

# Insurance Executive Review

Market Commentary on Current Developments within the P&C Insurance Industry

## Recent Natural Catastrophe Events ... Catalysts for Change in Commercial Market Conditions Before Its Time?

Our forecast for a possible change in commercial risk pricing later in 2012 might be considered in jeopardy given the frequency and size of global catastrophe events during the first two quarters of 2011. While we don't think these events have been of sufficient size to alter our outlook, it is still early in 2011. If the size and frequency of events continue for the remainder of the year we could see earlier pricing changes than we anticipated. It is clear that the homeowners market will be under intense pressure as catastrophe reinsurance protection terms will tighten further. That may be somewhat different than what the commercial market may face unless the catastrophic events impact more commercial/industrial properties rather than residential communities. Let's take a look at where we are today.

Cost of Global Catastrophes- Who bears the real cost of these events?

These recent natural catastrophe events can leave a wide gap between the total economic and human costs of these casualties and the financial impact on the global insurance and reinsurance markets. The data below shows the events to date and can only be considered preliminary as the claim assessment and settlement process is still ongoing for most of them.

### Global First Quarter 2011 Catastrophe Losses (in millions of U.S. Dollars)

Date	Event	Location/Country	Economic Loss	Insured Loss
1-Jan	Floods	Australia	\$10,000	\$5,000
26-Jan	Floods	Saudi Arabia	\$800	\$80
31-Jan	Winter Storms	N/E United States	\$600	\$450 *
2-Feb	Cyclone Yasi	Australia	\$800	\$500
22-Feb	Earthquake	New Zealand	\$20,000	\$10,000
11-Mar	Earthquake	Japan	\$150,000	\$60,000
Total First Quarter			\$182,200	\$76,030
<b>Subsequent Events</b>				
26-Apr	Tornadoes	United States	\$8,000	\$3,000
22-May	Tornadoes+	United States	\$9,000	\$3,000

\*includes Federal Flood Program losses

+ based on very preliminary estimates

Note: amounts above are based on news reports and are subject to revision as further information from claims processing takes place

The "insured" losses may involve government sponsored insurance programs as well as those covered by the private P&C global insurance and reinsurance market. This would not include government disaster relief, loan programs or similar aid to assist disaster victims. In addition, the amounts indicated under "economic loss" include damage to infrastructure (roads/bridges) and other public facilities that do not carry insurance. It also in-

cludes uninsured properties, underinsured facilities and properties subject to deductibles or other self insured conditions. The history of global catastrophe events is very diverse on a year-to-year basis as the severity of a single event can vary from the "average" event as indicated below:

<b>History Of Global Catastrophe Losses</b>				
<b>(US\$ in millions)</b>				
	<b>2009</b>	<b>2010</b>	<b>2000-2009</b>	<b>1980-2009</b>
			<b>Average</b>	<b>Average</b>
# of Events	900	950	785	615
Overall Loss (in millions)	\$60,000	\$130,000	\$ 110,000	\$ 95,000
Insured Losses (in millions)	\$22,000	\$37,000	\$ 35,000	\$ 23,000
% insured of Total	36.7%	28.5%	31.8%	24.2%
Fatalities	11,000	295,000	77,000	66,000

Source: Munich re

The percentage of economic losses insured will depend on whether the event took place in a developed region of the world where insurance is an important aspect of commerce or in an undeveloped region where insurance and commerce are still in the development stage. For example, below is a summary of events in the U.S. between 1998-2005 causing at least \$1 billion of total loss noting that a higher percentage were insured than in the global data above.

**Sample of Major Catastrophe Events 1998-2005**  
**Losses of \$1 Billions or More**

<b>MAJOR EVENT LIST-BY YEAR</b>		<b>Billions in Nominal Dollars</b>			
		<b>Insured Loss</b>	<b>Federal Flood</b>	<b>Total Loss</b>	<b>Percent Insured</b>
4 Events	<b>2005 Total</b>	<b>\$ 57.5</b>	<b>\$ 16.8</b>	<b>\$ 159.0</b>	<b>46.7%</b>
4 Events	<b>2004 Total</b>	<b>\$ 22.7</b>	<b>\$ 3.3</b>	<b>\$ 45.0</b>	<b>57.8%</b>
4 Events	<b>2003 Total</b>	<b>\$ 4.3</b>	<b>\$ 0.6</b>	<b>\$ 12.5</b>	<b>39.2%</b>
1 Event	<b>2002 Total</b>	<b>\$ 0.1</b>	<b>N/A</b>	<b>\$ 2.0</b>	<b>5.0%</b>
3 Events	<b>2001 Total</b>	<b>\$ 3.3</b>	<b>\$ 1.1</b>	<b>\$ 8.9</b>	<b>49.4%</b>
1 Event	<b>2000 Total</b>	<b>\$ 0.2</b>	<b>N/A</b>	<b>\$ 2.0</b>	<b>10.0%</b>
3 Events	<b>1999 Total</b>	<b>\$ 4.3</b>	<b>\$ 0.5</b>	<b>\$ 8.9</b>	<b>53.9%</b>
5 Events	<b>1998 Total</b>	<b>\$ 3.9</b>	<b>\$ 0.4</b>	<b>\$ 10.4</b>	<b>41.3%</b>

Data Sources

"Total Loss": Federal Financial Exposure to Natural Catastrophe risk, J D Cummins Temple University (2007 Study Paper)

"Insured Losses": Insurance Services Office-Property Claims Service (data from private insurers)

"Federal Flood": US Department of Homeland Security- FEMA Agency

It should be noted that data in this exhibit for the single events in 2002 and 2000 involved wildfires where much of the loss was to national forest standing timber. Industry and government sources capture data subject to vari-

ous threshold levels that often causes the data to be different.

### U.S. Dependency on the Global Reinsurance Market

The U.S. based domestic retail insurance carrier market requires the support of the global reinsurance market as do various government sponsored direct and indirect programs particularly for windstorm in the southeastern part of the country. The concept of "market share" can give an insurer a leadership position in a given market but that may come with the realization that the aggregation of the risks being assumed could be subject to a catastrophe exposure jeopardizing the financial security of an insurer. The catastrophe events have wide geographical differences that depend on local natural exposure to windstorm (including cyclones), earthquake, wildfires, tornadoes, winter (ice) storms, floods and landslides. Over recent decades the U.S. population growth has been greatest in areas prone to catastrophes particularly in the southeastern states where exposure to Atlantic basin hurricanes is the greatest. This along with natural catastrophe losses in 2004 and 2005 made reinsurance a necessity to cover risk accumulations. As shown below nearly \$60 billion of outward alien reinsurance was purchased by U.S. carriers in 2009.

**US Reinsurance Premiums ceded to Alien Reinsurers by Country**  
**Affiliated and Unaffiliated Reinsurers**  
**Dollars in Millions**  
**2005-2009**

Rank	Country	<-----Unaffiliated Alien Reinsurers----->					<-----Affiliated Alien Reinsurers----->					Total Reins. 2009	% Affiliated 2009
		2005	2006	2007	2008	2009	2005	2006	2007	2008	2009		
1	Bermuda	\$8,908	\$8,982	\$11,102	\$11,402	\$10,013	\$18,590	\$18,474	\$19,371	\$20,813	\$22,612	\$32,625	69.3%
2	Switzerland	\$950	\$797	\$858	\$955	\$1,129	\$7,664	\$7,991	\$8,942	\$7,578	\$8,361	\$9,490	88.1%
3	United Kingdom	\$4,827	\$4,630	\$4,578	\$4,428	\$4,706	\$252	\$346	\$777	\$823	\$765	\$5,471	14.0%
4	Germany	\$1,529	\$2,582	\$2,569	\$2,793	\$2,490	\$9,401	\$2,005	\$1,463	\$1,222	\$781	\$3,271	23.9%
5	Cayman Islands	\$1,780	\$1,806	\$2,023	\$2,003	\$2,086	\$646	\$435	\$409	\$375	\$202	\$2,288	8.8%
6	Barbados	\$837	\$652	\$496	\$553	\$413	\$917	\$965	\$1,212	\$888	\$754	\$1,167	64.6%
7	France	\$600	\$352	\$424	\$434	\$378	\$293	\$338	\$357	\$296	\$228	\$606	37.6%
8	Canada	\$211	\$256	\$326	\$255	\$277	\$173	\$171	\$209	\$175	\$181	\$458	39.5%
9	Turks and Caicos	\$382	\$398	\$481	\$518	\$500	\$157	\$156	\$102	\$111	\$141	\$641	22.0%
10	Ireland	\$788	\$532	\$419	\$485	\$489	\$90	\$518	\$427	\$155	\$227	\$716	31.7%
Total of Top 10		\$20,812	\$20,987	\$23,276	\$23,826	\$22,481	\$38,183	\$31,399	\$33,269	\$32,436	\$34,252	\$56,733	
All other		\$2,434	\$1,227	\$1,318	\$768	\$2,113	\$633	\$1,071	\$517	\$553	\$893	\$3,006	
Total (Global)		\$23,246	\$22,214	\$24,594	\$24,594	\$24,594	\$38,816	\$32,470	\$33,786	\$32,989	\$35,145	\$59,739	
% of Grand Total		37.5%	40.6%	42.1%	42.7%	41.2%	62.5%	59.4%	57.9%	57.3%	58.8%	100.0%	

Source: Insurance Information Institute/ RAA

Some of these alien reinsurers are affiliated with U.S. based carriers who cede the business to them and other reinsurers. In many cases these EOL or quota share cessions of business may involve retrocession to other global markets as reinsurers purchase their own spread of risk protections.

### Outlook for U.S. Catastrophe Events in 2011 off to a difficult start

The U.S. market has already suffered an unusual number of tornado events in April and May that if we were stop now would appear to equal all of 2010. We suffered winter storms that caused some \$450 million of insured losses in the first quarter which is well below our \$2 billion first quarter average (1998-2010). Our second quarter average insured catastrophe losses over the same 13 year period averaged \$3.77 billion with a high of \$7.11 billion in 2008. Well the April and May tornado insured loss season looks like this:

April per Risk Management Solutions.....\$3.5 to \$6.0 billion insured losses  
 May per AIR Worldwide.....\$4.0 to \$7.0 billion insured losses

Although these clearly are preliminary estimates, they may spell trouble ahead should the final tally come in at the higher end of the estimates and we start the hurricane season with any activity that should make landfall. As shown in the exhibit below we had a significant level of hurricane activity in 2010 with 12 hurricanes of which 5 were classified as intense storms but dodged a bullet as none of the storms made landfall in the U.S.

**HURRICANE FORECAST FOR 2011 SEASON  
EXTENDED/SEASONAL RANGE FORECAST  
Atlantic Basin Region**

Category (wind velocity)	2008 Actual	2009 Actual	2010 Actual	2011 Forecast Issue dates				1950-2000
				2011 12/8/2010	2011 4/6/2011	2011 6/1/2011	2011 8/4/2011	Average Season
Named Storms ( 39 MPH Minimum) <i>Named Storms Days</i>	16 84.75	9 27.25	19 88.25	17 85	16 80	16 80	TBD TBD	9.6 49.1
Hurricanes ( over 74 MPH) <i>Hurricanes Days</i>	8 29.50	3 11.25	12 37.50	9 40	8 35	9 35	TBD TBD	5.9 24.5
Intense Hurricanes** (111-155 MPH) <i>Intense Hurricanes Days</i>	5 8.50	2 5.00	5 11.00	5 10	4 10	5 10	TBD TBD	2.3 5

\*\* Category #3,4 and 5 hurricanes

**US LANDFALL STRIKE PROBABILITY FOR 2011**

Probability of one major (#3,4 or 5) Hurricane landfall	12/8/2010	4/6/2011	6/1/2011	8/4/2011	100 Year Average
<i>Entire US Coastline</i> ----->	73%	72%	72%	TBD	52%
<i>US East Coast including Florida</i> ----->	49%	48%	48%	TBD	31%
<i>Gulf Coast from Fl Panhandle to Brownsville Tx</i> ----->	48%	47%	47%	TBD	30%
<i>Major hurricane landfall risk in the Caribbean</i> ----->	62%	61%	61%	TBD	42%

Source: Phillip Klotzbach and William Gray, Colorado State University; June 1, 2011

The forecast above suggests an “above average” season and the prospect of having this achieved along with all storms missing U.S. landfall remains a low probability. If we should see a \$10-15 billion event early in the season the reinsurance market could get more difficult before year-end but a \$20+ event could be more disruptive to the retail market. The former would certainly take commercial rates out of negative growth position whereas the latter might cause rates to spike into positive increases. If we dodge a bullet again commercial rate activity will not move upward until later in 2012 when the earnings support from the so-called claim reserve redundancy benefits has been exhausted and underwriters are forced to show underwriting results on years of underpriced business without hiding behind investment gains.

So brokers should be preparing clients not just for more rate reductions and enhanced insurance coverage benefits, but rather advising on a strategic plan for when (not if) the cycle goes the other way. Underwriters are now “talking-up” the potential increase in commercial rates but this is not yet universal until the financial pain is widespread and we are not there yet. The combination of a meaningful downdraft in their capital position, some serious red ink and poor earnings outlook are the ingredients to bake this cake. This against a background of renewed global economic uncertainty may present significant issues in moving that cake off the shelf!

( For more on the subject of catastrophe losses go to our website and look for Newsletters #22, 24 and 34)



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