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FIRST Insurance Funding
A Wintrust Company

State of the Insurance Industry

Treasury Management Essentials
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Conquistador Hernando Cortez

Aztec Empire Conquered November 18, 1519



Hernando's Conquest:

- Conviction of mission: Take the Aztec Empire
- Organic creation of army: Accumulated followers while in route
- Amassed army of twenty horses, ten cannons, 600 men
- At Port Vera Cruz, Cortez burned his ships to reinforce commitment; eliminate retreat
- Cortez Army invaded the Aztec Empire populated by more than 5 Million people
- The Aztec Empire's regime failed to defend
- Cortez conquered the Aztec Empire and imprisoned Aztec Emperor Montezuma



What Cortez did not know:

The Aztec interpretation of astrological signs that predicted an eventual collapse

Myth that a god with light skin was to return and destroy the Aztec Empire

Outbreak of an epidemic that weakened the Aztec warriors

Burn the Ships

The Hernando Cortez Commitment

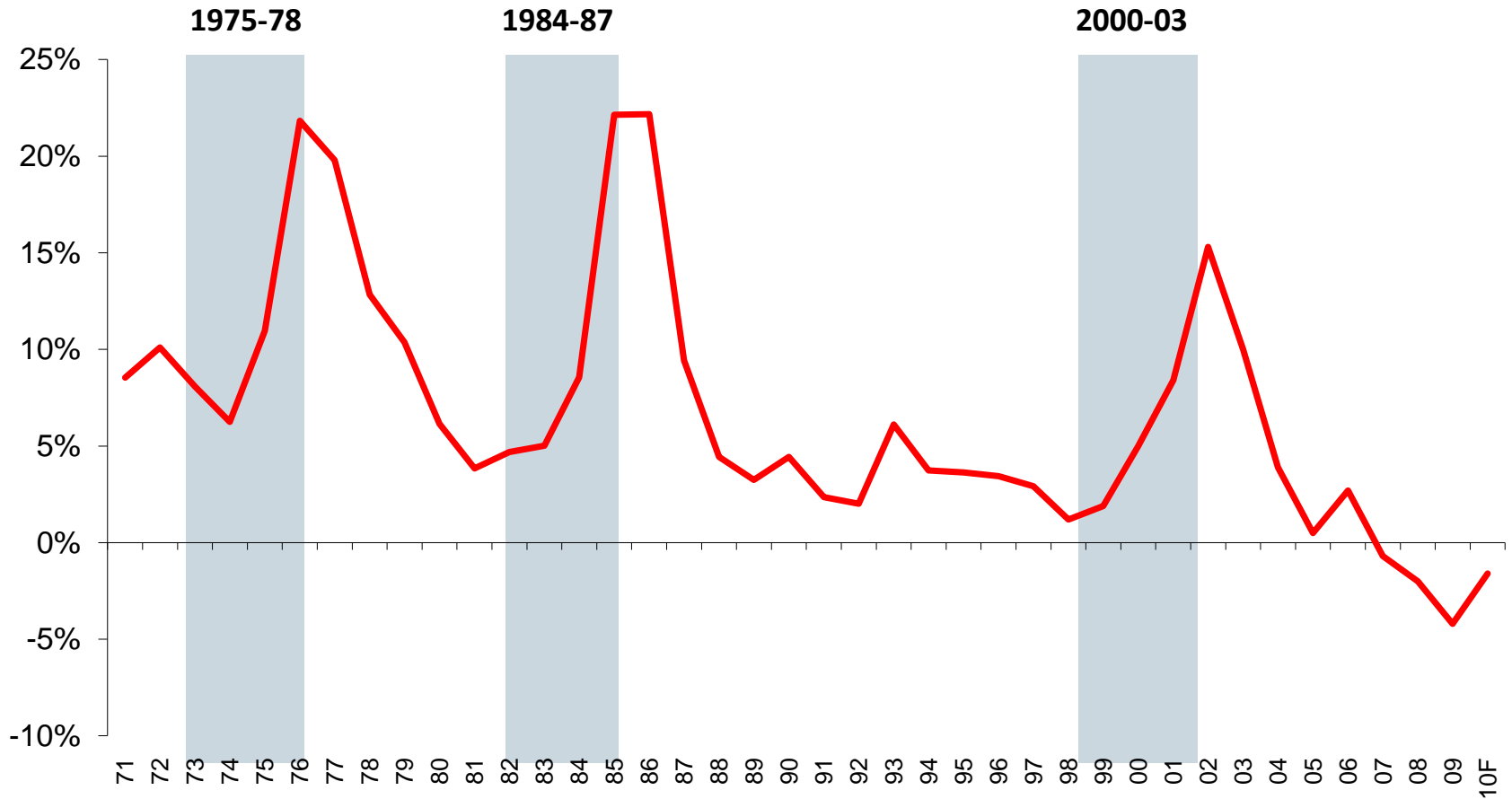


1. Unwavering clarity of mission
2. Made the impossible decision and dealt with the fall out
3. Created systemic spread of conviction
4. Created unity around mantra "failure is not an option"
5. Obstacles to mission were converted to assets or eliminated
6. The inability to turn back reinforced widespread perseverance
7. No potential for retreat by leadership or followers
8. Execution of a plan to succeed irrespective of enemy strength



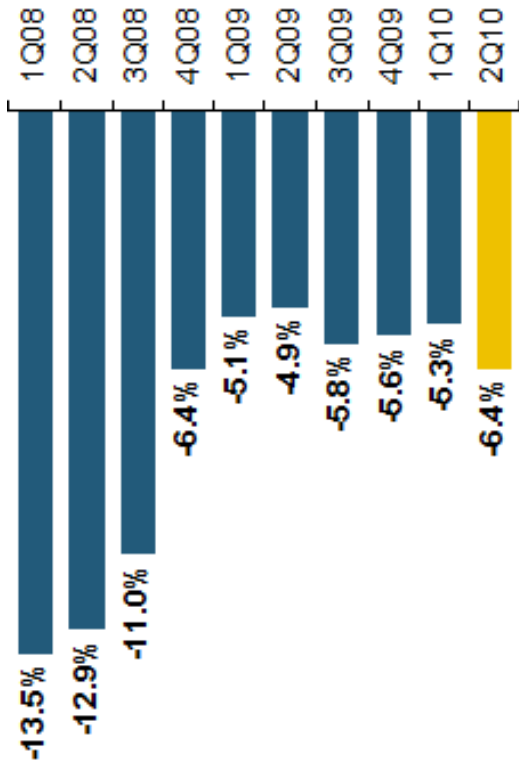
Waiting for a Hard Market?

Forty-Year Soft Market



Commercial Lines Rates

Short Term Reversal?



Hardening

1. Limited Redundant Reserves
2. Poor Return on Equity
3. Exposure Base Decline
4. Weak Economy

Softening

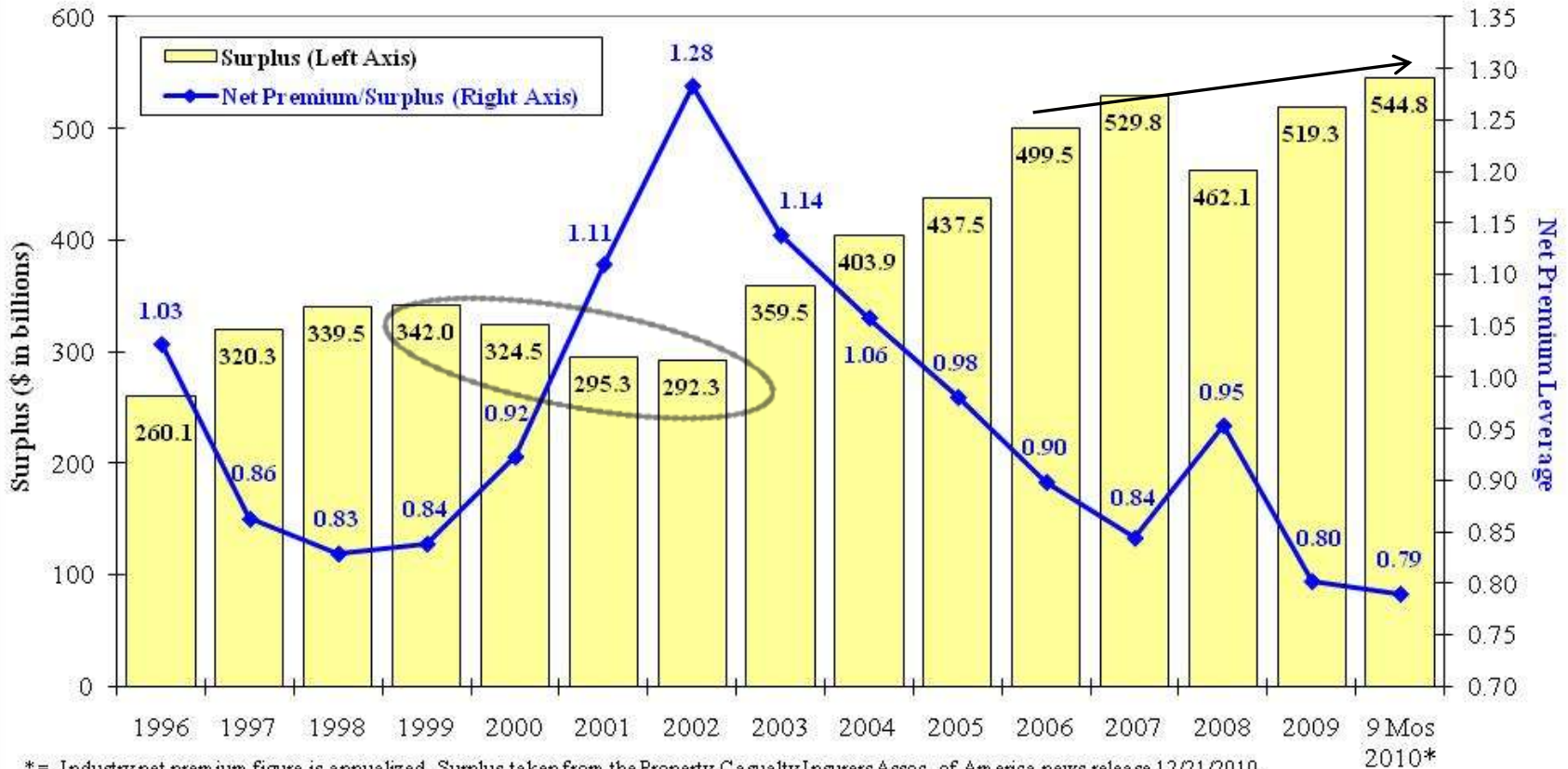
1. Low Catastrophic Losses
2. Reinsurance Market Soft
3. Bulging Surplus



Surplus (Capacity) and Premium Leverage



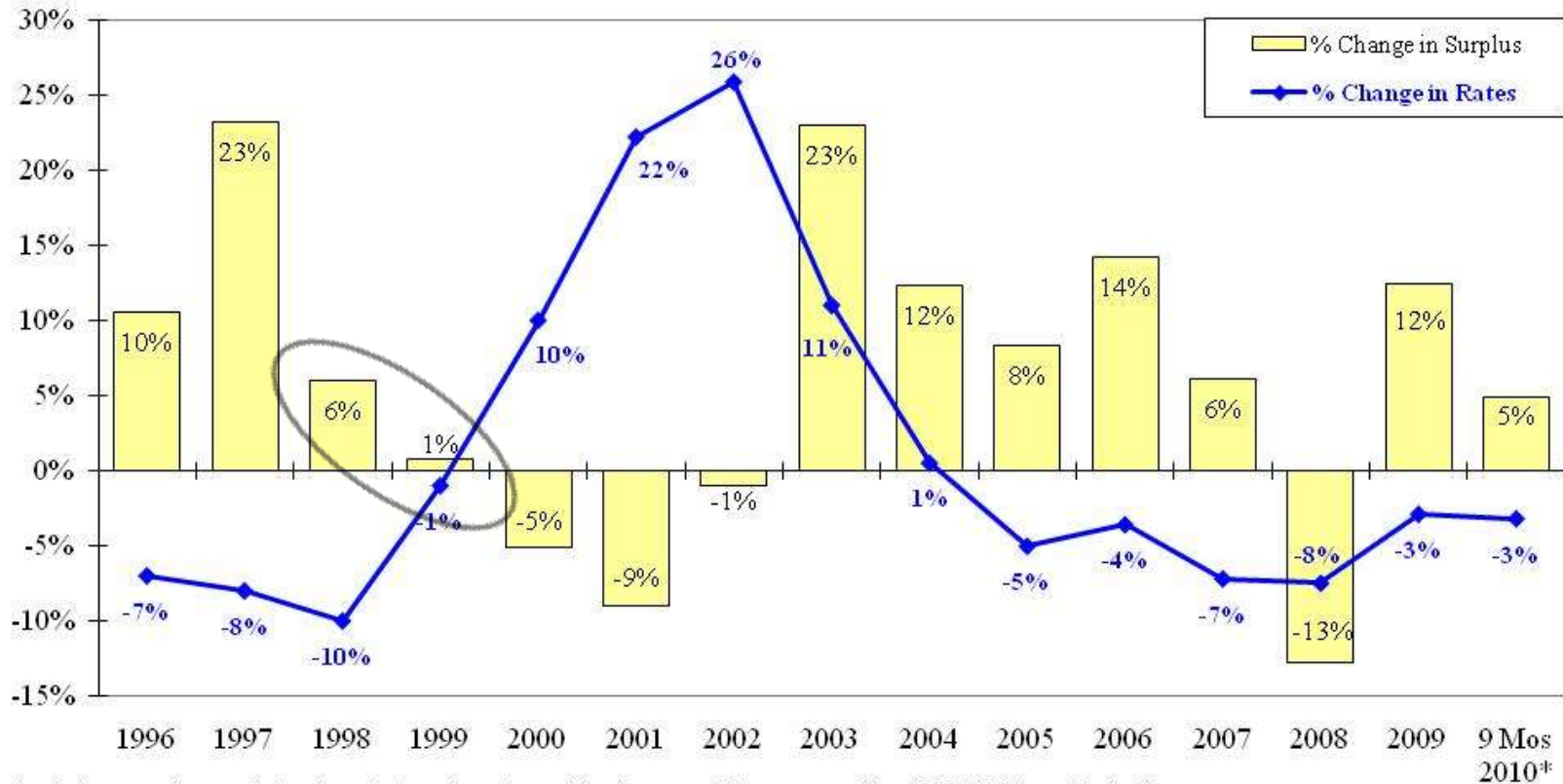
P&C Industry Surplus and Net Premium Leverage



Surplus (Capacity) and Rates



Percent Change in P&C Industry Surplus and Premium Rates



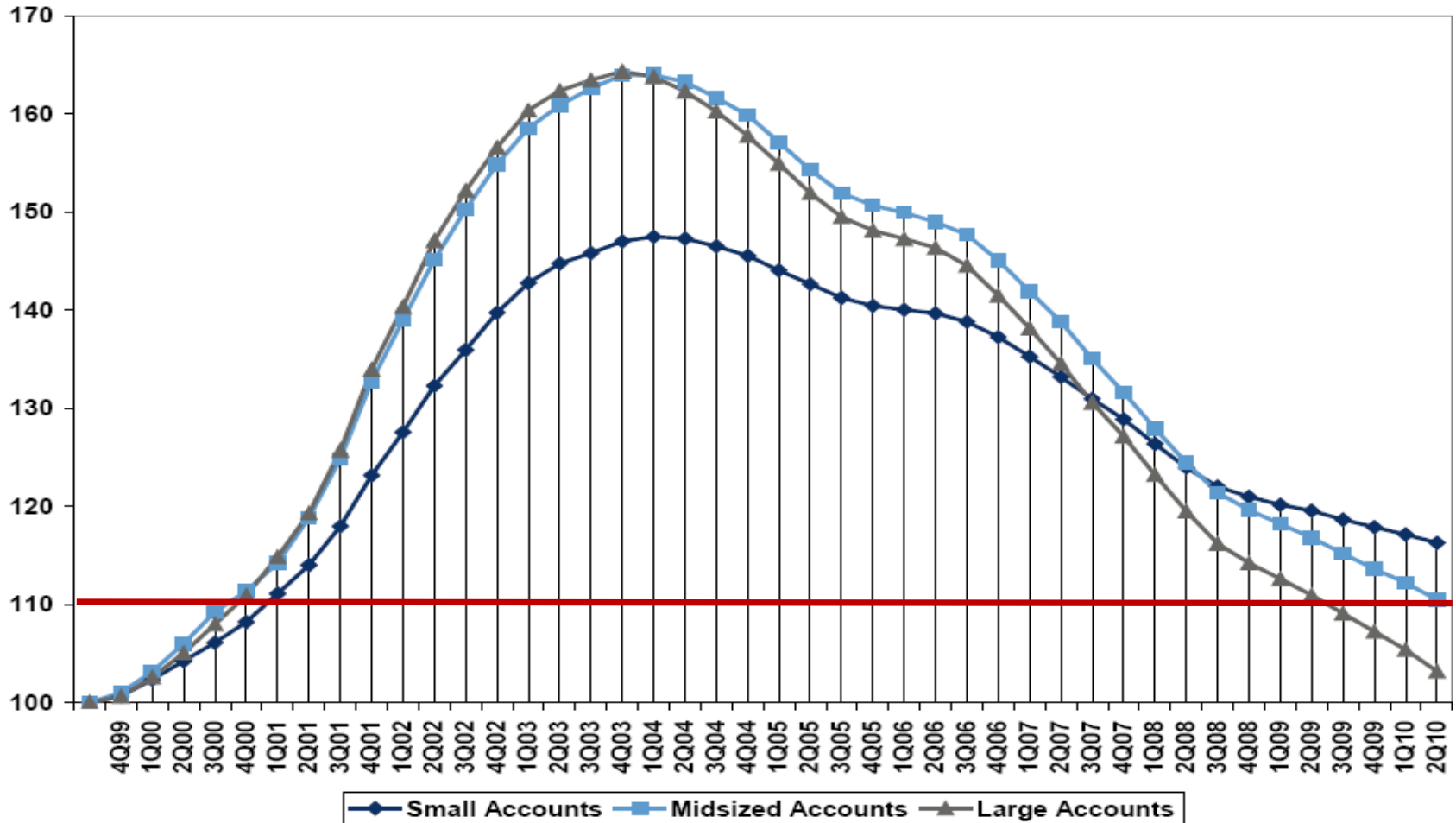
* = Industry surplus growth is estimated. Rate change is a weighted average of figures reported by CIAB, CLIPS and MarketScout.

Back Where You Started

The Lost Decade of Premium Growth

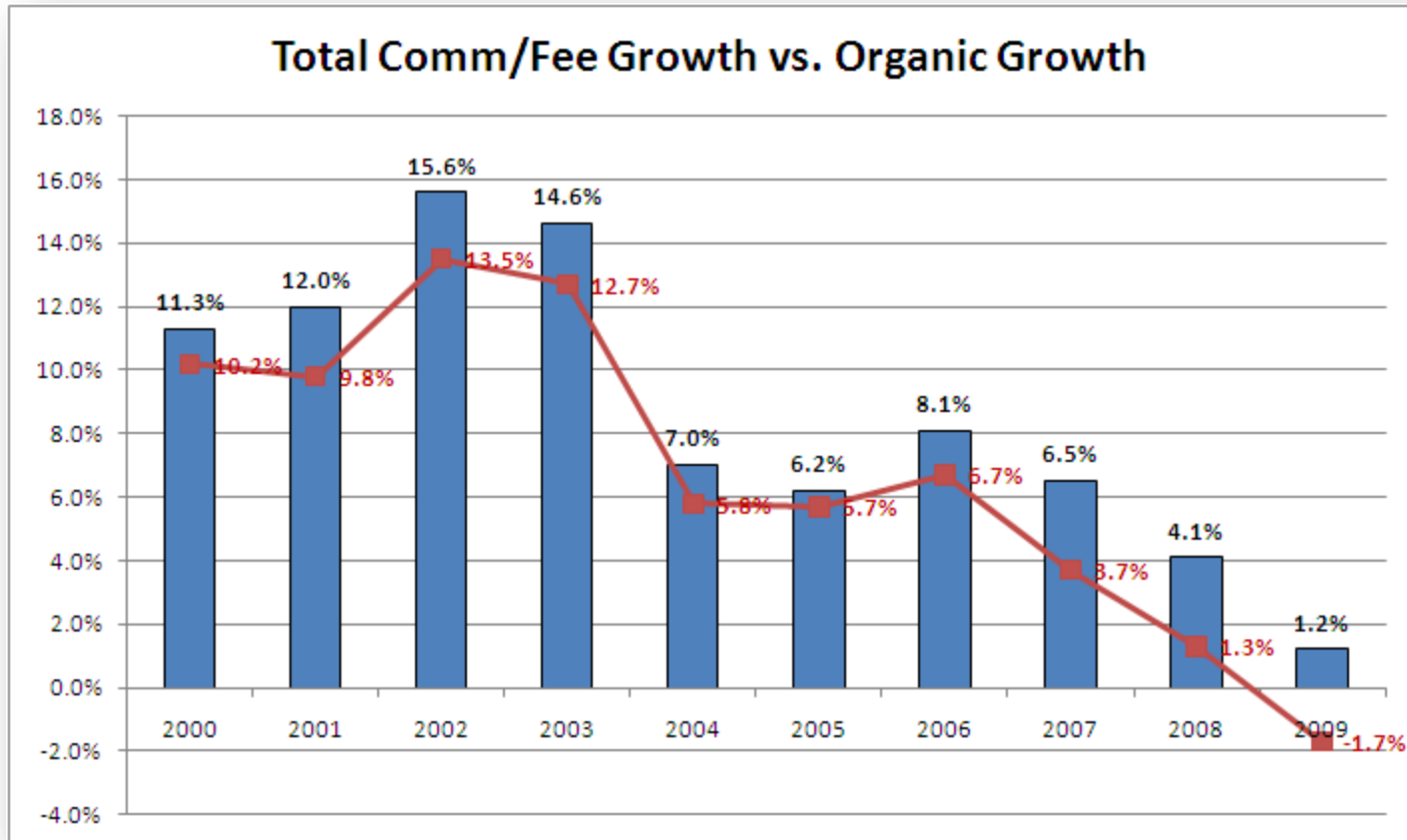


Cumulative Quarterly CL Rate Changes



Disintegrating Growth

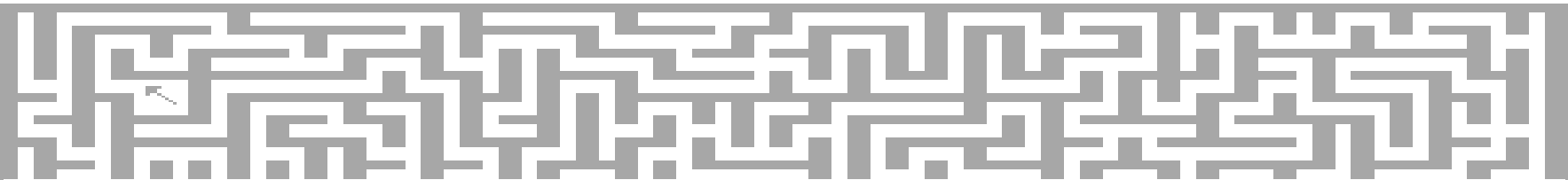
Independent Agencies Growth Rates



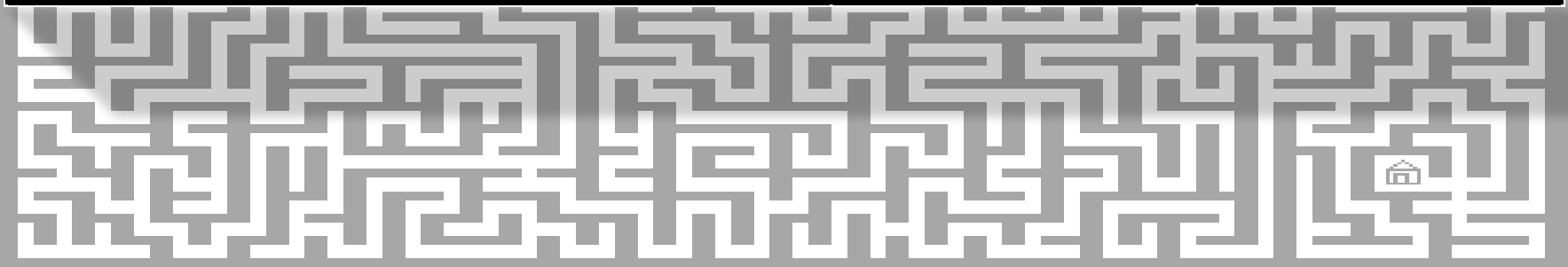
Data reflects growth of U.S.-Based Brokerage Business

The Organic Growth Maze

New Business Production



Trailing 12 Months as of 6/30/10	Bottom 80%	Top 20% High-Growth
New Business as % Prior Year Comm. & Fees	12.1%	20.1%
Less: Leakage (Rate, Retention, Compression)	16.0%	15.6%
Equals: Organic Growth	-3.9%	4.5%

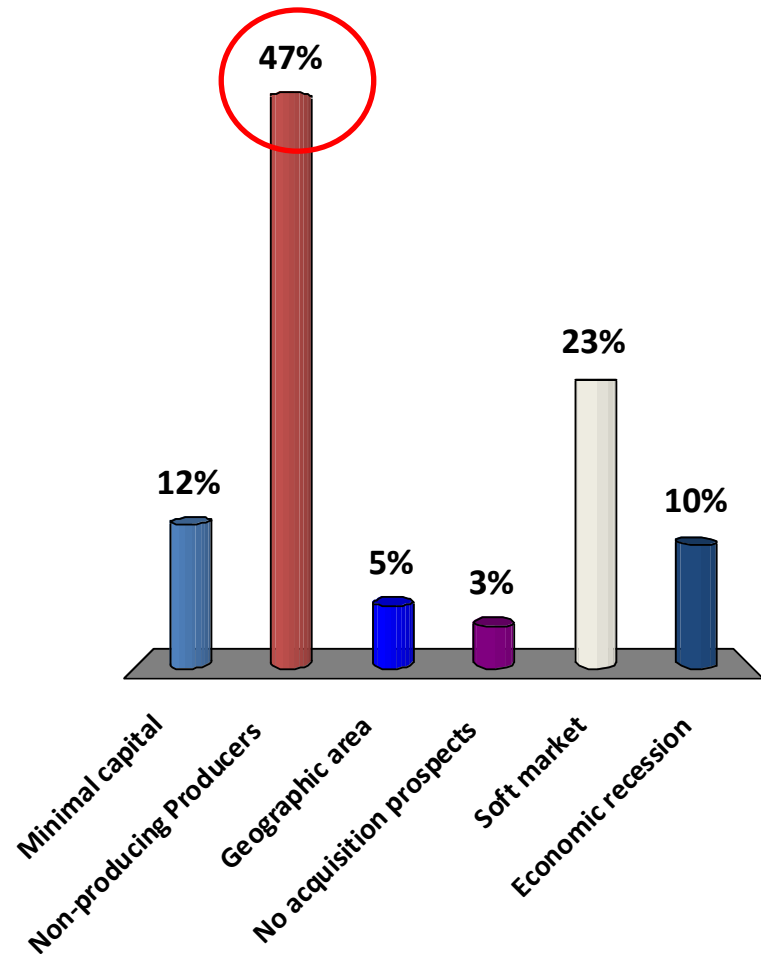


Growth

What is the industry's single largest obstacle to growth over the next 3 years?



- A. Minimal capital
- B. Non-producing producers
- C. Geographic area
- D. No acquisition prospects
- E. Soft market
- F. Economic recession



What is Your Battle Plan?

Predictable, Profitable Organic Growth



Continue

1. Accountability
2. Pipeline
3. Producer Reinvestment

Commit

1. Manage to Critical Performance Indicators
2. Systematic Staff Reinvestment
3. Proactive Company Management
4. Eliminate Driftwood
5. Create Capacity for Producers
6. Plan for Perpetuation or Sell
7. Control your Destiny

Typical Success

220 Producers Hired During 1998 Average Age 42



<u>1998 Producer Hires</u>	<u>Total Hired</u>	<u>1st Yr. Retained</u>	<u>5th Yr. Retained</u>	<u>9th Yr. Retained</u>	<u>9th Yr. Owners</u>
Producers Hired	220	152	99	73	26
Percentage	100%	69%	45%	33%	12%

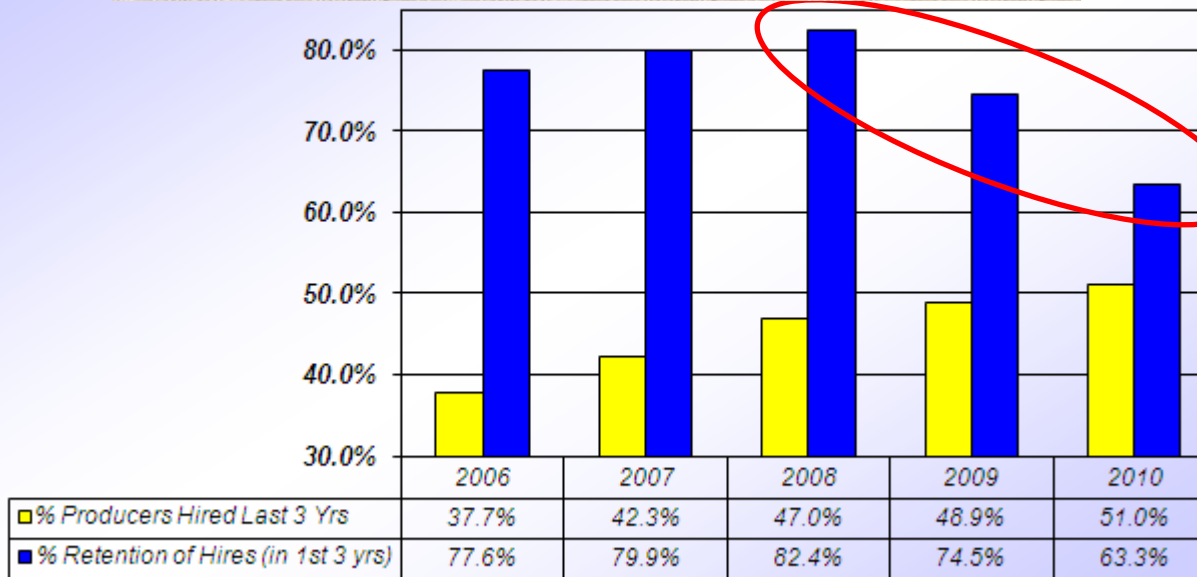
9 Year Process: Only 33% Retained: 12% Owners

Producer Reinvestment

Cut Weak and Reinvest in Young Buck



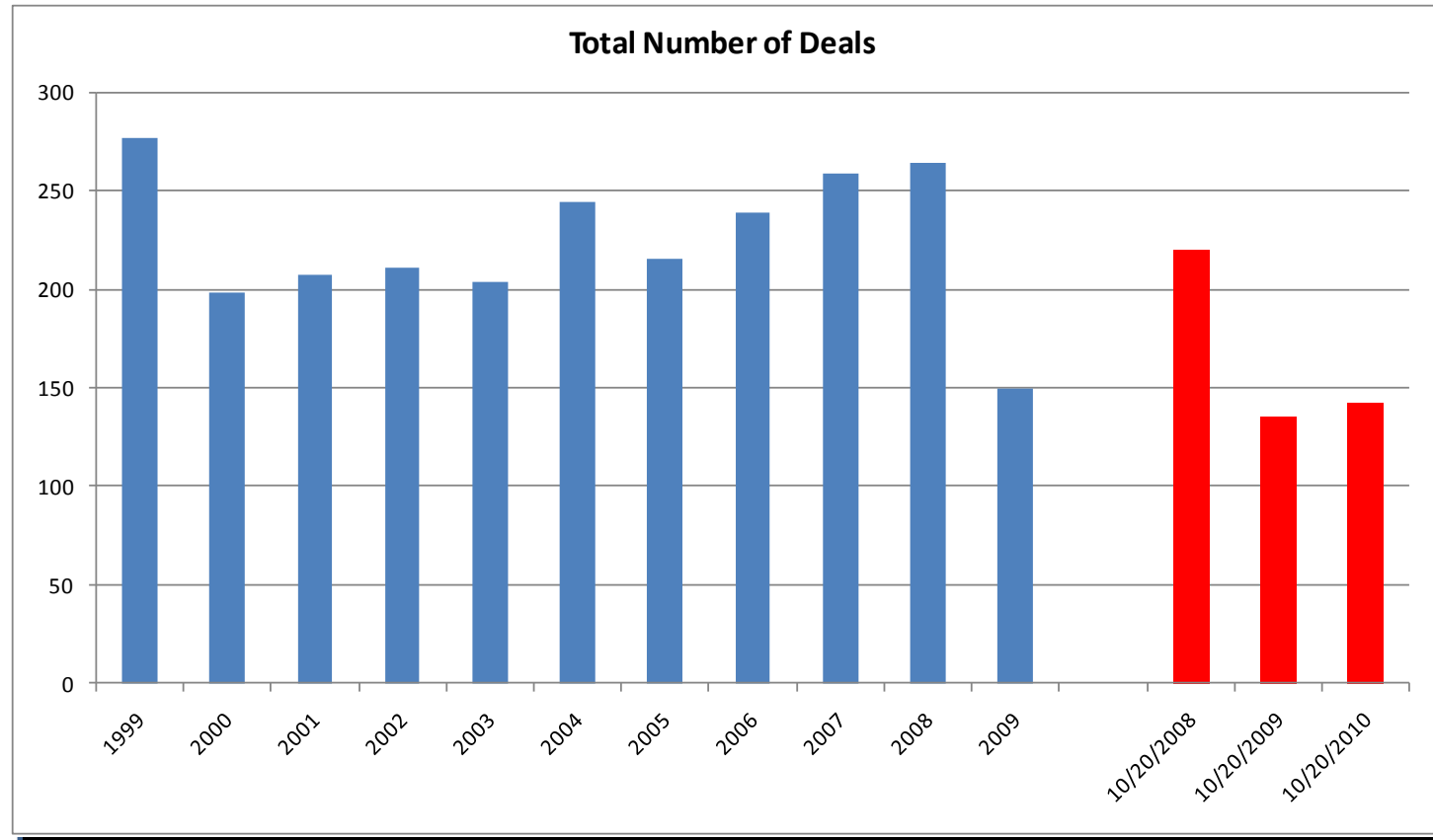
Large Agency Organic Growth Study Group:
40 Agencies, Average Revenue of \$30M



Cutting cord on fledgling hires earlier in the process.

2010 Deal Count Up

(4th quarter intense)

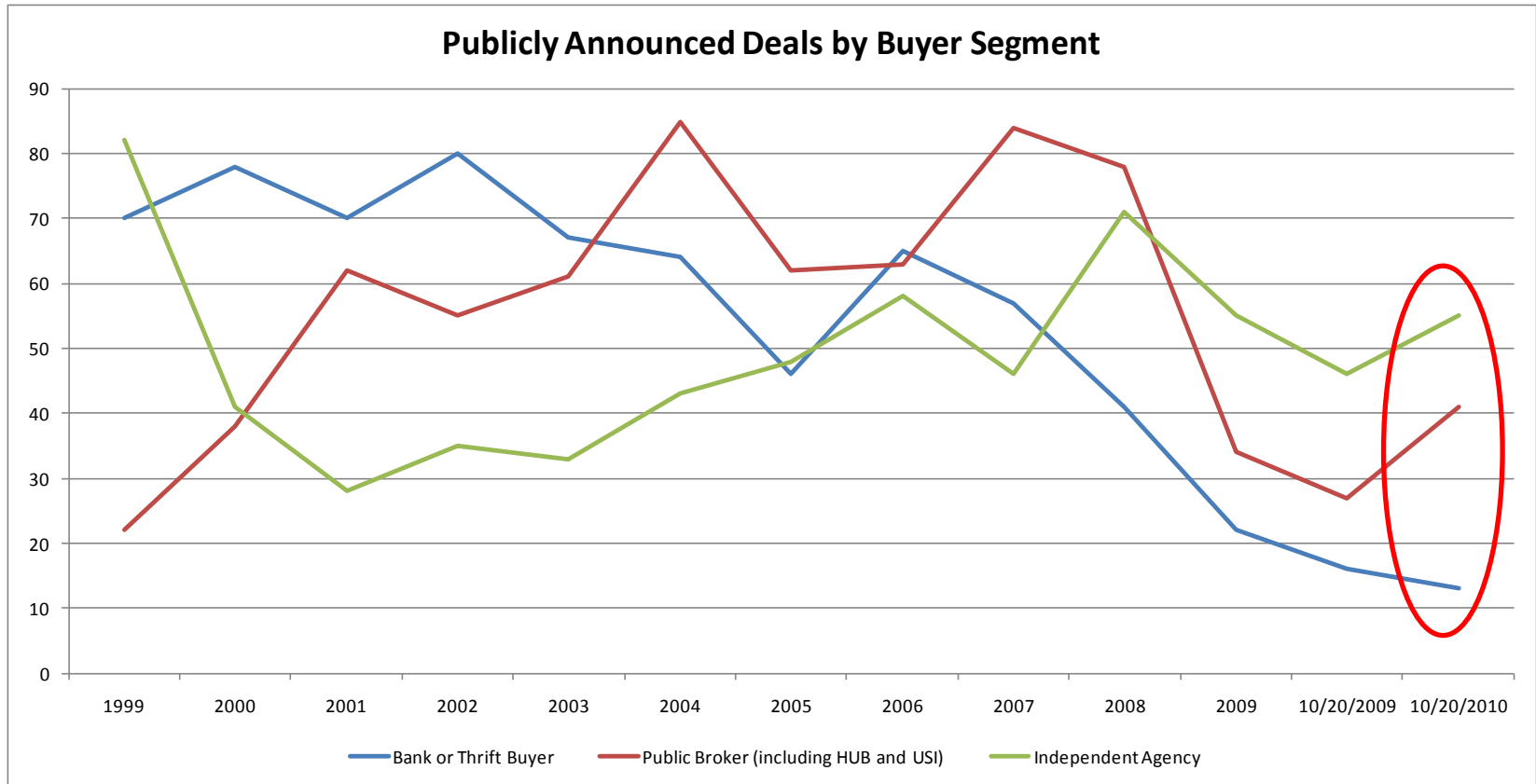


Transaction Activity

Independent Agencies Continue to Capture The Flag



Publicly Announced Deals by Buyer Segment



The 2011 M&A Outlook



2011 Outlook

1. Buyers back given improved trading values and poor organic growth
2. Those interested in selling now have two-year window given tax extension
3. Transaction activity improving due to increase in agency value (buyer desperation)
4. 2010 unheard of bottleneck
 - a) 2010 Quality Agencies - Seller Market
 - b) 2010 Poor Performing Agencies – Buyer Market
5. 2011—Anticipated large number of transactions—numerous buyers and sellers

Leading Causes of Consolidation

Sell-Side



1. **Disintegrating Organic Growth**
2. **Weighted Average Owner Age**
3. **Producer Management**
4. **Commitment to Reinvestment**
5. **Making Tough Decisions**
6. **Capital Gains Rate**
7. **Buyer Valuations Favorable Despite Decline**

Carrier Management

The tyrant hangover is gone--there is nothing illegal about Carrier Management



Reality

1. Peak performers subsidize poor-performing agencies
2. Carriers do not universally cut compensation of weak to support strong
3. Agencies wait for companies to dictate requirements and compensation
4. Companies rely almost solely on rep. perception, premium and loss experience
5. Agencies take for granted that carriers can distinguish good from bad
6. Most agencies reactively negotiate for higher compensation



Carrier Management

Continuous Preparation



1. **Maintain pitch book (outline of superior quality)**
 - a. *Organic Growth*
 - b. *Profitability*
 - c. *Weighted Average Owner Age*
 - d. *New as % Prior Year Commission*
 - e. *Producer and staff Reinvestment*
 - f. *Commitment to Perpetuation*
2. **Maintain updated comparison of contractual provisions of companies**
3. **Monthly tracking of YTD performance against contractual requirements**
4. **Rank companies A, B or C (Strategic, Improving, Non-strategic)**
5. **Consistent process to run off non-strategic carriers**
6. **Calculate by company, profit contribution to each carrier's overall book**
7. **Calculate investment income on profit contribution based on carrier inv. return**
8. **Complete report card of carrier strengths and weaknesses**



Company Evaluation Scorecard

Rate Carriers by Criteria



Excellent = 5, Very Good = 4, Good = 3, Fair = 2, Poor = 1

Company	Co. 1	Co. 2	Co. 3
Financial Stability			
Competitive Products (pricing)			
Product Line			
Underwriting Flexibility			
Promptness - Quotations			
Timely Policy & End. Issuance			
Competence of Staff			
Flexibility in Billing plans			
Interface capabilities			
Download capabilities			
Claim service			
Draft authority			
Market availability			
Market stability			
Compatibility of Marketing Philosophy			
Advertising support			
Commission schedule			
Profit Sharing Agreement			
Agency assistance programs			
Training programs			
Producer financing			
Incentives for volume commitments			
Importance of agency to company			
Assist agency growth plans			
Total Score			

Carrier Management

Proactively Push Fair Compensation



Proactive Management

1. Turn the tables: Proactively schedule meetings and outline results
2. Senior agency leadership involvement versus handing off to marketing manager
3. Quarterly update letter to Carrier CEO and Regional Representative

Meeting Agenda

1. Annual review of the agency and relationship
2. Owners' long-term commitment to the business
3. Long-term growth plan of the insurance operation
4. PY contribution of premium and underwriting profit relative to commitments
5. Cumulative premium and underwriting profit since inception of relationship
6. Contribution to profit relative to entire carrier book
7. Insurance company report card
8. Agency strategic commitment to company
9. Agency premium and loss ratio commitment
10. Strategy session on mutual commitments
11. Contract needs to support plan, not best contract

2011 Natural Catastrophes

Insurers face tough losses in wake of natural devastation



January, 2011:	Massive Flooding in Australia
February, 2011:	Earthquake in New Zealand
March, 2011:	Tsunami & Earthquake in Japan
April, 2011:	Tornadoes in United States of America

“Historically, large losses from natural disasters have been followed by price increases and stronger demand in the Property and Casualty Market. [We] believe that the combination of the recent natural catastrophes, very low interest rates, and years of price declines are likely to bring forward the turn in the cycle.”

—Swiss Re, *on 2011 Q1 Earnings*

Catastrophe Expense & Net Income

A glance at major insurers 2010 v. 2011



Carrier		2010	2011
Allianz	Catastrophe Cost	\$818 million ¹	\$1.12 billion ¹
	Net Income	\$2.38 billion ¹	\$1.34 billion ¹
Hannover Re	Catastrophe Cost	\$383 million ⁵	\$850 million ²
	Net Income	\$224 million ²	\$78 million ²
Argo Group	Catastrophe Cost	\$29 million ²	\$113 million ²
	Net Income	\$21 million ²	(\$92 million) ²
SCOR	Catastrophe Cost	\$218 million ⁶	\$529 million ³
	Net Income	\$53 million ³	(\$119 million) ³
Alterra Capital	Catastrophe Cost	\$10 million ³	\$116 million ³
	Net Income	\$36 million ³	(\$47 million) ³
Swiss Re	Catastrophe Cost	\$259 million ⁷	\$2.3 billion ⁴
	Net Income	\$226 million ⁴	(\$665 million) ⁴

*Data is approximate

Sources:

1. "Allianz Preliminary Q1 Figures Show \$1.339 Billion Profit"
2. "First Quarter Earnings Reports: Hannover RE, Argo Group"
3. "First Quarter Earnings Reports: SCOR, Alterra Capital"
4. "First Quarter Earnings Reports: Swiss Re, Zurich Financial Services"
5. "Hannover Re The profitable growth continues"
6. Score Group Q1 2010 Results
7. "Swiss Re [. . .] successful"

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- Yoh, Douglas A. Marsh, Berry & Company (2011). “State of the Industry.” *Used with permission*.