Property/Casualty Insurance Overview and Outlook: 2001 and Beyond

Inland Marine Underwriters Association
Keystone Resort & Conference Center
Keystone, CO
June 4, 2001
Presentation Outline

- Property/Casualty Overview and Outlook
- Why Ron Thornton Can’t Sleep at Night
  - Inland Marine Market
- Profits, Capital, Pricing, Investments
- Competition & Consolidation
- Distribution
- Courts & Torts
- Economy
PROPERTY/CASUALTY
OVERVIEW AND OUTLOOK
## Highlights: Full-Year 2000

($ Millions)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>1999</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Written Prem.</td>
<td>301,559</td>
<td>286,934</td>
<td>+5.1%</td>
</tr>
<tr>
<td>Loss &amp; LAE</td>
<td>241,602</td>
<td>222,270</td>
<td>+8.7%</td>
</tr>
<tr>
<td>Net UW Gain (Loss)</td>
<td>(28,634)</td>
<td>(19,729)</td>
<td>+45.1%</td>
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<tr>
<td>Net Inv. Income</td>
<td>40,836</td>
<td>38,855</td>
<td>+5.1%</td>
</tr>
<tr>
<td>Net Income (a.t.)</td>
<td>20,223</td>
<td>21,865</td>
<td>-7.5%</td>
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<tr>
<td>Surplus</td>
<td>319,399</td>
<td>334,348</td>
<td>-4.5%</td>
</tr>
<tr>
<td>Combined Ratio</td>
<td>110.5</td>
<td>107.8</td>
<td>+2.7 pts.</td>
</tr>
</tbody>
</table>
Growth in Net Premiums Written (All P/C Lines)

The underwriting cycle went AWOL in the 1990s. Is it Back?

1999: 1.9%
2000: 5.1%
2001 Forecast: 7.4%

Source: A.M. Best, Insurance Information Institute
P/C Industry Combined Ratio

1999 = 107.8
2000 = 110.5
2001 Forecast* = 109.1

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

* Based on III Groundhog Forecast
**U.S. Insured Catastrophe Losses**

CATs in 1990s caused $90B in insured losses

<table>
<thead>
<tr>
<th>Year</th>
<th>Billions</th>
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<tbody>
<tr>
<td>90</td>
<td>$2.7</td>
</tr>
<tr>
<td>91</td>
<td>$4.7</td>
</tr>
<tr>
<td>92</td>
<td>$22.9</td>
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<tr>
<td>93</td>
<td>$5.5</td>
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<tr>
<td>94</td>
<td>$16.9</td>
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<tr>
<td>95</td>
<td>$8.3</td>
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<tr>
<td>96</td>
<td>$7.3</td>
</tr>
<tr>
<td>97</td>
<td>$2.6</td>
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<tr>
<td>98</td>
<td>$10.1</td>
</tr>
<tr>
<td>99</td>
<td>$8.3</td>
</tr>
<tr>
<td>00</td>
<td>$4.3</td>
</tr>
<tr>
<td>01*</td>
<td>$0.7</td>
</tr>
</tbody>
</table>

CATs cost insurers $750 million per month during the 1990s

Didn’t lose much sleep over CATs in 2000

*First Quarter 2001.
Source: Property Claims Service, Insurance Information Institute
In 2000, P-C insurers will paid out nearly $29 billion more in claims & expenses than they collected in premiums.
P/C Net Income After Taxes
1993-2000 ($ Millions)

Sources: A.M. Best, ISO, Insurance Information Institute.
INLAND MARINE MARKET
Combined Ratio:
Inland Marine vs. Commercial Lines

Source: A.M. Best, Insurance Information Institute
Change in Net Premiums Written: Inland Marine vs. Commercial Lines

Source: A.M. Best, Insurance Information Institute
Combined Ratio: Inland Marine vs. All Lines

Source: A.M. Best, Insurance Information Institute
Change in Net Premiums Written: Inland Marine vs. All Lines

Source: A.M. Best, Insurance Information Institute
### Combined Ratio: Inland Marine vs. Ocean Marine

<table>
<thead>
<tr>
<th>Year</th>
<th>Inland Marine</th>
<th>Ocean Marine</th>
</tr>
</thead>
<tbody>
<tr>
<td>90</td>
<td>97.4</td>
<td>118.2</td>
</tr>
<tr>
<td>91</td>
<td>97.3</td>
<td>114.6</td>
</tr>
<tr>
<td>92</td>
<td>101.6</td>
<td>119.4</td>
</tr>
<tr>
<td>93</td>
<td>100.9</td>
<td>109.5</td>
</tr>
<tr>
<td>94</td>
<td>107.9</td>
<td>119.4</td>
</tr>
<tr>
<td>95</td>
<td>92.4</td>
<td>118.2</td>
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<tr>
<td>96</td>
<td>91.9</td>
<td>110.6</td>
</tr>
<tr>
<td>97</td>
<td>95.7</td>
<td>110.6</td>
</tr>
<tr>
<td>98</td>
<td>97.1</td>
<td>115.8</td>
</tr>
<tr>
<td>99</td>
<td>101.9</td>
<td>115.8</td>
</tr>
<tr>
<td>00*</td>
<td>96.0</td>
<td>106.8</td>
</tr>
</tbody>
</table>

Source: A.M. Best, AIMU, Insurance Information Institute
Change in Net Premiums Written:
Inland Marine vs. Ocean Marine

Ocean Marine  | Inland Marine
---|---
90  | -2.3%  | 3.4%
91  | -4.7%  | 1.2%
92  | -1.0%  | 5.4%
93  | 7.8%   | 22.9%
94  | 7.5%   | 18.4%
95  | 8.9%   | 4.3%
96  | 2.8%   | 7.1%
97  | 2.5%   | -5.6%
98  | 1.6%   | -3.0%
99  | 3.8%   | -6.4%
00* | 5.0%   | -19.5%

Source: A.M. Best, AIMU, Insurance Information Institute
Things to Consider: Inland Marine Insurance

- Inland marine consistently better performer among commercial and all p/c lines—expected to remain that way
  - Breakeven combined = 103 (2001 expected = 97)
  - Get “energized”: instrumentalities
  - Builders risk: + or - ?
  - Long-term trade prospects bright (e.g., China & WTO)

- No longer among fastest growing lines;
  - “Catching-up” by other lines
  - Slowing economy
  - High fuel prices reduces shipments
  - Sales of expensive baubles & trinkets falling
  - Land transportation equipment sales plummeting
  - Business expenditures on equipment falling
PROFITS
ROE: Financial Services
Industry Segments, 1987–2000

* Some 2000 figures are estimates.

Source: Insurance Information Institute
1999 Return on Equity (Profitability)

Source: NAIC, Insurance Information Institute
Sagging Profits are the Symptom, not the Cause

• Capital/Capacity
• Pricing
• Investments
• Competition
• Consolidation
• Distribution
• Class Action
• Wall Street
• Economy
CAPITAL/CAPACITY
Policyholder Surplus: 1975-2000 (Capital, Total P/C)

- 1999 Surplus = $336.3 Billion
  Is it a Peak?

- Surplus decreased 4.5% in 2000 to $319.4 Billion; First decline since 1984.

Source: A.M. Best, Insurance Information Institute
PRICING/REINSURANCE
Average Price Change of Commercial Insurance Renewals

Higher this Spring??

<table>
<thead>
<tr>
<th>Category</th>
<th>Fall 98</th>
<th>Fall 99</th>
<th>Spring 99</th>
<th>Spring 2000</th>
<th>Fall 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>E&amp;S</td>
<td>8.3%</td>
<td>9.5%</td>
<td>1.4%</td>
<td>6.1%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Umbrella</td>
<td>-6.0%</td>
<td>-6.6%</td>
<td>-1.8%</td>
<td>0.8%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Workers' Comp</td>
<td>-11.0%</td>
<td>-6.6%</td>
<td>-1.8%</td>
<td>4.1%</td>
<td>9.5%</td>
</tr>
<tr>
<td>Commercial Property</td>
<td>-6.0%</td>
<td>-4.1%</td>
<td>-1.6%</td>
<td>2.8%</td>
<td>8.8%</td>
</tr>
<tr>
<td>CMP</td>
<td>-10.0%</td>
<td>-5.0%</td>
<td>-1.2%</td>
<td>3.2%</td>
<td>8.3%</td>
</tr>
<tr>
<td>General Liability</td>
<td>-7.0%</td>
<td>-4.4%</td>
<td>-0.4%</td>
<td>3.2%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Commercial Auto</td>
<td>-3.0%</td>
<td>-2.0%</td>
<td>0.2%</td>
<td>3.5%</td>
<td>9.0%</td>
</tr>
</tbody>
</table>

Source: Conning
Reinsurance Price Changes
(Rate on Line Index, 1989=100)

Source: Guy Carpenter * Estimate
Growth in Net Premiums
Written: All P/C v. Reinsurance

2000: All P/C: 5.1%
Reinsurance 13.7% (RAA)

Source: A.M. Best, RAA, Insurance Information Institute
Combined Ratio:
All P/C vs. Reinsurance

*2000 reinsurance figure is RAA estimate.
** Based on III Groundhog Forecast
INVESTMENTS
Pricing & underwriting problems were exacerbated by declining investment income.

Facts

- 1997 Peak = $41.5B
- 1998 = $39.9B
- 1999 = $38.9B
- 2000 = $40.8B

Source: A.M. Best, Insurance Information Institute
Are interest rates too low for a recession?

Source: Federal Reserve, Insurance Information Institute
Stock Markets: Going Nowhere in 2001

Total Returns: First Quarter 2001

-25.51% (Nasdaq)
-12.11% (S&P 500)
-8.42% (DJIA)

Source: Insurance Information Institute
COMPETITION
Competition—Still on the Rise:
Number of Insurers: 1970-1999

Sources: P/C: A.M. Best; L/H: NAIC.
Market Share of Top 5 P/C Insurers

Source: Insurance Information Institute Fact Book (annual issues)
Global ART Market Still Small

Traditional Comm. 92.1%

Captives 6.0%
Finite Solutions 1.6%
Other 0.3%

Source: Swiss Re
CONSOLIDATION
Insurance Mergers and Acquisitions

1998: 565 deals valued at $165.4 B

Source: Compiled from Conning & Company reports.
Shifting Distribution Channels: Property/Casualty Insurers

Source: Datamonitor

1998
- Captive Agents: 56.5%
- Independent Agents: 27.0%
- Direct Response: 9.8%
- Internet: 0.9%
- Banks: 2.8%
- Other: 3.0%

2003
- Captive Agents: 48.8%
- Independent Agents: 23.3%
- Direct Response: 10.0%
- Internet: 7.3%
- Banks: 8.1%
- Other: 2.5%
1999 Bank Insurance Premiums

Total = $36.7 Billion

- Annuities: $24.2 billion (66%)
- Credit: $2.9 billion (8%)
- Commercial: $4.4 billion (12%)
- Personal: $3.1 billion (8%)
- Indiv. Health/Dis: $1.1 billion (3%)
- Indiv. Life: $0.7 billion (2%)
- Other: $0.3 billion (1%)

1999 Bank Insurance
Premiums

Total = $36.7 Billion
How Americans Shop for Auto Insurance

COURTS & TORTS
TORT-ure

- Asbestos
- Aftermarket Parts
- Medical Claims Review
- Lead
- Construction Defects
- Toxic Mold
- Guns
- Genetically Modified Foods (Corn)
- Y2K Sue & Labor
- Nursing Homes/Med Mal
- Tobacco
- What’s Next: Foot & Mouth, Mad Cow?
Average Jury Awards
1993 vs. 1999

*Comparison is between 1994 and 1999.
Source: Jury Verdict Research; Insurance Information Institute.
Trends in Million Dollar Verdicts*

*Verdicts of $1 million or more.
Source: Jury Verdict Research; Insurance Information Institute.
Asbestos: Reserve Deficiency and Ultimate Costs Growing

Reserve Deficiency = $33.1 Billion

Source: A.M. Best.
WALL STREET
### Performance on Wall Street

**Highly Erratic**

<table>
<thead>
<tr>
<th>Sector</th>
<th>2000 Percentage Change</th>
<th>1999 Percentage Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property/Casualty</td>
<td>-25.7%</td>
<td>43.4%</td>
</tr>
<tr>
<td>All Insurers</td>
<td>-6.5%</td>
<td>39.8%</td>
</tr>
<tr>
<td>Life/Health</td>
<td>-9.6%</td>
<td>34.5%</td>
</tr>
<tr>
<td>Banks</td>
<td>-3.1%</td>
<td>18.1%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>-9.1%</td>
<td>21.0%</td>
</tr>
<tr>
<td>Nasdaq</td>
<td>-39.3%</td>
<td>86.0%</td>
</tr>
</tbody>
</table>

P/C insurers were up 43.4% in 2000; Down 25.7% in 1999

Source: SNL Securities; Insurance Information Institute
Insurance Stock Performance: After the Tech Crash

Total Return: March 10 through Year End 2000*

-51.1%  
32.6%  
72.6%  
76.6%  
77.5%  
78.0%  
47.8%  

* NASDAQ peaked on March 10, 2000 at 5048.62
Source: Insurance Information Institute, SNL Securities
Insurance Stock Performance:
Off to a Slow Start in 2001

Total Return YTD through May 11, 2001

Source: SNL Securities, Insurance Information Institute
THE ECONOMY
Real GDP Growth

Source: US Department of Commerce; Insurance Information Institute.
*Forecasts: Blue Chip Economic Indicators.
Economy is experiencing negative G-forces after several quarters of unsustainably high real growth.

Source: US Department of Commerce; Insurance Information Institute.
*Preliminary.
Unemployment Holding Steady

Despite the economic slowdown, the unemployment rate remains at generational lows. But layoffs are up.

New Private Housing Starts
(Millions of Units)

New Private Housing Starts
Annualized starts in early 2001 are surprisingly strong: Virtually no exposure impact for insurers

Source: US Department of Commerce; Insurance Information Institute
*Annualized January 2001 data.
Motor Vehicle Retail Sales (Millions of Units)

New Motor Vehicle Sales

Sales in late 2000 fell sharply. There will be an impact on exposure growth in the personal auto line in 2001.

Net loss of 1 to 2 million vehicles likely in 2001.

Source: US Department of Commerce; Insurance Information Institute

*Seasonally Adjusted Annual Rate.

- Recession Years (1970; 74-75; 80-82; 90-91)
- Non-Recession Years (all other years, 1970-1999)

<table>
<thead>
<tr>
<th>Inflation (CPI)</th>
<th>NWP Growth (unadj.)</th>
<th>Real NWP Growth</th>
<th>ROE--P/C Insurers*</th>
<th>ROE--All Industries*</th>
<th>ROE--Banks*</th>
<th>ROE--Diversified Financial*</th>
</tr>
</thead>
<tbody>
<tr>
<td>-4%</td>
<td></td>
<td>-2.7%</td>
<td>4.1%</td>
<td>5.4%</td>
<td>4.7%</td>
<td>0.2%</td>
</tr>
<tr>
<td>0%</td>
<td></td>
<td></td>
<td>8.1%</td>
<td>8.8%</td>
<td>7.0%</td>
<td>8.9%</td>
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<tr>
<td>2%</td>
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<td></td>
<td>-2%</td>
<td>3.9%</td>
<td>3.8%</td>
<td>9.4%</td>
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<td>4%</td>
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<td>8%</td>
<td>6%</td>
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<td>12%</td>
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</tbody>
</table>

*GAAP return on equity, adjusted for inflation; Bank data 1952-99; Div. Fin. 1987-99
Source: Insurance Information Institute
Impact of Energy Price Shocks on P/C Premiums and Profitability

16.5% 9.0% -2.3% 0.7% 4.7% 3.5% 2.8% 1.3% 3.9% 6.8% 4.7% 9.5% 2.8% 11.3%

Energy Spike Years (1973-75; 1979-81; 1989-90)
Non-Energy Spike Years (all other years, 1970-1999)

US Power Crunch: A windfall for inland marine insurers?

Energy Inflation  Overall Inflation  Real NWP Growth  ROE--P/C Insurers*  ROE--All Industries*  ROE--Banks*  ROE--Diversified Financial*
1.3%  3.9%  4.7%  6.8%  4.7%  3.5%  2.8%  11.3%

*GAAP return on equity, adjusted for inflation.
Source: Insurance Information Institute
**Recession & Credit Risk:**

**Impact on Earnings & Surplus**

<table>
<thead>
<tr>
<th>Default Rate</th>
<th>2001E Earnings Decline</th>
<th>Surplus Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.08% All Corporates</td>
<td>-2.1%</td>
<td>-4.1%</td>
</tr>
<tr>
<td>10% Investment Grade</td>
<td>-0.5%</td>
<td></td>
</tr>
<tr>
<td>100% Investment Grade</td>
<td>-1.2%</td>
<td></td>
</tr>
</tbody>
</table>

Some Companies with Credit Woes:
- Xerox
- Sunbeam
- TWA
- PG&E
- Edison Intl.

Debt Guarantees
- Credit Default Swaps

Source: Goldman Sachs; 10K/10Q Reports.
If you would like a copy of this presentation, please give me your business card with e-mail address