Reasons for Optimism in the P-C Insurance Industry

Challenges & Opportunities: 2011 & Beyond

Professional Insurance Association of Ohio
Agency Management & Profitability Conference
Columbus, OH
September 23, 2010

Download at www.iii.org/presentations

Robert P. Hartwig, Ph.D., CPCU, President & Economist

Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038

Tel: 212.346.5520 ♦ Cell: 917.453.1885 ♦ bobh@iii.org ♦ www.iii.org

Presentation Outline

- **Reasons for Optimism, Causes for Concern**
- **Insurance Industry Financial Overview & Outlook**
  - Profitability
  - Premium Growth
  - Capital & Capacity
  - Underwriting Performance: Commercial & Personal Lines
  - Financial/Investment Review & Outlook
- **Financial Strength Overview**
- **Financial Services Reform: Impacts on the Insurance Industry**
- **Tort System Review: Overview and Causes for Concern**
- **Performance by Segment/Line**
  - Personal & Commercial Lines
- **The Global Economic Storm: Financial Crisis & Recession**
  - Crisis-Driven Exposure Issues: Personal & Commercial Lines
  - Exposure, Growth & Profitability
- **Catastrophe Losses**
- **Q&A**

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

- **Economic Recovery in US is Self-Sustaining: No Double Dip Recession**
- **Pessimism "Bubble" Persists; Negative Economic News Amplified; Positive News is Discounted**
  - **Financial market volatility will remain a reality**
- **Era of Mass P/C Insurance Exposure Destruction Has Ended**
  - **But restoration of destroyed exposure will take 3+ years in US**
- **No Secondary Spike in Unemployment or Swoon in Payrolls/WC Exposure**
  - **But job and wage growth remains sluggish**
- **Exposure Growth Will Begin in 2nd Half 2010, Accelerate in 2011**
- **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**
- **P/C Insurance Industry Will See Growth in 2011 for the First Time Since 2006**
- **Investment Environment Is/Remains Much More Favorable**
  - **Volatility, however, will persist and yields remain low**
  - **Both are critical issues in long-tailed commercial lines like WC, Med Mal, D&O**

Source: Insurance Information Institute.

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

INSURANCE INFORMATION INSTITUTE

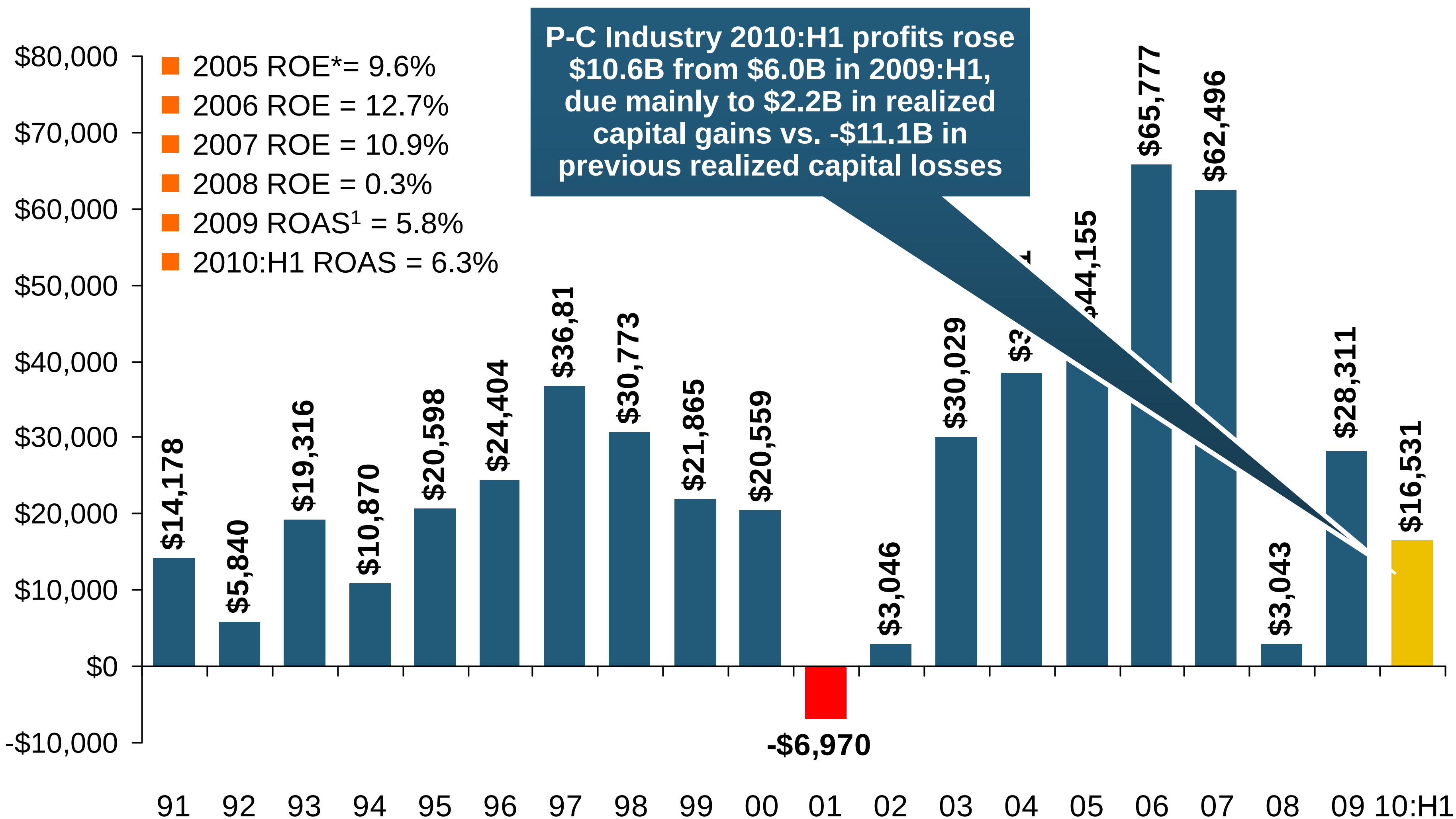
- **P/C Insurance Industry Capacity as of 6/30/10 Is at Record Levels and Has Recovered 100%+ of the Capital Lost During the Financial Crisis**
  - As of 12/31/09 capacity was within 2% of pre-crisis high
- **Record Capacity, Depressed Exposures Mean that Generally Soft Market Conditions Will Persist through 2010 and Potentially into 2011**
- **There is No Catalyst for a Robust Hard Market at the Current Time**
- **High Global First Half 2010 CAT Losses Insufficient to Trigger Hard Market**
  - Localized insurance and reinsurance impacts are occurring, especially earthquake coverage in Latin/South America, Offshore Energy Markets, European Wind Cover
- **Inflation Outlook for US and Major European Economies and Japan is Tame**
  - Will temper claims inflation
  - Deflation is highly unlikely
- **Financial Strength & Ratings of Global (Re)Insurance Industries Remained Strong Throughout the Financial Crisis in Sharp Contrast With Banks**
- **Insurers Avoided the Most Draconian Outcomes in Financial Services Reform Legislation**
- **Tort Environment in US is Beginning to Deteriorate; No Tort Reform in US**
- **Major Transformation of US Economy Underway with Major Opportunities for Insurers through 2020 in Health, Tech, Natural Resources, Energy**

Source: Insurance Information Institute.

Profitability

Historically Volatile

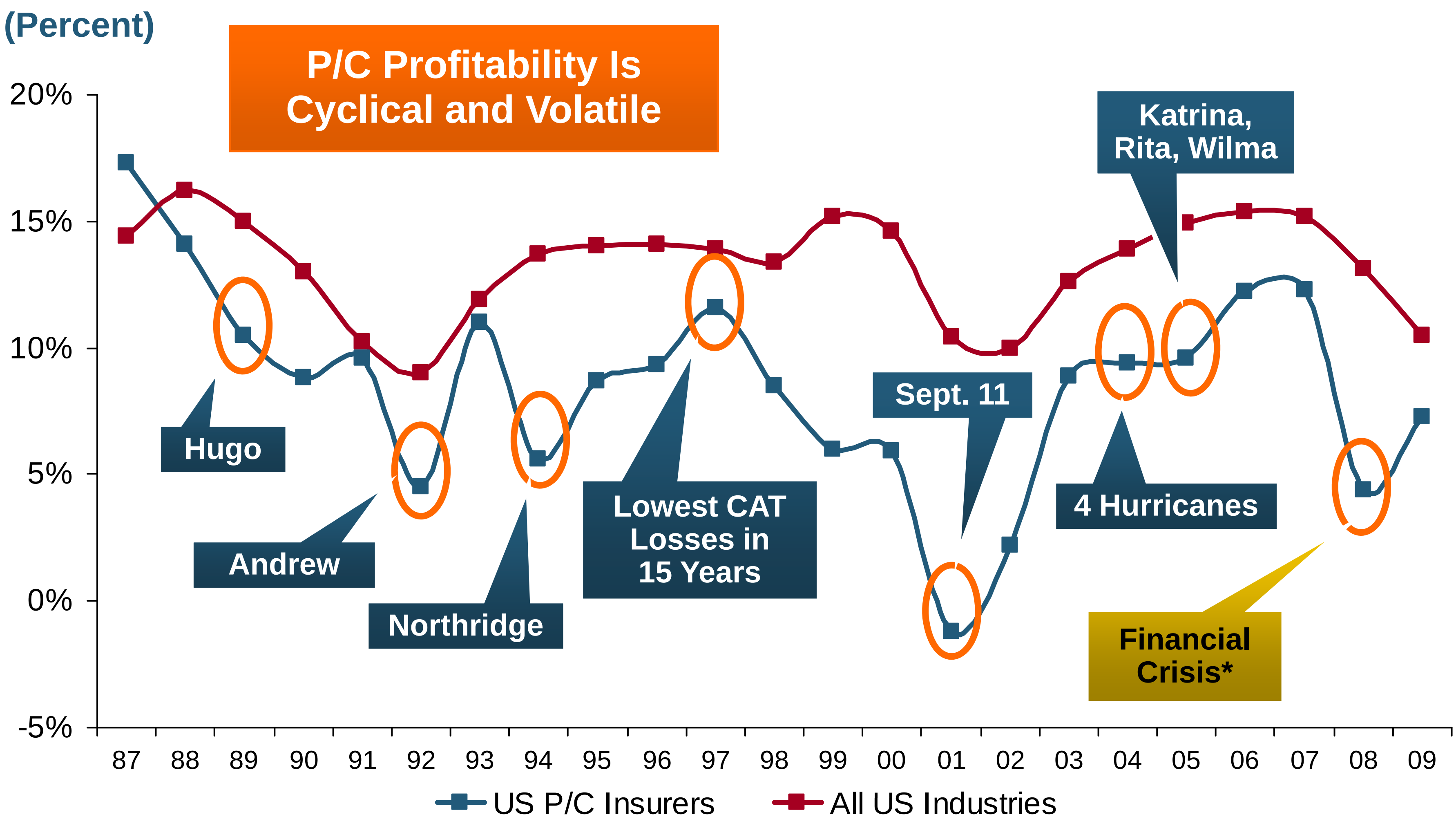
P/C Net Income After Taxes 1991–2010:H1 ($ Millions)



* ROE figures are GAAP; [1]Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.5% ROAS for 2010:H1 and 4.6% for 2009. 2009:H1 net income was $19.2 billion and $10.2 billion in 2008:H1 excluding M&FG.

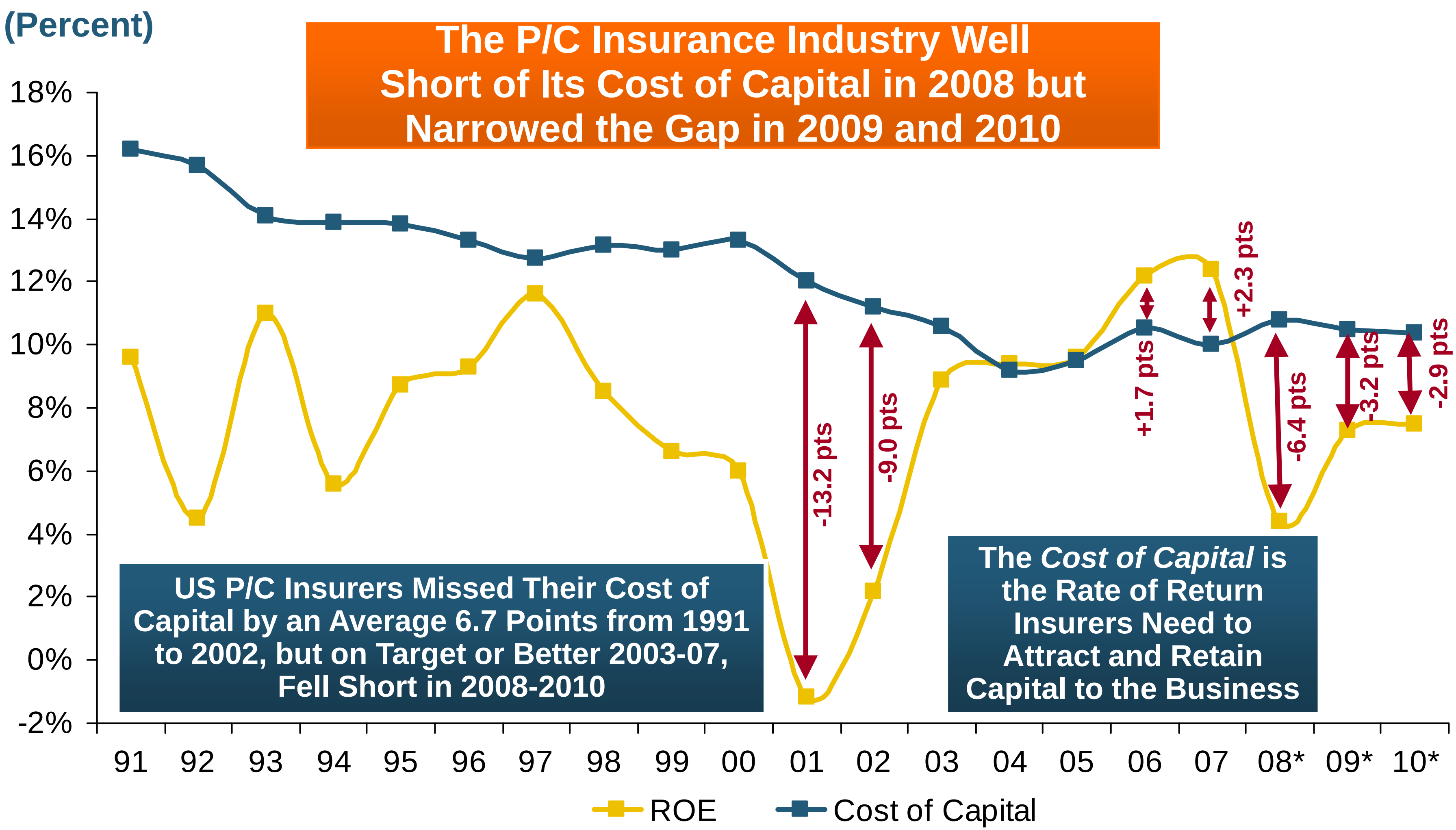
Sources: A.M. Best, ISO, Insurance Information Institute

ROE: P/C vs. All Industries 1987–2009*



* Excludes Mortgage & Financial Guarantee in 2008 and 2009.
Sources: ISO, *Fortune*; Insurance Information Institute.

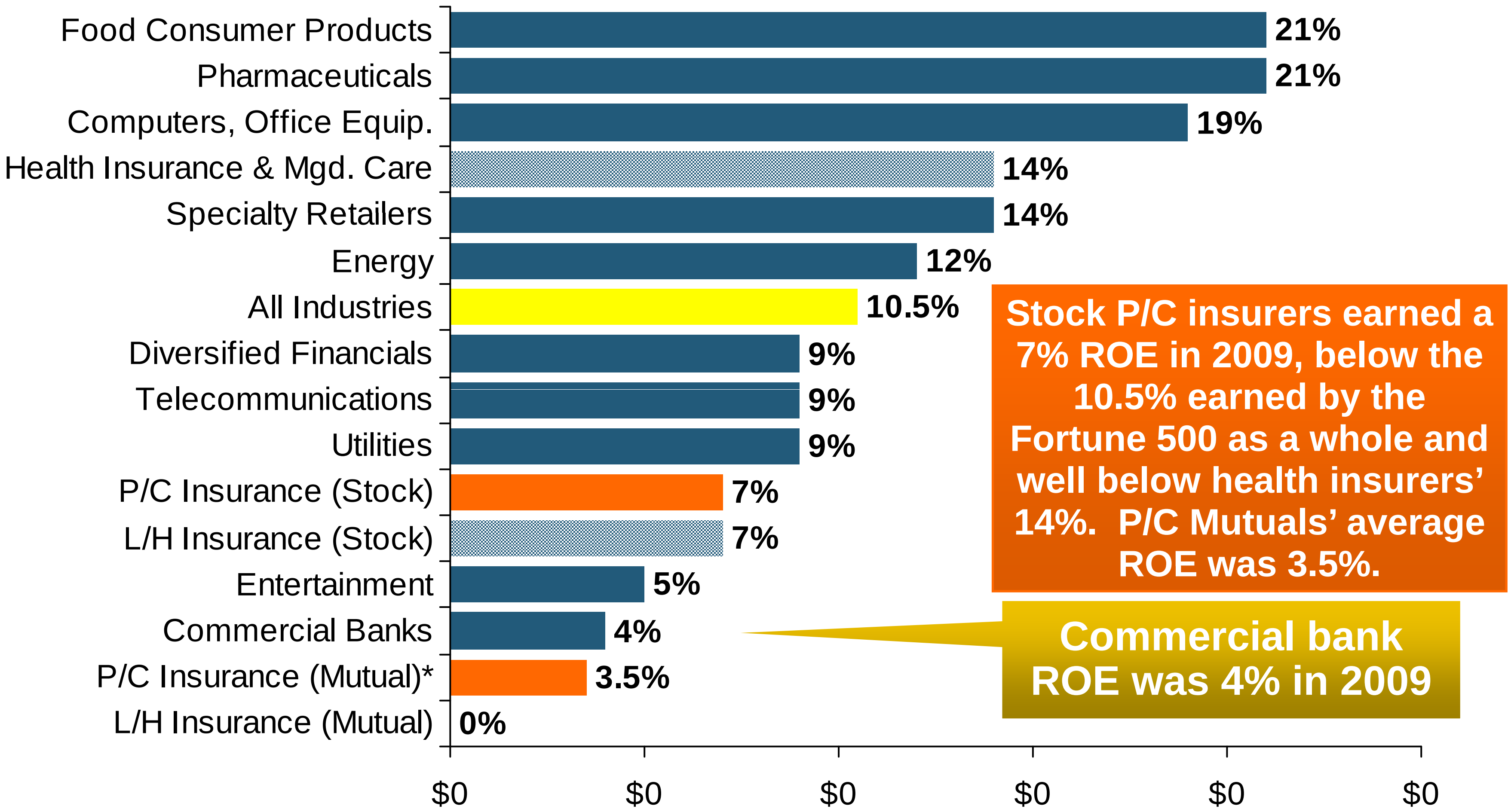
ROE vs. Equity Cost of Capital: U.S. P/C Insurance:1991-2010:H1*



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

Median ROE for Insurers vs. Financial Firms & Other Key Industries 2009

(Profits as a % of Stockholders' Equity)



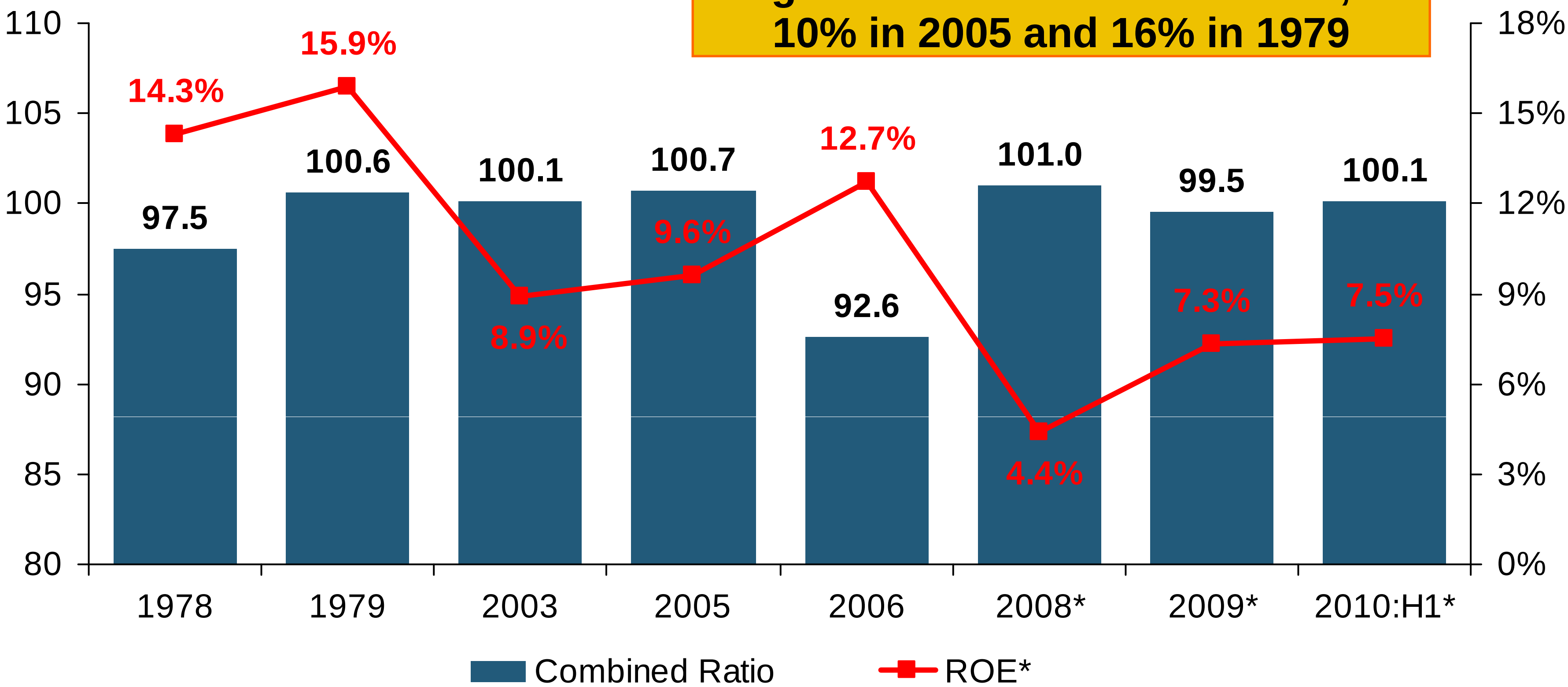
Source: *Fortune*, May 3, 2010; Insurance Information Institute.

A 100 Combined Ratio Isn’t What It Once Was: 90-95 Is Where It’s At Now

INSURANCE INFORMATION INSTITUTE

A combined ratio of about 100 generated a 7% ROE in 2009, 10% in 2005 and 16% in 1979

Combined Ratio / ROE



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

* 2009 and 2010:Q1 figures are return on average statutory surplus. 2008, 2009 and 2010:H1figures exclude mortgage and financial guaranty insurers

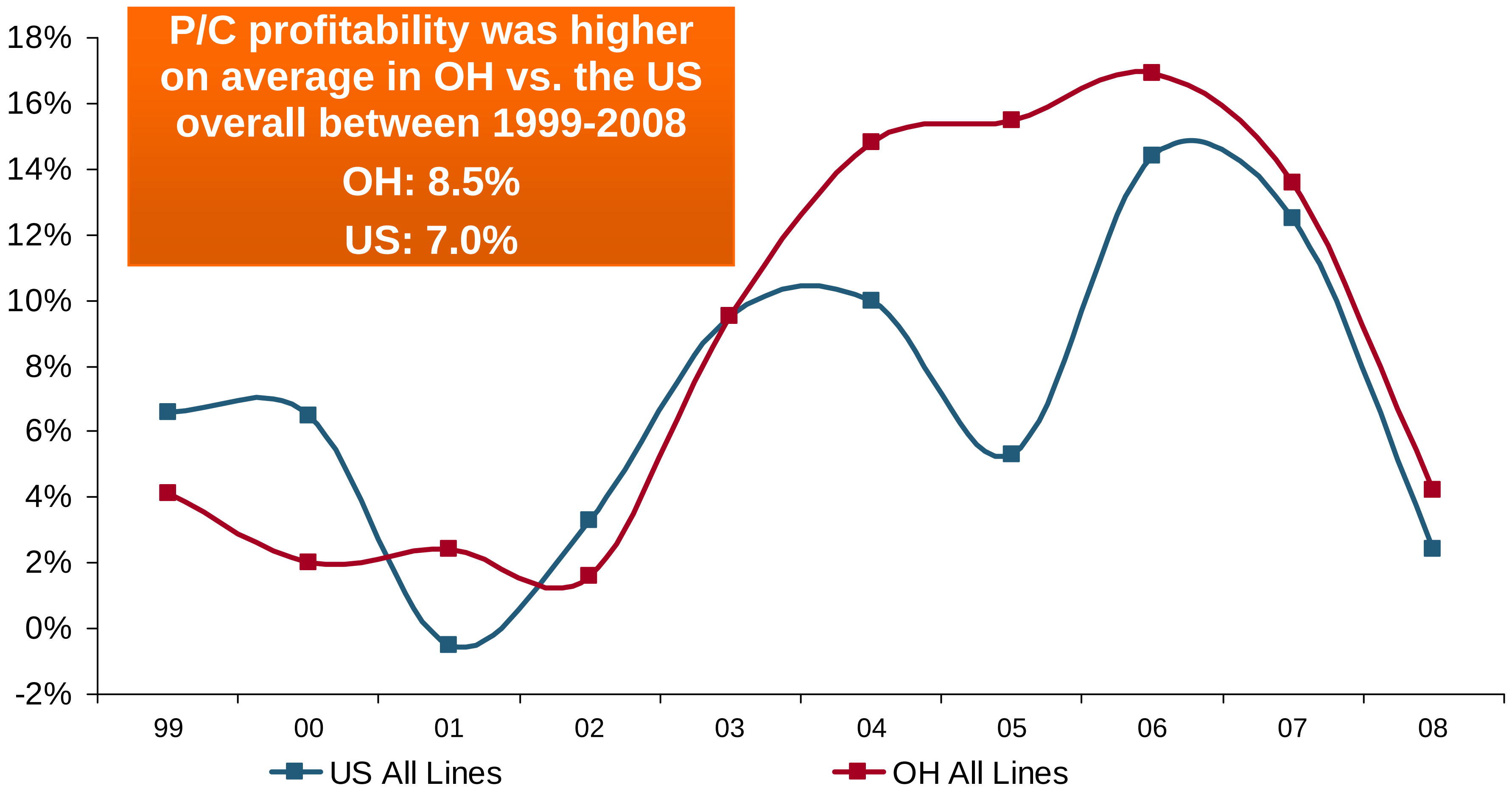
Source: Insurance Information Institute from A.M. Best and ISO data.

Profitability in Ohio P/C Insurance Markets

Analysis by Line and Nearby State Comparisons

RNW All Lines: OH vs. U.S., 1999-2008

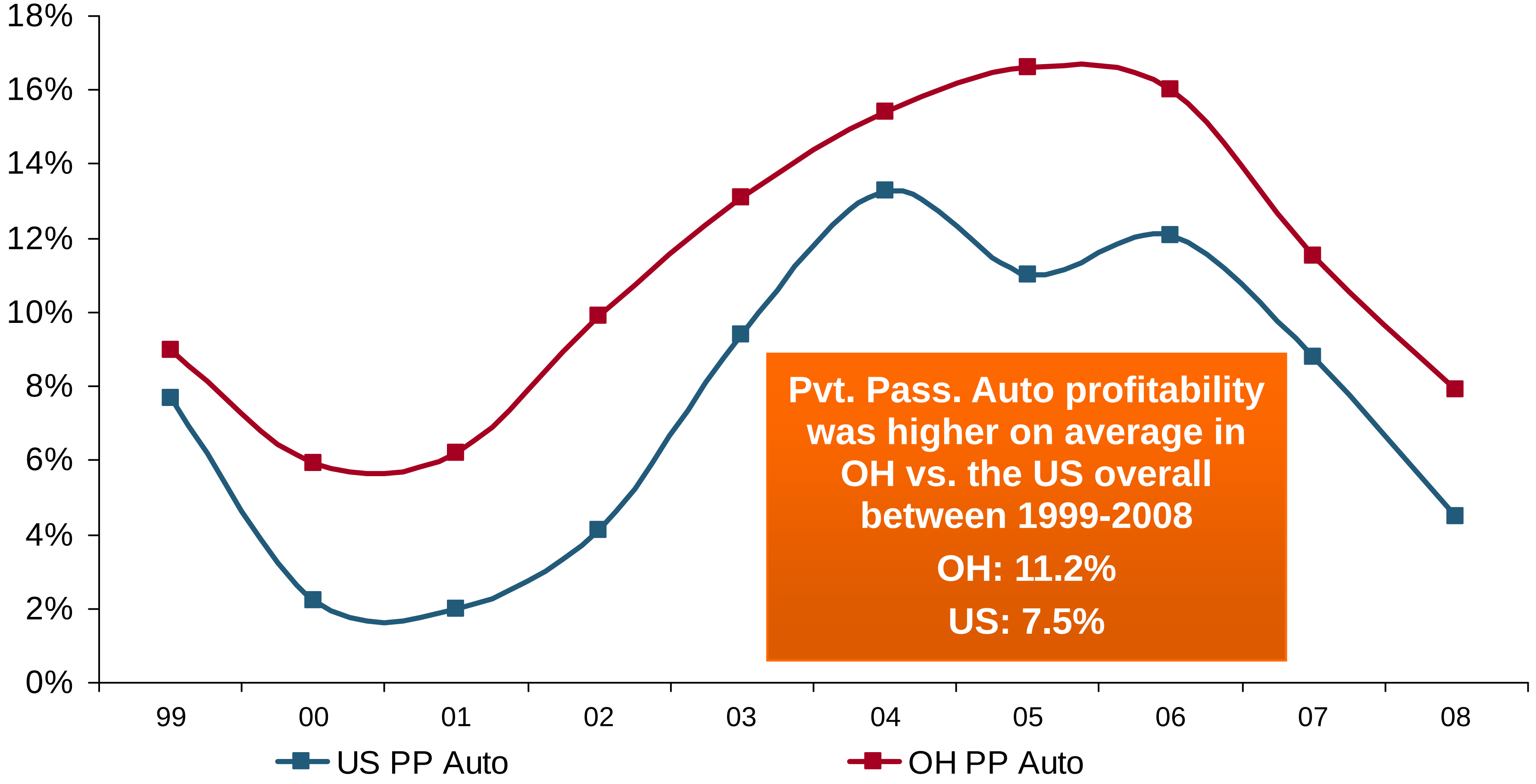
(Percent)



Sources: NAIC.

RNW PP Auto: OH vs. U.S., 1999-2008

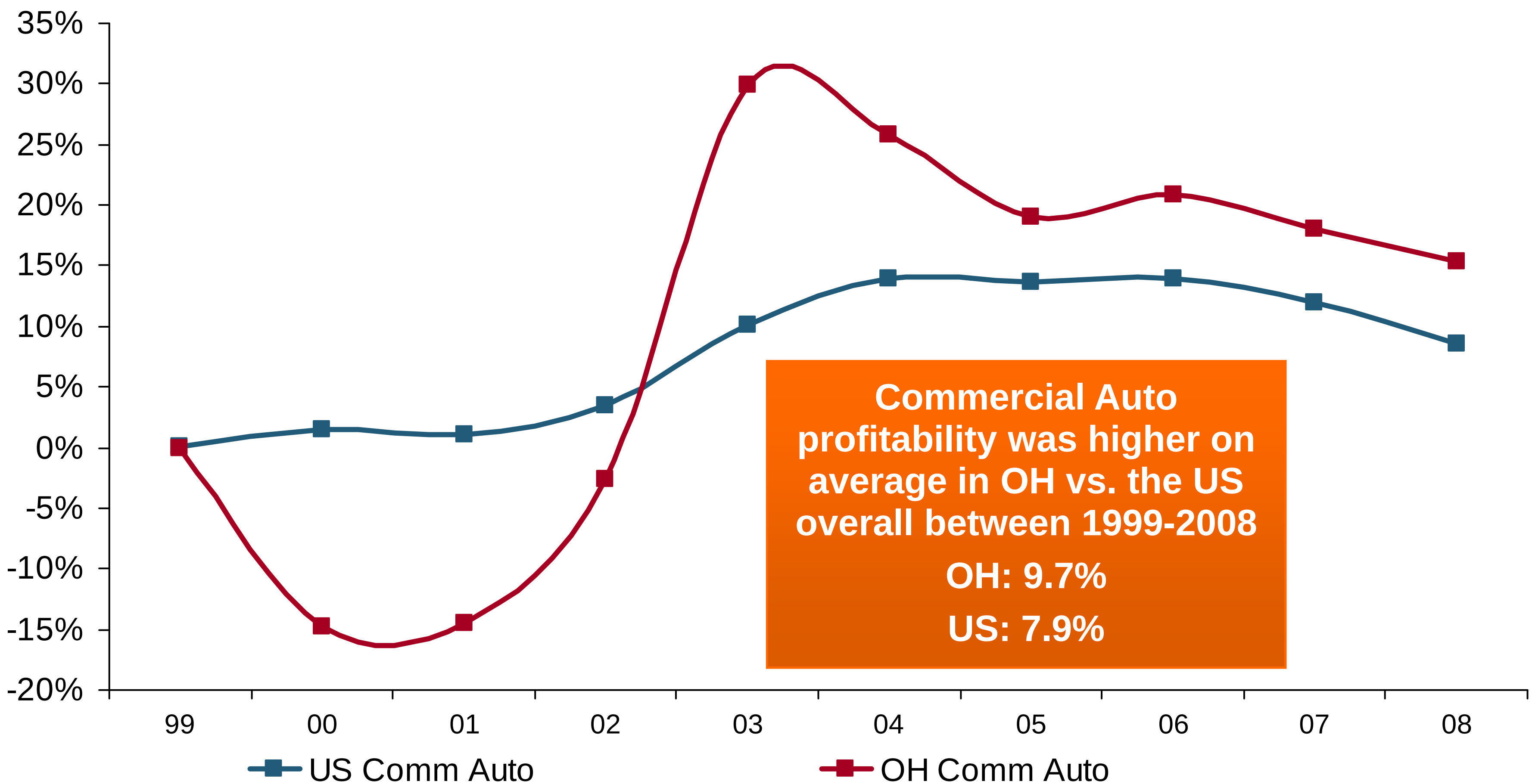
(Percent)



Sources: NAIC.

RNW Comm. Auto: OH vs. U.S., 1999-2008

(Percent)

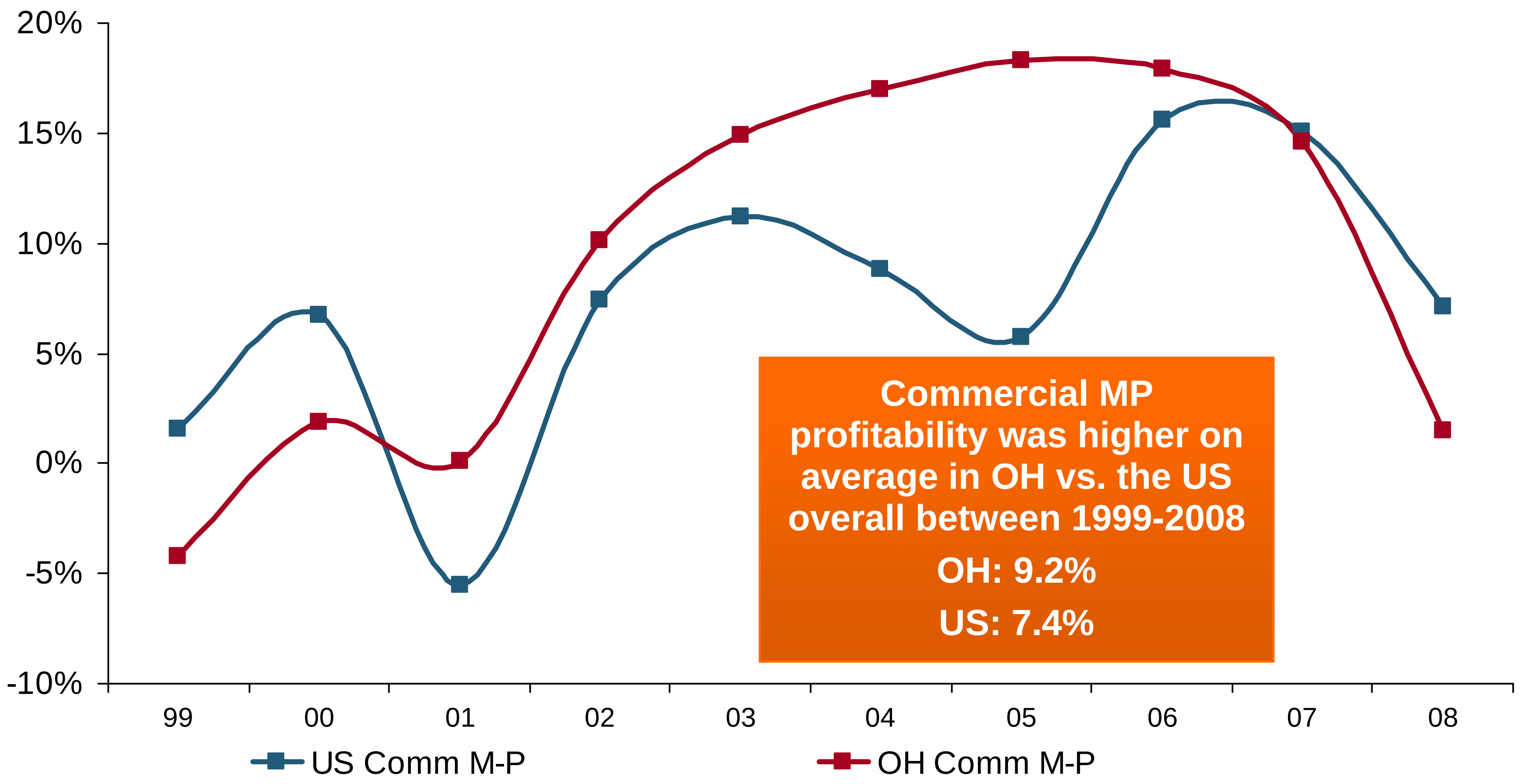


Sources: NAIC.

RNW Commercial Multi-Peril: OH vs. US: 1999-2008

INSURANCE INFORMATION INSTITUTE

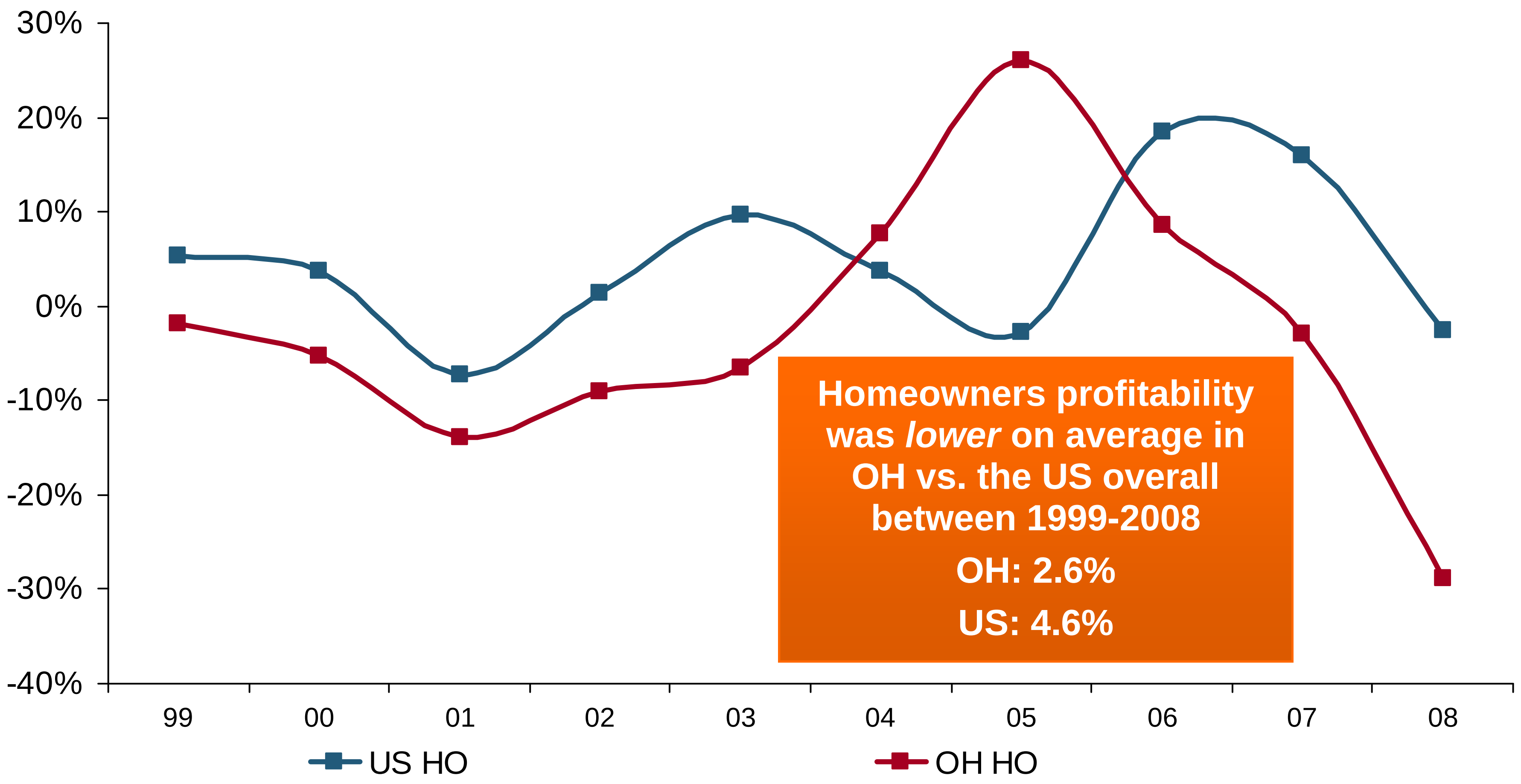
(Percent)



Sources: NAIC.

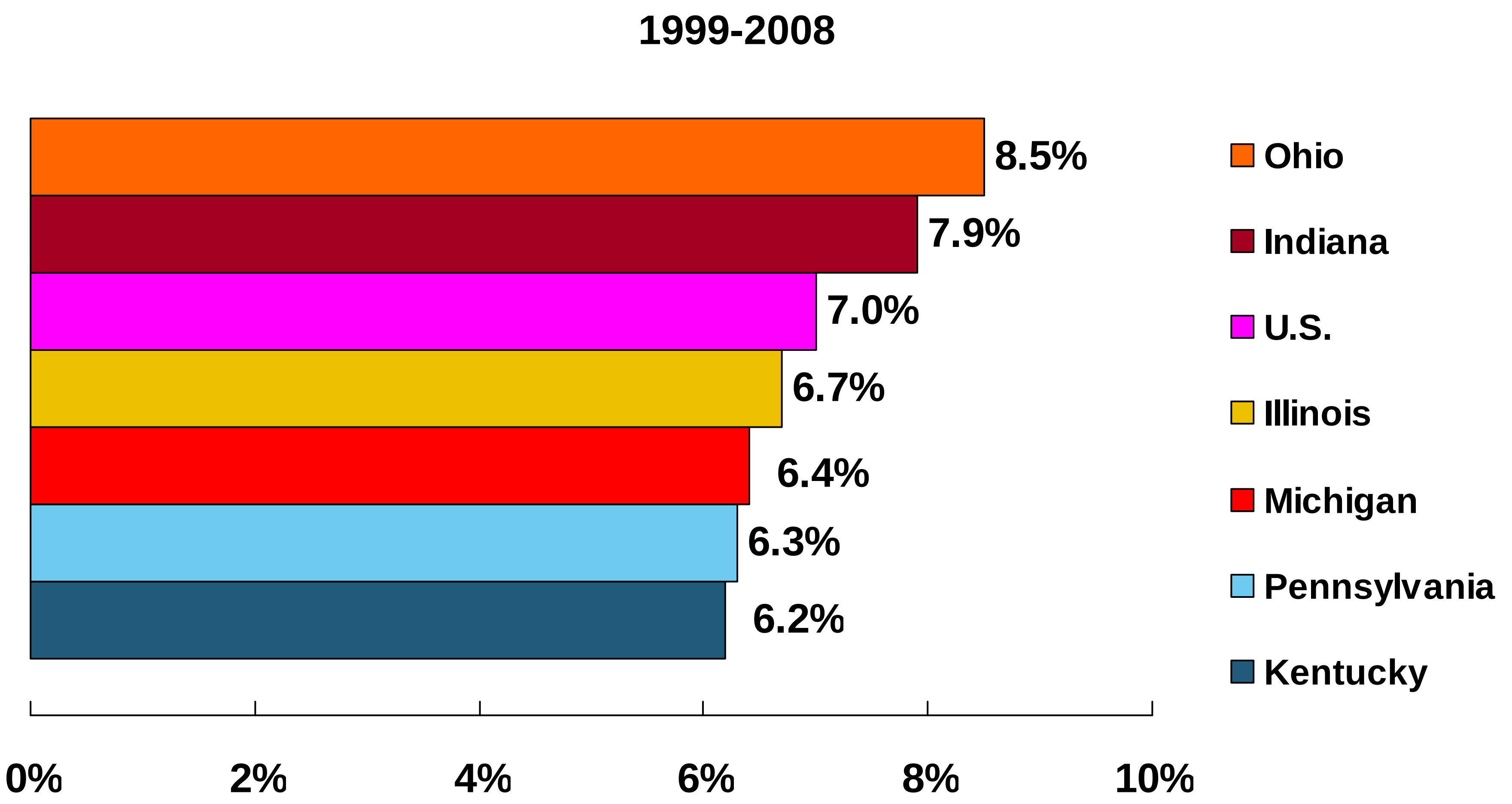
RNW Homeowners: OH vs. U.S., 1999-2008

(Percent)



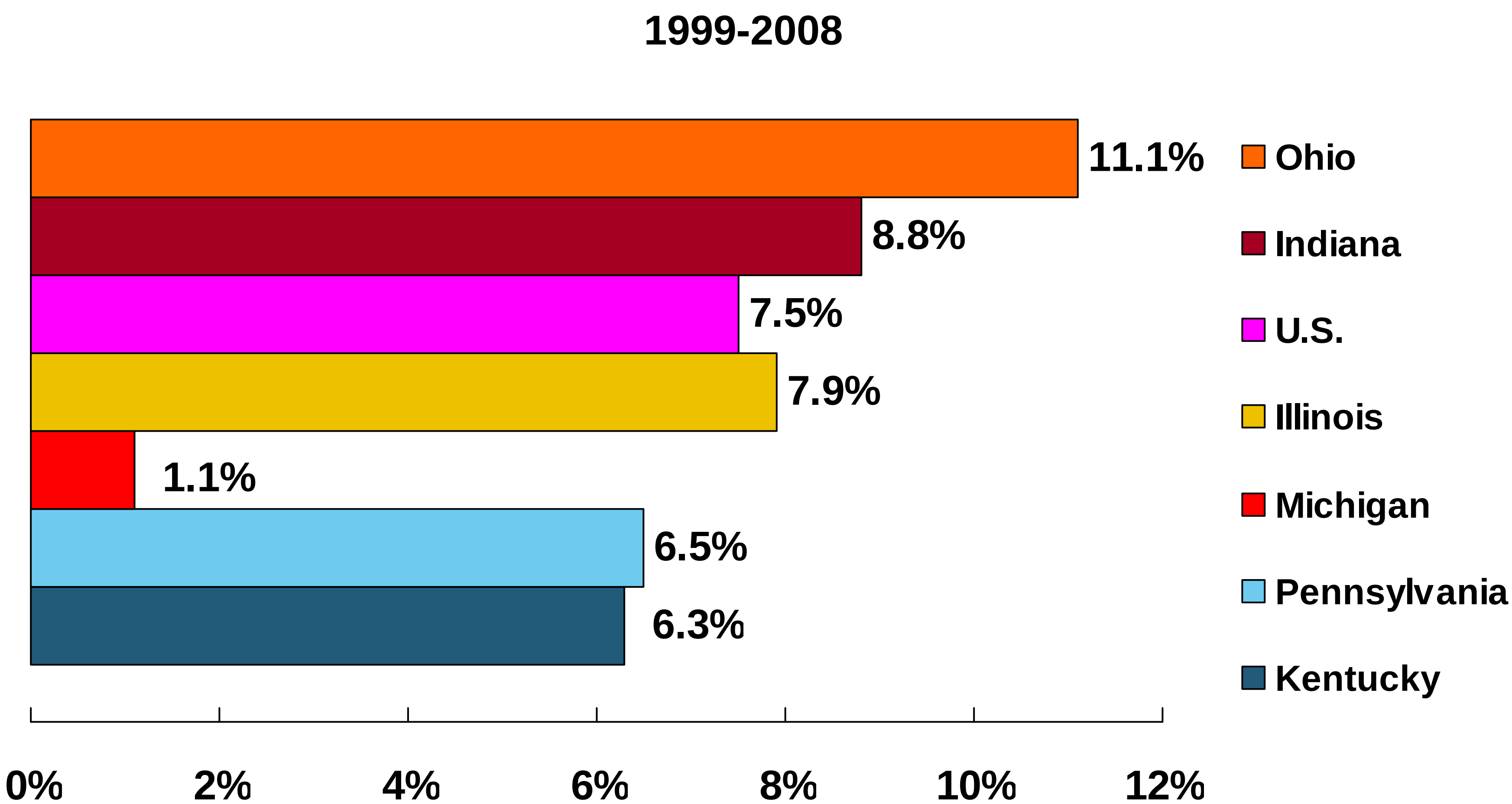
Sources: NAIC.

All Lines: 10-Year Average RNW OH & Nearby States



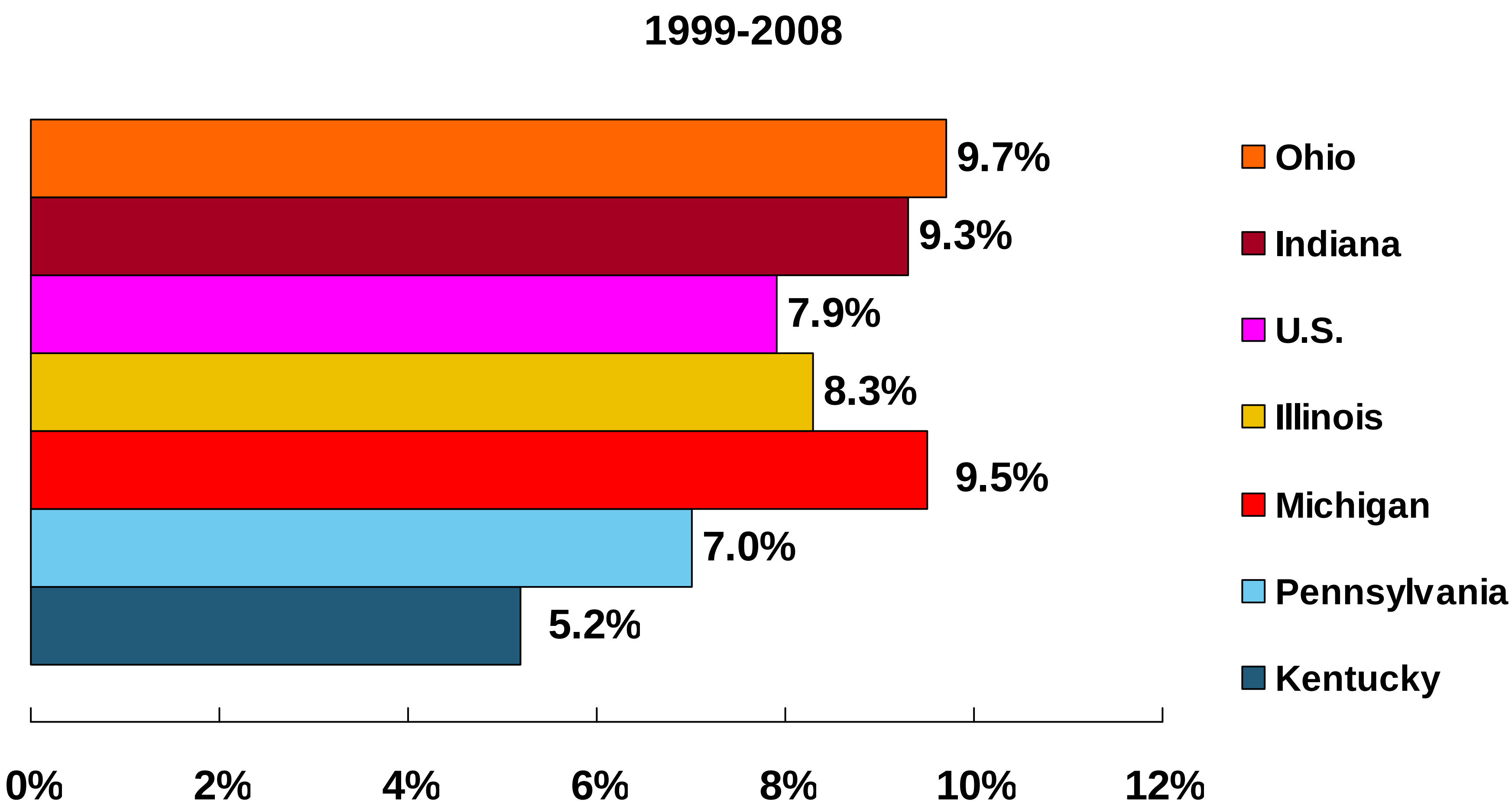
Source: NAIC, Insurance Information Institute

PP Auto: 10-Year Average RNW OH & Nearby States



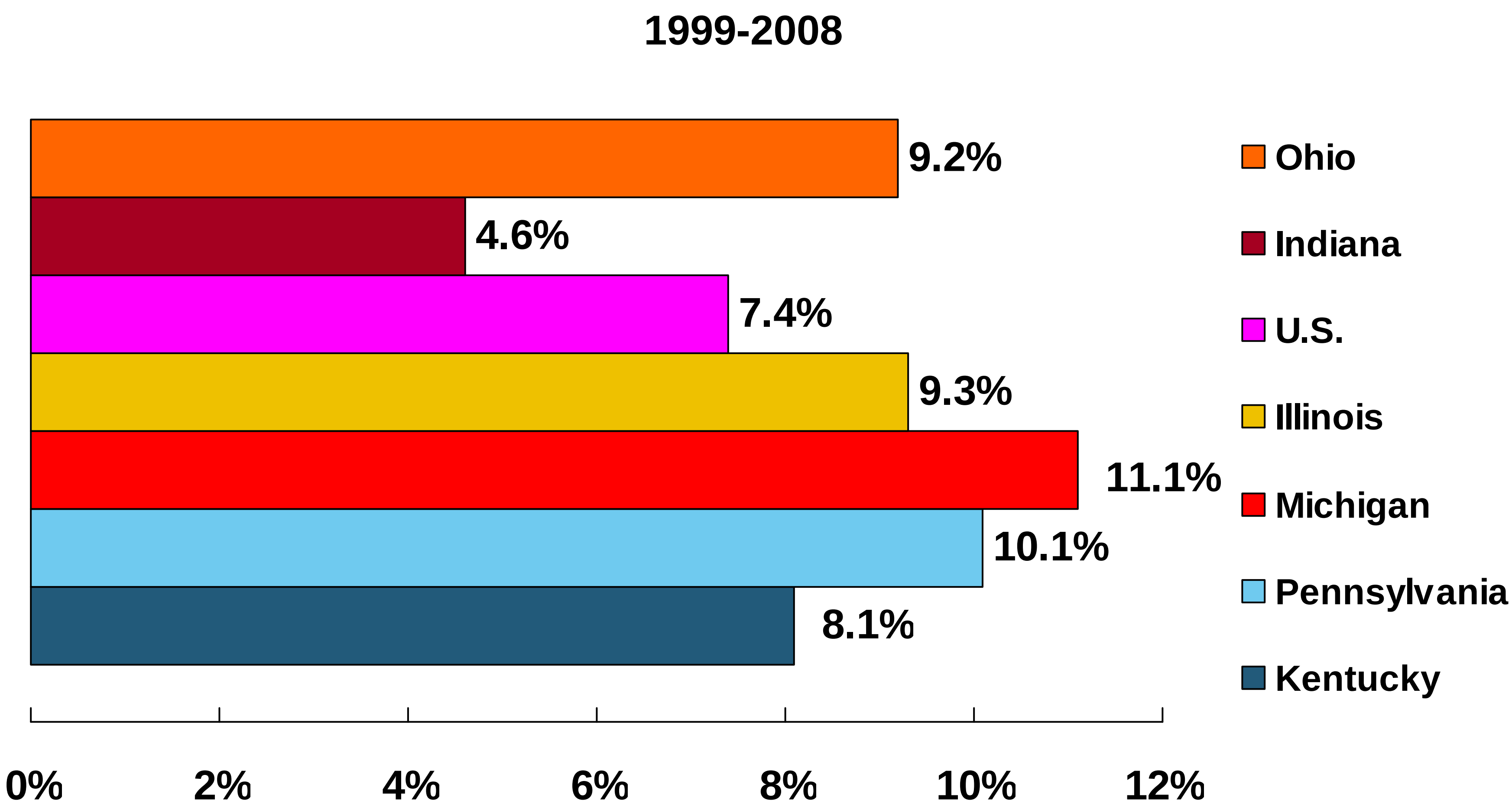
Source: NAIC, Insurance Information Institute

Comm. Auto: 10-Year Average RNW OH & Nearby States



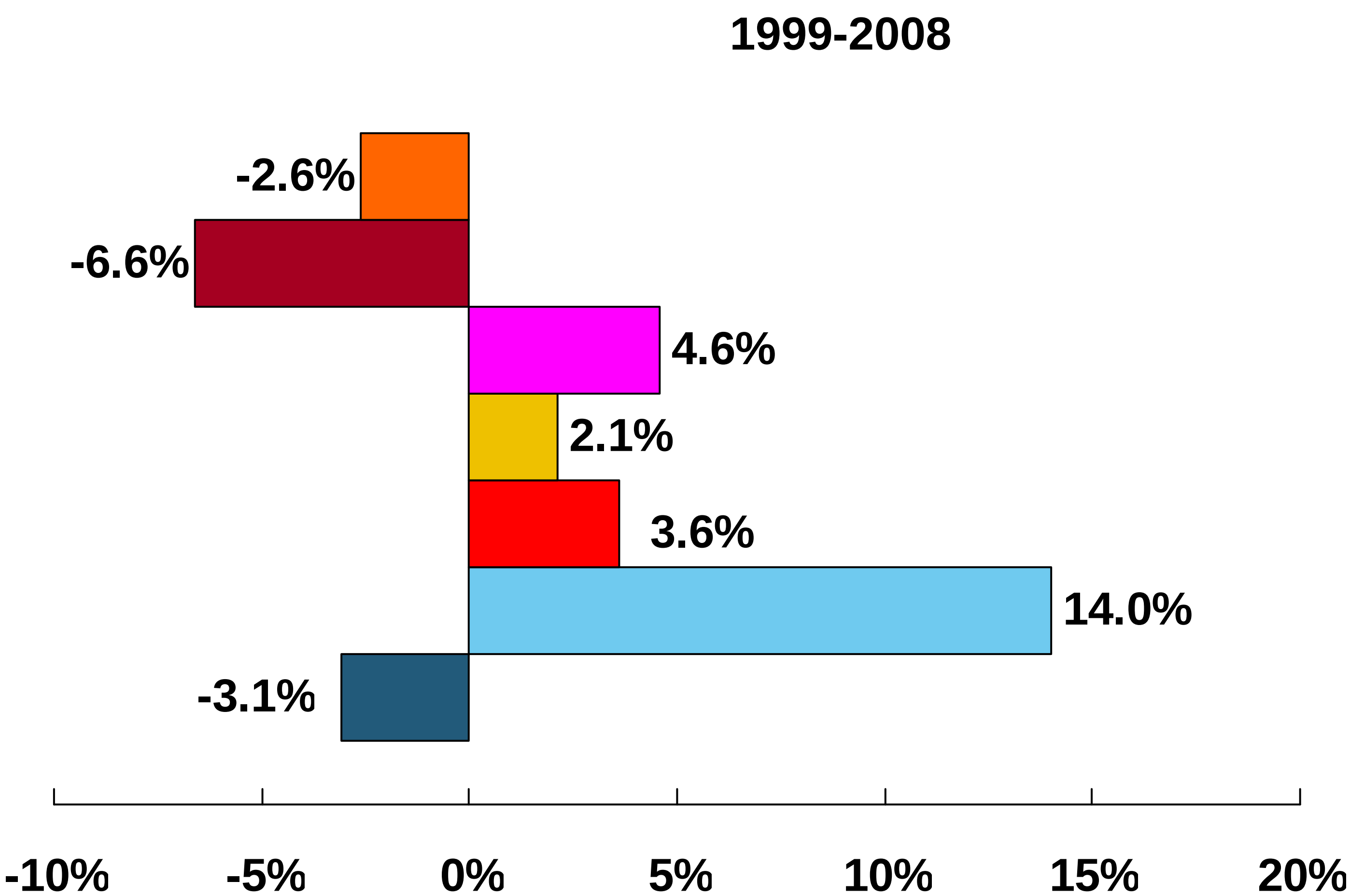
Source: NAIC, Insurance Information Institute

Comm. M-P: 10-Year Average RNW OH & Nearby States



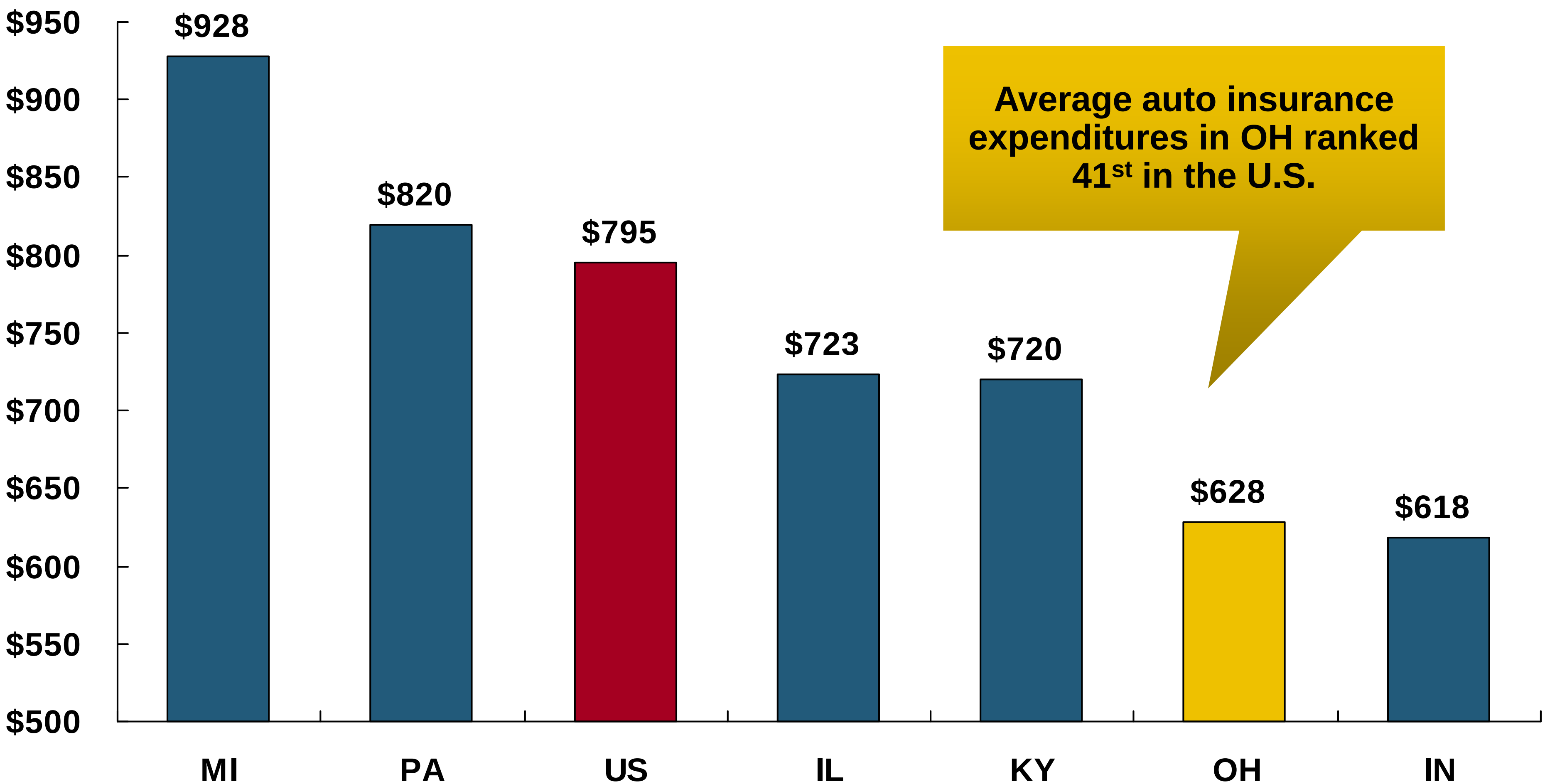
Source: NAIC, Insurance Information Institute

HO: 10-Year Average RNW OH & Nearby States



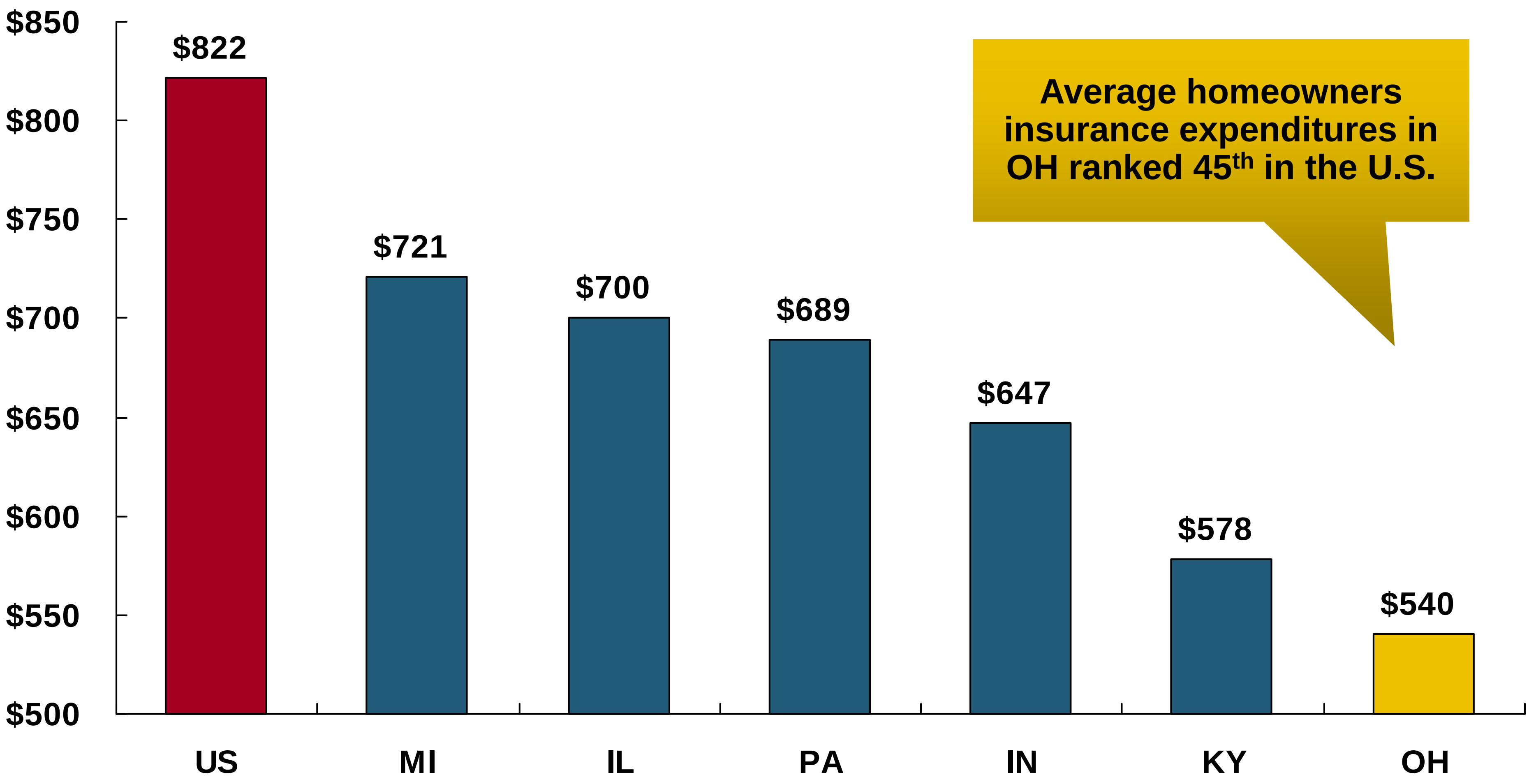
Source: NAIC, Insurance Information Institute

Avg. Expenditure on Private Passenger Auto Insurance, OH and Surrounding States, 2007*



*Latest available.
Source: NAIC; Insurance Information Institute.

Avg. Expenditure on Homeowners Insurance, OH and Surrounding States, 2007*



*Latest available.

Source: NAIC; Insurance Information Institute.

INSURANCE INFORMATION INSTITUTE

Financial Services Reform

Insurers Are Impacted, But Not Significantly

Financial Services Reform:
What does it mean for insurers?

INSURANCE INFORMATION INSTITUTE

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

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

Systemic Risk: Oversight & Resolution Authority

Issues Related to Systemic Risk & Resolution Authority

- **Orderly Liquidation (cont.)**
  - Insurers are generally exempt from the liquidation authority, but the FDIC would have “backup authority” to place an insurer into orderly liquidation under state law if the state regulator has not done so within 60 days of a systemic risk determination.
- **Liquidation Fund Assessments**
  - The liquidation fund would be funded by assessments on large financial companies, potentially including insurers.
  - But the insurance industry already has a funding system (state guaranty funds) to pay for the unwinding of failed companies. Therefore, contributions to these state guaranty funds must be considered.

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?

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 insurance 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.

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? (Cont.)*

INSURANCE INFORMATION INSTITUTE

Duties of the Federal Insurance Office

- **Establishes office within US Treasury headed by a Director appointed by Treasury Secretary, and charged with:**
  - Make recommendations to the FSOC on whether an insurer (incl. reinsurers) poses a systemic risk and should be placed under supervision of the Federal Reserve.
  - Annual reports to Congress and the President on the insurance industry are required.
  - A study on the modernization of insurance regulation in the U.S. is required within 18 months, as is a report on the U.S. and global reinsurance market
  - Oversee the federal Terrorism Risk Insurance Program.
  - Insurance will continue to be regulated by the states, but the FIO has limited preemption authority over state law in cases where it determines that state law is inconsistent with a negotiated international agreement and treats a non-U.S. insurer less favorably than a U.S. insurer.

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

Surplus Lines/Reinsurance Regulation: *What Is Included?*

INSURANCE INFORMATION INSTITUTE

Surplus Lines and Reinsurance Regulation

- **Title V of the Dodd-Frank bill includes the Nonadmitted and Reinsurance Reform Act (NRRA), comprising two parts:**
  - **Surplus Lines:**
  - Provides that the home state of the insured will have exclusive authority to regulate the placement of nonadmitted insurance.
  - Only the insured's home state will be permitted to collect premium taxes on nonadmitted insurance.
  - The legislation also establishes a uniform system for allocation of premium tax obligations through an interstate compact or other procedures established by the states.
  - The NRRA would also establish uniform standards for surplus lines eligibility criteria by requiring capital and surplus requirements for U.S.-domiciled insurers conform to those in the NAIC's Nonadmitted Insurance Model Act.

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

Surplus Lines/Reinsurance Regulation: *What Is Included? (Cont.)*

Surplus Lines and Reinsurance Regulation

- **Title V of the Dodd-Frank bill includes the Nonadmitted and Reinsurance Reform Act (NRRA), comprising two parts:**
  - **Reinsurance:**
  - NRRA's reinsurance part provides that a ceding insurer's state of domicile will be the single point of regulation with respect to credit for reinsurance, provided it is an NAIC-accredited state.
  - It also provides that a ceding insurer's state of domicile will be the single point of regulation for purposes of:
    - The rights of the parties to provide for dispute resolution through arbitration agreements
    - Choice of law
    - Imposition of standard terms different than those in the reinsurance contract
  - The reinsurance part also provides that a reinsurer's state of domicile will be solely responsible for regulating the reinsurer's solvency, providing it is an NAIC-accredited state.

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

Other Matters Impacting Insurance

Derivatives and Bureau of Consumer Financial Protection

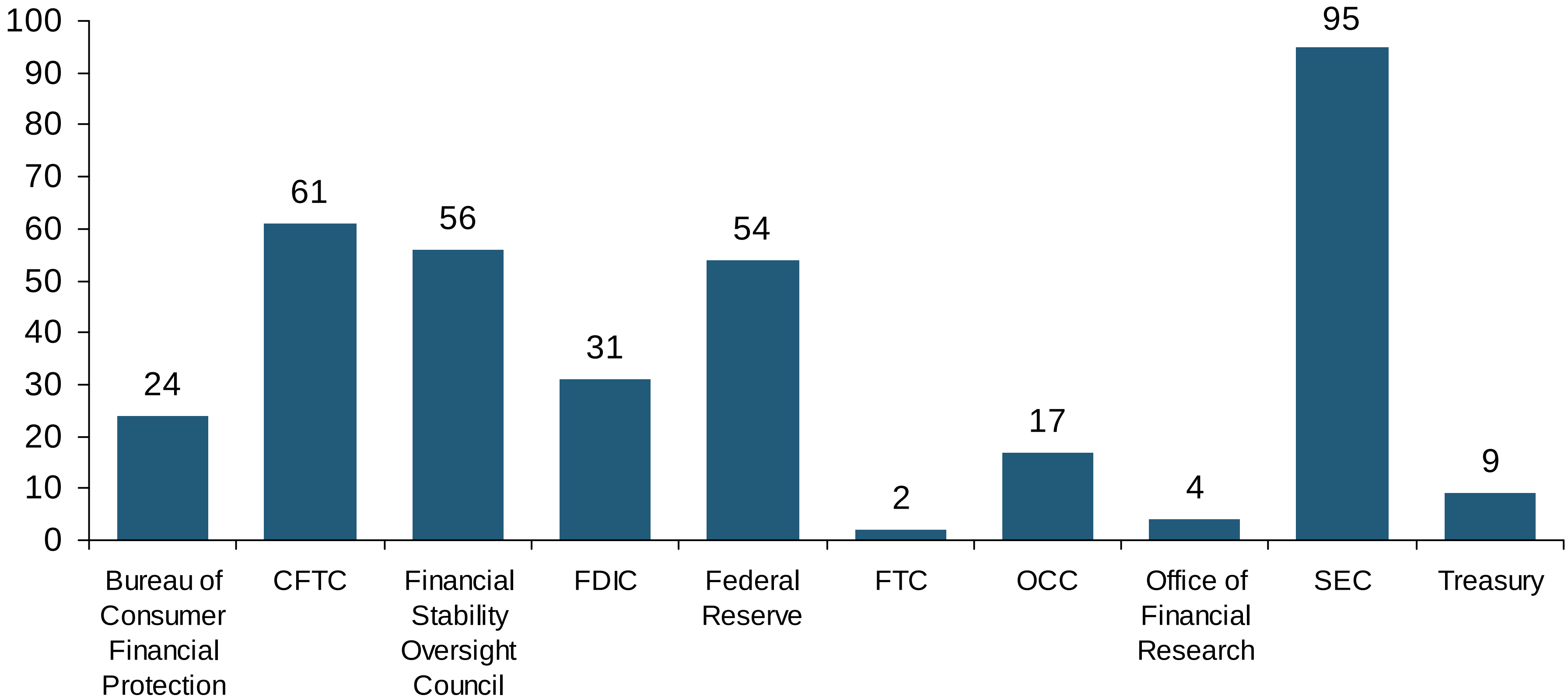
- **Derivatives:**
  - The bill would require most standardized derivatives to be routed through clearinghouses and traded on exchanges.
  - Two new classes of regulated entities would be created: swap dealers and major swap participants.
  - Both would be required to register with the SEC and/or the CFTC and would be subject to margin, capital, record-keeping and business conduct requirements.
- **Bureau of Consumer Financial Protection:**
  - The Bill creates a new federal level entity within the Federal Reserve with the authority to regulate financial products offered to consumers.
  - Insurance products are specifically exempted from this bureau's authority.

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

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

INSURANCE INFORMATION INSTITUTE

A total of at least 243 new rulemakings are expected under the Dodd-Frank financial reform by Federal Agency*



* 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.

Financial Services Reform: Impact on Insurers

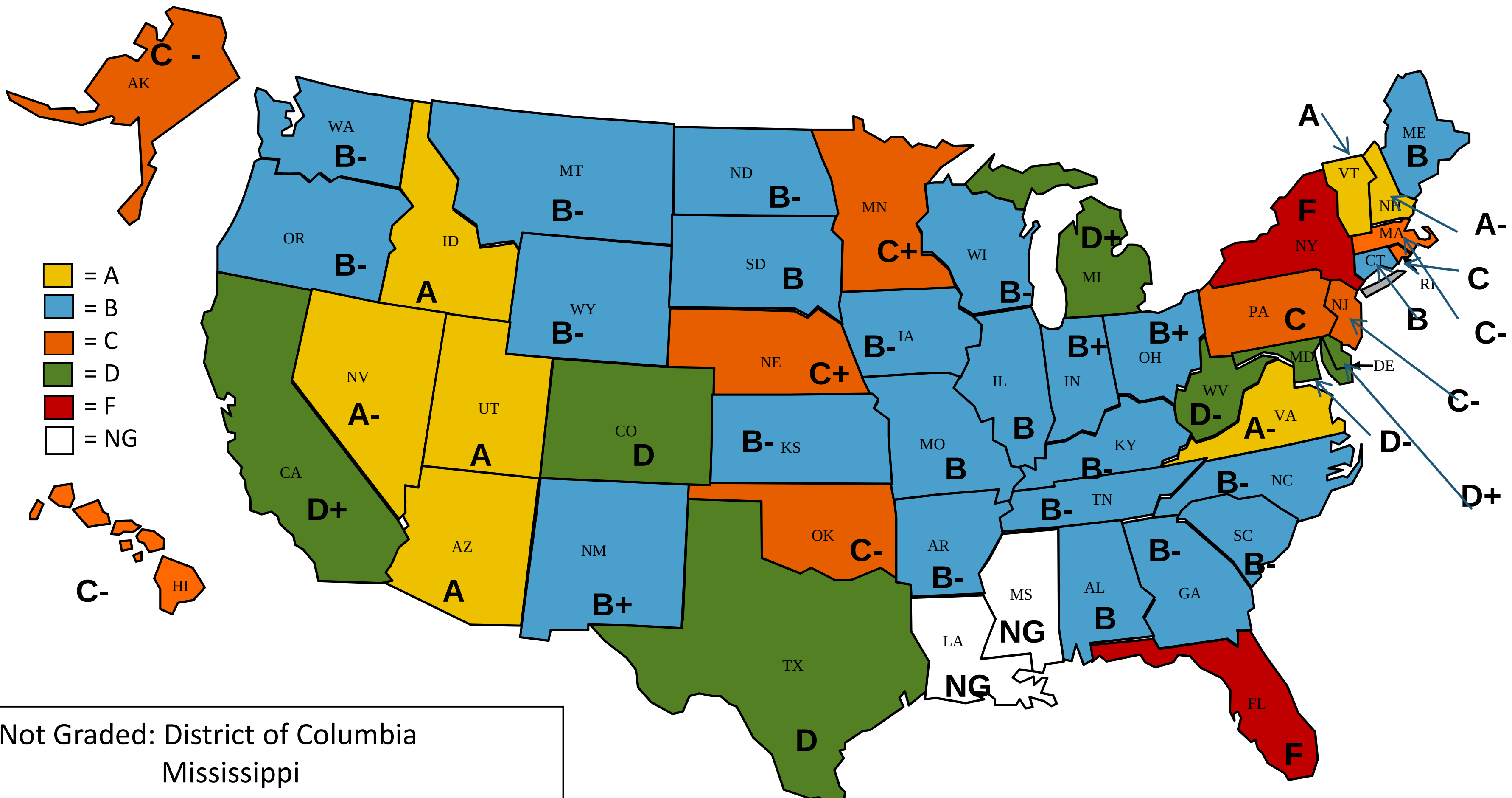
INSURANCE INFORMATION INSTITUTE

- **Resolution Authority/Systemic Risk:** Regulators may seize and break-up troubled financial firms whose collapse might cause widespread damage (i.e., systemically important companies)
  - Regulator would recoup fees with more than $50B in assets
  - Sets up liquidation procedure run by FDIC
  - Establishes 10-member oversight council to monitor and address risks to financial stability
  - Eliminates Office of Thrift Supervision (regulator of AIG's holding company, not its insurance units which were (are) state regulated)
- **Volcker Rule:** Largely bars largest firms largest investment firms from trading with their own funds
  - Exempts insurers, asset managers and trust/custody banks, though Fed could impose Volcker Rule and capital standards on individual firms if warranted
- **Derivatives:** Requires routine derivatives to be traded on exchanges and routed through clearinghouses
  - Imposes capital, margin, reporting and record keeping and business conduct rules on firms that deal in derivatives
- **Consumer Financial Protection Bureau:** To housed within Fed
  - Will it be limited to banks/creditors
- **Office of National Insurance:** To be established within Treasury to monitor and gather information in the insurance industry

Source: *Wall Street Journal*, June 26, 2010; Insurance Information Institute.

2010 Property and Casualty Insurance Report Card

INSURANCE INFORMATION INSTITUTE



Not Graded: District of Columbia
Mississippi
Louisiana

Source: Heartland Institute, May 2010

INSURANCE
INFORMATION
INSTITUTE

Critical Differences Between P/C Insurers and Banks

Superior Risk Management Model and Low Leverage Make a Big Difference

How P/C Insurance Industry Stability Has Benefitted Consumers

INSURANCE INFORMATION INSTITUTE

Bottom Line:

- Insurance markets – unlike banking – are operating ***normally***
- The basic function of insurance – the orderly transfer of risk from client to insurer – ***continues uninterrupted***
- This means that insurers continue to:
  - Pay claims (whereas 287 banks have gone under as of 9/10/10)
    - ***The promise is being fulfilled***
  - Renew existing policies *(banks are reducing and eliminating lines of credit)*
  - Write new policies *(banks are turning away people and businesses who want or need to borrow)*
  - Develop new products *(banks are scaling back the products they offer)*
  - Compete intensively *(banks are consolidating, reducing consumer choice)*

Source: Insurance Information Institute

Reasons Why P/C Insurers Have Fewer Problems Than Banks

A Superior Risk Management Model

- **Emphasis on Underwriting**
  - Matching of risk to price (via experience and modeling)
  - Limiting of potential loss exposure
  - ***Some banks sought to maximize volume and fees and disregarded risk***
- **Strong Relationship Between Underwriting and Risk Bearing**
  - **Insurers always maintain a stake in the business they underwrite, keeping "skin in the game" at all times**
  - ***Banks and investment banks package up and securitize, severing the link between risk underwriting and risk bearing, with (predictably) disastrous consequences – straightforward moral hazard problem from Econ 101***
- **Low Leverage**
  - Insurers do not rely on borrowed money to underwrite insurance or pay claims → ***There is no credit or liquidity crisis in the insurance industry***
- **Conservative Investment Philosophy**
  - High quality portfolio that is relatively less volatile and more liquid
- **Comprehensive Regulation of Insurance Operations**
  - The business of insurance remained comprehensively regulated whereas a separate banking system had evolved largely outside the auspices and understanding of regulators (e.g., hedge funds, private equity, complex securitized instruments, credit derivatives – CDS's)
- **Greater Transparency**
  - Insurance companies are an open book to regulators and the public

Source: Insurance Information Institute

Obama Administration Proposal to Scale Back Terrorism Risk Insurance Program

INSURANCE INFORMATION INSTITUTE

5 Administration's Budget Proposal for FY 2011:

- Includes proposal to scale back federal support for terrorism risk insurance program
- Proposal projects savings of $249 million from 2011-2020
- Administration's justification is that this would "encourage the private sector to better mitigate terrorism risk through other means, such as developing alternative reinsurance options and building safer buildings."

Key Concerns **Among Industry Observers Over Proposed Reduction in Federal Support**

- Suggestion of changes to law would have detrimental effect on availability and affordability of terrorism insurance
- A 2009 Aon study estimated some 70-80 percent of the commercial property insurance market would revert to absolute exclusions for terrorism, if TRIA is changed.

Source: Budget of the U.S. Government Fiscal Year 2011

Terrorism: Insurance Concerns Resurface

INSURANCE INFORMATION INSTITUTE

Reasons Why Concerns Are Mounting in 2010

- **Perception (Reality) that U.S. vulnerability is rising**
- **Thwarted Christmas Day attack by "underwear bomber"**
  - **And new bin Laden tape claiming al Qaeda is responsible**
- **Foiled NYC Subway Bomber Plot (Zazi case)**
- ***Failed Times Square Car Bombing on May 1***
- **Trials of Guantanamo 9/11 suspects in Manhattan Court (?)**
- **U.K. in January Raised Terror Alert Status to 2nd Highest Level**
- **Increased anti-terror efforts, including full-body scans**
- **Effort by government to appear more vigilant, prepared**
- **Rise of groups such al Qaeda in the Arabian Peninsula**
- **U.S. military surge in Afghanistan operations**
- **Most buyers/producers haven't thought about coverage recently**
- ***Obama Administration's Intent to Reduce Support for TRIA***

INSURANCE INFORMATION INSTITUTE

Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

Important Issues & Threats Facing Insurers: 2010–2015

INSURANCE INFORMATION INSTITUTE

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**

Source: Insurance Information Institute

Trial Bar Priorities

- 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

Source: Institute for Legal Reform.

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

INSURANCE INFORMATION INSTITUTE

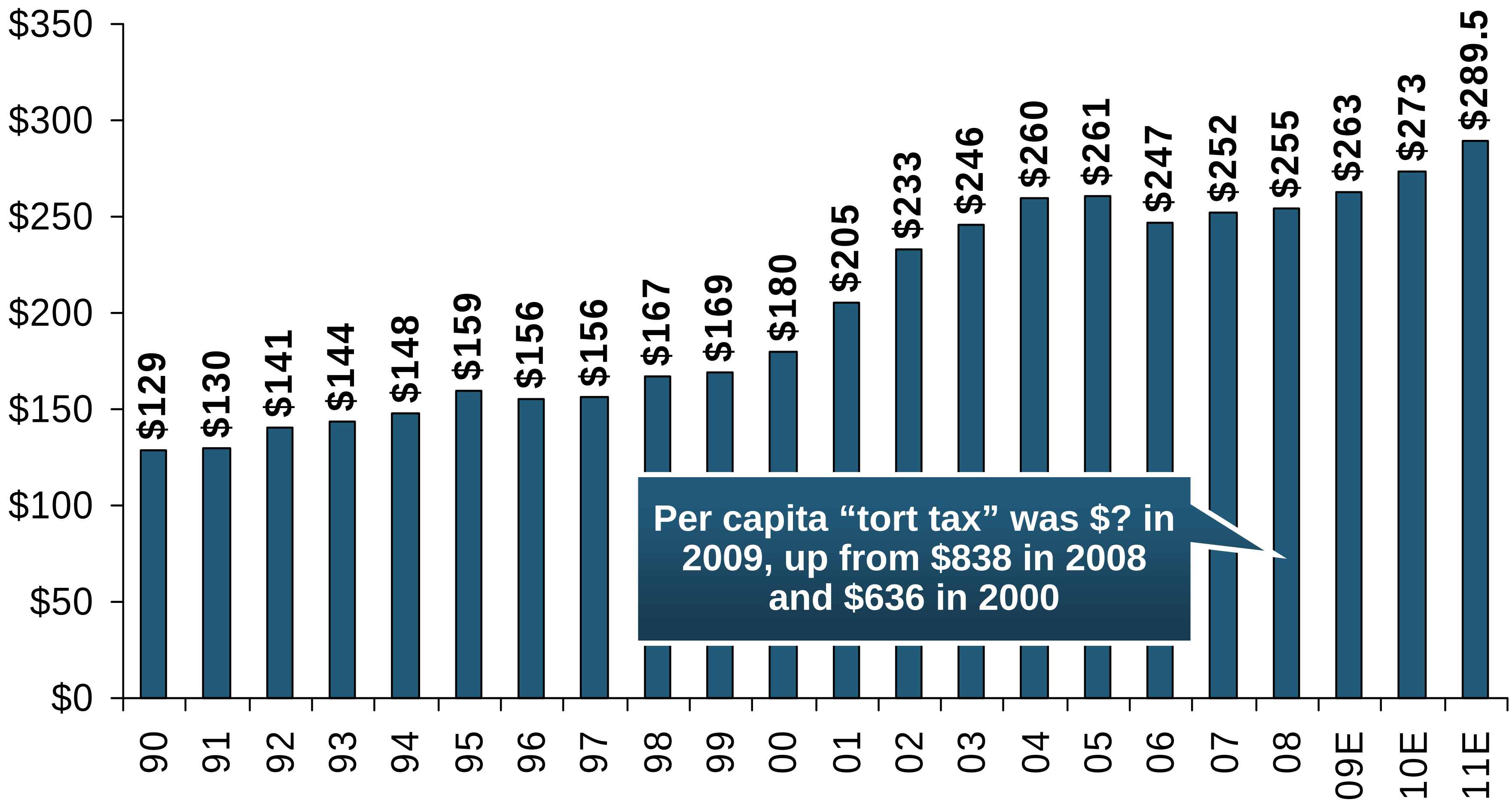
Top Categories	Percentage
Environmental	14%
Insurance coverage	13%
Mortgage fraud	12%
Nursing home/seniors issues	11%
Bad-faith against insurance companies	10%

41 different practice areas were included as categories

Source: Institute for Legal Reform poll, December 2009.

Cost of US Tort System ($ Billions)

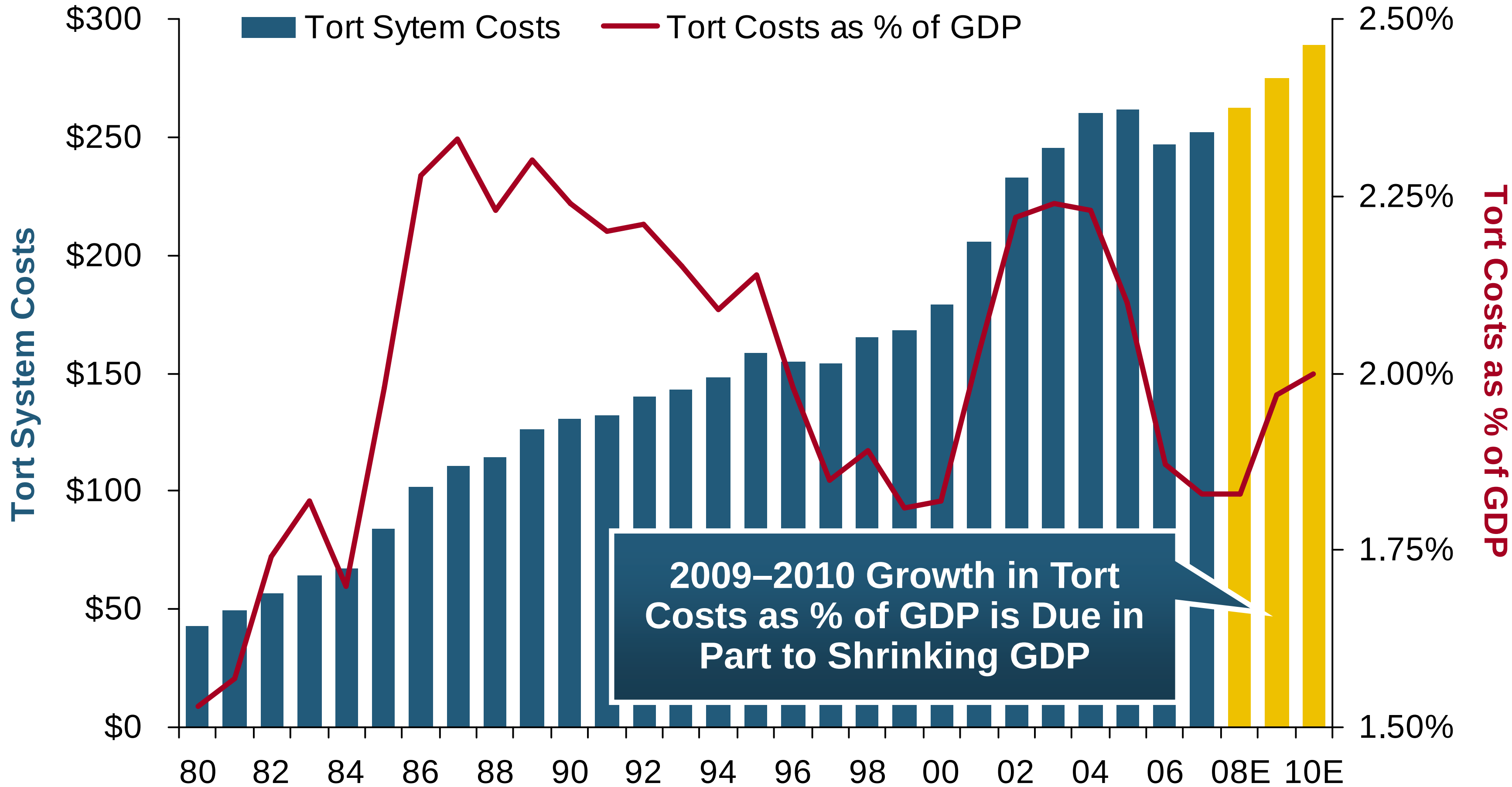
Tort costs consumed 1.79% of GDP in 2008, down from 2.24% in 2003



Source: Tillinghast-Towers Perrin, *2009 Update on US Tort Cost Trends.*

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

($ Billions)



* Excludes the tobacco settlement, medical malpractice

Sources: Tillinghast-Towers Perrin, *2008 Update on US Tort Cost Trends*, Appendix 1A; I.I.I. calculations/estimates for 2009 and 2010

Business Leaders Ranking of Liability Systems in 2009*

INSURANCE INFORMATION INSTITUTE

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 2009

- 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

Source: US Chamber of Commerce 2009 State Liability Systems Ranking Study; Insurance Info. Institute.

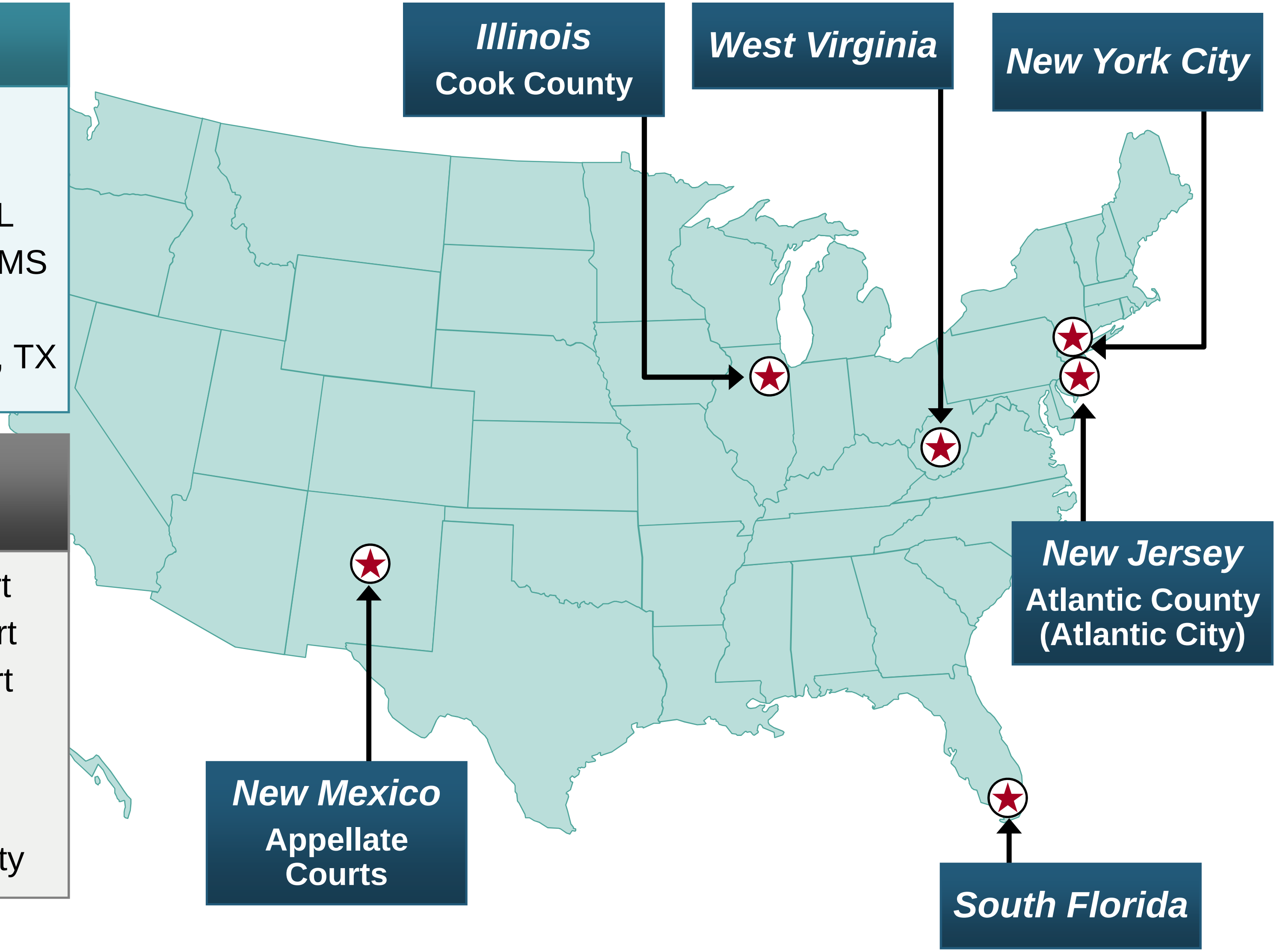
The Nation's Judicial Hellholes: 2010

Watch List

- California
- Alabama
- Madison County, IL
- Jefferson County, MS
- Texas Gulf Coast
- Rio Grande Valley, TX

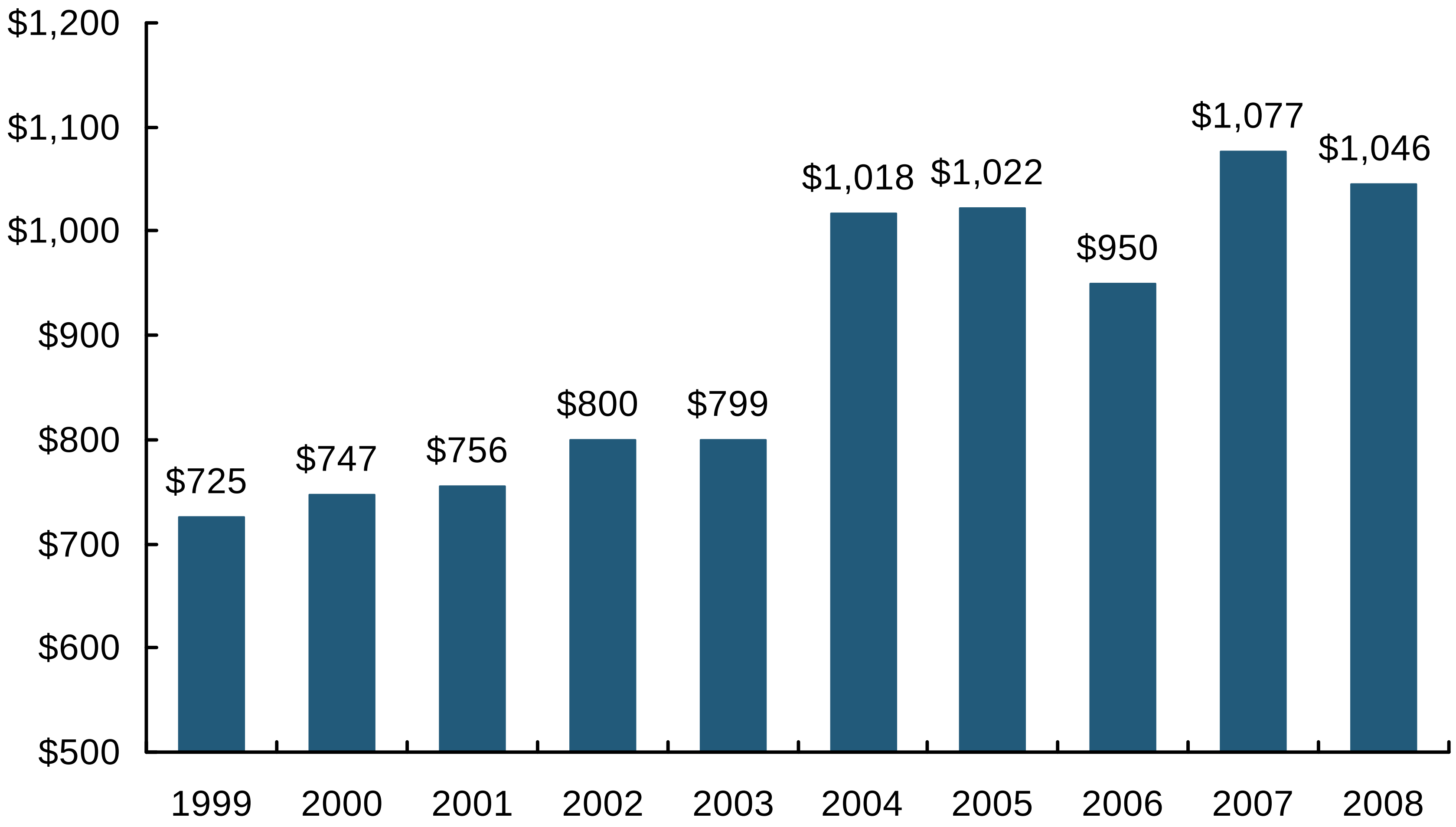
Dishonorable Mention

- AR Supreme Court
- MN Supreme Court
- ND Supreme Court
- PA Governor
- MA Supreme Judicial Court
- Sacramento County



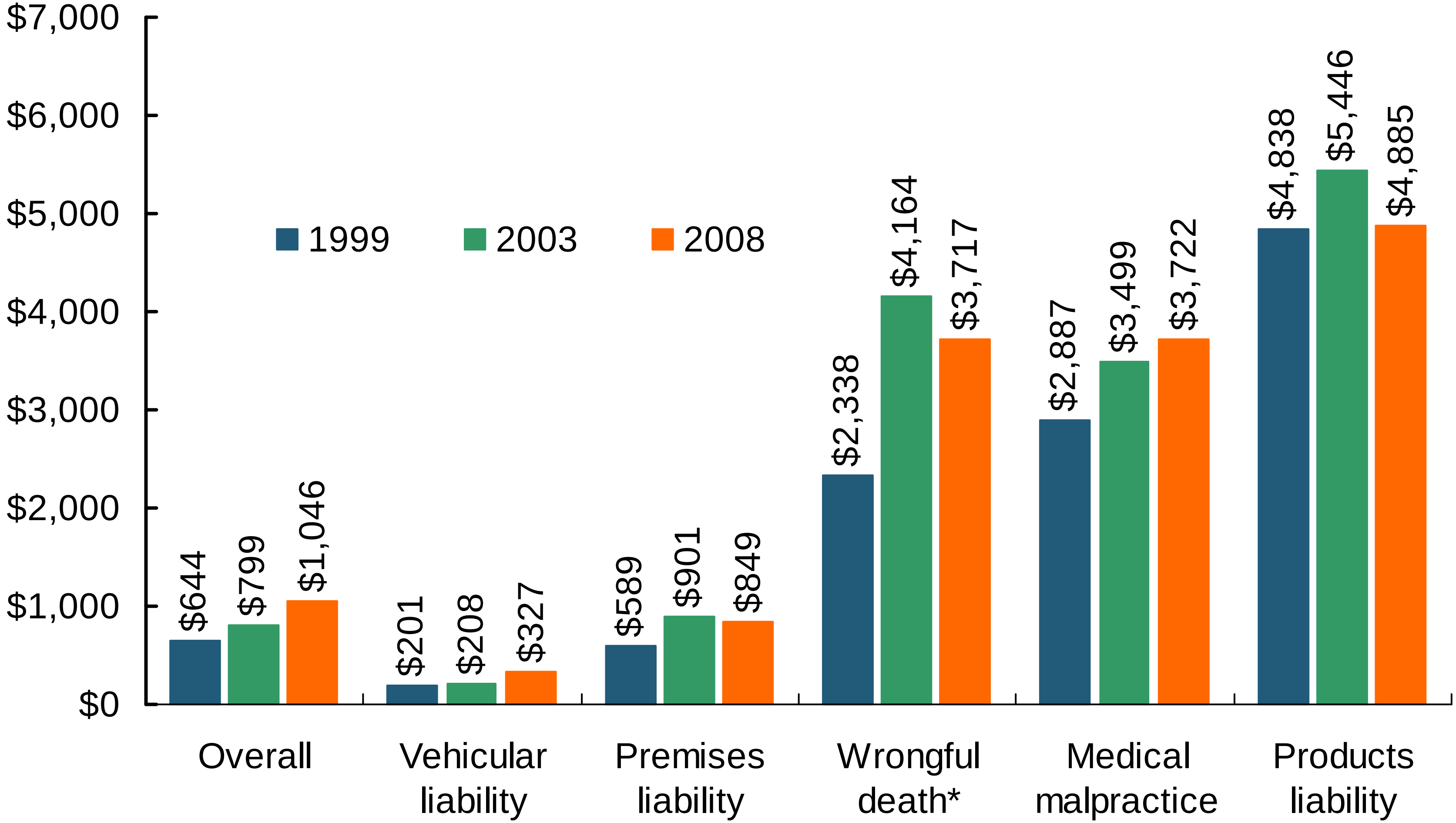
Source: American Tort Reform Association; Insurance Information Institute

Average Jury Awards 1999 - 2008



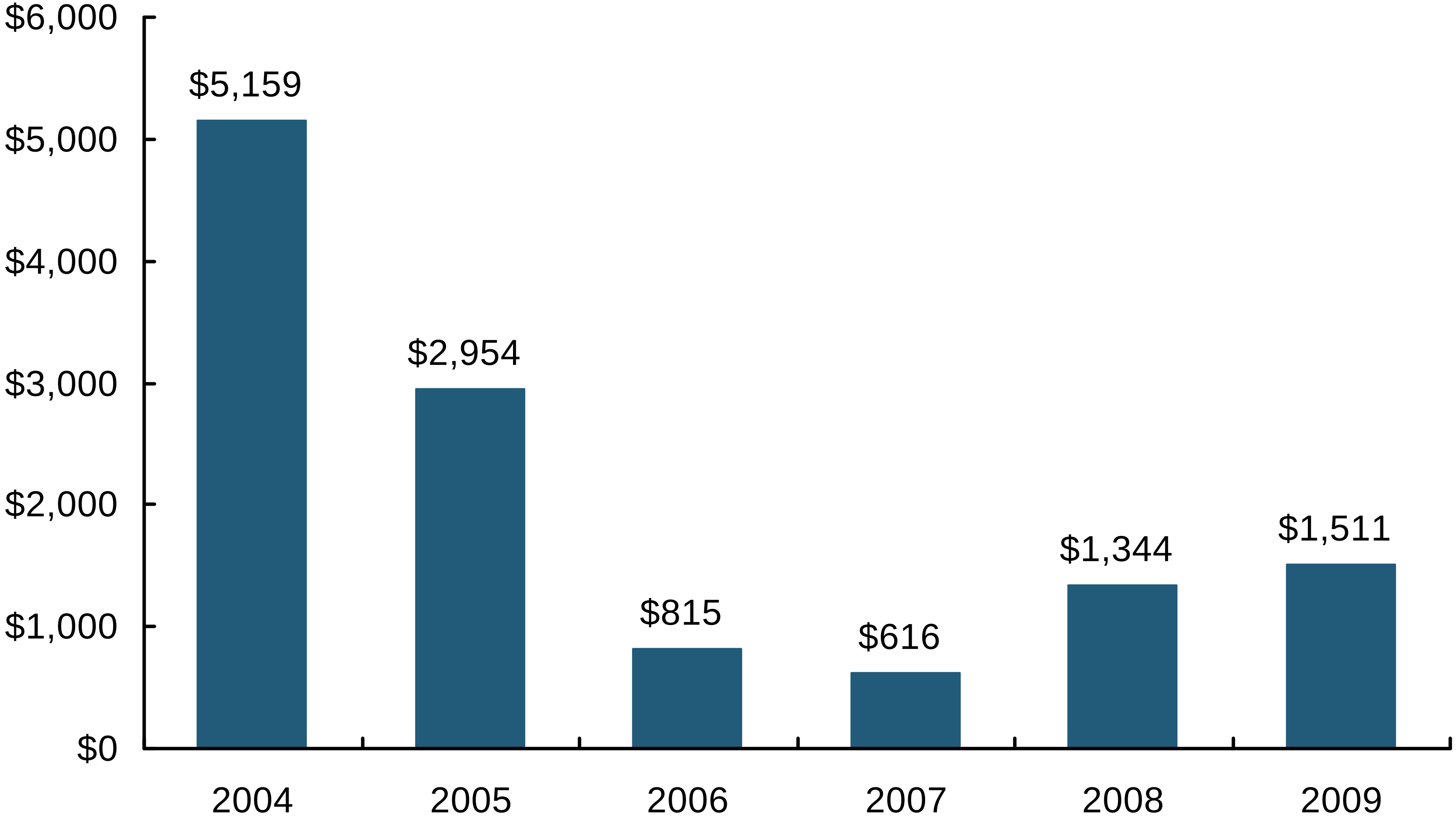
Source: Jury Verdict Research; Insurance Information Institute.

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 2004-2009



Source: Insurance Information Institute from Lawyers USA, January 2005, 2006, 2007, 2008, 2009 and 2010.

2009 Top Ten Jury Verdicts

INSURANCE INFORMATION INSTITUTE

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
$71 Million	Conversion and Breach of Fiduciary Duty	Texas
$70 Million	*Workers Comp Case*	*Texas*
$65 Million	Personal Injury	Florida
$60 Million	Medical Malpractice	New York

Source: Lawyers USA, January 15, 2010.

2008 Top Ten Jury Verdicts

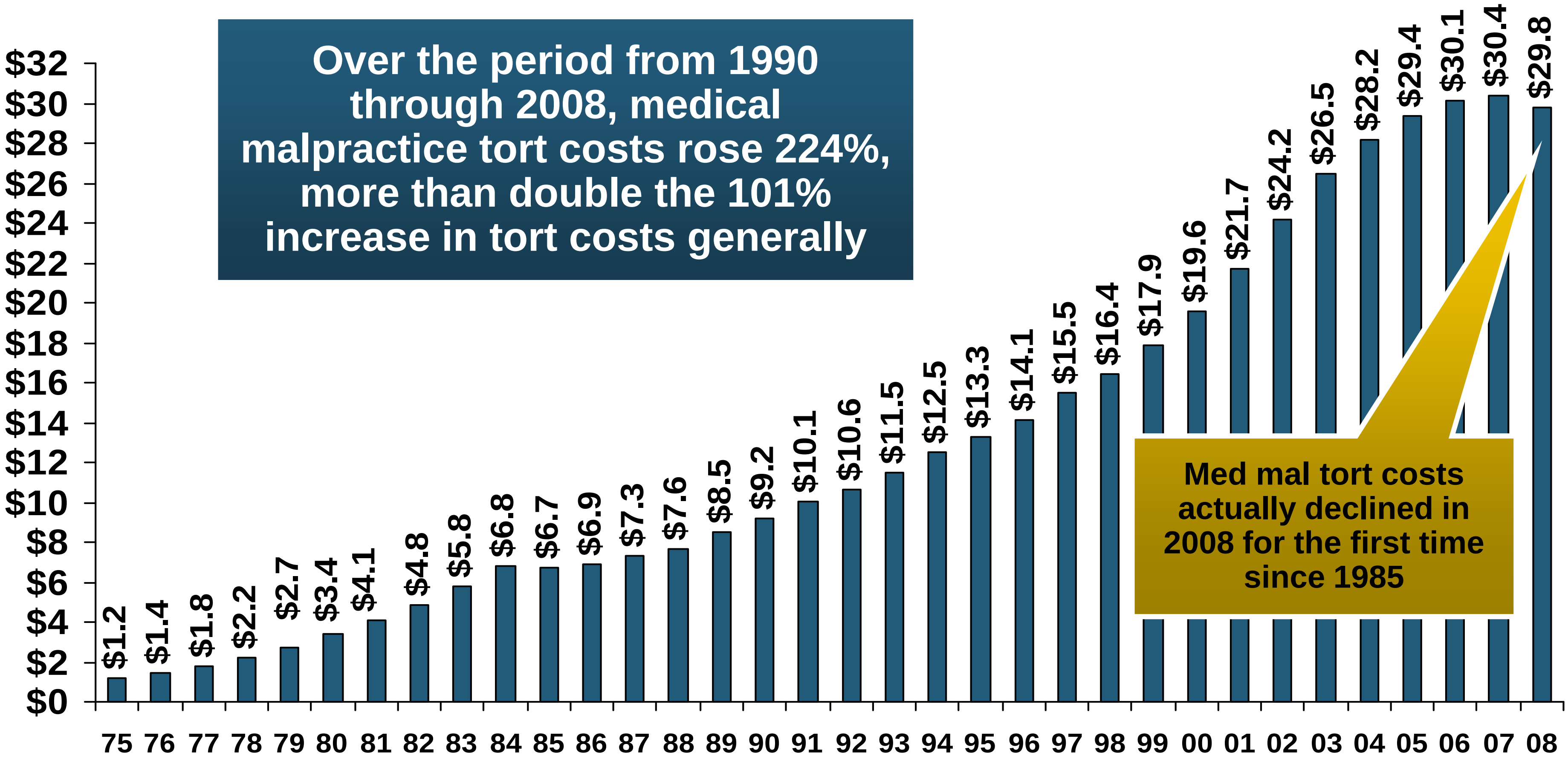
Value	Issue	State
$388 Million	Fraud, Intentional Infliction of Emotional Distress	Nevada
$316 Million	Breach of Contract	Georgia
$188 Million	Defamation	New York
$85 Million	Premises Liability	Pennsylvania
$84 Million	Negligence, Personal Injury	Texas
$66 Million	Breach of Fiduciary Duty	Oklahoma
$60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

Source: Lawyers USA, January 13, 2009.

Medical Malpractice Tort Cost: Growth Continues, Though Modestly

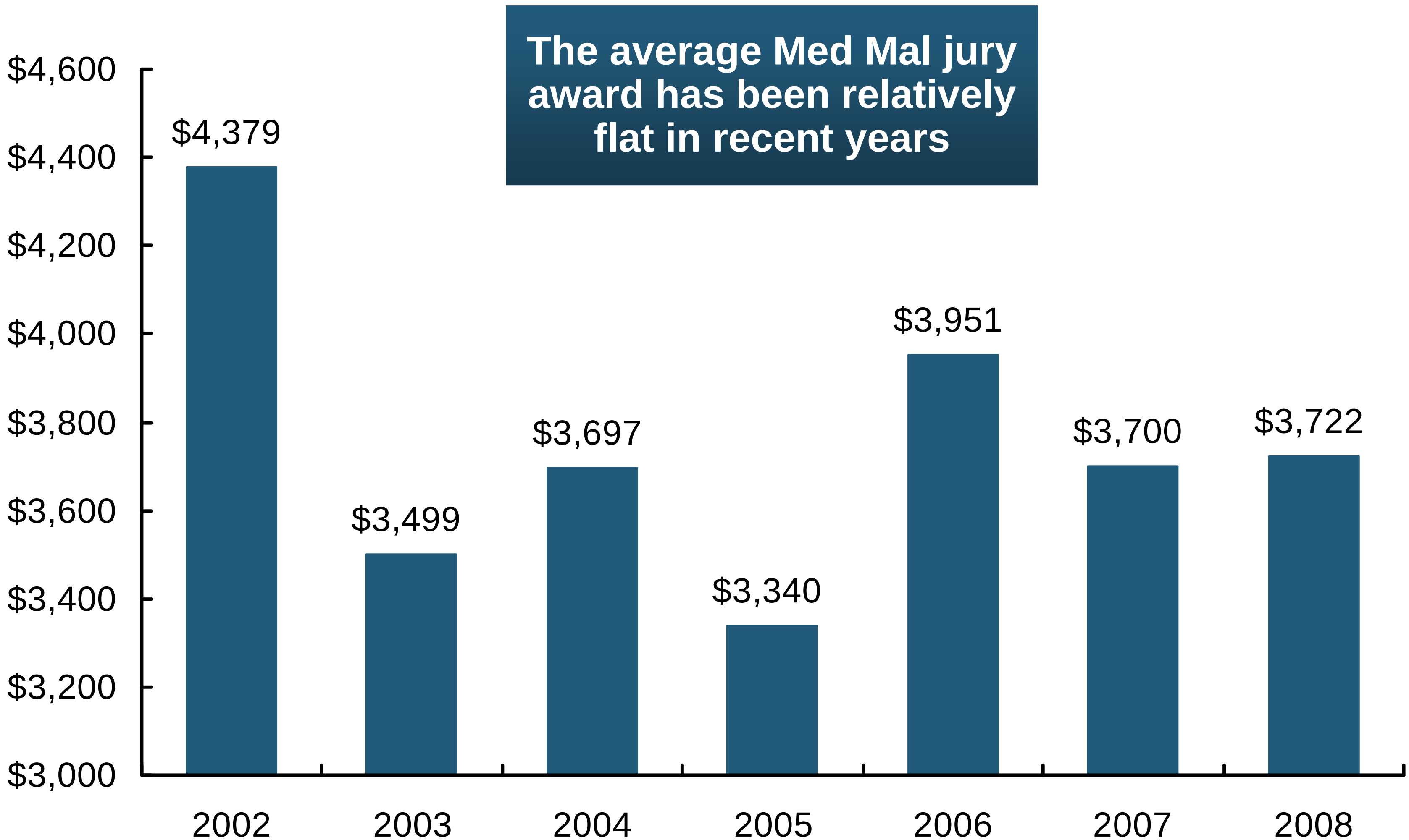
INSURANCE INFORMATION INSTITUTE

($ Billions)



Sources: Towers Perrin; Insurance Information Institute

Average Medical Malpractice Jury Award: 2002 - 2008

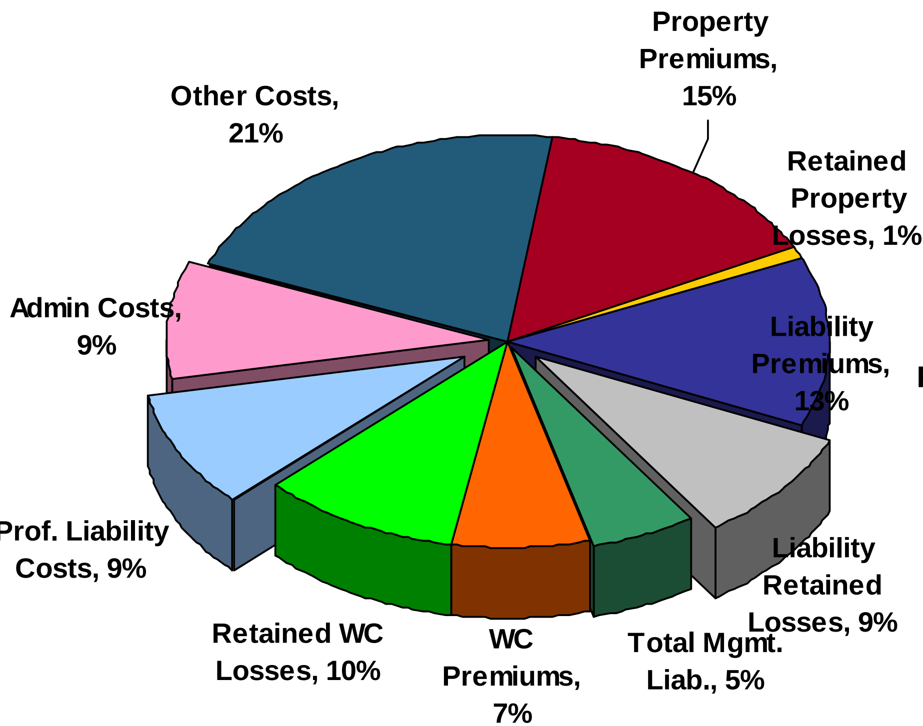


Source: Jury Verdict Research; Insurance Information Institute.

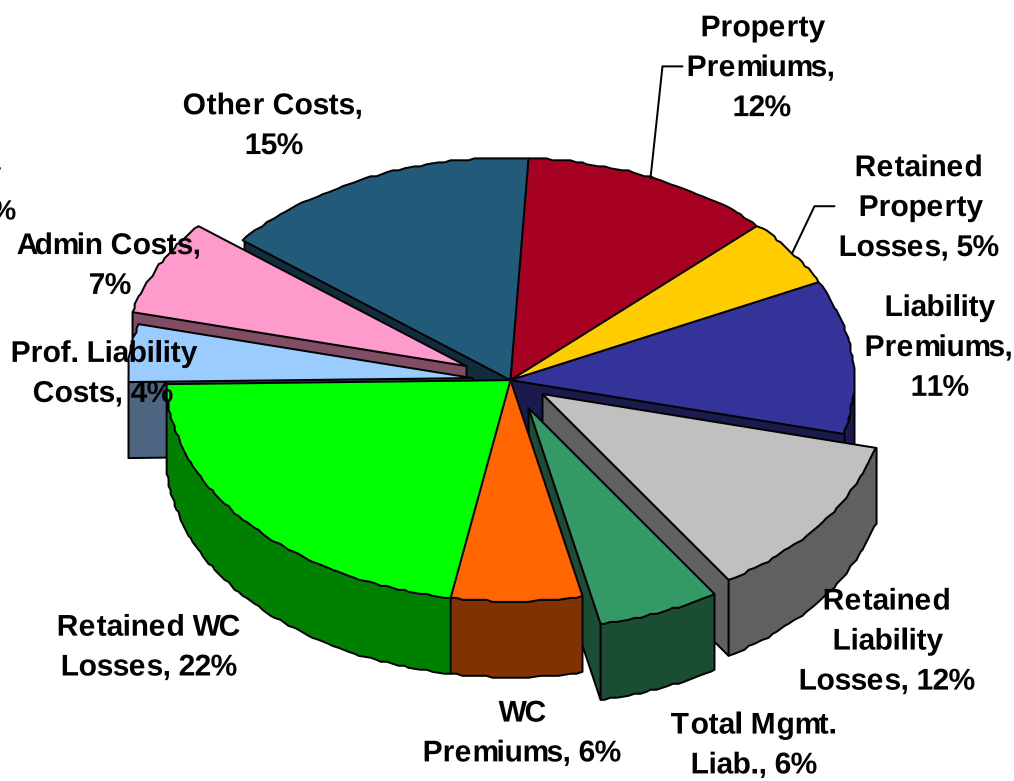
How the Risk Dollar is Spent (2008)

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

Firms w/Revenues < $1 Billion

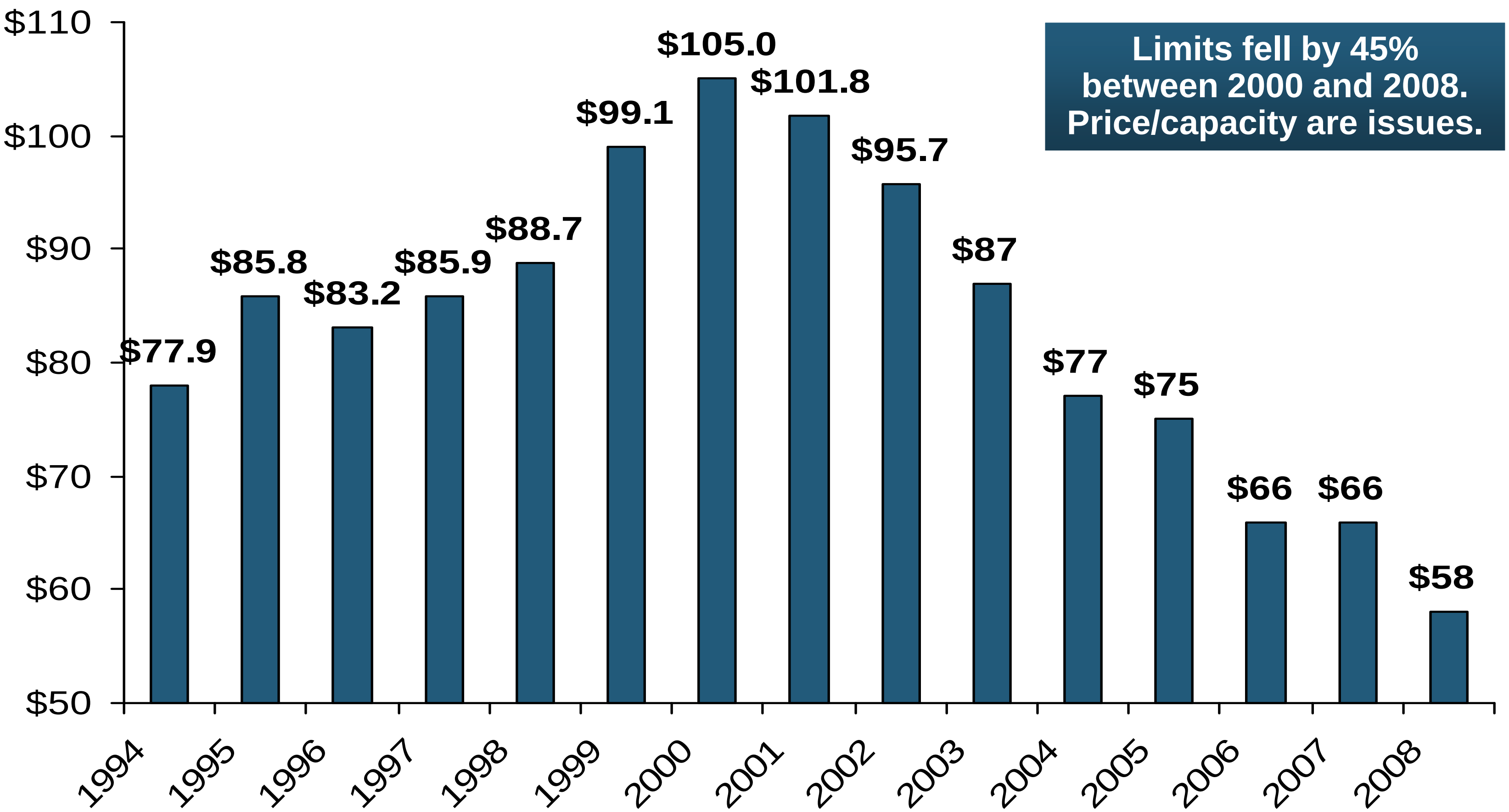


Firms w/Revenues > $1 Billion



Source: 2009 RIMS Benchmark Survey; Insurance Information Institute

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

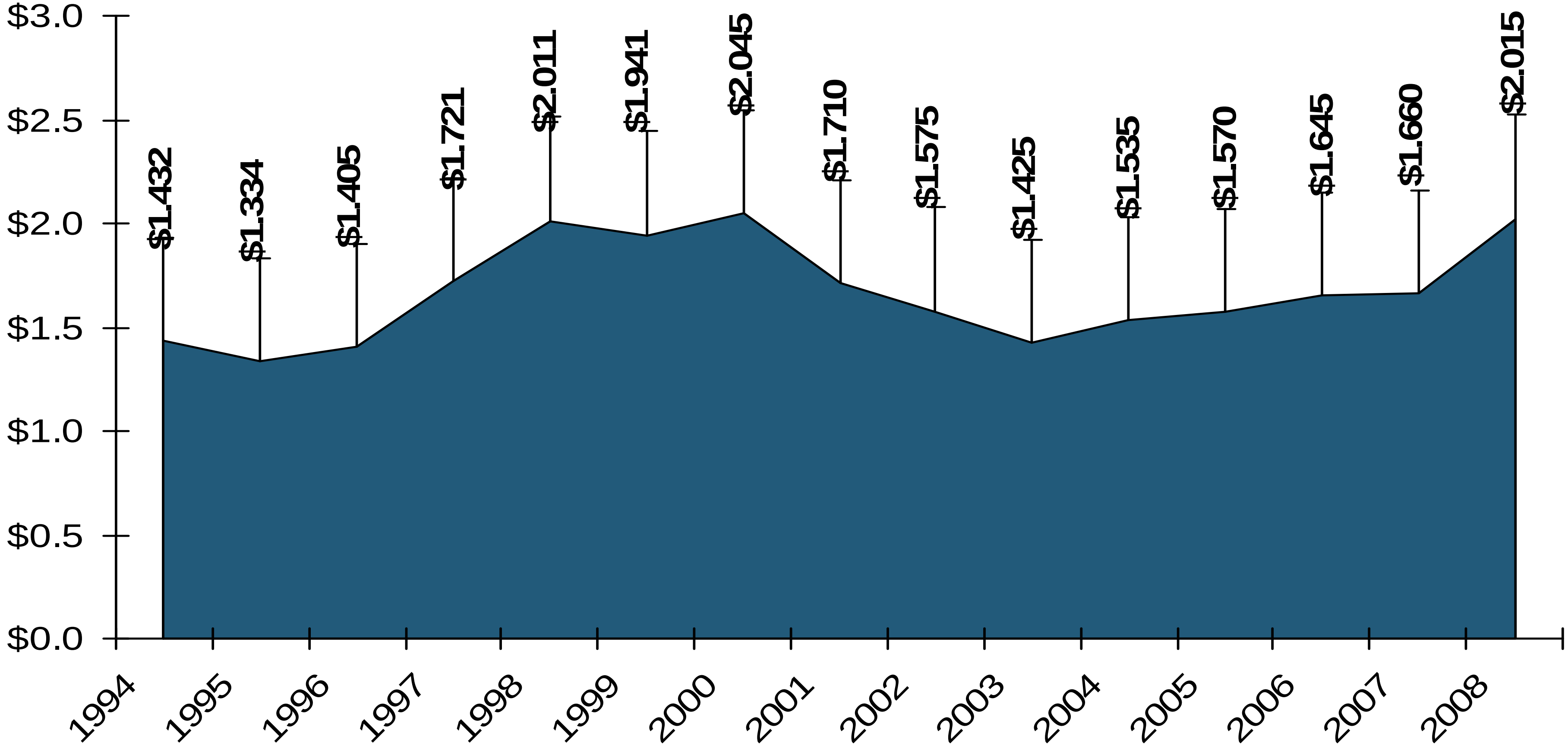


*Includes underlying primary limits

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

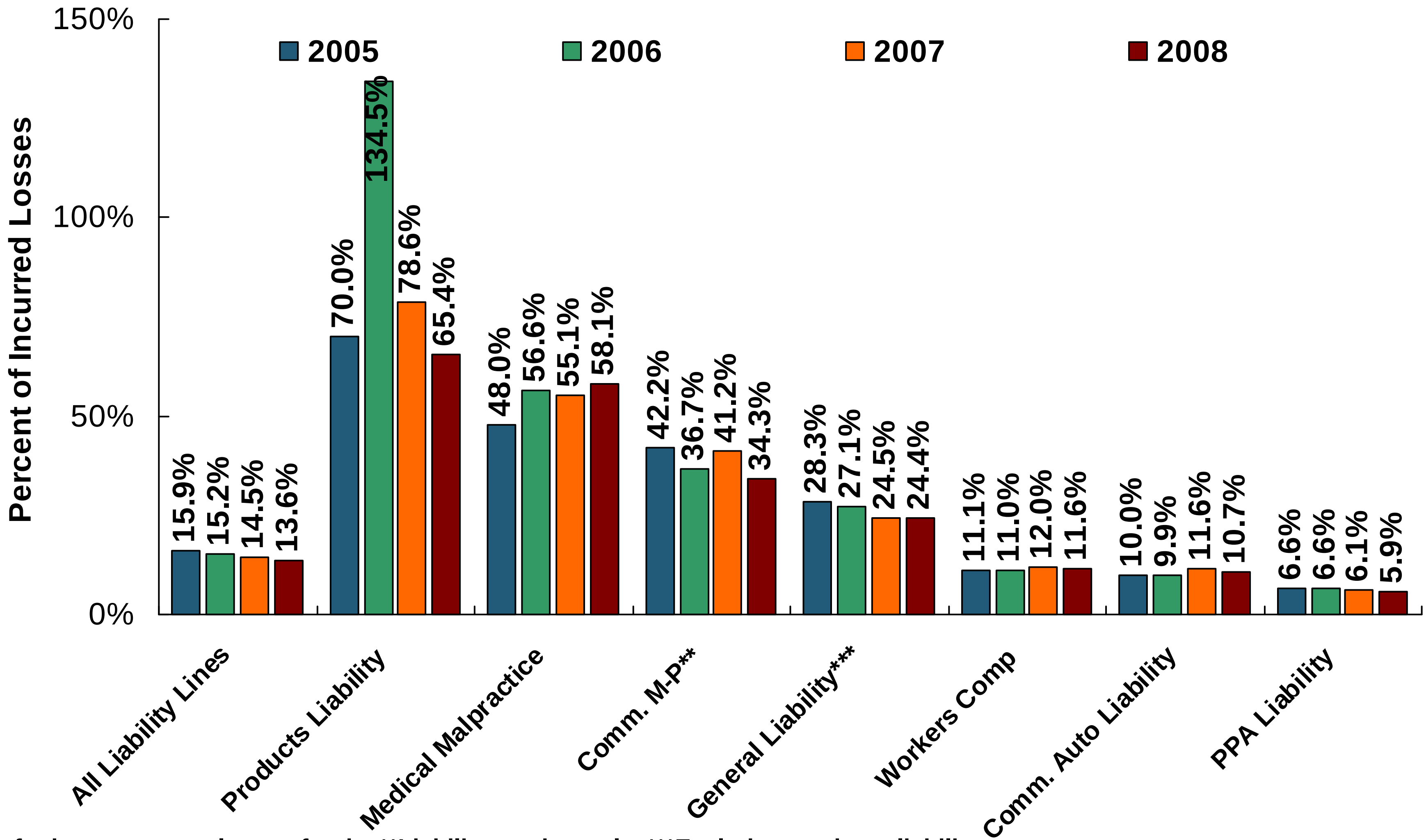
Excess Liability Market Capacity North America ($ Billions)

In 2008, capacity is back to 2000 levels.



Source: Marsh, 2008 Limits of Liability Report

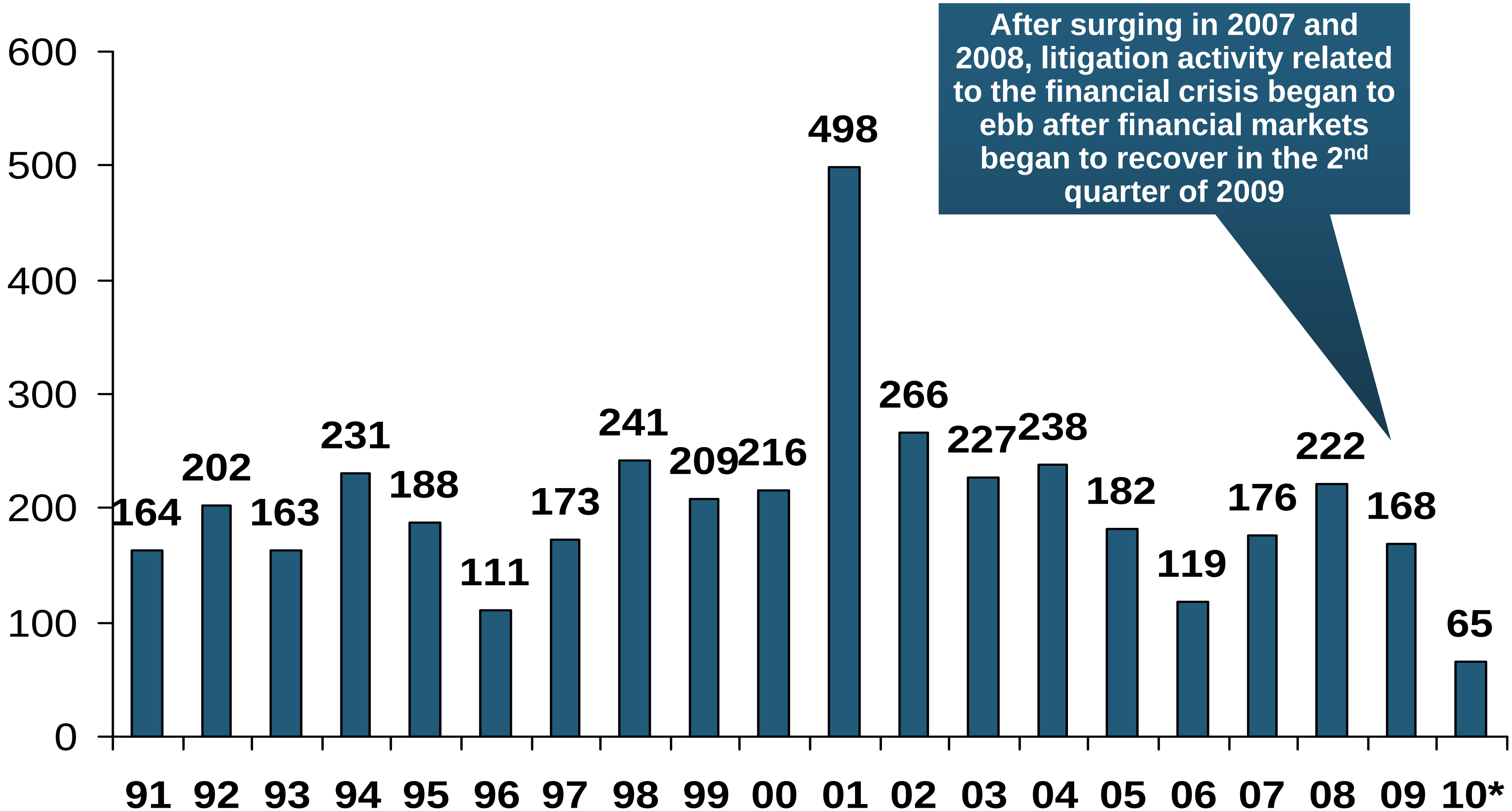
Insurer Defense & Cost Containment Expenses as a % of Incurred Losses, 2005-2008*



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

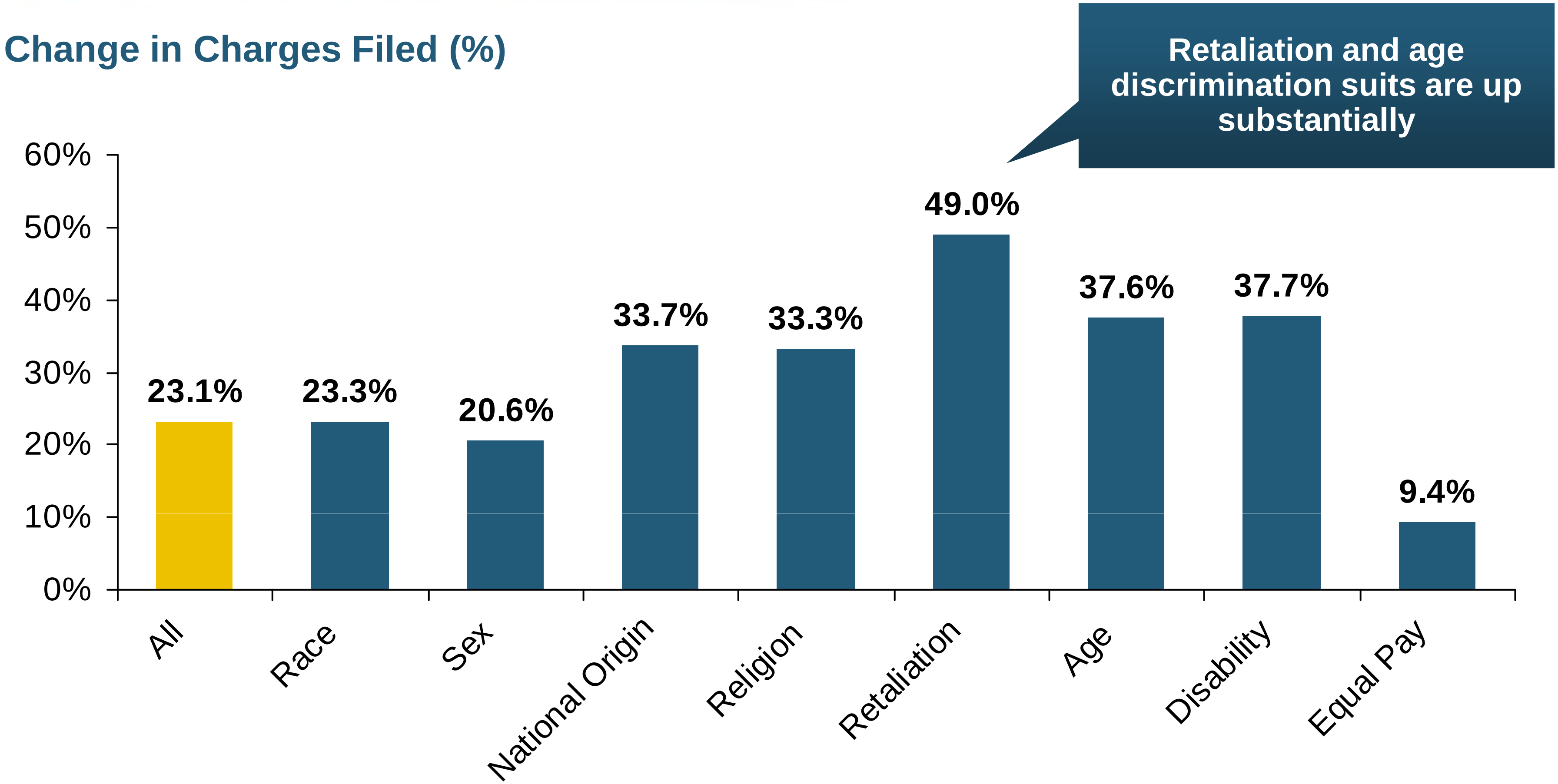
Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data, LLC; Insurance Information Institute.

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



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

Source: Equal Opportunity Employment Commission; Insurance Information Institute.

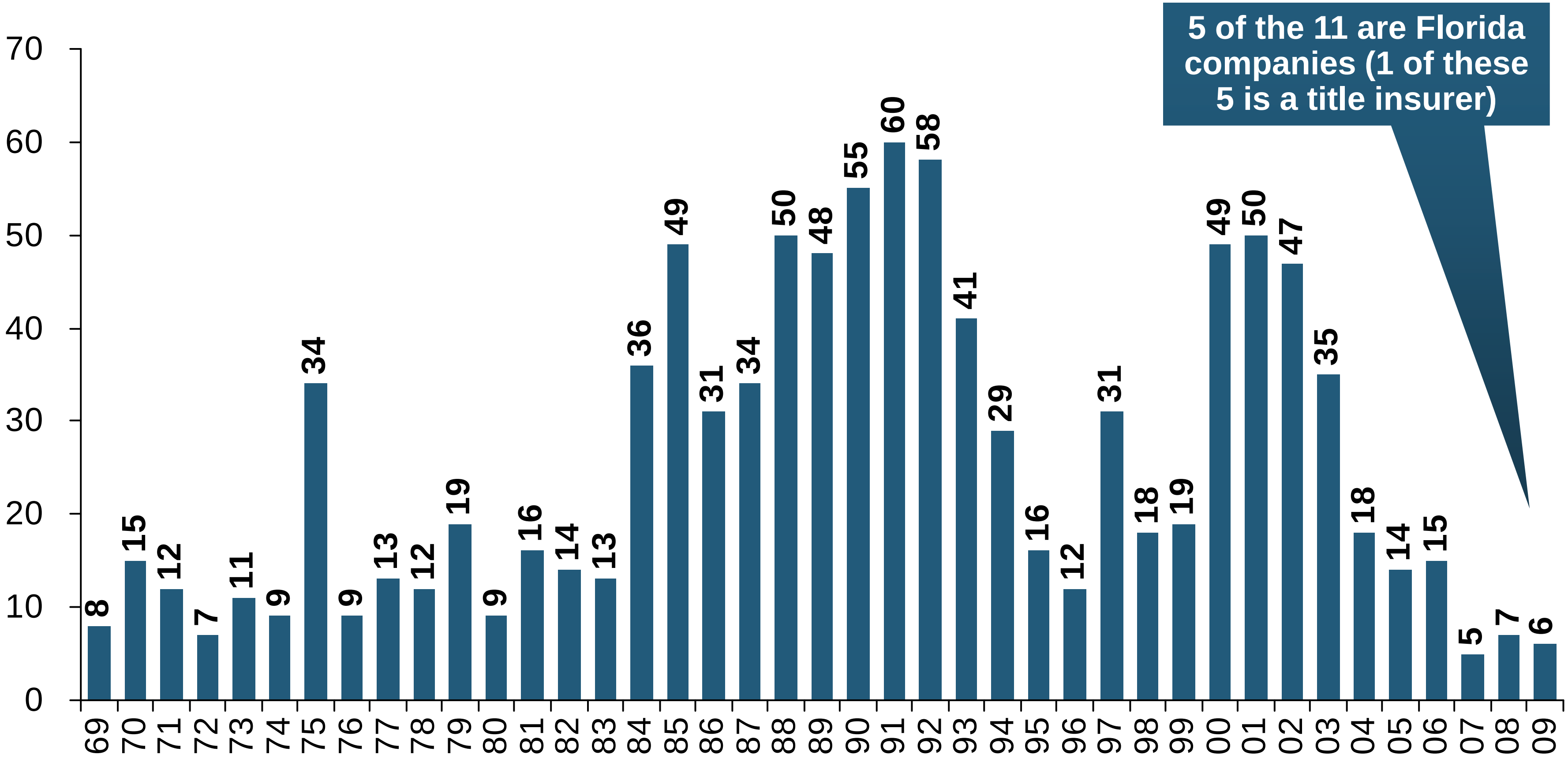
INSURANCE INFORMATION INSTITUTE

Financial Strength & Ratings

Industry Has Weathered the Storms Well

P/C Insurer Impairments, 1969–2009

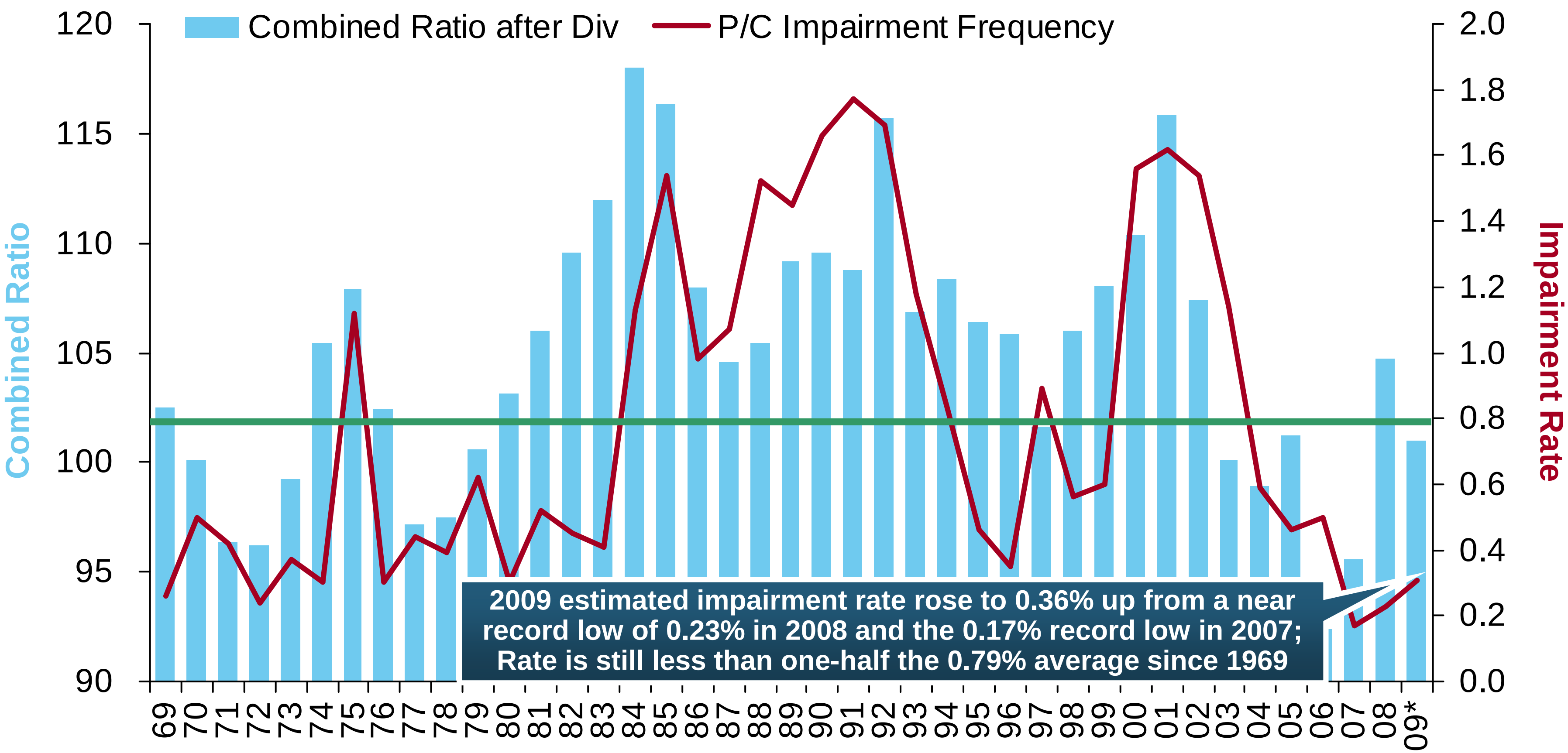
INSURANCE INFORMATION INSTITUTE



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

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

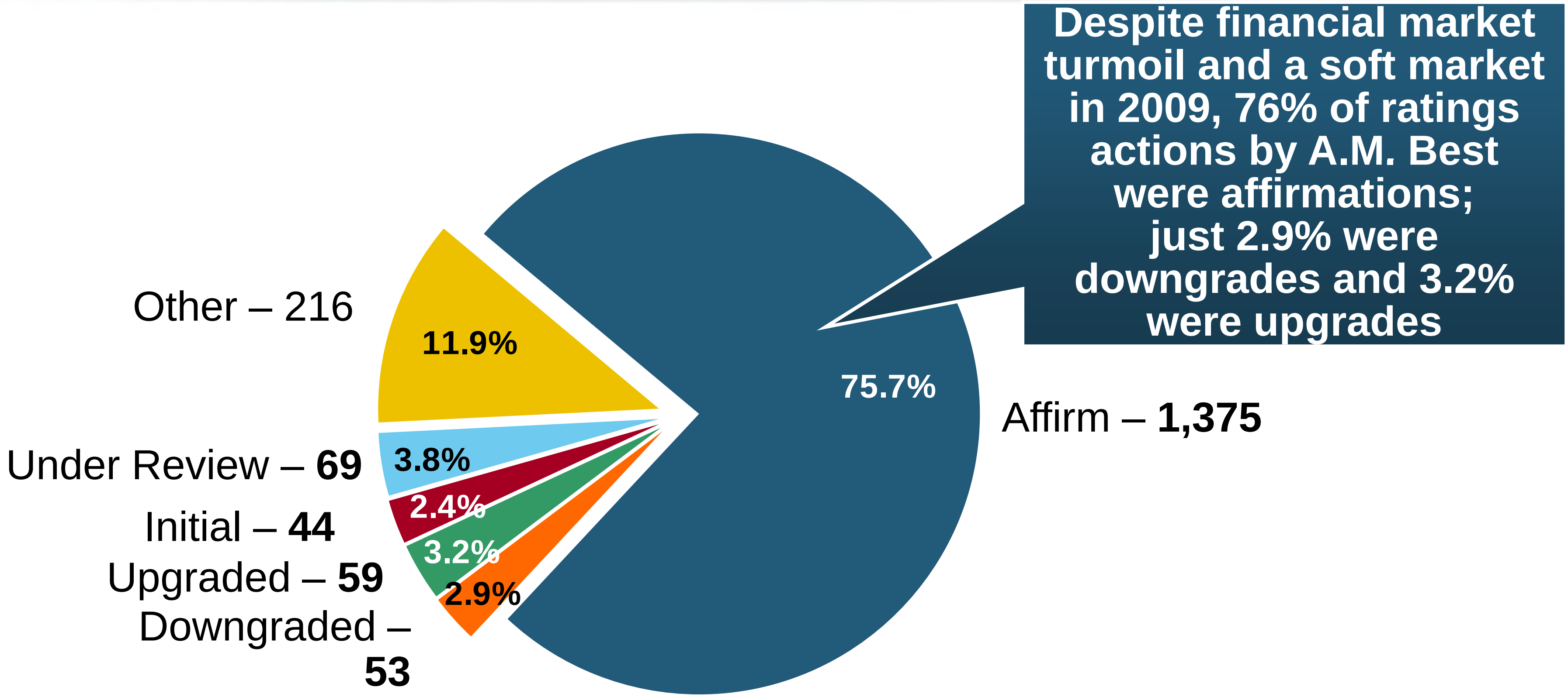
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2009



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

Source: A.M. Best; Insurance Information Institute

Summary of A.M. Best's P/C Insurer Ratings Actions in 2009



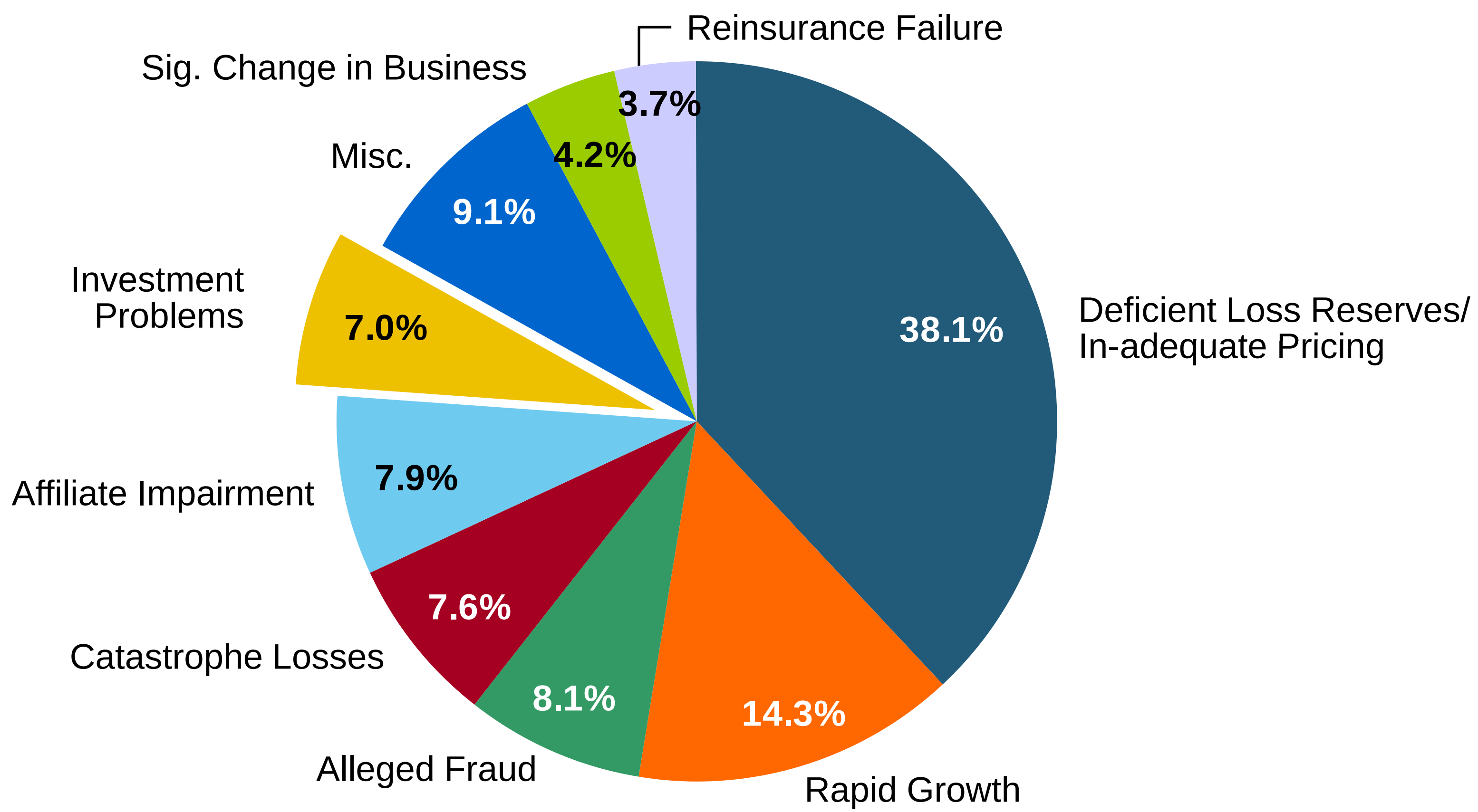
P/C Insurance is by Design a Resilient Business. The Dual Threat of Financial Disasters and Catastrophic Losses Are Anticipated in the Industry's Risk Management Strategy

Source: A.M. Best.

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

INSURANCE INFORMATION INSTITUTE

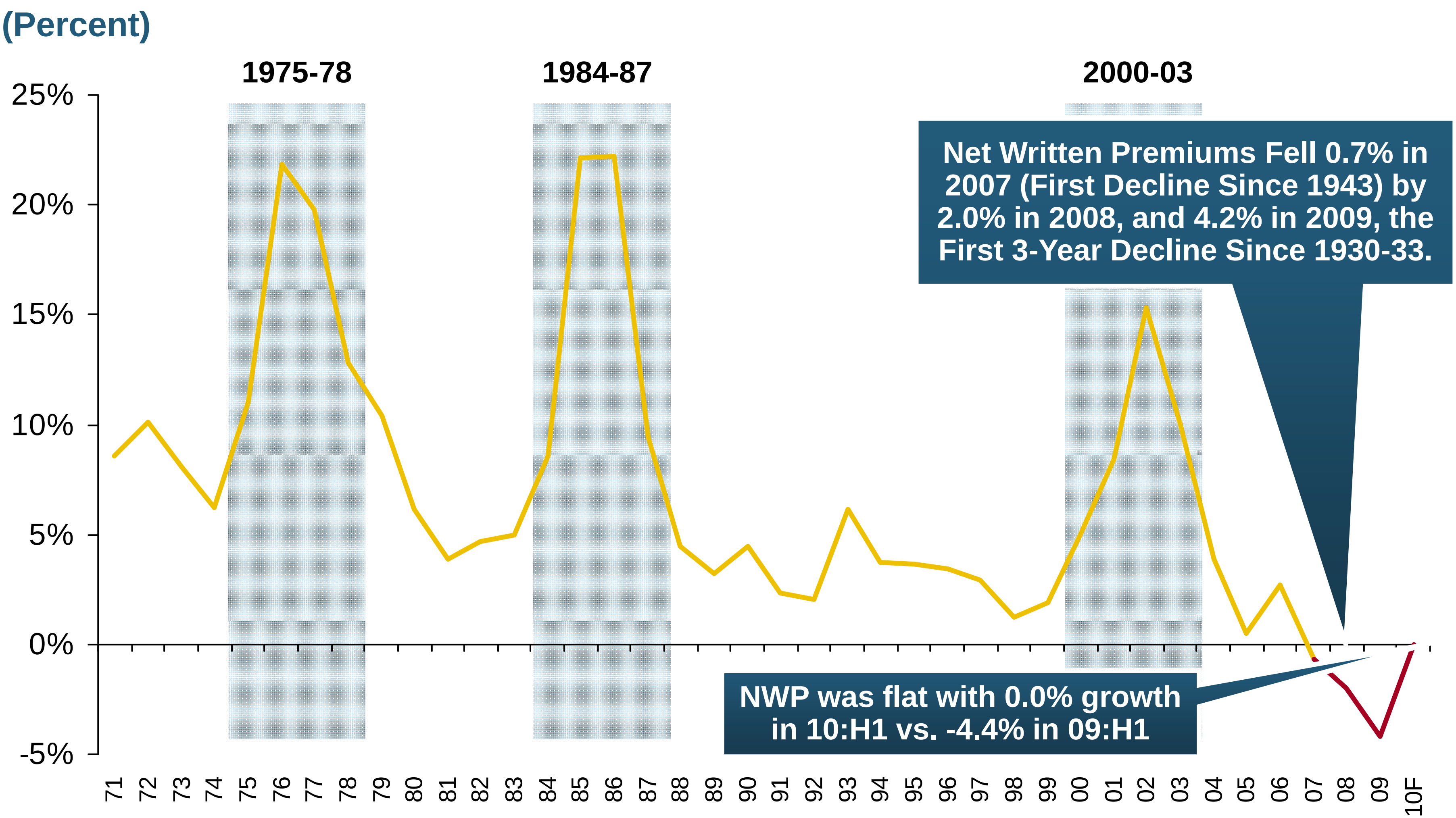
Deficient Loss Reserves and Inadequate Pricing Are the Leading Cause of Insurer Impairments, Underscoring the Importance of Discipline. Investment Catastrophe Losses Play a Much Smaller Role



Source: A.M. Best: *1969-2008 Impairment Review*, Special Report, Apr. 6, 2009

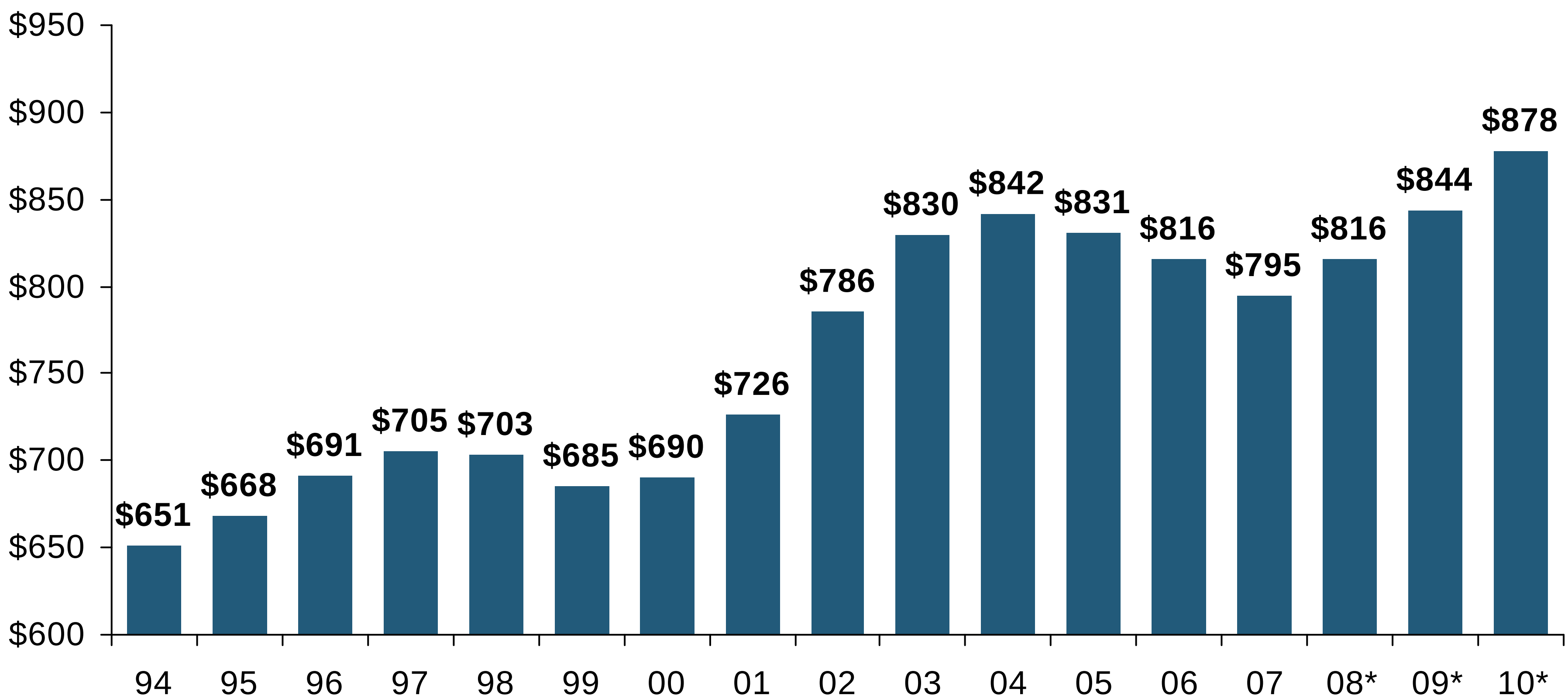
P/C Premium Growth Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Soft Market Appears to Persist in 2010 but May Be Easing: Relief in 2011?



Shaded areas denote “hard market” periods
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

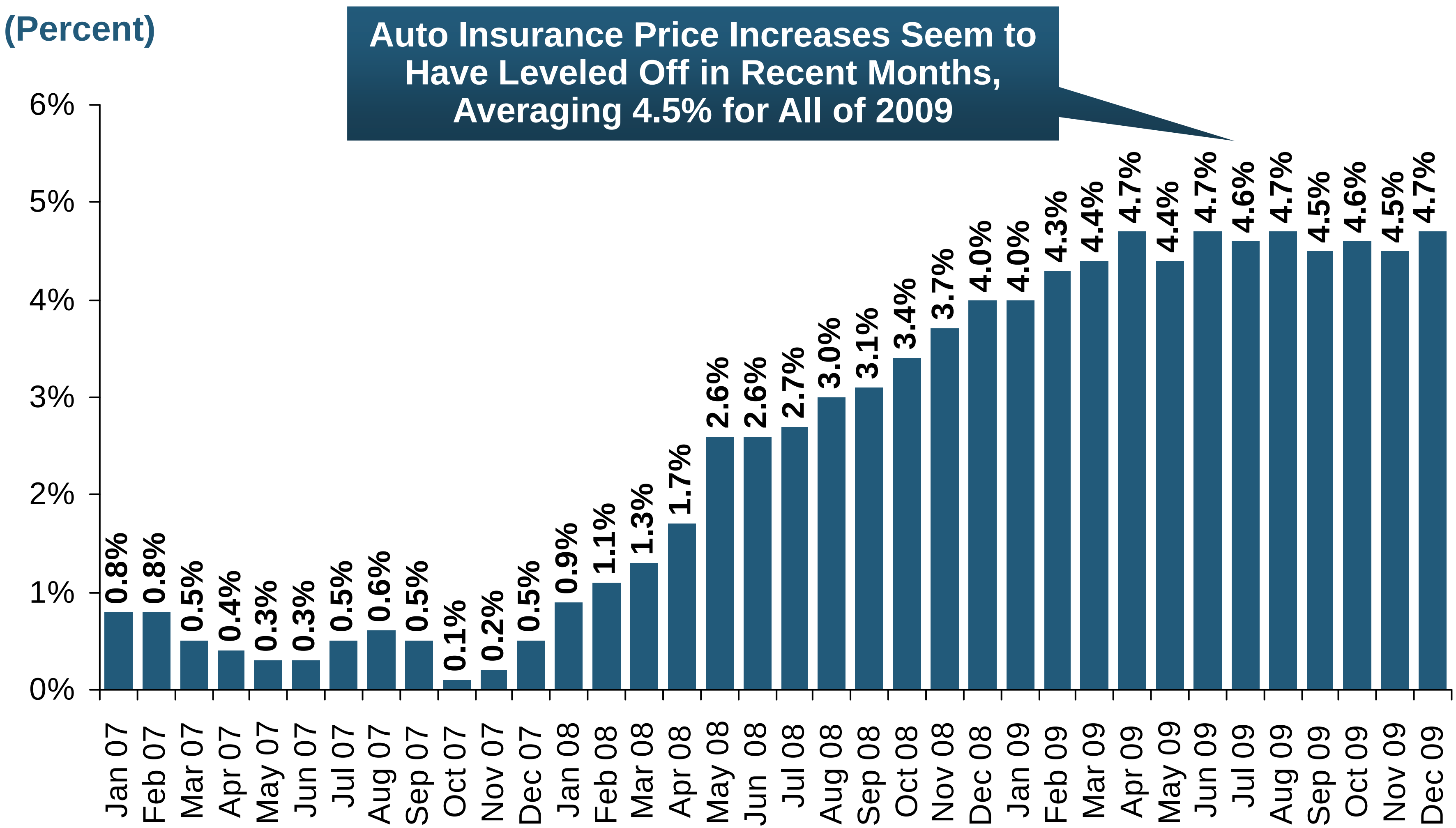
Average Expenditures on Auto Insurance



Countrywide Auto Insurance Expenditures Increased 2.6% in 2008 and 3.5% Pace in 2009 (est.) and 4% in 2010 (est.)

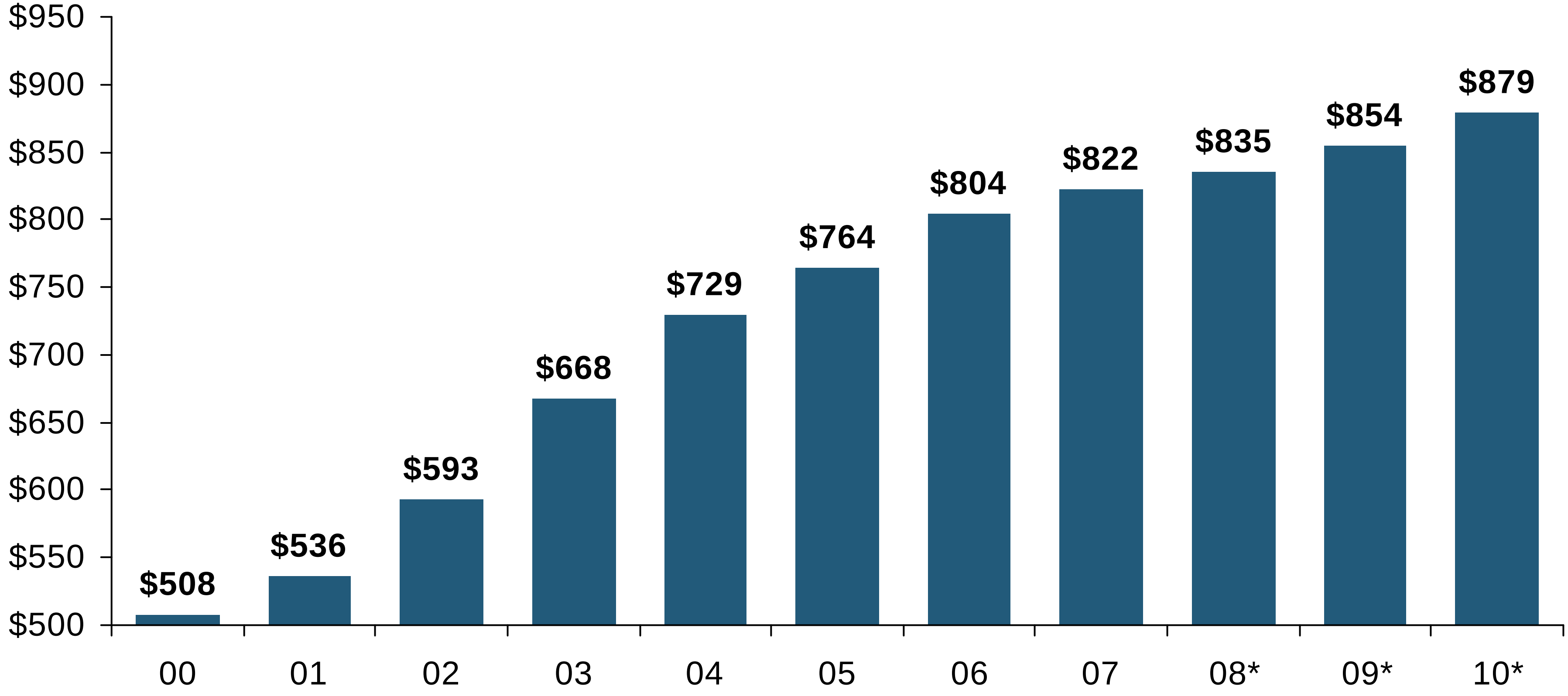
* Insurance Information Institute Estimates/Forecasts
Source: NAIC, Insurance Information Institute estimates 2008-2010 based on CPI data.

Monthly Change in Auto Insurance Prices*



* Percentage change from same month in prior year.
Source: US Bureau of Labor Statistics

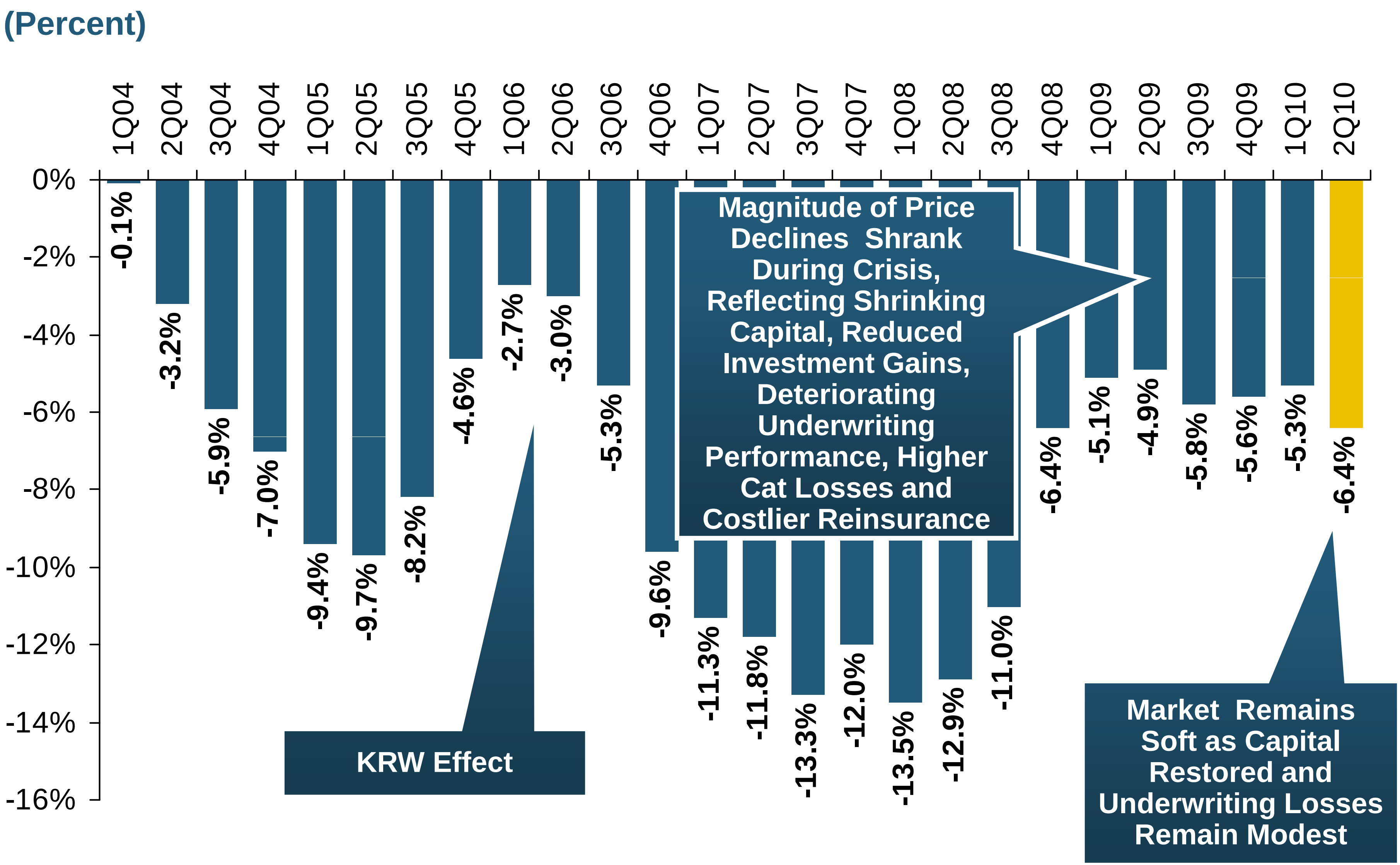
Average Premium for Home Insurance Policies**



* Insurance Information Institute Estimates/Forecasts **Excludes state-run insurers.
Source: NAIC, Insurance Information Institute estimates 2008-2010 based on CPI data.

Average Commercial Rate Change, All Lines, (1Q:2004–2Q:2010)

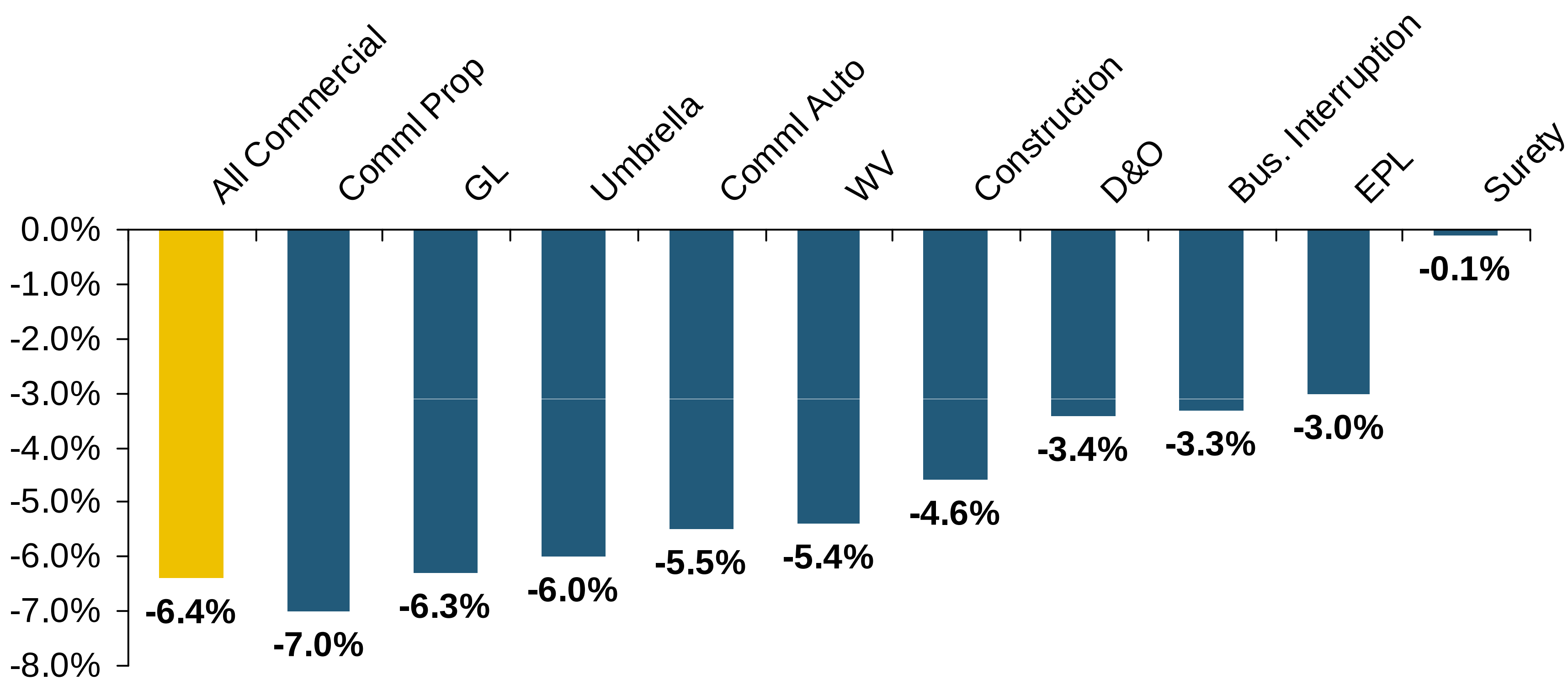
INSURANCE INFORMATION INSTITUTE



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

Change in Commercial Rate Renewals, by Line: 2010:Q2

Percentage Change (%)



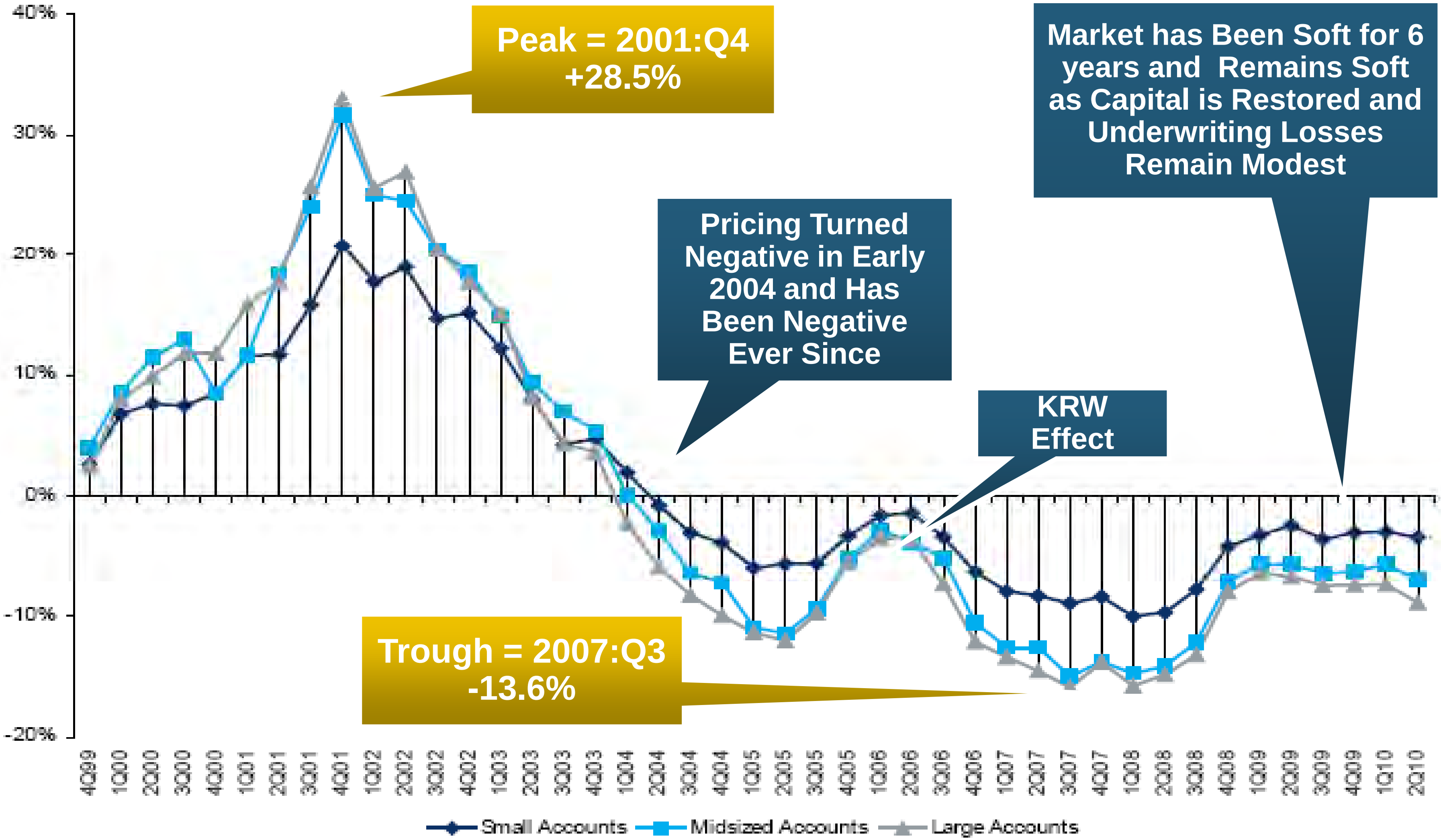
Most Major Commercial Lines Renewed Down in Q2:2010 at a Faster Pace than a year Earlier

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

Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2010:Q2

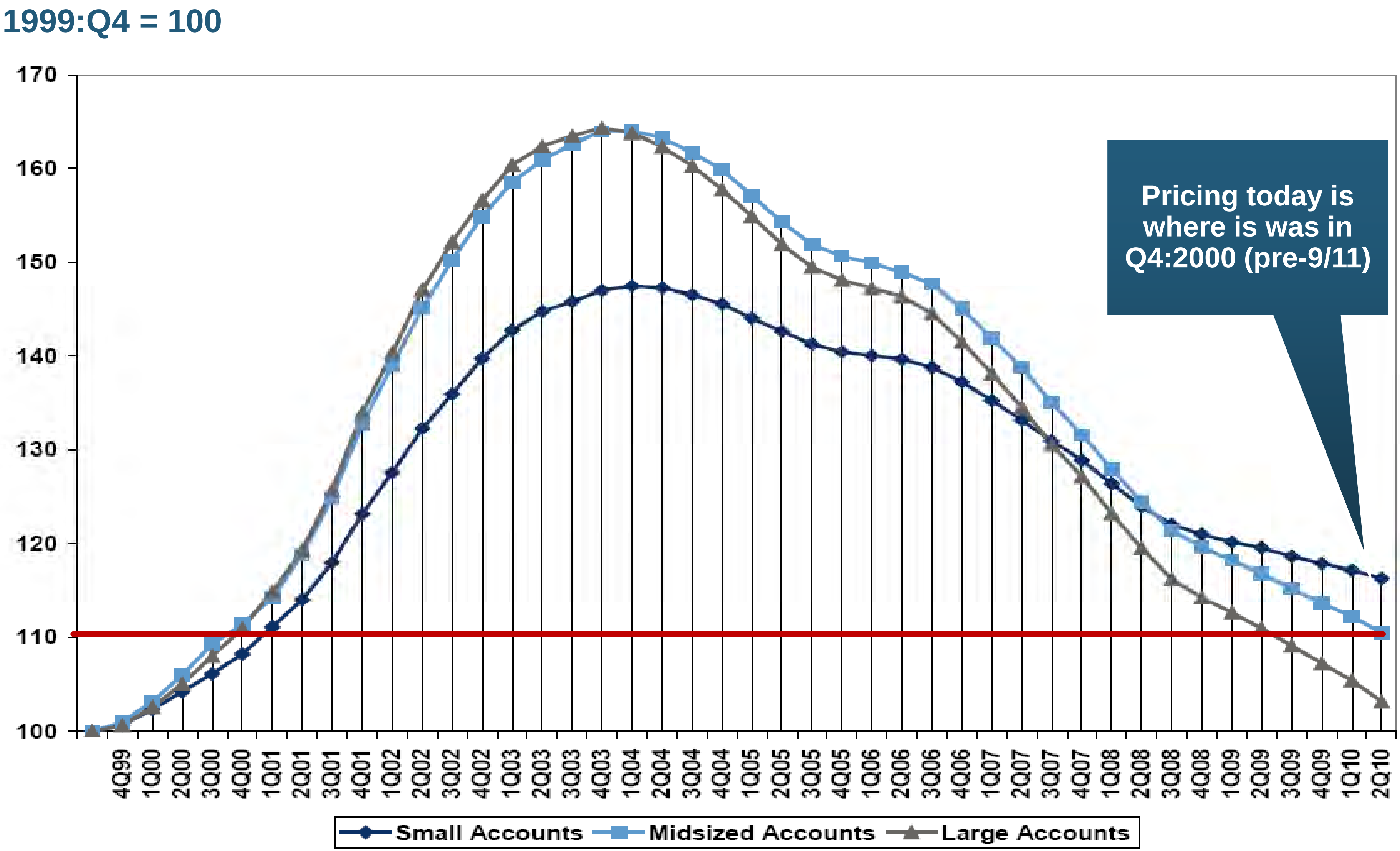
INSURANCE INFORMATION INSTITUTE

Percentage Change (%)



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

Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2010:Q2

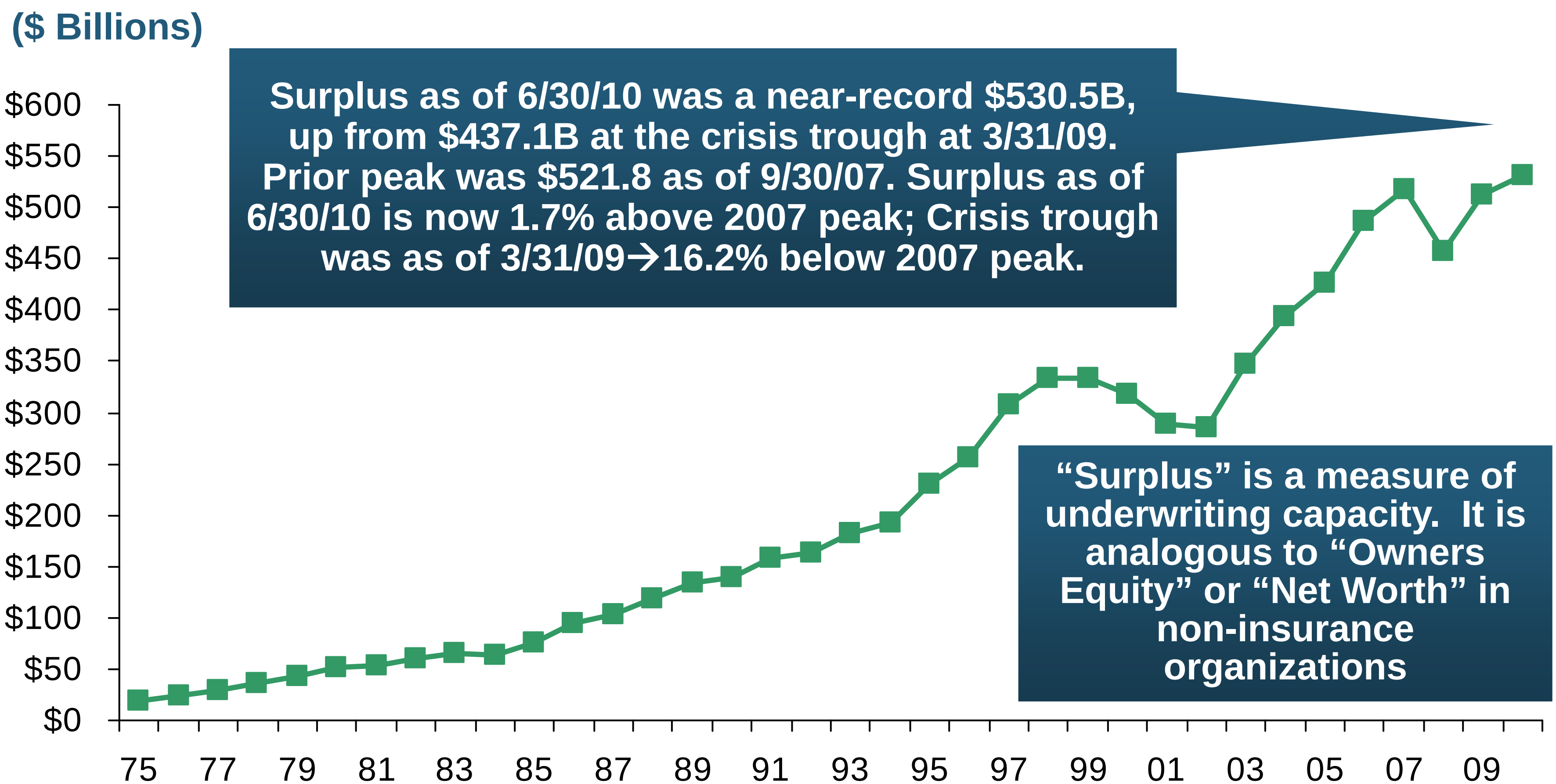


Source: Council of Insurance Agents and Brokers; Insurance Information Institute.

Capital/Policyholder Surplus (US)

Shrinkage, but Not Enough to Trigger Hard Market

US Policyholder Surplus: 1975–2010*



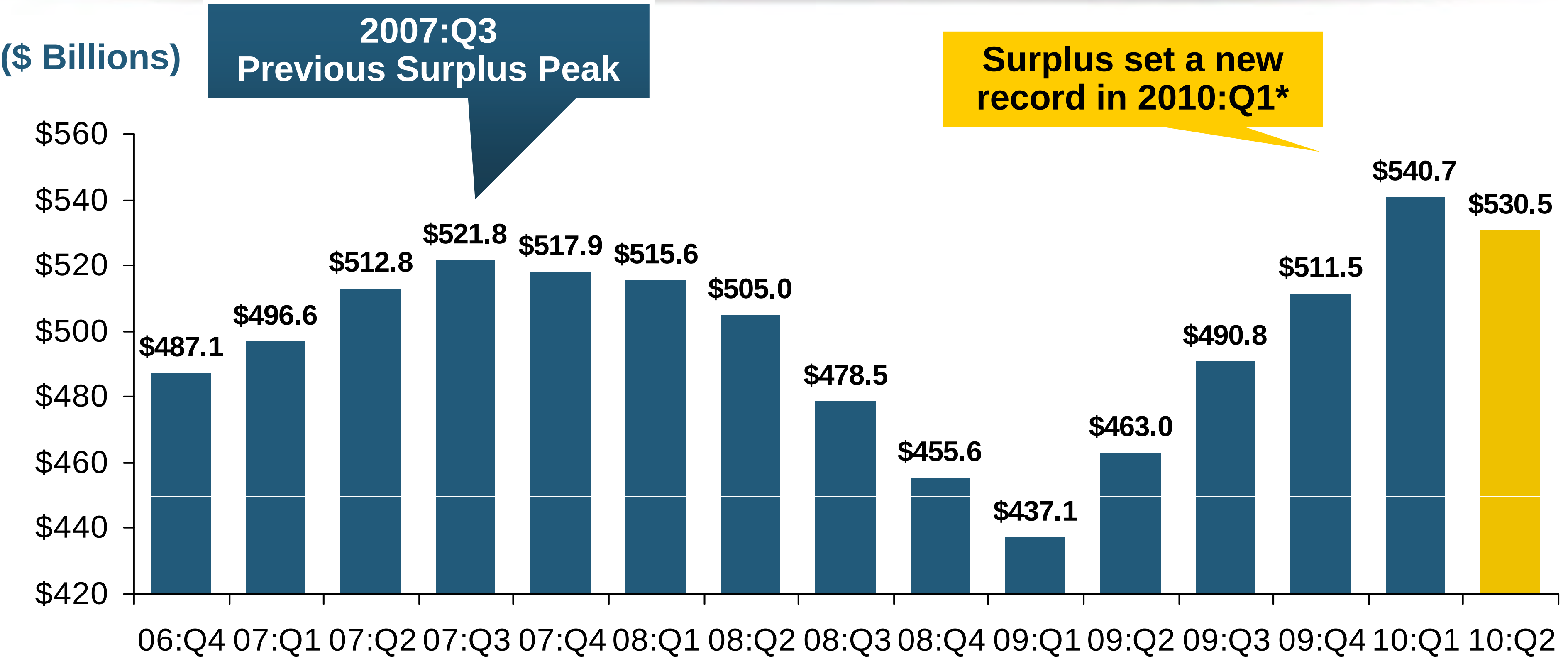
The Premium-to-Surplus Ratio Stood at $0.80:$1 as of 6/30/10, A Record Low (at Least in Recent History)**

* 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:Q2

INSURANCE INFORMATION INSTITUTE



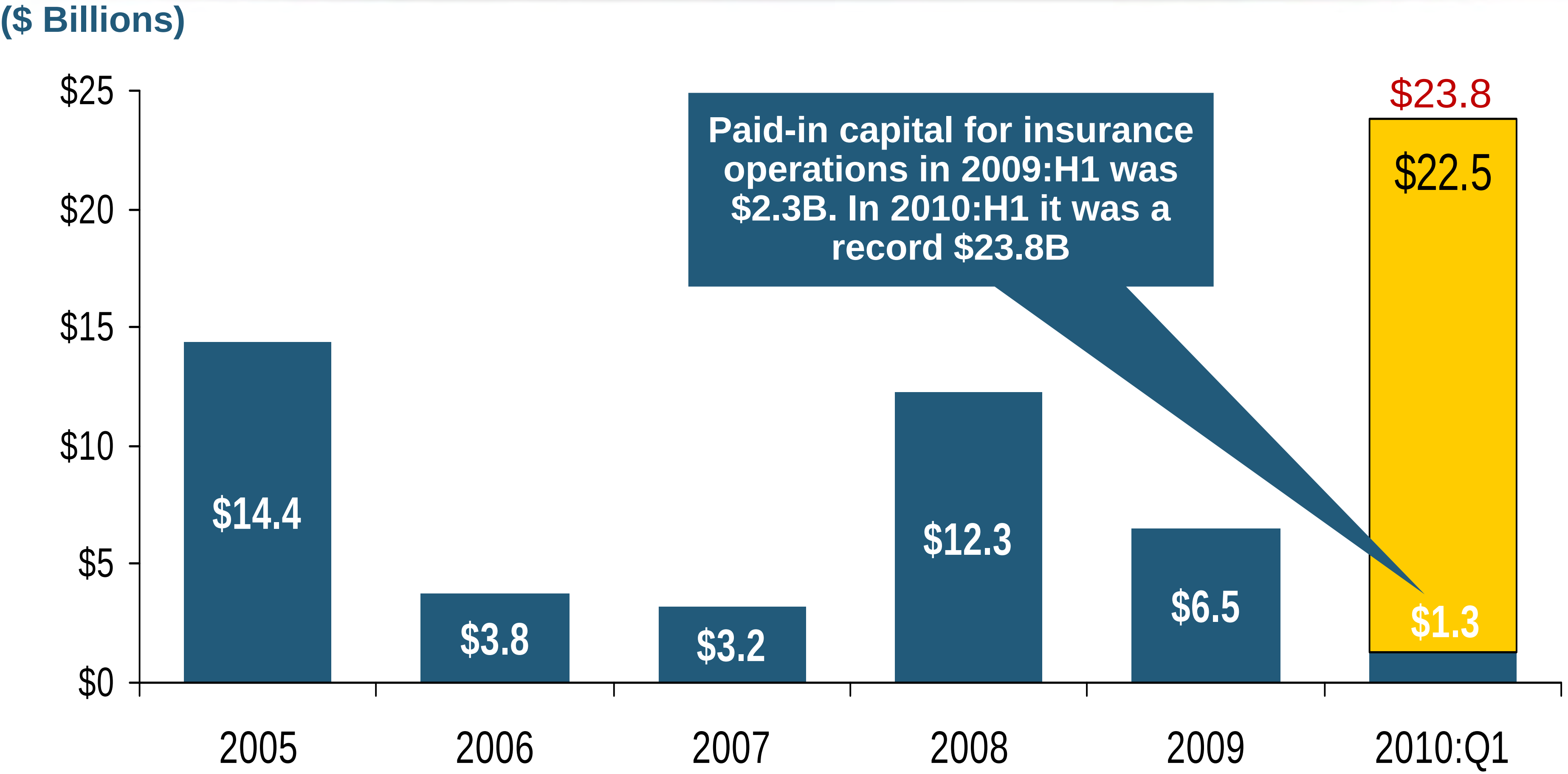
Quarterly Surplus Changes Since 2009:Q1 Trough

09:Q1: -$84.7B (-16.2%)	***10:Q1: +$18.9B (+3.6%)***
09:Q2: -$58.8B (-11.2%)	**10:Q2: -$10.2B (-1.9%)**
09:Q3: -$31.8B (-5.9%)	
09:Q4: -$10.3B (-2.0%)	

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

Sources: ISO, A.M .Best.

Paid-in Capital, 2005–2010:H1



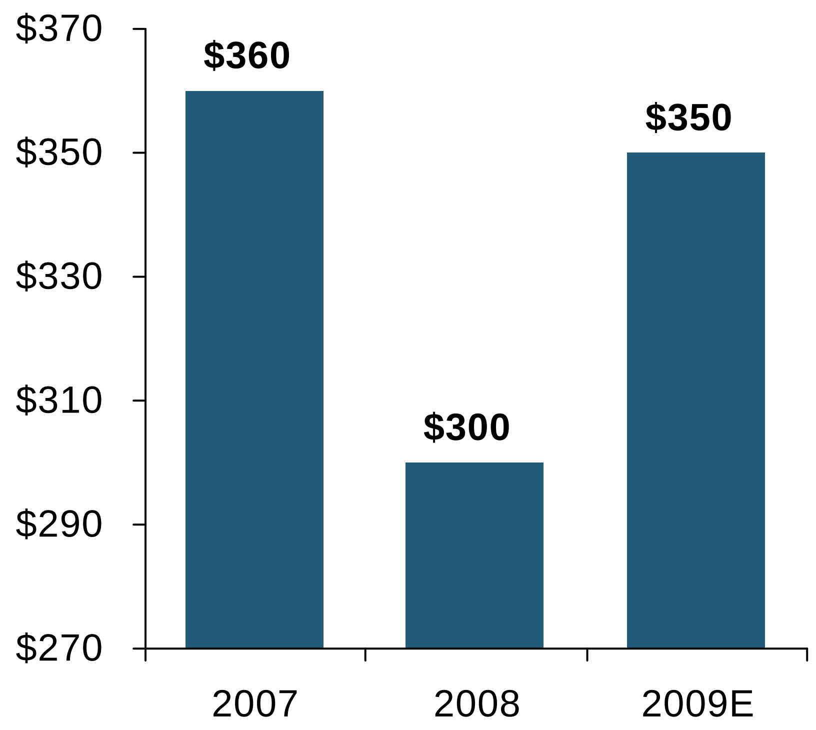
In 2010:H1 One Insurer's Paid-in Capital Rose by $22.5B as Part of an Investment in a Non-insurance Business

Source: ISO.

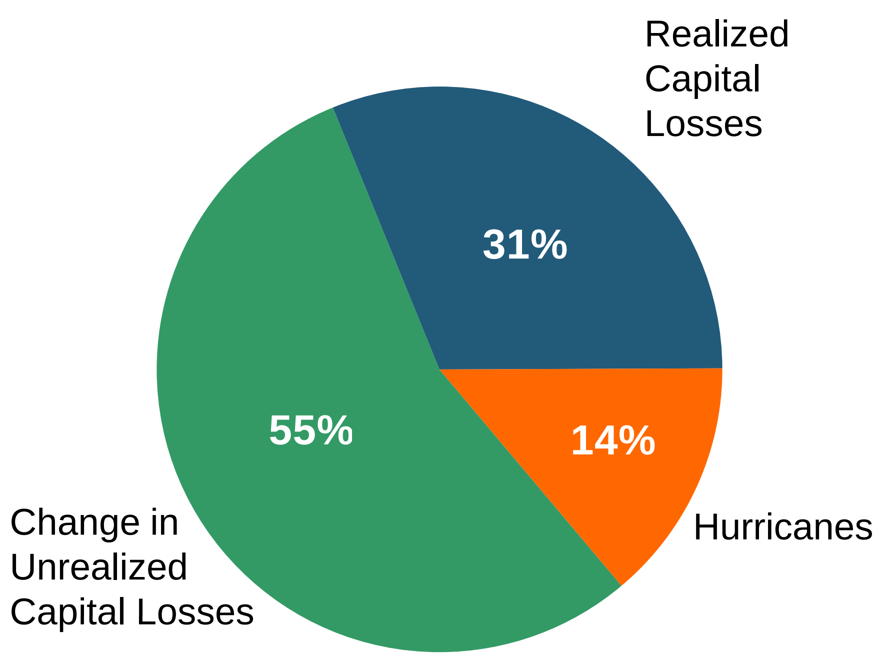
Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

INSURANCE INFORMATION INSTITUTE

Global Reinsurance Capacity



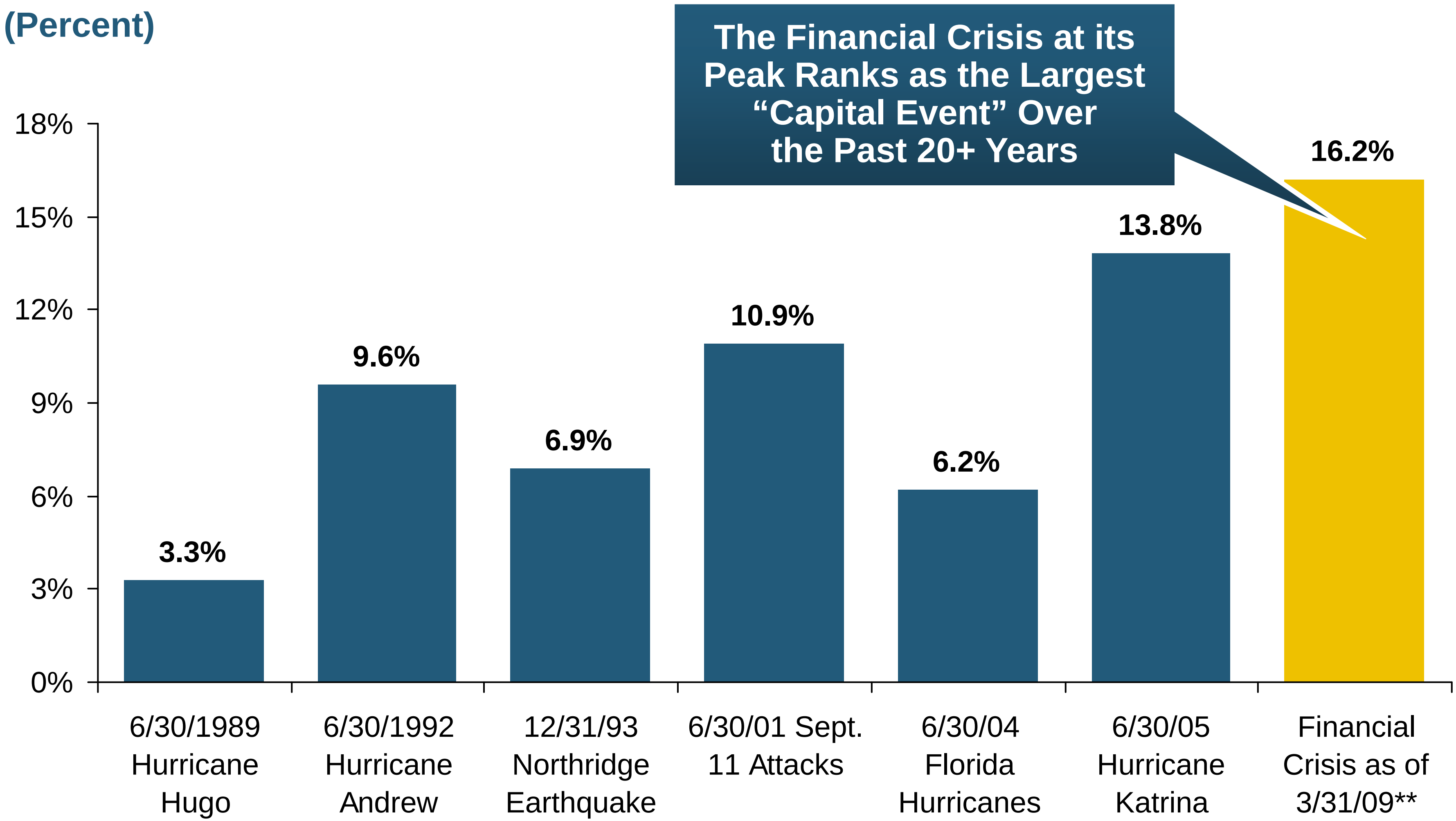
Source of Decline in 2008



Global Reinsurance Capacity Fell by an Estimated 17% in 2008

Source: AonBenfield Reinsurance Market Outlook 2009; Insurance Information Institute estimate for 2009.

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

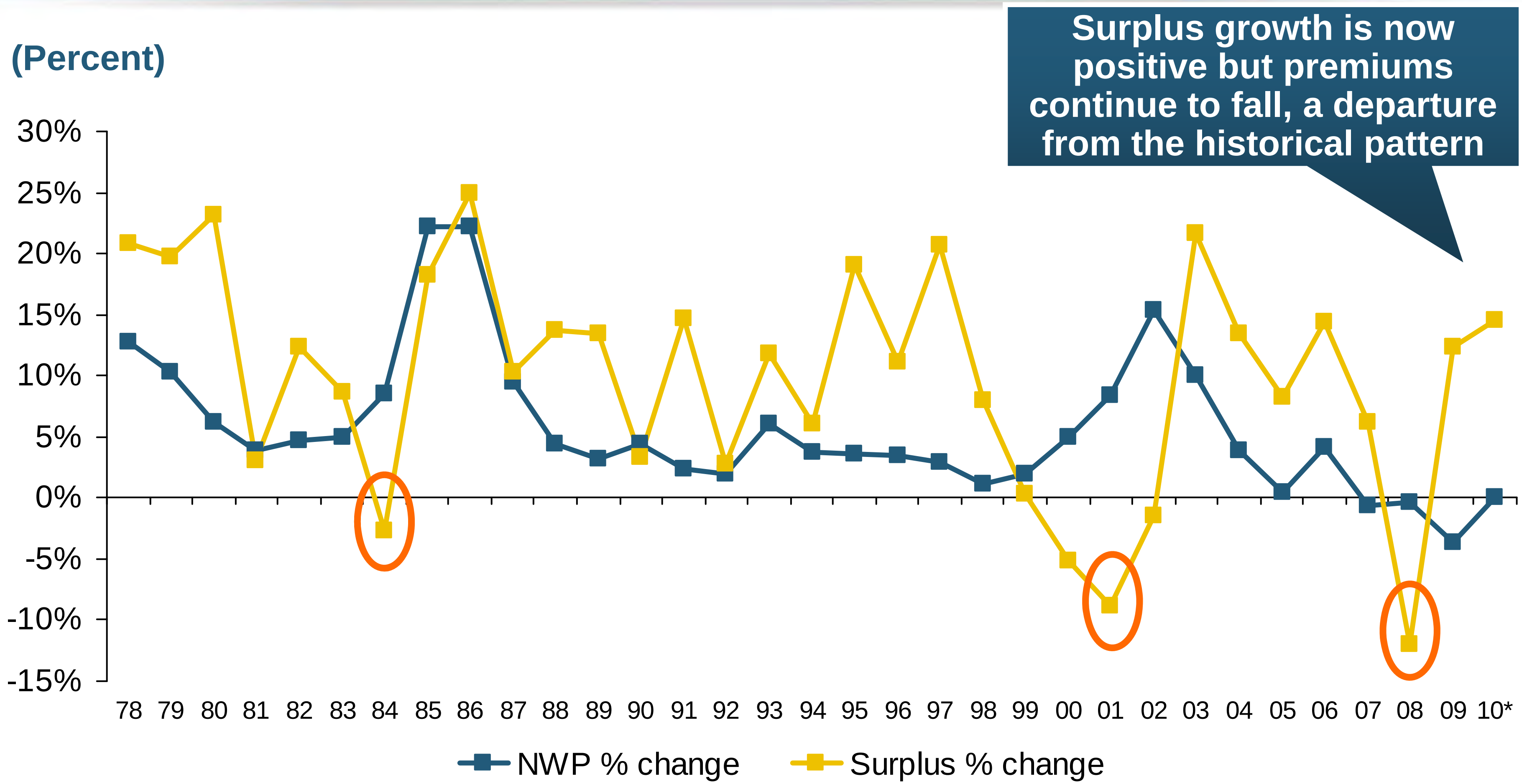


* Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event

** 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*



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 H1:10 vs H1:09.

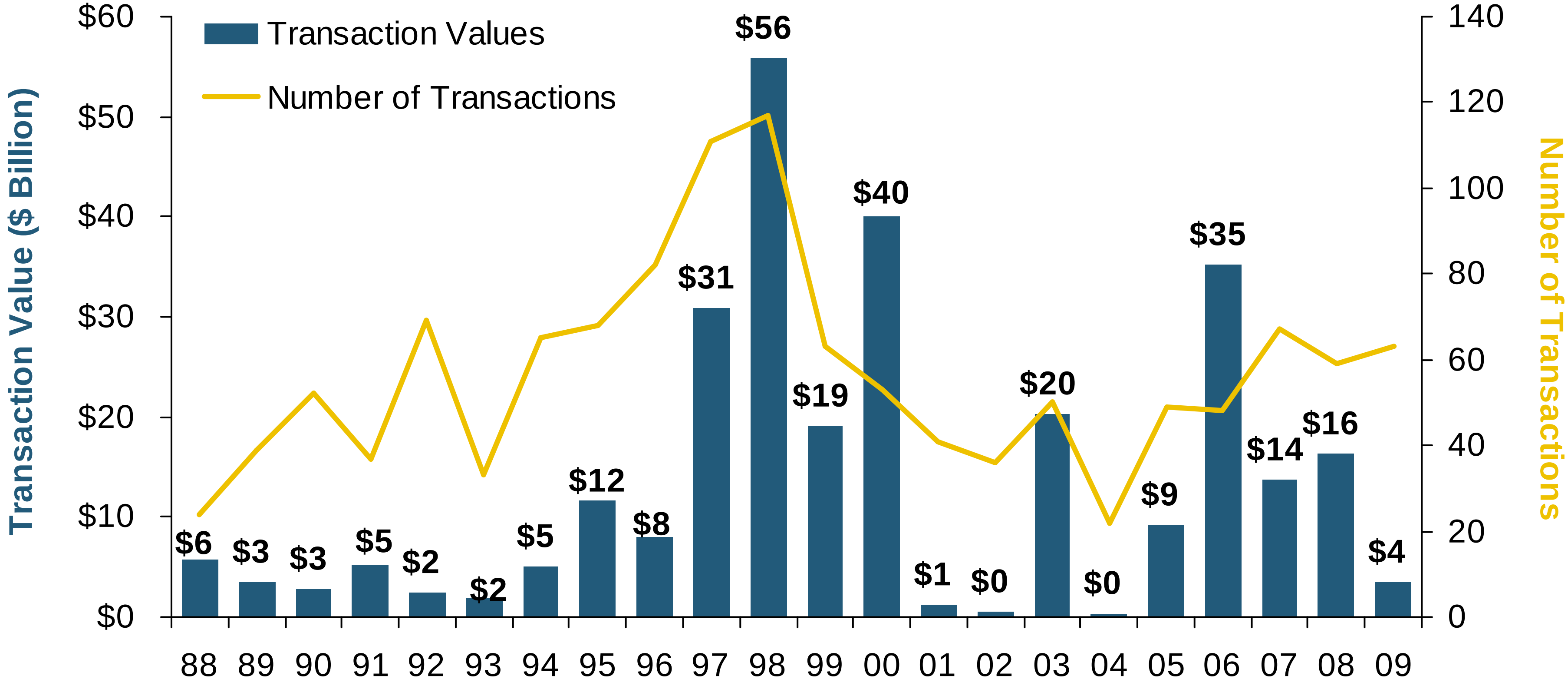
Sources: A.M. Best, ISO, Insurance Information Institute

INSURANCE INFORMATION INSTITUTE

Merger & Acquisition

Barriers to Consolidation Will Diminish in 2010

U.S. P/C Insurance-Related M&A Activity, 1988–2009



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

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

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

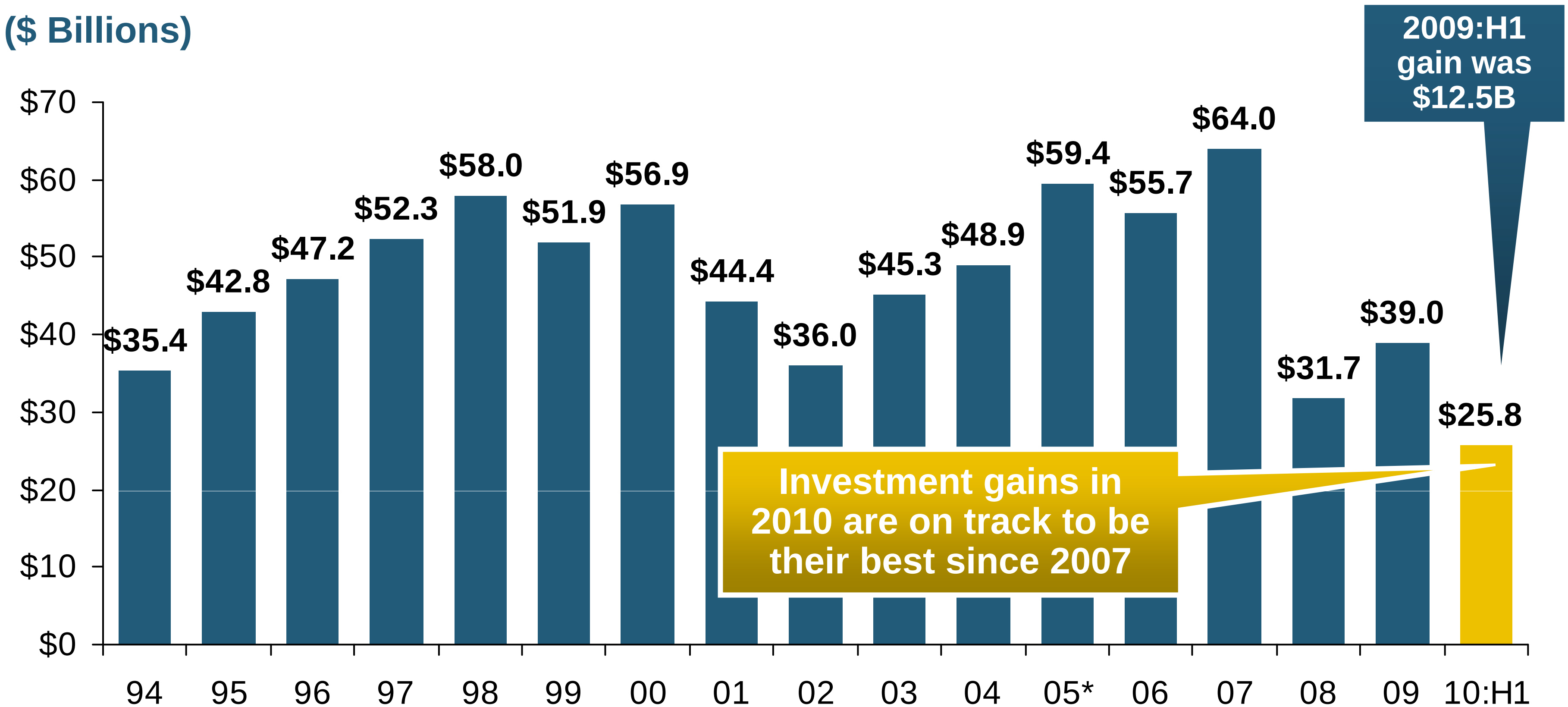
Source: Conning Research & Consulting.

Investment Performance

Investments Are a Principle Source of Declining Profitability

Property/Casualty Insurance Industry Investment Gain: 1994–2010:H1[1]

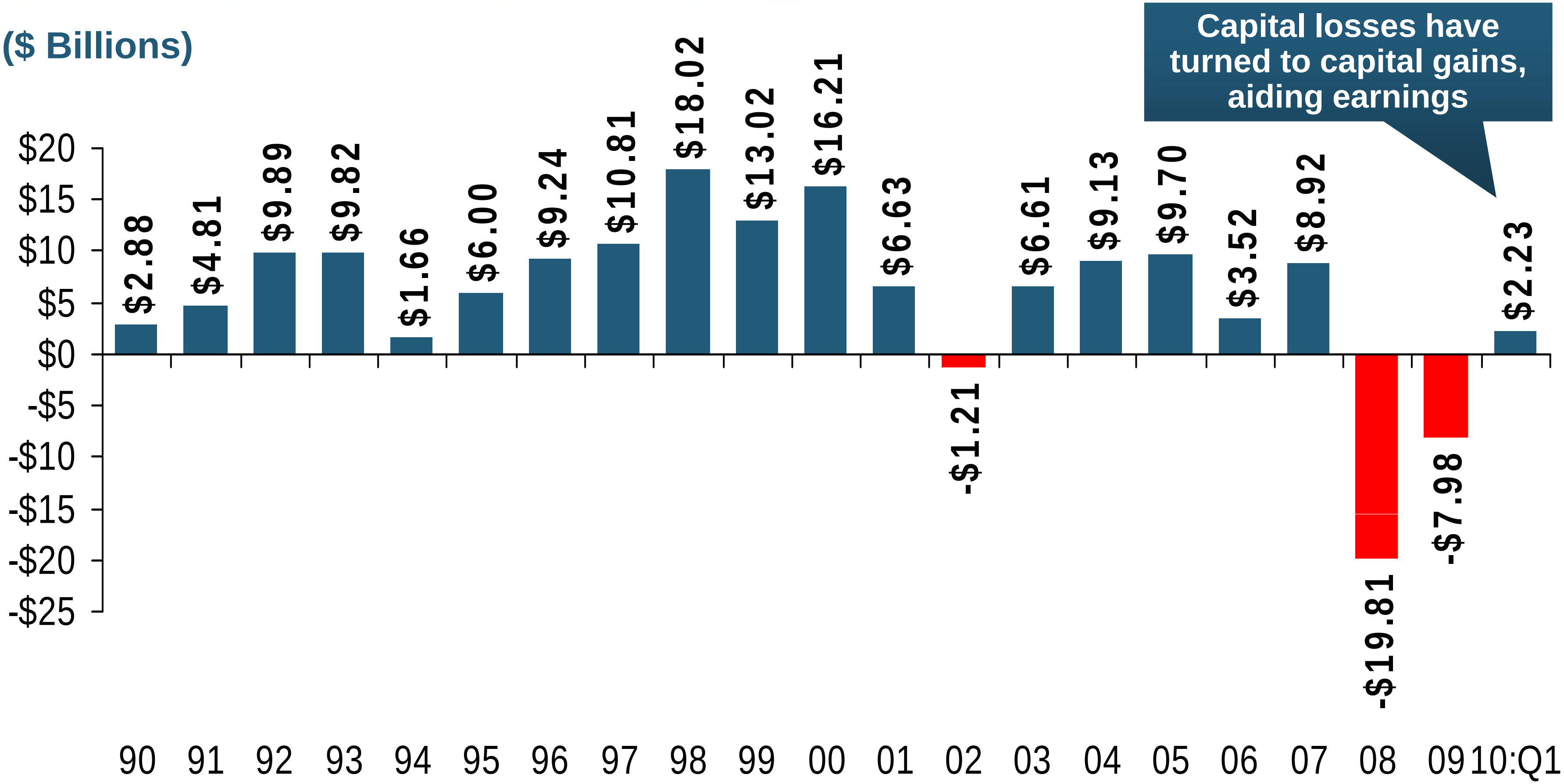
INSURANCE INFORMATION INSTITUTE



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 Are Recovering So Far 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.

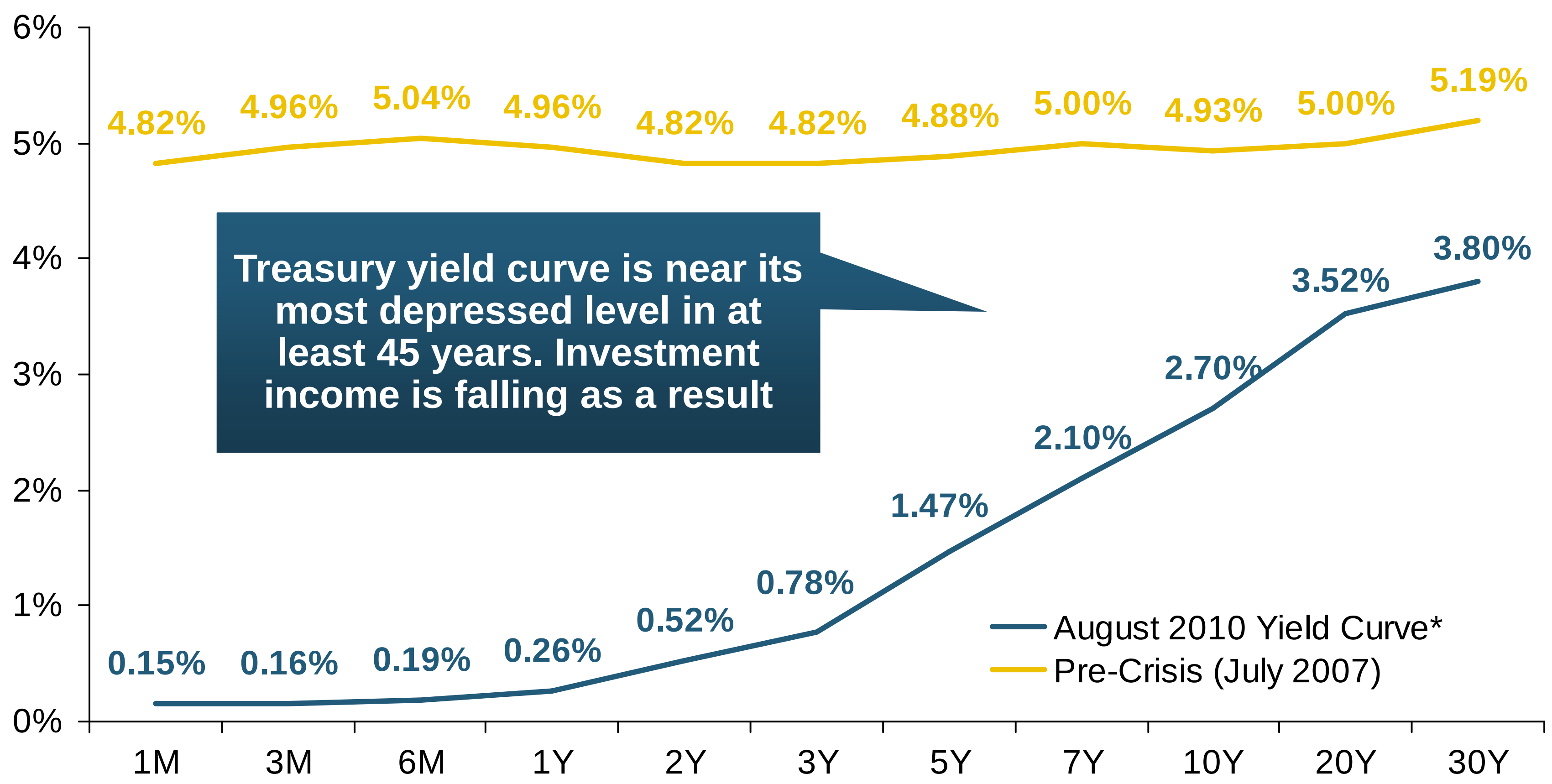
P/C Insurer Net Realized Capital Gains, 1990-2010:H1



Realized Capital Losses Were the Primary Cause of 2008/2009's Large Drop in Profits and ROE

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

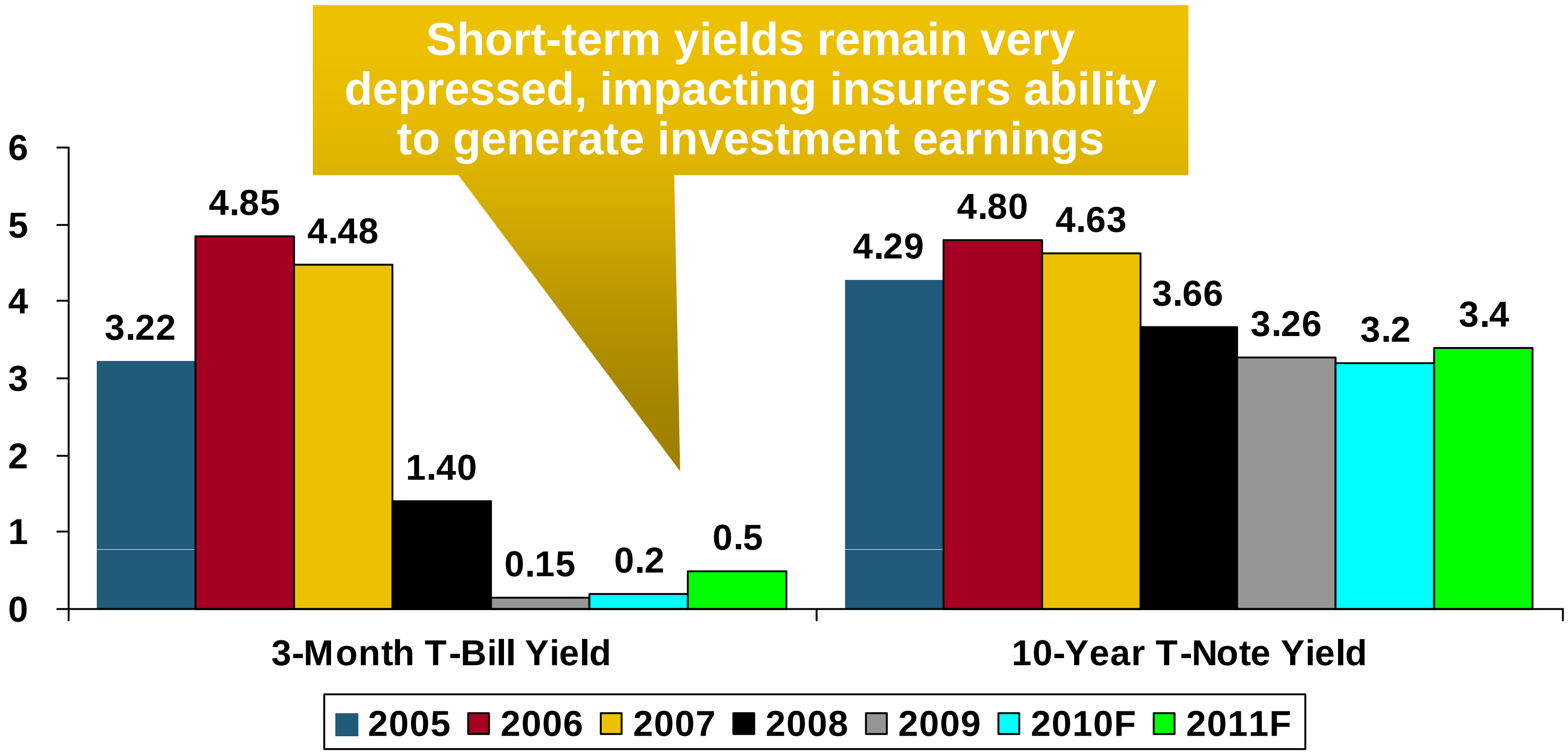
Treasury Yield Curves:
Pre-Crisis (July 2007) vs. August 2010



Stock Dividend Cuts Have Further Pressured Investment Income

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

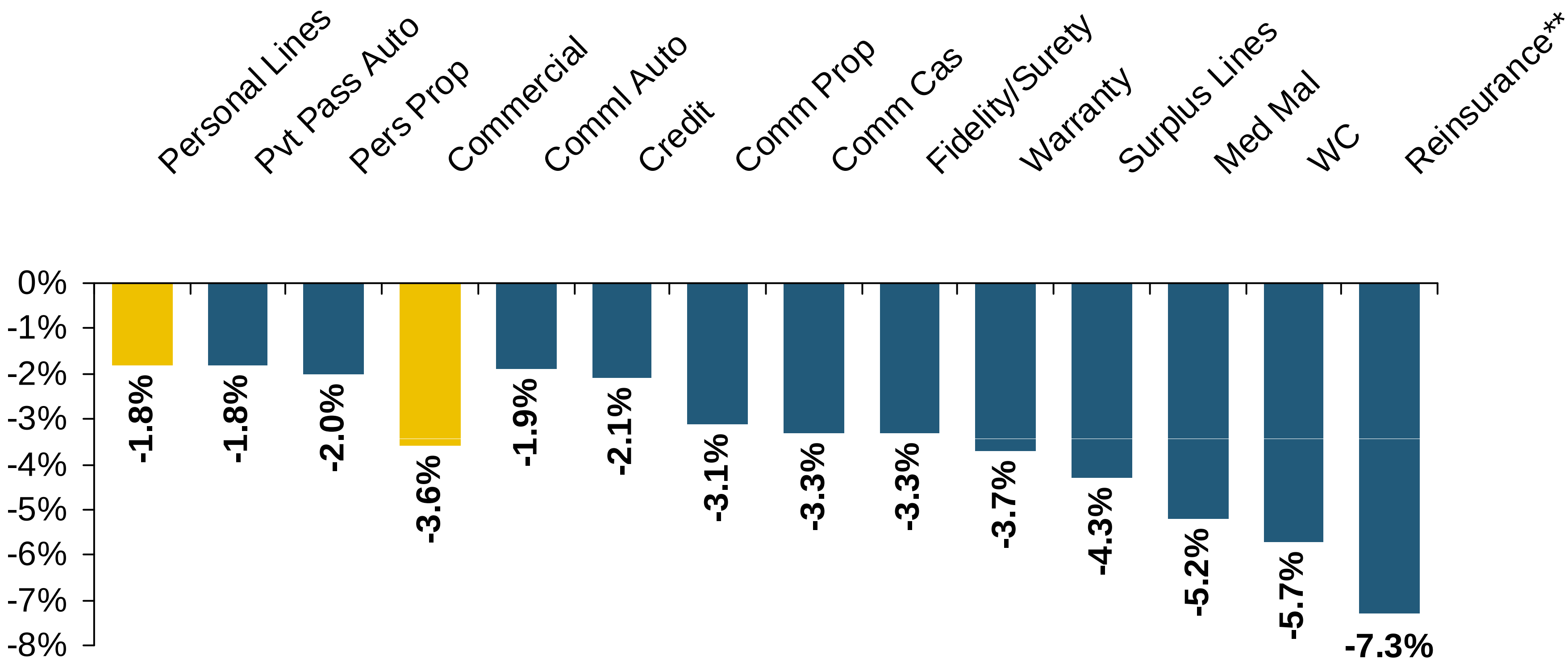
Treasury Yields Are Low and Expected to Remain Low Through 2011



The ability of reserves releases to favorably impact calendar year results will diminish over time reserved redundancies fall

Sources: Board of Governors of the United States Federal Reserve Bank; Blue Chip Economic Indicators, 9/10; Insurance Information Institute.

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.

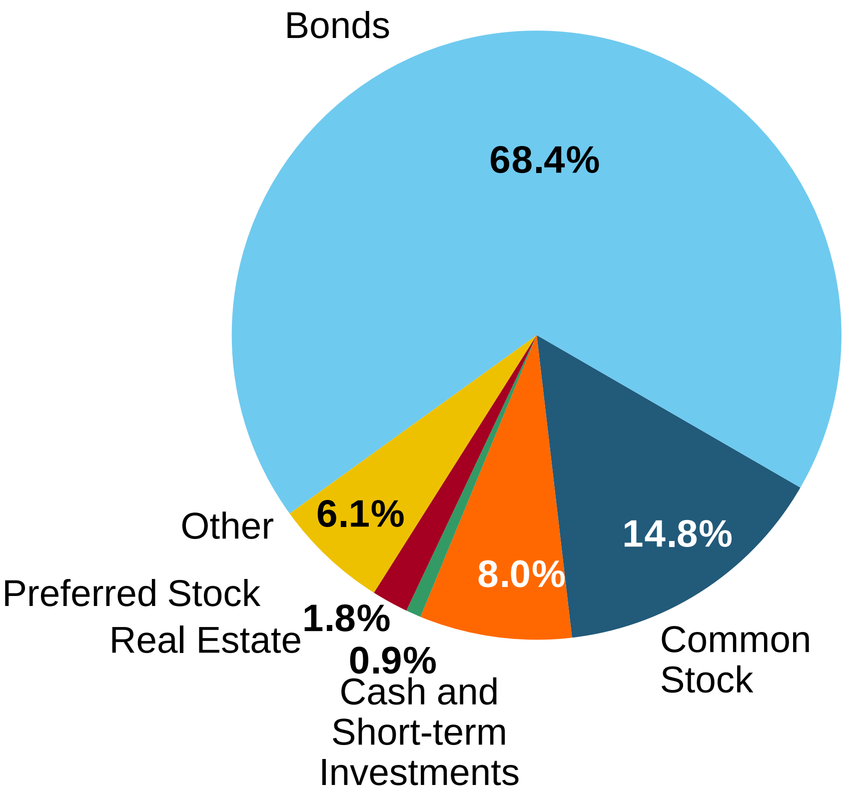
Distribution of P/C Insurance Industry's Investment Portfolio

INSURANCE INFORMATION INSTITUTE

Portfolio Facts

- Invested assets totaled $1.214 trillion as of 12/31/08
- Insurers are generally conservatively invested, with more than 2/3 of assets invested in bonds as of 12/31/08
- Only about 15% of assets were invested in common stock as of 12/31/08
- Even the most conservative of portfolios was hit hard in 2008

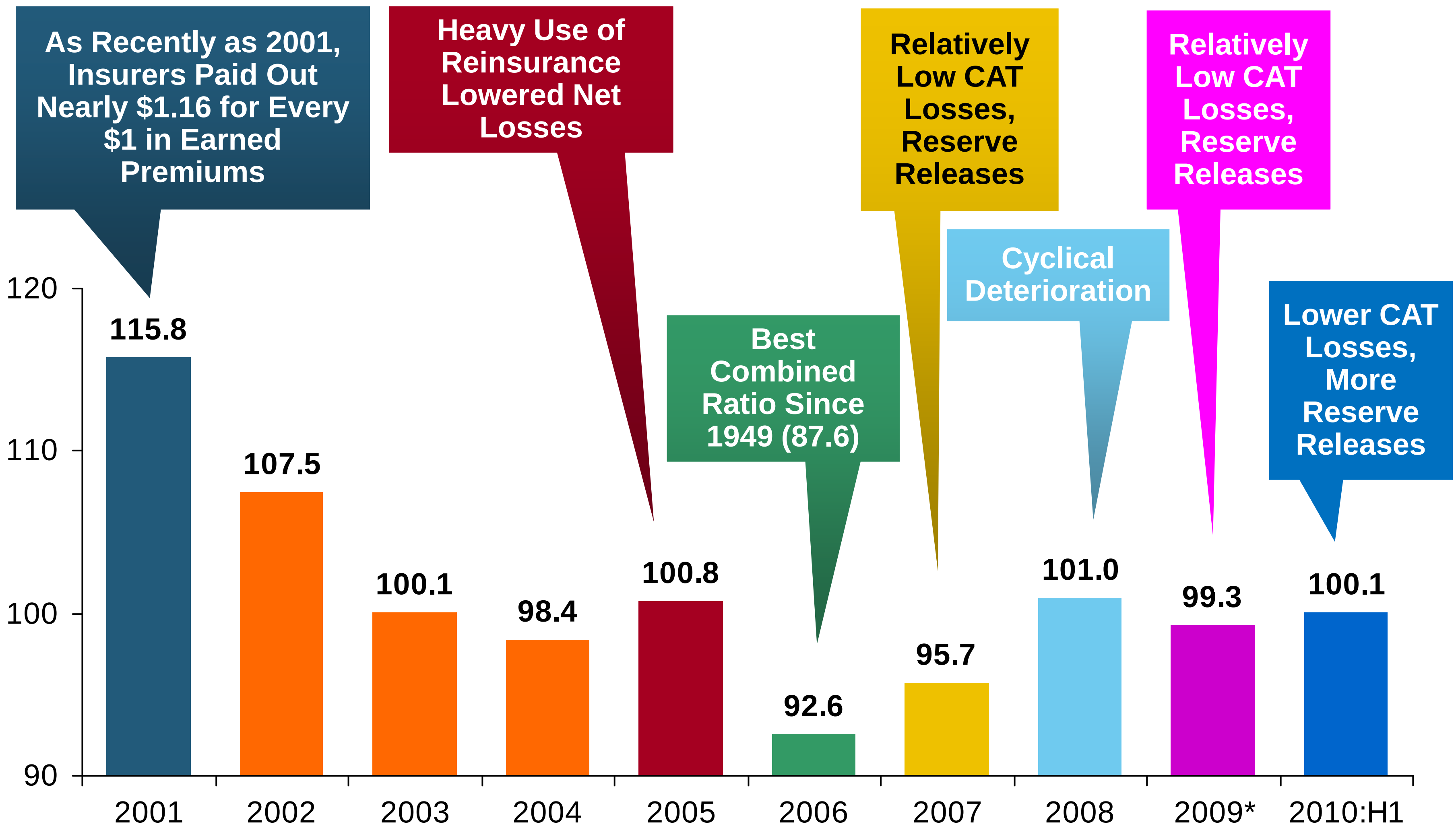
As of December 31, 2008



Sources: NAIC; Insurance Information Institute research.

Underwriting Trends – Financial Crisis Does *Not* Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

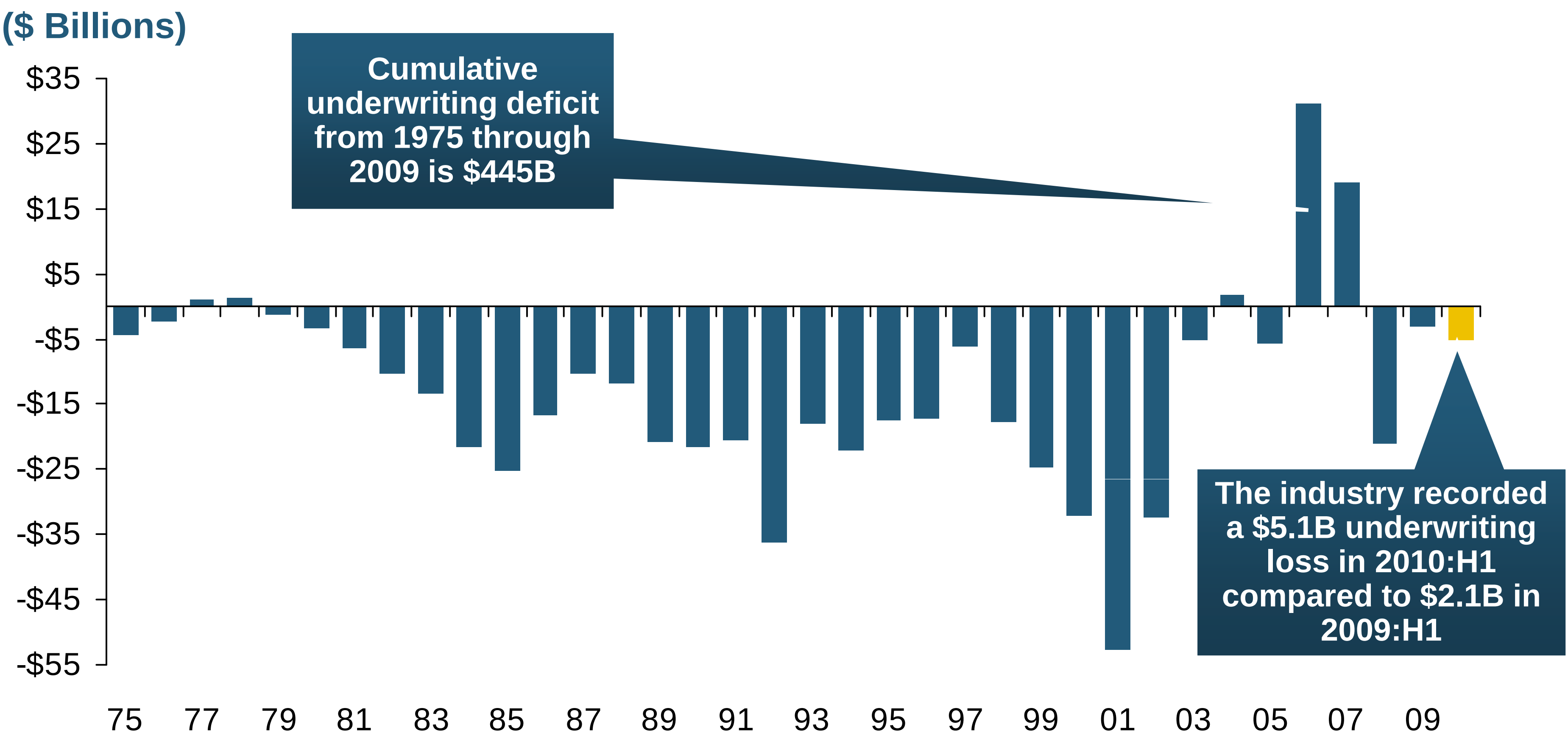
P/C Insurance Industry Combined Ratio, 2001–2010:H1*



* Excludes Mortgage & Financial Guaranty insurers in 2008, 2009 and 2010. Including M&FG, 2008=105.1, 2009=100.7, 2010:H1=101.7

Sources: A.M. Best, ISO.

Underwriting Gain (Loss) 1975–2010:H1*



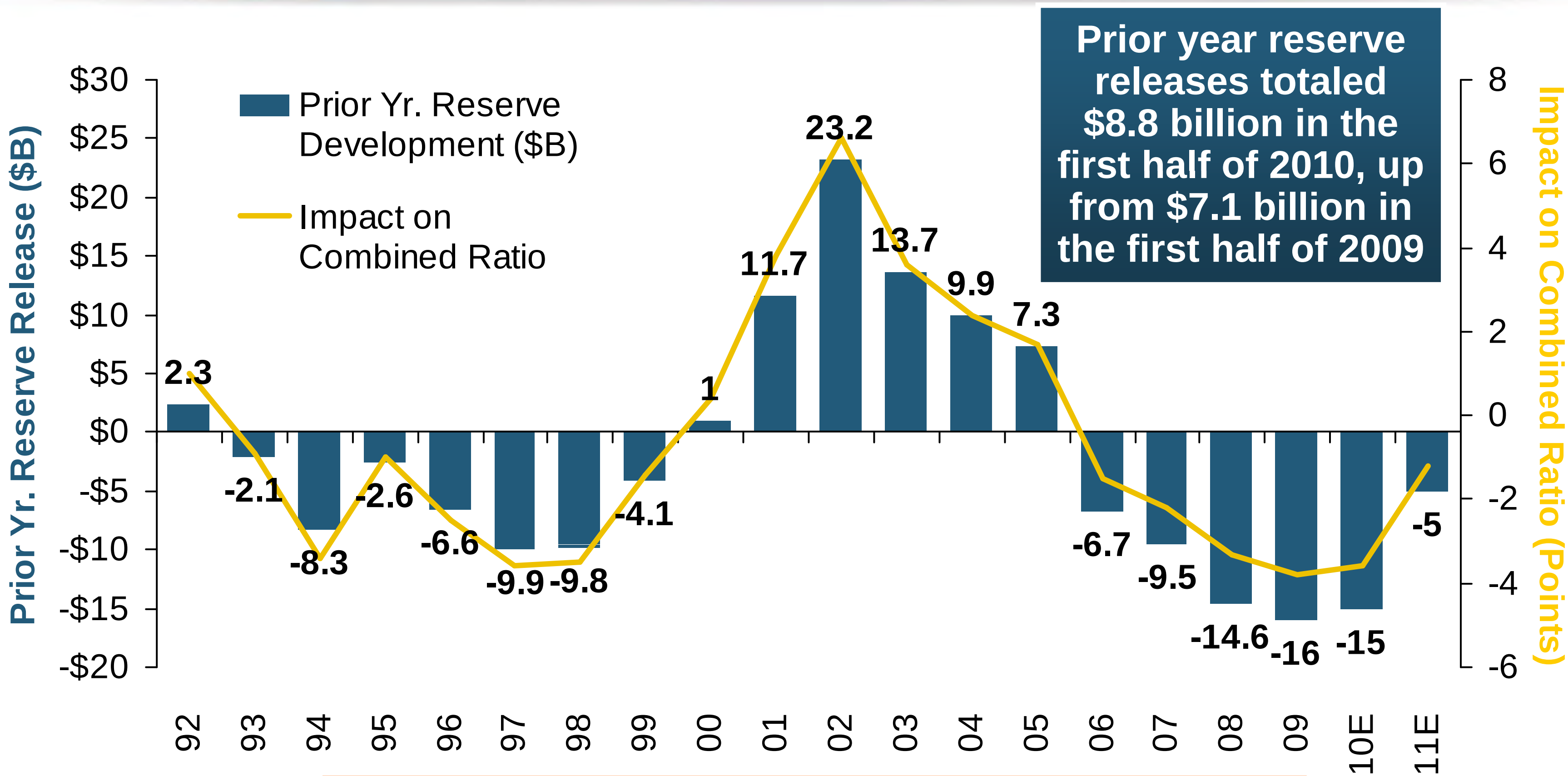
Large Underwriting Losses Are *NOT* Sustainable in Current Investment Environment

* Includes mortgage and financial guarantee insurers.

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

P/C Reserve Development, 1992–2011E

INSURANCE INFORMATION INSTITUTE

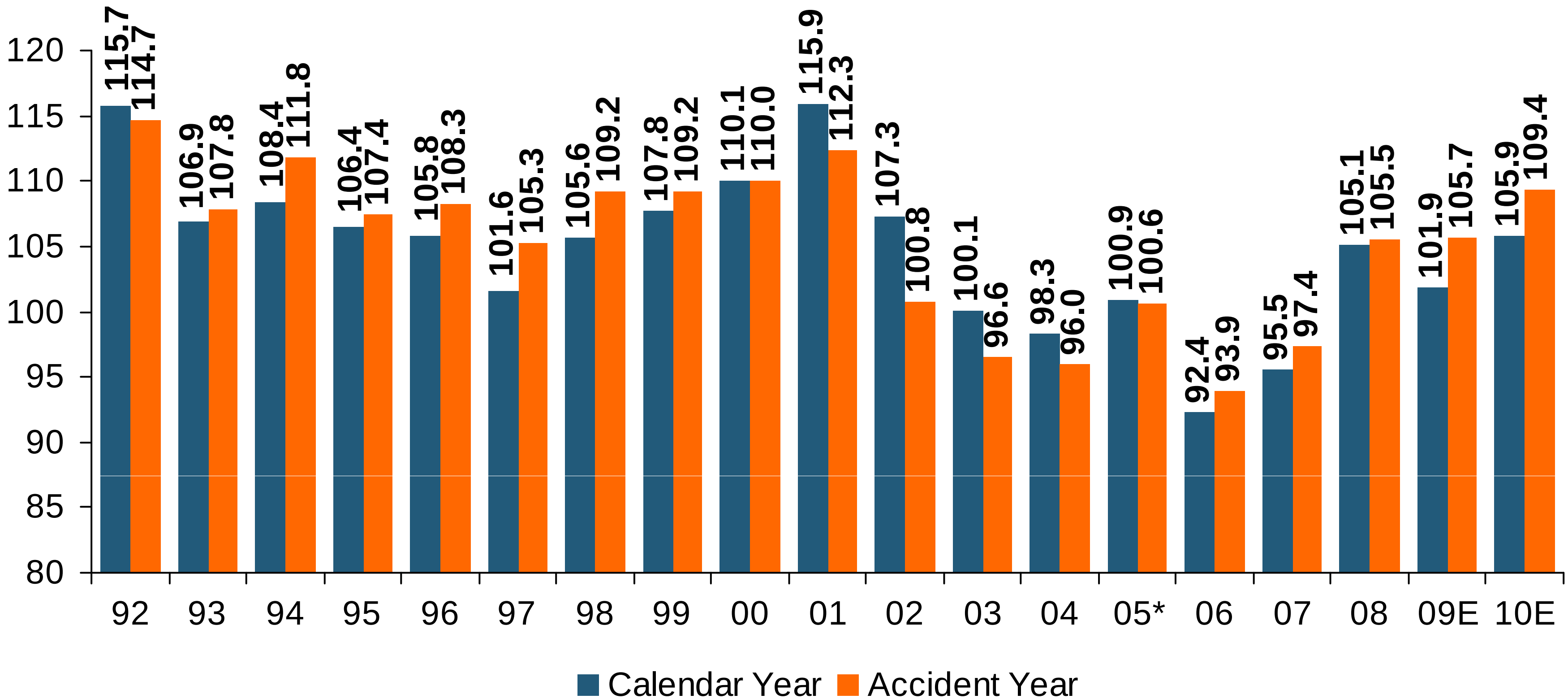


Reserve Releases Are Continuing Strong in 2010 But Should Begin to Taper Off in 2011

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.

Calendar Year vs. Accident Year P/C Combined Ratio: 1992–2010E[1]



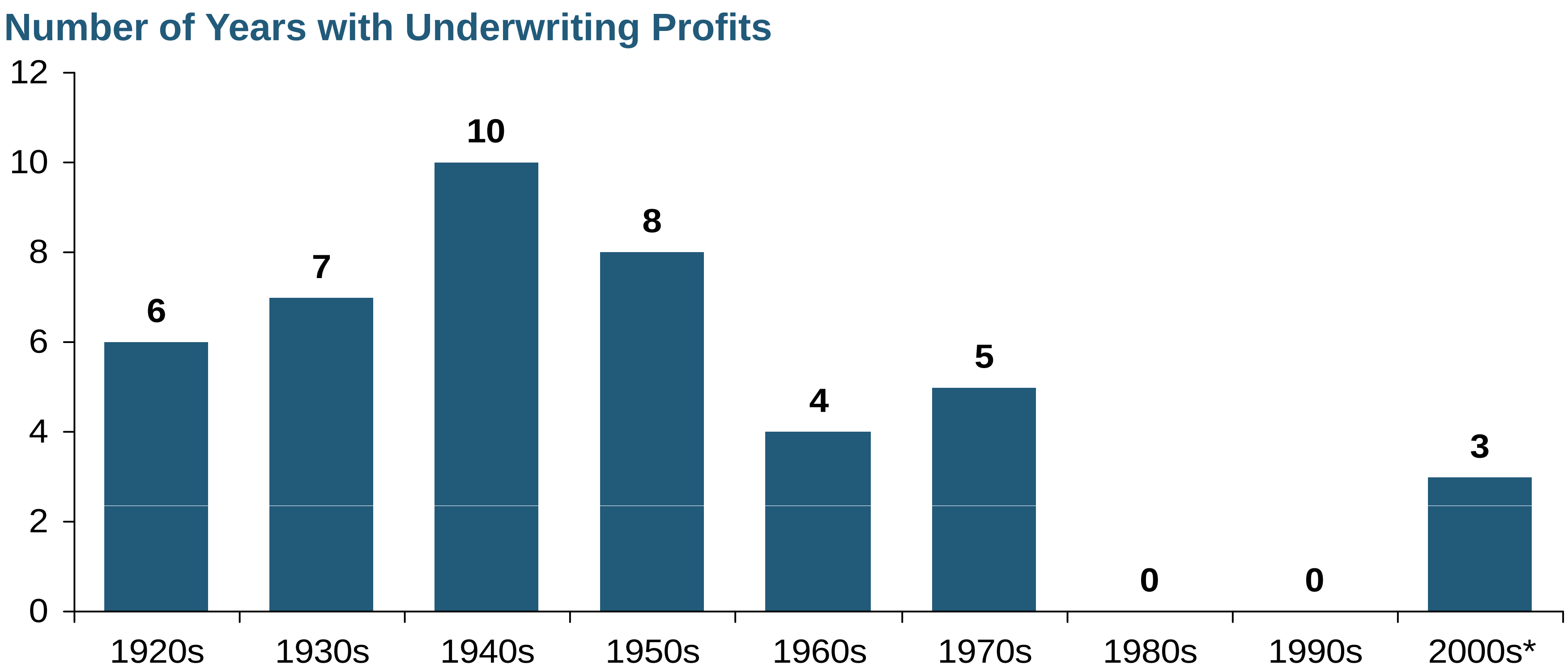
Accident Year Results Show a More Significant Deterioration in Underwriting Performance. Calendar Year Results Are Helped by Reserve Releases

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.

Number of Years with Underwriting Profits by Decade, 1920s–2000s

INSURANCE INFORMATION INSTITUTE



Underwriting Profits Were Common Before the 1980s (40 of the 60 Years Before 1980 Had Combined Ratios Below 100) – But Then They Vanished. Not a Single Underwriting Profit Was Recorded in the 25 Years from 1979 Through 2003

* 2000 through 2009. 2009 combined ratio excluding mortgage and financial guaranty insurers was 99.3, which would bring the 2000s total to 4 years with an underwriting profit.

Note: Data for 1920–1934 based on stock companies only.

Sources: Insurance Information Institute research from A.M. Best Data.

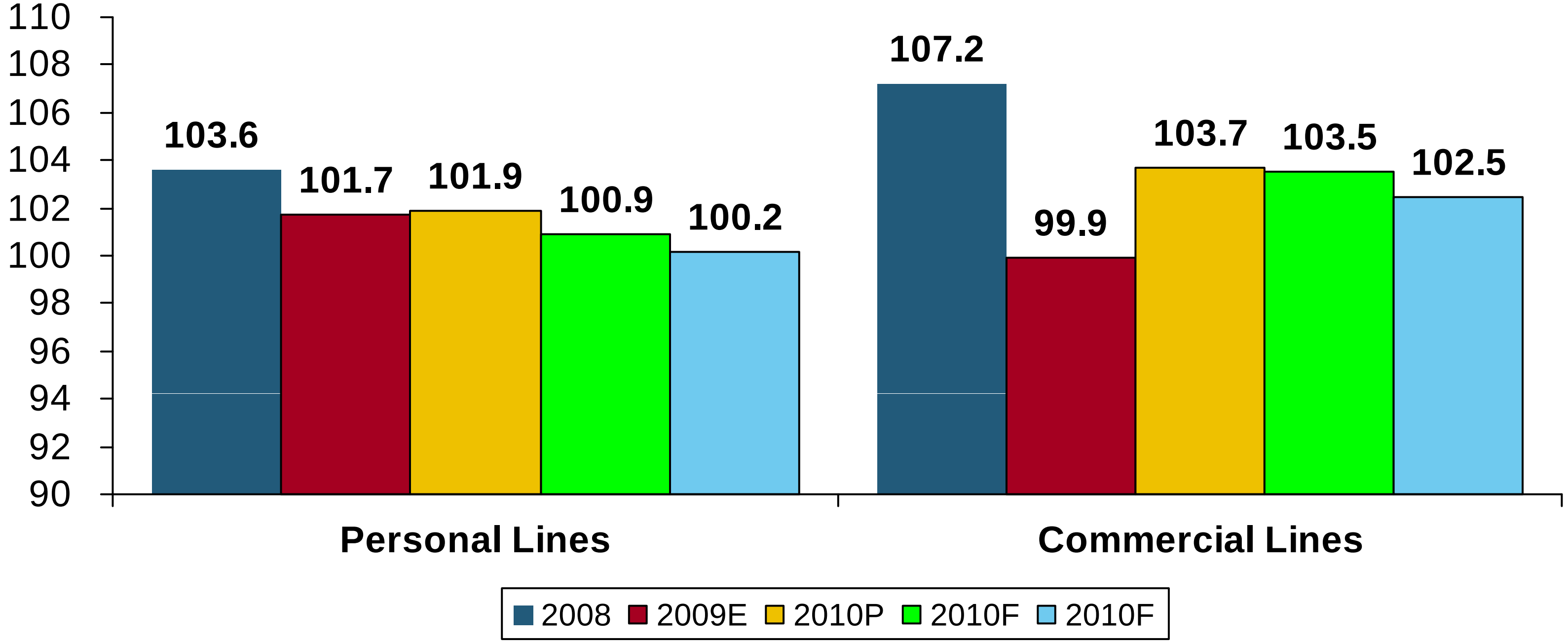
INSURANCE INFORMATION INSTITUTE

Performance by Segment: Commercial/Personal Lines

Calendar Year Combined Ratios by Segment: 2008-2012F

INSURANCE INFORMATION INSTITUTE

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



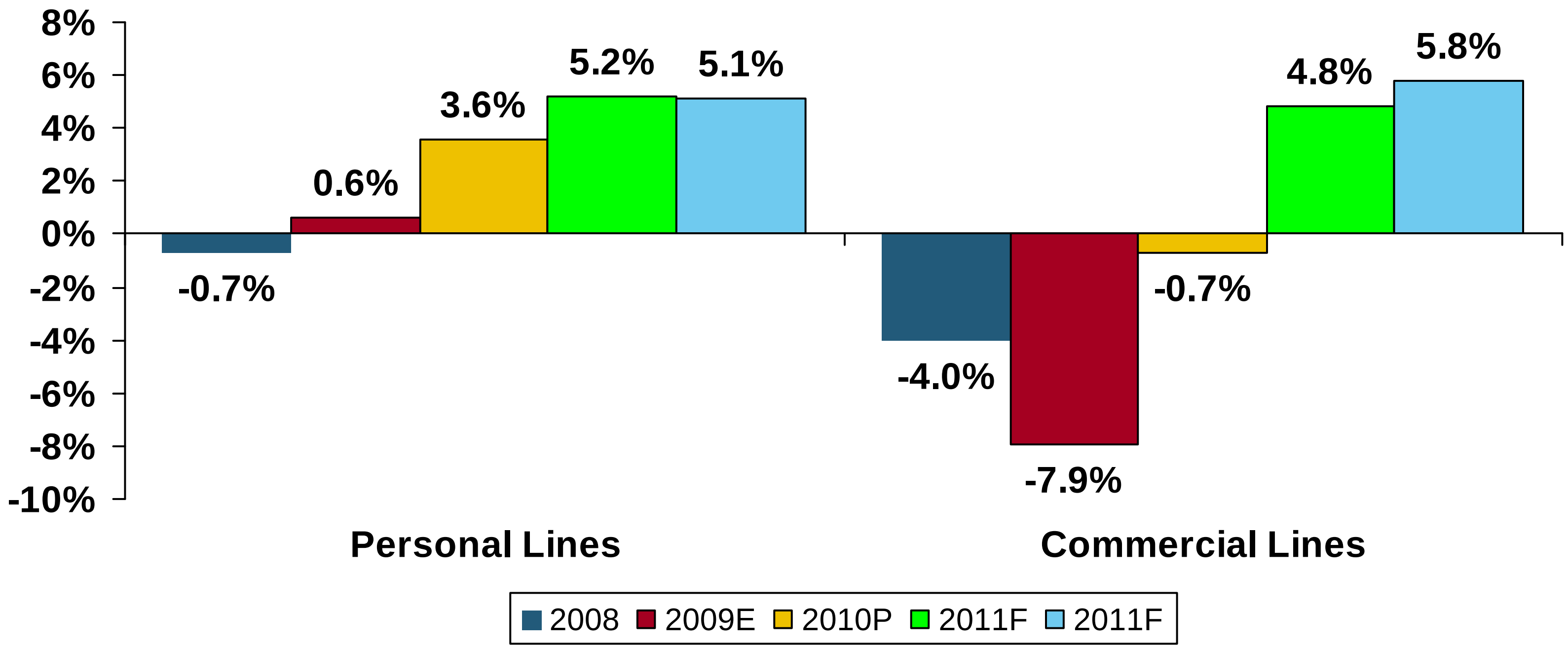
Overall deterioration in 2010 underwriting performance is due to expected return to normal catastrophe activity along with deteriorating underwriting performance related to the prolonged commercial soft market

Sources: A.M. Best (historical) Conning forecasts for 2010 - 2012); Insurance Information Institute.

Net Written Premium Growth by Segment: 2008-2012F

INSURANCE INFORMATION INSTITUTE

Personal lines will show growth in 2010 while commercial lines is expected to continue to shrink



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

Sources: A.M. Best (historical) Conning forecasts for 2010 - 2012); Insurance Information Institute.

Insurance, Monopoly and Workers Compensation: *in Ohio*

What Does Economics Have to Say About Monopoly in Workers Compensation Insurance Markets ?

The Debate Over WC in Ohio

Figure 1: Economic Test for Rationalization of Monopoly, 2010 vs. 1910

INSURANCE INFORMATION INSTITUTE

Economic Tests that Could Be Used to Rationalize the Existence of Monopoly in Workers Compensation	Do the Criteria Apply in 2010?	Observations	Did the Criteria Apply in 1910?	Observations
Does any insurer have exclusive ownership of a resource, expertise or capital necessary to write workers compensation coverage?	No	• 46 states allow private sector competition • 764 private insurers wrote workers comp insurance in these 46 states in 2009	Possibly	• State insurers often would have been in a better position to secure capital, data
Do any insurers have an exclusive patent or process necessary to write workers compensation insurance?	No	• Actuarial and underwriting methodologies for workers compensation are similar throughout the industry • Necessary skills/expertise and technology can be readily acquired through training or purchase	N/A	• There were established actuarial or underwriting procedures for WC in 1910
Do high fixed costs render the cost of providing workers compensation too high unless there is just a single provider of coverage?	No	• The marginal cost of offering workers comp in Ohio is relatively low, especially for insurers already offering the coverage in other states	Yes (in Some States)	• Creating a WC product and distribution system would have been costly

Source: Insurance Information Institute

Rationale for Government Monopoly & The Standard Monopoly Critique

INSURANCE INFORMATION INSTITUTE

- **Governments Do Not Create or Sanction Monopolies for the Purpose of Wealth Creation**
- **Governments Create Monopolies When They Believe the Public Interest Is Being Served**
  - To provide a necessary service that otherwise would be unavailable
  - To provide a service that otherwise would be unaffordable to most
  - To create an unavoidable service (e.g., toll road)
- **Any Level of Government Can Create a Monopoly: Federal, State, Local**

Standard Critique of Monopoly

- **Monopolies (Including Government Monopolies) Produce Products and Services that Are of Inferior Quality**
  - Due to the fact that the monopolist has no market-based incentive to provide high-quality service or to improve
  - Market share and finances are guaranteed by the government
  - No external benchmark for performance
  - In contrast, competition drives sellers to improve/innovate or lose market share
- **The Quality-of-Product Issue is One of the Most Frequently Leveled Criticisms Against Government Monopolies**
  - Examples: DMVs, highway maintenance, education, sanitation, public safety

Competition and Workers Compensation in the 21st Century: Market Observations

INSURANCE INFORMATION INSTITUTE

- **46 or the 50 State Allow Competition in their Worker Comp Markets**
  - Means most states believe competition in WC markets is feasible and desirable
  - Also implies that insurance departments can adequately regulate WC market
- **764 Insurers (Comprised of 314 Insurance Groups) Wrote Workers Coverage in 2009**
  - By U.S. Dept. of Justice standards, the WC market in every non-monopolistic fund state fits the definition of "competitive" (no antitrust concerns)
  - Even the largest WC carrier had only an 11% market share nationally in 2009
- **Barriers to Entry in Workers Compensation Are Low**
  - New insurers can enter WC markets with relative ease
- **Many Insurers Compete in States Near/Like Ohio**
  - **IN**: 88; **PA**: 85; **IL**: 95, **MI**: 62; **WI**: 82
  - If OH were competitive today, 65-85 private insurers would likely be writing coverage
- **No Traditional Economic Criteria that Would Justify the Existence of Monopoly Exist in 2010**
  - In 1910, the situation was different
- **Residual Market Shares Are Very Small and Are Shrinking**
  - Nationally, WC residual market share was just 5% of DPW in 2009 (NCCI states)
  - Combined underwriting loss of these states was just $75 million in 2009

Where Will the Growth in WC Exposure Come From?

Industry and Occupation Growth Analysis

Fastest Growing Occupations, 2008–2018: *Health/Science/Tech Dominate*

INSURANCE INFORMATION INSTITUTE

WC exposure growth the fastest in the health, science and tech areas

Occupations	Percent change	Number of new jobs *(in thousands)*	Wages (May 2008 median)	Education/training category
Biomedical engineers	72	11.6	$ 77,400	Bachelor's degree
Network systems and data communications analysts	53	155.8	71,100	Bachelor's degree
Home health aides	50	460.9	20,460	Short-term on-the-job training
Personal and home care aides	46	375.8	19,180	Short-term on-the-job training
Financial examiners	41	11.1	70,930	Bachelor's degree
Medical scientists, except epidemiologists	40	44.2	72,590	Doctoral degree
Physician assistants	39	29.2	81,230	Master's degree
Skin care specialists	38	14.7	28,730	Postsecondary vocational award
Biochemists and biophysicists	37	8.7	82,840	Doctoral degree
Athletic trainers	37	6.0	39,640	Bachelor's degree
Physical therapist aides	36	16.7	23,760	Short-term on-the-job training
Dental hygienists	36	62.9	66,570	Associate degree
Veterinary technologists and technicians	36	28.5	28,900	Associate degree
Dental assistants	36	105.6	32,380	Moderate-term on-the-job training
Computer software engineers, applications	34	175.1	85,430	Bachelor's degree
Medical assistants	34	163.9	28,300	Moderate-term on-the-job training
Physical therapist assistants	33	21.2	46,140	Associate degree
Veterinarians	33	19.7	79,050	First professional degree
Self-enrichment education teachers	32	81.3	35,720	Work experience in a related occupation
Compliance officers, except agriculture, construction, health and safety, and transportation	31	80.8	48,890	Long-term on-the-job training

SOURCE: BLS Occupational Employment Statistics and Division of Occupational Outlook

Sources: US Bureau of Labor Statistics: *Occupational Outlook Handbook, 2010-2011 Edition*; Insurance Information Institute

Occupations with Largest Numerical Growth, 2008–2018: *Health, Services Dominate*

INSURANCE INFORMATION INSTITUTE

Dollar growth in WC exposures should grow the most (at current rate levels) in the health and services industries

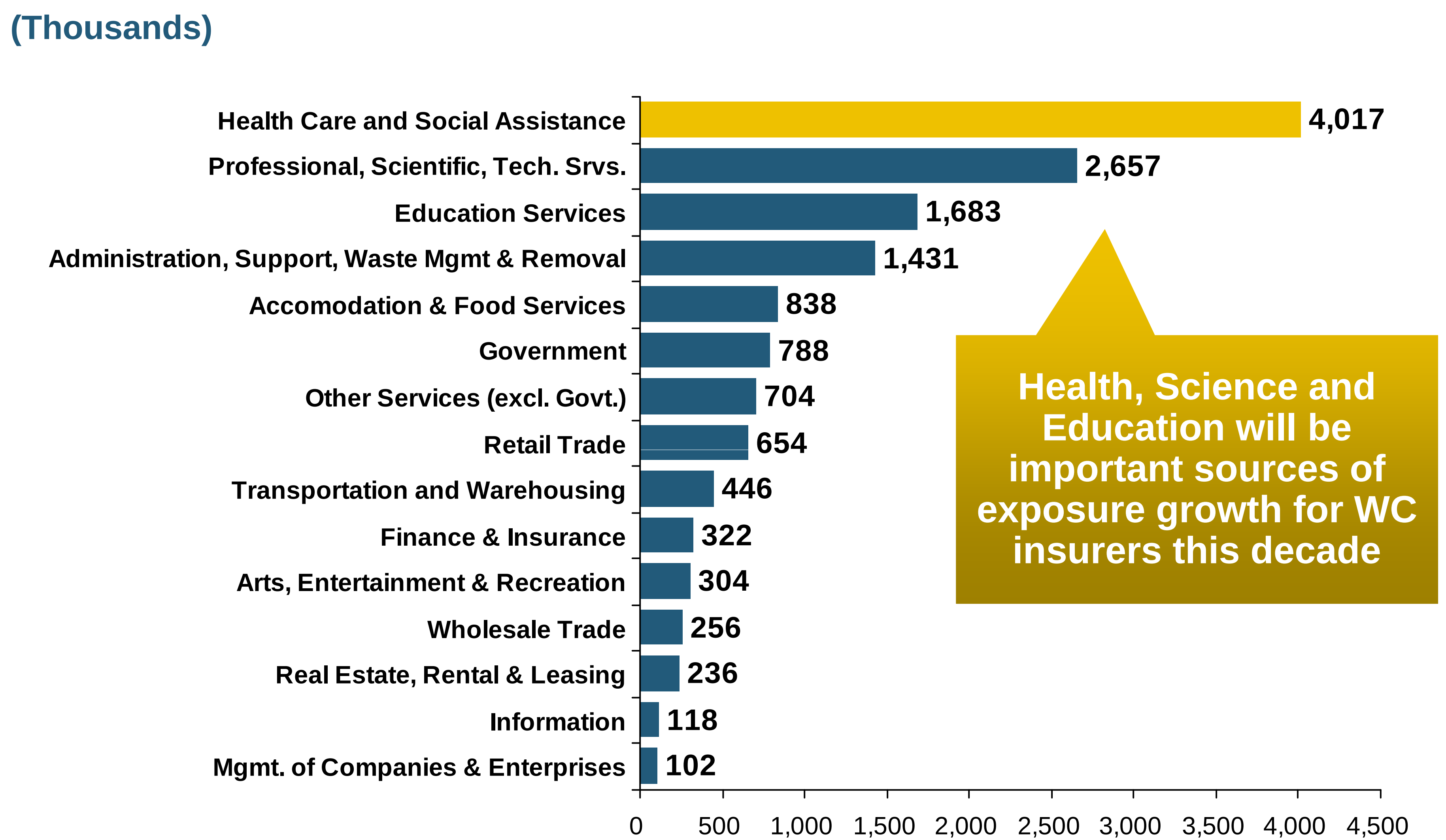
Occupations	Number of new jobs *(in thousands)*	Percent change	Wages (May 2008 median)	Education/training category
Registered nurses	581.5	22	$ 62,450	Associate degree
Home health aides	460.9	50	20,460	Short-term on-the-job training
Customer service representatives	399.5	18	29,860	Moderate-term on-the-job training
Combined food preparation and serving workers, including fast food	394.3	15	16,430	Short-term on-the-job training
Personal and home care aides	375.8	46	19,180	Short-term on-the-job training
Retail salespersons	374.7	8	20,510	Short-term on-the-job training
Office clerks, general	358.7	12	25,320	Short-term on-the-job training
Accountants and auditors	279.4	22	59,430	Bachelor's degree
Nursing aides, orderlies, and attendants	276.0	19	23,850	Postsecondary vocational award
Postsecondary teachers	256.9	15	58,830	Doctoral degree
Construction laborers	255.9	20	28,520	Moderate-term on-the-job training
Elementary school teachers, except special education	244.2	16	49,330	Bachelor's degree
Truck drivers, heavy and tractor-trailer	232.9	13	37,270	Short-term on-the-job training
Landscaping and groundskeeping workers	217.1	18	23,150	Short-term on-the-job training
Bookkeeping, accounting, and auditing clerks	212.4	10	32,510	Moderate-term on-the-job training
Executive secretaries and administrative assistants	204.4	13	40,030	Work experience in a related occupation
Management analysts	178.3	24	73,570	Bachelor's or higher degree, plus work experience
Computer software engineers, applications	175.1	34	85,430	Bachelor's degree
Receptionists and information clerks	172.9	15	24,550	Short-term on-the-job training
Carpenters	165.4	13	38,940	Long-term on-the-job training

SOURCE: BLS Occupational Employment Statistics and Division of Occupational Outlook

Sources: US Bureau of Labor Statistics: *Occupational Outlook Handbook, 2010-2011 Edition*; Insurance Information Institute

Numeric Change in Wage and Salary Employment in Service-Providing Industries: 2008-2018P

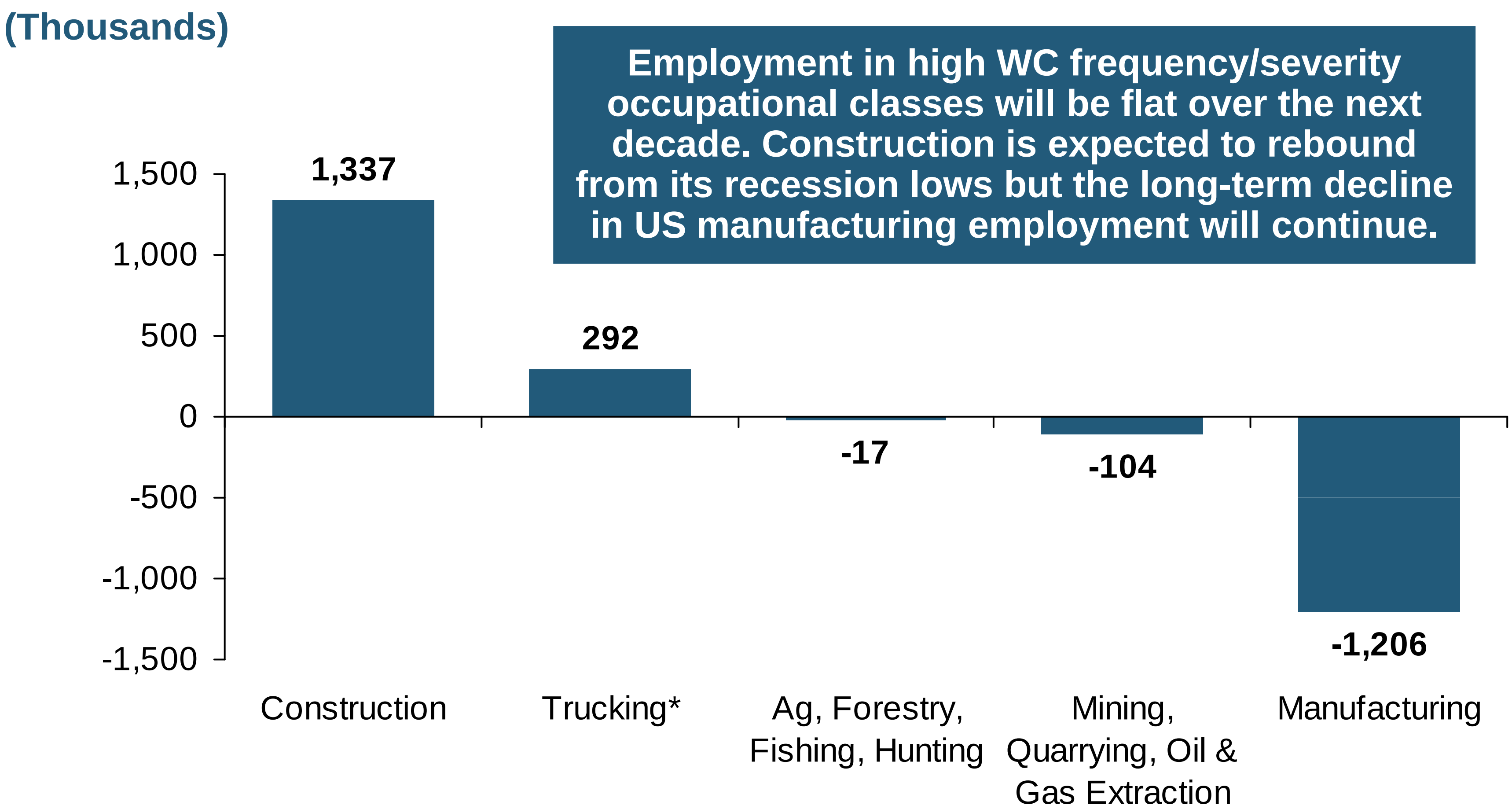
INSURANCE INFORMATION INSTITUTE



Sources: US Bureau of Labor Statistics: *Occupational Outlook Handbook, 2010-2011 Edition*; Insurance Information Institute

Numeric Change in Wage & Salary Employment in Goods-Producing & Trucking Industries: 2008-2018P

Employment in high WC frequency/severity occupational classes will be flat over the next decade. Construction is expected to rebound from its recession lows but the long-term decline in US manufacturing employment will continue.



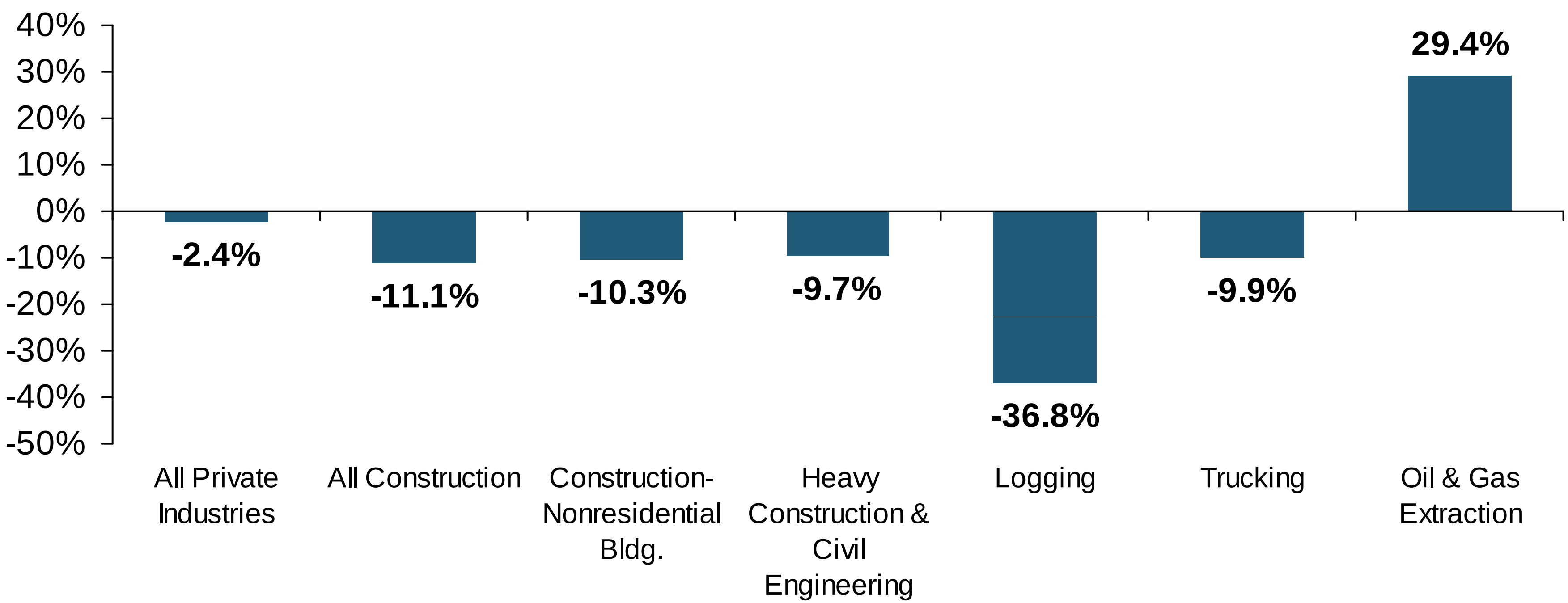
*Category includes truck drivers and drivers/sales personnel.

Sources: US Bureau of Labor Statistics: *Occupational Outlook Handbook, 2010-2011 Edition*; Insurance Information Institute

Many High Hazard Occupations Have Declined Disproportionately Over the Past Decade

INSURANCE INFORMATION INSTITUTE

Change in Employment (%), 2000 vs. 2009*



Most of the Loss of Jobs in High Hazard Classes Occurred Since 2007 with the Onset of the "Great Recession"

*I.I.I. calculations based on monthly seasonally adjusted data converted to annual averages.

Source: US Bureau of Labor; Insurance Information Institute.

Claim Trends in Auto Insurance

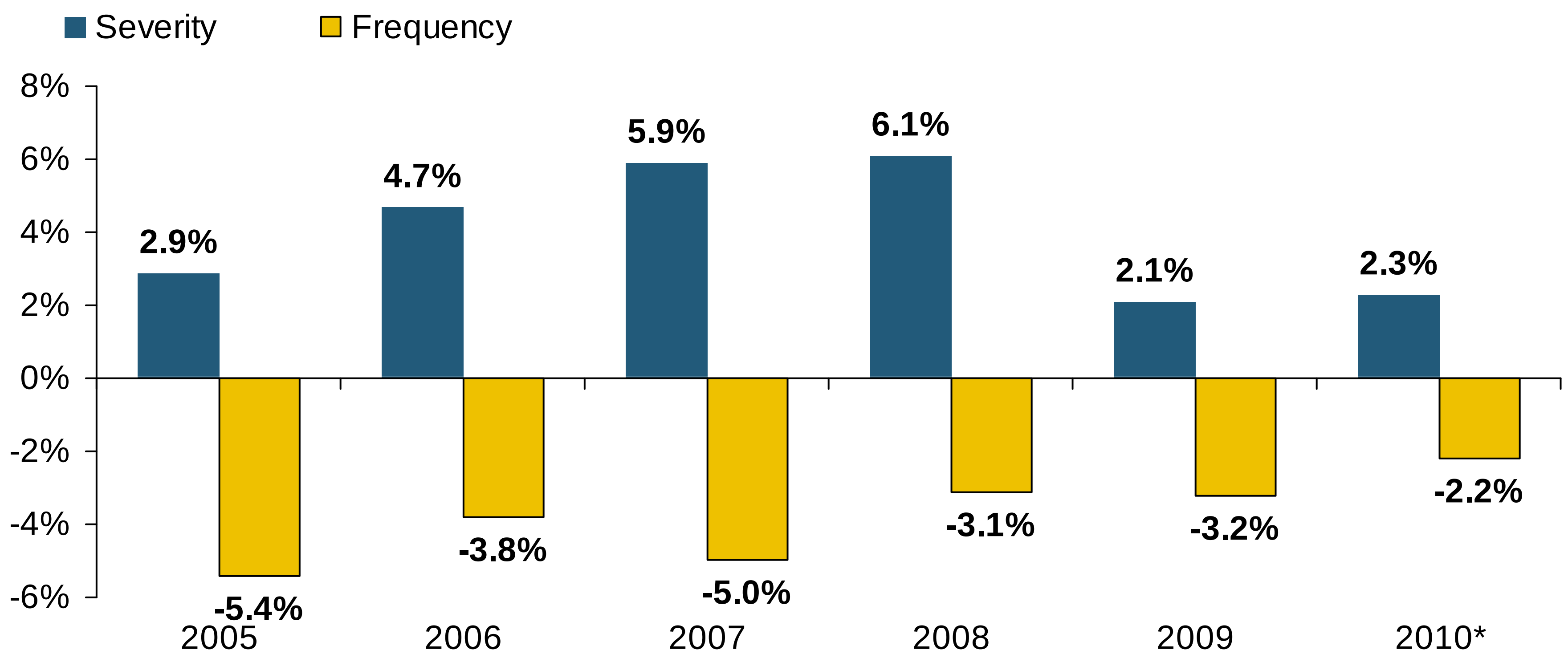
Rising Costs Held in Check by Falling Frequency:

Can That Pattern Be Sustained?

Bodily Injury: Severity Trends Generally Above Decline in Frequency

INSURANCE INFORMATION INSTITUTE

Annual Change, 2005 through 2010*



Cost Pressures Will Increase if BI Severity Increases Outpace Declines in Frequency

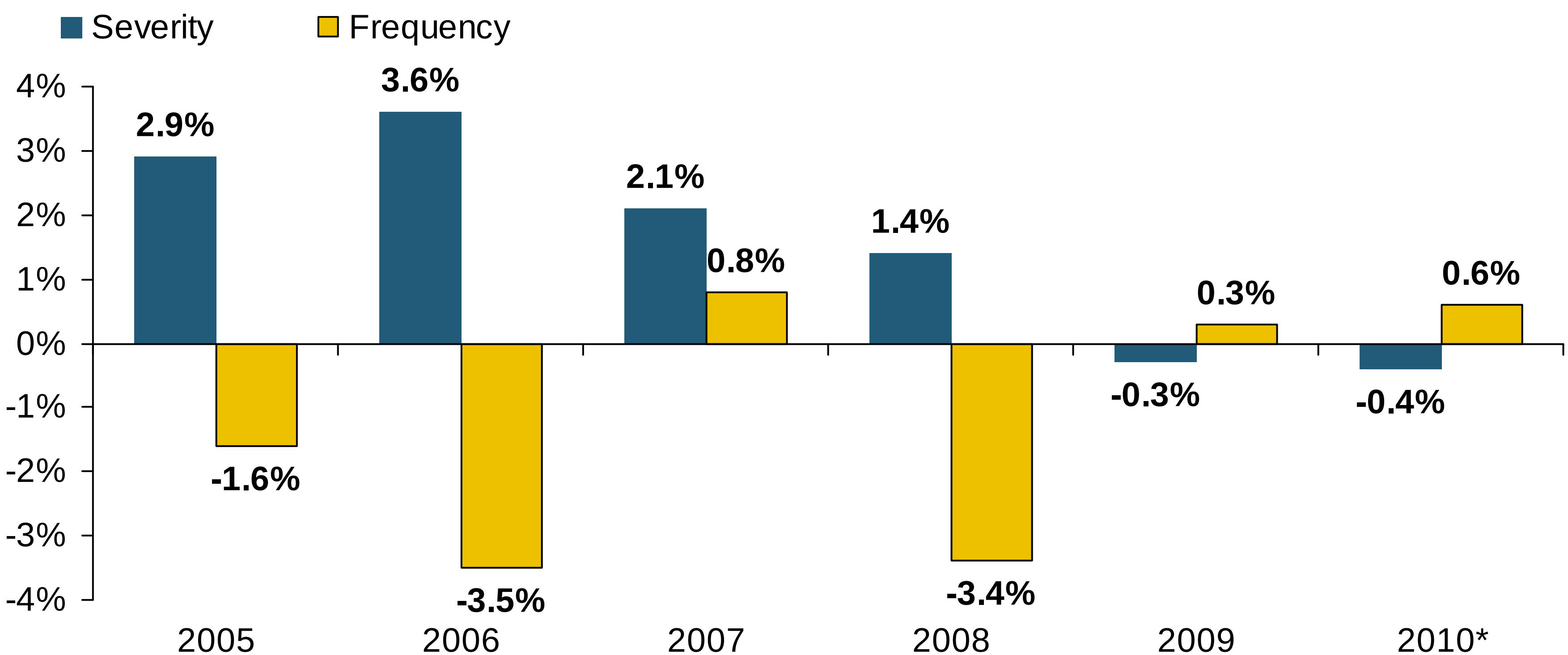
*For 2010, data are for the 4 quarters ending with 2010:Q1.

Source: ISO/PCI *Fast Track* data; Insurance Information Institute

Property Damage Liability: Frequency and Severity Trends Nearly Offset in 2009/10

INSURANCE INFORMATION INSTITUTE

Annual Change, 2005 through 2010*



Stable Severity/Frequency Trends Keeping PD Costs in Check, But Are These Trends Sustainable?

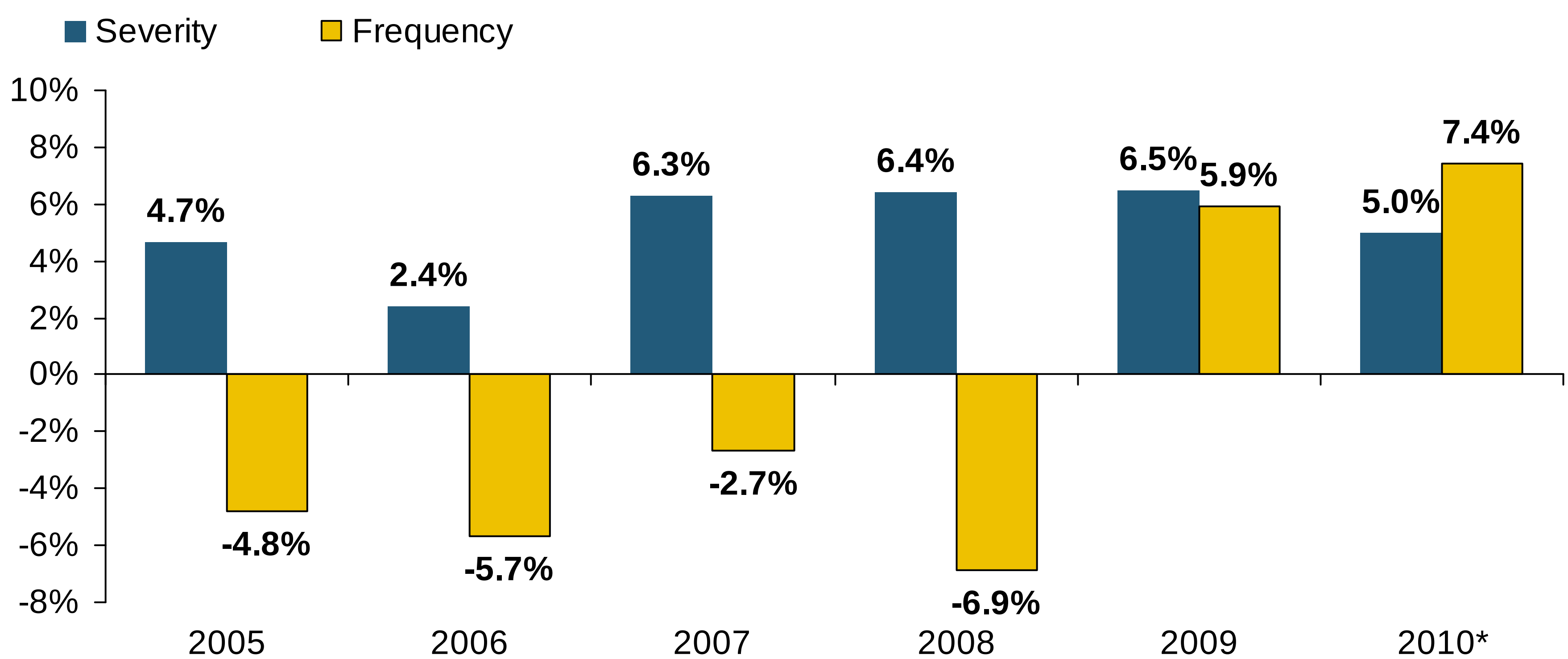
*For 2010, data are for the 4 quarters ending with 2010:Q1.

Source: ISO/PCI *Fast Track* data; Insurance Information Institute

No-Fault (PIP) Liability: Frequency and Severity Trends Are Adverse*

INSURANCE INFORMATION INSTITUTE

Annual Change, 2005 through 2010*



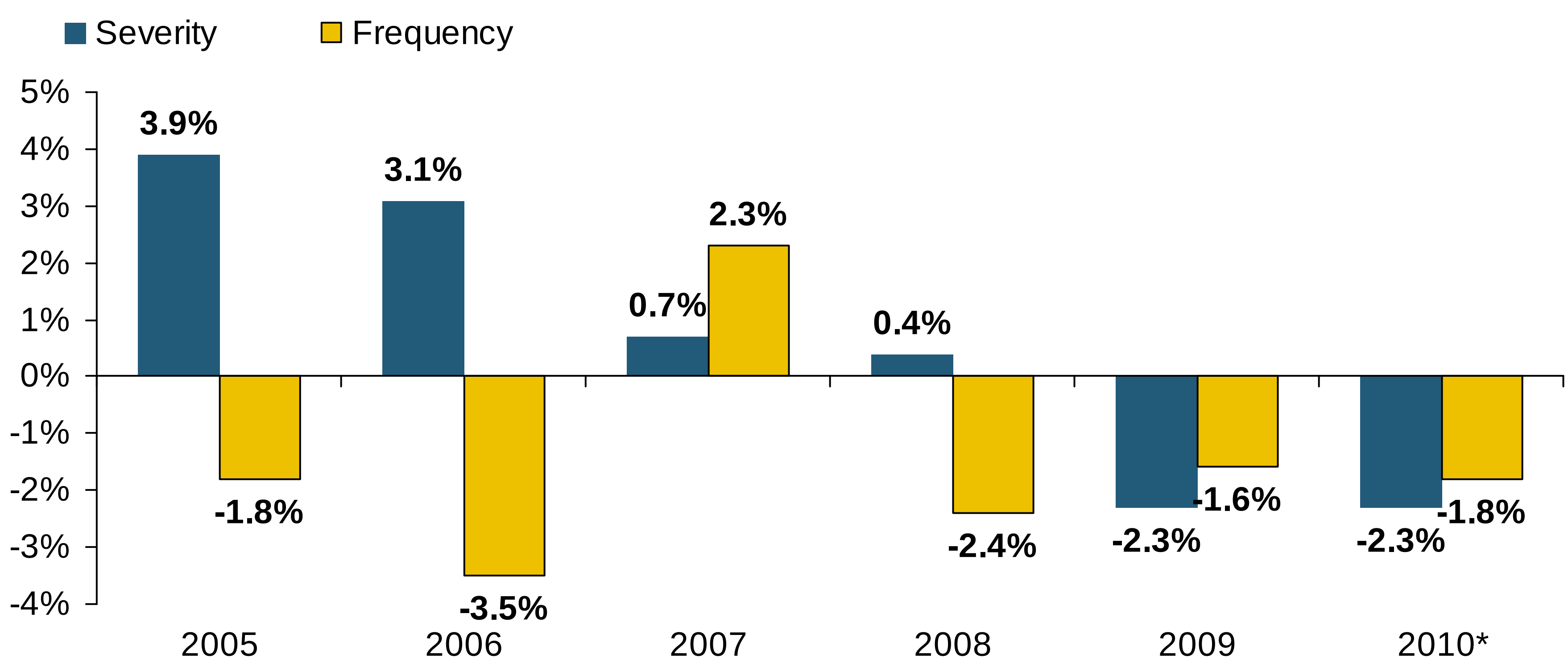
Multiple States Are Experiencing Severe Fraud and Abuse Problems in their No-Fault Systems, Especially FL, MI, NY and NJ

*No-fault states included are: FL, HI, KS, KY, MA, MI, MN, NY, ND and UT; 2010 data are for the 4 quarters ending 2010:Q1.
Source: ISO/PCI *Fast Track* data; Insurance Information Institute

Collision Coverage: Frequency and Severity Trends Have Been Favorable

INSURANCE INFORMATION INSTITUTE

Annual Change, 2005 through 2010*



The Recession, High Fuel Prices Have Helped Push Down Frequency and Temper Severity, But this Trend Will Likely Be Reversed Based on Evidence from Past Recoveries

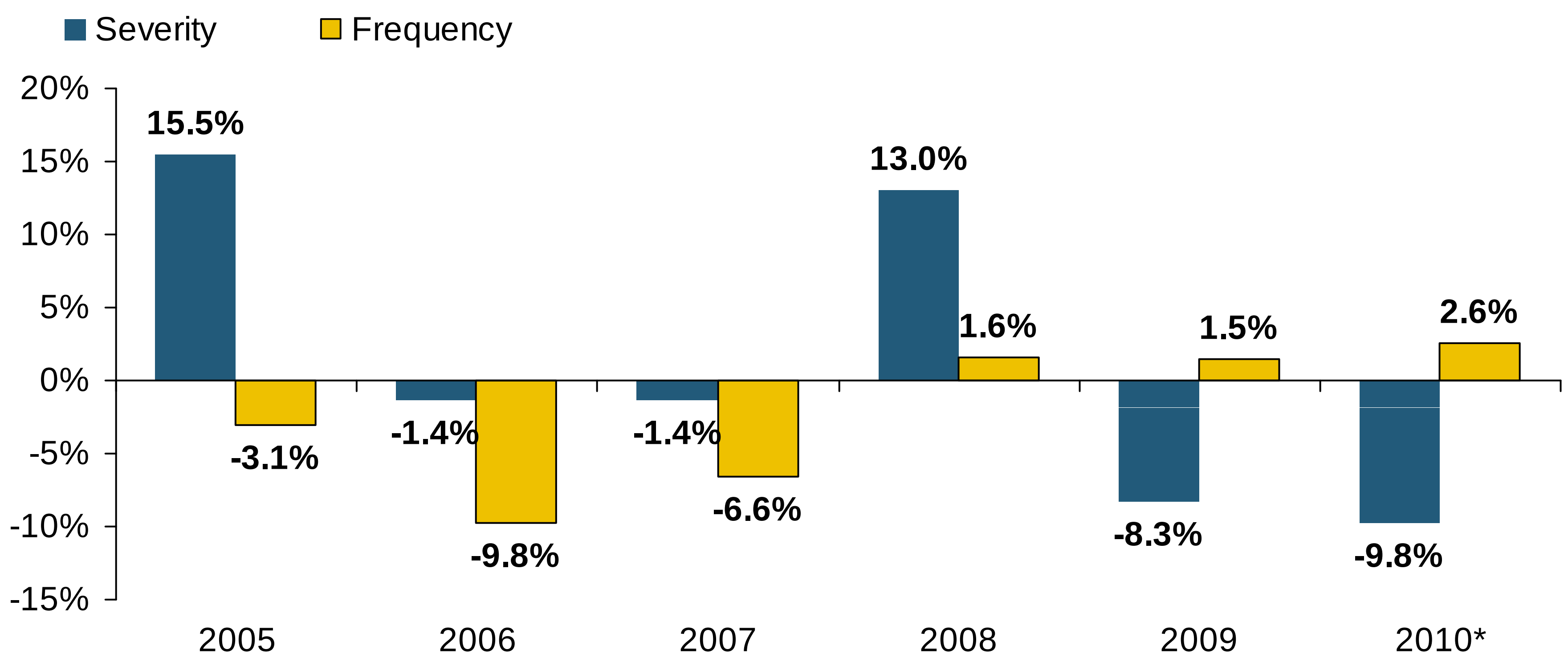
*For 2010, data are for the 4 quarters ending with 2010:Q1.

Source: ISO/PCI *Fast Track* data; Insurance Information Institute

Comprehensive Coverage: Severity Trends Very Favorable in 2009/2010

INSURANCE INFORMATION INSTITUTE

Annual Change, 2005 through 2010*



Weather Creates Volatility for Comprehensive Coverage; Recession Has Helped Push Down Frequency and Temper Severity, But This Factors Will Weaken as Economy Recovers

*For 2010, data are for the 4 quarters ending with 2010:Q1.

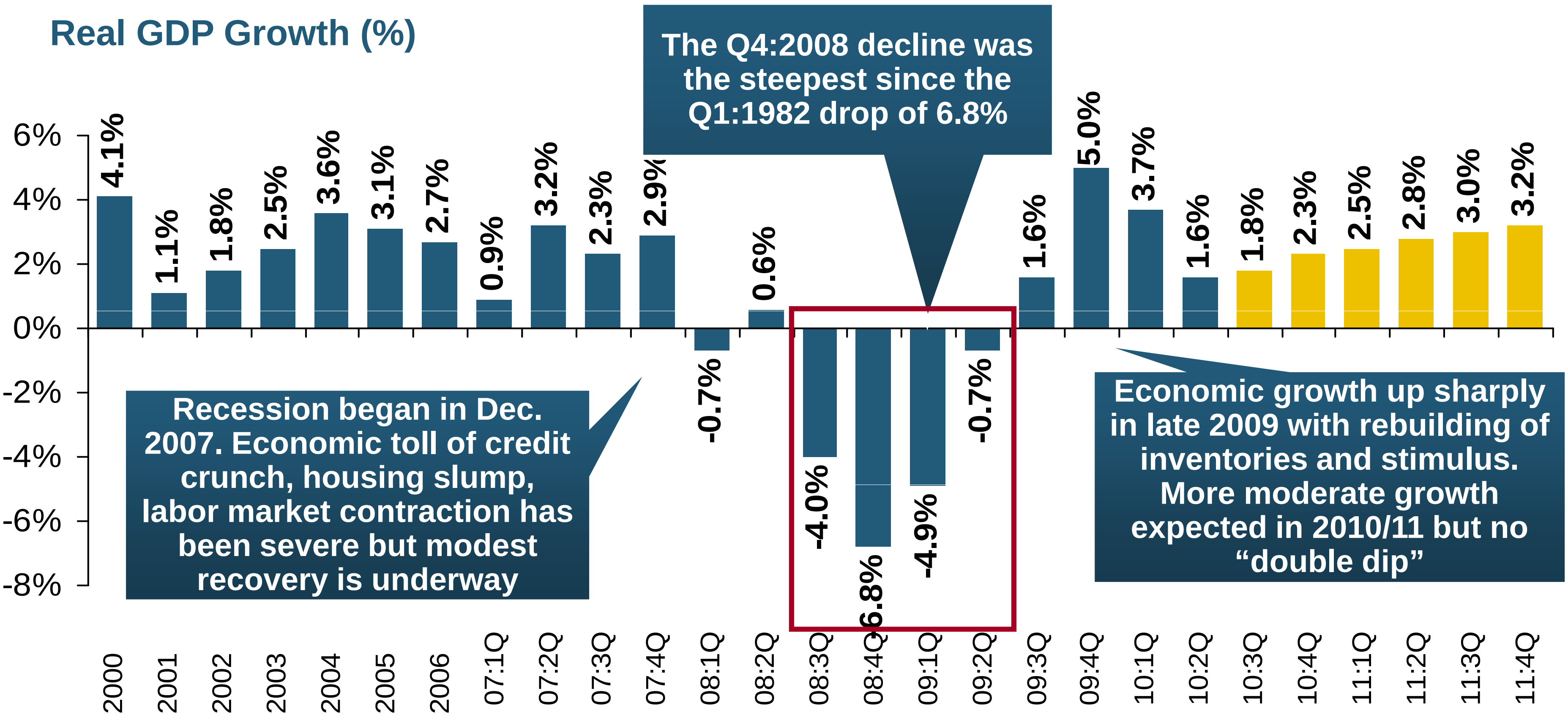
Source: ISO/PCI *Fast Track* data; Insurance Information Institute

The Economic Storm

What the Financial Crisis and Recession Mean for the Industry's Exposure Base, Growth and Profitability

US Real GDP Growth*

INSURANCE INFORMATION INSTITUTE

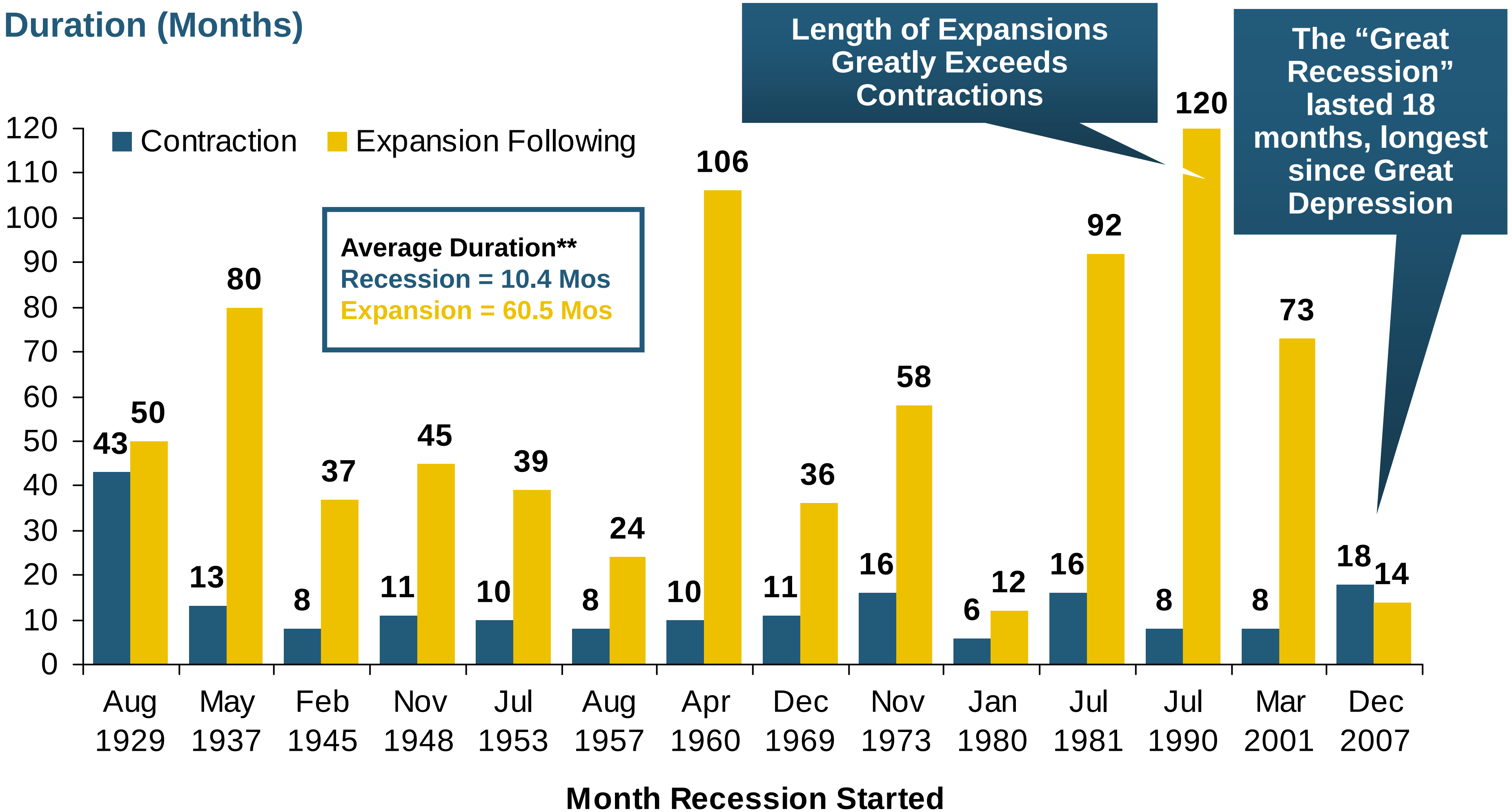


Demand Commercial Insurance Continues To Be Impacted by Sluggish Economic Conditions

* Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 7/10; Insurance Information Institute.

Length of US Business Cycles, 1929–Present*



*Through Sept. 2010. Most recent recession began Dec. 2007 and ended June 2009.

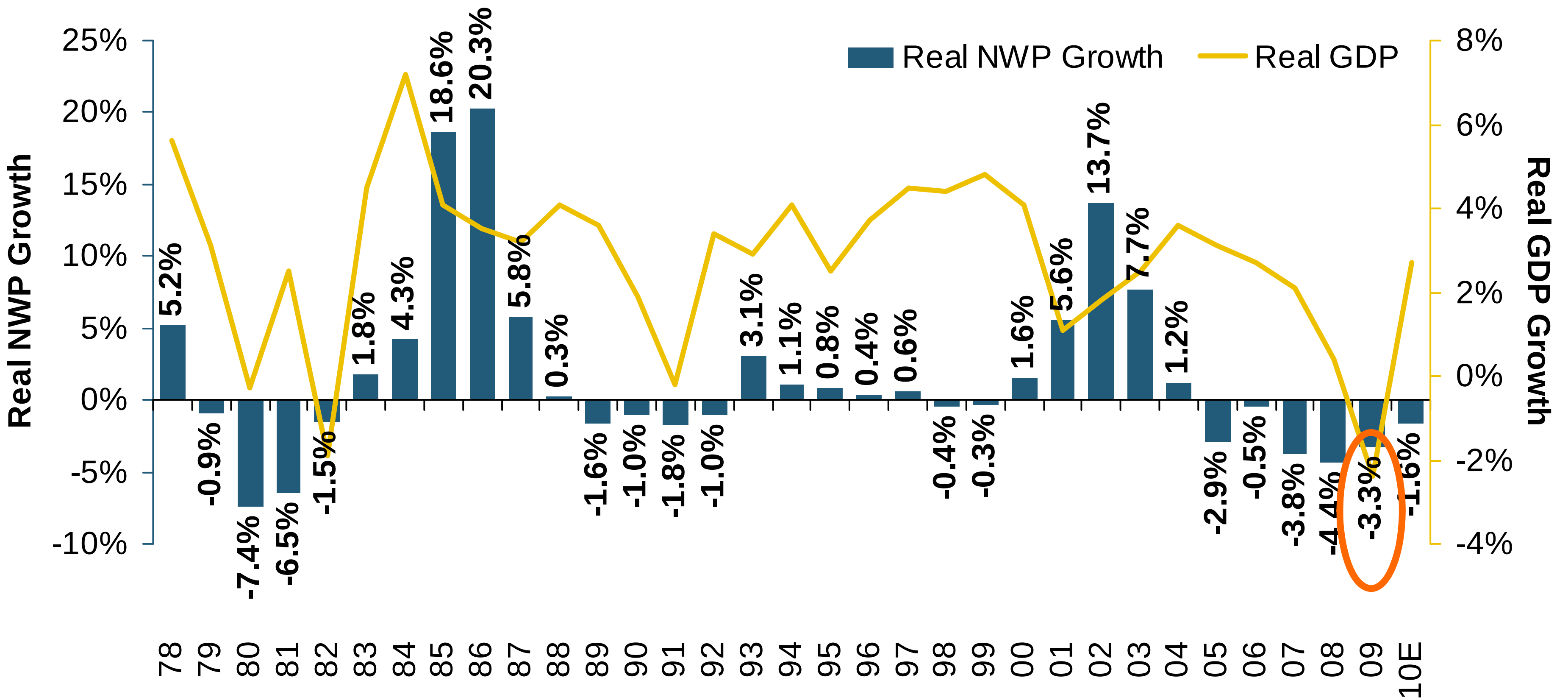
** Post-WW II period through end of most recent expansion.

Sources: National Bureau of Economic Research; Insurance Information Institute.

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

INSURANCE INFORMATION INSTITUTE

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



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

Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 9/10; Insurance Information Institute

Will Future Tax Policy Impact P/C Insurance Industry Exposure and Growth?

Various Tax Proposals for 2011 Could Have Significant Impacts on the P/C Insurance Industry for Years to Come

Potential Impacts of Current Federal Tax Proposals on P/C Insurance Industry

INSURANCE INFORMATION INSTITUTE

Proposal	Potential P/C Insurance Industry Impact	P/C Lines that Benefit
100% Expensing of New Investment in Plant & Equipment in 2011 and Continuation of Bonus Depreciation	Could produce a 5-10% surge in investment in physical plant and equipment in 2011 which will need to be insured immediately. Although the proposal only "steals" investment from the future, this provides a permanent benefit to commercial insurers since insurance coverage must be purchased sooner and be maintained. New construction activity boosts WC and surety.	•Commercial Property •Construction •Commercial Liability •Commercial Auto •Specialty Lines •Excess & Surplus •Workers Comp •Surety •Reinsurance
Reinstate 36% and 39.6% Rates for High Income Taxpayers >$250K	Potential damage to new/small business formation and growth. Weakness in these areas has hurt p/c insurance exposure and tax hikes could depress insurance exposure in this segment	•None
Continue 2001 and 2003 Tax Cuts for All Taxpayers	Should produce an environment that more beneficial to recovery in small business segment & associate insurance exposures	•Small Business Commercial Lines •Personal Lines

Sources: Proposals from Tax Policy Center; P/C discussion is Insurance Information Institute research.

Potential Impacts of Current Federal Tax Proposals on P/C Insurance Industry (cont'd)

INSURANCE INFORMATION INSTITUTE

Proposal	Potential P/C Insurance Industry Impact	P/C Lines that Benefit
Impose 20% Tax Rate for Capital Gains and Dividends for High Income Taxpayers	The increase in dividends and capital gains taxes makes private investment less attractive. Under current law the rate is 15%. Additional taxes on investment would presumably result in a marginal but negative impact on p/c insurance exposure.	•None
Payroll Tax Holiday	Reducing the cost of hiring workers would theoretically reduce the cost of employment and should spark hiring, increasing overall employment and payrolls	•Workers comp
Limit Value of Itemized Deductions to 28% for High Income Taxpayers	Will have an unambiguously negative impact on charitable giving. Nonprofit sector will be negatively impacted.	•None (Commercial lines products Designed for NPOs would be negatively impacted; This is a large p/c market.)

Sources: Proposals (except Payroll Tax Holiday) from Tax Policy Center; P/C discussion is Insurance Information Institute research.

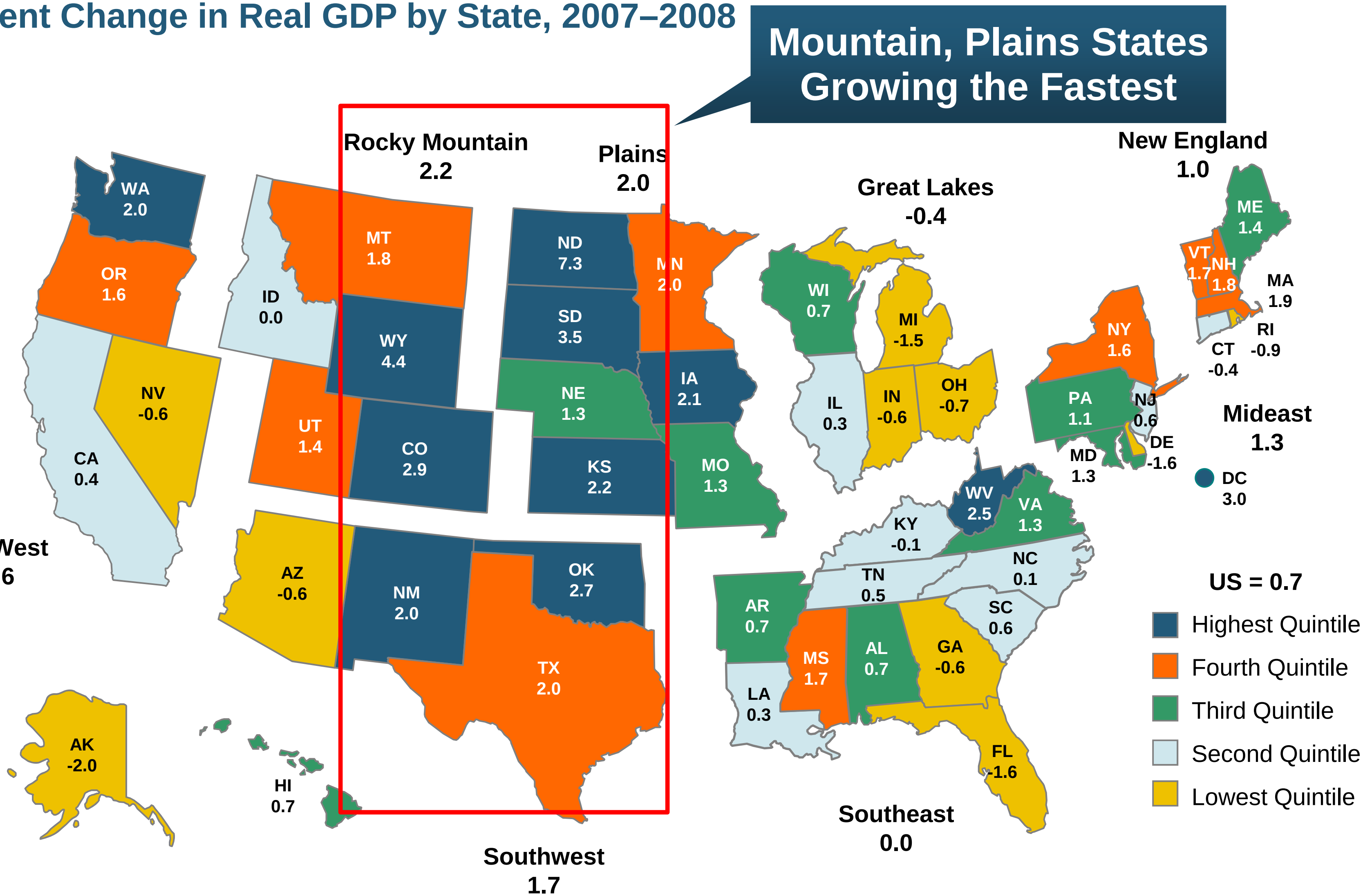
Regional Differences Will Significantly Impact P/C Markets

Recovery in Some Areas Will Begin Years Ahead of Others and Speed of Recovery Will Differ by Orders of Magnitude

State Economic Growth Varied Tremendously in 2008

INSURANCE INFORMATION INSTITUTE

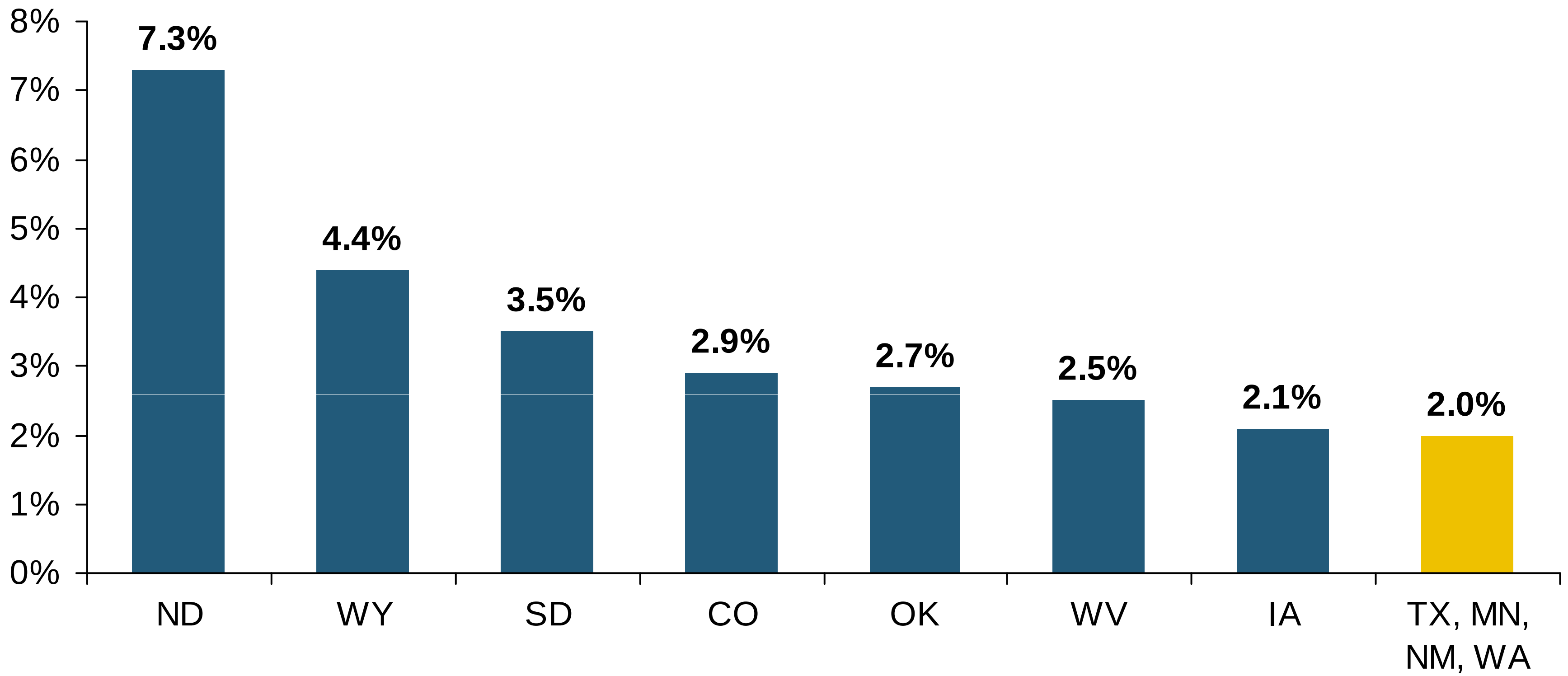
Percent Change in Real GDP by State, 2007–2008



US Bureau of Economic Analysis

Fastest Growing States in 2008: Plains, Mountain States Lead

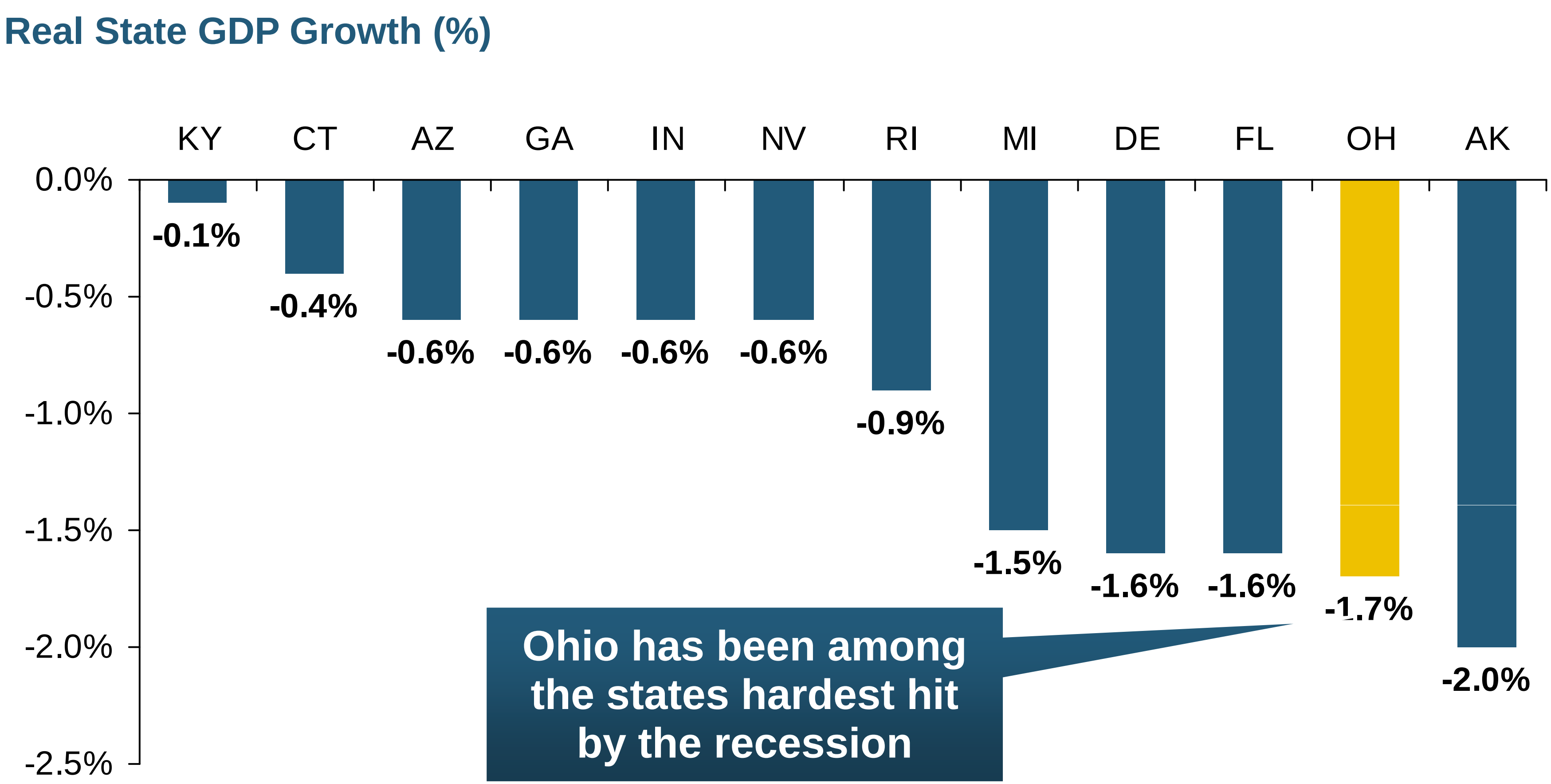
Real State GDP Growth (%)



Natural Resource and Agricultural States Have Done Better Than Most Others Recently, Helping Insurance Exposure in Those Areas

Source: US Bureau of Economic Analysis; Insurance Information Institute.

Slowest Growing States in 2008: Diversity of States Suffering



States in the North, South, East, Midwest and West All Represented Among Hardest Hit, But for Differing Reasons

Source: US Bureau of Economic Analysis; Insurance Information Institute.

INSURANCE INFORMATION INSTITUTE

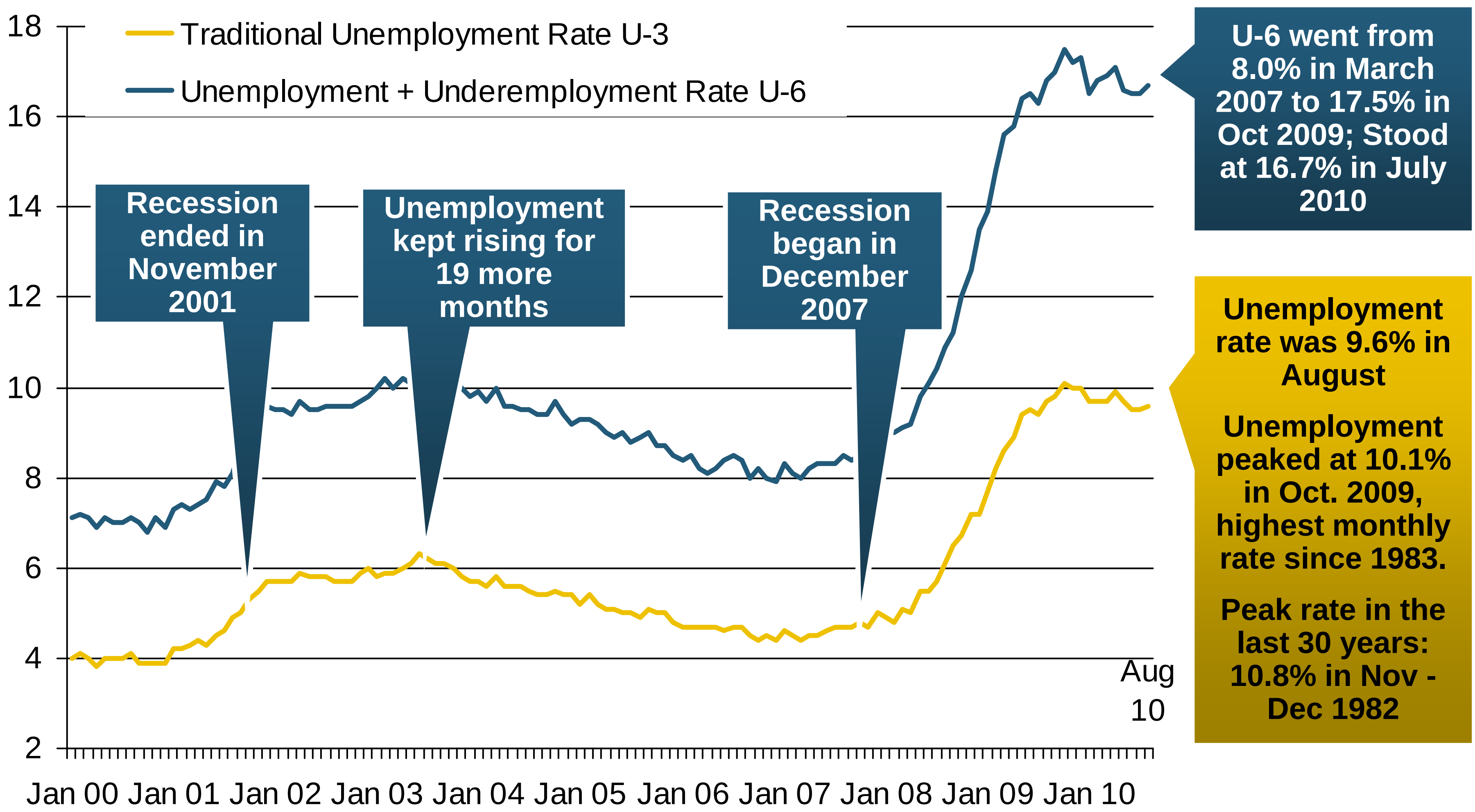
Labor Market Trends

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

Unemployment and Underemployment Rates: Rocked Up in 2008-09; Stabilizing in 2010?

INSURANCE INFORMATION INSTITUTE

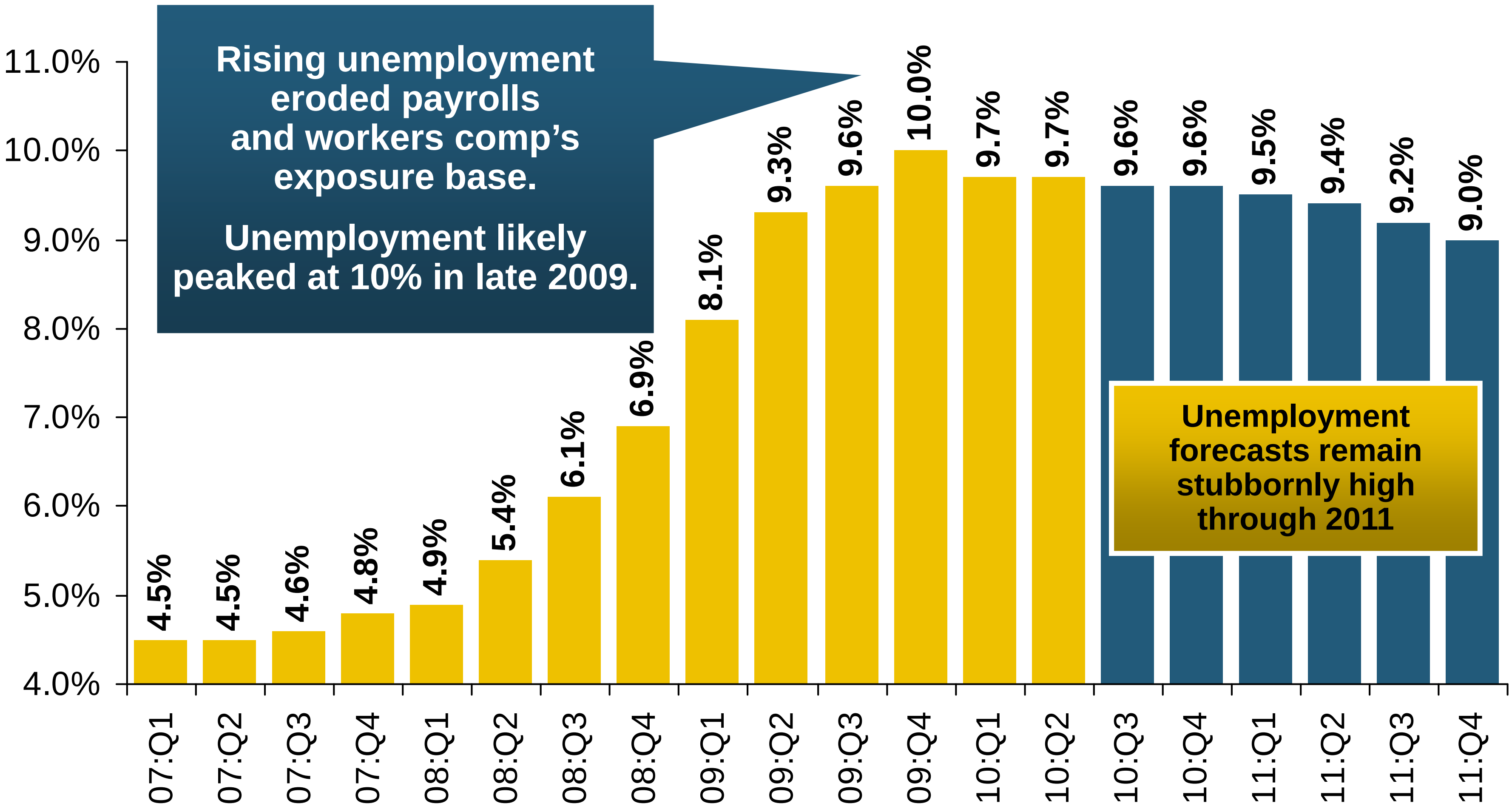
January 2000 through August 2010, Seasonally Adjusted (%)



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

US Unemployment Rate

2007:Q1 to 2011:Q4F*

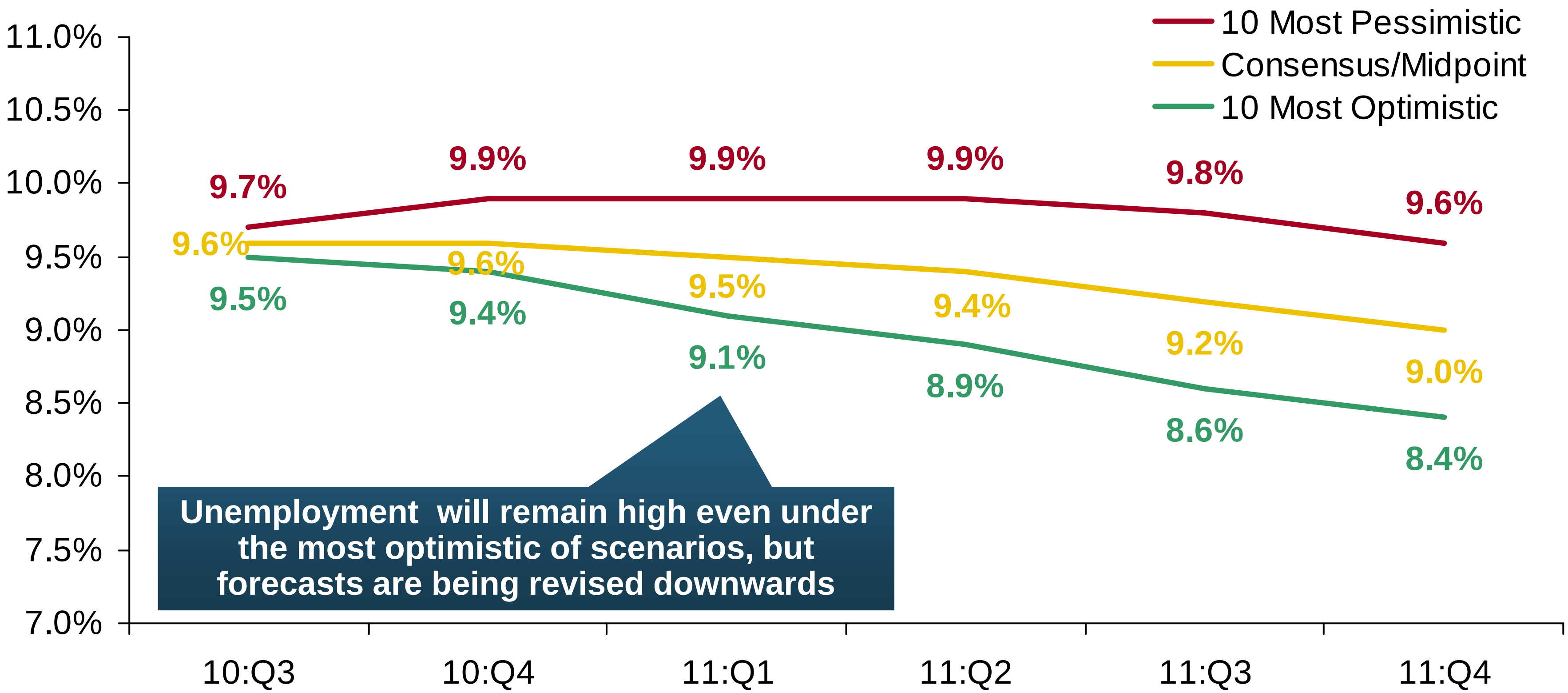


* = actual; = forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (9/10); Insurance Information Institute

US Unemployment Rate Forecasts

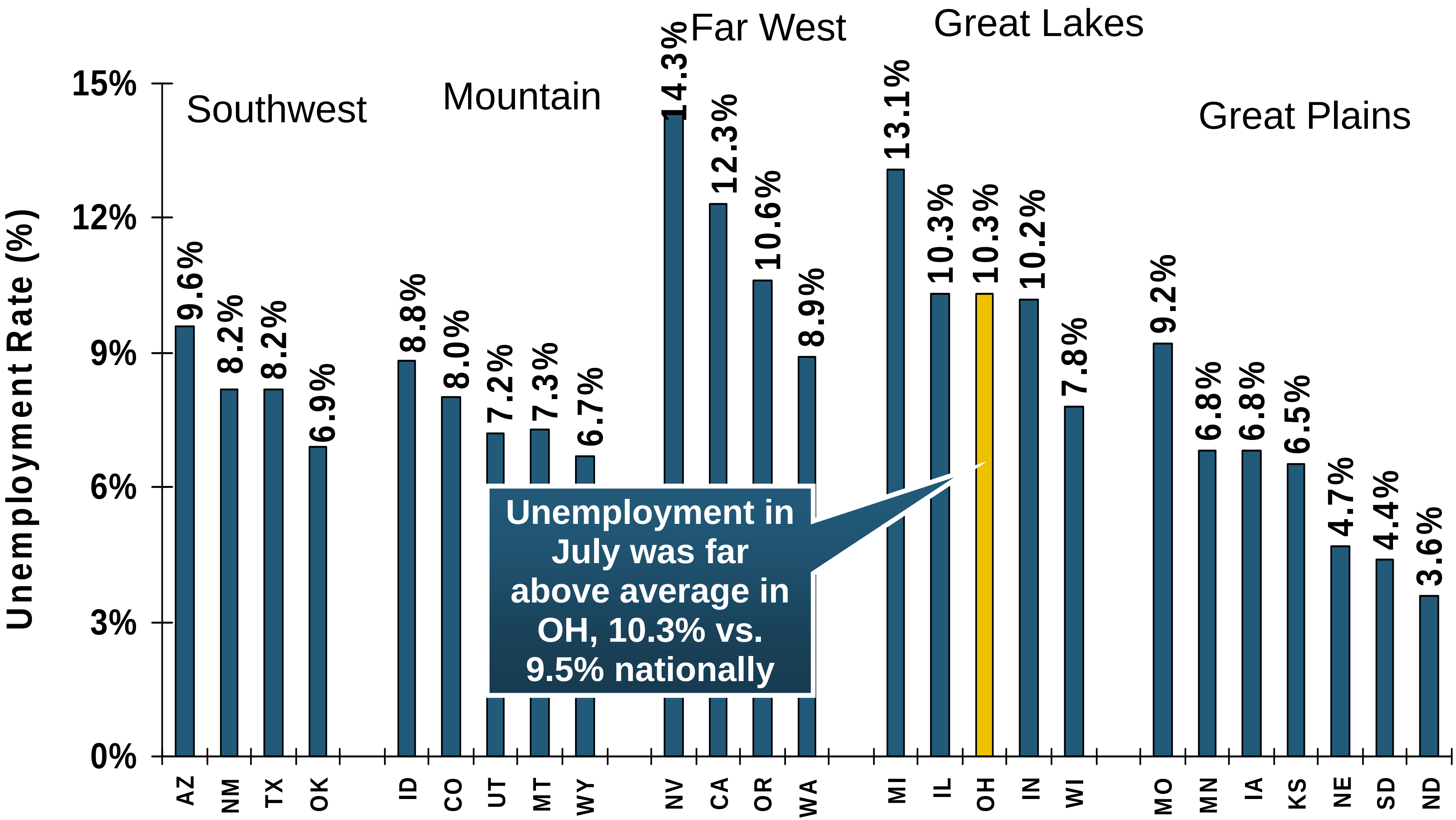
Quarterly, 2010:Q1 to 2011:Q4



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

Sources: Blue Chip Economic Indicators (9/10); Insurance Information Institute

Unemployment Rates Vary Widely by State and Region: July 2010*

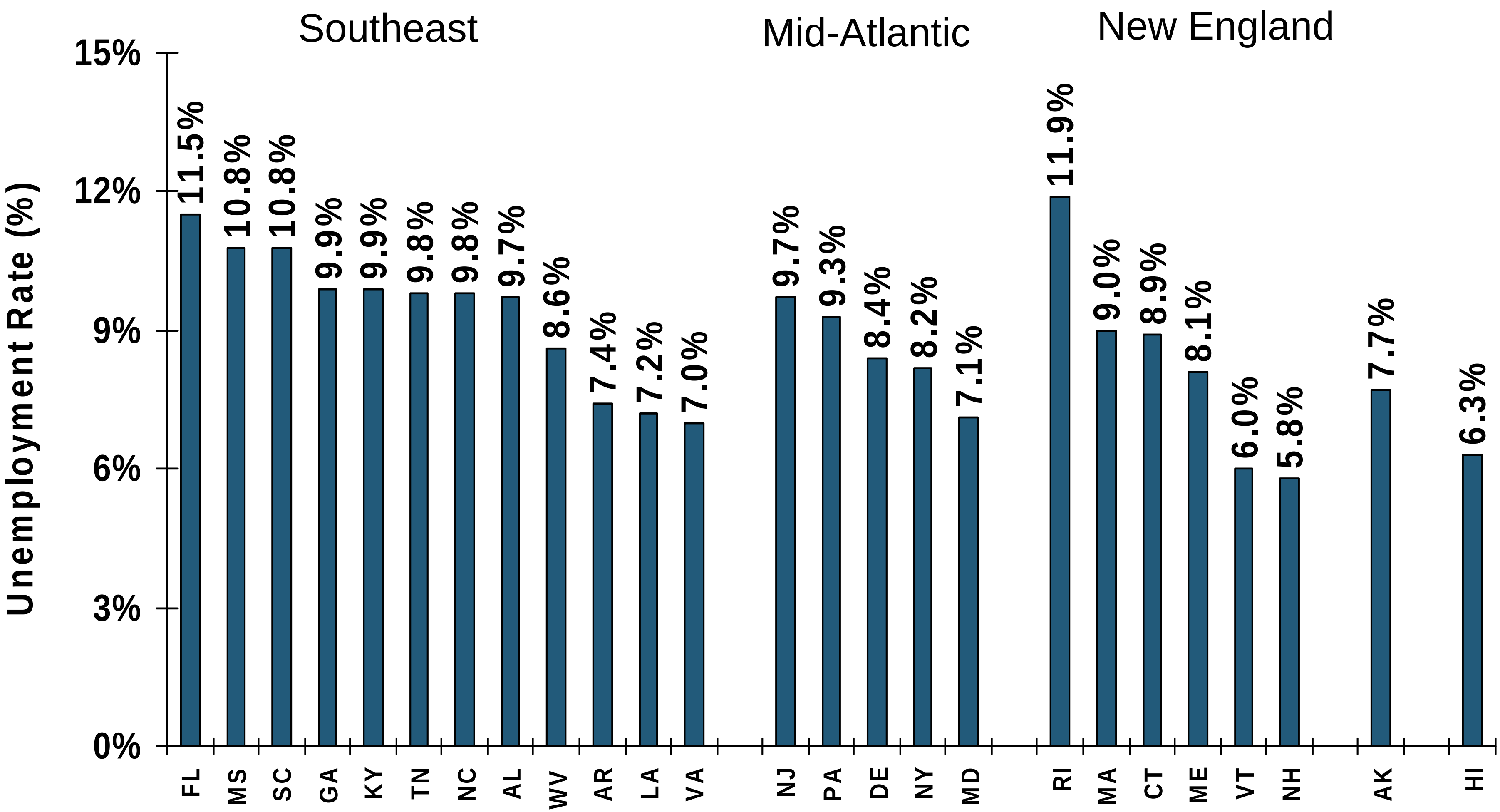


*Provisional figures for July 2010, seasonally adjusted.

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

Unemployment Rates Vary Widely by State and Region: July 2010* (cont'd)

INSURANCE INFORMATION INSTITUTE



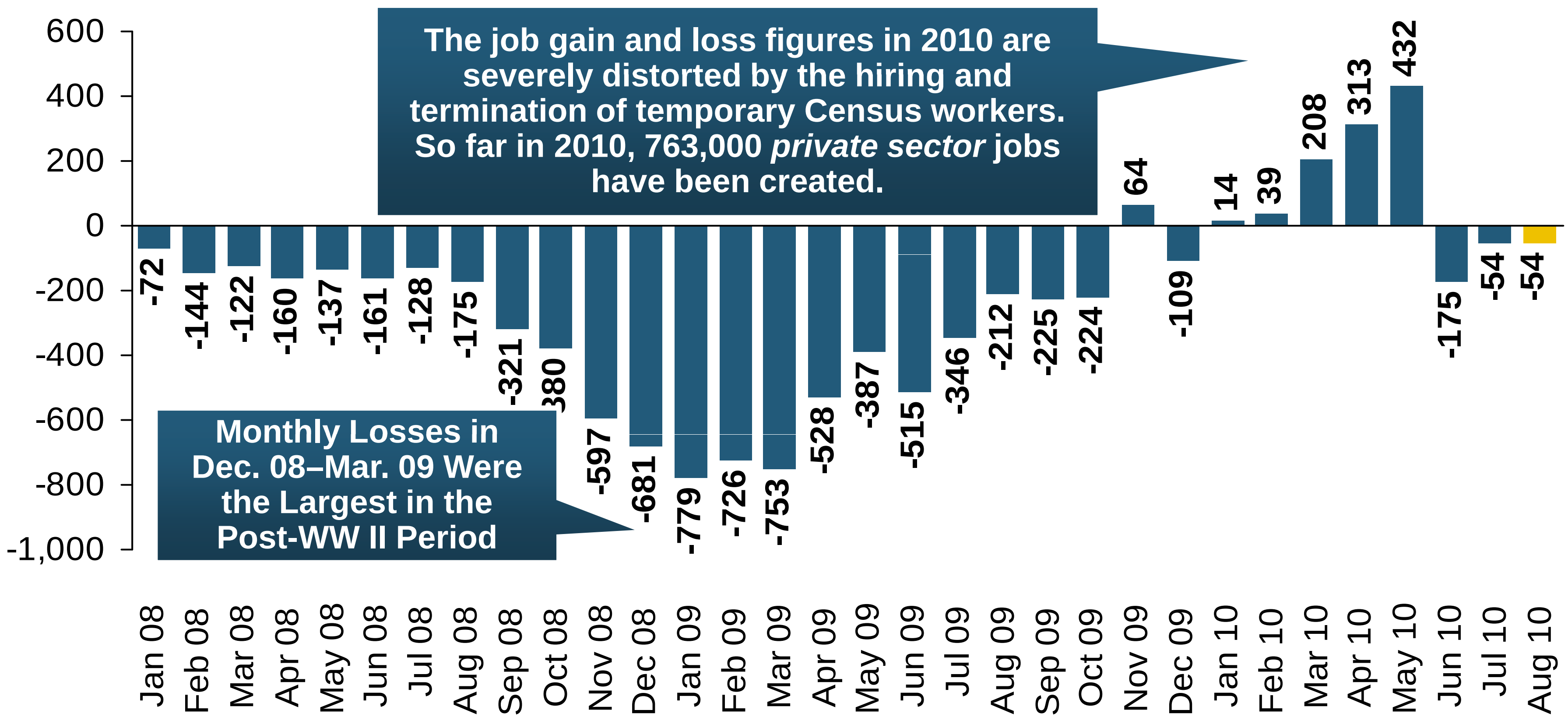
*Provisional figures for July 2010, seasonally adjusted.

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

Monthly Change Employment*

INSURANCE INFORMATION INSTITUTE

January 2008 through August 2010* (Thousands)



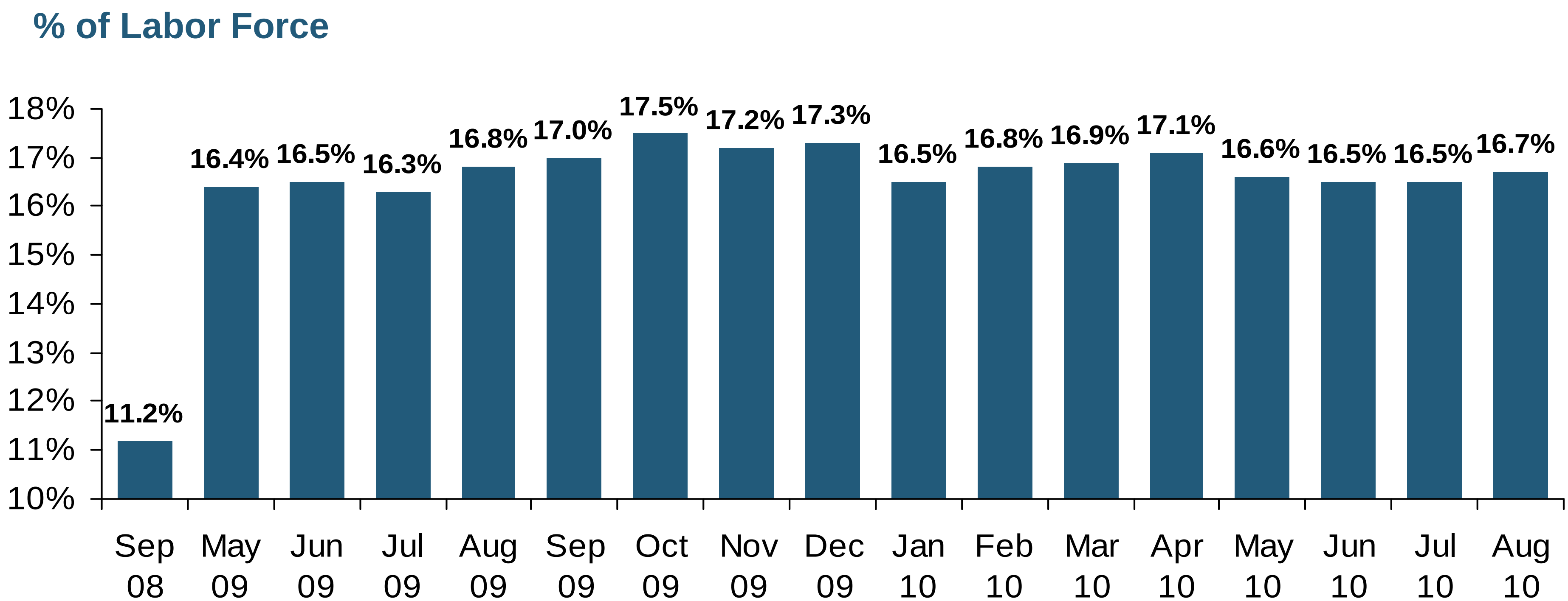
Job Losses Since the Recession Began in Dec. 2007 Peaked at 8.4 Mill in Dec. 09; Stands at 7.7 Million Through August 2010; 14.9 Million People are Now Defined as Unemployed

*Estimate based on Reuters poll of economists.

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

Labor Underutilization: Broader than Just Unemployment

INSURANCE INFORMATION INSTITUTE



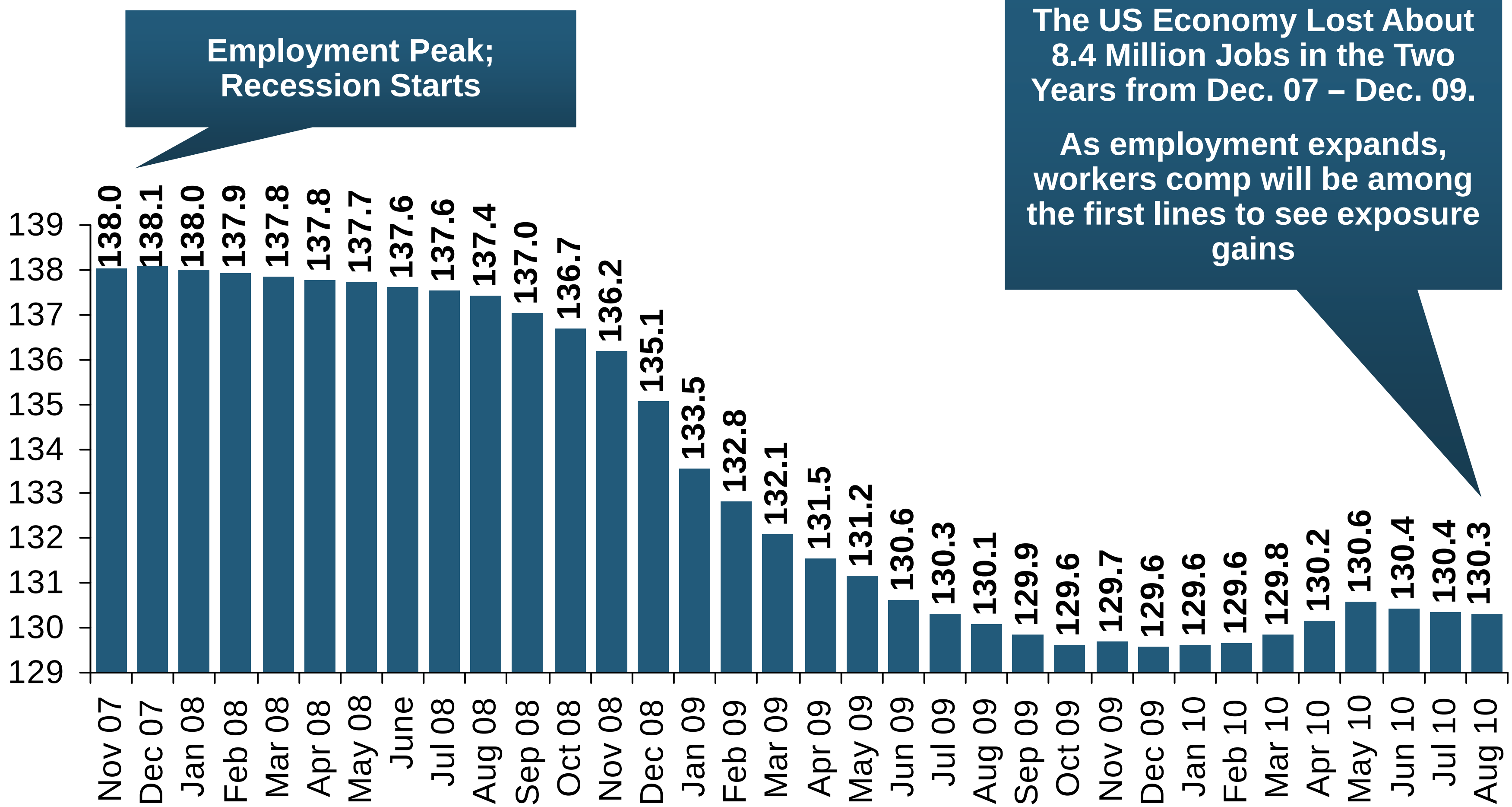
Marginally Attached and Unemployed Persons Account for 16.7% of the Labor Force in August 2010 (1 Out 6 People). Unemployment Rate Alone was 9.6%. Underutilization Shows a Broader Impact on WC and Other Commercial Exposures

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.

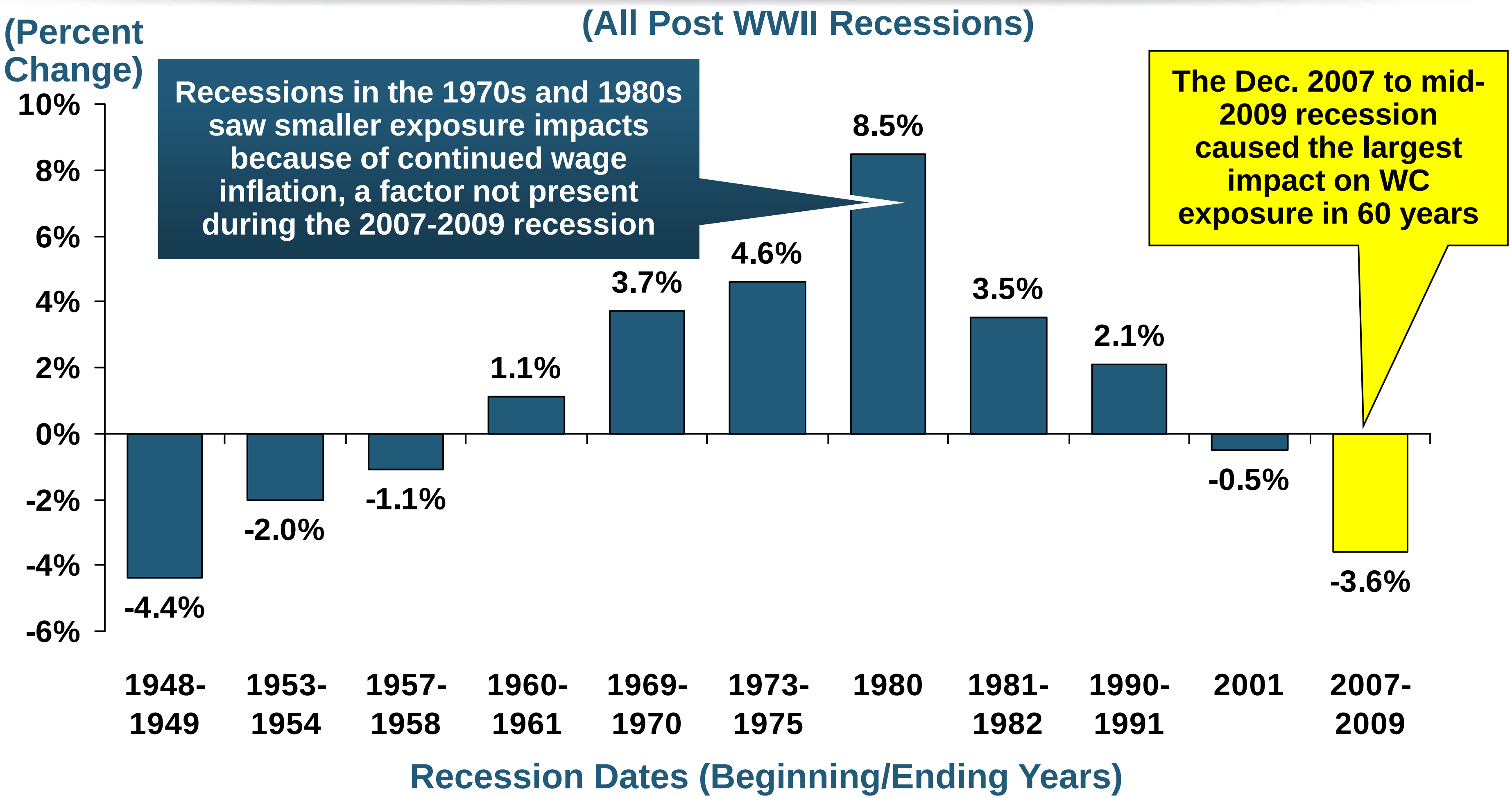
US Nonfarm Private Employment

Monthly, Nov 2007 – August 2010 (Millions)



Seasonally adjusted.
Source: US Bureau of Labor Statistics

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

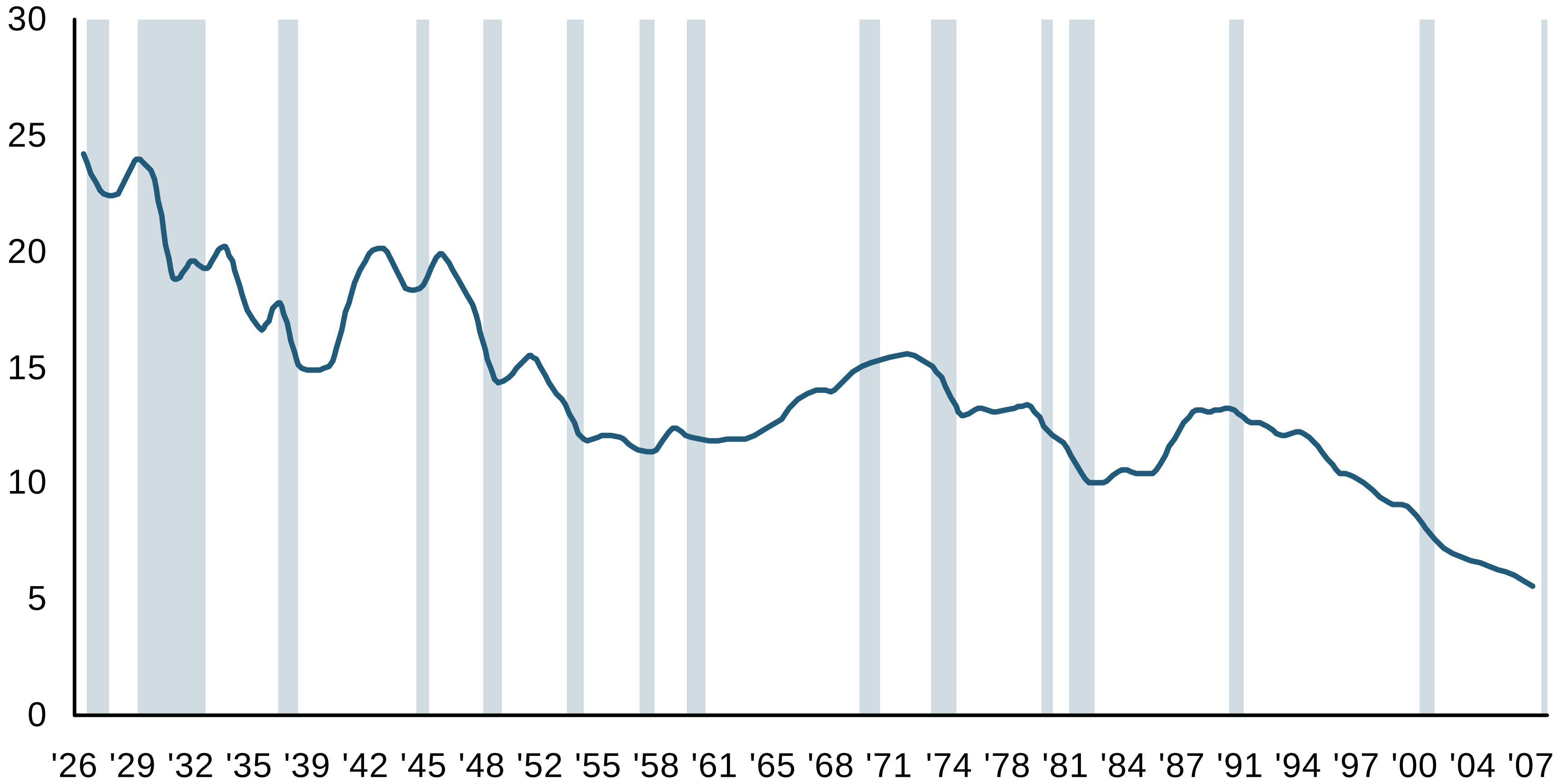


*Data represent maximum recorded decline over 12-month period using annualized quarterly wage and salary accrual data

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

Insurance Industry Employment Trends: 1990-2010

Robert P. Hartwig, Ph.D., CPCU, President & Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: 212.346.5520 ♦ Cell: 917.453.1885 ♦ bobh@iii.org ♦ www.iii.org

September 2010 Report: Employment Highlights*

- **P-C Insurers**
  - Employment down by 400 (-0.1%) vs. June 2010
  - Employment down by 17,700 (-3.7%) vs. July 2009
- **Reinsurers**
  - Employment up by 100 (+0.4%) vs. June 2010
  - Employment down by 1,400 (-5.1%) vs. July 2009
- **Claims Adjusters**
  - Employment up by 400 (+0.9%) vs. June 2010
  - Employment down by 4,800 (-9.9%) vs. July 2009
- **Insurance Agents & Brokers**
  - Employment up by 700 (+0.1%) vs. June 2010
  - Employment down by 16,300 (-2.5%) vs. July 2009
- **Life Insurers**
  - Employment down by 1,200 (-0.3%) vs. June 2010
  - Employment down by 5,500 (-1.6%) vs. July 2009
- **Health/Medical Insurers**
  - Employment down by 4,100 (-0.9%) vs. June 2010
  - Employment down by 7,200 (-1.6%) vs. July 2009

*data are through July 2010 and are preliminary (i.e., subject to later revision)

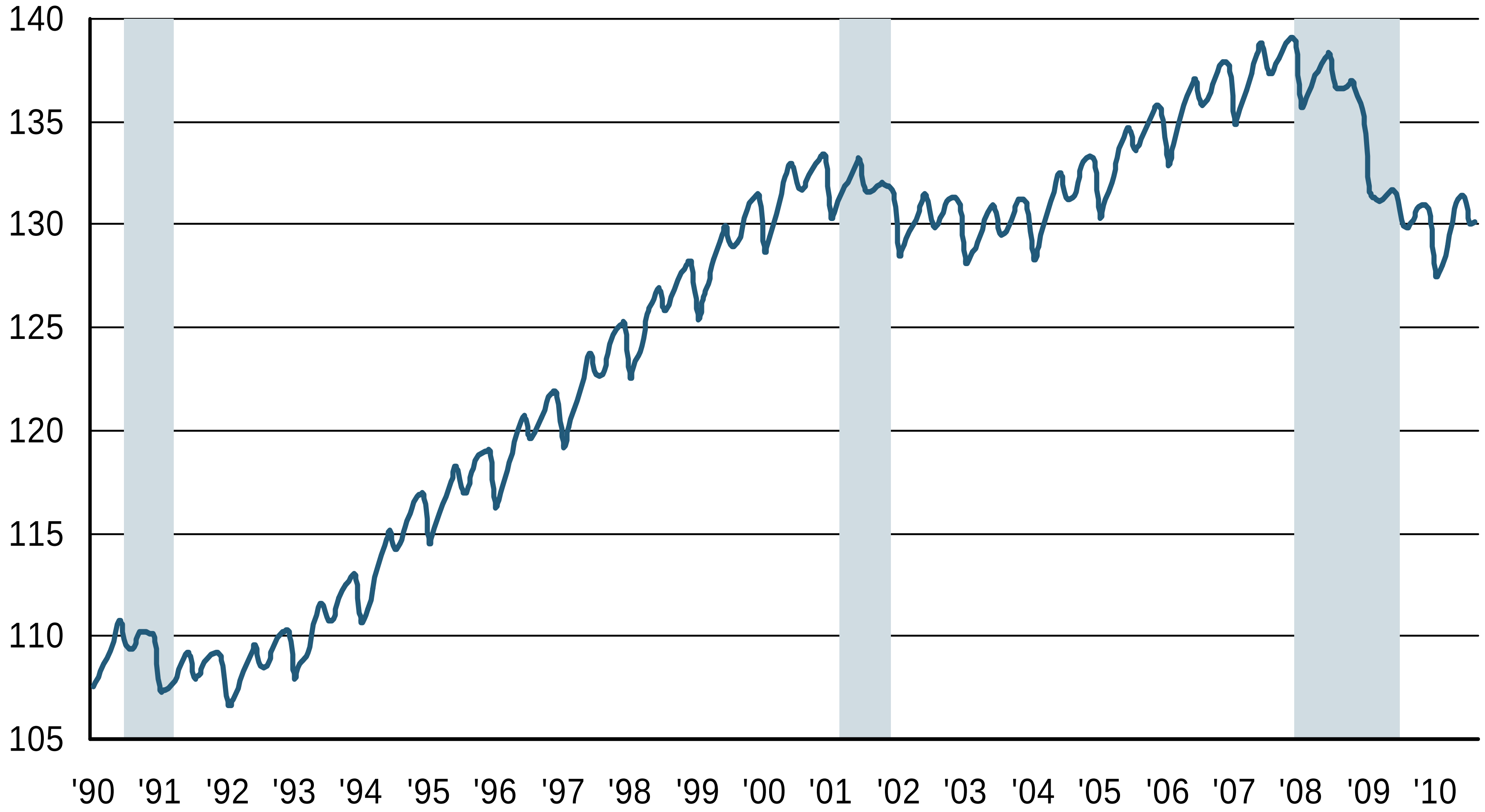
INSURANCE INFORMATION INSTITUTE

Baselines: U.S. Employment Trends

U.S. Nonfarm Employment, Monthly, 1990–2010*

INSURANCE INFORMATION INSTITUTE

Millions

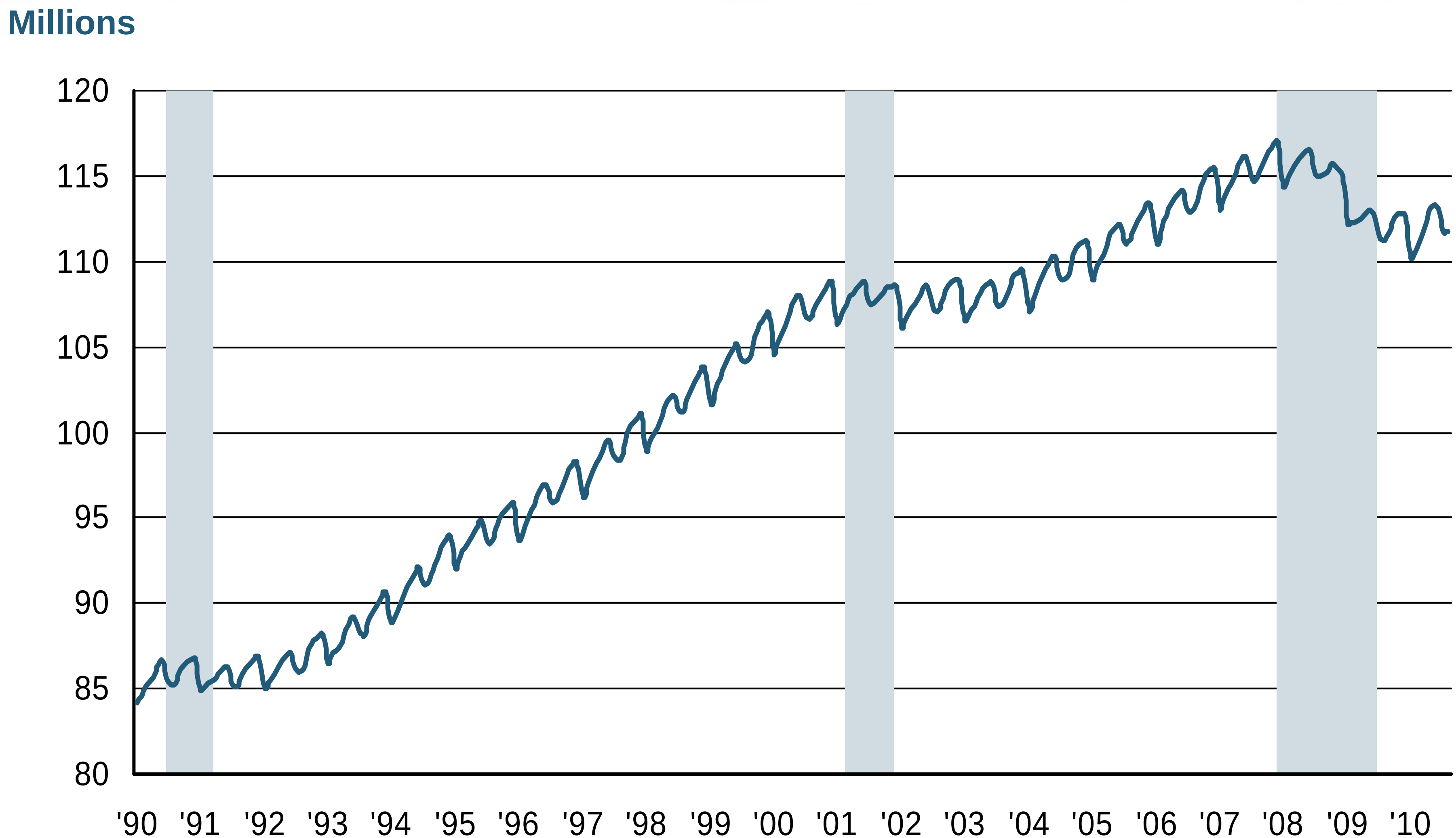


*As of August 2010; Not seasonally adjusted

Note: Recessions indicated by gray shaded columns.

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

U.S. Employment in Service Industries, Monthly, 1990–2010*



*As of August 2010; Not seasonally adjusted

Note: Recessions indicated by gray shaded columns.

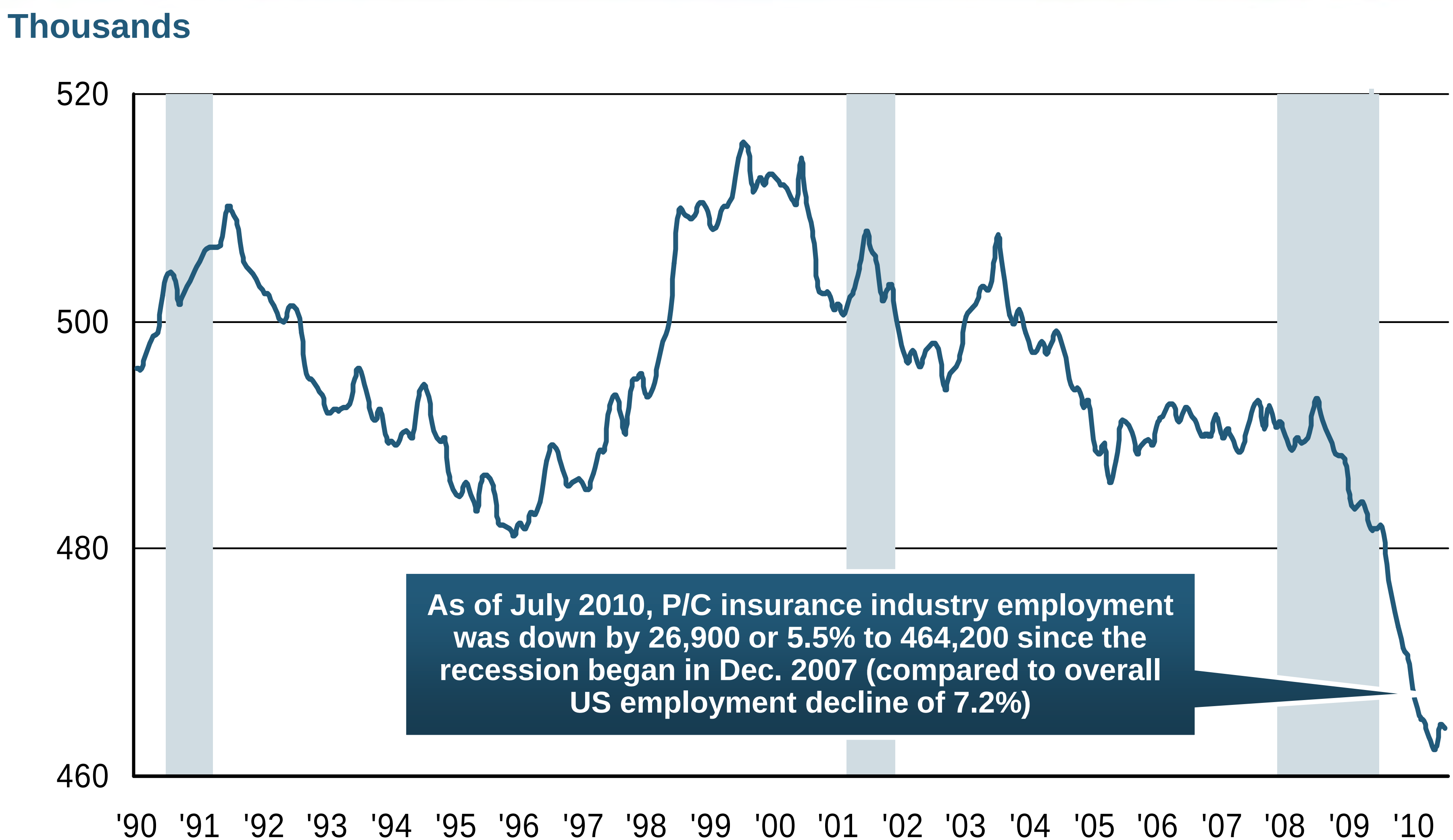
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Insurance Industry Employment Trends

Soft Market, Difficult Economy, Outsourcing, Productivity Enhancements and Consolidation Have Contributed to Industry's Job Losses

U.S. Employment in the Direct P/C Insurance Industry: 1990–2010*

INSURANCE INFORMATION INSTITUTE

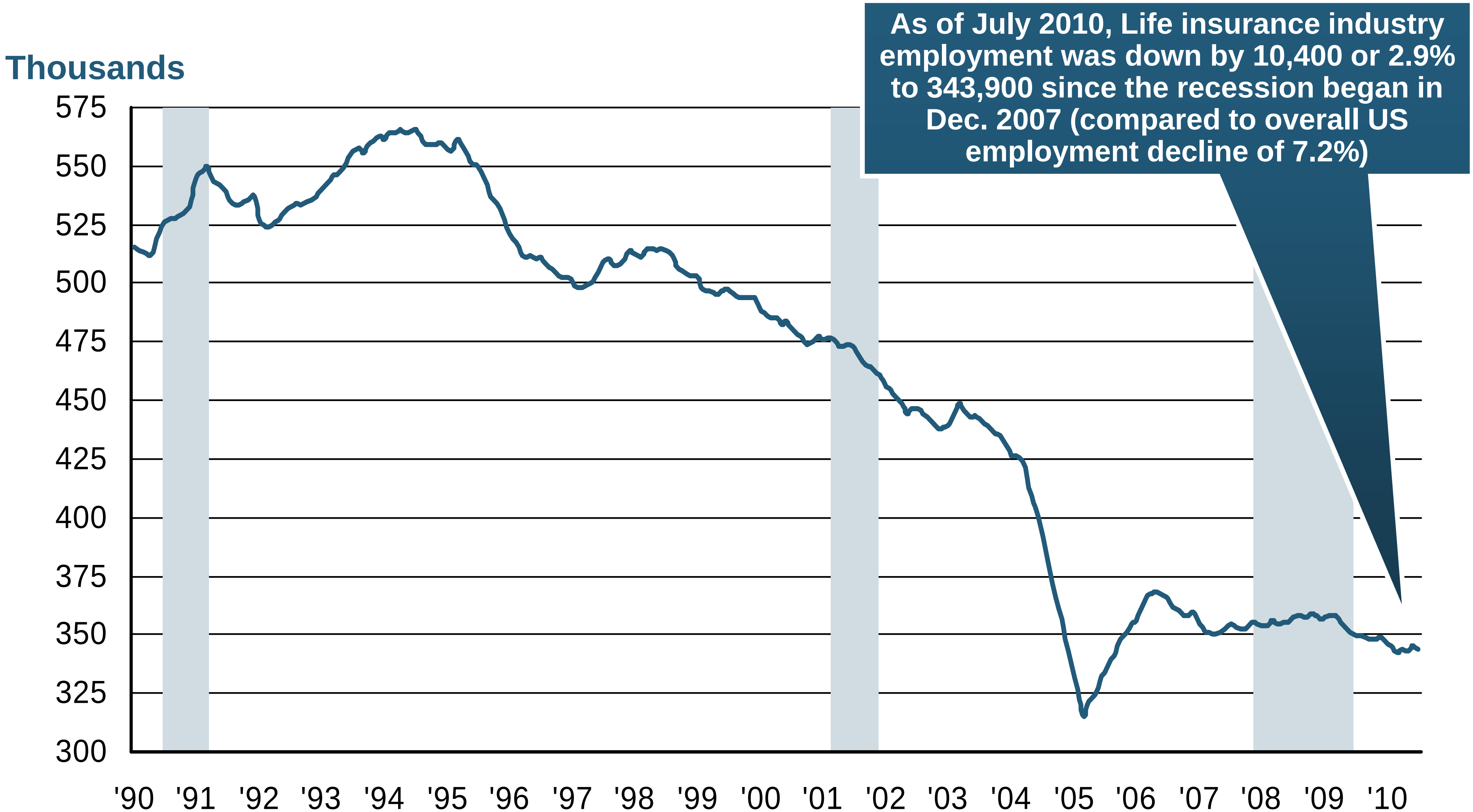


*As of July 2010; Not seasonally adjusted; Does not including agents & brokers

Note: Recessions indicated by gray shaded columns.

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

U.S. Employment in the Direct Life Insurance Industry: 1990–2010*



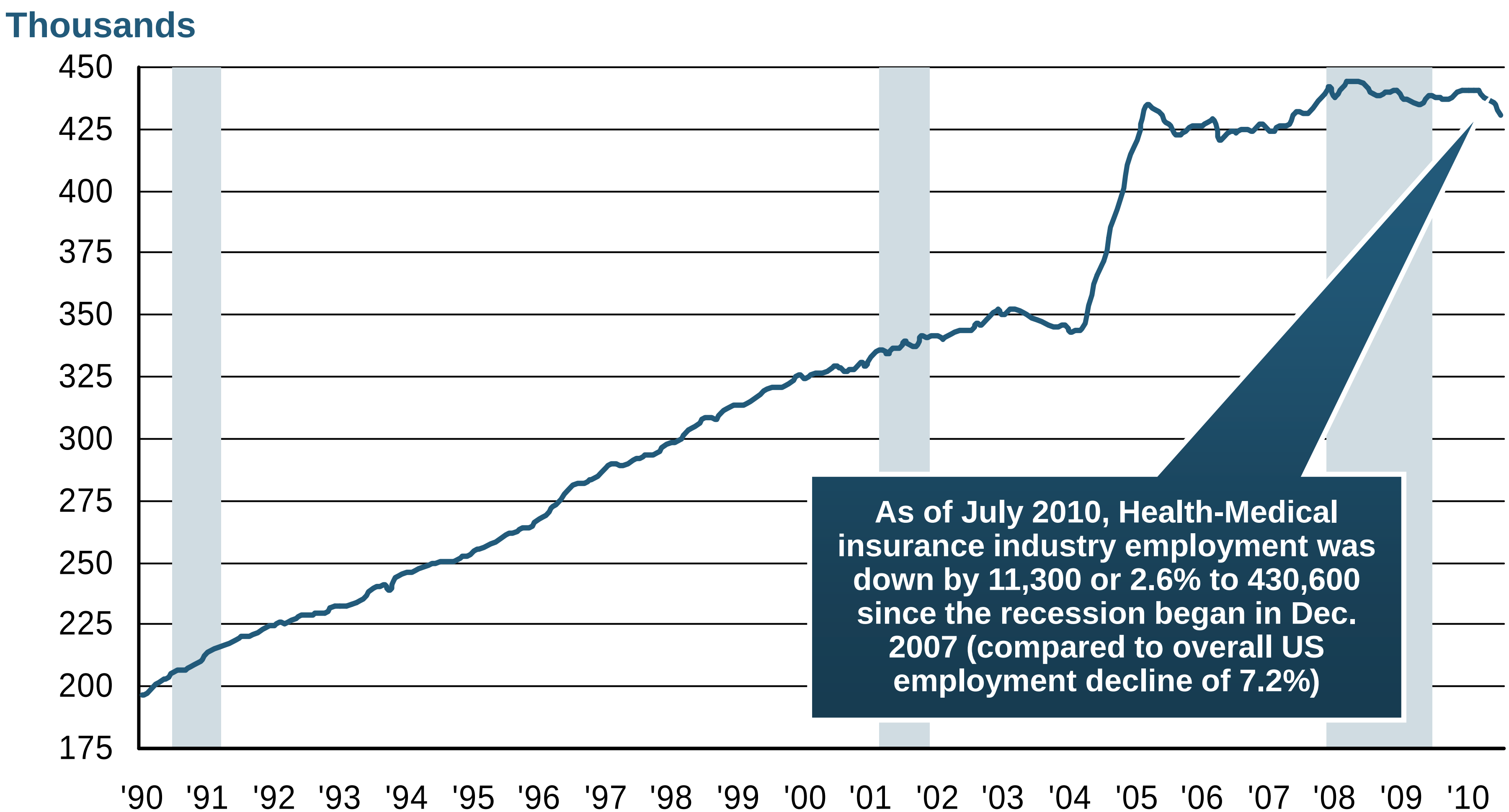
*As of July 2010; Not seasonally adjusted; Does not including agents & brokers

Note: Recessions indicated by gray shaded columns.

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

U.S. Employment in the Direct Health-Medical Insurance Industry: 1990–2010*

INSURANCE INFORMATION INSTITUTE

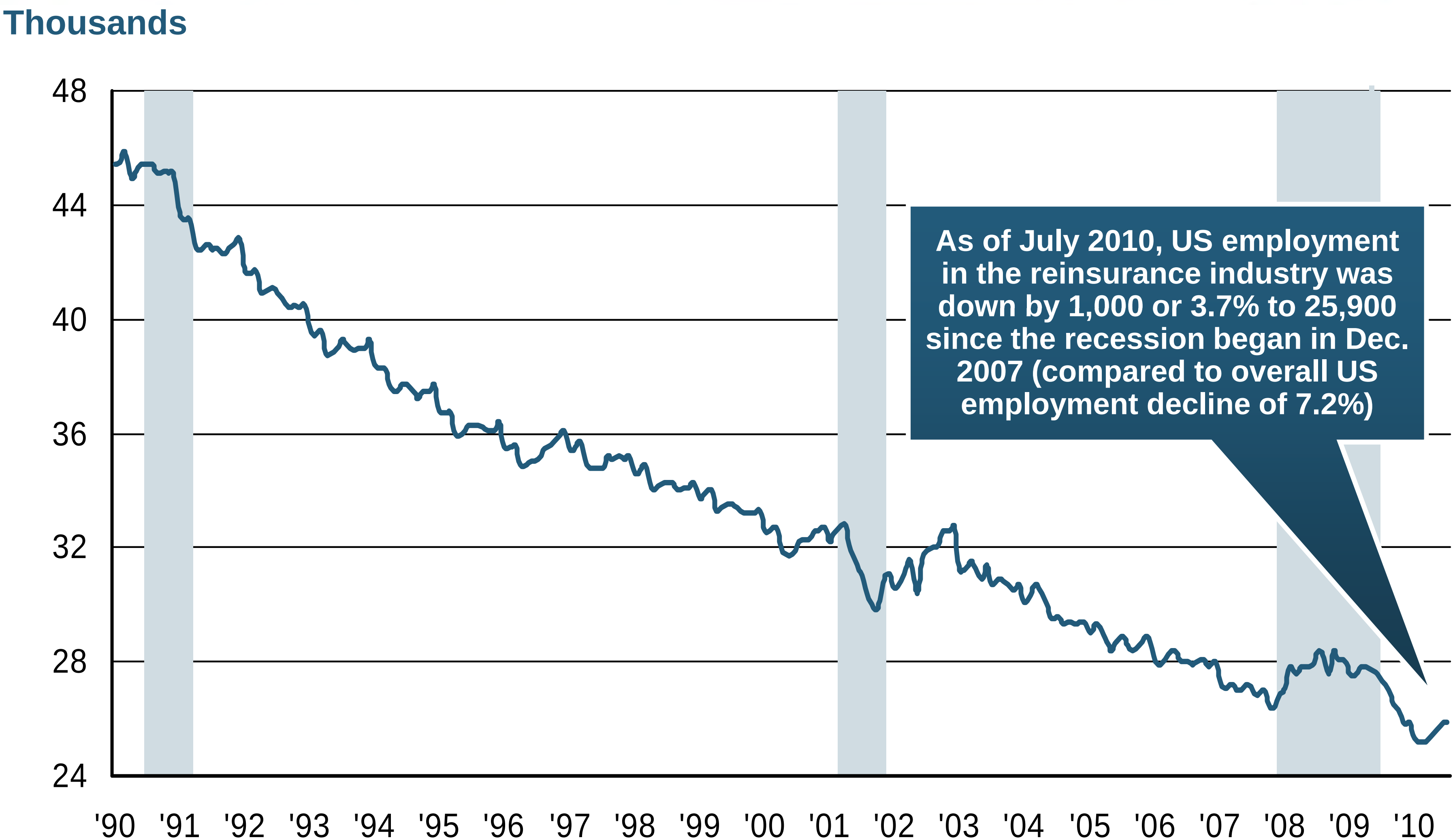


*As of July 2010; Not seasonally adjusted; Does not including agents & brokers

Note: Recessions indicated by gray shaded columns.

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

U.S. Employment in the Reinsurance Industry: 1990–2010*

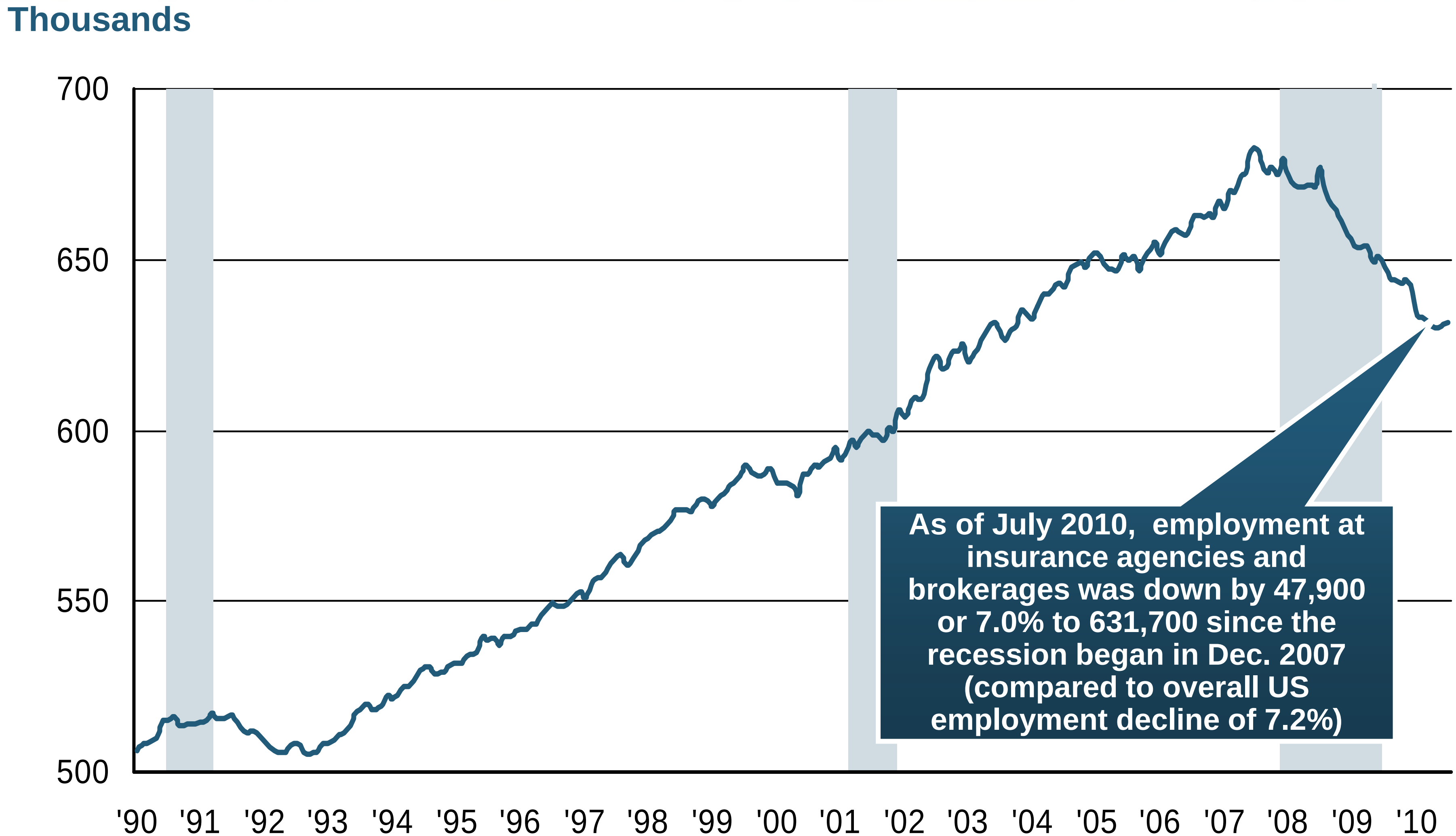


*As of July 2010; Not seasonally adjusted; Does not including agents & brokers

Note: Recessions indicated by gray shaded columns.

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

U.S. Employment in Insurance Agencies & Brokerages: 1990–2010*



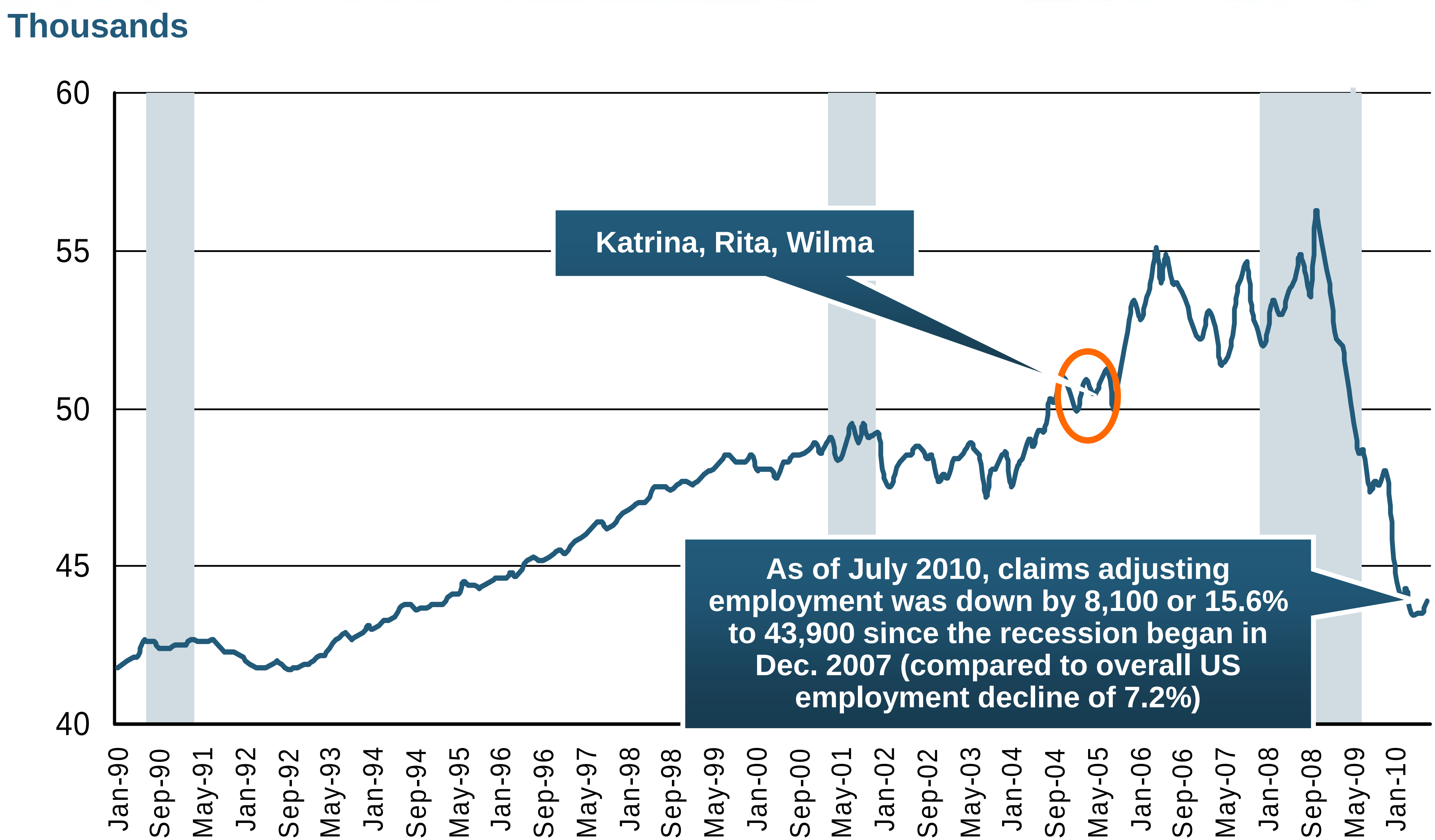
*As of July 2010; Not seasonally adjusted. Includes all types of insurance.

Note: Recessions indicated by gray shaded columns.

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

U.S. Employment in Insurance Claims Adjusting: 1990–2010*

INSURANCE INFORMATION INSTITUTE



*As of July 2010; Not seasonally adjusted.

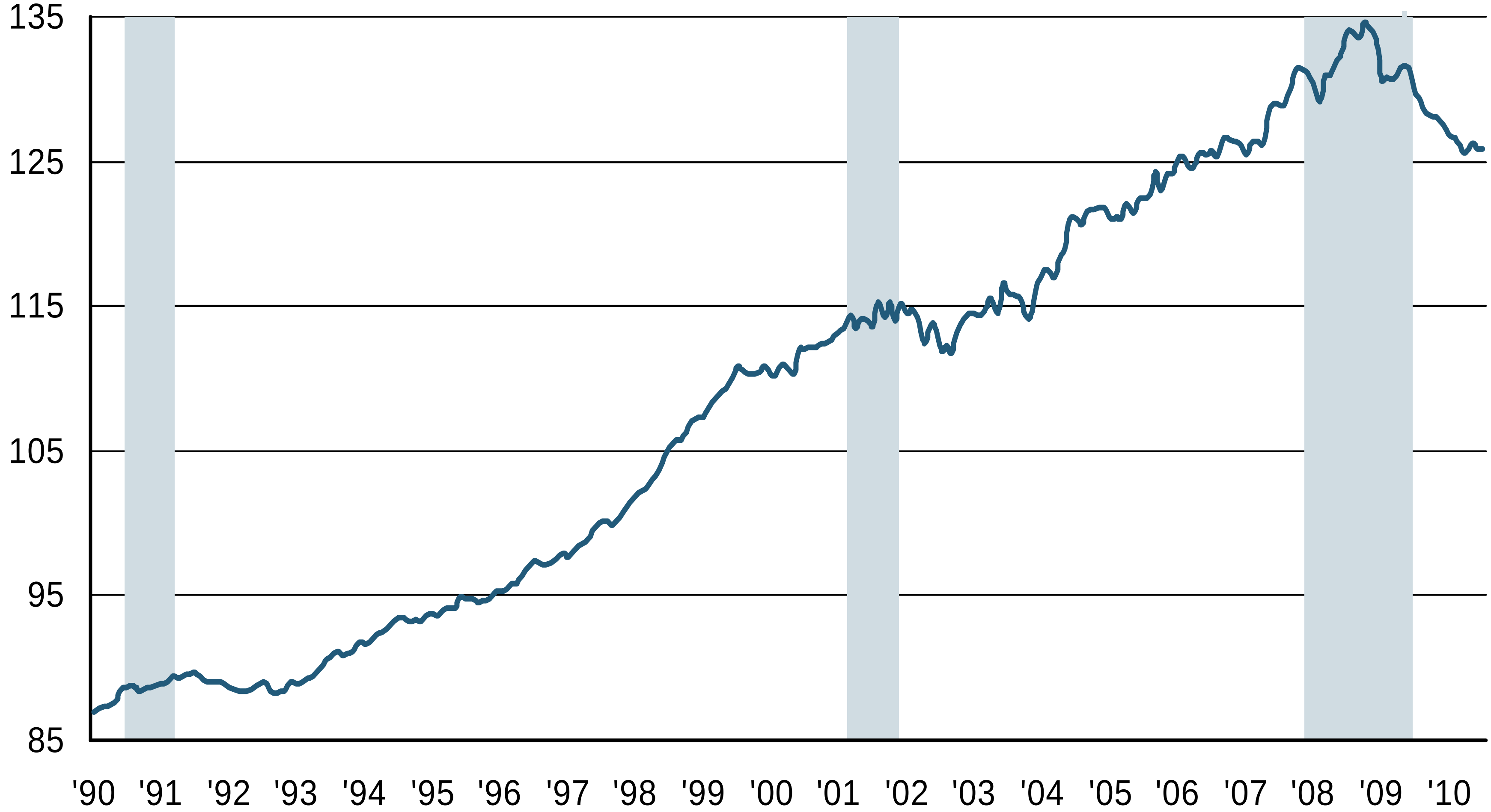
Note: Recessions indicated by gray shaded columns.

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

U.S. Employment in Third-Party Administration of Insurance Funds: 1990–2010*

INSURANCE INFORMATION INSTITUTE

Thousands



*As of July 2010; Not seasonally adjusted. Includes all types of insurance.

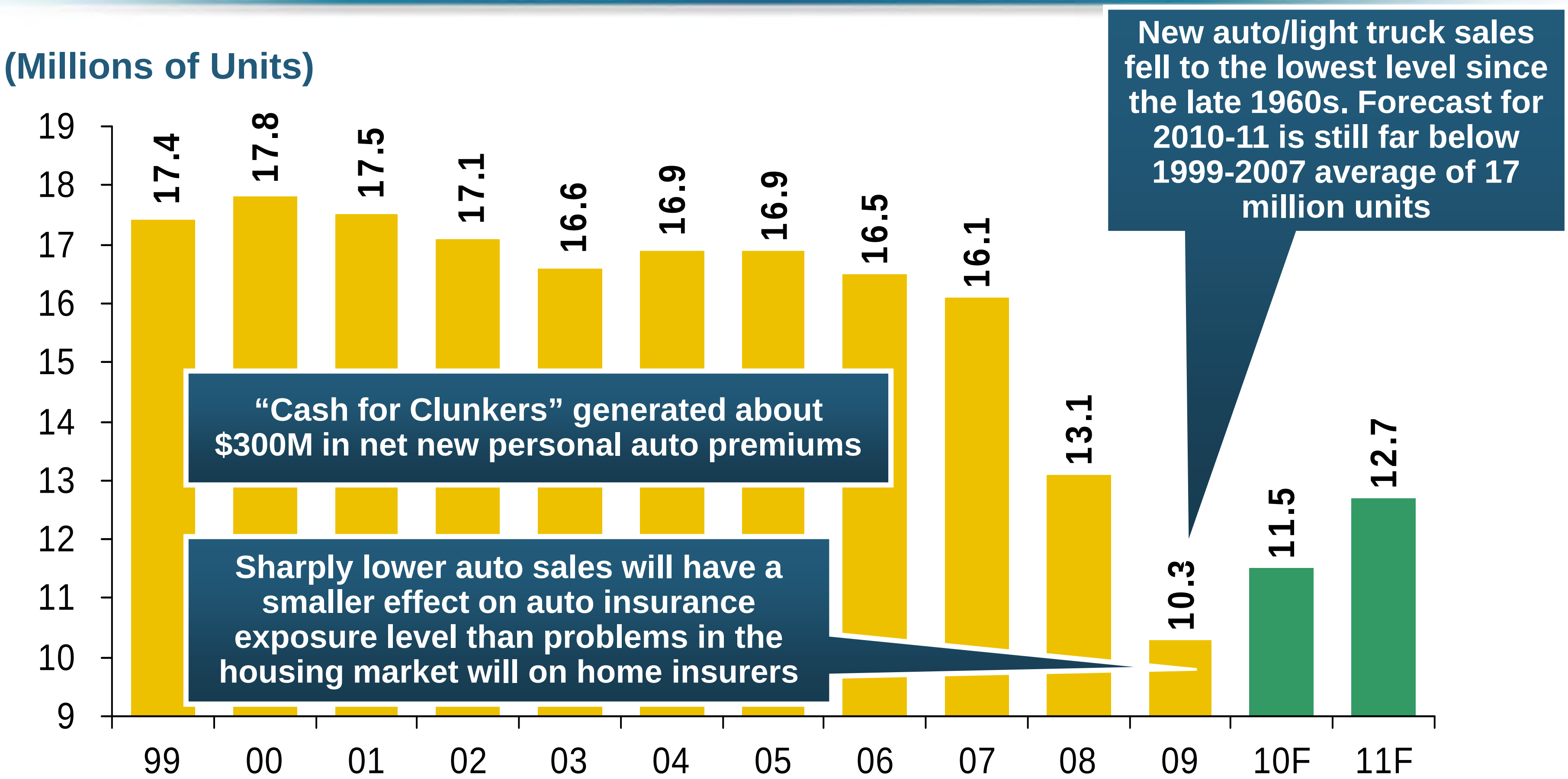
Note: Recessions indicated by gray shaded columns.

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

Crisis-Driven Exposure Drivers

Economic Obstacles to Growth in P/C Insurance

Auto/Light Truck Sales, 1999-2011F

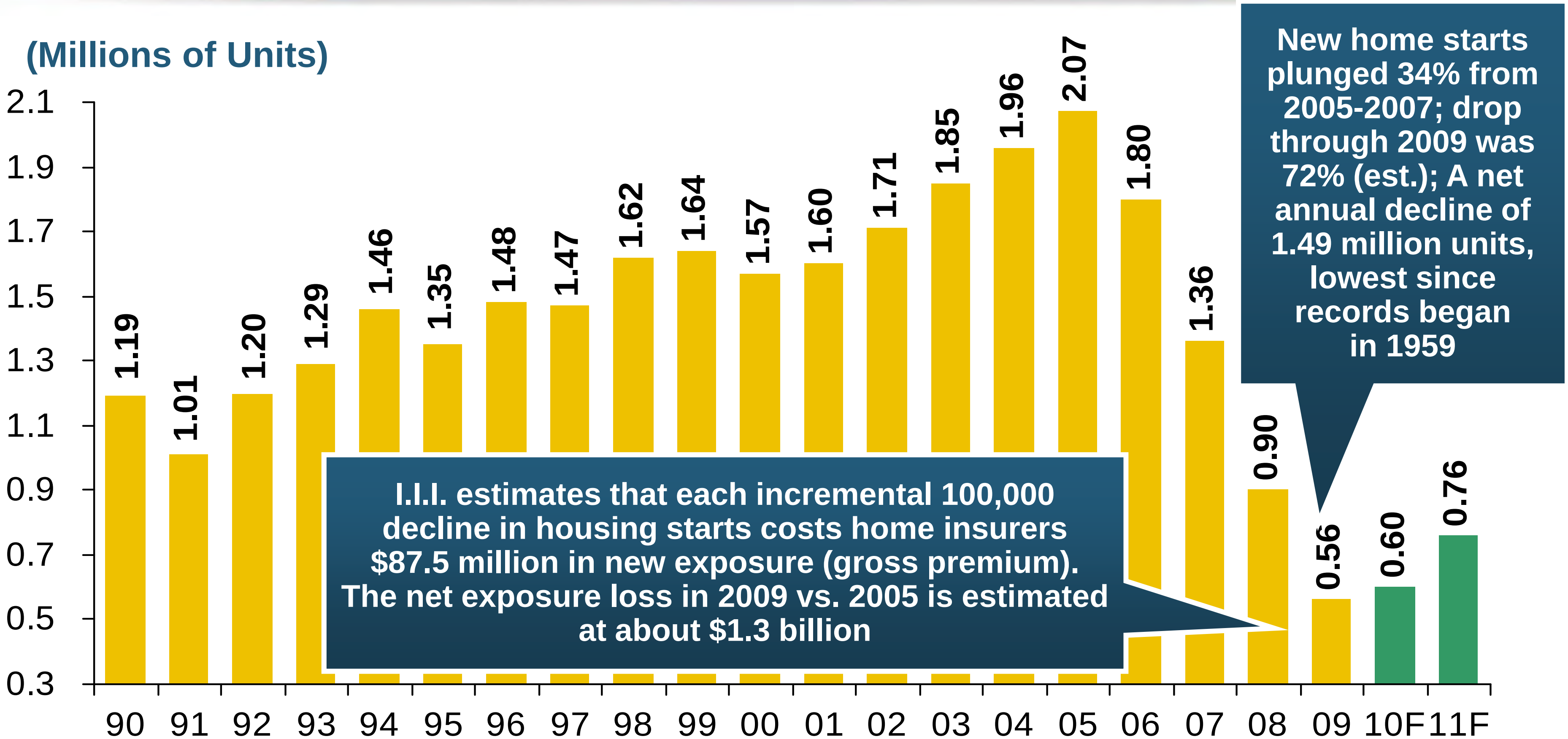


Car/Light Truck Sales Will Recover from the 2009 Low Point, but High Unemployment, Tight Credit Are Still Restraining Sales

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (9/10); Insurance Information Institute.

New Private Housing Starts, 1990-2011F

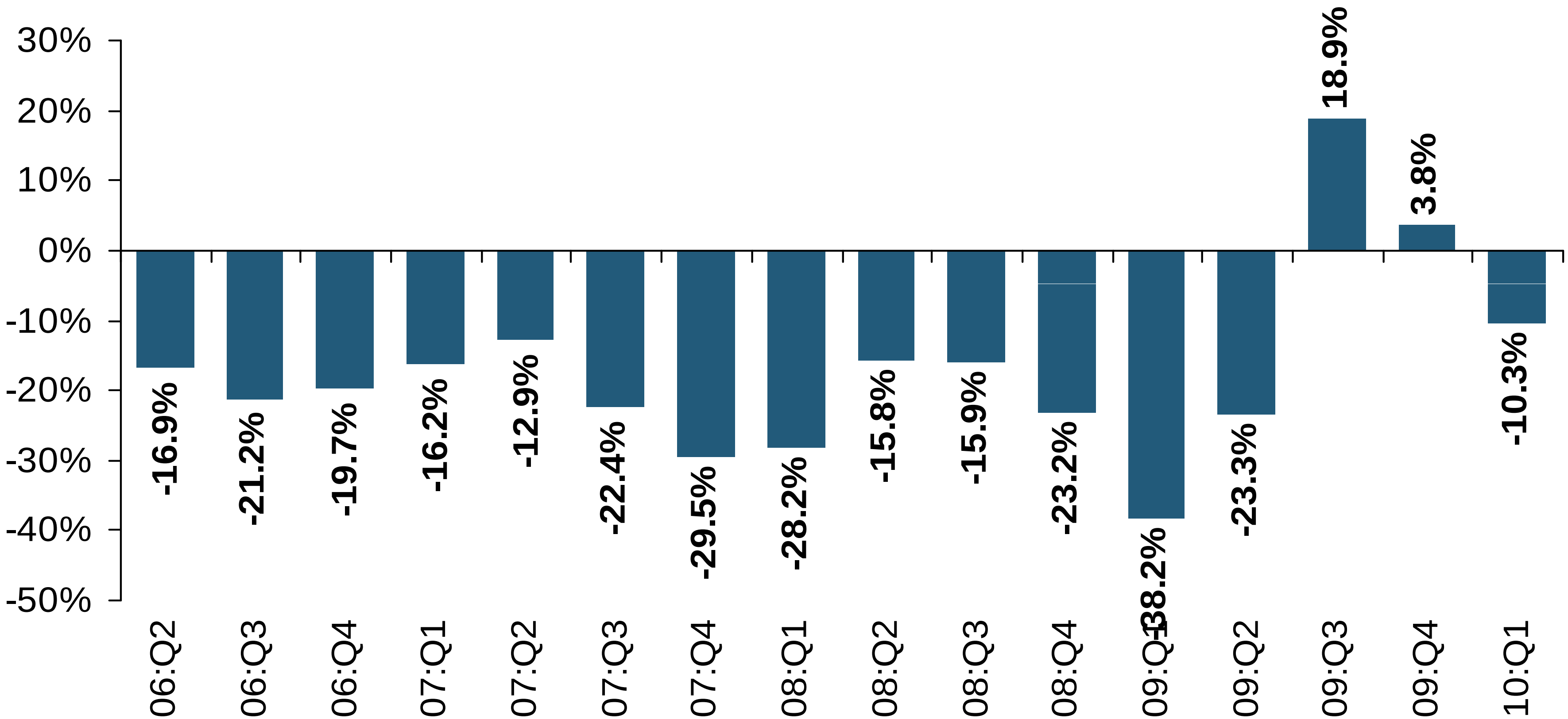
INSURANCE INFORMATION INSTITUTE



Little Exposure Growth Likely for Homeowners Insurers Due to Weak Home Construction Forecast for 2010-2011. Also Affects Commercial Insurers with Construction Risk Exposure, Surety

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (9/10); Insurance Information Institute.

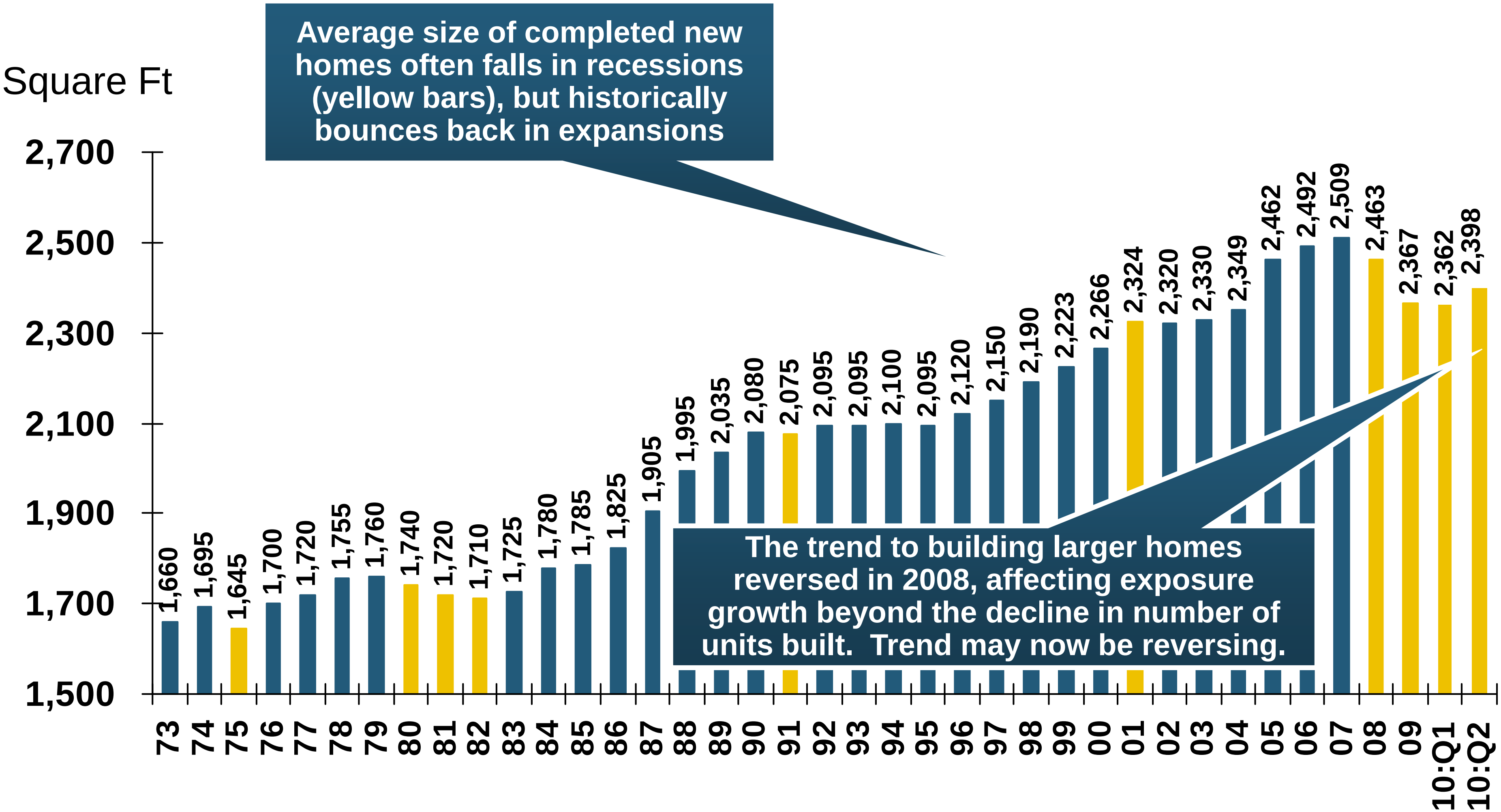
Percent Changes in Residential Fixed Investment, 2006:Q2-2010:Q1*



The Drop in 2006 is in Relation to the Record 2.07 Million Units Started in 2005; 1.8 Million Units Were Started That Year. The 2010:Q1 Drop Supports the Weak Home Construction Forecast for 2010-2011.

*seasonally adjusted
Source: U.S. Department of Commerce, Bureau of Economic Analysis

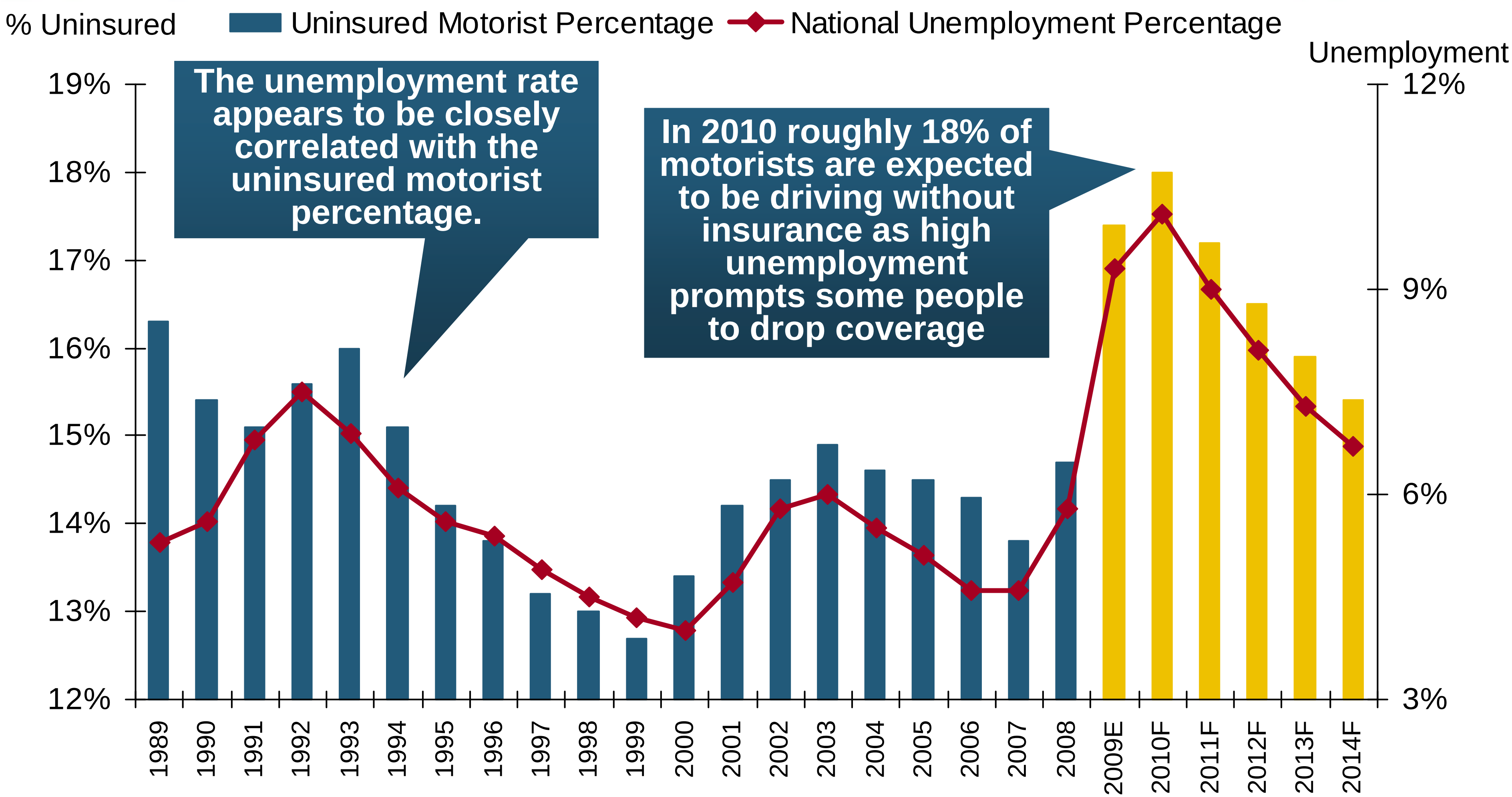
Average Square Footage of Completed New Homes in U.S., 1973-2010:Q2



Source: U.S. Census Bureau: http://www.census.gov/const/www/quarterly_starts_completions.pdf; Insurance Information Institute.

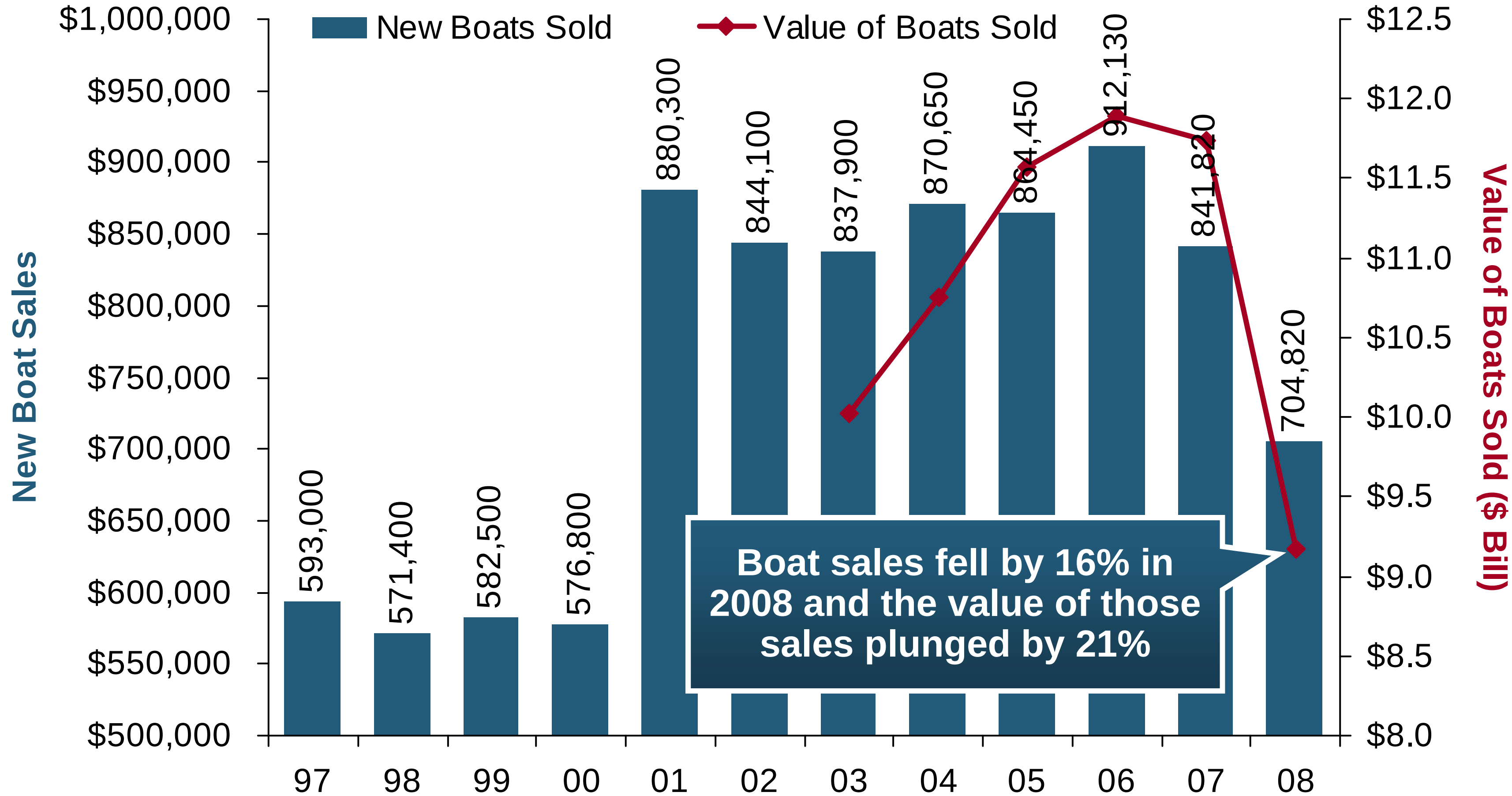
Unemployment's Effect on Percent of Uninsured Motorists, 1989-2014F

INSURANCE INFORMATION INSTITUTE



Source: *Uninsured Motorists, 2008* Edition, Insurance Research Council; Blue Chip Economic Indicators (Unemployment data, including forecasts); Insurance Information Institute.

New Boat Sales Symptomatic of Decline in Insured Exposure Growth for Luxury/Discretionary Items

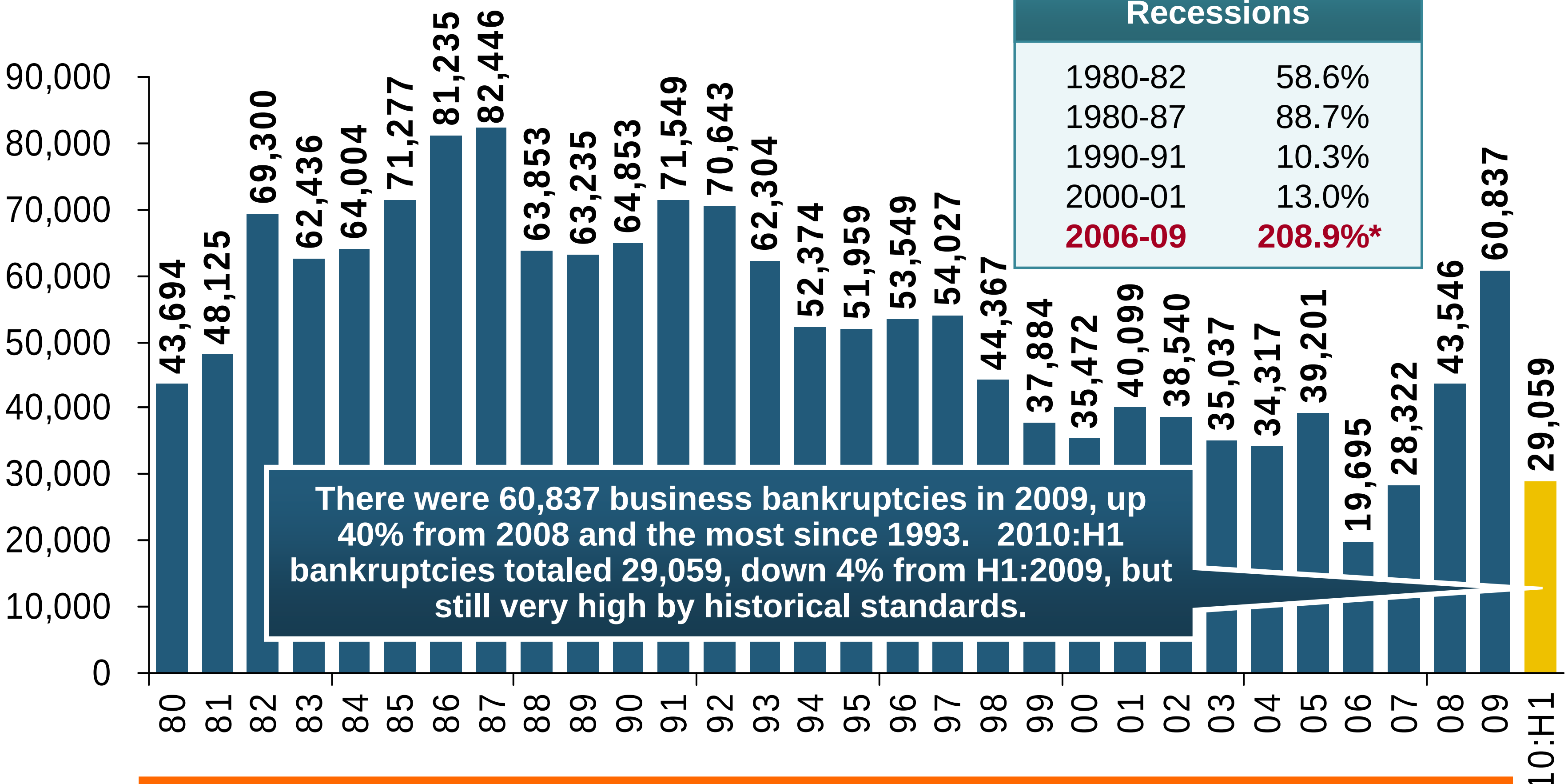


Sources: National Marine Manufacturers Association, 2008 Abstract (latest available as of Feb. 2010); Insurance Information Institute.

Business Bankruptcy Filings, 1980-2010:H1

INSURANCE INFORMATION INSTITUTE

% Change Surrounding Recessions	
1980-82	58.6%
1980-87	88.7%
1990-91	10.3%
2000-01	13.0%
2006-09	**208.9%***



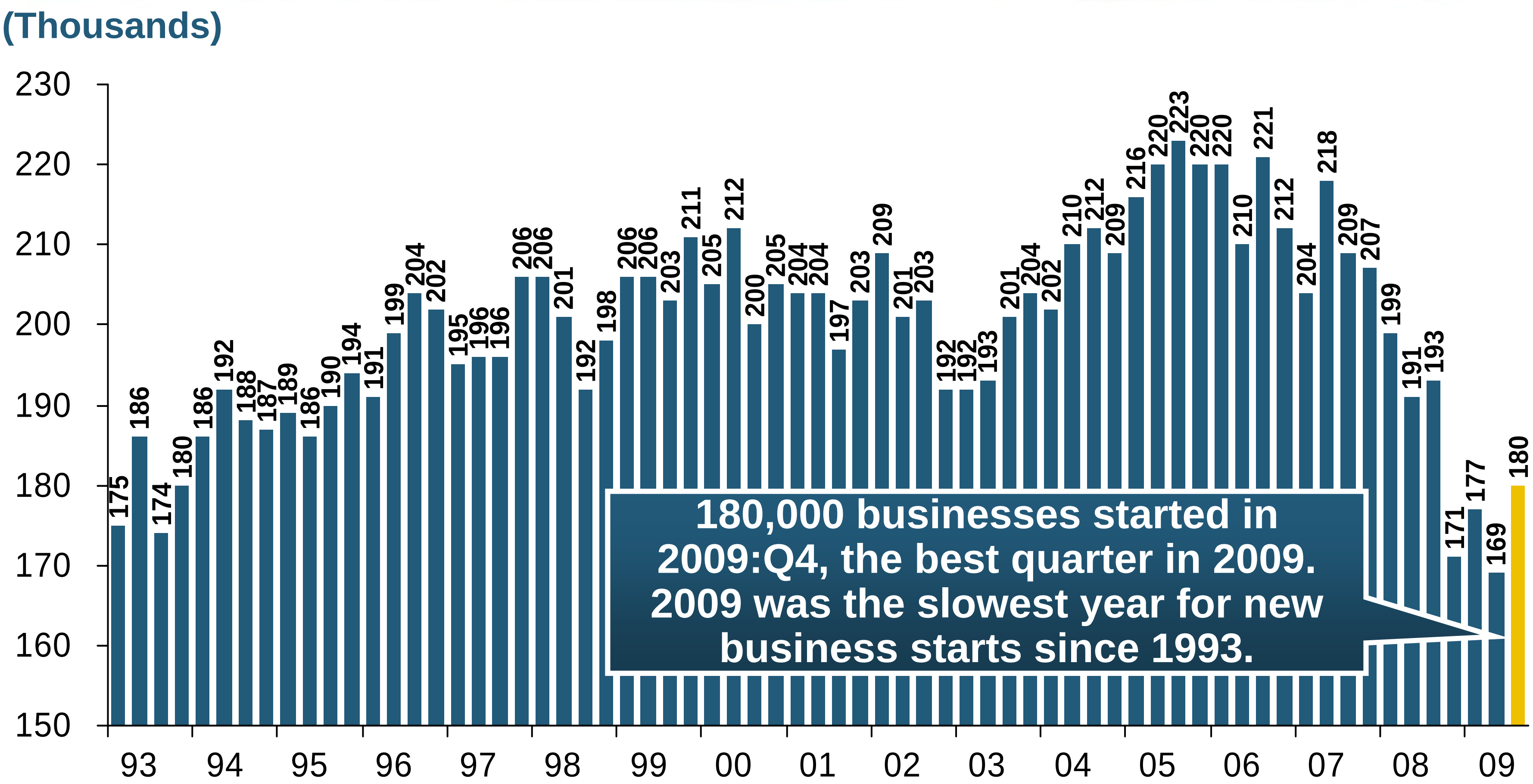
There were 60,837 business bankruptcies in 2009, up 40% from 2008 and the most since 1993. 2010:H1 bankruptcies totaled 29,059, down 4% from H1:2009, but still very high by historical standards.

Significant Exposure Implications for All Commercial Lines. There Are Some Preliminary Indications that Business Bankruptcies Are Beginning to Decline.

Source: American Bankruptcy Institute; Insurance Information Institute

Private Sector Business Starts, 1993:Q2 – 2009:Q4*

INSURANCE INFORMATION INSTITUTE

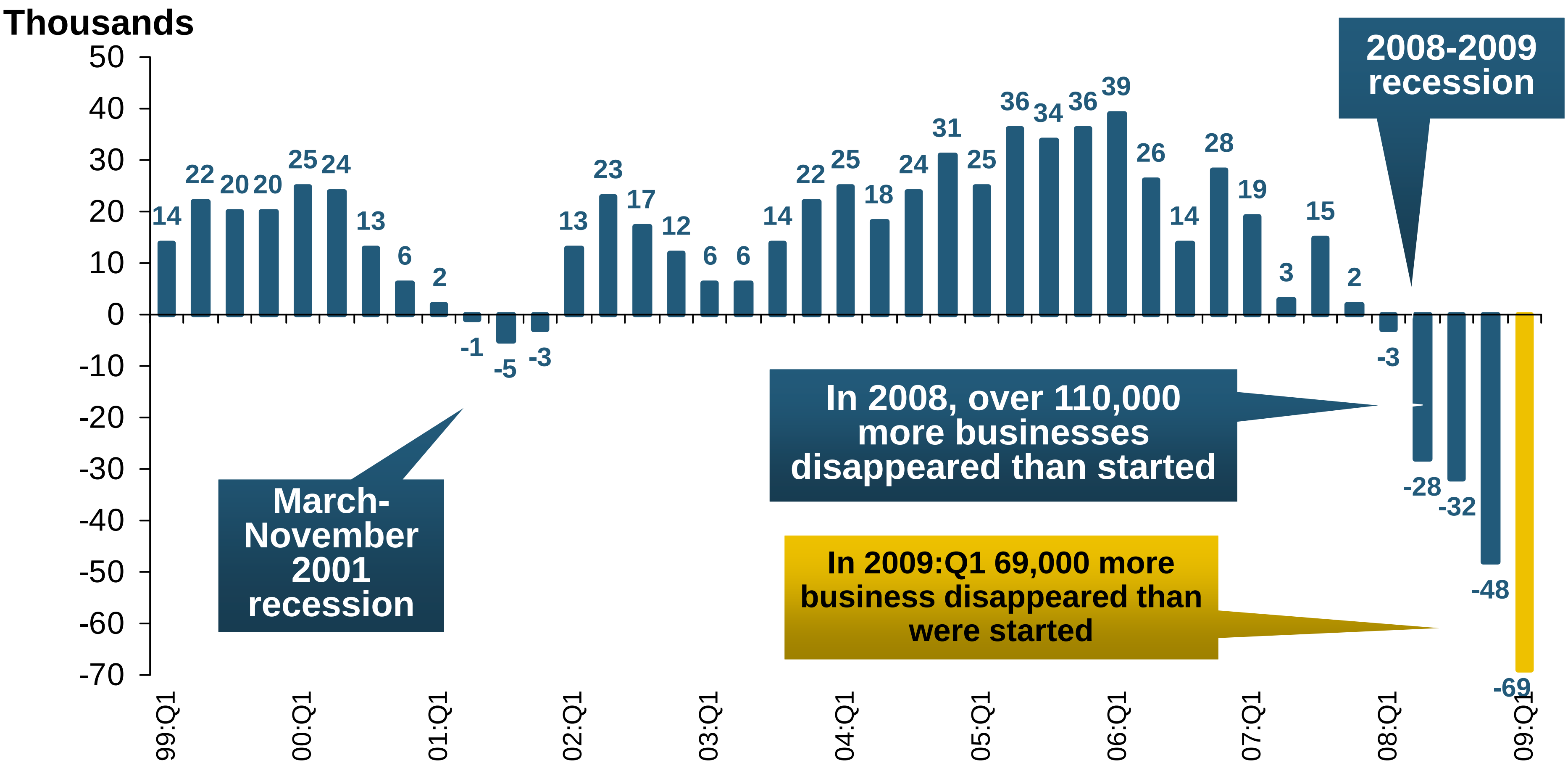


Business Starts Are Down Nearly 20% in the Current Downturn, Holding Back Most Types of Commercial Insurance Exposure

*Latest available as of September 12, 2010, seasonally adjusted

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

Net New Business Formations* 1999:Q1-2009:Q1*



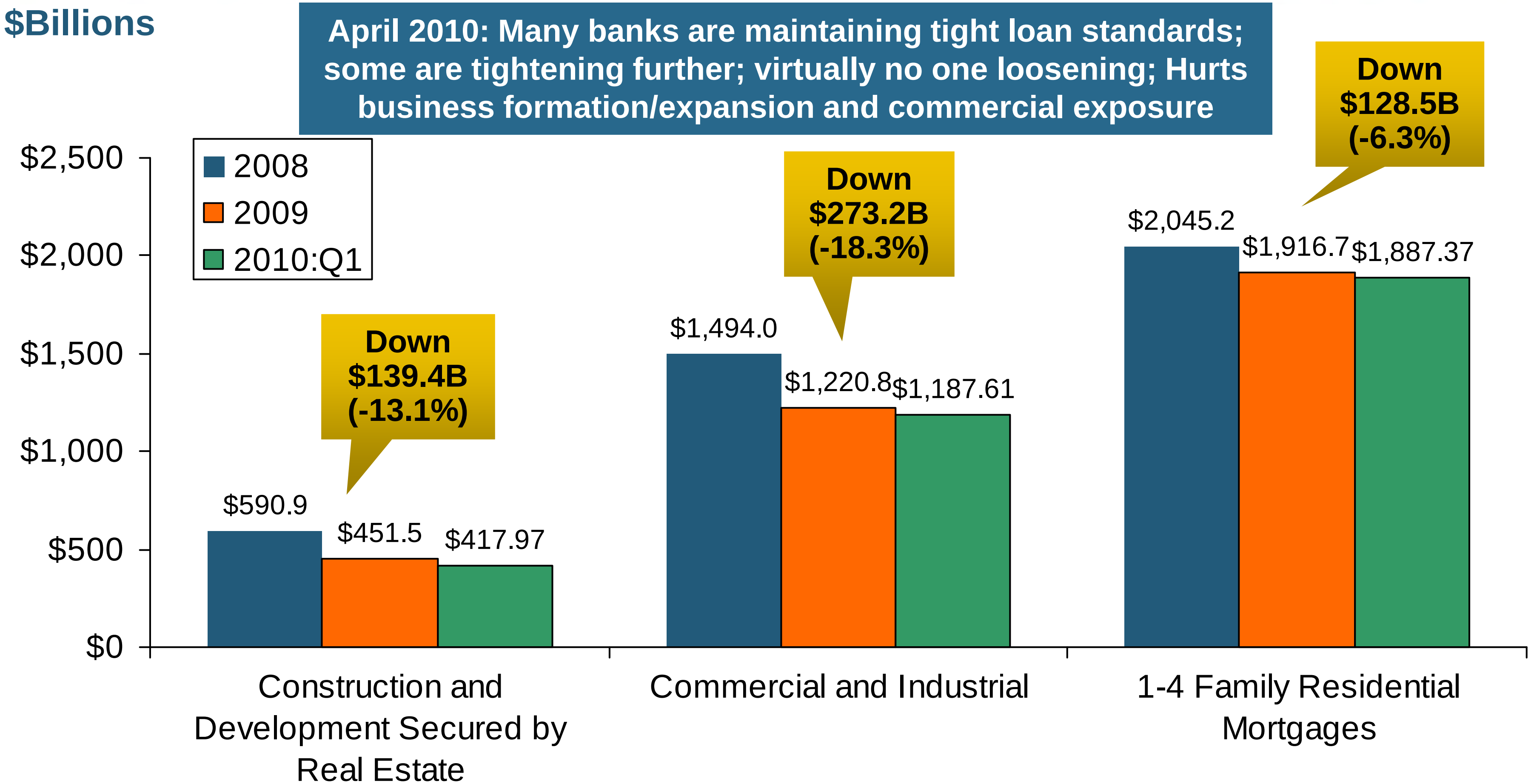
Net Business Formations Likely Were Positive Again, at Least in the Second Half of 2009 and into 2010.

*Business "births" minus business "deaths." Latest data on business "deaths" is for 2009:Q1 as of Sept. 12, 2010.
Sources: Bureau of Labor Statistics at http://www.bls.gov/news.release/cewbd.t07.htm ; Insurance Information Institute.

FDIC-Insured Banks Are Reducing Credit: 2008, 2009, 2010:Q1

INSURANCE INFORMATION INSTITUTE

April 2010: Many banks are maintaining tight loan standards; some are tightening further; virtually no one loosening; Hurts business formation/expansion and commercial exposure

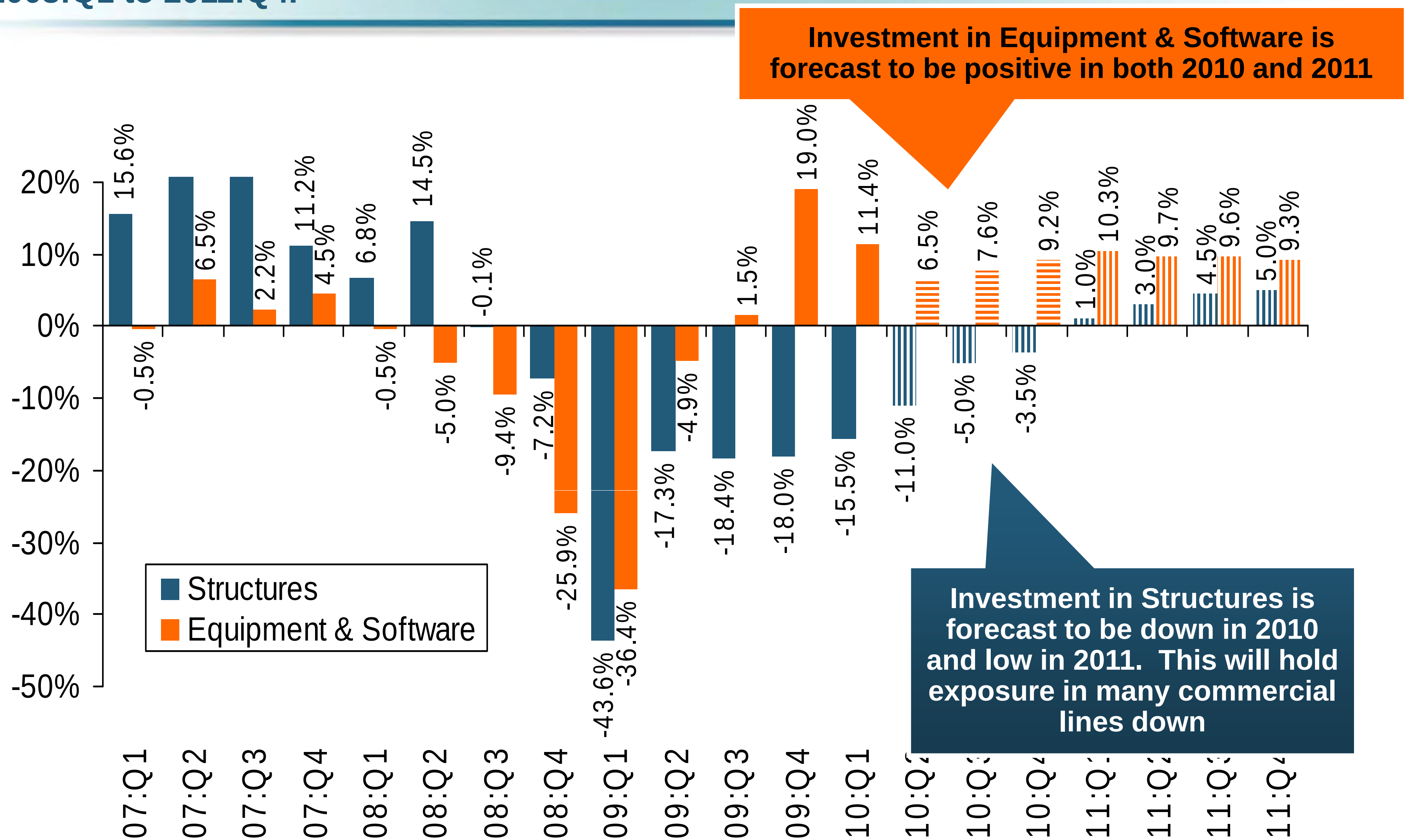


FDIC-Insured Institutions Had $541.1B (-13.1%) Less in Outstanding Loans in These Three Categories at Year-end 2009 vs. 2008, and Even Less at End of 2010:Q1

Source: FDIC Quarterly Banking Profile, First Quarter 2010, Table II-A

Business Fixed Investment

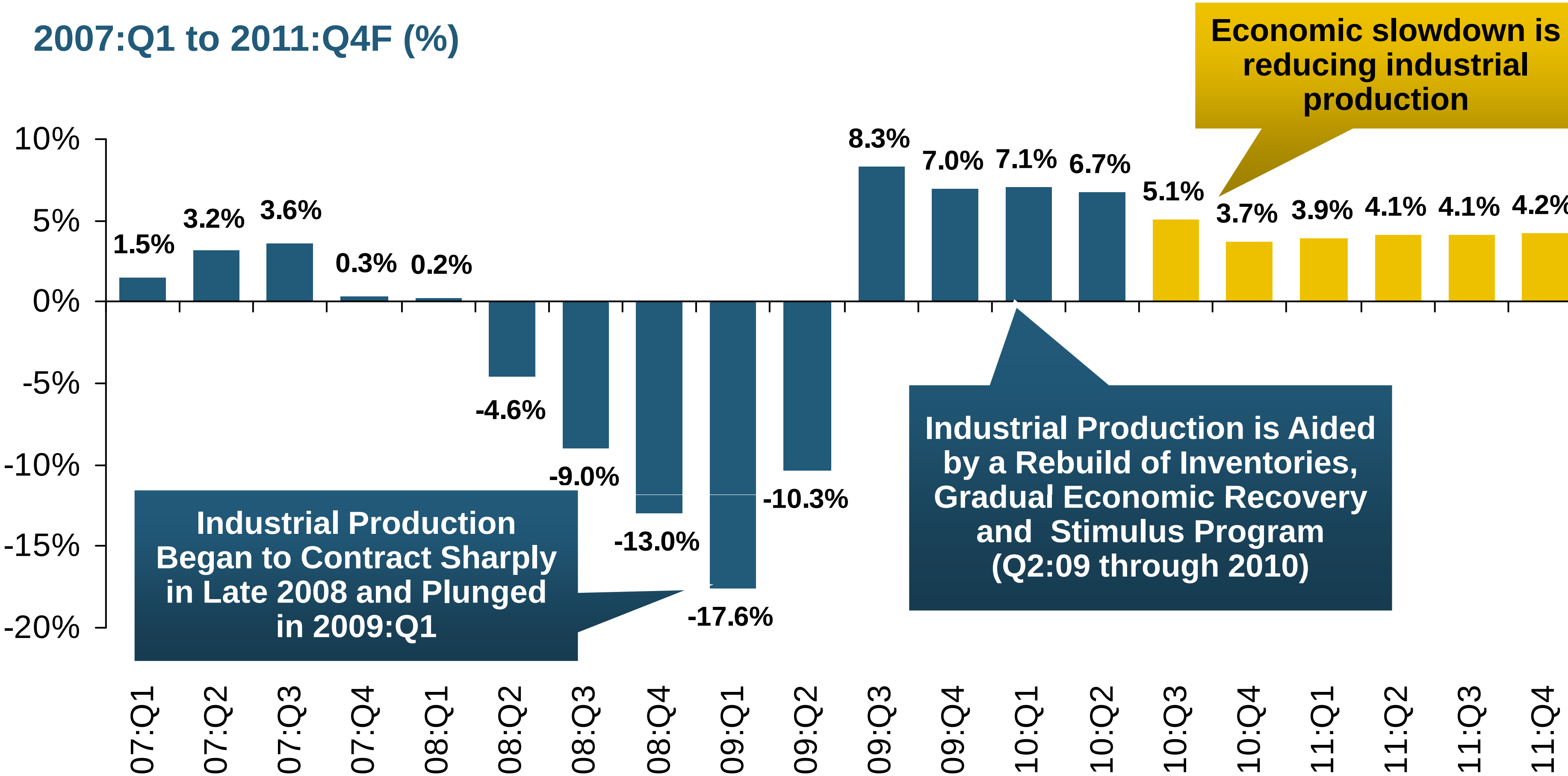
2008:Q1 to 2011:Q4F



Sources: Bureau of Economic Analysis, U.S. Department of Commerce (history); Wells Fargo Securities Economics Group, Monthly Outlook, April 7, 2010 (forecasts)

Total Industrial Production

INSURANCE INFORMATION INSTITUTE

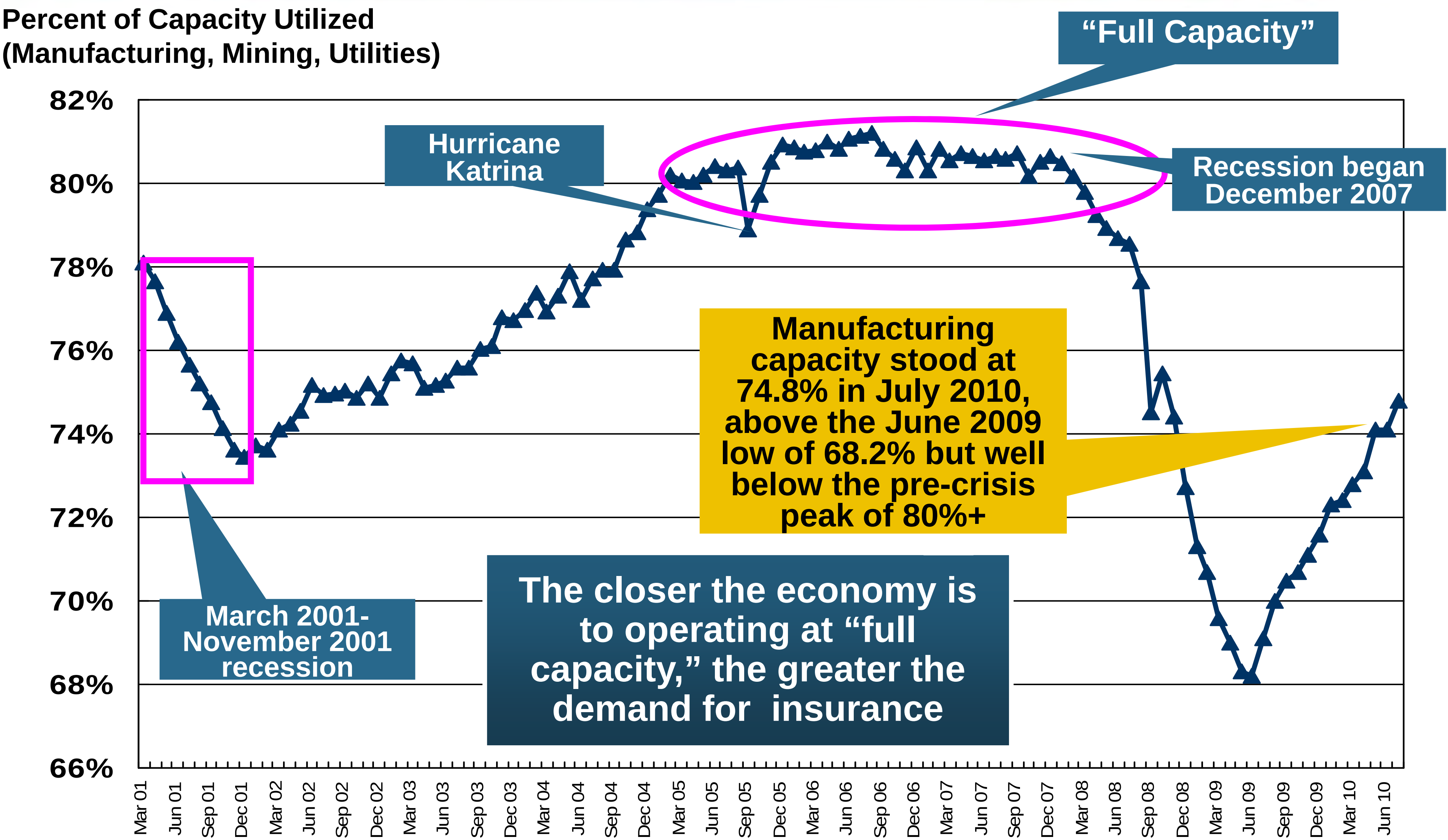


End of Recession in mid-2009, Stimulus Program Benefited Industrial Production and Insurance Exposure Both Directly and Indirectly, Albeit it Very Modestly; Stimulus Effect is Waning in 2010 and Will Be Gone in 2011.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (9/10); Insurance Information Institute

Recovery in Capacity Utilization is a Positive Sign for Insurance Exposure

INSURANCE INFORMATION INSTITUTE

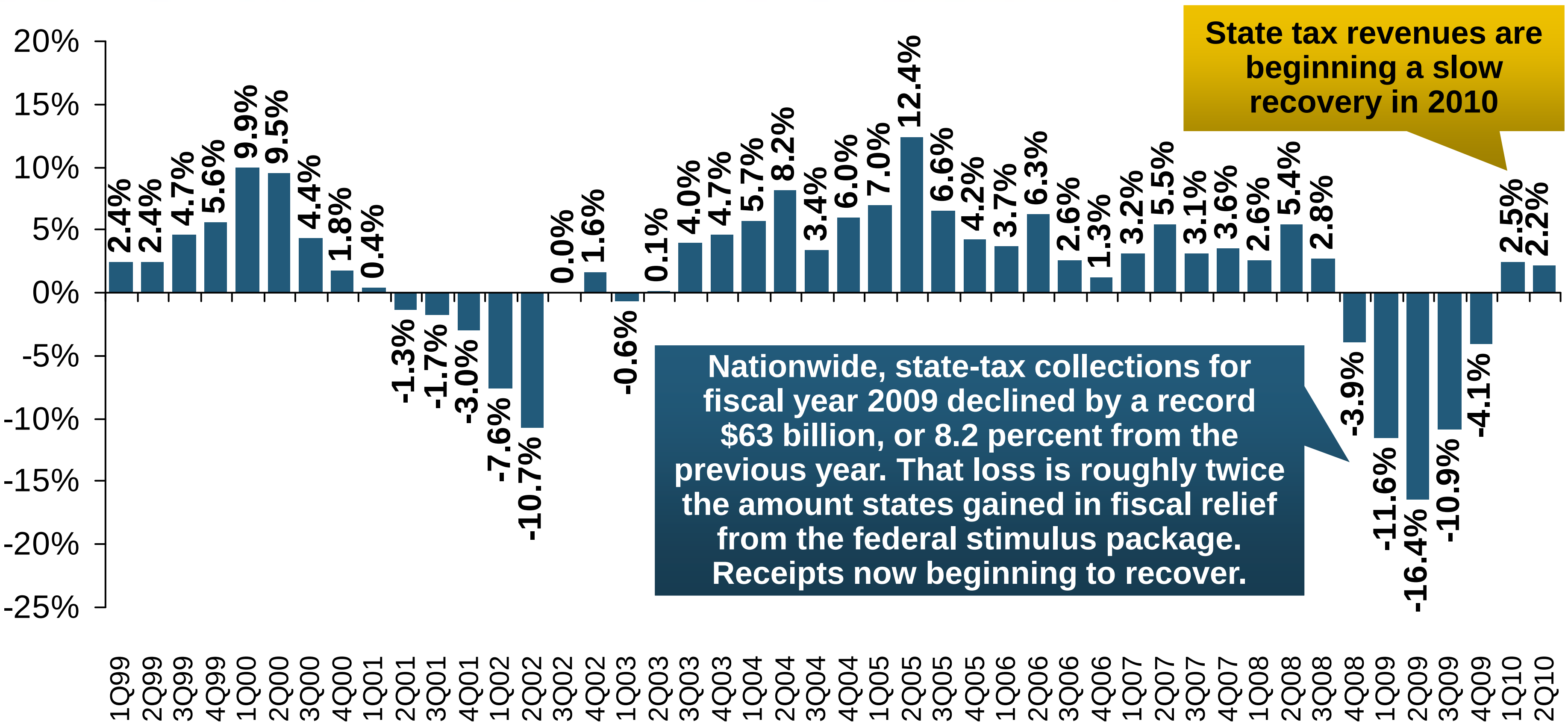


Source: Federal Reserve Board statistical releases at http://www.federalreserve.gov/releases/g17/Current/default.htm.

State & Local Government Finances in Dire Straits

Large, Long-Term Cuts Necessary to Align Spending with Shrinking Tax Revenues

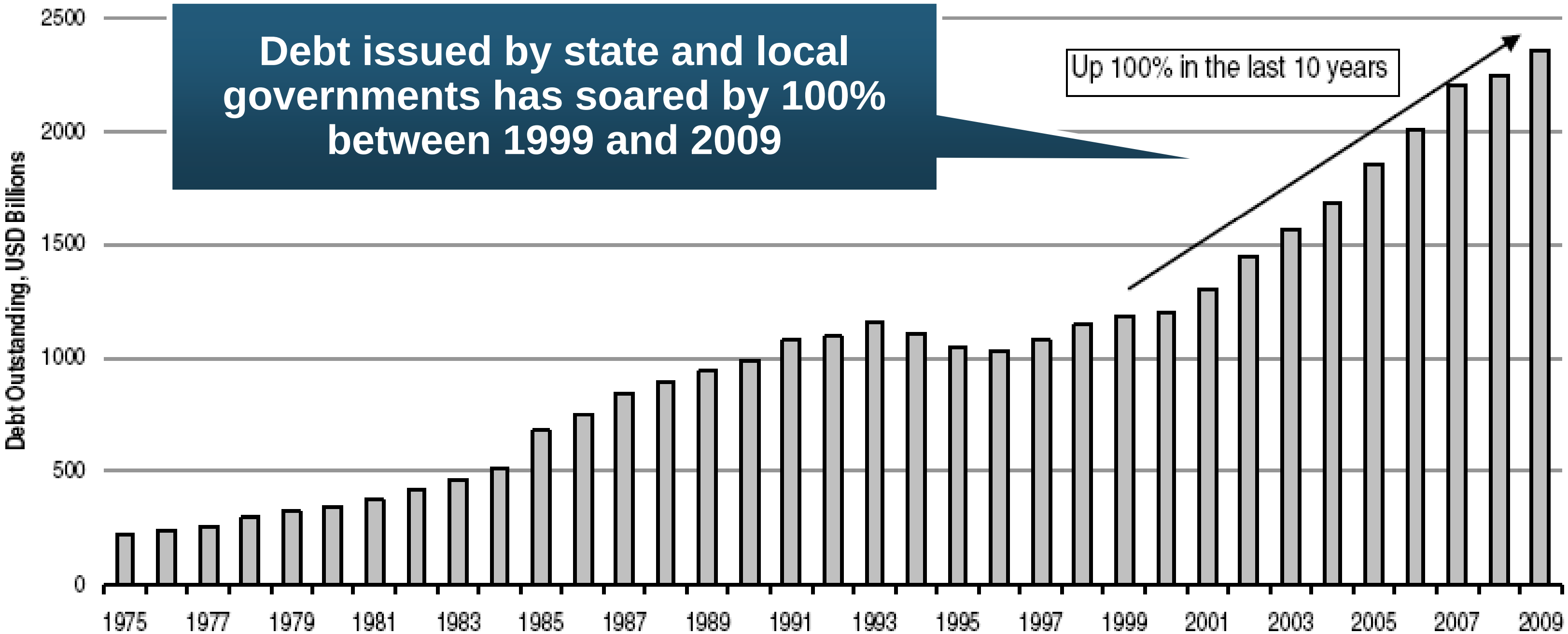
Year-Over-Year Change in Quarterly US State Tax Revenues, Inflation Adjusted



States Revenues Were Up 2.2% in Q2 2010, the 2nd Consecutive Quarter of Revenue Increase. Public Infrastructure Spending is Still Likely to Remain Depressed, Dampening Related Insurance Exposures and Demand.

Source: US Census Bureau; Nelson A. Rockefeller Institute of Government: http://www.rockinst.org/.

State and Local Debt Outstanding, 1975-2009

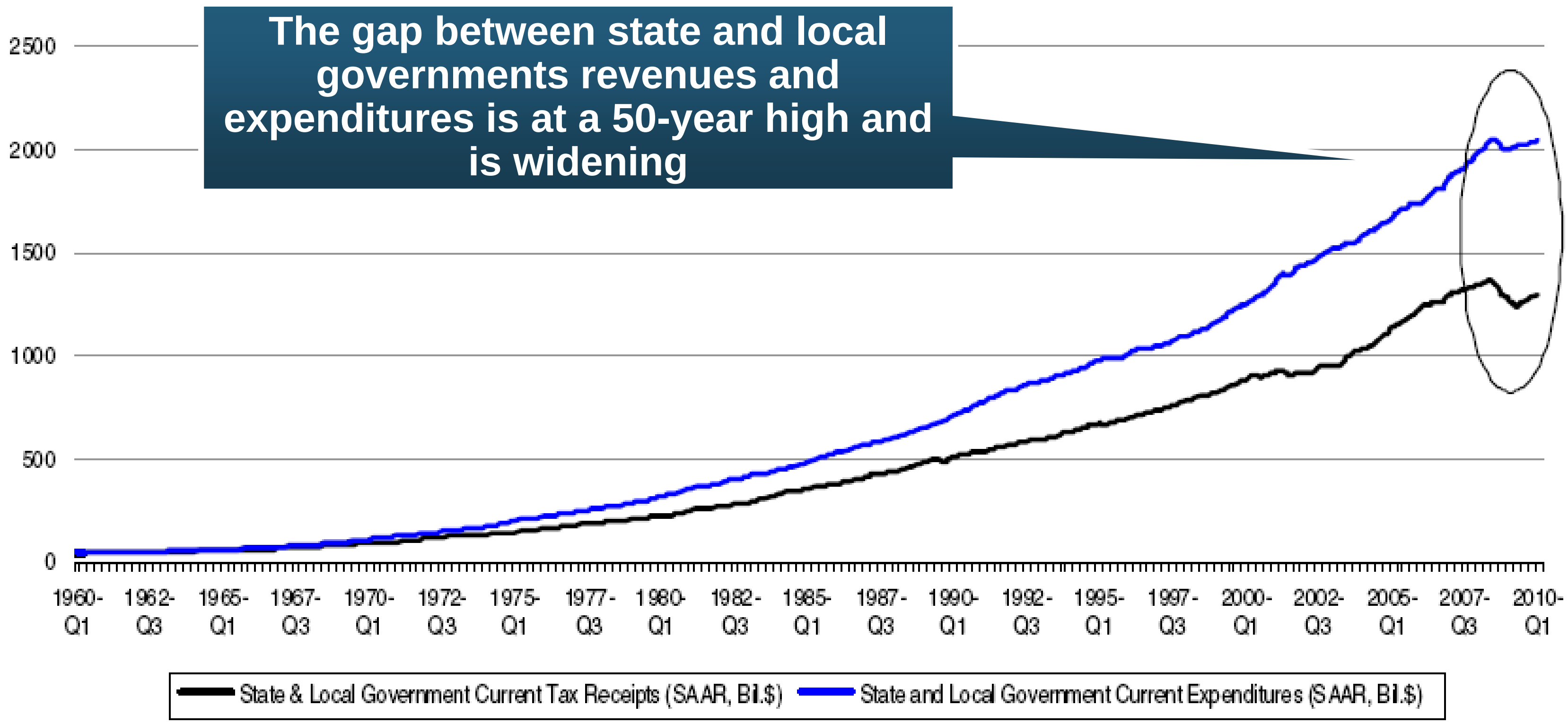


Many States/Localities Are in Dire Fiscal Straights, but the Default Rate on Moody's-Rated Muni Debt is Just 0.09% over the Past 10 Years. Just 1 State Has Defaulted in the Past 100 Years (AR). Default Rate on Munis During the Great Depression was 1.8%, 97% of Which Was Ultimately Recovered

Source: Federal Reserve Board of Governors, Flow of Funds Accounts from Credit Suisse.

State and Local Expenditures vs. Tax Receipts, 1960-2010:Q1

INSURANCE INFORMATION INSTITUTE



Many States/Localities Are in Dire Fiscal Straights, but the Default Rate on Moody's-Rated Muni Debt is Just 0.09% over the Past 10 Years. Just 1 State Has Defaulted in the Past 100 Years (AR). Default Rate on Munis During the Great Depression was 1.8%, 97% of Which Was Ultimately Recovered

Source: Bureau of Economic Analysis and Credit Suisse estimates.

INSURANCE INFORMATION INSTITUTE

Inflation Trends: *Concerns Over Stimulus Spending and Monetary Policy*

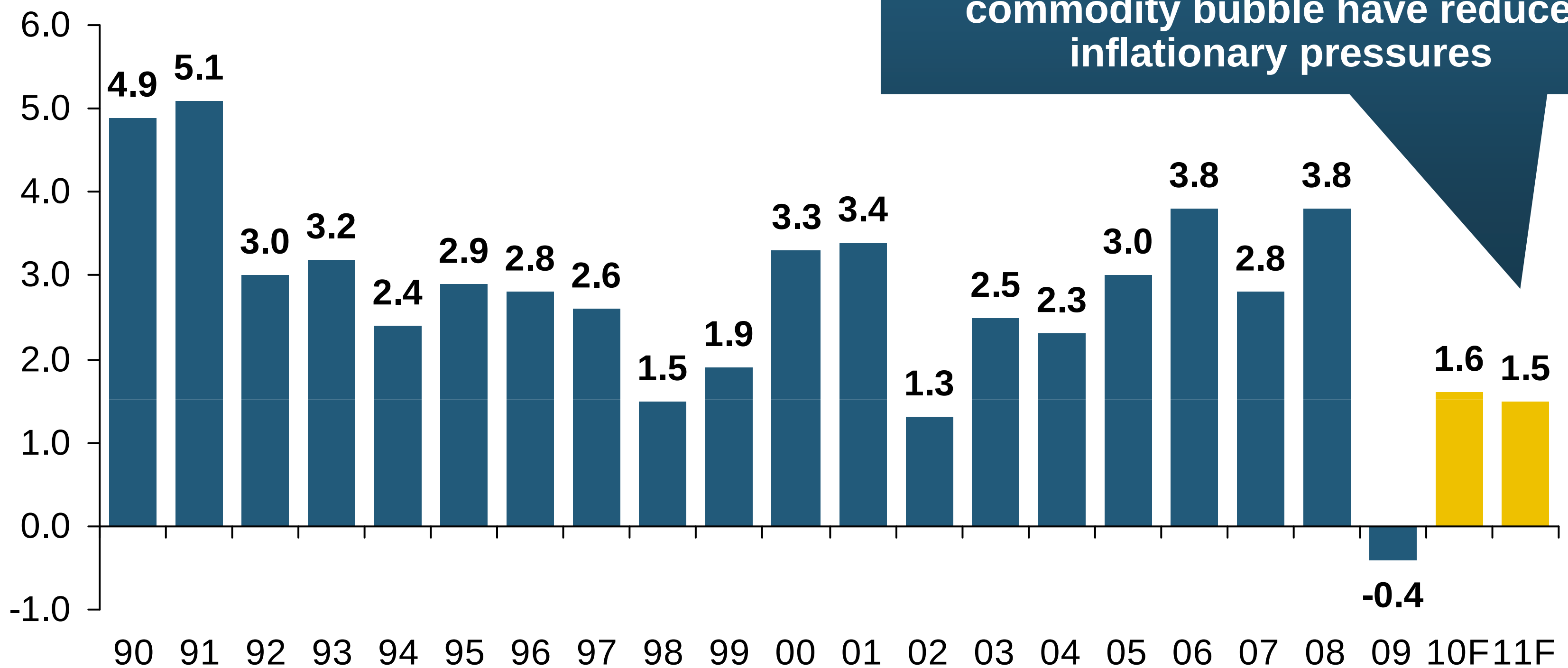
Mounting Pressure on Claim Cost Severities?

Annual Inflation Rates (CPI-U, %), 1990–2011F

INSURANCE INFORMATION INSTITUTE

Annual Inflation Rates (%)

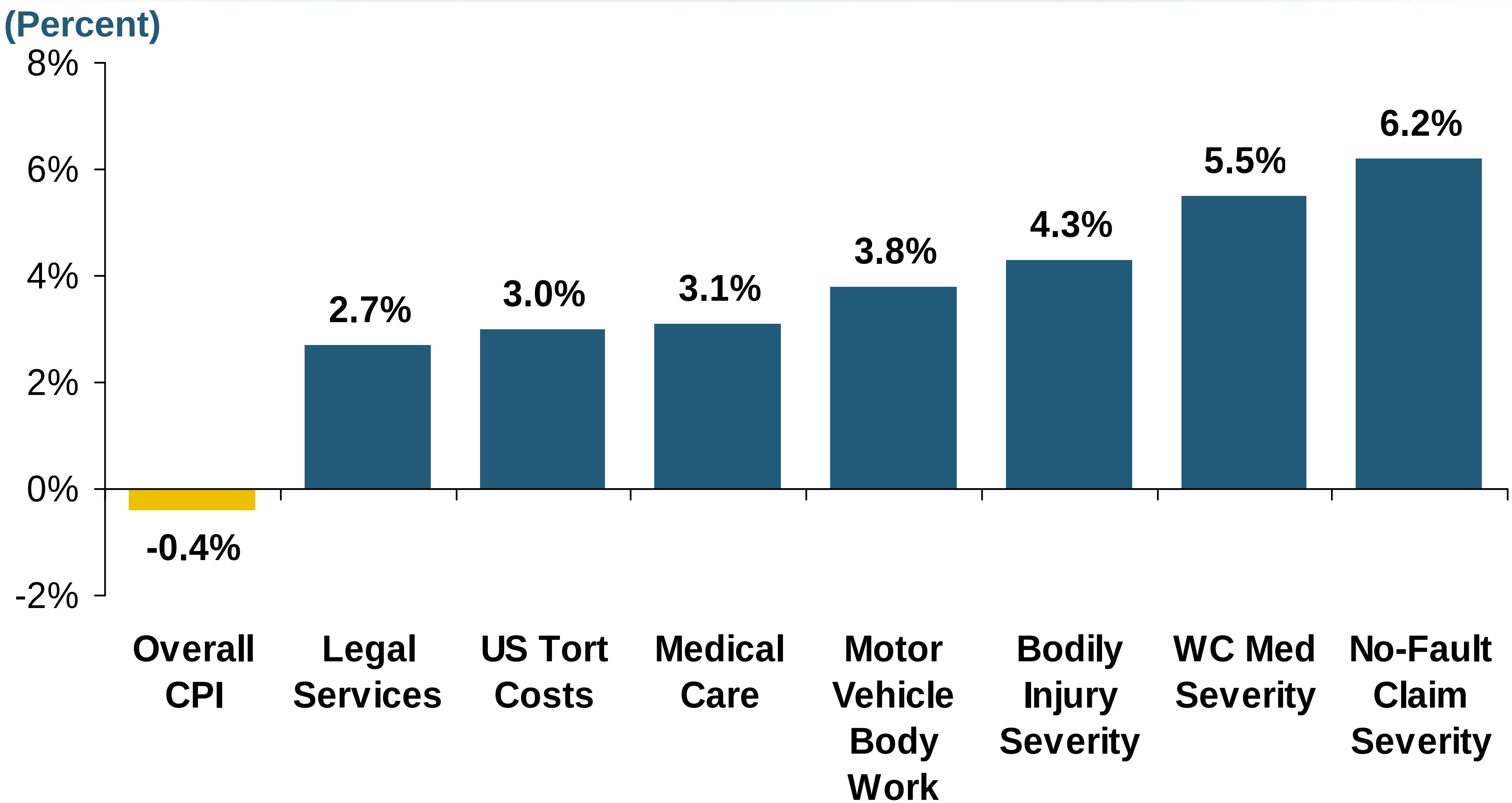
Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble have reduced inflationary pressures



There is So Much Slack in the US Economy Inflation Should Not Be a Concern Through 2010/11, but Deficits and Monetary Policy Remain Longer Run Concerns

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 9/10 (forecasts).

P/C Insurers Experience Inflation More Intensely than 2009 CPI Suggests

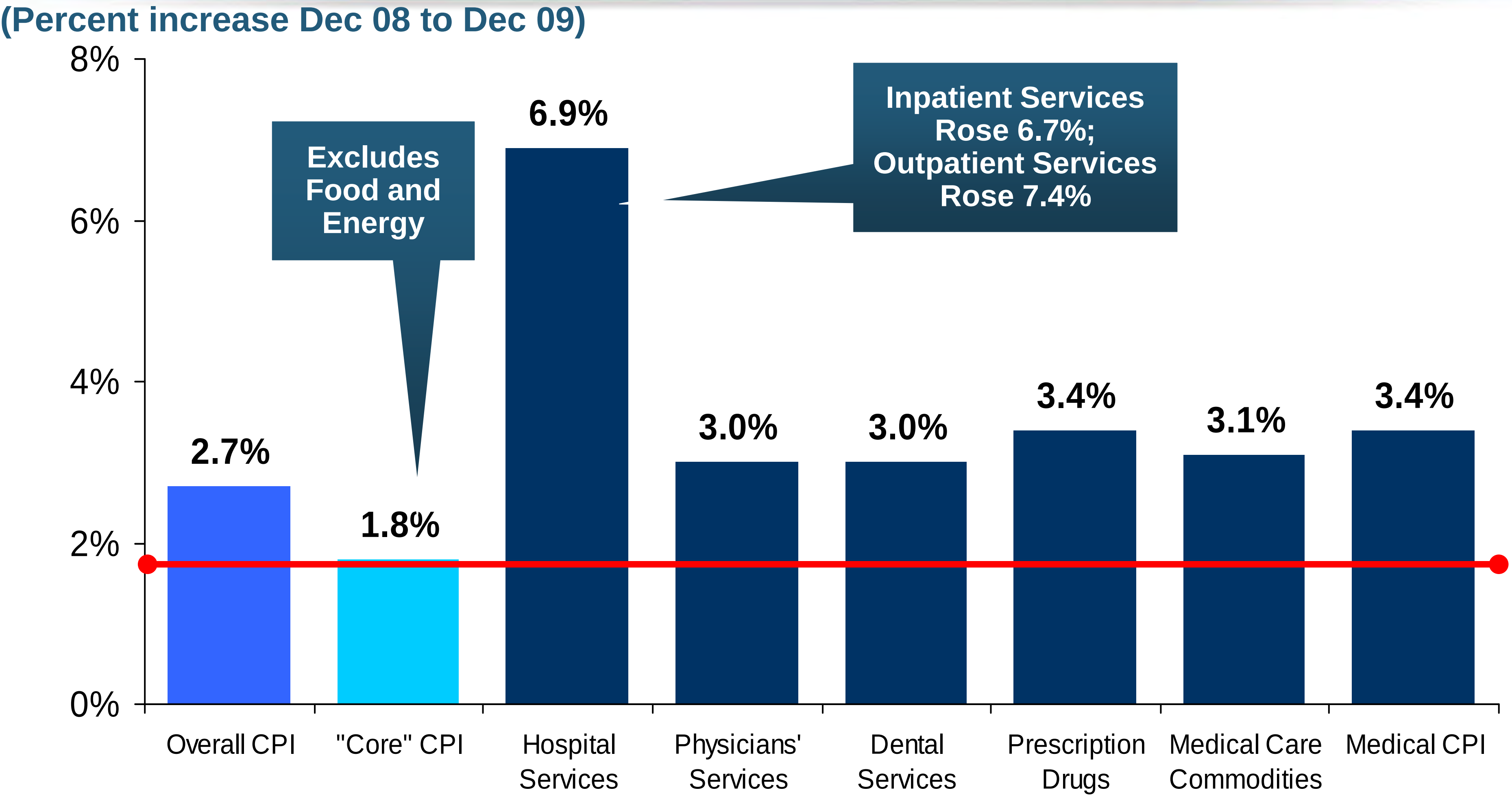


Healthcare and Legal/Tort Costs Are a Major P/C Insurance Cost Driver. These Are Expected to Increase Above the Overall Inflation Rate (CPI) Indefinitely

Source: CPI is Blue Chip Economic Indicator 2009 estimate, 12/09; Legal services, medical care and motor vehicle body work are avg. monthly year-over-year change from BLS; BI and no-fault figures from ISO Fast Track data for 4 quarters ending 09:Q3. Tort costs is 2009 Towers-Perrin estimate. WC figure is I.I.I. estimate based on historical NCCI data.

WC Insurers Experience Inflation More Intensely than 2009 CPI Suggests

INSURANCE INFORMATION INSTITUTE

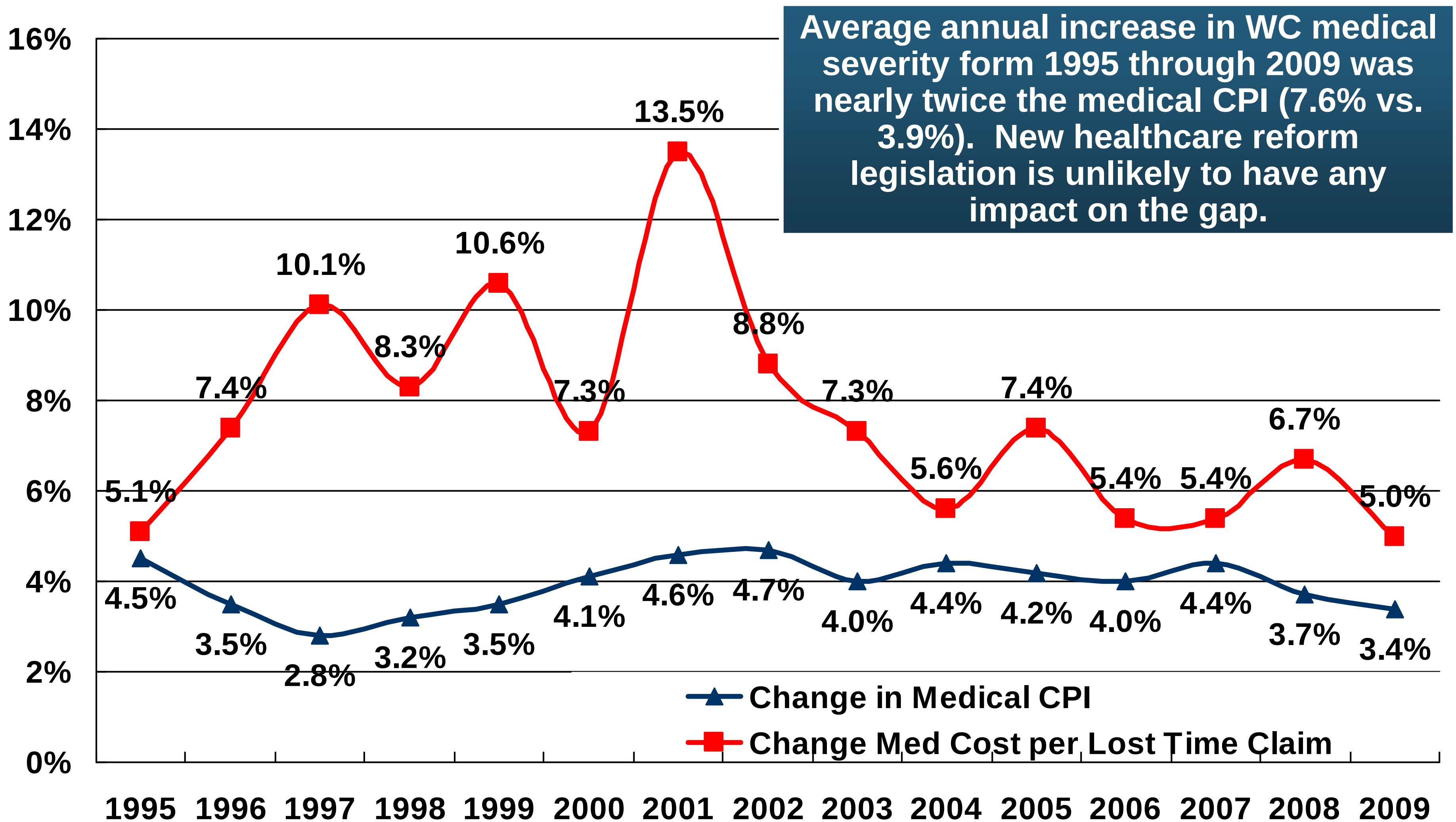


Healthcare Costs Are a Major WC Insurance Cost Driver. They Are Likely to Increase Faster than the CPI for the Next Few Years, at Least

Source: Bureau of Labor Statistics; Insurance Information Institute.

WC Medical Severity Rising at Twice the Medical CPI Rate

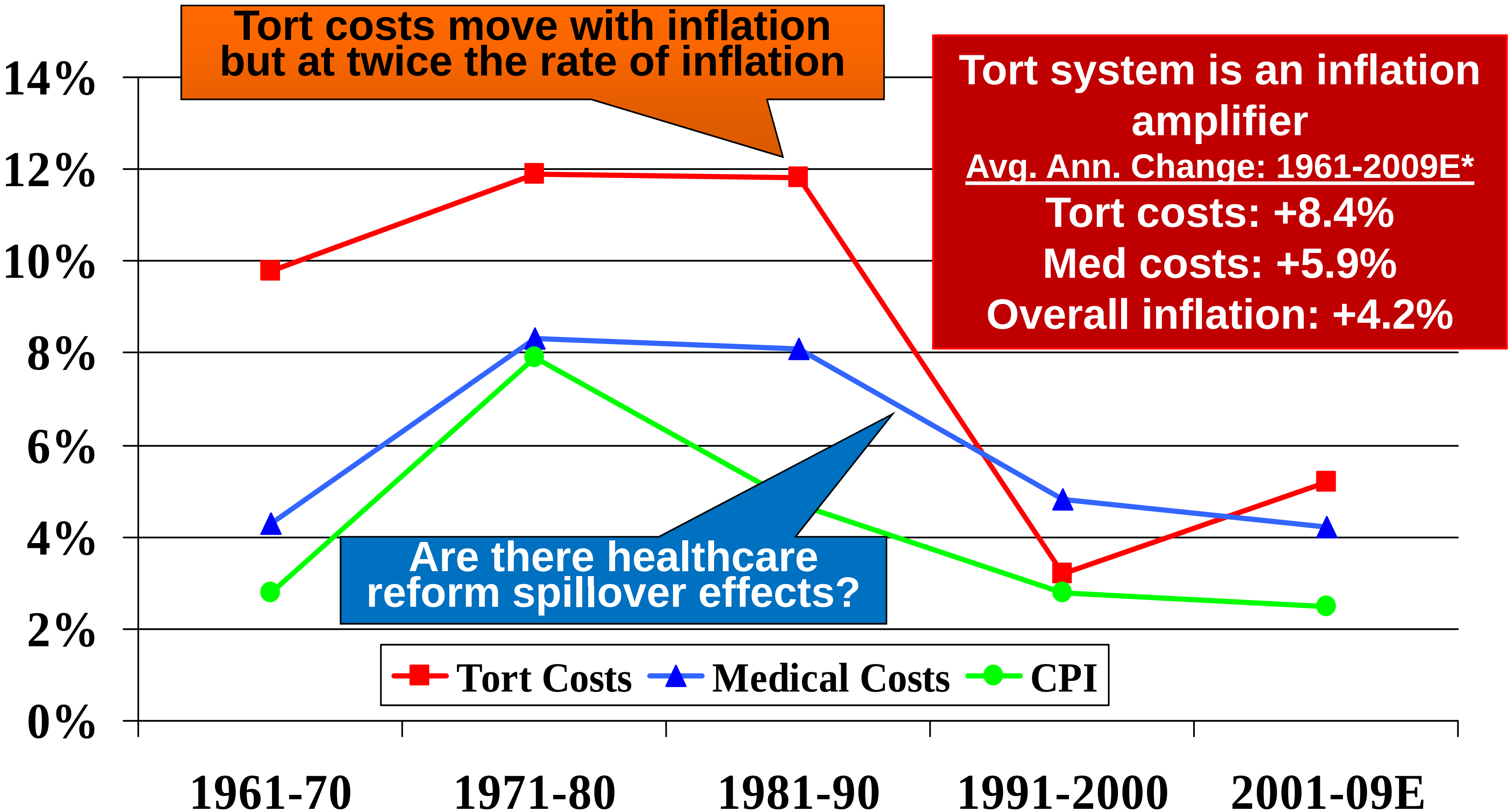
INSURANCE INFORMATION INSTITUTE



Sources: Med CPI from US Bureau of Labor Statistics, WC med severity from NCCI based on NCCI states.

Tort Cost Growth & Medical Cost Inflation vs. Overall Inflation (CPI-U), 1961-2009E*

INSURANCE INFORMATION INSTITUTE



* CPI-U and medical costs as of Sept 2009; Tort figure is for full-year 2009 from Tillinghast.

Source: U.S. Bureau of Labor Statistics; Tillinghast-Towers Perrin, *2008 Update on U.S. Tort Costs;* I.I.I.

Top Concerns/Risks for Insurers if Inflation Is Reignited

INSURANCE INFORMATION INSTITUTE

Concerns	The Federal Reserve Has Flooded Financial System with Cash (Turned on the Printing Presses), the Federal Gov't Has Approved a $787B Stimulus and the Deficit is Expected to Mushroom to $1.8 Trillion. All Are Potentially Inflationary.

- What are the potential impacts for insurers?
- What can/should insurers do to protect themselves from the risks of inflation?

Key Risks	From Sustained/Accelerating Inflation

- **Rising Claim Severities**
  - Cost of claims settlement rises across the board (property and liability)
- **Rate Inadequacy**
  - Rates inadequate due to low trend assumptions arising from use of historical data
- **Reserve Inadequacy**
  - Reserves may develop adversely and become inadequate (deficient)
- **Burn Through on Retentions**
  - Retentions, deductibles burned through more quickly
- **Reinsurance Penetration/Exhaustion**
  - Higher costs ➔ risks burn through their retentions more quickly, tapping into reinsurance more quickly and potentially exhausting their reinsurance more quickly

Source: Insurance Information Institute.

Top Concerns/Risks for Insurers if Deflation Becomes a Reality

INSURANCE INFORMATION INSTITUTE

Concerns	Deflation is defined as a sustained decline in the general price level. It can result from the reduction in the supply of money or credit or reductions in government, personal or investment spending. When deflation takes hold, the incentive is to defer purchases until prices decline further. This depresses aggregate demand, increases unemployment and triggers recessions.

- What are the potential impacts for insurers?
- What can/should insurers do to protect themselves from the risks of deflation?

Key Risks	From Sustained Deflation Inflation

- **Reduced Exposures**
  - Deflation is likely accompanied (potentially severe) recession, depressing insurance demand
- **Reduced Investment Earnings**
  - Deflationary periods that interest rates drop to very low levels. Stock markets may fall as the economy struggles with recessions and reduced corporate earnings.
- **Underwriting Profitability**
  - Lack of investment earnings makes sustained underwriting profitability a necessity
- **Rates**
  - Regulatory, buyer and market pressure will be biased strongly toward rate reduction
- **Lost Costs**
  - Even with a general decline in price levels insurers may experience rising costs in coverages vulnerable to medical claim costs, tort inflation and demand surge

Source: Insurance Information Institute.

INSURANCE INFORMATION INSTITUTE

Deflation Basics

Primary Causes and Major Bouts of Deflation

INSURANCE INFORMATION INSTITUTE

Deflation is:

- A falling general price level
  - Note: this is different from
    - A fall in *the rate of increase* of the general price level;
      - This is called **disinflation**
    - A fall in the prices of some items or category of items
- For a prolonged period
- That is expected to continue indefinitely

Deflation results from some or all of:

- A surge in productivity, generally from technological innovation
- A steep and prolonged drop in the money supply
- A steep and prolonged recession
  - Note: this is different from a fall in *the rate of increase* of the price level

Major US Bouts of Deflation

- 1920-22
- 1930-33

Sources: http://www-personal.umich.edu/~alandear/glossary/d.html; http://en.wikipedia.org/wiki/Deflation; I.I.I.

Broad Impact of Deflation

Deflation causes…

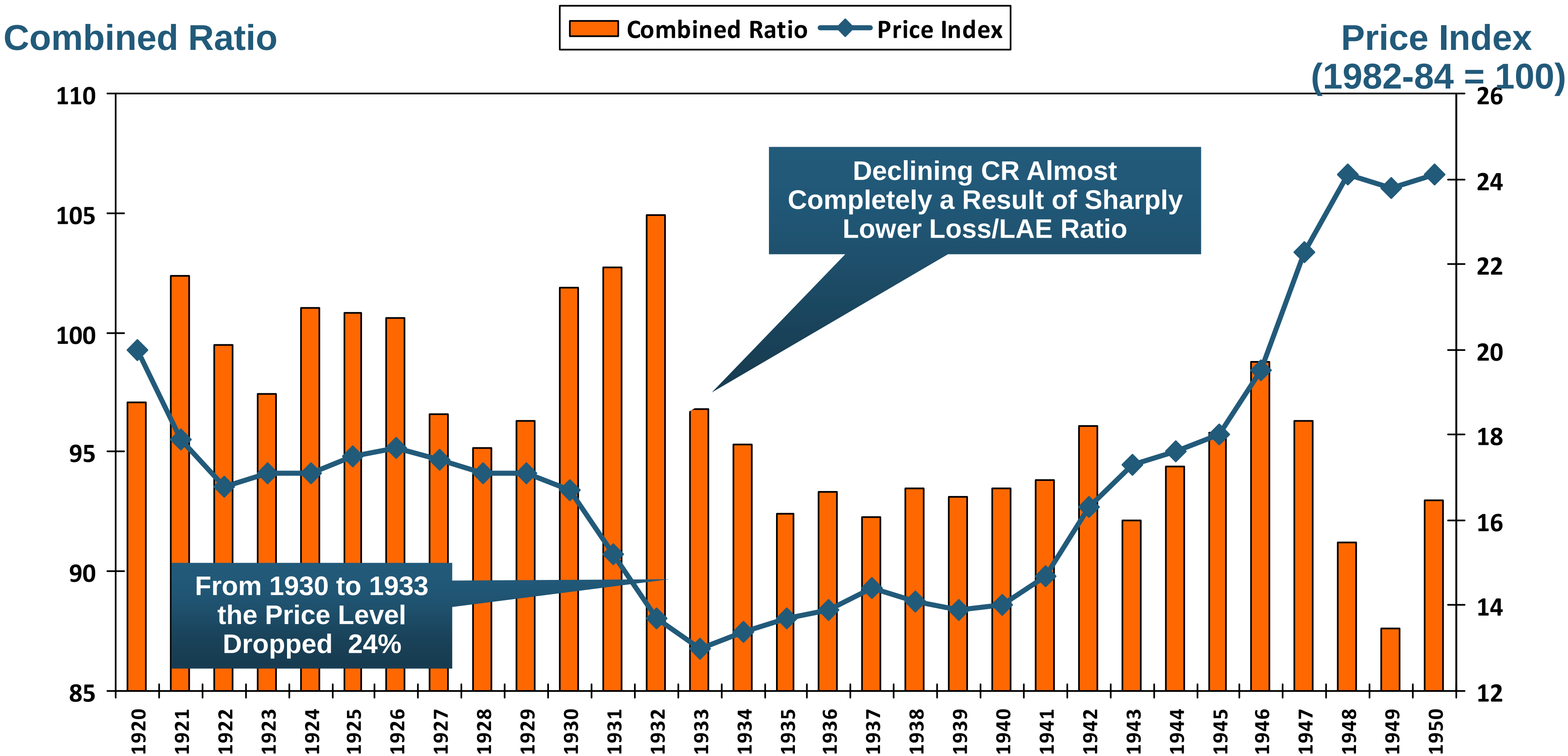
- Consumers to delay buying things
  - They expect to buy those things later at lower prices
- A drop in the level of aggregate demand, from the delay in consumption
- A transfer of wealth
  - From borrowers and holders of illiquid assets
  - To savers/lenders and holders of liquid assets and currency
- A drop in the level of business investment
  - Following the drop in aggregate demand
  - Slack in capacity if the economy is in recession
  - Increased likelihood of lower profits or losses as selling prices drop below costs

Sources: http://en.wikipedia.org/wiki/Deflation; I.I.I.

INSURANCE INFORMATION INSTITUTE

What History Teaches Us About Deflation and the P-C Industry

1920-1950: Inflation, Deflation and the P-C Industry's Combined Ratio*



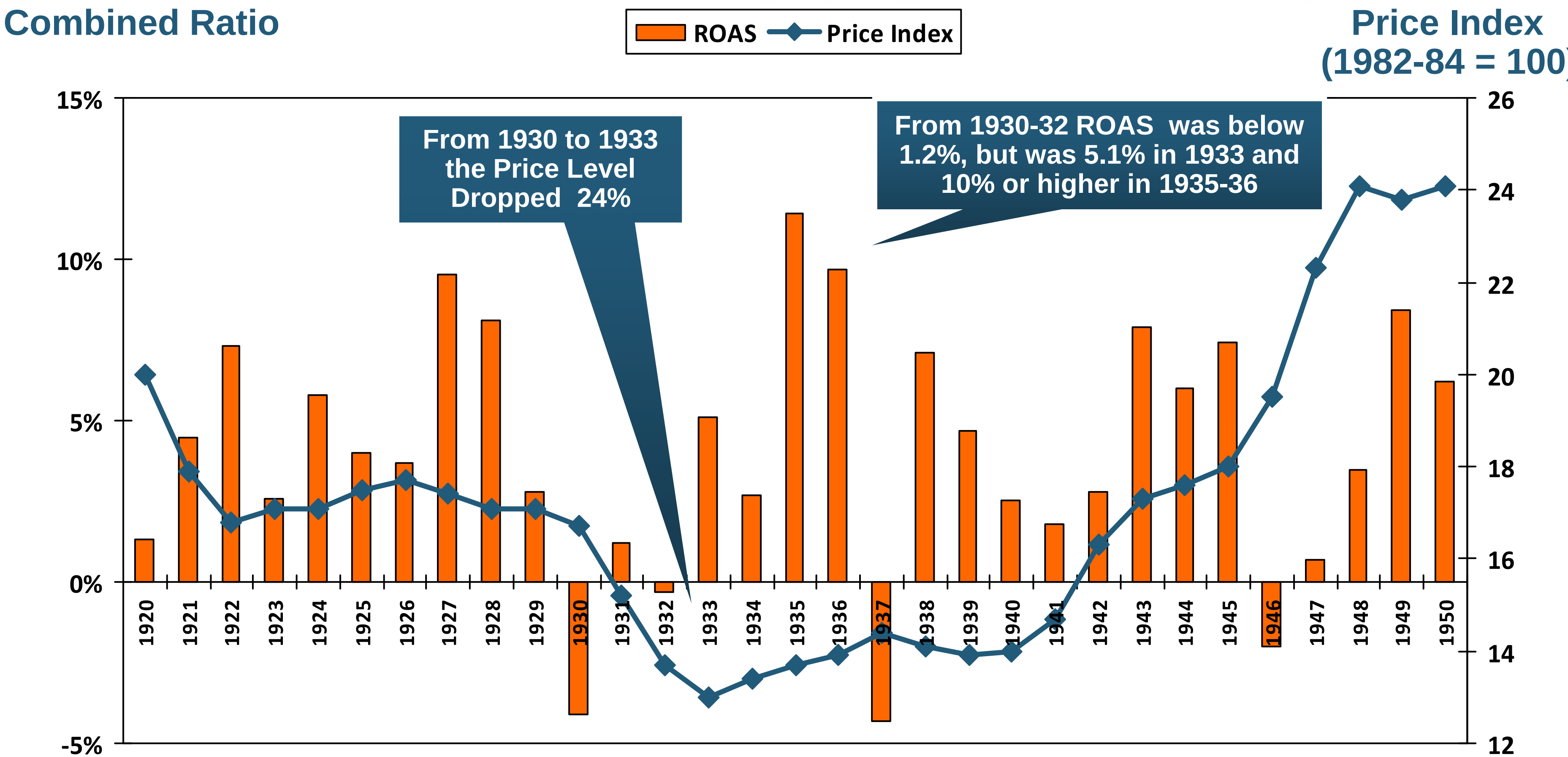
From Year-end 1929 Through 1932, the Industry's Combined Ratio Rose from 96.3 to 104.9 as the CPI Dropped. But from 1933 into the 1950s, the Combined Ratio Remained Below 100 Even as Prices Slowly Rose, Then Shot Up after WWII.

*From 1920-1934, stock companies only

Sources: Best's Aggregates & Averages; http://www.rateinflation.com/consumer-price-index/usa-historical-cpi.php?form=usacpi

1920-1950: Inflation, Deflation and P-C Industry Profitability*

INSURANCE INFORMATION INSTITUTE



The Significant Deflation from 1930-32 Punished the Industry's ROAS, But an Improving Economy (and Slight Inflation) Helped Achieve ROAS in Double Digits in 1935-36.

*stock companies only
Sources: Best's Aggregates & Averages; I.I.I.; ; http://www.rateinflation.com/consumer-price-index/usa-historical-cpi.php?form=usacpi

Deflation's Effects on the P-C Insurance Industry

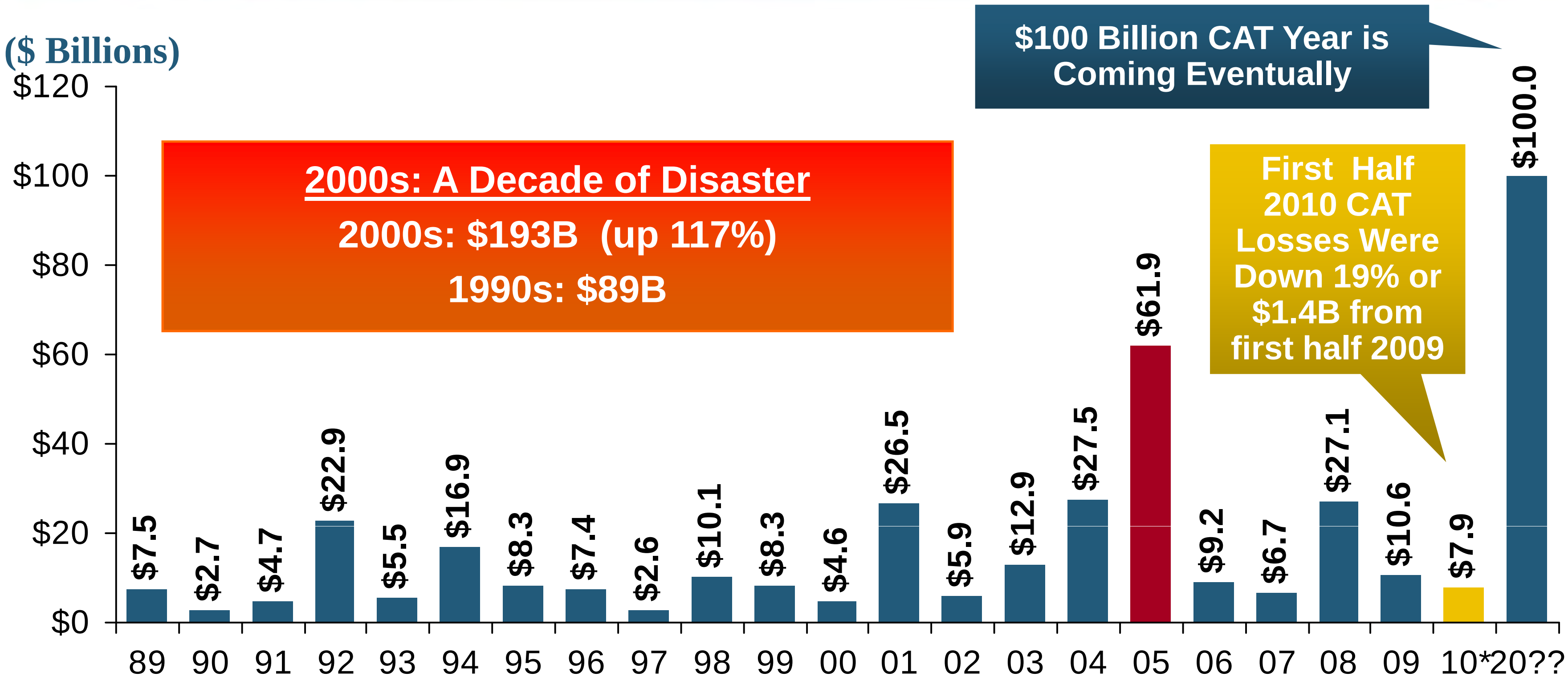
INSURANCE INFORMATION INSTITUTE

- **Lower Claim Severities**
  - Particularly for property claims, severity drops for many items that insurers pay for
- **Rate contingency margins increase**
  - At least until rate construction reflects persistently declining claims severity, margins will be higher than otherwise due to high trend assumptions arising from use of historical data
- **Reserve Releases?**
  - Reserves may develop beneficially to become "redundant"
- **Lower Claim Frequency as Fewer Claims Reach Deductible, Retention Levels**
- **Less Use of Reinsurance**
  - Lower costs ➔ risks burn through their retentions less quickly, reaching policy limits less quickly

INSURANCE INFORMATION INSTITUTE

Catastrophic Loss – Catastrophe Losses Trends Are Trending Adversely

US Insured Catastrophe Losses



2010 CAT Losses Are Running Below 2009, *So Far*
Figures Do Not Include an Estimate of Deepwater Horizon Loss

*Through June 30, 2010.

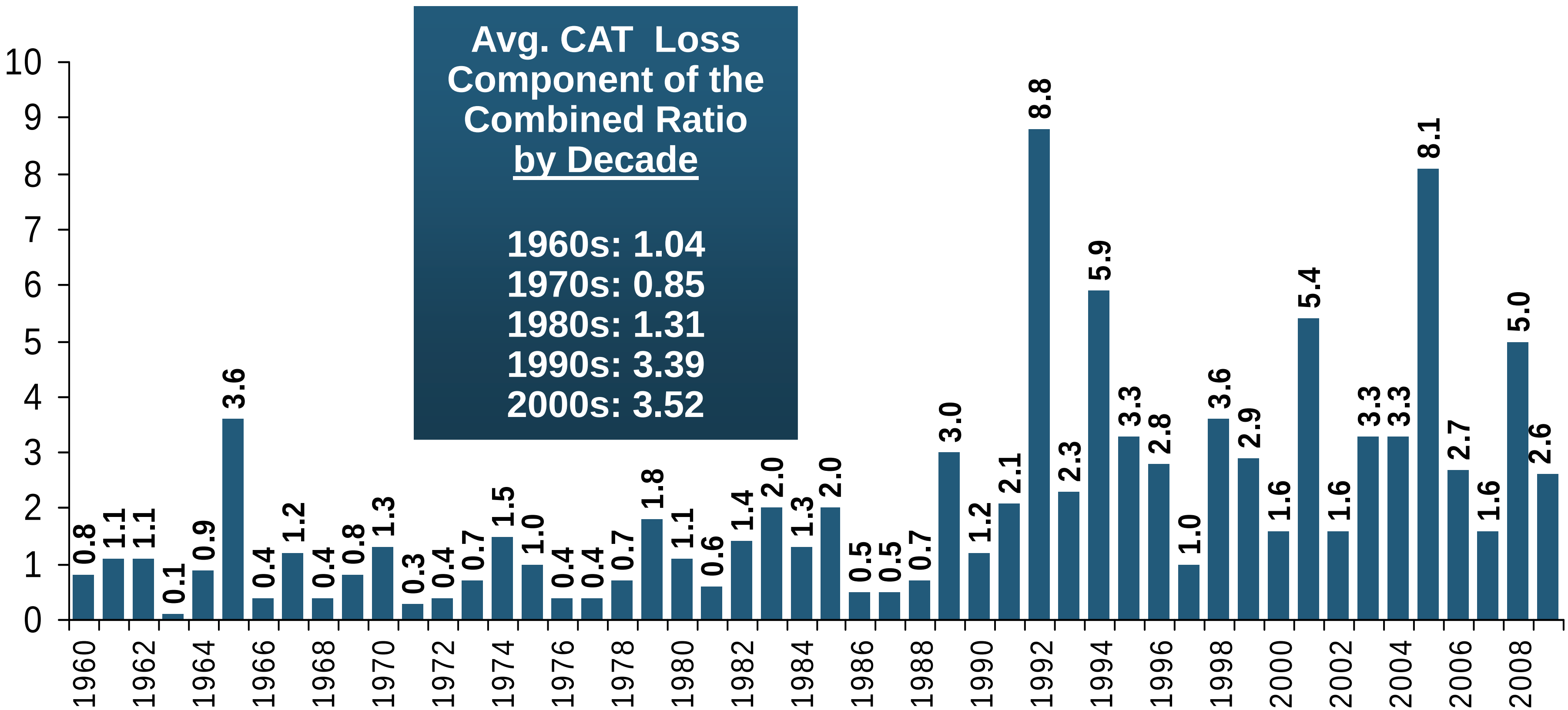
Note: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = $12.2B.

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

Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2009

INSURANCE INFORMATION INSTITUTE

Combined Ratio Points



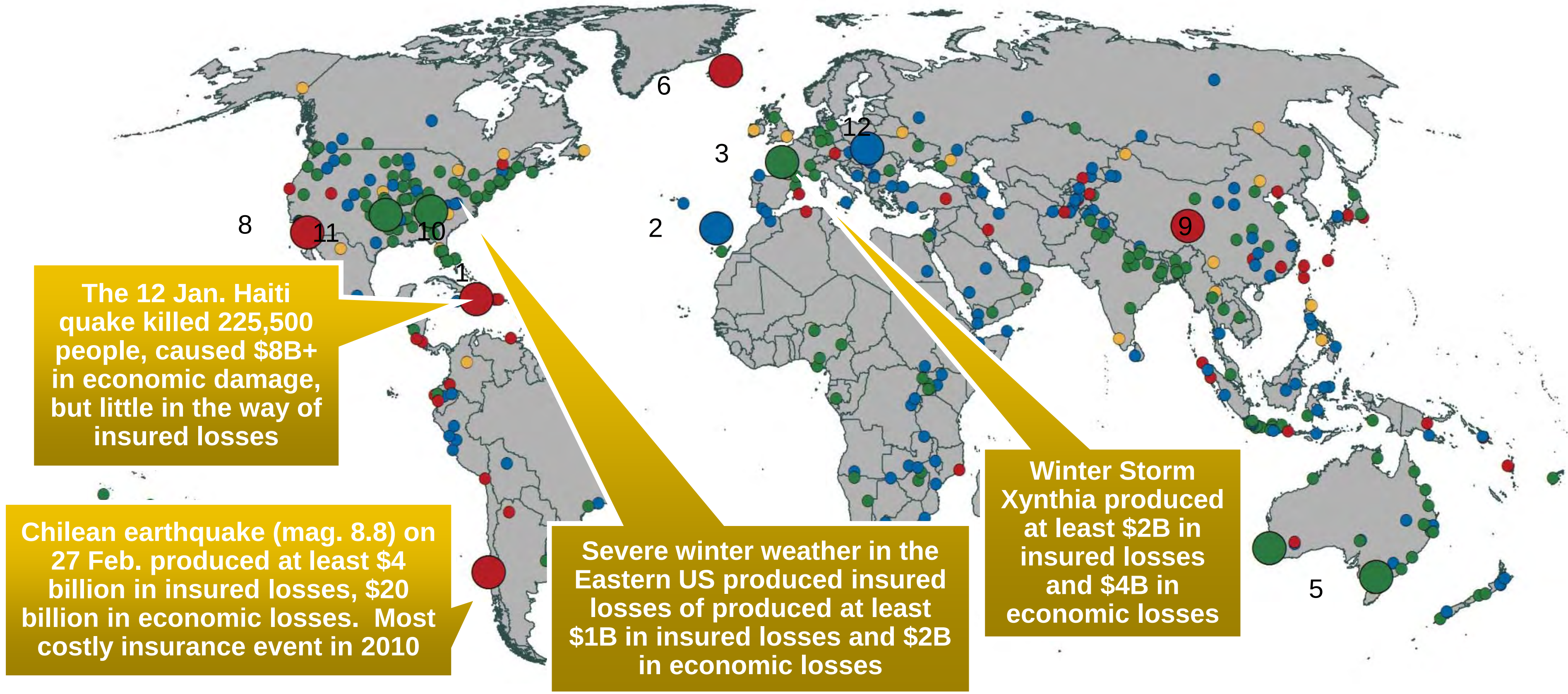
The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

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.

Global Natural Catastrophes: January – June 2010

INSURANCE INFORMATION INSTITUTE



- Global natural catastrophes
- Selection of significant natural catastrophes (see table)
- **Geophysical events** (earthquake, tsunami, volcanic activity)
- **Meteorological events** (storm)
- **Hydrological events** (flood, mass movement)
- **Climatological events** (extreme temperature, drought, wildfire)

Largest International Oil Well Blowouts by Volume, as of July 12, 2010*

INSURANCE INFORMATION INSTITUTE

Date	Well	Location	Bbl Spilled
April 20 2010-July 12, 2010	**Deepwater Horizon**	**Gulf of Mexico, USA**	**est. 4,900,000**
June 1979-April 1980	Ixtoc I	Bahia del Campeche, Mexico	3,300,000
October 1986	Abkatun 91	Bahia del Campeche, Mexico	247,000
April 1977	Ekofisk Bravo	North Sea, Norway	202,381
January 1980	Funiwa 5	Forcados, Nigeria	200,000
October 1980	Hasbah 6	Gulf, Saudi Arabia	105,000
December 1971	Iran Marine International	Gulf, Iran	100,000
January 1969	Alpha Well 21 Platform A	Pacific, CA, USA	100,000
March 1970	Main Pass Block 41 Platform C	Gulf of Mexico	65,000
October 1987	Yum II/Zapoteca	Bahia del Campeche, Mexico	58,643
December 1970	South Timbalier B-26	Gulf of Mexico, USA	53,095

*Date well was capped. Federal government estimate as of August 2, 2010. Does not include offset for any amounts recovered.

Source: American Petroleum Institute (API), 09/18/2009; http://www.api.org/ehs/water/spills/upload/356-Final.pdf and updates from the Insurance Information Institute.

Probabilty of Landfall of at Least One Major Hurricane (CAT 3-4-5) in 2010*

INSURANCE INFORMATION INSTITUTE

Region	Average Over Last Century	2010 Forecast*
Entire U.S. Coastline	52%	76%
U.S. East Coast Incl. FL Peninsula	**31%**	**51%**
Gulf Coast from FL Panhandle to Brownsville, TX	30%	50%
Caribbean	42%	65%

The Probability of a Major Hurricane Making Landfall Somewhere Along the US Coast is Greatly Elevated in 2010, Including a 50% Chance Along the Oil Spill-Impacted Gulf Coast

*Forecast as of June 2, 2010.

Source: Colorado State University, Department of Atmospheric Sciences; Insurance Information Institute.

Outlook for 2010 North Atlantic Hurricane Season*

Forecast Parameter	Average (1950-2000)	2010 Forecast*
Named Storms	9.6	18
Named Storm Days	49.1	90
Hurricanes	5.9	10
Hurricane Days	24.5	40
Major Hurricanes	2.3	5
Major Hurricane Days	5.0	13
Accumulated Cyclone Energy	96.1	185
Net Tropical Cyclone Activity	**100%**	**195%**

The 2010 Hurricane Season is Expected to Be Nearly Twice as Active as the Long-Run Average (195% of Normal)

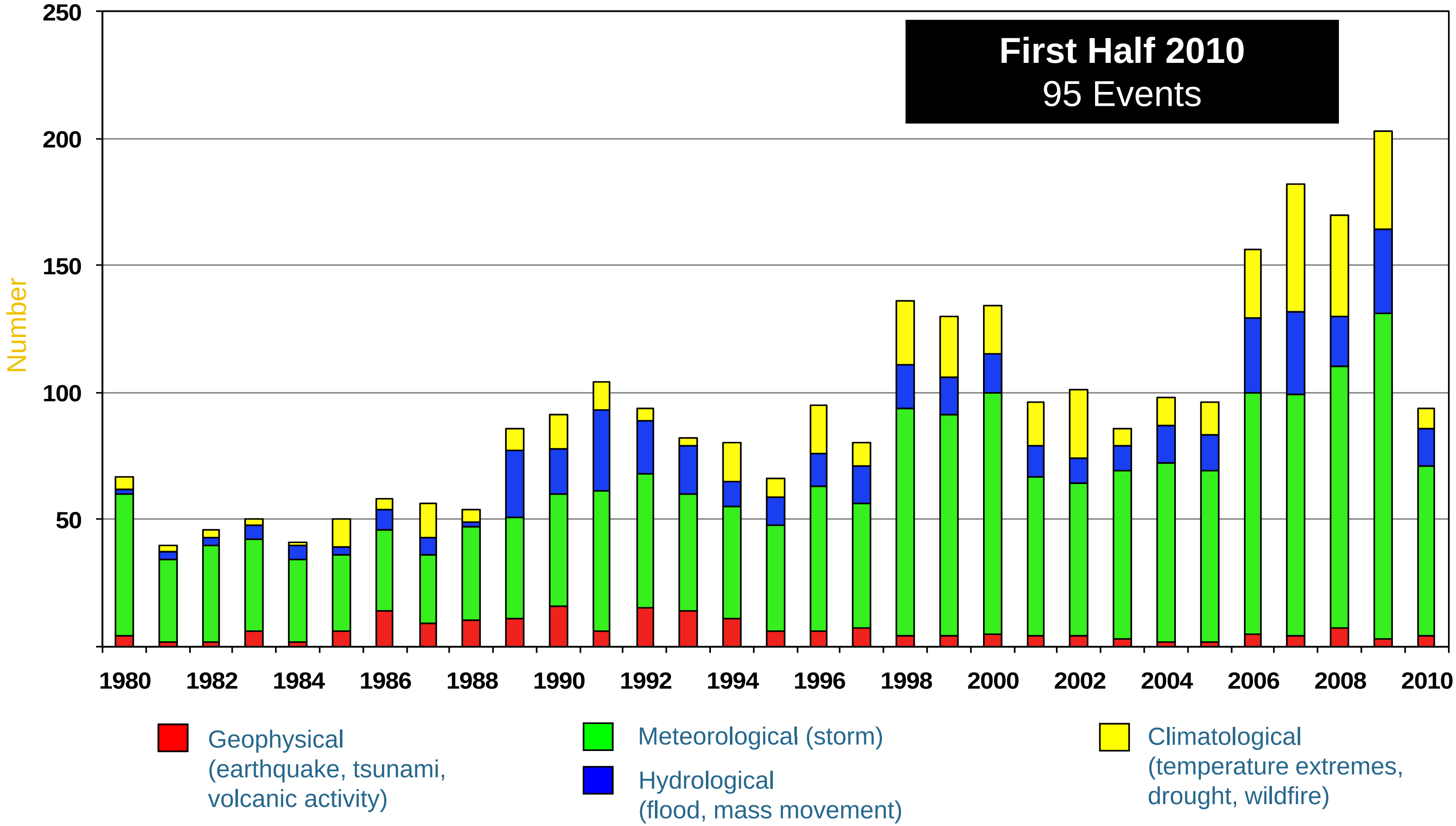
*Forecast as of June 2, 2010.

Source: Colorado State University, Department of Atmospheric Sciences; Insurance Information Institute.

Natural Disasters in the United States, 1980 – 2010

Number of Events (Annual Totals 1980 – 2009 vs. First Half 2010)

Number of events in first half of 2010 is close to the annual totals from five of past ten years.

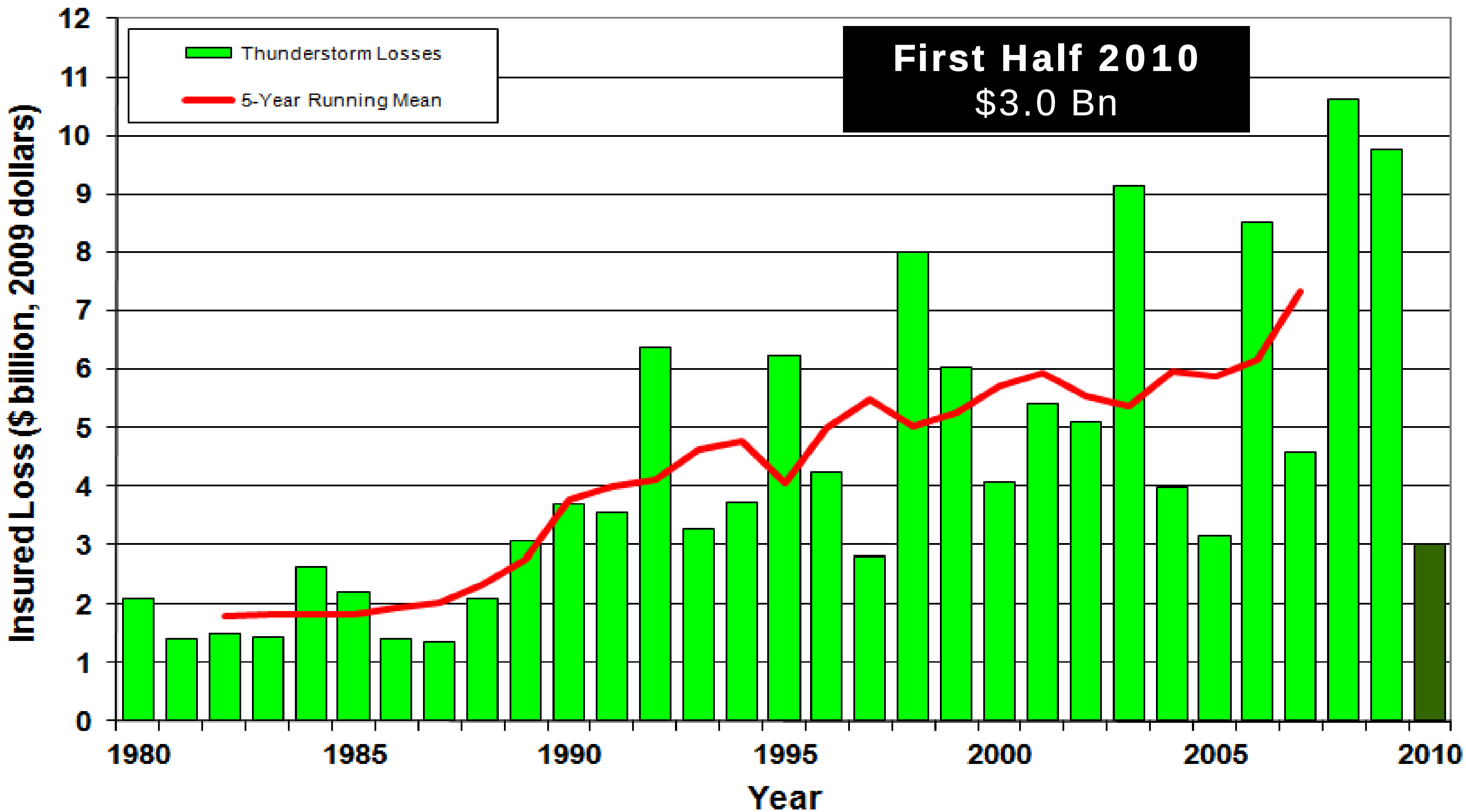


Source: MR NatCat*SERVICE*

U.S. Thunderstorm Loss Trends

Annual Totals 1980 – 2009 vs. First Half 2010

Thunderstorm losses have quadrupled since 1980.



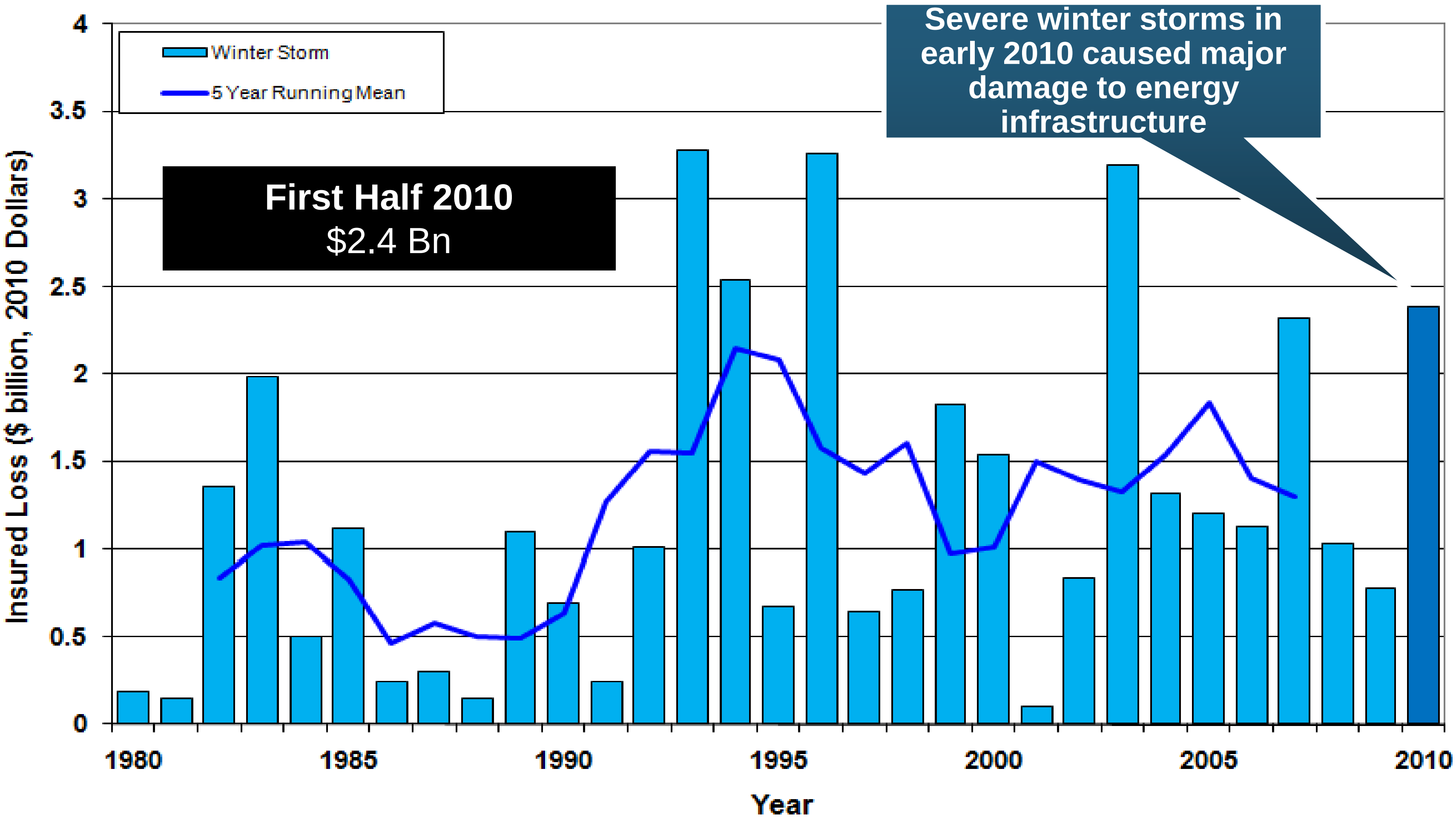
Source: Property Claims Service, MR NatCat*SERVICE*

U.S. Winter Storm Loss Trends

Annual totals 1980 – 2009 vs. First Half 2010

INSURANCE INFORMATION INSTITUTE

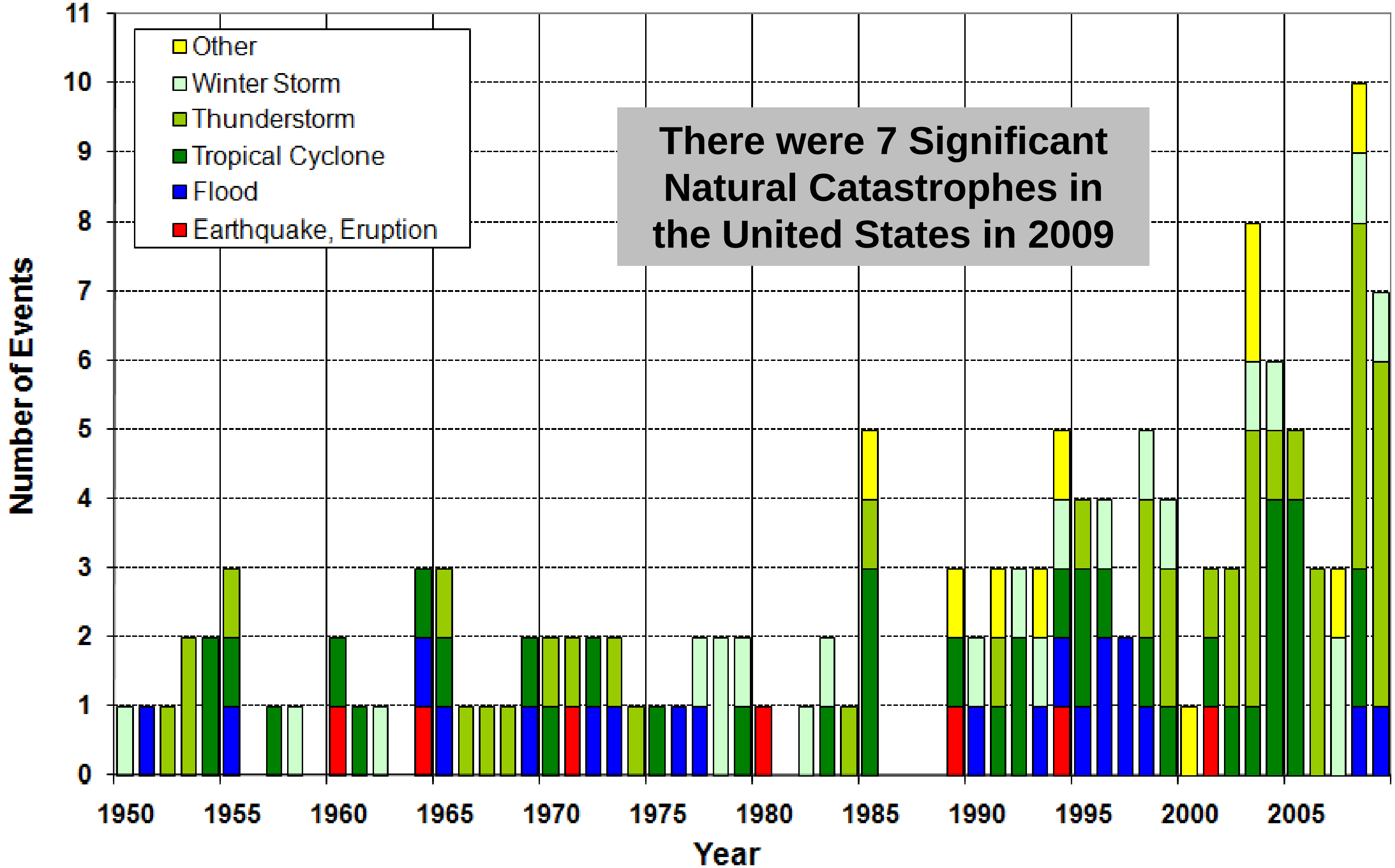
Average annual winter storm losses have increased over 50% since 1980.



Source: Property Claims Service, MR NatCat*SERVICE*

U.S. Significant Natural Catastrophes, 1950 – 2009

Number of Events ($1+ Bill economic loss and/or 50+ fatalities)

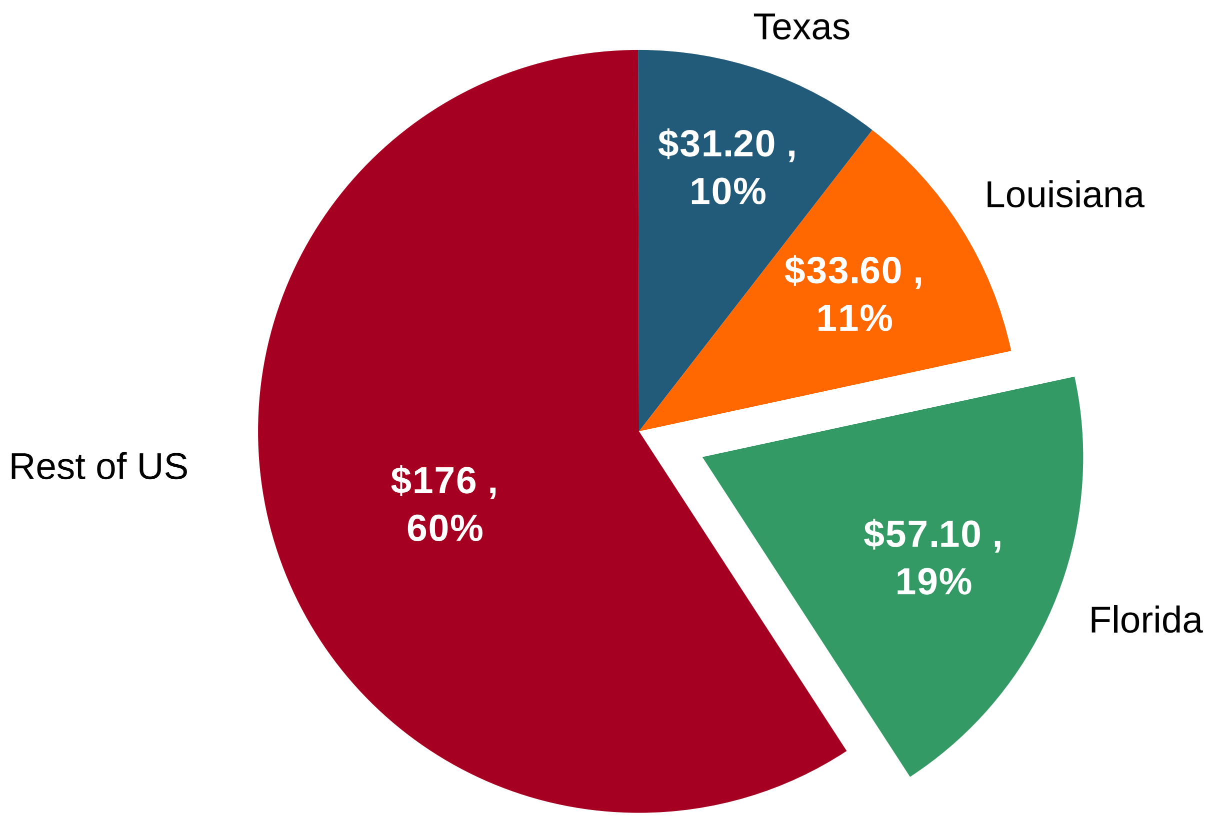


Sources: MR Nat*CatSERVICE*

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

INSURANCE INFORMATION INSTITUTE

($ Billions)

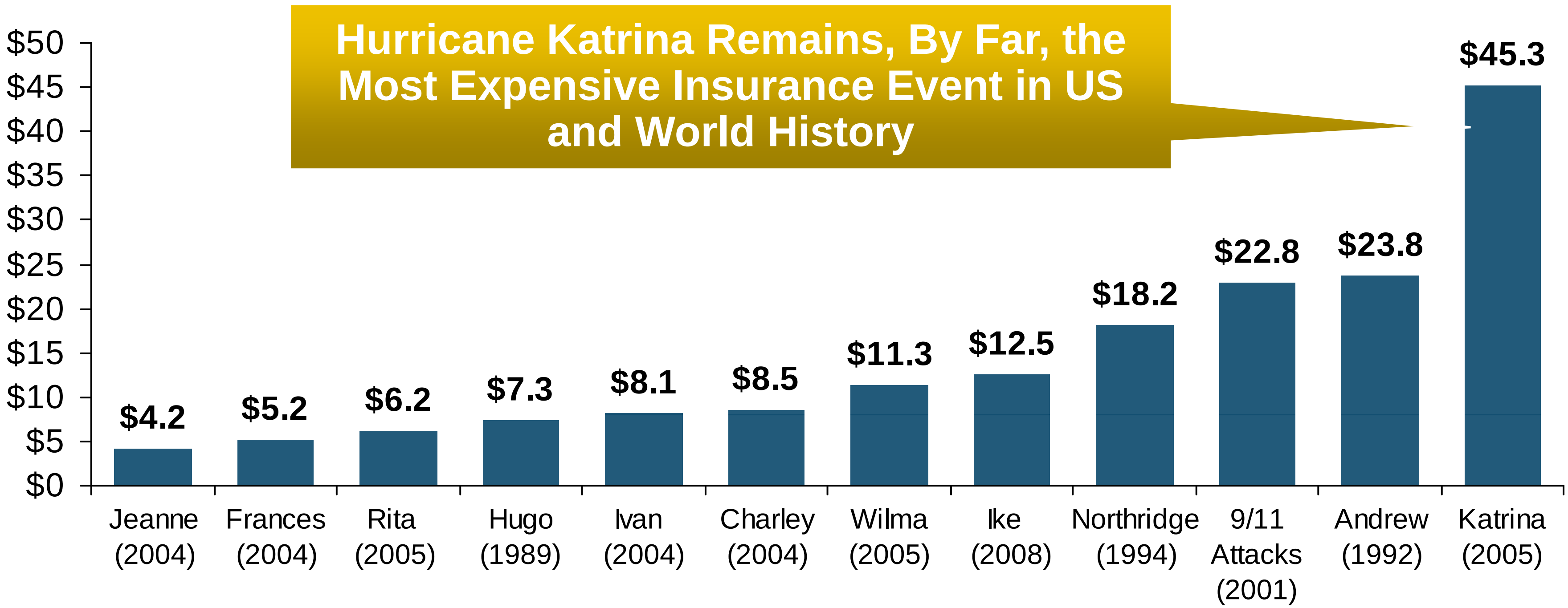


Florida Accounted for 19% of All US Insured CAT Losses from 1980-2008: $57.1B out of $297.9B

* 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)

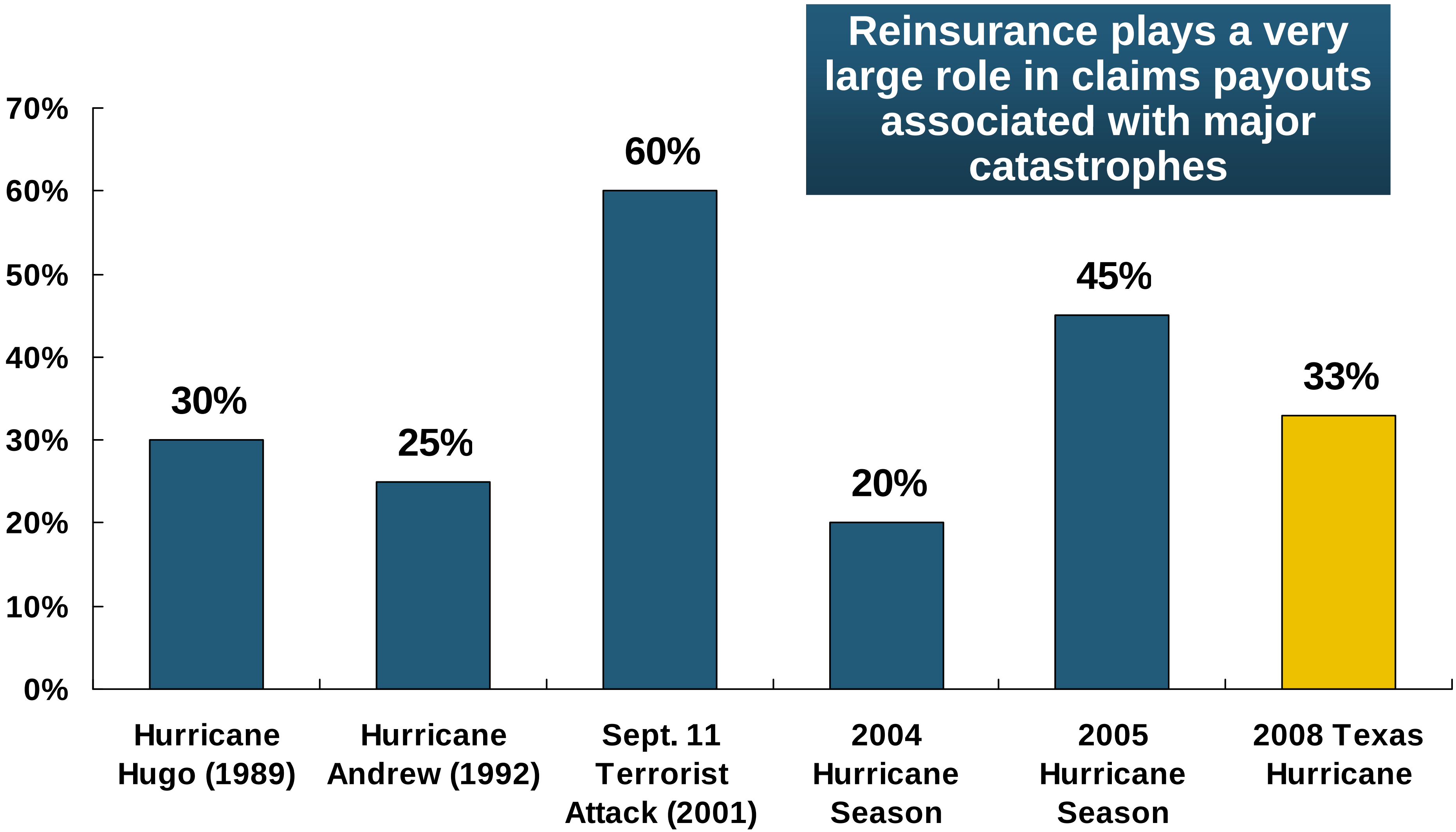


8 of the 12 Most Expensive Disasters in US History Have Occurred Since 2004;
8 of the Top 12 Disasters Affected FL

Sources: PCS; Insurance Information Institute inflation adjustments.

Share of Losses Paid by Reinsurers for Major Catastrophic Events

INSURANCE INFORMATION INSTITUTE

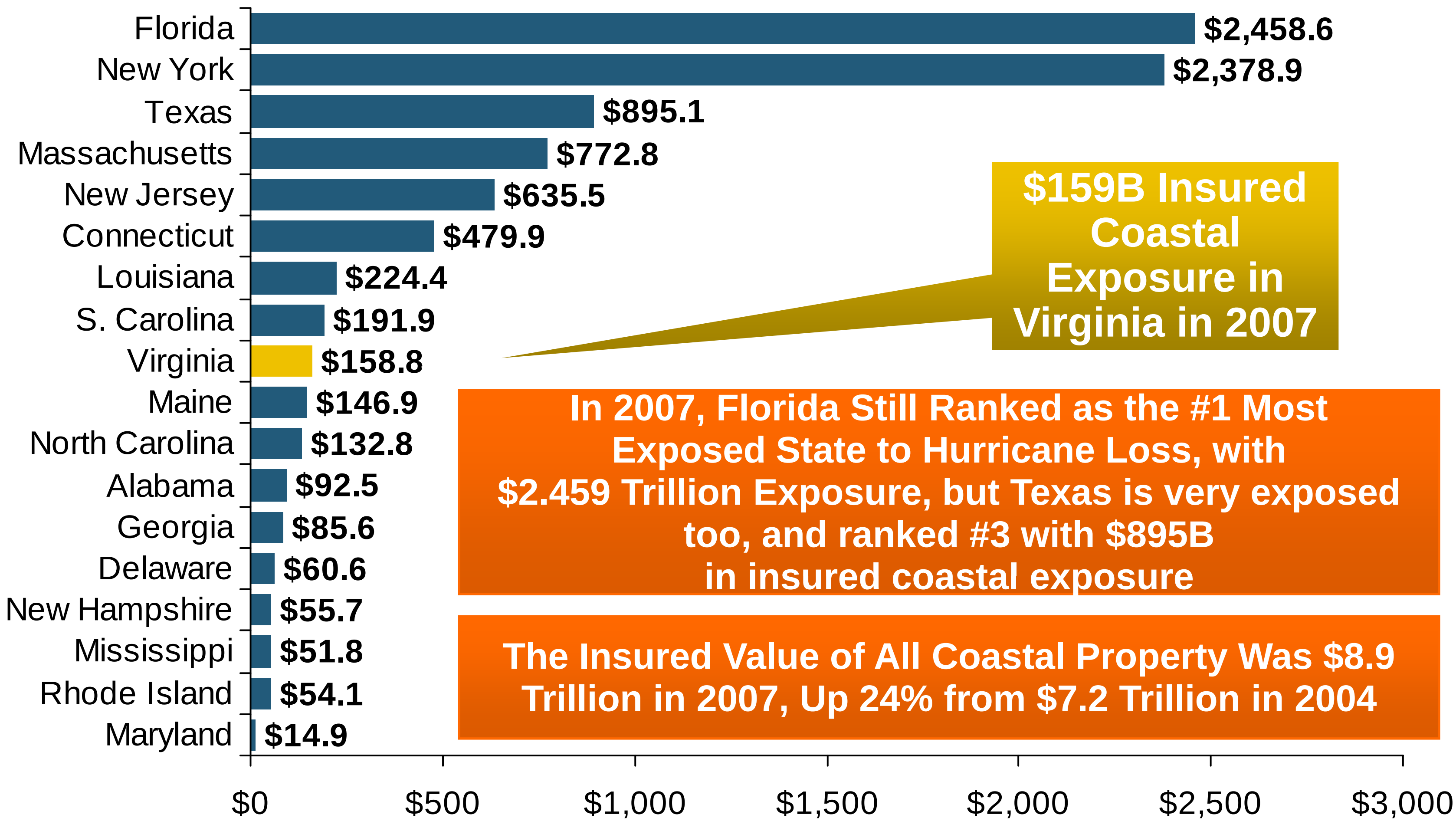


Source: Wharton Risk Center, Disaster Insurance Project, Renaissance Re, Insurance Information Institute.

Total Value of Insured Coastal Exposure

INSURANCE INFORMATION INSTITUTE

(2007, $ Billions)

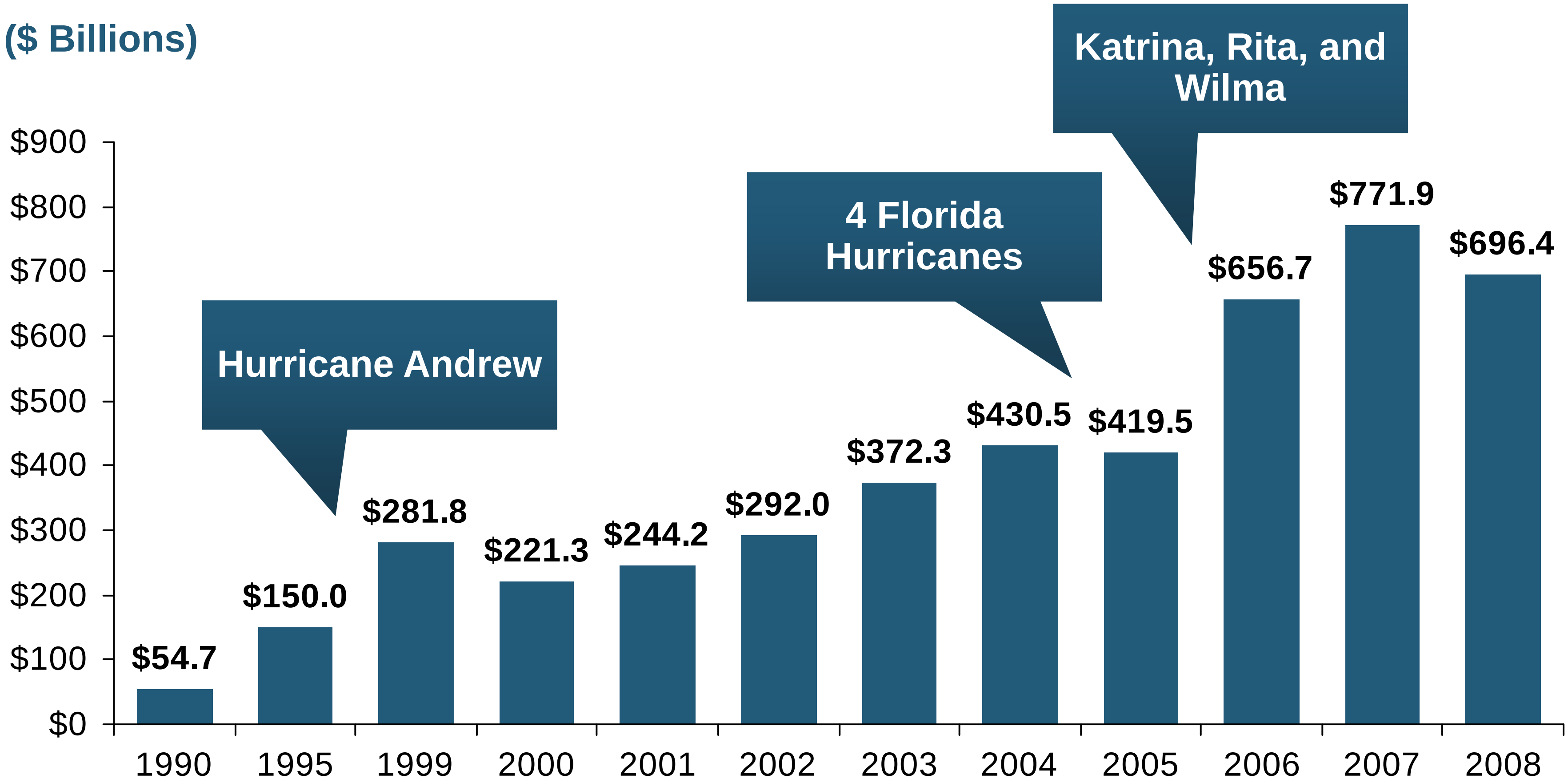


In 2007, Florida Still Ranked as the #1 Most Exposed State to Hurricane Loss, with $2.459 Trillion Exposure, but Texas is very exposed too, and ranked #3 with $895B in insured coastal exposure

The Insured Value of All Coastal Property Was $8.9 Trillion in 2007, Up 24% from $7.2 Trillion in 2004

Source: AIR Worldwide

US Residual Market Exposure to Loss



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

Source: PIPSO; Insurance Information Institute

INSURANCE INFORMATION INSTITUTE

Insurance Information Institute Online:

www.iii.org

Thank you for your time and your attention!

Twitter: twitter.com/bob_hartwig

Download: www.iii.org/presentations