Insurance & the Challenges of Economic Uncertainty

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26 November 2002

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Presentation Outline

Challenges of Economic Uncertainty

• Economic Origins & Geopolitical Instability
• Exogenous (External Influences)
• Endogenous (Internal Influences)
• Conclusions
• Q&A
The Impacts & Implications

**IMPACTS:**
- Volatile revenue streams
- Volatile underwriting results
- Volatile investment returns
- Inconsistent financial performance

**IMPLICATIONS:**
- Low Return on Equity
- Unattainable Cost of Capital
- Mergers and Acquisitions Difficult
ECONOMIC OVERVIEW

- Weak/Weakening Growth
- Geopolitical Uncertainty
Economic outlook for 2003 is mixed/weakening for major economies, esp. US, W. Europe, Japan.
Economy is experiencing sluggish growth following the recession of 2001
(first recession since 1990/91)

Source: US Department of Commerce, Blue Economic Indicators 10/02, Insurance Information Institute.
Profitability among the Fortune 500 has fallen during the difficult economic period of the past 2-3 years.

Source: Insurance Information Institute; Fortune

Recession Years (1970; 74-75; 80-82; 90-91; 2001)
Non-Recession Years (all other years, 1970-2001)

- Inflation (CPI)
- NWP Growth (unadj.)
- Real NWP Growth
- ROE--P/C Insurers*
- ROE--All Industries*
- ROE--Banks*
- ROE--Diversified Financial*

*GAAP return on equity, adjusted for inflation; Bank data 1952-2001; Div. Fin. 1987-2001
Source: Insurance Information Institute
Geopolitical Instability Remains High

Terrorists & Terrorism

Expansion of War

War on Terrorism

Is Iraq Next?
MANIFESTATIONS OF ECONOMIC UNCERTAINTY ON GLOBAL INSURANCE INDUSTRY:

- Profitability
- Underwriting Performance
- Ratings/Downgrades
- Management Shifts
US Non-Life Net Income After Taxes
1991-2002 ($ Millions)

- 2001 was the first year ever with a full year net loss
- 2002 First Half ROE = 3.3%

*I.I.I. estimate based on first half 2002 data.
Sources: A.M. Best, ISO, Insurance Information Institute.
There is an enormous gap between the industry’s cost of capital and its rate of return. US P/C insurers have missed their cost of capital by an average 6.7 points since 1991.
Gap Between Required and Actual UW Result Needed to Achieve Target ROE

As a % of Premium

<table>
<thead>
<tr>
<th>Country</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>-7.4</td>
</tr>
<tr>
<td>Canada</td>
<td>-7.0</td>
</tr>
<tr>
<td>U.K.</td>
<td>-12.6</td>
</tr>
<tr>
<td>France</td>
<td>-12.3</td>
</tr>
<tr>
<td>Germany</td>
<td>-14.3</td>
</tr>
</tbody>
</table>

Most major insurer markets missing target ROEs by wide margins even before 11 September

Note: US, Canada are 2000 data, 1999 for all others

Source: Swiss Re, sigma 5/01.

Return on Equity

Source: Insurance Information Institute; Insurance Bureau of Canada.
P/C Industry Combined Ratio

2001 = 115.7
2002E = 105.0*

Combined Ratios
1970s: 100.3
1980s: 109.2
1990s: 107.7
2000s: 110.4

*Based on first half 2002 results
Sources: A.M. Best; III
Growth in Premium Volume: Life vs. Non-Life*

Life insurance growth led the way in the 1990s through 2000. Non-Life growth will lead the way for some time to come.

*Growth rates based on premium volume in local currencies.
Source: Swiss Re, sigma 6/01.
**Growth in Net Premiums Written**
(All US Non-Life Lines)

The underwriting cycle went AWOL in the 1990s.

*Estimate based on first half 2002 results.*
Source: A.M. Best, Insurance Information Institute
Ratings Downgrades: Swarms of Downgrades Stinging Insurers

Reasons for Recent Downgrades of Insurers Worldwide

- Asbestos
- Reserve Deficiencies
- Management Issues (e.g., transitions)
- Reinsurance Uncollectibles
- Investment Write-Downs
- Adverse Development
- Missed/Shifting Earnings Targets
**Large Number of Senior Management Changes: Symptomatic of Underlying Difficulties**

### Senior Management Changes at Many Companies

- American Re AMP Ltd. Annuity & Life Re
- Assicur. Generali AXA Corp Solutions Caliber One
- CA State Fund Chubb Cigna
- CNA Credit Suisse Employers Re
- General Star Gerling MLP
- Mutual Risk Mgmt OneBeacon Royal & SunAlliance
- Royal America Safeco St. Paul
- Scor Swiss Life Trenwick
- Zurich

Source: Morgan Stanley as of Nov. 8, 2002.
SOURCES OF VOLATILITY & UNCERTAINTY

Exogenous & Endogenous Factors
EXOGENOUS INFLUENCES

Catastrophic Loss
Investment Volatility
Crisis in Corporate Governance
Excessive Litigiousness
Health Care Cost Inflation
Terrorism
Worldwide Insured Catastrophe Losses

In Billions of 2001 US Dollars

Source: Swiss Re
U.S. Insured Catastrophe Losses

CAT Losses for 2001 Set a Record
- 20 events (lowest since 1969)
- 1.5 million claims
- 9/11: $20.3B = 51,000 claims

*Estimate through October 2002.
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.
Source: Property Claims Service, Insurance Information Institute
The slide in equity markets has been felt more acutely by European and life companies because of the higher proportion of equities held.
US: Total Returns for Large Company Stocks: 1970-2002*

- Headed for 3rd consecutive year of decline for stocks
- Last happened 1939-1941
- Stocks account for just 21% of p/c insurer investments

*As of November 1, 2002.
Source: Ibbotson Associates, Insurance Information Institute
Common stock accounts for about 1/5 of invested assets.

Source: A.M. Best, Insurance Information Institute
Investment income in 2002 is expected to fall 5% due primarily to historically low interest rates.

Facts:
- 1997 Peak = $41.5B
- 2000 = $40.7B
- 2001 = $37.7B
- 2002E = $35.8B

Source: A.M. Best, Insurance Information Institute
1. Historically low interest rates are the primary driver behind lower investment yields. Nevertheless, overall insurer investment performance outpaces all major market indices and almost every major category of mutual fund.

2. 66% of the industry’s invested assets are in bonds.

*Average for week ending November 1, 2002.
Source: Board of Governors, Federal Reserve System; Insurance Information Institute
Falling Interest Rates Mean Lower Bond Yields for Years to Come

3-Month Yields

Most Recent 2002
Year Ago

Source: Blue Chip Economic Indicators, October 2002.

Interest rates are down globally. More room to fall in Europe than in US or Japan.
Accounting Problems are Getting Many Companies into Trouble

• Enron was tip of an iceberg

• Major implications for insurers (p/c and life)
Corporate Governance: Expensive and Hard-Learned Lessons

- Crisis of Confidence—skepticism is on the rise
  - Ratings agencies  Analysts  Regulators
  - Investors/Creditors  Employees  Lawmakers

- Regulatory/Legislative Fallout Unclear
  - SEC is “rudderless”
  - Enormous number of investigations under way
    - SEC, State Attorneys General, IRS, DoJ, etc.
    - Most new SEC cases are against large companies
  - Many competing reforms from Congress, SEC, A.G.’s., NYSE, NASDAQ, etc.
  - Collectively are likely to help, at least somewhat

- SEC, Administration & Congressional proposals vary

- Surge in shareholder suits well underway
The number of financial restatements is rising even though the number of publicly traded companies is falling.
Serious Implications for Insurers

- Insurers exposed to a wide variety of risks:
  - Investment risk (as institutional investors)
  - Insurance risk (surety, D&O, E&O, etc.)
  - Litigation risk (as both plaintiff & defendant)
  - Accounting Risk
  - Regulatory risk
Enron-Related Losses for Insurers

Total Exposure (Life & Non-Life): $3.796 Billion

- Enron is the biggest bankruptcy in US history ($31B+)
- Equity/debt widely-held as S&P 500 company
- Biggest impact in institutional investors/creditors
- 11 Congressional investigations
- 56 suits against officers & directors
- Will spark similar suits

Source: Loss estimates from Morgan Stanley as Feb. 8, 2002; Insurance Information Institute.
Average U.S. Jury Awards 1994 vs. 2000

Source: Jury Verdict Research; Insurance Information Institute.
Cost of U.S. Tort System
($ Billions)

Tort costs consumed 2.0% of GDP annually on average since 1990, expected to rise to 2.4% of GDP by 2005!

Tort costs equaled $636 per person in 2000!
Expected to rise to $1,000 by 2005

Source: Tillinghast-Towers Perrin; Insurance Information Institute estimates for 2001/2002 assume tort costs equal to 2% of GDP. 2005 forecasts from Tillinghast.
Who Will Pay for the US Asbestos Mess?

Estimated Total US Settlements & Expenses = $200 billion

- Asbestos Defendants: 39% ($78 billion)
- US Insurers: 30% ($60 billion)
- Foreign Insurers: 31% ($62 billion)

Source: Tillinghast-Towers Perrin; Insurance Information Institute
Non-Malignant Asbestos Claimants
File Most Claims, Get Most $$$

DISTRIBUTION OF CLAIMS

1991-2000

- Non-malignant: 90%
- Lung & Other Cancers: 7%
- Meso-thelioma: 3%

Source: RAND, Tillinghast-Towers Perrin

ALLOCATION OF COMPENSATION

1991-2000

- Non-malignant: 65%
- Meso-thelioma: 17%
- Lung & Other Cancers: 18%

Source: RAND, Tillinghast-Towers Perrin
THE CHALLENGE OF TERRORISM
Sept. 11 Industry Loss Estimates
($ Billions)

- Life $2.7 (7%)
- Aviation Liability $3.5 (9%)
- Other Liability $10.0 (25%)
- Aviation Hull $0.5 (1%)
- Workers Comp $2.0 (5%)
- Event Cancellation $1.0 (2%)
- Property - WTC 1 & 2 $3.5 (9%)
- Property - Other $6.0 (15%)
- Biz Interruption $11.0 (27%)

Consensus Insured Losses Estimate: $40.2B

Source: Insurance Information Institute
**Insured Loss Estimates**
*(updated through September 13, 2002)*

Top 20 Groups (pre-tax, net of reinsurance, $ millions)

<table>
<thead>
<tr>
<th>Group</th>
<th>Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lloyd's</td>
<td>2,913</td>
</tr>
<tr>
<td>Munich Re*</td>
<td>2,442</td>
</tr>
<tr>
<td>Berk Hath</td>
<td>2,400</td>
</tr>
<tr>
<td>Swiss Re</td>
<td>2,316</td>
</tr>
<tr>
<td>Allianz</td>
<td>1,323</td>
</tr>
<tr>
<td>XL</td>
<td>960</td>
</tr>
<tr>
<td>Aioi</td>
<td>952</td>
</tr>
<tr>
<td>St. Paul</td>
<td>941</td>
</tr>
<tr>
<td>Zurich**</td>
<td>900</td>
</tr>
<tr>
<td>Nissan</td>
<td>840</td>
</tr>
<tr>
<td>AIG</td>
<td>820</td>
</tr>
<tr>
<td>Citigroup</td>
<td>769</td>
</tr>
<tr>
<td>Hartford</td>
<td>677</td>
</tr>
<tr>
<td>ACE</td>
<td>650</td>
</tr>
<tr>
<td>Chubb</td>
<td>645</td>
</tr>
<tr>
<td>Taeko***</td>
<td>606</td>
</tr>
<tr>
<td>ERC</td>
<td>600</td>
</tr>
<tr>
<td>Axa</td>
<td>550</td>
</tr>
<tr>
<td>Liberty, Mut.</td>
<td>468</td>
</tr>
<tr>
<td>ING</td>
<td>462</td>
</tr>
<tr>
<td>Royal &amp; Sun</td>
<td>440</td>
</tr>
<tr>
<td>Partner Re</td>
<td>412</td>
</tr>
</tbody>
</table>
| **Source:** Morgan Stanley, Insurance Information Institute as of September 13, 2002.

**NOTES:**
*Includes $474 mil for American Re
**Includes $289 mil for Converium
***Insurer is bankrupt*
Industry Losses Under Proposed Federal Backstop Using 9/11 Scenario
(as proposed/interpreted as of 10/18/02)

Total Ind. Loss: $10.875B
$14.25B
$19.675B

Assumes $30B Commercial Prop & WC Loss, $125B “At Risk” Commercial DPW

Source: Insurance Information Institute.
Top 5 Costliest Terrorist Attacks
(by insured property loss*)

$ Millions, Adjusted to 2001 Price Level

9/11 Terrorist Attacks
- 9/11/01
  - 3,056 Killed
  - 4,000 Injured

Bomb Near NatWest Tower in London
- 4/24/93
  - 1 Killed
  - 54 Injured

IRA Car Bomb Near Manchester Mall
- 6/15/96
  - 0 Killed
  - 228 Injured

Bomb in WTC Garage
- 2/26/93
  - 6 Killed
  - 725 Injured

Bomb in London Financial District
- 4/10/92
  - 3 Killed
  - 91 Injured

Oklahoma City bombing in 1995 cost insurers $145 million, killed 166, 467 injured

*Includes business interruption and aviation hull losses.
Source: Swiss Re; Insurance Information Institute.
Total International Terrorist Attacks (1981-2001)

The number of terrorist attacks in 2001 actually declined!

Source: US Department of State
International Terrorist Attacks by Region, 1996-2001

Source: US Department of State
ENDOGENOUS INFLUENCES

Cyclicality
Capacity/Capital
Reserve Deficiencies
Pricing
Mergers & Acquisitions
**Length of Underwriting Cycle, Selected Countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Cycle Length (Years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>12.03</td>
</tr>
<tr>
<td>Malaysia</td>
<td>12.01</td>
</tr>
<tr>
<td>France</td>
<td>10.19</td>
</tr>
<tr>
<td>U.S.</td>
<td>7.39</td>
</tr>
<tr>
<td>Japan</td>
<td>7.07</td>
</tr>
<tr>
<td>Canada</td>
<td>5.79</td>
</tr>
<tr>
<td>Spain</td>
<td>5.73</td>
</tr>
<tr>
<td>Australia</td>
<td>5.18</td>
</tr>
<tr>
<td>Italy</td>
<td>4.84</td>
</tr>
</tbody>
</table>


*Study found no cycles evident in Austria, Denmark, S. Korea or Taiwan.
RESTORE & REBUILD DESTROYED CAPACITY
Global Non-Life Insurance Capacity is Falling Dramatically

Global non-life capacity is down 25% over the past 2 years

Sources: Insurance Information Institute, Swiss Re
Capital Funds as a Percentage of Net Premium

Global capital ratios are shrinking

Source: Swiss Re.
Surplus (capacity) peaked at $336.3 Billion in mid-1999 and has fallen by 15.9% ($53.4 billion) to $282.9 billion since then.

- Surplus fell 2.3% in the 1st half of 2002
- Surplus is now lower than at year-end 1997.

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

*As of June 30, 2002
Source: A.M. Best, Insurance Information Institute
Capital Raising by Non-Life Insurers Worldwide Since Sept. 11, 2001*

Capital Raising by P/C Insurers Since 9/11 Totals $53.2B

*As of September 13, 2002.

Source: Morgan Stanley, Insurance Information Institute.
Capital Myth: US P/C Insurers Have $300 Billion to Pay Terrorism Claims

Total PHS = $298.2 B as of 6/30/01
= $282.9 B as of 6/30/02

"Target" Commercial*
$100 billion
33%

Personal
$150 billion
50%

Other Commercial
$50 billion
17%

Only 33% of industry surplus backs up "target" lines

"Target" Commercial includes: Comm property, liability and workers comp; Surplus must also back-up on non-terrorist related property/liability and WC claims
Source: Insurance Information Institute
U.S. Reserve Deficiency, by Line
(AY 1992-2001, as of 12/01)

Estimated Deficiency

- Total Excluding A&E: $64 Billion
- A&E Deficiency: $55 Billion
- Total Including A&E: $120 Billion

*Occurrence and claims made
Source: Morgan Stanley
# US: Commercial Rate Survey

## Third Quarter 2002

### Rate Increases By Line of Business

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>No Change</th>
<th>Up 1-10%</th>
<th>10-20%</th>
<th>20-30%</th>
<th>30-50%</th>
<th>50%-100%</th>
<th>&gt;100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comm. Auto</td>
<td>6%</td>
<td>18%</td>
<td>37%</td>
<td>24%</td>
<td>12%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Workers Comp</td>
<td>9%</td>
<td>16%</td>
<td>27%</td>
<td>23%</td>
<td>13%</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>General Liability</td>
<td>8%</td>
<td>13%</td>
<td>38%</td>
<td>28%</td>
<td>9%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Comm. Umbrella</td>
<td>4%</td>
<td>9%</td>
<td>12%</td>
<td>27%</td>
<td>27%</td>
<td>11%</td>
<td>5%</td>
</tr>
<tr>
<td>D&amp;O</td>
<td>4%</td>
<td>9%</td>
<td>21%</td>
<td>16%</td>
<td>18%</td>
<td>16%</td>
<td>3%</td>
</tr>
<tr>
<td>Comm. Property</td>
<td>8%</td>
<td>9%</td>
<td>30%</td>
<td>23%</td>
<td>21%</td>
<td>5%</td>
<td>0%</td>
</tr>
<tr>
<td>Business Interr.</td>
<td>13%</td>
<td>17%</td>
<td>31%</td>
<td>20%</td>
<td>6%</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>Surety Bonds</td>
<td>16%</td>
<td>13%</td>
<td>17%</td>
<td>20%</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>Med Mal</td>
<td>5%</td>
<td>3%</td>
<td>5%</td>
<td>6%</td>
<td>17%</td>
<td>11%</td>
<td>19%</td>
</tr>
</tbody>
</table>

*Source: Council of Insurance Agents and Brokers*
Prices rising, limits falling: ROL up significantly

Source: Guy Carpenter

* III Estimate
Insurance Mergers and Acquisitions

- Number of M&As was down 39.4% during the first half of 2002 vs. first half 2001.
- Value of deals was down 80.8%.
- None of the top deals were in the P/C sector

Source: Compiled from Conning & Company reports.
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