Overview & Outlook for the Commercial P/C Insurance Industry: Trends, Challenges & Opportunities

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Insurance Industry: Financial Update & Outlook

2014 Was a Reasonably Good Year
2013 Was the Industry’s Best Year in the Post-Crisis Era

Net income rose strongly (+81.9%) in 2013 vs. 2012 on lower cats, capital gains.

• ROE figures are GAAP; \(^1\)Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.7% ROAS through 2014:Q2, 9.8% ROAS in 2013, 6.2% ROAS in 2012, 4.7% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

Sources: A.M. Best, ISO; Insurance Information Institute
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2014:Q3*

1977: 19.0%
1987: 17.3%
1997: 11.6%
2006: 12.7%
2013: 10.4%
2014:Q3 7.6%

History suggests next ROE peak will be in 2016-2017

10 Years
9 Years

*Profitability = P/C insurer ROEs. 2011-14 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers.
Source: Insurance Information Institute; NAIC, ISO, A.M. Best.
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2016F

*Profitability = P/C insurer ROEs. 2011-14 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers. Source: Insurance Information Institute; NAIC, ISO, A.M. Best, Conning
P/C Profitability Is Both by Cyclicality and Ordinary Volatility

- Hugo
- Andrew
- Northridge
- Katrina, Rita, Wilma
- Sept. 11
- 4 Hurricanes
- Sandy
- Record Tornado Losses
- Financial Crisis*
- Modestly higher CATs
- Low CATs

Back to the Future: Profitability Peaks & Troughs in the P/C Insurance Industry, 1950 – 2014*

*Profitability = P/C insurer ROEs. 2011-14 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers. 2014 figure is through Q3.

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

1950-70: ROEs were lower in this period. Low interest rates, low inflation, “Bureau” rate regulation all played a role.

1970-90: Peak ROEs were much higher in this period while troughs were comparable. High interest rates, rapid inflation, economic volatility all played roles.

1990-2010s: Déjà vu. Excluding mega-CATs, this period is very similar to the 1950-1970 period.
As Recently as 2001, Insurers Paid Out Nearly $1.16 for Every $1 in Earned Premiums

Heavy Use of Reinsurance Lowered Net Losses

Relatively Low CAT Losses, Reserve Releases

Relatively Low CAT Losses, Reserve Releases

Avg. CAT Losses, More Reserve Releases

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

Best Combined Ratio Since 1949 (87.6)

Cyclical Deterioration

Sandy Impacts

Lower CAT Losses


Sources: A.M. Best, ISO.
A 100 Combined Ratio Isn’t What It Once Was: Investment Impact on ROEs

Combined Ratio / ROE

A combined ratio of about 100 generates an ROE of ~7.0% in 2012/13, ~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

* 2008-2014 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2014:9M combined ratio including M&FG insurers is 97.7; 2013 = 96.1; 2012 =103.2, 2011 = 108.1, ROAS = 3.5%.
Source: Insurance Information Institute from A.M. Best and ISO Verisk Analytics data.
Return on Net Worth (RNW) All Lines: 2004-2013 Average

Commercial lines have tended to be more profitable than personal lines over the past decade

Source: NAIC; Insurance Information Institute.
RNW All Lines by State, 2004-2013 Average: Highest 25 States

The most profitable states over the past decade are widely distributed geographically, though none are in the Gulf region.

Profitability Benchmark: All P/C
US: 7.9%

Source: NAIC; Insurance Information Institute.
Some of the least profitable states over the past decade were hit hard by catastrophes.
Reserve releases are expected to gradually taper off, but will continue to benefit the bottom line and combined ratio through at least 2016.

Source: A.M. Best; Barclays research for estimates.
Top Insurance Issues: 
*What’s Hot, What’s Not*

No Dominant Even in 2014, but Some Key Commercial Lines Issues Spiked

*Terrorism, TRIA & Cyber*
Terrorism, Cyber, Autonomous/Driverless Vehicles and Aviation insurance issues experienced the sharpest increase in media attention. Year-ago leaders included Flood Insurance and Gun Liability; Hurricanes, Tornadoes and Wildfires faded.

Coverage of Epidemics/Pandemics and insurance increased 85,000% due to the Ebola scare. I.I.I. members uniformly directed media to us. WC was the principal issue, along with business interruption.

Source: Insurance Information Institute based on a search of Lexis/Nexis.
TERRORISM & TRIA LAPSE

Reauthorization Was a Major Industry Effort Over the Past Few Years

Outline of New TRIA Structure
Major Changes

- 6-Year reauthorization
- Trigger rises in steps from $100MM to $200MM
- Industry aggregate retention rises in steps from $27.5B to $37.5B
- Industry co-share above retained losses rise in steps from 15% to 20%

Source: Congressional Budget Office: [http://www.cbo.gov/publication/49866](http://www.cbo.gov/publication/49866); Insurance Information Institute research.
**Industry Aggregate Retention Under TRIA, from Inception through Extension**

**The Industry Aggregate Retention Will Have Nearly Quadrupled from $10 Billion at Inception to $37.5 Billion in 2019**

Industry aggregate retentions will rise by $2B per year from 2015 through 2019.

*First full year of program; TRIA was signed into law on Nov. 26, 2002, with provisions identical to those in 2003.
Source: Insurance Information Institute research.
The TRIA program trigger will double between 2015 and 2020.

Program trigger will rise in steps beginning in 2016 from $100 million to $200 million by 2020.

*First full year of program; TRIA was signed into law on Nov. 26, 2002, with provisions identical to those in 2003. Source: Insurance Information Institute research.
The industry co-pay share will have doubled by 2020 from program inception.

Insurer co-payments in excess of their individual retentions will rise in steps beginning in 2016 from 15% to 20%.

*First full year of program; TRIA was signed into law on Nov. 26, 2002, with provisions identical to those in 2003. Source: Insurance Information Institute research.
INVESTMENTS: THE NEW REALITY

Investment Performance is a Key Driver of Profitability

Depressed Yields Will Necessarily Influence Underwriting & Pricing
Distribution of Invested Assets: P/C Insurance Industry, 2013

$ Billions

- Bonds, 62%
- Stocks, 22%
- Cash, Cash Equiv. & ST Investments, 6%
- All Other, 10%

Total Invested Assets = $1.5 Trillion

Due to persistently low interest rates, investment income fell in 2012, 2013 and 2014.

Investment earnings are still below their 2007 pre-crisis peak.

1 Investment gains consist primarily of interest and stock dividends.  
*2014 figure is estimated based on annualized data through Q3. 
Sources: ISO; Insurance Information Institute.
Yields on 10-Year U.S. Treasury Notes have been essentially below 5% for a full decade.

U.S. Treasury yields plunged to historic lows in 2013. Longer-term yields have rebounded a bit.

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 Dec. 2014.
The yield on invested assets continues to decline as returns on maturing bonds generally still exceed new money yields. The end of the Fed’s QE program in Oct. 2014 should allow some increase in longer maturities while short term interest rate increases are unlikely until mid-to-late 2015.

Sources: Conning.
Interest Rate Forecasts: 2015 – 2020

Yield (%)

3-Month Treasury

10-Year Treasury

The Fed is expected to begin raising short-term rates in mid-2015, but this timeline could easily slip to late 2015 or even 2016

The end of the Fed’s QE program in 2014 and a stronger economy are expected to push longer-term yields higher

A Full Normalization of Interest Rates Is Unlikely Until 2018, More than a Decade After the Onset of the Financial Crisis

Sources: Federal Reserve Board of Governors (historical); Blue Chip Economic Indicators (1/15 for 2015 and 2016; for 2017-2020 10/14 issue); Insurance Info. Institute.
Annual Inflation Rates, (CPI-U, %), 1990–2016F

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

Slack in the U.S. economy and falling energy prices suggests that inflationary pressures should remain subdued for an extended period of times.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 1/15 (forecasts).
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.
Insurers Posted Net Realized Capital Gains in 2010 - 2014 Following Two Years of Realized Losses During the Financial Crisis. Realized Capital Losses Were a Primary Cause of 2008/2009’s Large Drop in Profits and ROE.

Sources: A.M. Best, ISO, Insurance Information Institute.
Total Investment Gains Were Flat in 2014 as Low Interest Rates Pressured Investment Income but Realized Capital Gains Remained Robust

Investment gains in 2014 will rival the post-crisis high reached in 2013

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;

Sources: ISO; Insurance Information Institute.
S&P 500 Index Returns, 1950 – 2015*

Volatility is endemic to stock markets—and may be increasing—but there is no persistent downward trend over long periods of time.

Source: NYU Stern School of Business: [http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html)
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 15.5% in 2012) and then trimmed bonds in the 5-10-year category (from 31.3% in 2003 to 27.6% in 2012). Falling average maturity of the P/C industry’s bond portfolio is contributing to a drop in investment income along with lower yields.

Sources: SNL Financial; Insurance Information Institute.
Capital Accumulation Has Multiple Impacts

The industry now has $1 of surplus for every $0.73 of NPW, close to the strongest claims-paying status in its history.

2010:Q1 data includes $22.5B of paid-in capital from a holding company parent for one insurer’s investment in a non-insurance business.

Sources: ISO, A.M. Best.

The P/C insurance industry entered 2015 in very strong financial condition.
US Policyholder Surplus: 1975–2014*

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

The Premium-to-Surplus Ratio Stood at $0.73:$1 as of 9/30/14, a Near Record Low (at Least in Recent History)

* As of 9/30/14.
The larger surplus is in relation to premiums—the lower the P:S ratio—and the greater the industry’s capacity to handle the risk it has accepted.

The Premium-to-Surplus Ratio Stood at $0.75:$1 as of 9/30/14, a Record Low (at Least in Recent History).

* As of 9/30/14.
Barclay’s suggests that surplus is approximately $200B (~30%)

The Industry’s Strong Capital Position Suggests Insurers Are in a Good Position to Increase Risk Appetite, Repurchase Shares and Pursue Acquisitions

Source: Barclays Research estimates.

Source: Calculations from A.M. Best data by Insurance Information Institute.
Alternative Capital

New Investors Continue to Change the Reinsurance Landscape

Total reinsurance capital reached a record $570B in 2013, up 68% from 2008.

But alternative capacity has grown 210% since 2008, to $50B. It has more than doubled in the past three years.

2014 data is as of June 30, 2014.
Source: Aon Benfield Analytics; Insurance Information Institute.

2014 data is as of June 30, 2014.
Source: Aon Benfield Analytics; Insurance Information Institute.
Growth of Alternative Capital Structures, 2002 - 2014

Collateralized Re’s Growth Has Accelerated in the Past Three Years.

Collateralized Reinsurance and Catastrophe Bonds Currently Dominate the Alternative Capital Market.

2014 data is as of June 30, 2014.
Source: Aon Benfield Analytics; Insurance Information Institute.
2014 Has Seen the Largest Cat Bond Ever - $1.5 Billion (Florida Citizens). Bond Issuance Set a Record.

Source: Guy Carpenter.

Source: Artemis.bm; Insurance Information Institute.
Reinsurance Pricing: Change in Rate on Line for Cat Business

Catastrophe Prices Fell 11 Percent on January 1 Renewals, Driven by Emergence of New Capital, Mild Catastrophe Losses.

2014 reflects change through June 30 from prior year end. 2015 is for January 1 renewals.

Source: Guy Carpenter; Insurance Information Institute.
ILS Issuance by Trigger

Terms Are Shifting Away From ‘Objective’ Triggers (Favored by Investors) Toward Indemnity Trigger (Favored by Insurers).

Source: Artemis.bm; Insurance Information Institute.
U.S. Wind-Exposed Risk Premium*
2010:Q1 to 2014: Q1

* Trailing 12-month average

- Issue of alternative capital in (re)insurance has received increased attention in recent years
- Significant structural changes in property catastrophe reinsurance space
- Questions addressed include:
  - Sources of new capital
  - Reasons/Drivers of growth
  - New structures
  - Impact of major triggering event(s)
  - Impacts of higher interest rates
  - Cat bond yield compression
Questions Arising from Influence of Alternative Capital

- What Will Happen When Investors Face Large-Scale Losses?
- What Happens When Interest Rates Rise?
- Does ILS Have a Higher Propensity to Litigate?
- How Much Lower Will Risk Premiums Shrink/ROLs Fall?
- Will There Be Spillover Into Casualty Reinsurance?
- Will Alternative Capital Drive Consolidation?
Survey Results Suggest Commercial Pricing Has Flattened Out
Average Commercial Rate Change, All Lines, (1Q:2004–4Q:2014)

(Percents)

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

Pricing as of Q4:2014 had turned (slightly) negative for only the 2nd time in 3 years

KRW Effect

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents & Brokers; Insurance Information Institute
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2014:Q4

Percentage Change (%)

Peak = 2001:Q4 +28.5%

Pricing turned negative in early 2004 and remained that way for 7 ½ years.

Trough = 2007:Q3 -13.6%

Pricing turned positive in Q3:2011, the first increase in nearly 8 years; Q1:2014 renewals were up 1.5%; Some insurers posted stronger numbers.

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Barclay’s Capital; Insurance Information Institute.

1999:Q4 = 100

Despite several years of gains, pricing today for midsized accounts is where it was in late 2001 (around 9/11), suggesting additional rate need going forward, esp. in light of record low interest rates.

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Barclay’s Capital; Insurance Information Institute.
Directional Pricing Trend in Large Account P/C Renewals

Early 2009 through Early 2015

Few accounts are seeing increases

Source: Barclays’ Commercial Insurance Buyers Survey.
Change in Commercial Rate Renewals, by Line: 2014:Q4

Major Commercial Lines Renewals Were Mixed to Flat in Q4:2014; Commercial Auto and EPL Led the Way

Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially. Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Performance by Segment

Private Passenger Auto Accounts for 37% of Industry Premiums and Remains the Profit Juggernaut of the P/C Insurance Industry

Homeowners Performance in 2011/12 Impacted by Large Cat Losses. Extreme Regional Variation Can Be Expected Due to Local Catastrophe Loss Activity.

Sources: A.M. Best (1990-2014F); Conning (2015F); Insurance Information Institute.
Commercial Lines Combined Ratio, 1990-2015F*

*2007-2012 figures exclude mortgage and financial guaranty segments.

Commercial Auto Combined Ratio:
1993–2015F

Commercial Auto is Expected to Improve as Rate Gains Outpace Any Adverse Frequency and Severity Trends

Sources: A.M. Best (1990-2014F); Conning (2015F); Insurance Information Institute.
Commercial Multi-Peril Underwriting Performance is Expected to Improve in 2013 Assuming Normal Catastrophe Loss Activity

*2013F-2012F figures are Conning figures for the combined liability and non-liability components. Sources: A.M. Best; Conning; Insurance Information Institute.

Commercial General Liability Underwriting Performance Has Been Volatile in Recent Years

Source: Conning Research and Consulting.
Growth Analysis by State and Business Segment

Post-Crisis Paradox?

*Premium Growth Rates Vary Tremendously by State*
Net Premium Growth: Annual Change, 1971—2016F

(Percent)

1975-78 1984-87 2000-03

Net Written Premiums Fell 0.7% in 2007 (First Decline Since 1943) by 2.0% in 2008, and 4.2% in 2009, the First 3-Year Decline Since 1930-33.

2015-16F: 4.0%
2014E: 3.9%*
2013: 4.6%
2012: +4.3%

*Actual figure based on data through Q3 2014.

Shaded areas denote “hard market” periods

Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.
While homeowners insurance has grown faster than auto over the past decade, auto is generally more profitable.

**Average 2000-2015F**
- **Auto:** 3.0%
- **Home:** 6.2%
- **All Lines:** 3.8%

Sources: A.M. Best (2000-2013); Conning (2014P-2015F); Insurance Information Institute.
Direct Premiums Written: Total P/C Percent Change by State, 2007-2013

Top 25 States

North Dakota was the country’s growth leader over the past 6 years with premiums written expanding by 74.6%, fueled by the state’s energy boom.

Growth Benchmarks: Total P/C

US: 7.9%

Sources: SNL Financial LC.; Insurance Information Institute.
Direct Premiums Written: Total P/C
Percent Change by State, 2007-2013

Bottom 25 States

Growth was negative in 7 states and DC between 2007 and 2013

Sources: SNL Financial LC.; Insurance Information Institute.
Direct Premiums Written: PP Auto
Percent Change by State, 2007-2013

Top 25 States

Growth Benchmarks: PPA
US: 10.9%

Sources: SNL Financial LC.; Insurance Information Institute.
Pvt. Passenger Auto premium growth was negative in 5 states between 2007 and 2013.
P/C ad spend hit an all time record high of $6.175 billion in 2013, up 1.5% over 2012. The pace of growth has slowed from 15.8% in 2011 and 23.8% in 2010.

P/C ad spending has more than tripled since 2002 (up 256% from 2002-2013)

Source: Insurance Information Institute from consolidated P/C Annual Statement data, Insurance Expense Exhibit (Part I).
Growth in Ad Spending has greatly exceeded growth in capacity (policyholder surplus) or premium growth. This suggests that there are diminishing returns to advertising.

Sources: Insurance Information Institute analysis from A.M. Best data.
Direct Premiums Written: Homeowners
Percent Change by State, 2007-2013

Top 25 States

Growth Benchmarks: HO
US: 26.8%

Sources: SNL Financial LLC.; Insurance Information Institute.
Direct Premiums Written: Homeowners
Percent Change by State, 2007-2013

Bottom 25 States

The collapse of the housing bubble hit CA, FL and NV hard, leading to the slowest growth rates in the US between 2007 and 2013.

Sources: SNL Financial LLC.; Insurance Information Institute.
Direct Premiums Written: Comm. Lines
Percent Change by State, 2007-2013

Top 25 States

Only 30 states showed any commercial lines growth from 2007 through 2013

Growth Benchmarks: Commercial
US: 1.3%

Sources: SNL Financial LLC.; Insurance Information Institute.
Direct Premiums Written: Comm. Lines
Percent Change by State, 2007-2013

Bottom 25 States

Nearly half the states have yet to see commercial lines premium volume return to pre-crisis levels.

States with the poorest performing economies also produced the most negative net change in premiums of the past 6 years.

Sources: SNL Financial LLC.; Insurance Information Institute.
Direct Premiums Written: Workers’ Comp
Percent Change by State, 2007-2013*

Only 13 states have seen work comp premium volume return to pre-crisis levels

*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, 2007-2013*

Bottom 25 States

States with the poorest performing economies also produced some of the most negative net change in premiums of the past 6 years

*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.
Predictive analytics is more like to be used in personal lines, but commercial lines use is growing.

82% of insurers report using predicative analytics in at least one line. 18% do not use it all.

Benefits Cited
Drive Profitability: 85%
Reduce Risk: 55%
Grow Revenue: 52%
Improve Op. Efficiency: 39%

Pricing and Underwriting are the leading uses for predictive analytics.

Source: Earnix/ISO September 2013 Survey
The Strength of the Economy Will Influence P/C Insurer Growth Opportunities

Growth Will Expand Insurer Exposure Base Across Most Lines
Demand for Insurance Should Increase in 2015 as GDP Growth Accelerates Modestly and Gradually Benefits the Economy Broadly

* Estimates/Forecasts from Blue Chip Economic Indicators.
Source: US Department of Commerce, Blue Economic Indicators 1/15; Insurance Information Institute.
The economic outlook for most of the US is generally positive, though flat-to-negative for 2 states.

Growth in the West is finally beginning to pick up.
Real GDP by State Percent Change, 2013: Highest 25 States

North Dakota was the economic growth juggernaut of the US in 2013—by far

Only 9 states experienced growth in excess of 3% in 2013, which is what we would see nationally in a more typical recovery

Growth Benchmarks: Real GDP
US: 1.8%

Sources: U.S. Bureau of Economic Analysis; Insurance Information Institute.
Real GDP by State Percent Change, 2013: Lowest 25 States

Growth rates in 11 states were still below 1% in 2013

DC and Alabama were the only states to shrink in 2013

Sources: US Bureau of Economic Analysis; Insurance Information Institute.
Percent Change in Real GDP by State, 2013

Sources: US Bureau of Economic Analysis; Insurance Information Institute.
Consumer confidence had been low for years amid high unemployment, falling home prices and other factors adversely impact consumers, but improved substantially over the past 2+ years, as job growth and falling energy prices aid consumers.

Source: University of Michigan; Insurance Information Institute
New auto/light truck sales fell to the lowest level since the late 1960s. Forecast for 2014-15 is still below 1999-2007 average of 17 million units, but a robust recovery is well underway.

Yearly car/light truck sales will likely continue at current levels, in part replacing cars that were held onto in 2008-12. New vehicles will generate more physical damage insurance coverage but will be more expensive to repair. PP Auto premium might grow by 5% - 6%.

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (1/15 and 10/14); Insurance Information Institute.
Cyclical peaks in PP Auto tend to occur roughly every 10 years (early 1990s, early 2000s and likely the early 2010s)

“Hard” markets tend to occur during recessionary periods

Pricing peak occurred in late 2010 at 5.3%, falling to 2.8% by Mar. 2012

The Dec. 2014 reading of 4.8% is up from 3.3% a year earlier

*Percentage change from same month in prior year; through December 2014; seasonally adjusted
Note: Recessions indicated by gray shaded columns.
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.
Average Expenditures on Auto Insurance

The average expenditure on auto insurance is lower today than it was in 2004

Countrywide Auto Insurance Expenditures Decreased by 0.8% in 2008 and 0.5% in 2009 and Increased 0.5% in 2010, 1.5% in 2011 (est.), 2.0% in 2012 and 2.2% in 2013 (forecast)

* Insurance Information Institute Estimates/Forecasts
Source: NAIC, Insurance Information Institute estimate for 2011-2013 based on CPI and other data.
New Private Housing Starts, 1990-2020F

Insurers Are Continue to See Meaningful Exposure Growth in the Wake of the “Great Recession” Associated with Home Construction: Construction Risk Exposure, Surety, Commercial Auto; Potent Driver of Workers Comp Exposure

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (1/15 and 10/14); Insurance Information Institute.
Yields on 30-Year mortgages have been below 6% for a six years

Mortgages rates plunged to near-record lows in early 2013 but rose as the Fed initiated tapering in its QE program, but have come down again through mid- and late-2014

Rising mortgage interest rates have impacted home sales marginally but are unlikely to derail the recovery on housing

*Monthly, through Dec. 2014. Note: Recessions indicated by gray shaded columns.
I.I.I. Poll: Renters Insurance

Percentage of Renters Who Have Renters Insurance, 2011-2014

Educational efforts about the need for renters insurance are slowly but surely penetrating the large and growing renting population; Understanding of affordability is improving.

Percentage Of Renters With Renters Insurance Is Increasing.

Source: Insurance Information Institute Annual *Pulse* Survey.
Small business optimism in September was at its highest level since Oct. 2006—more than a year before the crisis began.
Business Bankruptcy Filings: Still Falling

Business bankruptcies in 2014 were below both the Great Recession levels and the 2003:Q3-2005:Q1 period (the best five-quarter stretch in the last 20 years). Bankruptcies restrict exposure growth in all commercial lines.

Business Bankruptcy Filings, 1980-2014

% Change Surrounding Recessions

<table>
<thead>
<tr>
<th>Period</th>
<th>Change</th>
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<tbody>
<tr>
<td>1980-82</td>
<td>58.6%</td>
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<tr>
<td>1980-87</td>
<td>88.7%</td>
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<tr>
<td>1990-91</td>
<td>10.3%</td>
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<tr>
<td>2000-01</td>
<td>13.0%</td>
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<tr>
<td>2006-09</td>
<td>208.9%</td>
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2014 bankruptcies totaled 26,983, down 18.8% from 2013—the 5th consecutive year of decline. Business bankruptcies more than tripled during the financial crisis.

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

Private Sector Business Starts: 1993:Q2 – 2013:Q4* As Strong as Ever?

Business Starts
2006: 861,000
2007: 844,000
2008: 787,000
2009: 701,000
2010: 742,000
2011: 781,000
2012: 800,000
2013: 870,000**

Recessions in orange

2013:Q1 578,000 business starts*

Thousands

*Data posted Apr 29, 2014, the latest available; a classification change in 2013:Q1 resulted in a report of 578,000 businesses started in that quarter. Seasonally adjusted. **2014 number assumes 1st quarter equaled average of other three quarters

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

January 2010 through September 2014

Optimism among non-manufacturers has been generally increasing in 2014

Non-manufacturing industries have been expanding and adding jobs. This trend is likely to continue through 2014.

12 Industries for the Next 10 Years: Insurance Solutions Needed

<table>
<thead>
<tr>
<th>Industry</th>
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<tbody>
<tr>
<td>Health Care</td>
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<tr>
<td>Health Sciences</td>
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<tr>
<td>Energy (Traditional)</td>
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<tr>
<td>Alternative Energy</td>
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<td>Petrochemical</td>
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<td>Agriculture</td>
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<td>Natural Resources</td>
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<tr>
<td>Technology (incl. Biotechnology)</td>
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<tr>
<td>Light Manufacturing</td>
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<tr>
<td>Insourced Manufacturing</td>
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<tr>
<td>Export-Oriented Industries</td>
</tr>
<tr>
<td>Shipping (Rail, Marine, Trucking, Pipelines)</td>
</tr>
</tbody>
</table>

Many industries are poised for growth, though insurers’ ability to capitalize on these industries varies widely.
The Construction Sector Is Critical to the Economy and the P/C Insurance Industry
New Construction peaks at $911.8B in 2006

Trough in 2010 at $500.6B, after plunging 55.1% ($411.2B)

2014: Value of new pvt. construction hits $697.7B as of Nov. 2014, up 39% from the 2010 trough but still 25% below 2006 peak

Private Construction Activity Is Moving in a Positive Direction though Remains Well Below Pre-Crisis Peak; Residential Dominates

*2014 figure is a seasonally adjusted annual rate as of November.
Sources: US Department of Commerce [http://www.census.gov/construction/c30/c30index.html](http://www.census.gov/construction/c30/c30index.html) ; Insurance Information Institute.
Overall Construction Activity is Up, But Growth In the Private Sector Slowed in Late 2014 While Picking in the State/Local Sector Government Sector as Budget Woes Ease in Some Jurisdictions

*seasonally adjusted
Source: U.S. Census Bureau, [http://www.census.gov/construction/c30/c30index.html](http://www.census.gov/construction/c30/c30index.html); Insurance Information Institute.
Private Construction Activity is Up in Many Segments, Including the Key Residential Construction Sector; Bodes Well for the Remainder of 2014

*seasonally adjusted
Source: U.S. Census Bureau, [http://www.census.gov/construction/c30/c30index.html](http://www.census.gov/construction/c30/c30index.html); Insurance Information Institute.
Public Construction Activity is Beginning to Recover from its Long Contraction which Will Drive Demand in Many Commercial Insurance Lines

*seasonally adjusted
Real (Inflation-Adjusted) Nonresidential Construction, 2000-2014*

(Bar = CAGR; Line = Y/Y Growth Rate)

Construction activity has generally been positive since late 2010 but has occasionally been erratic. Forecast is for slowing improving growth.

*Through Q1 2014.

Source: US Dept. of Commerce; Wells Fargo Securities (June 6, 2014 research report).
Value of New Federal, State and Local Government Construction: 2003-2014*

Construction across all levels of government peaked at $314.9B in 2009

Austerity Reigns
Govt. construction MAY be turning a corner; still down $37.6B or 11.9% since 2009 peak

Government Construction Spending Peaked in 2009, Helped by Stimulus Spending, but Contracted As State/Local Governments Grappled with Deficits and Federal Sequestration

*2014 figure is a seasonally adjusted annual rate as of November; http://www.census.gov/construction/c30/historical_data.html

Sources: US Department of Commerce; Insurance Information Institute.
New Private Housing Starts, 1990-2020F

(Millions of Units)

Job growth, low inventories of existing homes, low mortgage rates and demographics should continue to stimulate new home construction for several more years.

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

Insurers Are Continue to See Meaningful Exposure Growth in the Wake of the “Great Recession” Associated with Home Construction: Construction Risk Exposure, Surety, Commercial Auto; Potent Driver of Workers Comp Exposure

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (1/15 and 10/14); Insurance Information Institute.
Construction Employment, Jan. 2010—December 2014*

Construction employment is +731,000 above Jan. 2011 (+13.4%) trough

*Seasonally adjusted.
The “Great Recession” and housing bust destroyed 2.3 million construction jobs.

Construction employment troughed at 5.435 million in Jan. 2011, after a loss of 2.291 million jobs, a 29.7% plunge from the April 2006 peak.

Construction employment as of Dec. 2014 totaled 6.166 million, an increase of 731,000 jobs or 13.4% from the Jan. 2011 trough.

Gap between pre-recession construction peak and today: 1.56 million jobs.

The Construction Sector Could Be a Growth Leader in 2014 as the Housing Market, Private Investment and Govt. Spending Recover. WC Insurers Will Benefit.

Note: Recession indicated by gray shaded column.
US Is Becoming an Energy Powerhouse but Fall in Prices Will Have Negative Impact
Crude oil production in the U.S. is expected to increase by 90.6% from 2008 through 2016—and could overtake Saudi Arabia as the world’s largest oil producer.
The U.S. is already the world’s largest natural gas producer—recently overtaking Russia. This is a potent driver of commercial insurance exposures.

Employment in Oil & Gas Extraction, Jan. 2010—Dec. 2014*

Oil and gas extraction employment is up 37.7% since Jan. 2010 as the energy sector booms. (Previous boom in 1979-81, employment peak at 267,000 in March 1982.)

Highest employment in this sector since July 1986.

*Seasonally adjusted
The U.S. Is Experiencing a Mini Manufacturing Renaissance That Is Benefitting the US Economy and the P/C Insurance Industry
Monthly shipments in Nov. 2014 exceeded the pre-crisis (July 2008) peak but has declined in recent months. Manufacturing is energy-intensive and growth leads to gains in many commercial exposures: WC, Commercial Auto, Marine, Property, and various Liability Coverages.

* Seasonally adjusted; Data published Jan. 6, 2015.
Manufacturing Growth for Selected Sectors, 2014 vs. 2013*

Manufacturing of durable goods is stronger than nondurables in 2014

**Durables: +4.8%**

**Non-Durables: +0.5%**

Manufacturing Is Expanding—Albeit Slowly—Across a Number of Sectors that Will Contribute to Growth in Insurable Exposures Including: WC, Commercial Property, Commercial Auto and Many Liability Coverages

*Seasonally adjusted; Date are YTD comparing data through November 2014 to the same period in 2013. Source: U.S. Census Bureau, Full Report on Manufacturers’ Shipments, Inventories, and Orders, [http://www.census.gov/manufacturing/m3/](http://www.census.gov/manufacturing/m3/)*
Manufacturing employment is a surprising source of strength in the economy. Employment in the sector is at a multi-year high.

*Seasonally adjusted.
The manufacturing sector expanded for 58 of the 60 months from Jan. 2010 through Dec. 2014. Pace of recovery has been uneven due to economic turbulence in the U.S., Europe and China.

Index of Total Industrial Production:* A Near Peak as of December 2014

Many economists expect business investment to rise in 2015

Insurance exposures for industrial production will continue growing in 2015, and commercial insurance premium volume with them. Y-o-Y growth to December 2014 was 4.6%. Both production and premium volume growth for 2015 should exceed this.

*Monthly, seasonally adjusted, through December 2014 (which is preliminary). Index based on year 2007 = 100
Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

March 2001 through Dec. 2014

Percent of Industrial Capacity

82%
80%
78%
76%
74%
72%
70%
68%
66%

The US operated at 79.7% of industrial capacity in Dec. 2014, well above the June 2009 low of 66.9% but is still below pre-recession levels.


The closer the economy is to operating at “full capacity,” the greater the inflationary pressure.
Business Fixed Investment is Forecast to Grow Steadily in 2015-16, Fueling Commercial Exposure Growth

Business investment will drive commercial property and liability insurance exposures and should drive employment and WC payroll exposures as well (with a lag).

Sources: Wells Fargo Economic Group; Insurance Information Institute.
Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend Has Greatly Improved
Stubbornly high unemployment and underemployment constrain overall economic growth, but the job market is now clearly improving.

“Headline” unemployment was 5.6% in Dec. 2014. 4.5% to 5.5% is “normal.”

U-6 went from 8.0% in March 2007 to 17.5% in October 2009; Stood at 11.2% in Oct. 2014. 8% to 10% is “normal.”

US Unemployment Rate Forecast

2007:Q1 to 2016:Q4F*

* = actual; = forecasts
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (1/15 edition); Insurance Information Institute.

Rising unemployment eroded payrolls and WC’s exposure base.
Unemployment peaked at 10% in late 2009.

Jobless figures have been revised downwards for 2015/16

Unemployment forecasts have been revised modestly downwards. Optimistic scenarios put the unemployment as low as 5.0% by Q4 of 2015.
Monthly Change in Private Employment

January 2007 through Dec. 2014 (Thousands, Seasonally Adjusted)

Private Employers Added 11.20 million Jobs Since Jan. 2010 After Having Shed 5.01 Million Jobs in 2009 and 3.76 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)


Billions

$7,750
$7,500
$7,250
$7,000
$6,750
$6,500
$6,250
$6,000
$5,750
$5,500

Prior Peak was 2008:Q3 at $6.54 trillion

Recent trough (2009:Q1) was $6.23 trillion, down 5.3% from prior peak

Latest (2014:Q3) was $7.46 trillion, a new peak--$1.21 trillion above 2009 trough

Growth rates
2011:Q3 over 2010:Q3: 4.1%
2012:Q3 over 2011:Q3: 3.2%
2013:Q3 over 2012:Q3: 3.6%
2014:Q3 over 2013:Q3: 4.4%

Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.
Sources: [http://research.stlouisfed.org/fred2/series/WASCUR](http://research.stlouisfed.org/fred2/series/WASCUR); National Bureau of Economic Research (recession dates); Insurance Information Institute.
Payroll vs. Workers Comp Net Written Premiums, 1990-2014P

Payroll Base* $Billions

Wage & Salary Disbursements WC NPW

WC premium volume dropped two years before the recession began

WC net premiums written were down $14B or 29.3% to $33.8B in 2010 after peaking at $47.8B in 2005

Continued Payroll Growth and Rate Gains Suggest WC NWP Will Grow Again in 2015

*Private employment; Shaded areas indicate recessions. WC premiums for 2014 are I.I.I. estimates..
Sources: NBER (recessions); Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR; NCCI; I.I.I.
Construction Employment, Jan. 2010—December 2014*

Construction employment is +734,000 above Jan. 2011 (+13.5%).

Constructions and manufacturing employment constitute 1/3 of all workers comp payroll exposure.

*Seasonally adjusted; Dec and Nov 2014 are preliminary

Construction employment troughed at 5.435 million in Jan. 2011, after a loss of 2.291 million jobs, a 29.7% plunge from the April 2006 peak.

The “Great Recession” and housing bust destroyed 2.3 million constructions jobs.

Construction employment peaked at 7.726 million in April 2006.

The Construction Sector Could Be a Growth Leader in 2015 as the Housing Market, Private Investment and Govt. Spending Recover.

Note: Recession indicated by gray shaded column.
In the past 5 years (from January 2010) manufacturing employment is up (+877,000 or +7.7%) and still growing.

Manufacturing employment is a surprising source of strength in the economy. Employment in the sector is at a multi-year high.

*Seasonally adjusted; Dec and Nov 2013 are preliminary

Oil and gas extraction employment is up 37.7% since Jan. 2010 as the energy sector booms. (Previous boom in 1979-81, employment peak at 267,000 in March 1982.)

*Seasonally adjusted
Workers Compensation
Operating Environment

Workers Comp Results Have Improved Substantially in Recent Years
Workers Compensation Combined Ratio: 1994–2014E

WC results have improved markedly since 2011

Workers Comp Results Began to Improve in 2012. Underwriting Results Deteriorated Markedly from 2007-2010/11 and Were the Worst They Had Been in a Decade.

Sources: A.M. Best (1994-2009); NCCI (2010-2014F) and are for private carriers only; Insurance Information Institute.
Workers Compensation Premium: Third Consecutive Year of Increase

<table>
<thead>
<tr>
<th>Year</th>
<th>State Funds ($ B)</th>
<th>Private Carriers ($ B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>90</td>
<td>31.0</td>
<td>31.3</td>
</tr>
<tr>
<td>91</td>
<td>34.3</td>
<td>34.6</td>
</tr>
<tr>
<td>92</td>
<td>35.4</td>
<td>35.3</td>
</tr>
<tr>
<td>93</td>
<td>33.6</td>
<td>33.6</td>
</tr>
<tr>
<td>94</td>
<td>30.1</td>
<td>28.5</td>
</tr>
<tr>
<td>95</td>
<td>26.9</td>
<td>25.9</td>
</tr>
<tr>
<td>96</td>
<td>26.9</td>
<td>25.0</td>
</tr>
<tr>
<td>97</td>
<td>25.9</td>
<td>26.1</td>
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<tr>
<td>98</td>
<td>25.9</td>
<td>25.0</td>
</tr>
<tr>
<td>99</td>
<td>28.1</td>
<td>32.1</td>
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<tr>
<td>00</td>
<td>37.7</td>
<td>42.3</td>
</tr>
<tr>
<td>01</td>
<td>46.5</td>
<td>47.8</td>
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<td>02</td>
<td>46.5</td>
<td>46.5</td>
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<tr>
<td>03</td>
<td>44.3</td>
<td>39.3</td>
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<td>04</td>
<td>39.3</td>
<td>34.6</td>
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<tr>
<td>05</td>
<td>33.8</td>
<td>33.8</td>
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<td>06</td>
<td>30.3</td>
<td>29.9</td>
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<tr>
<td>07</td>
<td>32.3</td>
<td>36.4</td>
</tr>
<tr>
<td>08</td>
<td>35.1</td>
<td>39.6</td>
</tr>
<tr>
<td>09</td>
<td>41.9</td>
<td>41.9</td>
</tr>
</tbody>
</table>

Pvt. Carrier NWP growth was +5.4% in 2013 and 8.7% in 2012

Source: 1990–2013p Private Carriers, Annual Statement Data, NCCI.
1996–2013p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements
State Funds available for 1996 and subsequent
2013 Workers Compensation Direct Written
Premium Growth, by State*

PRIVATE CARRIERS: Overall 2013 Growth = +5.4%

While growth rates varied widely, all states experienced positive growth in 2013

*Excludes monopolistic fund states (in white): OH, ND, WA and WY.
Source: NCCI.
Workers Compensation Lost-Time Claim Frequency Declined in 2013

Lost-Time Claims

Percent

Cumulative Change of −55.4%
(1991–2011 adj.)

Frequency Change: 2007—2012

Contracting: 7.9→7.1  -9.3%
Manufacturing: 13.6→12.0  -11.8%

Accident Year

*Adjustments primarily due to significant audit activity.
2013p: Preliminary based on data valued as of 12/31/2013
1991–2012: Based on data through 12/31/2012, developed to ultimate
Based on the states where NCCI provides ratemaking services, including state funds; excludes high deductible policies
Frequency is the number of lost-time claims per $1M pure premium at current wage and voluntary loss cost level
Source: NCCI.
Workers Compensation Medical Severity Moderate Increase in 2013

### Medical Claim Cost ($000s)

**Average Medical Cost per Lost-Time Claim**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Change</td>
<td>+1.9%</td>
<td>+8.9%</td>
<td>+5.2%</td>
</tr>
</tbody>
</table>

**Cumulative Change = 256% (1991-2013p)**

1991-2012: Based on data through 12/31/2012, developed to ultimate
Based on the states where NCCI provides ratemaking services including state funds, excluding WV; Excludes high deductible policies.
WC Medical Severity Generally Outpaces the Medical CPI Rate

Average annual increase in WC medical severity form 1995 through 2011 was well above the medical CPI (6.8% vs. 3.8%), but the gap is narrowing.

Though moderating, medical inflation will continue to exceed inflation in the overall economy.

Average Annual Growth Average 1995 – 2013
Healthcare: 3.8%
Total Nonfarm: 2.4%

*July 2014 compared to July 2013.
U.S. health care expenditures have been on a relentless climb for most of the past half century, far outstripping population growth, inflation of GDP growth.

From 1965 through 2013, US health care expenditures had increased by 69 fold. Population growth over the same period increased by a factor of just 1.6. By 2022, health spending will have increased 119 fold.

Health care expenditures as a share of GDP rose from 5.8% in 1965 to 18.0% in 2013 and are expected to reach 19.9% of GDP by 2022.

Since 2009, health expenditures as a % of GDP have flattened out at about 18%--the question is why and will it last?

The Affordable Care Act & Implications for P/C Insurance

The ACA Is Now Being Fully Implemented; Consequences for P/C Insurance Are Yet to Be Determined
Projected Number of People with No Health Insurance, 2013—2022*

By 2018 the number of people under age 65 without insurance is expected to drop by 25 million (~45%).

The projected decline in the uninsured population is very sensitive to the enrollment rate under the Affordable Care Act.

*Under age 65.
# A Few Potential Impacts of the ACA on Workers Compensation

<table>
<thead>
<tr>
<th>Issue</th>
<th>Concern</th>
<th>Contravening Argument</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surge in People Covered by Health Insurance</td>
<td>• System is overwhelmed</td>
<td>• Over time, people will have access to preventative care, improving the general health of the population</td>
</tr>
<tr>
<td></td>
<td>• MD shortage</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Patient care adversely impacted</td>
<td>• Greater use of PA’s, etc.</td>
</tr>
<tr>
<td>Electronic Health Records</td>
<td>• Cost</td>
<td>• Computerization of patient data could help flag issues and improve risk management and improve patient outcomes</td>
</tr>
<tr>
<td>Claim Shifting</td>
<td>• Provider/patient may prefer claim handled via WC system</td>
<td>• Reduction in uninsured population reduces shifting</td>
</tr>
<tr>
<td>Reimbursement Rates</td>
<td>• Cuts in MC reimbursement rates could makes docs less willing to take WC claims</td>
<td>• Impact would be short-lived. All MC-linked states already boost WC reimbursements</td>
</tr>
</tbody>
</table>

Source: Insurance Information Institute research; WCRI.
ACA Impact on WC May Occur via Changes in Rates Set by State Regulators

- WC rates often tied to Medicare but can change for reasons independent of this link
- There could be both positive and negative effects of a cut in Medicare rates on WC performance in states which tie reimbursement to Medicare
  - WC reimbursement rates would go down
  - Doctors may be unwilling to see WC patients:
    - 64% of Dr.’s surveyed said they would stop accepting new Medicare patients if planned rate cuts go through; some of these same doctors may also refuse WC patients if WC rates also decrease
- These effects would likely be short lived
  - All states which tie their fee schedules to Medicare already increase the Medicare rates to set WC rates, so any drop in the Medicare rates would likely be soon offset by a higher WC adjustment

WC Maximum Allowable Reimbursement Rates 
as Percentage of Medicare

PPACA May Have Distinct Impacts on WC Depending on Claim Frequency/Severity

Industry Portfolio by Claim Type

*Relative Volume by Claim Frequency & Paid Dollars*

- **High Volume, Low Severity**
  - *Ex: med only, quick to settle, <25K*

- **Complicated**
  - *Ex: back pain claims, very litigious*

- **Catastrophic Injuries**
  - *Ex: spinal cord injury, multiple trauma claims*

**Potential ACA Impact**

- Expanded coverage may shift some small claims to the health insurance system (+)
- Physician access problems could lead to indemnity increases and may bleed into the complicated cases (-)
- Preventative care and early record keeping decreases WC comorbidities (+)
- Soft tissue treatments, a large portion of “slow burn claims,” may decrease in cost (+)
- No significant impacts

**SOURCE:** Christopher Cunniff, FCAS, *Impacts of Healthcare Reform on Workers Compensation.*
Possible Effects on Workers Comp

1. Could slow the growth in WC medical care costs
   - IPAB recommendations and PCORI reports, plus Medicare changes, could have beneficial effects on cost and treatment effectiveness

2. Could ACA be first step in federal regulation of insurance products and markets?
   - Will regulation like that requiring products to be priced to meet Medical Loss Ratios be applied to WC?
   - Will cost-control mechanisms such as the Independent Payment Advisory Board be developed for WC?
   - Will WC insurers lose their limited exemption from anti-trust laws that they have had under McCarran-Ferguson since 1945?
# Potential Impacts of the ACA on Medical Professional Liability

<table>
<thead>
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<th>Contravening Argument</th>
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</thead>
<tbody>
<tr>
<td>Surge in People Covered by Health Insurance</td>
<td>• System is overwhelmed&lt;br&gt;• Doctors spend less time on patients&lt;br&gt;• Patient care adversely impacted</td>
<td>• Over time, people will have access to preventative care, improving the general health of the population&lt;br&gt;• People are receiving care already via suboptimal channels&lt;br&gt;• Less use of ERs</td>
</tr>
<tr>
<td>Electronic Health Records</td>
<td>• Digitization could create a treasure trove of data for plaintiff attorneys</td>
<td>• Computerization of patient data could help flag issues and improve risk management and improve patient outcomes</td>
</tr>
<tr>
<td>MPL Claim Severity</td>
<td>• More large verdicts will</td>
<td>• ACA will help contain system costs</td>
</tr>
</tbody>
</table>

Source: Insurance Information Institute research.
2014 Experiencing Below Average CAT Activity Following a Welcome Respite in 2013 from Very High CAT Losses in 2011/12
2013 was a welcome respite from 2012, the 3rd costliest year for insured disaster losses in US history. Longer-term trend is for more—not fewer—costly events.

*Through 12/31/14.

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

Catastrophe losses as a share of all losses reached a record high in 2012

Avg. CAT Loss Component of the Combined Ratio by Decade

- 1960s: 1.04
- 1970s: 0.85
- 1980s: 1.31
- 1990s: 3.39
- 2000s: 3.52
- 2010s: 6.1E*

Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2013*

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.

*2010s represent 2010-2013.
Homeowners Insurance Combined Ratio: 1990–2015F

Homeowners Performance in 2011/12 Impacted by Large Cat Losses but Lower CATs Helped 2013. Extreme Regional Variation Can Be Expected Due to Local Catastrophe Loss Activity

Top 8 States for Insured Catastrophe Losses, 2013

Oklahoma led the US with nearly $2 billion in insured CAT losses in 2013.

Source: The Property Claim Services (PCS) unit of ISO, a Verisk Analytics company.
Inflation Adjusted U.S. Catastrophe Losses by Cause of Loss, 1994–2013

1. Catastrophes are defined as events causing direct insured losses to property of $25 million or more in 2013 dollars.
2. Excludes snow.
3. Does not include NFIP flood losses.
4. Includes wildland fires.
5. Includes civil disorders, water damage, utility disruptions and non-property losses such as those covered by workers compensation.

Source: ISO’s Property Claim Services Unit.

- Hurricanes & Tropical Storms, $159.1
- Wind/Hail/Flood (3), $14.6
- Geological Events, $18.4
- Terrorism, $24.8
- Winter Storms, $24.7
- Events Involving Tornadoes (2), $139.3
- Fires (4), $5.5
- Other (5), $0.2

Wind losses are by far cause the most catastrophe losses, even if hurricanes/TS are excluded.
Top 16 Most Costly Disasters in U.S. History

(Insured Losses, 2013 Dollars, $ Billions)

Superstorm Sandy in 2012 was the last mega-CAT to hit the US

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

Sources: PCS; Insurance Information Institute inflation adjustments to 2013 dollars using the CPI.
Federal Disaster Declarations Patterns: 1953-2014

Disaster Declarations Set New Records in Recent Years
The number of federal disaster declarations set a new record in 2011, with 99, shattering 2010’s record 81 declarations.

54 federal disasters were declared in 2014*

The Number of Federal Disaster Declarations Is Rising and Set New Records in 2010 and 2011 Before Dropping in 2012-2014

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


Federal Disasters Declarations by State, 1953 – 2014: Lowest 25 States*

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


Natural Hazard Risk Scores, 2014
Highest 25 States*

Florida received the highest Natural Hazard Risk Score

Note: Score is based on data on 9 natural hazards: flood, wildfire, tornado, storm surge, earthquake, straight-line wind, hurricane, wind, hail and sinkhole.

*Analysis Includes DC. Excludes Alaska and Hawaii due to limited natural hazard risk data.

Sources: CoreLogic release “CoreLogic Identifies US States at Highest Risk of Property Damage Loss from Natural Hazards,” Sept. 10, 2014; Insurance Information Institute.
Natural Hazard Risk Scores, 2014
Bottom 24 States*

Michigan and West Virginia received the lowest Natural Hazard Risk Score

Note: Score is based on data on 9 natural hazards: flood, wildfire, tornado, storm surge, earthquake, straight-line wind, hurricane, wind, hail and sinkhole.

*Analysis Includes DC. Excludes Alaska and Hawaii due to limited natural hazard risk data.

Sources: CoreLogic release “CoreLogic Identifies US States at Highest Risk of Property Damage Loss from Natural Hazards,” Sept. 10, 2014; Insurance Information Institute.
Cyber Risk is a Rapidly Emerging Exposure for Businesses Large and Small in Every Industry

Rapidly Increasing Interest from Businesses, Media & Public Policymakers
Data Breaches 2005-2014, by Number of Breaches and Records Exposed

# Data Breaches/Millions of Records Exposed

<table>
<thead>
<tr>
<th>Year</th>
<th># Data Breaches</th>
<th># Records Exposed (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>157</td>
<td>66.9</td>
</tr>
<tr>
<td>2006</td>
<td>321</td>
<td>27.7</td>
</tr>
<tr>
<td>2007</td>
<td>446</td>
<td>222.5</td>
</tr>
<tr>
<td>2008</td>
<td>656</td>
<td>162</td>
</tr>
<tr>
<td>2009</td>
<td>498</td>
<td>498</td>
</tr>
<tr>
<td>2010</td>
<td>662</td>
<td>419</td>
</tr>
<tr>
<td>2011</td>
<td>16.2</td>
<td>22.9</td>
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<tr>
<td>2012</td>
<td>87.9</td>
<td>17.2</td>
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<tr>
<td>2013</td>
<td>85.6</td>
<td>19.1</td>
</tr>
<tr>
<td>2014</td>
<td>783</td>
<td>222.5</td>
</tr>
</tbody>
</table>

The Total Number of Data Breaches Rose 28% While the Number of Records Exposed Was Relatively Flat (-2.6%)

* 2014 figures as of Jan. 12, 2014 from the ITRC.
Source: Identity Theft Resource Center.
Worldwide Cybersecurity Spending, 2011-2016F


Data/Privacy Breach: Many Potential Costs Can Be Insured

- Costs of notifying regulatory authorities
- Costs of notifying affecting individuals
- Defense and settlement costs
- Lost customers and damaged reputation
- Cyber extortion payments
- Forensic costs to discover cause
- Business Income Loss
- Regulatory fines at home & abroad

Source: Zurich Insurance; Insurance Information Institute
The Three Basic Elements of Cyber Coverage: Prevention, Transfer, Response

Cyber risk management today involves three essential components, each designed to reduce, mitigate or avoid loss. An increasing number of cyber risk products offered by insurers today provide all three.

Source: Insurance Information Institute research.

- I.I.I.’s 2nd report on cyber risk released June 2014
- Provides information on cyber threats and insurance market solutions
- Global cyber risk overview
  - Quantification of threats by type and industry
- Cyber security and cost of attacks
- Cyber terrorism
- Cyber liability
- Insurance market for cyber risk
- 3rd Report in Q2 2015
Shifting Legal Liability & Tort Environment

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

Tort costs in dollar terms have remained high but relatively stable since the mid-2000s, but are down substantially as a share of GDP.

Sources: Towers Watson, 2011 Update on US Tort Cost Trends, Appendix 1A
Tort Costs and the Share Retained by Risks Both Grew Rapidly from the mid-1970s to mid-2000s, When Tort Costs Began to Fall But Self-Insurance Shares Continued to Rise

Commercial Lines Tort Costs: Insured vs. Self-(Un)Insured Shares, 1973-2010

The Share of Tort Costs Retained by Risks Has Been Steadily Increasing for Nearly 40 Years. This Trend Contributes Has Left Insurers With Less Control Over Pricing.

## Business Leaders Ranking of Liability Systems in 2012

### Best States
1. Delaware
2. Nebraska
3. Wyoming
4. Minnesota
5. Kansas
6. Idaho
7. Virginia
8. North Dakota
9. Utah
10. Iowa

### Worst States
41. Florida
42. Oklahoma
43. Alabama
44. New Mexico
45. Montana
46. Illinois
47. California
48. Mississippi
49. Louisiana
50. West Virginia

### New in 2012
- Wyoming
- Minnesota
- Kansas
- Idaho

### Drop-offs
- Indiana
- Colorado
- Massachusetts
- South Dakota

### Newly Notorious
- Oklahoma

### Rising Above
- Arkansas

The Nation’s Judicial Hellholes: 2012/2013

**Watch List**
- Philadelphia, Pennsylvania
- South Florida
- Cook County, Illinois
- New Jersey
- Nevada
- Louisiana

**Dishonorable Mention**
- MO Supreme Court
- WA Supreme Court

Source: American Tort Reform Association; Insurance Information Institute
Thank you for your time and your attention!

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