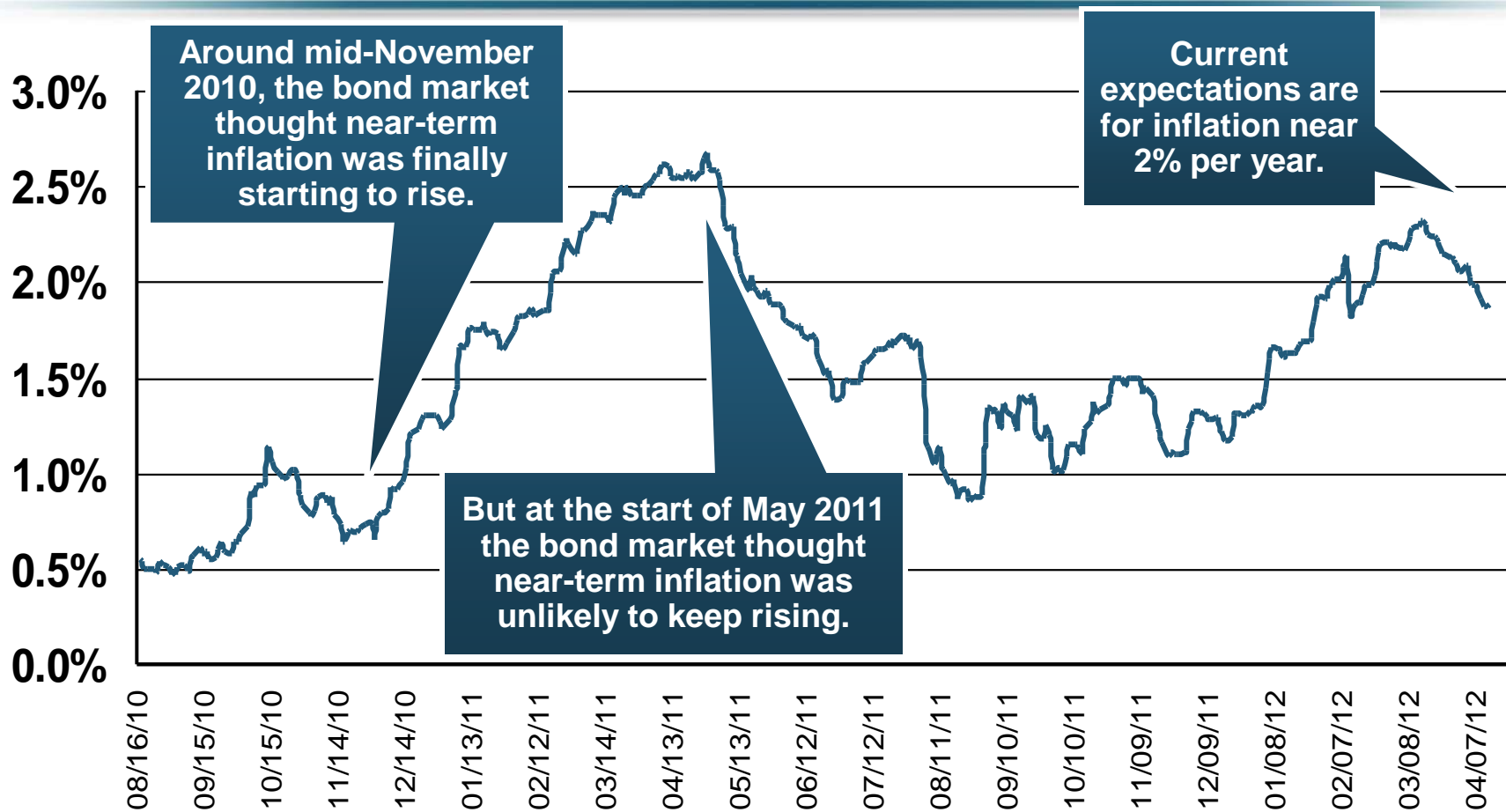
P/C Commercial Property Insurance Claim Cost Drivers Grow Faster than the Overall CPI Suggests

Price Level Change: 2011 vs. 2010



Copper prices spiked and retreated in 2011. In July its price was 33% higher than a year earlier; by November it cost 8% less than in November 2010.

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.

*through 4/13/2012

Source: <http://www.bloomberg.com/apps/quote?ticker=USGGBE02:IND>

What's a "MegaTrend?" What's a "MicroTrend?"

**Looking beyond day-to-day
developments**

***What are the implications for
Insurance and Risk Management?***

A MegaTrend is...

- Something...
 - Generally changing the way things get done
 - Happening on an enormous scale
 - Growing rapidly

Books and Websites Proclaim Various MegaTrends

Patricia Aburdene

Co-Author of the *New York Times* Bestseller MEGATRENDS 2000

Megatrends 2010

THE RISE OF
CONSCIOUS CAPITALISM

"In Megatrends 2010, Patricia Aburdene reveals with clarity seven new trends that compel business to recognize the financial power of integrity, measure the economic impact of trust, and learn the behaviors of high trust leaders. That's why I tell everyone to read Patricia's insightful book."

—Stephen R. Covey, author of *The Speed of Trust*

3 MegaTrends to Watch

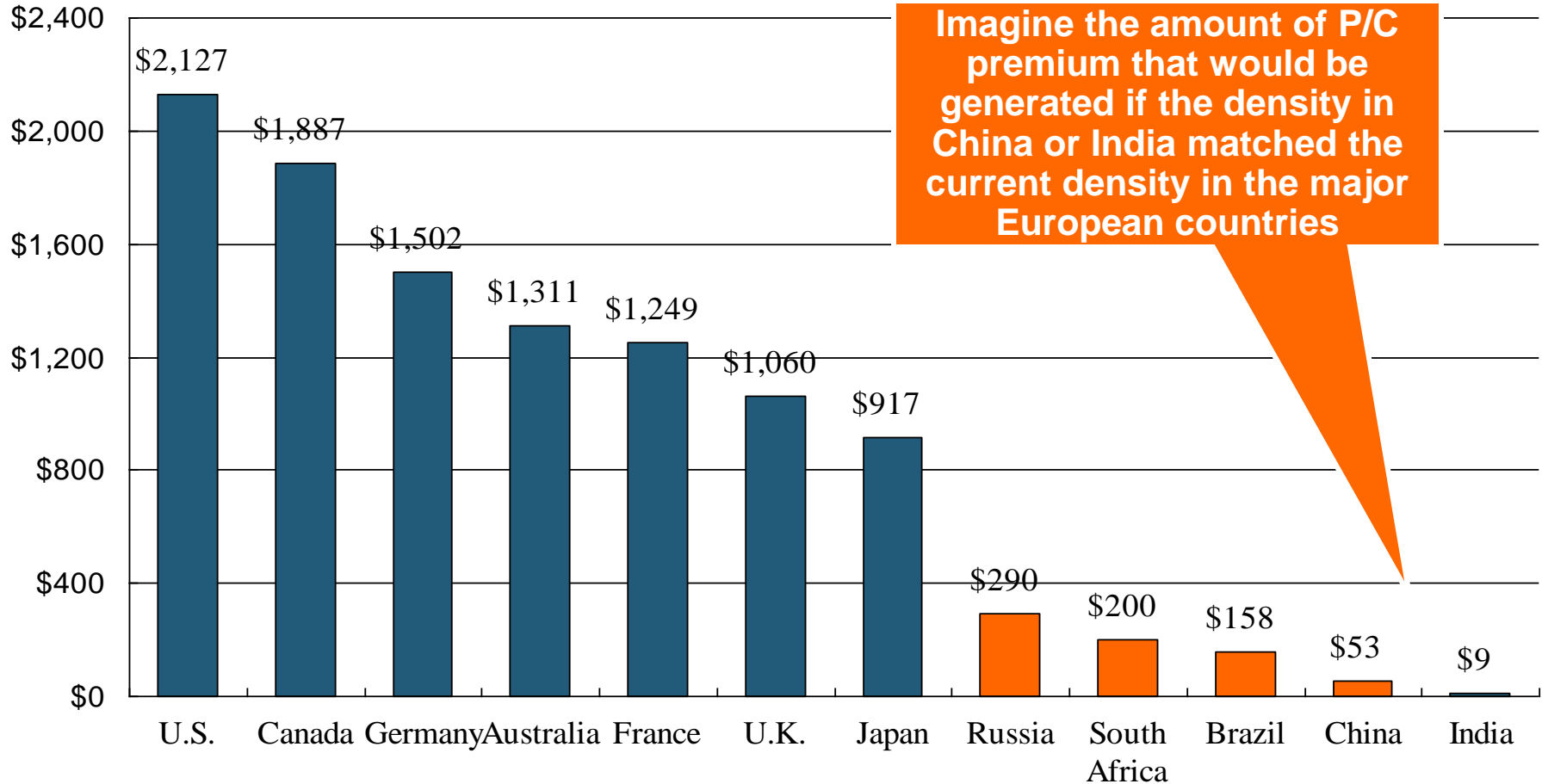
**There are many proclaimed MegaTrends.
These three come from Forbes.com**

<http://www.forbes.com/sites/haydnshaughnessy/2011/12/28/3-megatrends-for-2012-or-why-shared-value-is-indeed-an-answer/>

1. The Global Growth and Transformation of the Middle Class

- A huge market for personal insurance (possibly 1 billion people) is about to emerge in developing countries
- At the same time, the middle class in “advanced economies” is shrinking
- Selling insurance to the new global middle class will require teaching whole populations
 - what insurance is,
 - how it works, and
 - why one would choose one “brand” over another

Non-life Premium* per capita (Density) for Selected Economies, 2010



From 2002-2010, Insurance Density in India tripled, and in China it grew 5-fold. But the most spectacular Density growth in these years belongs to Russia: in 2010 Insurance Density in Russia was 7 times what it was in 2002!

2. The Growth of a More Individualistic Capitalism

Mass marketing is giving way to...

- Online services—retailers and special-interest community/peer sites—are giving customers/users more control, making the shopping/info-gathering experience more personalized
- The younger generations are leading the way to managing their lives as unique individuals, sharing with friends/peers but not strangers
- Implications for P/C insurance
 - Follow the microtrends?

3. The Rise of the New Business Ecosystem

- The new ecosystem is technology-enabled and works with potentially hundreds of sub-vendors
 - the Apple App store or iTunes
 - Amazon marketplace
- It marries small-firm innovation with large-firm financial muscle
- Implications for P/C insurance?
 - **A radically different “distribution” system?**
 - **Will Amazon.com develop a “virtual Lloyd’s”?**
 - **A radically different claims apparatus?**

An Insightful Book Published About 5 Years Ago

"Penn has a keen mind, and a fascinating sense of what makes America and the world tick, and you see it on every page." —Bill Gates

"The ideas in this book will help you see the world in a new way." —Bill Clinton



Mark J. Penn
with E. Kinney Zalesne

A MicroTrend is...

- An intense identity group, growing rapidly
- With needs and wants unmet by the current crop of companies, policymakers, and others who would influence society's behavior
- Typical size: $\pm 1\%$ of the population

7 MicroTrends to Watch

**There's More: Mark Penn's book
cites 68 other MicroTrends**

1. Sex-Ratio Singles (Single Women)

- For the first time in America, there are more single women than ever who are likely to stay that way.
- From shortly after birth, women outnumber men, and men are more likely to be homosexual than women are
 - In 2005, single women were the 2nd largest group of home buyers, just behind married couples.
 - They bought 1.5 million homes, more than twice as many as single men.
 - The number of single women bearing/adopting children in 2005 tripled since the early 1990s

2. Commuter Couples

- Dual-career couples who maintain two households
- In 1990: 1.7 million people
In 2005: 3.5 million
- All ages – the number of married people over 50 who live separately tripled between 2001 and 2005

3. 30-Winkers

- The number of people who sleep fewer than 6 hours/night is rising fast
 - 1998: 12%
 - 2005: 16% (34 million people)
- In the 2005 “Sleep in America” poll,
 - 37% said they’ve nodded off or fallen asleep while driving
- Less sleep leads to
 - Less productivity
 - Increased obesity
 - New businesses to help people get more sleep
- **Should sleep be an underwriting factor?**

4. Hard-of-Hearers

- Roughly 1/3 of people over 65 (about 35 million) are hard-of-hearing
 - But many with hearing loss are under 65
 - Hearing loss varies by race, geography, gender
- Occupational/Business Impact: Overcoming hearing loss will be a hot industry in the next few decades
 - New technology (who will lead this? Apple? Bose? Sony? Ford? New entrepreneurs?)
- Public policy/Insurance impact
 - An anti-noise campaign similar to anti-smoking?
 - **Do the hard-of-hearing cause more accidents?**

5. Old New Dads

- Births to men aged 50 or older
 - In 1980: 1 in 23
 - In 2002: 1 in 18
- Births to men age 40-44: up 32%
- Births to men age 45-49: up 21%

- Old dads will likely
 - Work longer
 - Retire later
 - **Drive at older ages**

6. Newly Released Ex-Cons

- 650,000 people (90% men, avg. age 34) released from prison or jail **each year**
- These people generally have little connection with economic society:
 - Little education
 - Few job prospects
 - Many employers won't hire them
- Likely results:
 - Increasing crime
 - Worsening public cost of family support “financial safety net”
- **Are these people insurable in the voluntary market?**

7. High School Moguls

- A dozen years ago 8% of all teens (1.6 million) were making money on the internet
- The top 100 entrepreneurs aged 8-18 in 2001 earned total profits of \$7 million
- In 2006 the U.S. Small Business Administration launched “Mind Your Own Business,” an online resource to help teenagers develop their start-ups
- **How much do teen business owners know about insurance? How well are we reaching them?**

Insurance Information Institute Online:

www.iii.org

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

Insurance “Penetration” and “Density”

**Beyond Exposure Growth,
Insurers Need
Increased Use of Insurance**

Definitions: Measures of Insurance Usage

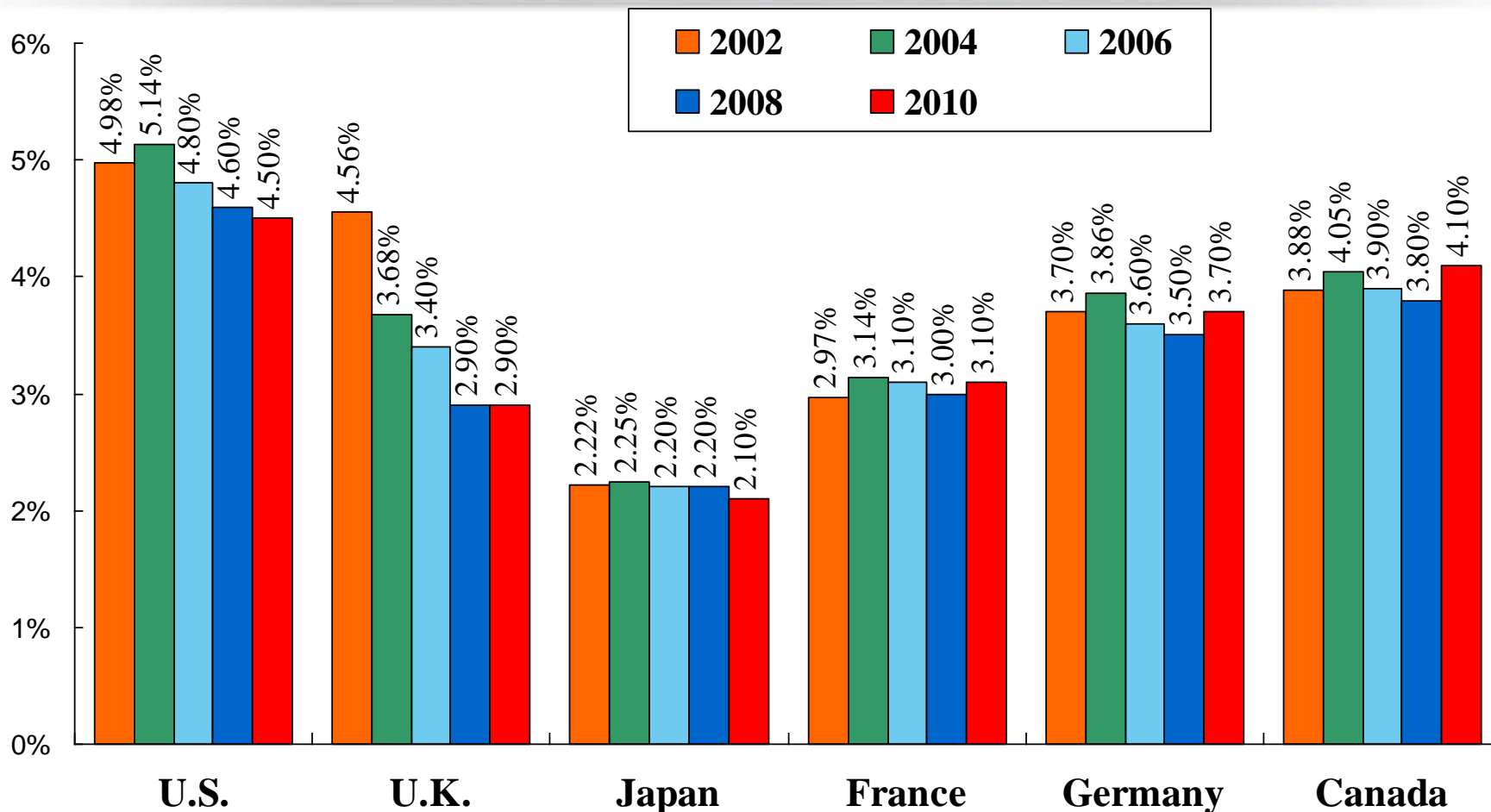
■ “Penetration”

- ◆ The ratio of premium to GDP
- ◆ Indicates the degree to which premium growth kept up with exposure growth (as proxied by GDP)

■ “Density”

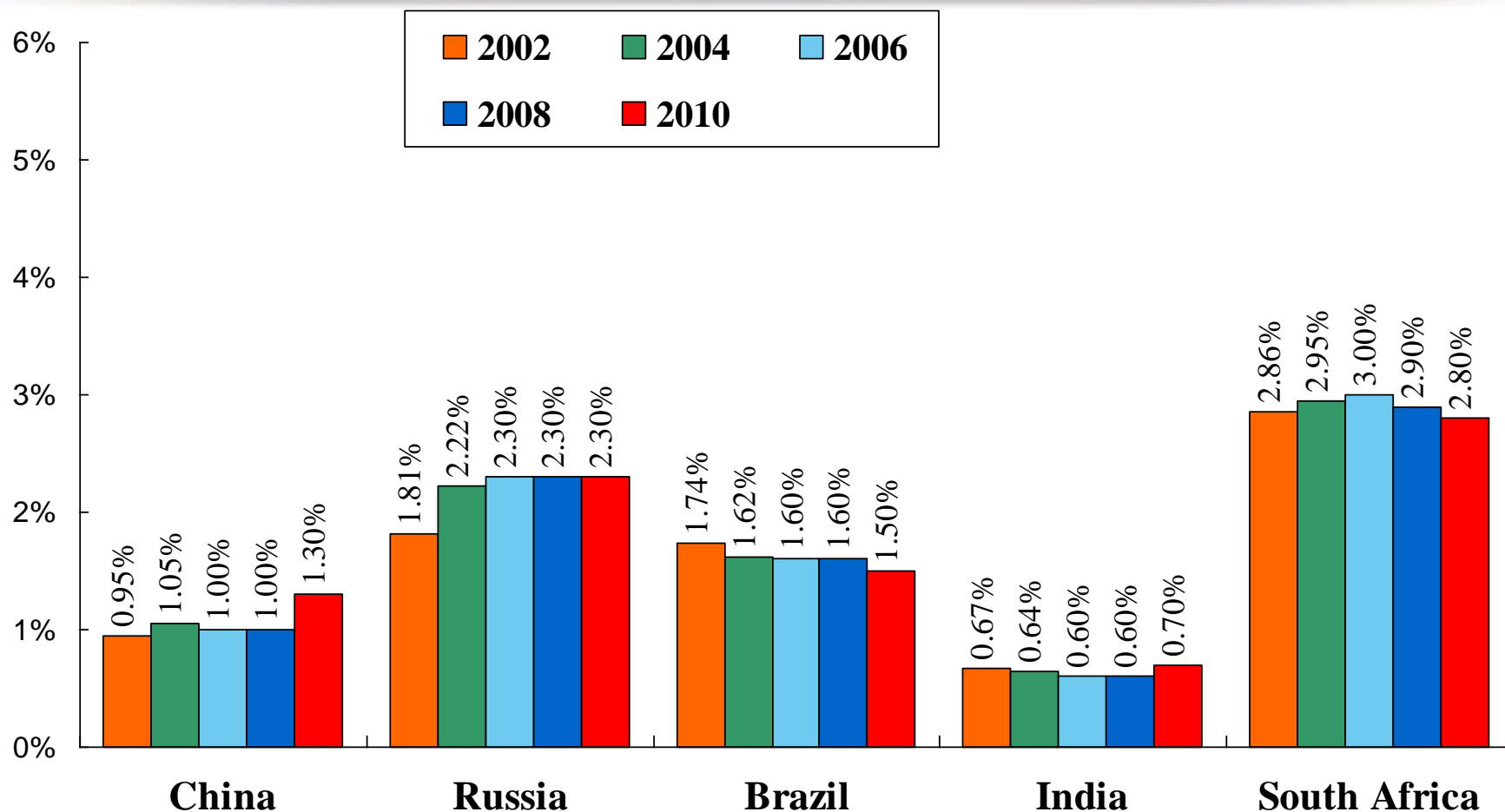
- ◆ The ratio of premium to total population
- ◆ Indicates the breadth of use of insurance

Non-life Premium/GDP* (Penetration) for Advanced Economies, 2002-2010



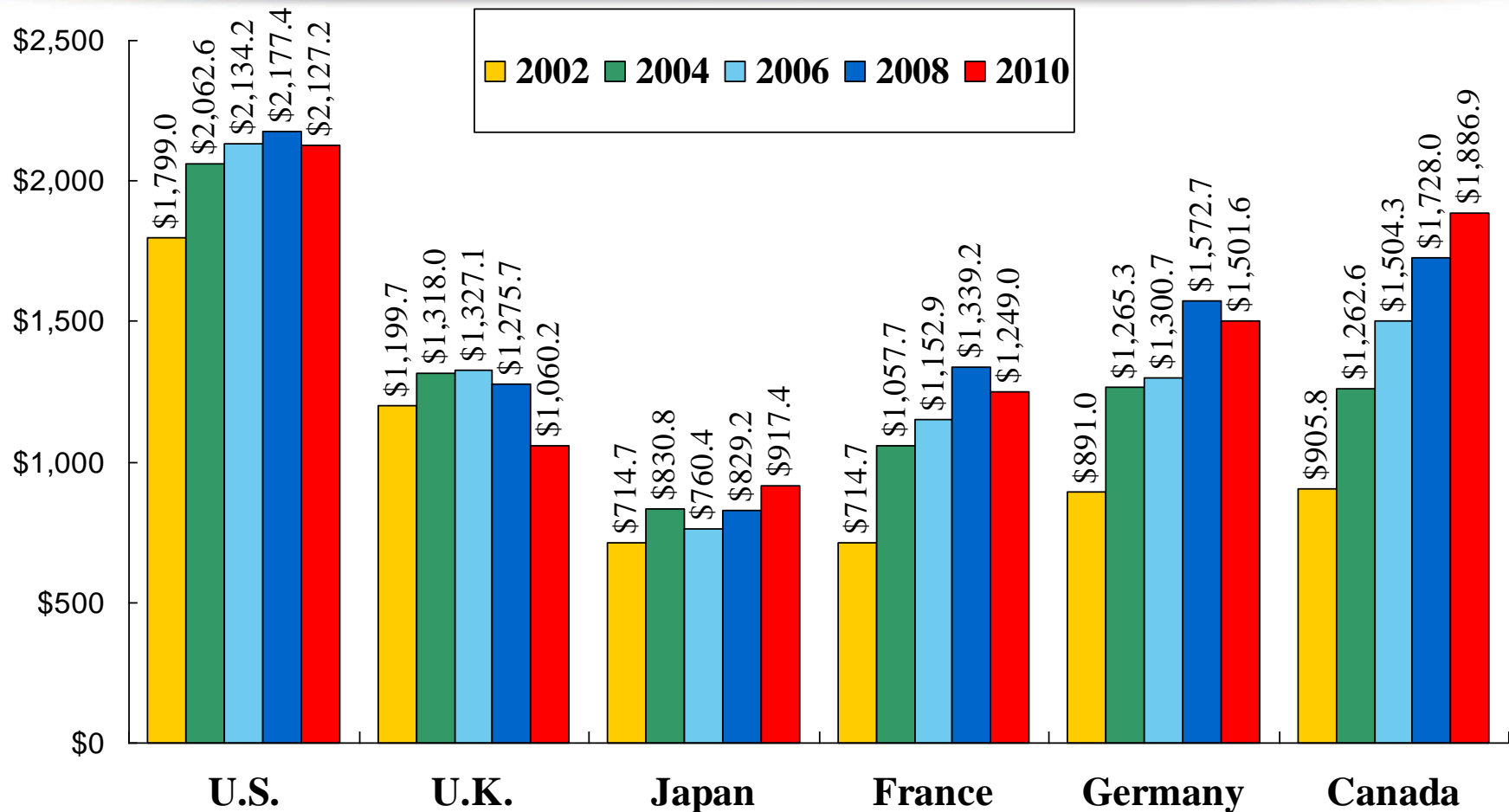
A flat pattern indicates that premiums are changing to the same extent as exposures (as proxied by GDP). A downward trend means premium volume isn't keeping up with economic growth.

Non-life Premium/GDP* (Penetration) for Emerging Economies, 2002-2010



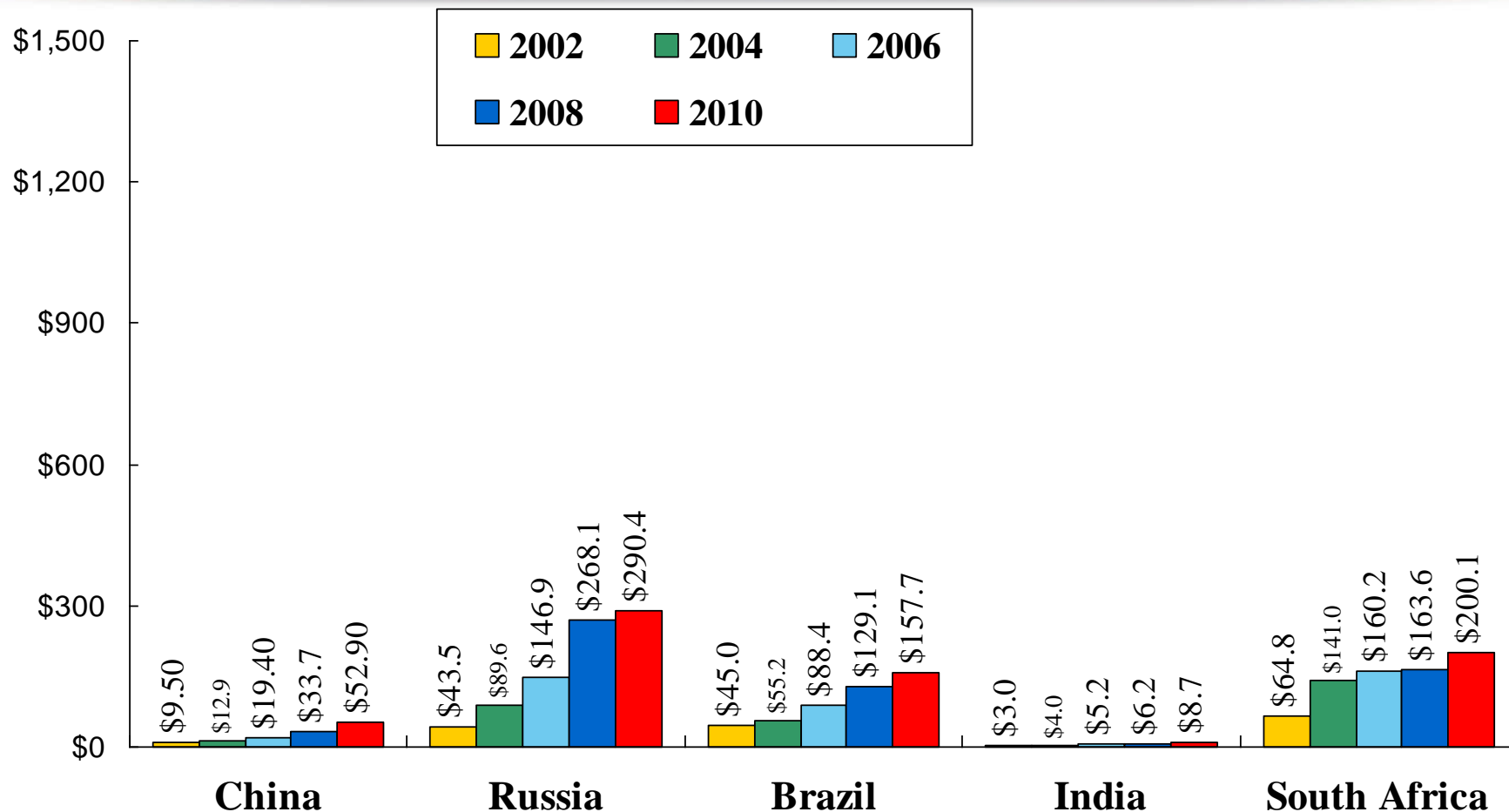
From 2001-2009, Penetration in China and Russia grew steadily—an especially strong showing in light of the rapid growth in GDP (denominator in the Penetration ratio). Similarly, although the Penetration ratios in Brazil and India were essentially flat, that means premium growth basically kept pace with exposure growth.

Non-life Premium* per capita (Density) for Advanced Economies, 2002-2010



From 2002-2010, Insurance Density grew in most advanced economies, retreating only slightly during the global recession. In Canada, premium density doubled from 2002-2010.

Non-life Premium* per capita (Density) for Emerging Economies, 2002-2010



From 2002-2010, Insurance Density in India tripled, and in China it grew 5-fold. But the most spectacular Density growth in these years belongs to Russia: in 2010 Insurance Density in Russia was 7 times what it was in 2002!