



Economic Issues and the P/C Insurance Industry

**Casualty Actuaries of Greater New York
New York, NY
December 4, 2014**

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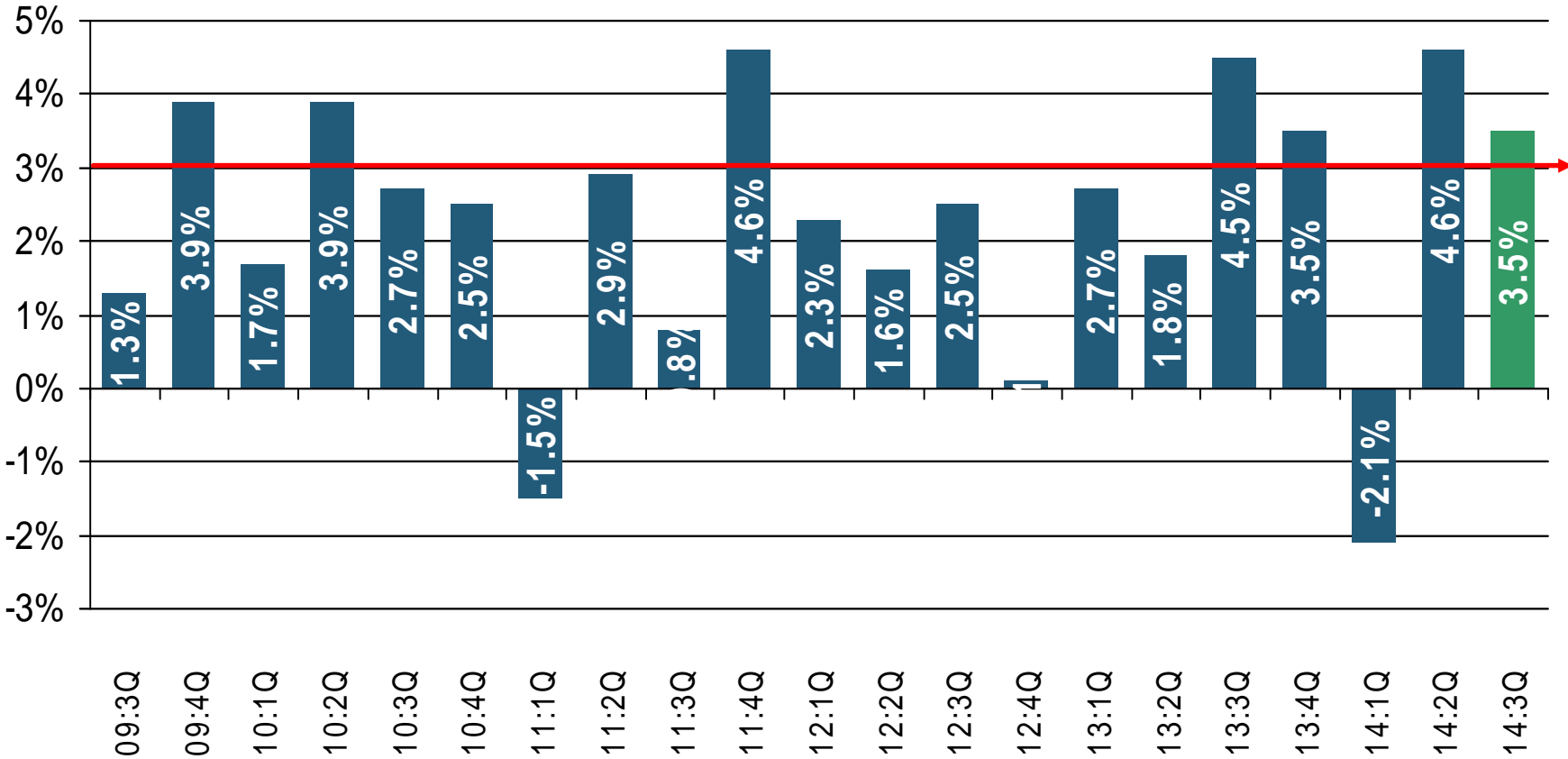
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How Will Economic Growth Affect Growth in the P/C Insurer Exposure Base?

**Economic Conditions and Prospects
Vary Widely Among the States**

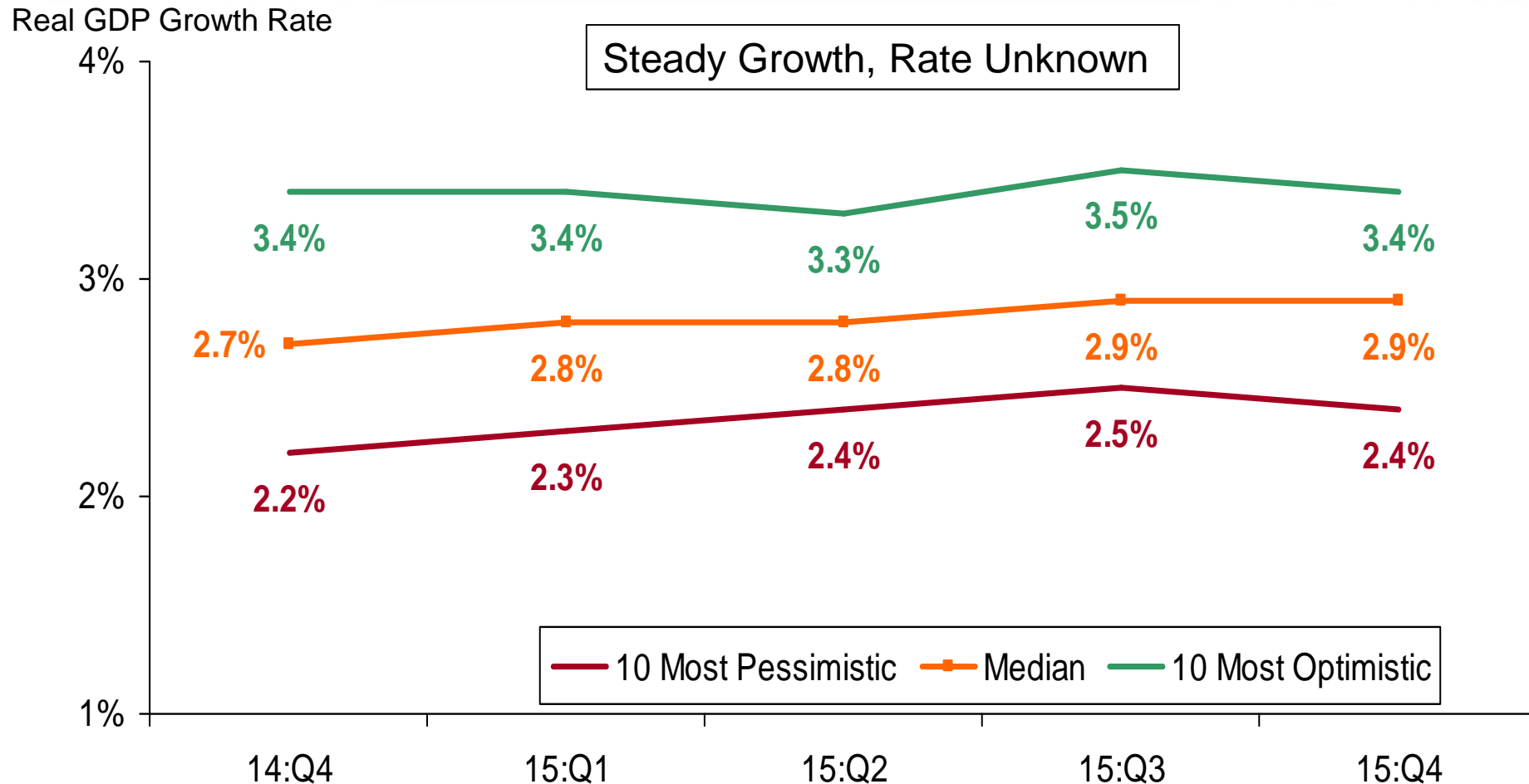
Real U.S. Quarterly GDP Growth Since the “Great Recession



Since the Great Recession ended, even 3% real growth (at an annual rate) in a quarter has been unusual. It happened only 7 times in 21 quarters, but 4 of those 7 were in the most recent 5 quarters.

Data are quarterly changes at annualized rates. 2014:Q3 is advance estimate
 Sources: US Department of Commerce, at <http://www.bea.gov/national/index.htm#gdp> ; Insurance Information Institute.

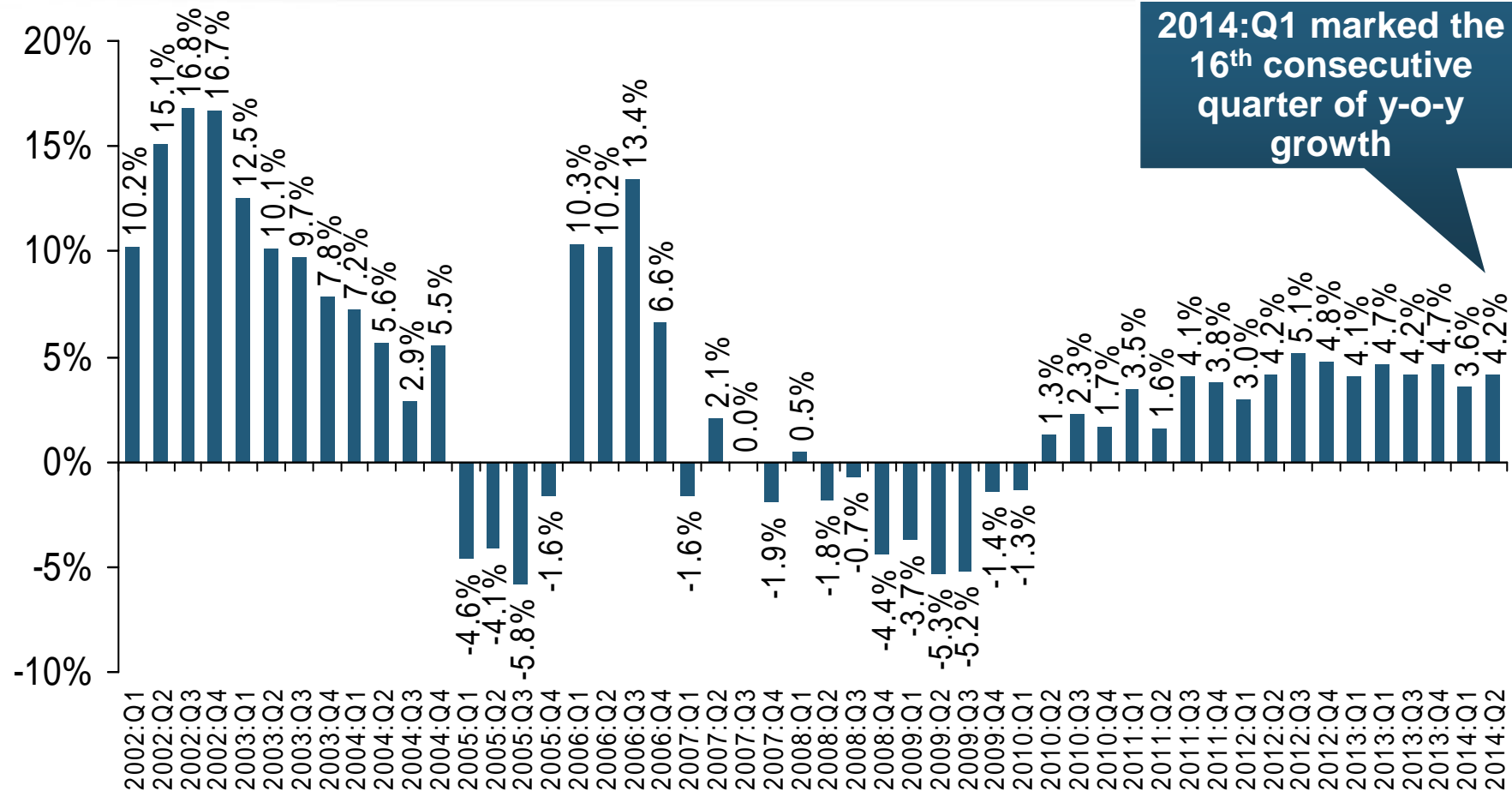
US Real GDP, Quarterly, 2014-15 November 2014 Forecasts



Despite the challenges to the U.S. economy, virtually every forecast in the Blue Chip universe in early November 2014 saw steady growth through the end of 2015

Sources: Blue Chip Economic Indicators (11/14); Insurance Information Institute

P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter



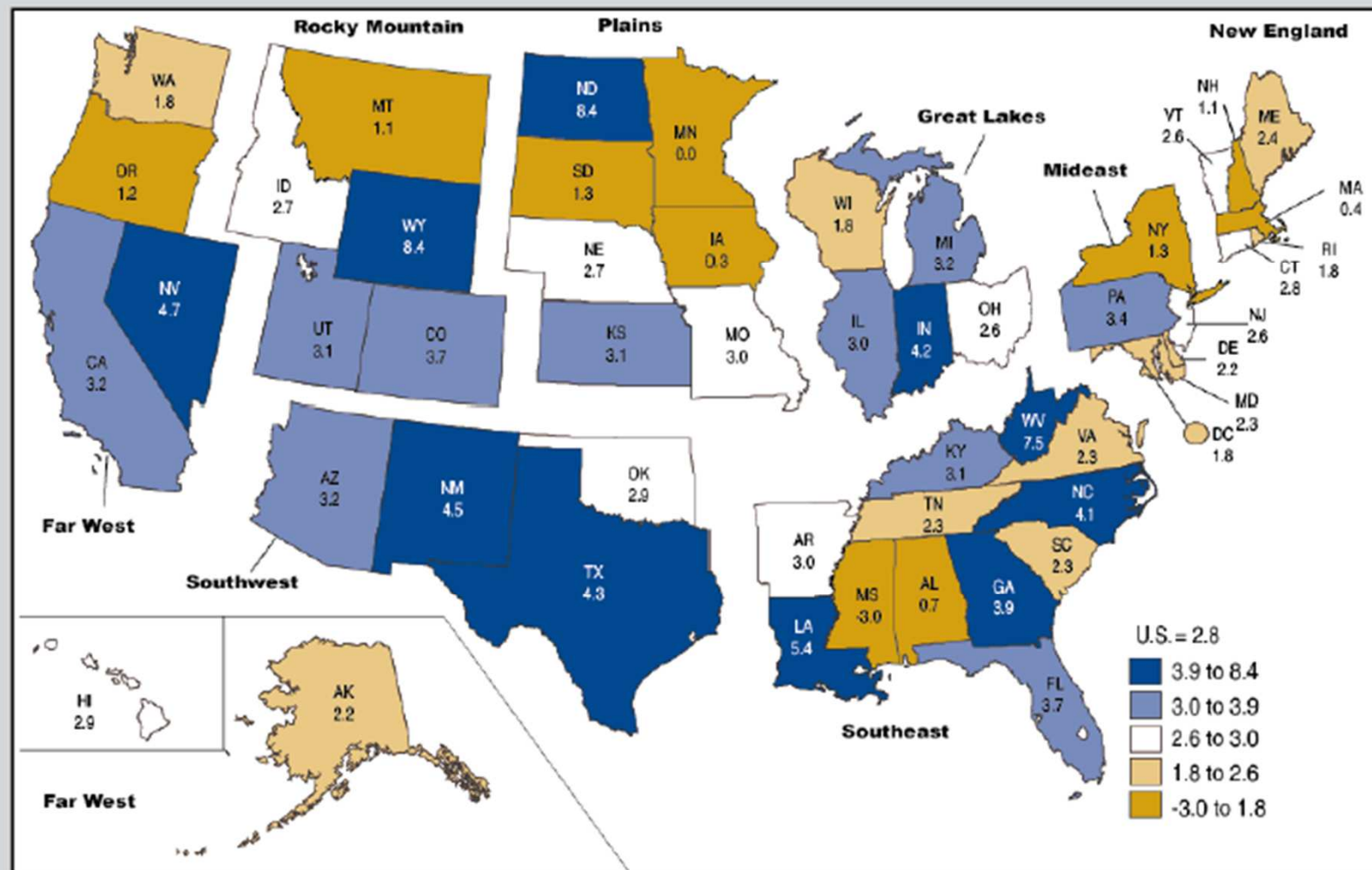
2014:Q1 marked the 16th consecutive quarter of y-o-y growth

Sustained growth in written premiums (vs. the same quarter, prior year) should continue through 2014.

Sources: ISO, Insurance Information Institute.

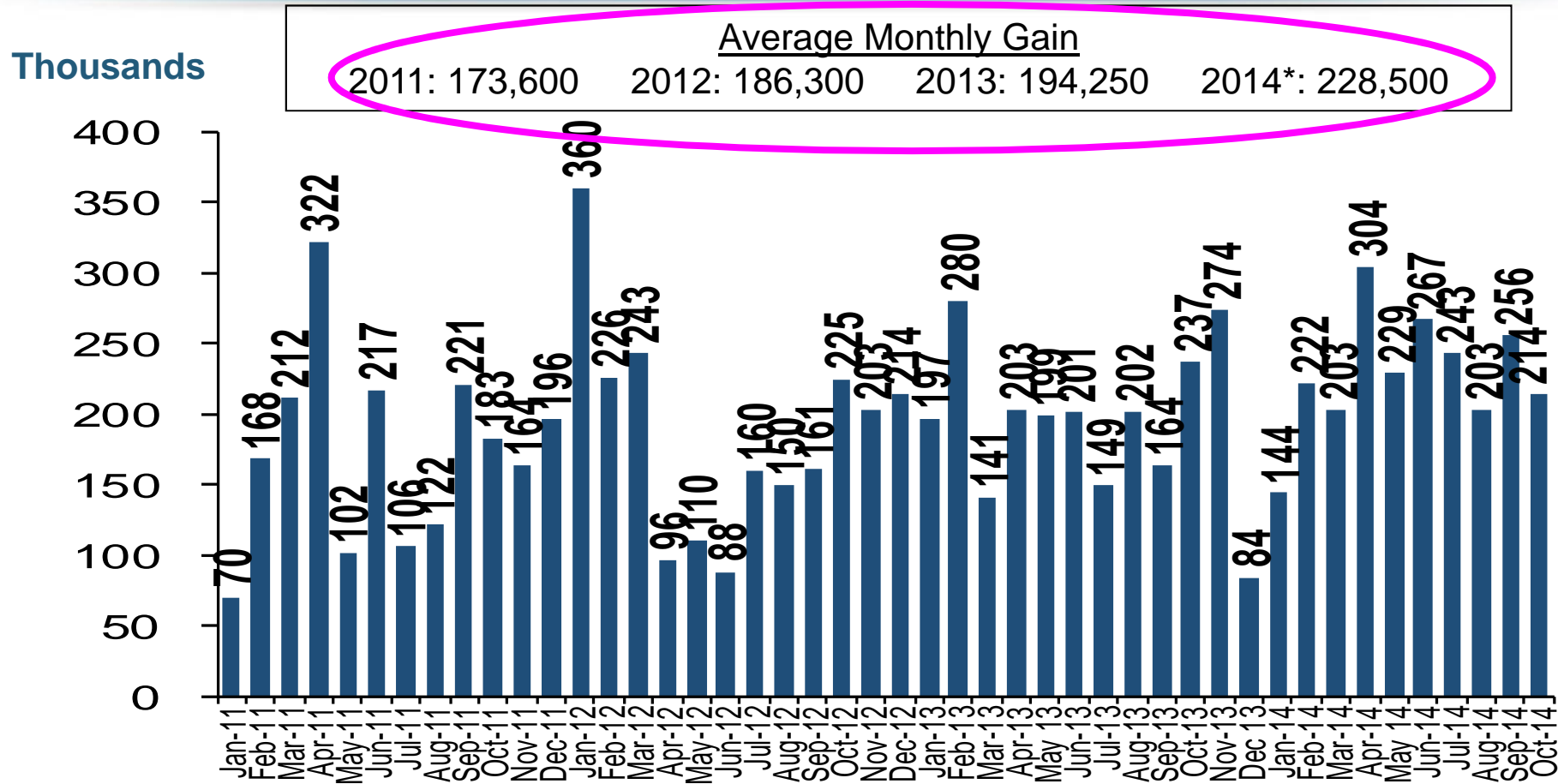
Percent Change in Real GDP by State, Fourth Quarter of 2013

Percent Change in Real GDP by State, 2013:III–2013:IV



U.S. Bureau of Economic Analysis

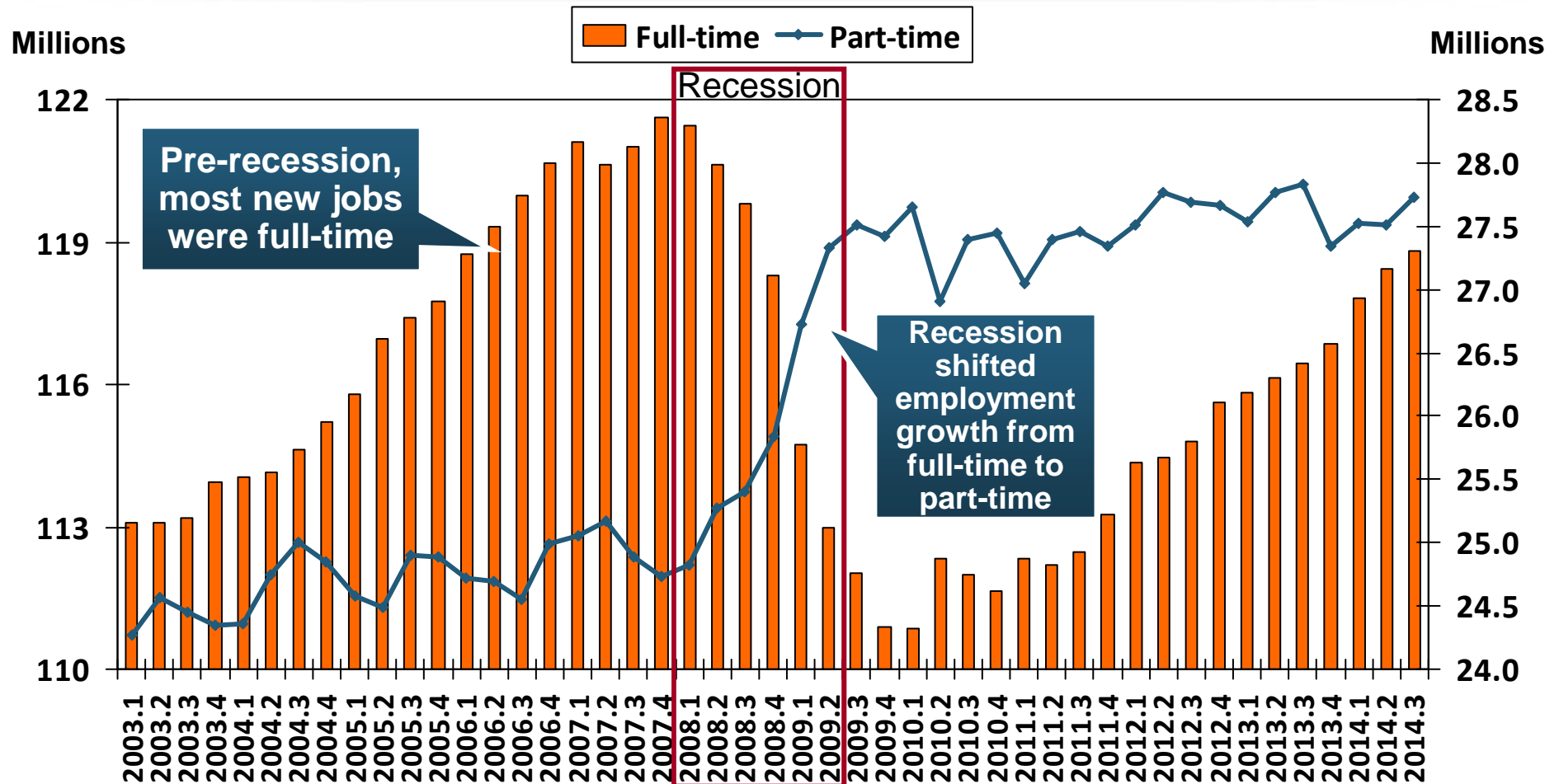
Monthly Change in Nonfarm Employment, 2011 - 2014



The pace of job growth varies considerably from month to month.

*Seasonally adjusted. Oct 2014 and Sept 2014 are preliminary data. Monthly gain for 2014 is average for January-October
 Sources: US Bureau of Labor Statistics; Insurance Information Institute

Full-time vs. Part-time Employment, Quarterly, 2003-2014: WC Implications



The Great Recession shifted employment from full-time to part-time, and the recovery to date hasn't changed that. Full-time employment is still 2.8 million below its pre-recession peak, but part-time recently reached a new peak.

Data are seasonally-adjusted. Sources: US Bureau of Labor Statistics, US Department of Labor; Insurance Information Institute.

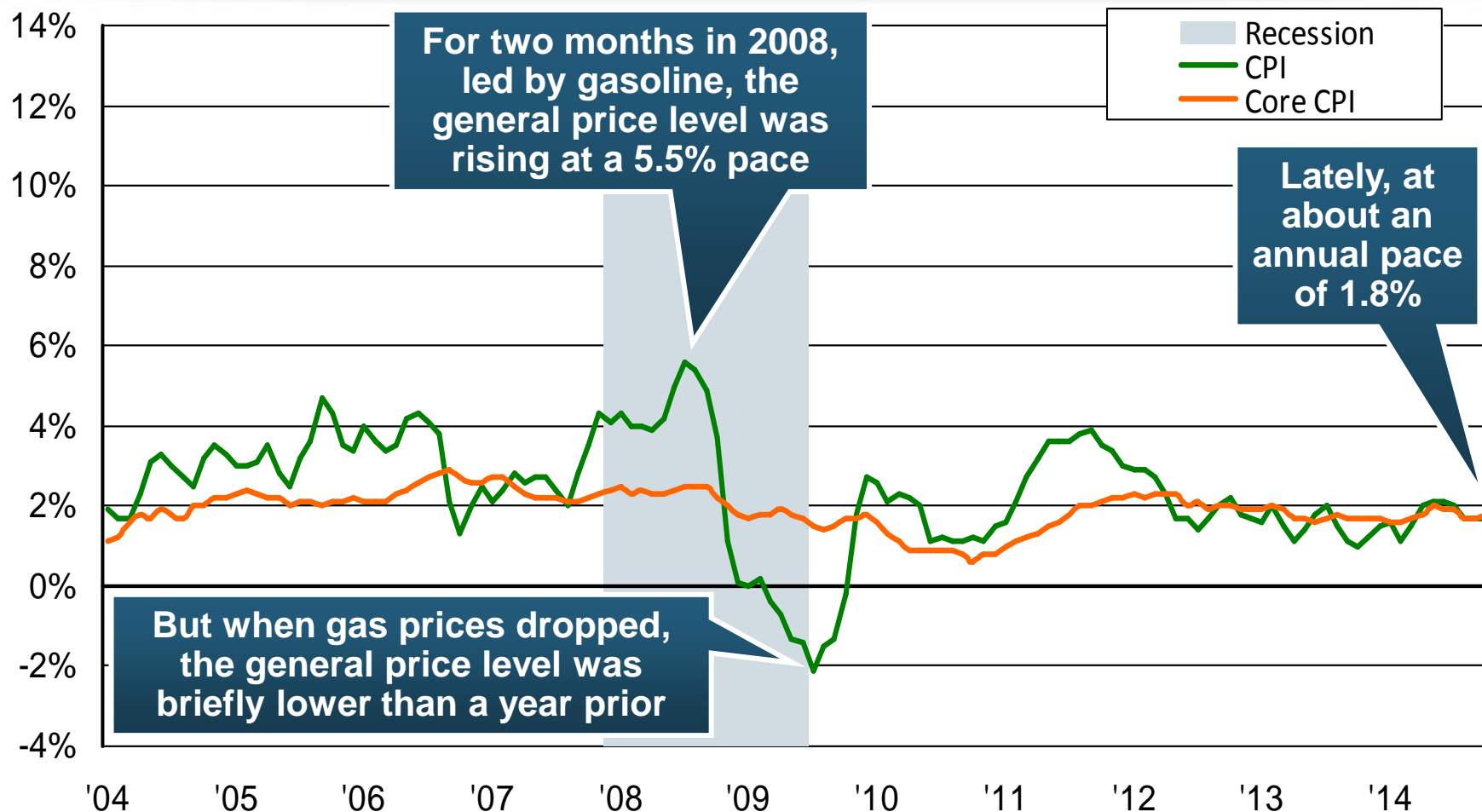
Labor Market Slack: Elevated Number of Involuntary Part-time Workers





Inflation & Claims

Change* in the Consumer Price Index, 2004–2014

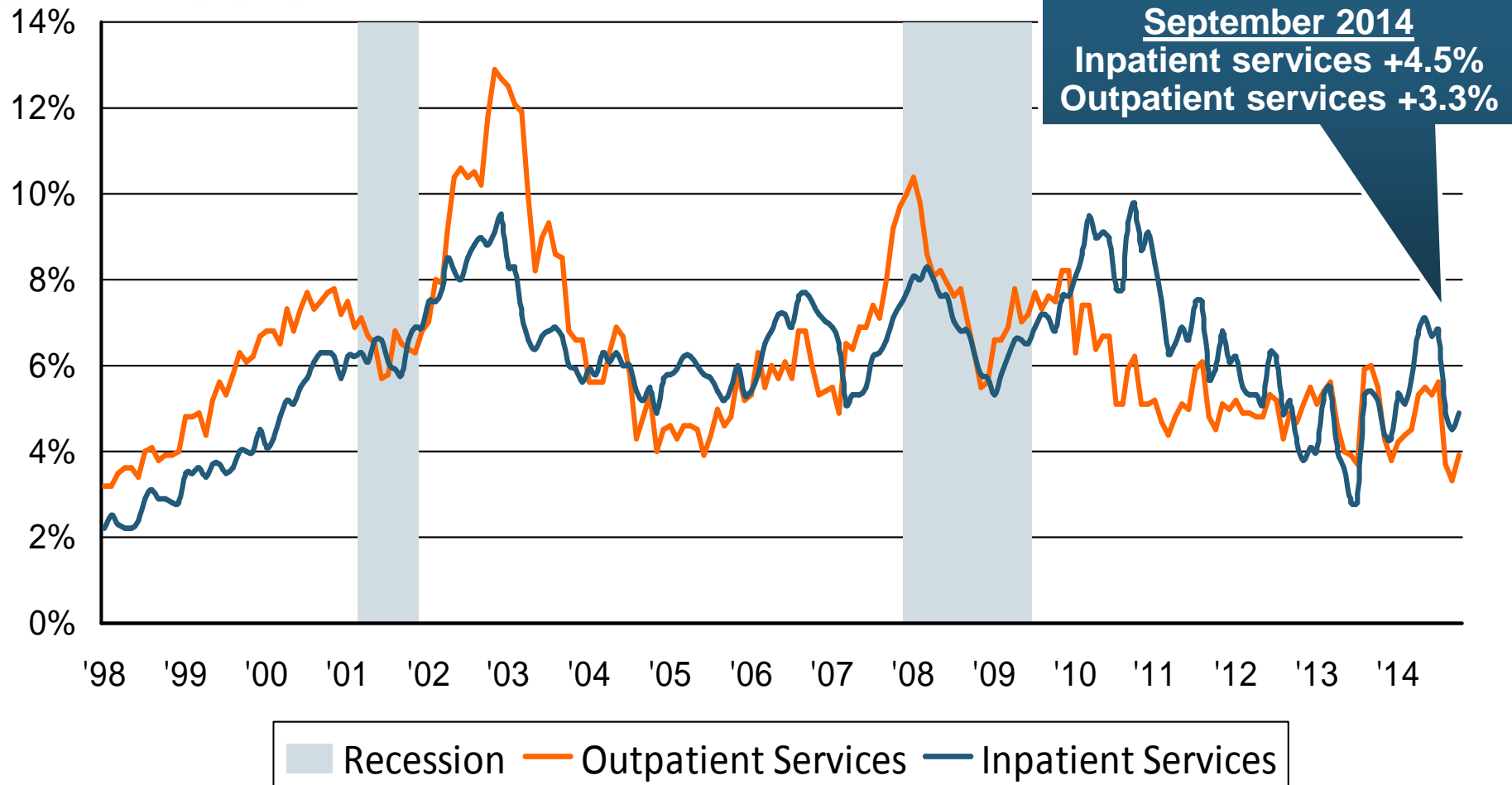


Over the last decade, prices generally rose about 2% per year.

*Monthly, year-over-year, through October 2014. Not seasonally adjusted.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Prices for Hospital Services: 12-Month Change,* 1998–2014



Prices for Hospital Services have risen at an annual rate of 4% or more for the last 15 years, while the general price level rose by 2%/year.

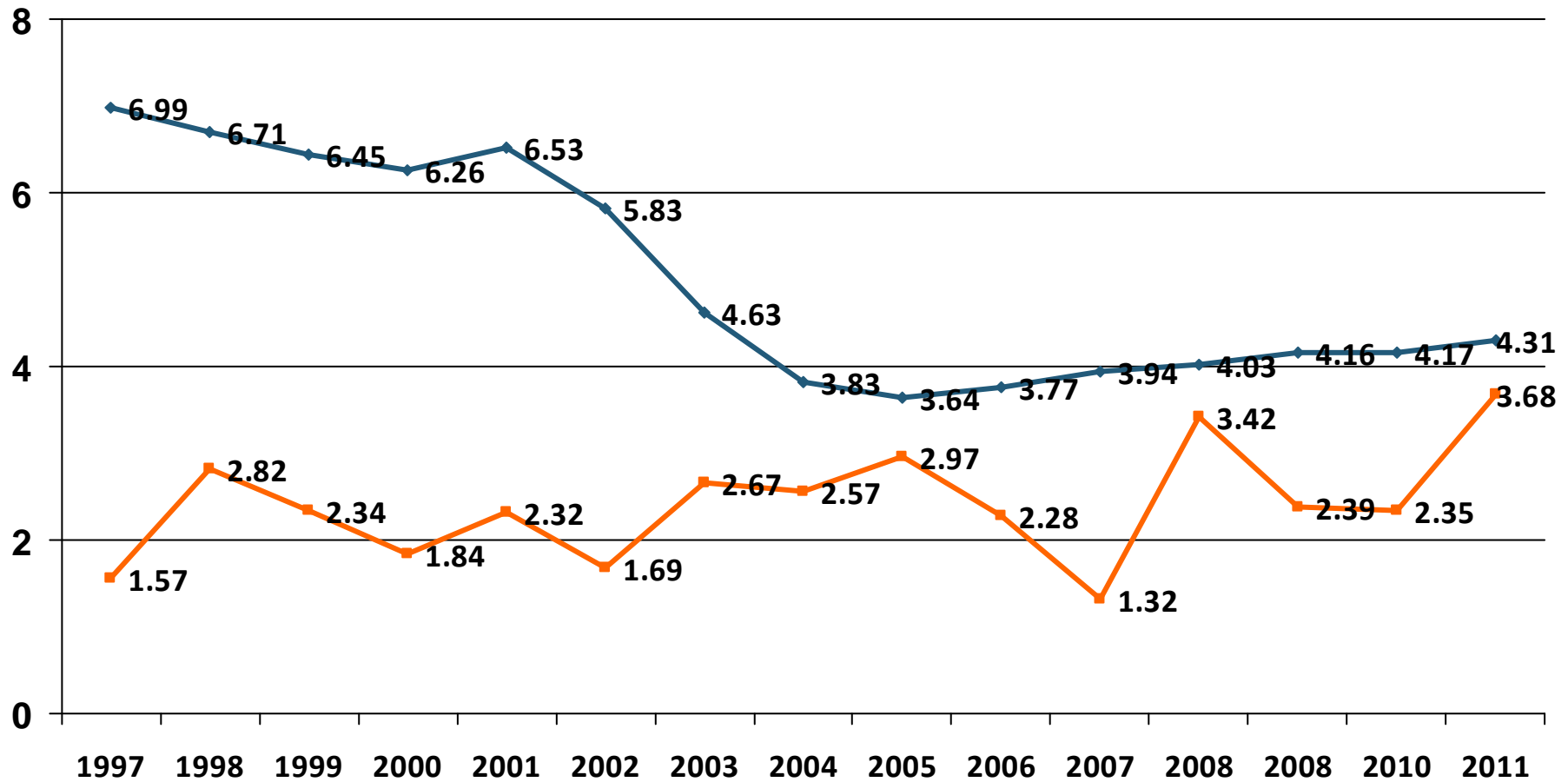
*Percentage change from same month in prior year; through October 2014; seasonally adjusted
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

P/C Industry Homeowners Claim Frequency, US, 1997-2011



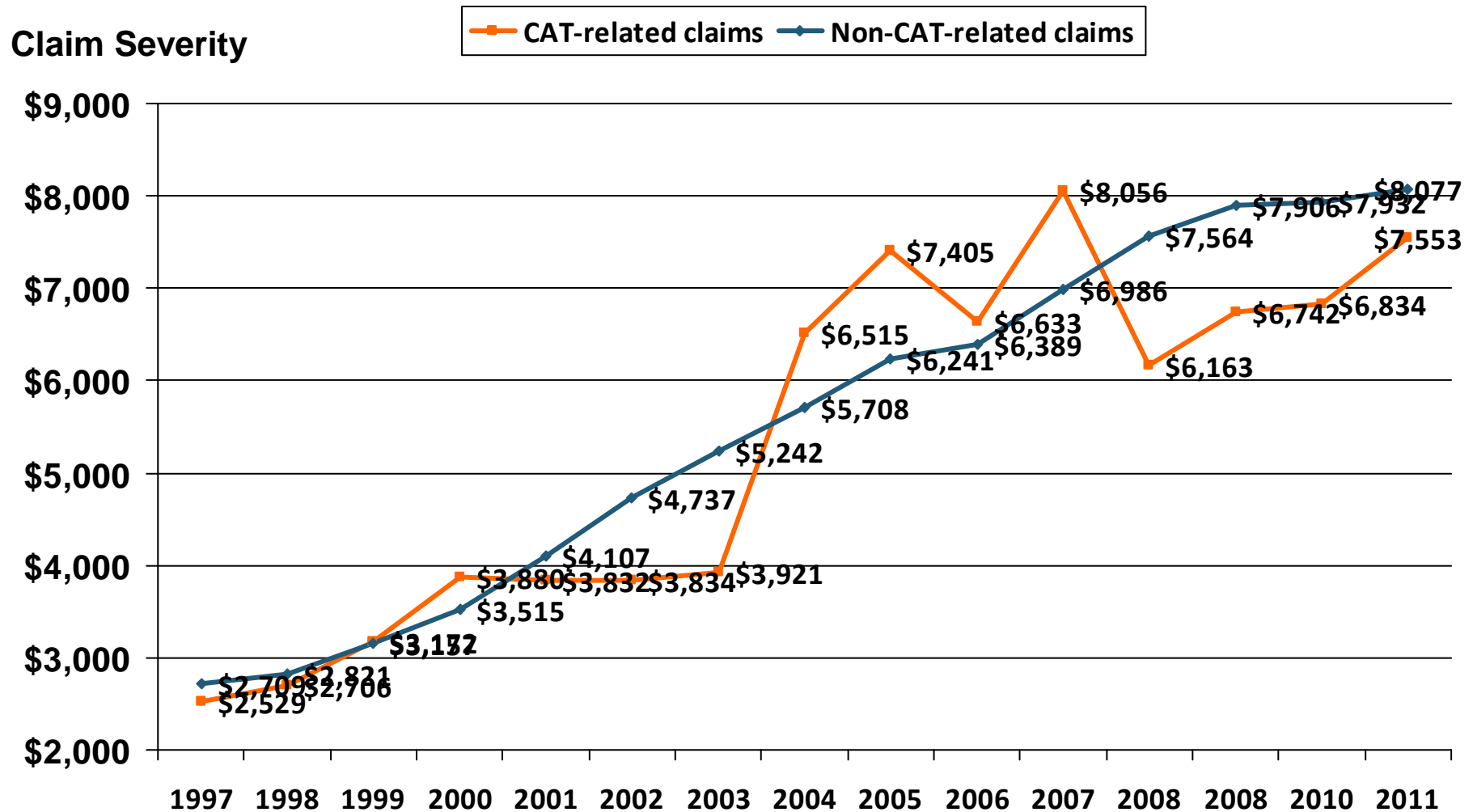
Claims Paid per 100 Exposures

—■ CAT-related claims
 —◆ Non-CAT-related claims



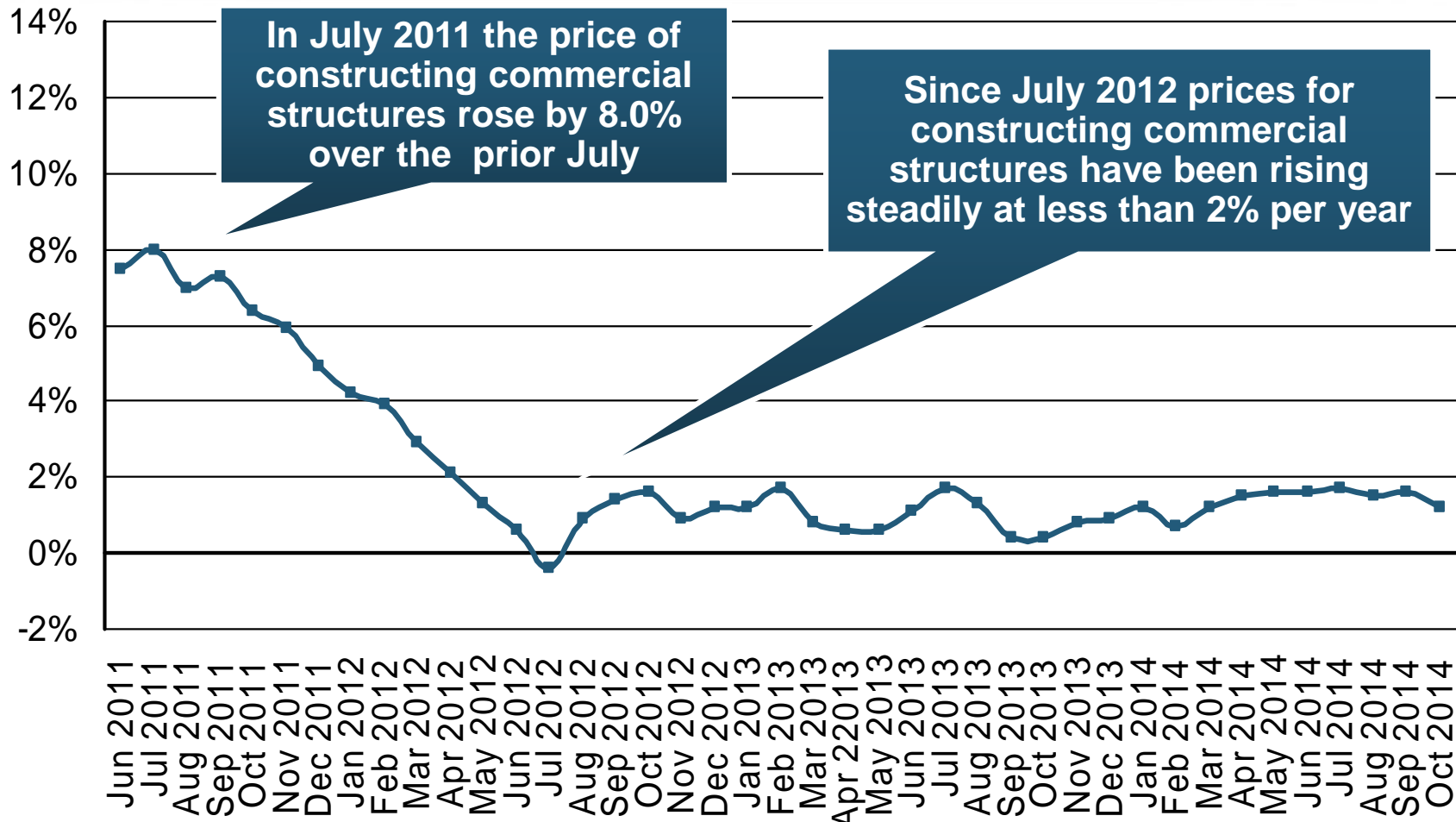
Sources: Insurance Research Council, "Trends in Homeowners Insurance Claims," p.29; Insurance Information Institute

P/C Industry Homeowners Claim Severity, US, 1997-2011



Sources: Insurance Research Council, "Trends in Homeowners Insurance Claims," p.29; Insurance Information Institute

Y-o-Y Change in Price Index for Commercial Structures, Monthly 2011–2014



This is a new price series, but it shows sharp differences in price increase rates within just a year or two.

Through October 2014. Not seasonally adjusted. July through October price changes are preliminary.
 Sources: US Bureau of Labor Statistics, Producer Price Index series PCUBNCS; Insurance Information Institutes.

A World Awash in Capital

Too Much of a Good Thing?

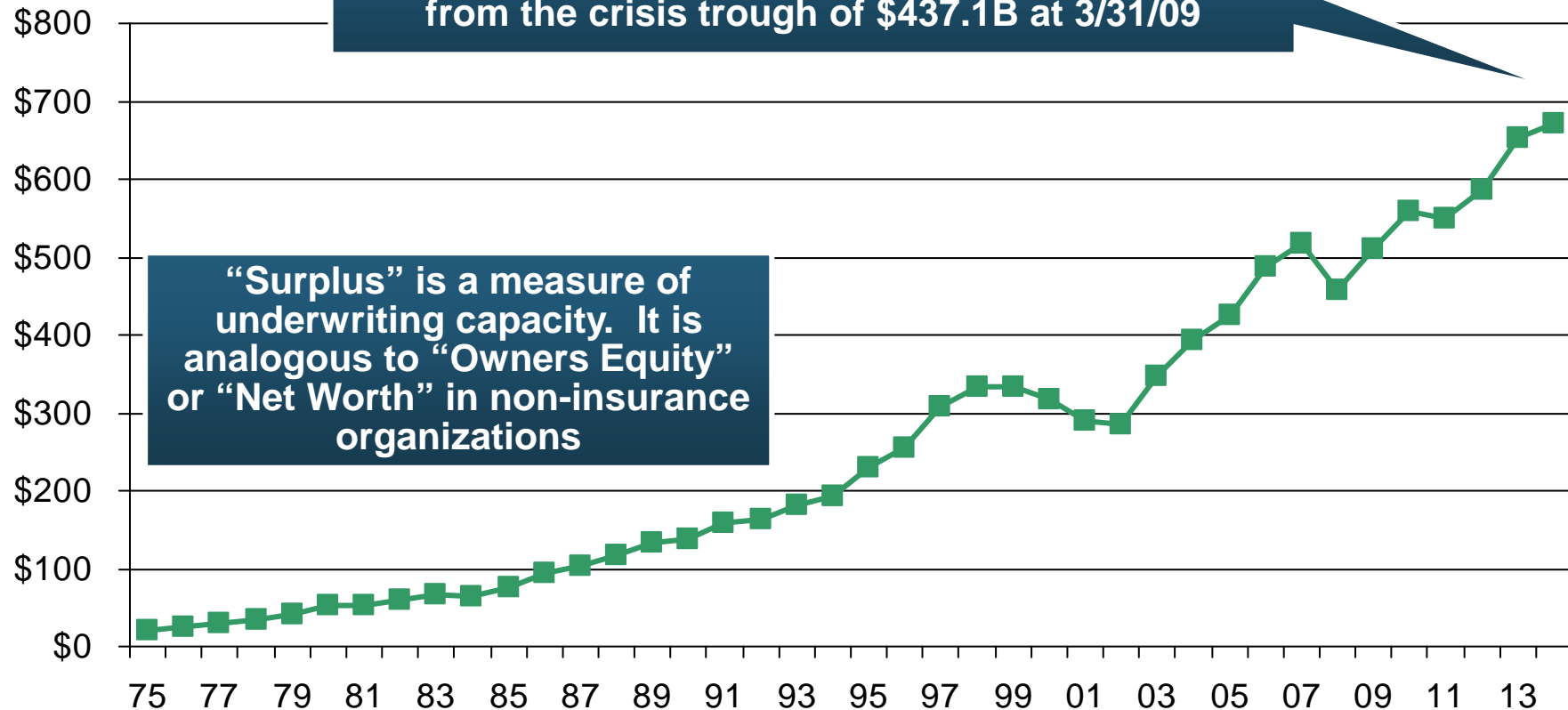
***The Global Glut of Capital
is Not Unique to (Re)Insurance***

U.S. Policyholder Surplus: 1975–2014*



(\$ Billions)

Surplus as of 6/30/14 was a record \$671.6, up 2.8% from \$653.3 of 12/31/13, and up 53.6% (\$234.5B) from the crisis trough of \$437.1B at 3/31/09



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

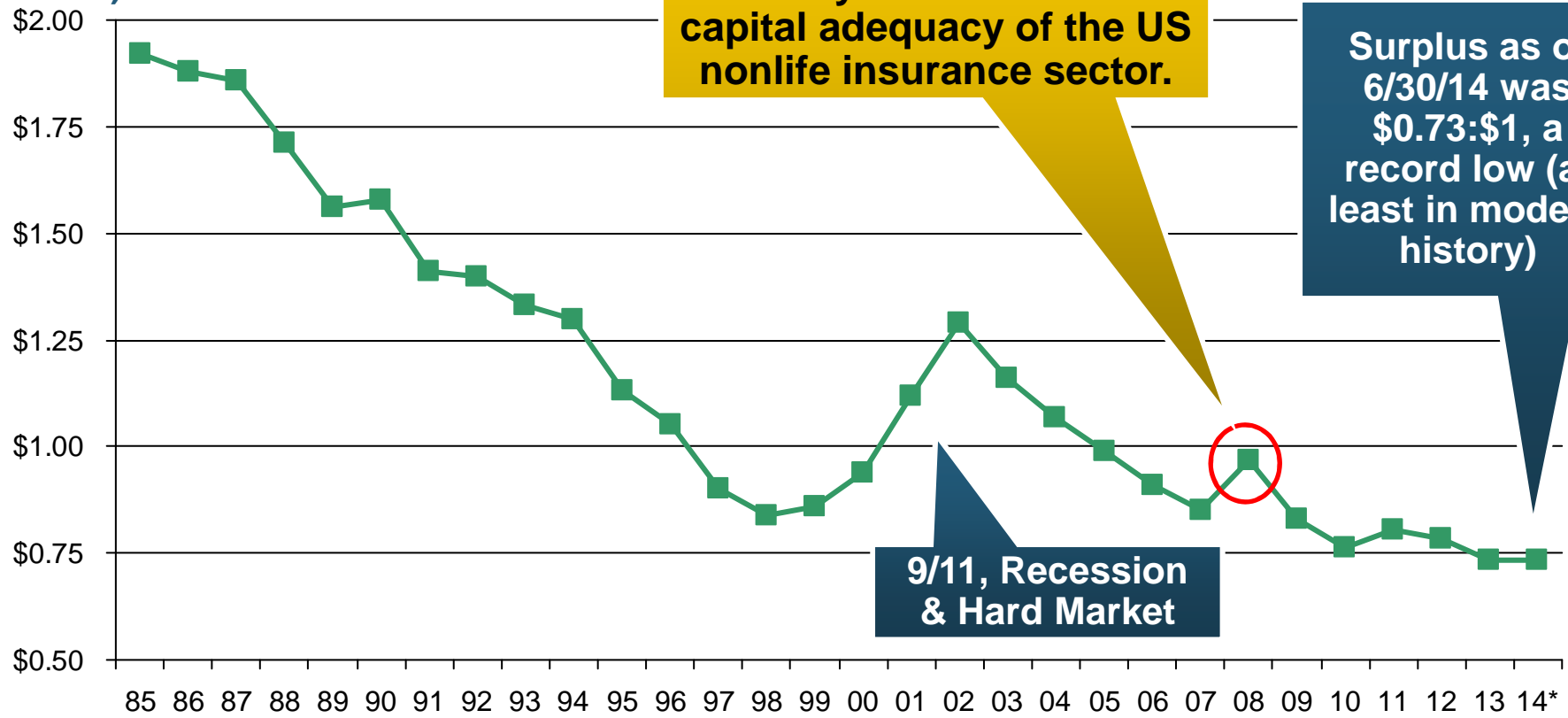
The Premium-to-Surplus Ratio Stood at \$0.73:\$1 as of 6/30/14, a Near Record Low (at Least in Recent History)

* As of 6/30/14.

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

Premium-to-Surplus Ratio: 1985–2014*

(Ratio of NWP
to PHS)



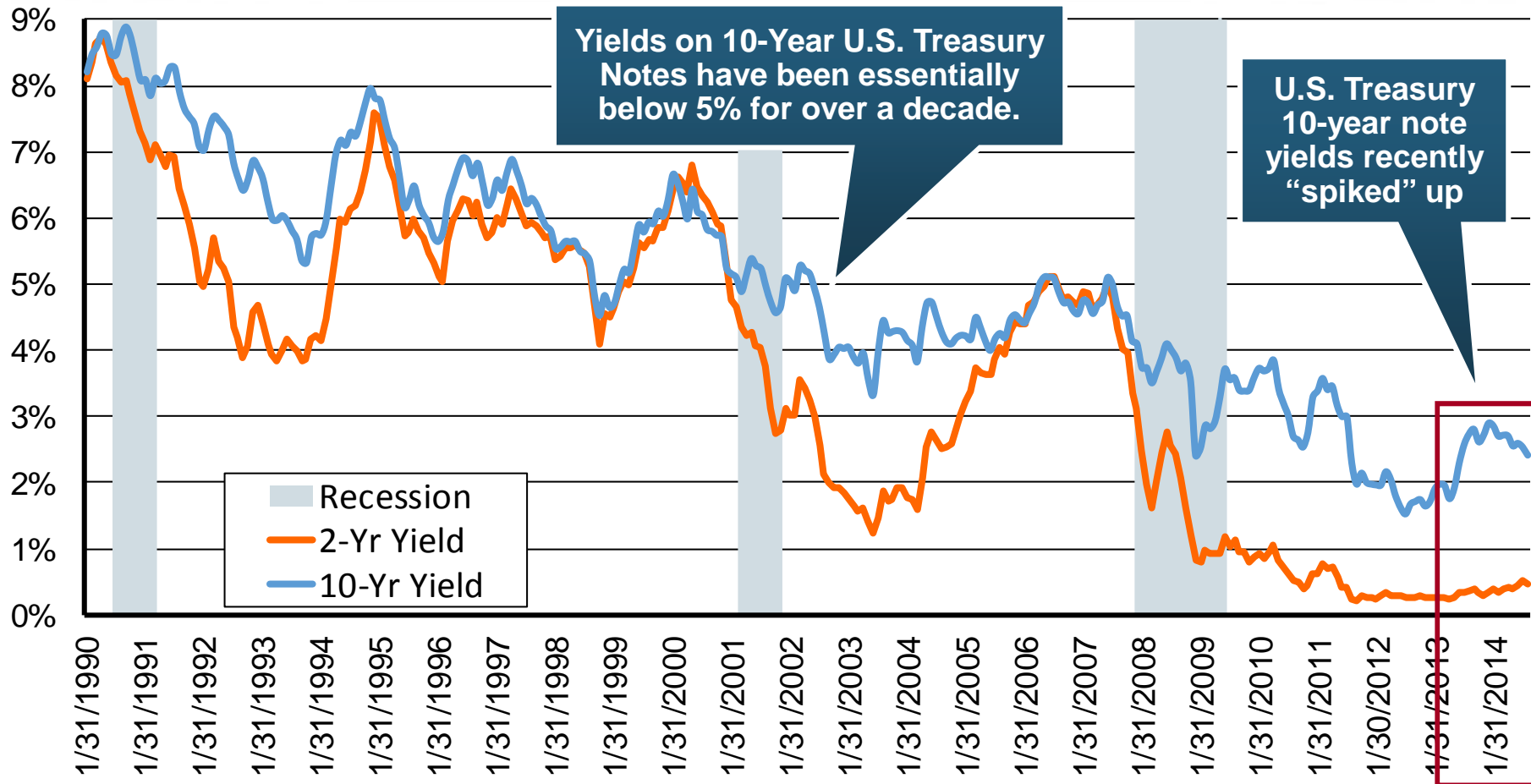
The larger surplus is in relation to premiums—the lower the P:S ratio—the greater is industry’s capacity to handle the risk it has accepted. The Premium-to-Surplus Ratio Stood at \$0.73:\$1 as of 6/30/14, a Record Low (at Least in Recent History).

* As of 6/30/14. Sources: A.M. Best, ISO, Insurance Information Institute.

A World of Low Yields

**Capital Will Seek Its Highest
(Risk-Adjusted) Return**

U.S. Treasury 2- and 10-Year Note Yields*: 1990–2014

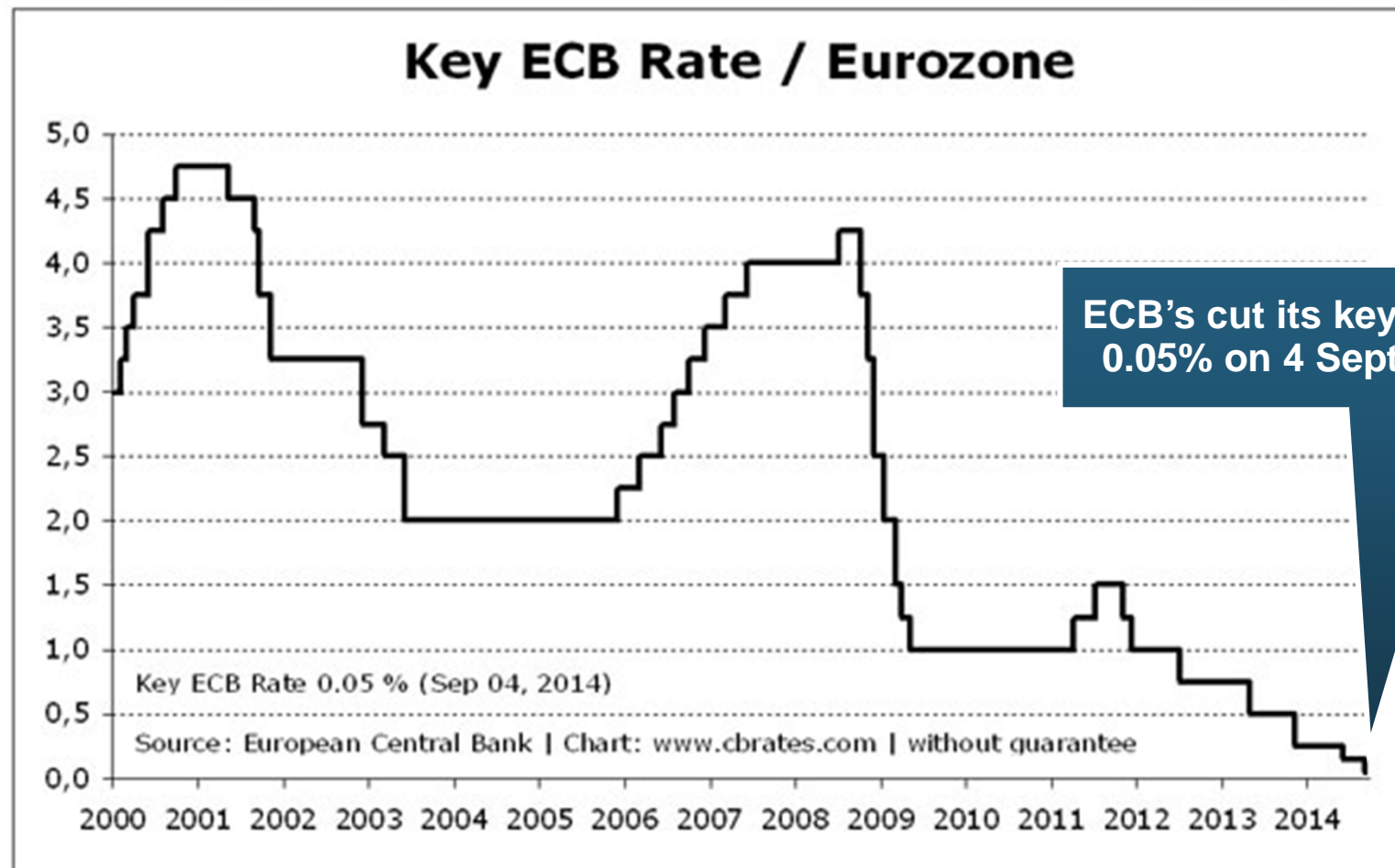


Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

*Monthly, constant maturity, nominal rates, through October 2014.

Sources: Federal Reserve Bank at <http://www.federalreserve.gov/releases/h15/data.htm>.
National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Key European Central Bank Interest Rates, 2000 - 2014



Interest Rates Have Been Slashed by Most Major Central Banks, Igniting a Global Quest for Yield. Reinsurance Is Just One of Many New Areas “Discovered” by Large Institutional Investors

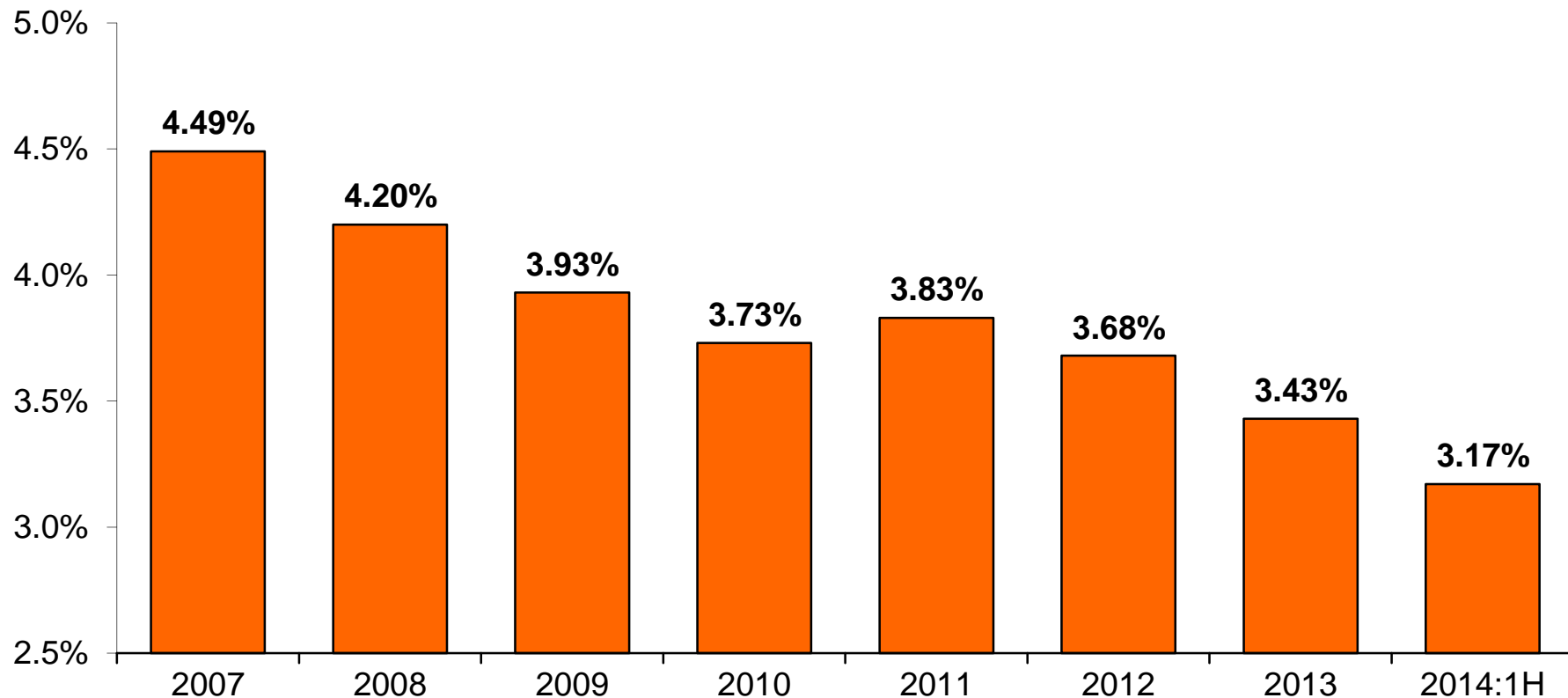
Source: European Central Bank from www.cbrates.com; Insurance Information Institute.

Industry Investments

**Investment Performance is a Key
Driver of Profitability**

***Depressed Yields Will Necessarily
Influence Underwriting & Pricing***

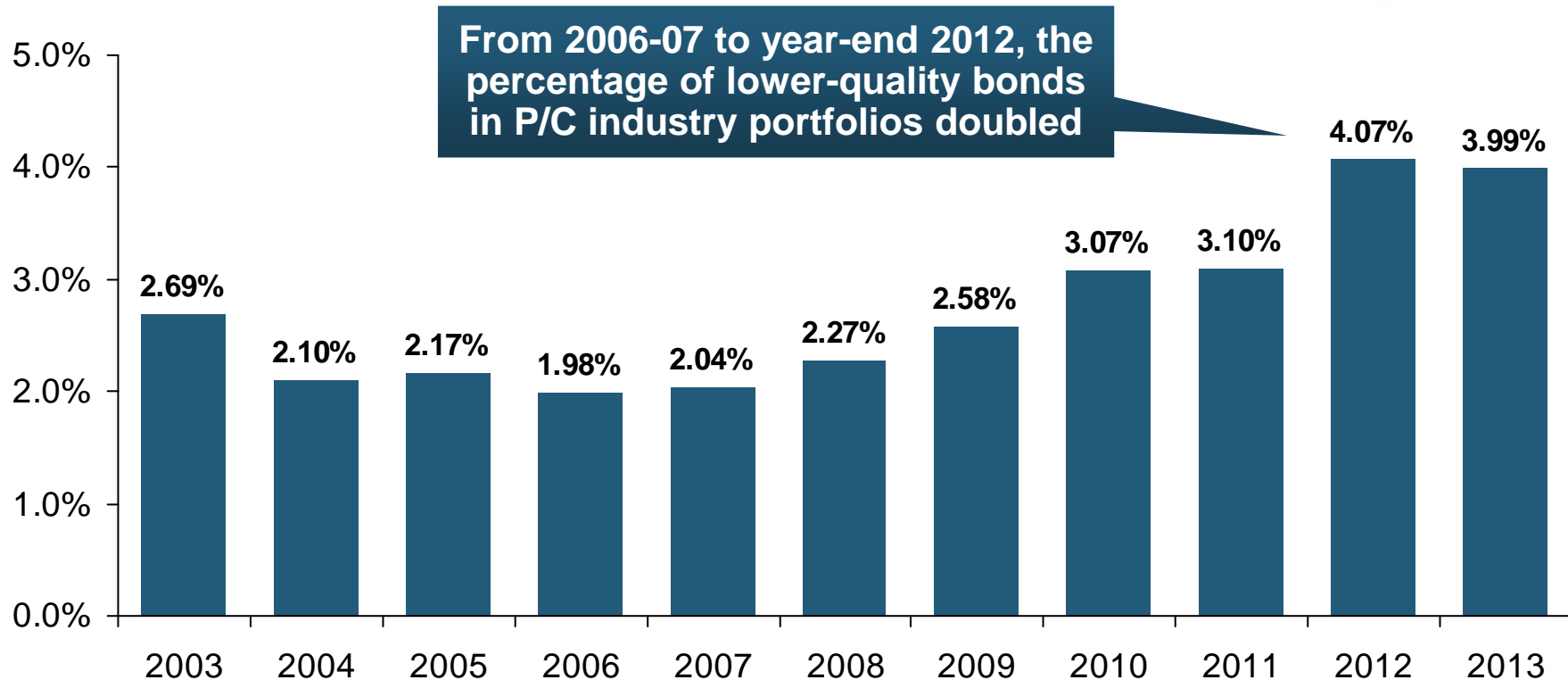
Net Yield on P/C Insurer Invested Assets, 2007-2014:1H



Since year-end 2007, P/C Insurer net yields dropped by 132 basis points. This downtrend is likely to continue as older, higher-yielding bonds mature and are replaced by lower-yielding ones.

Sources: NAIC, via SNL Financial; I.I.I.

Bonds Rated NAIC Quality Category 3-6 as a Percent of Total Bonds, 2003–2013



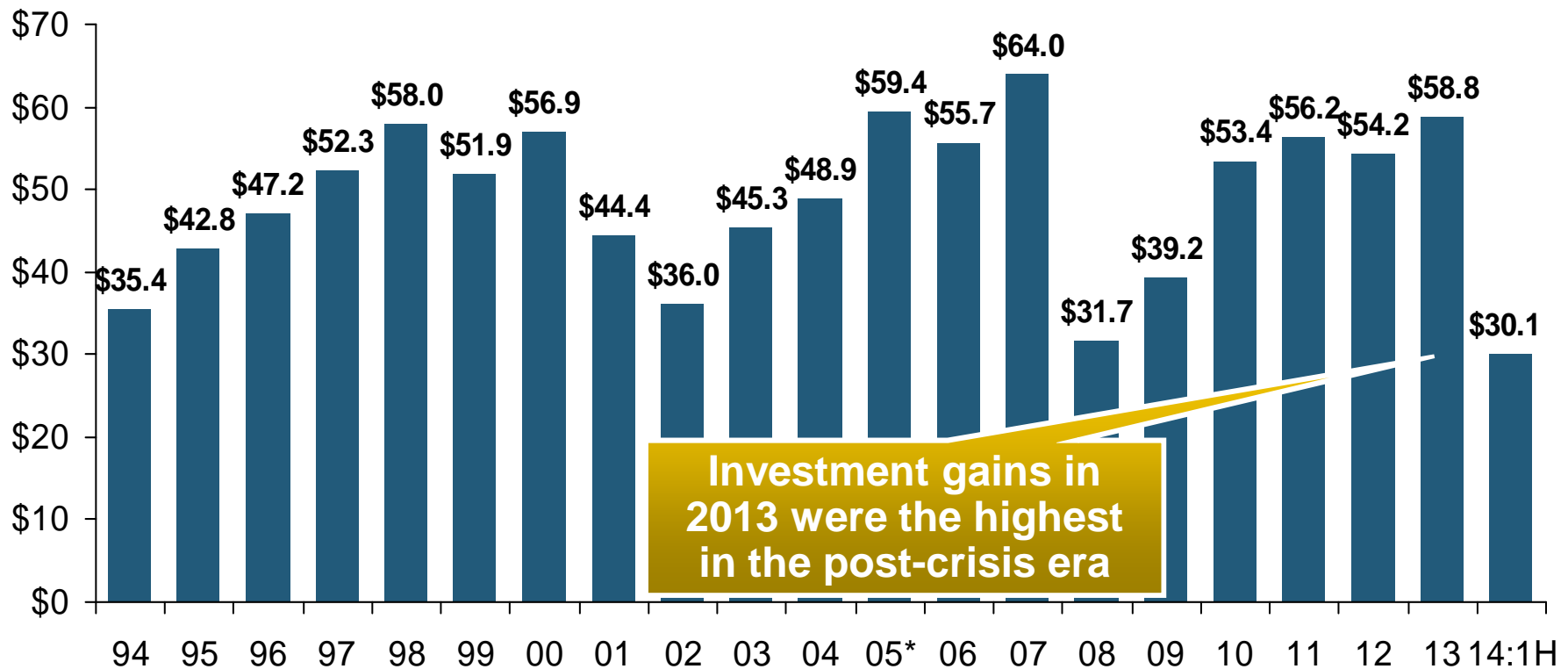
There are many ways to capture higher yields on bond portfolios. One is to accept greater risk, as measured by NAIC bond ratings. The ratings range from 1 to 6, with the highest quality rated 1. Even in 2012-13, over 95% of the industry's bonds were rated 1 or 2.

Sources: SNL Financial; Insurance Information Institute.

Property/Casualty Insurance Industry Investment Gain: 1994–2014:1H¹



\$ Billions



Investment gains in 2013 were the highest in the post-crisis era

Low interest rates in 2013 caused investment income to keep falling but realized investment gains were up sharply. The financial crisis caused investment gains to fall by 50% in 2008.

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.

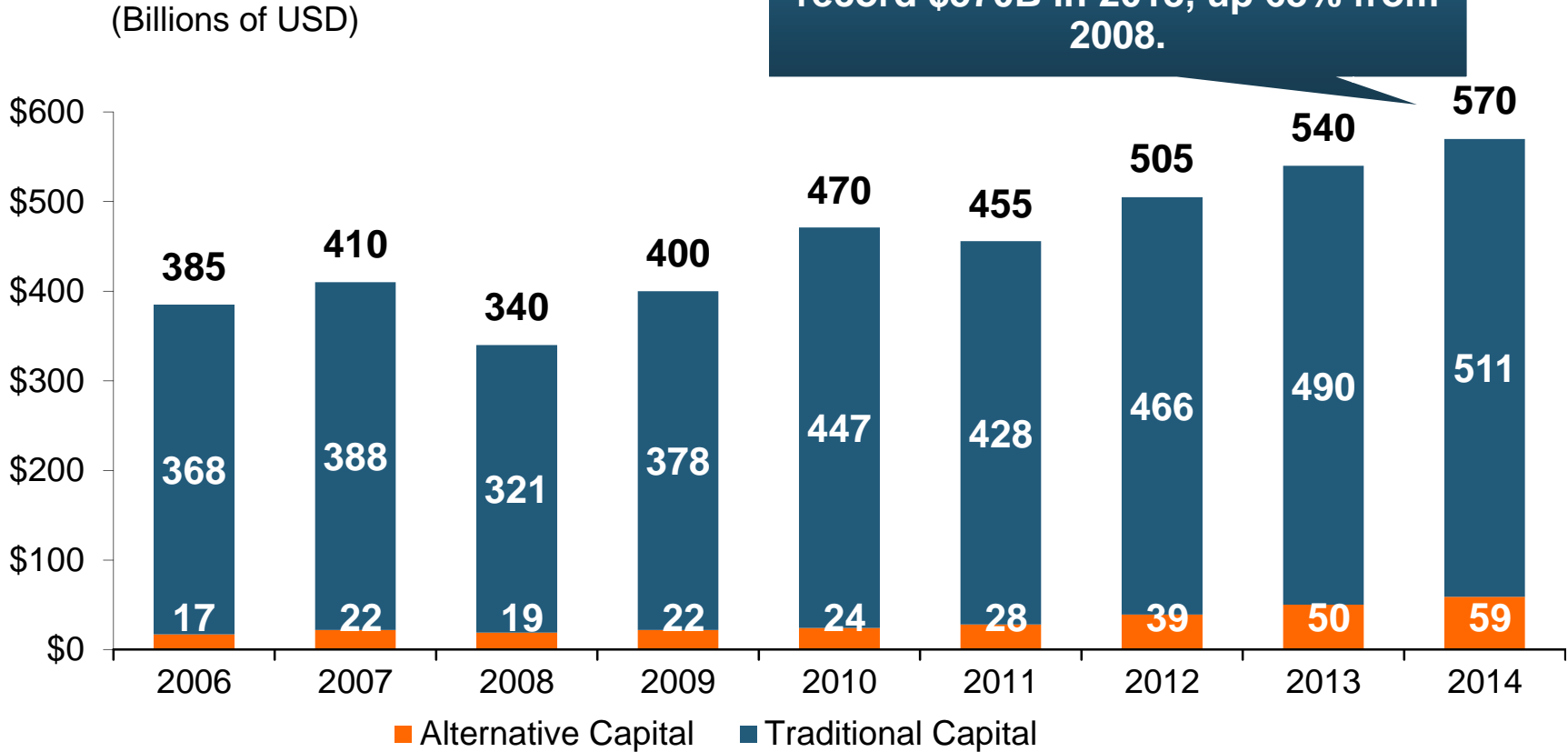
Alternative Capital in Global Reinsurance Markets

**The Hunt for Yield
Pushed Institutional Investors
Into New Areas
—(Re)Insurance Being One**

Global Reinsurance Capital (Traditional and Alternative), 2006 - 2014



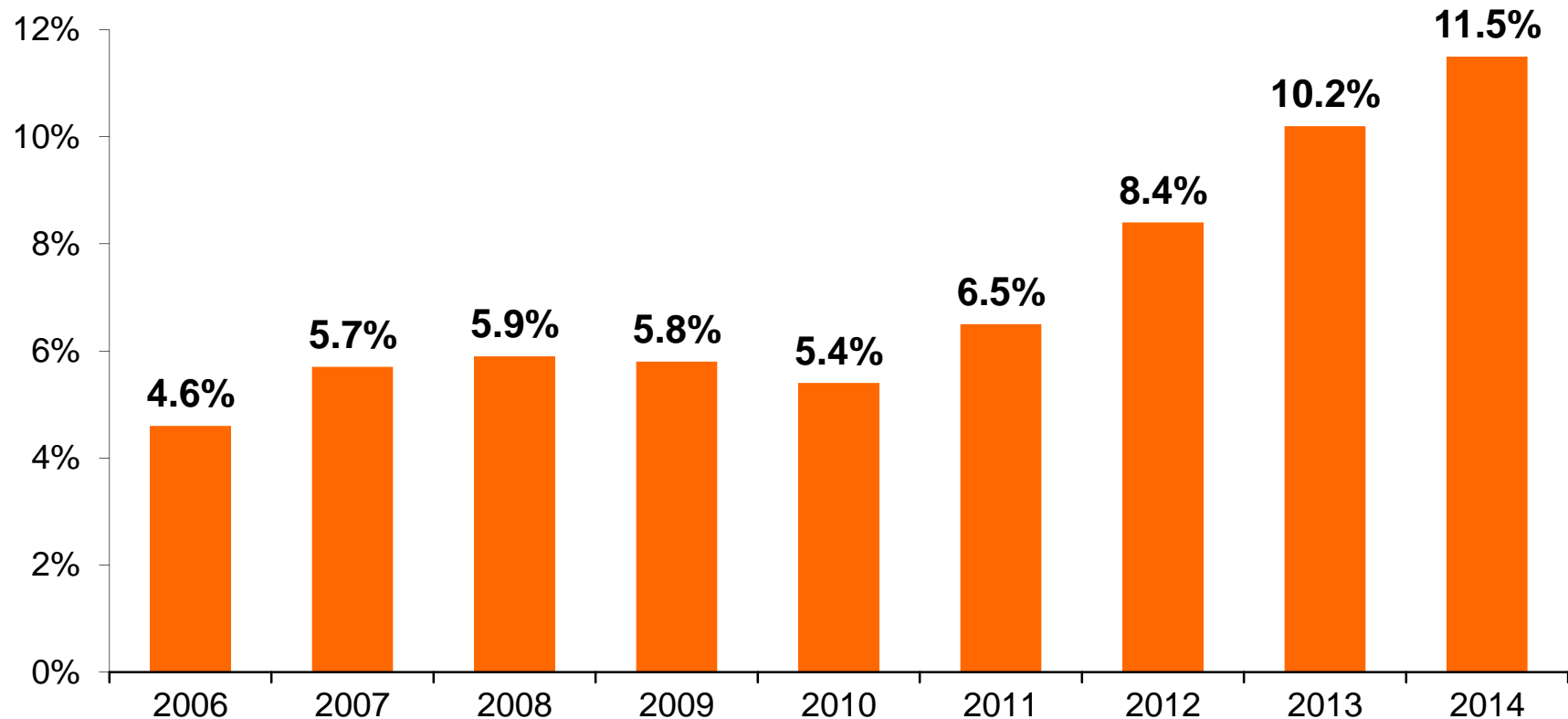
Total reinsurance capital reached a record \$570B in 2013, up 68% from 2008.



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.

Global Reinsurance Capital: Share in Alternatives, 2006 - 2014

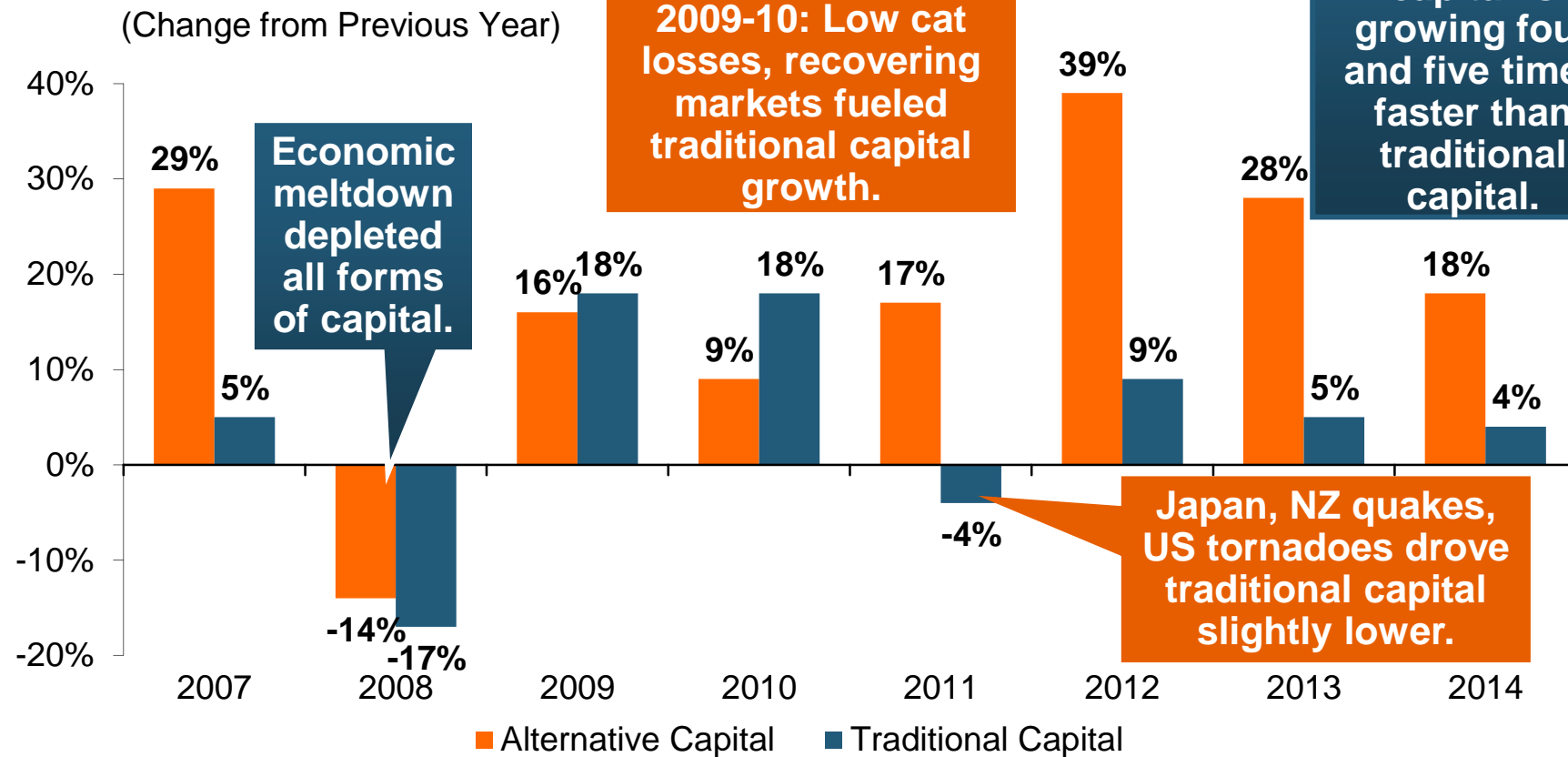


Alternative Capital's Share of Global Reinsurance Capital Has More Than Doubled Since 2010.

2014 data is as of June 30, 2014.

Source: Aon Benfield Analytics; Insurance Information Institute.

Growth in Traditional and Alternative Capital, 2007-2014



Post 2011, alternative capital is growing four and five times faster than traditional capital.

2009-10: Low cat losses, recovering markets fueled traditional capital growth.

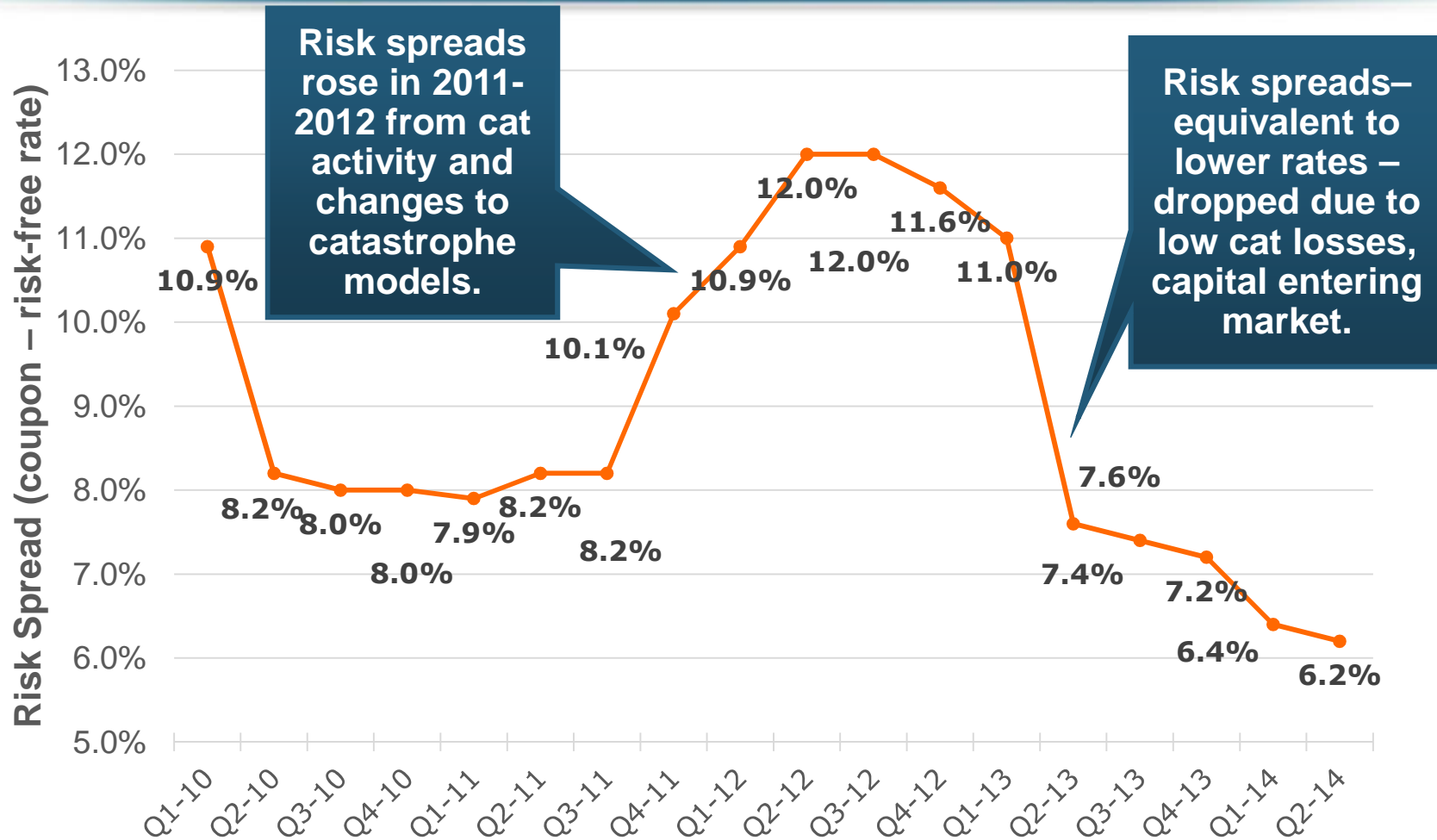
Economic meltdown depleted all forms of capital.

Japan, NZ quakes, US tornadoes drove traditional capital slightly lower.

Alternative capital has grown 247% since 2006, vs. 39% growth in traditional capital.

2014 reflects growth through June 30 from prior year end.
 Source: Aon Benfield Analytics; Insurance Information Institute.

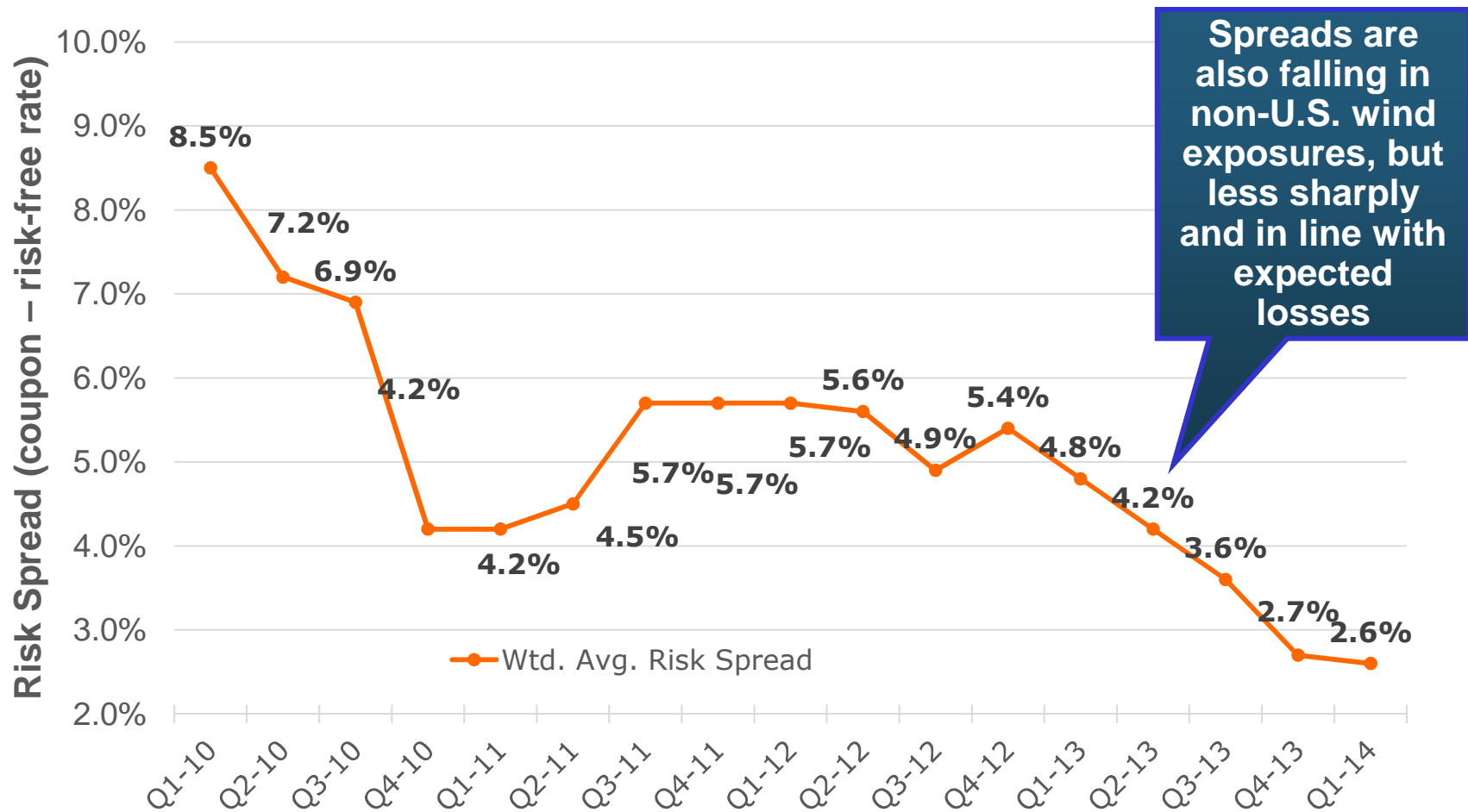
U.S. Wind-Exposed Risk Premium* 2010:Q1 to 2014: Q1



* Trailing 12-month average

SOURCE: Willis Capital Markets, Insurance Information Institute.

Non-U.S. Wind-Exposed Risk Premium* 2010:Q1-2014: Q1



* Trailing 12-month average.

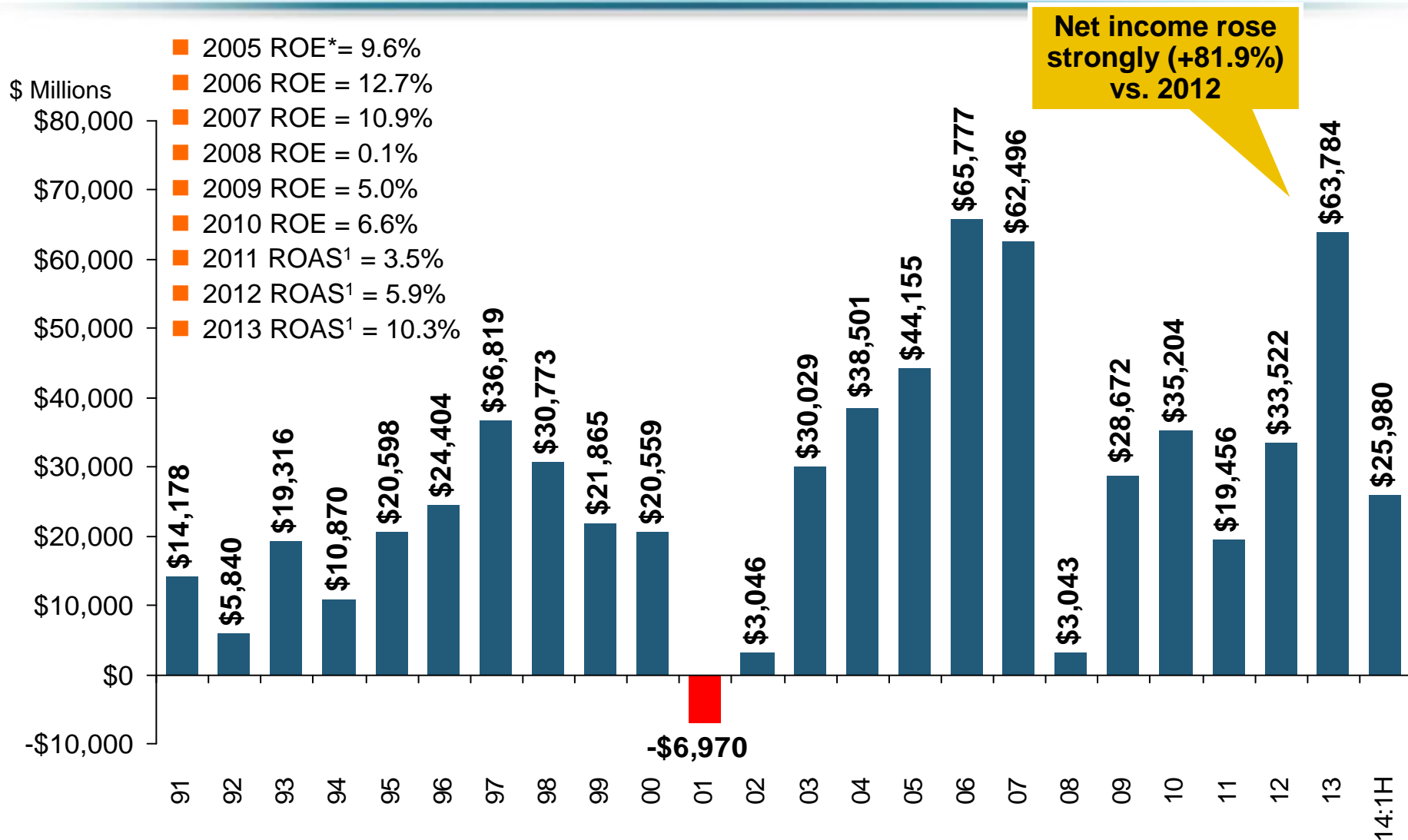
SOURCE: Willis Capital Markets, Insurance Information Institute.

What Is Happening to Insurer Profitability?

**Has Capital Accumulation
Affected Profitability?**

***Déjà Vu: Does History Suggest Cycles
or Super-Cycles in Insurance?***

P/C Industry Net Income After Taxes 1991–2014:1H

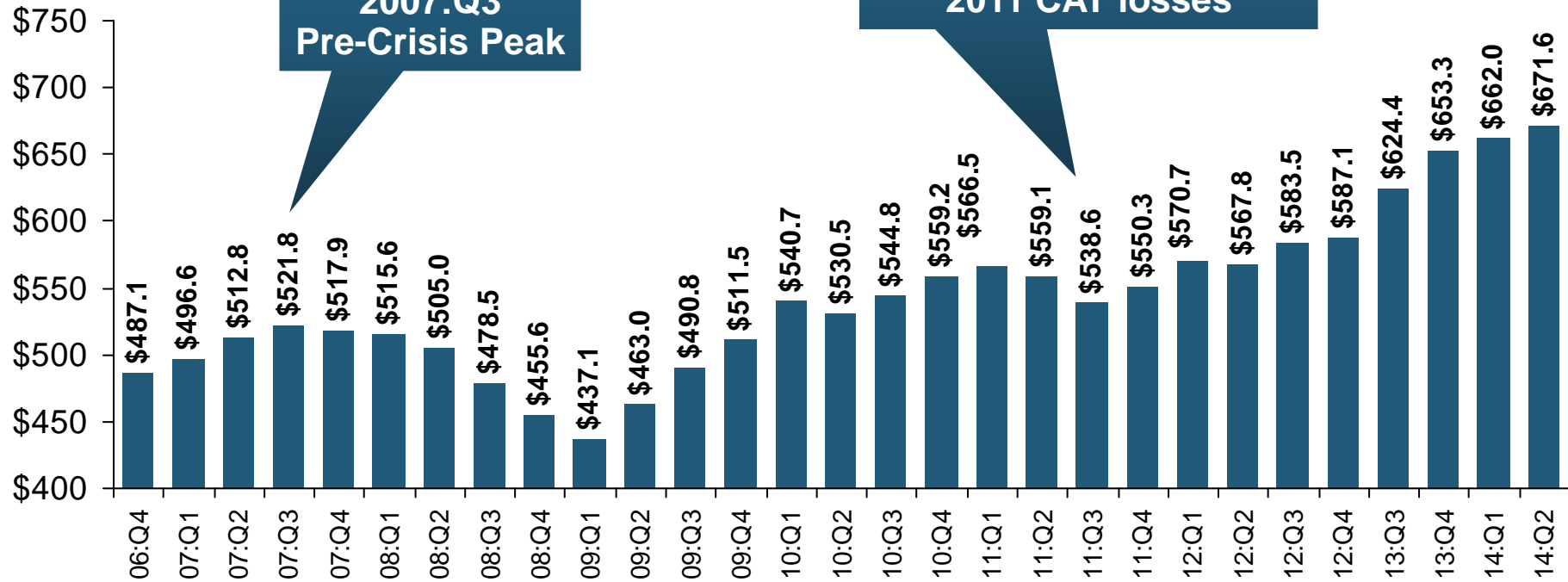


• ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 8.9% ROAS through 2013:Q3, 6.2% ROAS in 2012, 4.7% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

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

Policyholder Surplus, 2006:Q4–2014:1H

(\$ Billions)

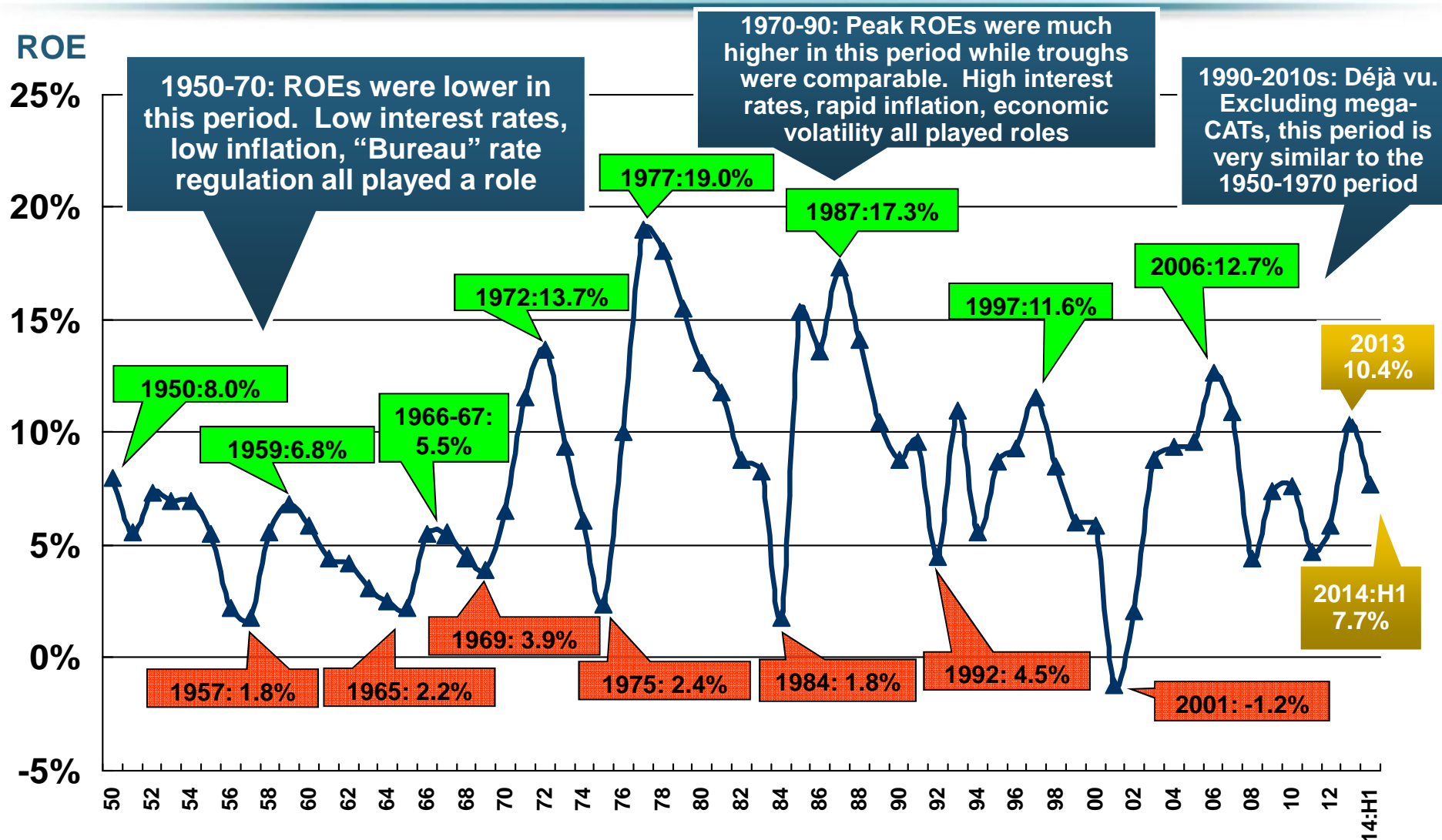


The industry now has \$1 of surplus for every \$0.73 of NPW, the strongest claims-paying status in its history.

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 .

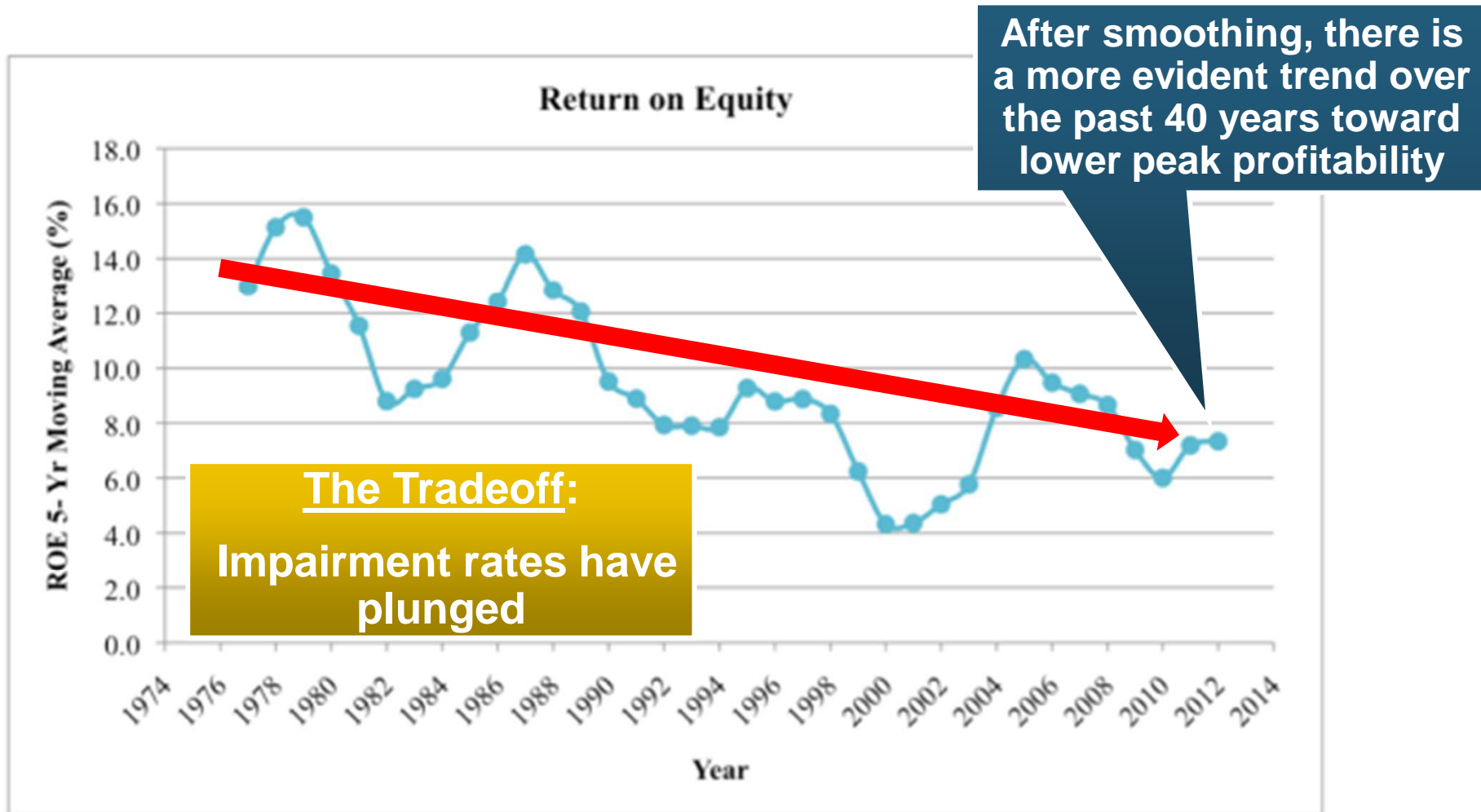
The P/C insurance industry entered the second half of 2014 in very strong financial shape.

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



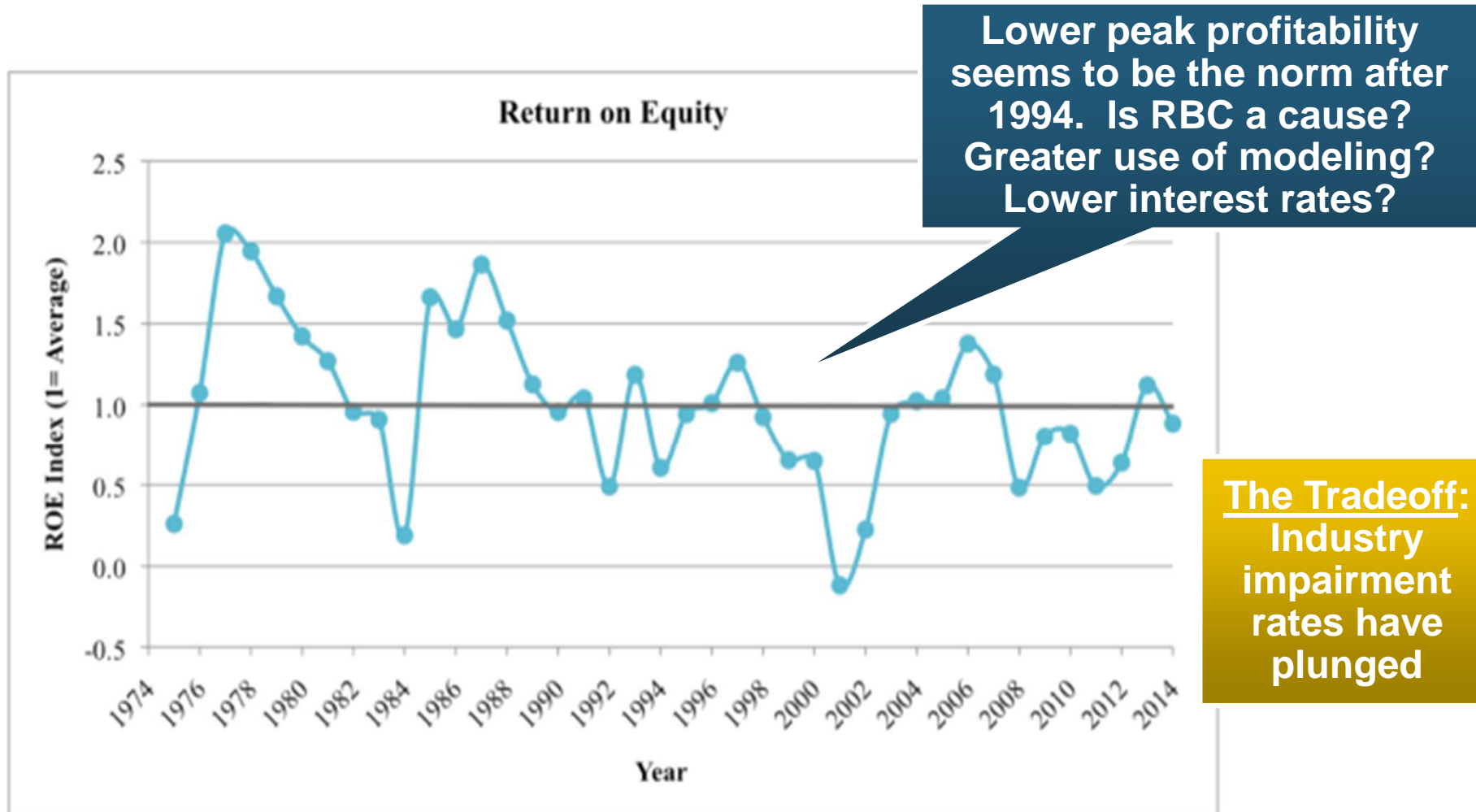
*Profitability = P/C insurer ROEs. 2011-14 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers. 2014 figure is through Q2.
 Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

P/C Insurance ROE as 5-Year Moving Average



Source: Jessica Weinkle, *Insurance Journal*, "An Average Perspective Based Insurance Profitability Cycles," October 6, 2014, based on I.I.I. data, <http://www.insurancejournal.com/magazines/closingquote/2014/10/06/342096.htm>.

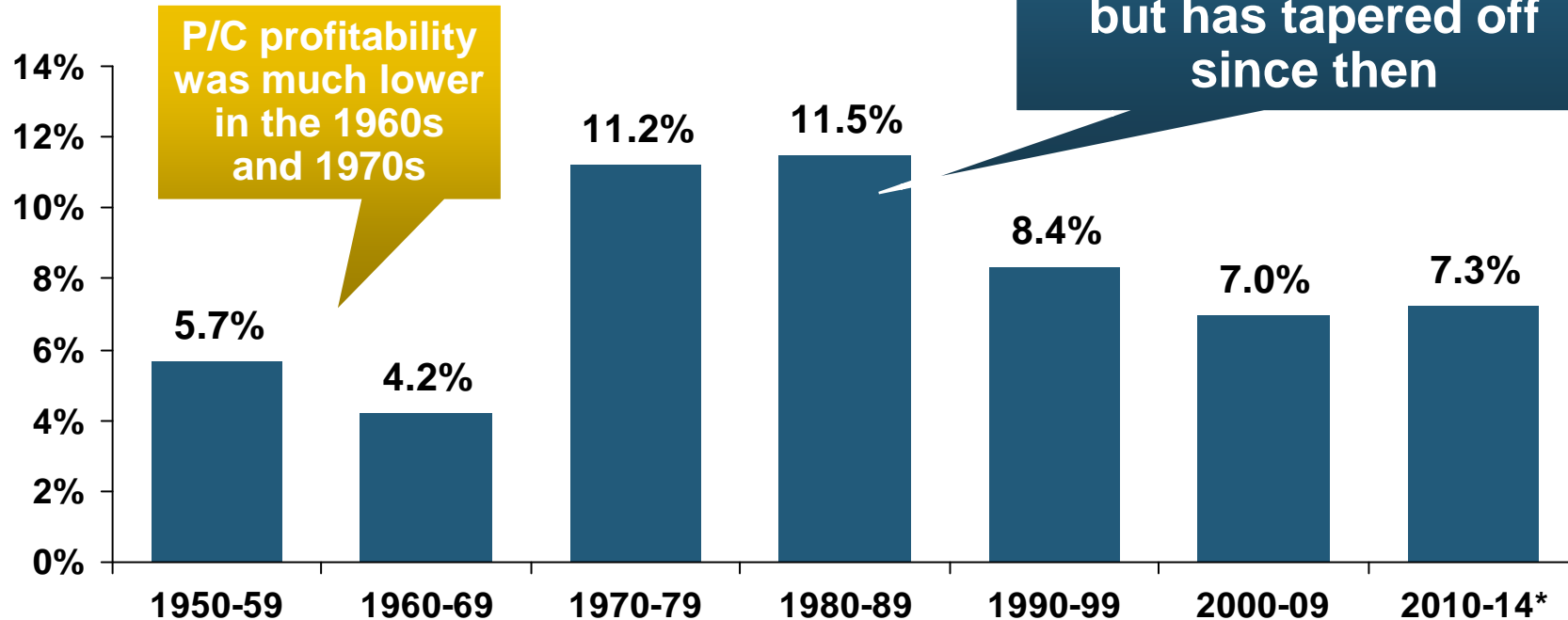
P/C Insurance ROE Index (1974-2014:Q1 = 100)



Source: Jessica Weinkle, *Insurance Journal*, "An Average Perspective Based Insurance Profitability Cycles," October 6, 2014, based on I.I.I. data, <http://www.insurancejournal.com/magazines/closingquote/2014/10/06/342096.htm>.

Average ROE for the P/C Insurance Industry by Decade, 1950s – 2010s

Average Annual Percent Change (%)



Profitability in the current low yield, low Inflation environment has declined since the highs of the 1970s and 1980s, but is above that of the 1950s and 1960s and the industry's impairment rates have dropped since the 1980s

BANK LESSON: Profitability, Capital and Systemically Important Banks

Safer but less profitable

Global systemically important banks*
Average:



Source: Bloomberg

*14 banks

Global Systemically Important bank Tier-1 capital ratios are up since the global financial crisis, but ROEs are lower

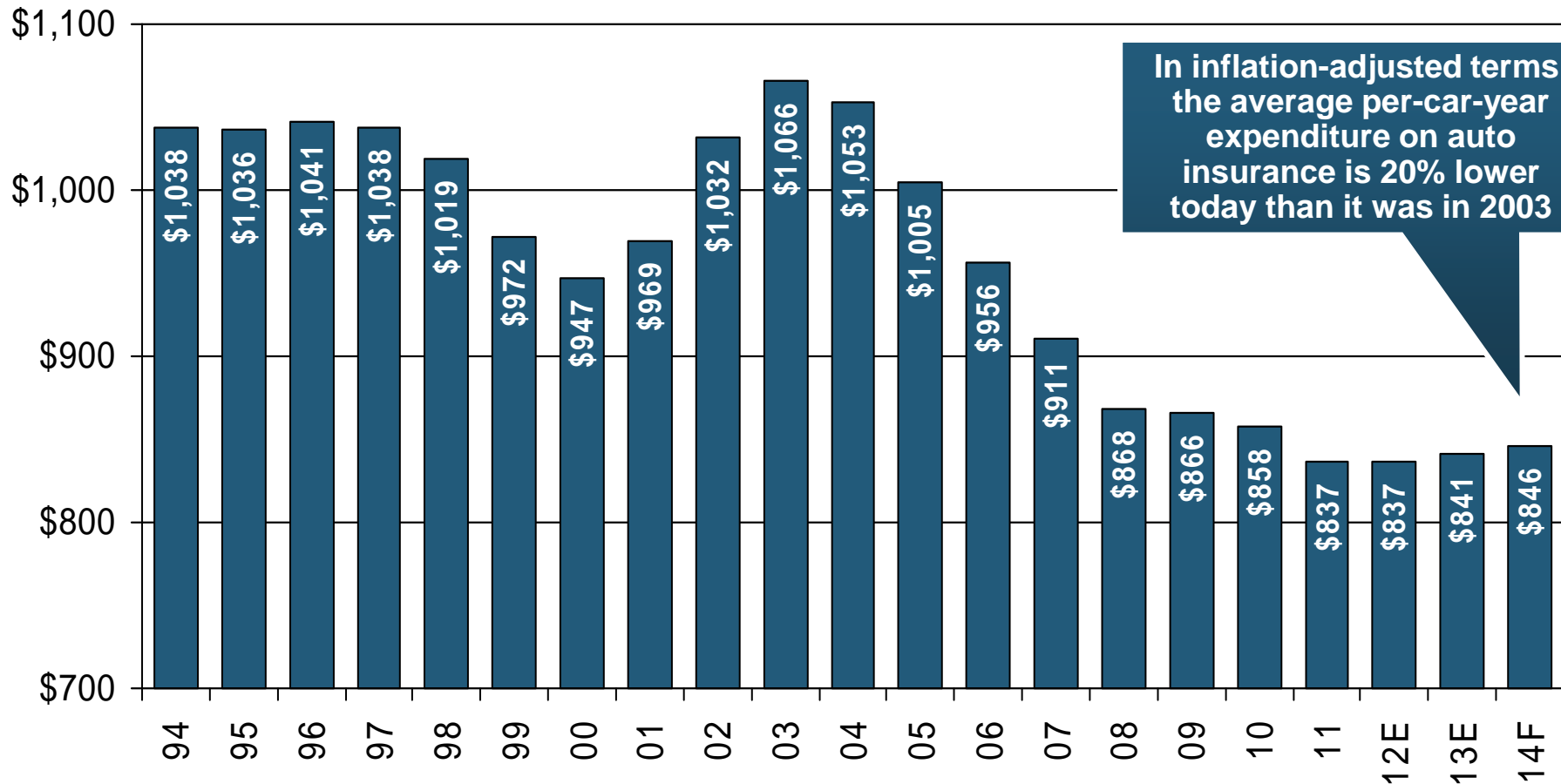
The Message from Bank Regulators:

Get used to it!

Is Auto Insurance Becoming Unaffordable for Low-Income Drivers?

**The Federal Insurance Office asked for comments
earlier this year**

Inflation-Adjusted* Average Expenditures** on Auto Insurance, 1994-2014F



In inflation-adjusted terms, the average per-car-year expenditure on auto insurance has been lower since 2011 than it was in the prior two decades

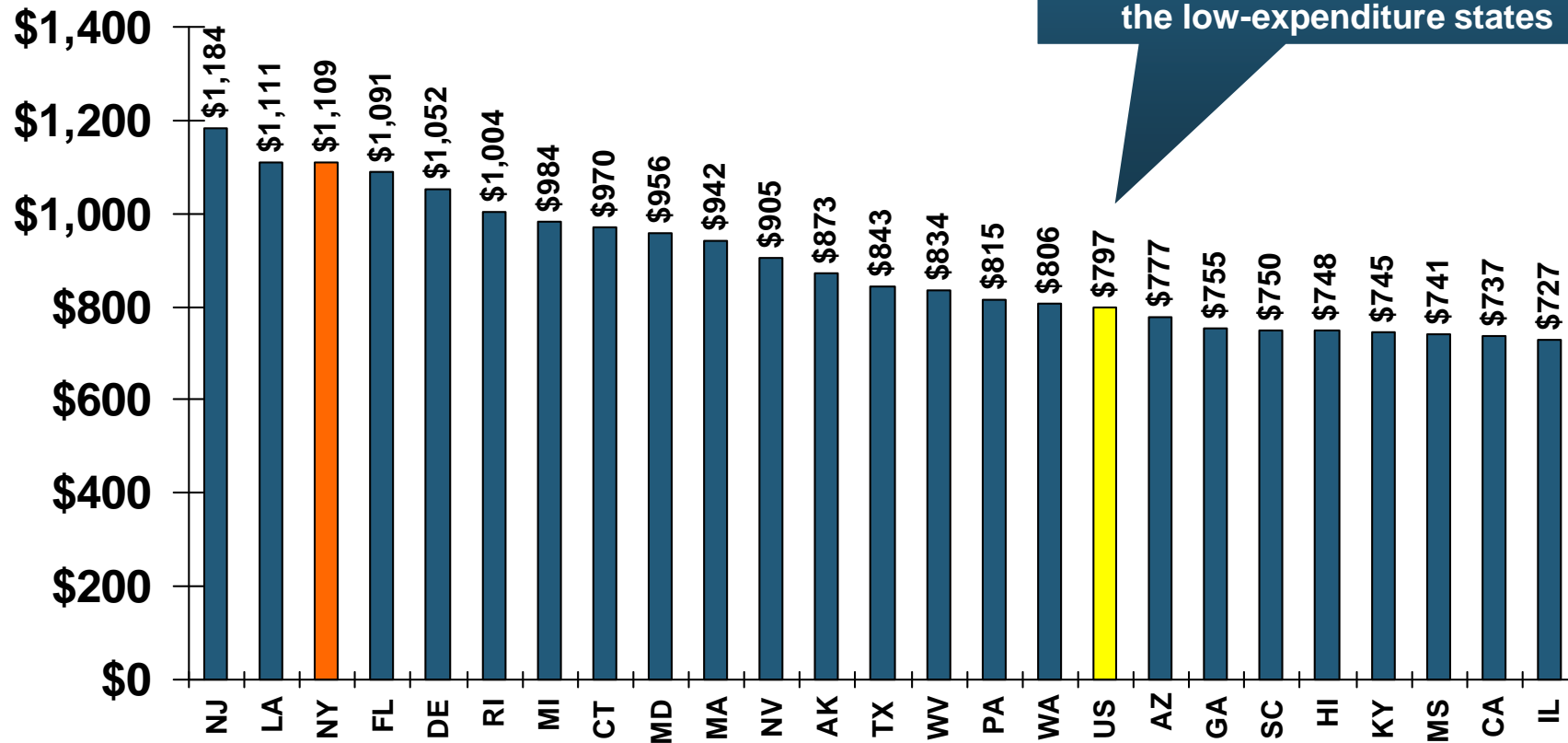
*to 2014 dollars. **for one vehicle insured for one year

Sources: NAIC for 1994-2011; Insurance Information Institute estimates for 2012-2014 based on CPI and other data.

Average Expenditures For Auto Insurance Vary Widely By State



Top 25 States in 2011



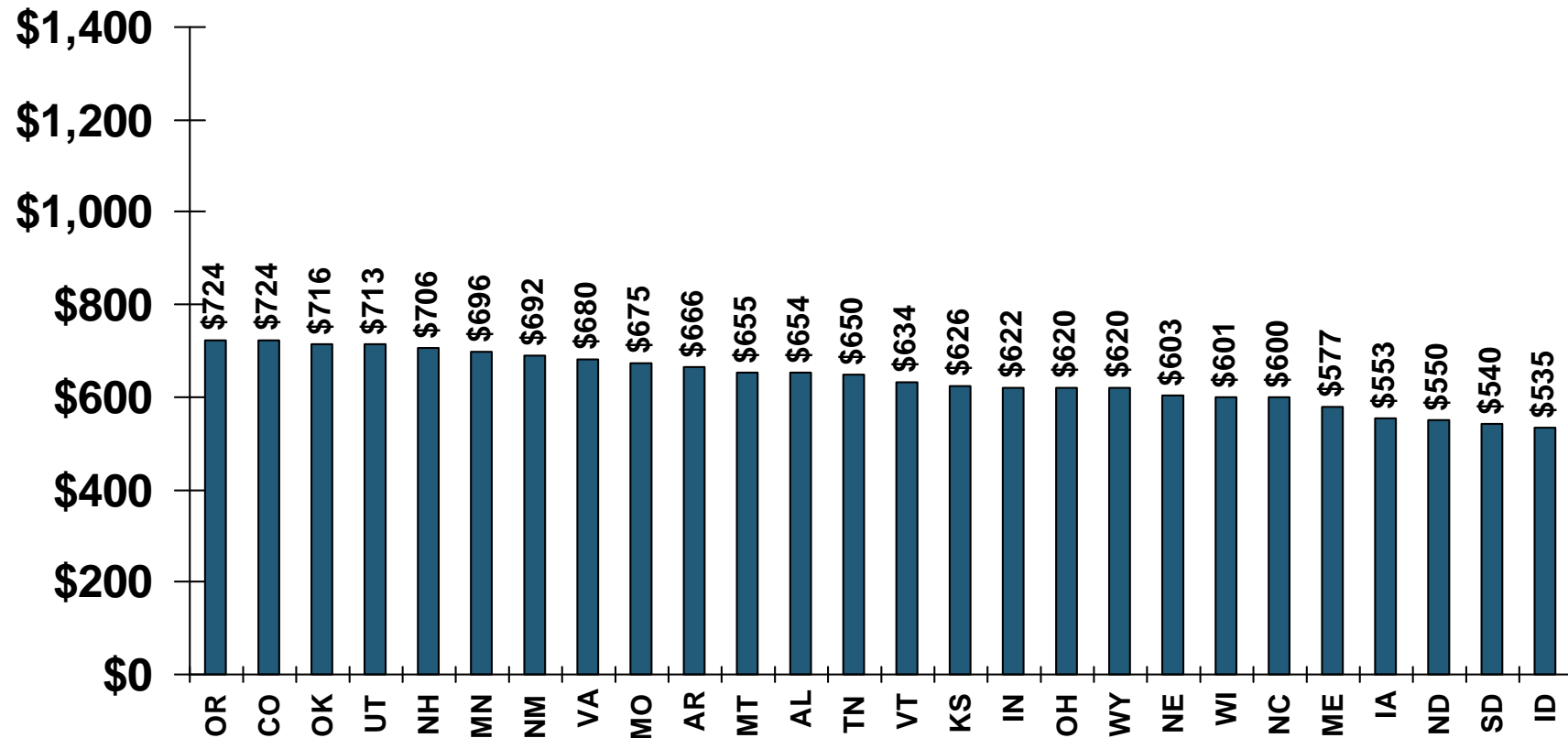
The average expenditure is higher than the median expenditure (which is \$727). This means the high-expenditure states outweigh the low-expenditure states

Note: Average expenditure=Total written premium/liability car years. A car year is equal to 365 days of insured coverage for a single vehicle.
 Source: © 2012 National Association of Insurance Commissioners.

Average Expenditures For Auto Insurance Vary Widely By State



Bottom 25 States in 2011



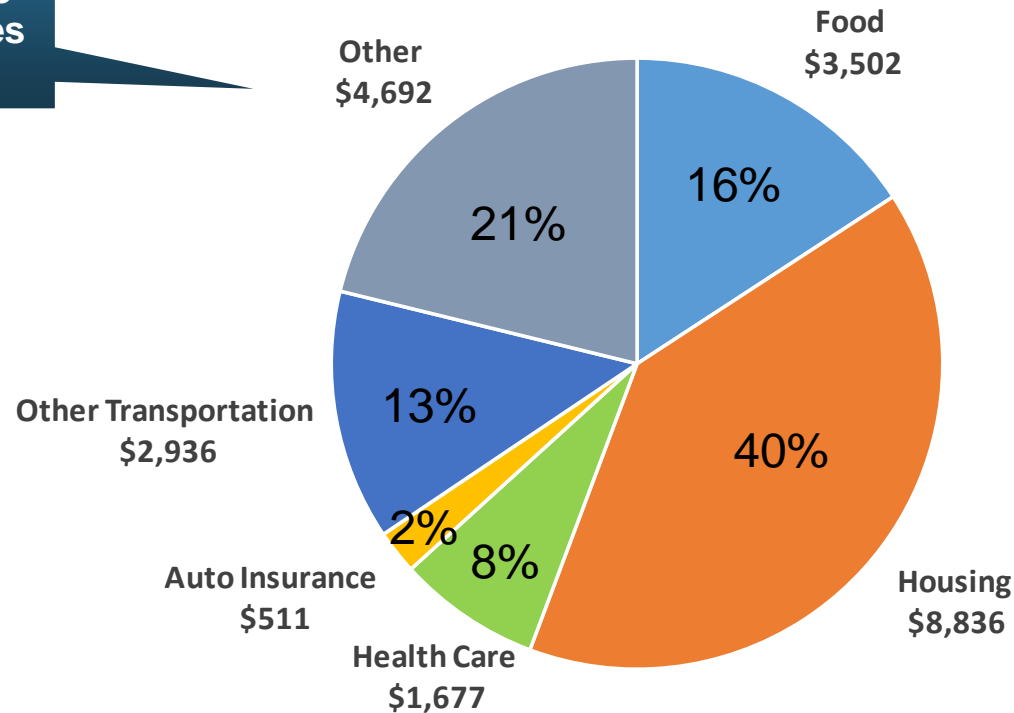
Note: Average expenditure=Total written premium/liability car years. A car year is equal to 365 days of insured coverage for a single vehicle.

Source: © 2012 National Association of Insurance Commissioners.

Spending Pattern in 2012 of Americans in the Lowest-Income Quintile

Income range for this quintile:	\$0 to \$19,111
Average annual expenditure range*:	\$21,382 to \$22,926
Average annual expenditure for auto insurance*:	\$406 to \$616

Numbers shown are average expenditures in 2012

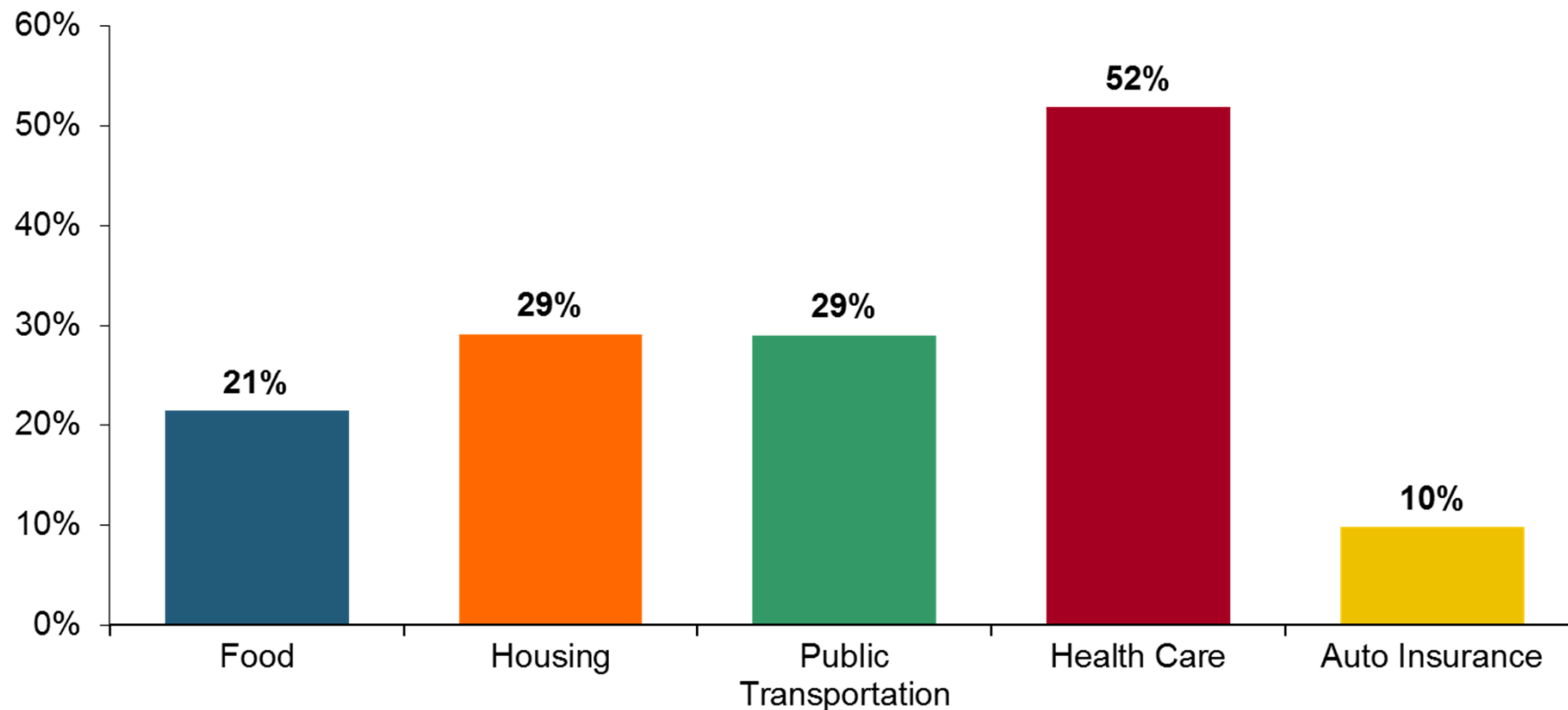


*Range computed by adding or subtracting two standard deviations from the mean expenditure.
 Source: Insurance Information Institute calculations based on data from Bureau of Labor Statistics, Consumer Expenditure Surveys for 2012.

Auto Insurance vs. Other Essentials

Auto insurance expenditures growing more slowly

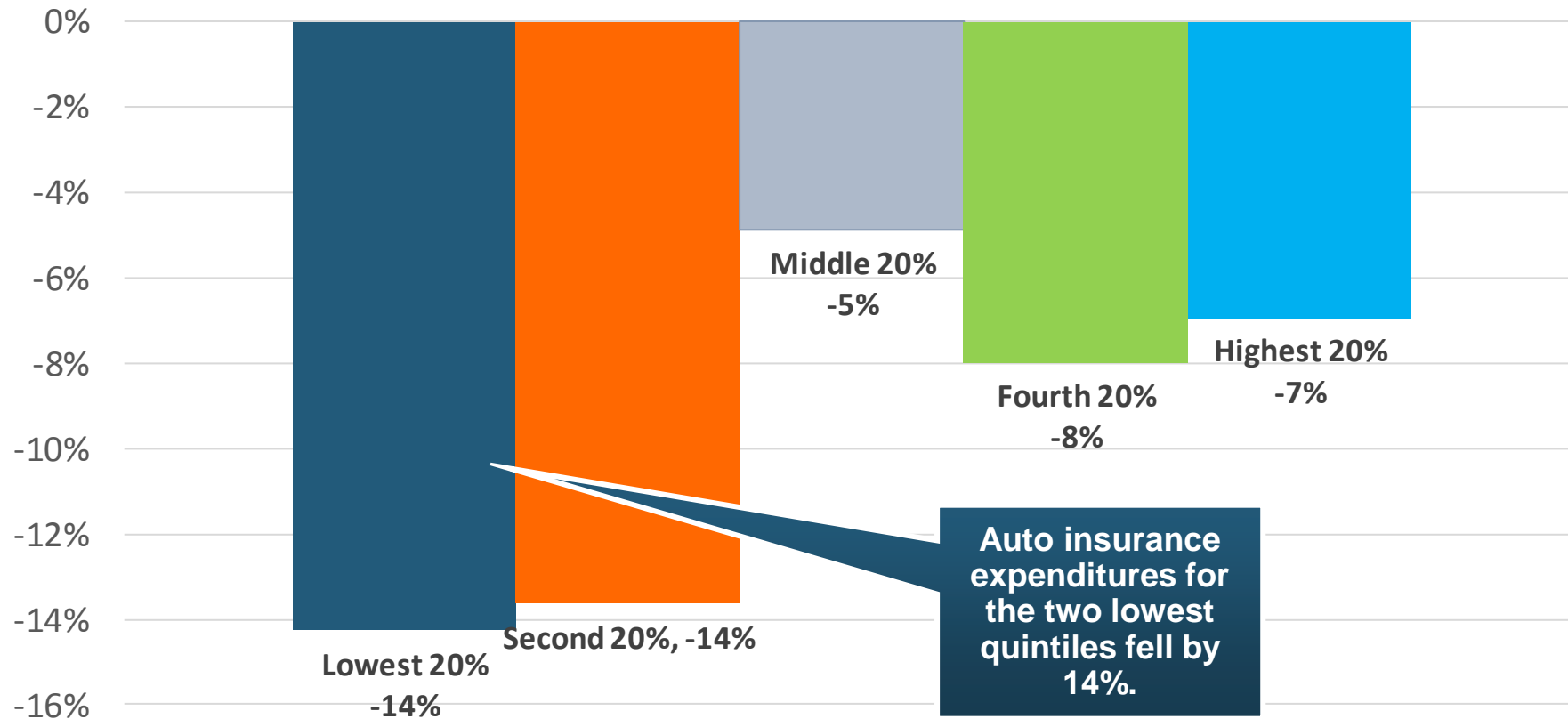
Percent Growth, 2001-2011



Source: Insurance Information Institute calculation based on data from Bureau of Labor Statistics, Consumer Expenditure Surveys for 2001 and 2011, and National Association of Insurance Commissioners.

Change in Auto Insurance Expenditure by Income Quintile, 2012 vs. 2008

% Change

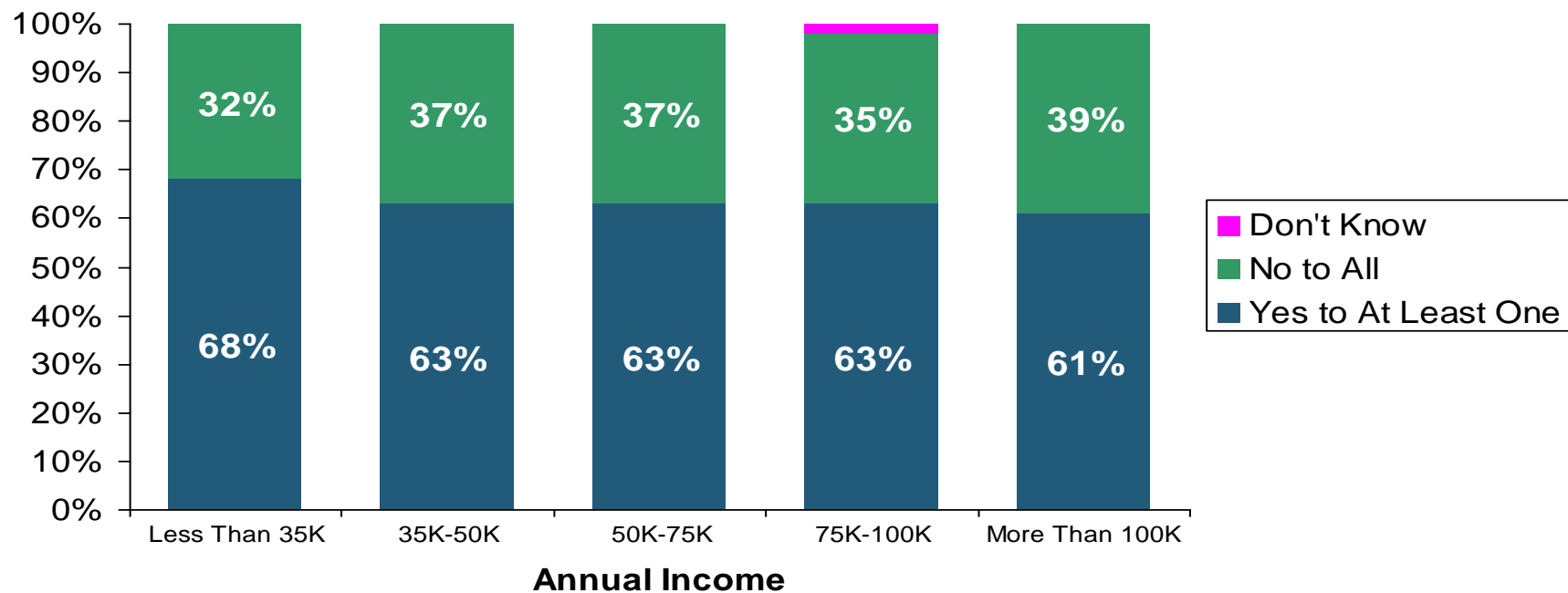


Auto insurance expenditures have fallen for all income groups, but most steeply (as a percent of prior expenditure) for the lowest income quintile.

Source: Insurance Information Institute calculations based on data from Bureau of Labor Statistics, Consumer Expenditure Surveys for 2008 and 2012.

I.I.I. Poll: Shopping for Insurance

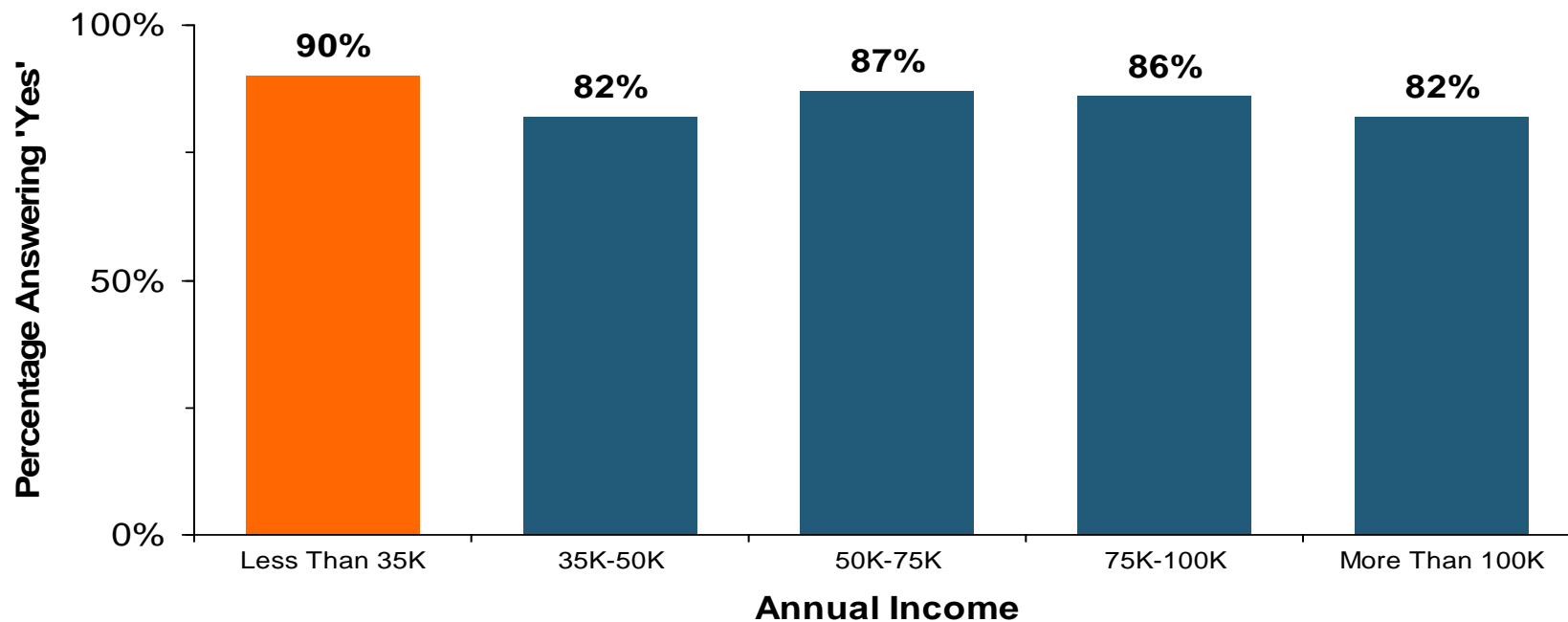
Q. When your auto insurance policy was up for renewal **did you compare prices** at different insurance companies in any of the following ways (Phone, Online, Agent)?



Almost Two-Thirds of Respondents Said They Compared Prices For Auto Insurers at Different Companies. Lower-Income Respondents Were More Likely to Have Comparison Shopped.

I.I.I. Poll: Shopping for Insurance

Q. Do you think you have more choices today among auto insurers than people had 10 years ago?



The Vast Majority of People Say They Have More Choices Among Auto Insurers Today vs. 10 Years Ago. Lowest-Income Americans Are the Most Likely to Say So.

Insurance Information Institute Online:

www.iii.org

***Thank you for your time
and your attention!***