

The State of the P/C Insurance Industry

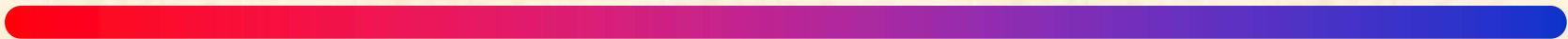
PAAS Annual Forum
San Diego, CA
June 3, 2009



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The Economy

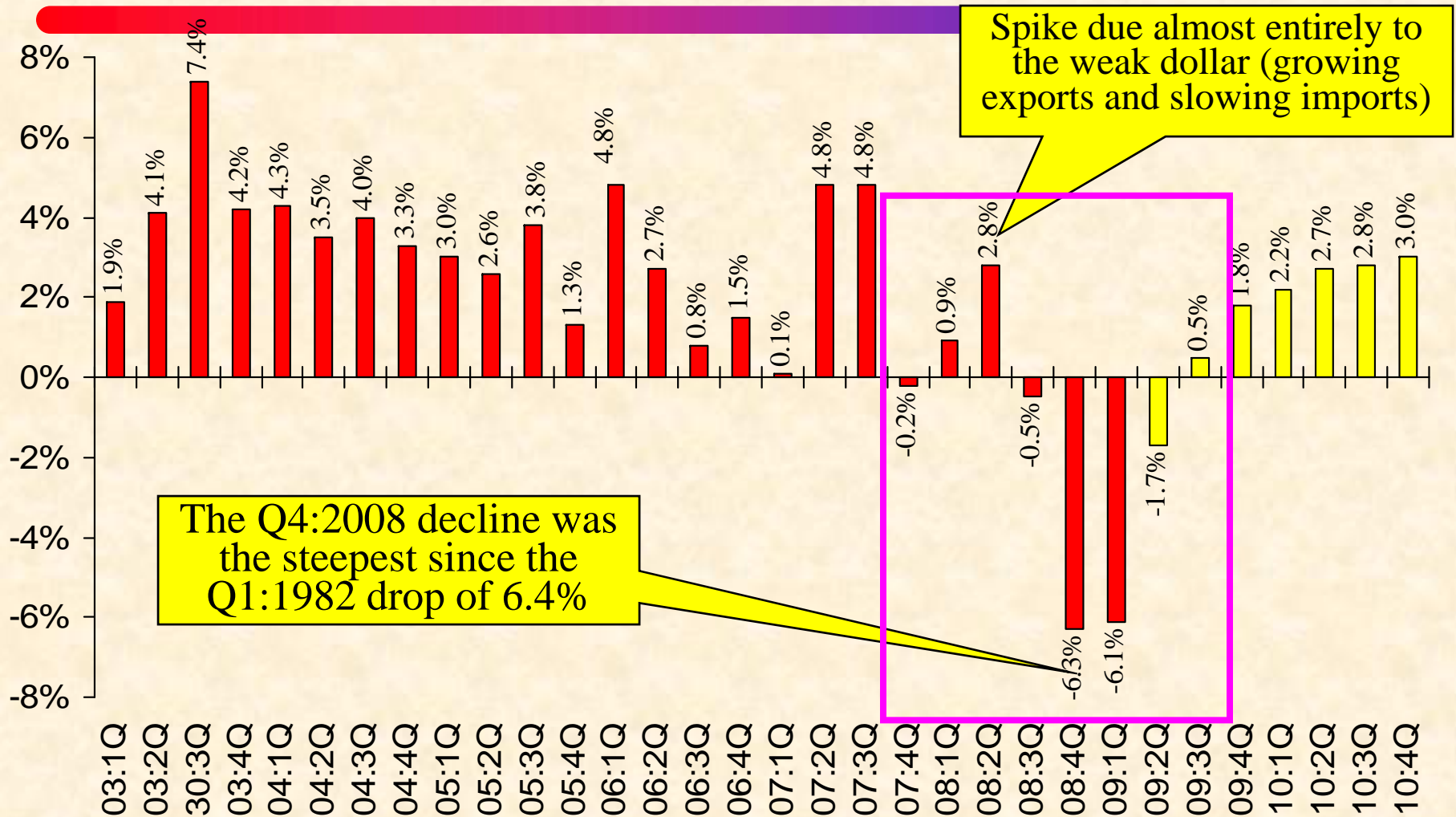
*How Long Will the Recession Last?
How Will the Recession Affect
Exposure & Claim Costs
for the P-C Insurance Industry*





Real Quarterly GDP Changes (annualized), 2003-2010F

Red bars are actual; Yellow bars are forecasts/estimates

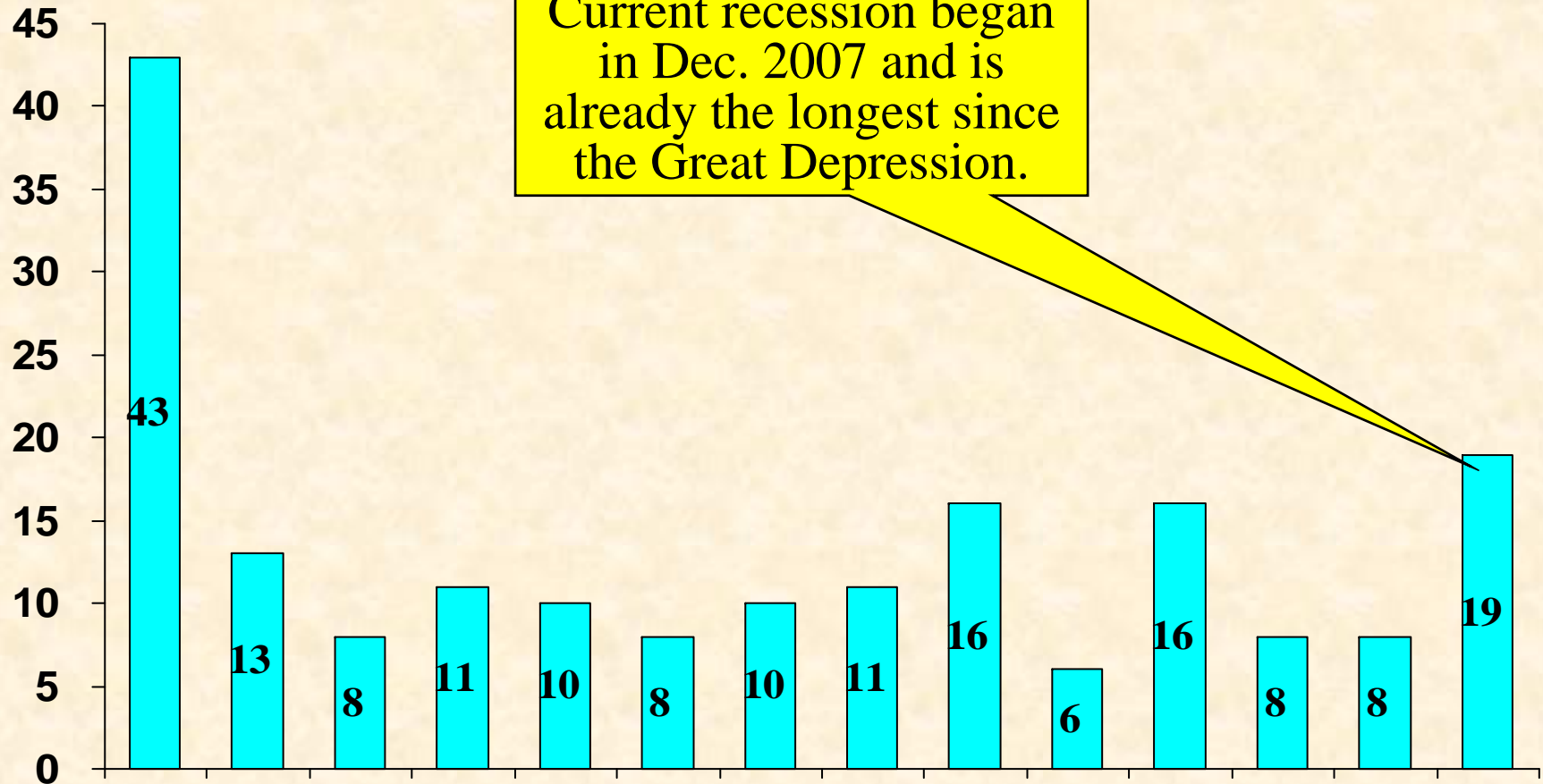


Sources: US Department of Commerce, Bureau of Economic Analysis (actual) at <http://www.bea.gov/national/xls/gdpchg.xls> Blue Chip Economic Indicators 5/09 issue (forecasts).



Length of U.S. Business Cycle Contractions, 1929-Present*

Duration (Months)



Current recession began in Dec. 2007 and is already the longest since the Great Depression.

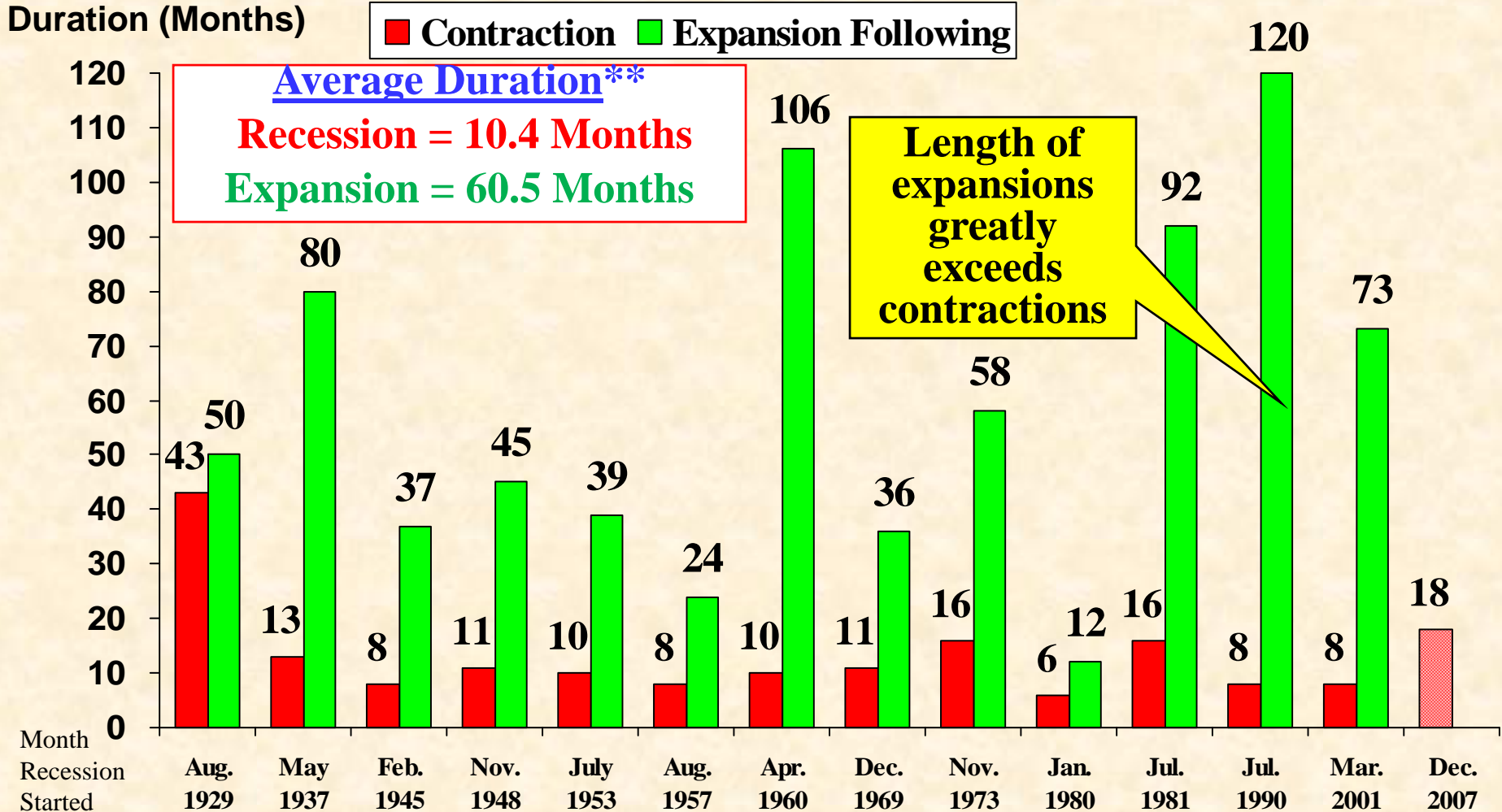
Month Recession Started Aug. 1929 May 1937 Feb. 1945 Nov. 1948 July 1953 Aug. 1957 Apr. 1960 Dec. 1969 Nov. 1973 Jan. 1980 Jul. 1981 Jul. 1990 Mar. 2001 Dec. 2007

*As of June 2009, inclusive

Source: National Bureau of Economic Research at <http://www.nber.org/cycles.html>



Length of U.S. Business Cycles, 1929-Present*



* As of May 2009, inclusive; **Post-WW II period through end of most recent expansion.

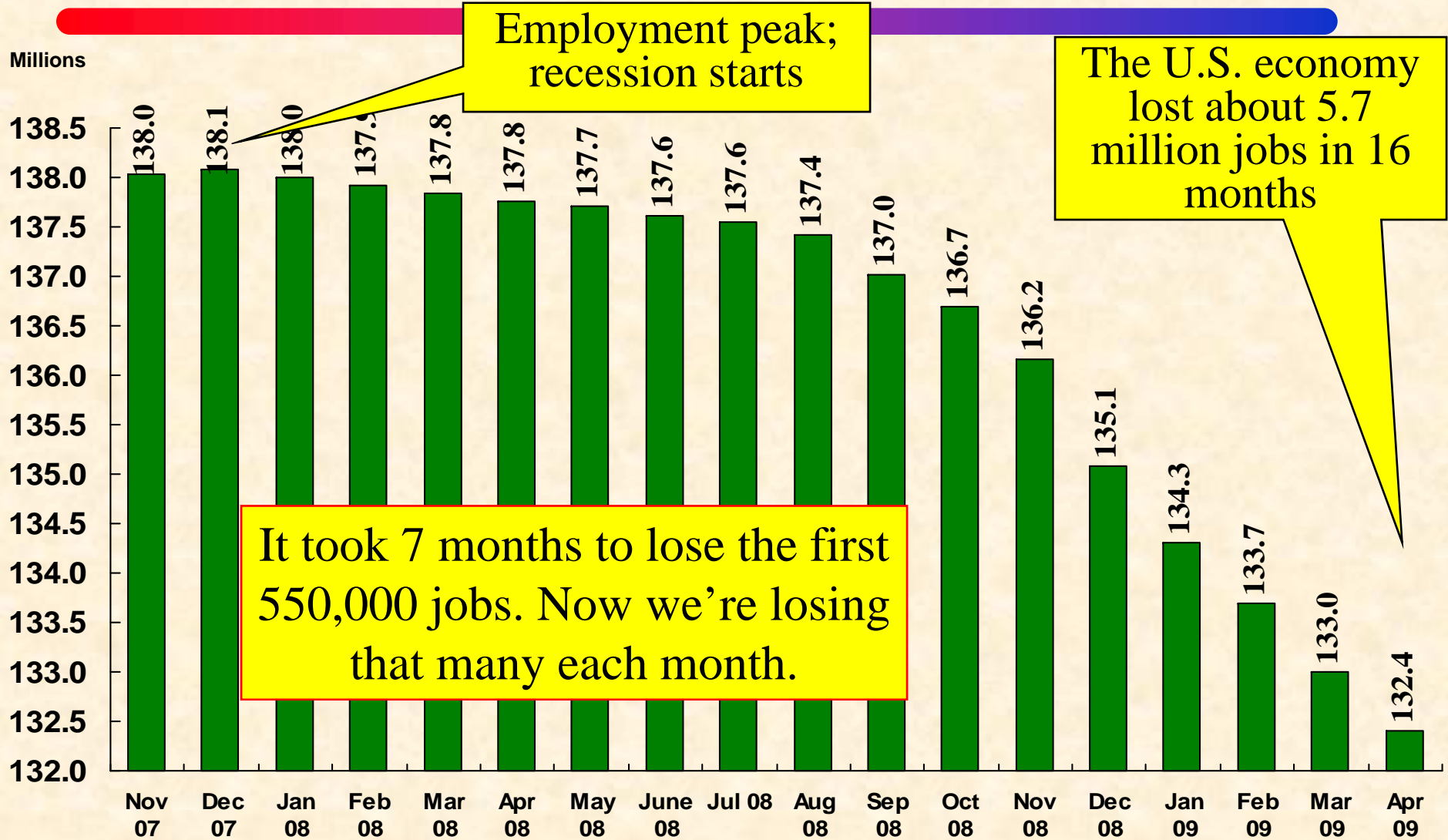
Sources: National Bureau of Economic Research; Insurance Information Institute.

Employment





U.S. Nonfarm Private Employment, Monthly, Nov 2007 – Apr 2009

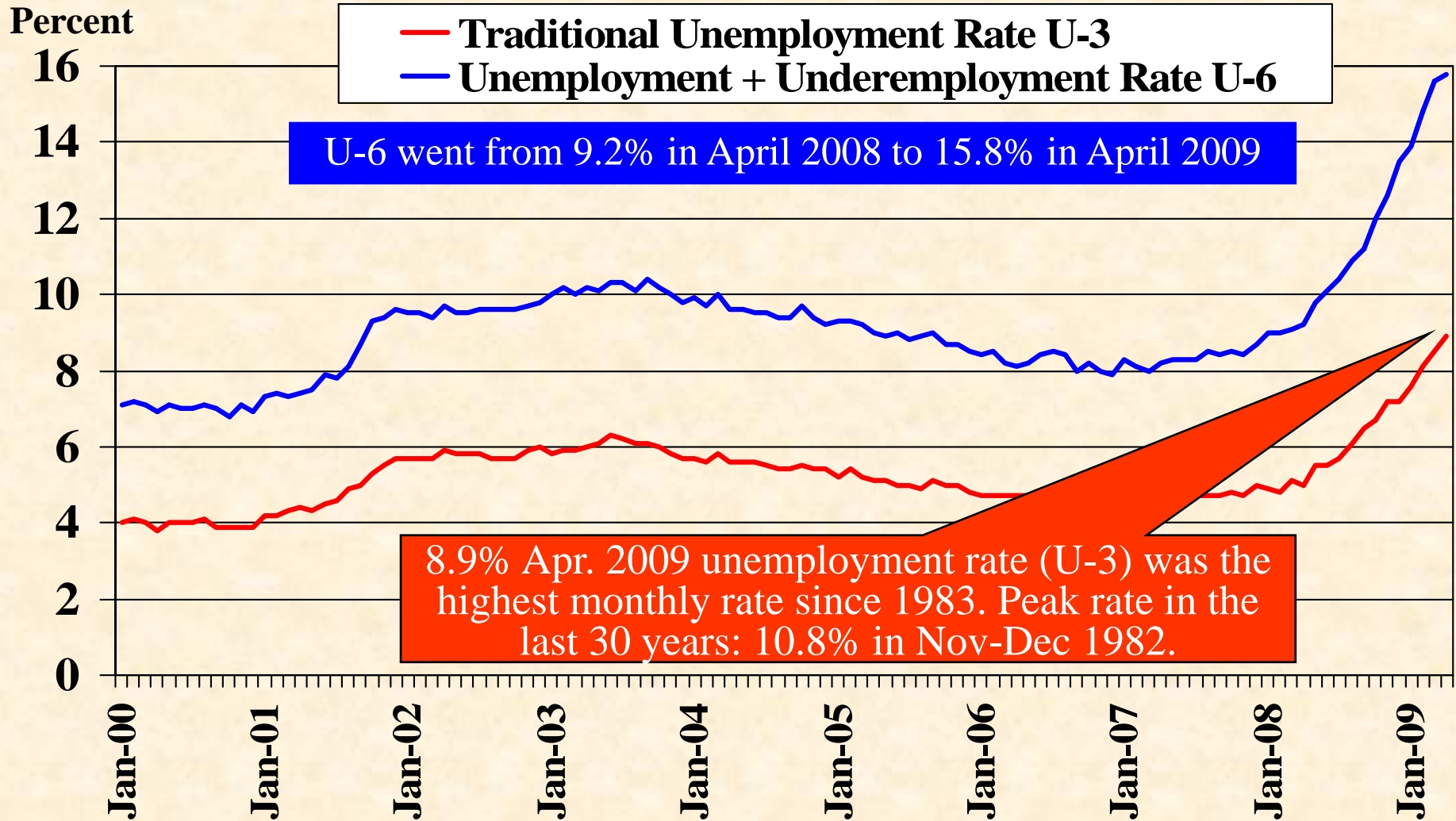


Seasonally adjusted. Source: US Bureau of Labor Statistics



Unemployment and Underemployment Rates: Rocketing Up in 2008-9

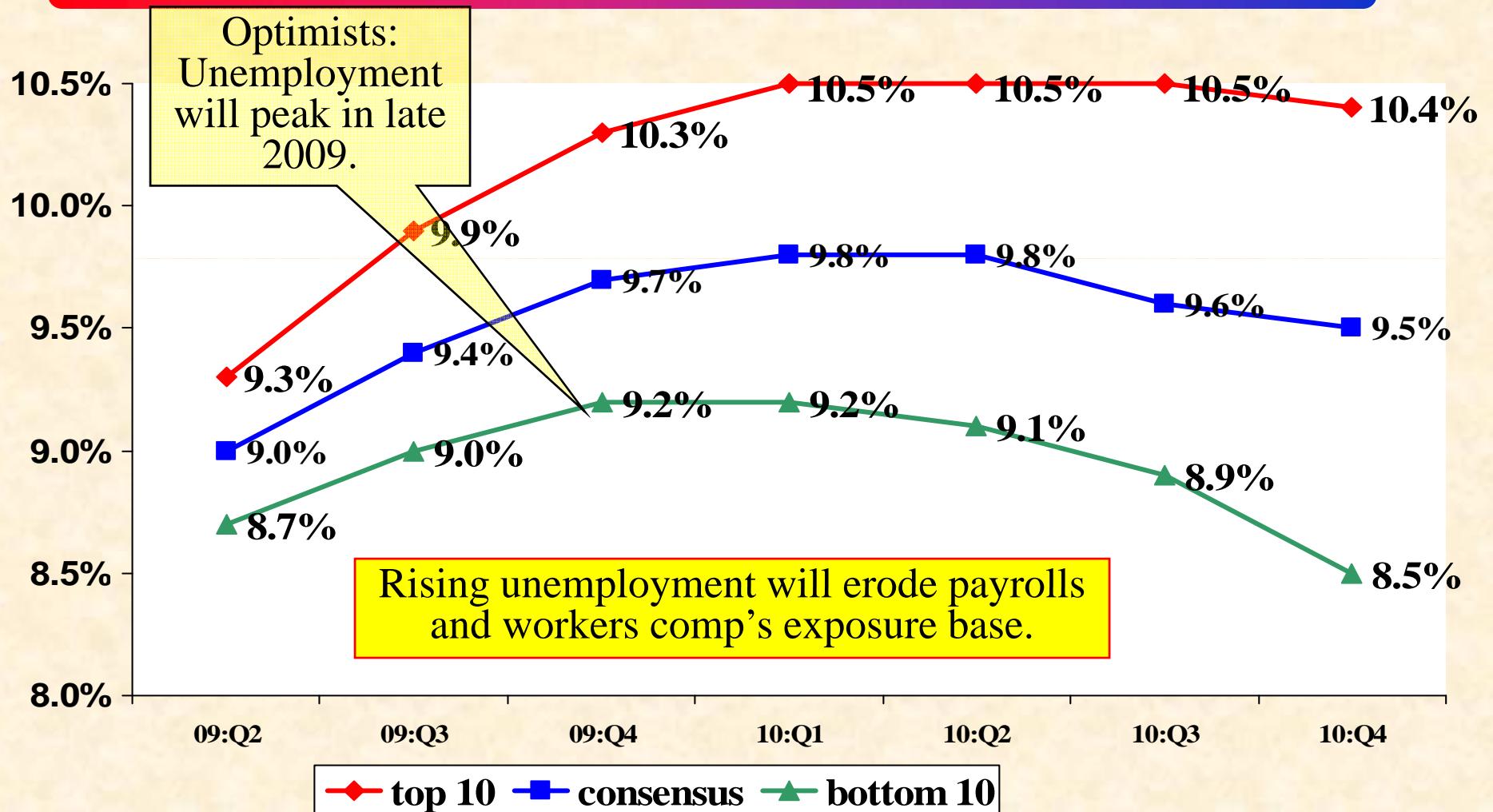
January 2000 through April 2009, seasonally adjusted



Source: US Bureau of Labor Statistics; Insurance Information Institute.



U.S. Unemployment Rate Forecasts Quarterly, 2009:Q2 to 2010:Q4



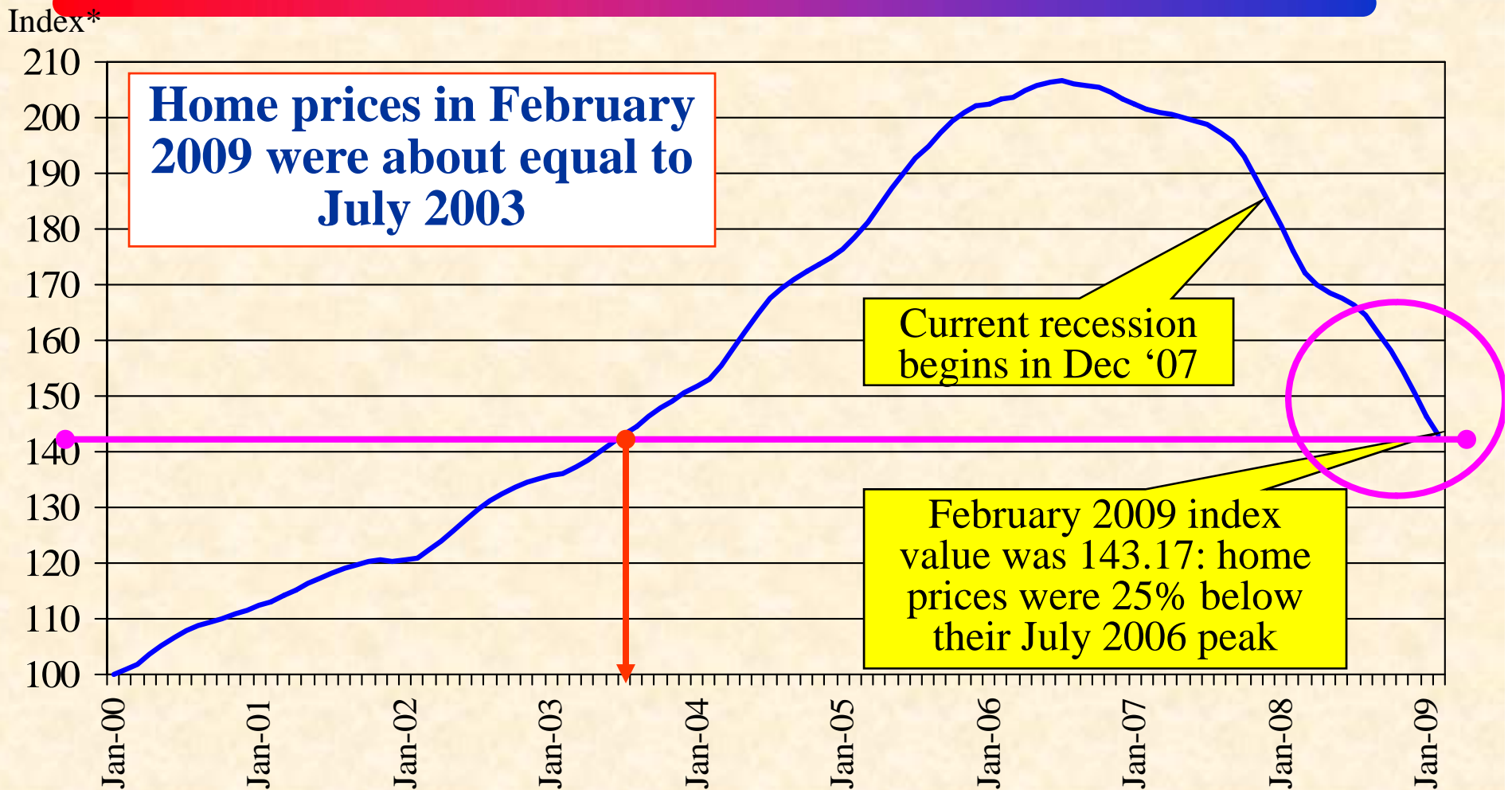
Sources: Blue Chip Economic Indicators (5/09); Insurance Info. Inst.

Housing





Most People's Main Asset (Their Home) Has Lost 5+ Years of Appreciation



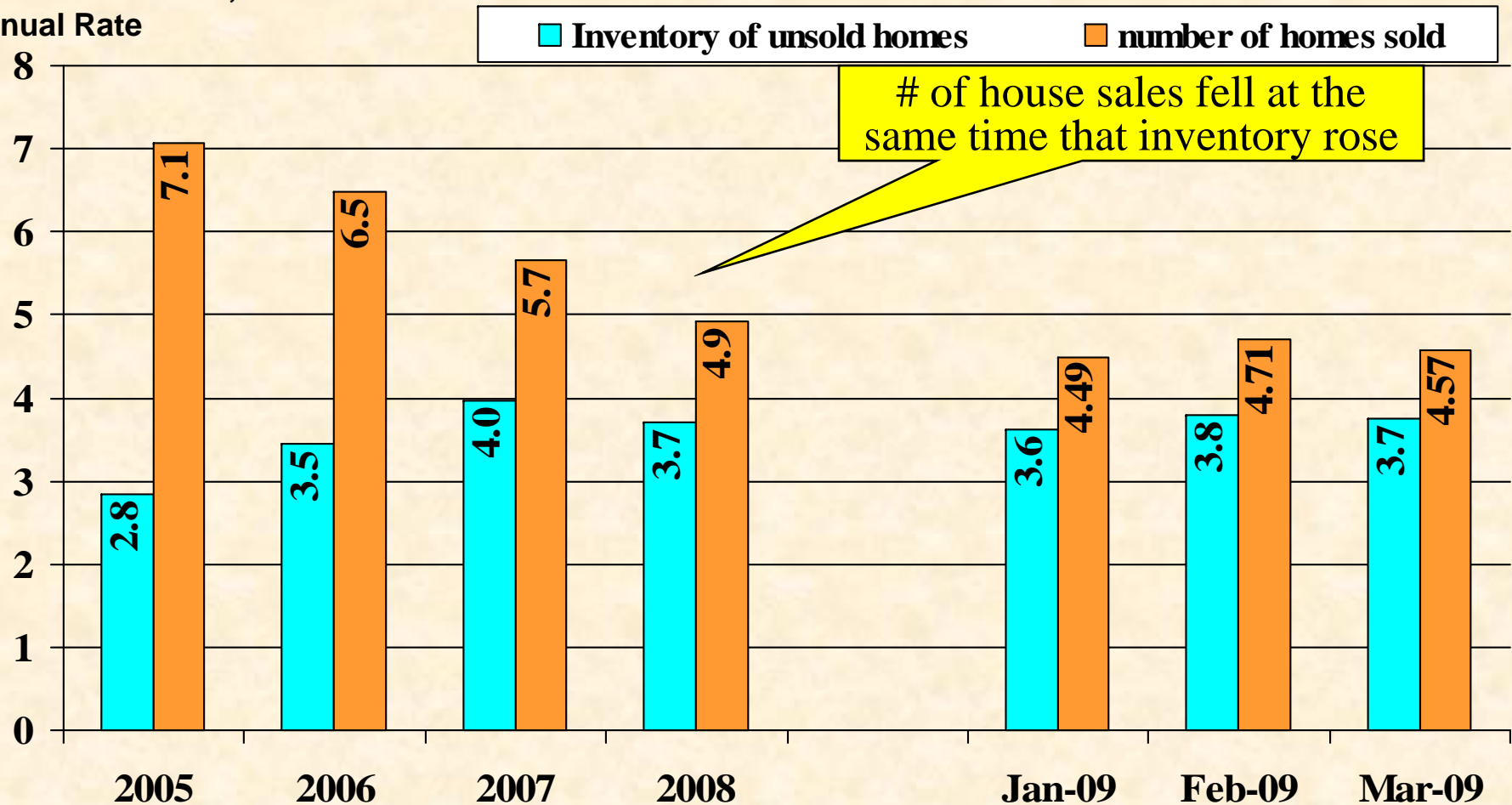
*Case-Shiller Home Price Index (20-city composite); January 2000=100.

Source: http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_History_042841.xls



High Inventory of Unsold Existing Homes Will Likely Keep Prices Falling

Millions of Homes,
Annual Rate



Source: <http://www.realtor.org/research/research/ehsdata>



Unsold Inventory: It's Probably Worse Than You Think

“Many foreclosed homes that are now owned by banks have yet to be listed for sale.”

- RealtyTrac recently noted that its database, compiled from court records, has many more homes than are in the Multiple Listing Service (MLS) database
- MLS in four states has only 1/3 of the homes in the RealtyTrac database

Banks might be holding back to avoid flooding the market with foreclosure sales

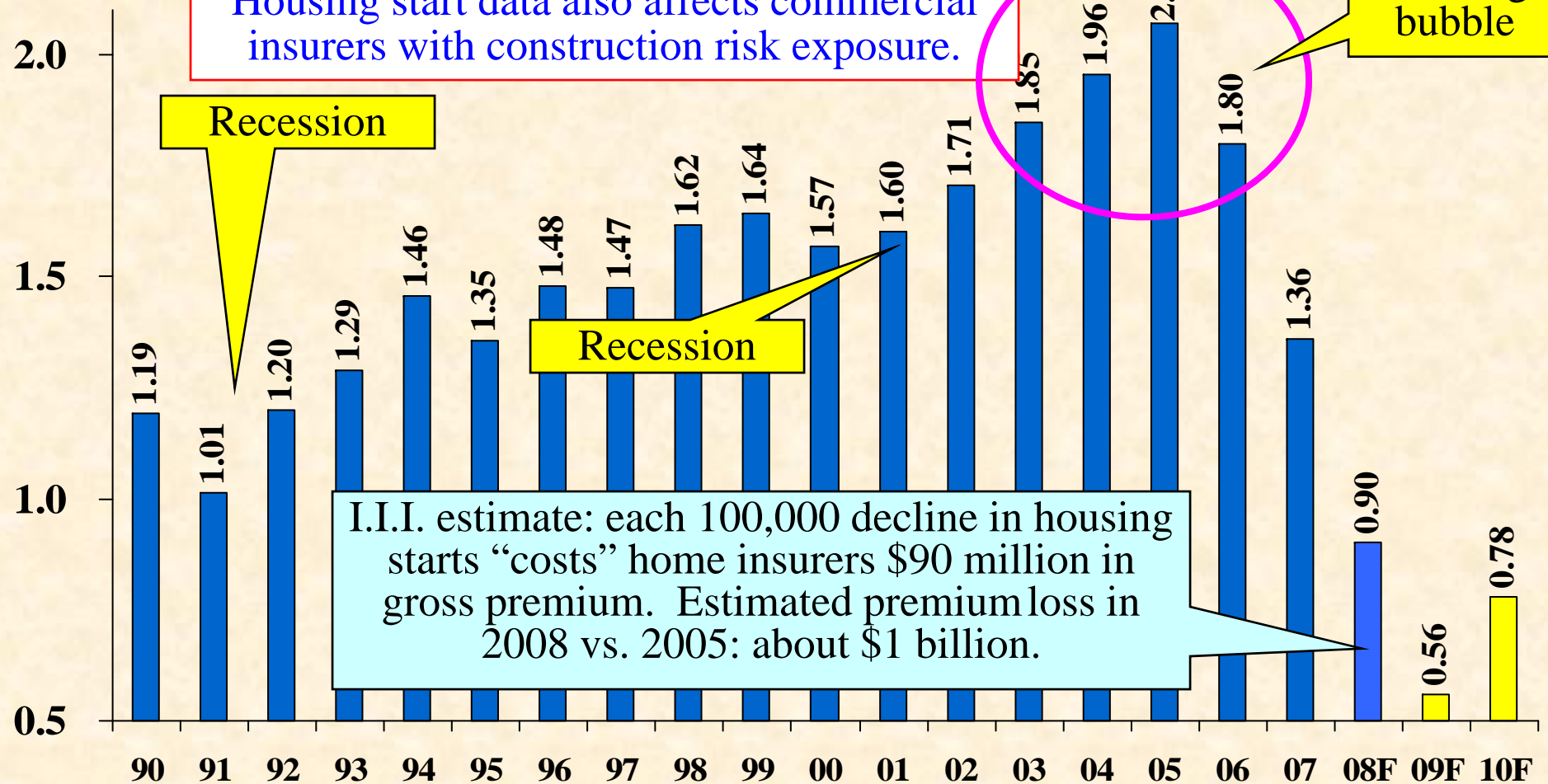
Banks might simply be overwhelmed with the record number of foreclosures



High Inventory Means Millions Fewer Private Housing Starts

Millions of Units

Measured by number of new units started, exposure growth for HO insurers is low. Housing start data also affects commercial insurers with construction risk exposure.



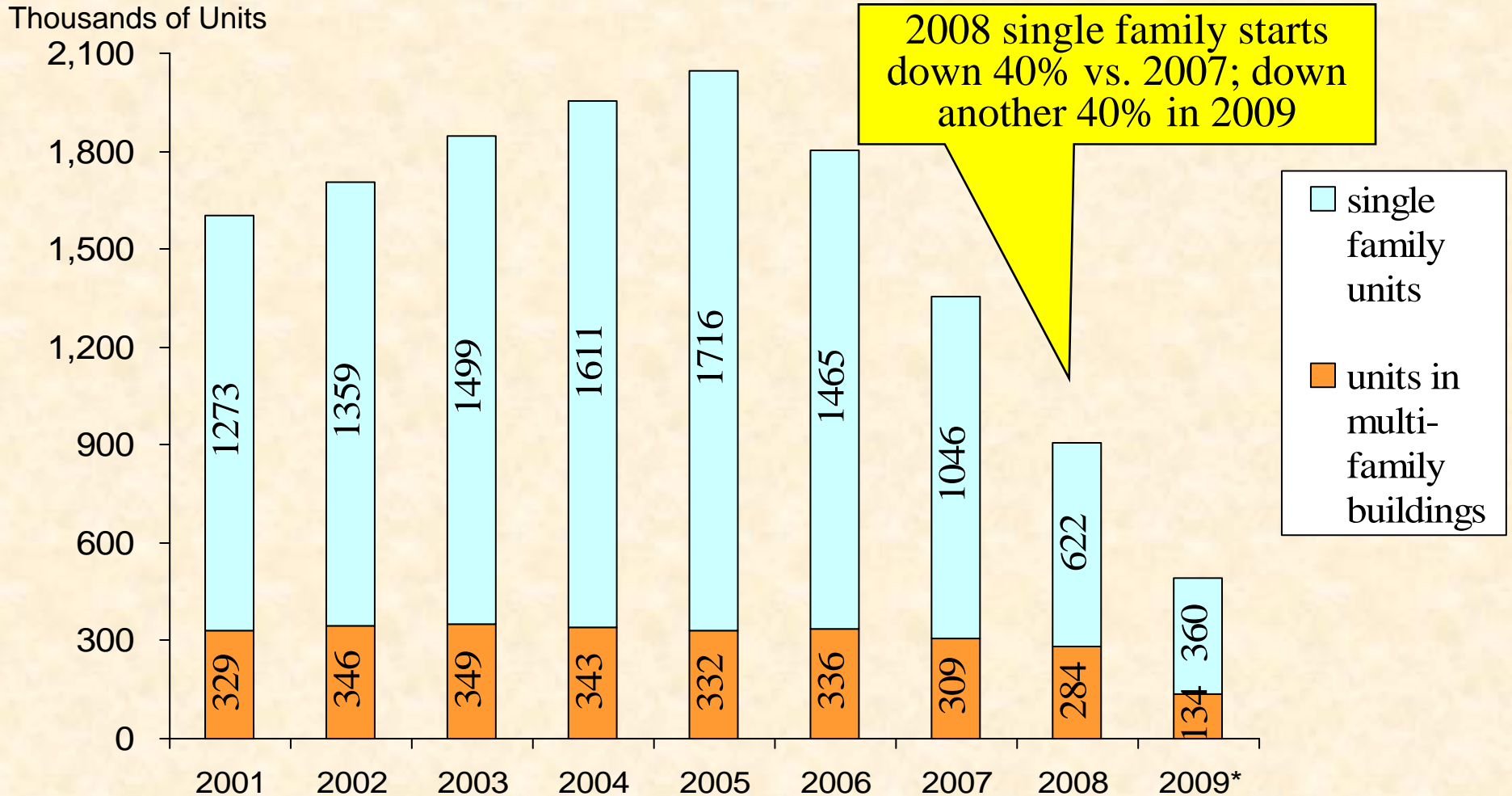
I.I.I. estimate: each 100,000 decline in housing starts “costs” home insurers \$90 million in gross premium. Estimated premium loss in 2008 vs. 2005: about \$1 billion.

Sources: US Department of Commerce; Blue Chip Economic Indicators (5/09); Insurance Information Inst.



Single vs. Multi-Family Housing Starts

The slump was mainly in single-family housing,
but starts of multi-family units have plummeted in 2009.



*Seasonally adjusted annual rate, based on average of Jan-April activity

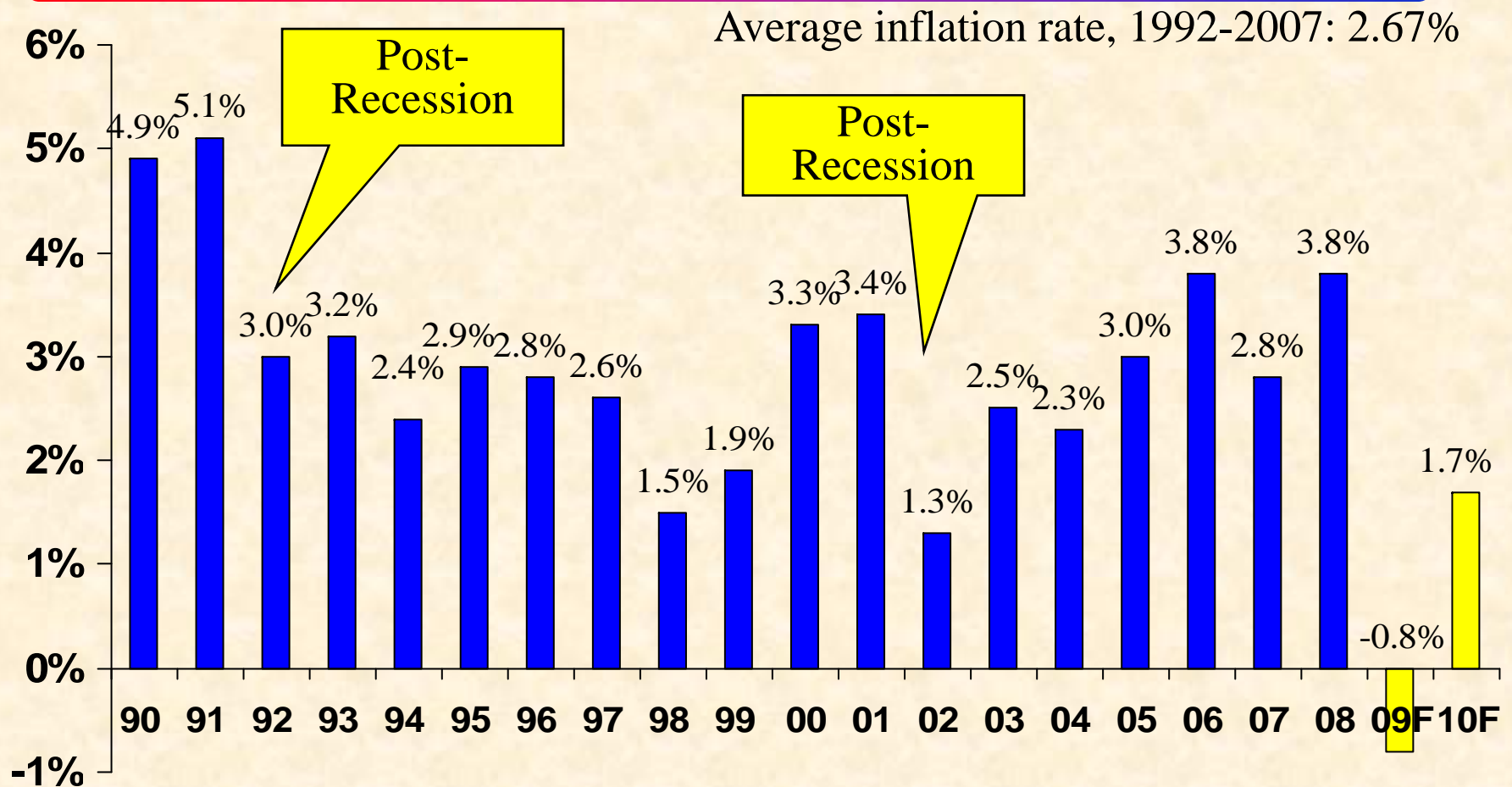
Source: US Census Bureau at <http://www.census.gov/const/newresconst.pdf> ; I.I.I. calculations



The “Silver Lining”? Inflation Might Be Relatively Low



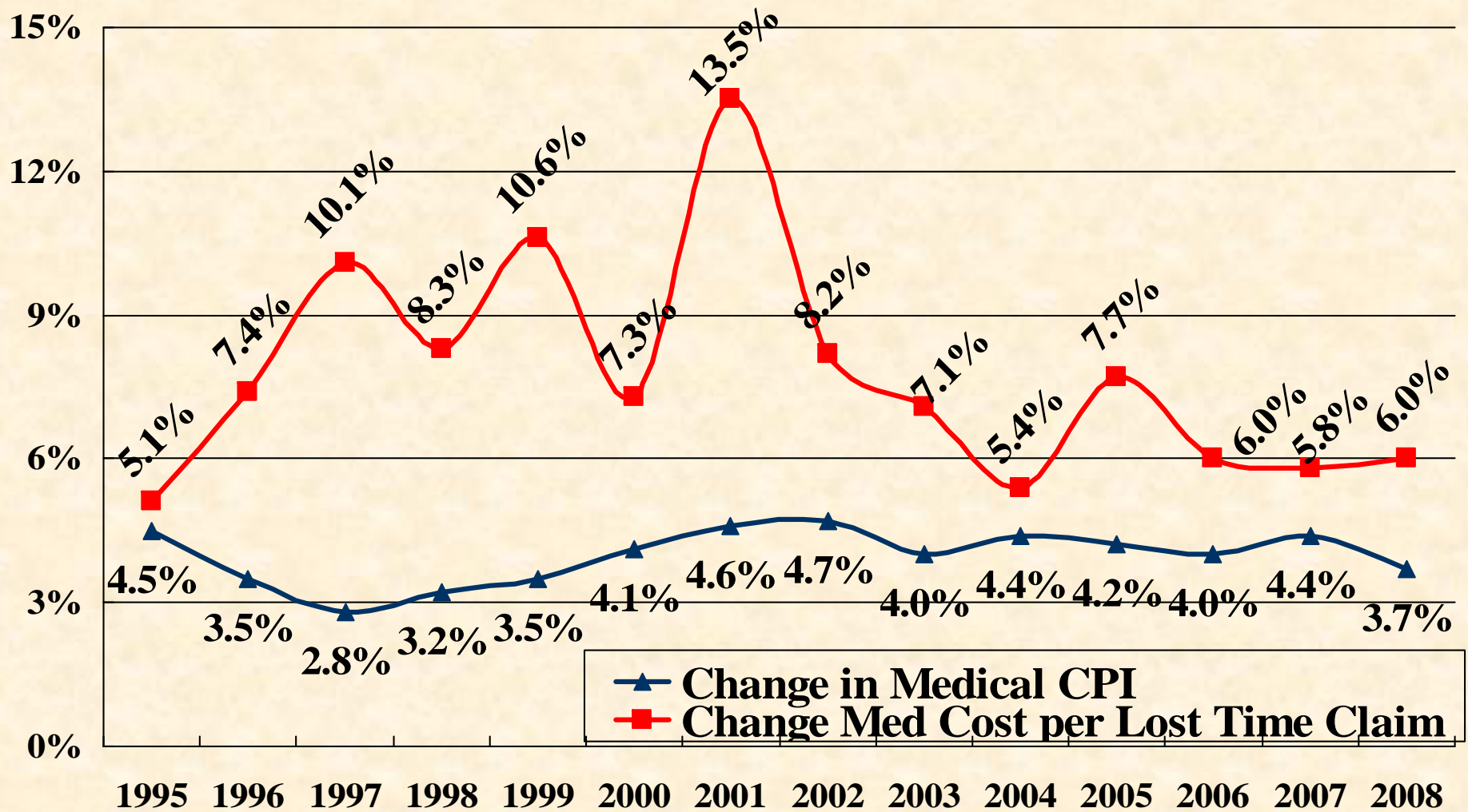
After Recent Recessions, the Annual Inflation Rate Dropped



Sources: US Bureau of Labor Statistics (actual, blue bars); Blue Chip Economic Indicators, 5/2009 issue, (forecasts, yellow bars)



WC Medical Severity Cost Still Rising Faster than the Medical CPI



Sources: Med CPI from I.I.I. Inflation Watch; WC med severity from NCCI based on NCCI states.

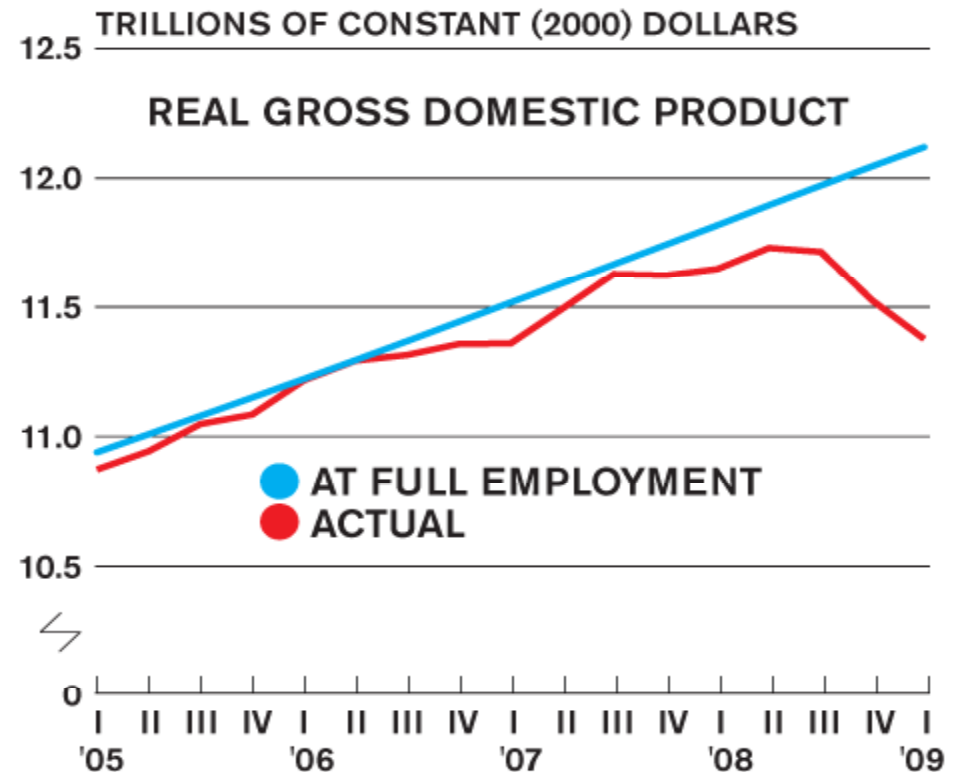


Theory: Re-ignited Inflation Won't Threaten Until the Economy Returns to a Full-Employment Level—Likely a Few Years Away

The markets are starting to worry that the flood of money for the recovery will re-ignite inflation (the spread between 10-Year TIPS and 10-Year T-Notes is widening).

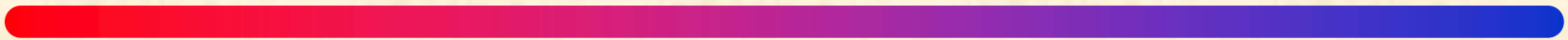
Source: Cooper, "Hints of Recovery—And Fears of Inflation," *BusinessWeek*, May 11, 2009, p. 8

A GAP THIS BIG WILL TAKE A LONG TIME TO CLOSE



Data: Bureau of Economic Analysis, Congressional Budget Office, IHS Global Insight

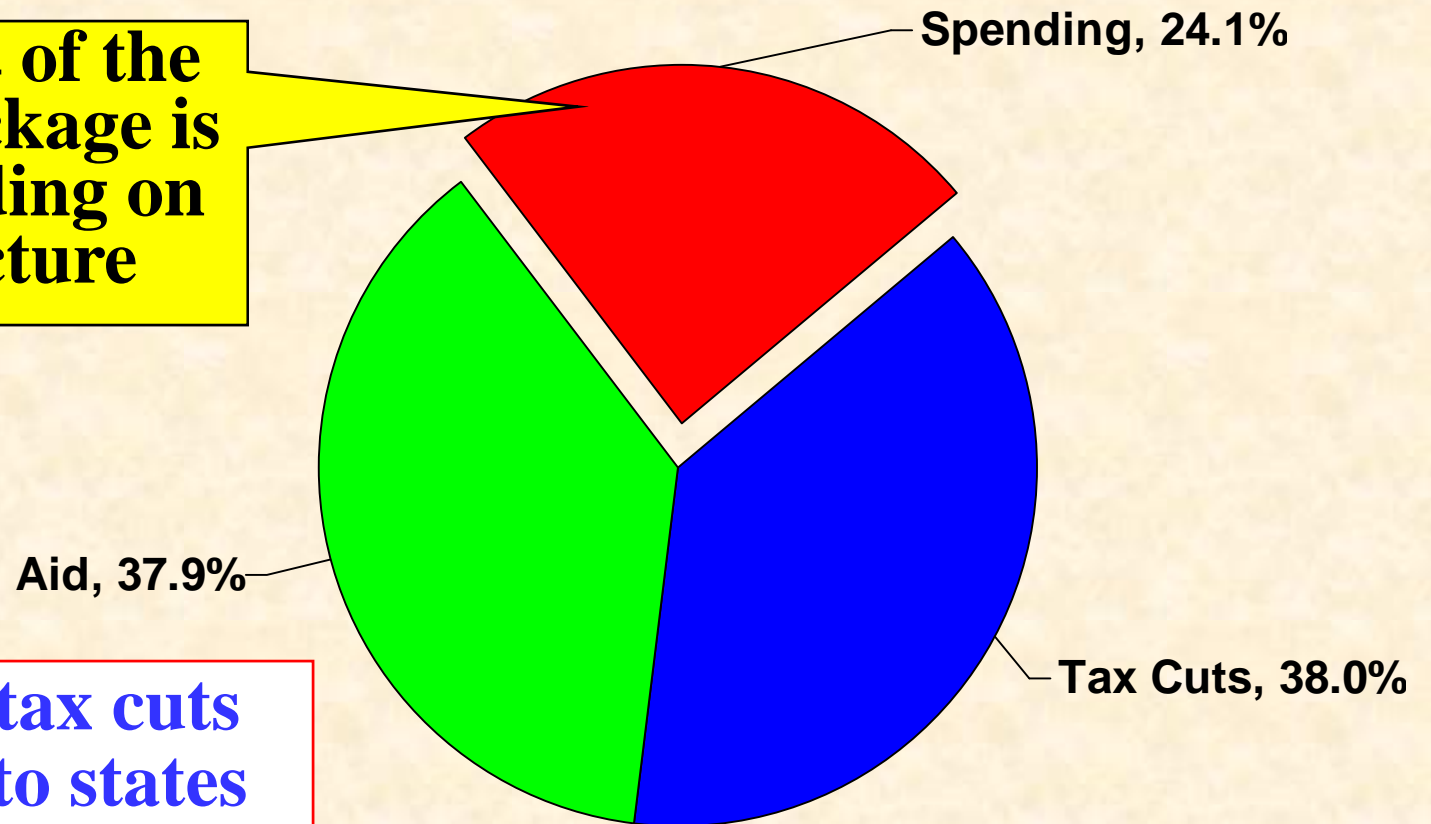
The American Recovery and Reinvestment Act (a.k.a. the Economic Stimulus Package)





The Economic Stimulus Package: Where the Money is Going

Less than ¼ of the stimulus package is direct spending on infrastructure



Neither the tax cuts nor the Aid to states will have much effect on P-C insurance



ARRA: Timing, Impact of Job Creation/ Preservation (CEA Assumptions)

- Impact: a 1% increase in real GDP translates into an increase of about 1 million jobs
- Timing:
 - Half of the effect [the job increase] occurs in the same quarter in which stimulus is spent
 - 1/3 of the effect occurs in the first quarter after the stimulus is spent
 - 1/6 of the effect occurs in the second quarter after the stimulus is spent

Source: *Estimates of Job Creation From the American Recovery and Reinvestment Act of 2009*, Council of Economic Advisors, May 2009, accessed at http://www.recovery.gov/sites/default/files/Job-Years_Revised5-8.pdf



Stimulus Spending: Massachusetts

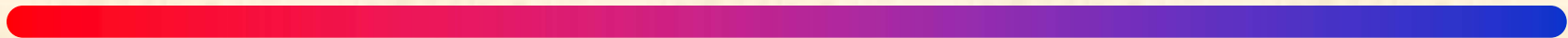
(as of April 23, 2009)

- Highway spending

- April 4: U.S. Department of Transportation (DoT) apportions about \$425 million for highway infrastructure to Massachusetts (about 17% of the roughly \$2.5 billion in ARRA funds apportioned to Massachusetts)
- April 16: U.S. DoT approves \$63.9 million for 19 highway projects in Massachusetts (this is 15% of MA's highway ARRA money)
- April 4: MA Office of Transportation advertised for bids on 19 projects, with an April 14 deadline. (Will seek reimbursement from DoT ARRA funds)
- **Work (road repaving, sign replacement) expected to begin “this spring”**

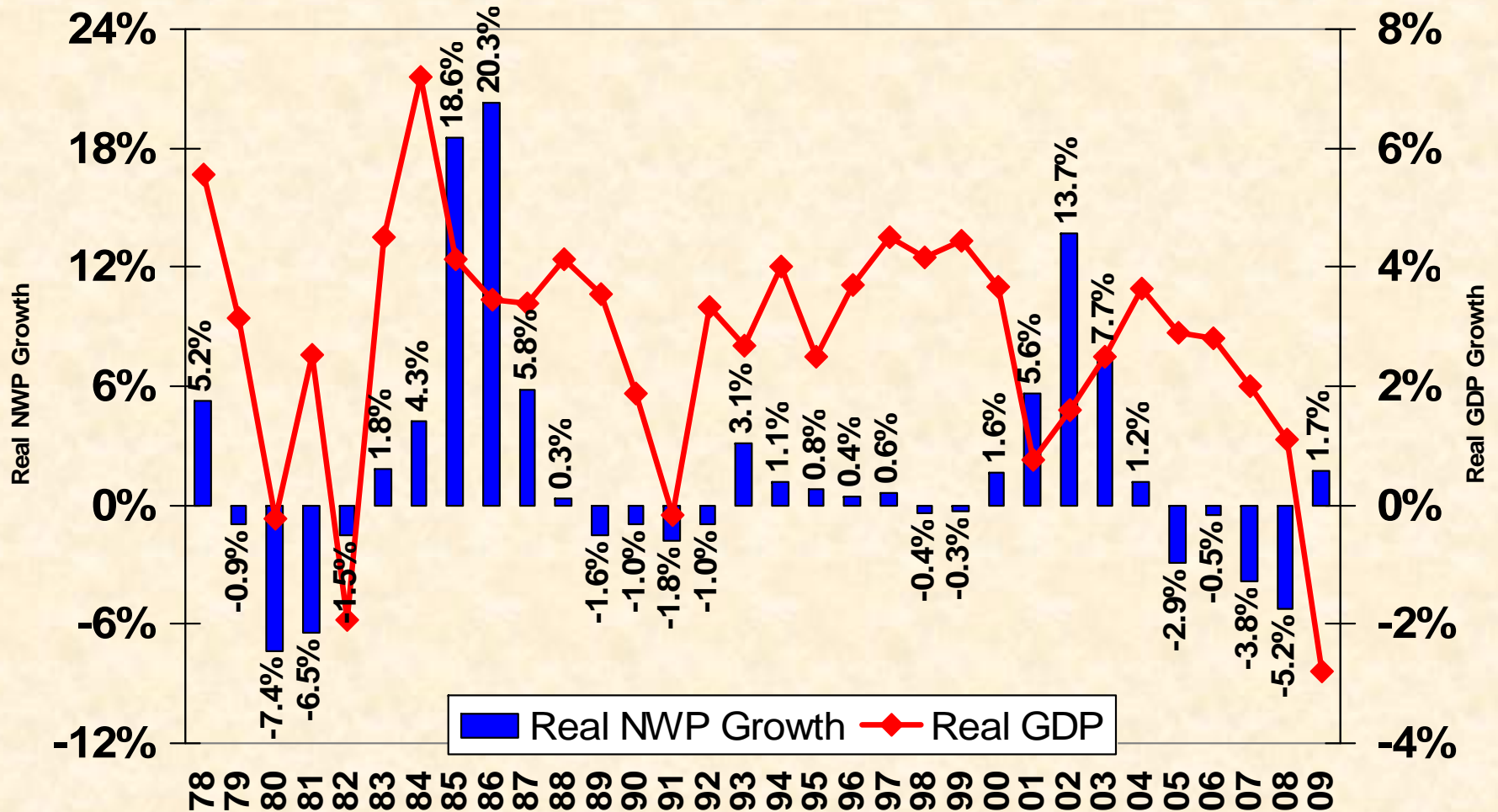
P/C Premiums

*Primarily Driven by the Industry's
Underwriting Cycle, Not the
Economy*





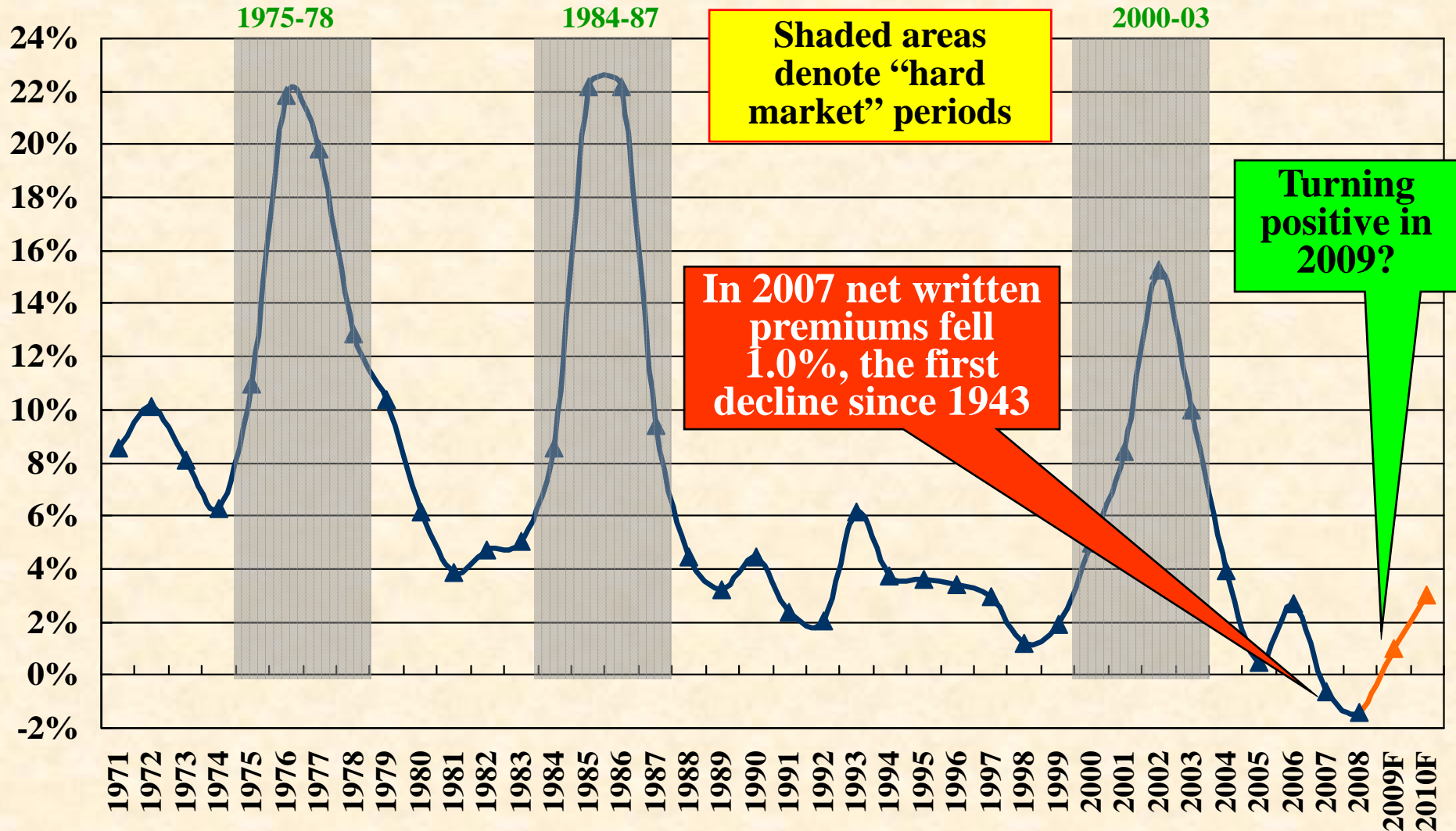
Does National Economic Growth Affect Real P/C Premium Growth? Not Much



Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 5/09; Insurance Information Inst.



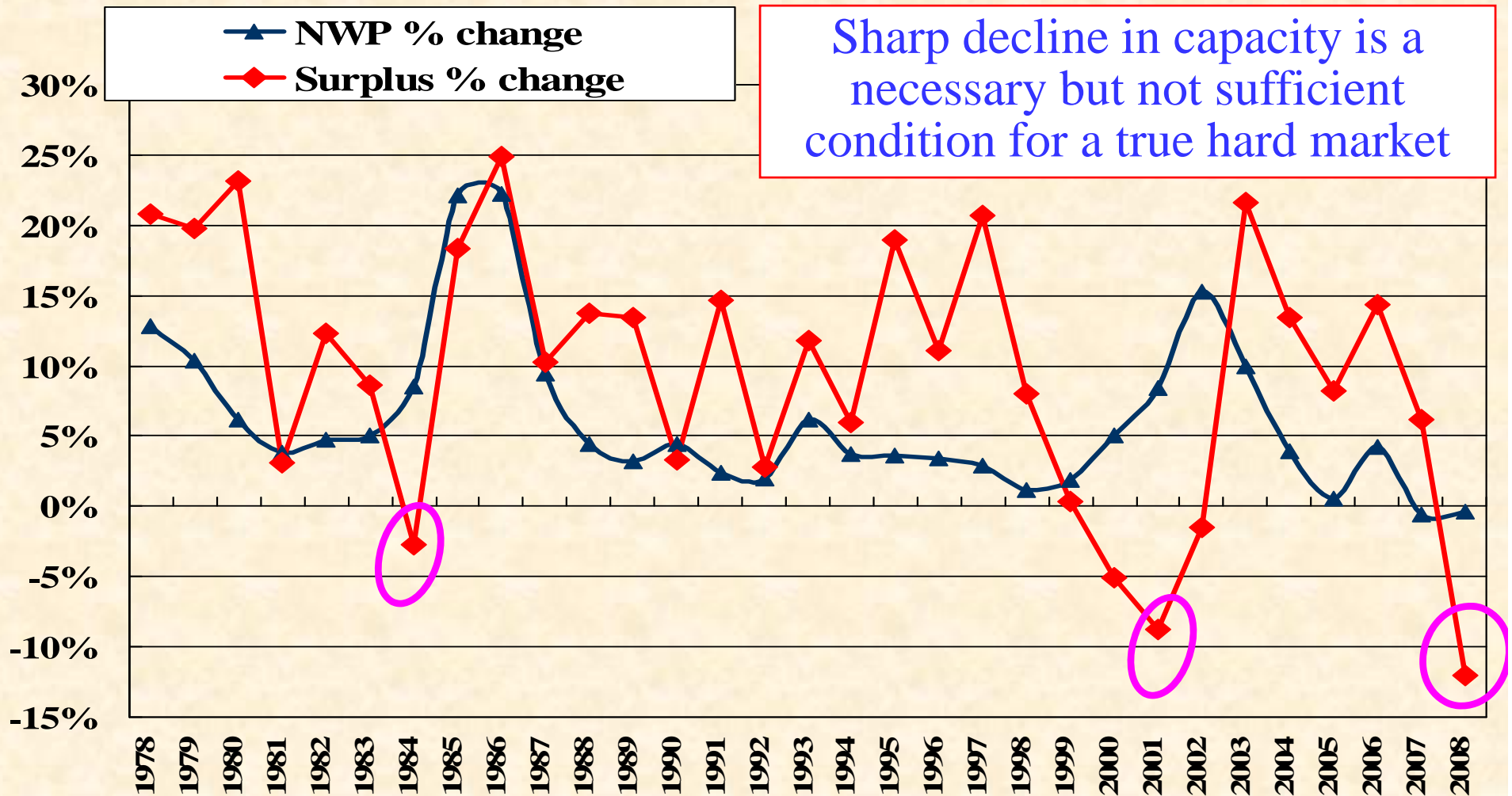
40 Years of Hard and Soft Markets



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



Historically, Hard Markets Follow When Surplus Drops Year-to-Year

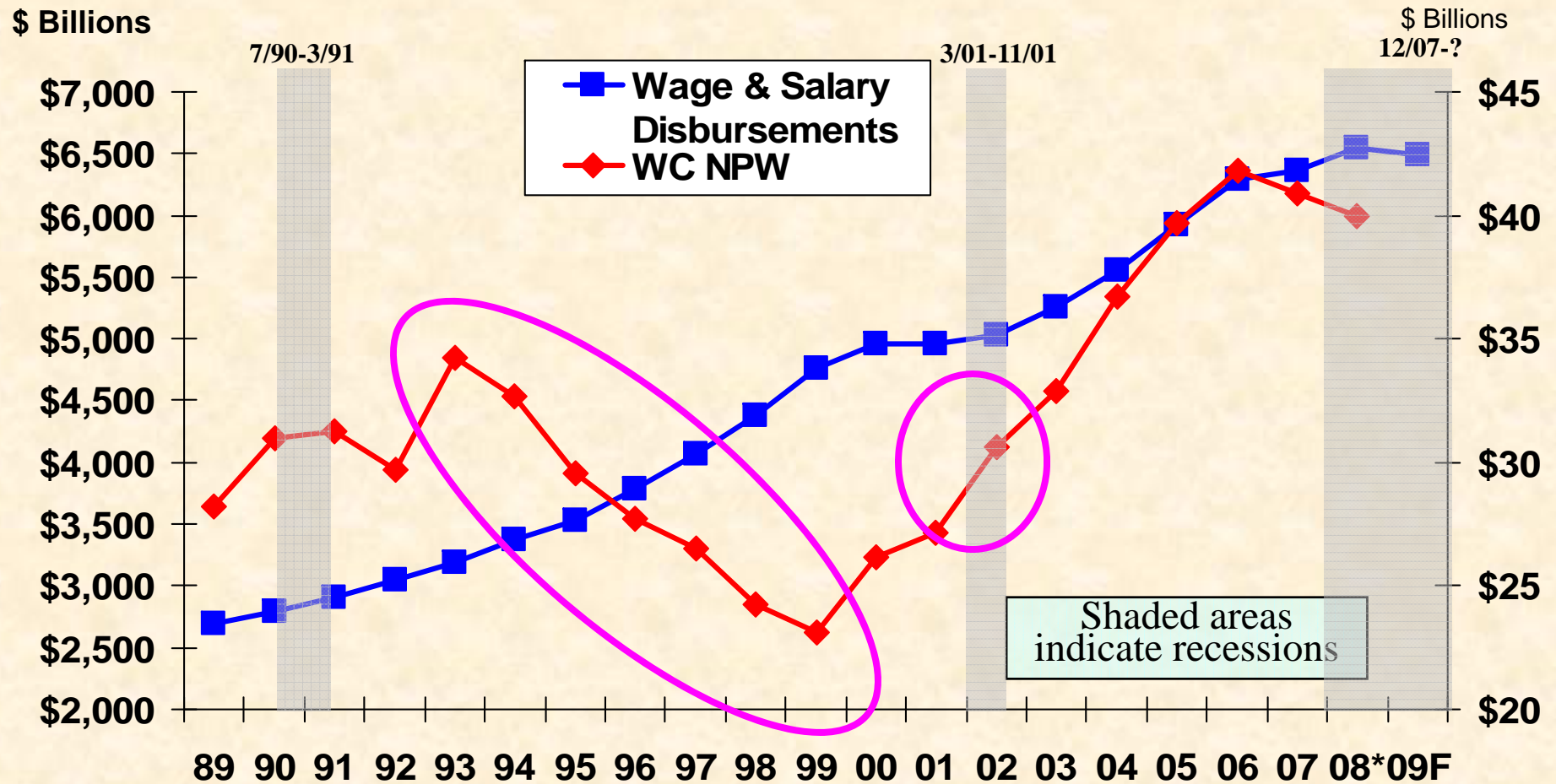


Sources: A.M. Best, ISO, Insurance Information Institute



Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums

Wage & Salary Disbursement (Private Employment) vs. WC NWP



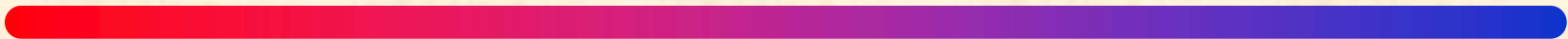
*9-month data for 2008

Sources: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at

<http://research.stlouisfed.org/fred2/series/WASCUR>; I.I.I. Fact Books

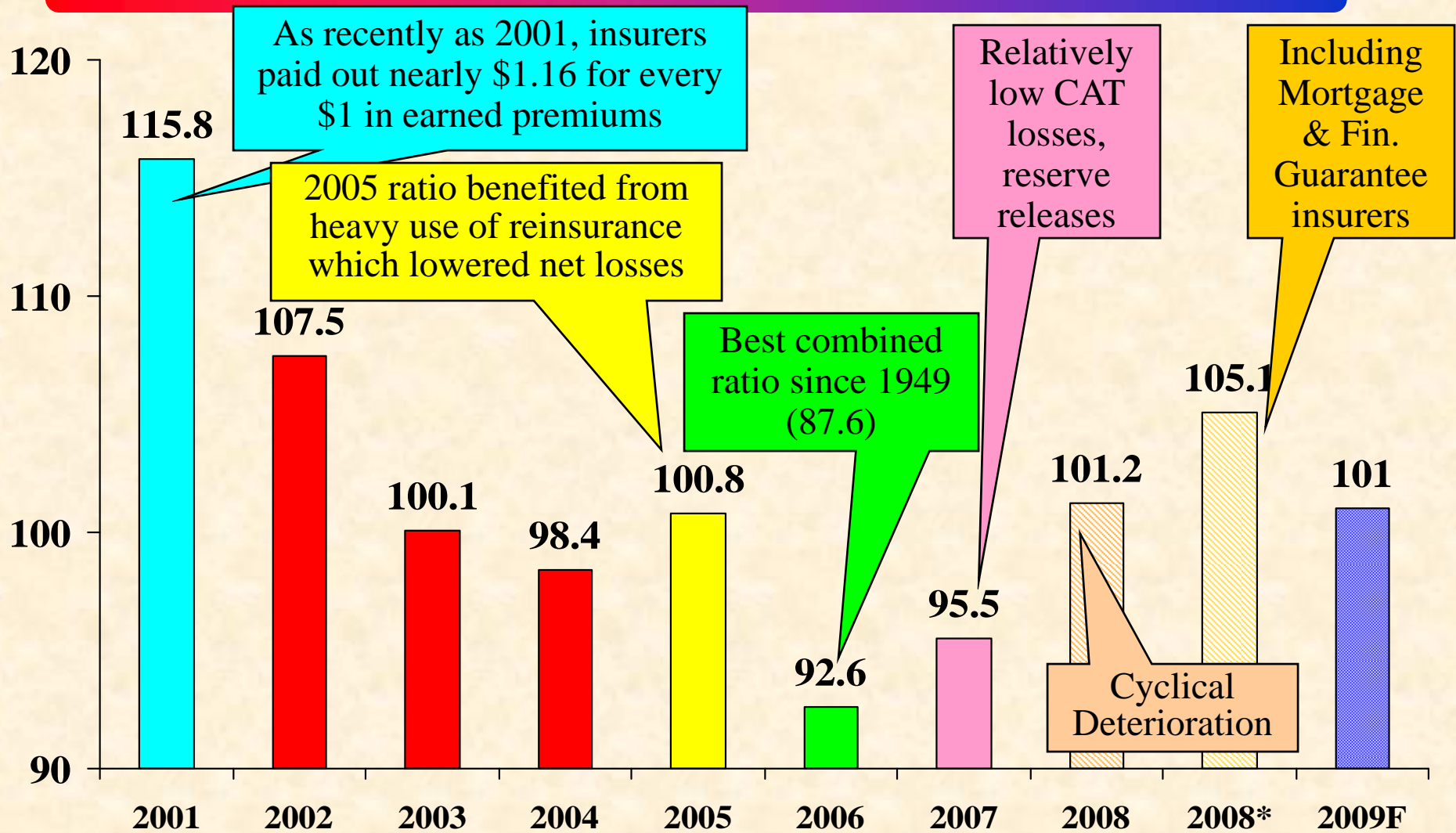
Underwriting Trends

*Financial Crisis Didn't Directly Affect
P-C Underwriting Performance;
Underwriting Cycle, Catastrophes
Were 2008's Drivers*





P/C Insurance Industry Combined Ratio, 2001-2009E

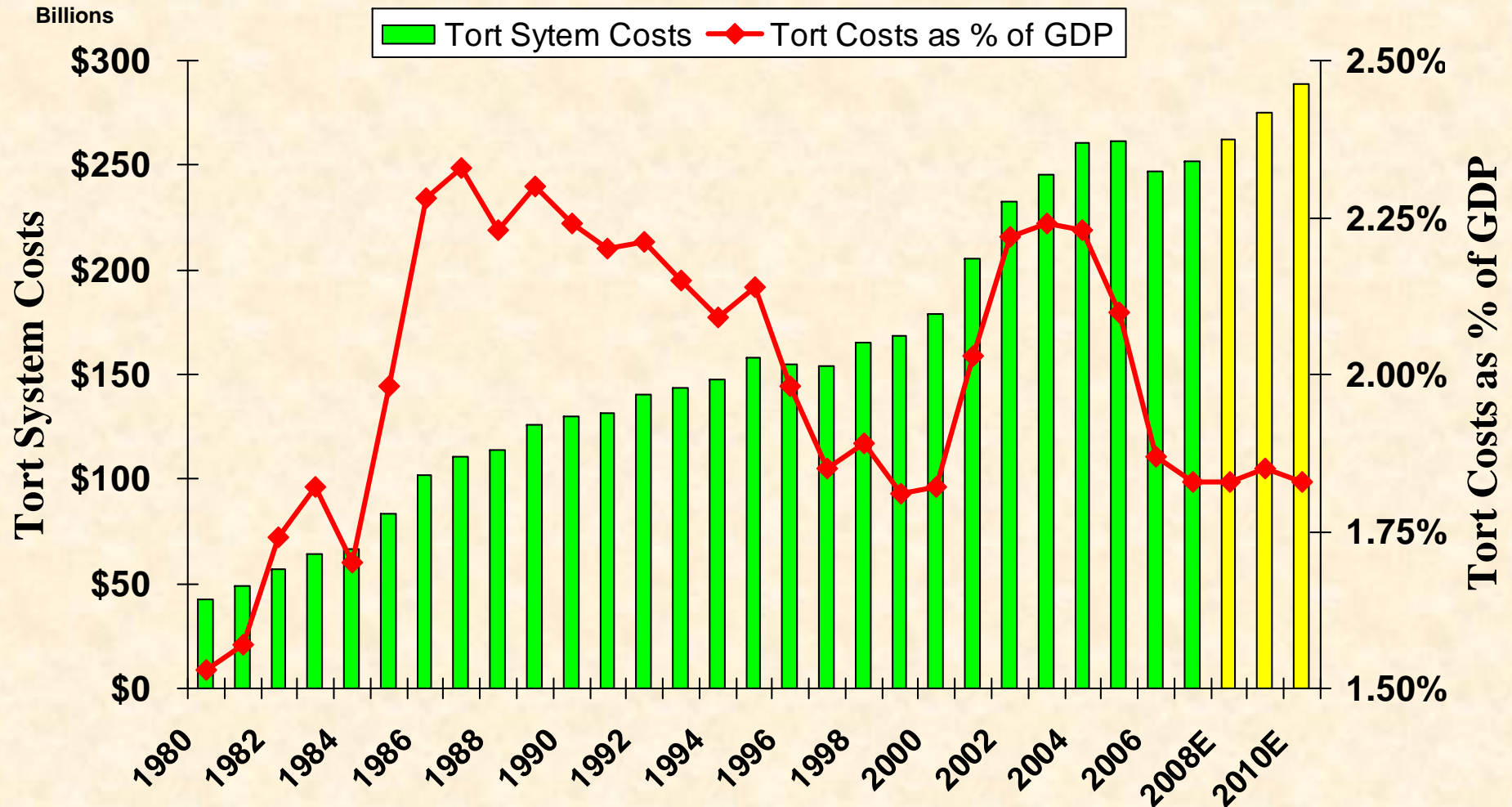


*Includes Mortgage & Financial Guarantee insurers.

Sources: A.M. Best.



Over the Last Three Decades, Total Tort Costs* as a % of GDP Appear Somewhat Cyclical

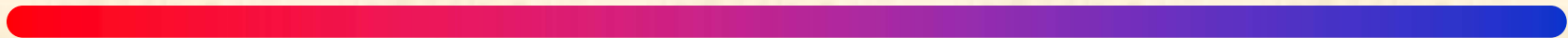


*Excludes the tobacco settlement, medical malpractice

Source: Tillinghast-Towers Perrin, 2008 Update on US Tort Cost Trends, Appendix 1A

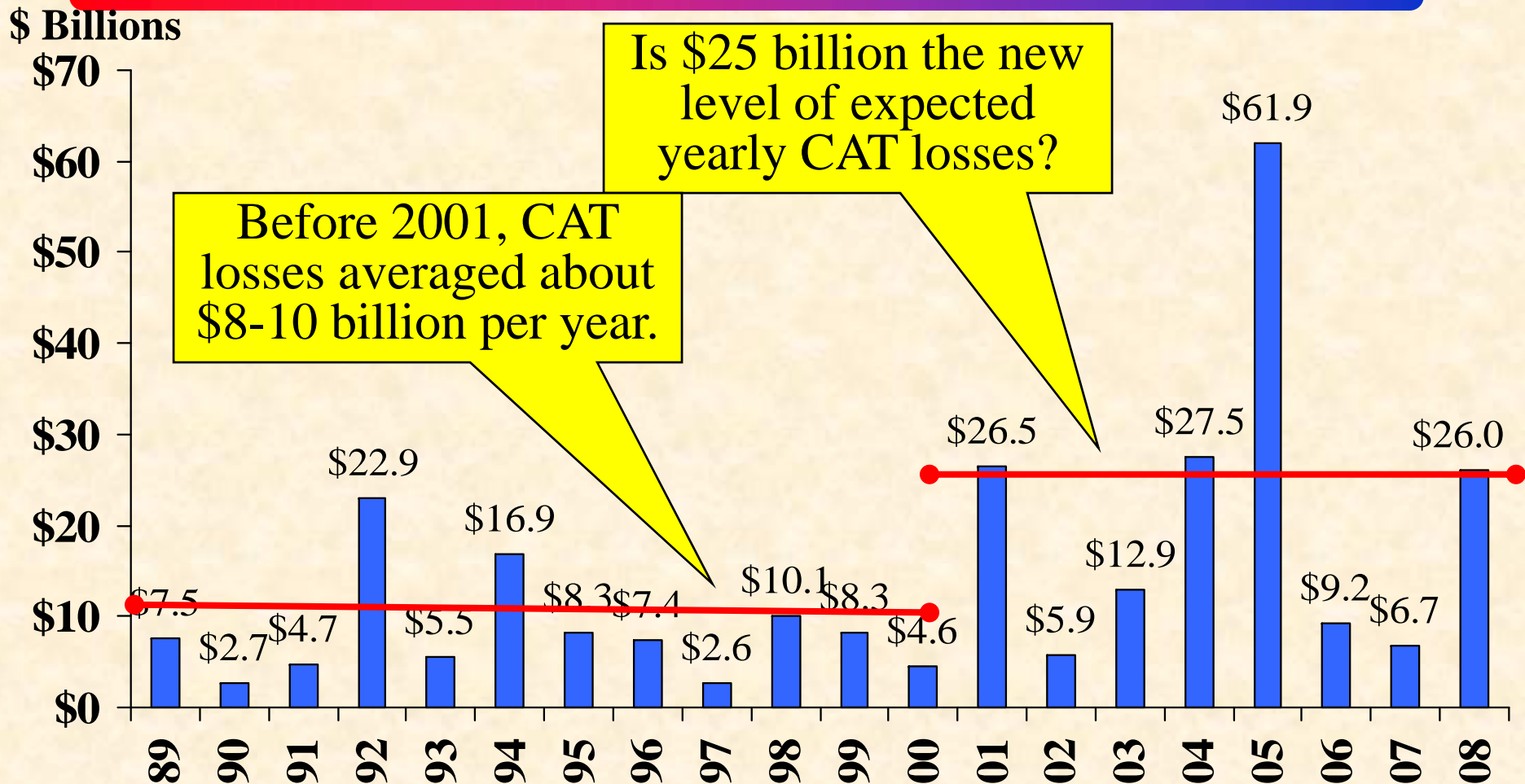
Catastrophic Loss

What Will 2009 Bring?





Catastrophic Losses*: Was 2005 an Outlier or a Harbinger?



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

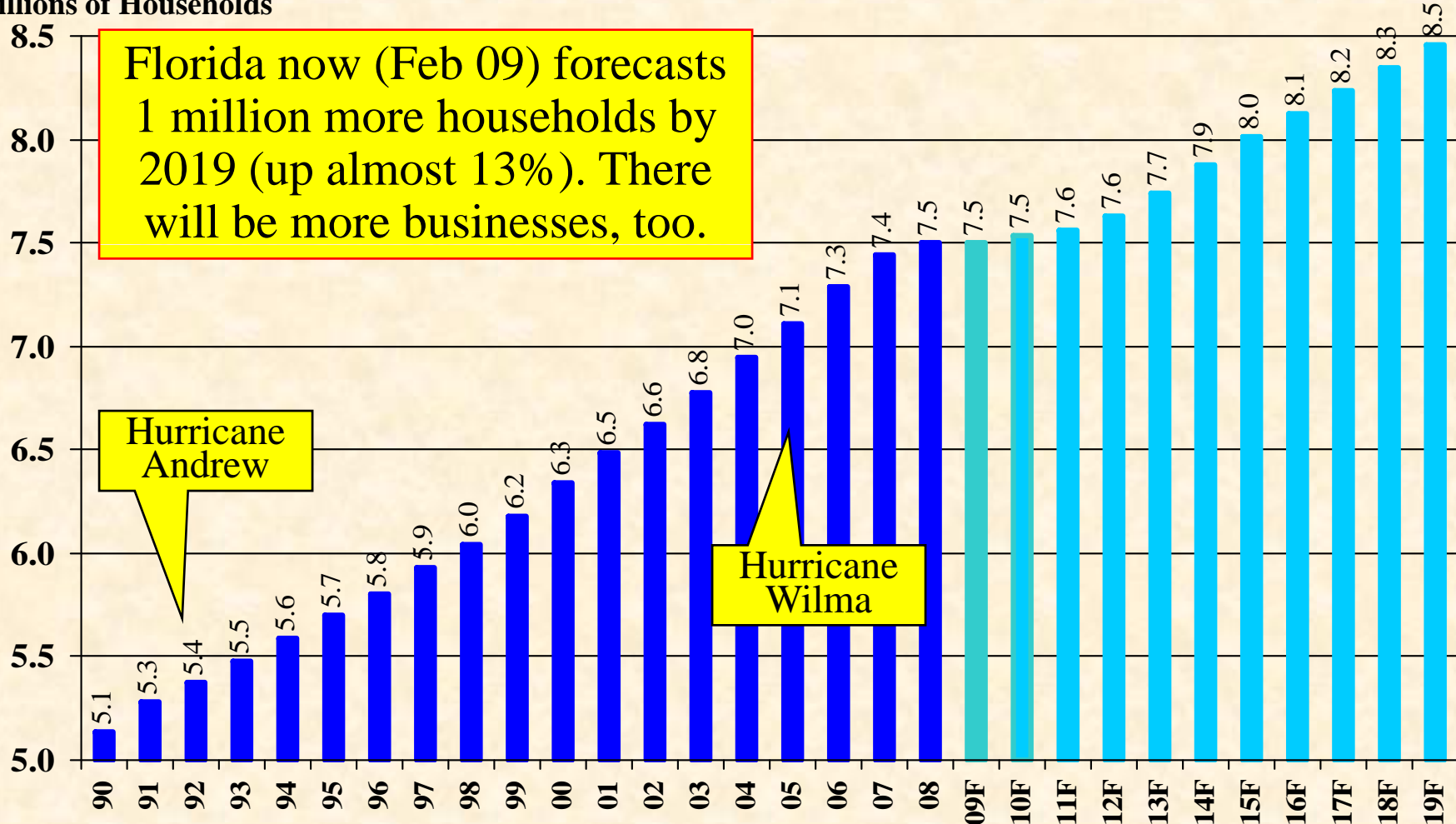
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B.

Source: Property Claims Service/ISO; Insurance Information Institute



A Million More Florida Resident Households in the Next Decade?

Millions of Households



Source: <http://edr.state.fl.us/conferences/population/demographic.htm>

Data are from Feb. 18, 2009 Florida Demographic Estimating conference



April 2009 Forecast for the 2009 Hurricane Season: 12 Named Storms

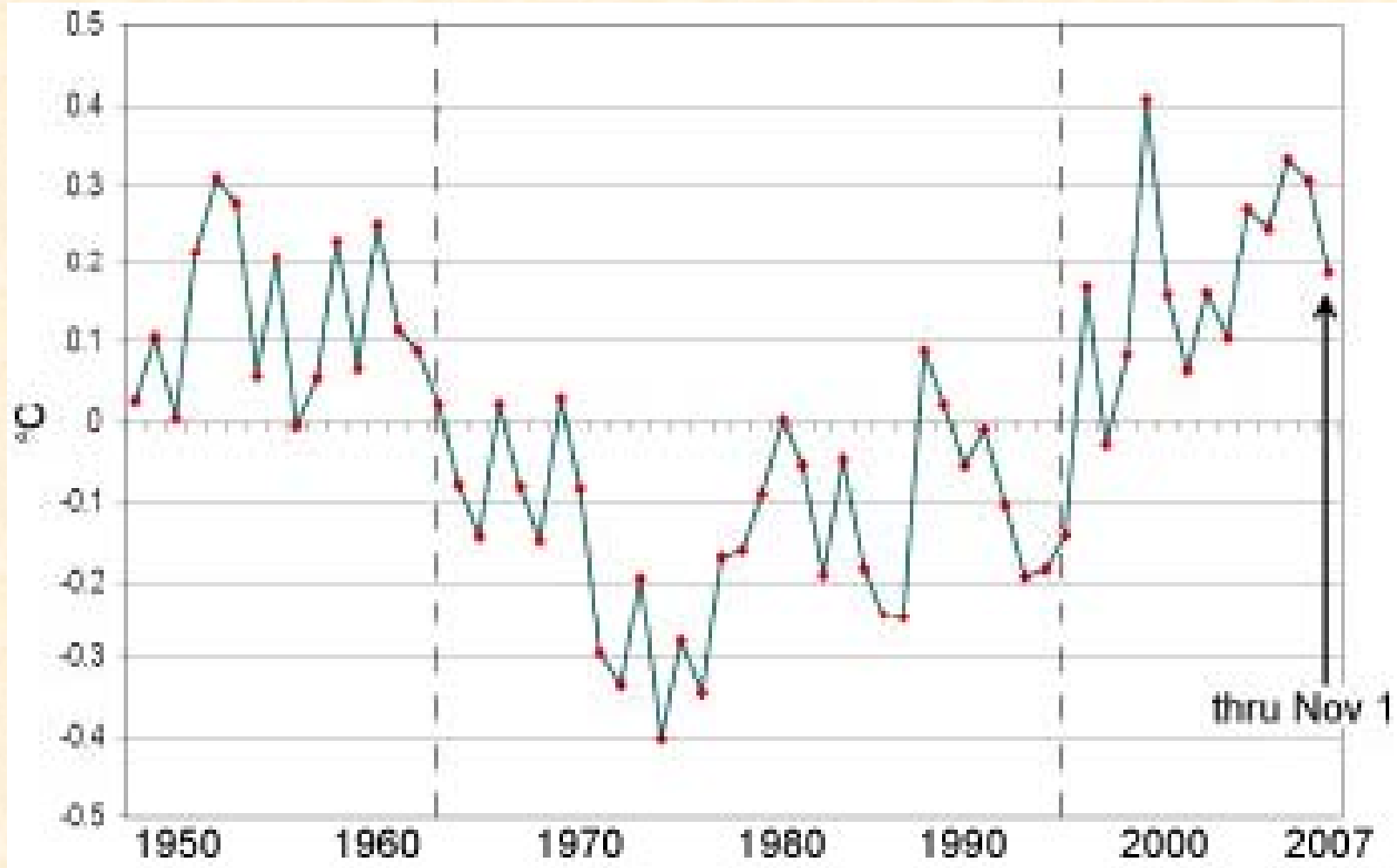
	Average, 1950- 2000	2005	2009F
Net Tropical Cyclone Activity	100%	275%	105%
Named Storms	9.6	28	12
Hurricanes	5.9	14	6
Intense Hurricanes	2.3	7	2

But how many will make
landfall, and how strong will
they be if they do?

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, April 7, 2009.

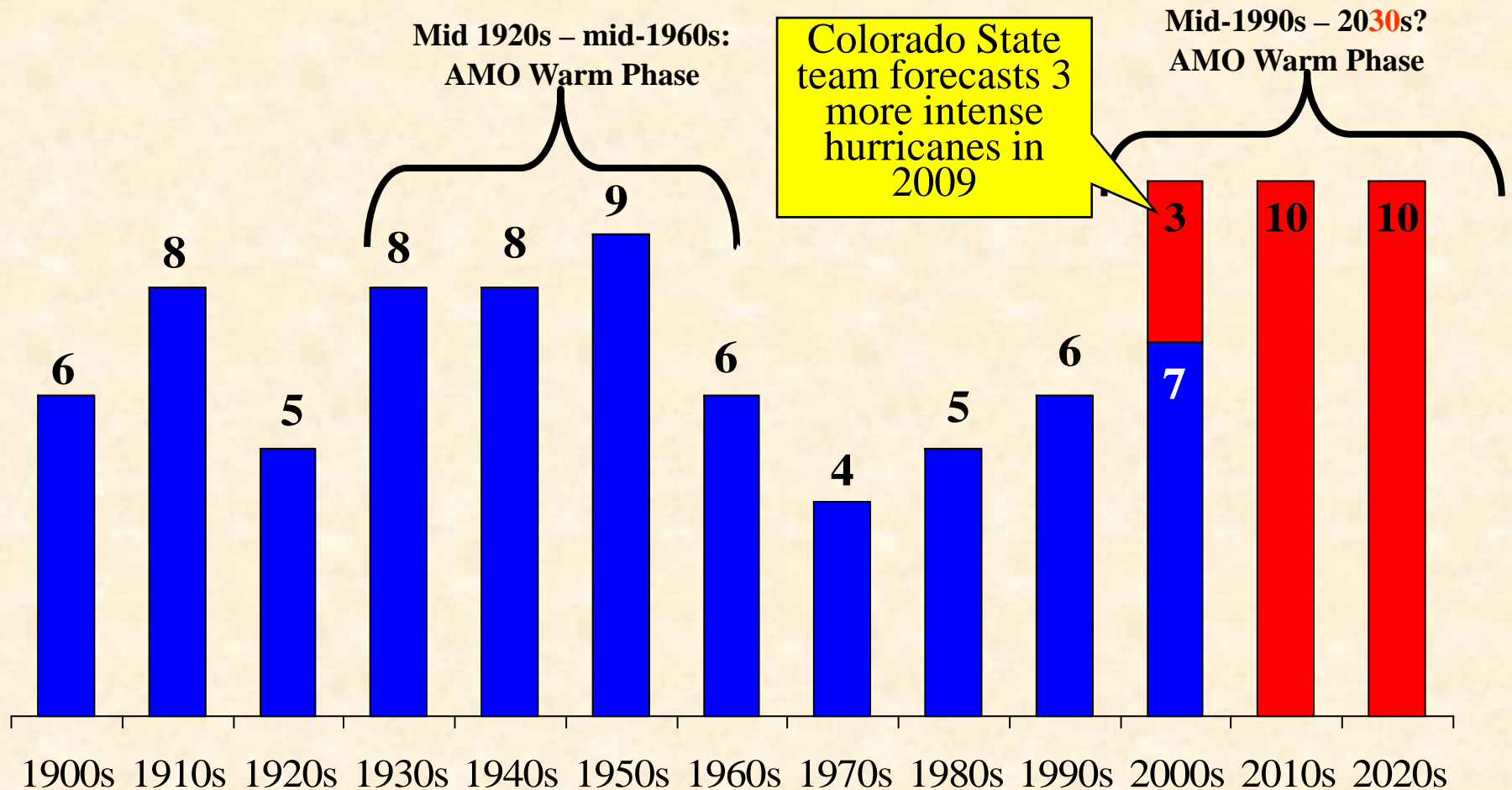


Atlantic Sea Surface Temperatures, 1948-2007





Major (Category 3, 4, 5) Hurricanes Striking the US by Decade

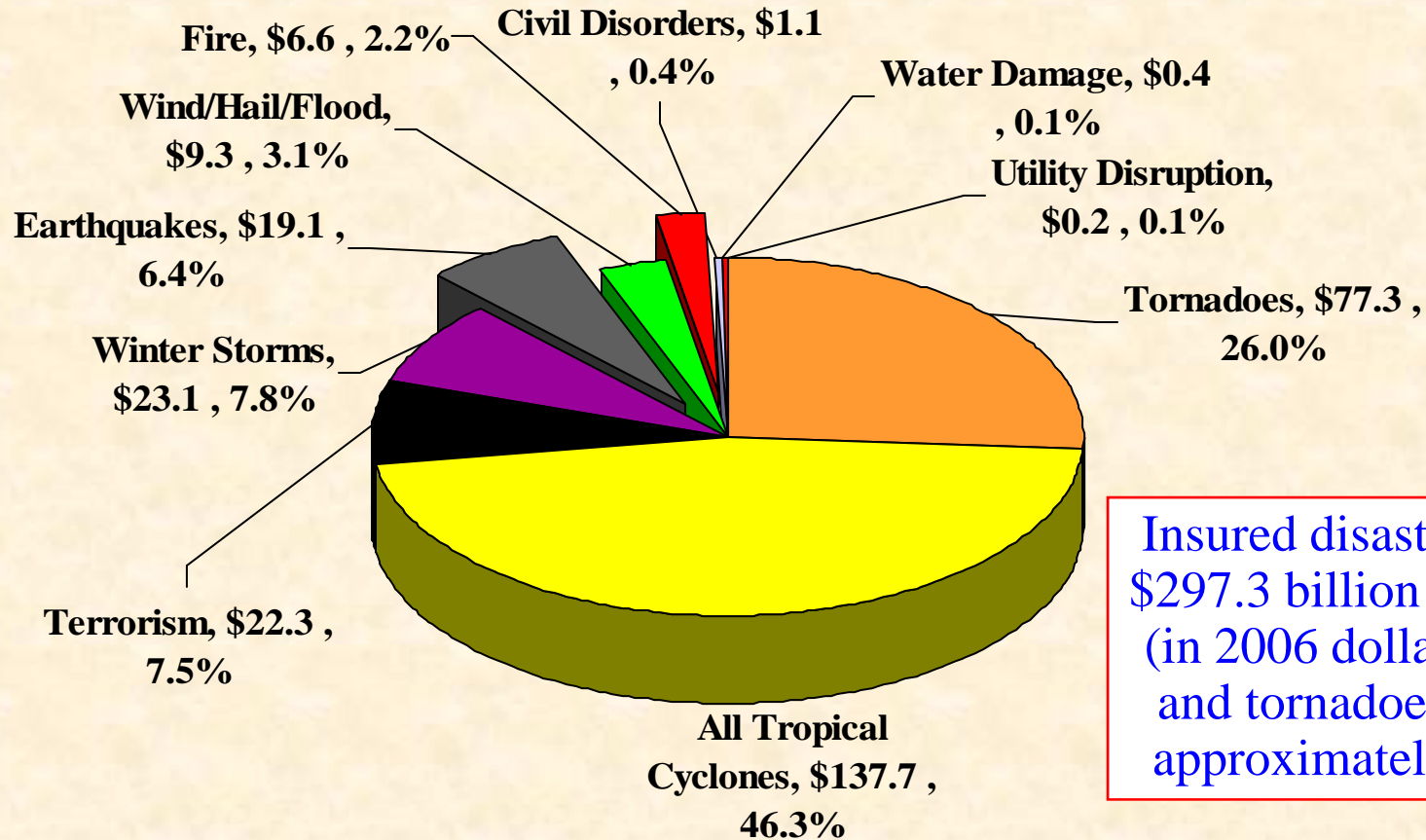


*Figure for 2000s is extrapolated based on data for 2000-2008 (7 major storms: Charley, Ivan, Jeanne (2004), Katrina, Rita, Wilma (2005), Ike (2008)).

Sources: Tillinghast from National Hurricane Center: <http://www.nhc.noaa.gov/pastint.shtm>; I.I.I.



Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1987-2006¹



Insured disaster losses totaled \$297.3 billion from 1987-2006 (in 2006 dollars). Hurricanes and tornadoes accounted for approximately 75% of these.

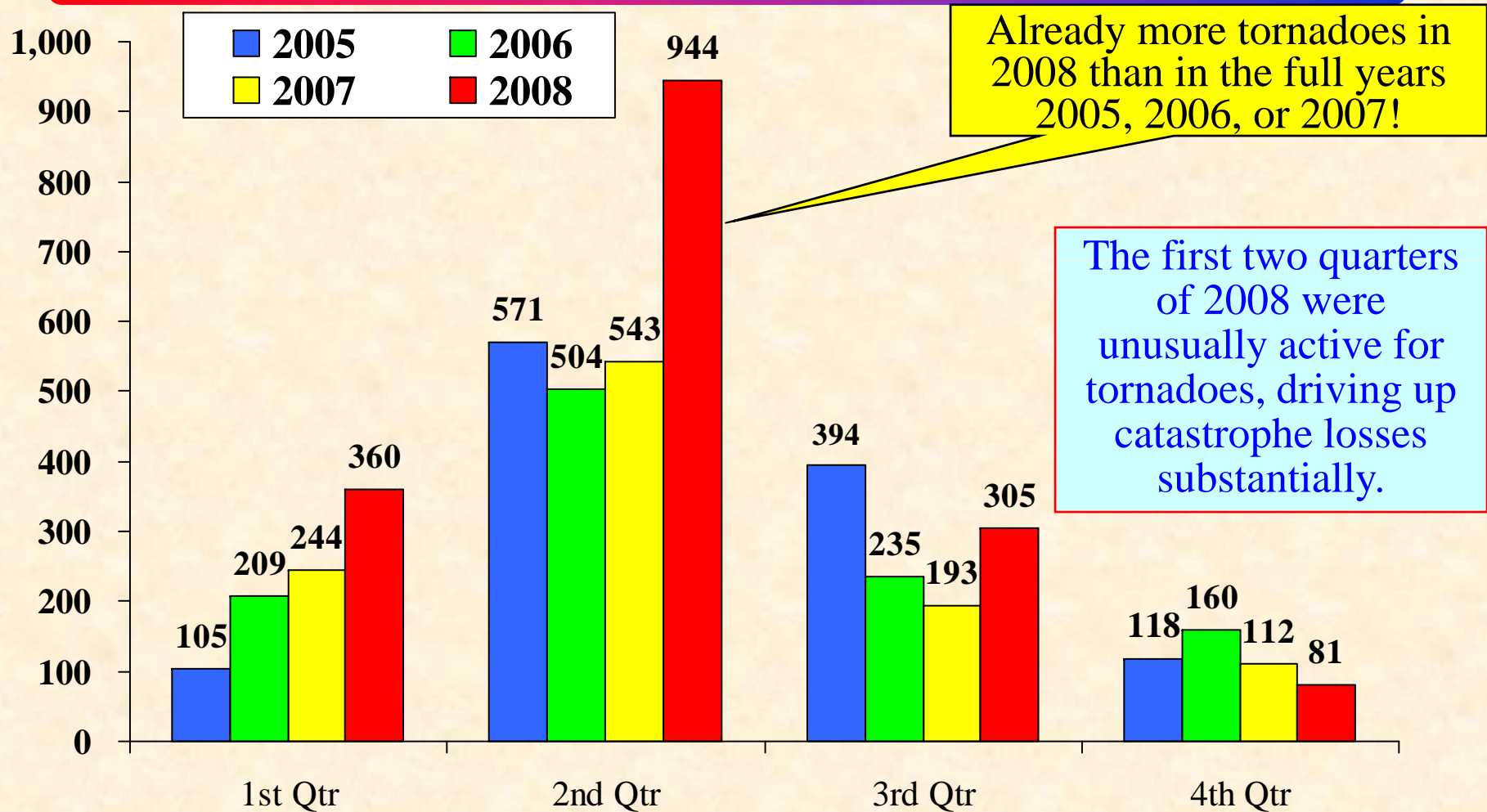
¹ Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2006 dollars.

Catastrophe threshold changed from \$5 million to \$25 million beginning in 1997. Adjusted for inflation by the III.

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



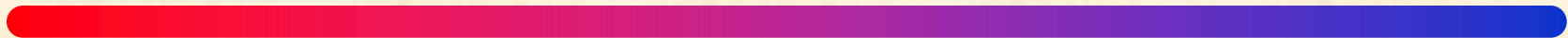
Number of Tornadoes in Each Calendar Quarter, 2005–2008



Sources: US Dept. of Commerce, Storm Prediction Center, National Weather Service, at <http://www.spc.noaa.gov/climo/torn/monthlytornstats.pdf>

Investment Performance

*Investments are
the Main Source
of Declining Profitability*





Asset Allocation of P/C Insurance Industry's Cash & Invested Assets

As of December 31, 2008

Bonds, \$847 , 66%

**Common Stock,
\$239 , 19%**

**Cash & Short-
Term Investments,
\$91 , 7%**

**Preferred Stock,
\$20 , 2%**

Other, \$75 , 6%

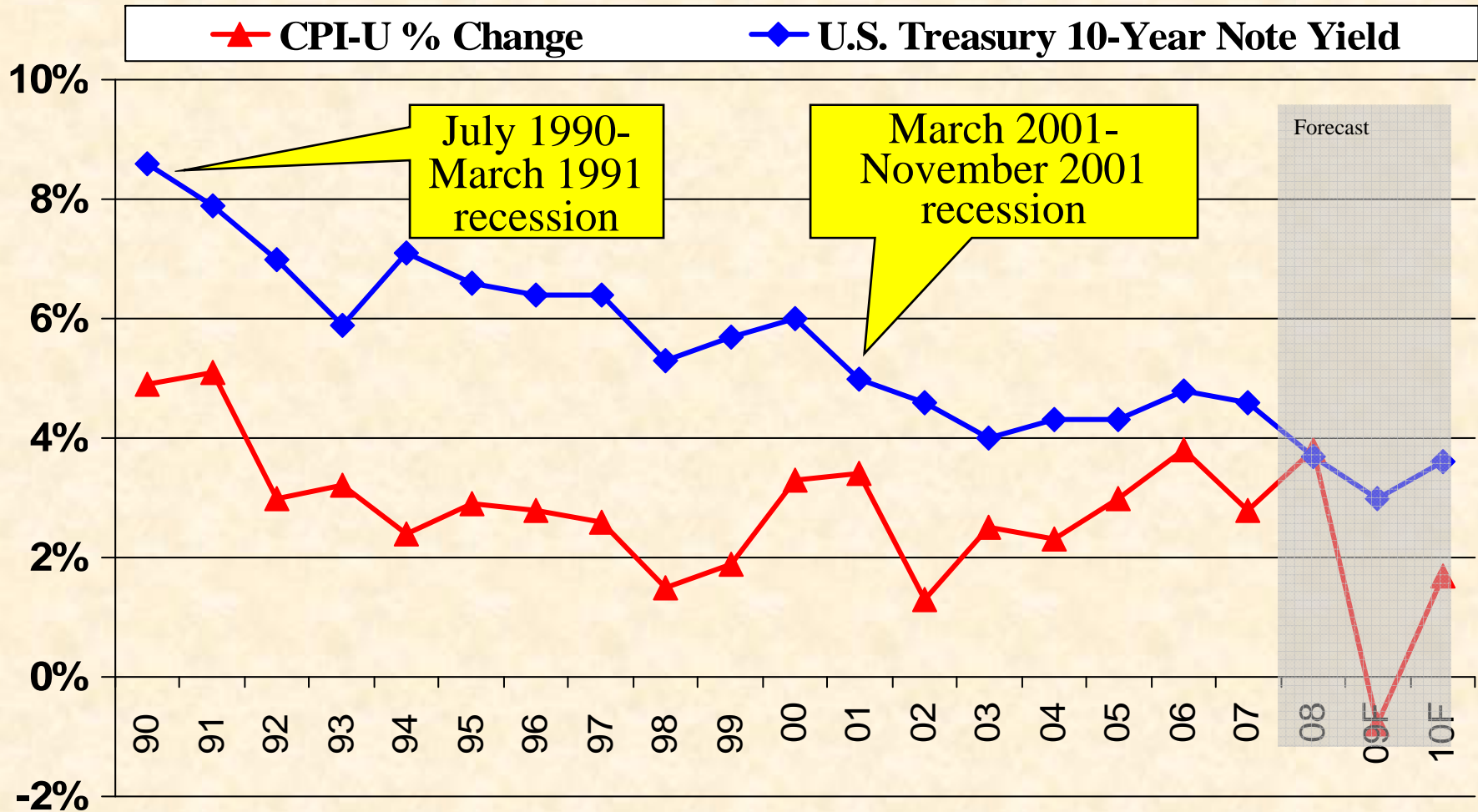
Portfolio Facts

- Invested assets totaled \$1.29 trillion as of 12/31/08
- Allocations were virtually unchanged from 12/31/07

Source: NAIC Annual Statements, via Highline Data



Bond Yields Tend to Follow Inflation, but the Relationship is a Loose One

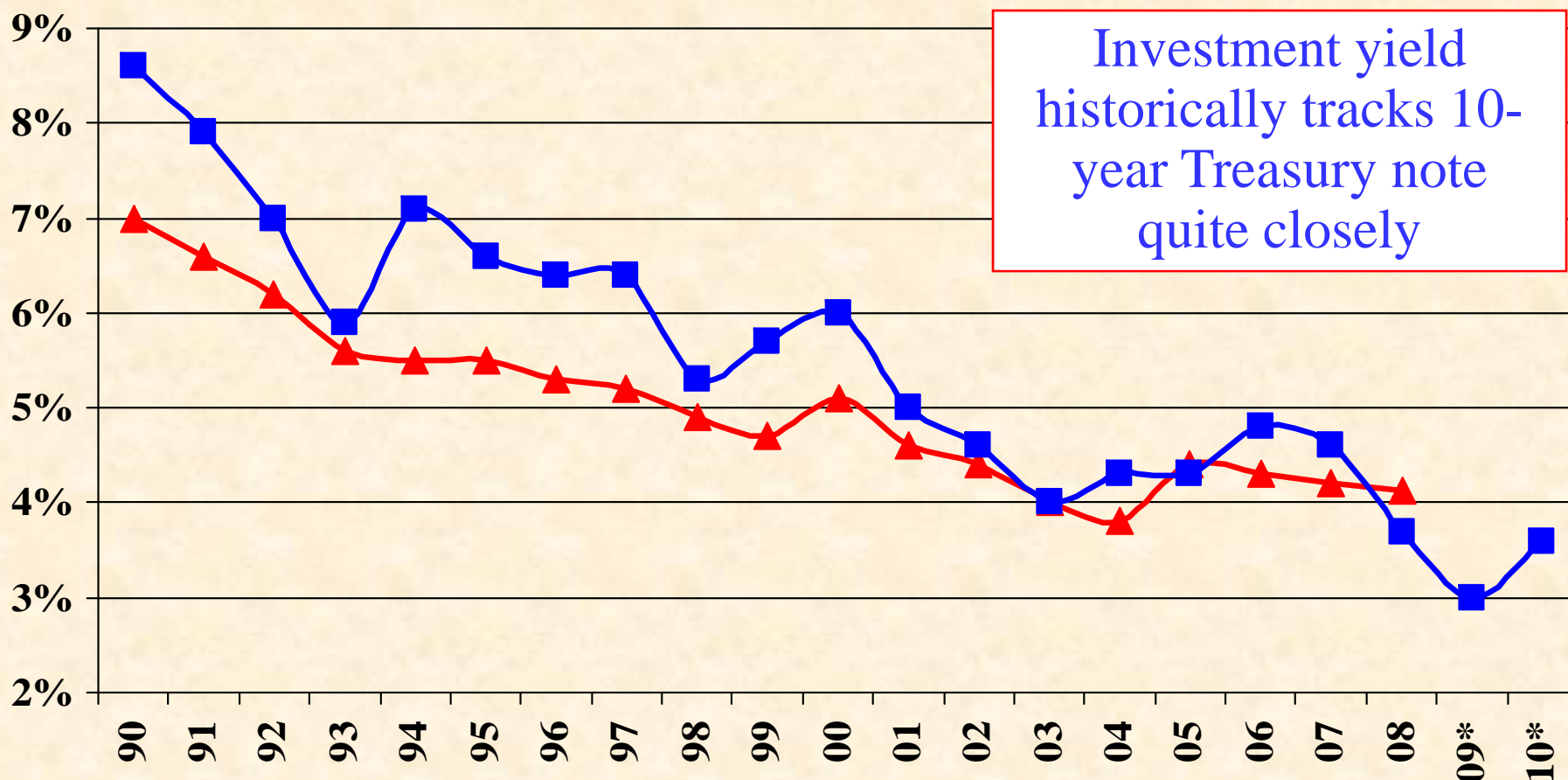


Sources: US Bureau of Labor Statistics (history); Blue Chip Economic Indicators, May 10, 2009 (forecasts)



P/C Investment Income as a % of Invested Assets Follows 10-Year U.S. T-Note

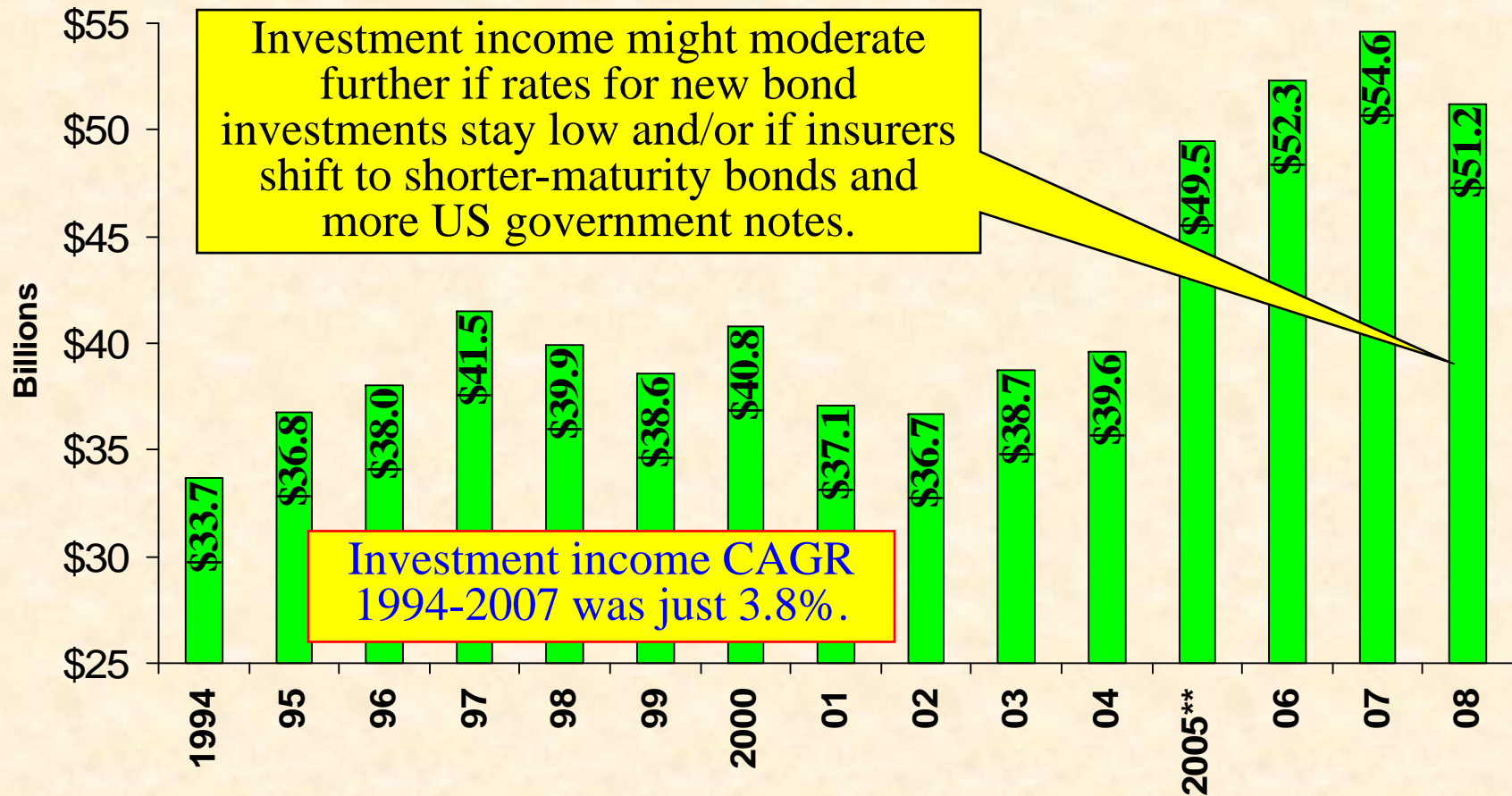
▲ P-C Inv Income/Inv Assets ■ 10-Year Treasury Note



*Blue Chip consensus forecasts. Sources: Board of Governors, Federal Reserve System; Blue Chip Economic Indicators (5/09 issue) A.M.Best; Insurance Information Institute.



P/C Industry Investment Income, 1994-2008*

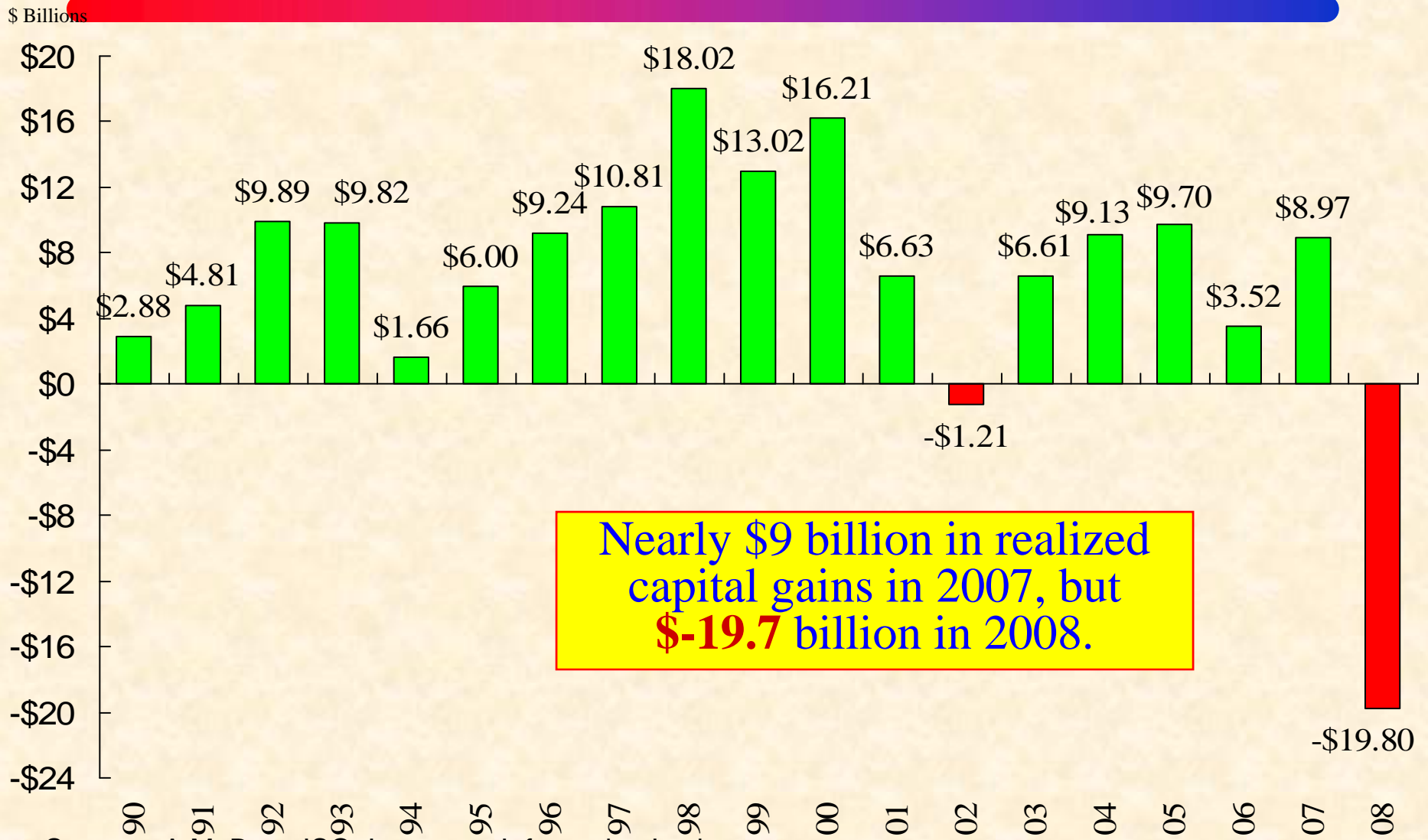


*Primarily interest and stock dividends. ** Investment income (excluding one-time dividend) jumped in 2005 as insurers that had accumulated cash captured rising bond interest rates. Also, 2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.



P/C Industry Net Realized Capital Gains and Losses, 1990-2008

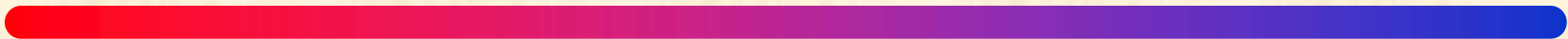


Nearly \$9 billion in realized capital gains in 2007, but **-\$19.7 billion** in 2008.

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

P/C Insurance Capacity

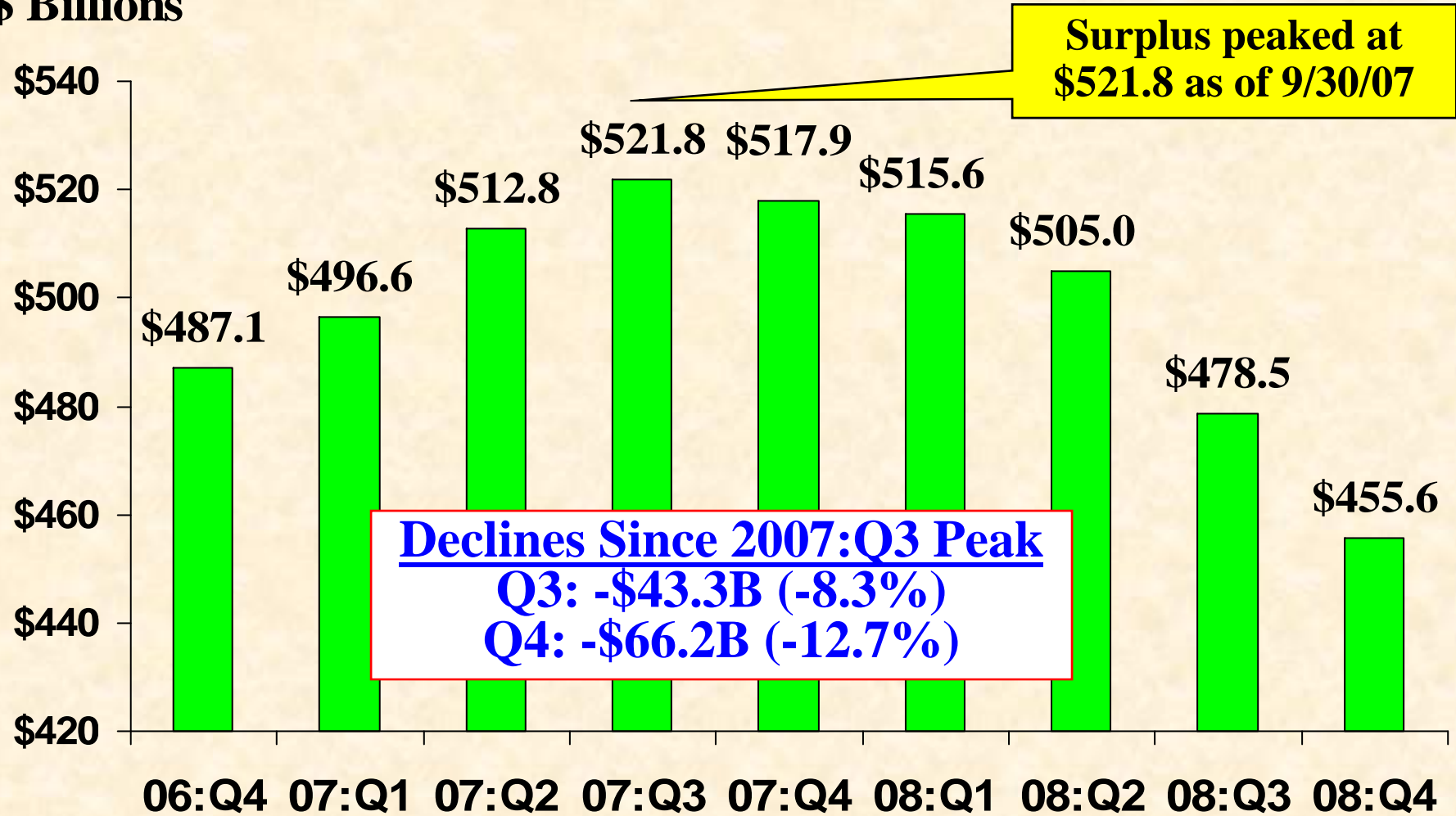
Diminished but Still Strong





P/C Industry Policyholder Surplus, 2006:Q4 – 2008:Q4

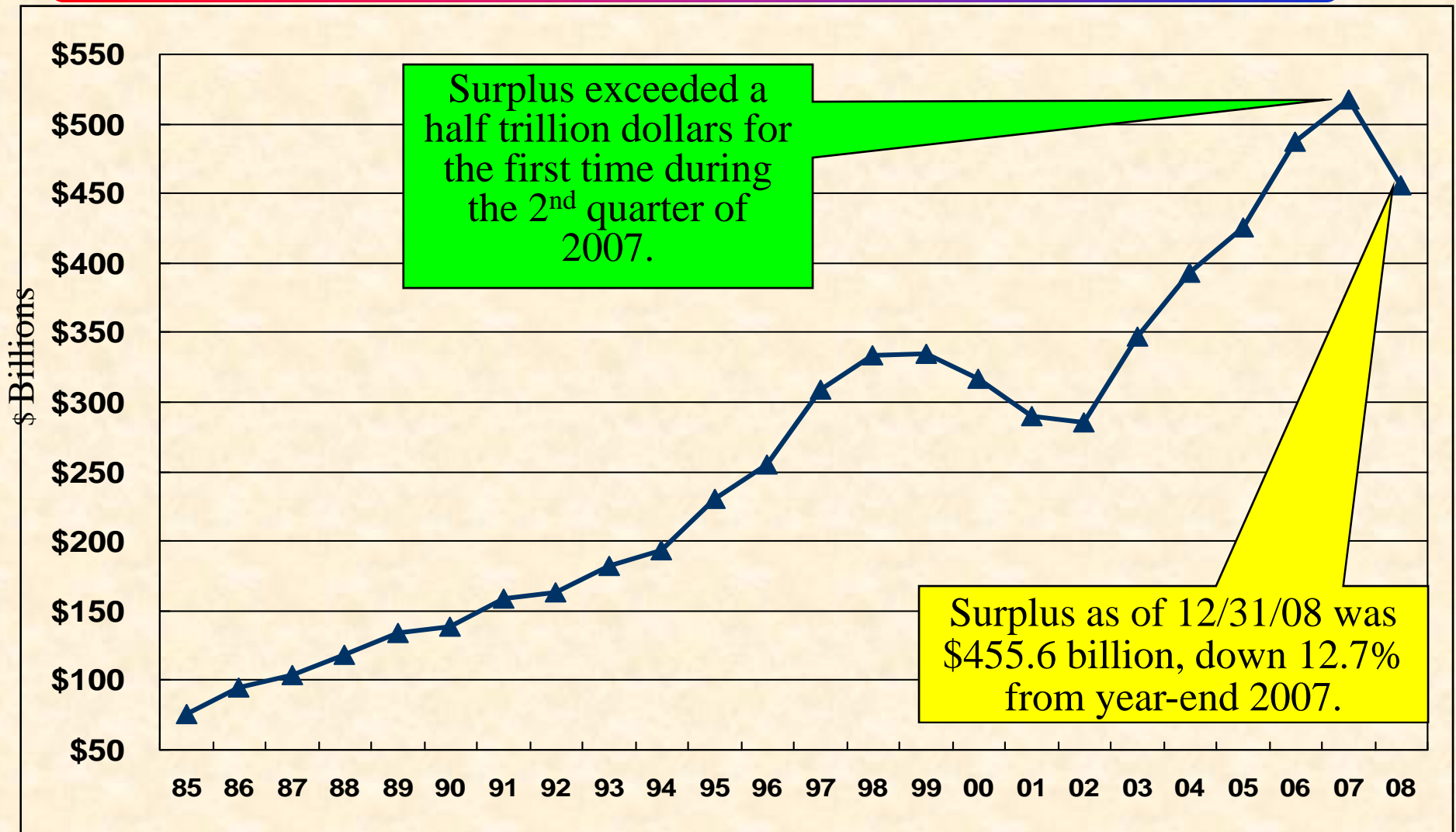
\$ Billions



Source: ISO



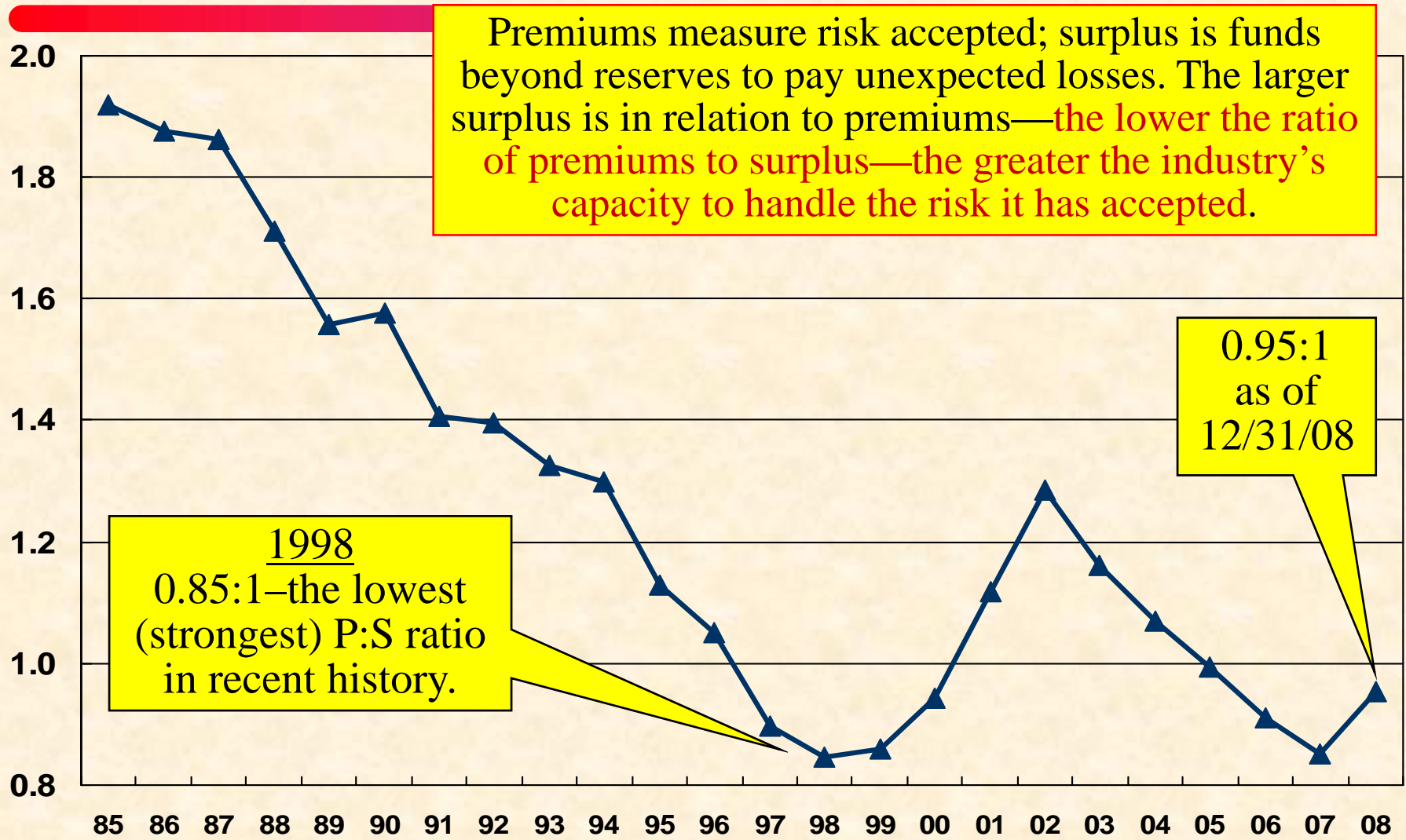
U.S. P/C Industry Policyholder Surplus: 1977-2008



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



U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2008

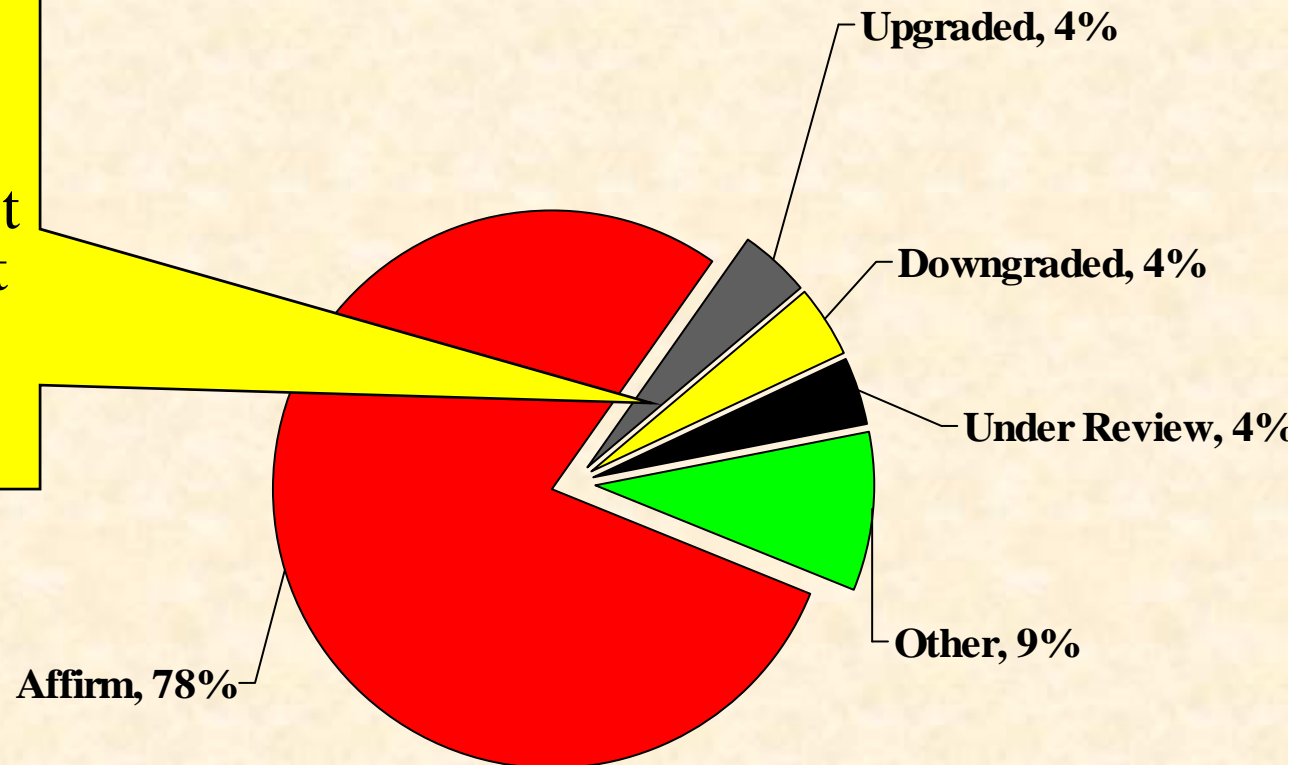


Sources: A.M. Best, ISO, Insurance Information Institute.



*In 2008, A.M. Best Affirmed or Upgraded 87% of P/C Insurers**

In 2008, despite financial market turmoil, high cat losses and a soft market, A.M. Best lowered ratings on just 4% of P-C insurers. It placed another 4% under review

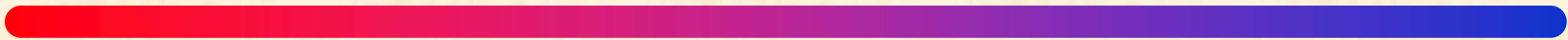


*Excludes insurers assigned initial ratings

Source: A.M. Best, *BestWeek*, February 16, 2009, p. 16

The Future of Insurance Regulation

*The Geithner Proposal
for Regulatory Reform of
the U.S. Financial System*





Overall Framework of the Geithner Proposal

- Four broad areas
 - Systemic risk
 - Consumer and investor protection
 - Eliminating gaps in regulatory structure
 - International coordination



The Geithner Proposal: Accumulate Capital to Anticipate Downturns

- “Large, interconnected firms and markets need to be under a more consistent, and more conservative, regime. These standards ... must also ensure the stability of the system itself.”
- “We need to examine our accounting rules to see whether, consistent with investor protection, we can require firms to build up loan loss reserves that look forward and account for losses in downturns.”
 - *Application to insurer reserves for catastrophes and similar low-frequency/high-severity loss scenarios?*



The Geithner Proposal: Philosophy on Who Regulates What

- “We must end the practice of allowing banks and other financial companies to choose their regulator simply by changing their charters; **regulators must choose who to regulate.**”
- “We must ensure that global standards for financial regulation are consistent with the high standards we will be implementing in the United States.”



The Geithner Proposal: Elements of a Plan to Address Systemic Risk

- A single entity with responsibility for systemic stability
- More conservative capital requirements “for institutions that pose potential risk to the stability of the financial system
 - Designed to dampen, not amplify, financial cycles
- New SEC regulation of hedge funds with assets under management over a certain threshold
- New regulation (oversight, protections, and disclosure) for the OTC derivatives market
- SEC: develop requirements for money market funds to reduce the risk of rapid withdrawals
- Stronger resolution tools to protect the financial system and the economy from the potential failure of large complex financial institutions (*FDIC?*)



Geithner: Defining Which Firms Are Too Systemically Important to Allow to Fail

- Legislation would define which firms pose systemic risk
- Characteristics Geithner recommends be considered
 - A firm's interdependence with the financial system
 - Its size
 - Its leverage (including off-balance-sheet exposures)
 - Degree of reliance on short-term funding
 - Importance as a source of credit for households, businesses, and governments
 - Importance as a source of liquidity for the financial system
 - “the inherent inability of regulators to predict future outcomes”
- **These firms would be held to liquidity, counterparty, and credit risk management requirements that are more stringent than for other financial firms.**



Geithner: Create a System for Orderly “Resolution” of Impaired Firms

- “We must create a resolution regime that provides authority to avoid the disorderly liquidation of any nonbank financial firm whose disorderly liquidation would have serious adverse effects on the financial system or the U.S. economy.
 - We must cover financial institutions that have the potential to pose systemic risks to our economy but that are not currently subject to the resolution authority of the FDIC. *This clearly includes insurance companies.*
 - The Treasury and the FDIC would decide whether to provide financial assistance to the institution or to put it into conservatorship/ receivership.



The Geithner Proposal: Consumer and Investor Protection

- “The choice of what home mortgage to get or how to save for retirement are some of the most important financial decisions that households make.”
- “It is crucial [to have] ... clear rules of the road that prevent manipulation and abuse.”
 - *Will these rules apply to insurance contracts?
Reinsurance?*



*Insurance Information
Institute On-Line*

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give me your business card with e-mail address*