Risk Management Insurance Market Update

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TOPICS OF DISCUSSION

• Property Insurance Market Update

• Casualty Market Update

• Q&A
The property market has continued to soften in 2014 due in large part to the following macro-economic factors:

- **Benign U.S. CAT Losses** (No major Hurricanes or CA Quake events in 2014)
- **Abundant capacity and lower treaty reinsurance costs**
- **Growth of Alternative/Convergence Capital** which now makes up approximately 16% of the global property reinsurance capital
- **Policyholder surplus hit another all-time high** of $671B at the end of June 2014
- **Solid financial results** for the P&C markets over the last seven quarters
2014 Reinsurance Treaty Renewals

2014 Treaty Renewals

January 1st, 2014 Treaty Renewals:
- U.S. Cat rates down 10% - 25% on average
- Non-U.S. CAT rates down 15% on average

April 1st, 2014 Treaty Renewals:
- U.S. Cat rates down 10% - 15% on average
- Non-U.S. CAT rates down 15% on average

July 1st, 2014 Treaty Renewals:
- U.S. CAT rates were consistent with the April 1, 2014 treaties
A Closer Look

- Wind driven accounts are seeing more significant reductions due to two benign hurricane seasons and the fact that much of the excess capital is geared towards CAT (Alternative or Convergence Capital specifically)
- CA EQ continues to decline driven by many carriers increasing their available limits and by the large MGAs that continue to dominate the stand-alone EQ market (including Arrowhead)
- Non-traditional placements such as deductible buy-downs and multi-year aggregate programs (MYSL) are much more available and competitive;
- Lloyds – historically, Lloyds has led the market up and followed the market down in the various cycles. However, in early 2014 Lloyds was the first market to pass savings from the early treaty renewals onto their clients
  - Lloyds announced a pre-tax profit of $2.86B for the first six months of 2014 (a 21% increase year over year;
  - Lloyds combined for the same period – 88.2%;
  - Many Syndicates are redeploying critical cat capacity from their treaty divisions to the open market and binder businesses
- The domestic market has now caught up with Lloyds;
  - AIG/Lexington has developed various mid-market and ground up products to compete with the traditional players and to diversify their books
  - Berkshire Hathaway Specialty Insurance has changed their underwriting philosophy and are continuing to push for premium growth
  - Carriers in general are working hard to maintain market share
A Closer Look

Top 16 Most Costly Disasters in U.S. History

(Insured Losses, 2013 Dollars, $ Billions)

Superstorm Sandy in 2012 was the last mega-CAT to hit the US

12 of the 16 Most Expensive Events in US History Have Occurred Over the Past Decade (2004-2013)

P/C Insurance ROE as 5-Year Moving Average

After smoothing, there is a more evident trend toward lower profitability

The Tradeoff: Industry impairment rates have plunged

Location of Large Hail Reports: 2013

There were 5,457 "Large Hail" reports in 2013, causing extensive property and vehicle damage
Casualty Update
2013 Results Recap

• P&C Combined Ratio: 2013: 96% 2012: 103%
  – The majority of the success came from premium growth at 4.6% and loss adjustment expenses decreased by 5.5%.
  – The insurers had a 15.5B net gain in 2013 vs 15.4B net loss in 2012.

• 2013 ROI for Insurers was 10.3%, which is up 68% from 2012. This is the highest ROI since 2007.

• WC Calendar Combined Ratio Improved for the first time since 2006:
  – 2011: 115% / 2012: 108% / 2013: 101% (Initially Projected at 106%)
  – Average medical cost per lost-time claim increased by 3% the third straight year showing this type of increase.
  – Severity

• Commercial Auto Calendar Combined: 2013: 105%
2013 View of 2014 WC Outlook

• Combined Ratio continue to improve
• Improvement in Underwriting Results
• Premium growth for the third consecutive year
• Claim frequency declined 2% by NCCI States – Mostly in lower back and multiple body party injuries – Arm and Shoulder claims up, but severity increased 2%.
• Claim Severity Increases remained stable.
2013 View of 2014 WC Outlook

• Slow Growth in employment, particularly in manufacturing and construction is impeding additional premium growth.
• ACA and TRIA renewal continues uncertainty
• Continuing low-interest rate environment threatens investment long-term.
2014 2Q P&C Analysis

- P&C Combined Ratio through 2Q of 2014: 98.9%, which is up from 2012.
  - The Combined Ratio is 5% better than the average over at 103.9%. But, it is estimated that the insurers will have to get to a combined ratio of 97% to earn their long-term average rate of return at 9%.

- Policy Surplus remains at record levels at $671.6B. But, creating competition in the market place thus driving down the rates from what they need to be to get a higher rate of return.
• Rate on Return through 2Q 2014 declined to 7.8% from 8.1% in first half of 2013.
2014 2Q P&C Analysis

- 2014 2Q Pre-Tax Operating Income Decreased 7% to 23.9B from 25.8B
  Driven by declines in net gains on underwriting and investment income.
  - Underwriting gains dropped 87% to .3 B from 2.2 B in second quarter 2013
  - Investment income dropped by 1.3%
S&P Profitability Analysis

Volatility is endemic to stock markets—and may be increasing—but there is no persistent downward trend over long periods of time.

Source: NYU Stern School of Business: [http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html)
P/C Profitability Is Both by Cyclicality and Ordinary Volatility

Historical ROE Analysis

- Hugo
- Andrew
- Northridge
- Lowest CAT Losses in 15 Years
- Sept. 11
- Katrina, Rita, Wilma
- 4 Hurricanes
- Financial Crisis*
- Record Tornado Losses
- Sandy
- Low CATs

Sources: ISO, Fortune; Insurance Information Institute.
2014 Outlook

• 2014 Elections: 6,000 seats up for election on November 4, 2014. Only 8 states will not be involved in elections within the state and/or house.

• Only 11 States have elected insurance regulators.
  – 36% of the states are having races in November: CA, GA, KS, and OK. AK and DC are also anticipate new commissioners due to recent departures.