The COVID Rollercoaster Continues: An Overview and Outlook for the P-C Insurance Industry *Focus on Texas*

Insurance Council of Texas

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P/C Insurance Overview & Outlook: Outline

- P/C Financial Overview & Outlook in the Post-COVID Era
  - Premium Growth
  - Underwriting Performance
  - Covid Impacts
- Investment Market Issues: Volatility Rules and the Hawkish Fed
- Catastrophe Loss Trends
- The Economy, Insurance and COVID-19: Overview & Outlook
  - Growth, Employment, Inflation…
- Private Passenger Auto: COVID Impacts in Texas
- Inflation: What It Means for P/C Insurers
- Summary and Q&A

P/C Insurance Industry Financial Overview & Outlook:

Challenges Amid Rising Inflation and Higher Interest Rates

The Current Economic Environment Presents Many Challenges for P/C Insurers

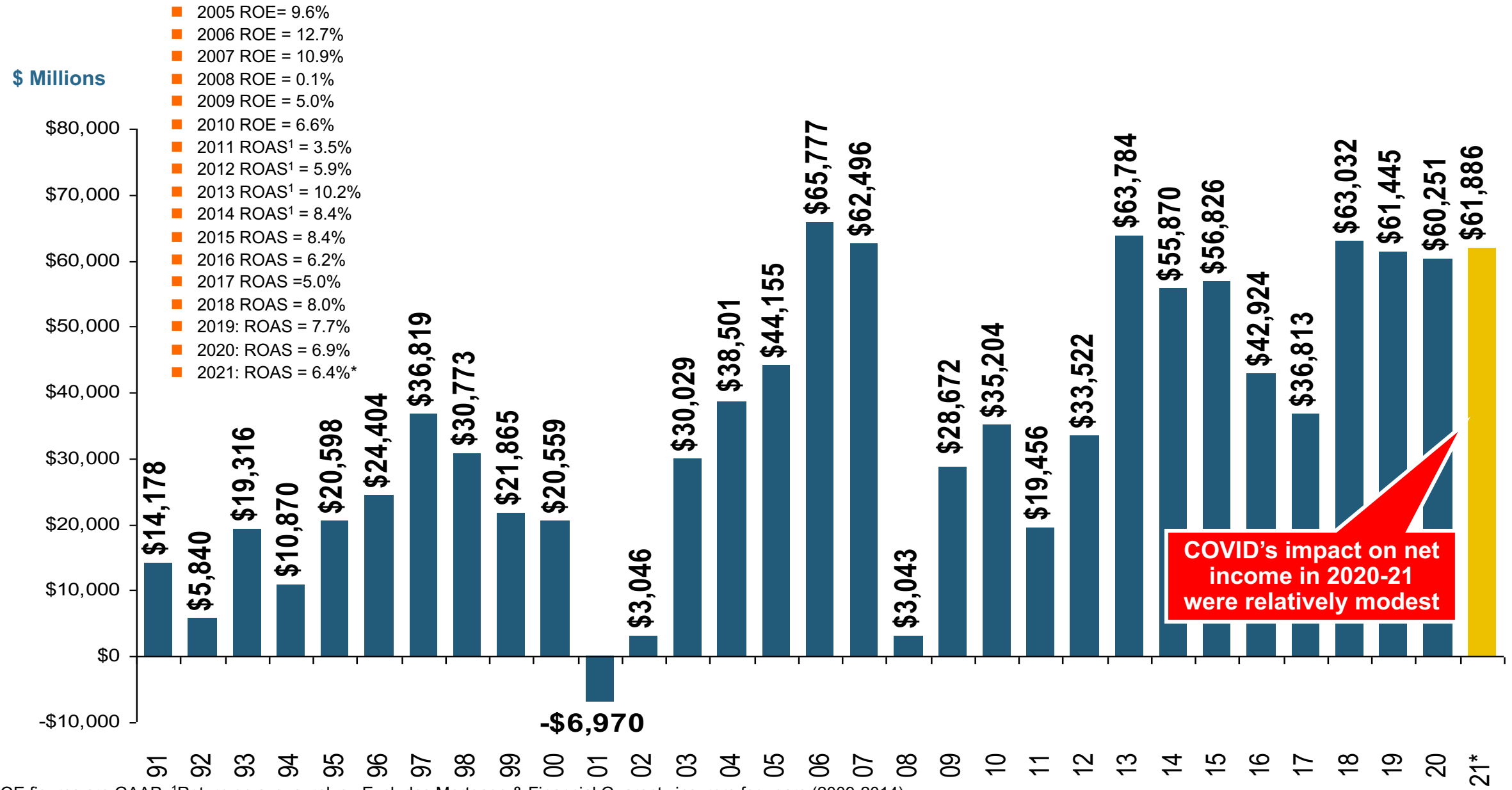
Industry Remains Strong

3

Profits and Profitability

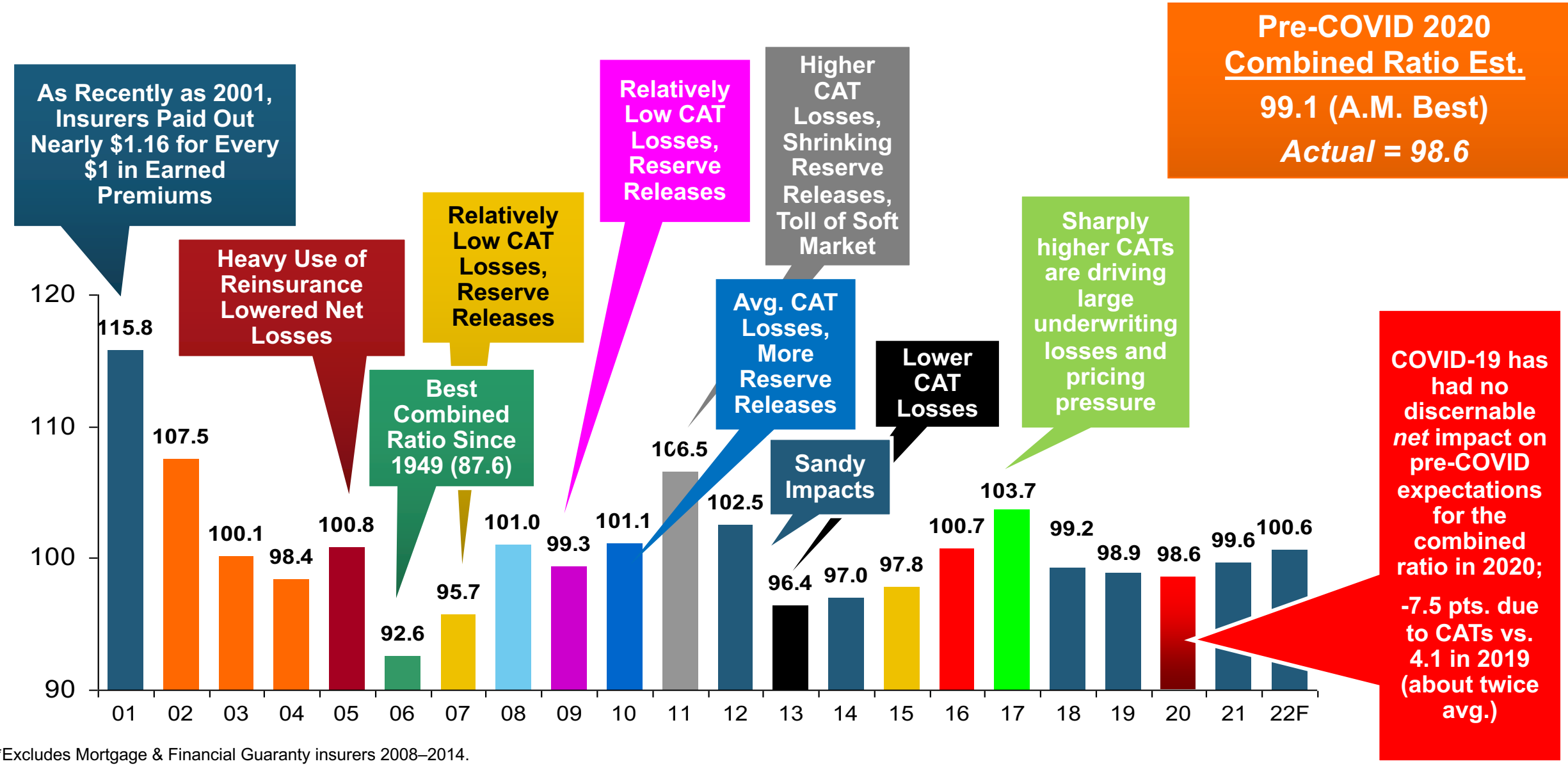
P/C Profitability Is Extremely Volatile

P/C Industry Net Income After Taxes, 1991–2021*



*ROE figures are GAAP; [1]Return on avg. surplus. Excludes Mortgage & Financial Guaranty insurers for years (2009-2014).
Sources: A.M. Best, ISO, APCIA.

P/C Insurance Industry Combined Ratio, 2001–2022F**



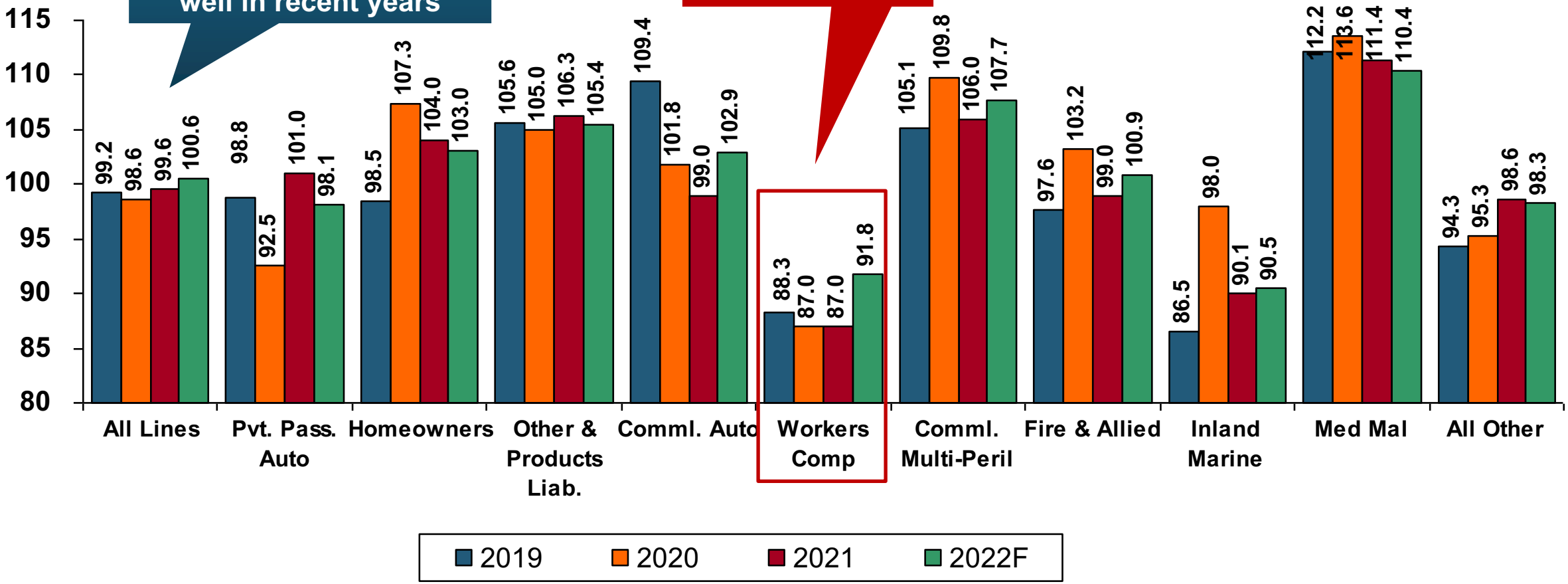
*Excludes Mortgage & Financial Guaranty insurers 2008–2014.
**2022 figure is forecast..
Sources: A.M. Best, ISO (2014-2022F).

Combined Ratios by Line: 2019 – 2022F

Despite COVID and high CAT losses, the overall P/C industry has performed reasonably well in recent years

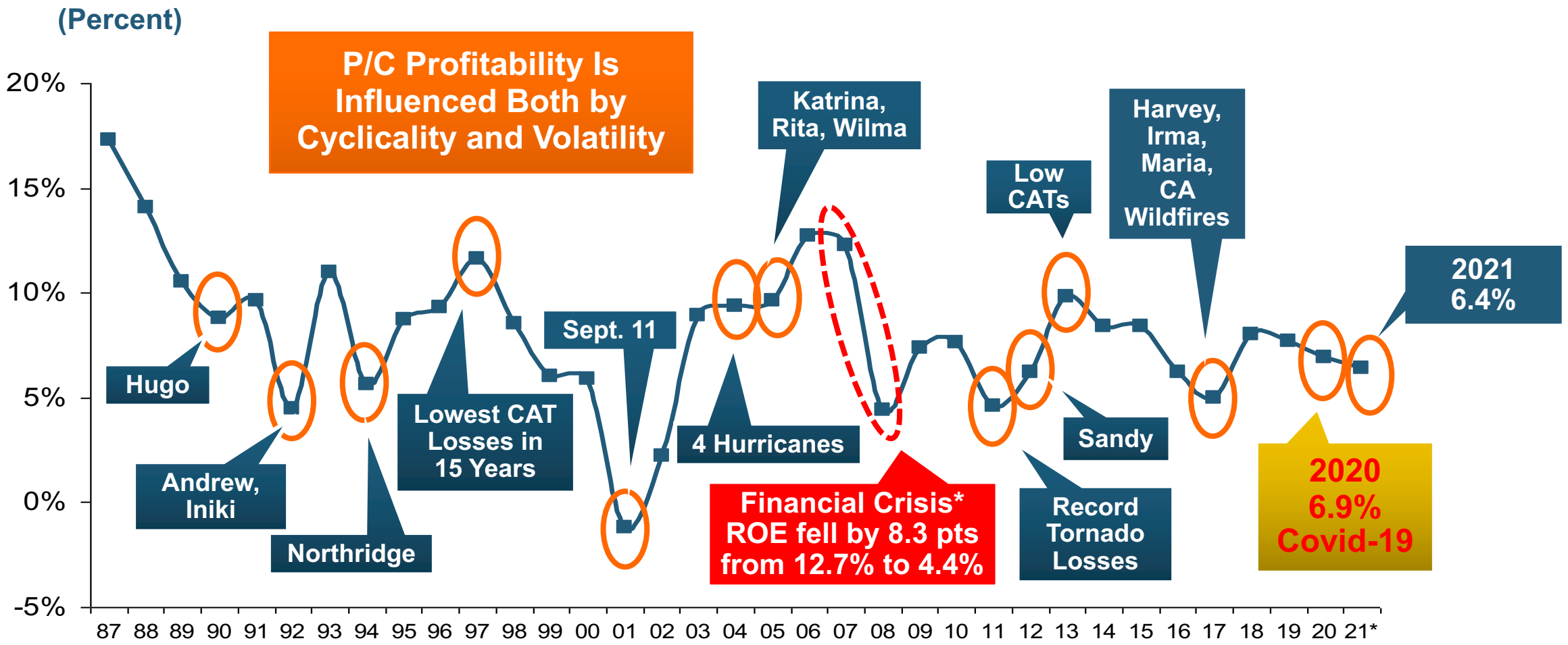
WC is the best performing line of insurance

Accelerating inflation could push the combined ratio upward in 2022 beyond the estimates shown here



Source: A.M. Best *Review & Preview* (2022 forecasts as of Feb. 2022); Univ. of South Carolina, Risk and Uncertainty Management Center.

ROE: Property/Casualty Insurance by Major Event, 1987–2021E*



*Excludes Mortgage & Financial Guarantee in 2008 – 2014.
Sources: ISO, *Fortune,* APCIA; USC RUM Center.

ROE: Property/Casualty Insurance, 1973 - 1989 vs. Recent

Although underwriting experience was far worse in the mid/late-1970s and most of the 1980s than in recent years, industry profitability was actually materially higher. Though after adjusting for inflation the difference is small.

Avg. ROE

1973 – 1979: 11.5%

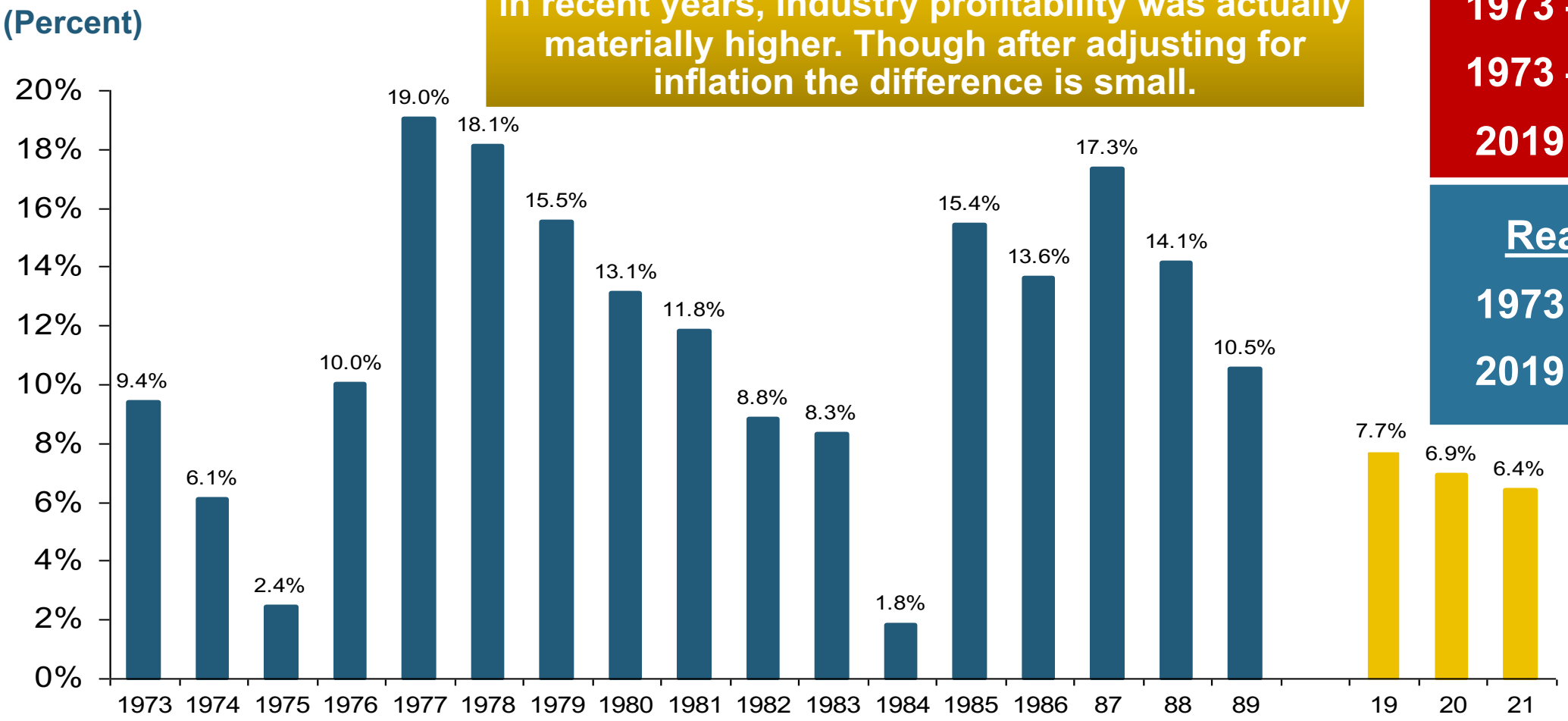
1973 – 1989: 11.5%

2019 – 2021: 7.0%

Real Avg. ROE

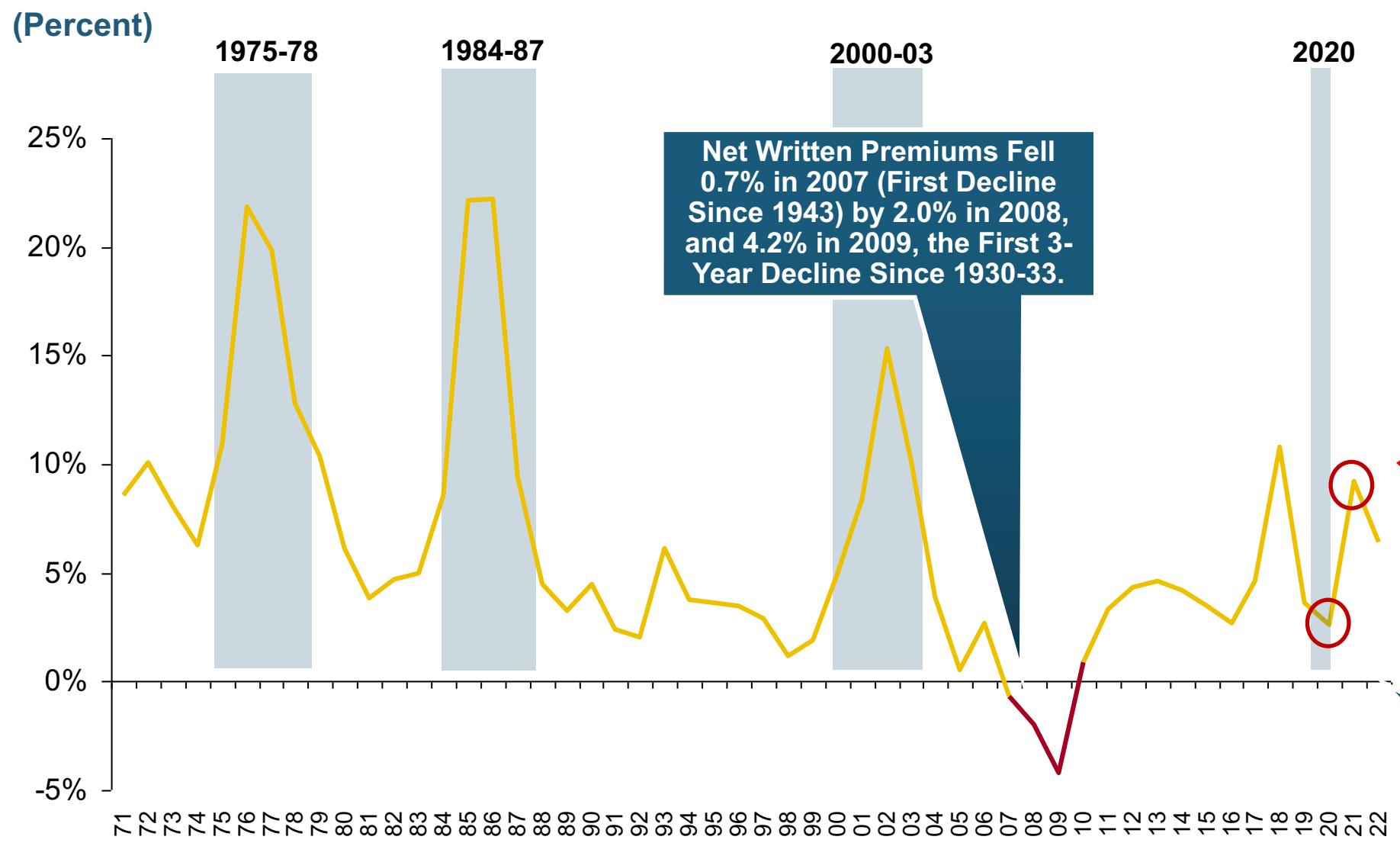
1973 – 1989: 4.8%

2019 – 2021: 4.5%



Sources: ISO, APCIA; USC RUM Center.

Net Written Premium Growth (All P/C Lines): Annual Change, 1971–2022F



Net Written Premiums Fell 0.7% in 2007 (First Decline Since 1943) by 2.0% in 2008, and 4.2% in 2009, the First 3-Year Decline Since 1930-33.

2022F: 6.4%
2021: 9.2%
2020: 2.6%
2019: 3.6%
2018: 10.8%
2017: 4.6%
2016: 2.7%
2015: 3.5%

Sharp recovery in NWP in 2021 (9.2%). Strong economic recovery and favorable rate environment both powered growth.

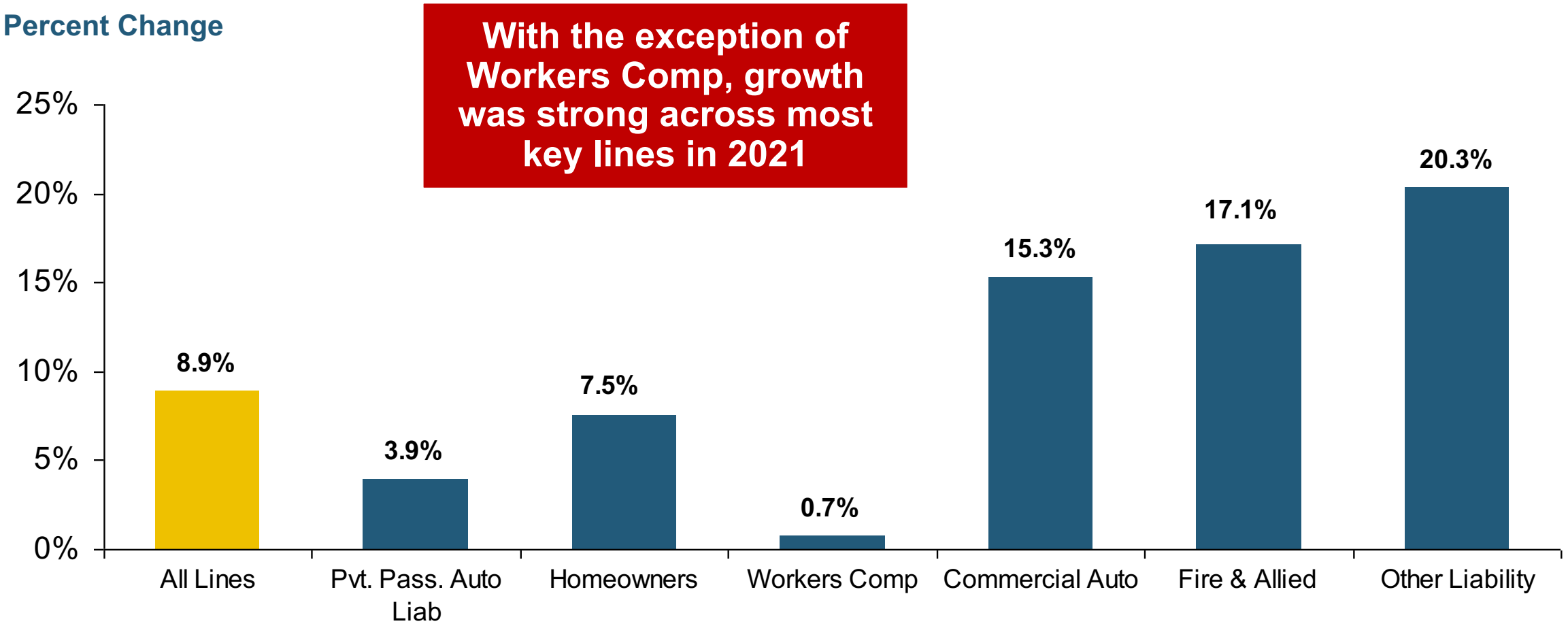
2020 Outlook

Pre-COVID: 3.8%

Actual: 2.6%**

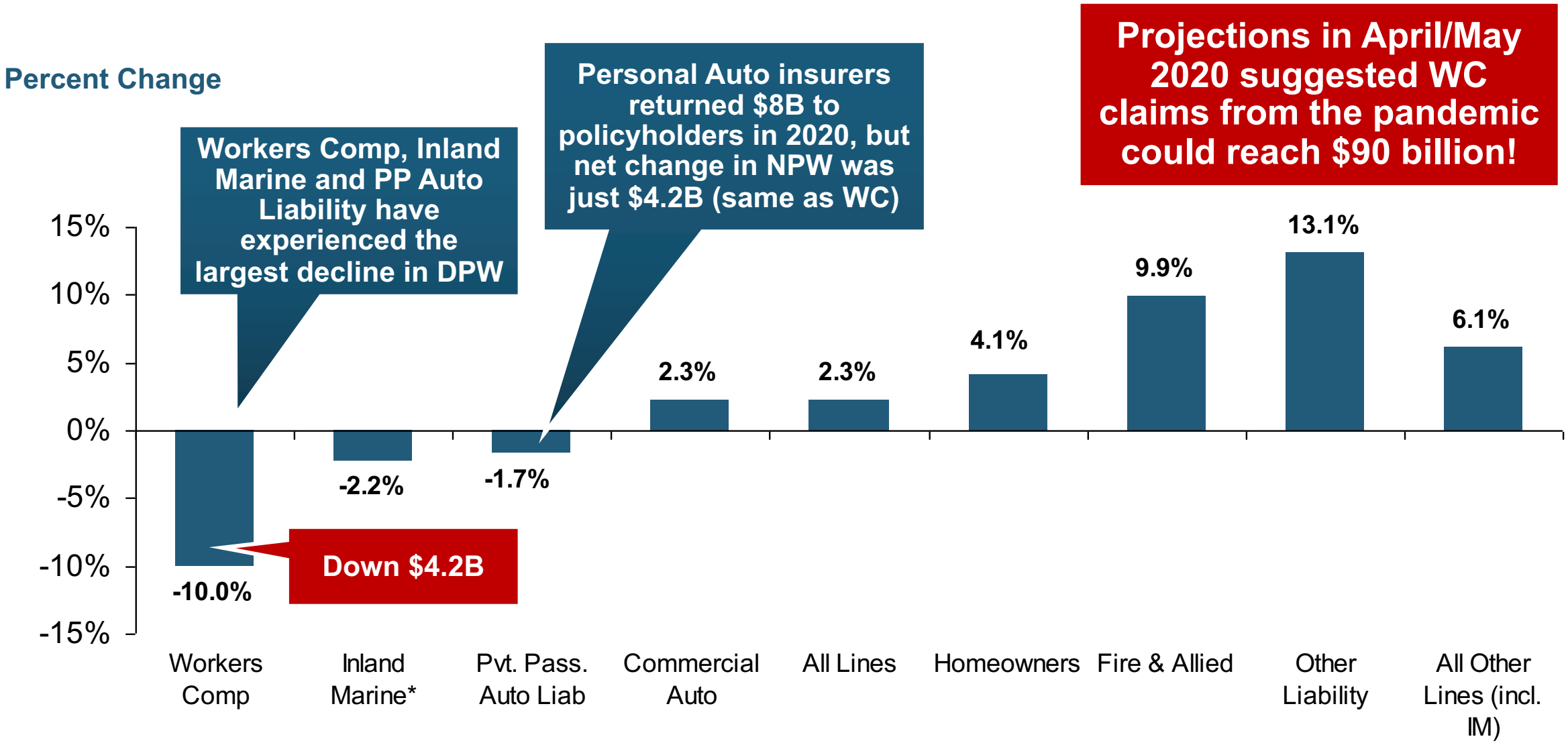
NOTE: Shaded areas denote "hard market" periods.
Sources: A.M. Best (1971-2013, 2022F), ISO (2014-21); Risk & Uncertainty Management Center, Univ. of South Carolina

Change in NPW for Key Lines: 2021



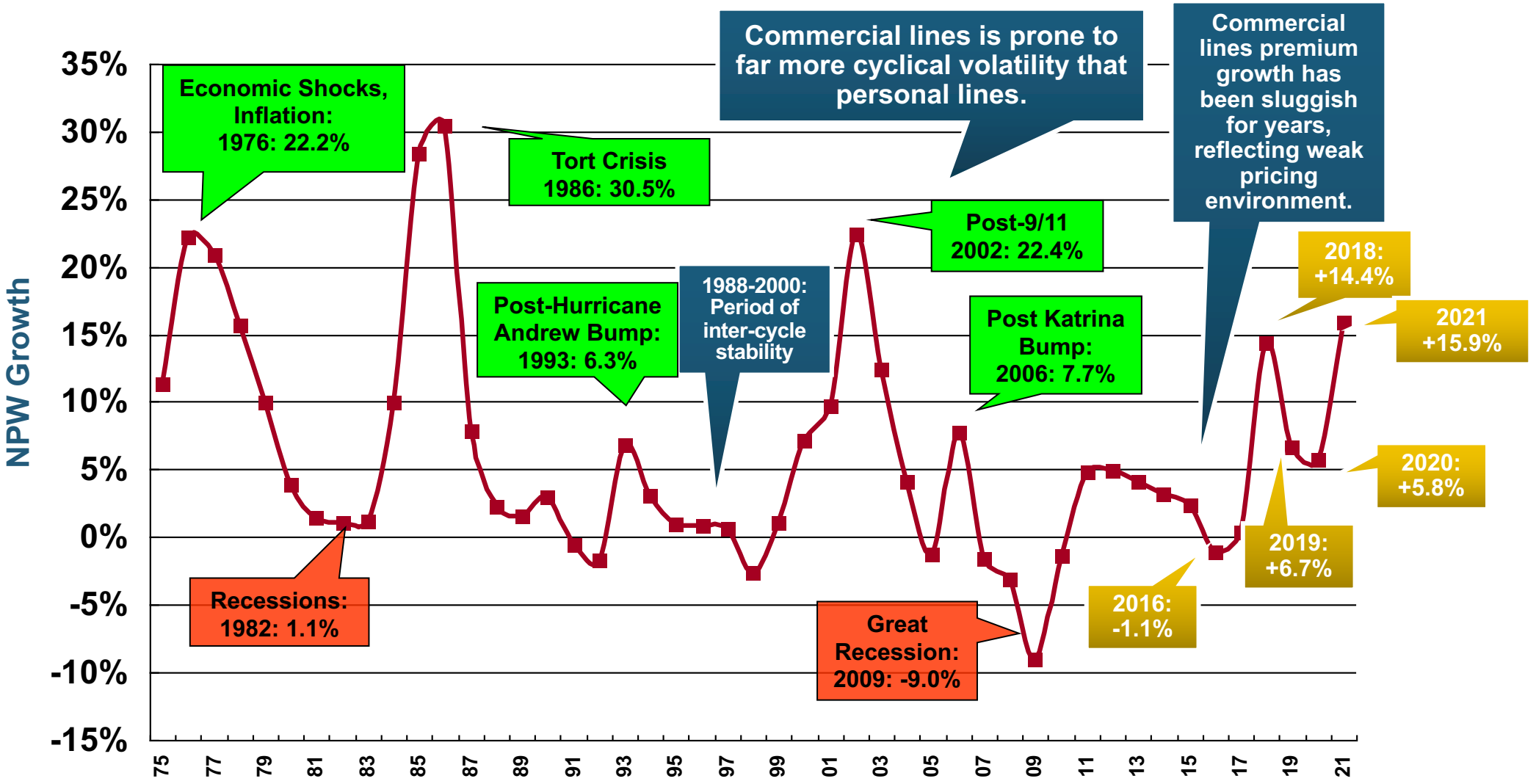
Sources: NAIC Annual Statement data, NCCI; Risk and Uncertainty Management Center, Univ. of South Carolina.

COVID's Impact on NPW Growth for Largest P/C Lines: 2020



*Inland Marine figure is DPW though first 9-months of 2020 (A.M. Best).
Sources: NAIC Annual Statement data, NCCI; Risk and Uncertainty Management Center, Univ. of South Carolina.

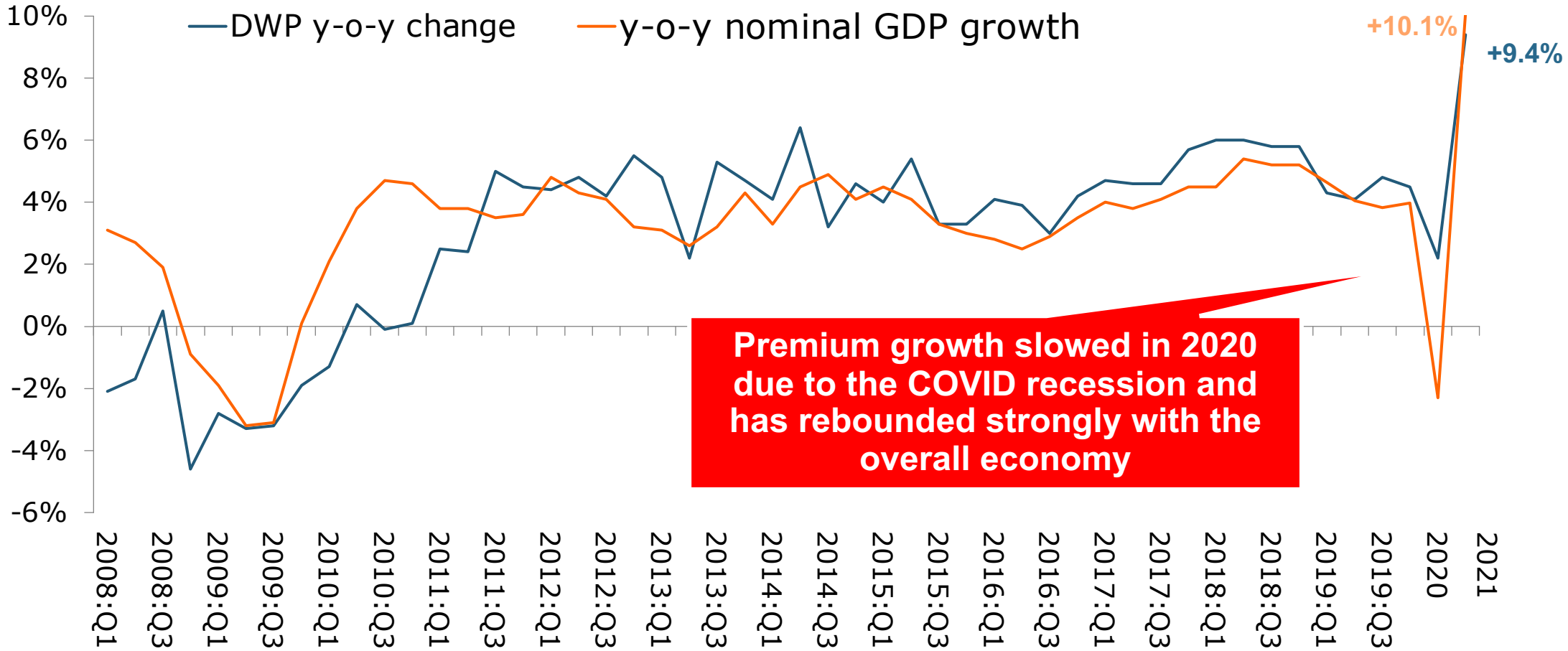
Commercial Lines NPW Premium Growth: 1975 – 2021



Note: Data include state funds beginning in 1998.
Source: A.M. Best; ISO; APCIA; Univ. of South Carolina Center for Risk and Uncertainty Management Center.

The Economy Drives P/C Insurance Industry Premiums: 2006:Q1–2021*

Direct Premium Growth (All P/C Lines) vs. Nominal GDP: Quarterly Y-o-Y Pct. Change



Premium growth slowed in 2020 due to the COVID recession and has rebounded strongly with the overall economy

Direct written premiums track nominal GDP fairly tightly over time, suggesting the P/C insurance industry's growth prospects inextricably linked to economic performance.

*2020-21 figures are annual;.

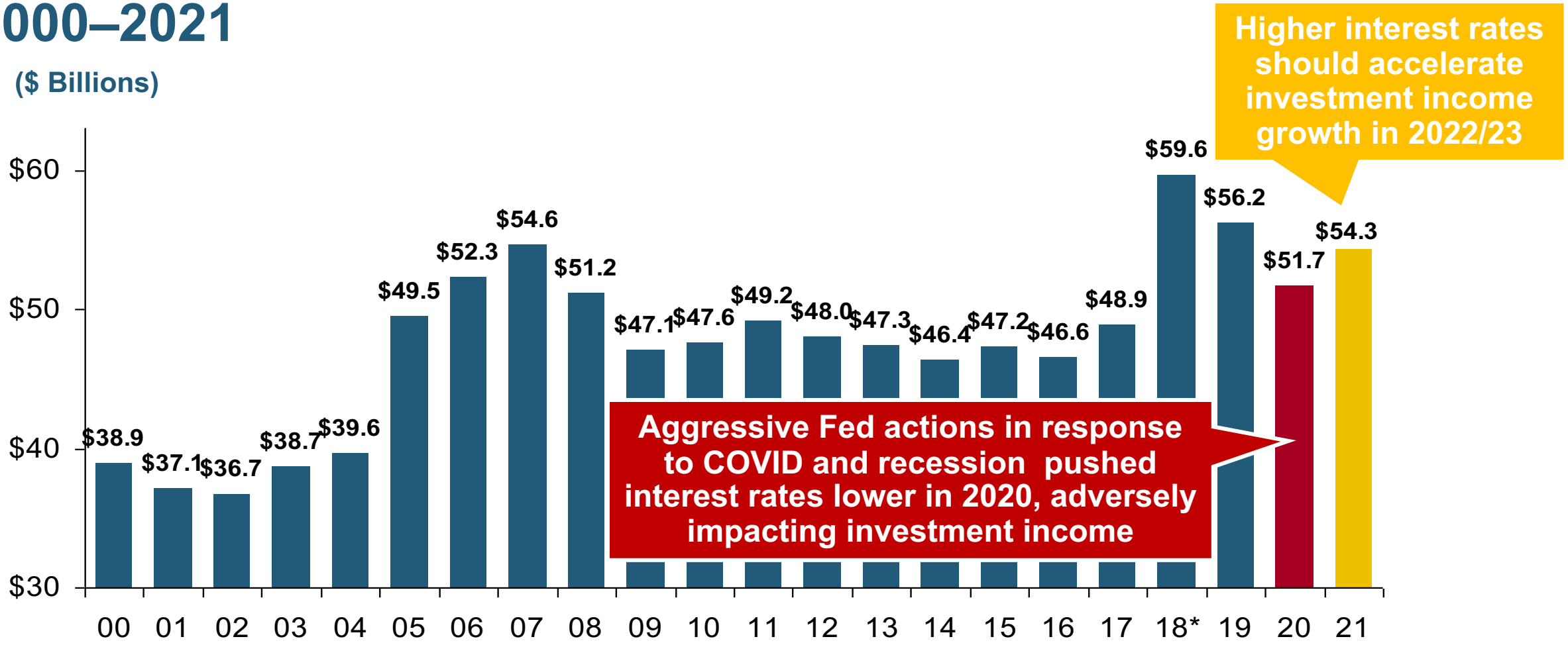
Sources: SNL Financial; U.S. Commerce Dept., Bureau of Economic Analysis; ISO; I.I.I.; Risk and Uncertainty Management Center, University of South Carolina.

Investments

Investment Performance Is a Key Driver of Insurer Profitability, Especially in Long-Tailed Lines Such as Workers Comp

Dove to Hawk: How Will an Aggressive Fed Impact Insurer Portfolios?

Property/Casualty Insurance Industry Investment Income: 2000–2021

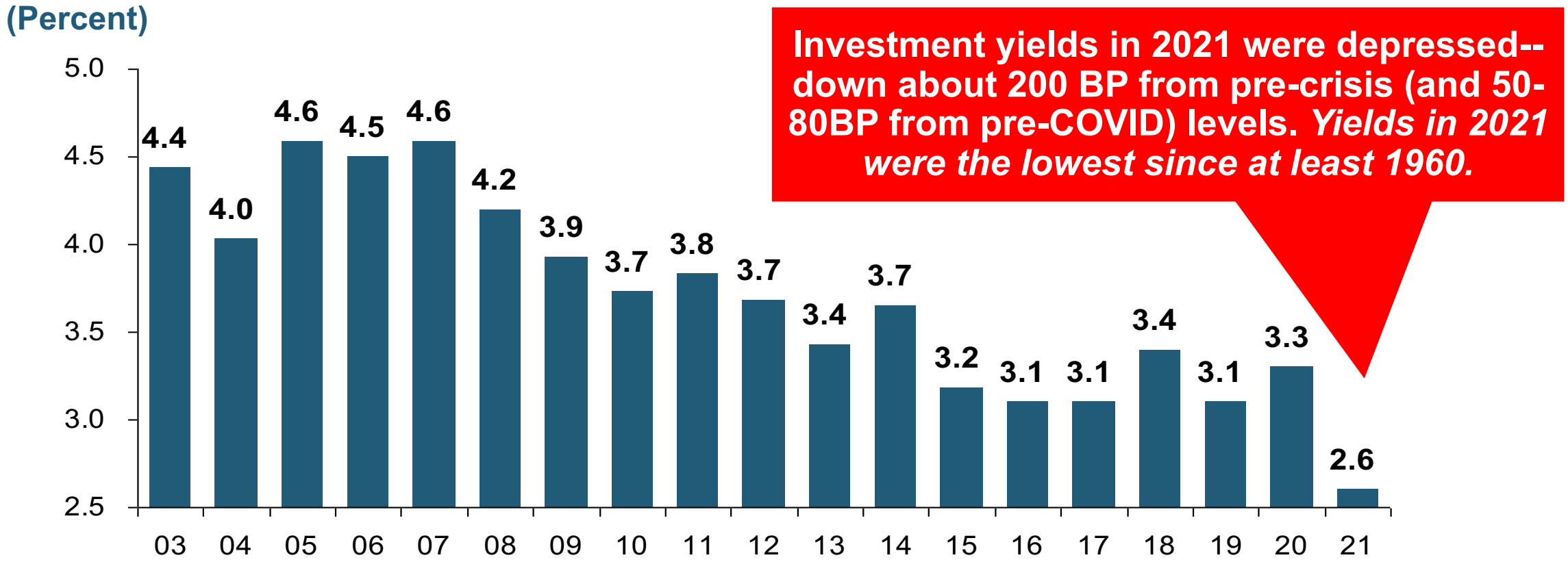


Due to persistently low interest rates, investment income remained below pre-crisis levels for a decade. Lower interest rates during COVID drove investment income down once again. Fed rate hikes in 2022 could reverse this trend.

*2021 figure is actual as of 12/31/21. 2018-19 figures are distorted by provisions of the TCJA of 2017. Increase reflects such items as dividends from foreign subsidiaries.

[1] Investment gains consist primarily of interest and stock dividends. Sources: ISO; University of South Carolina, Center for Risk and Uncertainty Management.

Net Investment Yield on Property/Casualty Insurance Invested Assets, 2007–2021



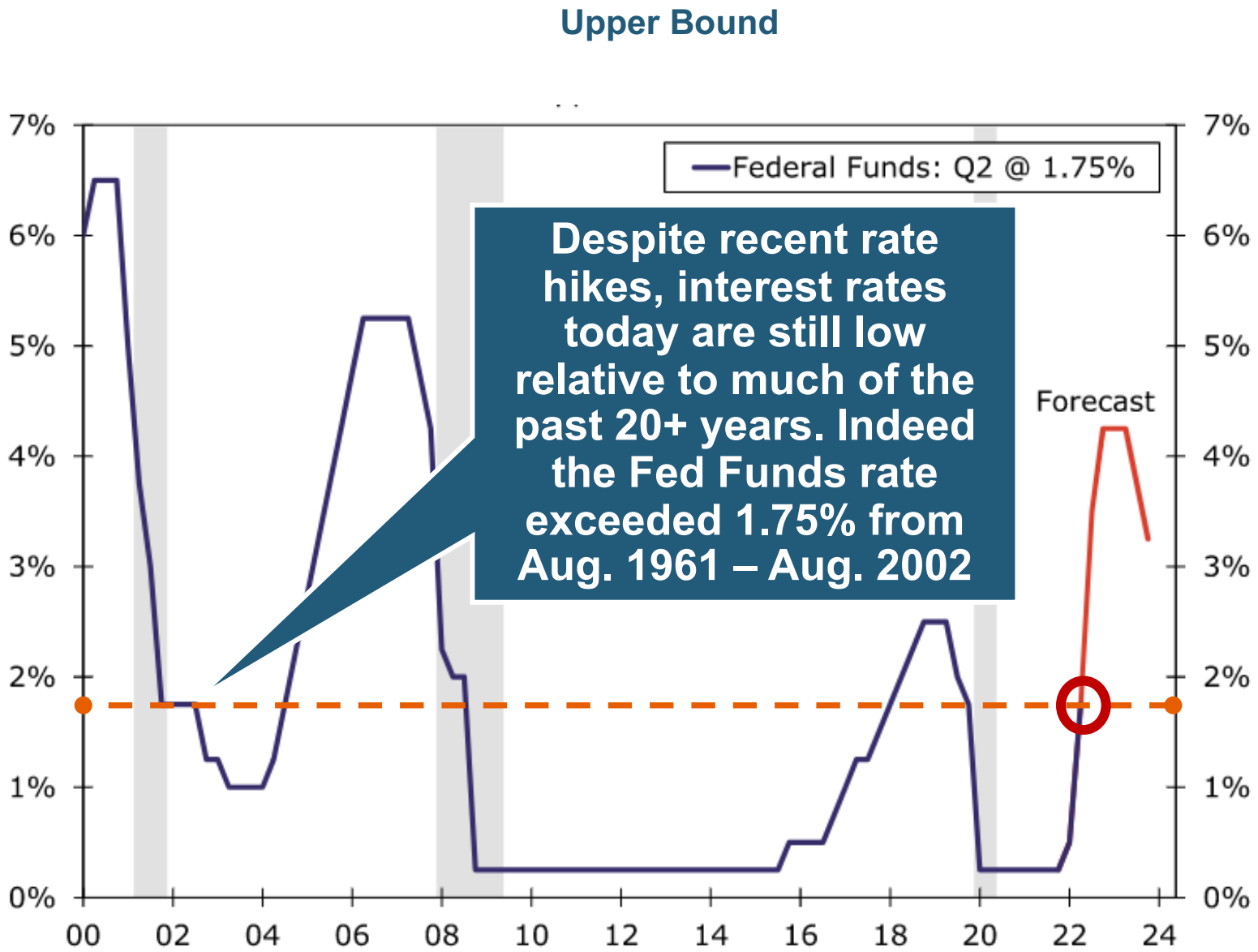
Investment yields in 2021 were depressed--down about 200 BP from pre-crisis (and 50-80BP from pre-COVID) levels. *Yields in 2021 were the lowest since at least 1960.*

The yield on invested assets remains depressed relative to pre-financial crisis and pre-COVID yields. Fed rate hikes in 2022 should begin to slowly lift yields.

Average: 1960-2019 = 4.9%
Low: 2.8% (1961)
High: 8.2% (1984/85)

Sources: NAIC data, sourced from S&P Global Market Intelligence; 2017-19 figures are from ISO. 2020-21 data from the APCIA. Risk and Uncertainty Management Center, Univ. of South Carolina.

Federal Funds Target Rate: Up, Up and Away!



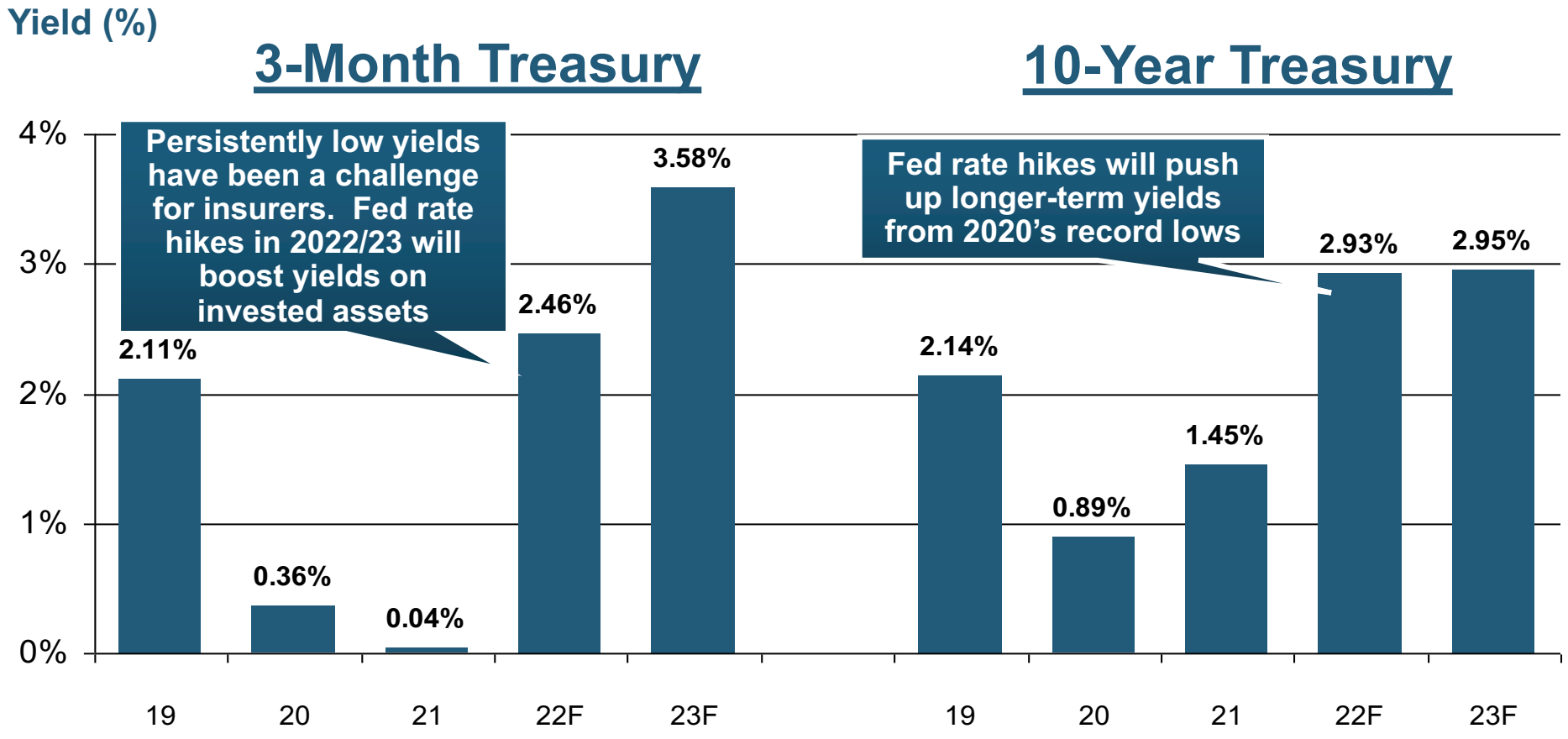
Despite recent rate hikes, interest rates today are still low relative to much of the past 20+ years. Indeed the Fed Funds rate exceeded 1.75% from Aug. 1961 – Aug. 2002

The Fed is expected hike rates into 2023 to as much as 4.25%. If the objective of lower inflation is met (or in sight), the Fed will likely lower rates in late 2023 to keep unemployment low

The Fed hiked short-term rates on June 15th by 75 basis points to a target range of between 1.50% and 1.75%

Source: Federal Reserve Board and Wells Fargo Economics (7/22); Risk and Uncertainty Management Center, University of South Carolina.

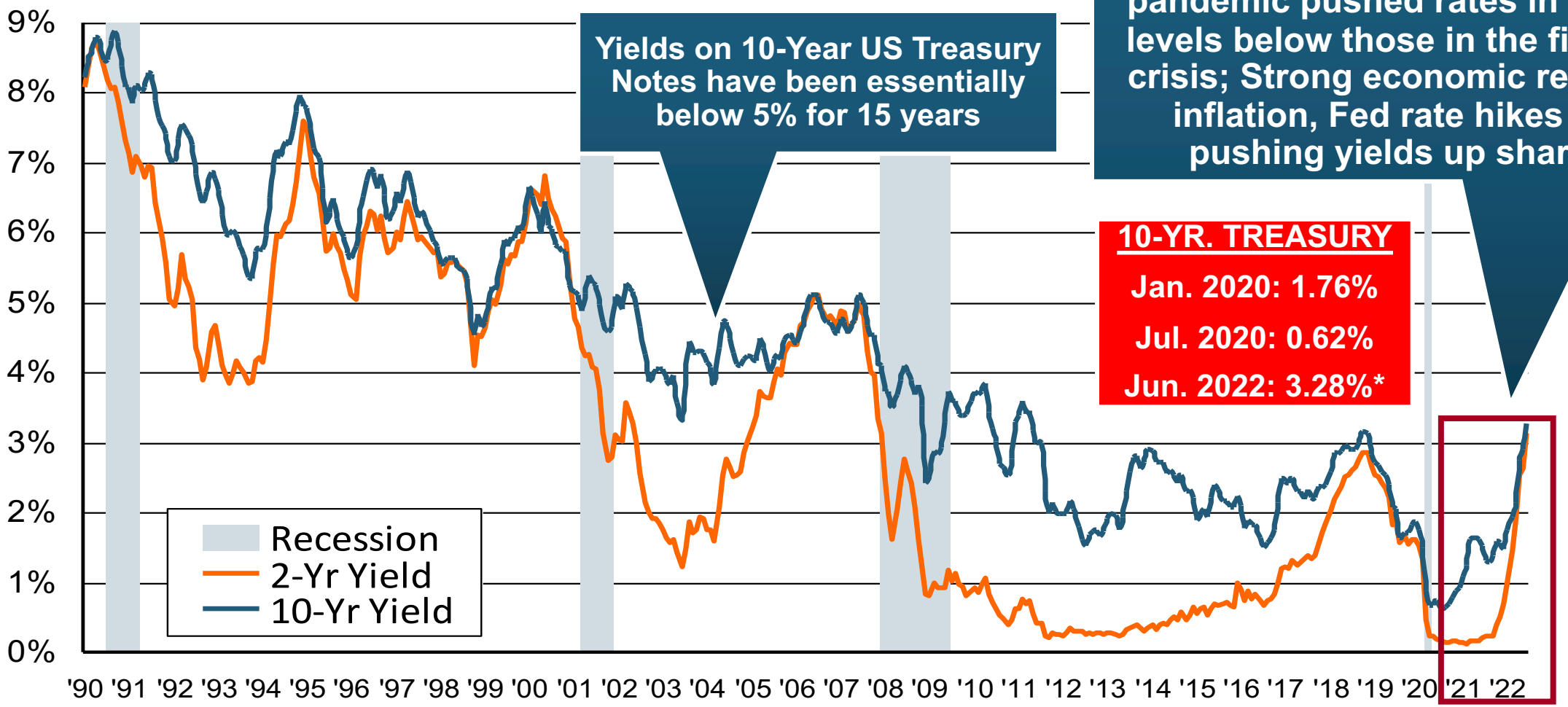
Interest Rate Forecasts: 2019 – 2023F



Rising interest rates will provide a modest tailwind for insurers as the Fed raises interest rates. This will be especially beneficial to longer-tailed lines such as Workers Comp.

Sources: Wells Fargo Securities (7/22); Risk and Uncertainty Management Center, University of South Carolina.

US Treasury Security Yields: A Long Downward Trend, 1990–2022*



Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, Fed rate hikes should over time provide a modest boost to P/C insurer portfolio yields

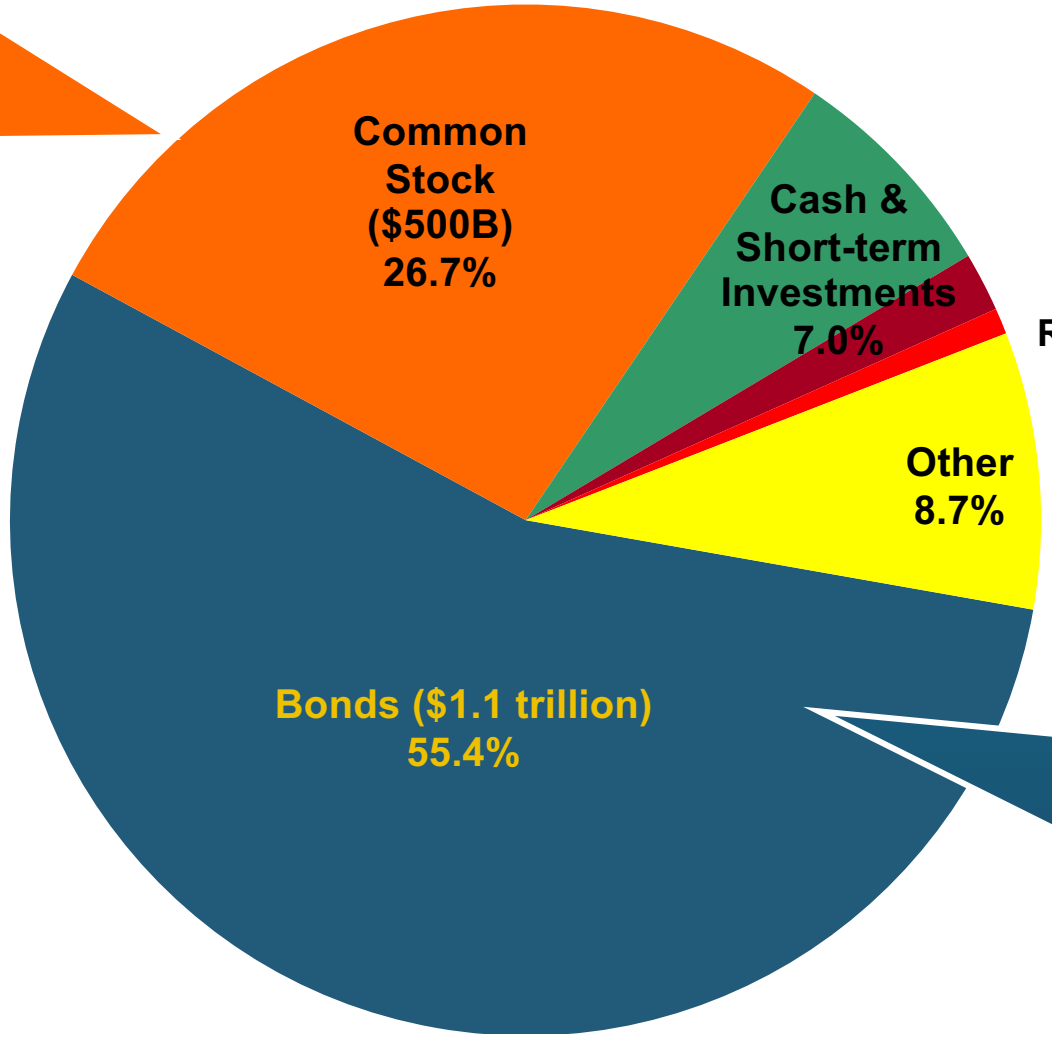
*Monthly, constant maturity, nominal rates, through June 2022 (as of June 16).

Sources: Federal Reserve Bank at http://www.federalreserve.gov/releases/h15/data.htm. National Bureau of Economic Research (recession dates); Risk and Uncertainty Management Center, University of South Carolina.

P/C Insurance Industry Investment Portfolio*

With stocks accounting for about 25% of invested assets, the current correction represents a buying opportunity for P/C insurers

P/C insurers in the U.S. managed $2 trillion in assets in 2020

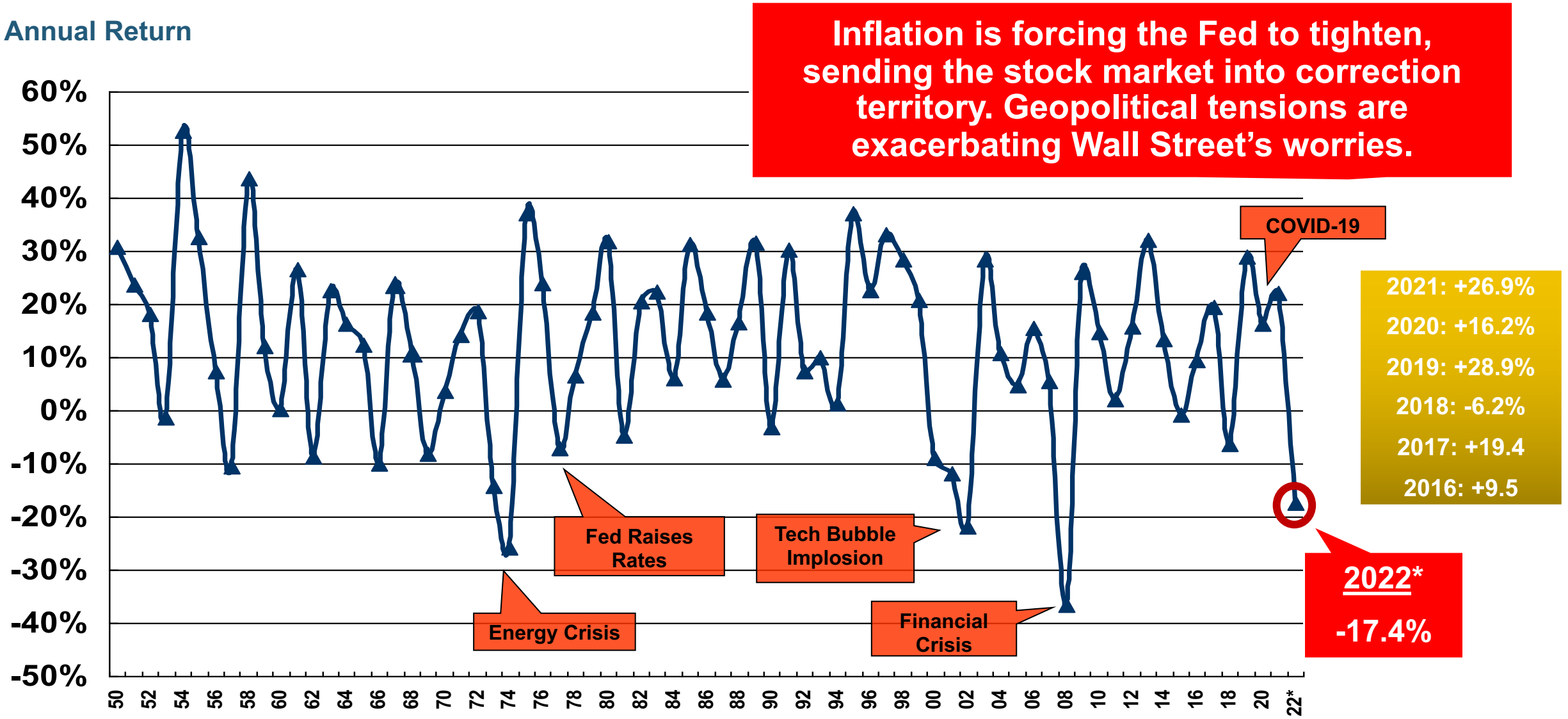


Nearly 60% of P/C assets are in the form of bonds. *This means higher interest will push up the return on invested assets.*

Long-tailed lines such as WC will benefit the most

*As of 12/31/20.
Sources: NAIC data from I.I.I.; Risk and Uncertainty Management Center, University of South Carolina.

S&P 500 Index Returns, 1950–2022*



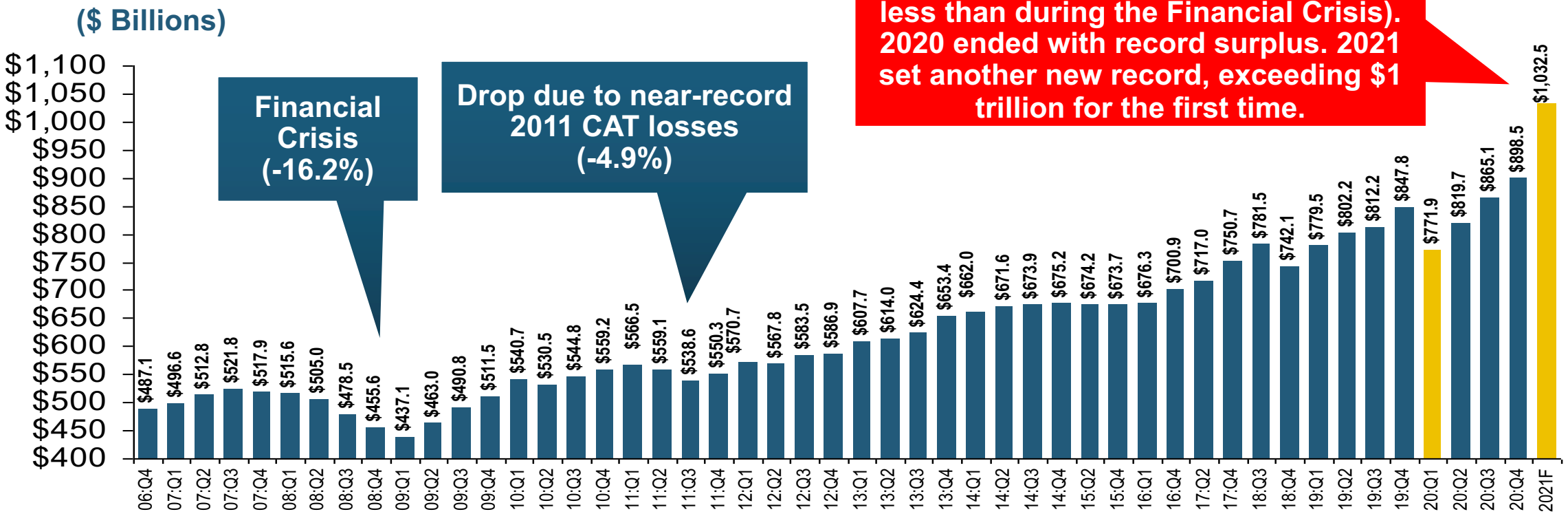
*Through July 19, 2022.
Source: NYU Stern School of Business: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html;
Center for Risk and Uncertainty Management, University of South Carolina.

Capital and Capacity

P/C Insurance: Over or Under Capitalized?

Is the Industry Creating Economic Value?

Policyholder Surplus (Capacity), 2006:Q4 – 2021*



The P/C insurance industry entered the COVID-19 pandemic from a position of strength and was able to withstand the 9.0% surplus decline in Q1 2020 (far less than during the Financial Crisis). 2020 ended with record surplus. 2021 set another new record, exceeding $1 trillion for the first time.

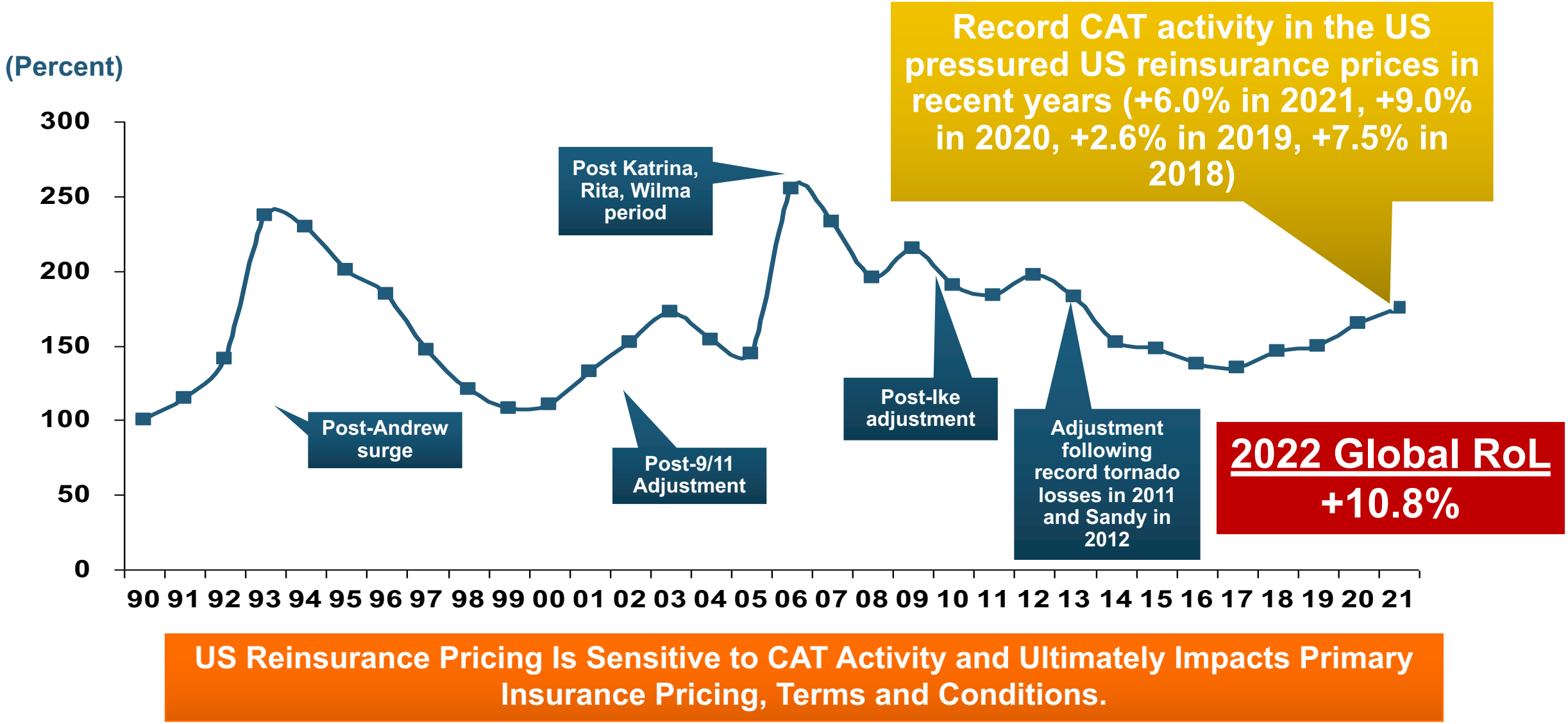
2010: Q1 data includes $22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business.

*2021 figure is actual through Q4.

Sources: ISO, A.M .Best; Risk and Uncertainty Management Center, University of South Carolina.

Policyholder Surplus is the industry's financial cushion against large insured events, periods of economic stress and financial market volatility. It is also a source of capital to underwrite new risks.

US Property Catastrophe Rate-on-Line Index: 1990 – 2021*



US Reinsurance Pricing Is Sensitive to CAT Activity and Ultimately Impacts Primary Insurance Pricing, Terms and Conditions.

*As of January 1 each year.

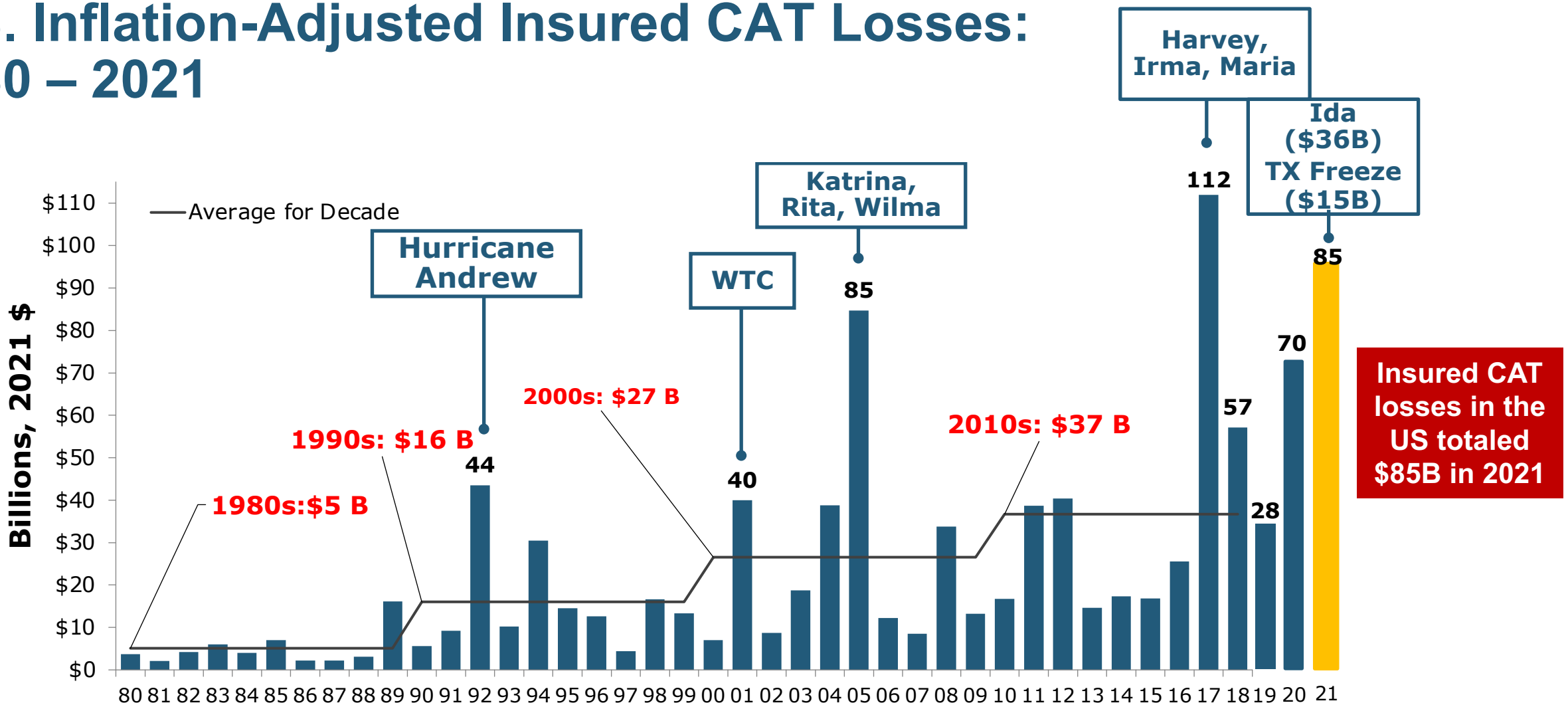
Source: Guy Carpenter; Artemis.bm accessed at: http://www.artemis.bm/us-property-cat-rate-on-line-index

Catastrophe Loss Trends

The Rise in CAT Losses Shows No Signs of Easing

The 2020s Are Off to an Ominous Beginning

U.S. Inflation-Adjusted Insured CAT Losses: 1980 – 2021



Insured CAT losses in the US totaled $85B in 2021

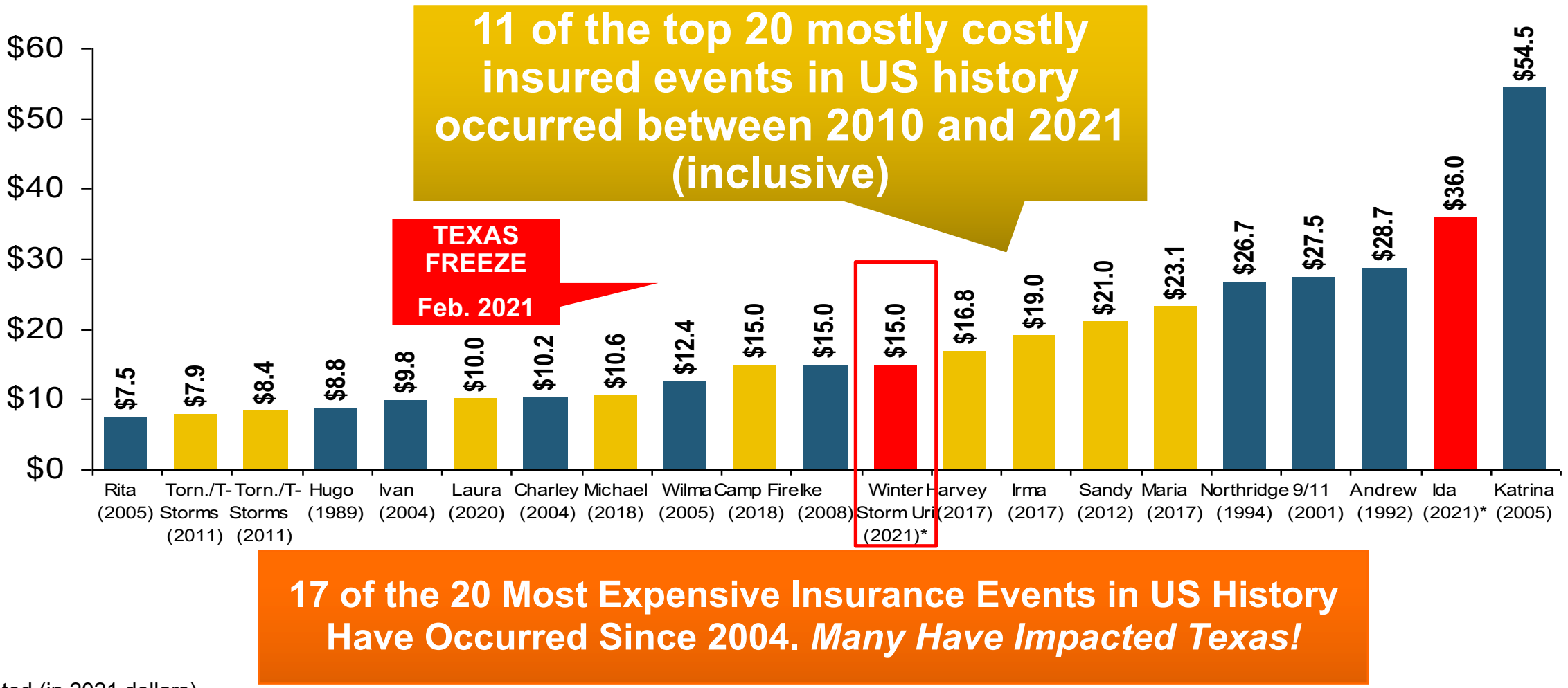
Average Insured Loss per Year*
1980-2021: $23.8 Billion
2012-2021: $44.1 Billion

The 2020s are off to an ominous start with $76B in average annual insured losses

*Stated in 2021 dollars.
Sources: Property Claims Service, a Verisk Analytics business (1980-2019); 2020 and 2021 figures from Munich Re; Insurance Information Institute; University of South Carolina, Risk & Uncertainty Management Center.

Top 21 Most Costly Disasters in U.S. History—Katrina Still Ranks #1

(Insured Losses, 2020 Dollars, $ Billions)



17 of the 20 Most Expensive Insurance Events in US History Have Occurred Since 2004. *Many Have Impacted Texas!*

*Estimated (in 2021 dollars)

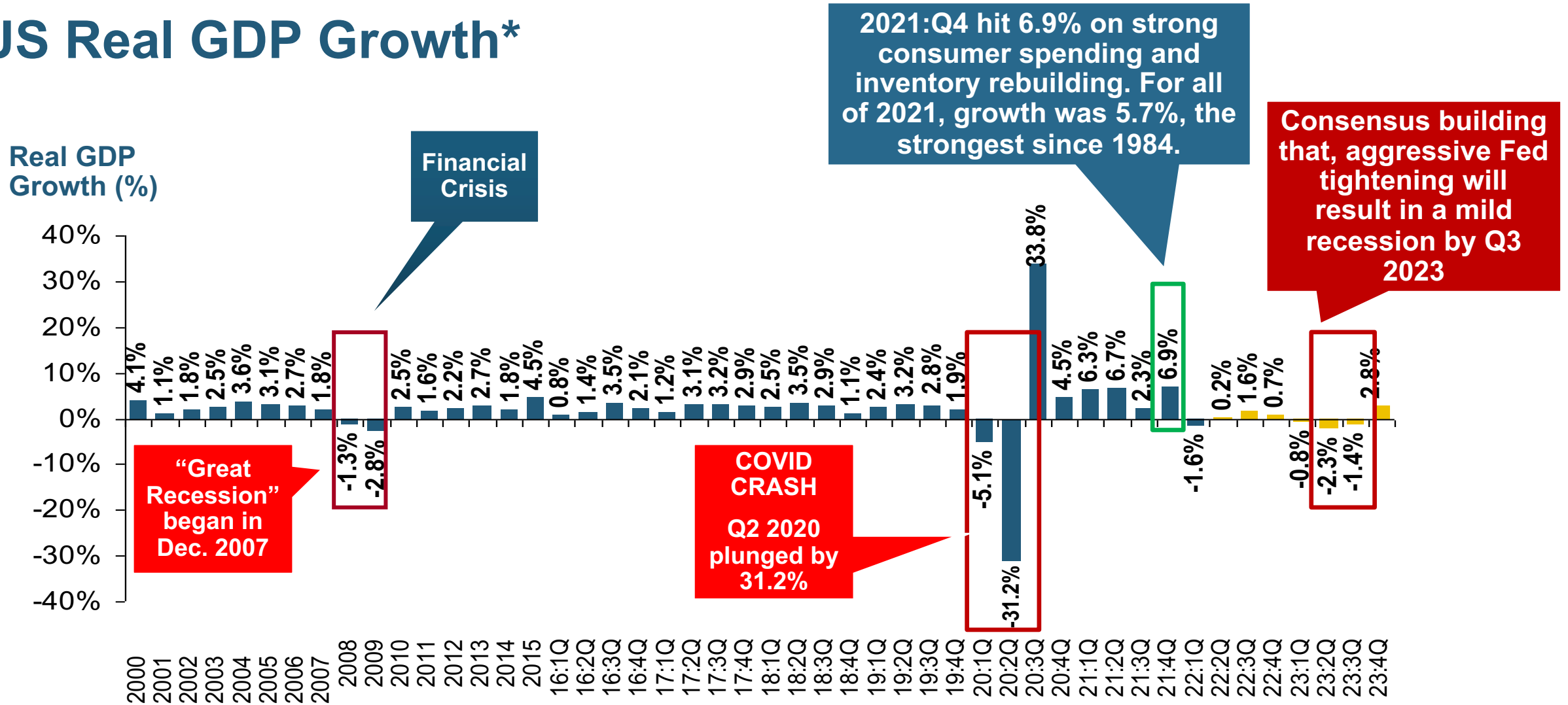
Sources: PCS, RMS, Aon, Karen Clark & Co; USC Center for Risk and Uncertainty Management adjustments to 2020 dollars using the CPI.

The Economy

The Strength of the Economy Has Always Influenced Growth in Insurers' Exposure Base Across Most Lines—Including During the COVID-19 Pandemic

The Links Between the Economy and the P/C Insurance Industry Are Strengthening

US Real GDP Growth*

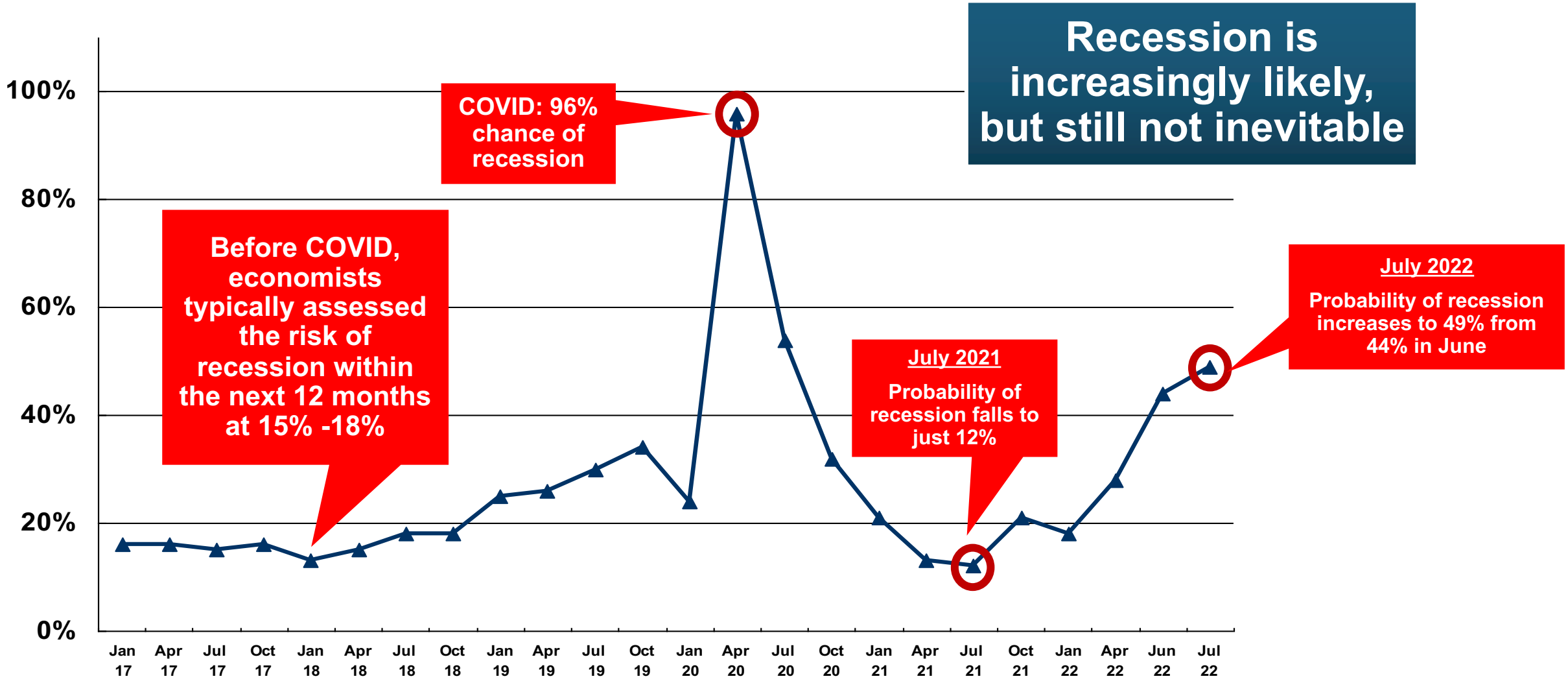


GDP Recovered to Q4 2019 Level in Q1 2021. Demand for Insurance Increased Materially in 2021/22—Particularly in Economically Sensitive Commercial Lines Such as WC. Premium growth will likely slow in 2023.

* Estimates/Forecasts from Wells Fargo Securities.

Source: US Department of Commerce, Wells Fargo Securities (7/22); Center for Risk and Uncertainty Management, University of South Carolina.

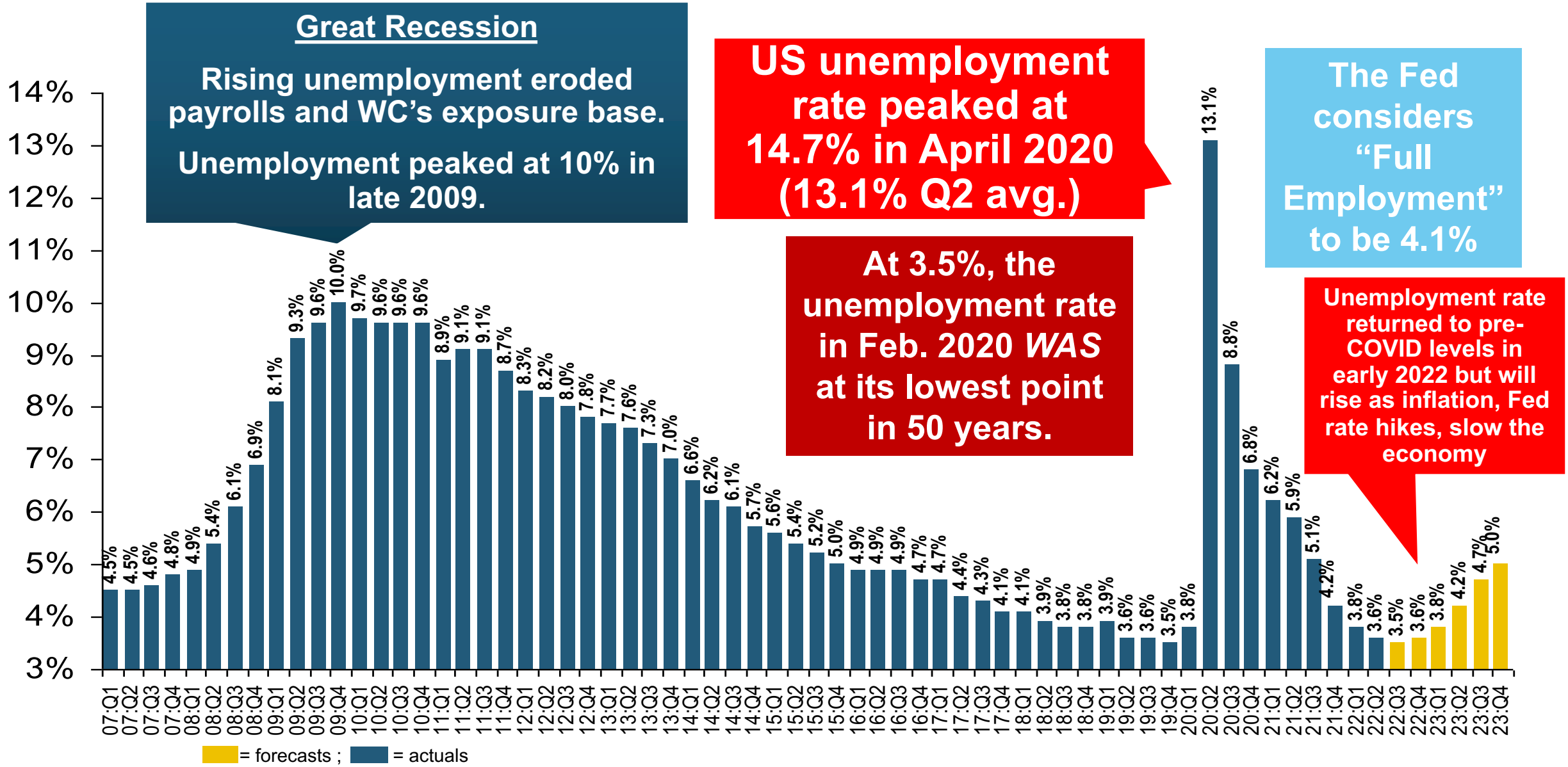
Probability the U.S. Is in a Recession Within Next 12 Months: Jan. 2017 – July 2022*



*July 2022 survey included the responses of 53 economists.

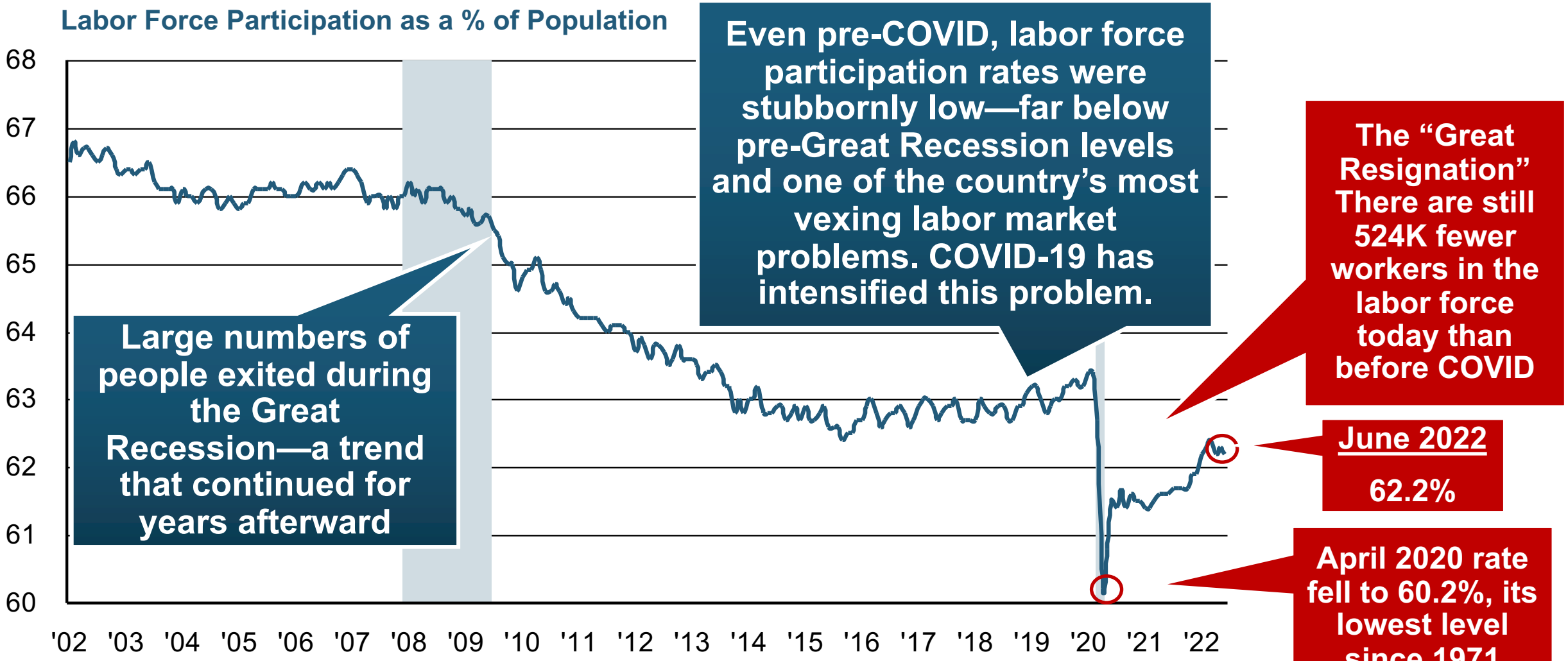
Source: Wall Street Journal surveys of economists: https://www.wsj.com/articles/recession-probability-soars-as-inflation-worsens-11655631002; Risk and Uncertainty Management Center, University of South Carolina.

US Unemployment Rate Forecast: 2007:Q1–2023:Q4



Sources: US Bureau of Labor Statistics; Wells Fargo Securities (7/22 edition); Risk and Uncertainty Management Center, University of South Carolina.

Labor Force Participation Rate, Jan. 2002–Jun. 2022*



*Defined as the percentage of working age persons in the population who are employed or actively seeking work.

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics at http://www.bls.gov/data/; National Bureau of Economic Research (recession dates); Center for Risk and Uncertainty Management, University of South Carolina.

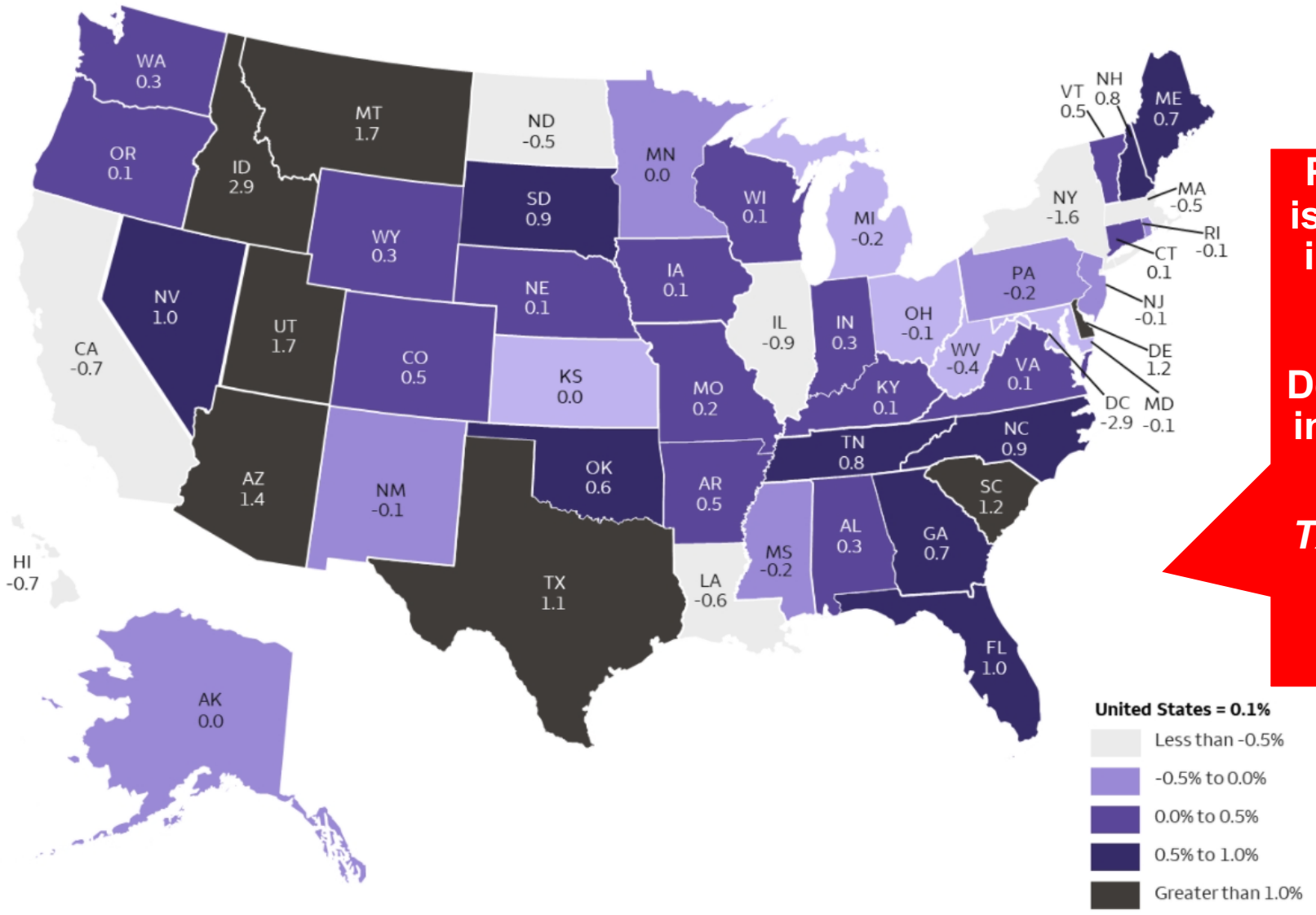
Population Change by State, July 2020–July 2021 (U.S.: 0.1%)

Top 5

ID	2.9%
MT	1.7%
UT	1.7%
AZ	1.4%
SC	1.2%

Bottom 5

NY	-1.6%
IL	-0.9%
CA	-0.7%
HI	-0.7%
LA	-0.6%

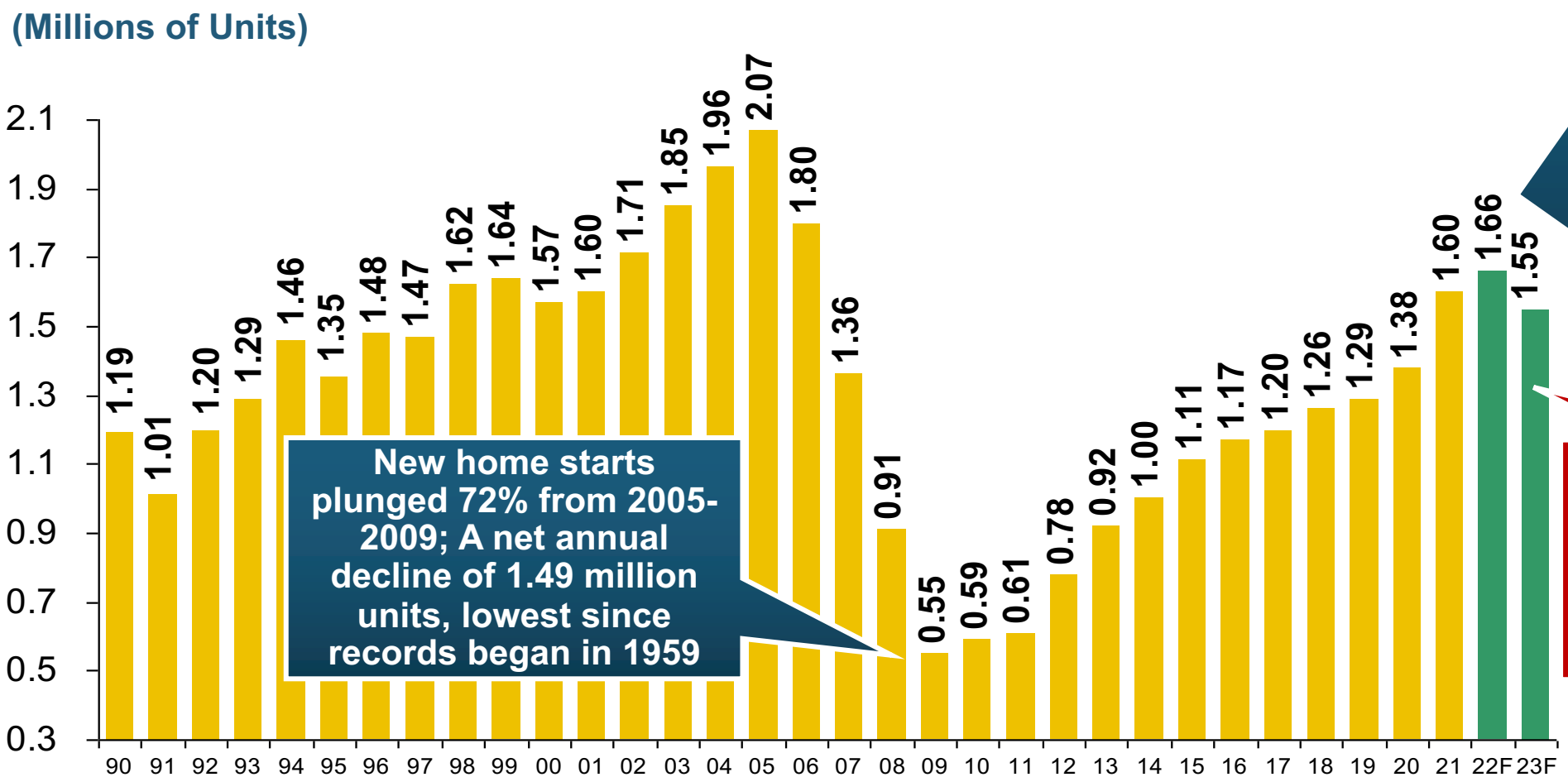


Population growth is a driver of growth insurance demand and insurable exposure. Demographic trends in the Northeast are generally weak.

TX experienced one of the the largest increases (in % terms) in the US.

Source: U.S. Census Bureau, Dec. 2021 estimates, www.census.gov/popest; Wells Fargo Securities; Risk an Uncertainty Management Center, University of South Carolina.

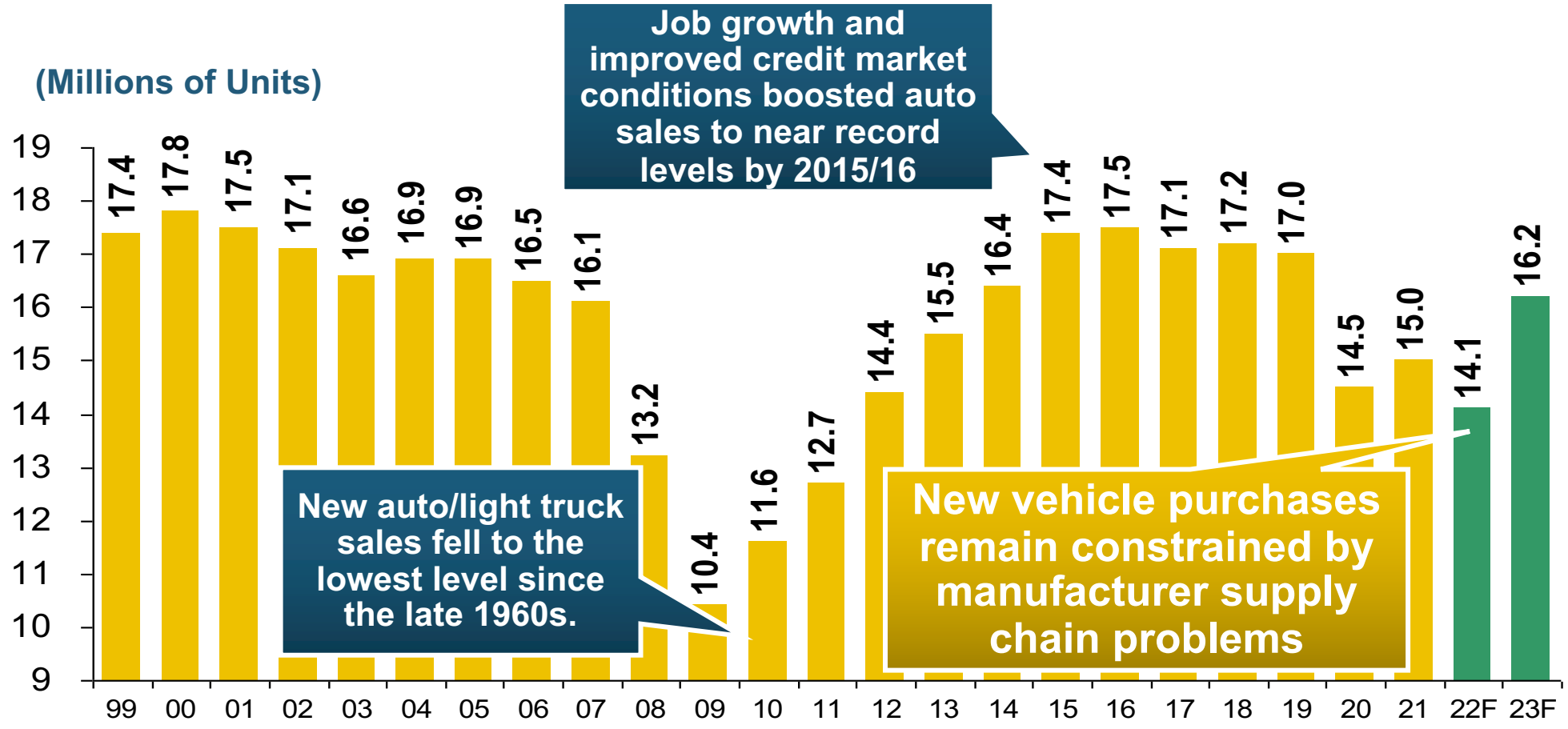
New Private Housing Starts, 1990-2023F



Insurers Are Continue to See Meaningful Exposure Growth in the Homeowners Line as well as Lines Associated with Home Construction: Construction Risk Exposure, Surety, Commercial Auto; Potent Driver of Workers Comp Exposure

Source: U.S. Department of Commerce; Wells Fargo Securities (7/22 for 2022-23); Univ. of South Carolina, Center for Risk and Uncertainty Management..

Auto/Light Truck Sales, 1999-2023F



Yearly car/light truck sales remain below pre-COVID levels. Auto manufacturer supply chain issues are expected to linger through 2022. PP Auto premium might grow by 3.5% - 5%.

Source: U.S. Department of Commerce; Wells Fargo Securities (7/22 for 2021-22); Univ. of South Carolina, Center for Risk and Uncertainty Management..

INFLATION

Claim Inflation Is Here Today

Rate and Reserve Adequacy and Insurance-to-Value Are Concerns if Current Inflationary Trends Persist

U.S. Inflation Rate: 2009-2023F*

Inflation accelerated sharply in 2021 and early 2022 (9.1% in June). Inflation is now not expected to moderate until Q4 2022; Forecast is highly dependent of trajectory of energy prices and Fed rate hikes

There's a great deal of concern that trillions of dollars of stimulus plus the post-COVID recovery, supply chain disruptions and labor shortages are causing the economy to overheat, resulting in inflation

Insurer Concerns About Inflation

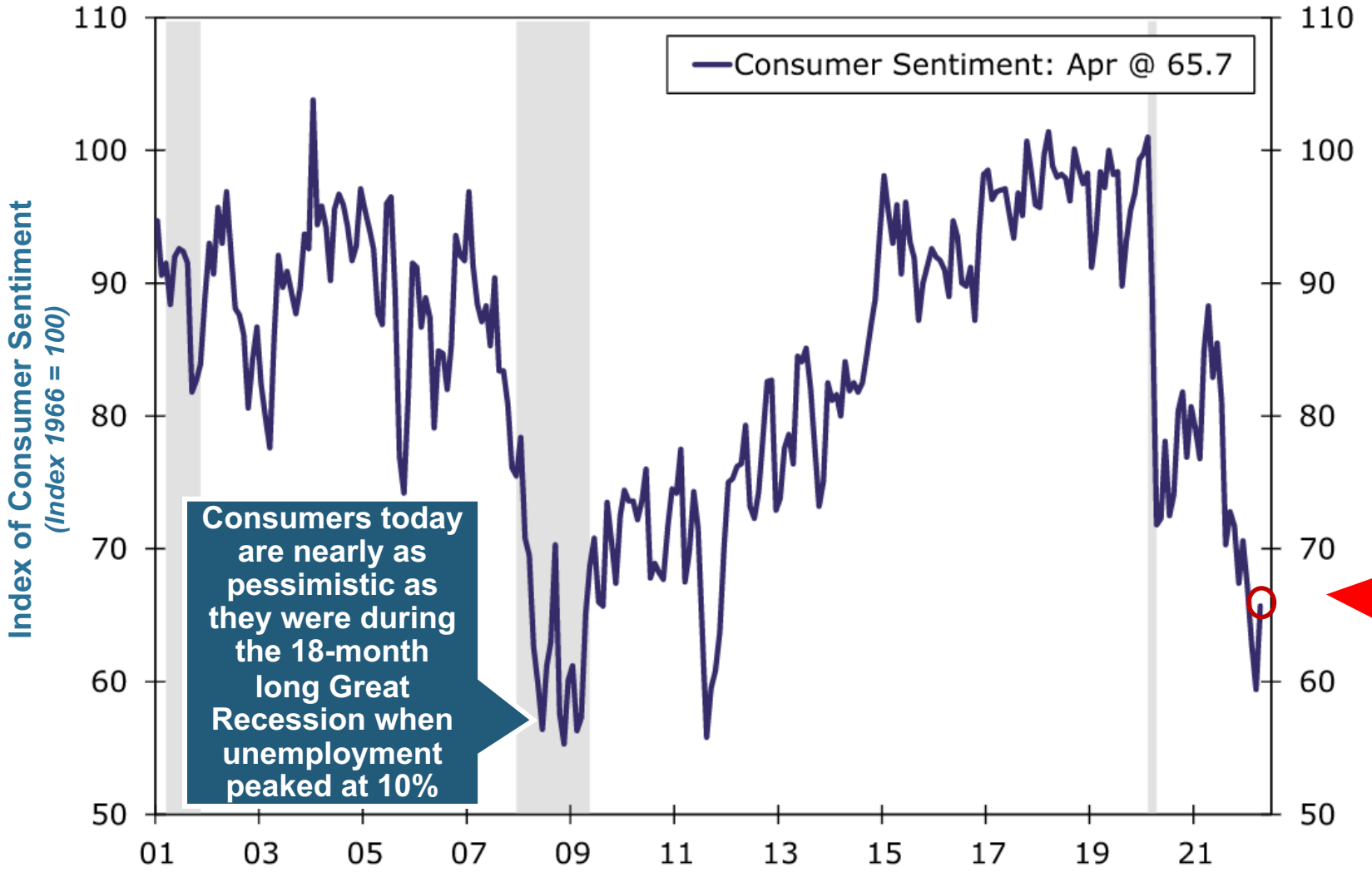
Rate Inadequacy

Reserve Inadequacy

*Annual change in Consumer Price Index for All Urban Consumers (CPI-U).

Source: U.S. Bureau of Labor Statistics; Wells Fargo Securities (7/22); USC Center for Risk and Uncertainty Management.

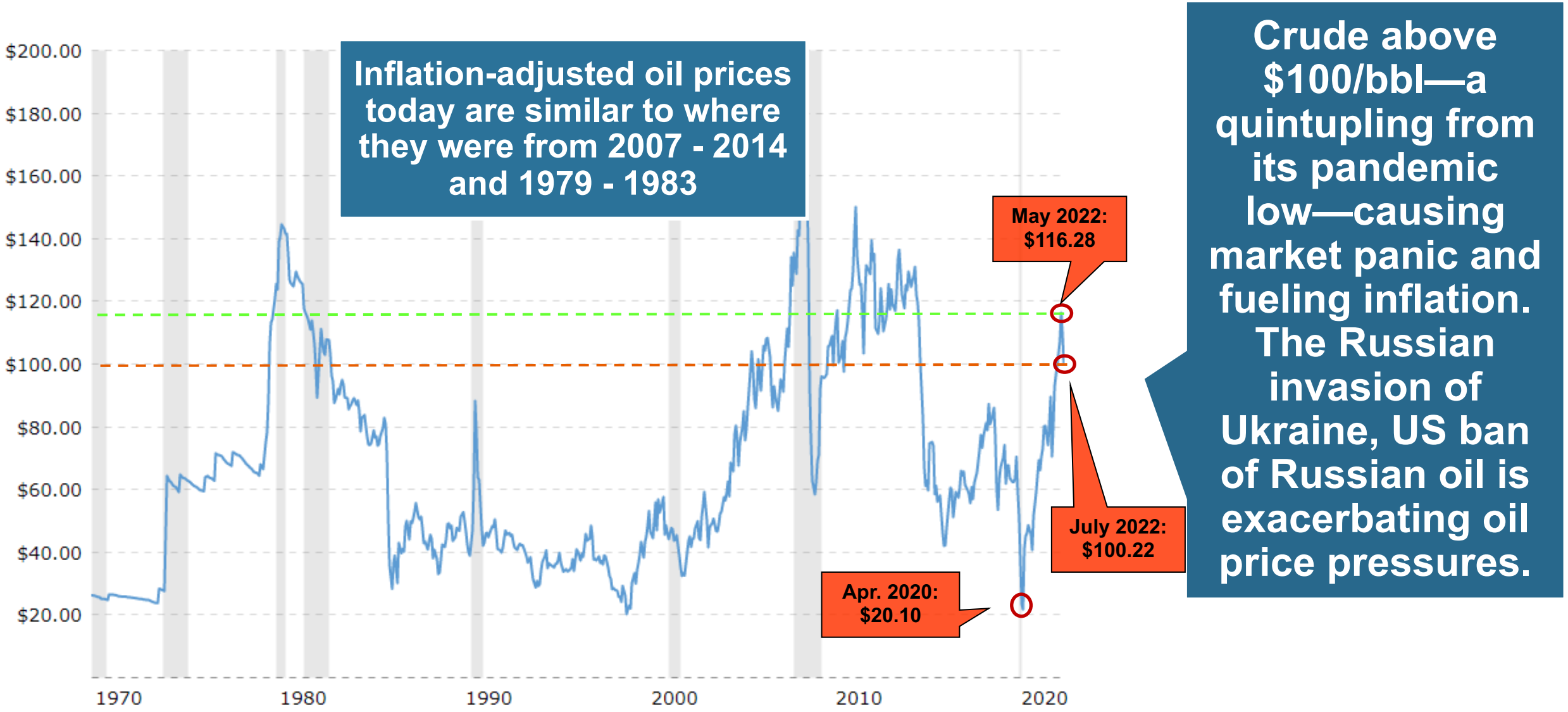
Consumer Sentiment: Near 20-Year Low Despite Strong Jobs Markets



Despite unemployment rates that are among the lowest in 50+ years and the "end" of the COVID pandemic, consumers are *GRUMPY*

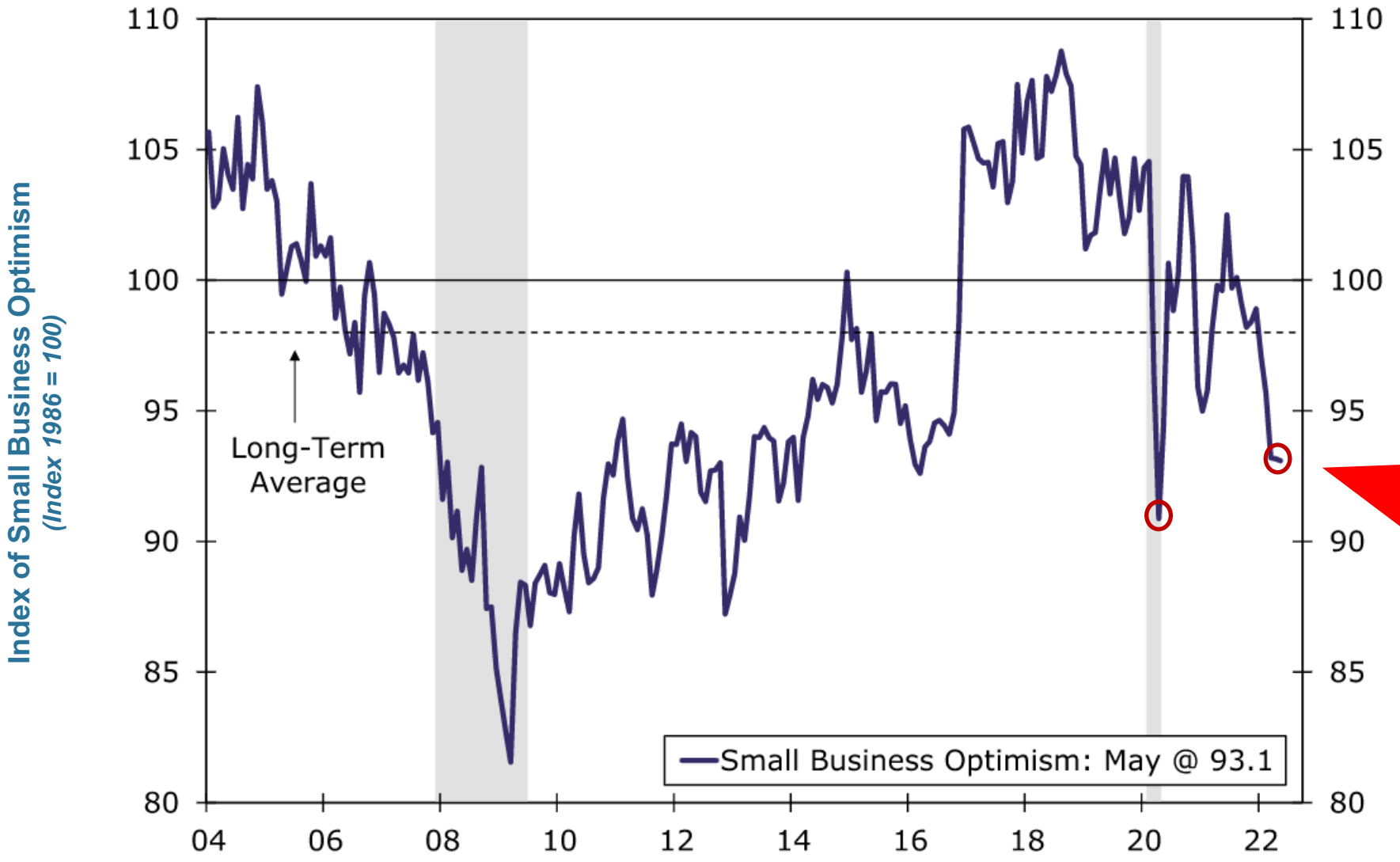
Source: University of Michigan and Wells Fargo Economics.

Crude Oil Prices: Price per Barrel,
Jan. 1970 – July 2022 (Inflation Adjusted)



Sources: Macrotrends.net accessed 7/19/22 at: https://www.macrotrends.net/1369/crude-oil-price-history-chart; Risk and Uncertainty Management Center, University of South Carolina.

Small Business Optimism: Falling Sharply Despite Strong Demand

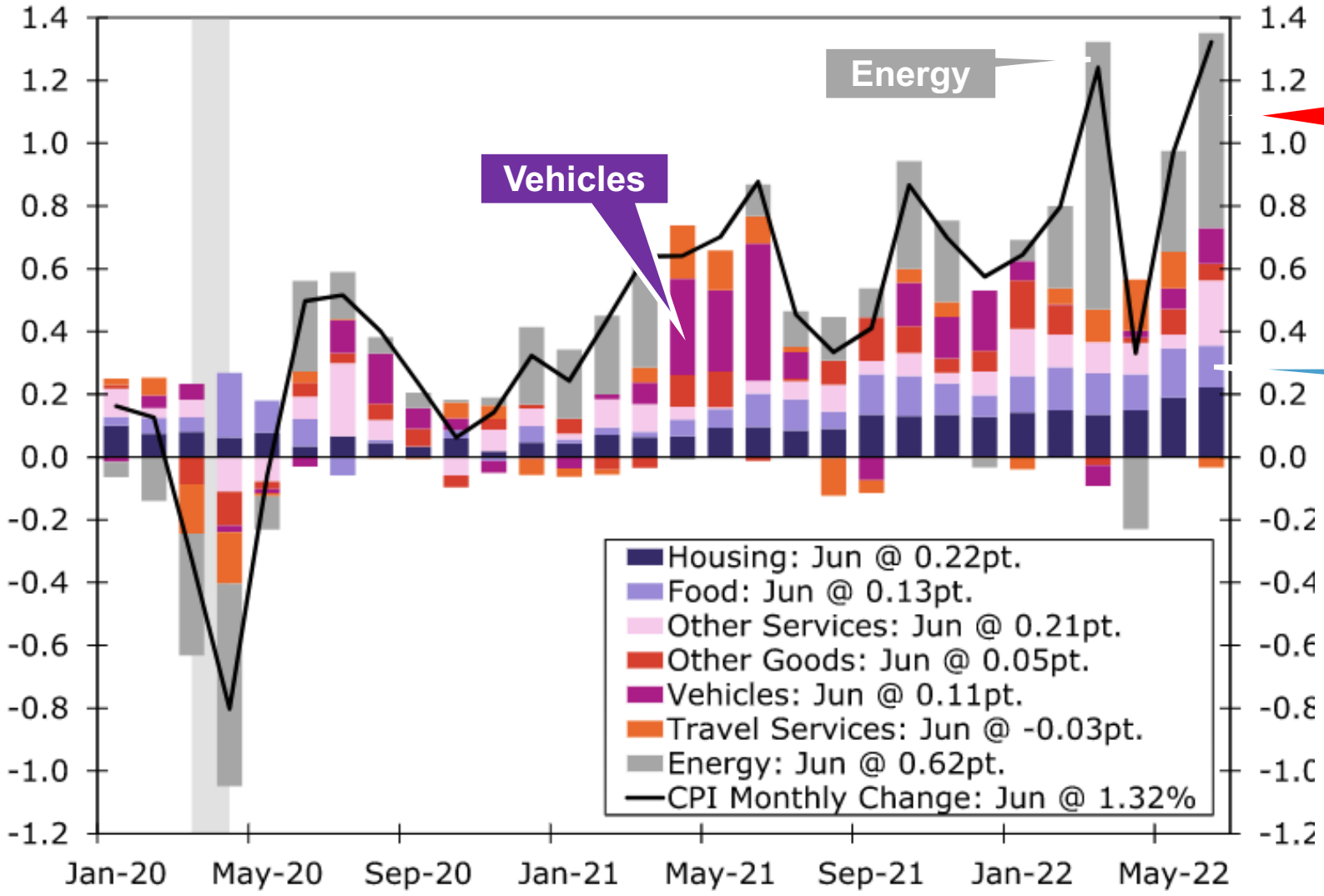


Small businesses are nearly as pessimistic as they were during the depths of pandemic, despite strong sales…inflation and labor issues are leading concerns

Source: NFIB and Wells Fargo Economics.

CPI Monthly Change, Jan. 2020 – June 2022

(Percentage Point Contribution by Category, Seasonally Adjusted)

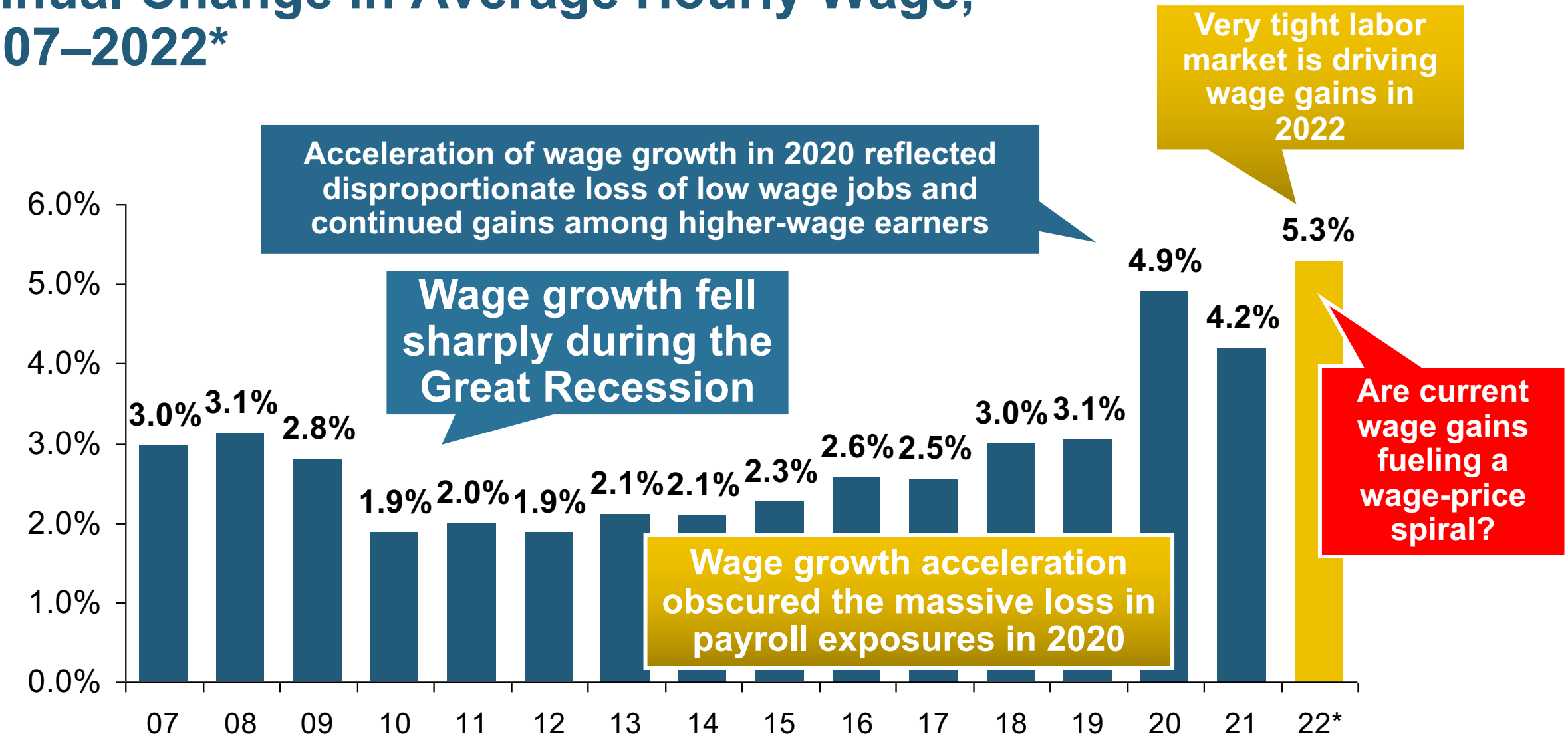


Energy was, by far, the greatest driver behind the 9.1% increase in the June CPI

Food

Source: U.S. Department of Labor and Wells Fargo Economics.

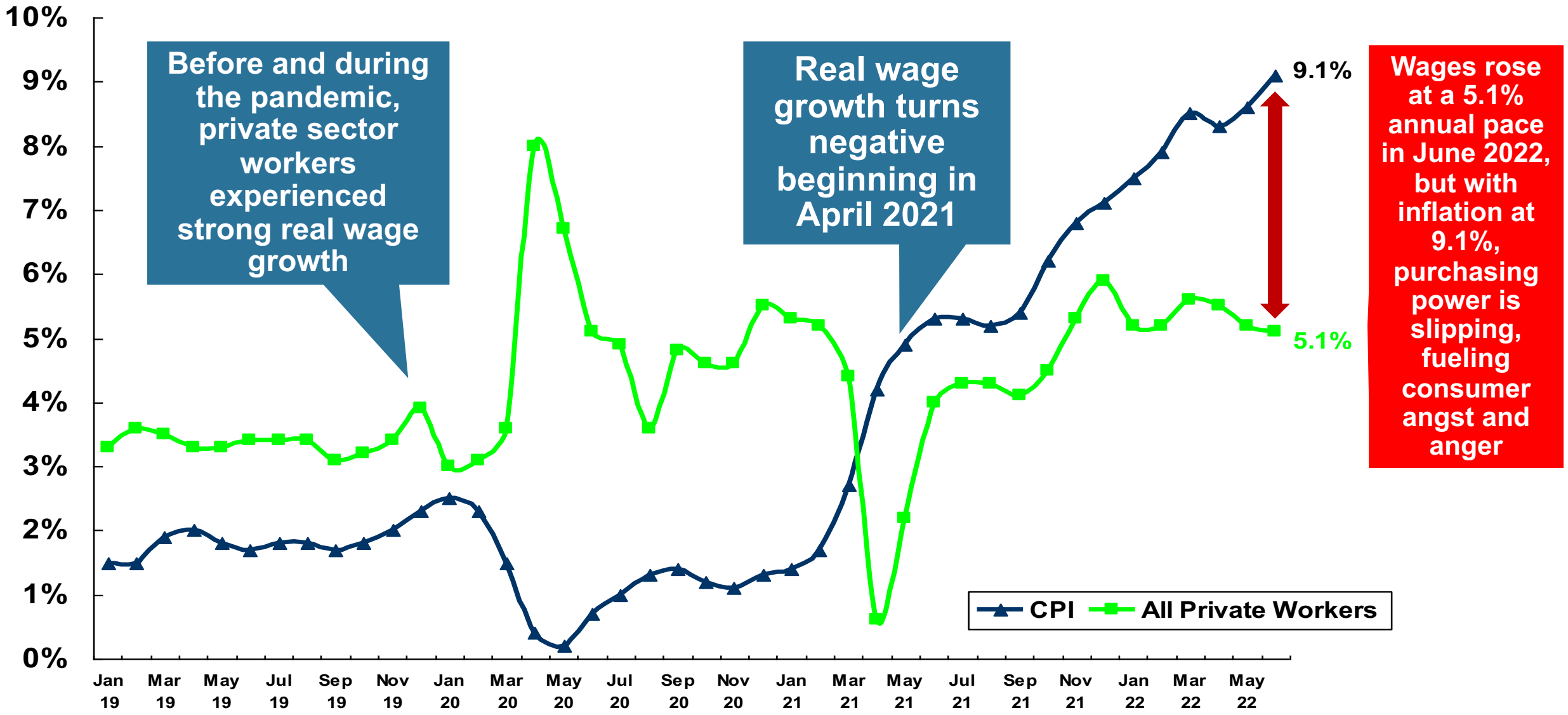
Annual Change in Average Hourly Wage, 2007–2022*



*2022 figure is average of monthly year-over-year increases through June 2022.

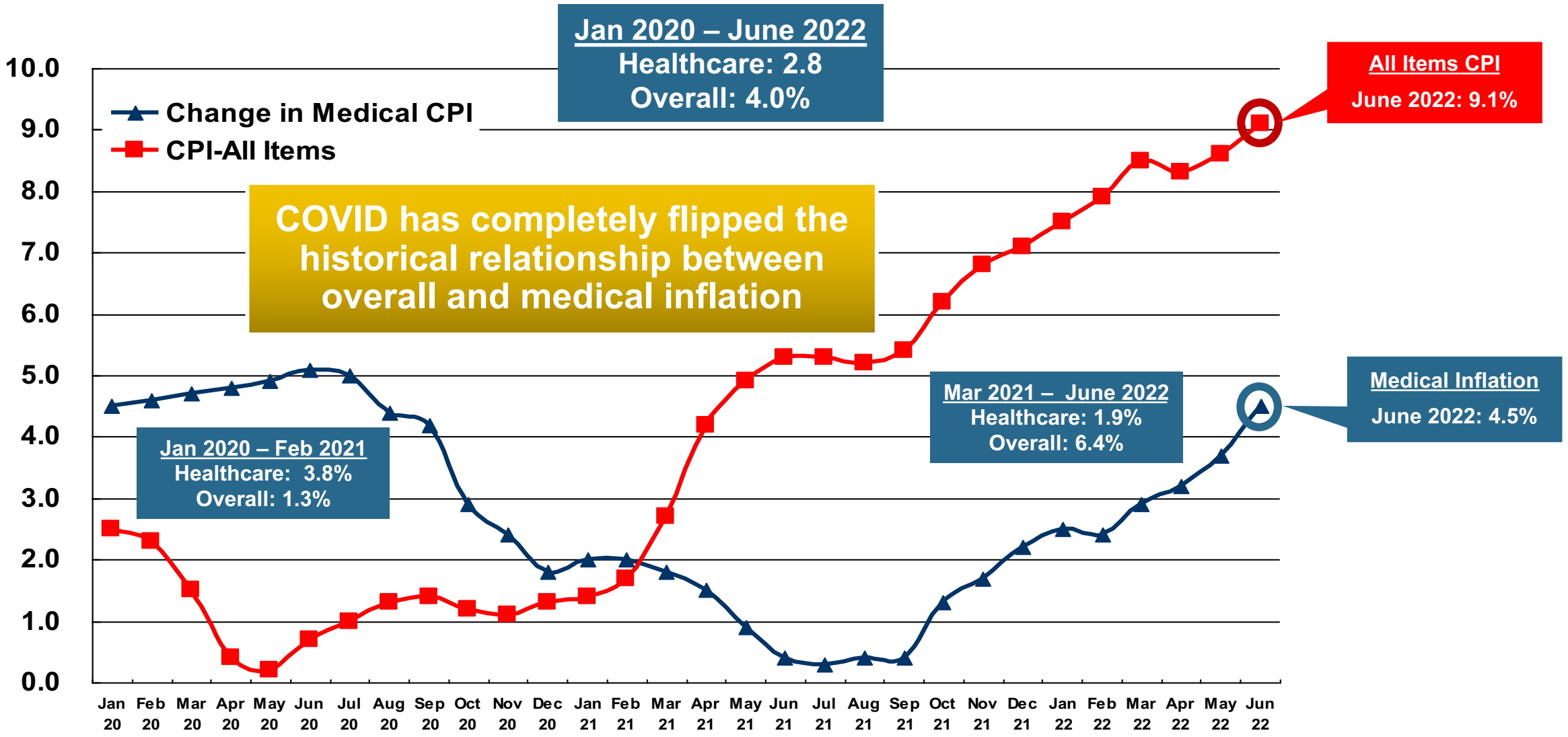
Sources: US Bureau of Labor Statistics at http://www.bls.gov/data/#employment; National Bureau of Economic Research (recession dates); Risk and Uncertainty Management Center, Univ. of South Carolina.

Inflation (CPI) vs. Hourly Earnings Growth: Jan. 2019 – June 2022*



Sources: U.S Bureau of Labor Statistics; Risk and Uncertainty Management Center, University of South Carolina.

Medical Cost Inflation vs. Overall CPI During COVID, Jan. 2020 – June 2022 *(Percent Change from Year Ago)*

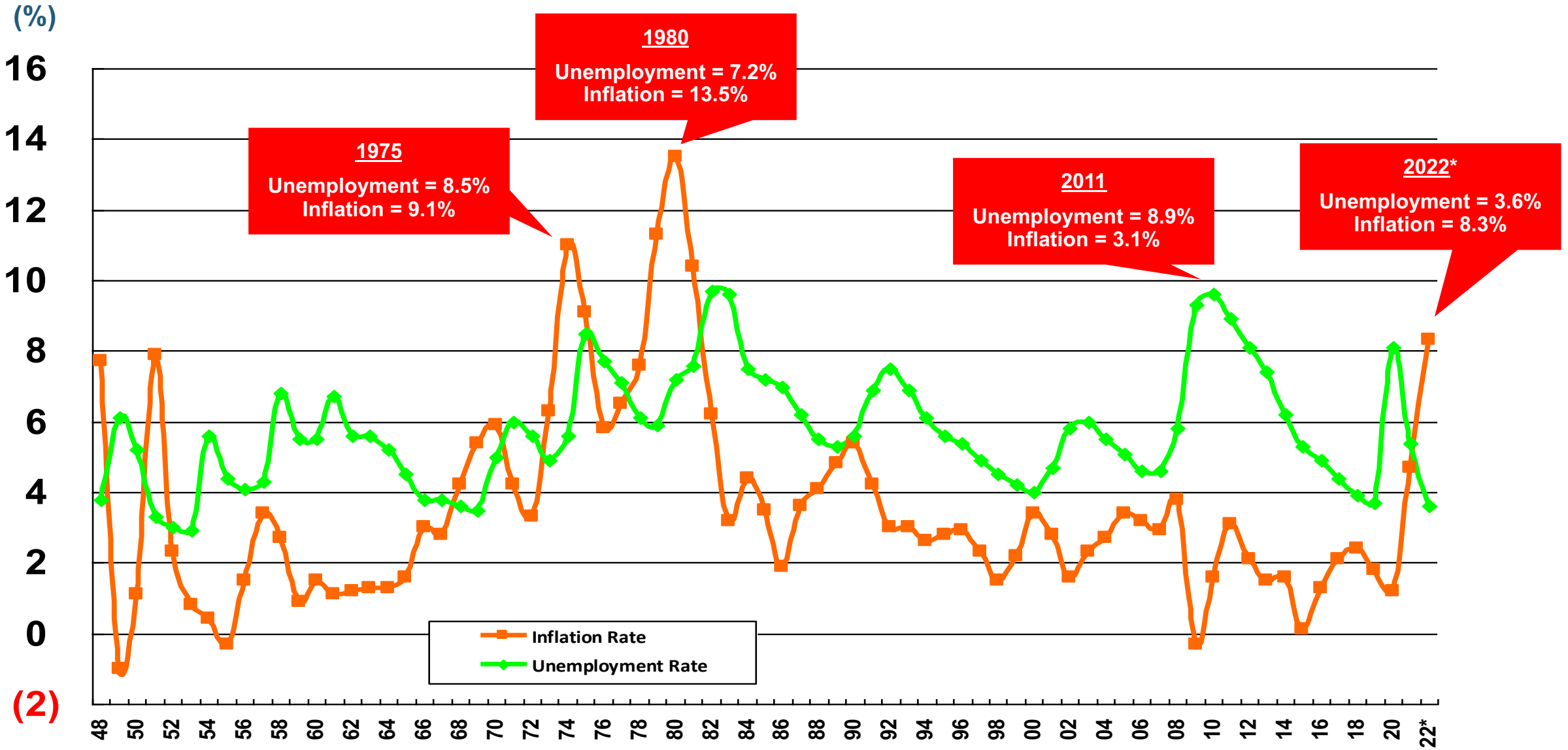


Sources: US Bureau of Labor Statistics; Risk and Uncertainty Management Center, University of South Carolina.

Are Things As Bad as Many Believe Them to Be?

A Quick Review of Economic History Is Helpful

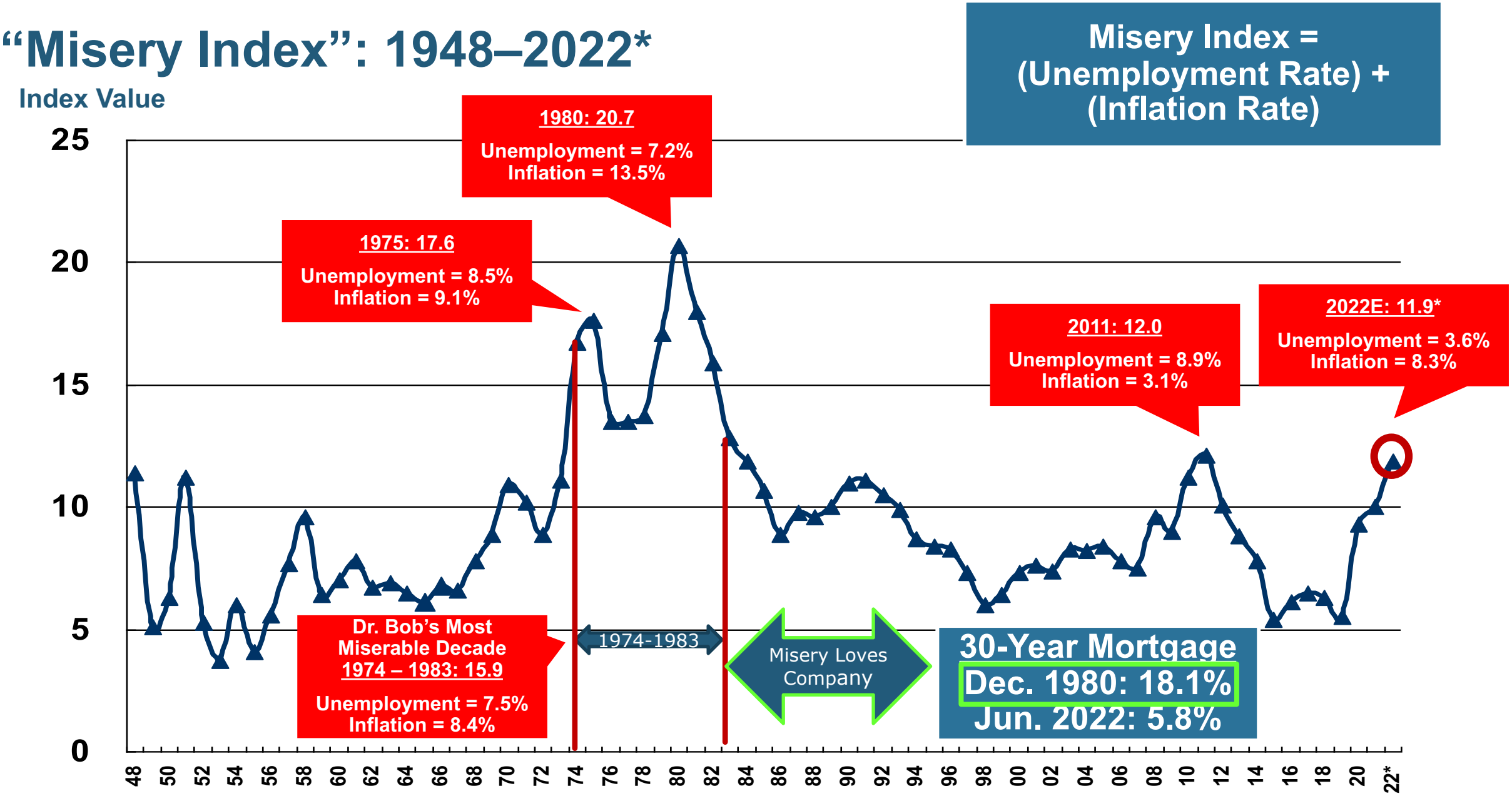
Inflation and Unemployment Rate, 1948–2022F*



,

*2022 forecast based on Wells Fargo Securities forecasts (7/22).
Source: U.S. Bureau of Labor Statistics; Center for Risk and Uncertainty Management, University of South Carolina.

“Misery Index”: 1948–2022*



*Estimated based on Wells Fargo Securities forecasts as 7/22.
Source: U.S. Bureau of Labor Statistics; Center for Risk and Uncertainty Management, University of South Carolina.

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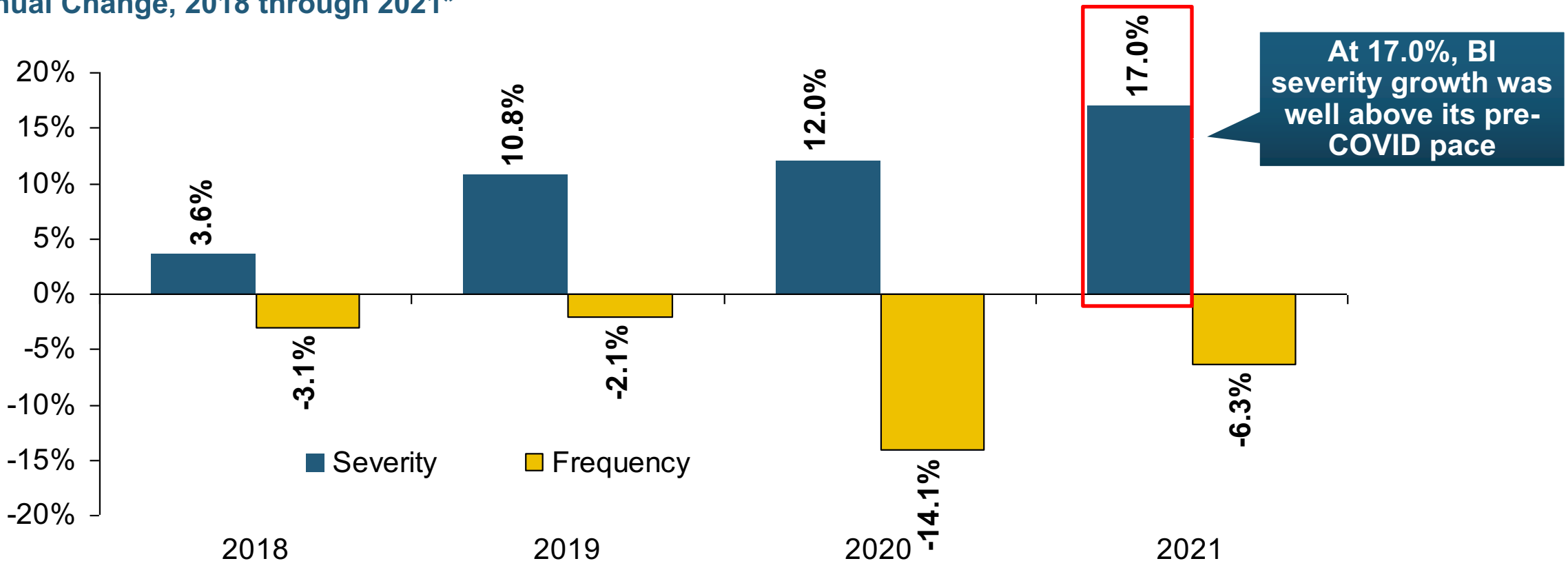
Private Passenger Auto Frequency & Severity Trends in Texas

Data Through 2021 Show Large-Scale COVID Impacts on Claim Frequency and Severity

Texas Personal Auto: BI Severity Up, Frequency Decline Moderating As State Began to Emerge from the Pandemic*

Annual Change, 2018 through 2021*



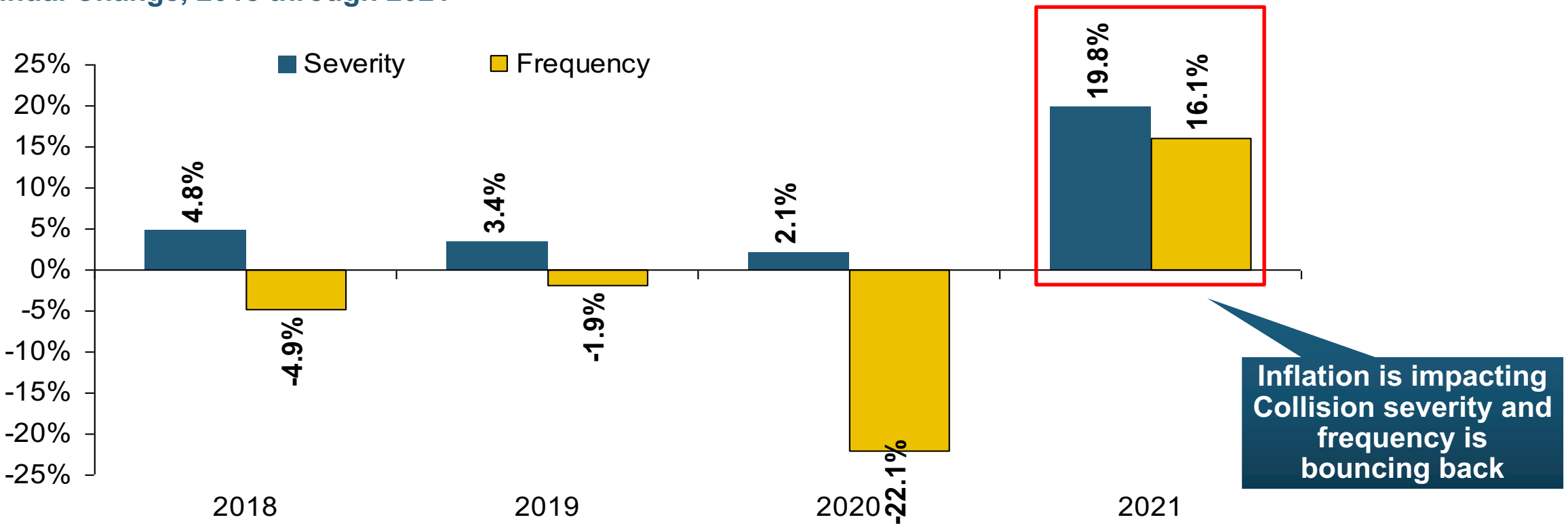
BI Severity Is Rising. Frequency will Likely Return to Pre-COVID Levels

*2021 data are for the 4 quarters ending Dec. 31, 2021.

Source: ISO/PCI *Fast Track* data; Risk and Uncertainty Management Center, University of South Carolina.

Texas Personal Auto: COVID Led to a Temporary Reduction in Collision Frequency and a Sharp Increase in Severity*

Annual Change, 2018 through 2021*



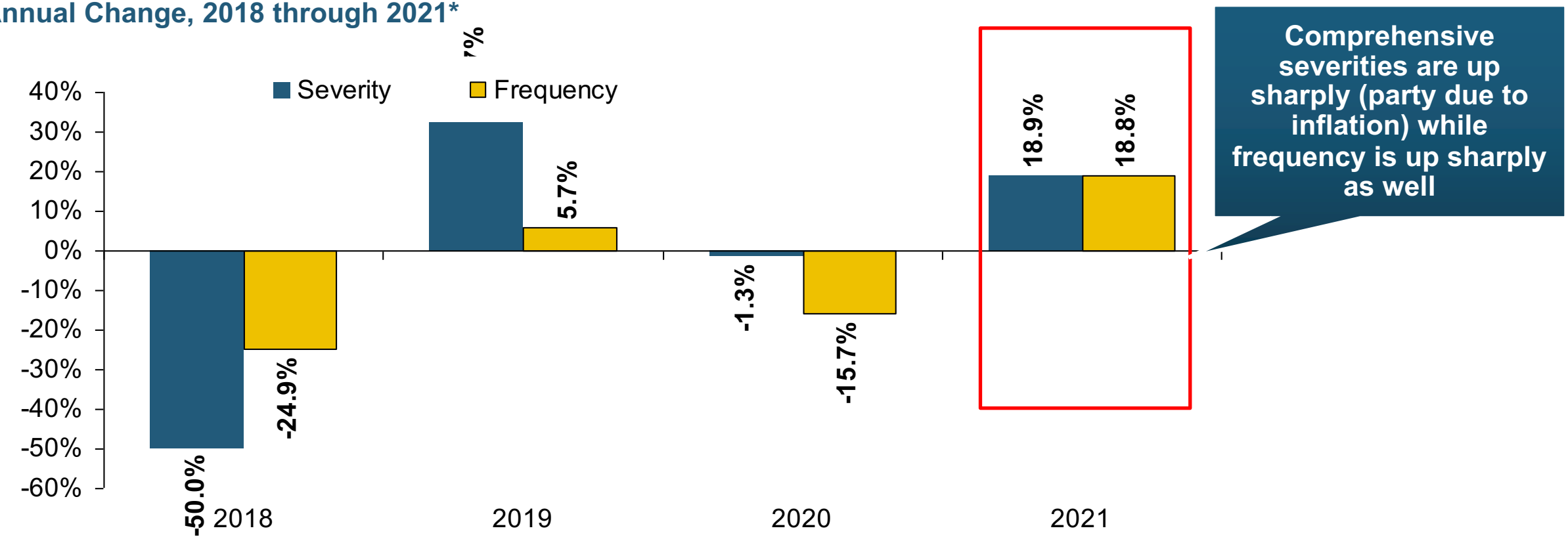
If 2021's Frequency and Severity Trends Continue throughout 2022, TX Auto Insurance Market Will Experience a Sharp Deterioration in Performance

*2021 data are for the 4 quarters ending Dec. 31, 2021.

Source: ISO/PCI *Fast Track* data; Risk and Uncertainty Management Center, University of South Carolina.

Texas Personal Auto: COVID Has Increased Comprehensive Claim Volatility*

Annual Change, 2018 through 2021*

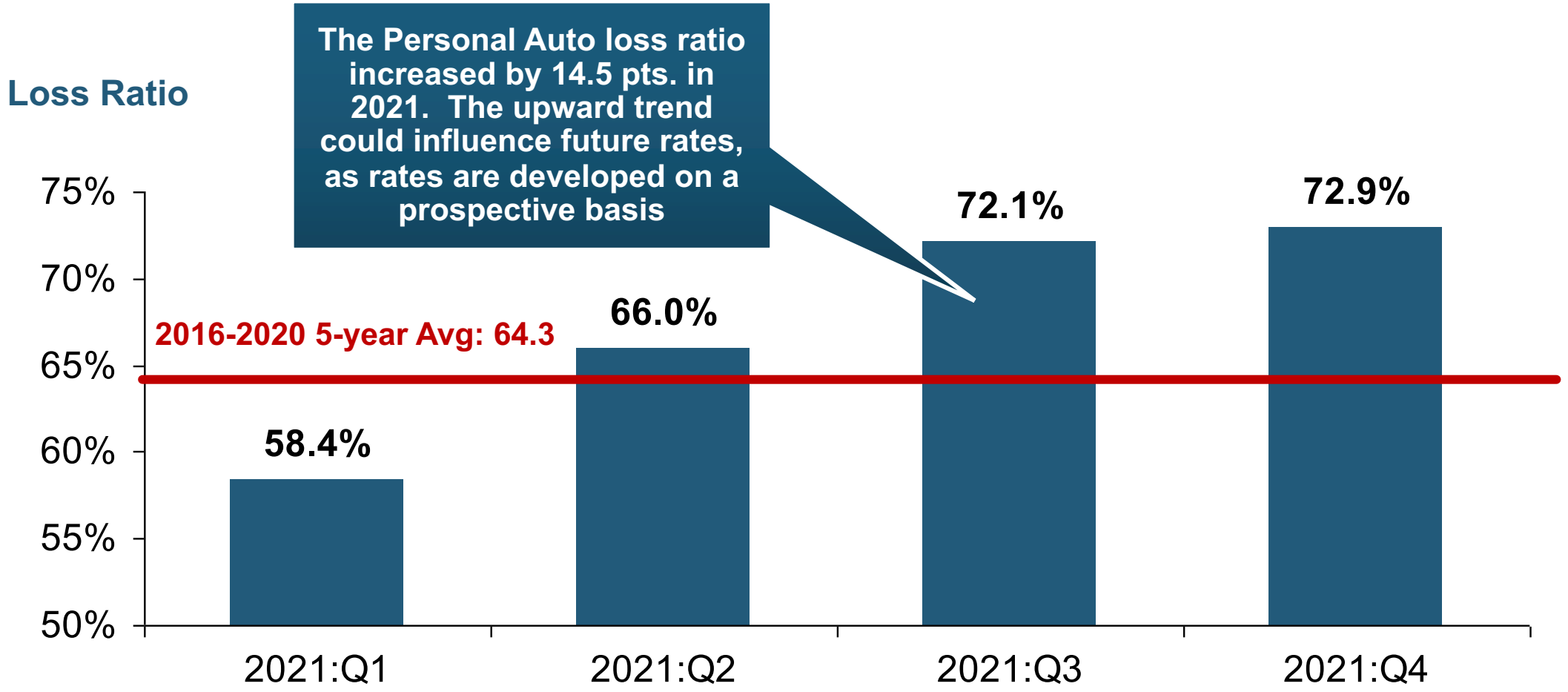


Collision Claim Frequency Is Volatile and Usually Most Impacted by Weather Impacts, though COVID Has Increased Overall Volatility

*2021 data are for the 4 quarters ending Dec. 31, 2021.

Source: ISO/PCI *Fast Track* data; Risk and Uncertainty Management Center, University of South Carolina.

Personal Auto Loss Ratios: 2021 Quarterly

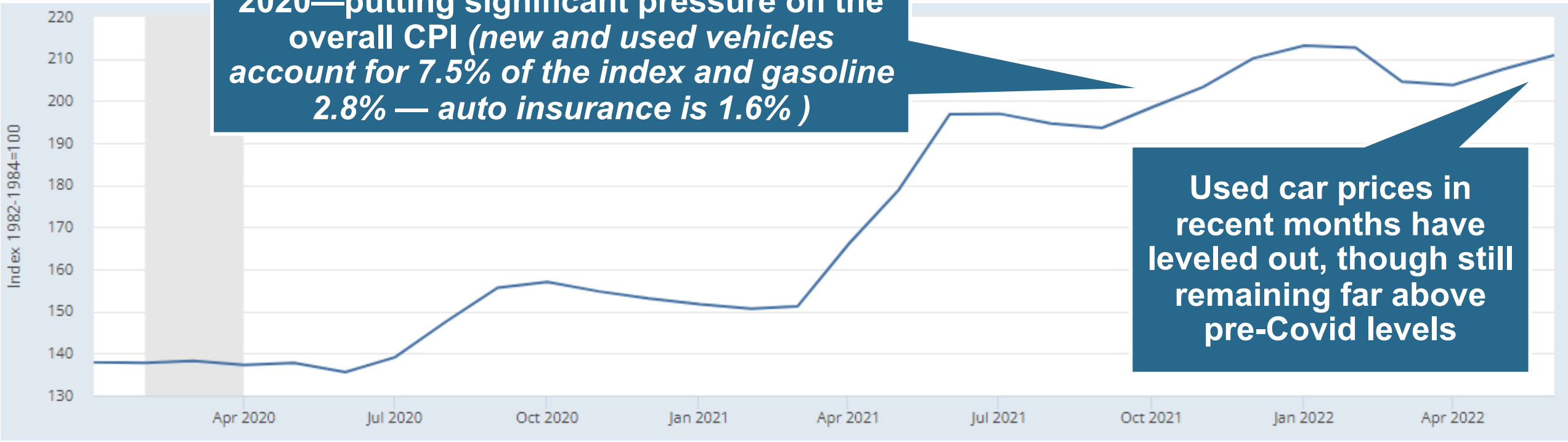


Collision Loss Ratios Are Rising Rapidly and Are Far Above the 5-Year Average

Source: APCIA via S&P Global Market Intelligence; University of South Carolina, Risk & Uncertainty Management Center.

Price Index Changes for Used Cars & Trucks, Jan. 2020 – Jun. 2022

New and Used Vehicle prices have surged during the pandemic, +52.9% since Jan. 2020—putting significant pressure on the overall CPI *(new and used vehicles account for 7.5% of the index and gasoline 2.8% — auto insurance is 1.6%)*

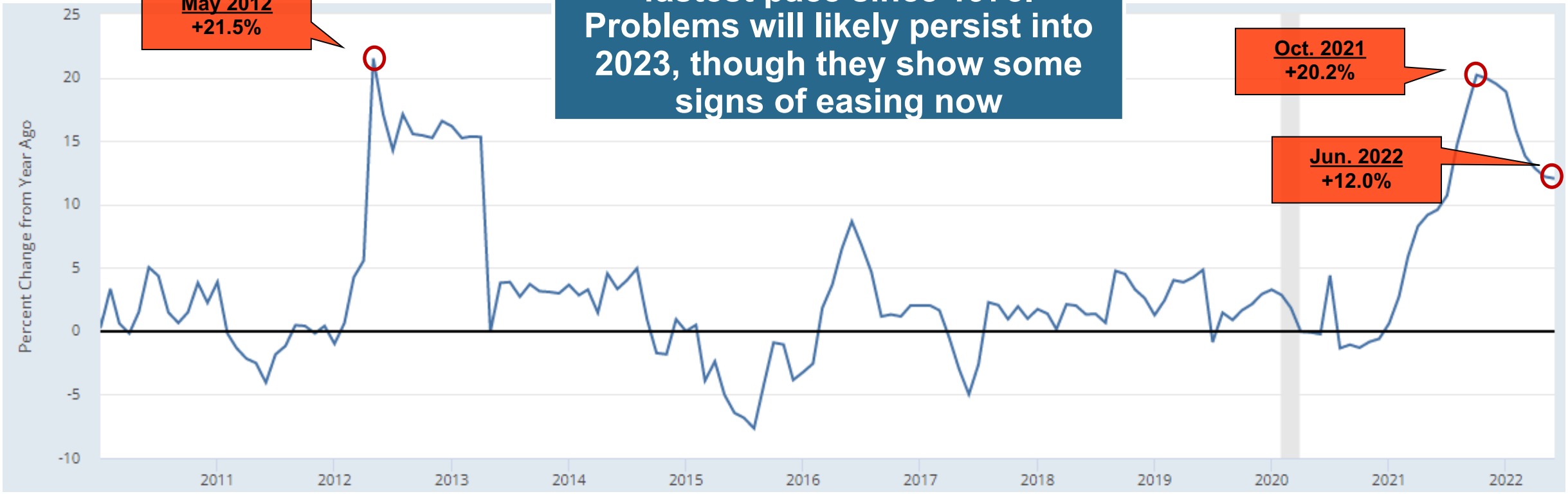


Used car prices in recent months have leveled out, though still remaining far above pre-Covid levels

Sources: US Bureau of Labor Statistics; Risk and Uncertainty Management Center, University of South Carolina.

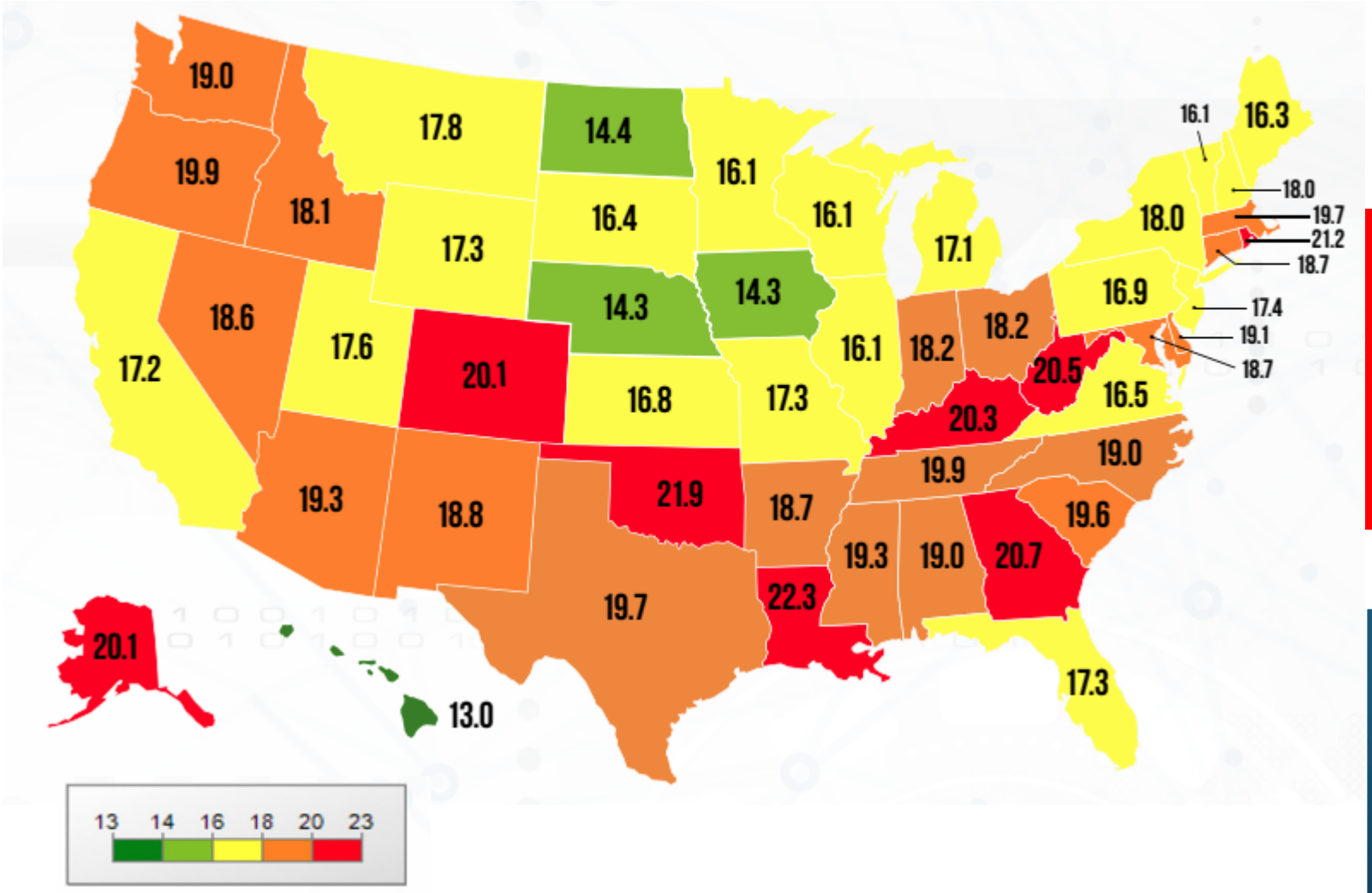
Change in Price for Replacement Passenger Car Rentals, Jan. 2010 – Jun. 2022 (% Change from Year Ago)

High demand and supply chain problems have caused new vehicle prices to surge at their fastest pace since 1975. Problems will likely persist into 2023, though they show some signs of easing now



Sources: Federal Reserve Bank of St. Louis at: https://fred.stlouisfed.org/series/PCU5321115321113#0 from US Bureau of Labor Statistics; Risk and Uncertainty Management Center, University of South Carolina.

Length of Collision Replacement Rentals by State (Days), 2022:Q1



Avg. Length of Rental

2022:Q1: 18.2 days

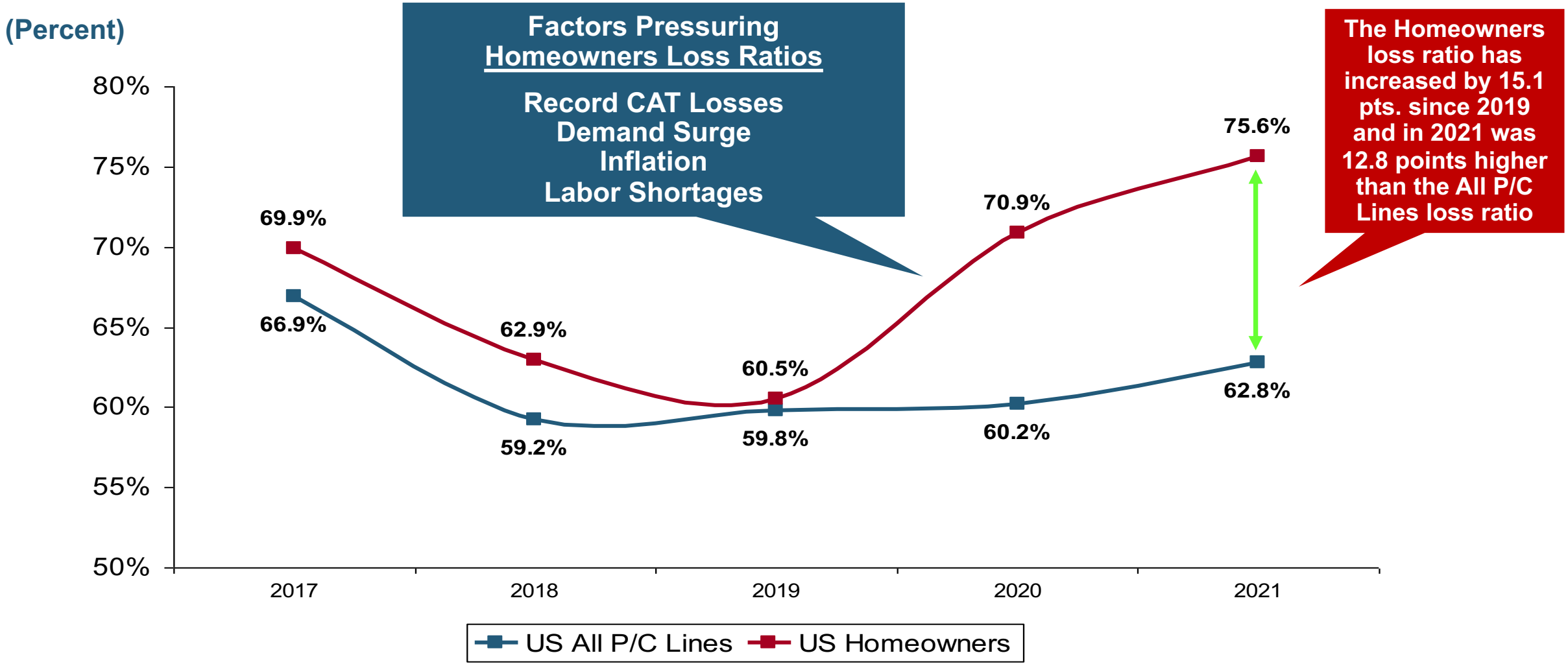
2021:Q1: 13.3 days

CHANGE: +4.9 Days

The increase in length of rental was referred to as "striking" by Enterprise and is a key driver of auto claim severity. The increase in the cost of rentals materially exacerbates the problem.

Source: Enterprise Rental-A-Car U.S. Length of Rental Report accessed via *Repair Driver News* at: https://www.repairerdrivennews.com/wp-content/uploads/2022/04/Q1-2022_US-Length-of-Rental-Report.pdf.

Direct Loss Ratios: Homeowners vs. All P/C Lines, 2017–2021

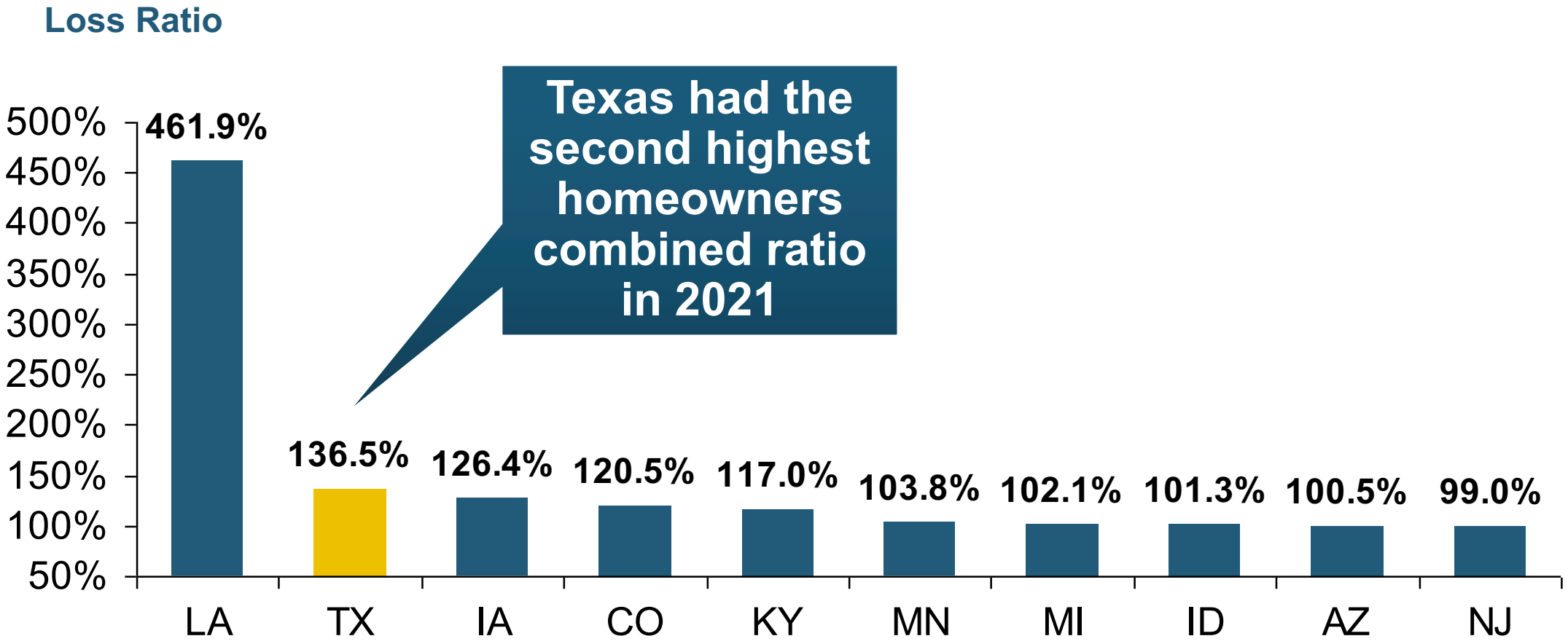


Sources: APCIA: *Insurers Struggling to Keep Pace with the Highest Inflation in 40 Years* (Feb. 2022) sourced from: *Insurance Journal*, based on data from A.M. Best, January 25, 2022 Report "US Property/Casualty Top Line Premiums Up, Loss Ratio Deteriorates Through 3Q 2021."

Producer Price Index: Lumber and Wood Products, Jan. 2020 – Jun. 2022

Sources: US Bureau of Labor Statistics; Risk and Uncertainty Management Center, University of South Carolina.

Homeowners Direct Combined Ratios: Top 10 States in for 2021



Source: A.M. Best; University of South Carolina, Risk & Uncertainty Management Center.

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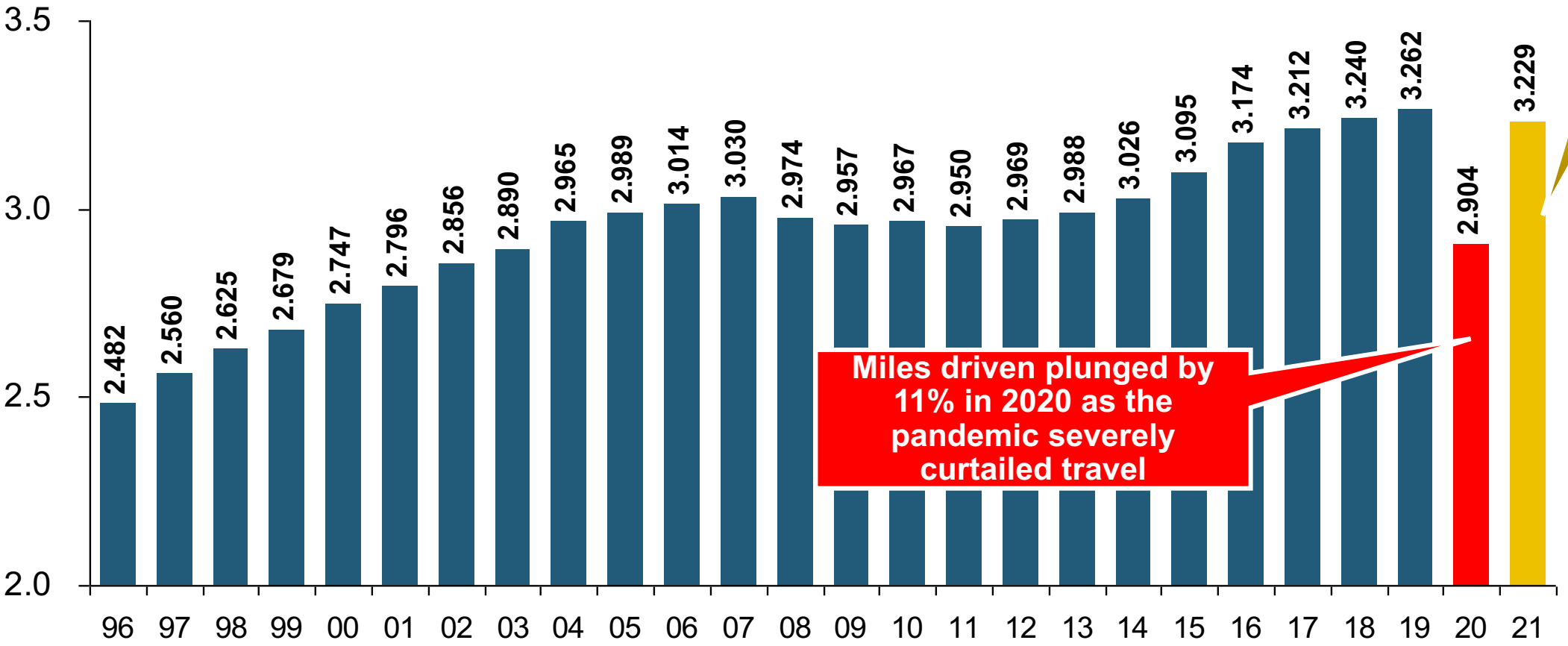
Back Behind the Wheel

Americans Are Back Behind the Wheel

Miles Driven Will Likely Set a New Record in 2022

Travel in Trillions of Vehicle Miles in U.S.: 1996–2021

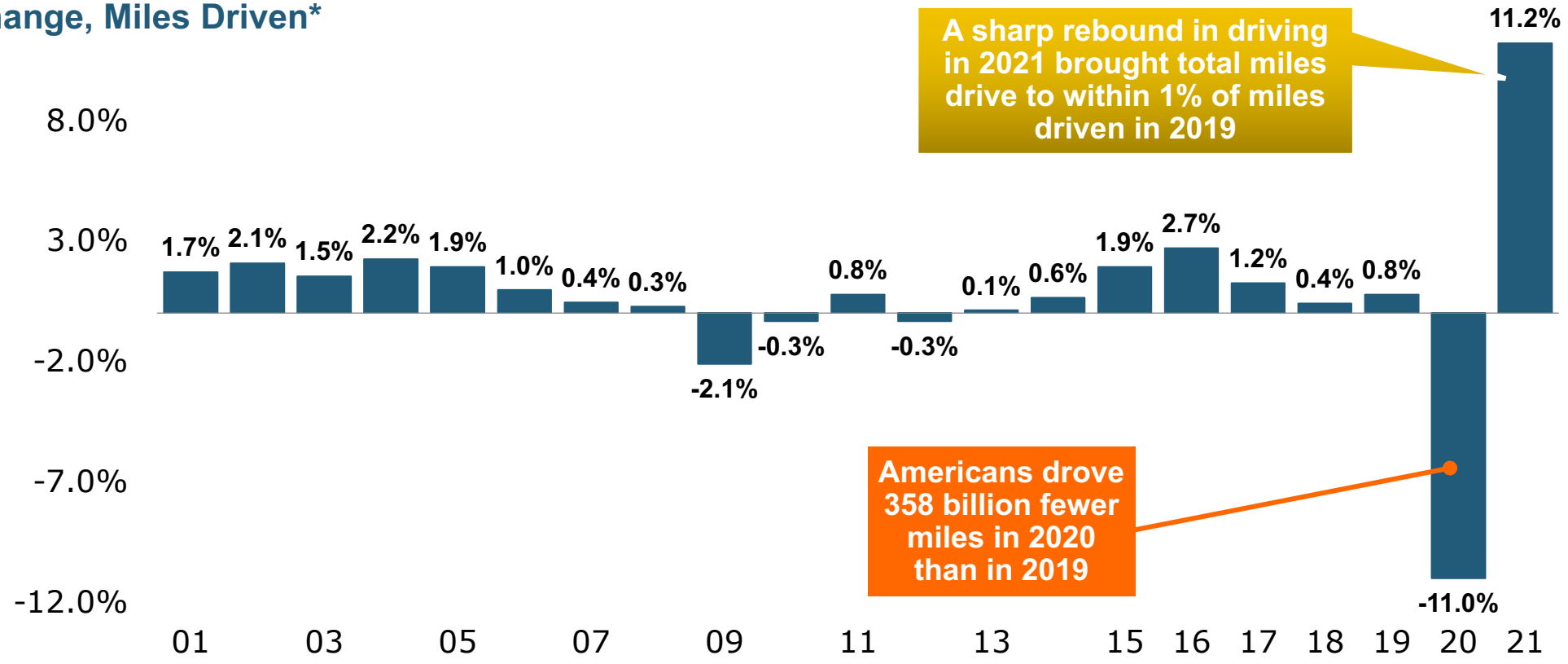


Miles driven in 2022 will likely set a new record, but could still be held back by soaring gas prices that could induce vehicle owners to scale back on their driving

Sources: Sources: Federal Highway Administration; USC RUM Center.

Vehicle Miles Driven Have Rebounded Sharply in 2021

Percent Change, Miles Driven*

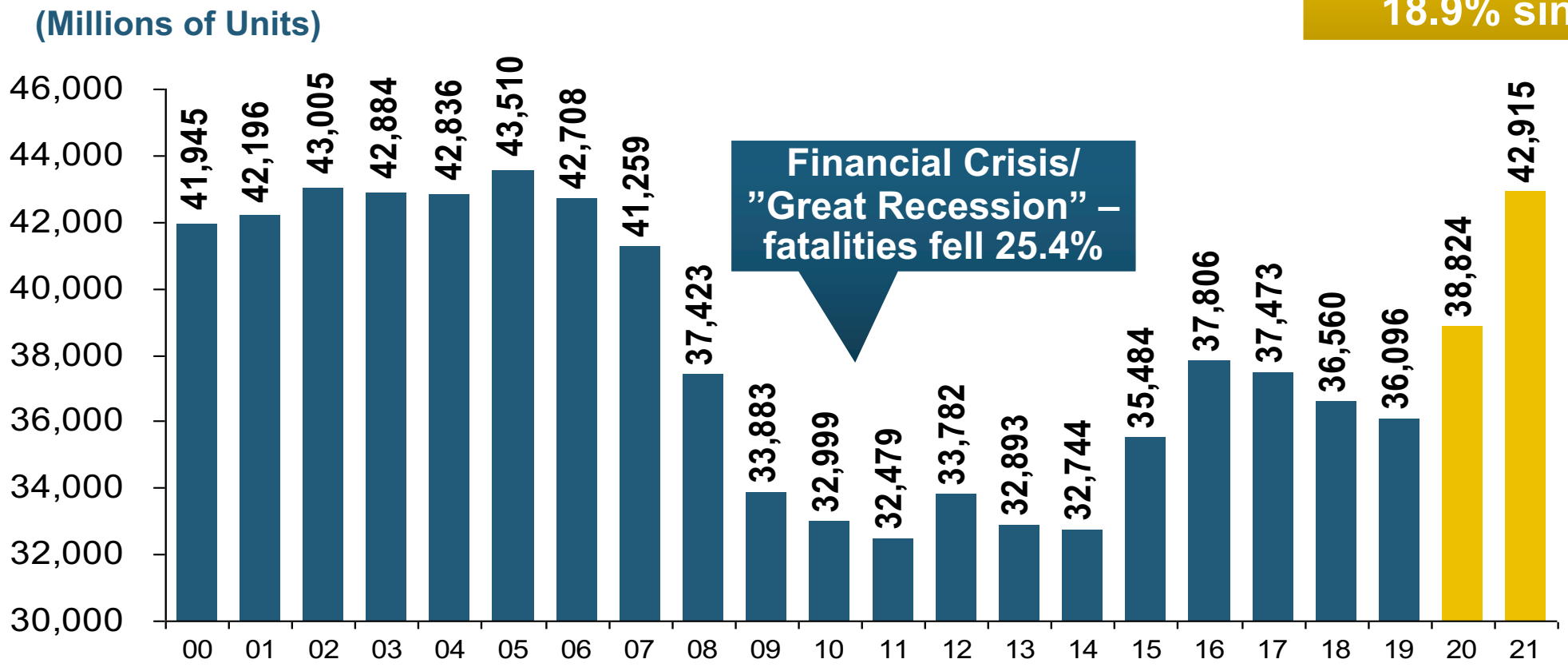


Tremendous Growth In Miles Driven. The More People Drive, the More Frequently They Get Into Accidents.

*Moving 12-month total vs. prior year through December 2021.
Sources: Federal Highway Administration.

Traffic Fatalities in the U.S., 2000-2021

During COVID, fatalities surged by 7.6% in 2020 and 10.5% in 2021 (up 18.9% since 2019)



Extraordinary Increase in Poor Driving Behaviors in 2020 and 2021 Contributed to Sharply Higher Auto Fatalities

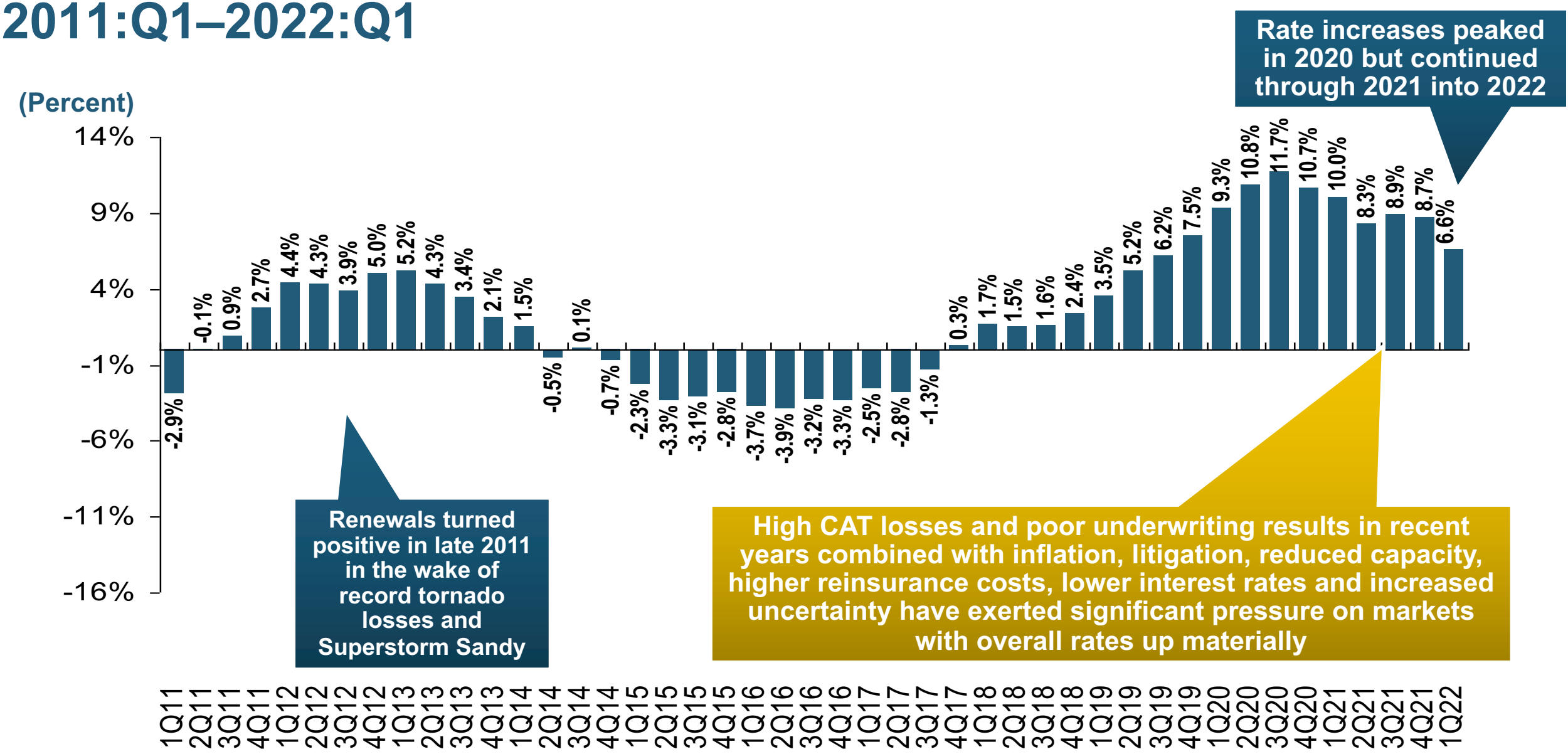
Source: Insurance Institute for Highway Safety and Highway Loss Data Institute: https://www.iihs.org/iihs/topics/t/general-statistics/fatalityfacts/overview-of-fatality-facts and NHTSA (2021): https://www.nhtsa.gov/press-releases/early-estimate-2021-traffic-fatalities#:~:text=NHTSA%20projects%20that%20an%20estimated,Fatality%20Analysis%20Reporting%20System's%20history; Risk and Uncertainty Management Center, University of South Carolina.

Commercial Lines & Pricing Cyclicality

Economic and Tort Environment Create Pricing Pressure

79

CIAB: Average Commercial Rate Change, All Lines, 2011:Q1–2022:Q1

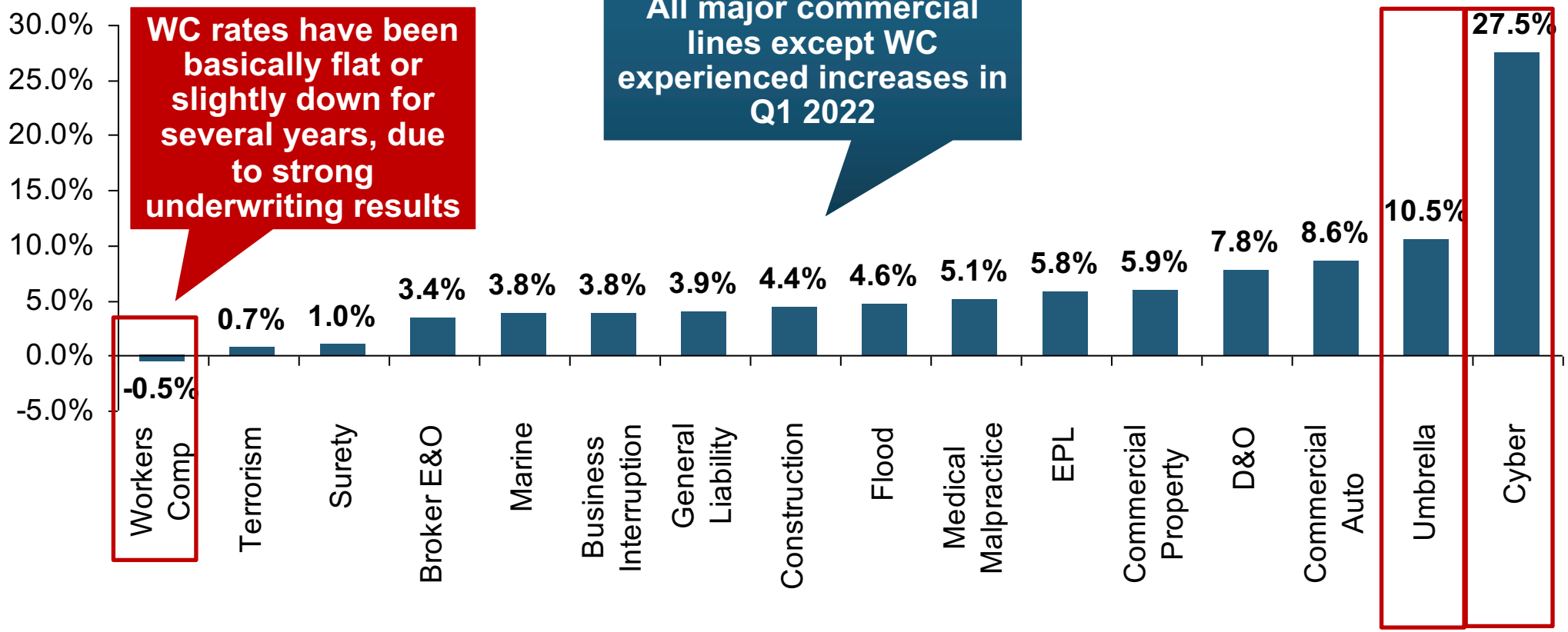


Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially.
Source: Council of Insurance Agents & Brokers; Center for Risk and Uncertainty Management, Univ. of South Carolina.

Change in Commercial Rate Renewals, by Line: 2022:Q1

Cyber is seeing record increase, in response to major breaches in 2020 and 2021, overtaking Commercial Umbrella

(Percent Change)



Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially.

Source: Council of Insurance Agents and Brokers; USC Center for Risk and Uncertainty Management.

SUMMARY

- The P/C Insurance Industry Remains Strong, Stable, Sound and Secure
- COVID Variants/Snarled Supply Chains Have Slowed the Economic Recovery, and a Shallow Recession is Increasingly Likely in 2023
  - Most P/C Exposures Restored to Pre-Pandemic Levels by mid-2022
- Asset Price Volatility Will Persist as Inflation, Geopolitical Concerns Mount
- Higher Interest Rates Will Eventually Provide a Modest Tailwind for Investment Income
- Inflation Surge Will Persist into 2023, But Will Subside
- Many Loss Cost Challenges—Inflation, Supply Chain and Social Inflation Issues
- Immediate P/C Concerns: CATs, Inflation→Rate Adequacy, ITV

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Thank you for your time and your attention!

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Download at www.uscriskcenter.com