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# Overview and Outlook for the P/C Insurance Industry: Trends and Challenges for 2013 and Beyond

## Underwriting Executives Council
## Bonita Springs, FL
## May 9, 2013

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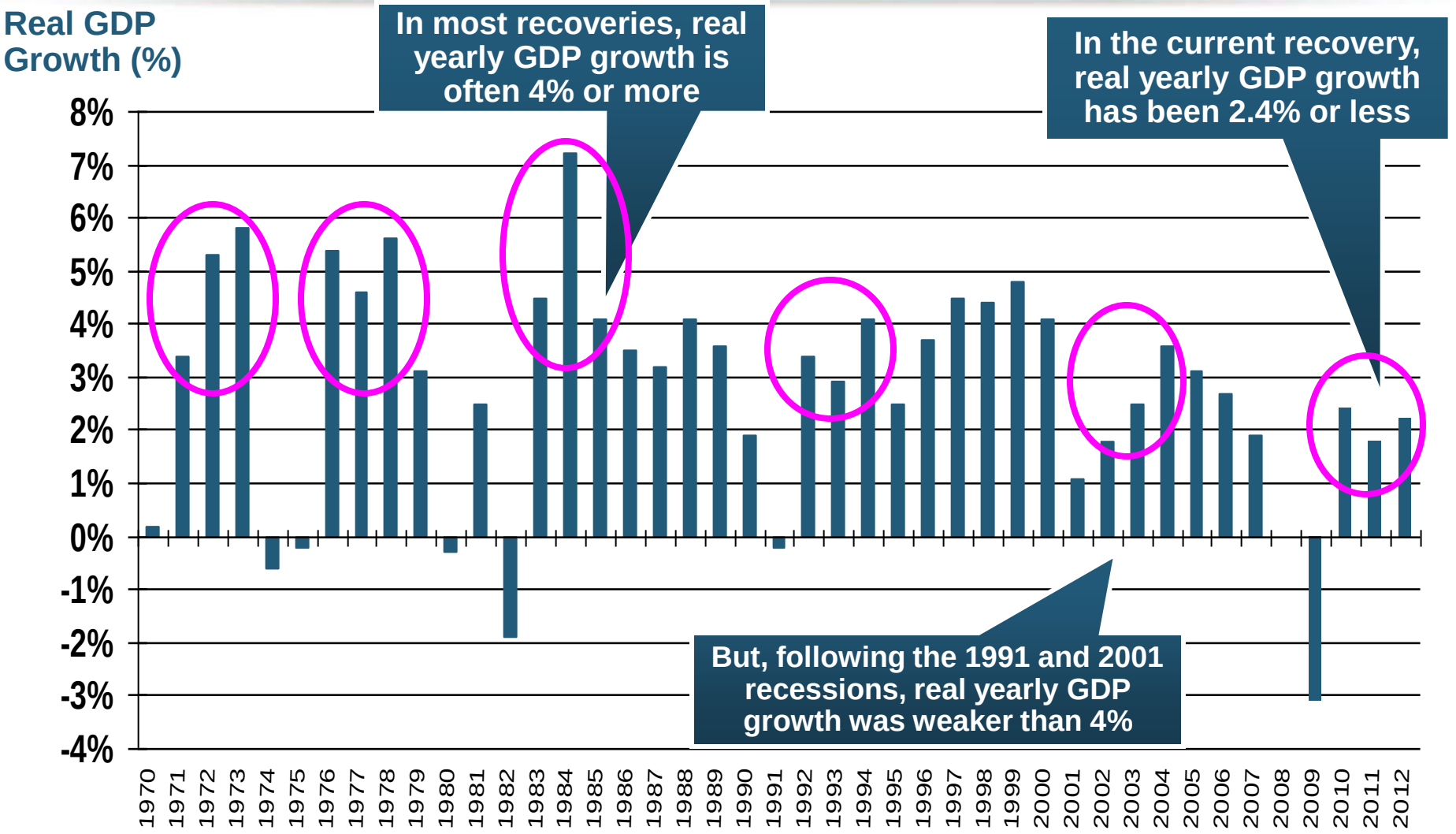
# SomeTrends & Challenges Affecting the P/C Industry

- Slow/Uncertain Exposure Growth
- Growing Impact of CATs
- Low Investment Income
- Highly Variable Claims Drivers
- Challenging Regulatory Environment

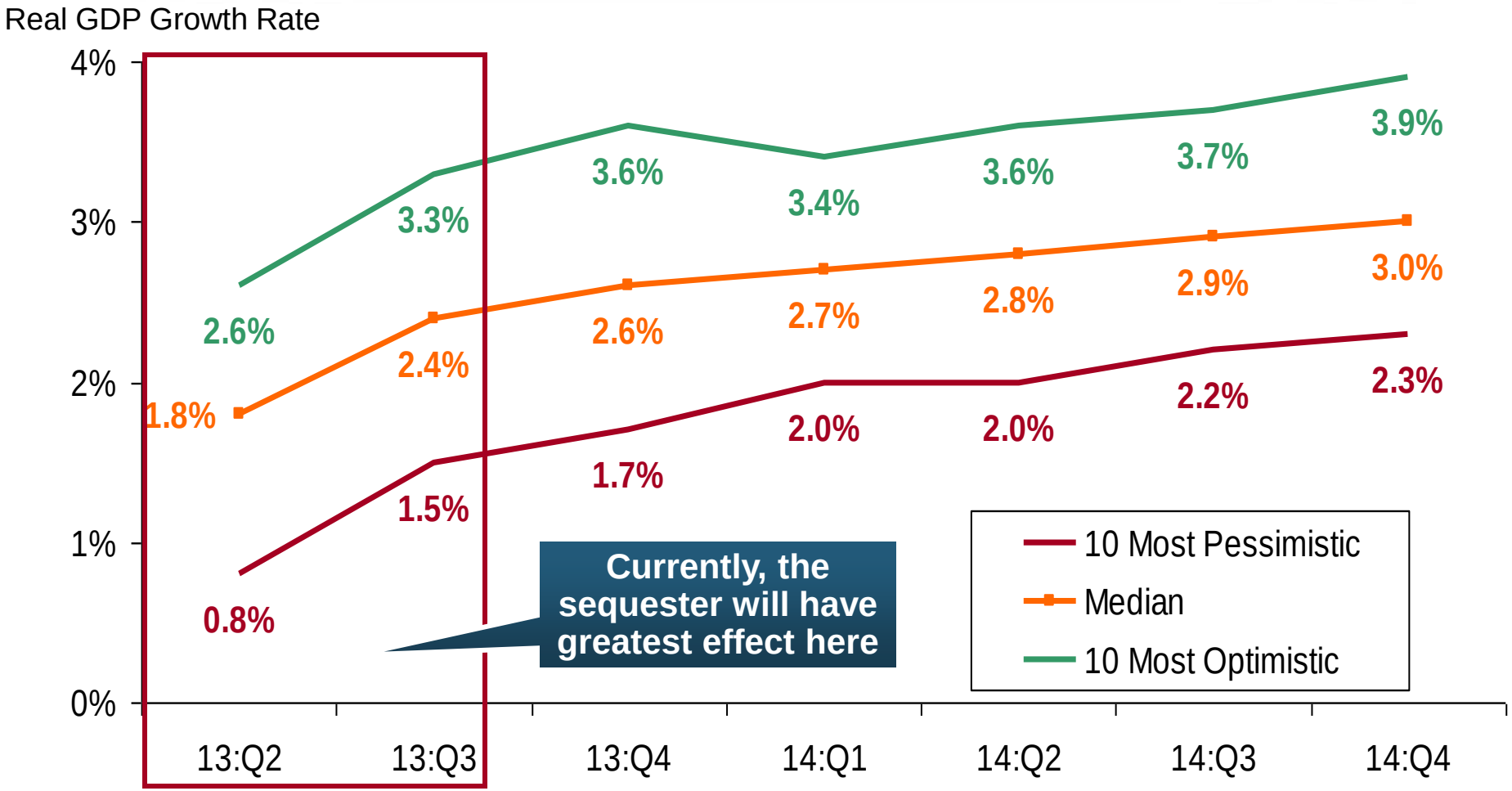
# Challenge #1: Slow/Variable Exposure Growth

# Real GDP Growth: Past Recessions and Recoveries, Yearly, 1970-2012




Source: (GDP) U.S. Department of Commerce at http://www.bea.gov/national/xls/gdpchg.xls.

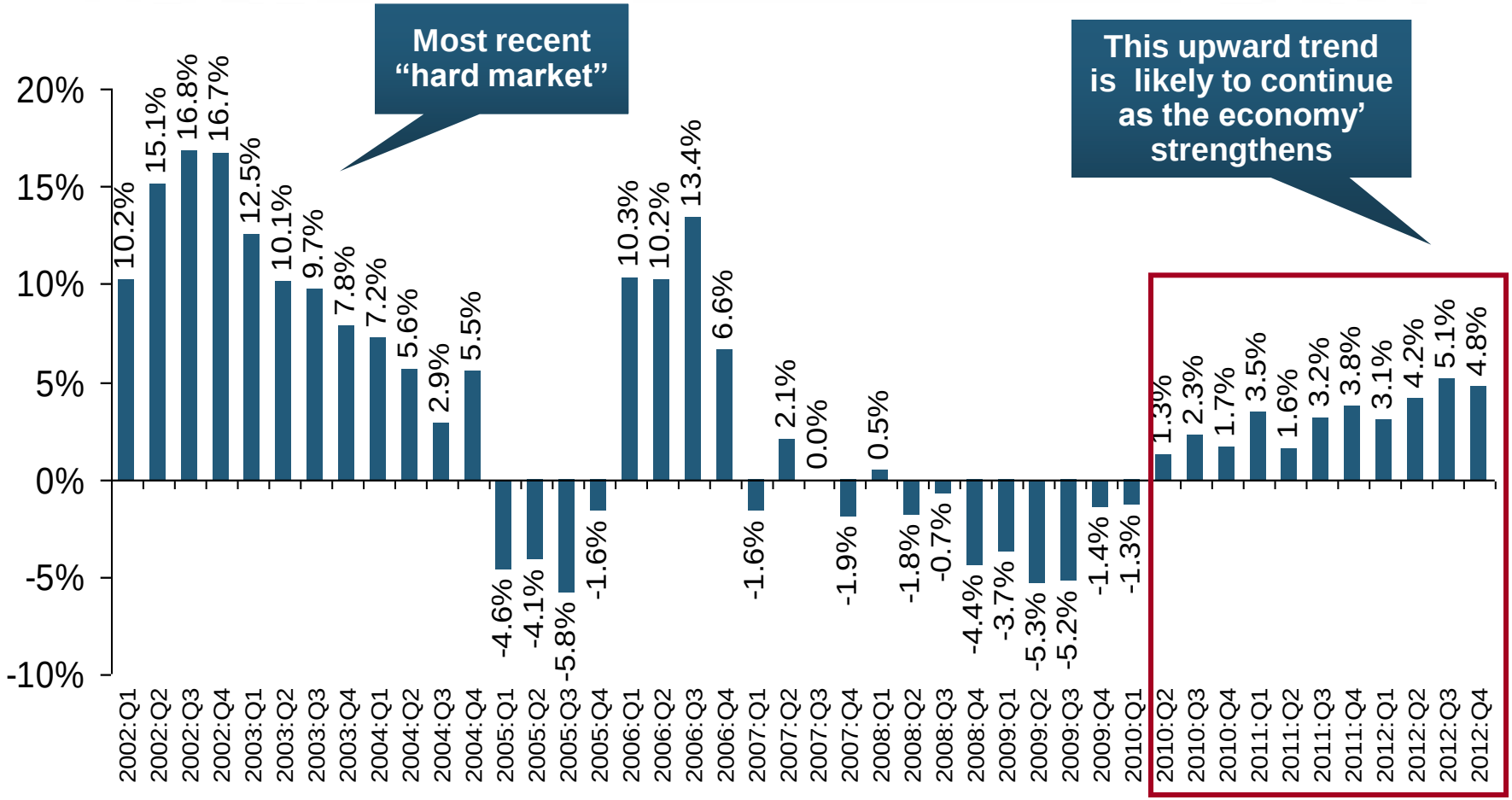
# April 2013 Forecasts of Quarterly US Real GDP for 2013-14




**Despite the sequester and other challenges to the U.S. economy, virtually every forecast in the Blue Chip universe in early April sees improvement ahead**

Sources: Blue Chip Economic Indicators (4/13); Insurance Information Institute

# P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter, 2002–2012




**Finally! A sustained period (11 quarters) of growth in net premiums written (vs. same quarter, prior year), and strengthening.**

Sources: ISO; Insurance Information Institute.

# Growth Analysis by State and Business Segment

## Premium Growth Rates Vary Tremendously by State

# Direct Premiums Written: Total P/C Percent Change by State, 2007-2012

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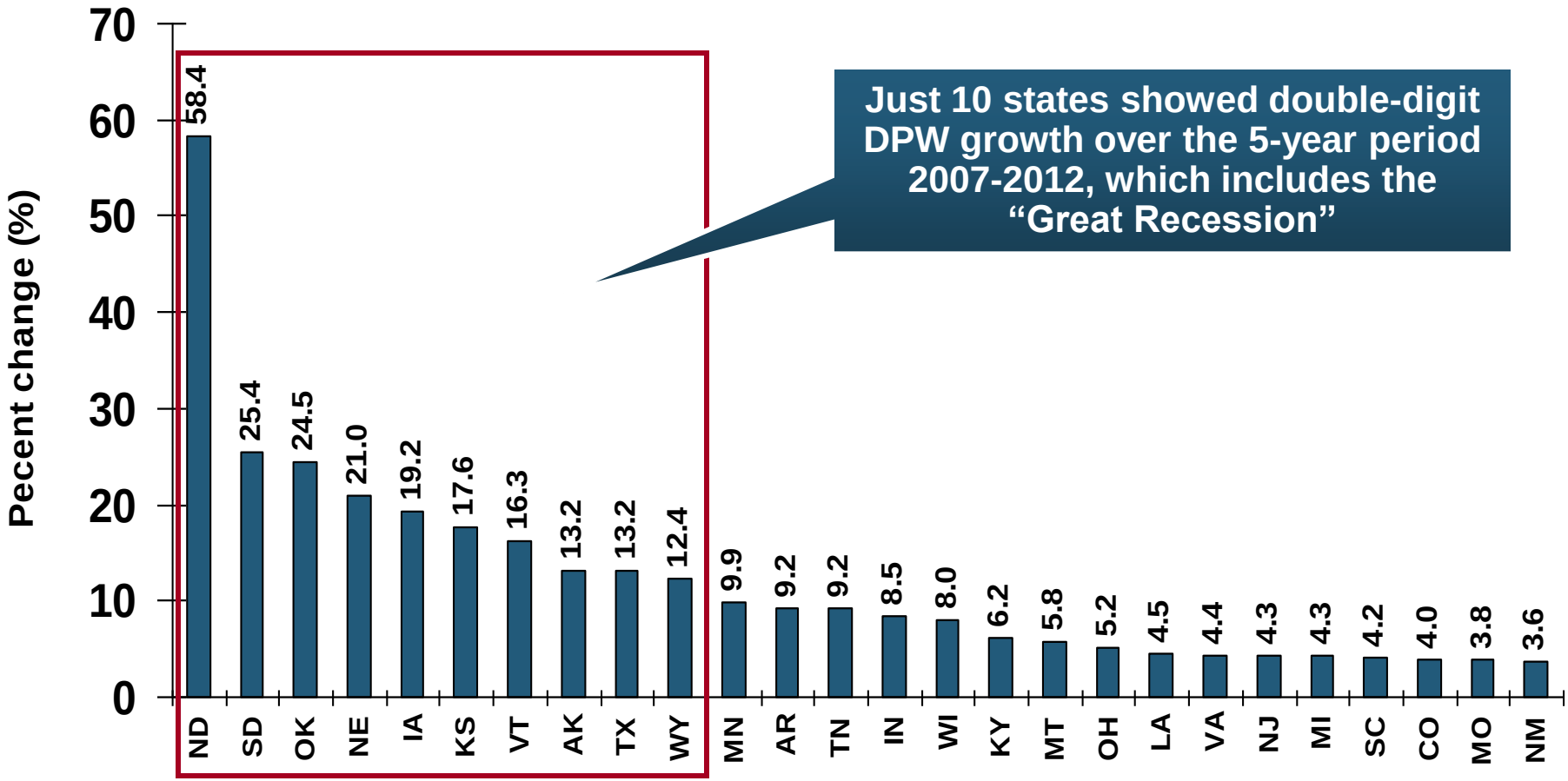
## Top 25 States




Sources: SNL Financial LC.; Insurance Information Institute.

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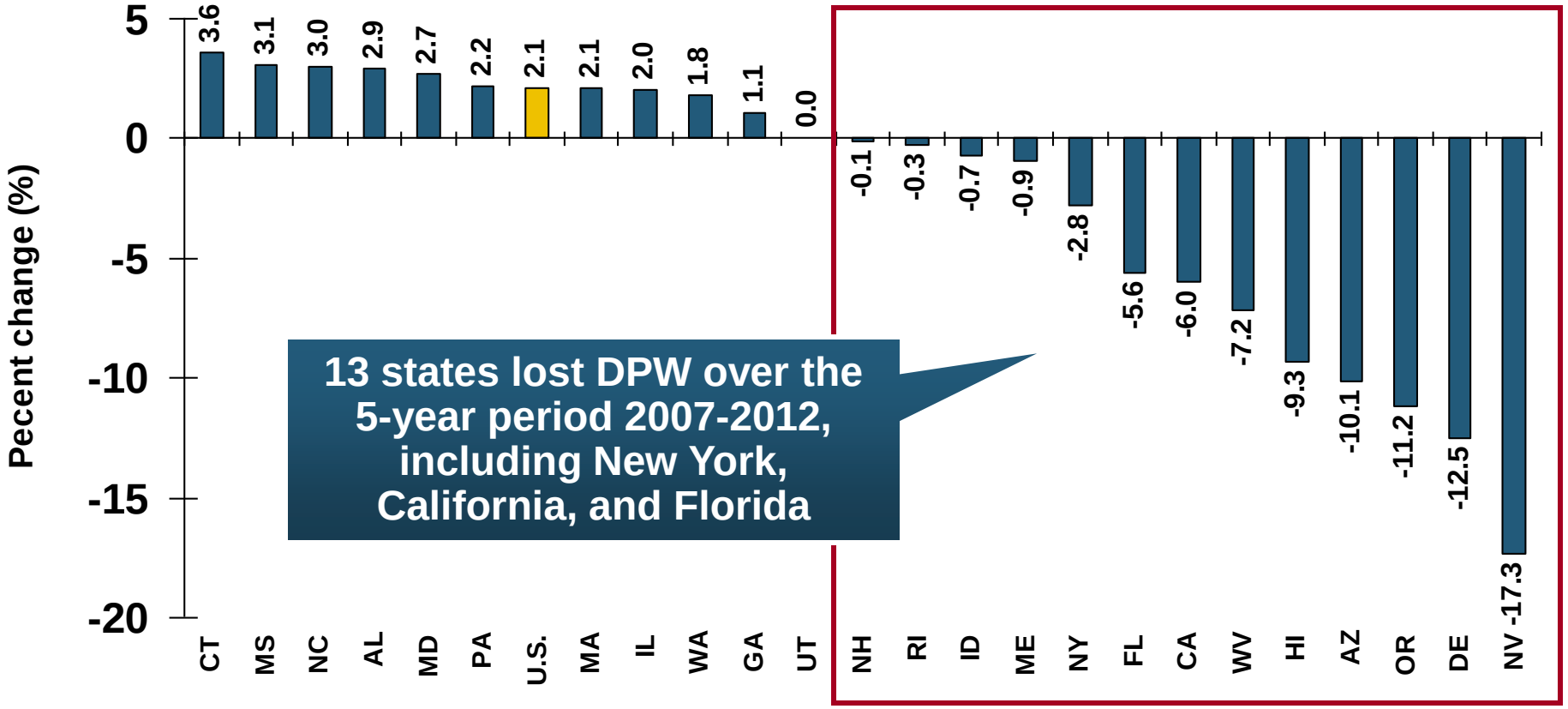


Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: PP Auto Percent Change by State, 2007-2012

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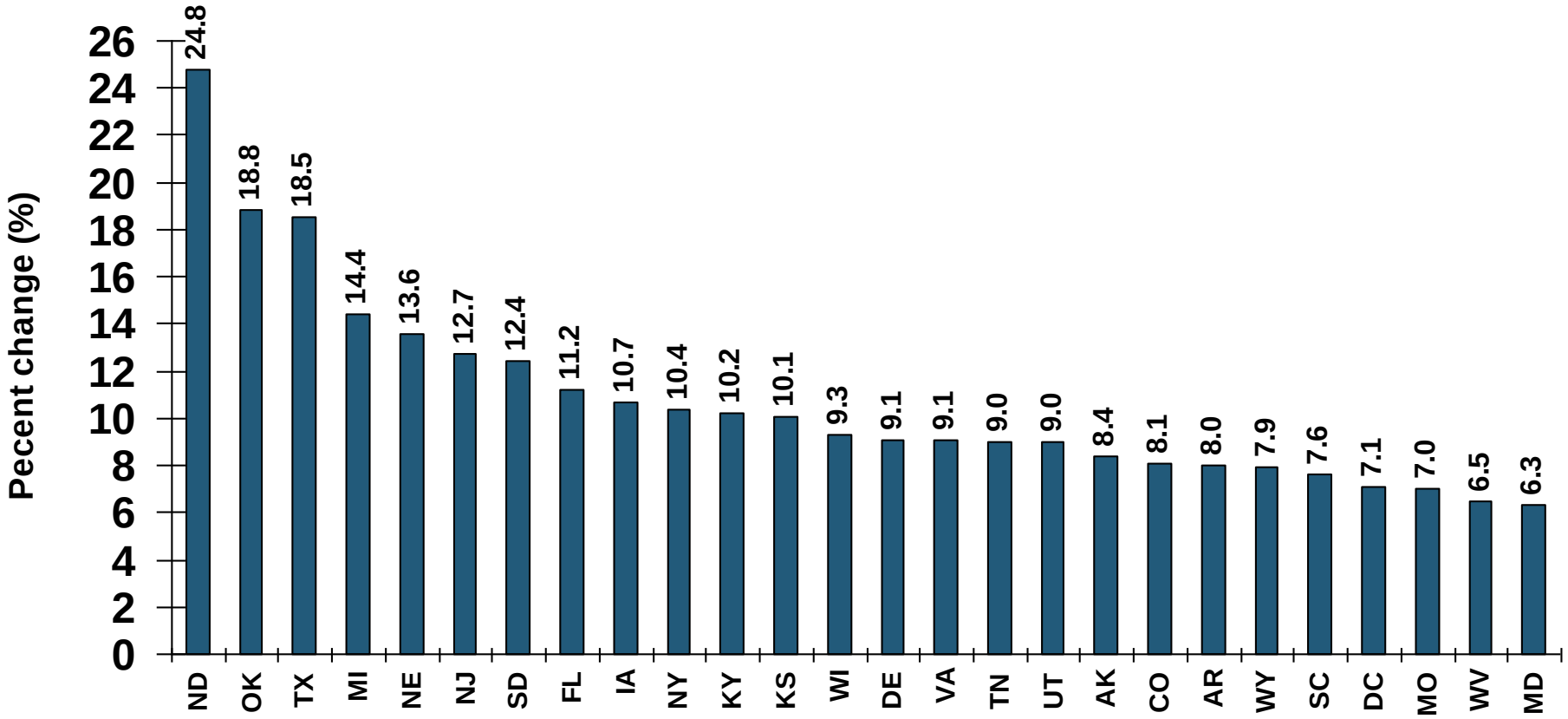
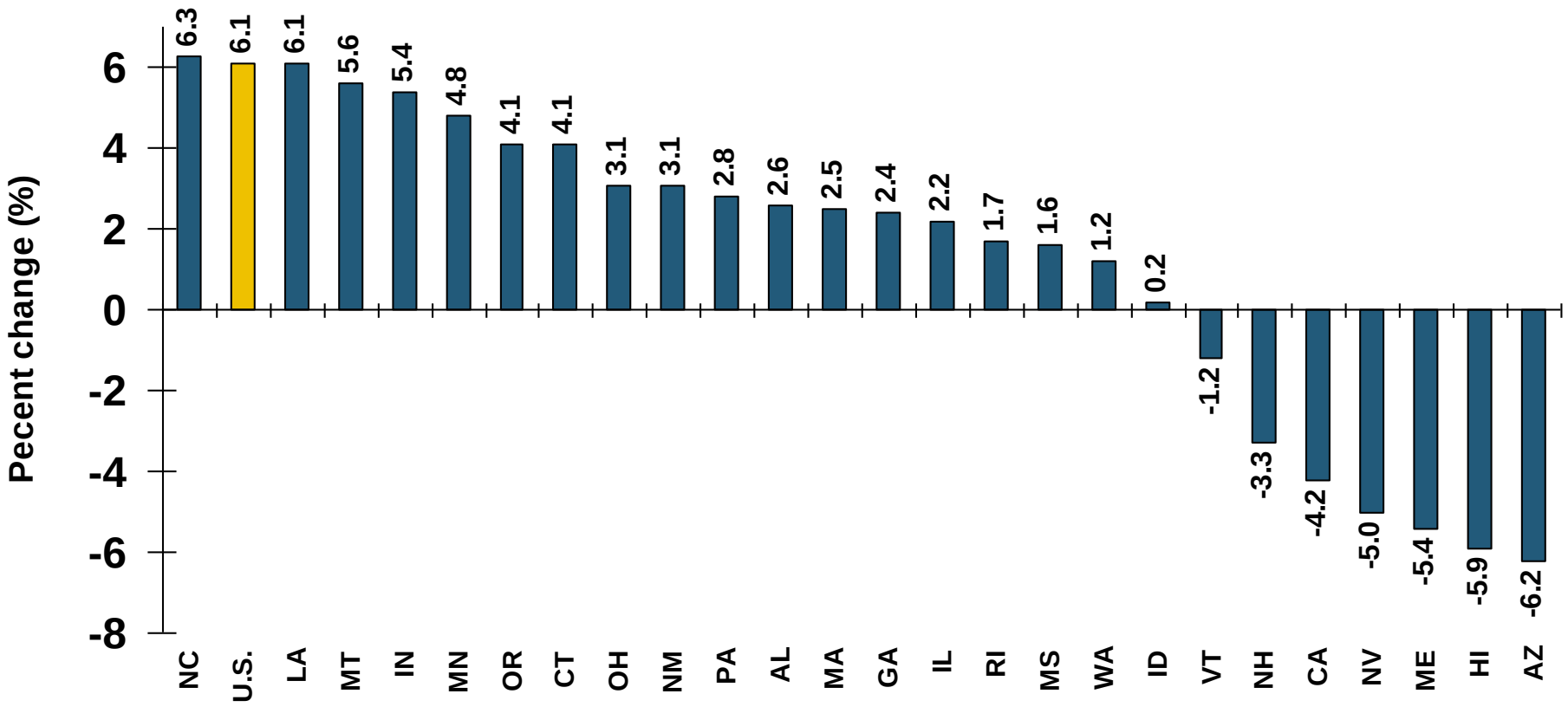
## Top 25 States




Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: PP Auto Percent Change by State, 2007-2012

## Bottom 25 States




Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: Homeowners Percent Change by State, 2007-2012

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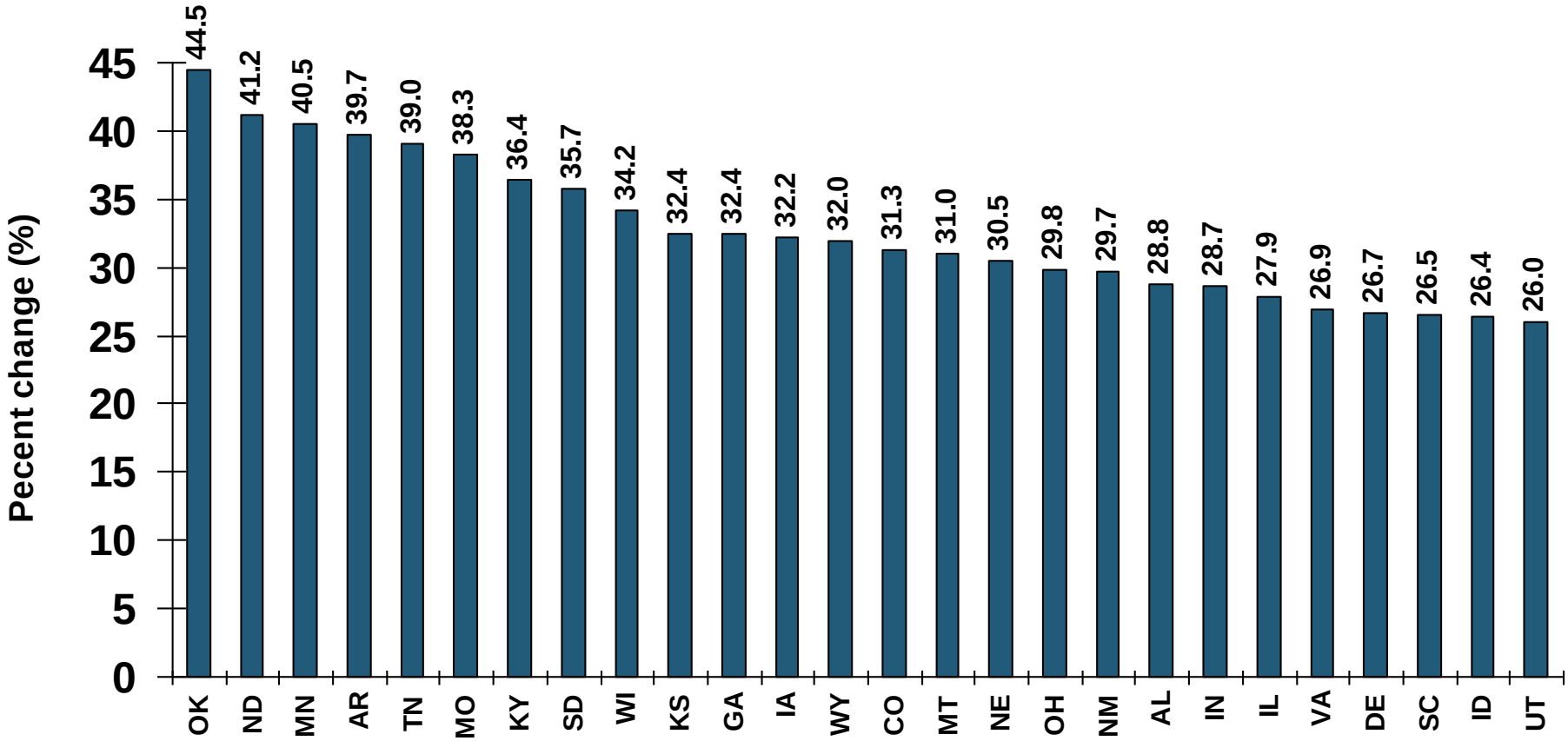
## Top 25 States




Sources: SNL Financial LC.; Insurance Information Institute.

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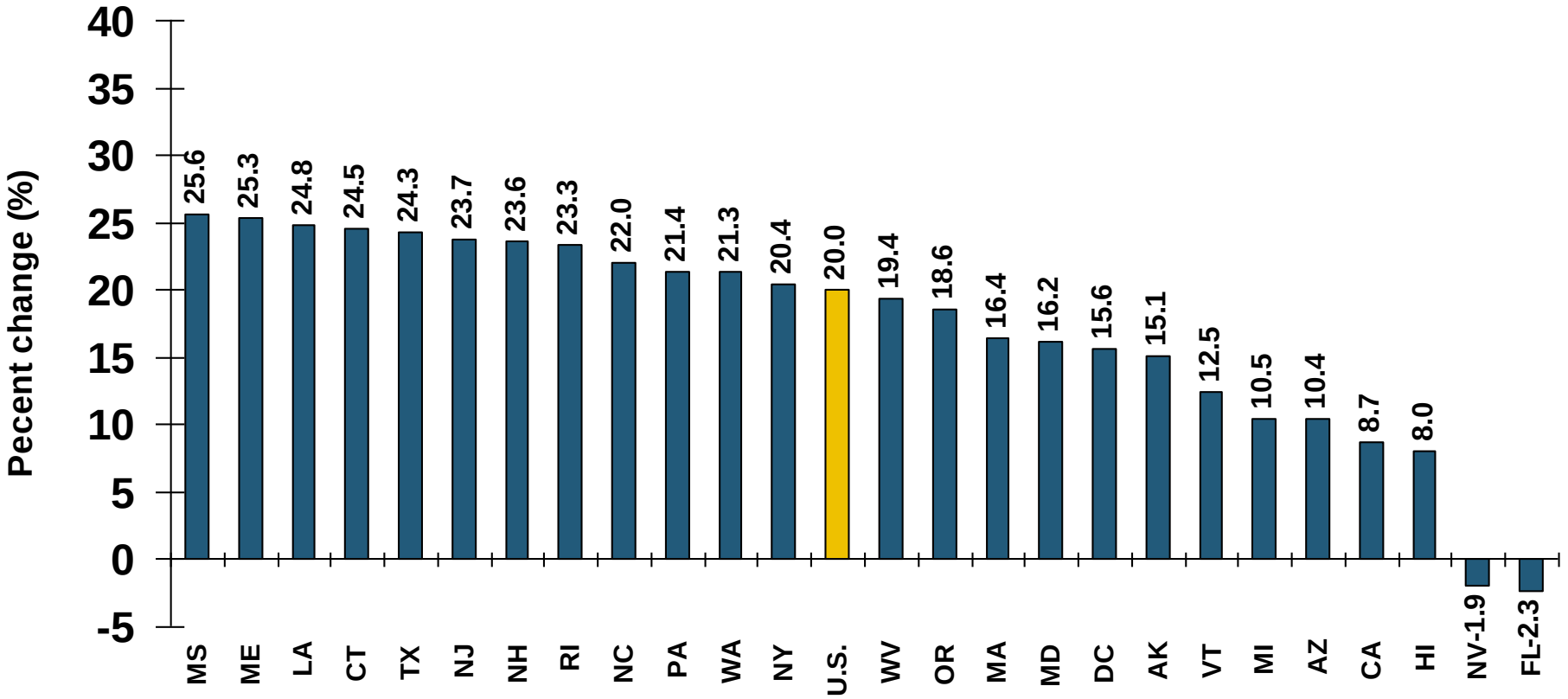


Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: Comm. Lines Percent Change by State, 2007-2012

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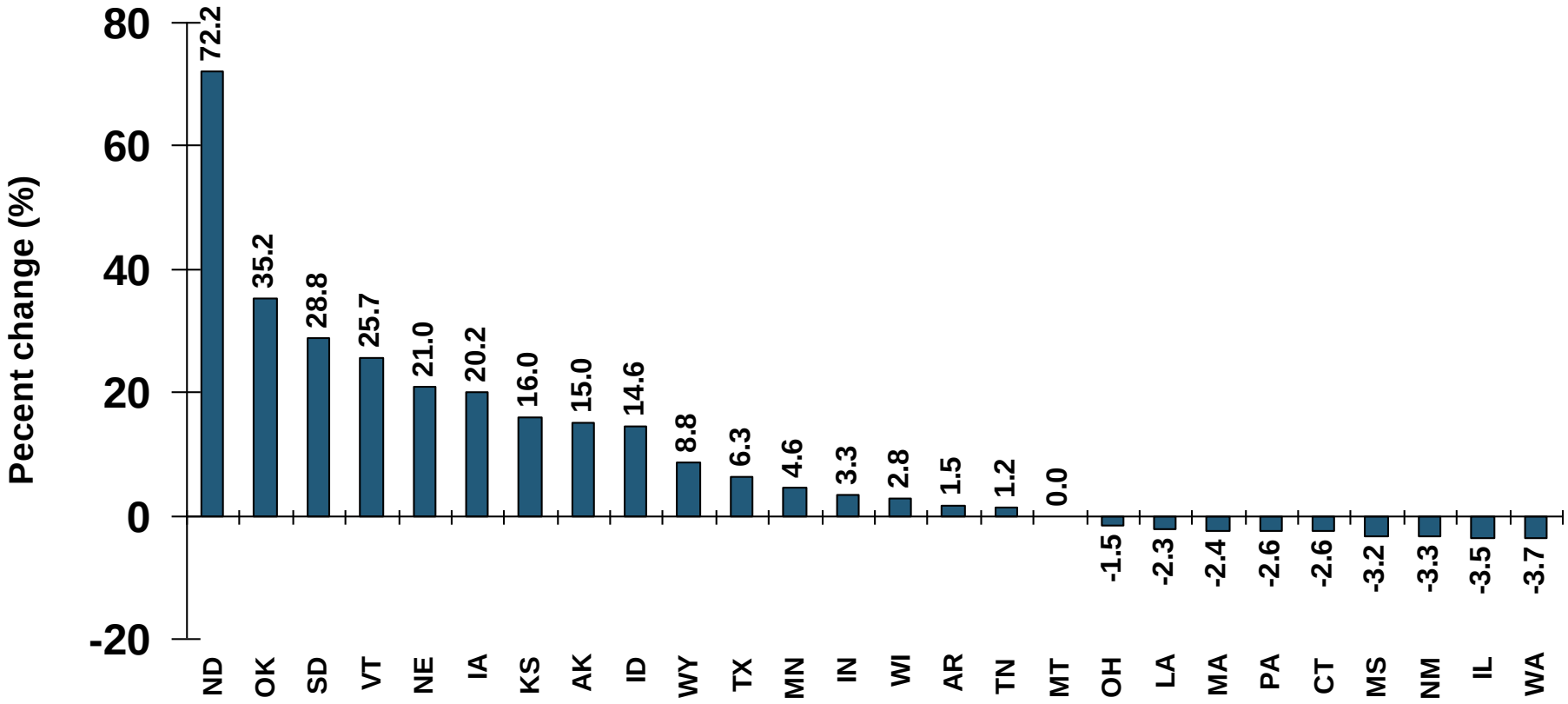
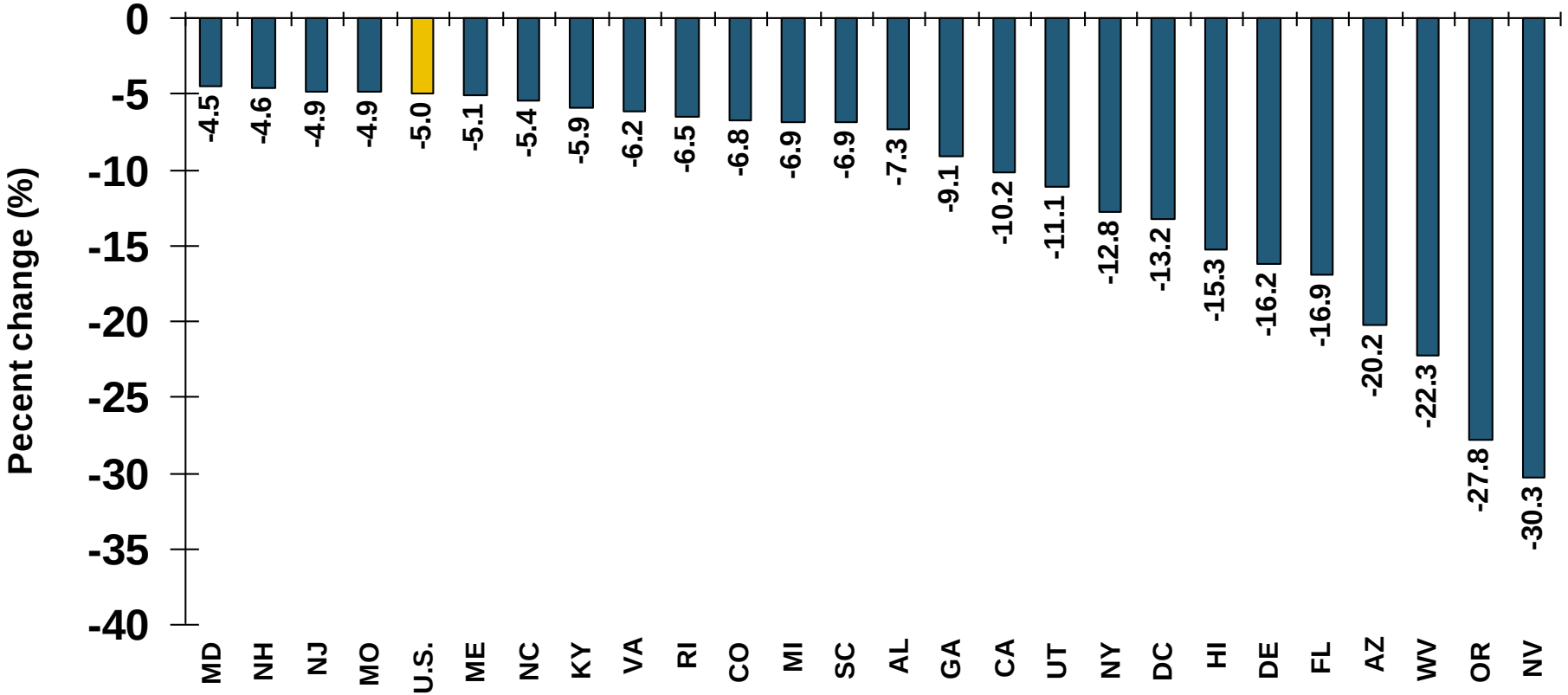
## Top 25 States




Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: Comm. Lines Percent Change by State, 2007-2012

## Bottom 25 States




Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: Workers' Comp Percent Change by State, 2007-2012

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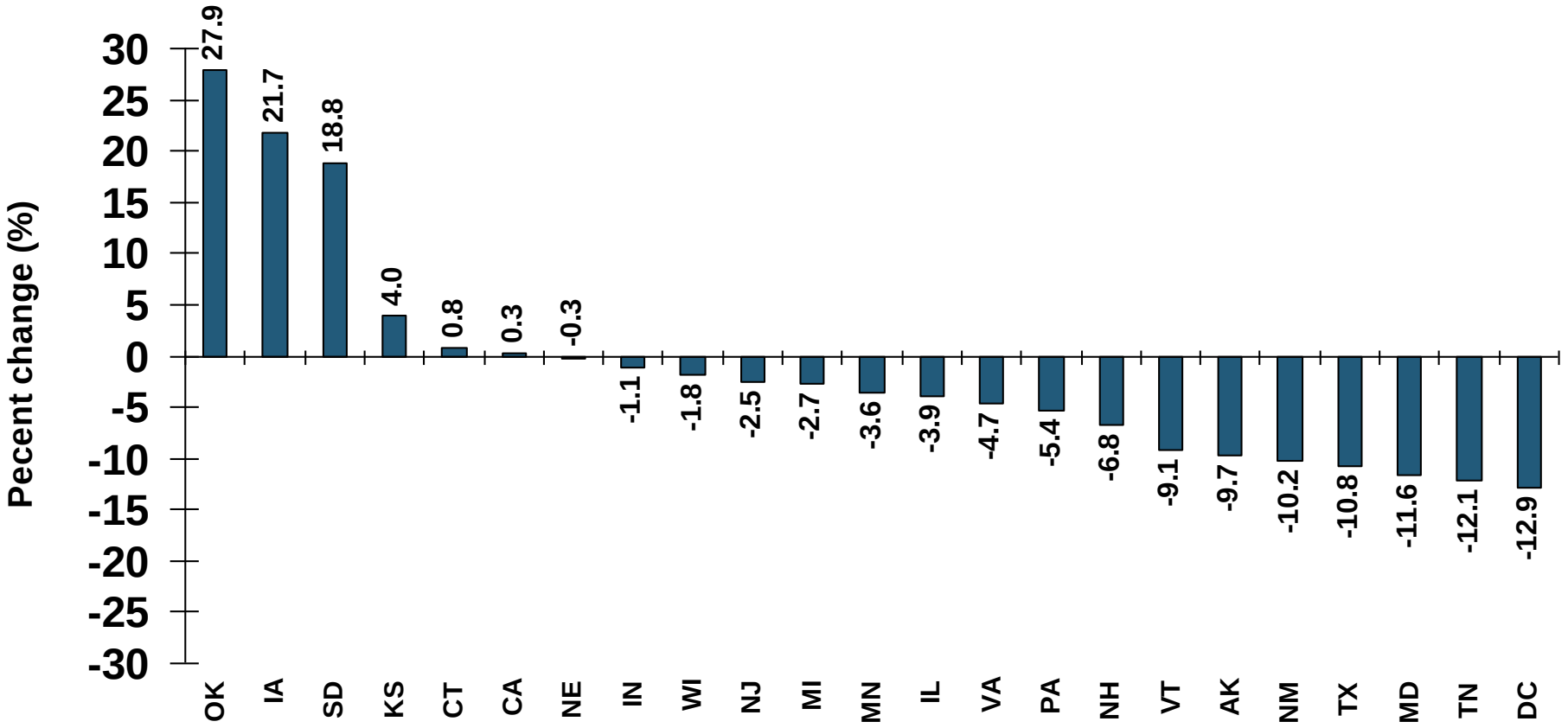
## Top 25 States




*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.

# Direct Premiums Written: Worker's Comp Percent Change by State, 2007-2012

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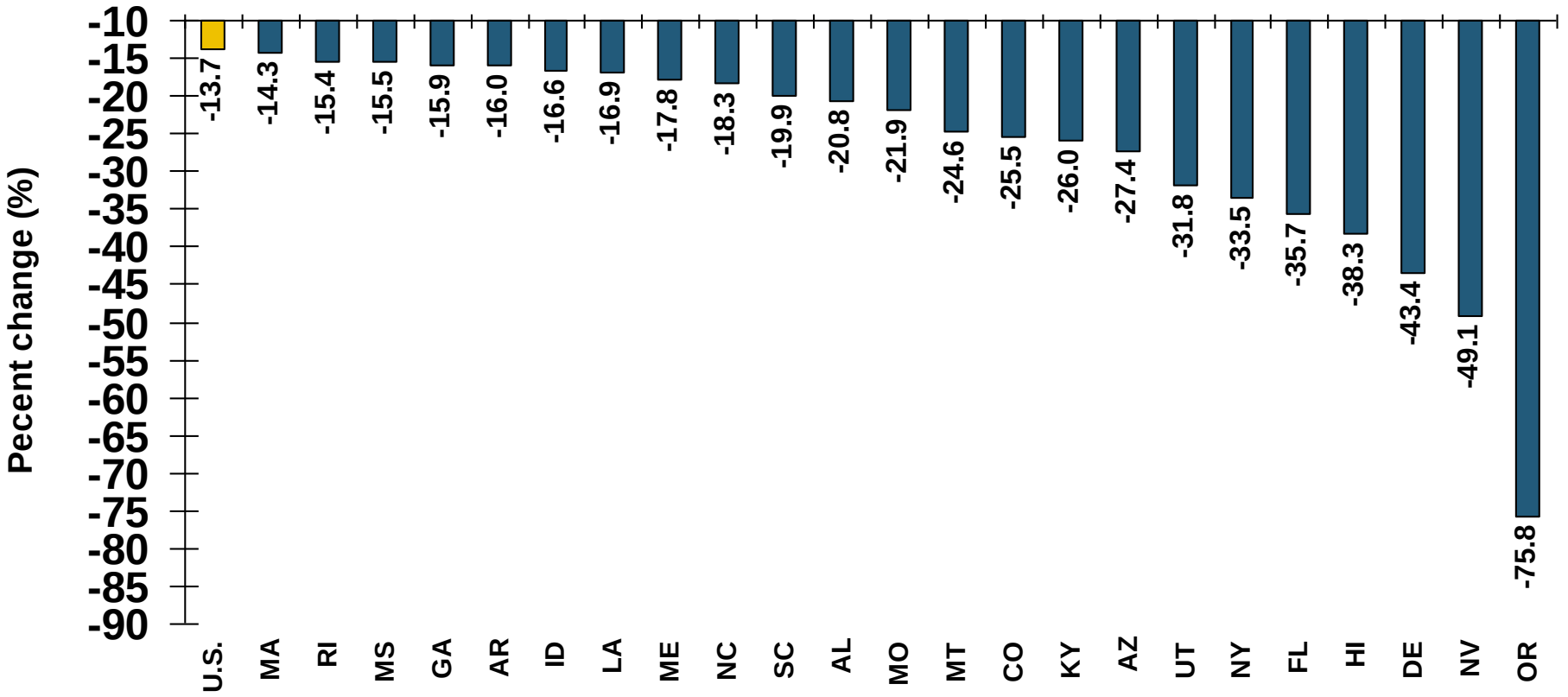
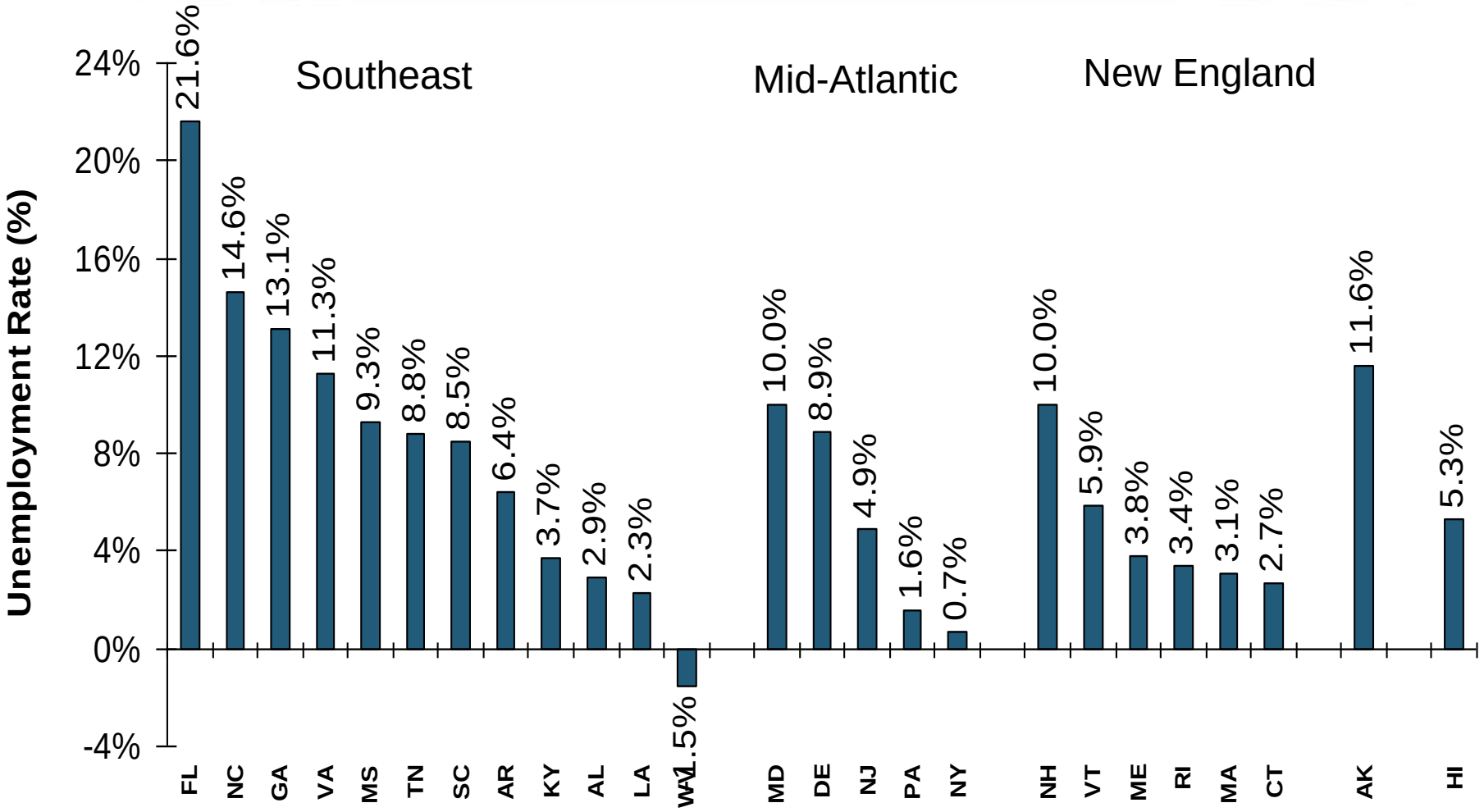



*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.

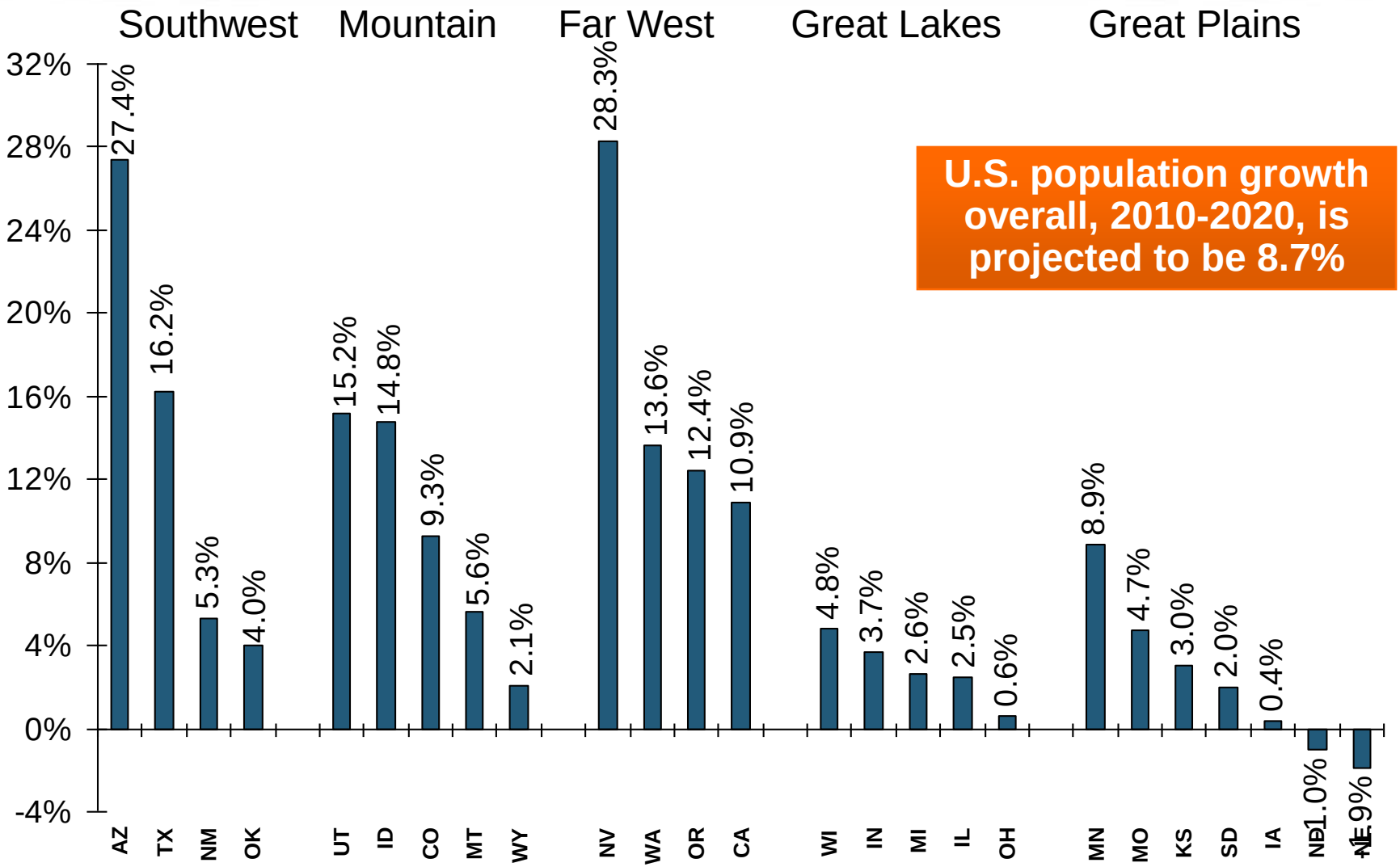
# Projected Population Growth Rates (2010-2020) Vary Widely by State and Region*




**U.S. population growth overall, 2010-2020, is projected to be 8.7%**

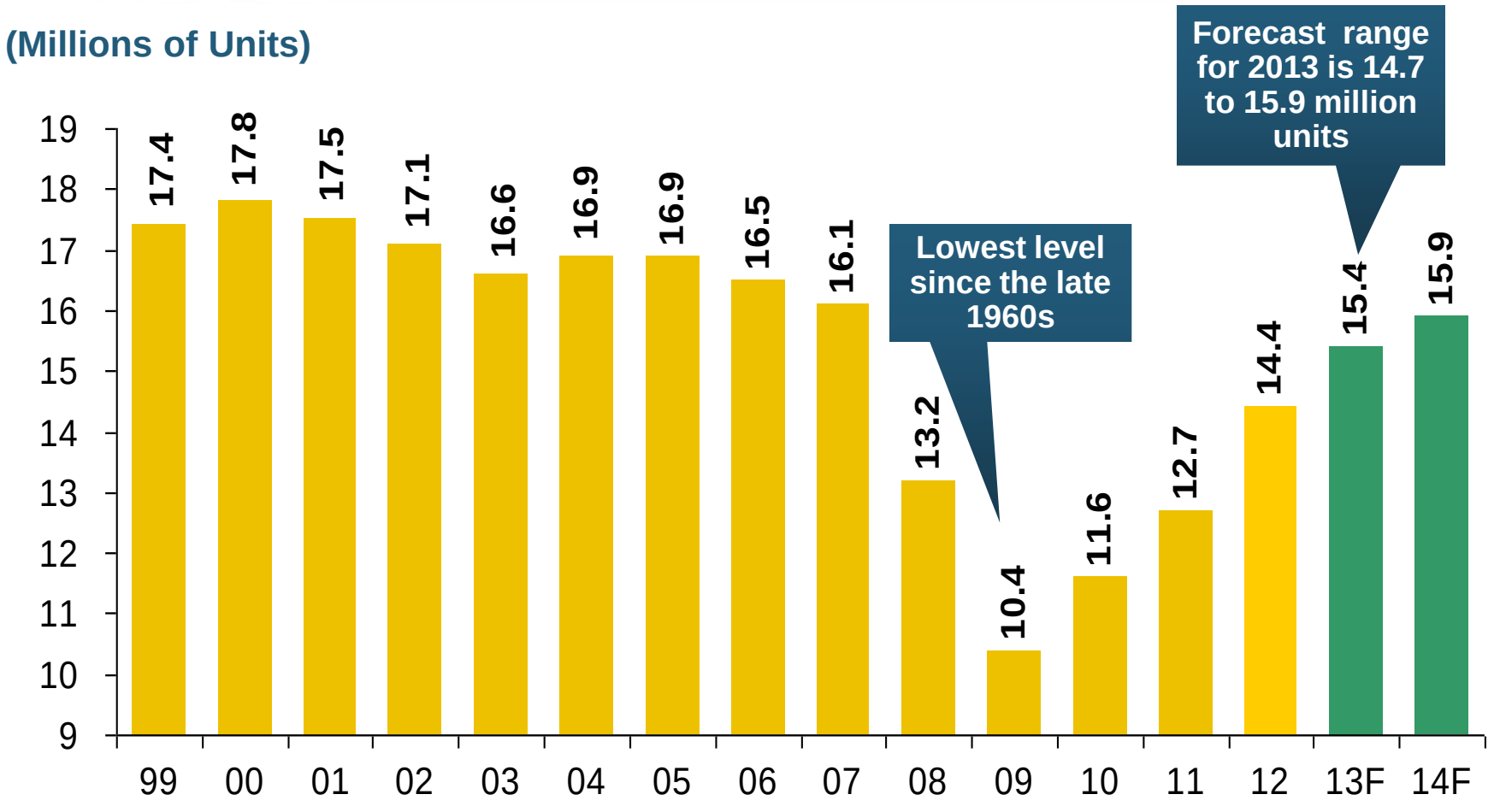
*based on 2000 census.
Source: http://www.census.gov/population/projections/data/state/projectionsagesex.html (Table 7)

# Projected Population Growth Rates (2010-2020) Vary Widely by State and Region* (cont'd)




*based on 2000 census.
Source: http://www.census.gov/population/projections/data/state/projectionsagesex.html (Table 7)

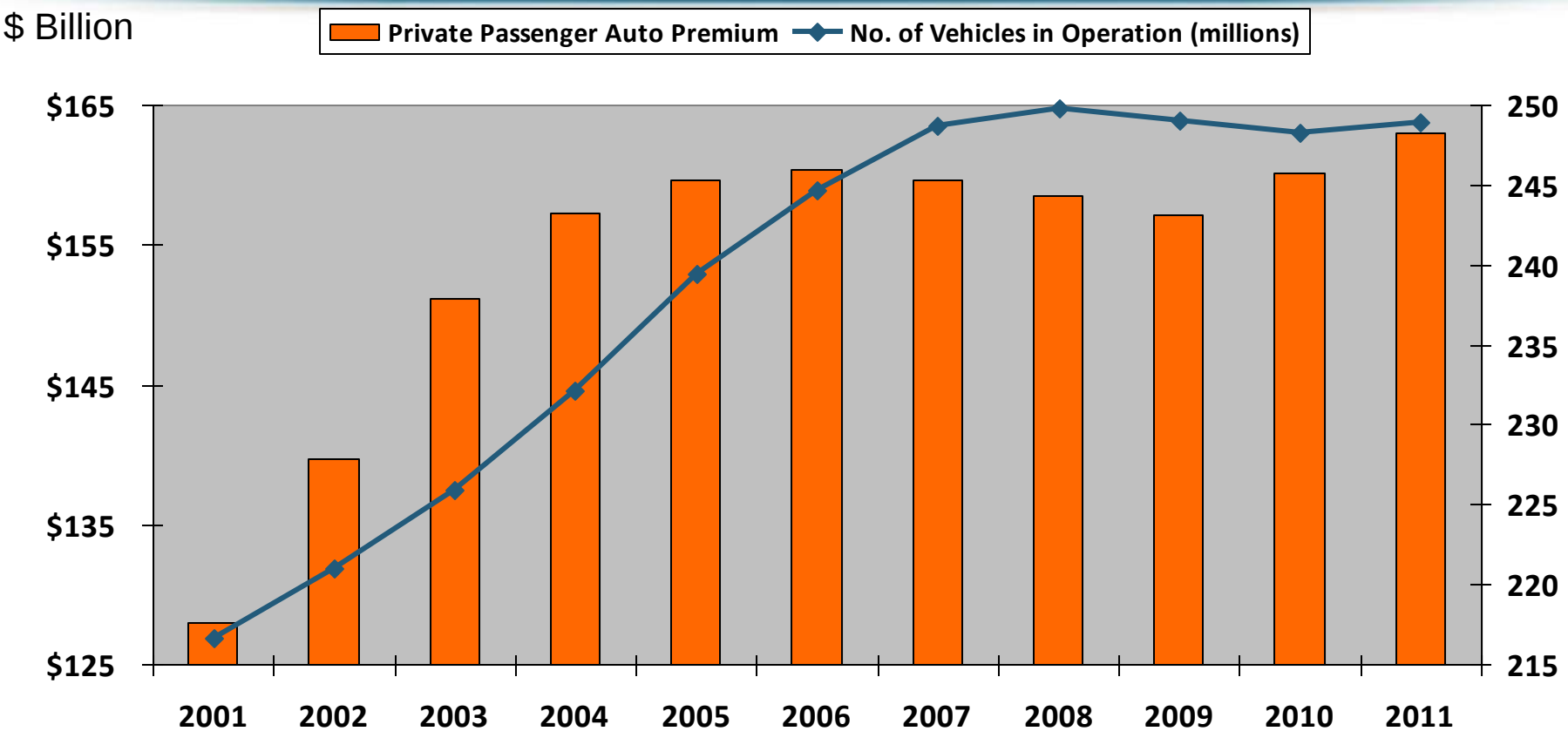
# Auto/Light Truck Sales, 1999-2014F




**Job growth and improved credit market conditions will boost auto sales in 2013 and beyond, bolstering the manufacturing sector and the economy generally.**

Sources: U.S. Department of Commerce; Blue Chip Economic Indicators (4/13); Insurance Information Institute.

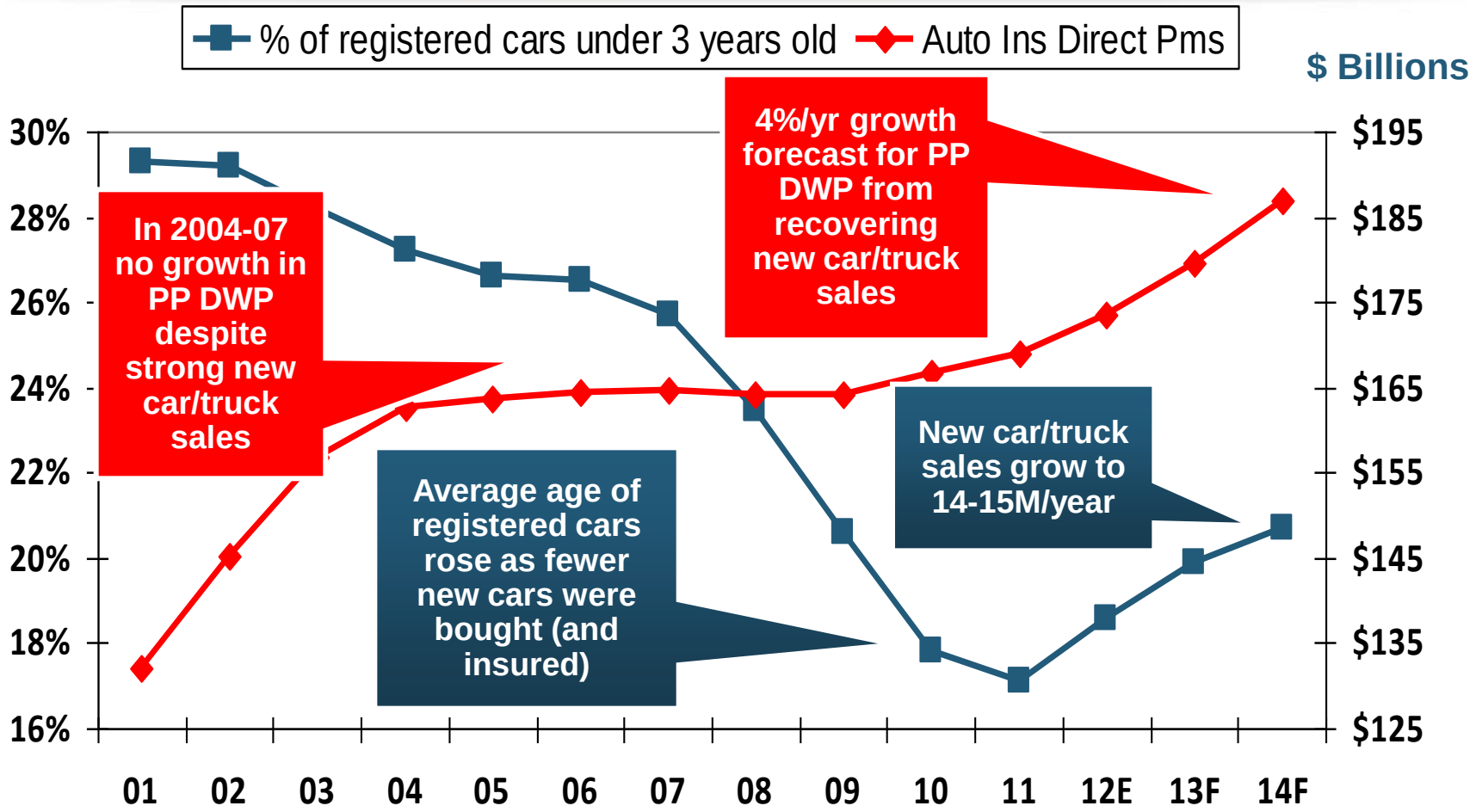
# PP Auto NWP vs. # of Vehicles in Operation, 2001–2011




**PP Auto premiums written are recovering from a period of no growth attributable to the weak economy affecting new vehicle sales, car choice, and increased price sensitivity among consumers**

Sources: A.M. Best; NADA, *State of the Industry Report 2012*, p. 16, at www.nada.org/nadadata citing R. L. Polk; Insurance Information Institute.

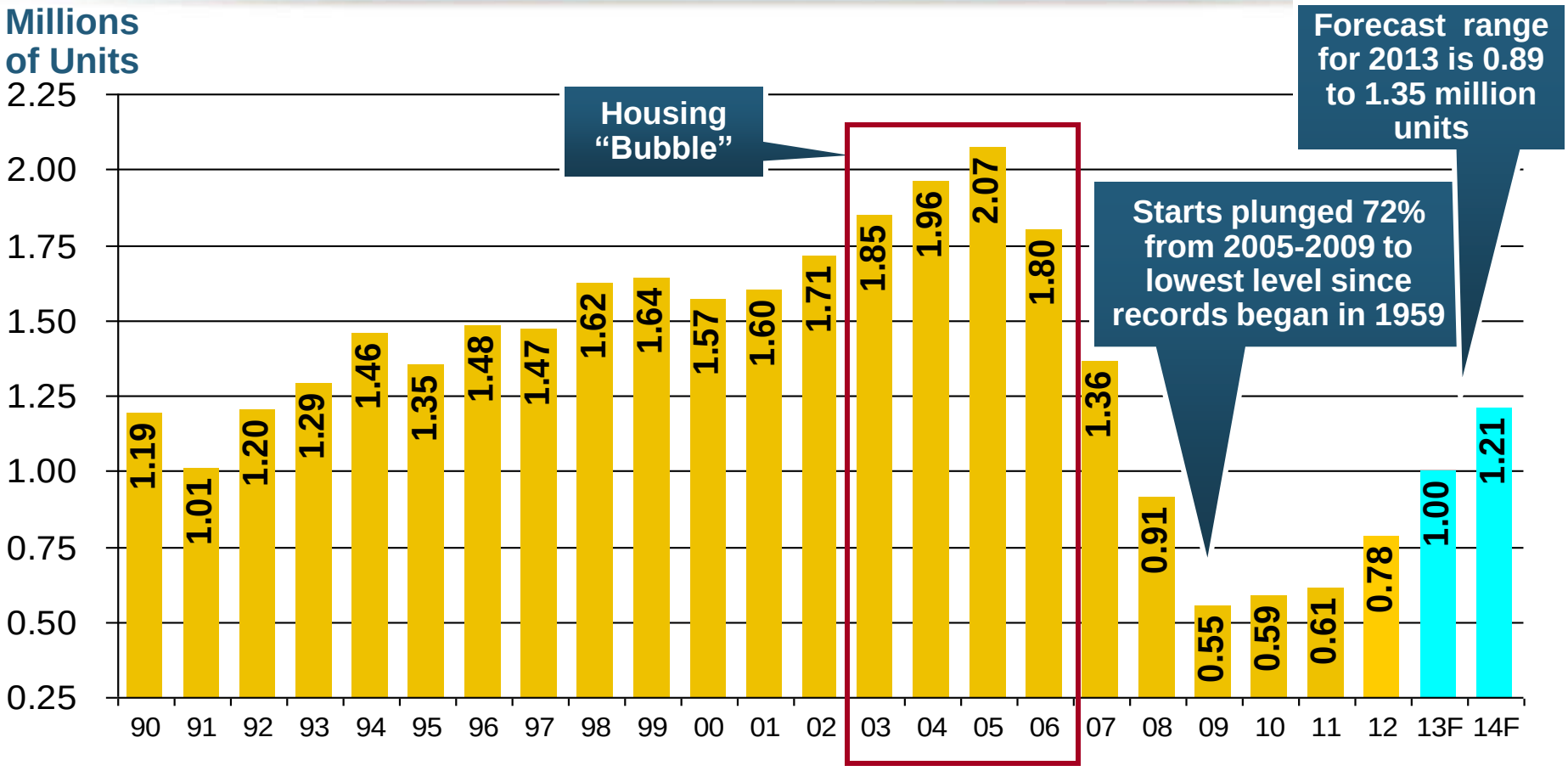
# Personal Auto Insurance Direct Written Premiums vs. Recently-Registered Cars




**PP DWP, flat from 2004-2009, is rising again.**
**Conning forecasts growth at 3.5% in 2013 and 4.0% in 2014.**

Sources: AIPSO Facts (various issues); SNL Financial; Conning Research & Consulting, *Property-Casualty Forecast and Analysis*, First Quarter 2012; Insurance Information Institute.

# Private Housing Unit Starts, 1990-2014F




**Homeowners insurers are starting to see meaningful exposure growth for the first time since 2005. Commercial insurers with construction risk exposure, surety also benefit.**

Sources: U.S. Department of Commerce; Blue Chip Economic Indicators (4/13); Insurance Information Institute.

# So Far, the Pickup Is Mostly in Multi-Family Housing Starts

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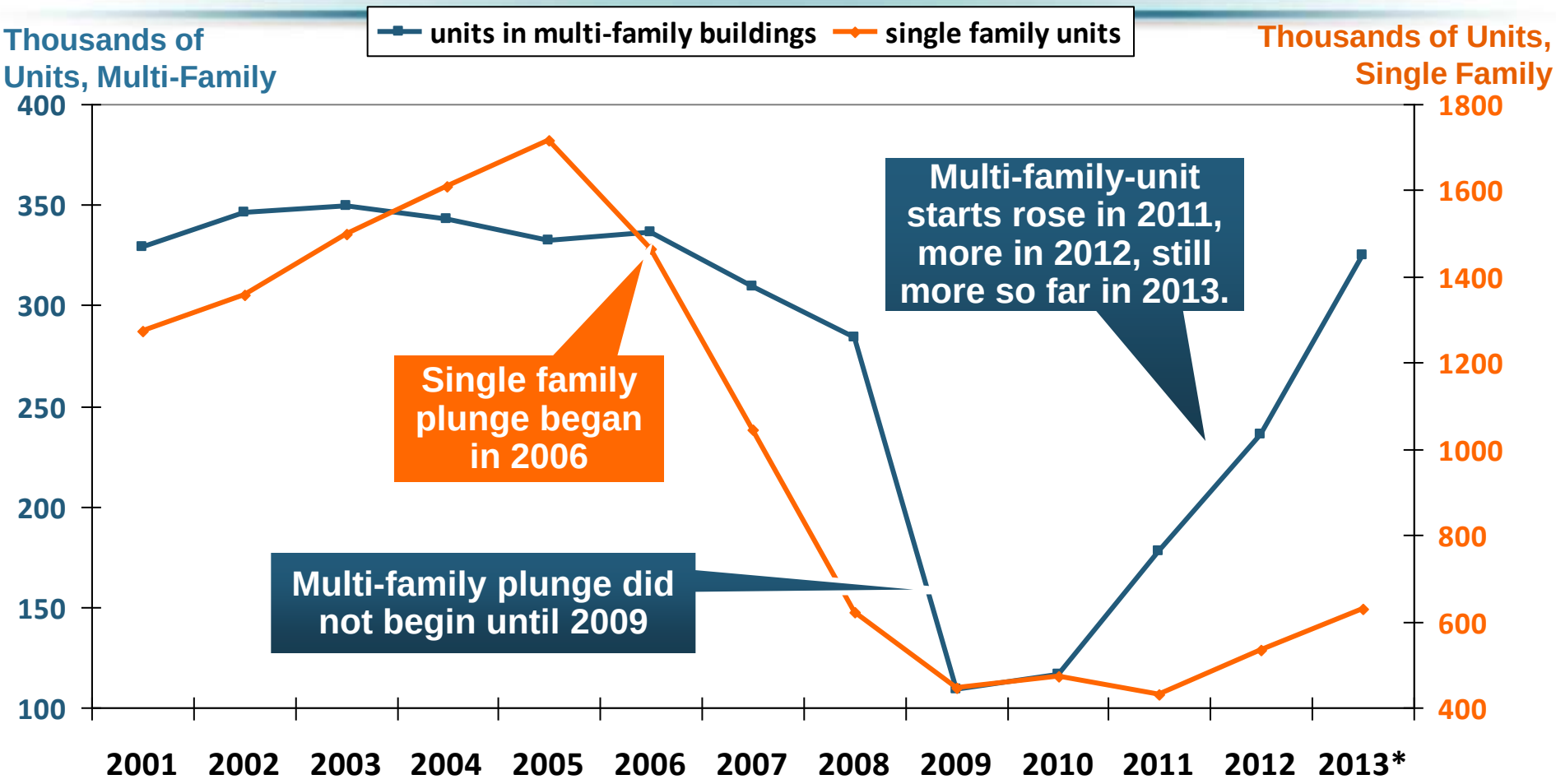


**2013:Q1 multi-unit starts at a seasonally adjusted annual rate of 325,000, are nearly back to the average annual pre-recession rate of 339,000.**

*average of annualized seasonally adjusted January, February, and March 2013 data; March is preliminary.
Source: US Census Bureau at www.census.gov/construction/nrc/pdf/newresconst.pdf.

# Housing Unit Starts: Building Momentum,
## Monthly, Jan 2011-Mar 2013*

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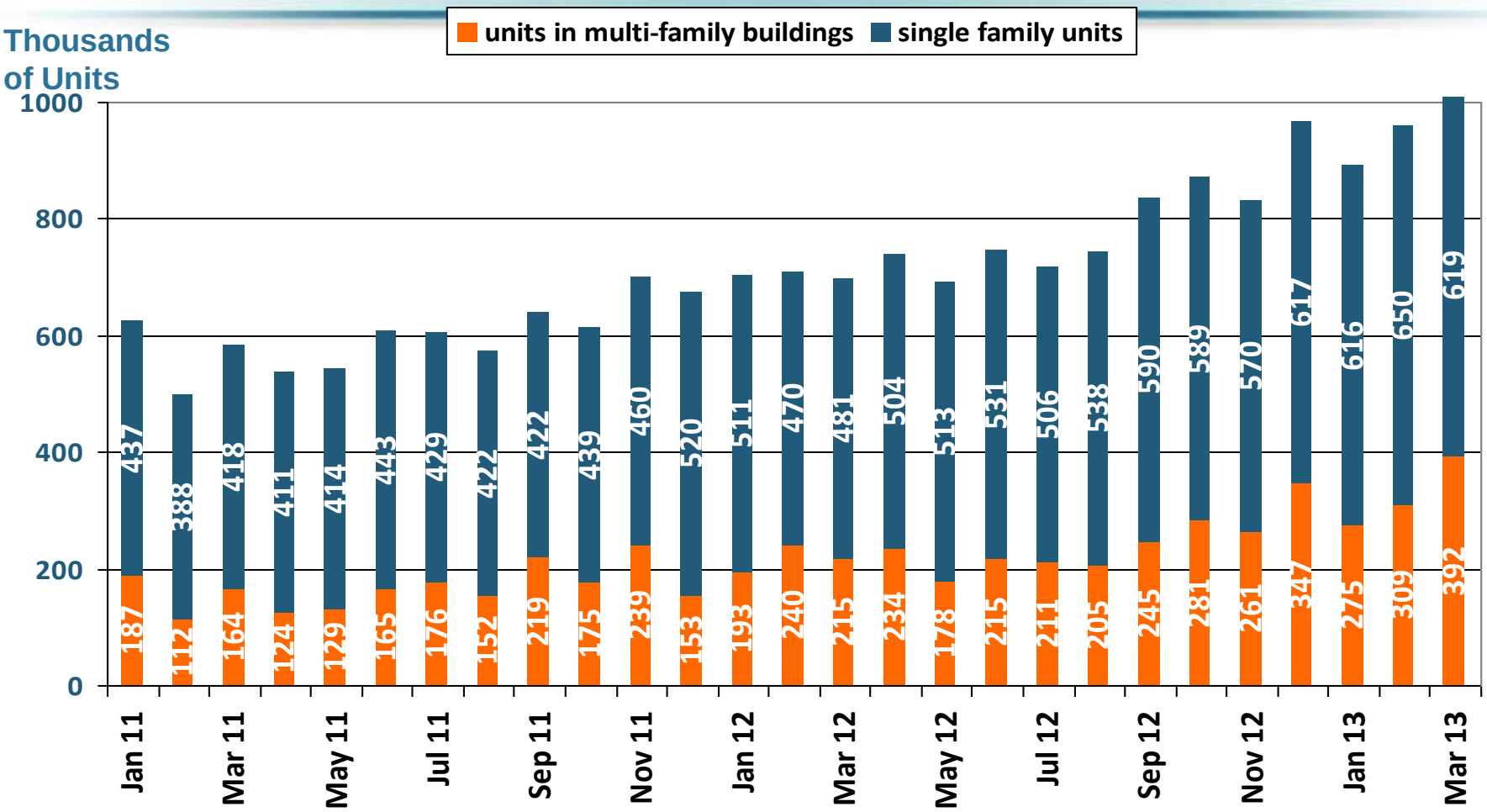
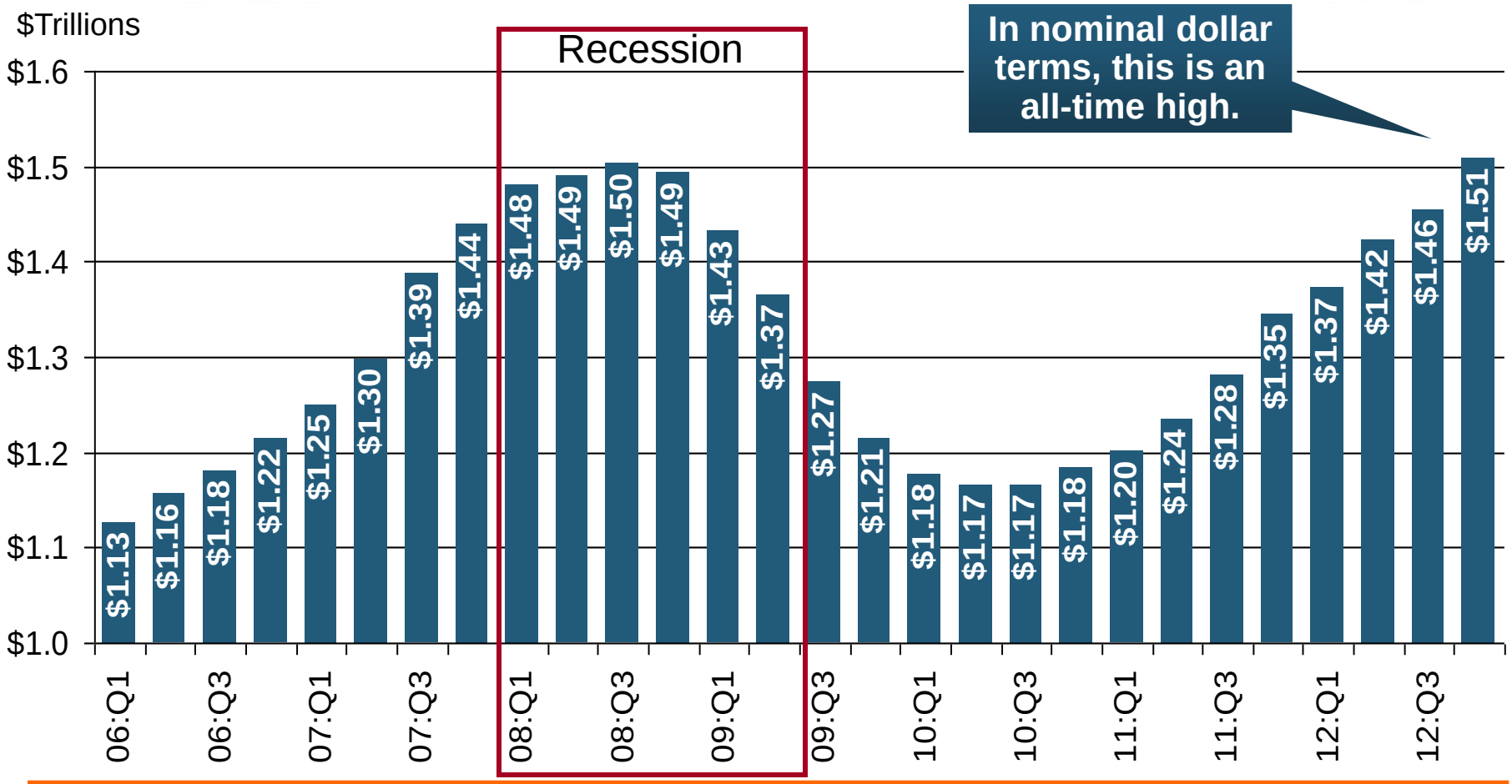



**The number of units in multi-unit starts more than doubled from Dec 2011 to Dec 2012. Single family start rose nicely, too.**

*at annualized rate, seasonally adjusted; Mar 2013 numbers are preliminary.
Source: US Census Bureau at www.census.gov/construction/nrc/pdf/newresconst.pdf.

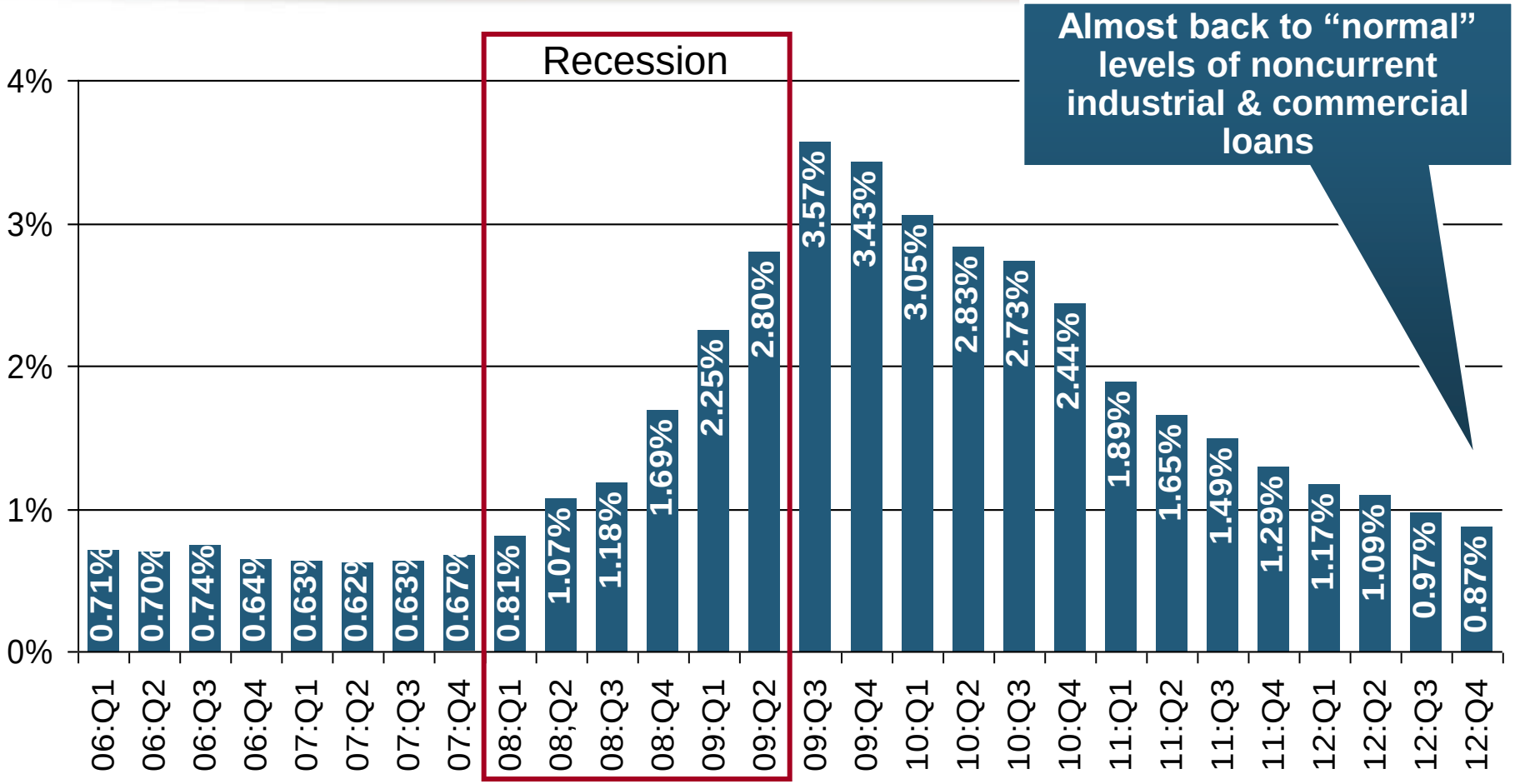
# Commercial & Industrial Loans Outstanding at FDIC-Insured Banks, Quarterly, 2006-2012*




**Outstanding loan volume has been growing for over two years and (as of year-end 2012) surpassed previous peak levels.**

*Latest data as of 2/28/2013.
Source: FDIC at http://www2.fdic.gov/qbp/ (Loan Performance spreadsheet); Insurance Information Institute.

# Percent of Non-current Commercial & Industrial Loans Outstanding at FDIC-Insured Banks,
## Quarterly, 2006-2012*




**Non-current loans (those past due 90 days or more or in nonaccrual status) are back to early-recession levels, fueling bank willingness to lend.**

*Latest data as of 2/28/2013.
Source: FDIC at http://www2.fdic.gov/qbp/ (Loan Performance spreadsheet); Insurance Information Institute.

# Dollar Value* of Manufacturers' Shipments Monthly, Jan. 1992—Feb. 2013

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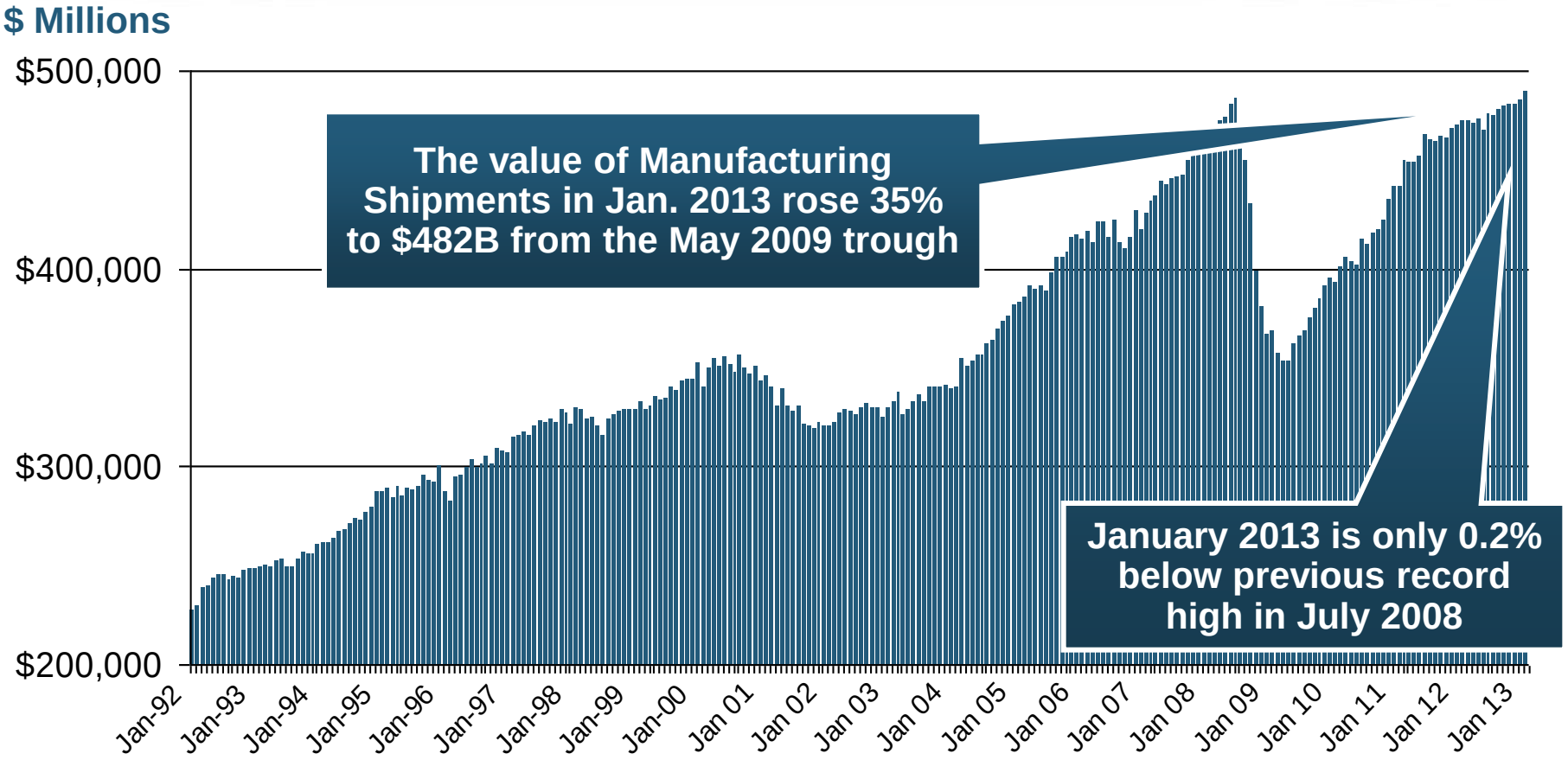
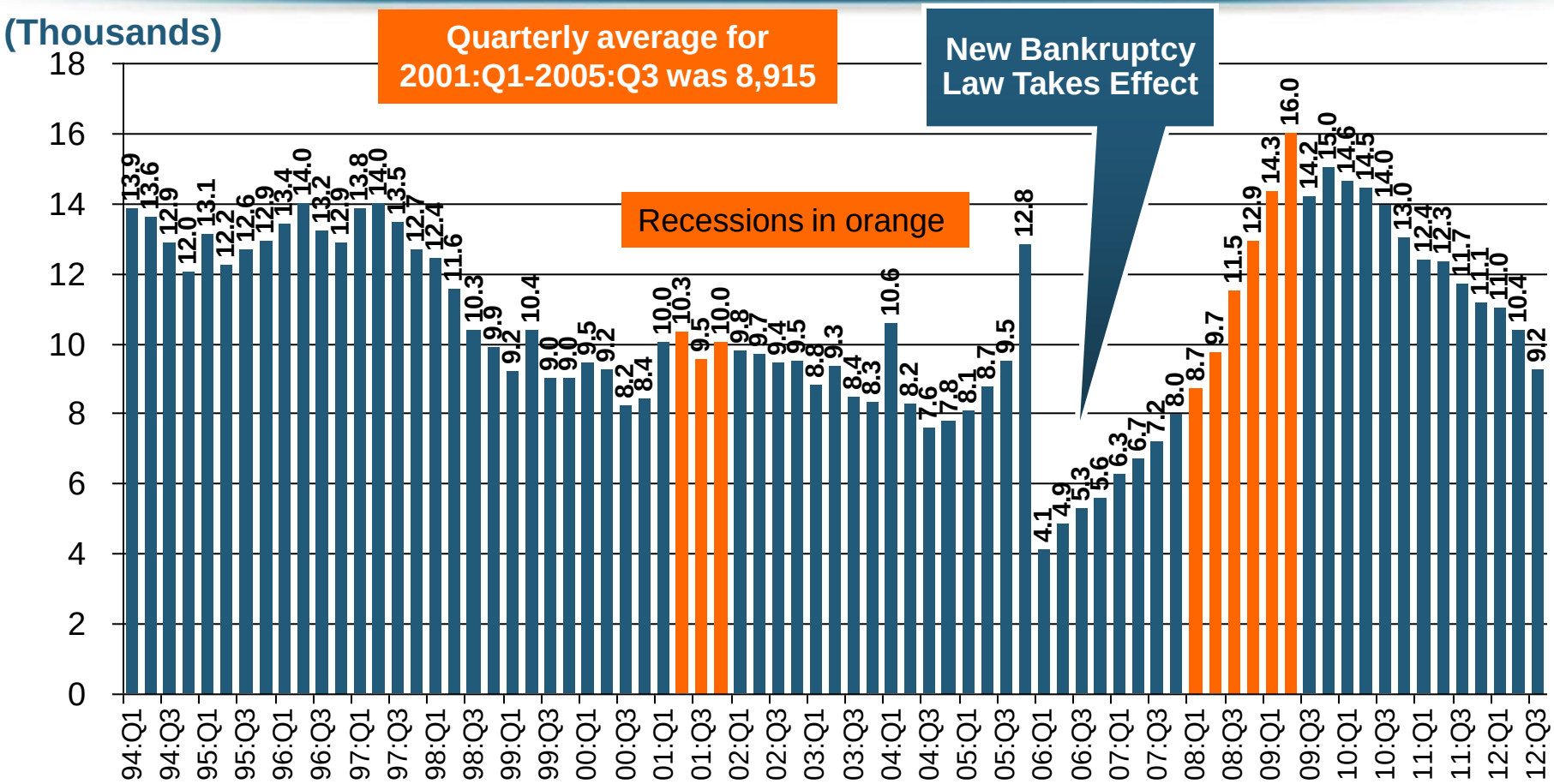



**Manufacturing is energy intensive. Growth leads to gains in many commercial exposures: WC, Commercial Auto, Marine, Property and various Liability coverages.**

*Seasonally adjusted; Jan. 2013 is preliminary but is from the Full Report for February.
Source: US Census Bureau, *Full Report on Manufacturers' Shipments, Inventories, and Orders,* www.census.gov/manufacturing/m3/.
Revised historical data, based on benchmark revisions, will be released on May 17, 2013.

# Business Bankruptcy Filings: Falling but Still High in 2012 (1994:Q1 – 2012:Q3)




**Business bankruptcies were down 42% in 2012:Q3 vs. recent peak in 2009:Q2 but were still higher than 2008:Q1, the first full quarter of the Great Recession. Bankruptcies restrict exposure growth in all commercial lines.**

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

# Private Sector Business Starts, 1993:Q2 – 2012:Q2*

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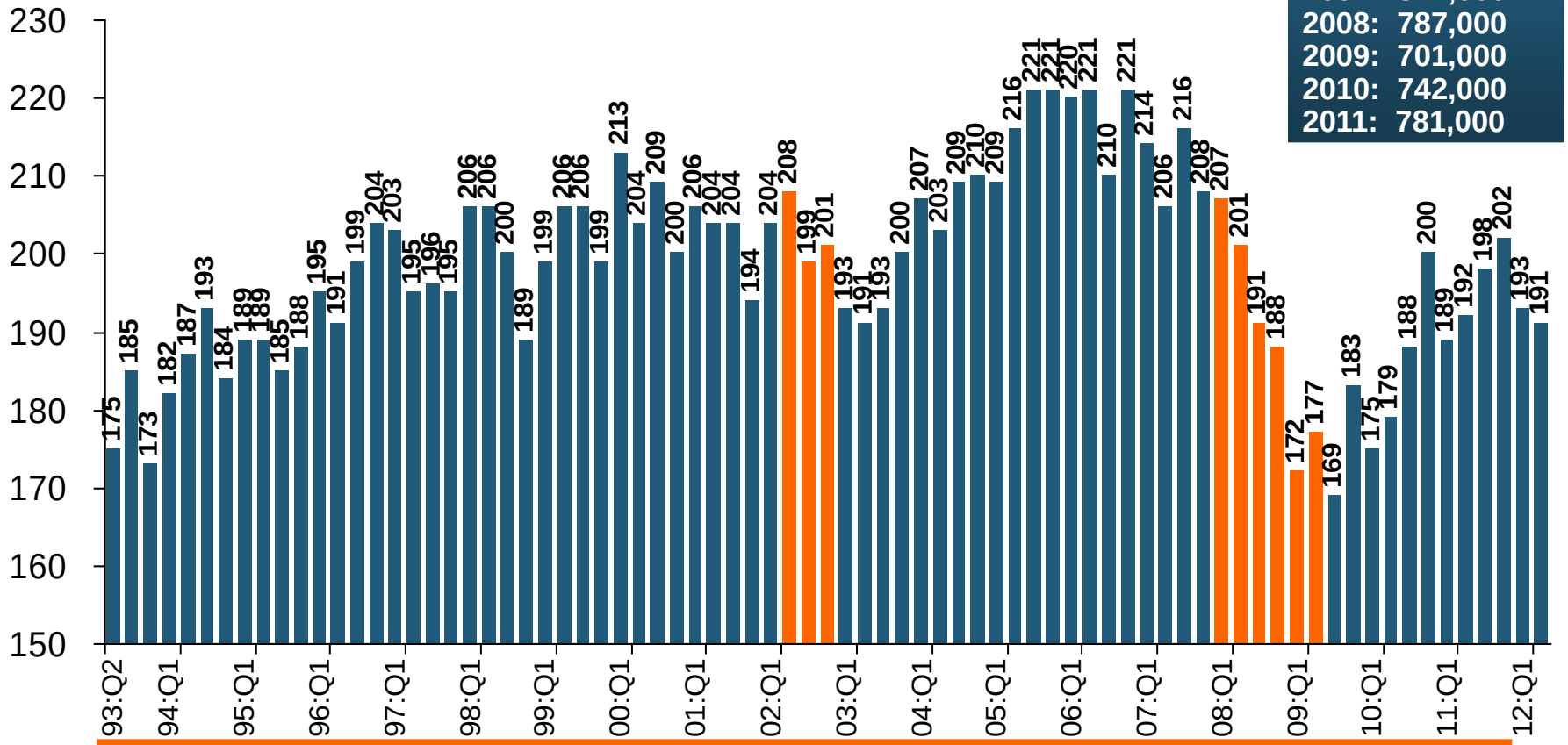
(Thousands)

Recessions in orange

**Business Starts**
2006: 861,000
2007: 844,000
2008: 787,000
2009: 701,000
2010: 742,000
2011: 781,000



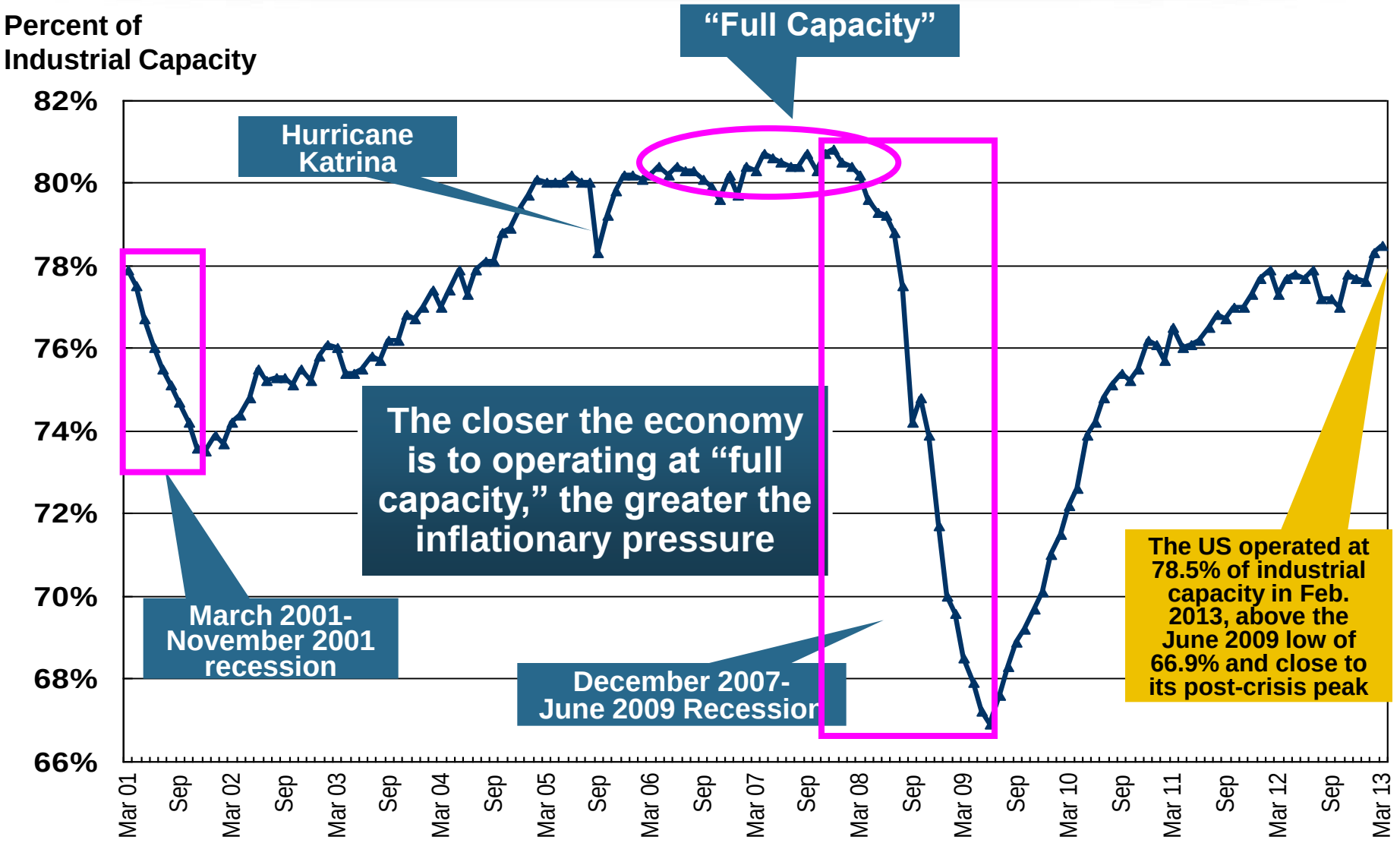

**Business starts were down nearly 20% in the Great Recession, holding back most types of commercial insurance exposure, but now are recovering.**

* Data through Jun 30, 2012 are the latest available (posted Jan 29, 2013); Seasonally adjusted.

Sources: Bureau of Labor Statistics, www.bls.gov/news.release/cewbd.t08.htm; NBER (recession dates).

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

## March 2001 through Mar. 2013




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



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# Challenge #2: Dealing with Catastrophes

## Are they more frequent and more severe?

# US Insured Catastrophe Losses

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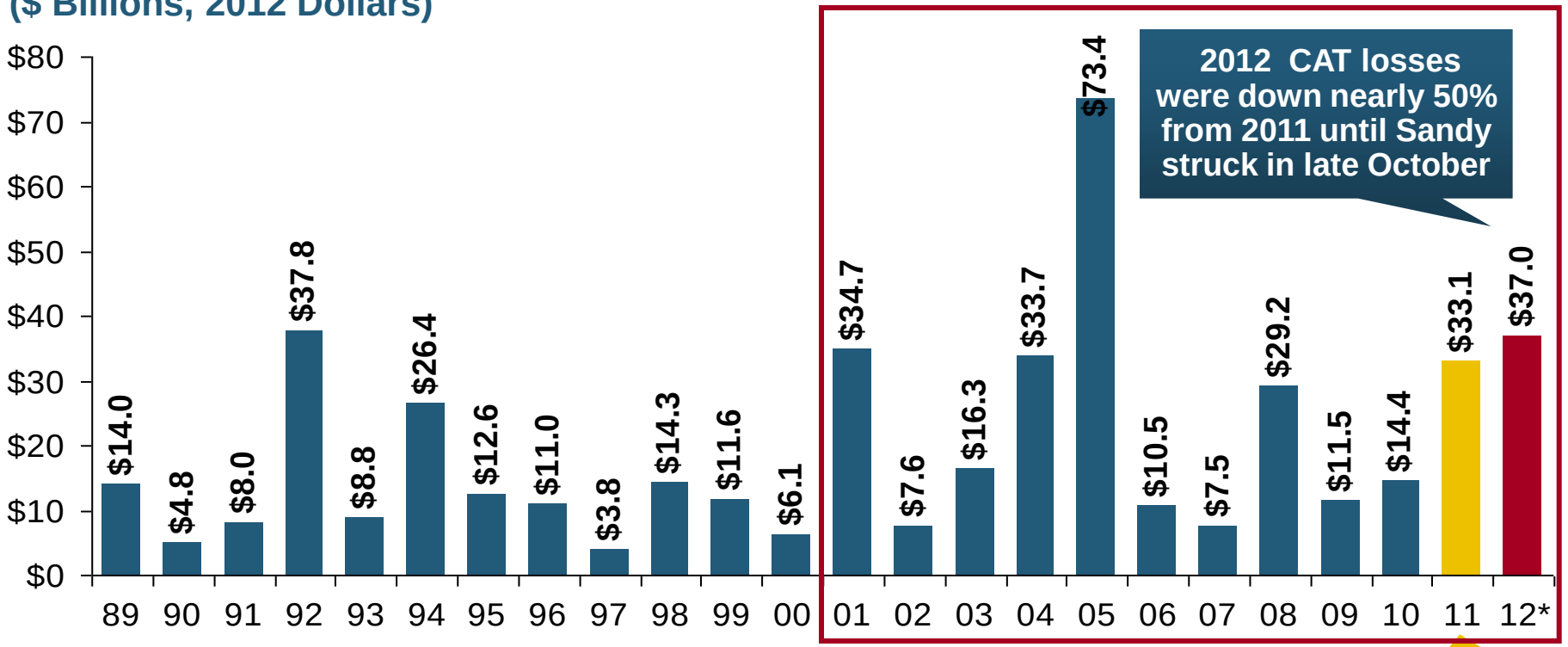
($ Billions, 2012 Dollars)




**US CAT Losses in 2012 Will Likely Become the 2nd or 3rd Highest in US History on An Inflation-Adjusted Basis (Pvt Insured). 2011 Losses Were the 5th Highest**

**Record Tornado Losses Caused 2011 CAT Losses to Surge**

*As of 1/2/13. Includes $20B gross loss estimate for Hurricane Sandy.

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.

# Natural Disasters in the United States, 1980 – 2012

## Number of Events (Annual Totals 1980 – 2012)

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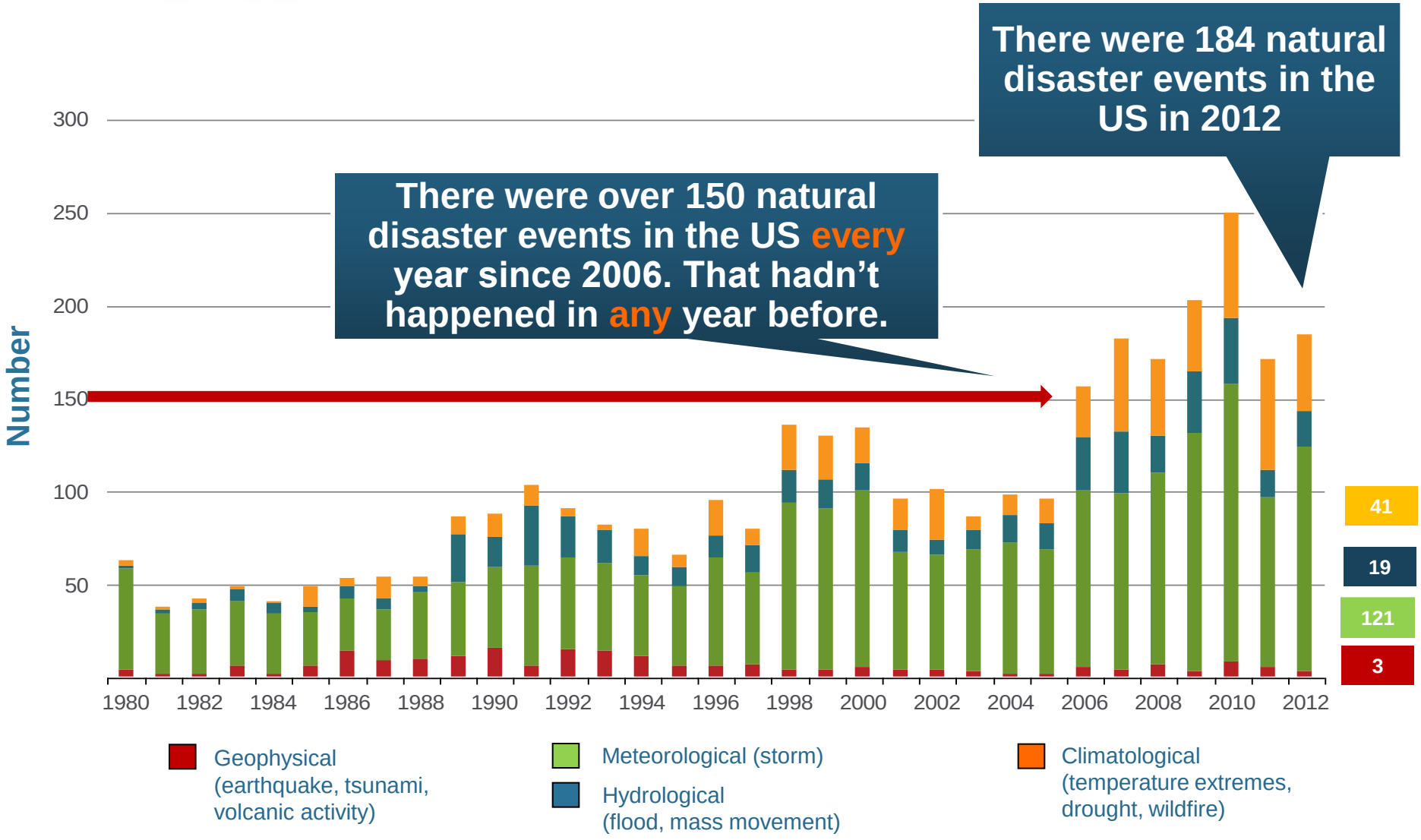
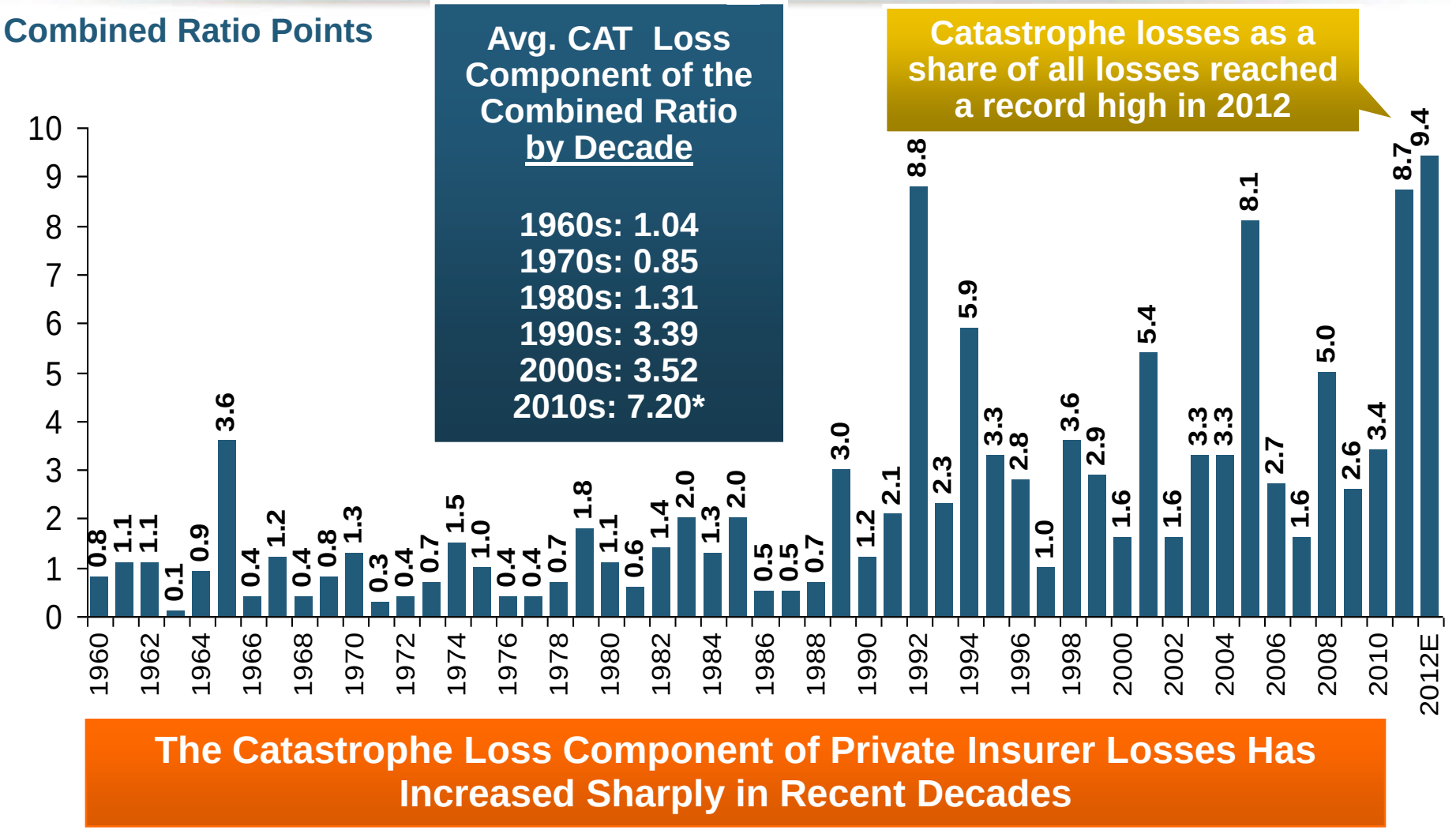



Source: MR NatCat*SERVICE*

# Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2012*




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

Notes: Private carrier losses only. Excludes loss adjustment expenses and reinsurance reinstatement premiums. Figures are adjusted for losses ultimately paid by foreign insurers and reinsurers.

Source: ISO (1960-2011); A.M. Best (2012E) Insurance Information Institute.

# The Dozen Most Costly Hurricanes in U.S. History

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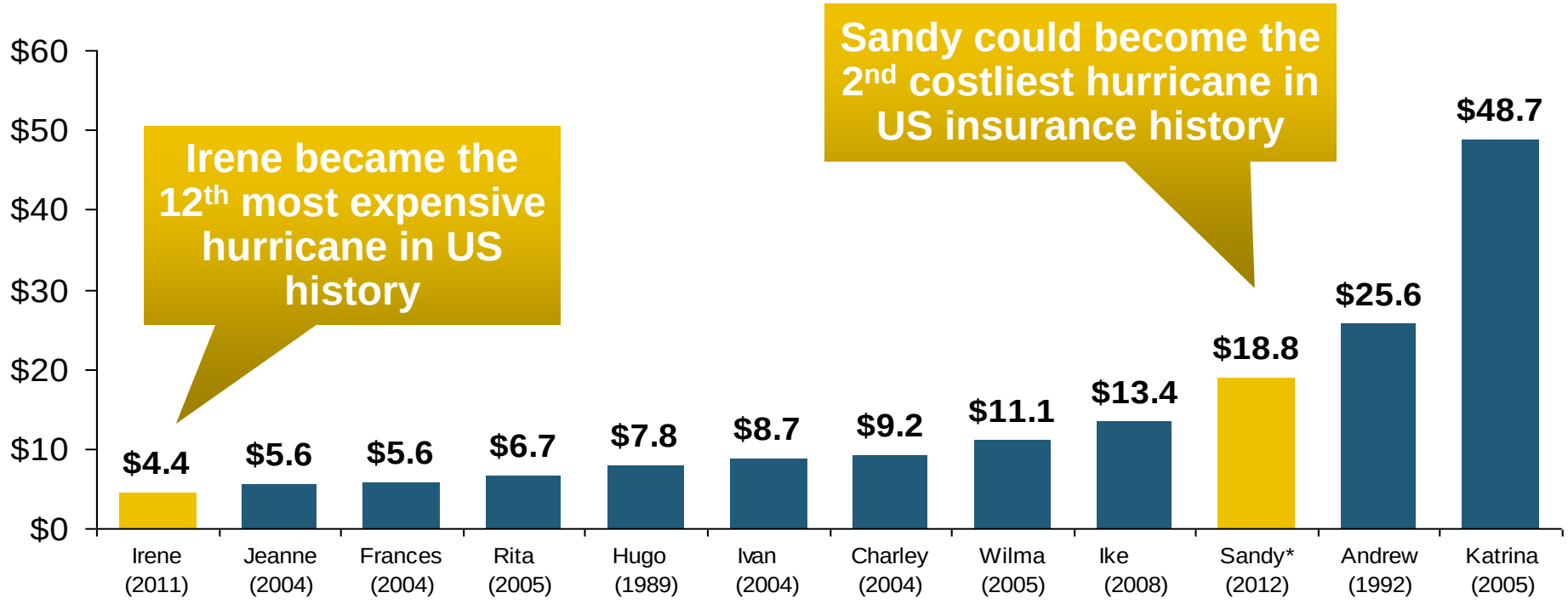
**Insured Losses, 2012 Dollars, $ Billions**




**10 of the 12 costliest hurricanes in private insurance history occurred in the past 9 years (2004—2012)**

*Estimate as of 12/09/12 based on estimates of catastrophe modeling firms and reported losses as of 1/12/13. Estimates range up to $25B.
Sources: PCS; Insurance Information Institute inflation adjustments to 2012 dollars using the CPI.

# If They Hit Today, the Dozen Costliest (to Insurers) Hurricanes in U.S. History

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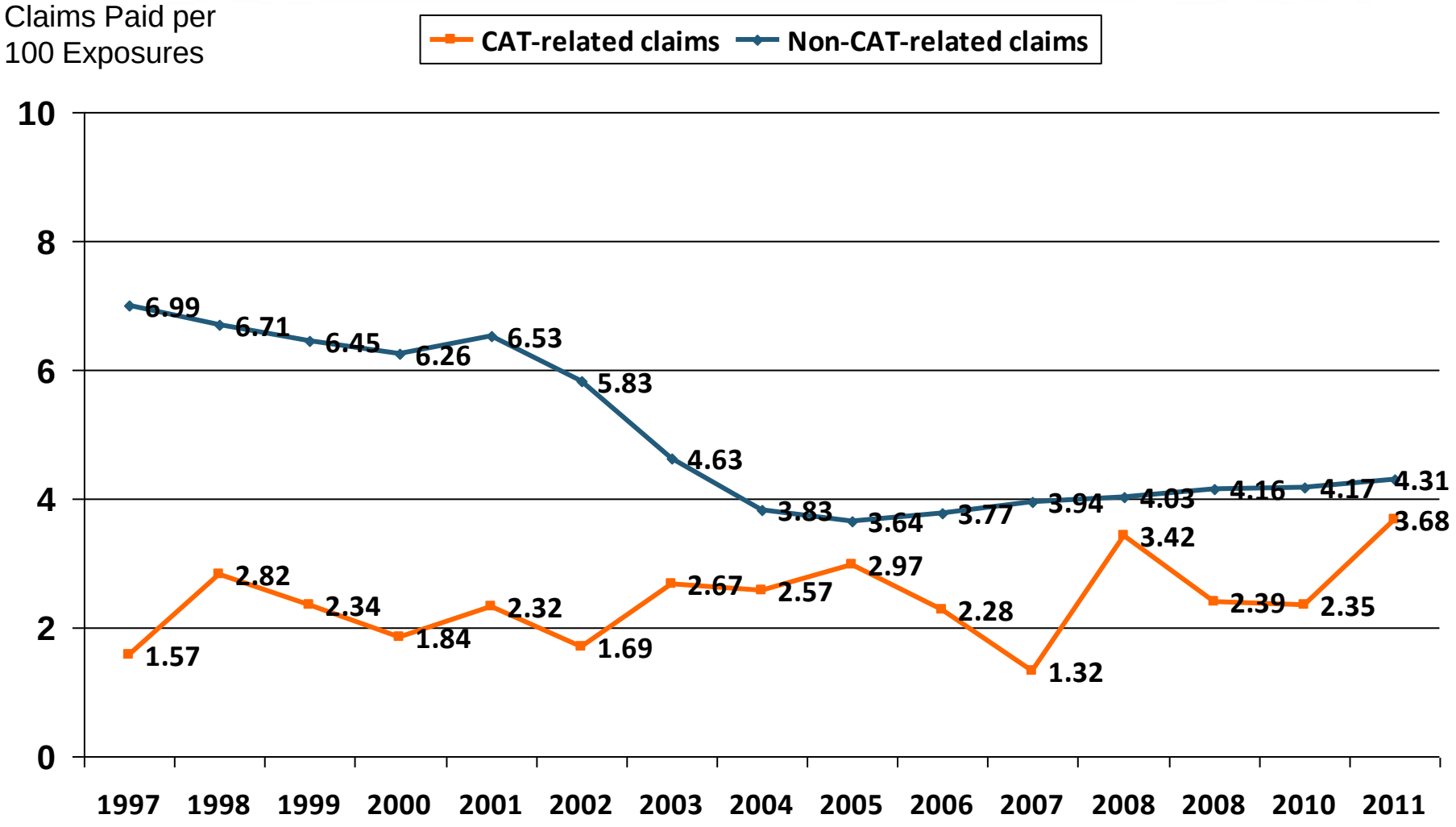
**Insured Losses, 2012 Dollars, $ Billions**

**Storms that hit long ago had less property and businesses to damage, so simply adjusting their actual claims for inflation doesn't capture their destructive power.**
**Karen Clark's analysis aims to overcome that.**


**When you adjust for the damage prior storms could have done if they occurred today, Hurricane Katrina slips to a tie for 6th among the most devastating storms.**

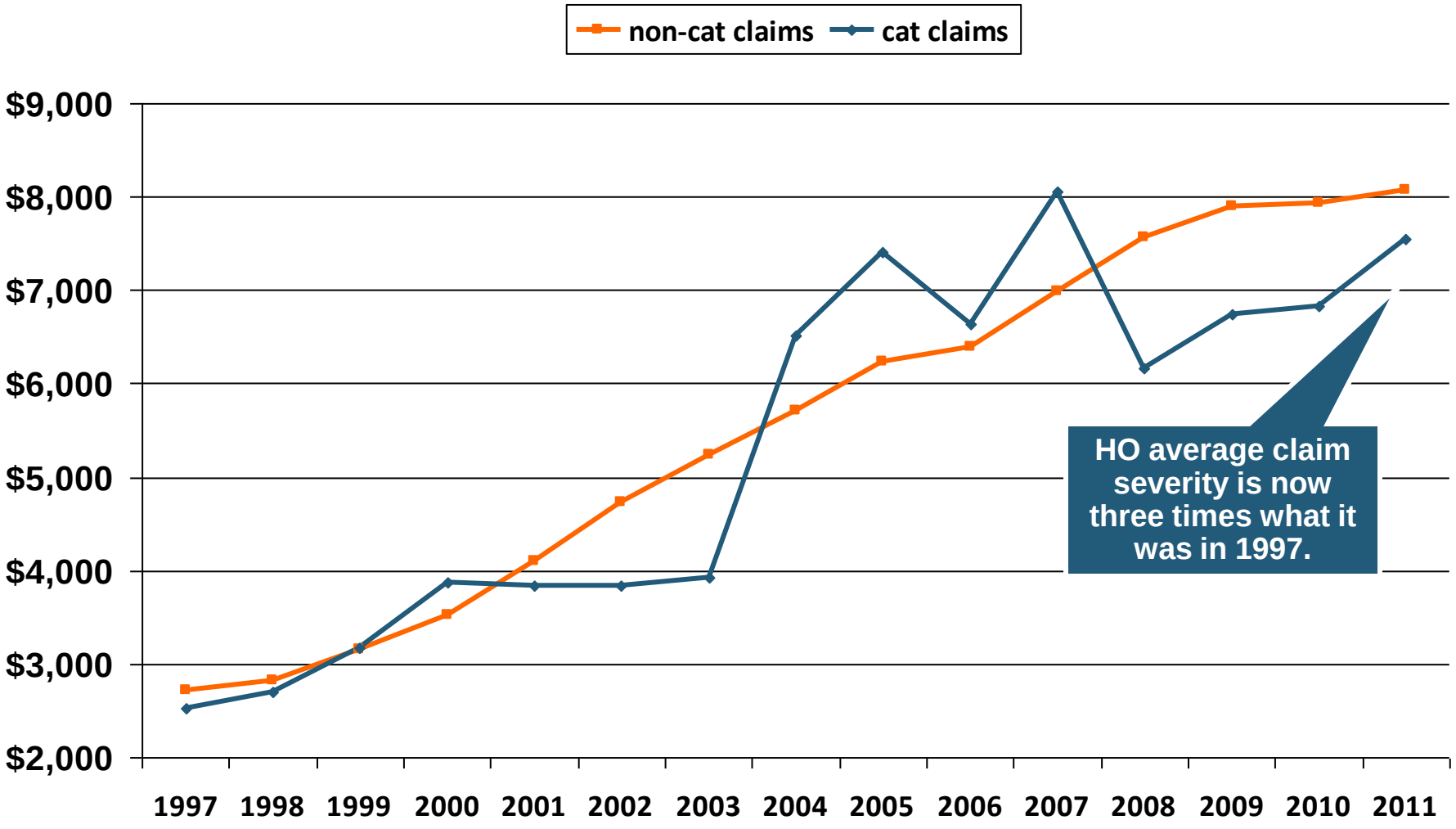
*Estimate as of 12/09/12 based on estimates of catastrophe modeling firms and reported losses as of 1/12/13. Estimates range up to $25B.
Sources: Karen Clark & Company, *Historical Hurricanes that Would Cause $10 Billion or More of Insured LossesToday*, August 2012; I.I.I.

# P/C Industry Homeowners Claim Frequency, US, 1997-2011



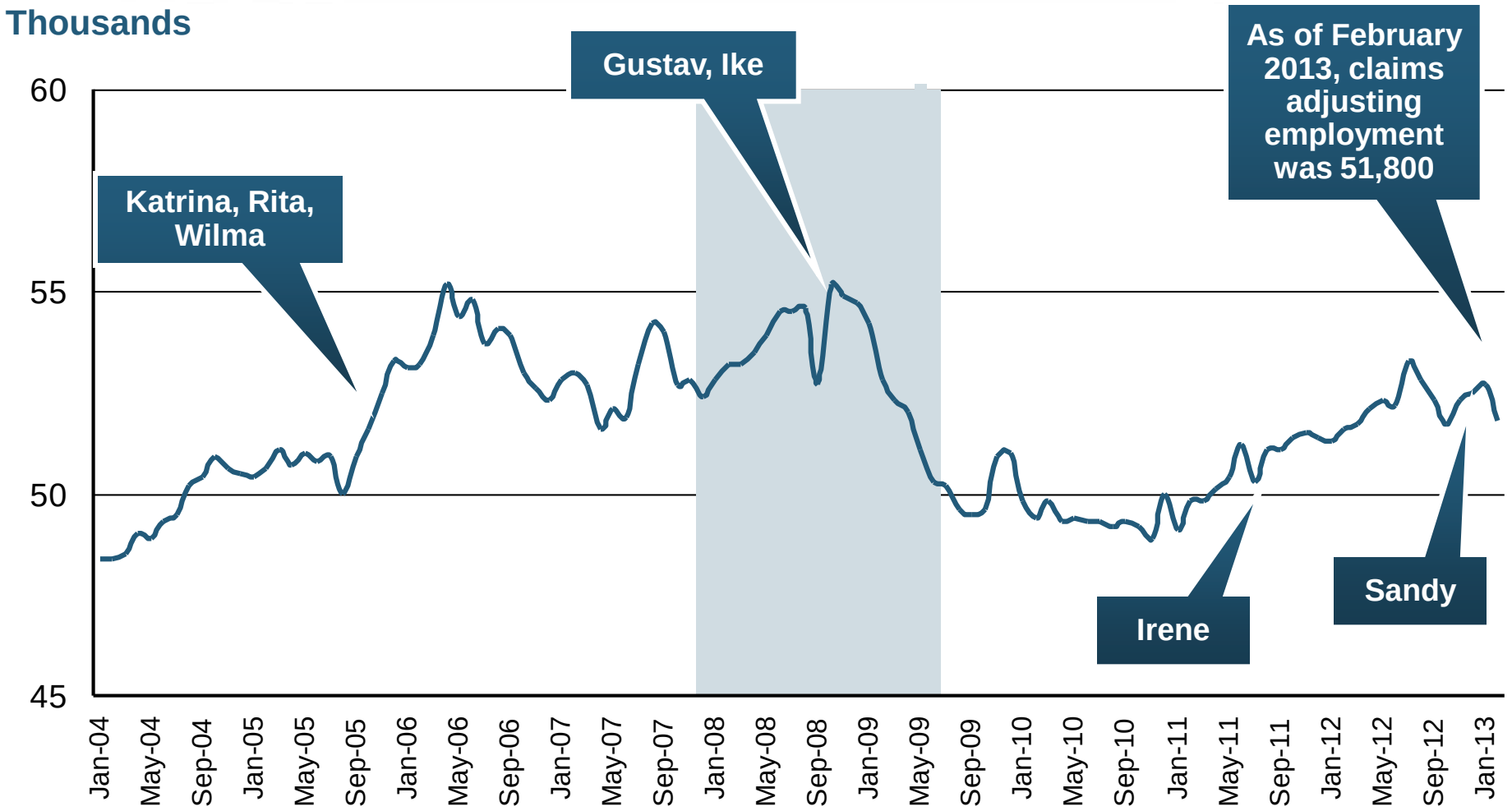

Sources: Insurance Research Council, "Trends in Homeowners Insurance Claims," p.29; Insurance Information Institute

# P/C Industry Homeowners Average Claim Severity, 1997-2011



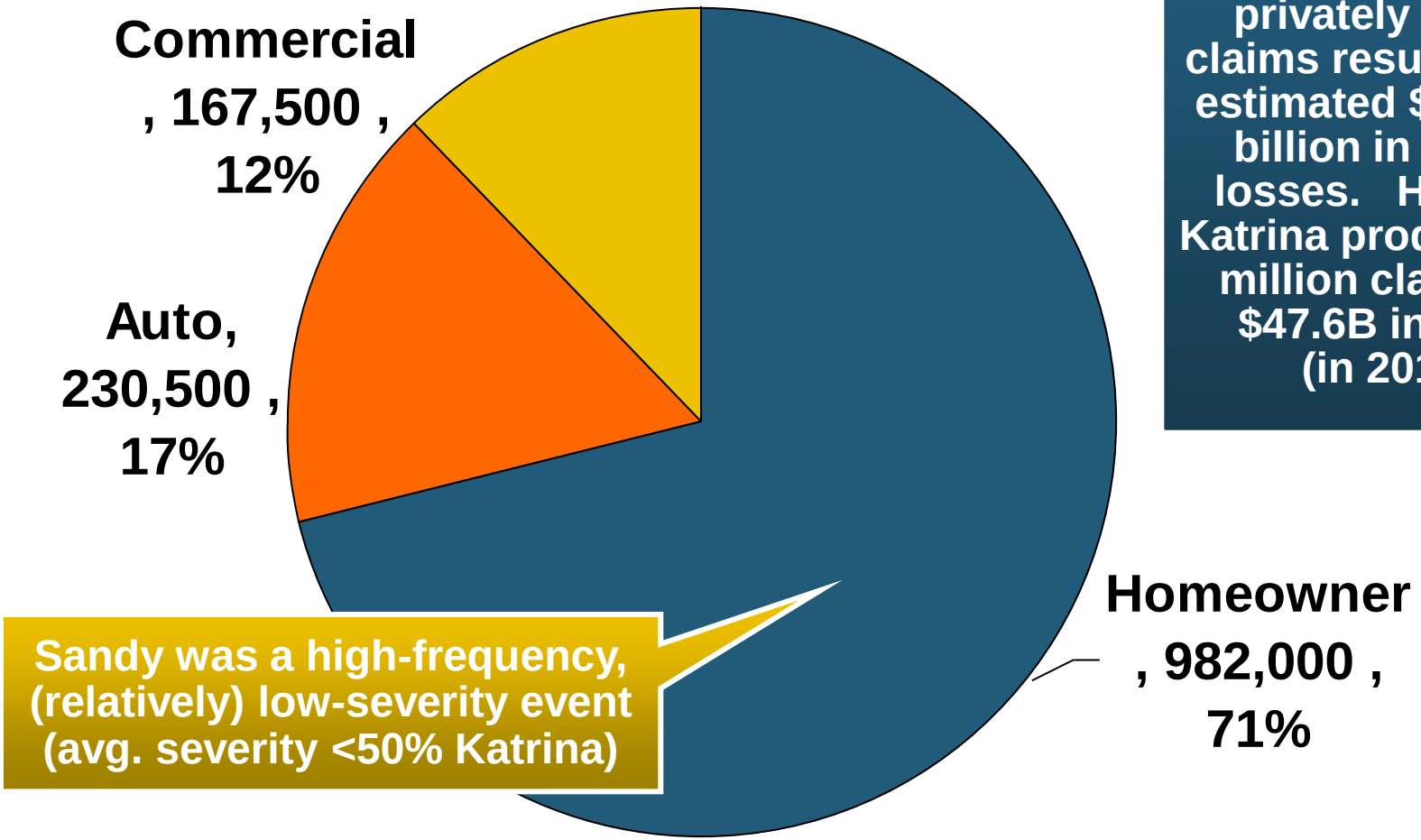

Sources: Insurance Research Council, "Trends in Homeowners Insurance Claims," p. 29, BLS inflation calculator, and Insurance Information Institute

# U.S. Employment in Insurance Claims Adjusting: 2004–2013*




*As of February 2013; Seasonally adjusted.
Note: Recession indicated by gray shaded column.
Sources: U.S. Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

# Superstorm (barely a CAT 1) Sandy: 1.4 million Claims, by Type*




**Sandy caused an estimated 1.4 million privately insured claims resulting in an estimated $15 to $25 billion in insured losses. Hurricane Katrina produced 1.74 million claims and $47.6B in losses (in 2011 $)**

*PCS claim count estimate as of 11/26/12. Loss estimate represents high and low end estimates by risk modelers RMS, Eqecat and AIR. PCS estimate of insured losses as of 11/26/12 $11 billion. All figures exclude losses paid by the NFIP.
Source: PCS; AIR, Eqecat, AIR Worldwide; Insurance Information Institute.

# Top 16 Most Costly Disasters in U.S. History

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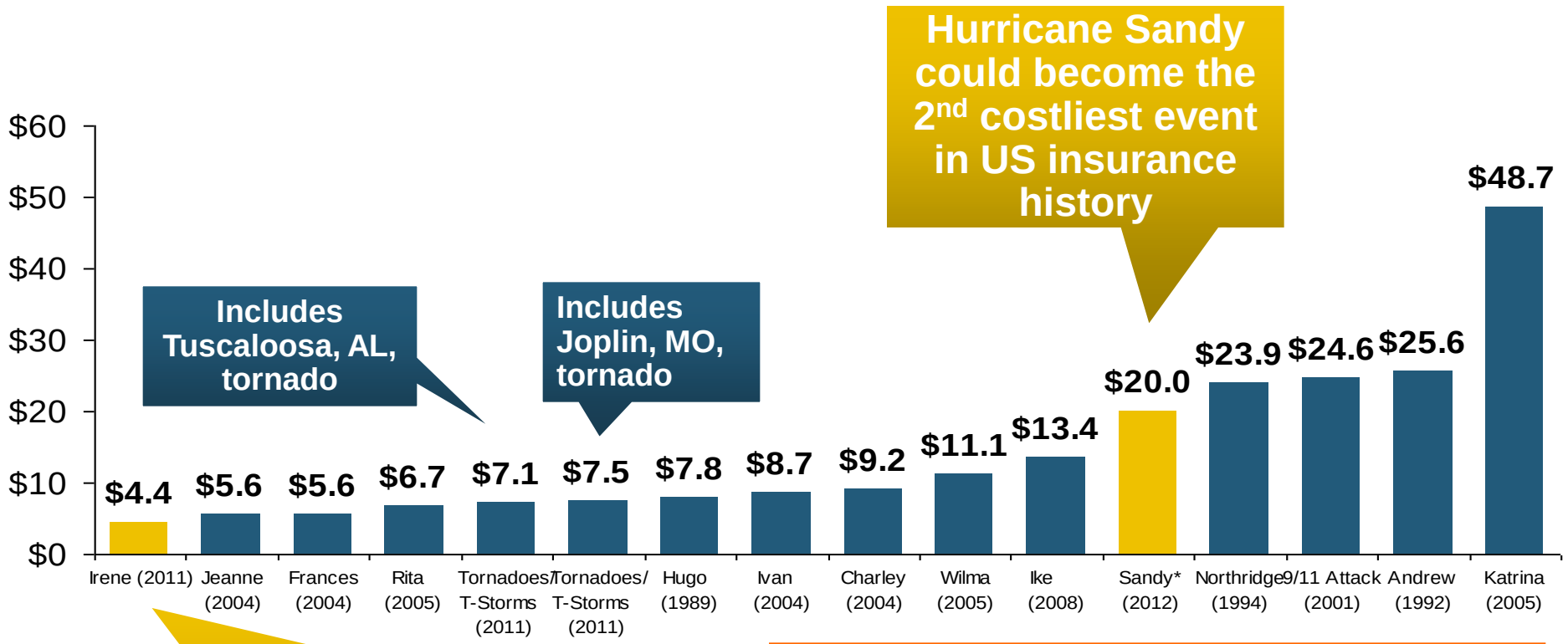
**(Insured Losses, 2012 Dollars, $ Billions)**




**Hurricane Irene became the 12th most expense hurricane in US history in 2011**

**12 of the 16 Most Expensive Events in US History Have Occurred Over the Past Decade**

*Estimate as of 12/09/12 based on estimates of catastrophe modeling firms and reported losses as of 1/12/13. Estimates range up to $25B.
Sources: PCS; Insurance Information Institute inflation adjustments to 2012 dollars using the CPI.

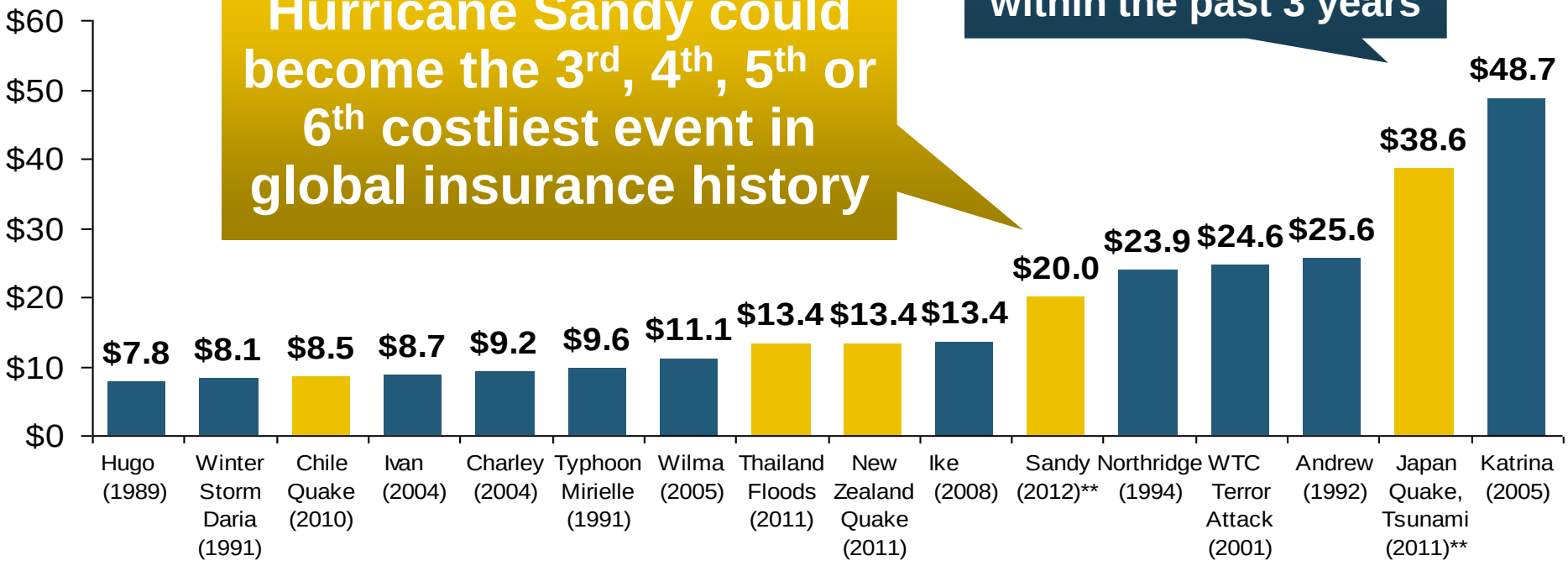
# Top 16 Most Costly World Insurance Losses, 1970-2012*

INSURANCE INFORMATION INSTITUTE

**(Insured Losses, 2012 Dollars, $ Billions)**

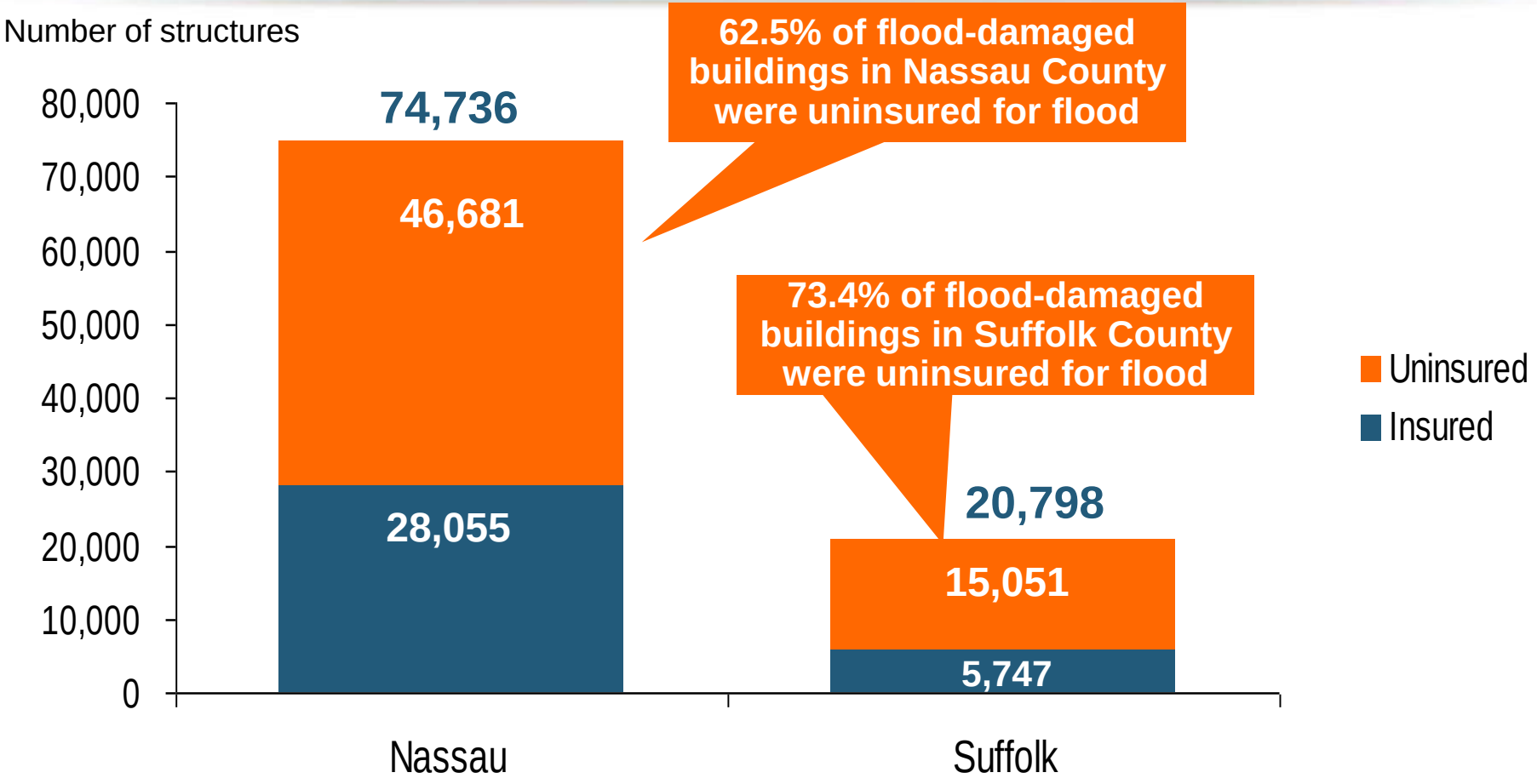
**5 of the top 14 most expensive catastrophes in world history have occurred within the past 3 years**

**Hurricane Sandy could become the 3rd, 4th, 5th or 6th costliest event in global insurance history**




*Figures do not include federally insured flood losses.
**Average of range estimates of $35B - $40B as of 1/4/12 adjusted to 2012 dollars; Privately insured losses only.
***Estimate as of 1/12/13, based on estimates from catastrophe modeling firms and actual reported losses.
Sources: Swiss Re *sigma 1/2011*; Munich Re; Insurance Information Institute research.

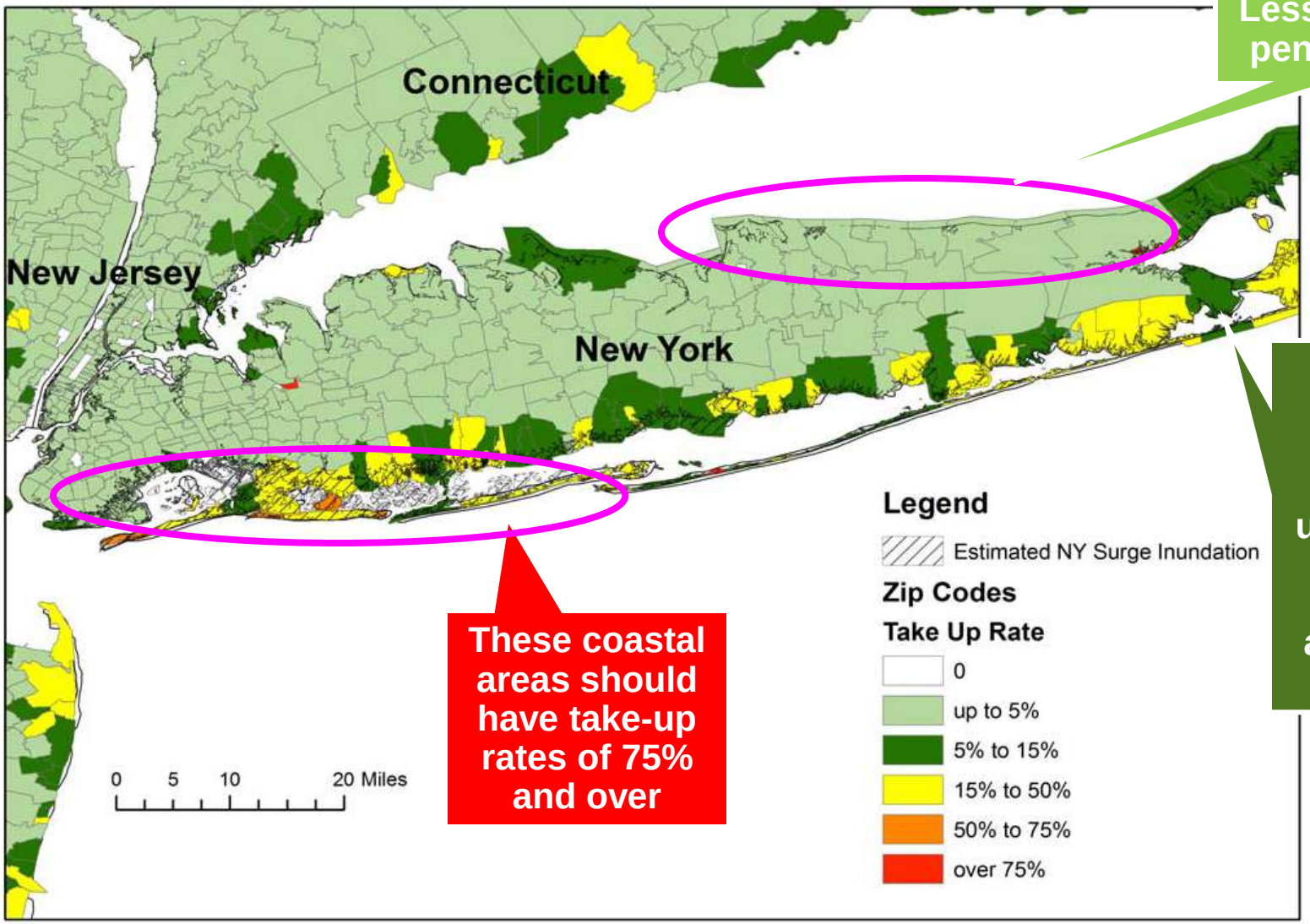
# Flood-Damaged Structures with/without Flood Insurance: Long Island NY




**Here's a marketing challenge. Most people who live on the coast in Long Island didn't buy flood insurance.**

Source: *Newsday*, 1/14/13 from FEMA and Small Business Administration.

# Residential NFIP Flood Take-Up Rates in NY, CT (2010) & Sandy Storm Surge




Less than 5% penetration!

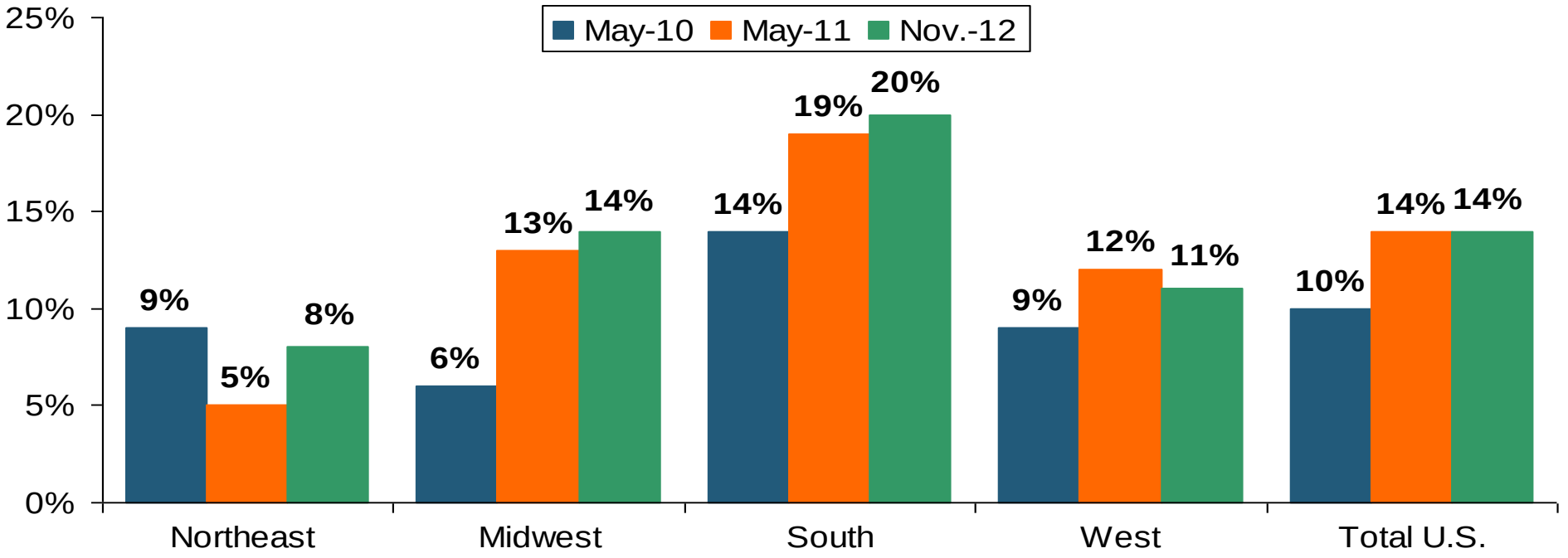
Flood insurance penetration rates were under 15% in many very vulnerable areas of NY and CT.

These coastal areas should have take-up rates of 75% and over

Source: Wharton Center for Risk Management and Decision Processes, *Issue Brief,* Nov. 2012; Insurance Information Institute.

# I.I.I. Poll: Disaster Preparedness

## Q. Do you have a separate flood insurance policy?[1]



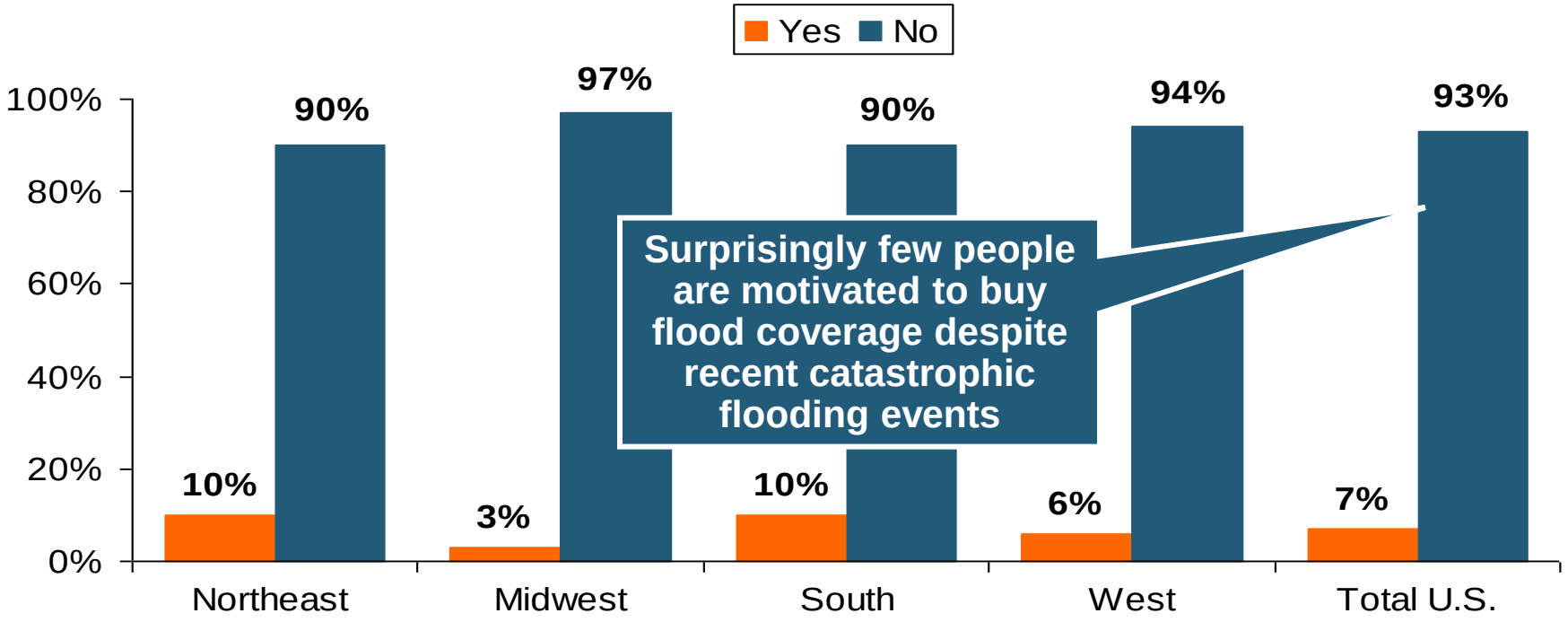

**Only 14 percent of American homeowners say they have a flood insurance policy. The percentage is lowest in the Northeast at 8 percent.**

[1]Asked of those who have homeowners insurance and who responded "yes".

Source: Insurance Information Institute Annual *Pulse* Survey.

# I.I.I. Poll: Disaster Preparedness

## Q. Have recent flooding events such as Hurricane Sandy or Hurricane Irene motivated you to buy flood coverage?[1]



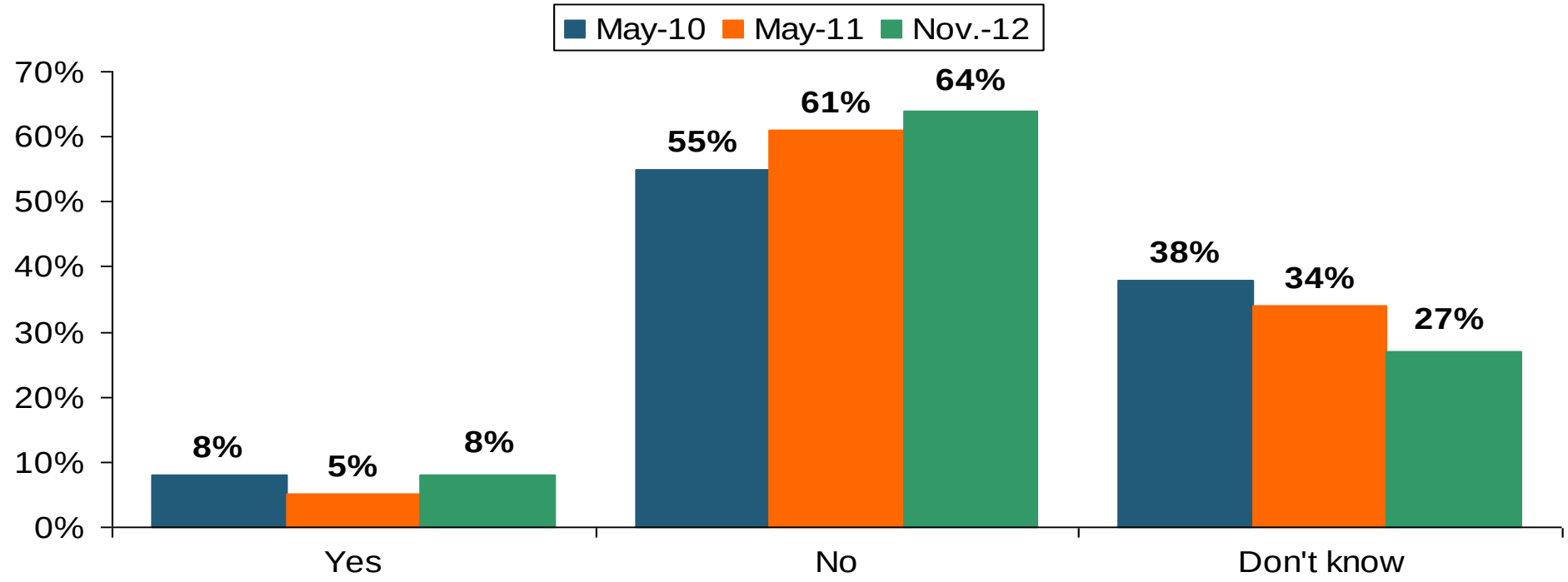

**Recent storms have not motivated people to buy flood insurance coverage.**

[1]Asked of those who have homeowners insurance but not flood insurance.

Source: Insurance Information Institute Annual *Pulse* Survey.

# I.I.I. Poll: Disaster Preparedness

## Q. Will the government pay for damage to your home that is not covered in your homeowners policy?[1]




**Sixty-four percent of homeowners say that the government will not pay for damage to their homes that is not covered by their homeowners policy.**

[1]Asked of those who have homeowners insurance and who responded "yes".

Source: Insurance Information Institute Annual *Pulse* Survey.

# Challenge #3: Prolonged Low Investment Gains

## Investment Performance is a Key Driver of Profitability

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

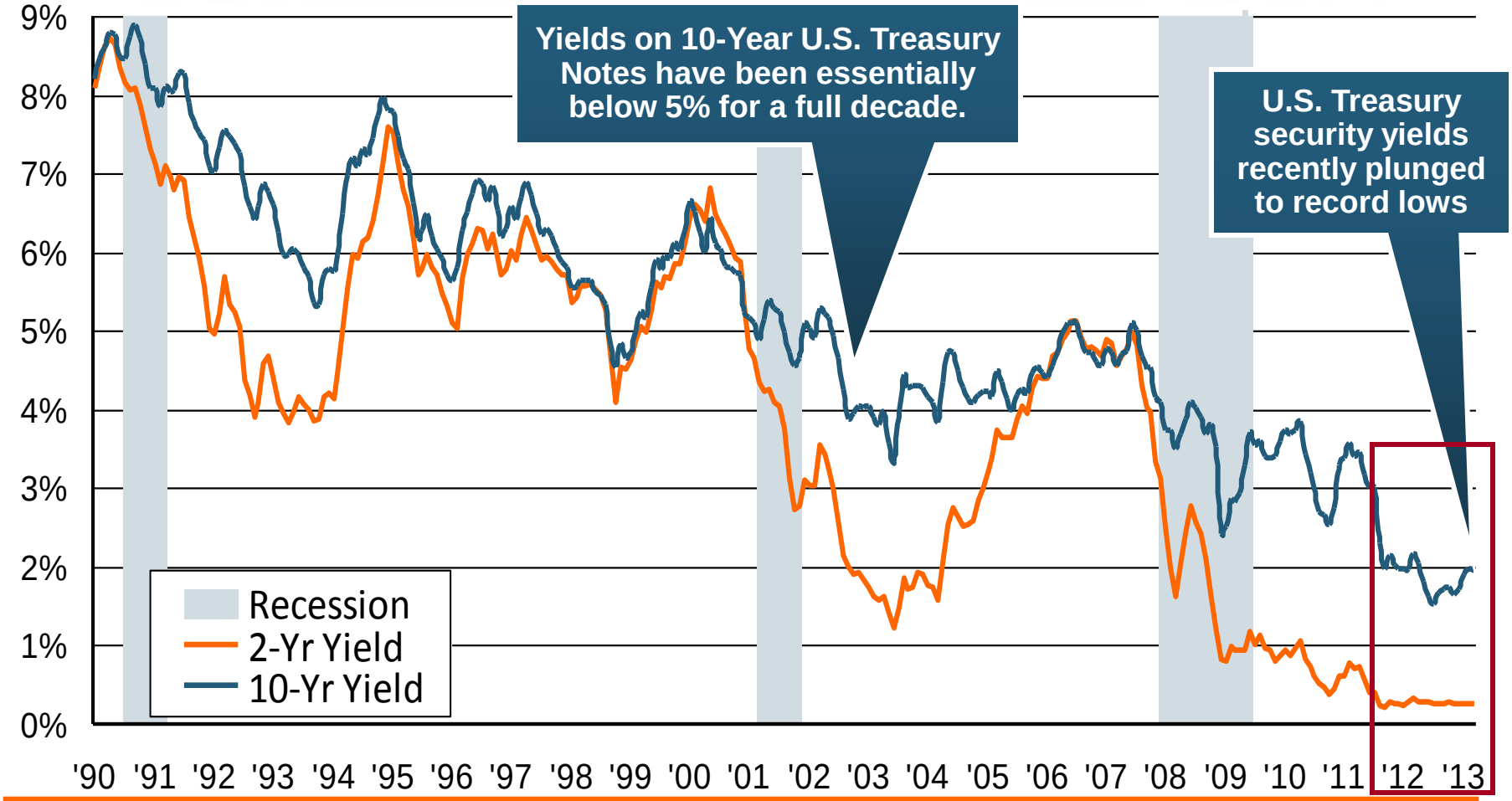
- They Didn't Expect Rates to be
  - Pushed to Such Low Levels
  - Pushed Down so Rapidly
  - Held to Such Low Levels for So Long
  - Suppressed via Unprecedented Aggressiveness of the Federal Reserve
- Ability to Release Prior Reserves Eased Urgency

**OFFSETTING FACTORS**

- Capitalization Still Solid
- Emergence of Sophisticated Price Monitoring and Underwriting Tools

# U.S. Treasury Security Yields*: A Long Downward Trend, 1990–2013

INSURANCE INFORMATION INSTITUTE

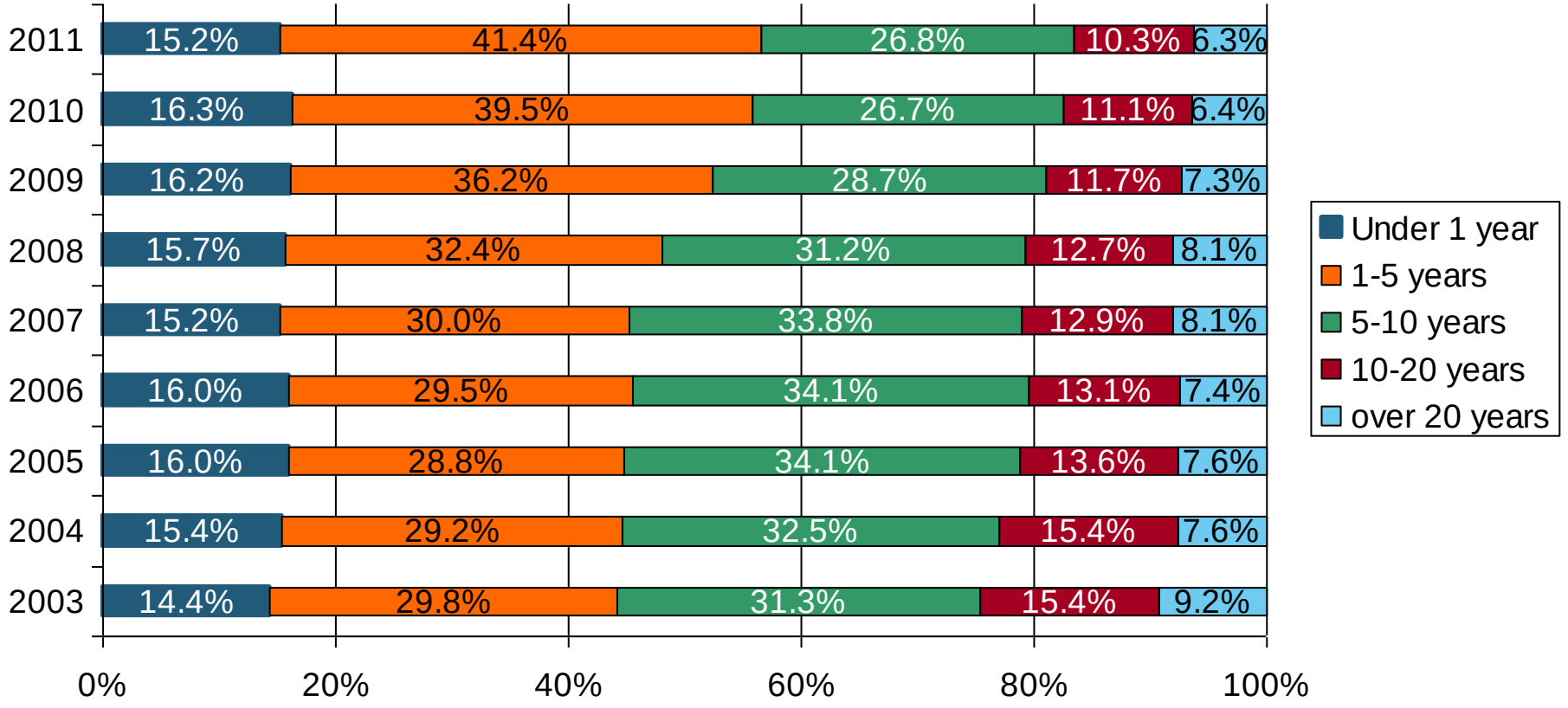



**Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.**

*Monthly, constant maturity, nominal rates, through Mar 2013.

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

# Distribution of Bond Maturities, P/C Insurance Industry, 2003-2011



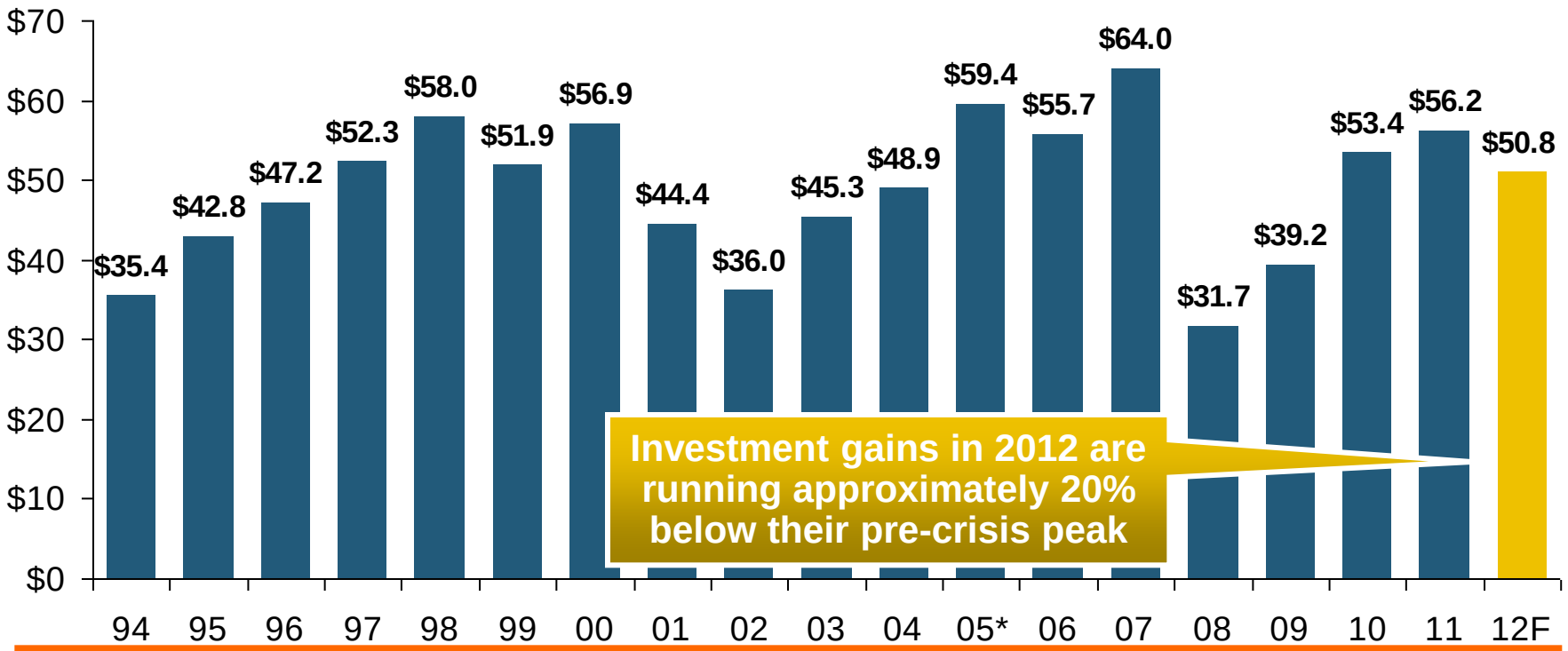

**The main shift over these years has been from bonds with longer maturities to bonds with shorter maturities. The industry first trimmed its holdings of over-10-year bonds (from 24.6% in 2003 to 16.9% in 2011) and then trimmed bonds in the 5-10-year category. Falling average maturity of the P/C industry's bond portfolio is contributing to a drop in investment income along with lower yields.**

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

# Property/Casualty Insurance Industry Investment Gain: 1994–2012F[1]

INSURANCE INFORMATION INSTITUTE

($ Billions)



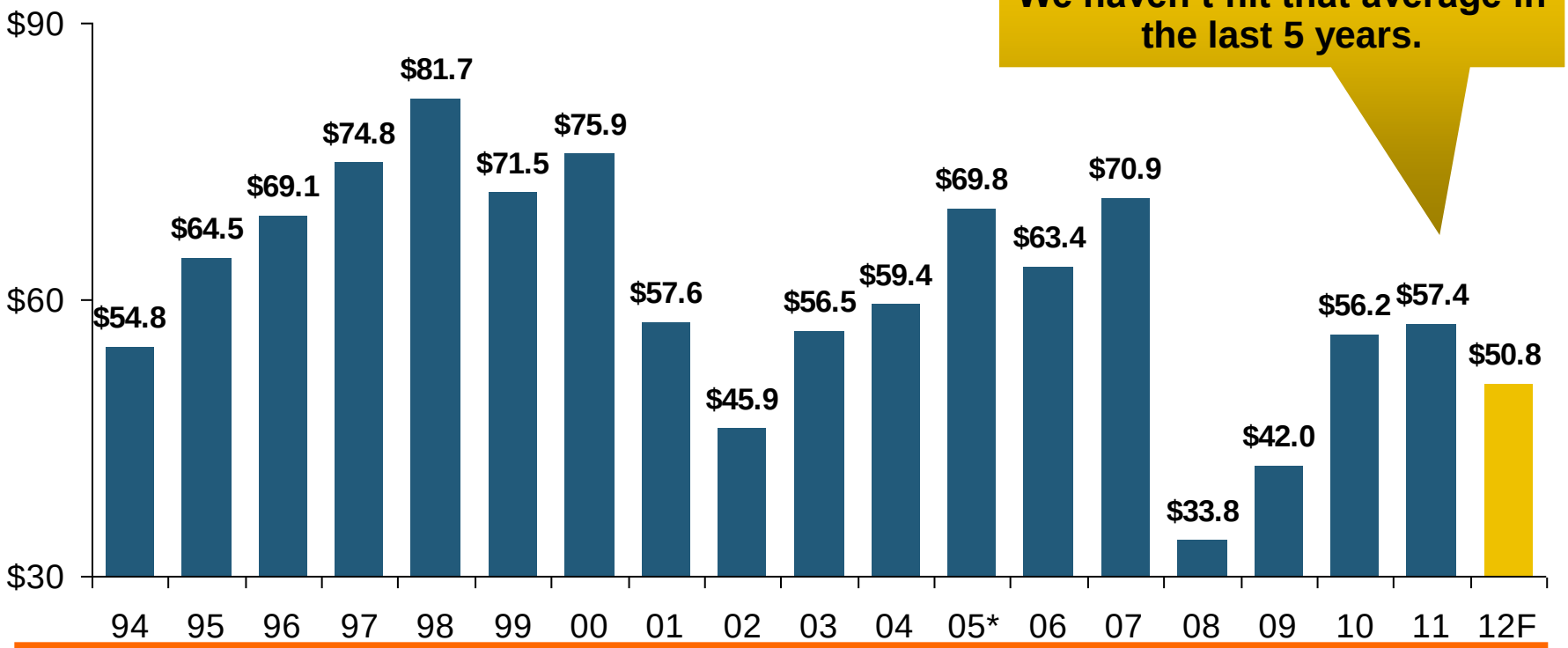

**In 2012 (1st three quarters) both investment income and realized capital gains were lower than in the comparable period in 2011. And because the Federal Reserve Board aims to keep interest rates exceptionally low until the unemployment rate hits 6.5%—likely at least another year off—maturing bonds will be re-invested at even lower rates.**

[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; 2012F figure is I.I.I. estimate based on annualized actual 2012:Q3 result of $38.089B. Sources: ISO; Insurance Information Institute.

# Purchasing Power of P/C Industry Investment Gains: 1994–2012F[1]

INSURANCE INFORMATION INSTITUTE

($ Billions, 2012 dollars)

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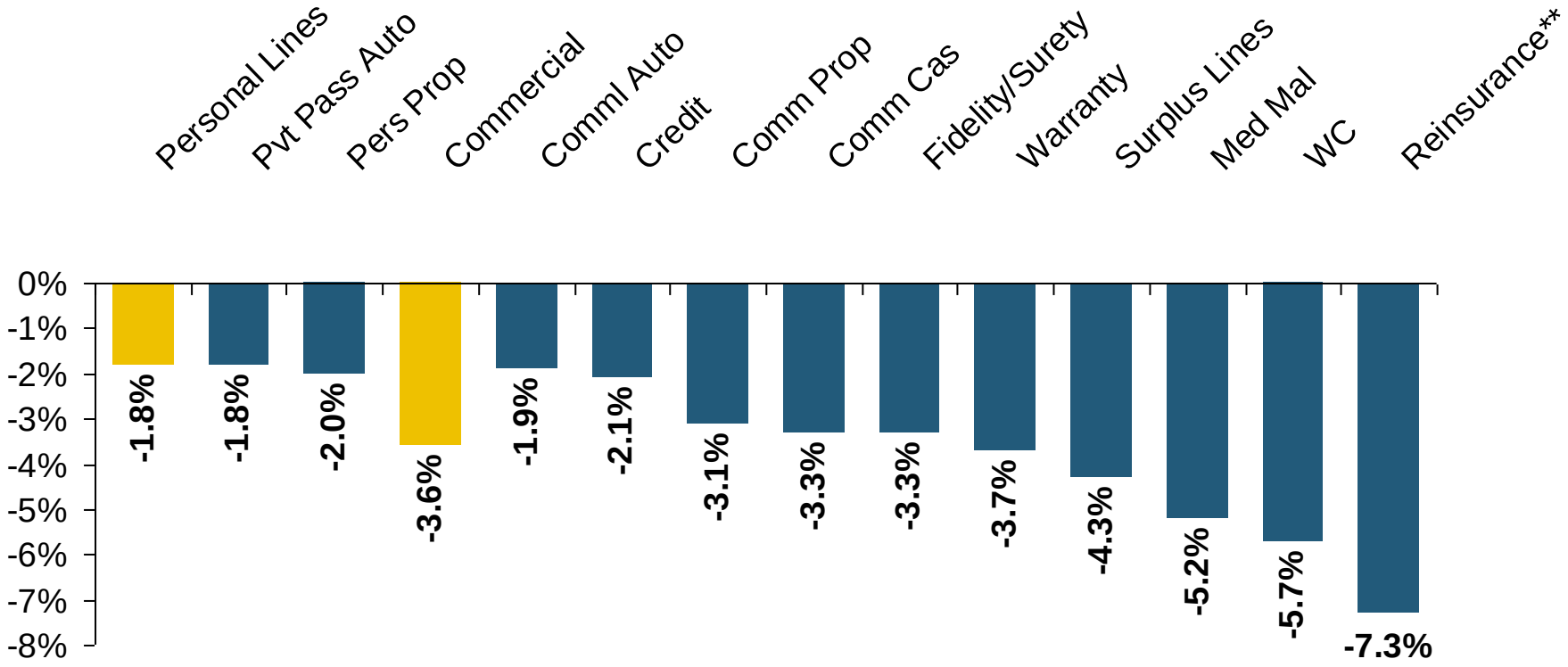
# Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line*

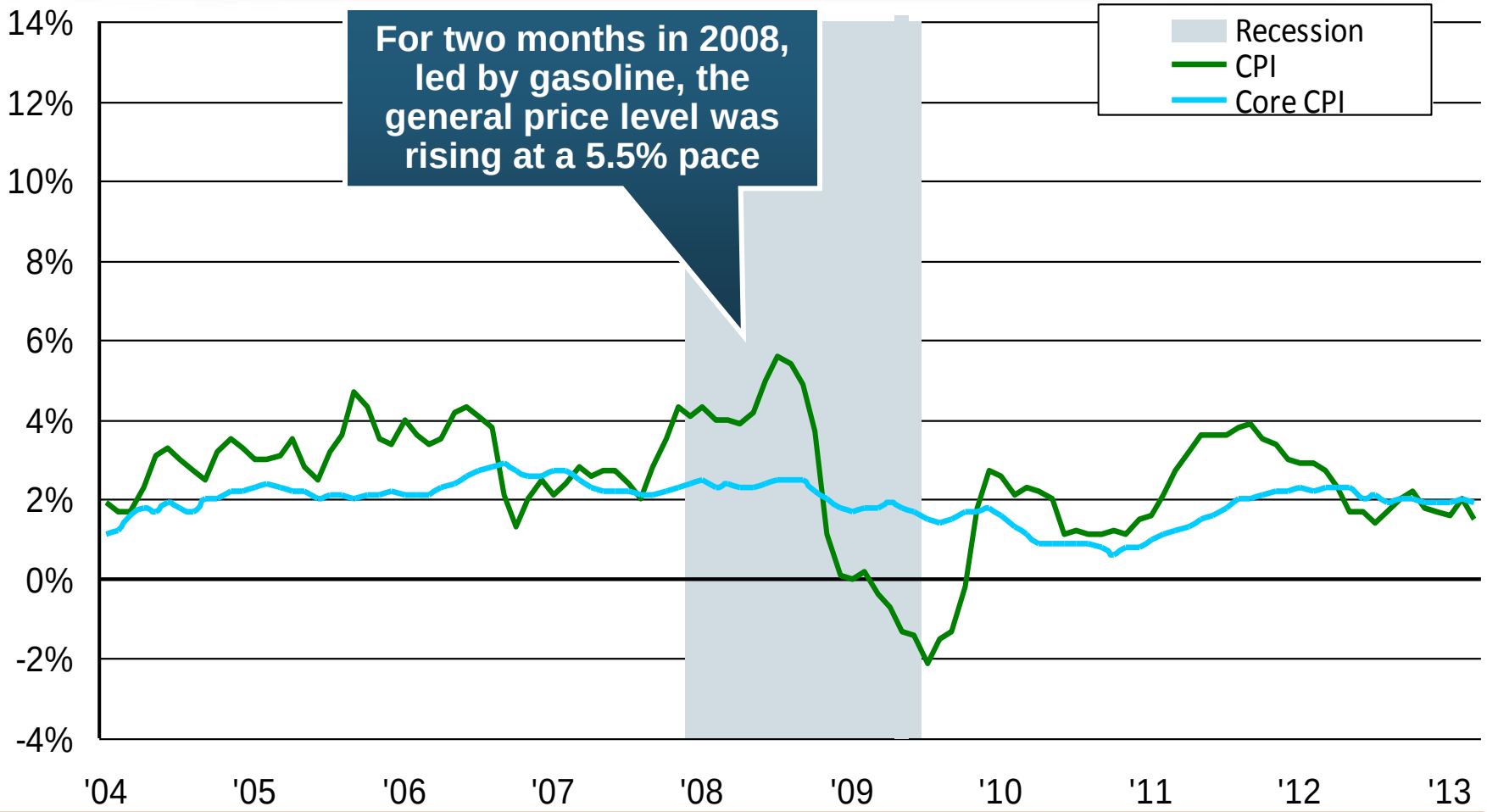



**Lower Investment Earnings Place a Greater Burden on Underwriting and Pricing Discipline**

*Based on 2008 Invested Assets and Earned Premiums
**US domestic reinsurance only
Source: A.M. Best; Insurance Information Institute.

# Challenge #4: Highly Variable P/C Claims Drivers

# Change* in the Consumer Price Index, 2004–2013

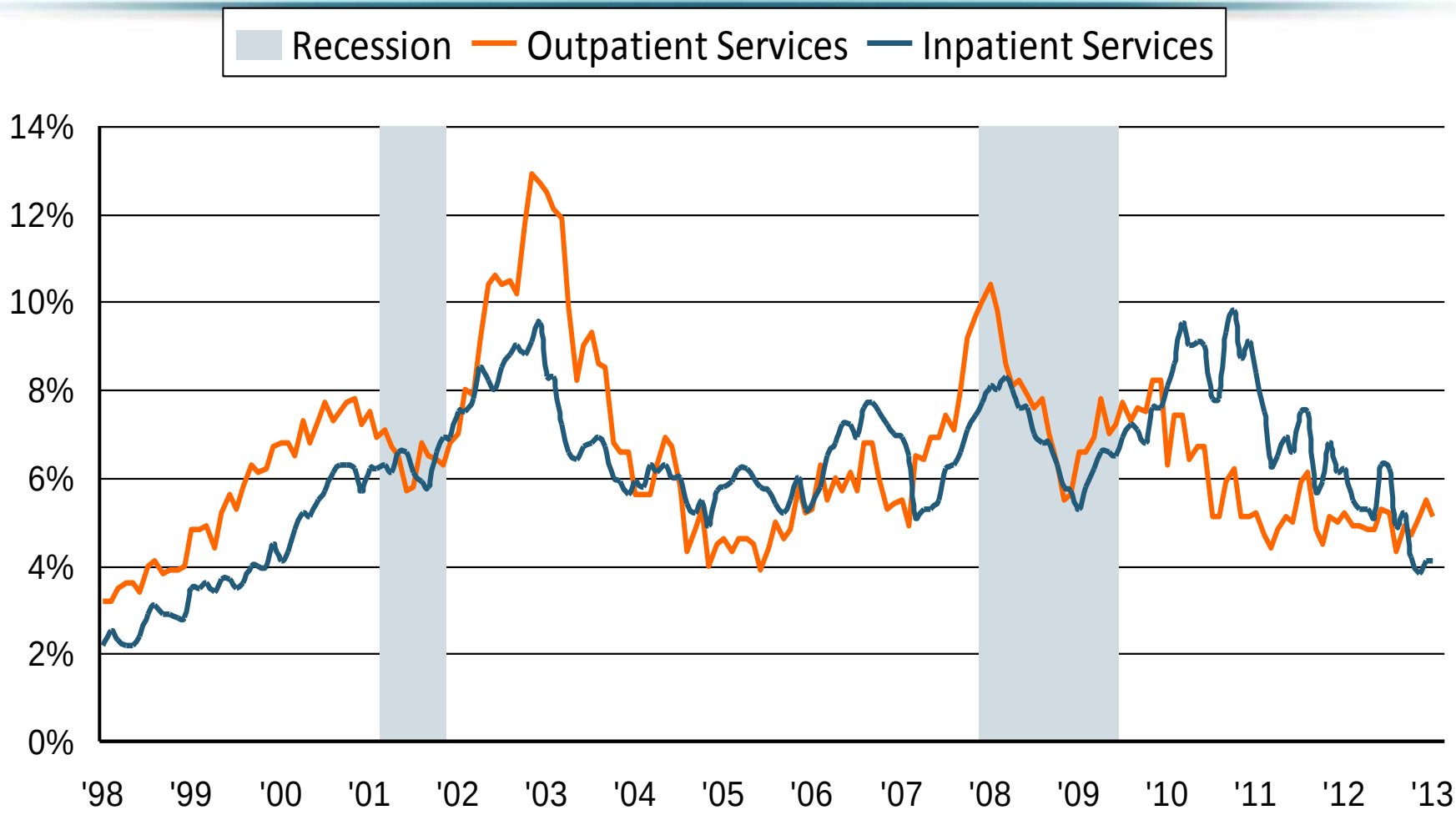



**Over the last decade, prices generally rose about 2% per year.**

*Monthly, year-over-year, through March 2013. Not seasonally adjusted.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

# Prices for Hospital Services:
## 12-Month Change,* 1998–2013

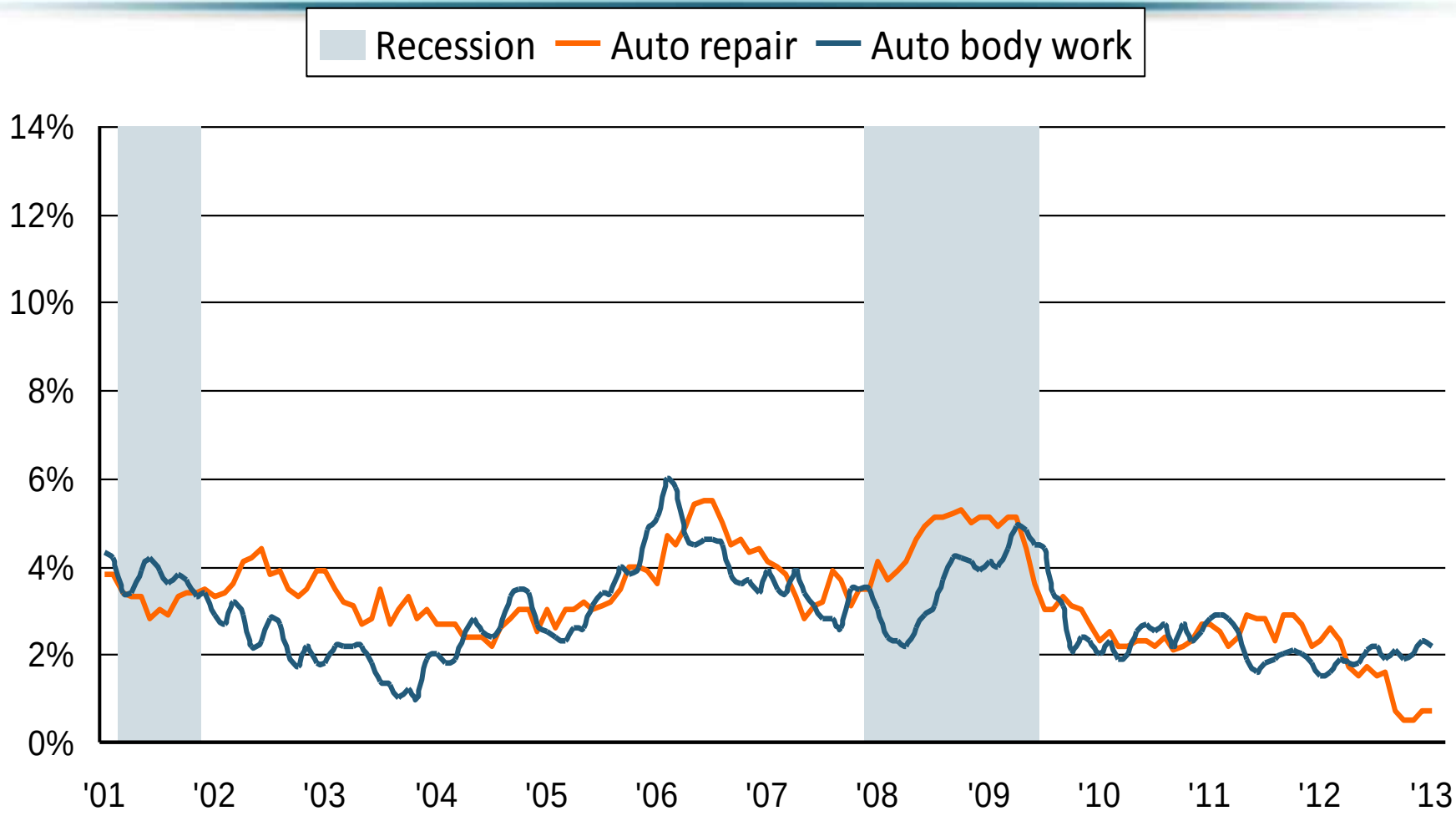



**Cyclical peaks in PP Auto tend to occur approximately every 10 years (early 1990s, early 2000s, and possibly the early 2010s)**

*Percentage change from same month in prior year; through January 2013; seasonally adjusted

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

# Forces that Drive Car Repair Costs:
## 12-Month Change,* 2001–2013

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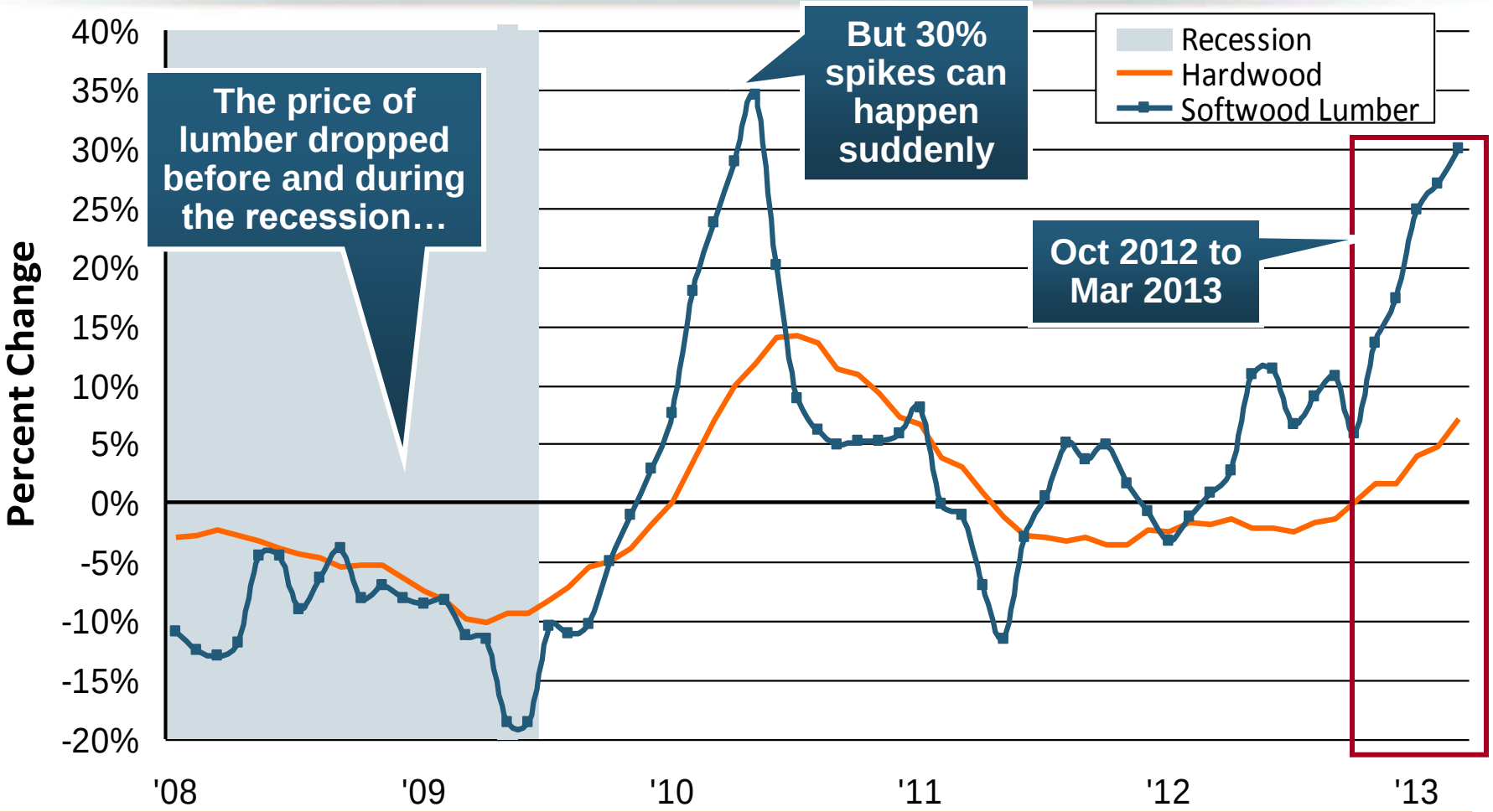
*Percentage change from same month in prior year; through January 2013; seasonally adjusted

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

# Change* in Price Index for Lumber: Sudden Spikes, 2008–2013

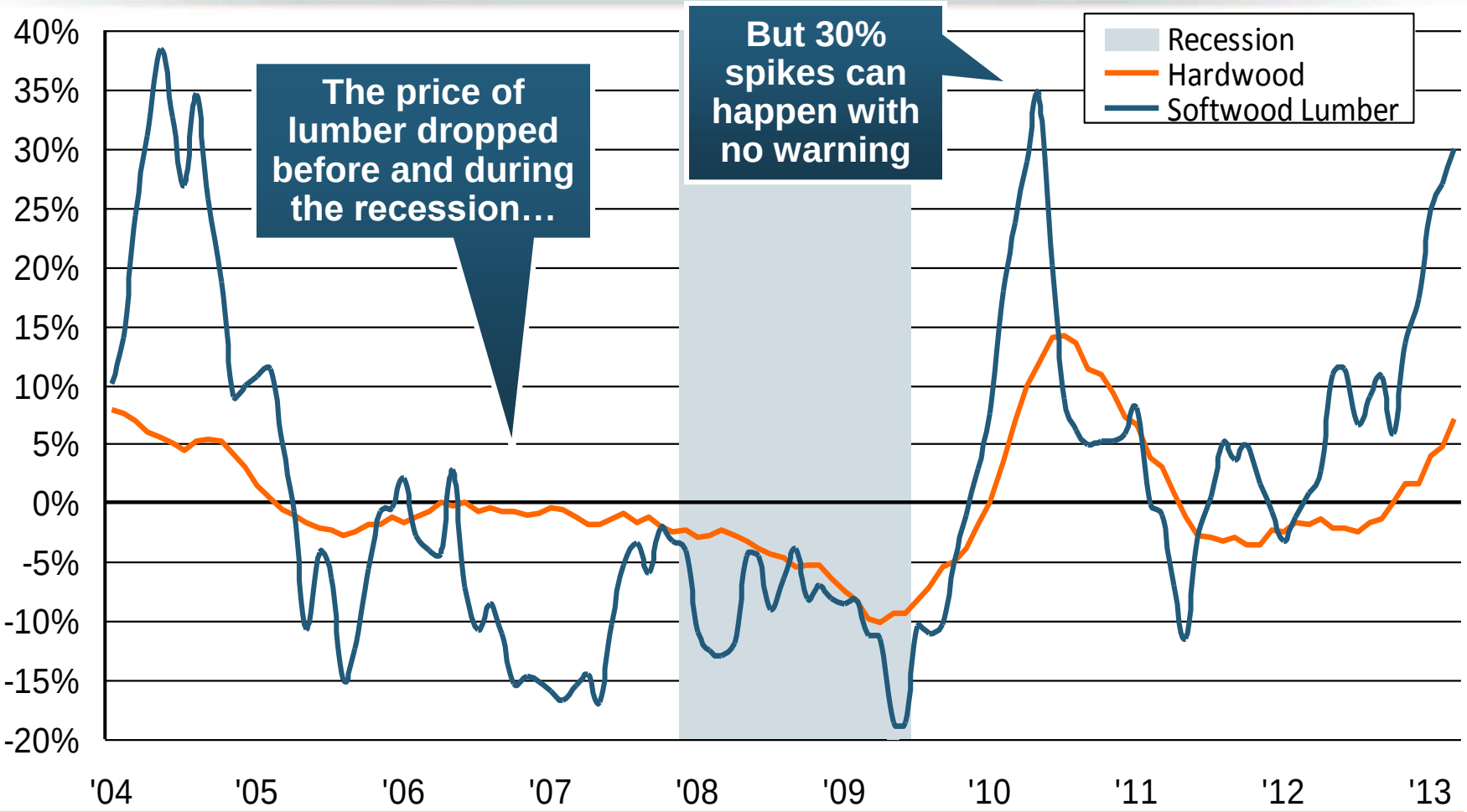



**The prices of building materials vary wildly and change levels rapidly. Prices for hardwood have been much less variable than softwood lumber.**

*Monthly, year-over-year, through March 2013. Not seasonally adjusted. Dec. 2012 and Jan., Feb., and Mar. prices are preliminary.

Sources: US Bureau of Labor Statistics, Producer Price Index series WPS0811; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

# Change* in Price Index for Lumber: A Downward Trend but Sudden Spikes, 2004–2013

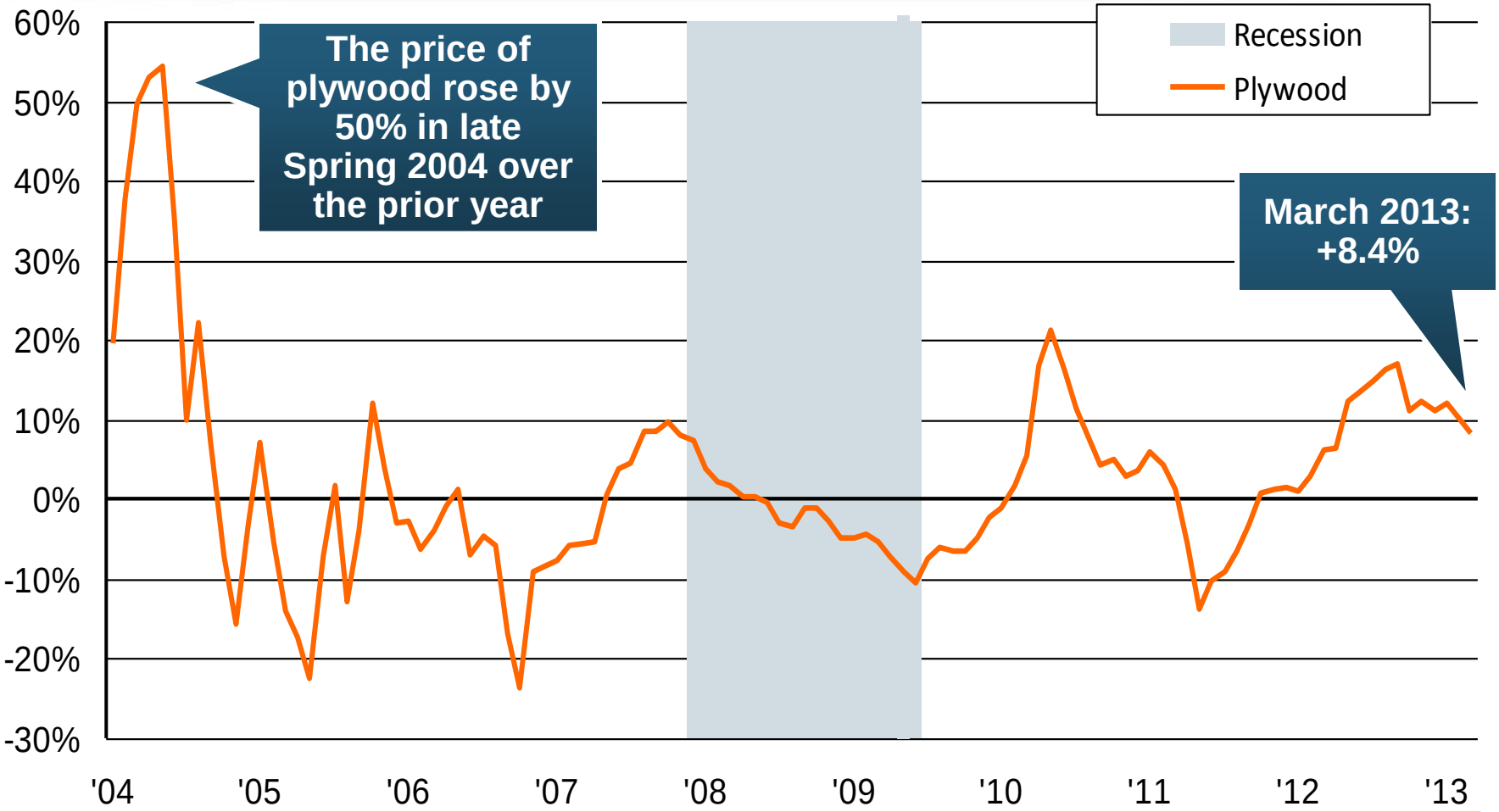



**The prices of building materials vary wildly and change levels rapidly. Prices for hardwood have been much less variable than softwood lumber.**

*Monthly, year-over-year, through March 2013. Not seasonally adjusted. Dec. 2012 and Jan., Feb., and Mar. prices are preliminary.

Sources: US Bureau of Labor Statistics, Producer Price Index series WPS0811; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

# Change* in Price Index for Plywood: A Downward Trend but Sudden Spikes, 2004–2013

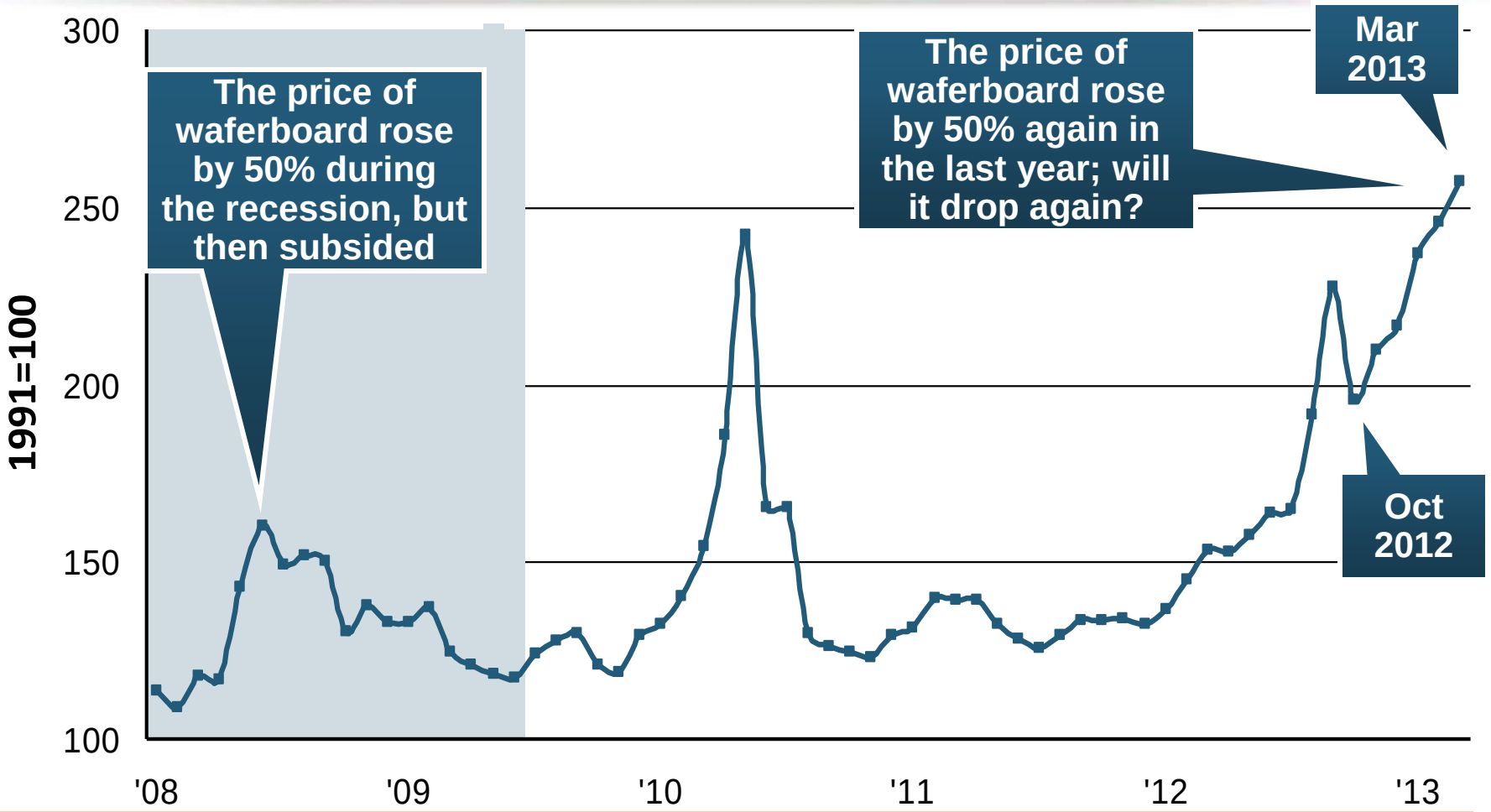



**From the end of the recession (June 2009) to March 2013, the effect of the ups and downs of the price of plywood has resulted in a rise of 25.6%.**

*Monthly, year-over-year, through March 2013. Not seasonally adjusted. Dec. 2012 and Jan., Feb., and Mar. prices are preliminary.

Sources: US Bureau of Labor Statistics, Producer Price Index series WPU083; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

# Price Index for Waferboard, Monthly 2008–2013

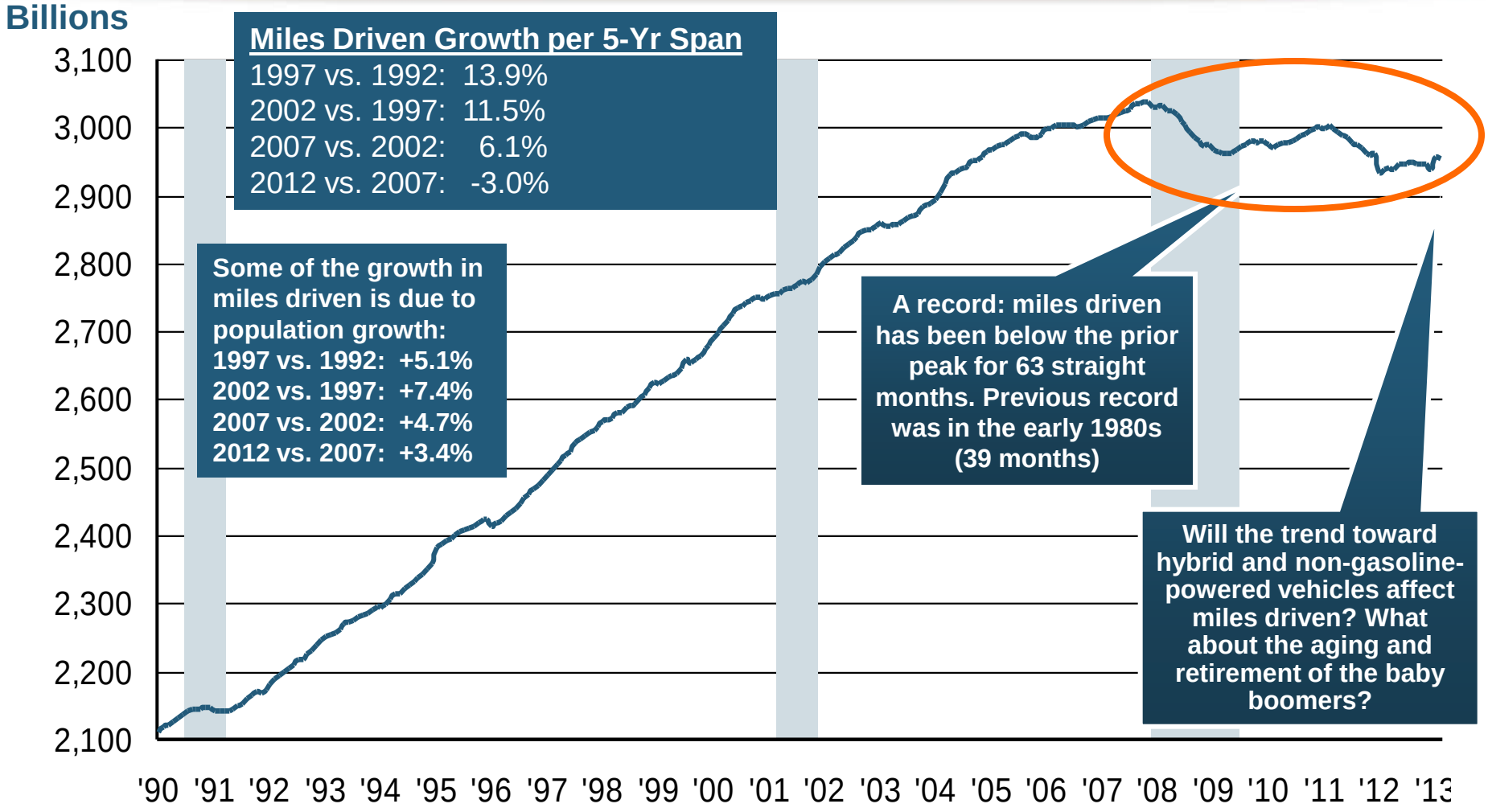



**The prices of building materials such as waferboard and strandboard vary wildly and change levels rapidly.**

Through March 2013. Not seasonally adjusted. Dec. 2012 and Jan., Feb., and Mar. price indeses are preliminary.

Sources: US Bureau of Labor Statistics, Producer Price Index series WPU09220124; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

# But Something Unusual is Happening: Miles Driven*, 1990–2013



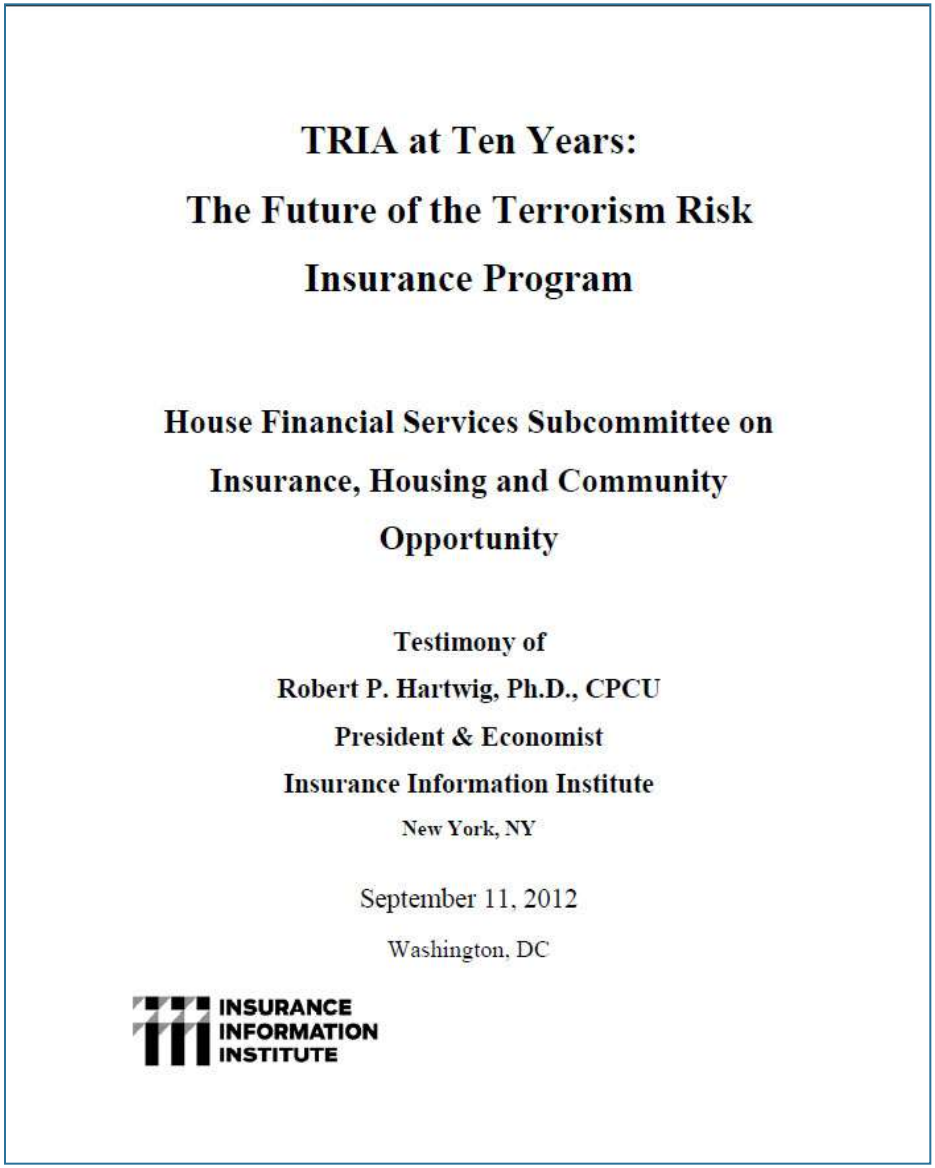

*Moving 12-month total. The latest data is for February 2013. Note: Recessions indicated by gray shaded columns..

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

# Challenge #5: Regulatory Pressure?

## From Congress (TRIA), HUD, CFPB, FSOC/Federal Reserve (SIFIs), the NAIC's SMI, etc.

# I.I.I. Congressional Testimony on the Future of the Terrorism Risk Insurance Program



TRIA at Ten Years:

The Future of the Terrorism Risk Insurance Program

House Financial Services Subcommittee on Insurance, Housing and Community Opportunity

Testimony of

Robert P. Hartwig, Ph.D., CPCU

President & Economist

Insurance Information Institute

New York, NY

September 11, 2012

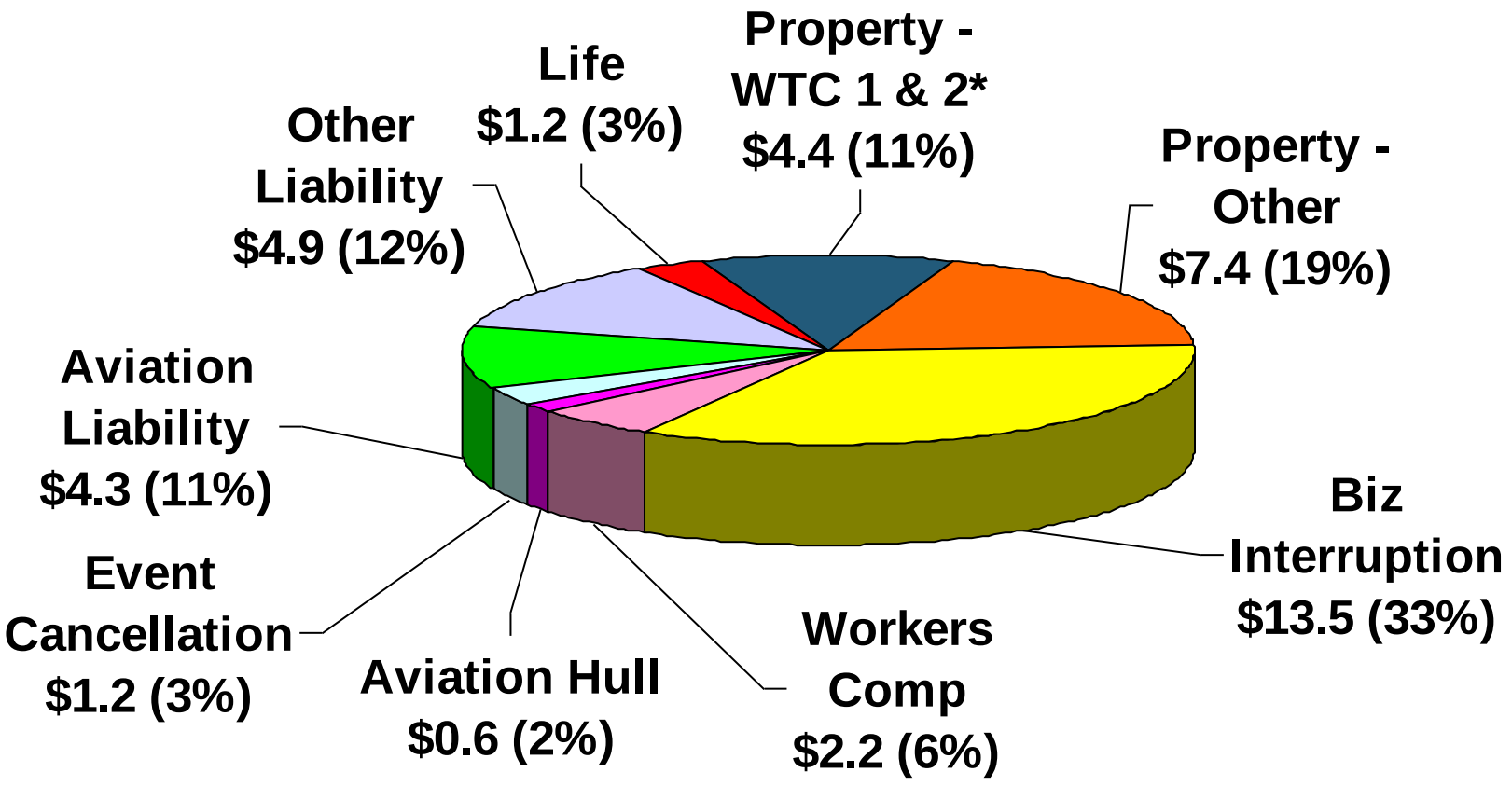
Washington, DC

INSURANCE INFORMATION INSTITUTE

- **Issue:** Act expires 12/31/14. Insurers still generally regard large-scale terror attacks as fundamentally uninsurable
- **I.I.I. Input:** Testified at first hearing on the issue in DC (on 9/11/12) on trends in terrorist activity in the US and abroad, difficulties in underwriting terror risk; Noted that bin Laden may be dead but war on terror is far from over
- **Status:** New House FS Committee Chair Jeb Hensarling has opposed TRIA in the past; Obama Administration does not seem to support extension; Little institutional memory on insurance subcommittee
- **Media:** Virtually no media coverage yet apart form trade press; WSJ will likely editorialize against it.
- **Objective:** Work with trades, risk management community and others to help build support

# Loss Distribution by Type of Insurance from Sept. 11 Terrorist Attack ($ 2011)

($ Billions)




**Total Insured Losses Estimate: $40.0B****

*Loss total does not include March 2010 New York City settlement of up to $657.5 million to compensate approximately 10,000 Ground Zero workers or any subsequent settlements.

**$32.5 billion in 2001 dollars.

Source: Insurance Information Institute.

Exhibit 3A

# Terrorism Violates Traditional Requirements for Insurability

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| Requirement | Definition | Violation |
|---|---|---|
| **Estimable Frequency** | •Insurance requires large number of observations to develop predictive rate-making models (an actuarial concept known as credibility) | •Very few data points<br>•Terror modeling still in infancy, untested.<br>•Inconsistent assessment of threat |
| **Estimable Severity** | •Maximum possible/ probable loss must be at least estimable in order to minimize "risk of ruin" (insurer cannot run an unreasonable risk of insolvency though assumption of the risk) | •Potential loss is virtually unbounded.<br>•Losses can easily exceed insurer capital resources for paying claims.<br>•Extreme risk in workers compensation and statute forbids exclusions. |

Source: Insurance Information Institute

# Terrorism Violates Traditional Requirements for Insurability (cont'd)

| Requirement | Definition | Violation |
|---|---|---|
| **Diversifiable Risk** | •Must be able to spread/distribute risk across large number of risks<br>•"Law of Large Numbers" helps makes losses manageable and less volatile | •Losses likely highly concentrated geographically or by industry (e.g., WTC, power plants) |
| **Random Loss Distribution/ Fortuity** | •Probability of loss occurring must be purely random and fortuitous<br>•Events are individually unpredictable in terms of time, location and magnitude | •Terrorism attacks are planned, coordinated and deliberate acts of destruction<br>•Dynamic target shifting from "hardened targets" to "soft targets"<br>•Terrorist adjust tactics to circumvent new security measures<br>•Actions of US and foreign govts. may affect likelihood, nature and timing of attack |

Source: Insurance Information Institute

# The New HUD Ruling

## HO Underwriting vs. Disparate Impact

# What Did HUD Rule?

- The Fair Housing Act prohibits discrimination in the sale, rental, or financing of dwellings on the basis of race, color, religion, sex, disability, familial status, or national origin.
- HUD's rule says Plaintiffs may use statistical analysis to show that certain insurer/lender/municipality behavior had a disproportionately adverse effect on the sale, rental, or financing of housing for minorities
  - Under the rule, this showing violates the federal Fair Housing Act even if the insurer/lender/municipality did not intend to discriminate
  - Defendant can prevail if it shows the practice was needed to achieve one or more substantial, legitimate, nondiscriminatory interests
  - But plaintiff may win by showing that another practice with a less discriminatory effect could achieve this interest

# Potential Impact on Property Insurance Underwriting

- Why does this affect property insurance?
  - Insurers don't use race, religion, sex, etc. to underwrite property insurance
  - But they *do* use credit-based insurance scores, neighborhood, and other factors that could be the basis of a "disparate impact" conclusion
- Isn't this a federal government agency's intrusion into state regulation, against McCarran-Ferguson?
  - HUD says M-F says federal laws/regulations that "specifically relate to the business of insurance" supercede state law
- But how can insurers defend themselves if they don't have data on race (which they're prohibited from collecting)?
  - HUD says plaintiff have the same problem, so it's fair

# Potential Impact on Property Insurance Underwriting (cont'd)

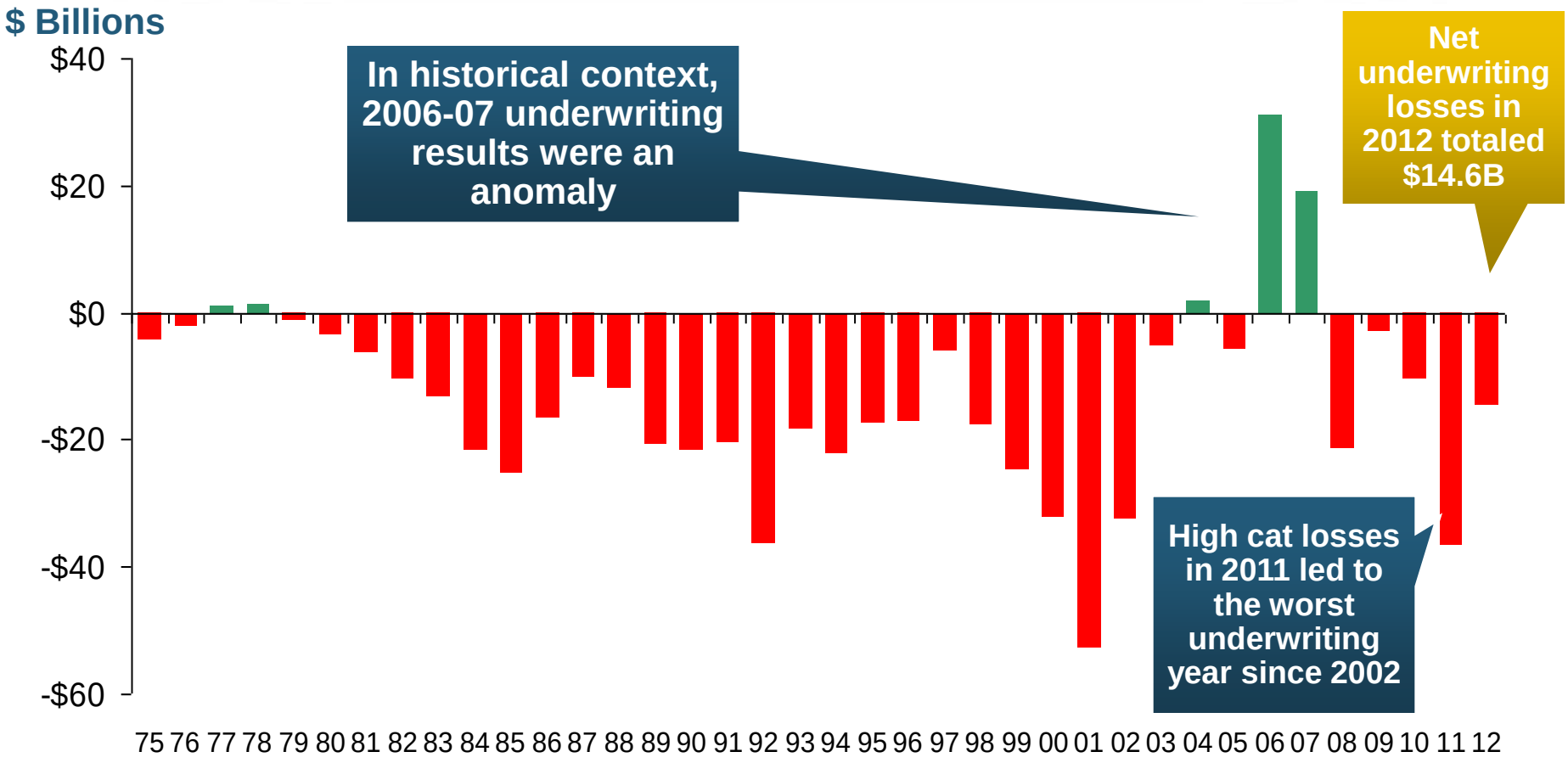
- Could increase costs to monitor compliance and defend suits alleging discrimination
- Potentially Changes State/Federal Regulatory Balance
  - Not necessarily by itself, but in the trail of
    - Federal Insurance Office
    - FSOC
    - CFPB

# Other Regulatory Challenges?

- Designating Some Insurers as Systemically Important?
  - Creating a two-tiered, “unlevel playing field”
- Extending the “Reach” of the Consumer Financial Protection Bureau?
  - The CFPB is now proposing regulations for mortgage servicers regarding property insurance on homes with mortgages
  - Will it deal with insurance offered with credit cards?
  - Bank marketing of insurance products?

# Brief Overview of P/C Industry Financial Status

# Underwriting is Rarely a Profit Source
## *Gain (Loss)* 1975–2012***

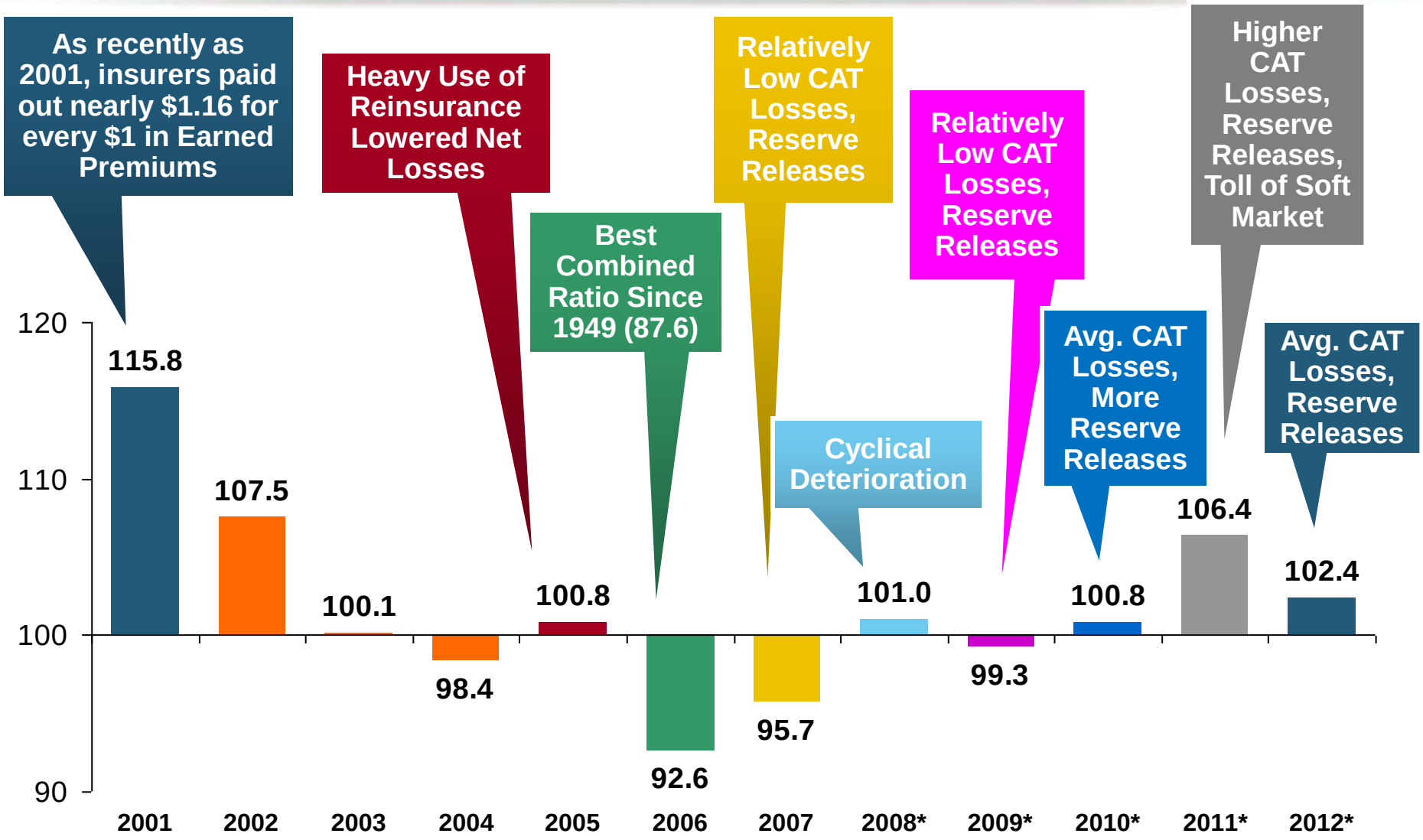



**Average yearly underwriting loss in the 2008-2012 low-interest-rate environment? $17.2B. With interest rates this low, large persistent underwriting losses are not a recipe for success.**

*Includes mortgage and financial guaranty insurers in all years.

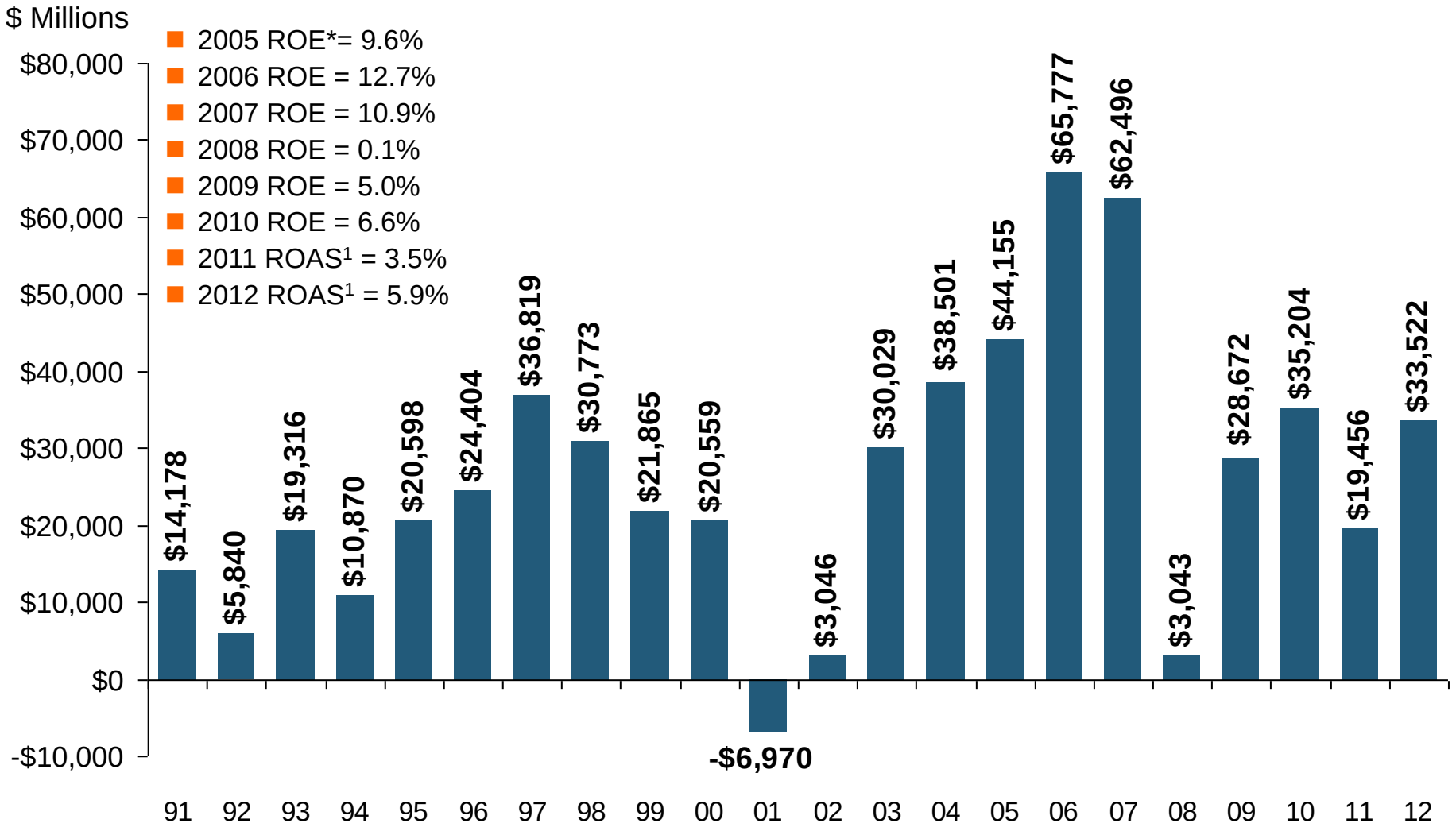
Sources: A.M. Best; ISO; Insurance Information Institute.

# P/C Insurance Industry Combined Ratio, 2001–2012




* Excludes Mortgage & Financial Guaranty insurers 2008--2012. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.2; 2012=103.2.
Sources: A.M. Best; ISO.

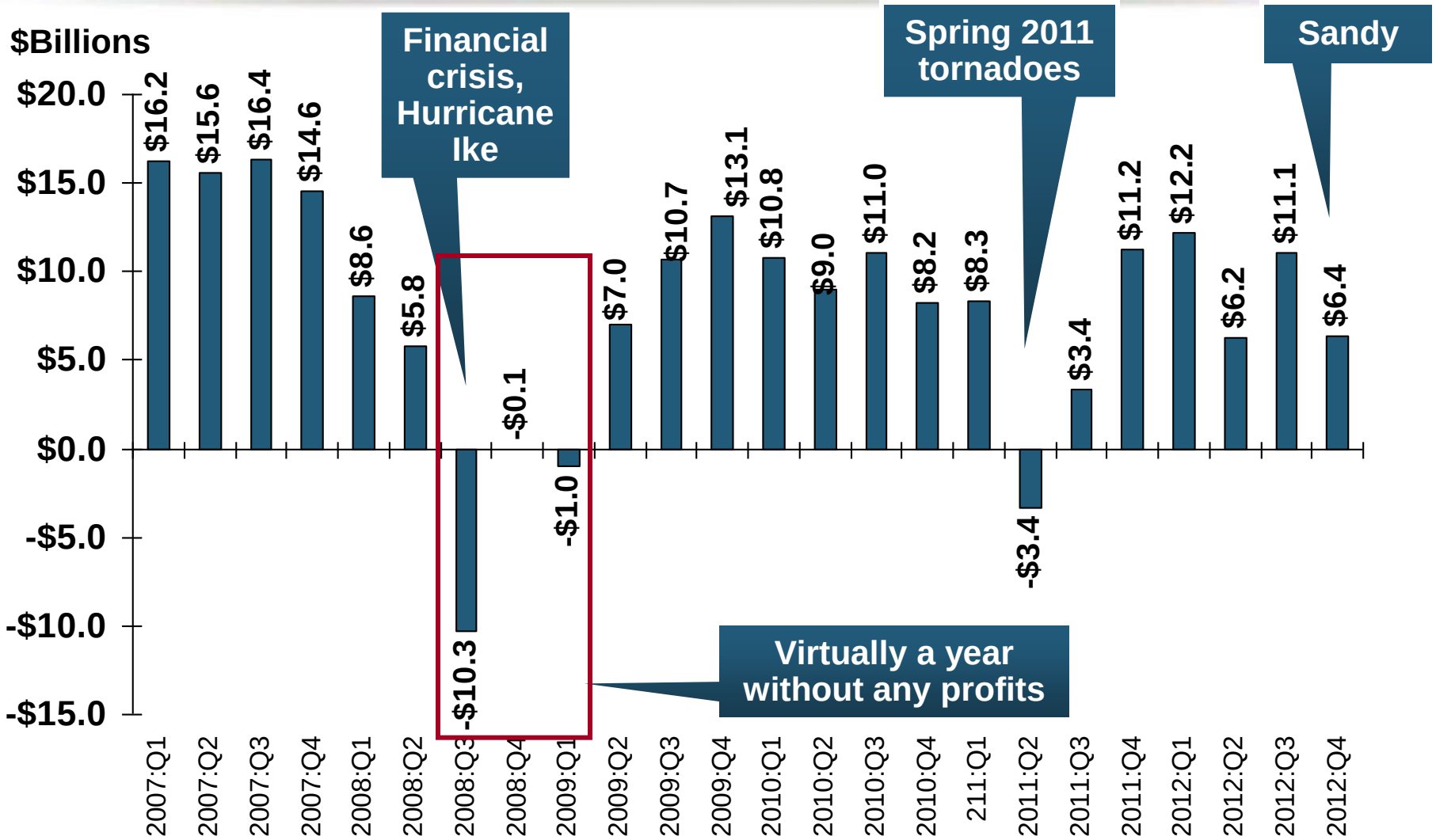
# P/C Net Income After Taxes 1991–2012




* ROE figures are GAAP; [1]Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 6.2% ROAS for 2012:H1, 4.6% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

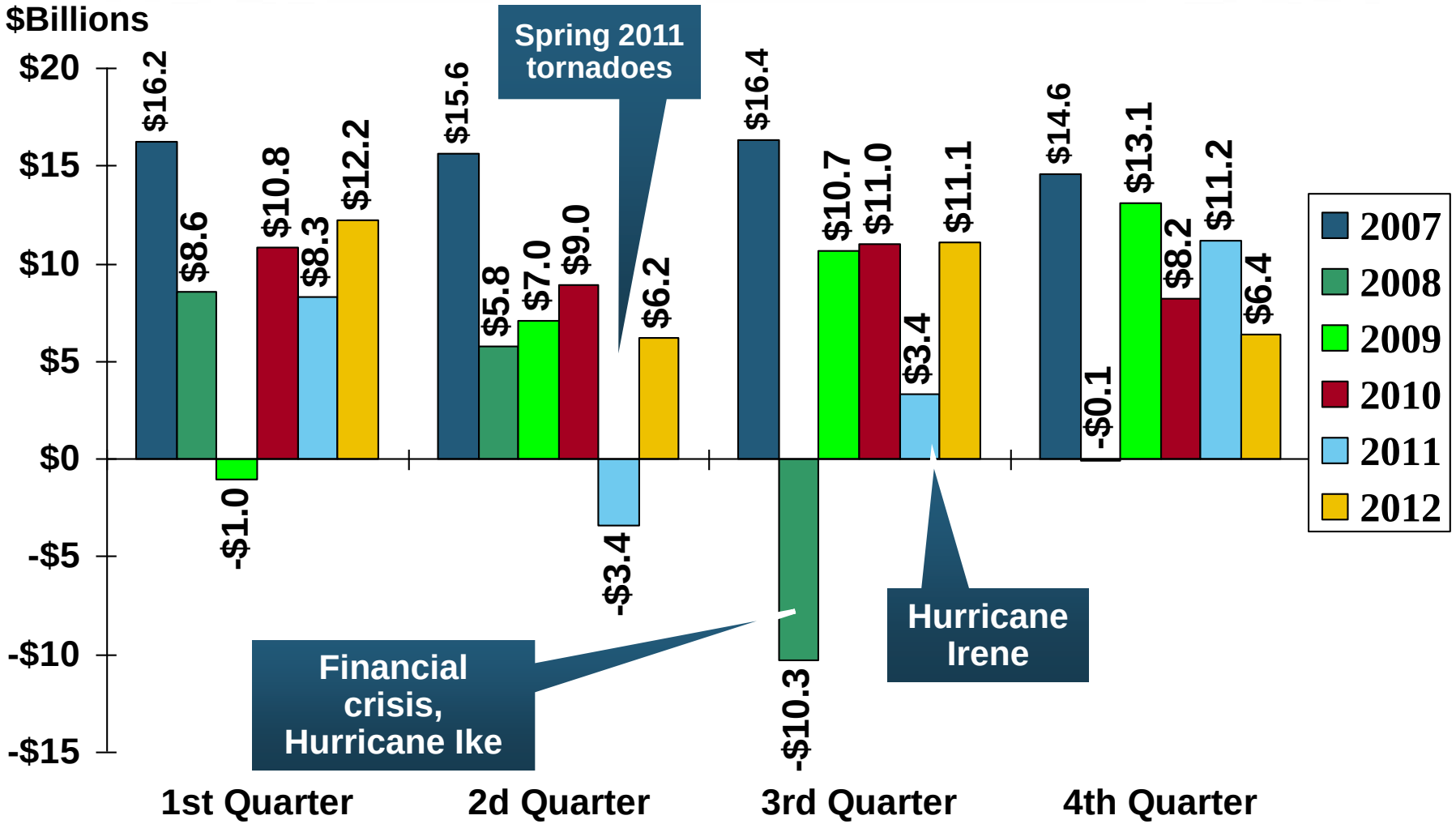
Sources: A.M. Best; ISO; Insurance Information Institute.

# P/C Industry Net Income, Quarterly, 2007:Q1-2012:Q4




Sources: SNL Financial; Insurance Information Institute

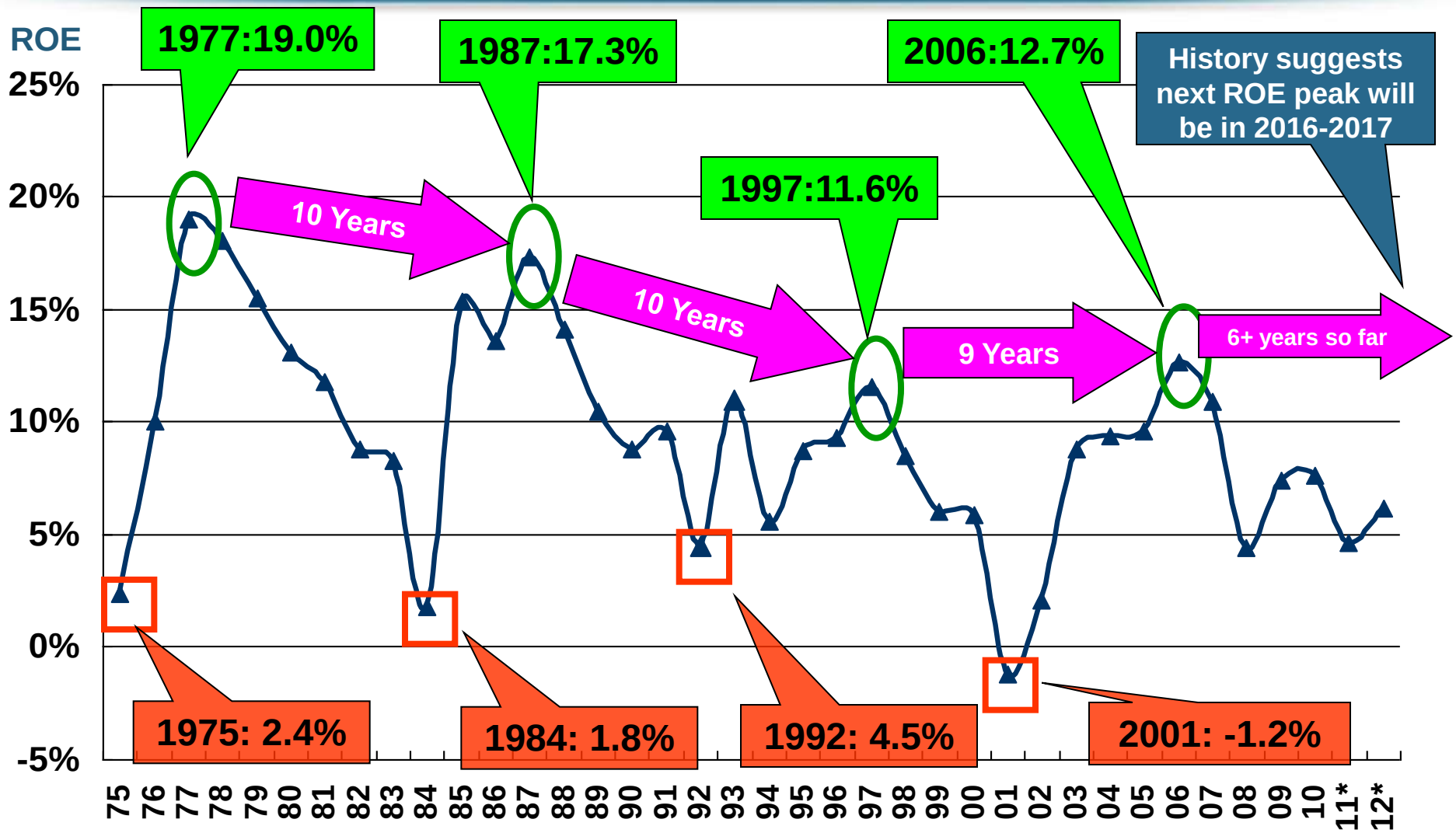
# P/C Industry Net Income, Quarterly, 2007:Q1-2012:Q4




**Over the past 6 years, no calendar quarter has been consistently profitable.**

Sources: SNL Financial; Insurance Information Institute

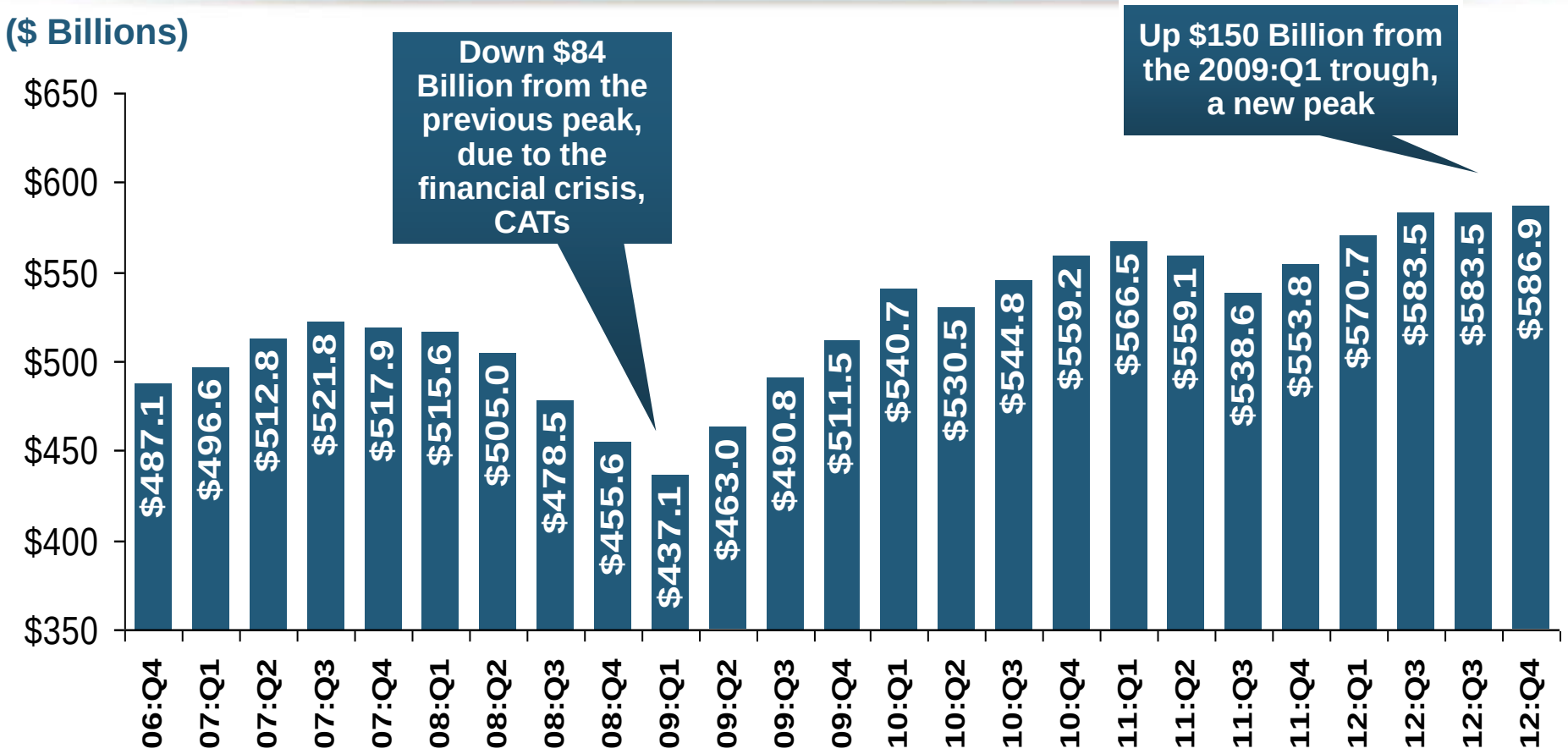
# Profitability (ROE) Peaks & Troughs, P/C Insurance Industry, 1975 – 2012




*Profitability = P/C insurer ROEs. 2012 is an estimate based on ROAS data. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. 2012 ROAS = 5.9% including M&FG.
Sources: Insurance Information Institute; NAIC; ISO; A.M. Best.

# Policyholder Surplus, Quarterly, 2006:Q4–2012:Q4

INSURANCE INFORMATION INSTITUTE




**The industry now (at year-end 2012) has $1 of surplus for every $0.78 of NPW, the strongest claims-paying status in its history.**

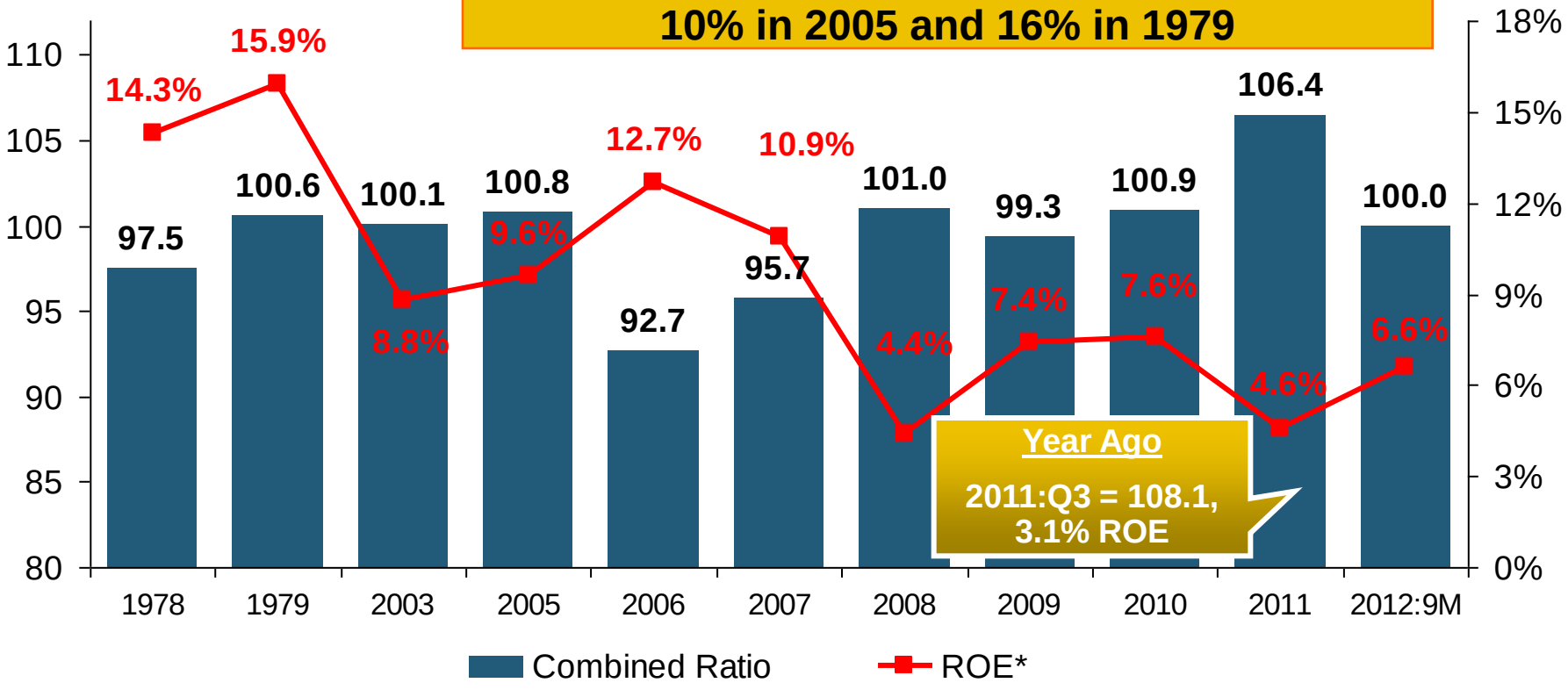
Sources: ISO; A.M .Best.

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

INSURANCE INFORMATION INSTITUTE

## Combined Ratio / ROE

**A combined ratio of about 100 generates an ROE of ~6.6% in 2012, ~7.5% 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**

* 2008 -2012 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2012:Q3 combined ratio including M&FG insurers is 100.9, ROAS = 6.3%; 2011 combined ratio including M&FG insurers is 108.2, ROAS = 3.5%.

Source: Insurance Information Institute from A.M. Best and ISO data.

# US Policyholder Surplus: 1975–2012*

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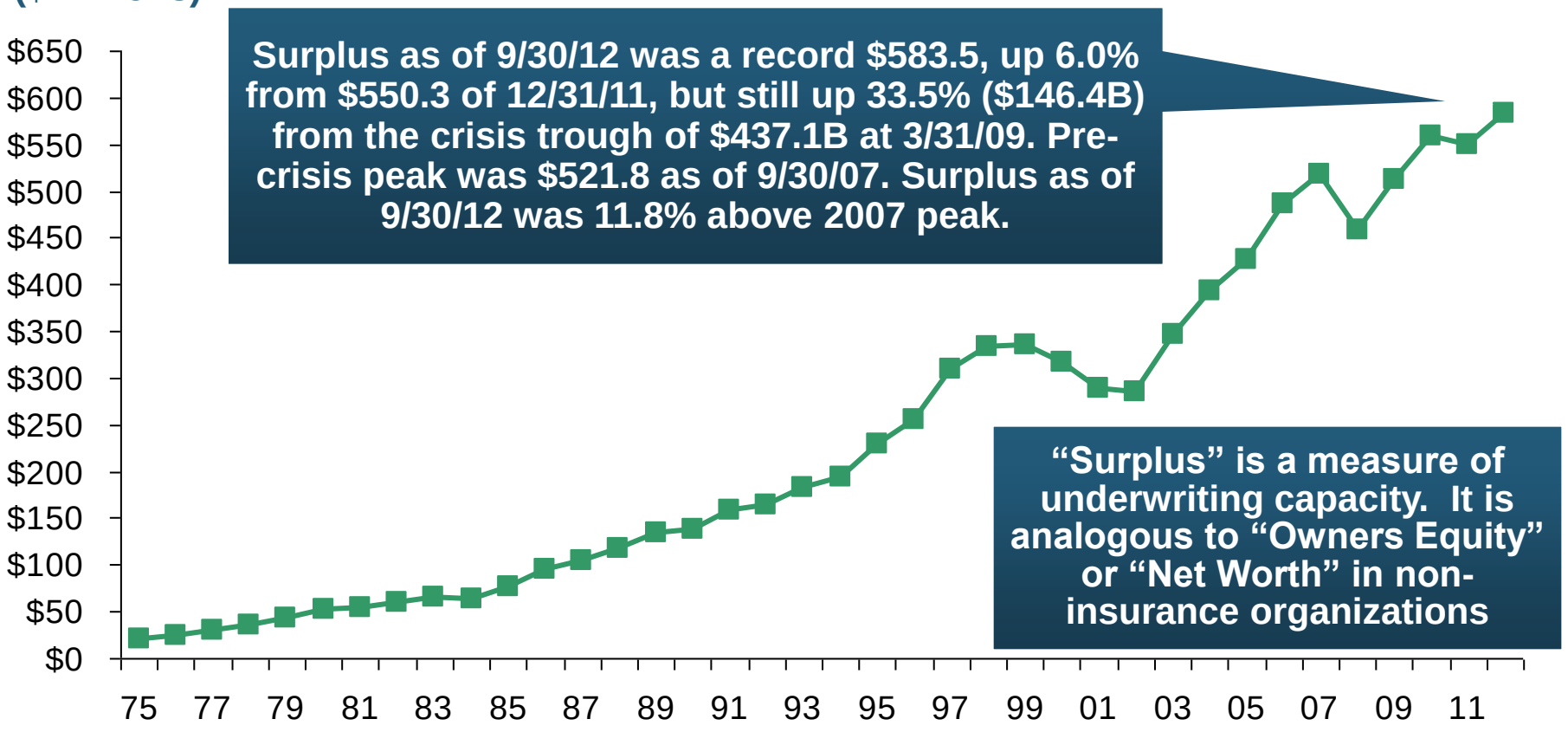
($ Billions)




Surplus as of 9/30/12 was a record $583.5, up 6.0% from $550.3 of 12/31/11, but still up 33.5% ($146.4B) from the crisis trough of $437.1B at 3/31/09. Pre-crisis peak was $521.8 as of 9/30/07. Surplus as of 9/30/12 was 11.8% above 2007 peak.

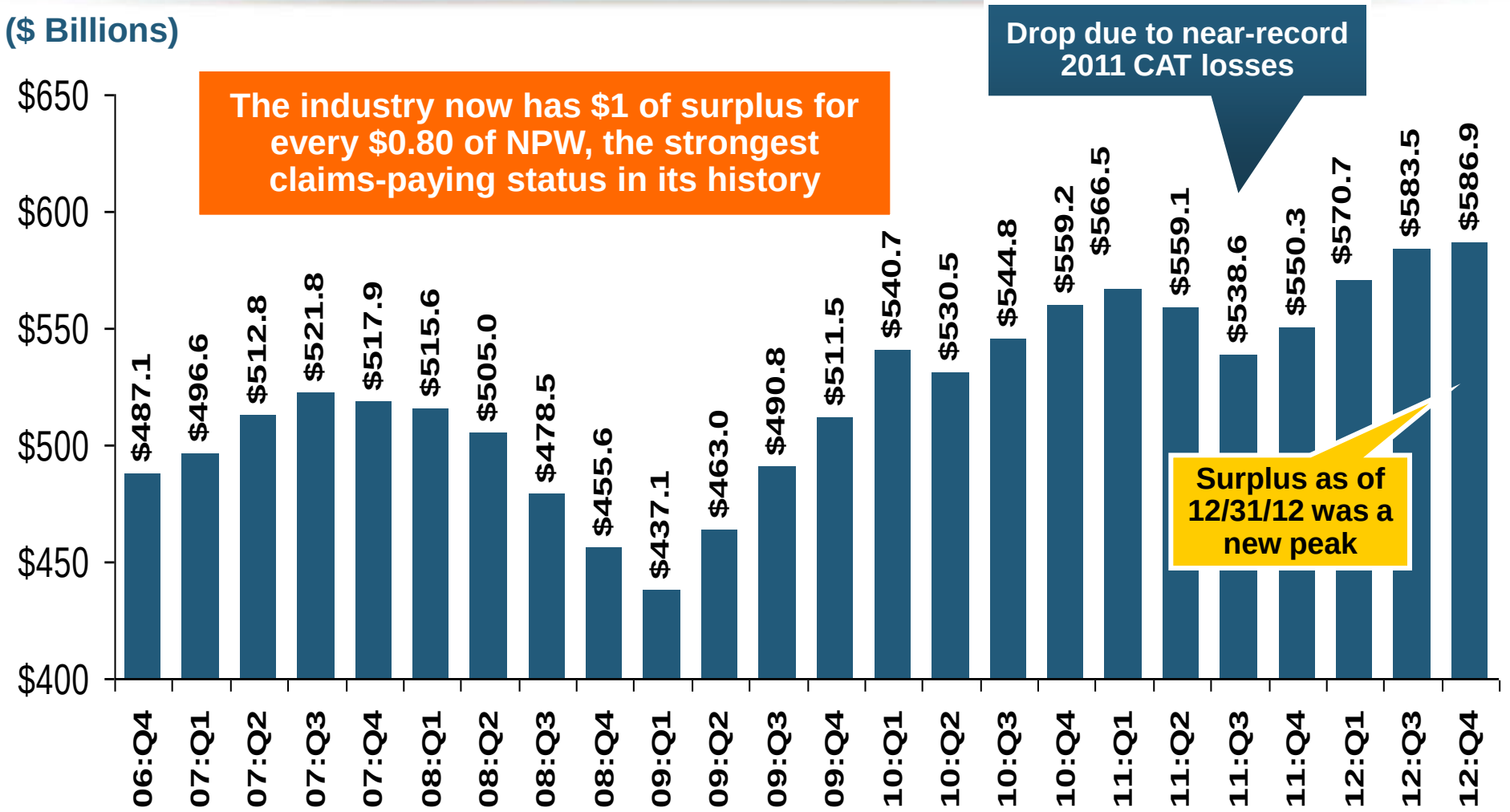
"Surplus" is a measure of underwriting capacity. It is analogous to "Owners Equity" or "Net Worth" in non-insurance organizations

**The Industry's Claims Paying Resources Reached an All-Time Record High as of Q3 2012, Just Before Sandy Struck, A Vivid Demonstration of the Strength**

* As of 9/30/12.

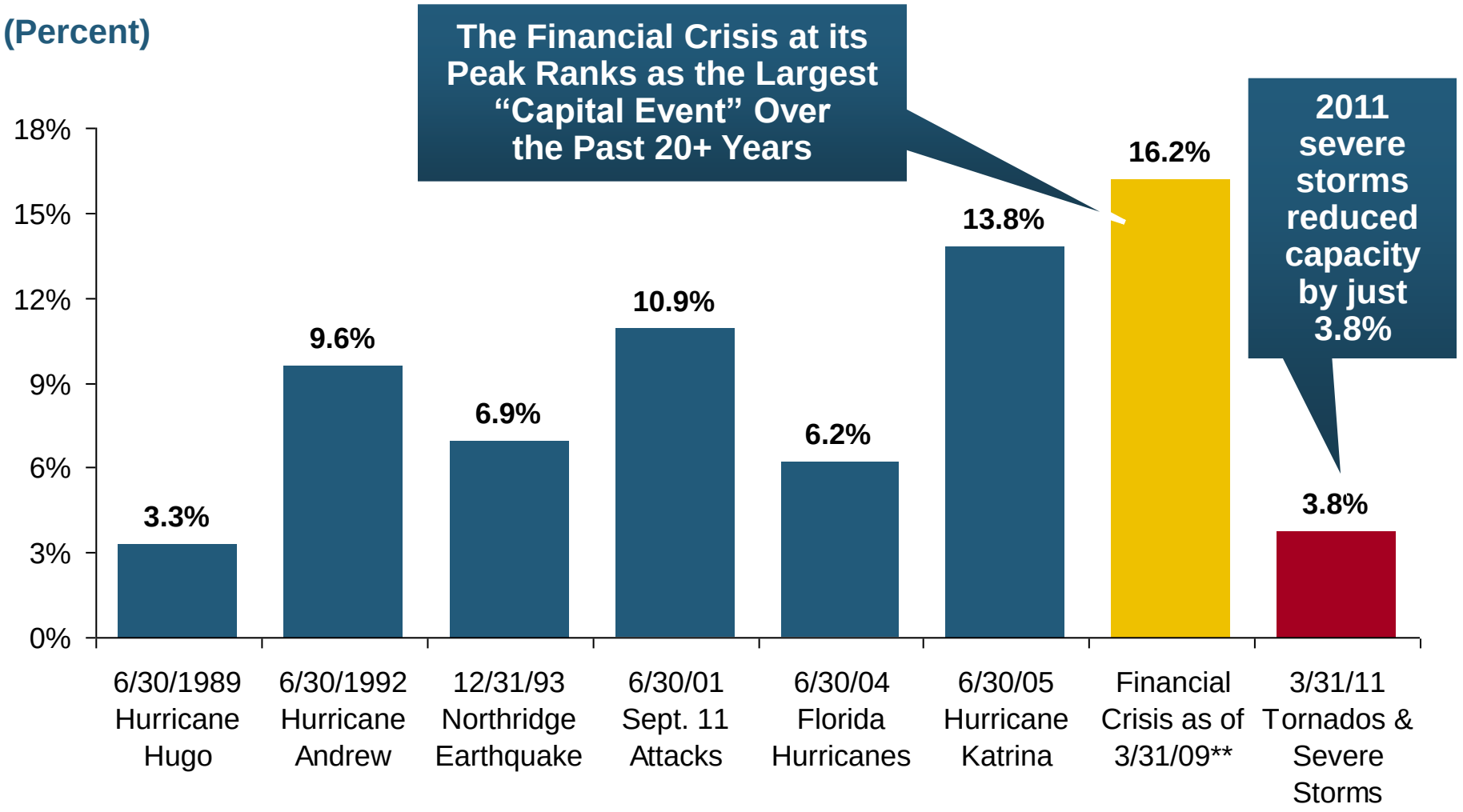
Source: A.M. Best, ISO, Insurance Information Institute.

# Policyholder Surplus, 2006:Q4–2012:Q4




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

# Key Takaways

# Takeaways: Insurance Industry Predictions for 2013

- **P/C Insurance Exposures Will Grow With the U.S. Economy**
  - Personal and commercial exposure growth is likely in 2013
    - But restoration of destroyed exposure will take until mid-decade
  - Wage growth is also positive and could modestly accelerate
- **P/C Industry Growth in 2013 Will Be Strongest Since 2004**
  - Growth likely to exceed A.M. Best projection of +3.8% for 2012
  - No traditional "hard market" emerges in 2013
- **Underwriting Fundamentals Deteriorate Modestly**
  - Some pressure from claim frequency, severity in some key lines
  - But WC will be tough to fix
- **Industry Capacity Hits a New Record by Year-End 2013 (Barring Meg-CAT)**
- **Investment Environment Is/Remains Challenging**
  - Interest rates remain low

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