Overview and Outlook for the P/C Insurance Industry: *Focus on Commercial Lines*

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UNIVERSITY OF
SOUTH CAROLINA
Darla Moore School of Business

P/C Insurance Overview & Outlook: Outline

- P/C Financial Overview & Outlook in the Post-COVID, High-Inflation Era
  - Premium Growth
  - CAT Loss Update
  - Underwriting Performance
  - Investment Market Issues
- Economic Overview & Outlook—Impacts for P/C Insurers
  - Growth, Employment, Inflation and Recession
- Inflation: Where it Is Headed & What It Means for P/C Insurers
  - Impacts on claim severities and loss ratios
  - Long-term inflation considerations
- Bank and Budget Debacles: Are there Any Impacts for P/C Insurers?
- Tort System Abuse/Social Inflation
- A Look Ahead: Trends in the P/C Competitive Environment
- Summary and Q&A

P/C Insurance Industry Financial Overview & Outlook:

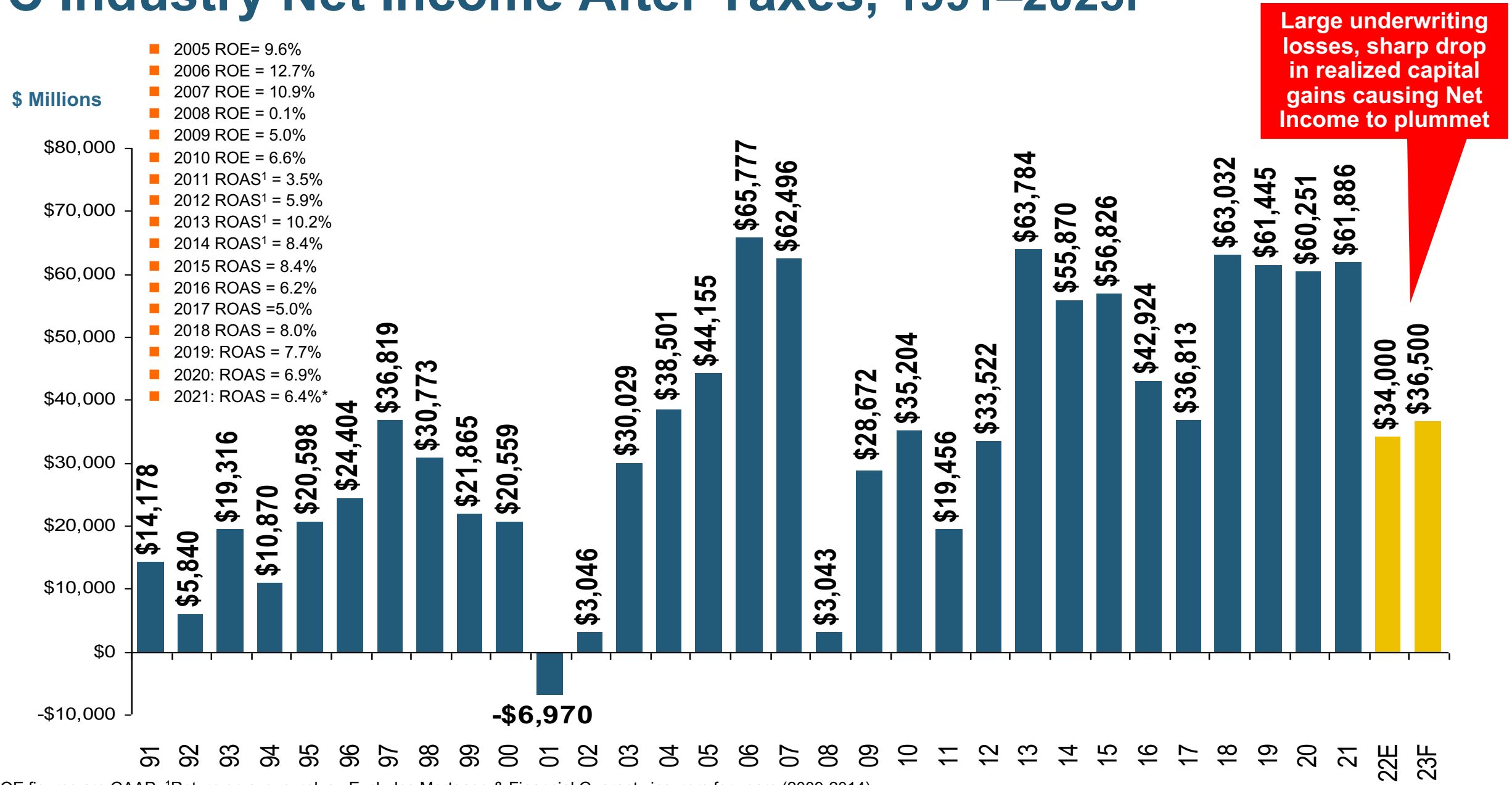
Challenges Amid Rising Inflation and Higher Interest Rates

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

Industry Remains Strong

3

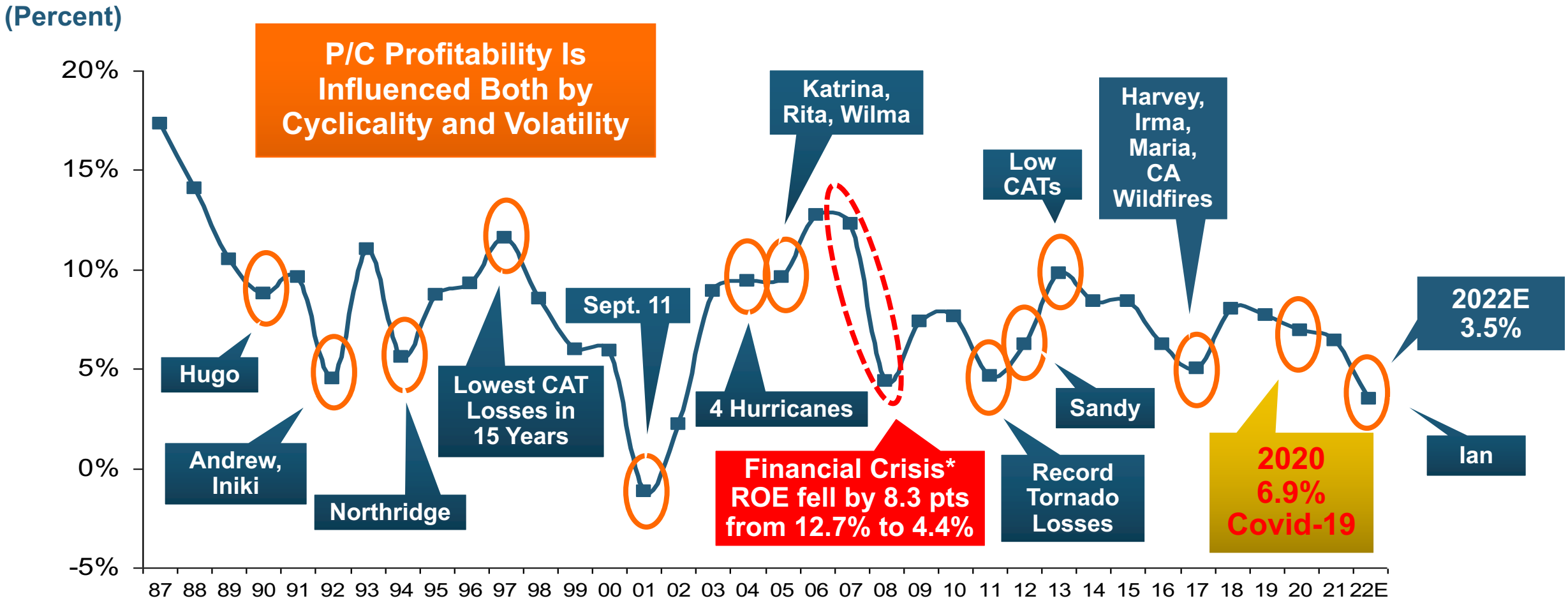
P/C Industry Net Income After Taxes, 1991–2023F



*ROE figures are GAAP; [1]Return on avg. surplus. Excludes Mortgage & Financial Guaranty insurers for years (2009-2014).

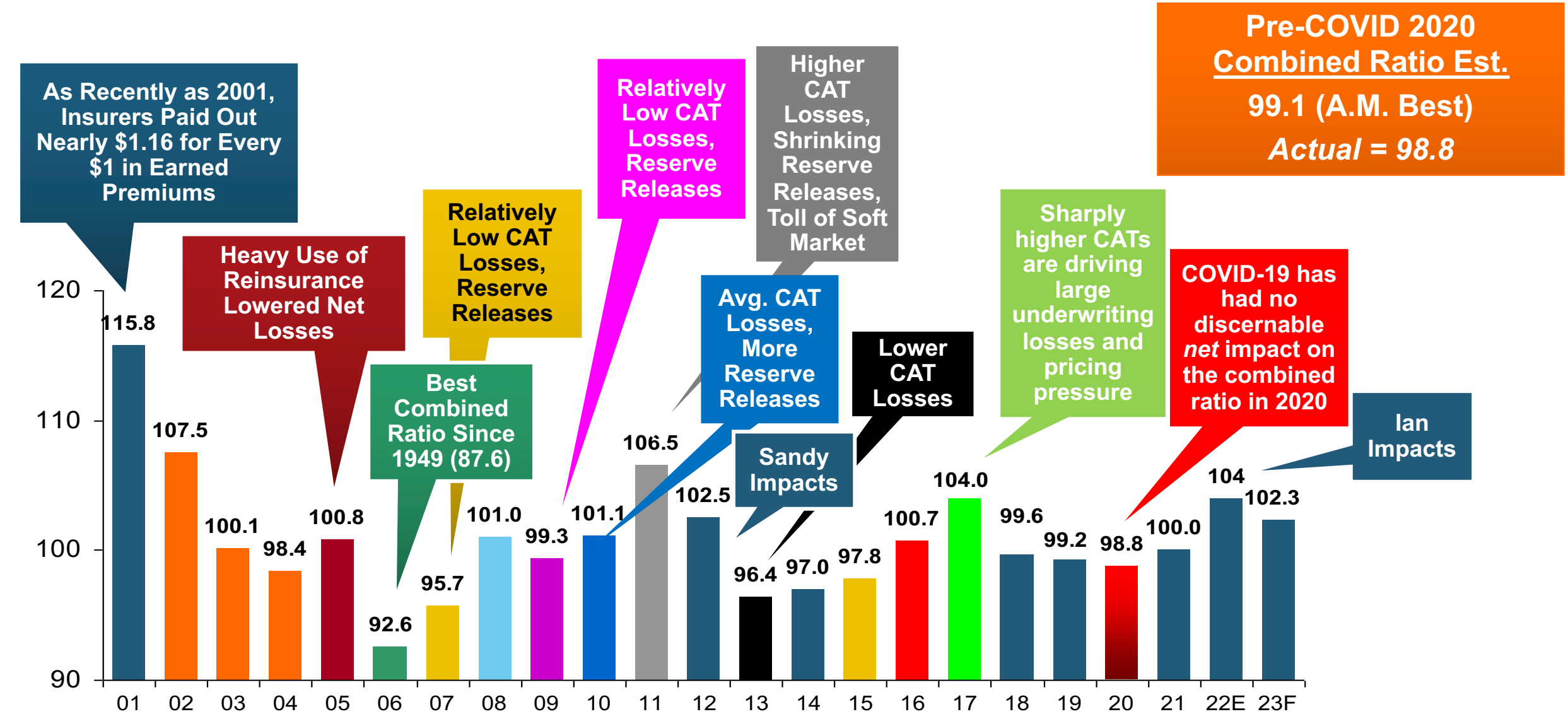
Sources: A.M. Best, ISO, APCIA.

ROE: Property/Casualty Insurance by Major Event, 1987–2022E*



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

P/C Insurance Industry Combined Ratio, 2001–2023F*



*Excludes Mortgage & Financial Guaranty insurers 2008–2014.
Sources: A.M. Best, ISO (2014-2024F).

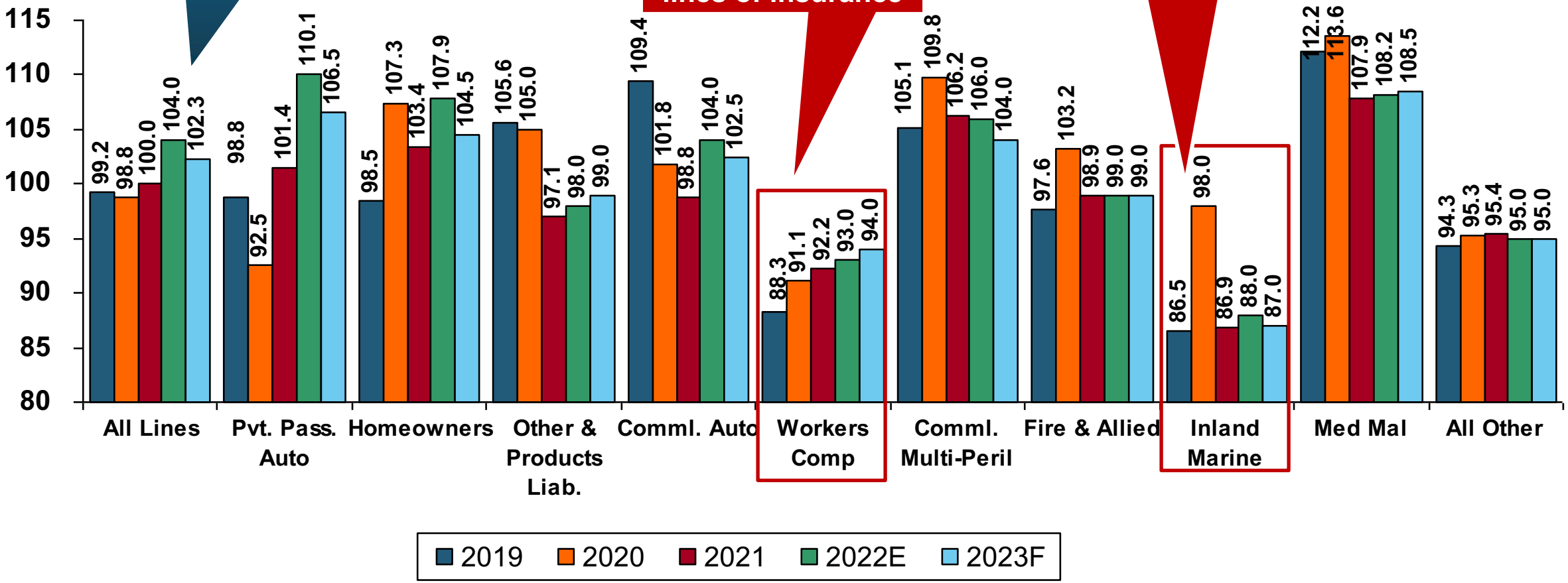
Combined Ratios by Line: 2019 – 2023F

High CAT losses and inflation are pushing up combined ratios

WC is among the best performing lines of insurance

Inland Marine is also among the best performing lines of insurance

Inflation will continue to pressure combined ratios in 2023

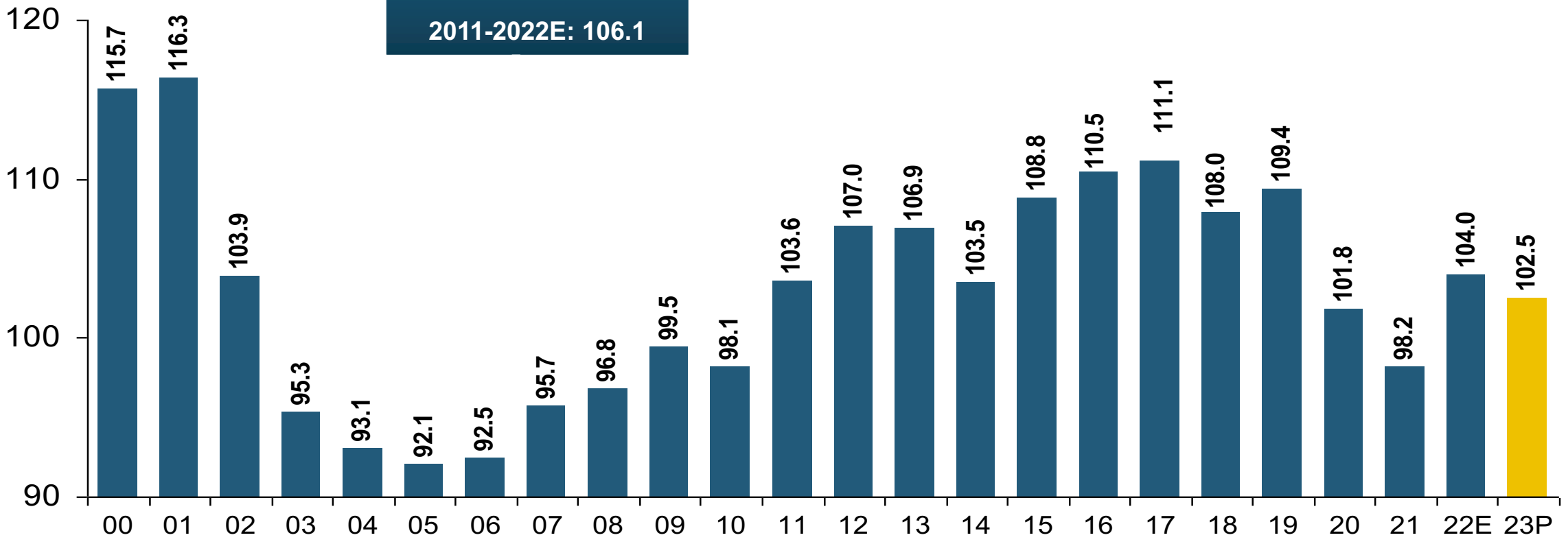


Source: A.M. Best *Review & Preview* (2023 forecasts as of Mar. 2023); Univ. of South Carolina, Risk and Uncertainty Management Center.

Commercial Auto Combined Ratio, 2000–2022

Commercial Auto has been one of the most challenging lines for P/C insured since 2011

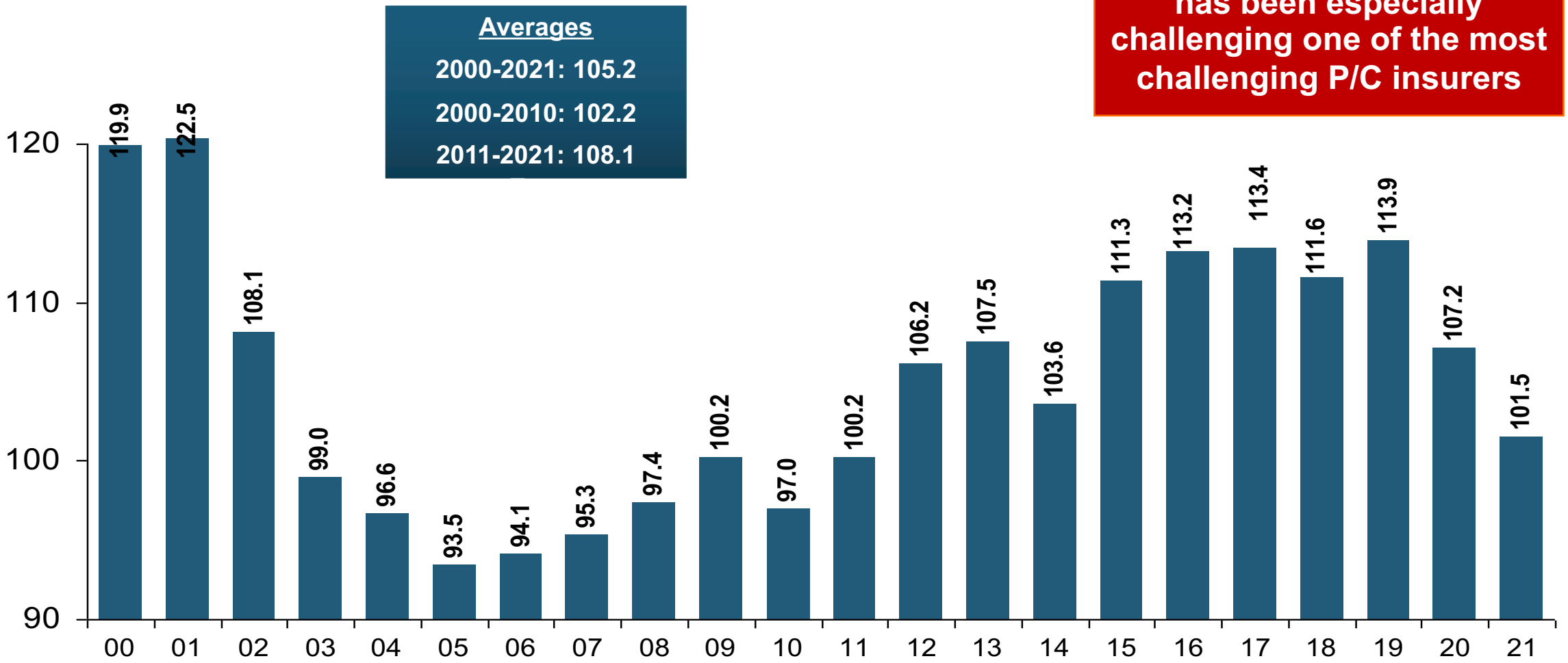
Averages
2000-2022E: 103.1
2000-2010: 99.8
2011-2022E: 106.1



Sources: S&P Global Market Intelligence (2000-2021). A.M. Best (2022E-2023P).

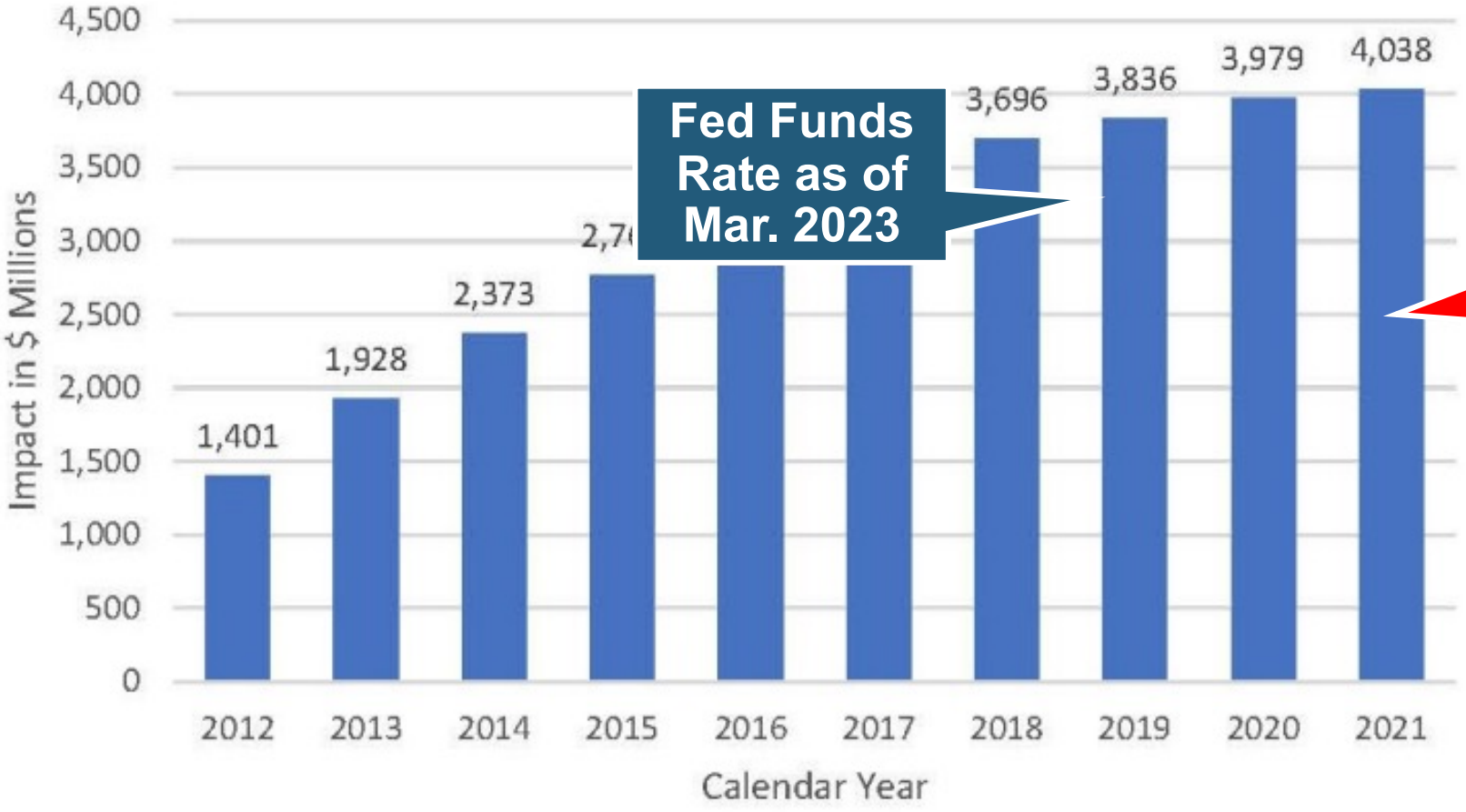
Commercial Auto *Liability* Combined Ratio, 2000–2021

Commercial Auto Liability has been especially challenging one of the most challenging P/C insurers



Sources: S&P Global Market Intelligence (2000-2021).

Estimate of Social Inflation, Commercial Auto Liability, 2012-2021



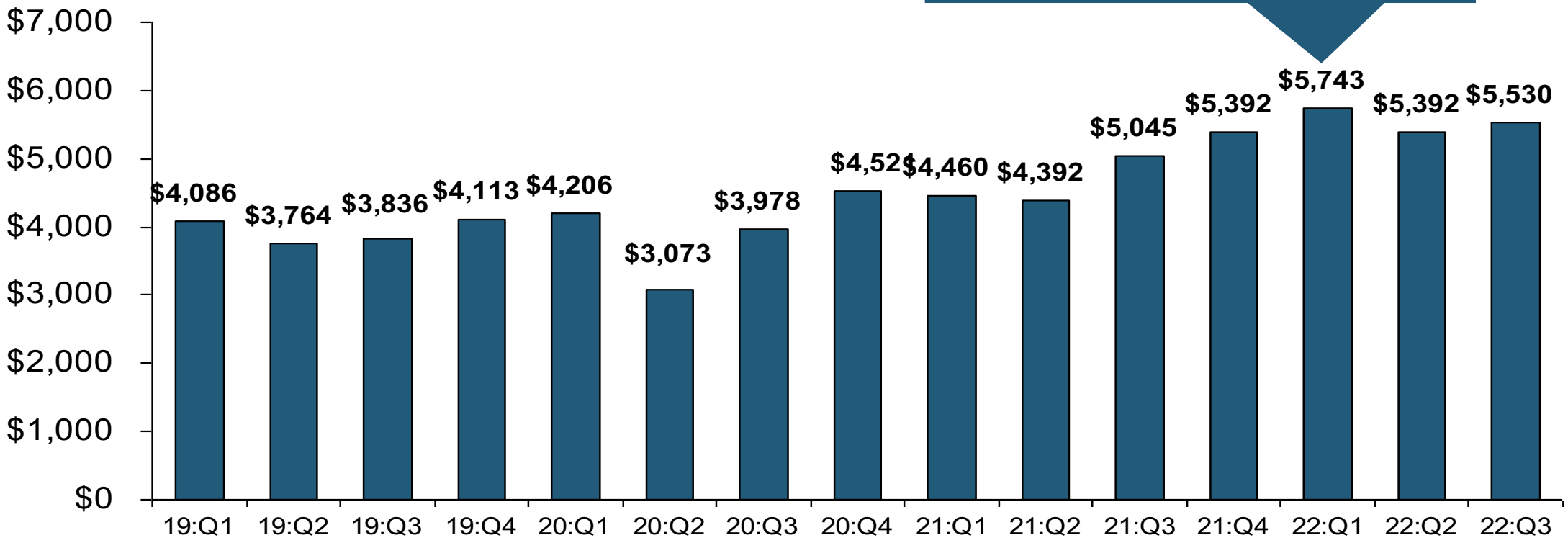
Legal system abuse is estimated to cost commercial auto insurers billions each year, which combined ratio and rates high

Source: CAS Research Paper, Social Inflation and Loss Development—An Update (2023) by Jim Lynch, FCAS and Dave Moore, FCAS.

Collision Claim Severity: Rising to New Record Highs

Average Loss, 2018:Q1 through 2022:Q3

Collision claim severity reached a record high in 2022:Q1, up 36.5% from 2020:Q1



Severities Are Up Sharply—Inflation Is a Major Factor

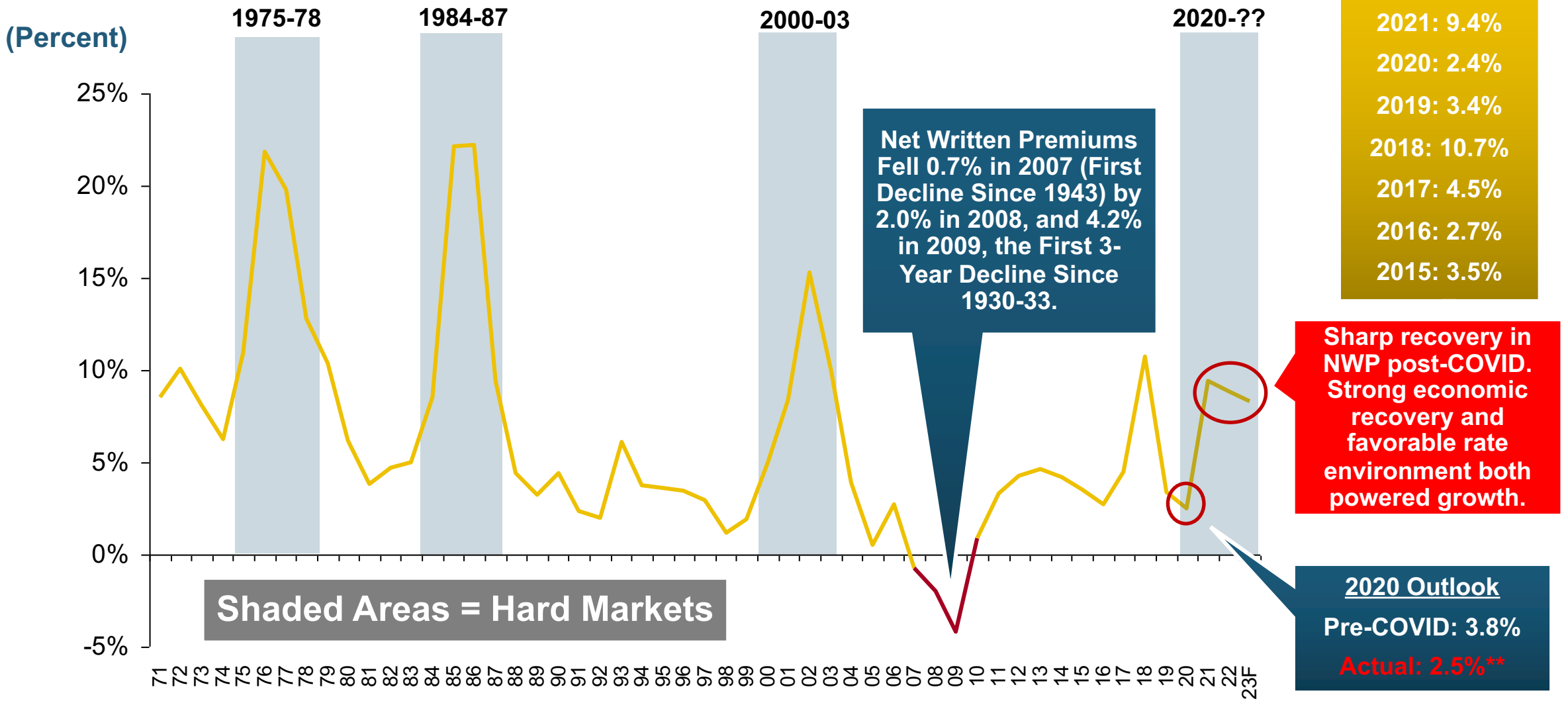
Source: ISO/PCI *Fast Track* data; Center for Risk and Uncertainty Management, Univ. of South Carolina.

Commercial Lines Growth & Pricing Cyclicality

Economic and Tort Environment Create Pricing Pressure

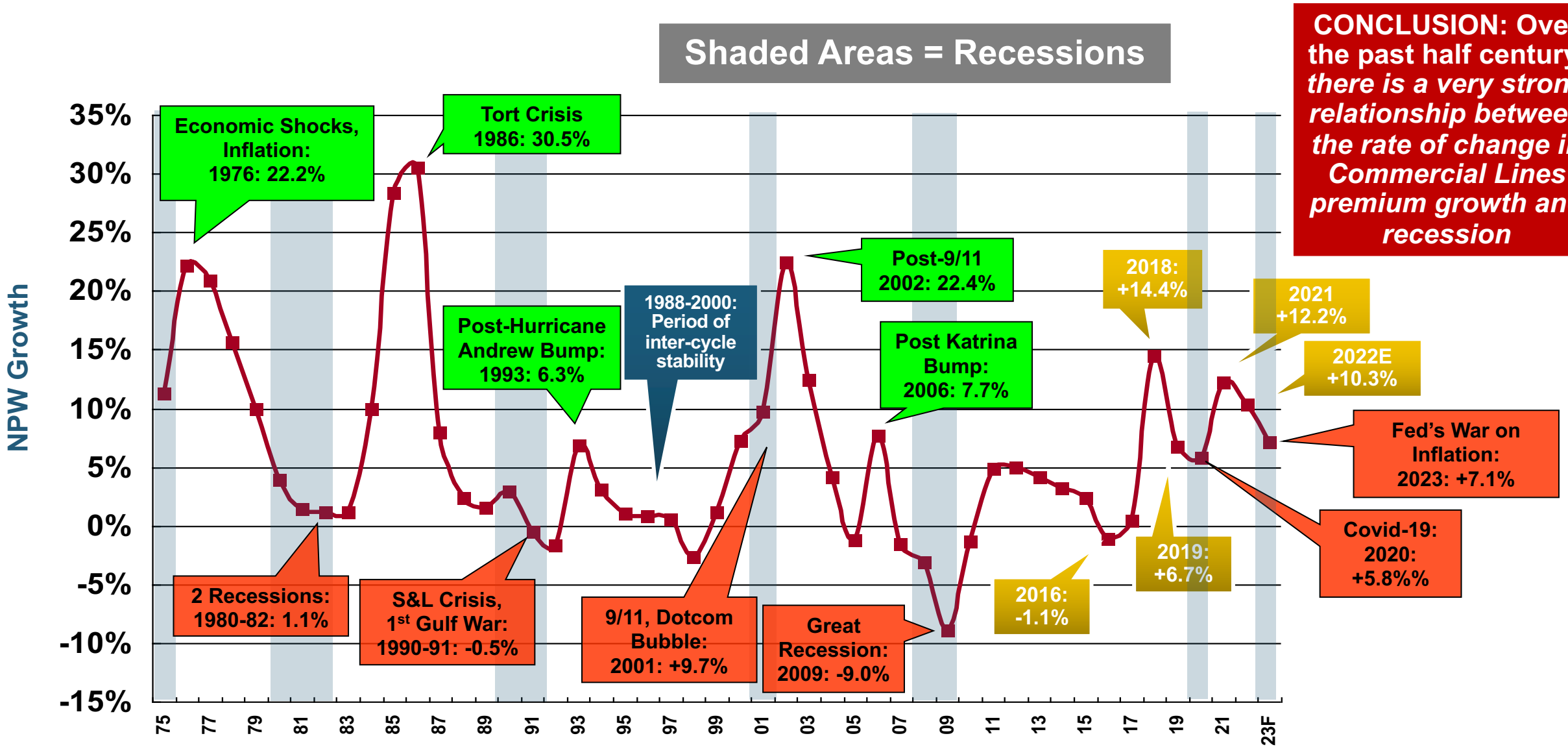
13

Net Written Premium Growth (All P/C Lines): Annual Change, 1971–2023F



NOTE: Shaded areas denote "hard market" periods.
Sources: A.M. Best (1971-2013, 2022E – 2023F), ISO (2014-21); Risk & Uncertainty Management Center, Univ. of South Carolina

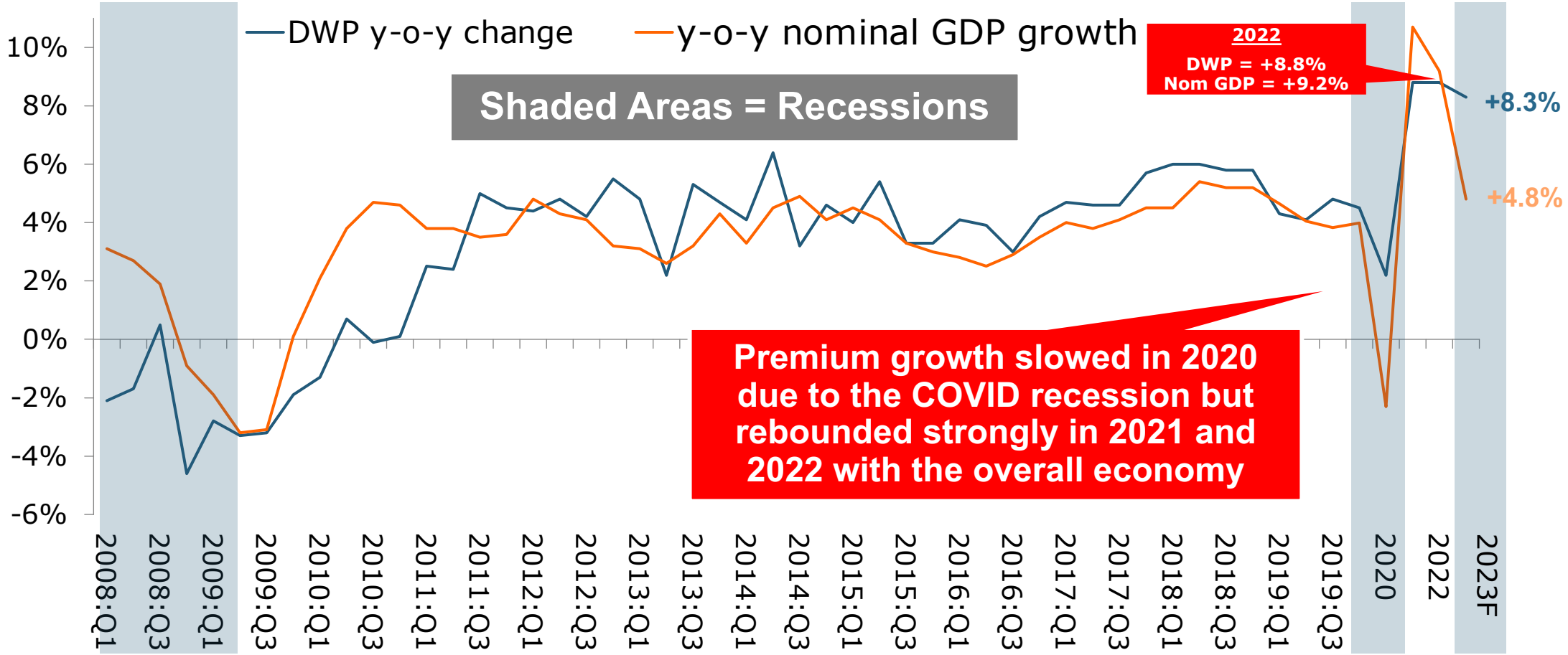
Commercial Lines NPW Premium Growth: 1975 – 2023F



Note: Data include state funds beginning in 1998. . Recession dates (1975–2022) from NBER: https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions
Source: A.M. Best (2022E-23P); ISO; APCIA; Univ. of South Carolina Center for Risk and Uncertainty Management Center.

The Economy Drives P/C Insurance Industry Premiums: 2006:Q1–2023F*

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

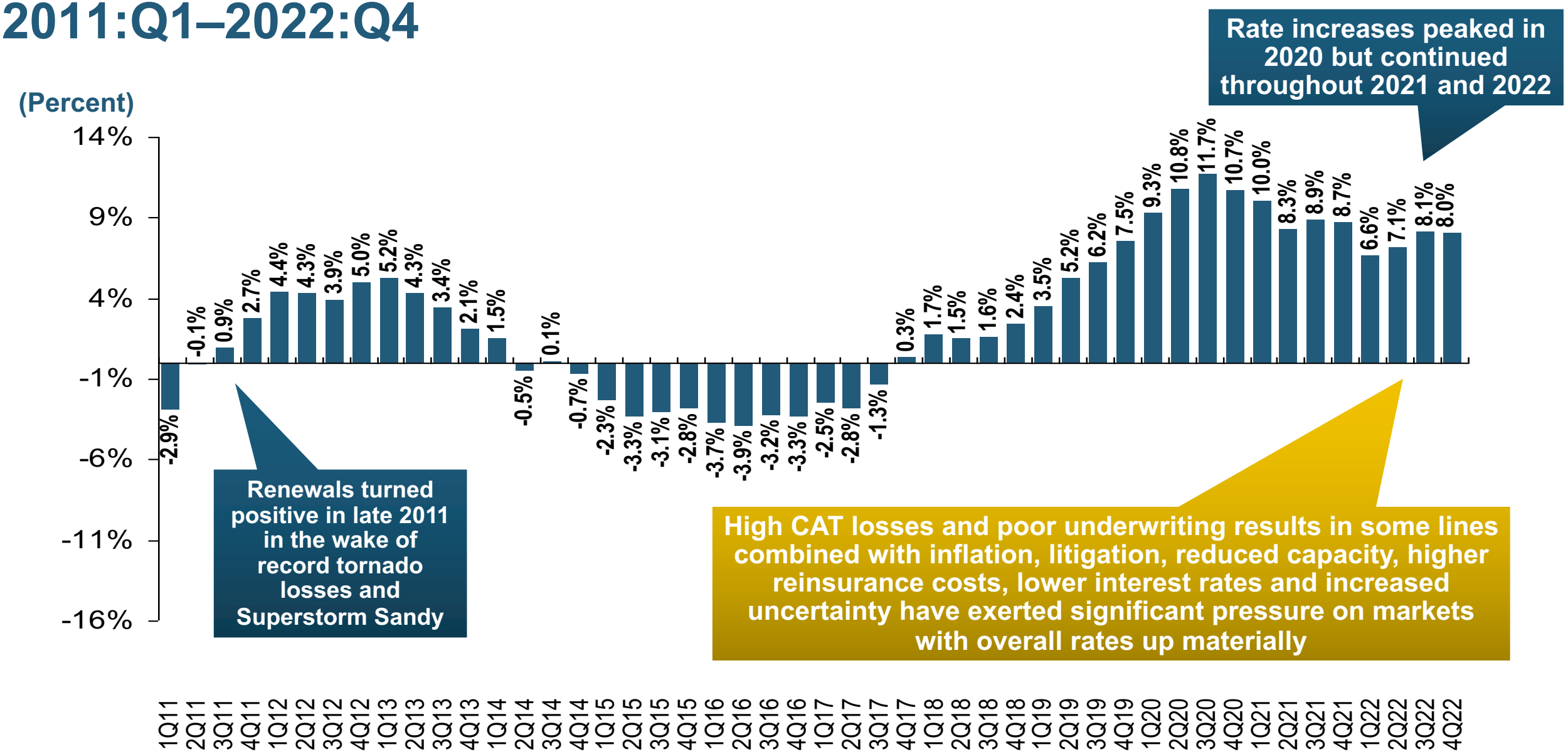


Direct written premiums track nominal GDP fairly tightly over time, suggesting the P/C insurance industry's growth prospects are inextricably linked to economic performance.

*2020-23F 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.

CIAB: Average Commercial Rate Change, All Lines, 2011:Q1–2022:Q4

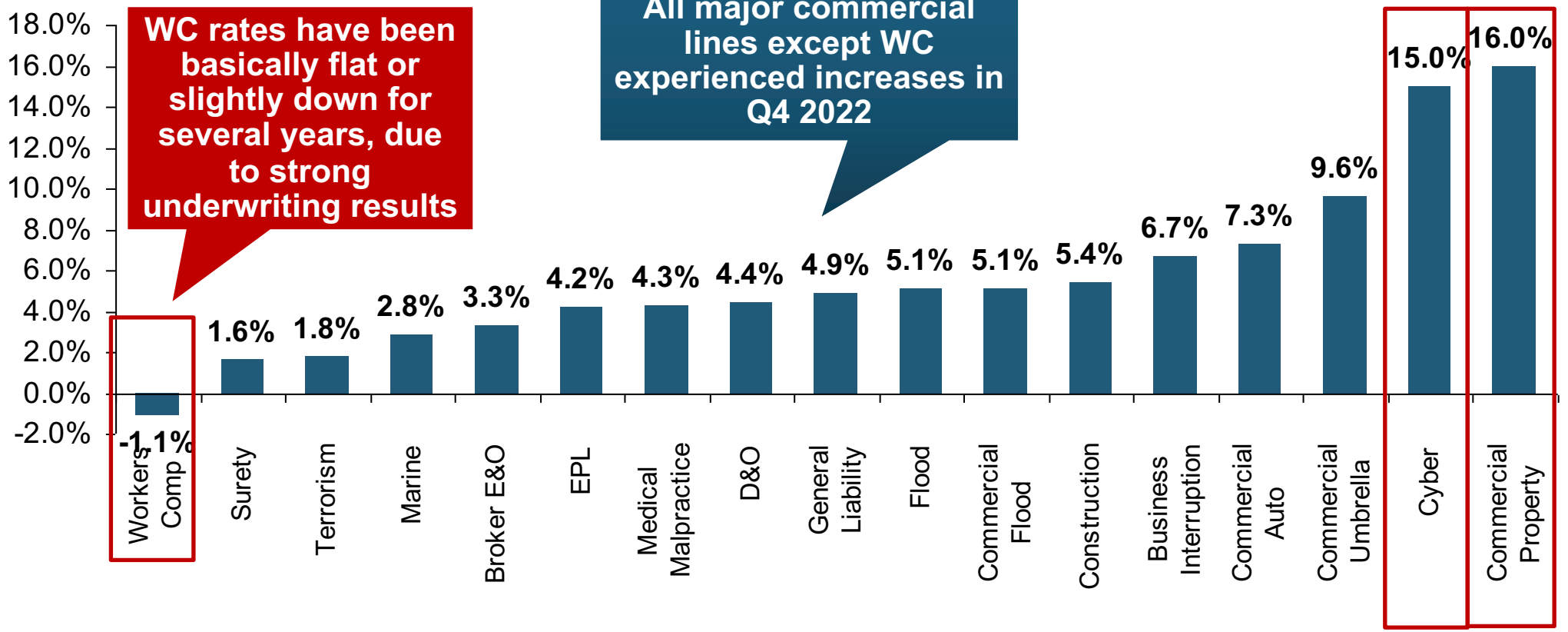


Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially.
Source: Council of Insurance Agents & Brokers; Center for Risk and Uncertainty Management, Univ. of South Carolina.

Change in Commercial Rate Renewals, by Line: 2022:Q4

Commercial property is up sharply as CAT losses and inflation continue to take their toll, overtaking Cyber, which is up in response to major breaches in recent years.

(Percent Change)



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

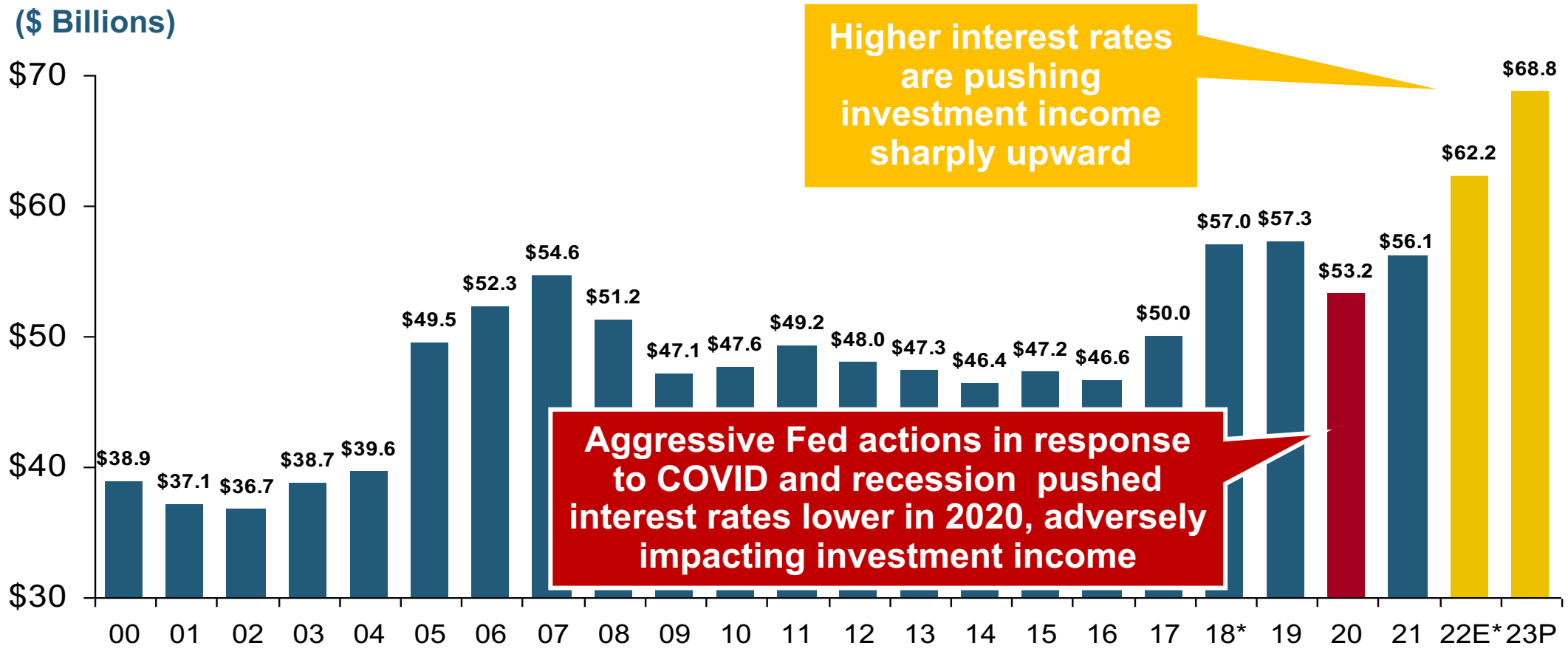
Source: Council of Insurance Agents and Brokers; USC Center for Risk and Uncertainty Management.

Investments:
Wall Steet's Wild Ride Continues

Investment Performance Is a Key Driver of Insurer Profitability

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

Property/Casualty Insurance Industry Investment Income: 2000–2023P

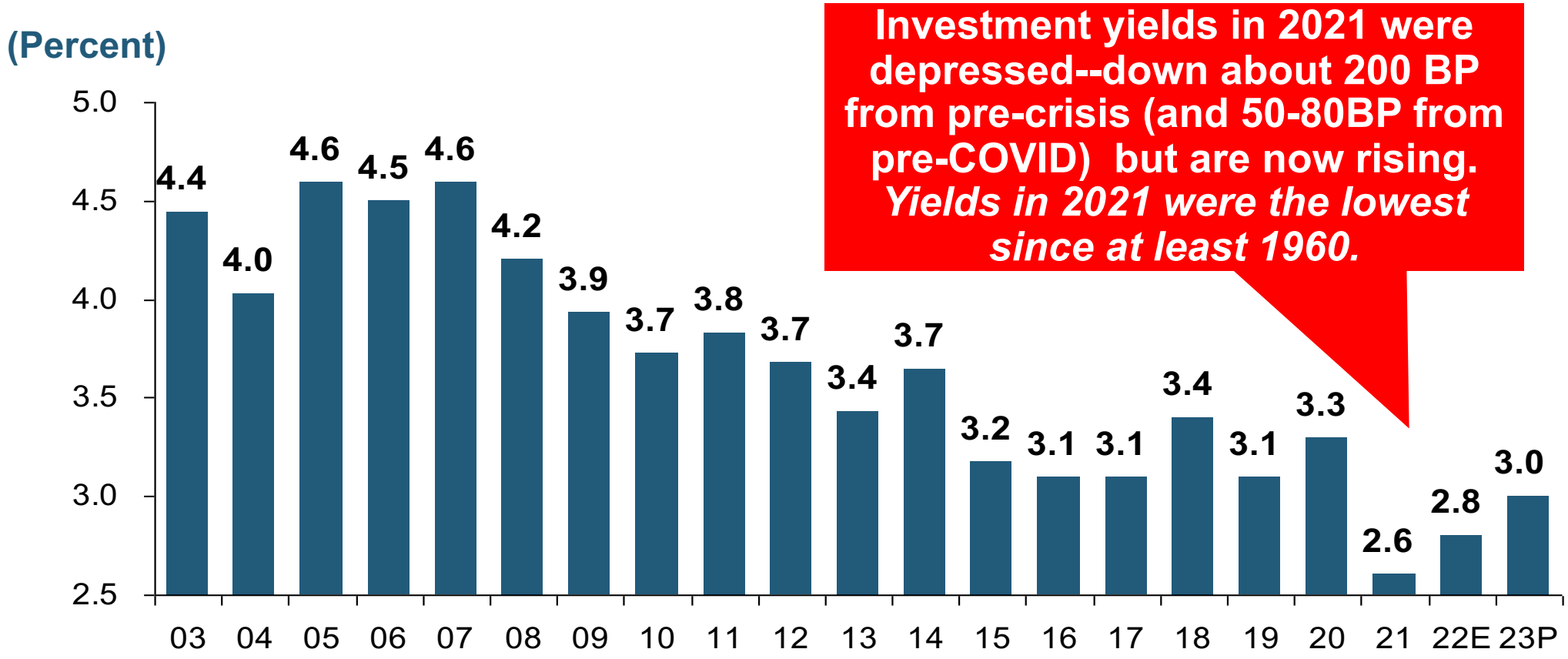


Due to persistently low interest rates, investment income remained below pre-crisis levels for a decade. Lower interest rates during COVID drove investment income down once again. Fed rate hikes in 2022-23 are reversing this trend.

*2022 figure excludes $10.8B intercompany distribution at a large reinsurer. 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: A.M. Best Review & Preview (March 2023); ISO; University of South Carolina, Center for Risk and Uncertainty Management.

Net Investment Yield on Property/Casualty Insurance Invested Assets, 2007–2023P



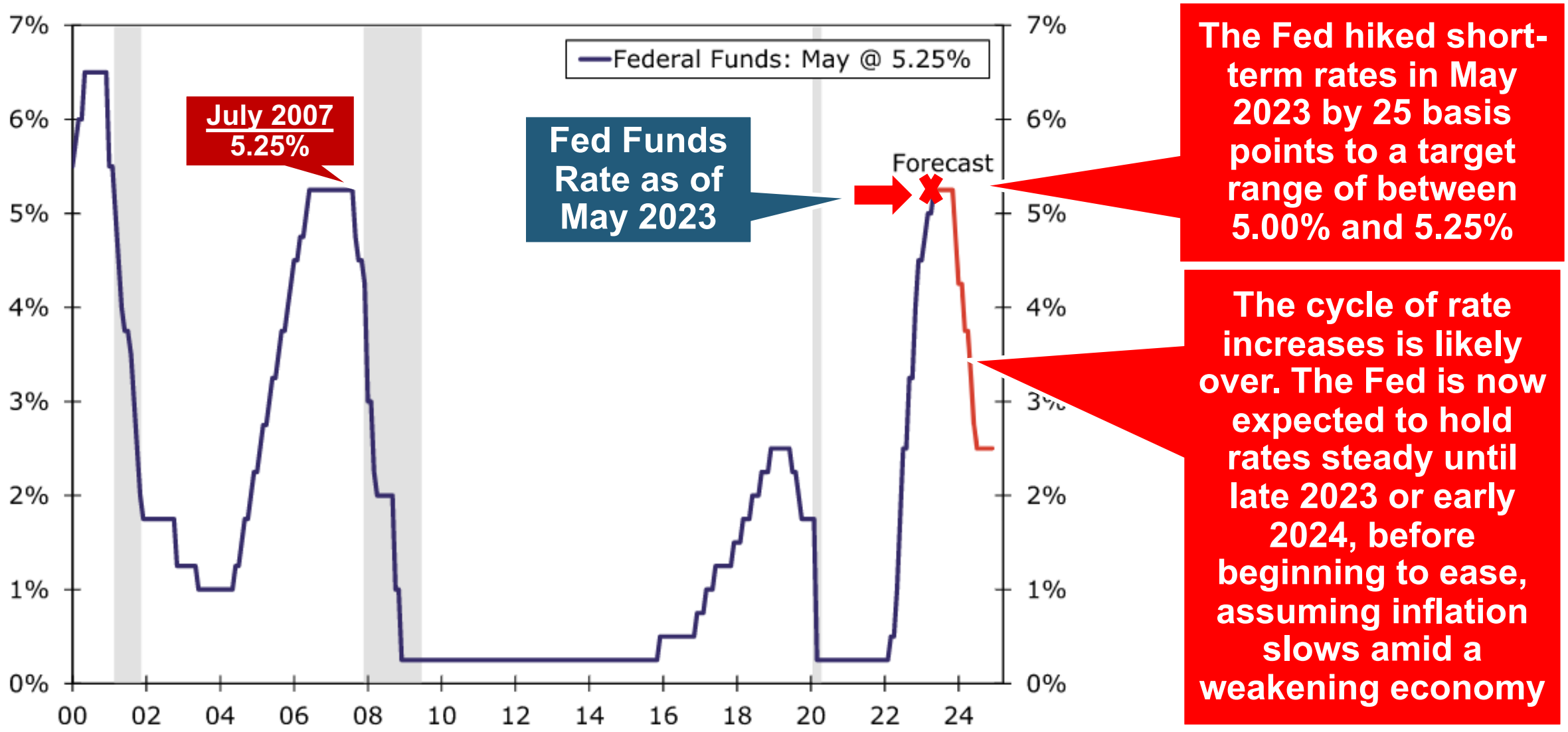
Investment yields in 2021 were depressed--down about 200 BP from pre-crisis (and 50-80BP from pre-COVID) but are now rising. *Yields in 2021 were the lowest since at least 1960.*

The yield on invested assets remains depressed relative to pre-financial crisis and pre-COVID yields. Fed rate hikes in 2022-23 are lifting yields and investment income.

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. 2022^{E}-23P from A.M. Best Review & Preview (March 2023). Risk and Uncertainty Management Center, Univ. of South Carolina.

Federal Funds Target Rate: Up, Up and Away!

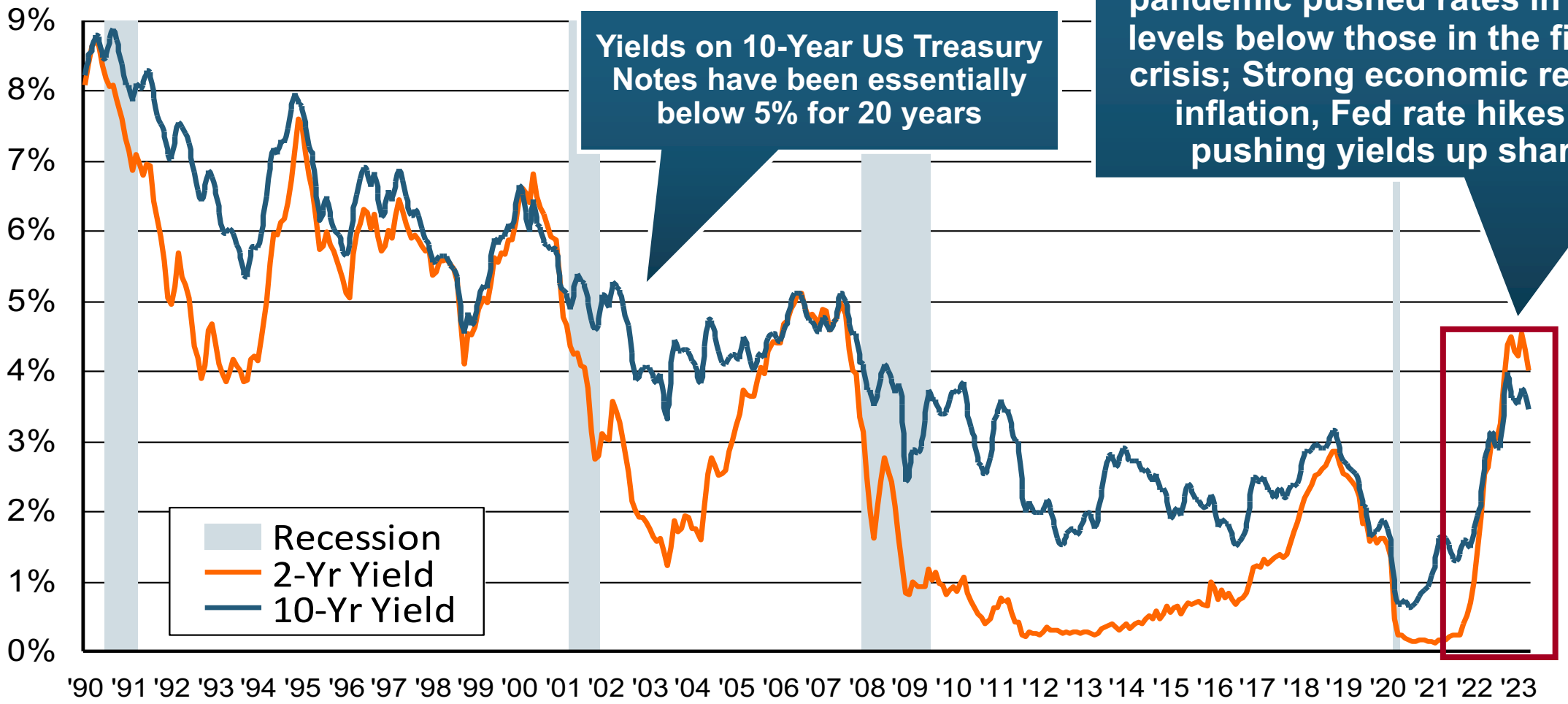


The Fed hiked short-term rates in May 2023 by 25 basis points to a target range of between 5.00% and 5.25%

The cycle of rate increases is likely over. The Fed is now expected to hold rates steady until late 2023 or early 2024, before beginning to ease, assuming inflation slows amid a weakening economy

Source: Federal Reserve Board and Wells Fargo Economics (5/23); Risk and Uncertainty Management Center, University of South Carolina.

US Treasury Security Yields: A Long Downward Trend, 1990–2023*

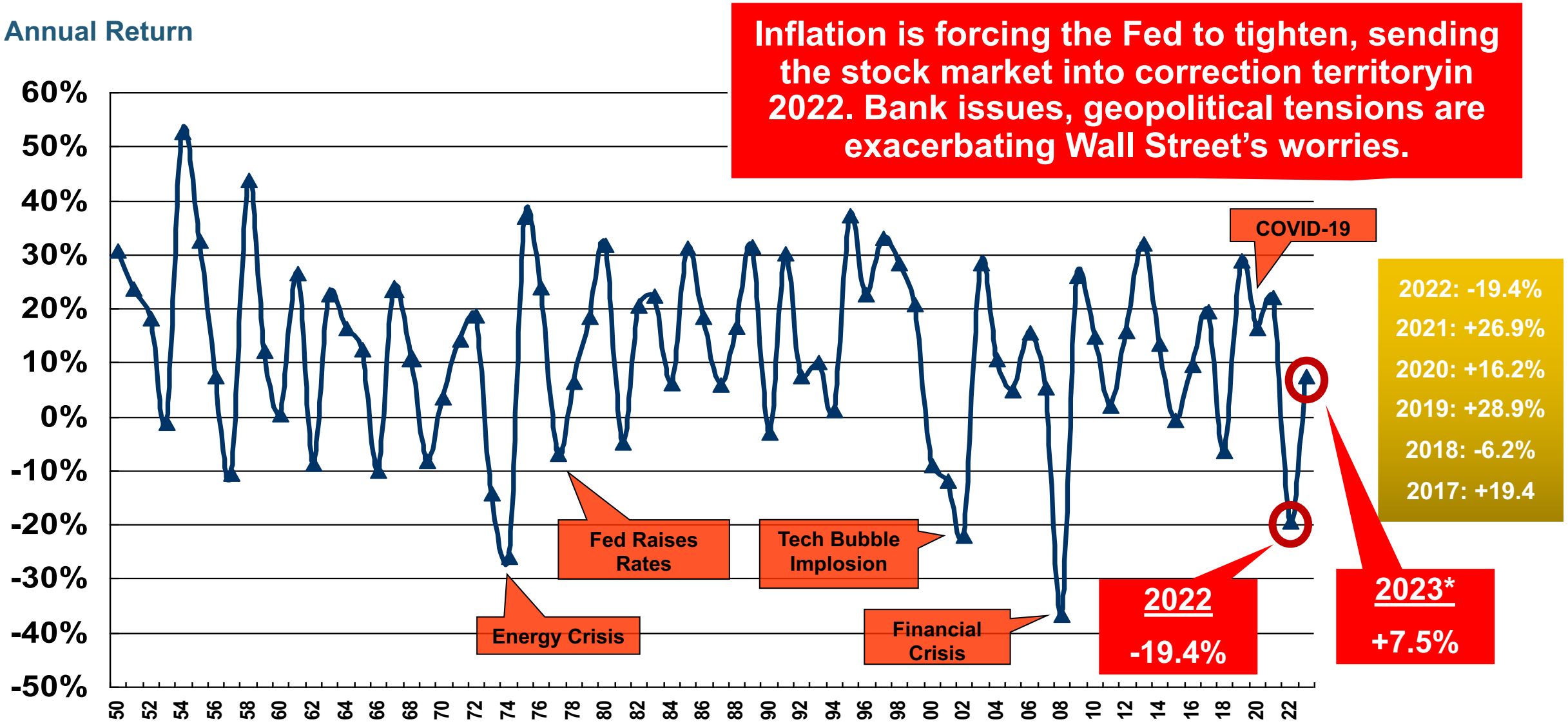


Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, Fed rate hikes should over time provide a modest boost to P/C insurer portfolio yields

*Monthly, constant maturity, nominal rates, through Apr. 2023.

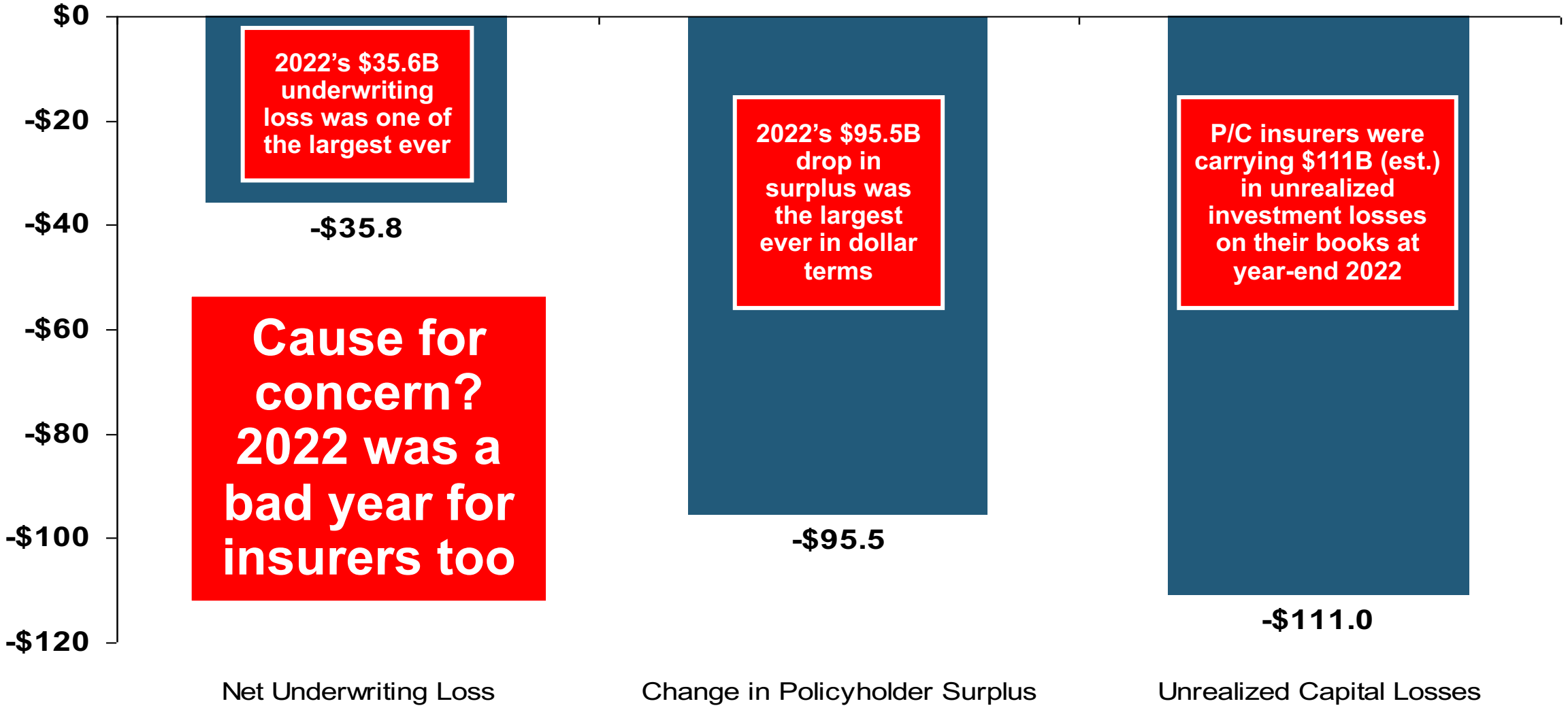
Sources: Federal Reserve Bank at http://www.federalreserve.gov/releases/h15/data.htm. National Bureau of Economic Research (recession dates); Risk and Uncertainty Management Center, University of South Carolina.

S&P 500 Index Returns, 1950–2023*



*Through May 5, 2023.
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.

Change in in Key P/C Financial Metrics in 2022
($ Billions)



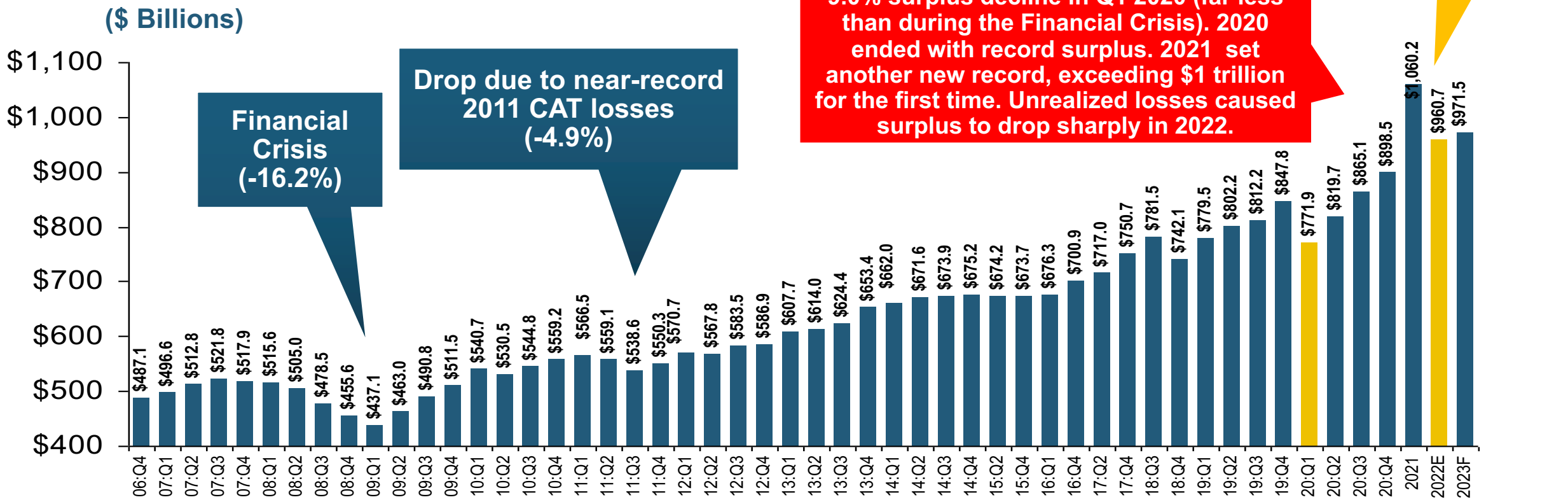
Source: A.M. Best, *2023 P/C Review & Preview* (March 2023); Risk and Uncertainty Management Center, University of South Carolina.

Capital and Capacity

P/C Insurance: Over or Under Capitalized?

Is the Industry Creating Economic Value?

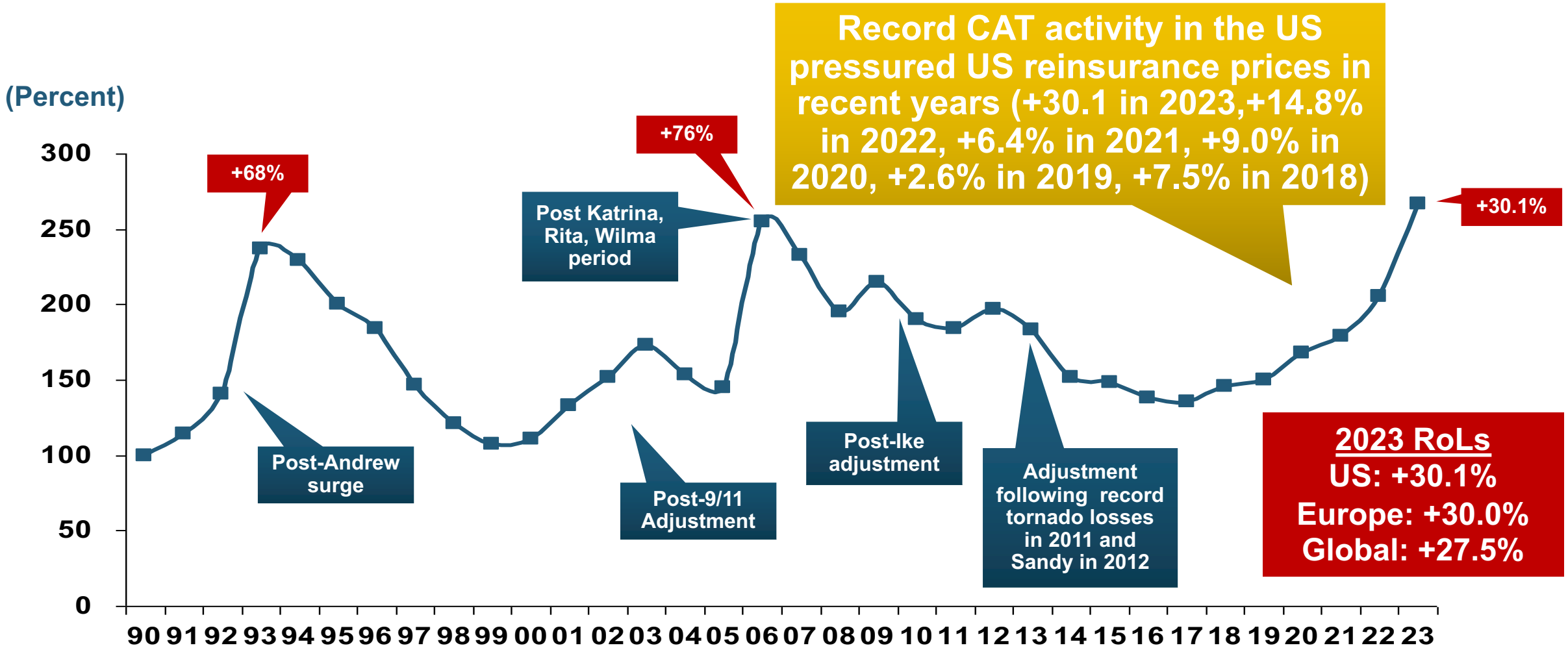
Policyholder Surplus (Capacity), 2006:Q4 – 2023F



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.

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

US Property Catastrophe Rate-on-Line Index: 1990 – 2023*



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

*As of January 1 each year.

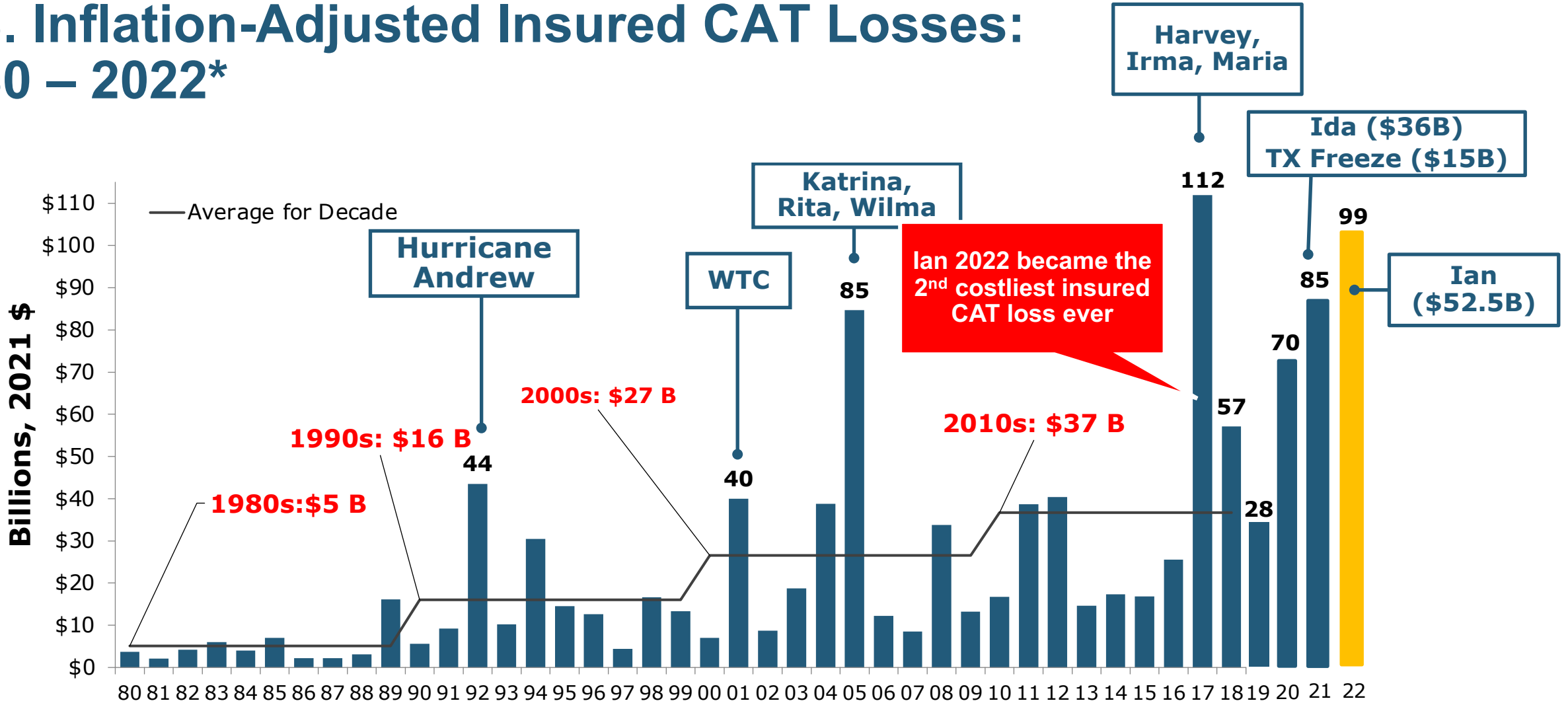
Source: Guy Carpenter; Artemis.bm accessed at: http://www.artemis.bm/us-property-cat-rate-on-line-index

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 – 2022*



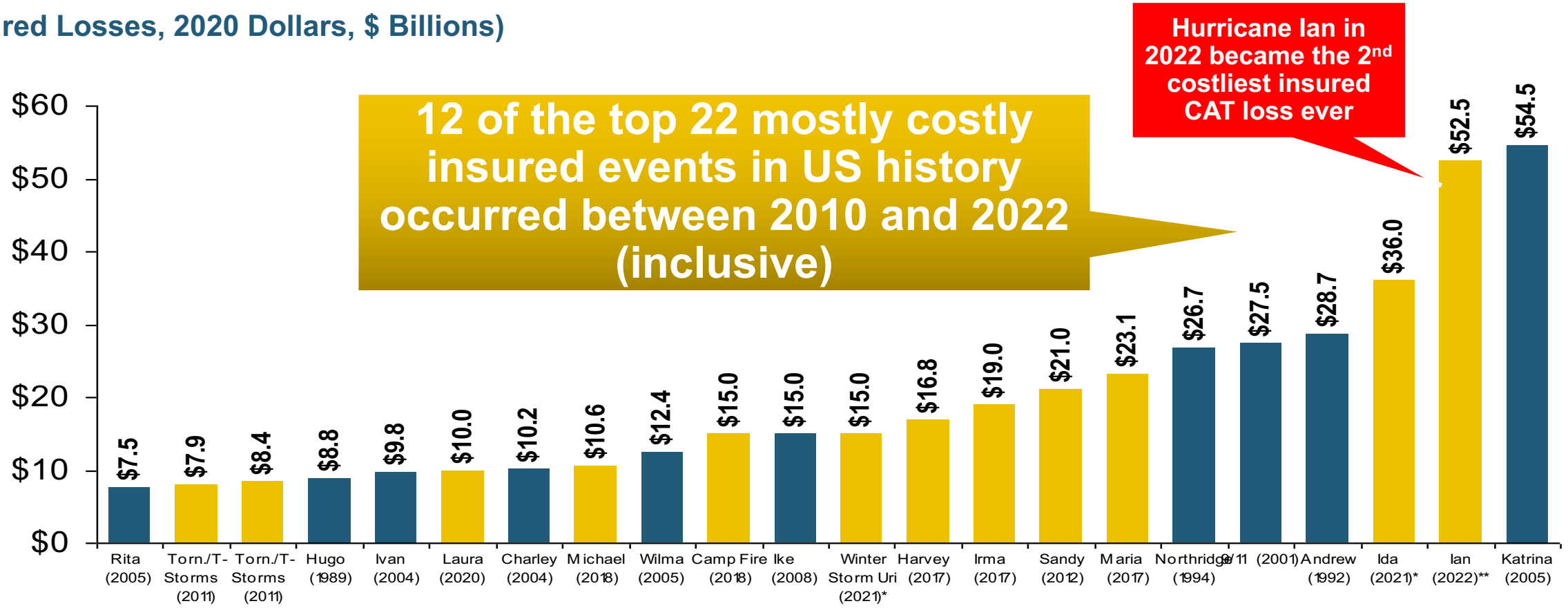
Average Insured Loss per Year*
1980-2021: $23.8 Billion
2012-2021: $44.1 Billion

The 2020s are off to an ominous start with $85B in average annual insured losses (2020-22)

*Stated in 2021 dollars except 2022 (2022 dollars).
Sources: Property Claims Service, a Verisk Analytics business (1980-2019); 2020-21 figures from Munich Re; 2023 YTD data from Aon; Insurance Information Institute; University of South Carolina, Risk & Uncertainty Management Center.

Top 22 Most Costly Disasters in U.S. History

(Insured Losses, 2020 Dollars, $ Billions)



*2021 dollars; **2022 dollars (Aon insured loss estimate as of 1/25/23).

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

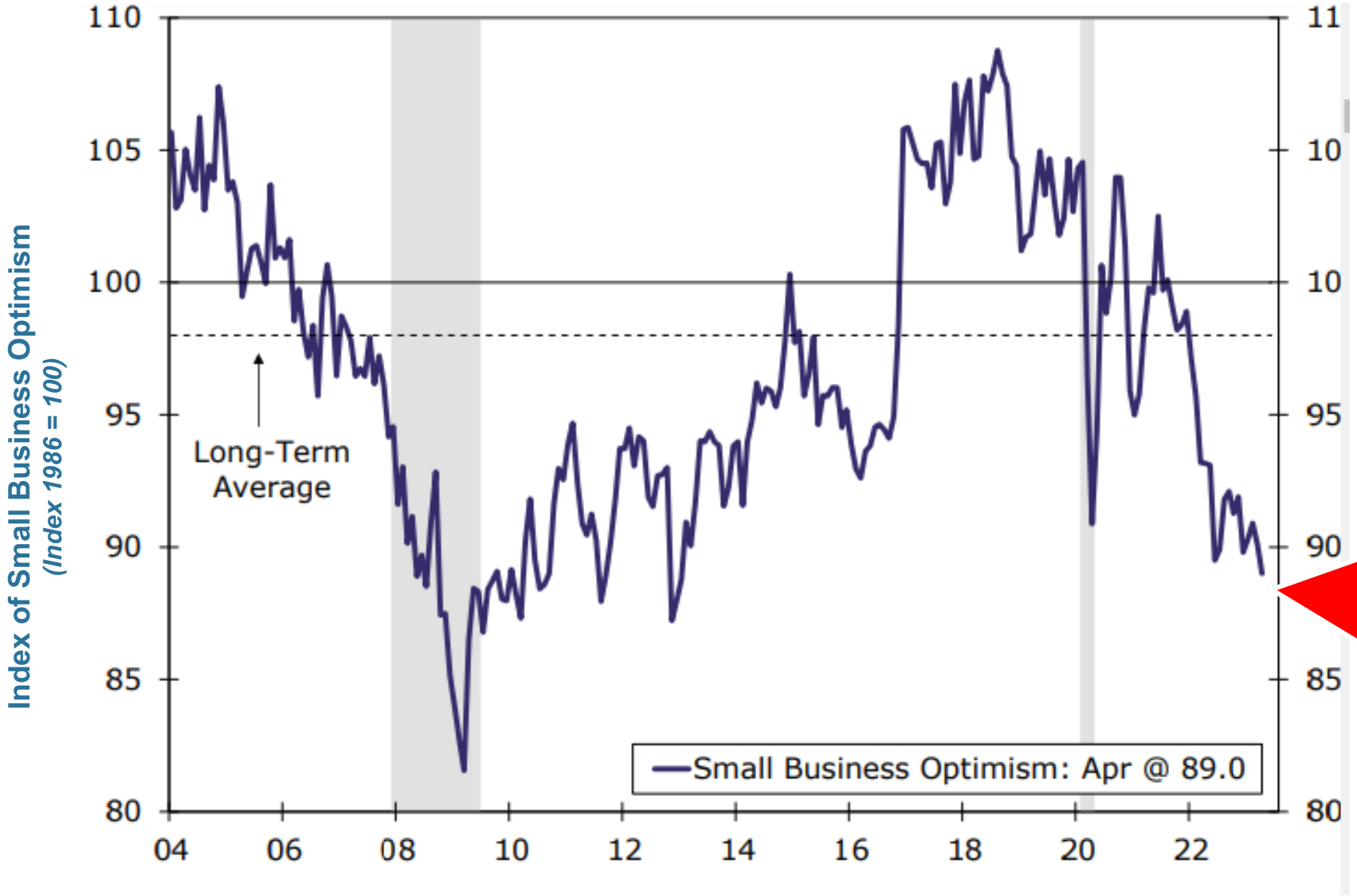
Economic Overview
Economic Optimism Plummeted in 2022-2023
Inflation is Breeding Ground for Pessimism

Inflation, Geopolitical Conflicts and Rising Interest Rates and Weighing Heavily on Business and Consumer Sentiment

Can the Fed "Thread the Needle" and Achieve a "Soft Landing"?

35

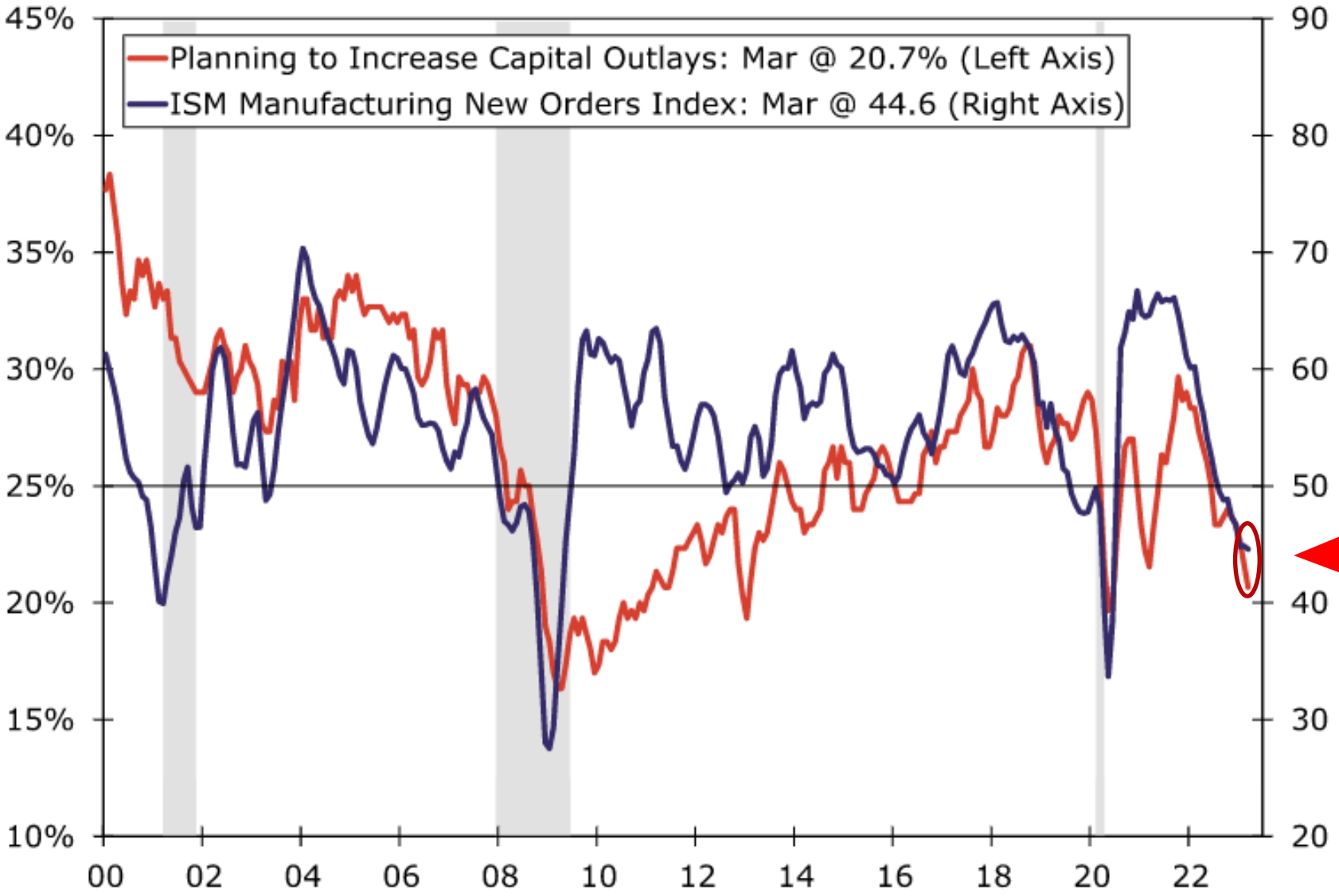
Small Business Sentiment: Optimism is at 12-Year Low



Small businesses today are even *more* pessimistic than they were during the depths of pandemic, despite strong spending by consumers and easing labor market issues. *Business owner concerns are pivoting from cost concerns to recession worries.*

Source: NFIB and Wells Fargo Economics.

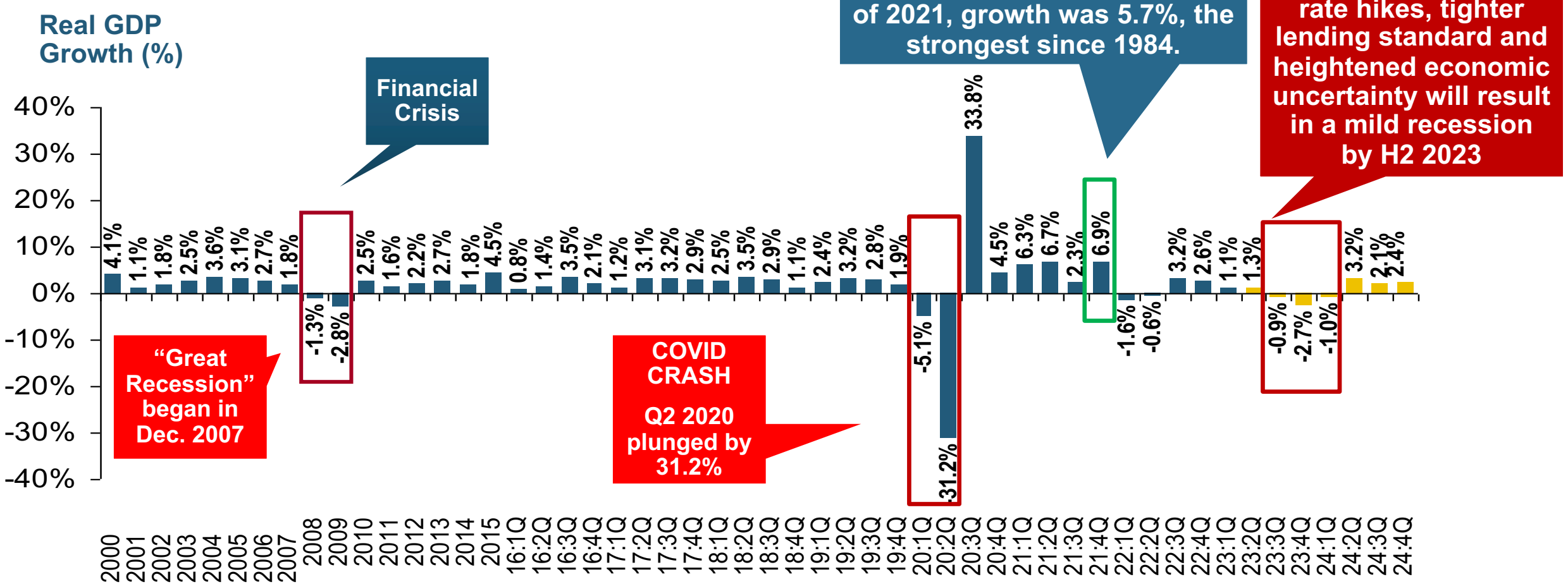
Small Business Capital Investment vs. New Orders



New orders at Manufacturers are shrinking and small businesses are scaling back capital outlays (presumably including trucks)

Source: NFIB, Wells Fargo Economics.

US Real GDP Growth*

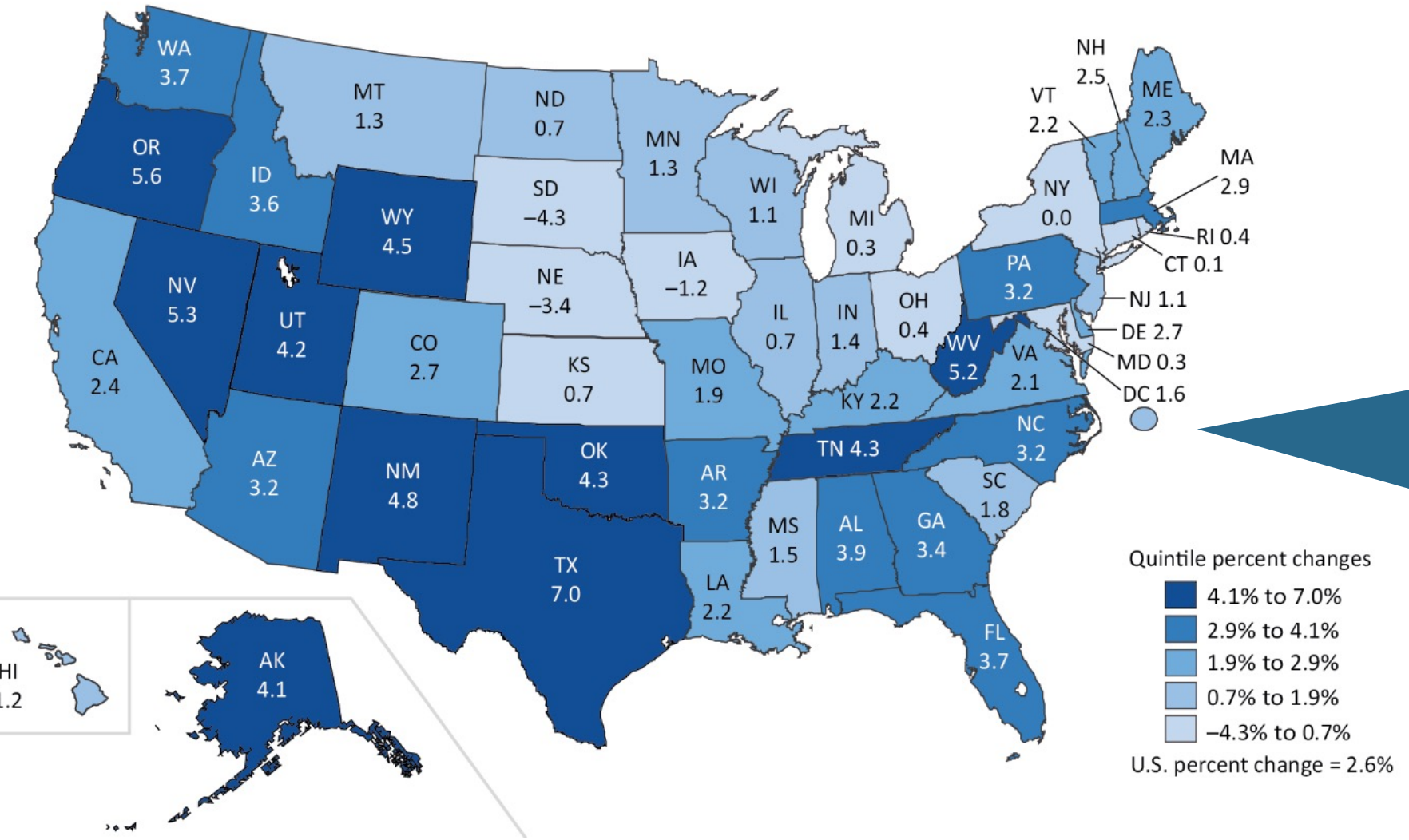


Demand for Insurance Increased Materially in 2021/22 During Recovery from the Pandemic—Particularly in Economically Sensitive Commercial Lines Such as WC. Premium growth will likely slow in 2023 as Economy Slows.

* Estimates/Forecasts from Wells Fargo Securities.

Source: US Department of Commerce, Wells Fargo Securities (4/23); Center for Risk and Uncertainty Management, University of South Carolina.

Real GDP by State, 2022:Q3 – 2022:Q4
(Annualized Rate)

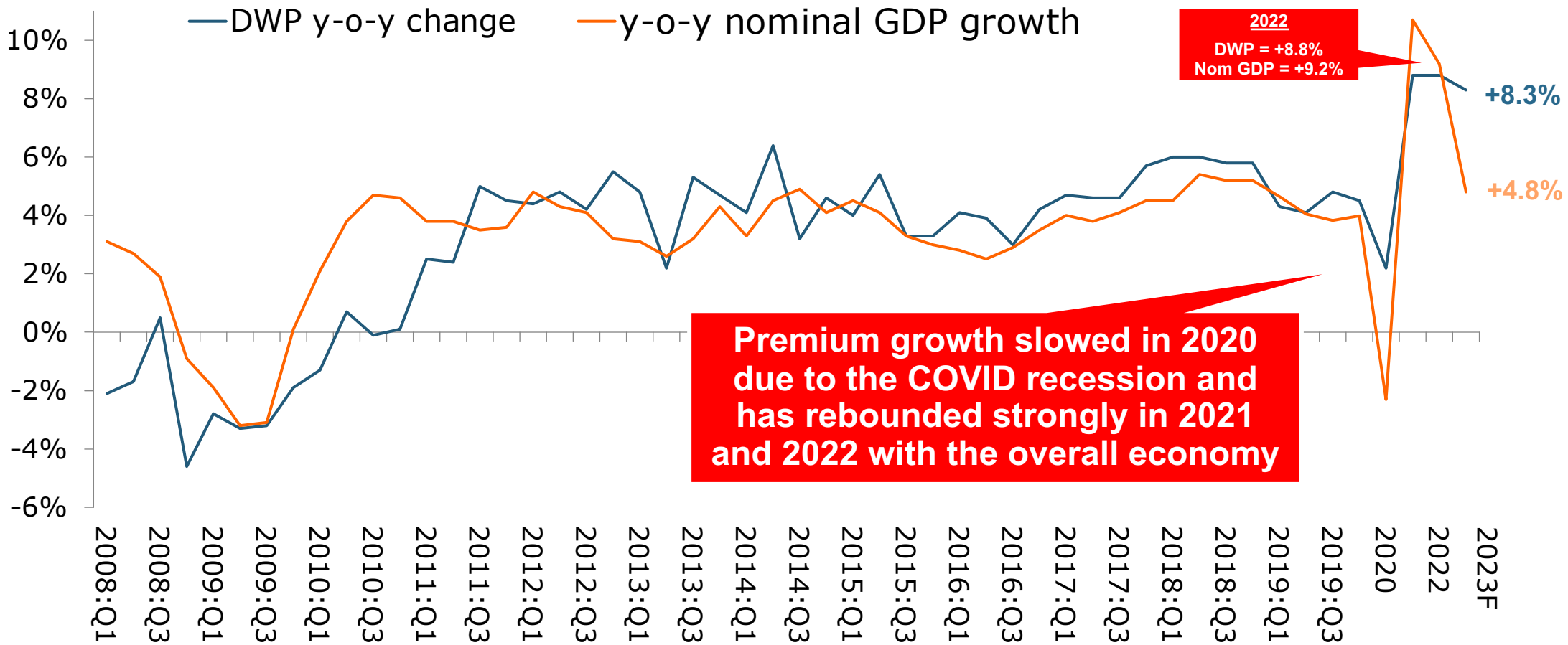


Economies in the Southeast and Southwest are performing well, along with some New England states

Sources: US Bureau of Economic Analysis at https://www.bea.gov/system/files/stgdppi3q22.png; Risk and Uncertainty Management Center, University of South Carolina.

The Economy Drives P/C Insurance Industry Premiums: 2006:Q1–2023F*

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



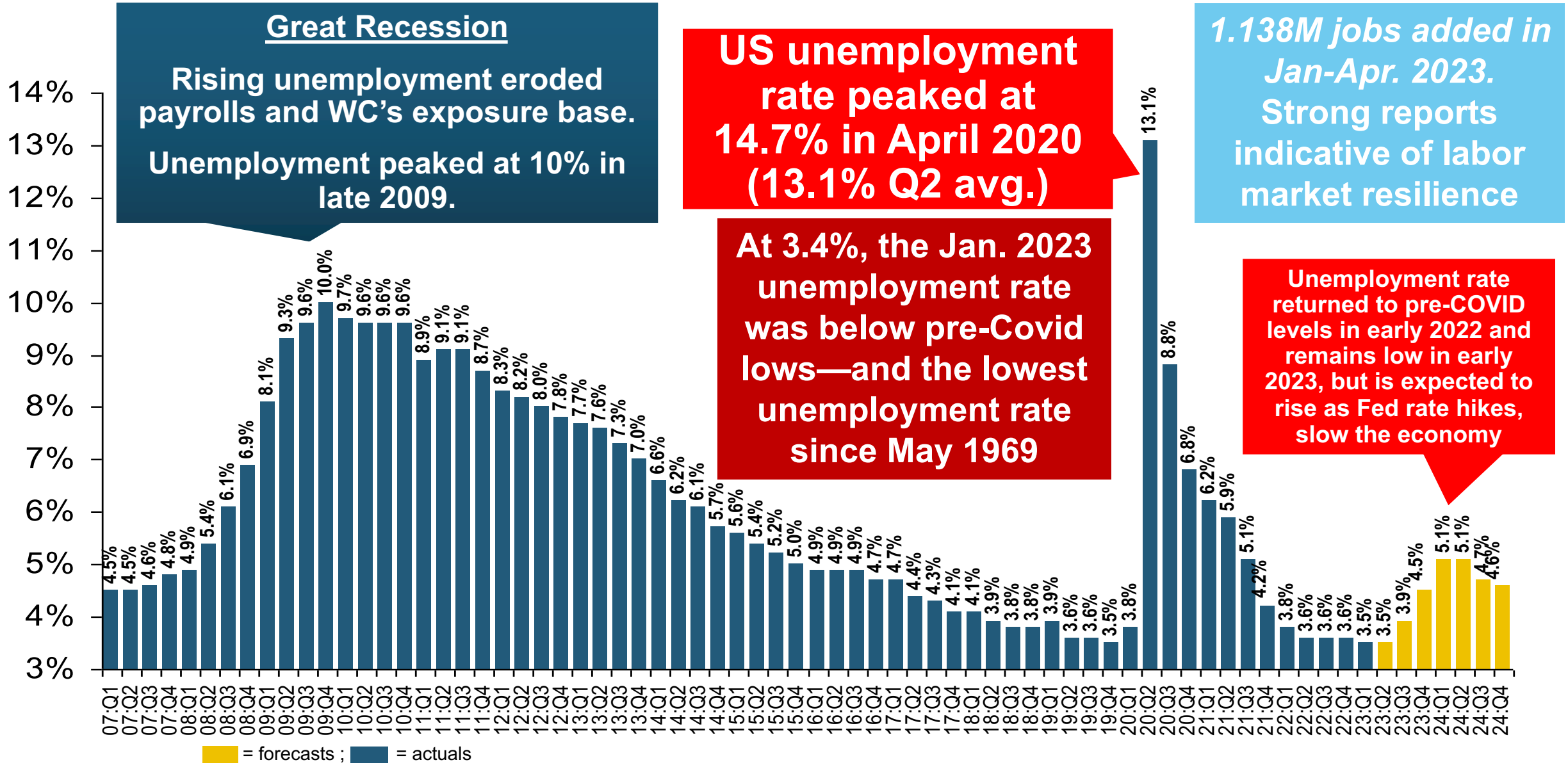
Premium growth slowed in 2020 due to the COVID recession and has rebounded strongly in 2021 and 2022 with the overall economy

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

*2020-23F figures are annual.

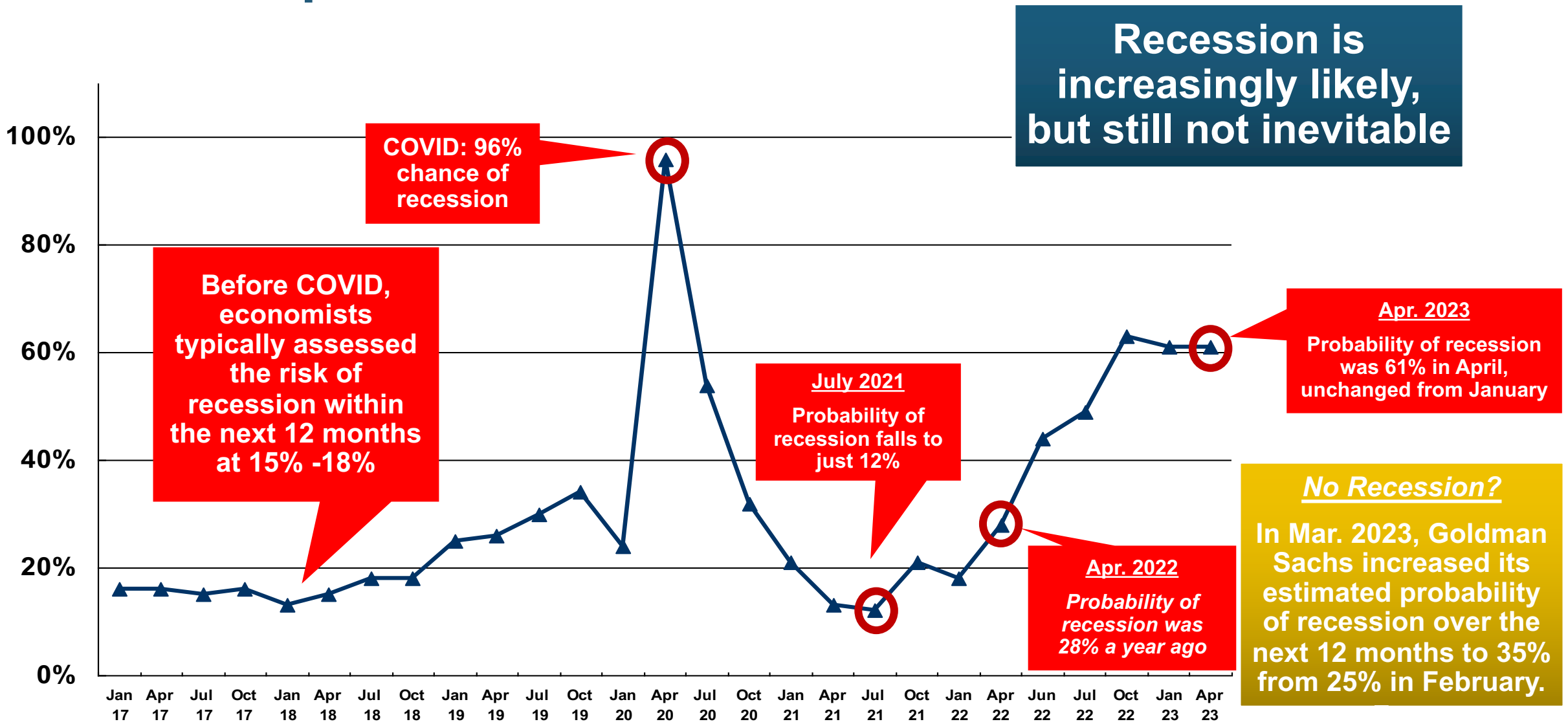
Sources: SNL Financial; U.S. Commerce Dept., Bureau of Economic Analysis; ISO; I.I.I.; Risk and Uncertainty Management Center, University of South Carolina.

US Unemployment Rate Forecast: 2007:Q1–2024:Q4



Sources: US Bureau of Labor Statistics; Wells Fargo Securities (4/23 edition); Risk and Uncertainty Management Center, University of South Carolina.

Probability the U.S. Is in a Recession Within Next 12 Months: Jan. 2017 – Apr. 2023*



*Apr. 2023 survey included the responses of 62 economists.

Source: Wall Street Journal surveys of economists: https://www.wsj.com/articles/despite-easing-price-pressures-economists-in-wsj-survey-still-see-recession-this-year-11673723571; Risk and Uncertainty Management Center, University of South Carolina.

Not All Recessions Are Created the Same – What Are the Possibilities Over the Next 12 Months?

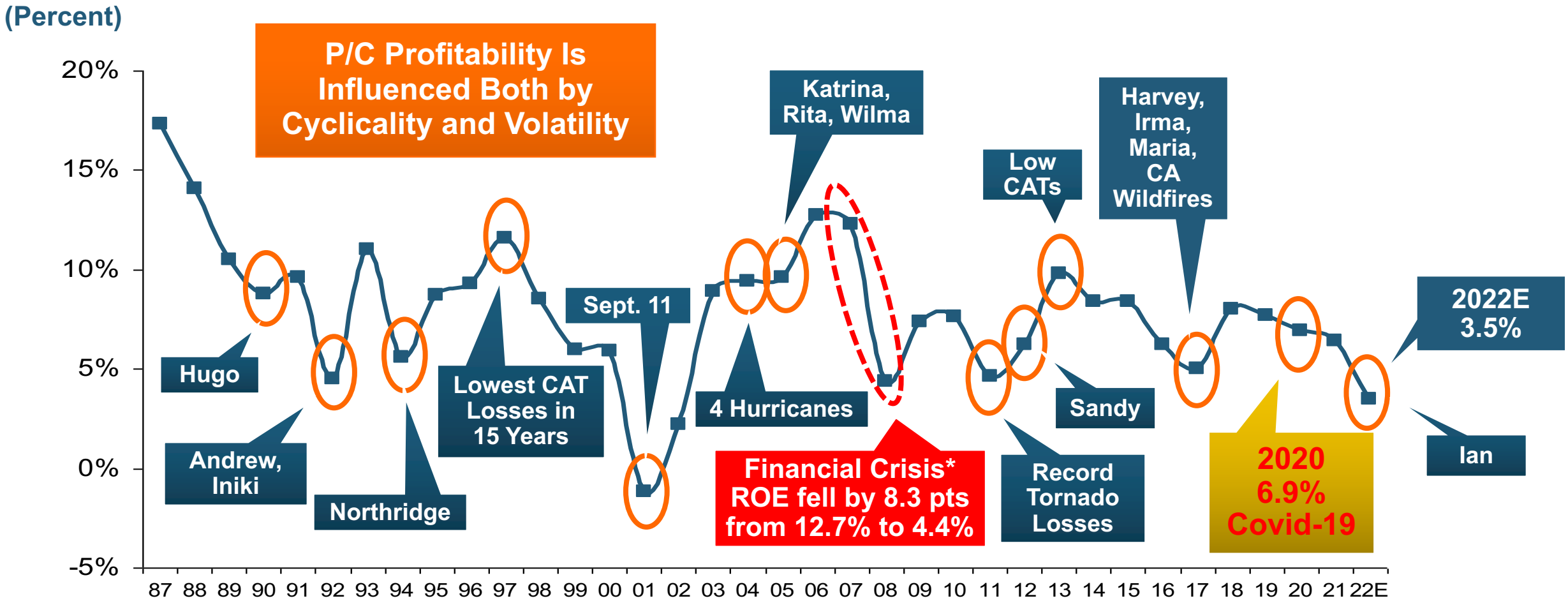
Soft Landing

Hard Landing

No Landing

Source: Public Mutual; Univ. of South Carolina, Risk and Uncertainty Management Center.

ROE: Property/Casualty Insurance by Major Event, 1987–2022E*

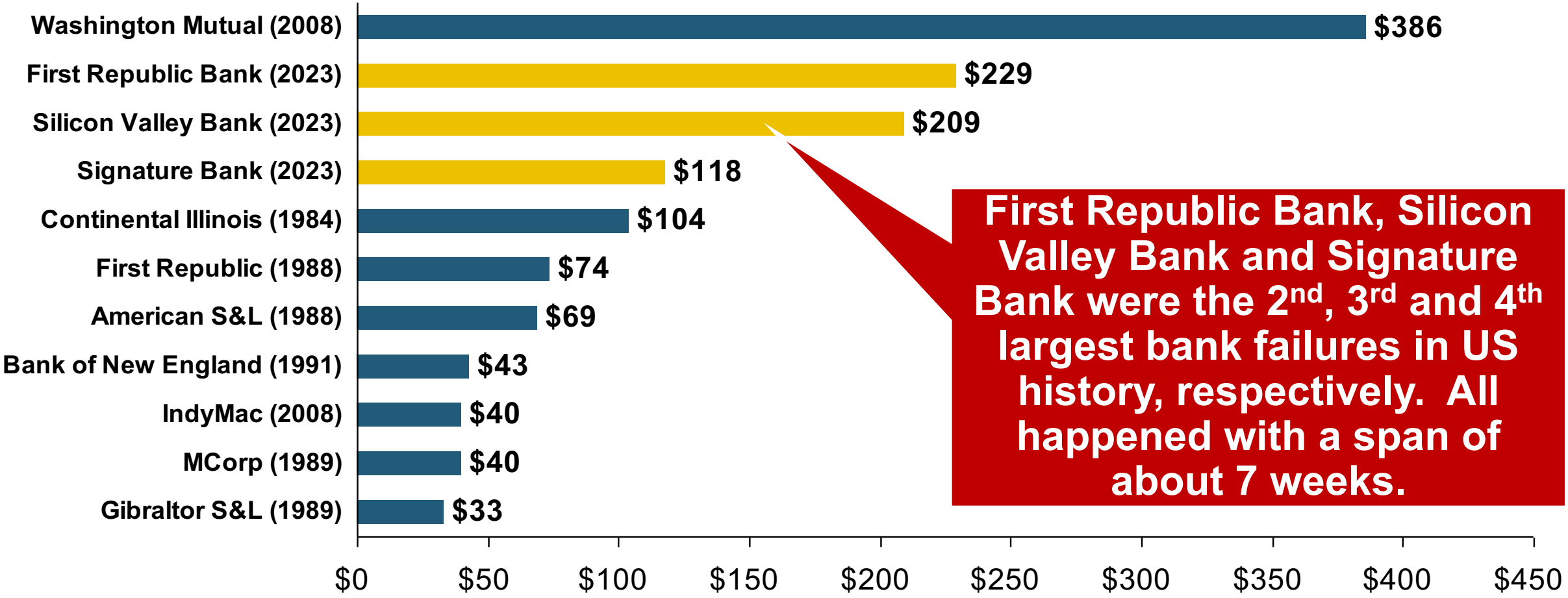


*Excludes Mortgage & Financial Guarantee in 2008 – 2014.
Sources: A.M. Best, ISO, *Fortune,* APCIA; USC RUM Center.

Bank Failures & Recession Risk: What Happened and Why?

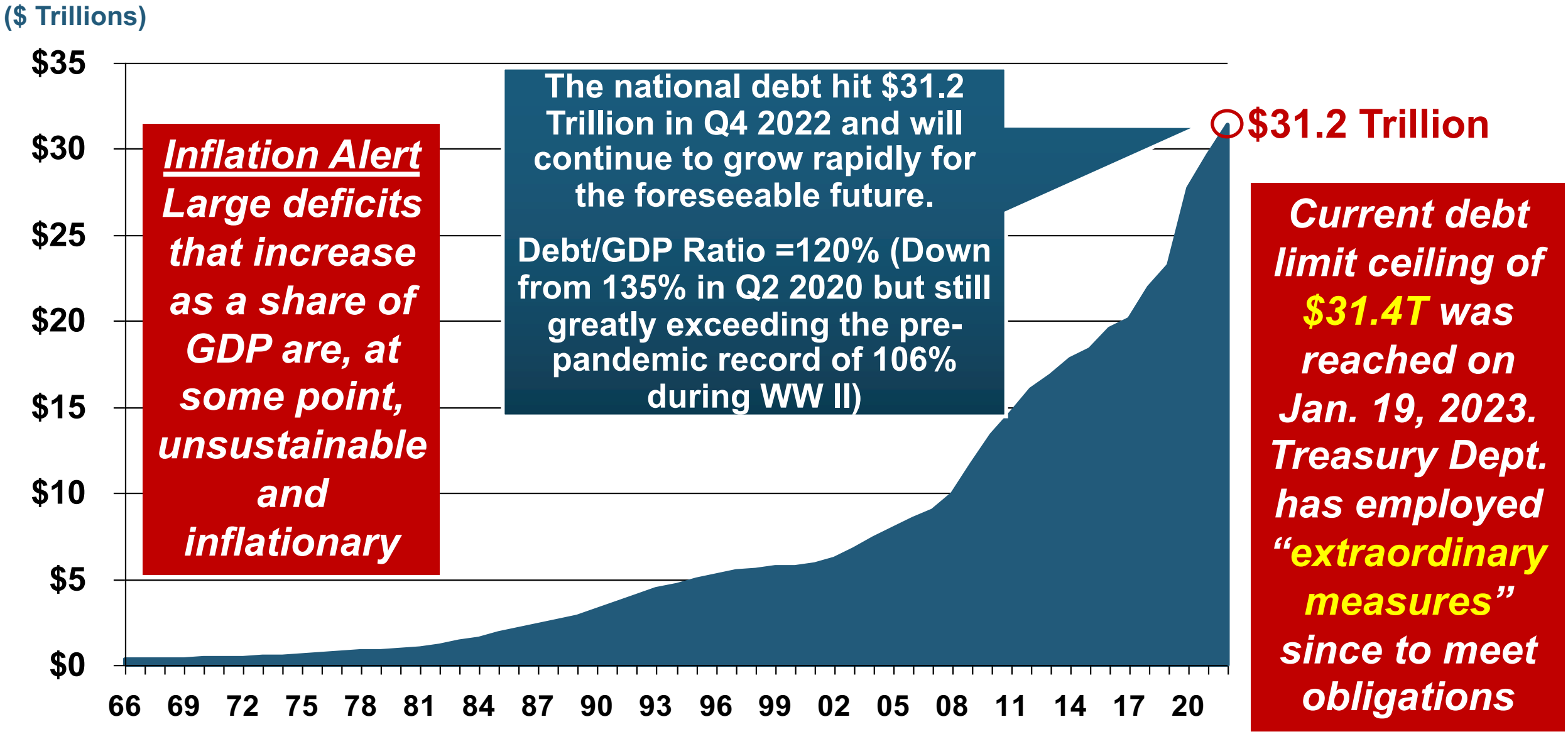
- Silicon Valley Bank failed on March 10th — 2nd Largest Failure in US History
- Signature Bank failed on March 12th — 3rd Largest U.S. Failure Ever
- Credit Suisse taken over by UBS on March 19th — Raising Global Concerns
- First Republic Bank fails on May 1 — 2nd Largest Failure in US History
  - Displacing SVB
- Several Other Regional Banks Under Pressure
- *Financial sector stress is leading to a tightening of credit, which increases the likelihood of recession*

Top 11 Bank Failures in U.S. History
*(Based on Assets at Time of Failure, $Billions)**



*Figures are inflation-adjusted to 2021 dollars, except Silicon Valley and Signature Bank which are as reported at year-end 2022 and First Republic reported as of 2023:Q1.
Source: FDIC; USC Risk and Uncertainty Management Center.

U.S. National Debt, 1966–2022:Q4—Could the U.S. Default? What are the Implications for Insurers?



Source: Congressional Budget Office; Federal Reserve Bank of St. Louis: https://fred.stlouisfed.org/series/GFDEGDQ188S and https://fred.stlouisfed.org/series/GFDEBTN.

Consequences of Not Reaching an Agreement by the X-Date Could in Include Any or All of the Following

- **Immediate cuts to spending already authorized by Congress**
  - **Examples: Late, partial, or missed payments to Social Security and Medicare recipients, government employees, and government contractors**
- **Suspension by US Treasury of interest payments on existing debt**
  - **This option could be pursued in lieu of withholding funds committed to federal programs, but would cause material harm**
  - **Constitutes a technical *default* in existing debt**
- **As X-Date approaches, expect:**
  - **Increasing pressure on interest rates**
  - **Increased financial market volatility**
  - **Political fallout**
  - **Increased consumer and business caution**
  - **Media madness**

X-Date 2023: Exacerbating Factors

- **Fed is well into rate tightening cycle**
- **3 of the 4 largest banks failures in history have just occurred**
- **Increased political polarization**

The Last Word on the "R" Word

- **Recession has no discernable impact on WC or overall P/C underwriting performance, based on data over the past 50 years**
- **Recession has an adverse impact on Commercial Lines NWP growth rates, though magnitude varies w/state of the underwriting cycle (Hard/Soft market)**
- **ROEs are also impacted by recession (often via investment income effects)**
- ***Current banking "crisis" increases likelihood of recession***
  - ***Primarily through a contraction in credit***
- **A recession in 2023 will likely:**
  - **Lead to a deceleration in Commercial Lines NWP growth**
  - **Take some pressure off the current hard market as demand for P/C insurance slows**
  - **ROEs will likely rise (assuming "normal" underwriting performance) due to rising investment income**
  - **No repeat of Financial Crisis, but beware the "X-Date"**

The U.S. Inflation Threat

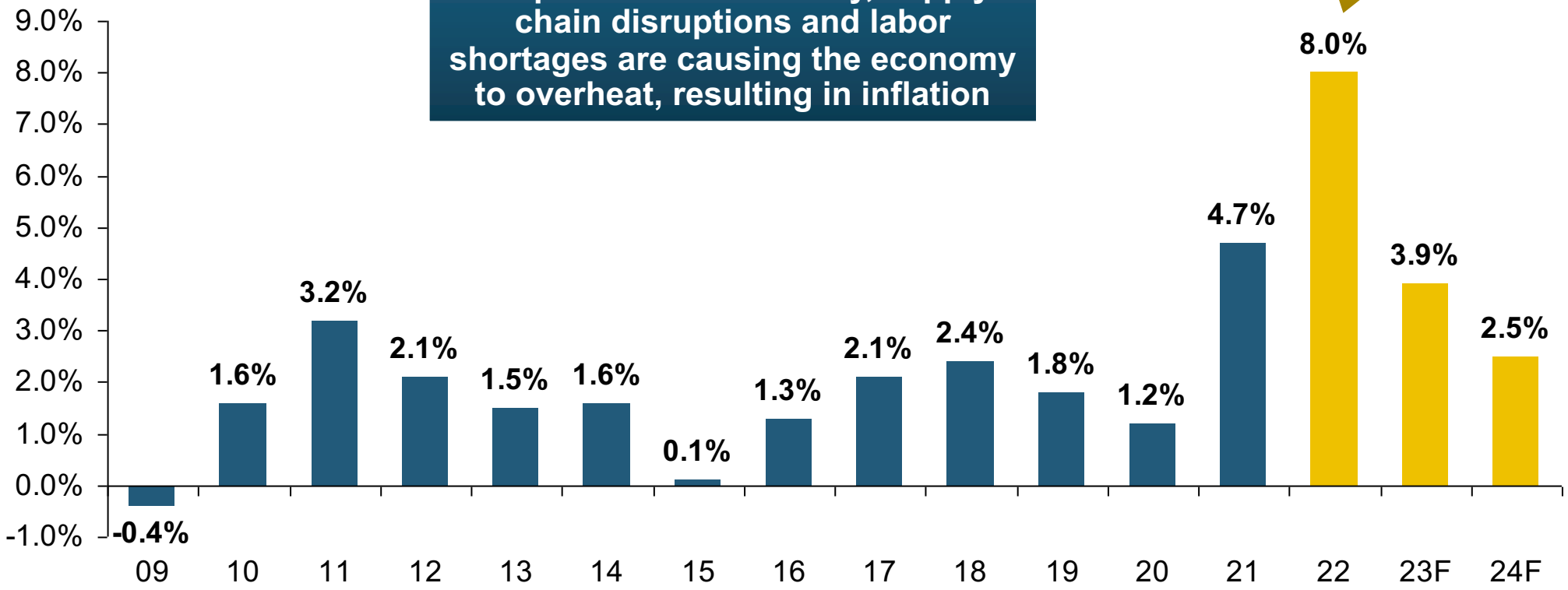
Inflation is the #1 Concern of U.S. Consumers and Corporations…

It's Also a Major Concern of Insurers

U.S. Inflation Rate: 2009-2024F*

Inflation accelerated sharply in 2021 before peaking at 9.1% in June 2022. Inflation should moderate through 2023/24; 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



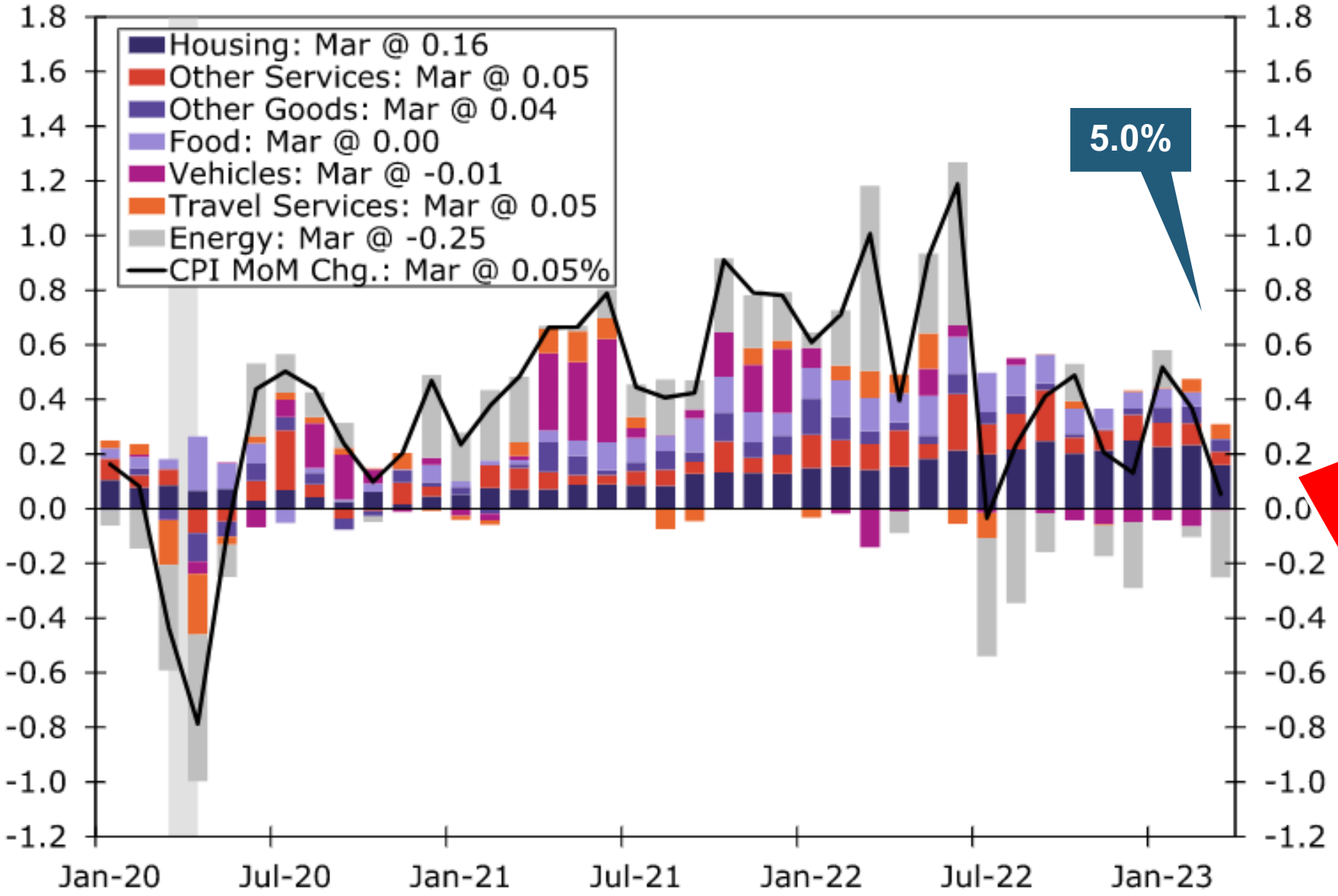
Insurer Concerns About Inflation

- **Rate Inadequacy**
- **Reserve Inadequacy**
- **Insurance-to-Value**

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

Source: U.S. Bureau of Labor Statistics; Wells Fargo Securities (4/23); USC Center for Risk and Uncertainty Management.

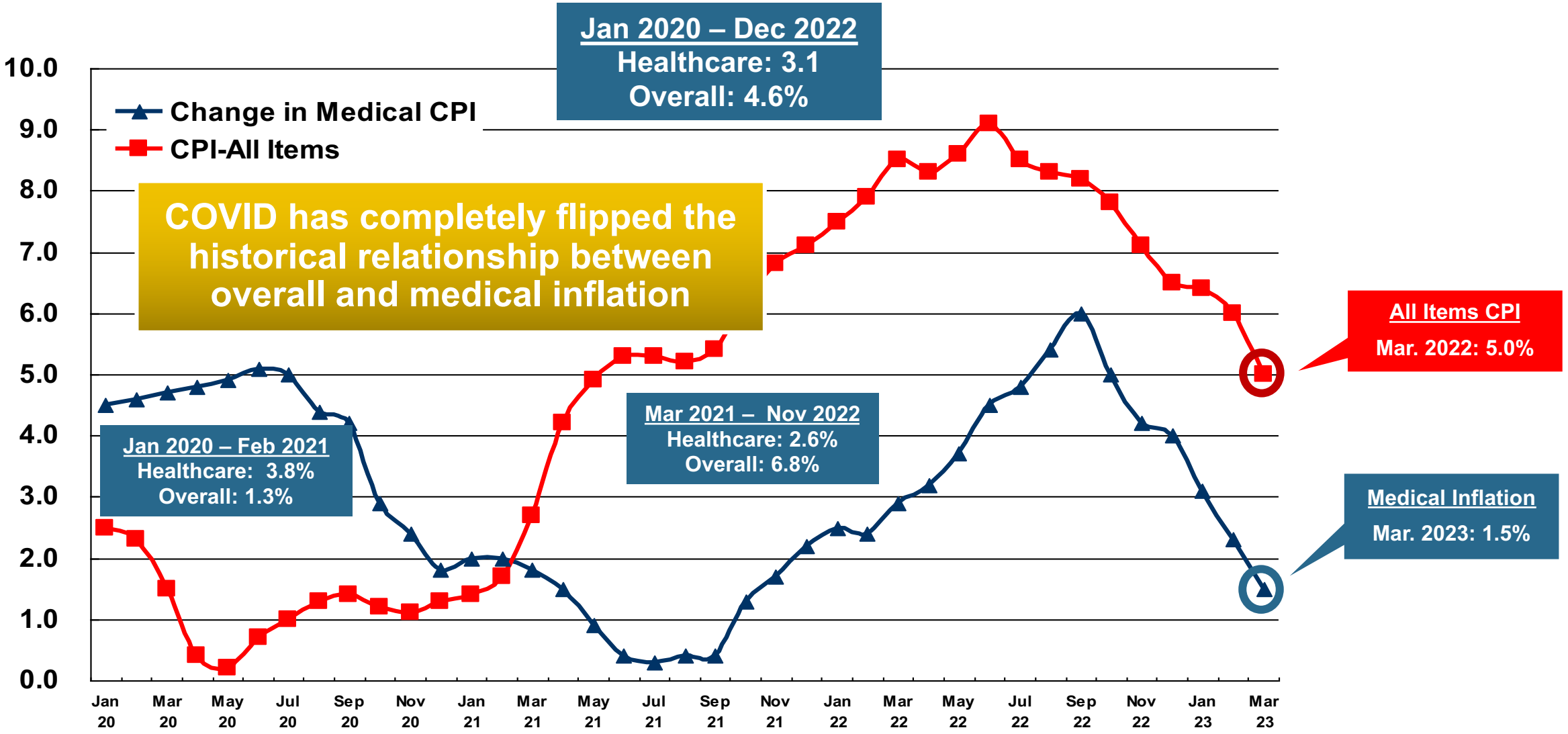
Contribution to CPI by Category: March 2023



Prices were up 5.0% in Mar. 2023 vs. a year ago, down from the June 2022 peak of 9.1%. Even as energy prices recede fom their 2022 peak, increases in Housing, Food, and Other Services are the major obstacles to tempering inflation

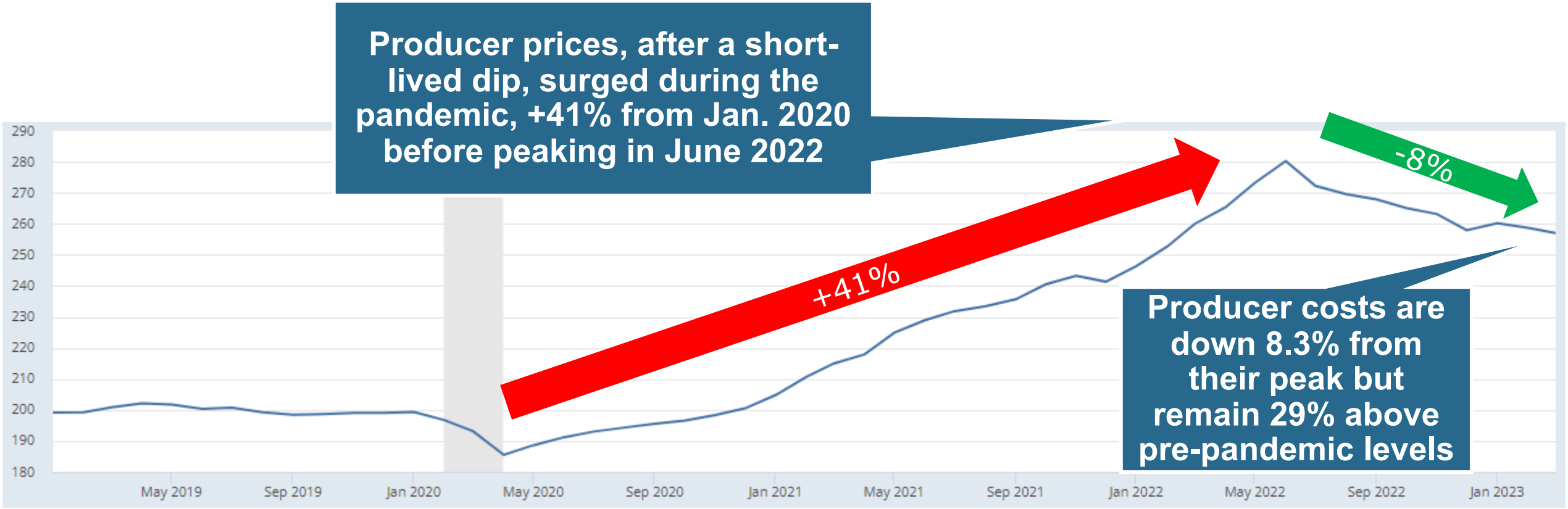
Source: U.S. Department of Commerce and Wells Fargo Economics.

Medical Cost Inflation vs. Overall CPI During COVID, Jan. 2020 – Mar. 2023 *(Percent Change from Year Ago)*



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

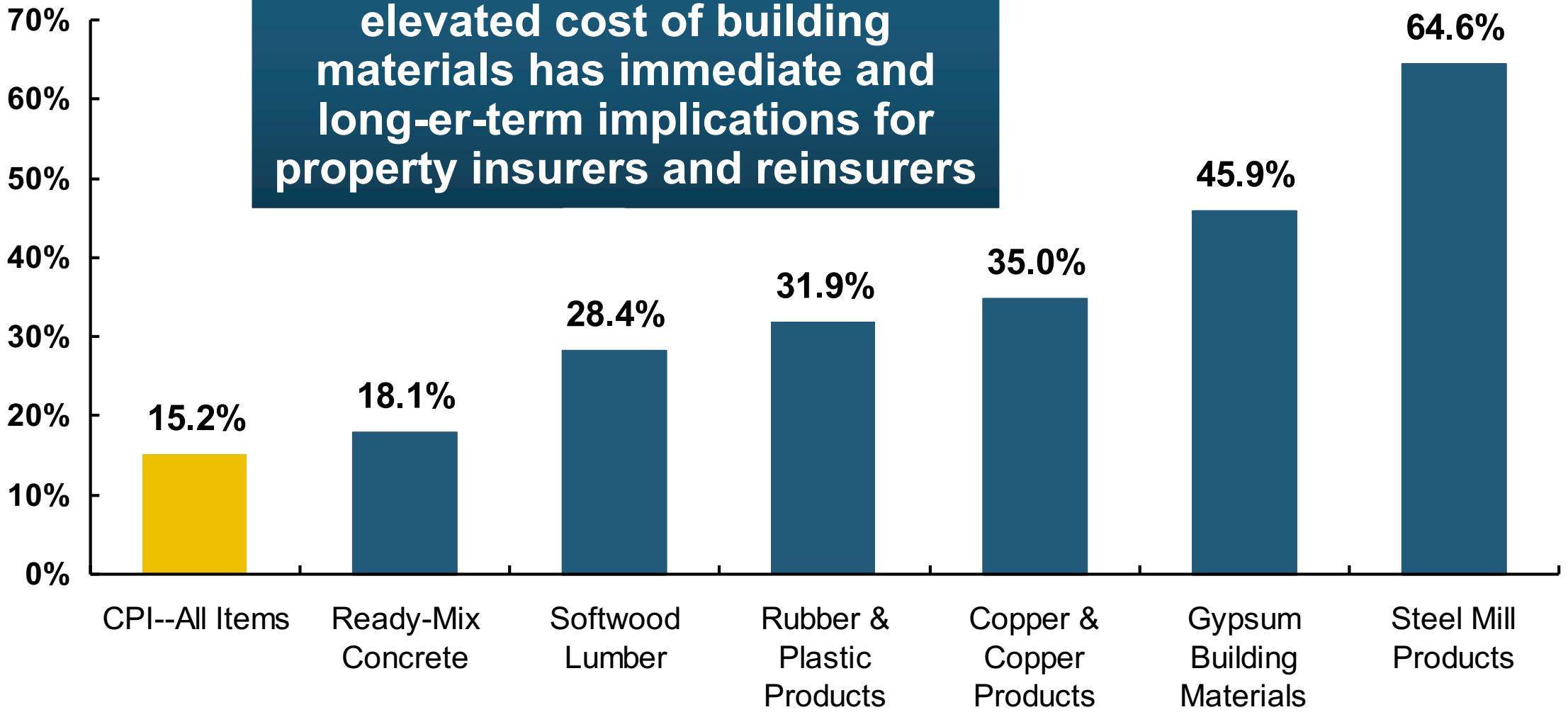
Producer Price Index
Jan. 2020 – Mar. 2023



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

Change in Cost Indicators for Selected Construction Inputs, Jan. 2020 – Dec. 2022

The rapid increase in and still-elevated cost of building materials has immediate and long-er-term implications for property insurers and reinsurers



Source: U.S. Bureau of Labor Statistics.

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

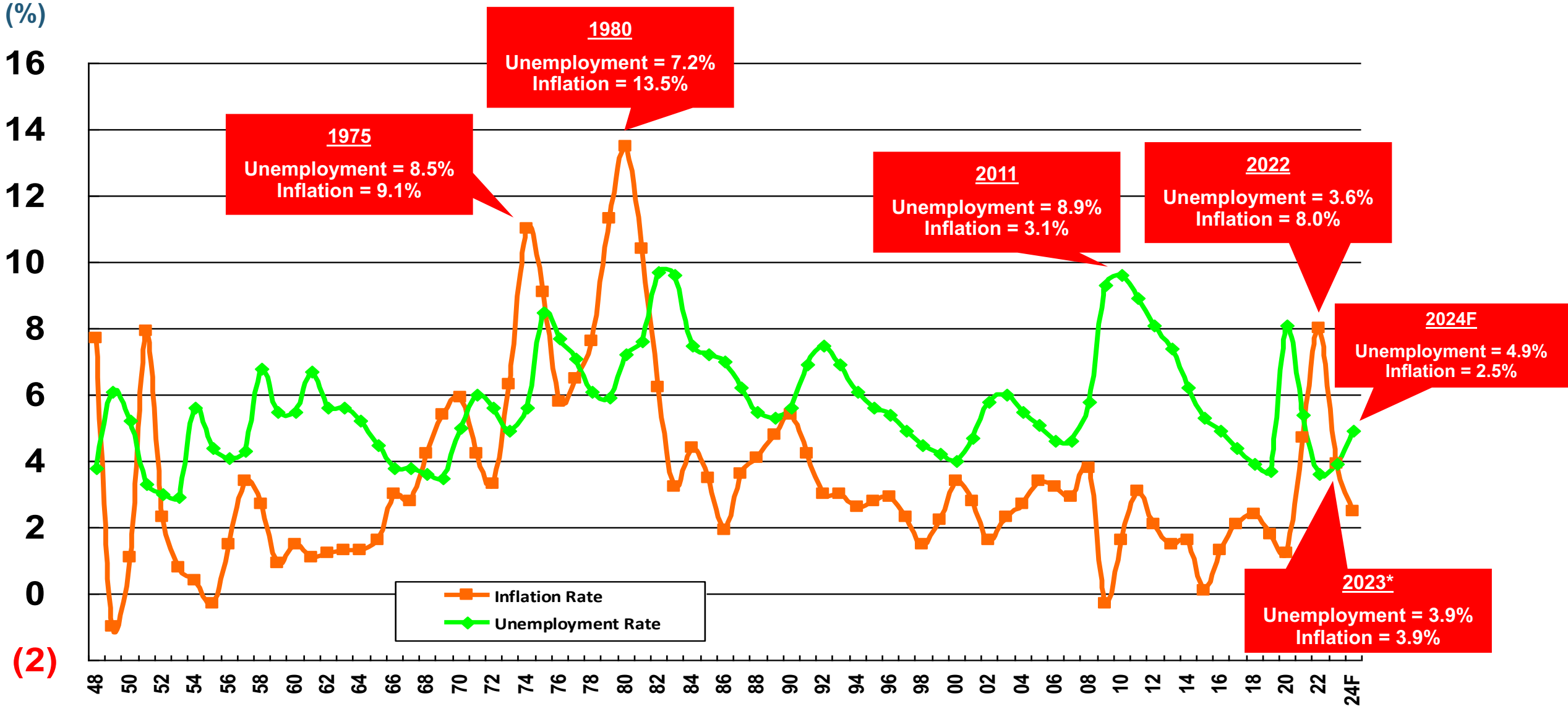
Sources: US Bureau of Labor Statistics; Risk and Uncertainty Management Center, University of South Carolina.

Are Things As Bad as Many *Still* Believe Them to Be?

Many Believed that We Were in a Recession in 2022—*We Weren't*

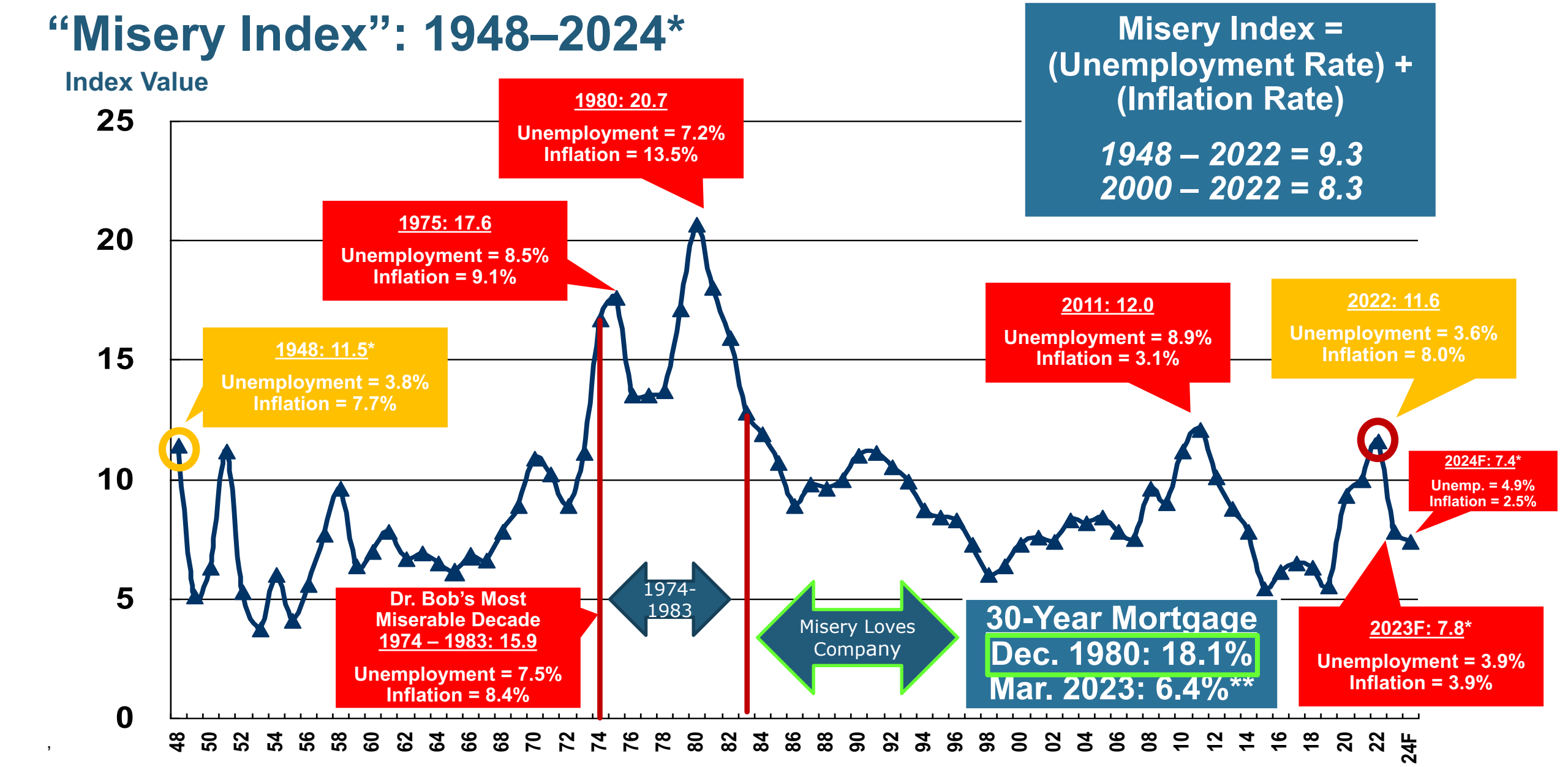
A Quick Review of Economic History Is Helpful

Inflation and Unemployment Rate, 1948–2024F*



*2023-24 forecast of unemployment and inflation rates based on Wells Fargo Securities forecasts (4/23).
Source: U.S. Bureau of Labor Statistics; Center for Risk and Uncertainty Management, University of South Carolina.

“Misery Index”: 1948–2024*



*Estimated based on Wells Fargo Securities forecasts (4/23).
**As of 3/28/23 based on Freddie Mac data.
Source: U.S. Bureau of Labor Statistics; Center for Risk and Uncertainty Management, University of South Carolina.

Legal System Abuse (Social Inflation) & Litigation Trends

Rising Litigation Costs Are a Concern for Businesses Large and Small—*and Their Insurers*

Major Driver of Rate Across Multiple Lines

67

Social Inflation: Many Interrelated Causes, Difficult to Manage

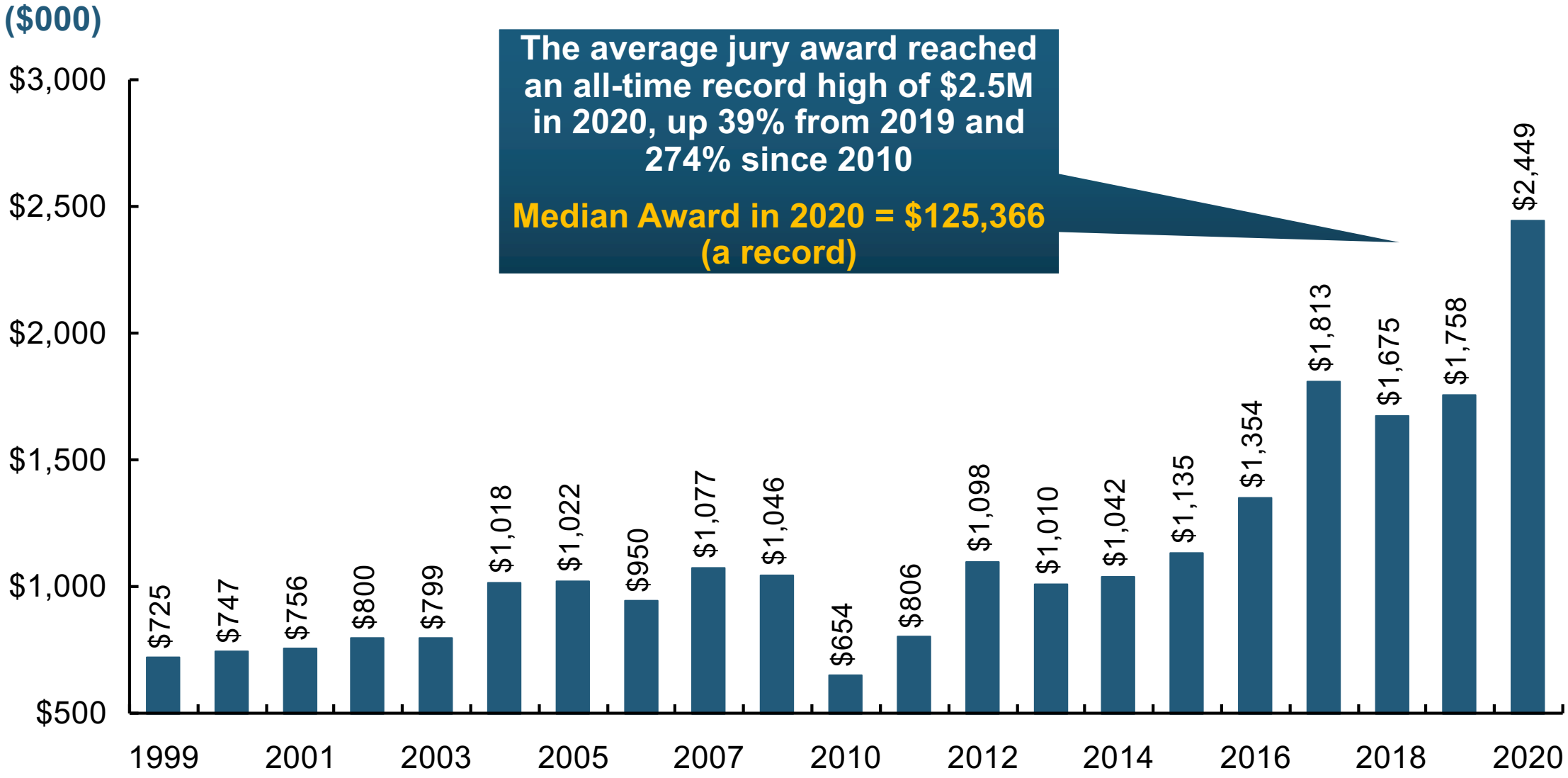
INSURANCE CLAIM COSTS

- Increasing Propensity to Sue
- Size of Jury Awards
- Courts/ Juries Favoring Plaintiffs
- Growing Distrust of Large Corps.
- Litigation Financing
- Aggressive Plaintiff Bar Ads
- Changes in Regulatory and Legal Environment Bar Ads

Applied to a seemingly limitless number of issues, these drivers are pushing tort costs (and therefore claim costs upward)

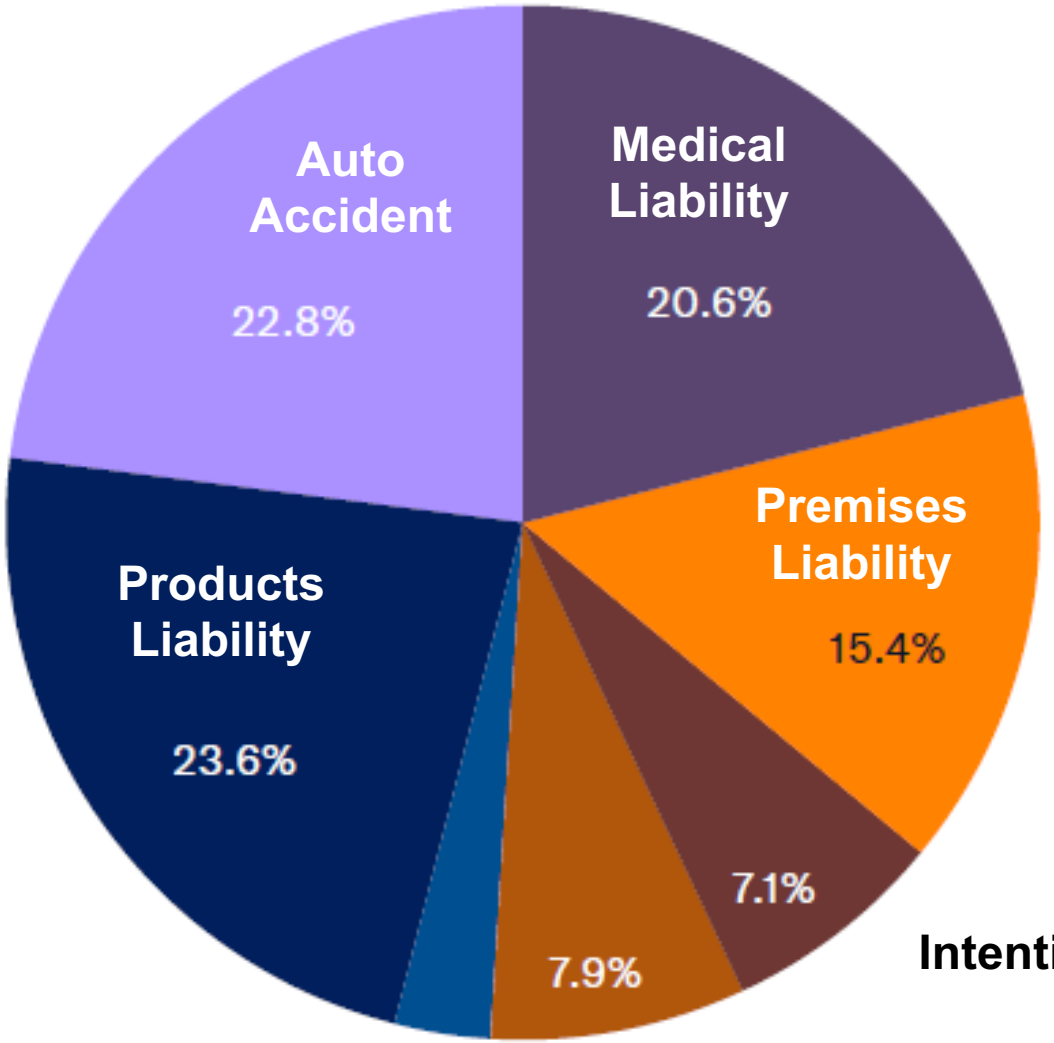
Source:Risk and Uncertainty Management Center, Univ. of South Carolina, adapted from Verisk “Social Inflation” presentation (2020).

Average Jury Awards, 1999 – 2020 (latest available)



Source: Jury Verdict Research; *Current Award Trends in Personal Injury* (61st Edition), Thomson Reuters; Risk and Uncertainty Management Center, Univ. of South Carolina.

Nuclear Verdicts by Case Type: 2010 – 2019*



Products, Auto and Medical Liability account for 2/3 of nuclear verdicts

**The ILR defines a nuclear verdict as a jury verdict of $10M or more.*

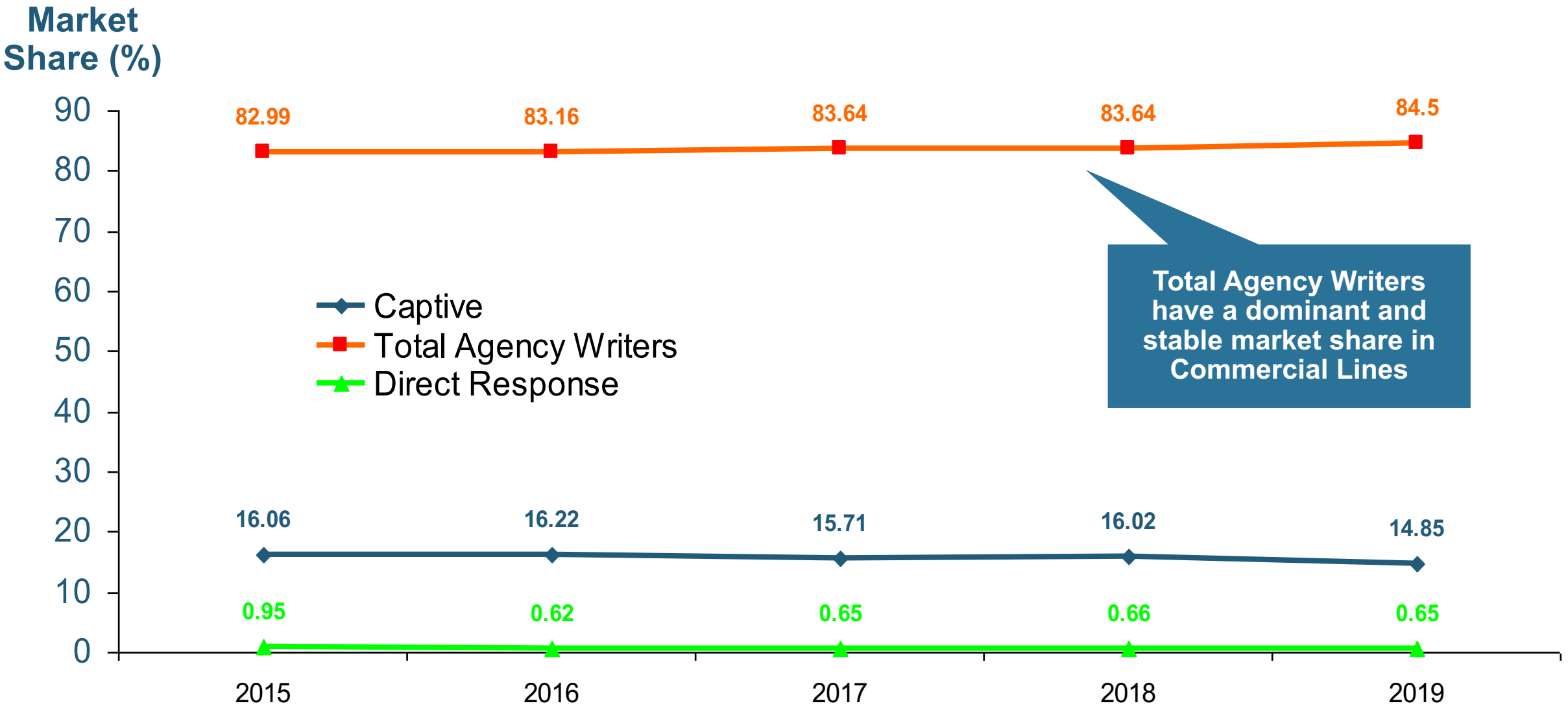
Source: US Chamber of Commerce Institute for Legal Reform (Sept. 2022), "*Nuclear Verdicts: Trends, Causes and Solutions,*" accessed at: https://instituteforlegalreform.com/research/nuclear-verdicts-trends-causes-and-solutions/. Risk and Uncertainty Management Center, Univ. of SC.

The Competitive Environment in P/C Insurance

Trends in Marketing, Branding and Distribution

72

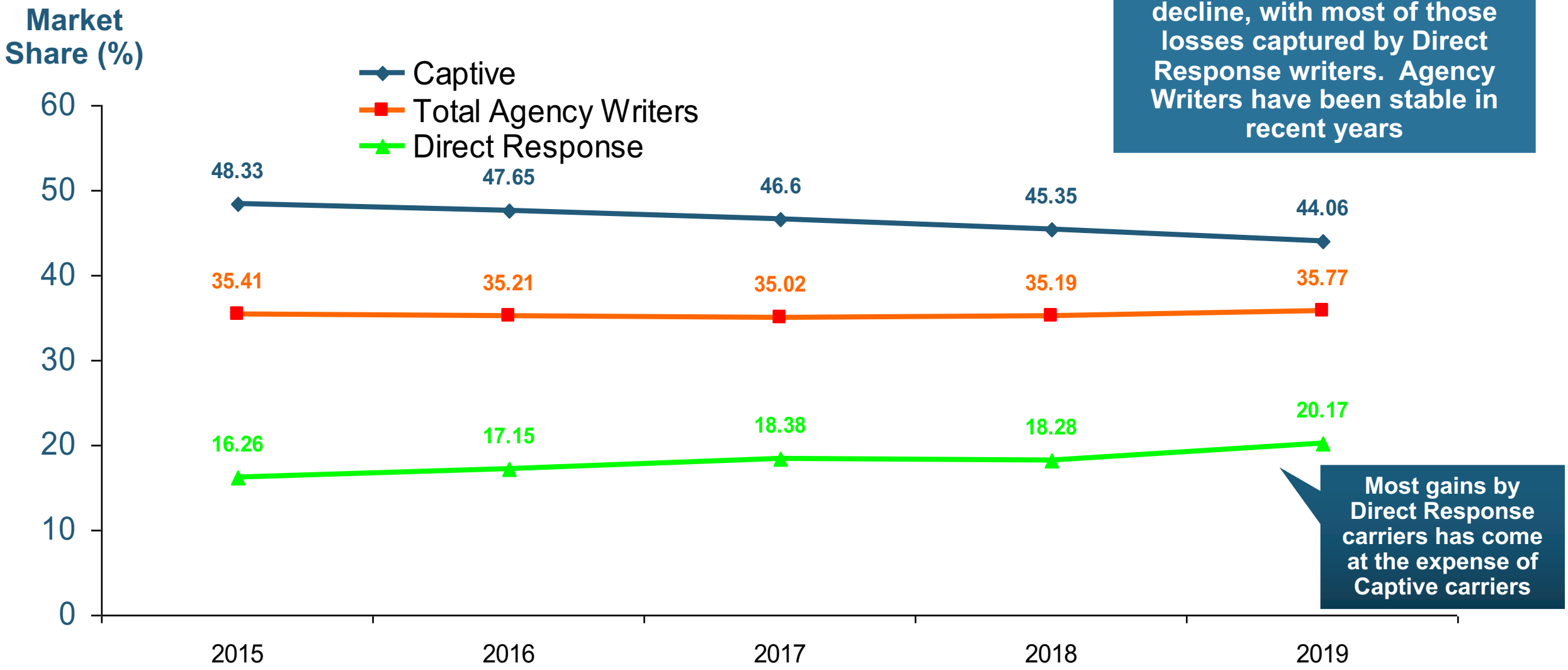
5-Year Market Share by Distribution Channel: *Commercial Lines*



Sources: 2020 Market Share Report (latest available), IIABA from A.M. Best data at https://www.independentagent.com/research/SiteAssets/MarketShareReport/default/2020-Market-Share-Report-BasedOn2019Data.pdf; University of South Carolina, Risk and Uncertainty Management Center.

5-Year Market Share by Distribution Channel: *Personal Lines*

Captive Agency market share in Personal Lines continues to decline, with most of those losses captured by Direct Response writers. Agency Writers have been stable in recent years



Most gains by Direct Response carriers has come at the expense of Captive carriers

Sources: 2020 Market Share Report, IIABA from A.M. Best data at https://www.independentagent.com/research/SiteAssets/MarketShareReport/default/2020-Market-Share-Report-BasedOn2019Data.pdf; University of South Carolina, Risk and Uncertainty Management Center.

Selected Important Trends

- P/C spending on advertising is falling sharply
  - Most major p/c insurers have cut back on ad spending, in part to lower expense ratios after most suffered poor underwriting results in 2022
  - Ad spend is down by an average of about 20% among many of the largest p/c carriers
- Insurtech firms for years have claimed to be "disruptors," but so far their market success is limited
  - Only 6-8% of P/C insurtech funding is carrier-related
- For years, pundits have claimed many P/C insurance products were at risk of becoming commoditized, but insurers continue to differentiate on criteria other than price:
  - Service Flexibility Convenience Financial Strength
- Technology, including AI, will continue to enhance consumer experience
  - Question of whether tech is a job killer or new tool for agents and insurers

SUMMARY

- **The P/C Insurance Industry Remains Strong, Stable, Sound and Secure**
  - **Commercial auto line remains challenged**
- **A Shallow Recession is Increasingly Likely Beginning in Q3 or Q4 2023**
- **Asset Price Volatility Will Persist as Inflation Uncertainty**
- **Banking Sector Problems Will Have Few Direct Impacts on P/C Insurers**
- **Higher Interest Rates Provide a Modest Tailwind for Investment Income**
- **Inflationary Pressures Will Persist in 2023, But Will Subside (Peak Reached in June 2022)**
- **Loss Cost Challenges Remain but Should Ease in 2023—Inflation, Supply Chain**
- **Legal System Abuse Issues Remain a Long-Term Challenge**
- **Commercial Lines IA Market Share Is Stable**

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