



Overview & Outlook for the P/C Insurance Industry

*Drivers of Revenue, Cost and Competition in
the Aftermath of the “Great Recession”*

Independent Insurance Agents of Westchester County
Tarrytown, NY
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Download at www.iii.org/presentations

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- **Reasons for Optimism, Causes for Concern in the P/C Insurance Industry**
- **P/C Profitability Overview & Outlook**
- **5 Key Pillars of Profitability: Past, Present & Future**
 - ◆ Underwriting
 - ◆ Pricing Trends (Commercial Lines)
 - ◆ Investments
 - ◆ Expenses
 - ◆ Leverage
- **External Factors Influencing Profitability**
 - ◆ Tort System Review: Overview and Causes for Concern
 - ◆ Regulatory Environment
- **Exposure Analysis: Where Will Growth Come from in the Aftermath of the Great Recession?”**
 - ◆ Crisis-Driven Exposure Issues: Commercial Lines
 - ◆ Growth in the Post-Crisis World
- **Catastrophe Loss Review**
- **Q&A**



Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

The Outlook for the Economy Has Brightened, But the Outlook for P/C Insurance Is Mixed

Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- **Economic Recovery in US is Self-Sustaining and Strengthening**
 - ◆ No Double Dip Recession
 - ◆ Economy is more resilient than most pundits presume
- **Consumer Confidence is Gradually Improving**
- **Consumer Spending is Recovering Gradually**
- **Consumer and Business Lending Are Expanding**
- **Housing Market Remains Weak, but Some Improvement Expected in 2011**
- **Inflation Remains Tame**
 - ◆ Runaway inflation is highly unlikely; Fed has things under control
 - ◆ Deflation—threat has virtually disappeared
- **Private Sector Hiring is Consistently Positive for 13 Months**
 - ◆ Acceleration in hiring later in 2011
 - ◆ No significant secondary spike in unemployment
- **Sovereign Debt, Muni Bond “Crises” Overblown**
- **Current Middle East Turmoil Poses Little Risk to US Economy**
- **Interest Rates Are Rising but Remain Low by Historical Standards**
- **Stock and Bond Markets More Stable, Less Volatile**
- **Political Environment Is More Hospitable to Business Interests**

Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- **Era of Mass P/C Insurance Exposure Destruction Has Ended**
 - ◆ Personal and commercial exposure growth is virtually certain in 2011
 - ◆ But restoration of destroyed exposure will take 3-5 years in US
- **Exposure Growth Returned in 2nd Half 2010, Will Accelerate in 2011**
- **P/C Industry Saw Growth in 2010 (+0.8%) for the First Time Since 2006**
- **Increasing Private Sector Hiring Will Drive Payrolls/WC Exposures**
 - ◆ Wage growth is also positive and could modestly accelerate
- **Increase in Demand for Commercial Insurance Is in its Earliest Stages and Will Accelerate in 2011**
 - ◆ Includes workers comp, commercial auto, marine, many liability coverages, D&O
 - ◆ Laggards: Property, inland marine, aviation
 - ◆ Personal Lines: Auto leads, homeowners lags
- **Investment Environment Is/Remains Much More Favorable**
 - ◆ Return of realized capital gains as a profit driver
 - ◆ Interest rates are low but are rising→Boost to investment income
- **Agent Commissions Should Begin to Rise in 2011**
- **Demand, Capital Management Strategies Will Temper Overcapitalization**

Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- **Economic Recovery Is Not as Broad Based as Past Recoveries**
 - ◆ Housing, Construction remain weak
- **Recovery Is Uneven**
 - ◆ Certain states remain in recession and recoveries will lag: CA, FL, MI, NV
- **Credit Markets Are Not Completely Yet Healed**
 - ◆ While the financial sector has strengthened, hundreds more banks failures are possible
- **Consumers/Businesses Will Remain Cautious in their Borrowing/Spending**
- **Energy and Commodity Price Volatility Are Serious Economic Risks**
 - ◆ Effects can be disruptive to a fragile recovery even without igniting overall inflation
 - ◆ Concern over serial bubbles in various economic sectors on a global scale
- **Financial Markets, While Calm Now, Remain Jittery**
 - ◆ Markets buy into “crisis du jour” mindset quickly; Another “Flash Crash” possibility
 - ◆ Currency risk is elevated
- **Minor Muni Bond Default(s) Could Result in Irrational Market Response**
- **Potential for Botched Implementation of Dodd-Frank**
 - ◆ Systemic risk definition may be too broad
 - ◆ Banks will eventually find a way to screw up the economy—again
- **Strength of Admin/Congress Commitment to Pro-Business Policies Unclear**

Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

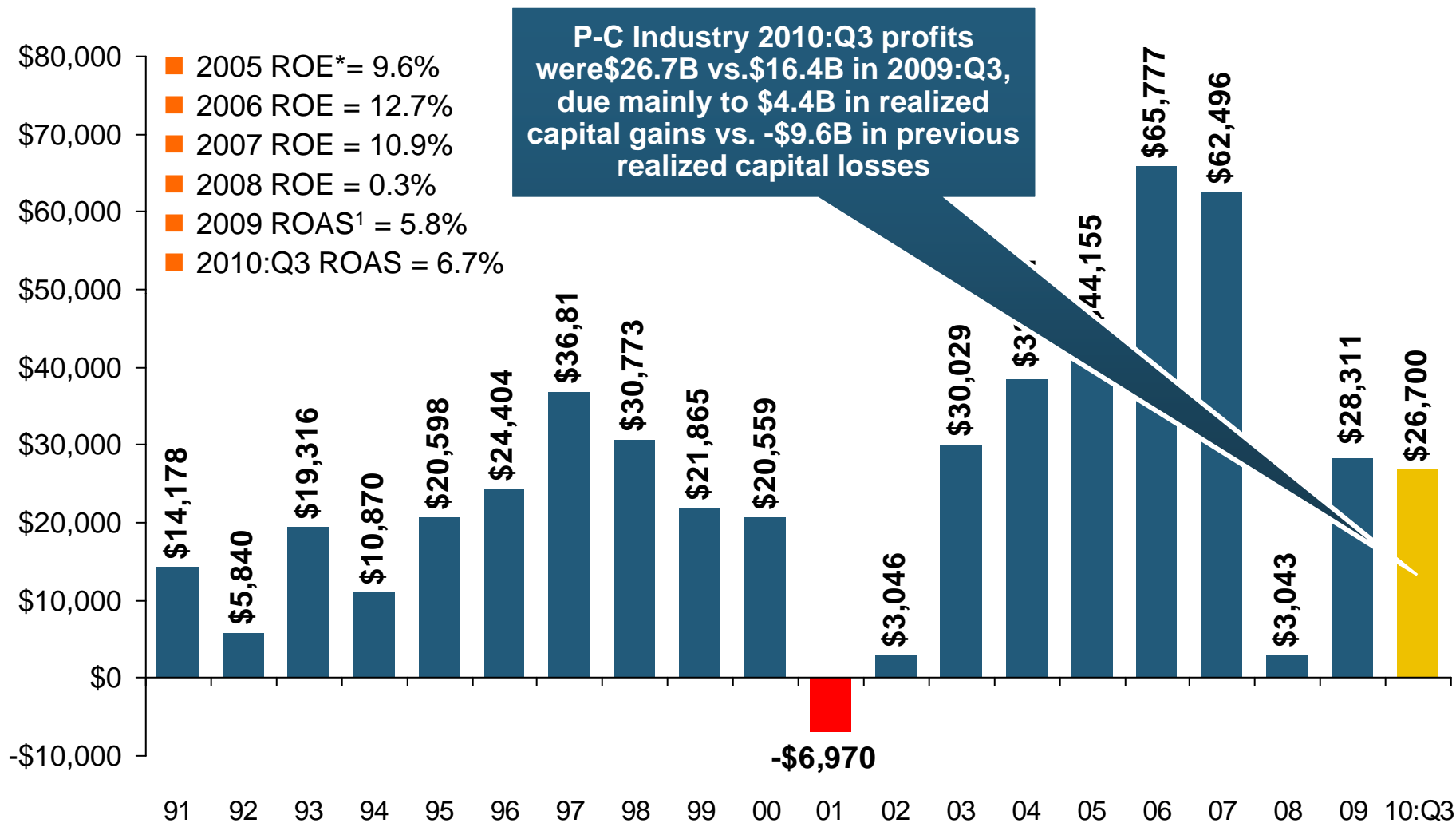
- **Exposure Loss Was Extraordinary, Concentrated in Commercial Lines**
 - ◆ Will take years to restore lost capacity
 - ◆ Capacity will not be restored in the same industrial or geographic sectors
- **Consumers Emerged from the Crisis Much More Cost Conscious**
 - ◆ Quicker to shop/switch; Price elasticity of demand is higher
 - ◆ Heightens retention challenge
- **Commercial Customers Remain Comfortable/Able Retaining More Risk**
 - ◆ “Leakage” remains a problem (ART, captives, self insurance, large ded. progs.)
- **Strength of Recovery Insufficient to Absorb Excess Capital or Firm Pricing**
- **P/C Insurance Industry Capacity as of 12/31/10 Is at Record Levels and Has Recovered 100%+ of the Capital Lost During the Financial Crisis**
 - ◆ The industry is overcapitalized by approximately \$100 billion
 - ◆ Record capacity, depressed exposures (S>D) mean that generally soft market conditions will persist through 2011
- **There is No Catalyst for a Robust Hard Market at the Current Time**
- **Pricing Today Does Not Reflect New Investment Realities or Underlying Deterioration in Underwriting Performance Masked by Release of Prior-Year Reserves**



P/C Insurance Industry Financial Overview

**Profit Recovery Continues
Early Stage Growth Begins**

P/C Net Income After Taxes 1991–2010:Q3 (\$ Millions)

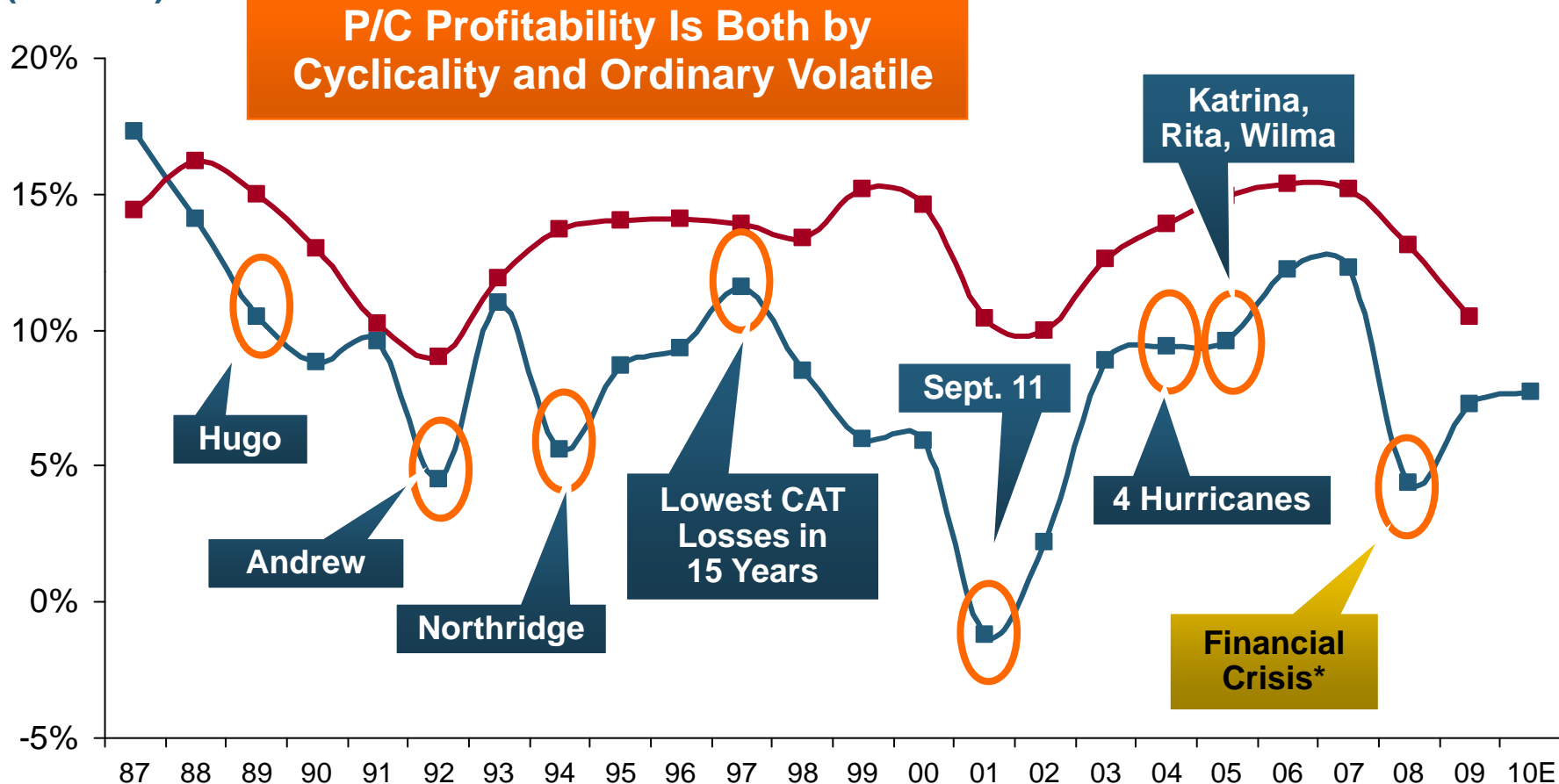


* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.7% ROAS for 2010:Q3 and 4.6% for 2009. 2009:Q3 net income was \$29.8 billion excluding M&FG.

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

ROE: Property/Casualty Insurance, 1987–2010E*

(Percent)



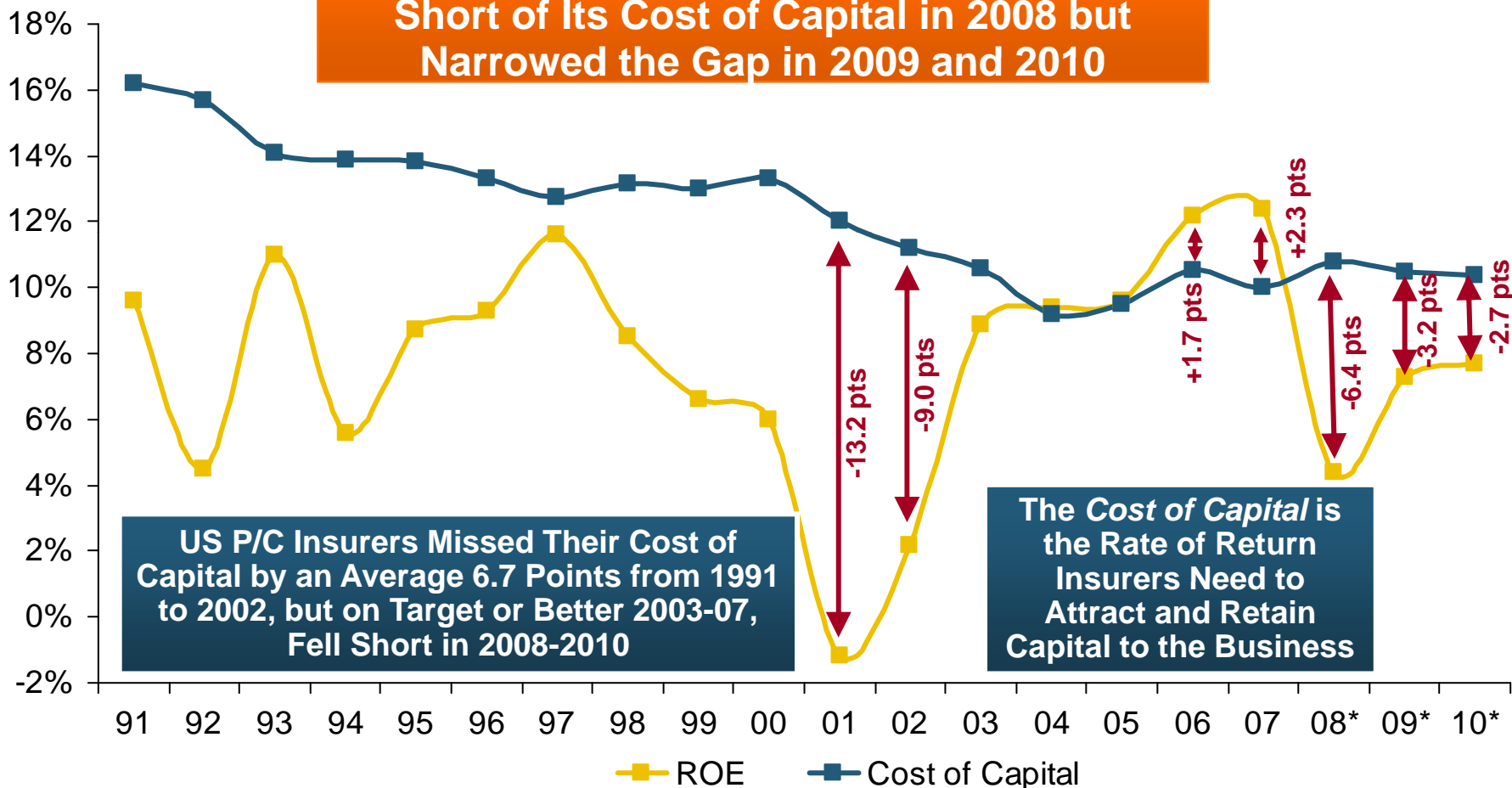
* Excludes Mortgage & Financial Guarantee in 2008 - 2010.

Sources: ISO, *Fortune*; Insurance Information Institute figure for 2010 is actual through 2010:Q3.

ROE vs. Equity Cost of Capital: U.S. P/C Insurance:1991-2010:H1*

(Percent)

The P/C Insurance Industry Fell Well Short of Its Cost of Capital in 2008 but Narrowed the Gap in 2009 and 2010



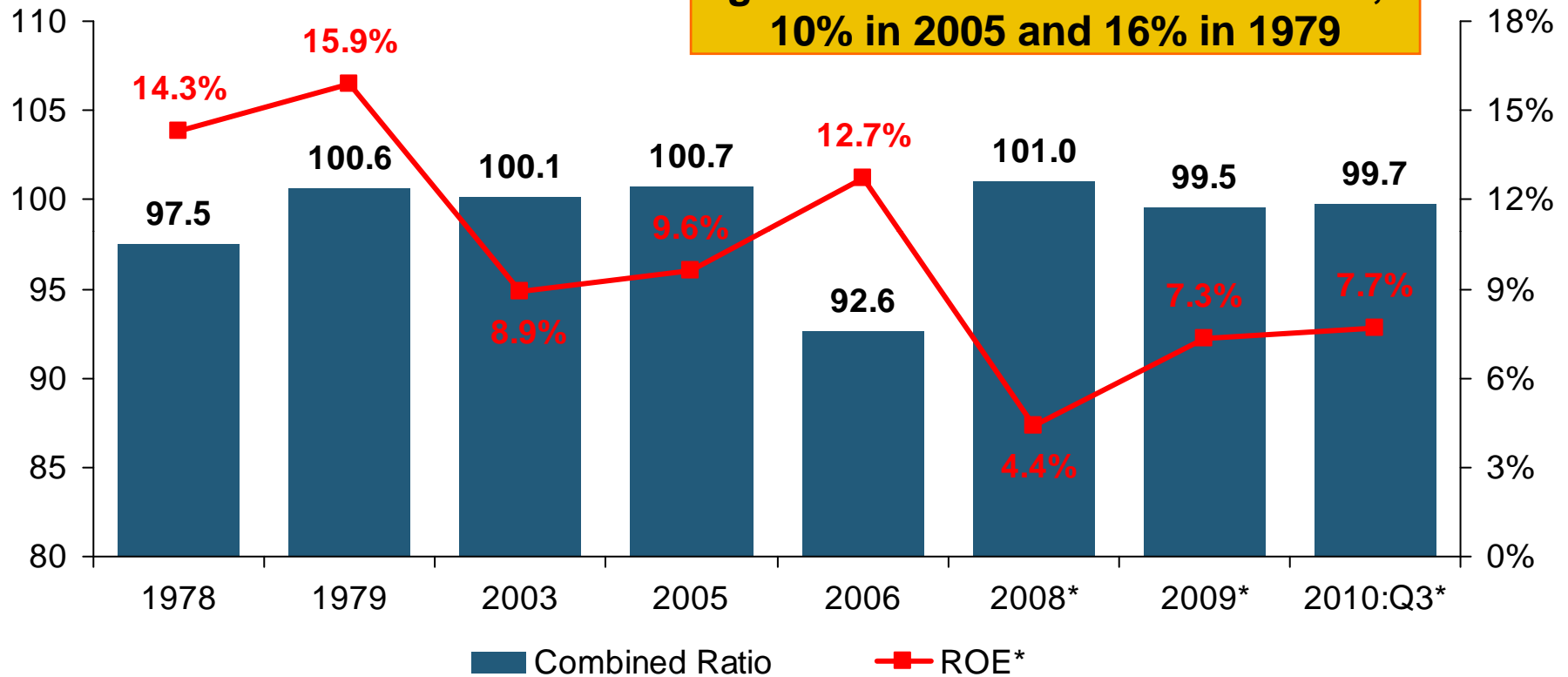
US P/C Insurers Missed Their Cost of Capital by an Average 6.7 Points from 1991 to 2002, but on Target or Better 2003-07, Fell Short in 2008-2010

The Cost of Capital is the Rate of Return Insurers Need to Attract and Retain Capital to the Business

* Return on average surplus in 2008-2010 excluding mortgage and financial guaranty insurers.
Source: The Geneva Association, Insurance Information Institute

A 100 Combined Ratio Isn't What It Once Was: Investment Impact on ROEs

Combined Ratio / ROE



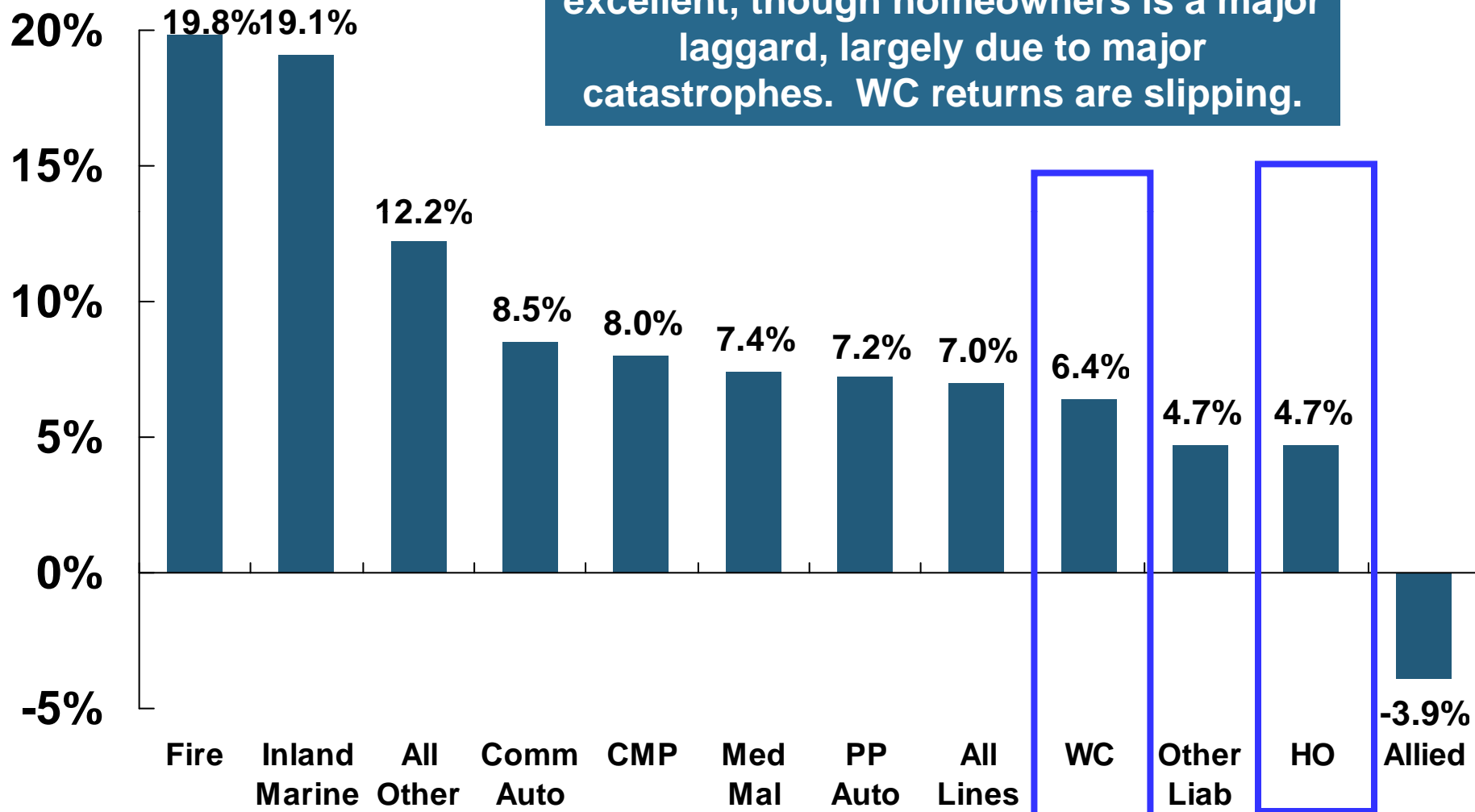
Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs

* 2009 and 2010:Q3 figures are return on average statutory surplus. 2008, 2009 and 2010:H1 figures exclude mortgage and financial guaranty insurers

Source: Insurance Information Institute from A.M. Best and ISO data.

RNW for Major P/C Lines, 2000-2009 Average

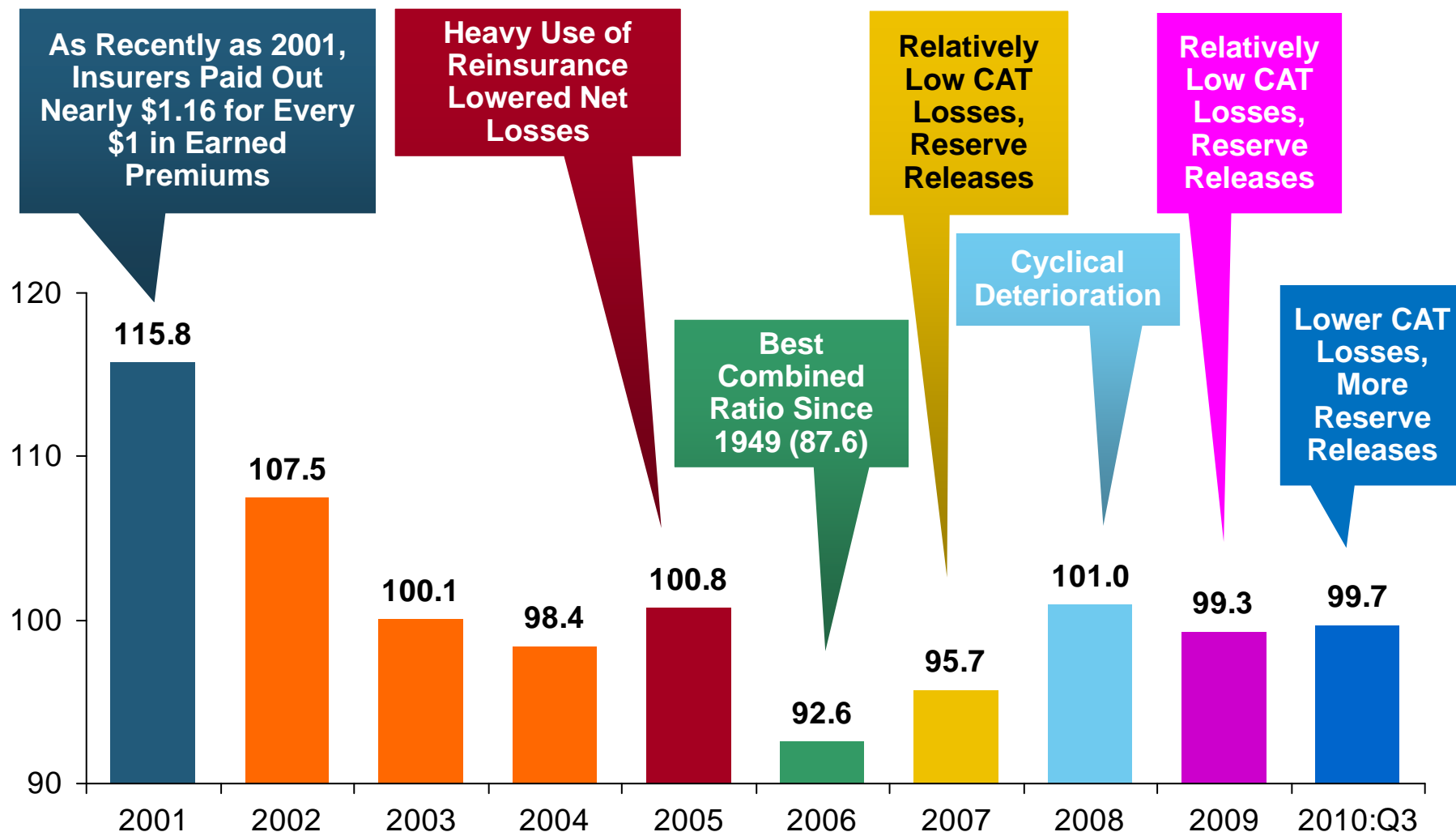
10-year returns for some lines are excellent, though homeowners is a major laggard, largely due to major catastrophes. WC returns are slipping.



Profit Pillar #1 UNDERWRITING

**Cyclicalicity is Driven Primarily
by the Industry's Underwriting
Cycle, Not the Economy**

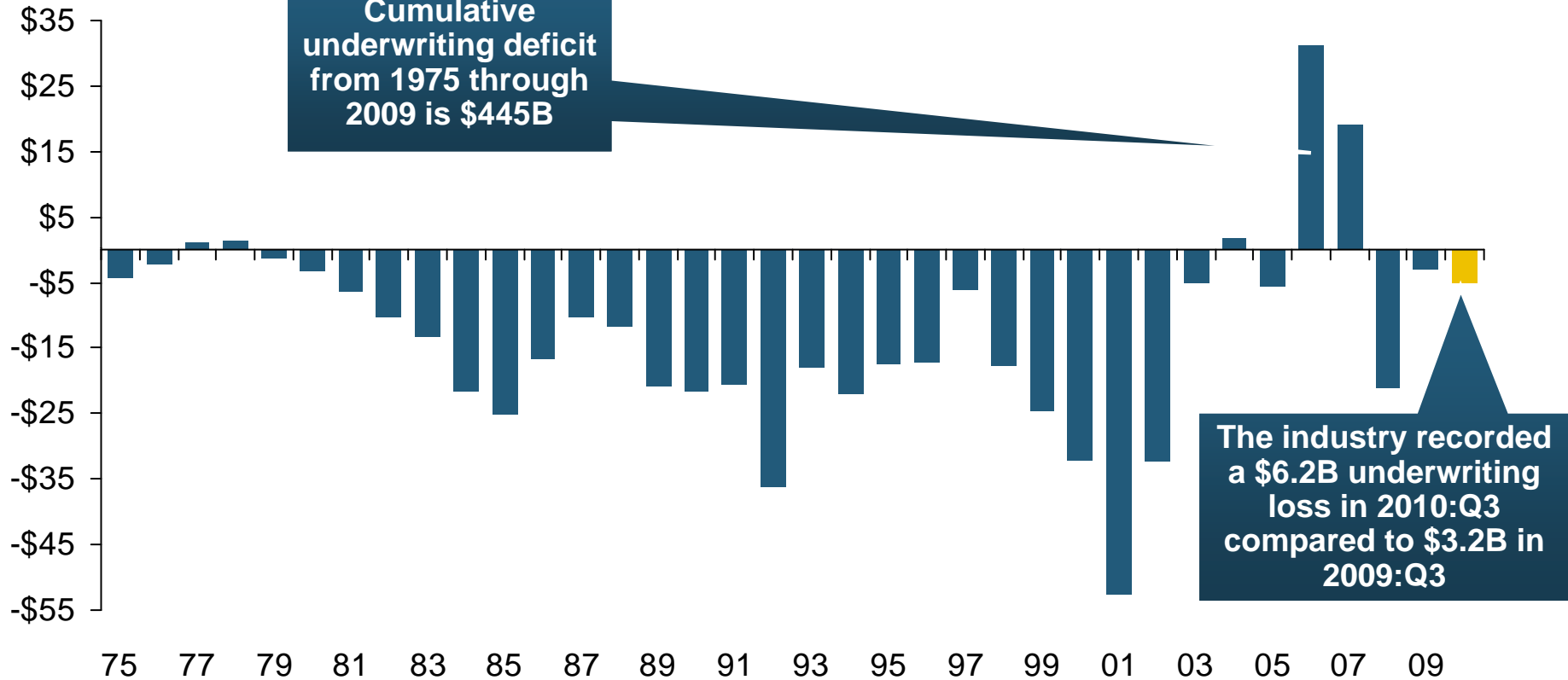
P/C Insurance Industry Combined Ratio, 2001–2010:Q3*



* Excludes Mortgage & Financial Guaranty insurers in 2008, 2009 and 2010. Including M&FG, 2008=105.1, 2009=100.7, 2010:Q3=101.2
Sources: A.M. Best, ISO.

Underwriting Gain (Loss) 1975–2010:Q3*

(\$ Billions)



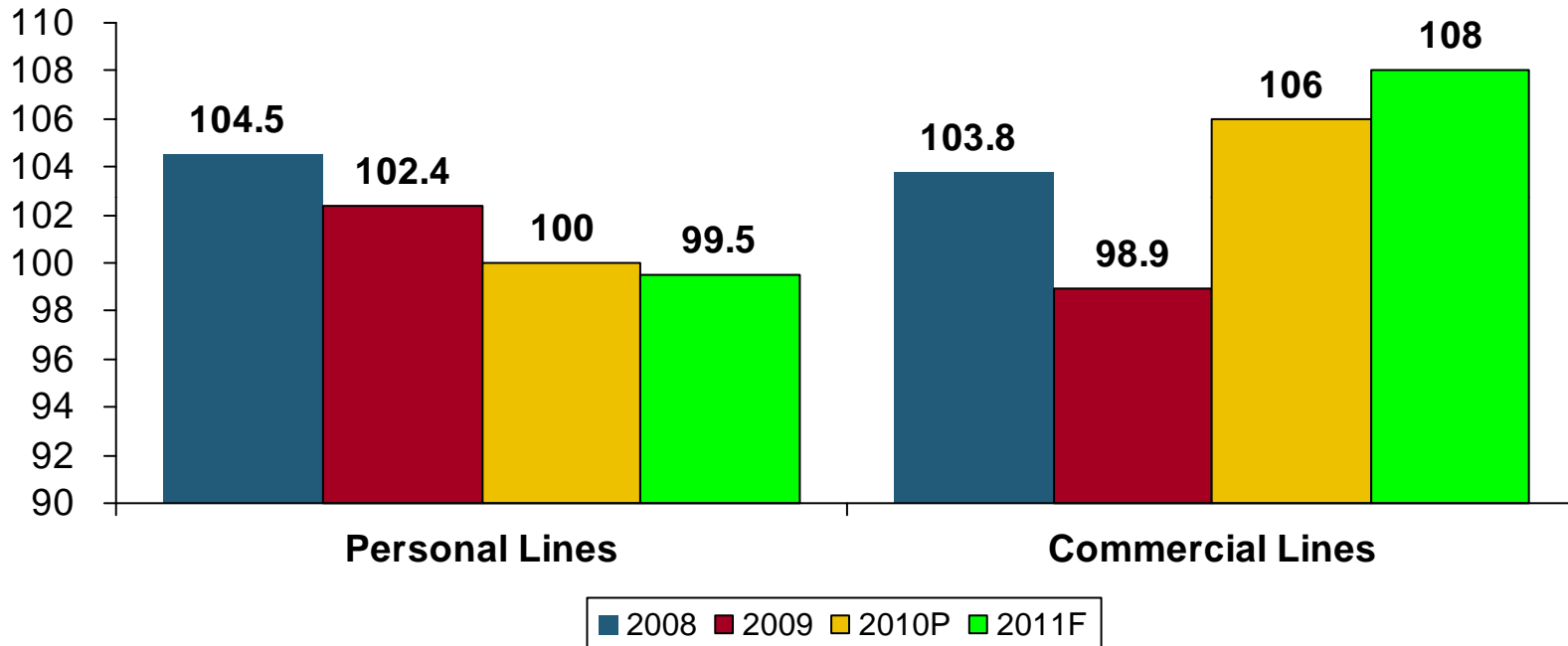
**Large Underwriting Losses Are *NOT* Sustainable
in Current Investment Environment**

* Includes mortgage and financial guarantee insurers.

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

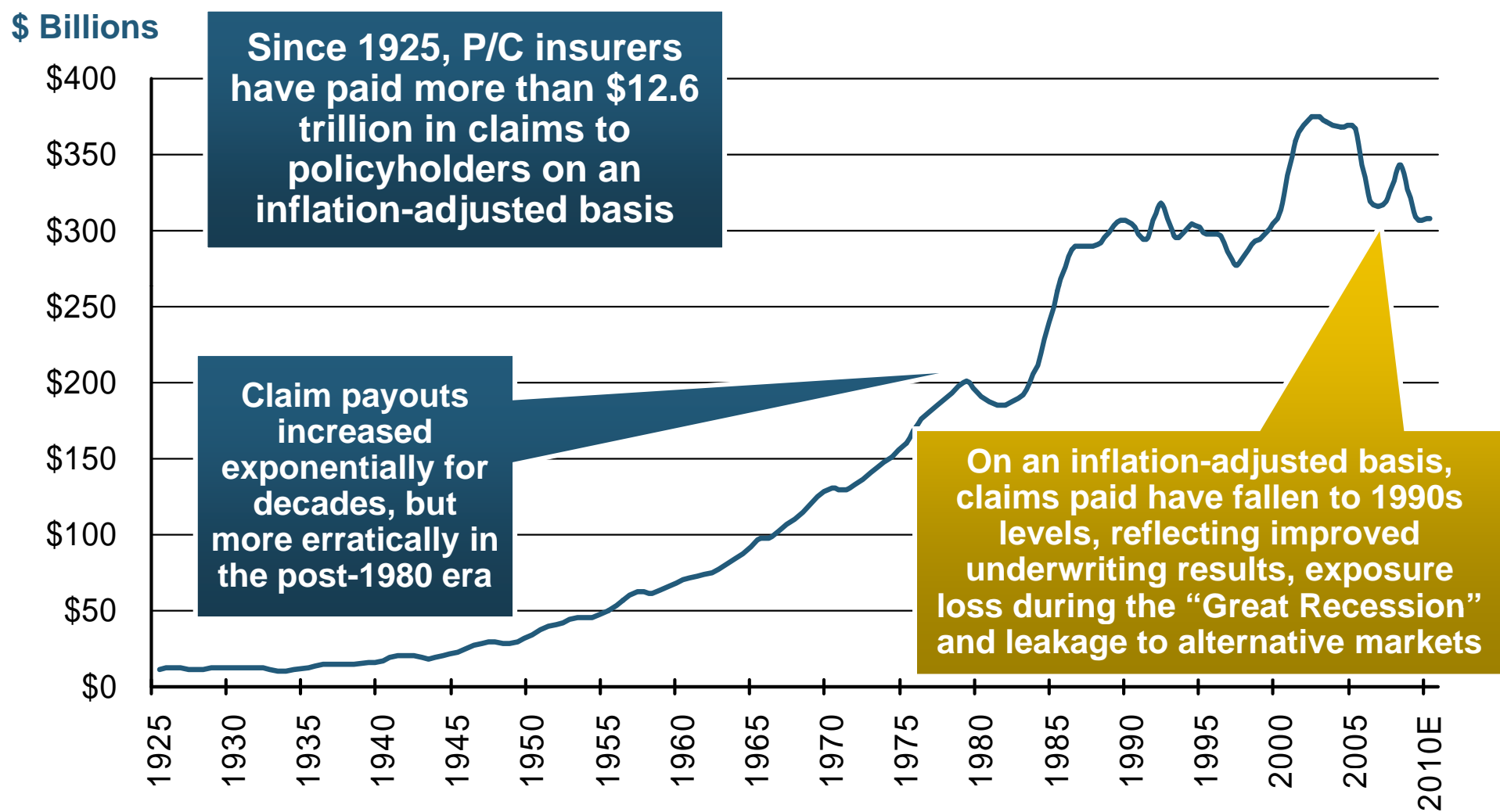
Calendar Year Combined Ratios by Segment: 2008-2011F

Personal lines combined ratio is expected to remain stable in 2010 while commercial lines and reinsurance deteriorate



Overall deterioration in 2011 underwriting performance is due to expected return to normal catastrophe activity along with deteriorating underwriting performance related to the prolonged commercial soft market

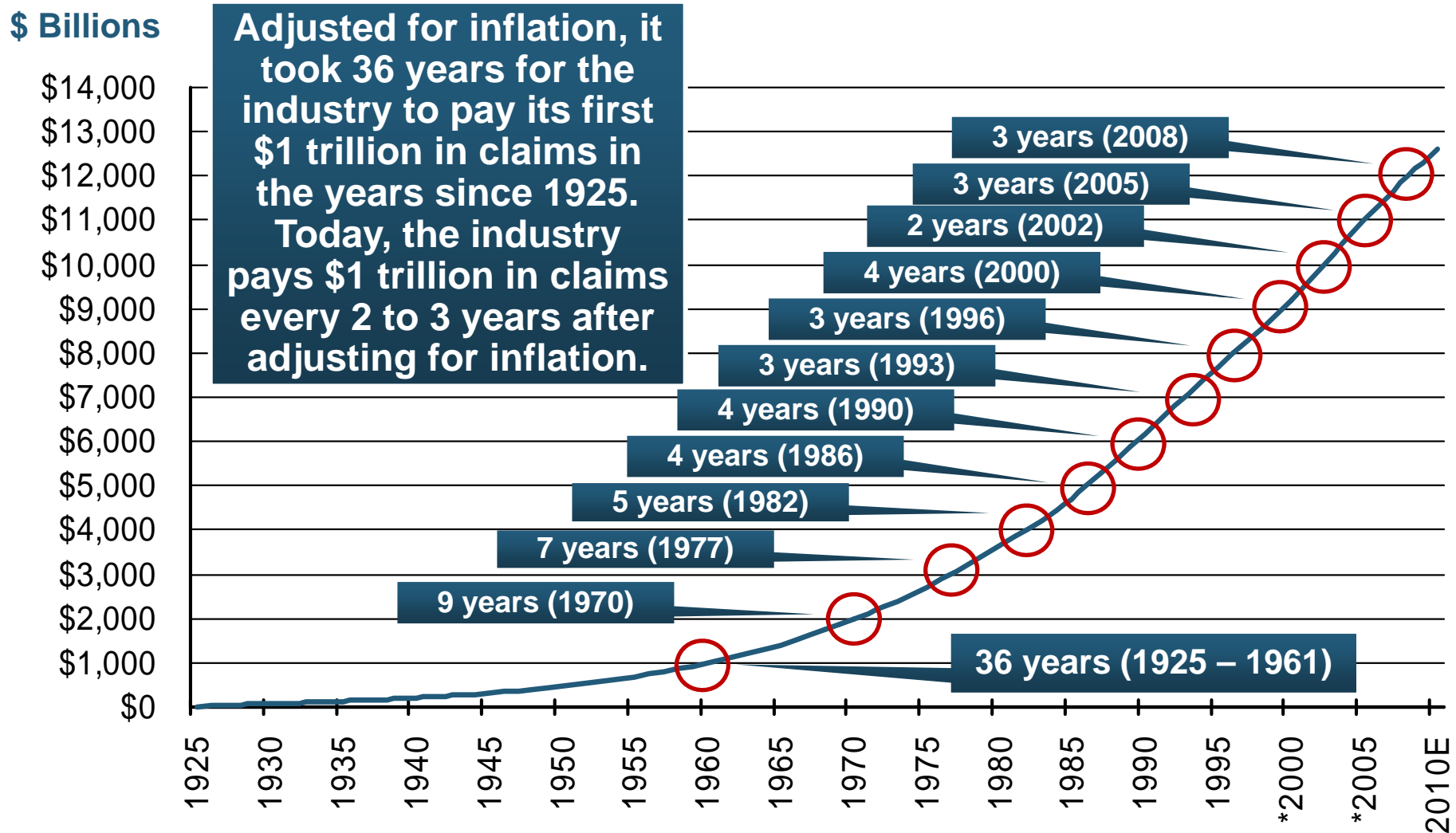
Inflation-Adjusted Dollar Value of Claims Paid by P/C Insurers, 1925–2010E*



*1925 – 1934 stock companies only. Includes workers compensation state funds 1998-2006.

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

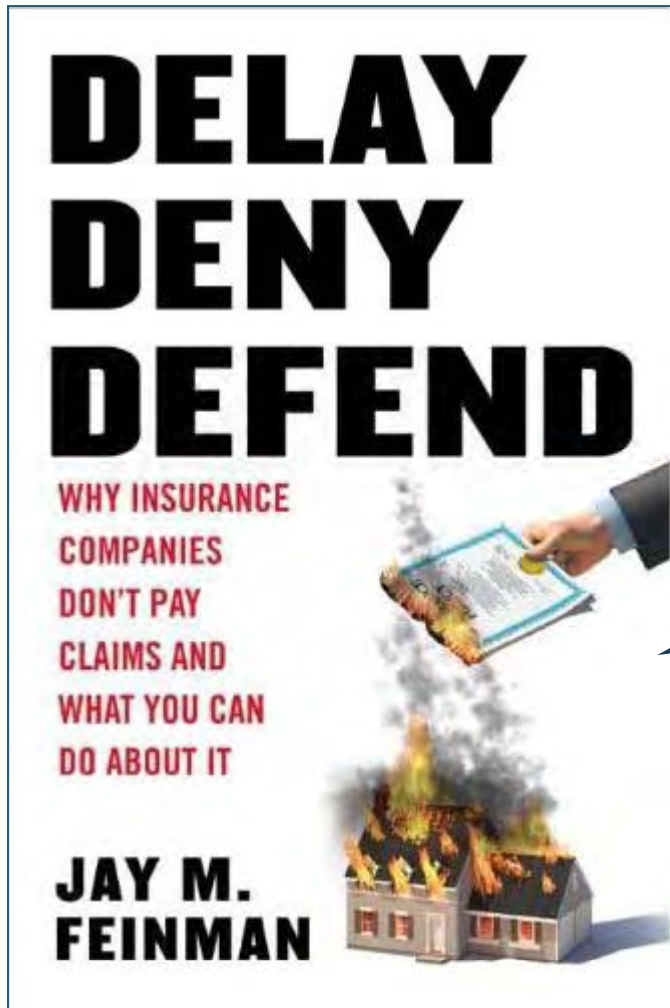
Cumulative Value of Inflation-Adjusted Claims Paid by P/C Insurers, 1925–2010E*



*1925 – 1934 stock companies only. Includes workers compensation state funds 1998-2006.

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

\$12.5 Trillion of Paid Claims and Someone Still Writes a Book With This Title?



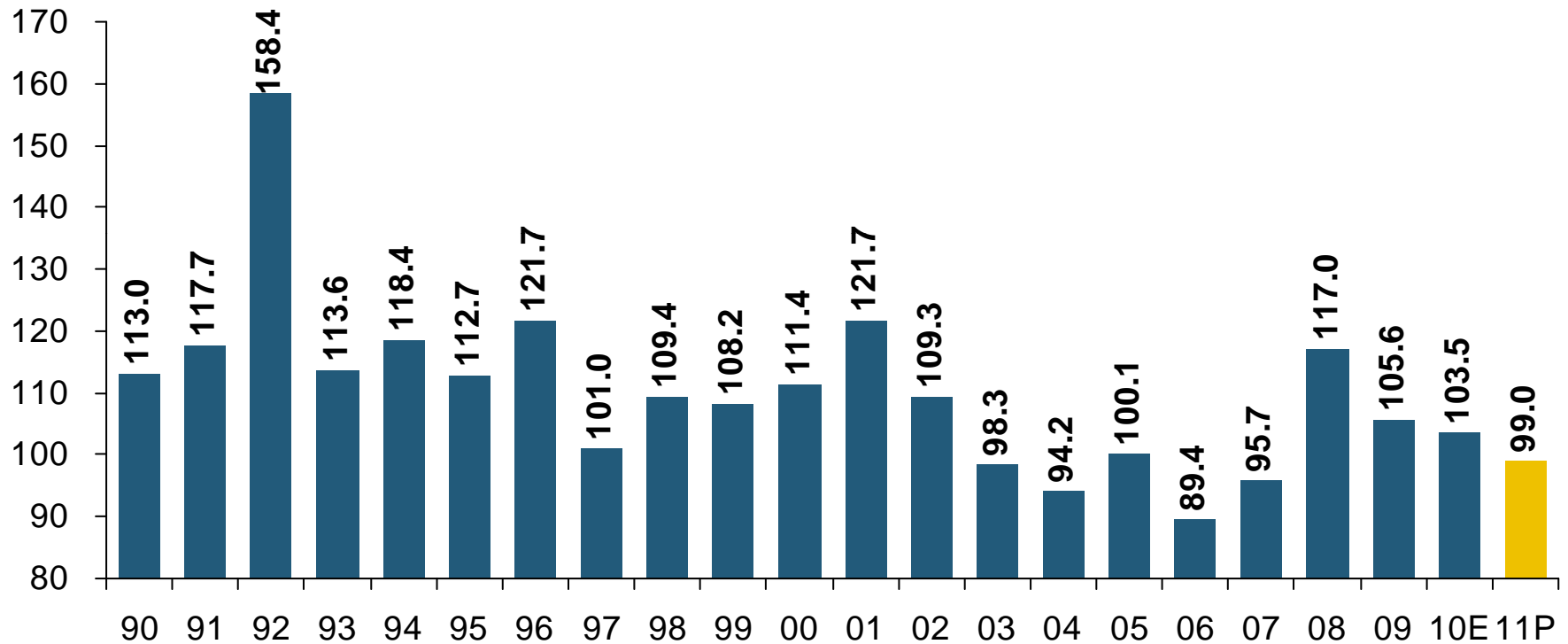
This book by a Rutgers University law professor asserts that insurers do everything possible to avoid paying legitimate claims.

I will be debating the thesis of Prof. Feinman's book and refuting his allegations in New Orleans on March 24.

Performance by Segment: Commercial/Personal Lines

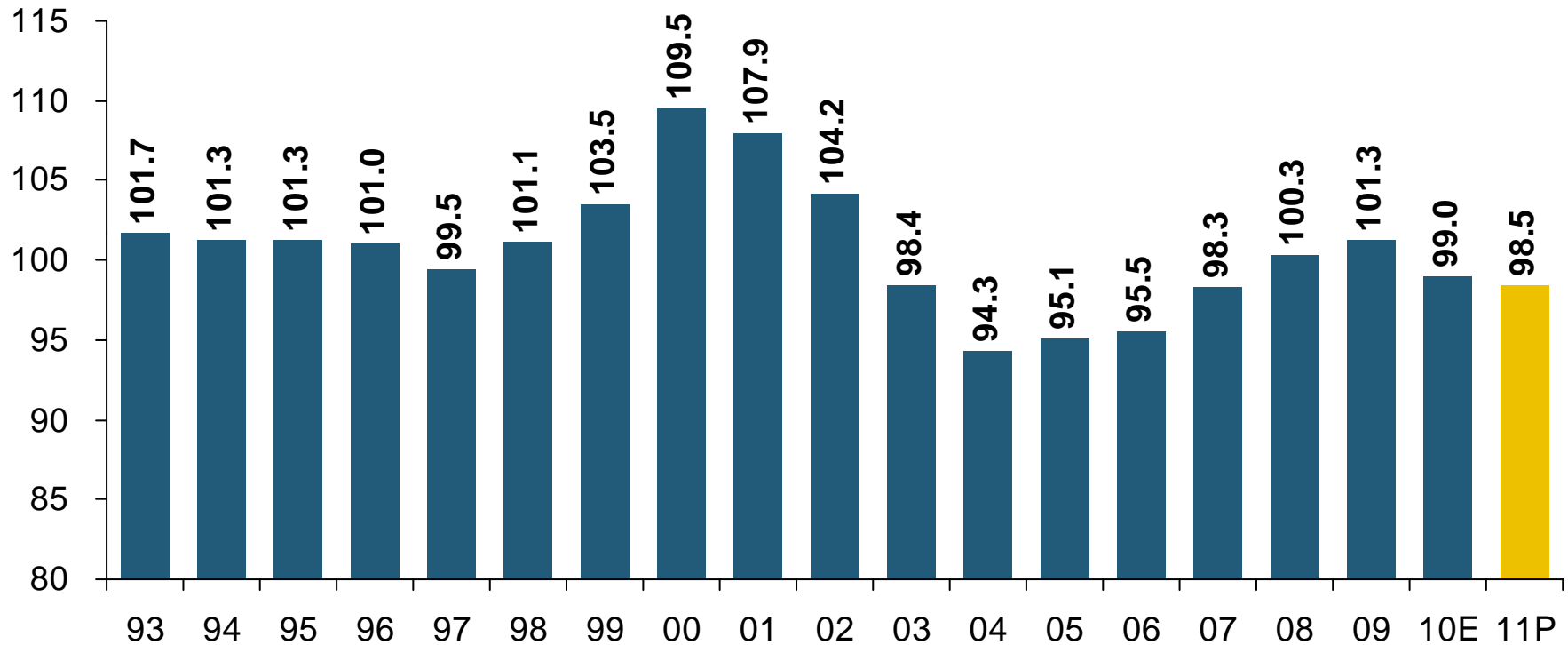
Auto/Home Outperform Most Commercial Lines

Homeowners Insurance Combined Ratio: 1990–2011P



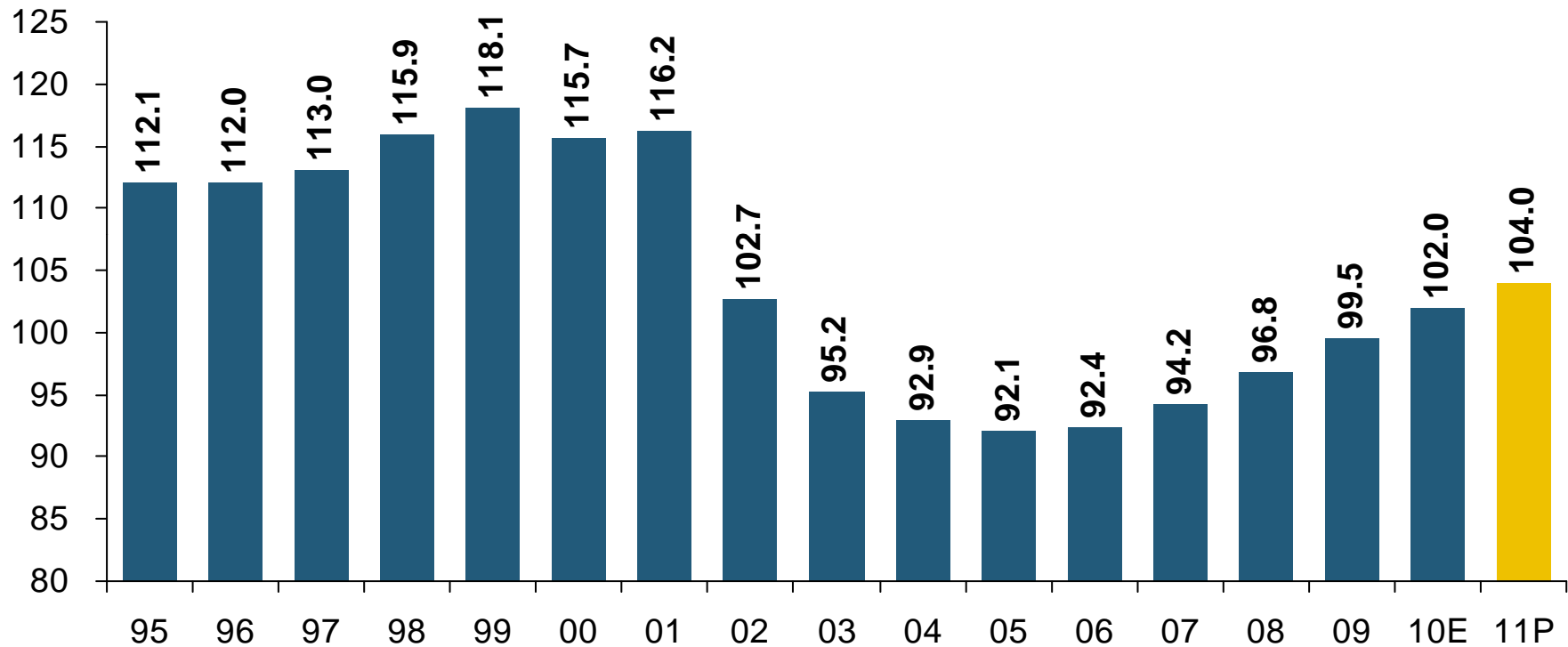
Homeowners Line Is Expected to Improve in 2011. Extreme Regional Variation Can Be Expected Due to Local Catastrophe Loss Activity

Private Passenger Auto Combined Ratio: 1993–2011P



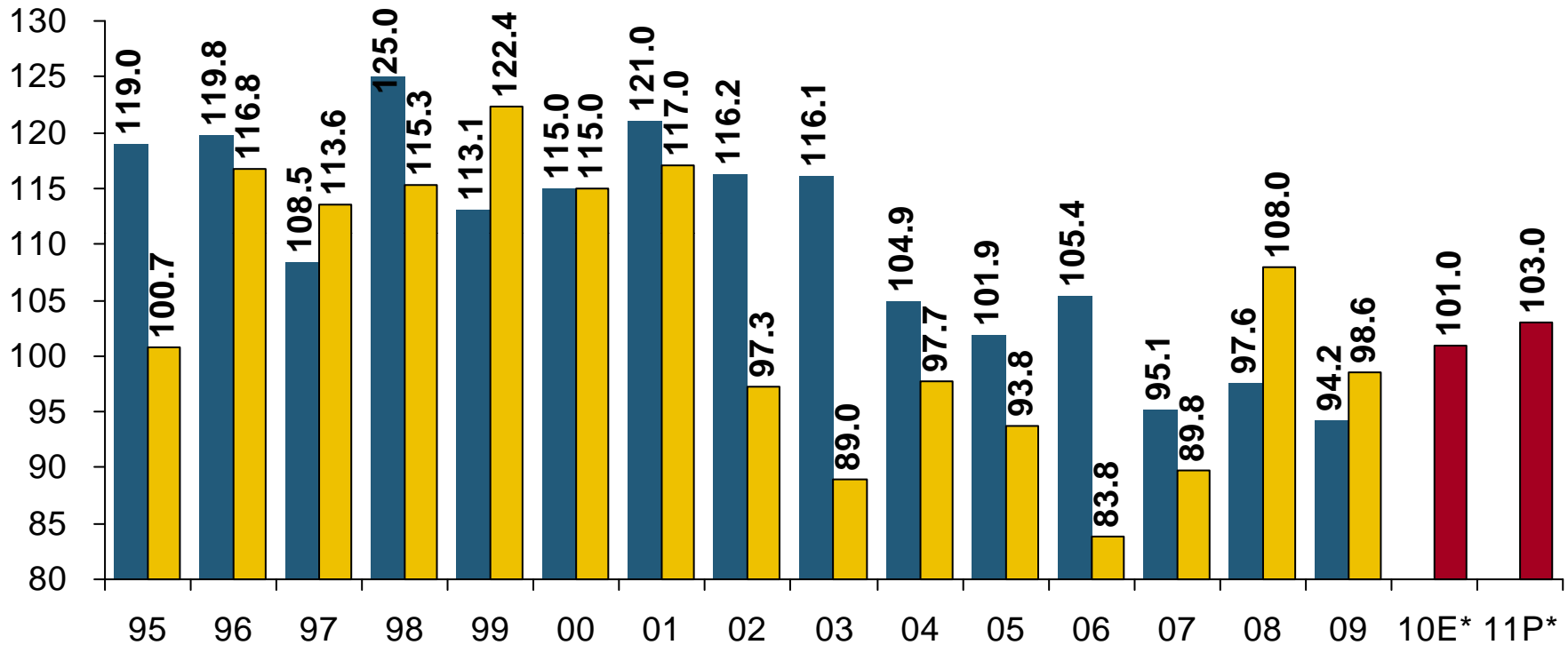
Private Passenger Auto Accounts for 34% of Industry Premiums and Remains the Profit Juggernaut of the P/C Insurance Industry

Commercial Auto Combined Ratio: 1993–2011P



**Commercial Auto Underwriting Performance is
Expected to Deteriorate Modestly**

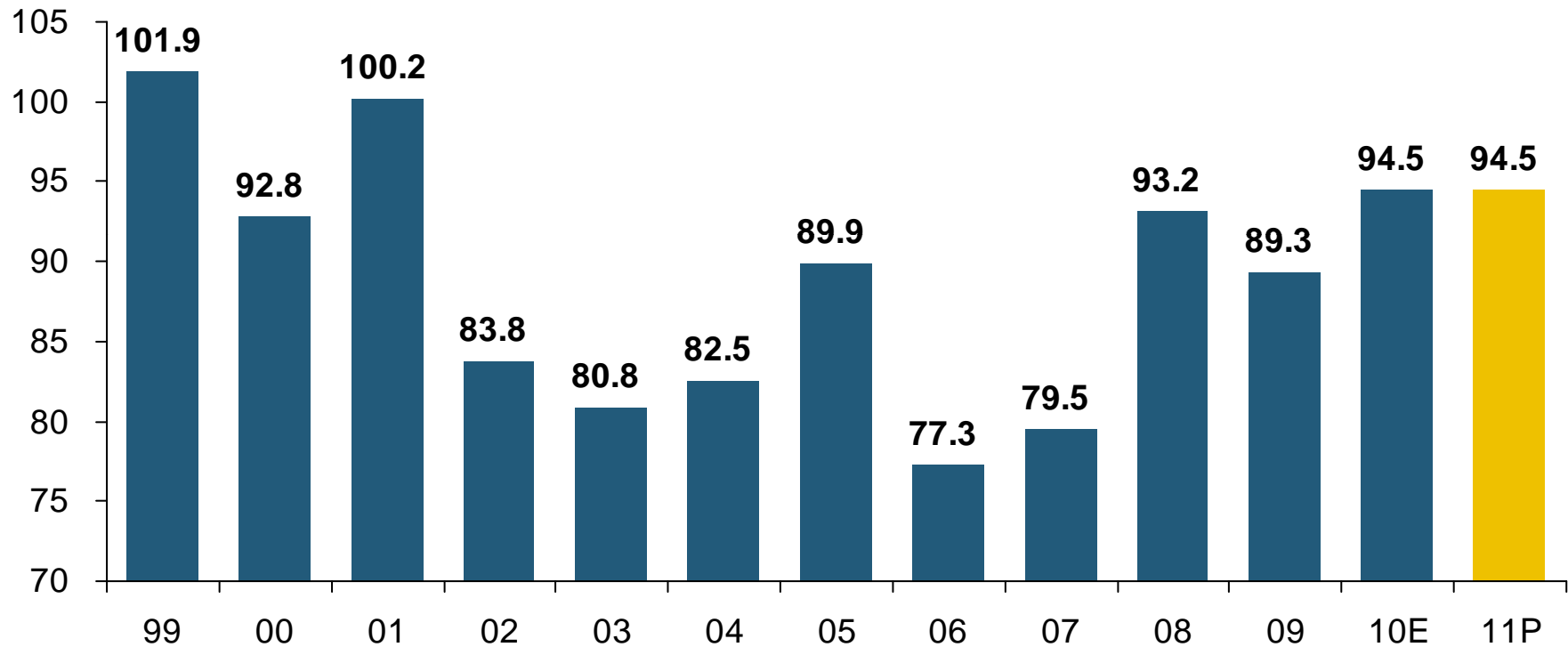
Commercial Multi-Peril Combined Ratio: 1995–2011P



**Commercial Multi-Peril Underwriting Performance
is Expected to Deteriorate Modestly**

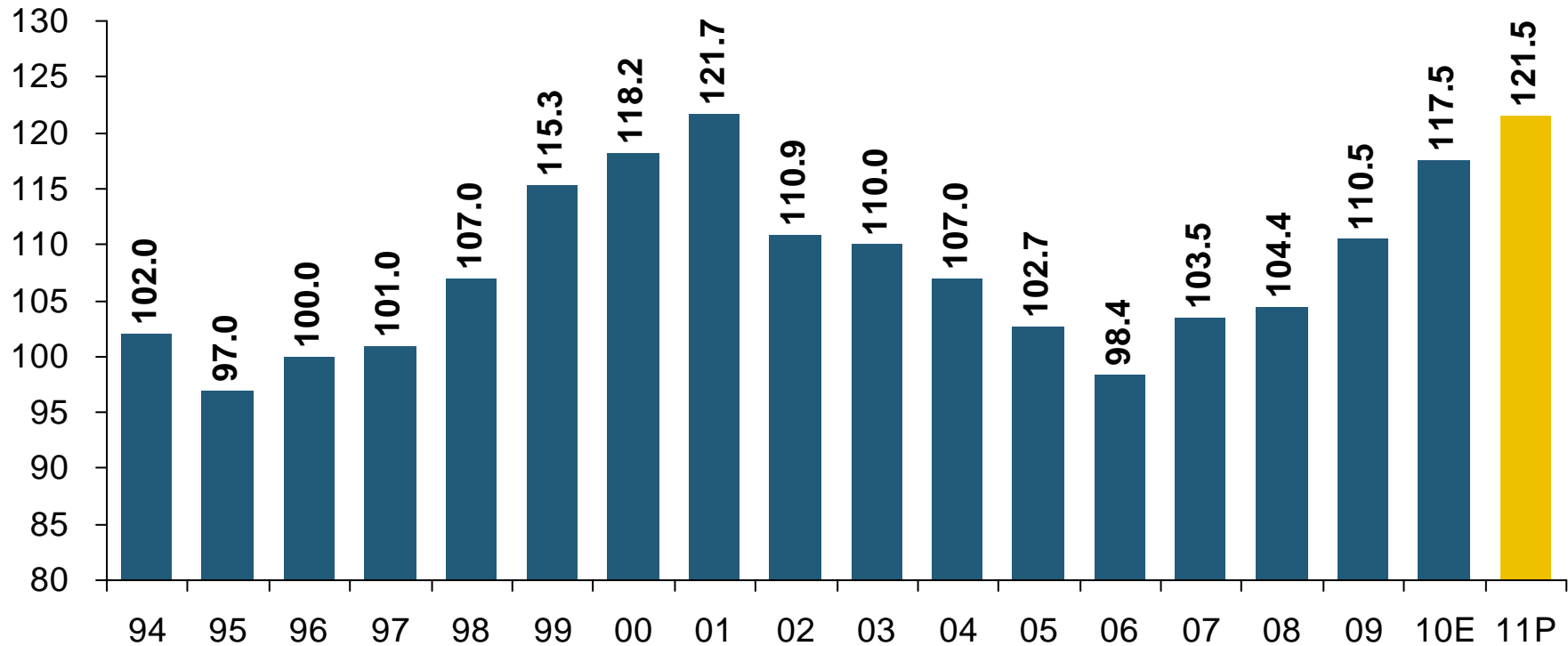
*2010E and 2011P figures are for the combined liability and non-liability components.
Sources: A.M. Best; Insurance Information Institute.

Inland Marine Combined Ratio: 1999–2011P



Inland Marine is Expected to Remain Among the Most Profitable of All Lines

Workers Compensation Combined Ratio: 1994–2011P



Workers Comp Underwriting Results Are Deteriorating Markedly and the Worst They Have Been in a Decade

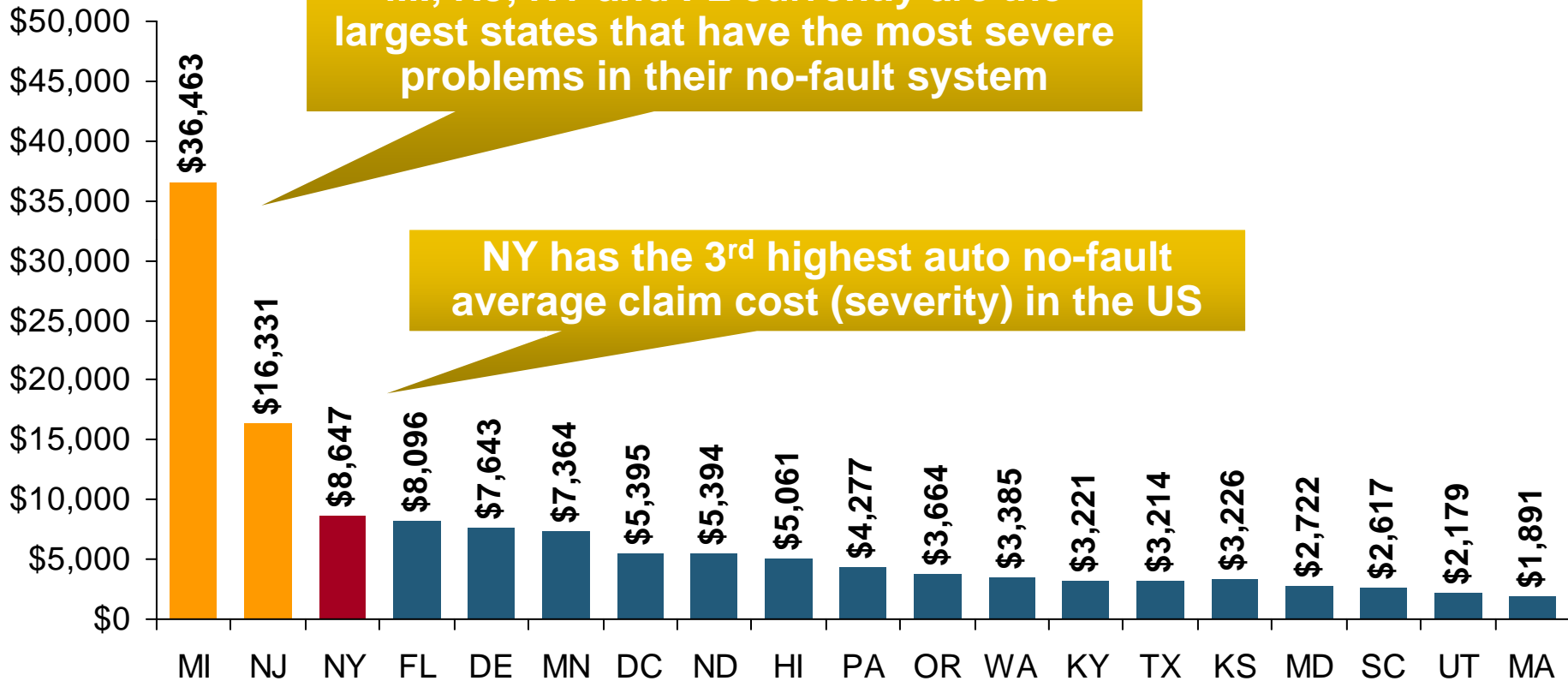
New York No-Fault Update

**Costs Among the Highest in the
US and Continue to Rise**

Average No-Fault Claim Severity, 2010:Q3

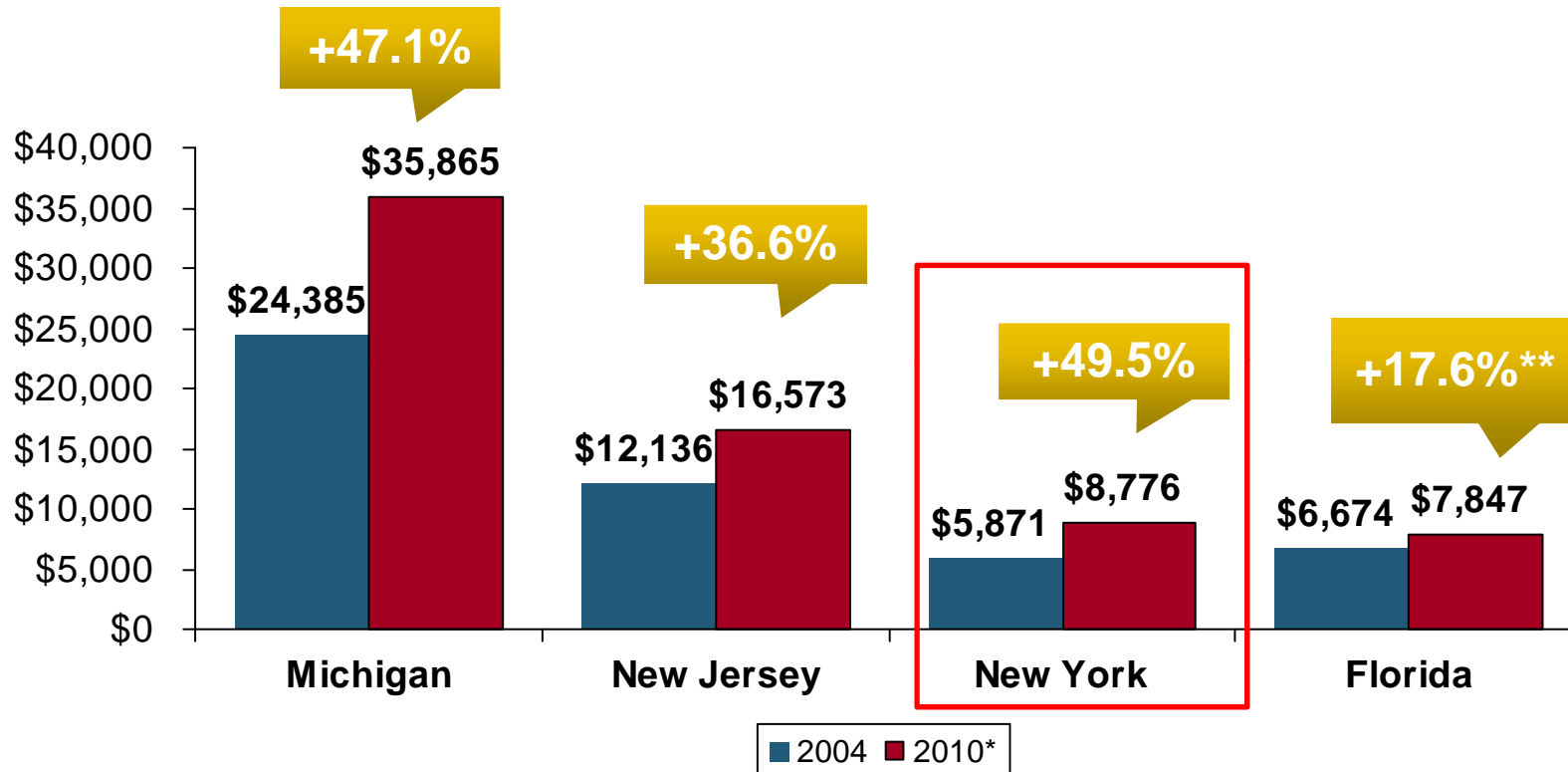
MI, NJ, NY and FL currently are the largest states that have the most severe problems in their no-fault system

NY has the 3rd highest auto no-fault average claim cost (severity) in the US



Several States Have Severe and Growing Problems With Rampant Fraud and Abuse in their No-Fault Systems. Claim Severities Are Up Sharply.

Increase in No-Fault Claim Severity: 2004-2010*



The no-fault systems in MI, NJ, NY and FL are under stress due to rising fraud and abuse which will ultimately lead to higher premiums for drivers

*2009 figure is for the 4 quarters ending 2010:Q3.

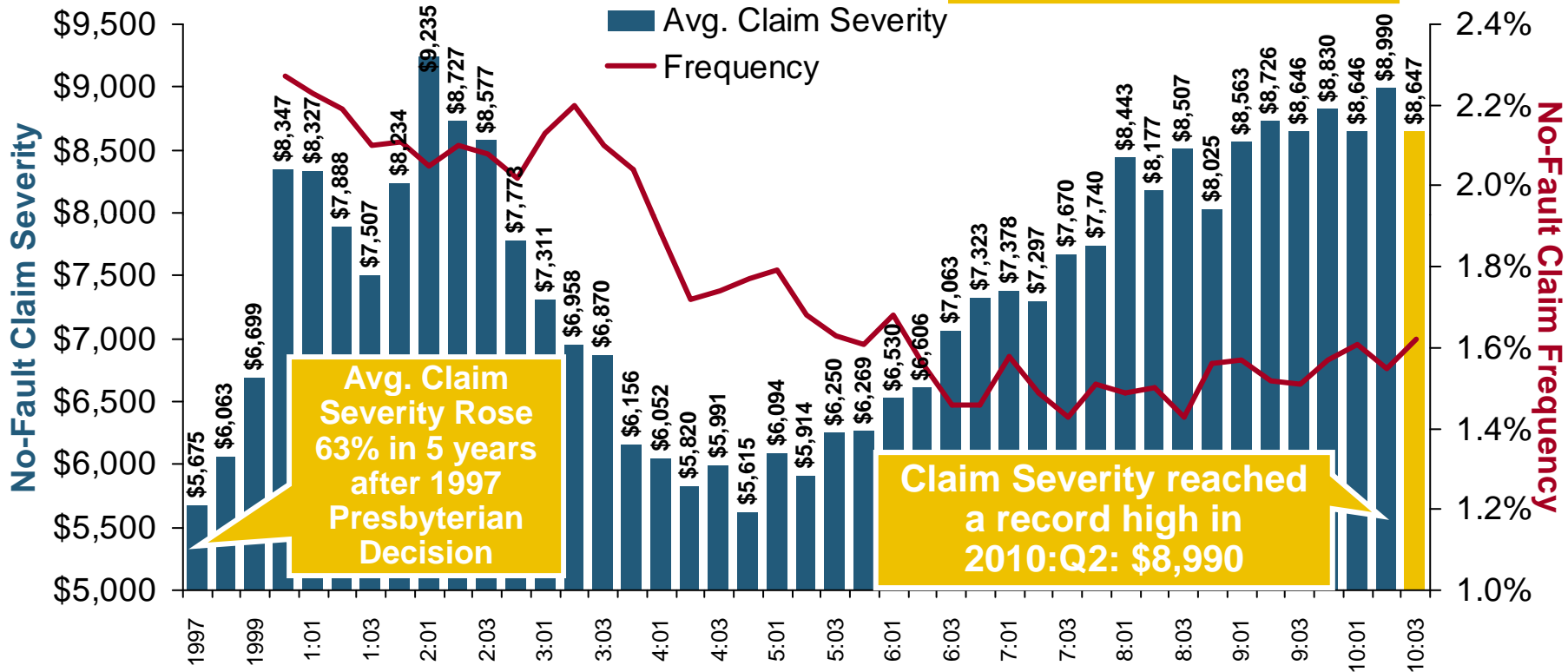
**Since 2006 the increase in Florida was 23.7% (average severity that year was \$6,344).

Sources: Insurance Information Institute research from ISO/PCI *Fast Track* data.

New York State No-Fault Claim Severity, 1997–2010:Q3

No-Fault Claim Severity

Avg. Claim Severity is up 54% since 2004:Q4

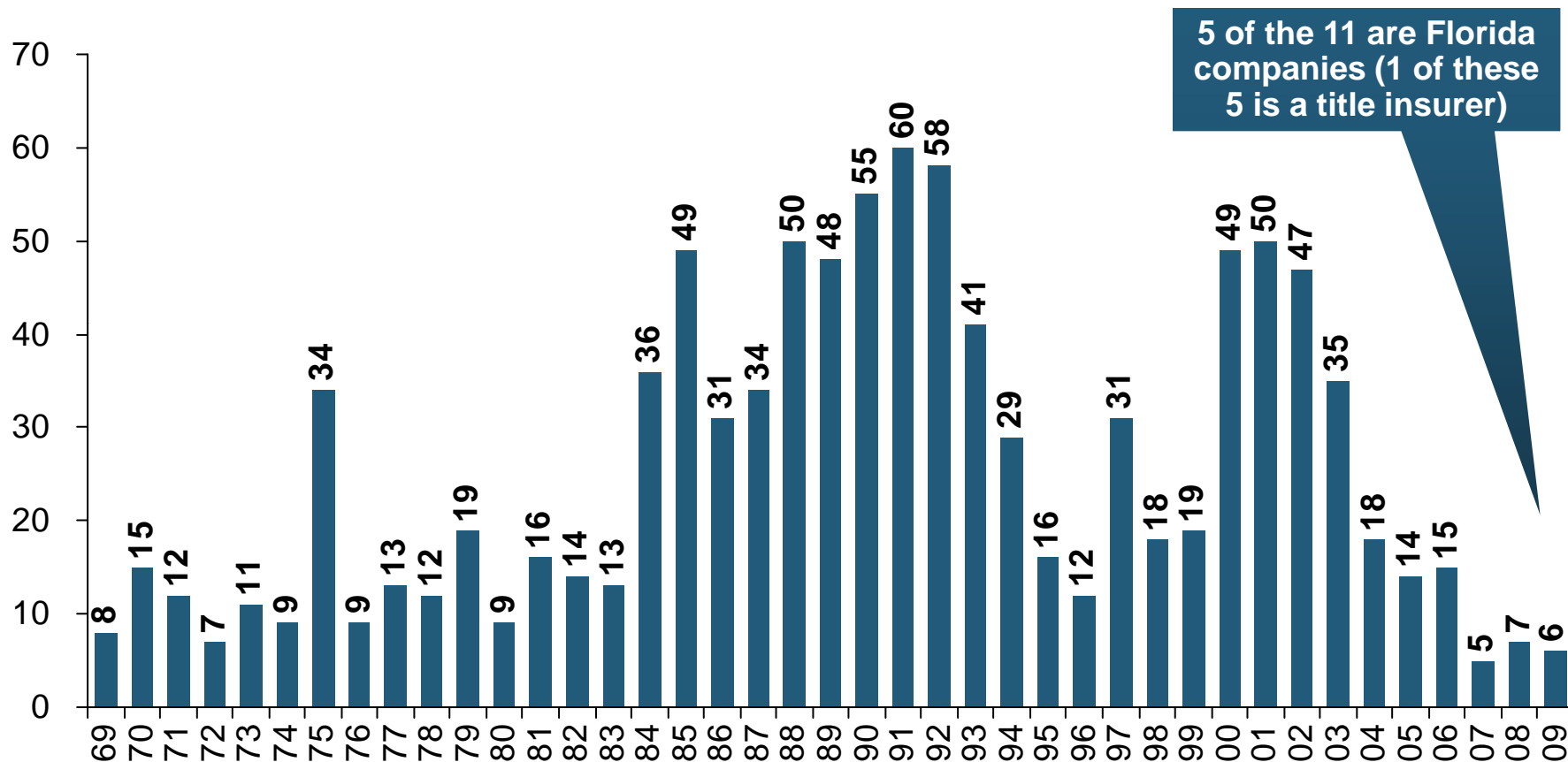


About 20% of No-Fault Claim Costs Are Attributable to Fraud and Abuse

Financial Strength & Underwriting

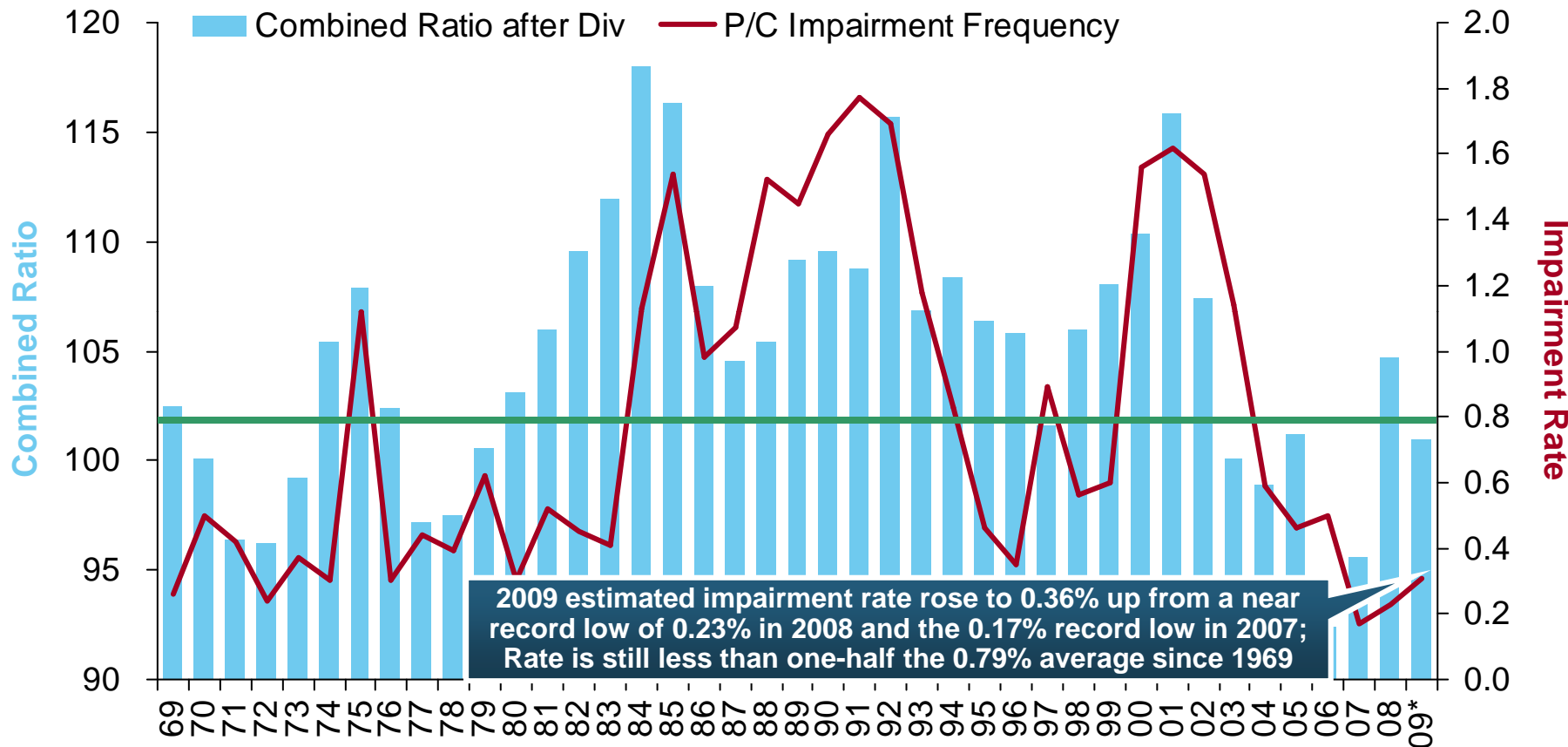
**Cyclical Pattern is P-C Impairment
History is Directly Tied to
Underwriting, Reserving & Pricing**

P/C Insurer Impairments, 1969–2009



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

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2009

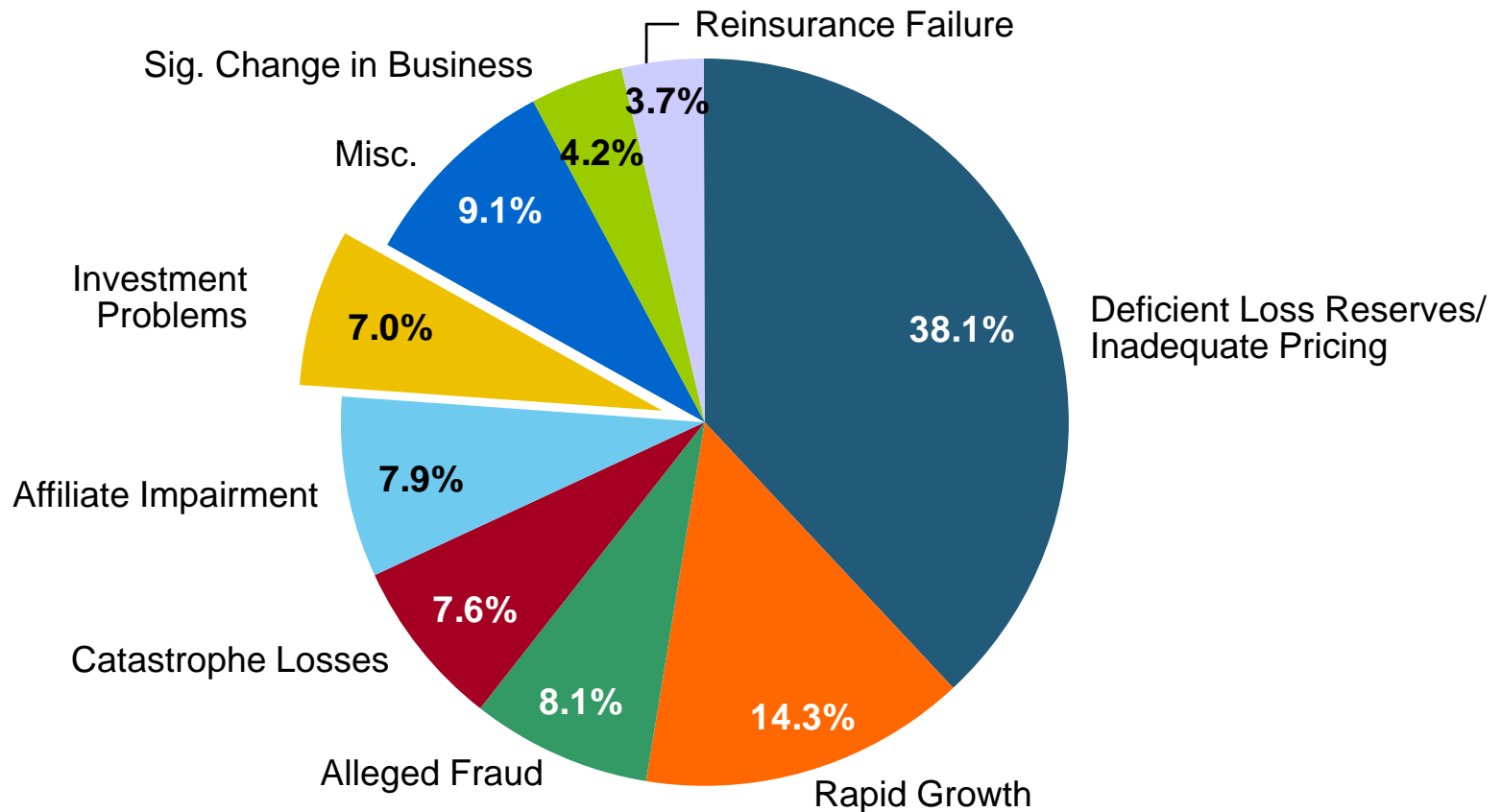


2009 estimated impairment rate rose to 0.36% up from a near record low of 0.23% in 2008 and the 0.17% record low in 2007; Rate is still less than one-half the 0.79% average since 1969

Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007/08

Reasons for US P/C Insurer Impairments, 1969–2008

Deficient Loss Reserves and Inadequate Pricing Are the Leading Cause of Insurer Impairments, Underscoring the Importance of Discipline. Investment Catastrophe Losses Play a Much Smaller Role

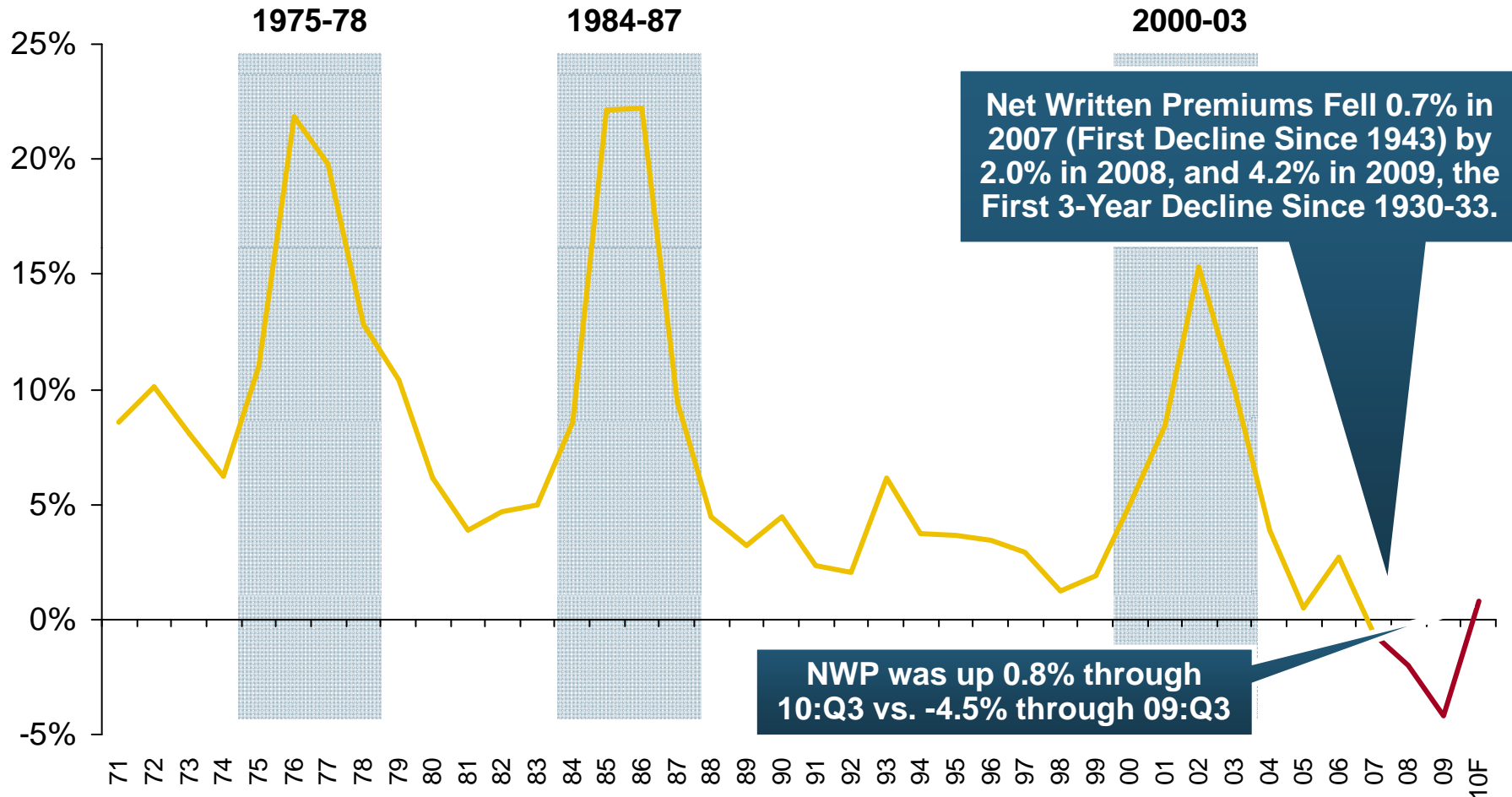


Profit Pillar #2 PRICING

Pricing is Key to Profitability
*Trends in Personal and
Commercial*

Soft Market Persisted in 2010 but May Be Easing: Relief in 2011?

(Percent)

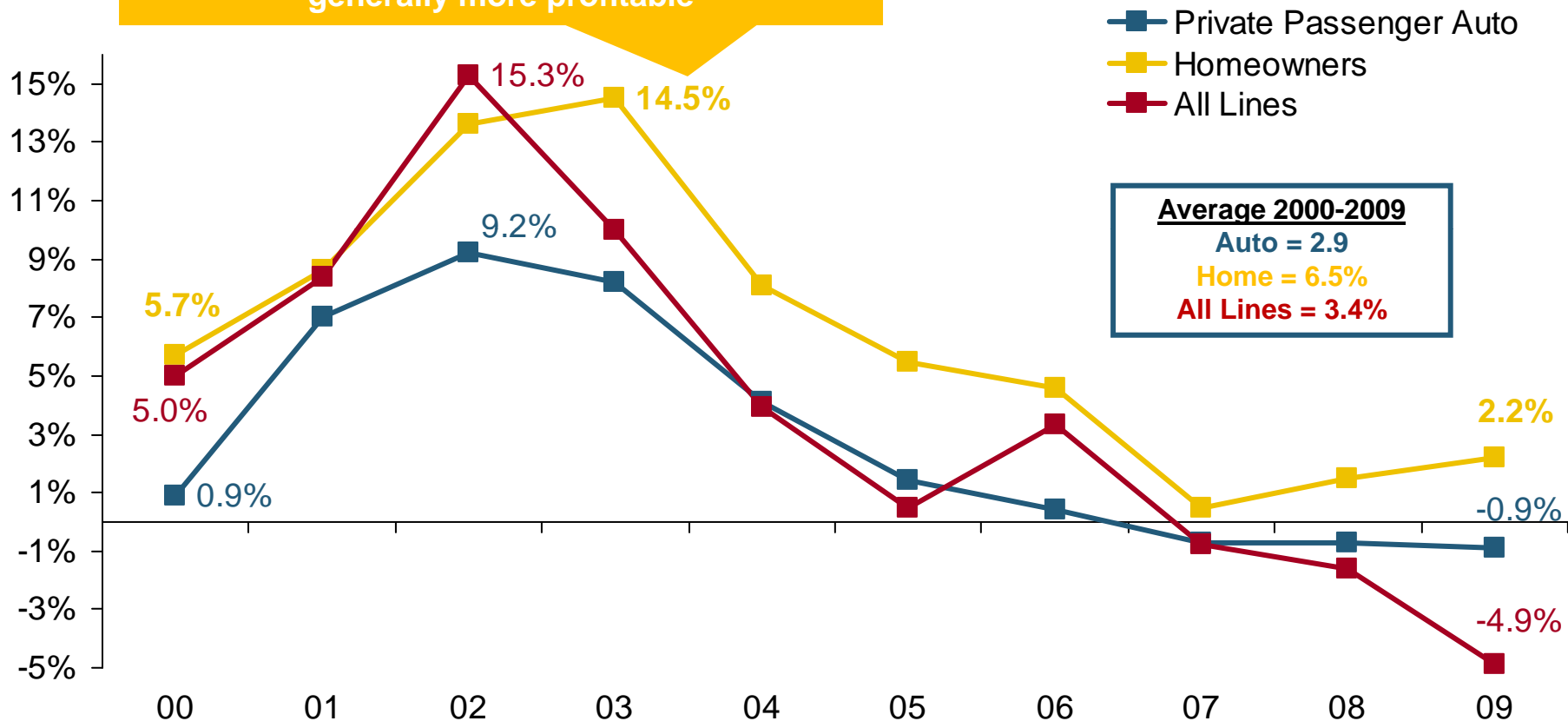


Shaded areas denote "hard market" periods

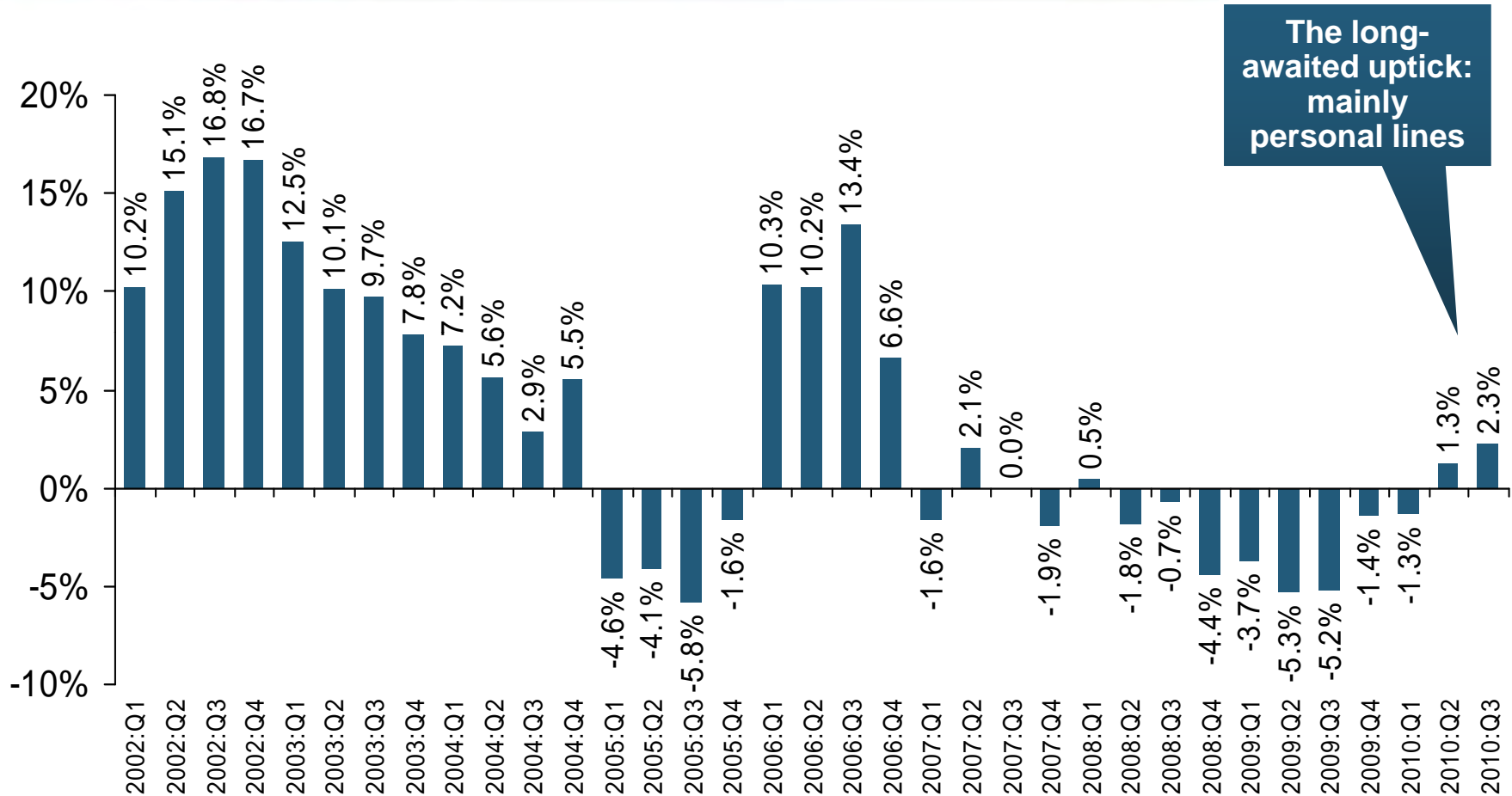
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

Auto & Home vs. All Lines, Net Written Premium Growth, 2000–2009

While homeowners insurance has grown faster than auto over the past decade, auto is generally more profitable



P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter

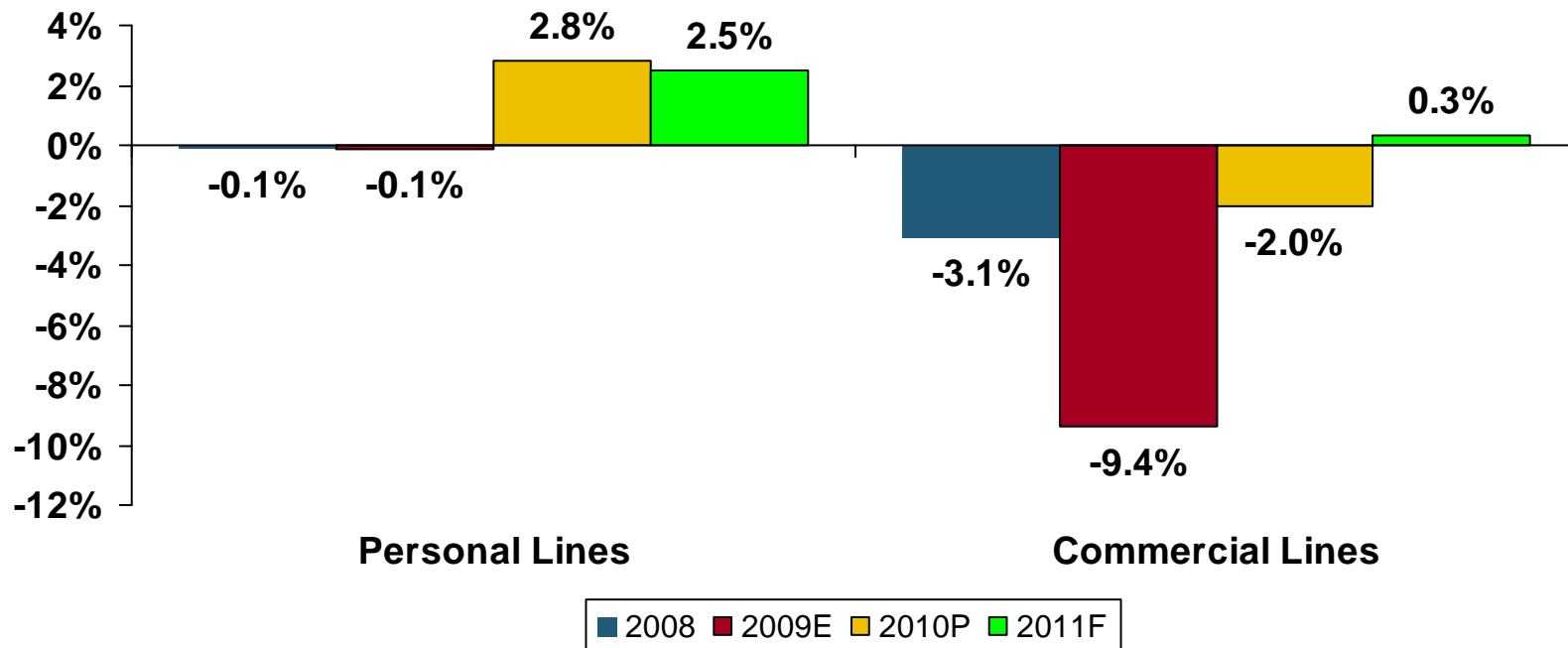


The long-awaited uptick: mainly personal lines

Finally! Back-to-back quarters of net written premium growth (vs. the same quarter, prior year)

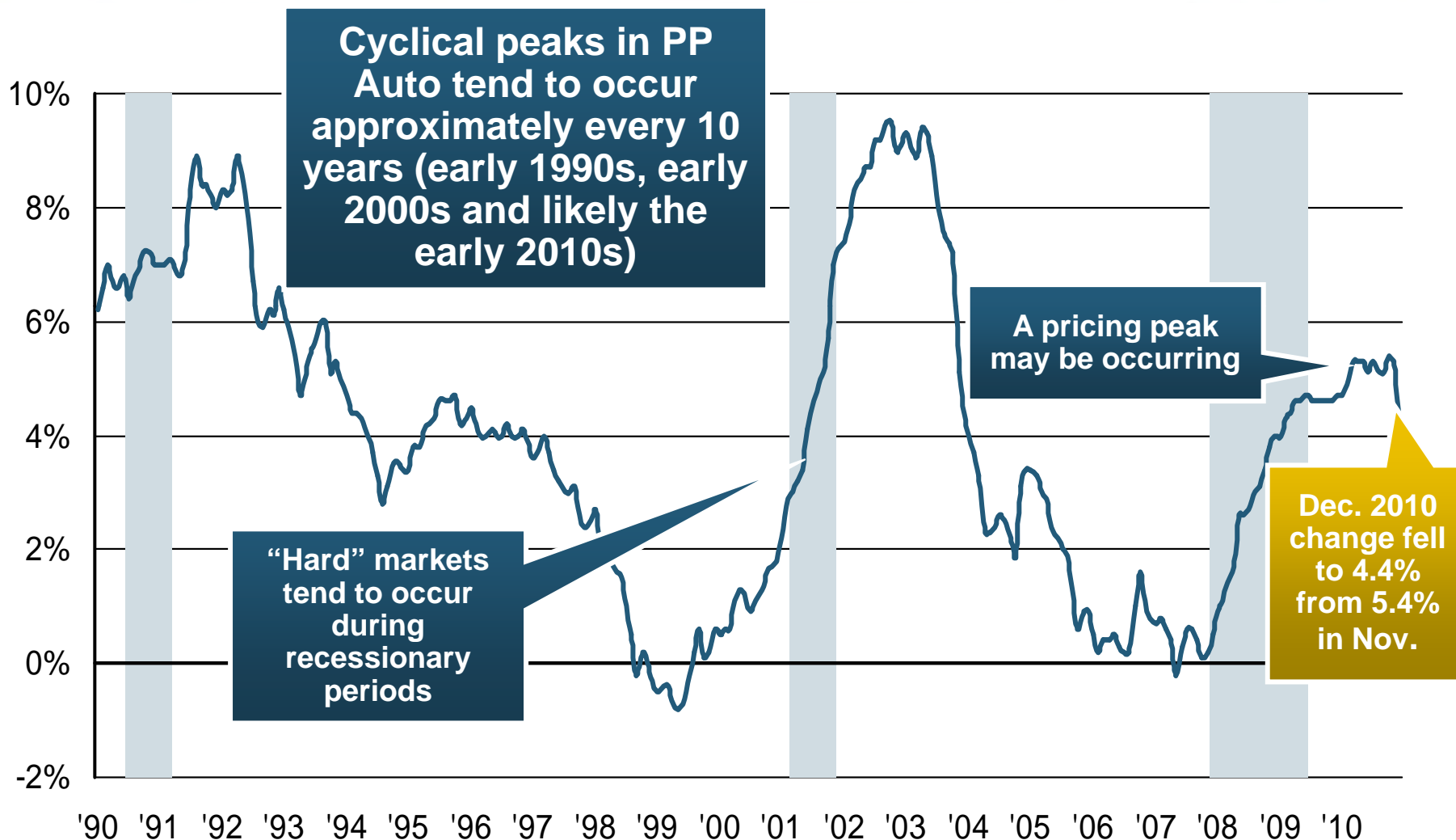
Net Written Premium Growth by Segment: 2008-2011F

Personal lines growth resumed in 2010 and will continue in 2011, while commercial lines contracted again in 2010 and but will stabilize in 2011



Rate and exposure are more favorable in personal lines, whereas a prolonged soft market and sluggish recovery from the recession weigh on commercial lines.

Monthly Change* in Auto Insurance Prices, 1991–2010*

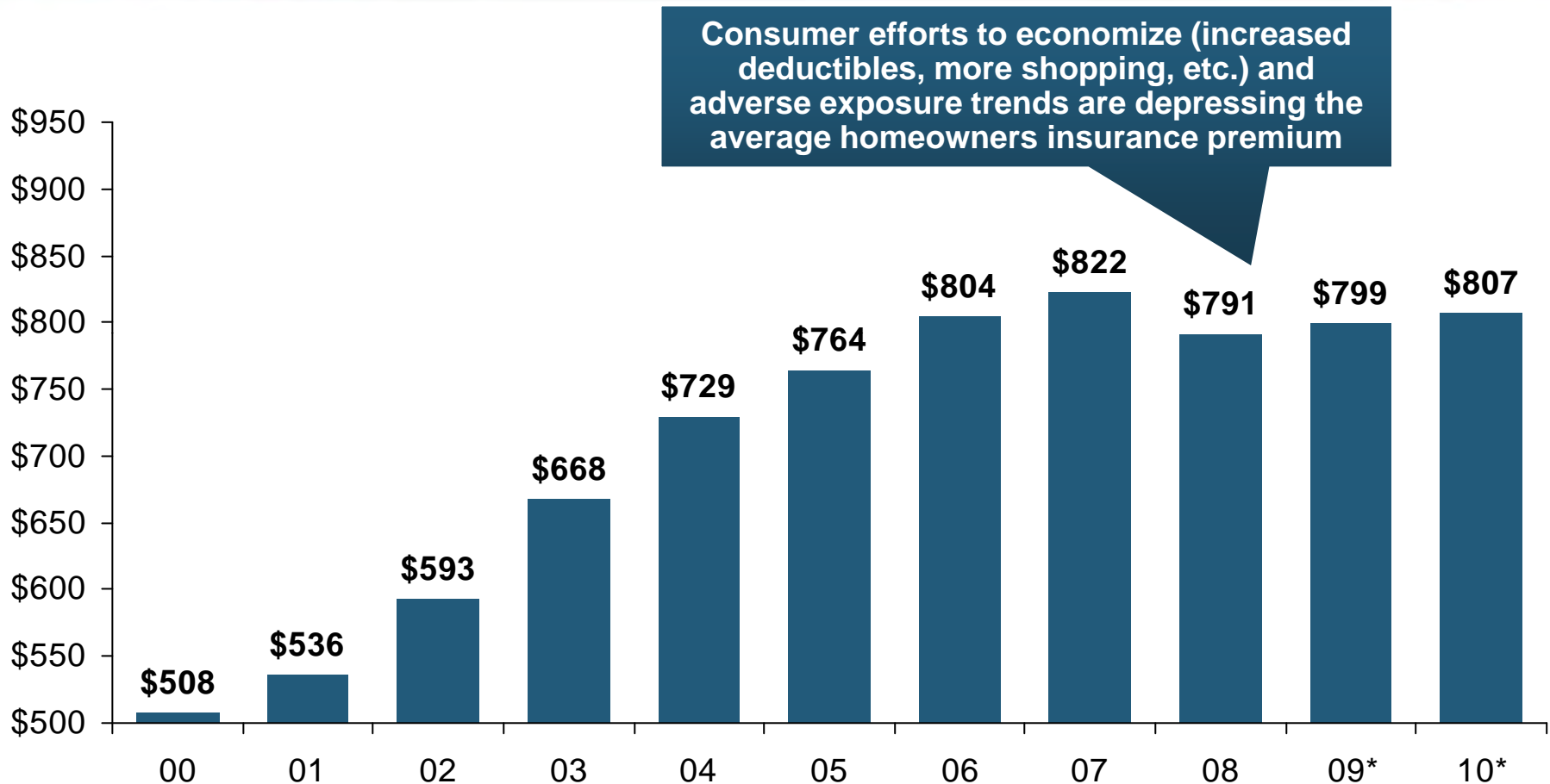


*Percentage change from same month in prior year; through December 2010; seasonally adjusted

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

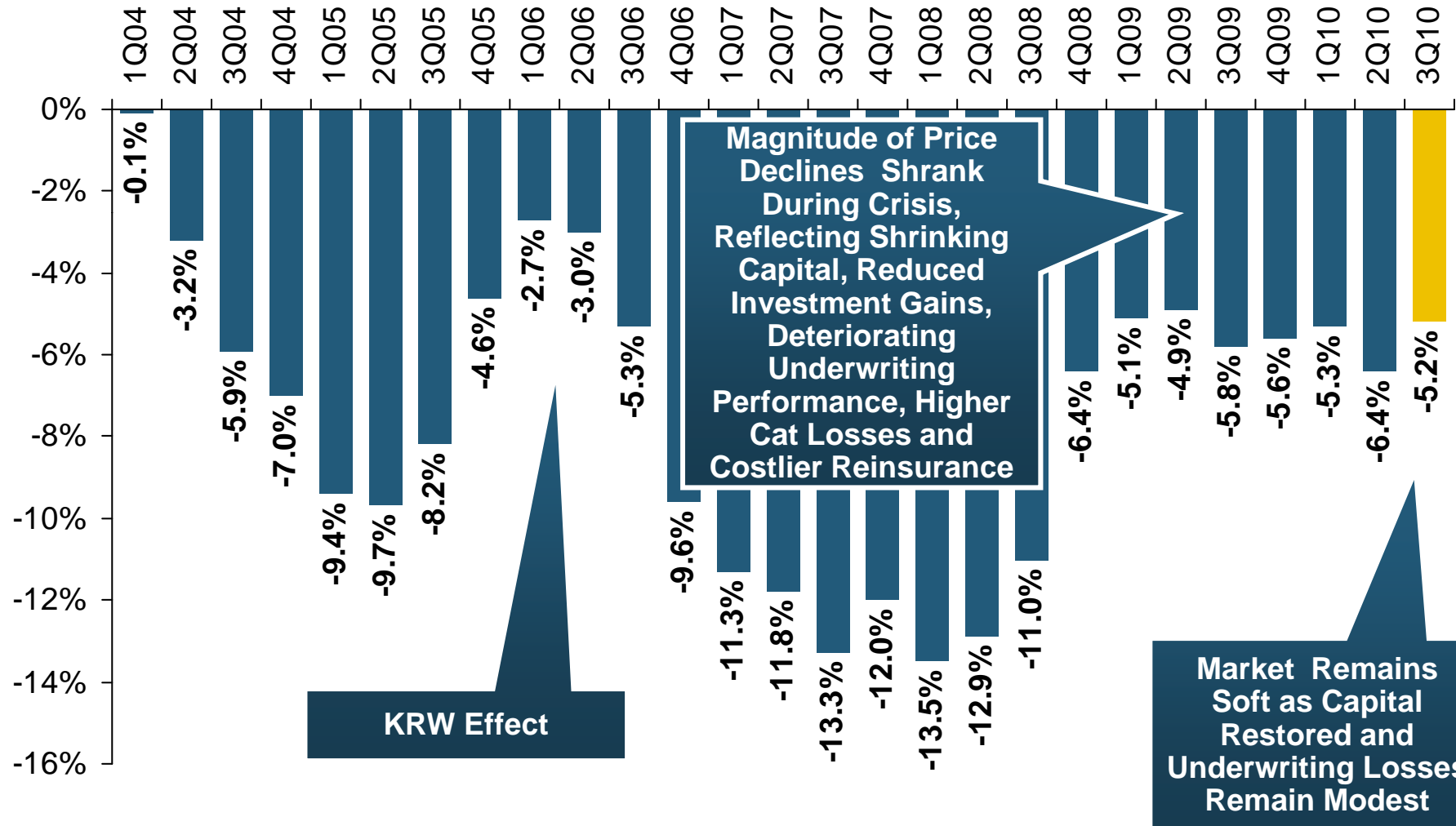
Average Premium for Home Insurance Policies**



* Insurance Information Institute Estimates/Forecasts **Excludes state-run insurers.
Source: NAIC, Insurance Information Institute estimates 2009-2010 based on CPI and other data.

Average Commercial Rate Change, All Lines, (1Q:2004–3Q:2010)

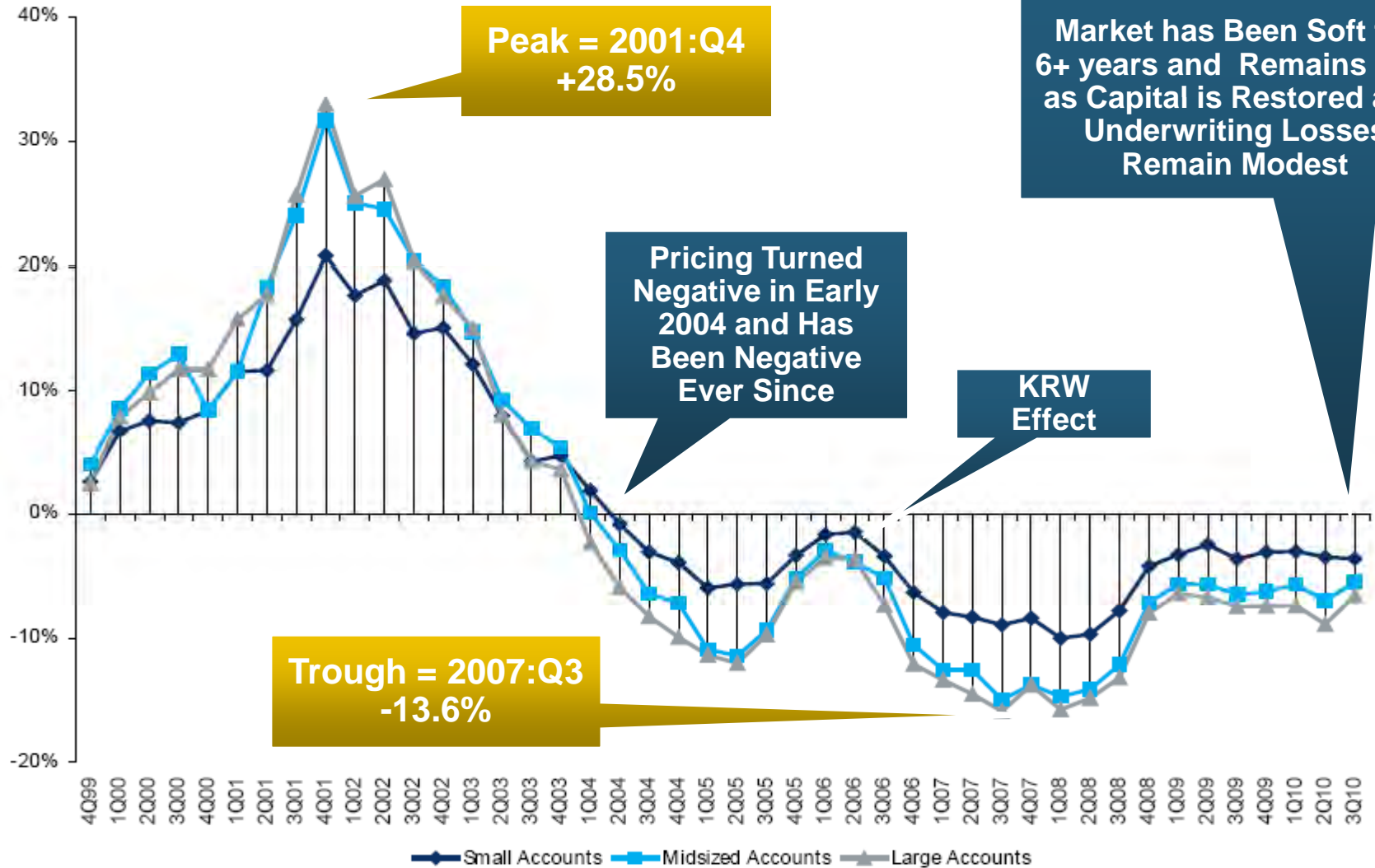
(Percent)



Source: Council of Insurance Agents & Brokers; Insurance Information Institute

Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2010:Q3

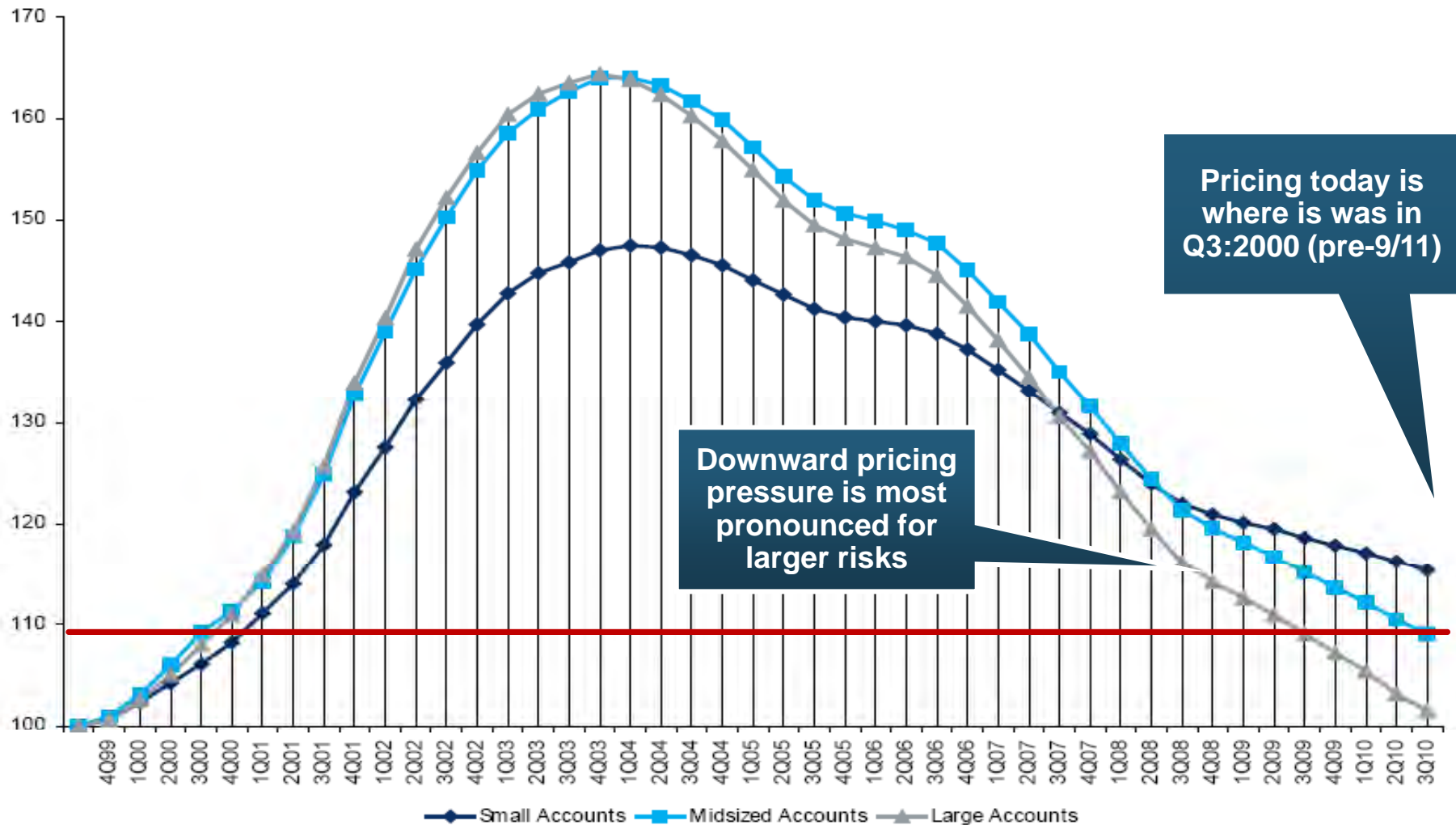
Percentage Change (%)



Source: Council of Insurance Agents and Brokers; Insurance Information Institute.

Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2010:Q3

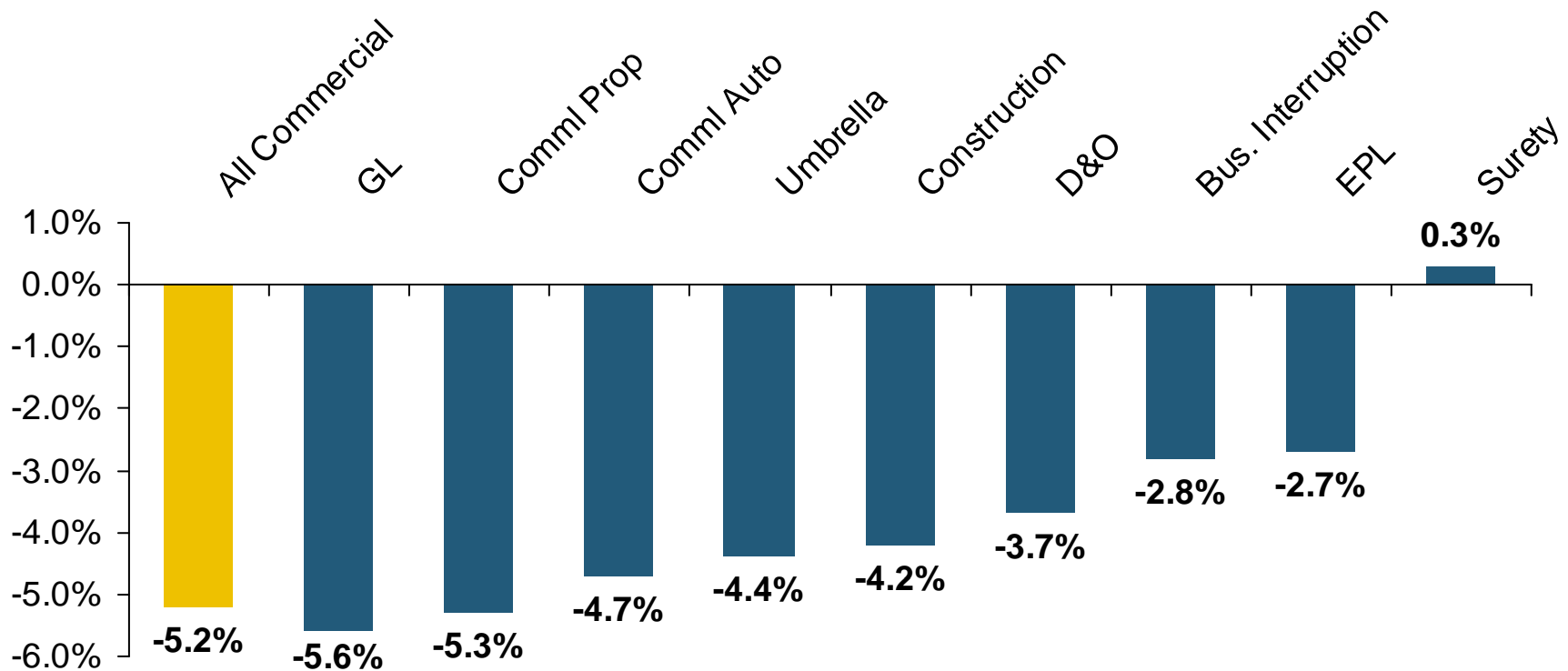
1999:Q4 = 100



Source: Council of Insurance Agents and Brokers; Insurance Information Institute.

Change in Commercial Rate Renewals, by Line: 2010:Q3

Percentage Change (%)



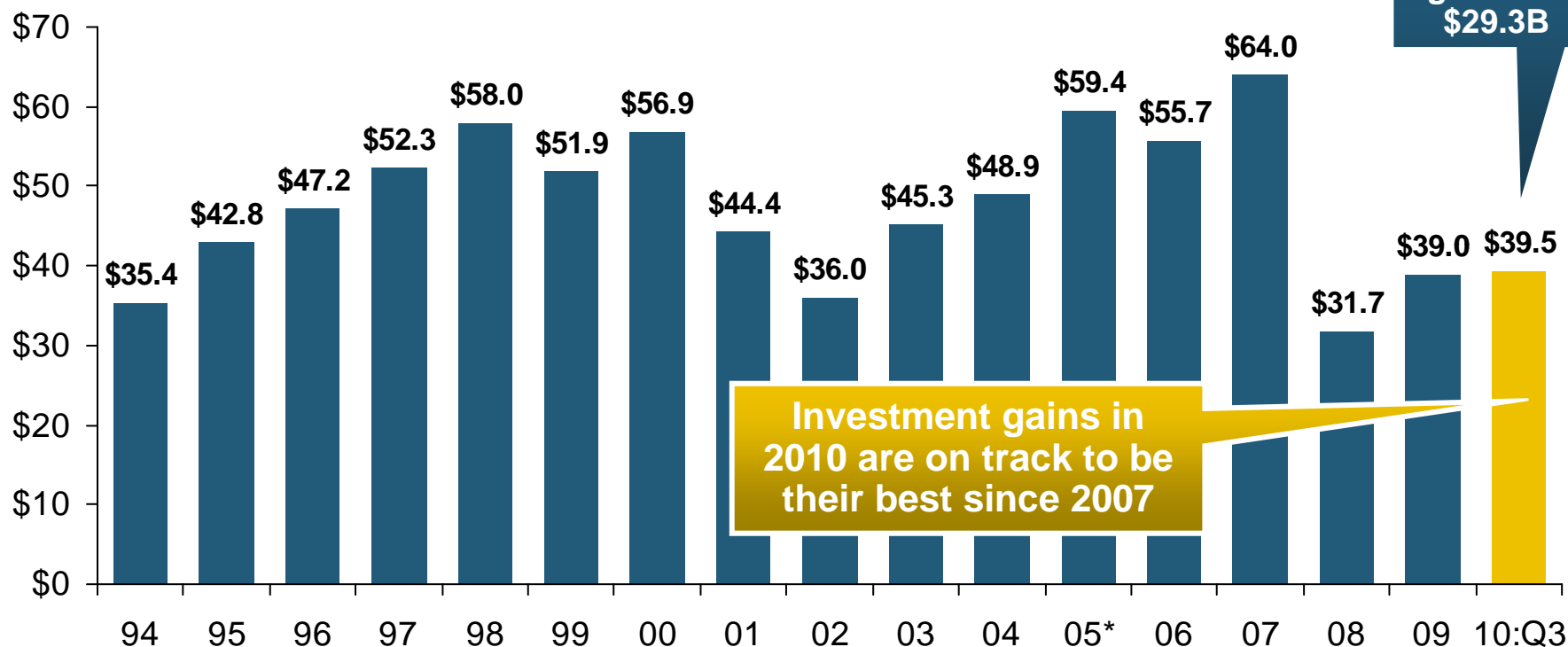
Most Major Commercial Lines Renewed Down in Q3:2010 at a Pace Similar to that of a Year Earlier

Profit Pillar #3 INVESTMENTS

**Investment Performance is a
Key Driver of Profitability
*Does It Influence
Underwriting?***

Property/Casualty Insurance Industry Investment Gain: 1994–2010:Q3¹

(\$ Billions)



2009:Q3
gain was
\$29.3B

Investment gains in
2010 are on track to be
their best since 2007

In 2008, Investment Gains Fell by 50% Due to Lower Yields and Nearly \$20B of Realized Capital Losses
2009 Saw Smaller Realized Capital Losses But Declining Investment Income
Investment Gains Recovered Significantly in 2010

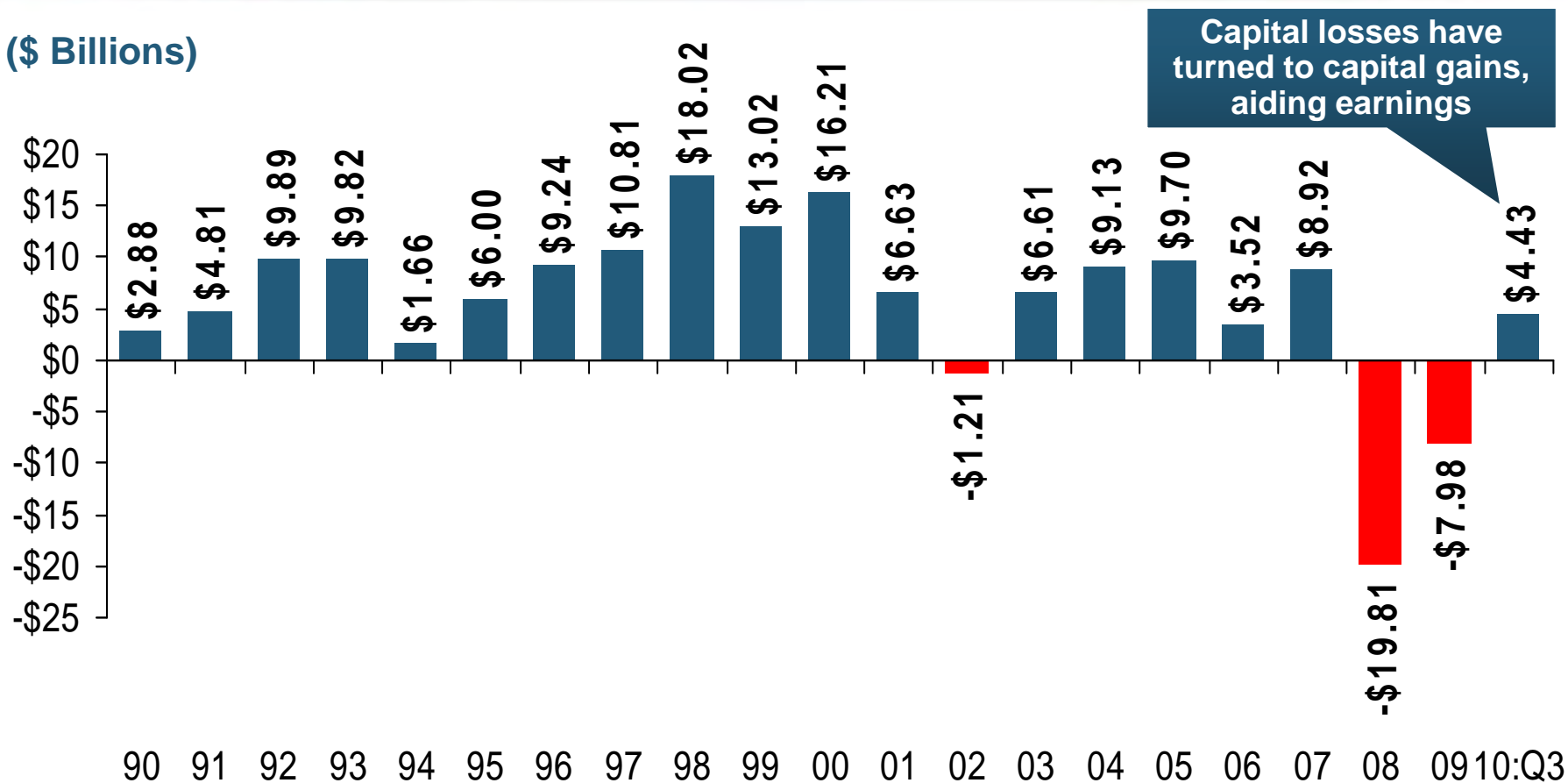
¹ Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

* 2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.

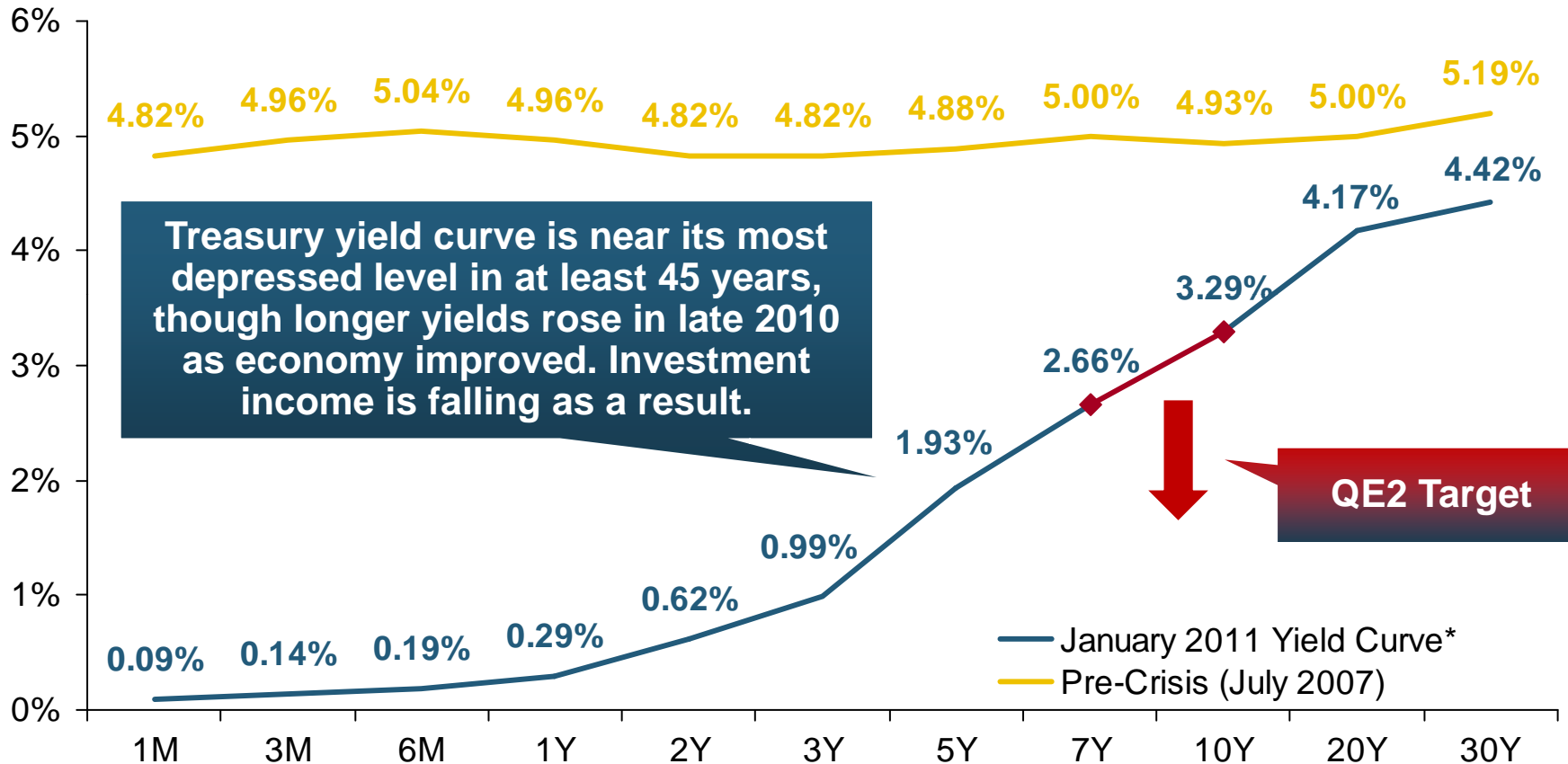
P/C Insurer Net Realized Capital Gains, 1990-2010:Q3

(\$ Billions)



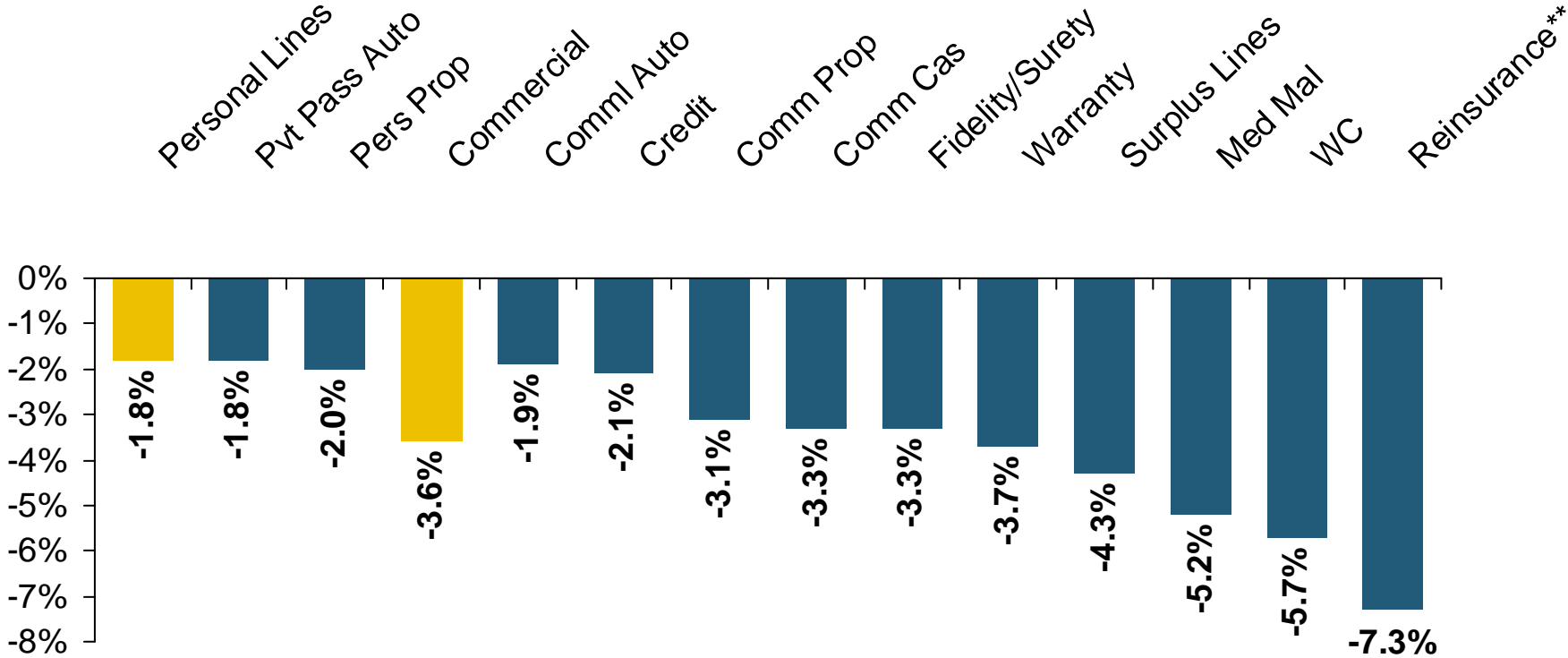
Realized Capital Losses Were the Primary Cause of 2008/2009's Large Drop in Profits and ROE and Were a Major Driver of Its Recovery in 2010

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



The Fed's Announced Intention to Pursue Additional Quantitative Easing Could Depress Rates in the 7 to 10-Year Maturity Range through June

Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line*



Lower Investment Earnings Place a Greater Burden on Underwriting and Pricing Discipline

*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

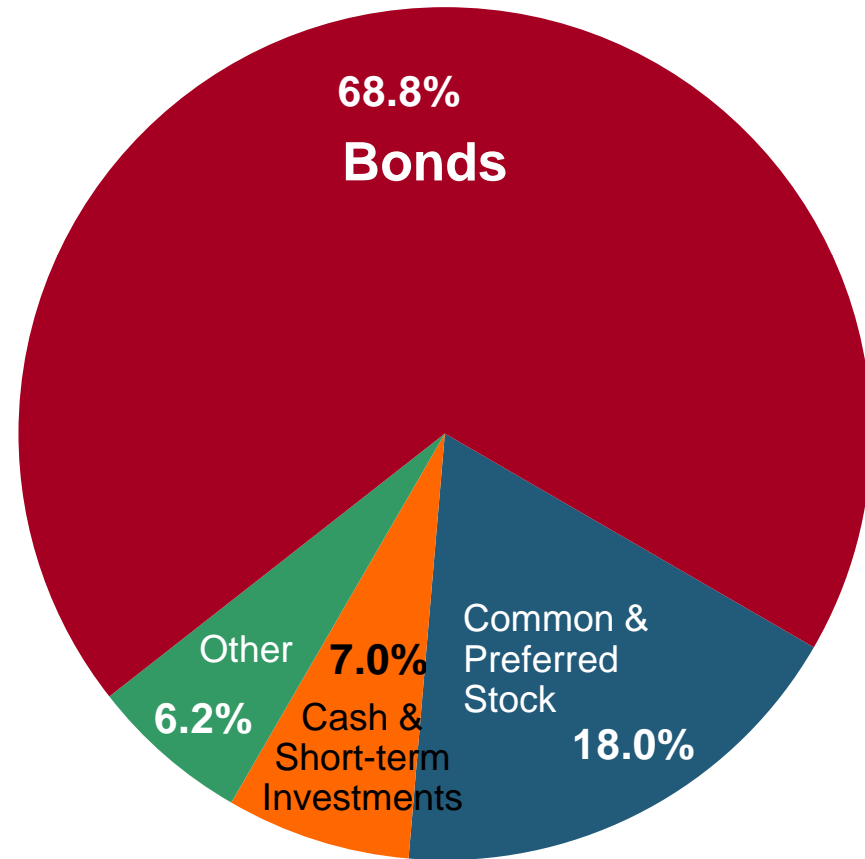
Source: A.M. Best; Insurance Information Institute.

Distribution of P/C Insurance Industry's Investment Portfolio

Portfolio Facts as of 12/31/2009

- Invested assets totaled \$1.26 trillion
- Generally, insurers invest conservatively, with over 2/3 of invested assets in bonds
- Only 18% of invested assets were in common or preferred stock

As of December 31, 2009



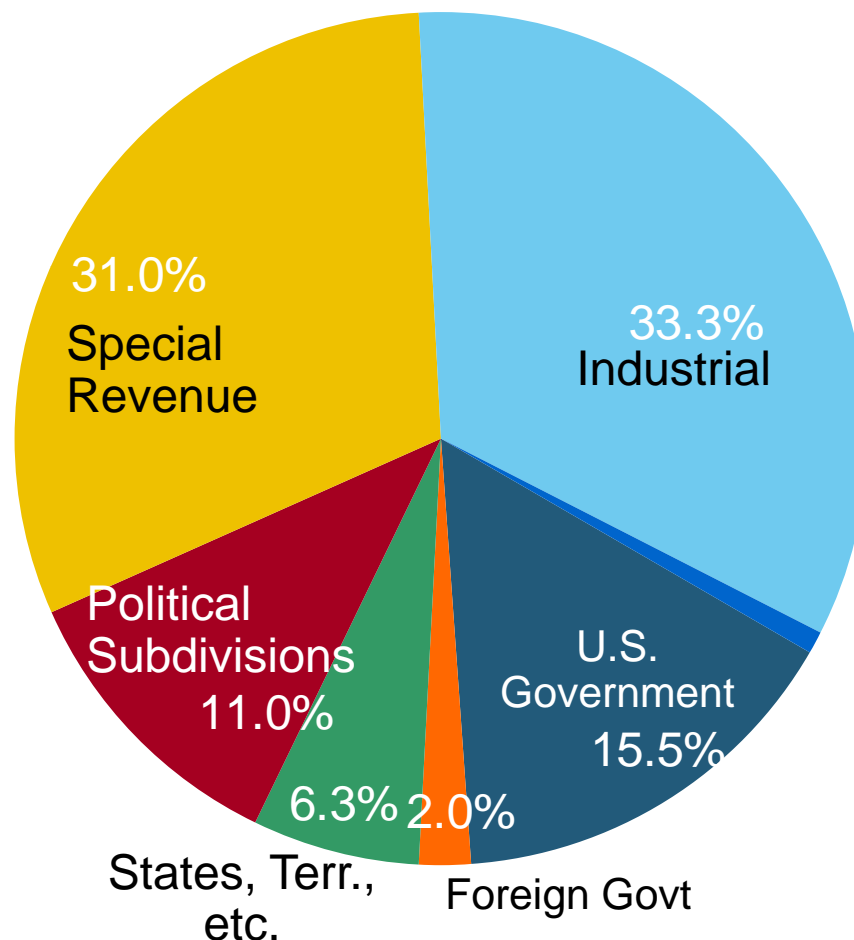
2011 Financial Overview

About Half of the P/C Insurance Industry's Bond Investments Are in Municipal Bonds

Bond Investment Facts as of 12/31/09

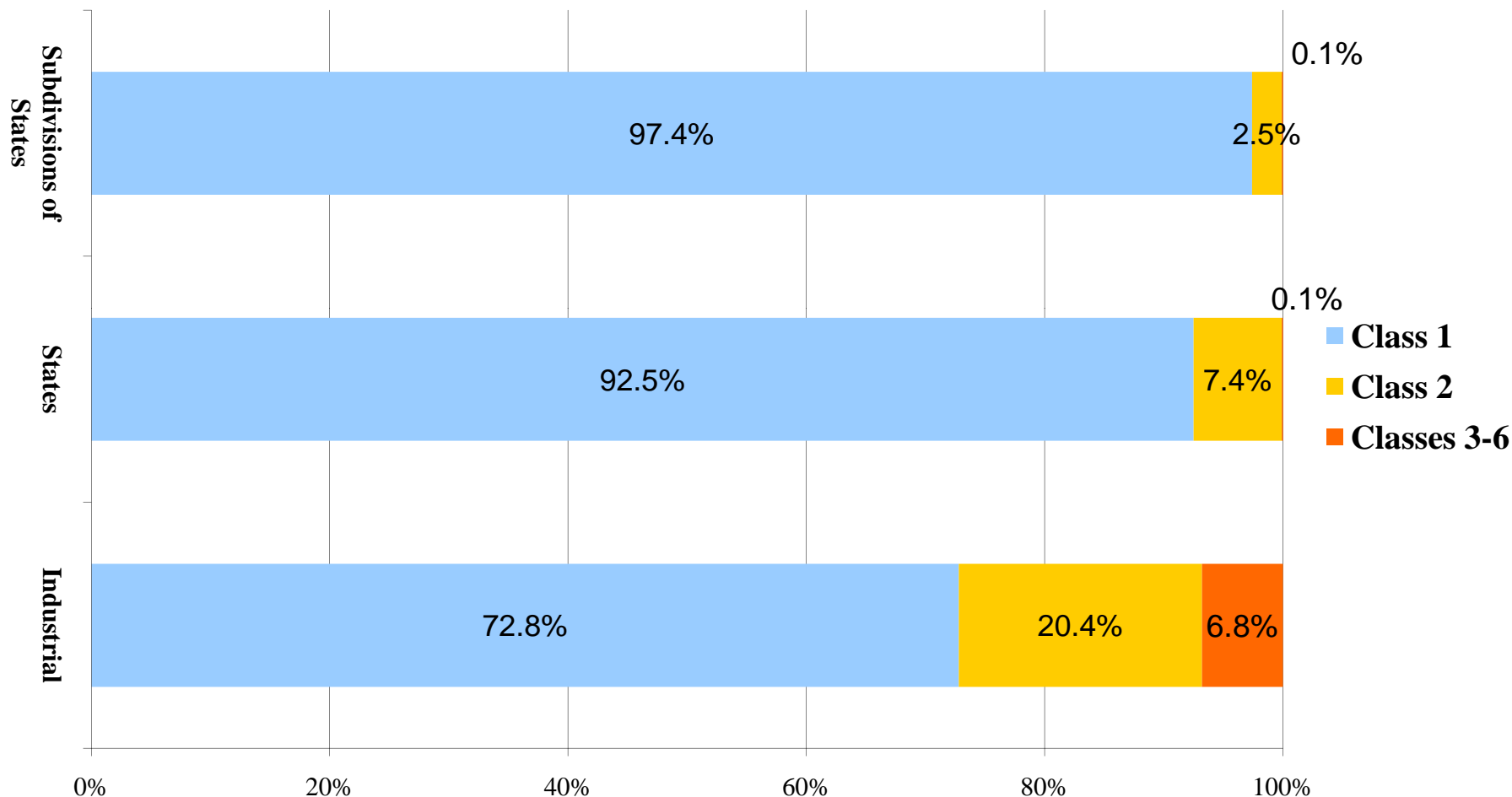
- Investments in "Political Subdivision [of states]" bonds were \$102.5 billion
- Investments in "States, Territories, & Possessions" bonds were \$58.9 billion
- Investments in "Special Revenue" bonds were \$288.2 billion
- All state, local, and special revenue bonds totaled 48.2% of bonds, about 35.7% of total invested assets

As of December 31, 2009



2011 Financial Overview

When P/C Insurers Invest in Higher Risk Bonds, It's Corporates, Not Munis



The NAIC's Securities Valuation Office puts bonds into one of 6 classes: class 1 has the lowest expected impairments; successively higher numbered classes imply increasing impairment likelihood.

Data are as of year-end 2009.

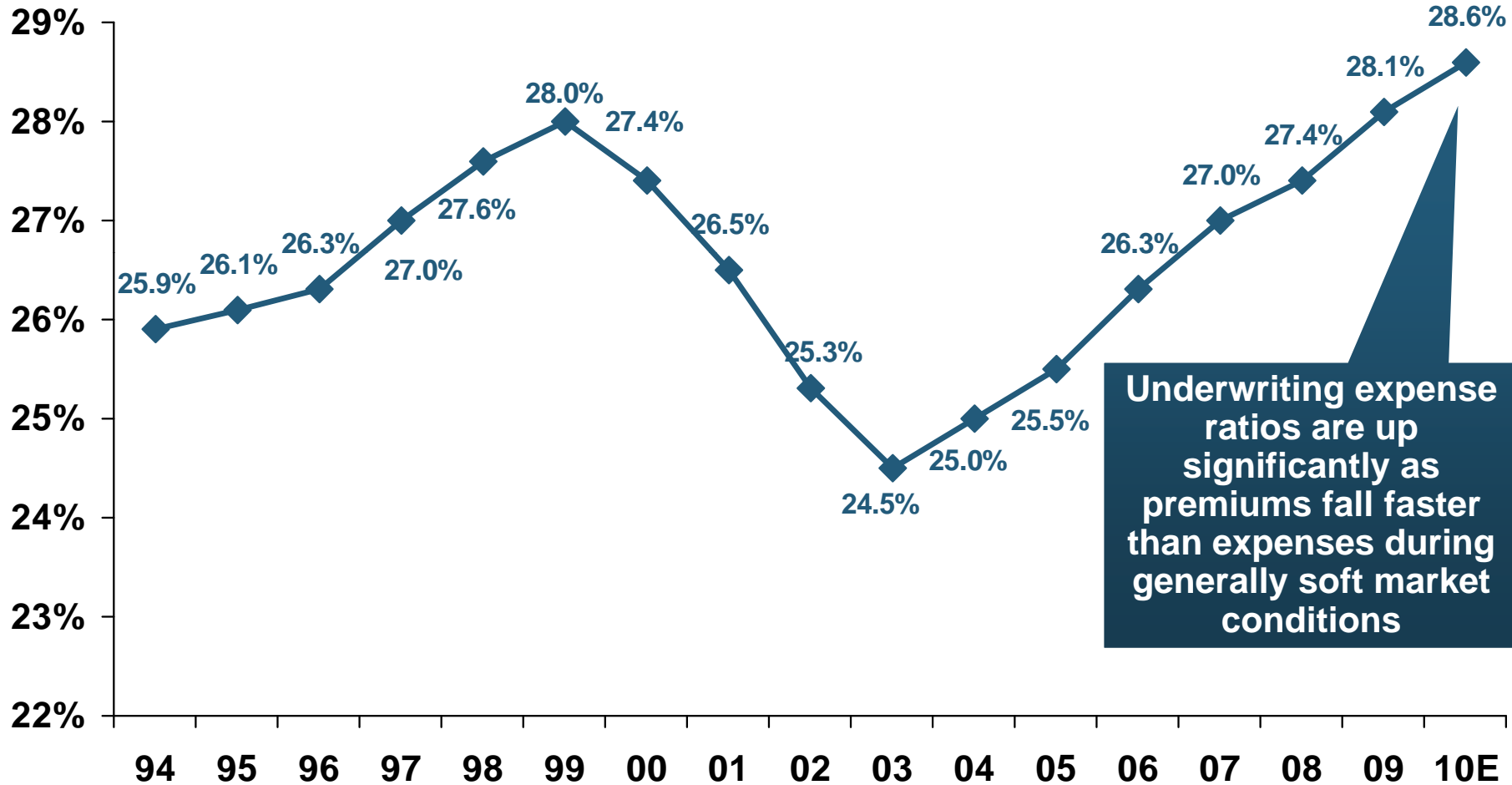
Sources: SNL Financial; Insurance Information Institute.

Profit Pillar #4 EXPENSES

**Will Expense Ratios Fall As
Premium Growth Turns Positive?**

Underwriting Expense Ratio*

All P/C Lines, 1994-2010E**



Underwriting expense ratios are up significantly as premiums fall faster than expenses during generally soft market conditions

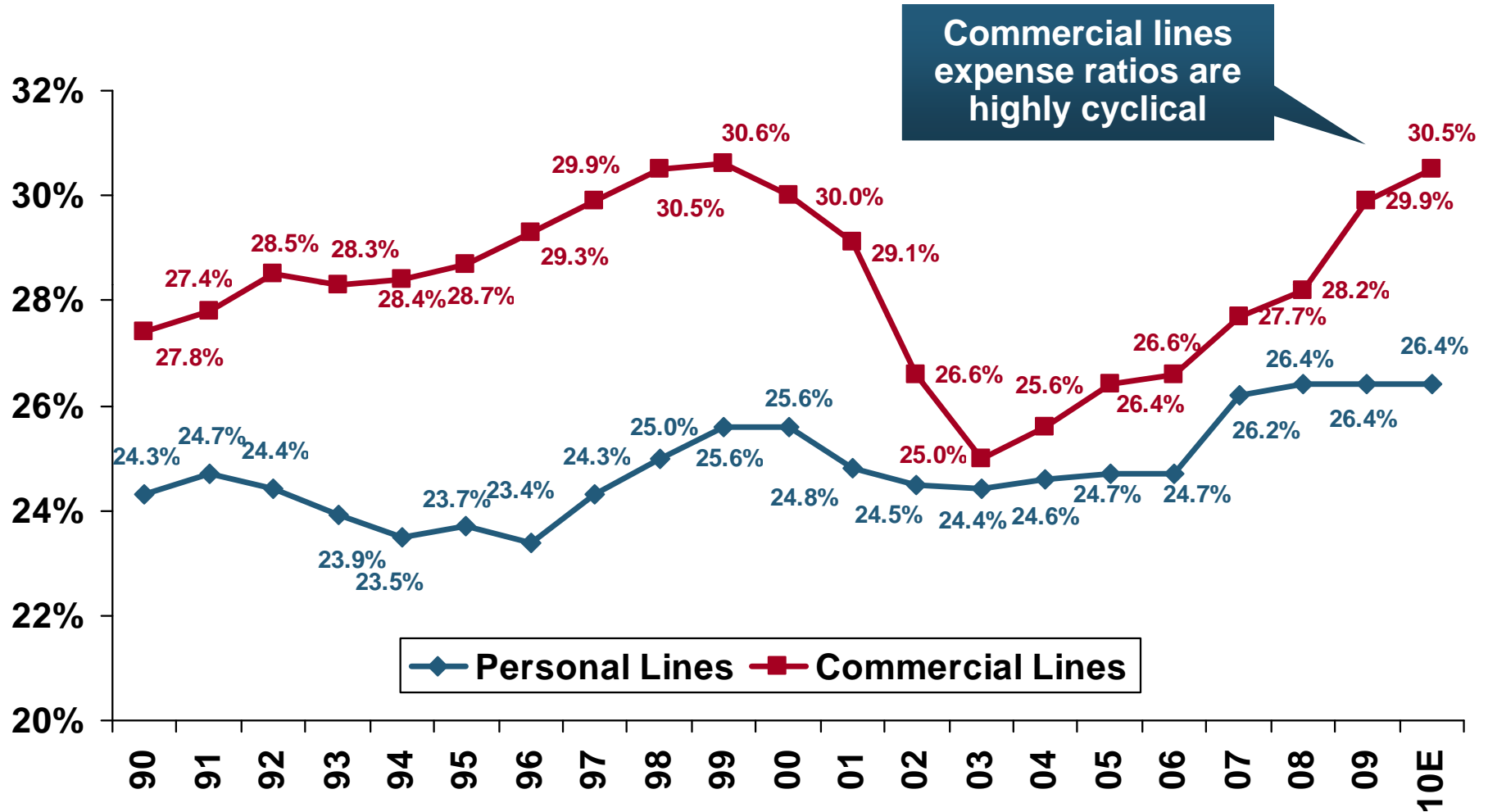
*Ratio of expenses incurred to net premiums written.

**2010 figure based on data through 2010:Q3.

Source: A.M. Best; Insurance Information Institute.

Underwriting Expense Ratio*:

Personal vs. Commercial Lines, 1990-2010E**

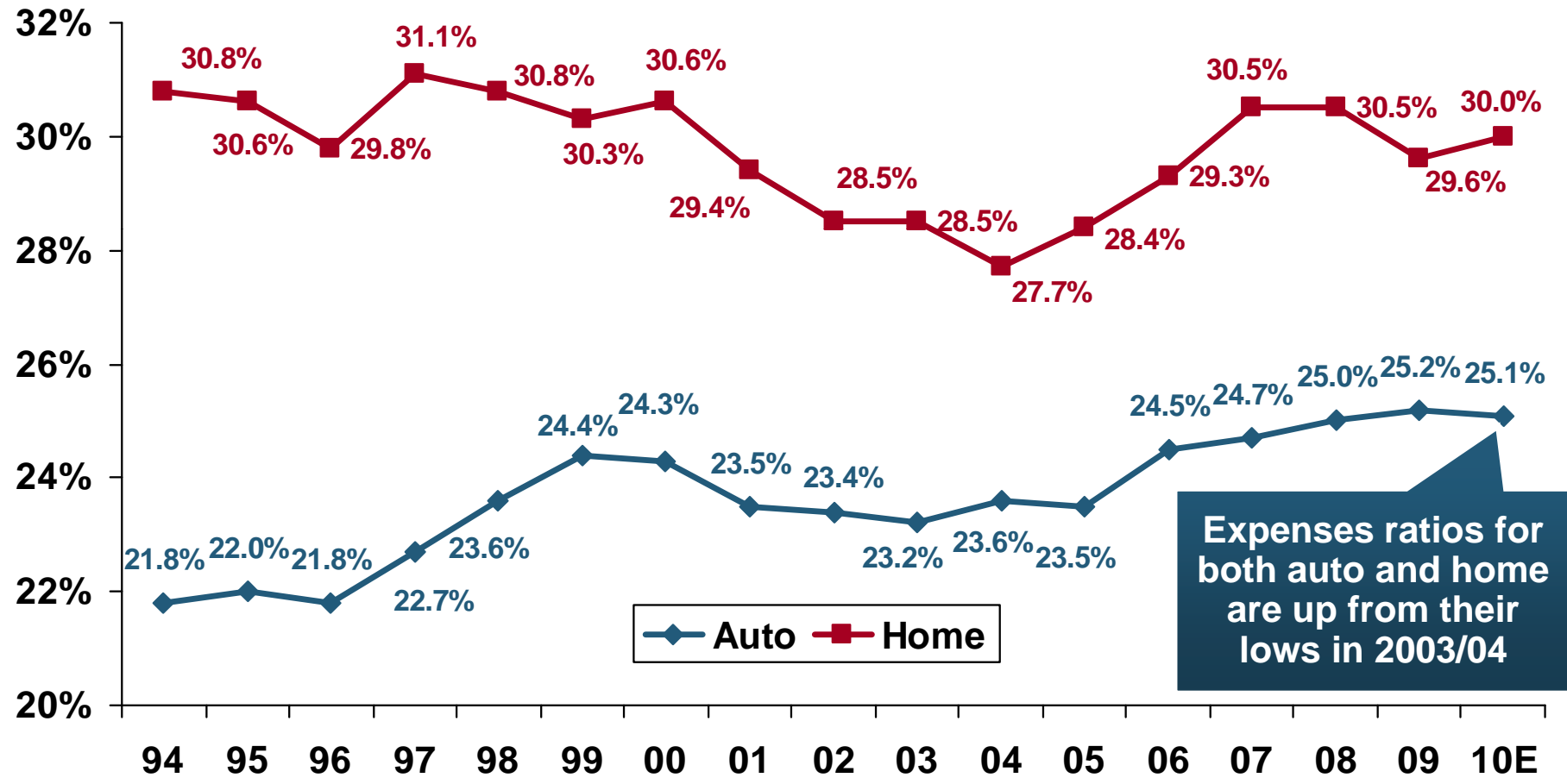


*Ratio of expenses incurred to net premiums written.

**2010 figures are estimates.

Source: A.M. Best; Insurance Information Institute.

Underwriting Expense Ratio* Personal Lines (Auto & Home), 1994-2010E**



Expenses ratios for both auto and home are up from their lows in 2003/04

*Ratio of expenses incurred to net premiums written.

**2010 figures are estimates.

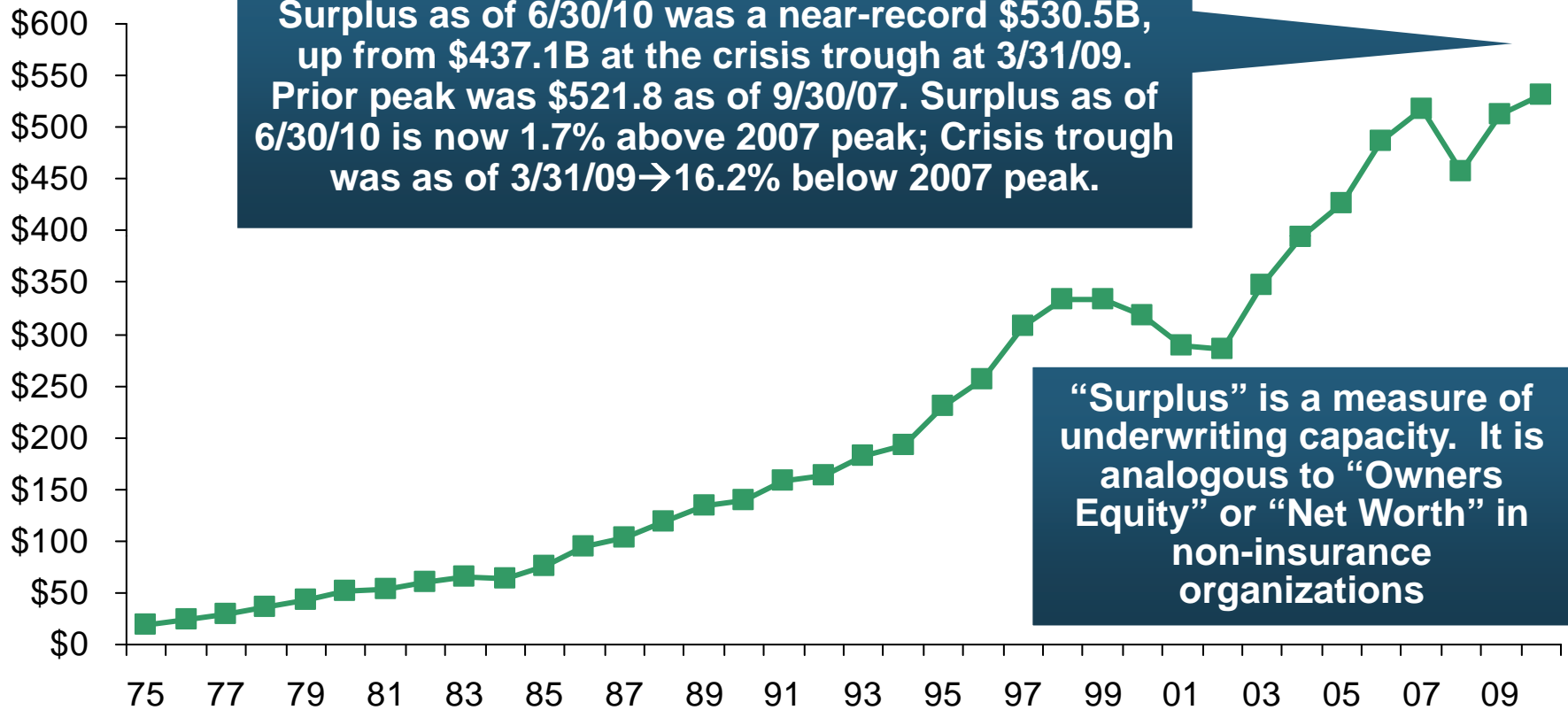
Source: A.M. Best; Insurance Information Institute.

Profit Pillar #5 LEVERAGE

**Efficient Deployment of Capital
Exerts a Significant Impact on
Profitability**

US Policyholder Surplus: 1975–2010*

(\$ Billions)

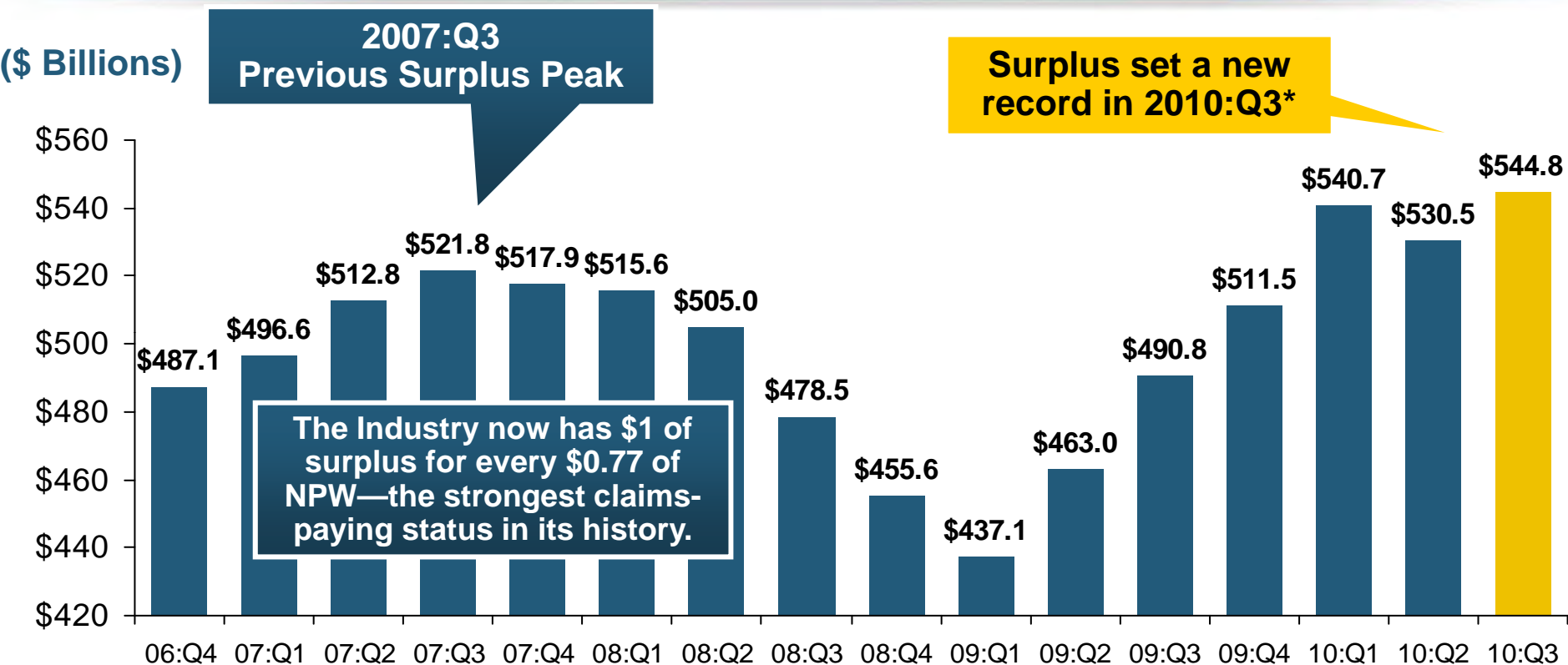


The Premium-to-Surplus Ratio Stood at \$0.80:\$1 as of 6/30/10, A Record Low (at Least in Recent History)**

* As of 6/30/10; **Calculated using annualized net premiums written based on H1 2010 data.

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

Policyholder Surplus, 2006:Q4–2010:Q3



Quarterly Surplus Changes Since 2007:Q3 Peak

09:Q1: -\$84.7B (-16.2%)

09:Q2: -\$58.8B (-11.2%)

09:Q3: -\$31.0B (-5.9%)

09:Q4: -\$10.3B (-2.0%)

10:Q1: +\$18.9B (+3.6%)

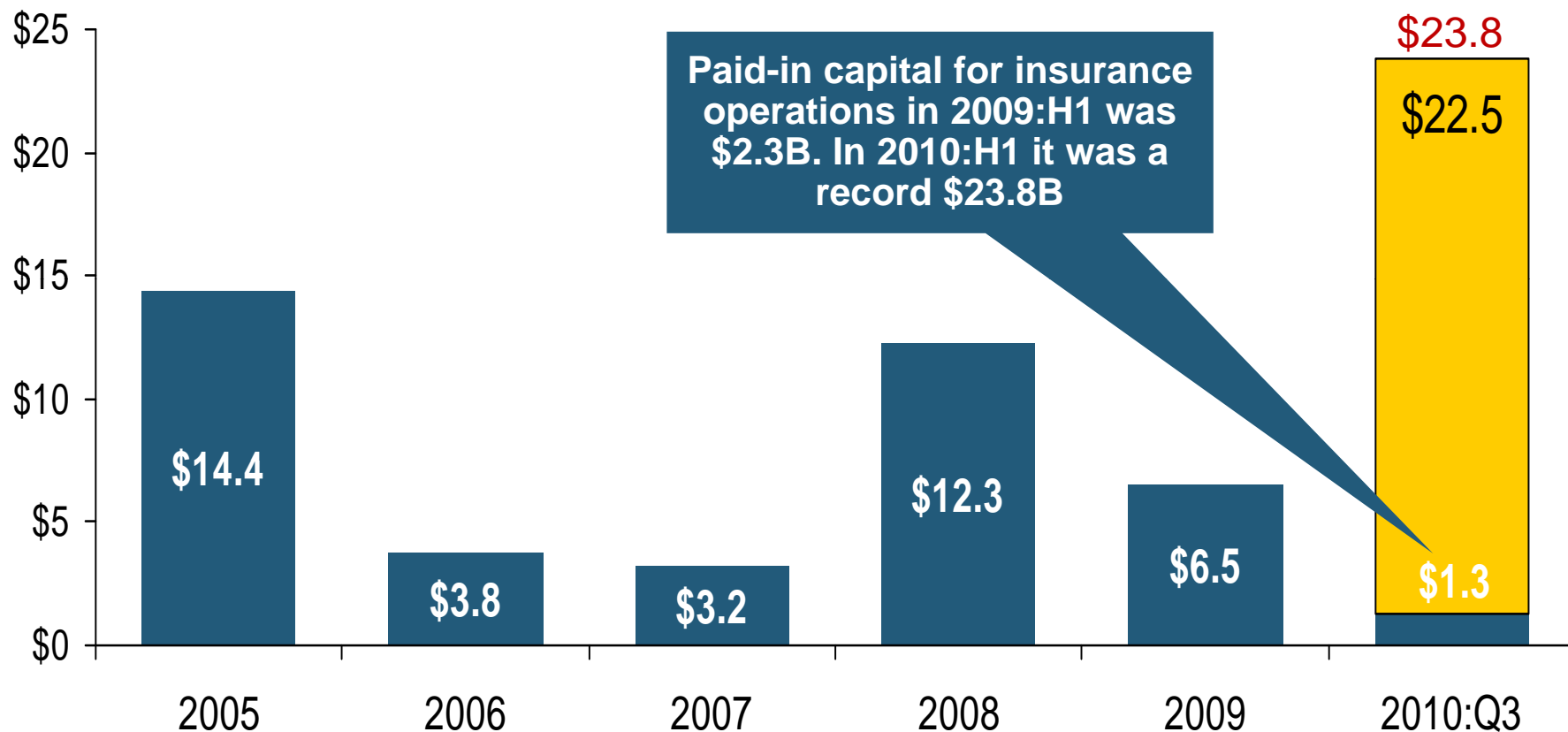
10:Q2: +\$8.7B (+1.7%)

10:Q3: +\$23.0B (+4.4%)

*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.

Paid-in Capital, 2005–2010:Q3

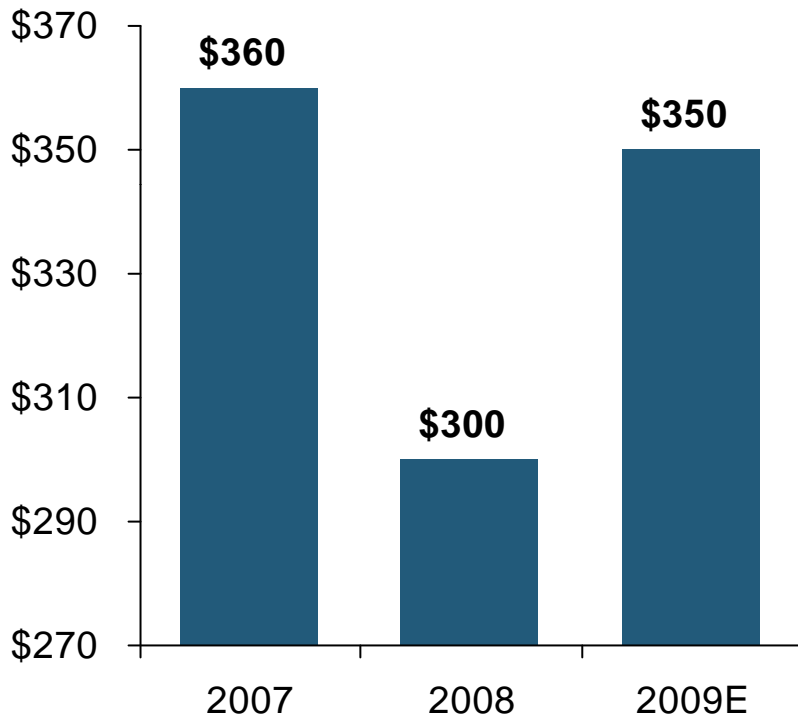
(\$ Billions)



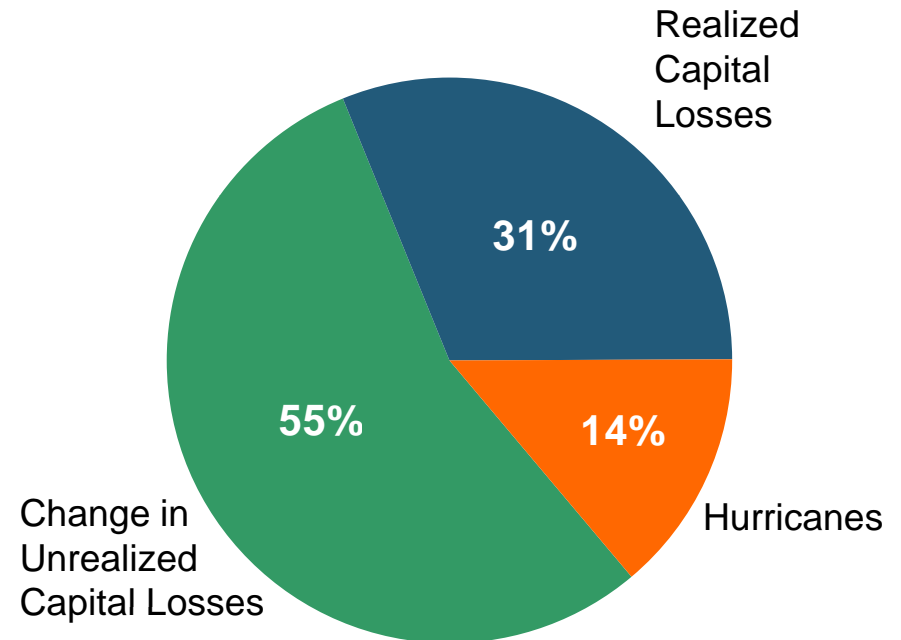
In 2010:Q3 One Insurer's Paid-in Capital Rose by \$22.5B as Part of an Investment in a Non-insurance Business

Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

Global Reinsurance Capacity



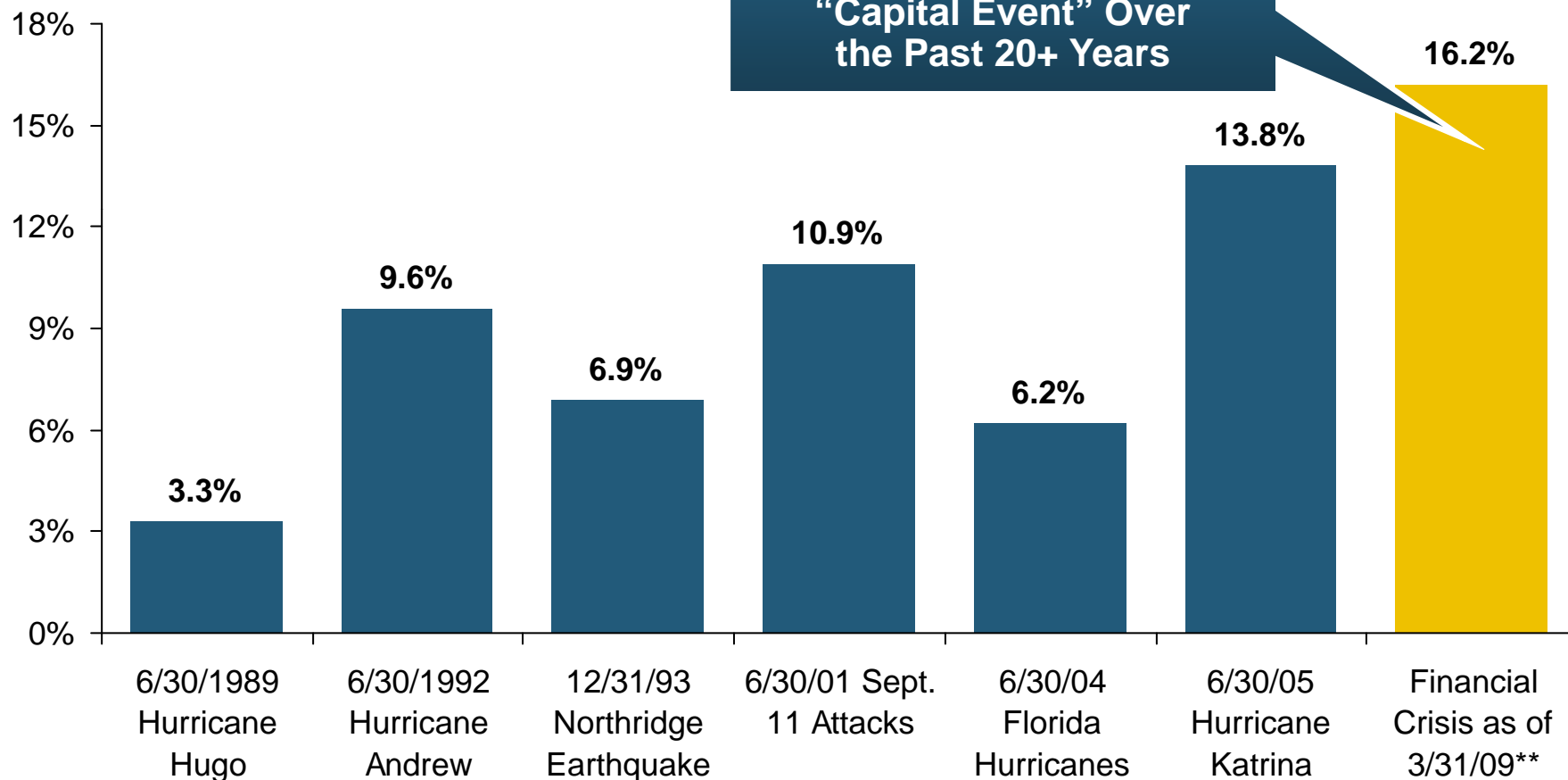
Source of Decline in 2008



**Global Reinsurance Capacity
Fell by an Estimated 17% in 2008**

Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989*

(Percent)



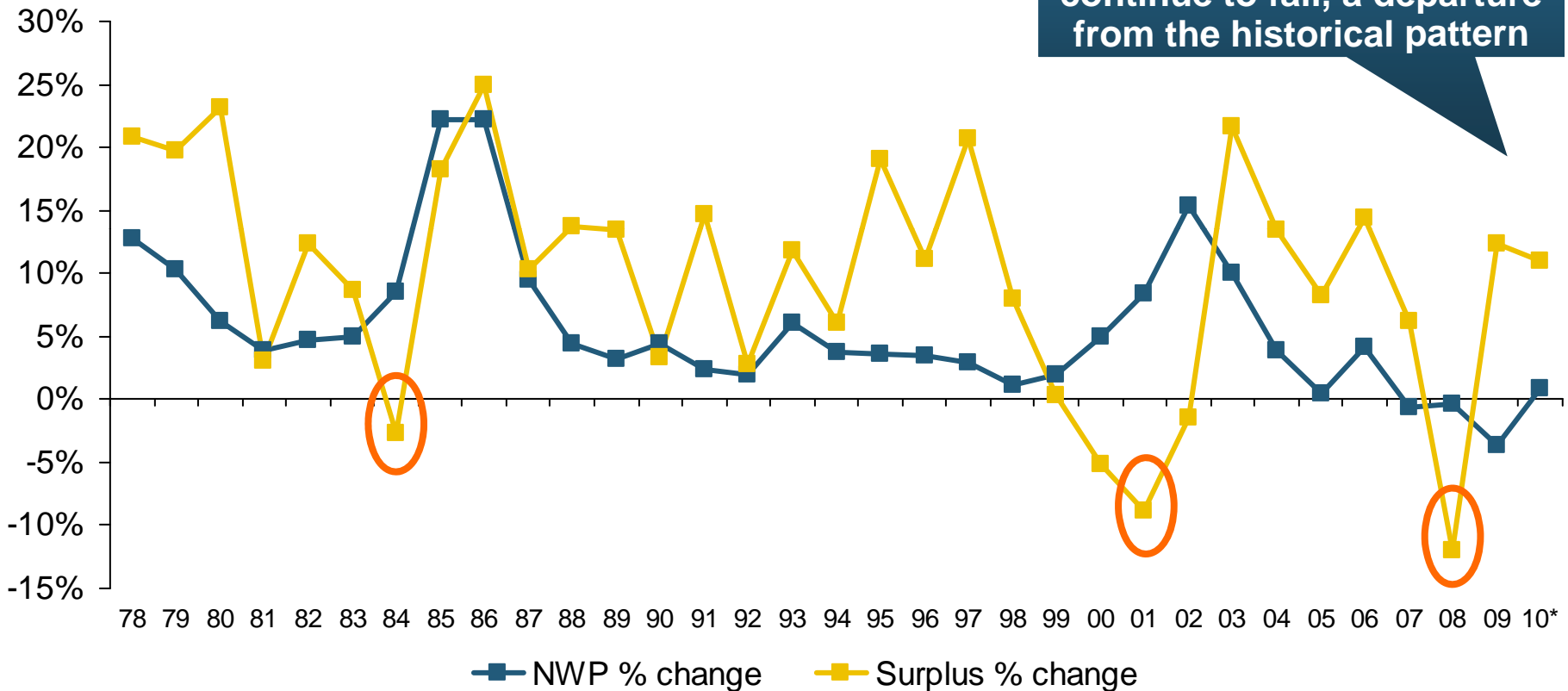
* Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event

** Date of maximum capital erosion; As of 9/30/09 (latest available) ratio = 5.9%

Source: PCS; Insurance Information Institute

Historically, Hard Markets Follow When Surplus “Growth” is Negative*

(Percent)



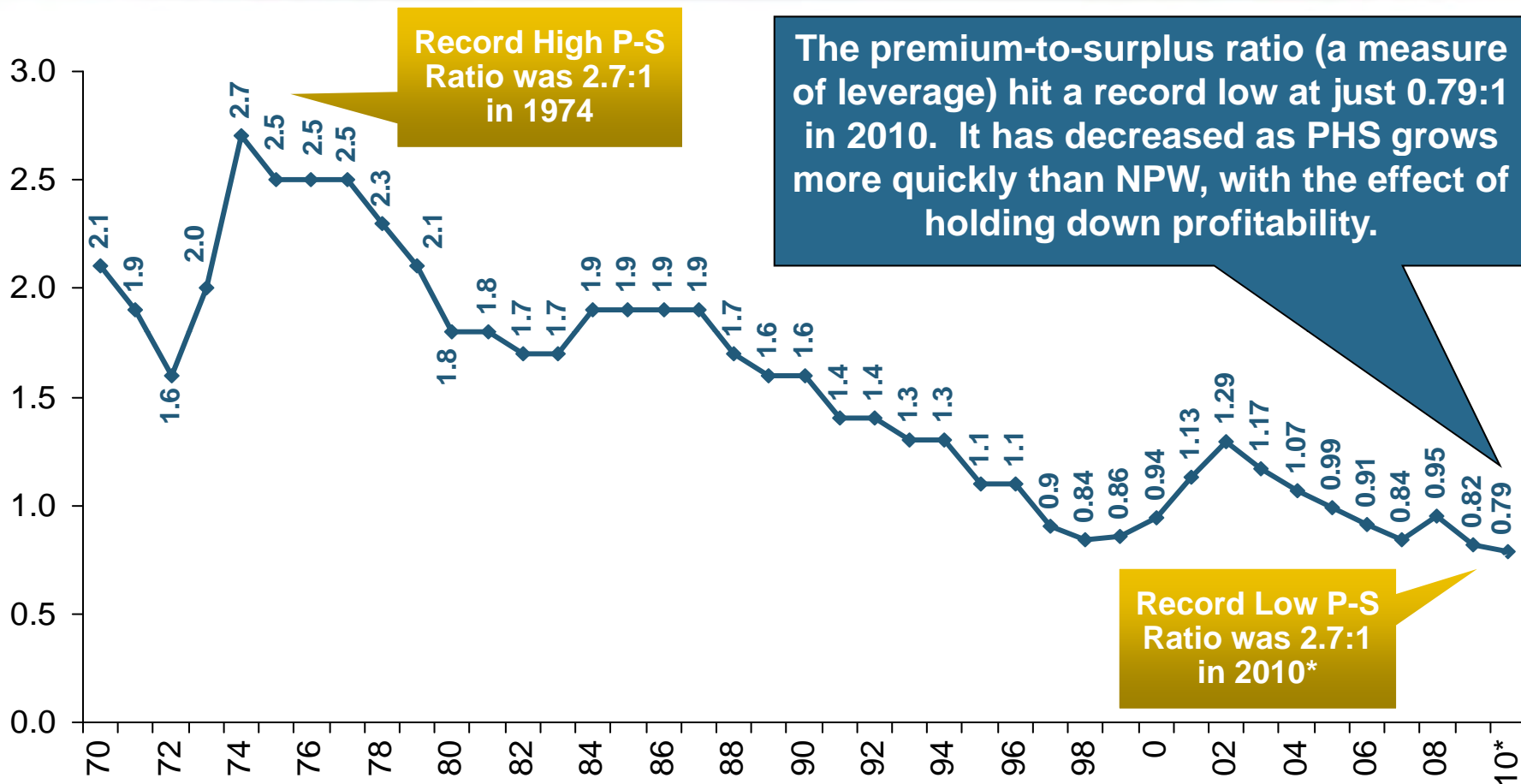
Surplus growth is now positive but premiums continue to fall, a departure from the historical pattern

Sharp Decline in Capacity is a Necessary but Not Sufficient Condition for a True Hard Market

* 2010 NWP and Surplus figures are % changes as of Q3:10 vs Q3:09.

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

Ratio of Net Premiums Written to Policyholder Surplus, 1970-2010*



Record High P-S Ratio was 2.7:1 in 1974

The premium-to-surplus ratio (a measure of leverage) hit a record low at just 0.79:1 in 2010. It has decreased as PHS grows more quickly than NPW, with the effect of holding down profitability.

Record Low P-S Ratio was 0.79:1 in 2010*

The Premium-to-Surplus Ratio in 2010 Implies that P/C Insurers Held \$1 in Surplus Against Each \$0.79 Written in Premiums. In 1974, Each \$1 of Surplus Backed \$2.70 in Premium.

*2010 data are estimated using annualized NWP data through 2010:Q3.

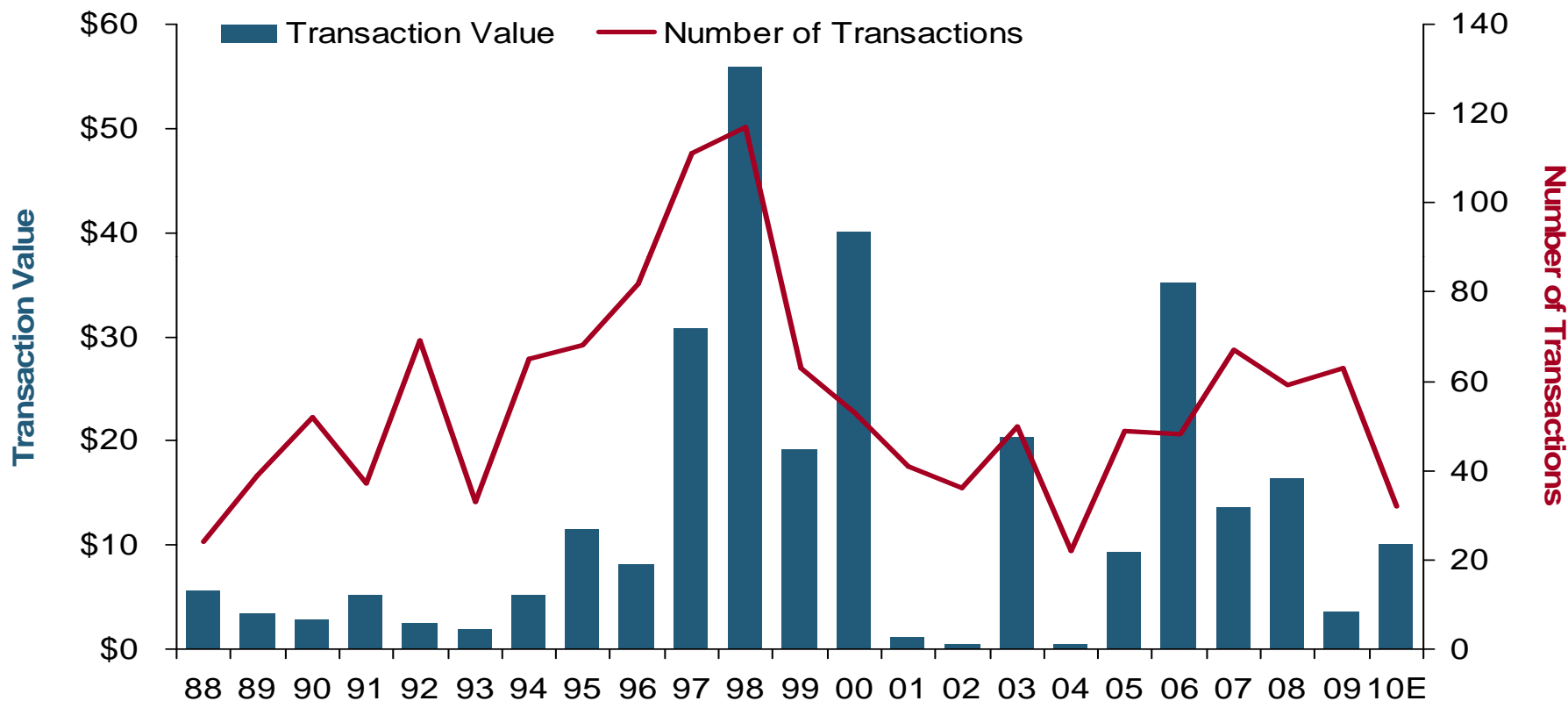
Sources: Insurance Information Institute calculations from A.M. Best data.

Merger & Acquisition

**Capital Cycles Can
Drive Consolidation**

U.S. P/C Insurance-Related M&A Activity, 1988–2010E*

(\$ Billions)



**\$ Value of Deals Down 78%
in 2009, Volume Up 7%**

**2010: No Mega Deals, Despite Record
Capital, Slow Growth and Improved
Financial Market Conditions**

Note: U.S. Company was the acquirer and/or target.

Source: Conning Research & Consulting. *2010E is derived from A.M. Best data for p/c insurers only (excludes brokers/agencies)



Secondary Profit Pillars
OPERATING ENVIRONMENT
REGULATORY ENVIRONMENT

Many Other Factors Influence
P/C Insurer Profitability

Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

Important Issues & Threats Facing Insurers: 2010–2015

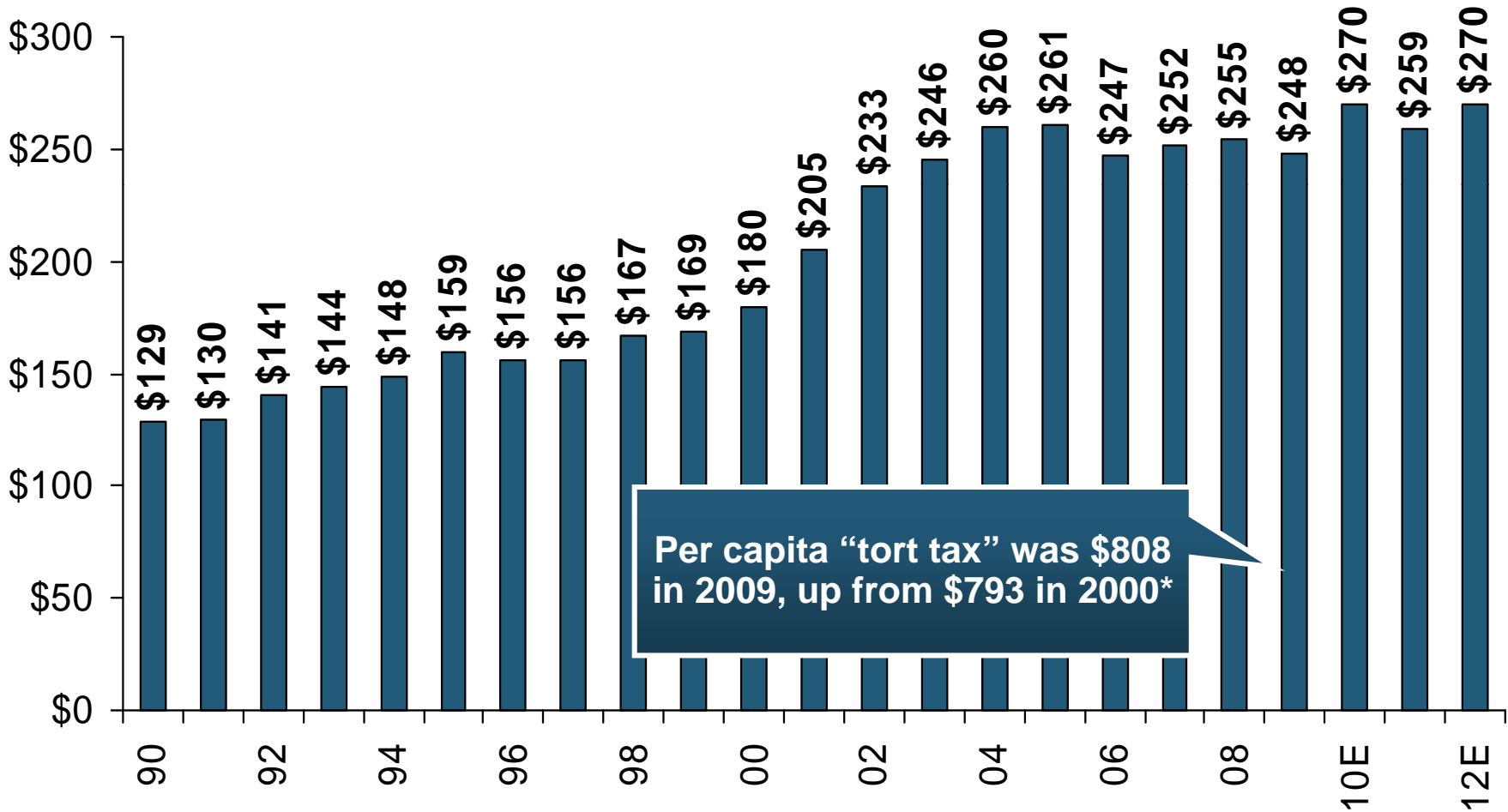
Emerging Tort Threat

- No tort reform (or protection of recent reforms) is forthcoming from the current Congress or Administration
- Erosion of recent reforms is a certainty (already happening)
- Innumerable legislative initiatives will create opportunities to undermine existing reforms and develop new theories and channels of liability
- Torts twice the overall rate of inflation
- Influence personal and commercial lines, esp. auto liability
- Historically *extremely* costly to p/c insurance industry
- Leads to reserve deficiency, rate pressure

***Bottom Line:* Tort “crisis” is on the horizon and will be recognized as such by 2012–2014**

Cost of US Tort System (\$ Billions)

Tort costs consumed 1.74% of GDP in 2009, down from 2.21% in 2003

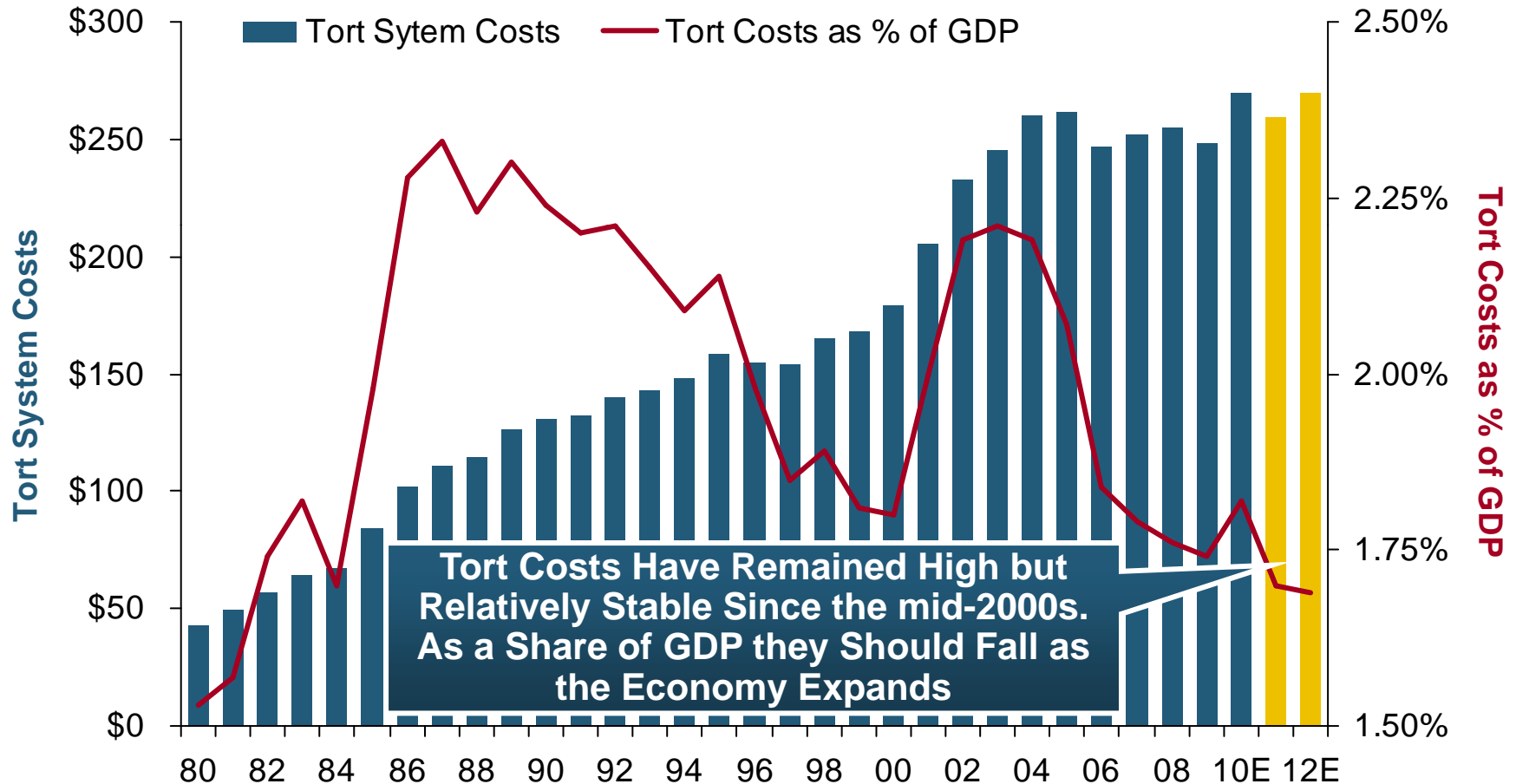


* Restated in 2009 dollars, based on CPI.

Source: Towers Watson, 2010 Update on US Tort Cost Trends.

Over the Last Three Decades, Total Tort Costs as a % of GDP Appear Somewhat Cyclical

(\$ Billions)



Sources: Towers Watson, 2010 Update on US Tort Cost Trends, Appendix 1A



AMERICAN ASSOCIATION *for* JUSTICE

- Reverse U.S. Supreme Court decisions on pleadings
- Eliminate pre-dispute arbitration
- Erode federal preemption
- Expand securities litigation
- Pass Foreign Manufactures Legal Accountability Act
- Grant enforcement authorities to state
- Confirm pro-trial lawyer judges – “Federalize Madison County”
- Roll back existing legal reforms

Trial Lawyer Poll: Which Areas Offer the Greatest Potential Benefit?

| Top Categories | Percentage |
|---------------------------------------|------------|
| Environmental | 14% |
| Insurance coverage | 13% |
| Mortgage fraud | 12% |
| Nursing home/seniors issues | 11% |
| Bad-faith against insurance companies | 10% |

41 different practice areas were included as categories

Business Leaders Ranking of Liability Systems in 2010

Best States

1. Delaware
2. North Dakota
3. Nebraska
4. Indiana
5. Iowa
6. Virginia
7. Utah
8. Colorado
9. Massachusetts
10. South Dakota

New in 2010

- North Dakota
- Massachusetts
- South Dakota

Drop-offs

- Maine
- Vermont
- Kansas

Midwest/West has mix of good and bad states.

Worst States

41. New Mexico
42. Florida
43. Montana
44. Arkansas
45. Illinois
46. California
47. Alabama
48. Mississippi
49. Louisiana
50. West Virginia

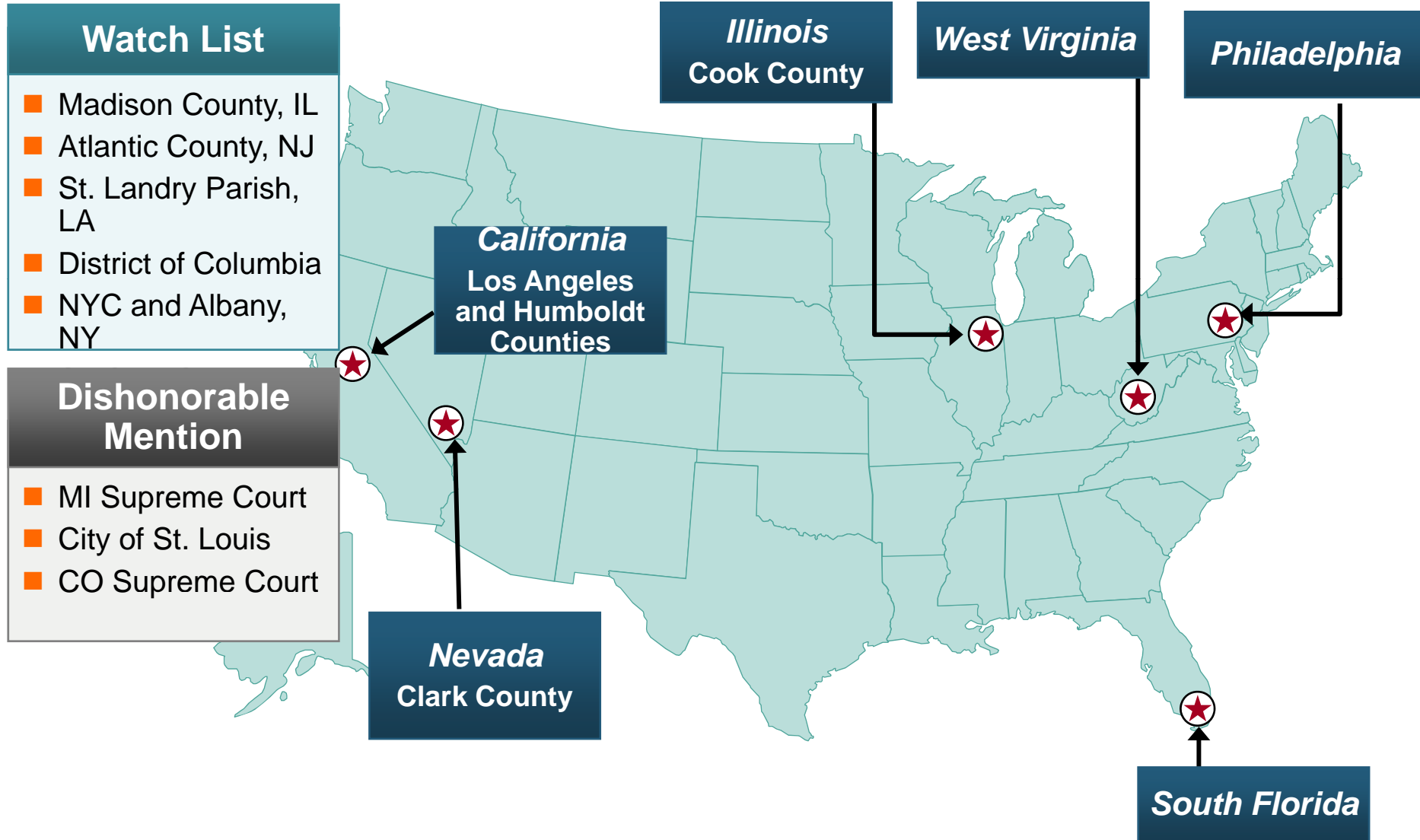
Newly Notorious

- New Mexico
- Montana
- Arkansas

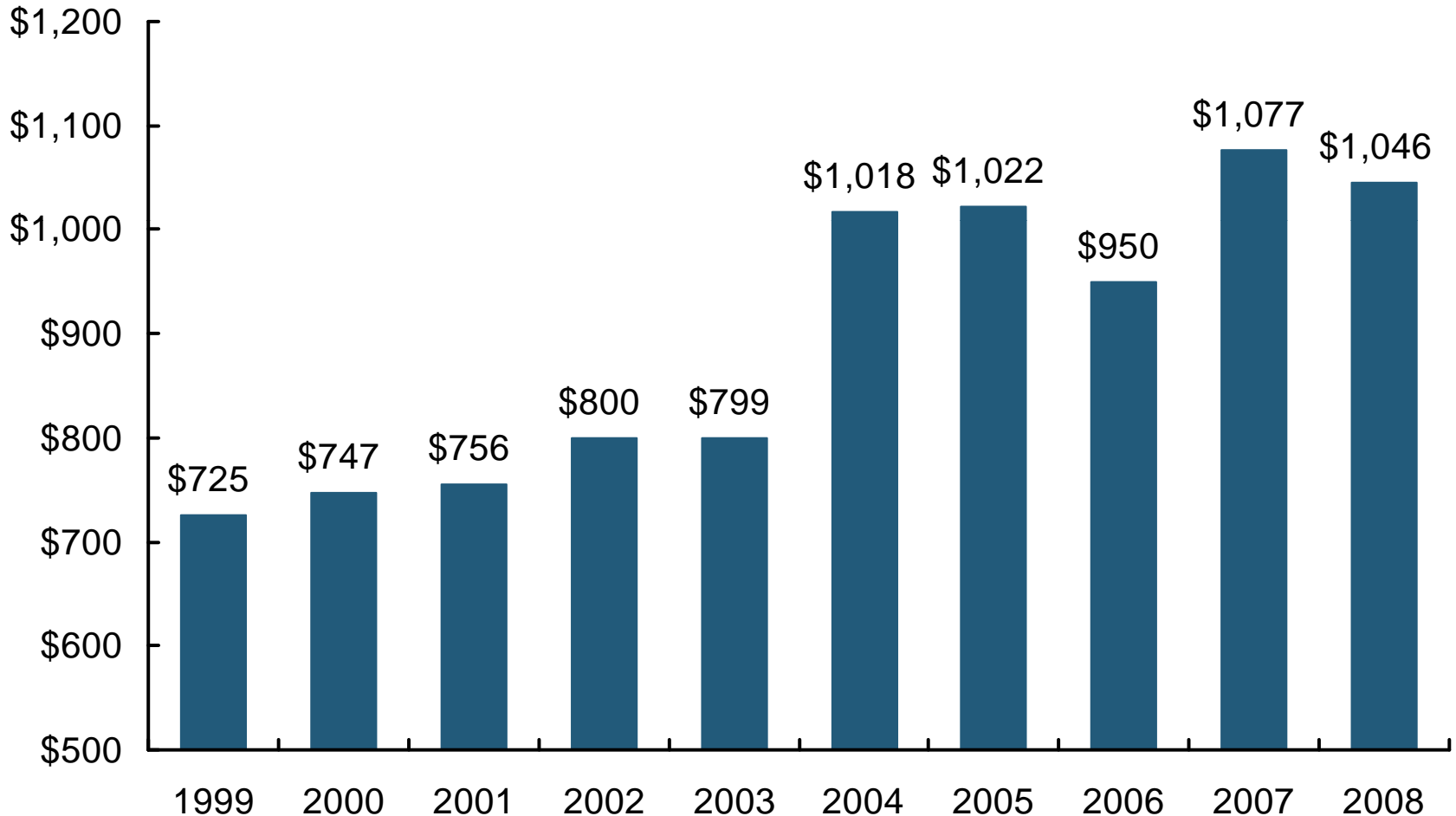
Rising Above

- **Texas**
- South Carolina
- Hawaii

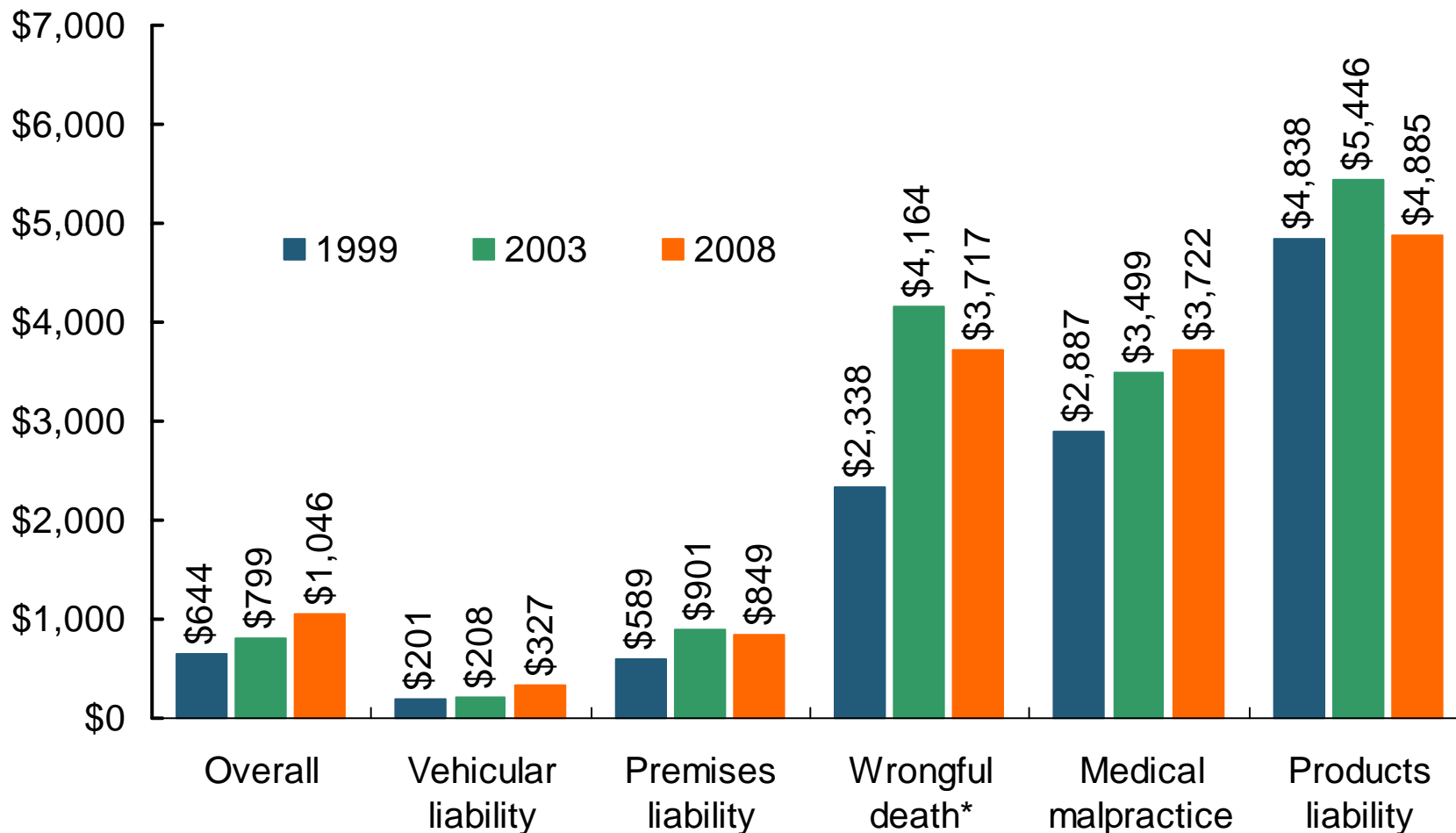
The Nation's Judicial Hellholes: 2010



Average Jury Awards 1999 - 2008



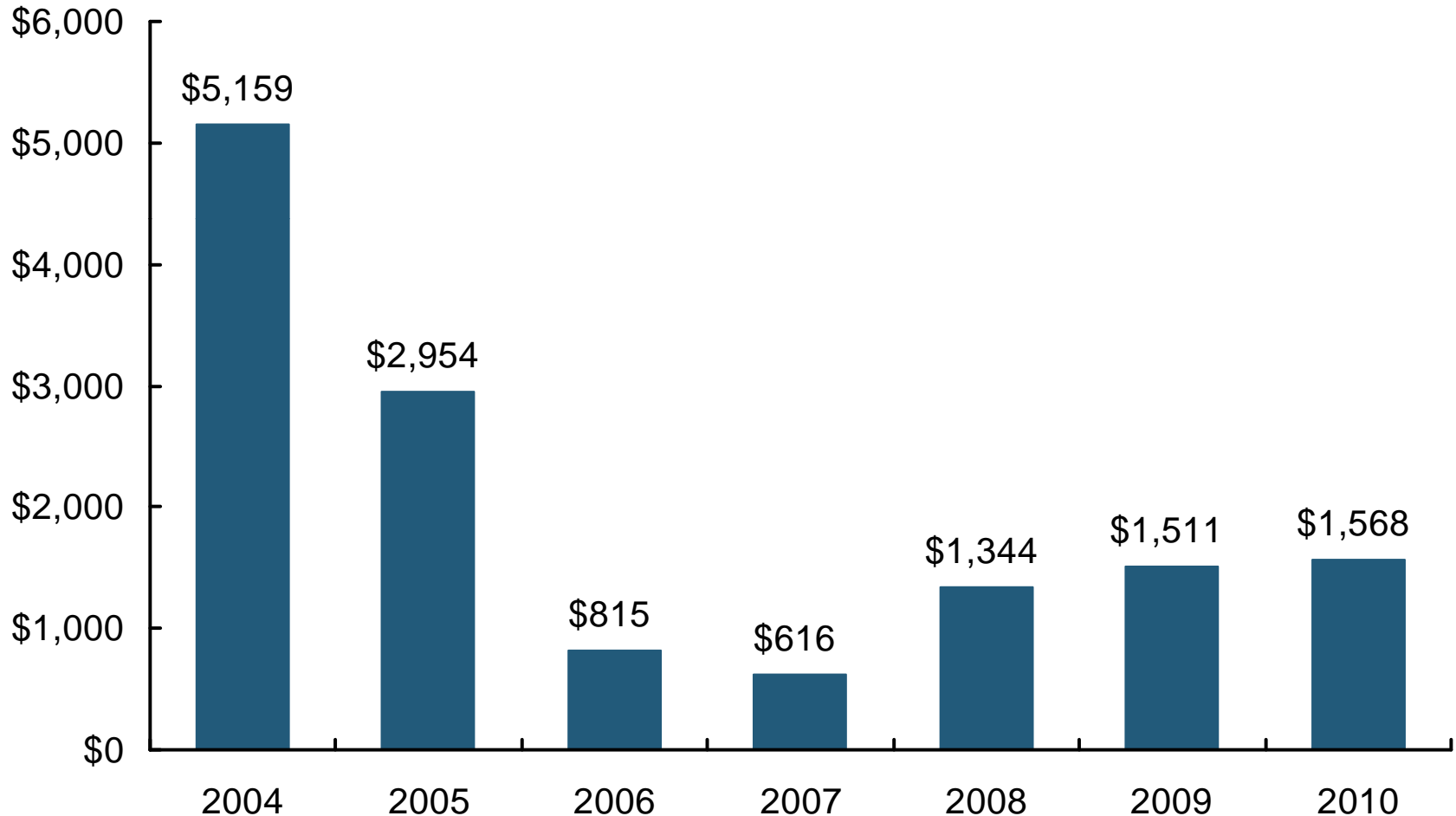
Avg. Jury Awards 1999 vs. 2003 and 2008



*Award trends in wrongful deaths of adult males.

Source: Jury Verdict Research; Insurance Information Institute.

Sum of Top 10 Jury Awards 2004-2010



2010 Top Ten Jury Verdicts

| Value | Issue | State |
|-----------------|--|---------------|
| \$505.1 Million | Products Liability | Nevada |
| \$208.8 Million | Personal Injury (Asbestos/Mesothelioma case) | California |
| \$152 Million | Wrongful Death (Tobacco verdict) | Massachusetts |
| \$132.5 Million | Personal Injury (Ford rollover retrial) | Mississippi |
| \$124.5 Million | Personal Injury (Passenger van rollover case) | Texas |
| \$103 Million | Legal Malpractice/Breach of Fiduciary Duty | Mississippi |
| \$90.8 Million | Products Liability, Wrongful Death (Tobacco verdict) | Florida |
| \$89 Million | Personal Injury, Products Liability | Pennsylvania |
| \$82.5 Million | Wrongful Death | Texas |
| \$80 Million | Wrongful Death (Tobacco verdict) | Florida |

2009 Top Ten Jury Verdicts

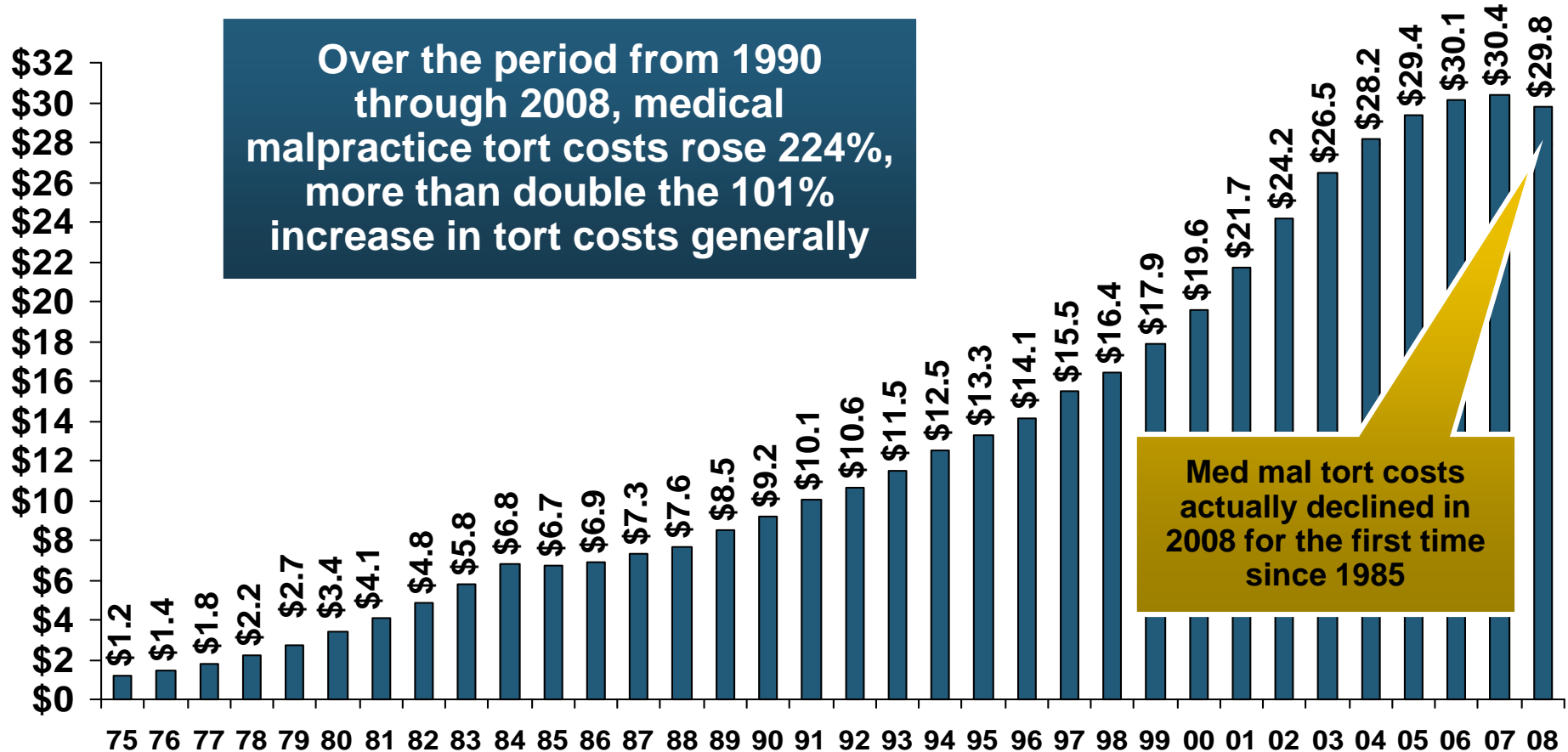
| Value | Issue | State |
|---------------------|--|--------------|
| \$370 Million | Defamation | California |
| \$330 Million | Personal Injury (Drunk driving case) | Florida |
| \$300 Million | Personal Injury (Tobacco verdict) | Florida |
| \$89 Million | Personal Injury (Drunk driving case) | Missouri |
| \$78.75 Million | Personal Injury (Prempro) | New Jersey |
| \$77.4 Million | Medical Malpractice | New York |
| <i>\$71 Million</i> | <i>Conversion and Breach of Fiduciary Duty</i> | <i>Texas</i> |
| <i>\$70 Million</i> | <i>Workers Comp Case</i> | <i>Texas</i> |
| \$65 Million | Personal Injury | Florida |
| \$60 Million | Medical Malpractice | New York |

2008 Top Ten Jury Verdicts

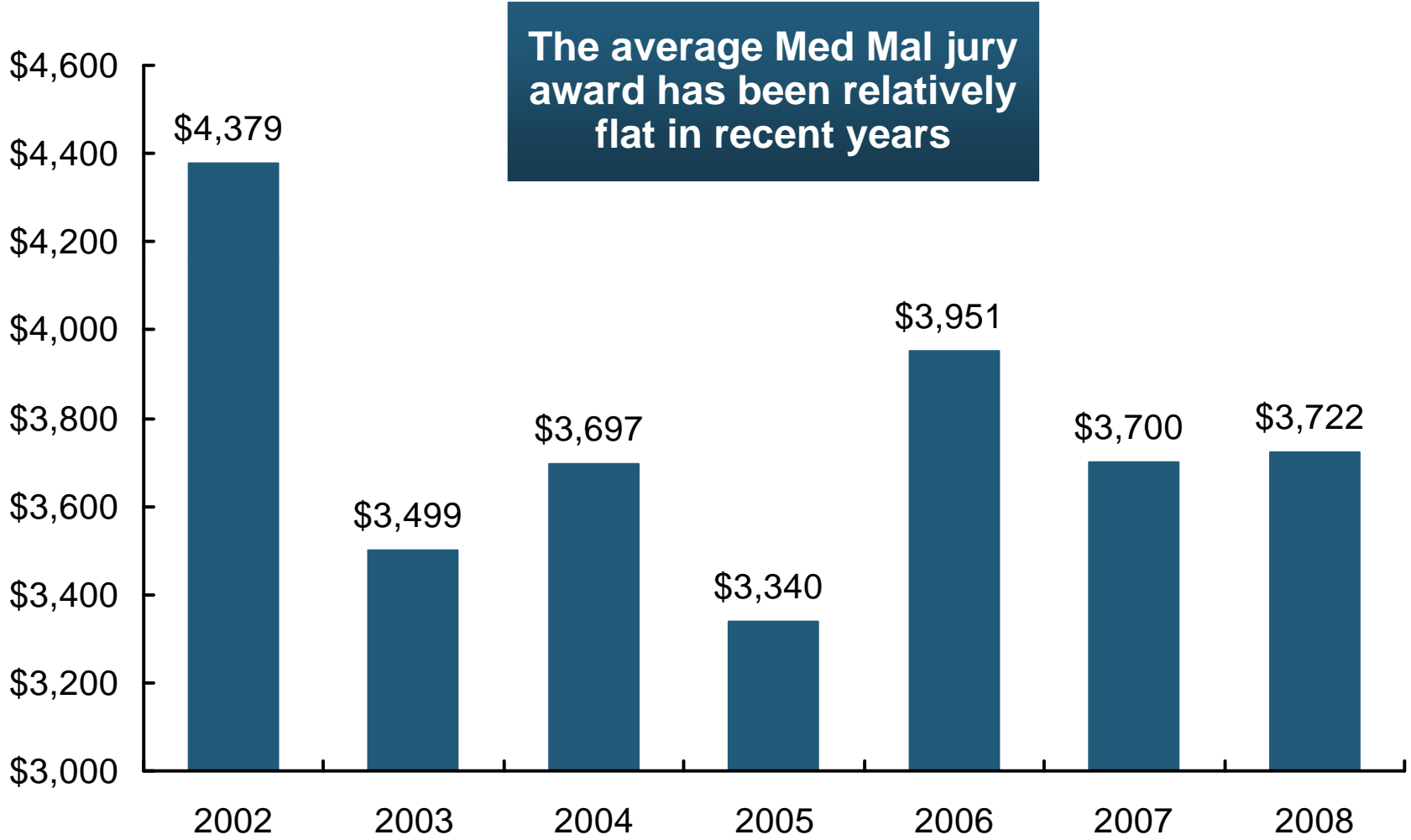
| Value | Issue | State |
|---------------------|---|--------------|
| \$388 Million | Fraud, Intentional Infliction of Emotional Distress | Nevada |
| \$316 Million | Breach of Contract | Georgia |
| \$188 Million | Defamation | New York |
| \$85 Million | Premises Liability | Pennsylvania |
| <i>\$84 Million</i> | <i>Negligence, Personal Injury</i> | <i>Texas</i> |
| \$66 Million | Breach of Fiduciary Duty | Oklahoma |
| \$60 Million | Insurance Bad Faith | Nevada |
| \$55 Million | Negligence | California |
| \$54 Million | Wrongful Death | Georgia |
| \$48 Million | Negligence | Indiana |

Medical Malpractice Tort Cost: Growth Continues, Though Modestly

(\$ Billions)



Average Medical Malpractice Jury Award: 2002 - 2008

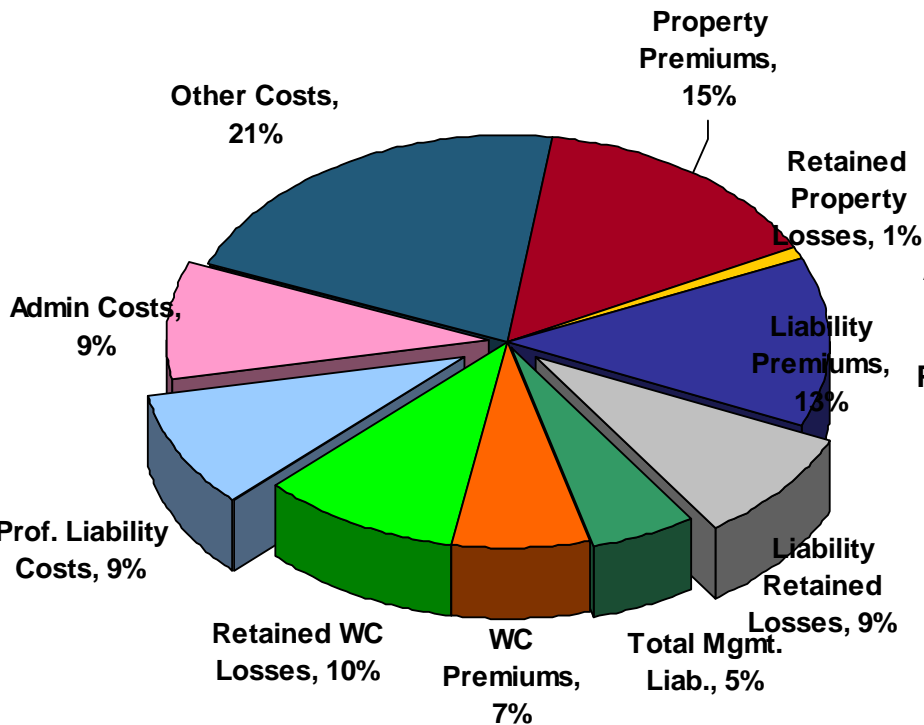


Source: Jury Verdict Research; Insurance Information Institute.

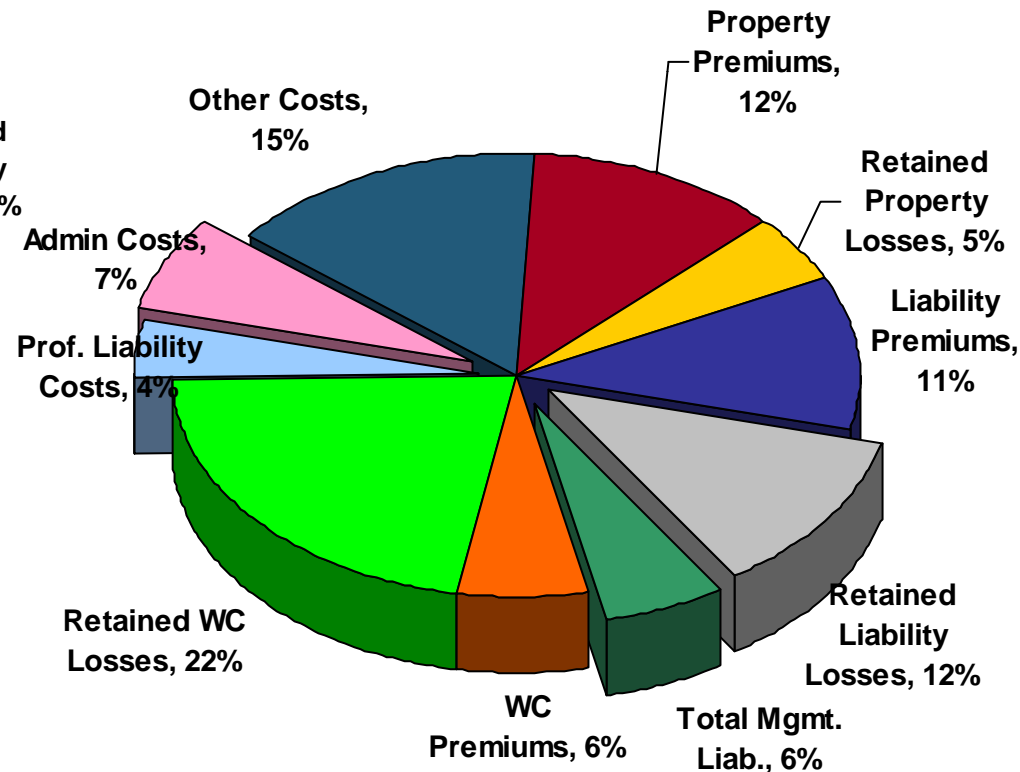
How the Risk Dollar is Spent (2008)

Total liability costs account for about 30% of the risk dollar

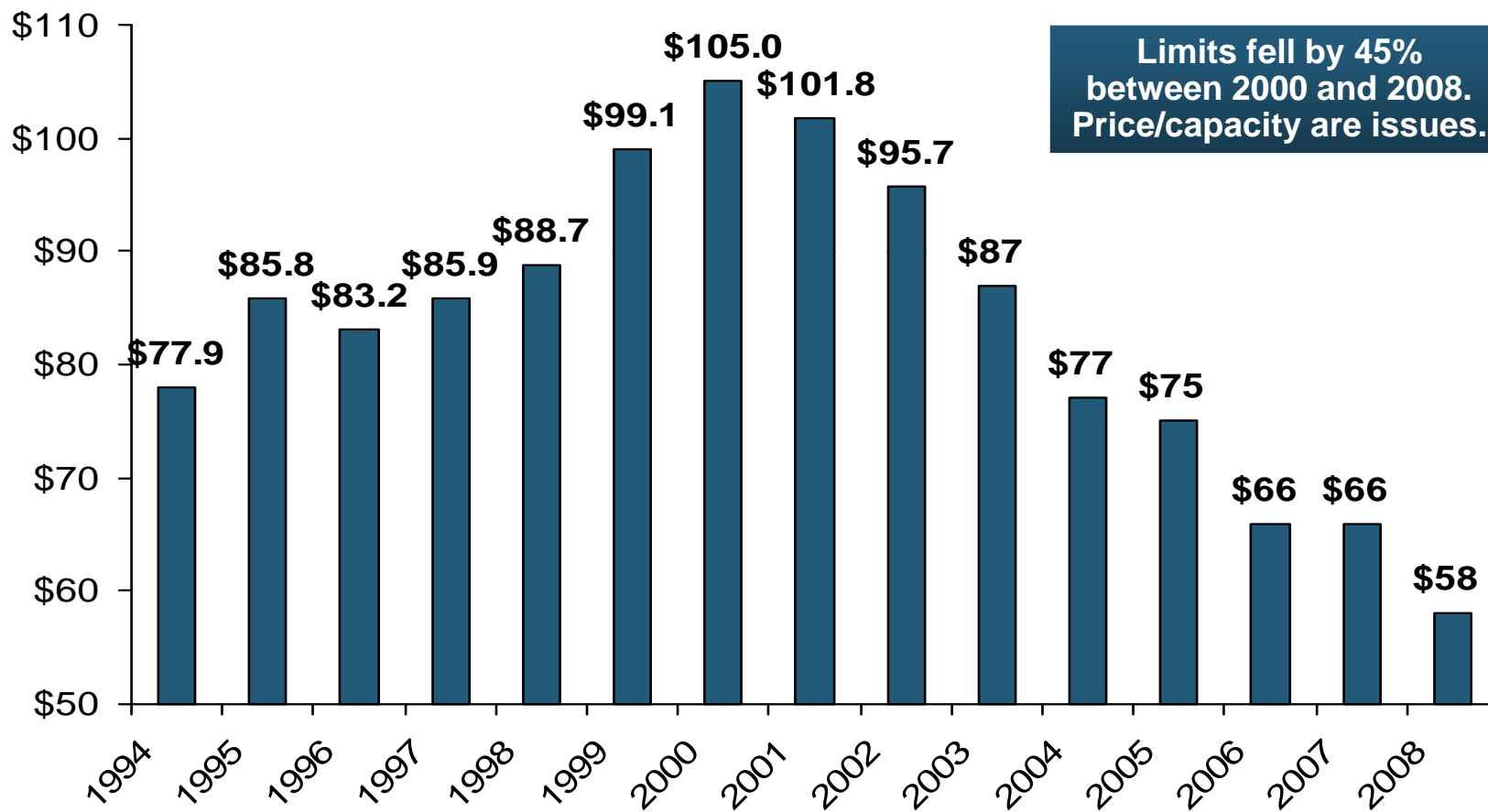
Firms w/Revenues < \$1 Billion



Firms w/Revenues > \$1 Billion



Average Total Limits Purchased by All U.S. Firms* (\$ Millions)

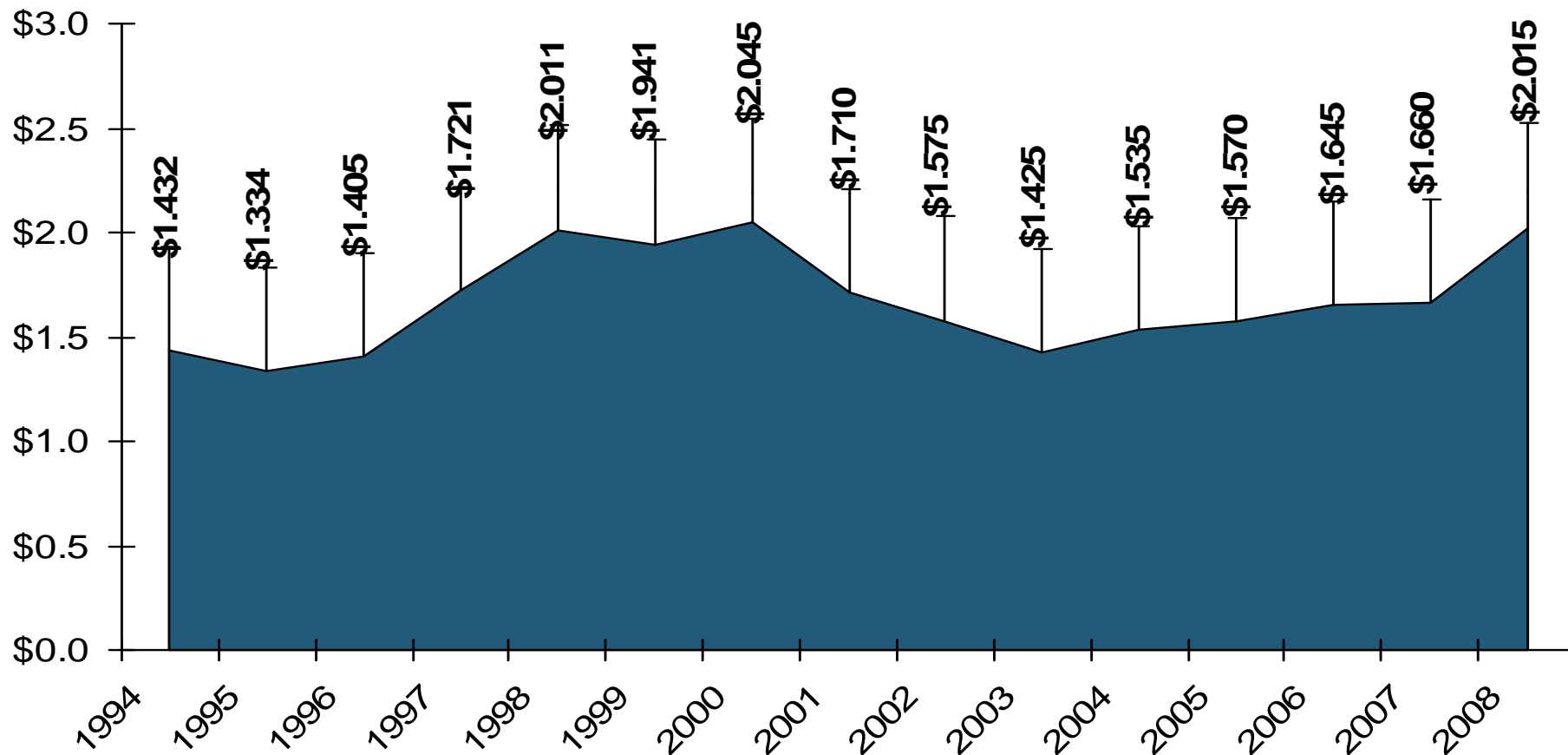


*Includes underlying primary limits

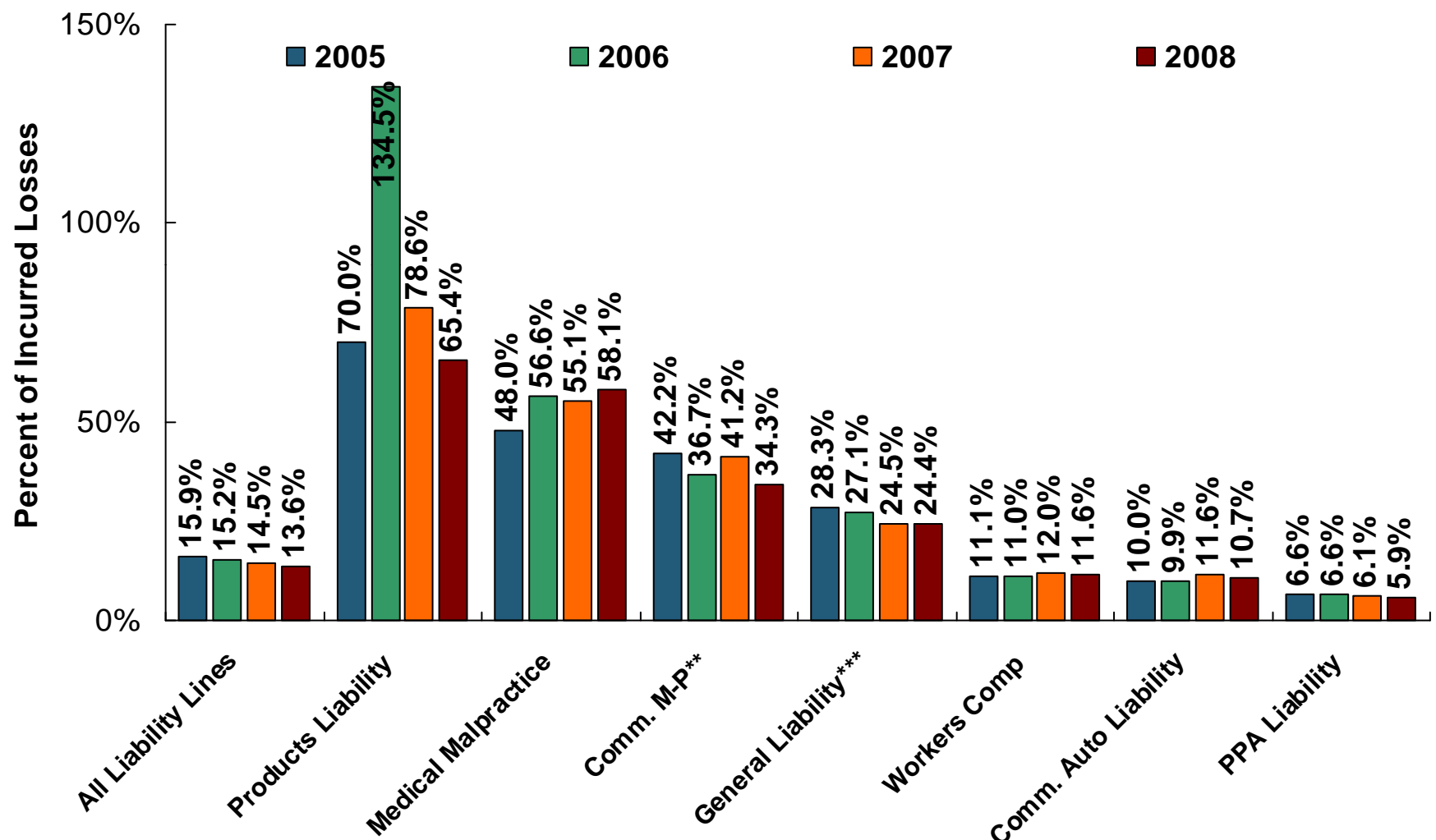
Source: *Limits of Liability 2008*, Marsh, Inc.

Excess Liability Market Capacity North America (\$ Billions)

In 2008, capacity is back to 2000 levels.



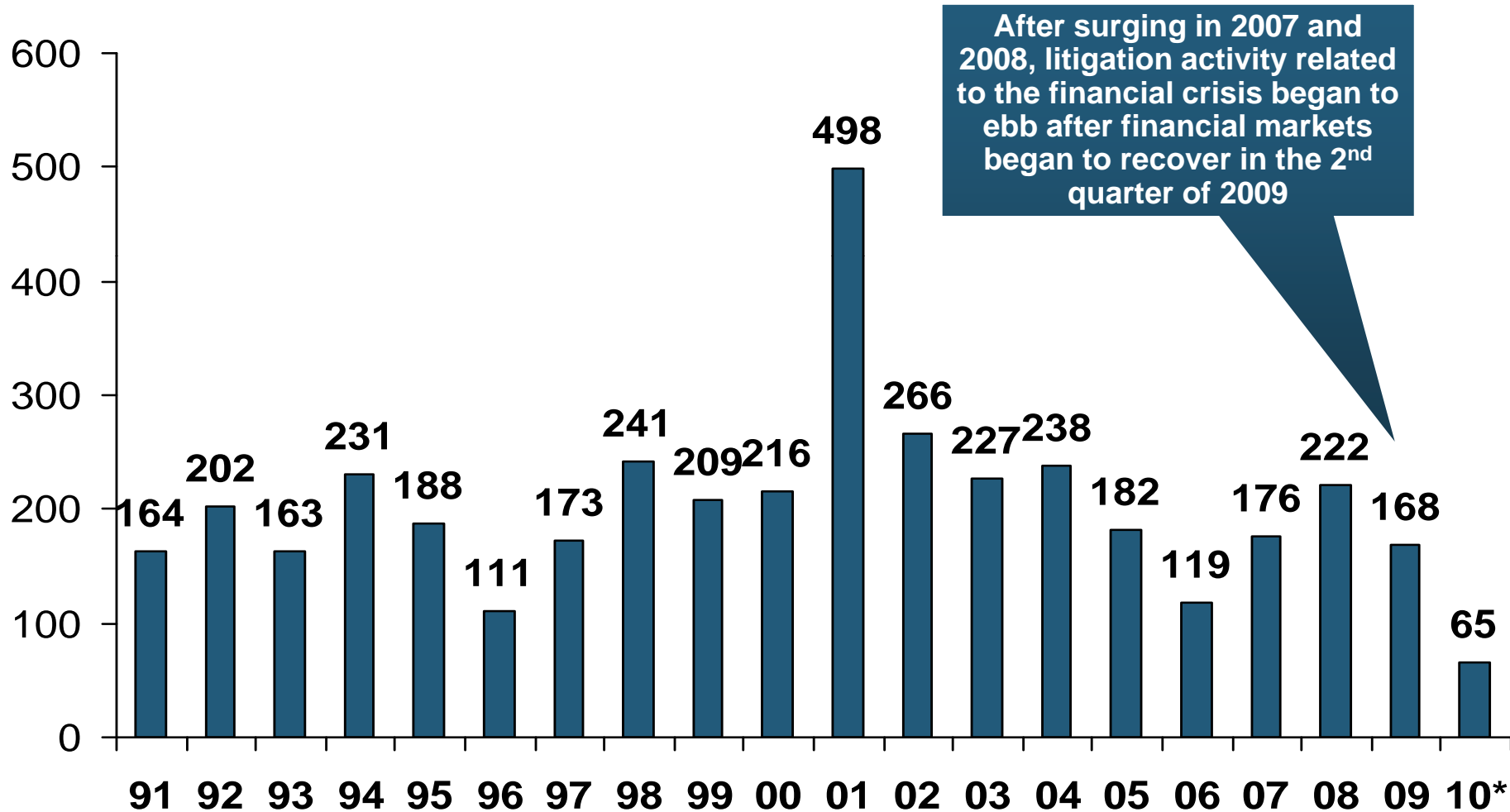
Insurer Defense & Cost Containment Expenses as a % of Incurred Losses, 2005-2008*



*Net of reinsurance, excl. state funds. **Liability portion only. ***Excludes products liability.

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data, LLC; Insurance Information Institute.

Shareholder Class Action Lawsuits*

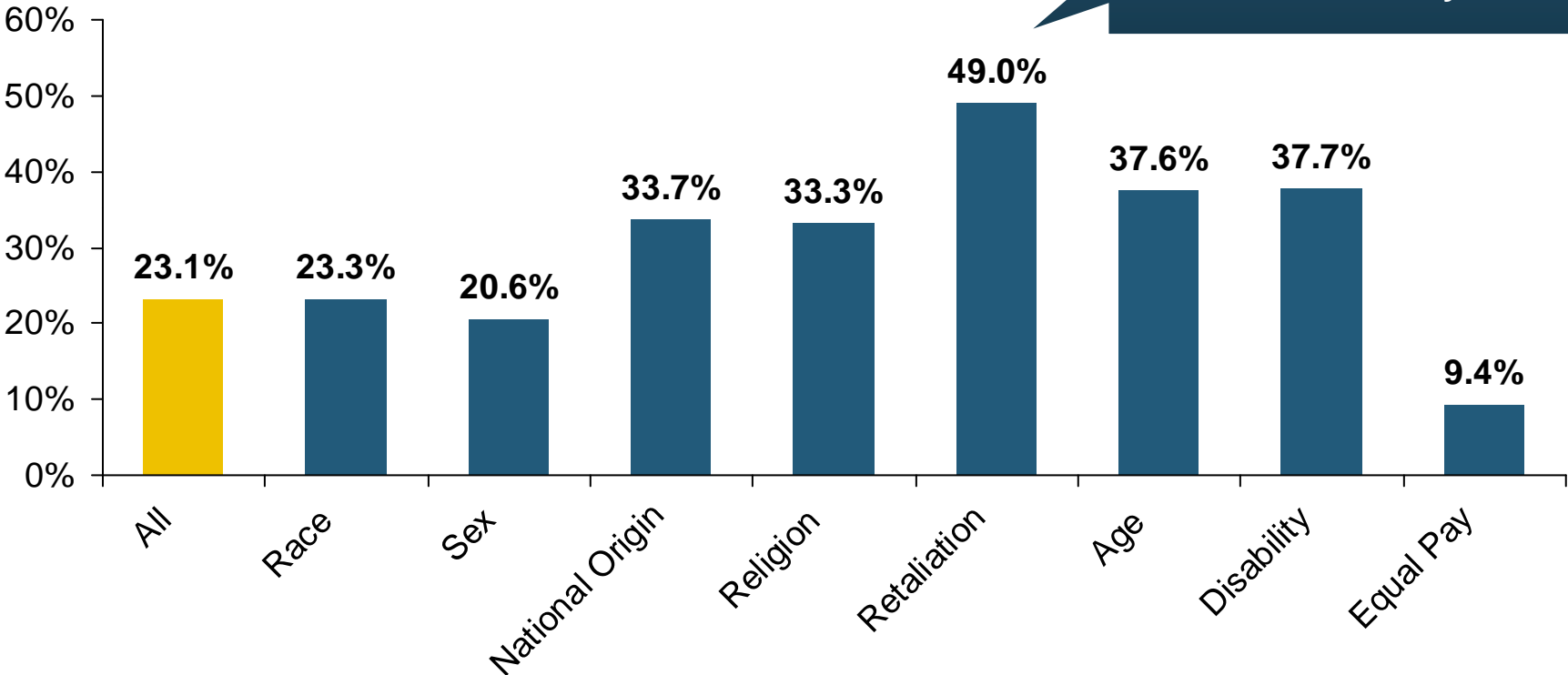


*Securities fraud suits filed in U.S. federal courts as of June 25, 2010.

Source: Stanford University School of Law (securities.stanford.edu); Insurance Information Institute

Discrimination Charges Filed with EEOC by Type: Percent Change FY06-FY09

Change in Charges Filed (%)



The Financial Crisis and Poor Labor Market Conditions Have Contributed to a Surge Employment Discrimination Charges

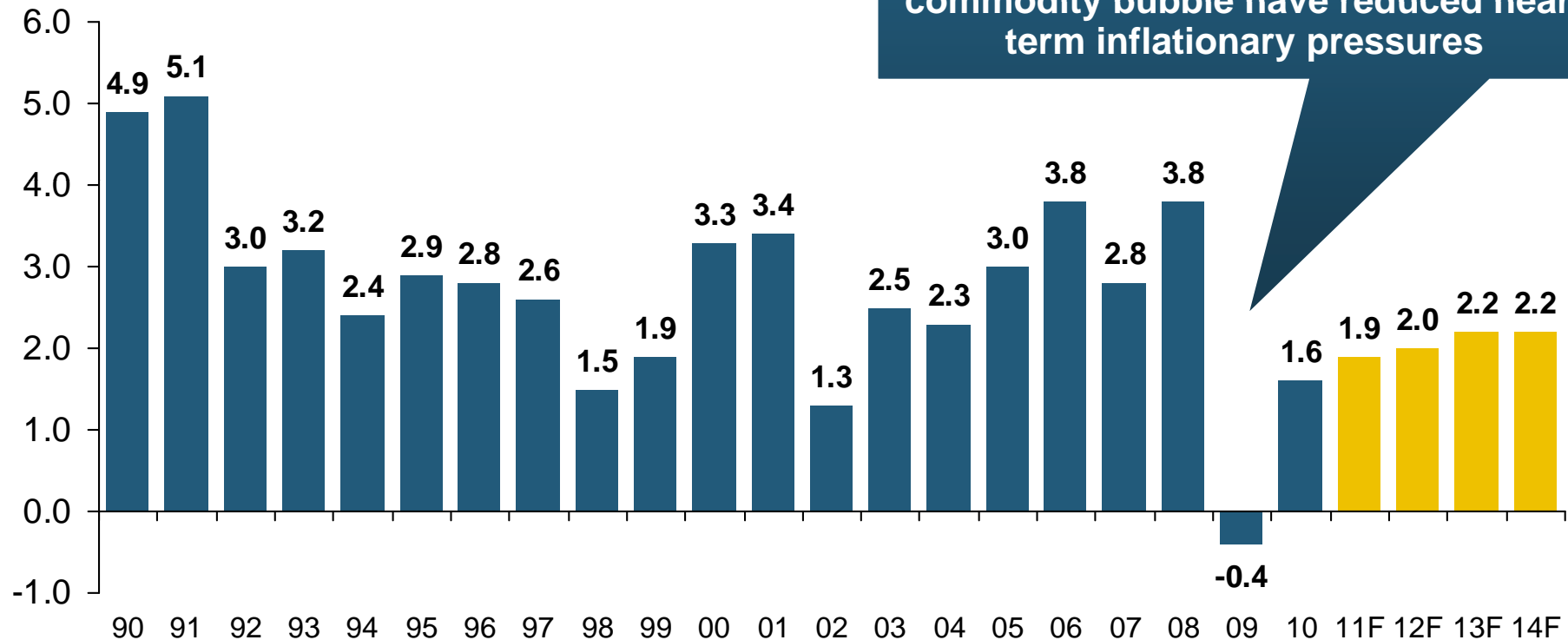
Source: Equal Opportunity Employment Commission; Insurance Information Institute.

Inflation

**Is it a Threat to Claim Cost
Severities**

Annual Inflation Rates, (CPI-U, %), 1990–2014F

Annual Inflation Rates (%)



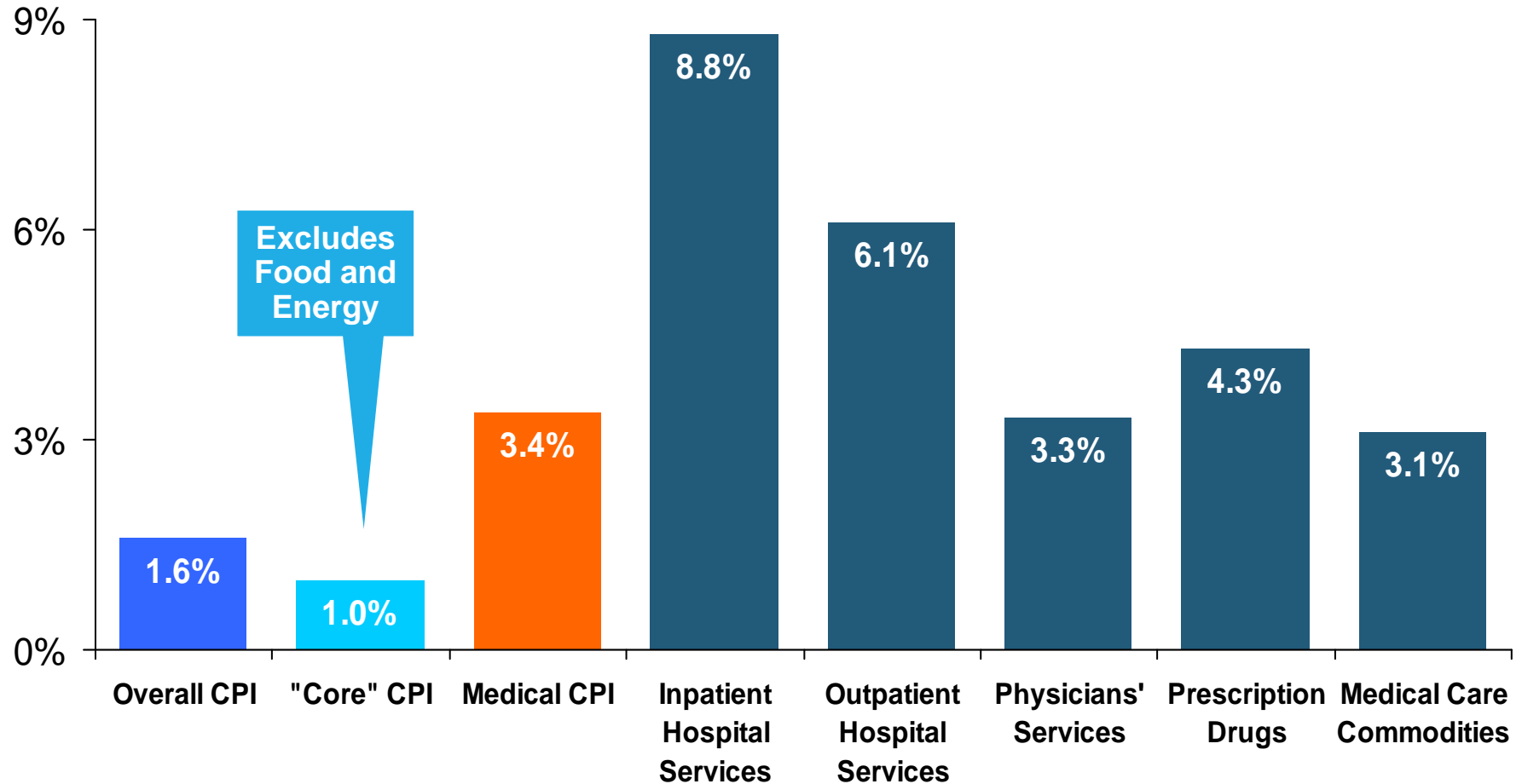
Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble have reduced near-term inflationary pressures

The slack in the U.S. economy suggests that inflation should not heat up before 2012, but other forces (commodity prices, inflation in countries from which we import, etc.), plus U.S. debt burden, remain longer-run concerns

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 10/10 and 2/11 (forecasts).

P/C Insurance Claim Cost Drivers Grow Faster than even the Medical CPI Suggests

Price Changes
in 2010



Healthcare costs are a major liability, med pay, and PIP claim cost driver. They are likely to grow faster than the CPI for the next few years, at least

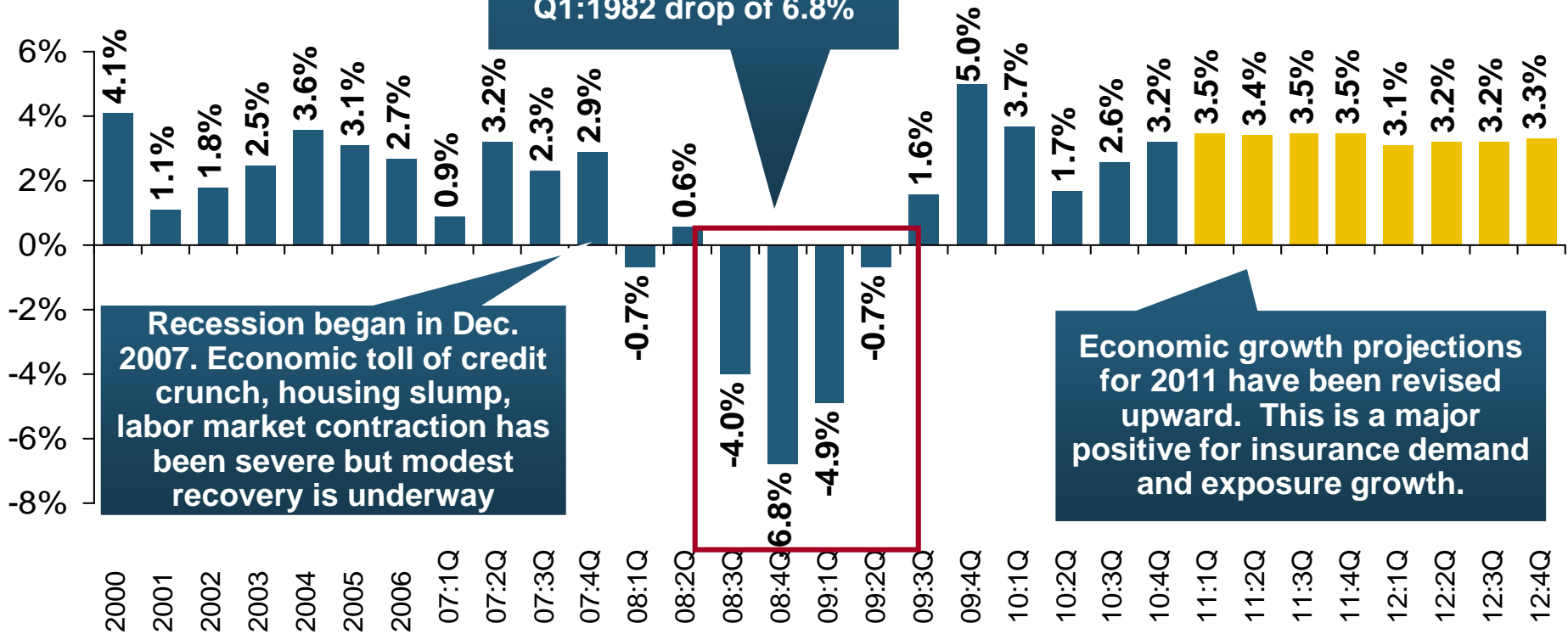


Economic Drivers of P/C Insurance Exposures

**Growth in the Wake
of the “Great Recession”**

US Real GDP Growth*

Real GDP Growth (%)



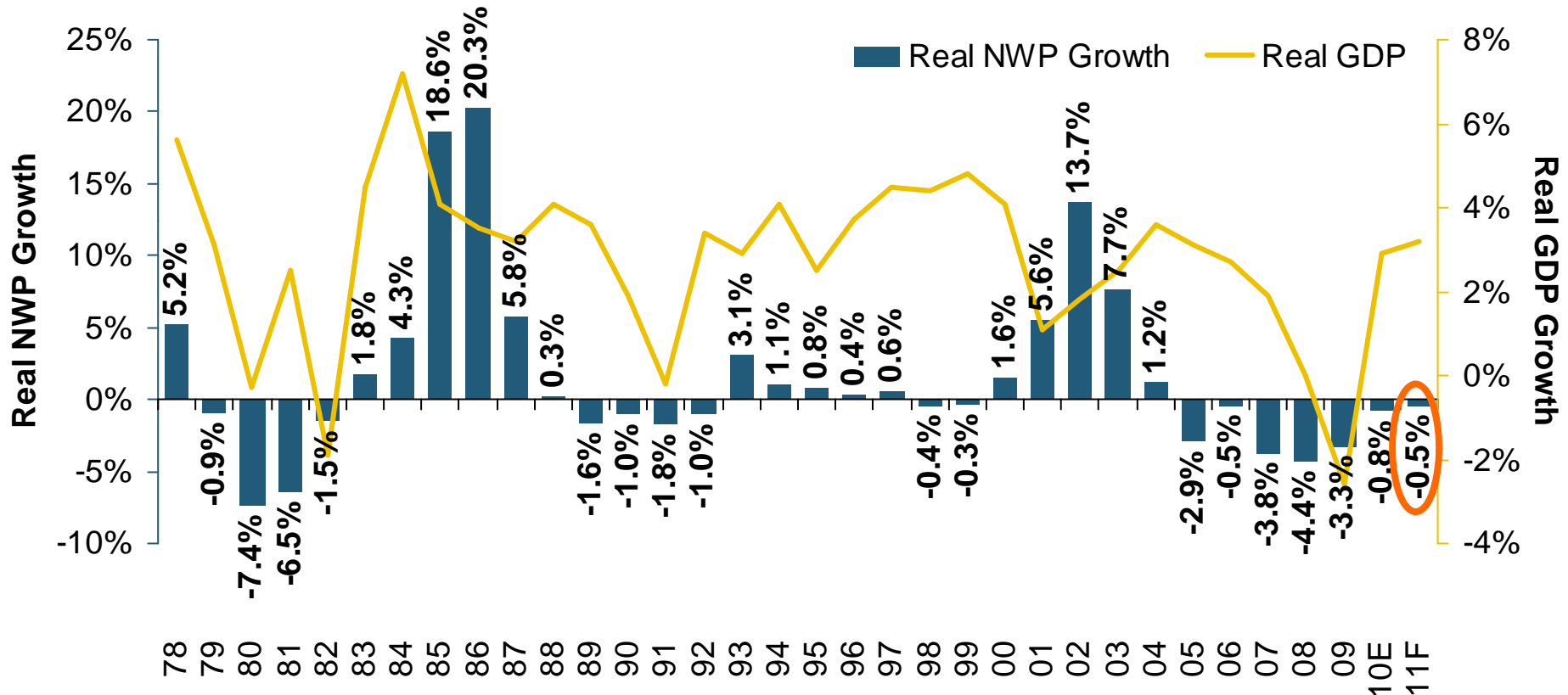
Demand for Insurance Continues To Be Impacted by Sluggish Economic Conditions, but the Benefits of Even Slow Growth Will Compound and Gradually Benefit the Economy Broadly

* Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 2/11; Insurance Information Institute.

Real GDP Growth vs. Real P/C Premium Growth: Modest Association

Real GDP Growth vs. Real P/C (%)



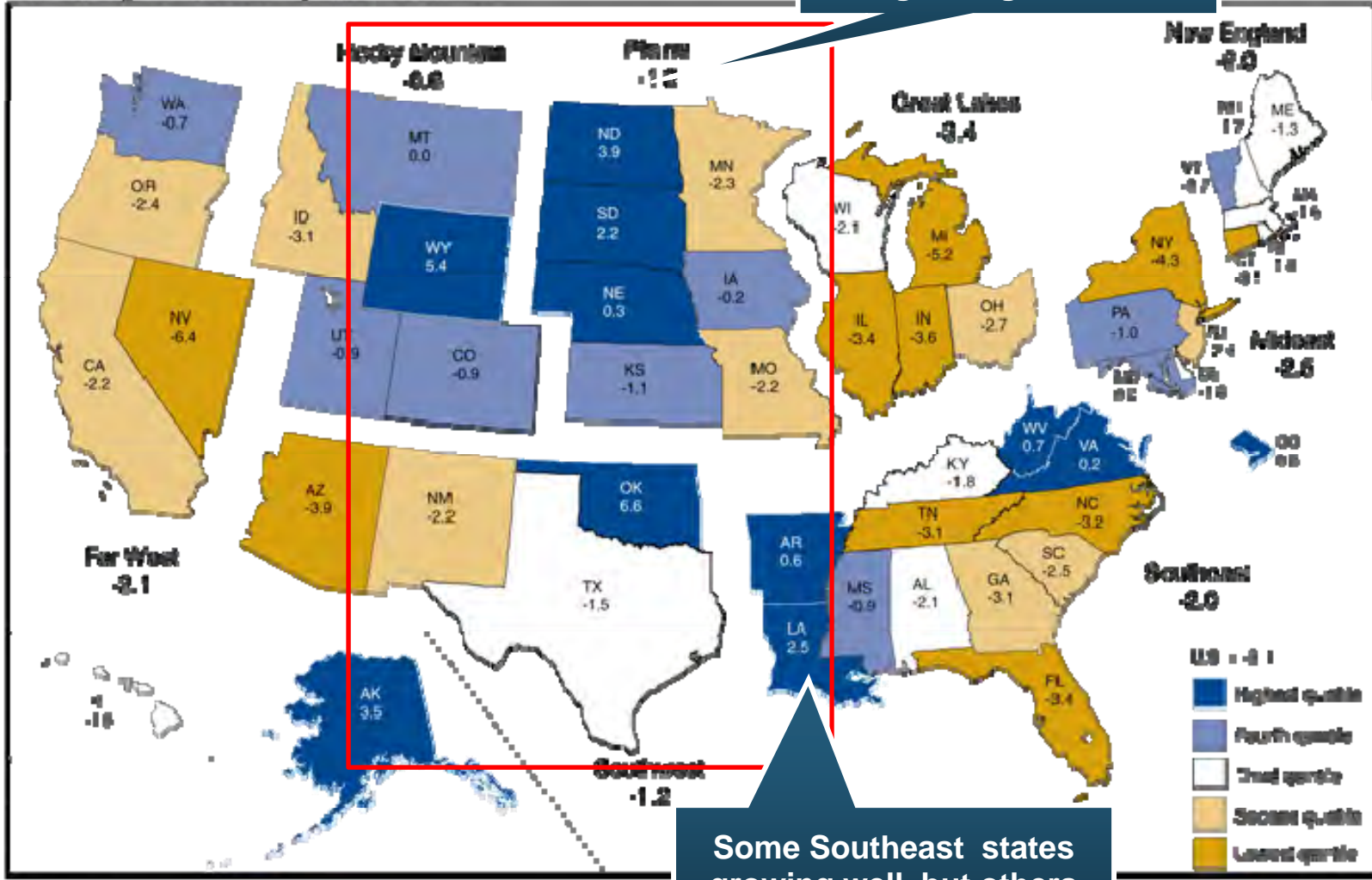
P/C Insurance Industry's Growth is Influenced Modestly by Growth in the Overall Economy

2011 Financial Overview

State Economic Growth Varied in 2009

Mountain, Plains states still growing the fastest

Percent Change in Real GDP by State 2008-2009

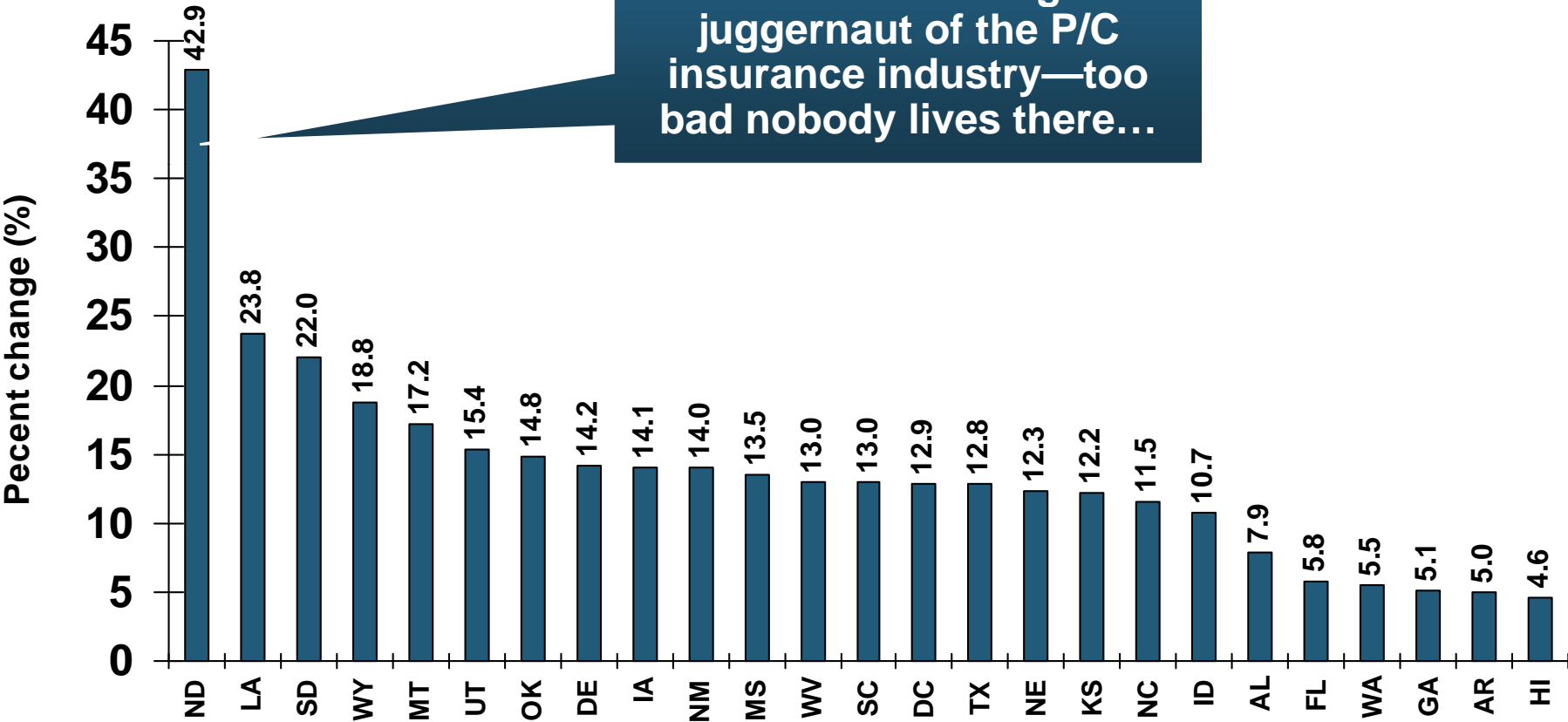


Some Southeast states growing well, but others among the weakest

Direct Premiums Written: All Lines Percent Change by State, 2004-2009

Top 25 States

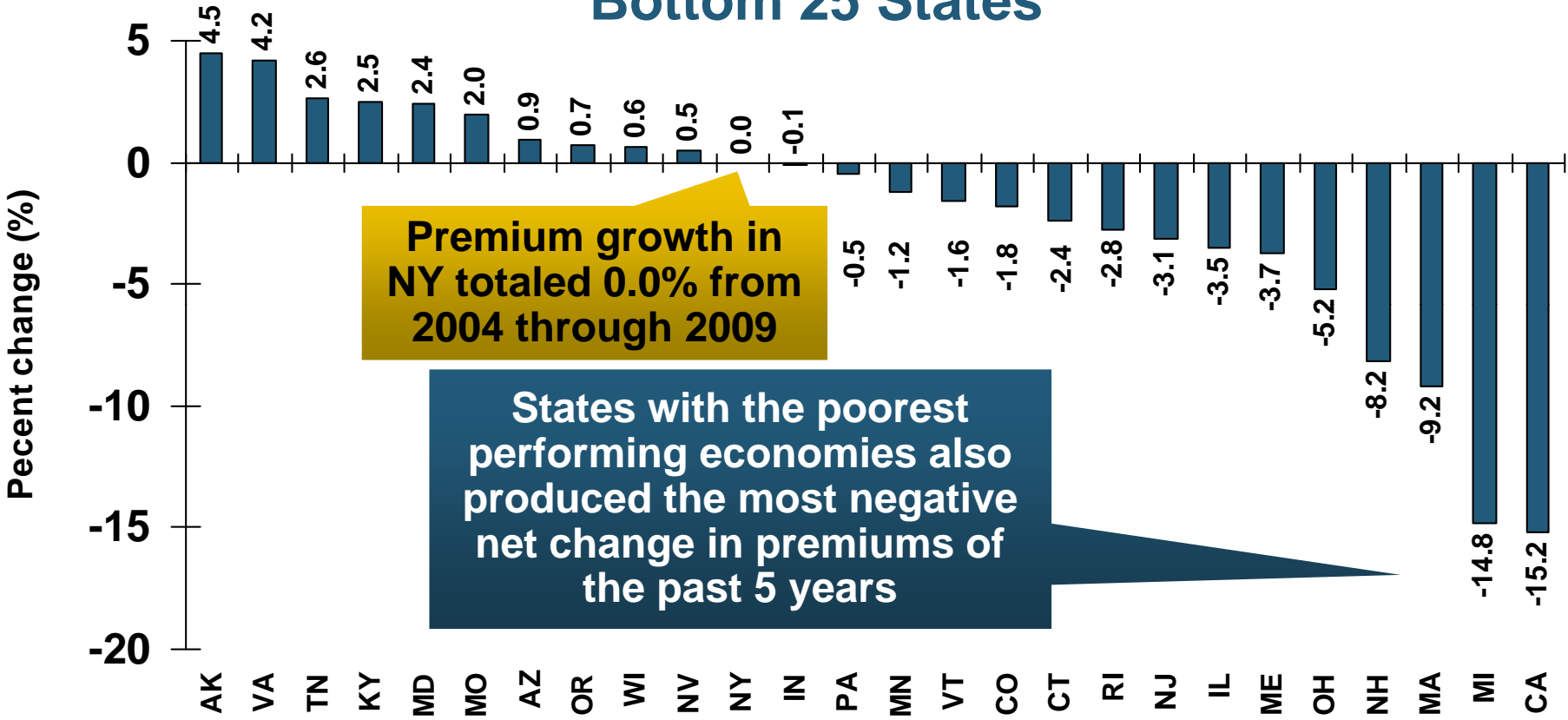
North Dakota is the growth juggernaut of the P/C insurance industry—too bad nobody lives there...



Sources: SNL Financial LLC.; Insurance Information Institute.

Direct Premiums Written: All Lines Percent Change by State, 2004-2009

Bottom 25 States



Over the 5 years from 2004-2009, 15 states saw premiums *shrink*, one had no growth, and 4 others grew premiums by less than 1%

Sources: SNL Financial LLC; Insurance Information Institute.

11 Industries for the Next 10 Years: Insurance Solutions Needed

Health Care

Health Sciences

Energy (Traditional)

Alternative Energy

Agriculture

Natural Resources

Environmental

Technology (incl. Biotechnology)

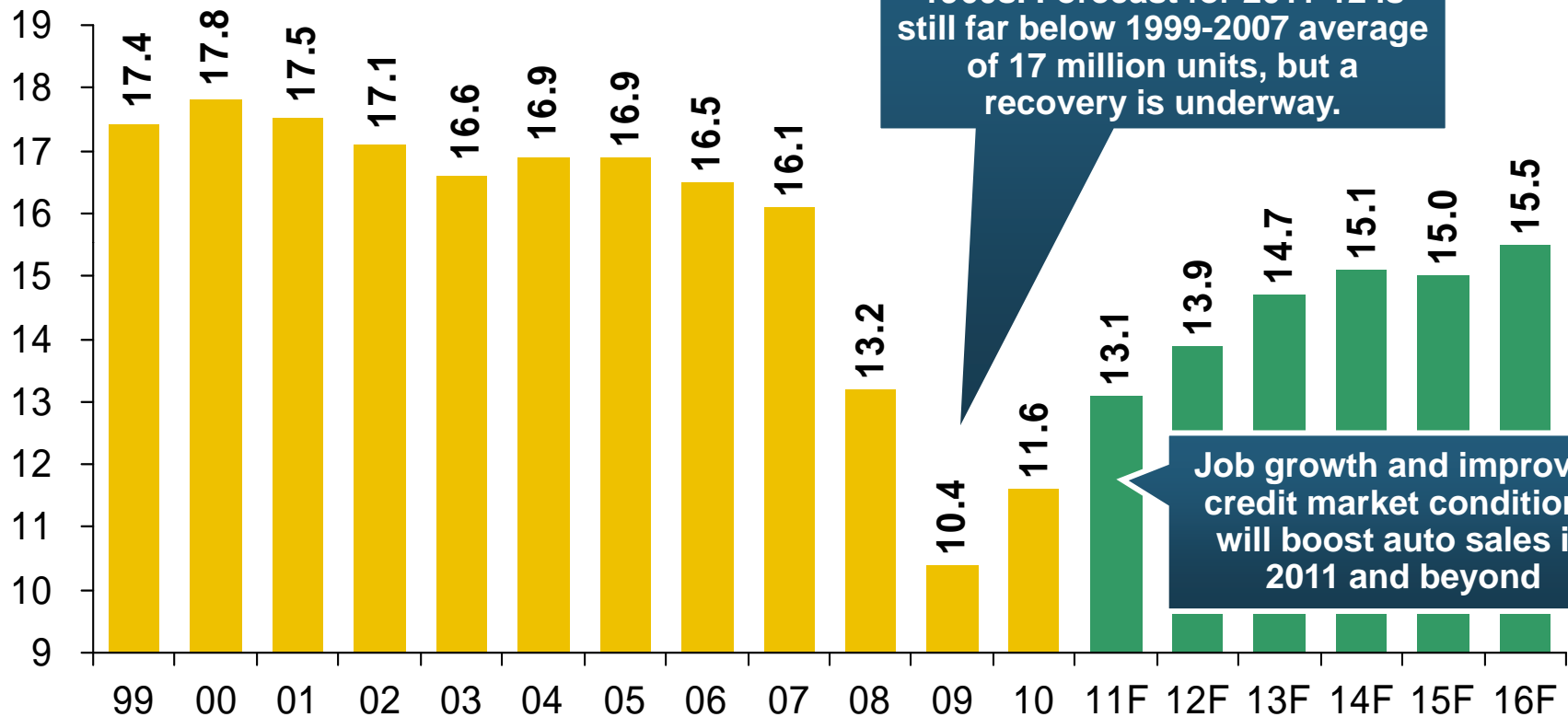
Light Manufacturing

Export-Oriented Industries

Shipping (Rail, Marine)

Auto/Light Truck Sales, 1999-2016F

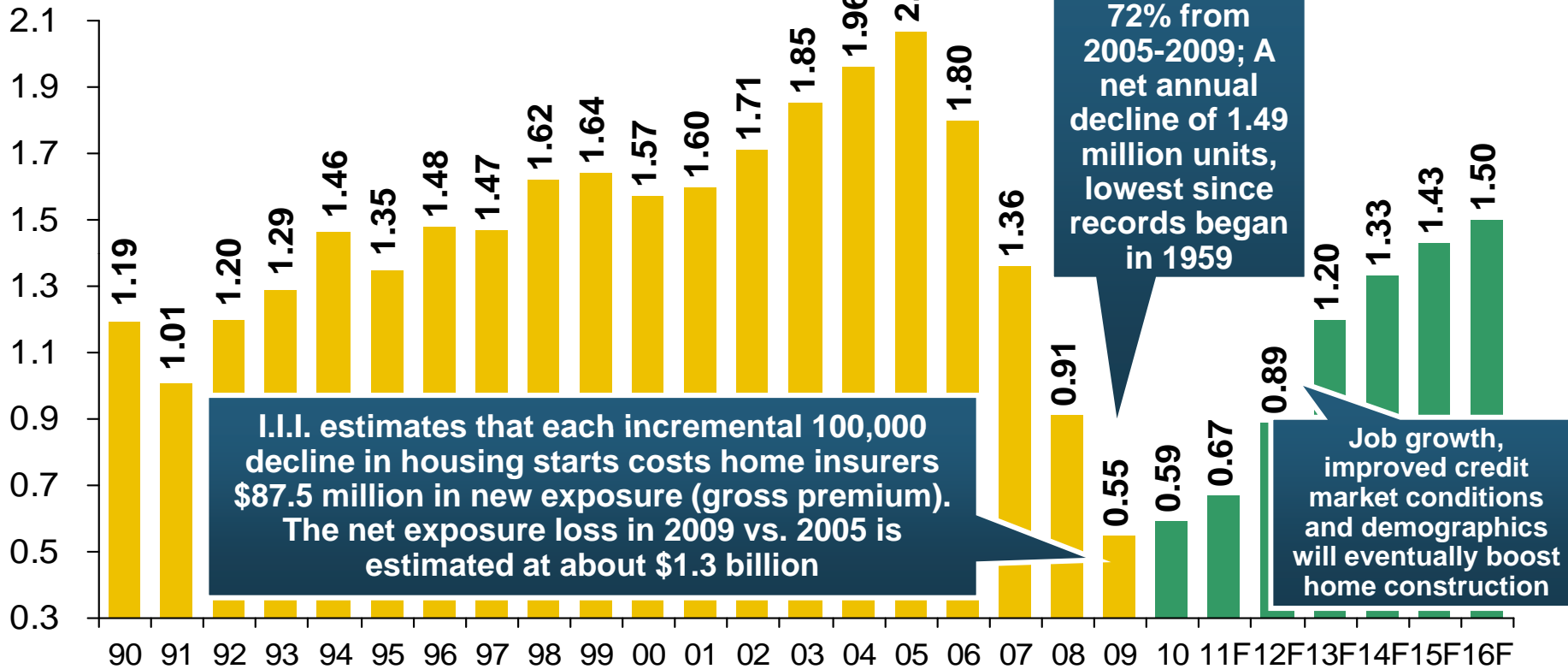
(Millions of Units)



Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, but High Unemployment, Tight Credit Are Still Restraining Sales in 2011

New Private Housing Starts, 1990-2016F

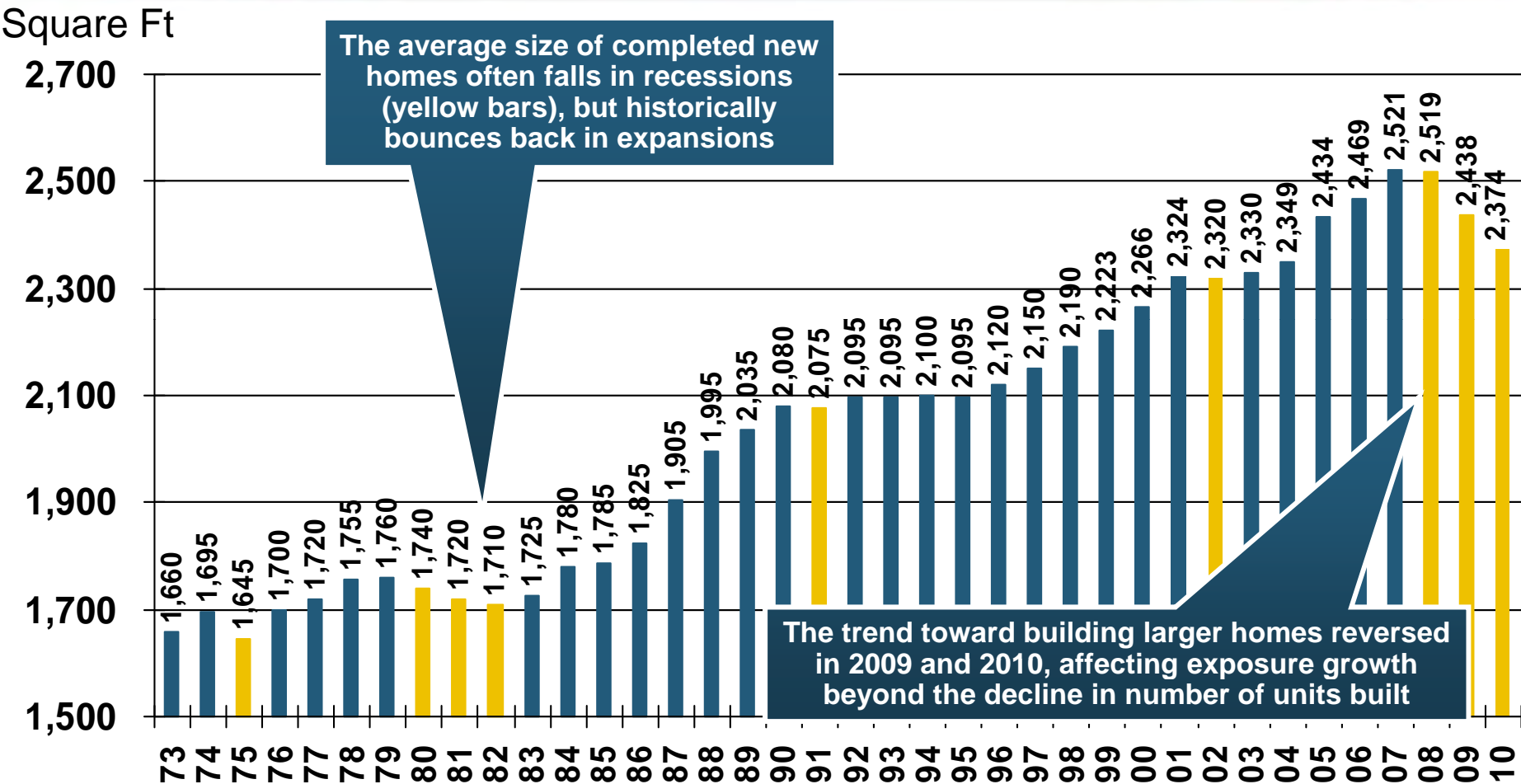
(Millions of Units)



Little Exposure Growth Likely for Homeowners Insurers Until 2012. Also Affects Commercial Insurers with Construction Risk Exposure, Surety

2011 Financial Overview

Average Square Footage of Completed New Homes in U.S., 1973-2010*

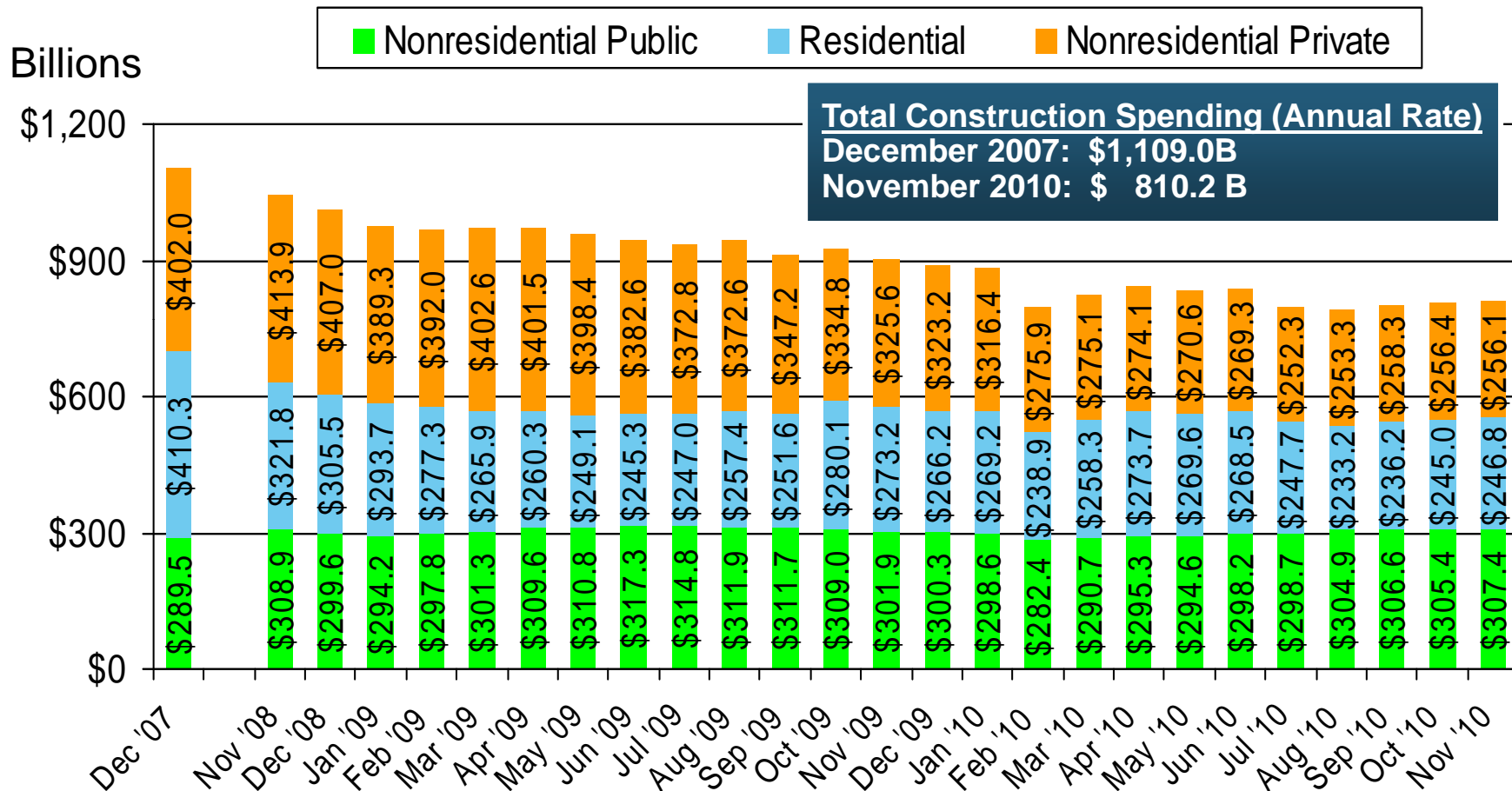


The average size of completed new homes fell by 145 square feet (5.75%) from 2008-2010, the largest recession-based drop in nearly four decades

*2010 figure is weighted average square feet of completed homes in first three quarters of 2010
 Source: U.S. Census Bureau: http://www.census.gov/const/www/quarterly_starts_completions.pdf; Insurance Information Institute.

2011 Financial Overview

Value* of Construction Put In Place



Since the recession started, private residential and nonresidential construction together are down \$300 billion (annual rate), a drop of 38%. This affects property, surety, and other construction-related exposures

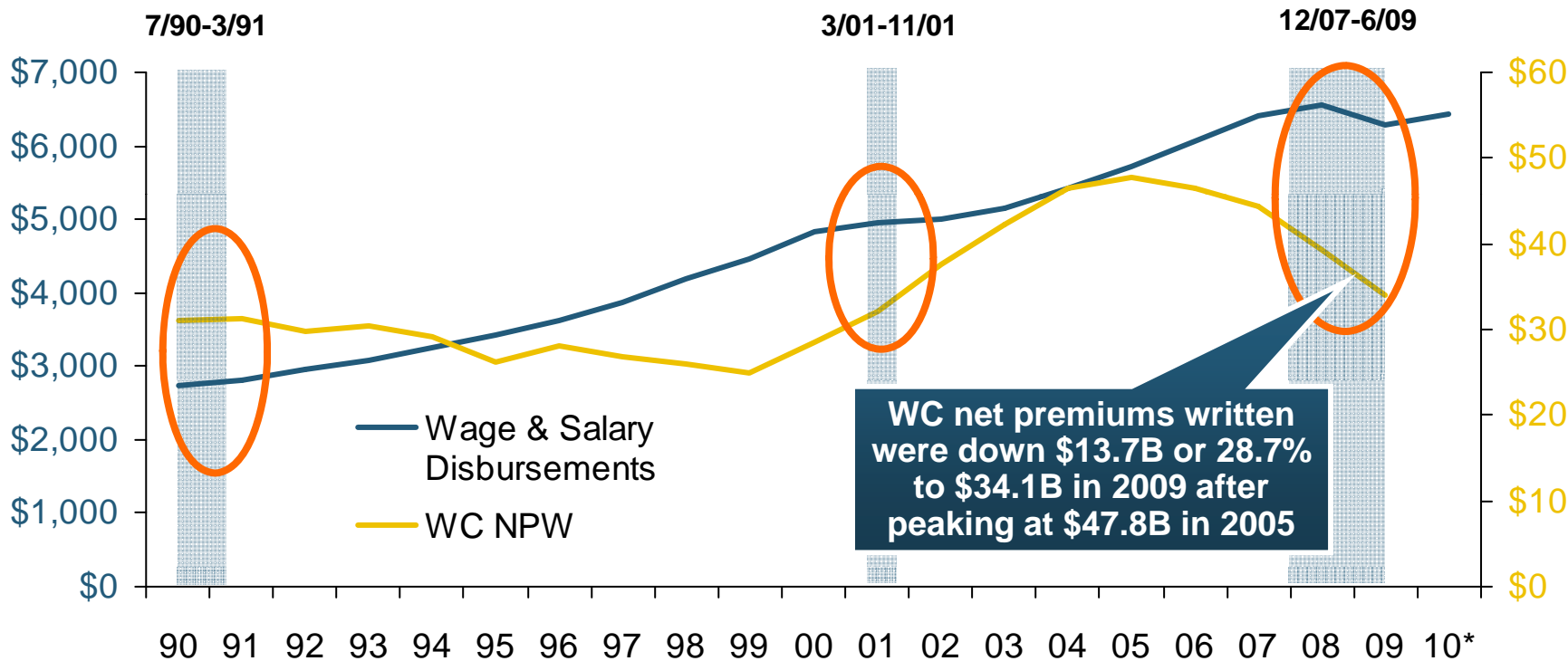
*Seasonally adjusted annual rate

Source: <http://www.census.gov/const/C30/release.pdf>

2011 Financial Overview

Wage and Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums

Wage and Salary Disbursement (Private Employment) vs. WC NWP (\$ Billions)



Weakening payrolls have eroded \$2B+ in workers comp premiums; nearly 29% of NPW has been eroded away by the soft market and weak economy

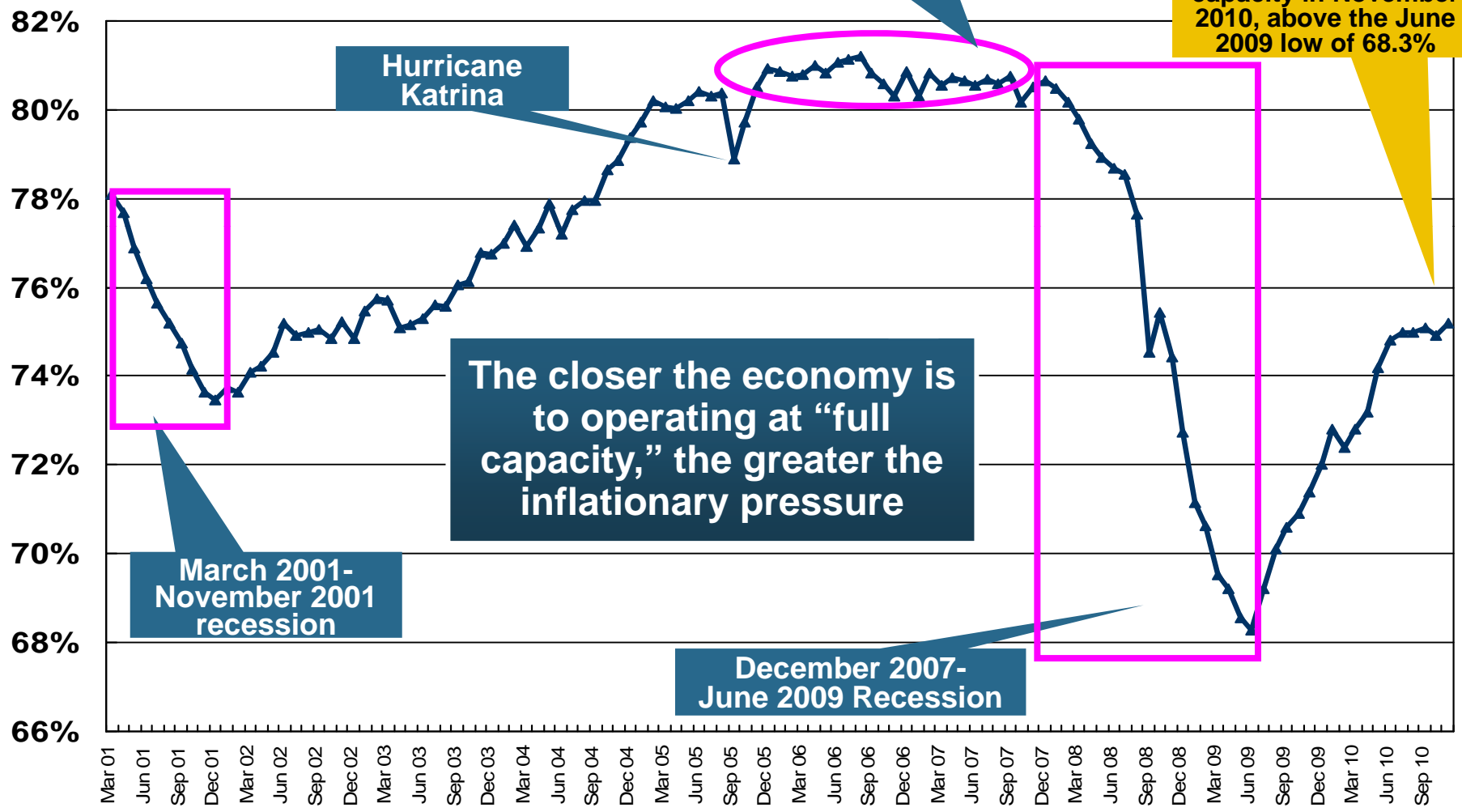
* Average Wage and Salary data as of 7/1/2010. Shaded areas indicate recessions.

**Estimated "official" end of recession June 2009.

Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at <http://research.stlouisfed.org/fred2/series/WASCUR>; I.I.I. Fact Books

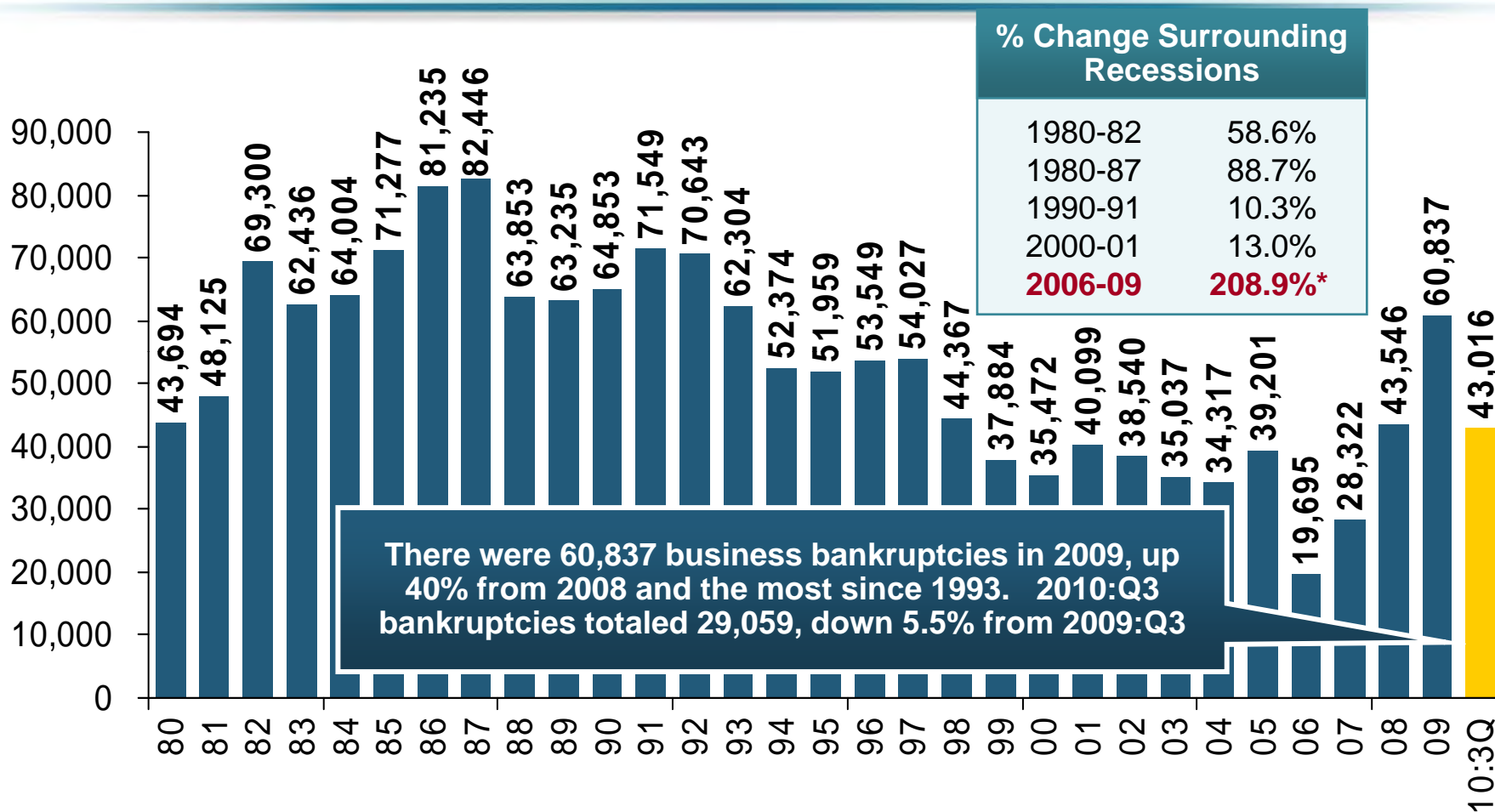
Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

Percent of Industrial Capacity



Source: Federal Reserve Board statistical releases at <http://www.federalreserve.gov/releases/q17/Current/default.htm>.

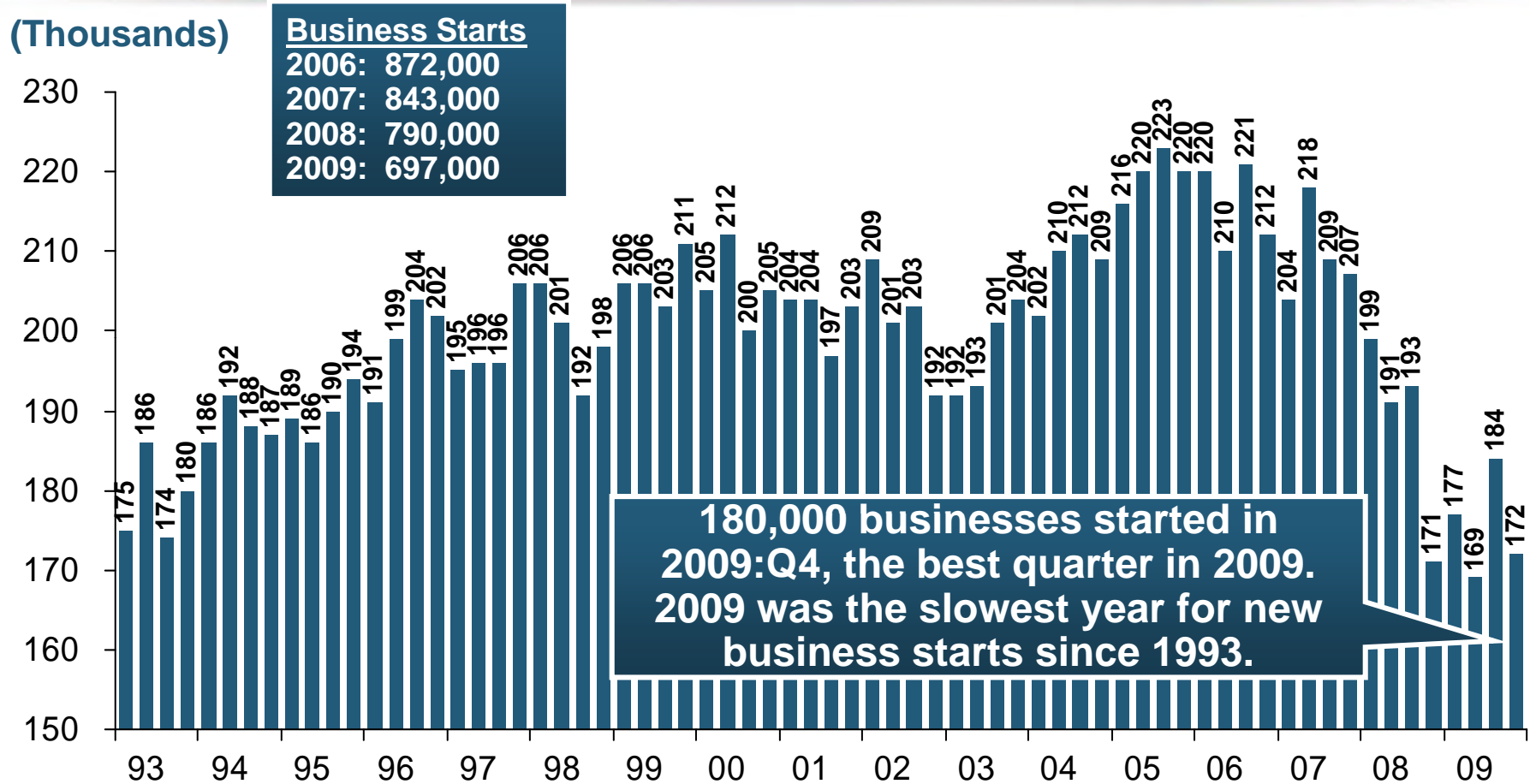
Business Bankruptcy Filings, 1980-2010:Q3



Significant Exposure Implications for All Commercial Lines

Sources: American Bankruptcy Institute at <http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=61633> ; Insurance Information Institute

Private Sector Business Starts, 1993:Q2 – 2010:Q1*



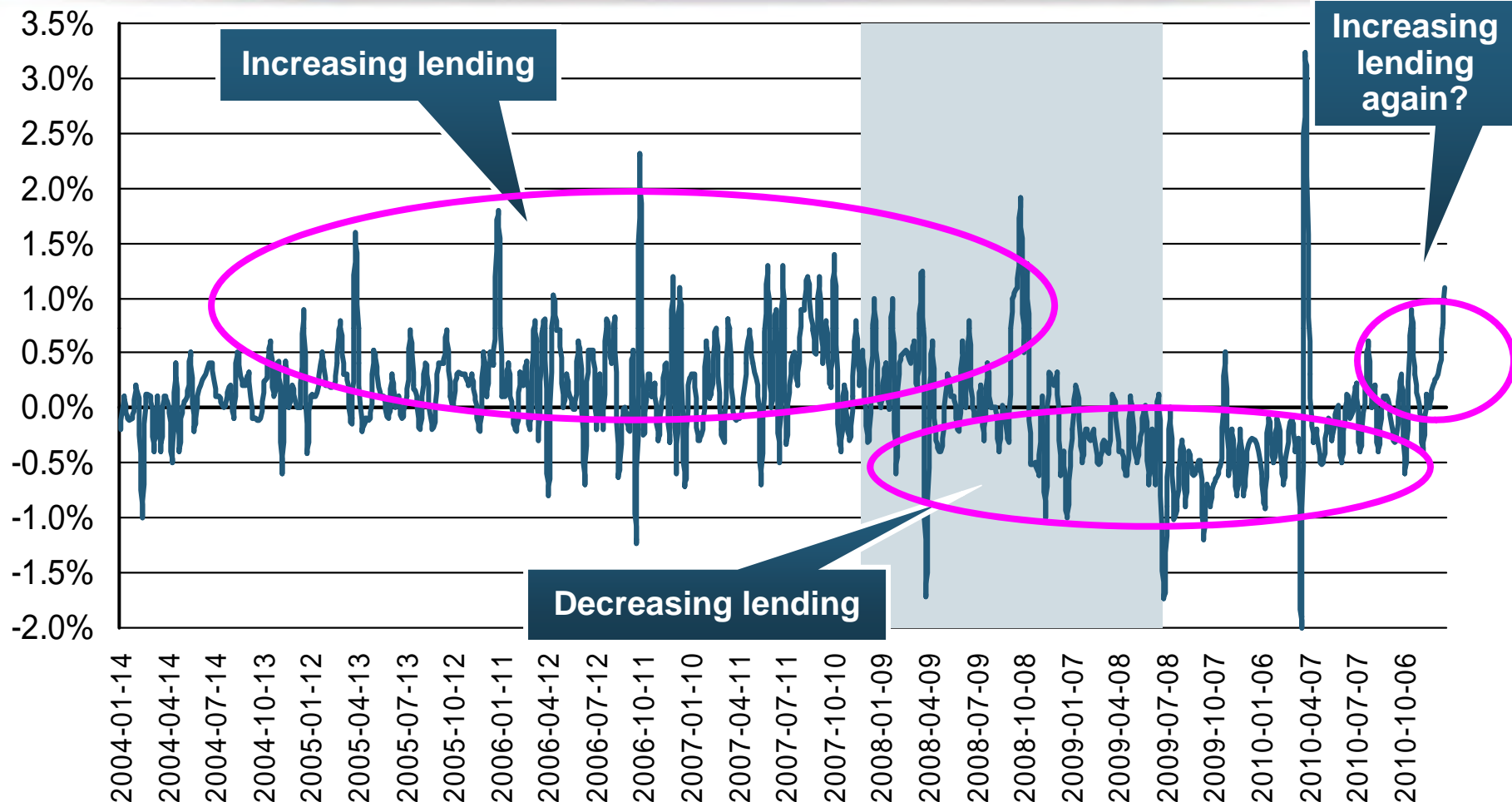
Business Starts Were Down Nearly 20% in the Recession, Holding Back Most Types of Commercial Insurance Exposure

* Latest available as of December 29, 2010, seasonally adjusted

Source: Bureau of Labor Statistics, <http://www.bls.gov/news.release/cewbd.t07.htm>.

2011 Financial Overview

Weekly Percentage Change in Commercial and Industrial Loans by Large U.S. Banks, 2004-2010



**Lending peak: \$827.3 billion at mid-October 2008;
Trough \$600.5 billion at mid-October 2010; Latest (12/20/2010) \$619.9 billion**

Note: Recession indicated by gray shaded column.

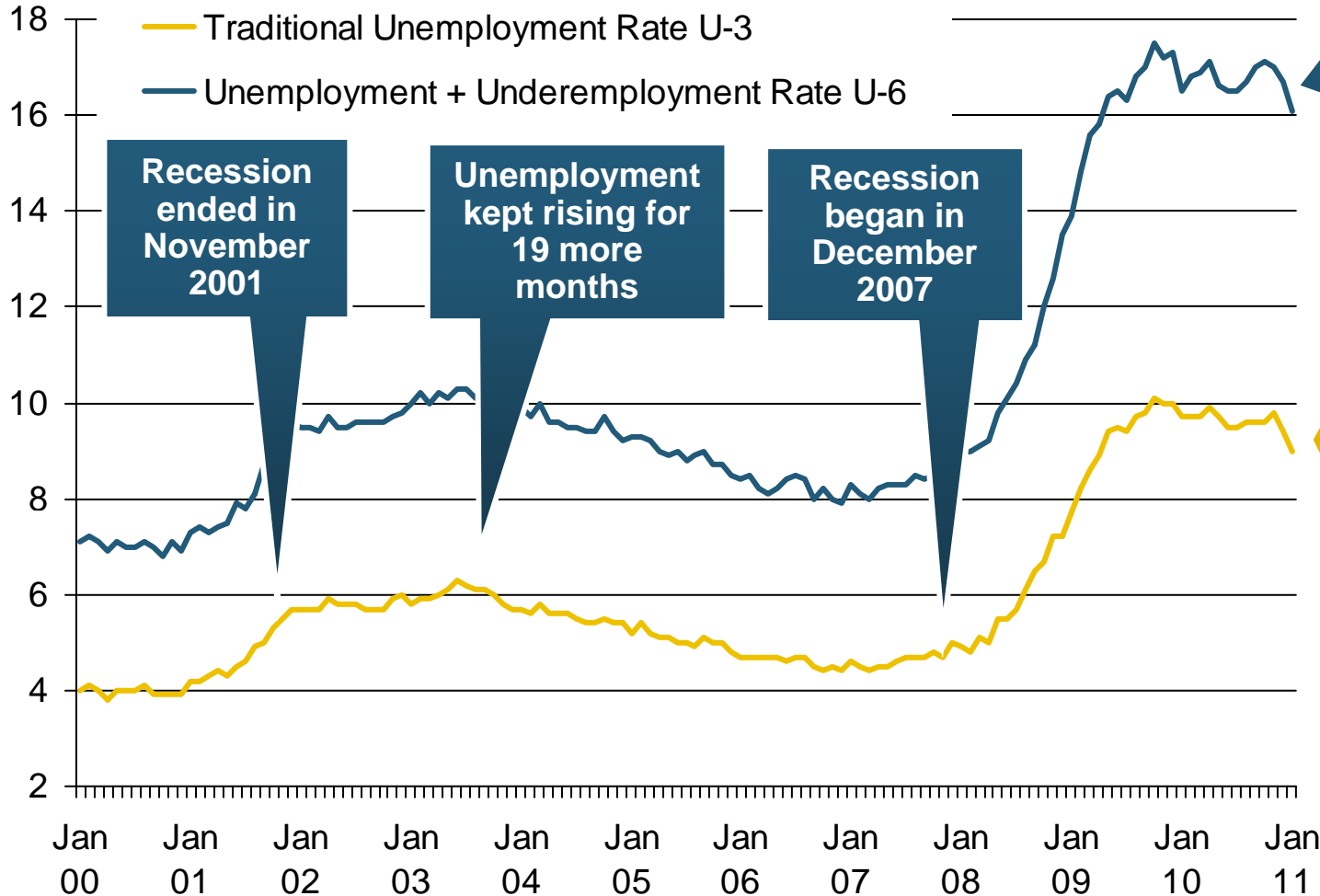
Sources <http://research.stlouisfed.org/fred2/series/CIBOARD/downloaddata?cid=100> ; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Labor Market Trends

Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend is Improving

Unemployment and Underemployment Rates: Falling Faster in 2011?

January 2000 through January 2011, Seasonally Adjusted (%)



U-6 went from 8.0% in March 2007 to 17.5% in October 2009; Stood at 16.1% in December 2010

Unemployment rate fell to 9.4% in December

Unemployment peaked at 10.1% in October 2009, highest monthly rate since 1983.

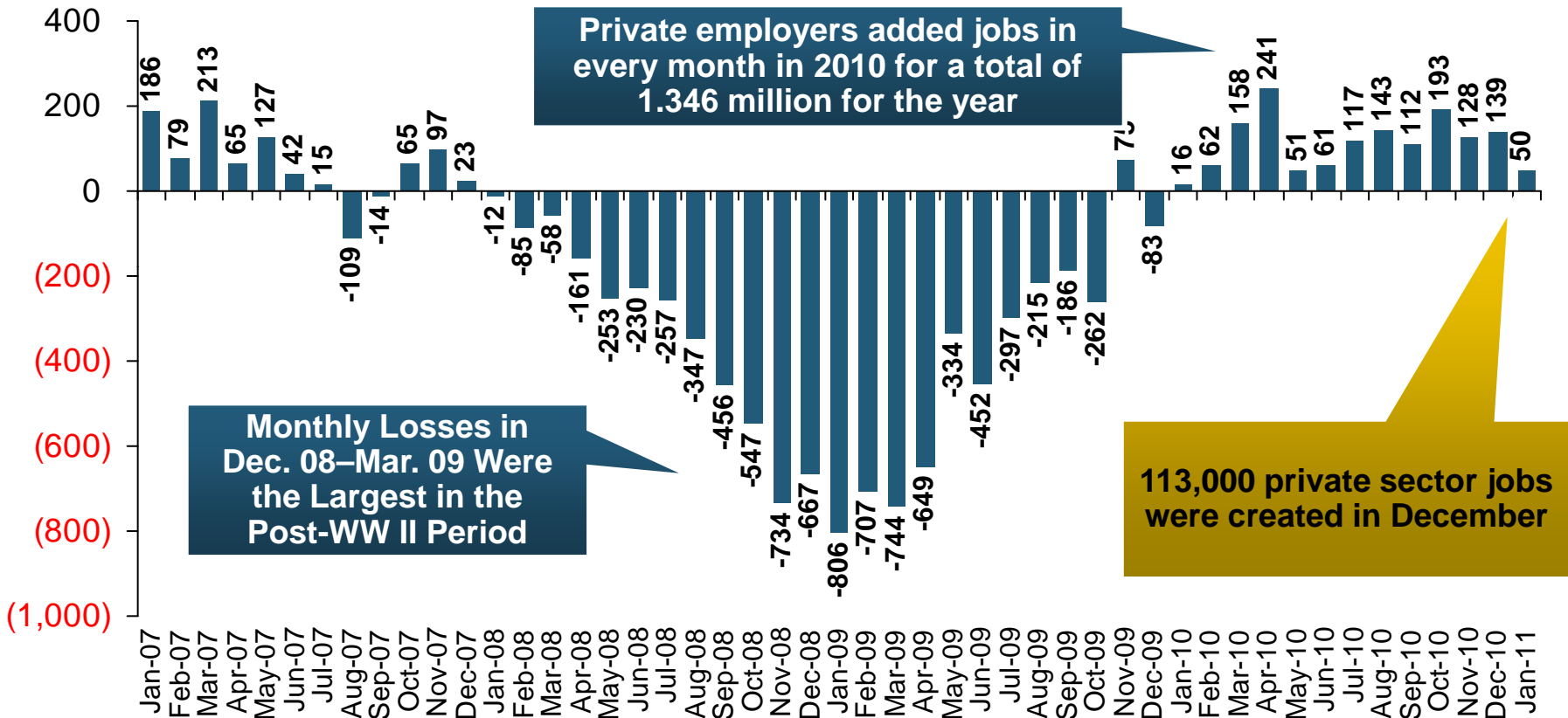
Peak rate in the last 30 years: 10.8% in November - December 1982

Stubbornly high unemployment and underemployment will constrain payroll growth, which directly affects WC exposure

Source: US Bureau of Labor Statistics; Insurance Information Institute.

Monthly Change in Private Employment

January 2008 through January 2011* (Thousands)



Monthly Losses in Dec. 08–Mar. 09 Were the Largest in the Post-WW II Period

Private employers added jobs in every month in 2010 for a total of 1.346 million for the year

113,000 private sector jobs were created in December

Private Employers Added 1.411 million Jobs in 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008

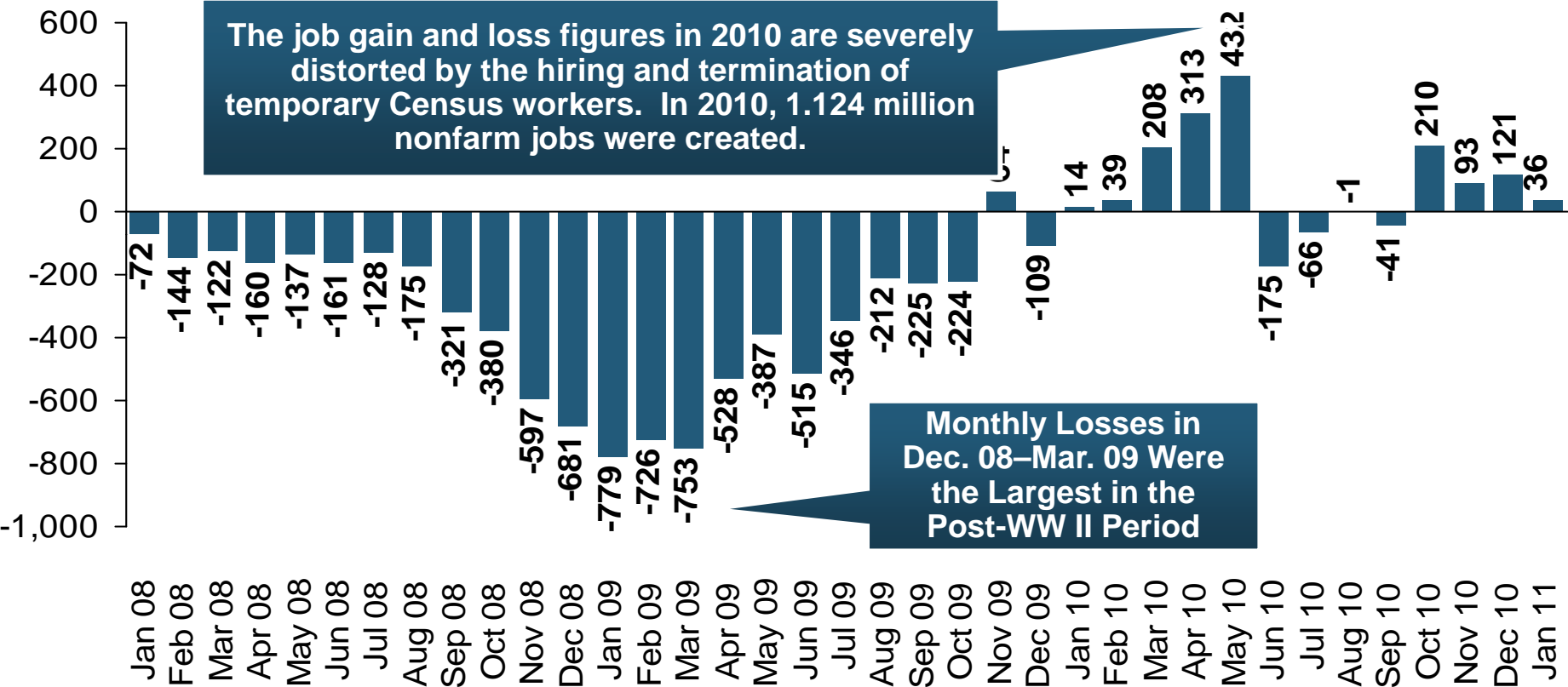
Monthly Change Employment*

January 2008 through January 2011* (Thousands)

The job gain and loss figures in 2010 are severely distorted by the hiring and termination of temporary Census workers. In 2010, 1.124 million nonfarm jobs were created.

Monthly Losses in Dec. 08–Mar. 09 Were the Largest in the Post-WW II Period

Job Losses Since the Recession Began in Dec. 2007 Peaked at 8.4 Mill in Dec. 09; Stands at 7.5 Million Through October 2010; 14.5 Million People are Now Defined as Unemployed

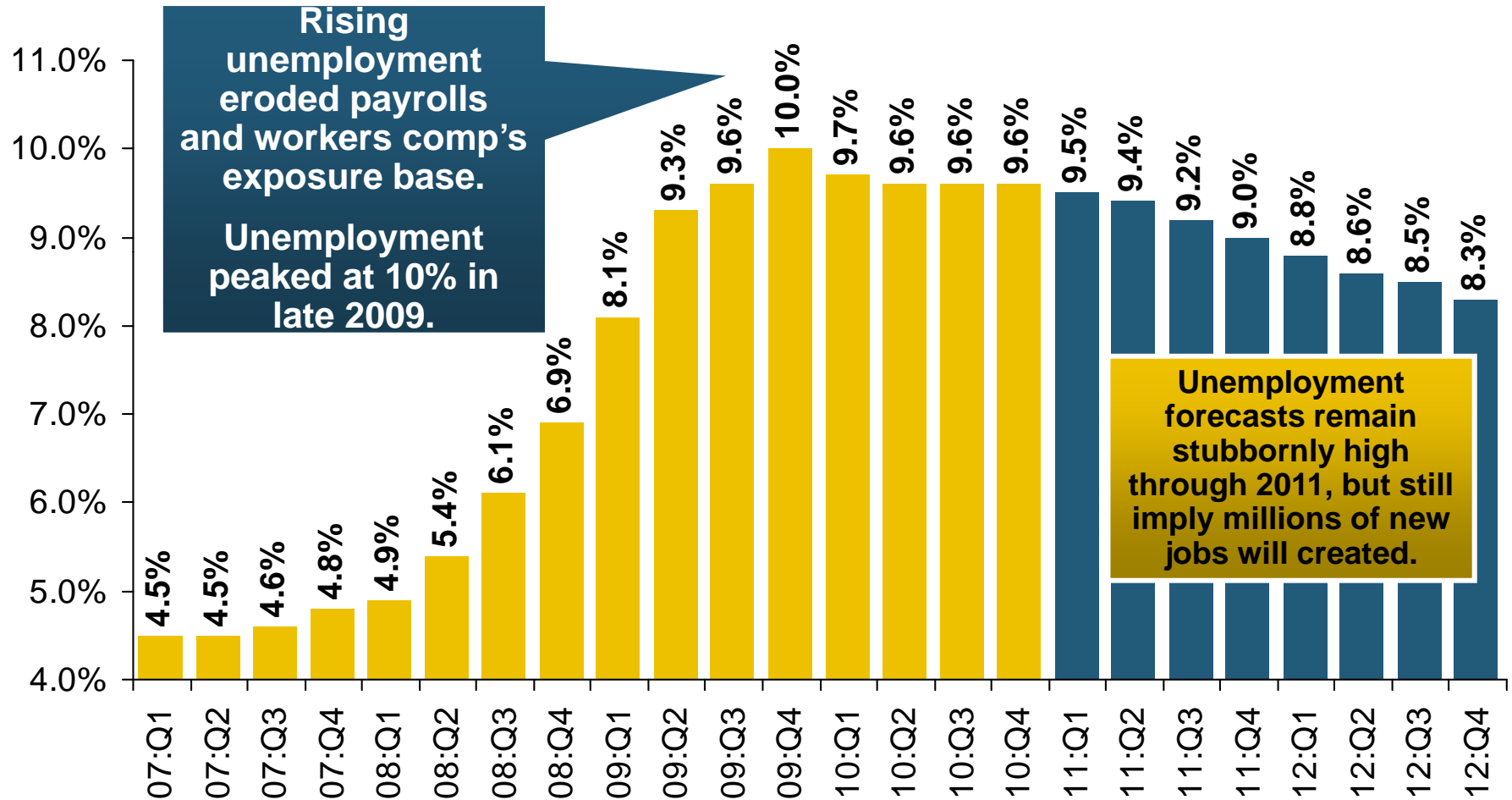


*Estimate based on Reuters poll of economists.

Source: US Bureau of Labor Statistics: <http://www.bls.gov/ces/home.htm>; Insurance Information Institute

US Unemployment Rate

2007:Q1 to 2012:Q4F*

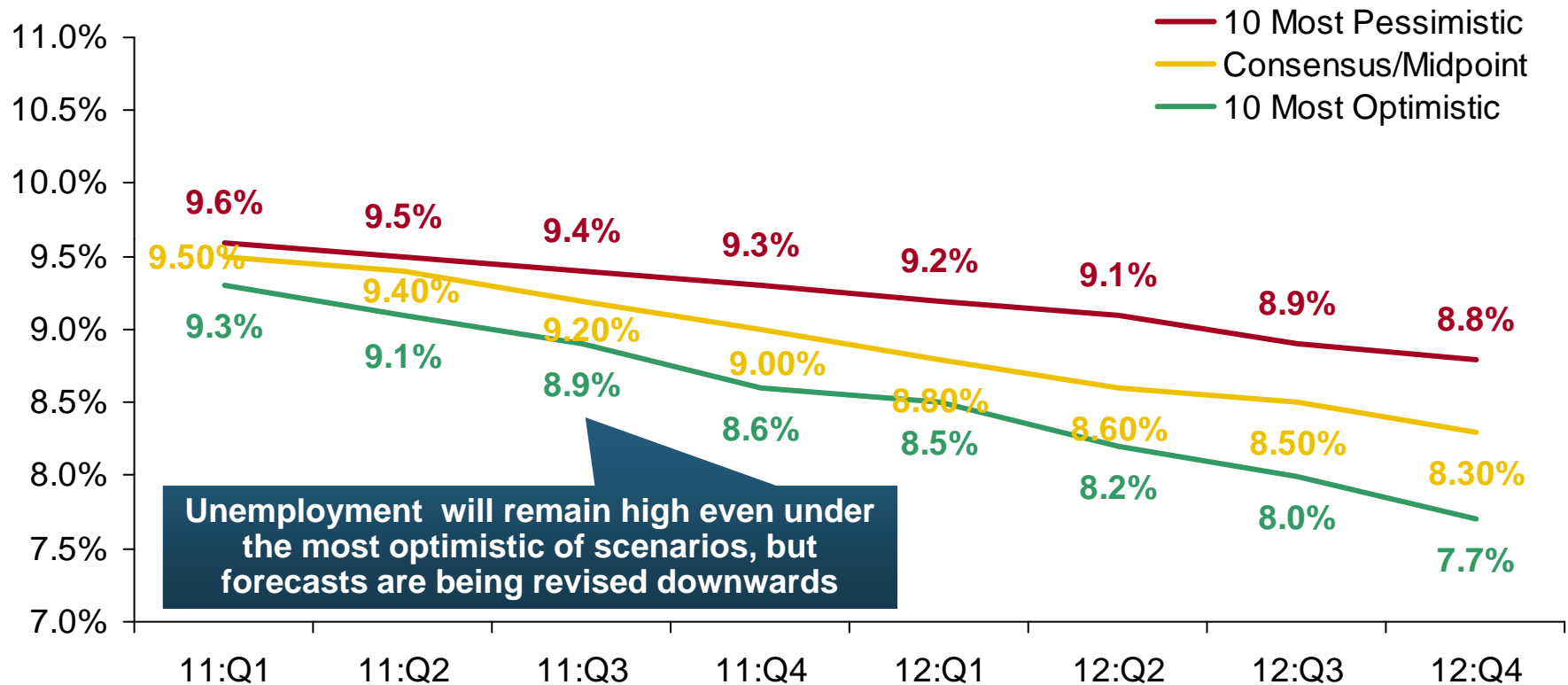


*  = actual;  = forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (2/11); Insurance Information Institute

US Unemployment Rate Forecasts

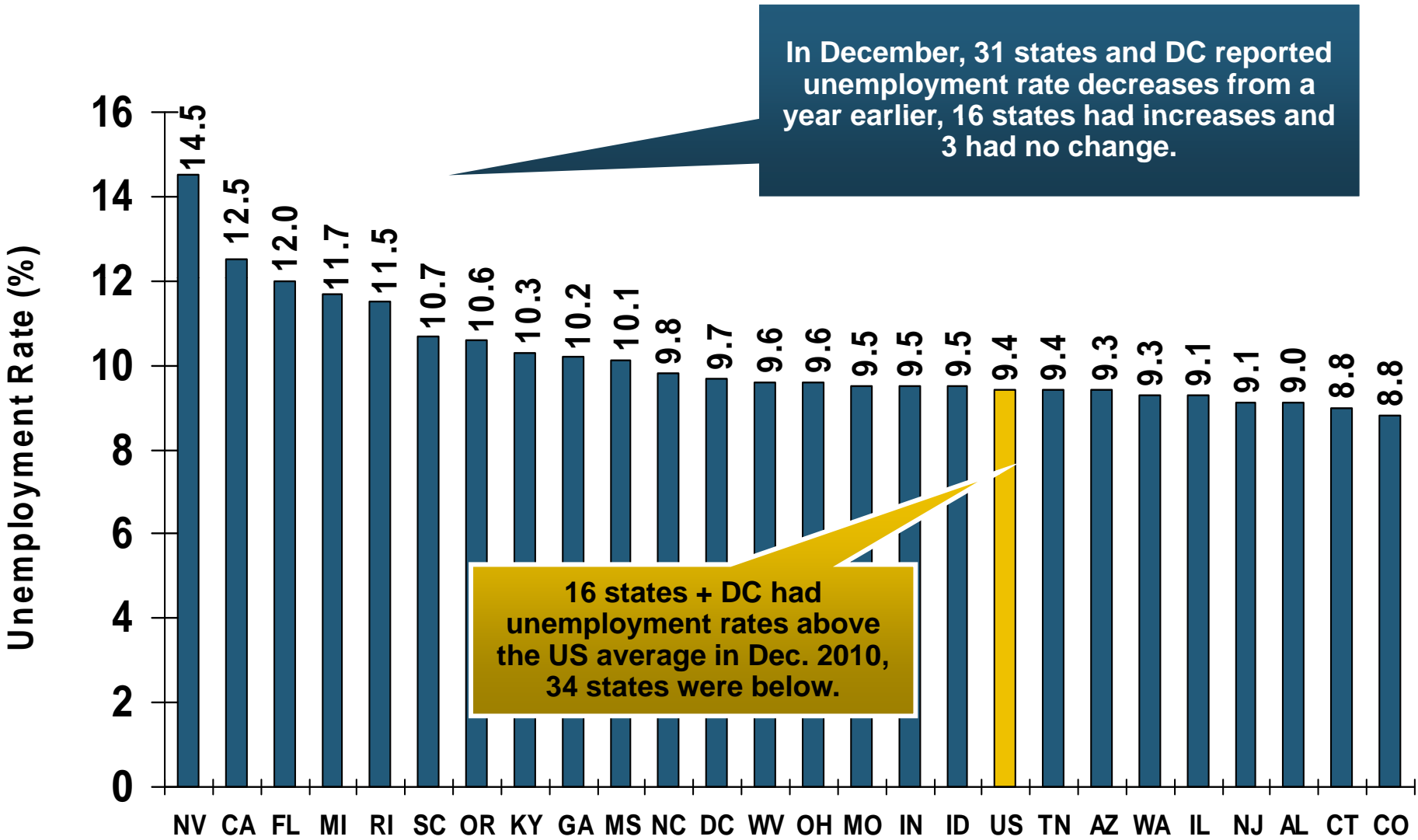
Quarterly, 2011:Q1 to 2012:Q4



Unemployment will remain high even under the most optimistic of scenarios, but forecasts are being revised downwards

Stubbornly High Unemployment Will Slow the Recovery of the Workers Comp Exposure Base

Unemployment Rates by State, December 2010: Highest 25 States*



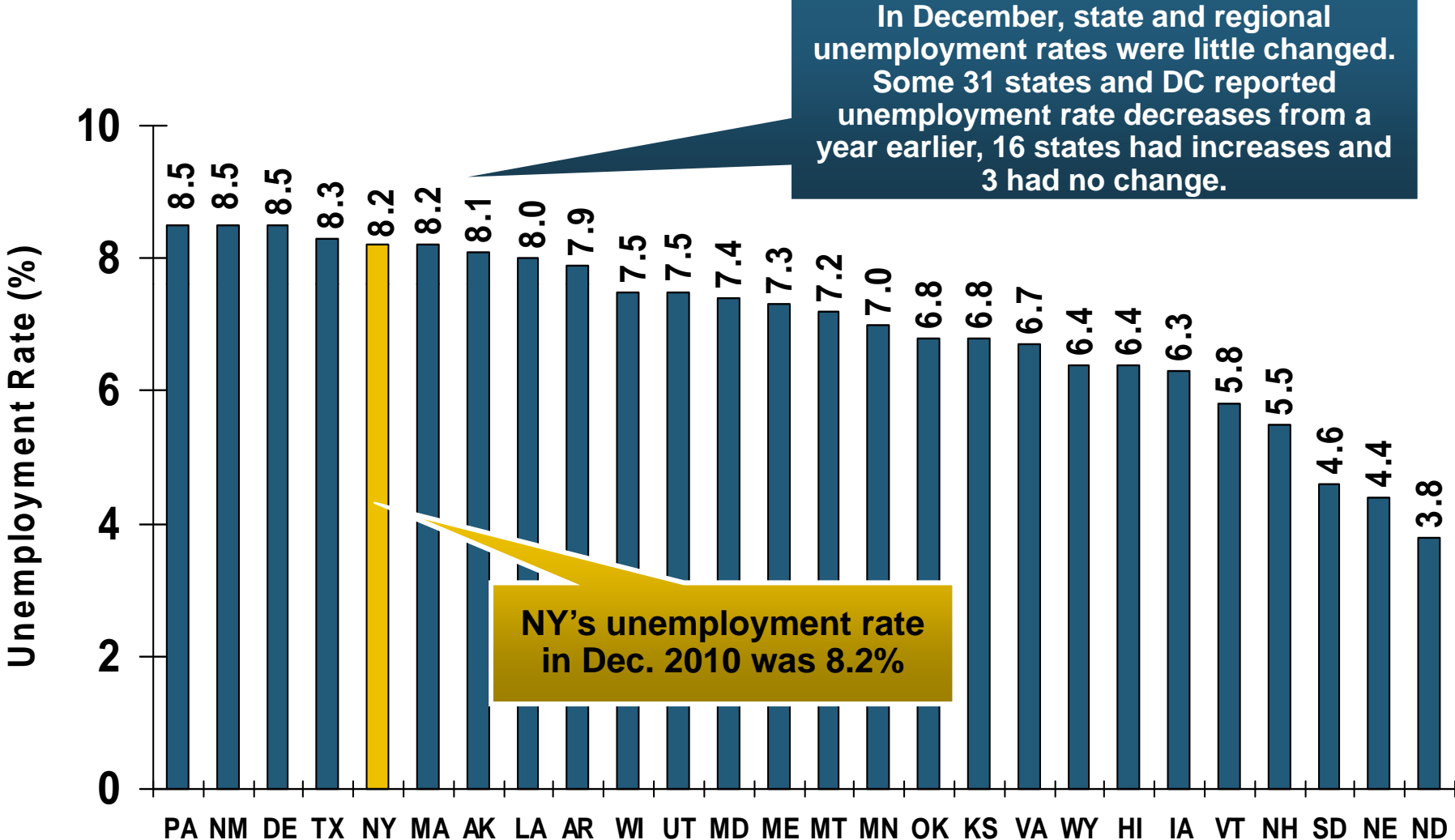
In December, 31 states and DC reported unemployment rate decreases from a year earlier, 16 states had increases and 3 had no change.

16 states + DC had unemployment rates above the US average in Dec. 2010, 34 states were below.

*Provisional figures for December 2010, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute.

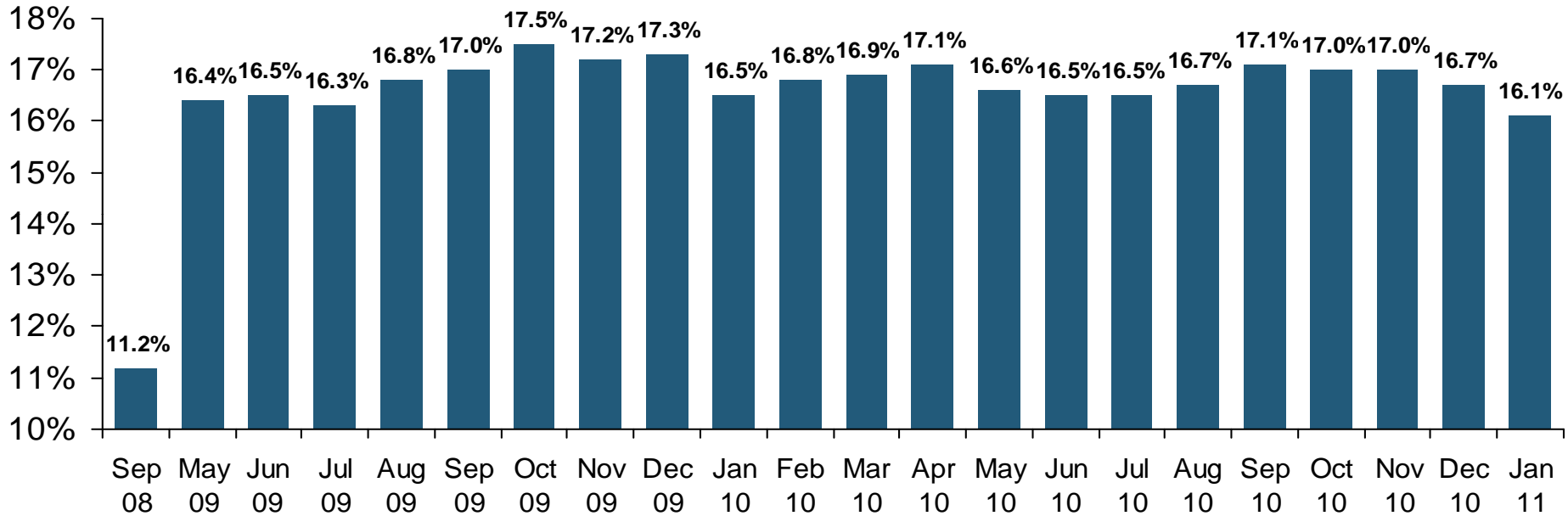
Unemployment Rates By State, December 2010: Lowest 25 States*



*Provisional figures for December 2010, seasonally adjusted.
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

Labor Underutilization: Broader than Just Unemployment

% of Labor Force



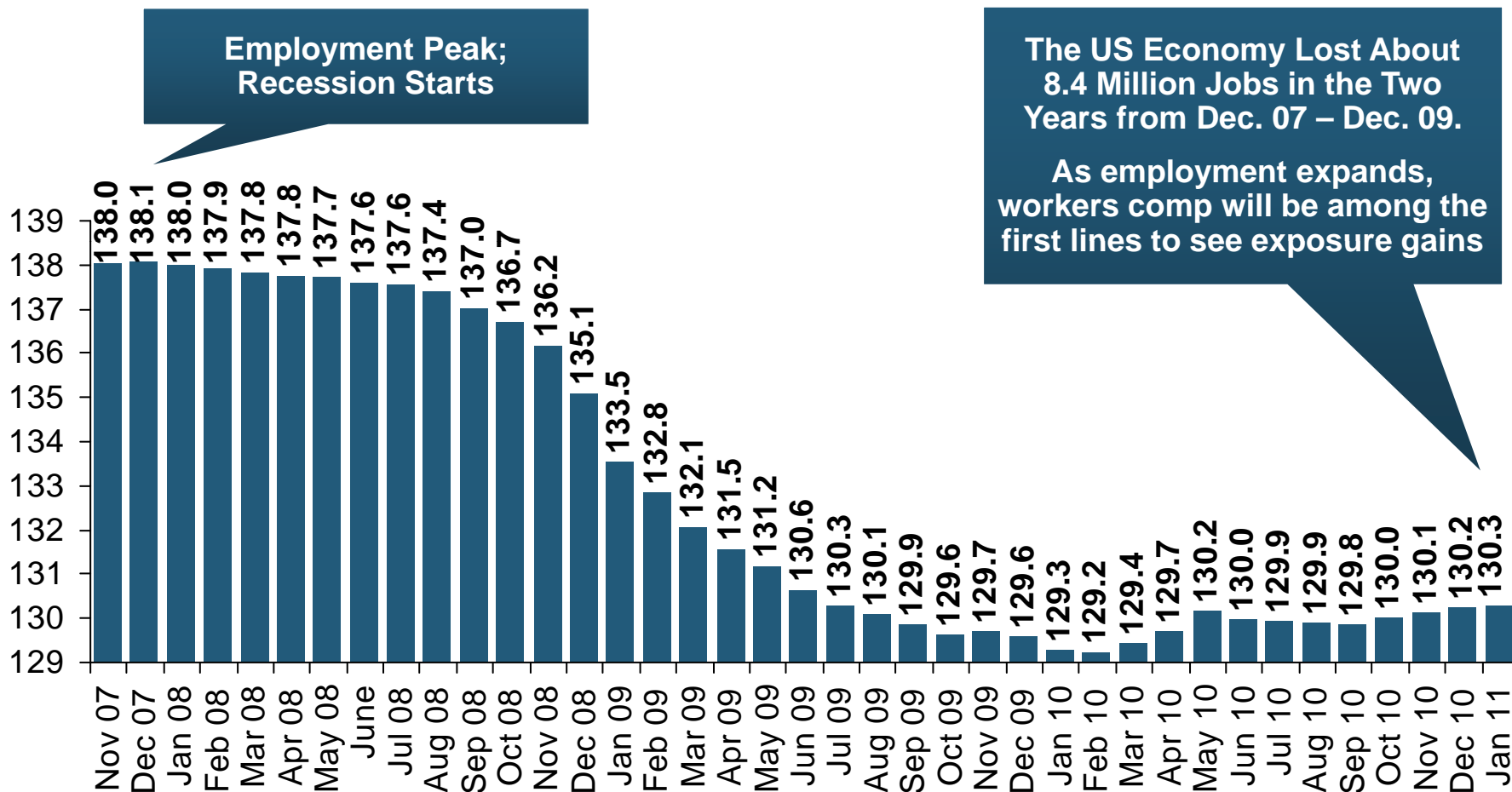
Marginally Attached and Unemployed Persons Account for 16.1% of the Labor Force in January 2011 (1 Out of 6 People). Unemployment Rate Alone was 9.0%. Underutilization Shows a Broader Impact on WC and Other Commercial Exposures

NOTE: Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not looking currently for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule.

Source: US Bureau of Labor Statistics; Insurance Information Institute.

US Nonfarm Private Employment

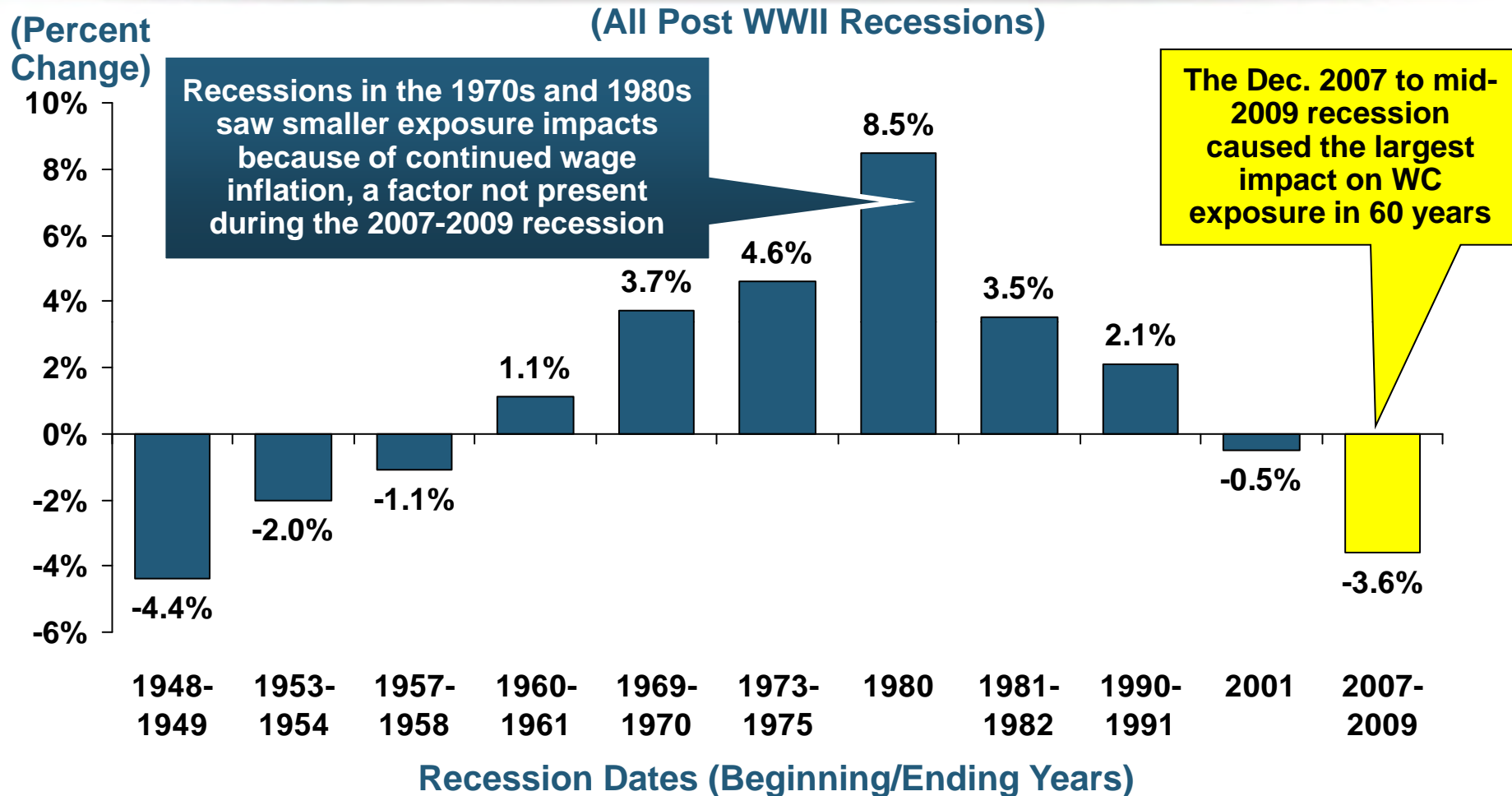
Monthly, Nov 2007 – January 2011 (Millions)



Seasonally adjusted.

Source: US Bureau of Labor Statistics

Estimated Effect of Recessions* on Payroll (Workers Comp Exposure)

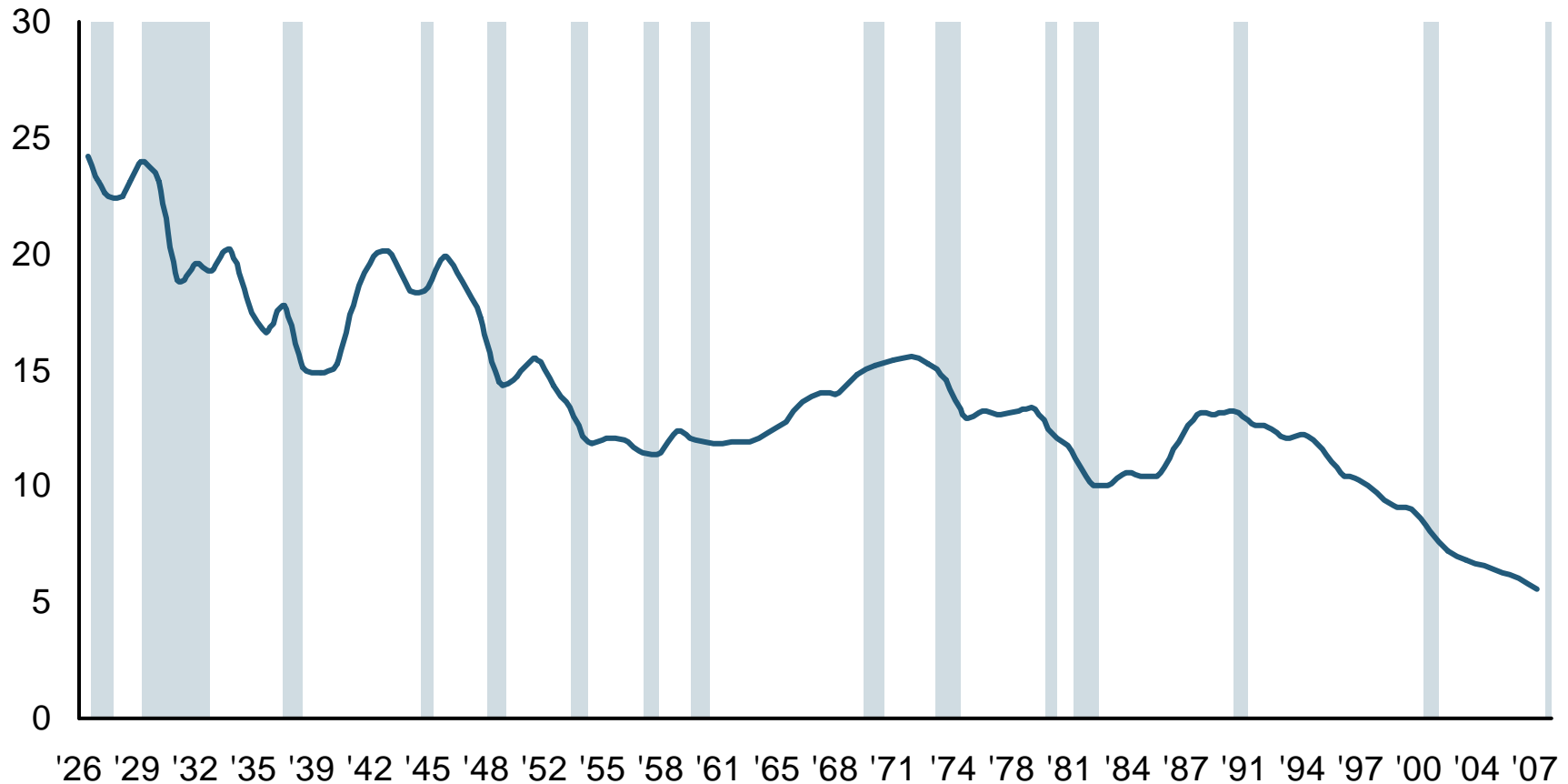


*Data represent maximum recorded decline over 12-month period using annualized quarterly wage and salary accrual data
 Source: Insurance Information Institute research; Federal Reserve Bank of St. Louis (wage and salary data); National Bureau of Economic Research (recession dates).

Frequency: 1926–2008

A Long-Term Drift Downward

Manufacturing – Total Recordable Cases
Rate of Injury and Illness Cases per 100 Full-Time Workers

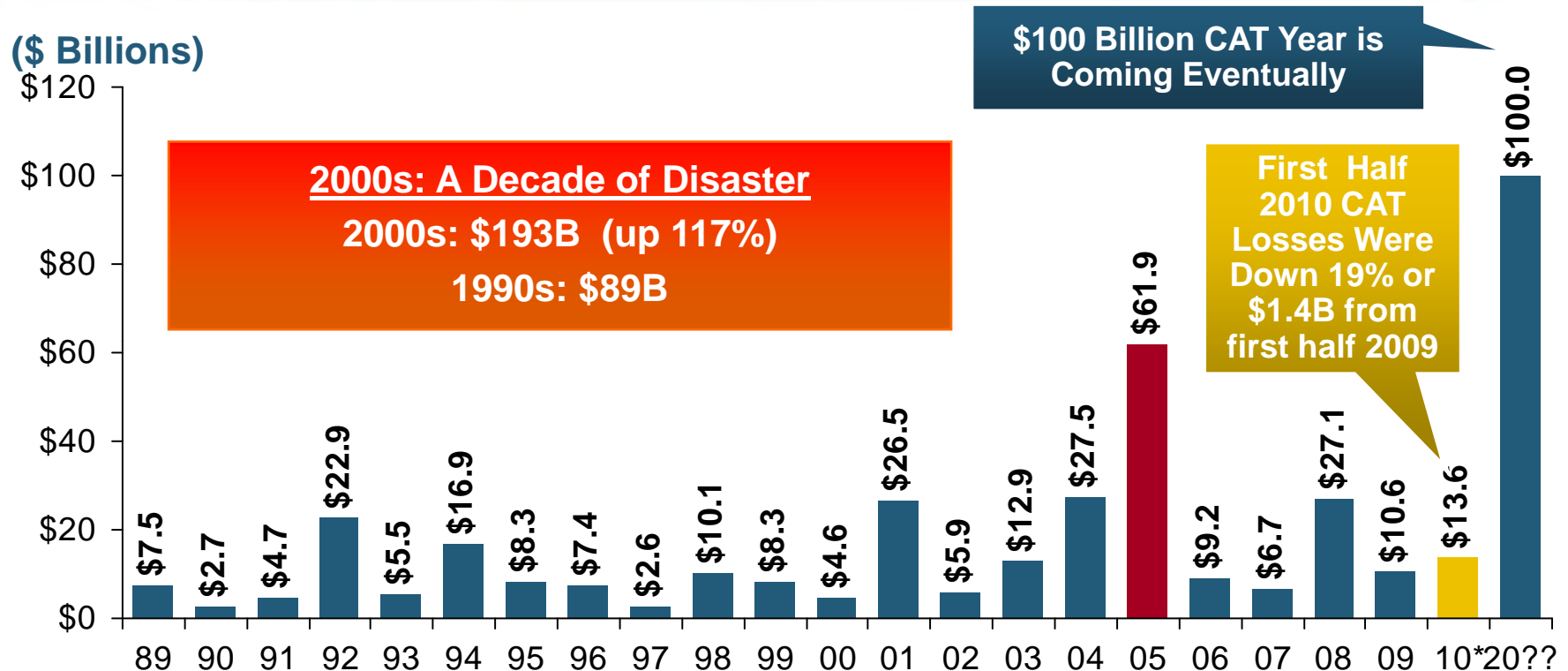


Note: Recessions indicated by gray bars.

Sources: NCCI from US Bureau of Labor Statistics; National Bureau of Economic Research

**Catastrophic Loss –
Catastrophe Losses Trends Are
Trending Adversely**

US Insured Catastrophe Losses



2010 CAT Losses Were Close to “Average”
Figures Do Not Include an Estimate of Deepwater Horizon Loss

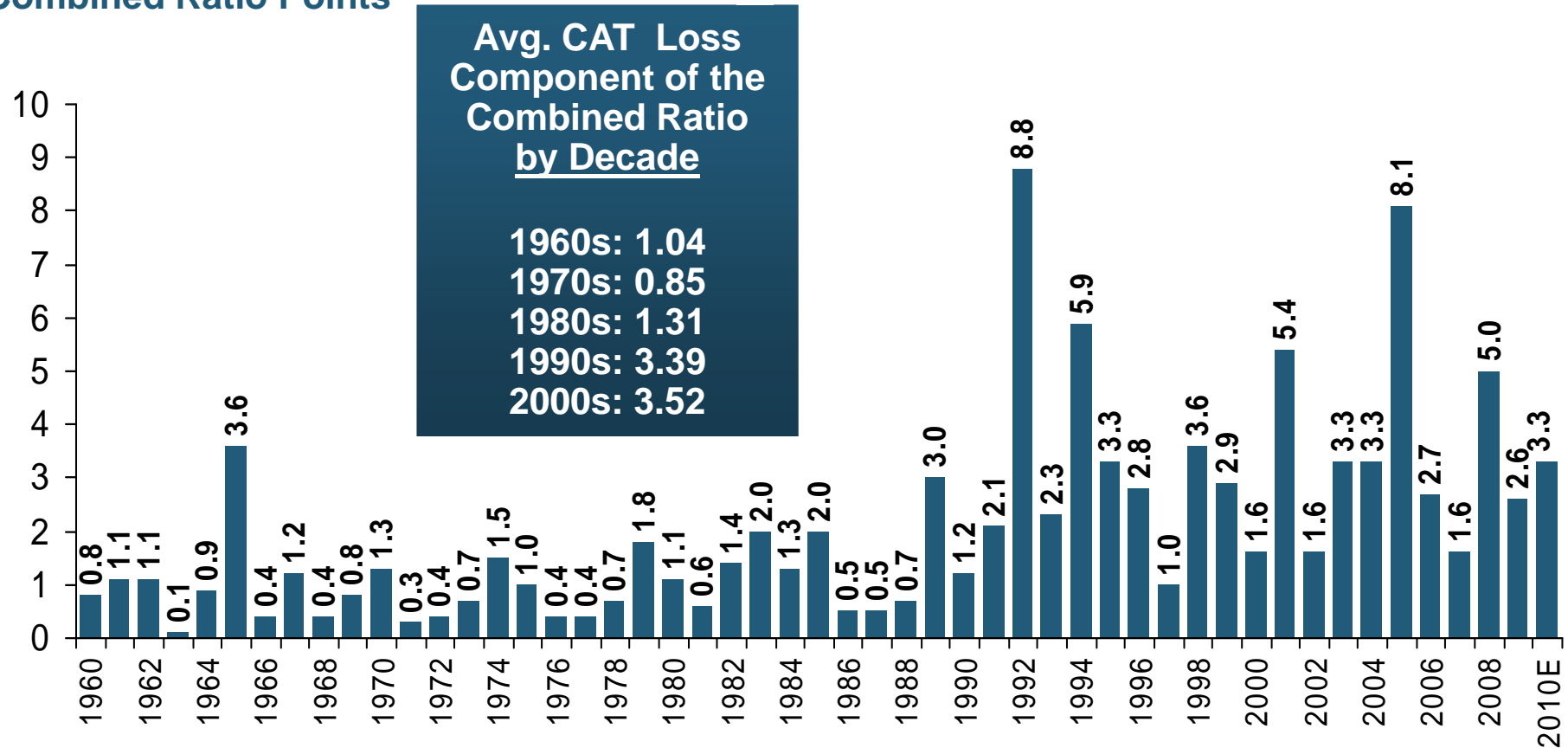
*Estimate from Munich Re.

Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B.

Sources: Property Claims Service/ISO; Munich Re; Insurance Information Institute.

Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2010E

Combined Ratio Points



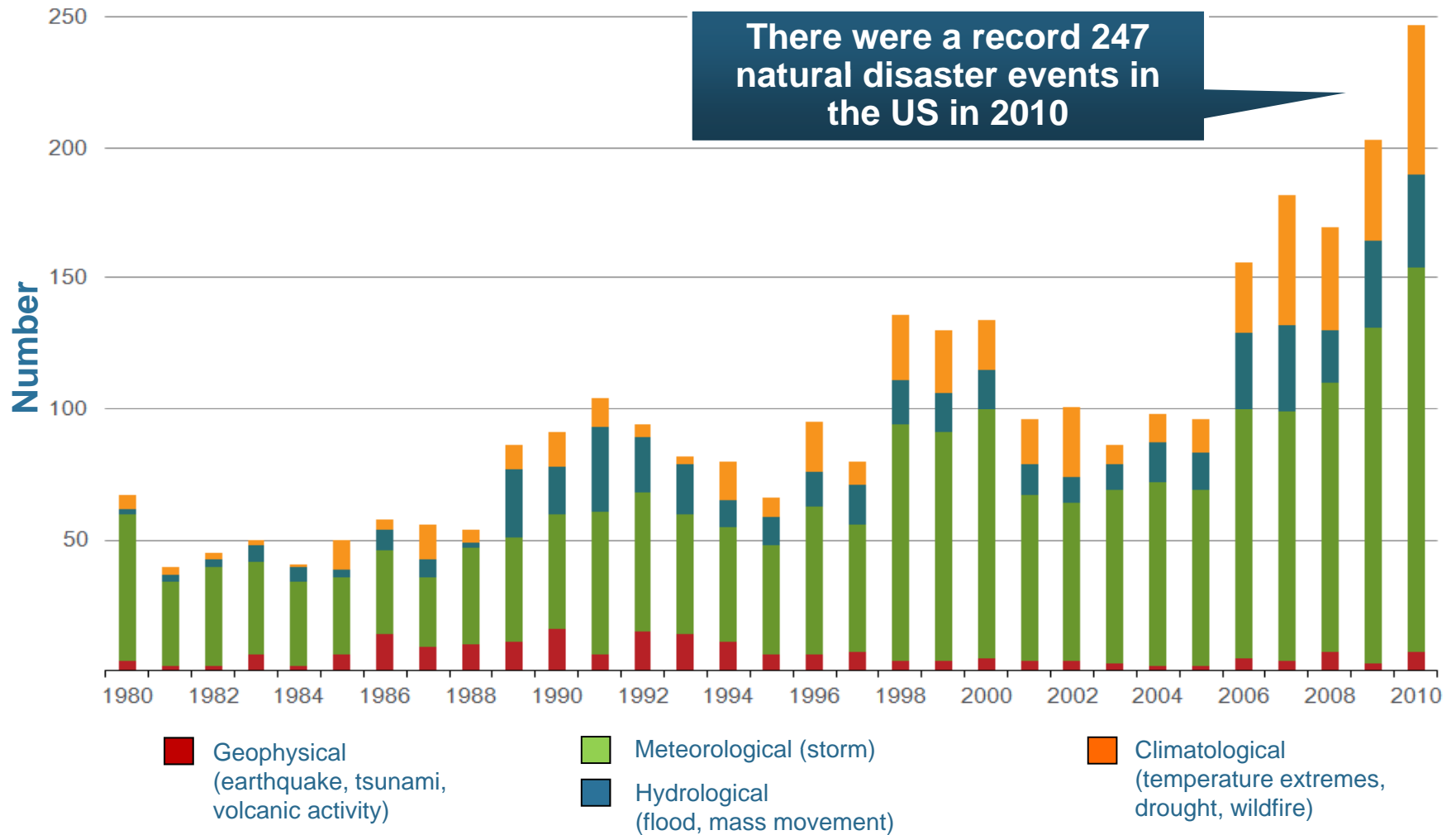
The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

Notes: Private carrier losses only. Excludes loss adjustment expenses and reinsurance reinstatement premiums. Figures are adjusted for losses ultimately paid by foreign insurers and reinsurers.

Source: ISO; Insurance Information Institute estimate for 2010.

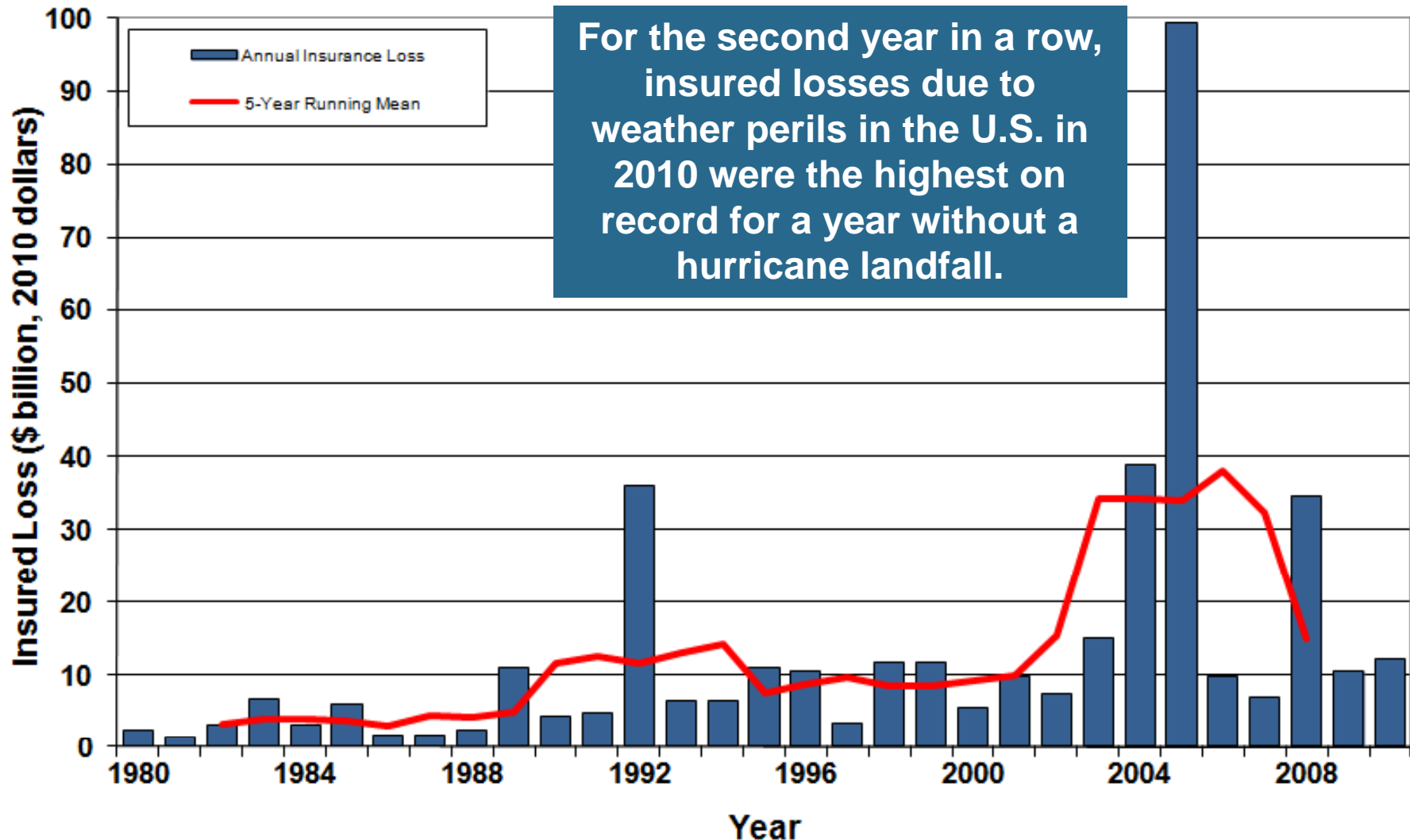
Natural Disasters in the United States, 1980 – 2010

Number of Events (Annual Totals 1980 – 2010)



Insured Losses Due to Weather Perils in the U.S.: 1980 – 2010

(Tropical Cyclone, Thunderstorm, and Winter Storm only)



Significant Natural Catastrophes, 2010

(\$1 Billion + Economic Loss and/or 50 Fatalities)

| Date (As of January 1, 2011) | Event | Estimated Economic Losses (US \$m) | Estimated Insured Losses (US \$m) |
|---------------------------------|---------------|------------------------------------|-----------------------------------|
| March 13 - 15 | Winter Storm | 1,700 | 1,225 |
| April 30 – May 3 | Thunderstorms | 2,700 | 800 |
| May 12 – 1 | Thunderstorms | 2,700 | 2,000 [†] |
| July 20 – 25 | Thunderstorms | 1,050 | 785 [†] |
| October 4 – 6 | Thunderstorms | 2,000 | 1,450 [†] |

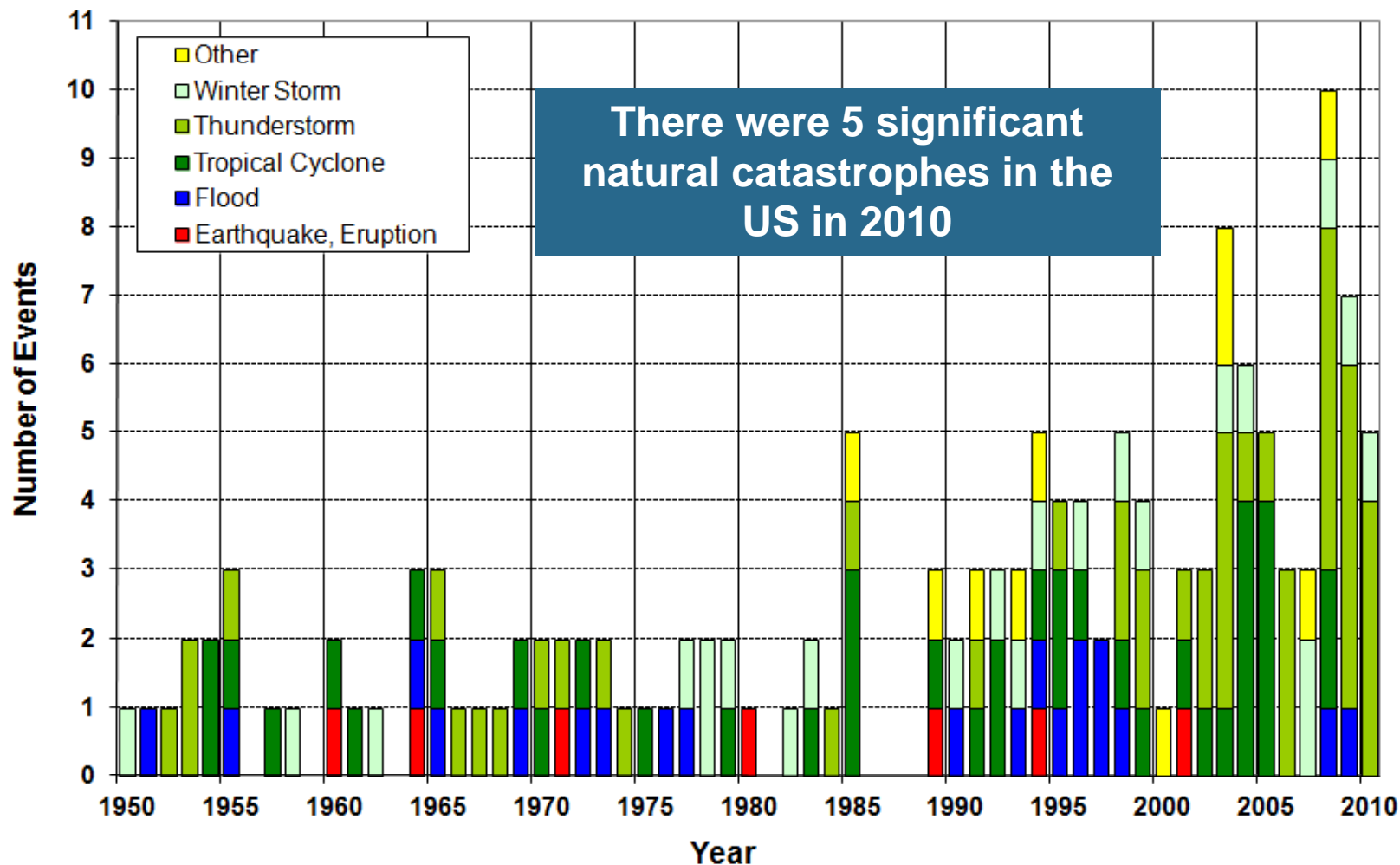
Sources: MR NatCat *SERVICE*,
[†] - Property Claims Services (PCS)

Natural Disasters in the United States, 2010 (Insured Losses)

| As of December 31, 2010 | Fatalities | Estimated Overall Losses (US \$m) | Estimated Insured Losses (US \$m) |
|-------------------------|------------|-----------------------------------|-----------------------------------|
| Severe Thunderstorms | 56 | 13,185 | 9,503 |
| Winter Storm | 64 | 3,734 | 2,625 |
| Flood | 68 | 2,933 | 1,059 |
| Wildfire | 1 | 314 | 210 |
| Earthquake | 0 | 200 | 128 |
| Tropical Cyclone | 8 | 200 | 120 |

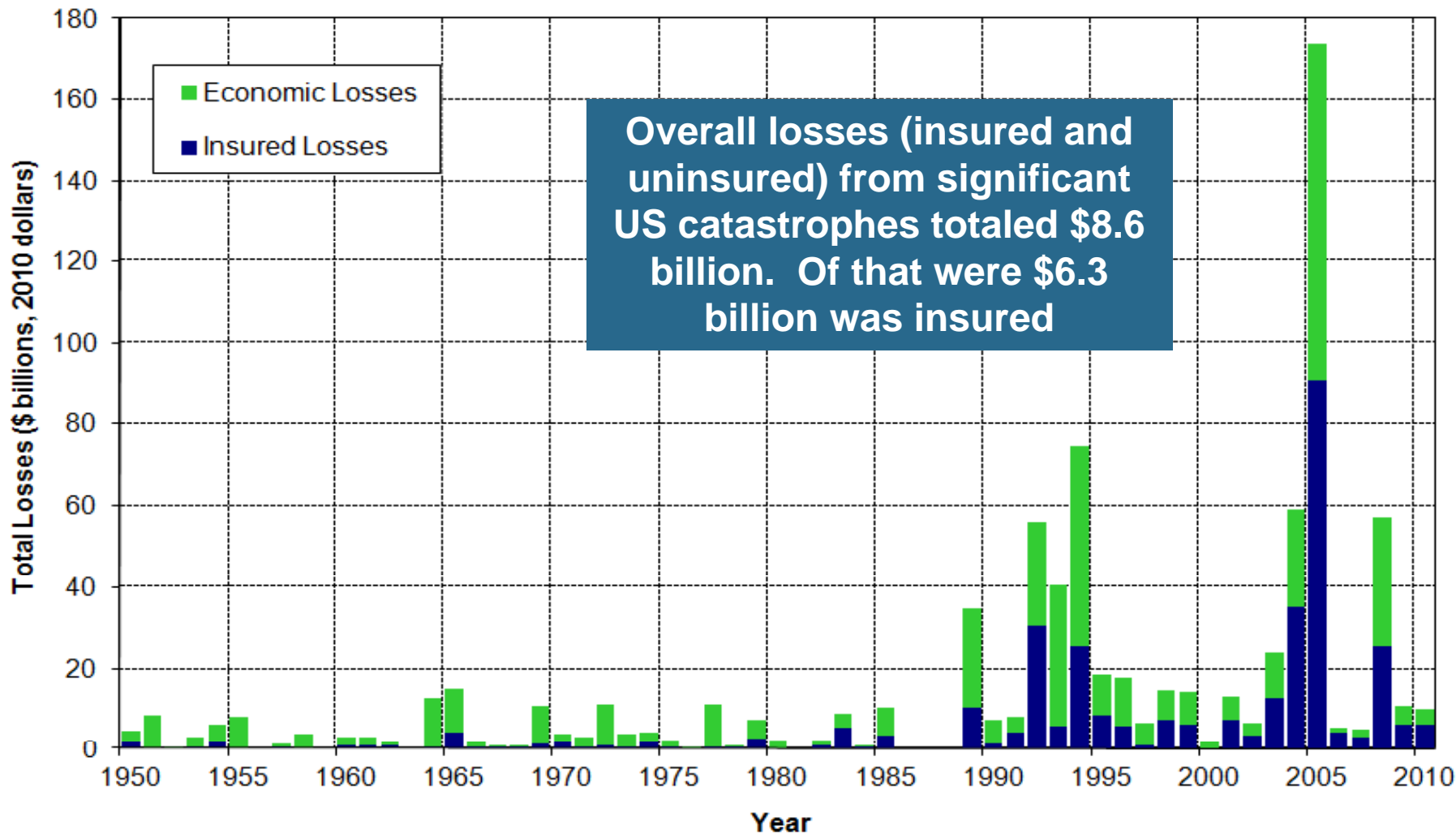
Significant Natural Catastrophes, 1950 – 2010

Number of Events (\$1 billion economic loss and/or 50 fatalities)

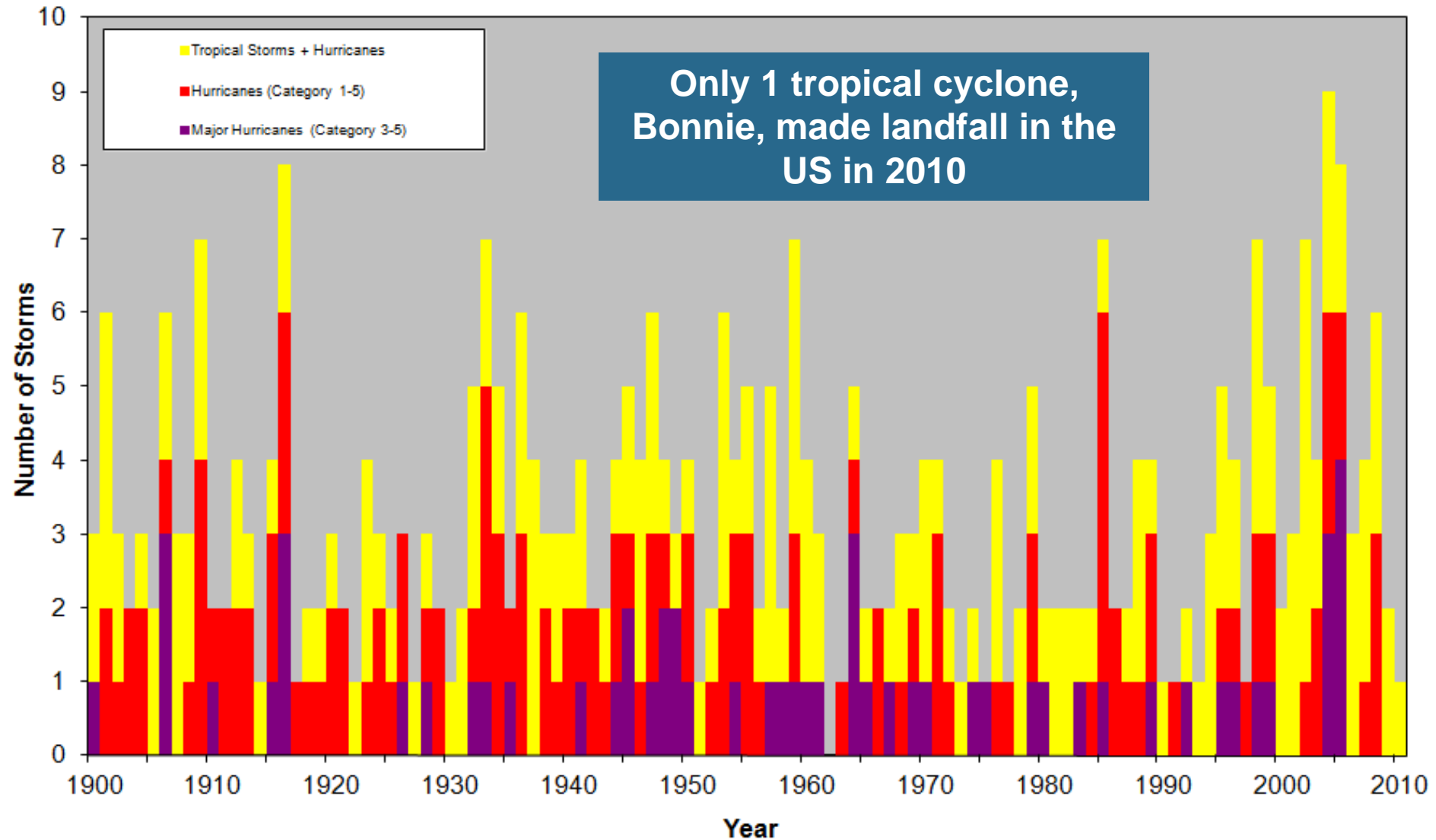


Significant Natural Catastrophes, 1950 – 2010

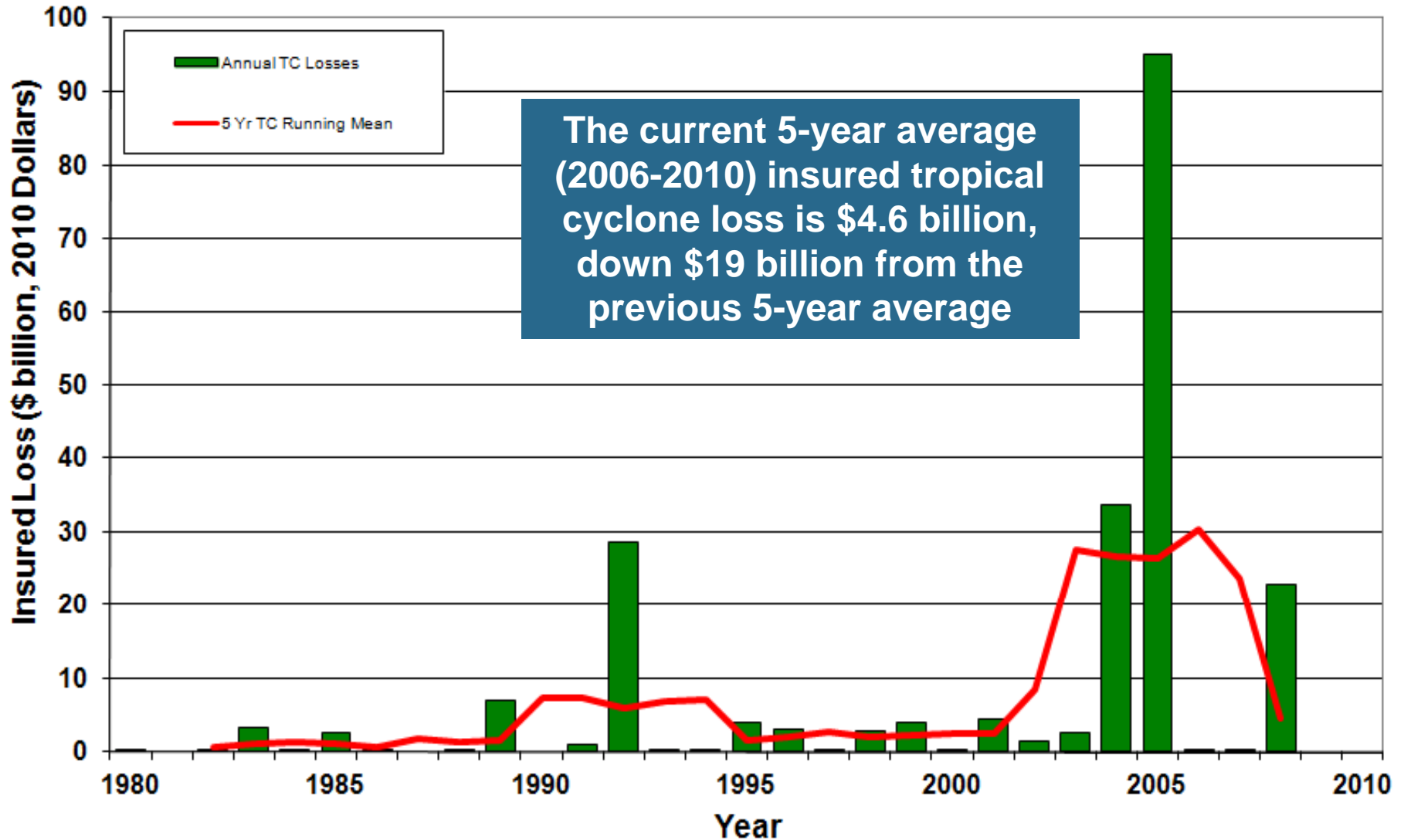
Losses (\$1 billion economic loss and/or 50 fatalities)



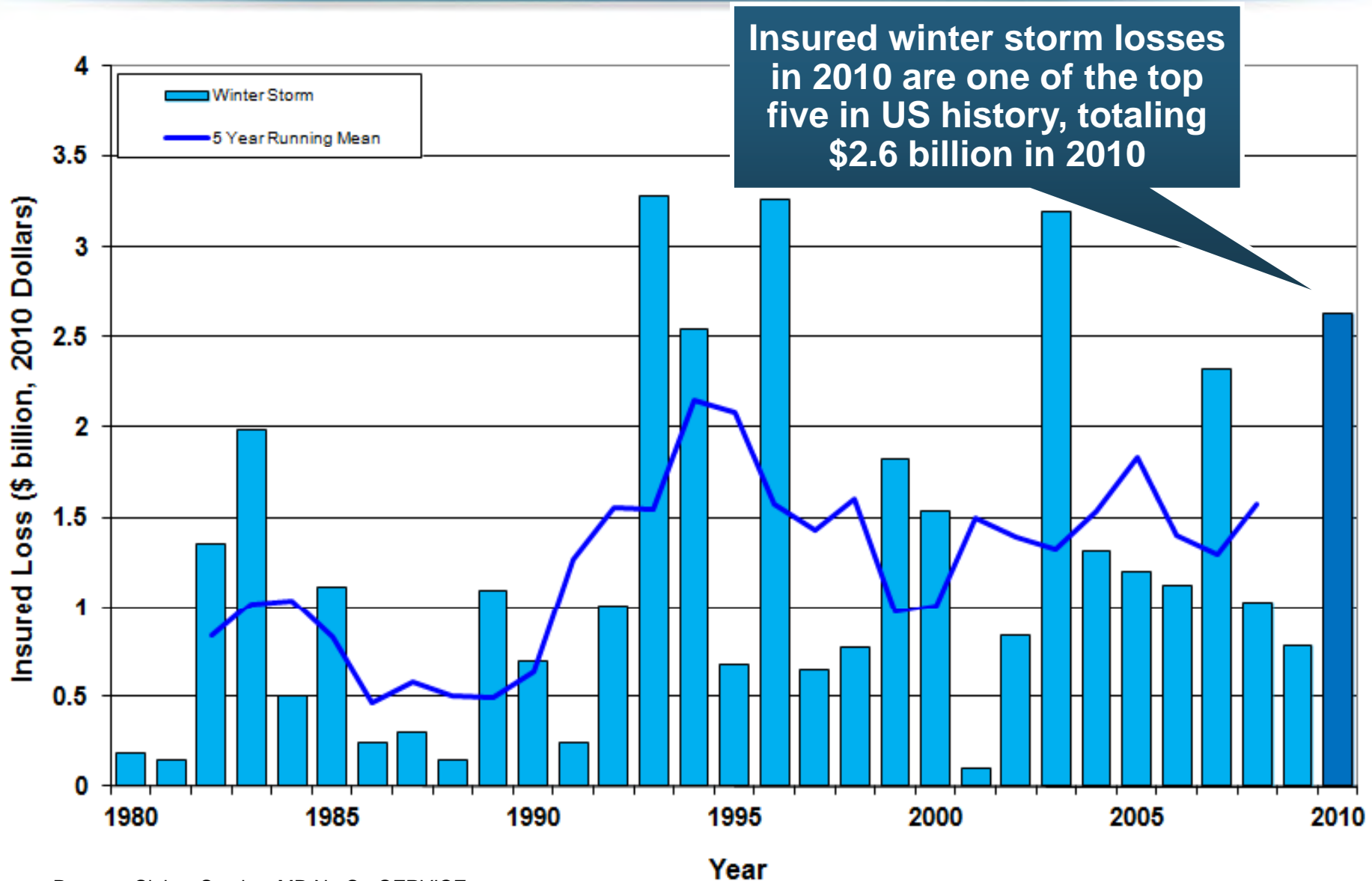
Number of U.S. Landfalling Tropical Cyclones, 1900 – 2010



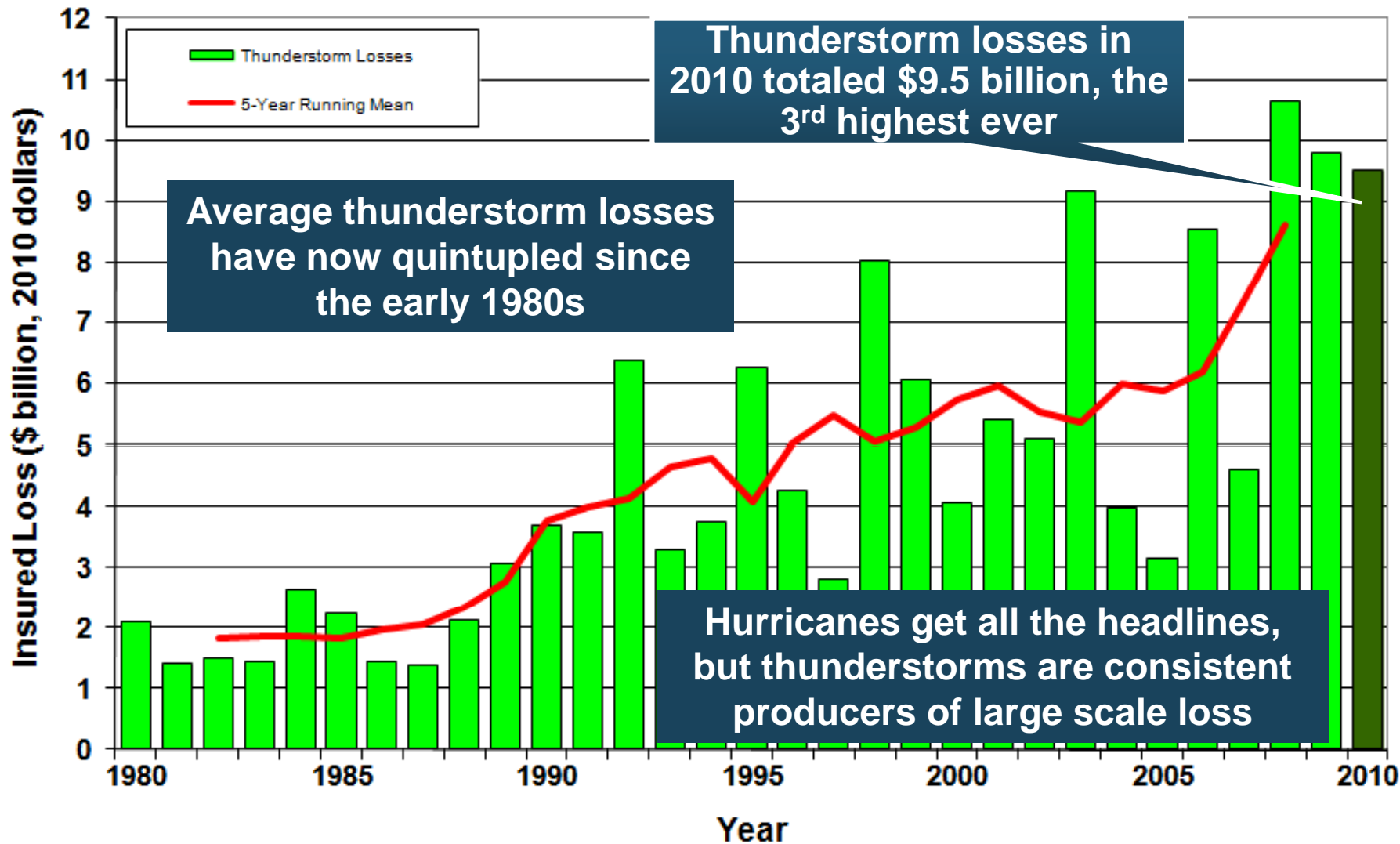
Insured U.S. Tropical Cyclone Losses, 1980 – 2010



U.S. Winter Storm Loss Trends, 1980 – 2010 (Annual Totals)

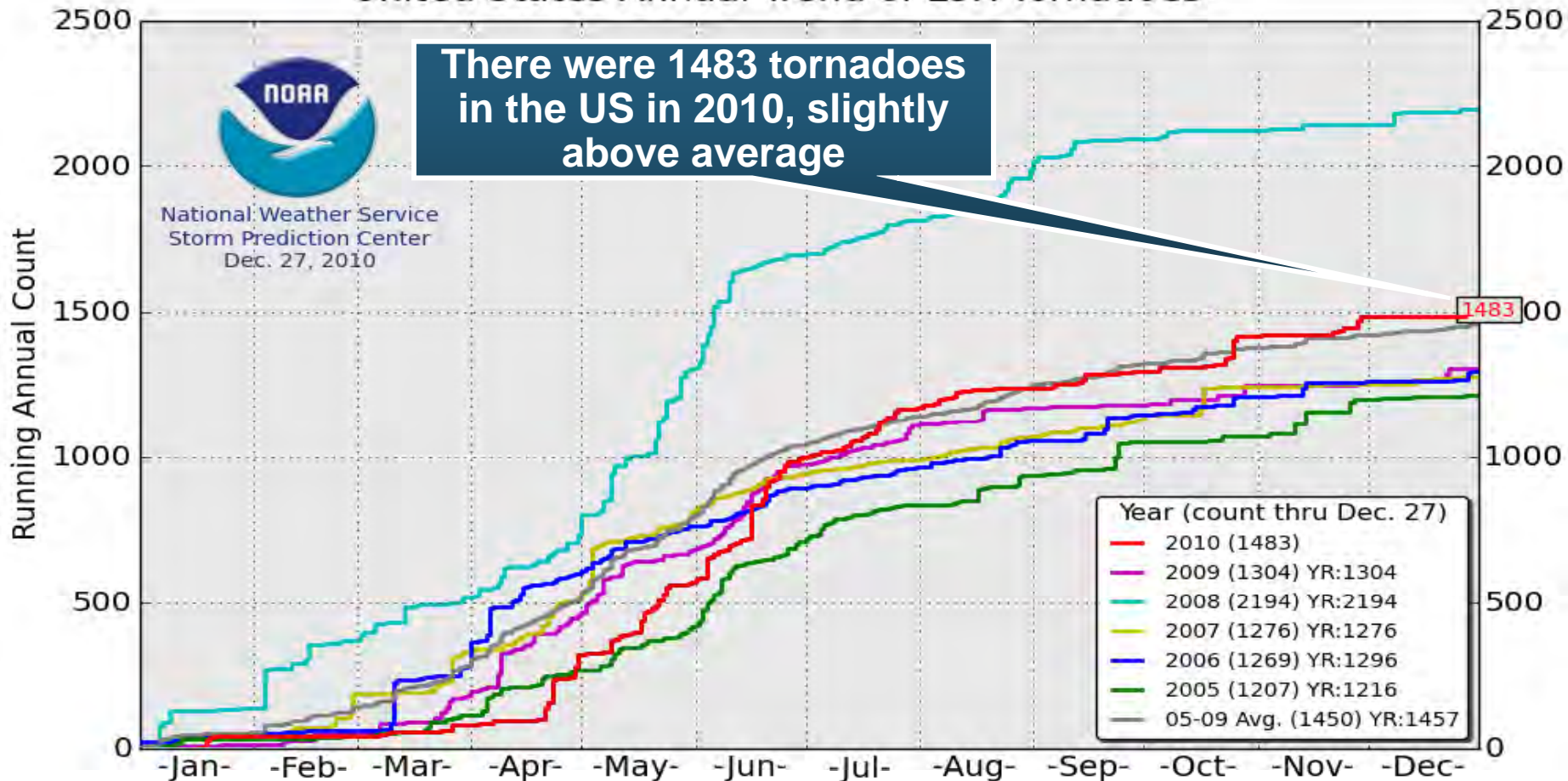


U.S. Thunderstorm Loss Trends, 1980 – 2010 (Annual Totals)



U.S. Tornado Count, 2010

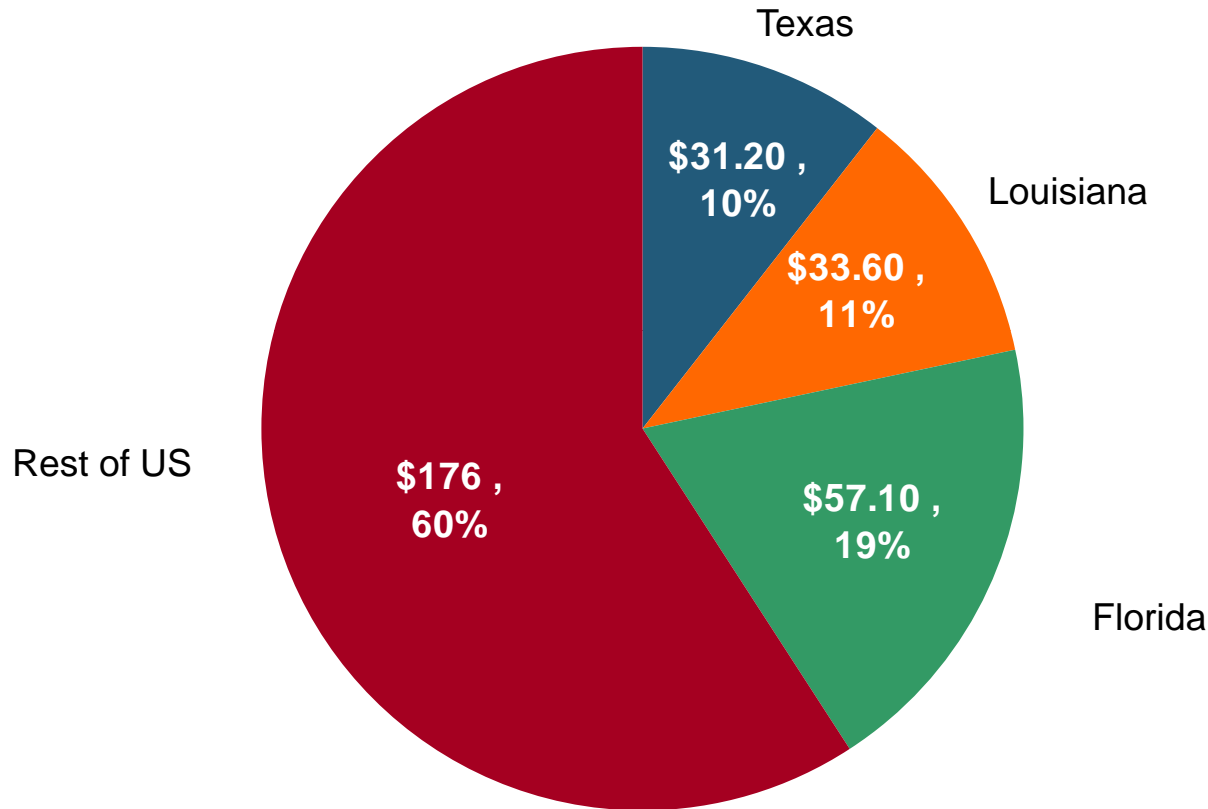
United States Annual Trend of LSR Tornadoes*



*Preliminary tornadoes from NWS Local Storm Reports (LSRs)
Annual average is based on preliminary LSRs, 2005-2009

Distribution of US Insured CAT Losses: TX, FL, LA vs. US, 1980-2008*

(\$ Billions)

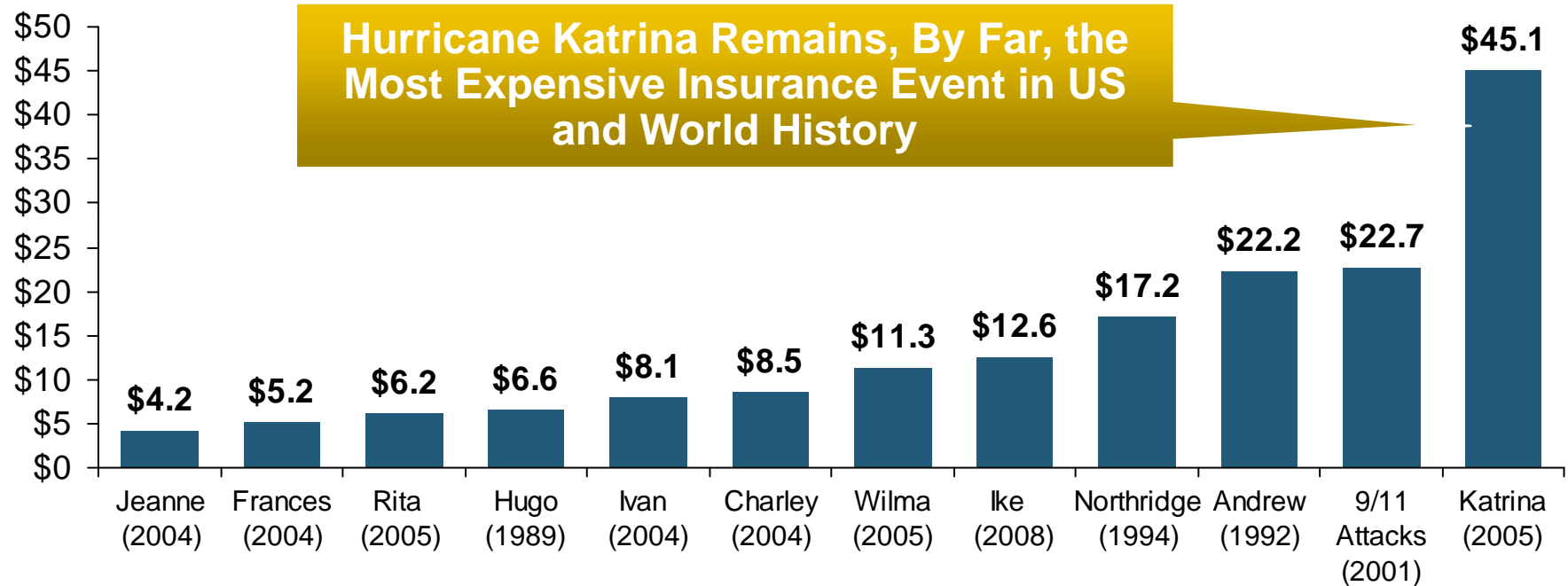


**Texas Accounted for 10% of All US Insured CAT Losses
from 1980-2008: \$57.1B out of \$297.9B**

* All figures (except 2006-2008 loss) have been adjusted to 2005 dollars.
Source: PCS division of ISO.

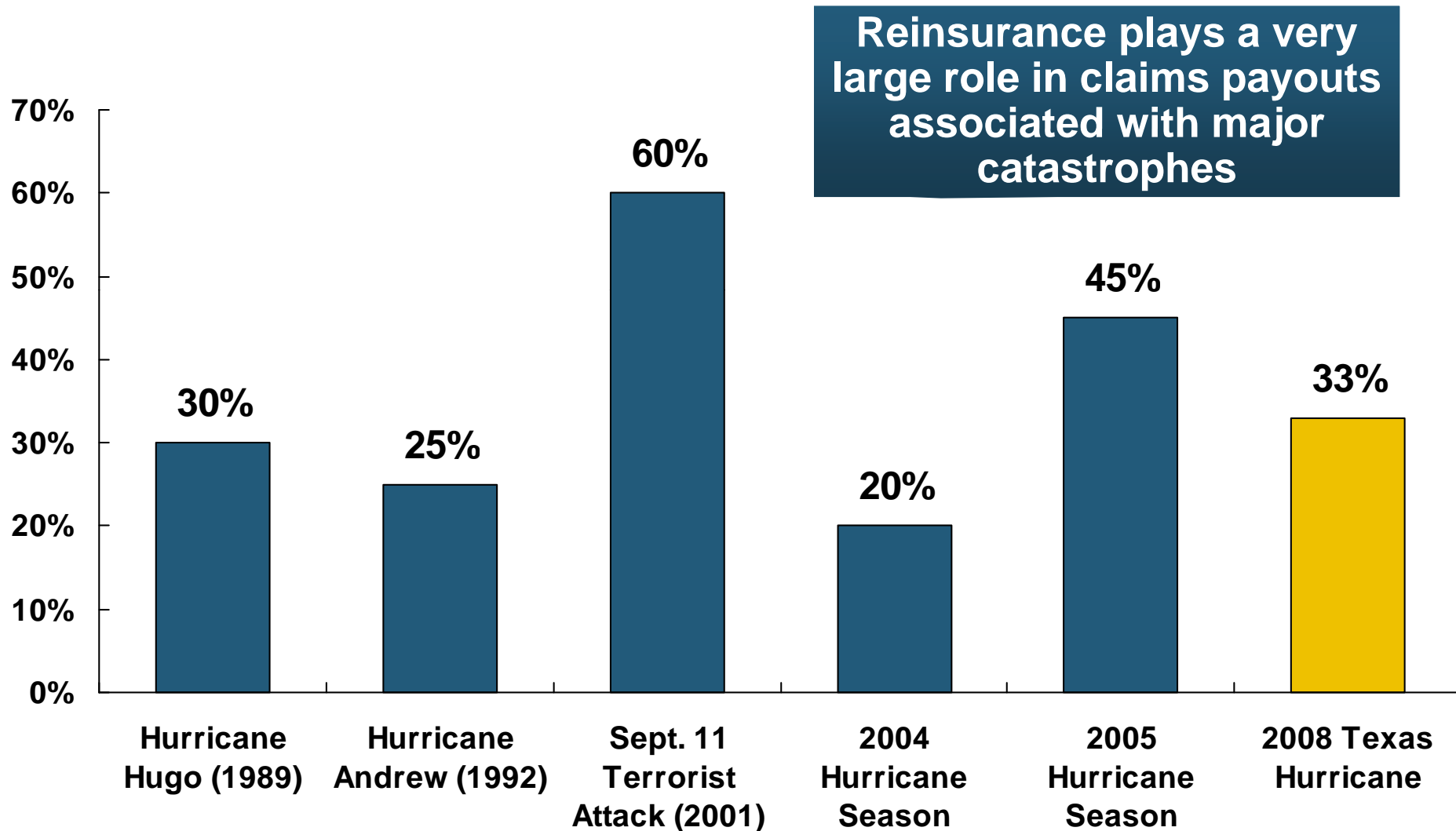
Top 12 Most Costly Disasters in US History

(Insured Losses, 2009, \$ Billions)



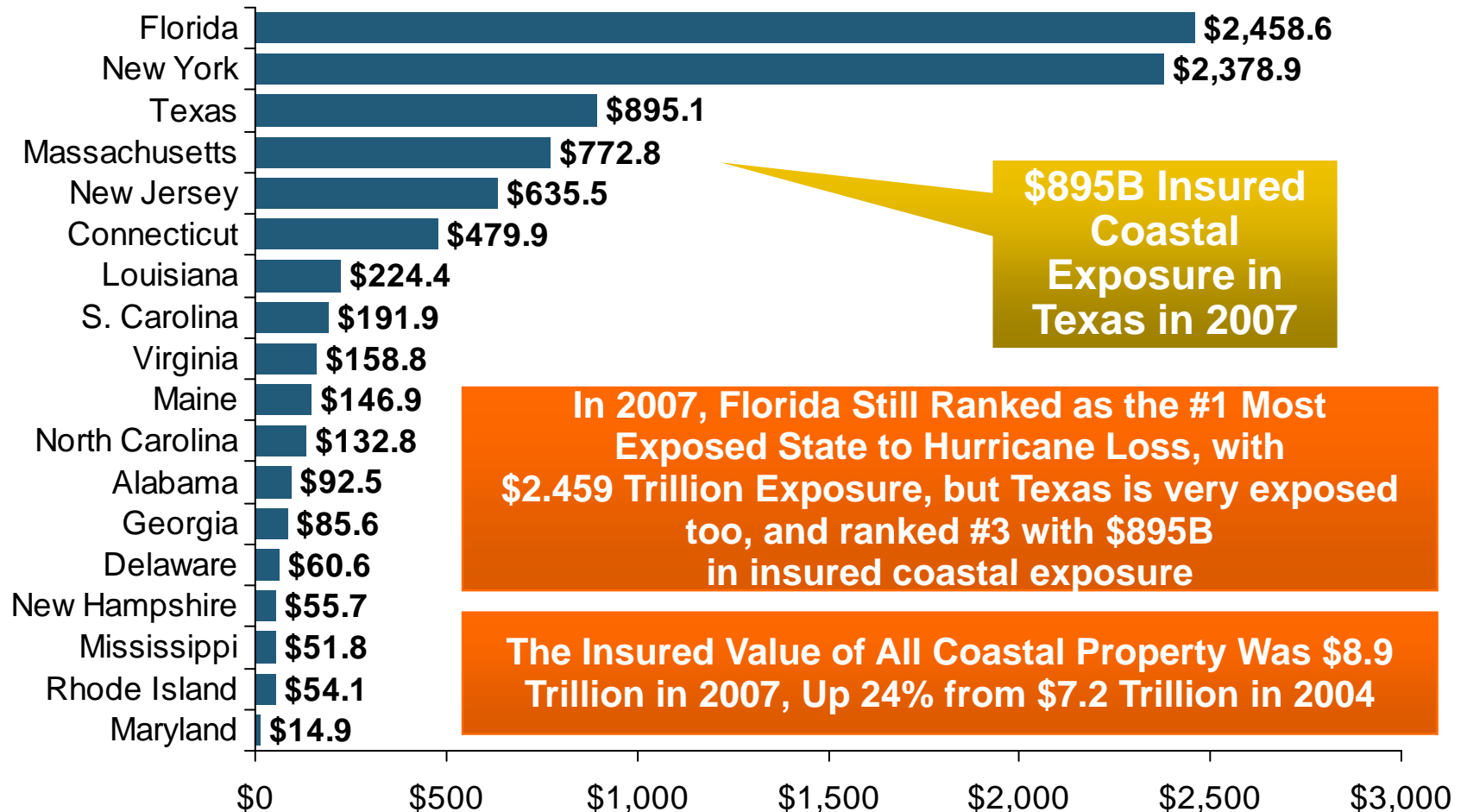
**8 of the 12 Most Expensive Disasters in US History
Have Occurred Since 2004;
8 of the Top 12 Disasters Affected FL**

Share of Losses Paid by Reinsurers for Major Catastrophic Events



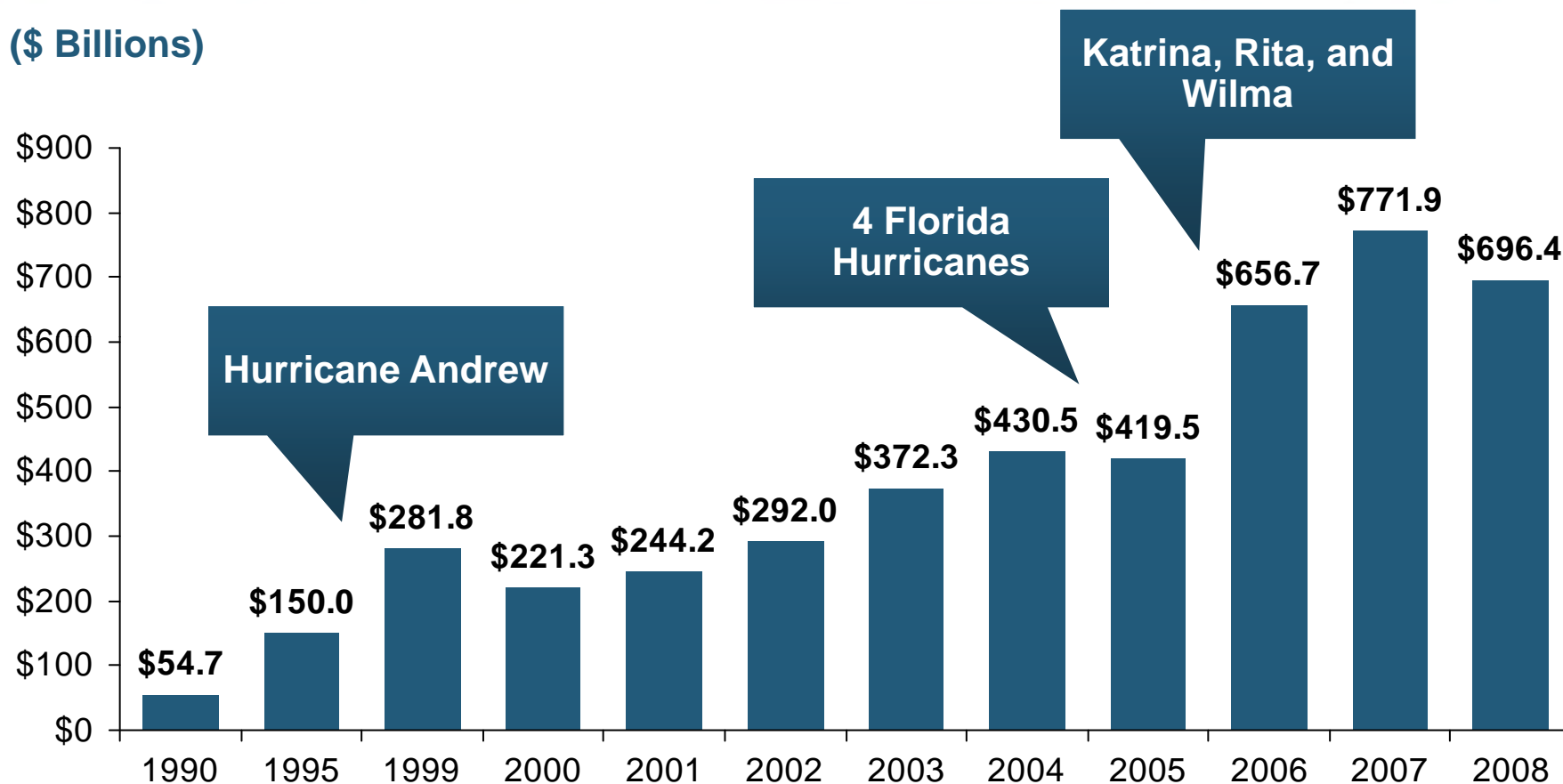
Total Value of Insured Coastal Exposure

(2007, \$ Billions)



US Residual Market Exposure to Loss

(\$ Billions)



In the 19-year Period Between 1990 and 2008, Total Exposure to Loss in the Residual Market (FAIR & Beach/Windstorm) Plans Has Surged from \$54.7B in 1990 to \$696.4B in 2008

Insurance Information Institute Online:

www.iii.org

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