US Insurance Market Briefing and an Update of Dodd-Frank Implementation

Insurance Information Institute

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Presentation Outline

- **Insurance Industry Financial Developments: Overview & Outlook**
  - Profitability
  - Premium growth
  - Capital & capacity
- **Financial Strength & Solvency**
  - Non-Life (P/C), Life
- **Dodd-Frank Financial Services Reform & Consumer Protection Act**
  - Summary of implications for insurers
  - Systemic Risk
  - Financial Stability Oversight Council (FSOC)
  - Federal Insurance Office (FIO)
- **Dodd-Frank: One Year On**
  - Status Report: Focus on FSOC and FIO
  - Reasons for slow implementation, including issues relevant to insurers
- **Dodd-Frank & Insurance: The Years Ahead**
  - Short, Medium, Longer-Term & Global Issues;
    - Regulatory Streamlining
    - Ultimate Regulatory Authority: Federal vs. State
    - International Coordination/Harmonization of Regulation

Insurance Industry Financial Developments

Developments in the US Insurance Industry Potentially Influencing Dodd-Frank Implementation

P/C Net Income After Taxes 1991–2011:H1 ($ Millions)

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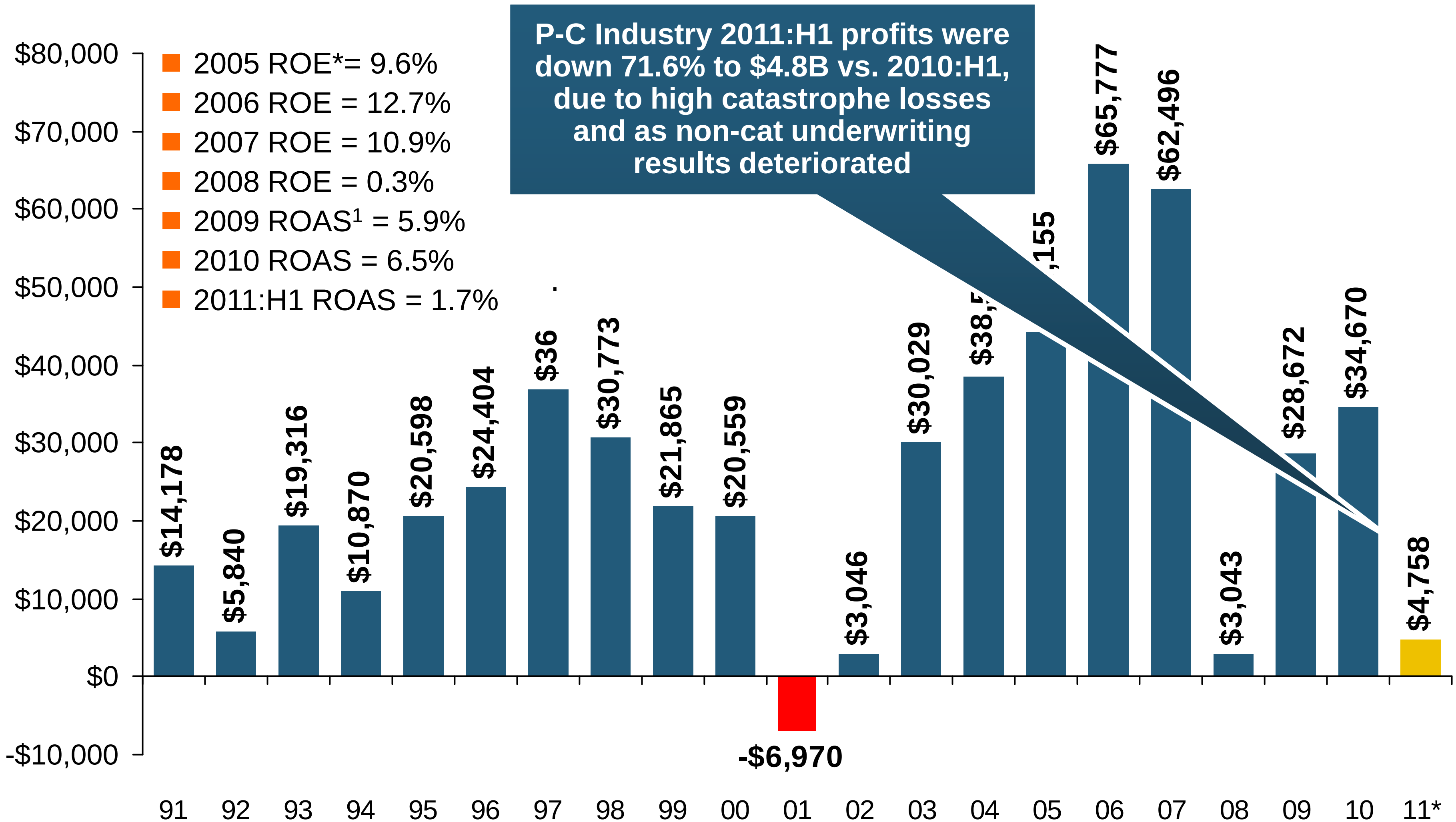

* ROE figures are GAAP; [1]Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 2.3% ROAS for 2011:H1, 7.5% for 2010 and 7.4% for 2009.

Sources: A.M. Best, ISO, Insurance Information Institute

Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2011*

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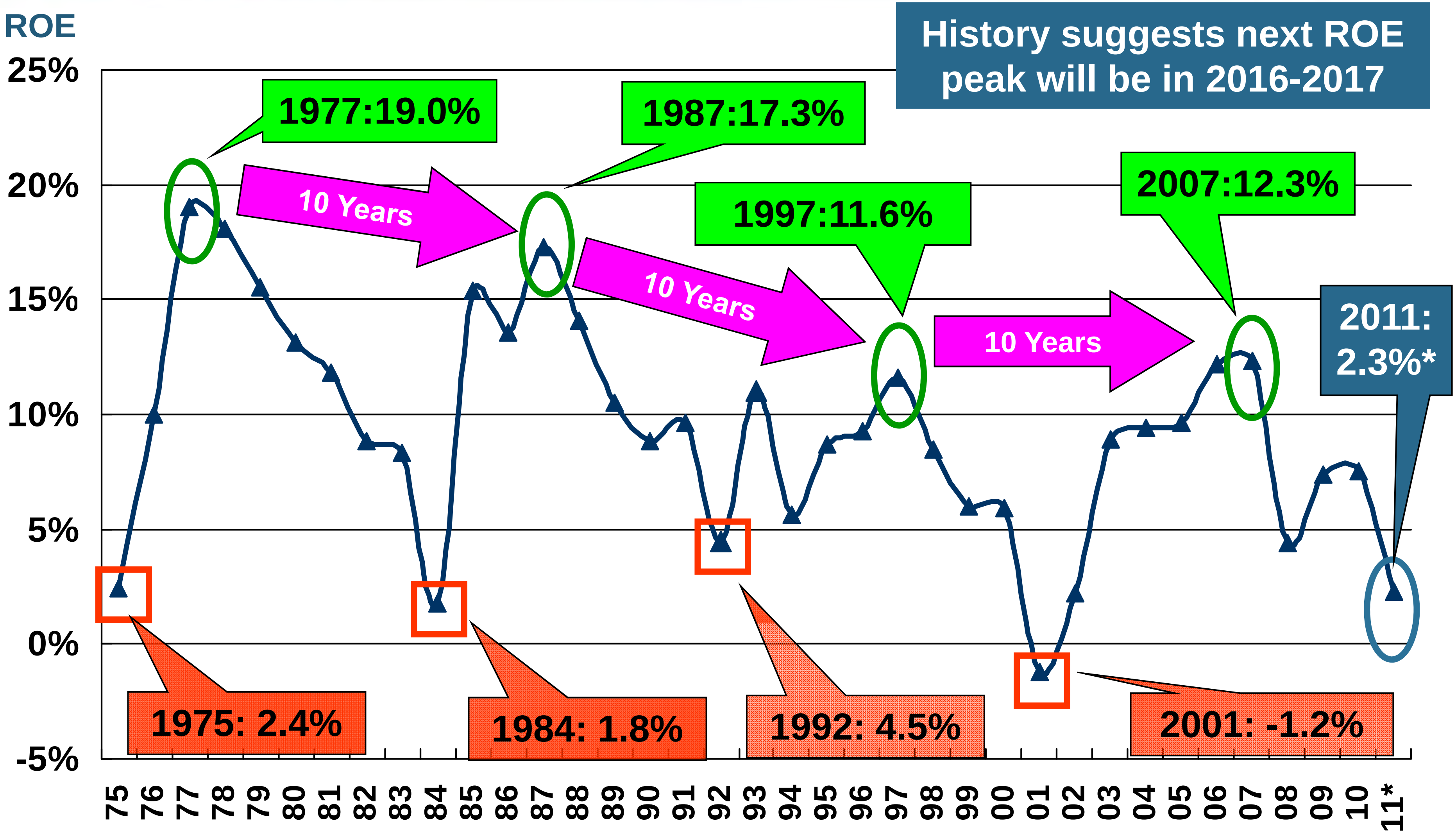

*Profitability = P/C insurer ROEs are I.I.I. estimates. 2011 figure is an estimate based on annualized ROAS for H1 data.
Note: Data for 2008-2011 exclude mortgage and financial guaranty insurers. For 2011:H1 ROAS = 1.7% including M&FG.
Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

Life/Annuity Industry Profits, 2001-2010

The Life/Annuity industry has produced steady (if unspectacular) profits, except for years in which the industry's investment results produced significant realized capital losses.

Sources: NAIC, via SNL Financial; Insurance Information Institute.

Soft Market Persisted in 2010 but Growth Returned: More in 2011?

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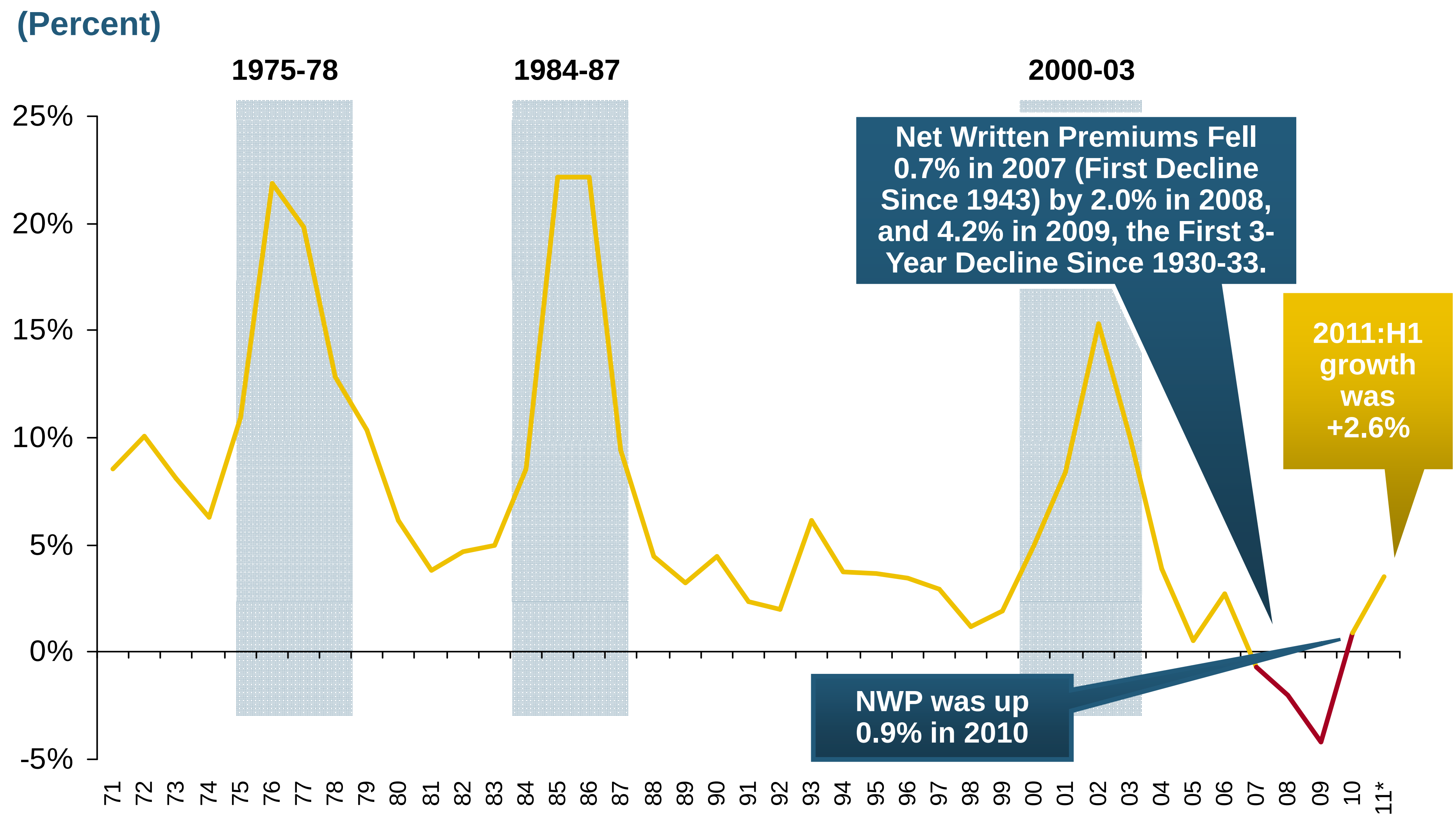

*2011 figure is for H1 vs. 2010:H1.
Shaded areas denote “hard market” periods
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

Life/Health US Total Premiums, 1996-2010

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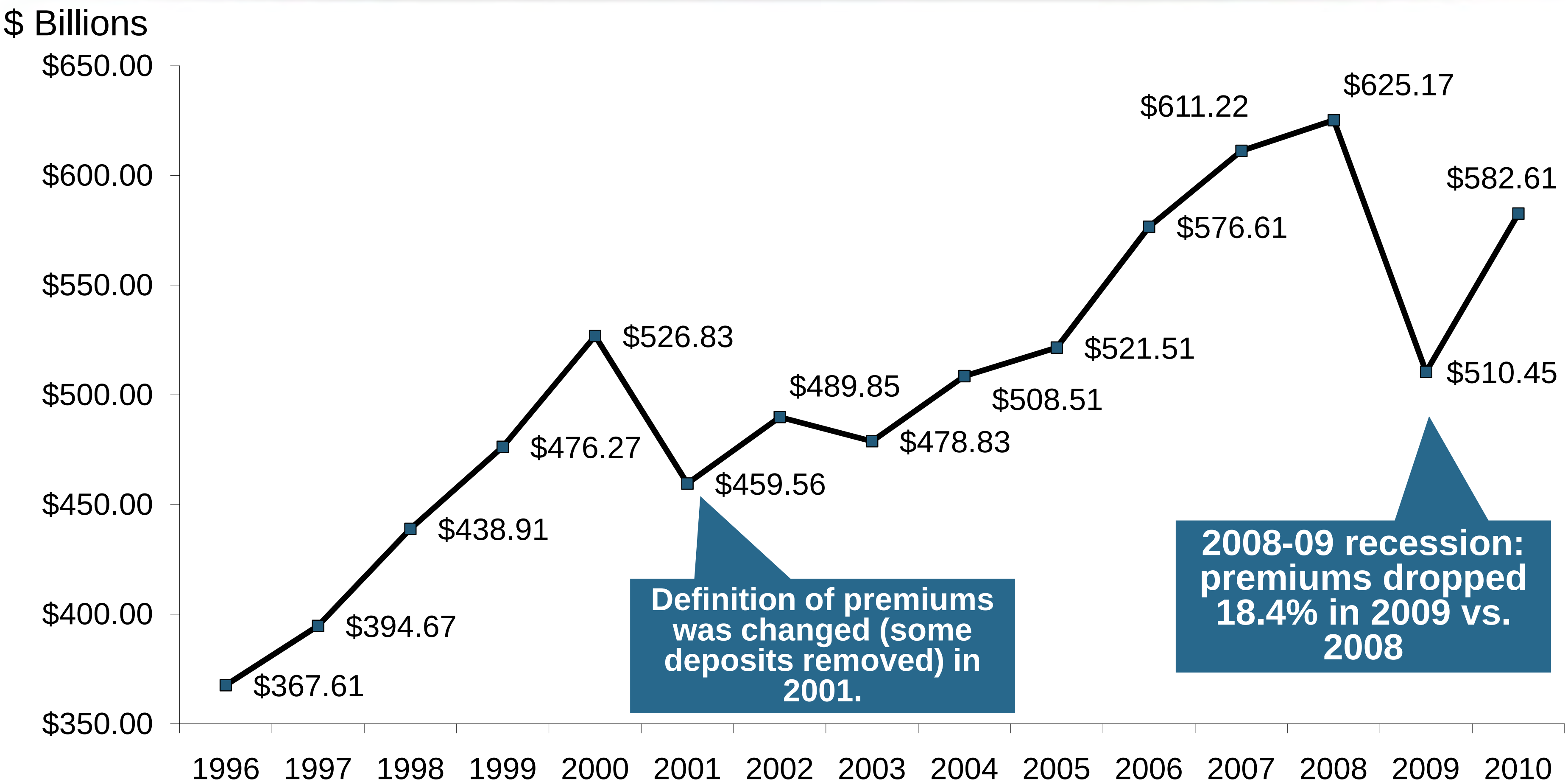
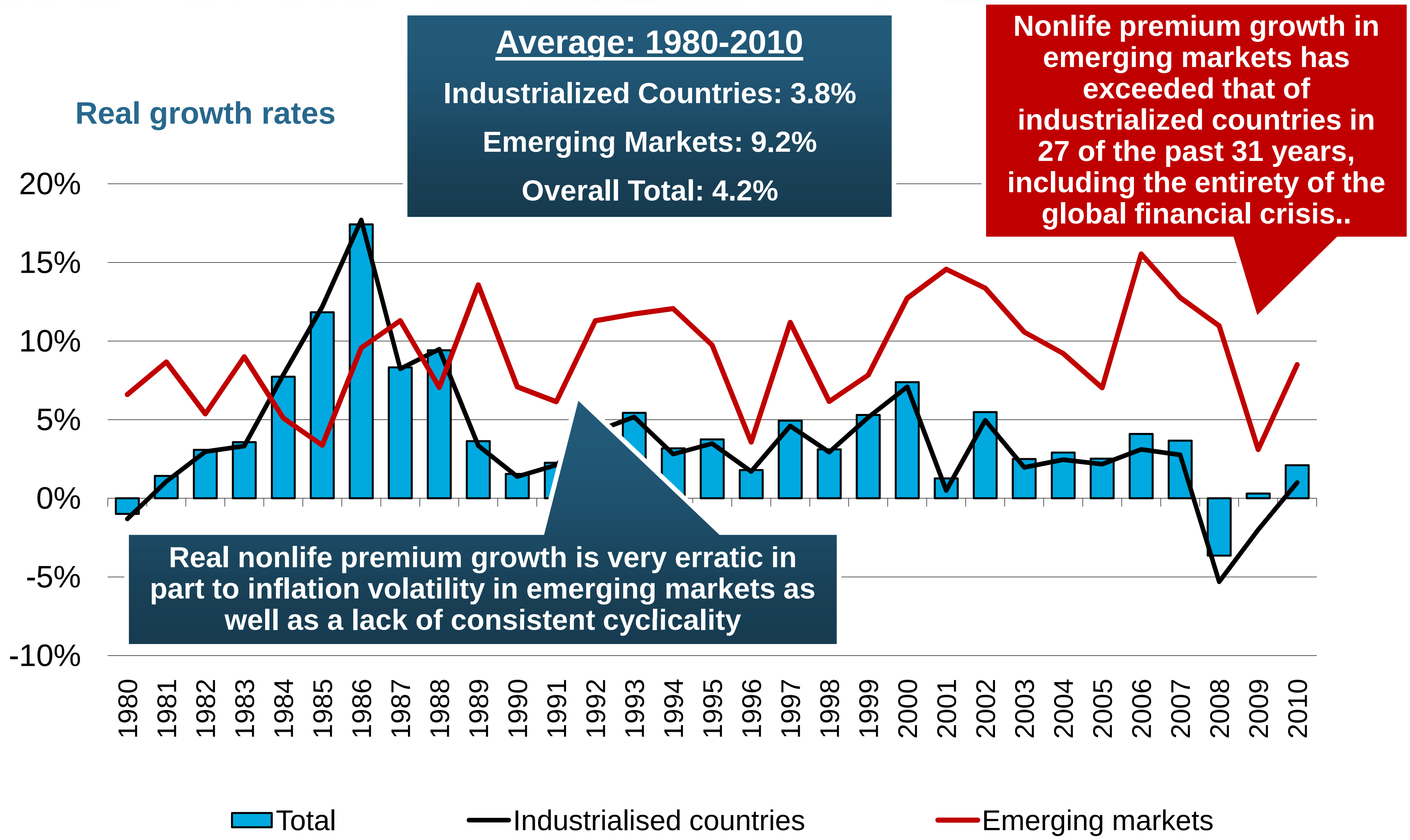


From 2001 to 2010, the industry's total premiums grew by 26.8%. However, adjusted for inflation (as measured by the CPI-U), premiums were virtually flat (they grew by only 3.0%) over that decade.

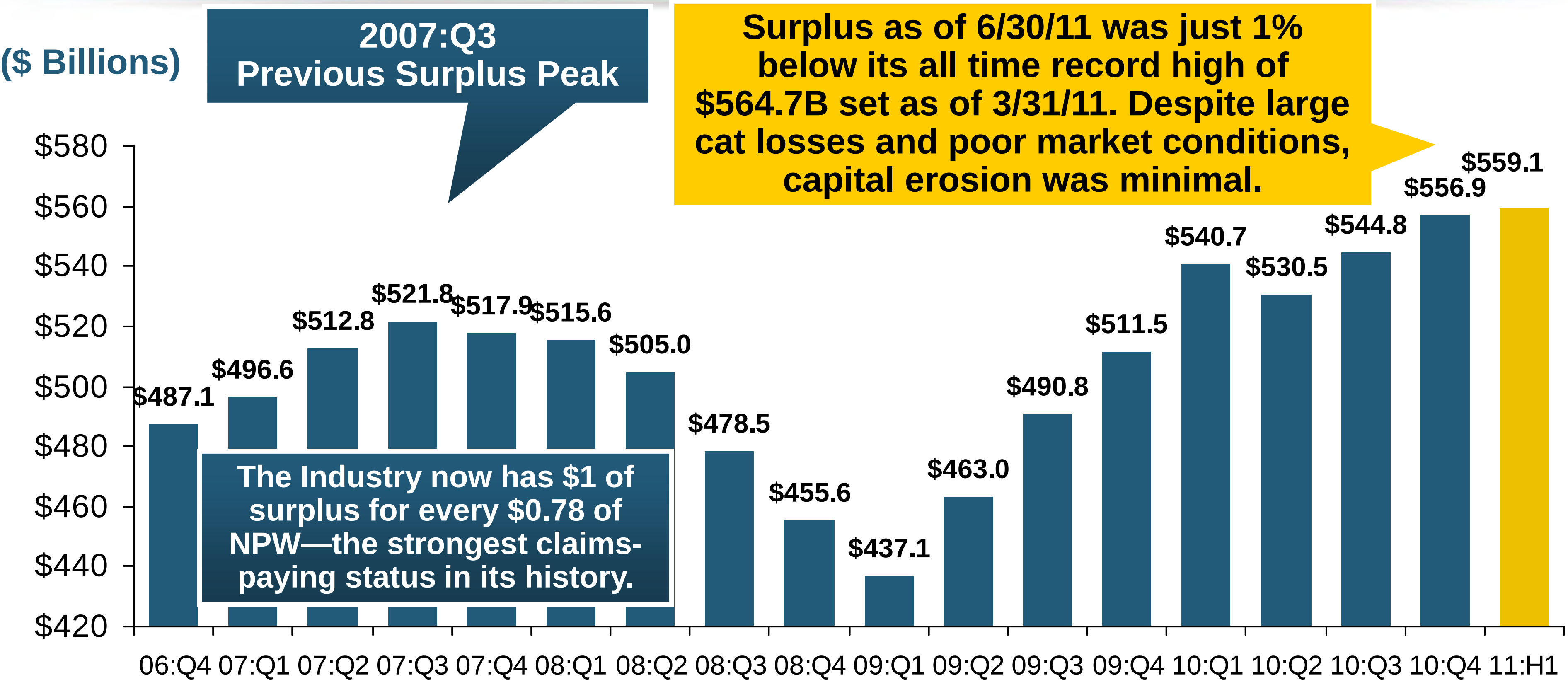
Source: SNL Financial, based on NAIC Annual Statements

Global Real (Inflation Adjusted) Nonlife Premium Growth: 1980-2010



Source: Swiss Re, *sigma*, No. 2/2010.

Policyholder Surplus, 2006:Q4–2011:Q2

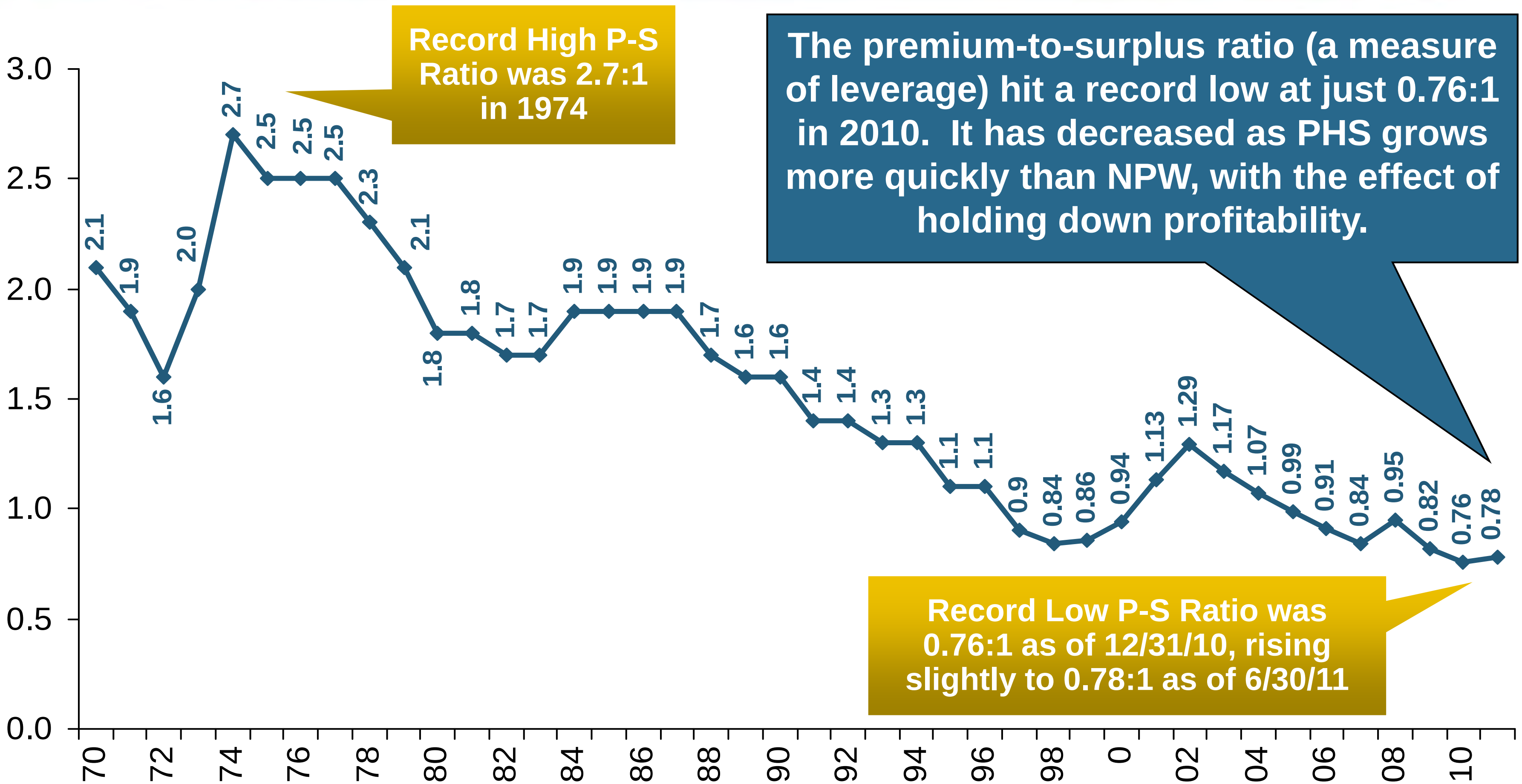


*Includes $22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business in early 2010.

Sources: ISO, A.M .Best.

Quarterly Surplus Changes Since 2007:Q3 Peak	
09:Q1: -$84.7B (-16.2%)	10:Q2: +$8.7B (+1.7%)
09:Q2: -$58.8B (-11.2%)	10:Q3: +$23.0B (+4.4%)
09:Q3: -$31.0B (-5.9%)	10:Q4: +$35.1B (+6.7%)
09:Q4: -$10.3B (-2.0%)	11:Q1: +$42.9B (+8.2%)
10:Q1: +$18.9B (+3.6%)	11:Q2: +37.3B (+7.1%)

Ratio of Net Premiums Written to Policyholder Surplus, 1970-2011*



The Premium-to-Surplus Ratio in 2011:H1 Implies that P/C Insurers Held $1 in Surplus Against Each $0.78 Written in Premiums. In 1974, Each $1 of Surplus Backed $2.70 in Premium.

*2011 data are as of 6/30/11.

Sources: Insurance Information Institute calculations from A.M. Best data.

Distribution of A.M. Best Ratings for L-H Insurers, 2000-2010

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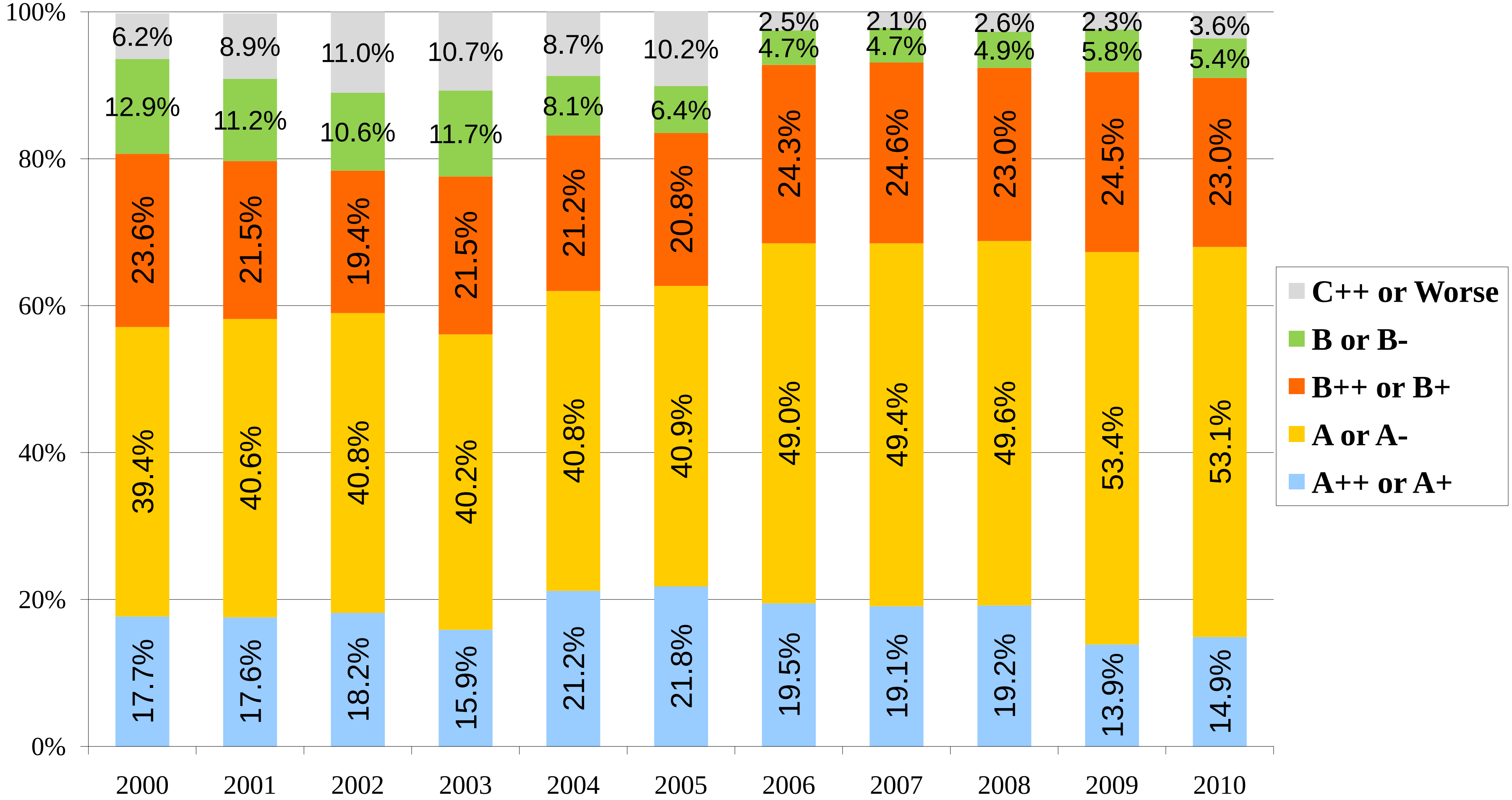

The Percent of A/A- L-H Insurers Has Grown.
Today 2/3 of L-H Insurers Have A. M. Best Ratings of A- or Better

Source: *The Insurance Forum*, September issue, various years

Treasury Yield Curves: Pre-Crisis (July 2007) vs. Sept. 2011*

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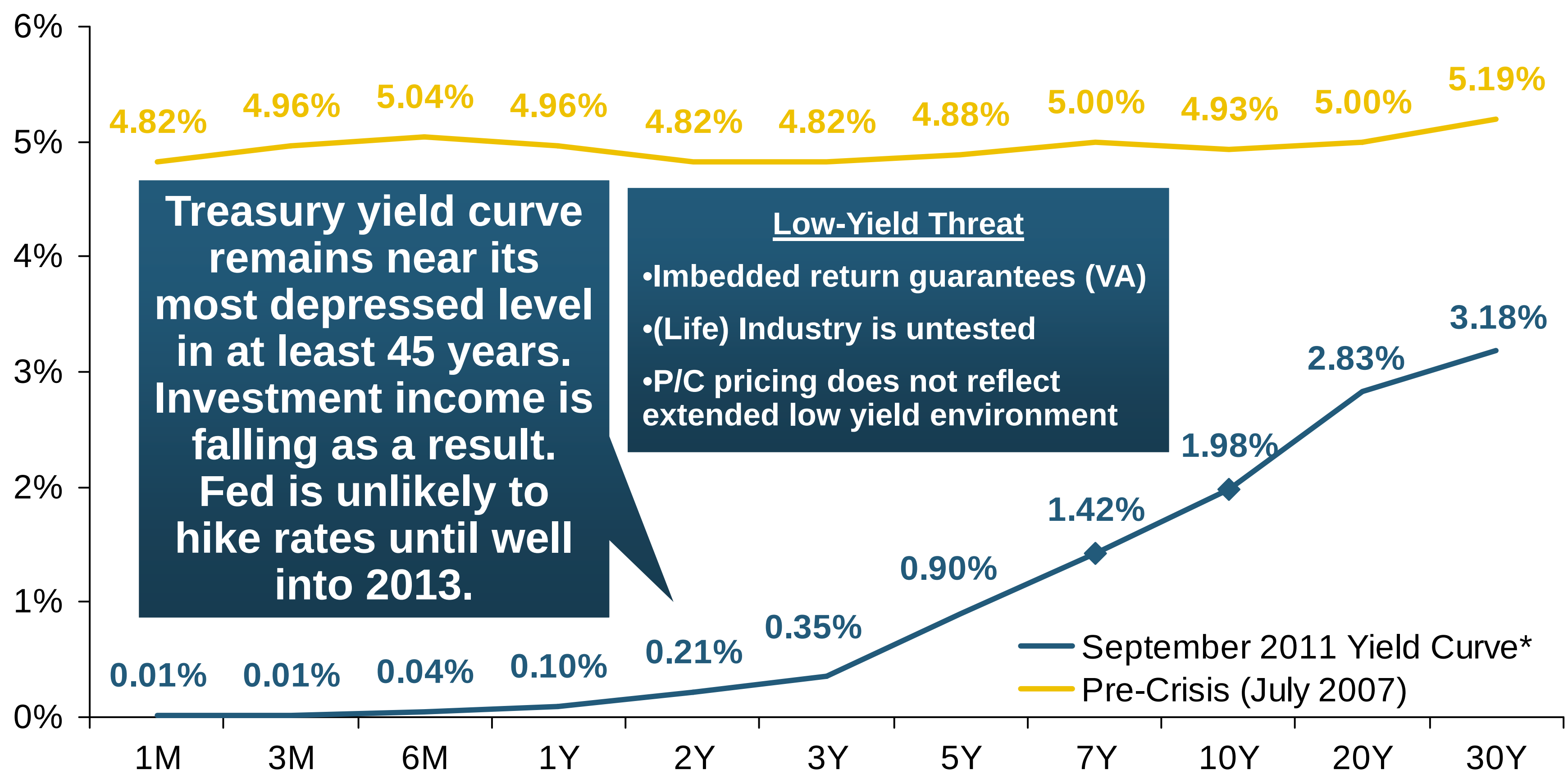

Low Interest Rates Are Potentially the Most Serious Threat to Insurers.
Rates Actually Fell Following the End of the Fed's Quantitative Easing Program Due to Ongoing Economic Weakness

*Average of daily rates.

Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.

Interest Rates in Critical Insurance Markets as of Early Oct. 2011 vs. Greece, Italy, Spain

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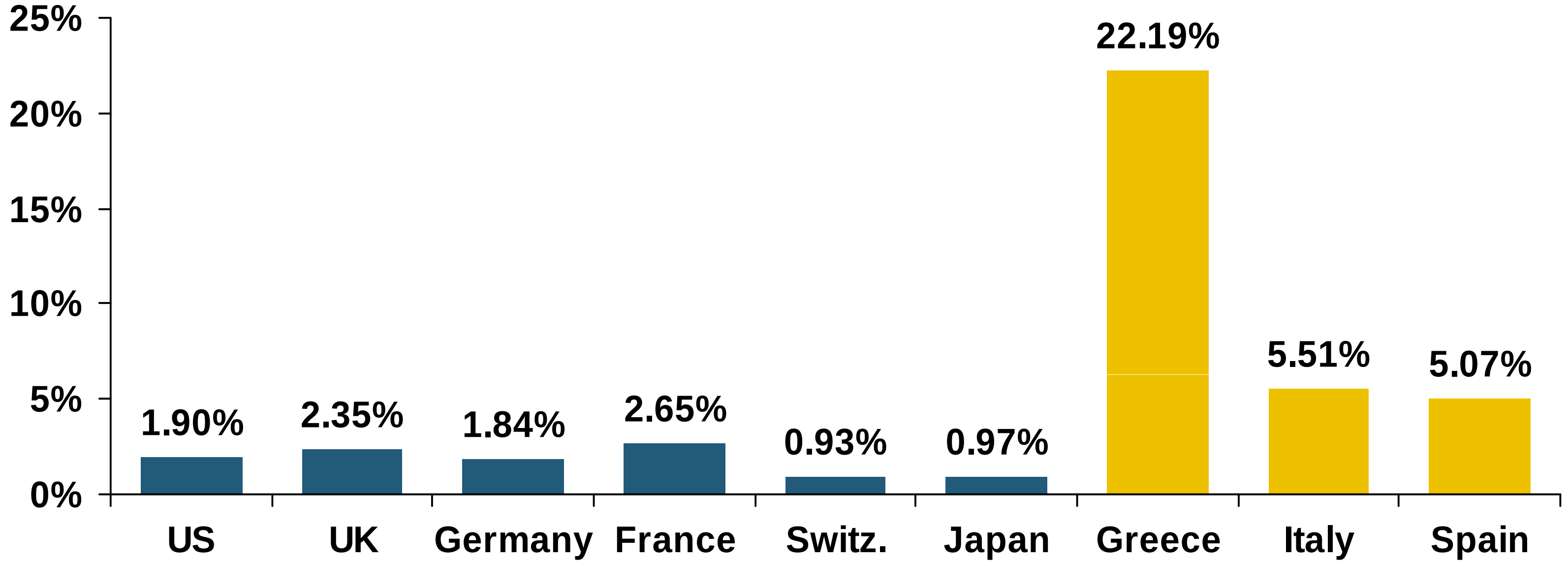
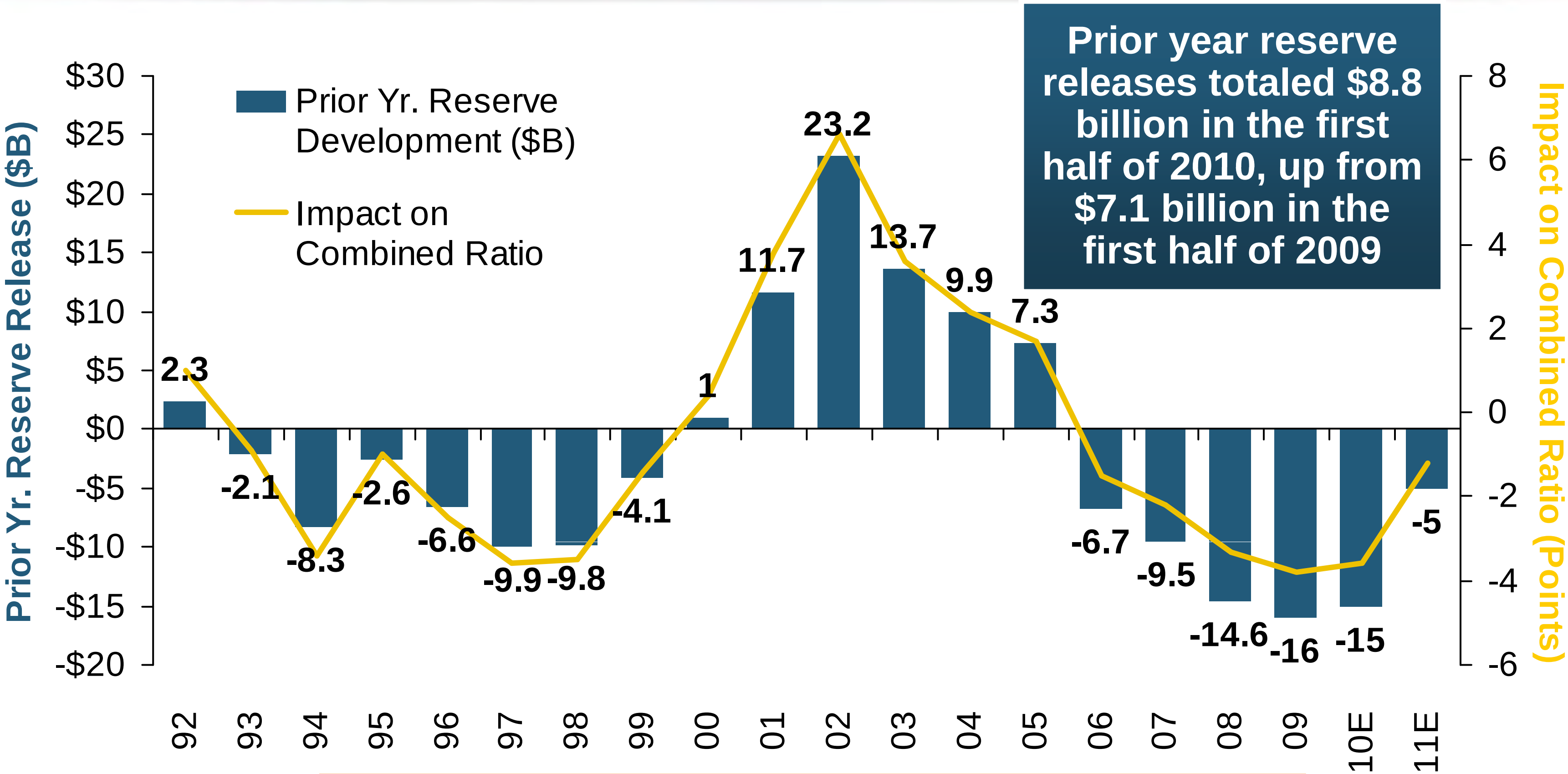
Yield on 10-Year Government Bonds



Low, long-term yields are a major challenge for many of the world's major insurers, particularly life and pension companies

Sources: *The Economist,* Oct. 8, 2011; Insurance Information Institute.

P/C Reserve Development, 1992–2011E



Reserve Releases Are Remained Strong in 2010 But Are Tapering Off in 2011

Note: 2005 reserve development excludes a $6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was $7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.

Sources: Barclay's Capital; A.M. Best.

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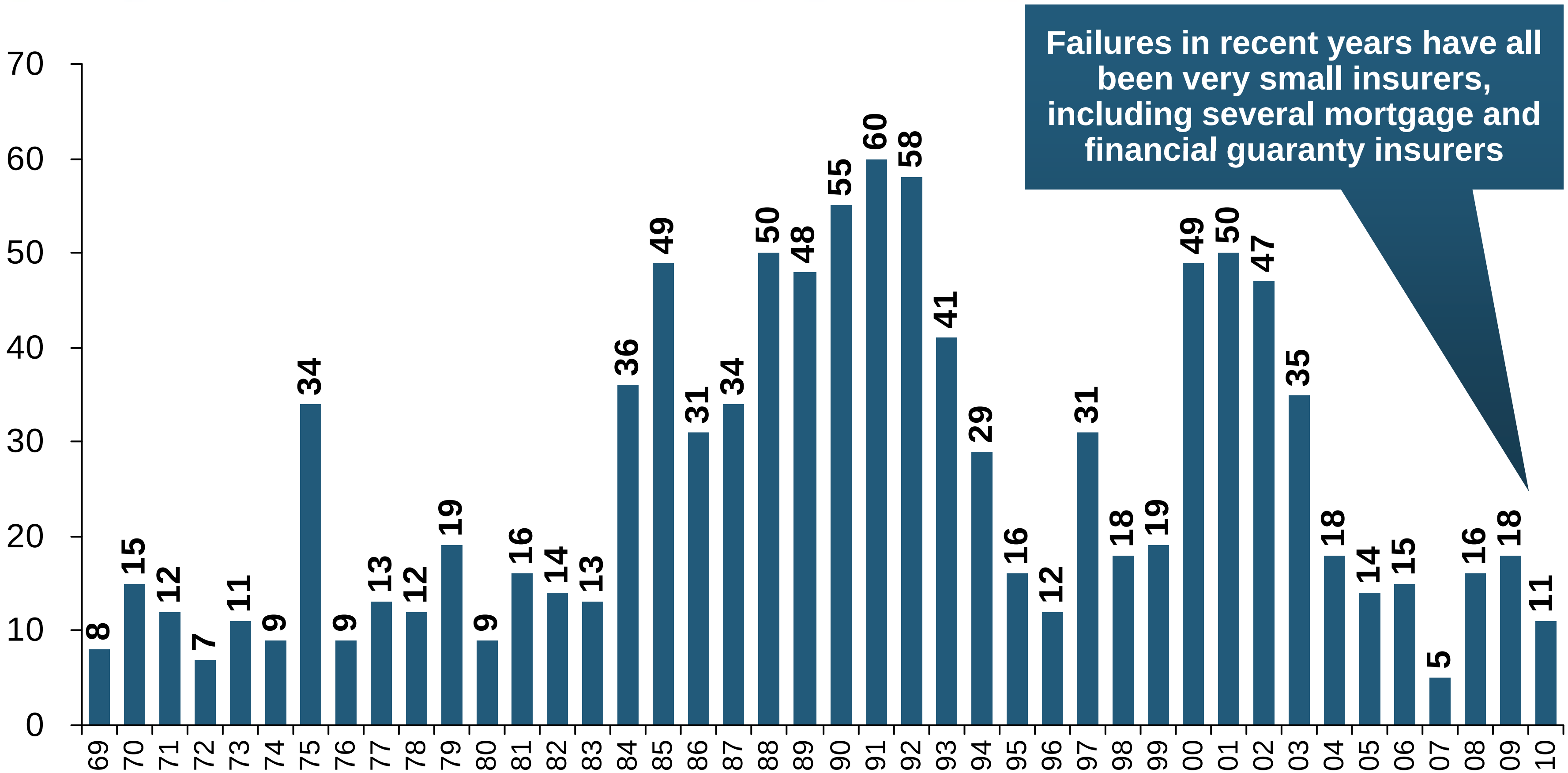
Financial Strength: Reserving, Low Yields Are the Greatest Challenge

Impairment History is Tied, Reserving & Pricing; No Systemic Linkages; Low Interest Rates Are a New Threat

P/C Insurer Impairments, 1969–2010



The Number of Impairments Varies Significantly Over the P/C Insurance Cycle, With Peaks Occurring Well into Hard Markets

Source: A.M. Best Special Report "1969-2010 Impairment Review," June 21, 2011; Insurance Information Institute.

Number of Impaired L/H Insurers, 1976–2010

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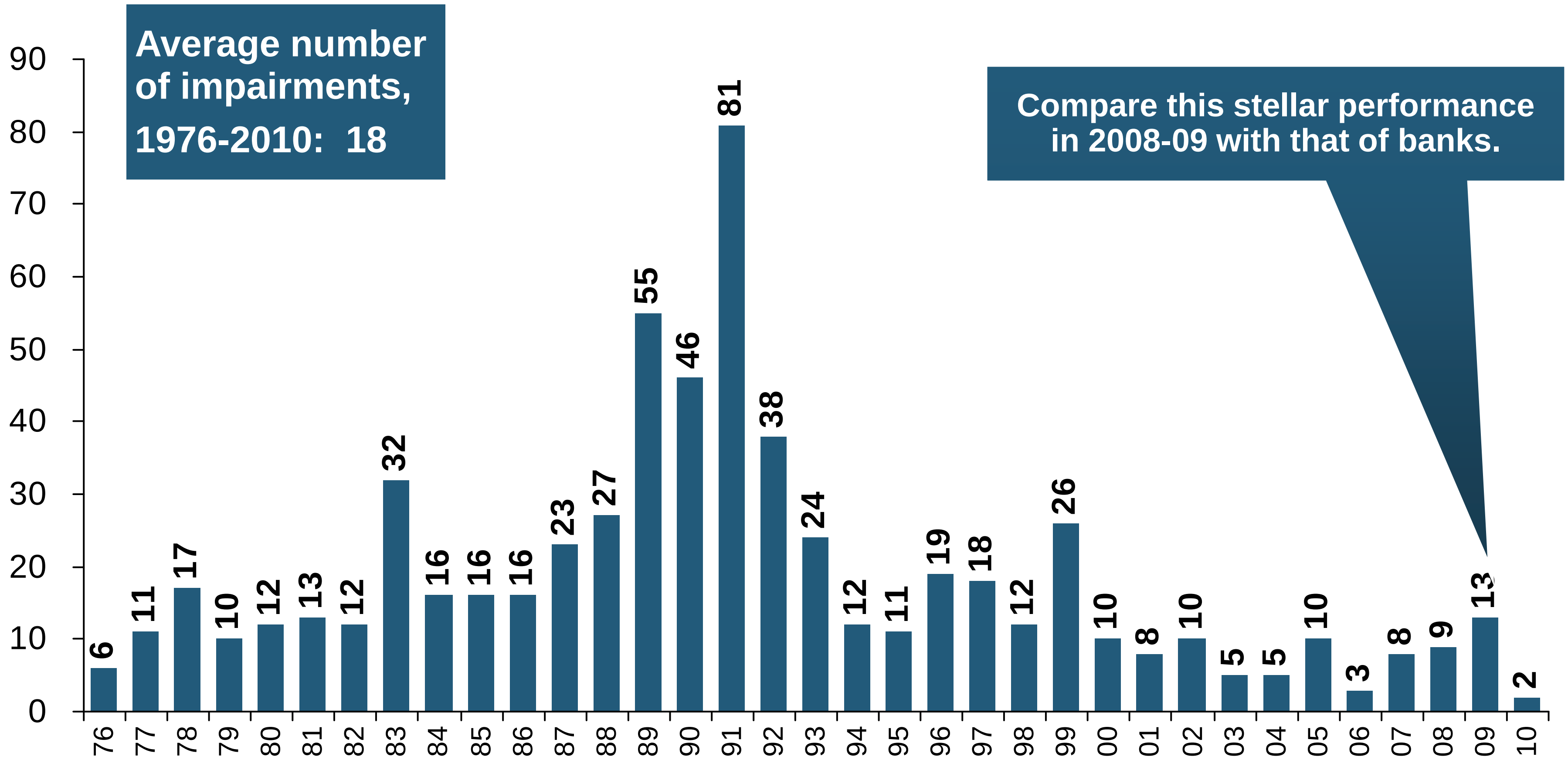
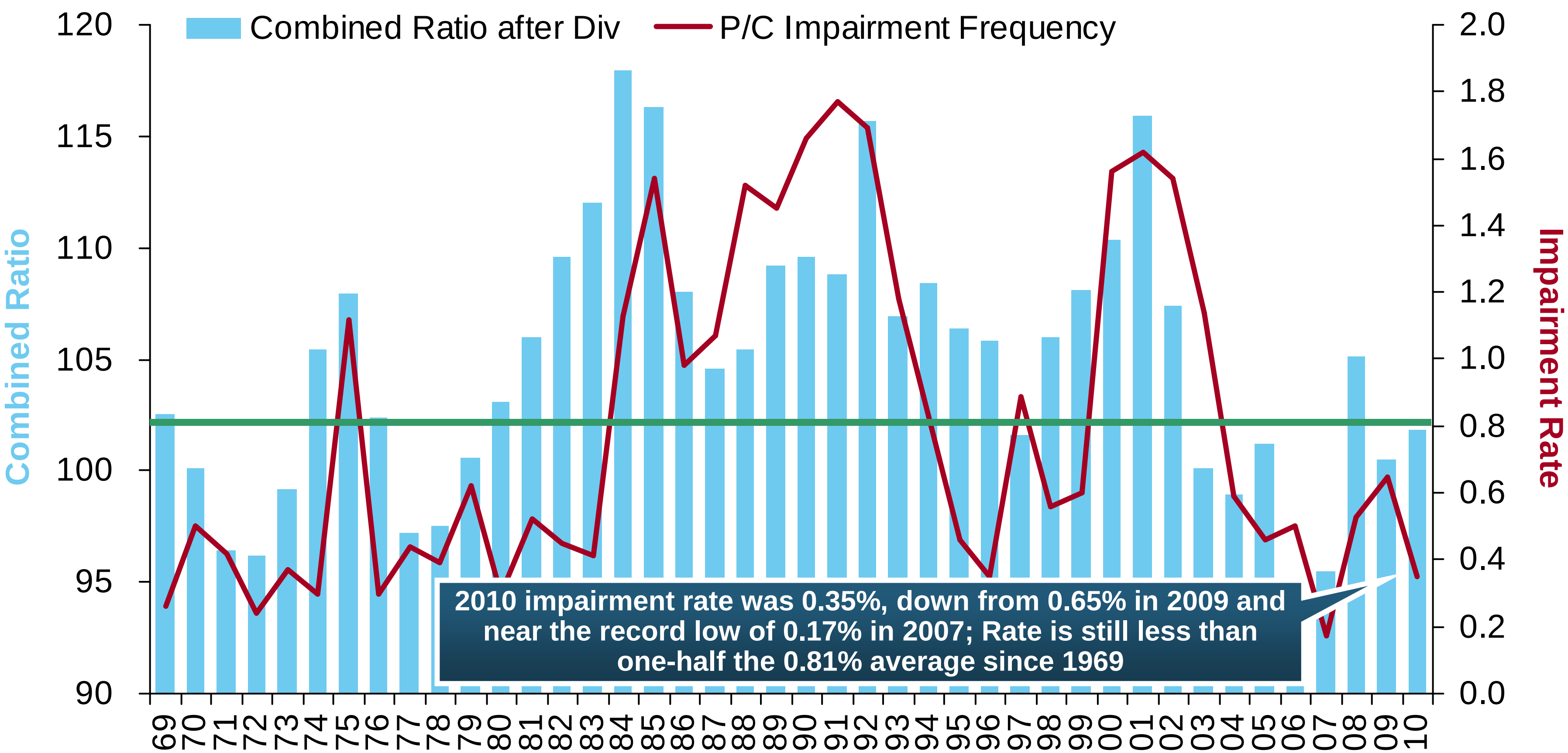


The Number of Impairments Spiked in 1989-92, with Smaller Spikes in 1983 and 1999. But in the Financial Crisis, When Hundreds of Banks Failed, Virtually No Life Insurers Failed.

Source: A.M. Best Special Report "1976-2010 Impairment Review", published May 23, 2011; Insurance Information Institute.

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2010



Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007

Source: A.M. Best; Insurance Information Institute

Reasons for US P/C Insurer Impairments, 1969–2010

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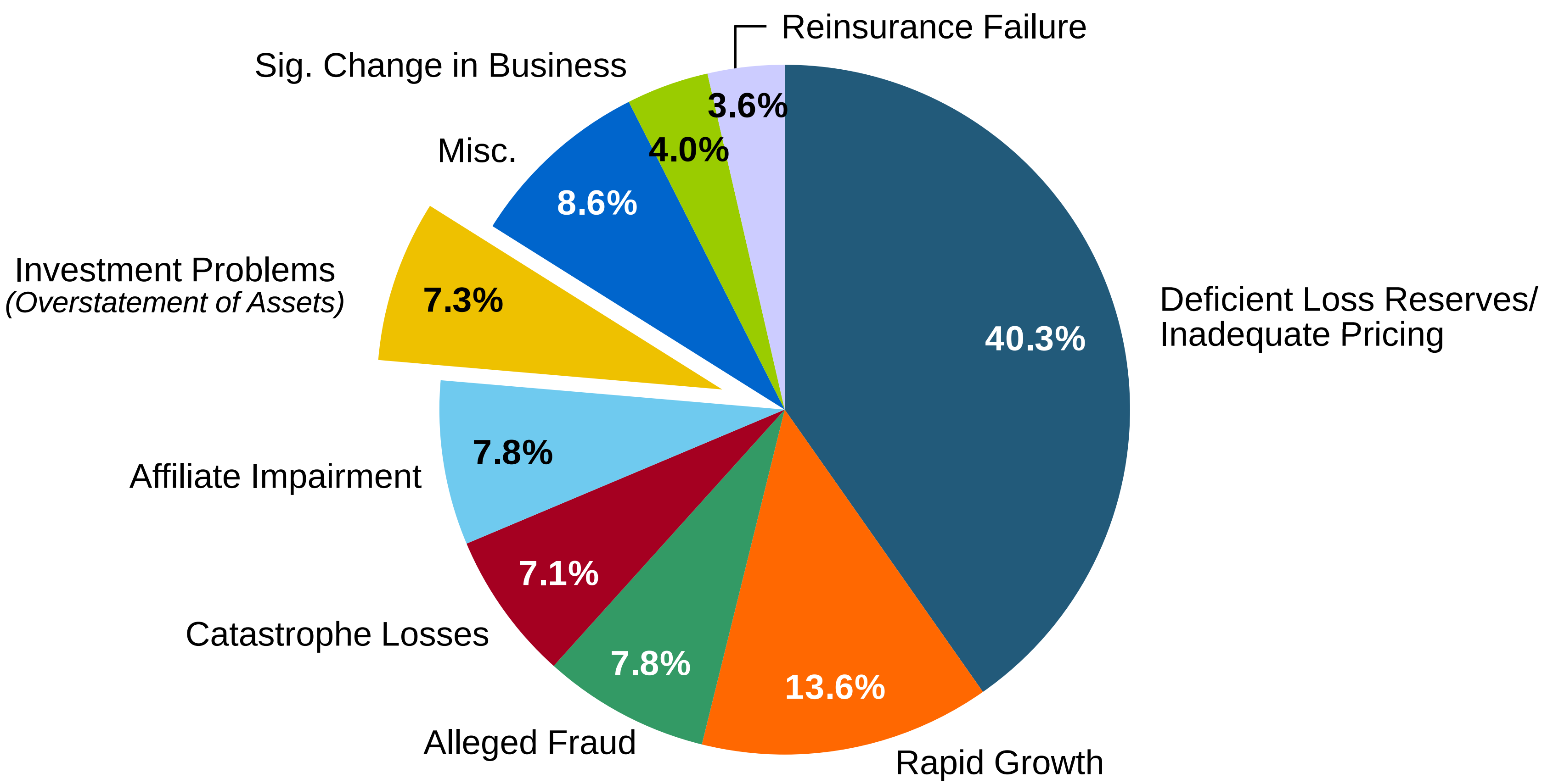
Historically, Deficient Loss Reserves and Inadequate Pricing Are By Far the Leading Cause of P-C Insurer Impairments. Investment and Catastrophe Losses Play a Much Smaller Role



Source: A.M. Best: *1969-2010 Impairment Review*, Special Report, April 2011.

Dodd-Frank Financial Services Reform & Consumer Protection Act

A Brief Summary of Implications for Insurers

Financial Services Reform:
What does it mean for insurers?

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The Dodd-Frank Wall Street Reform and Consumer Protection Act

- **Systemic Risk and Resolution Authority**
  - Creates the Financial Stability Oversight Council and the Office of Financial Research
  - Imposes heightened federal regulation on large bank holding companies and "systemically risky" nonbank financial companies, including insurers
- **Federal Insurance Office (FIO)**
  - Establishes the FIO (while maintaining state regulation of insurance) within the Department of Treasury, headed by a Director appointed by the Secretary of Treasury
  - FIO will have authority to monitor the insurance industry, identify regulatory gaps that could contribute to systemic crisis
  - ***CONCERN: FIO morphs into quasi/shadow or actual regulator***
- **Surplus Lines/Reinsurance**
  - Title V of the Dodd-Frank bill includes, as a separate subtitle, the Nonadmitted and Reinsurance Reform Act (NRRA), which eliminates regulatory inefficiencies associated with surplus lines insurance and reinsurance

Source: Insurance Information Institute (I.I.I.) updates and research; The Financial Services Roundtable; Adapted from summary by Dewey & LeBoeuf LLP

Systemic Risk: Oversight & Resolution Authority

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Issues Related to Systemic Risk & Resolution Authority

- **Financial Stability Oversight Council created to oversee systemic risk of large financial holding companies) [a.k.a. TOO BIG TOO FAIL]**
  - P/C insurers potentially could be determined to present systemic risk to the financial system and thus be supervised by the Federal Reserve.
  - Such supervision would subject such insurers to prudential standards, if the Council determines that financial distress at the company would pose a threat to the U.S. financial system.
- **Orderly Liquidation**
  - The legislation provides an "Orderly Liquidation Authority" mechanism whereby the FDIC would have enhance powers to resolve distress at financial institutions.
  - Insurance holding companies and any non-insurance subsidiaries of insurers may be subject to this authority.

Source: Insurance Information Institute (I.I.I.) updates/research; The Financial Services Roundtable; Adapted from summary by Dewey & LeBoeuf LLP

Federal Insurance Office (FIO): *What Would it Do?*

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Duties of the Federal Insurance Office

- **Establishes office within US Treasury headed by a Director appointed by Treasury Secretary, and charged with:**
  - Monitor the insurance industry to gain expertise (oversight extends to all lines of insurance except health insurance, long-term care and federal crop insurance).
  - Identify regulatory gaps that could contribute to a systemic crisis in the insurance industry or the U.S. financial system.
  - Gather information from the insurance industry in order to analyze such data and issue reports. May require insurers, with exception of small insurers which are exempt, to submit data and FIO director can issue subpoenas to gain such info.
  - Deal with international insurance matters.
  - Monitor the extent to which underserved communities have access to affordable insurance products.
  - Assist in administration of the Terrorism Risk Insurance Program (expires end of 2014)

Source: Insurance Information Institute (I.I.I.) updates/research; The Financial Services Roundtable; Adapted from summary by Dewey & LeBoeuf LLP

Dodd-Frank One Year:
Status Report

Expectations vs. Reality

Dodd-Frank Implementation
Status Report for Insurers: Slow Start

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The Dodd-Frank Wall Street Reform and Consumer Protection Act

- **Financial Stability Oversight Council—*Slow to Consider Insurer Concerns***
  - FSOC deliberates largely behind closed doors
  - Criteria and process for designation of Systemically Important Financial Institutions (SIFIs) were not announced until October 12, 2011
    - ***Possible that small number of US insurers will be designated as SIFIs***
  - Operated/deliberated until late September 2011 without a voting member representing the insurance industry
    - ***Roy Woodall, approved by Senate in Sept. 27, 2011, is the sole voting representative for the entire p/c and life insurance industry (was Kentucky Ins. Comm. 1966-1967; Worked in other insurance trade posts, Treasury)***
  - Two non-voting FSOC members represent insurance interests:
    - ***FIO Director Michael McGraith (started June 1, 2011)***
    - ***Missouri Insurance Director John Huff (started in Sept. 2010)***
      - ***Not allowed to brief fellow regulators on FSOC discussions***

Source: Insurance Information Institute (I.I.I.) updates and research

Dodd-Frank Implementation: *SYSTEMIC RISK CRITERIA*

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The Dodd-Frank Act and Systemic Importance

- **All Banks with Assets > $50B Considered Systemically Important**
- **Non-Bank Financial Groups with Global Consolidated Assets > $50B Will Be Examined for Systemic Riskiness, But Not Automatically Labeled as a Systemically Important Financial Institution (SIFI)**
  - Foreign firms with assets in the US exceeding $50 billion will also fall under review
- **If Firm Exceeds the $50B Threshold, a 3-Stage Test Applies**
- **STAGE 1: Non-Banks Financial Groups with $50B+ Assets Will Be Evaluated on Five "Uniform Quantitative Thresholds," at Least One of Which Will Have to Be Met to Trigger a Further (Stage 2) Review Potentially Leading to a SIFI Designation**
  - **Leverage:** Would have to be leveraged more than 15:1 (insurers unlikely to trigger)
  - **ST Debt-to-Assets**: Would have to a ratio of ST debt (less than 12 months to maturity) to consolidate assets (excluding separate accounts) exceeding 10%
  - **Debt:** Have total debt exceeding $20 billion (i.e., loans borrowed and bond issues)
  - **Derivative Liabilities:** Have derivative liabilities exceeding $3.5 billion
  - **Credit Default Swaps:** Have more than $30 billion CDS outstanding for which the nonbank financial firm is the reference entity (i.e., CDS written against firm's failure)
- **Thresholds Considered to Be Guideposts**
  - Not all companies that breach a barrier will be deemed systemically important
  - Regulators retain right to include firms that do meet any of the criteria

Source: Financial Stability Oversight Council; Insurance Information Institute (I.I.I.) research.

Dodd-Frank Implementation: *SYSTEMIC RISK CRITERIA (continued)*

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The Dodd-Frank Act and Systemic Importance

- **STAGE 2: Analysis of Firms Triggering Uniform Quantitative Thresholds**
  - Firms triggering one or more of the quantitative thresholds in Stage 1 will be analyzed using publicly available information in order to conduct a more thorough review
  - No data call will be required at this stage
  - Firms viewed as potentially systemically important (candidate SIFIs) will subject to a Stage 3 analysis
- **STAGE 3: Analysis of Candidate Systemically Important Financial Institutions**
  - Firms deemed in Stage 2 to be potentially systemically important will be subjected to more detailed analysis including data not available during the Stage 2 analysis
  - Stage 3 firms will be notified by the FSOC that they are under consideration and will have the opportunity to contest their consideration
- **SIFI DESIGNATION PROCEDURE: 2-Stage Voting Procedure by FSOC is Required Before a Final SIFI Designation is Made**
  - At the conclusion of the Stage 3, FSOC has the authority to propose a firm be designated as a SIFI
  - Requires 2/3 majority vote of FSOC members, including affirmation of the Chair (Treasury Secretary)
  - Potential SIFI firm will be given written explanation for the determination
  - Firm can request a hearing to contest the determination
  - Final determination requires *another* 2/3 majority of FSOC members and affirmation of the Chair

Source: Financial Stability Oversight Council; Insurance Information Institute (I.I.I.) research.

Dodd-Frank Implementation: *FSOC MEMBERS*

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The Dodd-Frank Act and Systemic Importance

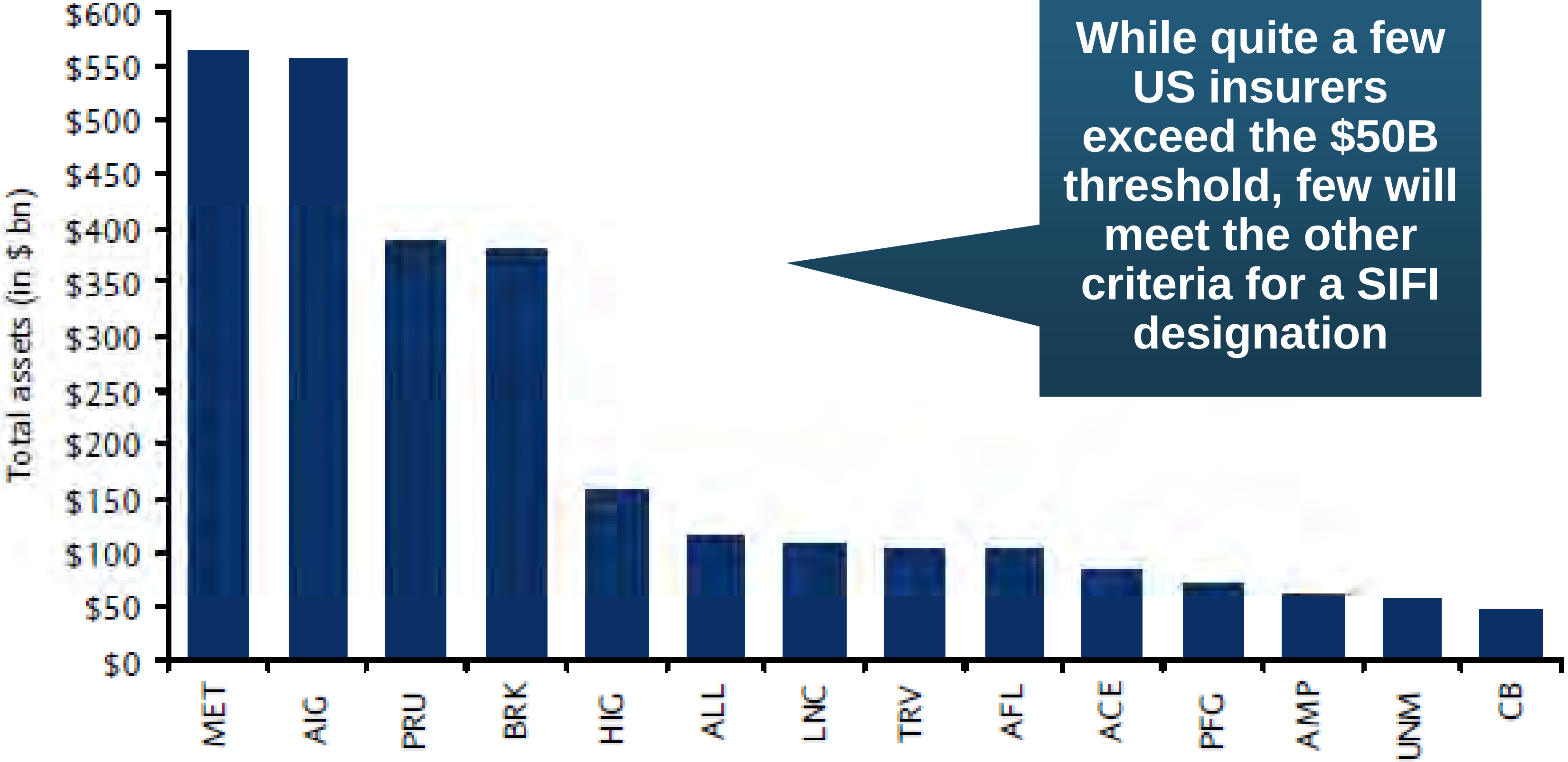
Members of the Financial Stability Oversight Council

- There are 10 voting members of the FSCO

- **Treasury Secretary and FSOC Chair: Timothy Geithner**
- **Federal Reserve Chairman: Ben Bernanke**
- **Securities & Exchange Commission Chairman: Mary Shapiro**
- **Commodities Futures Trading Commission Chairman: Gary Gensler**
- **National Credit Union Administration Chairman: Debbie Matz**
- **(Acting) Comptroller of the Currency: John Walsh**
- **Federal Housing Finance Agency (Acting) Director: Edward DeMarco**
- **Consumer Financial Protection Bureau Director: *Position is Currently Vacant***
- **Independent Insurance Expert: Roy Woodall**
  - There are 2 nonvoting members of the FSOC representing insurance interests
    - Federal Insurance Office Director Mike McGraith
    - John Huff, Director of the Missouri Insurance Department

Source: Financial Stability Oversight Council; Insurance Information Institute (I.I.I.) research.

Total Assets Greater than $50 Billion: Publically Traded US Insurers

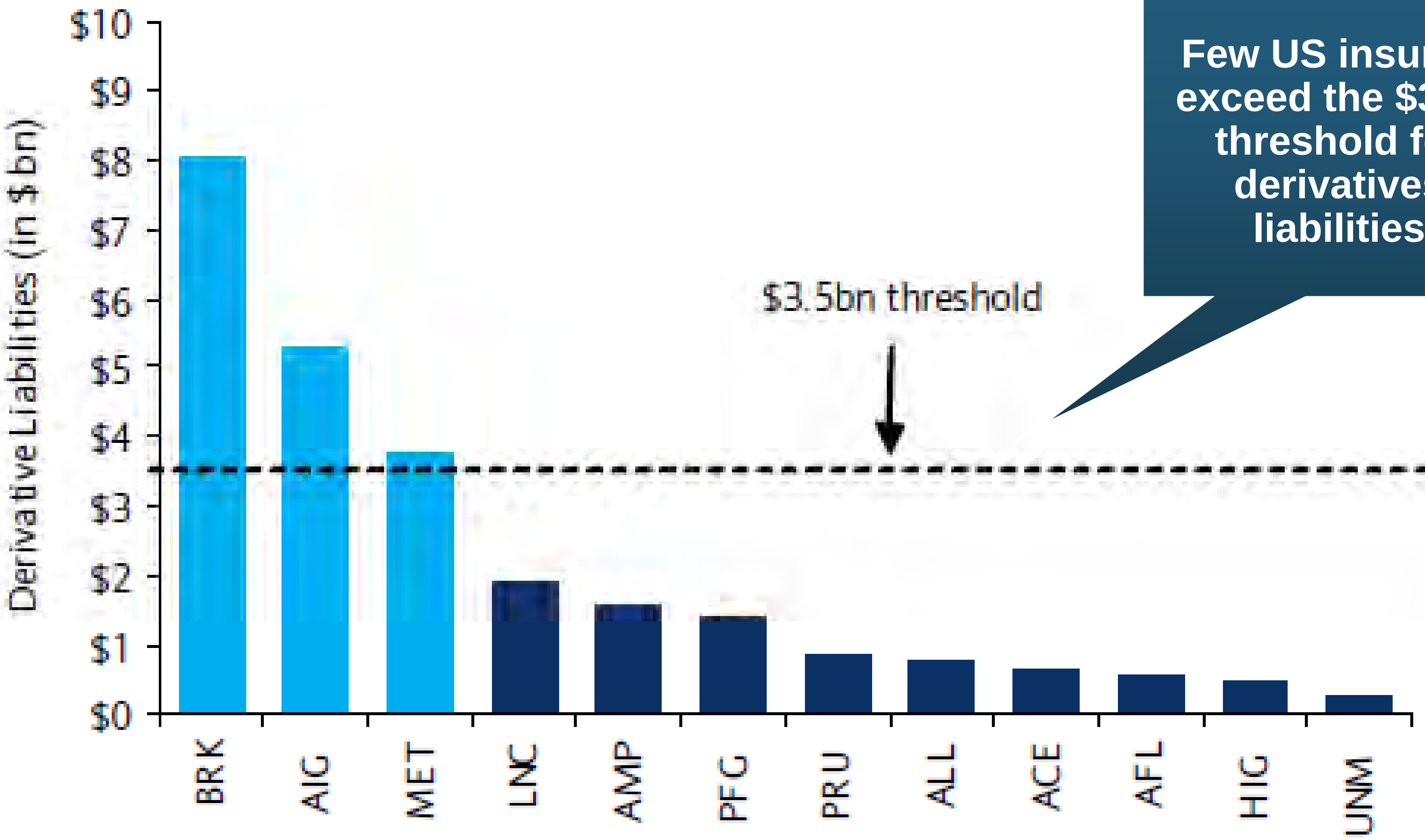


While quite a few US insurers exceed the $50B threshold, few will meet the other criteria for a SIFI designation

Note: Total assets excluding separate accounts as of 2Q11.

Source: Barclays Capital

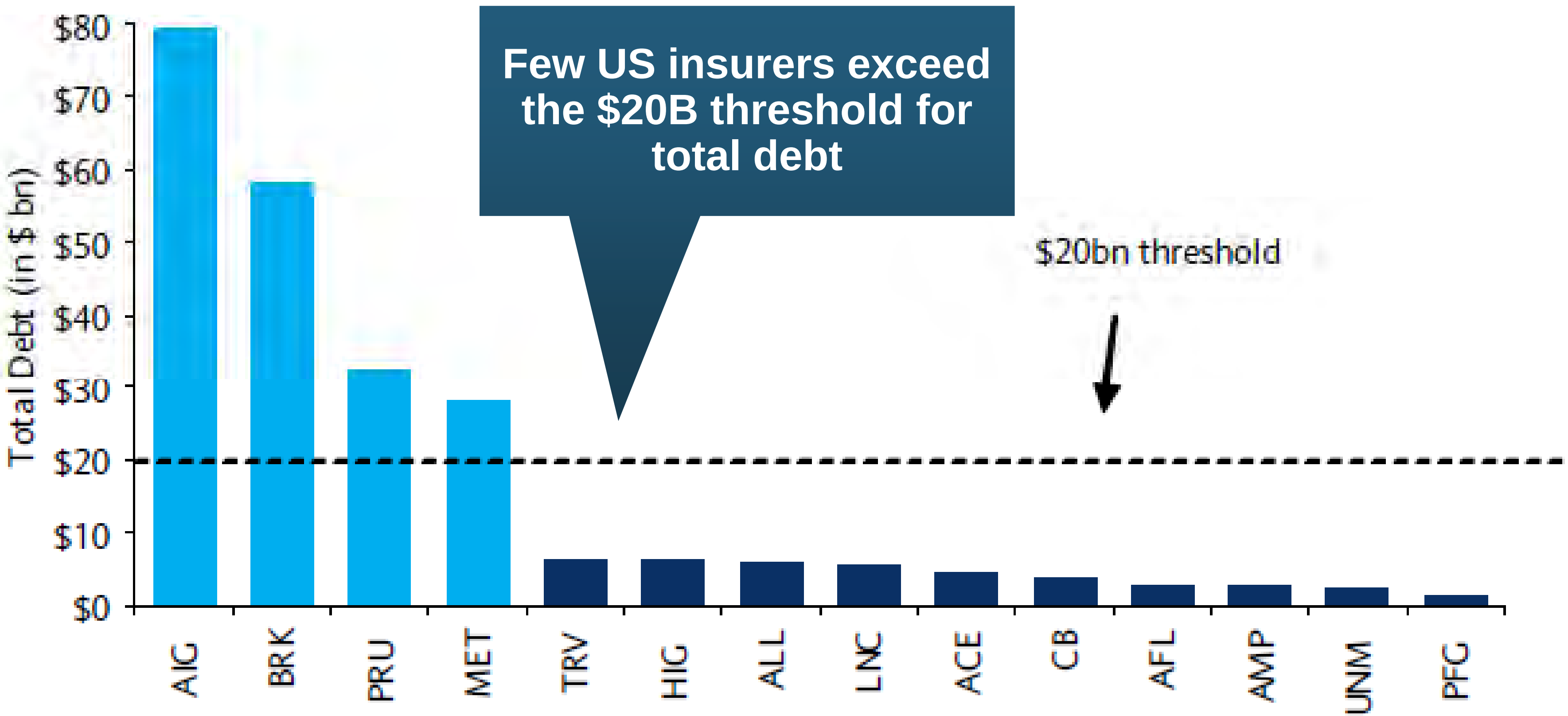
Derivative Liabilities: Publically Traded US Insurers



Few US insurers exceed the $3.5B threshold for derivatives liabilities

Source: Barclays Capital

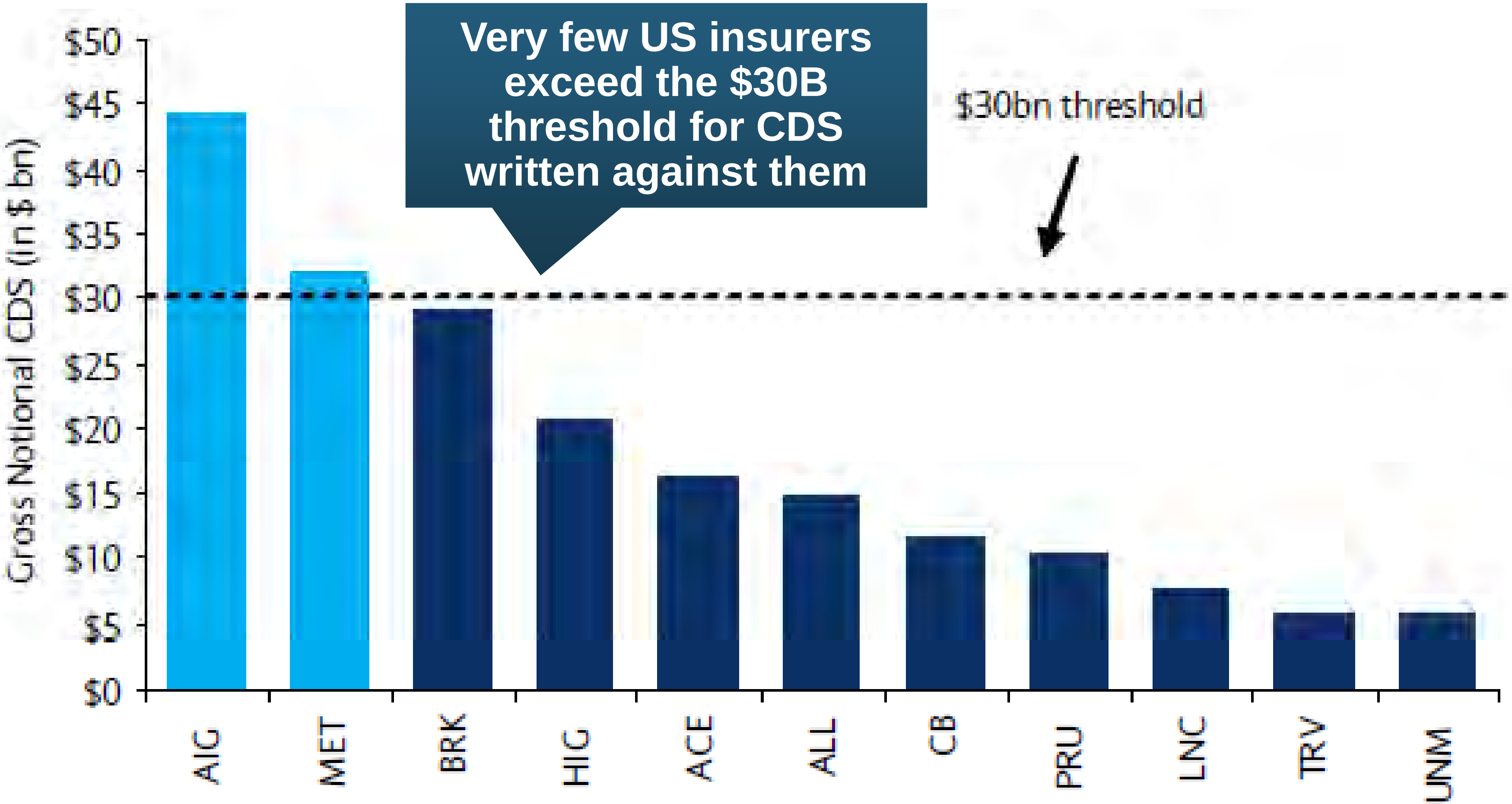
Total Debt: Publically Traded US Insurers



Note: Includes short-term and long-term debt outstanding.

Source: Barclays Capital

Gross Notional Credit Default Swaps: Publically Traded US Insurers



Note: Gross notional CDS outstanding as of October 7 2011.

Source: Barclays Capital

Dodd-Frank Implementation: *Federal Insurance Office: Very Quiet*

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Federal Insurance Office Update: *Activity Update*

- **FIO's First Director Did Not Assume Office Until June 1, 2011**
  - Former Illinois Insurance Director Michael McGraith
  - Small staff (10-12) and modest budget
  - McGraith has made few appearances or public comments

- **Study on State of Insurance Regulation Due Jan. 21, 2012**
  - Report will likely review previously identified inefficiencies and strengths of current regulatory system with an eye toward modernization.
- **Treasury Will Likely Exert Heavy Influence on the Report**

Former President of P/C Insurance at The Hartford

Source: Insurance Information Institute (I.I.I.) updates and research

Questions Solicited by the FIO Ahead of its Required January 2012 Study*

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- **The FIO Asked 12 Broad-Based Questions on the Future Course of Insurance Regulation, With an Eye Toward a Greater Federal Role**

1. Systemic risk regulation with respect to insurance;
2. Capital standards and the relationship between capital allocation and liabilities, including standards relating to liquidity and duration risk;
3. Consumer protection for insurance products and practices, including gaps in State regulation and access by traditionally underserved communities and consumers, minorities, and low and moderate-income persons to affordable insurance products;
4. The degree of national uniformity of State insurance regulation, including the identification of, and methods for assessing, excessive, duplicative or outdated insurance regulation or regulatory licensing process;
5. The regulation of insurance companies and affiliates on a consolidated basis;
6. International coordination of insurance regulation;
7. The costs and benefits of potential Federal regulation of insurance across various lines of insurance (except health insurance);

*Comment period ends December 16, 2011.

Source: Federal Register, Vol. 76, No.. 200, October 17, 2011; Insurance Information Institute.

Questions Solicited by the FIO Ahead of its Required January 2012 Study (cont'd)

1. The feasibility of regulating only certain lines of insurance at the Federal level, while leaving other lines of insurance to be regulated at the State level;
2. The ability of any potential Federal regulation or Federal regulators to eliminate or minimize regulatory arbitrage;
3. The impact that developments in the regulation of insurance in foreign jurisdictions might have on the potential Federal regulation of insurance;
4. The ability of any potential Federal regulation or Federal regulator to provide robust consumer protection for policyholders; and
5. The potential consequences of subjecting insurance companies to a Federal resolution authority, including the effects of any Federal resolution authority:
   i. On the operation of State insurance guaranty fund systems, including the loss of guaranty fund coverage if an insurance company is subject to a Federal resolution authority;
   ii. On policyholder protection, including the loss of the priority status of policyholder claims over other unsecured general creditor claims;
   iii. In the case of life insurance companies, on the loss of the special status of separate account assets and separate account liabilities; and
   iv. On the international competiveness of insurance companies

*Comment period ends December 16, 2011.

Source: Federal Register, Vol. 76, No.. 200, October 17, 2011; Insurance Information Institute.

2010 Property & Casualty Insurance Regulatory Report Card: Enormous Variation

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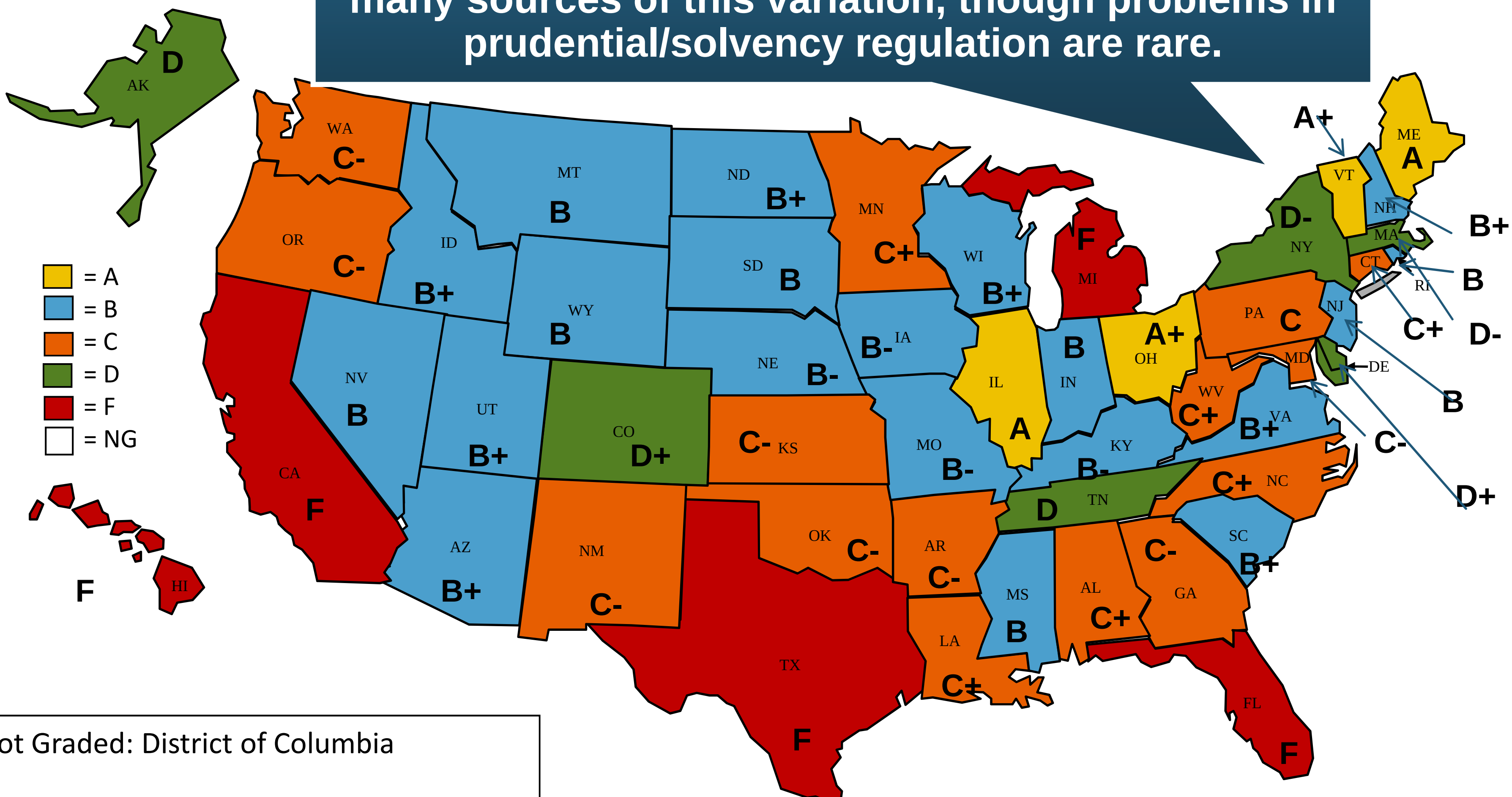
There is enormous variation in the quality of insurance regulation in the United States. There are many sources of this variation, though problems in prudential/solvency regulation are rare.



Not Graded: District of Columbia

Source: Heartland Institute, May 2011

New Rulemakings Under The Dodd Frank Wall Street Reform and Consumer Protection Act

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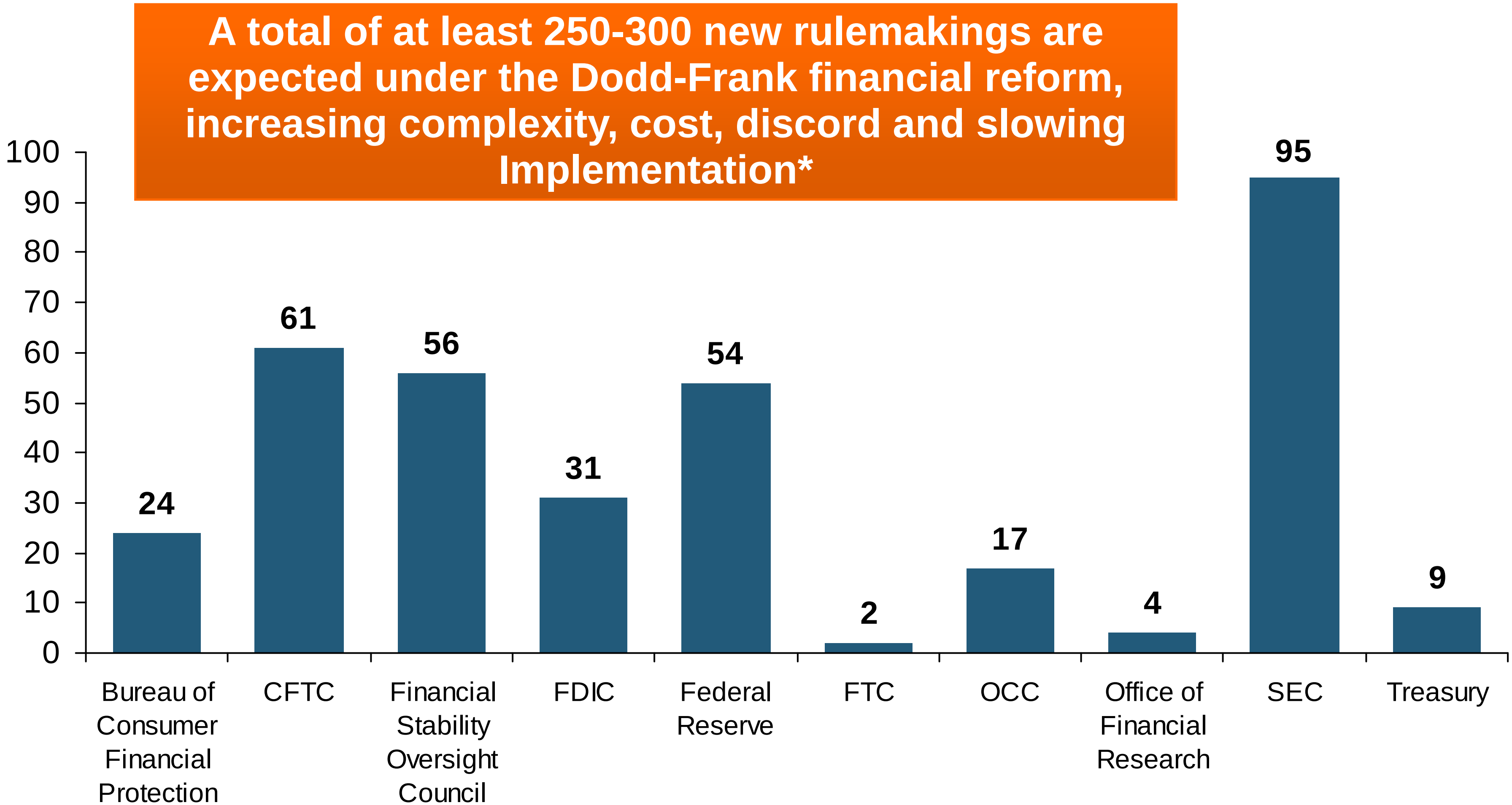

* Total eliminates double counting for joint rule-makings and this estimate only includes explicit rule-makings in the bill, and thus likely represents a significant underestimate.
Source: Wall Street Journal, July 14, 2010; Davis Polk & Wardwell.

Is Popular Discontent with Financial Services Reform Rising in the US?

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Source: Photographs taken by the Insurance Information Institute, New York City, Oct. 7, 2011.

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Dodd-Frank and Insurance: *The Years Ahead*

Outlook for Its Medium and Long-Term Viability & Global Influence

Dodd-Frank:
What does the future hold for insurers?

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Insurance Issues Timeline for Dodd-Frank

- **Short-to-Mid-Term Uncertainty**
  - Outcome of 250-300 rules across many federal agencies (ETA: months to years)
  - Legal challenges to the Dodd-Frank (ETA: Years)
  - Outcome of 2012 election (US Senate will likely fall under Republican control, Republican presidential candidates vow to repeal/revisit reforms) (ETA: 16-24 months)
- **Mid-Term Issues for Insurers**
  - FIO report in 2012: Will there be renewed effort for federal chartering in the US?
  - Federal chartering will reopen a large scale battle within the US insurance industry
  - Systemic Risk Designations: Will affect very few US insurers (3-5)
  - ***CONCERN: FIO morphs into quasi/shadow or actual regulator; CFPB too.***
- **Mid-to-Long-Term Issues for Insurers**
  - SIFI: Do enhanced capital requirements put them at a competitive disadvantage or is the “Too Big To Fail” designation viewed as an advantage?
  - Solvency II: Tough sell in the US right now (Solvency II = Basel III = European Banks)

Source: Insurance Information Institute (I.I.I.) updates and research.

Dodd-Frank: *Long-term Issues for Insurers & the Dodd-Frank Blueprint*

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Insurance Issues Timeline for Dodd-Frank

- **Longer-Term Issues for Insurers**
  - ***Streamlining of Regulation***: Dodd-Frank does little to directly address the inefficiencies of the US insurance regulatory system. (ETA: Many Years, Never)
    - Jan. 2012 FIO study will address some of these issues, but likelihood of timely, uniform implementation of recommendations is remote (FIO has no regulatory power; Treasury/Fed powers very limited)
    - Begs questions of regulatory authority: States vs. Federal Government
  - ***Ultimate Resolution of Regulatory Authority***: (ETA: Years)
    - Possible outcomes: OFC, status quo or bifurcation (life = federal, nonlife = OFC)
- **Can Dodd-Frank Serve as a Blueprint for International Reforms?**
  - The US is and will remain in a greatly weakened position in terms of its credibility to offer regulatory or policy solutions internationally
  - Elements of Dodd-Frank (e.g., derivatives regulation) could prove useful; Systemic risk criteria
  - Dodd-Frank provides little guidance on international insurance issues, though FIO will define its role (albeit a narrow one) on this issue

Source: Insurance Information Institute (I.I.I.) updates and research.

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Thank you for your time and your attention!

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