

# Implications of financial crisis on Engineering Insurance

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MARP  
Munich Re Group



**What are the characteristics of the current recession?**

**What impacts does the recession have on the construction business?**

**What impacts does the recession have on the insurance industry?**

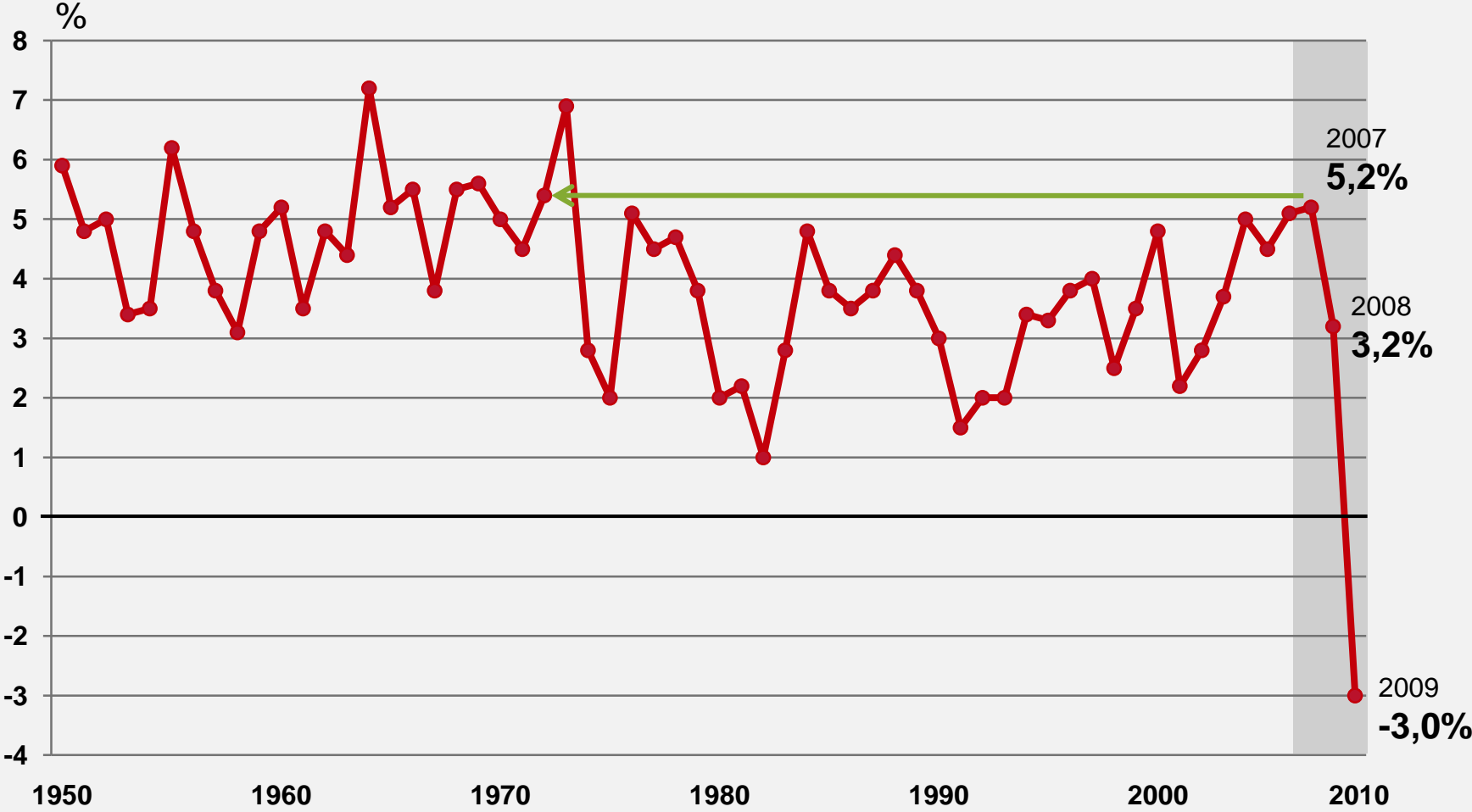
**What are the possible interlinks between the construction business and the insurance portfolio?**

**Outlook: Is the recession over?**



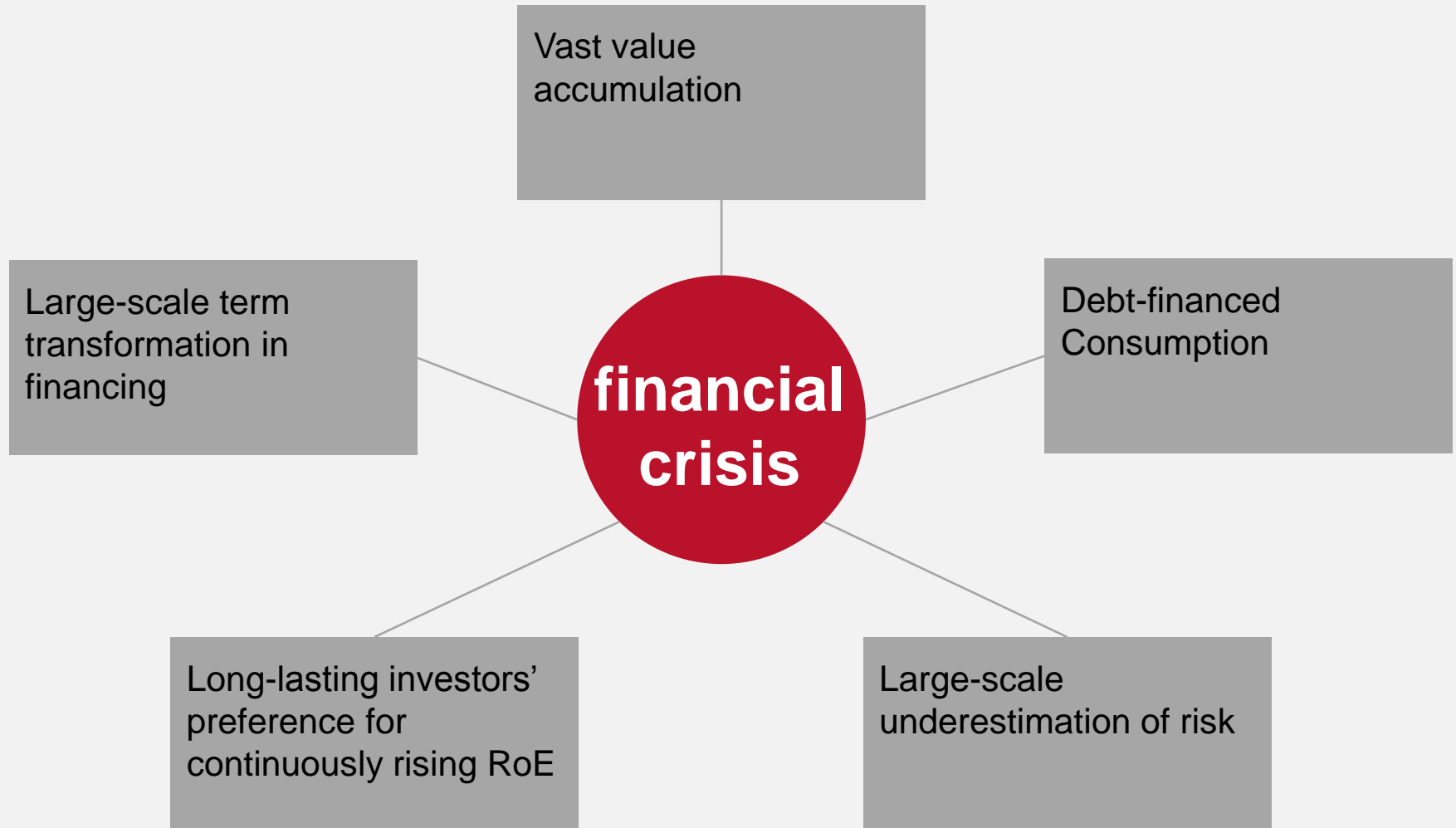
*Macroeconomic business cycles and cycles in the construction business are nearly synchronal.*

# Growth of the global economy 1951-2009



Source: ifo, Presentation H.-W. Sinn, 23rd June 2009

# Main drivers for the financial crisis





## **The economy is not capable of self-stabilising.**

This is primarily caused by the current lack of trust between the market participants.



## **Corrective actions:**

- „Bad Bank“, Stress tests
- Taking over guarantees
- Taking over stock options
- Nationalisation of companies
- Programme for the stimulation of the economy

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“Employment in the construction industry has contracted by 1.4 million since the onset of the recession.”

## UK construction industry shrinks for 18th consecutive month

Although rate of decline in the construction sector has reduced 'it is still the sick man of the UK economy' says Cips chief

The U.S. Bureau of Labor Statistics reported in February 2009 that “Construction lost 111,000 jobs in January [2009]. Employment in the industry has fallen by about 1 million since peaking in January 2007”.

BC Economic Forecast 2009

**Construction industry will be hit hardest by recession, economist says**

# Possible recession effects for the construction business



- Tightened credit conditions
- Funding of projects at risk (incl. PPPs)
- Cancellation and postponement of orders
- Increasing late payment by clients
- Risk of “cascading bankruptcies” throughout the supply chain
- Pressure on project costs
- Private investors reduce investment activity
- More public investment in infrastructure (economic programmes)
- ...



# Decreased number of new construction starts

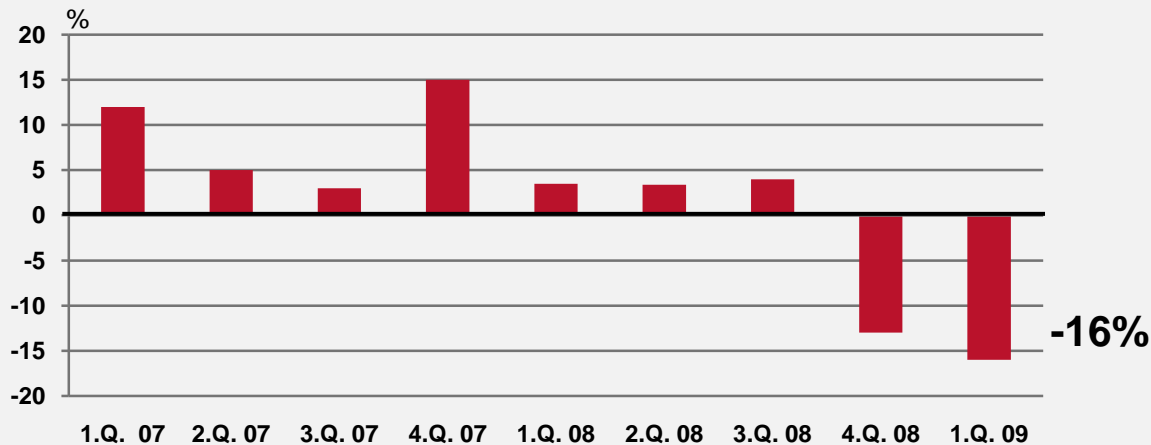
## US United Arab Emirates

	2008	2009 (Forecast)
Residential	-27%	-2 to 2%
Non-residential	11%	-3 to -9%
<b>Total</b>	<b>-15%</b>	<b>-1 to -7%</b>

**Building projects** with a total value of **€ 454 bn** have been stopped (e.g., development projects such as the new district Nakheel Harbour & Tower in Dubai)

## Germany

Rate of change versus previous year  
Moving three-month-average since January 2007



Source: AGC Building Division/PIAC Meetin, Ken Simonson, 12.07.09  
Stats Office

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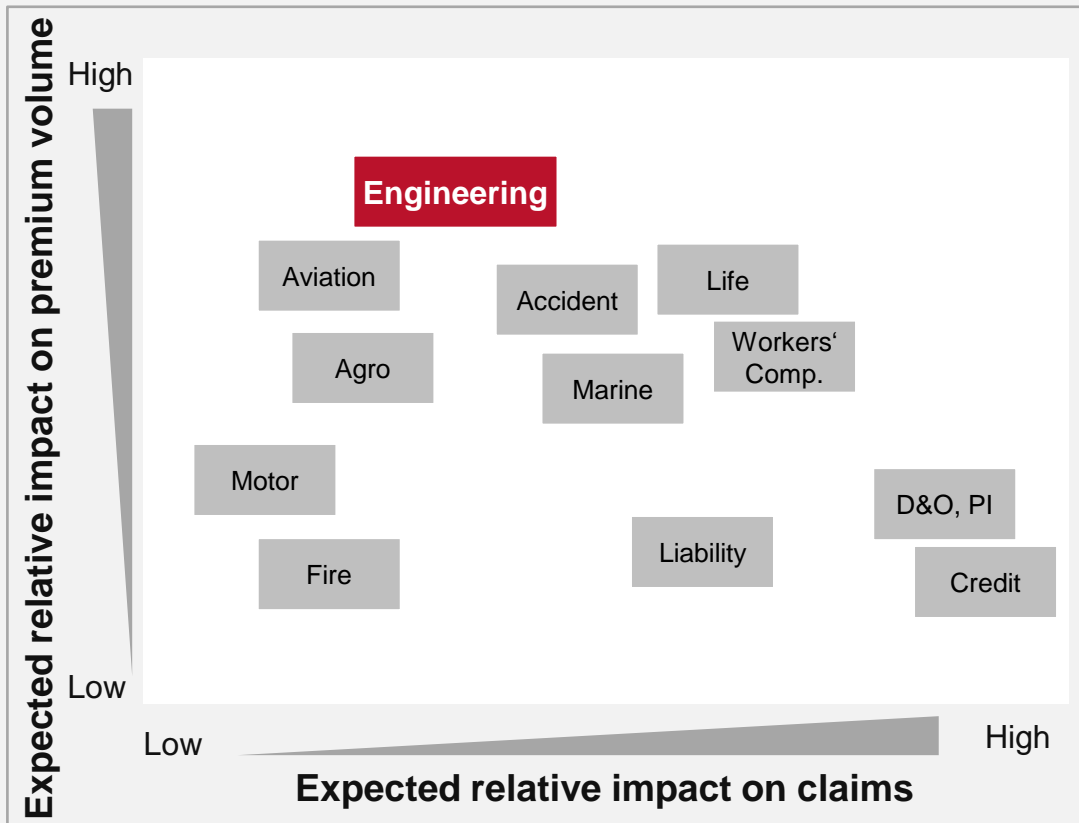
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# Impact of the recession on the insurance business

## Impact of severe recession scenario on insurance portfolio



**Workers' Comp.:** Higher number of midsize losses succeeding lay offs and decline in premiums

**Liability:** Lower investments, fewer quality controls and low cost components in production lead to higher claims

**D&O and PI:** Increase in loss frequency at early stage of recession, hardening of market with time lag

**Motor:** Slightly positive effect on loss ratios, but possibly decrease in demand

**Fire:** Decline in claims due to higher discipline, demand dependent on economy

**Engineering:** Declining premiums as consequence of reduced activities in building sector; claims ambiguous

**Accident:** Reduction in premiums, moderate increase of loss ratio due to moral hazard

**Marine:** Declining premiums due to lower shipping volume possibly moral hazard claims

**Credit:** Significant increase of losses due to higher default rates; higher rates

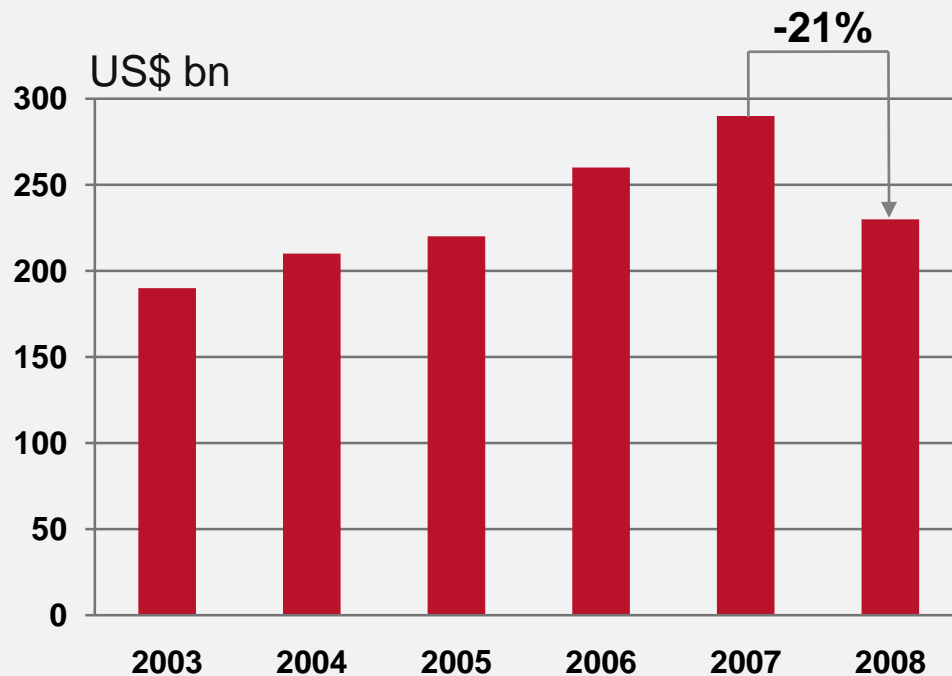
**Aviation:** Demand will decrease due to less passengers

**Agro:** With stable rates, insured values depending on commodity prices

**Life:** Reduced volume, higher lapse rates, lower investment results, more suicides and disability claims

# Impact of the recession on capitalization in the reinsurance industry

## Net assets of the reinsurance industry decreasing

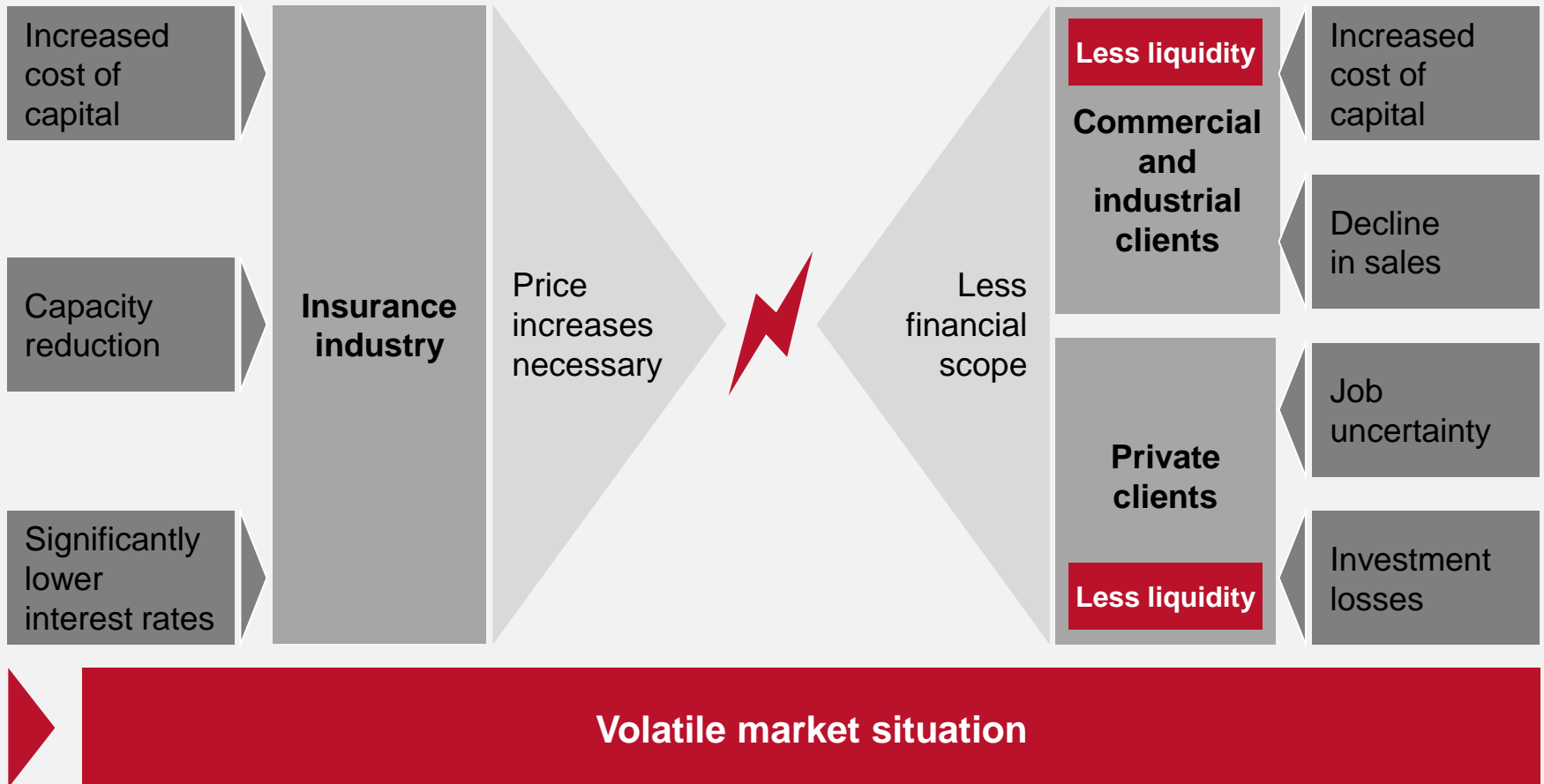


## Main reasons for decreasing capitalisation:

- Realised and unrealised loss of assets (ca. 90% of reduction)
- Hurricanes Ike and Gustav (ca. 10% of reduction)

# Insurance industry market forces: Market characterized by highly charged field of tension

## Current market forces in the insurance industry



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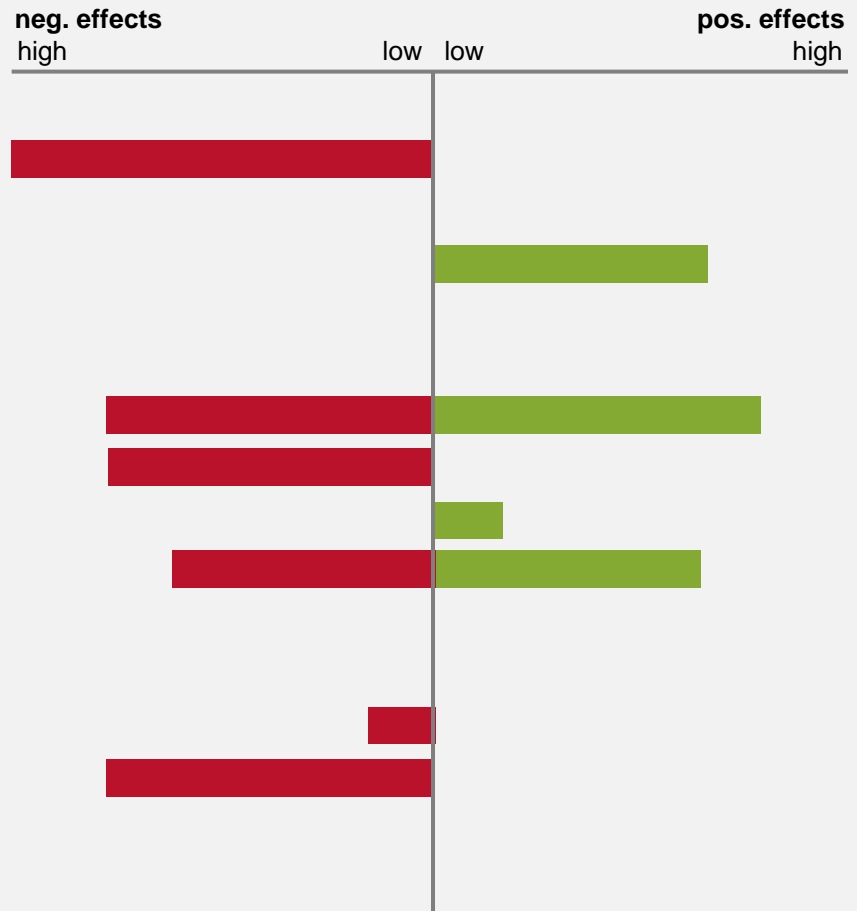
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## Relevance of negative / positive effects



### Potential for project business

- Reduced investment activity of private investors
- More public investment in infrastructure

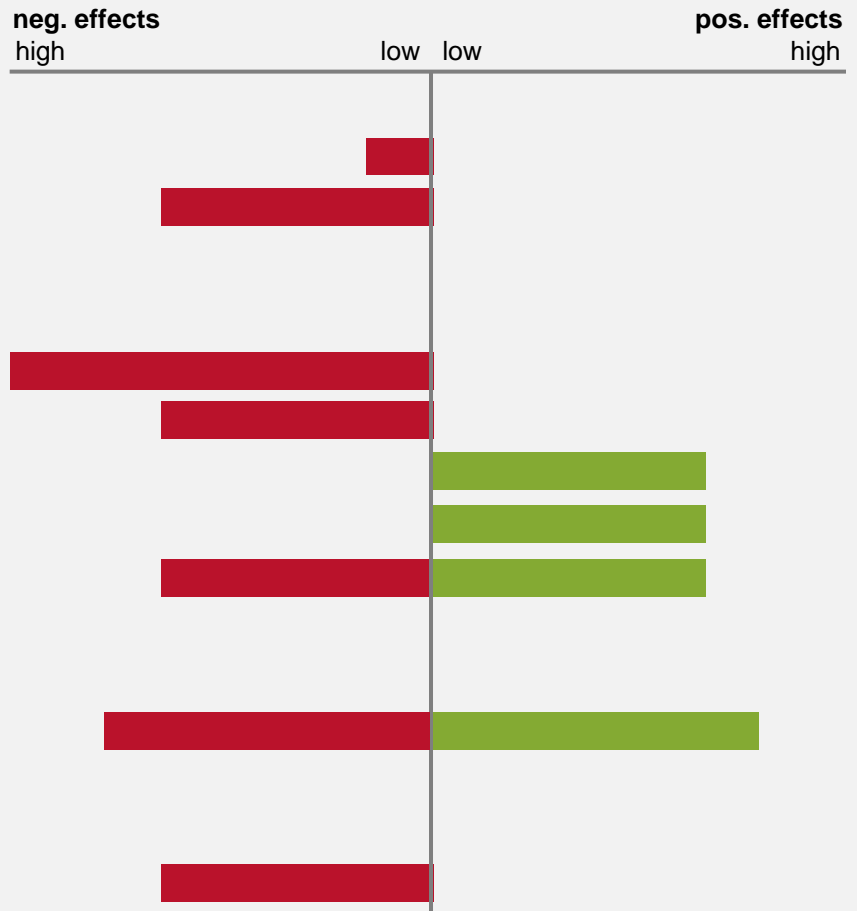
### Increased pressure on project costs

- Pressure on project costs
- Projects cancelled or postponed
- Conservative risk management
- Decrease of DSU/BI sums insured

### Sums insured over term of projects

- Substantial fall in prices
- Fall in indexed contract amounts

## Relevance of negative / positive effects



### Risk mngt., third-party inspection

- Less spent on risk management
- Less spent on quality management

### Claims costs

- Inflated claims costs
- Large fluctuations in commodity prices
- Decrease in replacement values
- Shorter delivery times for equipment
- Expansion in scope cover

### Specialist staff

- Availability of specialist staff

### Others

- Moral hazard



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## Three scenarios for the future development

>> What will happen strongly depends on the political developments

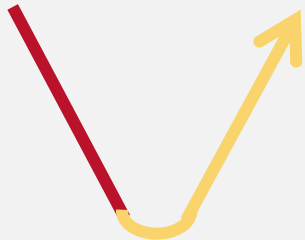


### Short contraction in 2009, speedy upturn

- Recession in 2009
- Recovery 2010

### Return to former growth rates

- Minor growth in established markets
- Emerging economies as growth driver



### Recession lasts until 2010, massive impacts

- Deep recession 2009, 2010
- Slow recovery 2011

### Minor growth rates

- Minor growth compared to former historical growth
- Paralysis of emerging economies



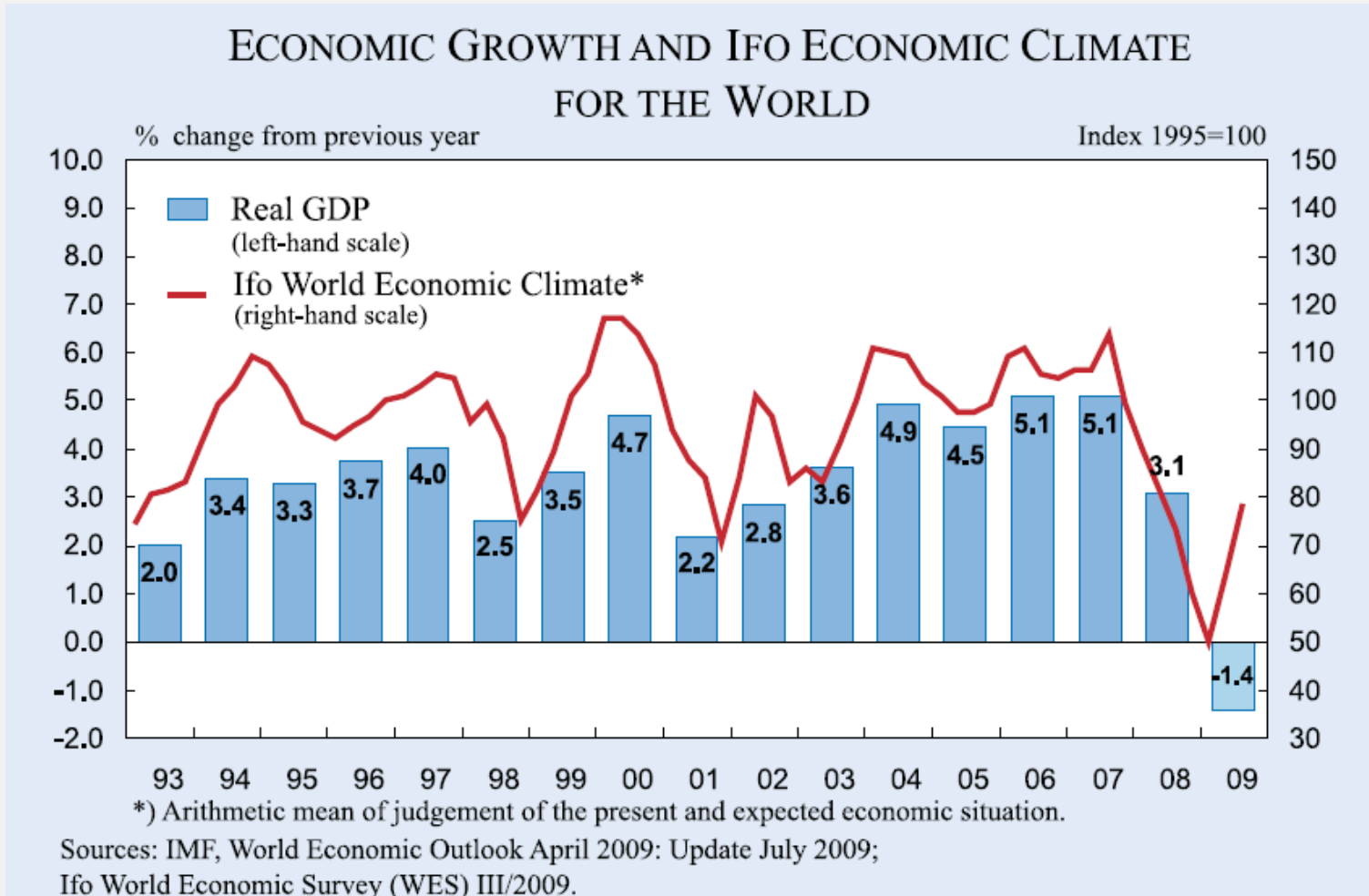
### Long contraction until 2011, weak recovery in 2012

- Negative or slow growth in 2011 and 2012
- Gradual recovery in 2012/13

### Structurally low growth rates

- Missing demand stimulus in world economy
- Emerging Economies with focus on domestic markets

# Since June 09: Is there a light at the end of the tunnel?



# Thank you very much for your attention!

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