

# Implications of the Quiet Catastrophe Season of 2006

## *An Industry at the Crossroads*

**2007 PCS Catastrophe Conference**

**Phoenix, AZ**

**April 30, 2007**



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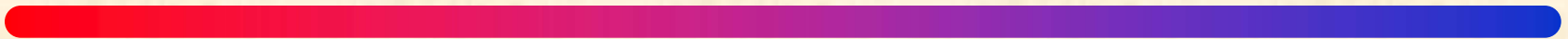


# *Presentation Outline*

- **P/C Profit Overview—2006, A Cyclical Peak**
- **Underwriting Trends: *Unsustainable?***
- **Premium Growth: *Approaching a Standstill***
- **Pricing: Quiet 2006→Competitive Pressures Mounting**
- **Capital & Capacity: Growing Rapidly Post-KRW**
- **Catastrophe Loss Management**
- **What is the Appropriate Role for Government?**
- **Reinsurance Summary**
- **Financial Strength & Ratings**
- **Investments: More Money to Invest**
- **Katrina-Spawned Litigation**
- **Legislative & Regulatory Interest in CATs**
  - **Federal, Florida**
- **Q&A**

# PROFITS

*Quiet 2006 Not the Major  
Reason for Great Results*





# Highlights: Property/Casualty, 2006 vs. 2005

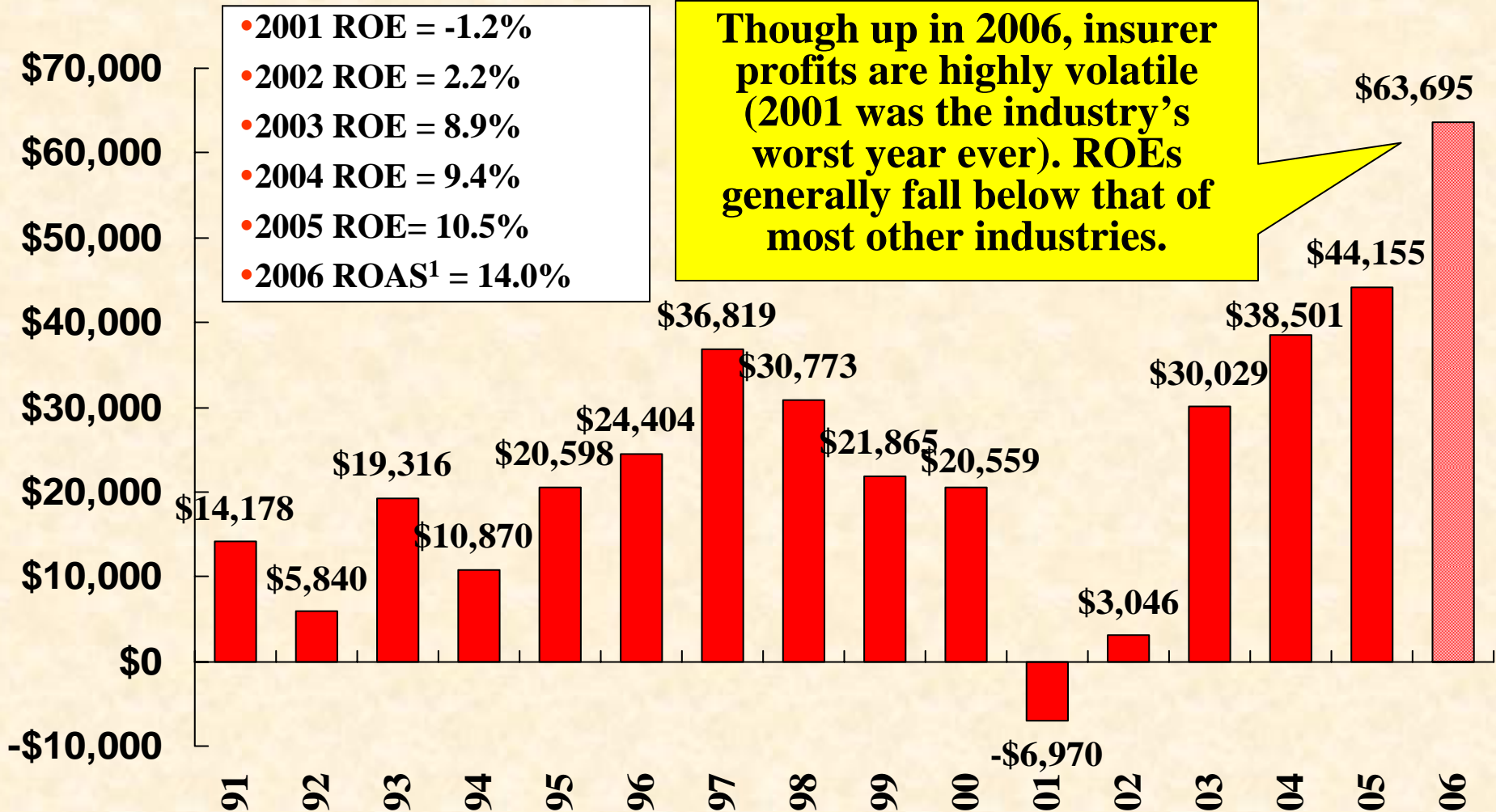
**Growth up due to coastal  
property premiums**

	2006	2005	Change
Net Written Prem.	443,778	425,500	+4.3%
Loss & LAE	283,700	311,624	-9.0%
Net UW Gain (Loss)	31,232	(5,612)	N/A
<b>Record underwriting profit: Unsustainable</b>	55,561	59,430	-6.4%
<b>Net Income (a.t.)</b>	<b>63,695</b>	<b>44,155</b>	<b>+44.3%</b>
Surplus*	487,123	425,760	+14.4%
Combined Ratio*	92.4	100.9	-8.5 pts.

\*Comparison is with year-end 2004 value. \*\*Includes invest income and realized investment gains/losses.  
Source: ISO, Insurance Information Institute



# *P/C Net Income After Taxes* *1991-2006 (\$ Millions)\**

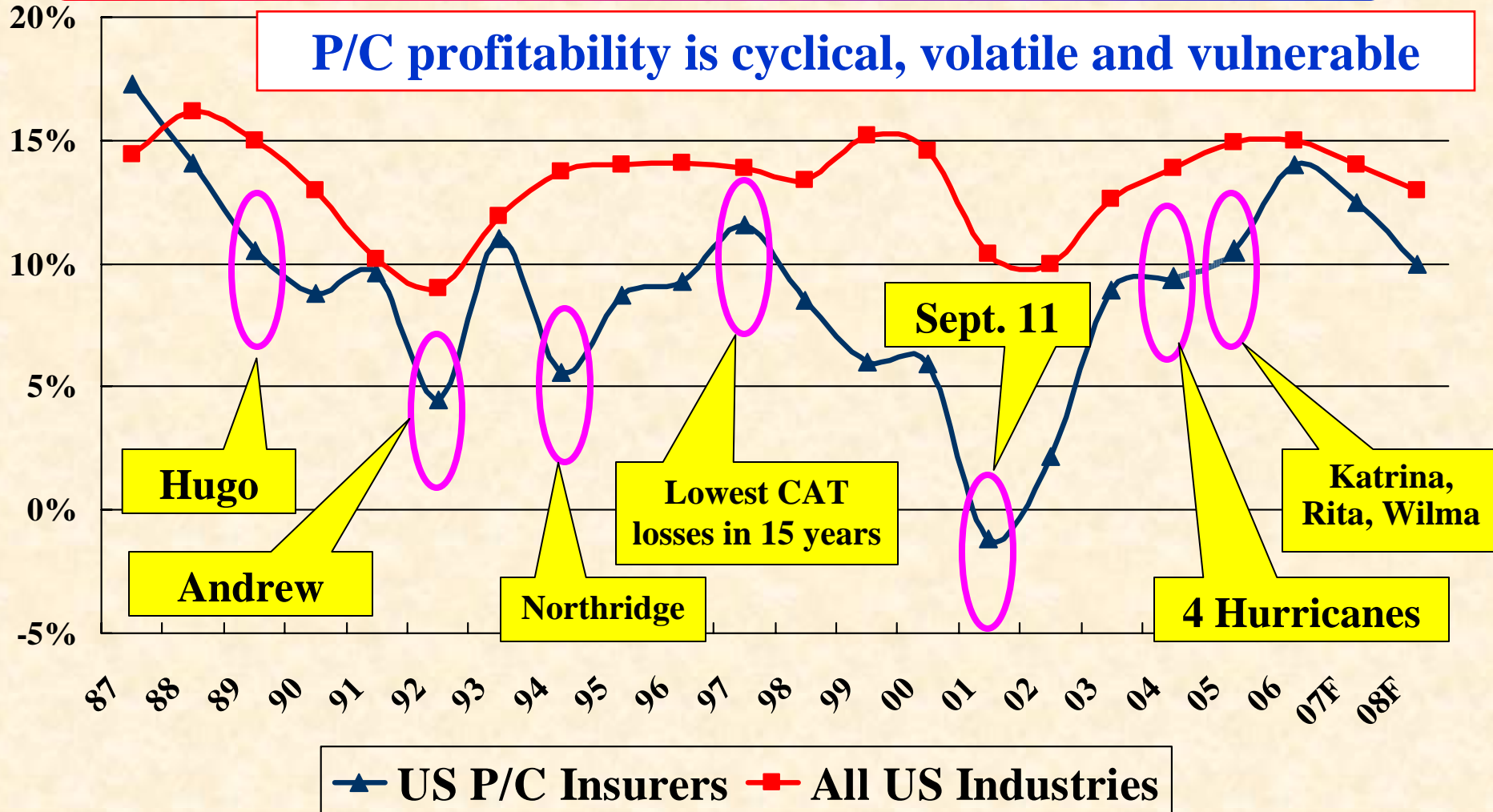


\*ROE figures are GAAP; <sup>1</sup>Return on avg. Surplus.  
Sources: A.M. Best, ISO, Insurance Information Inst.



# ROE: P/C vs. All Industries

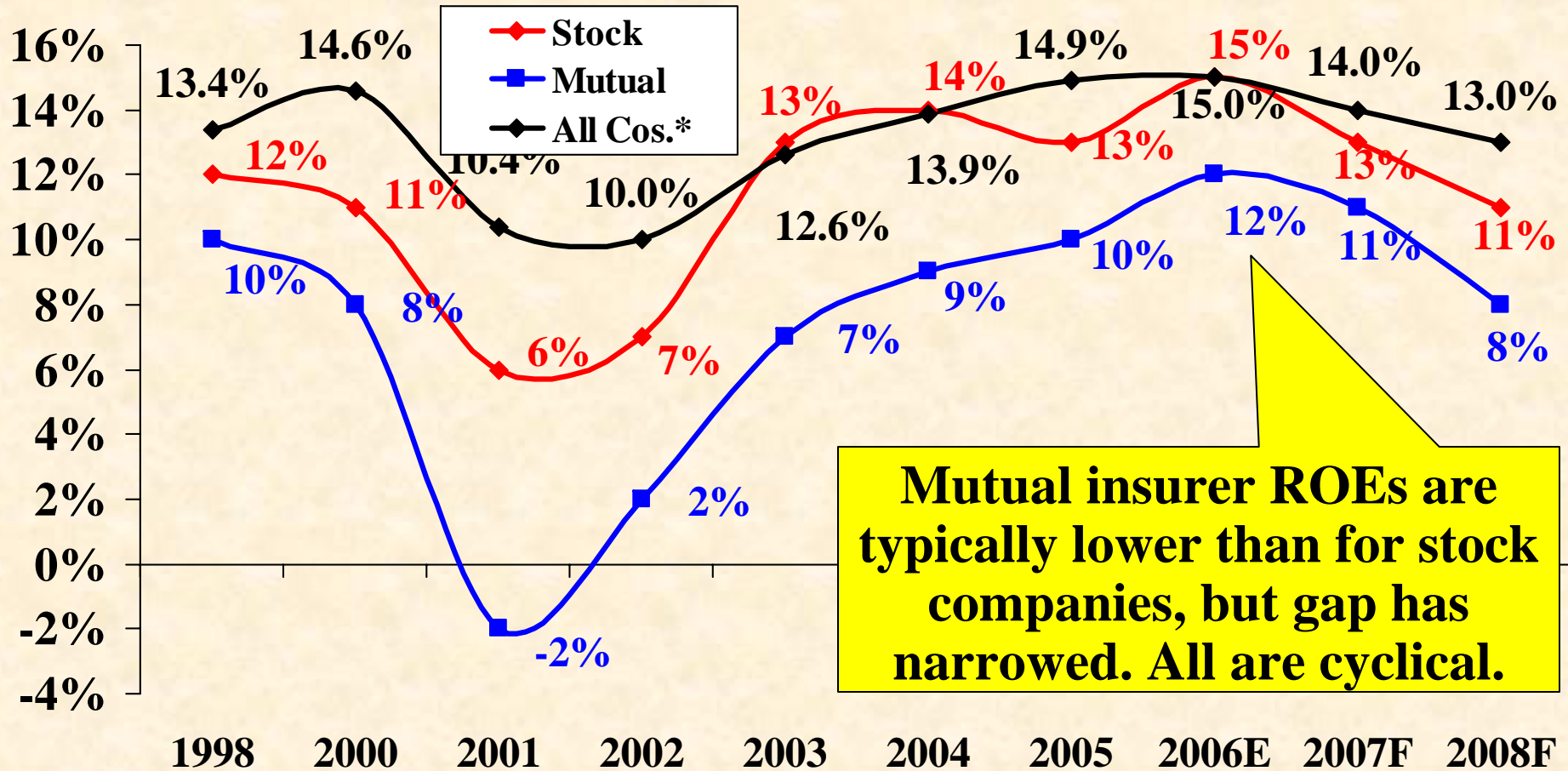
## 1987–2008E



\*2007-08 P/C insurer ROEs are I.I.I. estimates.  
Source: Insurance Information Institute; *Fortune*



# RETURN ON EQUITY (Fortune): Stock & Mutual vs. All Companies\*

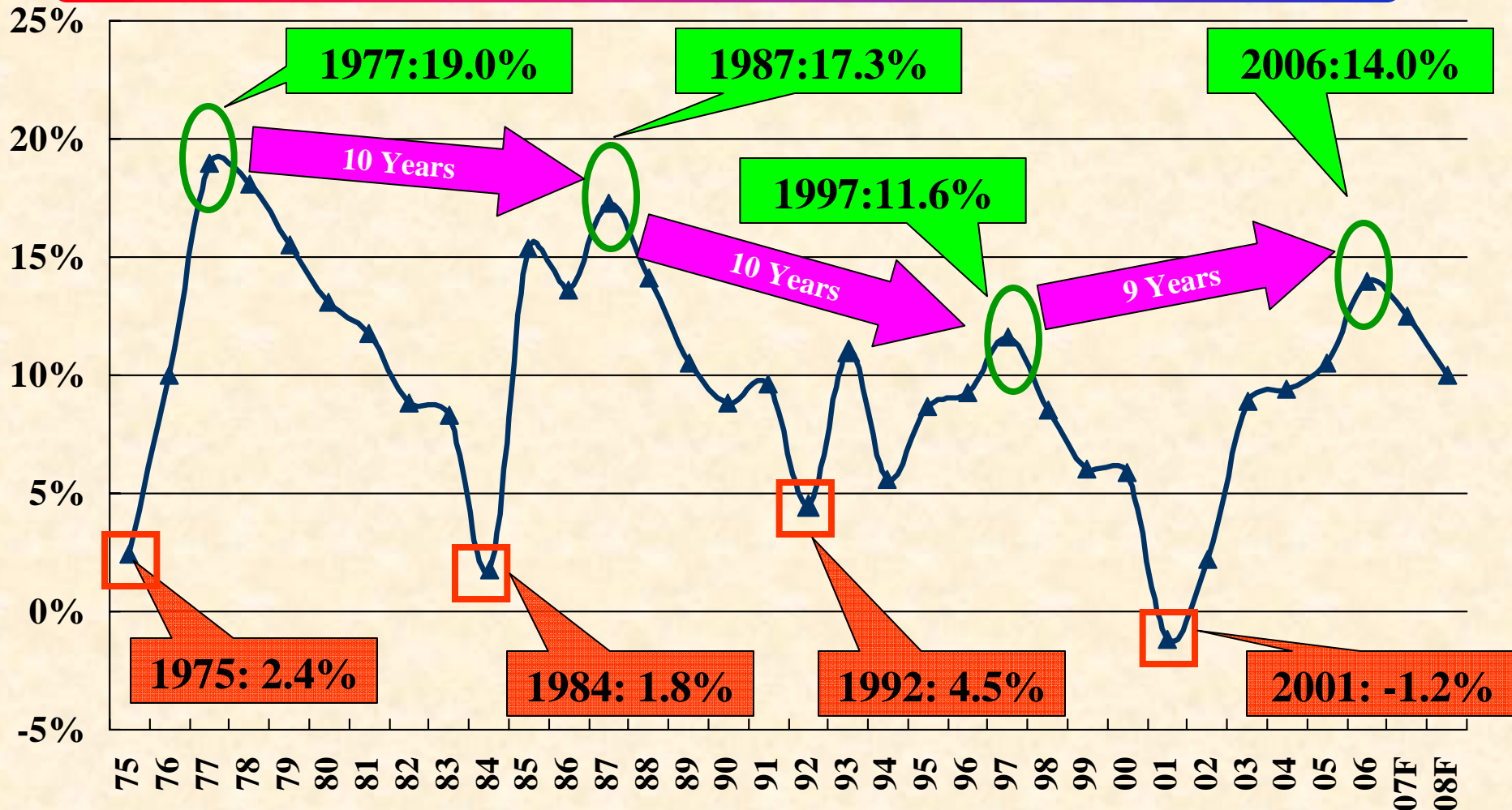


\*Fortune 1,000 group.

Source: *Fortune Magazine*, Insurance Information Institute.



# Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2008F

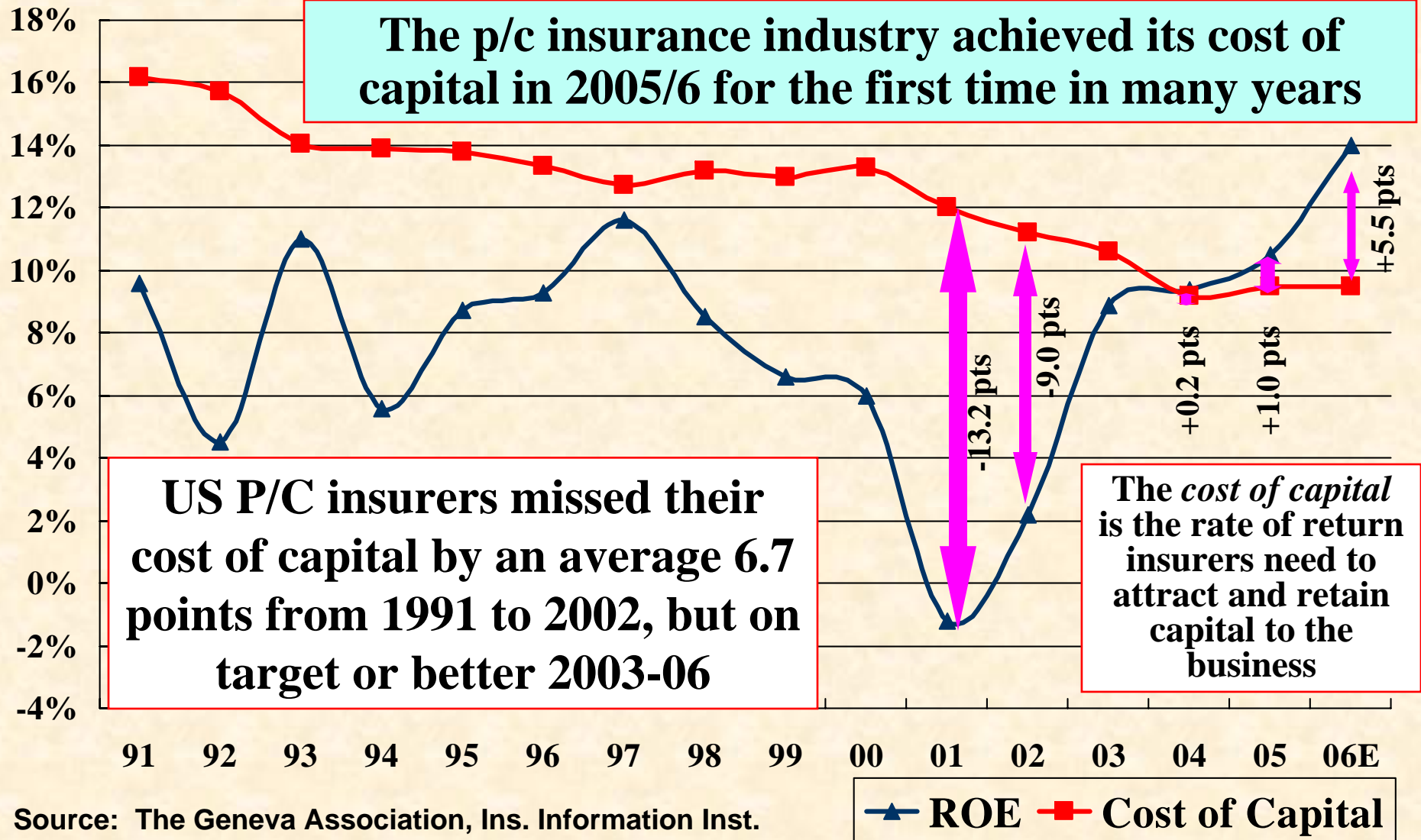


\*2007-08 P/C insurer ROEs are I.I.I. estimates.

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



# ROE vs. Equity Cost of Capital: US P/C Insurance: 1991-2006

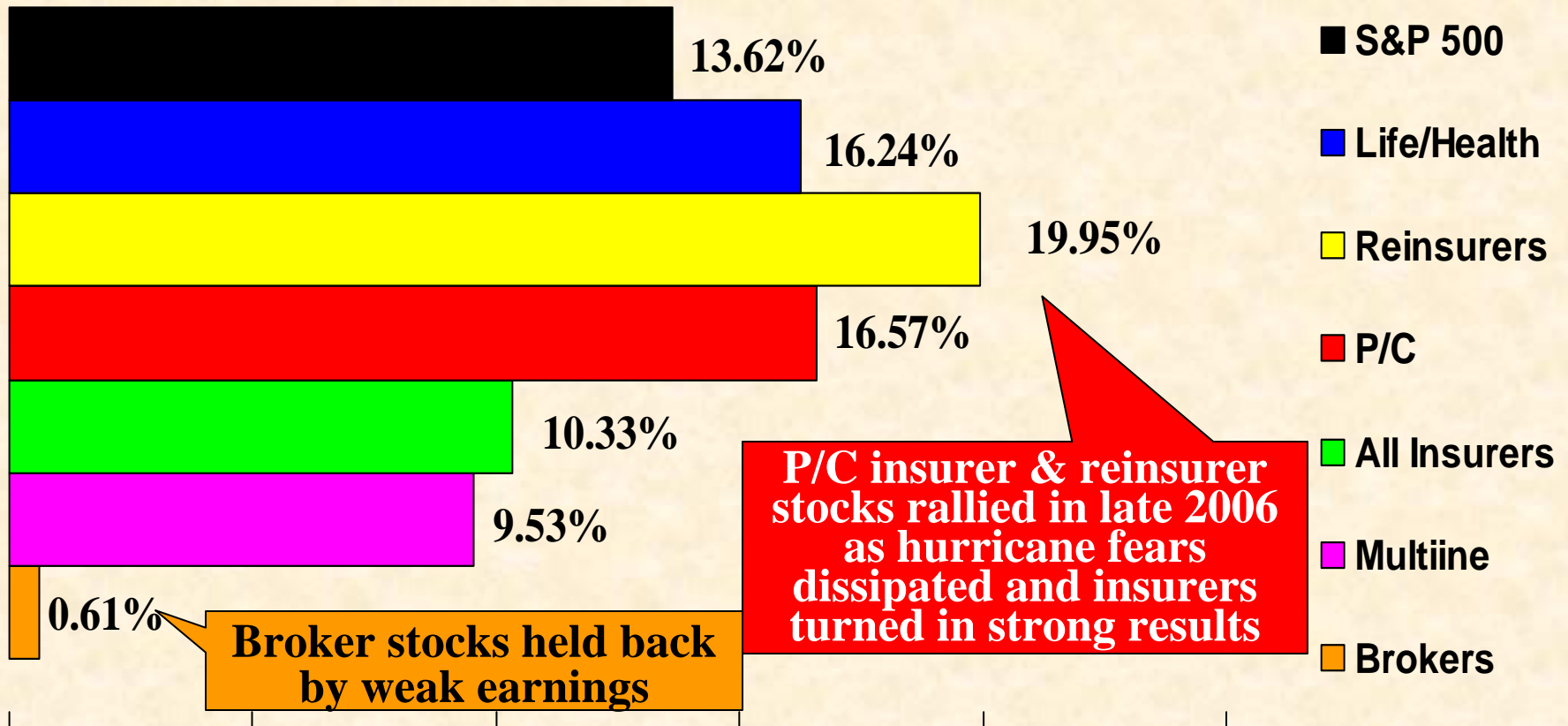


Source: The Geneva Association, Ins. Information Inst.



# Insurance & Reinsurance Stocks: Strong Finish in 2006

## Total Returns for 2006

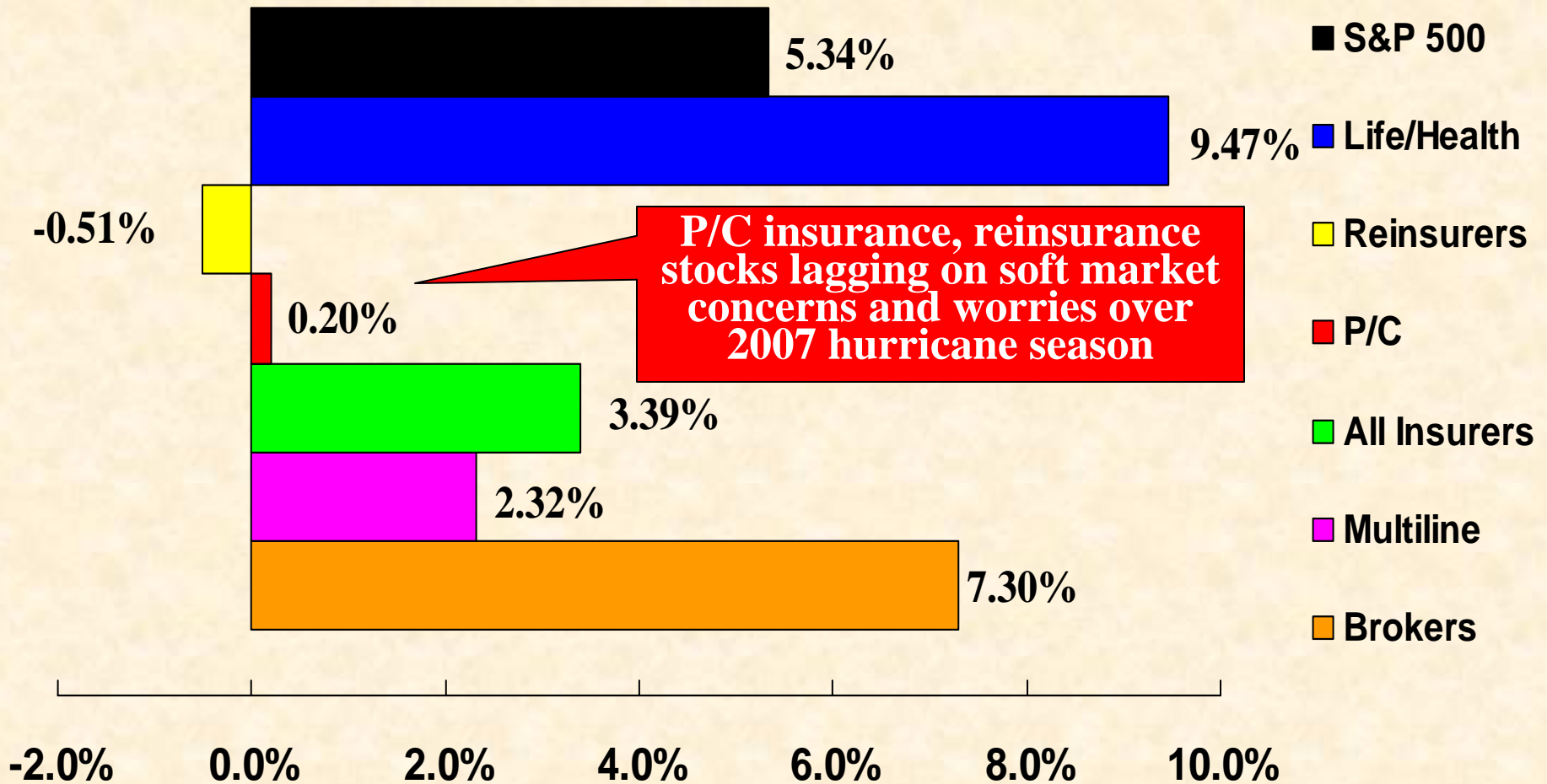


0.0% 5.0% 10.0% 15.0% 20.0% 25.0%



# *Insurance & Reinsurance Stocks: Slow Start in 2007 in P/C, Reins*

**Total YTD Returns Through April 27, 2007**

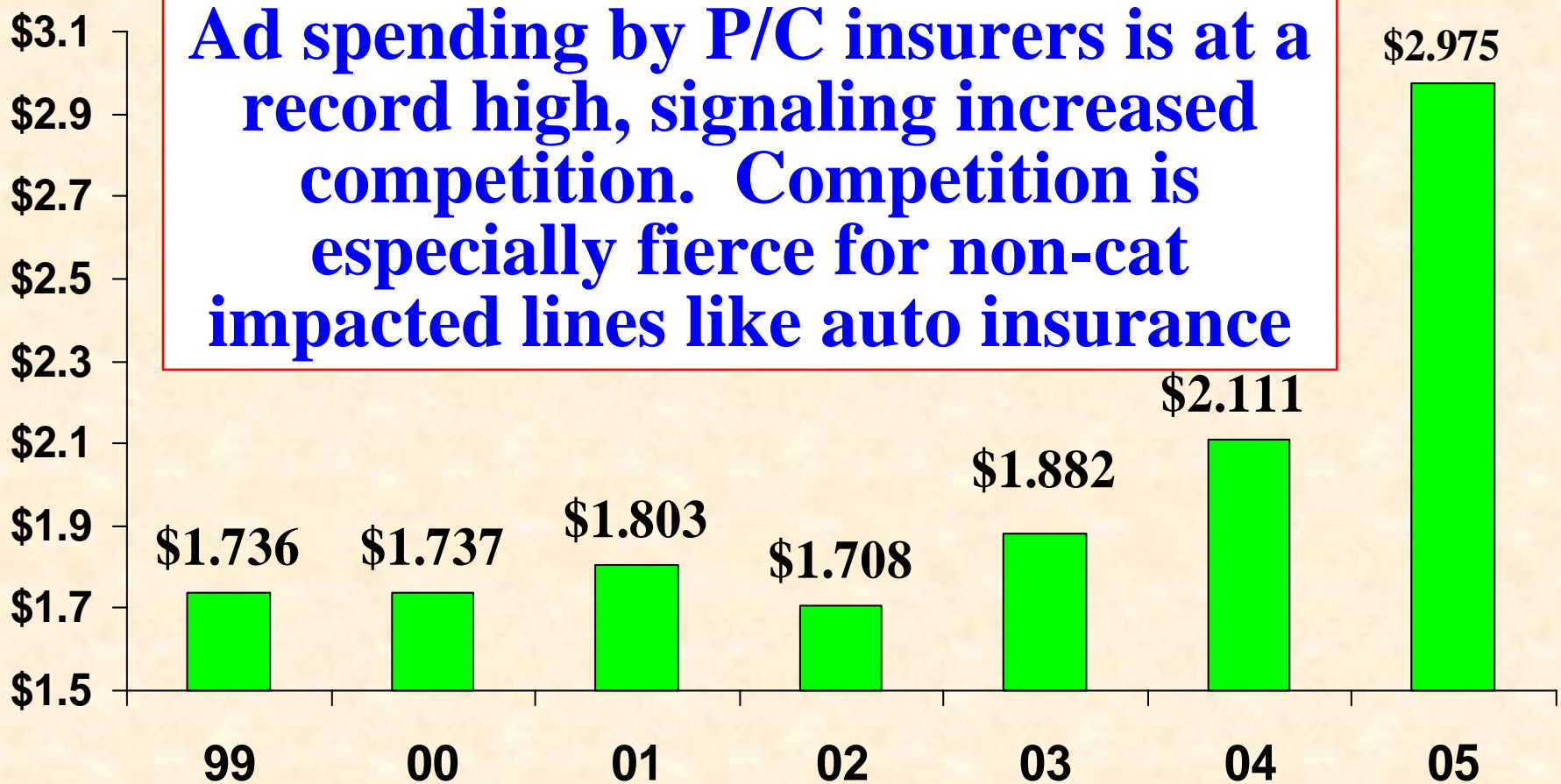


Source: SNL Securities, Standard & Poor's, Insurance Information Institute



# Advertising Expenditures by P/C Insurance Industry, 1999-2005

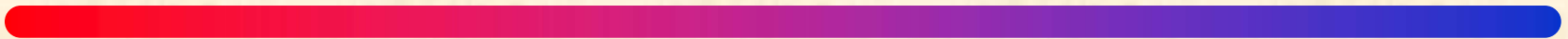
\$ Billions



Source: Insurance Information Institute from consolidated P/C Annual Statement data.

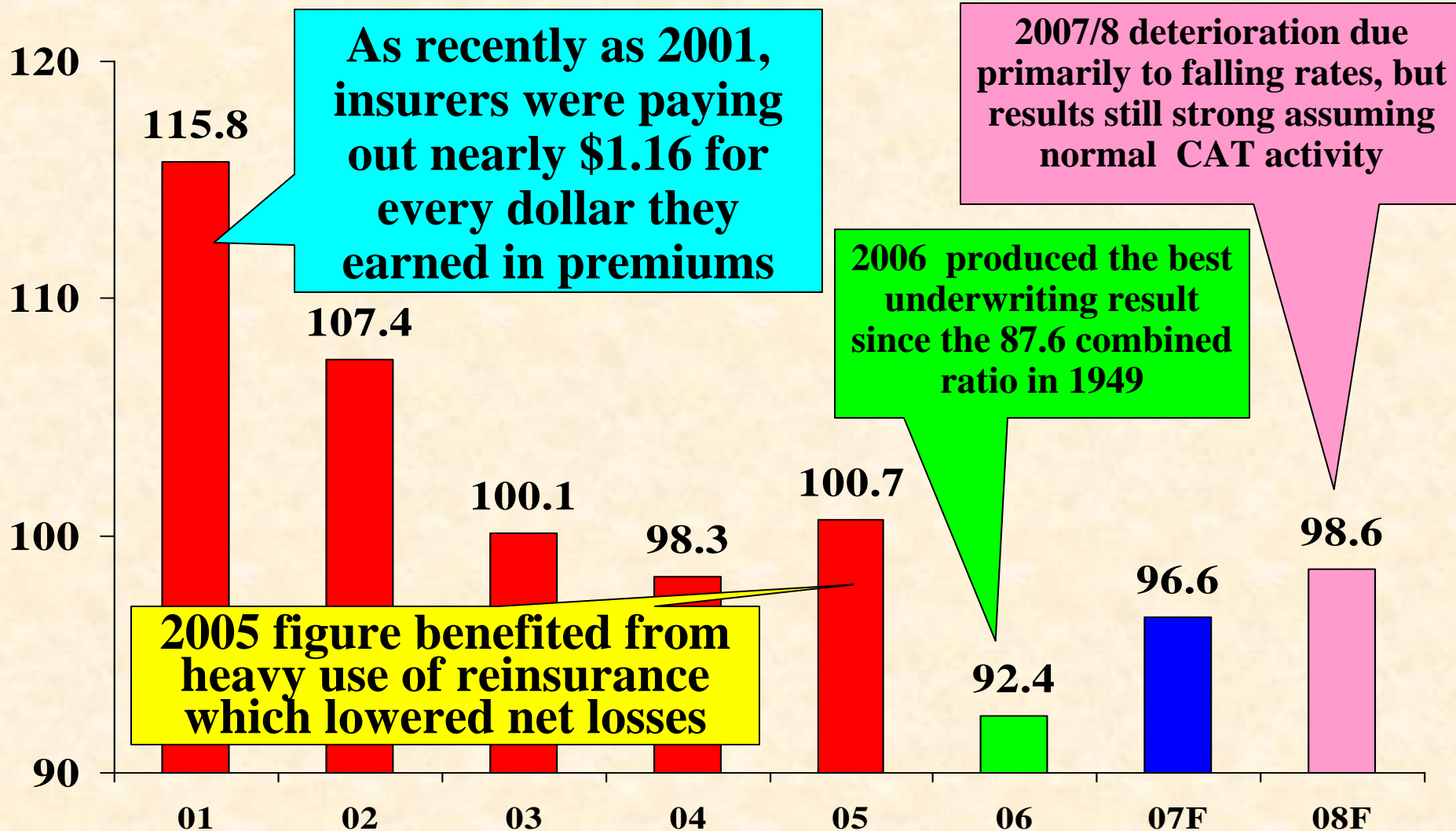
# UNDERWRITING

*Extremely Strong Results  
Across the Board*





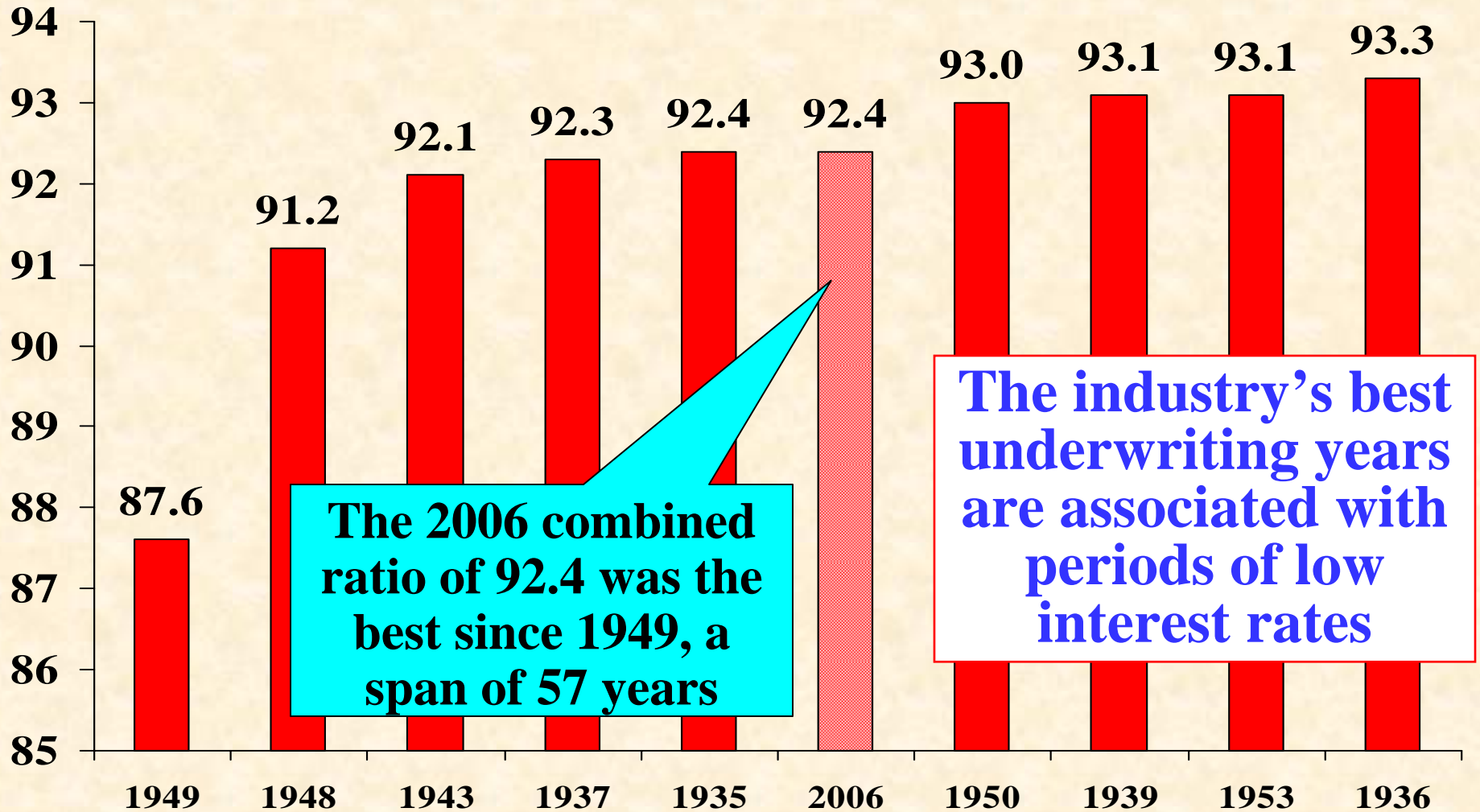
# *P/C Industry Combined Ratio*



Sources: A.M. Best; ISO, III. \*Estimates/forecasts based on III's 2007 Early Bird survey.



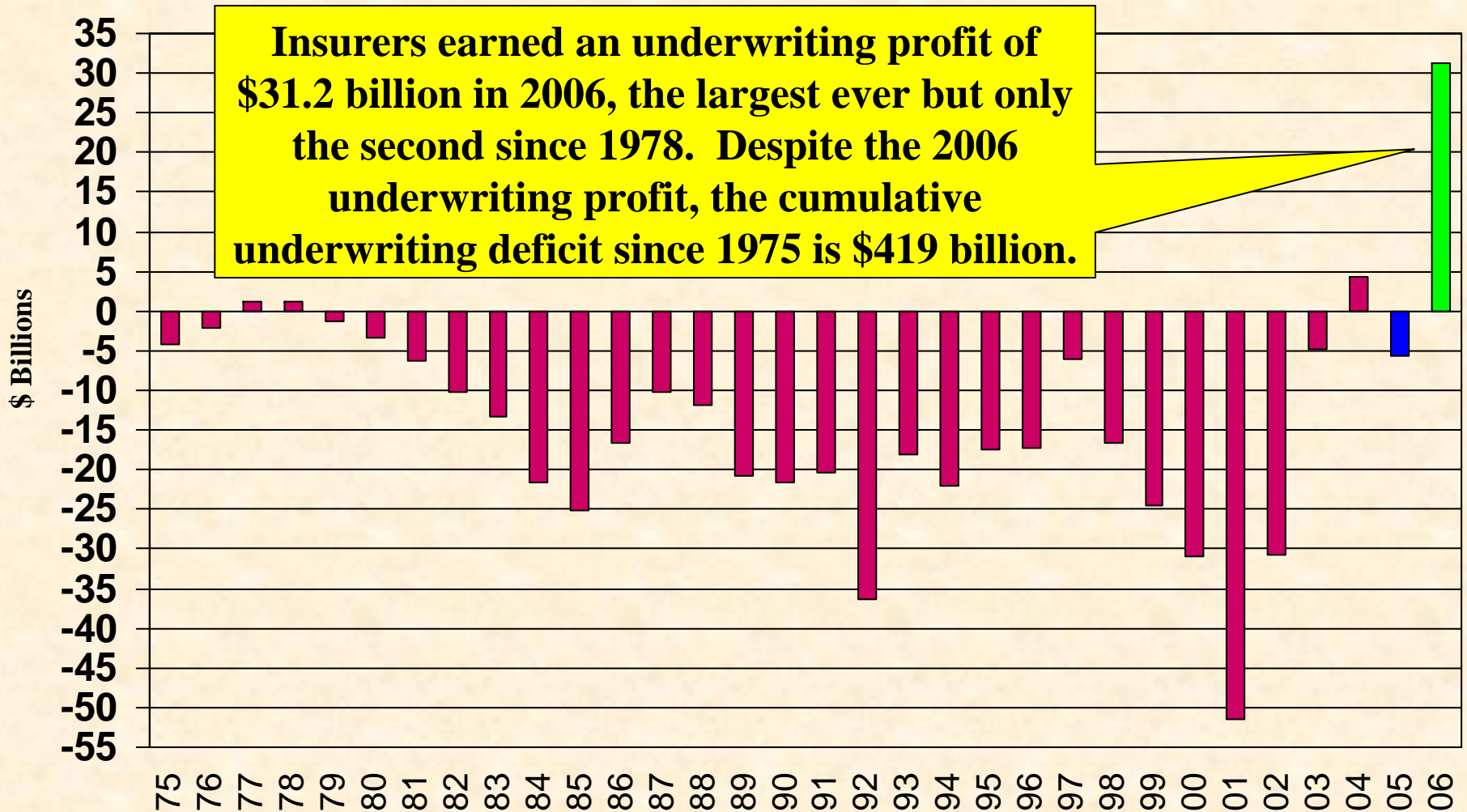
# *Ten Lowest P/C Insurance Combined Ratios Since 1920*





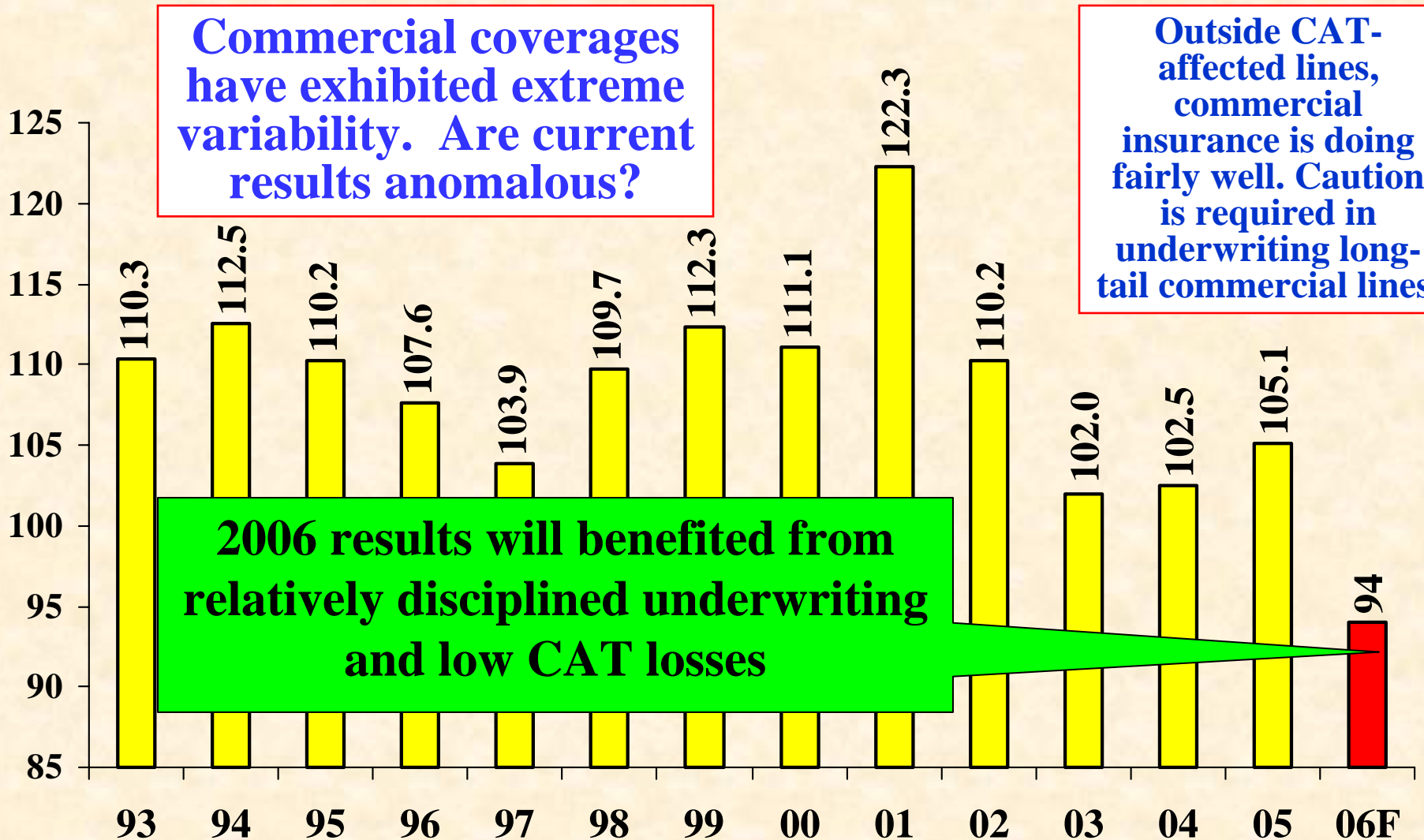
# *Underwriting Gain (Loss)*

## *1975-2006*



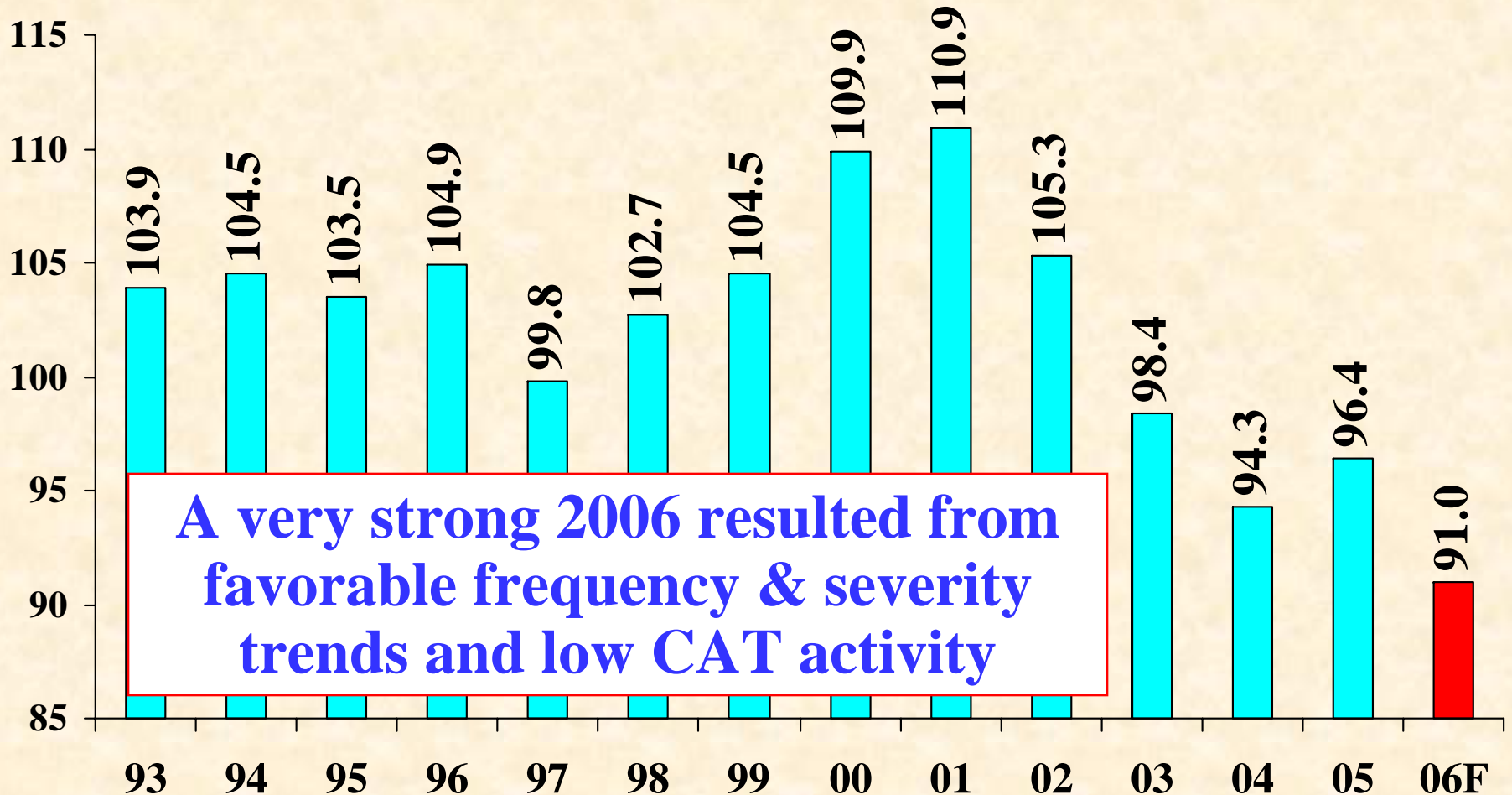


# Commercial Lines Combined Ratio, 1993-2006E\*



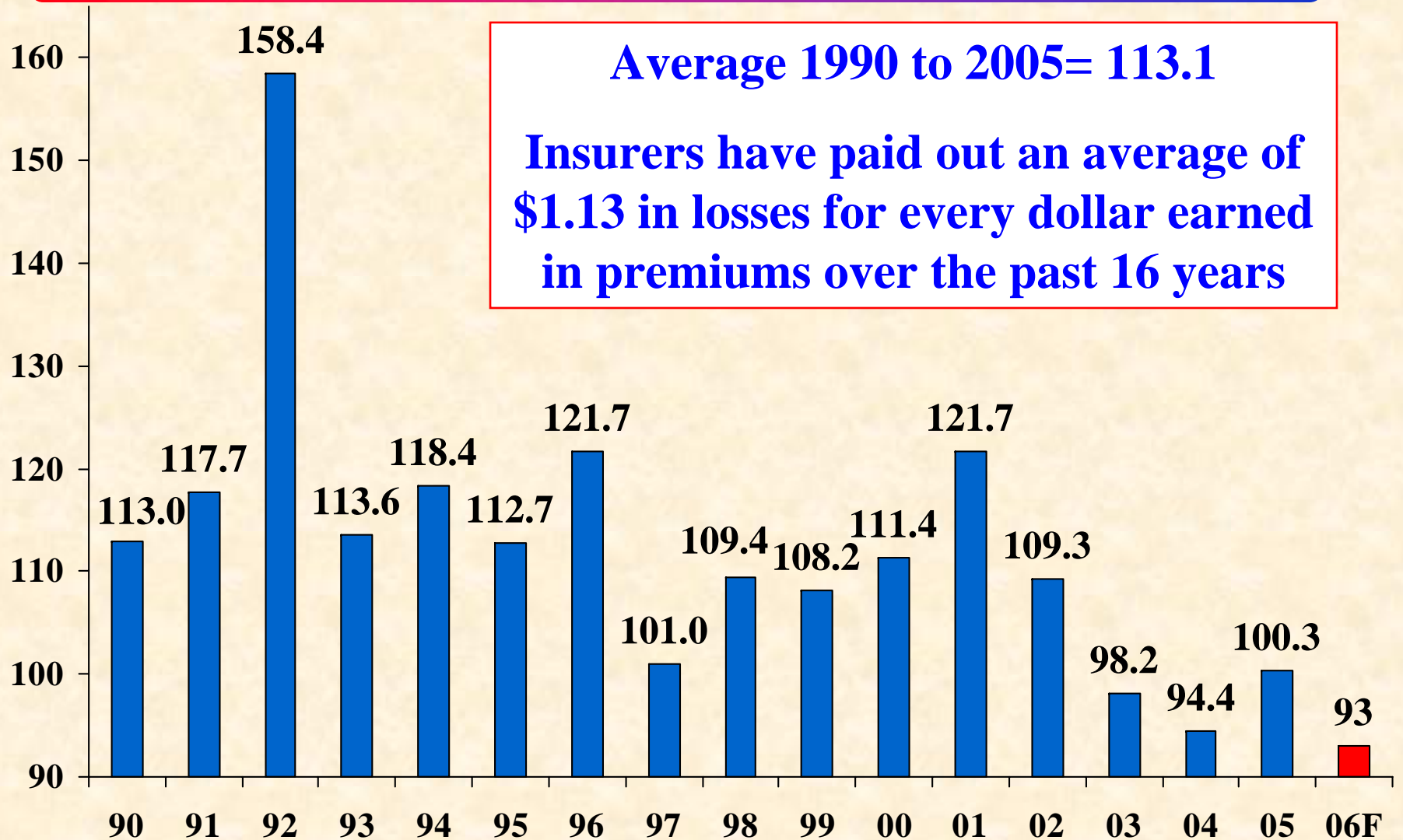


# *Personal Lines Combined Ratio, 1993-2006E*



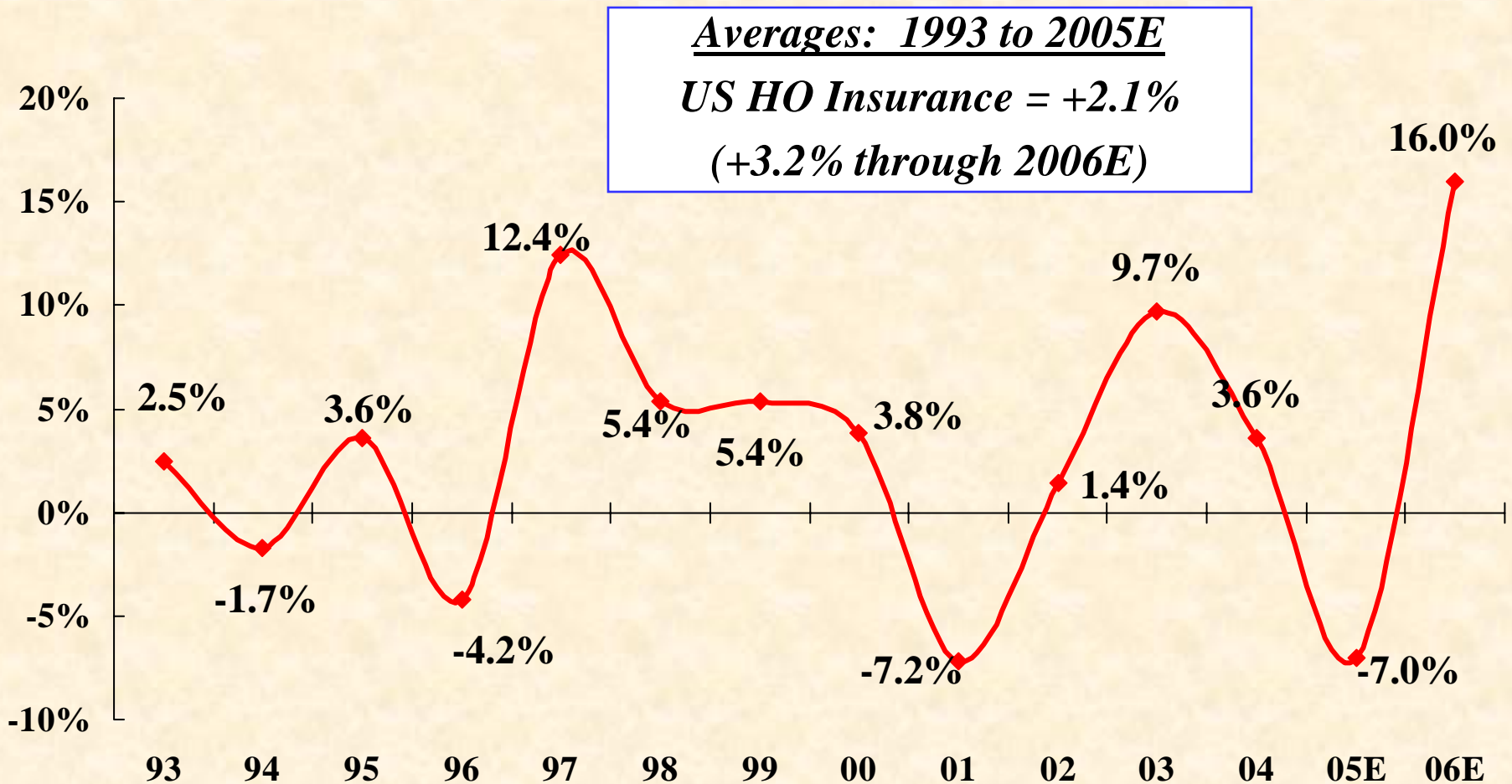


# Homeowners Insurance Combined Ratio



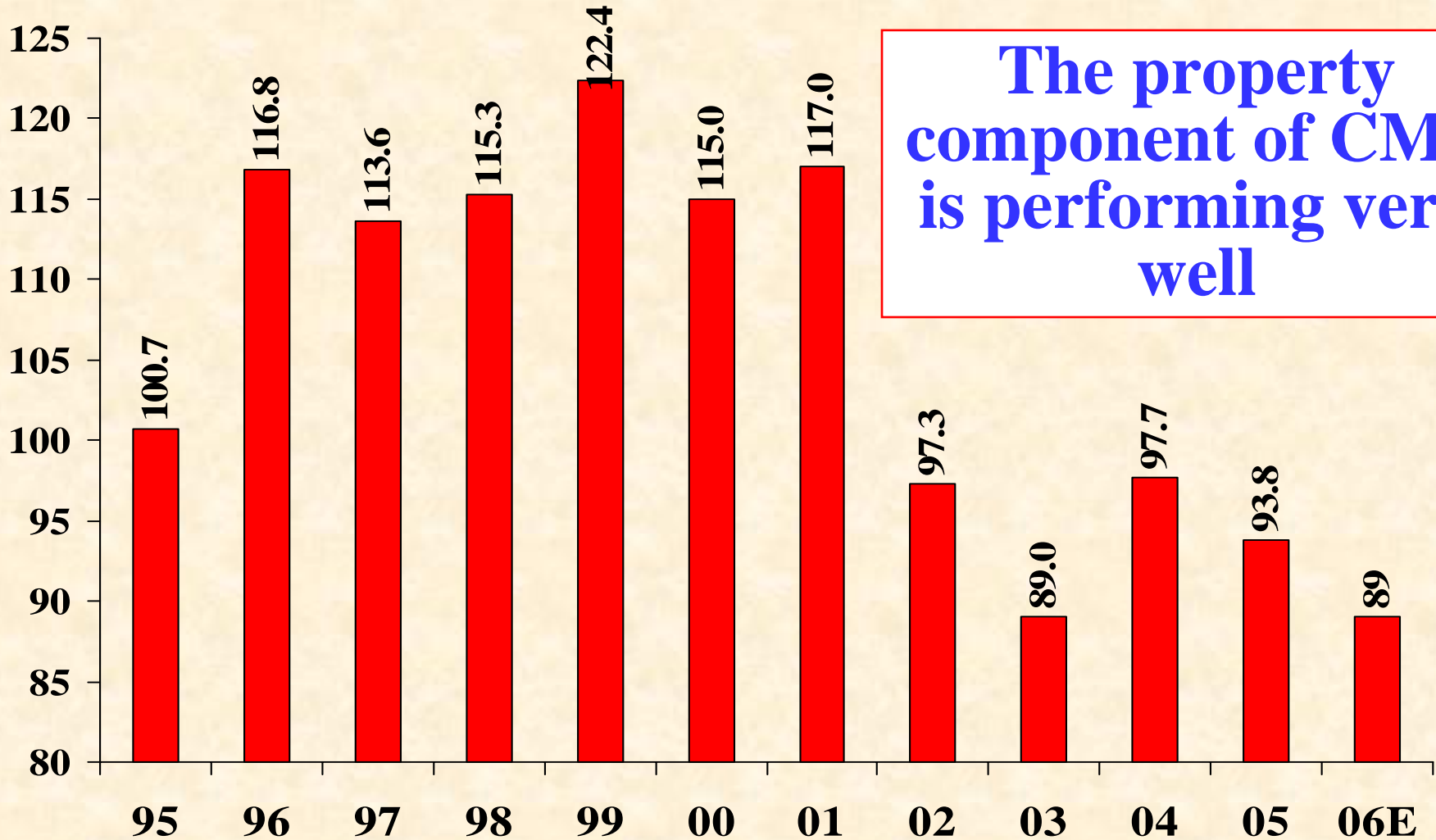


# Rates of Return on Net Worth for Homeowners Ins: US



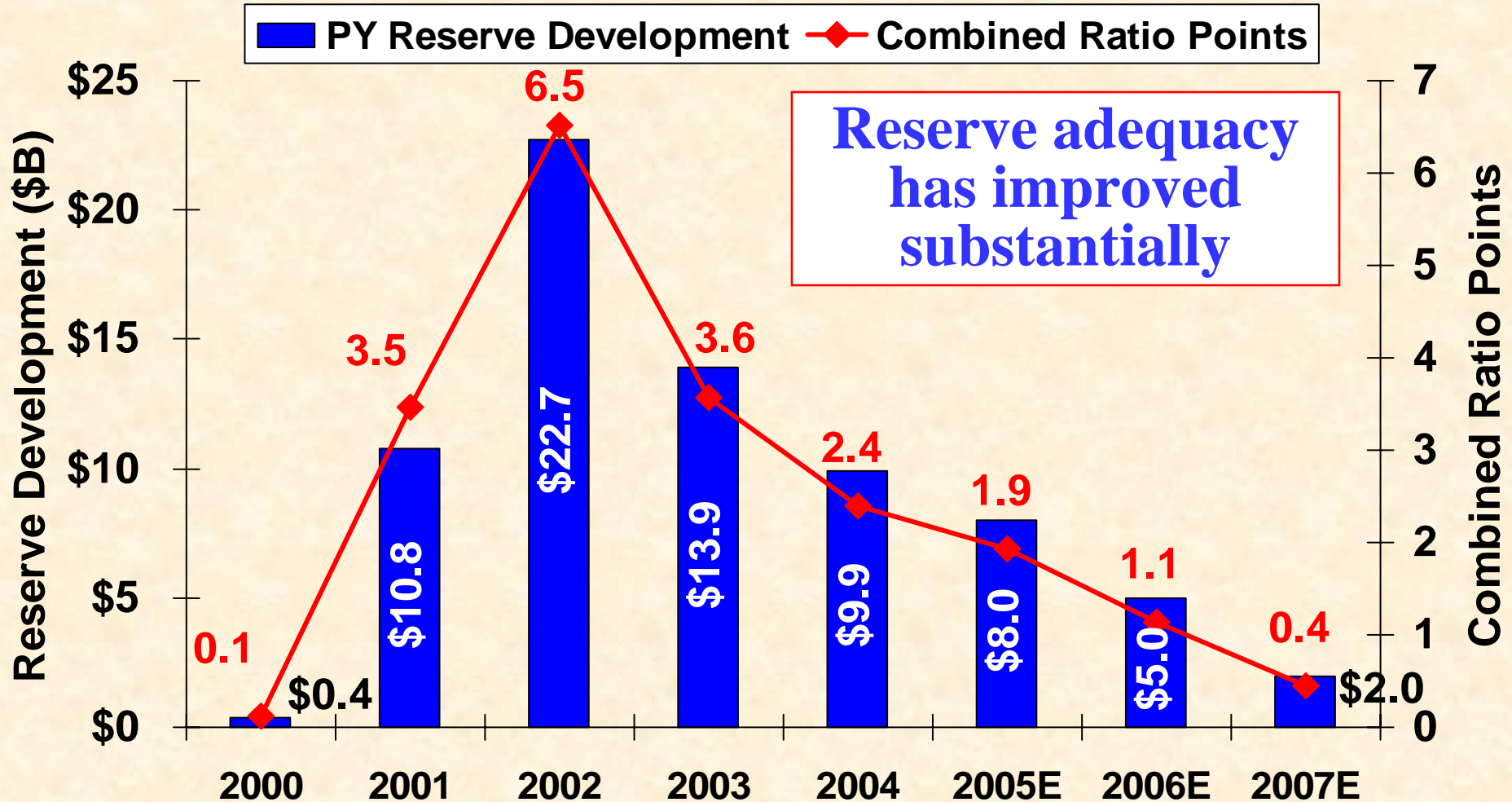


# *Commercial Multi-Peril Combined* *(Non-Liability Portion Only)*





# Impact of Reserve Changes on Combined Ratio



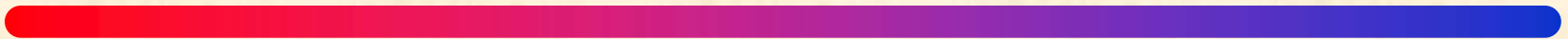


# *The Big Question: Is the Industry More Disciplined Today?*

- **Signs suggest that the answer is *yes***
- **Current period of sustained underwriting profitability is the first since the 1950s**
- **While prices are falling, underlying lost cost trends (frequency and severity trends) are generally favorable to benign**
  - **Suggest impact of falling prices will be less pronounced than late 1990s**
- **Reserve situation appears much improved and under control**
- **Management Information Systems: Much More Sophisticated**
  - **Insurers can monitor and make adjustments much more quickly**
  - **Adjustments made quickly by line, geographic area, producer, etc.**
- **Investment Income**
  - **Relative to late 1990s, interest rates and stock markets returns are lower**
  - **Has effect of imposing (some) discipline**
- **Ratings Agencies**
  - **More stringent capital requirements**
  - **Quicker to downgrade**

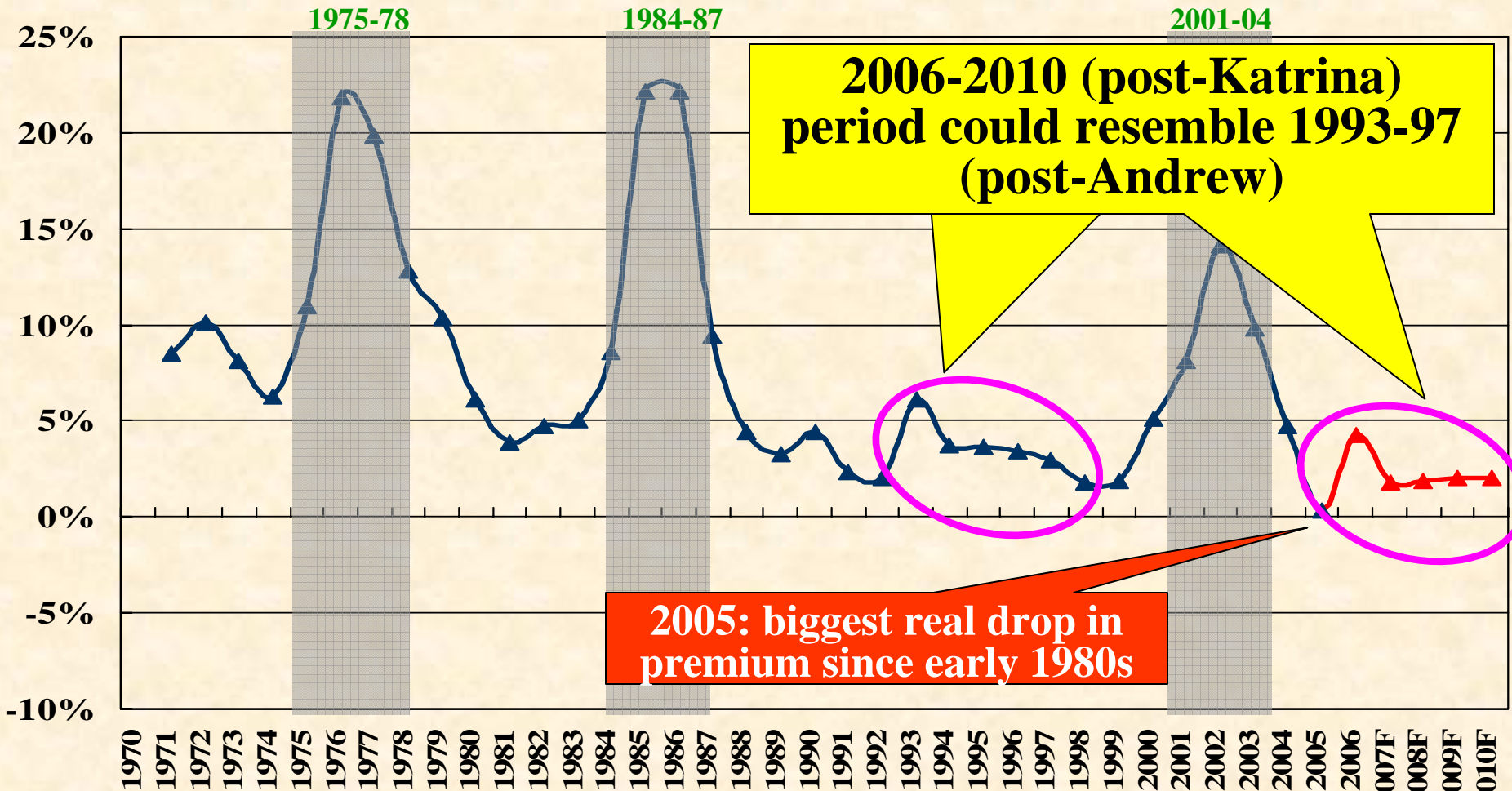
# PREMIUM GROWTH

**Property Blip in 2006,  
But Profits Spur  
Competition**





# Strength of Recent Hard Markets by NWP Growth\*

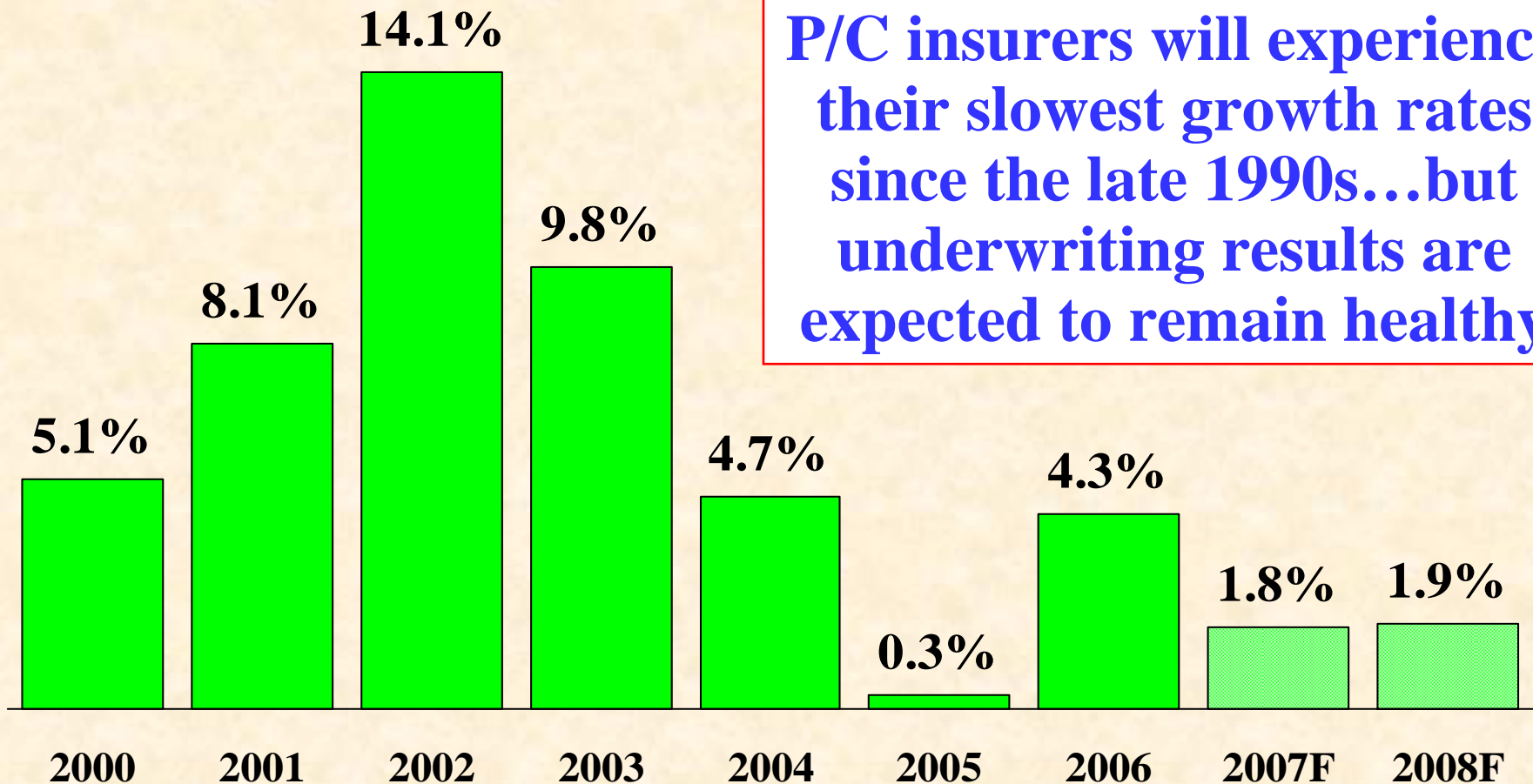


\*2007-10 figures are III forecasts/estimates. 2005 growth of 0.4% equates to 1.8% after adjustment for a special one-time transaction between one company and its foreign parent. 2006-2008 figures from III Groundhog Survey.

Note: Shaded areas denote hard market periods.  
Source: A.M. Best, Insurance Information Institute



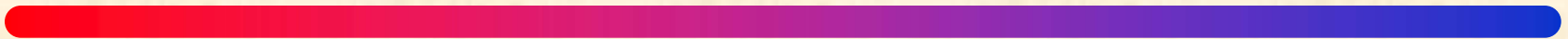
# *Growth in Net Written Premium, 2000-2008F*



**P/C insurers will experience their slowest growth rates since the late 1990s...but underwriting results are expected to remain healthy**

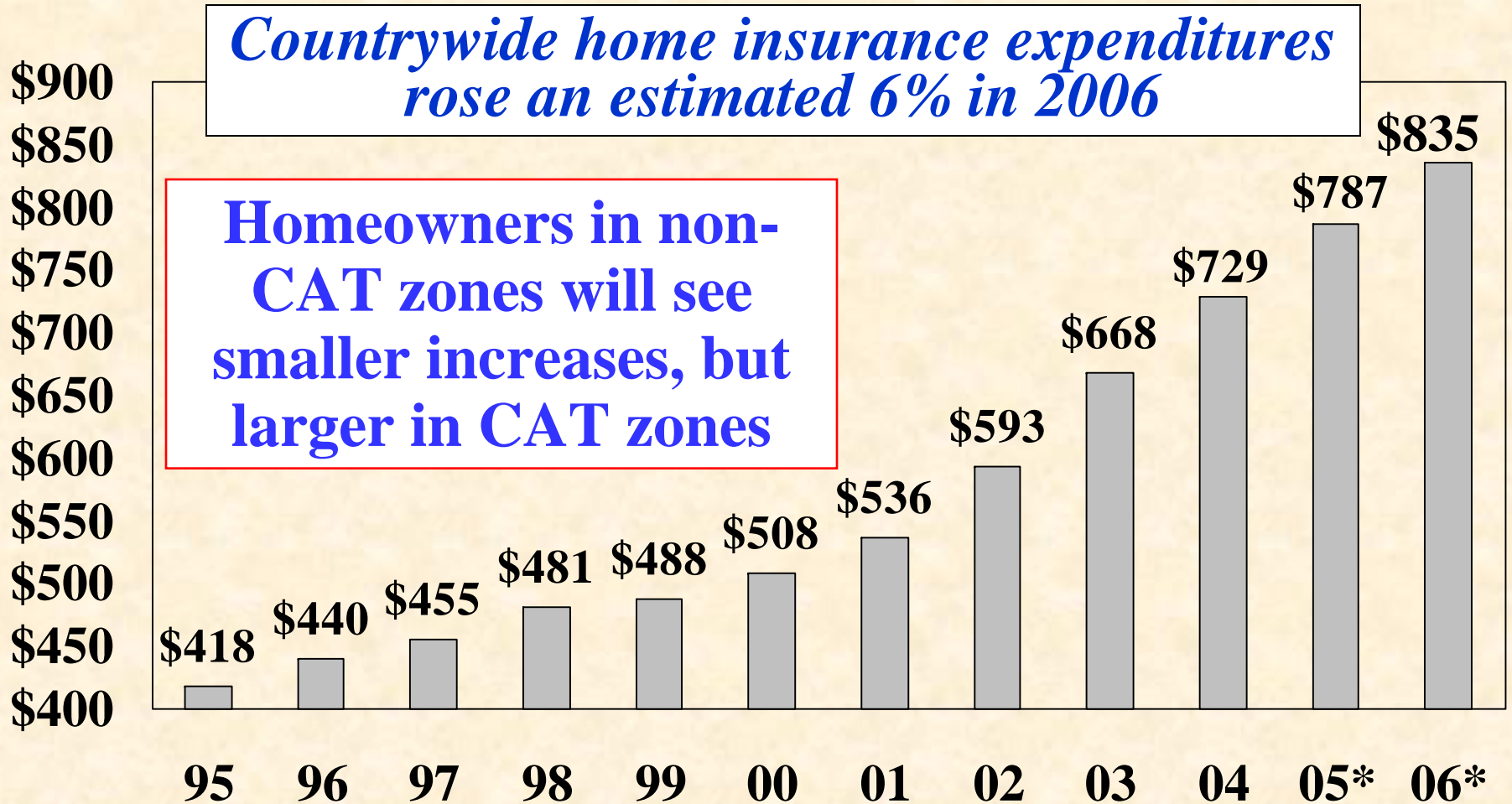
# PRICING

**Under Pressure in 2007  
in All Non-Coastal Risks**





# Average Expenditures on Homeowners Insurance\*\*



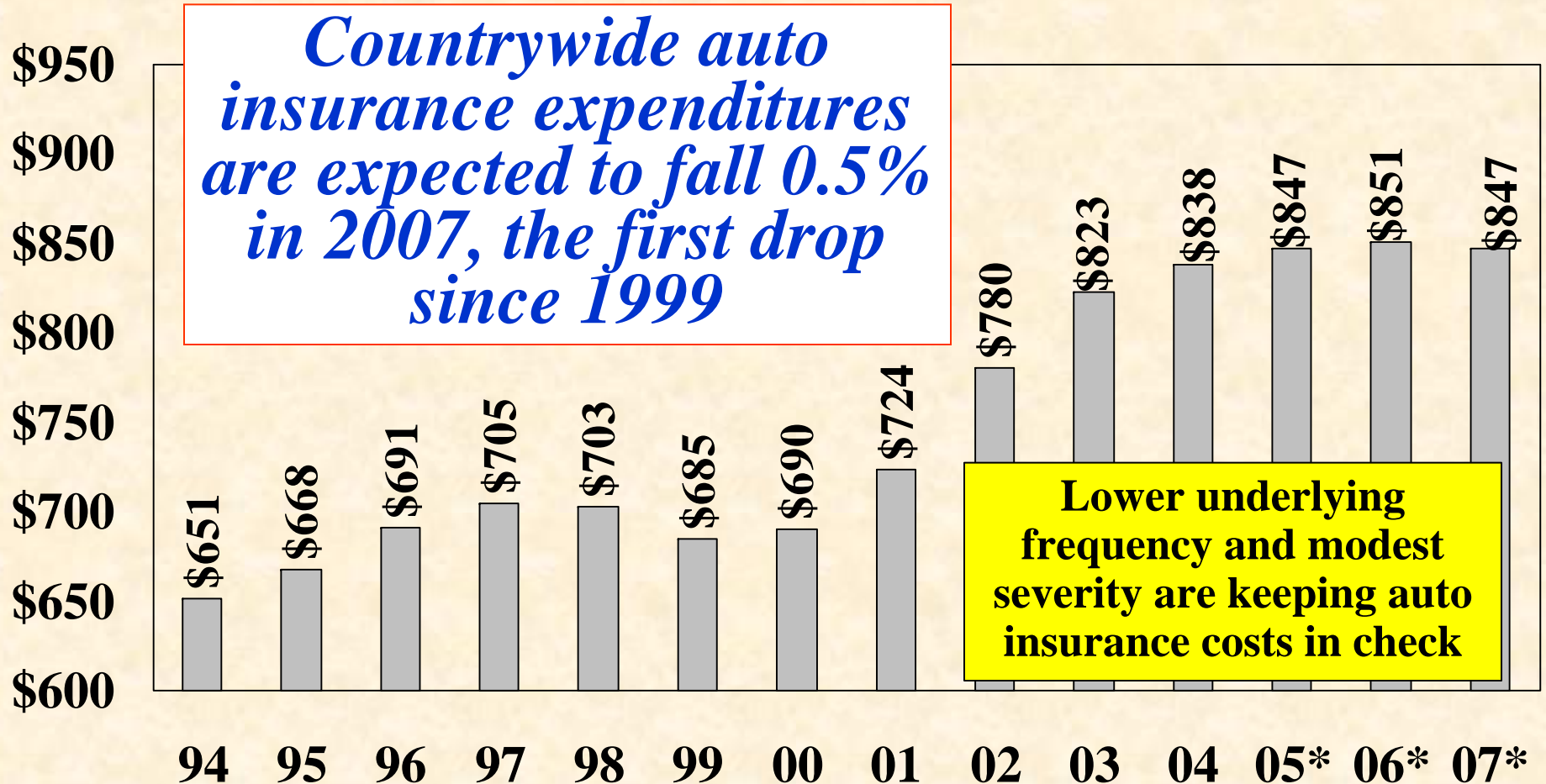
\*Insurance Information Institute Estimates/Forecasts

\*\*Excludes cost of flood and earthquake coverage.

Source: NAIC, Insurance Information Institute



# Average Expenditures on Auto Insurance

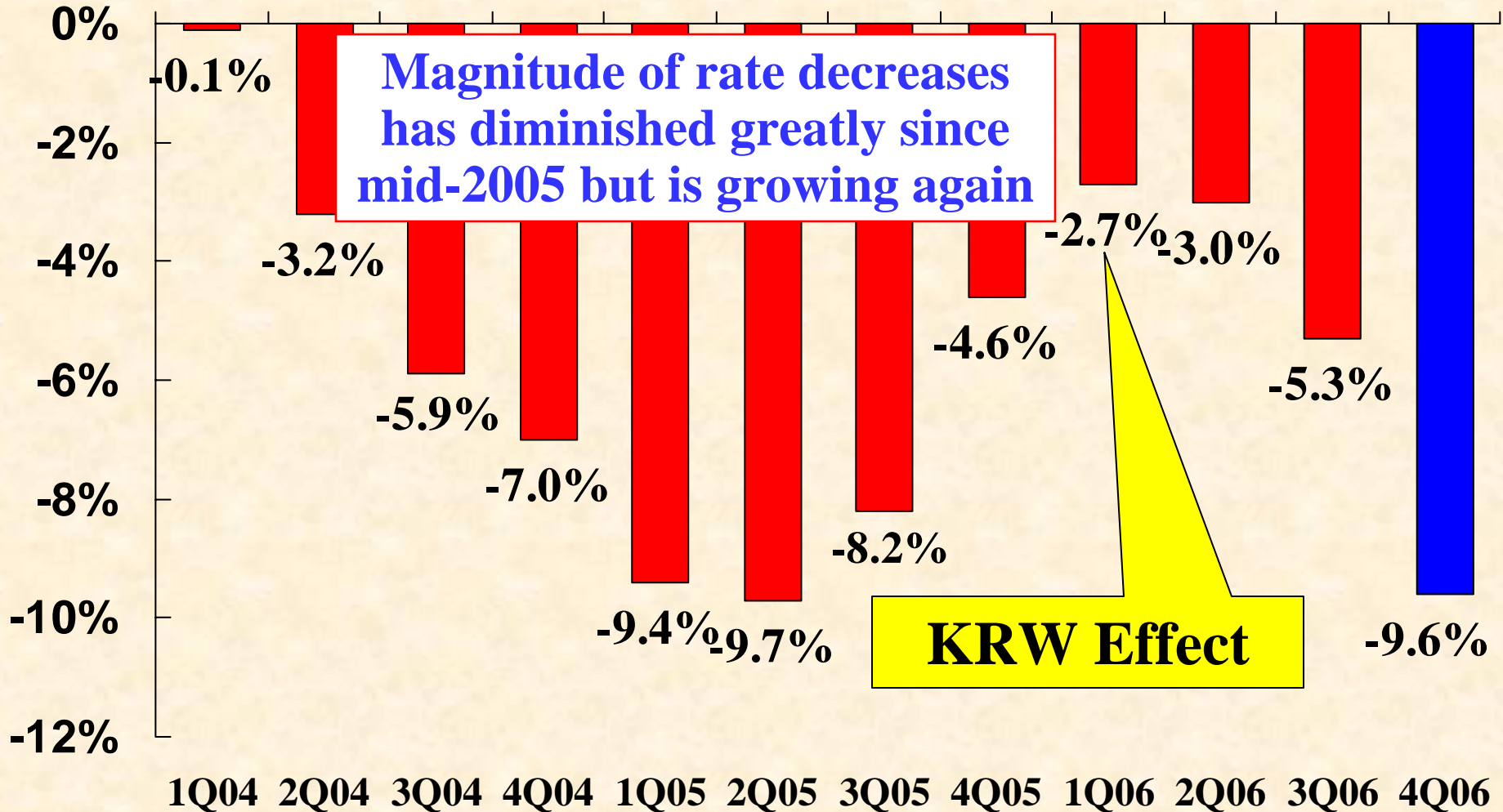


\*Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute

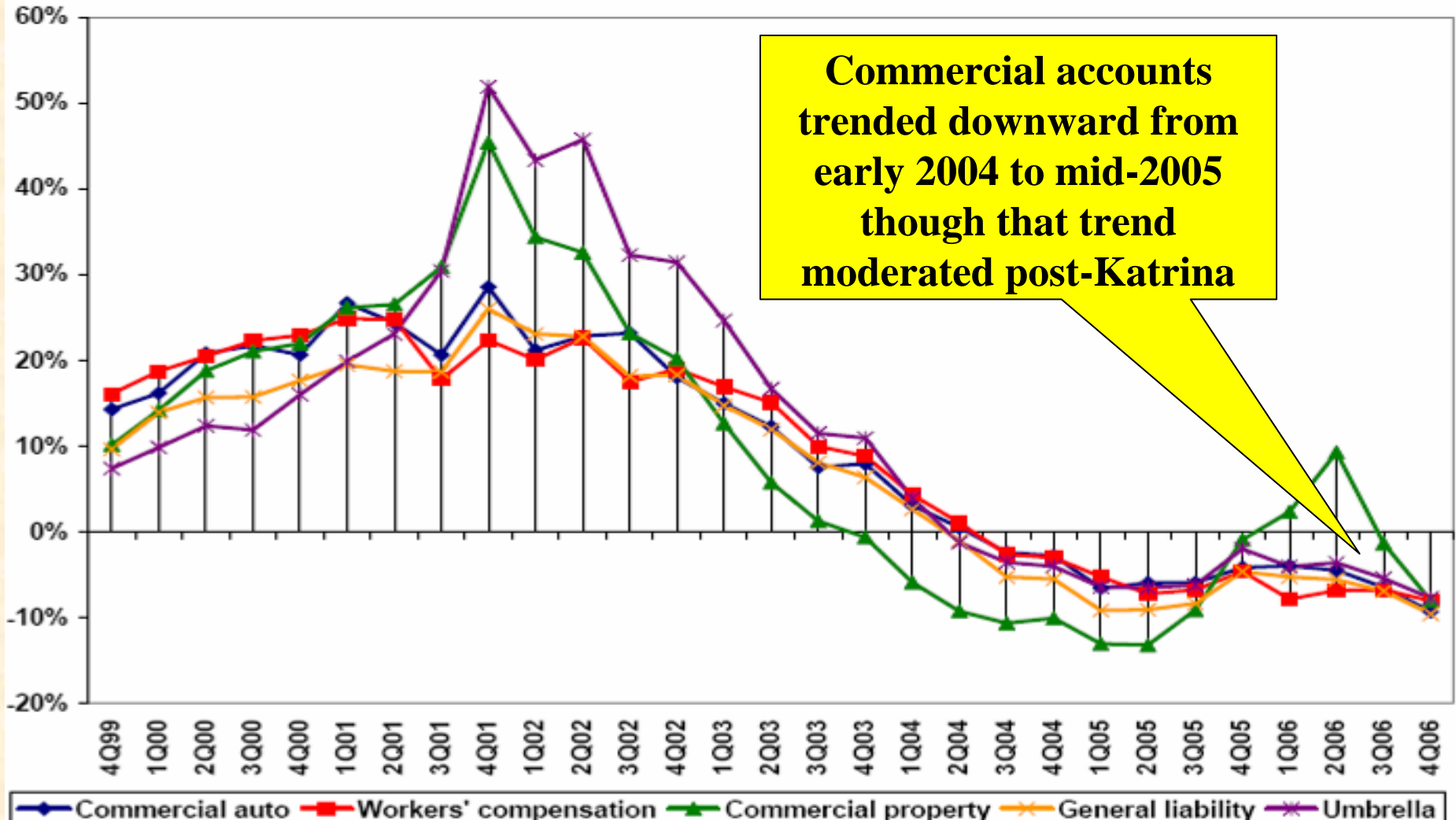


# Average Commercial Rate Change, All Lines, (1Q:2004 – 4Q:2006)



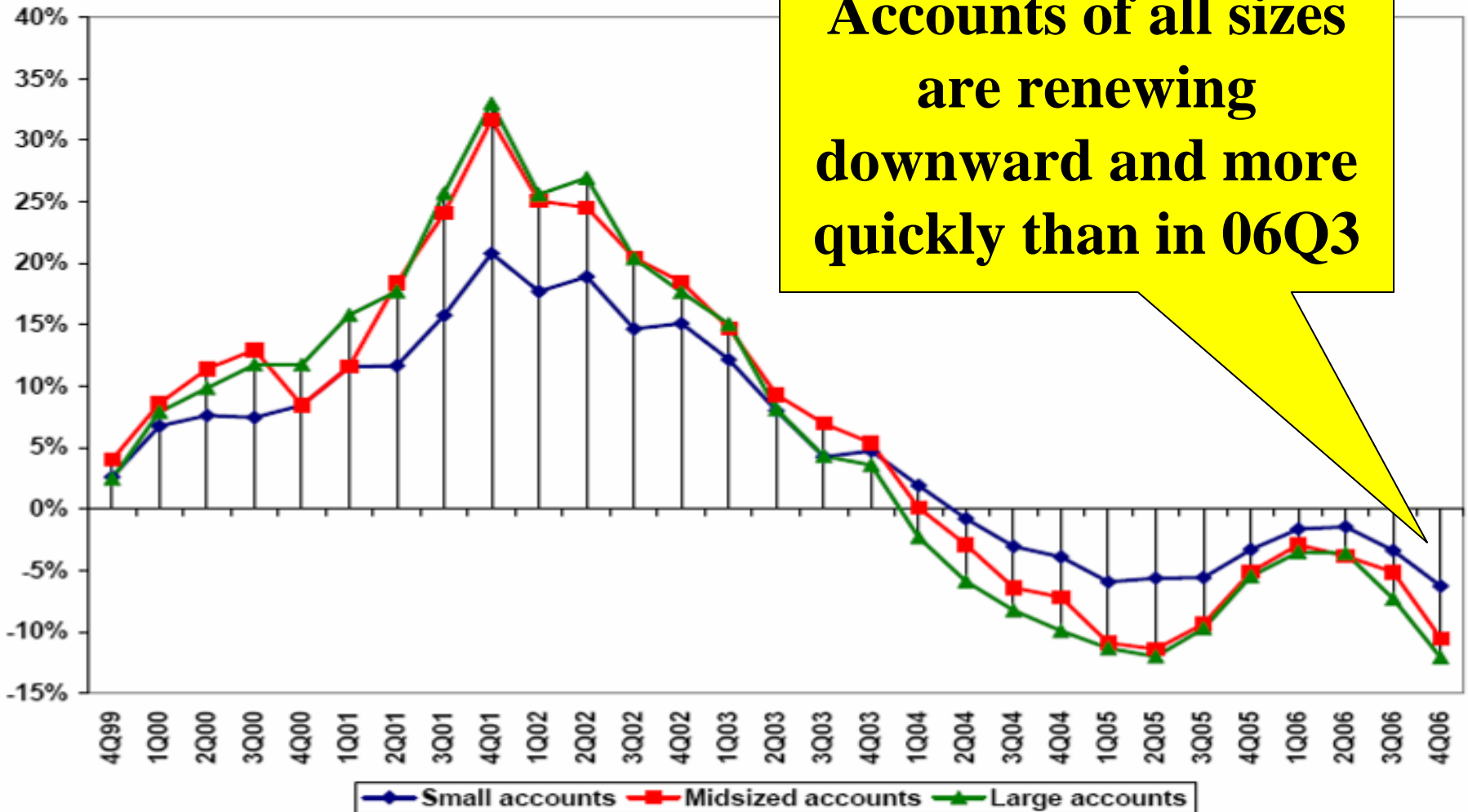


# Average Commercial Rate Change by Line: 4Q99 – 4Q06

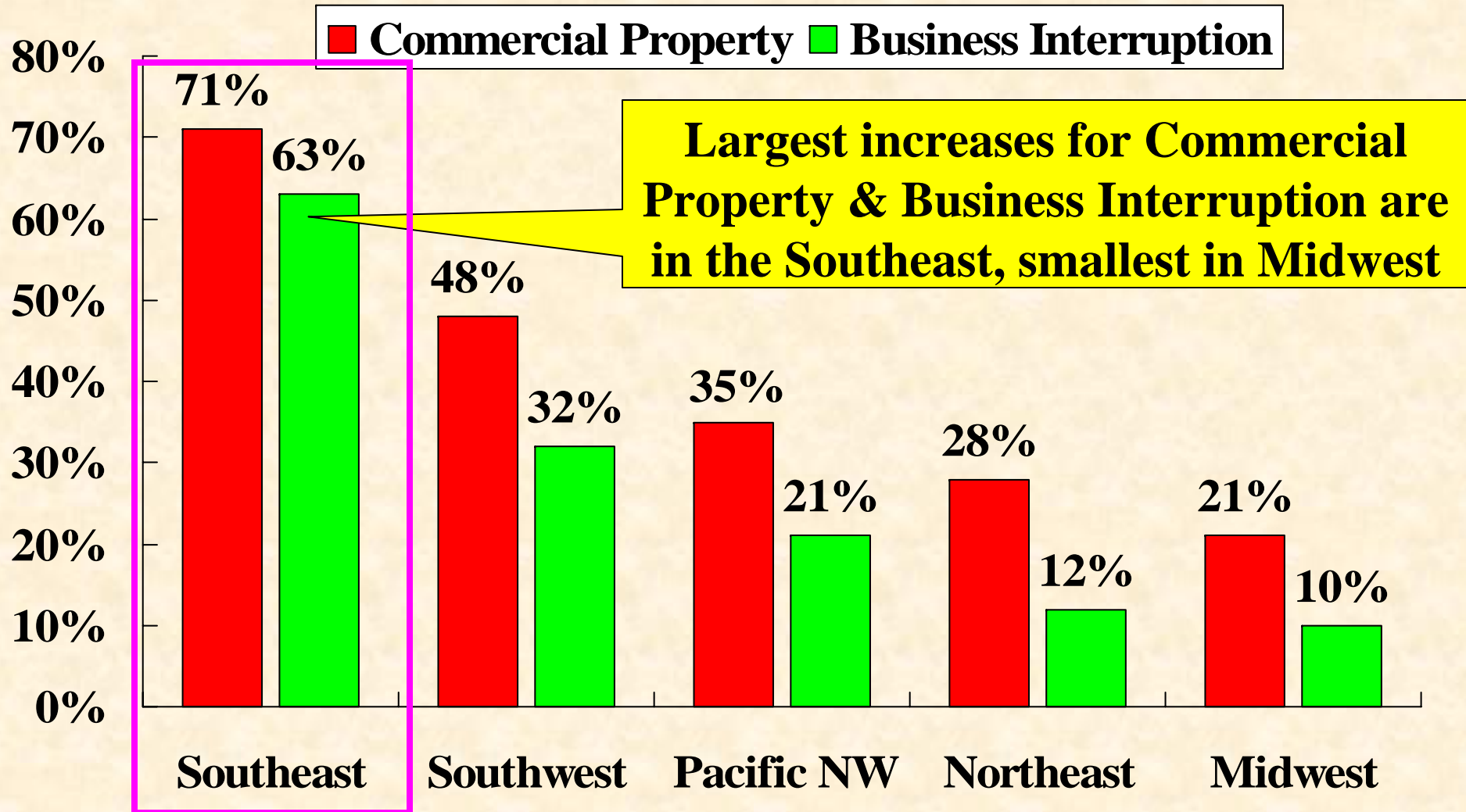




# Average Commercial Rate Change by Account Size: 4Q99 – 4Q06

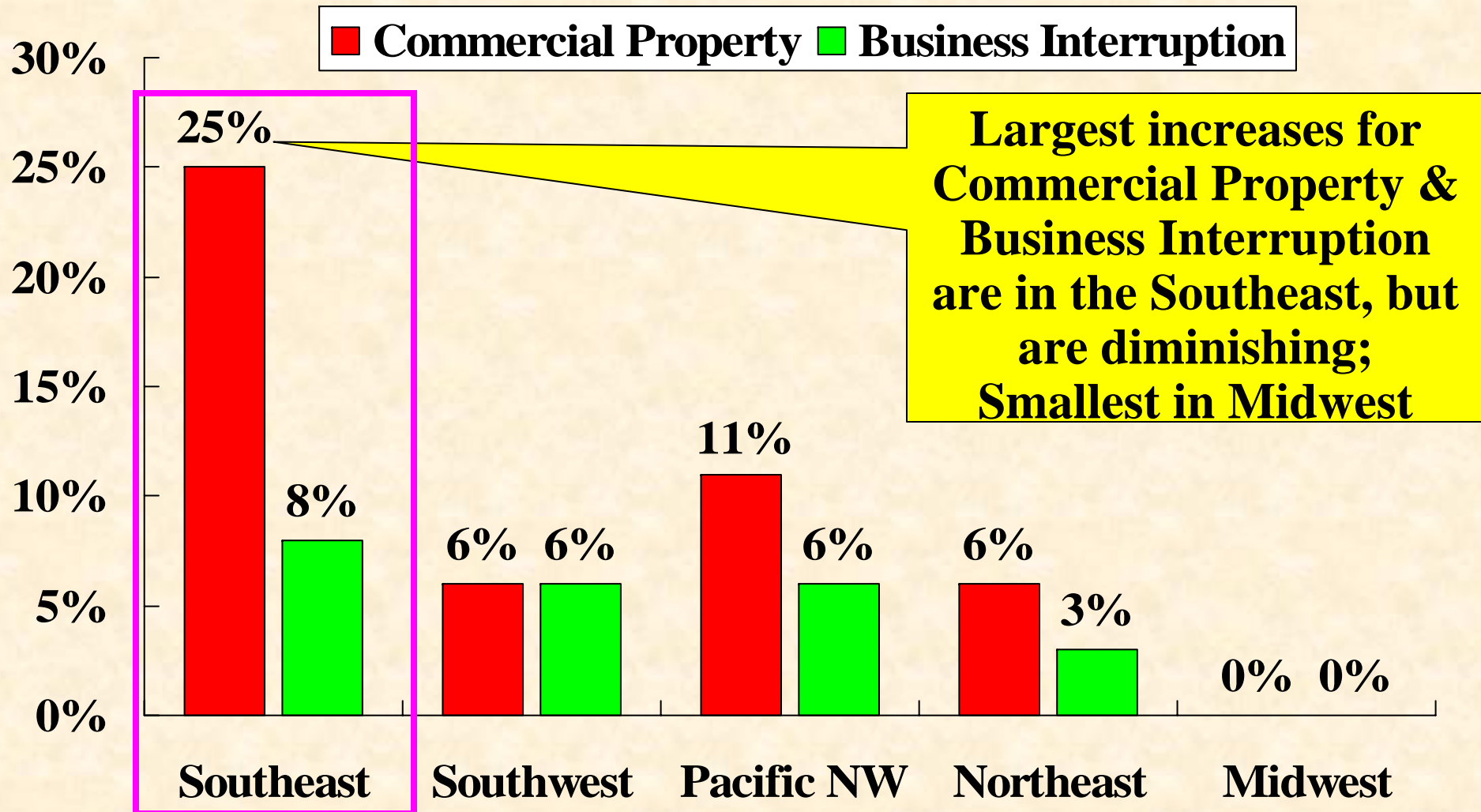


# Percent of Commercial Accounts Renewing with/Positive Rate Changes, 2<sup>nd</sup> Qtr. 2006



Source: Council of Insurance Agents and Brokers

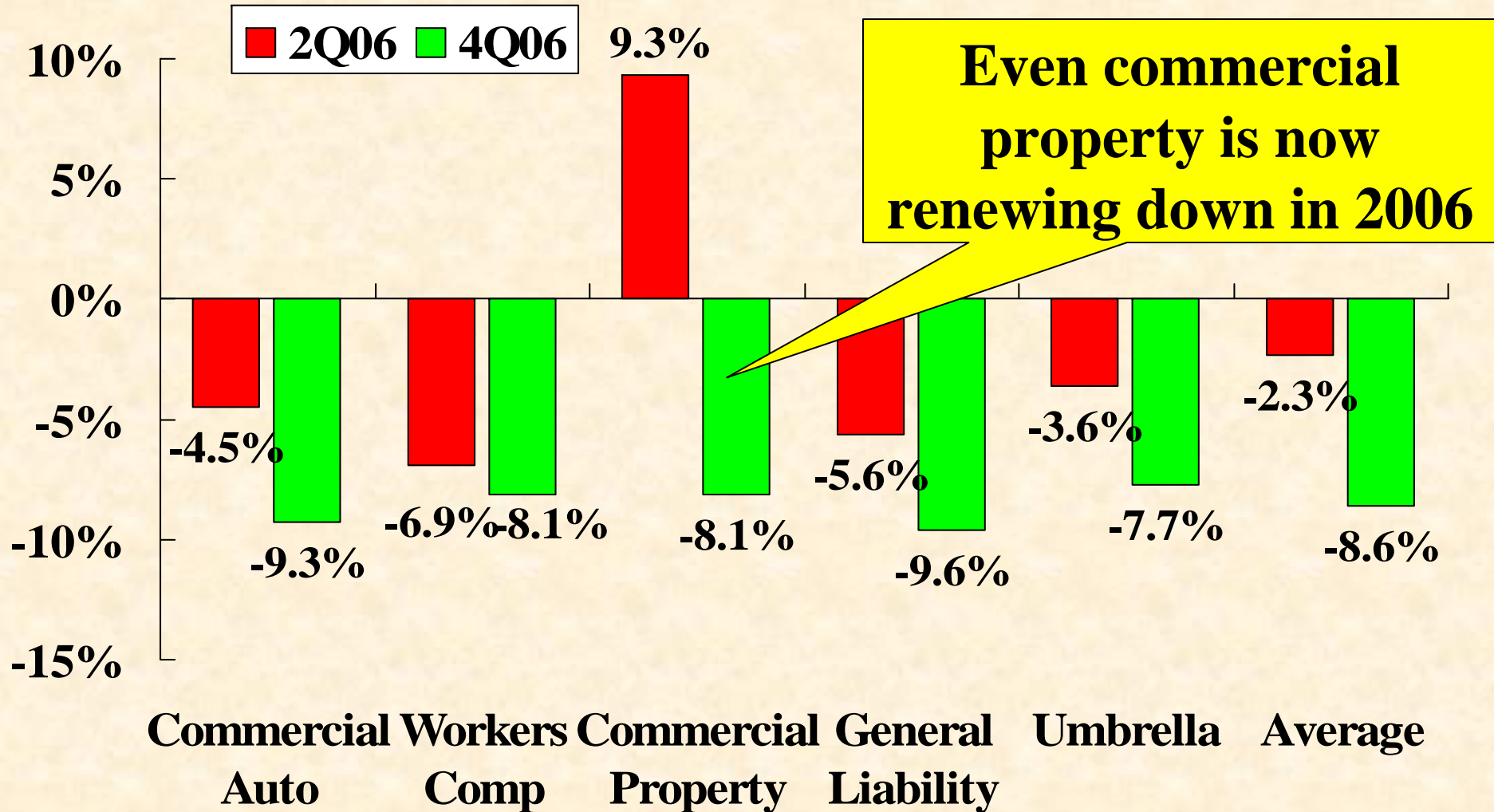
# Percent of Commercial Accounts Renewing w/Positive Rate Changes, 4<sup>th</sup> Qtr. 2006





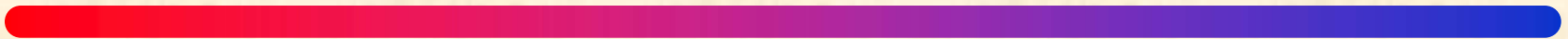
# Commercial Accounts Rate Changes,

2<sup>nd</sup> Qtr. 2006 vs. 4<sup>th</sup> Qtr. 2006



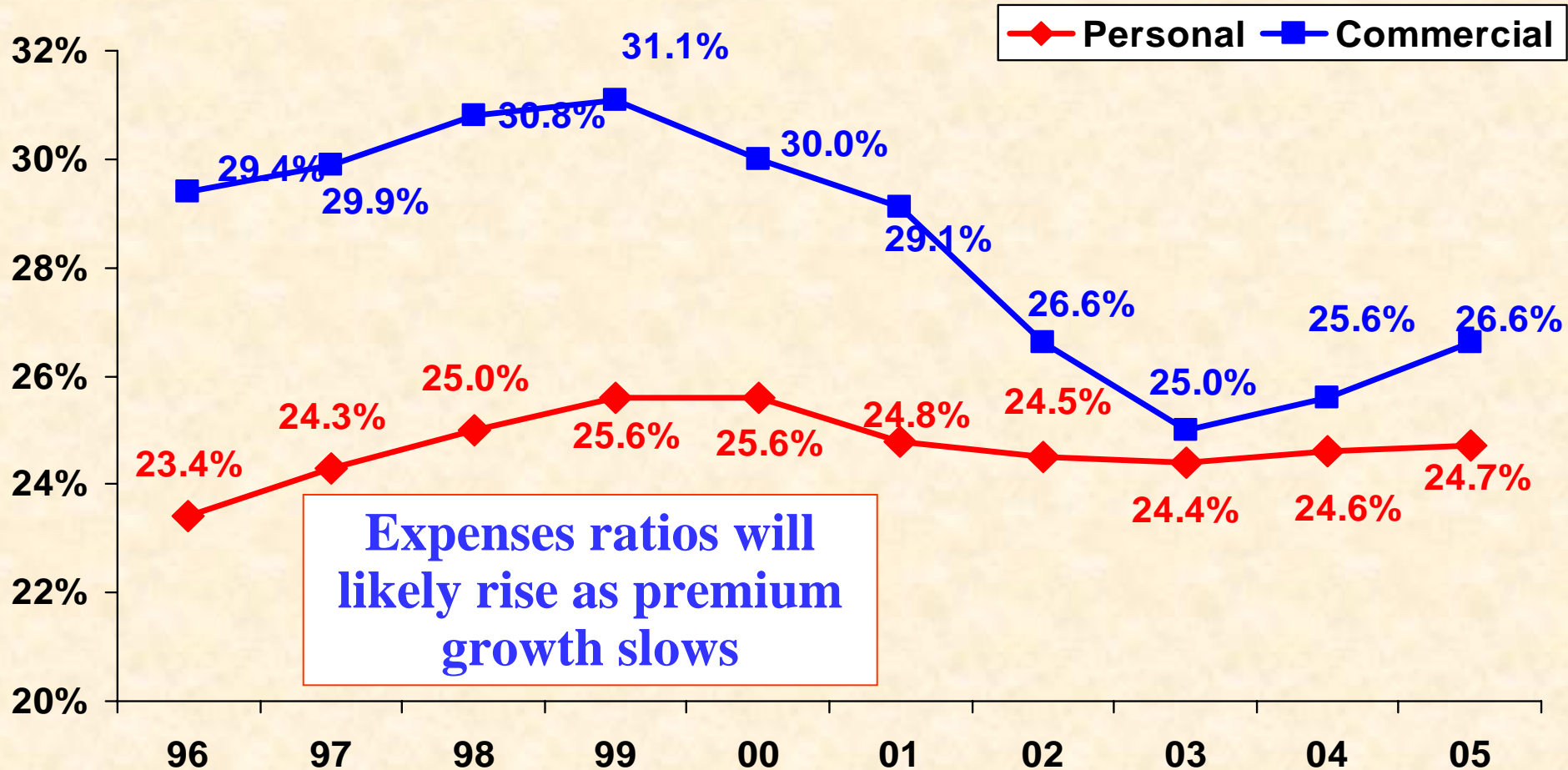
# EXPENSES

*Will Expense Ratio Rise as  
Premium Growth Slows?*





# Personal vs. Commercial Lines Underwriting Expense Ratio\*



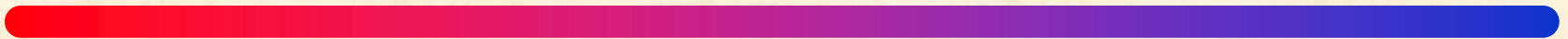
Expenses ratios will likely rise as premium growth slows

\*Ratio of expenses incurred to net premiums written.

Source: A.M. Best; Insurance Information Institute

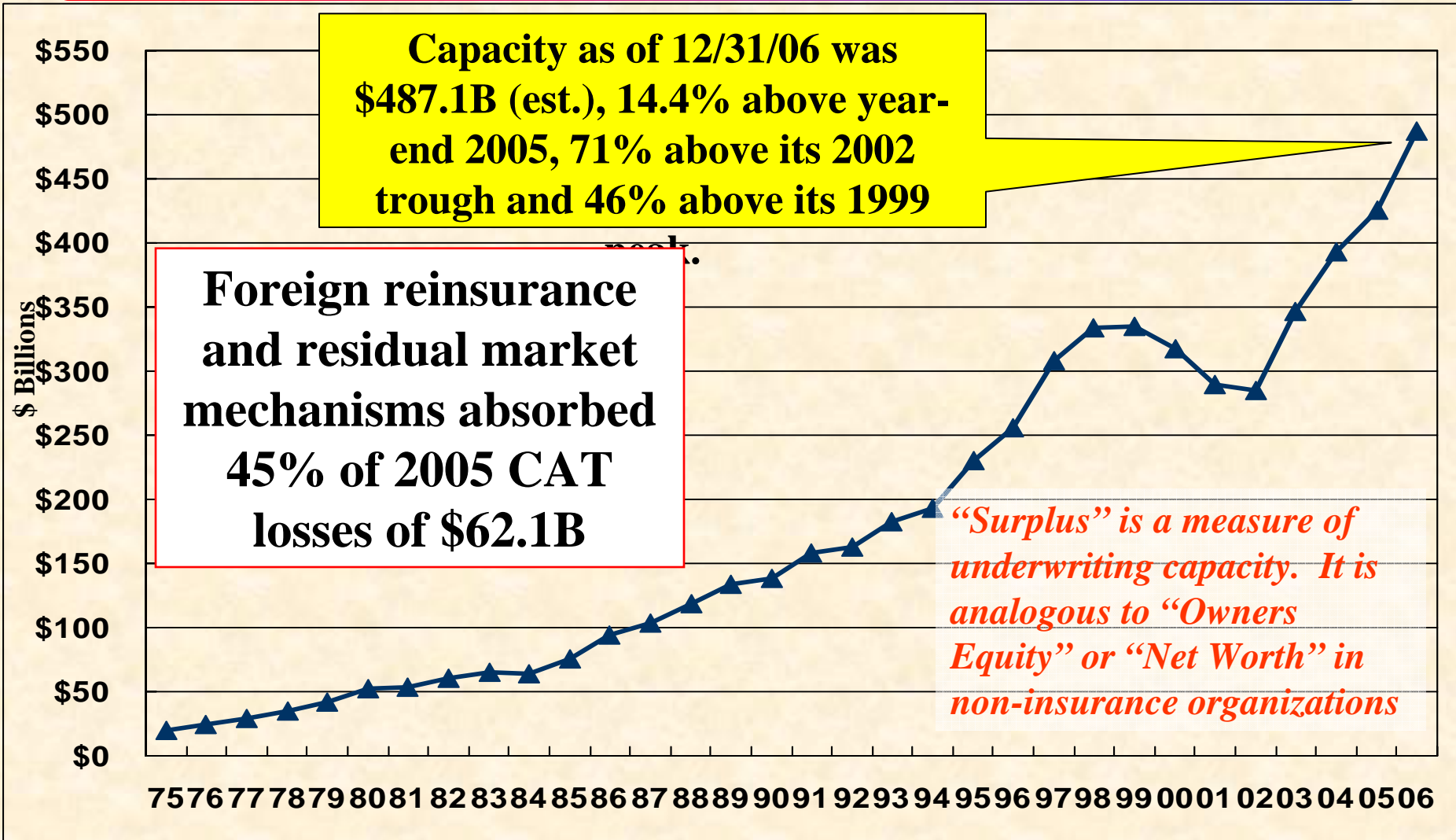
# CAPACITY/ SURPLUS

**Profits are Being  
Reinvested & Banked for  
Future Catastrophes**





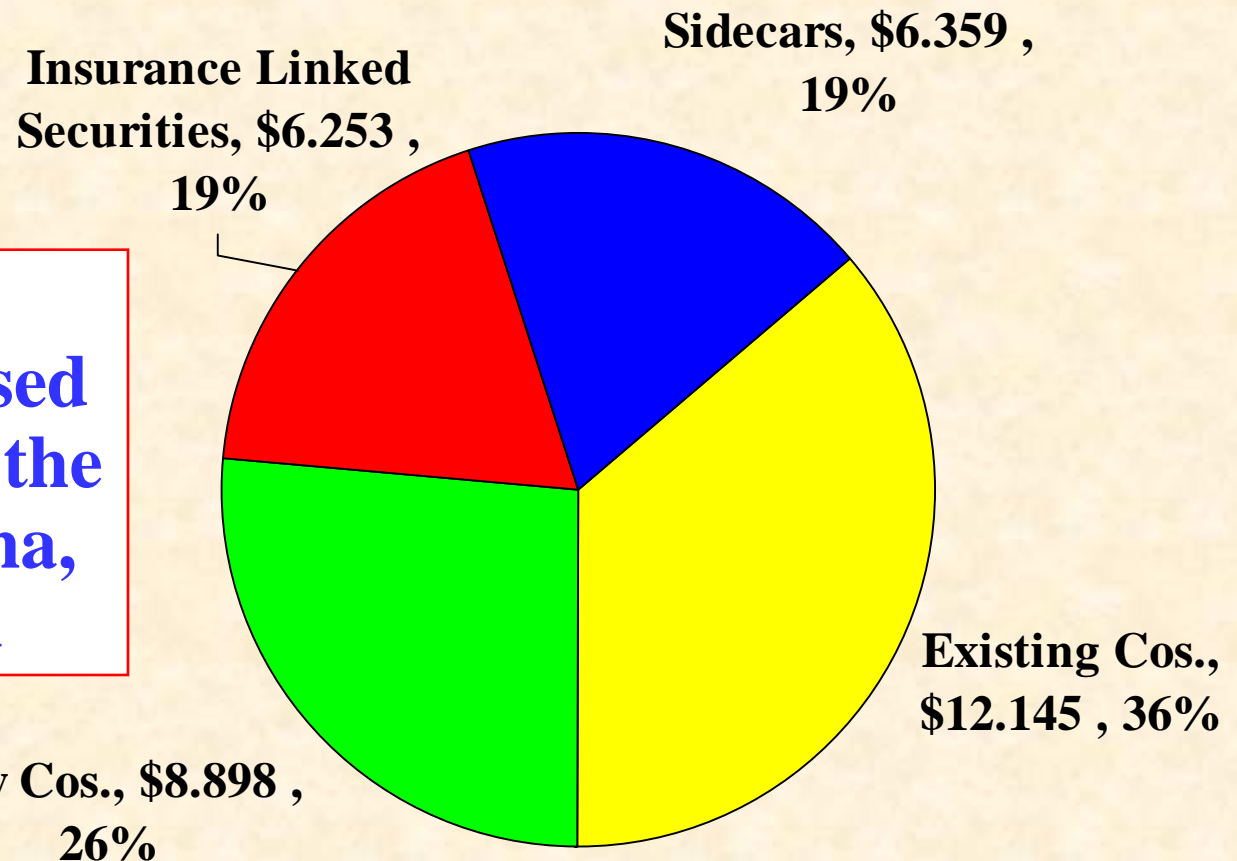
# U.S. Policyholder Surplus: 1975-2006





# Capital Raising by Class Within 15 Months of KRW

**\$ Billions**

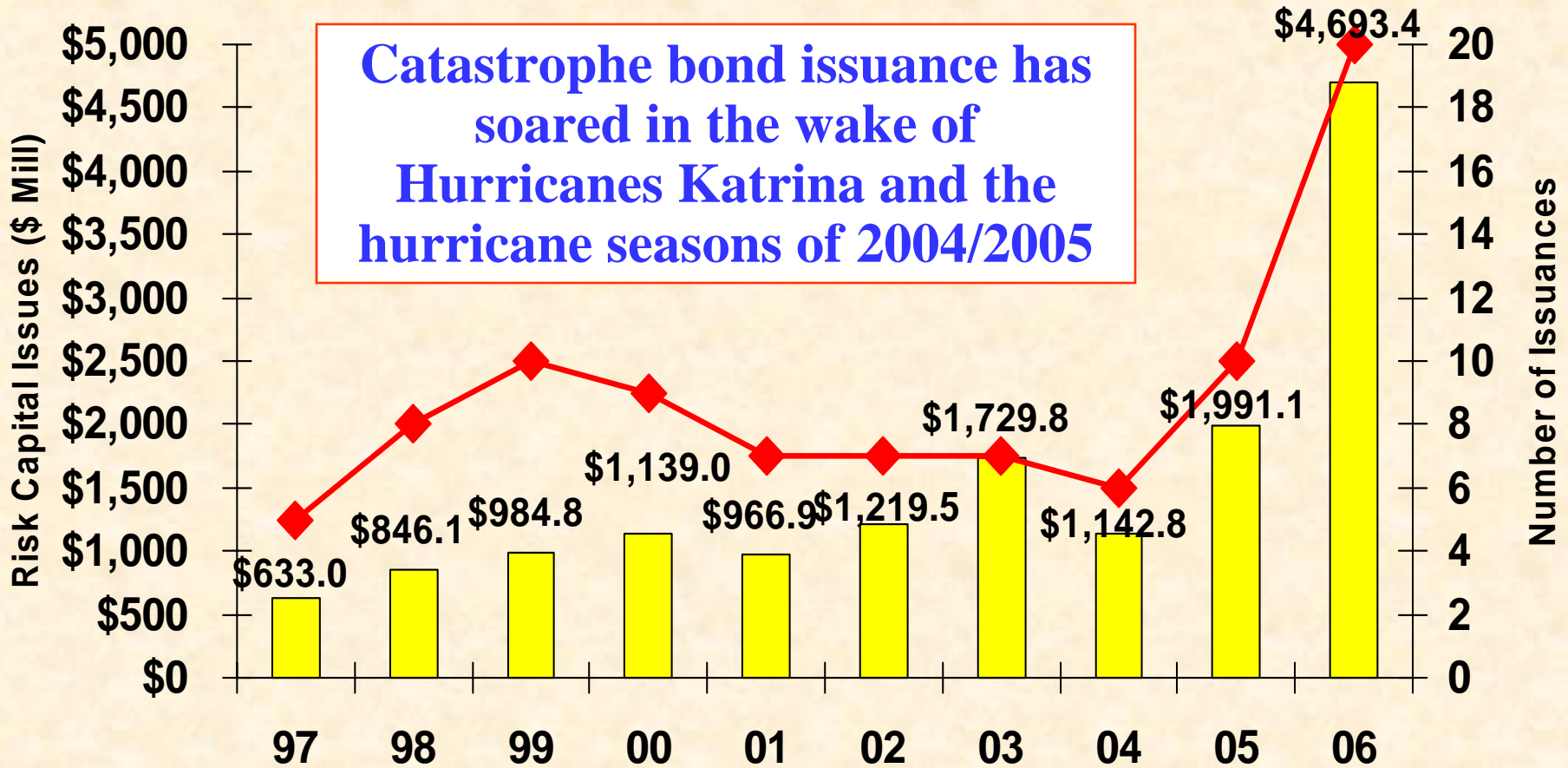


**Insurers &  
Reinsurers raised  
\$33.7 billion in the  
wake of Katrina,  
Rita, Wilma**



# Annual Catastrophe Bond Transactions Volume, 1997-2006

■ Risk Capital Issued ◆ Number of Issuances



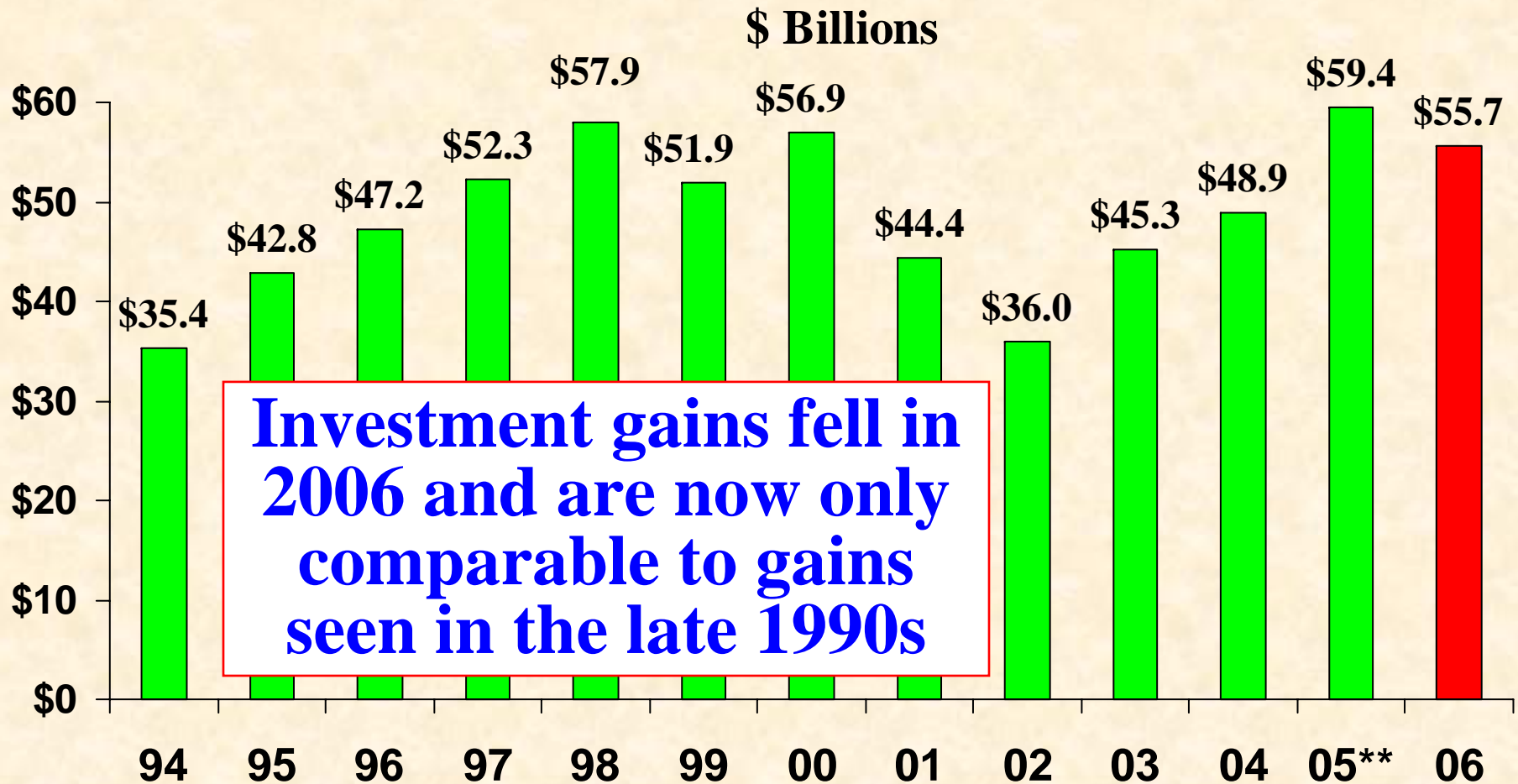
# INVESTMENT IRONY

*More Money Available  
to Invest, but Little to  
**iii** Show for It*

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# Property/Casualty Insurance Industry Investment Gain\*

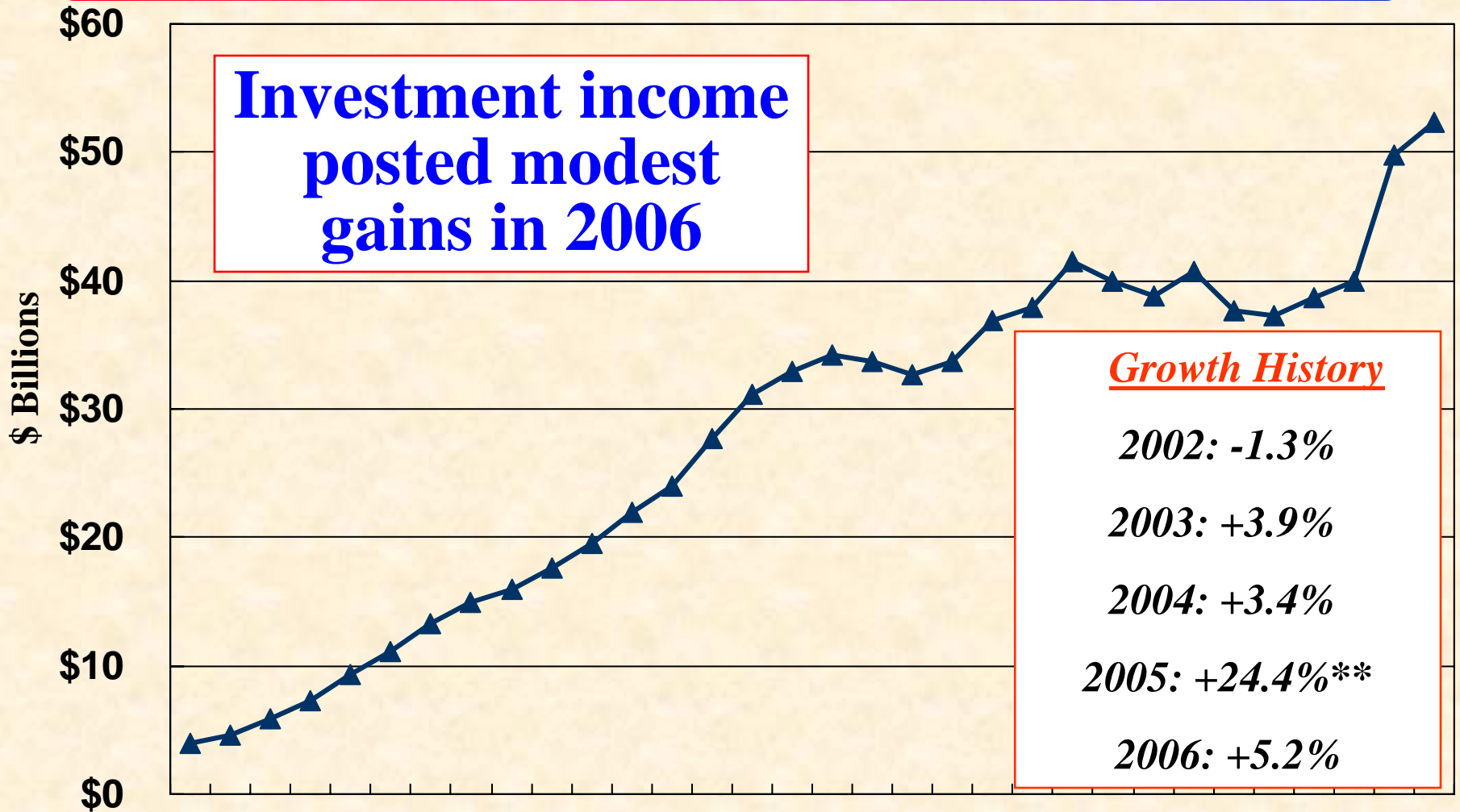


\*Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain.

\*\*2005 figure includes special one-time dividend of \$3.2B. Source: ISO; Insurance Information Institute.



# Net Investment Income



75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06

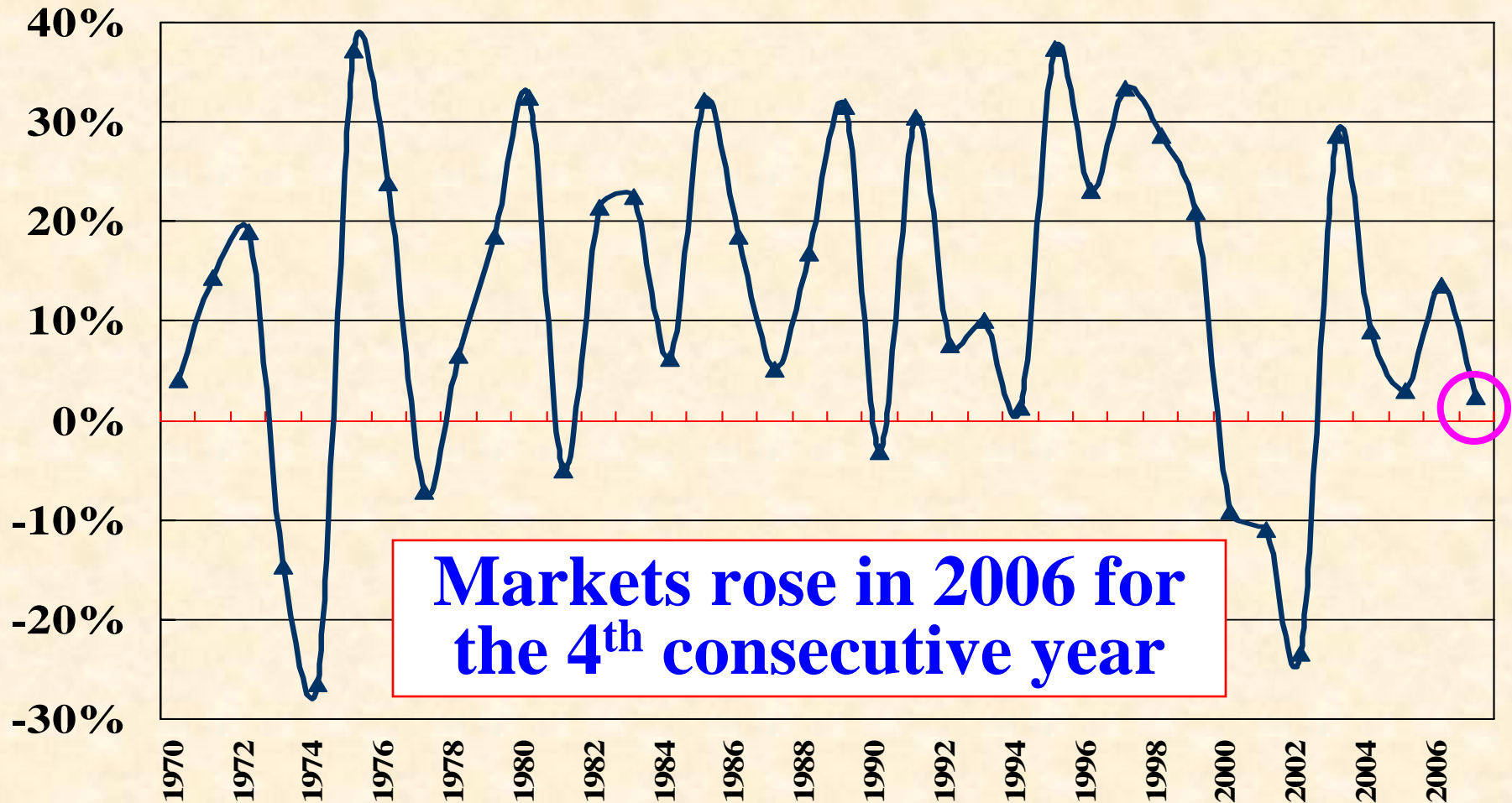
Source: A.M. Best, ISO, Insurance Information Institute;

\*\*Includes special dividend of \$3.2B. Increase is 15.7% excluding dividend.



# Total Returns for Large Company Stocks: 1970-2007\*

**S&P 500 was up 13.62% in 2006, Up 2.44% YTD 2007\***

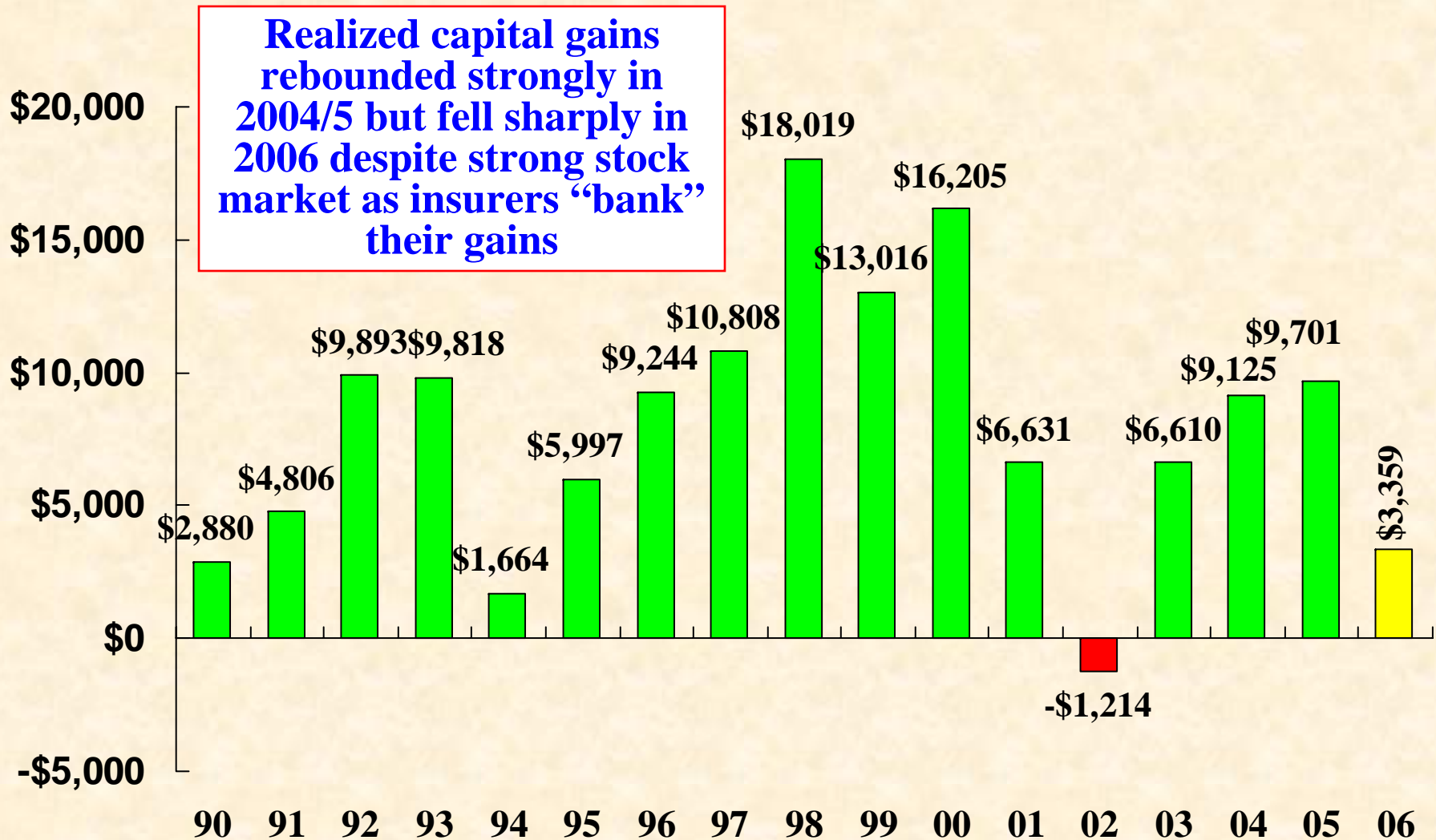


Source: Ibbotson Associates, Insurance Information Institute.

\*Through April 13, 2007.

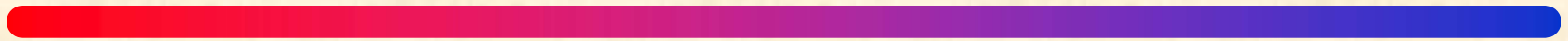


# US P/C Net Realized Capital Gains, 1990-2006 (\$ Millions)



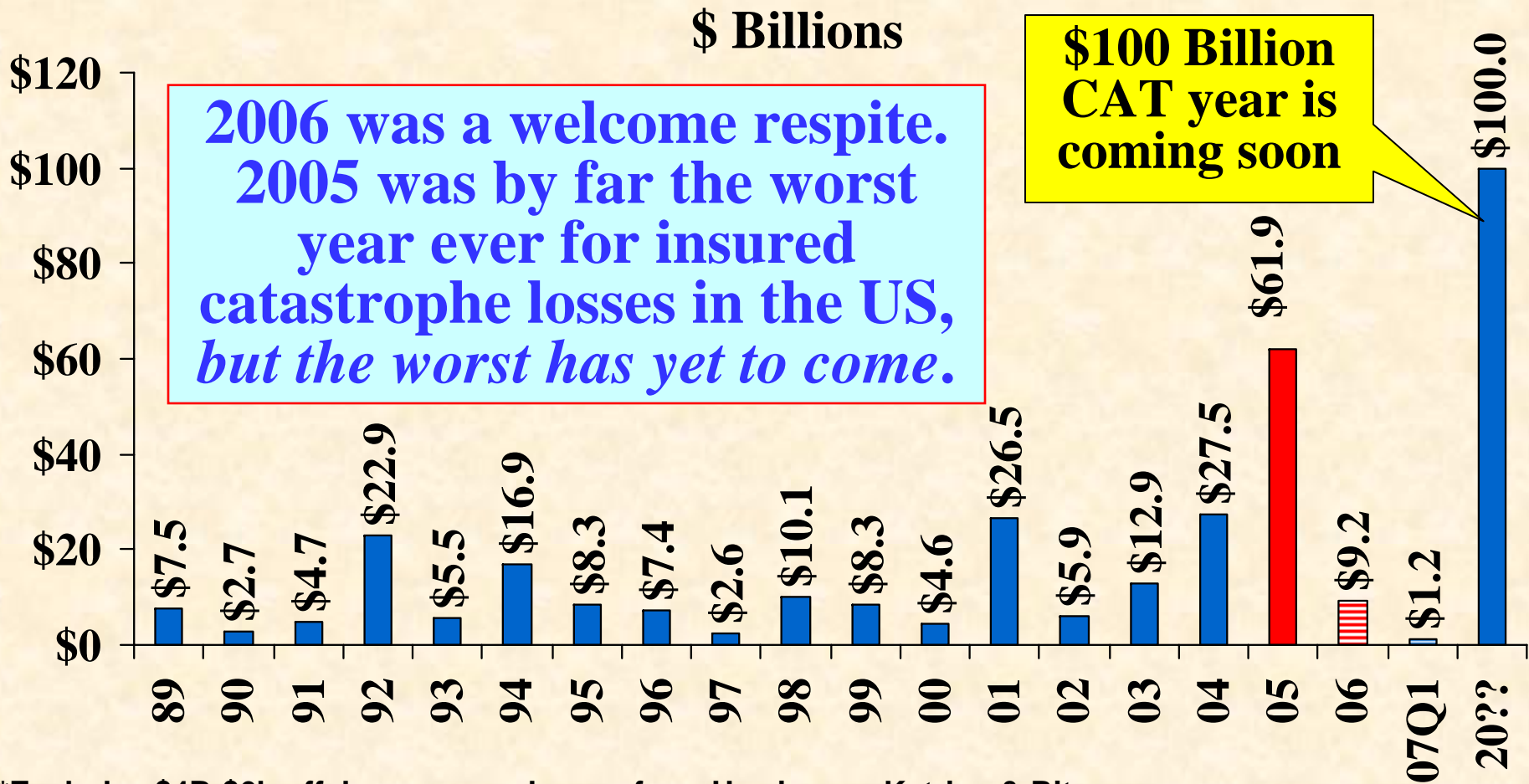
# CATASTROPHIC LOSS

**Insurers Accused of  
Crying Wolf Over Cats,  
But Worst is Yet to Come**





# U.S. Insured Catastrophe Losses\*



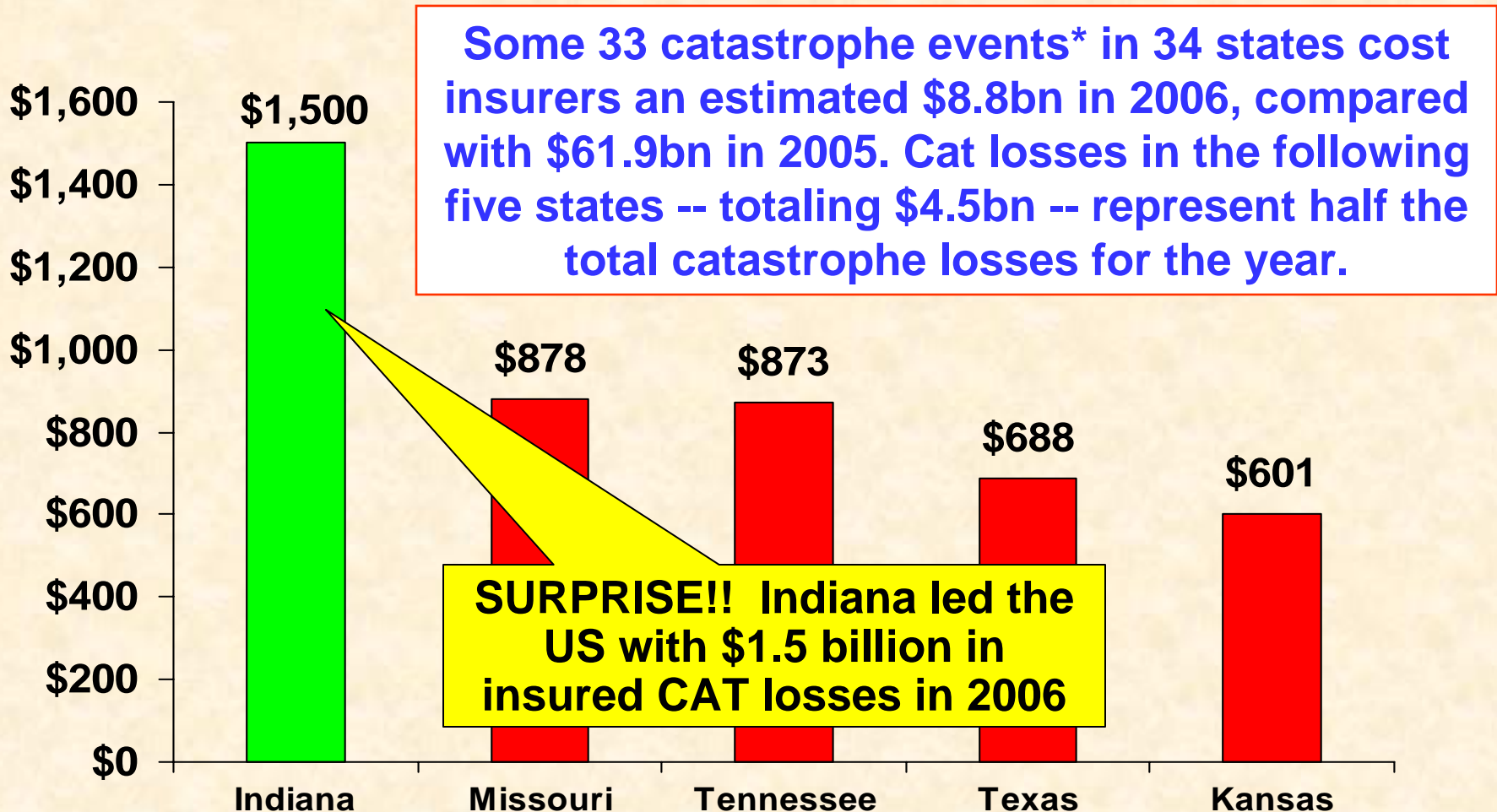
\*Excludes \$4B-\$6b offshore energy losses from Hurricanes Katrina & Rita.

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

Source: Property Claims Service/ISO; Insurance Information Institute



# *U.S. Catastrophe Losses 2006: States With Largest Losses (\$ Millions)*



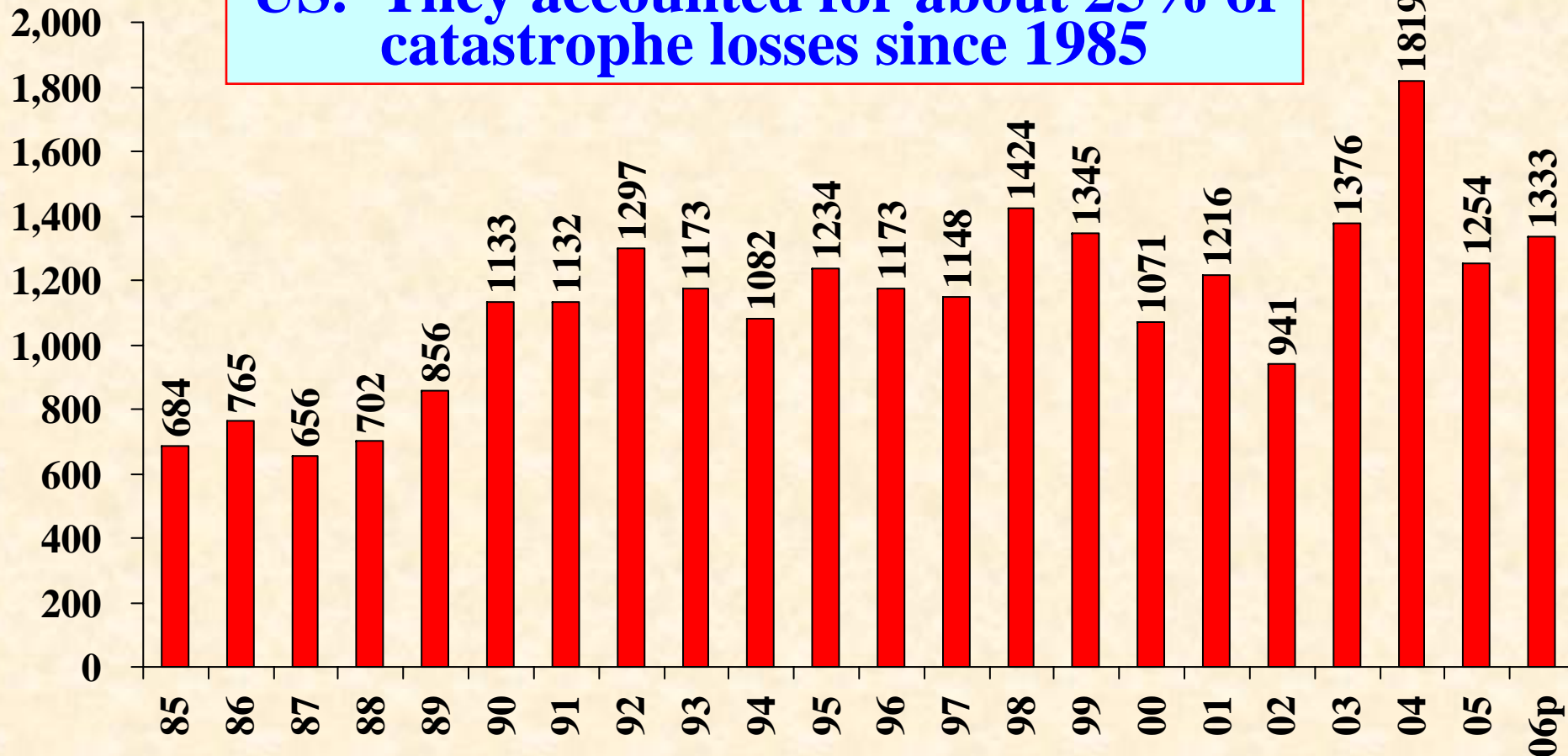
\*ISO defines a catastrophe event as an event causing \$25 million or more in insured property losses.

Source: ISO; Insurance Information Institute



# *Number of Tornadoes, 1985 – 2006p*

**There are usually more than 1,000 confirmed tornadoes each year in the US. They accounted for about 25% of catastrophe losses since 1985**

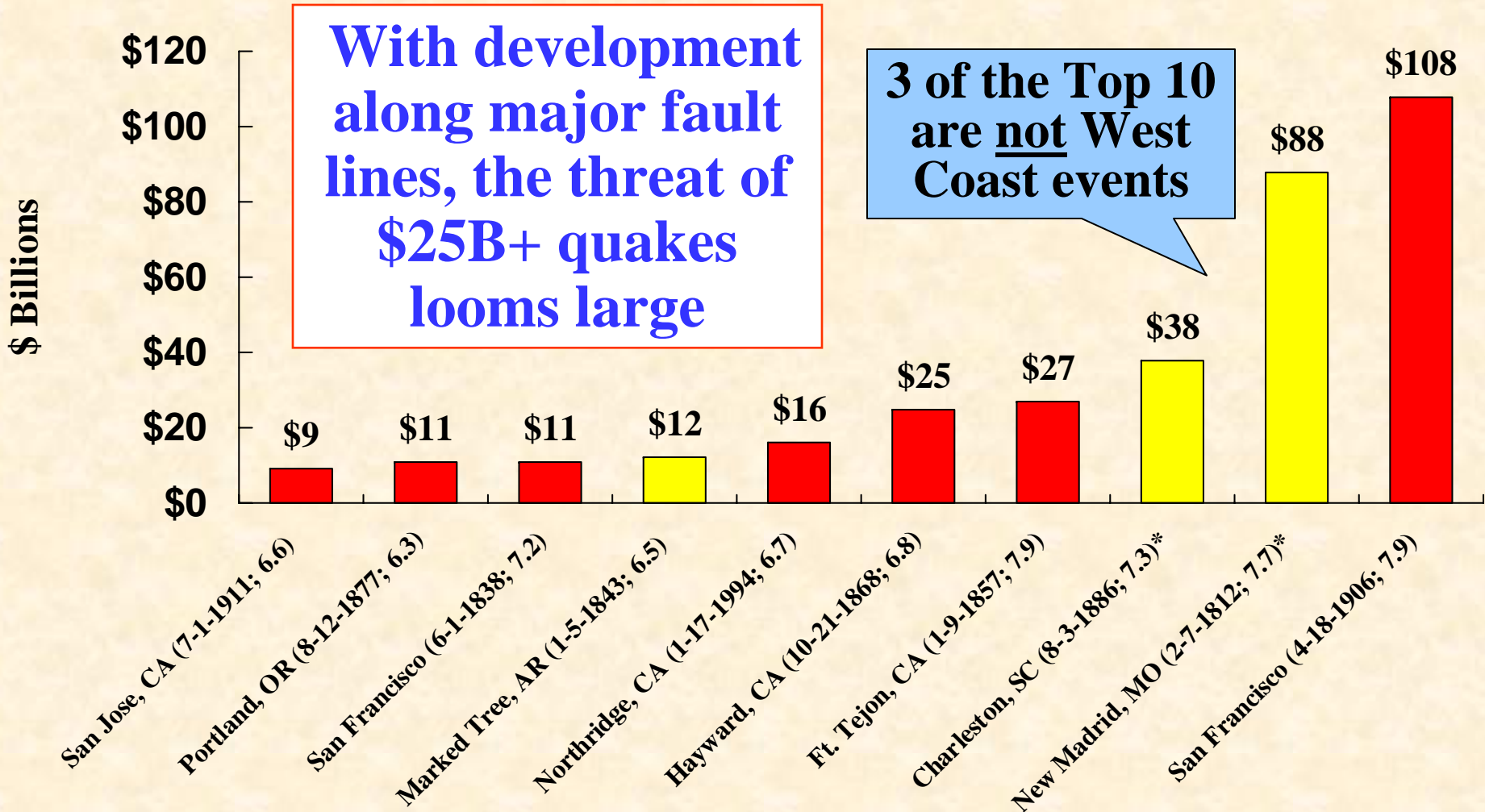


Source: US Dept. of Commerce, Storm Prediction Center, National Weather Service; Ins. Info. Inst.



# Insured Losses from Top 10 Earthquakes Adjusted to 2005 Exposure Levels

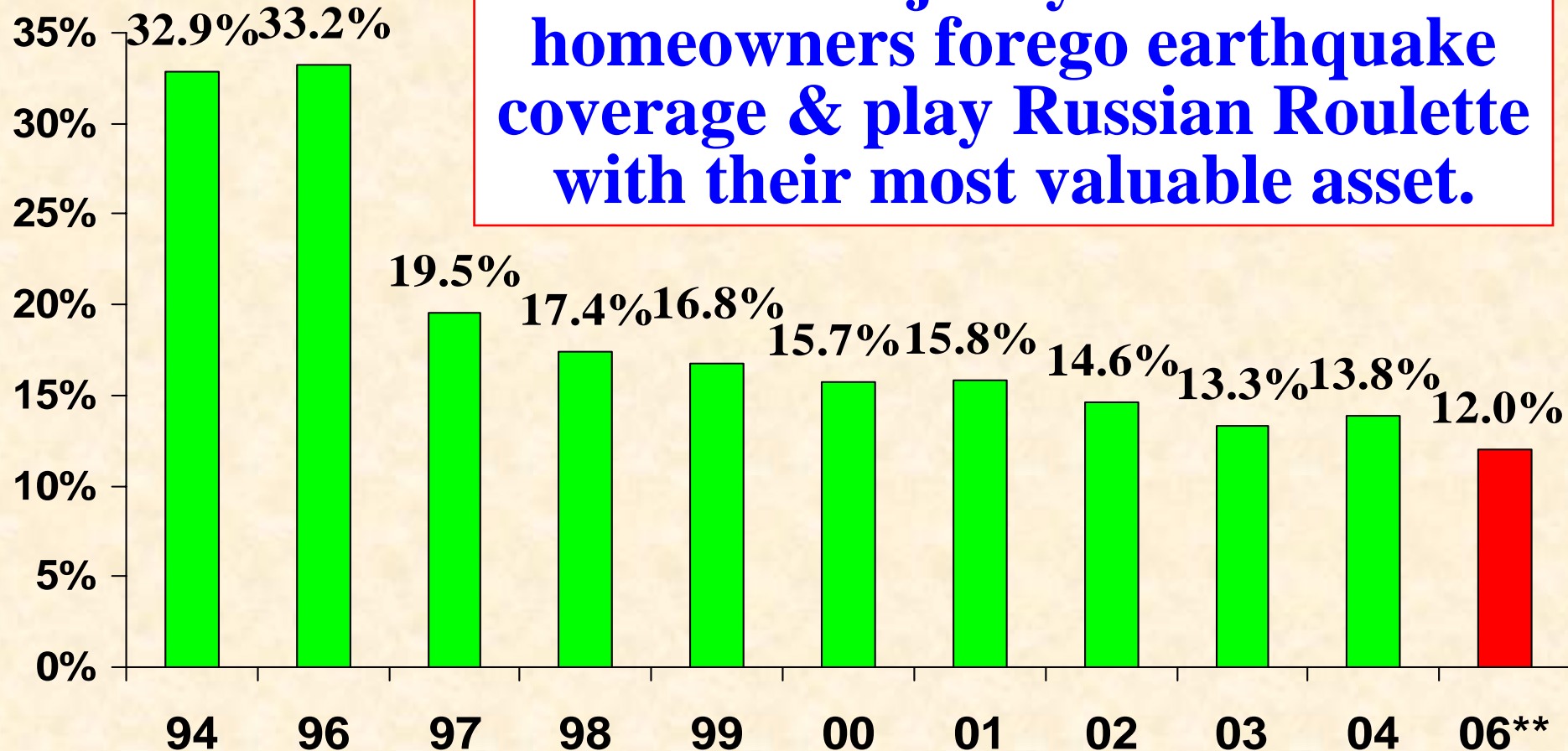
(Billions of 2005 Dollars)





# Percentage of California Homeowners with Earthquake Insurance, 1994-2004\*

**The vast majority of California homeowners forego earthquake coverage & play Russian Roulette with their most valuable asset.**

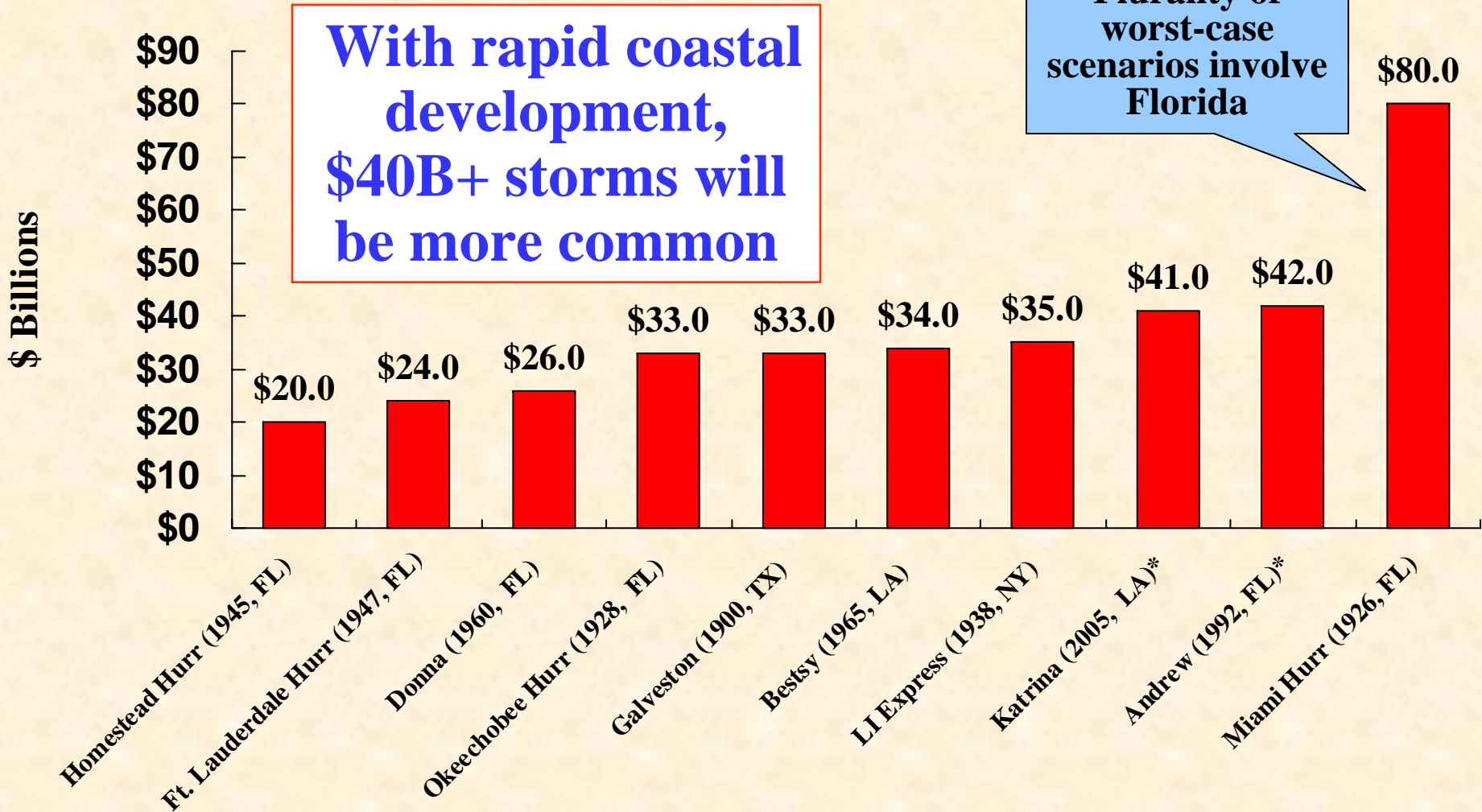


\*Includes CEA policies beginning in 1996. \*\*2006 estimate from Insurance Information Network of CA.  
Source: California Department of Insurance; Insurance Information Institute.

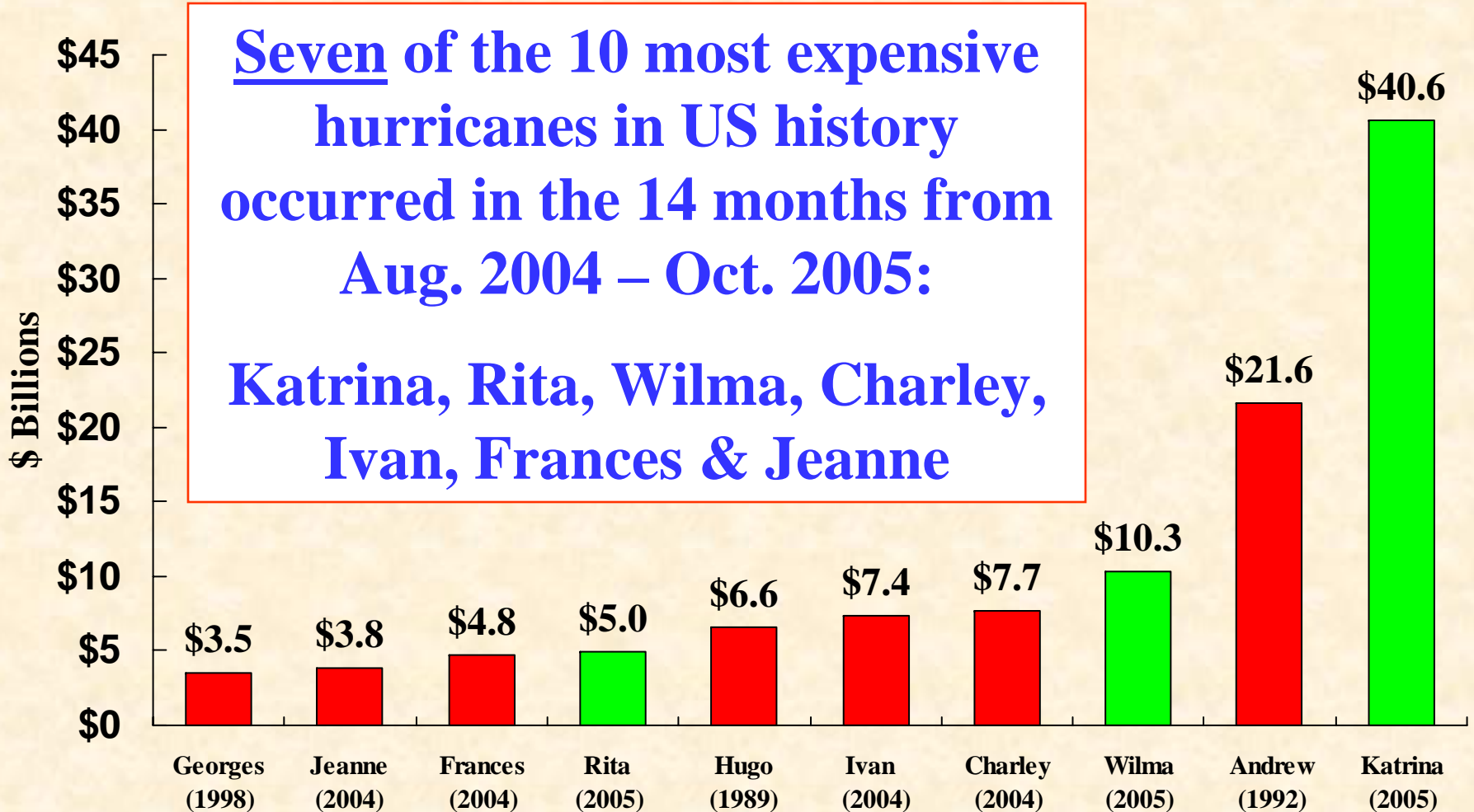


# Insured Losses from Top 10 Hurricanes Adjusted to 2005 Exposure Levels

(Billions of 2005 Dollars)

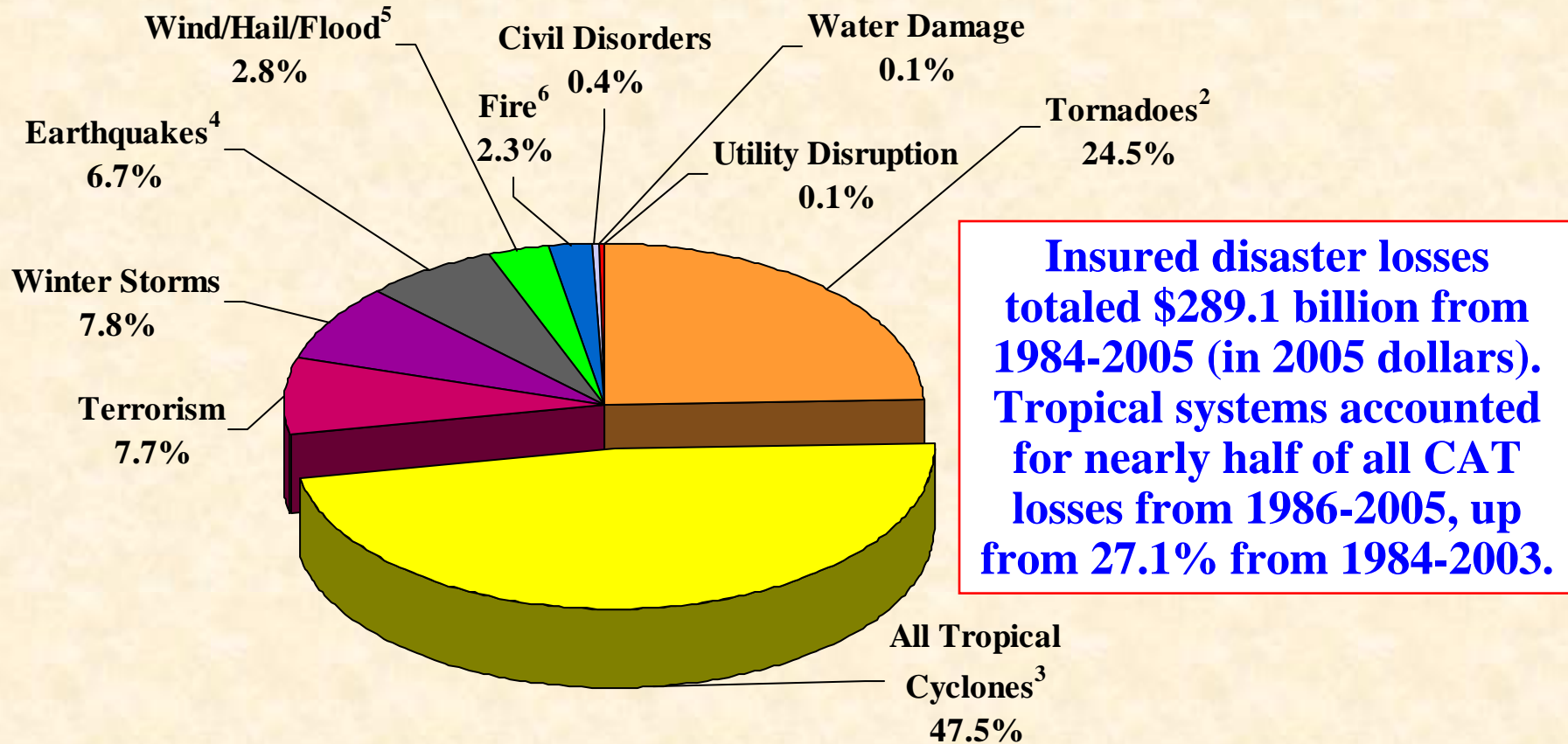


**Figure 2.** *Top 10 Most Costly Hurricanes in US History, (Insured Losses, \$2005)*





# *Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1986-2005<sup>1</sup>*



<sup>1</sup> Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2005 dollars. Catastrophe threshold changed from \$5 million to \$25 million beginning in 1997. Adjusted for inflation by the III.

<sup>2</sup> Excludes snow. <sup>3</sup> Includes hurricanes and tropical storms. <sup>4</sup> Includes other geologic events such as volcanic eruptions and other earth movement. <sup>5</sup> Does not include flood damage covered by the federally administered National Flood Insurance Program. <sup>6</sup> Includes wildland fires.



# Total Value of Insured Coastal Exposure (2004, \$ Billions)

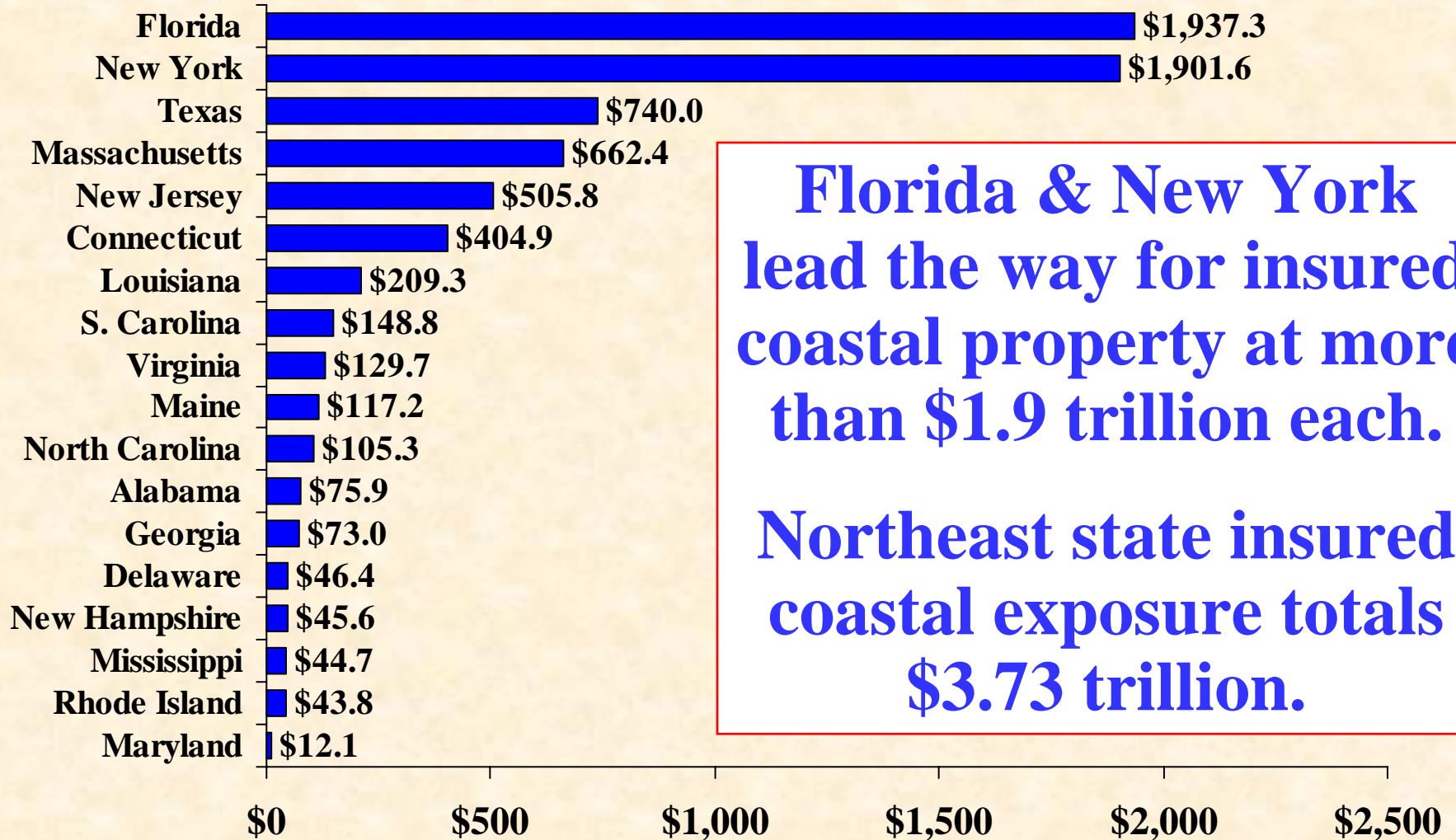


Figure 14.



# *New Condo Construction in South Miami Beach, 2007-2009*

- **Number of New Developments: 15**
- **Number of Individual Units: 2,111**
- **Avg. Price of Cheapest Unit: \$940,333**
- **Avg. Price of Most Expensive Unit: \$6,460,000**
- **Range: \$395,000 - \$16,000,000**
- **Overall Average Price per Unit: \$3,700,167\***
- **Aggregate Property Value: At least \$6 Billion**

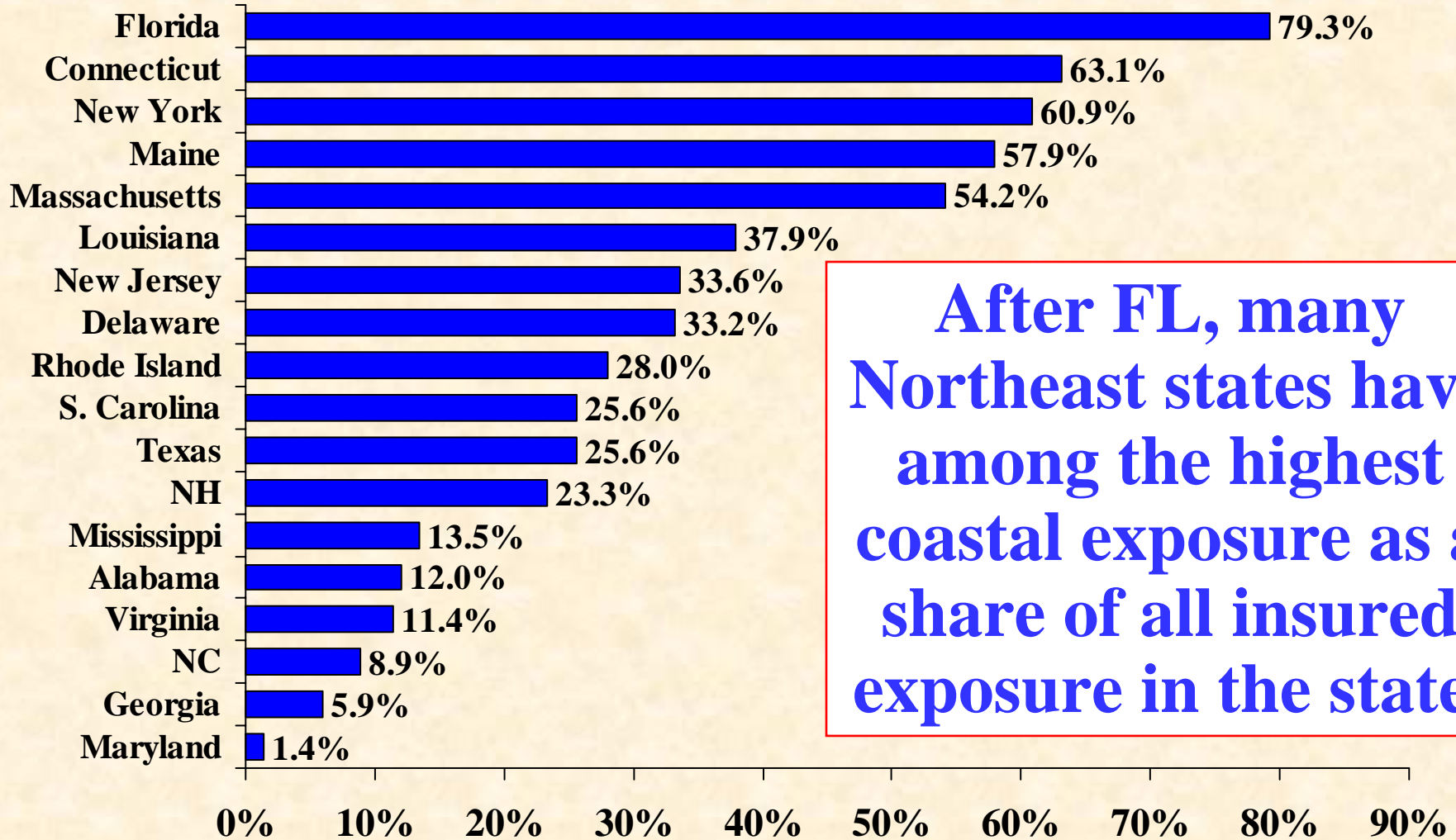


\*Based on average of high/low value for each of the 15 developments

Source: Insurance Information Institute from [www.miamicondolifestyle.com](http://www.miamicondolifestyle.com) accessed April 5, 2007.



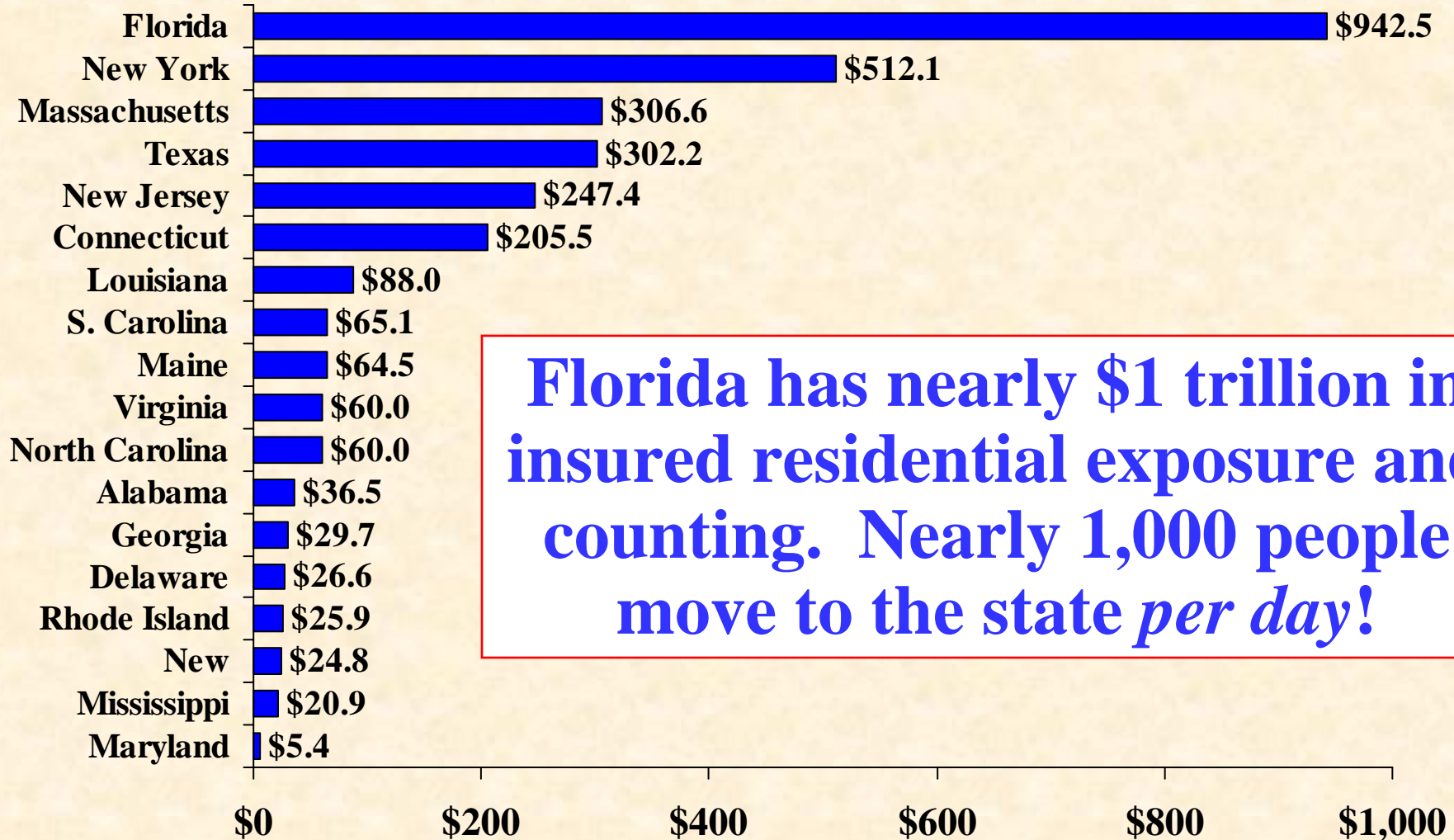
# *Insured Coastal Exposure as a % of Statewide Insured Exposure (2004, \$ Billions)*



**After FL, many  
Northeast states have  
among the highest  
coastal exposure as a  
share of all insured  
exposure in the state.**



# Value of Insured Residential Coastal Exposure (2004, \$ Billions)



**Florida has nearly \$1 trillion in insured residential exposure and counting. Nearly 1,000 people move to the state *per day!***



# *Value of Insured Commercial Coastal Exposure (2004, \$ Billions)*

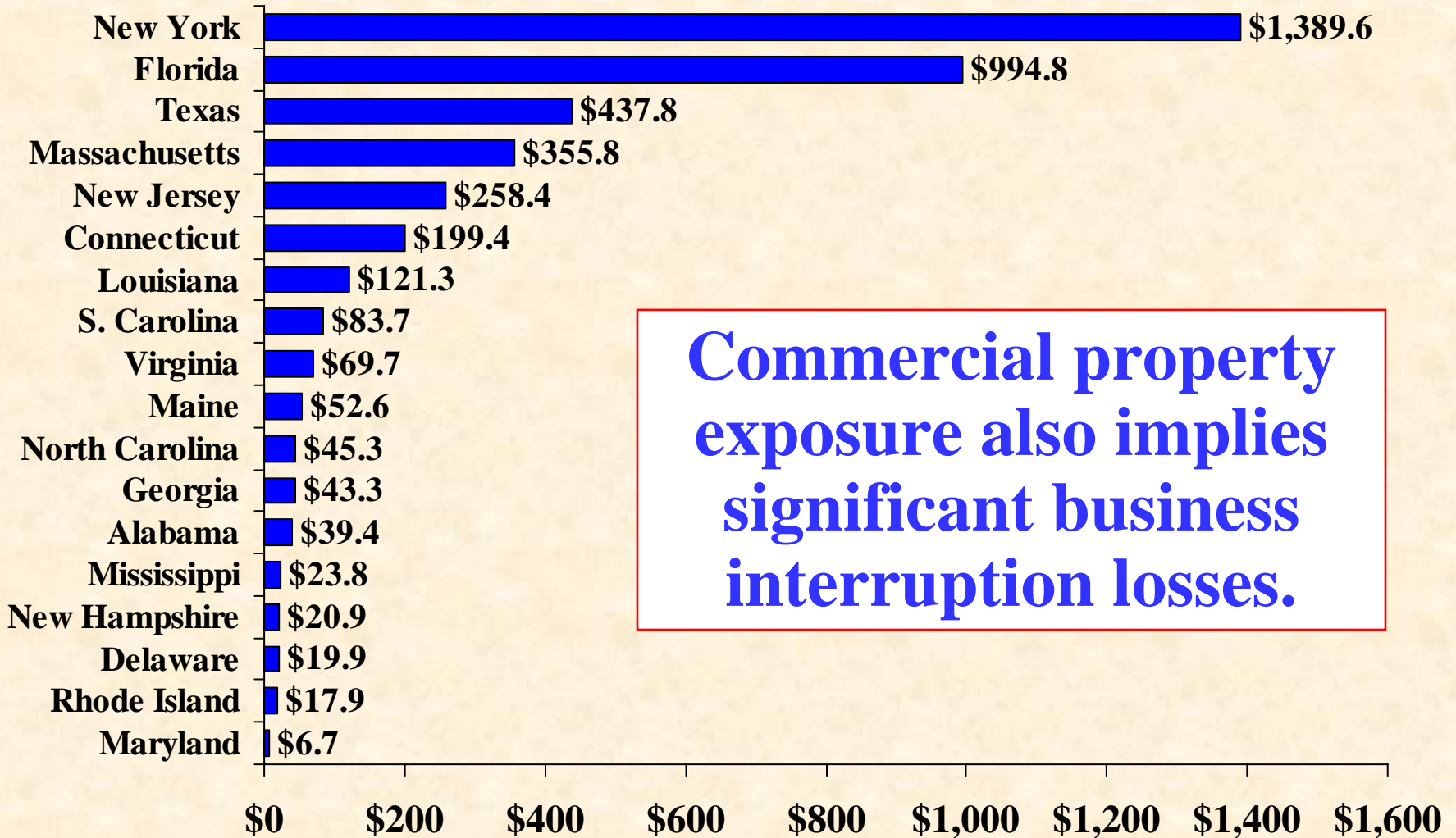


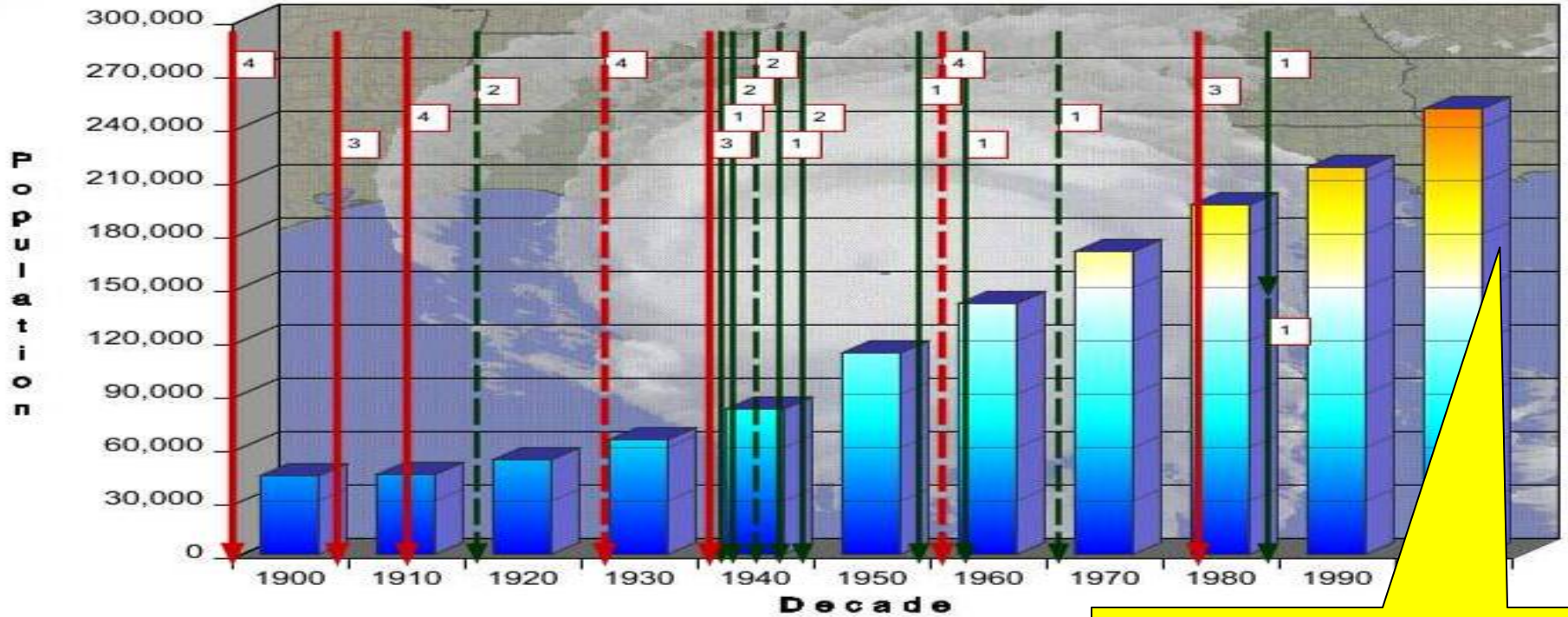
Figure 7.



# Historical Hurricane Strikes in Galveston County, TX, 1900-2002



## Galveston, TX



**Population of Galveston County is 5 times what it was when the hurricane of 1900 struck, killing 8,000**

Figure 8.



# Historical Hurricane Strikes in Suffolk County, NY, 1900-2002

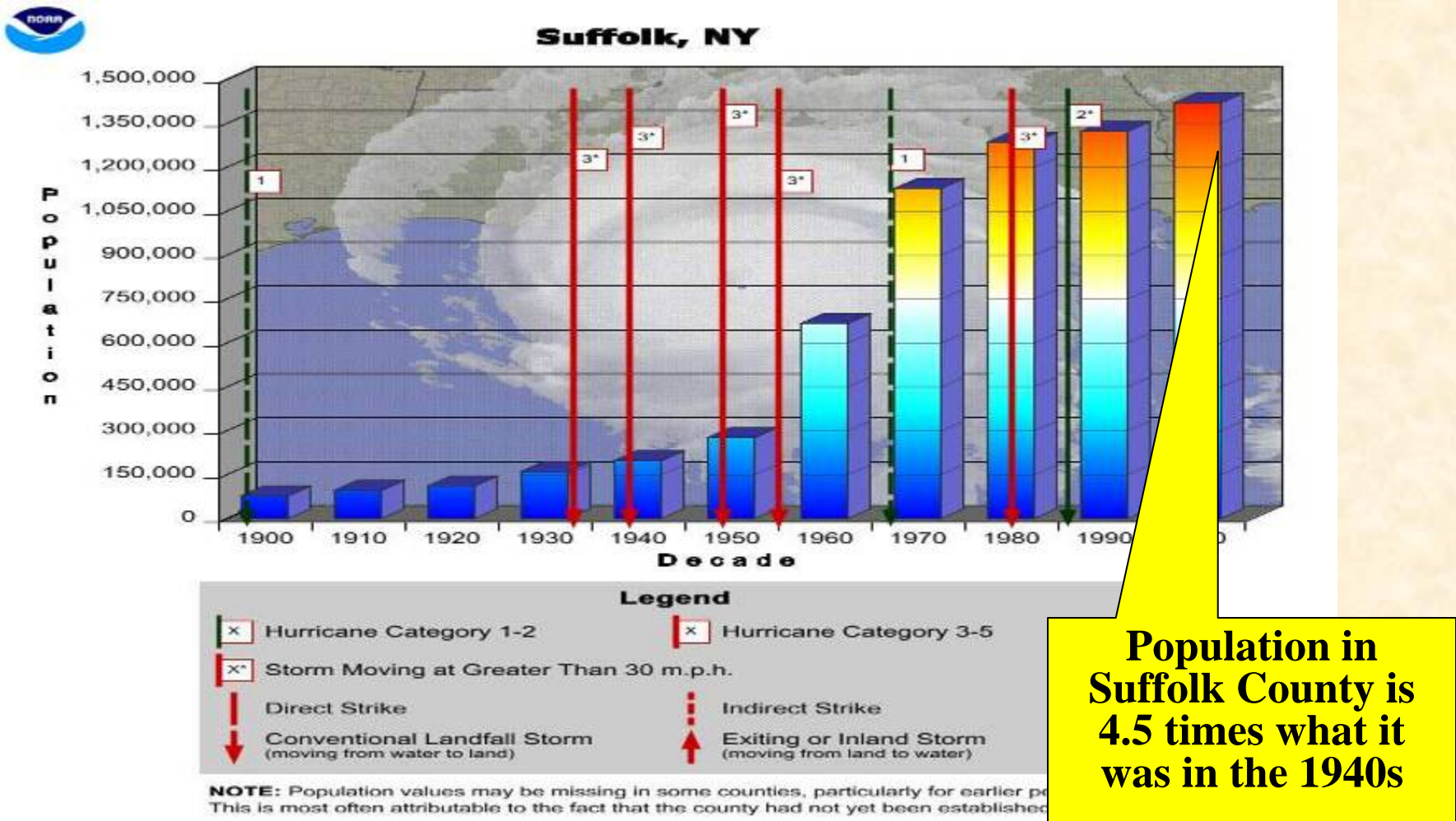


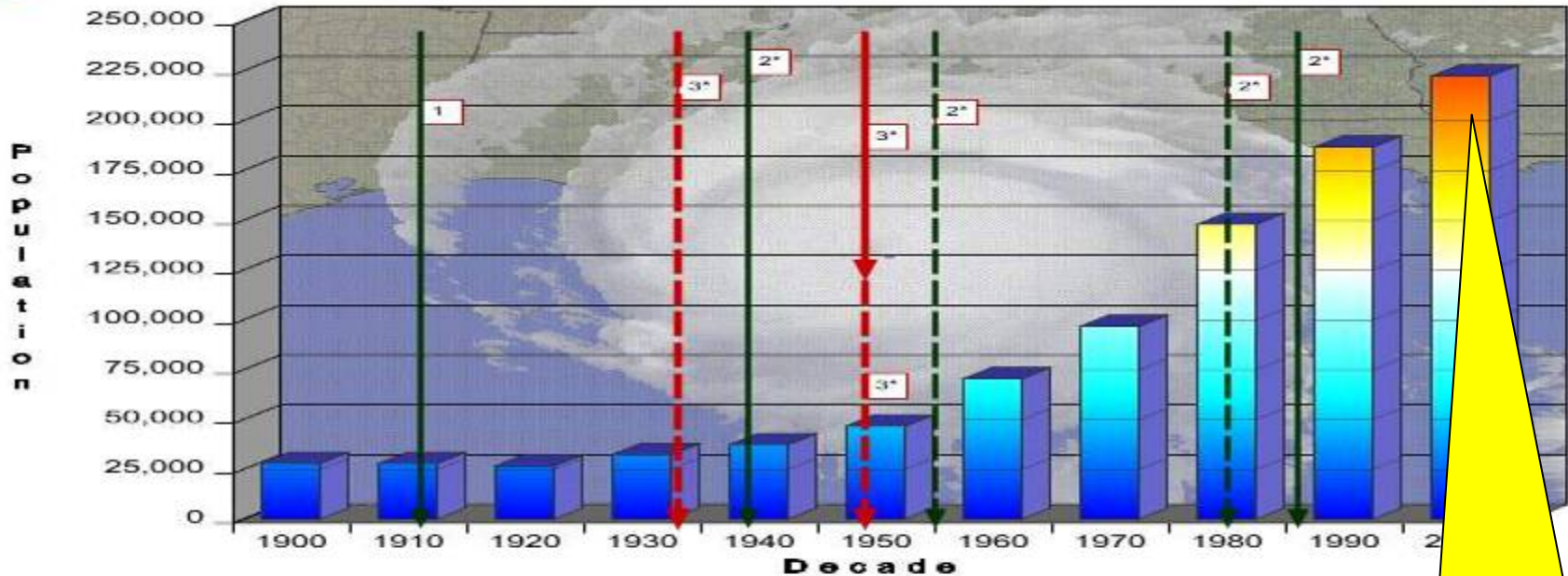
Figure 9.



# Historical Hurricane Strikes in Barnstable County, MA, 1900-2002



## Barnstable, MA



**Legend**

Hurricane Category 1-2	Hurricane Category 3*
Storm Moving at Greater Than 30 m.p.h.	Direct Strike
Conventional Landfall Storm (moving from water to land)	Exiting or Inland Storm (moving from land to water)

**NOTE:** Population values may be missing in some counties, particularly for earlier periods. This is most often attributable to the fact that the county had not yet been established.

**Population in Barnstable County (Cape Cod) is 5 times what it was in the 1950s**

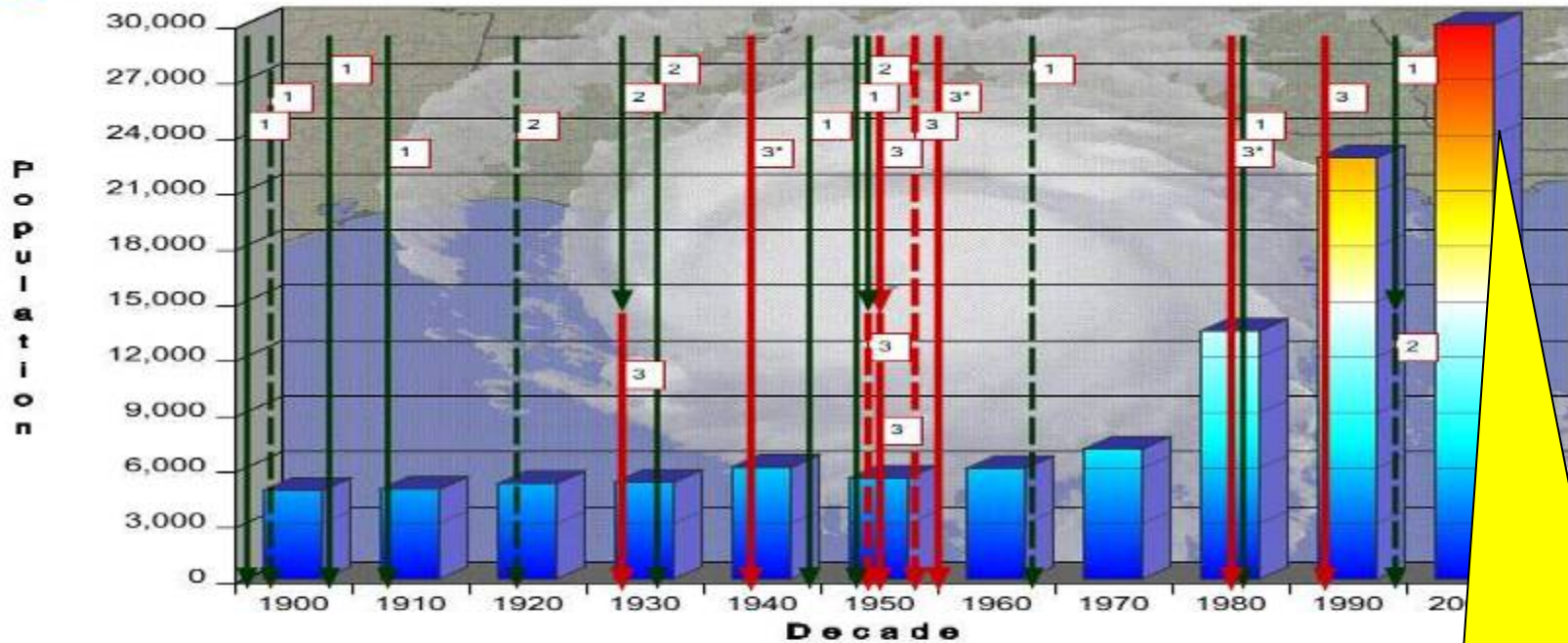
Figure 10.



# Historical Hurricane Strikes in Dare County, NC, 1900-2002



## Dare, NC



### Legend

- x Hurricane Category 1-2
- x\* Storm Moving at Greater Than 30 m.p.h.
- ↓ Direct Strike
- ↓ Conventional Landfall Storm (moving from water to land)
- x Hurricane Category 3
- ↑ Indirect Strike
- ↑ Exiting or Inland Storm (moving from land to water)

**Population in Dare County is 6 times what it was in the 1950s**

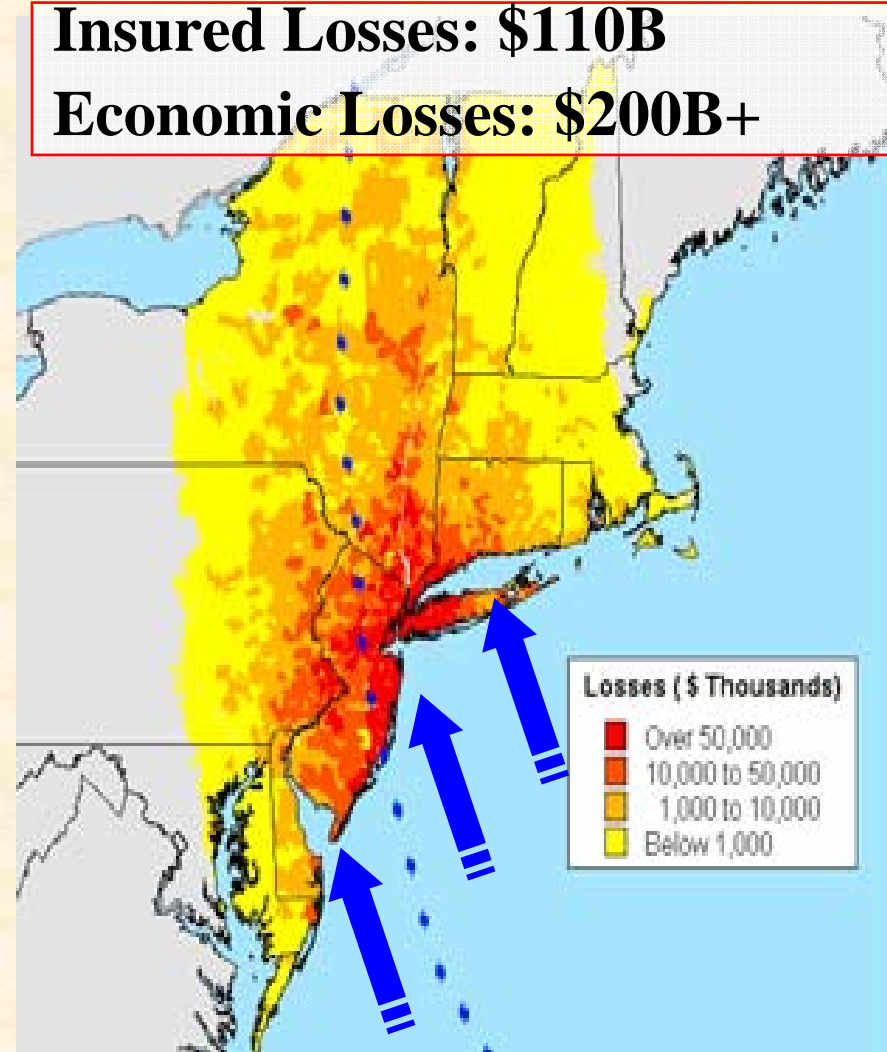
**NOTE:** Population values may be missing in some counties, particularly for earlier periods. This is most often attributable to the fact that the county had not yet been established.



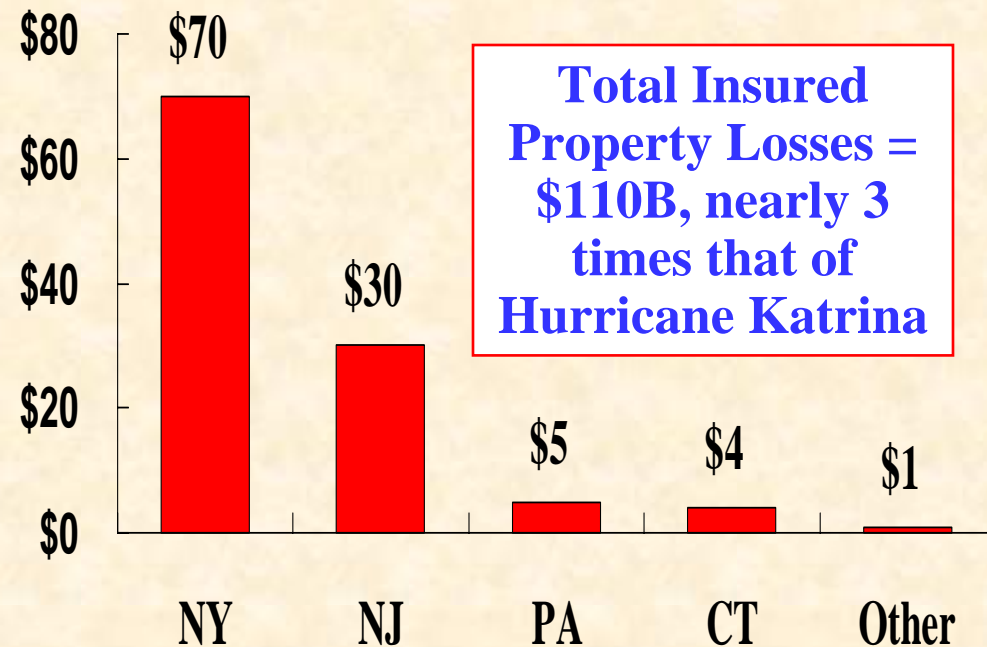
# Nightmare Scenario: Insured Property Losses for NJ/NY CAT 3/4 Storm

**Insured Losses: \$110B**

**Economic Losses: \$200B+**

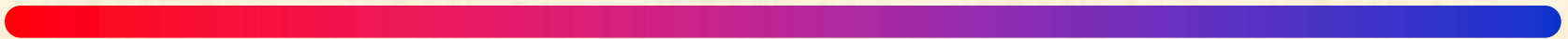


**Distribution of Insured Property Losses, by State, (\$ Billions)**



# The 2007 Hurricane Season:

*Preview to Disaster?*





# *Outlook for 2007 Hurricane*

## *Season: 85% Worse Than Average*

	Average*	2005	2007F
Named Storms	9.6	28	17
Named Storm Days	49.1	115.5	85
Hurricanes	5.9	14	9
Hurricane Days	24.5	47.5	40
Intense Hurricanes	2.3	7	5
Intense Hurricane Days	5	7	11
Accumulated Cyclone Energy	96.2	NA	170
Net Tropical Cyclone Activity	100%	275%	<b>185%</b>

\*Average over the period 1950-2000.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, April 3, 2007.



# *Probability of Major Hurricane Landfall (CAT 3, 4, 5) in 2007*

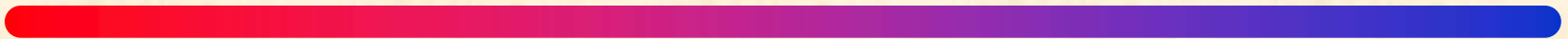
	Average*	2007F
Entire US Coast	52%	74%
<b>US East Coast Including Florida Peninsula</b>	31%	50%
Gulf Coast from FL Panhandle to Brownsville, TX	30%	49%
<b><i>ALSO...Above-Average Major Hurricane Landfall Risk in Caribbean for 2007</i></b>		

\*Average over the period 1950-2000.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, April 3, 2007.

# REINSURANCE MARKETS

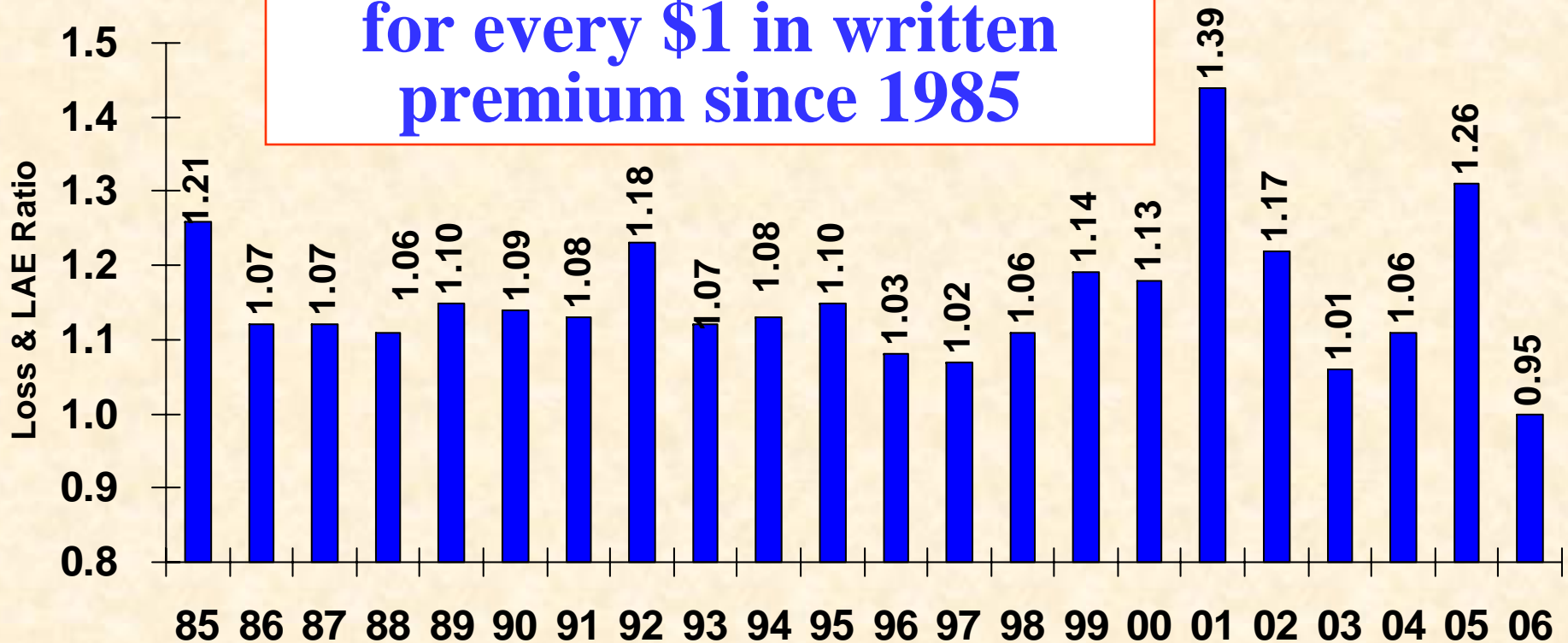
*Capital Flowing In,  
But So Does Criticism*





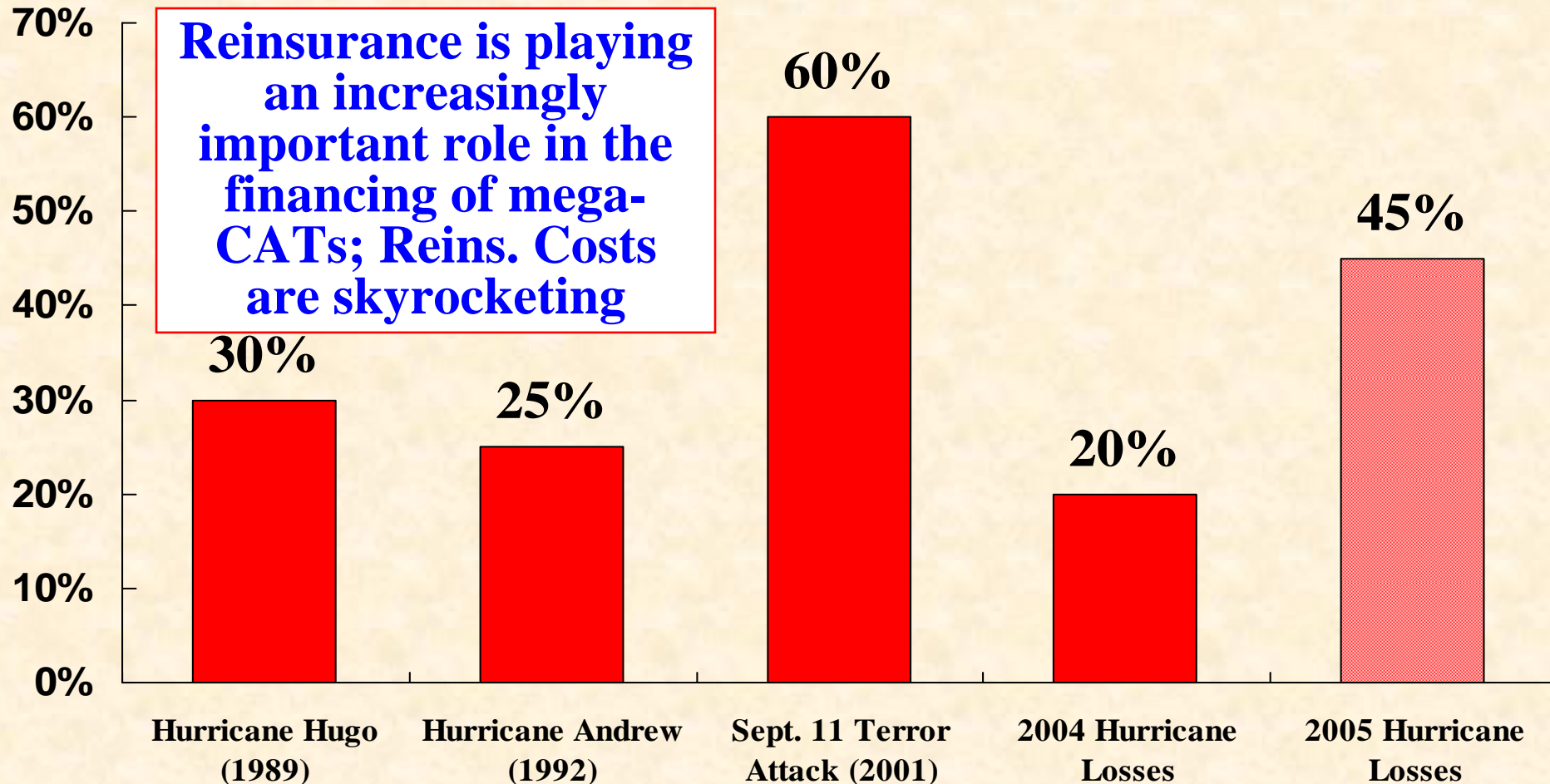
# *Ratio of Reinsurer Loss & Underwriting Expense to Premiums Written, 1985-2006*

**Despite the respite in 2006, reinsurers paid an average of \$1.11 in loss and expense for every \$1 in written premium since 1985**





# Share of Losses Paid by Reinsurers, by Disaster\*



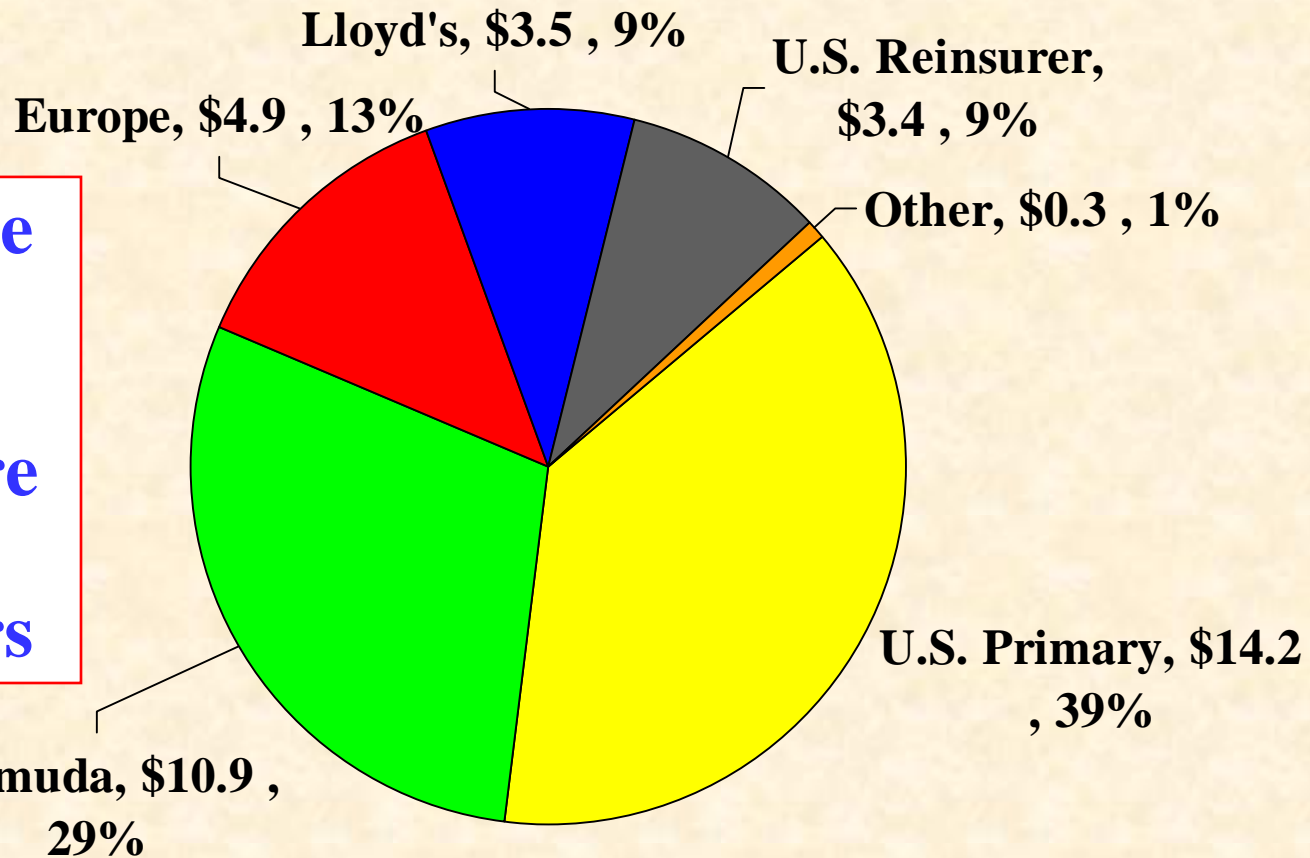
\*Excludes losses paid by the Florida Hurricane Catastrophe Fund, a FL-only windstorm reinsurer, which was established in 1994 *after* Hurricane Andrew. FHCF payments to insurers are estimated at \$3.85 billion for 2004 and \$4.5 billion for 2005.

Sources: Wharton Risk Center, Disaster Insurance Project; Insurance Information Institute.



# *Announced Katrina, Rita, Wilma* *Losses by Segment*

**\$ Billions**



**Catastrophes are global events. Only 39% of KRW losses were borne by US primary insurers**

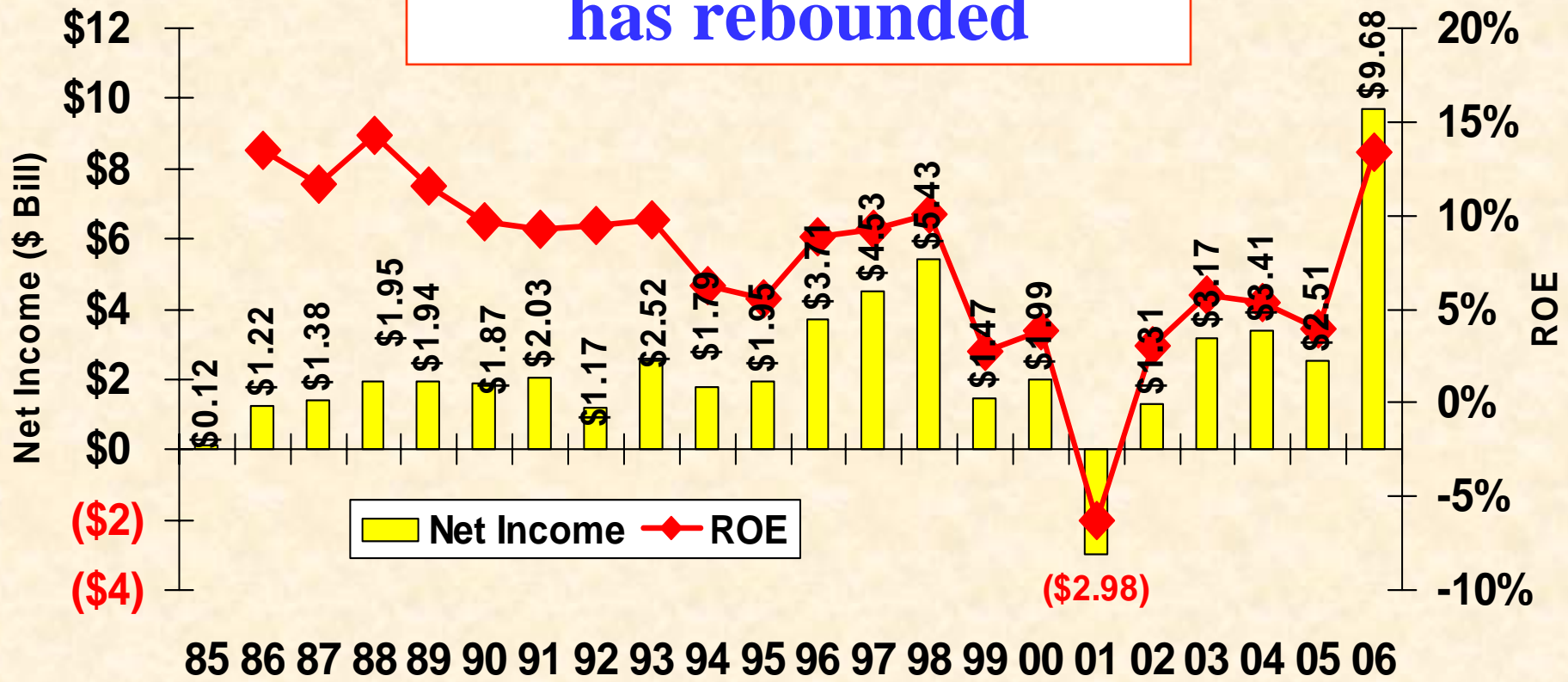
\*As of 2/21/06

Source: Dowling & Partners, RAA.

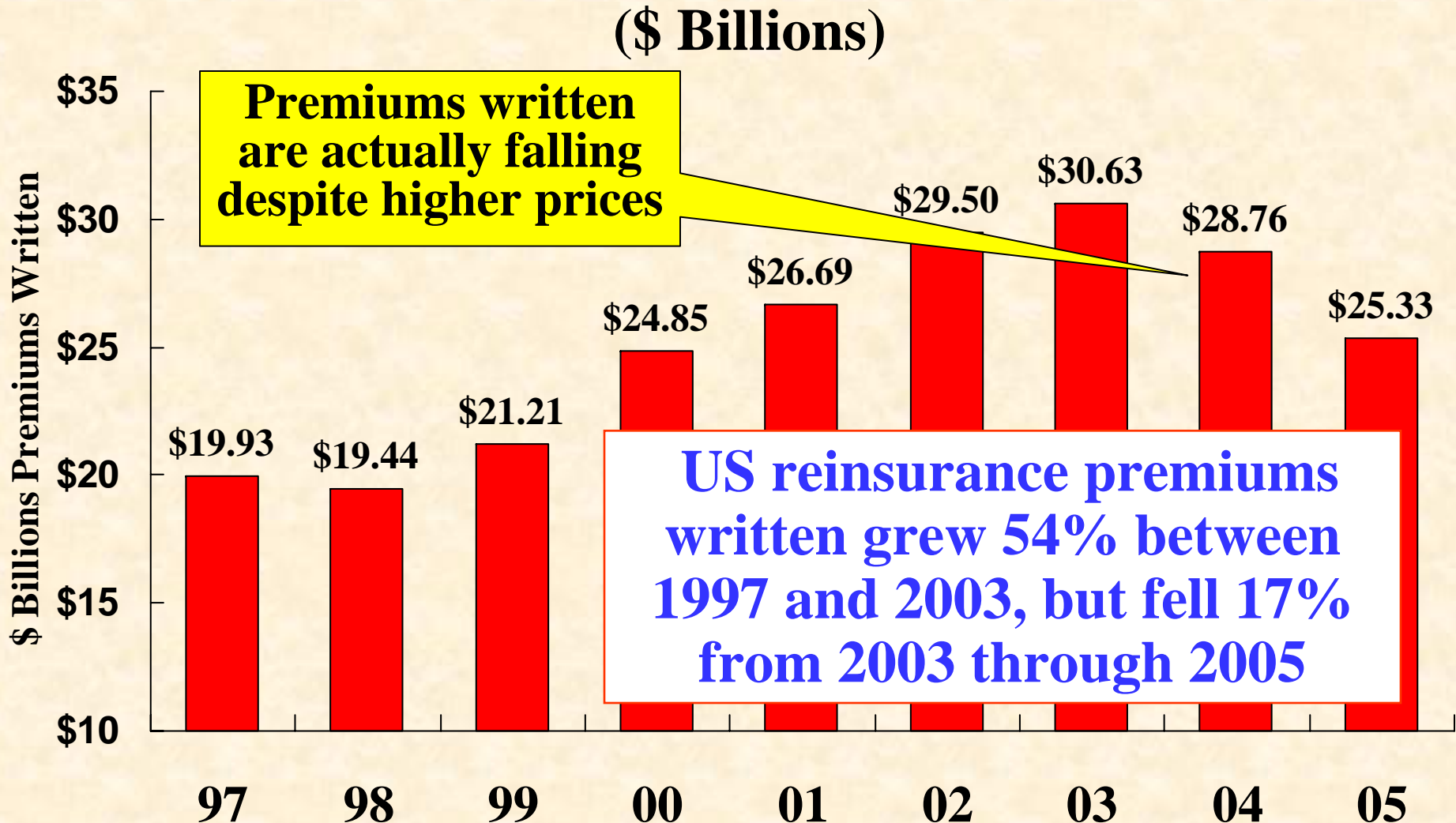


# US Reinsurer Net Income & ROE, 1985-2006

Reinsurer profitability  
has rebounded



# Reinsurers Net Written Premiums, US Business, 1997 - 2005



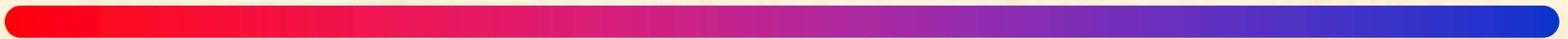


# Debate Over Reinsurance Market Performance & Government

- Reinsurance markets typically suffer large shocks, followed by a period of higher prices and transient capacity constraints
- A new equilibrium between Supply and Demand is typically found within 18 months, commensurate with changes in the risk landscape. This is Economics 101 and is a textbook illustration of how capitalism works.
- A competing hypothesis suggests that reinsurance markets “fail” because they do not provide a stable price or quantity of protection as is required in an economy with *continuously exposed fixed assets, especially one that is growth oriented*
- Public Policy Solution: Acting on this hypothesis generally results in displacement of private (re)insurance capital by government intermediaries
- **Question Asked**: Are policyholders and the economy better served through free markets, government or some hybrid?

# FINANCIAL STRENGTH & RATINGS

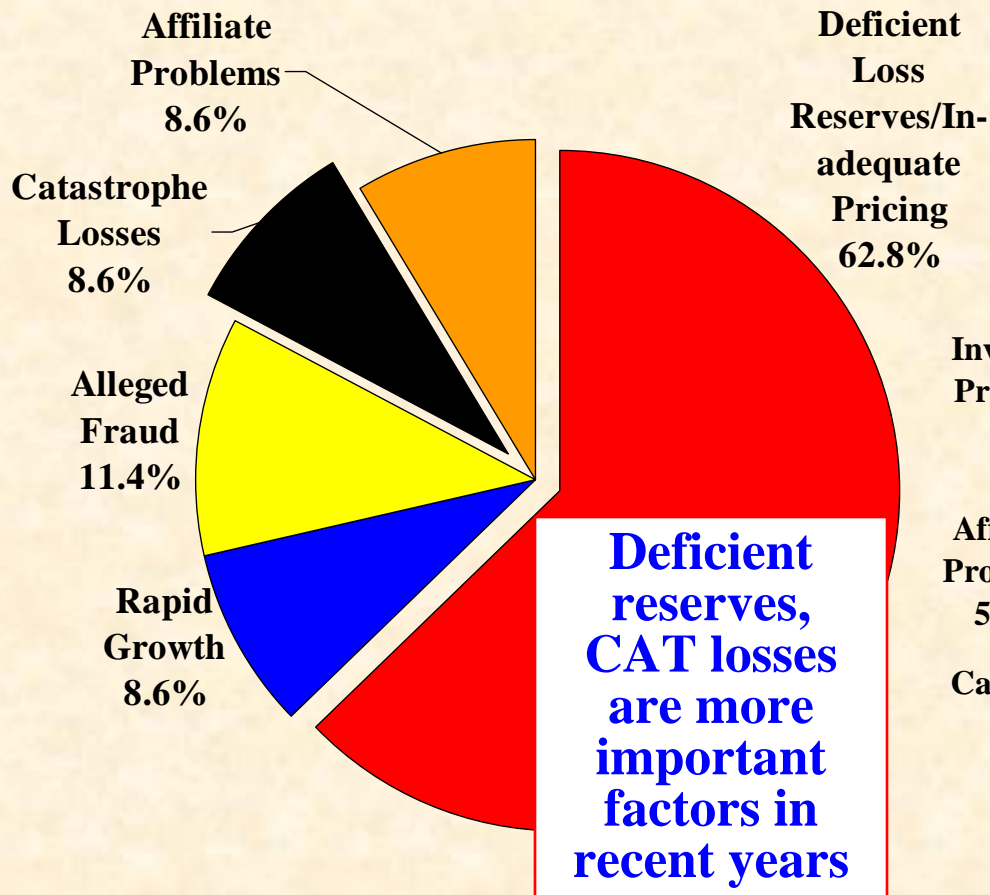
**Industry Has Weathered  
the Storms Well**



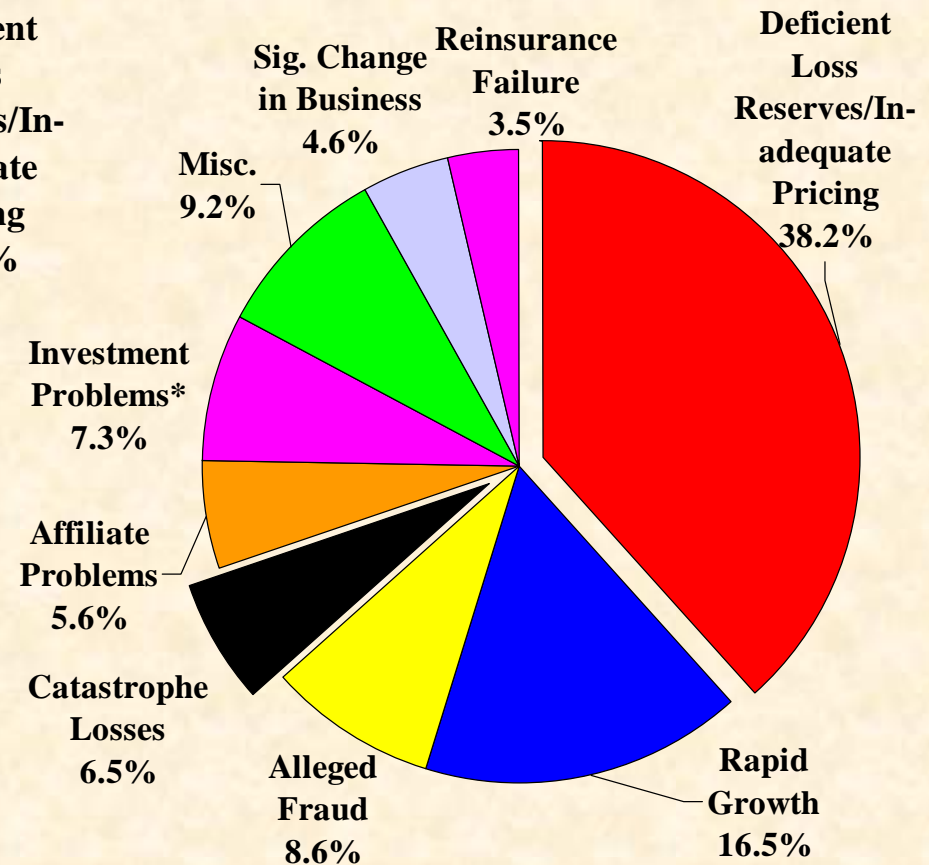


# Reasons for US P/C Insurer Impairments, 1969-2005

**2003-2005**



**1969-2005**



\*Includes overstatement of assets.



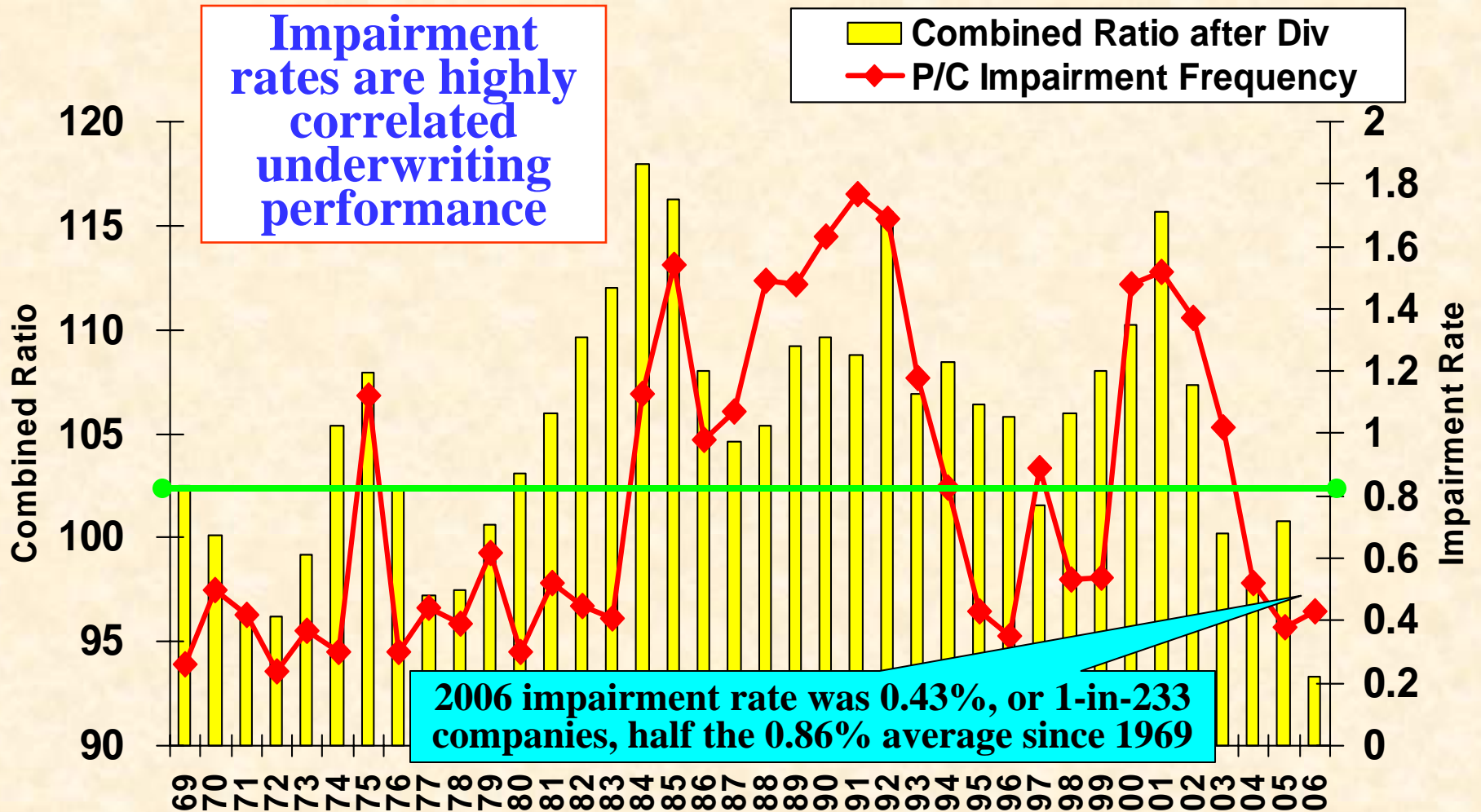
# *P/C Insurer Impairments, 1969-2006*

**The number of impairments varies significantly over the p/c insurance cycle, with peaks occurring well into hard markets**



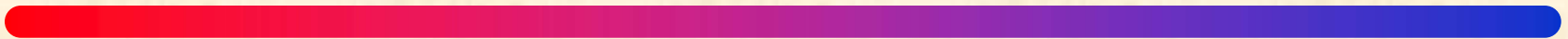


# *P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2006*



# STATE RESIDUAL MARKETS

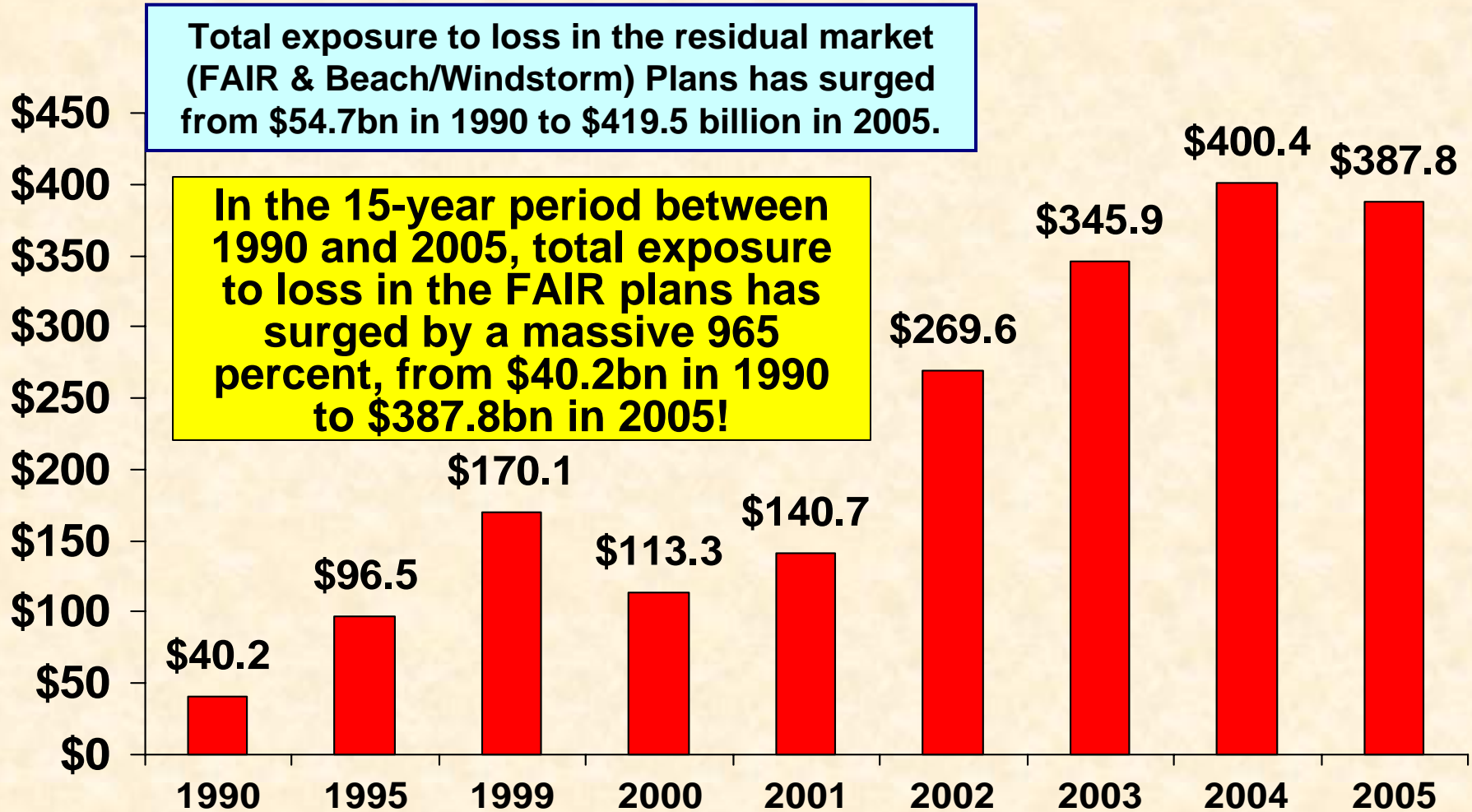
*Still Growing Despite  
a Quiet 2006*





# *US FAIR Plans Exposure to Loss\**

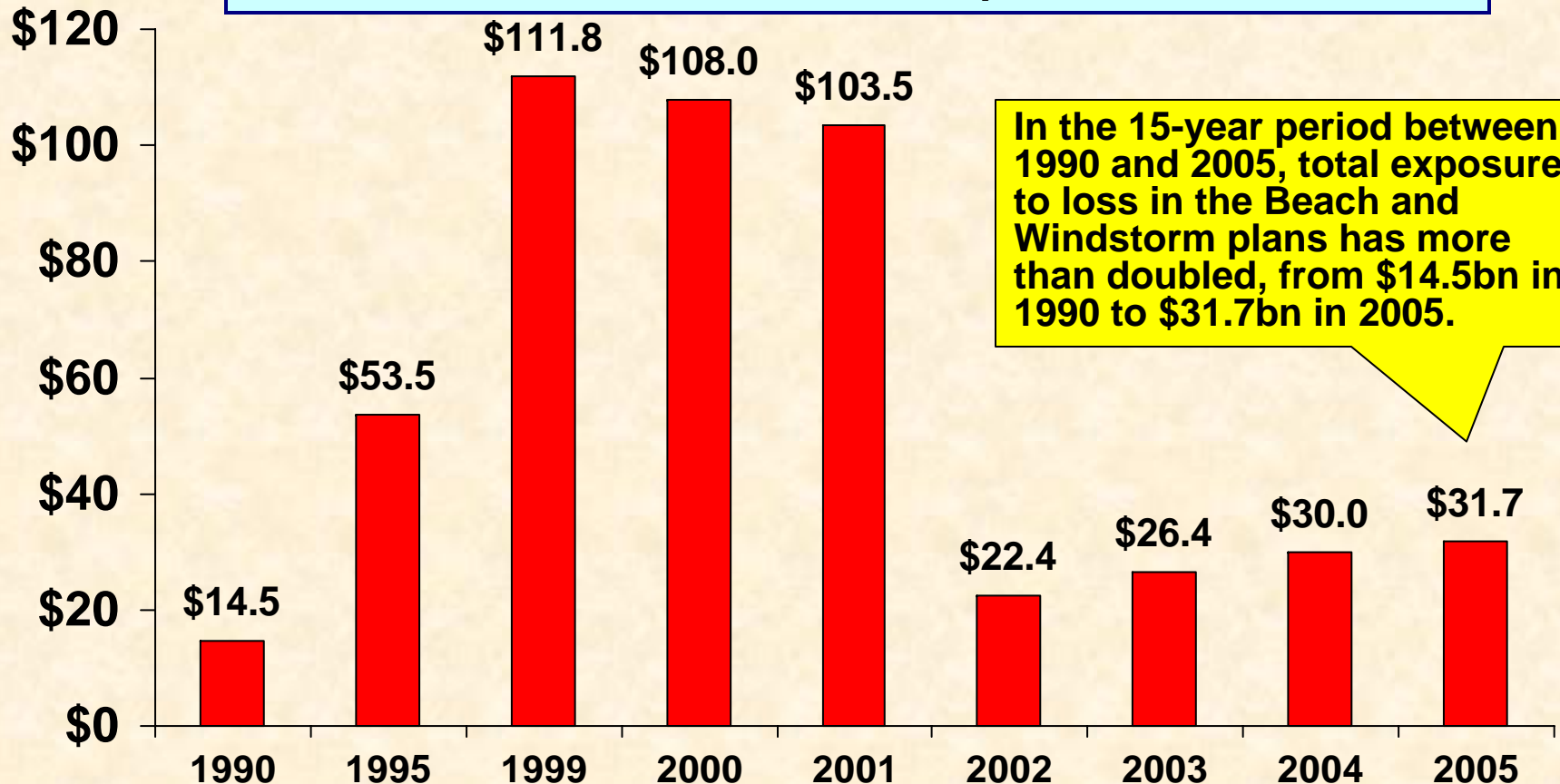
## *(Billions of Dollars)*





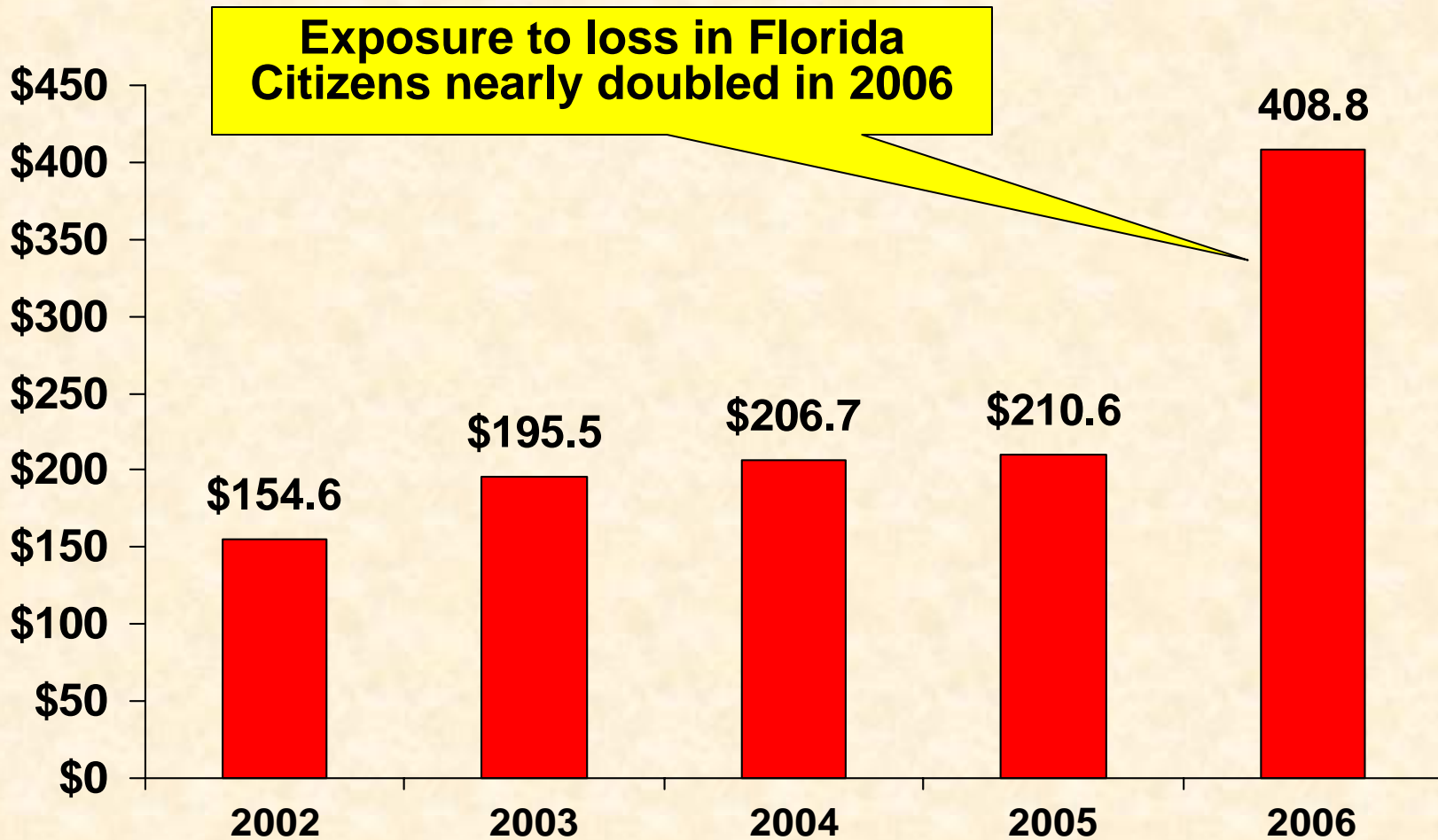
# *U.S. Beach and Windstorm Plans Exposure to Loss (Bill. of Dollars)*

In 2002 Florida combined its Windstorm and Joint Underwriting Association to create Florida Citizens, so Florida data shifted to the FAIR plans from this date



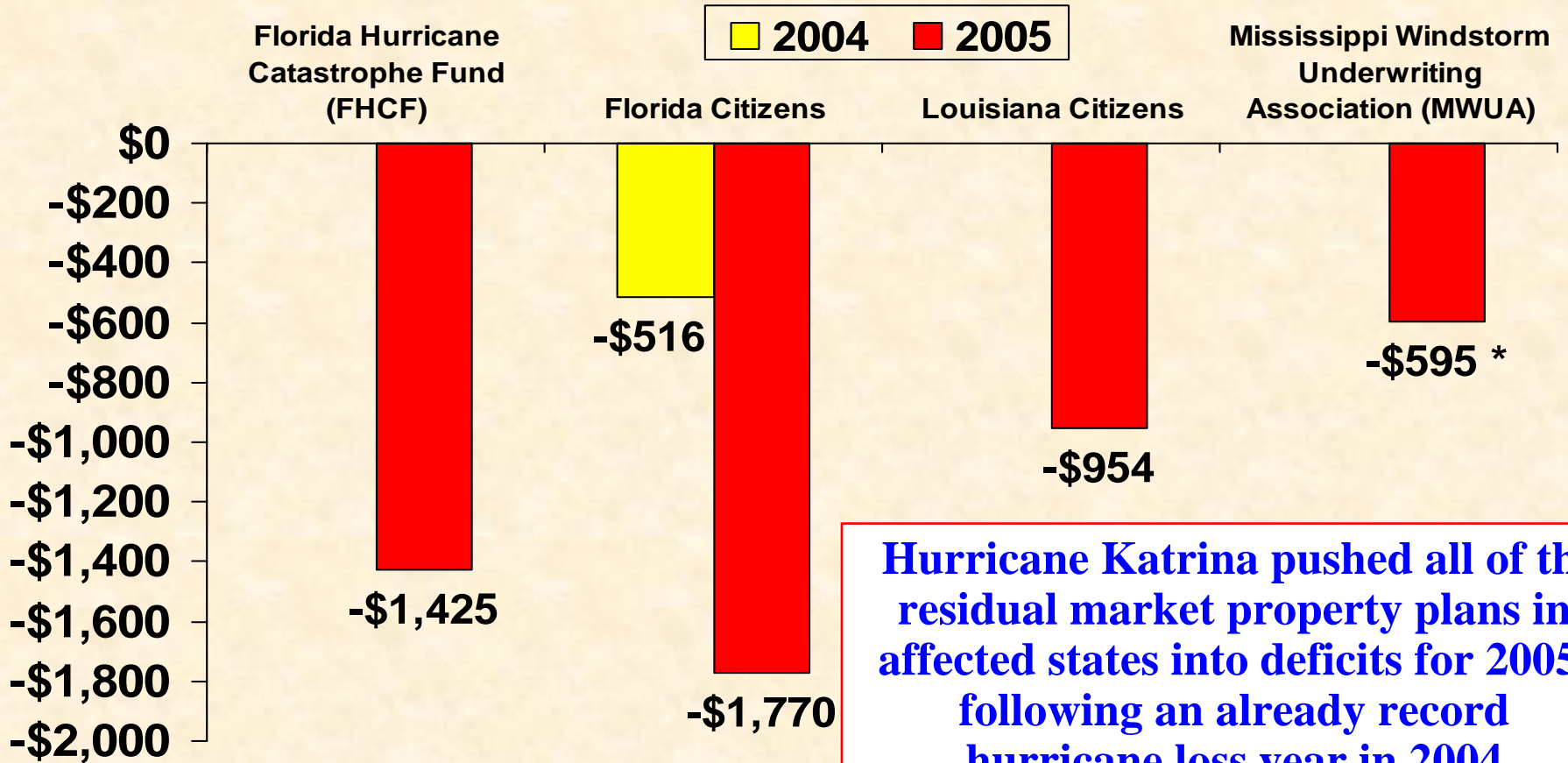


# *Florida Citizens Exposure to Loss (Billions of Dollars)*





# Major Residual Market Plan Estimated Deficits 2004/2005 (Millions of Dollars)

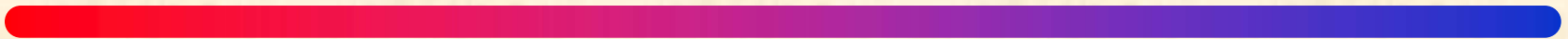


**Hurricane Katrina pushed all of the residual market property plans in affected states into deficits for 2005, following an already record hurricane loss year in 2004**

\* MWUA est. deficit for 2005 comprises \$545m in assessments plus \$50m in Federal Aid.

Source: Insurance Information Institute

*What Role Should the  
Federal Government  
Play in Insuring  
Against Natural  
Disaster Risks?*





# *NAIC's Comprehensive National Catastrophe Plan*

---

- **Proposes Layered Approach to Risk**
- **Layer 1: Maximize resources of private insurance & reinsurance industry**
  - Includes “All Perils” Residential Policy
  - Encourage Mitigation
  - Create Meaningful, Forward-Looking Reserves
- **Layer 2: Establishes system of state catastrophe funds (like FHCF)**
- **Layer 3: Federal Catastrophe Reinsurance Mechanism**



# *Guiding Principles of NAIC's National Catastrophe Plan*

---

- **National program should promote personal responsibility among policyholders**
- **National program should support reasonable building codes, development plans & mitigation tools**
- **National program should maximize risk-bearing capacity of private markets, and**
- **National plan should provide quantifiable risk management to the federal government**



# *Comprehensive National Catastrophe Plan Schematic*

**1:500 Event**

**National Catastrophe Contract Program**

**1:50 Event**

**State Regional Catastrophe Fund**

**State Attachment**

**Personal  
Disaster  
Account**

**Private Insurance**

**Private Reinsurance**



Legislation has been introduced and ideas espoused by ProtectingAmerica.org will likely get a more thorough airing in 2007/8

**A VULNERABLE AMERICA**

HURRICANES EARTHQUAKES

WHAT ARE YOU AT RISK FOR?

OUR MISSION IS TO RAISE AWARENESS, EDUCATE THE PUBLIC AND POLICYMAKERS, AND OFFER SOLUTIONS THAT WILL BETTER PREPARE AND PROTECT AMERICA FROM MAJOR CATASTROPHE IN A SENSIBLE, COST-EFFECTIVE FASHION.

REPLAY

- HELP PROTECT AMERICA
- UNDERSTAND YOUR RISKS >
  - STRENGTHEN 1ST RESPONDERS >
  - BUILD SMARTER & STRONGER >
  - ADVOCATE CATASTROPHE FUNDS >

PREPARE YOURSELF:

HOW YOU CAN BETTER PREPARE  
tips for average americans >

- RECENT NEWS:
- Teaching Earthquake Science Made Easy: USGS Partnership Puts Curriculum into the Classroom  
2.1.06
  - Faculty Senate hears report on emergency-preparedness plan  
2.1.06
  - It's Earthquake Preparedness Week In Kentucky  
2.1.06

**AMERICA NEEDS YOUR VOICE!**

Our current system leaves too many people unprotected and unable to rebuild their lives following a catastrophe. We need to prepare for future catastrophes and protect ourselves.

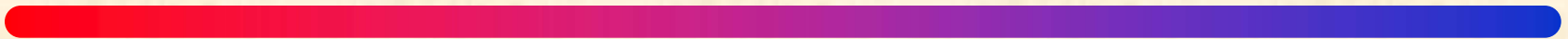
**CONTACT YOUR ELECTED OFFICIALS >**      **JOIN OUR CAUSE >**

STATS & FIGURES:

repeat of the 1886 Charleston, South Carolina, earthquake today would cause

# Legal Liability & Tort Environment

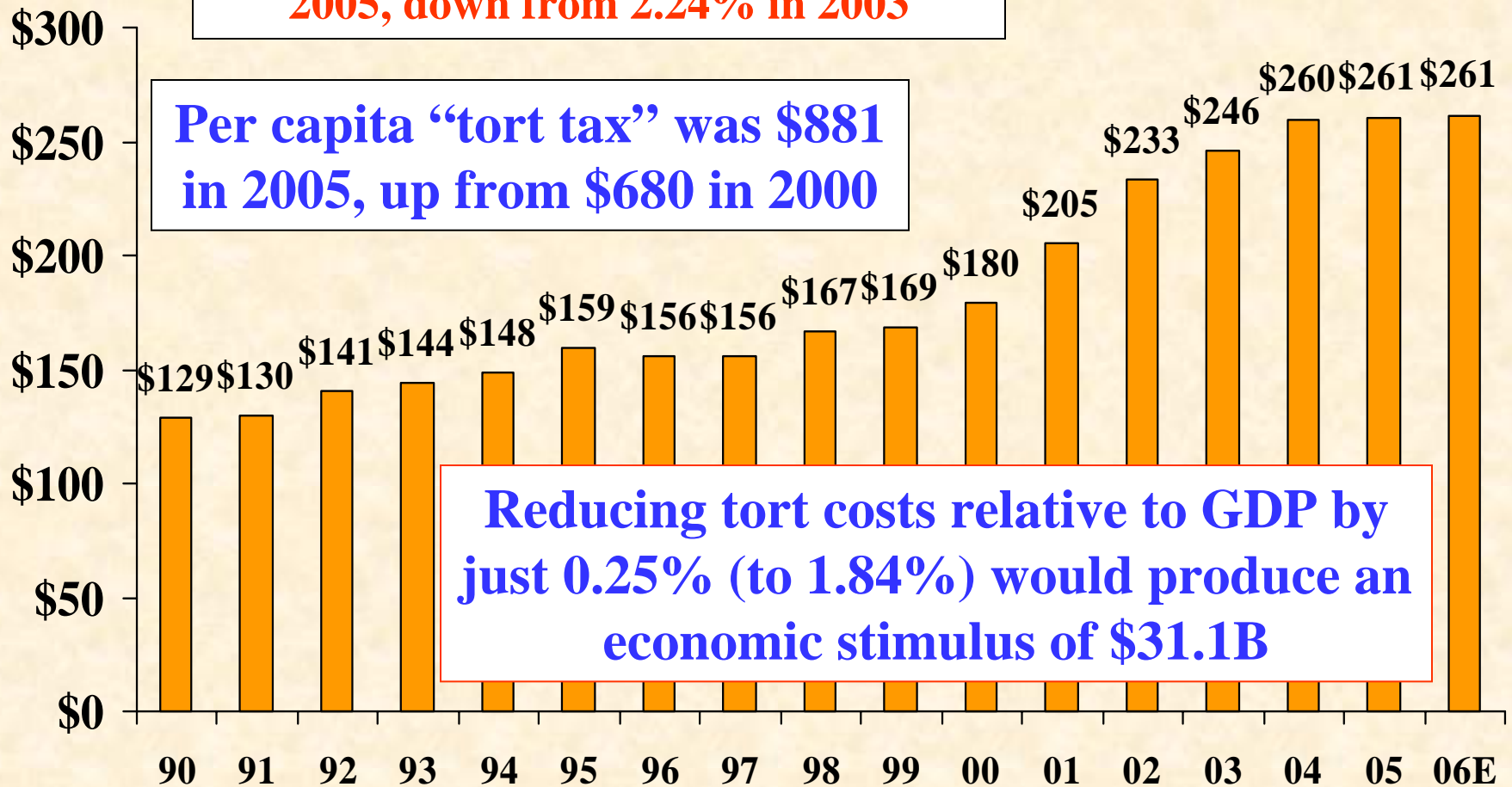
*Definitely Improving But  
Not Out of the Woods*



# Cost of U.S. Tort System (\$ Billions)



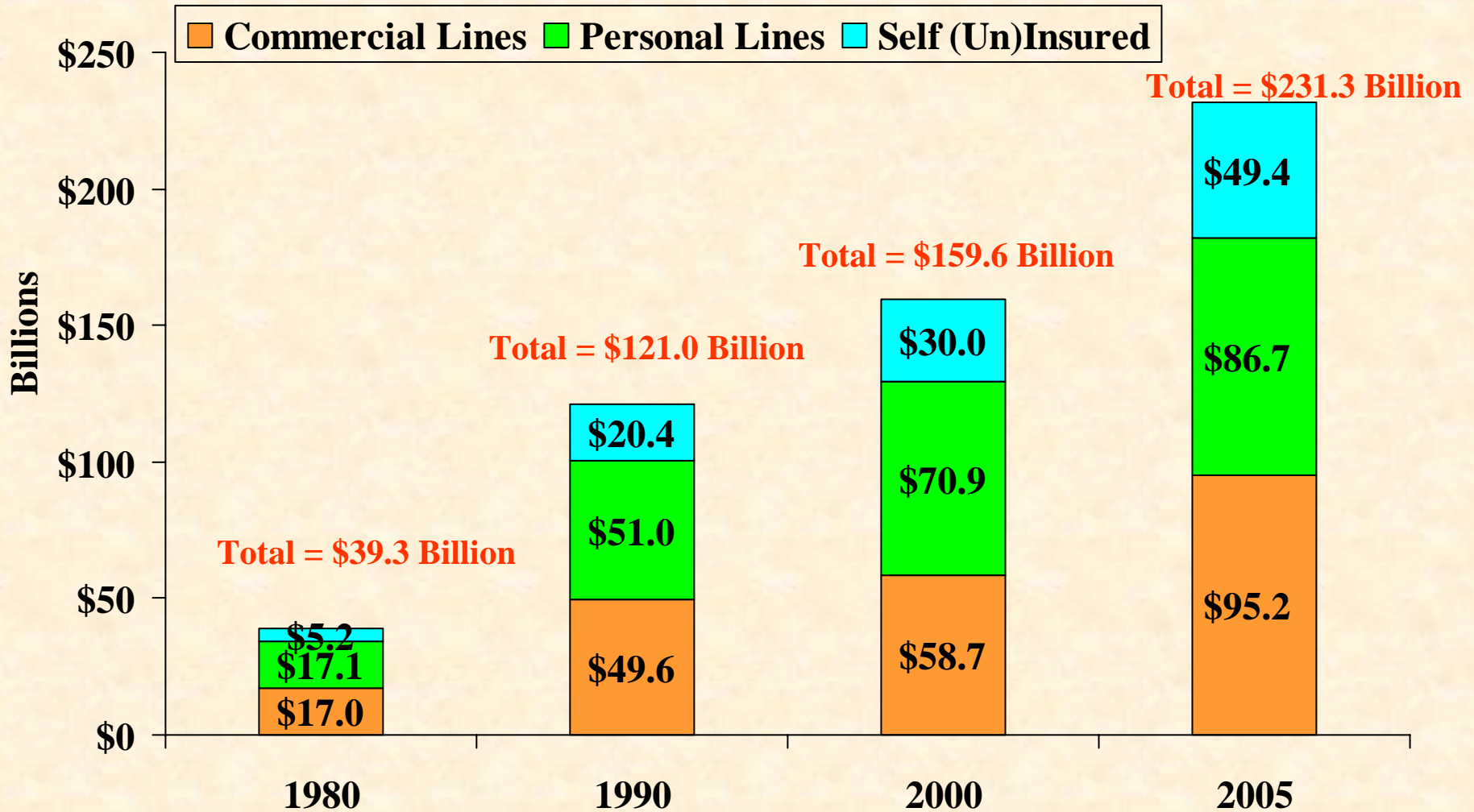
**Tort costs consumed 2.09% of GDP in 2005, down from 2.24% in 2003**



**Per capita “tort tax” was \$881 in 2005, up from \$680 in 2000**

**Reducing tort costs relative to GDP by just 0.25% (to 1.84%) would produce an economic stimulus of \$31.1B**

# *Personal, Commercial & Self (Un) Insured Tort Costs\**

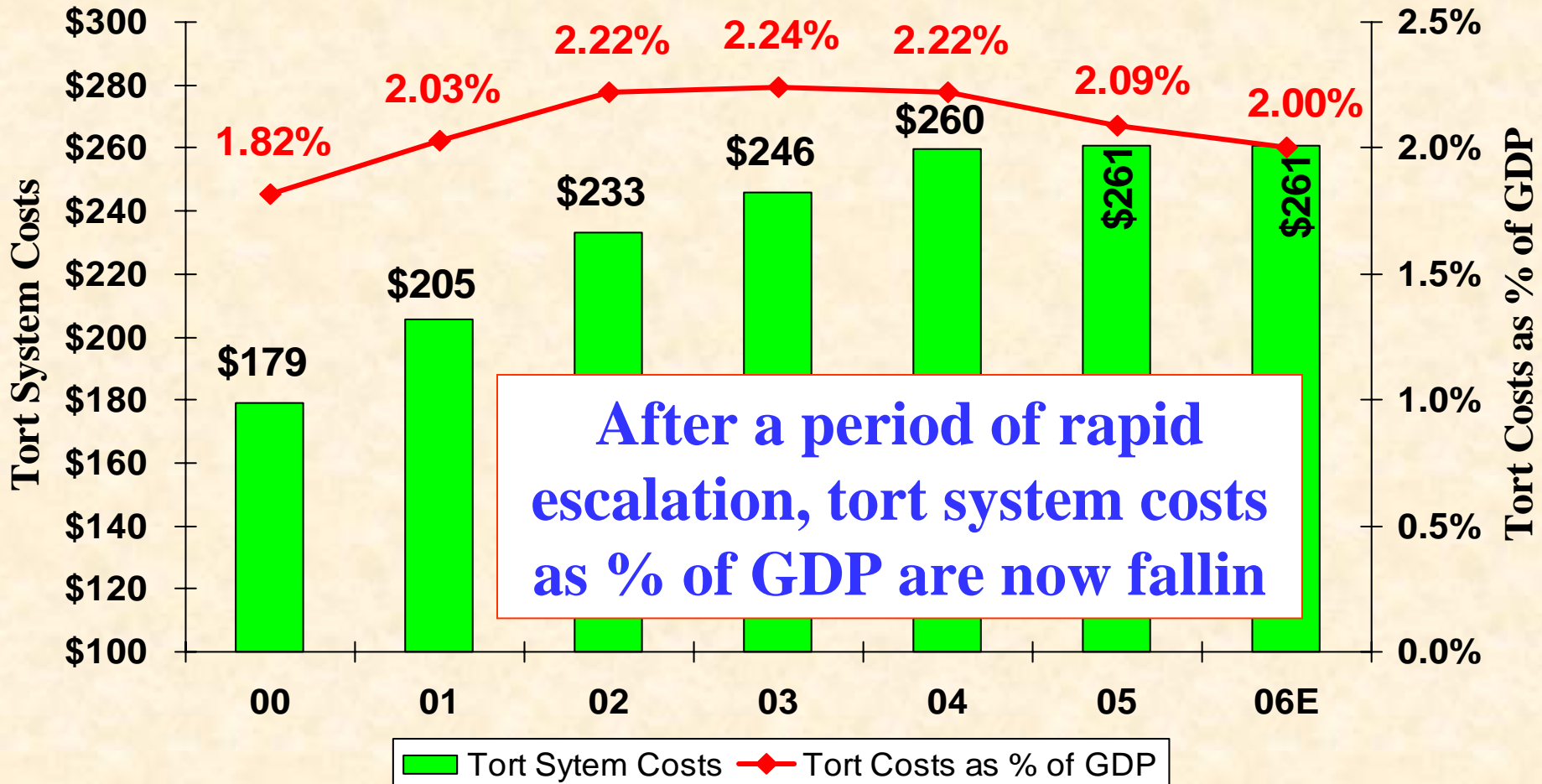


\*Excludes medical malpractice

Source: Tillinghast-Towers Perrin, 2006 Update on US Tort Cost Trends.



# Tort System Costs, 2000-2006E



# **KATRINA: The Legal Storm**

*Silence in the Court?*



*Keep Dreaming*

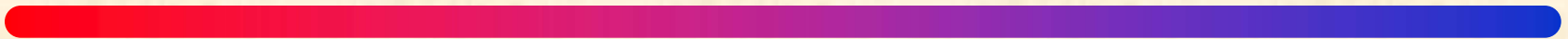
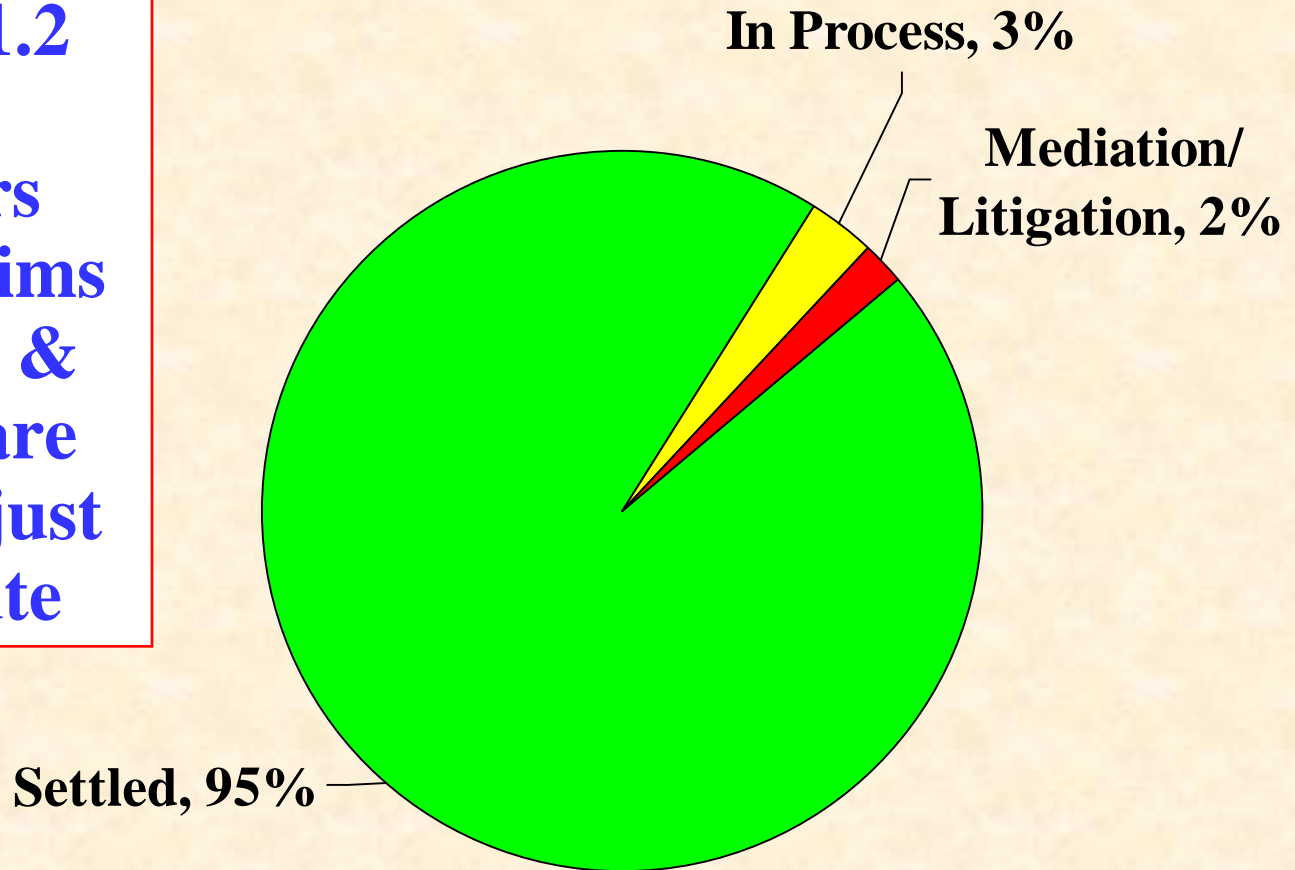


Figure 3.

# *Hurricane Katrina Claim Status on Storm's 1<sup>st</sup> Anniversary\**



**95% of the 1.2 million homeowners insurance claims in Louisiana & Mississippi are settled, with just 2% in dispute**



\*Hurricane Katrina made its north Gulf coast landfall August 29, 2005.  
Source: Insurance Information Institute survey, August 2006.



# *Katrina Litigation Timeline for Significant Wind/Flood Disputes*

<b>Date</b>	<b>Case</b>	<b>State</b>	<b>Judge</b>	<b>Outcome for Industry</b>	<b>Ruling</b>
9/05	Hood v. State Farm, et al	MS	State/Fed*	Negative	Suit was held up for 15 months on jurisdictional grounds, but ultimately remanded back to a MS state court in Dec. 2006.
4/06	Buente v. Allstate	MS	Senter	Positive	Upheld flood exclusion. Rules flood exclusions in policy are “clear are unambiguous”
5/06	Tuepker v. State Farm	MS	Senter	Negative	Storm surge as excludable flood loss upheld, but ruled that policy language on losses caused by both wind and water was ambiguous and therefore unenforceable

\*Originally filed 9/15/05 in MS state court, but jurisdiction challenged by insurers because suit also references the federal government’s National Flood Insurance Program.

Sources: Lehman Brothers, Insurance Information Institute.



# *Katrina Litigation Timeline for Significant Wind/Flood Disputes (cont'd)*

Date	Case	State	Judge	Outcome for Industry	Ruling
5/06	Turk, <i>et al</i> v. Louisiana Citizens, <i>et al</i>	LA	Haik	Positive	Upheld flood exclusion. Ruling says that if policy only covered wind damage then flood-related damage not covered
8/06	Class Action Certification	MS	Senter	Positive	Refuses to certify class actions cases involving State Farm Katrina cases
8/06	Leonard v. Nationwide	MS	Senter	Positive	Flood exclusion upheld. Nationwide ordered to pay only for wind damage of \$1,228.
11/06	Levee Breaks	LA	Duval	Negative	Losses from levee breaks should be covered by insurers
1/19/07	Broussard v. State Farm	MS	Senter	Negative	Rules against State Farm for refusal to cover Katrina damage for \$1M. Ruling reduced to \$1M. 1/31 pays for 1/31 of \$1M. Ruling of \$2.5 million for wind and flood damages

Sources: Lehman Brothers, Insurance Information Institute.



# *Katrina Litigation Timeline for Significant Wind/Flood Disputes (cont'd)*

<b>Date</b>	<b>Case</b>	<b>State</b>	<b>Judge</b>	<b>Outcome for Industry</b>	<b>Ruling</b>
1/07	Congressional Investigations	MS	NA	Negative	Rep, Gene Taylor (D-MS) calls for Congressional investigations into insurer claims handling practices. Separately, Dept. of Homeland Security inspector general must submit results of investigation by 4/1/07.
1/23/07	Tejedor v. State Farm	MS	Senter	Negative	State Farm settles for an estimated \$1 million based on \$96,000 in uncovered losses. Home insured for \$260,000; recovered \$200,000 from NFIP and \$13,944 from SF on structure. Also recovered \$80,000 from NFIP on \$130,000 contents



# Katrina Litigation Timeline for Significant Wind/Flood Disputes (cont'd)

Date	Case	State	Judge	Outcome for Industry	Ruling
<p><b>Scruggs legal team will earn as much as \$46 million from these settlements, paid in addition to sums offered to plaintiffs (\$26M for the “Woullard Agreement” and up to \$20M for the class action case)</b></p>					<p>State Farm settles civil suit with MS AG Hood for at least \$50 million. SF will offer about 1000 homeowners whose homes were completely destroyed at least 50% of the policy's actual cash value for some of the destroyed homes. Settlement also resolves a criminal investigation by AG into allegations that claims were fraudulently denied. <b>Settlement does not involve any other insurers.</b></p>
1/23/07	State Farm Class Action Settlement	MS	Senter*	Negative	<p>as many as many families can be affected and seek arbitration.</p>
1/23/07	“Woullard Agreement”	MS	NA	Negative	<p>State Farm agrees to pay \$79.5 million to 639 families in private suit. Suit handled by Richard Scruggs. Sen. Trent Lott (R-MS) was party to this suit.</p>

**Refused!!!**

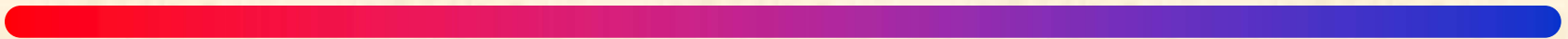


# *Likely Market Impacts of Post-Katrina Litigation*

- **Litigation Creates an Additional Layer of Uncertainty in What is Already a Very Difficult Market**
  - **Ultimate Thrust of Litigation is to Compel Insurers to Pay Water Damage (Flood/Surge) Losses for Which They Have Never Received A Penny in Premium**
- **Some Courts' Apparent Willingness to Retroactively Rewrite Long-Standing, Regulator Approved Terms & Conditions of Insurance Contracts Creates an Unpriceable Risk**
  - **Compounded by juries willing to award millions in punitives**
- **People Discouraged from Buying Flood Coverage**
- **BOTTOM LINE: Weather, Courts, Juries Together Create Nearly Impossible Operating Environment**
- **Coverage Under These Circumstances Will Necessarily Become More Expensive, Less Available**

# REGULATORY ACTIVITY

*Washington Has Taken an  
Interest in Catastrophe-  
Related Issues*





# *Federal Legislative Update*

## **Natural Disaster Coverage**

- **Some insurers are pushing for federal catastrophic risk fund coverage in the wake of billions of dollars of losses suffered by insurers from the 2004-2005 hurricane seasons.**
- **Legislative relief addressing property/casualty insurers' exposure to natural catastrophes, such as the creation of state and federal catastrophe funds, has been advocated by insurers include Allstate and State Farm recently. However, there is active opposition many other insurers and all reinsurers.**
- **There are supporters in Congress, mostly from CAT-prone states. Skeptics in Congress believe such a plan would be a burden on taxpayers like the NFIP and that the private sector can do a better job. Unlike TRIA, the industry is not unified on this issue.**
- **Allowing insurers to establish tax free reserves for future catastrophe losses has also been proposed, but Congress has not yet indicated much support.**



# *Federal Legislative Update*

## **McCarran-Ferguson Insurance Antitrust Exemption**

- **Under McCarran-Ferguson Act of 1945, insurers have limited immunity under federal anti-trust laws allowing insurers to pool past claims information to develop accurate (actuarially credible) rates.**
- **Very low level of understanding of M-F in Washington**
- **Certain legislators threaten to revoke McCarran-Ferguson because of alleged collusion in the wake of Hurricane Katrina. However, the view among some Washington insiders is that such a move would hurt small insurers with less resources rather than the large insurers perhaps being targeted. The current bills designed to revoke McCarran-Ferguson are S.618 and H.R. 1081.**
- **The government appointed Antitrust Modernization Commission in an April 2007 report strongly encouraged Congress to re-examine the McCarran-Ferguson Act. Notably, 4 of the commissions 12 members called for a full repeal of the law. Sources: Lehman Brothers, Insurance Info. Institute**



# *Federal Legislative Update*

## **Federal Terrorism Reinsurance (TRIA)**

- **TRIA expires 12/31/07. The current federal program offers \$100 billion of coverage subject to a \$27.5B industry aggregate retention.**
- **New Democratic Congress (with Committee chairs from urban Northeast states) predisposed to extend. Despite resistance/lackluster Administration support TRIA will likely be extended for a multi-year period, perhaps 6-8 but potentially as long as 15 years (last extension in 2005 was for 2 years)**
- **Potential changes include extensions of coverage for domestic terrorism losses (not included currently), and a lower industry retention for nuclear, biological, chemical, or radiological (NBCR) attacks. There could possibly be a modestly higher industry retention for non-NBCR losses, and it needs to be resolved whether liability and group life losses will be covered.**
- **Original hope for first-half 2007 extension have faded. Now looking at fall or even 11<sup>th</sup>-hour extension as in 2005.**



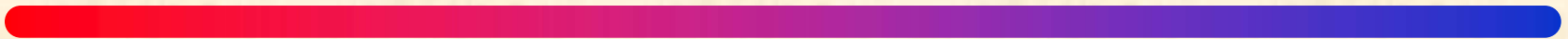
# *Federal Legislative Update*

## **Optional Federal Charter (OFC)**

- **Large P&C and life insurers are the major supporters of OFC. Supporters argue that the current patchwork of 50 state regulators reduces competition, is redundant, slows new product introductions and adds cost to the system.**
- **In general, global P/C insurers, reinsurers and large brokers mostly support the concept, while regulators (state insurance commissioners), small single-state and regional insurers, and independent agency groups largely oppose the idea. An optional federal charter is more favorable for global P&C insurers, because an insurer that operates in multiple states could opt to be regulated under federal rules rather than multiple state regulations. As a result, this could increase innovation in the industry.**
- **A new bill should be introduced in May or June. Currently appears to be more momentum for OFC for life than for P&C insurers based on the homogeneous nature of many life products. The debate should intensify and although passage may not occur in the current session of Congress, it may lay the groundwork for passage in the 2009-2010 session.**

# TRIA EXTENSION

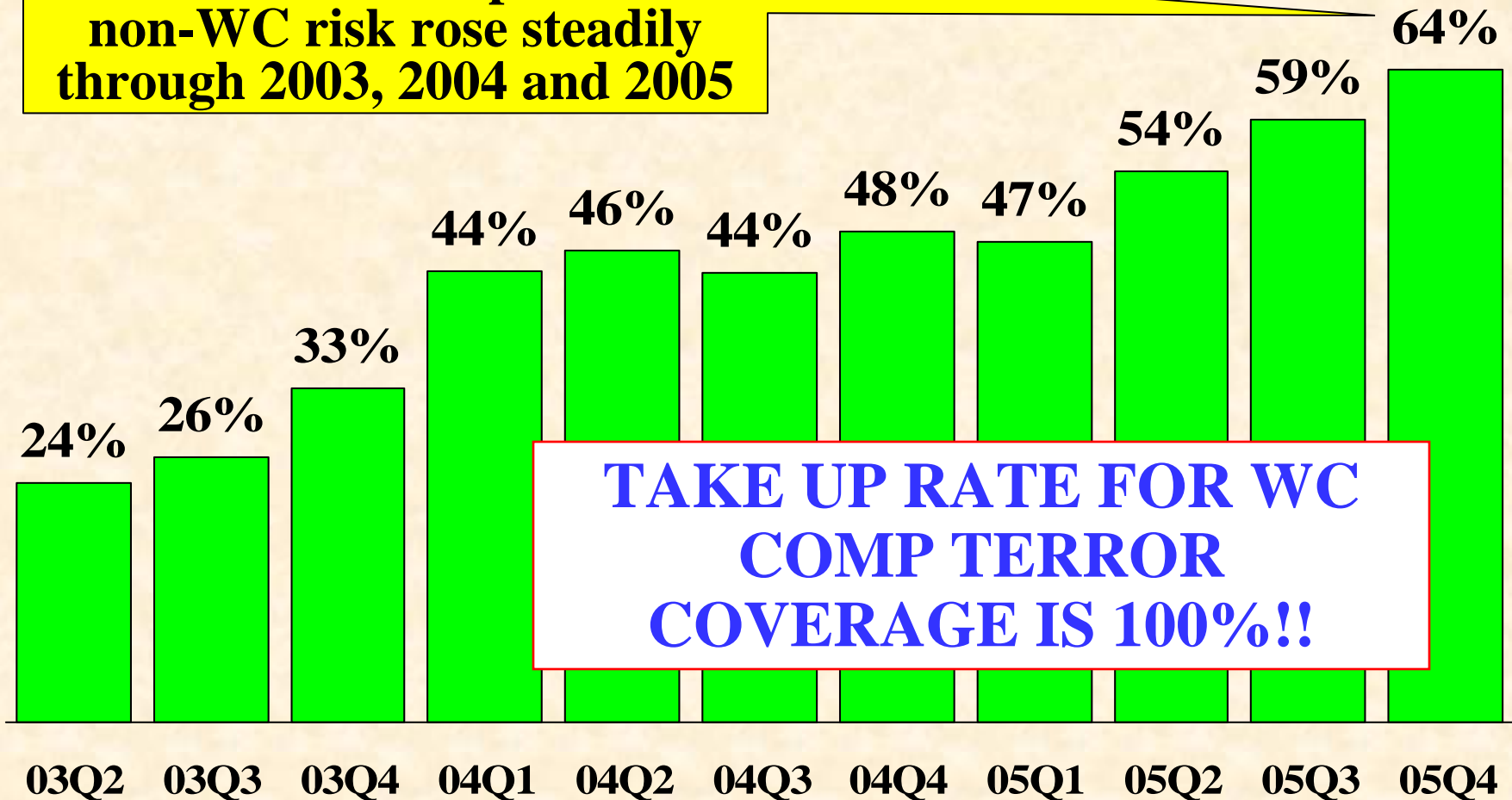
*The Burden Grows, and the  
Clock is Ticking*





# Terrorism Coverage Take-Up Rate Continues to Rise

**Terrorism take-up rate for non-WC risk rose steadily through 2003, 2004 and 2005**

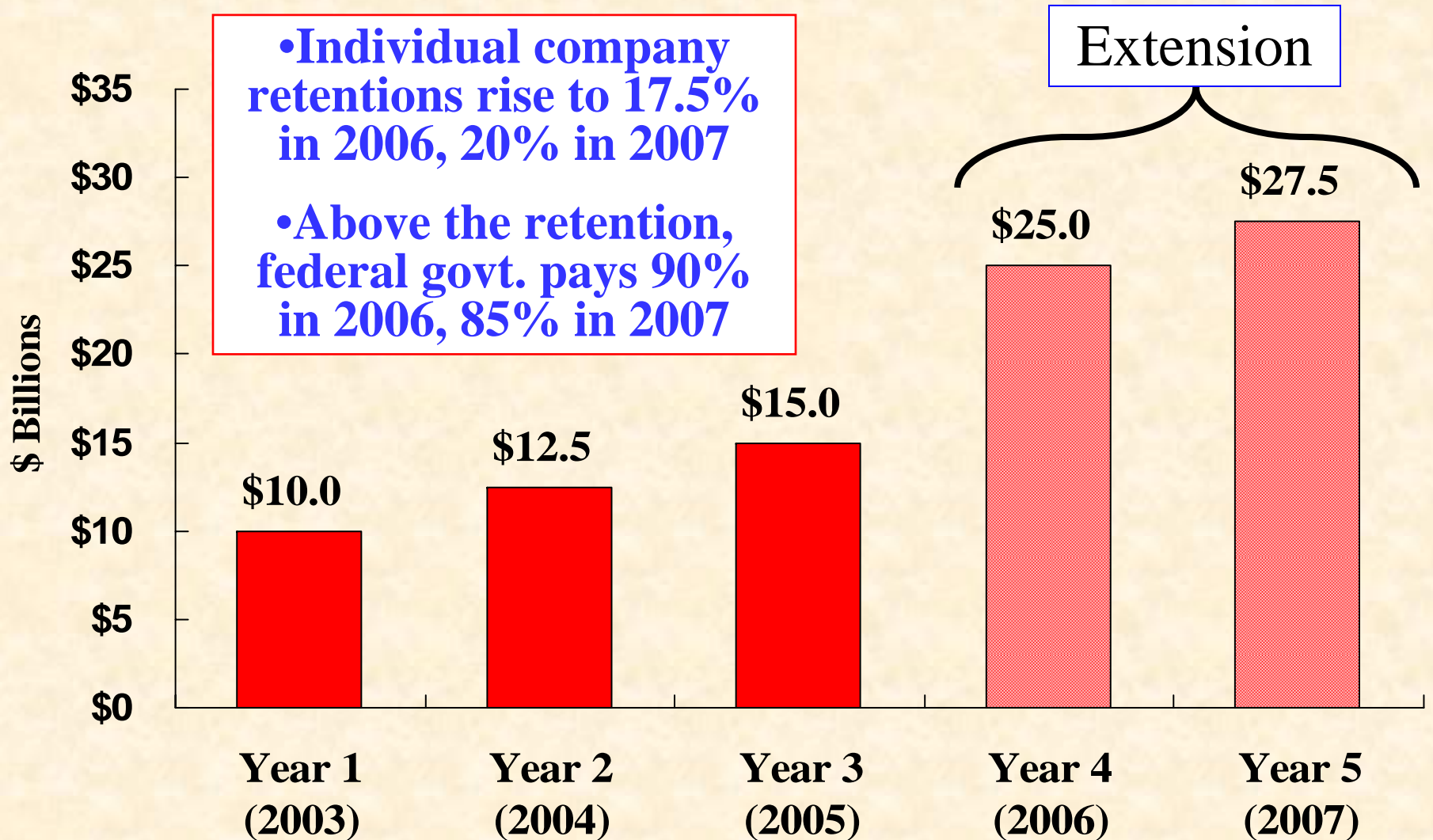


**TAKE UP RATE FOR WC  
COMP TERROR  
COVERAGE IS 100%!!**



# *Insurance Industry Retention*

## *Under TRIA (\$ Billions)*





# *Insured Loss Estimates:*

## *Large CNBR Terrorist Attack (\$ Bill)*

Type of Coverage	New York	Washington	San Francisco	Des Moines
Group Life	\$82.0	\$22.5	\$21.5	\$3.4
General Liability	14.4	2.9	3.2	0.4
Workers Comp	483.7	126.7	87.5	31.4
Residential Prop.	38.7	12.7	22.6	2.6
Commercial Prop.	158.3	31.5	35.5	4.1
Auto	1.0	0.6	0.8	0.4
<b>TOTAL</b>	<b>\$778.1</b>	<b>\$196.8</b>	<b>\$171.2</b>	<b>\$42.3</b>

Source: American Academy of Actuaries, Response to President's Working Group, Appendix II, April 26, 2006.

# FLORIDA SPECIAL SESSION LEGISLATIVE CHANGES

**iii** Insurer, Policyholder &  
State Impacts

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# *Summary: Florida Legislature Special Session (January 2007)*

## **1. Exponential Expansion of the Role of the State in Insuring Homes & In Reinsurance Markets**

- **More than doubles exposure of Florida Hurricane Catastrophe Fund to \$35 billion from \$16 billion (FHCF only has \$1B cash), greatly displacing private reinsurers**
- **Allows Florida Citizens to compete with private insurers by lowering rates and lowering eligibility standards**
- **Allows Florida Citizens to displace private insurers by expanding into non-wind coastal business**
- **Disbands disciplined, small and adequately priced Commercial JUA and transfers business to poorly run, underpriced, Citizens Commercial Account**



# *Summary: Florida Legislature Special Session (January 2007)*

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## **2. Dramatically Increases Exposure of Florida Policyholders to Post-Catastrophe Taxes**

- **Expands the Citizens assessment base more than 4 fold**
- **Increases maximum annual assessment facing Florida policyholders from \$9.2 billion to \$25 billion**
- **Increases maximum general liability and commercial auto assessment exposure from 14% to 74% (*These are 2 types of insurance that having nothing to do with hurricane risk*)**
- **Accelerates growth of Citizens, already the largest home insurers in the state and which doubled in size in 2006, by lowering rates and making access easier**



# *Summary: Florida Legislature Special Session (January 2007)*

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## **3. Disincentives for Insurers to Offer Policies in Florida**

- **Introduces “excess profits law” (a virtual oxymoron in FL)**
- **Requires Executive Officer review on routine rate filings**
  - **Threatens perjury charges and administrative penalties**
- **Increases cost of processing and maintaining policies**
- **Requires “premium discounts” even if not actuarially justified**

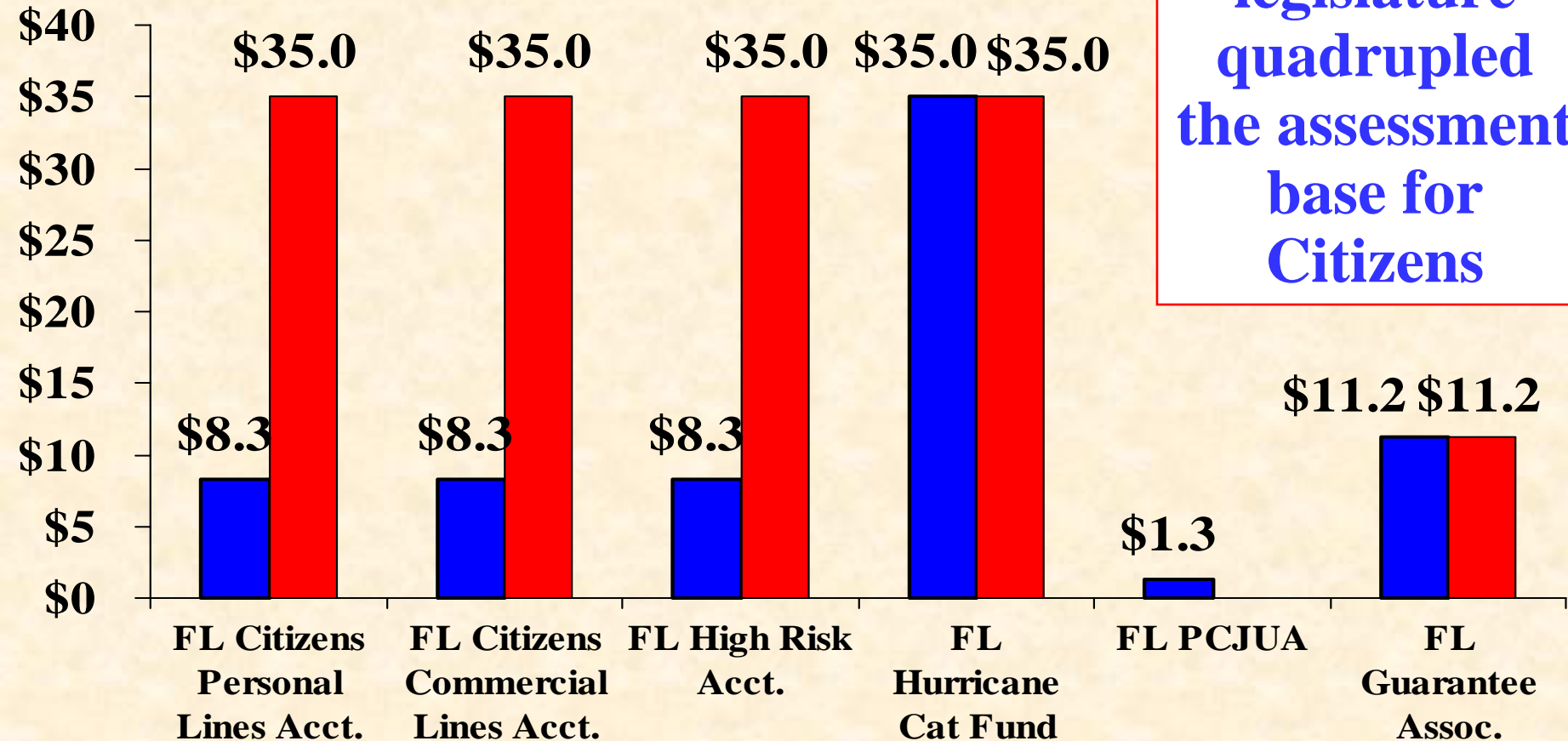
## **4. Threatens State of Florida’s Credit Rating**

- **Major event could result in simultaneous issuance of \$40+ billion in debt from Cat Fund, Citizens and Guarantee Fund**
- **Governor’s promise to cut property taxes could compound state’s fiscal problems after an event**



# Florida Hurricane Assessment Base, 2006 vs. 2007\* (\$ Bill)

■ 2006 ■ 2007



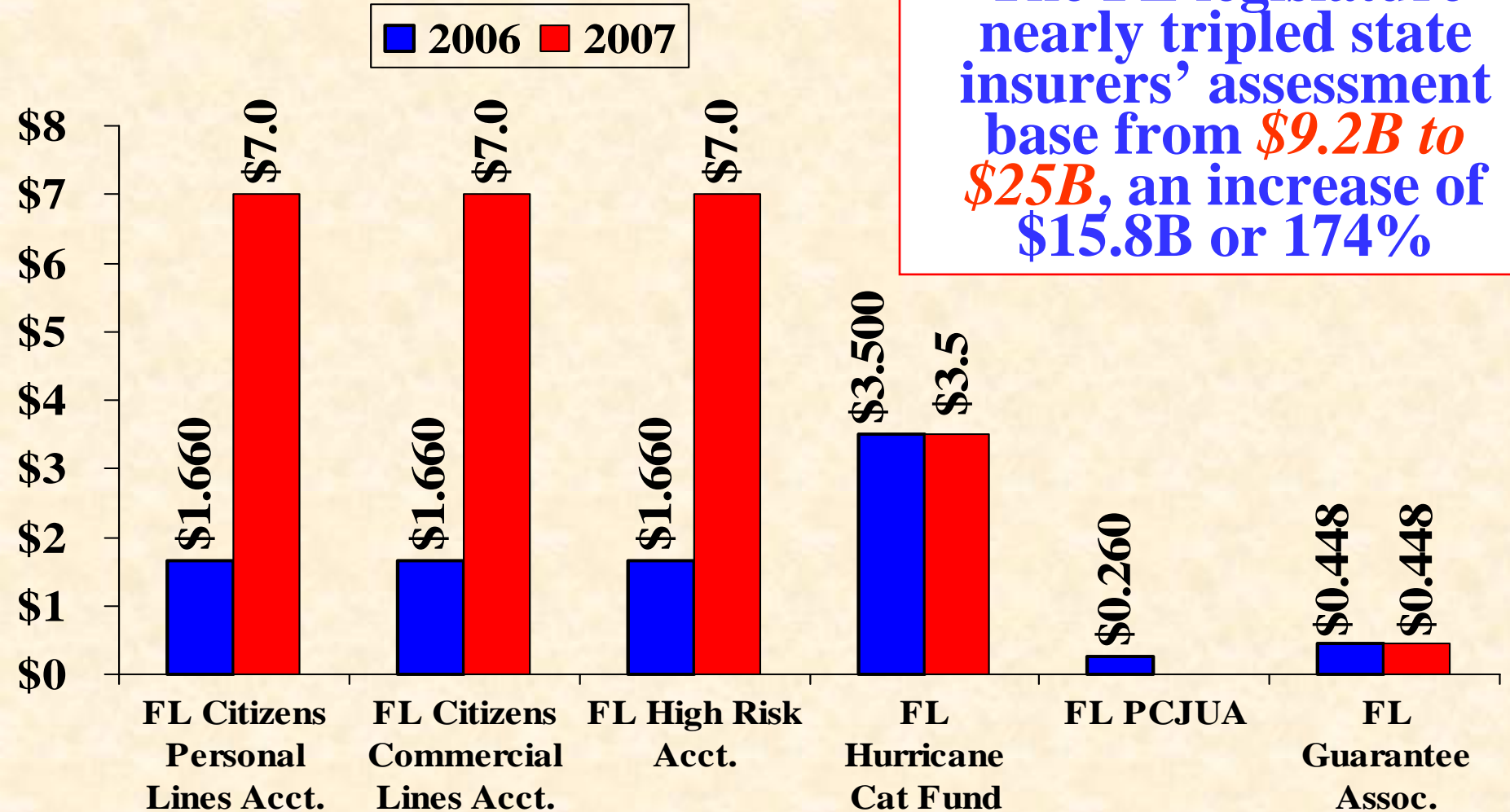
The FL legislature quadrupled the assessment base for Citizens

Sources: Zurich Insurance Technical Center; Ins. Info. Inst. \*Per special legislative session, Jan. 2007.



# Florida Hurricane Max. Policyholder Annual Burden, 2006 vs. 2007\* (\$ Bill)

The FL legislature nearly tripled state insurers' assessment base from **\$9.2B** to **\$25B**, an increase of **\$15.8B** or **174%**



Sources: Zurich Insurance Technical Center; Ins. Info. Inst.

\*Per special legislative session, Jan. 2007.

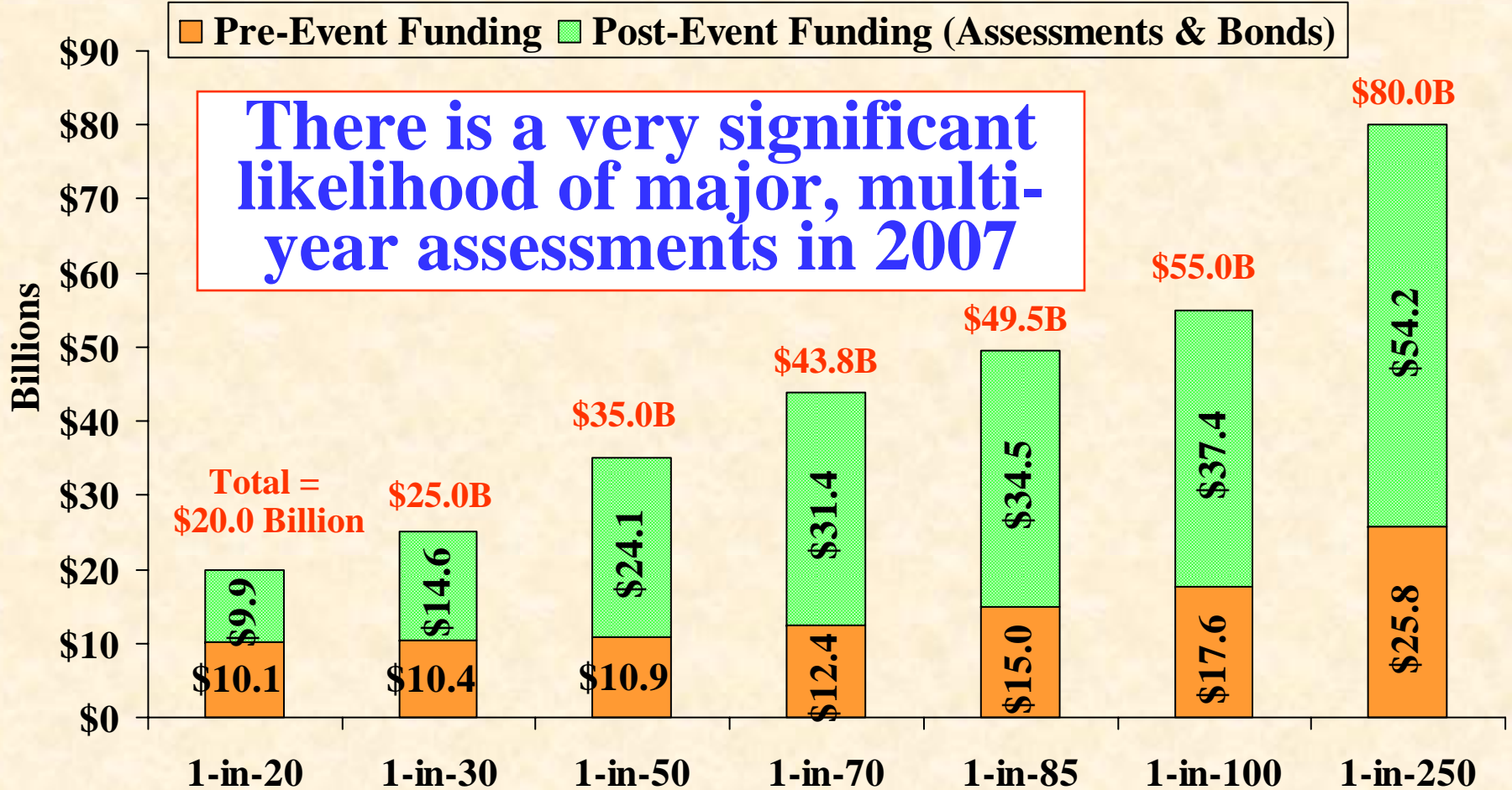


# *Why There is Concern Over the Florida Legislature's & Governor's Changes*

- **Risk is Now Almost Entirely Borne Within State**
- **Virtually Nothing Done to Reduce Actual Vulnerability**
- **Creates Likelihood of Very Large Future Assessments**
- **Potentially Crushing Debt Load**
- **State May be Forced to Raise/Levy Taxes to Avoid Credit Downgrades**
- **Many Policyholder Will See Minimal Price Drop**
  - **“Savings” came from canceling recent/planned rate hikes**
- **Residents in Lower-Risk Areas, Drivers, Business Liability Policyholders Will Come to Resent Subsidies to Coastal Dwellers**
- **Governor's Emergency Order for Rate Freezes & Rollbacks Viewed as Unfair & Capricious**



# Pre- vs. Post-Event in FL for 2007 Hurricane Season



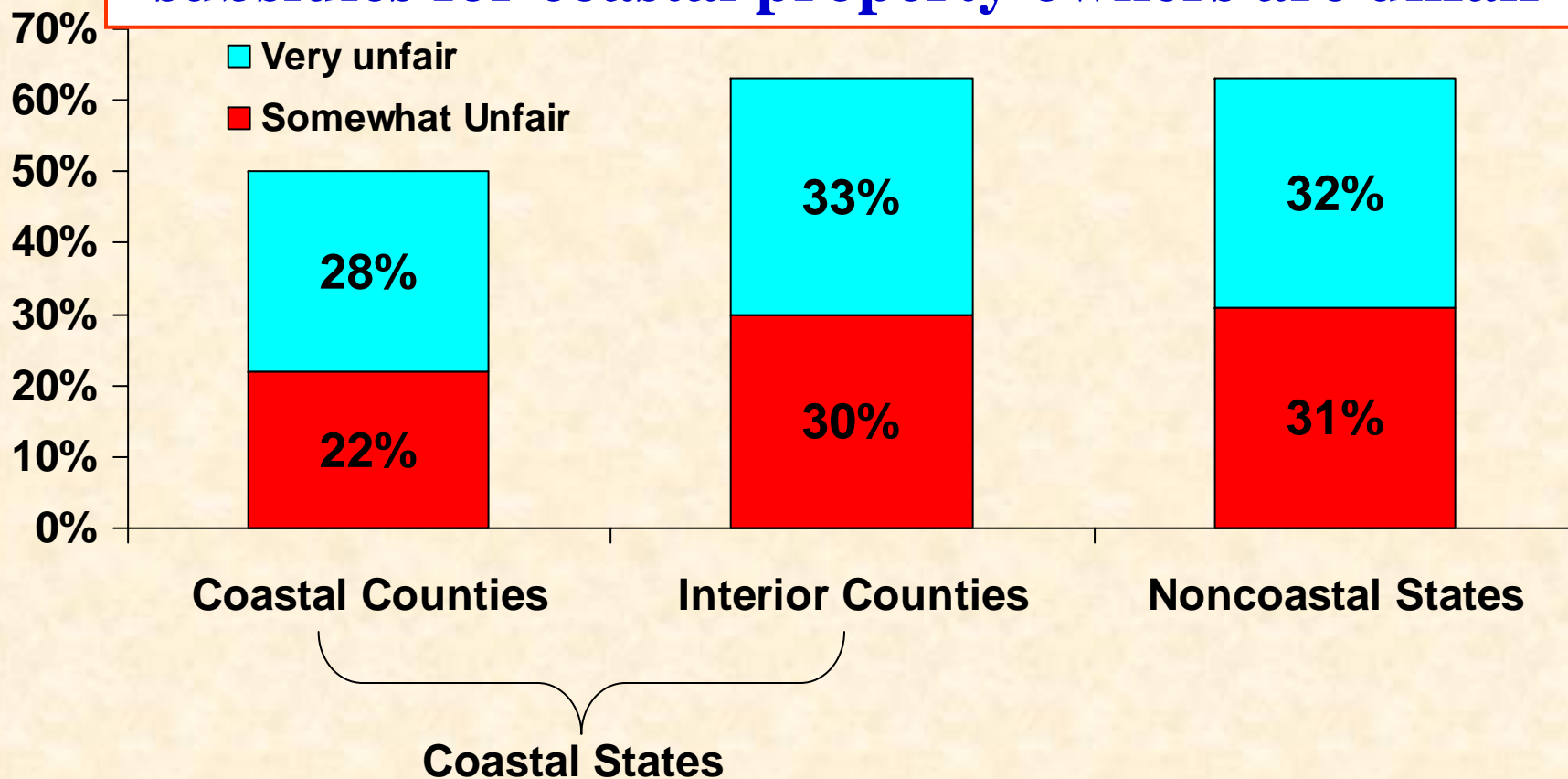
Notes: Pre-event funding includes funds available to Citizens, FHCFC and private carriers plus contingent funding available through private reinsurance to pay claims in 2007. Post-event funding is on a present value basis and does not include financing costs. Probabilities are expressed as “odds of a single storm of this magnitude or greater happening in 2007.”  
Source: Tillinghast Towers Perrin, *Study of Recent Legislative Changes to Florida’s Property Insurance Mechanisms*, 3/07.



# Public Attitude Monitor 2006:

## Unfairness of Policyholder Subsidies

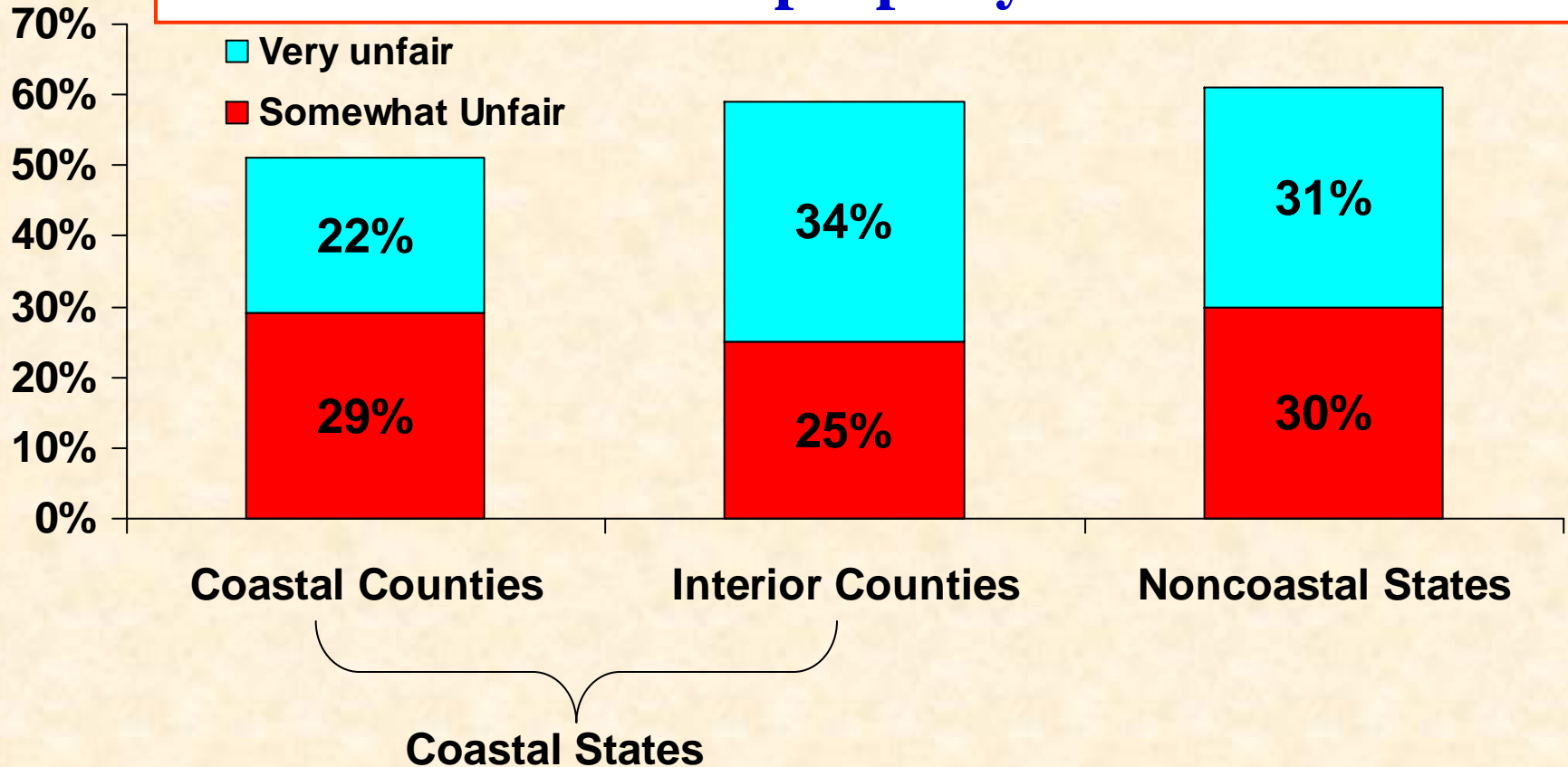
**Most non-coastal policyholders believe premium subsidies for coastal property owners are unfair**





# *Public Attitude Monitor 2006:* *Unfairness of Taxpayer Subsidies*

**Most non-coastal dwellers believe taxpayer subsidies for coastal property owners are unfair**





# Summary

- Quiet 2006 was a welcome respite for insurers and policyholders
- Underwriting results were merely aided by lack of CATs. Strong underwriting results and favorable underlying loss trends accounted for most of the improvement
- Personal & Commercial lines results were *unsustainably* good 2006; Overall profitability reached its highest level (est. 14%) since 1988
- Premium growth rates are slowing to their levels since the late 1990s; Commercial leads decreases
- Clear need to remain underwriting focused for catastrophic and non-cat risks alike
- Major Challenges:
  - Slow Growth Environment Ahead
  - Maintaining price/underwriting discipline
  - Managing variability/volatility of results



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