

## Professional Development Day

29 March 2006

# Session – Insurance Industry Outlook

### Panel



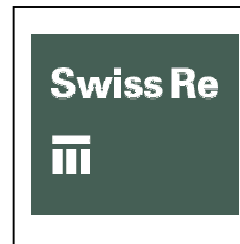
**John Chippindale**  
*President, Integro Insurance Brokers*



**Jeff Settingington**  
*AVP Sales & Marketing, AIG*



**Joel Baker**  
*President, MSA Research Inc.*



**Bill Lacourt**  
*SVP Marketing, Swiss Re*

## Market Conditions

### Impacted by:

- Frequency and severity of claims
- Legal and regulatory outlook
- Economic conditions and interest rate environment
- Financial stability of insurers and reinsurers
- Existence of competition

The logo for INTEGRO Insurance Brokers features the word "INTEGRO" in a large, green, serif font, with "INSURANCE BROKERS" in a smaller, green, sans-serif font below it.

### Trends:

- UW profit in 2004/5
- No insurer solvency problems
- Impact of hurricanes \$76B in 2005
- New capital provides required capacity
- Increased cost of capital
- Review of 2005/6 net premium growth and combined rates



## Tillinghast Forecast

### 2005 and 2006 Net Premium Growth and Combined Rates

Line of Business	Net Written Premium Growth		Combined Ratio After Dividends	
	2005	2006	2005	2006
Commercial Auto Liability	-3.8%	0.0%	95.4%	100.6%
Commercial Auto Physical Damage	1.0	3.0	86.2	85.1
Commercial Multiple Peril	4.0	10.6	115.6	98.1
Fire and Allied Lines	3.3	8.1	122.9	95.1
Homeowners	7.9	8.5	106.9	94.0
Other Liability	4.0	7.0	102.4	101.6
Private Passenger Auto Liability	2.2	-0.5	98.2	100.6
Private Passenger Physical Damage	-1.0	-2.0	88.8	90.6
Products Liability	-3.0	6.0	117.8	113.0
Reinsurance	-12.0	18.5	122.3	103.6
Workers Compensation	-1.7	5.0	107.2	109.1
<b>Total U.S. P/C Insurance Industry</b>	<b>2.4%</b>	<b>3.9%</b>	<b>101.1%</b>	<b>97.6%</b>

Source: Towers Perrin



**MSA Research Inc.**

## **Definitive Insurance Information for Intelligent Business Decisions**

*2005 Insurer Results and Outlook for 2006*

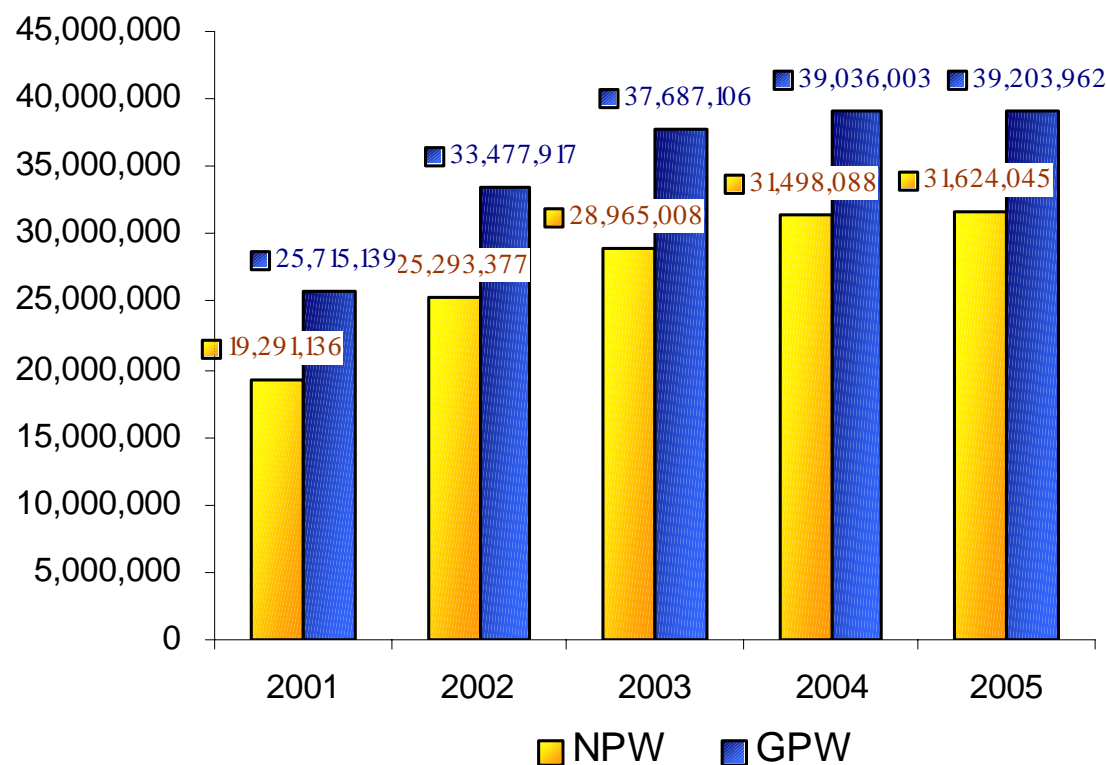
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**Joel Baker**

*President, MSA Research Inc.*



## 2005 Year-end Results Overall CDN Industry\*

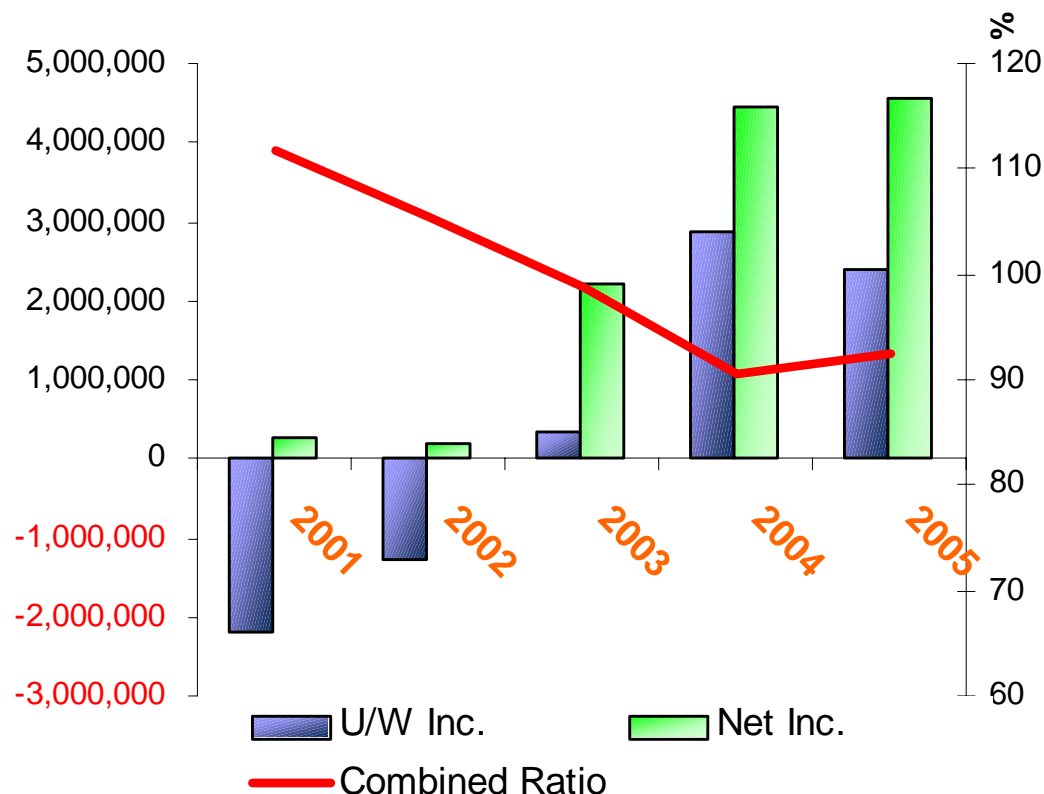


- Writings flat over 2004
- or down slightly in real terms

\* Based on 191 companies – excludes most reinsurers.  
\$ amounts in \$'000s. Source: MSA Research Inc.



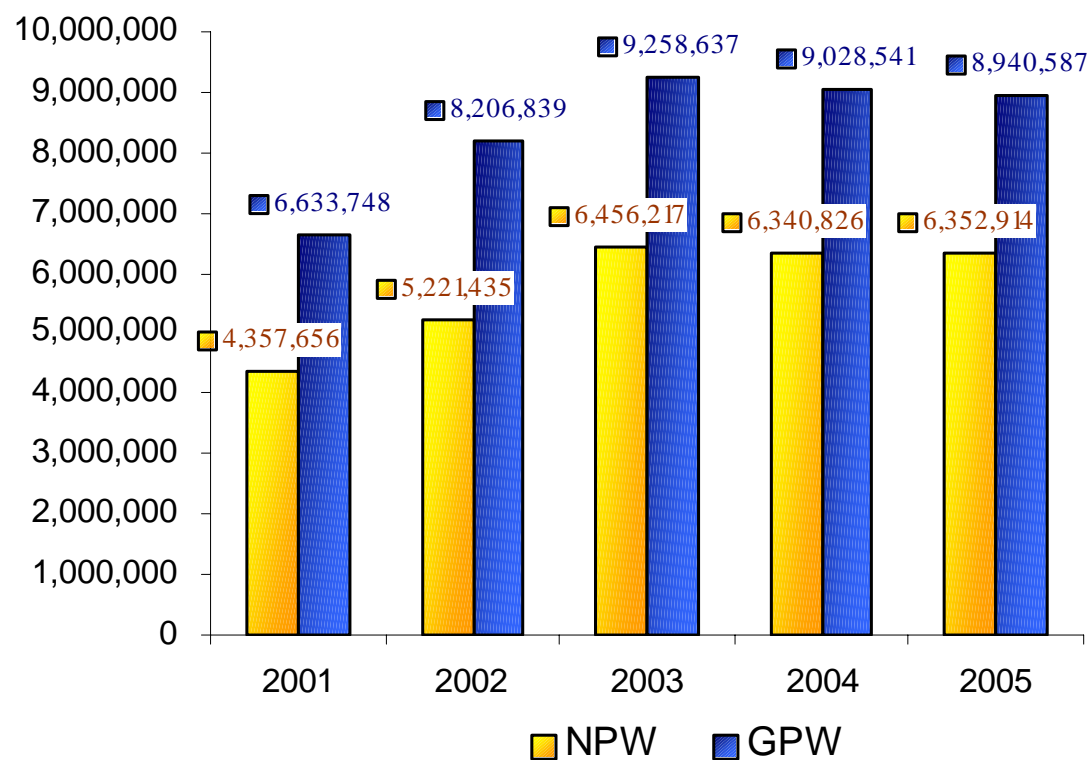
## 2005 Year-end Results Overall CDN Industry\*



- **Claims up 5.5%**
- **Underwriting income down 18%**
- **Inv. Inc+Gains up 22%**
- **Net income up 2.5%**
- **ROE 18% down from 21%**

\* Based on 191 companies – excludes most reinsurers.  
\$ amounts in \$'000s. Source: MSA Research Inc.

## Commercial Writers\*

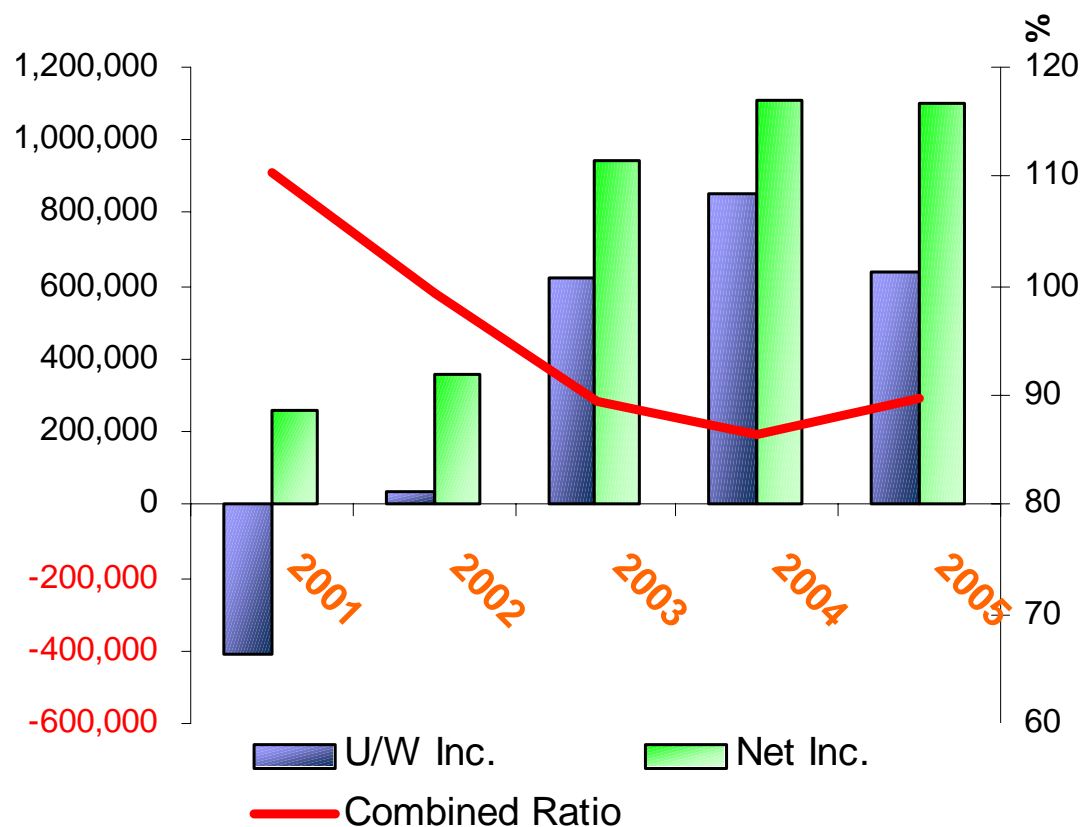


- Writings have been flat since 2003

\* Based on 75 companies  
\$ amounts in \$'000s.

Source: MSA Research Inc.

## Commercial Writers\*



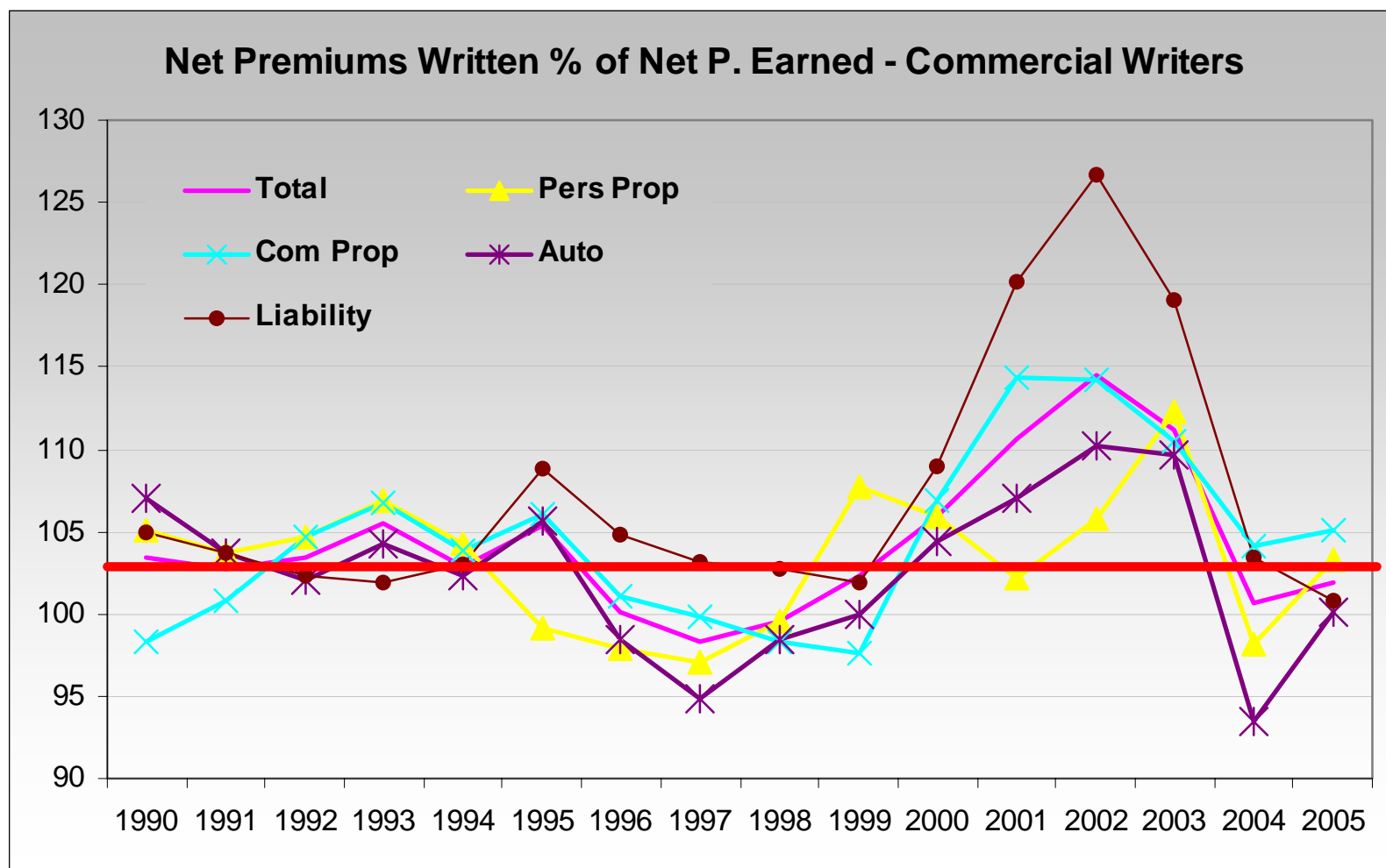
- **Claims up 8.2%**
- **Underwriting income down 24.6%**
- **Inv. Inc+Gains up 40%**
- **Net income down 0.5%**
- **ROE 14.3% down from 15.9%**
- **MCT 267% up from 259%**

\* Based on 75 companies

\$ amounts in \$'000s.

Source: MSA Research Inc.

## Earnings Pipeline – Most Lines in ‘Soft Range’



Source: MSA Research Inc.



## Key 2005 Metrics for Largest Commercial Writers in Canada

<i>Company/Group</i>	<i>Net Premiums Written</i>	<i>Change in NPW</i>	<i>Net LR</i>	<i>CR</i>	<i>ROE</i>	<i>MCT*</i>
Northbridge	1,171,402	-3.6	68.15	93.2	21.93	250.37
Lloyd's Underwriters	1,311,110	5.86	84.8	110.52	-14.88	NA
AIG	635,740	-0.91	68.62	81.64	17.23	179.27
Zurich	665,400	11.15	70.06	94.41	12.57	211.58
Chubb	582,547	2.6	66.59	96.18	12.32	184.71
ACE INA	208,358	-1.45	45.94	70.56	30.76	297.09

\* BAAT ratio used for branches. Aggregated pro-forma for NB and AIG Source: MSA Research Inc.

<i>Company/Group</i>	<i>S&amp;P FSR**</i>	<i>A.M. Best**</i>
Northbridge	BBB/POSITIVE	A-/Under Review Neg
Lloyd's Underwriters	A/STABLE	A/Stable
AIG	AA+/NEGATIVE	A+/Negative
Zurich	A+/STABLE	A/Stable
Chubb	AA/STABLE	A++/Stable
ACE INA	A/STABLE	A/Stable

\*\* Home office ratings for Lloyds, Zurich and AIG; Ratings indicated for Northbridge and AIG are those of their insurance subsidiaries. Ratings as of March 24/06

## Key Takeaways

- Cycle has turned – but not sharply.
- Indicators show weakening in most lines.
- Increased capacity in professional liability (Arch, Executive Risk Services/Lloyds)
- Anecdotal evidence of under-pricing.
- Insurers motivated to hold the line:
  - Lessons learned.
  - Higher CAT exposures, severity trending upwards (water, the new fire?).
  - More litigious casualty environment – Think Nortel/CIBC.
  - Rating agency pressures and low interest rates

## *Insurance Industry Outlook*

### ***ORIMS Professional Development Day***

*29 March 2006*



**Jeff Settingington**

*AVP Sales & Marketing, AIG*



## Impact of Recent Catastrophes on the Insurance Industry

- 7 of the 10 most expensive hurricanes in history in 2004 & 2005
- 2005 costliest year ever for catastrophes. Estimated claims:
  - Katrina - \$40+ billion
  - Rita - \$5+ billion
  - Wilma - \$8+ billion
- 2004: Charlie, Frances, Ivan, Jeanne est. @ \$25 billion
- Rita had the potential to be bigger than Katrina – Houston
- Dramatic growth in development of coastal regions
- Retrocession market
- CAT aggregate management - Change in the CAT models - Rating agencies – capital requirement

## Impact of Recent Catastrophes on the Insurance Industry

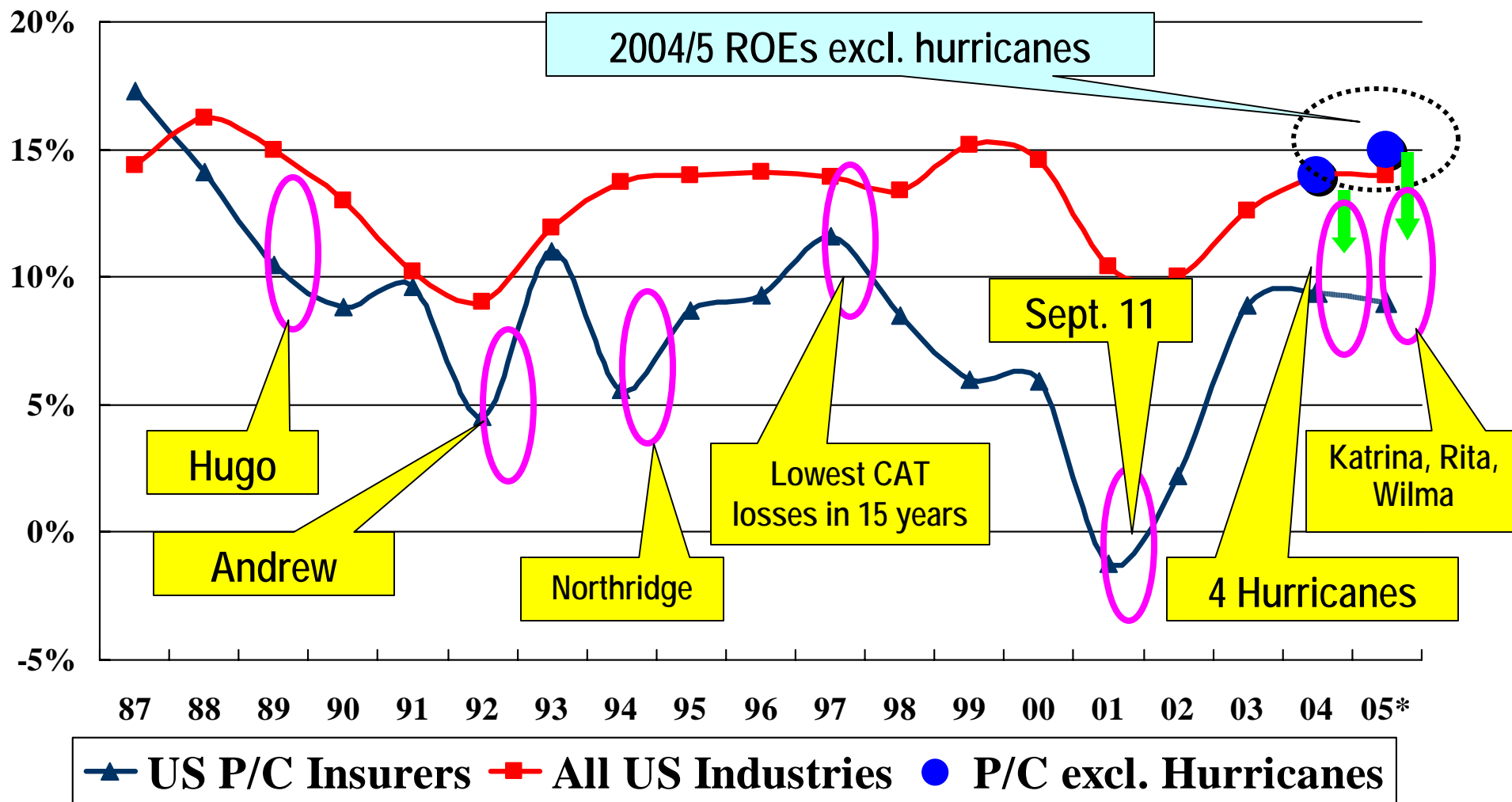
### What Does it Mean?

- Increased cost for CAT covers – Increased CAT retention and co-participation – Purchase of increased CAT covers – Tight retrocession market
- Restrictions in per risk covers – Occurrence limitations

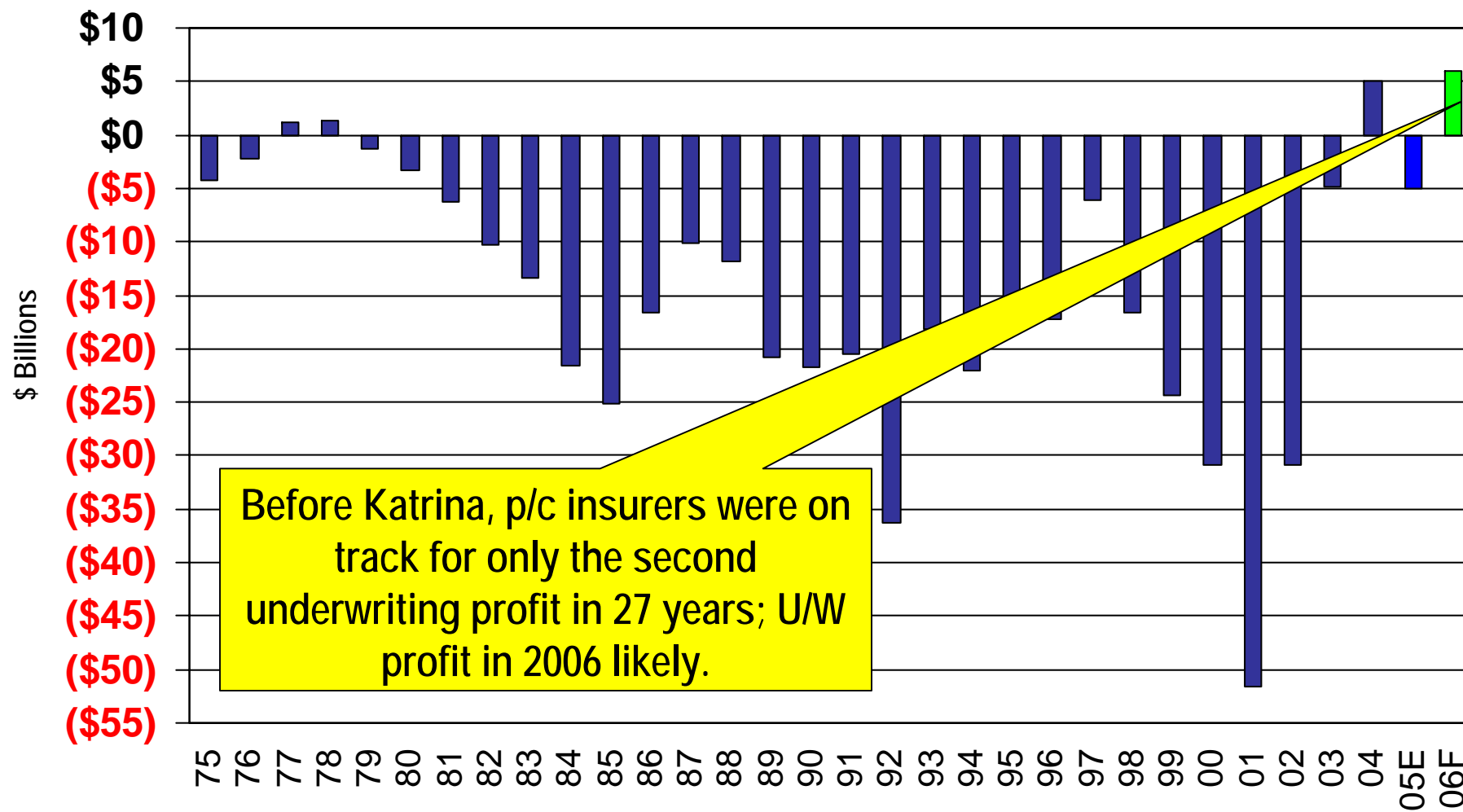
### 2006 Outlook

- Property
  - Rates
  - Retentions/deductibles
  - Co-insurance
- Impact on Casualty(?)

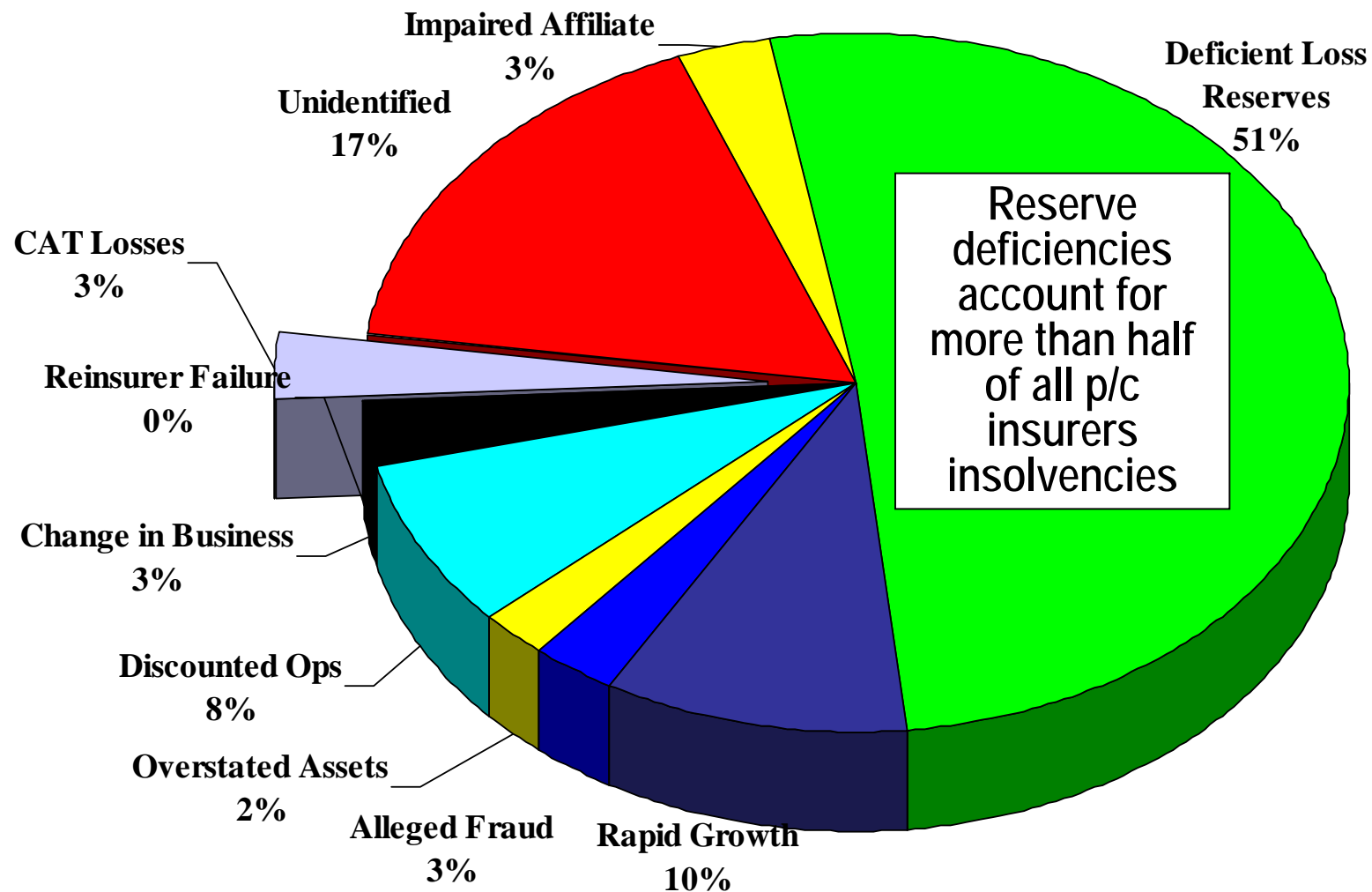
## ROE: P/C vs. All Industries 1987–2005E



## Underwriting Gain (Loss) - 1975-2006F\*



## Reason for P/C Insolvencies (218 Insolvencies, 1993-2002)



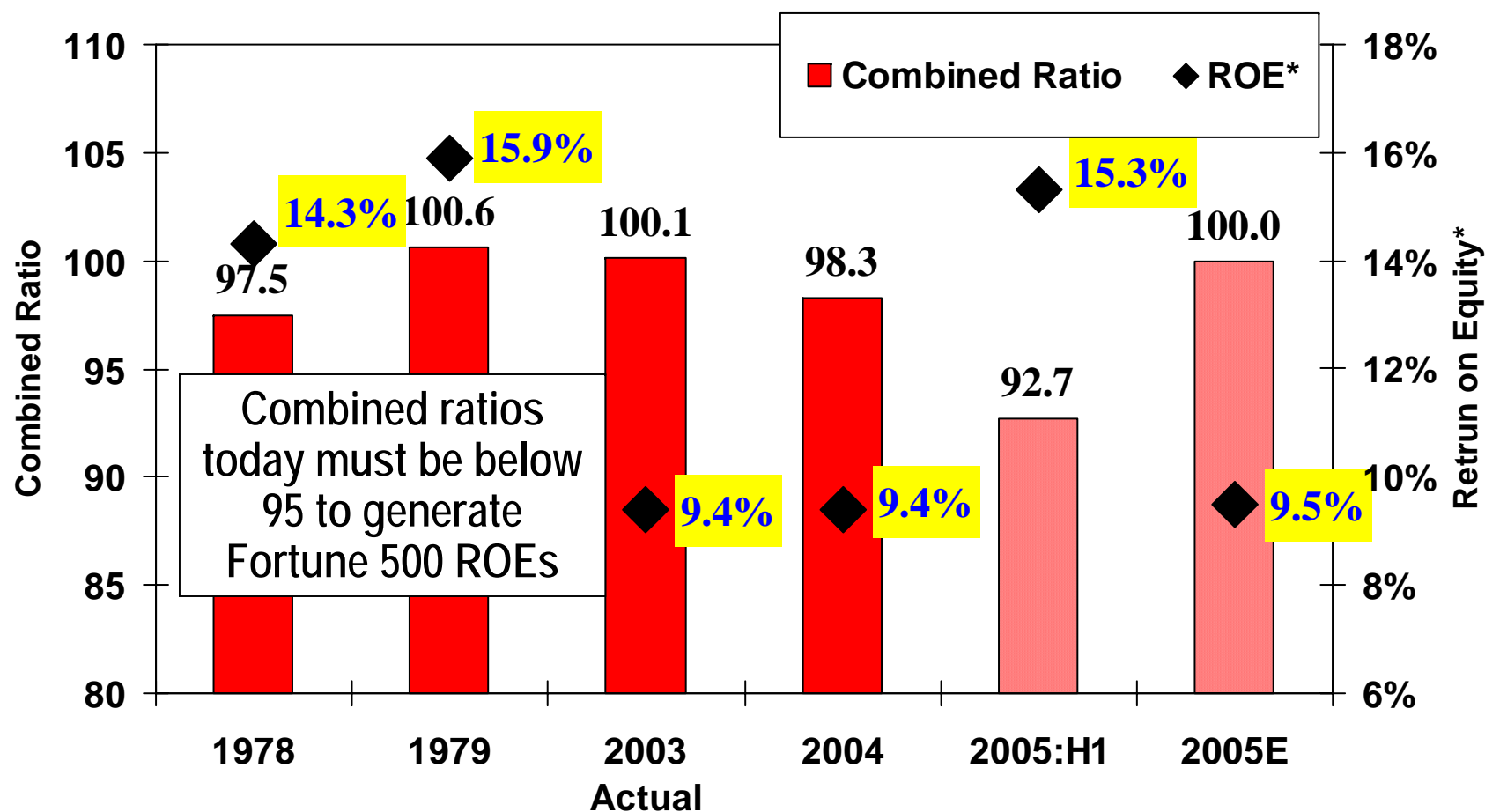
## Ratings Agencies Tightening Requirements for CATs

- 2006 SRQ CAT Model Reqs.\*
  - All Property Exposure
  - Auto Physical Damage
  - Reinsurance Assumed
  - Pools & Assessments
  - All Flood Exposure
  - WC Losses from Quake
  - Fire Following
  - Storm Surge
  - Demand Surge
  - Secondary Uncertainty
- Best currently estimates PML for 100-yr. wind & 250-yr. quake to determine capital adequacy
- ALSO “A.M. Best will perform additional “stress-tested” risk-adjusted capital analysis for a second event in order to determine the potential financial condition of an entity post a severe event.”
  - IMPLICATION: Some insurers may be required to carry more capital to maintain the same rating.

\*SRQ = Supplemental Rating Questionnaire

Source: A.M. Best Review & Preview, January 2006.

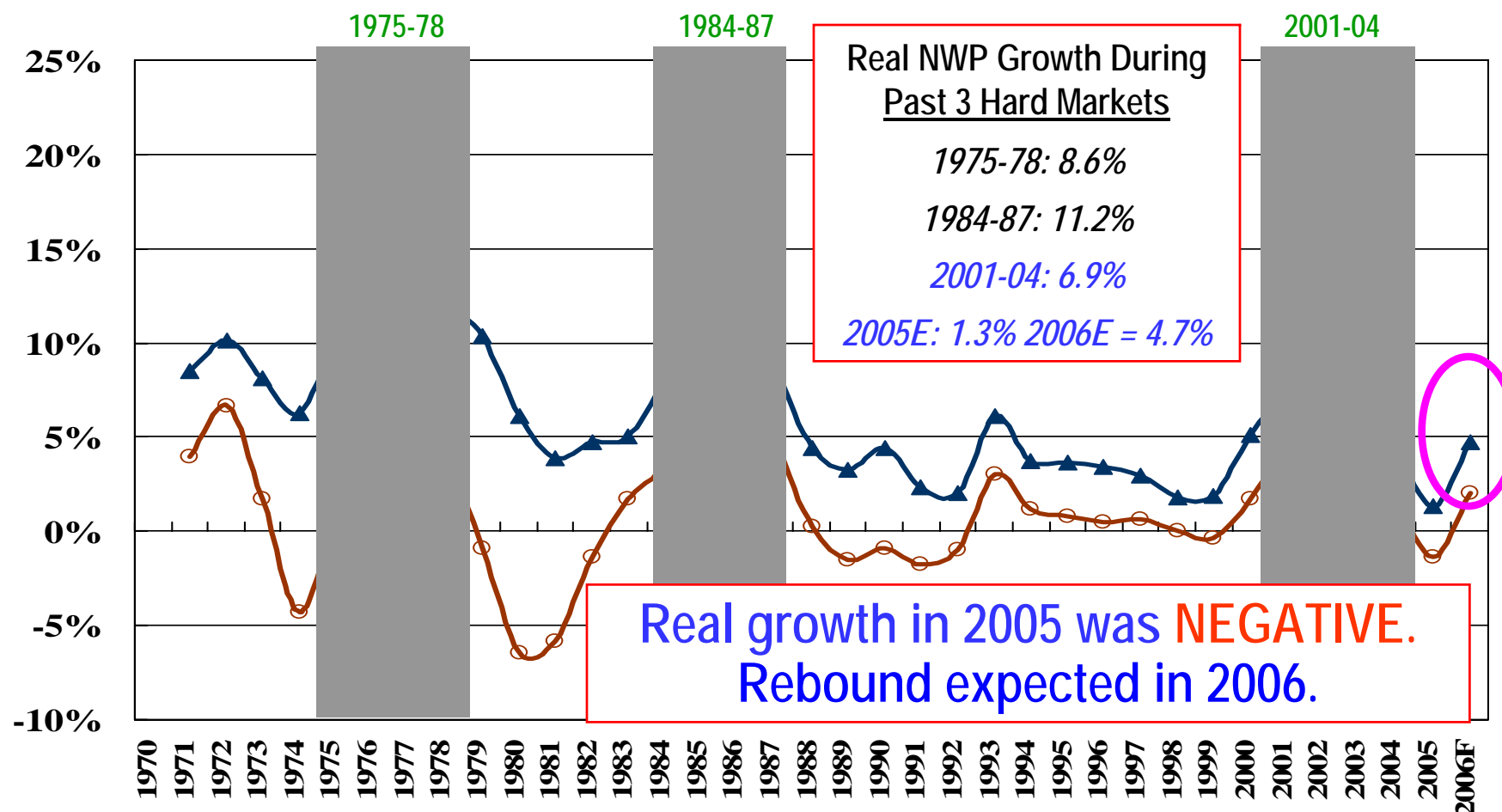
## A 100 Combined Ratio Isn't What it Used to Be: 95 is Where It's At



\* 2005 figure is return on average statutory surplus based in first 9 months data

Source: Insurance Information Institute from A.M. Best and ISO data.

## Strength of Recent Hard Markets by NWP Growth\*



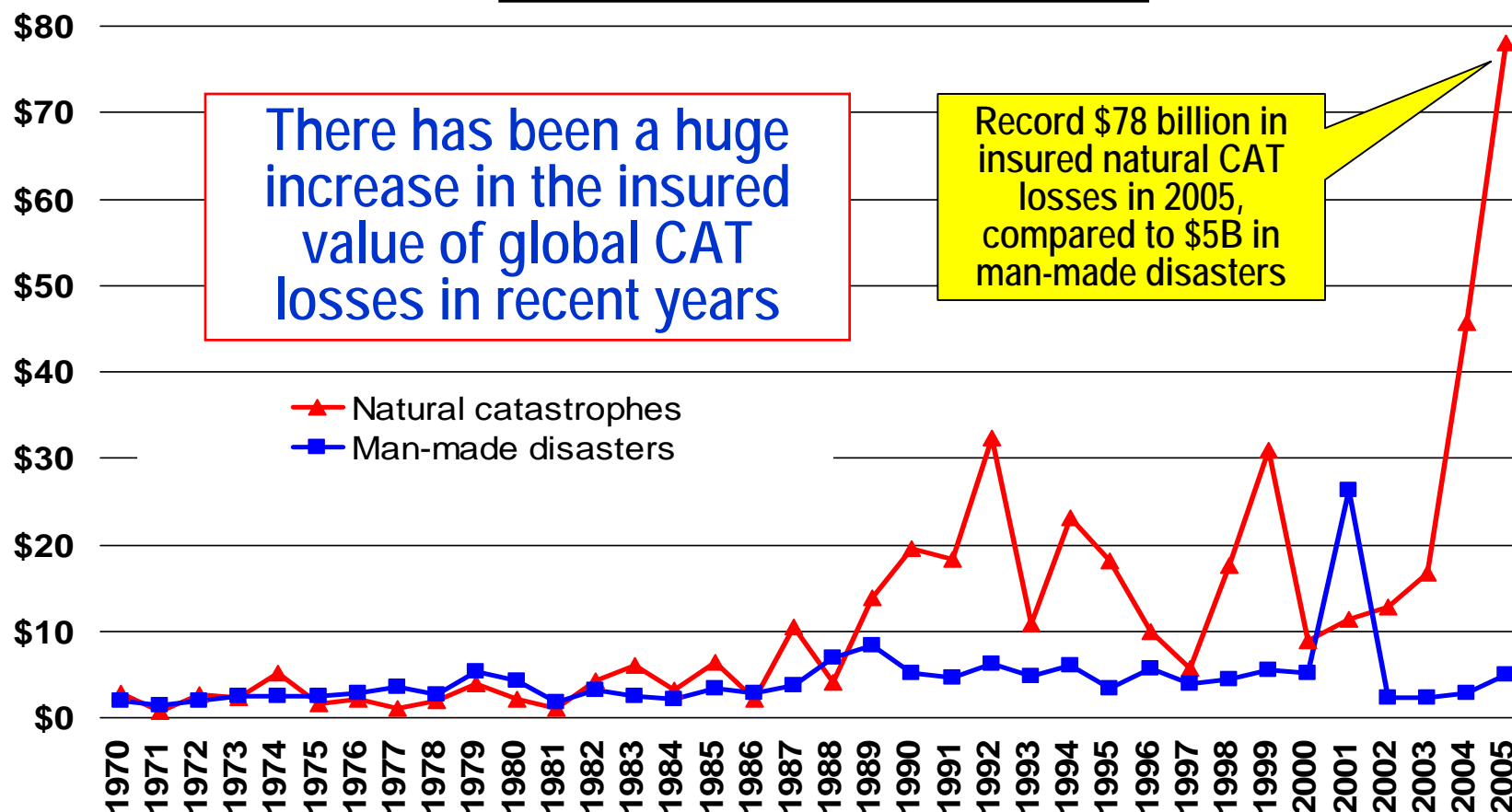
Note: Shaded areas denote hard market periods.

Source: A.M. Best, Insurance Information Institute

\*2005/6 figures are III forecasts/estimates.

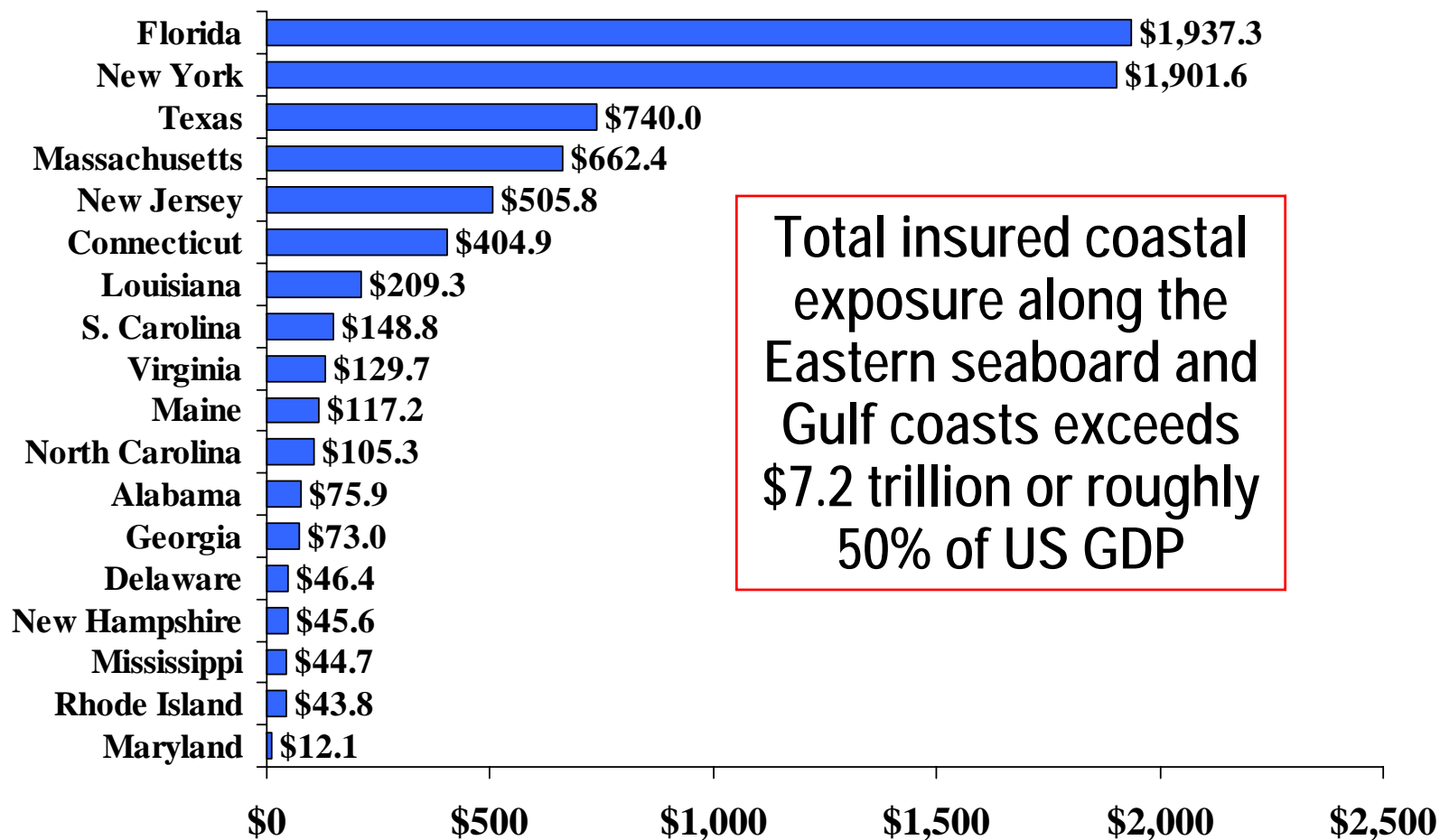
## Global Insured CAT Losses, 1970–2005 (Property and Business Interruption)

Billion USD, at 2004 prices



Source: Swiss Re, *sigma* No. 1/2005 & 2/2006.

## Total Value of Insured Coastal Exposure (2004, \$ Billions)



Source: AIR Worldwide



## Probability of Major Hurricane Landfall (CAT 3, 4, 5) in 2006

	Average*	2006F
Entire US Coast	52%	81%
US East Coast Including Florida Peninsula	31%	64%
Gulf Coast from FL Panhandle to Brownsville, TX	30%	47%
<i>ALSO...Above-Average Major Hurricane Landfall Risk in Caribbean for 2006</i>		

\*Average over past century.

Source: Dr. William Gray, Colorado State University, December 6, 2005.

## Types of Litigation in the Wake of the Hurricane Season of 2005

- **Homeowners: Wind vs. Water Claims**
  - MS Attorney General Hood; Scruggs & others
  - Contain many different allegations
  - Agent Errors & Omission issues?
- **Negligence/Construction Defect: Levee Breach**
  - Government Liability, Army Corps, Contractors
- **Pollution/Contamination**
  - Oil spill on land (Murphy Oil case, for example)
- **Environmental**
  - Fouling of fishing grounds
  - Wetlands degradation
  - Global Warming

## Summary

- P/C picture is fairly bright for 2006, assuming “normal” CAT loss activity
- Concerns about post-Katrina bounce/pricing discipline
- Rising investment returns insufficient to support deep soft market in terms of price, terms & conditions
- Clear need to remain underwriting focused
- Major Challenges:
  - Maintaining price/underwriting discipline
  - Managing variability/volatility of results
  - Anticipating emerging risks
  - Competing against alternative forms of risk transfer

## Damage to Gulf of Mexico Platforms and Rigs

	<u><b>IVAN</b></u>	<u><b>KATRINA</b></u>	<u><b>RITA</b></u>
<b>Platforms destroyed</b>	<b>7</b>	<b>47</b>	<b>66</b>
<b>Platforms extensively damaged</b>	<b>20</b>	<b>20</b>	<b>32</b>
<b>Rigs adrift</b>	<b>5</b>	<b>6</b>	<b>13</b>
<b>Rigs extensively damaged</b>	<b>4</b>	<b>9</b>	<b>10</b>
<b>Rigs destroyed</b>	<b>1</b>	<b>4</b>	<b>4</b>



## What Have We Learned?

- Vulnerability of shelf properties
- Pipelines are cat exposed
- Business Interruption exposure underestimated



## What Will Change?

- Policy limitations on windstorm
- Windstorm capacity scarcity
- Increased information required
- Rate rises across the spectrum

## Ocean Warwick



Rig rests by the shore in Daupin Island, Ala. Tuesday August 30, 2005 after hurricane Katrina passed through the area.

## D&O Marketplace

“Northern Exposure set to Explode” – Excerpts from National Post, Wednesday March 15, 2006 by Legal Columnist Sandra Rubin following an AIG hosted Forum on Bill 198

- “Bill 198 is very hospitable for U.S. plaintiff firms.”
- “Ontario’s new securities class-action regime has a lower pleading standard than its U.S. counterpart making it much easier to get traction in Canada, says New York lawyer from both sides of the class-action bar.”
- Michael Spencer, a senior partner at Milberg Weiss Bershad & Schulman states: “When Bill 198 was drafted, the Milbergs of the world were exactly who the OSC and its external counsel were trying to keep out. Mr. Spencer’s message to last week’s panel discussion was: it’s not going to work.”

## D&O Marketplace (cont'd)

- Spencer: "I am looking forward to an opportunity to litigate in a Canadian litigation in partnership with a class-action firm up here. In fact, I've got the New York-Toronto plane schedule taped to the wall of my office."
- Won Kim, a litigator with Roy Elliot Kim O'Connor states: "Canada has entered a different world. You used to be immune to these kinds of suits and the myriad of issues they raise, but immunity has been eviscerated with this law."



Swiss Re

## Global Reinsurance Market: Review and Trends

*Industry Outlook*

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**Bill Lacourt**

*SVP Marketing, Swiss Re*

Swiss Re



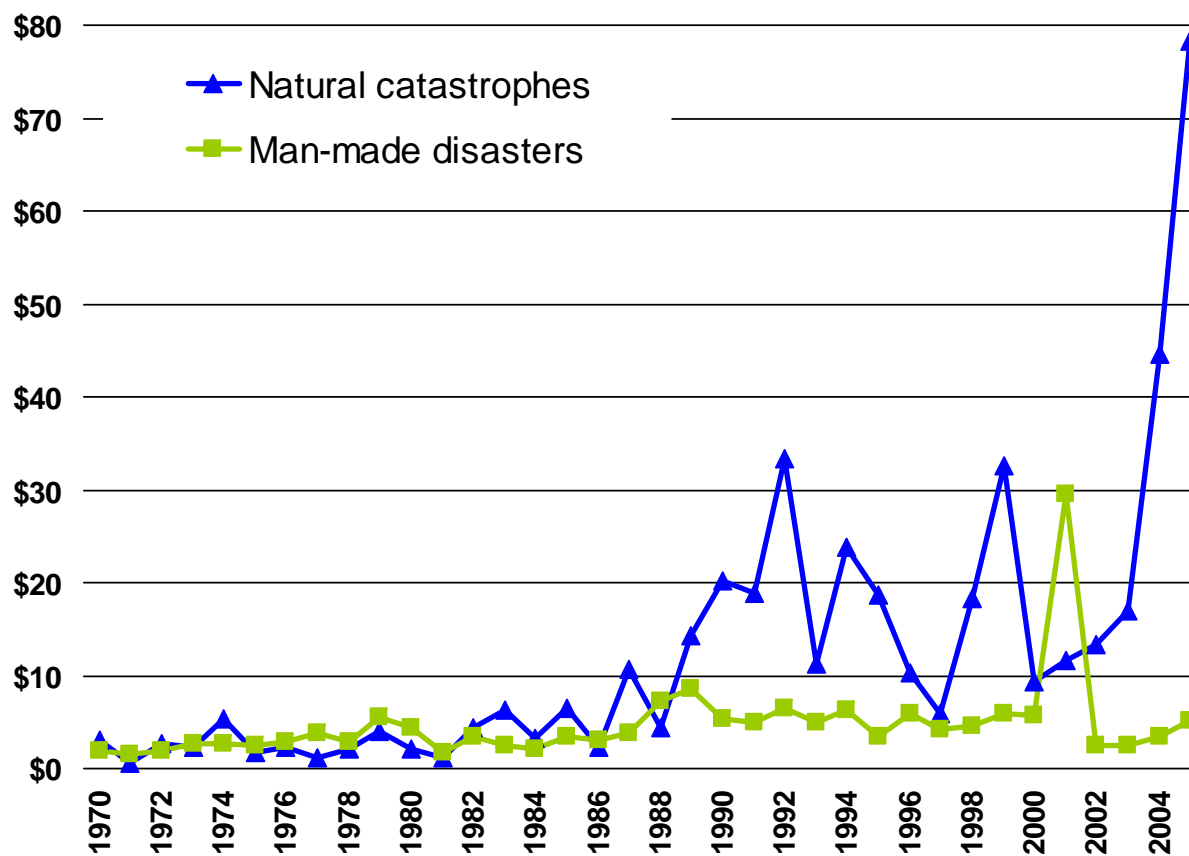
## Global Reinsurance Market: Review and Trends

- The economy will remain stable, the world economy is entering a mature phase of the business cycle
- Growth in 2006 and 2007 will remain solid and inflation will not be a major threat
- Risk of a recession is remote but rising – a sharp hike in oil prices, collapses of US consumption and housing prices are major risks
- Investment returns will remain relatively low

## Global Insured Cat Losses at Record Levels

Property and  
business  
interruption  
losses

USD billion,  
at 2005 prices



Source: Source: Swiss Re, sigma No. 2/2006

## More Risk

### **Due to cyclical changes in the North Atlantic Weather Pattern**

- Greater number of and increased energy of hurricanes in the period 1995-2005 ...
  - ... reflect increased surface temperatures in the North Atlantic...
  - ... marking the return of the high frequency – high severity North Atlantic hurricane cycle
- *Models will account for more and stronger North Atlantic hurricanes*

## Review of the 2005 Hurricane Season

<b>Katrina</b>	<b>45</b>
<b>Rita</b>	<b>10</b>
<b>Wilma</b>	<b>10</b>

- Most expensive cat season in relation to the size of the industry since 1906
- Insurers are expected to pay USD 78 billion losses from catastrophes globally (before reinsurance)
- Private insurance proved capable of dealing with the biggest catastrophe ever; no major defaults in insurance and in reinsurance
- The loss will be spread globally with roughly half to be borne by foreign (re)insurers
- The global reinsurance market's 2005 profit will be significantly reduced

## The Industry Weathered the Storm

- Private insurance proved capable of dealing with the biggest catastrophe ever, no major defaults in insurance and in reinsurance
- Only 45% of the losses are borne by US companies, the rest has been spread through the world (mainly Bermuda and Europe)
- Large and well diversified companies were better able to absorb the losses
- The industry was able to raise \$20 b capital just after the event, \$10.6 b “reload”, \$9.4 b new. New capital insufficient to keep up with exposure growth.

## New Perception of Risk – Losses Exceed Modelled Losses

- Lack of prevention was not properly accounted for
- Losses increased unexpectedly due to insufficient post disaster management
- Concurrent storm and flood losses were not adequately taken into account by the models
- Exposure of corporations to storm and flood losses was underestimated

## How will the Insurance and its Environment React?

### Rating agencies

- Looking at total exposure in addition to PML and simulation of multiple catastrophes increases the need for capital in P&C insurance
- Wave of downgrades hit the industry after Katrina Modelling firms
- Models published and announced will show both higher frequencies and higher severity
- *The industry needs to charge higher prices and tighten conditions for hurricane exposed risks*

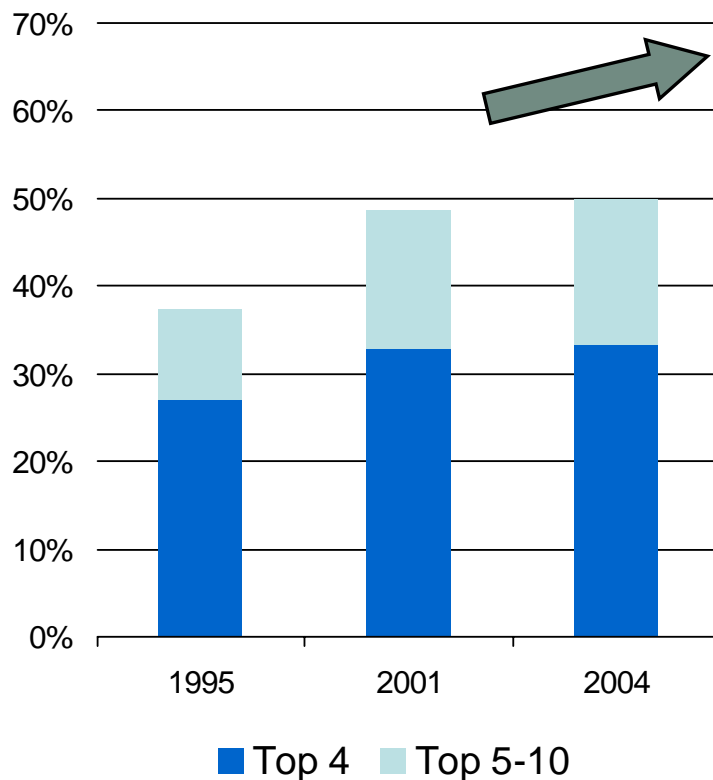
## More Scrutiny from Regulators and Other Stakeholders

- Insurance supervisors  
Solvency II, EU reinsurance directive, EU Financial Conglomerates
- Standard setting bodies (accounting, disclosure)  
IFRS, Sarbanes Oxley
- Rating agencies, Financial Analysts, Accounting firms  
More information, stricter standards
- Policy makers  
Disclosure of management compensation etc.
- *(Re)insurers face a broader shift in their environment regarding transparency and corporate governance*

## Size and Diversification Matter

### Consolidation of Global Reinsurance Continues

#### Non-life reinsurance



Quelle: Geschäftsberichte, Swiss Re Economic Research & Consulting

- Increasing concentration of global reinsurance will continue
- Diversification and long-standing relationships gain importance
- Reinsurer security is major concern for cedents
- Flight to quality