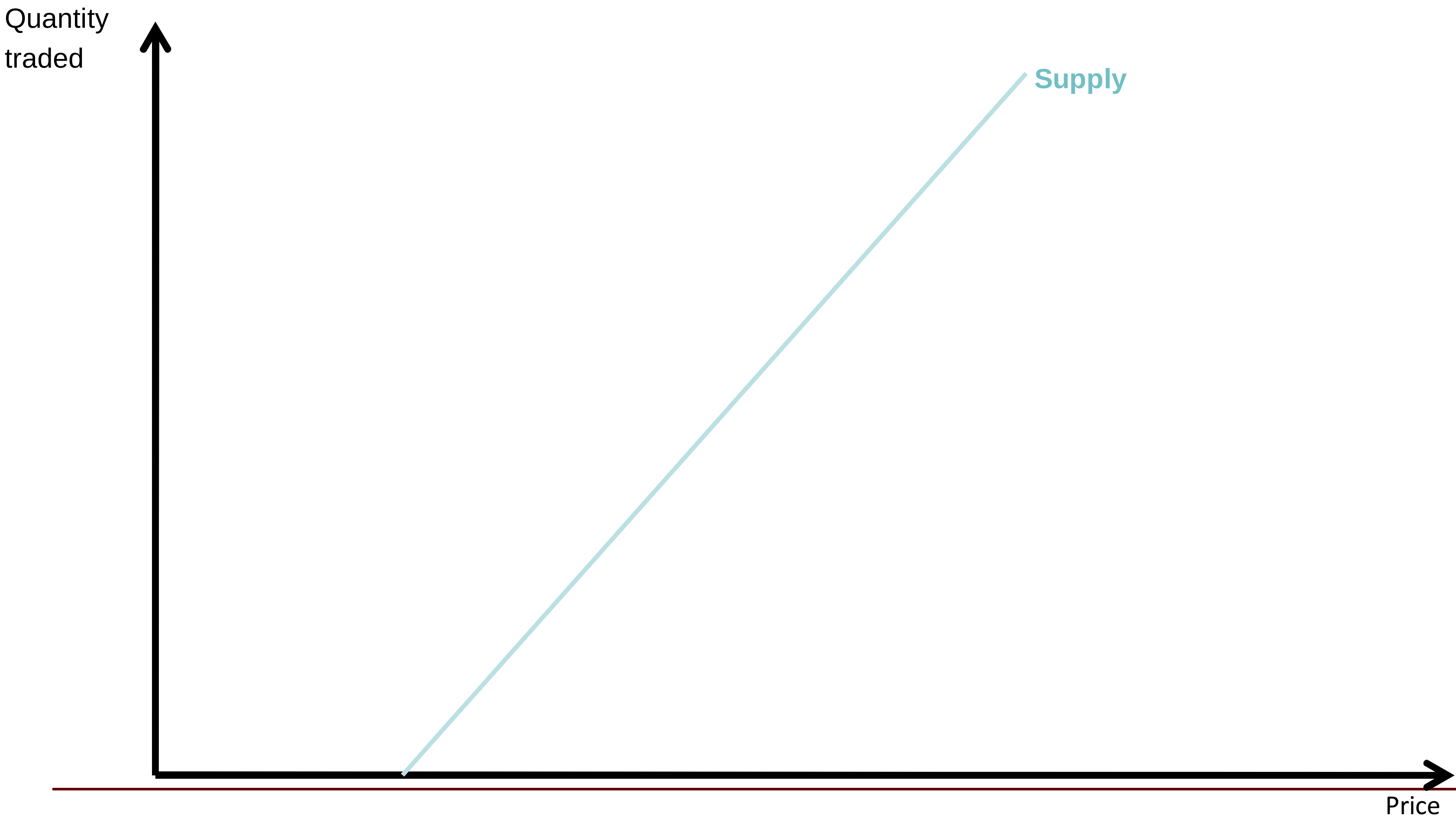
The Actuarial Profession
making financial sense of the future

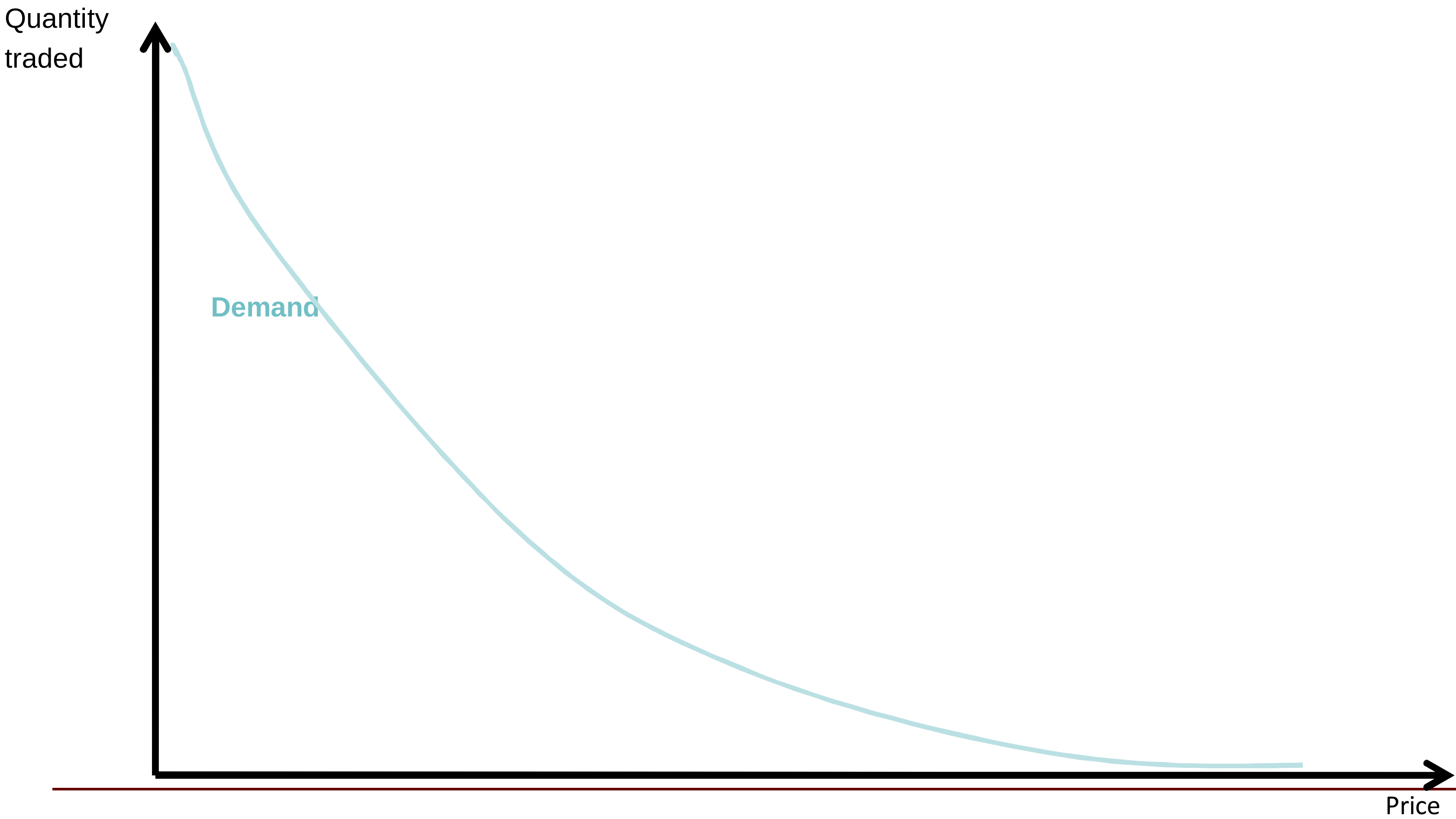
Insurance in Terms of Basic Economics

GIRO 2009, Edinburgh

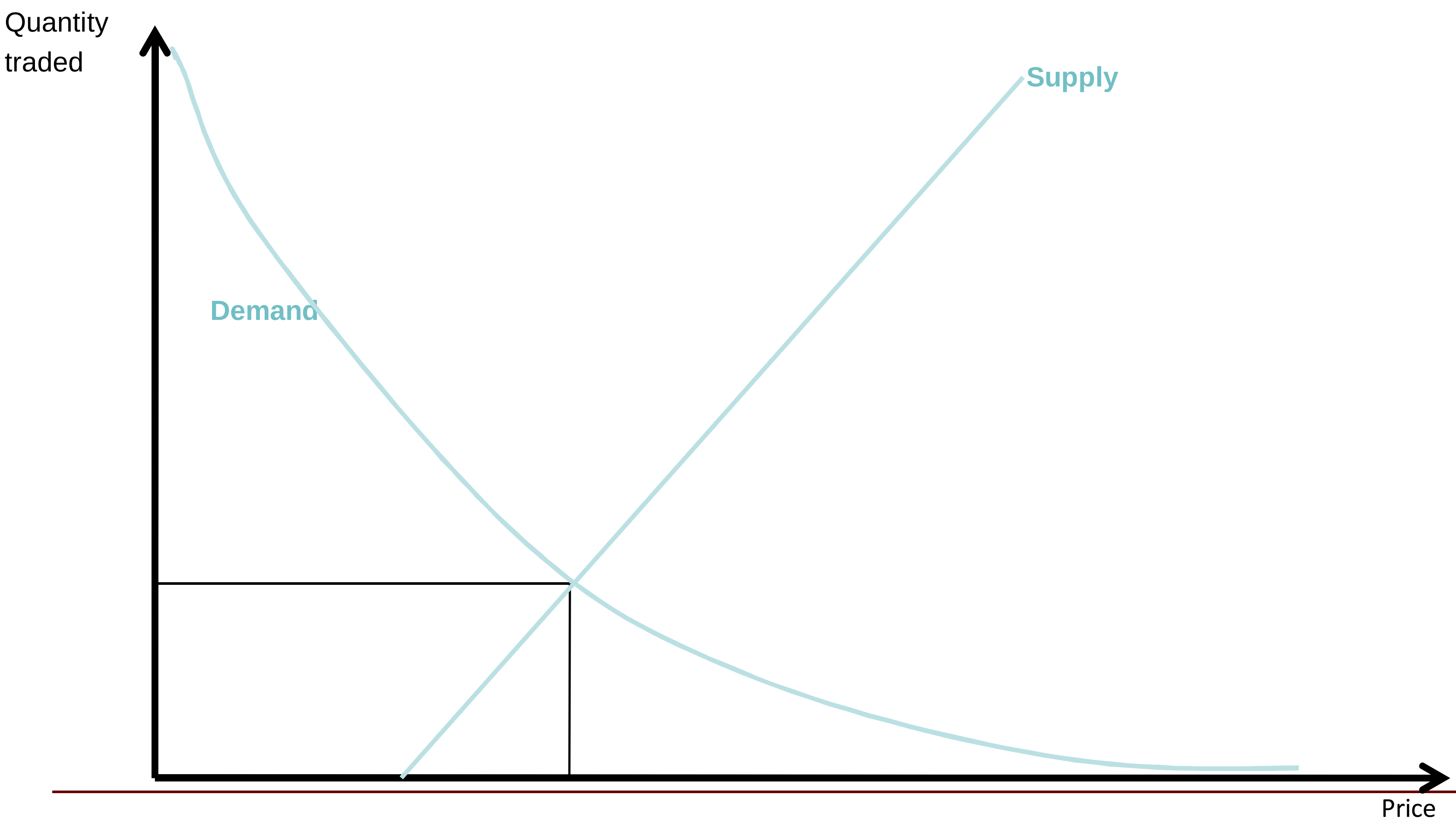
The first thing we learn in economics …



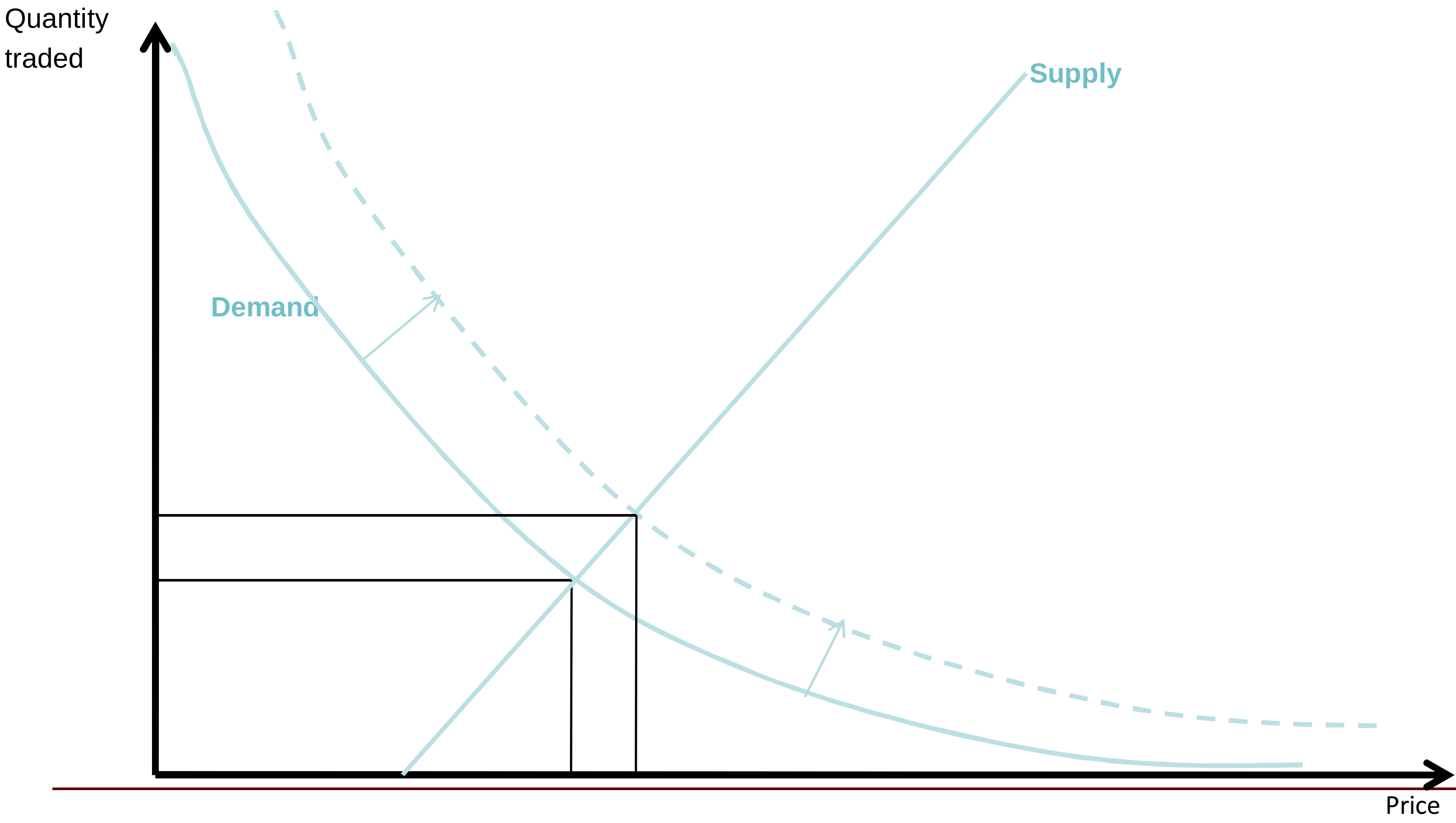
The first thing we learn in economics …



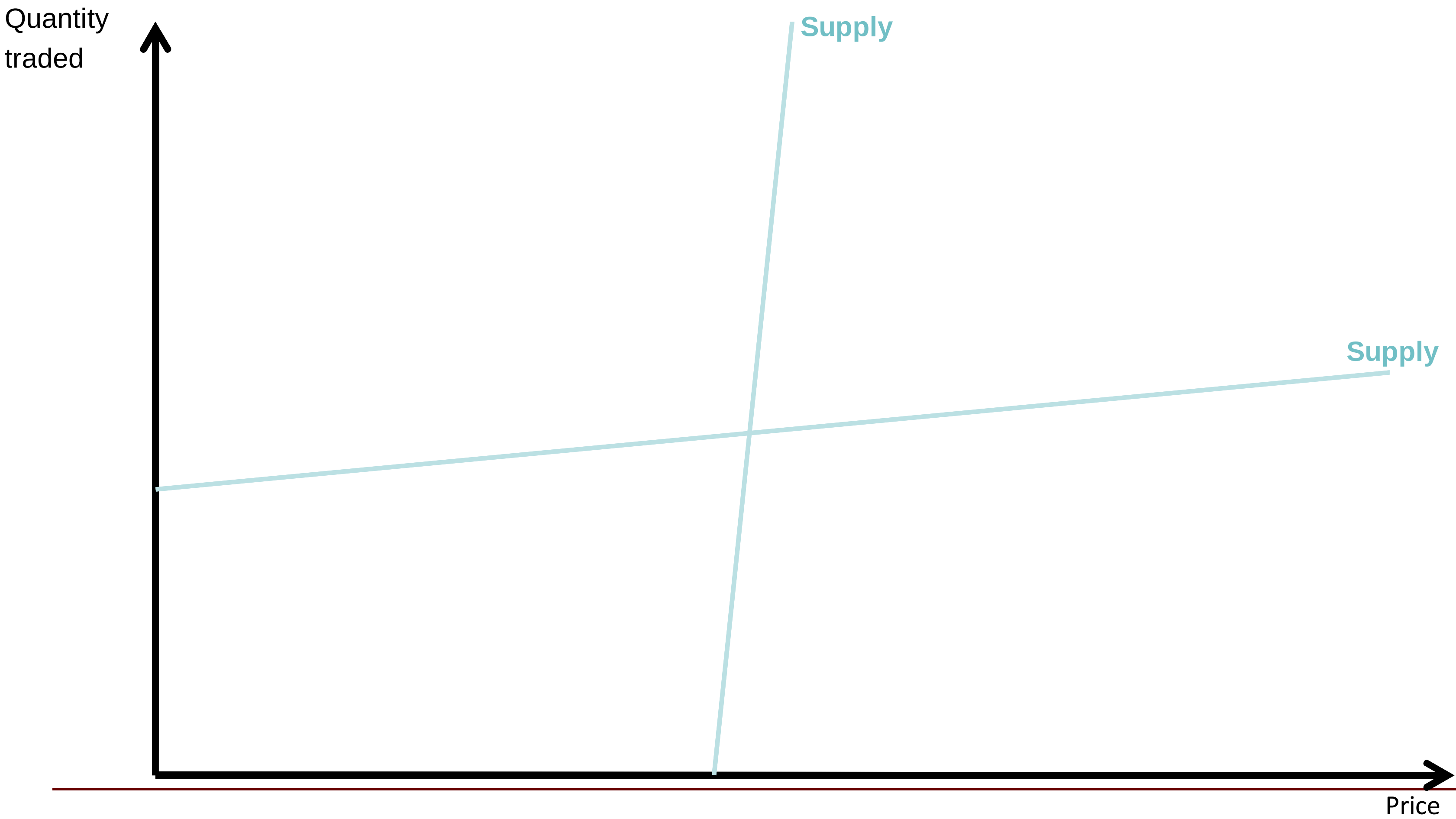
... is how a market has an equilibrium



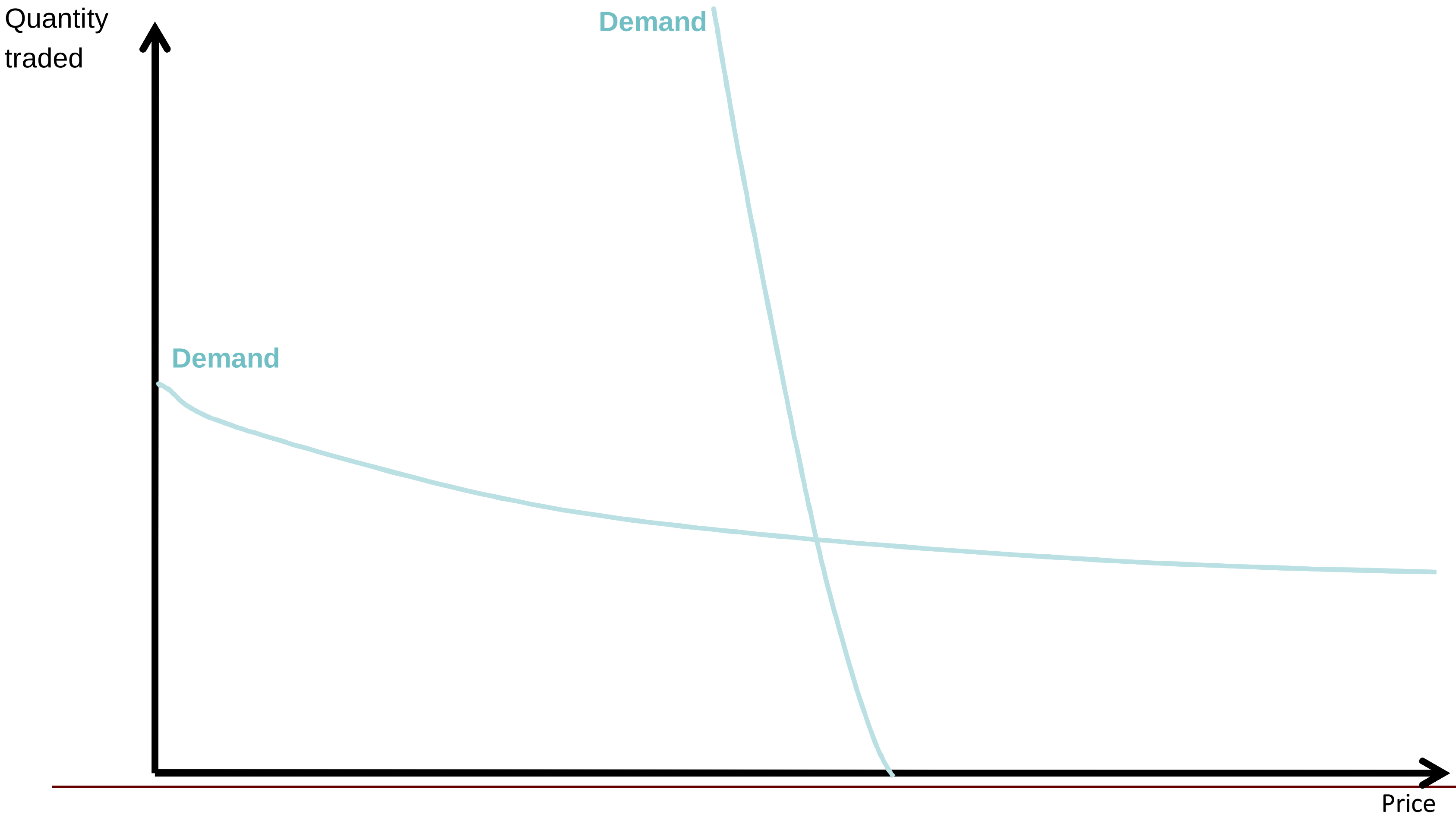
Things change



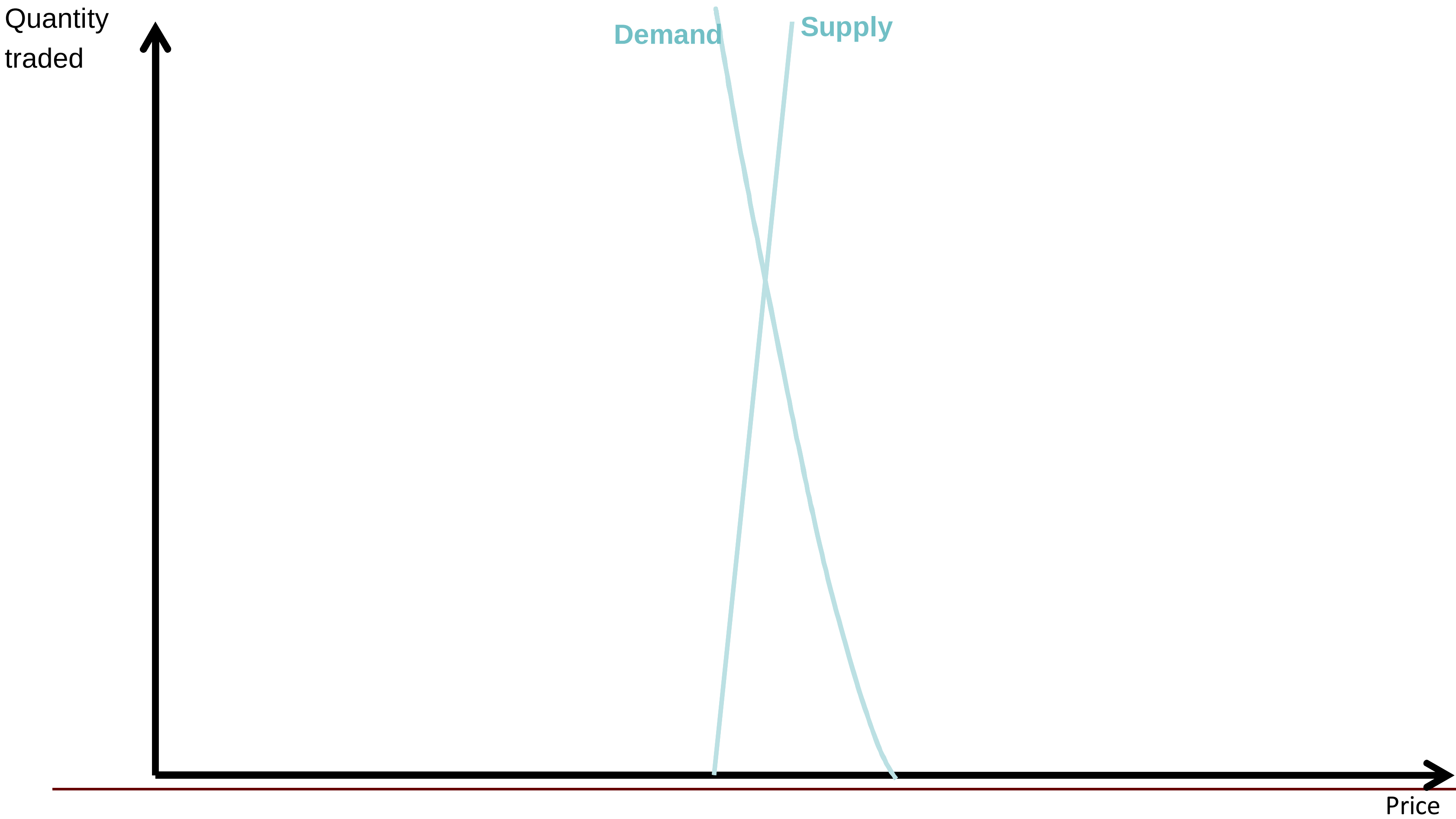
Different supply curves



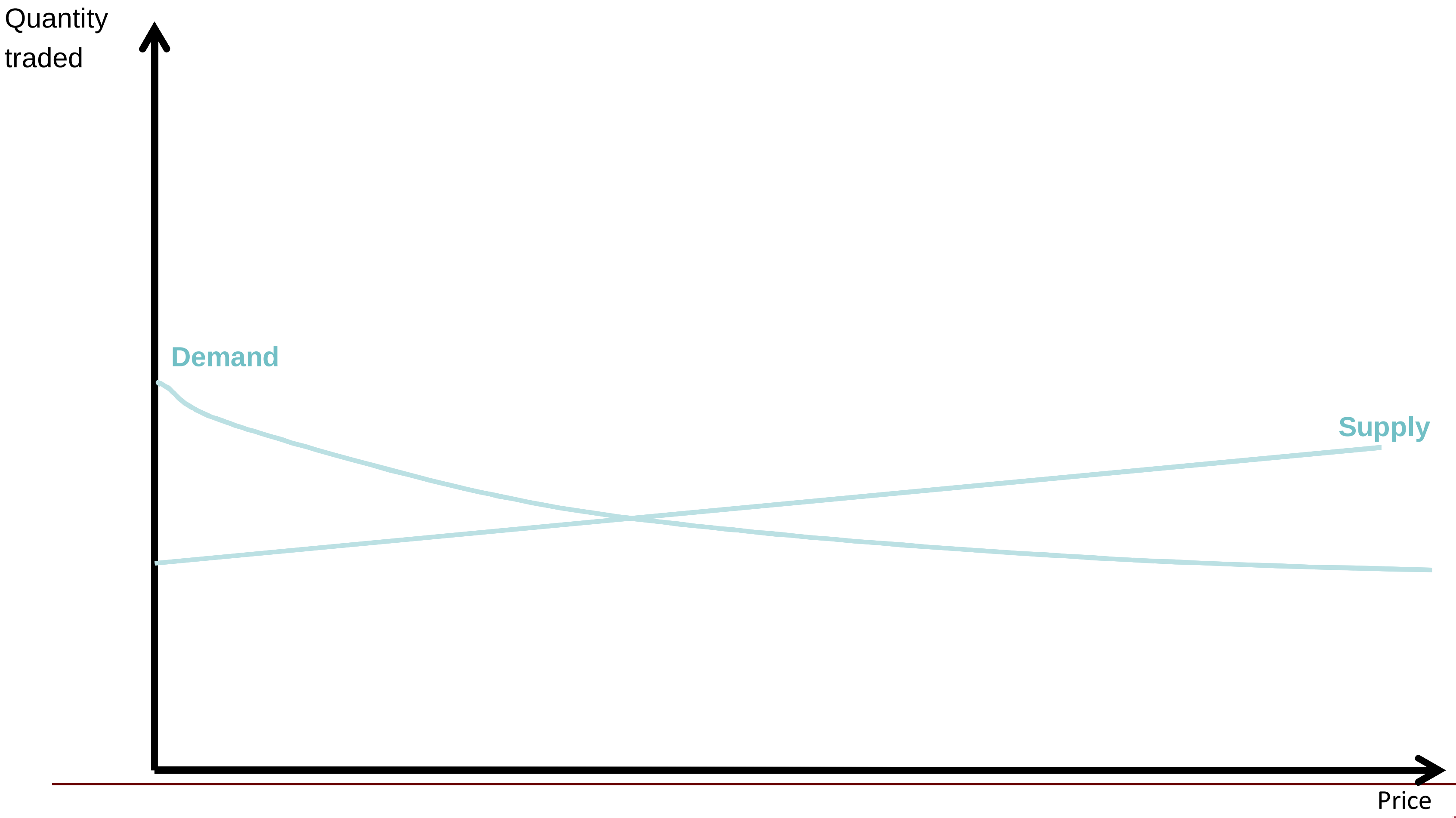
Different demand curves



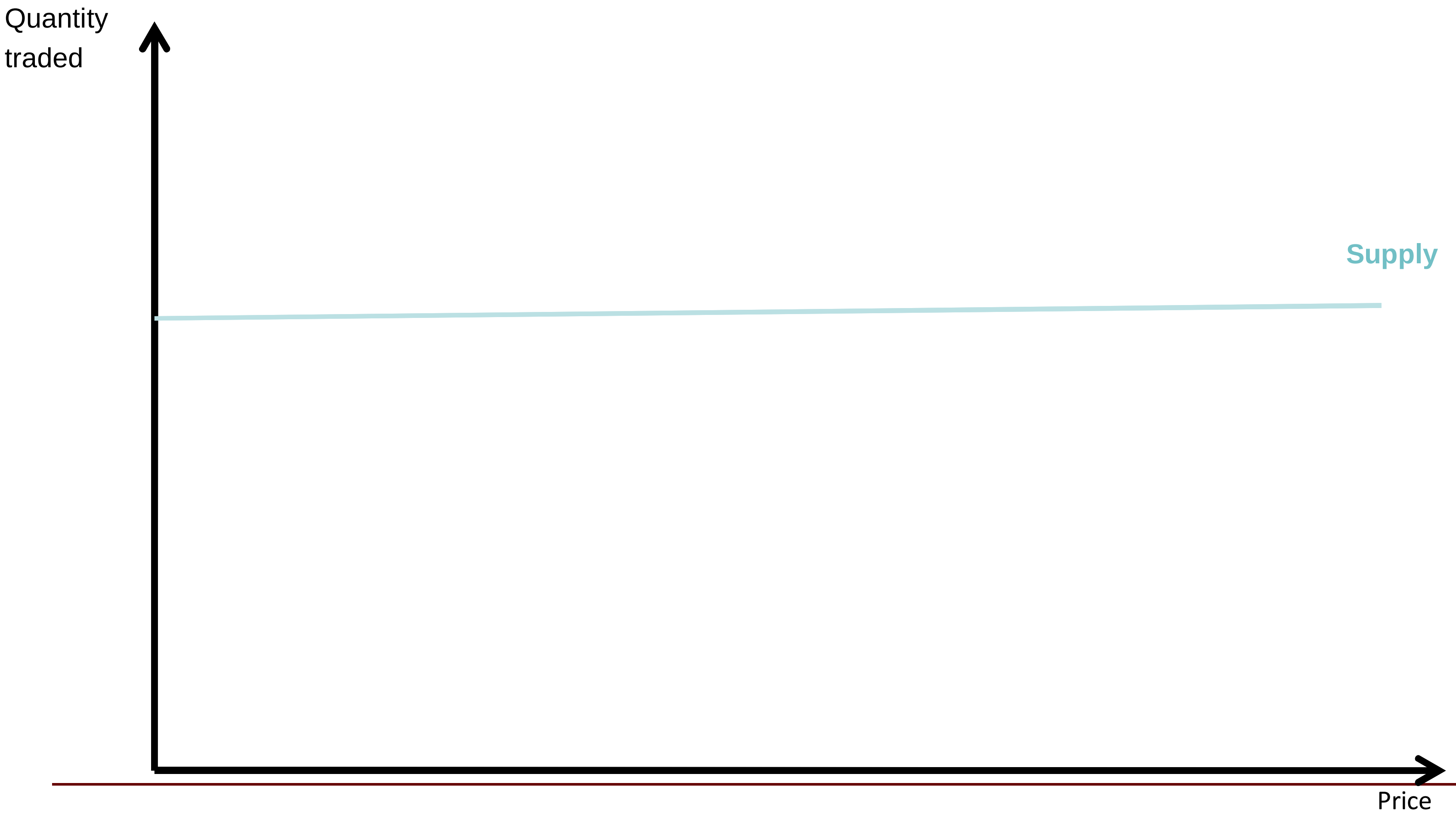
Sensitivity



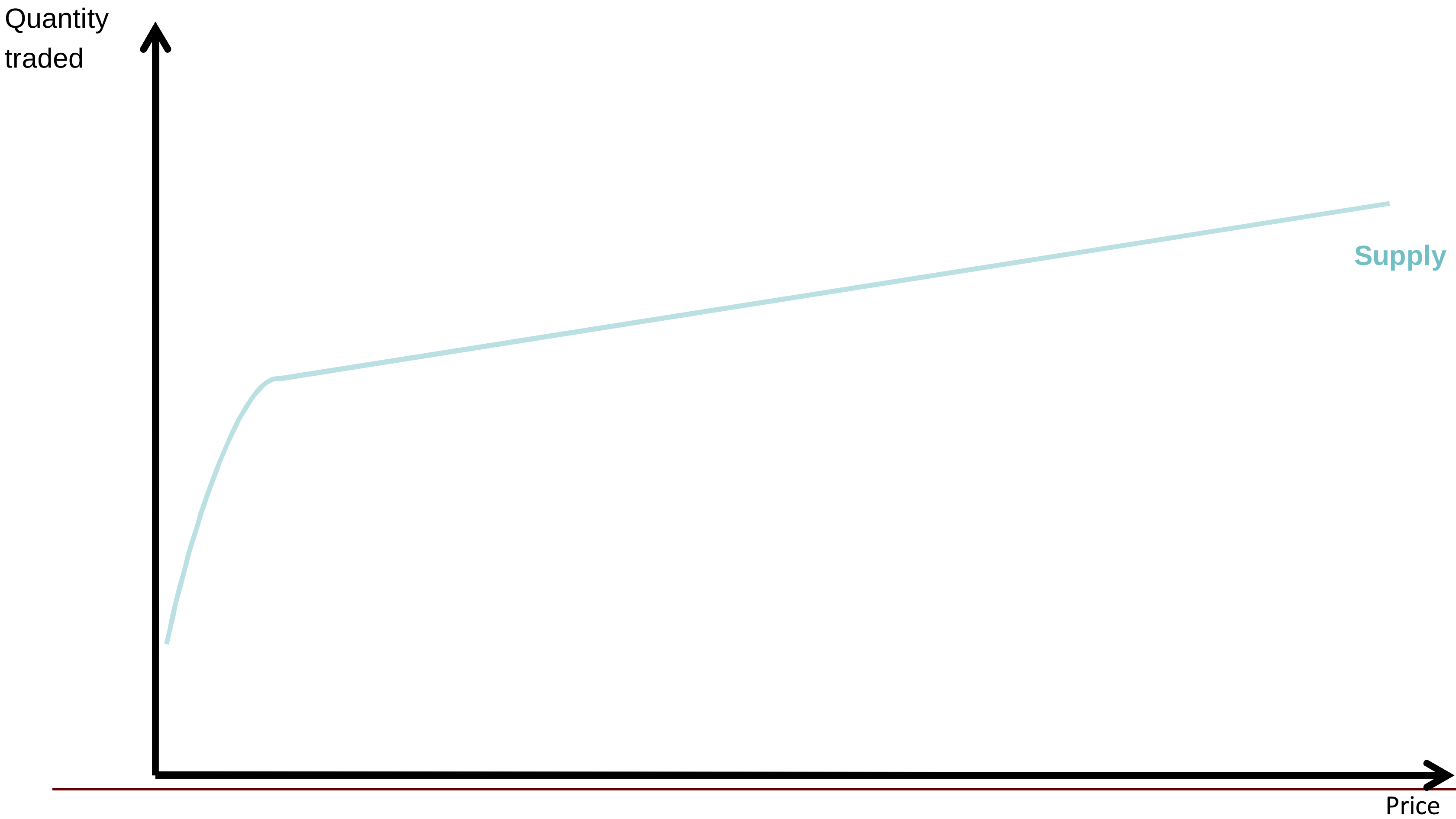
Sensitivity



The supply curve today



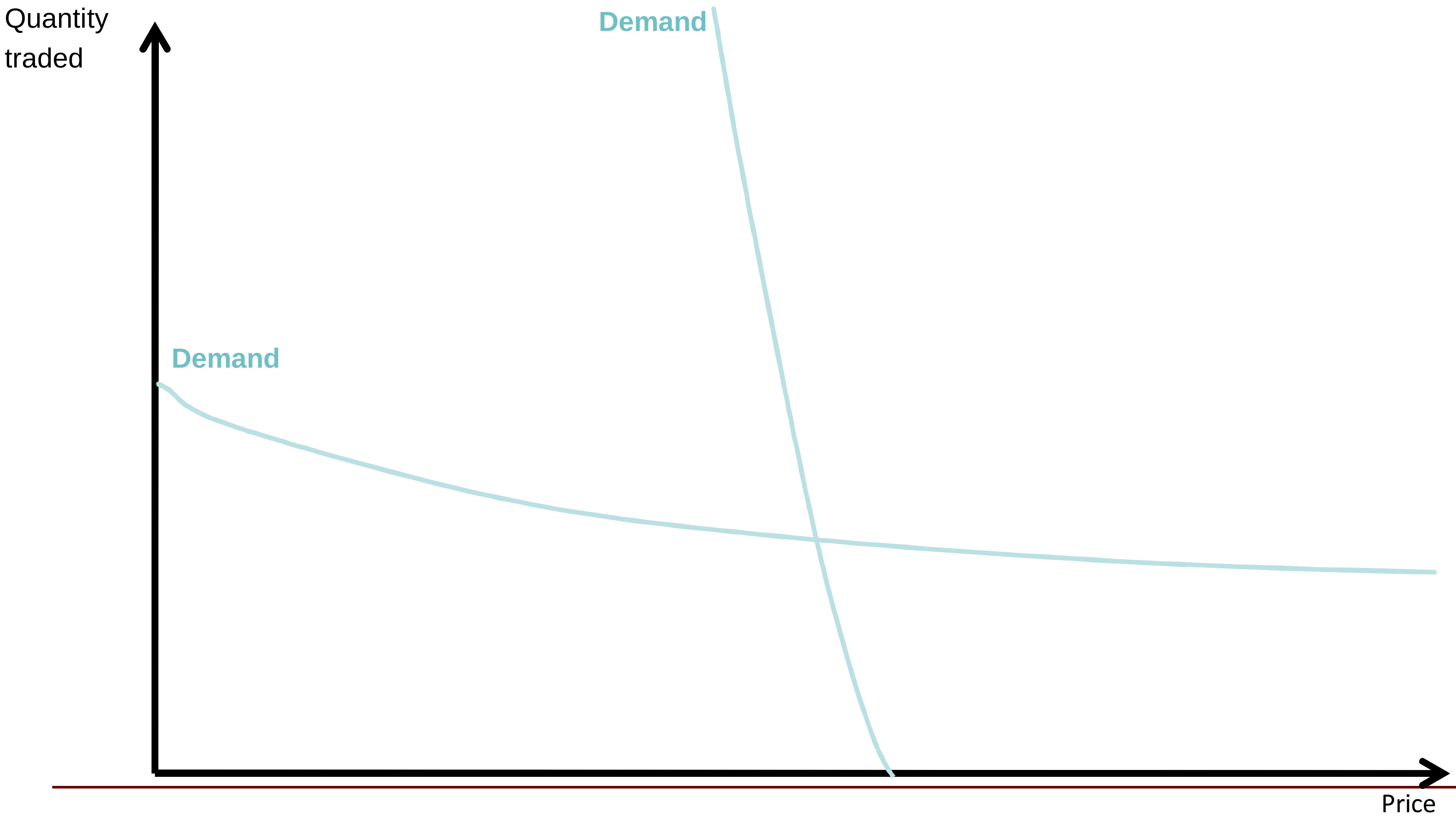
The supply curve soon



Demand for insurance

- People will always need insurance
- Sometimes we must have it
- Little appetite for extra
- An inferior good?
- A commodity?

Demand for insurance



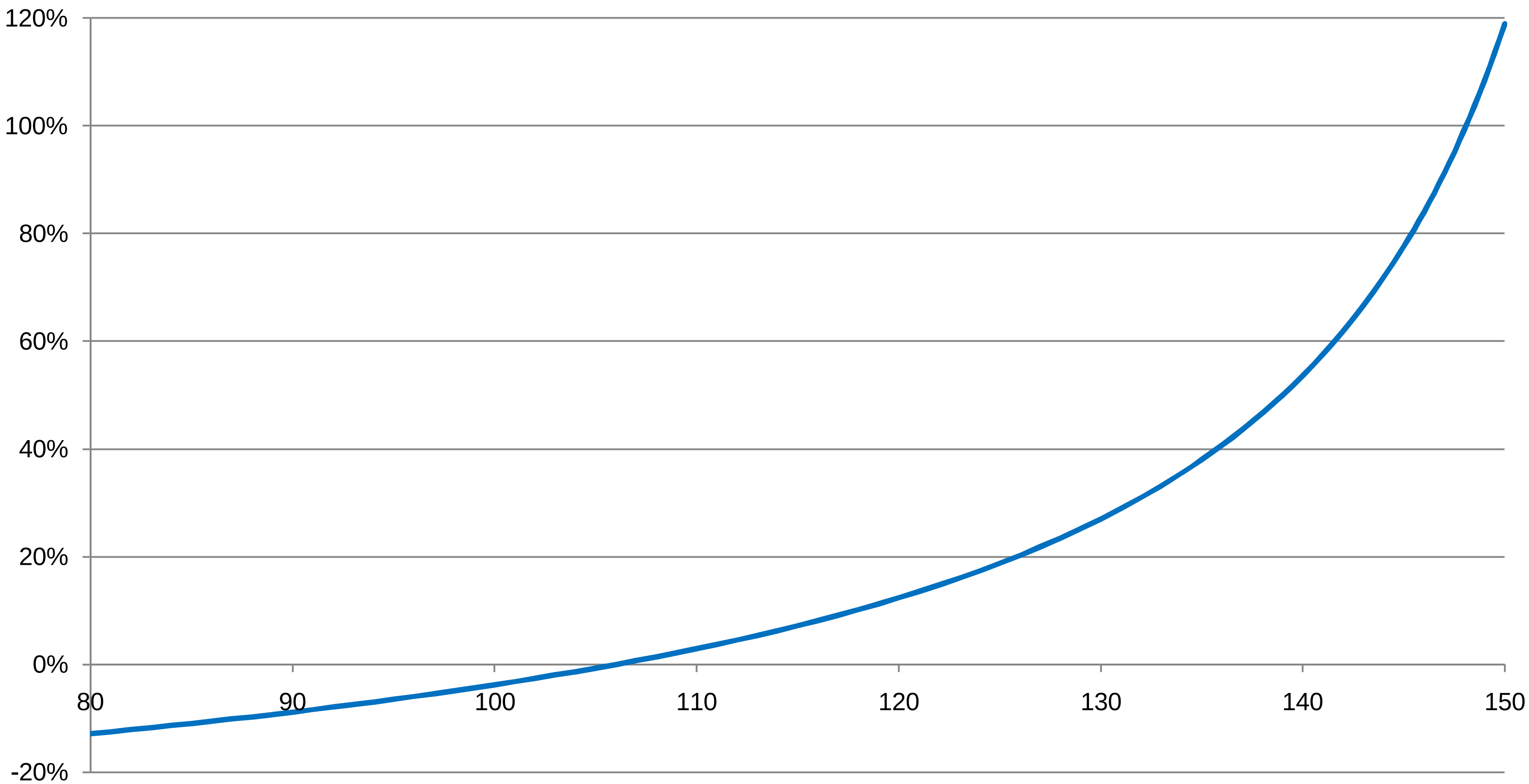
Supply of insurance

- Quick and easy to make
- No stock to clear
- Limited by capital/need to service capital
- Desire for profit

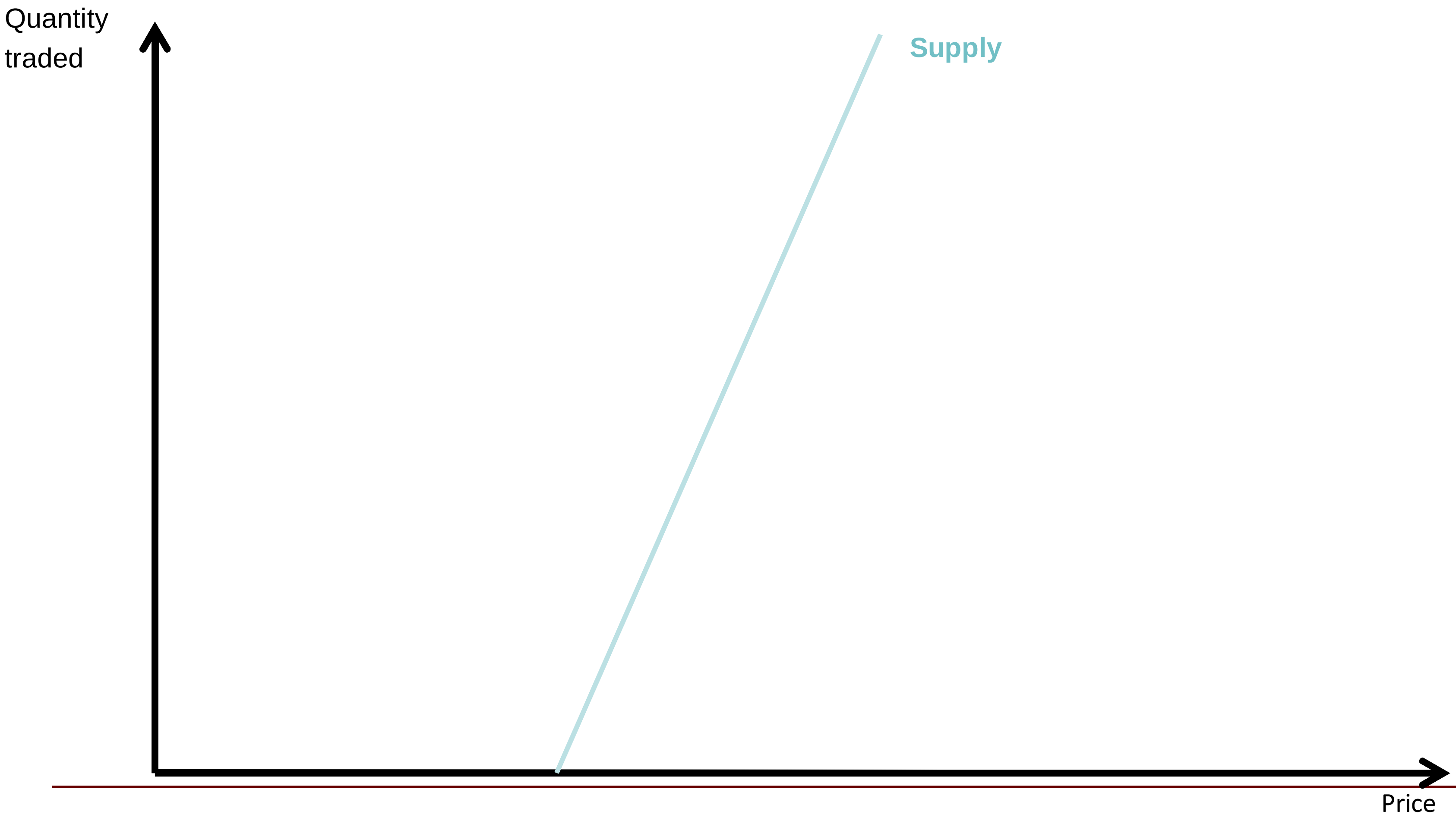
Typical insurance product

- Claims 100
- Paid over 5 years
- Expenses 25
- Investment income 5%
- Capital 40
- Half released at year end

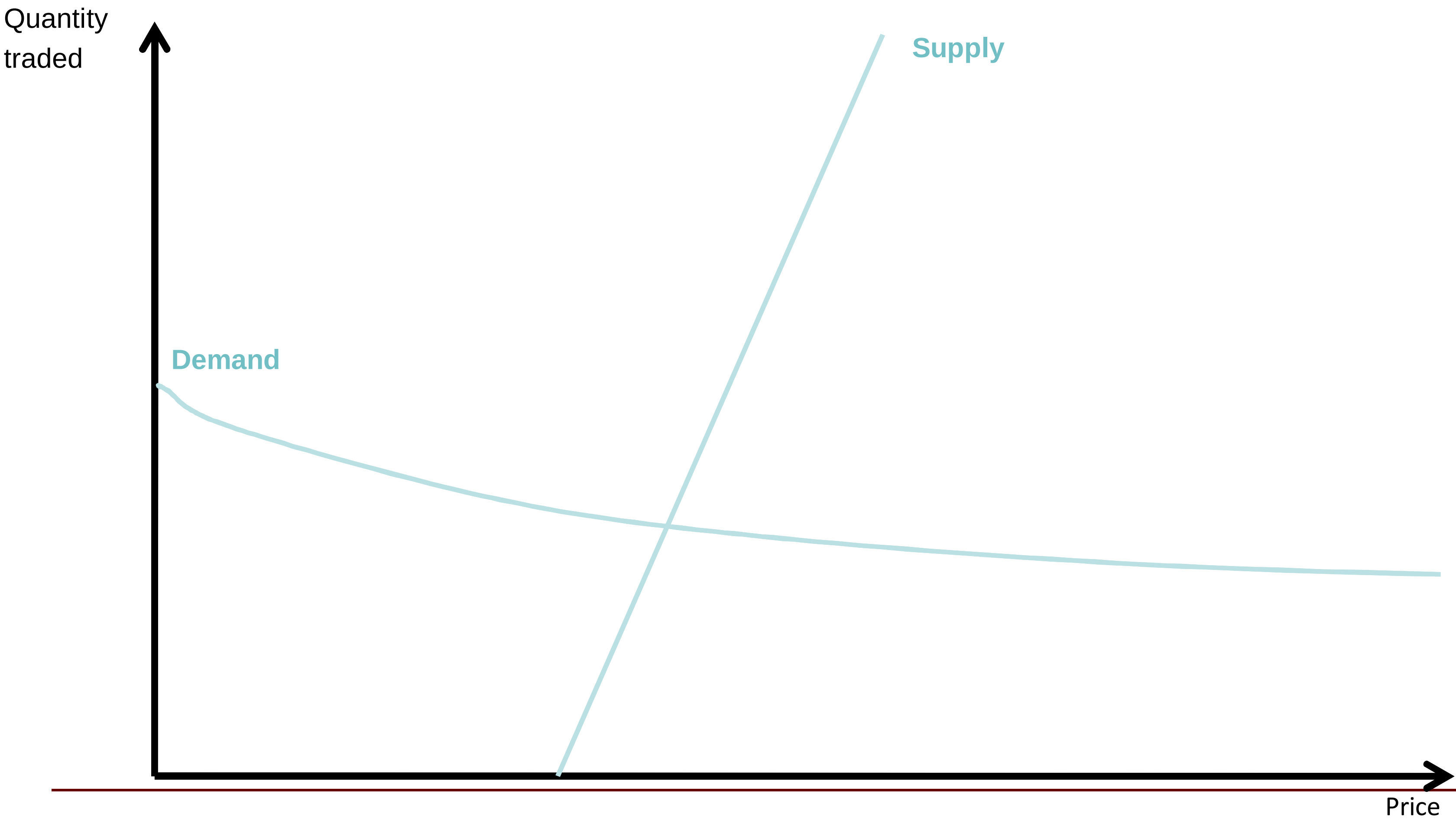
Return on capital



Supply of insurance



The insurance market

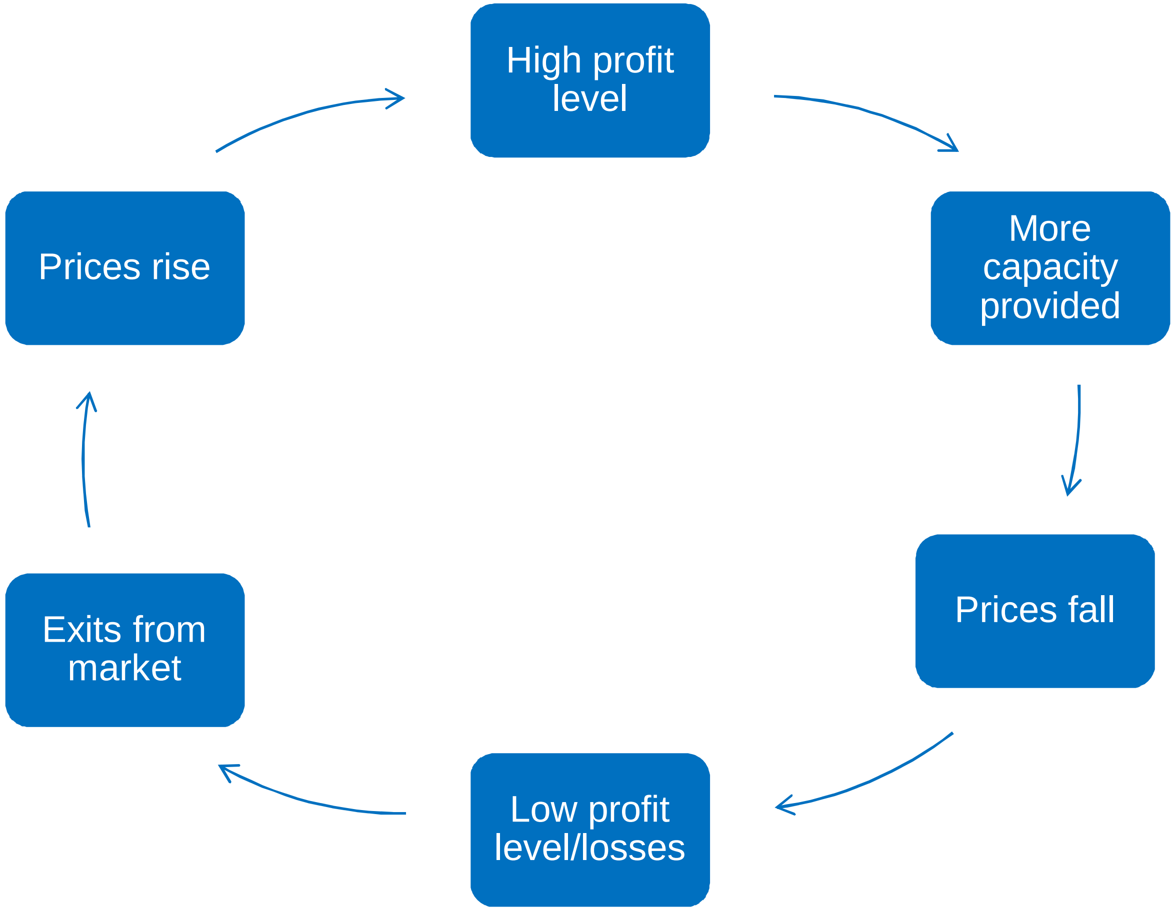


Characteristics

- Not much variation in quantity
- Price could be quite variable
  - Demand changes will not move price much
  - Changes in supply could

- Is this what we see in practice?

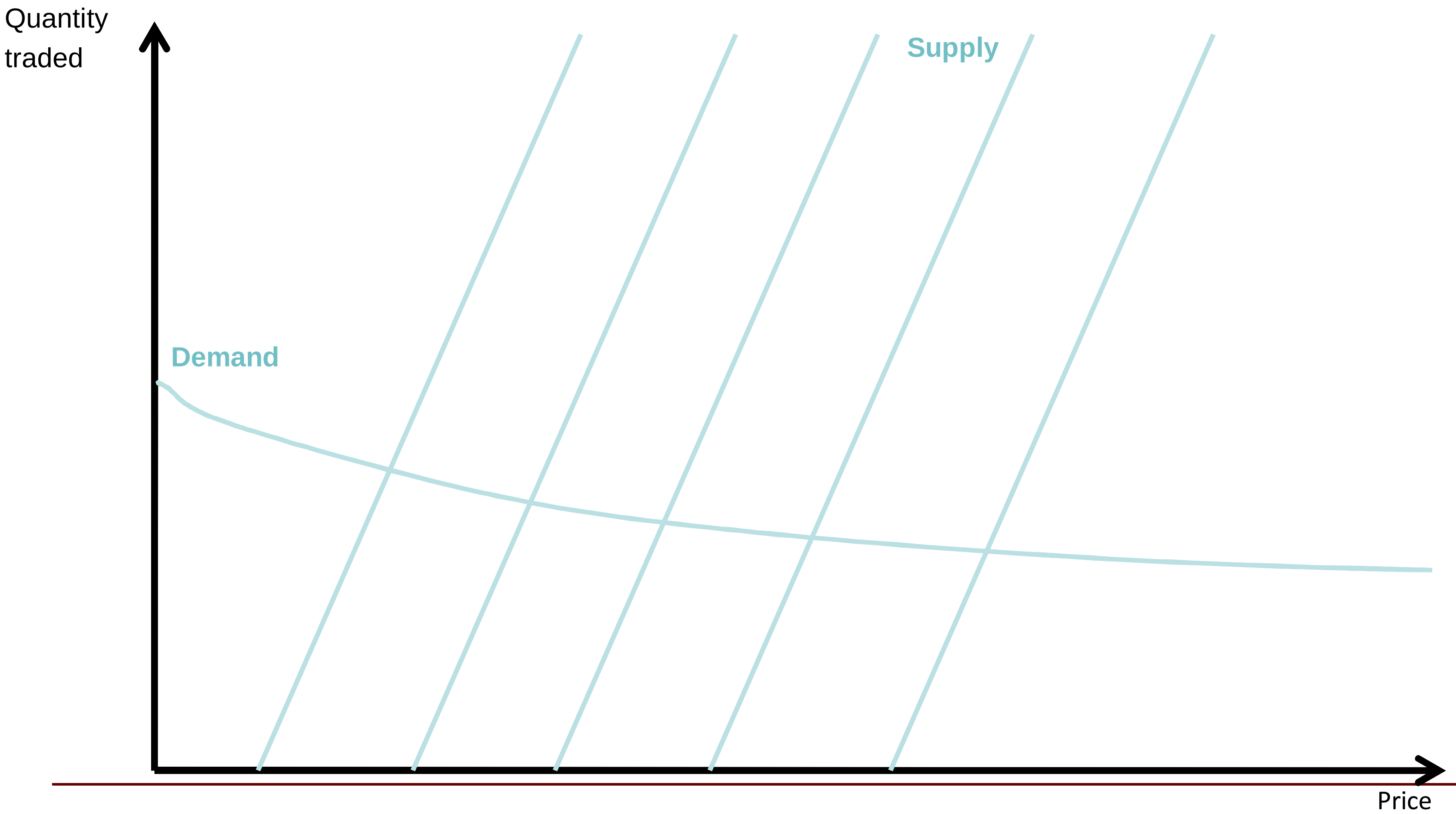
The insurance cycle



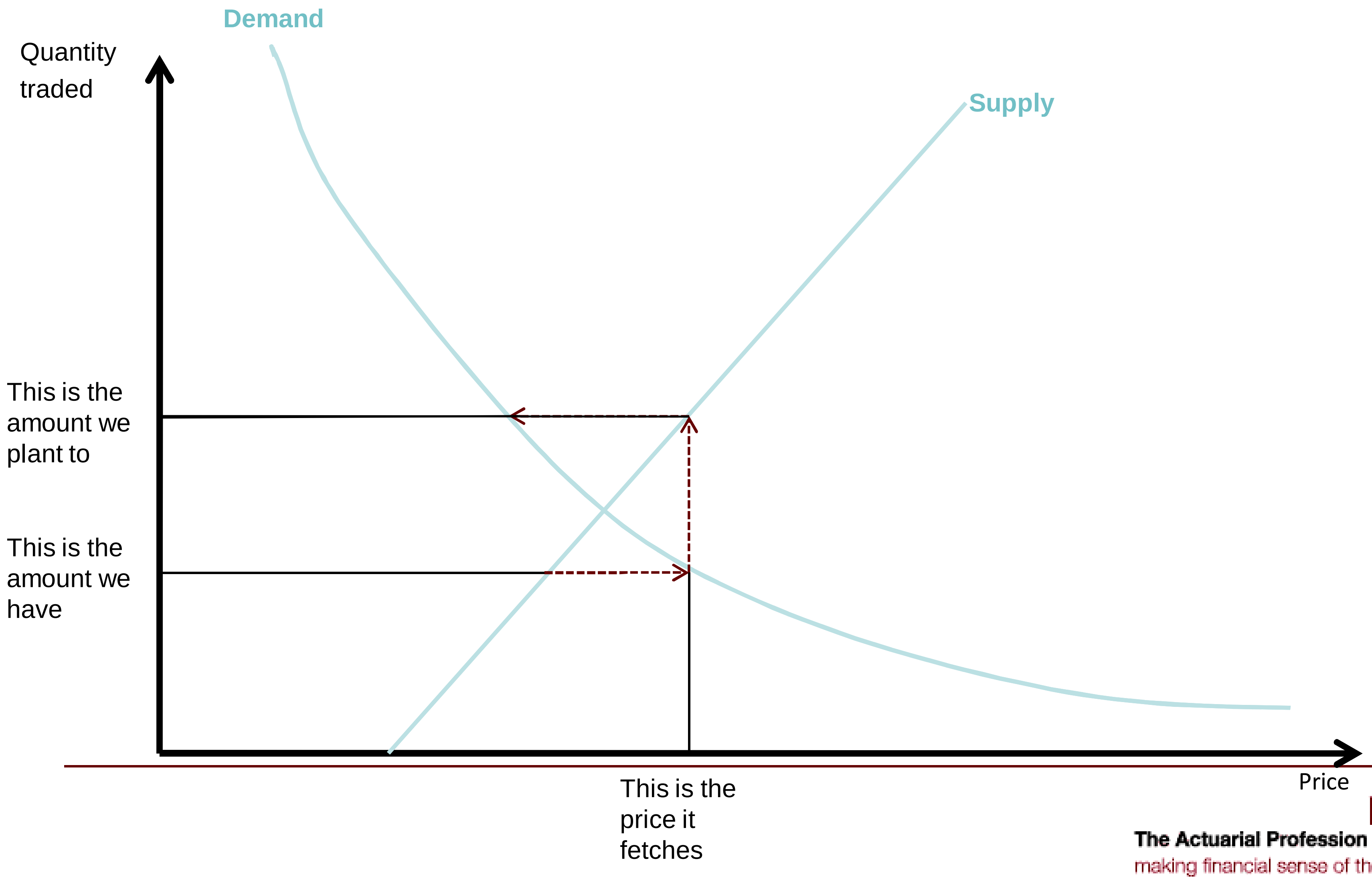
Where does the cycle come from?

- Entirely on the supply side
- Movements in the supply curve

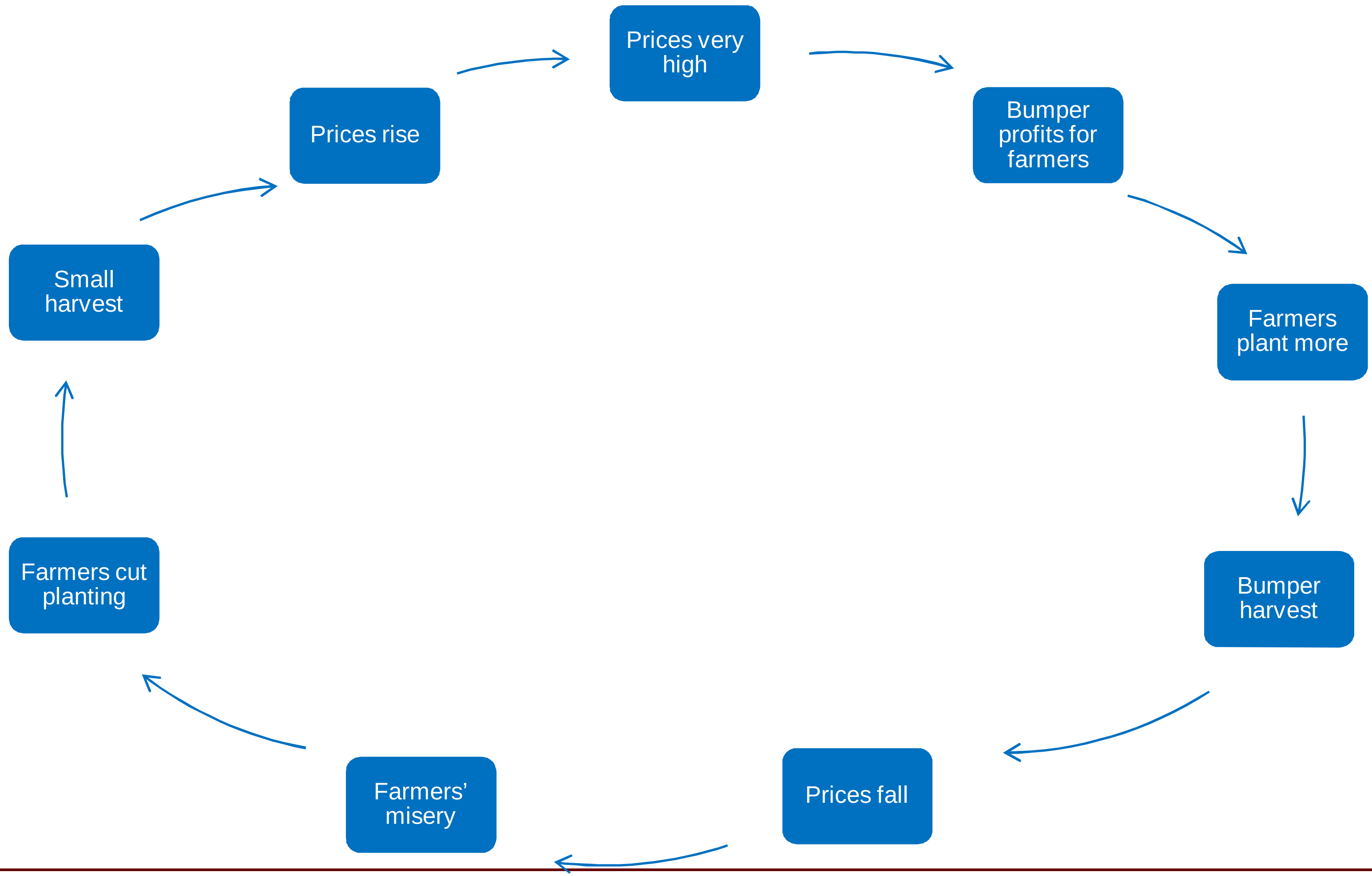
The insurance market



The market for wheat



The wheat cycle



Compare two industries

Wheat

Insurance

Conclusions

- The insurance cycle is not like an agricultural cycle
- The insurance cycle is not entirely rational
- It may be more rational than it used to be