

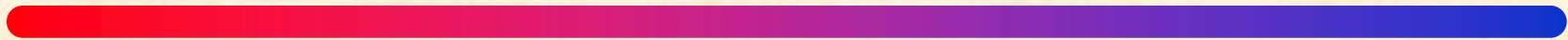
Market and Cycle: How Long Can We Stay Profitable?

Casualty Actuarial Society Spring Meeting
Fairmont Le Chateau Frontenac
Quebec City, Quebec, Canada
June 16, 2008



Steven N. Weisbart, Ph.D., CLU, Vice President & Chief Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: (212) 346-5540 ♦ Cell: (917) 494-5945 ♦ stevenw@iii.org ♦ www.iii.org

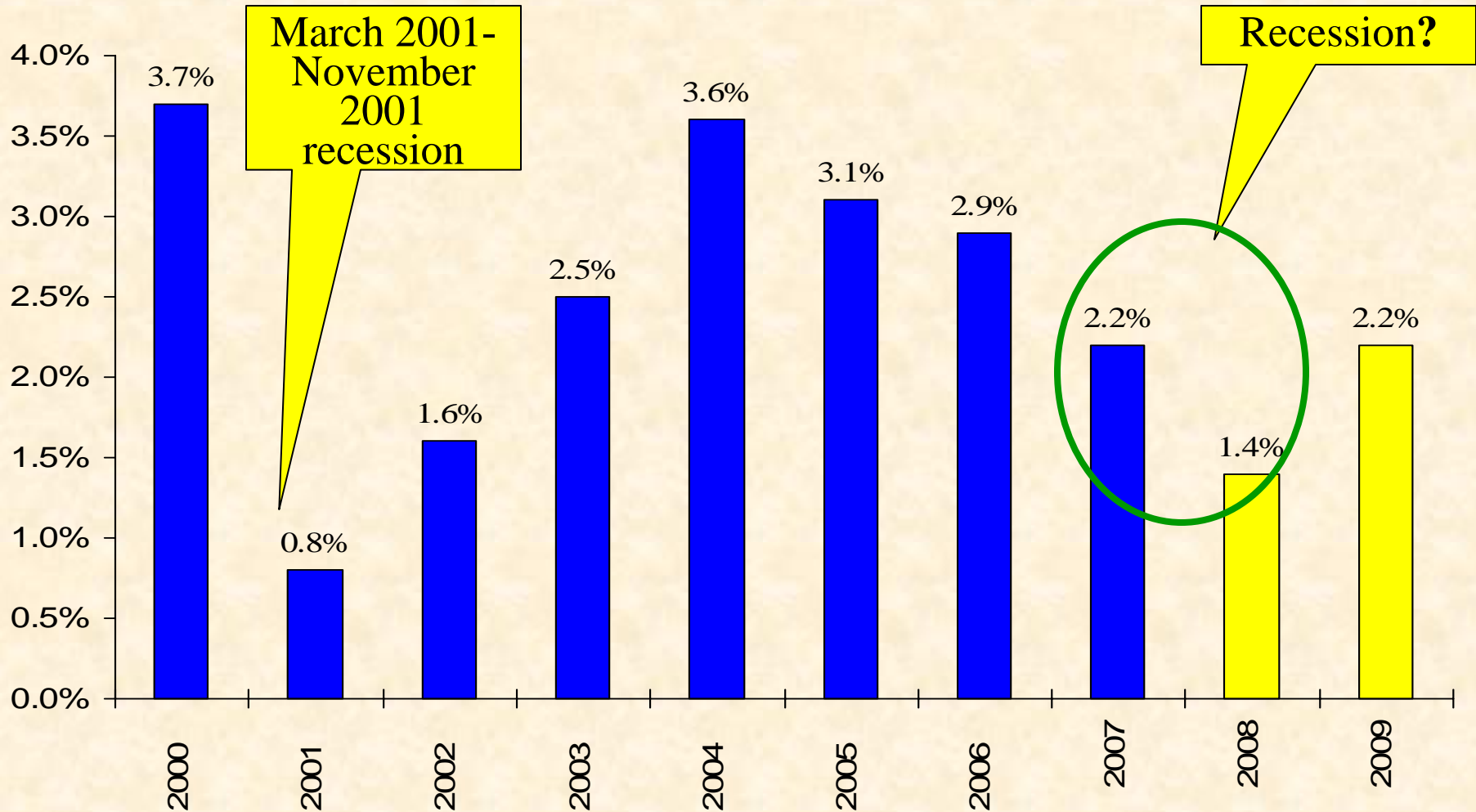
The Weakening Economy and the P/C Insurance Industry



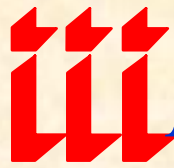


Real Annual GDP Growth, 2000-2009F

Blue bars are actual; Yellow bars are forecasts

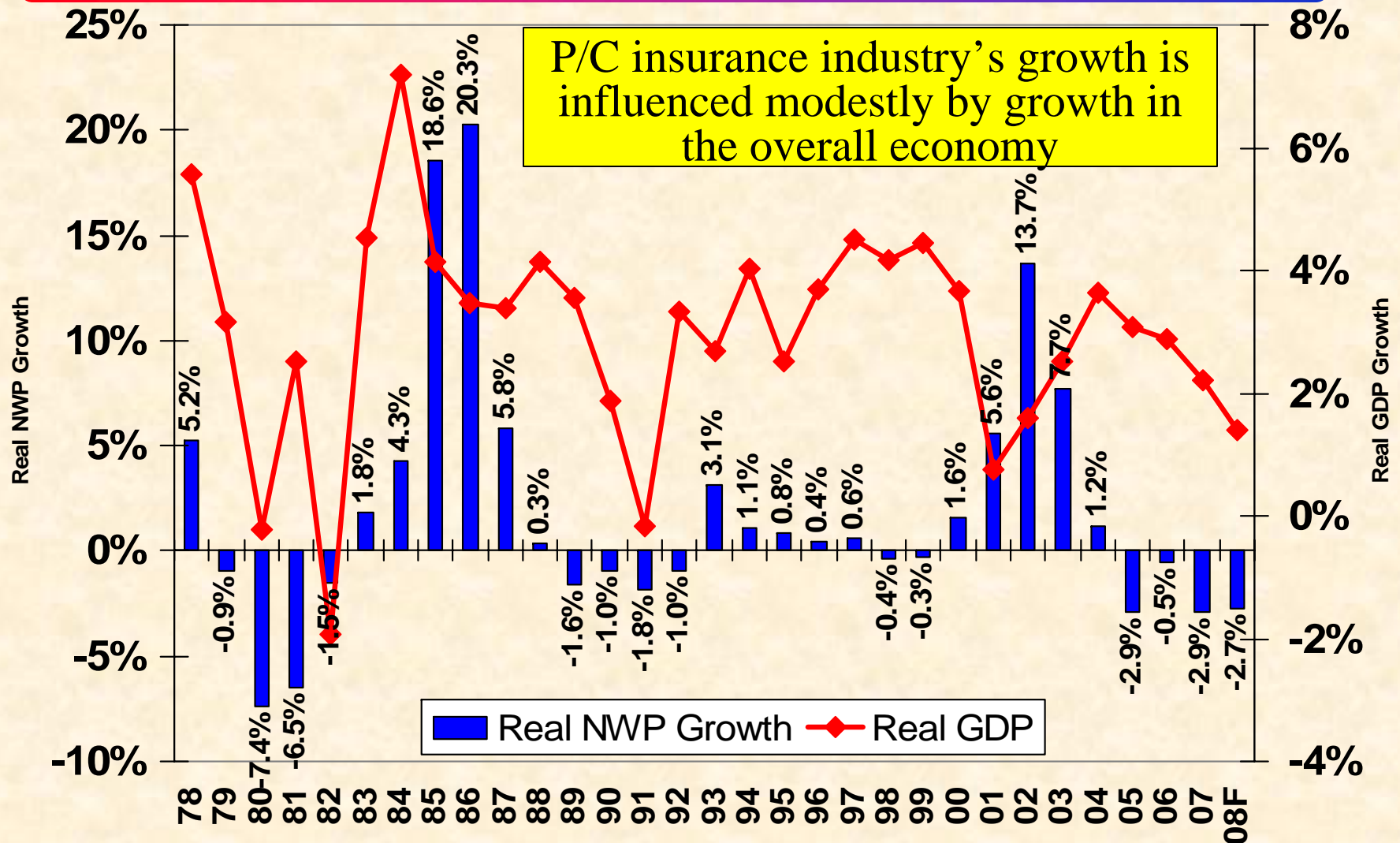


Sources: US Department of Commerce, Blue Chip Economic Indicators 4/08; Insurance Information Institute.



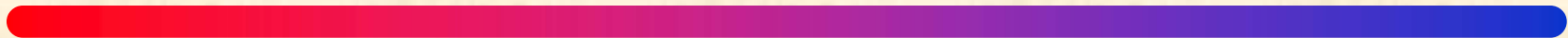
Real GDP Growth vs. Real P/C

Premium Growth: Modest Association



Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 4/08; I.I.I.

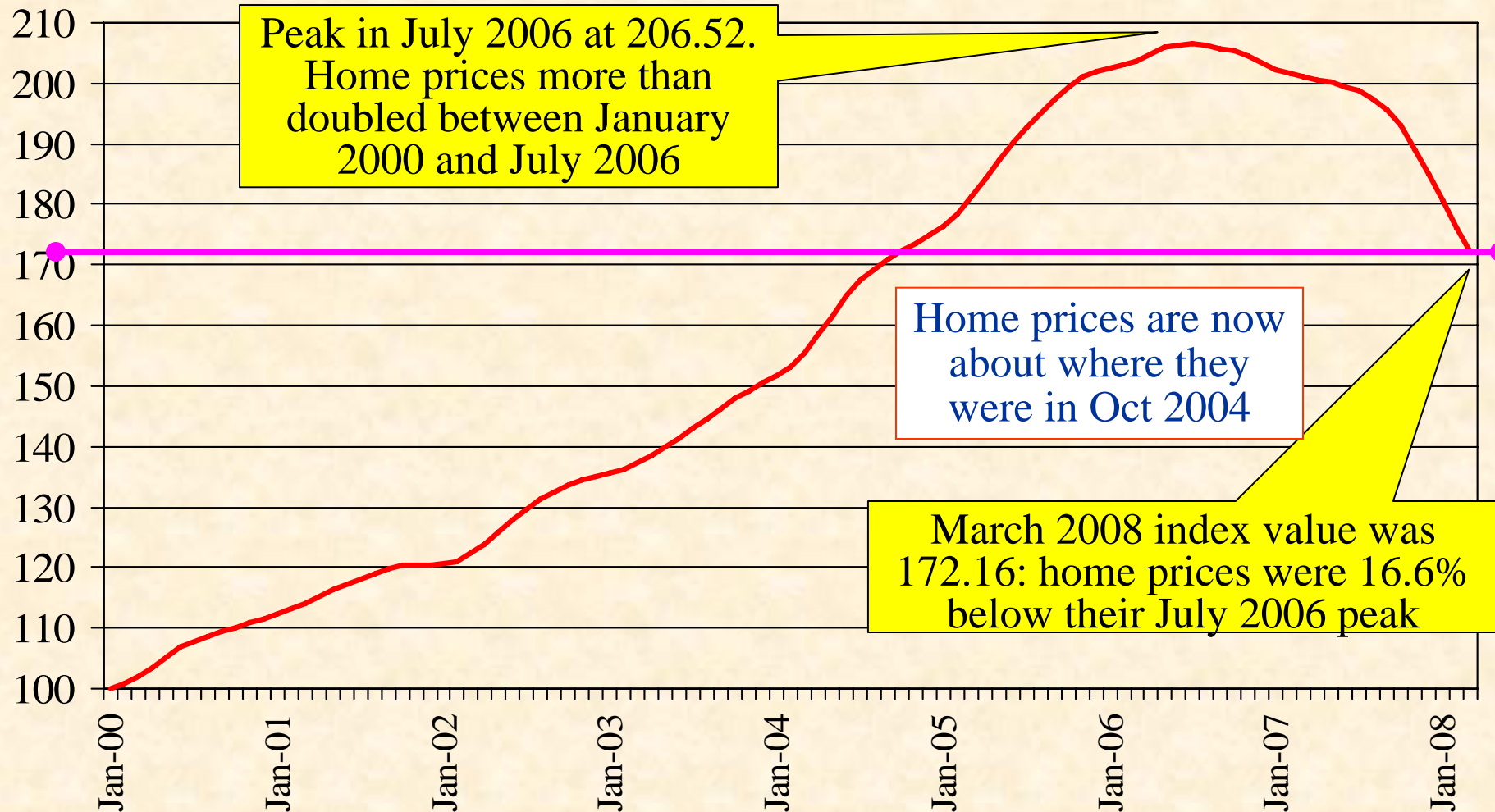
Housing and Homeowners' Insurance





Case-Schiller Home Price Index

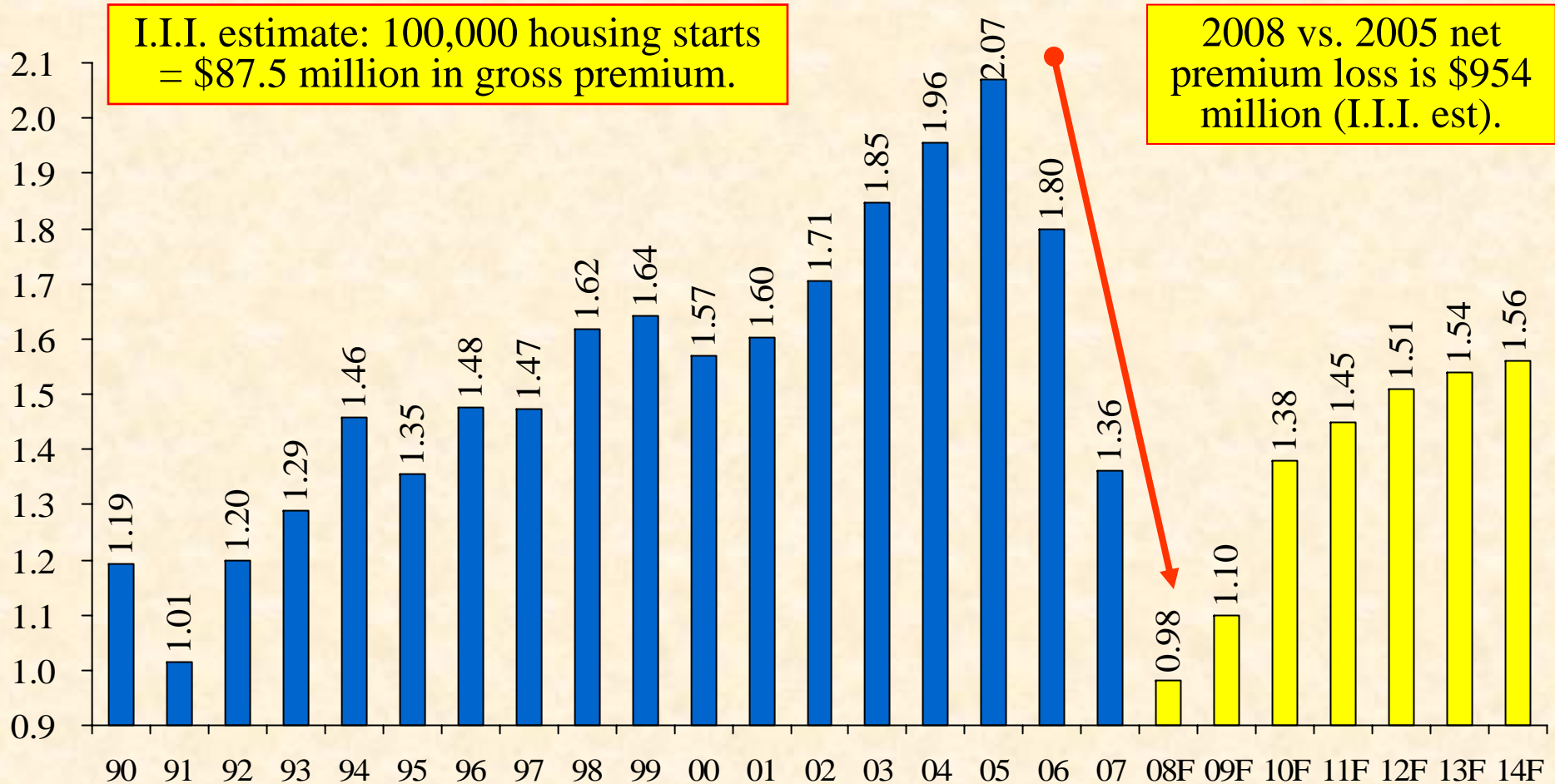
Monthly: 20 City Composite (Jan 2000=100)



Source: http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_History_052703.xls



New Private Housing Starts, 1990-2014F (Millions of Units)

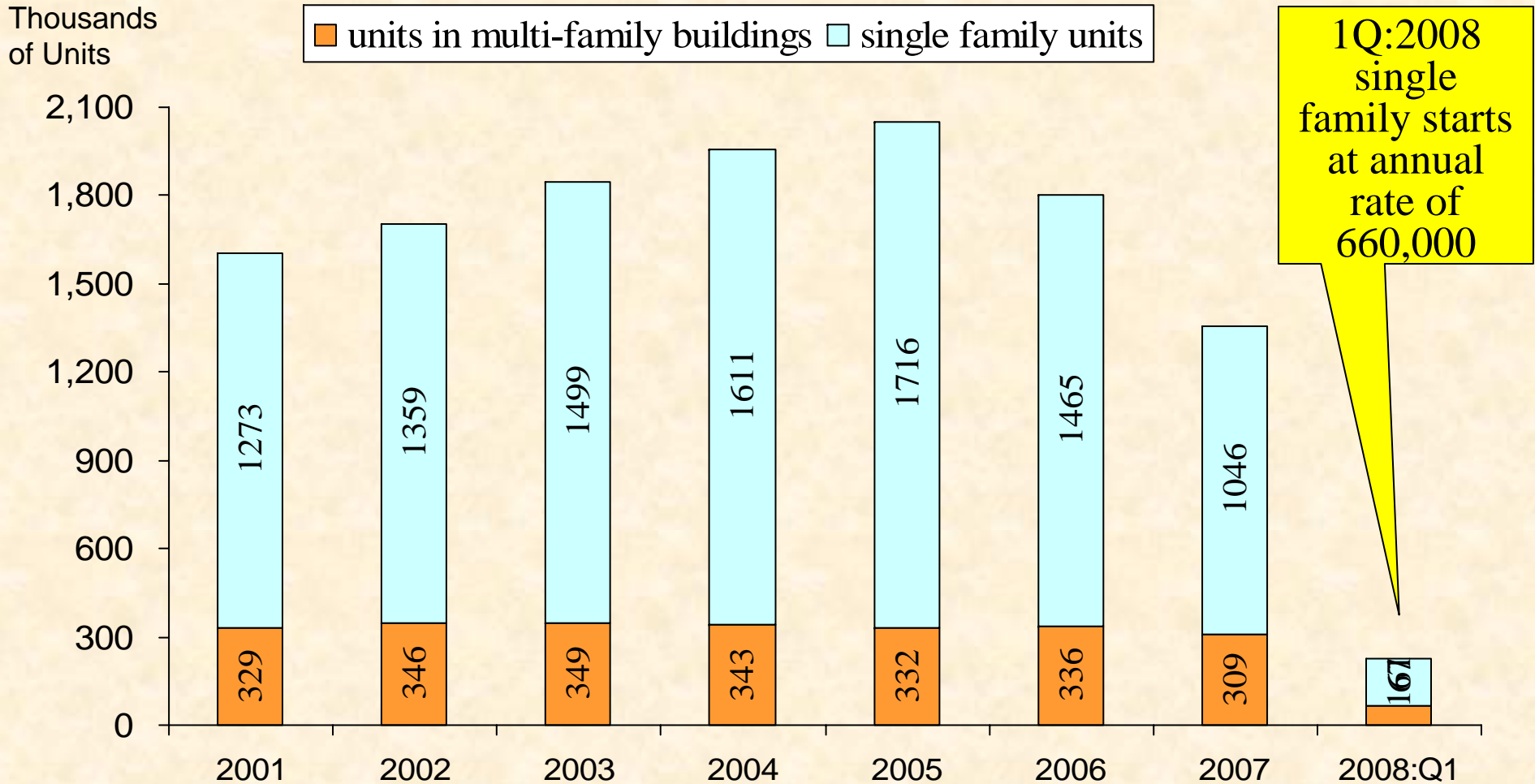


Source: US Department of Commerce; Blue Chip Economic Indicators (10/07), except 2008/09 figures from 4/08 edition of BCEI; Insurance Info. Institute



Single vs. Multi-Family Housing Starts

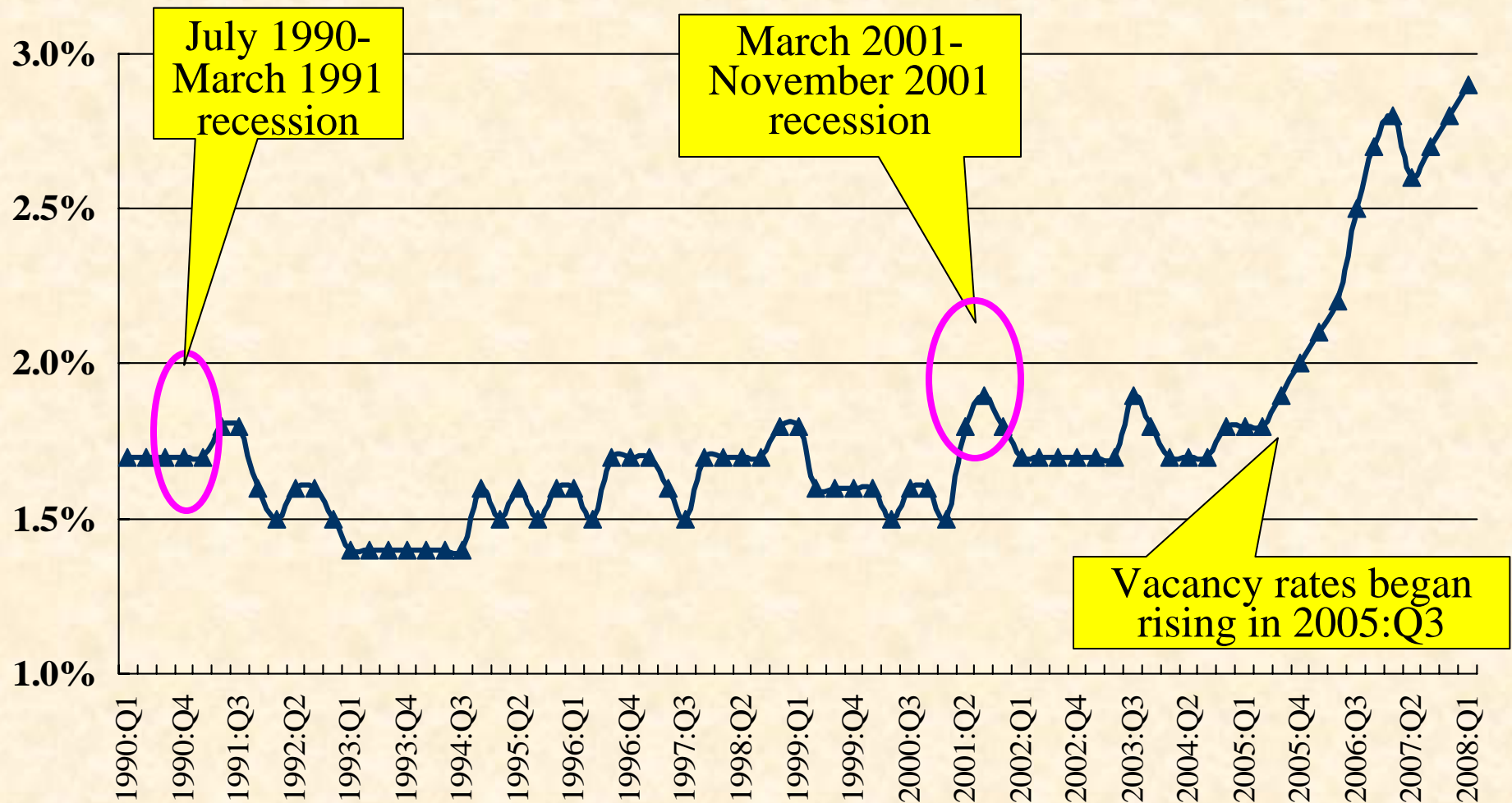
The slump is in single-family housing. Starts of multi-family buildings have held at 310,000 to 350,000 units each year.



Source: US Census Bureau



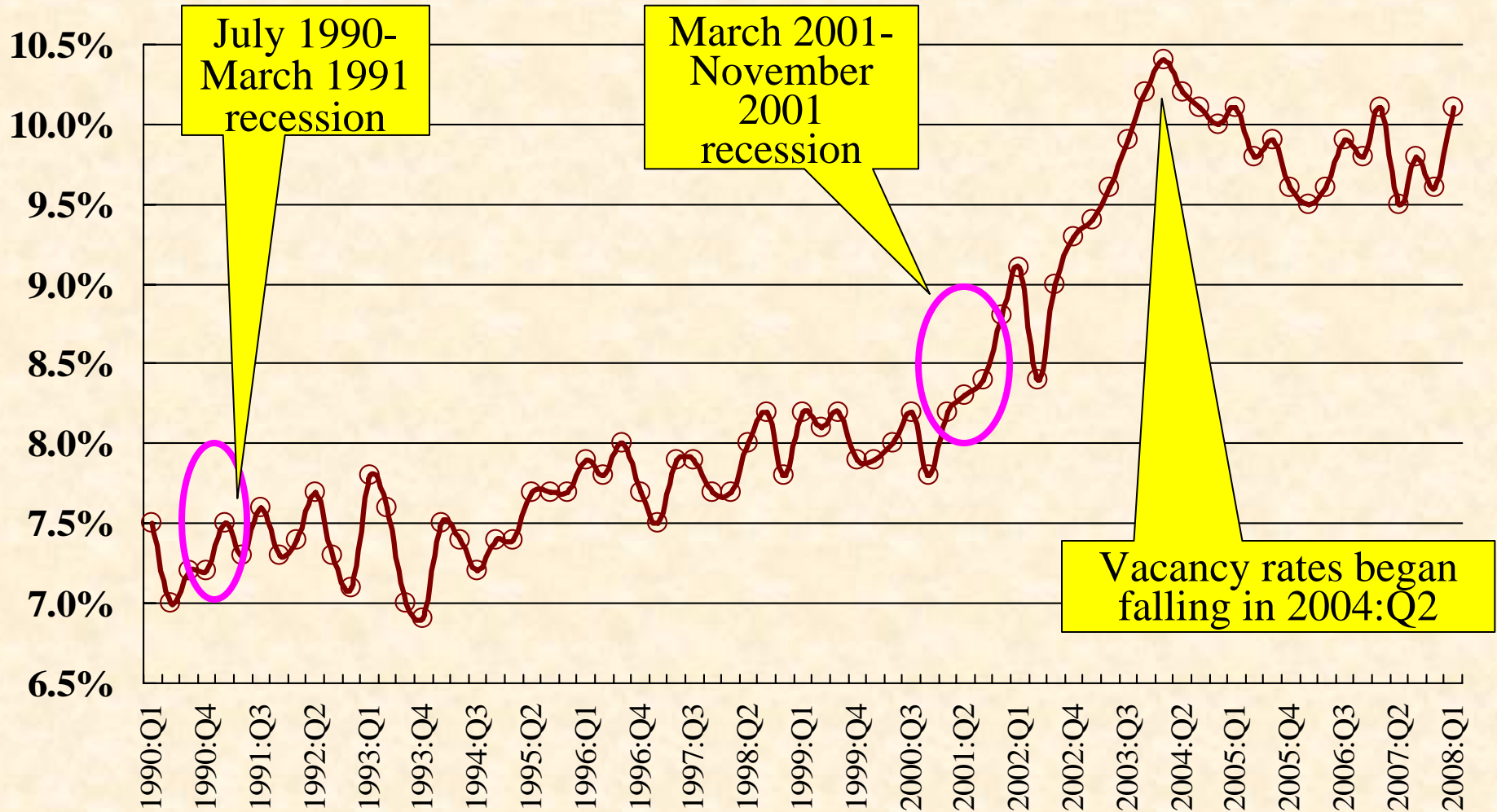
Homeowner Vacancy Rates, Quarterly, 1990-2008:Q1



Source: U.S. Census Bureau, <http://www.census.gov/hhes/www/housing/hvs/qtr108/q108tab1.html>

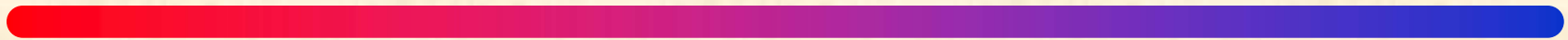


Rental Vacancy Rates, Quarterly, 1990-2008:Q1



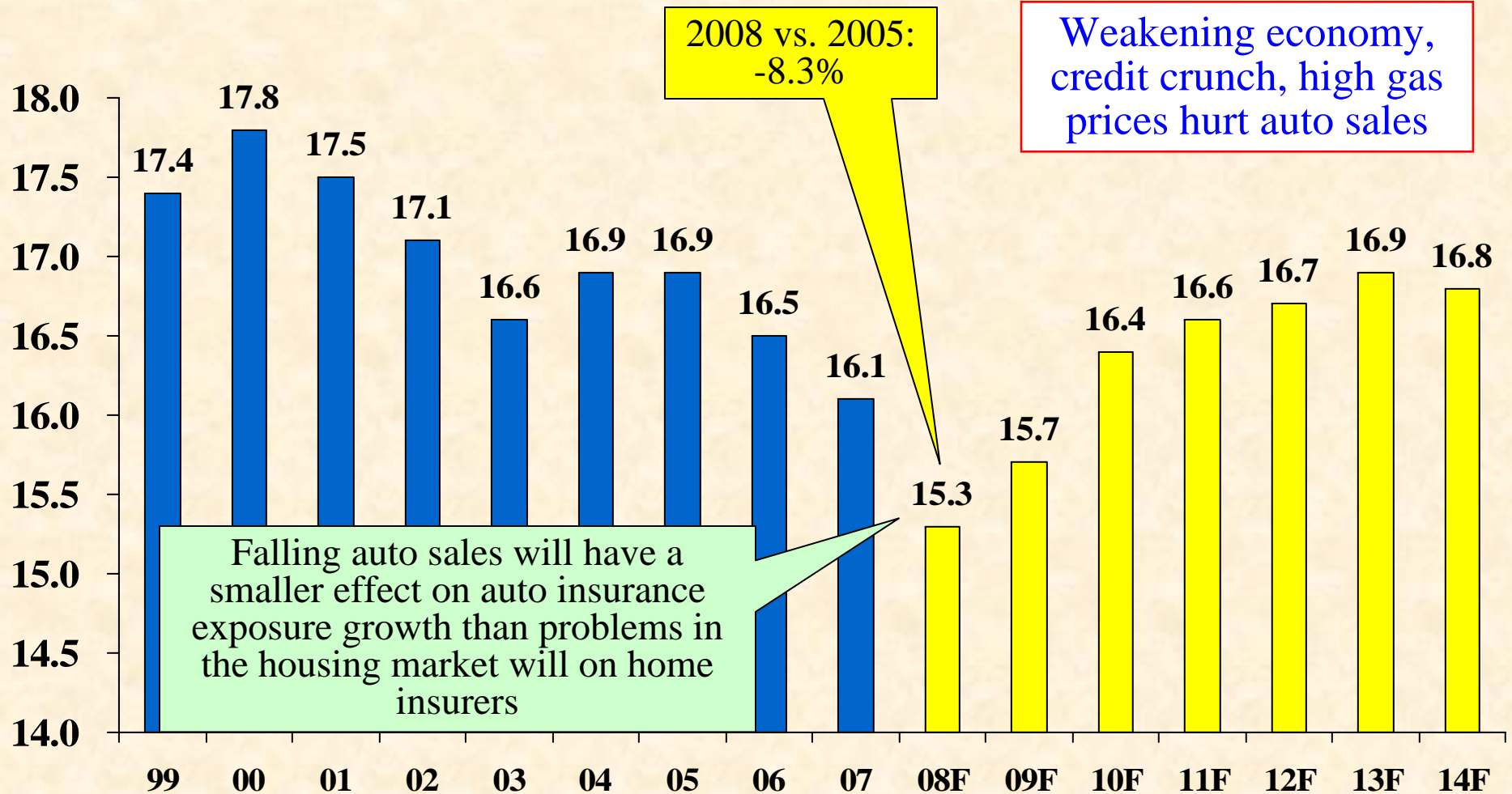
Source: U.S. Census Bureau, <http://www.census.gov/hhes/www/housing/hvs/qtr108/q108tab1.html>

Driving and Auto Insurance





Auto/Light Truck Sales, 1999-2014F (Millions of Units)



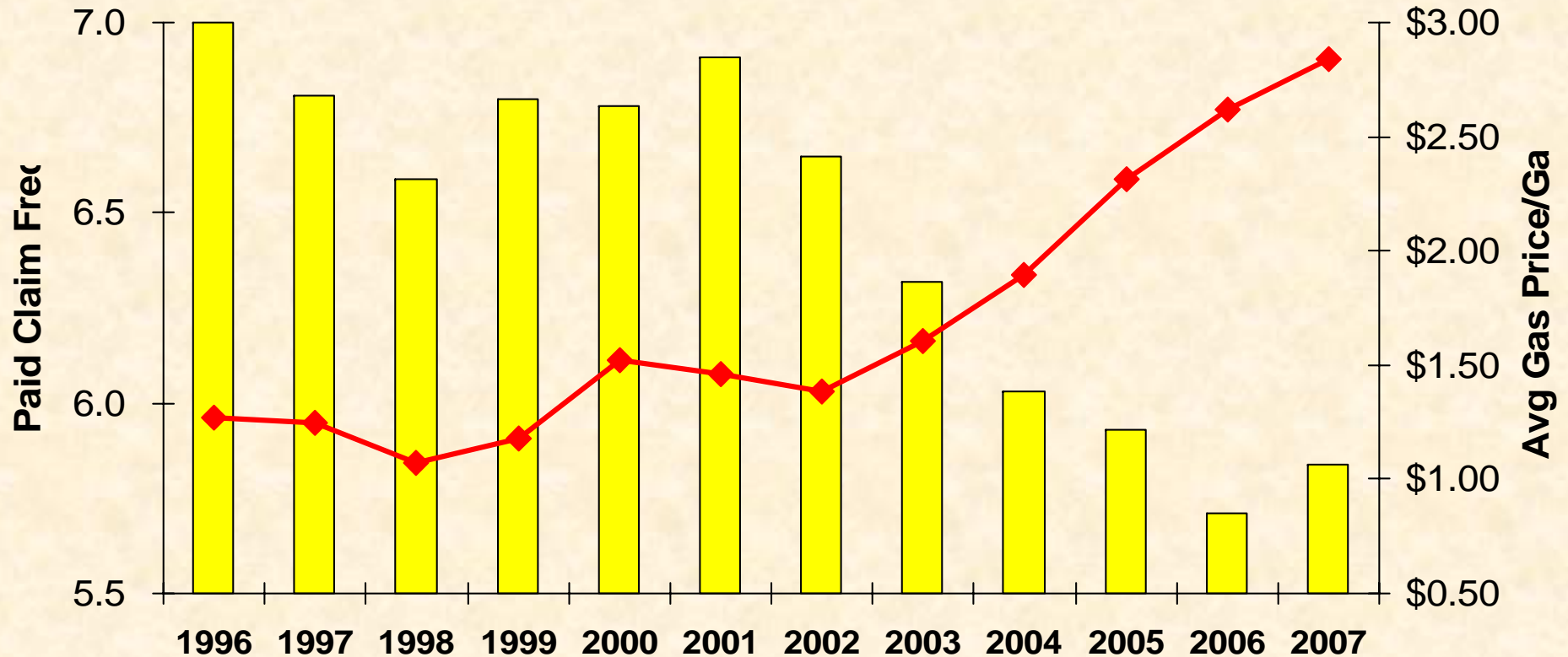
Sources: US Department of Commerce; Blue Chip Economic Indicators (10/07), except 2008/09 figures from 3/08 edition of BCEI; Insurance Info. Institute



Do Increases in Gas Prices Affect Auto Collision Claim Frequency?

Paid Claim Frequency = (No. of paid claims)/(Earned Car Years) x 100

Collision Claim Frequency Gas Prices



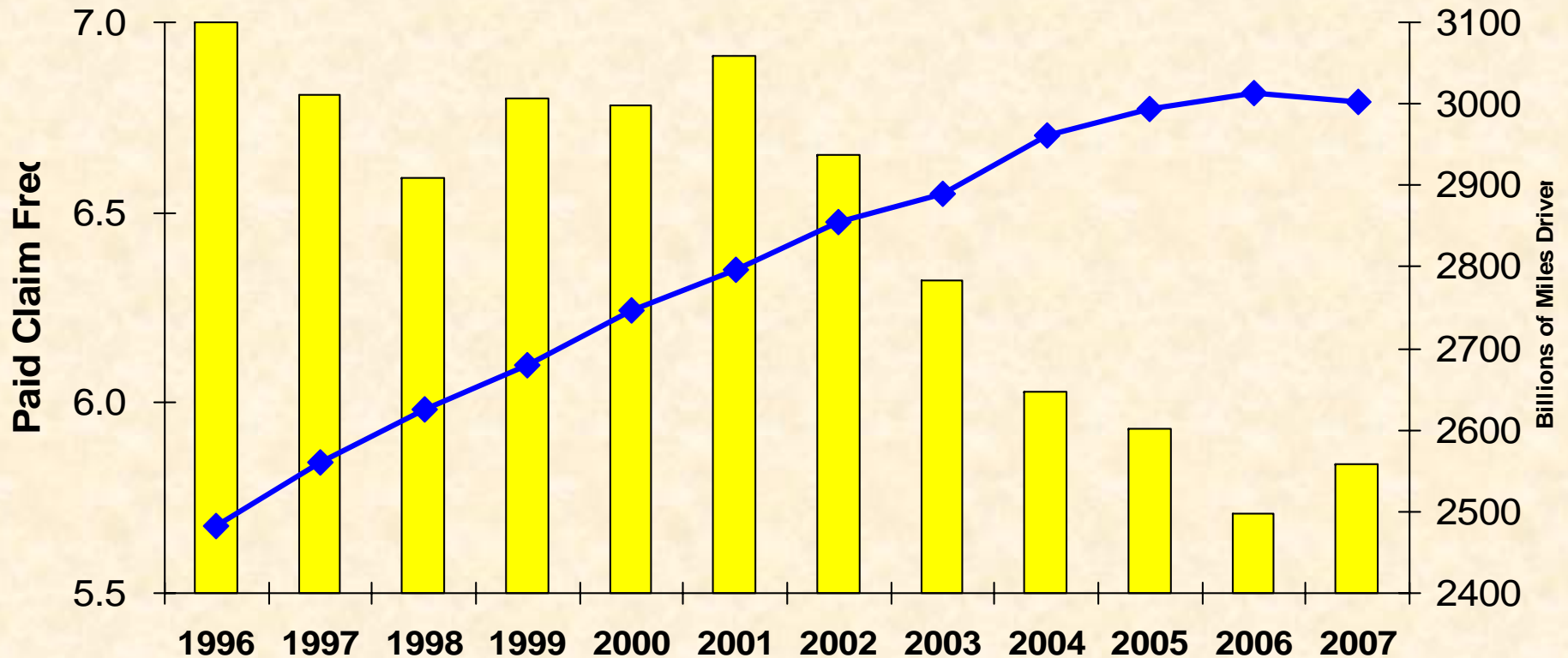
Sources: Energy Information Administration (http://tonto.eia.doe.gov/dnav/pet/hist/mg_tt_usA.htm); ISO Fast Track Monitoring System, *Private Passenger Automobile Fast Track Data: Fourth Quarter 2007*, published March 31, 2008 and earlier reports.



Do Changes in Miles Driven Affect Auto Collision Claim Frequency?

Paid Claim Frequency = (No. of paid claims)/(Earned Car Years) x 100

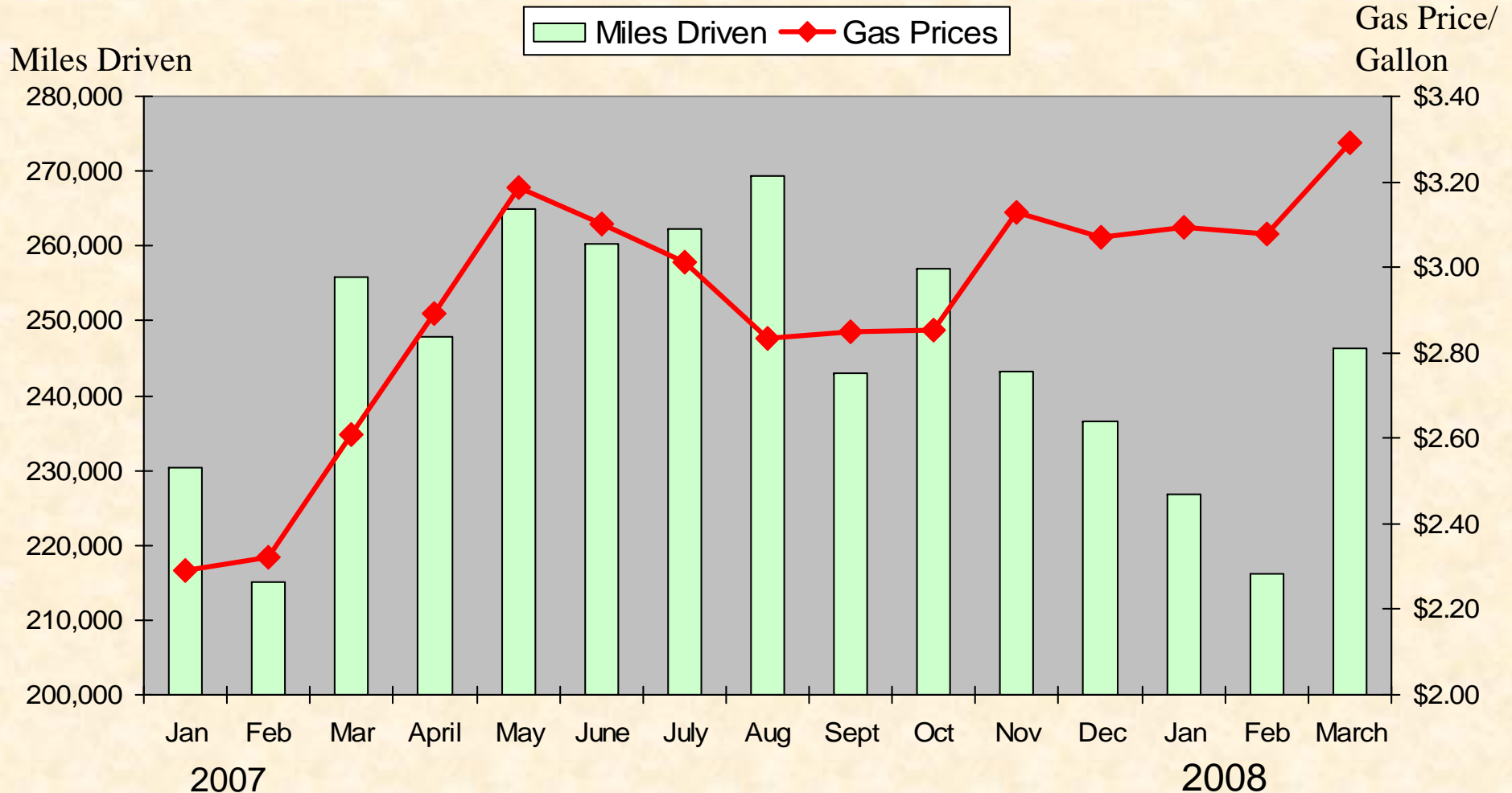
Collision Claim Frequency
Billions of Vehicle Miles



Sources: Federal Highway Administration (<http://www.fhwa.dot.gov/ohim/tvtw/08martvt/08martvt.pdf>); ISO Fast Track Monitoring System, *Private Passenger Automobile Fast Track Data: Fourth Quarter 2007*, published March 31, 2008 and earlier reports.



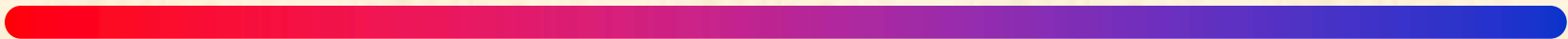
Miles Driven vs. Gas Prices in Recent Months



Sources: Energy Information Administration (http://tonto.eia.doe.gov/dnav/pet/hist/mg_tt_usA.htm);
Federal Highway Administration (<http://www.fhwa.dot.gov/ohim/tvtw/08martvt/08martvt.pdf>); .

Legal Aspects of the Credit Crunch

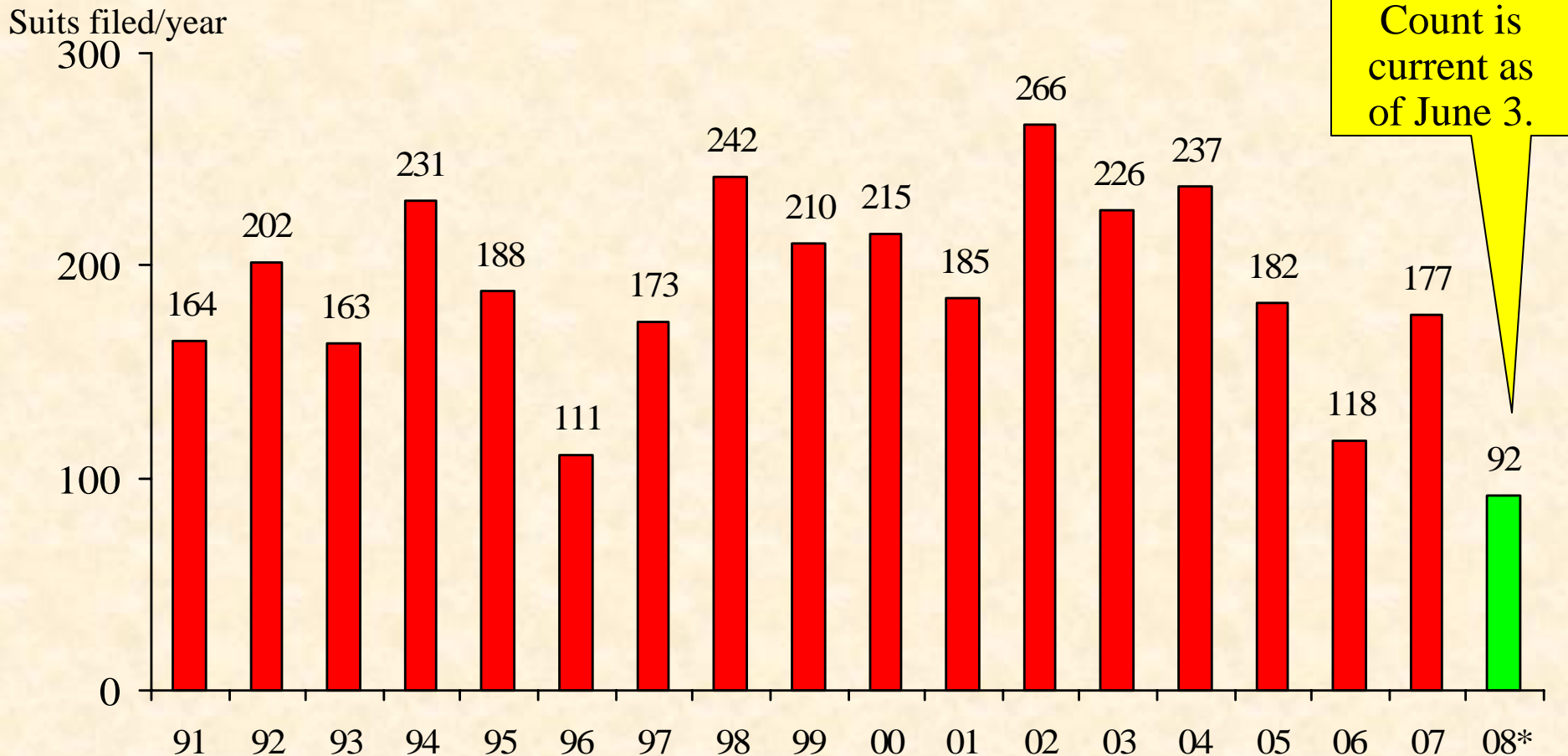
Turbulent Markets
Give Rise to Lawsuits





Shareholder Class Action Lawsuits*

Defendants include banks, investment banks, builders, lenders, and bond and mortgage insurers

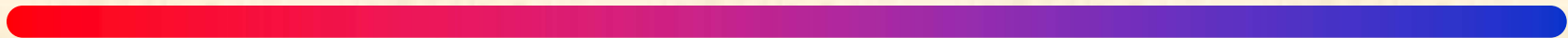


Count is current as of June 3.

*Securities fraud suits filed in U.S. federal courts. Not included above are 313 suits (all but 1 filed in 2001) relating to IPO allocations.

Source: Stanford University School of Law <http://securities.stanford.edu>

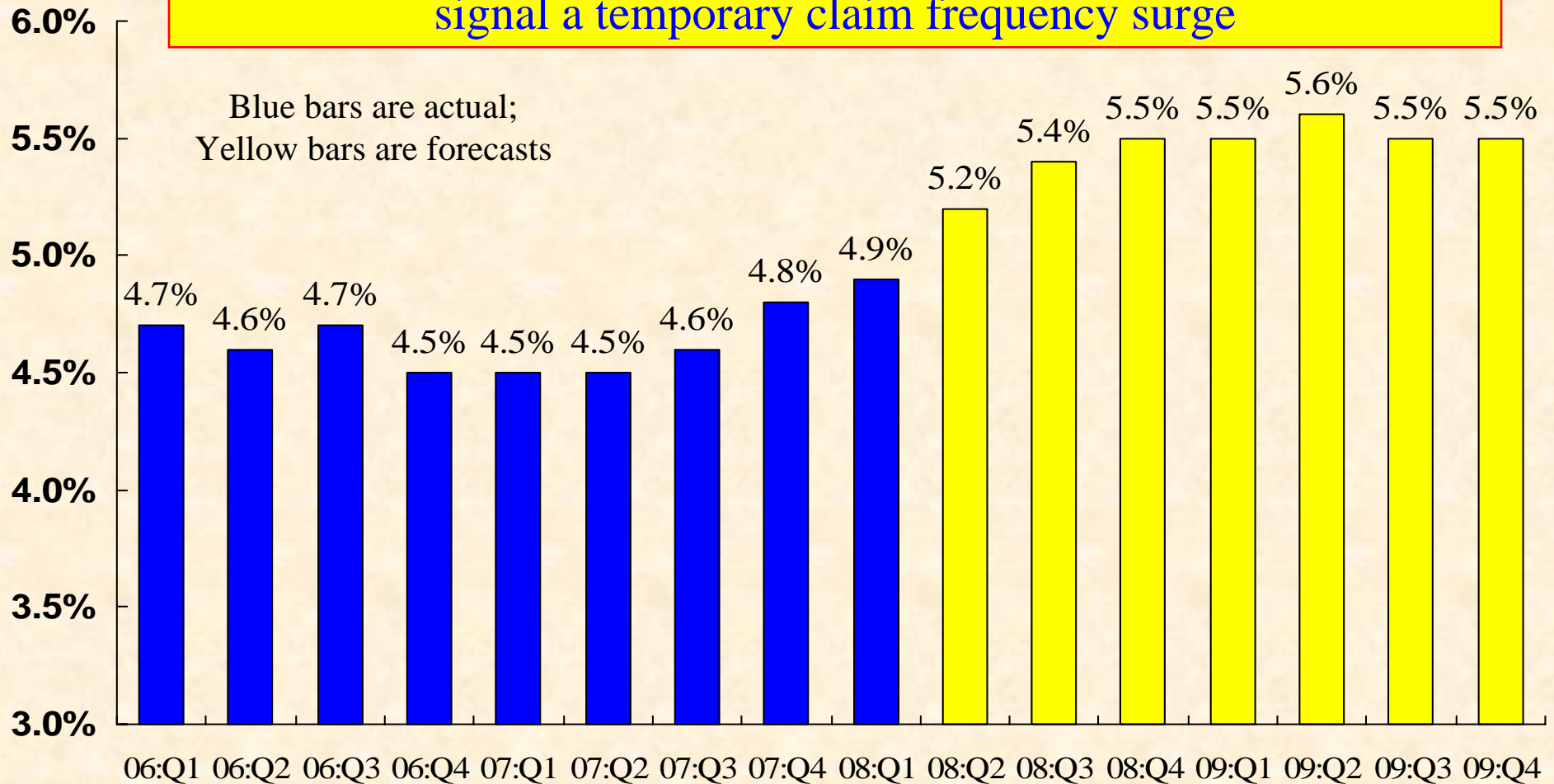
Workers Comp Insurance





US Unemployment Rate, (2007:Q1 to 2009:Q4F)

Higher unemployment rate reduces workers comp exposure; could signal a temporary claim frequency surge

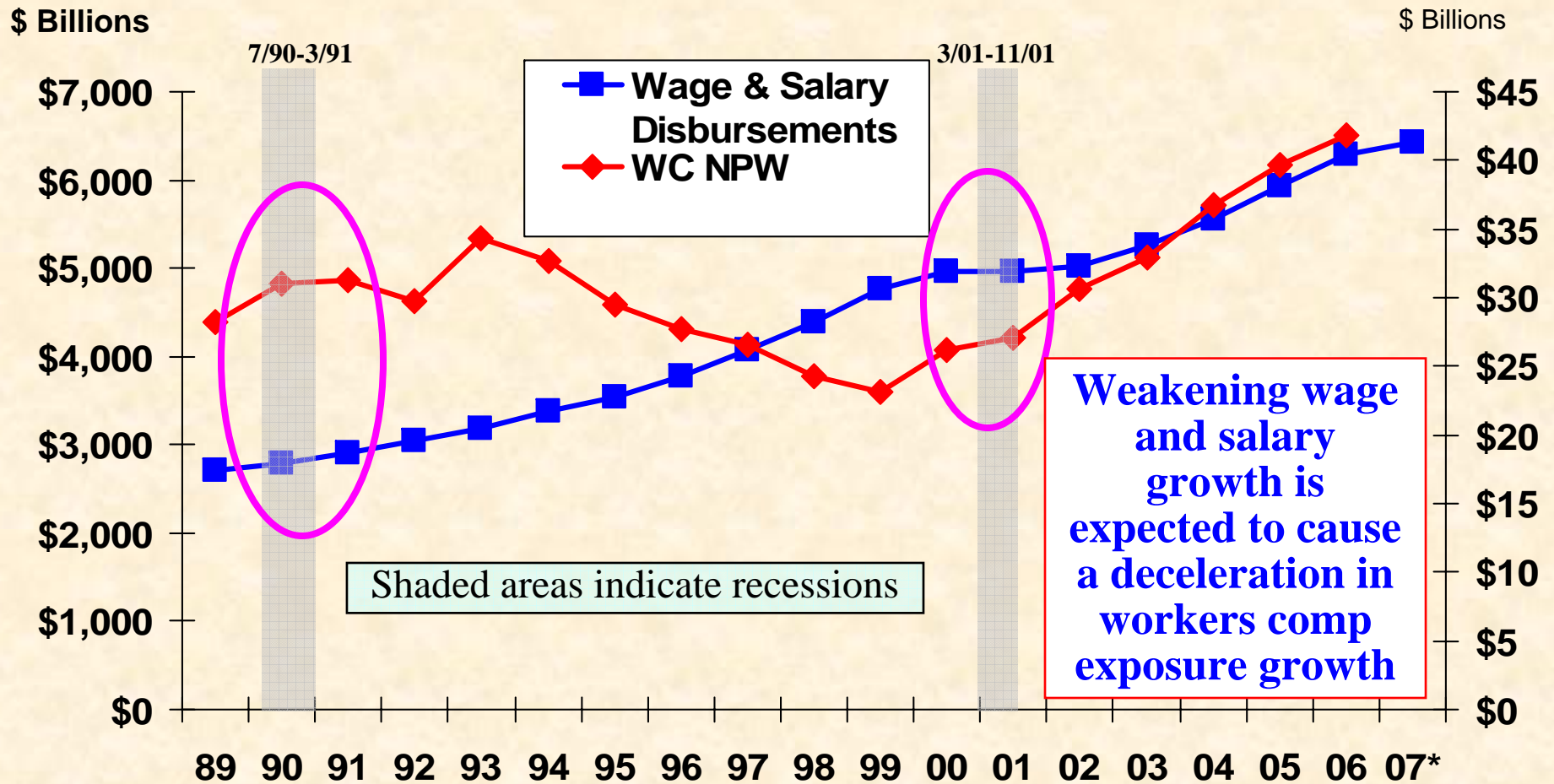


Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (4/08); Insurance Info. Inst.



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

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

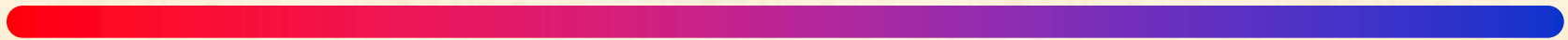


*As of 7/1/07 (latest available).

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

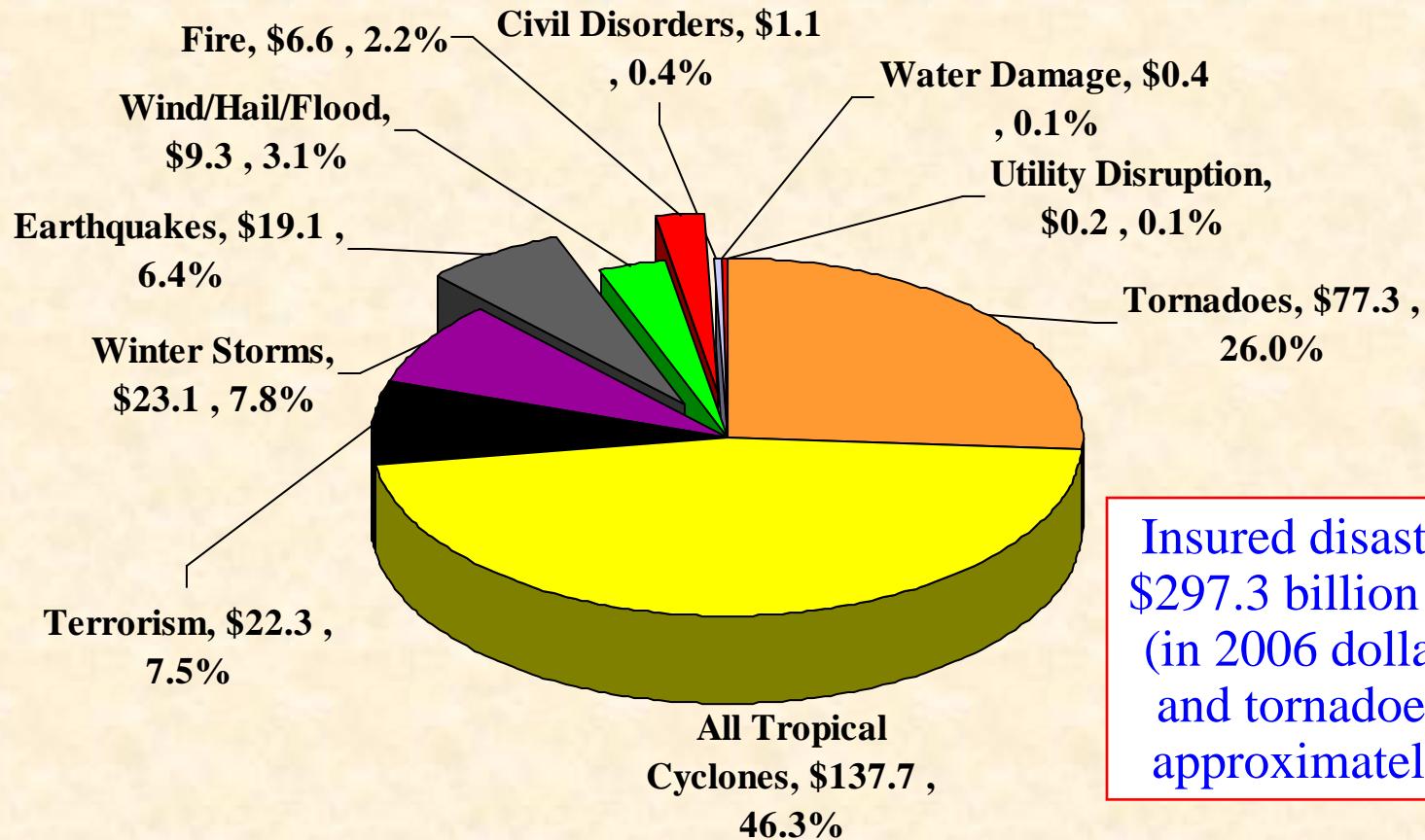
<http://research.stlouisfed.org/fred2/series/WASCUR>; I.I.I. Fact Books

Catastrophic Losses





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.

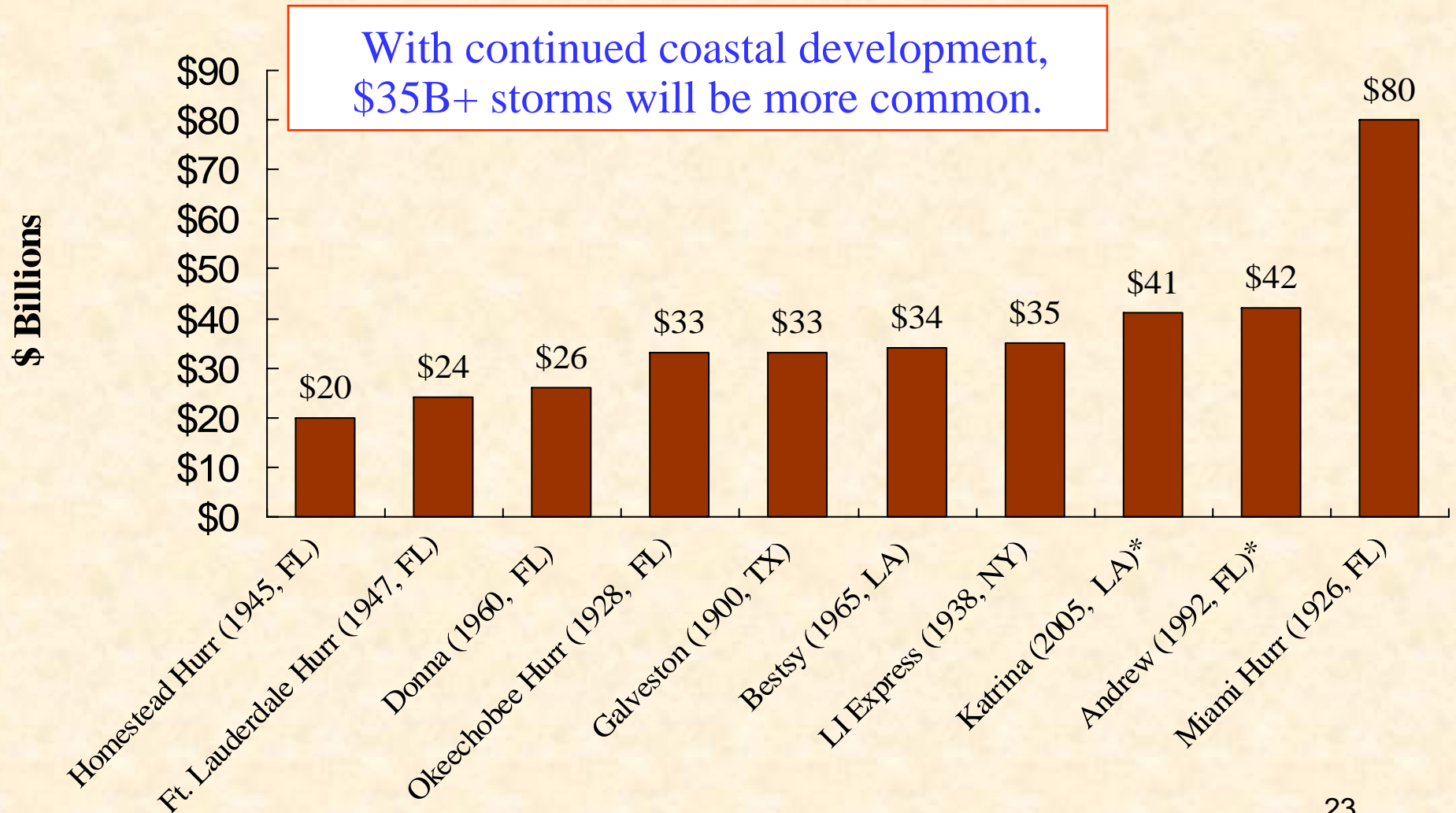
¹ Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2006 dollars.

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.

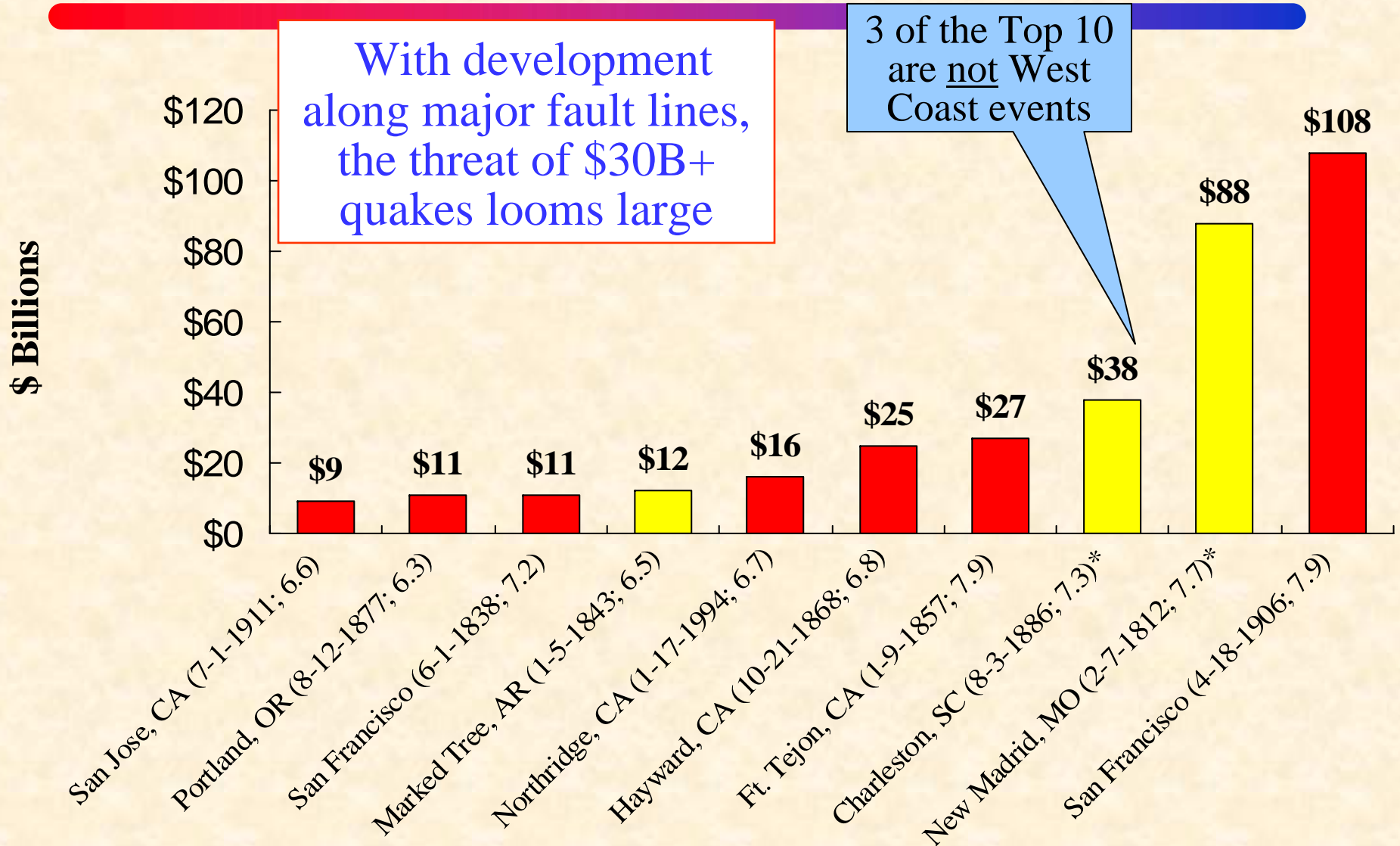


Largest Insured Losses (Adjusted to 2005 Exposure Levels) from 10 Hurricanes





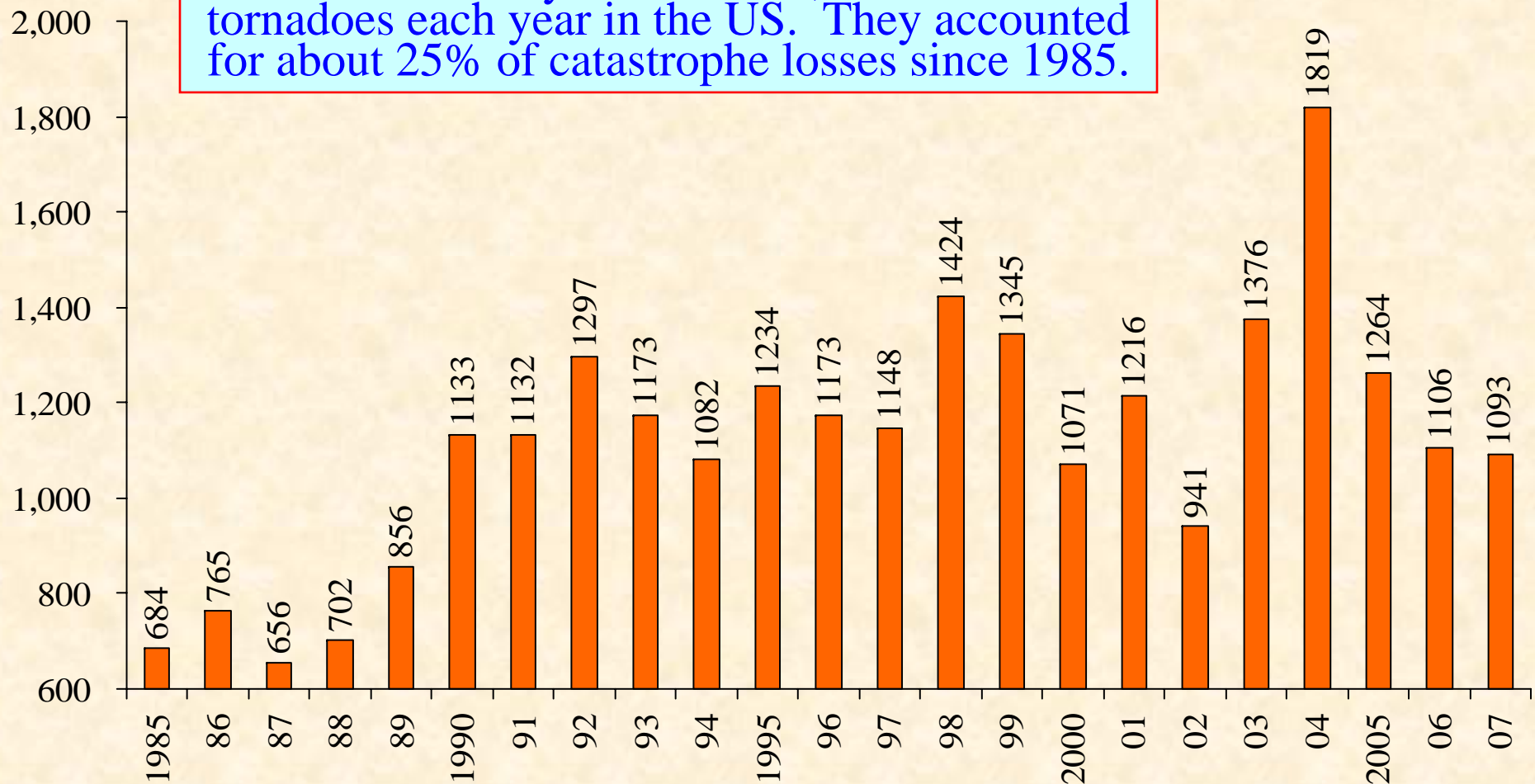
Insured Losses (adjusted to 2005 exposure levels) from 10 Most Damaging US Earthquakes





Number of Tornadoes, 1985 – 2007

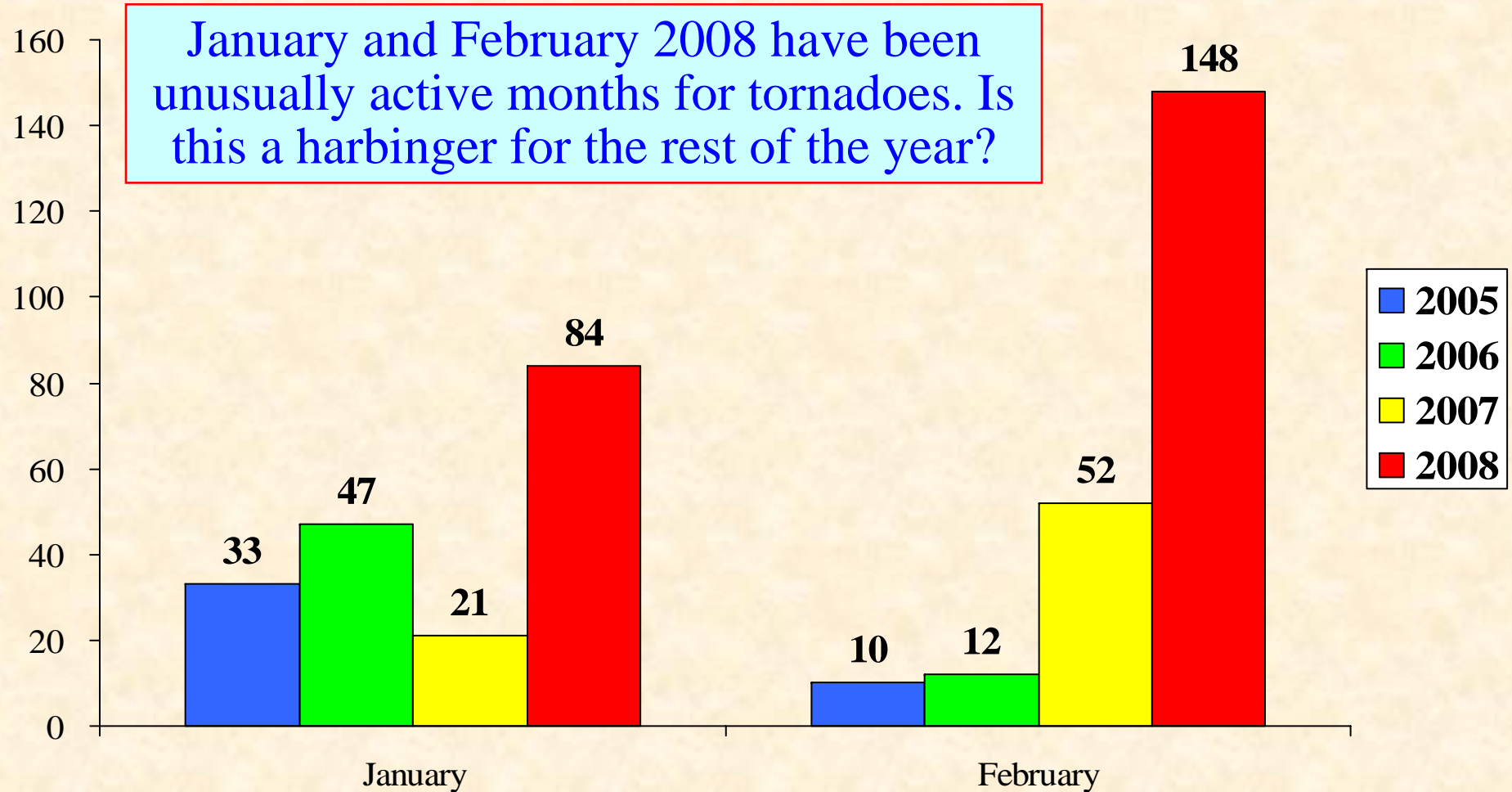
There are usually more than 1,000 confirmed tornadoes each year in the US. They accounted for about 25% of catastrophe losses since 1985.



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



Number of Tornadoes in January and February, 2005–2008

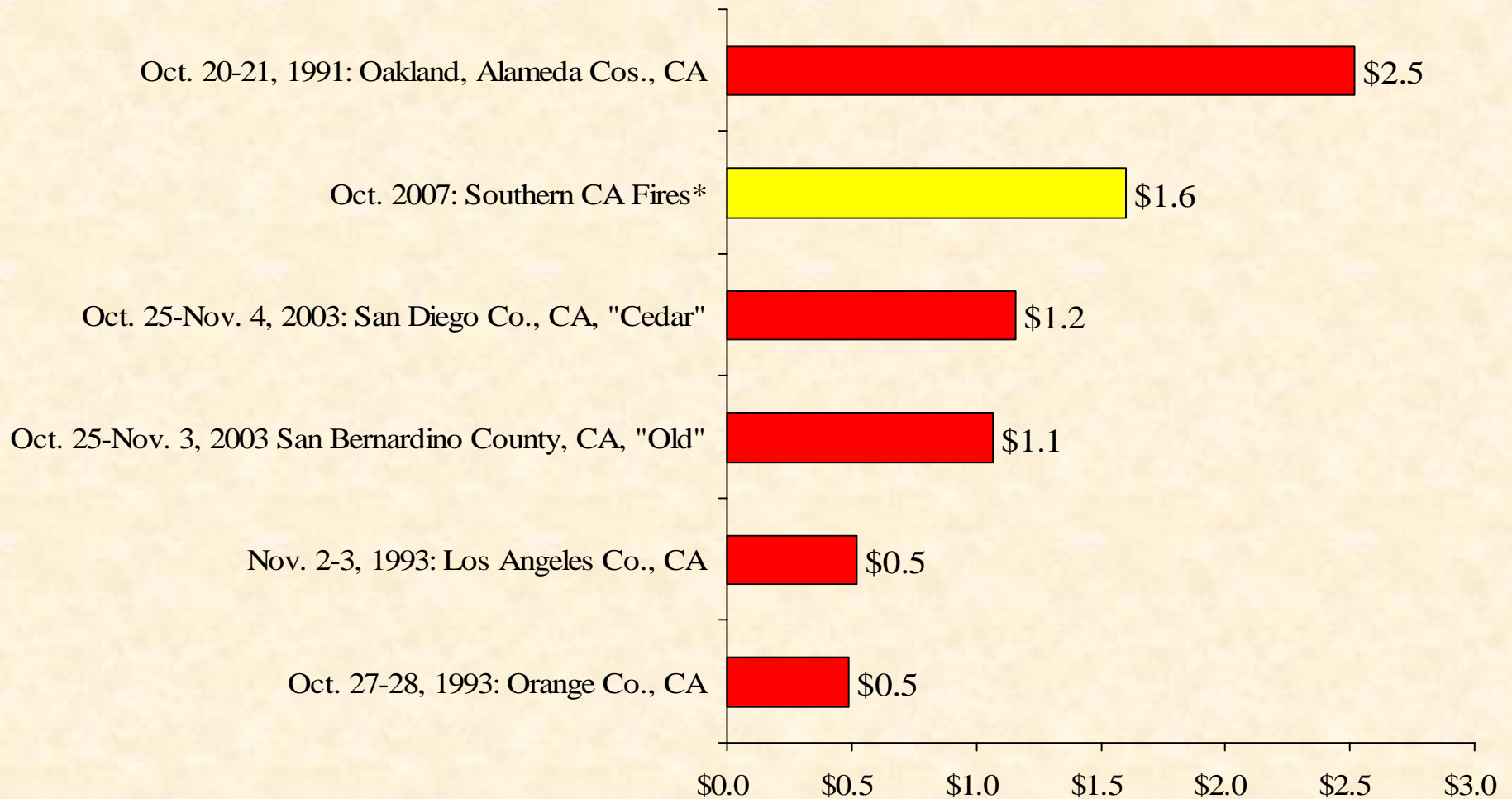


Sources: US Dept. of Commerce, Storm Prediction Center, National Weather Service,
at <http://www.spc.noaa.gov/climo/torn/monthlytornstats.pdf>



Top Five Catastrophic Wildland Fires In California, 1970-2007*

Insured Losses (Billions 2006 \$)



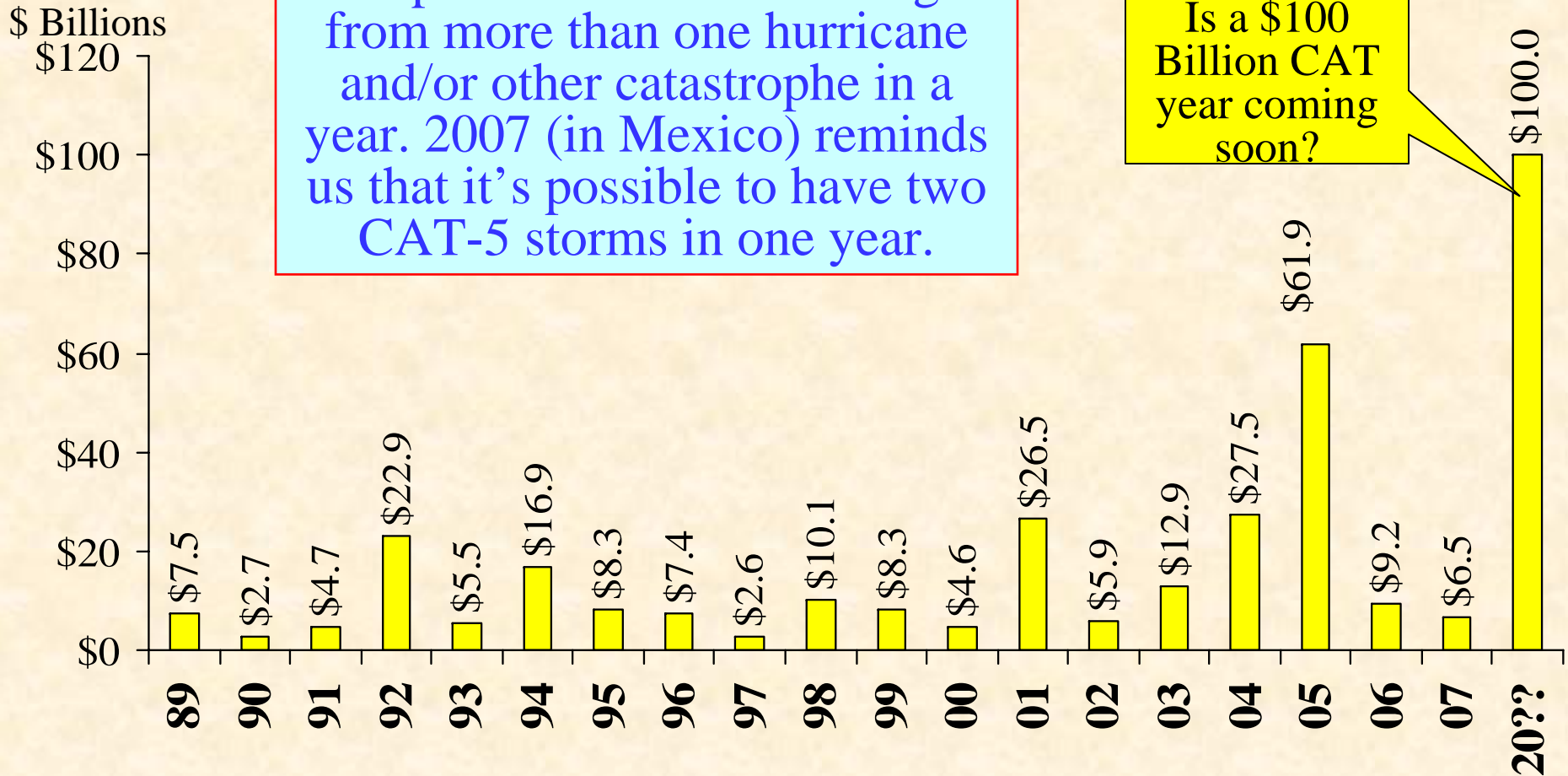
*Estimated insured losses. Adjusted to 2006 dollars by the Insurance Information Institute. 2007 fire losses are stated in 2007 dollars. Source: ISO's Property Claim Services Unit; Insurance Information Institute.



U.S. Insured Catastrophe Losses*

2004 and 2005 remind us that it's possible to suffer damage from more than one hurricane and/or other catastrophe in a year. 2007 (in Mexico) reminds us that it's possible to have two CAT-5 storms in one year.

Is a \$100 Billion CAT year coming soon?



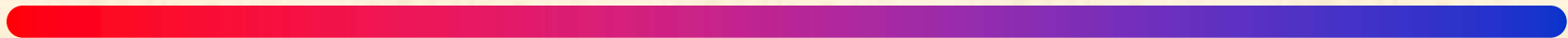
*Excludes \$4B-\$6b offshore energy losses from Hurricanes Katrina & Rita.

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

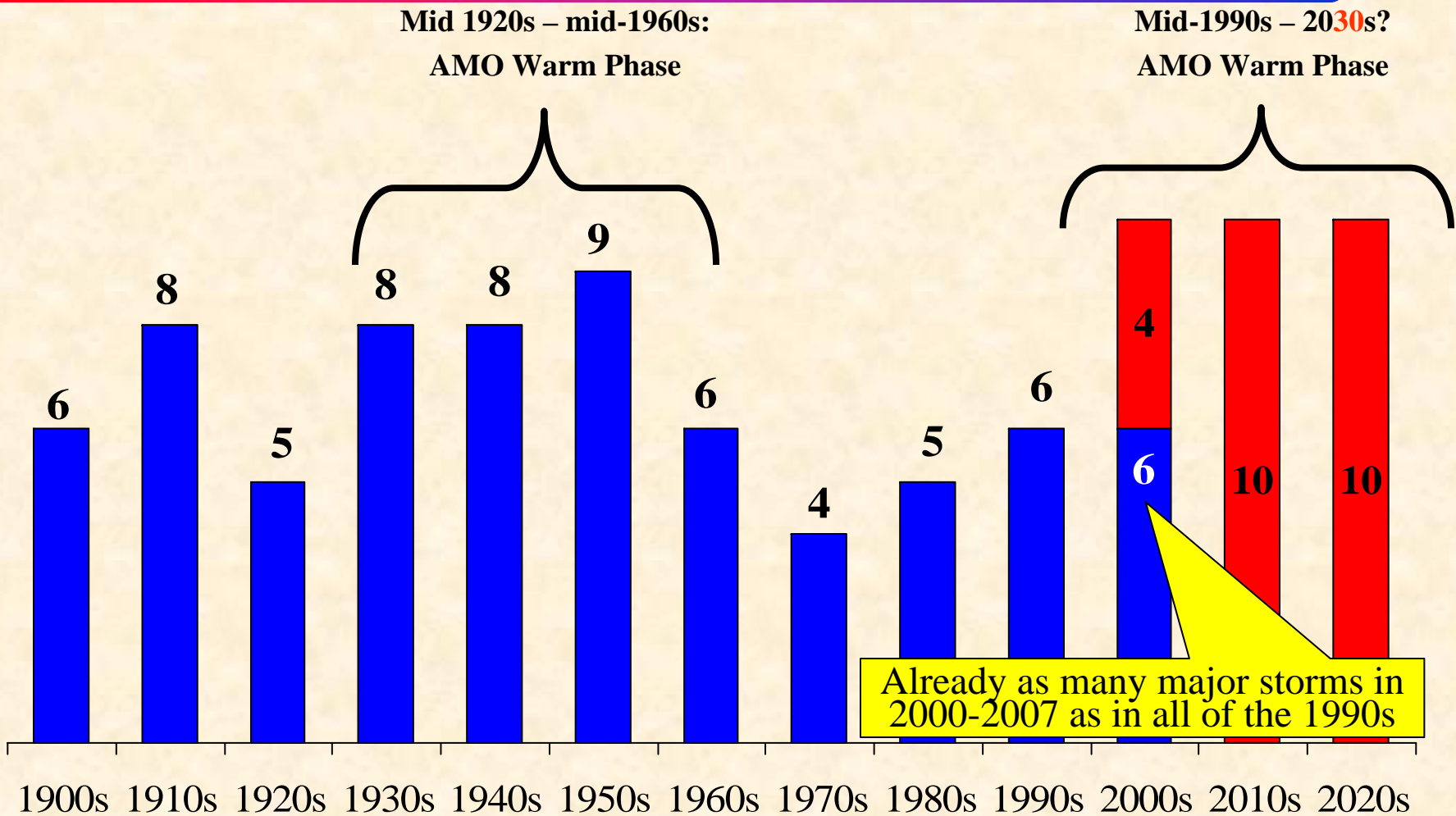
The 2008 Hurricane Season:

Is a Bad Year in the Forecast?





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

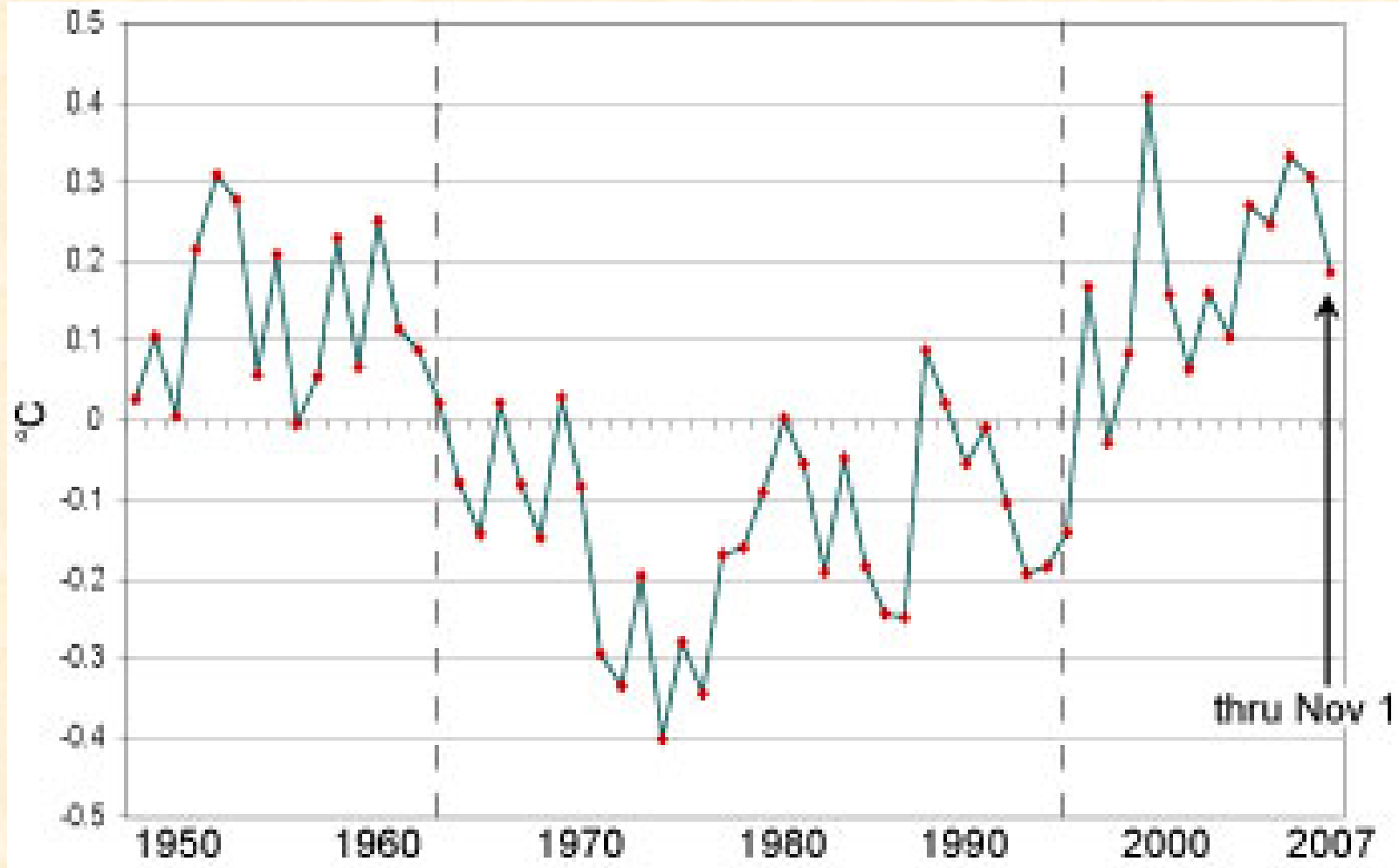


*Figure for 2000s is extrapolated based on data for 2000-2007 (6 major storms: Charley, Ivan, Jeanne (2004) & Katrina, Rita, Wilma (2005)).

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



Atlantic Sea Surface Temperatures, 1948-2007





Outlook for 2008 Hurricane

Season: 60% Worse Than Average

	Average*	2005	2008F
Named Storms	9.6	28	15
Named Storm Days	49.1	115.5	80
Hurricanes	5.9	14	8
Hurricane Days	24.5	47.5	40
Intense Hurricanes	2.3	7	4
Intense Hurricane Days	5	7	9
Accumulated Cyclone Energy	96.2	248	150
Net Tropical Cyclone Activity	100%	275%	160%

*Average over the period 1950-2000.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, June 3, 2008.



Increased Likelihood of Landfall with High NTC (based on 1950-2007)

	# of Named Storms	# of Hurricanes	# of Major Hurricanes
15 Years When NTC > 130	66	41	18
15 Years When NTC < 65	32	14	5

With high NTC (compared to low NTC),

- Twice as many named storms made landfall
- Three times as many hurricanes made landfall
- Three times as many major hurricanes made landfall

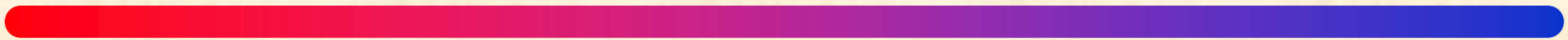


Major Hurricanes Might Form But Not Make Landfall

- From Hurricane Irene in 1999 to Hurricane Lili in 2002, 21 consecutive hurricanes developed in the Atlantic basin *without a single U.S. landfall.*
- “This is how nature sometimes works.”
 - From 1966 to 2003, of 79 major (3-4-5) hurricanes, 19 (24%) made landfall.
 - During 2004-5, 7 of 13 (54%) major hurricanes made landfall
 - During 2006-7, 0 of 4 (0%) major hurricanes made landfall

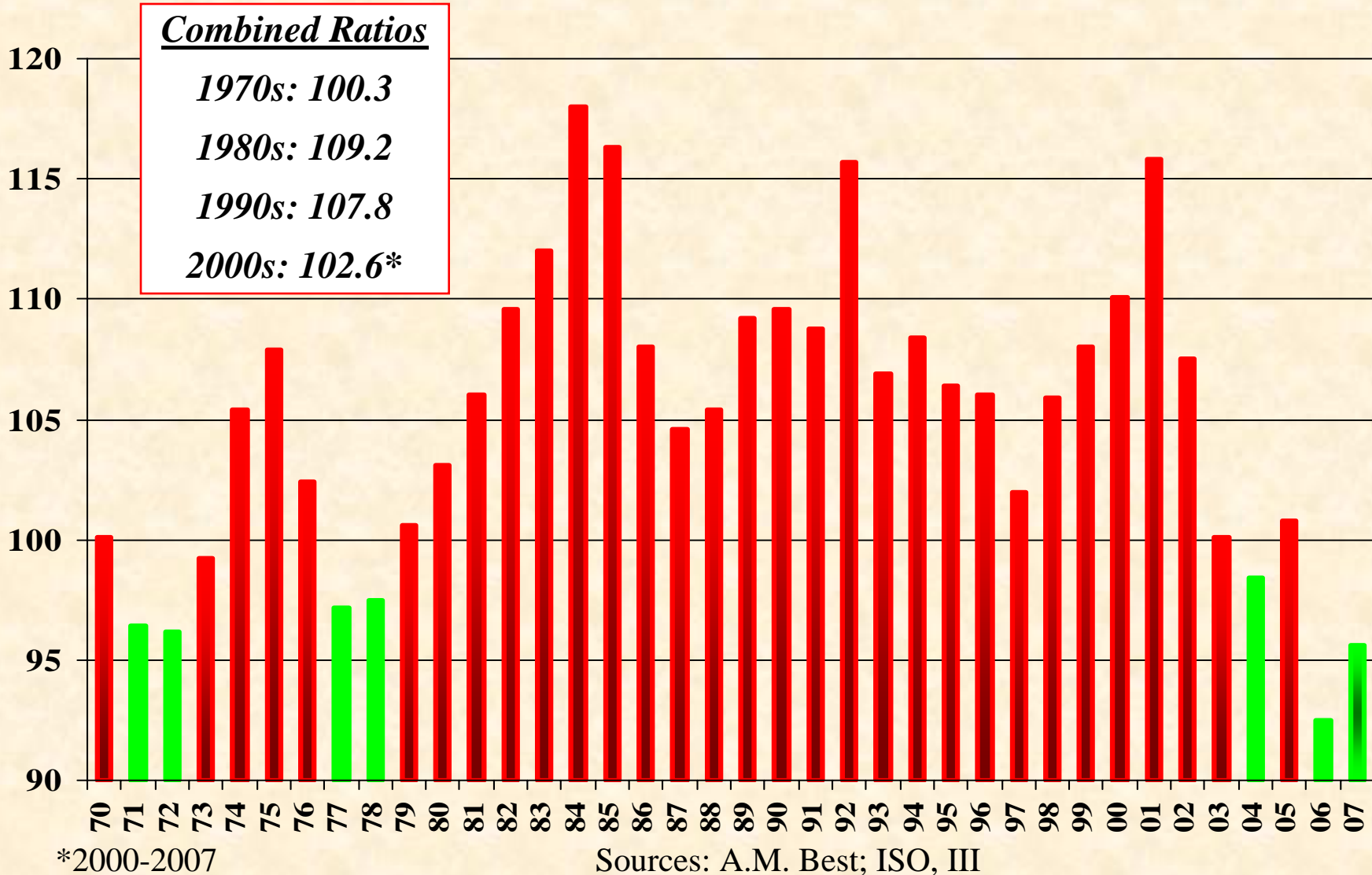
Source: Philip Klotzbach and William Gray, “Extended Range Forecast of Atlantic Seasonal Hurricane Activity and U.S. Landfall Strike Probability for 2008,” Department of Atmospheric Science, Colorado State University, June 3, 2008, p. 34.

Underwriting Trends



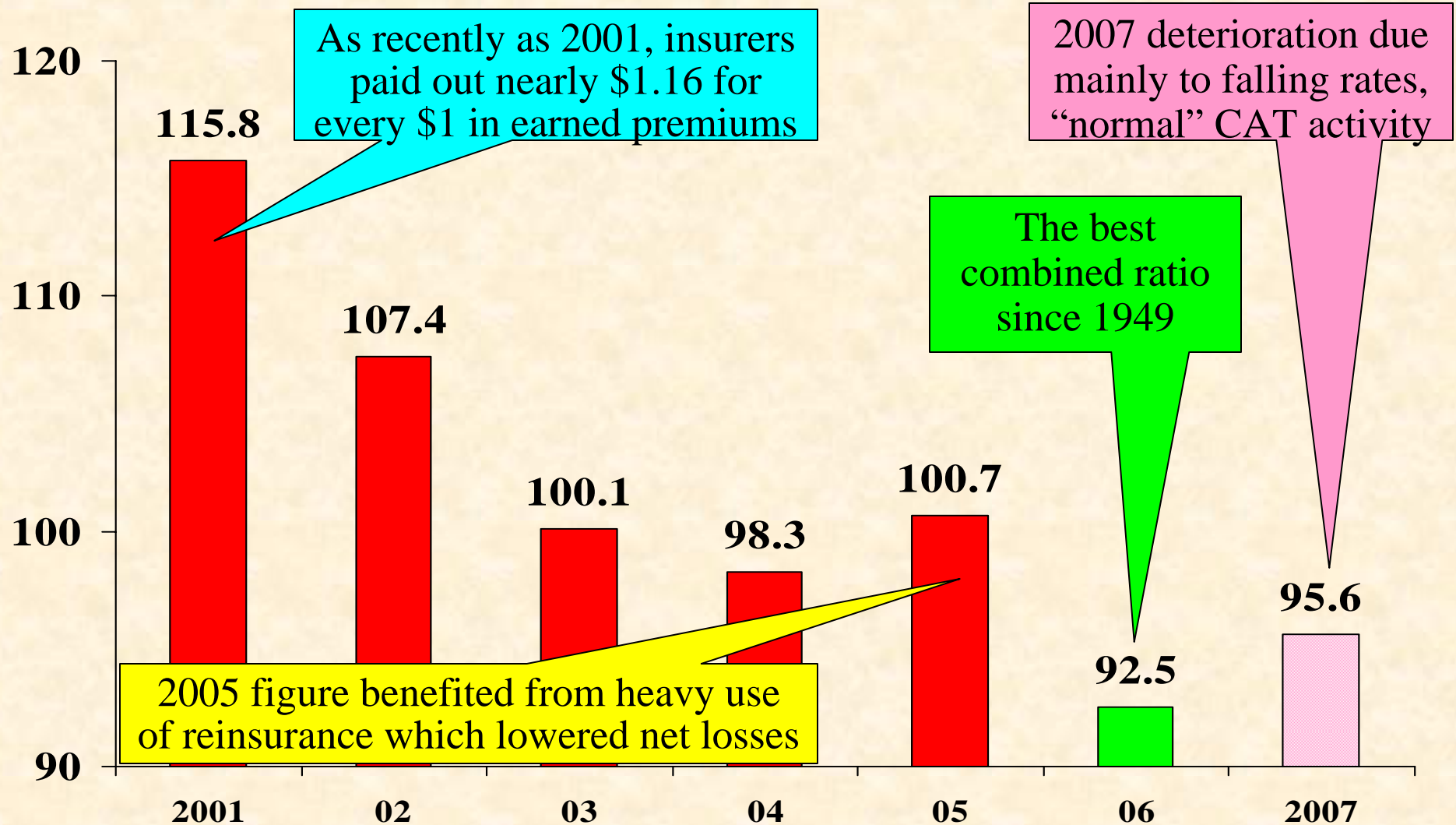


U.S. P/C Insurance Industry Combined Ratio, 1970-2007





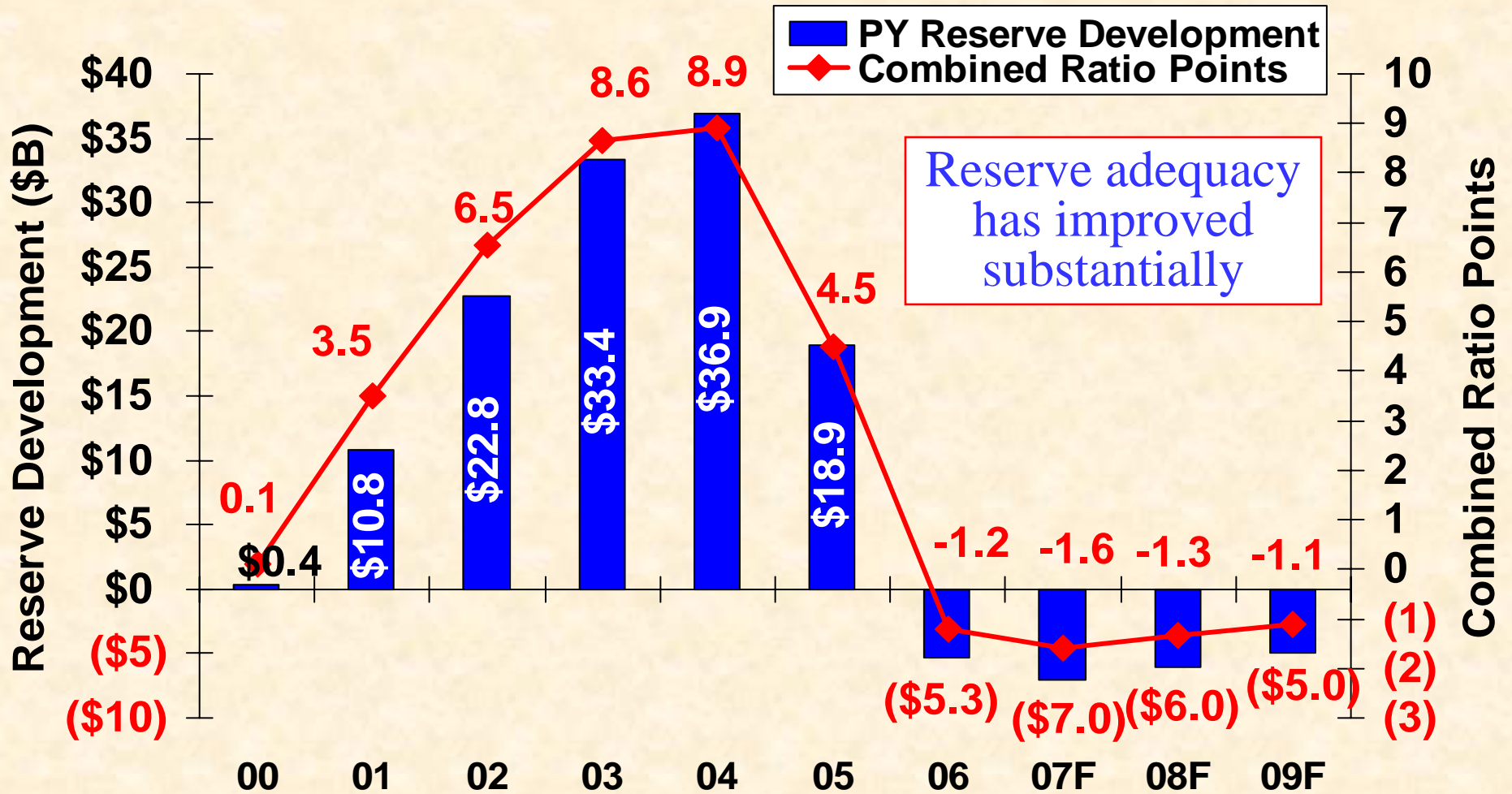
P/C Insurance Combined Ratio, 2001-2007



Sources: A.M. Best; ISO, III.



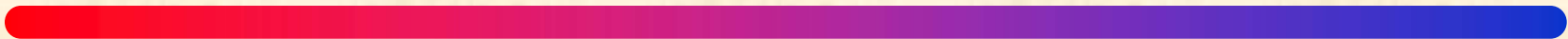
Impact of Reserve Changes on Combined Ratio



Source: A.M. Best, Lehman Brothers estimates for years 2007-2009

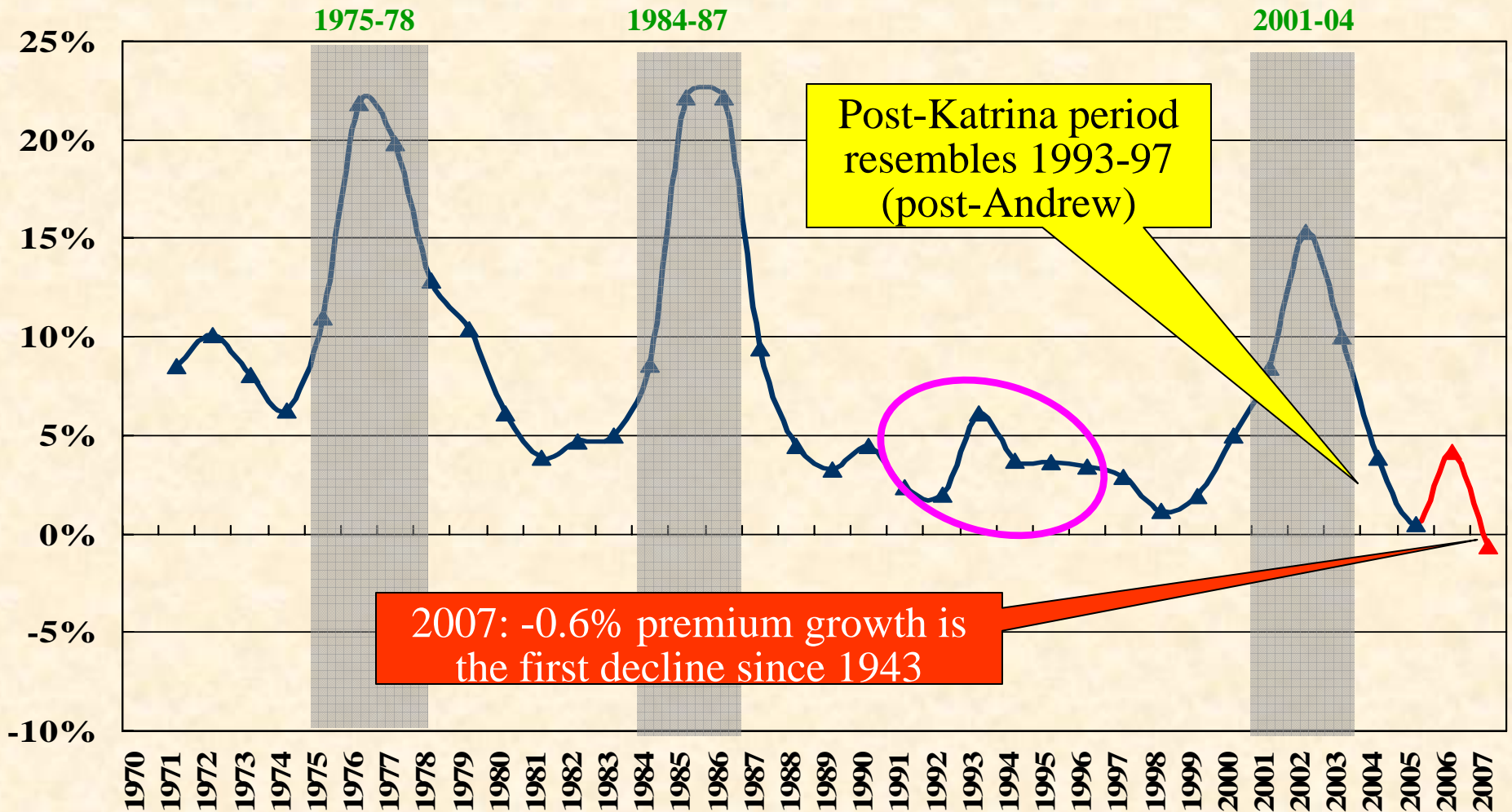
Premium Growth

At a Virtual Standstill
in 2007/08





Three “Hard Markets” in the Last 40 Years



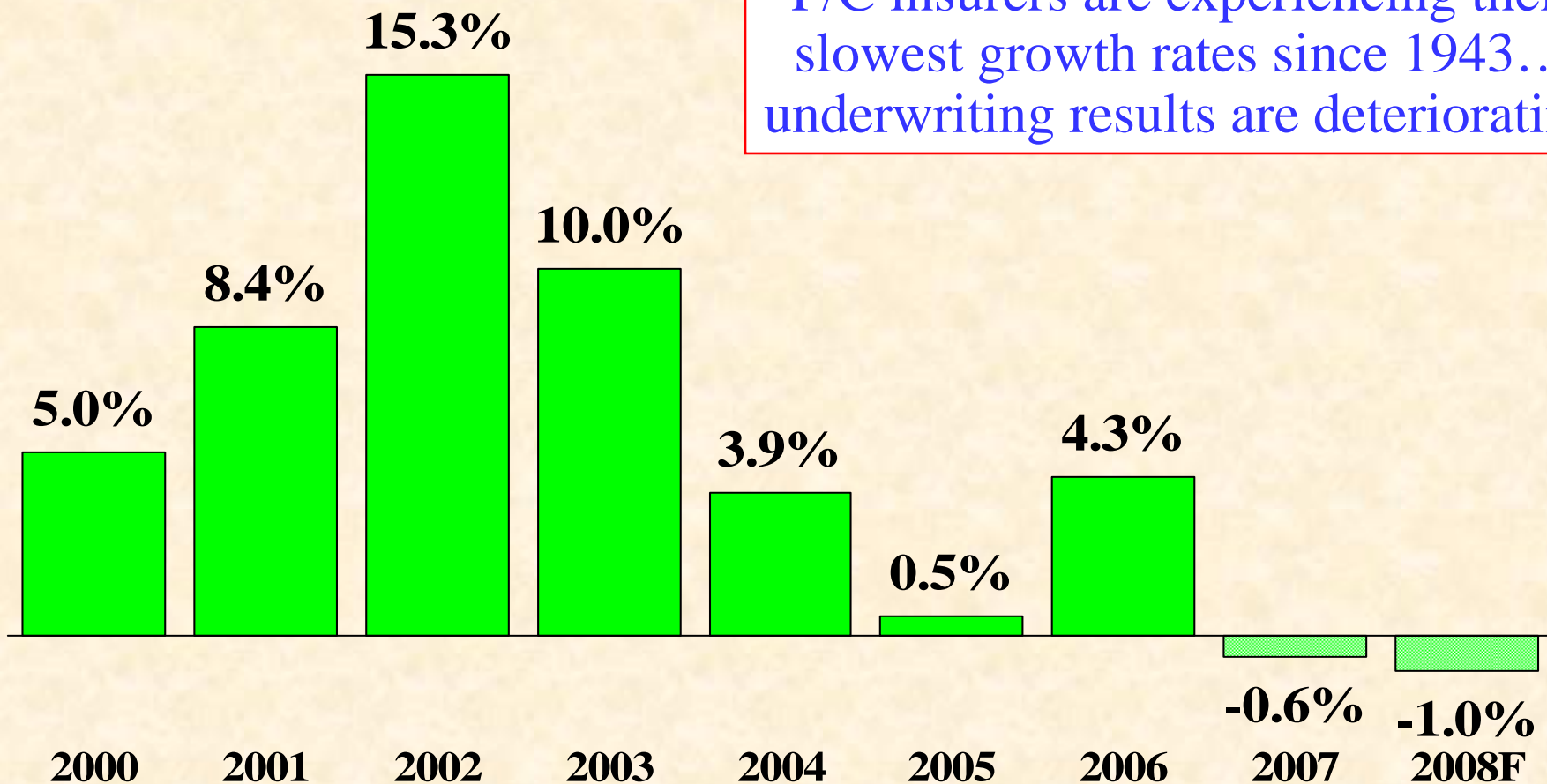
Note: Shaded areas denote hard market periods.

Source: A.M. Best, Insurance Information Institute



Year-to-Year Changes in Net Written Premium, 2000-2008F

P/C insurers are experiencing their slowest growth rates since 1943... underwriting results are deteriorating

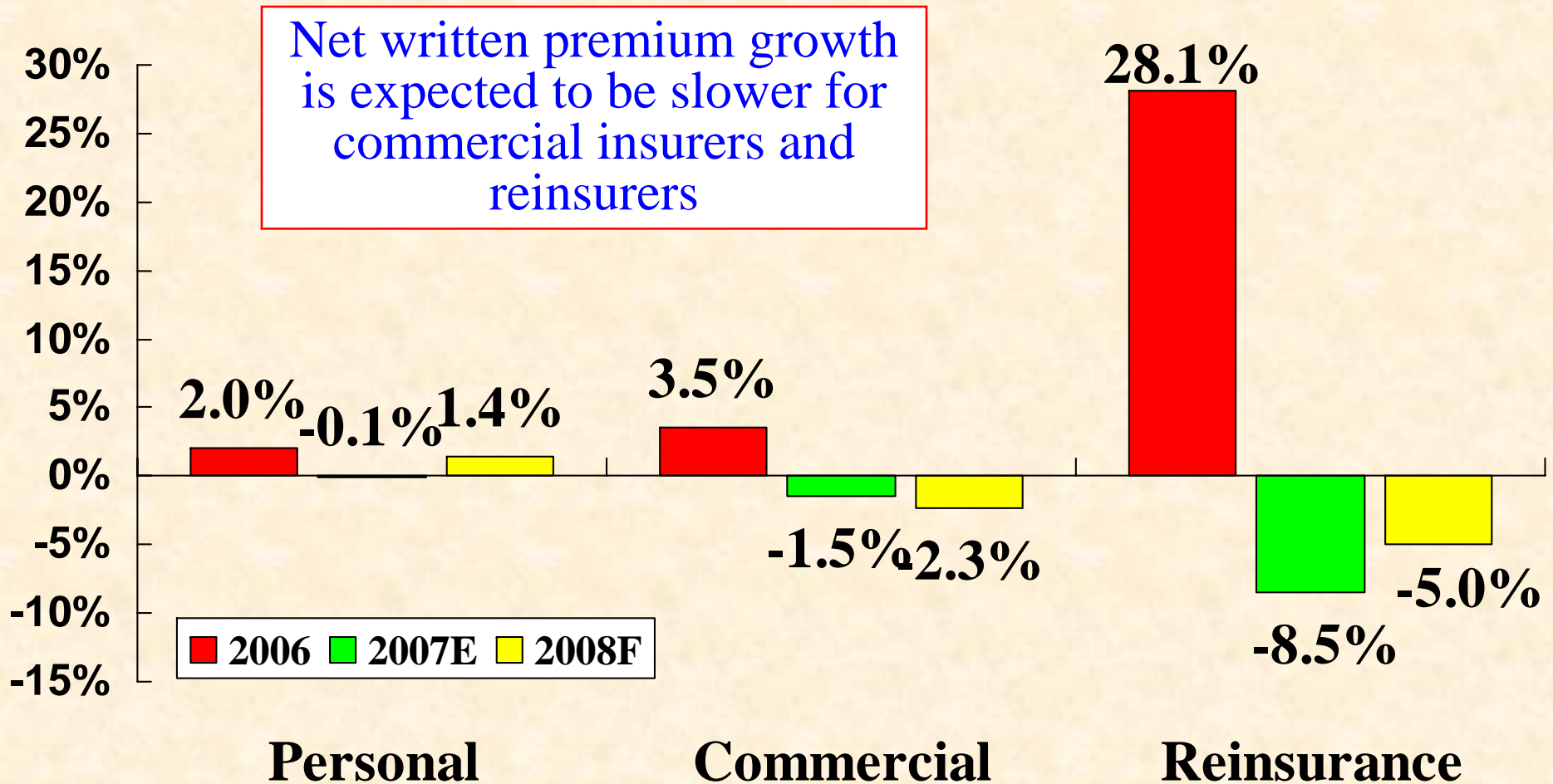


*2008 forecast from A.M. Best.

Source: A.M. Best; Forecasts from the Insurance Information Institute.

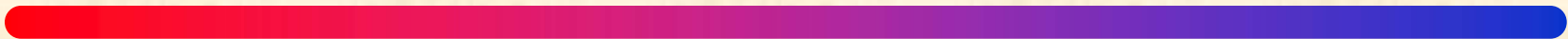


Personal/Commercial Lines & Reinsurance NPW Growth, 2006-2008F



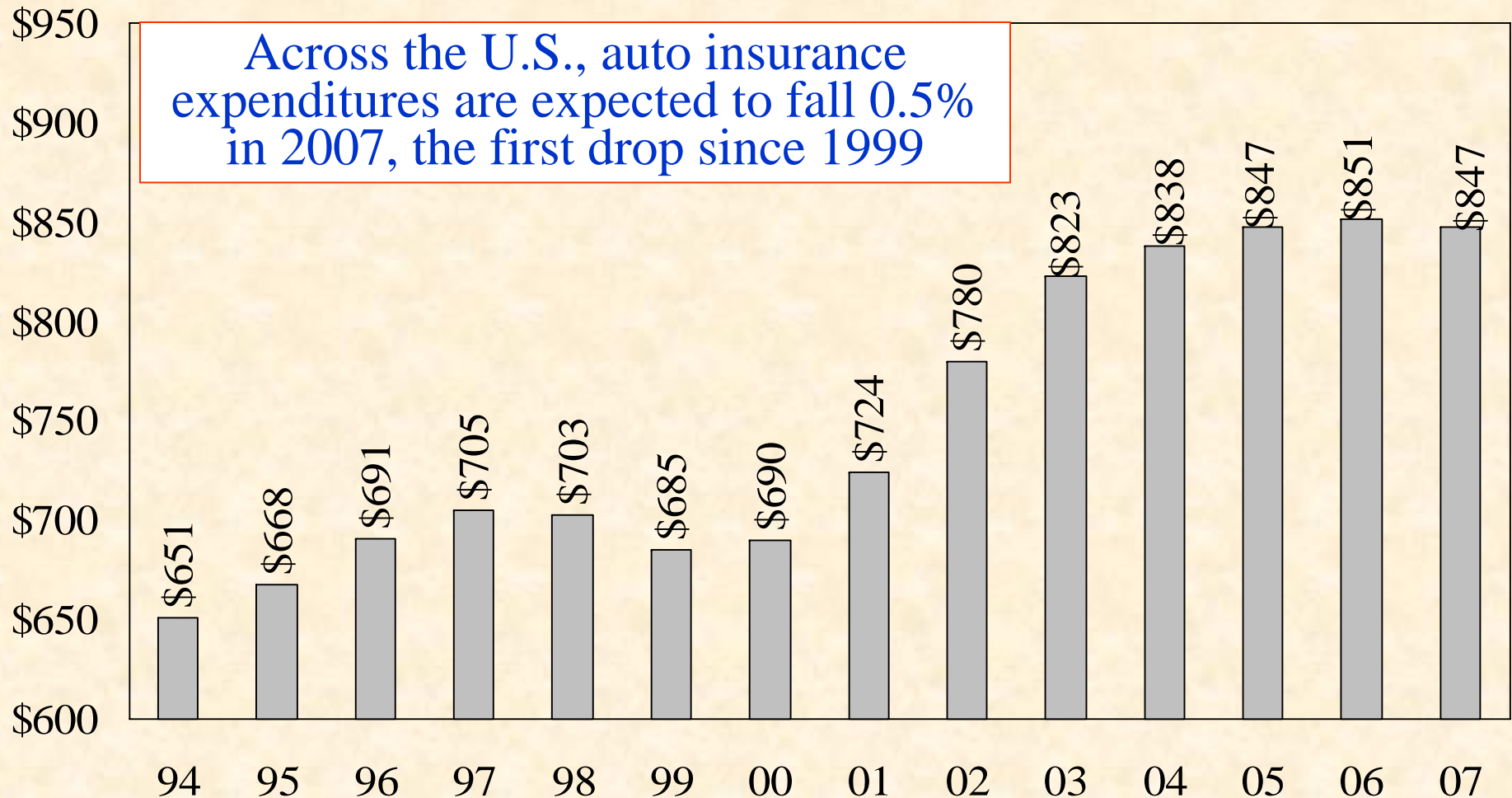
Sources: A.M. Best Review & Preview (historical and forecast).

Rates Under Pressure
in 2008,
Especially Commercial Lines





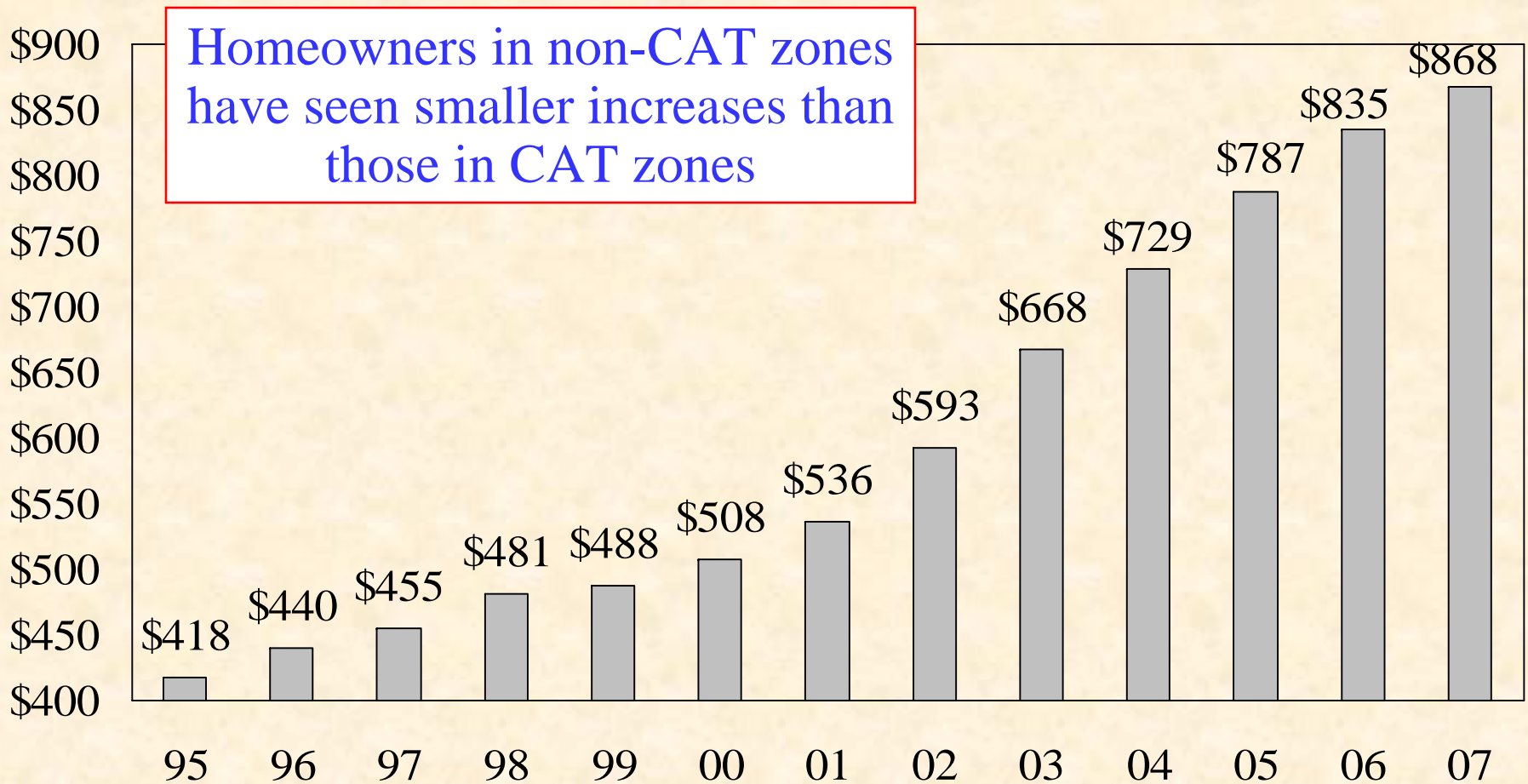
Lower Underlying Frequency, Modest Severity, Check Auto Insurance Costs



Sources: NAIC, Insurance Information Institute



Across the U.S., Home Insurance Costs* Rose 4% in 2007

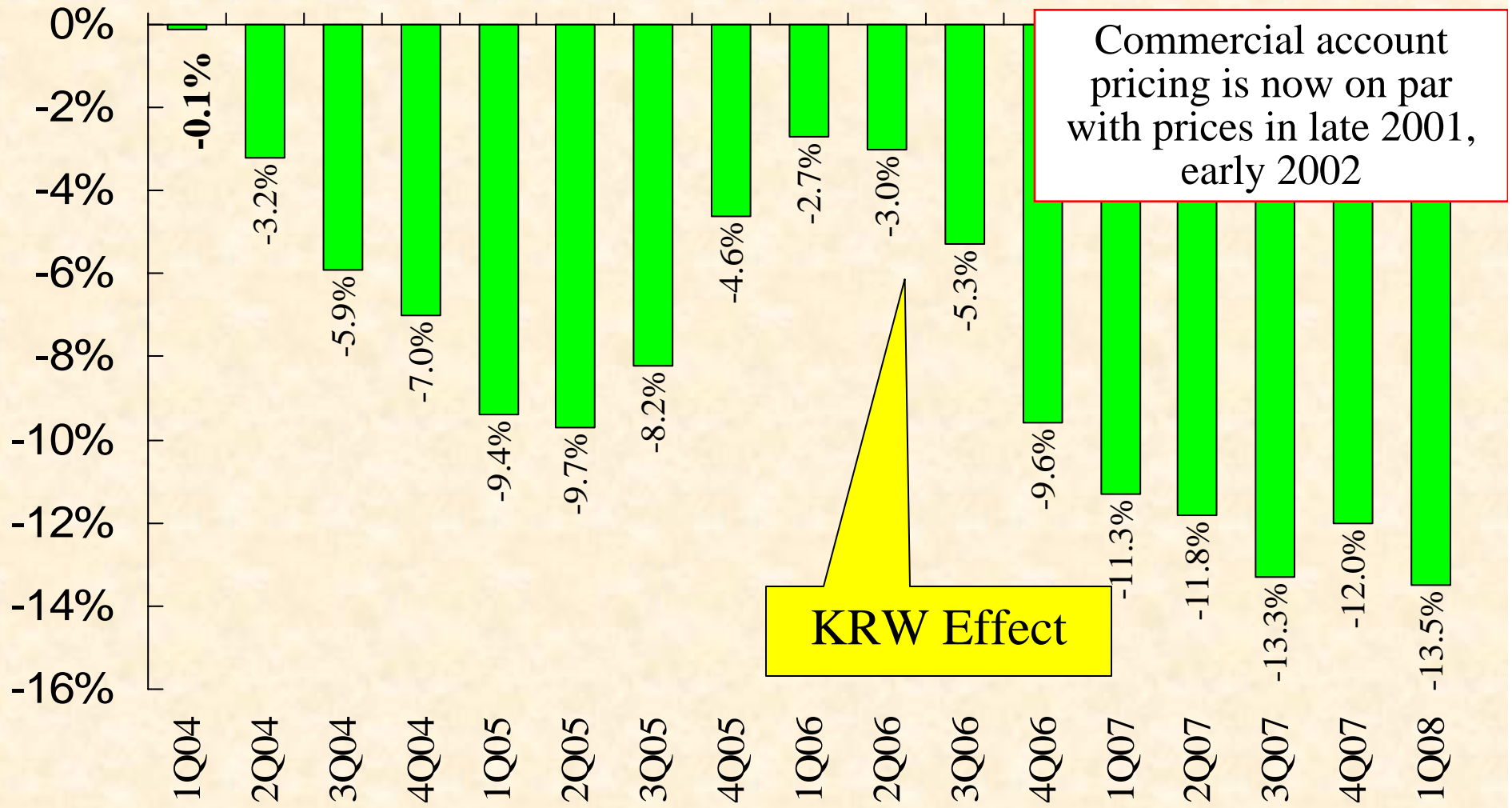


*Excludes cost of flood and earthquake coverage.

Source: NAIC, Insurance Information Institute

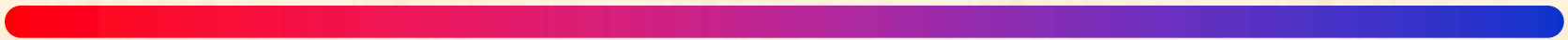


Average Quarterly Commercial Rate Change, All Lines, (1Q:2004 – 1Q:2008)



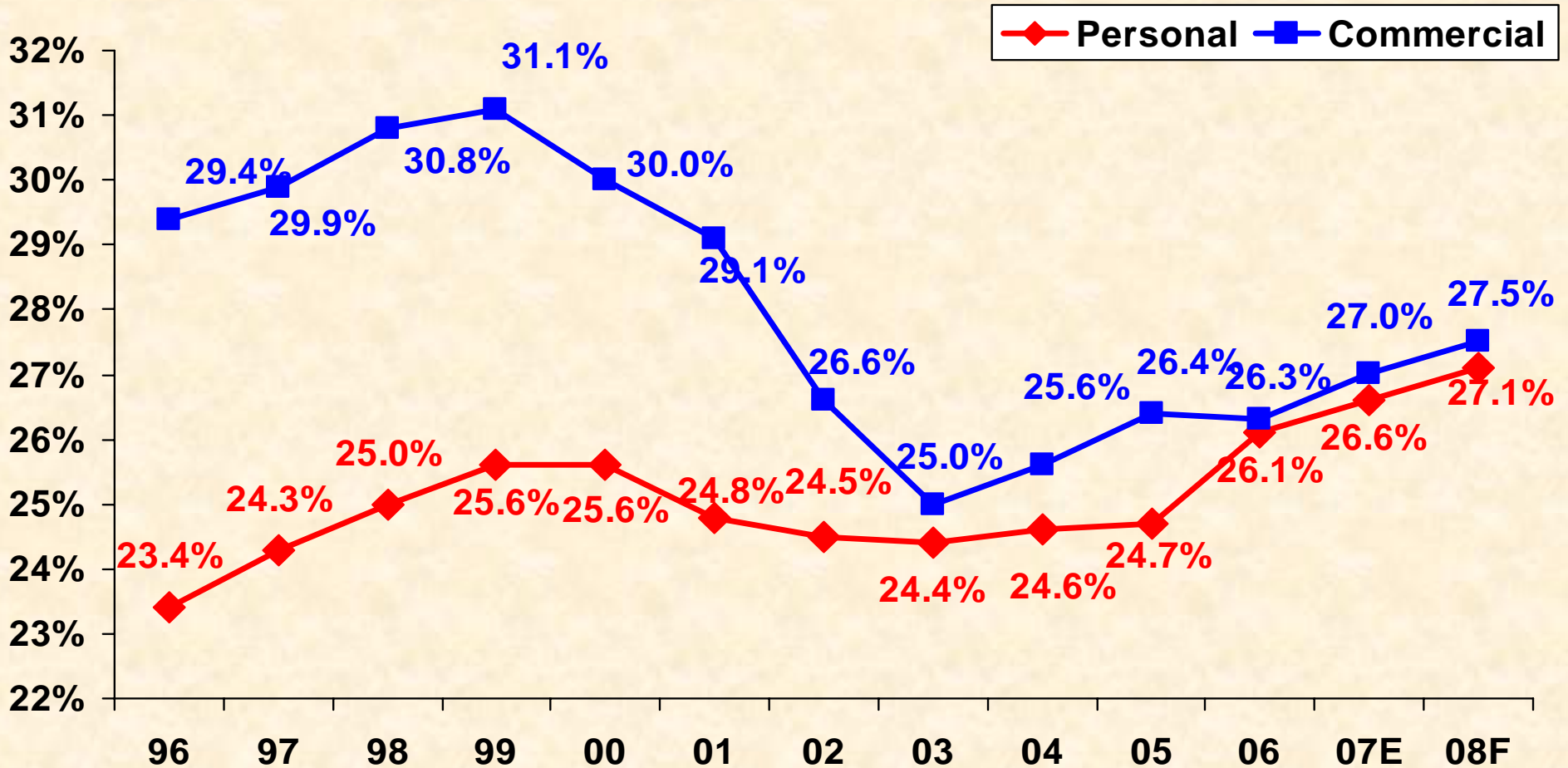
Source: Council of Insurance Agents & Brokers; Insurance Information Institute

Rising Expenses





Expense Ratios Will Rise as Premium Growth Slows



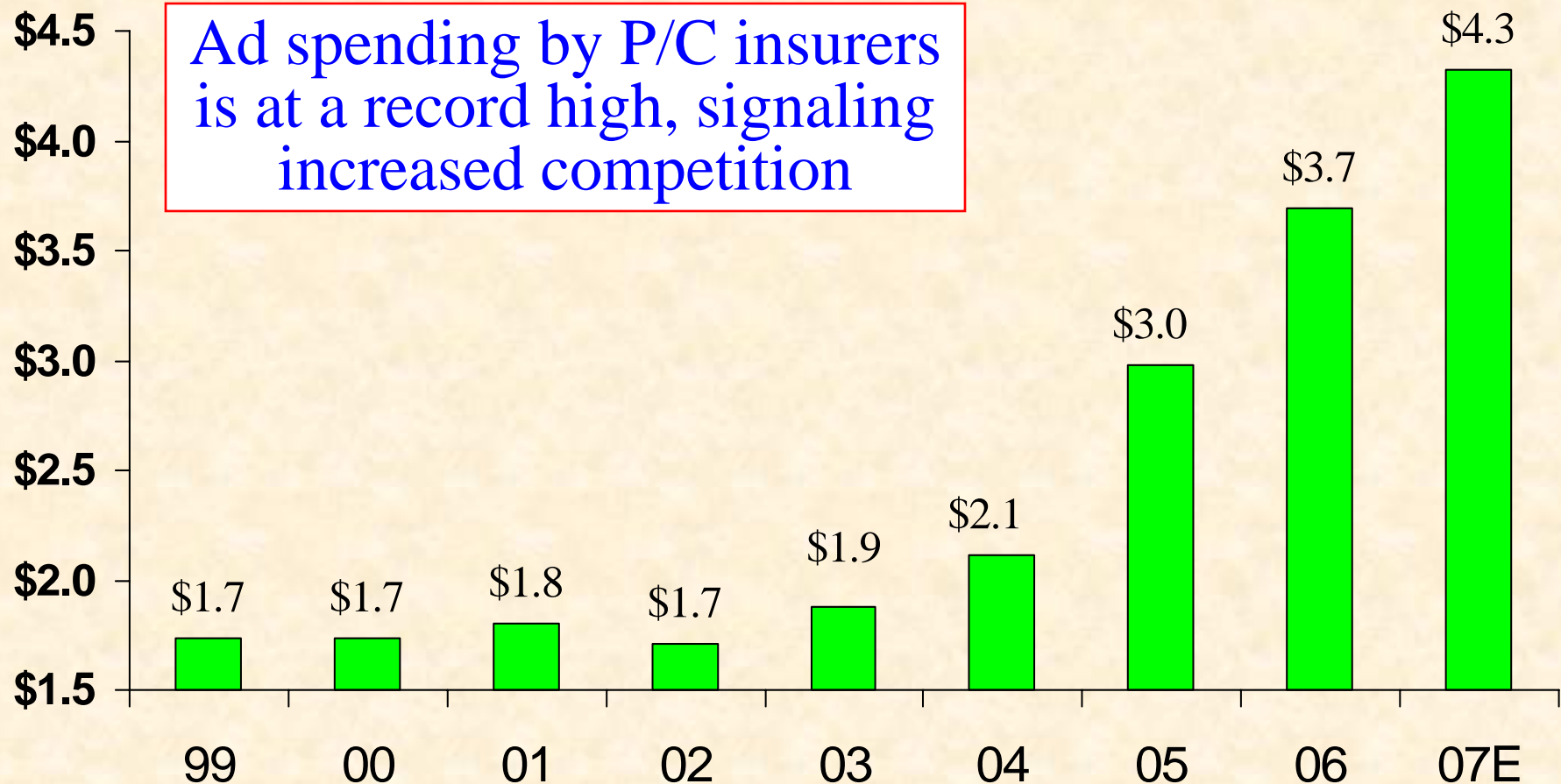
*Ratio of expenses incurred to net premiums written.

Source: A.M. Best; Insurance Information Institute



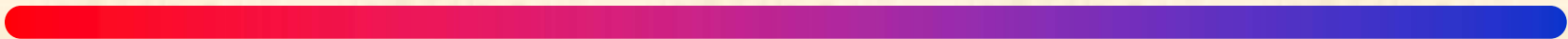
Advertising Expenditures by P/C Insurance Industry, 1999-2007E

\$ Billions



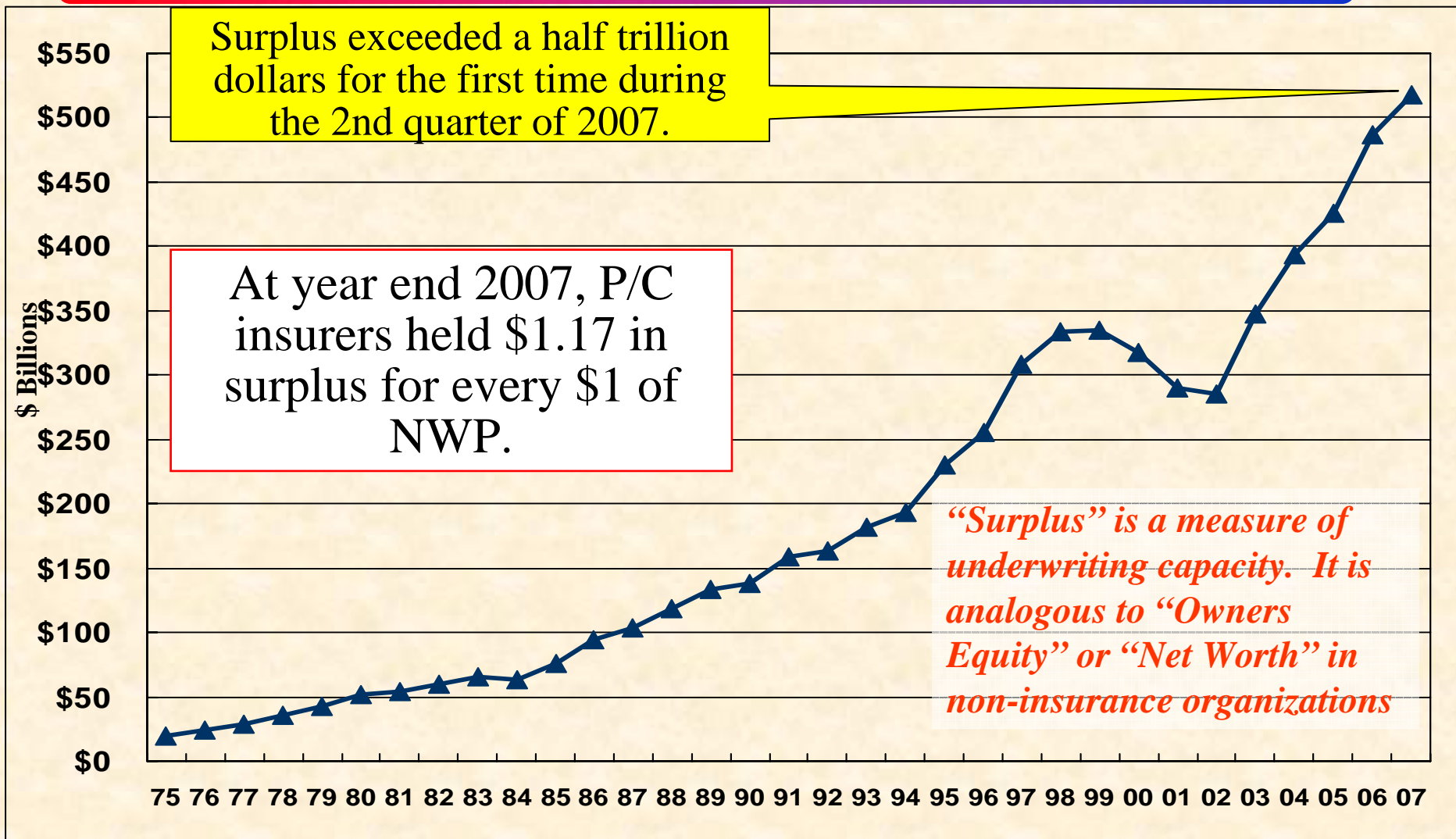
Source: Insurance Information Institute from consolidated P/C Annual Statement data.

The P/C Industry's Financial Strength and Capacity





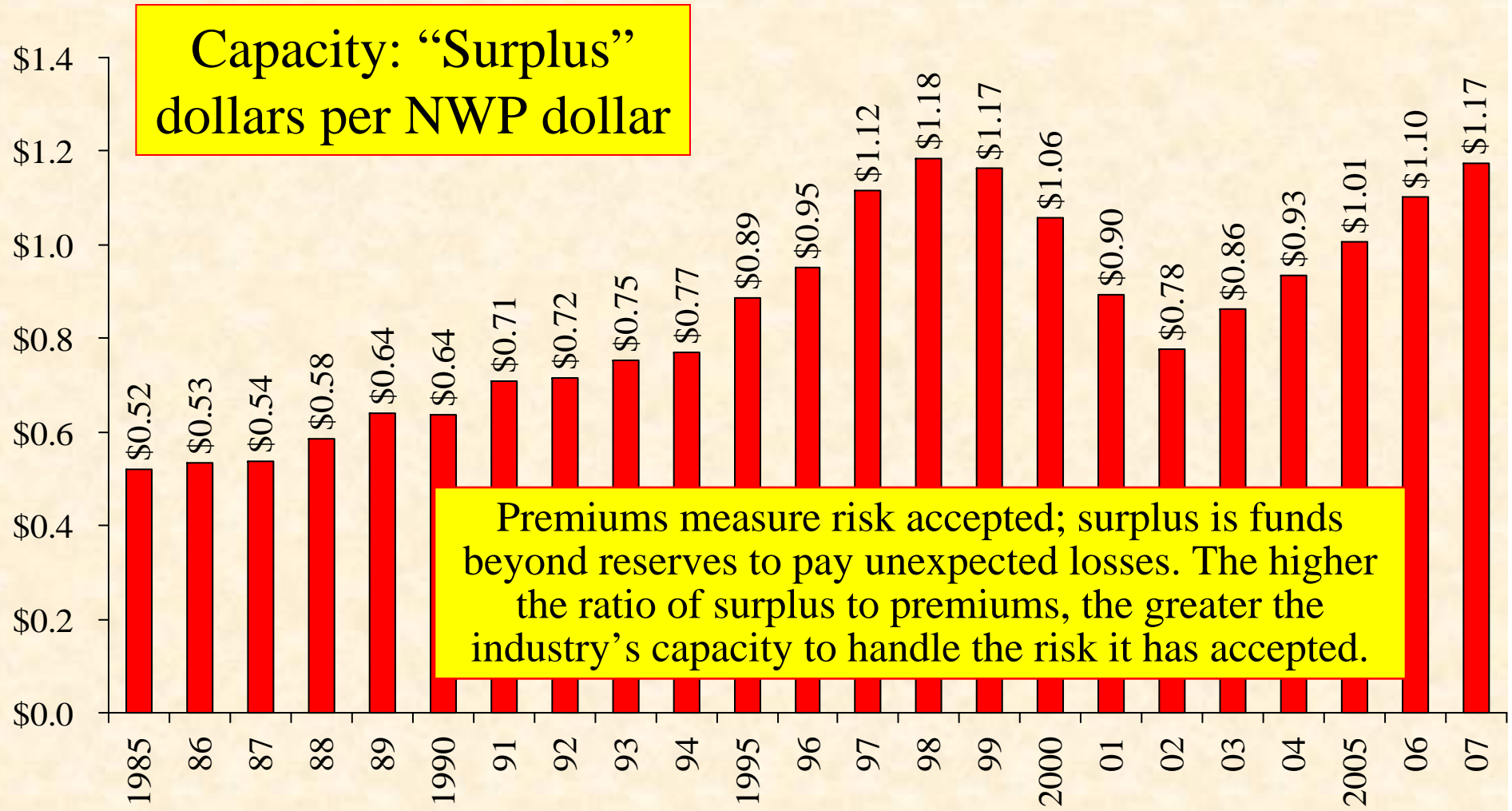
U.S. P-C Insurers' Policyholder Surplus: 1975-2007



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



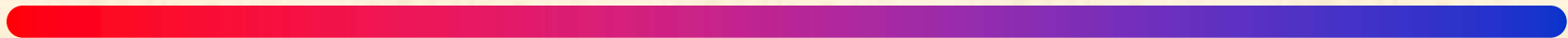
In General, the Industry Has Grown Its Capacity to Accept Risk (but that capacity can also shrink)



Sources: NAIC Annual Statement data, via HighlineData; Ins. Info. Inst.

Investment Overview

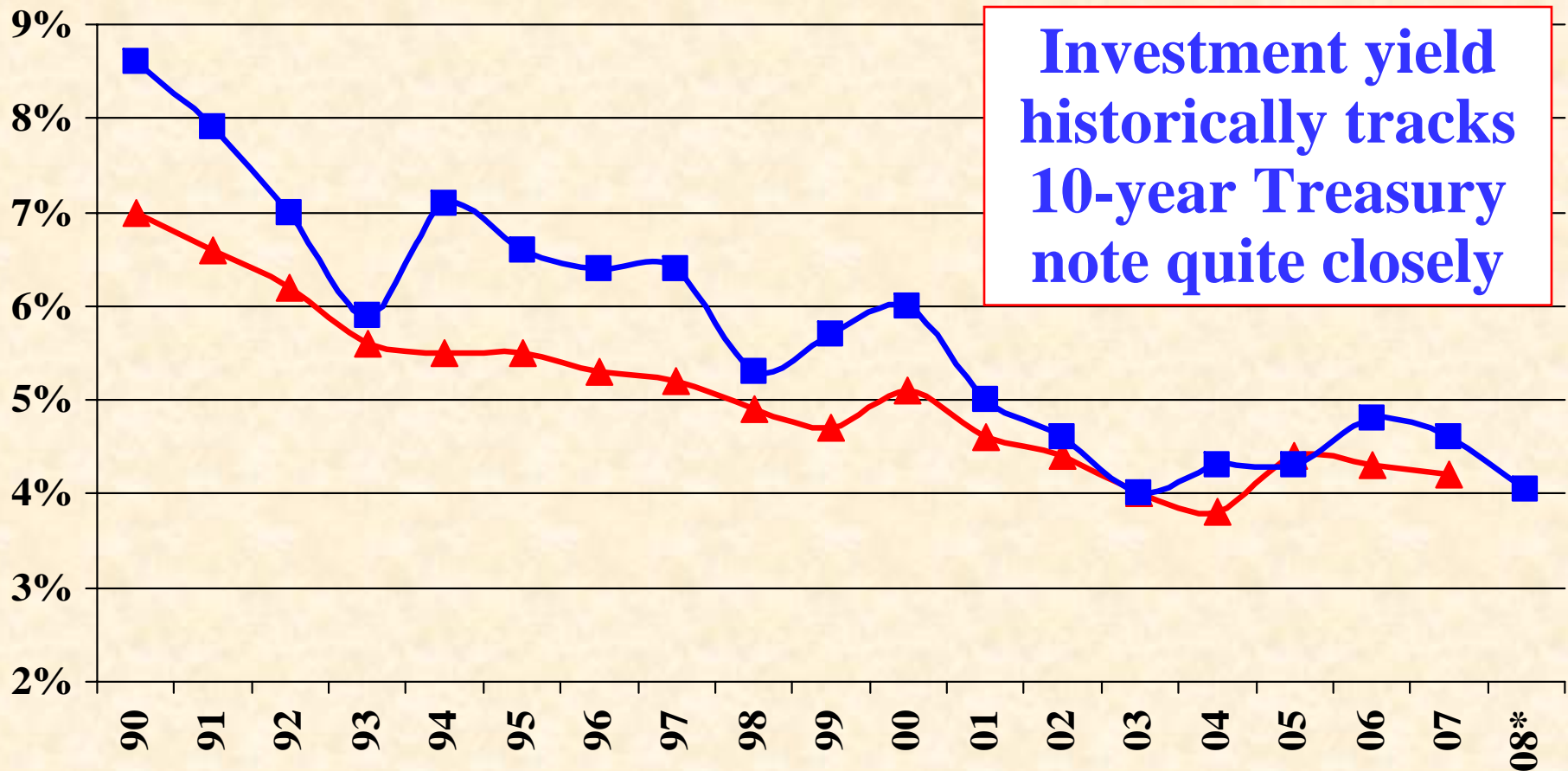
Not Much to Look Forward To





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

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

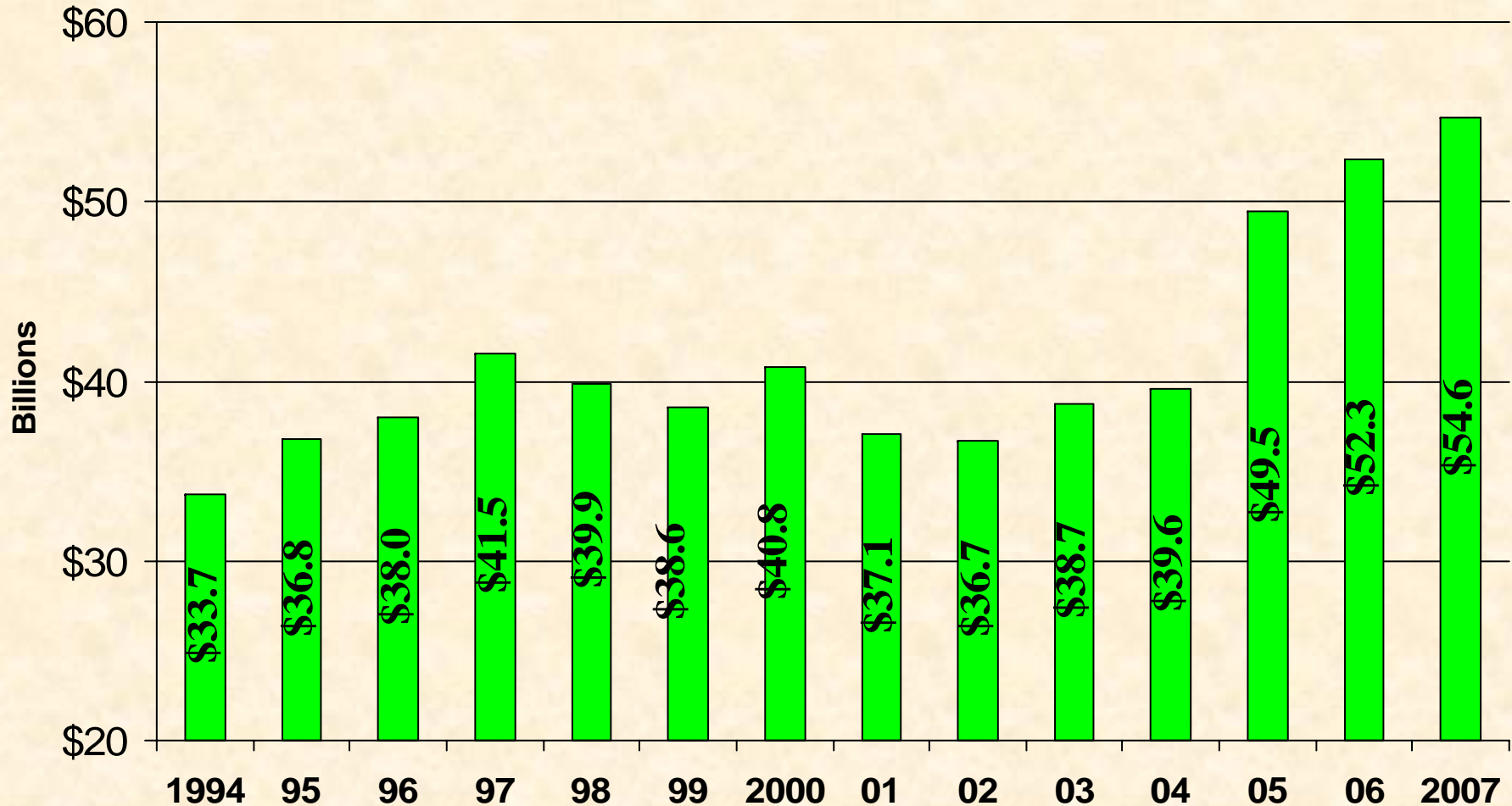


*As of May 30, 2008.

Sources: Board of Governors, Federal Reserve System; A.M.Best; Insurance Information Institute.



Property/Casualty Industry Investment Income*, 1994-2007



*Primarily interest and stock dividends.

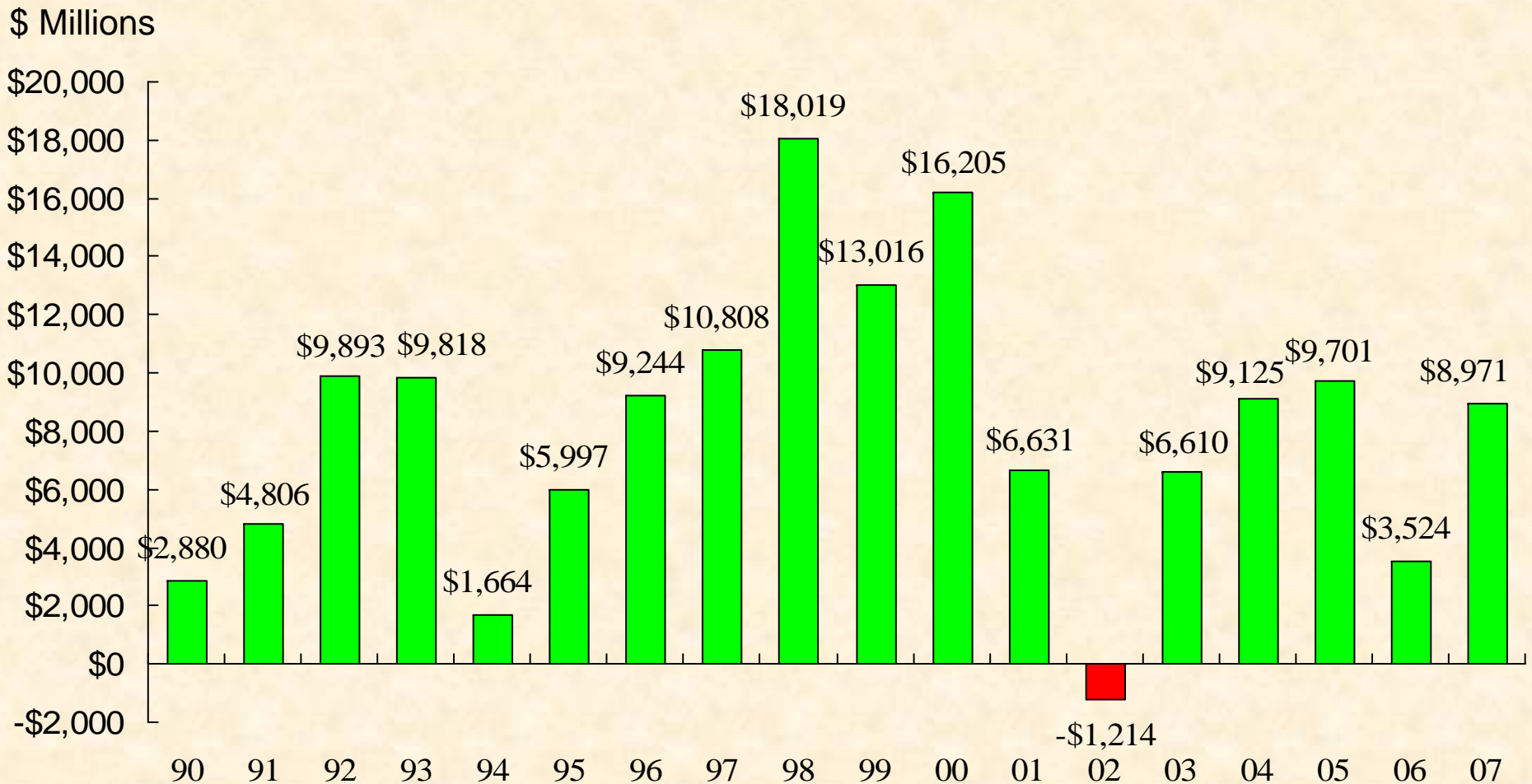
2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.



US P/C Industry Net Realized Capital Gains, 1990-2007

Realized capital gains exceeded \$9 billion in 2004/5 but fell sharply in 2006 despite a strong stock market. Nearly \$9 billion again in 2007.



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



What's Being Done to "Fix" the Economy?

"Fix"	Effect on Insurers
Fed Rate Cuts	<ul style="list-style-type: none"><input type="checkbox"/> Might reduce yields on new bond investments, but<input type="checkbox"/> Might also raise asset value of existing bonds (65-80% of portfolio)<input type="checkbox"/> In the longer run, might contribute to inflation
\$168 Billion Stimulus Package	<ul style="list-style-type: none"><input type="checkbox"/> Hope is that plan boosts overall economic activity and employment (by 500,000 jobs)<input type="checkbox"/> and therefore might support p/c personal and commercial exposures<input type="checkbox"/> But plan contributes to already-large federal budget deficits; Washington might hike taxes
Bear Stearns Bailout	<ul style="list-style-type: none"><input type="checkbox"/> No direct effect, but tighter regulation of banks and hedge funds seems likely.<input type="checkbox"/> Will it be the stimulus for a financial regulatory structure that includes insurers, too?

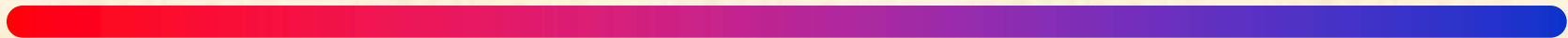


Summary of Economic Risks and Implications for (Re) Insurers

Economic Concern	Risks to Insurers
Subprime Meltdown/ Credit Crunch	<ul style="list-style-type: none">• <i>Some</i> insurers have <i>some</i> asset risk• D&O/E&O exposure for <i>some</i> insurers• Client asset management liability for <i>some</i>• Bond insurer problems; Muni credit quality
Housing Slump	<ul style="list-style-type: none">• Reduced exposure growth• Deteriorating loss performance on neglected, abandoned and foreclosed properties
Lower Interest Rates	<ul style="list-style-type: none">• Lower investment income
Stock Market Slump	<ul style="list-style-type: none">• Decreased capital gains (often relied upon more heavily as a source of earnings as underwriting results deteriorate)
General Economic Slowdown/Recession	<ul style="list-style-type: none">• Reduced commercial lines exposure growth• Surety slump• Increased workers comp frequency

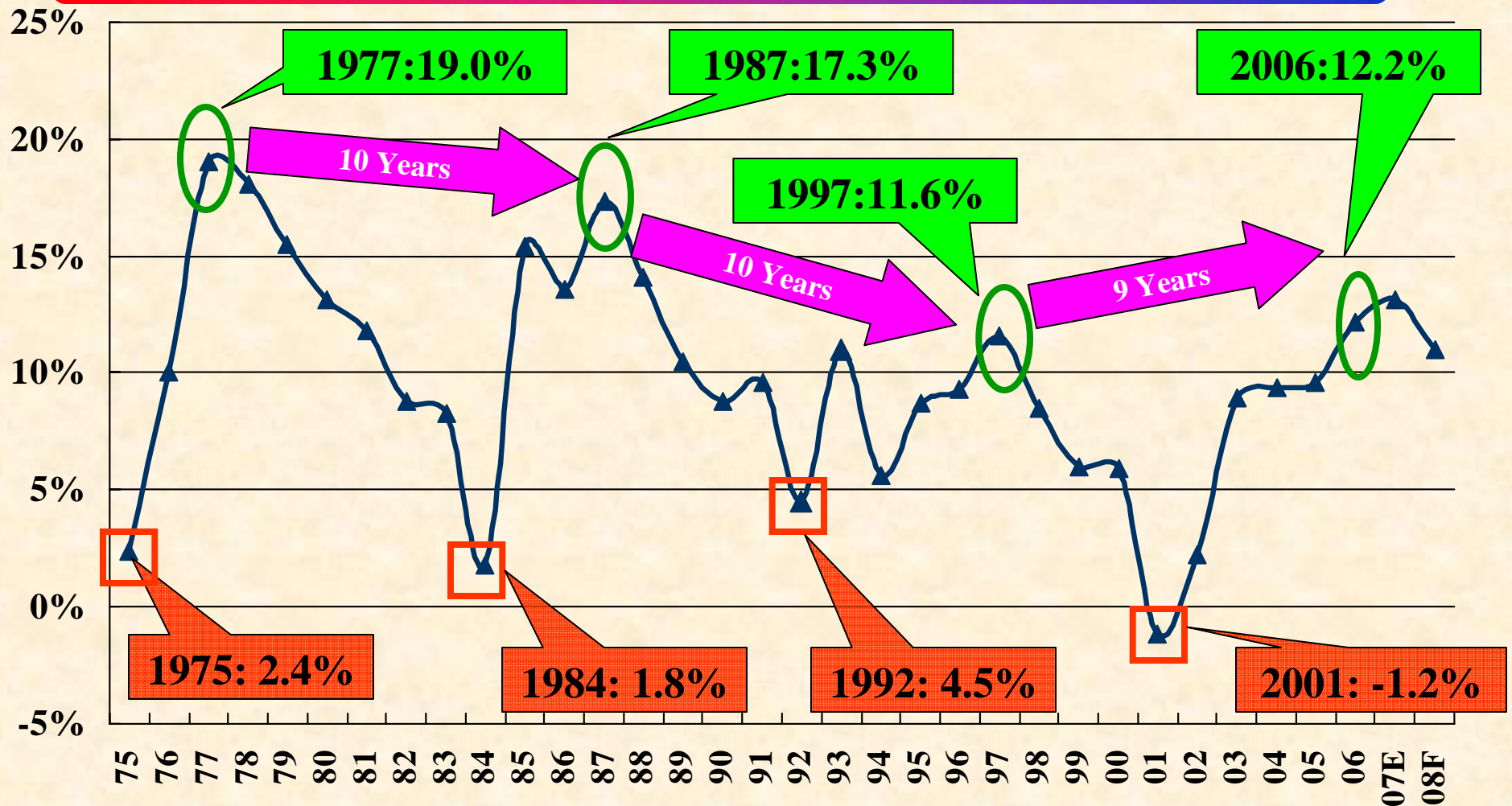
Profitability: Did Profits Reach a Cyclical Peak in 2006/07?

By No Reasonable Standard Can
Profits Be Deemed Excessive





Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2008F*

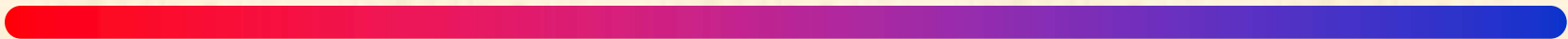


*GAAP ROE for all years except 2007 which is actual ROAS of 12.3%. 2008 ROE is I.I.I. estimate.

Sources: Insurance Information Institute; *Fortune*

Can Anything Change the Profit Cycle?

4 Factors That Could Affect
the Length and Depth of the Cycle





Two Factors that Could Make the Cycle Longer and Deeper

Capacity: Analysts say surplus growth in recent years has left the industry with between \$85-\$100 billion in excess capital

- All else equal, rising capital leads to greater price competition and a liberalization of terms and conditions

Reserves: Reserves are in the best shape (in terms of adequacy) in decades, which could extend the depth and length of the cycle

- Many companies have been releasing “redundant” reserves, which allows them to boost net income even as underwriting results deteriorate
- But reserve releases will diminish in 2008; Even more so in 2009



Two Factors that Could Make the Cycle Shorter and Shallower

Information Systems: Management has more and better tools that allow faster adjustments to price, underwriting and changing market conditions than it had during previous soft markets

Investment Results: 2007 was the 5th consecutive up year on Wall Street. With declines in stock prices and falling interest rates, portfolio yields are likely to fall

- Smaller realized capital gains
- A sustained equity market decline (and potentially a drop in bond values) could reduce policyholder surplus



Summary

- The P/C business has been highly cyclical
- Profits were strong in 2006/07, but
 - Underwriting results were aided by lack of CATs & favorable underlying loss trends
 - 2008 Hurricane forecast is for worse-than-average season
- Premium growth rates are at their lowest levels since WW II
 - Commercial lines lead decreases
 - Housing slump cuts HO exposure growth
- Investment returns insufficient to support deep soft market in terms of price, terms & conditions as in 1990s



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