

September 2013



KEEFE, BRUYETTE & WOODS
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CASUALTY LOSS RESERVE SEMINAR

The Case of the Mysteriously Persistent Reserve Releases

North America Equity Research

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Predictions Are Hard

“Proof of Trotsky's farsightedness is that none of his predictions have come true yet.”

-Isaac Deutscher, Oxford, 1964 (as quoted by George Will)

Source: ABC News: “George Will: Skeptical of Predictions,” 4/20/2013.

It All Started in 2010...

STIFEL
NICOLAUS

Insurance Brokers

April 19, 2010

Calling for a 2012 Hard Market

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The Bottom Line

We think that in 2012, commercial property/casualty insurance rates will begin rising faster than loss cost inflation, i.e., enter a hard market phase. In the interim, underwriting results are likely to deteriorate rapidly as the drying-up well of prior-period reserve redundancies exacerbates still-declining insurance rates and loss cost inflation.

Source: Stifel Nicolaus Research.

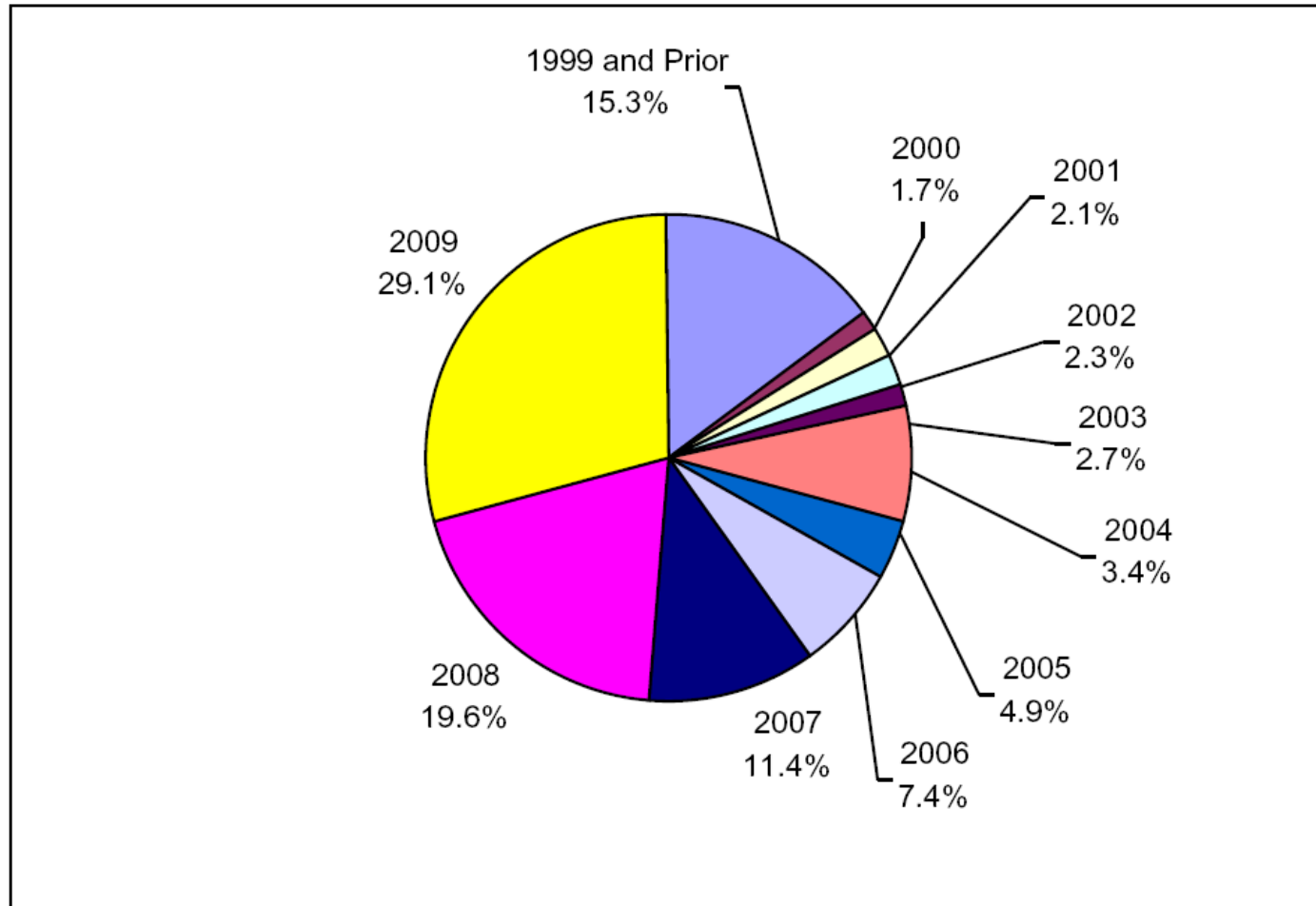


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Stop Me if You've Heard This One...

Figure 5: Year-end 2009 Loss and D&CC Reserves by Accident-Year

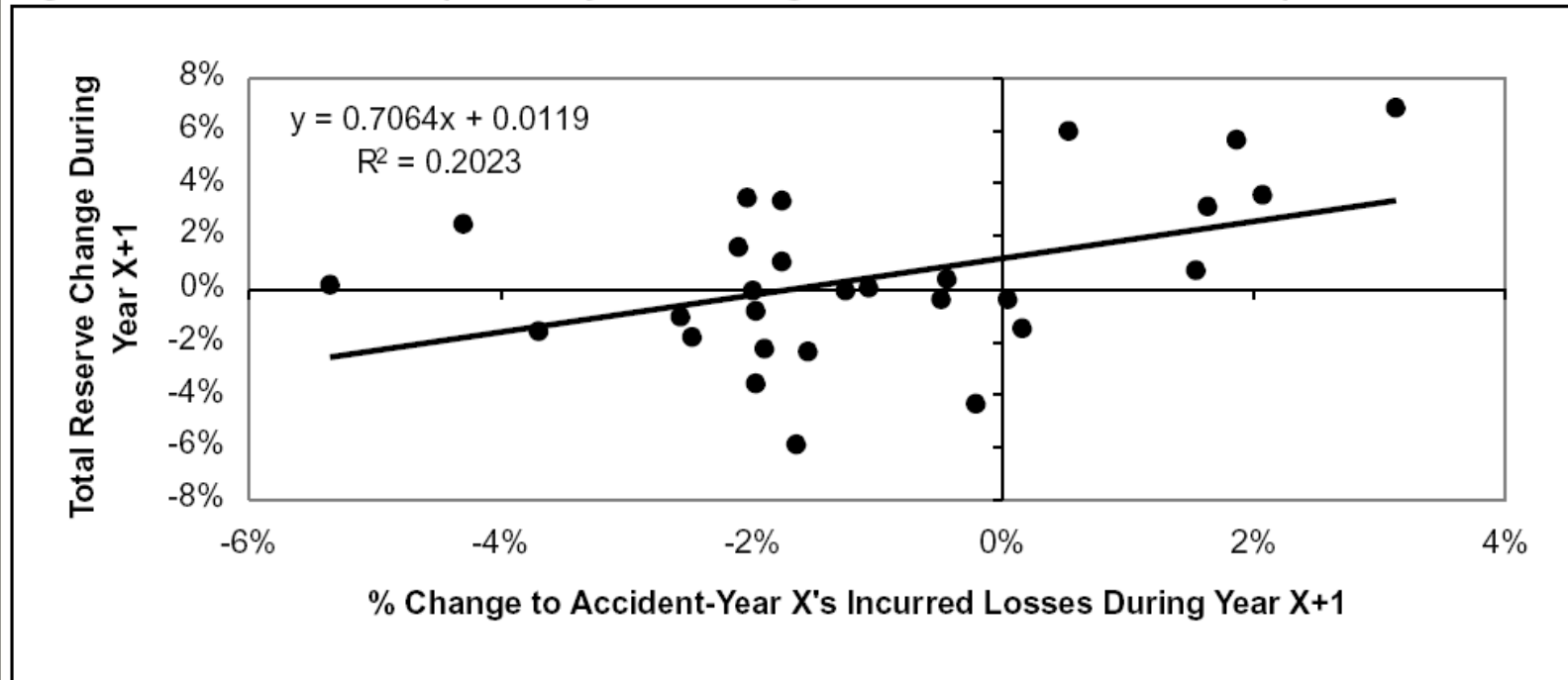


Source: Highline data and Stifel Nicolaus analysis



Everyone's Always Impressed by Scatter Plots...

Figure 7: Last Year's Development says *Something* about This Year's Total Development...

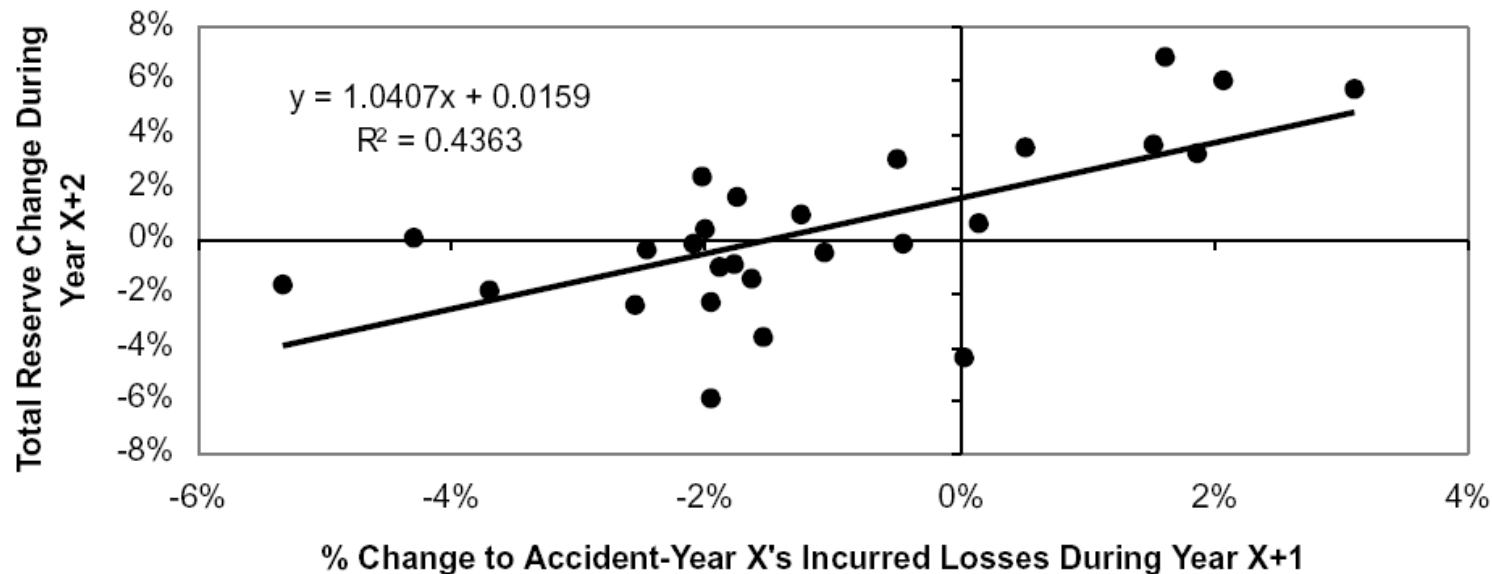


Source: A.M. Best, Highline data, and Stifel Nicolaus analysis



...Especially If The Title Starts With an Ellipsis

Figure 8: ... But Even More About Next Year's Total Development...



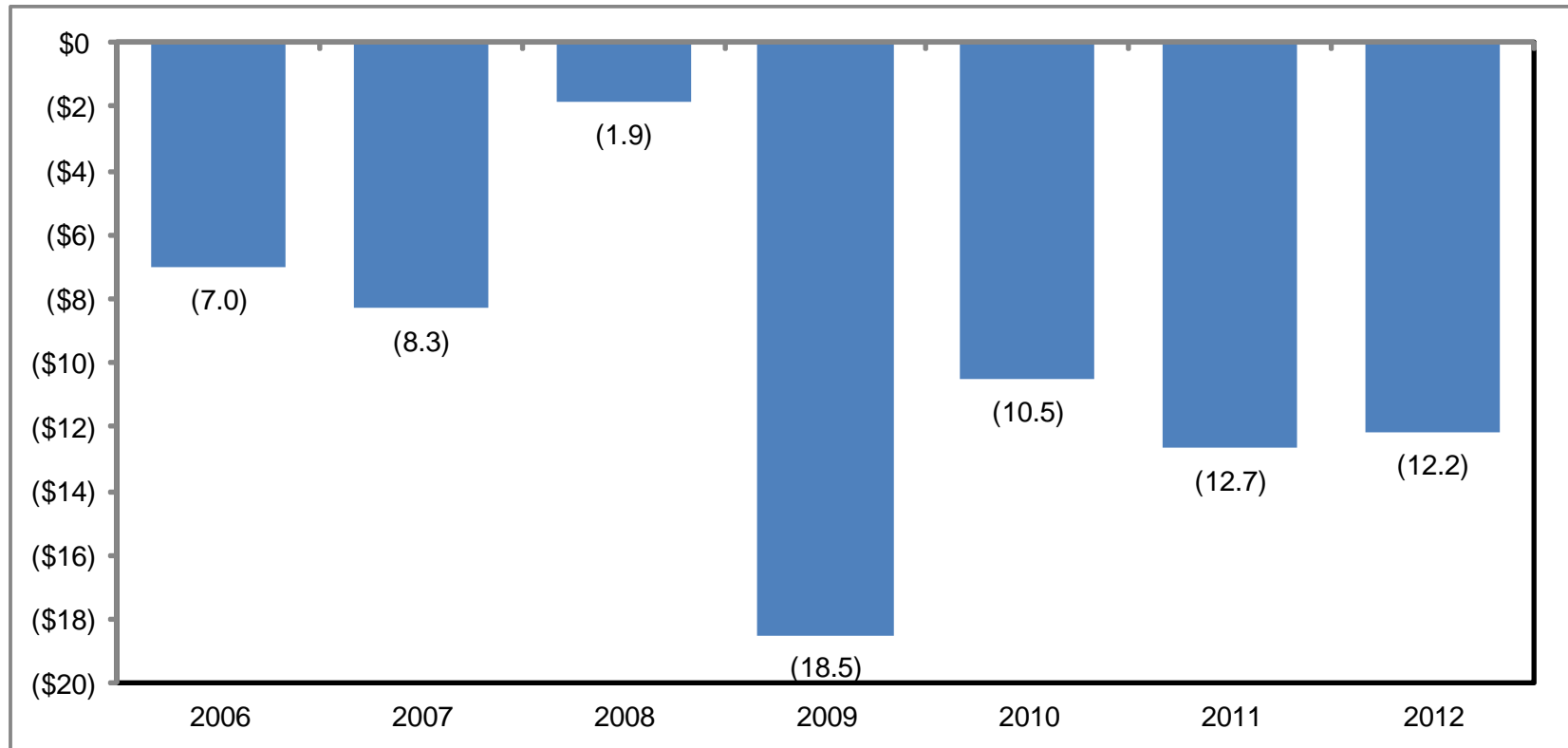
Source: A.M. Best, Highline data, and Stifel Nicolaus analysis



Reality Regrettably Begged to Disagree

Annual Reserve Strengthening/(Releases), P&C Industry

\$ in billions



Source: SNL and KBW Research

Balancing Stability and Responsiveness...

“Insanity (is) doing the same thing over and over again and expecting different results.”

- Attributed to Albert Einstein

Source: *Psychology Today*. “The Definition of Insanity is ...” ; 7/27/2009.

...Okay, Balancing Stability with Stability



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North America Equity Research

Industry Update

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Insurance **Property and Casualty**

Favorable Reserve Development Likely Almost Over

July 8, 2013

Source: KBW Research.

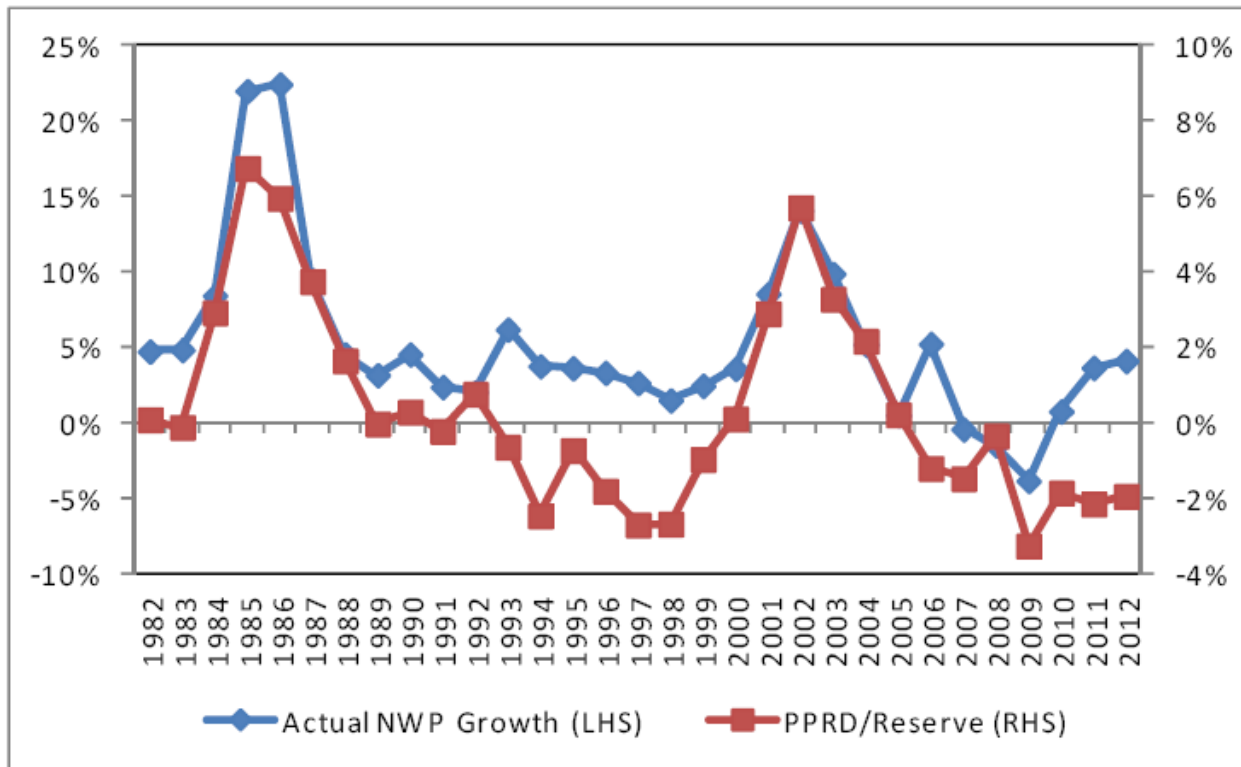


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Correlation Does Not Imply Causation*

Exhibit 1: The Overlapping Pricing and Reserving Cycles

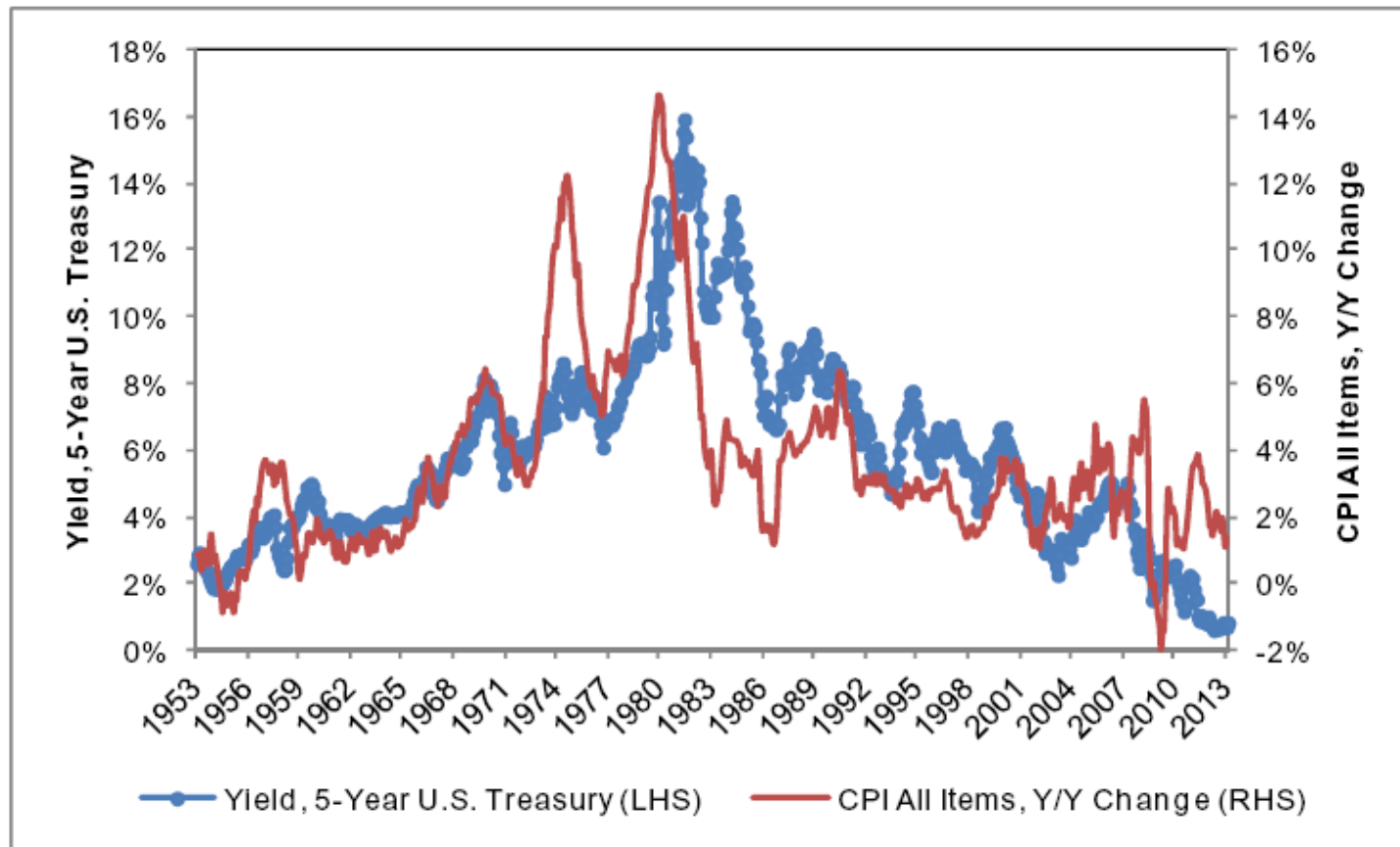


Source: A.M. Best, SNL, BLS, and KBW Research

* Sure it does. It doesn't *confirm* causation.

Rushing In Where Angels Fear to Tread

Exhibit 5: Interest Rates and Inflation Rates

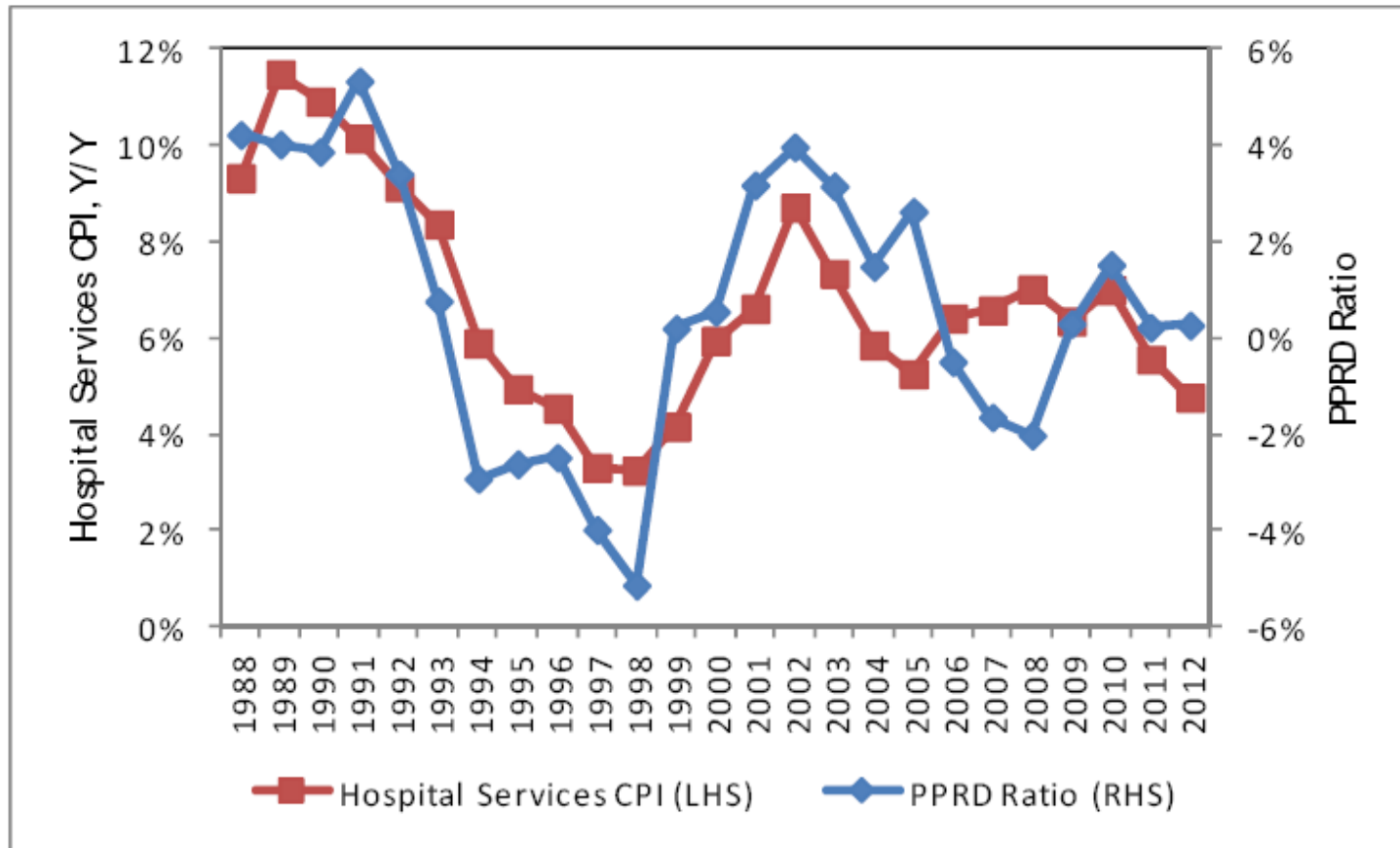


Source: BLS and the Federal Reserve Board via freelunch.com and KBW Research



Another Interesting Relationship

Exhibit 6: Low Hospital Services Inflation Helps WC Reserve Development

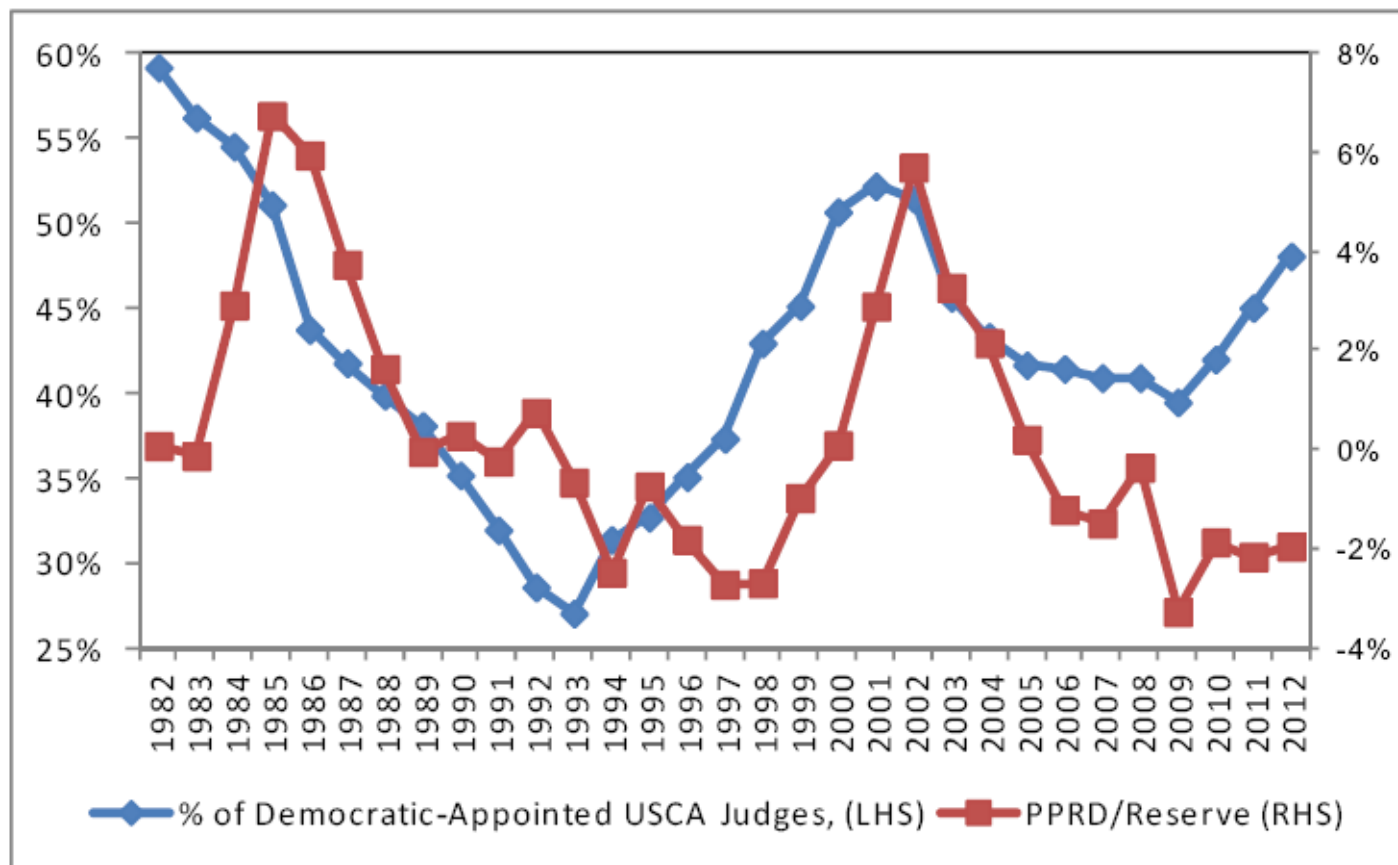


Source: A.M. Best, SNL, BLS, and KBW Research



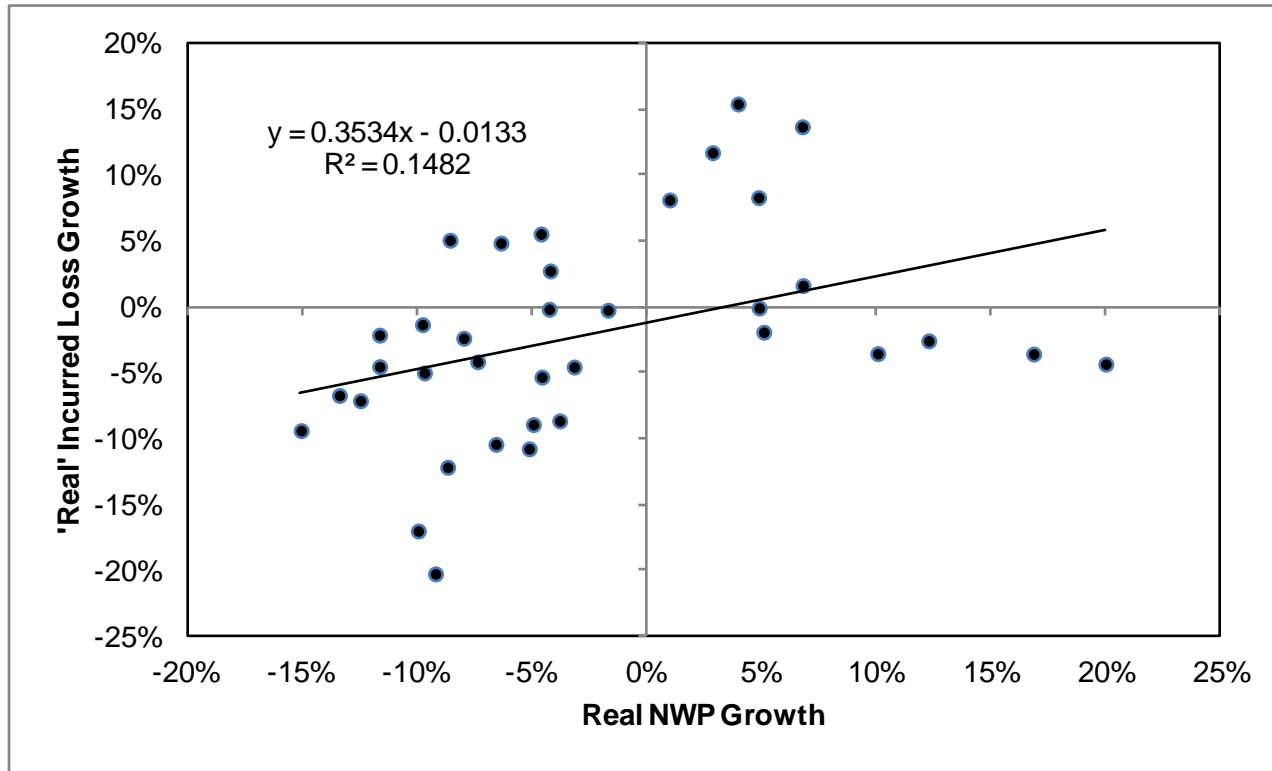
Reserving Judgment

Exhibit 8: Court of Appeals Appointments Drive Adverse Development (Eventually)



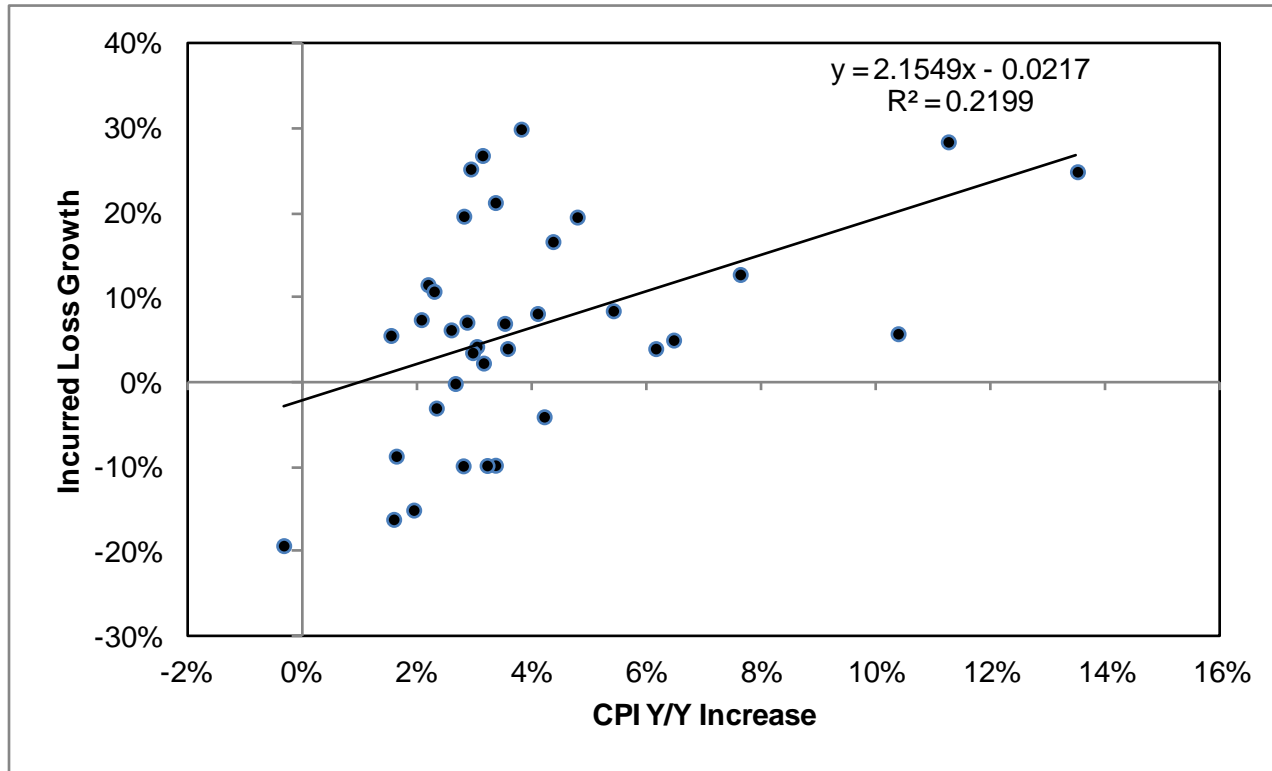
Source: A.M. Best, SNL, History of the Federal Judiciary. <http://www.fjc.gov>, Web site of the Federal Judicial Center, Washington, DC via Dr. John Kastellec, and KBW Research

Commercial Auto Liability Losses Reflect Rate Trends



Source: A.M. Best, BLS via freelunch.com, and KBW Research.

Inland Marine Losses Reflect Inflation



Source: A.M. Best, BLS via freelunch.com, and KBW Research.



Oh, That Reserving Cycle Stuff? Still There

Exhibit 9: Isolating Commercial Lines Reserve Development

\$ in billions

Relative Accident Year	Calendar Year												
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Prior(10+)	0.5	1.1	7.2	6.3	7.6	6.9	3.8	5.6	2.0	4.5	4.9	2.1	2.1
AY(-9)	(0.6)	(0.3)	(0.1)	0.3	0.2	0.3	0.4	0.7	0.1	0.4	0.2	0.2	(0.3)
AY(-8)	(0.6)	(0.3)	0.2	0.6	0.5	0.4	0.4	0.4	0.4	0.6	0.2	(0.2)	(0.5)
AY(-7)	(0.9)	0.1	(0.0)	0.4	0.7	0.8	1.1	0.6	(0.2)	0.6	(0.1)	(0.4)	(0.5)
AY(-6)	(0.7)	(0.3)	0.2	0.6	1.7	1.5	1.4	0.8	(0.5)	0.1	(0.7)	(0.9)	(1.0)
AY(-5)	(0.8)	(0.0)	1.0	1.4	2.0	2.0	1.2	0.3	(0.7)	(0.5)	(1.1)	(1.6)	(1.0)
AY(-4)	(0.4)	1.0	2.5	3.1	3.7	1.6	1.1	(0.8)	(2.9)	(1.2)	(3.3)	(1.5)	(4.1)
AY(-3)	0.0	2.6	4.5	4.1	2.8	2.9	(1.1)	(3.0)	(4.2)	(7.9)	(0.9)	(3.3)	0.3
AY(-2)	2.3	3.9	5.0	2.3	2.1	(1.6)	(3.6)	(4.3)	(1.3)	(2.9)	(0.8)	(1.7)	0.9
AY(-1)	3.6	3.3	0.9	(3.3)	(7.8)	(10.8)	(7.3)	(7.6)	(5.7)	(4.5)	(4.4)	(1.8)	(1.9)

Source: A.M. Best, SNL, and KBW Research



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Restricted [RES]	0	0.00	0	0.00
Suspended [SP]	20	3.57	5	25.00
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As of September 3, 2013

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