# Global Economic Growth, P/C Exposure Trends, Employment and Low Interest Rates:
## *P/C Insurance Markets in a Challenging World*

**Insurance Information Institute**

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# Presentation Outline

- **U.S. and Global Economic Overview and Outlook**
  - Economy as a Growth Engine for P/C (Re)Insurers
  - Exposure Analysis
  - Geopolitical Instability: An Economic Threat
  - Labor Market Review
- **Investment Income: The New Reality of Persistently Low Yields**
  - Have Insurers Adapted to the New Reality?
  - Quantification of Impact
- **Workers Compensation**
  - Underwriting Challenges
  - Low Yield Impacts on a Long-Tail Line
- **Q&A**

# Economics 2012: The World Is Changing

## 2012 Is the First Year Since 2005 Where Economic Perceptions and Reality in the US Will Be Positive

***Potentially Enormous Benefits for P/C Insurers***

# Global Economic Outlook for 2012-2013

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- **Economic Growth Will Accelerate Modestly in 2012/13, Beating Expectations**
  - No Double Dip Recession
  - Economy remains more resilient than most pundits presume
- **Consumer Confidence Will Continue to Improve**
- **Consumer Spending/Investment Will Continue to Expand**
- **Consumer and Business Lending Continue to Expand**
- **Housing Market Remains Weak, but Some Improvement Expected in 2012**
- **Inflation Remains Tame**
  - Runaway inflation highly unlikely but energy spike possible; Fed has things under control
- **Private Sector Hiring Remains Consistently Positive, Exceeds Expectations**
  - Unemployment dips below 8% by Q3 2012
- **Sovereign Debt, Euro Currency/Economy, Muni Bond "Crises" Manageable**
- **European Recession is Milder than Commonly Presumed**
- **Soft Landing in China**
- ***Higher Oil Prices and Current Middle East Turmoil Pose Greater Risk to US Economy than in 2011: Threat of Israeli Attack on Iran Is High in 2012***
- **Interest Rates Remain Low by Historical Standards; Edge Up by Year's End**
- **Stock and Bond Markets More Stable, Less Volatile**
- **Political Environment Is More Hospitable to Business Interests**
- **Obama Gains Re-Election Edge from Improving Economy**

# Insurance Industry Predictions for 2012

- **P/C Insurance Exposures Grow Robustly**
  - Personal and commercial exposure growth is certain in 2012; Strongest since 2004
  - But restoration of destroyed exposure will take until mid-decade
- **P/C Industry Growth in 2012 Will Be Strongest Since 2004**
  - Growth likely to exceed A.M. Best projection of +3.8% for 2012
  - No traditional "hard market" emerges in 2012
- **Underwriting Fundamentals Deteriorate Modestly**
  - Some pressure from claim frequency, severity in some key lines
- **Increasing Private Sector Hiring Will Drive Payrolls/WC Exposures**
  - Wage growth is also positive and could modestly accelerate
  - WC will prove to be tough to fix from an underwriting perspective
- **Increase in Demand for Commercial Insurance Will Accelerate in 2012**
  - Includes workers comp, property, marine, many liability coverages & industries like energy, ag
  - Laggards: surety, construction business
  - Personal Lines: Auto leads, homeowners lags *(though HO leads in NPW growth due to rates)*
- **Investment Environment Is/Remains Much More Favorable**
  - Return of realized capital gains as a profit driver
  - Interest rates remain low; Some upward pressure if economic strength surprises
- **Industry Capacity Hits a New Record by Year-End 2012 (Barring Mega-CAT) or Significant Market Turmoil**

# Economic Outlook: US and Global Perspectives

## Strength of Economies Around the World Will Influence P/C Insurer and Reinsurer Growth Opportunities

# US Real GDP Growth*

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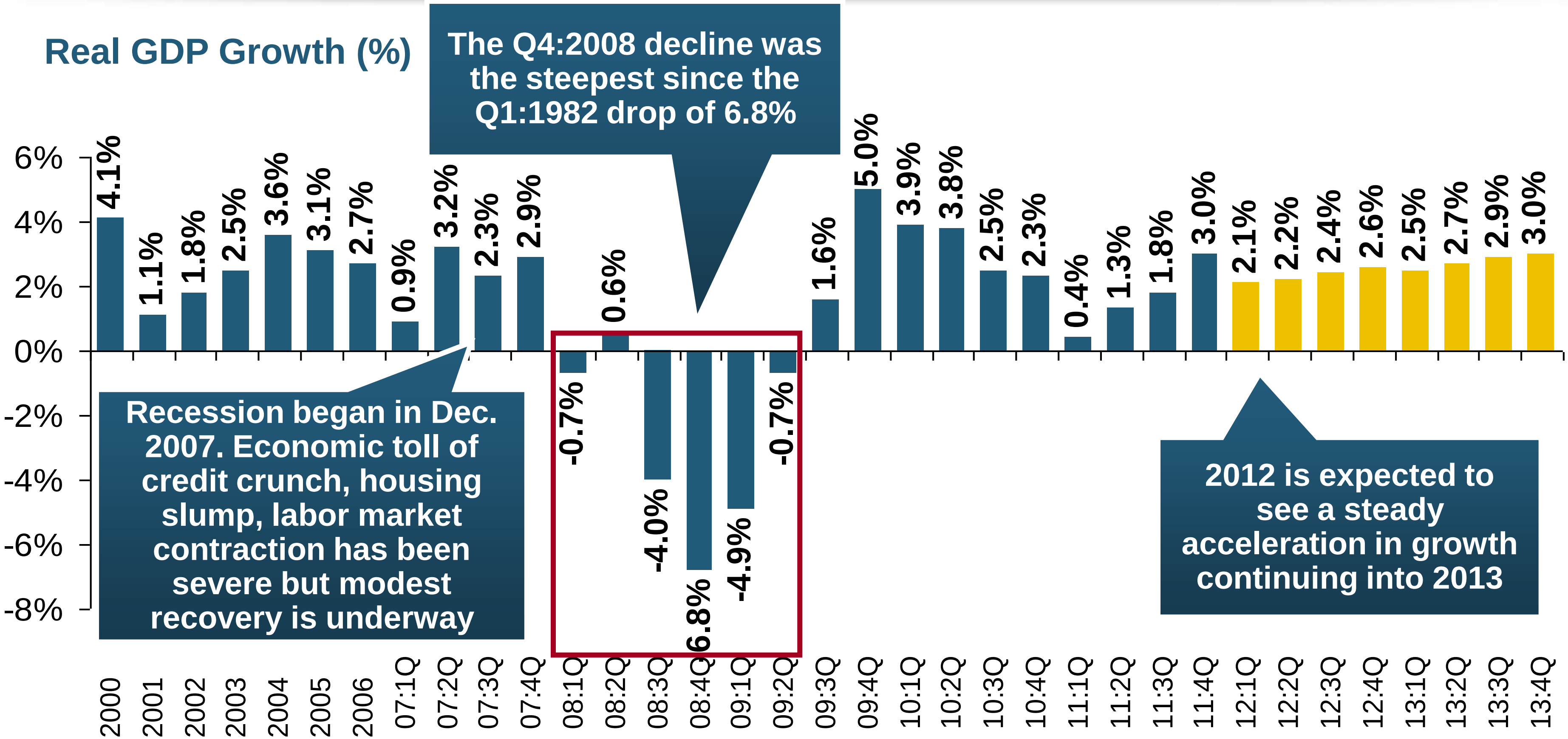
Real GDP Growth (%)




**Demand for Insurance Continues To Be Impacted by Sluggish Economic Conditions, but the Benefits of Even Slow Growth Will Compound and Gradually Benefit the Economy Broadly**

* Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 2/12; Insurance Information Institute.

# Real GDP Growth Forecasts: US and Major Trading Economies: 2011 – 2012F

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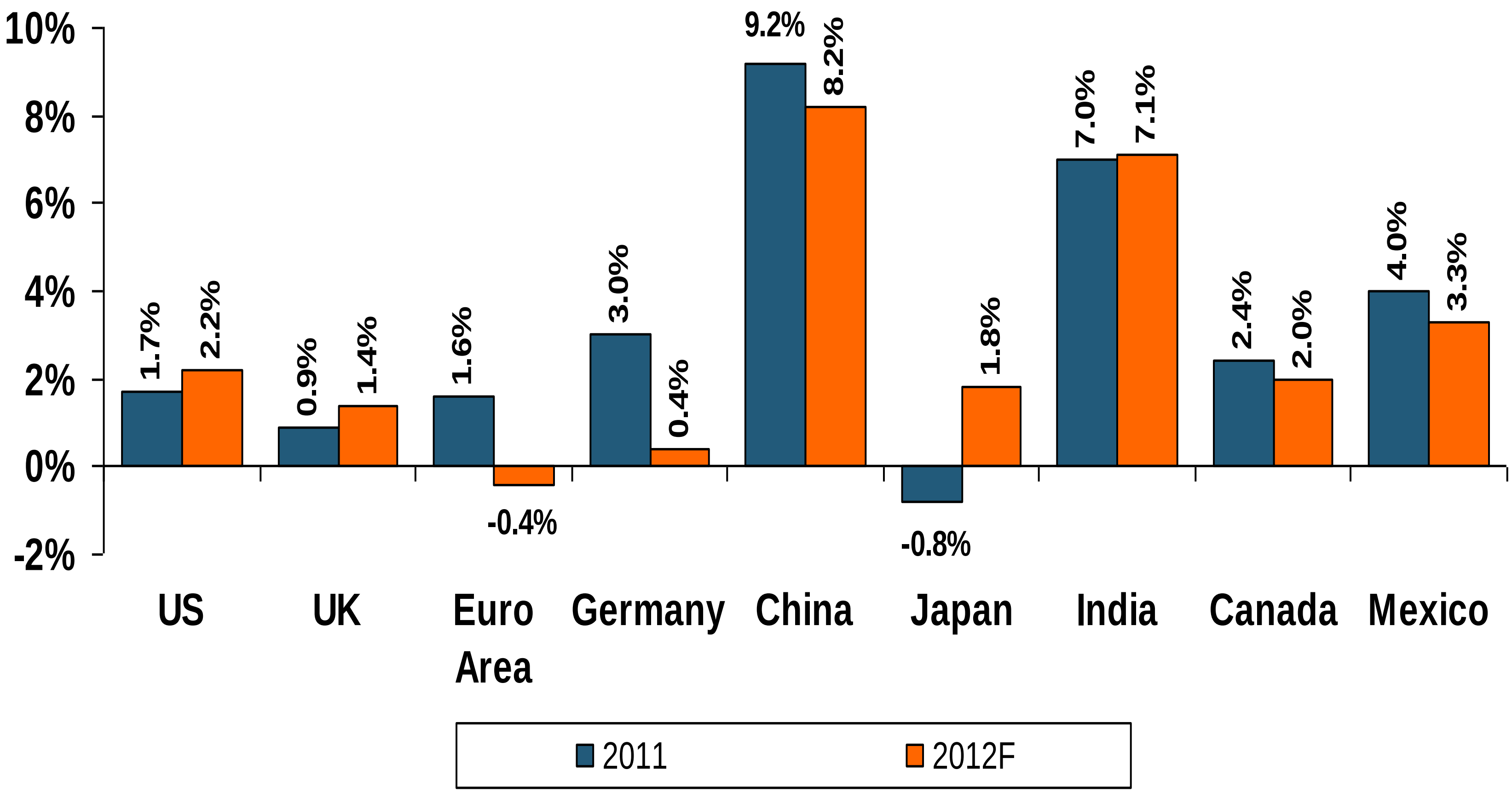
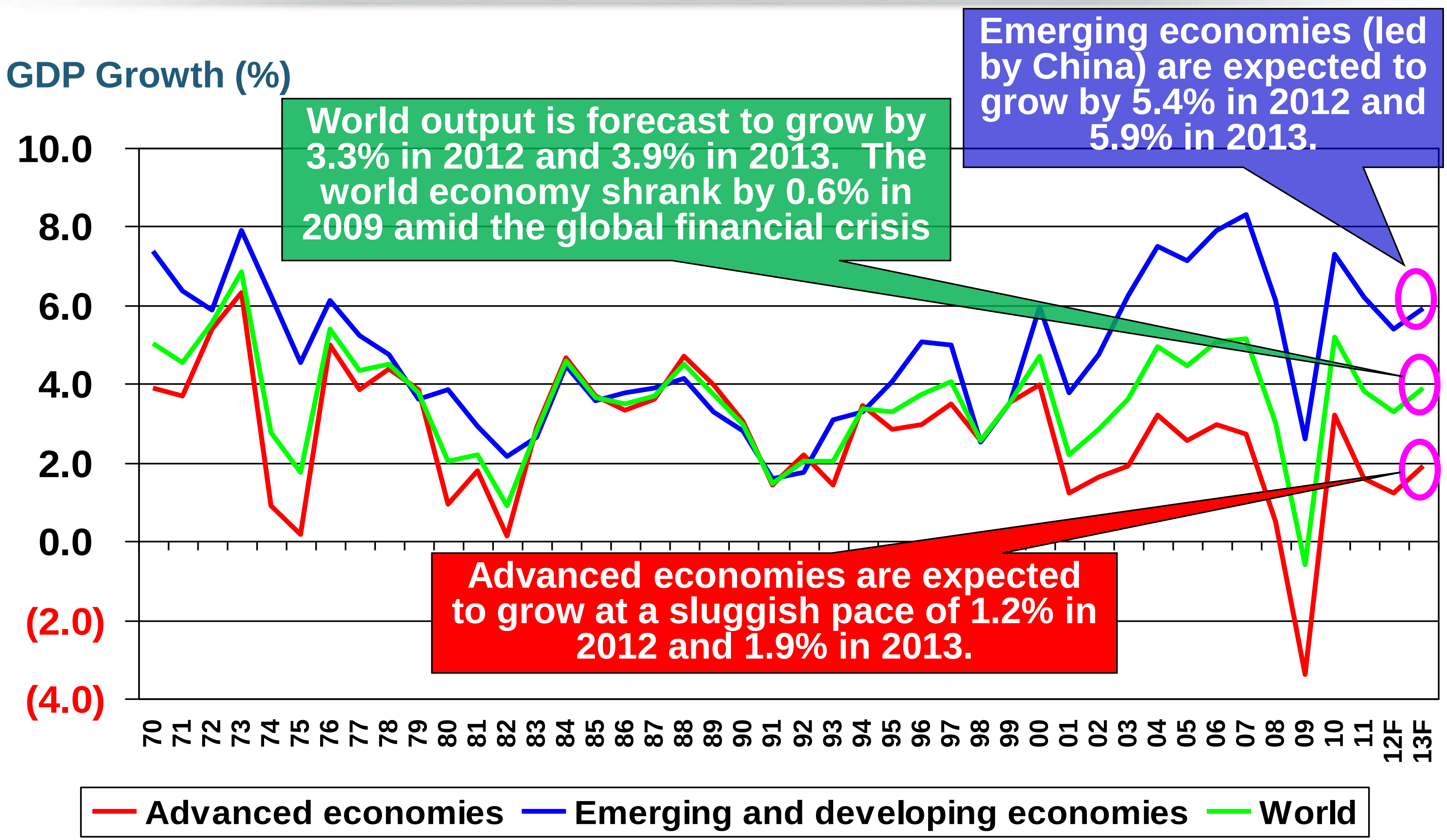



**Growth Prospects Vary Widely by Region: Brightening in the US, Mild Recession in the Eurozone, A "Soft Landing" in China, Strength in India, Reconstruction Stimulus in Japan and Modest Growth in America's Largest Trading Partners—Canada and Mexico.**

Sources: Blue Chip Economic Indicators (2/2012 issue); Insurance Information Institute.

# GDP Growth: Advanced & Emerging Economies vs. World, 1970-2013F




Source: International Monetary Fund, *World Economic Outlook Update*, Jan. 2012; Ins. Info. Institute.

# Global Real (Inflation Adjusted) Nonlife Premium Growth: 1980-2010

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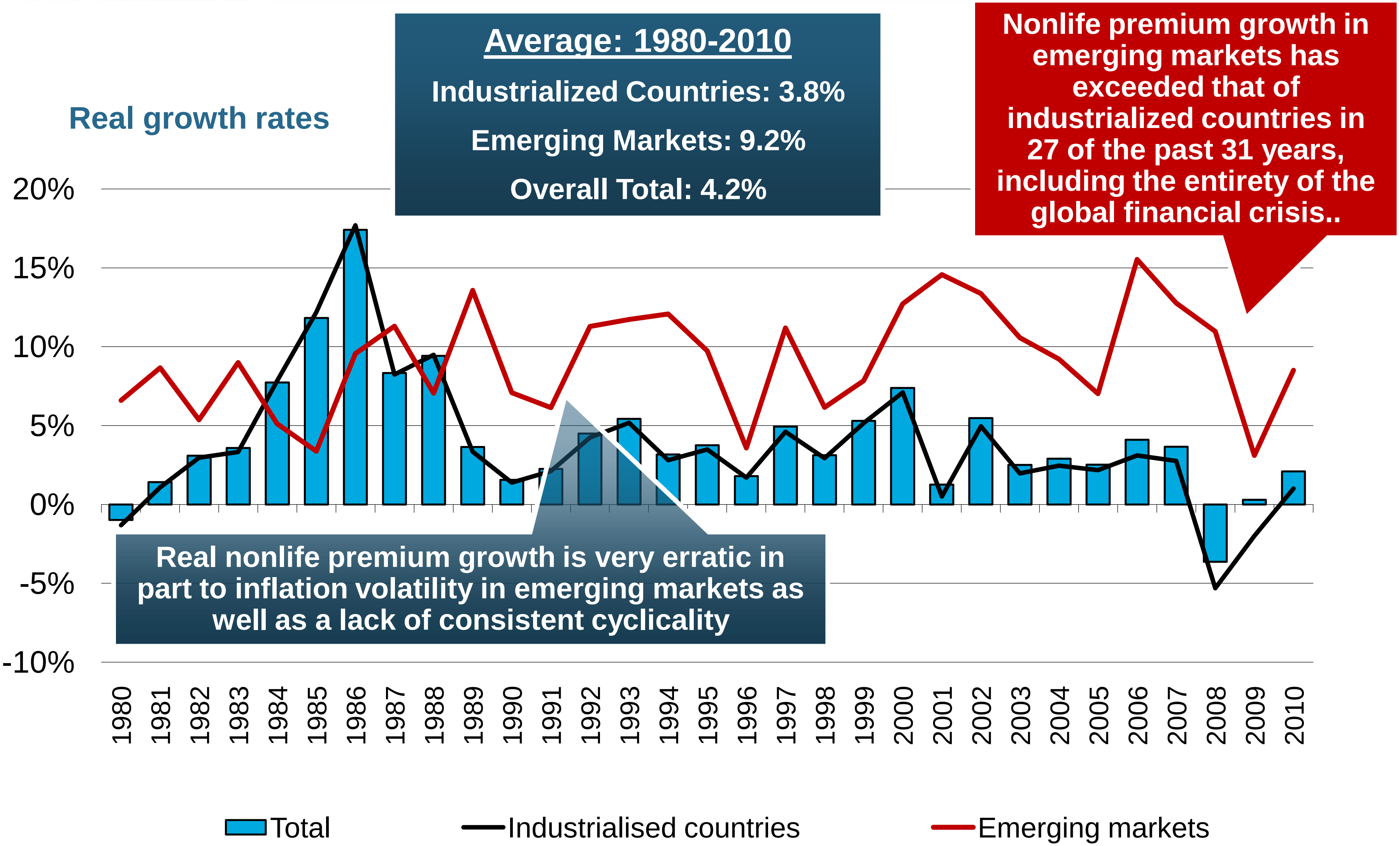
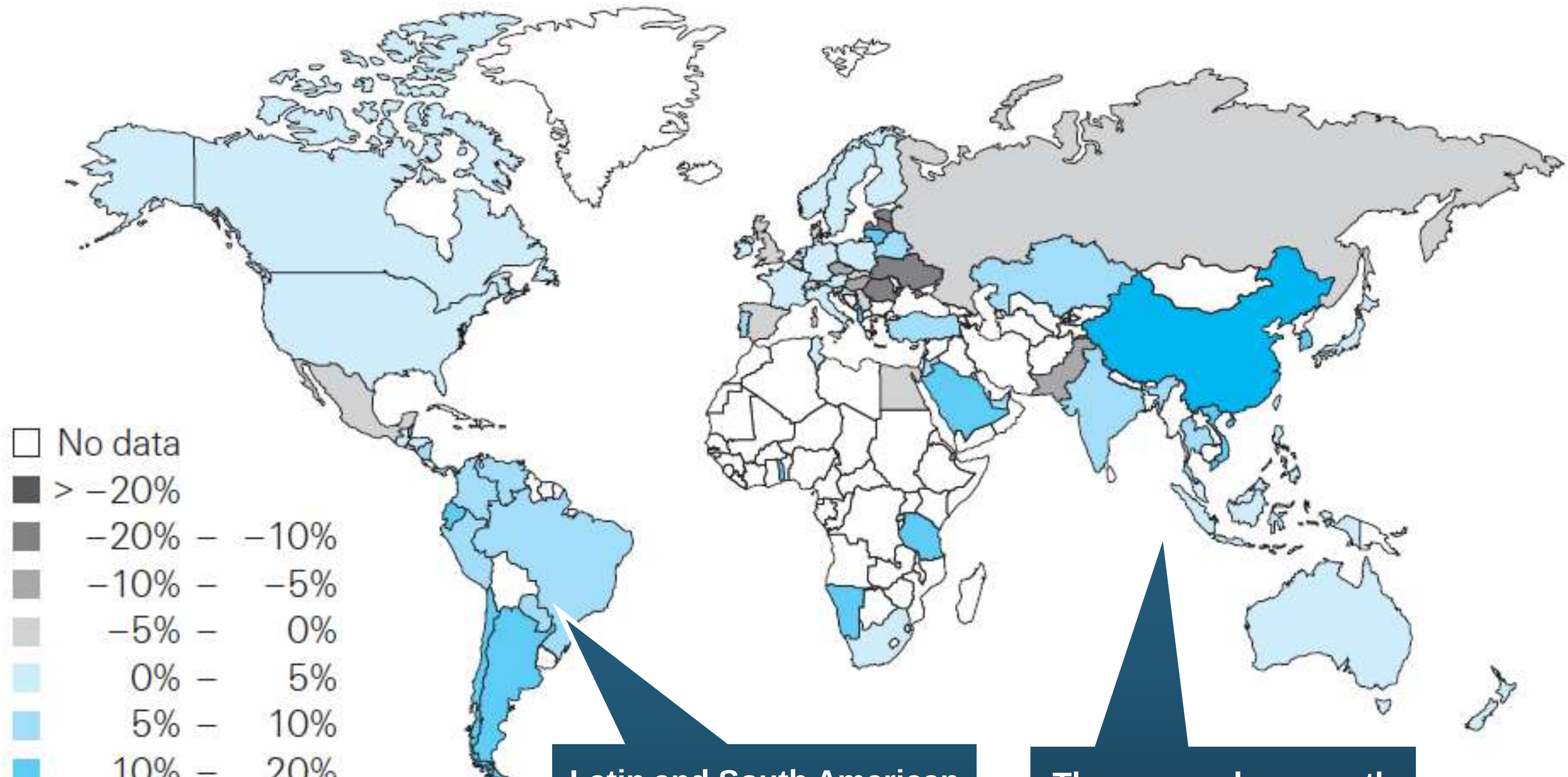



Source: Swiss Re, *sigma*, No. 2/2011.

# Nonlife Real Premium Growth in 2010




Latin and South American markets performed relatively well during and after the global financial crisis in terms of growth

There was also growth in the Middle East, East and South Asia as well as Australia and New Zealand

Source: Swiss Re, *sigma*, No. 2/2011.

# Political Risk in 2011: Greatest Business Opportunities Are Often in Risky Nations

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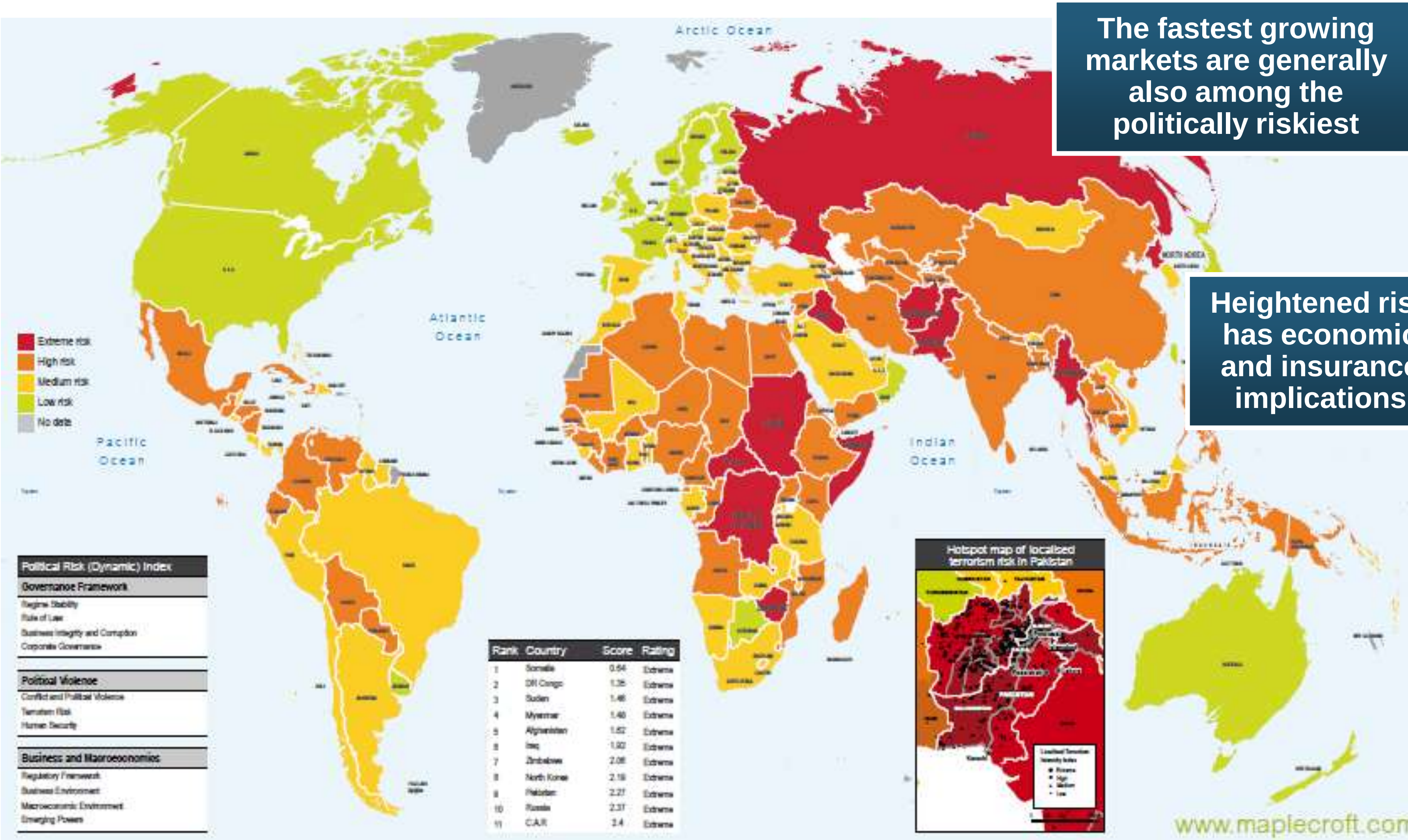
**The fastest growing markets are generally also among the politically riskiest**

**Heightened risk has economic and insurance implications**




Source: Maplecroft

# Consumer Sentiment Survey *(1966 = 100)*

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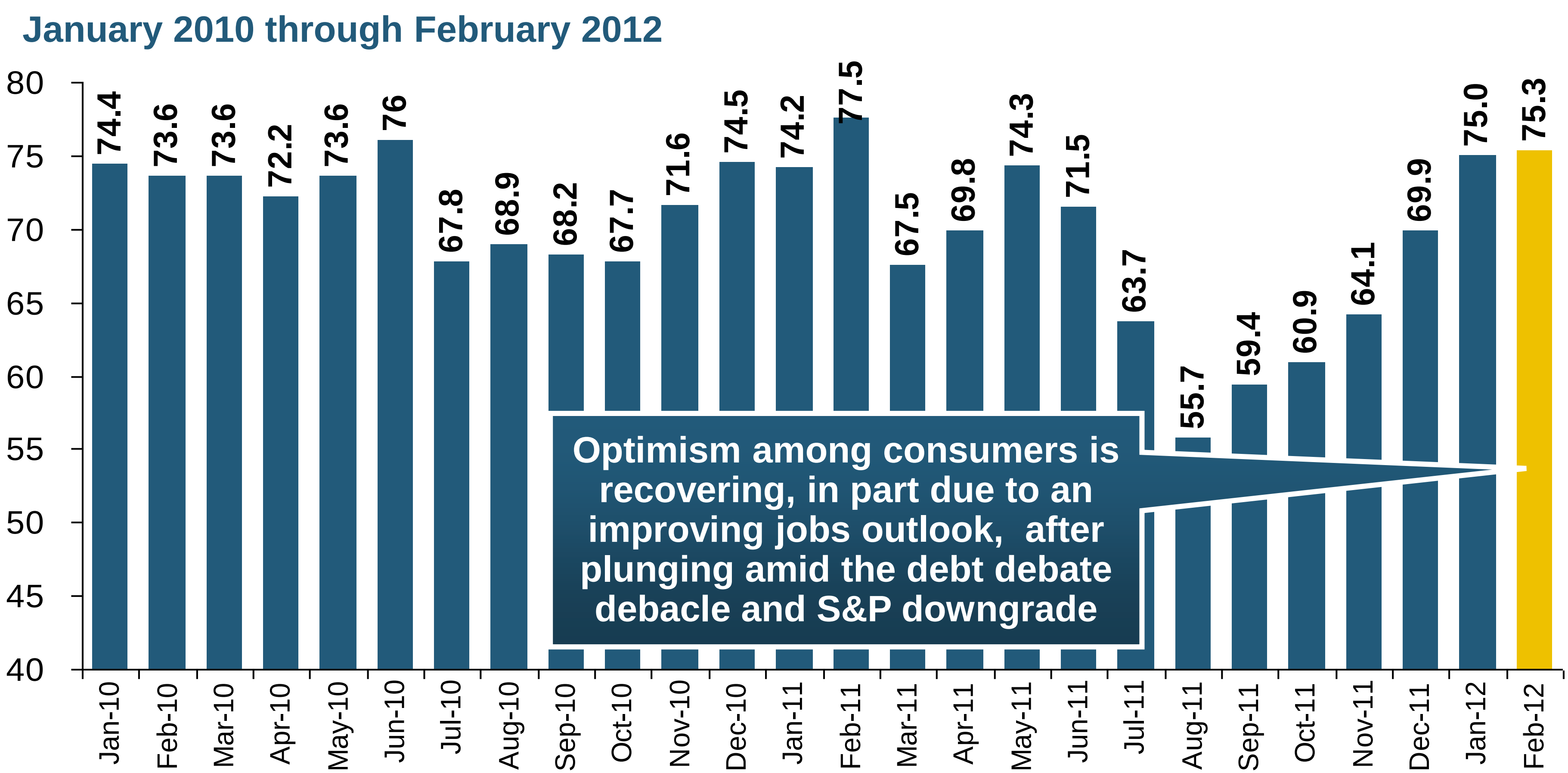


**Consumer confidence has been low for years amid high unemployment, falling home prices and other factors adversely impact consumers, but improved substantially in late 2011 and early 2012**

Source: University of Michigan; Insurance Information Institute

# Auto/Light Truck Sales, 1999-2022F

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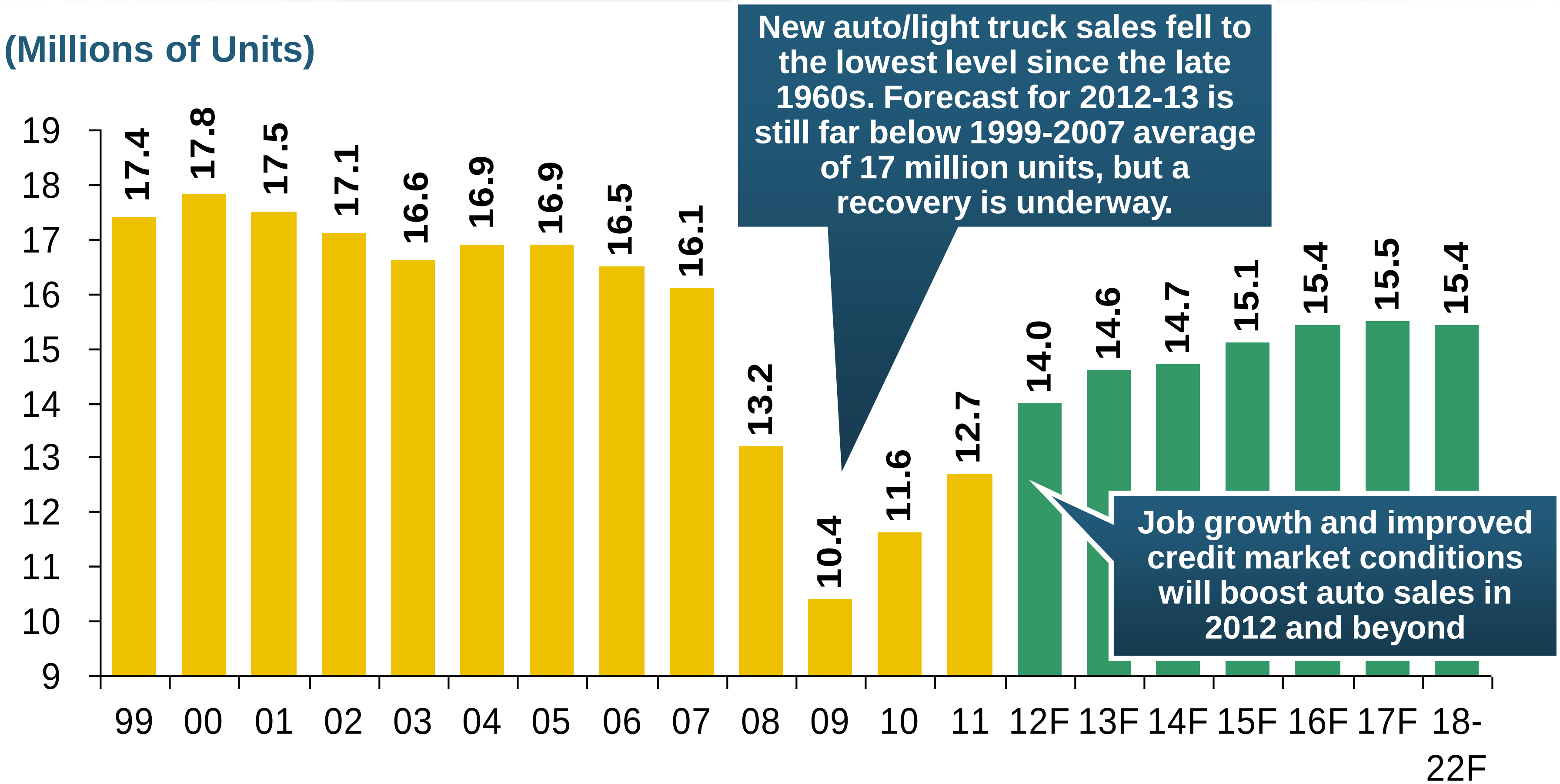


**Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, Bolstering the Auto Insurer Growth and the Manufacturing Sector.**

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (10/11 and 2/12); Insurance Information Institute.

# New Private Housing Starts, 1990-2022F

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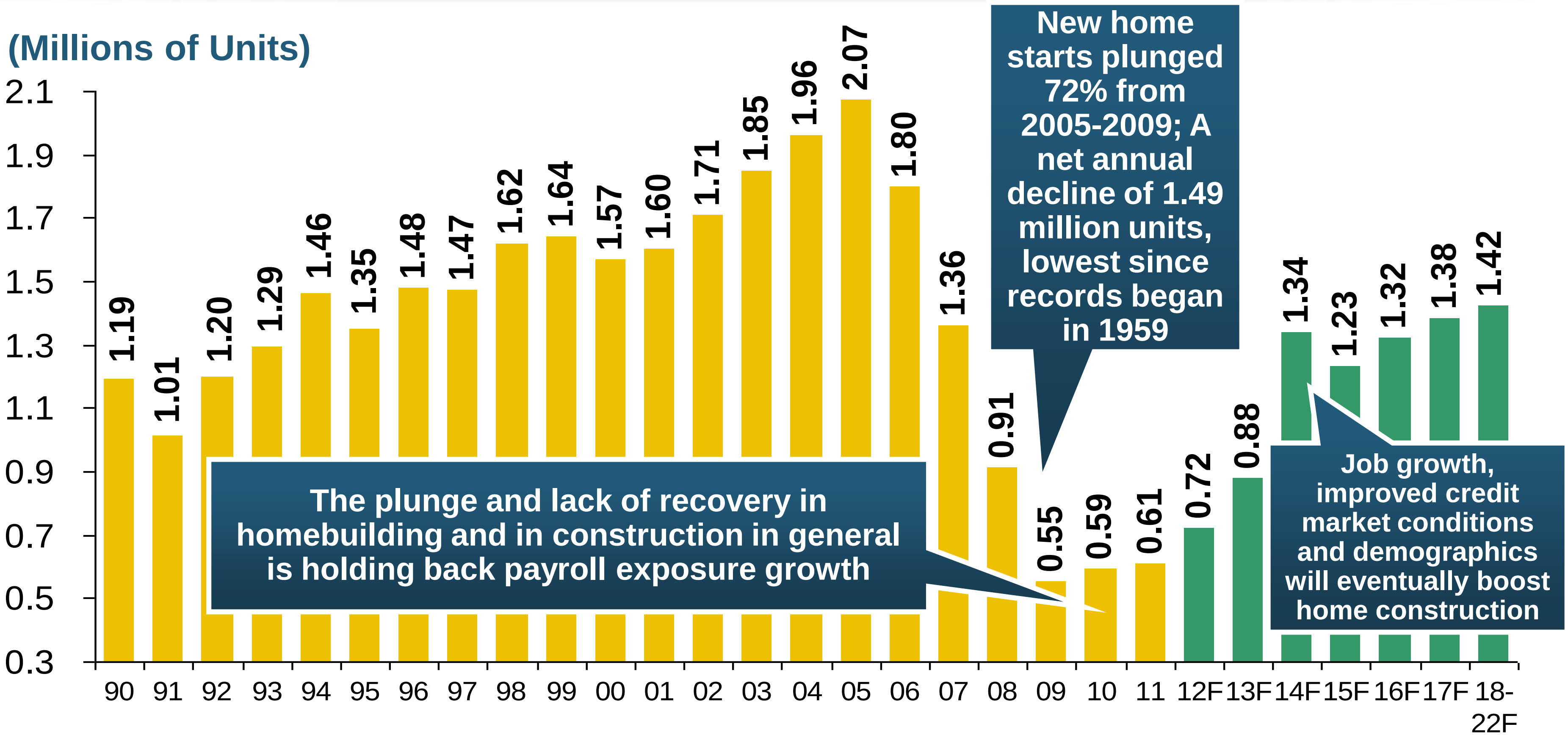


**Little Exposure Growth Likely for Homeowners Insurers Until at least 2014. Also Affects Commercial Insurers with Construction Risk Exposure, Surety**

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (10/11 and 2/12); Insurance Information Institute.

# ISM Manufacturing Index
# *(Values > 50 Indicate Expansion)*

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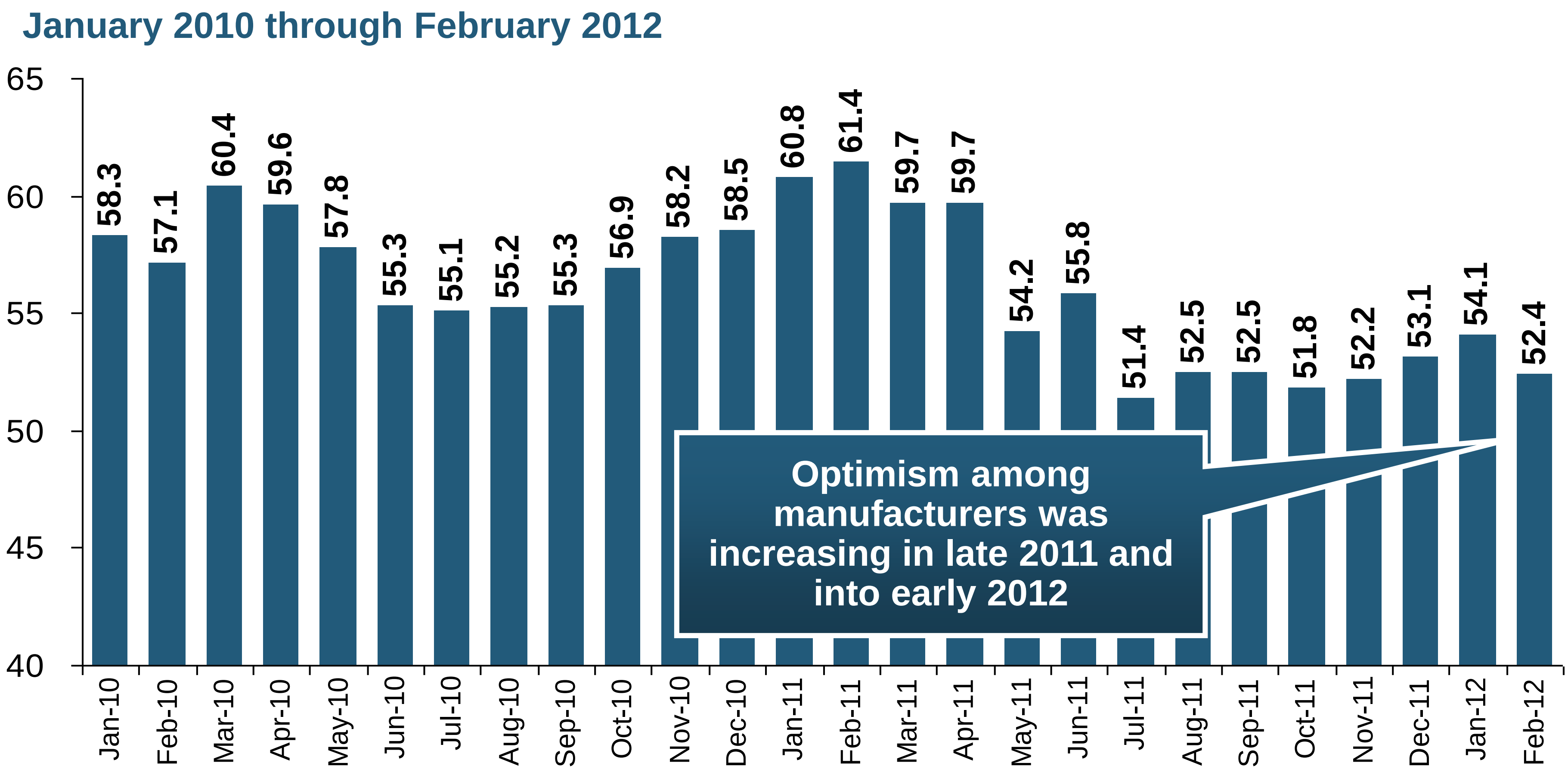


**The manufacturing sector has been expanding and adding jobs. The question is whether this will continue.**

Source: Institute for Supply Management at http://www.ism.ws/ismreport/mfgrob.cfm; Insurance Information Institute.

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

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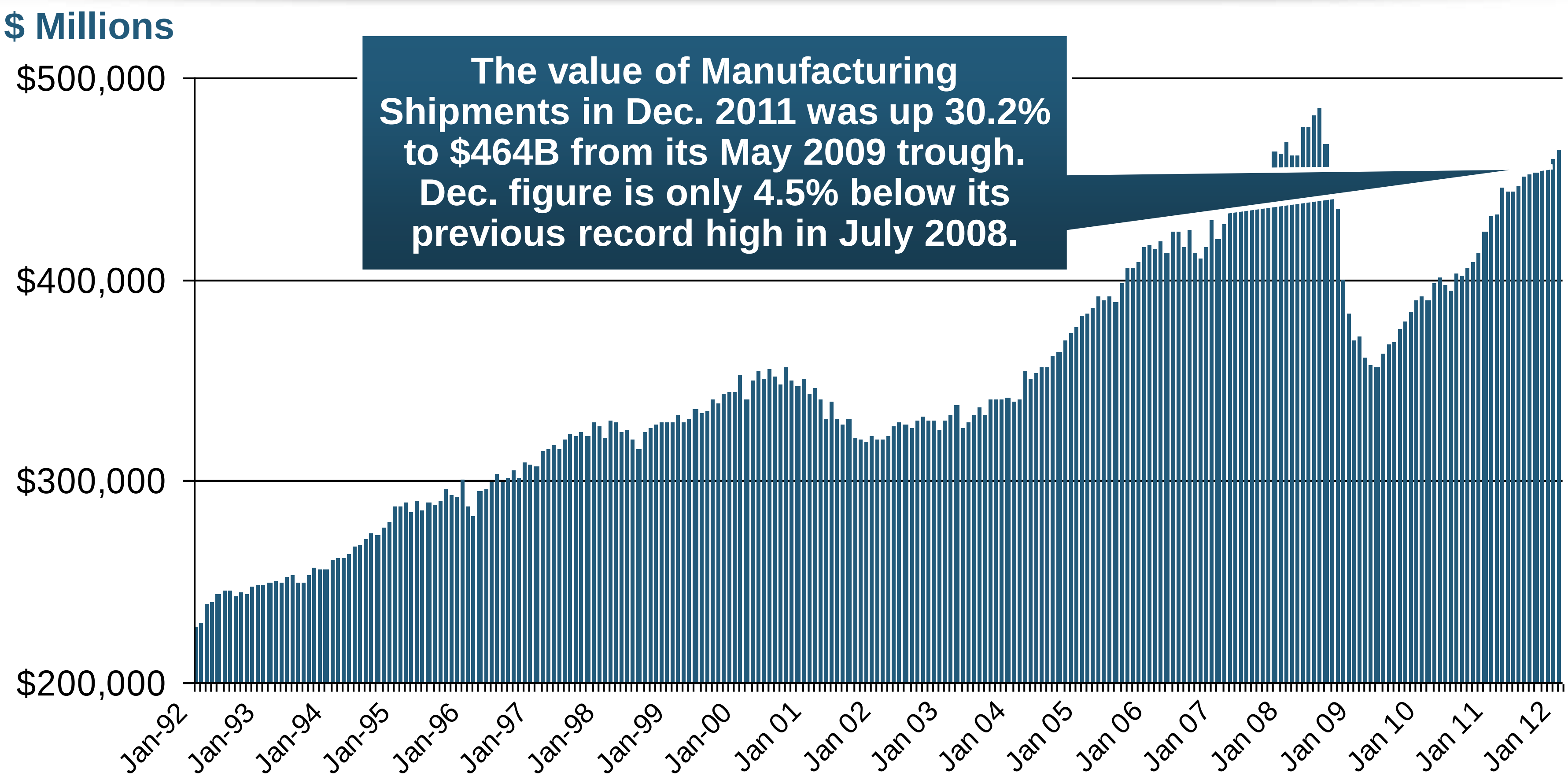
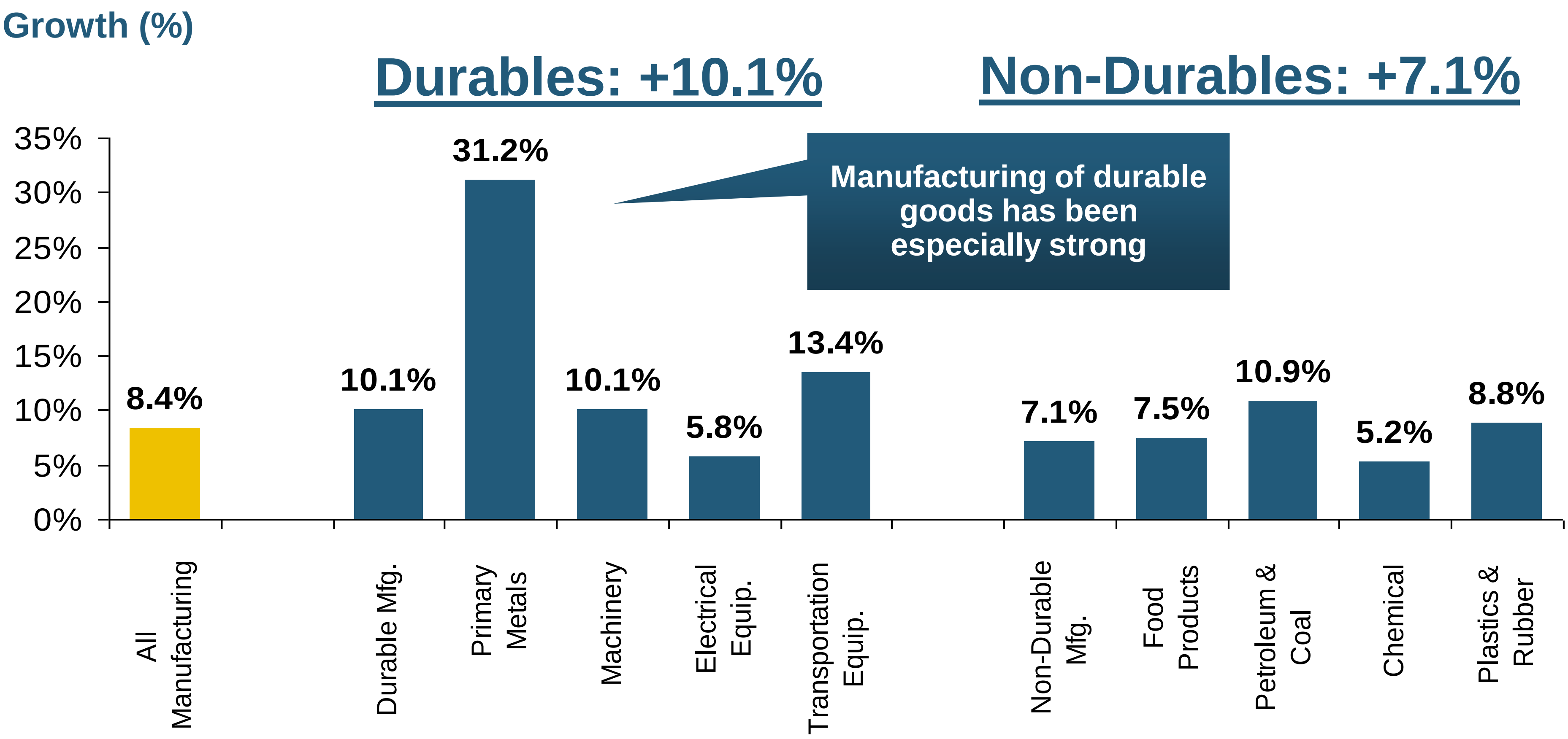



**Monthly shipments are nearly back to peak (in July 2008, 8 months into the recession). Trough in May 2009. Growth from trough to December 2011 was 30.2%. This growth leads to gains in many commercial exposures: WC, Commercial Auto, Property and Various Liability Coverages**

*seasonally adjusted

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

# Manufacturing Growth for Selected Sectors, Jan. 2012 vs. Jan. 2011




**Manufacturing Is Expanding Across a Wide Range of Sectors that Will Contribute to Growth in Insurable Exposures Including: WC, Commercial Property, Commercial Auto and Many Liability Coverages**

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

# Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

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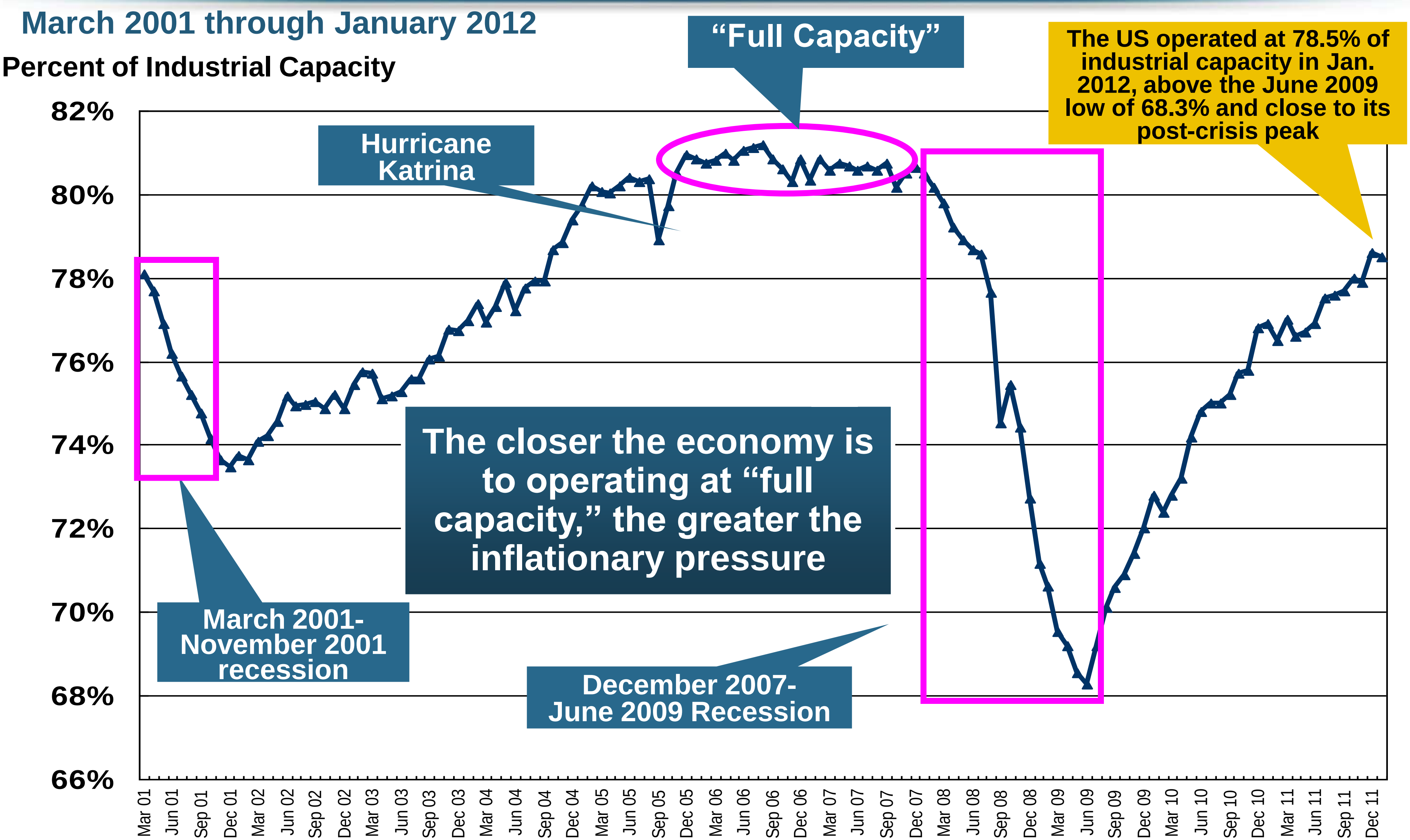


Source: Federal Reserve Board statistical releases at http://www.federalreserve.gov/releases/g17/Current/default.htm.

# ISM Non-Manufacturing Index
# *(Values > 50 Indicate Expansion)*

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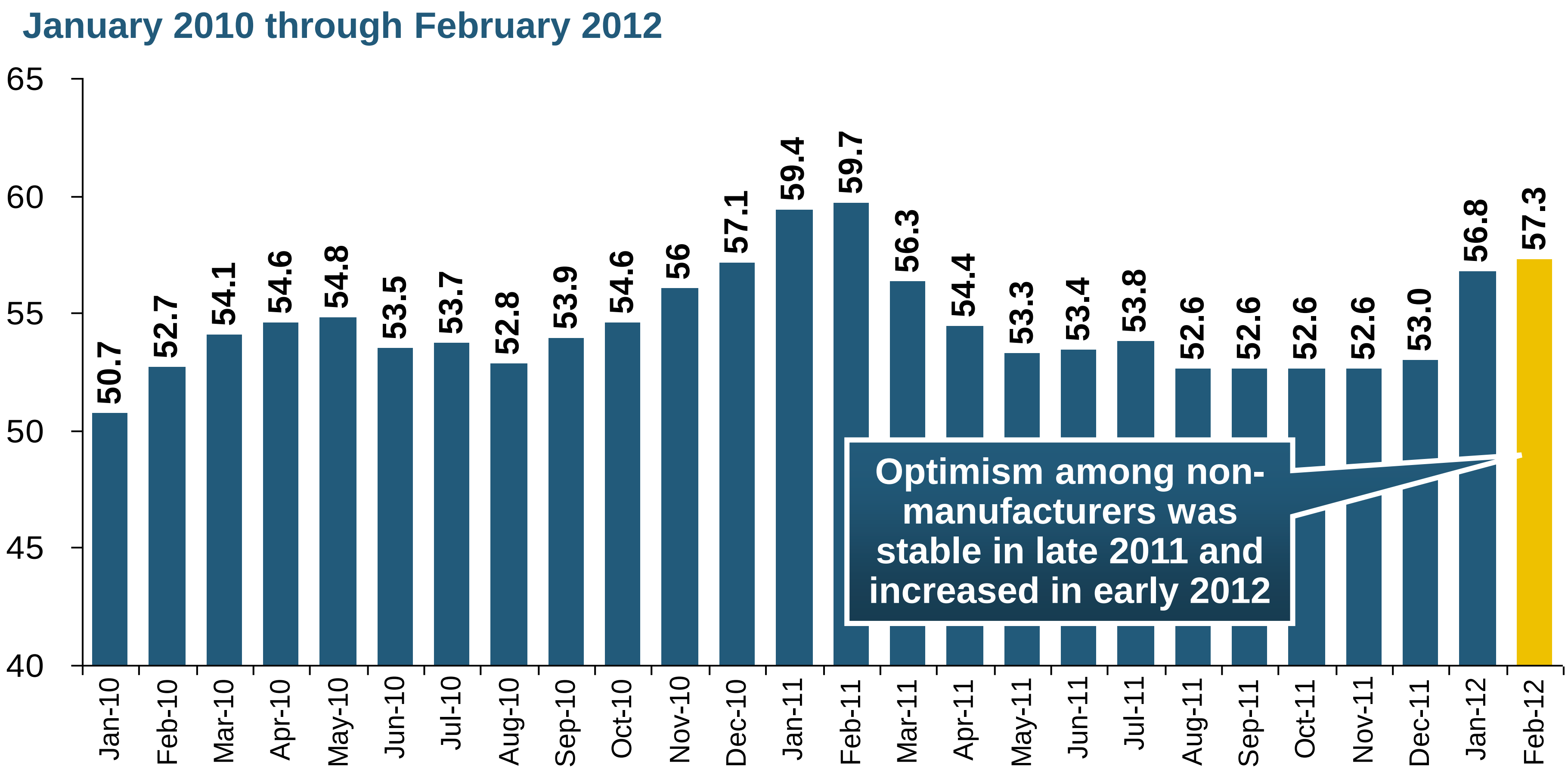
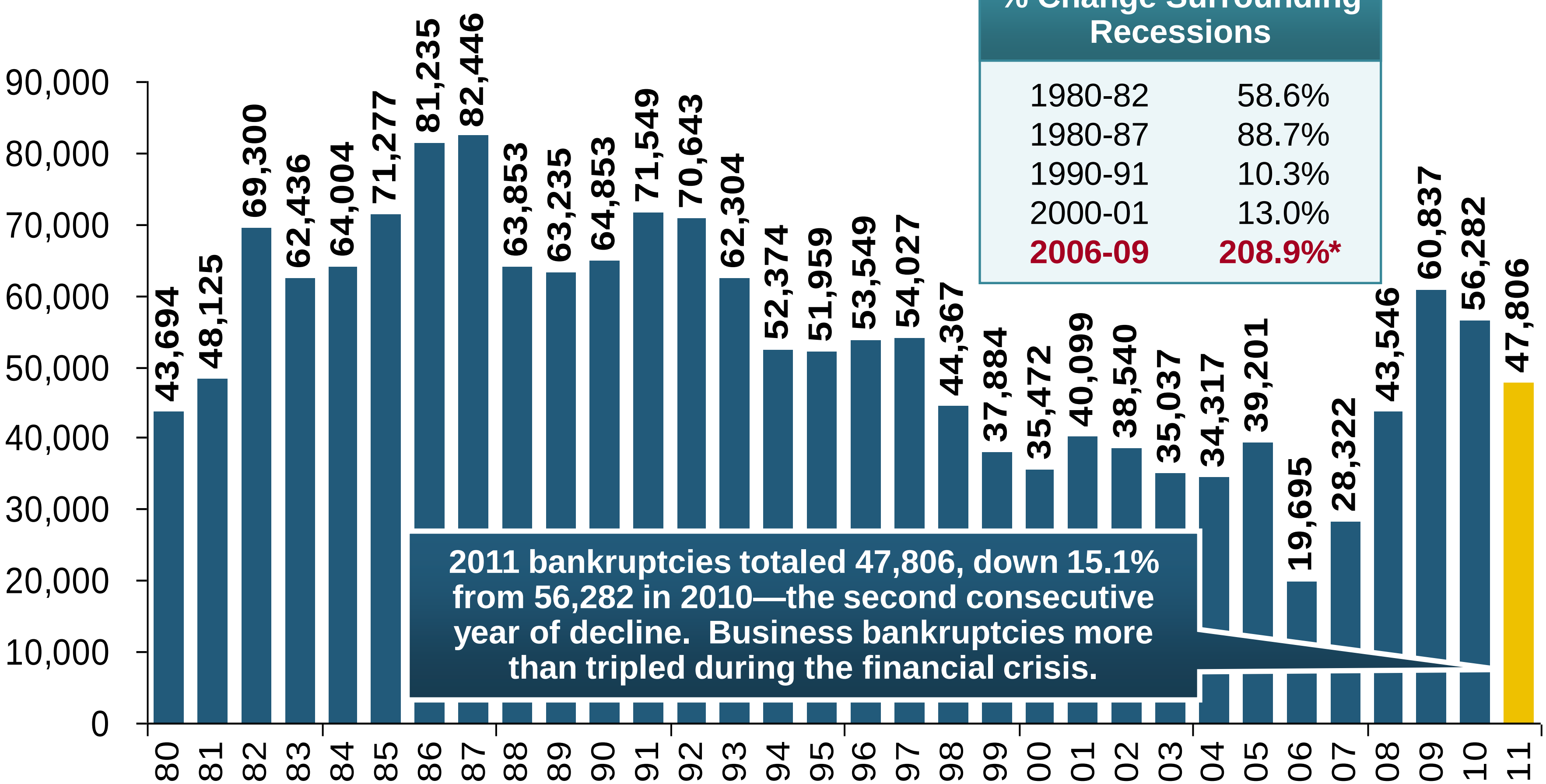



**Non-manufacturing industries have been expanding and adding jobs. The question is whether this will continue.**

Source: Institute for Supply Management at http://www.ism.ws/ismreport/nonmfgrob.cfm; Insurance Information Institute.

# Business Bankruptcy Filings, 1980-2011



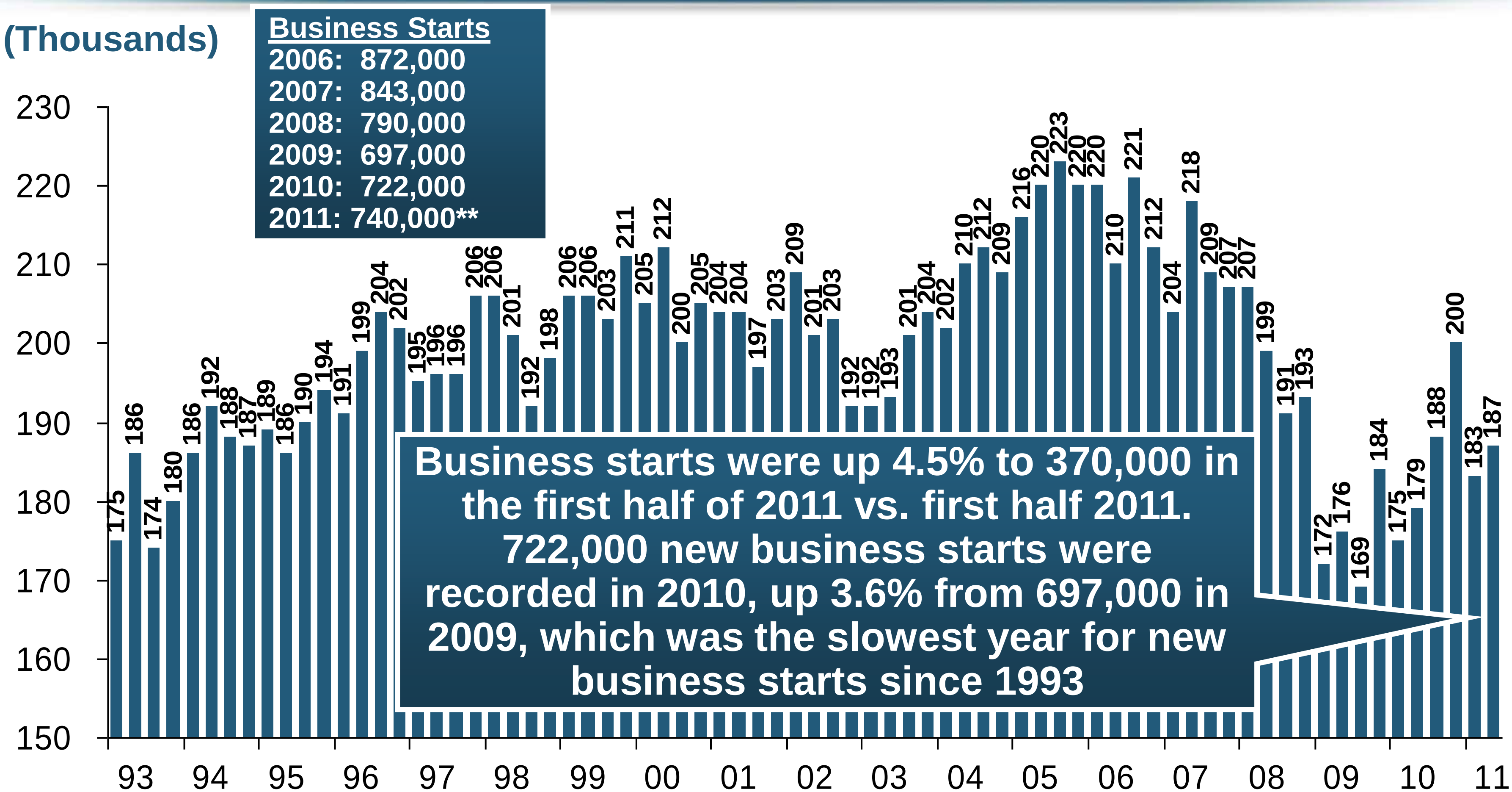



| % Change Surrounding Recessions | |
|---|---|
| 1980-82 | 58.6% |
| 1980-87 | 88.7% |
| 1990-91 | 10.3% |
| 2000-01 | 13.0% |
| **2006-09** | **208.9%*** |

**Significant Exposure Implications for All Commercial Lines as Business Bankruptcies Begin to Decline**

Sources: American Bankruptcy Institute at http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=61633; Insurance Information Institute

# Private Sector Business Starts, 1993:Q2 – 2011:Q2*




**Business Starts Were Down Nearly 20% in the Recession, Holding Back Most Types of Commercial Insurance Exposure, But Are Recovering Slowly**

* Data through June 30, 2011 are the latest available as of March 7, 2012; Seasonally adjusted.

Source: Bureau of Labor Statistics, http://www.bls.gov/news.release/cewbd.t08.htm.

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

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- Health Care
- Health Sciences
- Energy (Traditional)
- Alternative Energy
- Petrochemical
- Agriculture
- Natural Resources
- Technology (incl. Biotechnology)
- Light Manufacturing
- Insourced Manufacturing
- Export-Oriented Industries
- Shipping (Rail, Marine, Trucking)

**Many industries are poised for growth, though insurers' ability to capitalize on these industries varies widely**

# Labor Market Trends

## Employment and Payroll Trends Have Significant Direct and Indirect Impacts on P/C Insurance Exposures

# Unemployment and Underemployment Rates: Stubbornly High in 2011, But Falling

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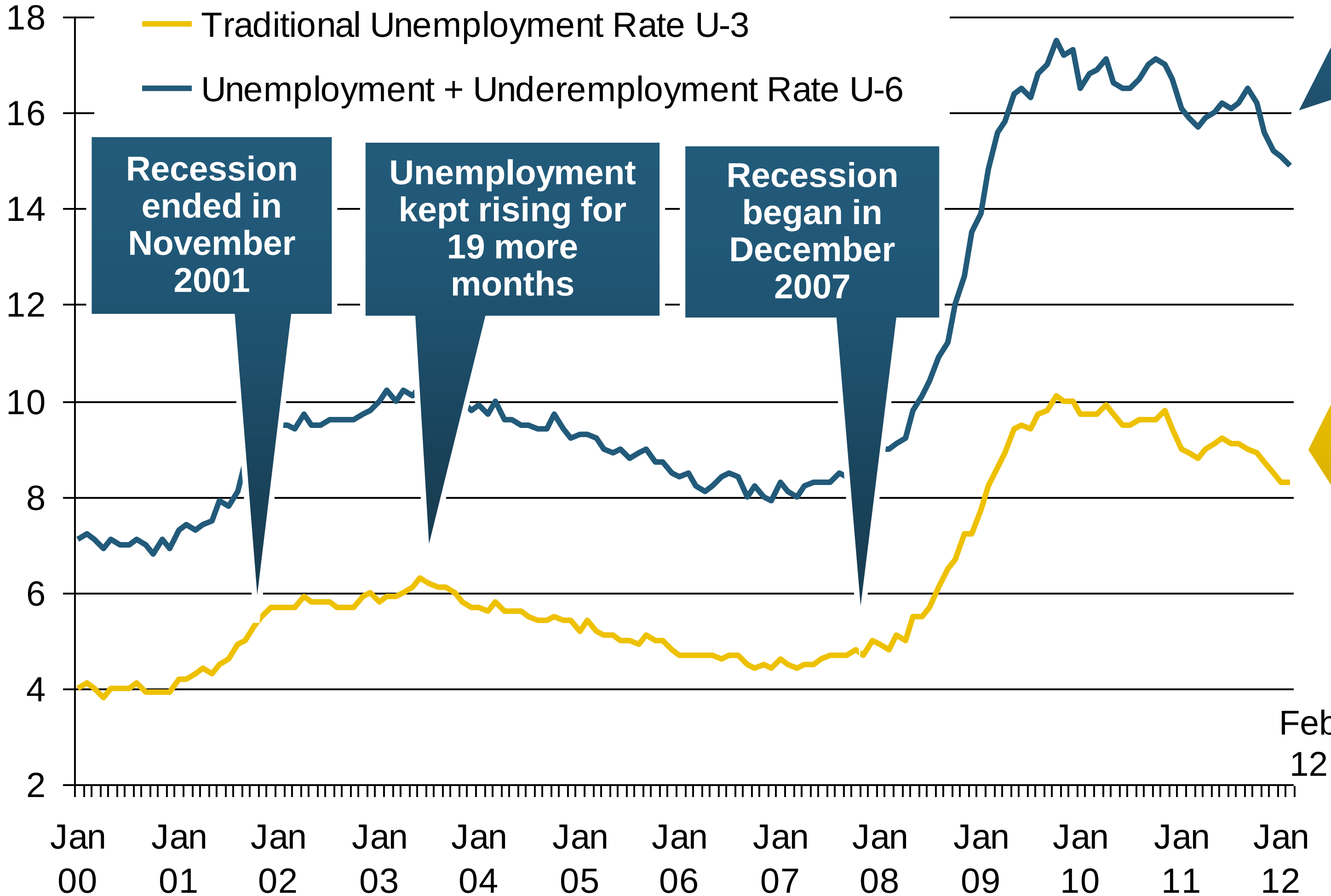
## January 2000 through February 2012, Seasonally Adjusted (%)




**U-6 went from 8.0% in March 2007 to 17.5% in October 2009; Stood at 14.9% in Feb. 2012**

**Unemployment stood at 8.3% in February 2012**

**Unemployment peaked at 10.1% in October 2009, highest monthly rate since 1983.**

**Peak rate in the last 30 years: 10.8% in November - December 1982**

**Stubbornly high unemployment and underemployment constrain overall economic growth, but the job market is now clearly improving**

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

# Monthly Change in Private Employment

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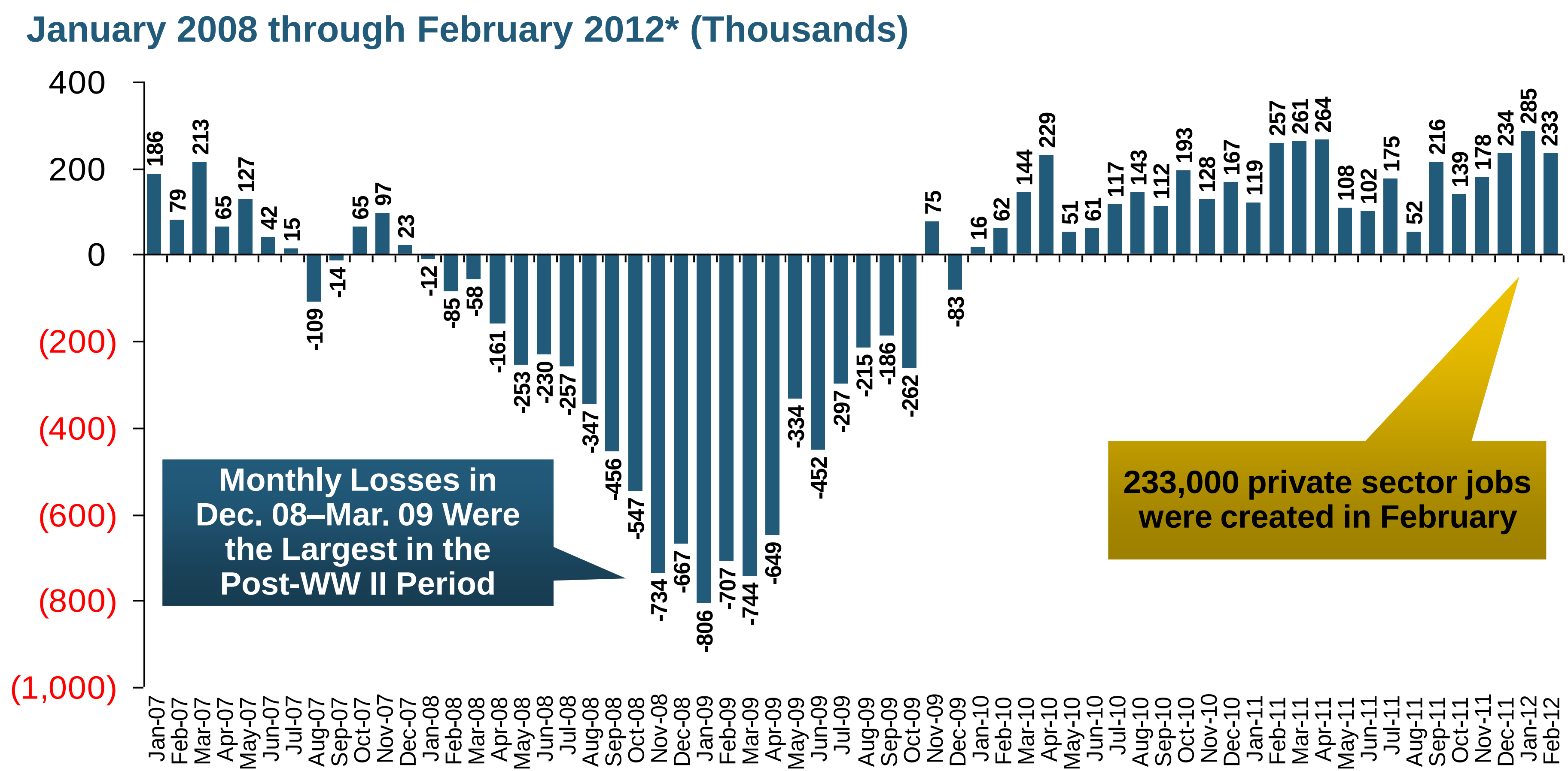
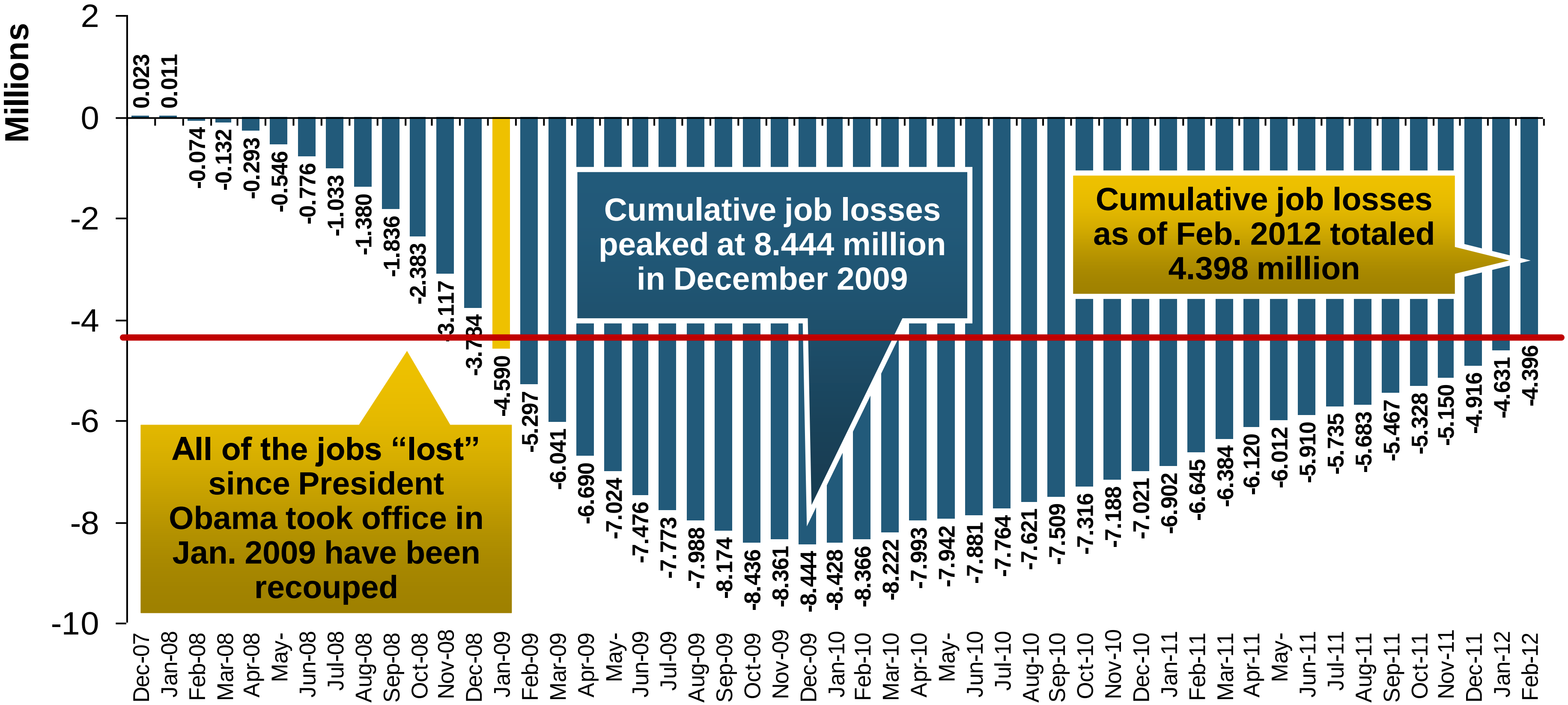



**Private Employers Added 4.046 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs**

Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Information Institute

# Cumulative Change in Private Employment: Dec. 2007—Feb. 2012

## December 2007 through February 2012* (Millions)




**Private Employers Added 4.046 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)**

Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Information Institute

# Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2011:Q4

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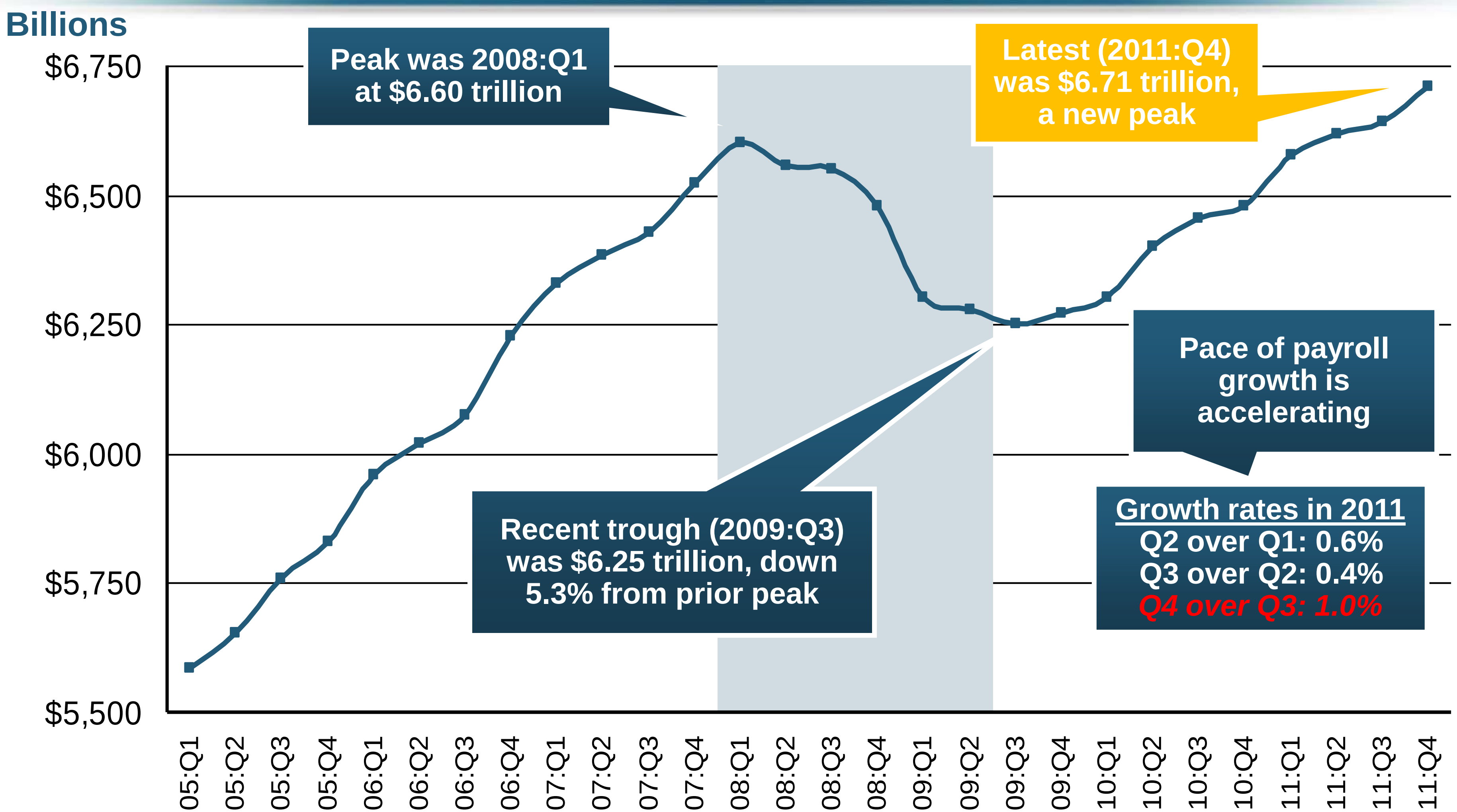
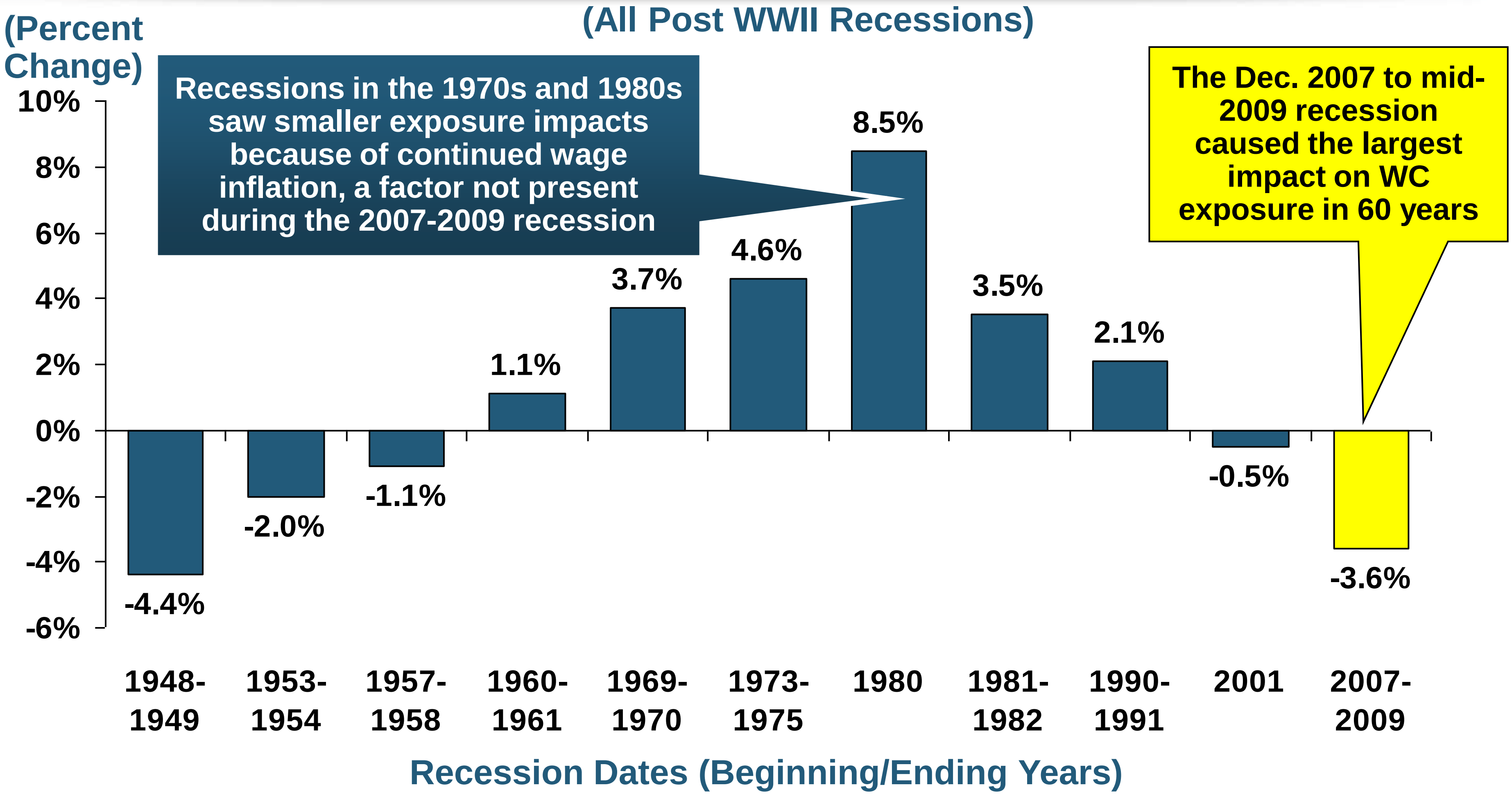



Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

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

# Estimated Effect of Recessions* on Payroll (Workers Comp Exposure)




*Data represent maximum recorded decline over 12-month period using annualized quarterly wage and salary accrual data

Source: Insurance Information Institute research; Federal Reserve Bank of St. Louis (wage and salary data); National Bureau of Economic Research (recession dates).

# US Unemployment Rate

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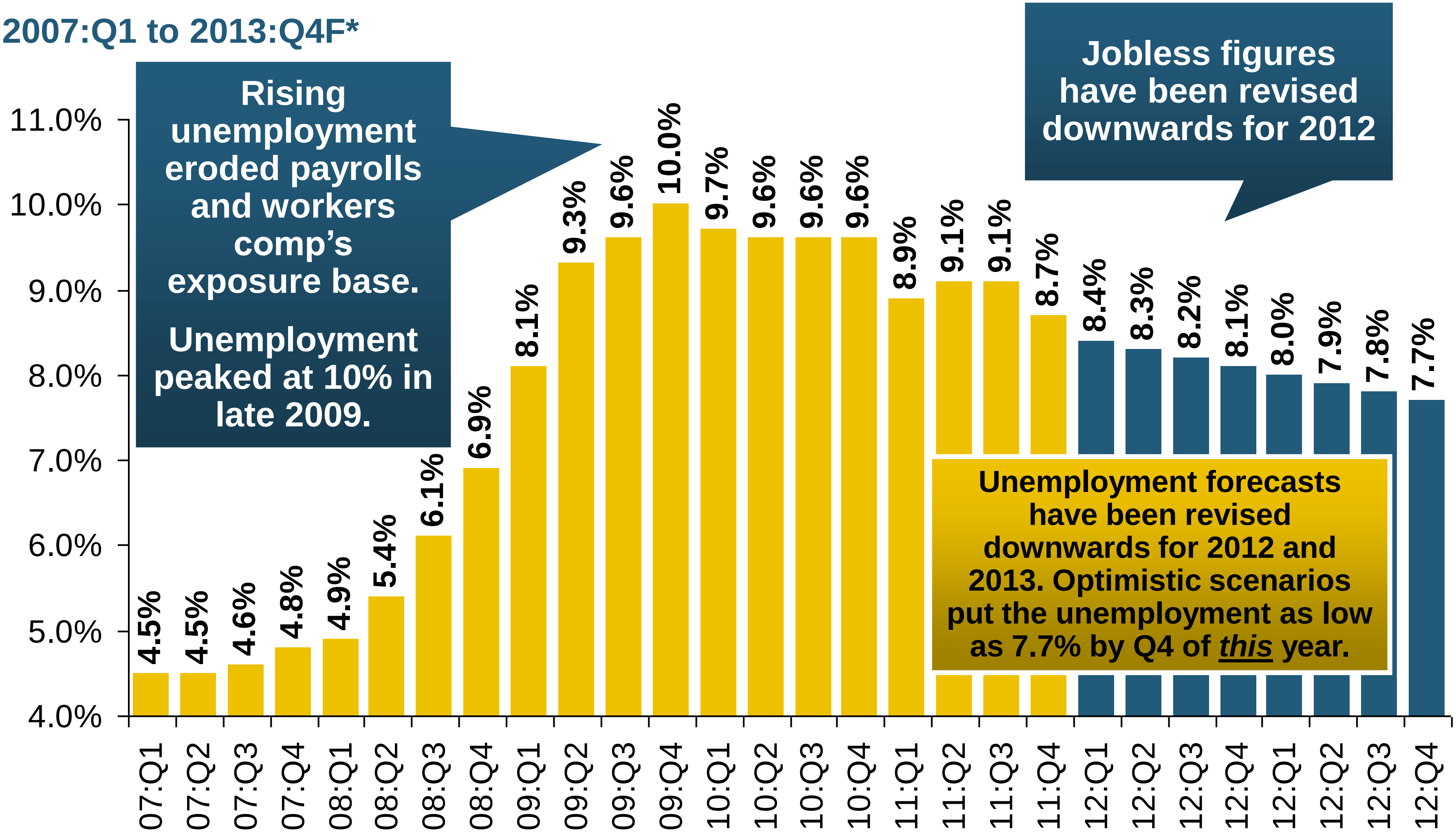
**2007:Q1 to 2013:Q4F***




* [yellow] = actual; [blue] = forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (2/12 edition); Insurance Information Institute (forecasts)

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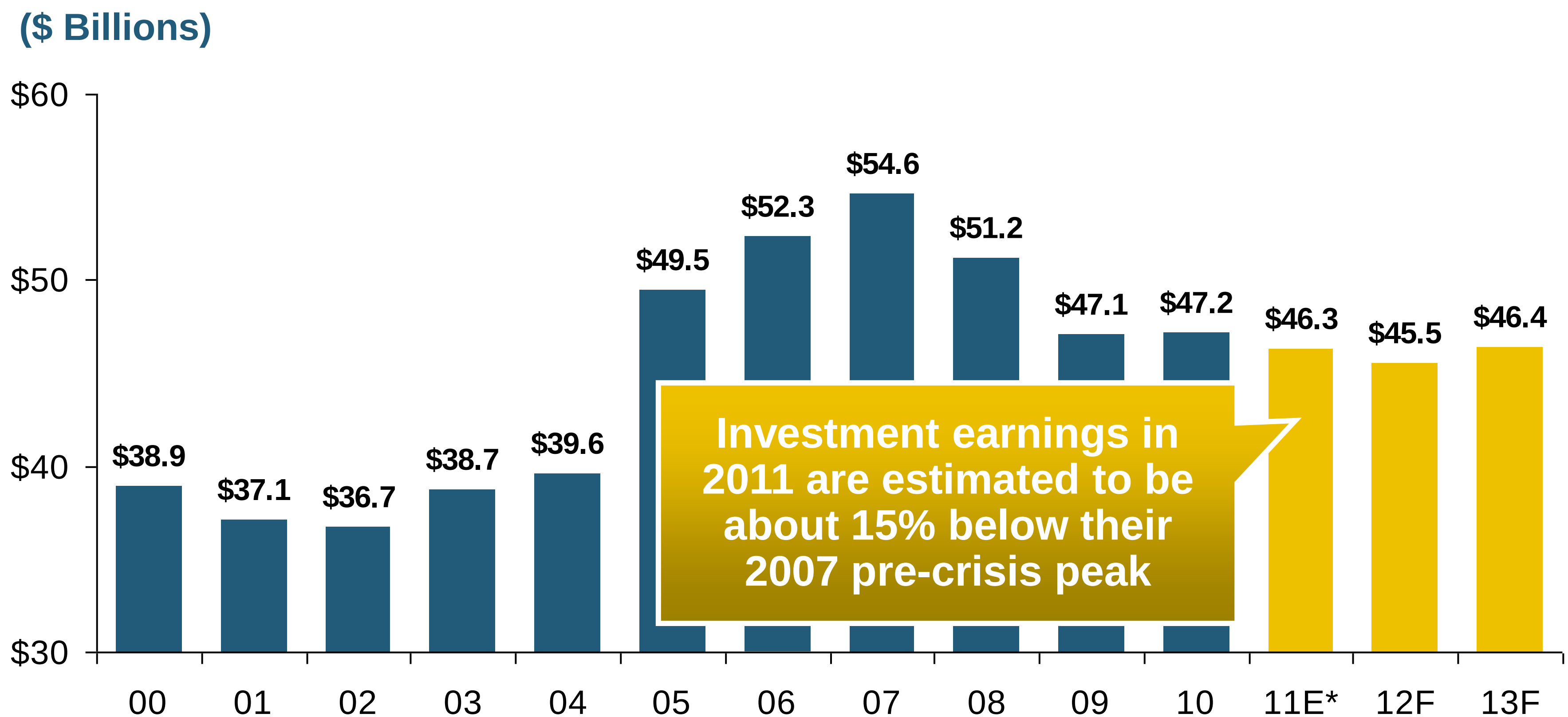
# INVESTMENTS: THE NEW REALITY

## How Much of a Threat Are Persistently Low Interest Rates for P/C Insurers?

# Insurers Have Not Yet Fully Adapted to a Persistently Low Interest Rate Environment

- **No Expectation that Rates Would Be:**
  - **Pushed to Such Low Levels**
  - **Pushed Down so Rapidly**
  - **Held to Such Low Levels for So Long**
  - **Suppressed via Unprecedented Aggressiveness of the Federal Reserve**
    - **Use of traditional and unconventional tools (QE)**
    - **Unconventional 's policies couldn't be anticipated, esp. QE1, 2 (3?)**
- **Competitive Pressure→Protracted Soft Market**
- **Release of Prior Year Reserves Eases Urgency**
- **Realization of Capital Gains**

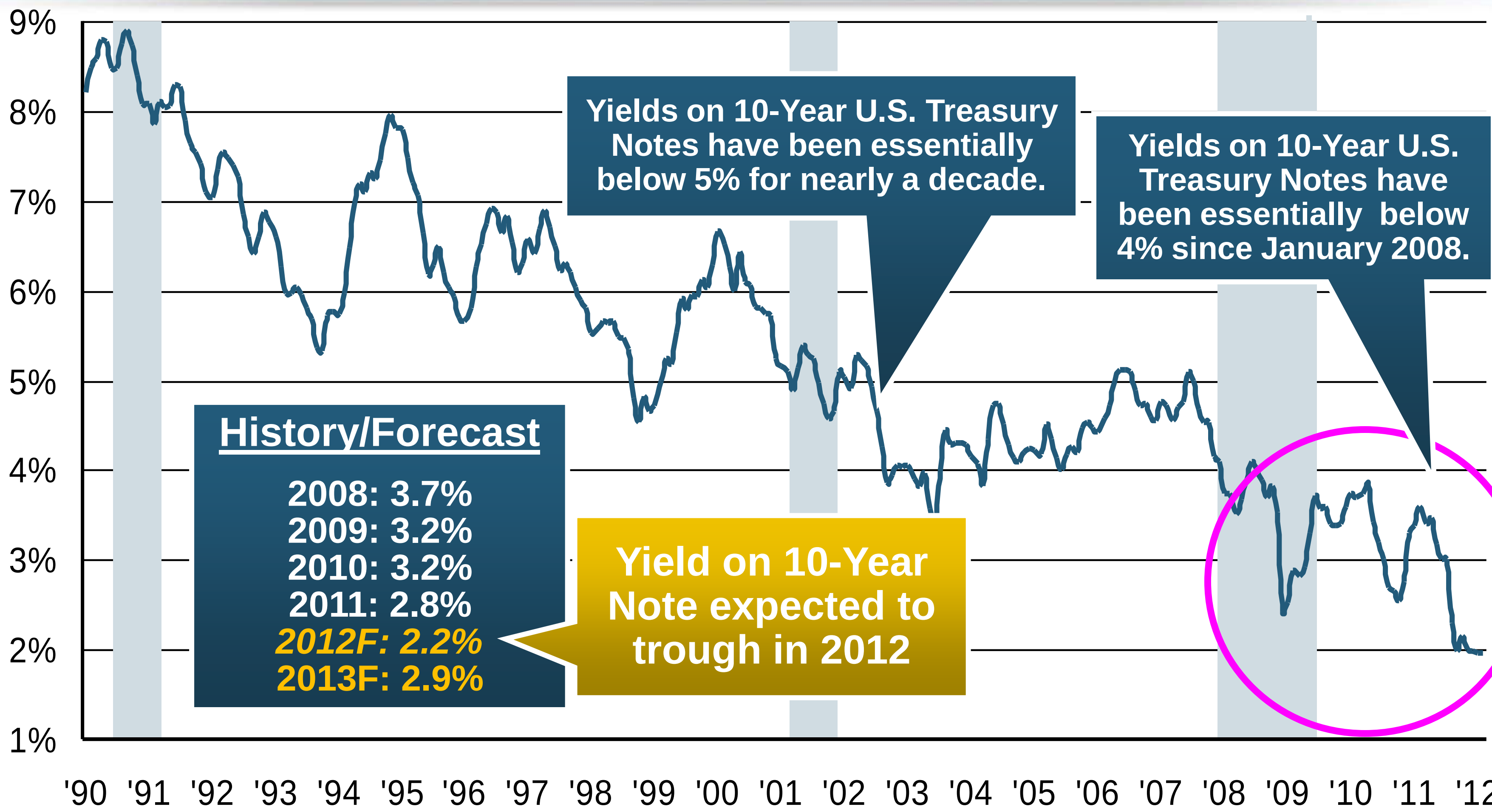
# Property/Casualty Insurance Industry Investment Income: 2000–2013F[1]




**Investment Income in 2011 Was Surprisingly Strong, Though Investment Income Is Likely to Weaken in 2012 Due to Persistently Low Interest Rates**

[1] Investment gains consist primarily of interest and stock dividends.
*2011E figure is annualized based on actual investment income through 2011:Q3; 2012F-201F based on Conning projections.
Sources: ISO; Conning Research & Consulting; Insurance Information Institute.

# U.S. 10-Year Treasury Note Yields: A Long Downward Trend, 1990–2012*

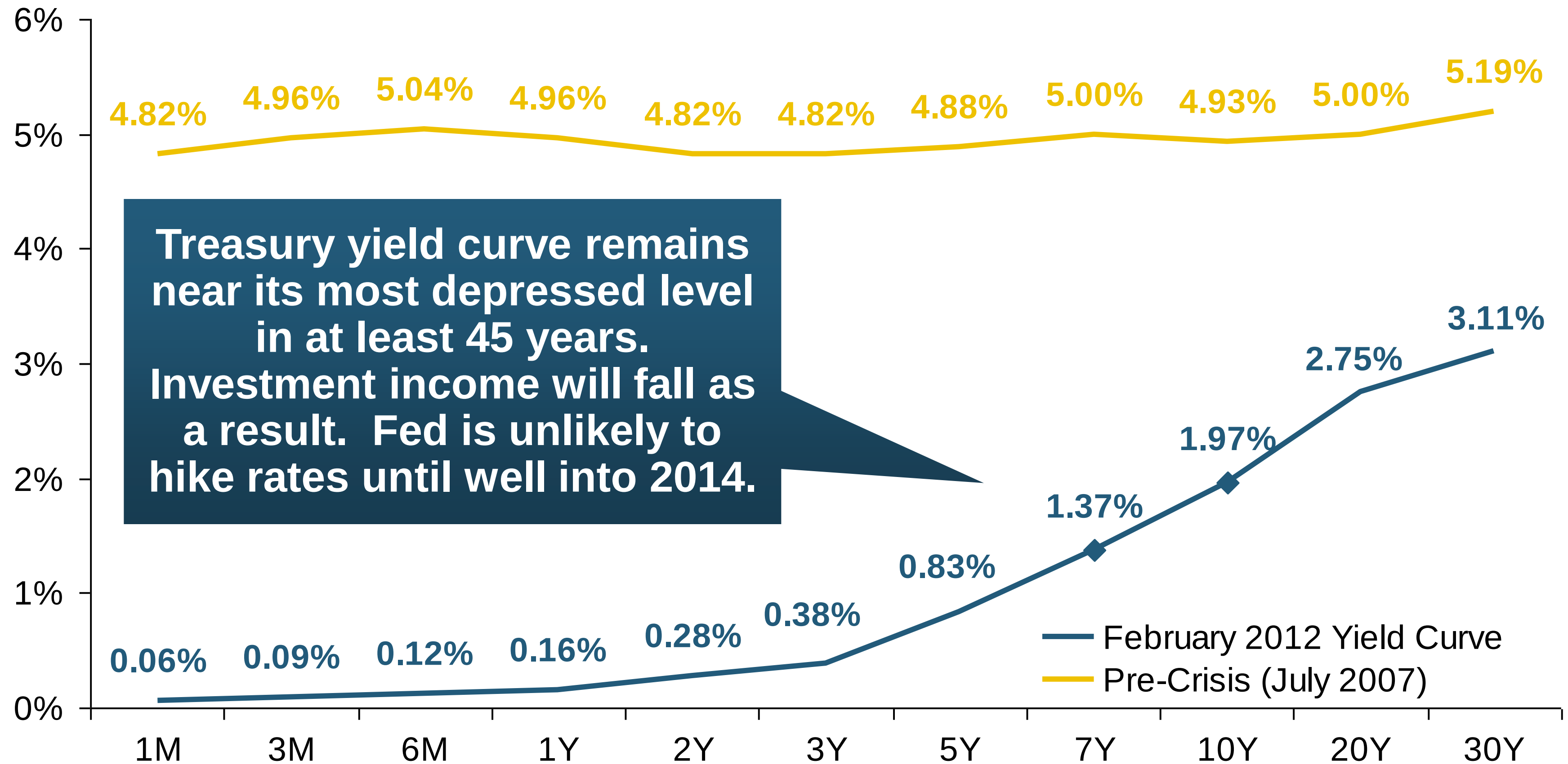



**Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.**

*Monthly, through February 2012. Note: Recessions indicated by gray shaded columns.

Sources: Federal Reserve Bank at http://www.federalreserve.gov/releases/h15/data/Monthly/H15_TCMNOM_Y10.txt
National Bureau of Economic Research (recession dates); Blue Chip Economic Indicators (2/12); Insurance Information Institutes.

# Treasury Yield Curves: Pre-Crisis (July 2007) vs. Feb. 2012




**The Fed Is Actively Signaling that it Is Determined to Keep Rates Low Through Late 2014**

Source: Federal Reserve Board of Governors; Insurance Information Institute.

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

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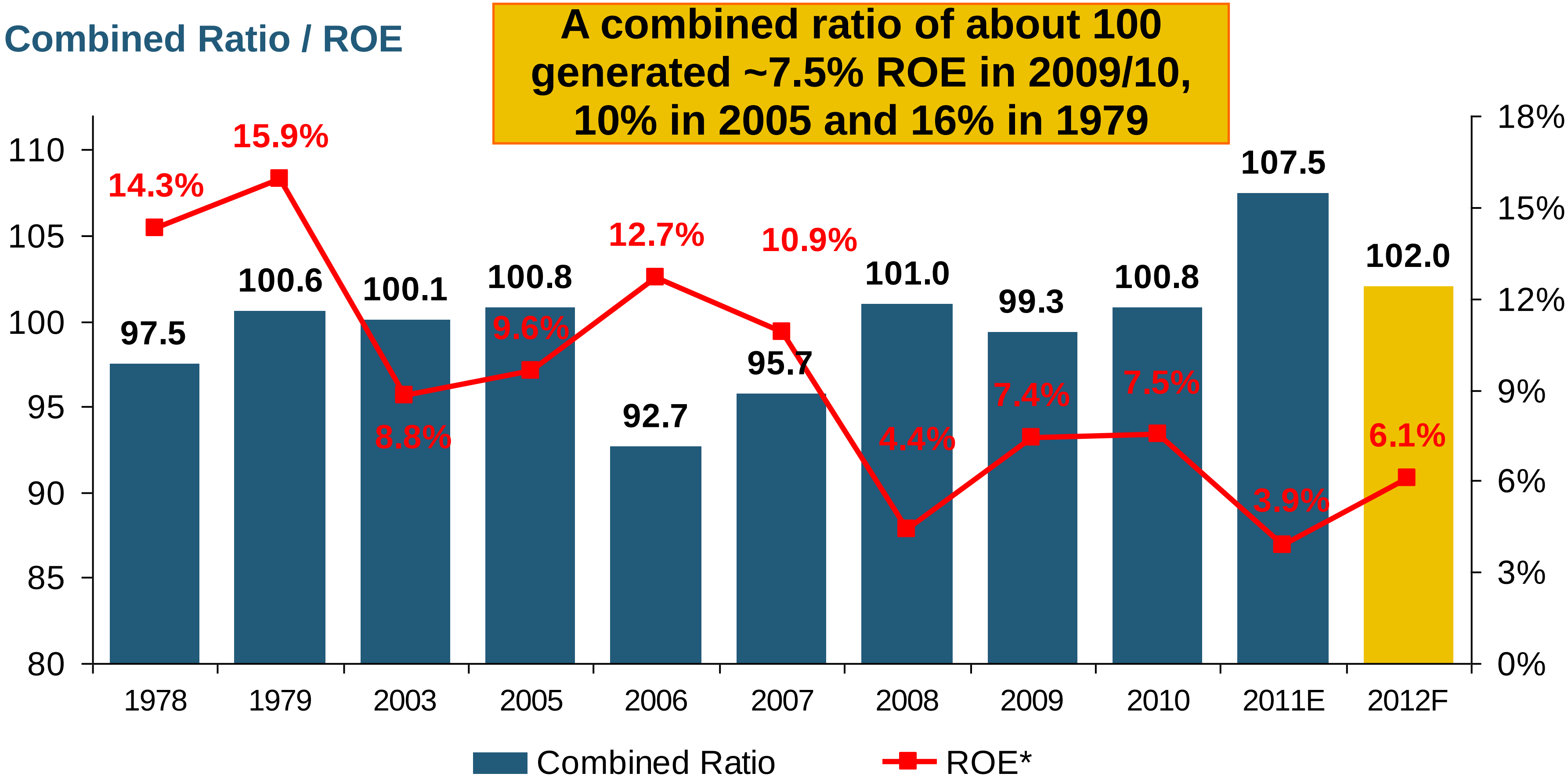
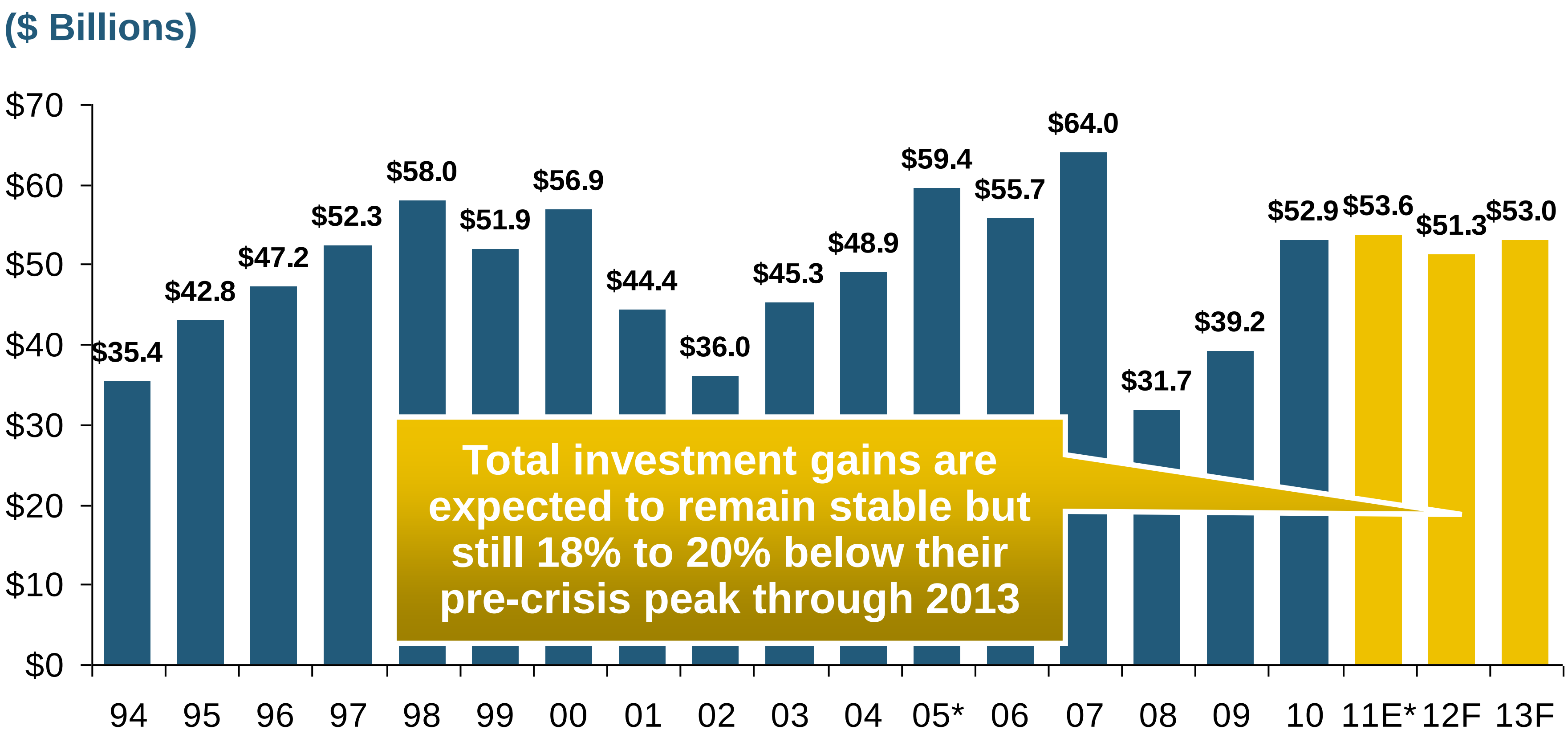



**Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs**

* 2008 -2010 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2011-12 combined ratios are A.M. Best estimate excl. M&FG insurers.
Source: Insurance Information Institute from A.M. Best and ISO data.

# Property/Casualty Insurance Industry Investment Gain: 1994–2013F[1]



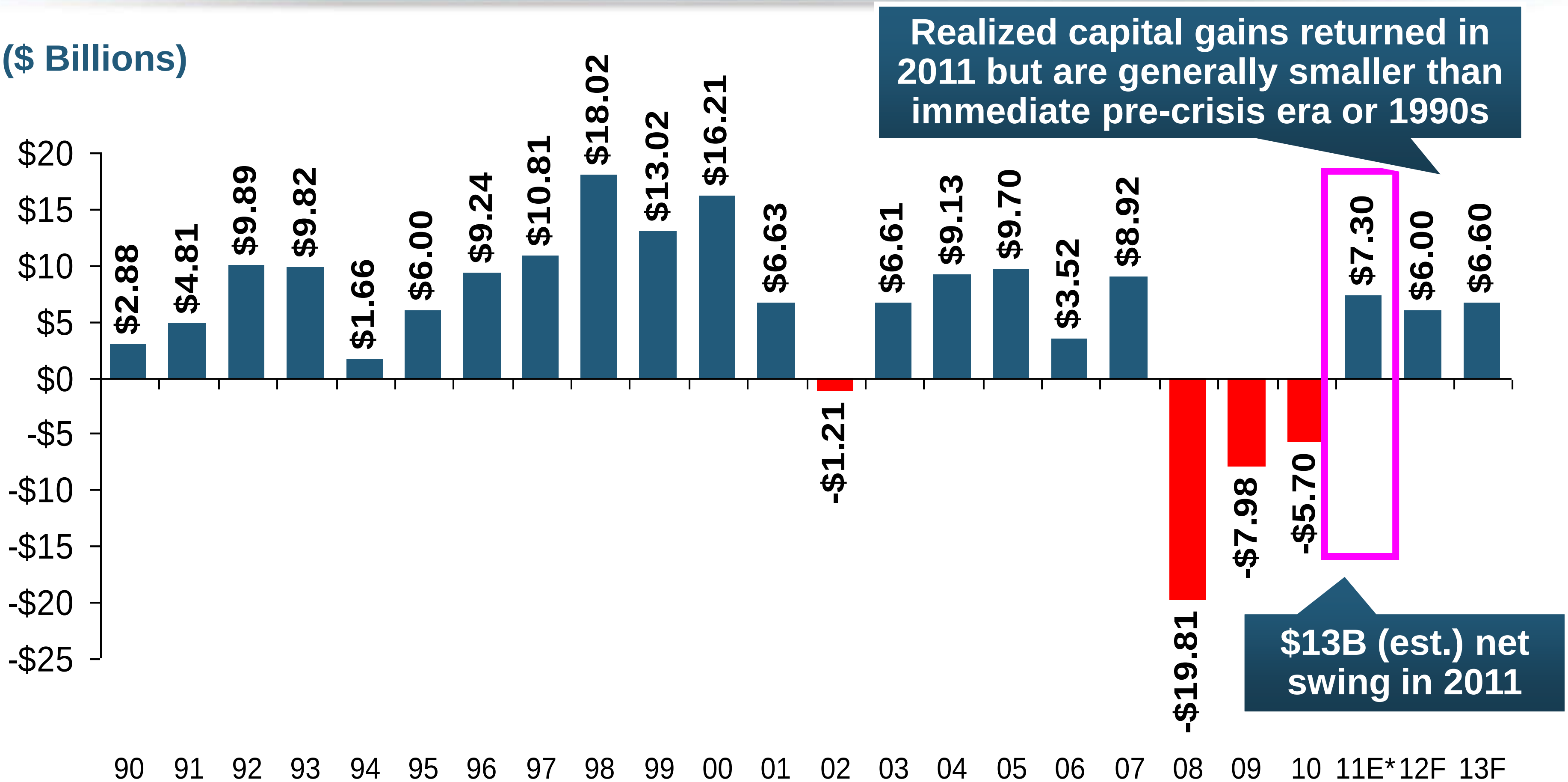

**Investment Gains in 2011 Were Surprisingly Robust. Investment Gains Recovered Significantly Due to Realized Investment Gains; The Financial Crisis Caused Investment Gains to Fall by 50% in 2008**

[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; 2011 figure is annualized based 2011:Q3 actual; 2012-13F derived from Conning forecast data.

Sources: ISO; Conning; Insurance Information Institute.

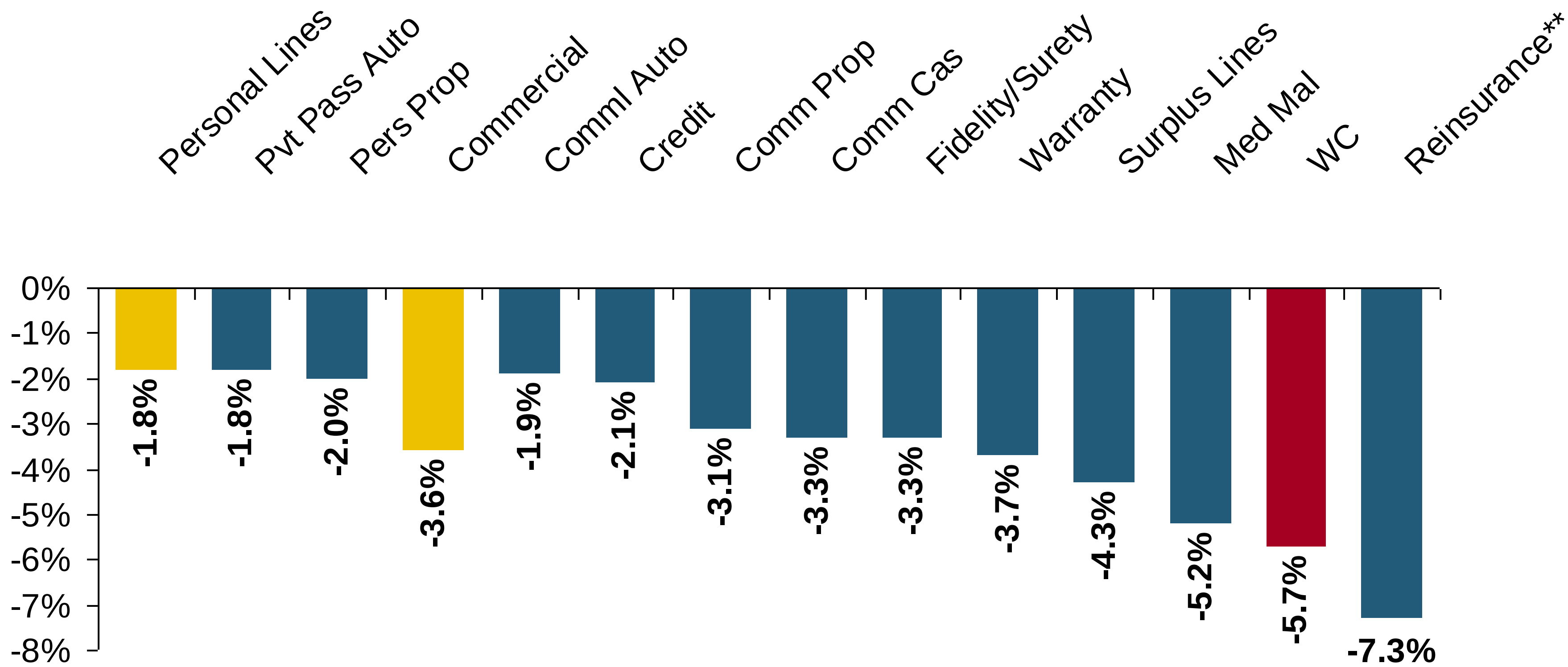
# P/C Insurer Net Realized Capital Gains/Losses, 1990-2013F




**Insurers Posted Net Realized Capital Gains in 2011 for the First Time Since 2007. Realized Capital Losses Were a Primary Cause of 2008/2009's Large Drop in Profits and ROE**

*2011 is an estimate based on annualized actual 2011 9-month figure of $5.5B; 2012F and 2013F are Conning estimates.
Sources: A.M. Best, ISO, Conning; 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**

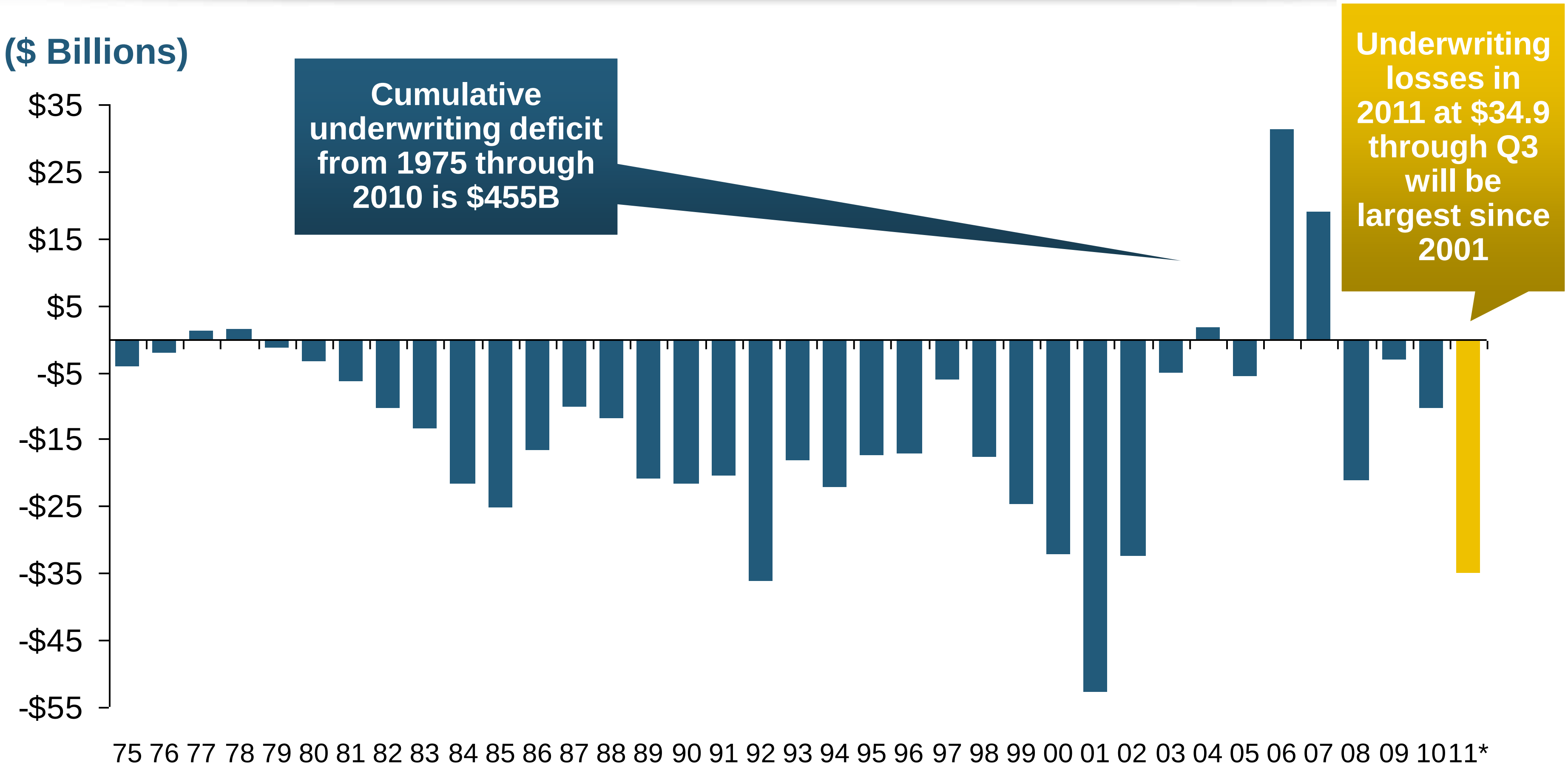
*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

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

# Underwriting Gain (Loss) 1975–2011*



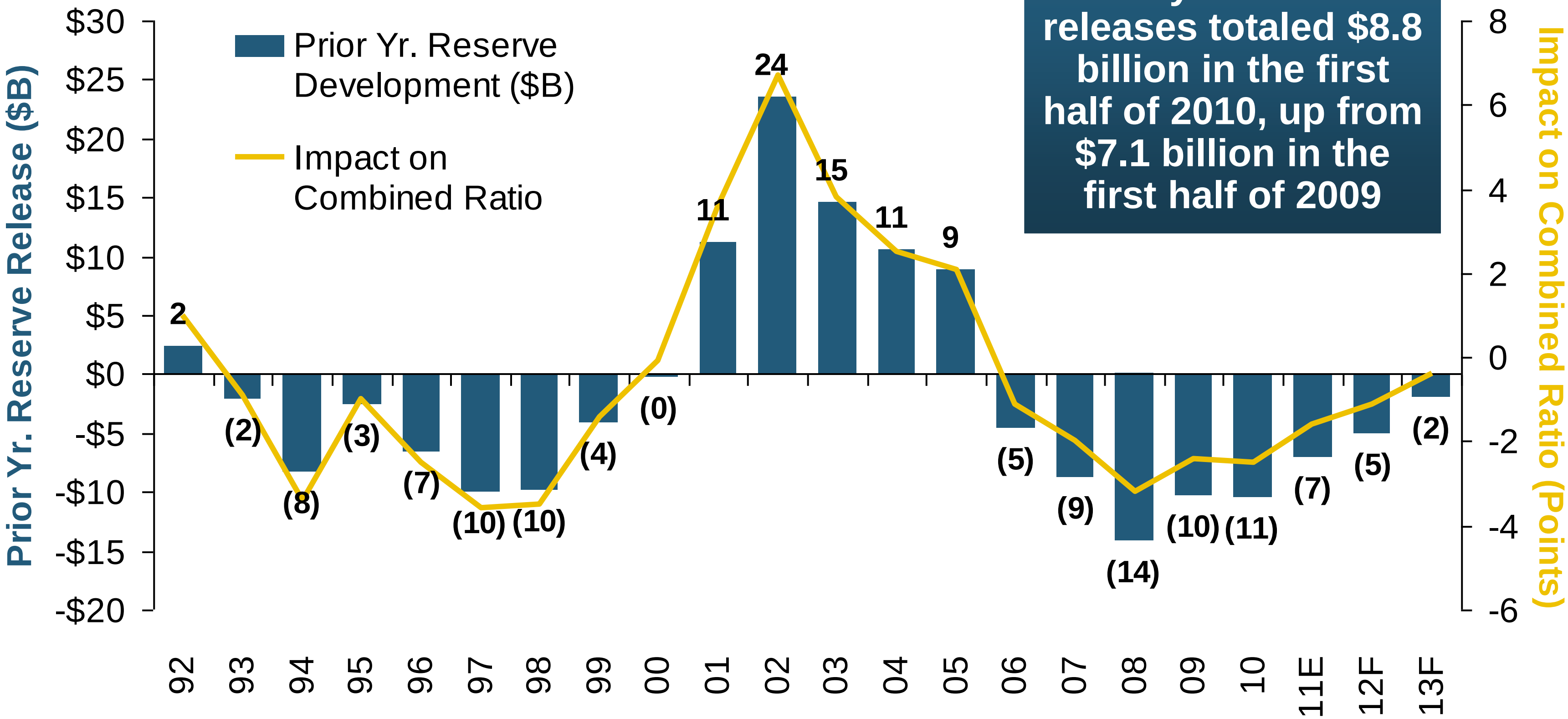



**Large Underwriting Losses Are *NOT* Sustainable in Current Investment Environment**

* Includes mortgage and financial guaranty insurers in all years

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

# P/C Reserve Development, 1992–2013F




**Prior year reserve releases totaled $8.8 billion in the first half of 2010, up from $7.1 billion in the first half of 2009**

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

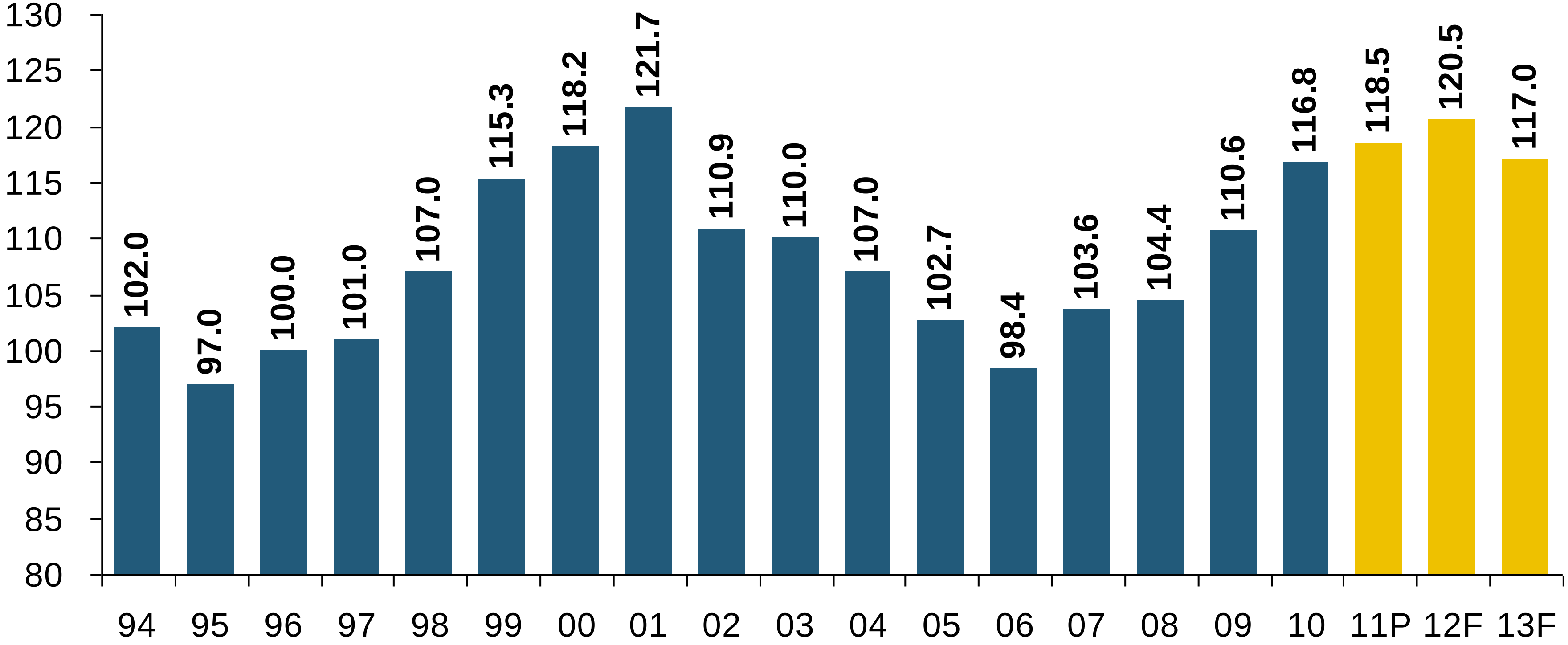
Note: 2005 reserve development excludes a $6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was $7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.

Sources: Barclays Capital; A.M. Best.

# Workers Compensation: Vulnerability to Low Yield Interest Rate Environment

## Low Yields Compound a Workers Comp Market Already Suffering from Poor Underwriting Results and Still-Weak Labor Markets

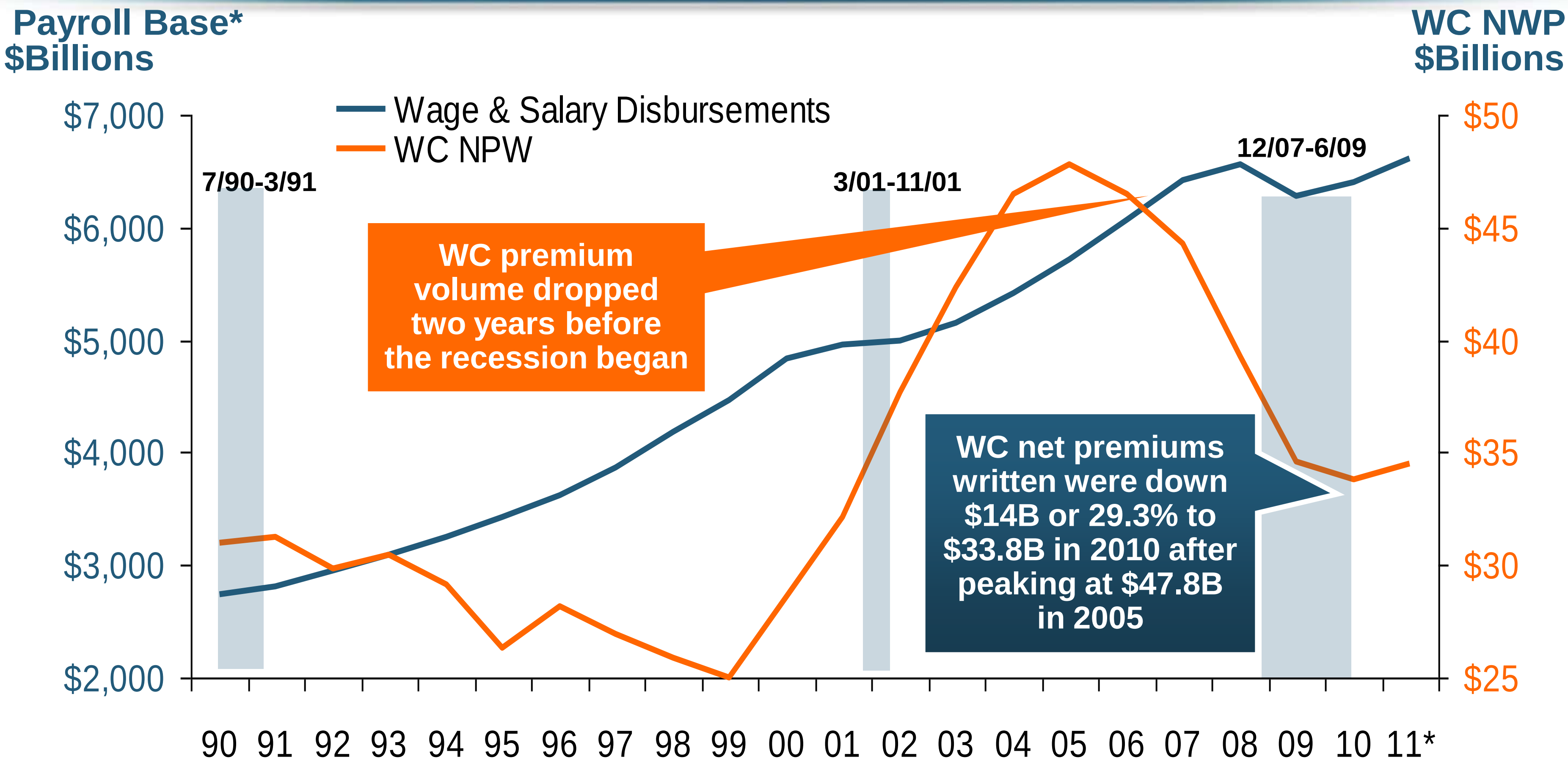
# Workers Compensation Combined Ratio: 1994–2013F




**Workers Comp Underwriting Results Are Deteriorating Markedly and the Worst They Have Been in a Decade**

Sources: A.M. Best (1994-2012F); Conning (2013F) ; Insurance Information Institute.

# Payroll vs. Workers Comp Net Written Premiums, 1990-2011




**Resumption of payroll growth and rate increases suggests WC NWP will grow again in 2012**

*Private employment; Shaded areas indicate recessions. Payroll and WC premiums for 2011 is I.I.I. estimate

Sources: NBER (recessions); Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR ; NCCI; I.I.I.

# Workers Compensation Investment Returns

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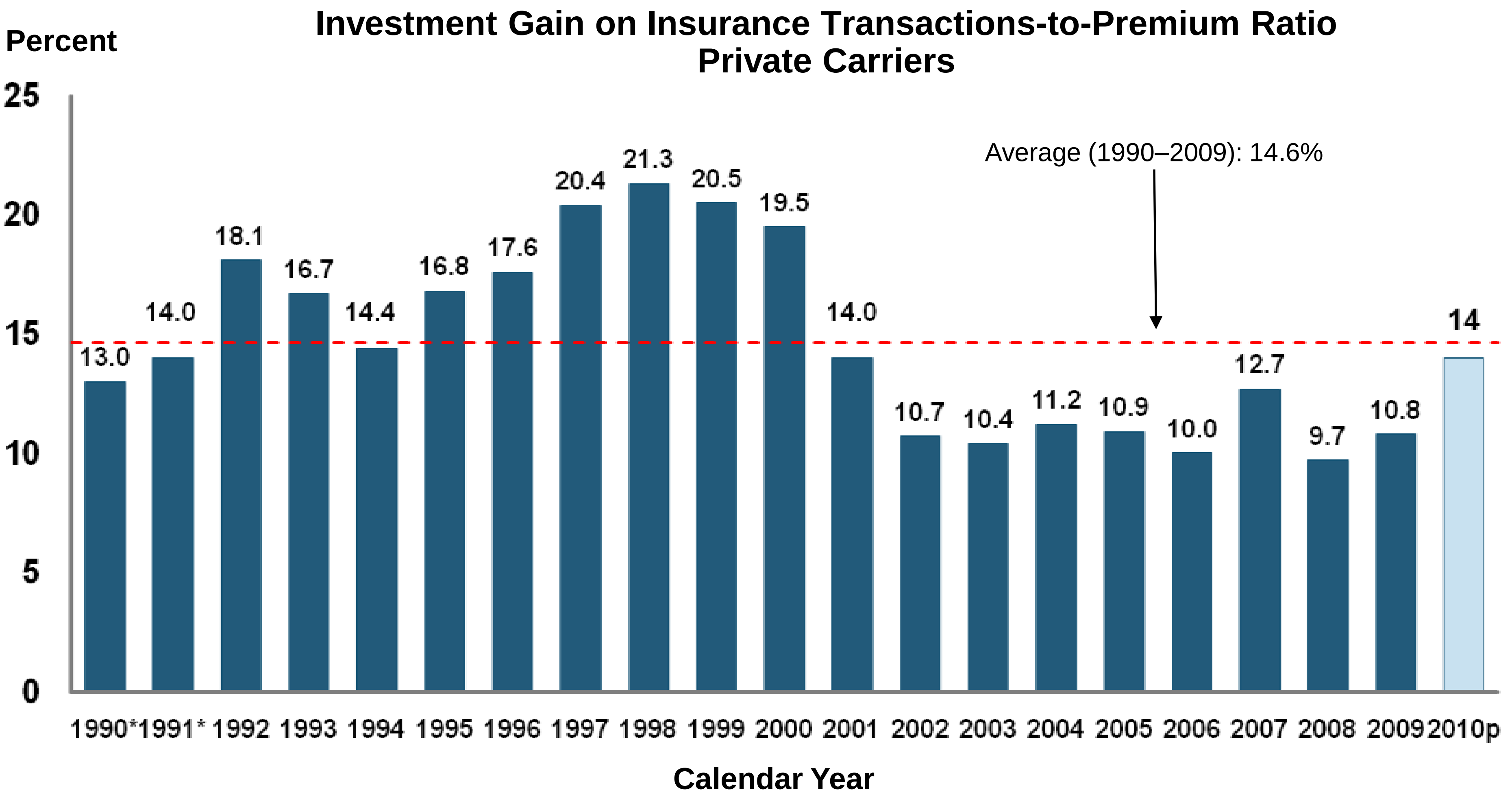


p=Preliminary

Source: 1990–2009, Annual Statement Data; 2010p, NCCI
Investment Gain on Insurance Transactions includes Other Income
•Adjusted to include realized capital gains to be consistent with 1992 and after
Source: NCCI

# Workers Compensation Results Modest Operating Loss

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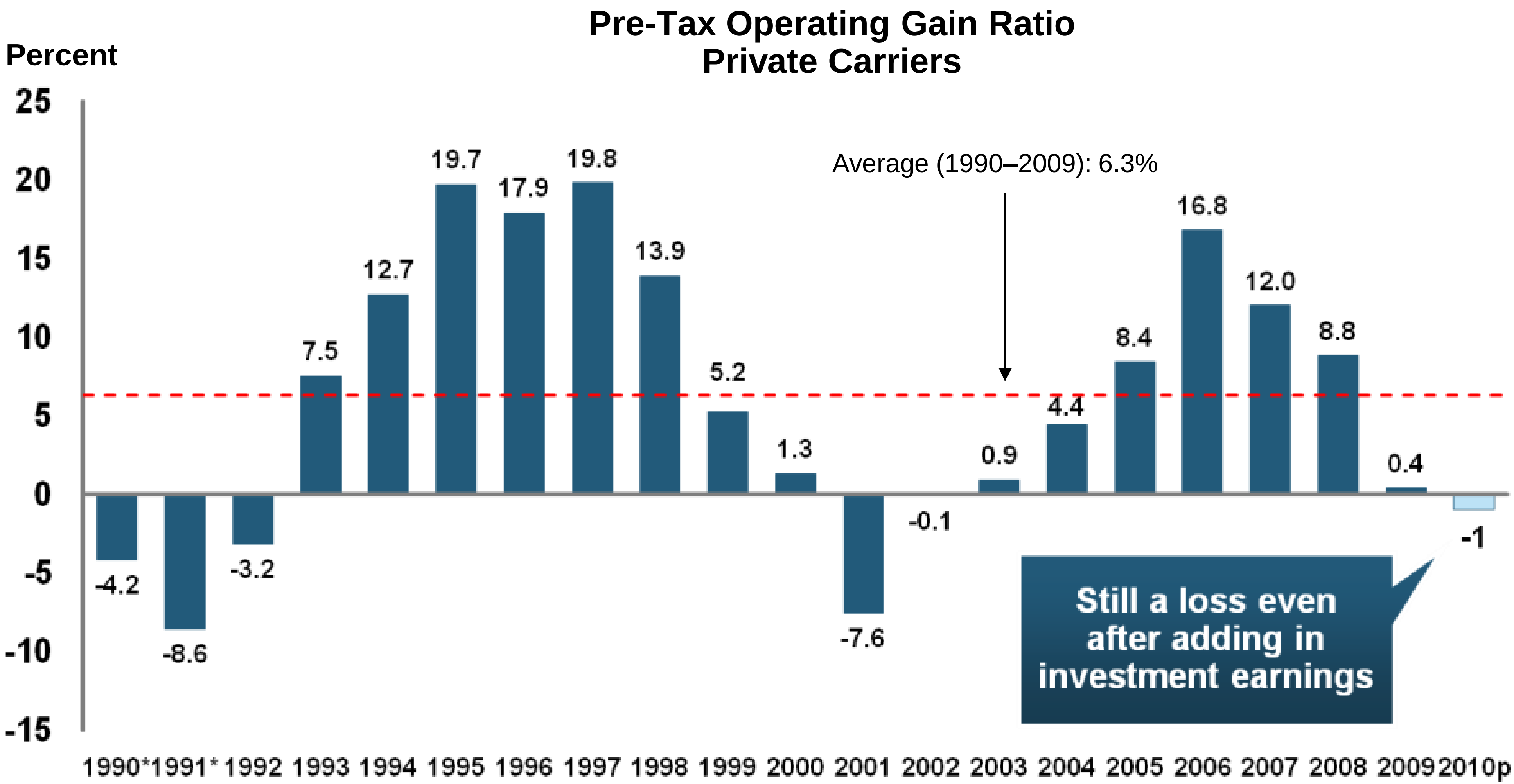


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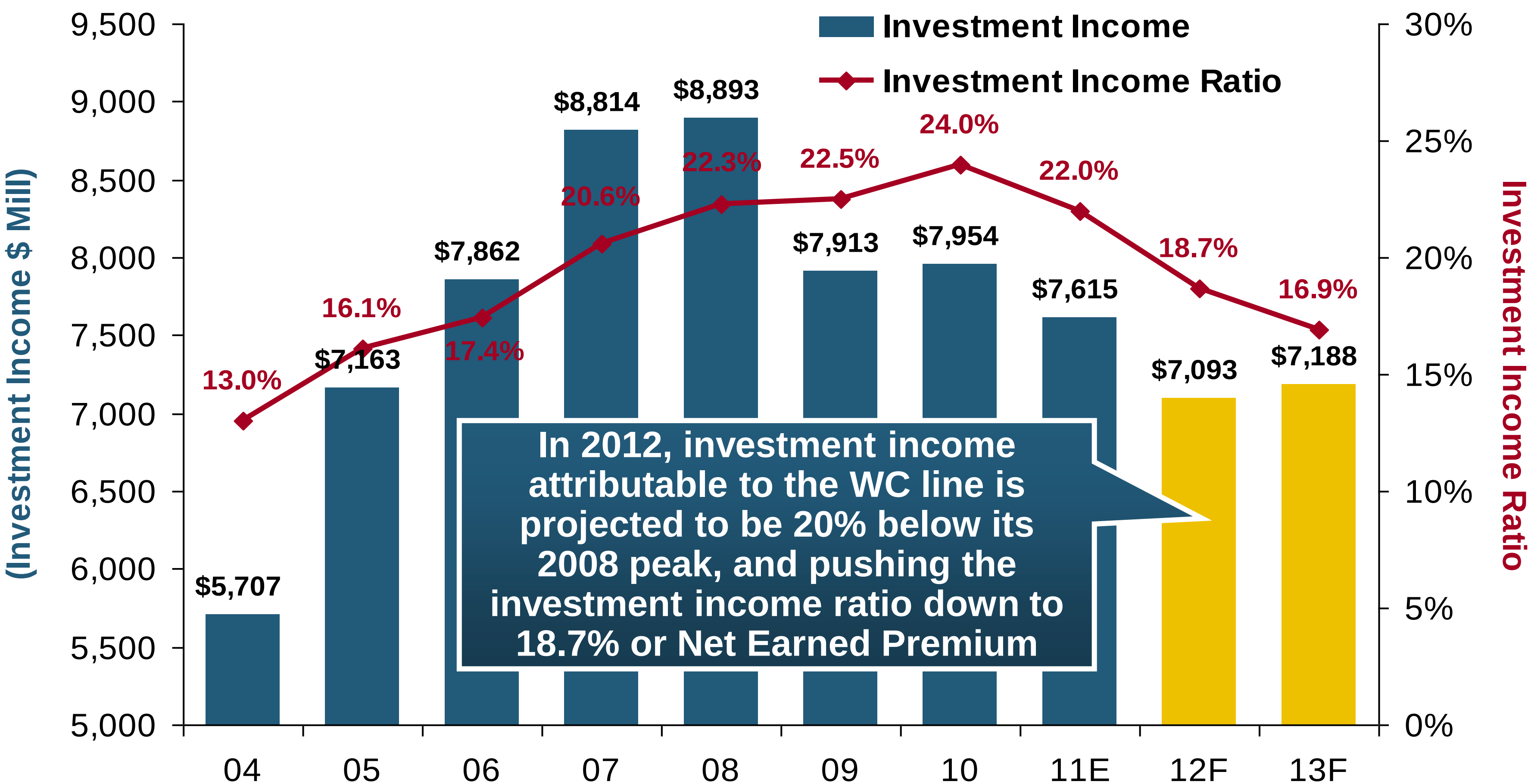
Source: 1990–2009, Annual Statement Data; 2010p, NCCI
Operating Gain Equals 1.00 minus (Combined Ratio Less Investment Gain on Insurance Transactions and Other Income)
•Adjusted to include realized capital gains to be consistent with 1992 and after
Source: NCCI

# Workers Comp Investment Income Earned and Investment Income Ratio, 2004-2013F




**Restoring the Workers Comp Line to Profitability Will Be Made More Difficult Because Investments Will Provide Little Lift, Requiring More of an Emphasis on Underwriting Profitability**

Source: Conning. Note: Investment Income Ration is ratio of investment income from WC reserves and surplus to WC net earned premium.

## Insurance Information Institute Online:

# www.iii.org

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

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