

# The Legend of the Price-Gouging Insurer

November 2002



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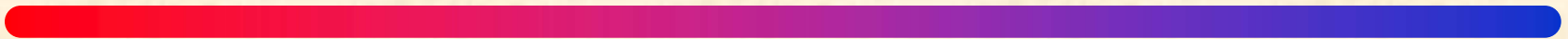
# *Presentation Outline*

- **Overview**

## **URBAN LEGENDS OF THE HARD MARKET**

- **Insurers are Making a Killing**
- **Commercial Insurance is More Expensive than Ever**
- **Rate Hikes are to Make Up for 9/11 Losses**
- **Rate Hikes are Mostly Due to Bad Investments**
- **There's No Connection Between Litigiousness & Rates**
- **Insurers are Drowning in Capital**
- **Insurers are “Redlining” Businesses post-9/11**
- **The Federal Terrorism Backstop will Solve Everything**
- **Investors are Satisfied with P/C Stock Performance**
- **Q&A**

***PRICING:***  
***Past, Present &***  
***Future***





# CIAB Rate Survey

Third Quarter 2002

## Rate Increases By Size of Account

	No Change	Up 1-10%	10-20%	20-30%	30-50%	50%-100%	>100%
Small (<\$25K)	8%	17%	46%	19%	2%	0%	0%
Med (\$25-\$100K)*	6%	8%	23%	44%	13%	2%	0%
Large (>\$100K)**	6%	6%	14%	38%	21%	2%	0%

\*1% indicated a decline of between 1% and 10%.

\*\*1% indicated a decline of between 10% and 20%; 12% indicated don't know or don't handle this type of account

Source: Council of Insurance Agents and Brokers



# CIAB Rate Survey

Third Quarter 2002

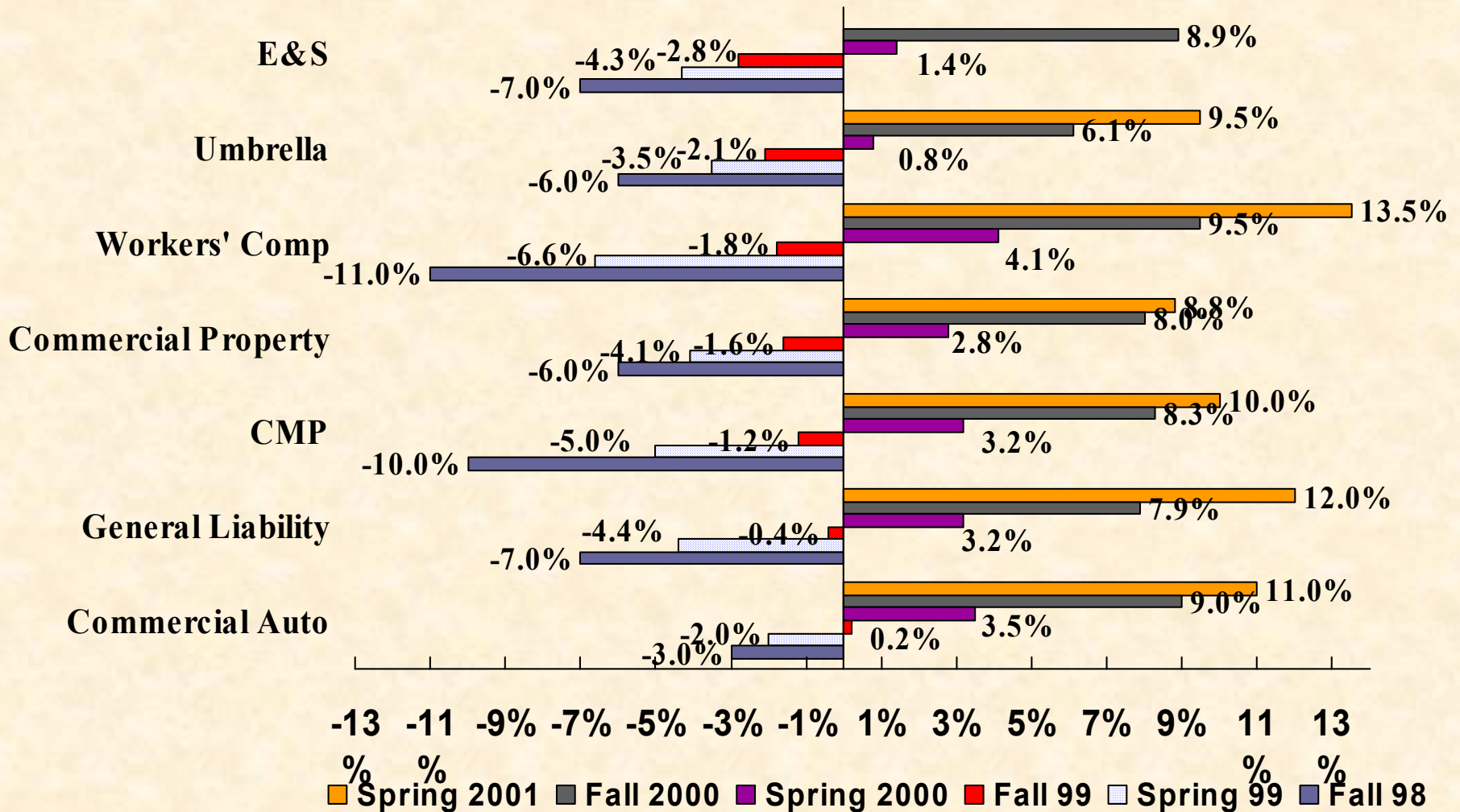
## Rate Increases By Line of Business

No

Change	Up 1-10%	10-20%	20-30%	30-50%	50%-100%	>100%	
Comm. Auto	6%	18%	37%	24%	12%	0%	0%
Workers Comp	9%	16%	27%	23%	13%	2%	0%
General Liability	8%	13%	38%	28%	9%	1%	0%
Comm. Umbrella	4%	9%	12%	27%	27%	11%	5%
D&O	4%	9%	21%	16%	18%	16%	3%
Comm. Property	8%	9%	30%	23%	21%	5%	0%
Business Interr.	13%	17%	31%	20%	6%	2%	0%
Surety Bonds	16%	13%	17%	20%	2%	0%	1%
Med Mal	5%	3%	5%	6%	17%	11%	19%



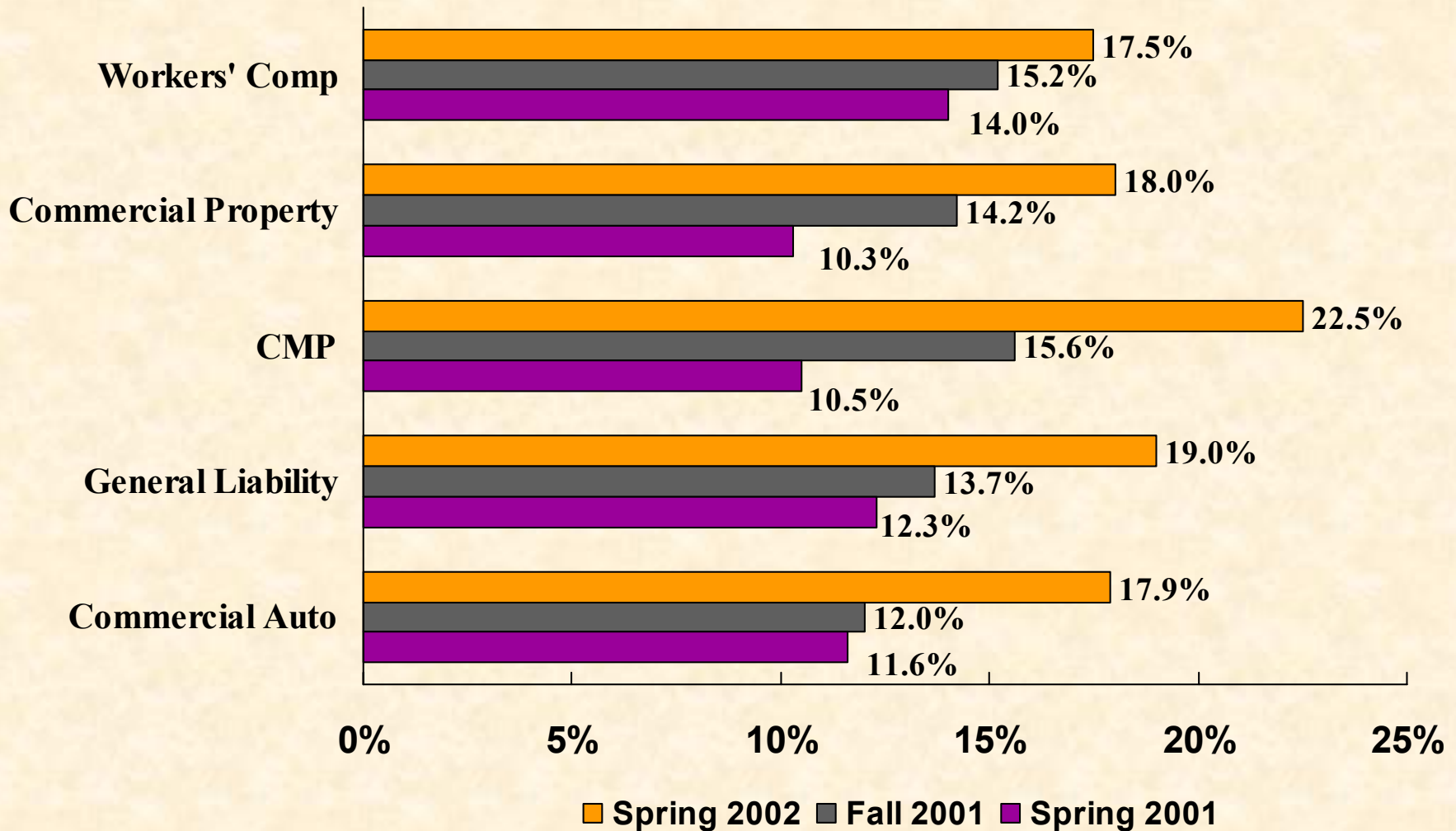
# Average Price Change of Commercial Insurance Renewals (Pre-9/11)



Source: Conning



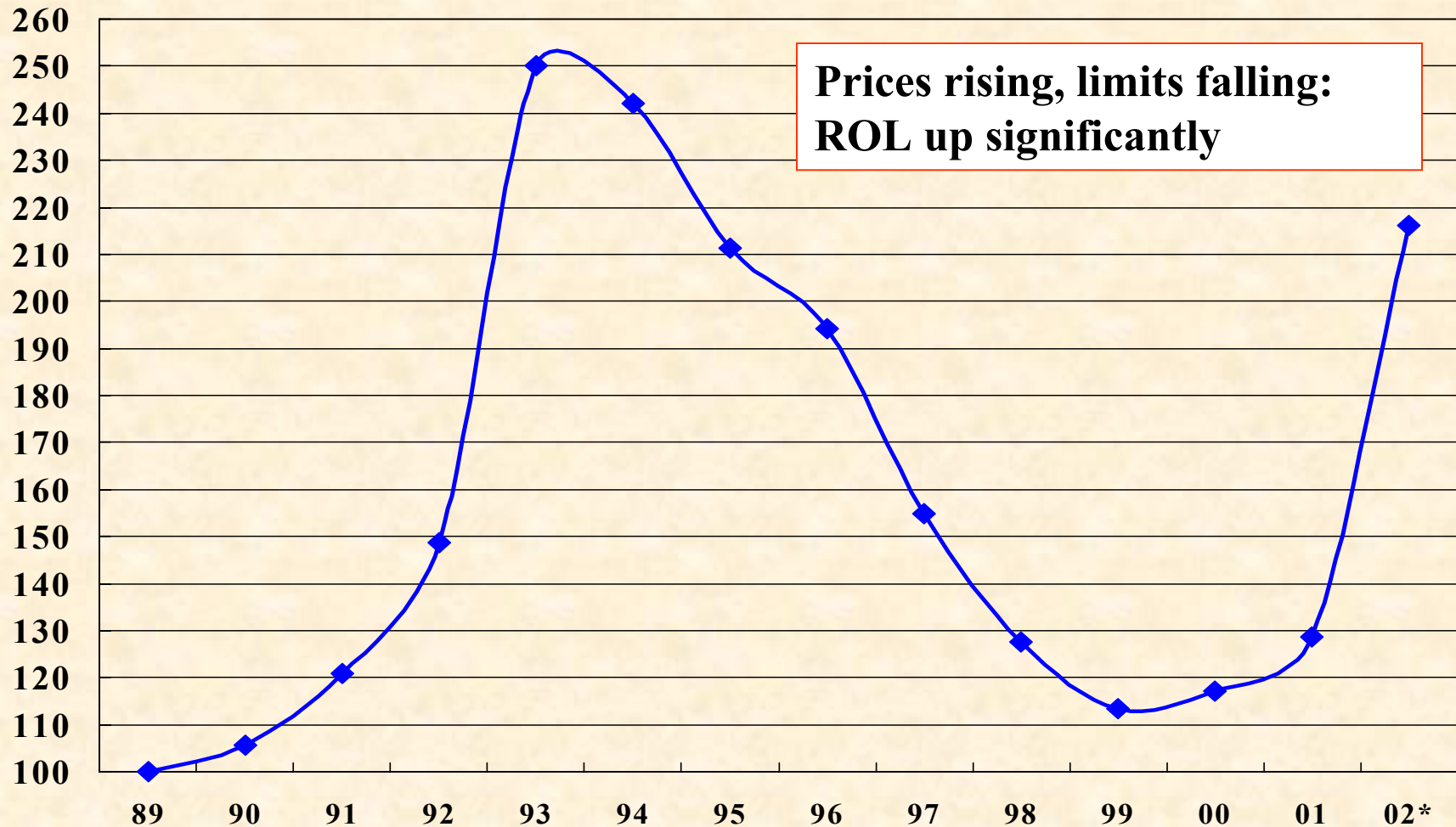
# Average Price Change of Commercial Insurance Renewals



Source: Conning



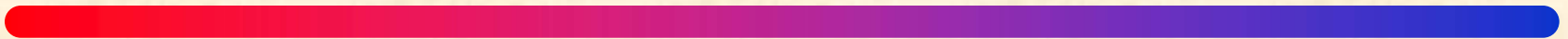
# Rate On Line Index (1989=100)



Source: Guy Carpenter

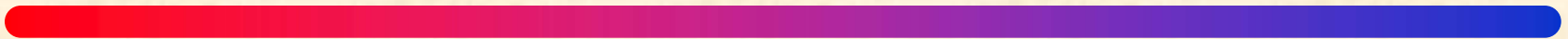
\* III Estimate

# DEBUNKING URBAN LEGENDS OF THE HARD MARKET



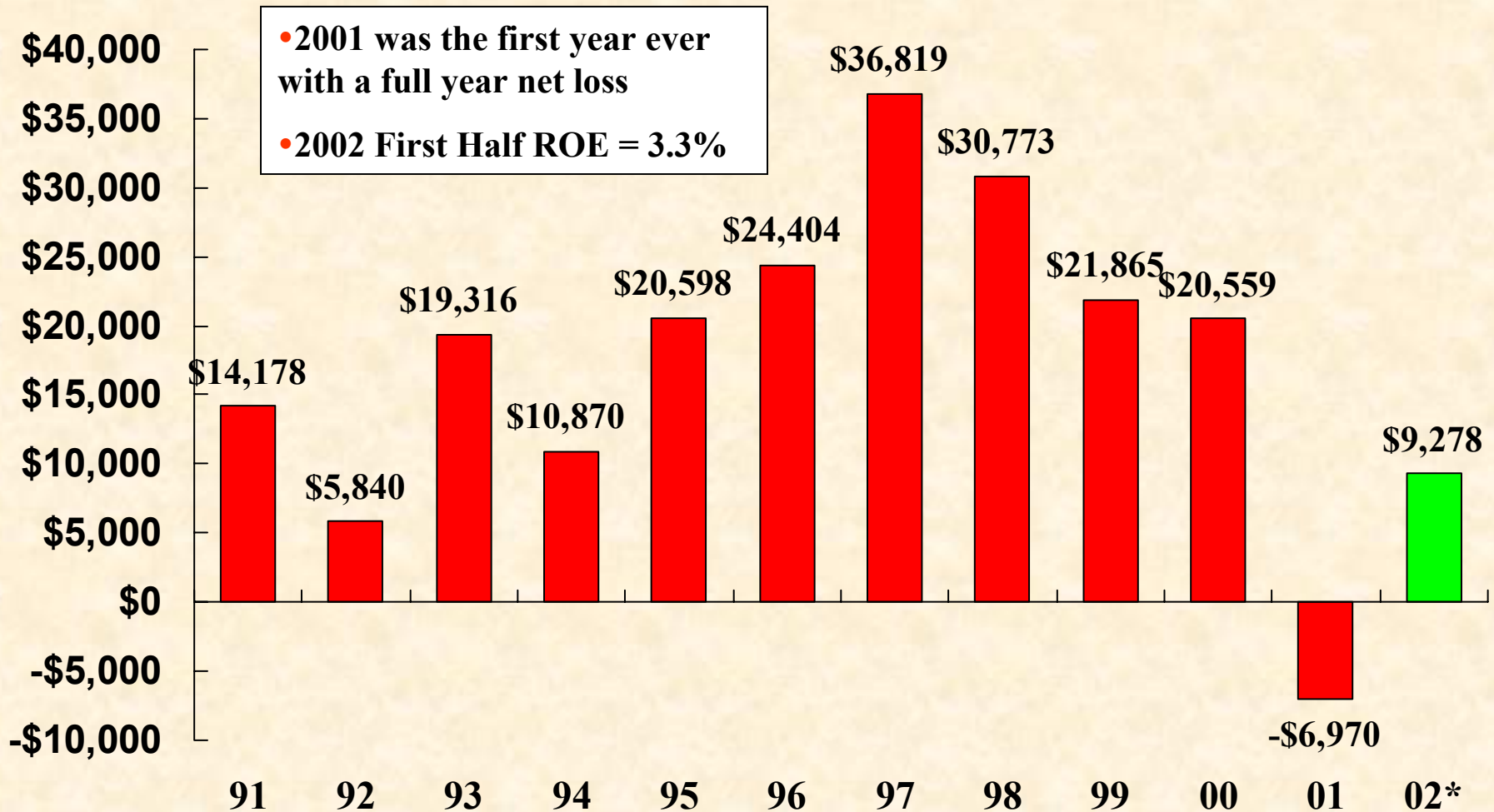
# *Legend #1:*

Insurers are Exploiting the  
Current Hard Market and  
Making a Killing





# *P/C Net Income After Taxes* *1991-2002 (\$ Millions)*



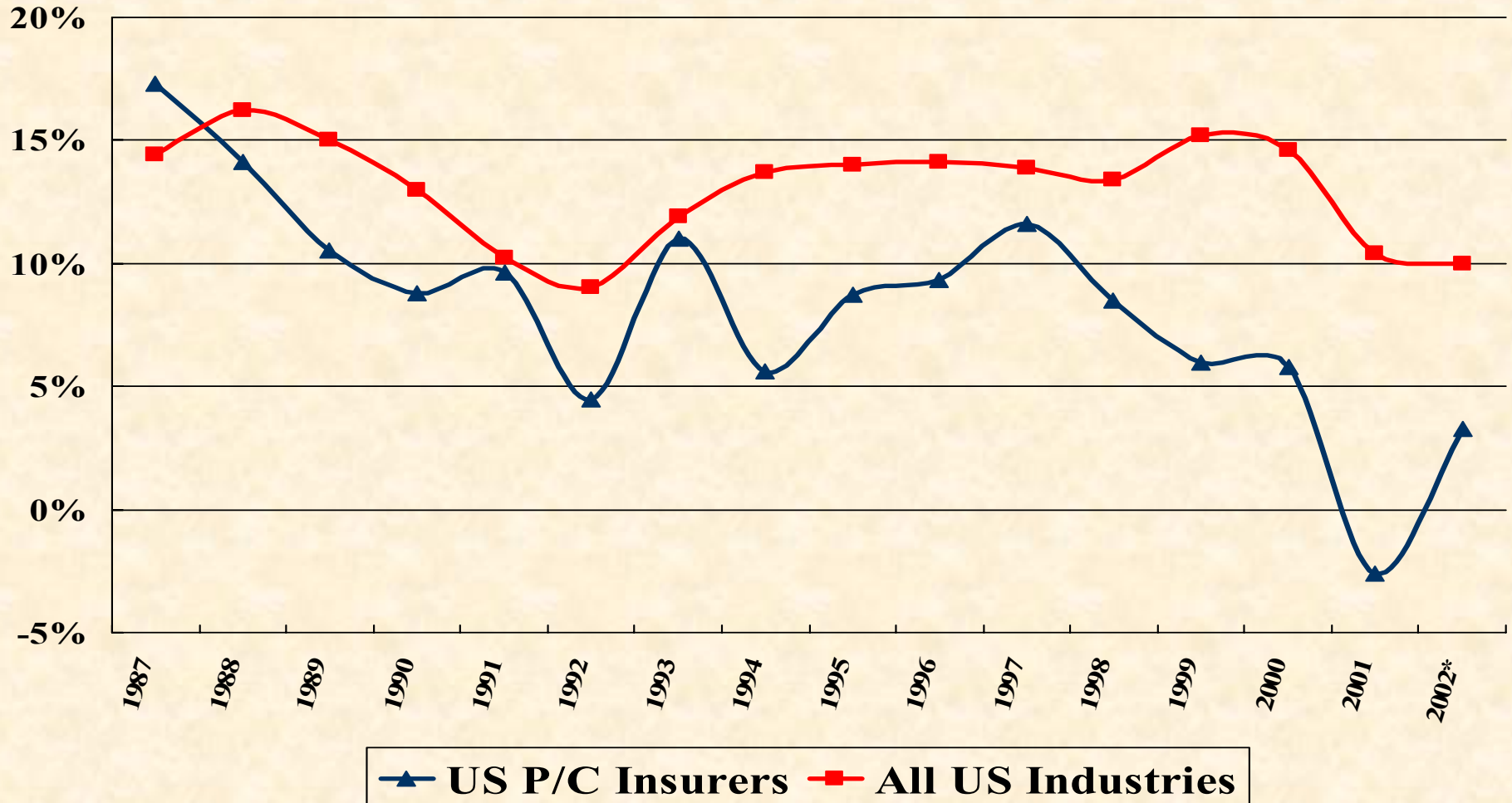
\*I.I.I. estimate based on first half 2002 data.

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



# ROE: P/C vs. All Industries

## 1987–2002\*

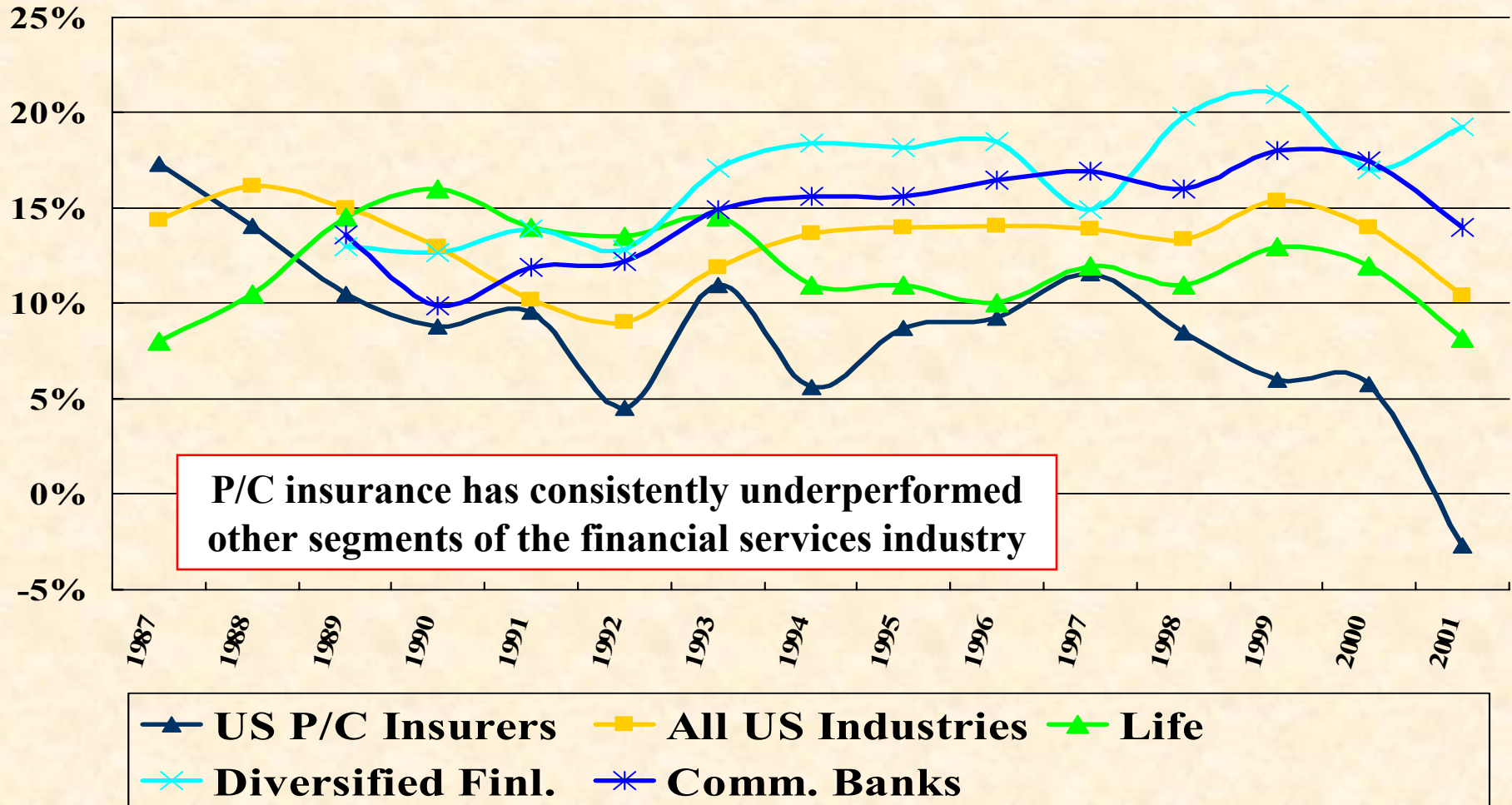


\*2002 figures are estimates; p/c figure based on first-half 2002 data.

Source: Insurance Information Institute; *Fortune*

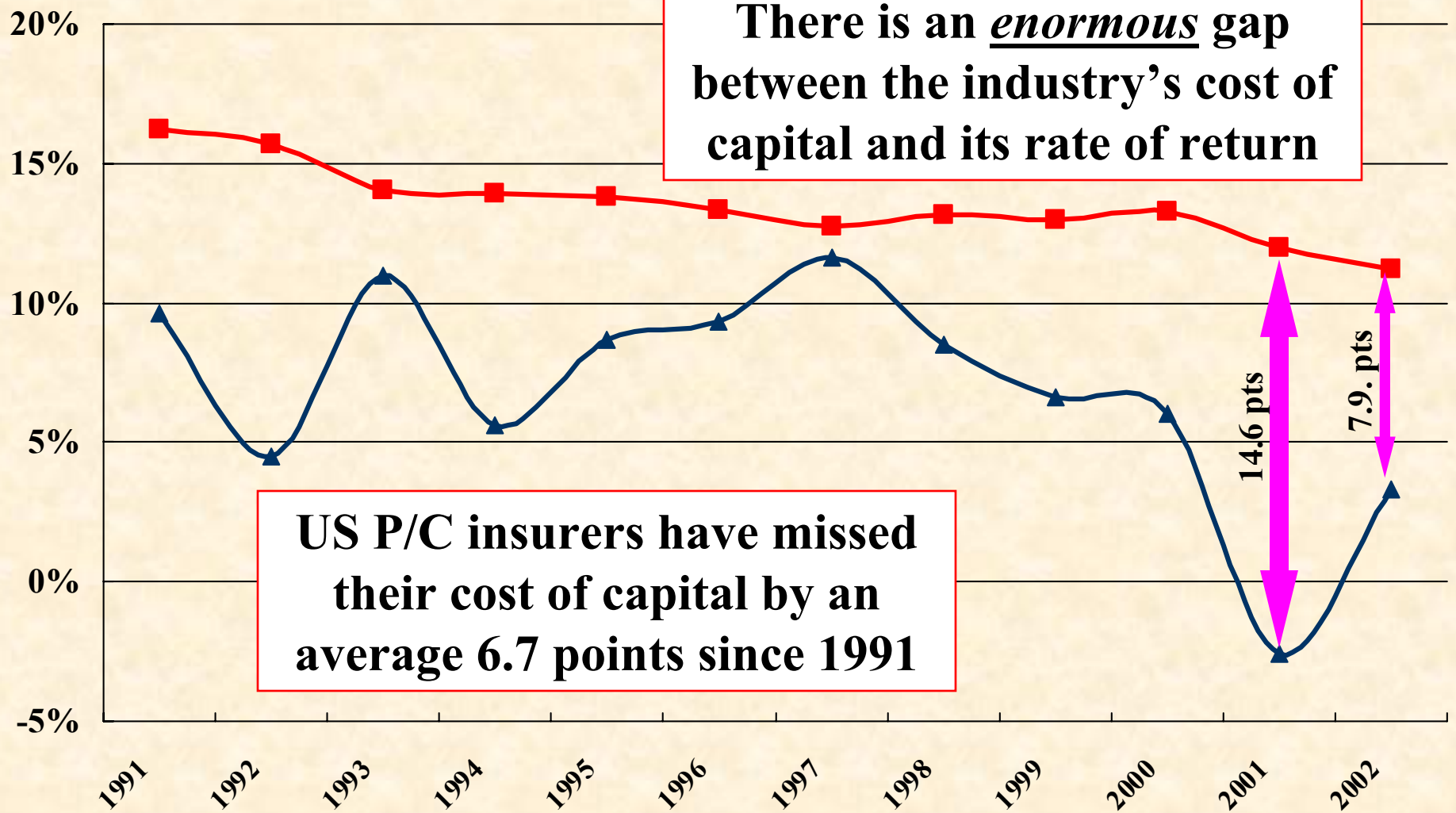


# ROE: Financial Services Industry Segments, 1987–2001





# ROE vs. Cost of Capital: US Non-Life 1991 – 2002

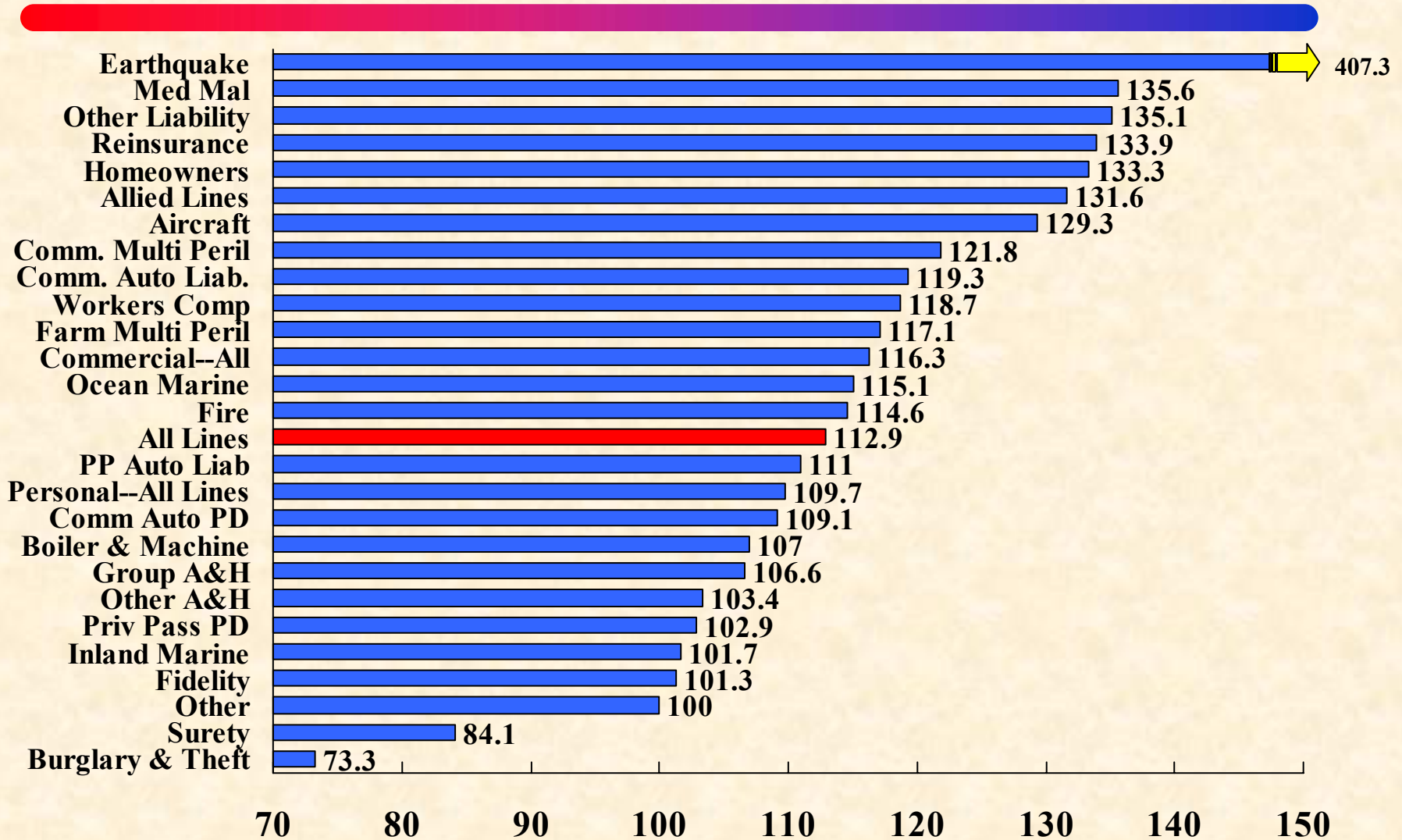


Source: The Geneva Association, Ins. Information Inst.

—▲— ROE —■— Cost of Capital



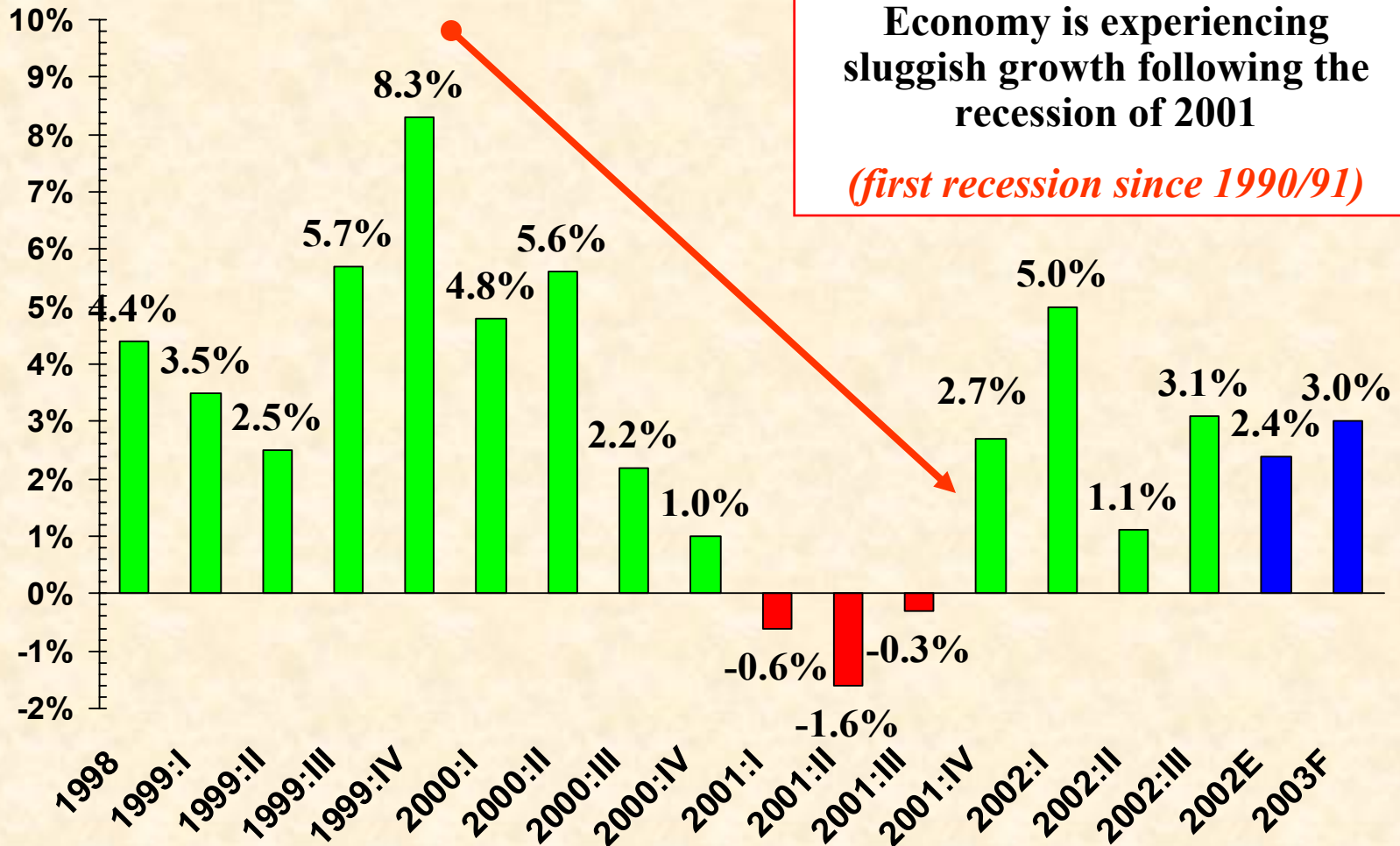
# *World's Most Dangerous Lines of Insurance* *(Combined Ratio + 1 Std. Deviation)*



Source: Insurance Information Institute, calculated from A.M. Best combined ratio data.

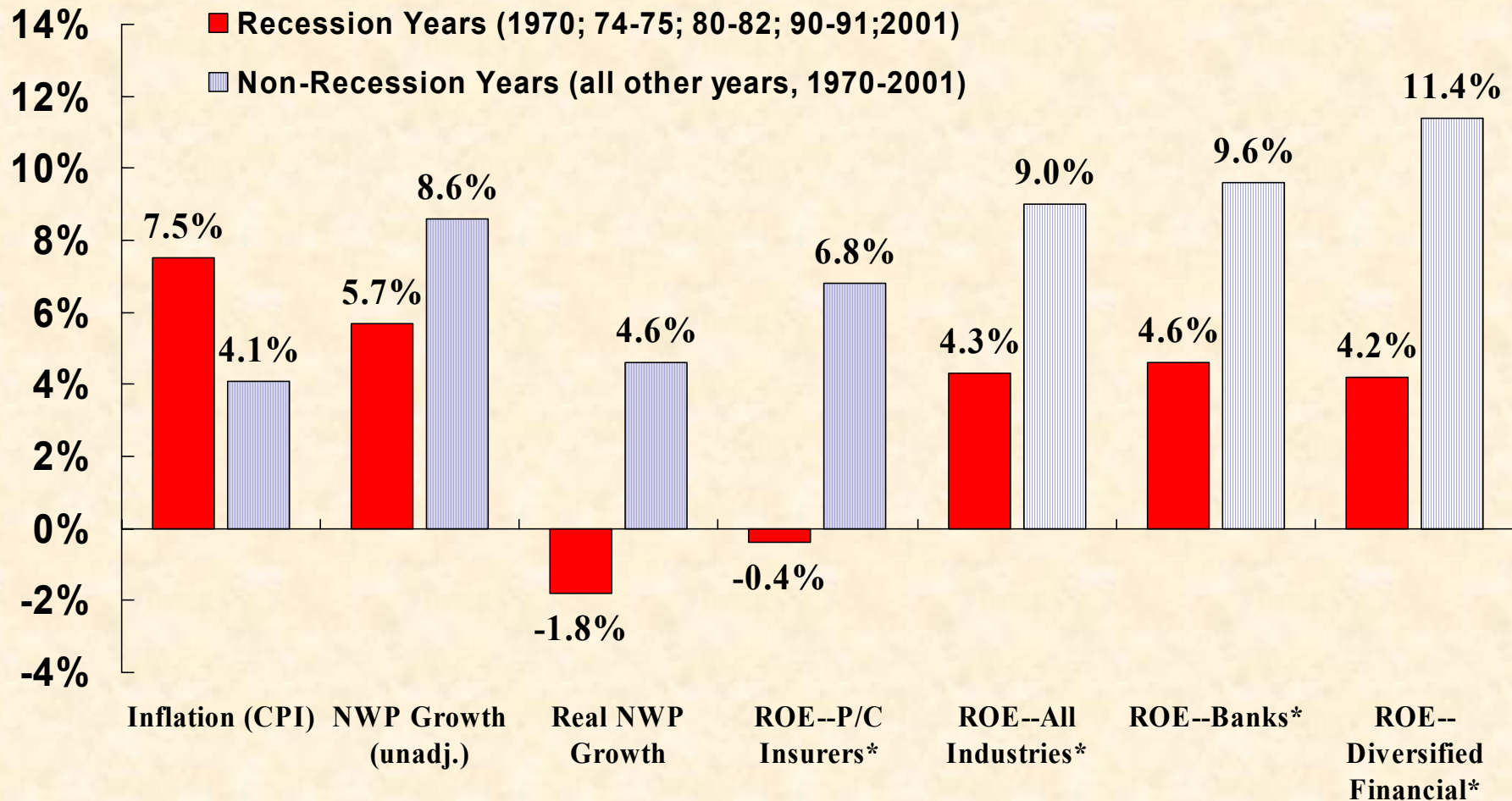


# Real GDP Growth





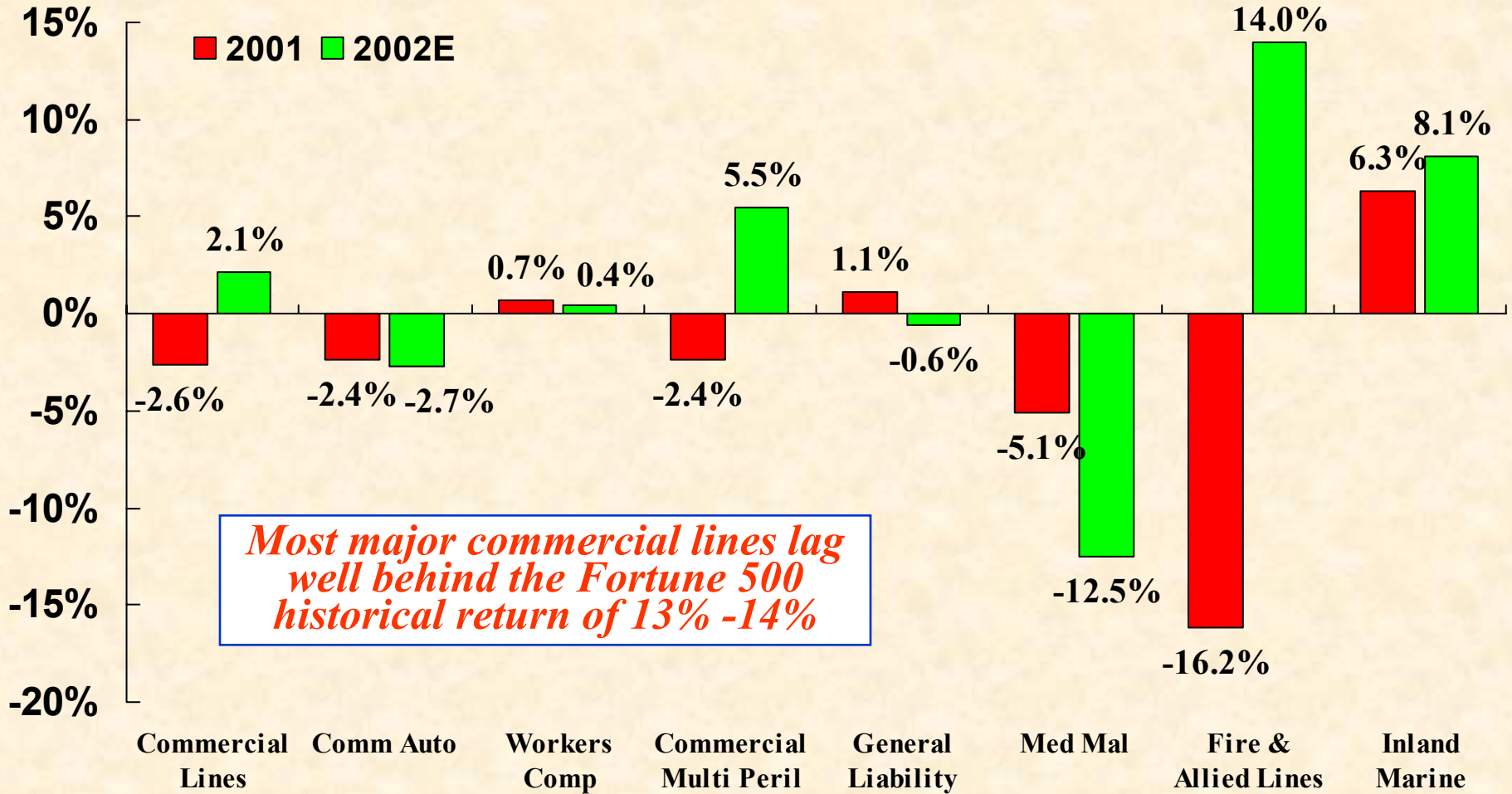
# Impact of Recession on P/C Premiums and Profitability (1970-2001)



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



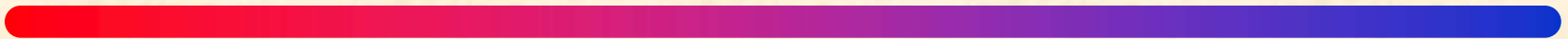
# ROE for Major Commercial Lines (2001 vs. 2002E)



Source: Conning

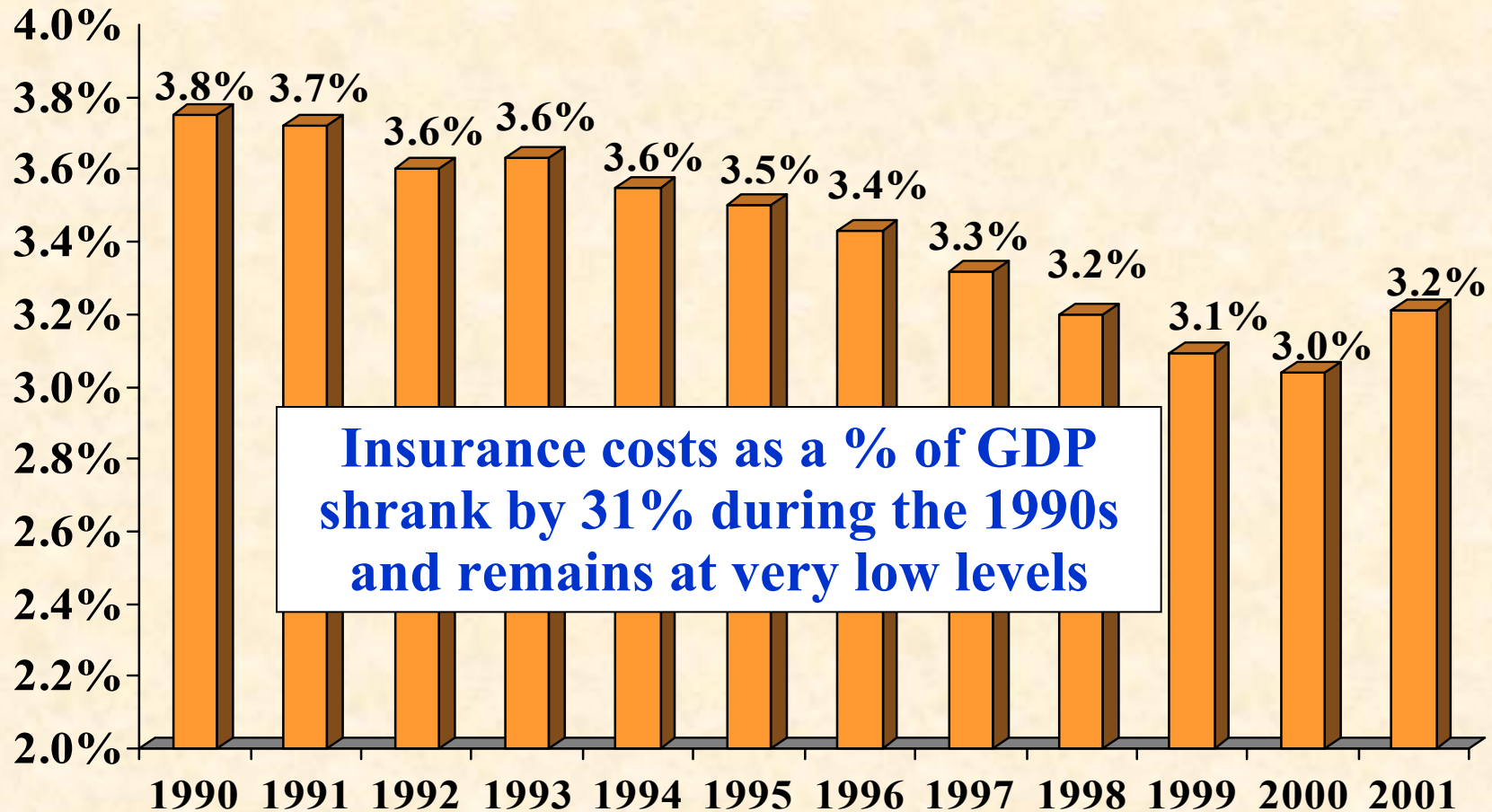
*Legend #2:*

Insurance is More  
Expensive than Ever and is  
Squeezing Businesses and  
Families Alike





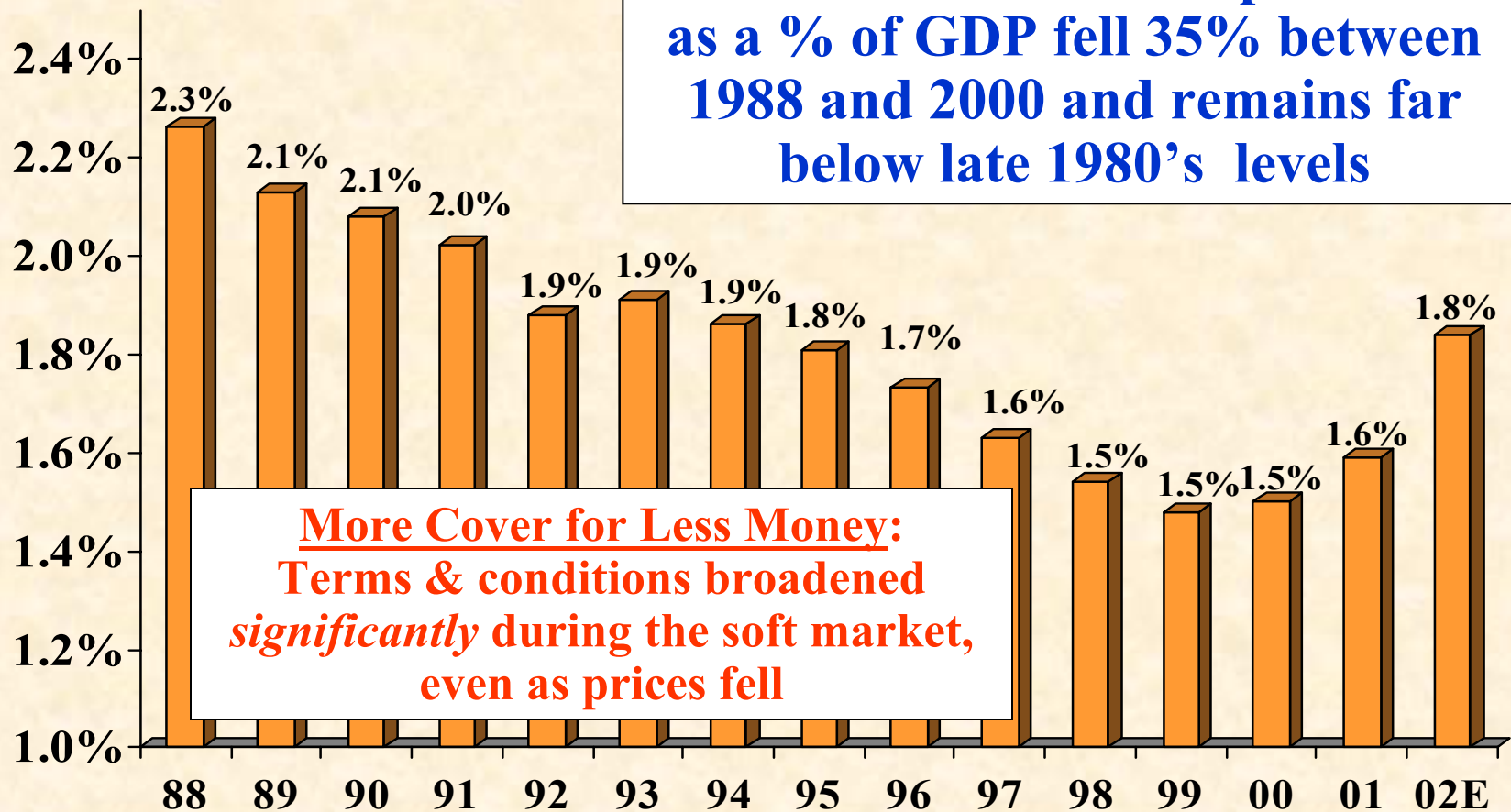
# *Net Written Premium as % of GDP*



Sources: Insurance Information Institute, calculated from U.S. Bureau of Economic Analysis and A.M. Best data.



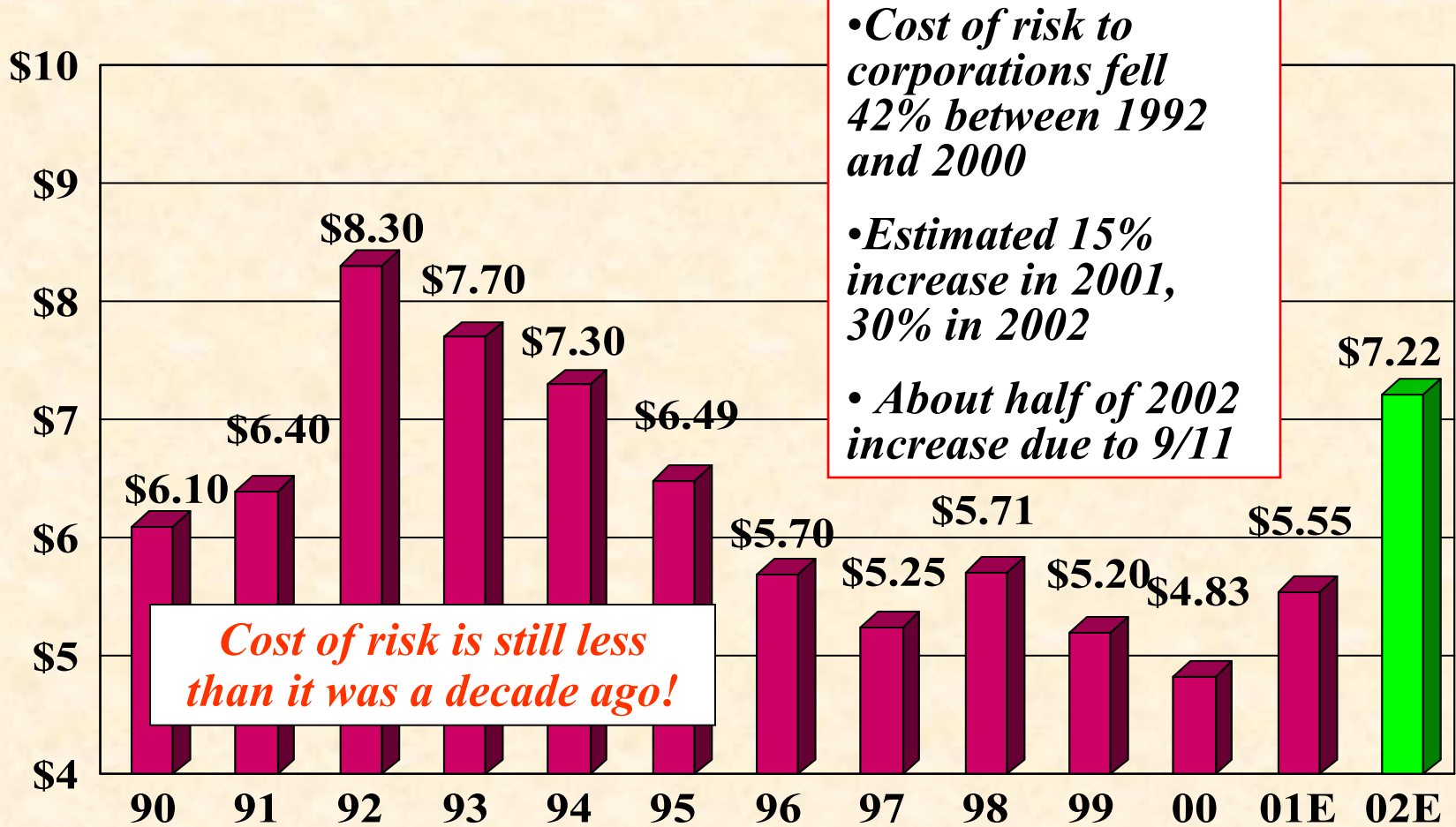
# Commercial Lines Net Written Premium as % of GDP



Sources: Insurance Information Institute, calculated from U.S. Bureau of Economic Analysis and A.M. Best data.

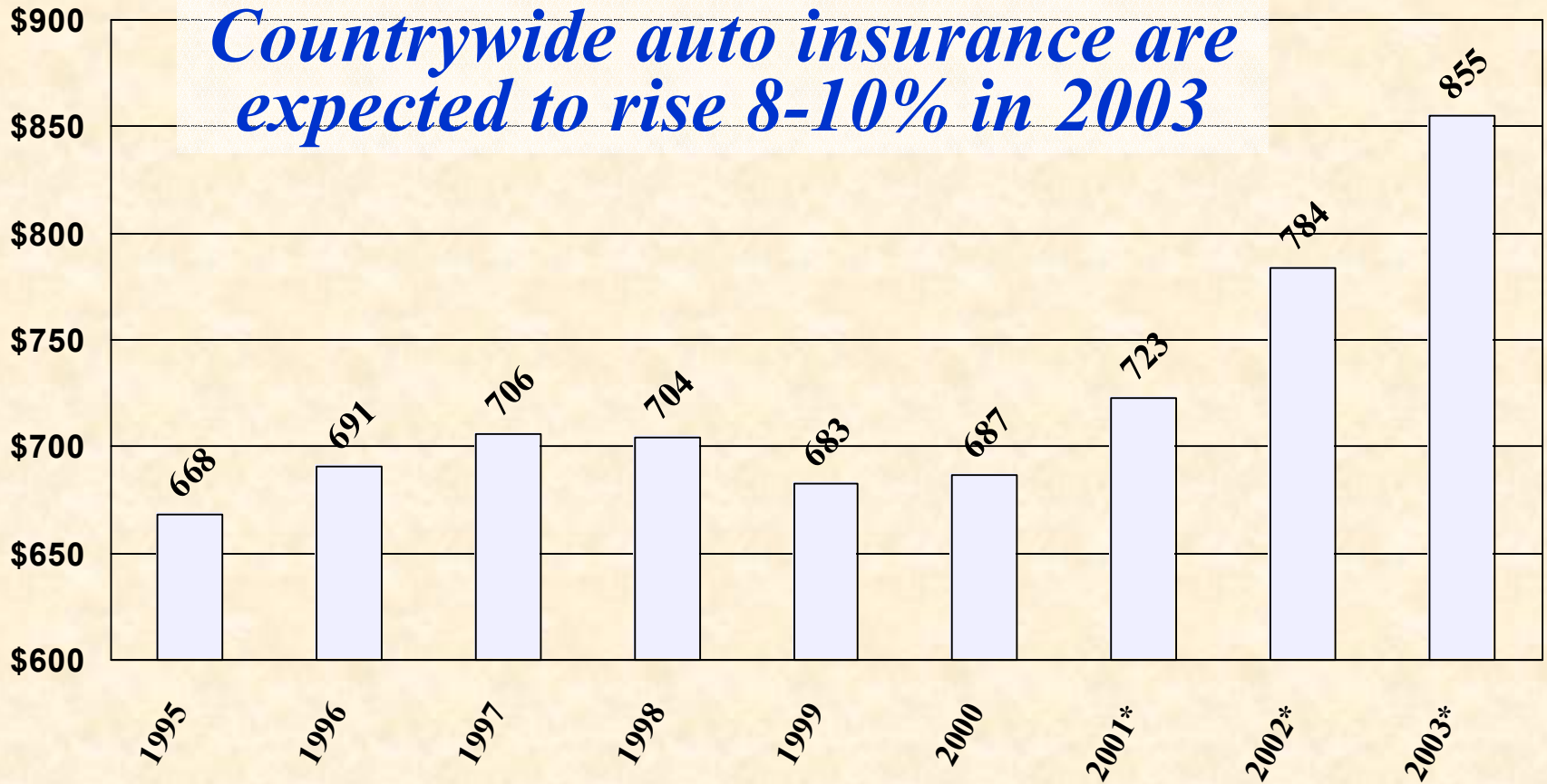


# Cost of Risk per \$1,000 of Revenues: 1990-2002E





# Average Expenditures on Auto Insurance: US

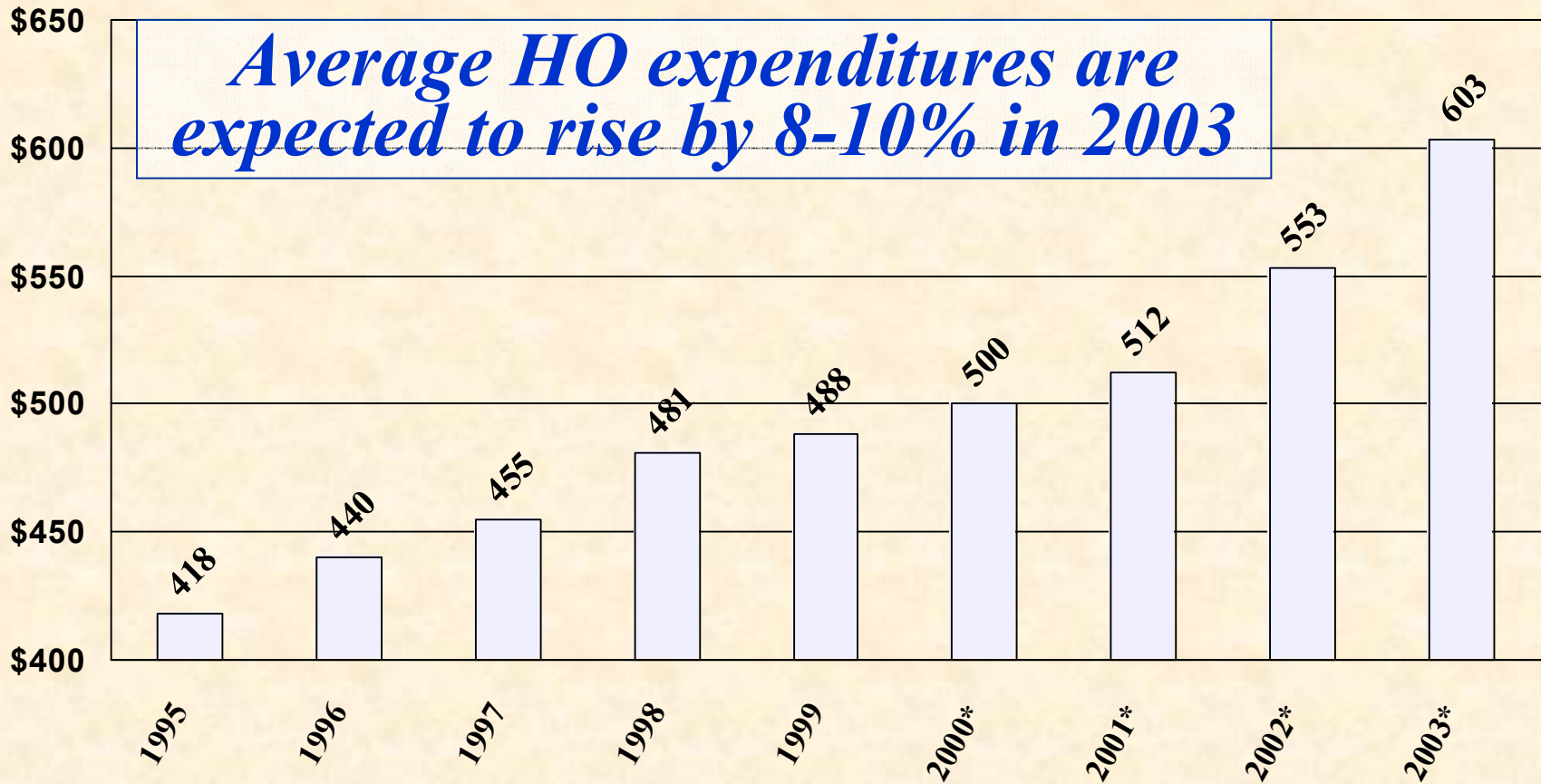


\*Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute



# Average Expenditures on Homeowners Ins.: US

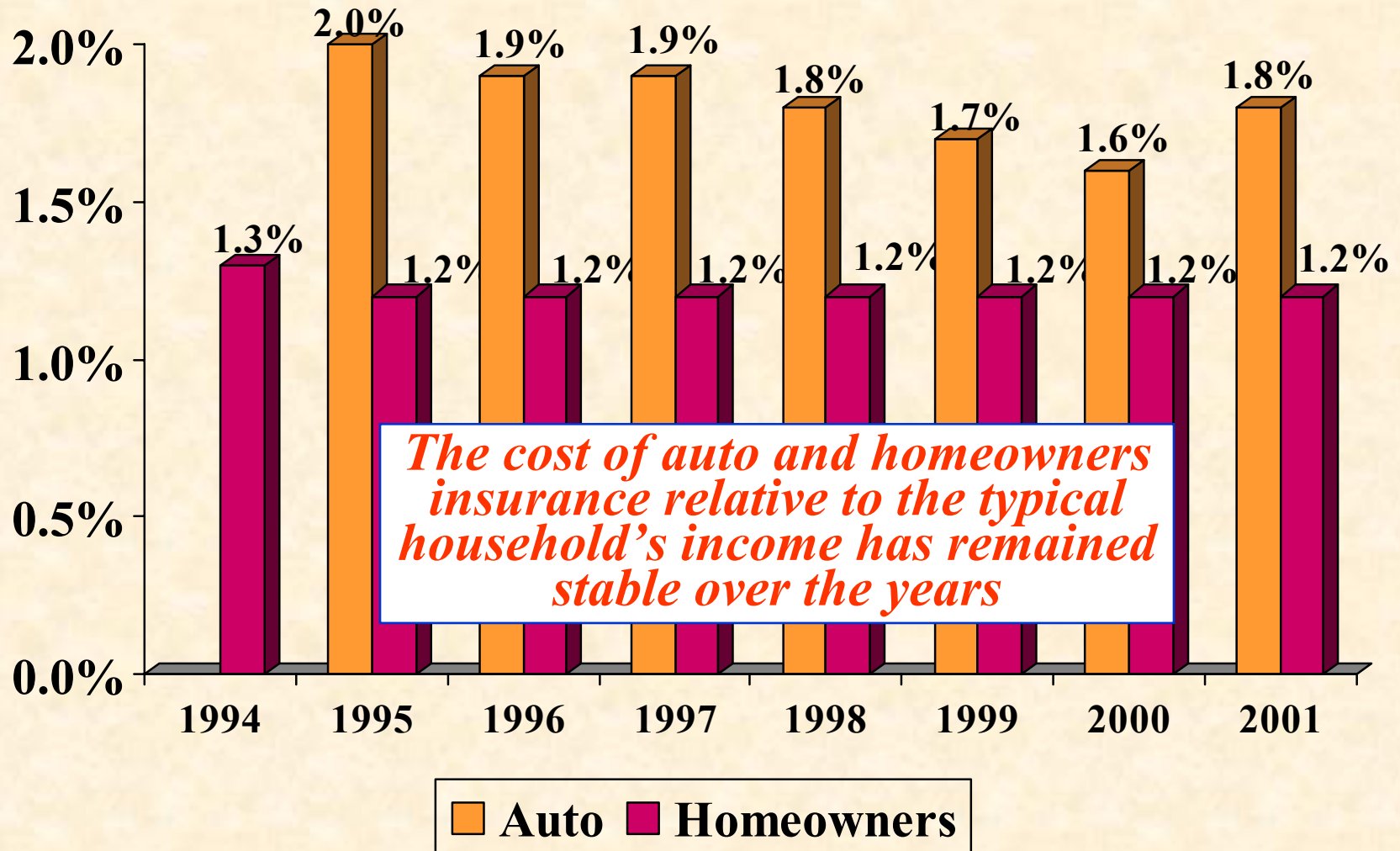


\*III Estimates

Source: NAIC, Insurance Information Institute

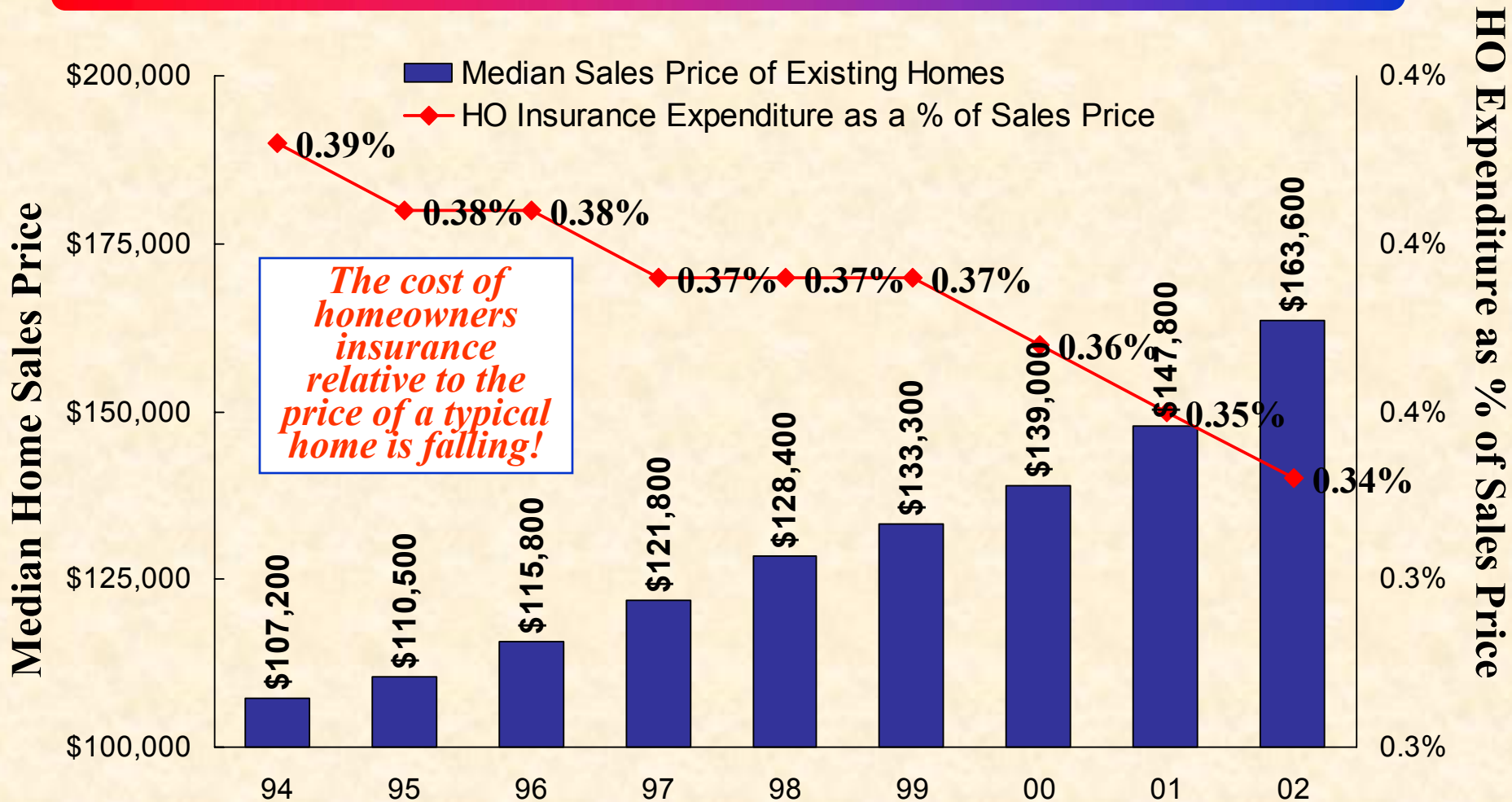


## *Auto & Homeowners Insurance Expenditures as a% of Median Household Income*





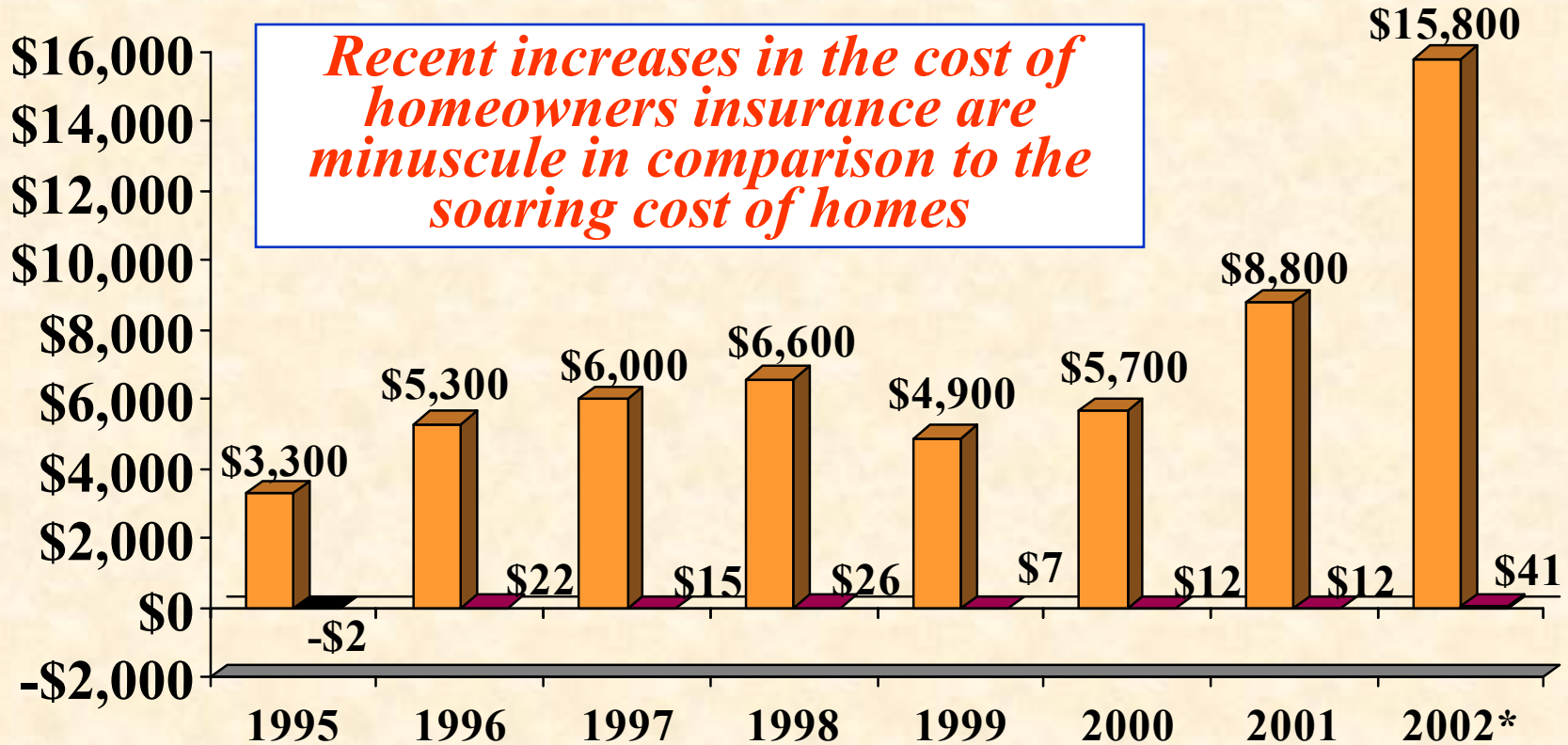
# Homeowners Insurance Expenditure as a % of Median Home Price\*



Source: Insurance Information Institute calculations based on data from National Association of Realtors, NAIC.



# Change in Cost of Homes vs. Change in Cost of Homeowners Insurance



Change in Cost of Median Existing Home

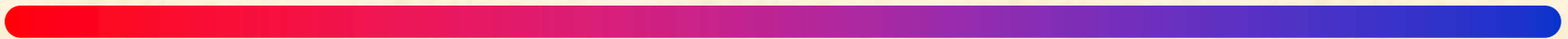
Change in Average Homeowners Insurance Expenditure

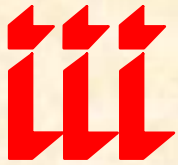
\*August 2002

Source: Insurance Info. Inst. calculations based on data from Natl. Association of Realtors, NAIC.

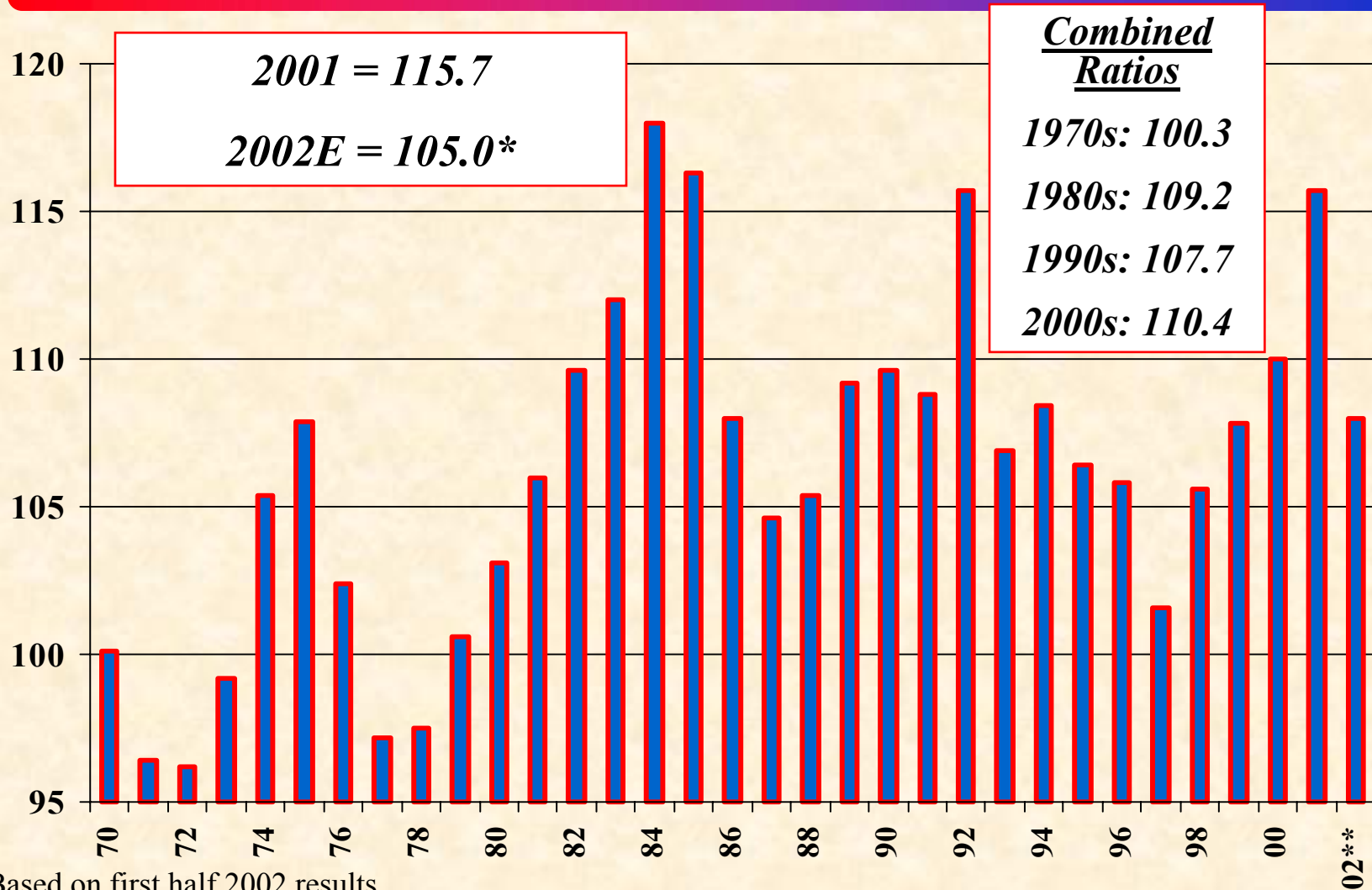
*Legend #3:*

Insurers are Raising Rates  
to Make up for 9/11 Losses





# *P/C Industry Combined Ratio*



\*Based on first half 2002 results

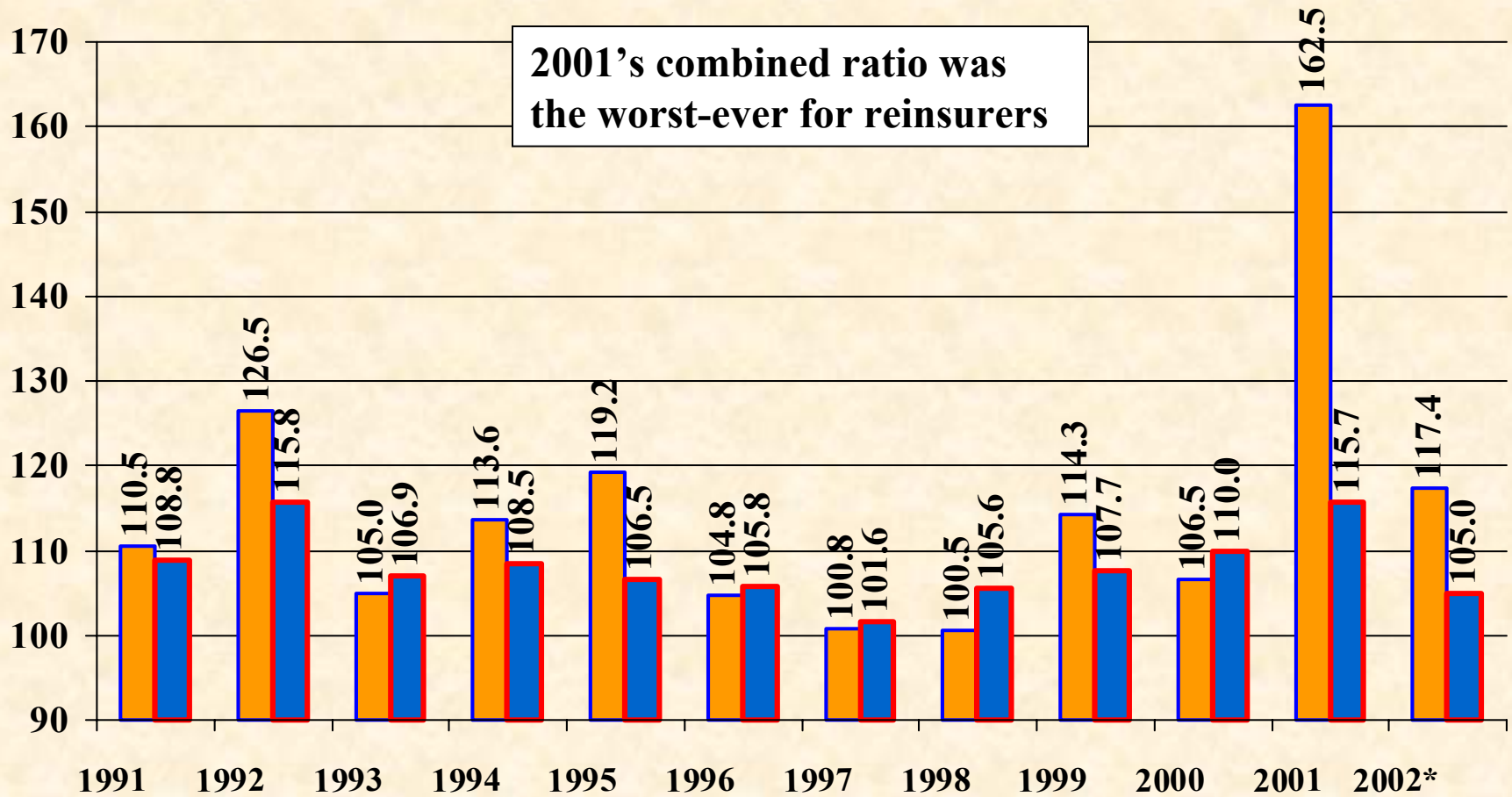
Sources: A.M. Best; III



# Combined Ratio: Reinsurance vs. P/C Industry

■ Reinsurance ■ All Lines Combined Ratio

2001's combined ratio was the worst-ever for reinsurers



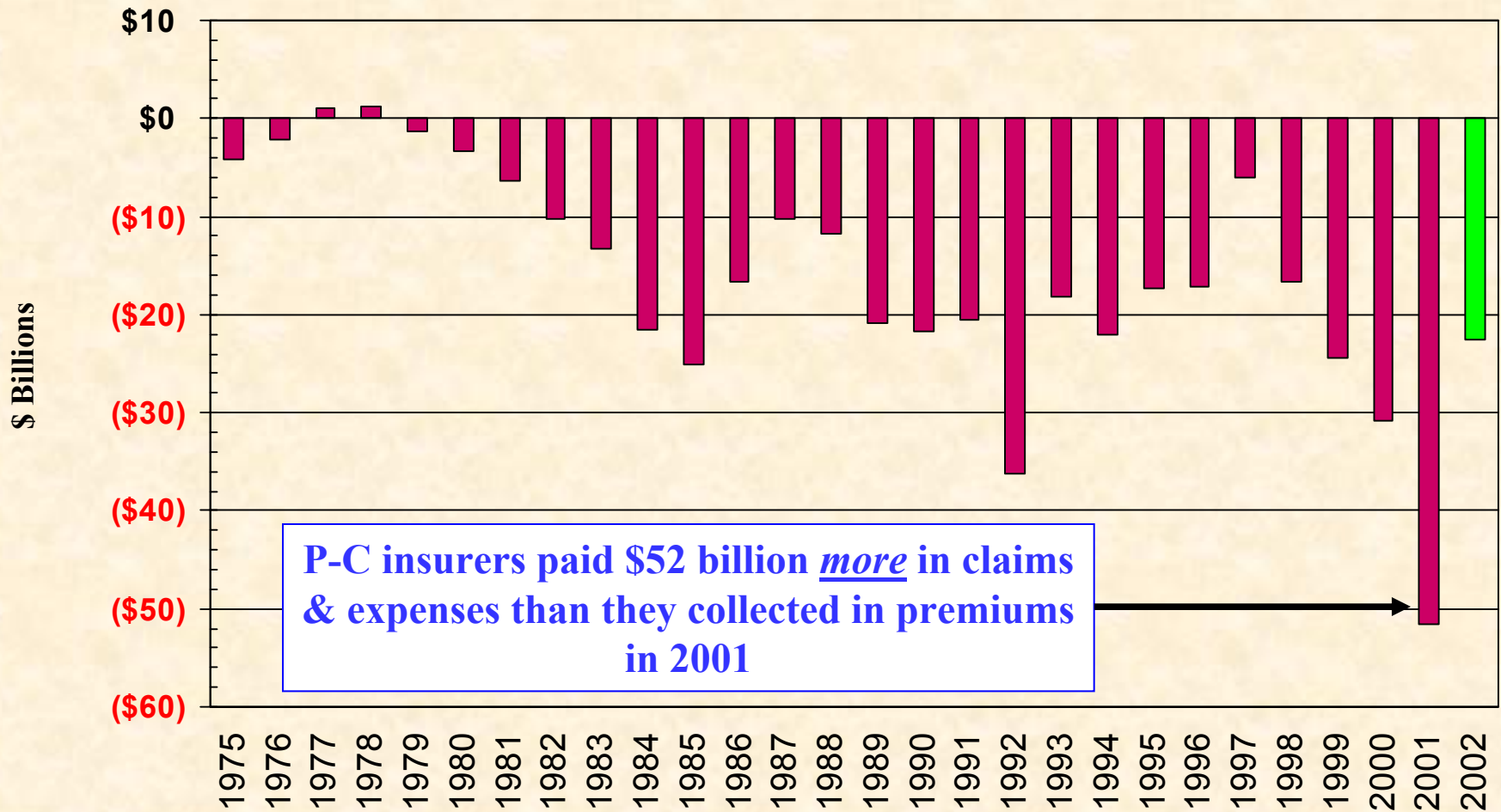
\*First Half 2002 figures.

Source: A.M. Best, ISO, Reinsurance Association of America, Insurance Information Institute



# Underwriting Gain (Loss)

## 1975-2002\*



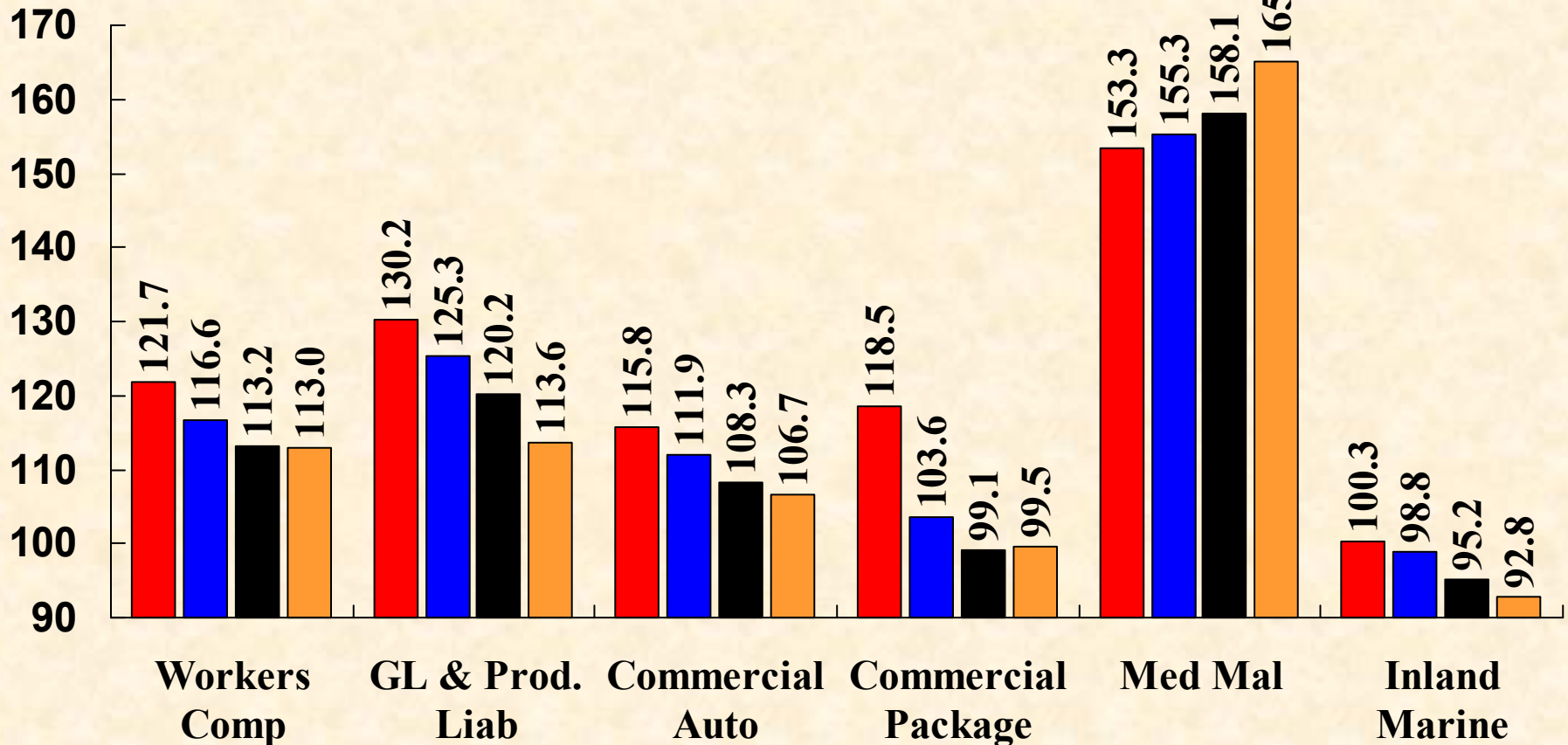
\*Annualized estimate based on first half 2002 data.

Source: A.M. Best, Insurance Information Institute



# Outlook for Commercial Lines: 2002 - 2004

■ 2001 ■ 2002E ■ 2003F ■ 2004F





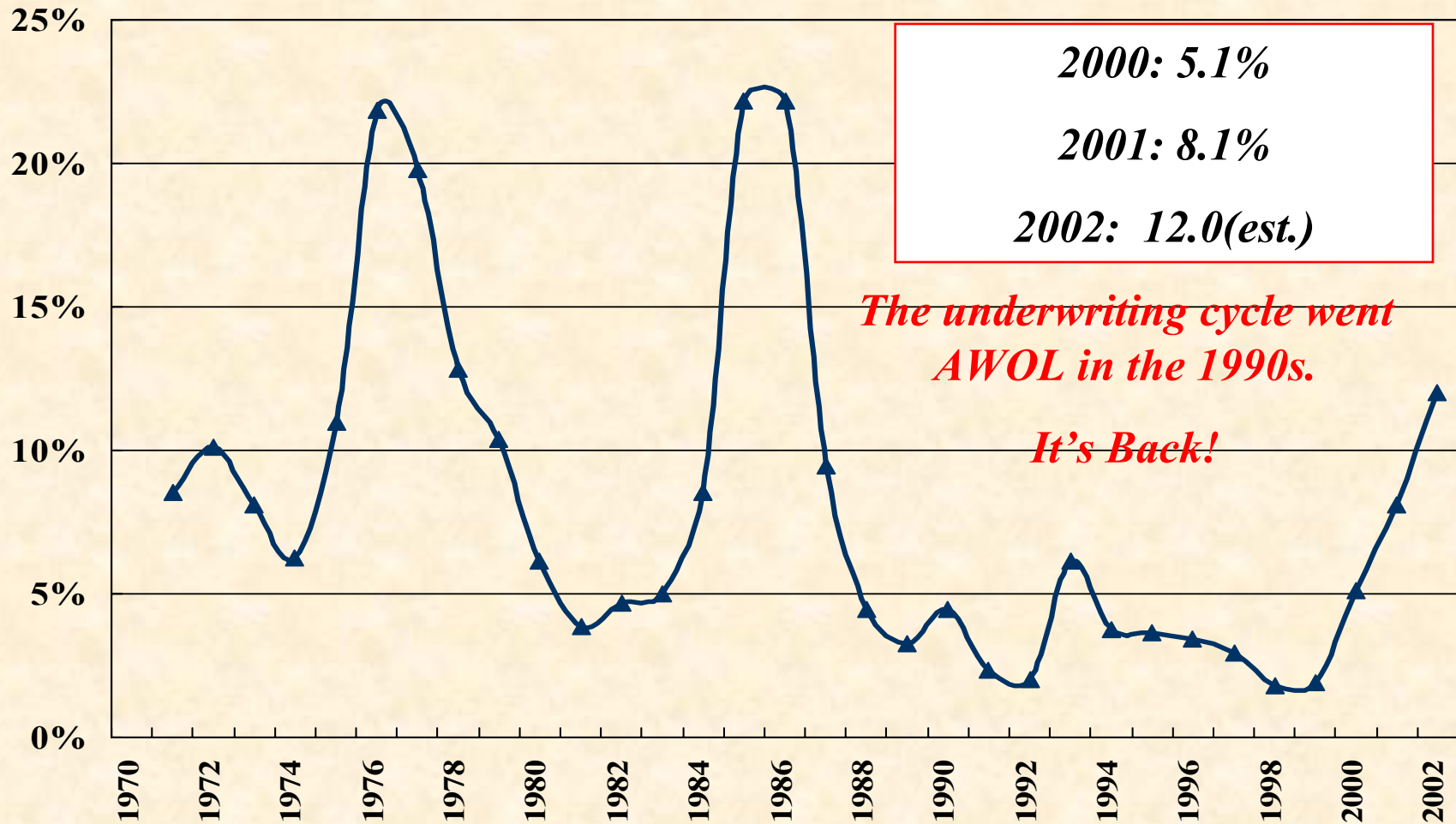
# 12% After Tax ROE Requires Underwriting Profit

P : S	<i>Accident Year Combined Ratio</i>									
	90.0%	92.5 %	95.0 %	97.5 %	100.0 %	102.5 %	105.0 %	107.5 %	110.0 %	112.5 %
<b>100 %</b>	13.0 %	11.5 %	10.1 %	8.6 %	7.1 %	5.6 %	4.1 %	2.6 %	1.1 %	-0.4 %
<b>110 %</b>	14.0 %	12.4 %	10.7 %	9.1 %	7.5 %	5.8 %	4.2 %	2.5 %	0.9 %	-0.7 %
<b>120 %</b>	15.0 %	13.2 %	11.4 %	9.6 %	7.8 %	6.1 %	4.3 %	2.5 %	0.7 %	-1.1 %
<b>130 %</b>	16.0%	14.0 %	12.1 %	10.2 %	8.2 %	6.3 %	4.4 %	2.4 %	0.5 %	-1.5 %
<b>140 %</b>	16.9 %	14.9 %	12.8 %	10.7 %	8.6 %	6.5 %	4.4 %	2.4 %	0.3 %	-1.8 %
<b>150 %</b>	17.9 %	15.7 %	13.5 %	11.2 %	9.0 %	6.8 %	4.5 %	2.3 %	0.1 %	-2.2 %
<b>160 %</b>	18.9 %	16.5 %	14.1 %	11.8 %	9.4 %	7.0 %	4.6 %	2.2 %	-0.2 %	-2.5 %
<b>170 %</b>	19.9 %	17.3 %	14.8 %	12.3 %	9.8 %	7.2 %	4.7 %	2.2 %	-0.4 %	-2.9 %
<b>180 %</b>	20.9 %	18.2 %	15.5 %	12.8 %	10.1 %	7.5 %	4.8 %	2.1 %	-0.6 %	-3.3 %
<b>190 %</b>	21.8 %	19.0 %	16.2 %	13.3 %	10.5 %	7.7 %	4.9 %	2.0 %	-0.8 %	-3.6 %
<b>200 %</b>	22.8 %	19.8 %	16.9 %	13.9 %	10.9 %	7.9 %	4.9 %	2.0 %	-1.0 %	-4.0 %
<b>225 %</b>	25.3 %	21.9 %	18.6 %	15.2 %	11.9 %	8.5 %	5.2 %	1.8 %	-1.5 %	-4.9 %
<b>250 %</b>	27.7 %	24.0 %	20.3 %	16.5 %	12.8 %	9.1 %	5.4 %	1.7 %	-2.1 %	-5.8 %

Source: Dowling & Partners



# Growth in Net Premiums Written (All P/C Lines)



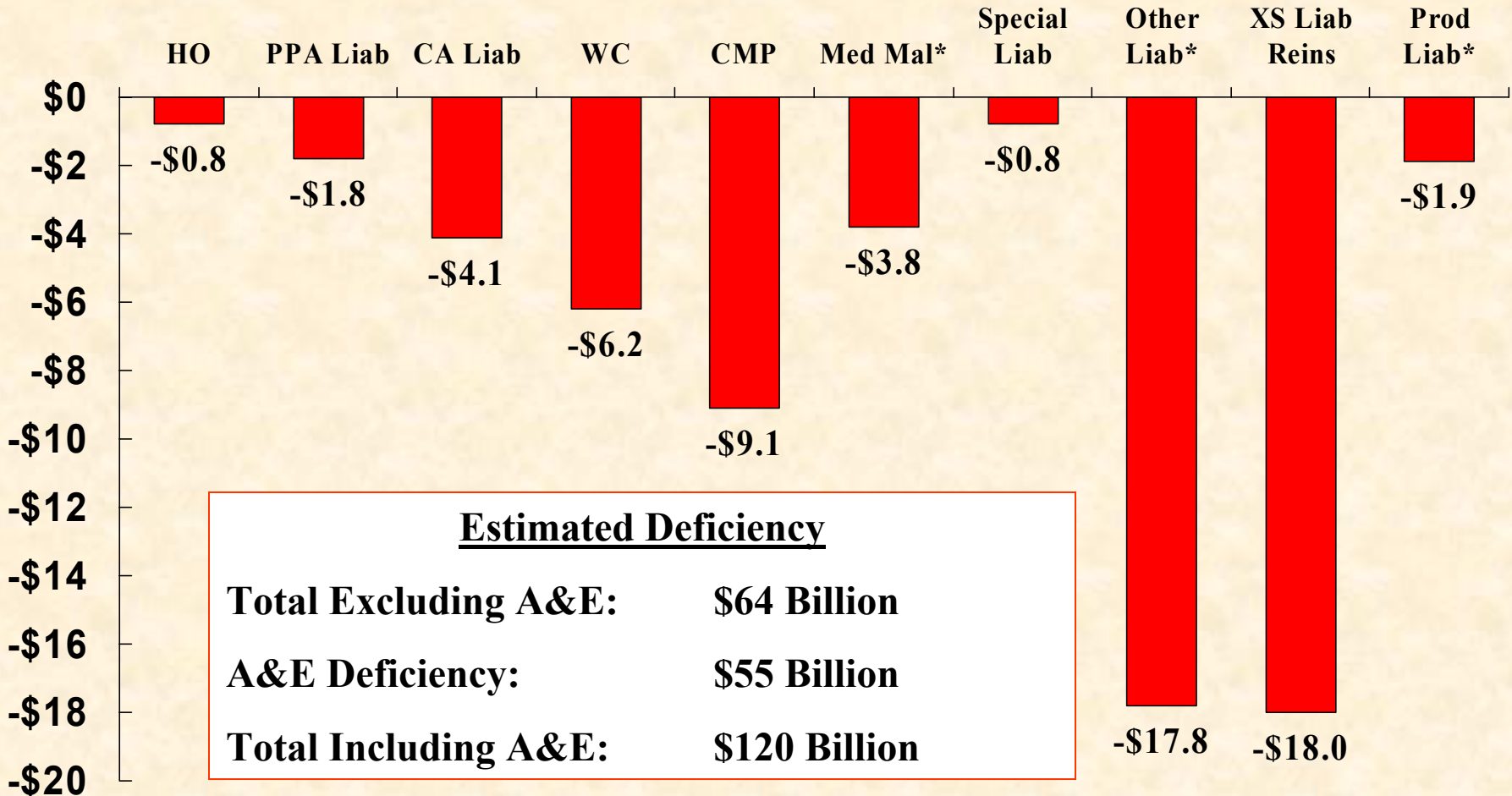
\*Estimate based on first half 2002 results.

Source: A.M. Best, Insurance Information Institute



# Reserve Deficiency, by Line

(AY 1992-2001, as of 12/01)

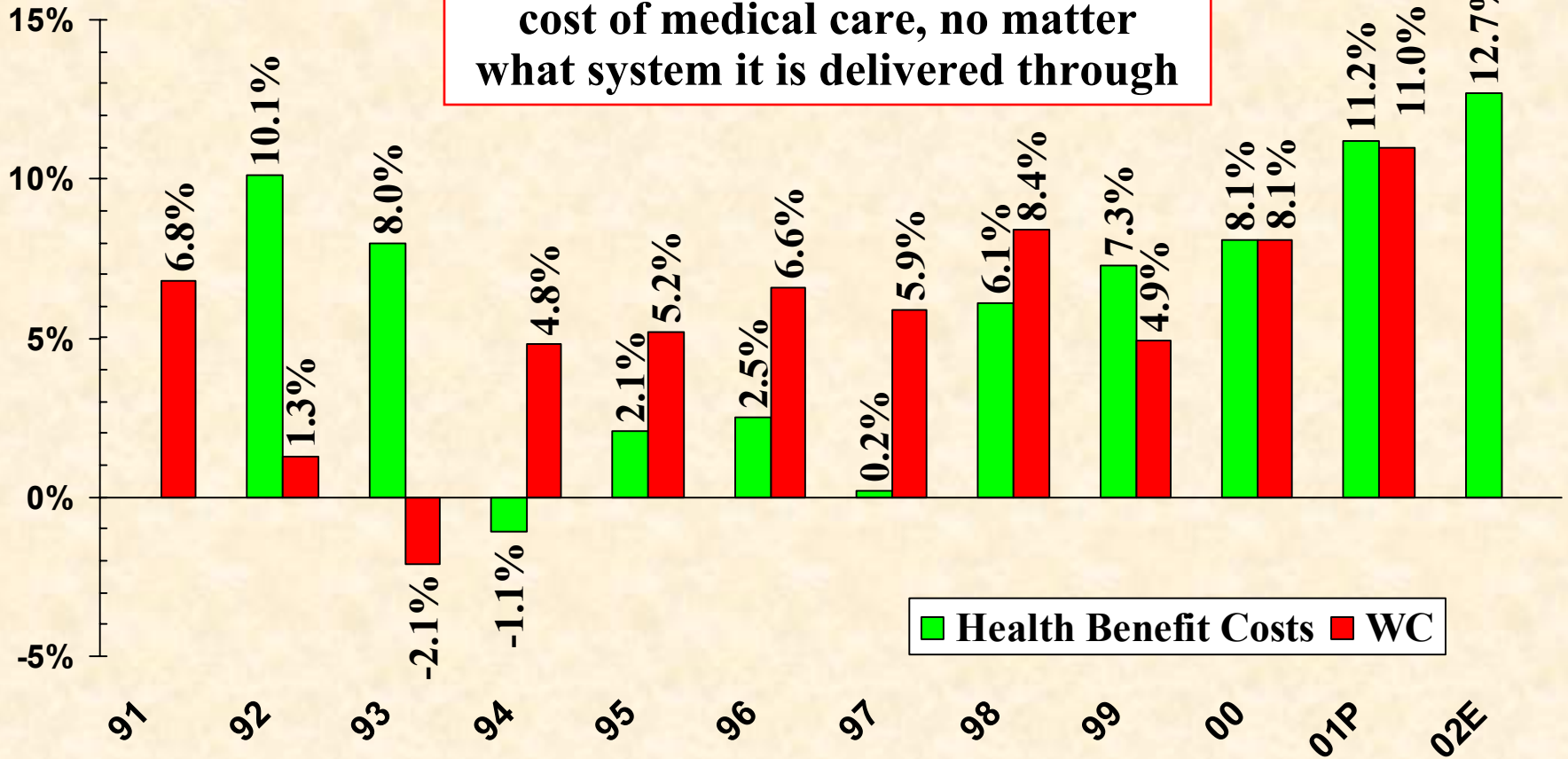


\*Occurrence and claims made  
Source: Morgan Stanley



# Med Claim Costs Rising Sharply

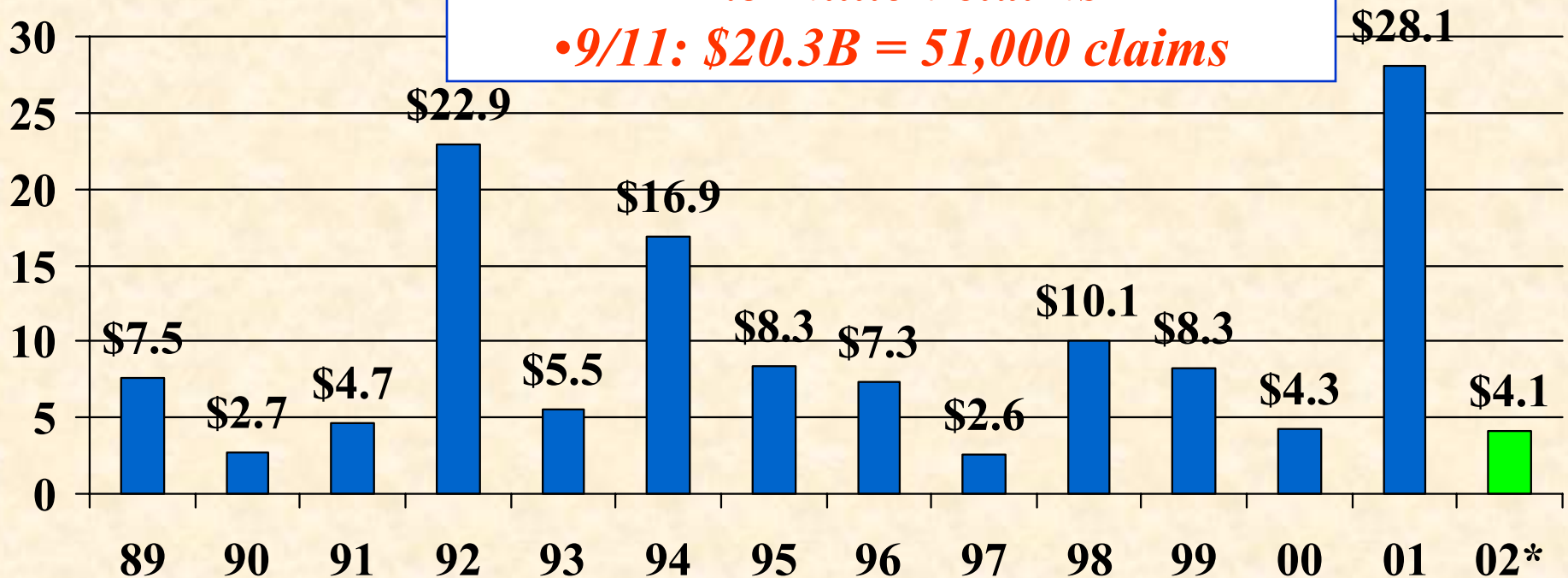
Health care inflation is affecting the cost of medical care, no matter what system it is delivered through





# U.S. Insured Catastrophe Losses

\$ Billions



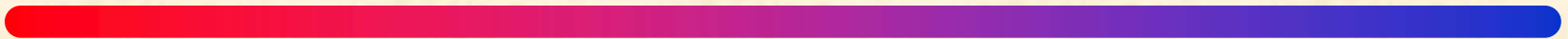
\*Estimate through October 2002.

**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

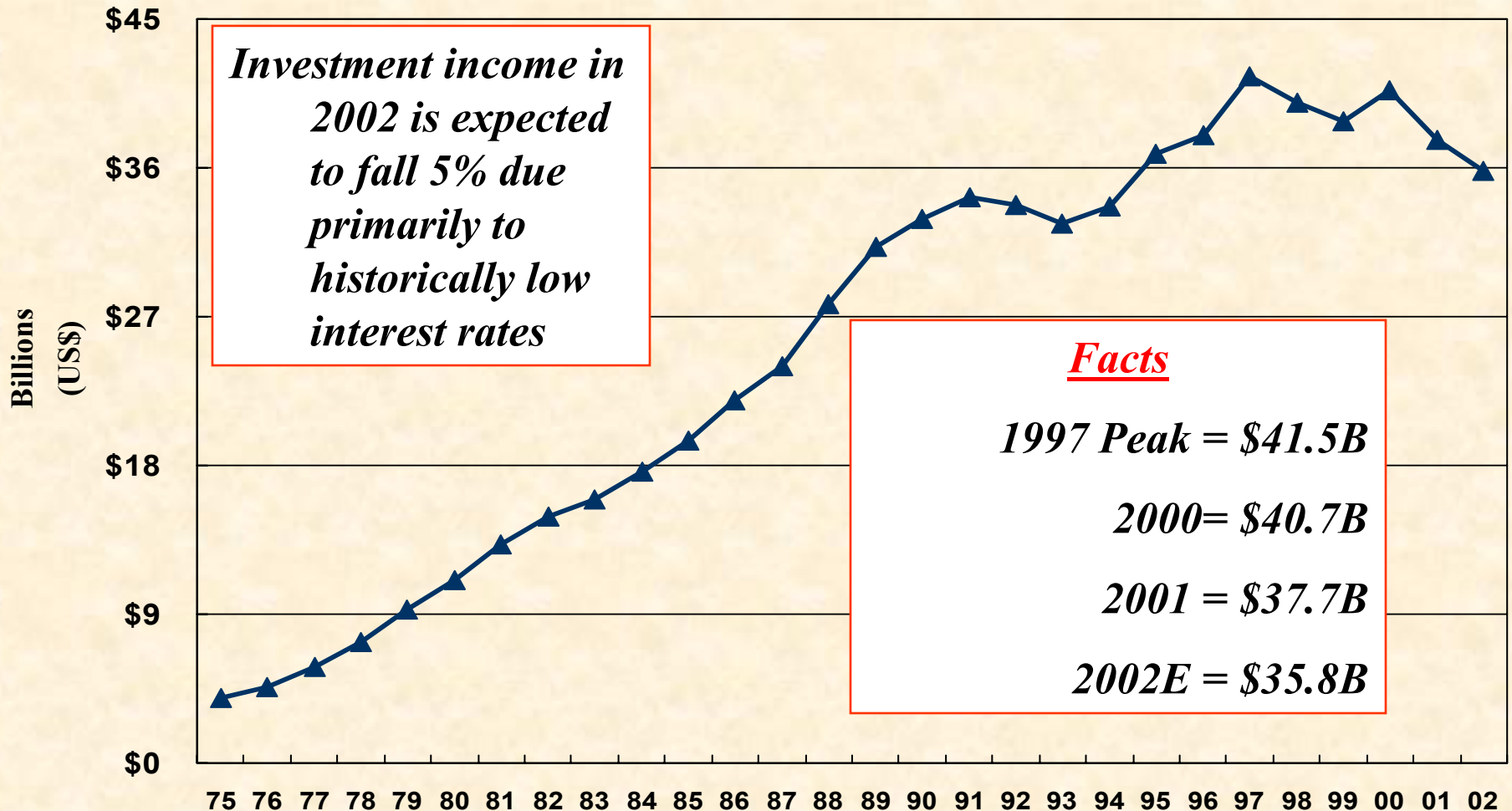
*Legend #4:*

Insurers' Reckless  
Investment Strategies are the  
Primary Reason Why Rates  
are Rising Today



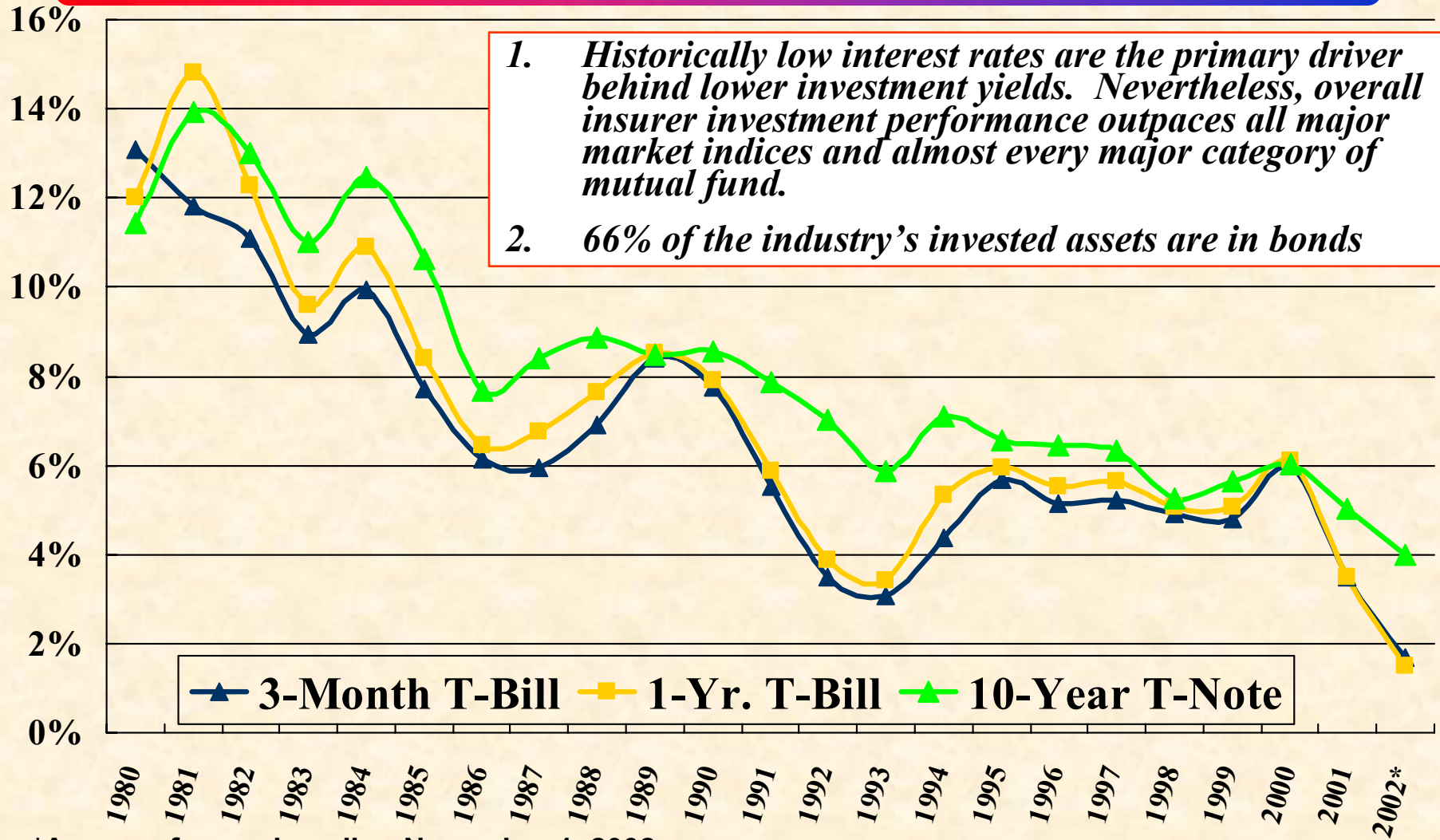


# Net Investment Income





# Interest Rates: Lower Than They've Been in Decades



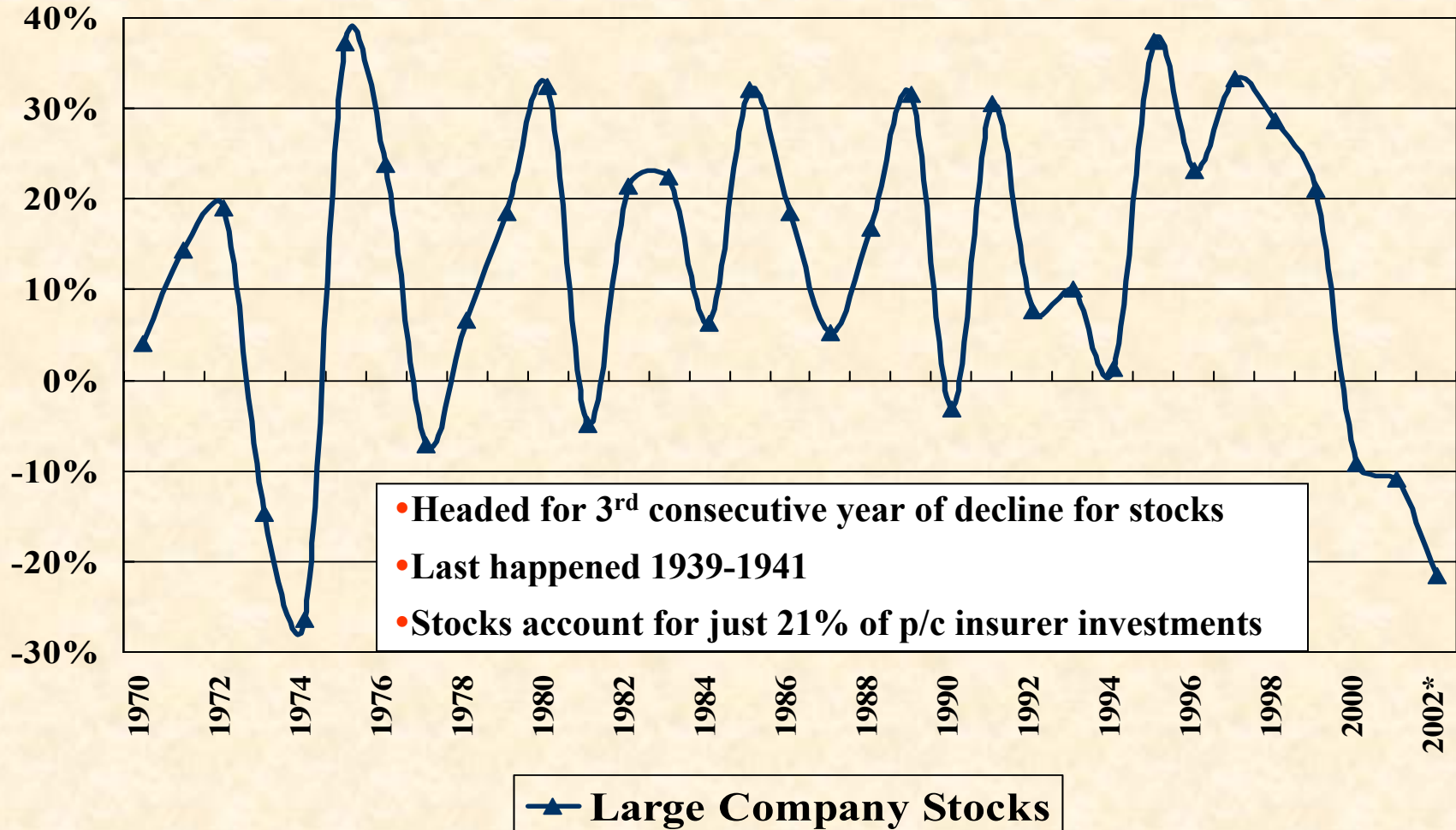
1. *Historically low interest rates are the primary driver behind lower investment yields. Nevertheless, overall insurer investment performance outpaces all major market indices and almost every major category of mutual fund.*
2. *66% of the industry's invested assets are in bonds*

\*Average for week ending November 1, 2002.

Source: Board of Governors, Federal Reserve System; Insurance Information Institute



# Total Returns for Large Company Stocks: 1970-2002\*

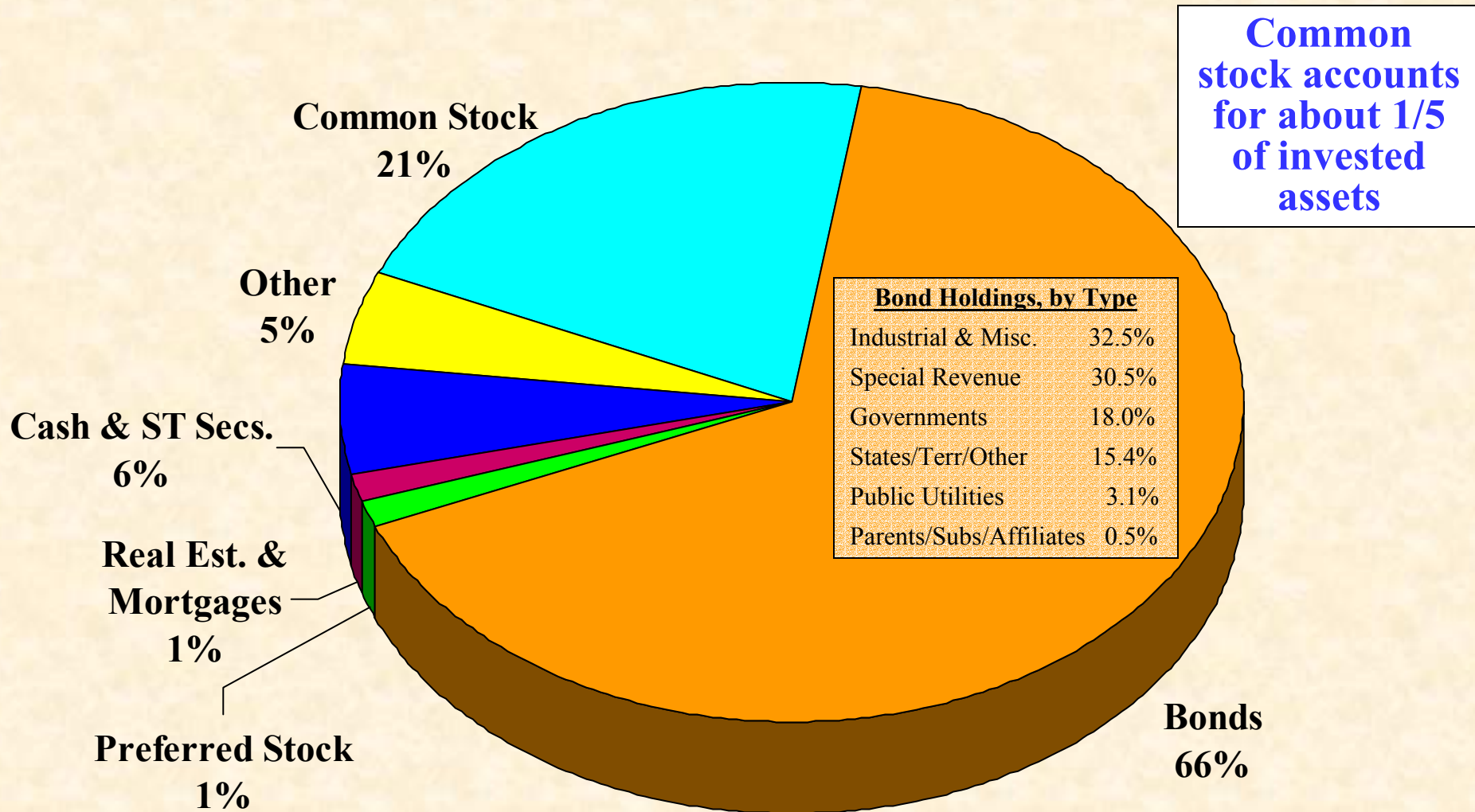


\*As of November 1, 2002.

Source: Ibbotson Associates, Insurance Information Institute



# *P/C Industry Investments, by Type (as of Dec. 31, 2001)*

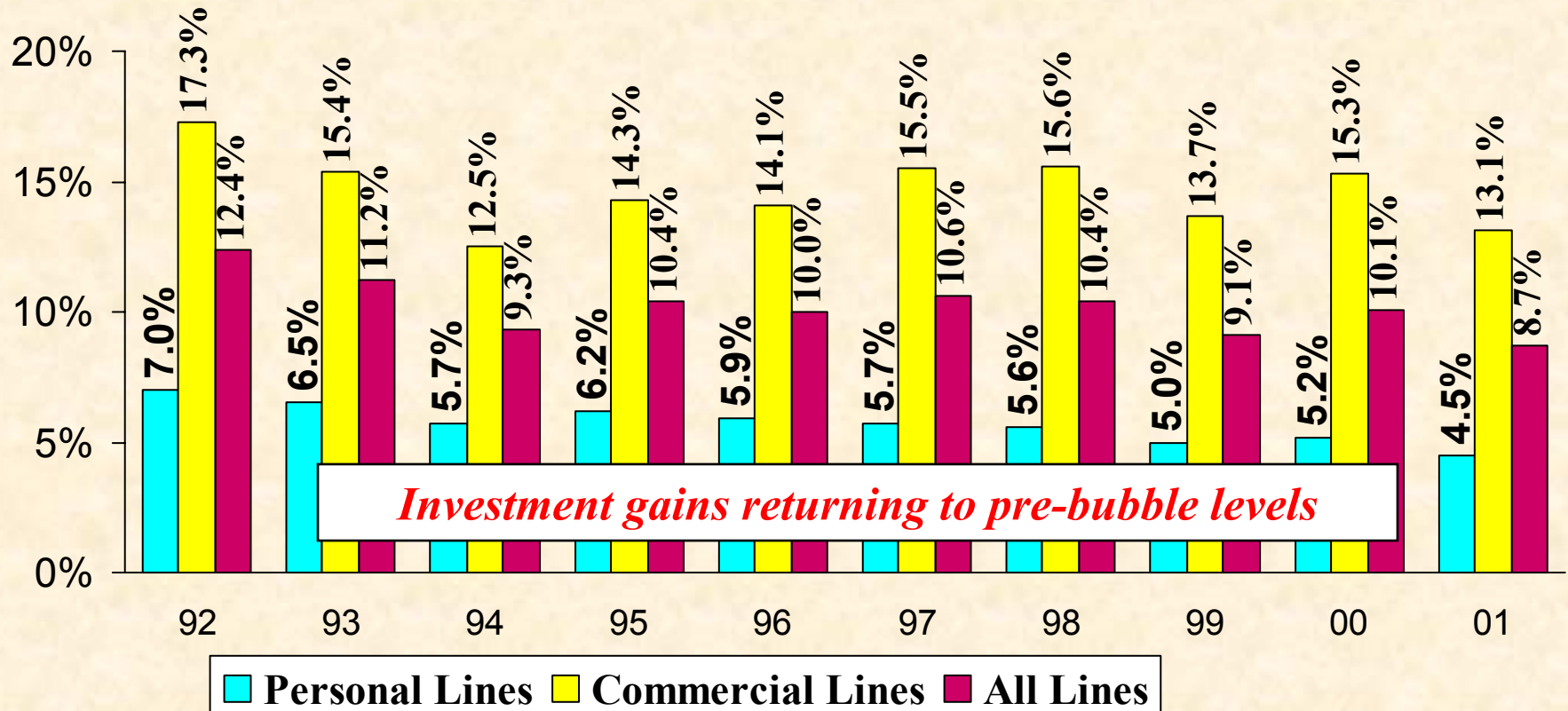


Source: A.M. Best, Insurance Information Institute



# Investment Gain, by Segment\*

*Investment returns have shrunk, but are still important. “Heavy Lifting” must be done through underwriting & pricing*



\*As a % of net earned premium. Investment gains consists primarily of interest, dividends and realized capital gains and losses.

Source: A.M. Best; Insurance Information Institute estimate



# Property/Casualty Insurance Industry Investment Gain\*

\$ Billions

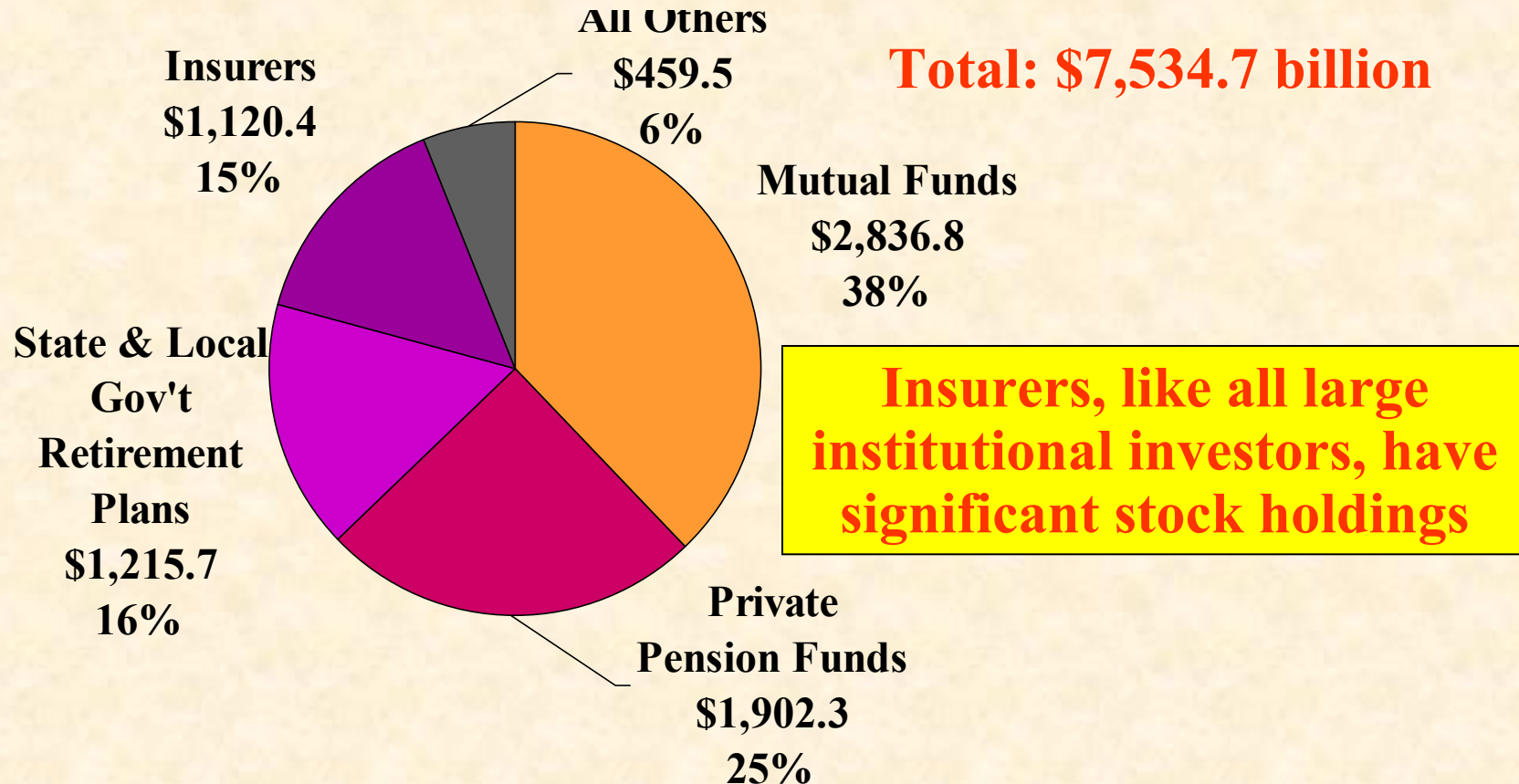


\*Investment gains consists primarily of interest, stock dividends and realized capital gains and losses.  
Source: Insurance Services Office; Insurance Information Institute estimate



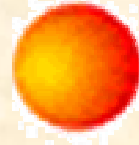
# *Institutional Investor Market in Corporate Equities*

by Market Value of Holdings, as of December 31, 2001



# *Crisis in Corporate Governance* *Affecting Even Blue Chip Portfolios*

- Crisis has affected both equity and bond markets



**ANDERSEN**

THE DOCUMENT COMPANY  
**XEROX**

**tyco**

 **ImClone Systems  
Incorporated**

ride the light  
**Qwest**

**WORLD.COM**



**Global Crossing**

**Reliant  
Energy**

**GEMSTAR-TV GUIDE  
INTERNATIONAL**

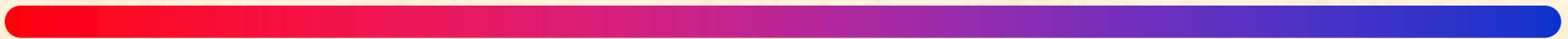
**CORNELL**

**Adelphia**

## *Legend #5:*

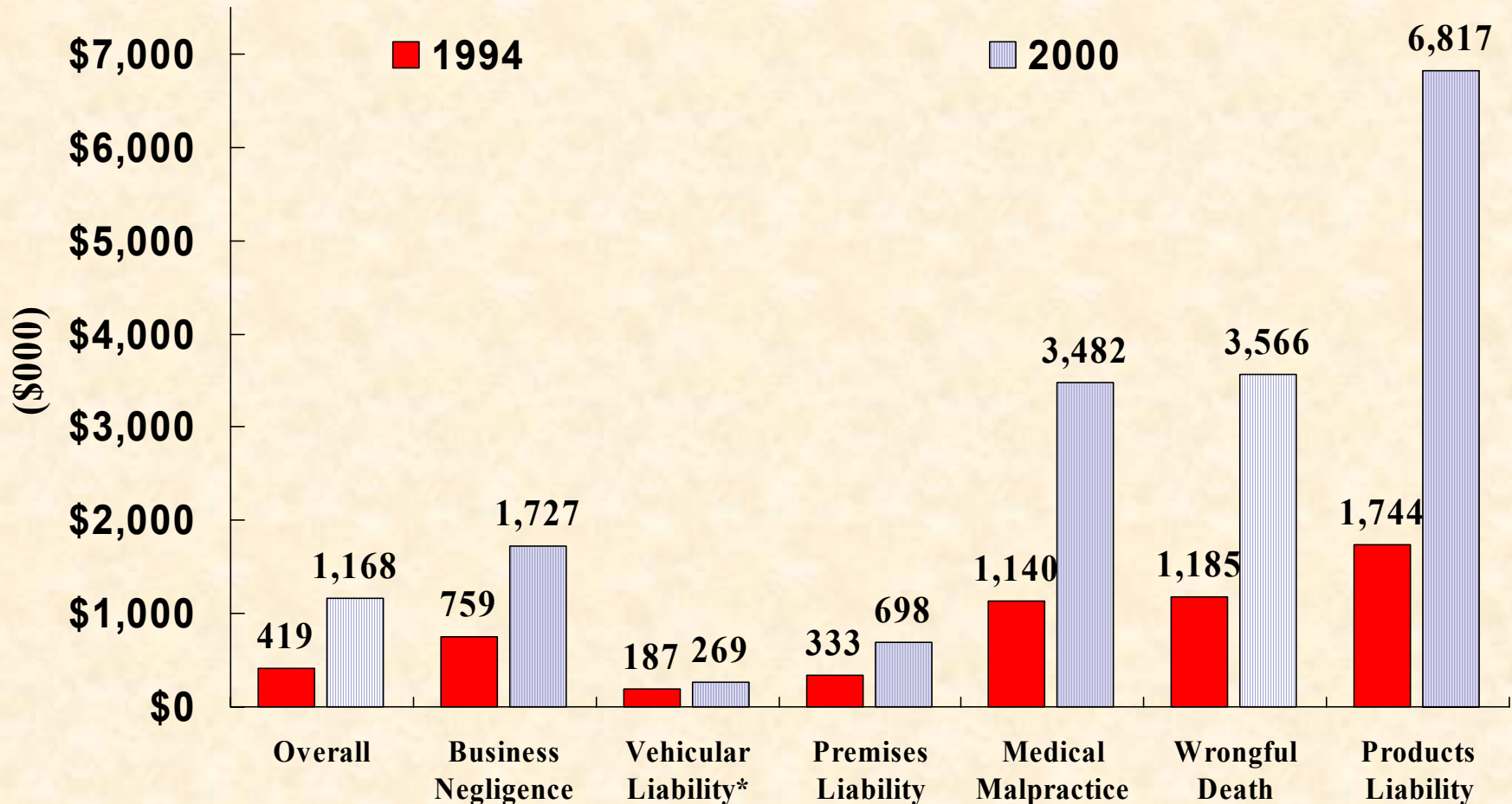
There is No Relationship  
Between Litigiousness and  
Rising Insurance Costs

*(A Trial Lawyer Favorite)*





# Average Jury Awards 1994 vs. 2000



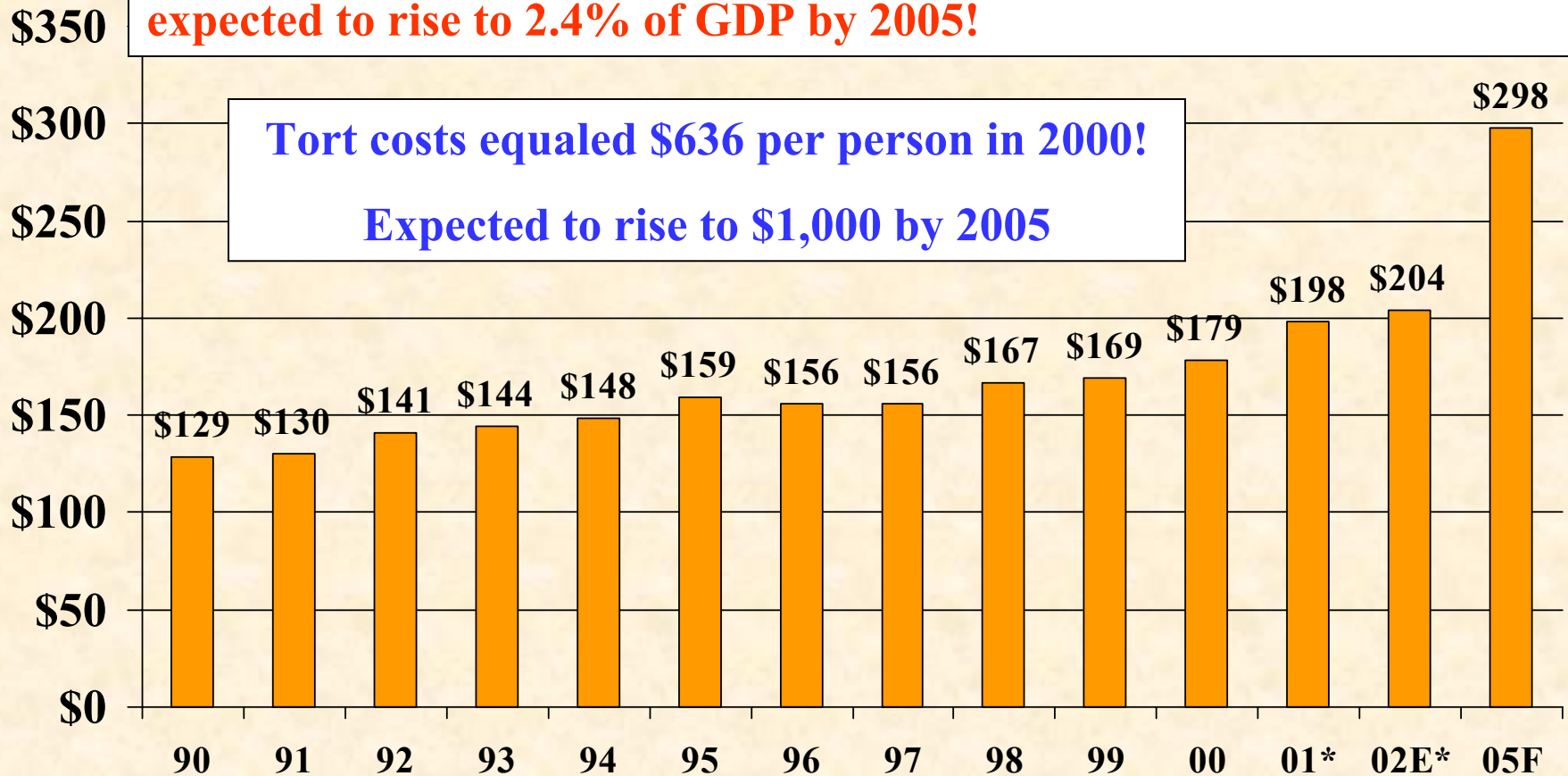
Source: Jury Verdict Research; Insurance Information Institute.



# 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!**

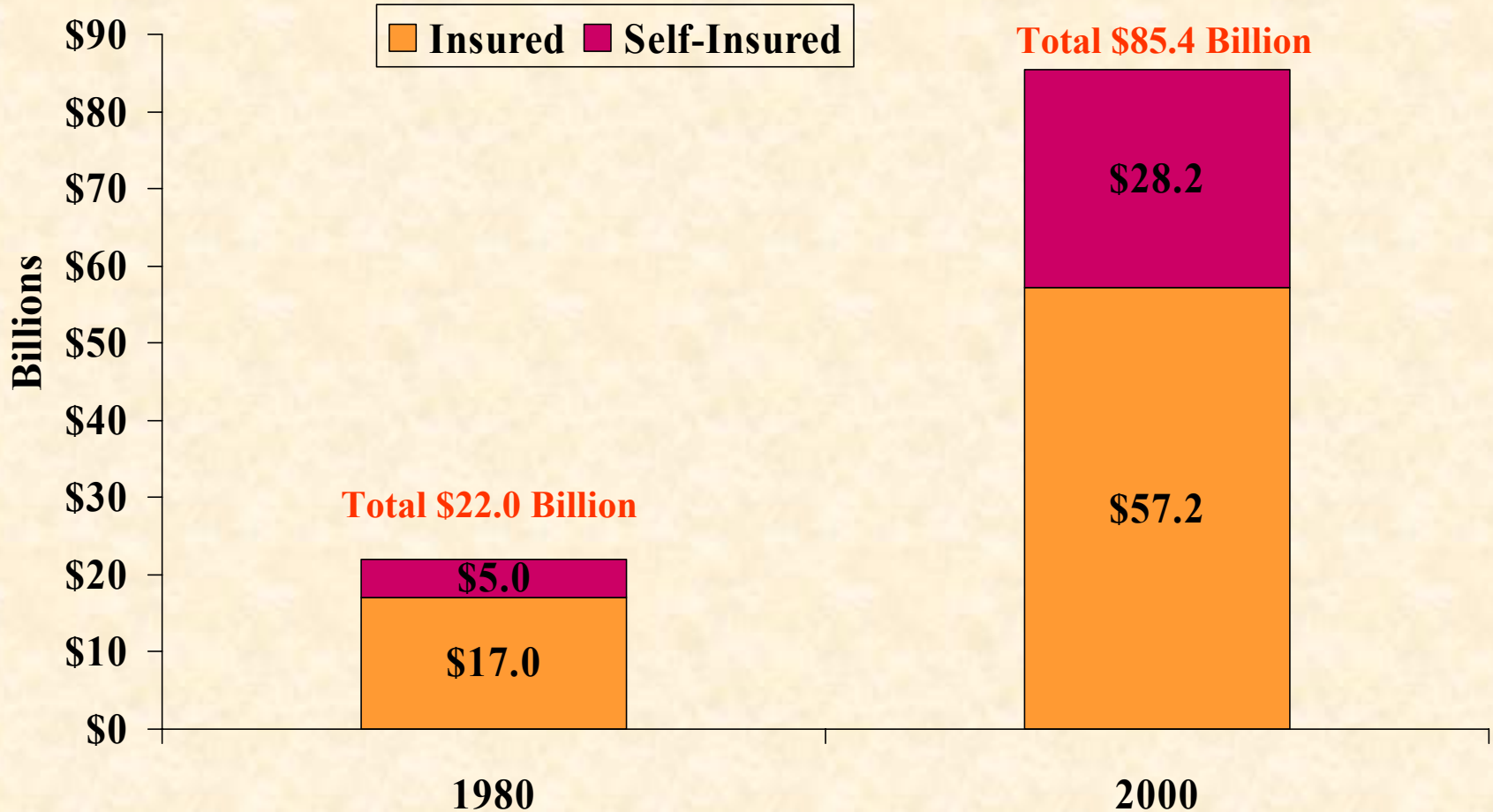


Source: Tillinghast-Towers Perrin; Insurance Information Institute estimates for 2001/2002 assume tort costs equal to 2% of GDP. 2005 forecasts from Tillinghast.



# *Commercial Lines Tort Costs*

*(\$ Billions)*

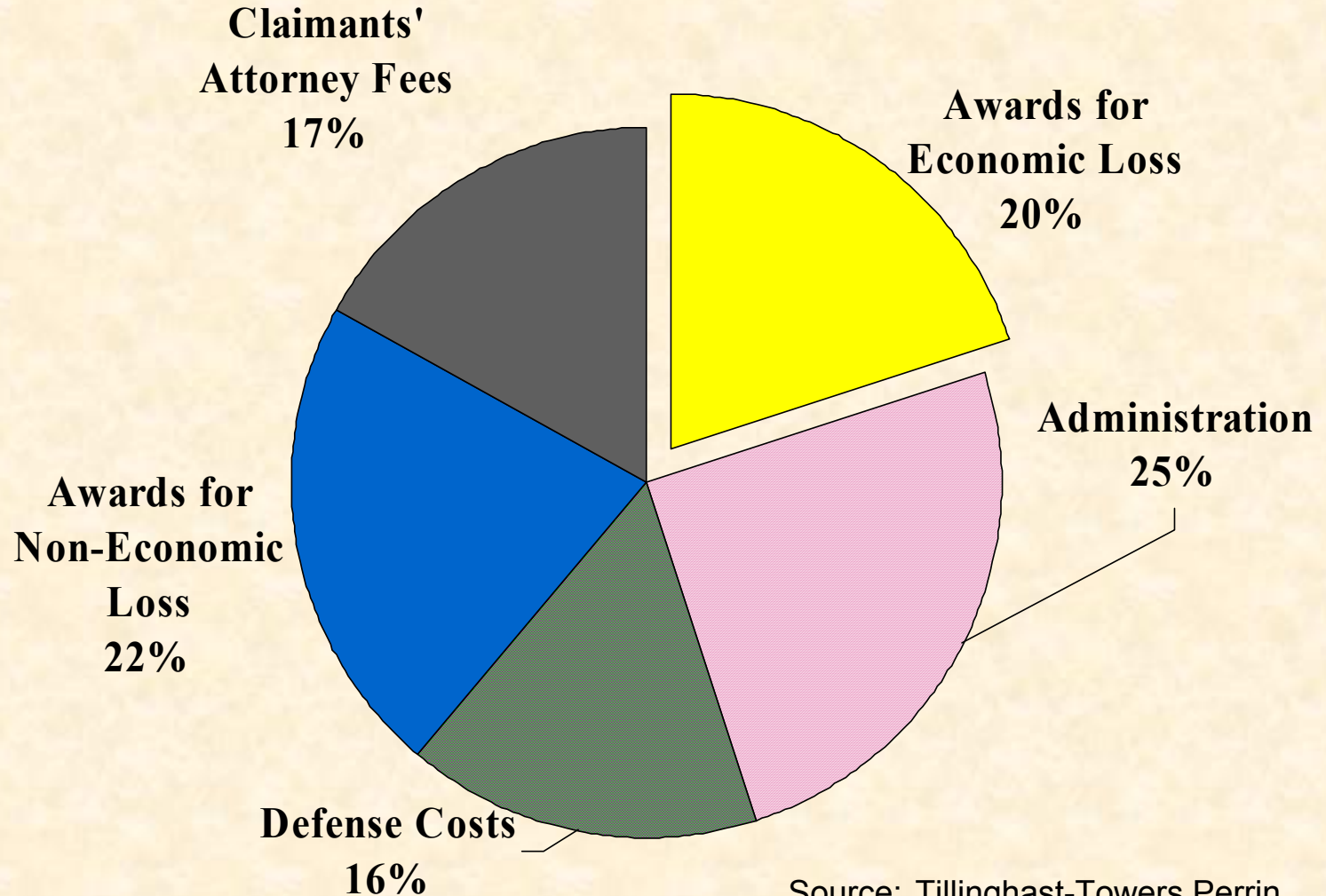




# Where the Tort Dollar Goes (2000)

Tort System is extremely inefficient:

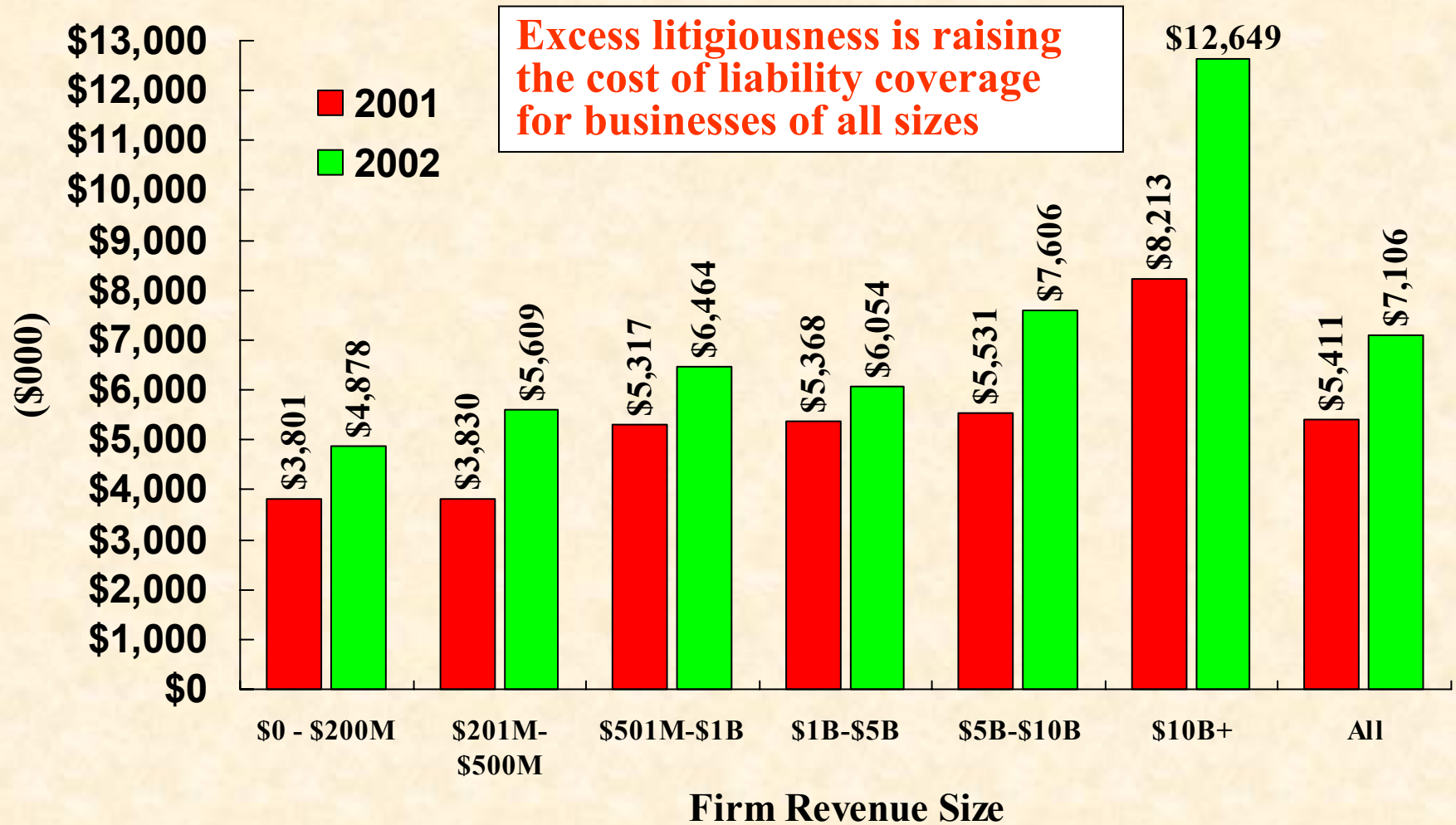
- Only 20% of the tort dollar compensates victims for economic losses
- At least 58% of every tort dollar never reaches the victim



Source: Tillinghast-Towers Perrin

# Average Cost per \$1 Million Liability Coverage

## 2001 vs. 2002



# *EXAMPLES*

*Medical Malpractice*

*Asbestos*

*“Toxic” Mold*

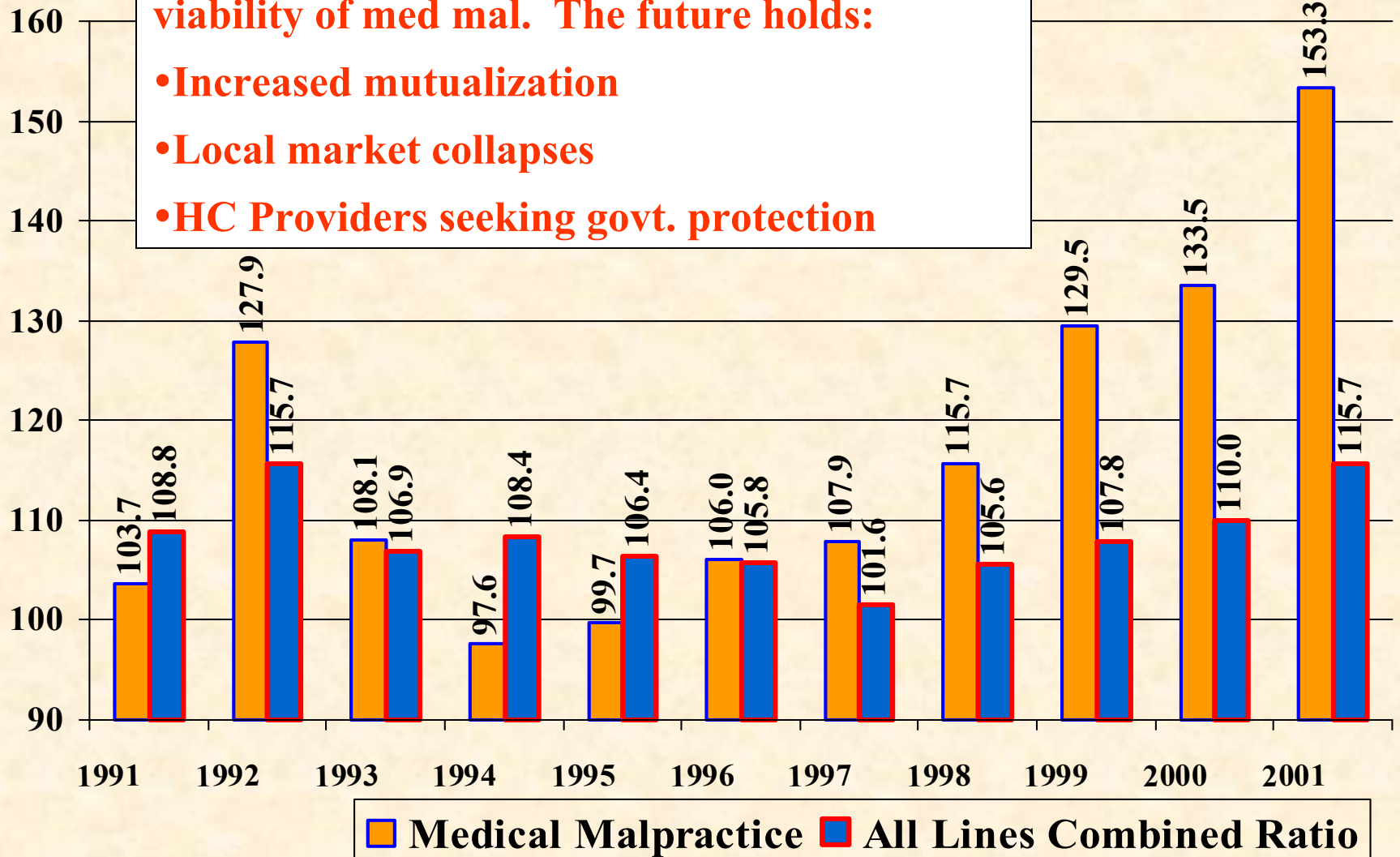


# Medical Malpractice Combined Ratio



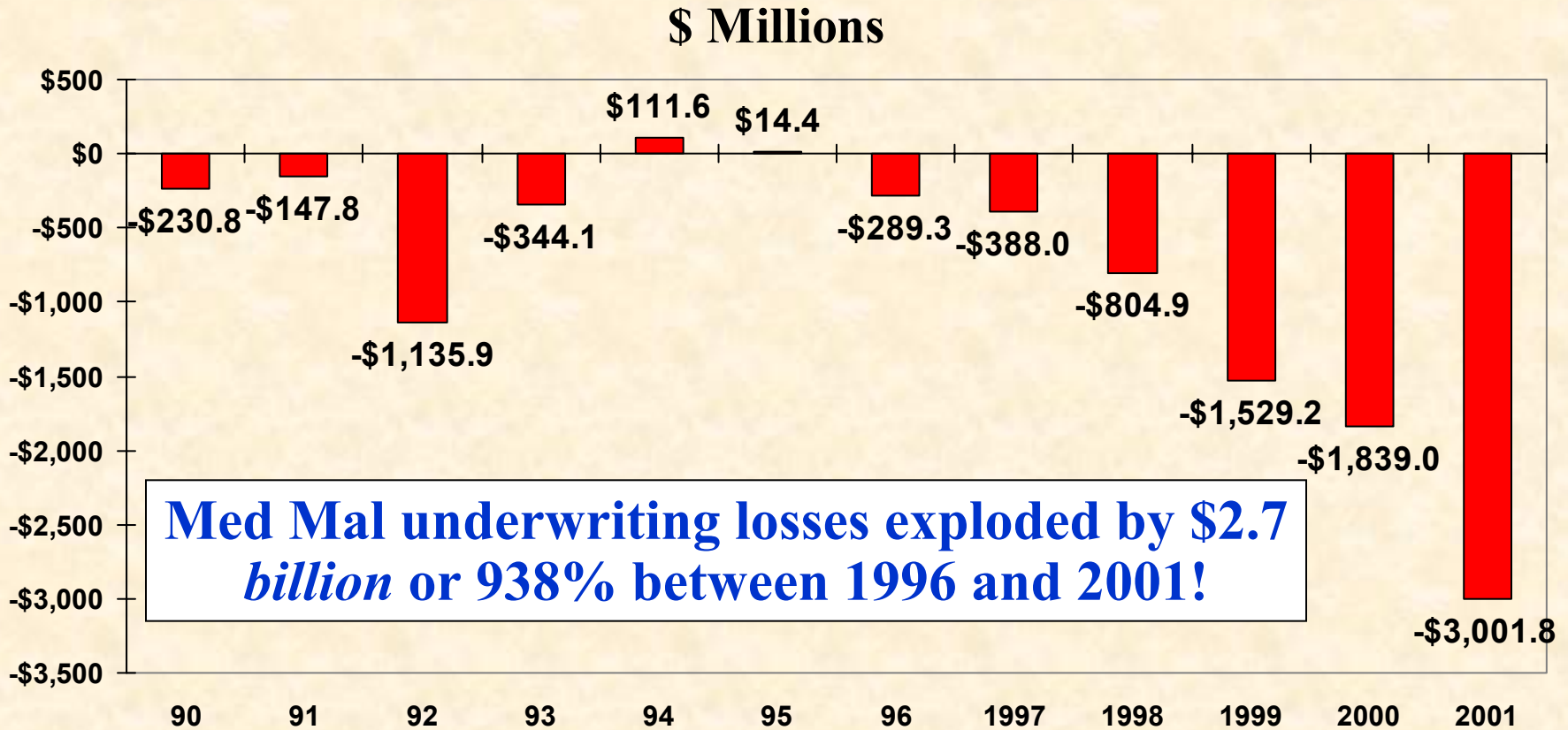
**Trial lawyers have destroyed commercial viability of med mal. The future holds:**

- **Increased mutualization**
- **Local market collapses**
- **HC Providers seeking govt. protection**





# Medical Malpractice: Underwriting Losses



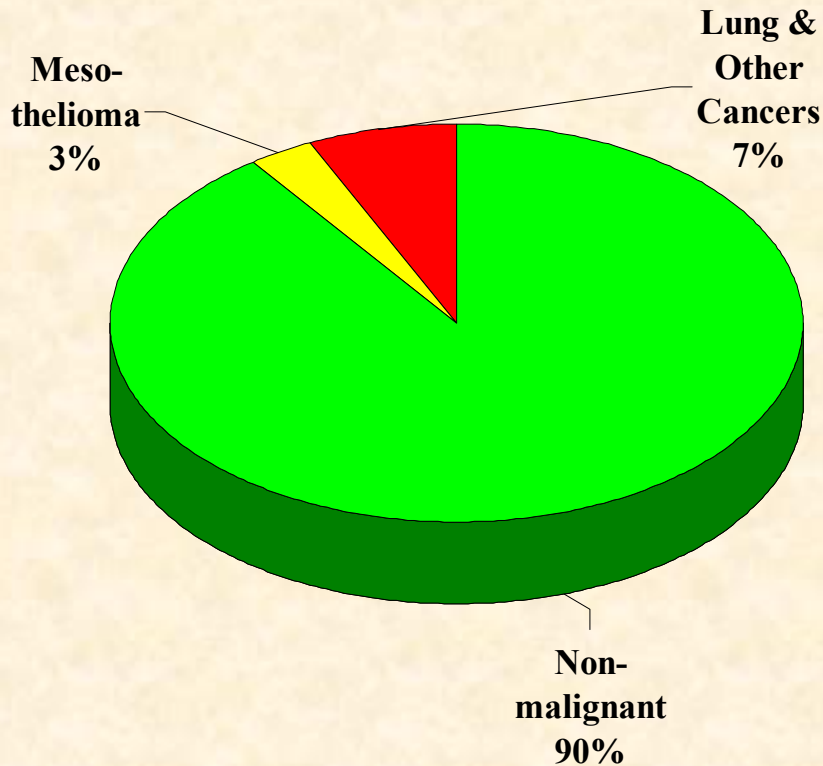


# *Non-Malignant Asbestos Claimants File Most Claims, Get Most \$\$\$*

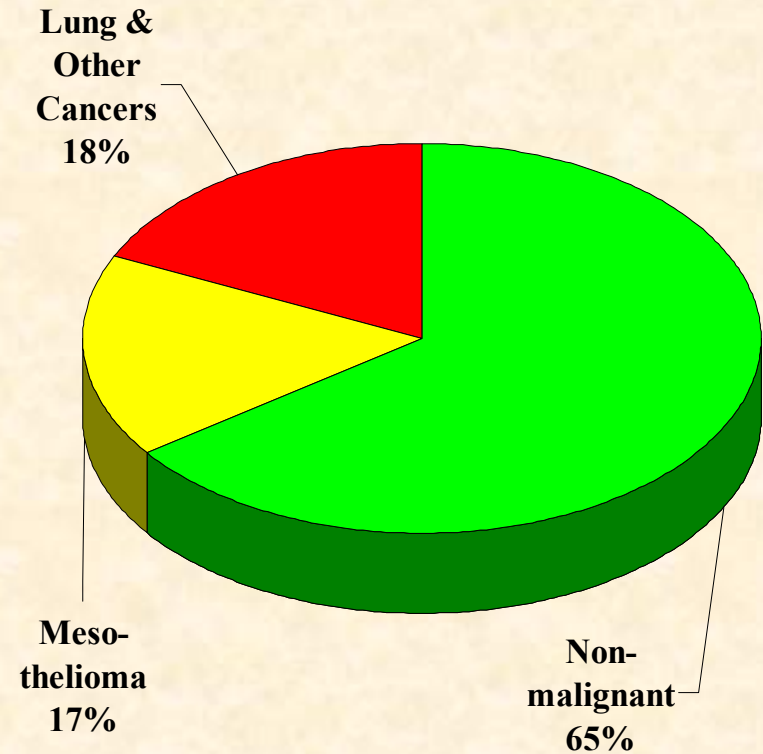
## **DISTRIBUTION OF CLAIMS**

## **ALLOCATION OF COMPENSATION**

1991-2000



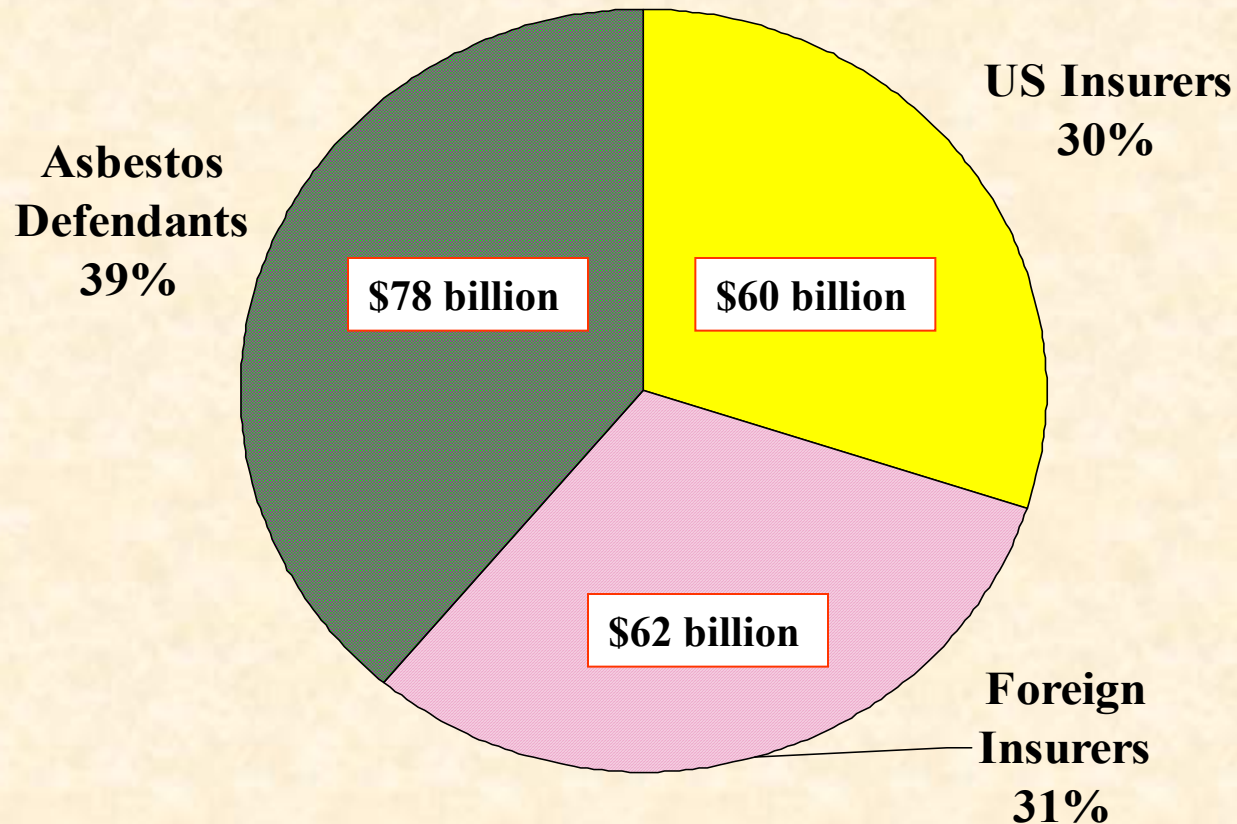
1991-2000





# Who Will Pay for the US Asbestos Mess?

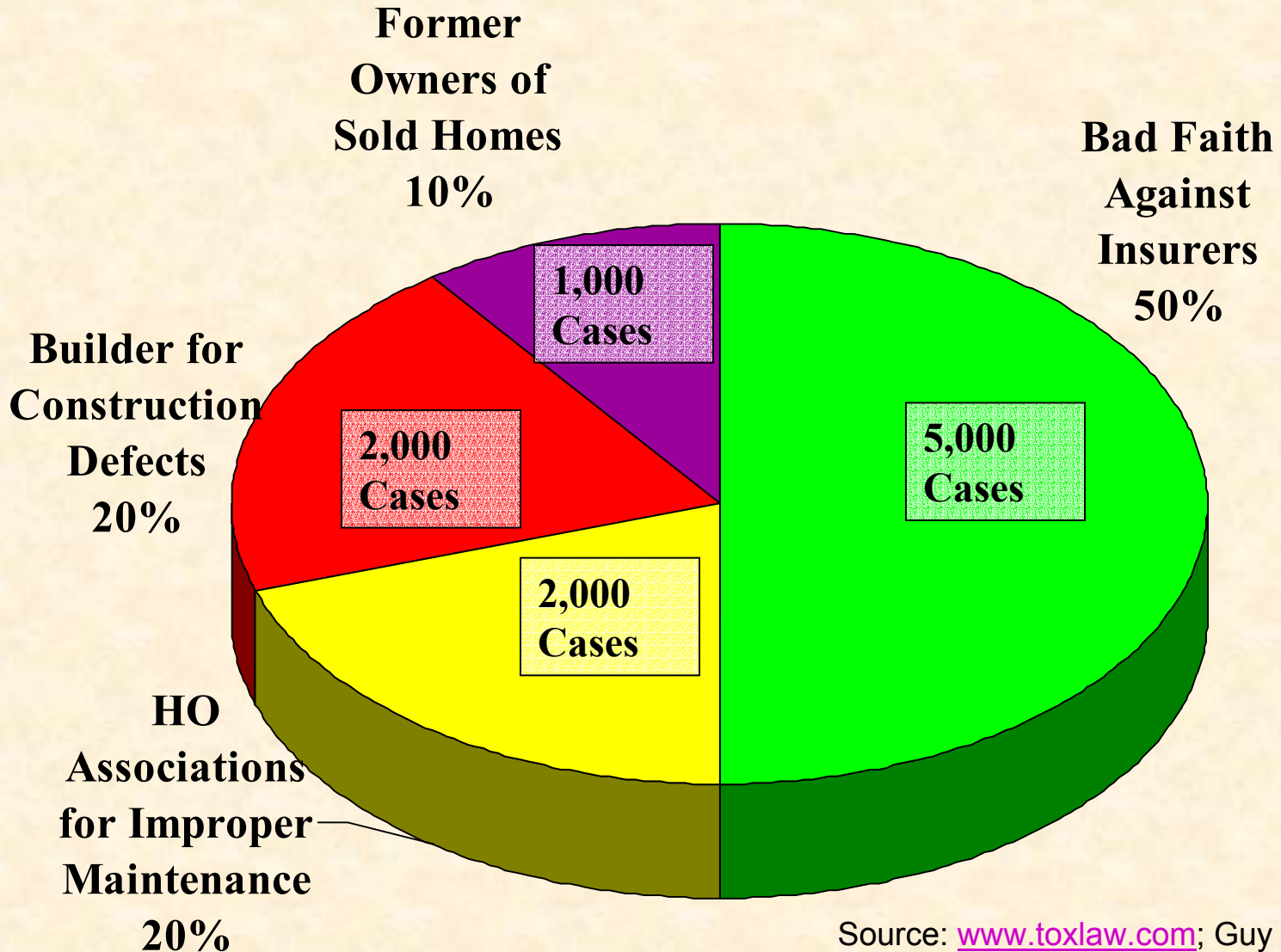
**Estimated Total US Settlements & Expenses = \$200 billion**



Source: Tillinghast-Towers Perrin; Insurance Information Institute

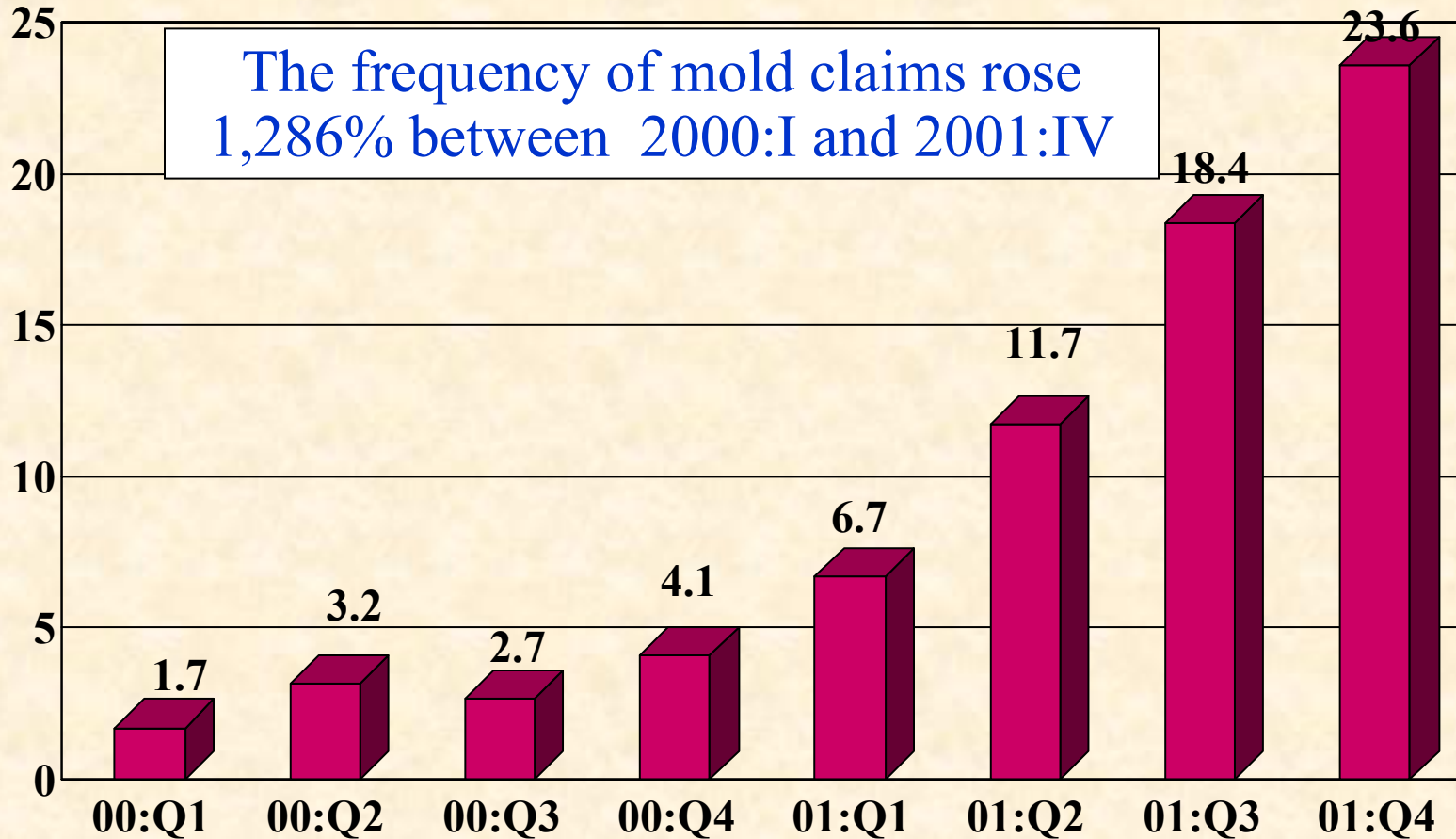


# *U.S.: Documented Toxic Mold Suits*





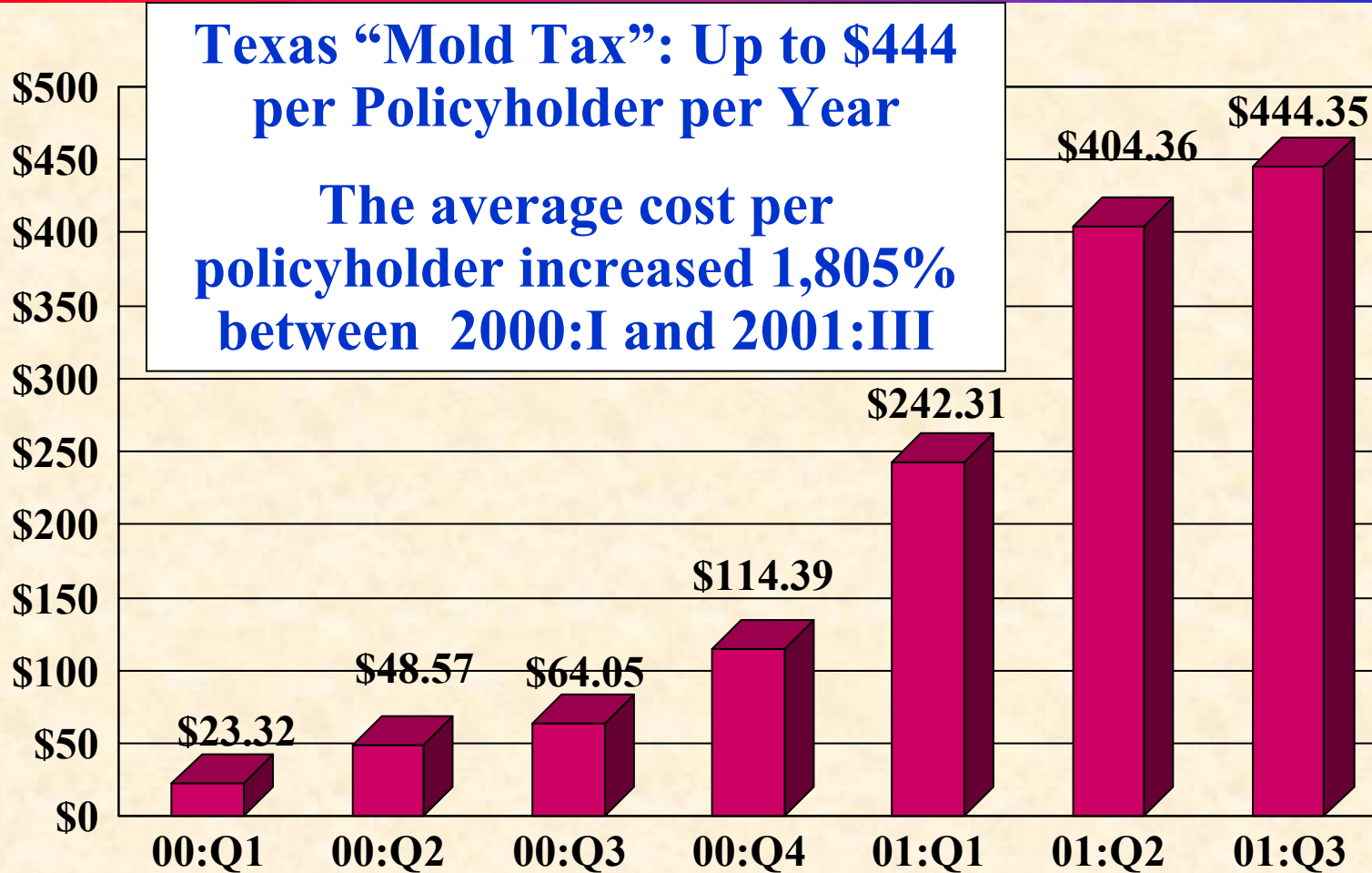
## *TX: Mold Claim Frequency\** (# claims per 1,000 policyholders)



Source: Texas Department of Insurance; Insurance Information Institute estimates.



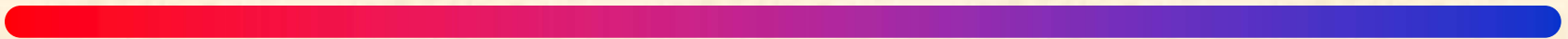
# *TX : Average Cost per Policyholder Due to Mold (per year)*



Source: Texas Department of Insurance; Insurance Information Institute estimates.

## *Legend #6:*

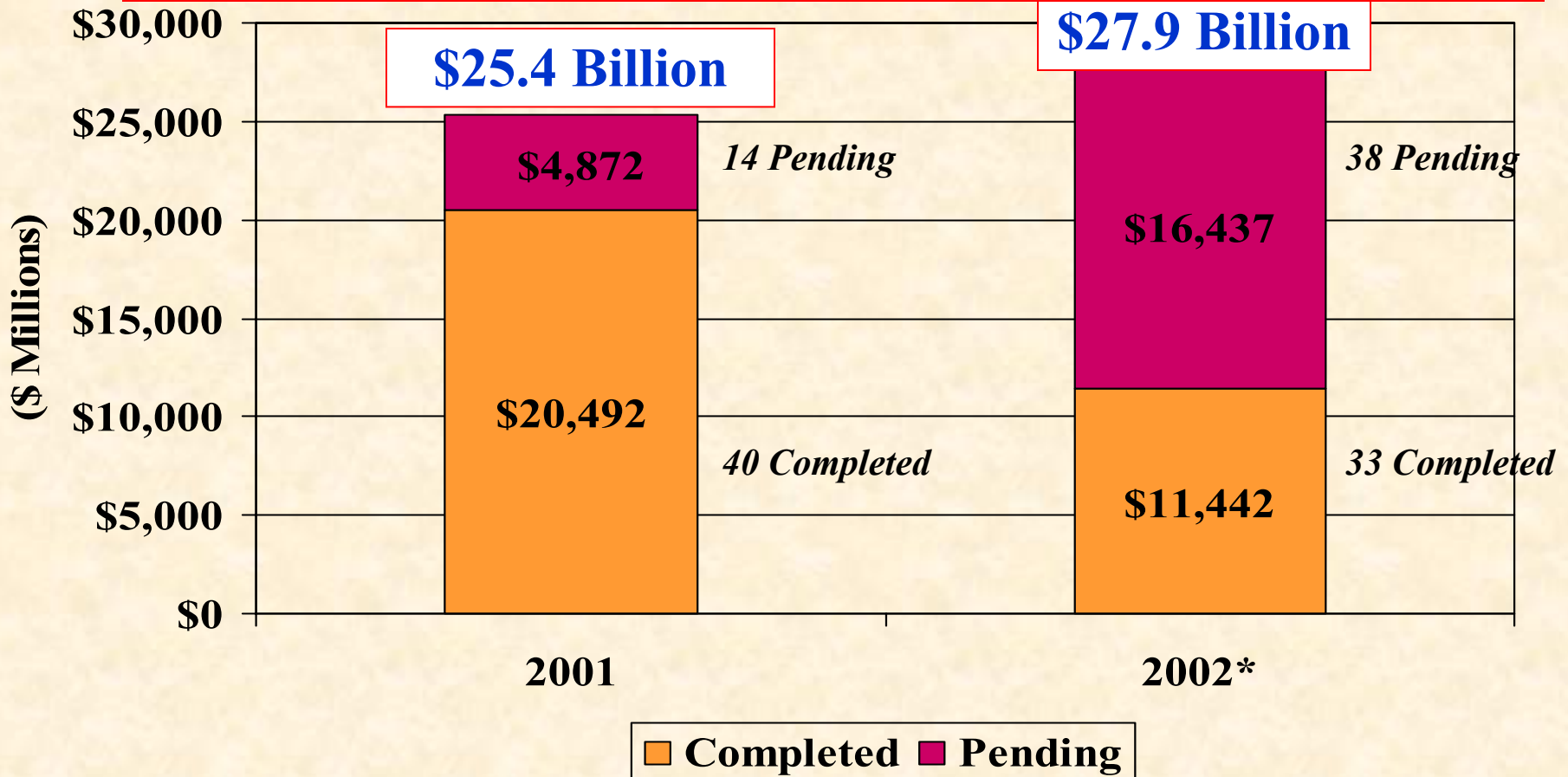
*Insurers are Awash in Cash  
and Have More Money than  
They Know What to Do With*





# Capital Raising by P/C Insurers Since September 11, 2001\*

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

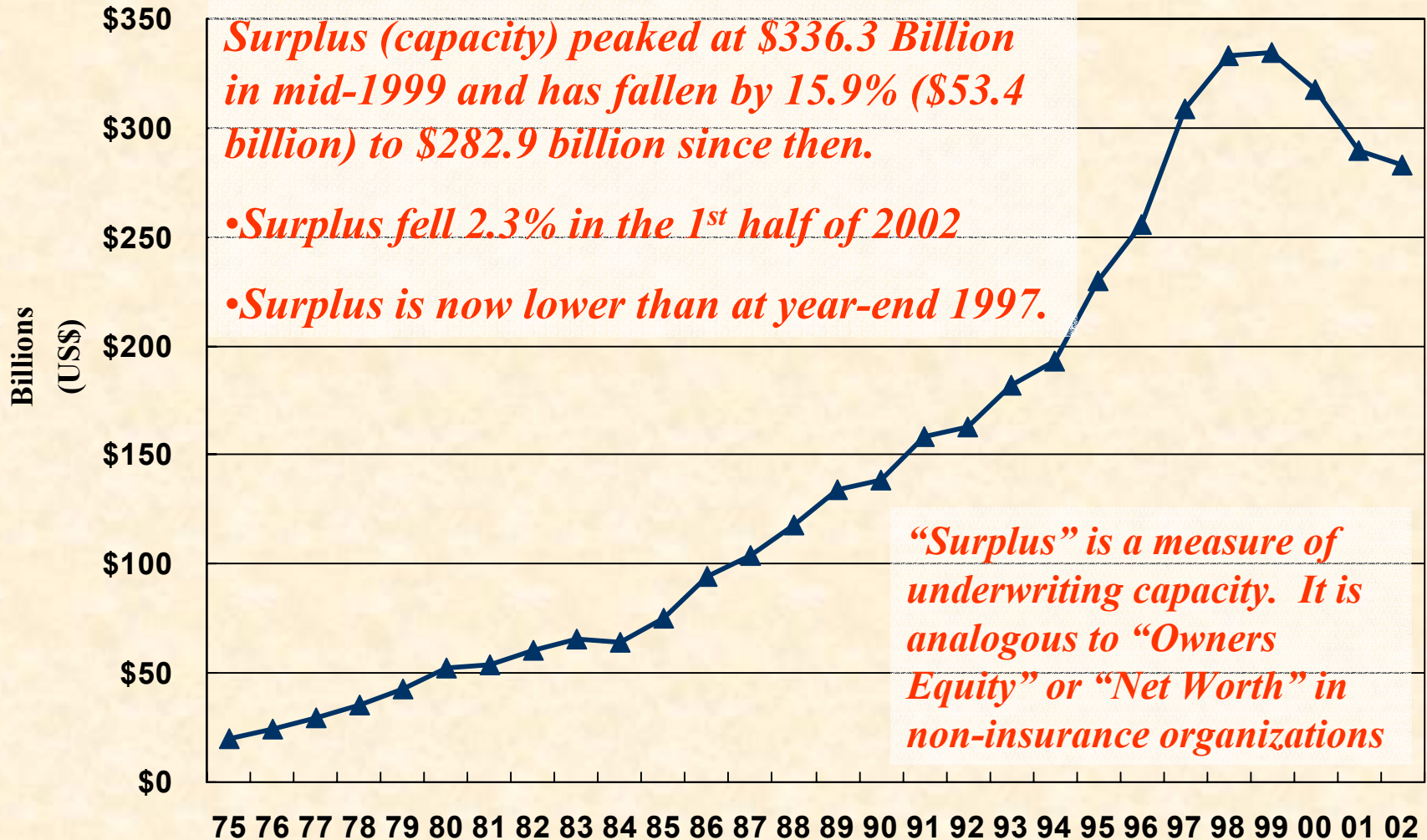


\*As of September 13, 2002.

Source: Morgan Stanley, Insurance Information Institute.



# Policyholder Surplus: 1975-2002\*



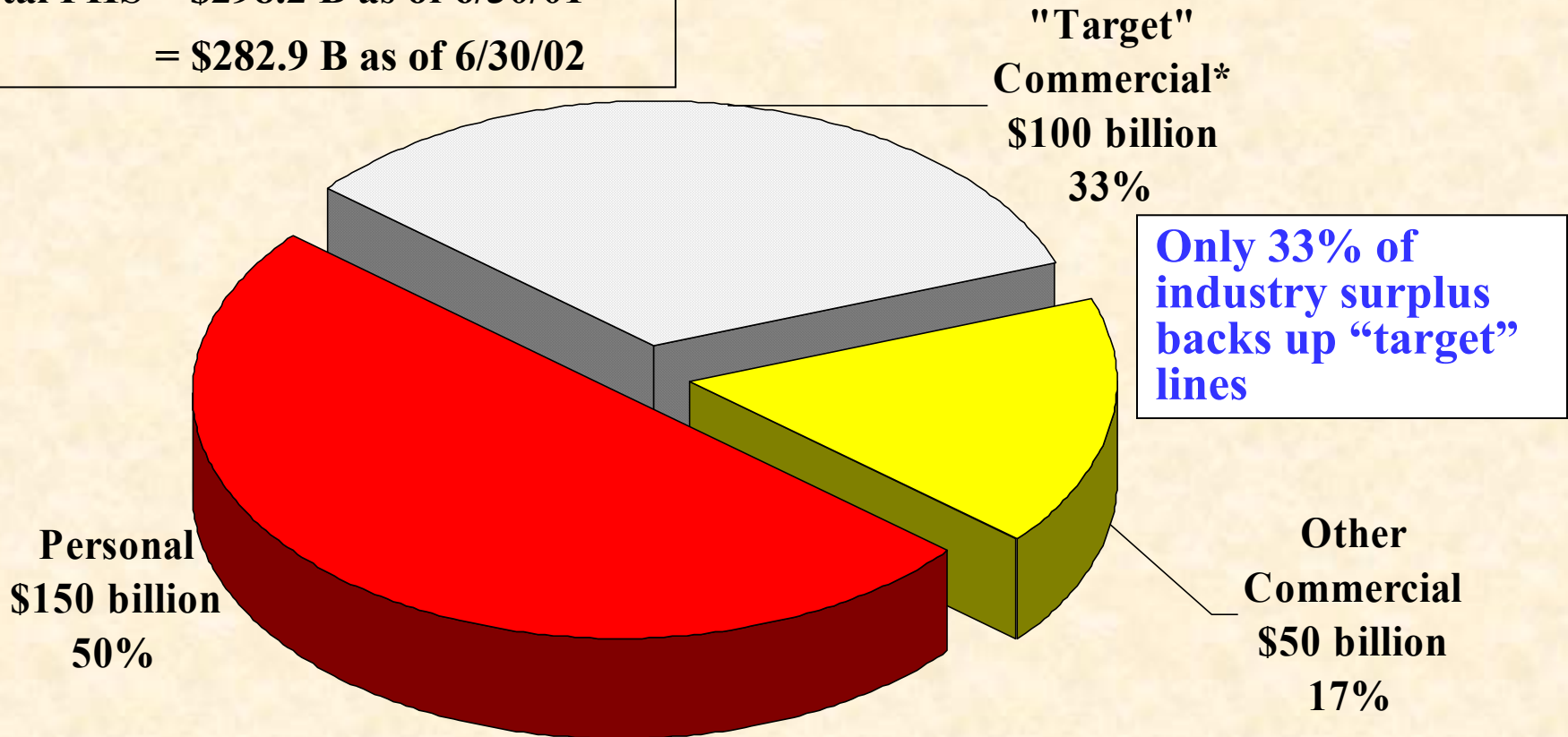
\*As of June 30, 2002

Source: A.M. Best, Insurance Information Institute



# Capital Myth: 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 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

*Legend #7:*

Insurers are “Redlining”

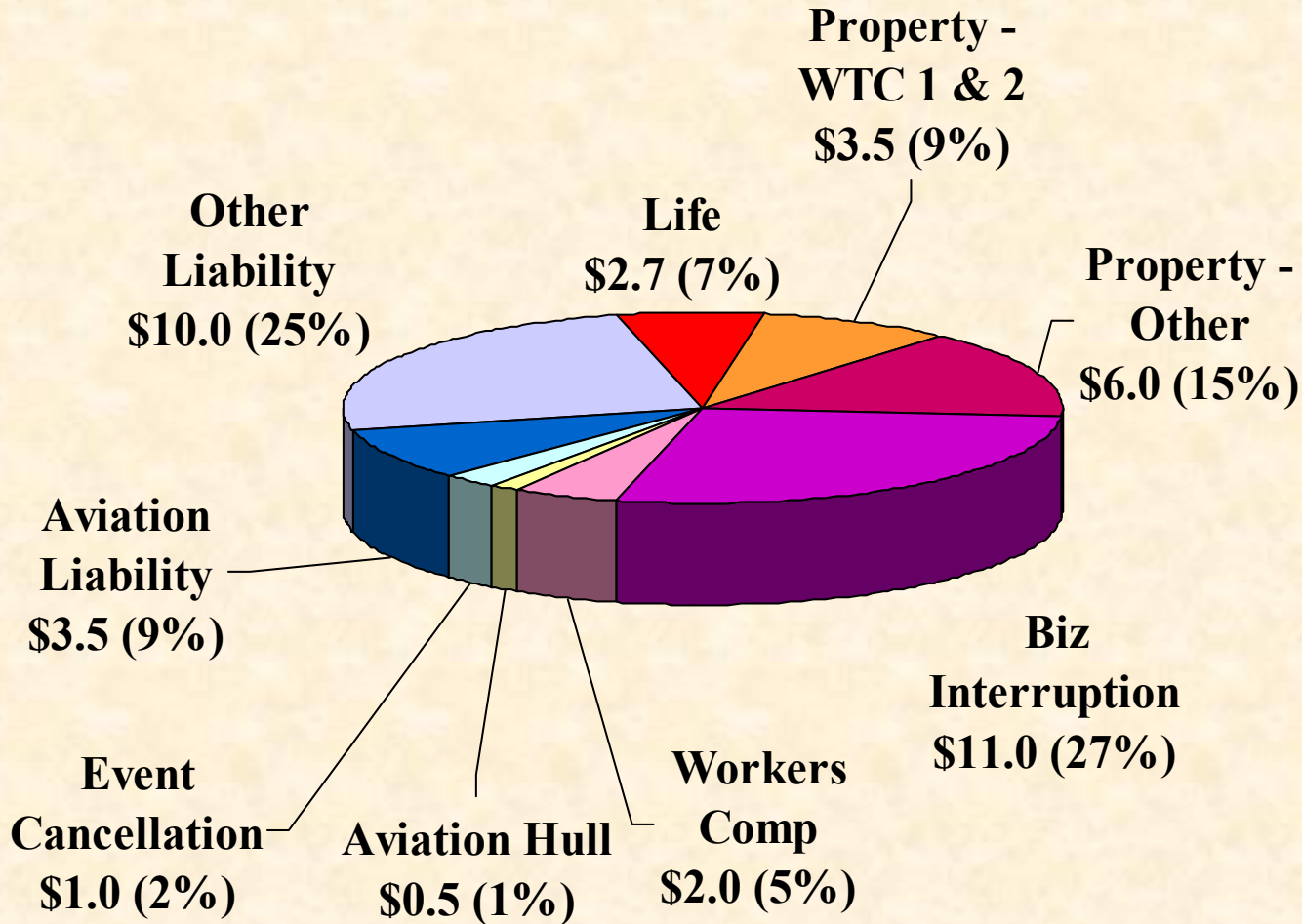
Businesses in the Wake of 9/11





# Sept. 11 Industry Loss Estimates

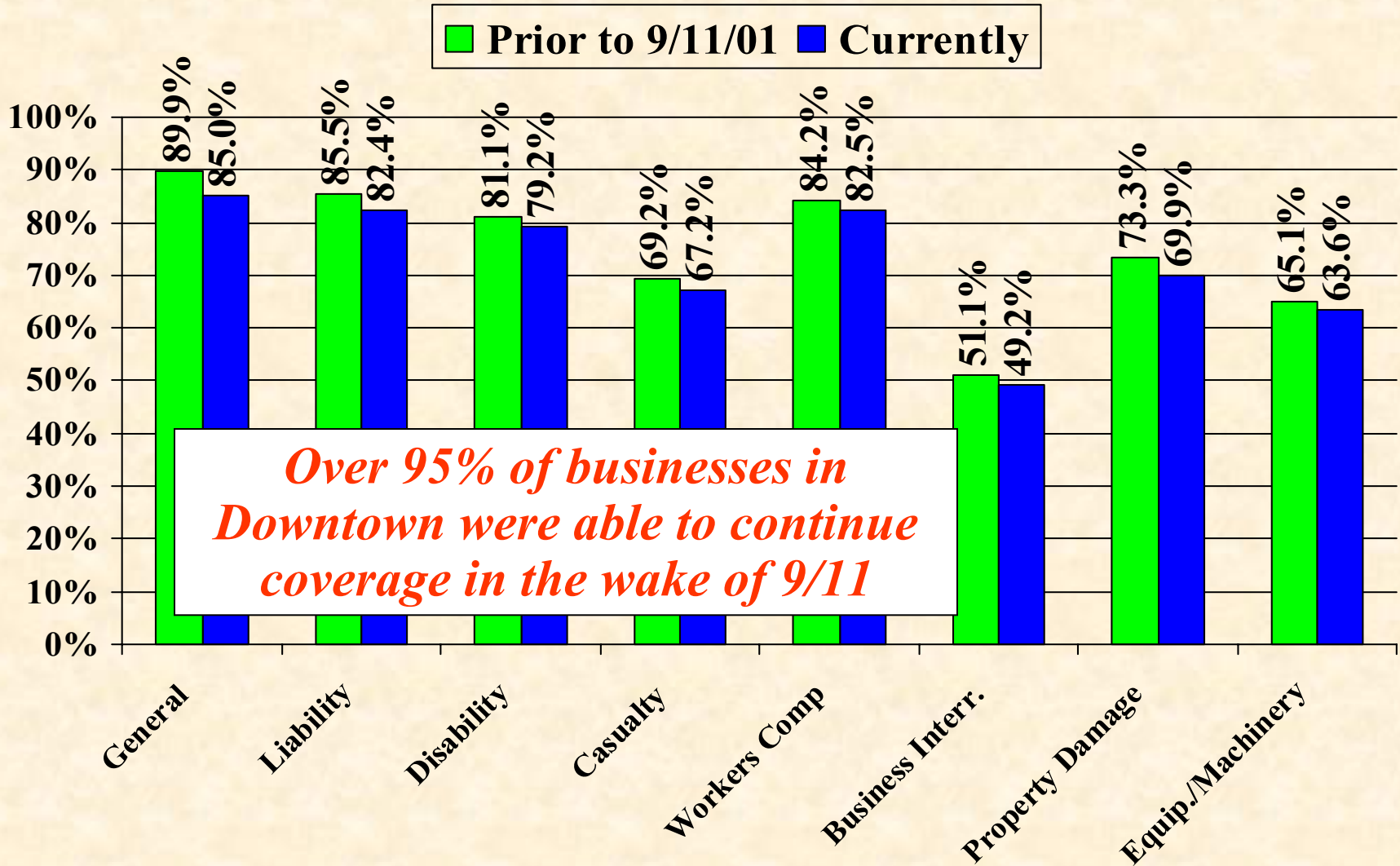
(\$ Billions)



## Consensus Insured Losses Estimate: \$40.2B



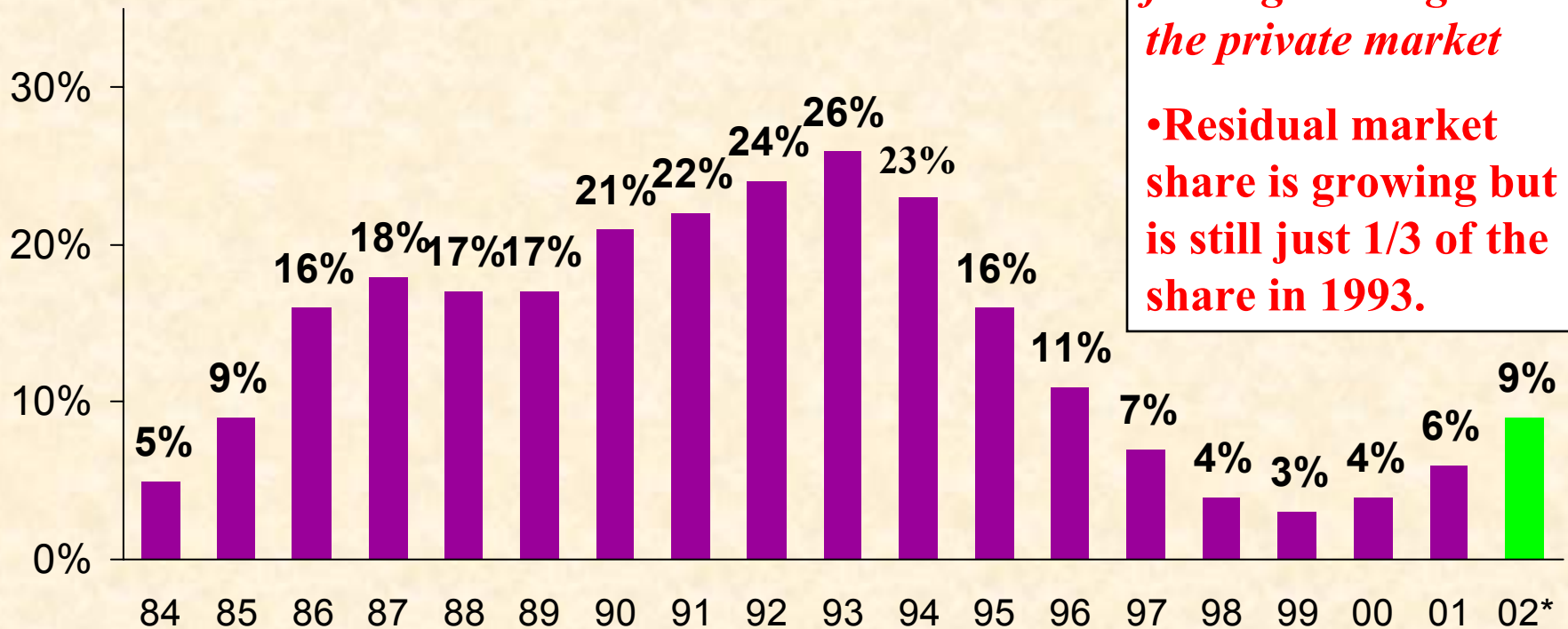
# Insurance Coverage in Lower Manhattan





# WC Residual Market Shares

Residual Market Shares



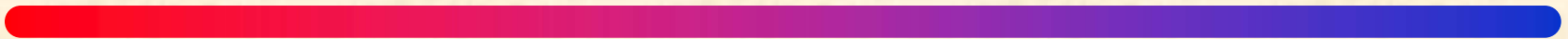
*•The vast majority of employers are finding coverage in the private market*

*•Residual market share is growing but is still just 1/3 of the share in 1993.*

\*Insurance Information Institute estimate  
Source: NCCI

*Legend #8:*

Federal Backstop Alone Will  
Solve Capacity Problems

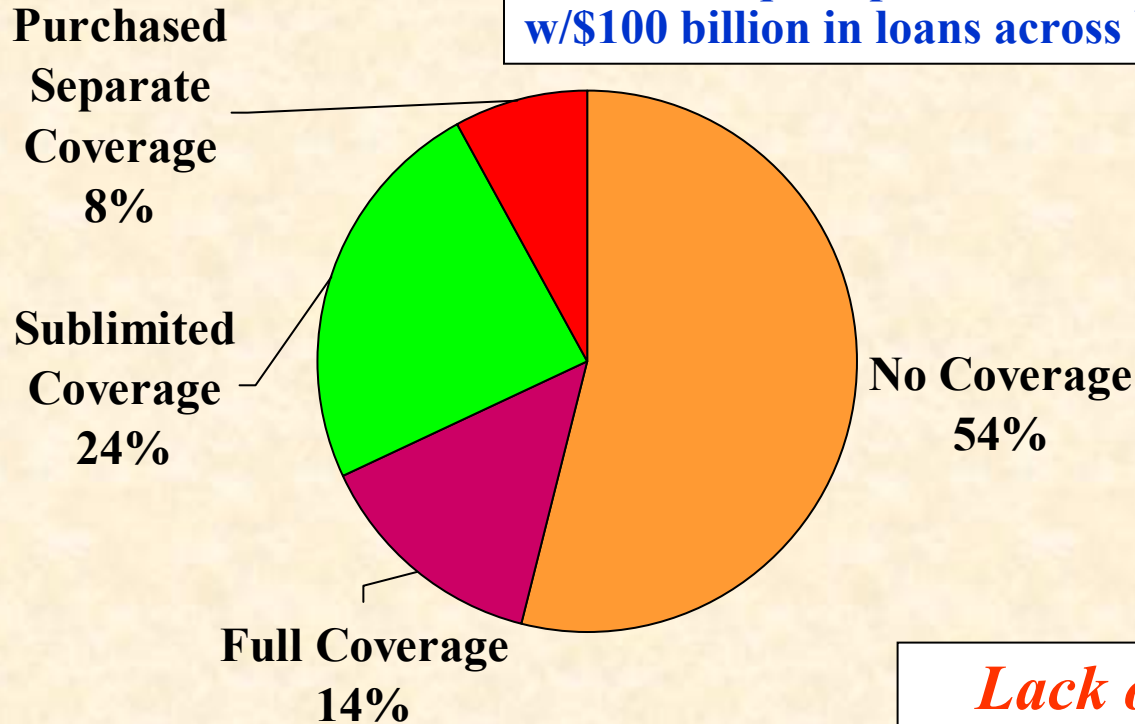




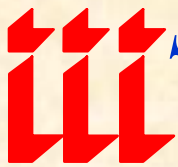
# *Most Businesses Have Little or No Terrorism Coverage*

## Lenders vs. Commercial Mortgage Holders

- Cigna/Durst/4 Times Square/\$5 mill for cover
- GMAC require purchase on 40,000 properties w/\$100 billion in loans across US.

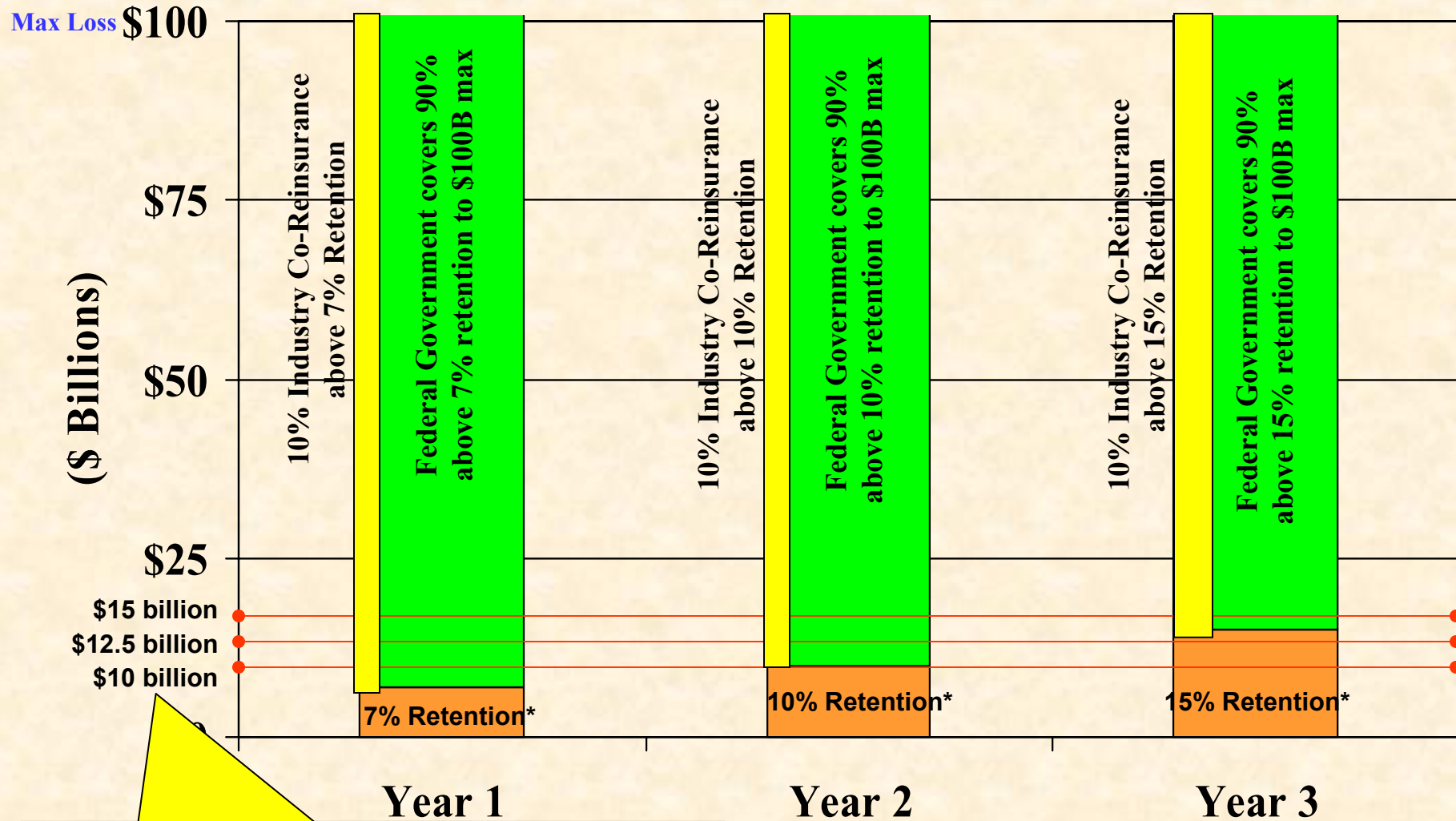


*Lack of coverage underscores need for federal backstop*



# Structure of Proposed Federal Backstop

(as proposed/interpreted as of 11/1/02)



Government recoups payouts below \$10B in Year 1, \$12.5 Year 2, \$15B Year 3 with 3% max surcharge on policy premium

\* Industry retention based on direct premiums written.

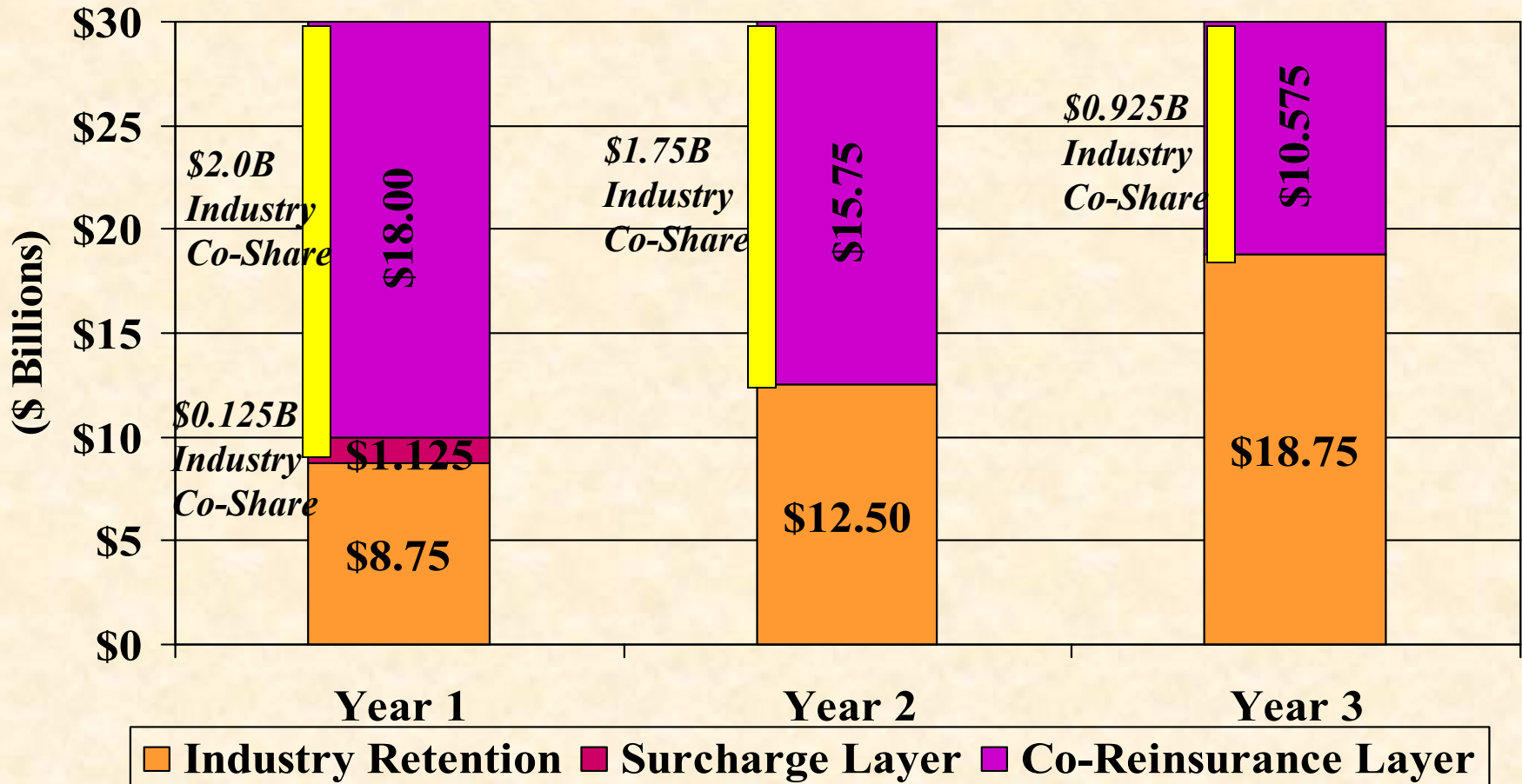
Source: U.S. Congress, Insurance Information Institute.



# 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

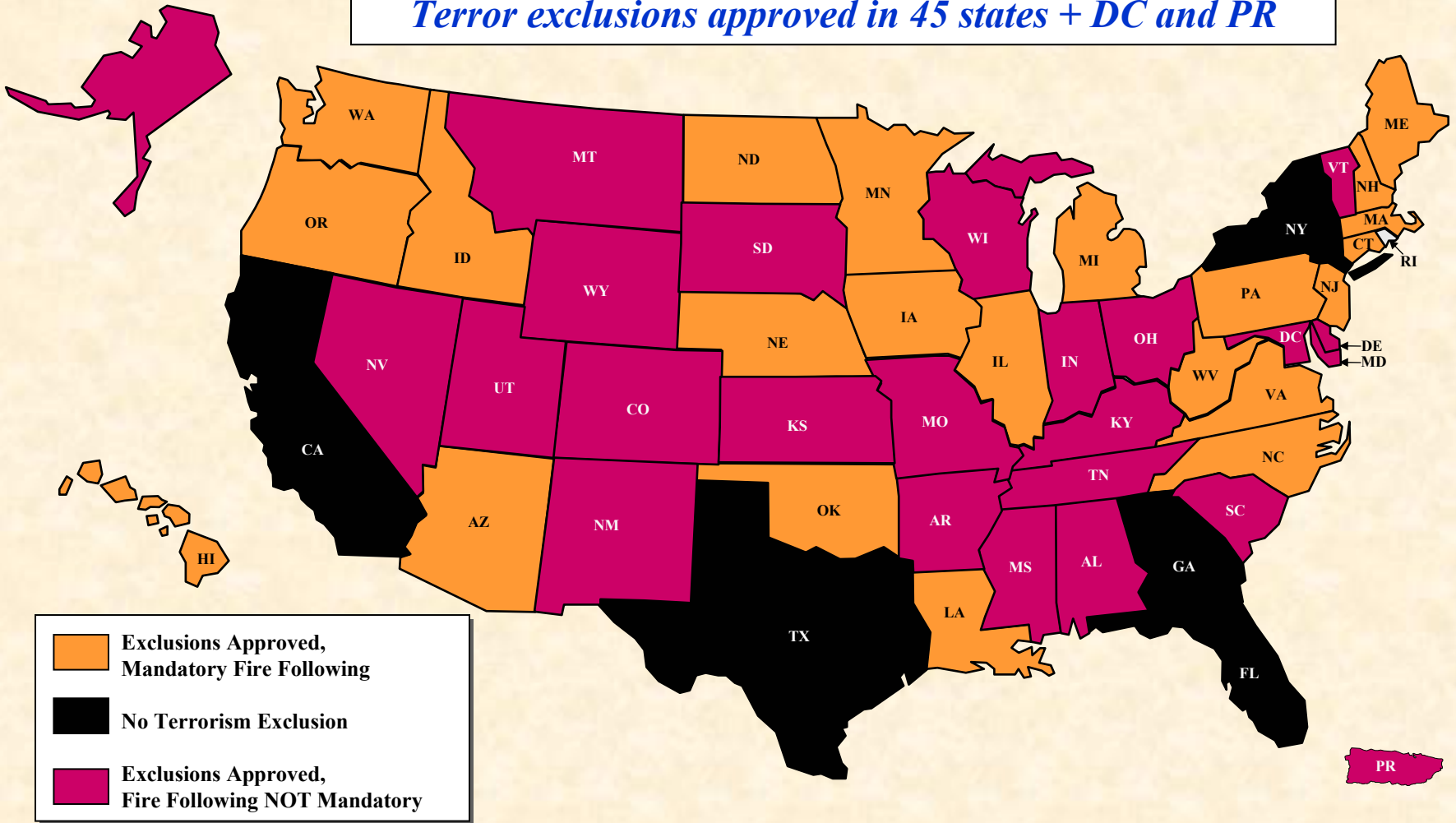


**Assumes \$30B Commercial Prop & WC Loss, \$125B "At Risk" Commercial DPW**



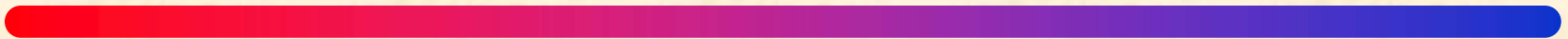
# Terrorism Exclusions

*Terror exclusions approved in 45 states + DC and PR*



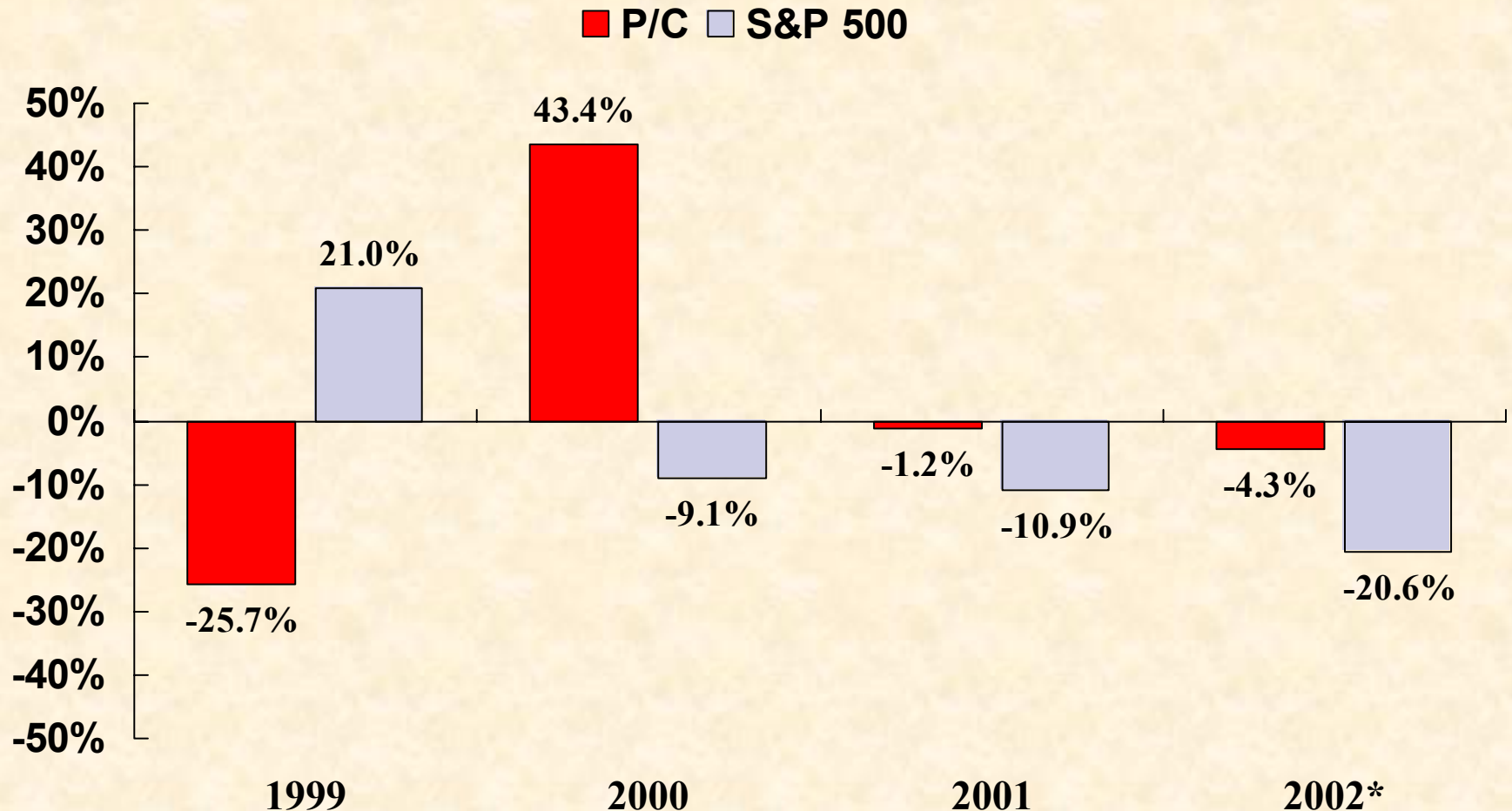
*Legend #9:*

*Wall Street Investors Should  
be Satisfied With Insurer Stock  
Performance*





# *P/C Performance Volatile, but Better than S&P 500 Lately*



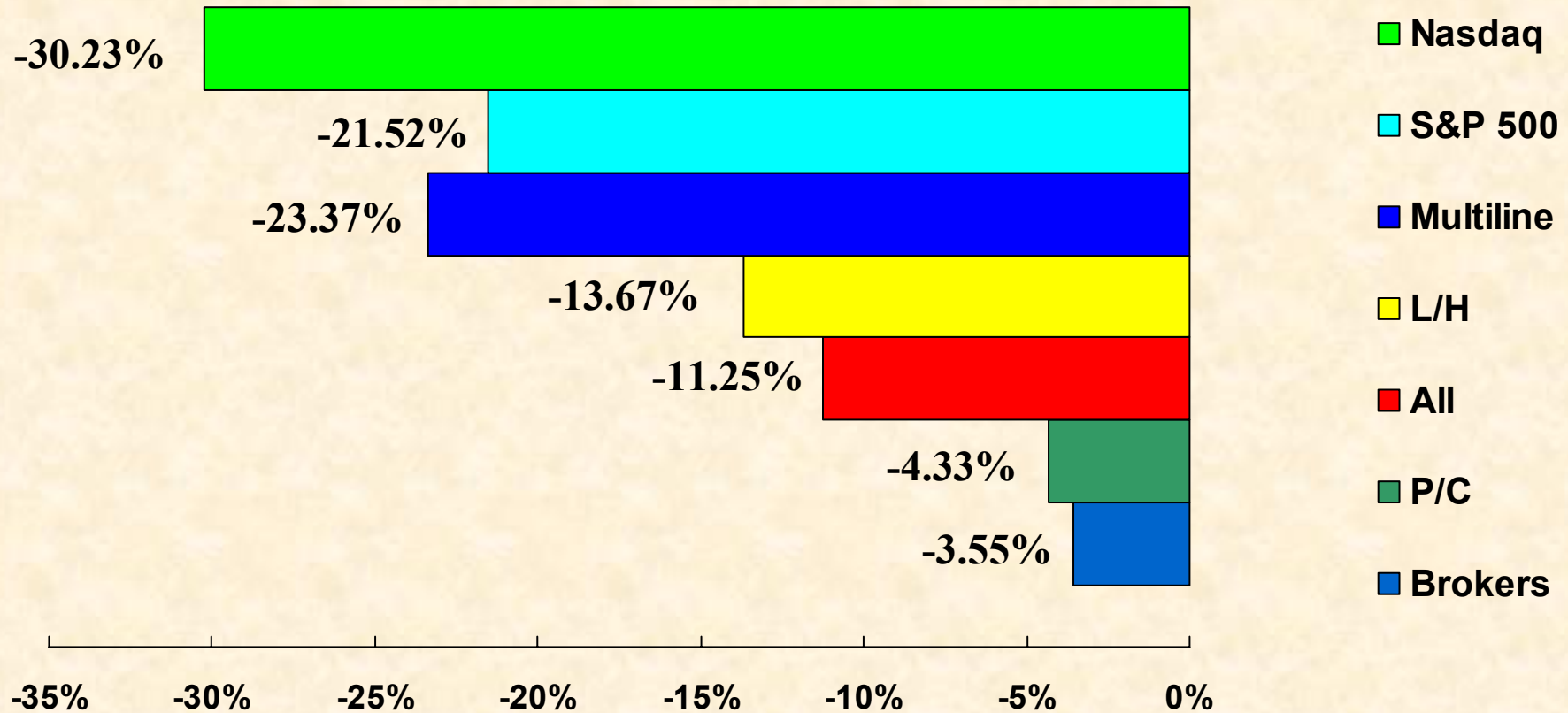
\*Through November 1, 2002.

Source: SNL Securities, Insurance Information Institute



# *Insurer Stocks: Outperforming the S&P 500, but Negative Returns Still Disappoint*

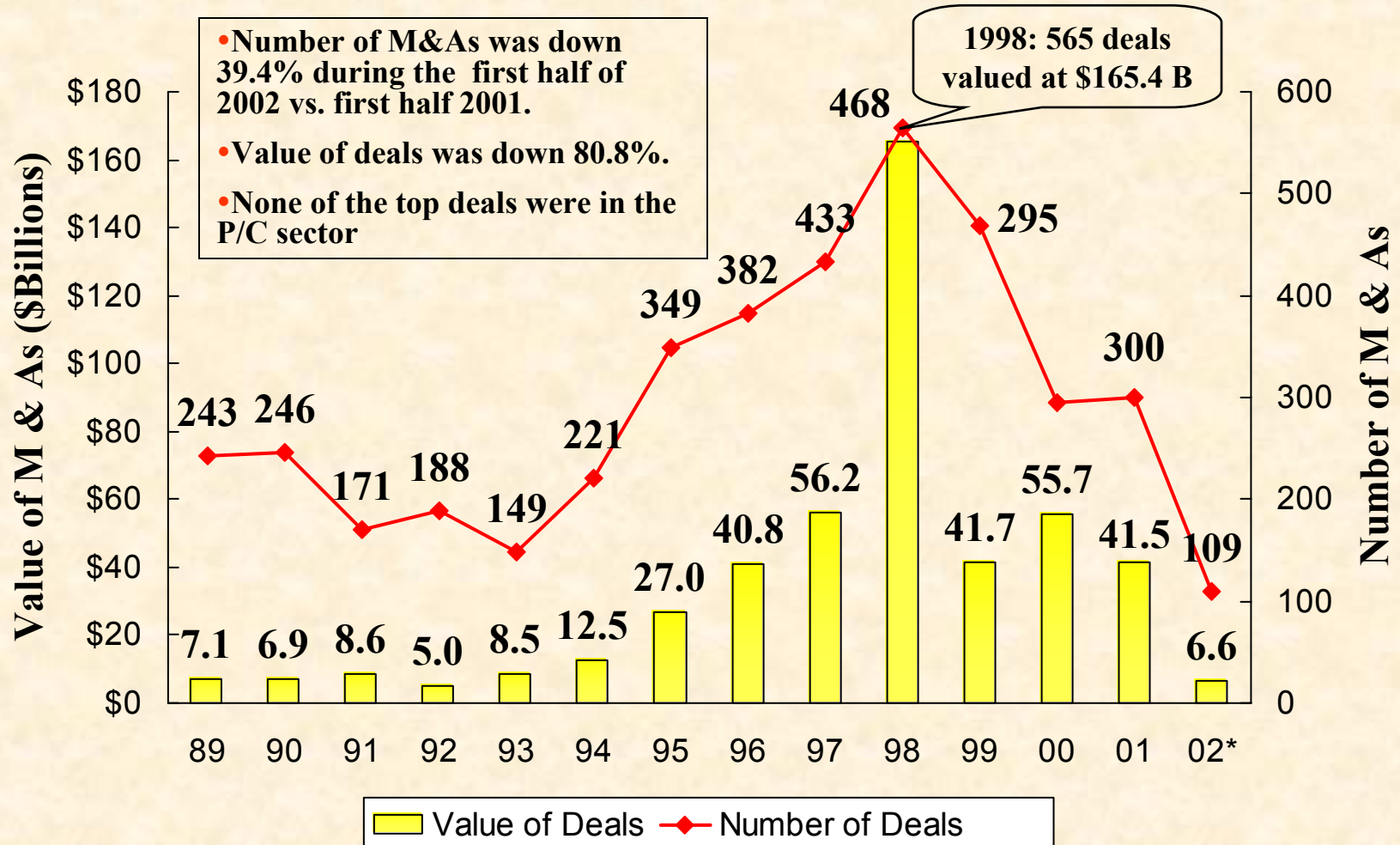
**Total Return 2002 YTD Through November 1, 2002**



Source: SNL Securities, Insurance Information Institute



# Insurance Mergers and Acquisitions



Source: Compiled from Conning & Company reports.



# *Insurance Information Institute On-Line*

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