

The “New Normal” of Business and Insurance

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Presentation Outline: The “New Normal” in...

- The U.S. Economy
- The P-C Insurance Industry
- The Liability Insurance Marketplace
- Litigation/Tort System Cost Trends

Q&A

The “New Normal” in the U.S. Economy

*Tough Times for
the Foreseeable Future*





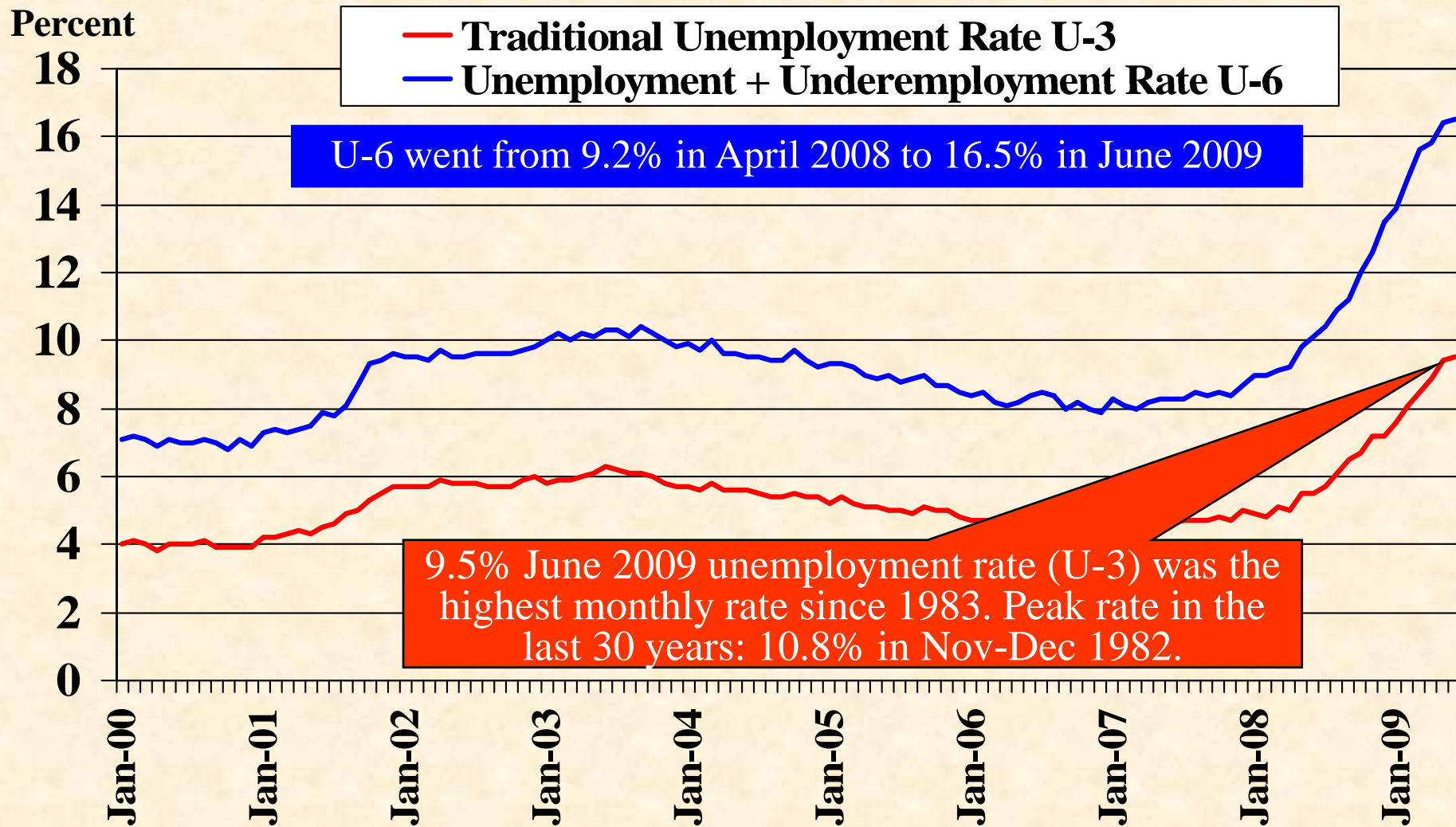
What Does the “New Normal” Economy Look Like?

- High levels of unemployment/
underemployment
- Low levels of investment return
- Low levels of new borrowing
 - Affects housing, autos, other consumer durables
- Low levels consumer demand/
business investment
 - Significant increase in the personal saving rate, but
virtually all used to pay down outstanding debt

Unemployment and Underemployment Rates: Rocketing Up in 2008-9

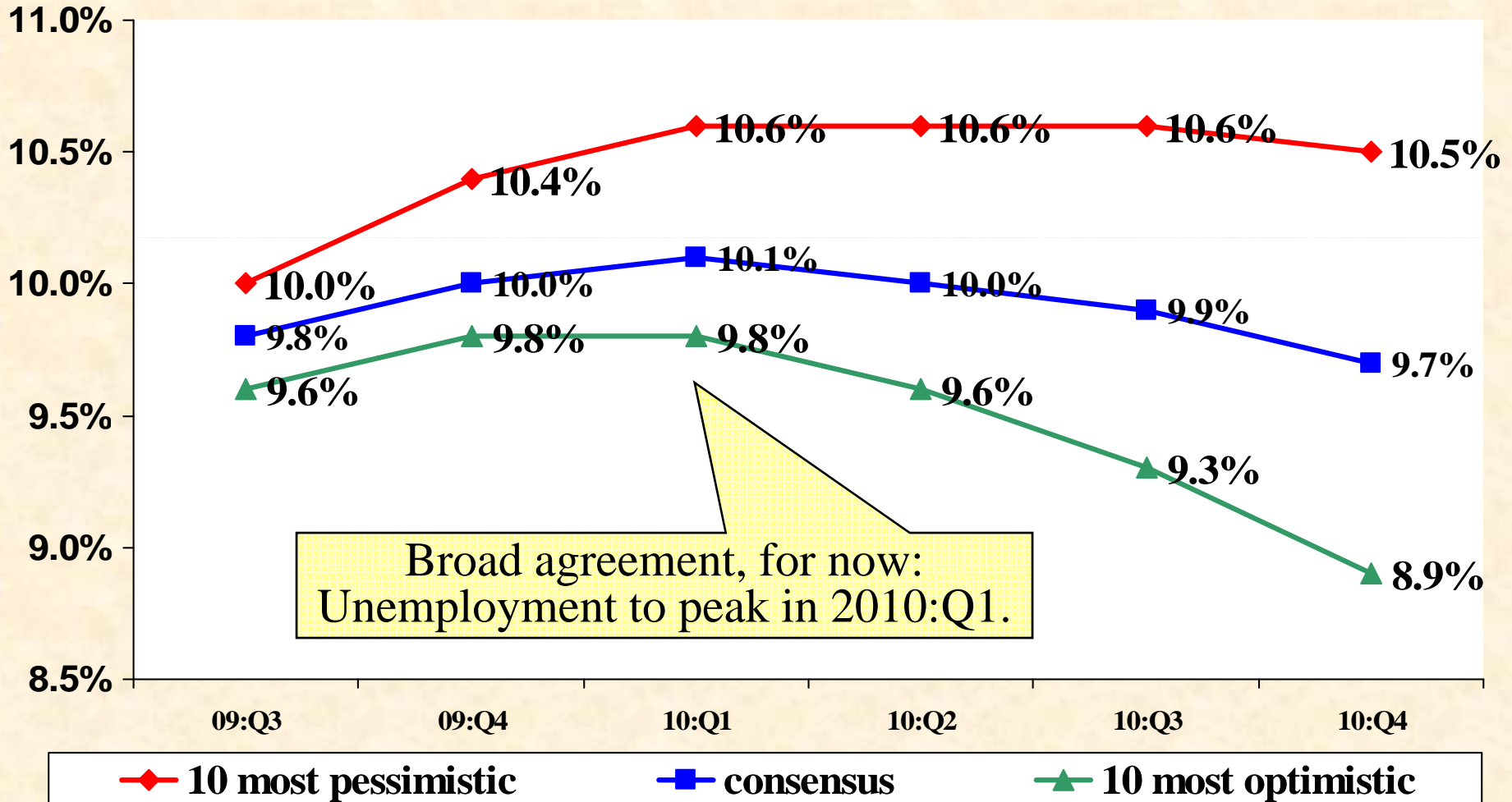


January 2000 through June 2009, seasonally adjusted



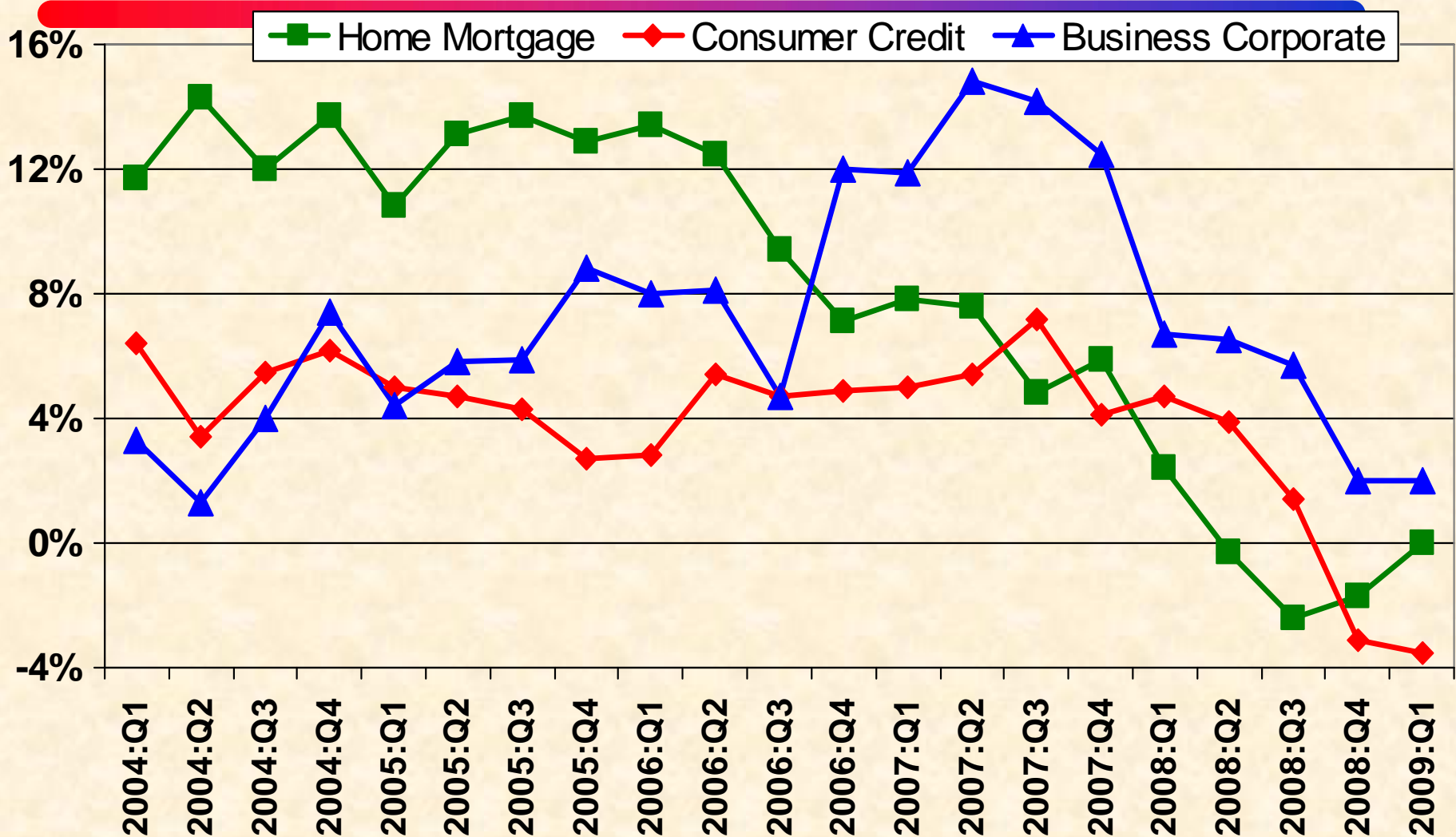


U.S. Unemployment Rate Forecasts Quarterly, 2009:Q3 to 2010:Q4



Households and Businesses Are Now “Deleveraging”

Percent Change in Debt Held (Quarterly since 2004 at Annualized Rate)





Millions Fewer Private Homes to be Started through 2010

Millions of Units

Measured by number of new units started, exposure growth for HO insurers is low. Housing start data also affects commercial insurers with construction risk exposure.

Housing bubble

Recession

Recession

I.I.I. estimate: each 100,000 decline in housing starts "costs" home insurers \$90 million in gross premium. Estimated premium loss in 2008 vs. 2005: about \$1 billion.

0.55

0.76

90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09F 10F

Sources: US Department of Commerce; Blue Chip Economic Indicators (7/09); Insurance Information Inst.

1.19

1.01

1.20

1.29

1.46

1.35

1.48

1.47

1.62

1.64

1.57

1.60

1.71

1.85

1.96

2.07

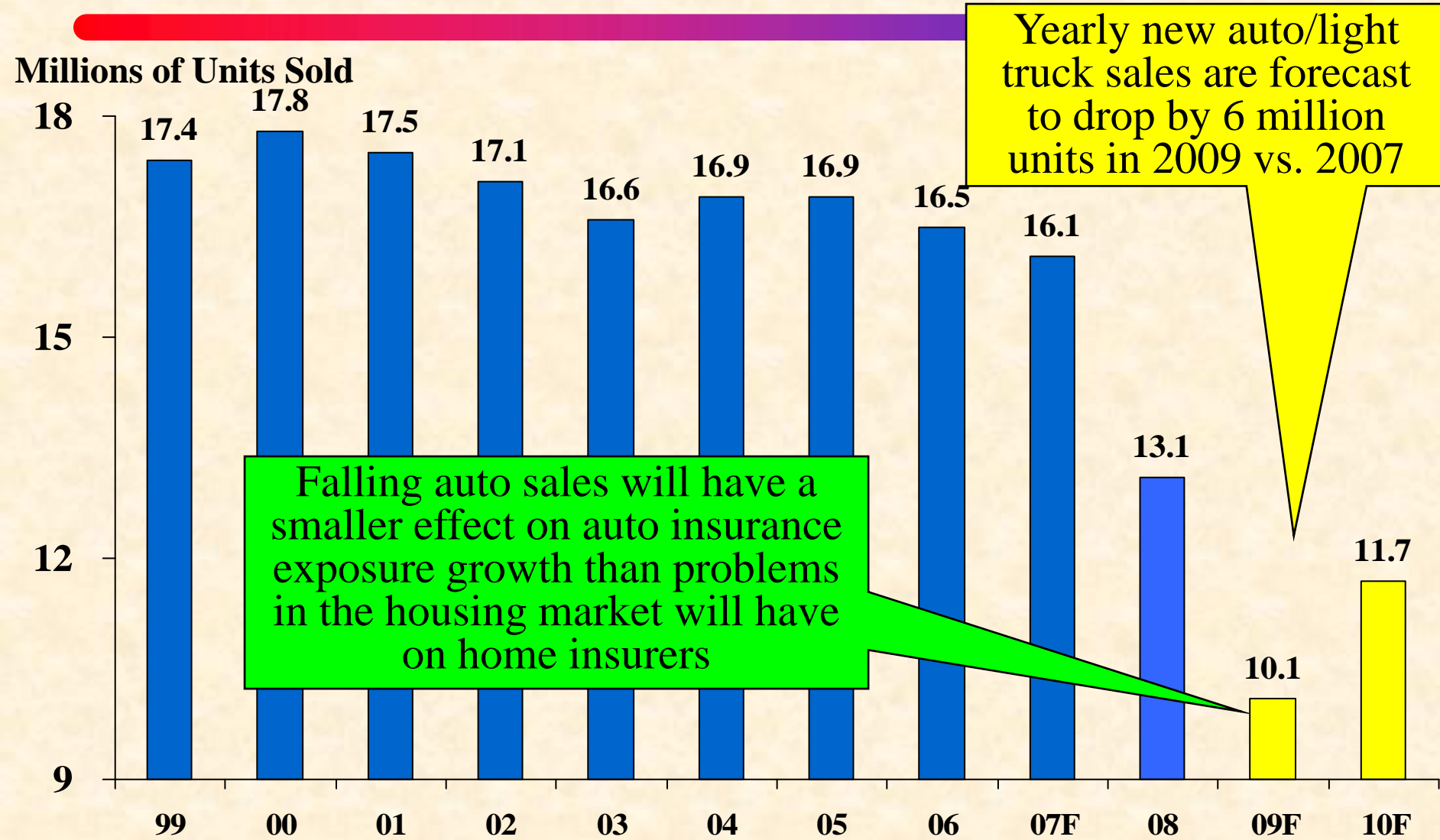
1.80

1.36

0.90



Weak Economy, Tight Credit are Hurting Auto Sales



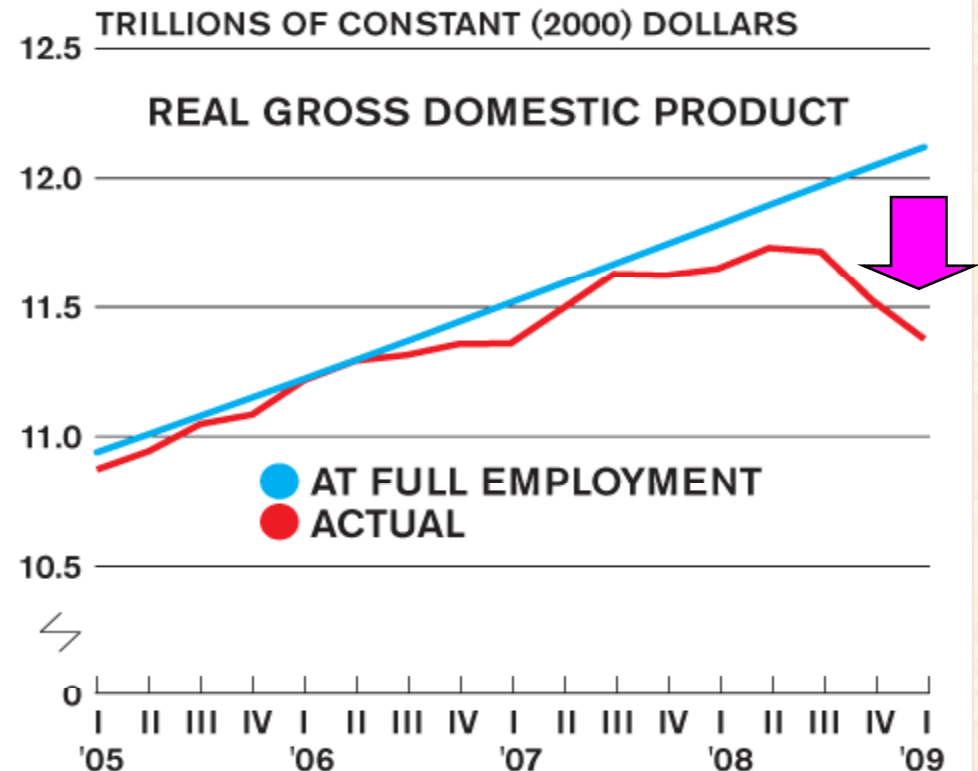


Theory: Re-ignited Inflation Won't Threaten Until the Economy Returns to a Full-Employment Level—Likely a Few Years Away

The markets are starting to worry that the flood of money for the recovery will re-ignite inflation (the spread between 10-Year TIPS and 10-Year T-Notes is widening).

Source: Cooper, "Hints of Recovery—And Fears of Inflation," *BusinessWeek*, May 11, 2009, p. 8

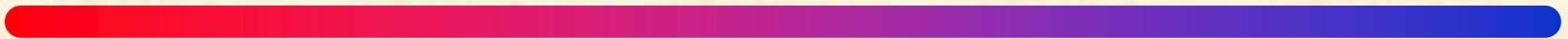
A GAP THIS BIG WILL TAKE A LONG TIME TO CLOSE



Data: Bureau of Economic Analysis, Congressional Budget Office, IHS Global Insight

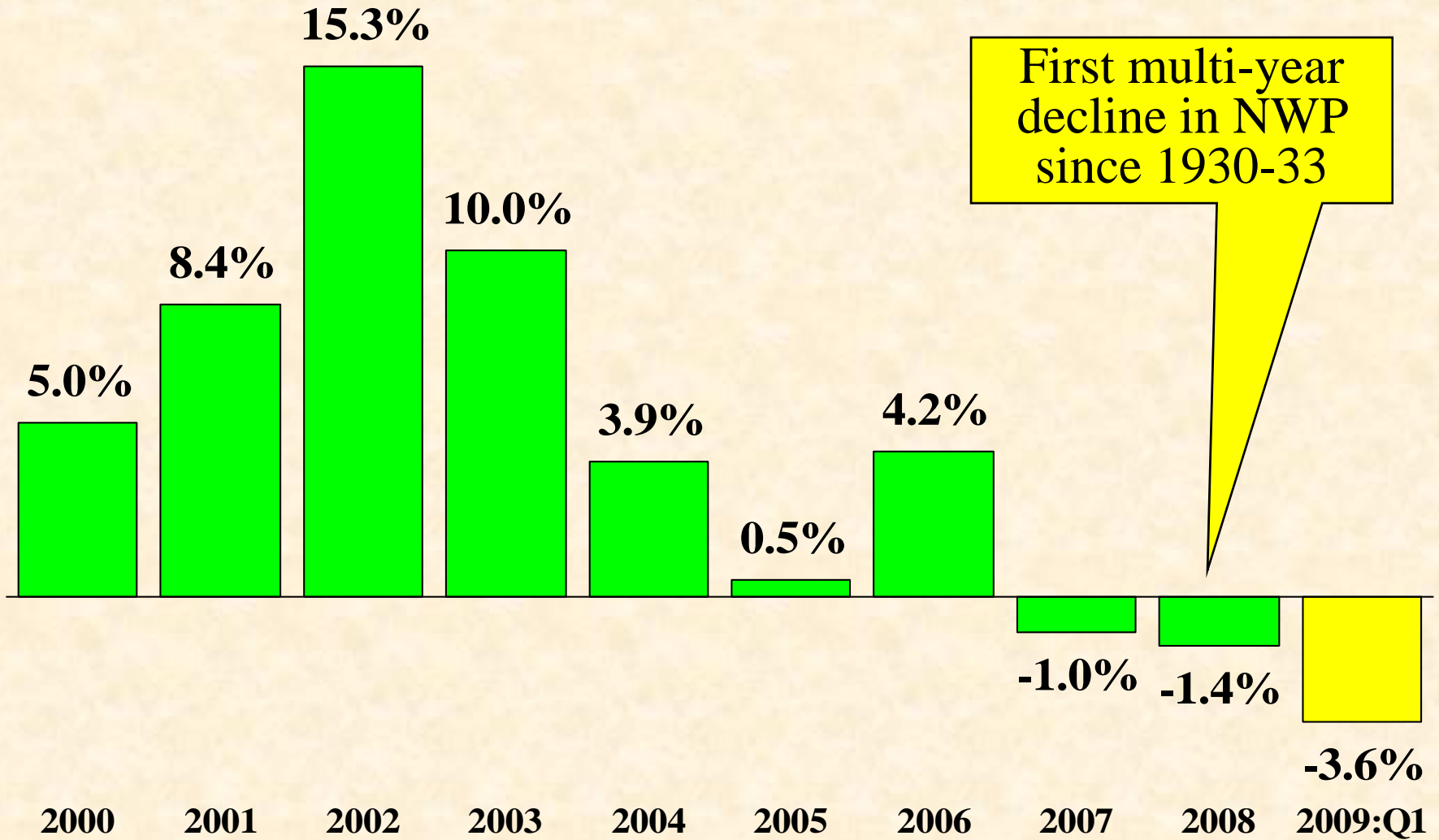
The “New Normal” for the P.C. Insurance Industry

*Premiums, Investments
Flat or Down;
Pressure on Expenses*





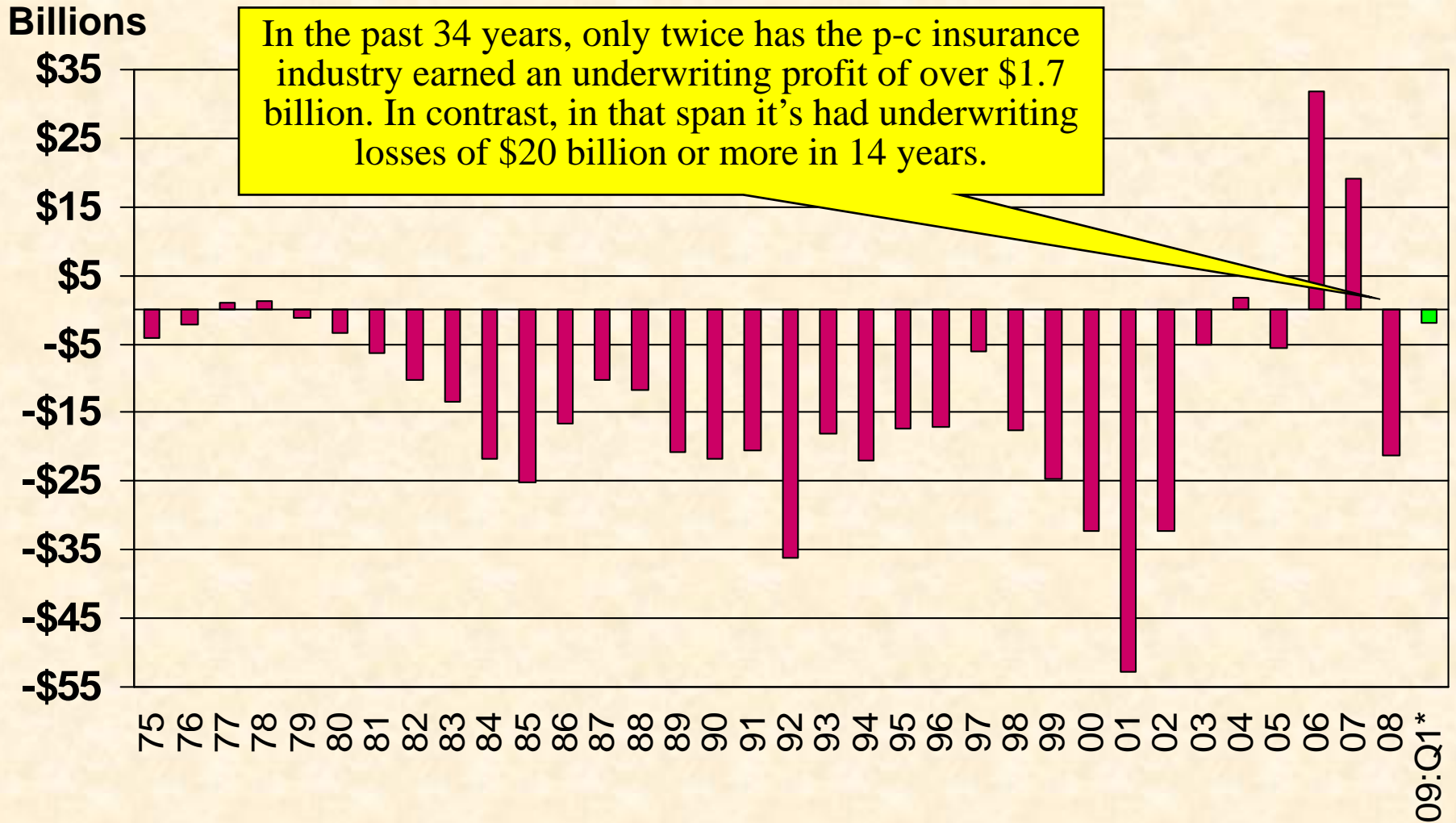
Year-to-Year Change in Net Written Premium, 2000-2009:Q1



Sources: A.M. Best, but 2009:Q1 is from ISO.

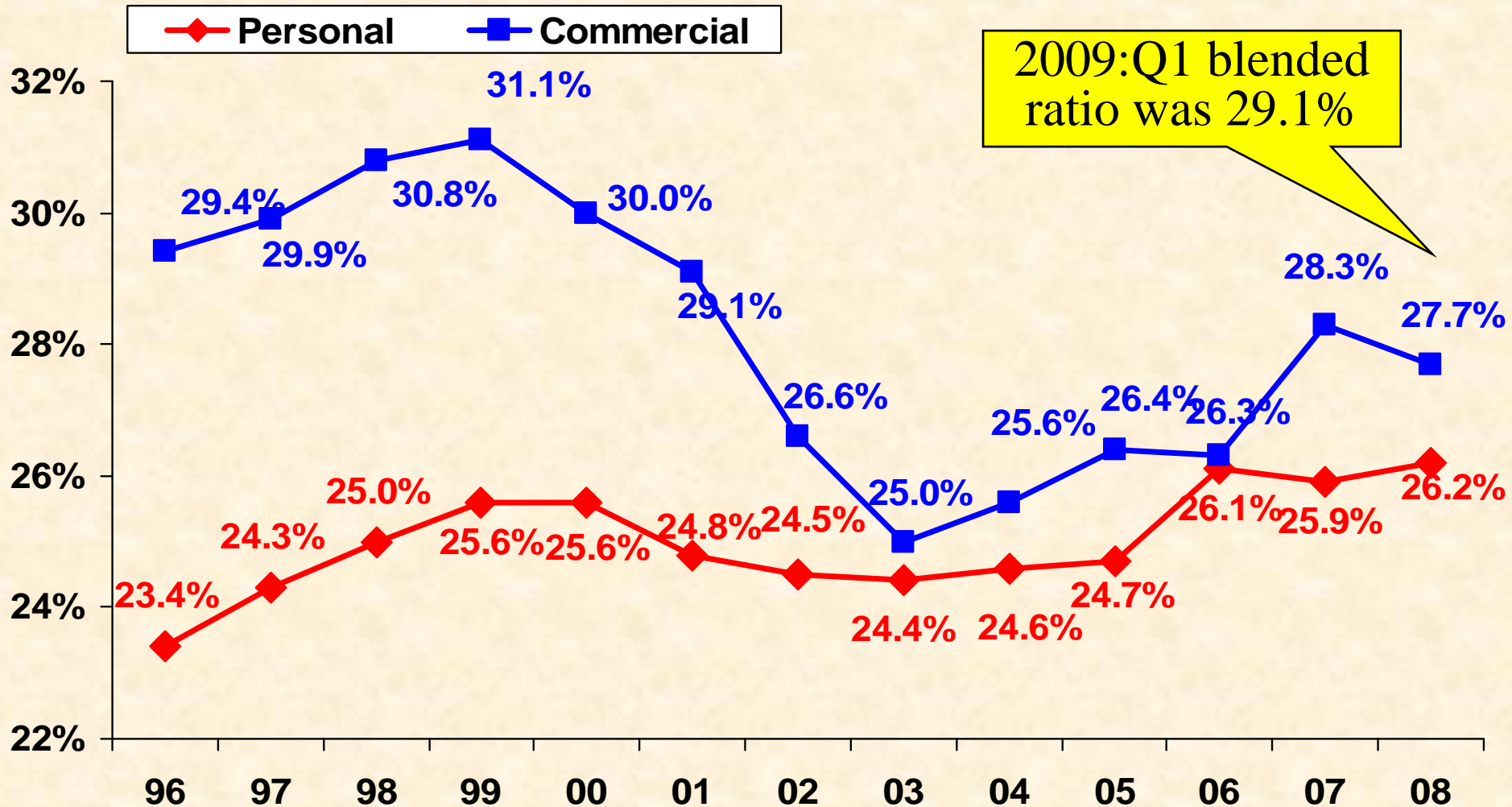


Underwriting Gain/(Loss) 1975-2009:Q1





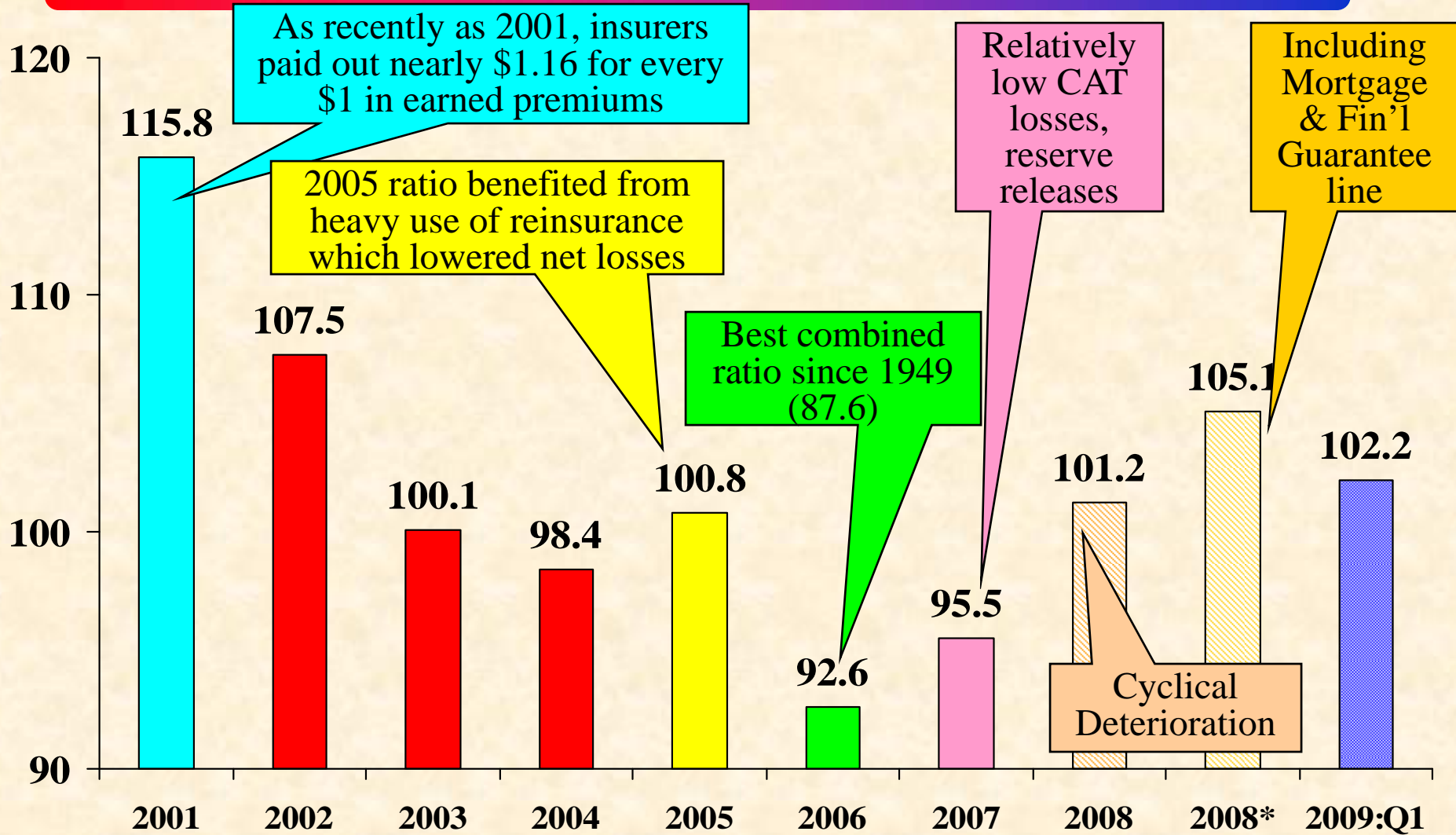
Underwriting Expense Ratios Likely Will Rise as Premium Growth Lags



*Ratio of expenses incurred to net premiums written.
Sources: A.M. Best; ISO; Insurance Information Institute



P/C Insurance Industry Combined Ratio, 2001-2009:Q1



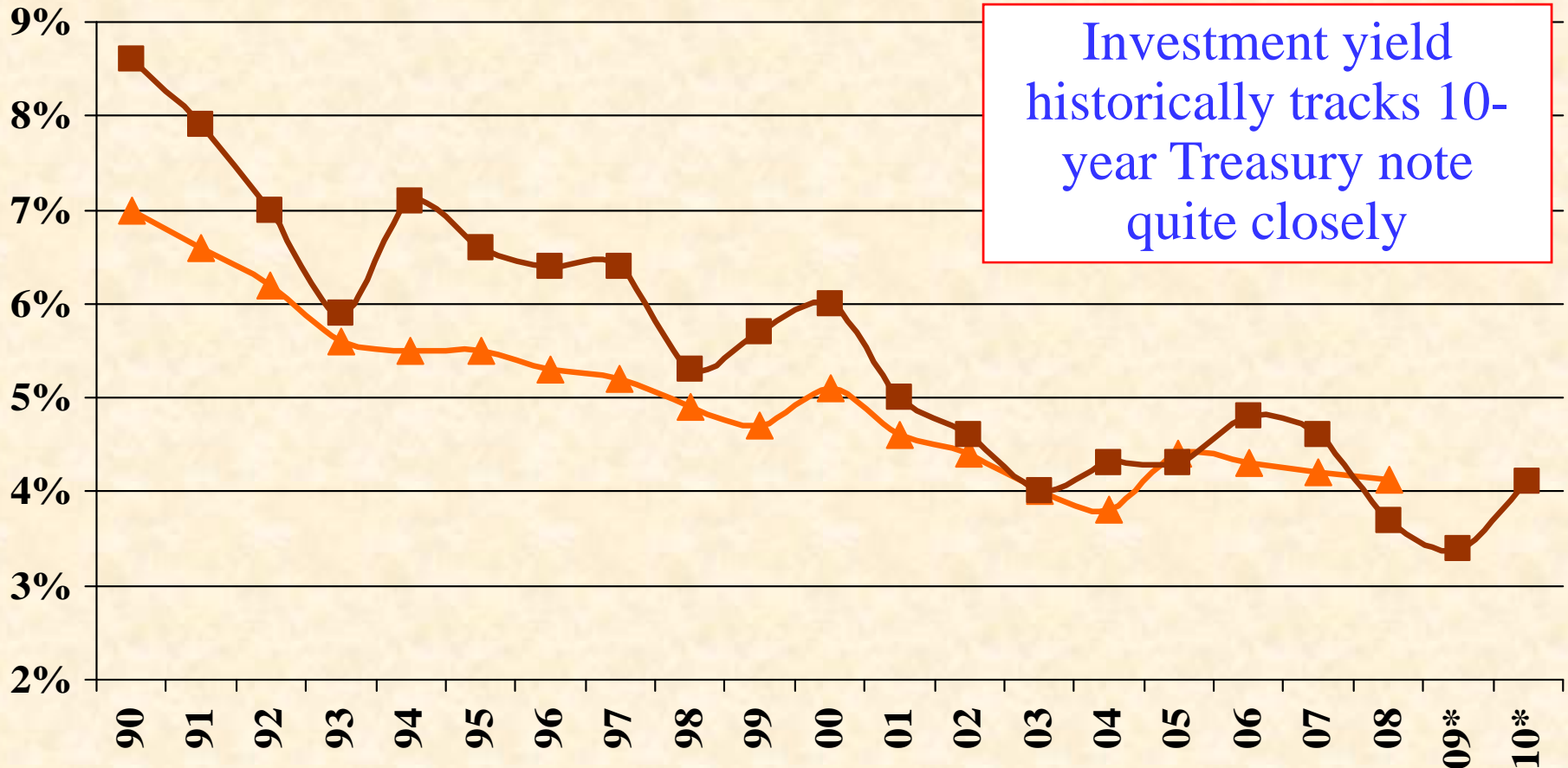
*Includes Mortgage & Financial Guarantee insurers.

Sources: A.M. Best.



P/C Investment Income as a % of Invested Assets Follows 10-Year U.S. T-Note

—▲— P-C Inv Income/Inv Assets —■— 10-Year Treasury Note



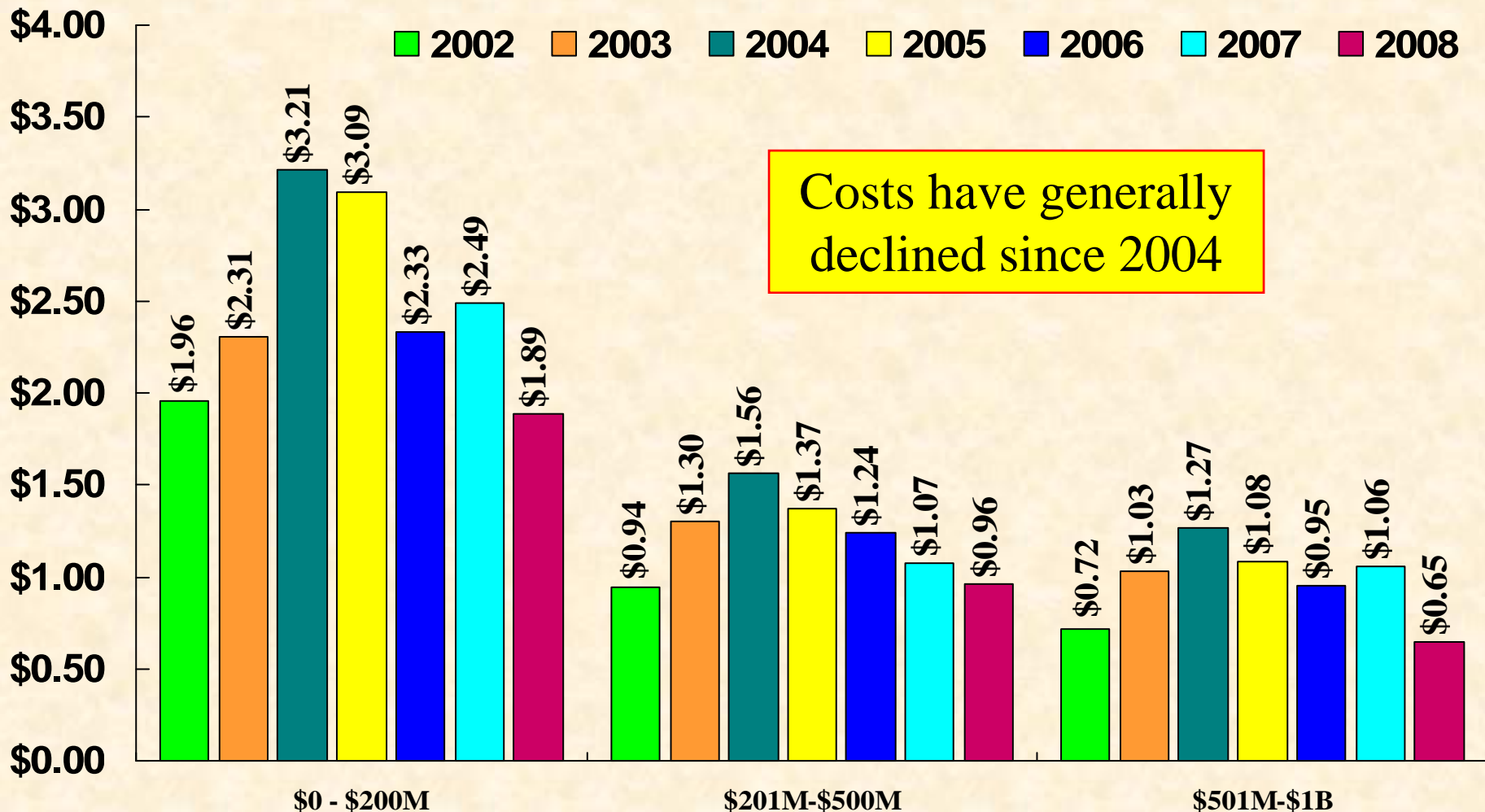
*Blue Chip consensus forecasts. Sources: Board of Governors, Federal Reserve System; Blue Chip Economic Indicators (7/09 issue) A.M.Best; Insurance Information Institute.

The “New Normal” in the Liability Insurance Marketplace





Liability: Average Yearly Cost* Small and Medium-Sized Businesses, 2002-2008

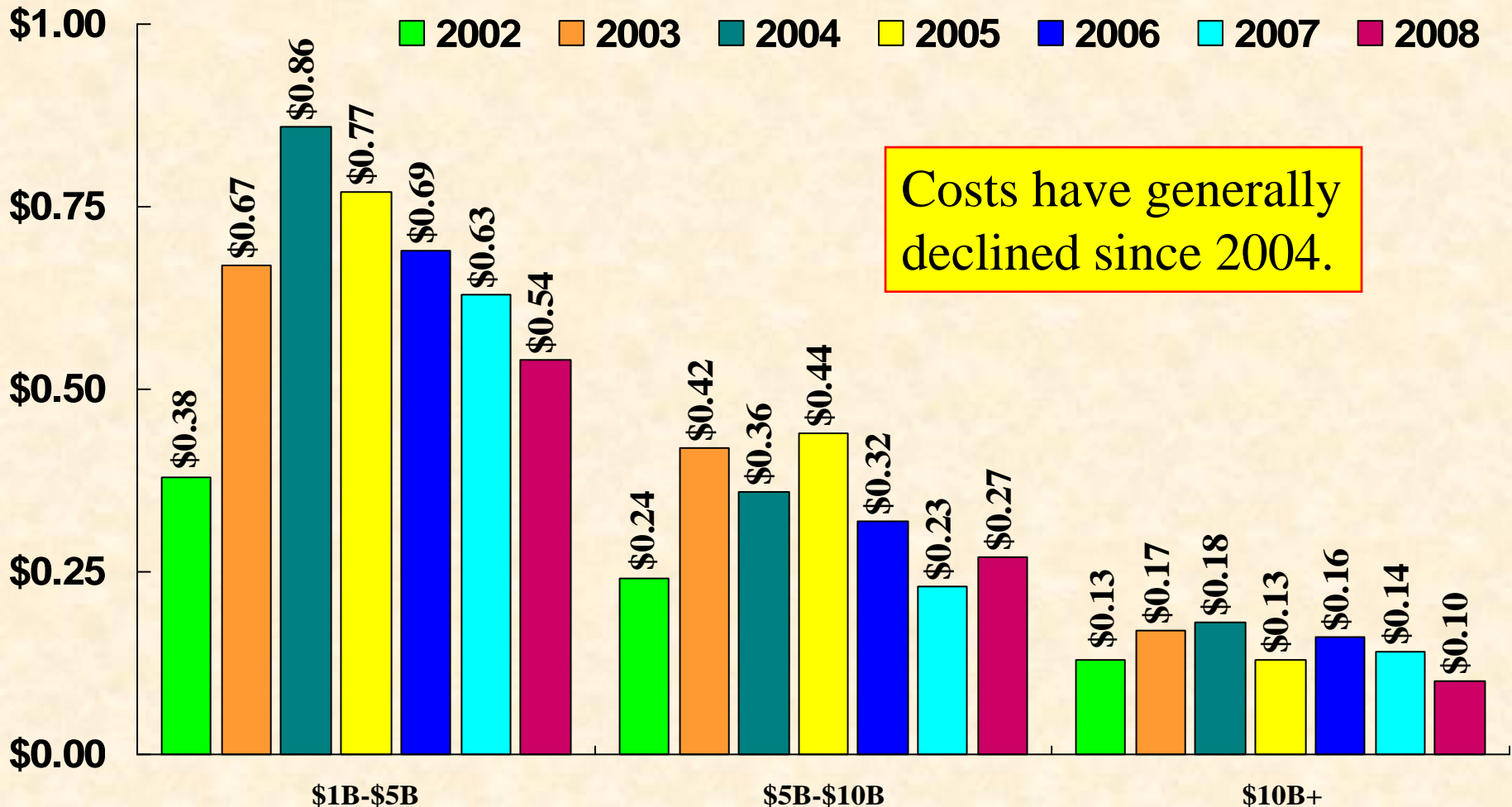


*per \$1,000 of revenue, across entire liability program (full population)

Source: Marsh, 2008 Limits of Liability Report



Liability: Average Yearly Cost* Medium and Large Businesses, 2002-2008



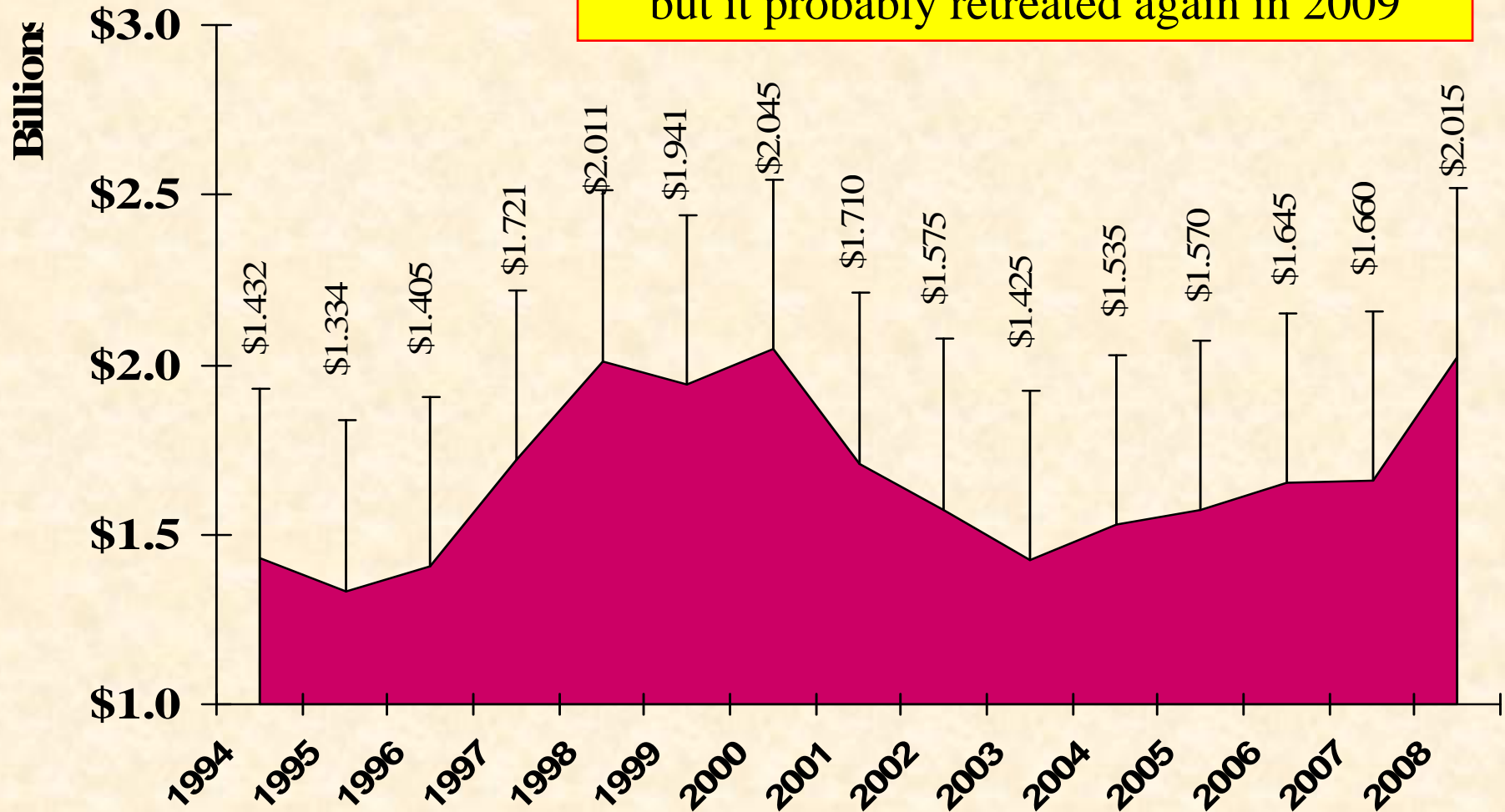
*per \$1,000 of revenue, across entire liability program (full population)

Source: Marsh, 2008 Limits of Liability Report

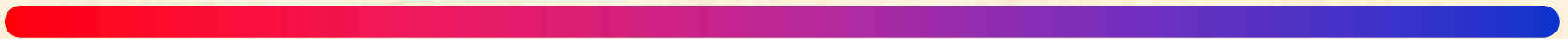


Excess Liability Market Capacity – North America

In 2008, capacity returned to 2000 levels,
but it probably retreated again in 2009

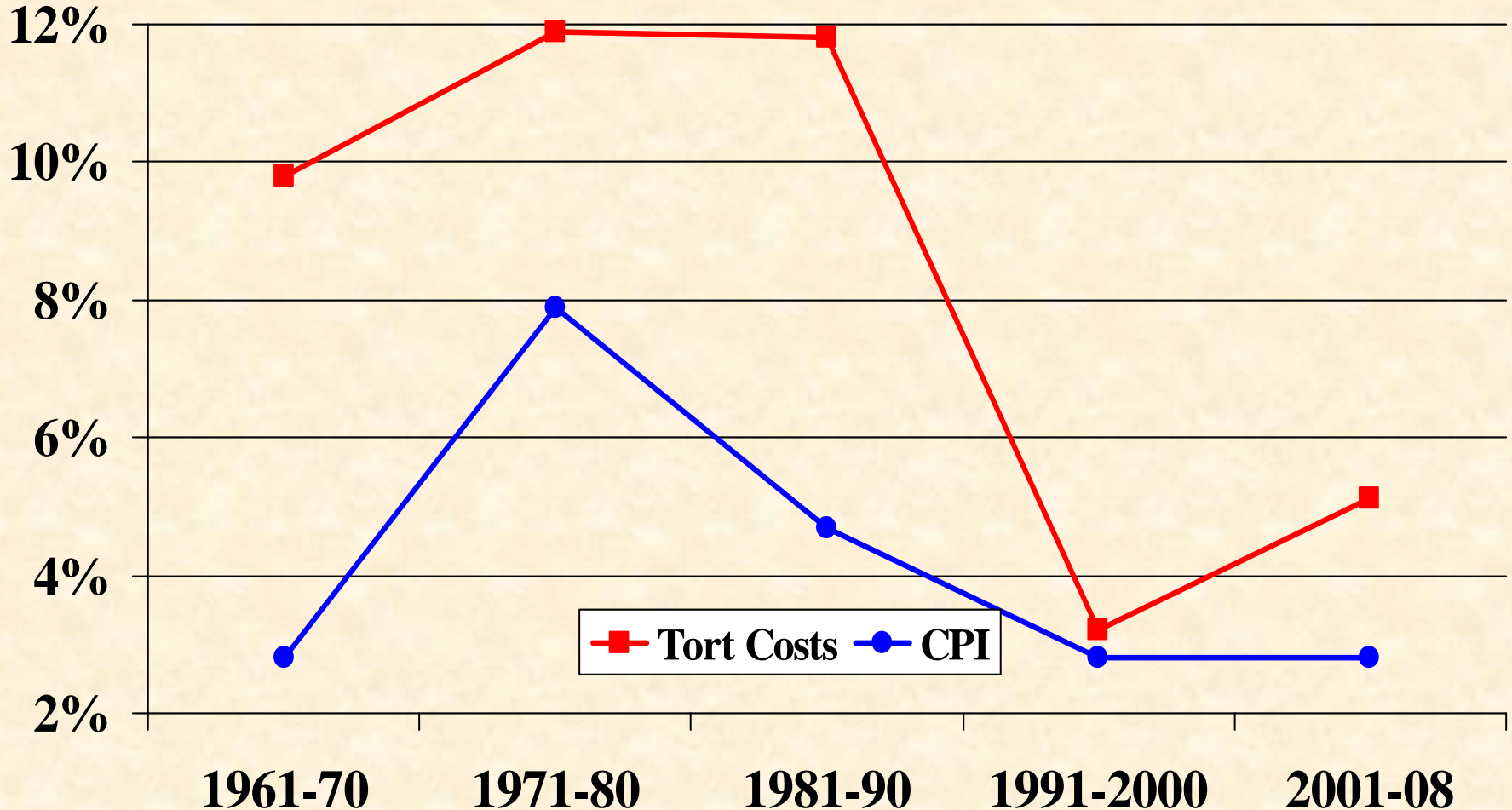


Litigation, Tort System Cost Trends



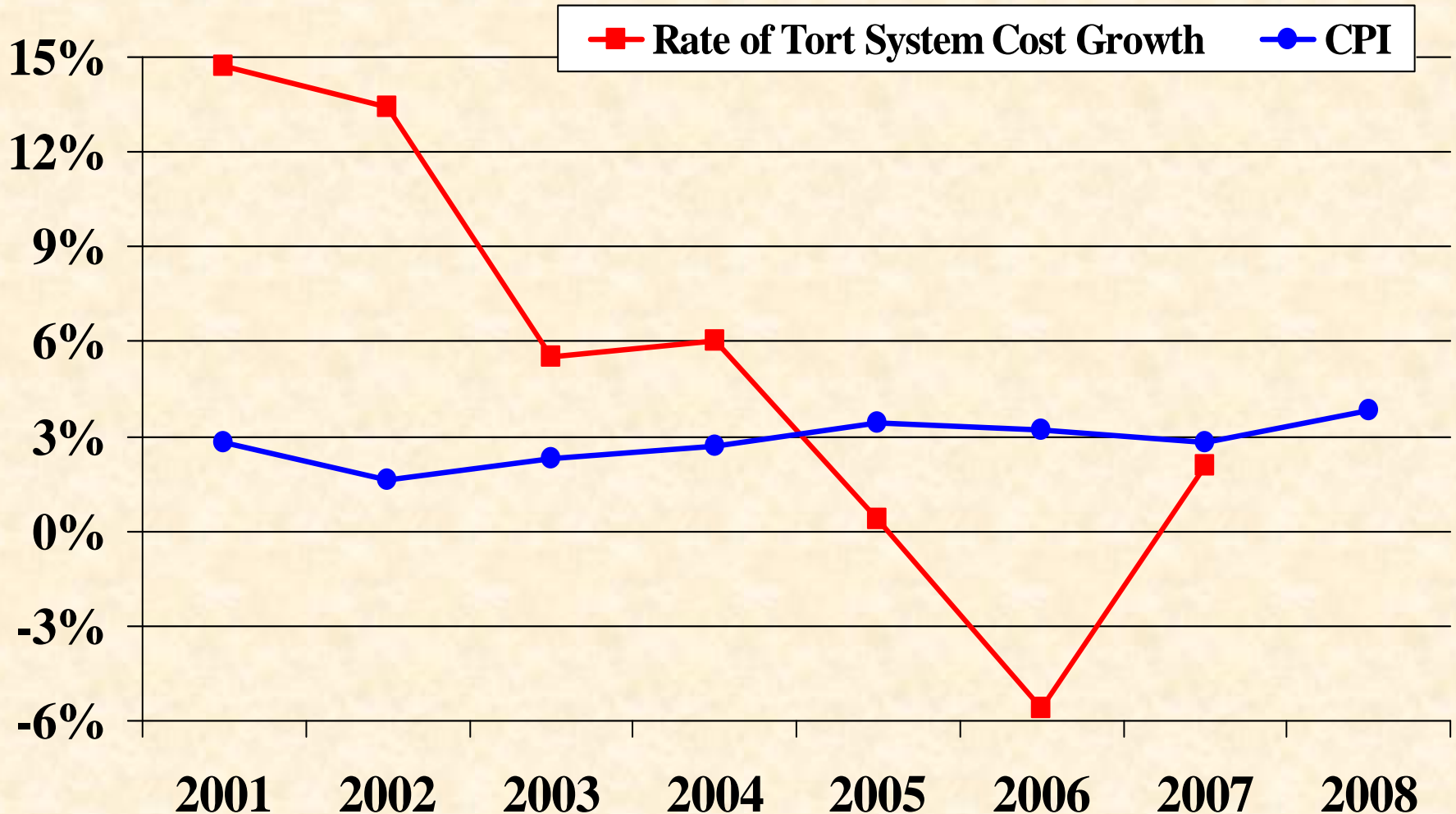


In the '60s, '70s, and '80s, Tort System Costs Grew Much Faster than Inflation



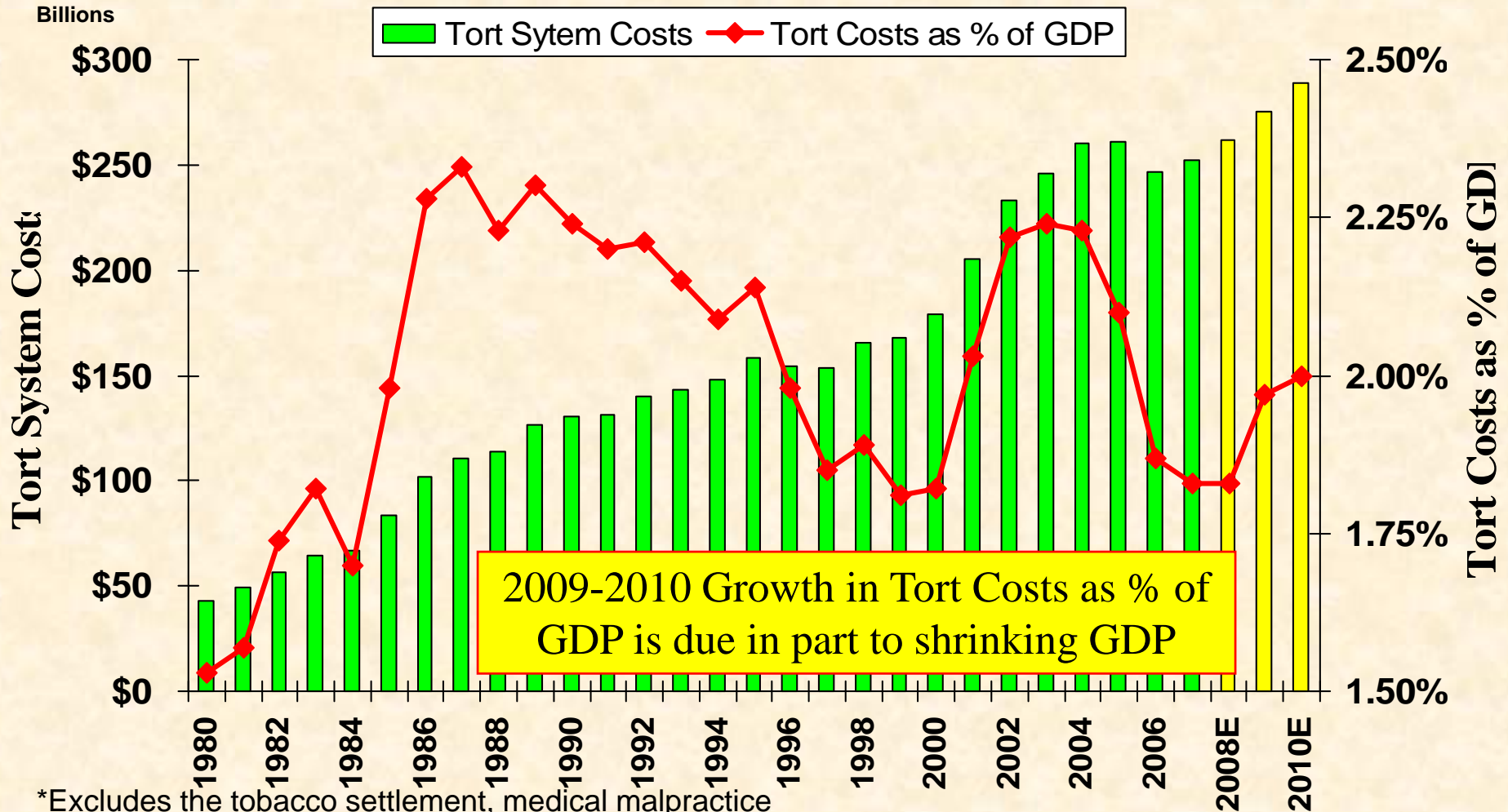


In the 1990s and Since 2003, Tort System Cost Growth Has Moderated





Over the Last Three Decades, Total Tort Costs* as a % of GDP Appear Somewhat Cyclical

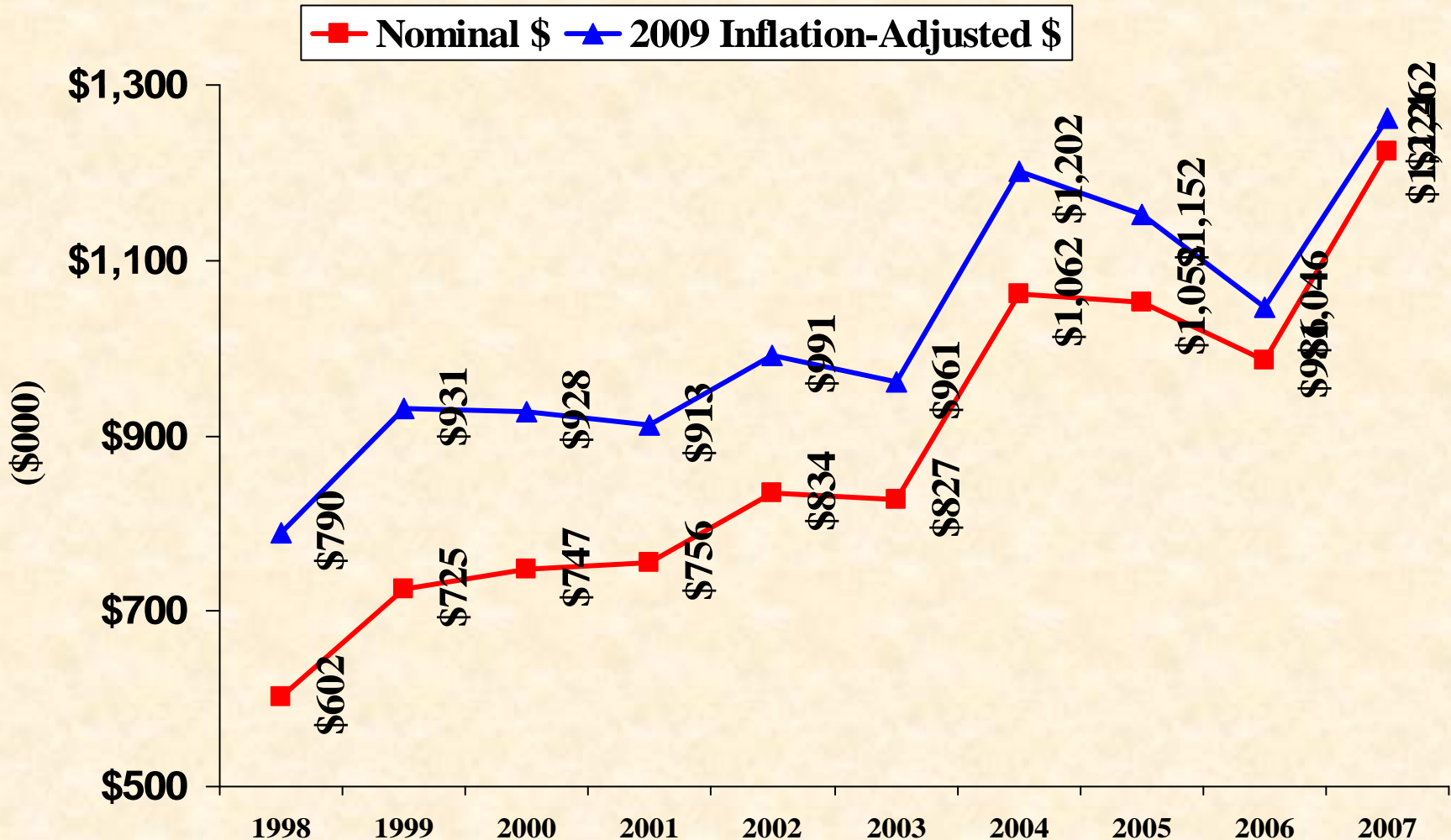


*Excludes the tobacco settlement, medical malpractice

Sources: Tillinghast-Towers Perrin, *2008 Update on US Tort Cost Trends*, Appendix 1A; I.I.I. calculations/estimates for 2009 and 2010

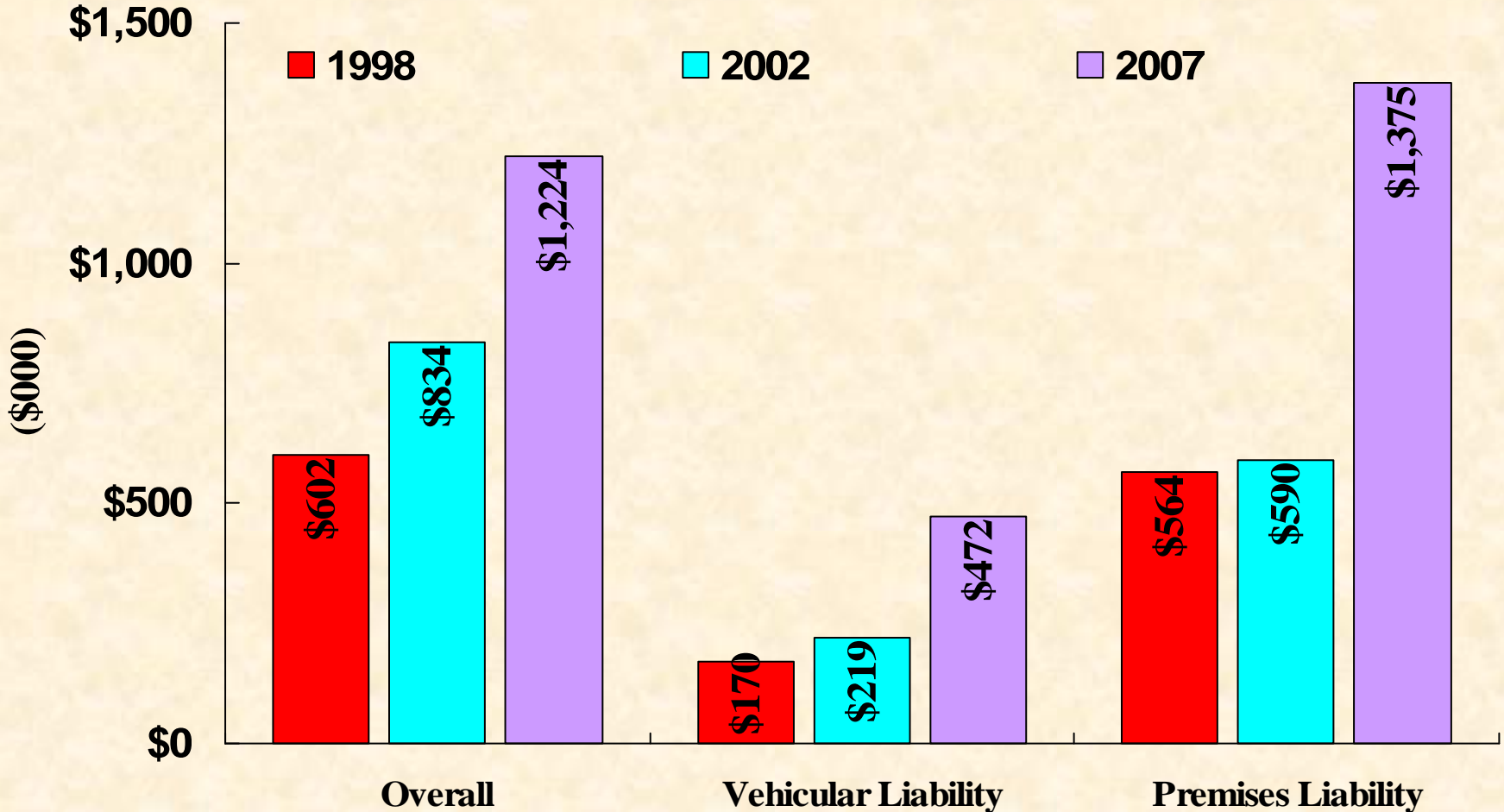


In 10 Years, the Average Jury Award Grew (Inflation-Adjusted) by 60%





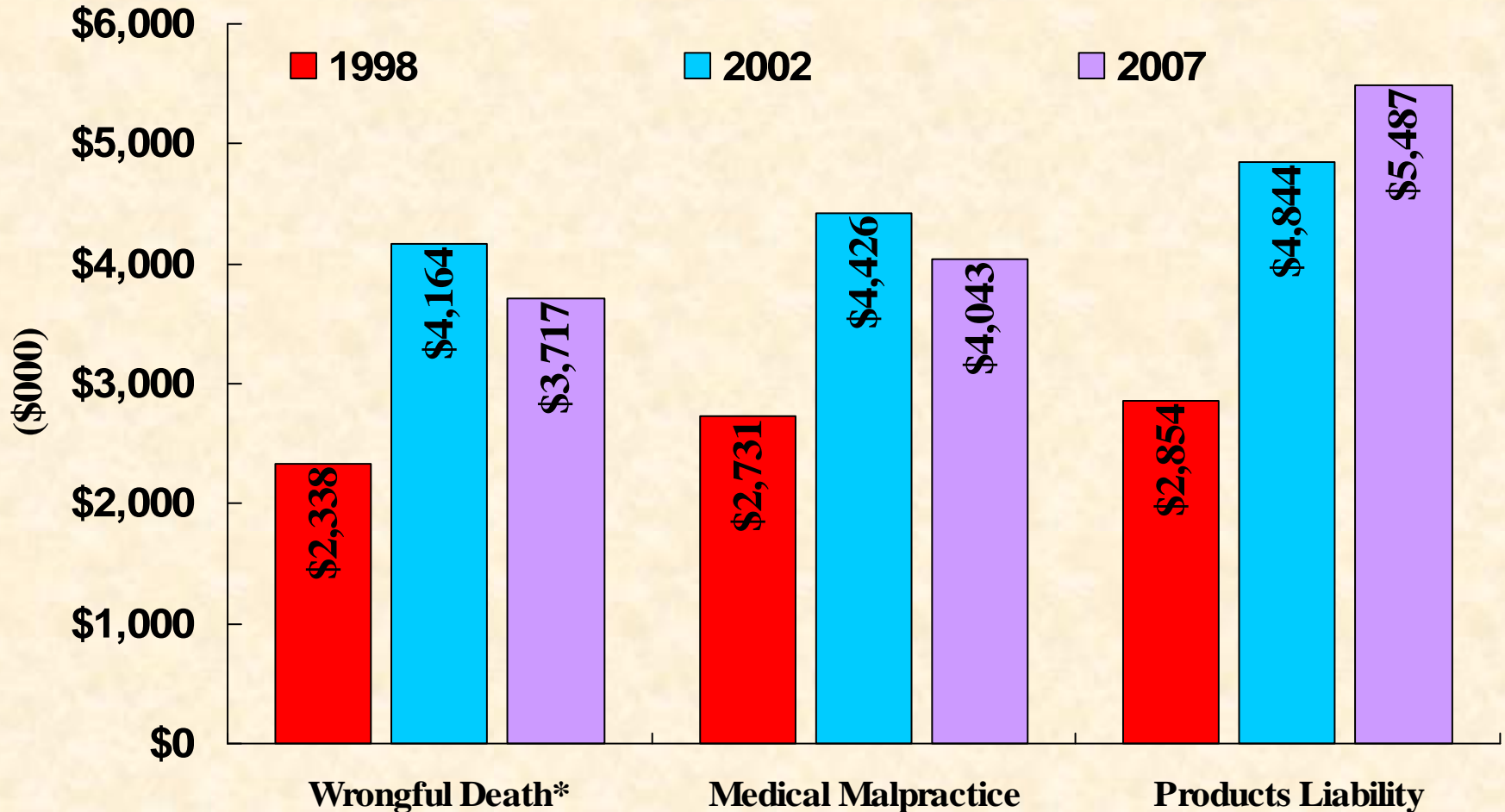
Average Jury Awards for Selected Cases



Source: Jury Verdict Research; Insurance Information Institute.



Average Jury Awards for Selected Cases (cont'd)

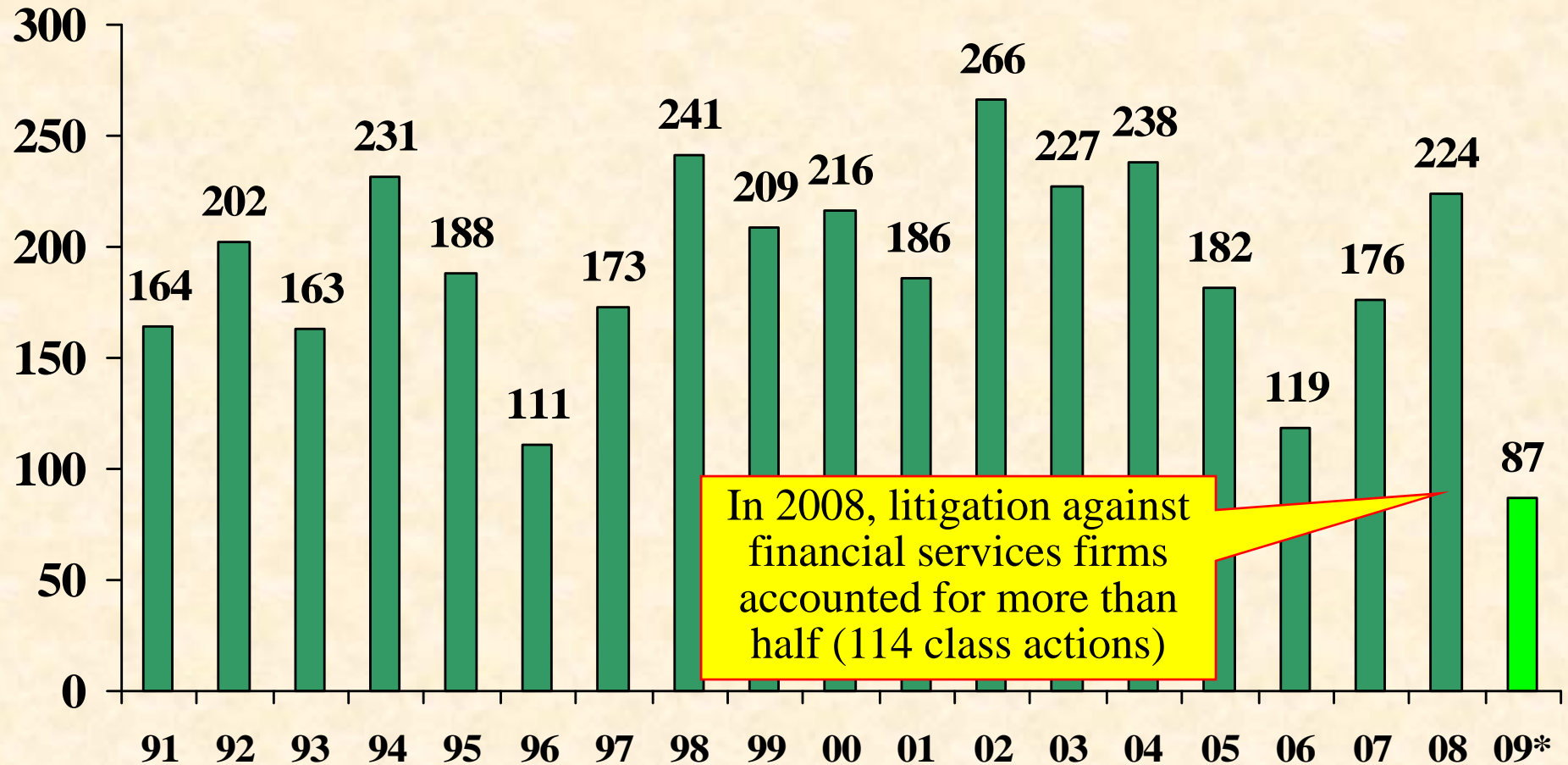


*Adult males

Sources: Jury Verdict Research; Insurance Information Institute.



Shareholder Class Action Lawsuits Filed Annually in Federal Courts*



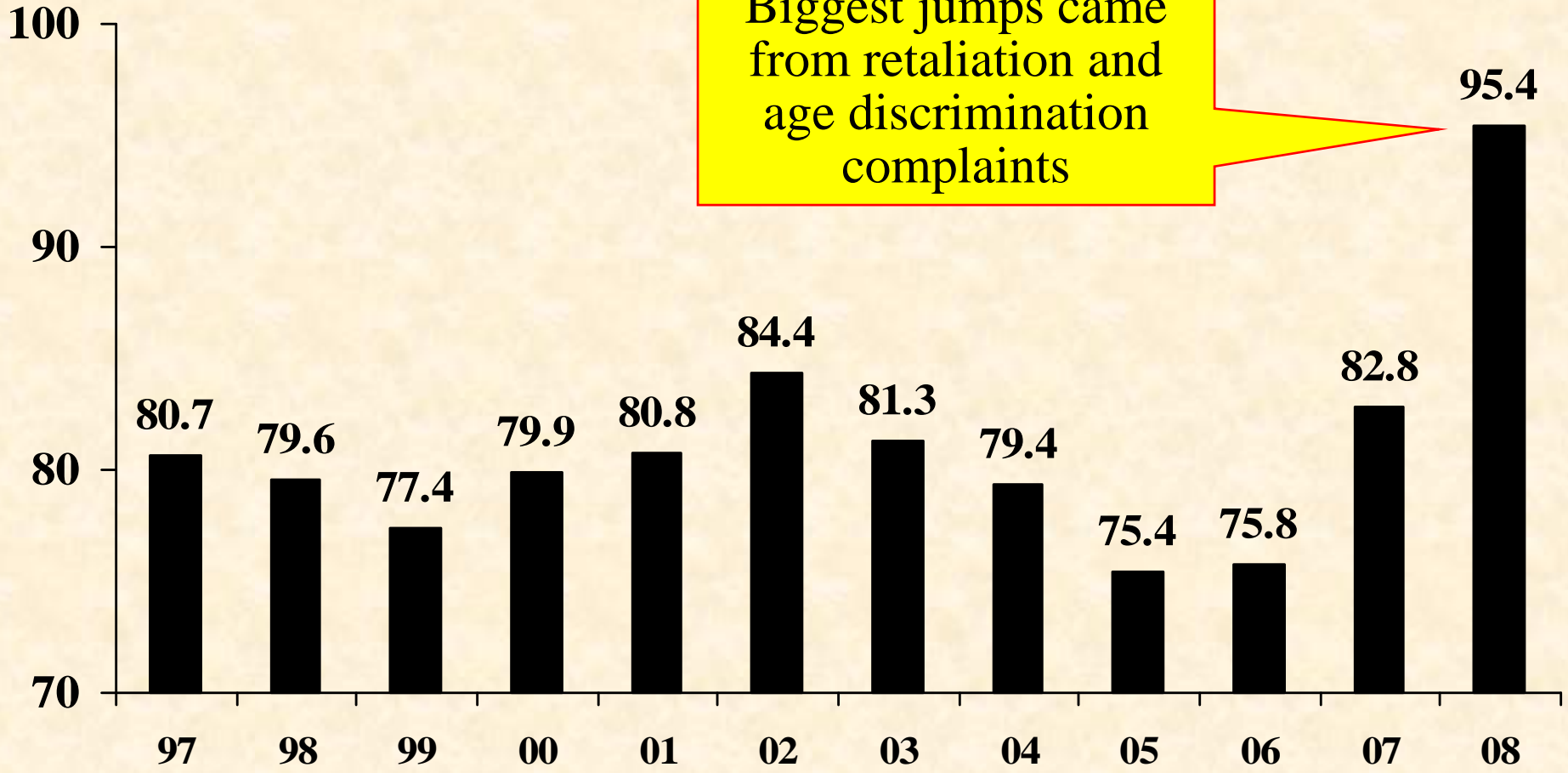
*Securities fraud suits filed in U.S. federal courts; 2009 figure is current through 07/15/09. 2001 figure excludes 312 IPO suits that were unique to that year.

Source: Stanford University School of Law (<http://securities.stanford.edu>); Insurance Information Institute



EEOC Workplace Discrimination Complaints, FY1997-FY2008

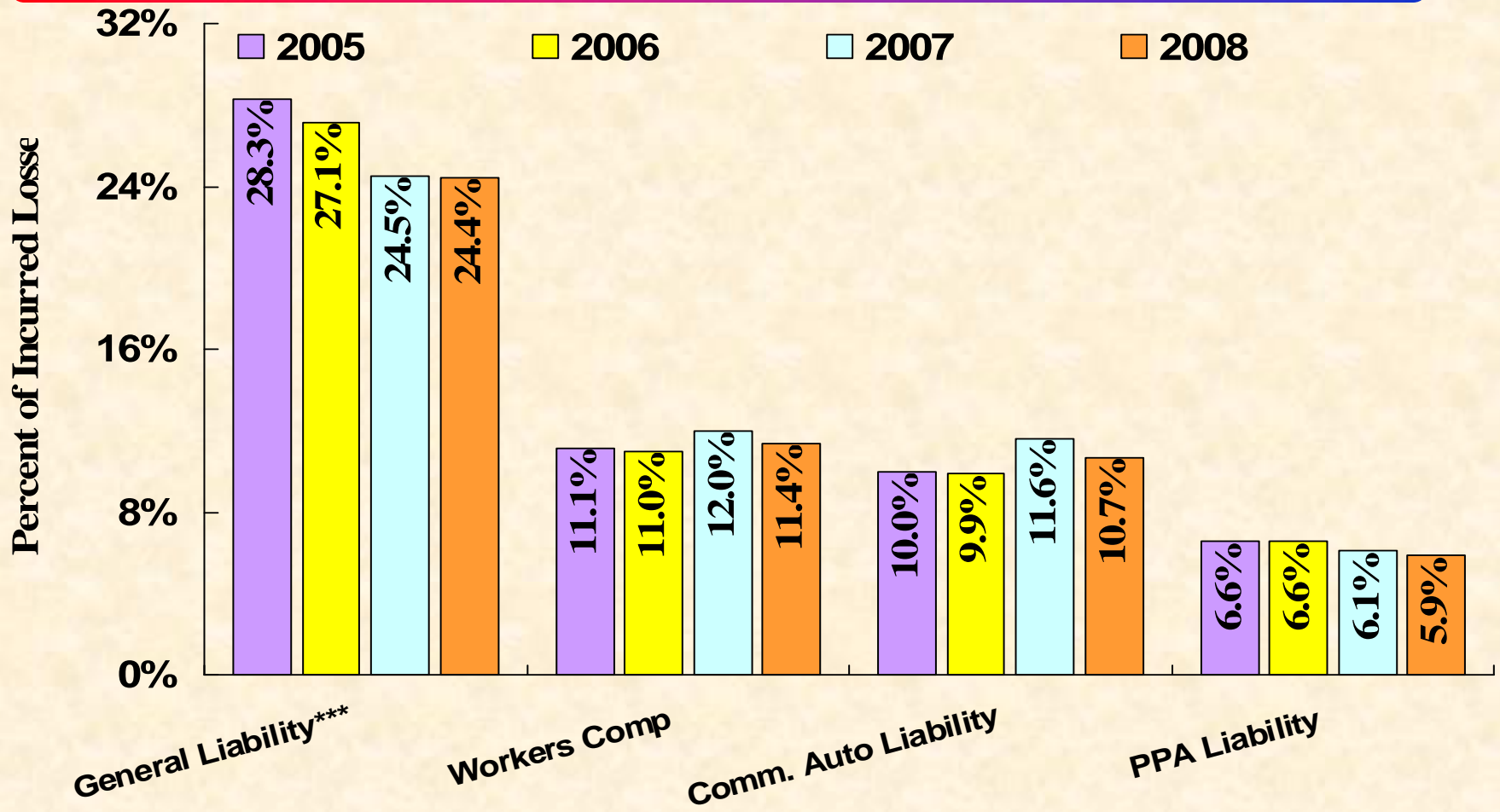
Thousands of Complaints



Source: EEOC at <http://www.eeoc.gov/stats/charges.html>



*Insurer Defense and Cost Containment Expenses as a Percent of Incurred Losses, 2005-2008**

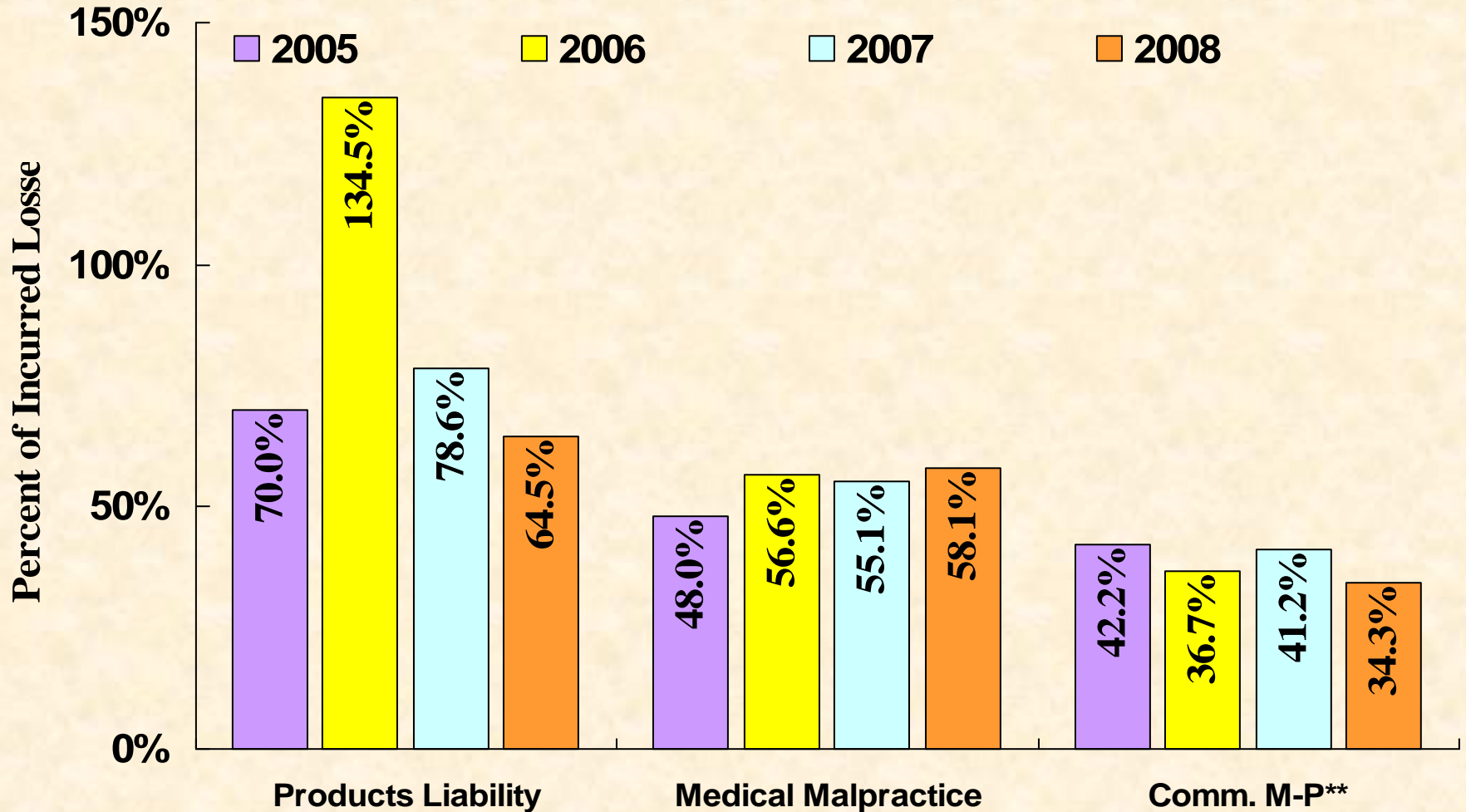


*Net of reinsurance, excl. state funds. ***Excludes products liability.

Sources: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data, LLC; Insurance Information Institute.



*Insurer Defense and Cost Containment Expenses as a Percent of Incurred Losses, 2005-2008**

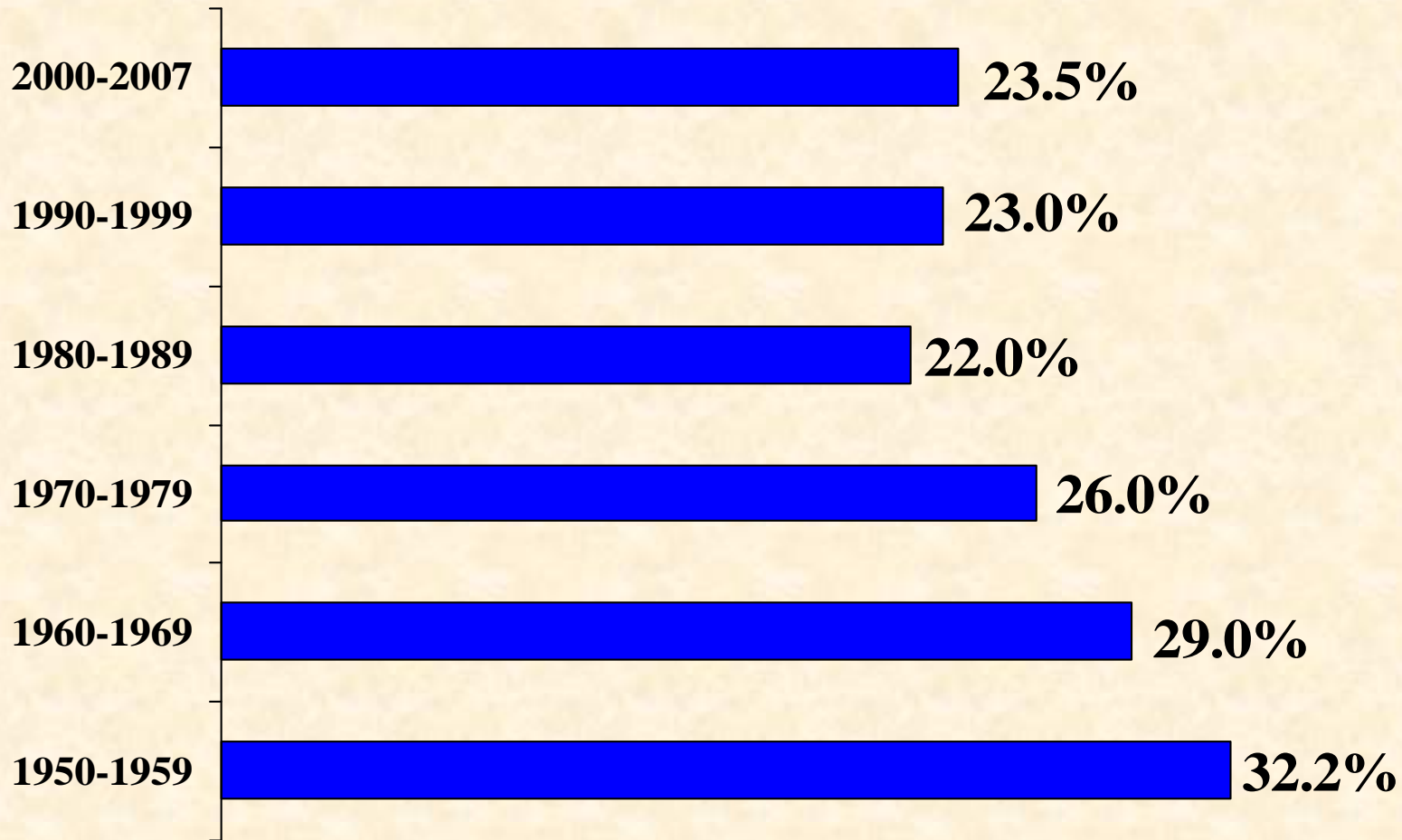


*Net of reinsurance. **Liability portion only.

Sources: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data, LLC; Insurance Information Institute.



The Administrative Expense Portion of Tort Costs Has Stabilized Since the 1980s



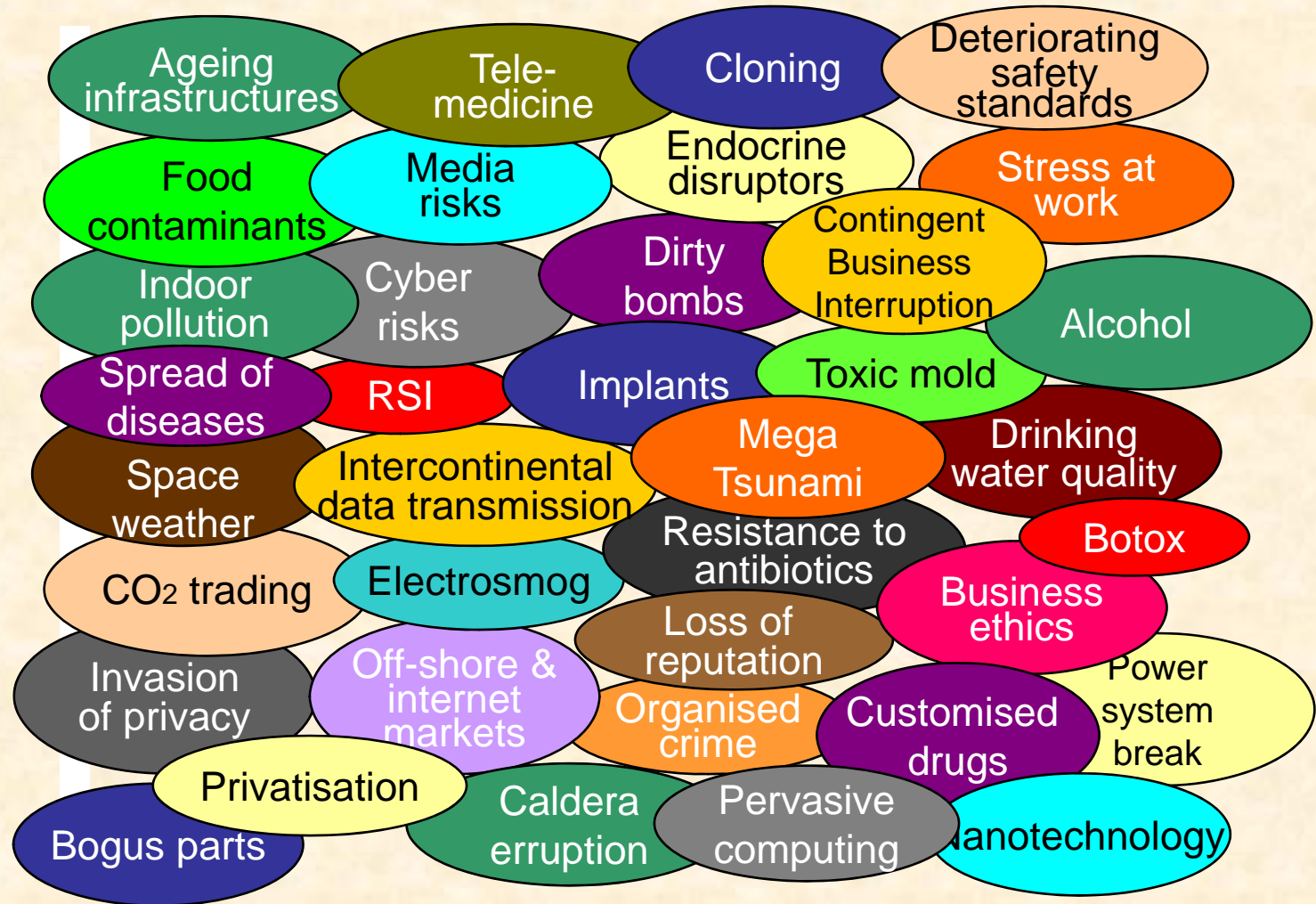


What Else Could Drive Tort System Costs Up?

- A switch to small, fuel-efficient cars with less crash-protection could lead to more severe accidents
- If a Financial Products Safety Commission is created as part of regulatory reform, suits might be filed claiming damages resulting manufacture or sale of “defective” financial products
- A more liberal federal judiciary and executive branch could ease standards for bringing tort actions
- There are many emerging risks to be alert to



Landscape of Emerging Risks





Presentation Summary

- The U.S. economy will likely struggle for perhaps a few more years
- The P-C insurance industry will likely be challenged by low exposure growth, low investment results, and expense and profitability pressures
- The costs of liability insurance and the tort system generally have recently moderated, but not in all cases
- There are many emerging risks to be alert to

Q&A



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