An Industry and Economy in Transition: Overview and Outlook for Commercial Insurance Markets & the US Economy
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Presentation Outline

- U.S. Economic Overview and Outlook
  - Economy as a Growth Engine for P/C Insurers
  - Labor Market Review
- Summary of P/C Financial Performance
- Catastrophe Loss Developments & Trends
  - Global, US
- Will the Market Turn? Four Necessary Criteria:
  - Underwriting Loss Trends
  - Capital/Capacity
  - Reinsurance Markets
  - Pricing Discipline
- Analysis by Key Line
- Other Contributing Factors to the Underwriting Cycle
  - Investment Environment
  - Tort/Casualty Environment
  - Inflation
- 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

Enormous Consequences for P/C Insurers
Economic Outlook for 2012

- Economic Growth Will Accelerate Modestly in 2012/13, Albeit Unevenly
  - 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 by 2013
- Inflation Remains Tame
  - Runaway inflation highly unlikely but energy spike possible; Fed has things under control
- Private Sector Hiring Remains Consistently Positive
  - Unemployment dips below 8% by year’s end
- Sovereign Debt, Euro Currency/Economy, Muni Bond “Crises” Overblown
- European Recession in 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
- 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
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, in some severity in 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
  - Laggards: inland marine, aviation, commercial auto, surety
  - 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 pressured if economic strength surprises

- **Industry Capacity Hits a New Record by Year-End 2012 (Barring Mega-CAT)**
The Strength of the Economy Will Influence P/C Insurer Growth Opportunities

Growth Will Expand Insurable Exposures and Help Absorb Excess Capital
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 4/12; Insurance Information Institute.
Consumer Sentiment Survey (1966 = 100)

January 2010 through March 2012

Optimism among consumers is recovering, in part due to an improving jobs outlook, after plunging amid the debt debate debacle and S&P downgrade

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
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 4/12); Insurance Information Institute.
New Private Housing Starts, 1990-2022F

(Millions of Units)

New home starts plunged 72% from 2005-2009; A net annual decline of 1.49 million units, lowest since records began in 1959.

The plunge and lack of recovery in homebuilding and in construction in general is holding back payroll exposure growth.

Job growth, improved credit market conditions and demographics will eventually boost home construction.

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 4/12); Insurance Information Institute.
Value of Construction Put in Place, Feb. 2012 vs. Feb. 2011*

Overall Construction Activity is Up, But Growth Is Entirely in the Private Sector as State/Local Government Budget Woes Continue

*seasonally adjusted
Source: U.S. Census Bureau, [http://www.census.gov/construction/c30/c30index.html](http://www.census.gov/construction/c30/c30index.html) ; Insurance Information Institute.
Value of Private Construction Put in Place, by Segment, Feb. 2012 vs. Feb. 2011*

Private sector construction activity is up by double digits in many segments after plunging during the “Great Recession”

Private Construction Activity is Up in Most Segments, Including Residential Construction

*seasonally adjusted
Source: U.S. Census Bureau, [http://www.census.gov/construction/c30/c30index.html](http://www.census.gov/construction/c30/c30index.html); Insurance Information Institute.
The manufacturing sector has been expanding and adding jobs. The question is whether this will continue.

The value of Manufacturing Shipments in Feb. 2012 was up 30% to $462B from its May 2009 trough. Dec. figure is only 4.7% below its previous record high in July 2008.

Monthly shipments are nearly back to peak (in July 2008, 8 months into the recession). Trough in May 2009. Growth from trough to February 2012 was 30%. This growth leads to gains in many commercial exposures: WC, Commercial Auto, Property and Various Liability Coverages.

*seasonally adjusted
Manufacturing Growth for Selected Sectors, 2012 vs. 2011*

Durables: +11.4%

Non-Durables: +8.5%

Manufacturing of durable goods has been especially strong.

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; Date are YTD comparing data through Feb. 2012 to the same period in 2011.
Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

March 2001 through March 2012

Percent of Industrial Capacity

The US operated at 78.6% of industrial capacity in Mar. 2012, above the June 2009 low of 68.3% and close to its post-crisis peak.

The closer the economy is to operating at “full capacity,” the greater the inflationary pressure.

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

2011 bankruptcies totaled 47,806, down 15.1% from 56,282 in 2010—the second consecutive year of decline. Business bankruptcies more than tripled during the financial crisis.

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
Business starts were up 4.5% to 370,000 in the first half of 2011 vs. first half 2011. 722,000 new business starts were recorded in 2010, up 3.6% from 697,000 in 2009, which was the slowest year for new business starts since 1993.

Business Starts
2006: 872,000
2007: 843,000
2008: 790,000
2009: 697,000
2010: 722,000
2011: 740,000**

* Data through June 30, 2011 are the latest available as of March 7, 2012; Seasonally adjusted.
Many industries are poised for growth, though insurers’ ability to capitalize on these industries varies widely.

<table>
<thead>
<tr>
<th>12 Industries for the Next 10 Years: Insurance Solutions Needed</th>
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<tbody>
<tr>
<td>Health Care</td>
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<td>Health Sciences</td>
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<td>Energy (Traditional)</td>
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<td>Alternative Energy</td>
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<td>Petrochemical</td>
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<td>Agriculture</td>
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<td>Natural Resources</td>
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<td>Technology (incl. Biotechnology)</td>
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<td>Light Manufacturing</td>
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<td>Insourced Manufacturing</td>
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<td>Export-Oriented Industries</td>
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<td>Shipping (Rail, Marine, Trucking)</td>
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</table>
Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend is Improving
Unemployment and Underemployment Rates: Stubbornly High in 2012, But Falling

January 2000 through March 2012, Seasonally Adjusted (%)

- Traditional Unemployment Rate U-3
- Unemployment + Underemployment Rate U-6

Unemployment stood at 8.2% in March 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

Monthly Change in Private Employment

January 2008 through March 2012* (Thousands)


Monthly Losses in Dec. 08–Mar. 09 Were the Largest in the Post-WW II Period

121,000 private sector jobs were created in March


December 2007 through March 2012* (Millions)

- Cumulative job losses peaked at 8.444 million in December 2009.
- All of the jobs “lost” since President Obama took office in Jan. 2009 have been recouped.


In March, 30 states reported over-the-month unemployment rate decreases, 8 had increases, and 12 and the District of Columbia had no change.
In March, 30 states reported over-the-month unemployment rate decreases, 8 had increases, and 12 and the District of Columbia had no change.
US Unemployment Rate

**2007:Q1 to 2013:Q4F**

Rising unemployment eroded payrolls and workers comp’s exposure base.

Unemployment peaked at 10% in late 2009.

Jobless figures have been revised downwards for 2012.

Unemployment forecasts have been revised downwards for 2012 and 2013. Optimistic scenarios put the unemployment as low as 7.7% by Q4 of this year.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (4/12 edition); Insurance Information Institute.

* = actual;  = forecasts
Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2011:Q4

Billions

Peak was 2008:Q1
at $6.60 trillion

Latest (2011:Q4) was $6.71 trillion, a new peak

Pace of payroll growth is accelerating

Recent trough (2009:Q3) was $6.25 trillion, down 5.3% from prior peak

Growth rates in 2011
Q2 over Q1: 0.6%
Q3 over Q2: 0.4%
Q4 over Q3: 1.0%

Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.
Sources: [http://research.stlouisfed.org/fred2/series/WASCUR](http://research.stlouisfed.org/fred2/series/WASCUR); National Bureau of Economic Research (recession dates); Insurance Information Institute.
P/C Insurance Industry
Financial Overview

Profit Recovery Was Set Back in 2011 by High Catastrophe Loss & Other Factors
P/C Net Income After Taxes
1991–2011 ($ Millions)

- 2005 ROE* = 9.6%
- 2006 ROE = 12.7%
- 2007 ROE = 10.9%
- 2008 ROE = 0.1%
- 2009 ROE = 5.0%
- 2010 ROE = 6.6%
- 2011:Q3 ROAS\(^1\) = 3.5%

P-C Industry 2011 profits were down 46% to $19.2B vs. 2010, due primarily to high catastrophe losses and as non-cat underwriting results deteriorated

* ROE figures are GAAP; \(^1\)Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 4.6% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.
Sources: A.M. Best, ISO, Insurance Information Institute
A 100 Combined Ratio Isn’t What It Once Was: Investment Impact on ROEs

A combined ratio of about 100 generated ~5.5% ROE in 2009/10, 10% in 2005 and 16% in 1979

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

Combined Ratio / ROE

* 2008-2011 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2011 combined ratio including M&FG insurers is 108.2, ROAS = 3.5%.
Source: Insurance Information Institute from A.M. Best and ISO data.
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2011*

*Profitability = P/C insurer ROEs are I.I.I. estimates. 2011 figure is an estimate based on ROAS data. Note: Data for 2008-2011 exclude mortgage and financial guaranty insurers. For 2011:Q3 ROAS = 3.5% including M&FG.
Source: Insurance Information Institute; NAIC, ISO, A.M. Best.
Global Catastrophe Loss Developments and Trends

2011 Rewrote Catastrophe Loss and Insurance History

But Will Losses Turn the Market?
Natural Loss Events, 2011

World Map

Number of Events: 820

- **Natural catastrophes**

- **Geophysical events**
  (earthquake, tsunami, volcanic activity)

- **Hydrological events**
  (flood, mass movement)

- **Selection of significant loss events (see table)**

- **Meteorological events**
  (storm)

- **Climatological events**
  (extreme temperature, drought, wildfire)

Source: MR NatCatSERVICE
### Top 16 Most Costly World Insurance Losses, 1970-2011**

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Insured Losses, 2011 Dollars, $ Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>Hugo</td>
<td>$7.7</td>
</tr>
<tr>
<td>1991</td>
<td>Winter Storm Daria</td>
<td>$8.1</td>
</tr>
<tr>
<td>2004</td>
<td>Chile Quake</td>
<td>$8.3</td>
</tr>
<tr>
<td>2004</td>
<td>Ivan</td>
<td>$8.5</td>
</tr>
<tr>
<td>2004</td>
<td>Typhoon Mireille</td>
<td>$9.3</td>
</tr>
<tr>
<td>2004</td>
<td>Charley</td>
<td>$9.7</td>
</tr>
<tr>
<td>2005</td>
<td>Wilma</td>
<td>$11.9</td>
</tr>
<tr>
<td>2011</td>
<td>Thailand Floods</td>
<td>$13.0</td>
</tr>
<tr>
<td>2011</td>
<td>New Zealand Quake</td>
<td>$13.0</td>
</tr>
<tr>
<td>2005</td>
<td>Northridge</td>
<td>$19.1</td>
</tr>
<tr>
<td>2011</td>
<td>Spring Tornadoes/Storms</td>
<td>$21.3</td>
</tr>
<tr>
<td>2011*</td>
<td>WTC Terror Attack</td>
<td>$24.0</td>
</tr>
<tr>
<td>2011</td>
<td>Andrew</td>
<td>$25.0</td>
</tr>
<tr>
<td>2005</td>
<td>Japan Quake, Tsunami</td>
<td>$37.5</td>
</tr>
<tr>
<td>2005</td>
<td>Katrina</td>
<td>$47.6</td>
</tr>
</tbody>
</table>

*Average of range estimates of $35B - $40B as of 1/4/12; Privately insured losses only.

**Figures do not include federally insured flood losses.

Sources: Swiss Re *sigma* 1/2011; Munich Re; Insurance Information Institute research.

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Taken as a single event, the Spring 2011 tornado and thunderstorm season would likely become the 5th costliest event in global insurance history.
U.S. Insured Catastrophe Loss Update

2011 Was One of the Most Expensive Years on Record
Top 14 Most Costly Disasters in U.S. History

(Insured Losses, 2011 Dollars, $ Billions)

*Losses will actually be broken down into several “events” as determined by PCS. Includes losses for the period April 1 – June 30.

Sources: PCS; Insurance Information Institute inflation adjustments.

**Hurricane Irene became the 11th most expense hurricane in US history**
Natural Disasters in the United States, 1980 – 2011
Number of Events (Annual Totals 1980 – 2011)

There were 117 natural disaster events in 2011

Source: MR NatCatSERVICE
US CAT Losses in 2011 Were the 5th Highest in US History on An Inflation Adjusted Basis

*PCS figure as of April 6, 2012.

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.
2011’s Most Expensive Catastrophes, Insured Losses

- **$7,300** for Thunderstorms, Apr. 22-26
- **$6,900** for Thunderstorms, May 20-27
- **$5,000** for Hurricane Irene, Aug. 26-28**
- **$2,000** for Thunderstorms, Apr. 3-5
- **$1,510** for Thunderstorms, Apr. 8-11
- **$1,400** for Thunderstorms, Apr. 14-16
- **$1,200** for Thunderstorms, Jun. 16-22
- **$1,000** for Texas Drought, 2011*
- **$980** for Thunderstorms, Jul. 10-14
- **$975** for Winter Storm, Jan. 31-Feb. 3
- **$840** for Thunderstorms, Aug. 18-19
- **$830** for Thunderstorms, Apr. 19-20
- **$530** for Wildfire, Sep. 4-19
- **$500** for Flooding, April*

**Includes $700 million in flood losses insured through the National Flood Insurance Program.**

Source: PCS except as noted by “*” which are sourced to Munich Re; Insurance Information Institute.

**Includes $1.65B in AL, mostly in the Tuscaloosa and Birmingham areas.**

**Includes approximately $2B in losses for May 22 Joplin tornado.**
Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2011*

Combined Ratio Points

Avg. CAT Loss Component of the Combined Ratio by Decade

- 1960s: 1.04
- 1970s: 0.85
- 1980s: 1.31
- 1990s: 3.39
- 2000s: 3.52
- 2010s: 6.20*

The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

*Insurance Information Institute estimates for 2010 and 2011 based on A.M. Best data.

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; Insurance Information Institute.

Average thunderstorm losses are up more than 5 fold since the early 1980s.

Thunderstorm losses in 2011 totaled a record $25.8 billion.

Hurricanes get all the headlines, but thunderstorms are consistent producers of large scale loss. 2008-2011 are the most expensive years on record.

Source: Property Claims Service, MR NatCatSERVICE
Insured winter storm losses in 2011 totaled $2.0 billion. Average winter storm losses have nearly doubled since the early 1980s.
8.3 millions acres were burned by wildfires in 2011, one of the worst years on record, causing $855 in insured losses.
U.S. Insured Catastrophe Losses by Cause of Loss, 2011 ($ Millions)

- Hurricanes & Tropical Storms, $5,510 (72.1%)
- Wildfires, $855 (15.4%)
- Other, $1,000 (11.5%)
- Thunderstorms & Tornadoes, $25,813 (45.6%)
- Flood, $535 (1.5%)
- Geological Events, $50 (0.1%)
- Winter Storms, $2,017 (3.6%)
- Other, $1,000 (1.5%)

Thunderstorm/Tornado losses were 2.5 times above the 30-year average.

2011’s insured loss distribution was unusual with tornado and thunderstorm accounting for the vast majority of loss.

Source: ISO’s Property Claim Services Unit, Munich Re; Insurance Information Institute.
Federal Disaster Declarations Patterns: 1953-2012

Records Were Set for Federal Disaster Declarations in 2010 and 2011—Most Declarations Were Unrelated to Tropical Activity
Number of Federal Disaster Declarations, 1953-2012*

The number of federal disaster declarations set a new record in 2011, with 99, shattering 2010’s record 81 declarations.

There have been 2,057 federal disaster declarations since 1953. The average number of declarations per year is 34 from 1953-2010, though that few haven’t been recorded since 1995.

12 federal disasters were declared through Apr. 30, 2012

The Number of Federal Disaster Declarations Is Rising and Set New Records in 2010 and 2011

Federal Disasters Declarations by State, 1953 – 2012: Highest 25 States*

Over the past nearly 60 years, Texas has had the highest number of Federal Disaster Declarations

AL has had 56 federal disaster declarations since 1953, nearly one per year, and has had 1 so far in 2012

Federal Disasters Declarations by State, 1953 – 2012: Lowest 25 States*

Over the past nearly 60 years, Utah and Rhode Island had the fewest number of Federal Disaster Declarations

2012 Is Off to a Worrisome Start, But a Repeat of 2011 Is Unlikely
Number of Tornadoes and Related Deaths, 1990 – 2012*

- Tornadoes claimed 550 lives in 2011, the most since 1925
- 584 tornadoes have been recorded so far this year claiming 63 lives*

2012 Tornado Losses Is Off to a Ominous Beginning. First Half 2011 Insured Losses from Tornadoes and Thunderstorms Topped $21B.


There were 1,897 tornadoes in the US in 2011 far above average, but well below 2008’s record

2012 count is running behind 2011

Source: http://www.spc.noaa.gov/wcm/
Location of Tornadoes in the US, 2012*

586 tornadoes killed 63 people through April 23

*Through April 7, 2012.
Source: NOAA Storm Prediction Center; http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html#
There were 2,084 “Large Hail” reports through April 23, 2012, causing extensive damage to homes, businesses and vehicles.

Location of Wind Damage Reports in the US, 2012*

There were 1,850 “Wind Damage” reports through Apr. 23, causing extensive damage to homes and businesses.

Source: NOAA Storm Prediction Center; [http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html](http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html)
Severe Weather Reports, 2012*

There were already 4,520 severe weather reports through Apr. 23; including 586 tornadoes; 2,084 “Large Hail” reports and 1,850 high wind events.

Source: NOAA Storm Prediction Center; http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html#
Severe Weather Reports, 2011

There were 29,996 severe weather reports in 2011; including 1,894 tornadoes; 9,417 “Large Hail” reports and 18,685 high wind events.

The BIG Question: When Will the Market Turn?

Are Catastrophes and Other Factors Pressuring Insurance Markets?
Criteria Necessary for a “Market Turn”: All Four Criteria Must Be Met

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<tr>
<th>Criteria</th>
<th>Status</th>
<th>Comments</th>
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<tbody>
<tr>
<td>Sustained Period of Large Underwriting Losses</td>
<td>Early Stage, Inevitable</td>
<td>• Apart from 2011 CAT losses, overall p/c underwriting losses remain modest</td>
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<tr>
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<td>• Combined ratios (ex-CATs) still in low 100s (vs. 110+ at onset of last hard market)</td>
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<td>• Prior-year reserve releases continue to reduce u/w losses, boost ROEs, though more modestly</td>
</tr>
<tr>
<td>Material Decline in Surplus/Capacity</td>
<td>Entered 2011 At Record High; Only Small Decline</td>
<td>• Surplus hit a record $565B as of 3/31/11</td>
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<td>• Fell just 1.6% through 12/31/11 from 12/31/10</td>
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<td></td>
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<td>• Will likely see new record in 2012</td>
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<td></td>
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<td>• Little excess capacity remains in reinsurance markets</td>
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<td></td>
<td>• Modest growth in demand for insurance is insufficient to absorb much excess capacity</td>
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<tr>
<td>Tight Reinsurance Market</td>
<td>Somewhat in Place</td>
<td>• Much of the global “excess capacity” was eroded by cats</td>
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<td></td>
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<td>• Higher prices in Asia/Pacific</td>
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<td>• Modestly higher pricing for US risks</td>
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<tr>
<td>Renewed Underwriting &amp; Pricing Discipline</td>
<td>Some Firming esp. in Property, WC</td>
<td>• Commercial lines pricing trends have turned from negative to flat and now positive, esp. Property &amp; WC;</td>
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<td></td>
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<td>• Competition remains intense as many seek to maintain market share</td>
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Sources: Barclays Capital; Insurance Information Institute.
1. UNDERWRITING

Have Underwriting Losses Been Large Enough for Long Enough to Turn the Market?
As Recently as 2001, Insurers Paid Out Nearly $1.16 for Every $1 in Earned Premiums

Heavy Use of Reinsurance Lowered Net Losses

Relatively Low CAT Losses, Reserve Releases

Relatively Low CAT Losses, Reserve Releases

Avg. CAT Losses, More Reserve Releases

Higher CAT Losses, Shrinking Reserve Releases, Toll of Soft Market

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


Sources: A.M. Best, ISO.
The combined ratios for both personal and commercial lines insurers jumped by similar amounts in 2011.
Underwriting Gain (Loss)
1975–2011E*

Cumulative underwriting deficit from 1975 through 2011 is $479B

Underwriting losses in 2011 totaled $36.5B, the largest since 2001

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.
Reserve Releases Are Continuing Strong in 2010 But Should Begin to Taper Off in 2011

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: Barclay’s Capital; A.M. Best.
Financial Strength & Underwriting

Cyclical Pattern is P-C Impairment History is Directly Tied to Underwriting, Reserving & Pricing
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.

Source: A.M. Best; Insurance Information Institute

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

Performance by Segment: Commercial Lines
Commercial Lines Combined Ratio, 1990-2012F*

*2007-2012 figures exclude mortgage and financial guaranty segments.
Source: A.M. Best; Insurance Information Institute
Commercial Auto Combined Ratio: 1993–2012F

Commercial Auto is Expected to Deteriorate as Loss Frequency and Severity Trends Deteriorate 2011-2012

Sources: A.M. Best Insurance Information Institute.
Liability Lines Have Performed Better in the Post-Tort Reform Era (~2005), but There Has Been Some Deterioration in Recent Years

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

Commercial General Liability Underwriting Performance Has Deteriorated in Recent Years

Source: Conning Research and Consulting.
Workers Compensation Combined Ratio: 1994–2012F

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

Sources: A.M. Best; Insurance Information Institute.
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](http://research.stlouisfed.org/fred2/series/WASCUR); NCCI; I.I.I.
Direct Premiums Written: Worker’s Comp Percent Change by State, 2005-2010*

Top 25 States

Only 7 (small) states showed growth in workers comp premium volume between 2005 and 2010

Workers Comp DPW in MD dropped 14.7% from between 2005 and 2010

*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 Percent Change by State, 2005-2010*

Bottom 25 States

States with the poorest performing economies also produced the most negative net change in premiums of the past 5 years.

Workers Comp DPW plunged 28.7% from between 2005 and 2010.

*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.
2. SURPLUS/CAPITAL/CAPACITY

Have Large Global Losses Reduced Capacity in the Industry, Setting the Stage for a Market Turn?
Policyholder Surplus, 2006:Q4–2011:Q4

($ Billions)

2007:Q3 Previous Surplus Peak

The Industry now has $1 of surplus for every $0.80 of NPW, close to the strongest claims-paying status in its history.

Surplus as of 12/31/11 was down 2.5% below its all time record high of $564.7B set as of 3/31/11. A new record high in 2012 is possible.

Quarterly Surplus Changes Since 2011:Q1 Peak

11:Q2: -$5.6B (-1.0%)
11:Q3: -$26.1B (-4.6%)
11:Q4: -$14.3B (-2.5%)

*Includes $22.5B of paid-in capital from a holding company parent for one insurer’s investment in a non-insurance business in early 2010.

Sources: ISO, A.M. Best.
Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989*

* Ratio is for end-of-quarter surplus immediately after the event. Date shown is end of quarter prior to event

** Date of maximum capital erosion; As of 9/30/09 (latest available) ratio = 5.9%

Source: PCS; Insurance Information Institute

The Financial Crisis at its Peak Ranks as the Largest “Capital Event” Over the Past 20+ Years

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>6/30/1989</td>
<td>Hurricane Hugo</td>
<td>3.3%</td>
</tr>
<tr>
<td>6/30/1992</td>
<td>Hurricane Andrew</td>
<td>9.6%</td>
</tr>
<tr>
<td>12/31/93</td>
<td>Northridge Earthquake</td>
<td>6.9%</td>
</tr>
<tr>
<td>6/30/01</td>
<td>Sept. 11 Attacks</td>
<td>10.9%</td>
</tr>
<tr>
<td>6/30/04</td>
<td>Florida Hurricanes</td>
<td>6.2%</td>
</tr>
<tr>
<td>6/30/05</td>
<td>Hurricane Katrina</td>
<td>13.8%</td>
</tr>
<tr>
<td>3/31/09**</td>
<td>Financial Crisis as of</td>
<td>16.2%</td>
</tr>
<tr>
<td>3/31/11</td>
<td>Tornados &amp; Severe Storms</td>
<td>3.8%</td>
</tr>
</tbody>
</table>
M&A Activity in the US P/C Insurance Industry, 1997-2011*

P/C M&A activity in 2011 is up 60% since 2008, its highest level (in $ terms) since 2008

M&A Activity in the P/C Insurance Industry Remains Well Below its 1990s Peak

*2011 data are through December 1.
Source: SNL Securities; Insurance Information Institute.
3. REINSURANCE MARKET CONDITIONS

Record Global Catastrophes Activity is Pressuring Pricing
Global Property Catastrophe Rate on Line Index, 1990—2012 (as of Jan. 1)

Property-Cat reinsurance pricing is up about 8% as of 1/1/12—modest relative to the level CAT losses.

Sources: Guy Carpenter; Insurance Information Institute.
4. RENEWED PRICING DISCIPLINE

Is There Evidence of a Broad and Sustained Shift in Pricing?
Premium Growth Is Up Modestly: More in 2012?

Shaded areas denote “hard market” periods
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.
Finally! Back-to-back quarters of net written premium growth (vs. the same quarter, prior year)

Sources: ISO, Insurance Information Institute.
Direct Premiums Written: All P/C Lines
Percent Change by State, 2005-2010

Top 25 States

North Dakota is the growth juggernaut of the P/C insurance industry—too bad nobody lives there…

West Virginia premium growth was among the fastest in the US in recent years…

Sources: SNL Financial LC.; Insurance Information Institute.
States with the poorest performing economies also produced the most negative net change in premiums of the past 5 years.

US Direct Premiums Written declined by 1.6% between 2005 and 2010.

Sources: SNL Financial LC; Insurance Information Institute.
Growth in Net Written Premium by Segment, 2011 vs. 2010

Personal lines insurer growth decelerated as auto pricing moderated even has homeowners insurance rates rose.

Commercial lines growth improved dramatically as a 7-year long soft market came to an end and an improving economy bolstered demand.

Source: ISO/PCI; Insurance Information Institute
Average Commercial Rate Change, All Lines, (1Q:2004–4Q:2011)

(Percents)

Pricing as of Q3:2011 was positive for the first time since 2003. Slightly stronger gains in Q4.

Q2 2011 marked the 30th consecutive quarter of price declines.

Source: Council of Insurance Agents & Brokers (1Q04-4Q11); Insurance Information Institute
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2011:Q4

Percentage Change (%)

Peak = 2001:Q4
+28.5%

Pricing Turned Negative in Early 2004 and Remained that way for 7 ½ years

Trough = 2007:Q3
-13.6%

Pricing turned positive (+0.9%) in Q3:2011, the first increase in nearly 8 years; Q4:2011 renewals were up 2.8%

Source: Council of Insurance Agents and Brokers; Barclay’s Capital; Insurance Information Institute.
Despite Q4:2011 gain of 2.8%, pricing today is where it was in late 2000 (pre-9/11)

Upward pricing pressure is small for large accounts, 1.8% in Q4:2011, vs. 3.1% for small accounts and 3.5% for medium accounts.
Change in Commercial Rate Renewals, by Line: 2011:Q4

### Percentage Change (%)

<table>
<thead>
<tr>
<th>Type</th>
<th>Percentage Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surety</td>
<td>0.8%</td>
</tr>
<tr>
<td>EPL</td>
<td>2.0%</td>
</tr>
<tr>
<td>Comm Auto</td>
<td>2.0%</td>
</tr>
<tr>
<td>D&amp;O</td>
<td>2.1%</td>
</tr>
<tr>
<td>General Liability</td>
<td>2.2%</td>
</tr>
<tr>
<td>Umbrella</td>
<td>2.3%</td>
</tr>
<tr>
<td>Construction</td>
<td>2.7%</td>
</tr>
<tr>
<td>Bus. Interruption</td>
<td>3.0%</td>
</tr>
<tr>
<td>Commercial Property</td>
<td>5.7%</td>
</tr>
<tr>
<td>Workers Comp</td>
<td>7.5%</td>
</tr>
</tbody>
</table>

- Property lines are showing larger increases than casualty lines, with the exception of workers compensation.

Major Commercial Lines Renewed Uniformly Upward in Q4:2011 for Only the Second Time Since 2003; Property Lines & Workers Comp Leading the Way

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
INVESTMENTS: THE NEW REALITY

Investment Performance is a Key Driver of Profitability

Does It Influence Underwriting or Cyclicality?
Investment Gains in 2011 Were Surprisingly Robust. Investment Gains Recovered Significantly in 2011 Due to Realized Investment Gains; The Financial Crisis Caused Investment Gains to Fall by 50% in 2008.

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.
Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line*

- Personal Lines: -1.8%
- Ptw Pass Auto: -1.8%
- Pers Prop: -2.0%
- Commercial: -3.6%
- Comm Auto: -1.9%
- Credit: -2.1%
- Comm Prop: -3.1%
- Comm Cas: -3.3%
- Fidelity/Surety: -3.3%
- Warranty: -3.7%
- Surplus Lines: -4.3%
- Med Mal: -5.2%
- WC: -5.7%
- Reinsurance**: -7.3%

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.
Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?
Over the Last Three Decades, Total Tort Costs as a % of GDP Appear Somewhat Cyclical, 1980-2013E

Tort costs in dollar terms have remained high but relatively stable since the mid-2000s, but are down substantially as a share of GDP since the mid-2000s. The Deepwater Horizon Spike in 2010 increased tort costs significantly as a share of GDP.

Sources: Towers Watson, 2011 Update on US Tort Cost Trends, Appendix 1A
The Nation’s Judicial Hellholes: 2011

**Watch List**
- Eastern District of Texas
- Cook County, IL
- Southern NJ
- Franklin County, AL
- Smith County, MS
- Louisiana

**Dishonorable Mention**
- MI Supreme Court
- AK Supreme Court
- MO Supreme Court

Source: American Tort Reform Association; Insurance Information Institute
Inflation

Is it a Threat to Claim Cost Severities
Annual Inflation Rates, (CPI-U, %), 1990–2017F

Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble reduced inflationary pressures in 2009/10.

Higher energy, commodity and food prices pushed up inflation in 2011, but not longer turn inflationary expectations.

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.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 10/11 and 4/12 (forecasts).
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 liability, med pay, and PIP claim cost driver. They are likely to grow faster than the CPI for the next few years, at least

Thank you for your time and your attention!

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