The Financial Crisis and the Future of the P/C Insurance Industry

Focus on Public Sector Risk

Public Risk and Insurance Management Association
Naples, FL

October 28, 2009

Download at: www.iii.org/presentations/PRIMA-102809/

Robert P. Hartwig, Ph.D., CPCU, President & Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: (212) 346-5520 ♦ Fax: (212) 732-1916 ♦ bobh@iii.org ♦ www.iii.org

Presentation Outline

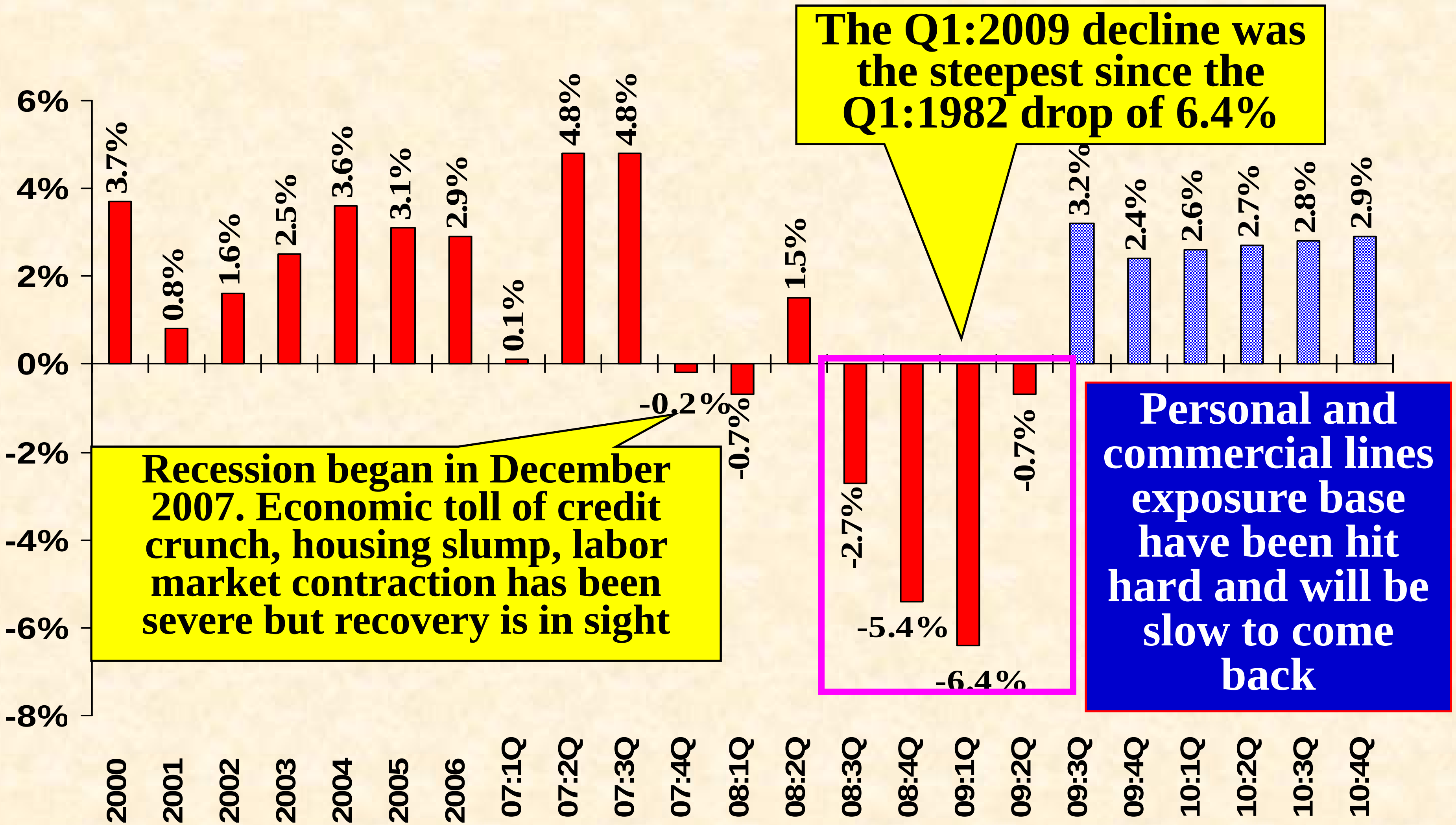
- The Economic Storm: Financial Crisis & Recession
  - Exposure, Growth & Profitability
  - Florida's Woes: Worse than Most States
- Key Threats and Issues Facing P/C Insurers Through 2015
- Regulatory Reform
- Financial Strength & Ratings
  - Key Differences Between Insurer and Bank Performance During Crisis
- Insurance Industry Financial Overview & Outlook
  - Profitability
  - Premium Growth
  - Underwriting Performance: Commercial & Personal Lines
  - Financial Market Impacts
  - Merger & Acquisition Activity
- Capital & Capacity
- Catastrophe Loss Trends

Q&A

THE ECONOMIC STORM

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

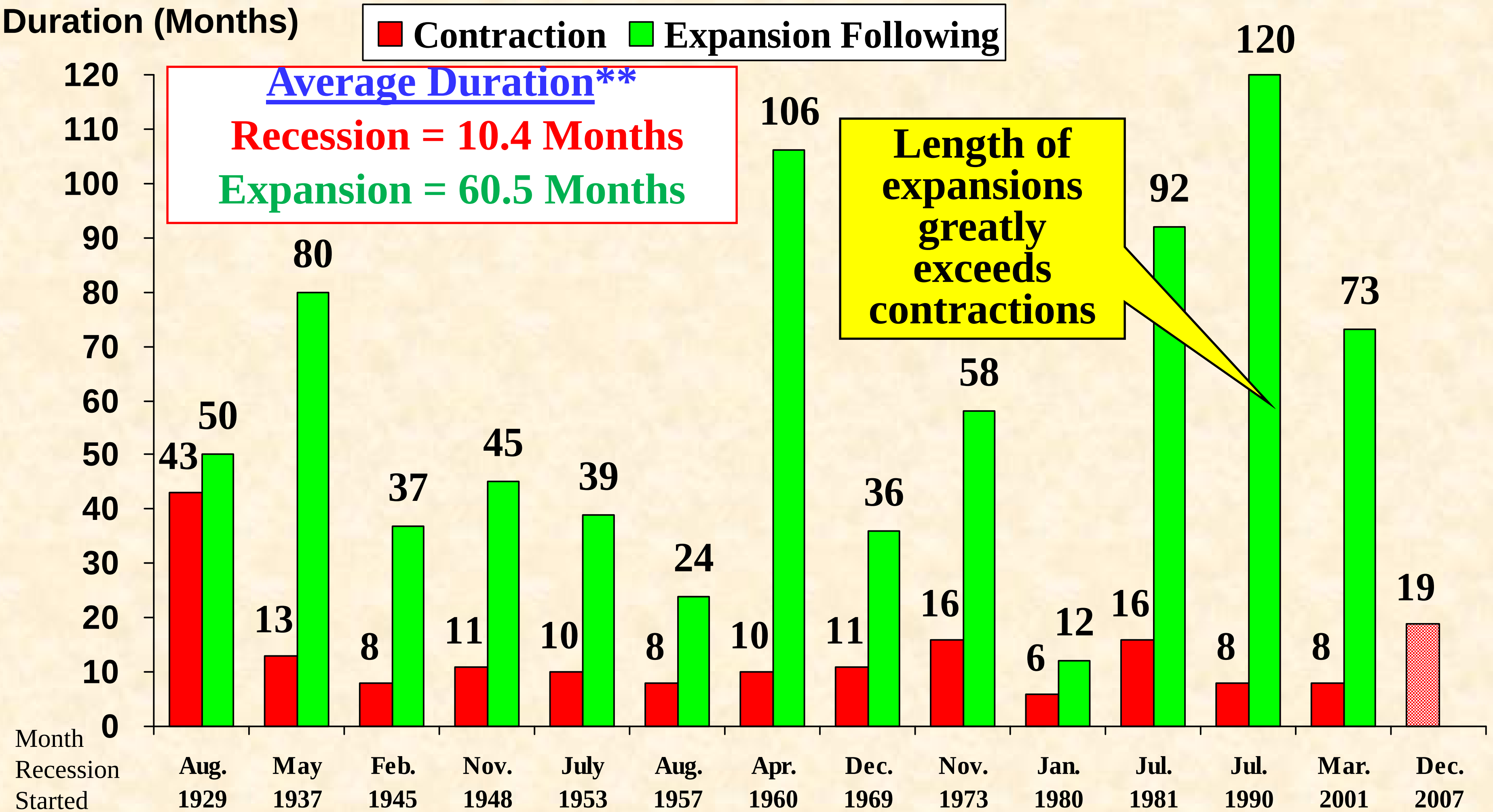
Real GDP Growth*



*Blue bars are Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 10/09; Insurance Information Institute.

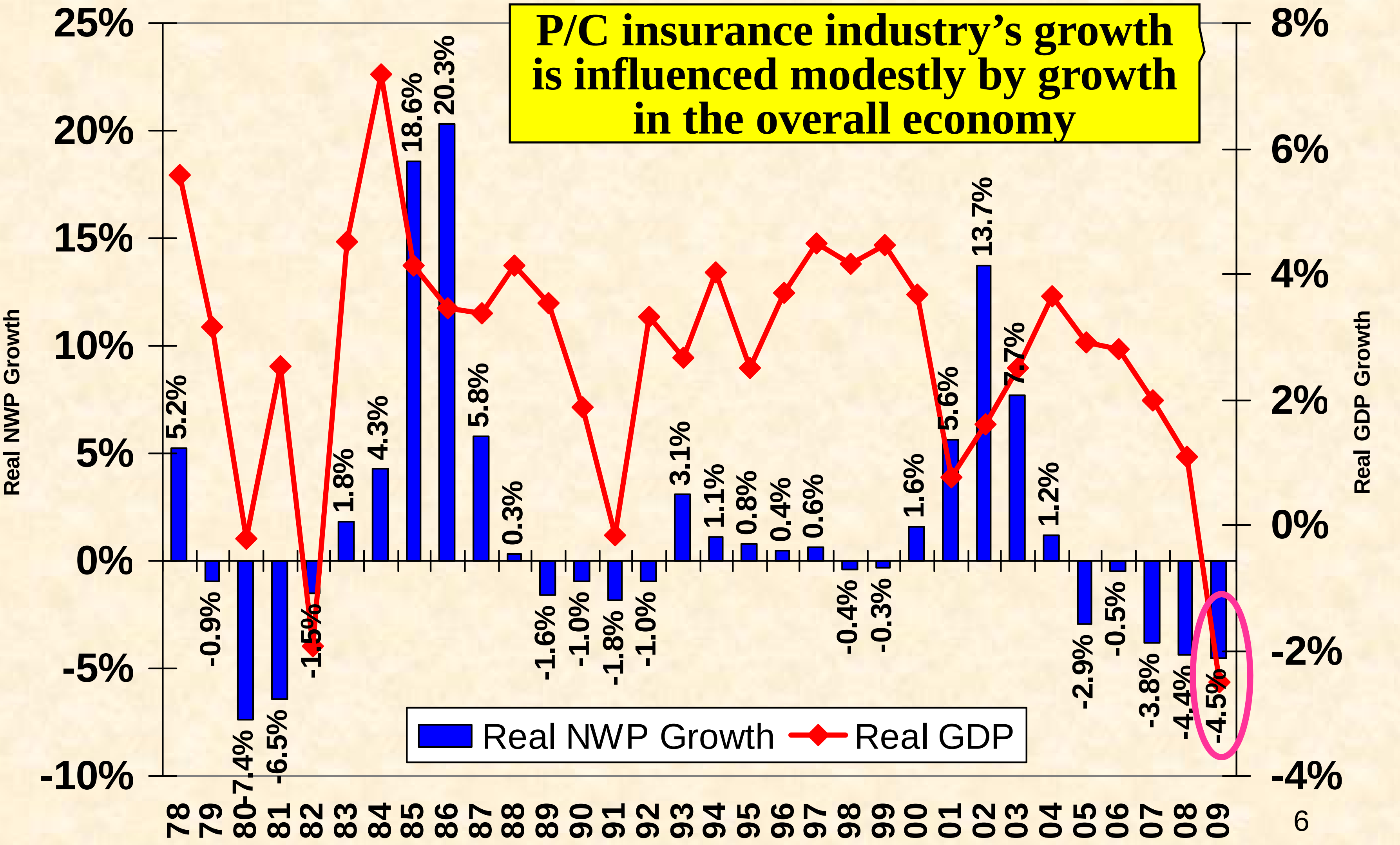
Length of U.S. Business Cycles, 1929-Present*



* Through June 2009 (likely the "official end" of recession) **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

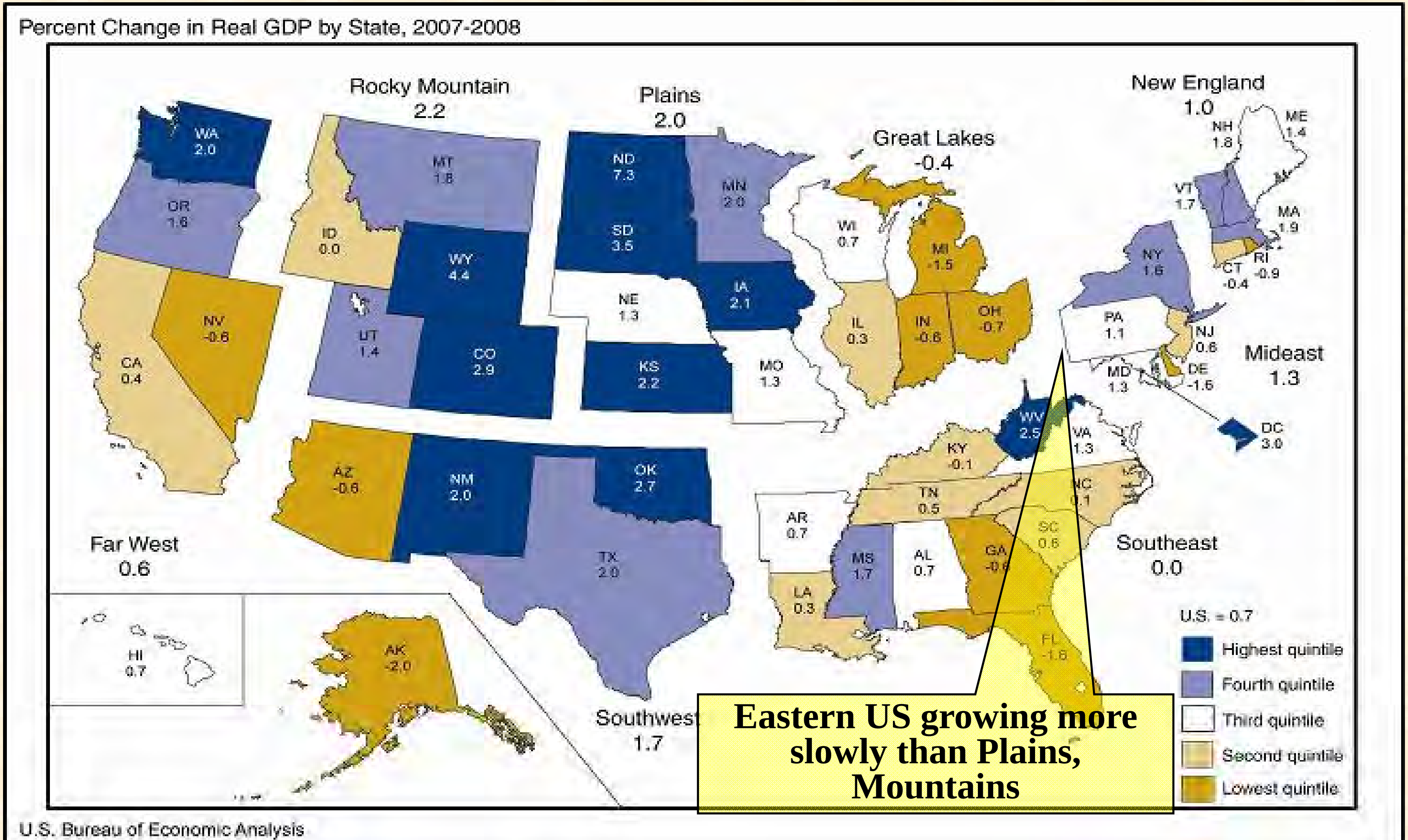


Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 10/09; Insurance Information Inst.

Regional Differences Will Significantly Impact P/C Markets

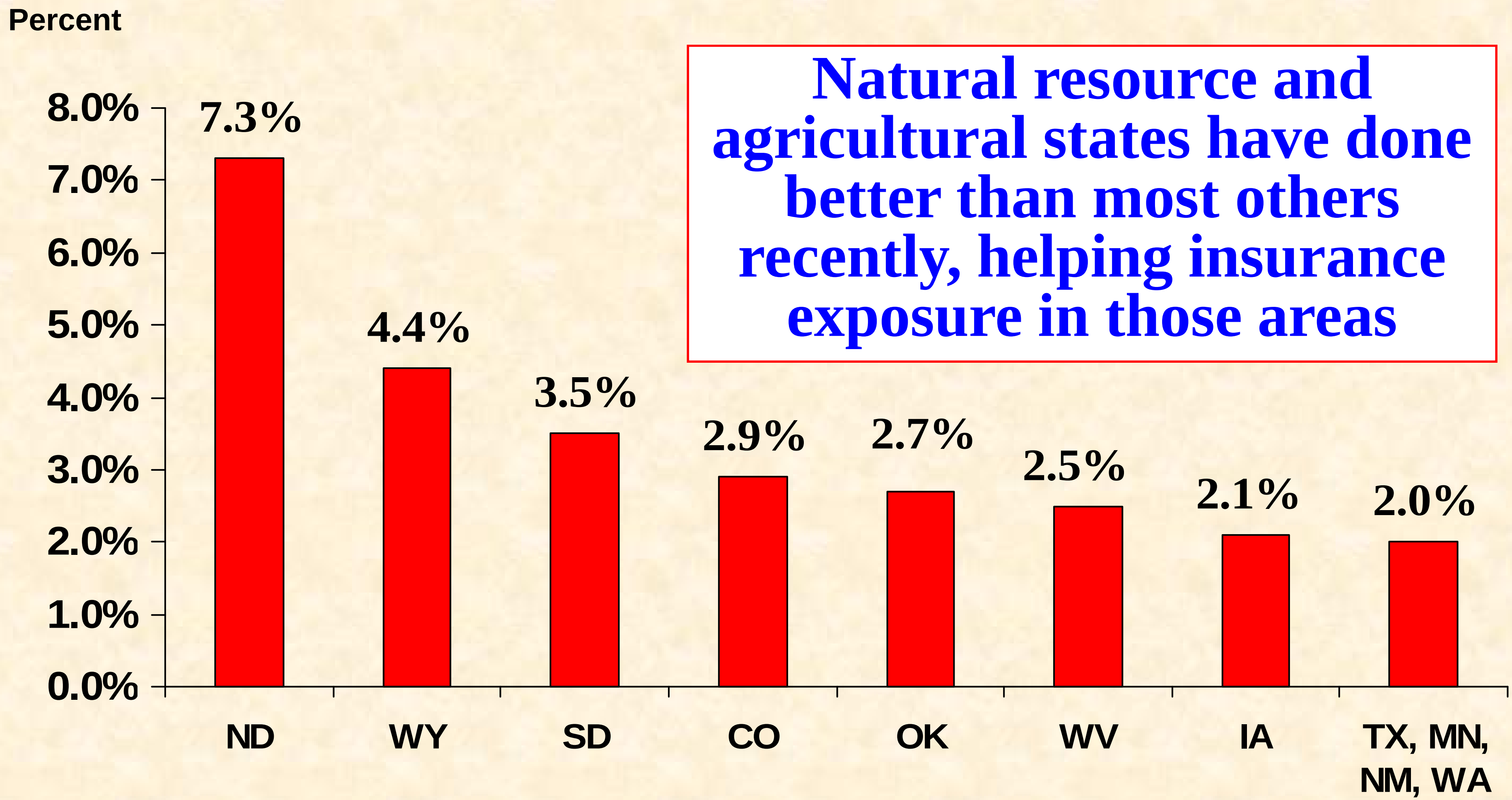
Recovery in Some Areas Will Begin Years Ahead of Others & Speed of Recovery Will Differ By Orders of Magnitude

State Economic Growth Varied Tremendously in 2008



Fastest Growing States in 2008: Plains, Mountain States Lead

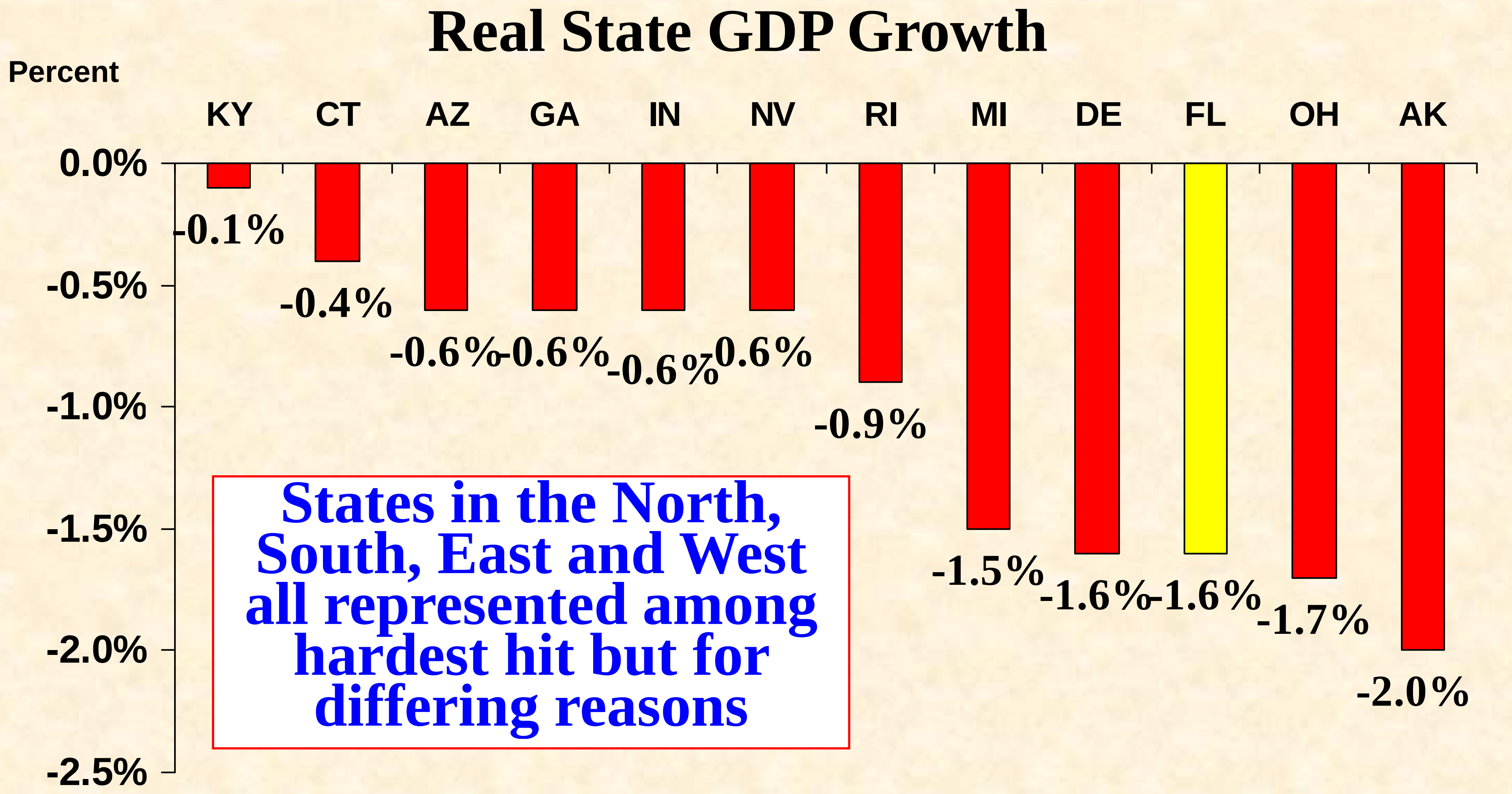
Real State GDP Growth



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



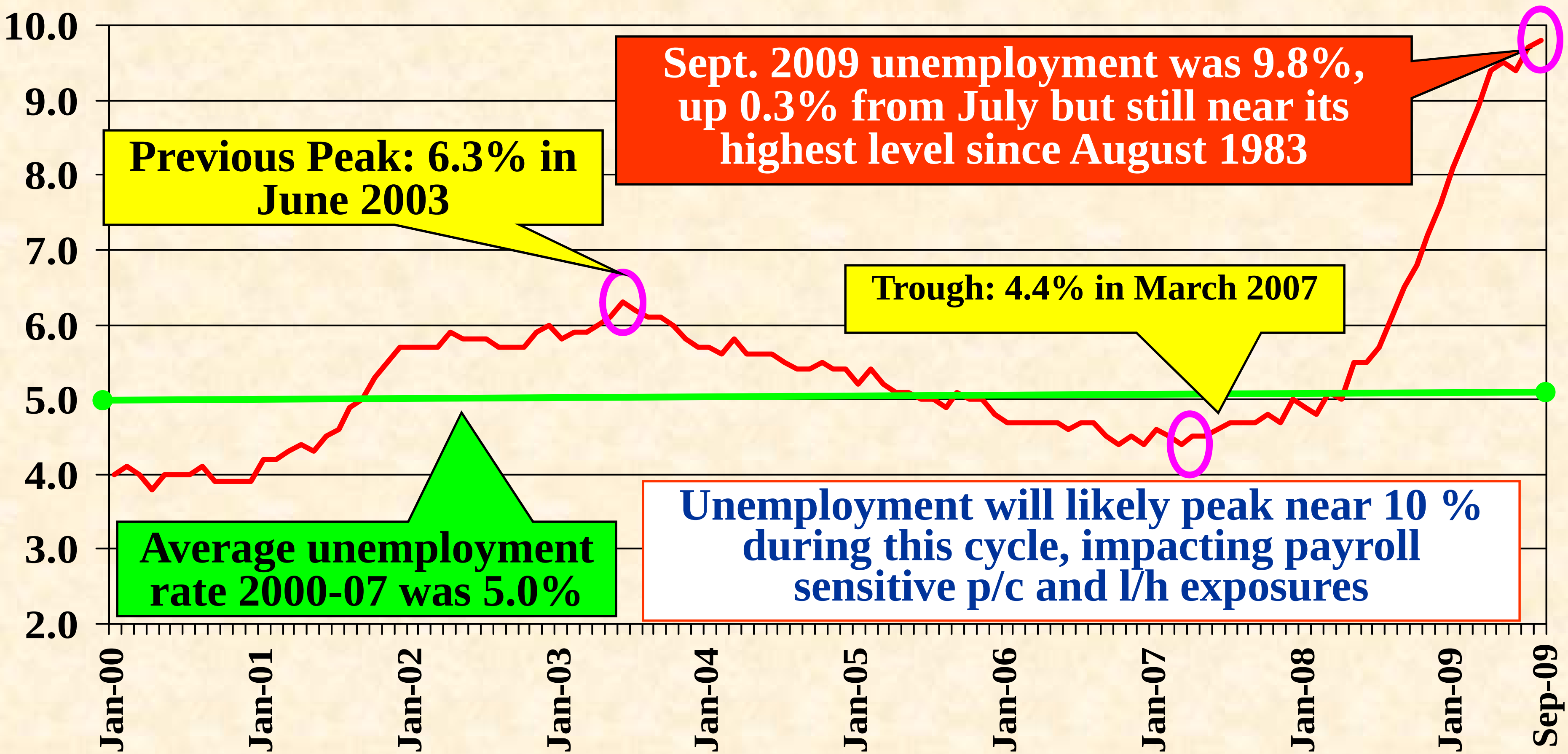
Source: US Bureau of Economic Analysis; Insurance Information Institute.

Labor Market Trends

Fast & Furious: Massive Job Losses Sap the Economy and Personal & Commercial Lines Exposure

Unemployment Rate: On the Rise

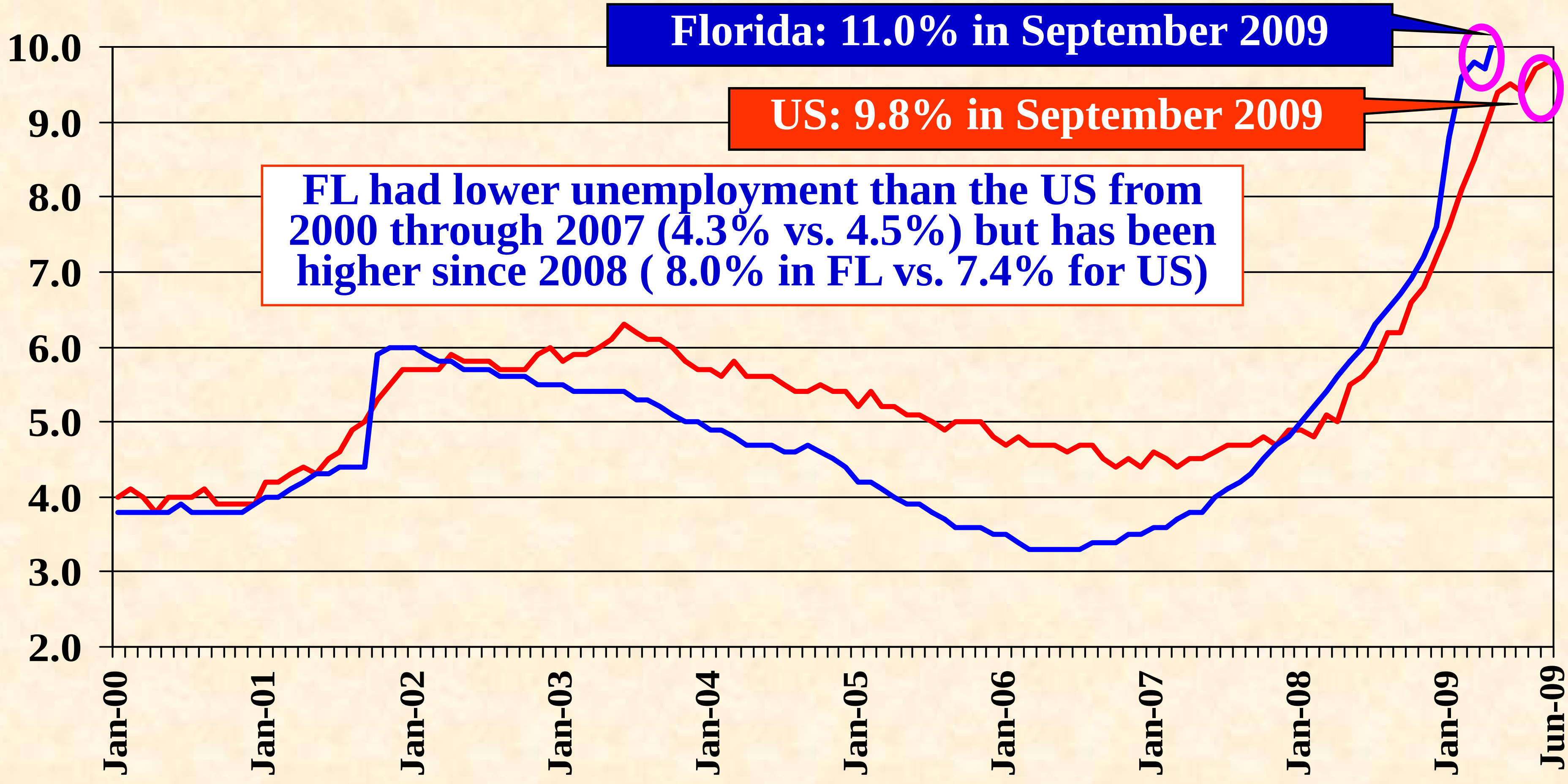
January 2000 through September 2009*



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

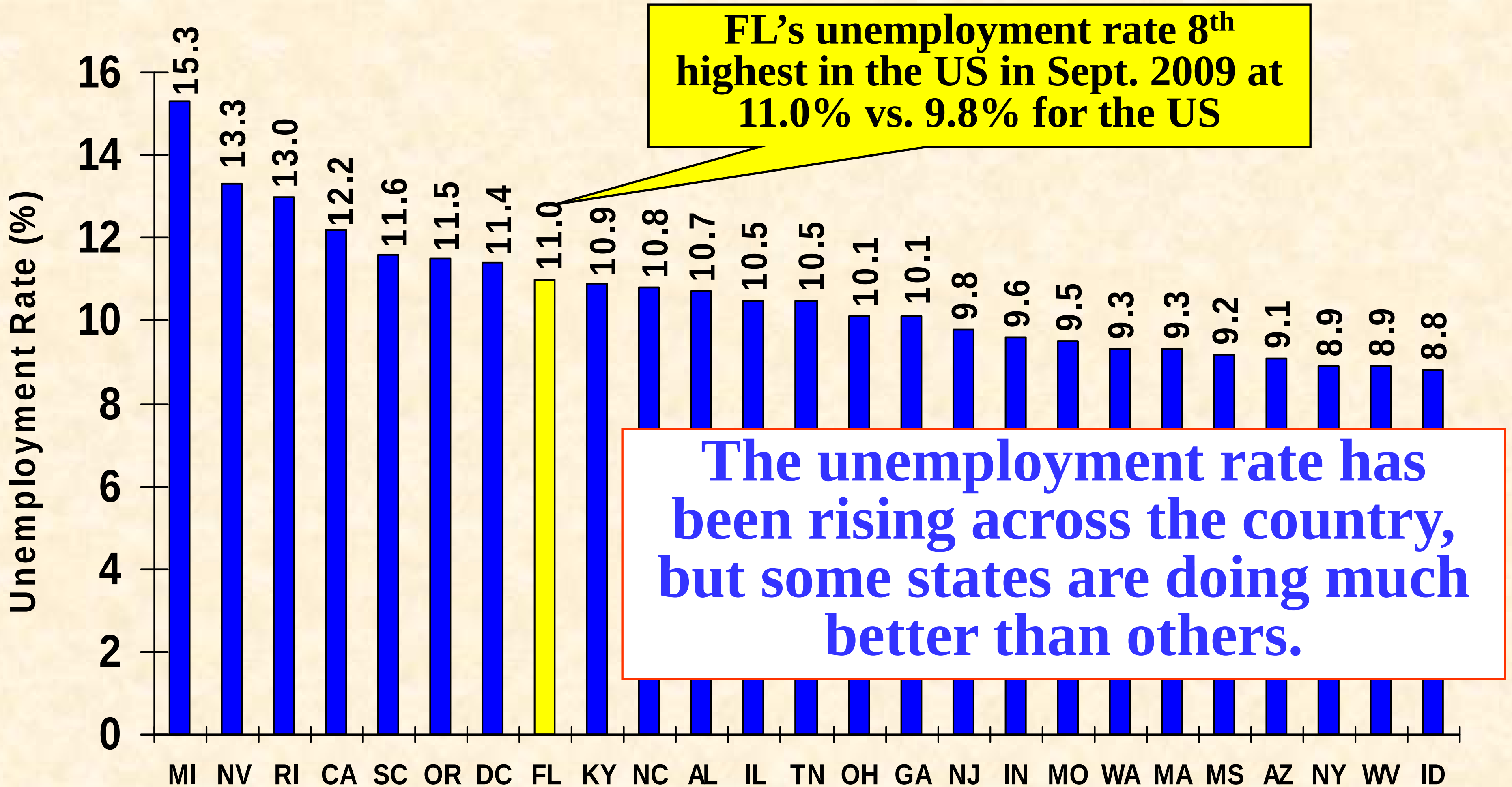
Unemployment Rate: Florida is Now Doing Worse Than US

January 2000 through September 2009



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

Unemployment Rates by State, September 2009: Highest 25 States*



*Provisional figures for September 2009, seasonally adjusted.

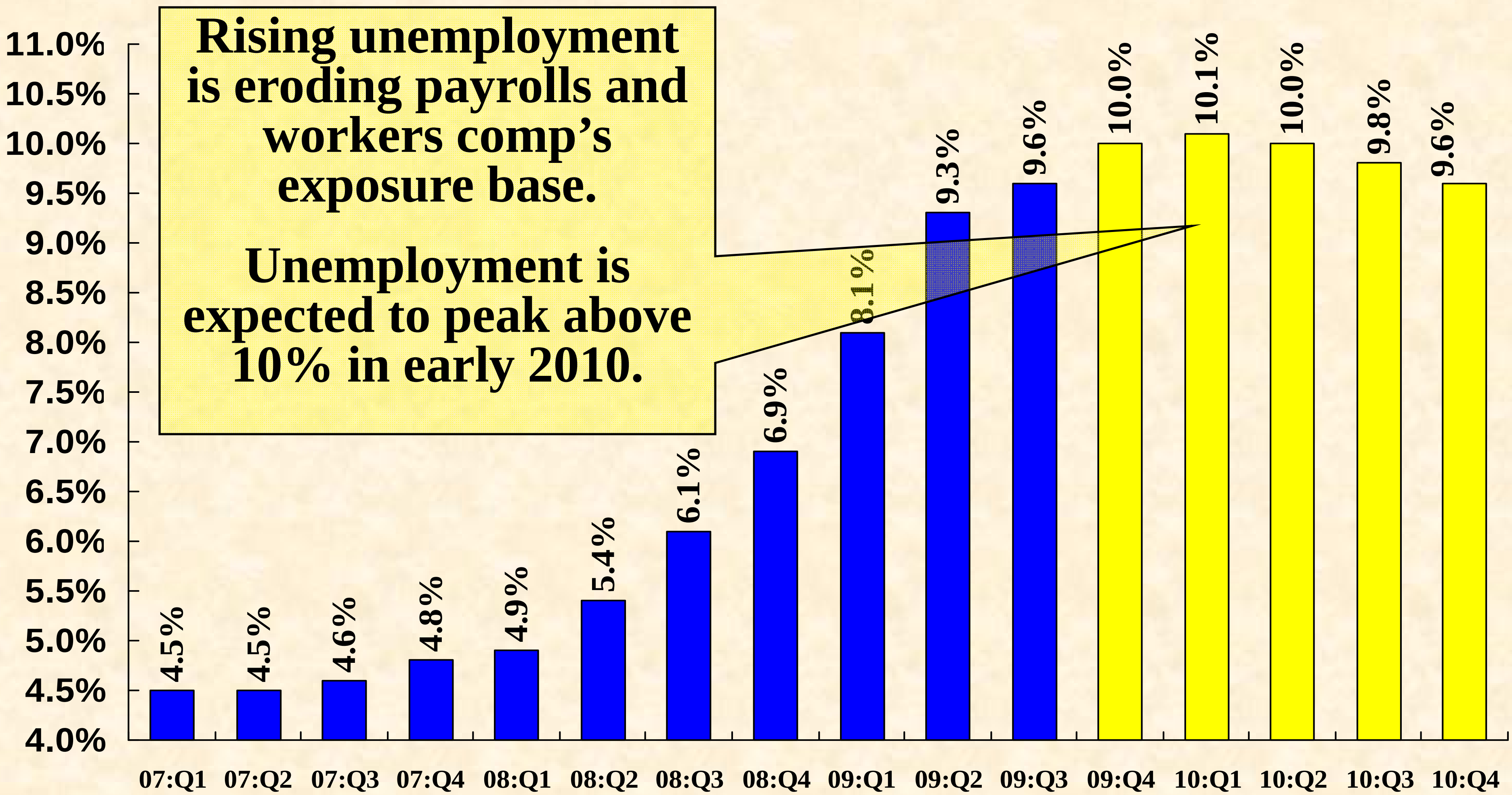
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

Unemployment Rates By State, September 2009: Lowest 25 States*

*Provisional figures for September 2009, seasonally adjusted.

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

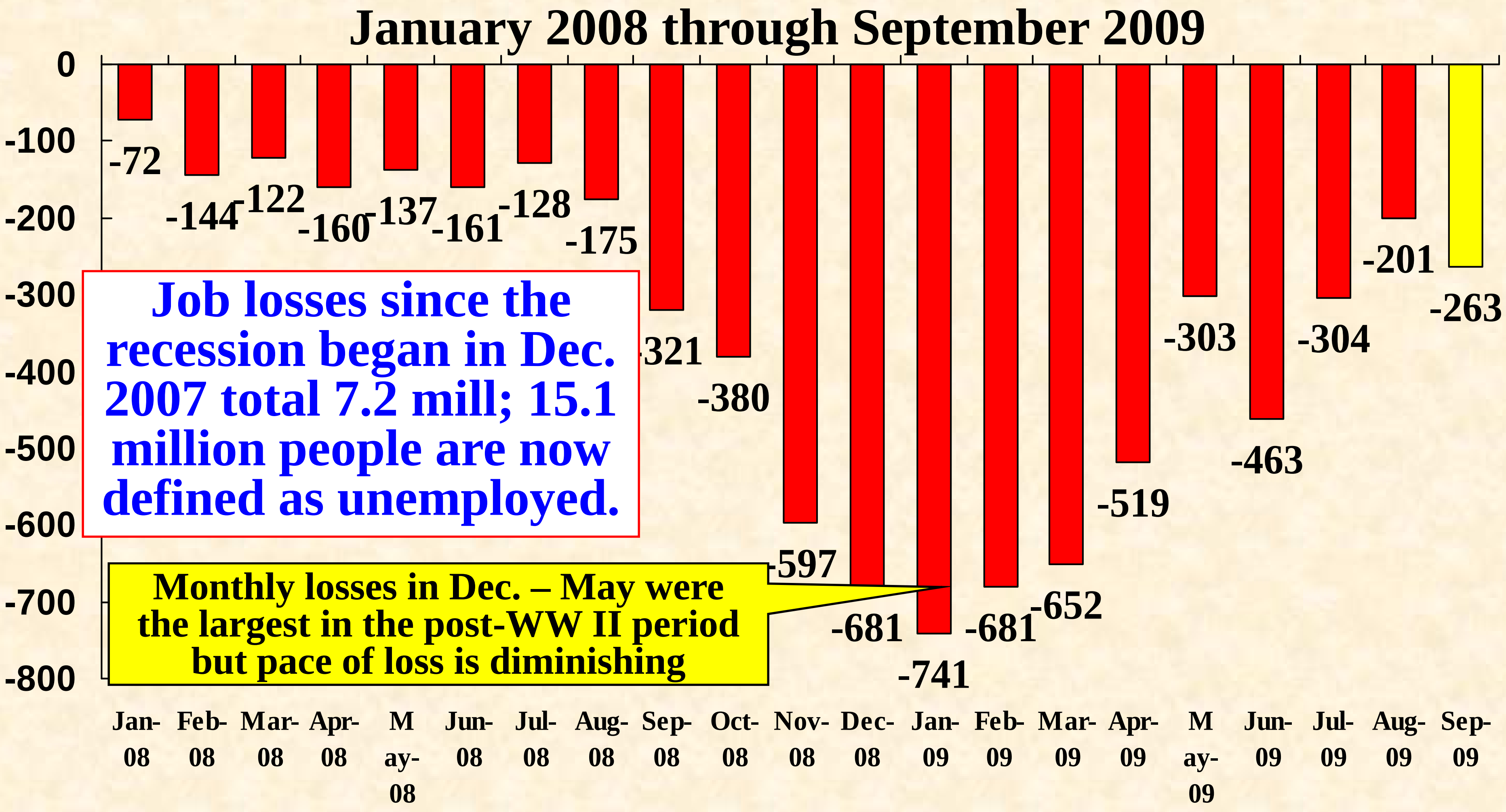
U.S. Unemployment Rate, (2007:Q1 to 2010:Q4F)*



* Blue bars are actual; Yellow bars are forecasts

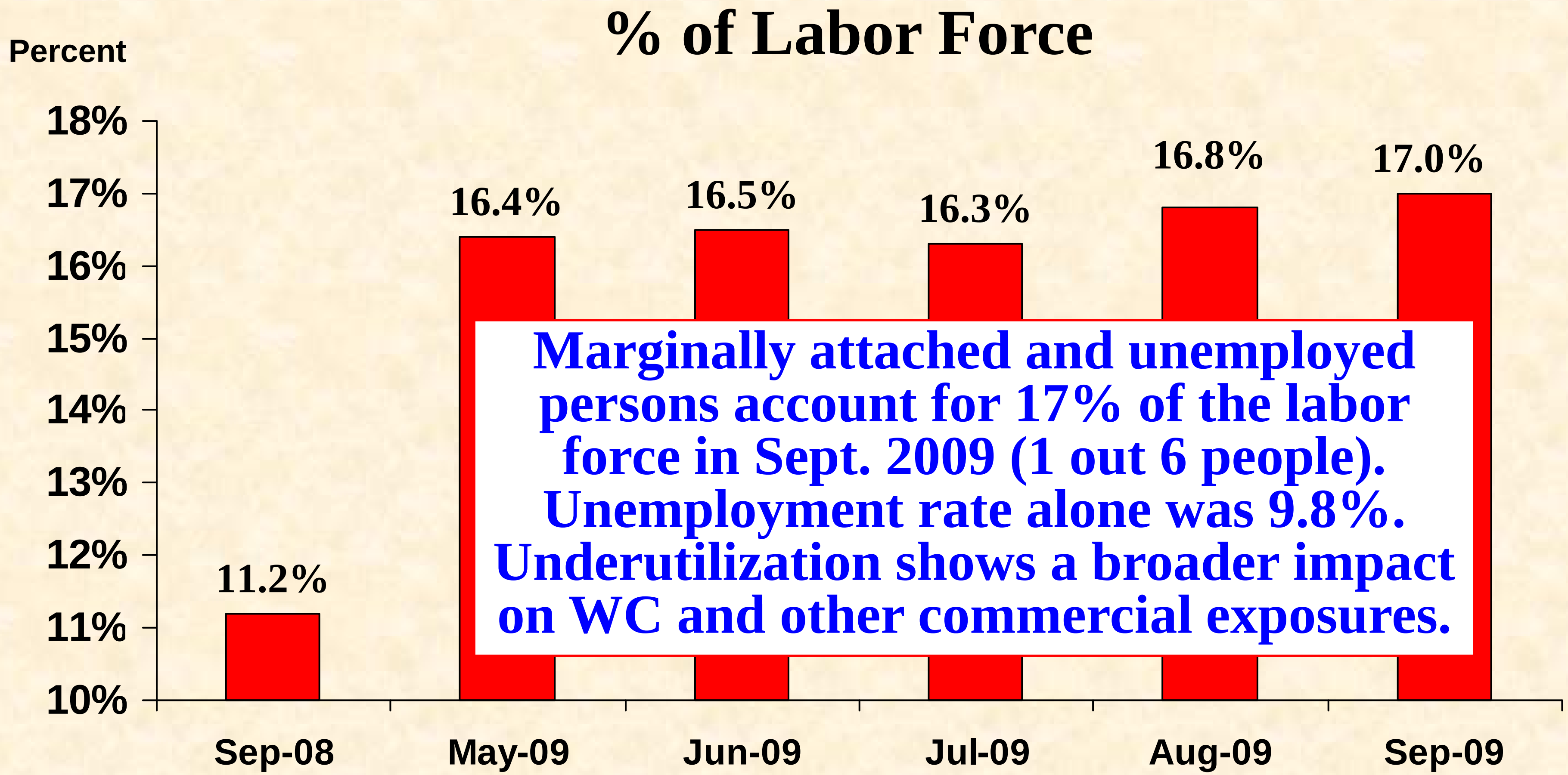
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (10/09); Insurance Info. Inst.

Monthly Change Employment* (Thousands)



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

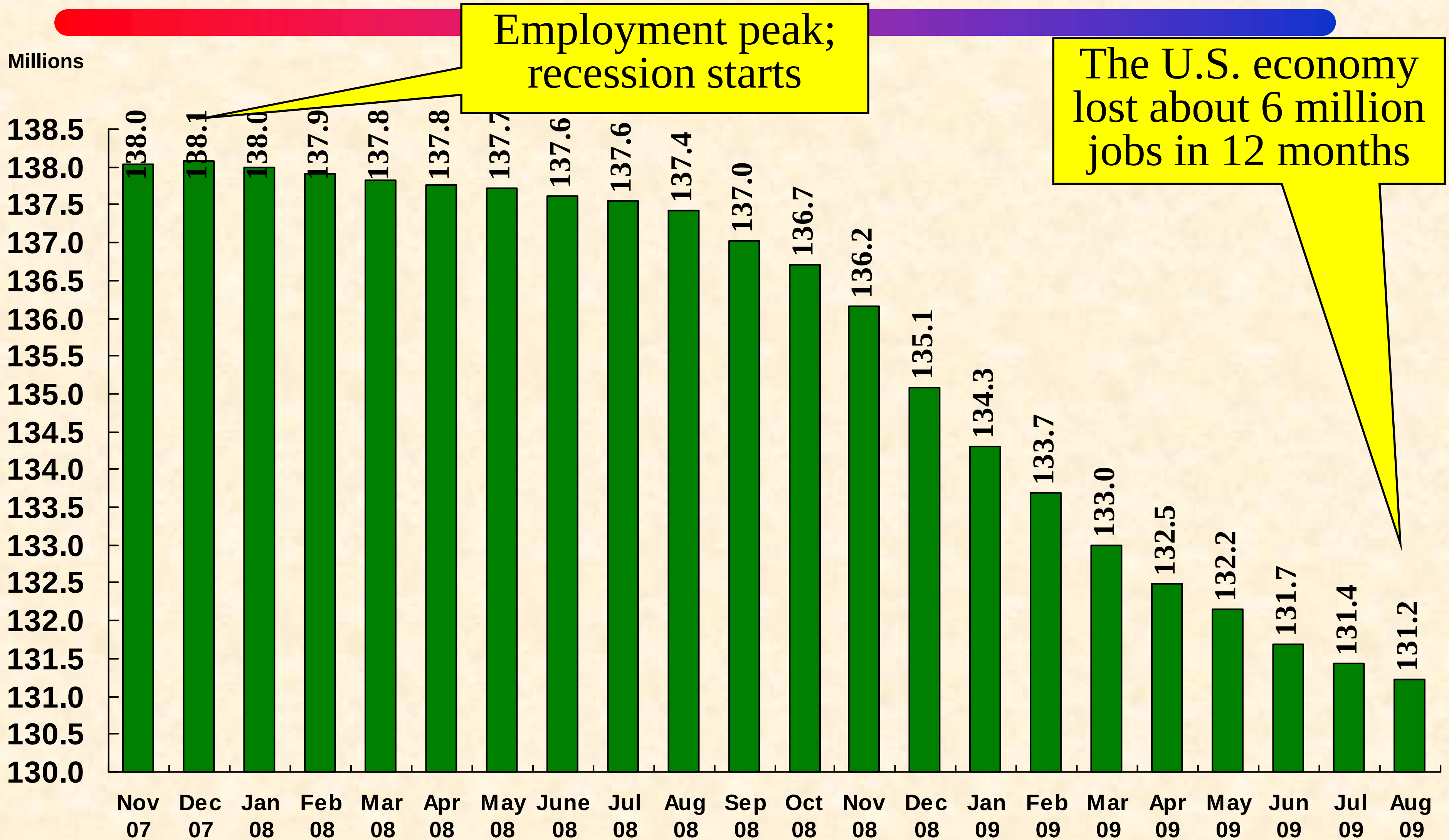
Labor Underutilization: Broader than Just Unemployment



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.

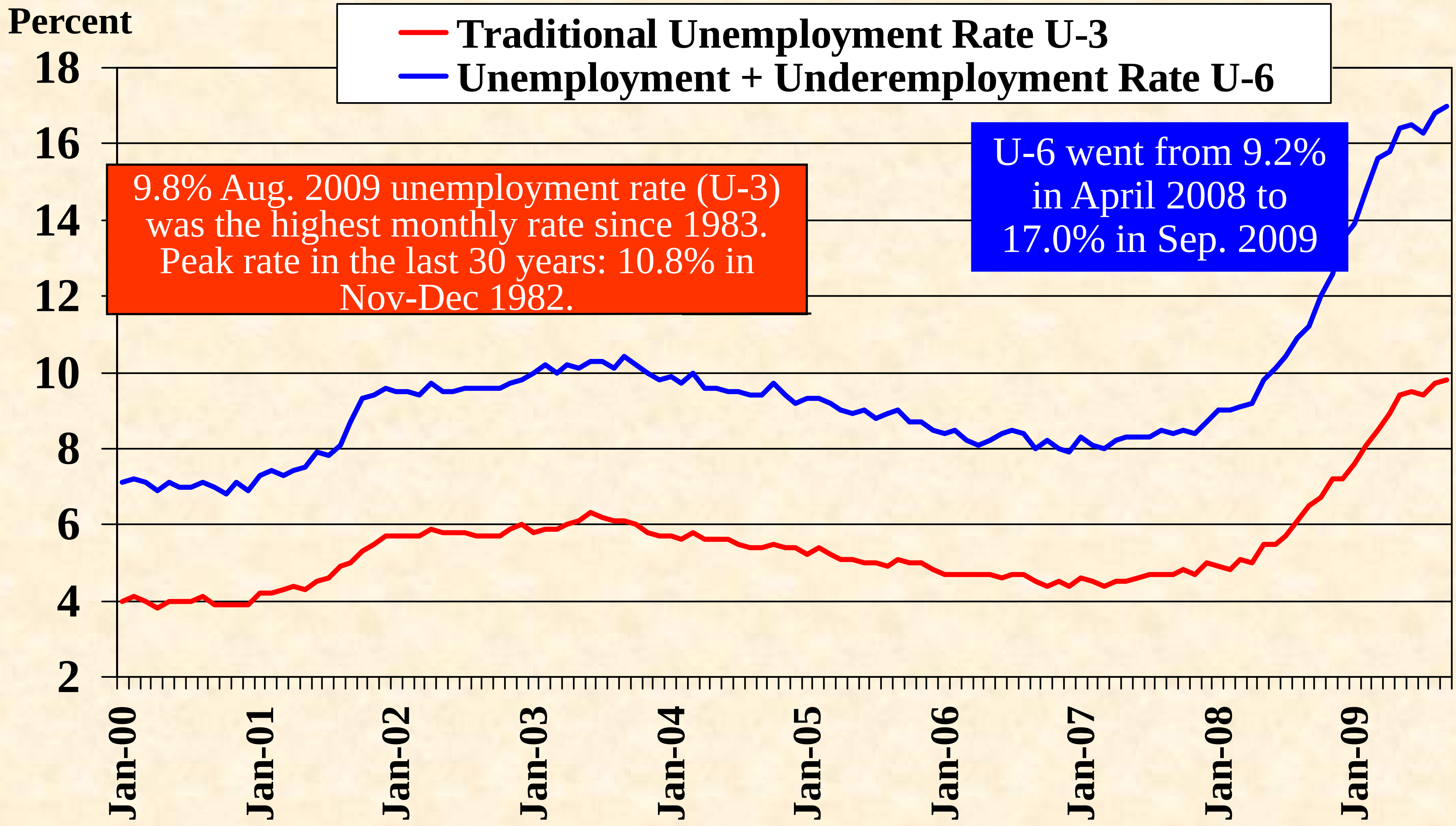
U.S. Nonfarm Private Employment, Monthly, Nov 2007 – August 2009



Seasonally adjusted. Source: US Bureau of Labor Statistics

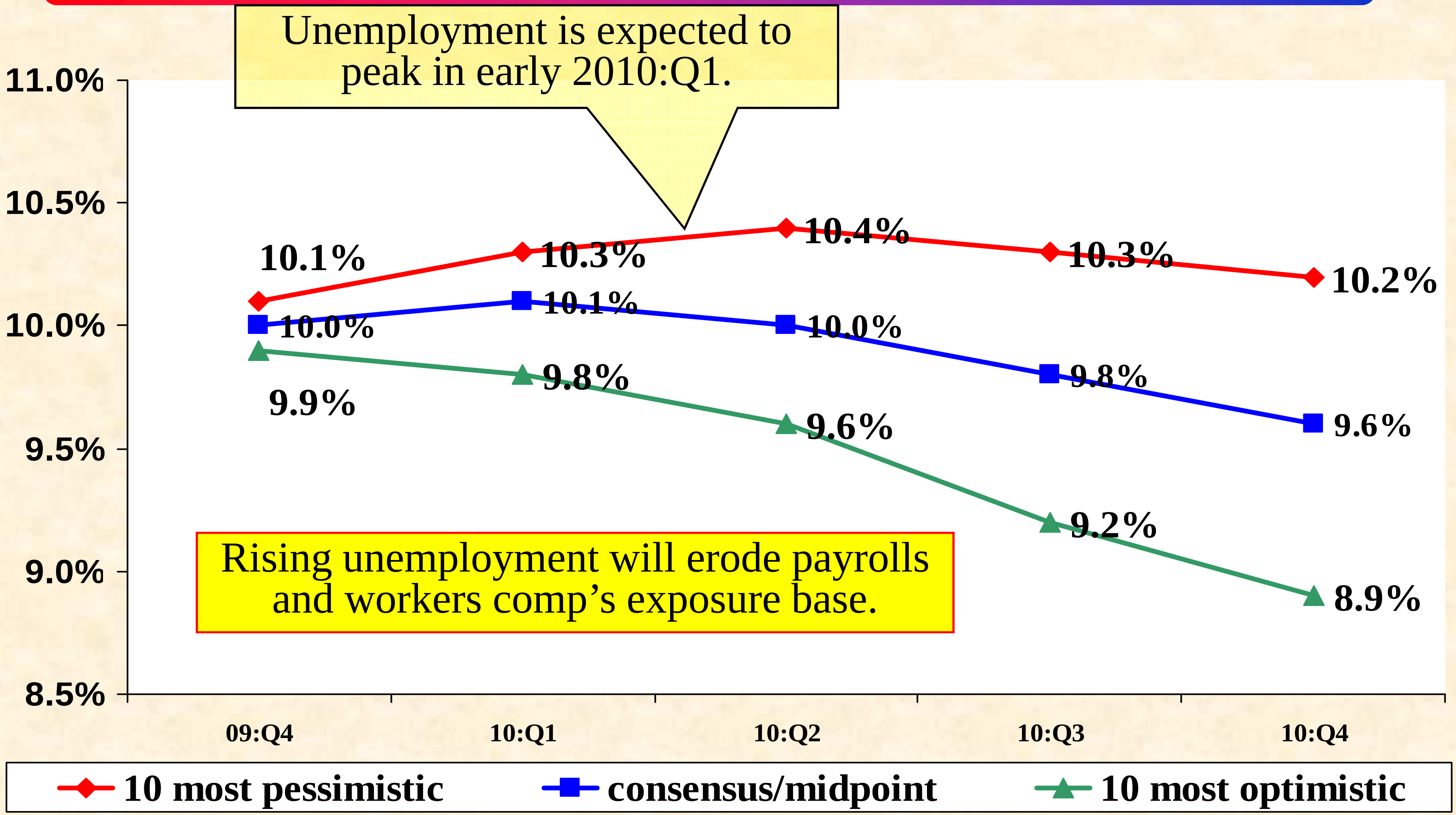
Unemployment and Underemployment Rates: Rocketing Up in 2008-09

January 2000 through September 2009, seasonally adjusted



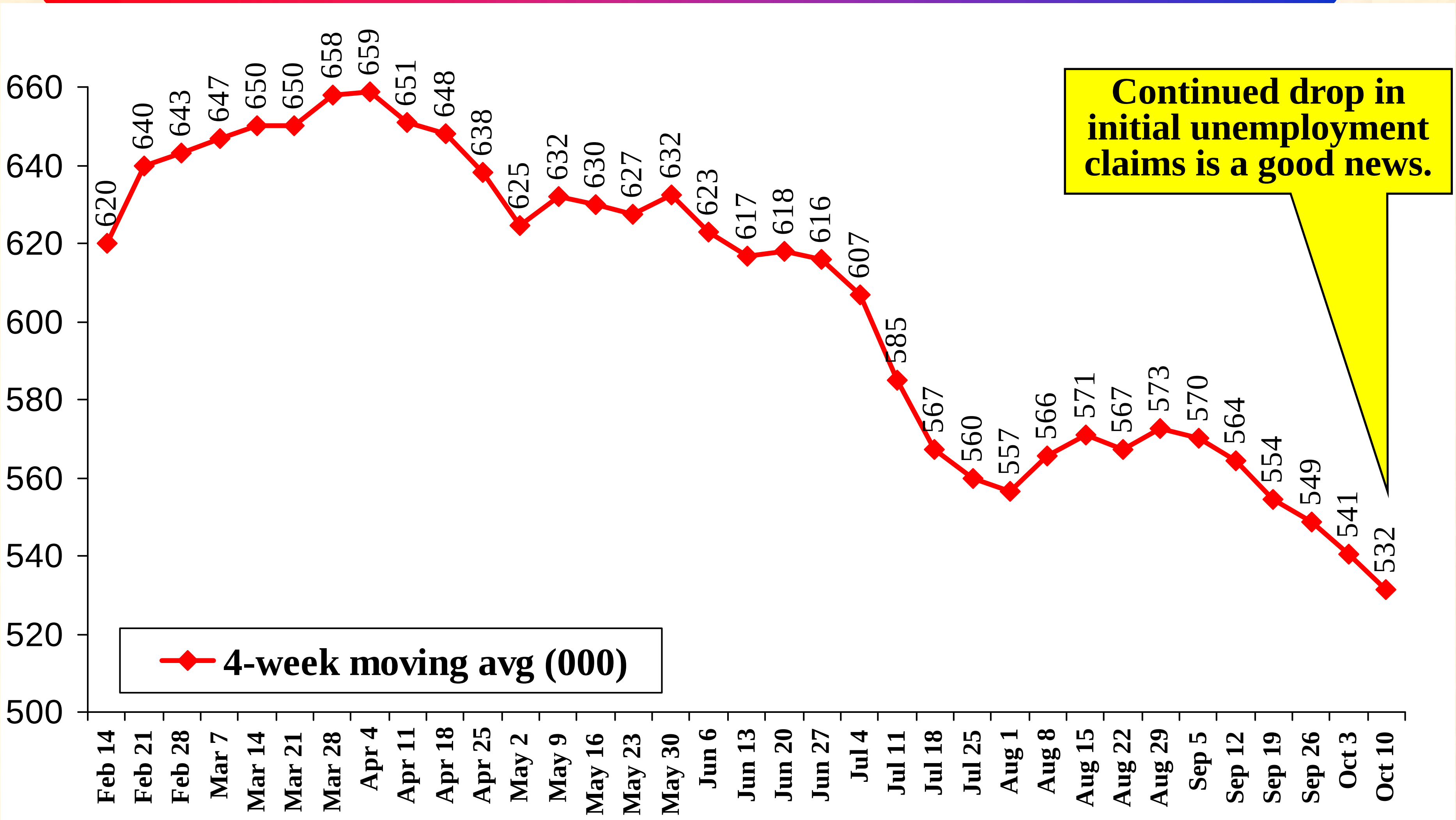
Source: US Bureau of Labor Statistics; Insurance Information Institute.

U.S. Unemployment Rate Forecasts
Quarterly, 2009:Q4 to 2010:Q4



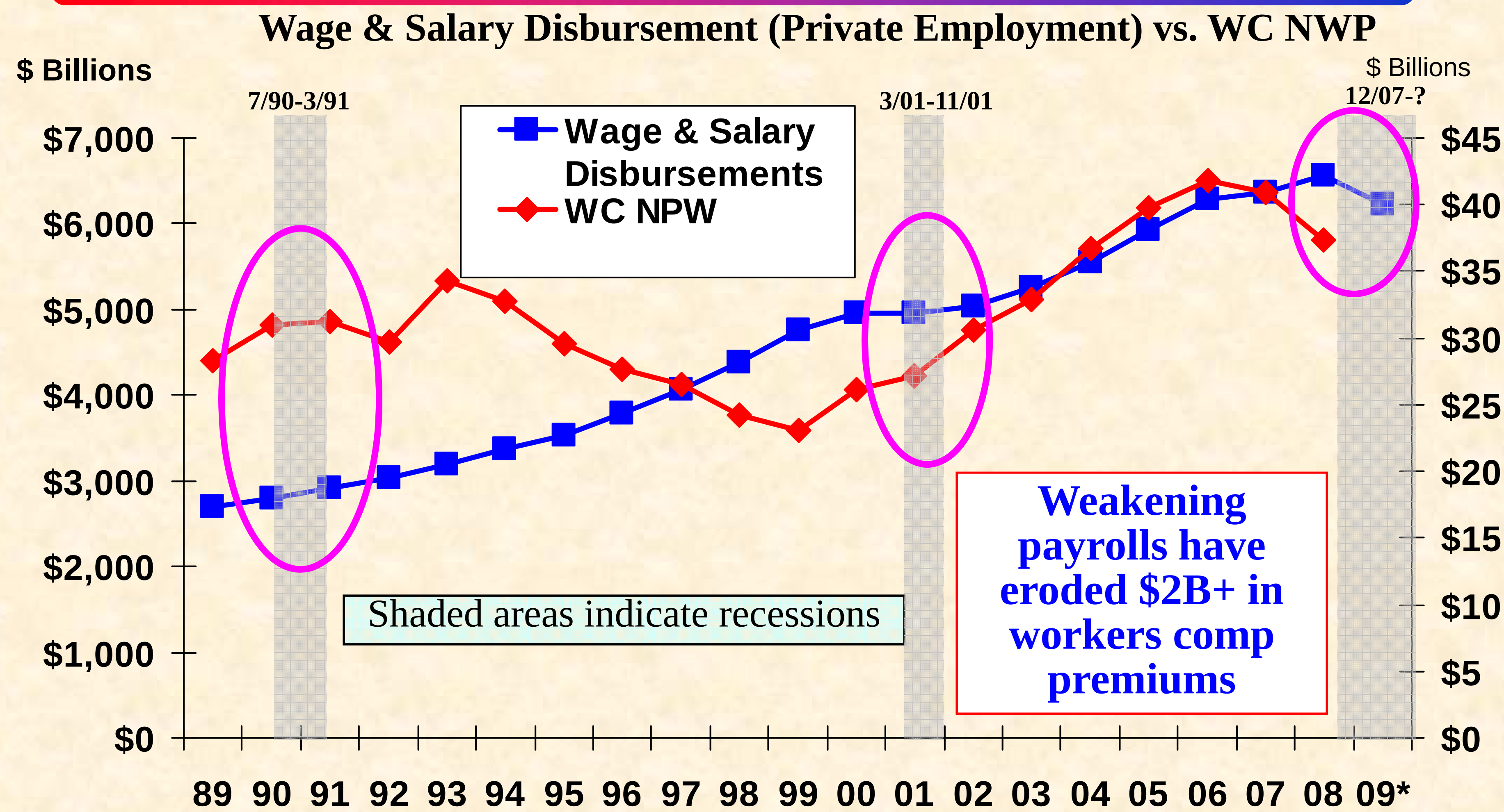
Sources: Blue Chip Economic Indicators (10/09); Insurance Info. Inst.

Will the Recession End Soon? Feb.-Oct. 2009 Initial Jobless Claims*



*seasonally adjusted; state programs only Source: http://www.dol.gov/opa/media/press/eta/ui/current.htm

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



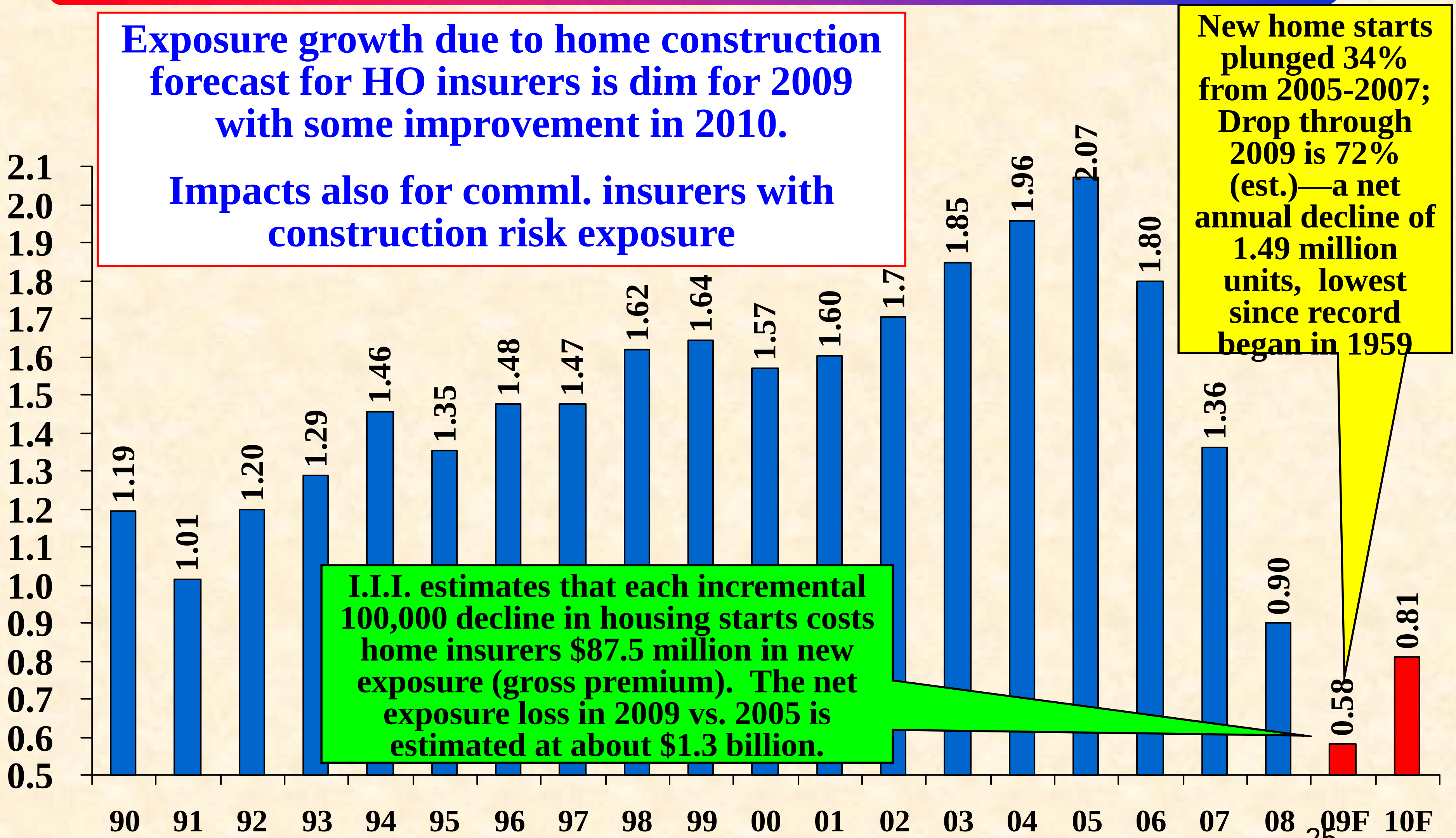
*Average Wage and Salary data as of 7/1/2009.

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

Crisis-Driven Exposure Drivers

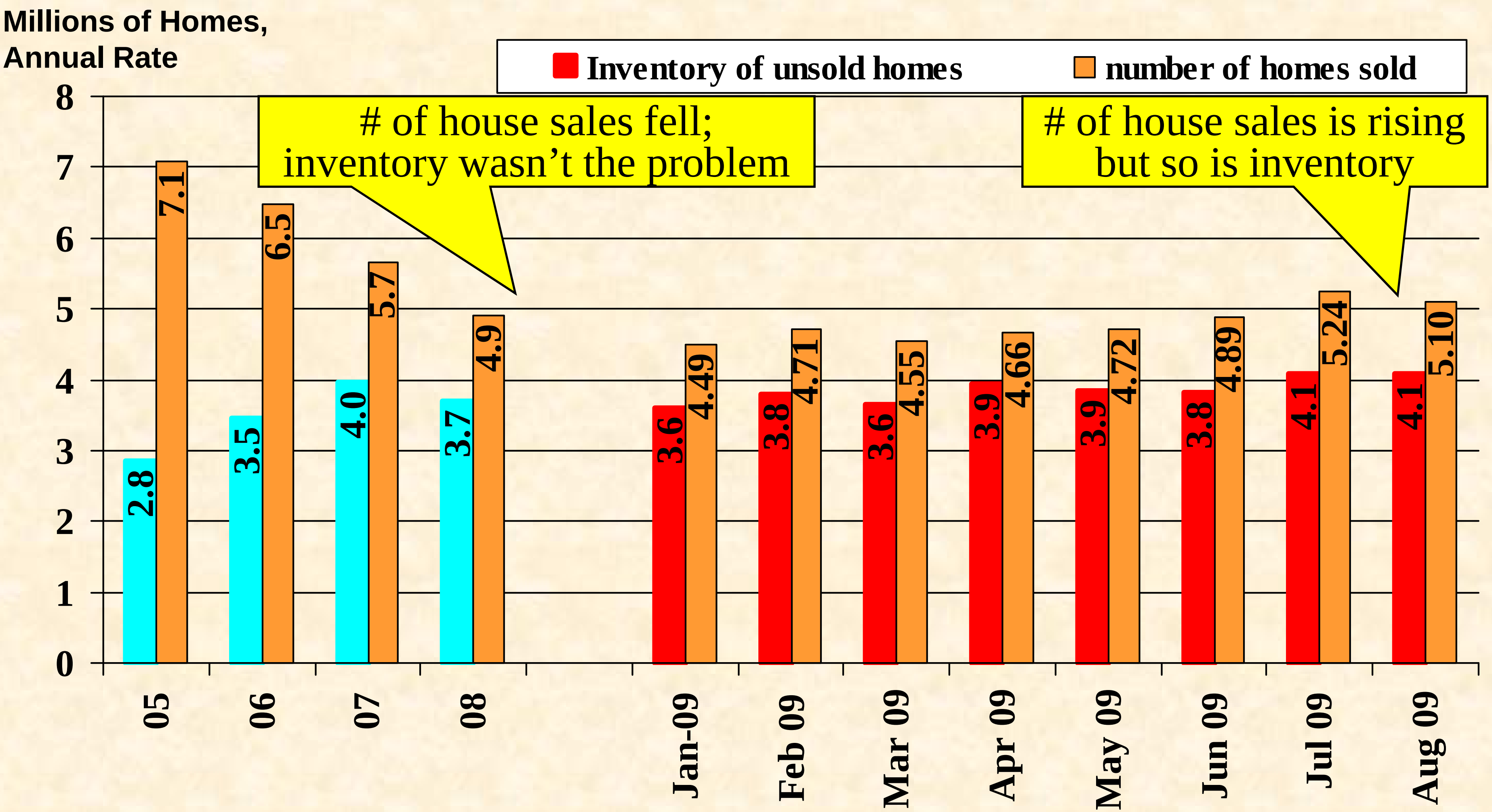
Economic Obstacles to Growth in P/C Insurance

New Private Housing Starts, 1990-2010F (Millions of Units)



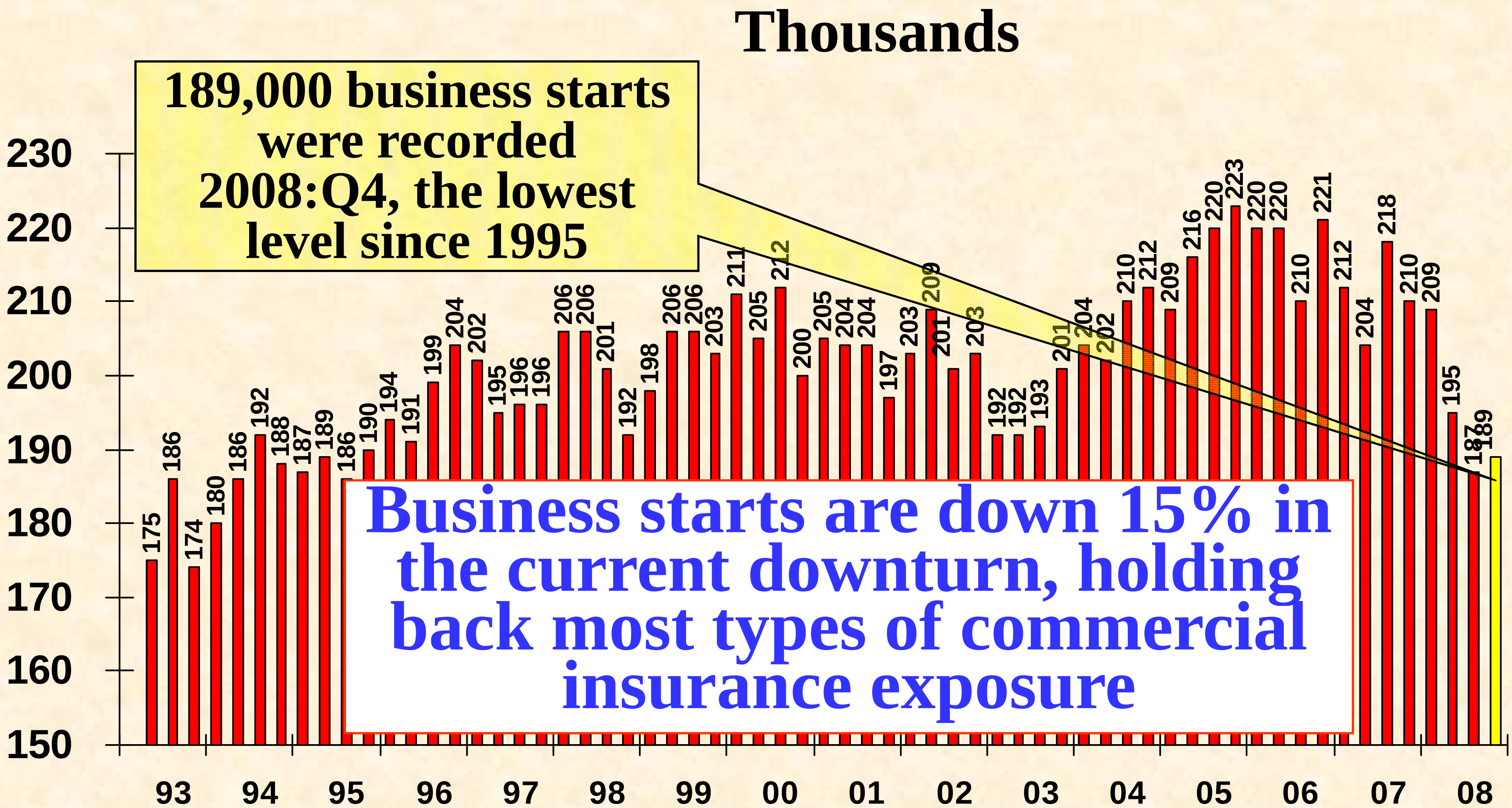
Source: US Department of Commerce; Blue Chip Economic Indicators (10/09); Insurance Information Inst.

High Ratio of Unsold-Homes Inventory to Sales Will Likely Keep Prices Falling



Source: http://www.realtor.org/research/research/ehsdata

Private Sector Business Starts, 1993:Q2-2008:Q4*



*Latest available as of Oct. 2009.

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

Business Bankruptcy Filings, 1980-2009*

Significant implications for bond & surety lines

% Change Surrounding Recessions

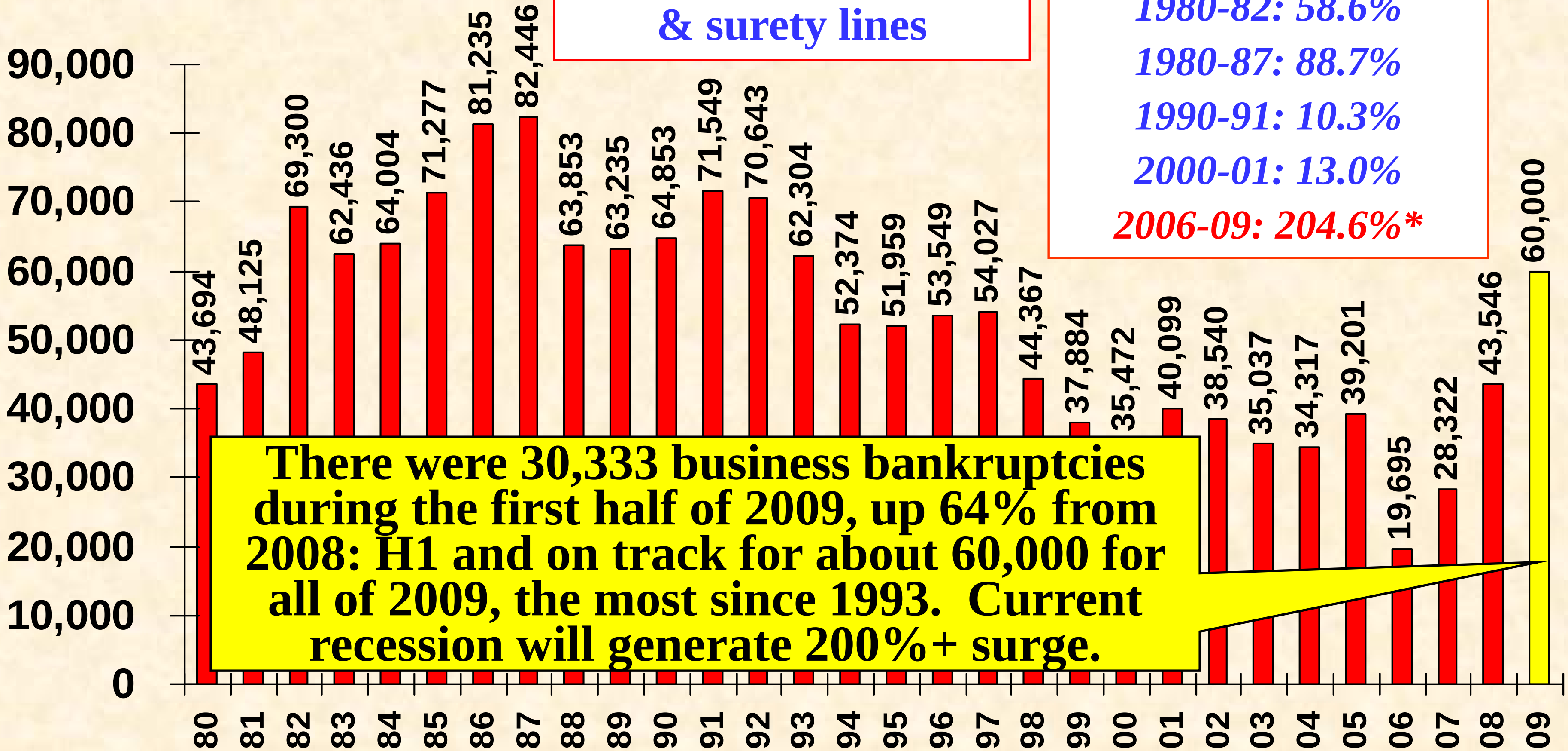
1980-82: 58.6%

1980-87: 88.7%

1990-91: 10.3%

2000-01: 13.0%

*2006-09: 204.6%**

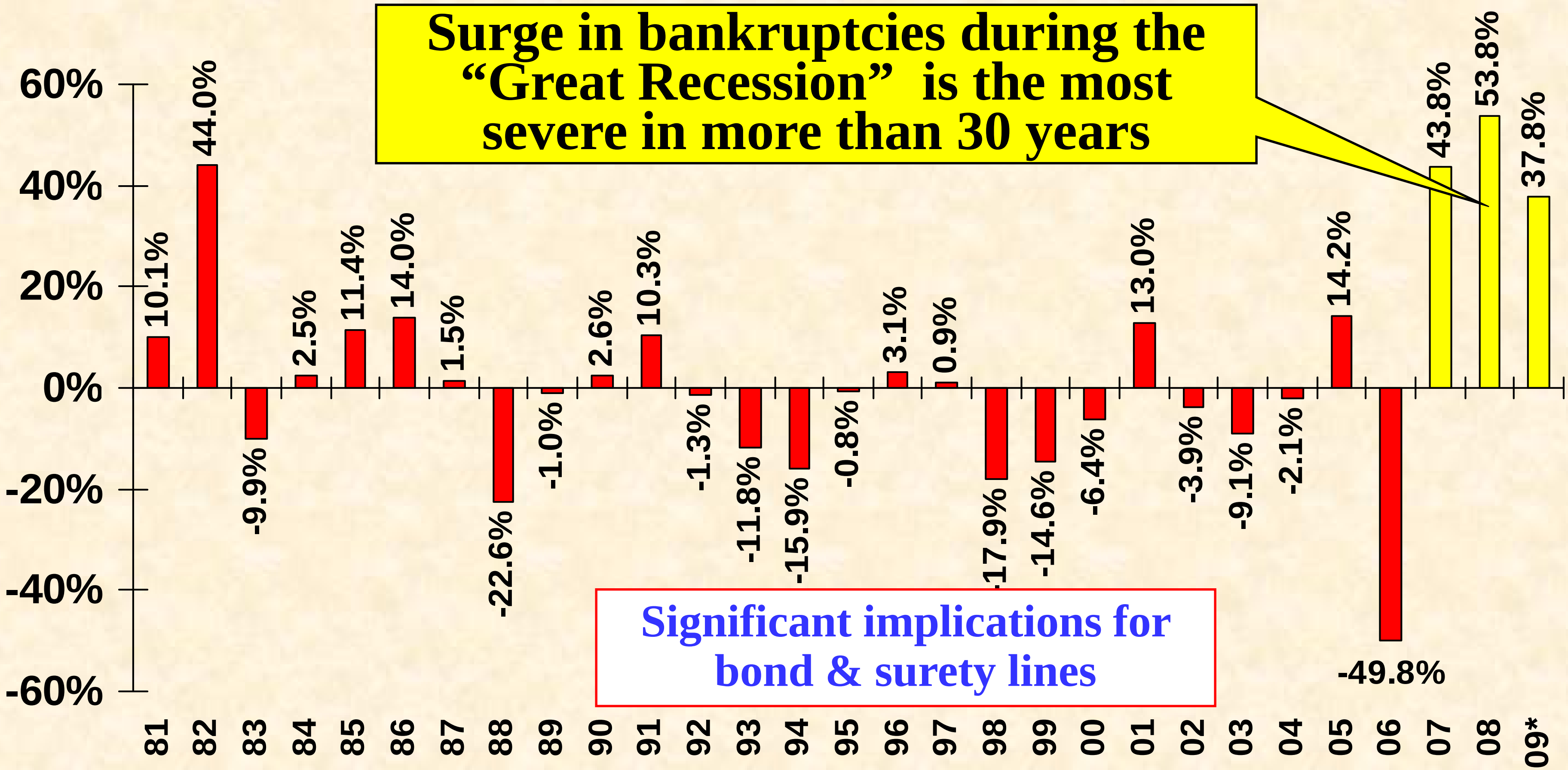


There were 30,333 business bankruptcies during the first half of 2009, up 64% from 2008: H1 and on track for about 60,000 for all of 2009, the most since 1993. Current recession will generate 200%+ surge.

*Based estimate of 60,000 business bankruptcies in 2009; actual first half total was 30,333.

Source: American Bankruptcy Institute; Insurance Information Institute

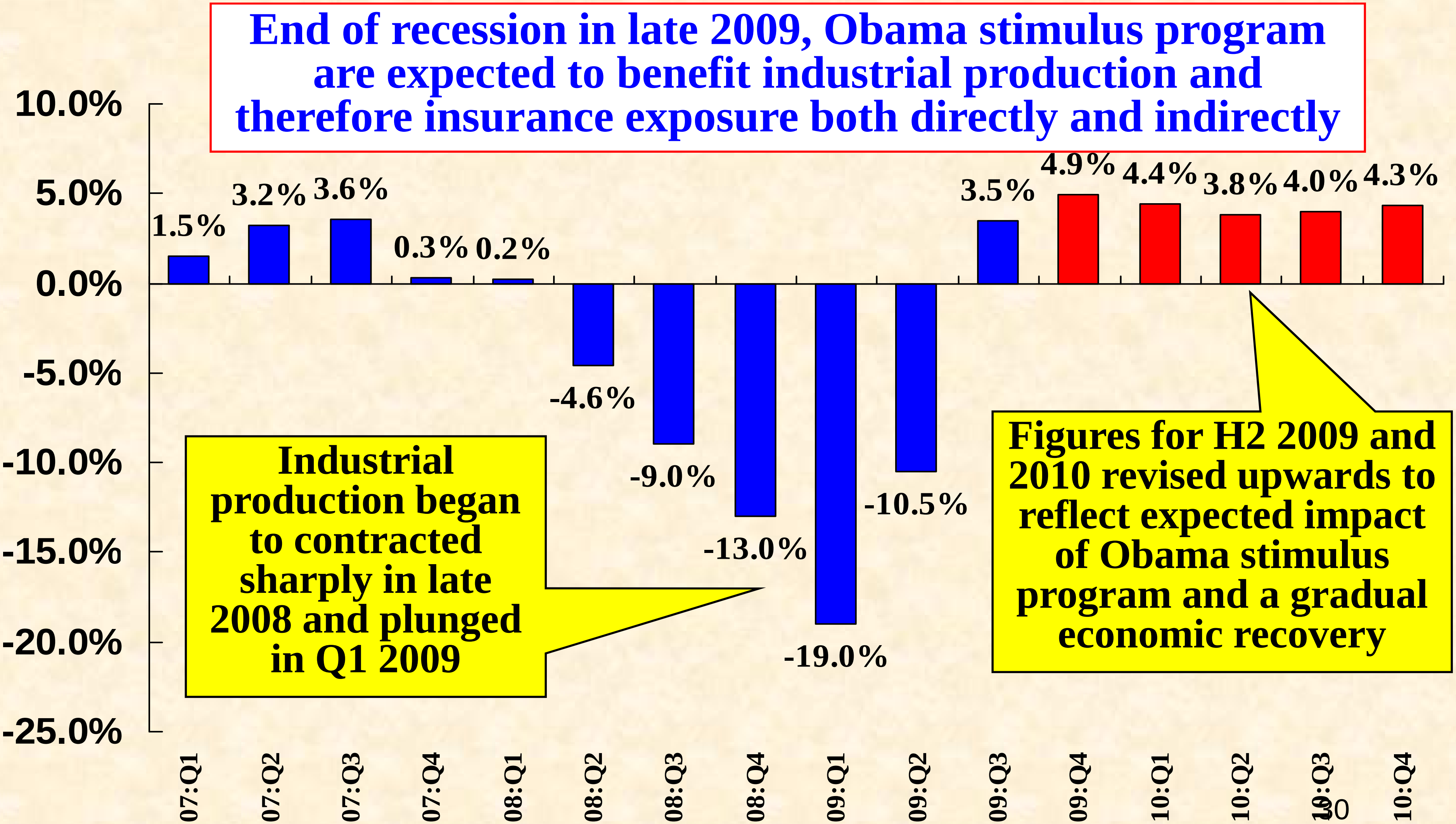
Percent Change in Business Bankruptcy Filings,1980-2009*



*Based estimate of 60,000 business bankruptcies in 2009. All figures are percent change from previous year.

Source: Insurance Information Institute from American Bankruptcy Institute data.

Total Industrial Production, (2007:Q1 to 2010:Q4F)



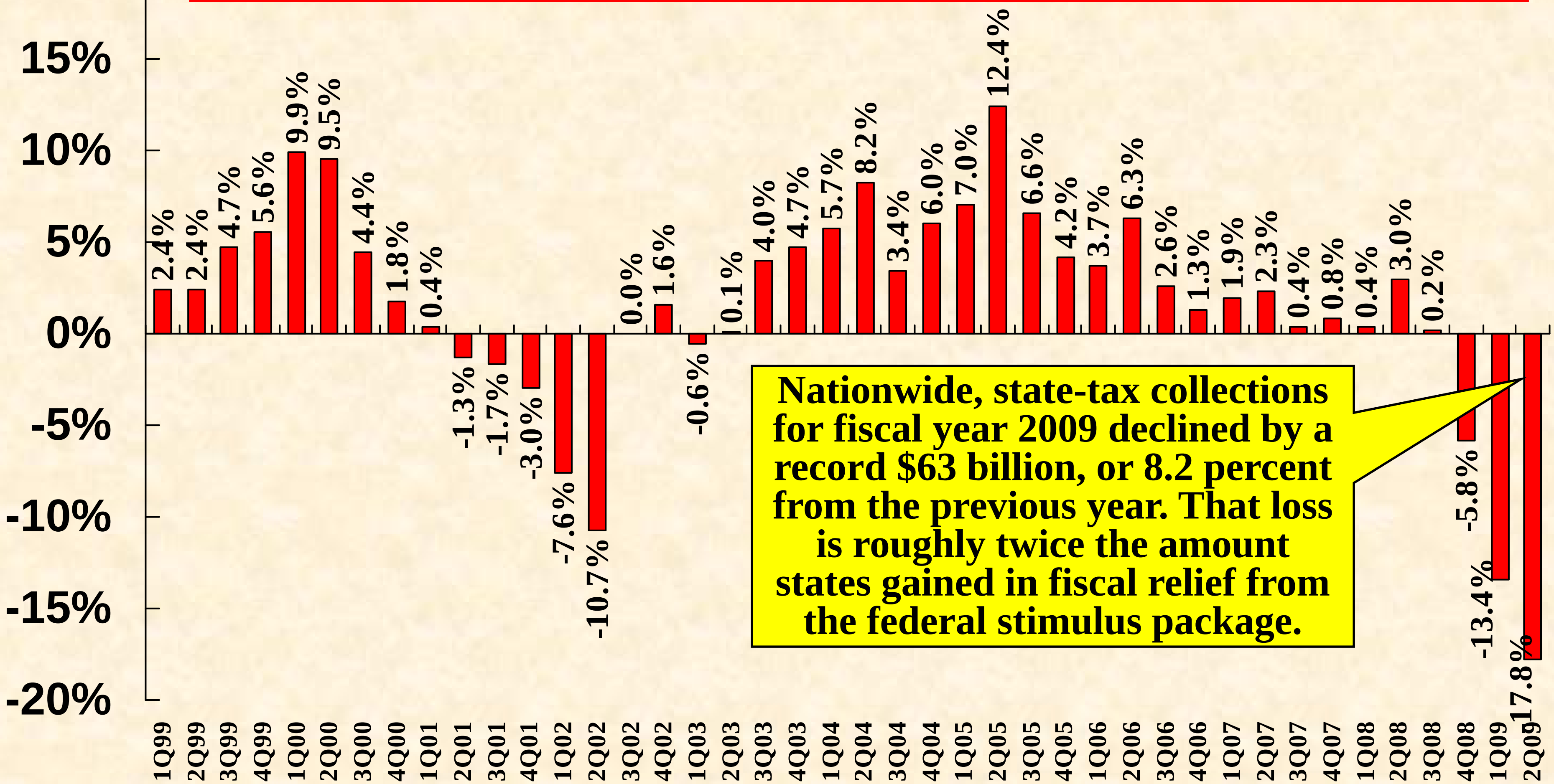
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (10/09); Insurance Info. Inst.

State & Local Government Finances in Dire Straights

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

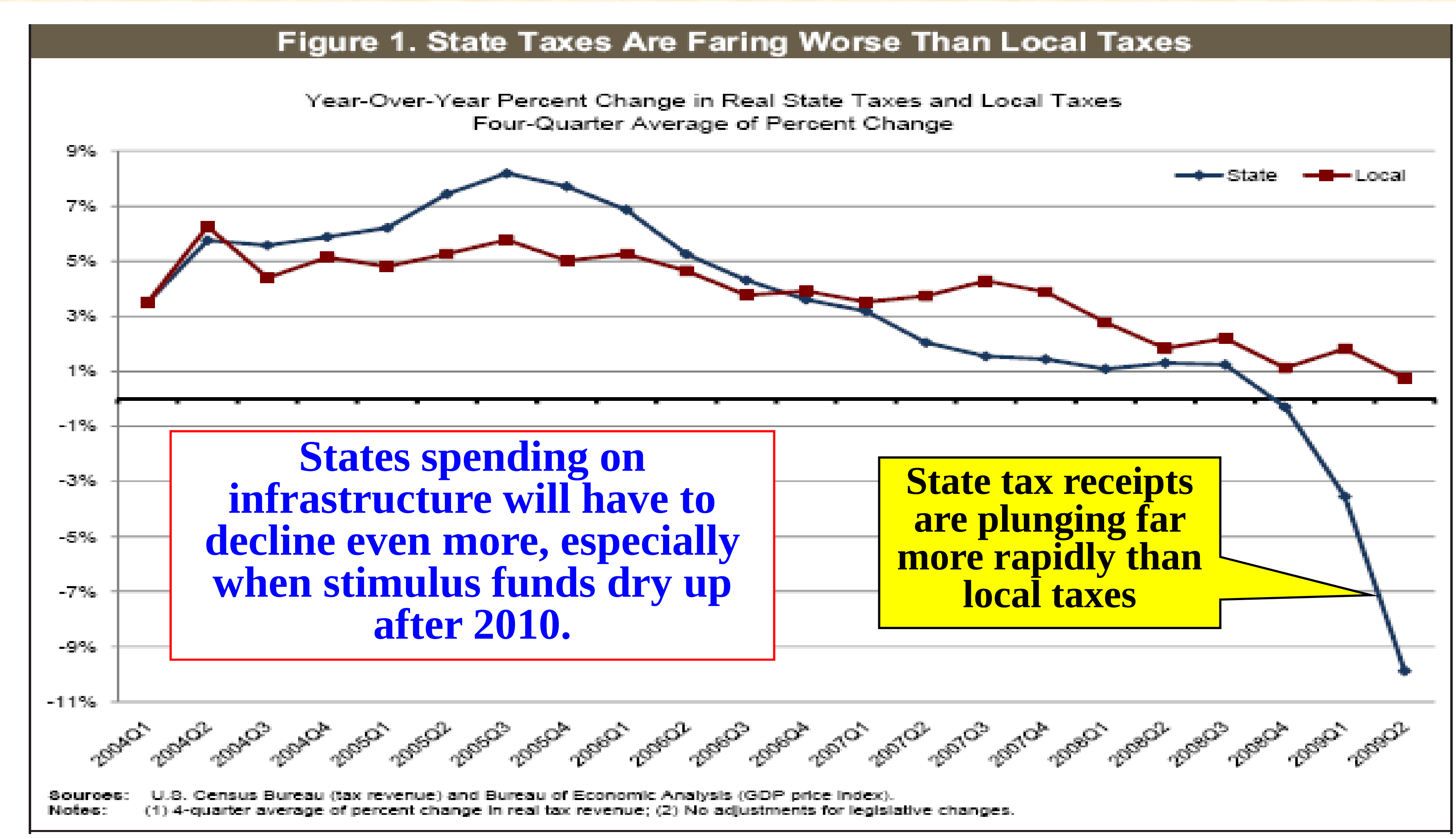
Year-Over-Year Change in Quarterly U.S. State Tax Revenues, Inflation Adjusted

States revenues were down 17.8% in Q2 2009, the second consecutive quarter of record revenue decline. This will impact public infrastructure spending significantly.



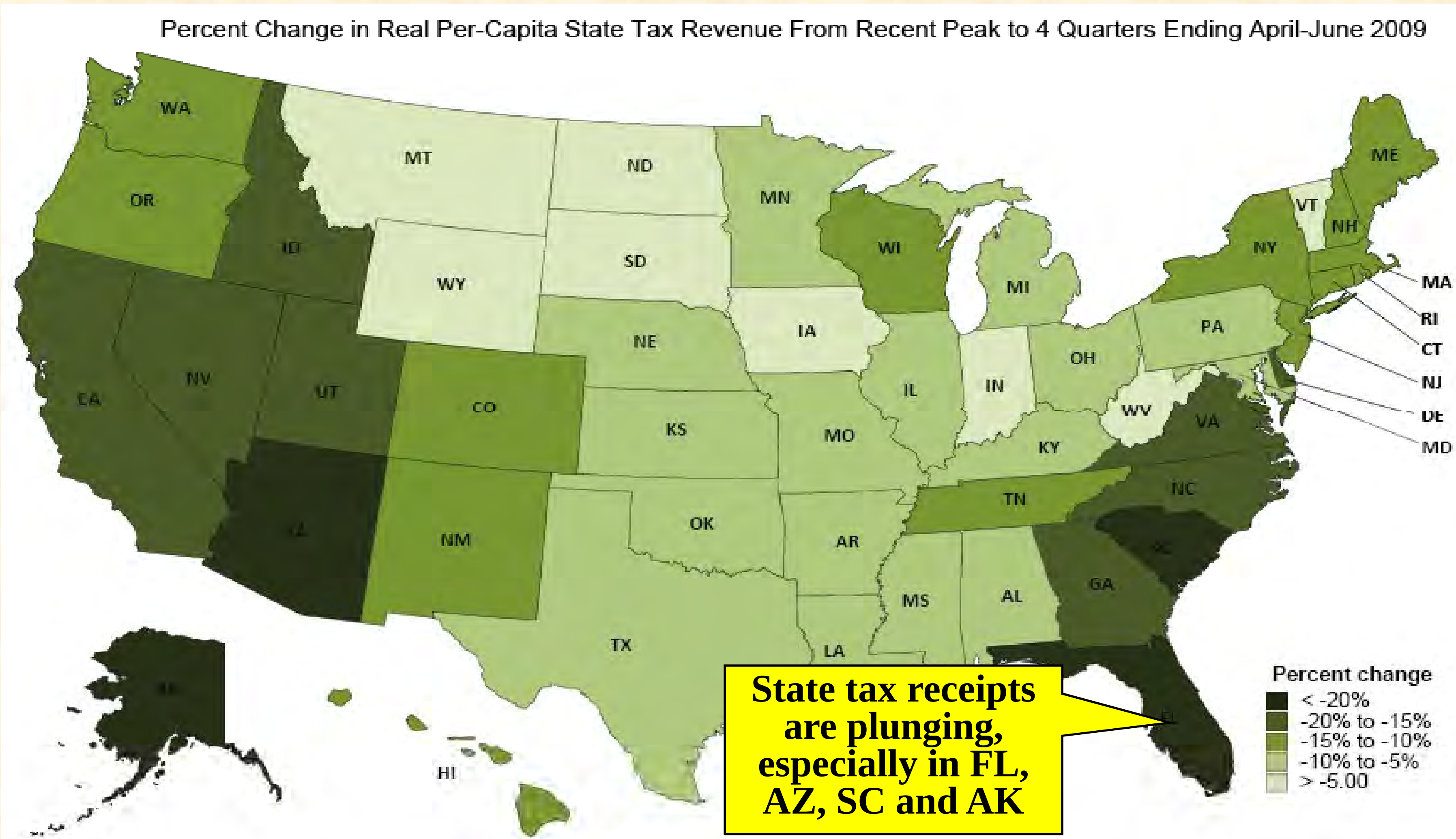
Source: U.S. Census Bureau; Nelson A. Rockefeller Institute of Government:
http://www.rockinst.org/pdf/government_finance/state_revenue_report/2009-10-15-SRR_77.pdf

Year-Over-Year Change in Quarterly State and Local Tax Revenues (Inflation Adjusted)



Source: U.S. Census Bureau; Nelson A. Rockefeller Institute of Government: http://www.rockinst.org/pdf/government_finance/state_revenue_report/2009-10-15-SRR_77.pdf

State Tax Revenue Growth Adjusted for Legislative Changes

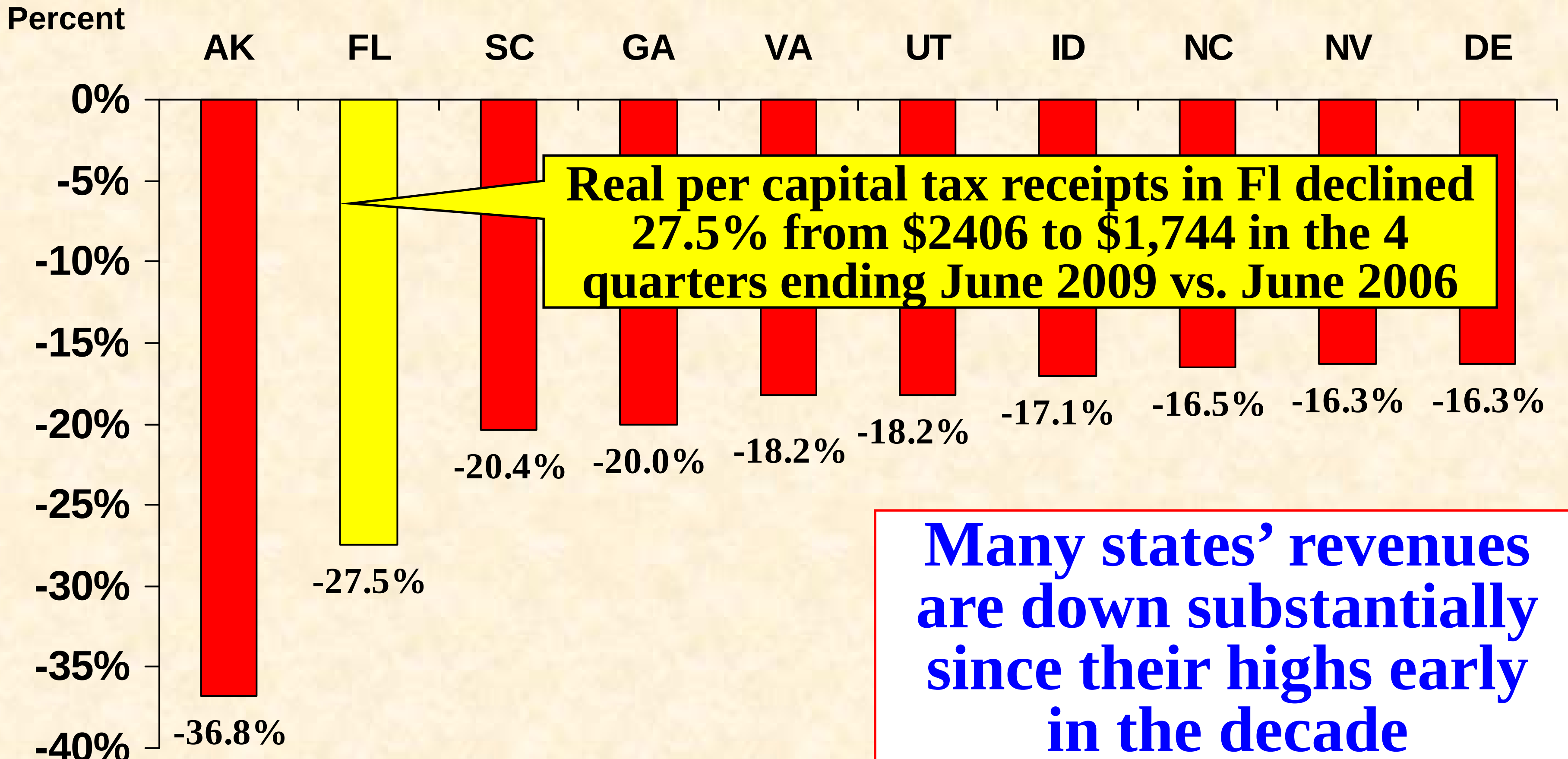


State tax receipts are plunging, especially in FL, AZ, SC and AK

Source: U.S. Census Bureau and Bureau of Economic Analysis; Nelson A. Rockefeller Institute of Government: http://www.rockinst.org/pdf/government_finance/state_revenue_report/2009-10-15-SRR_77.pdf

States with Fastest Decline in Real Per-Capita Tax Revenues

Period Ending April-June 2009 vs. Recent Peak*

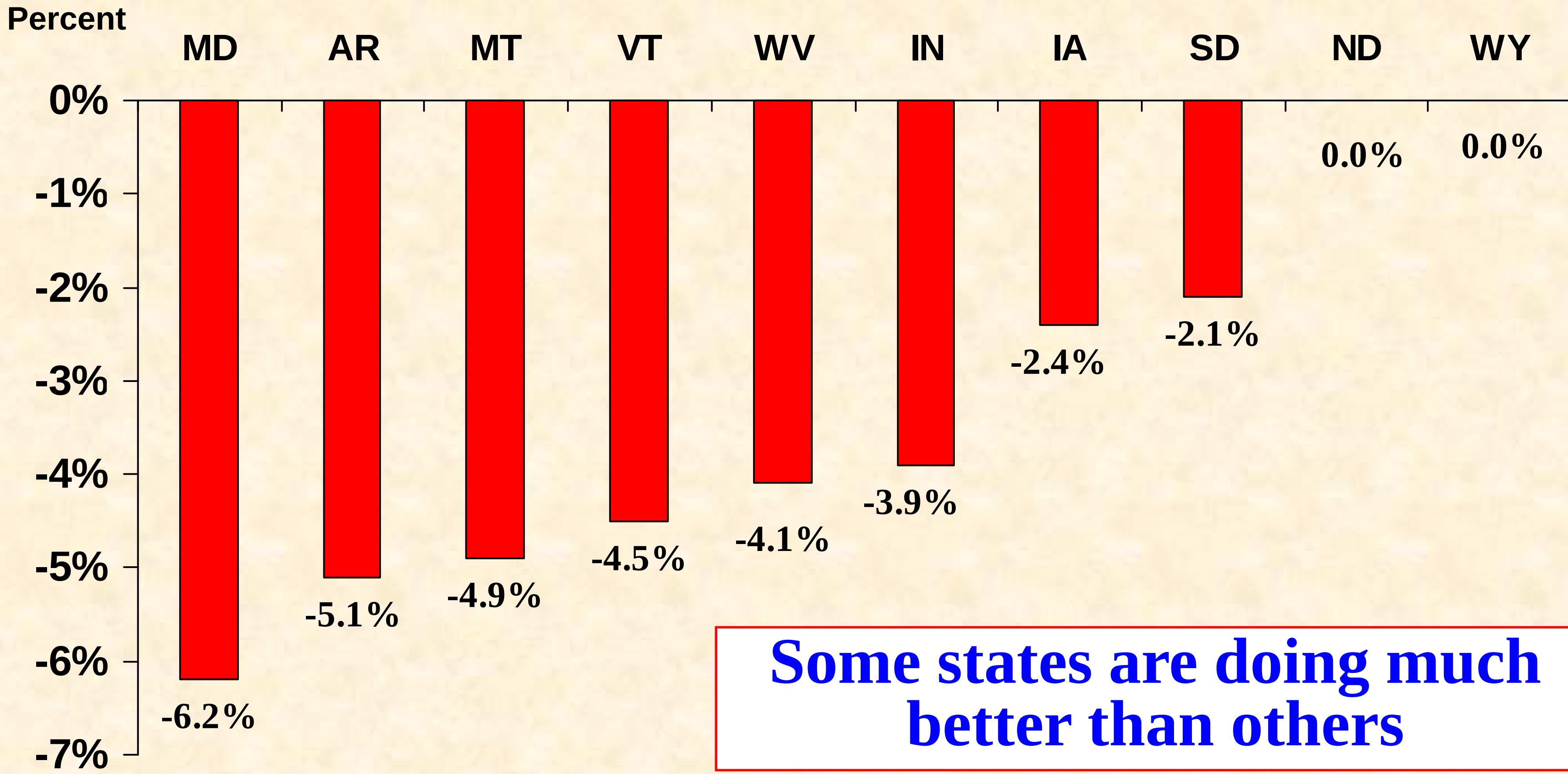


Many states' revenues are down substantially since their highs early in the decade

*Peak defined as July – June period between 2006-2009 with highest peak per capita revenues.
Source: US Bureau of Economic Analysis; Nelson A. Rockefeller Institute of Govt.; Insurance Info. Inst.

States with Slowest Decline in Real Per-Capita Tax Revenues

Period Ending April-June 2009 vs. Recent Peak*



Some states are doing much better than others

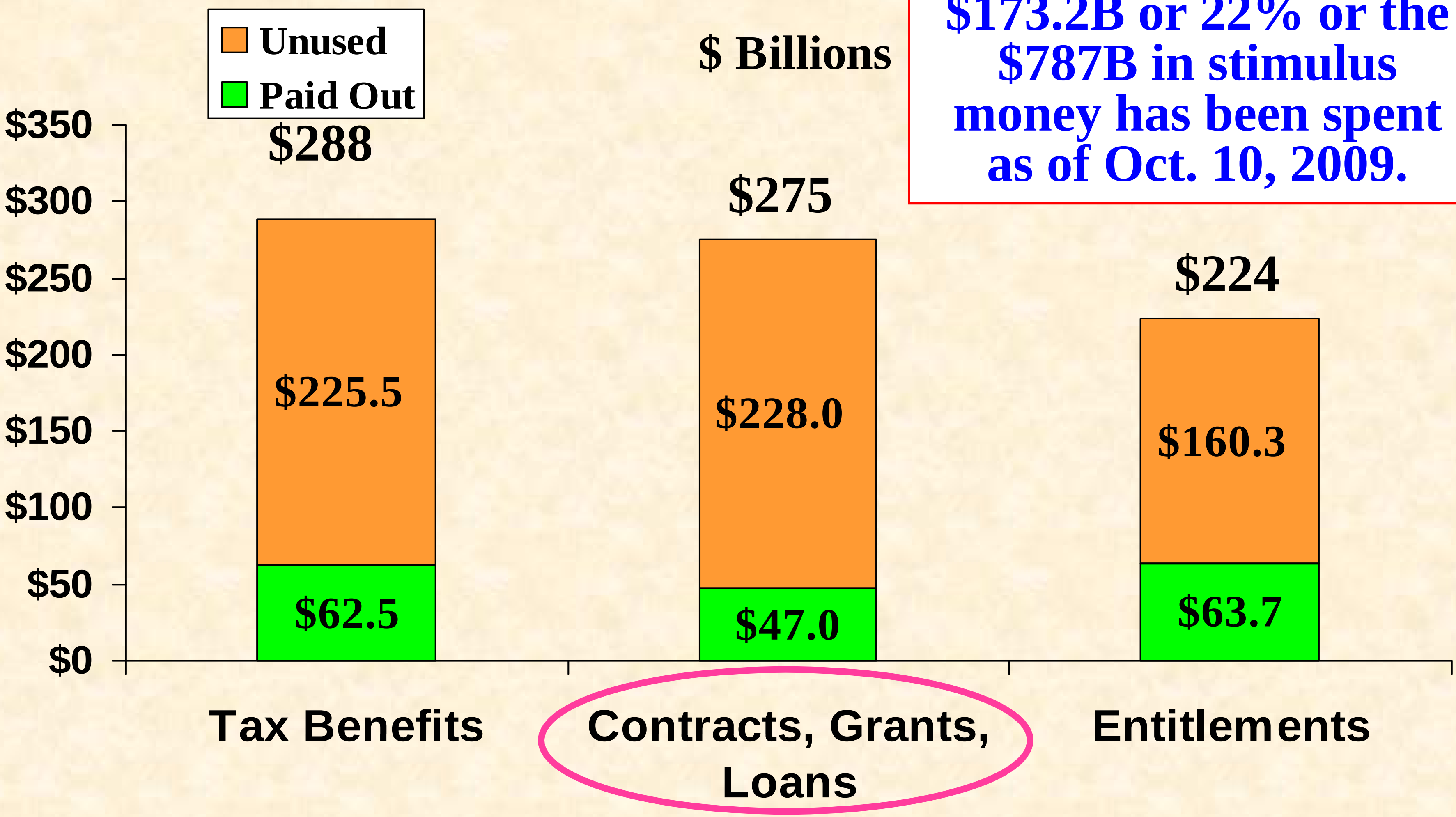
*Peak defined as July – June period between 2006-2009 with highest peak per capita revenues.
Source: US Bureau of Economic Analysis; Nelson A. Rockefeller Institute of Govt.; Insurance Info. Inst.

State-by-State Infrastructure Spending & Job Gains

Bigger States Get More, Should Benefit Commercial Insurers Exposure

*Distribution of $787 B in Stimulus Funds**

$173.2B or 22% or the $787B in stimulus money has been spent as of Oct. 10, 2009.



*As of 10/10/09

Source: www.recovery.gov accessed 10/17/09; Insurance Information Institute.

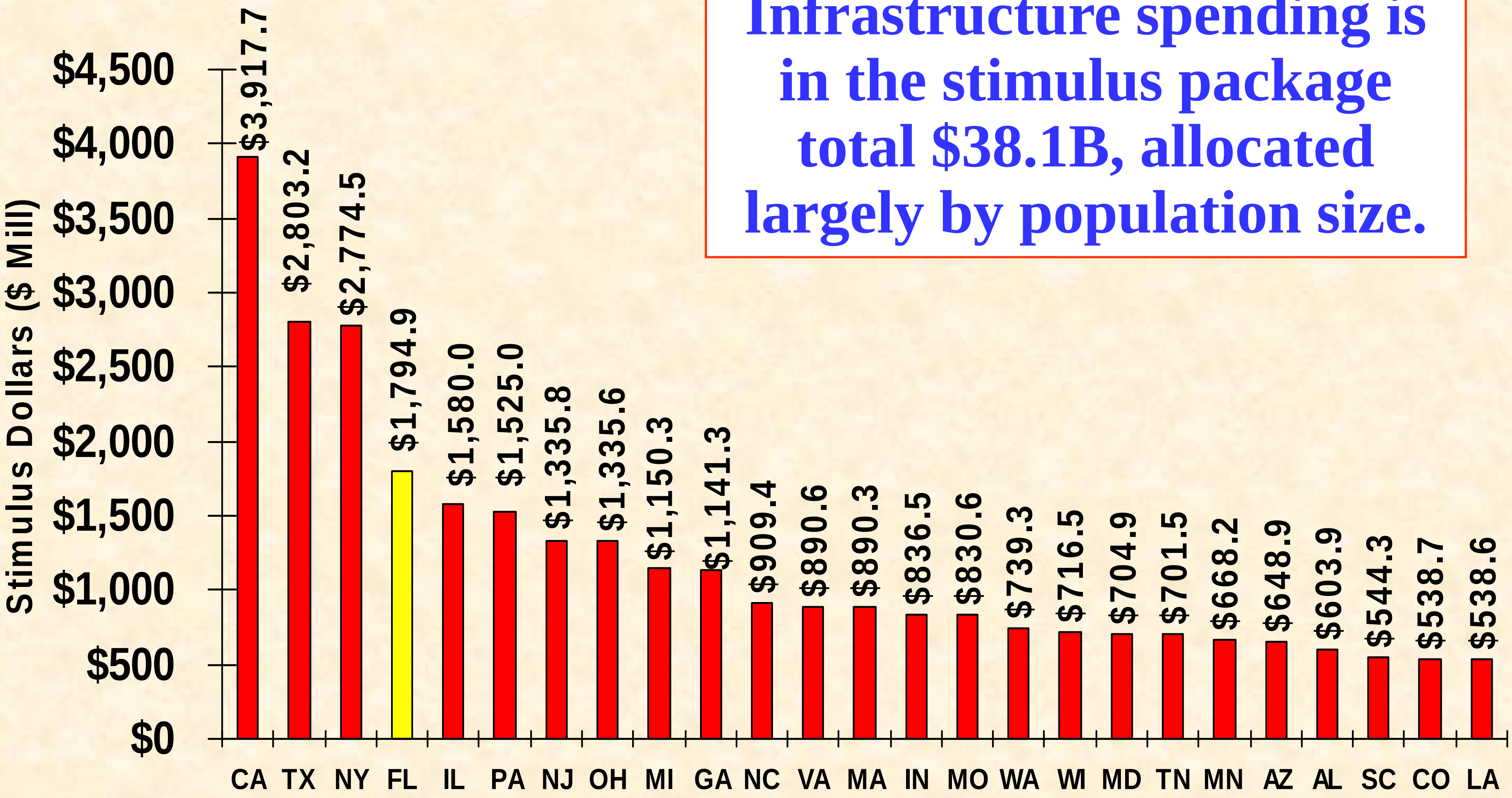
Infrastructure Stimulus Spending by State (Total = $38.1B)

State	Allocation	State	Allocation	State	Allocation
AL	$603,871,807	LA	$538,575,876	OK	$535,407,908
AK	$240,495,117	ME	$174,285,111	OR	$453,788,475
AZ	$648,928,995	MD	$704,863,248	PA	$1,525,011,979
AR	$405,531,459	MA	$890,333,825	RI	$192,902,023
CA	$3,917,656,769	MI	$1,150,282,308	SC	$544,291,398
CO	$538,669,174	MN	$668,242,481	SD	$213,511,174
CT	$487,480,166	MS	$415,257,720	TN	$701,516,776
DE	$158,666,838	MO	$830,647,063	TX	$2,803,249,599
DC	$267,617,455	MT	$246,599,815	UT	$292,231,904
FL	$1,794,913,566	NE	$278,897,762	VT	$150,666,577
GA	$1,141,255,941	NV	$270,010,945	VA	$890,584,959
HI	$199,866,172	NH	$181,678,856	WA	$739,283,923
ID	$219,528,313	NJ	$1,335,785,100	WV	$290,479,108
IL	$1,579,965,373	NM	$299,589,086	WI	$716,457,120
IN	$836,483,568	NY	$2,774,508,711	WY	$186,111,170
IA	$447,563,924	NC	$909,397,136	U.S. Territories	$238,045,760
KS	$413,837,382	ND	$200,318,301		
KY	$521,153,404	OH	$1,335,600,553	Total	$38,101,898,173

Sources: USA Today, 2/17/09; House Transportation and Infrastructure Committee; the Associated Press.

Infrastructure Stimulus Spending By State: Top 25 States ($ Millions)

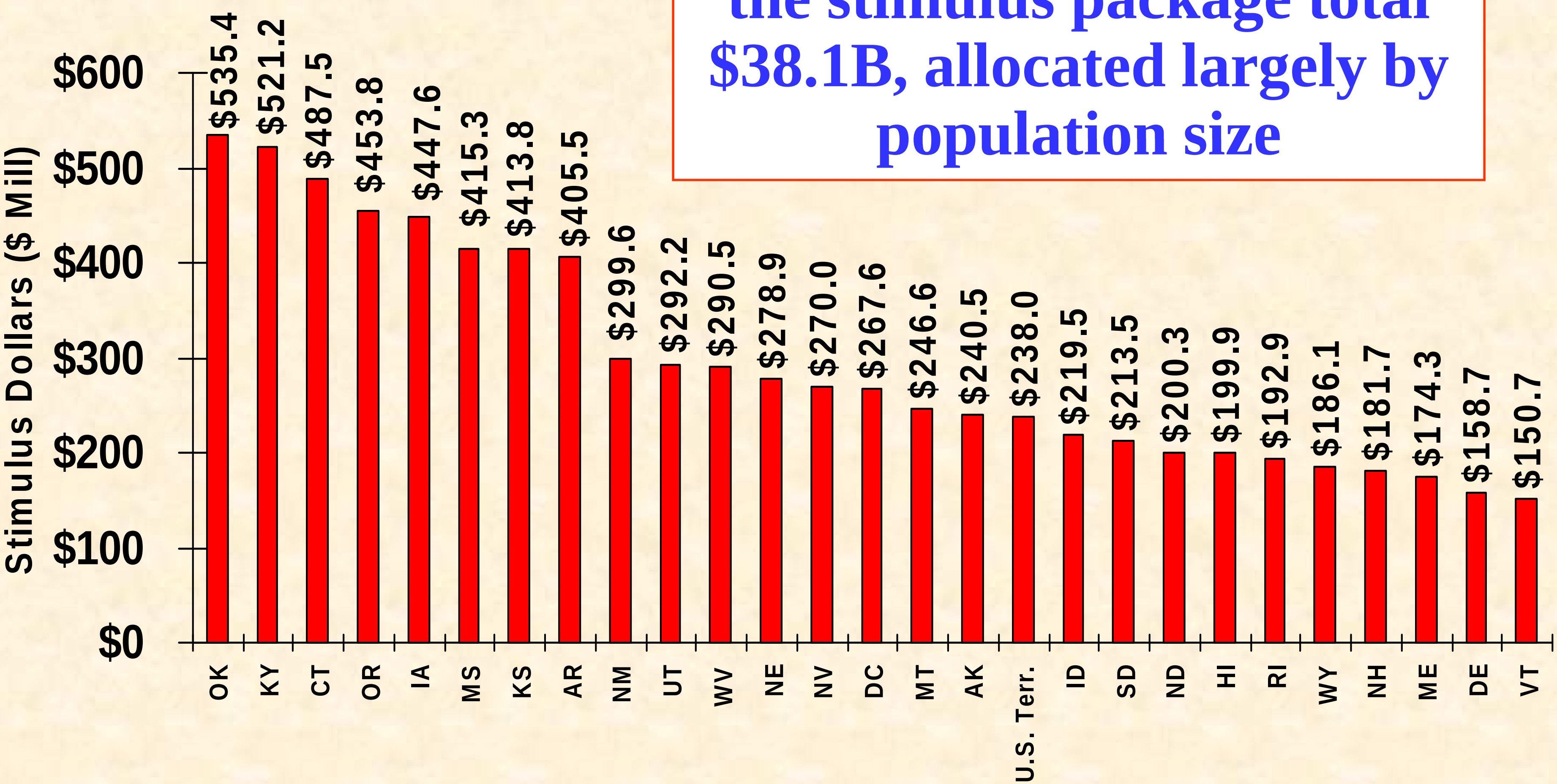
Infrastructure spending is in the stimulus package total $38.1B, allocated largely by population size.



Sources: USA Today 2/19/09; House Transportation and Infrastructure Committee; the Associated Press.

Infrastructure Stimulus Spending By State: Bottom 25 States ($ Millions)

Infrastructure spending is in the stimulus package total $38.1B, allocated largely by population size



Sources: USA Today 2/19/09; House Transportation and Infrastructure Committee; the Associated Press.

Expected Number of Jobs Gained or Preserved by Stimulus Spending

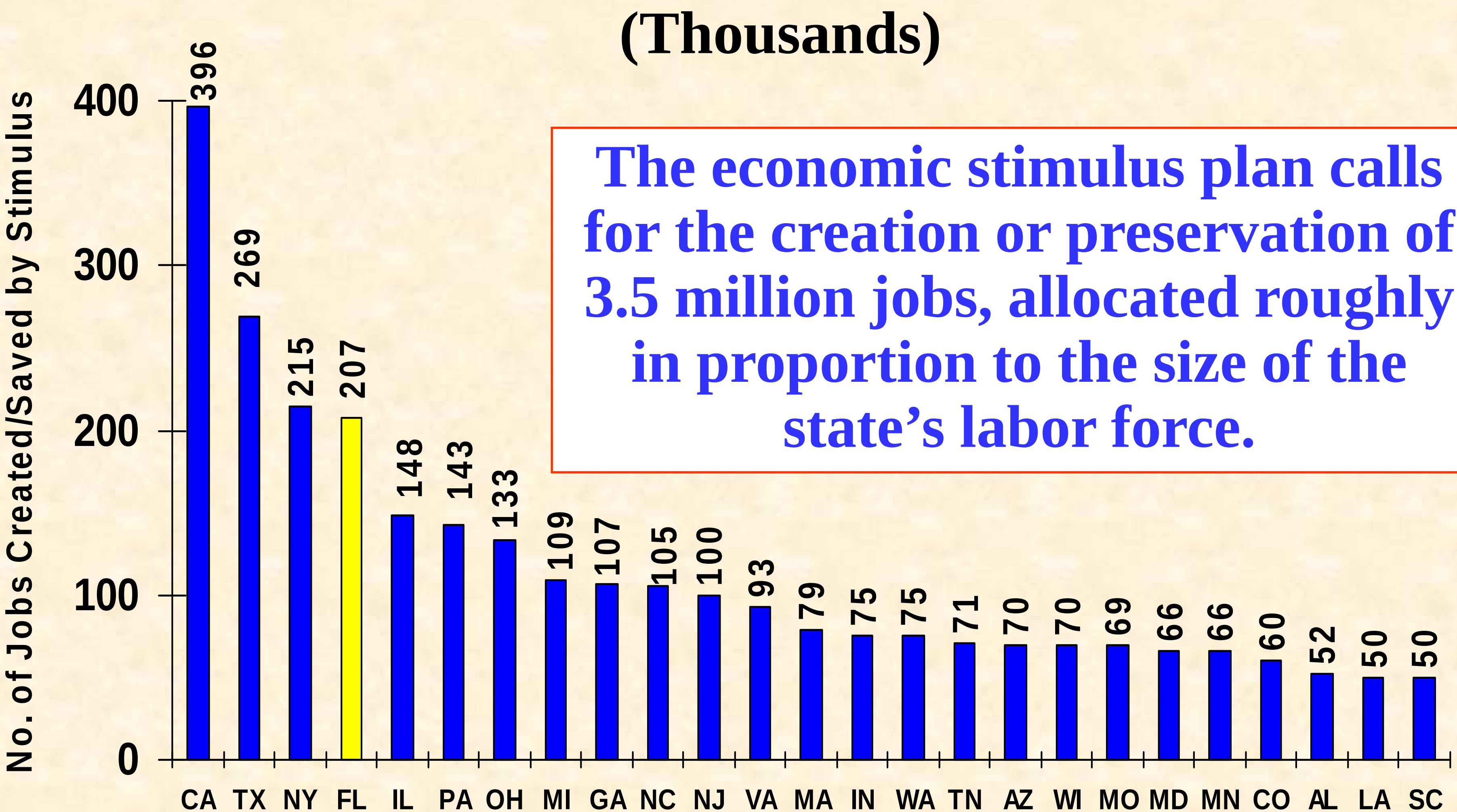
Larger States = More Jobs
Workers Comp Benefits

Estimated Job Effect of Stimulus: Jobs Created/Saved By State = 3.5 Mill Total

State	Jobs Created	State	Jobs Created	State	Jobs Created
AL	52,000	LA	50,000	OK	40,000
AK	8,000	ME	15,000	OR	44,000
AZ	70,000	MD	66,000	PA	143,000
AR	32,000	MA	79,000	RI	12,000
CA	396,000	MI	109,000	SC	50,000
CO	60,000	MN	66,000	SD	10,000
CT	41,000	MS	30,000	TN	71,000
DE	11,000	MO	69,000	TX	269,000
DC	12,000	MT	11,000	UT	32,000
FL	207,000	NE	23,000	VT	8,000
GA	107,000	NV	34,000	VA	93,000
HI	16,000	NH	16,000	WA	75,000
ID	17,000	NJ	100,000	WV	20,000
IL	148,000	NM	22,000	WI	70,000
IN	75,000	NY	215,000	WY	8,000
IA	37,000	NC	105,000		
KS	33,000	ND	9,000		
KY	48,000	OH	133,000	Total	3,467,000

Sources: http://www.recovery.gov/; Council of Economic Advisers; Insurance Information Institute.

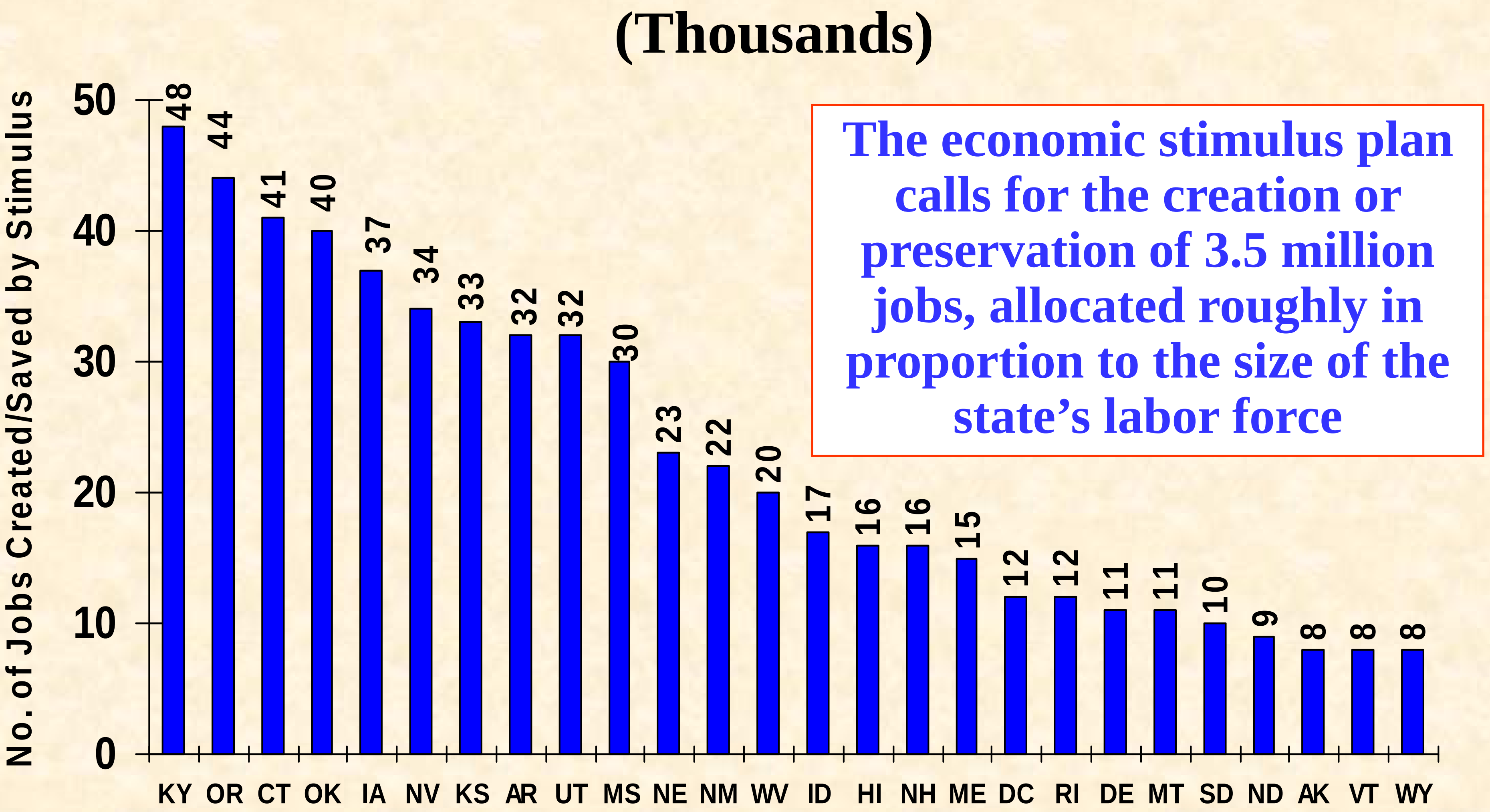
Estimated Job Effect of Stimulus Spending By State: Top 25 States



The economic stimulus plan calls for the creation or preservation of 3.5 million jobs, allocated roughly in proportion to the size of the state's labor force.

Sources: http://www.recovery.gov/; Council of Economic Advisers Insurance Information Institute.

Estimated Job Effect of Stimulus Spending By State: Bottom 25 States



Sources: http://www.recovery.gov/; Council of Economic Advisers Insurance Information Institute.

GREEN SHOOTS

Is the Recession Nearing an End?

Hopeful Signs that the Economic Recovery Is Underway

- Recession Appears to be Bottoming Out, Freefall Has Ended
  - Pace of GDP shrinkage is beginning to diminish
  - Pace of job losses is slowing
  - Major stock market indices well off record lows, anticipating recovery
  - Some signs of retail sales stabilization are evident
- Financial Sector is Stabilizing
  - Banks are reporting quarterly profits
  - Many banks expanding lending to <u>very</u> credit worthy people & businesses
- Housing Sector Seems To Be Bottoming Out
  - Home are much more affordable (attracting buyers)
  - Mortgage rates are still low relative to pre-crisis levels (attracting buyers)
  - Freefall in housing starts and existing home sales is ending in many areas
- Inflation & Energy Prices Are Under Control
- Consumer & Business Debt Loads Are Shrinking

Source: Ins. Info. Inst.

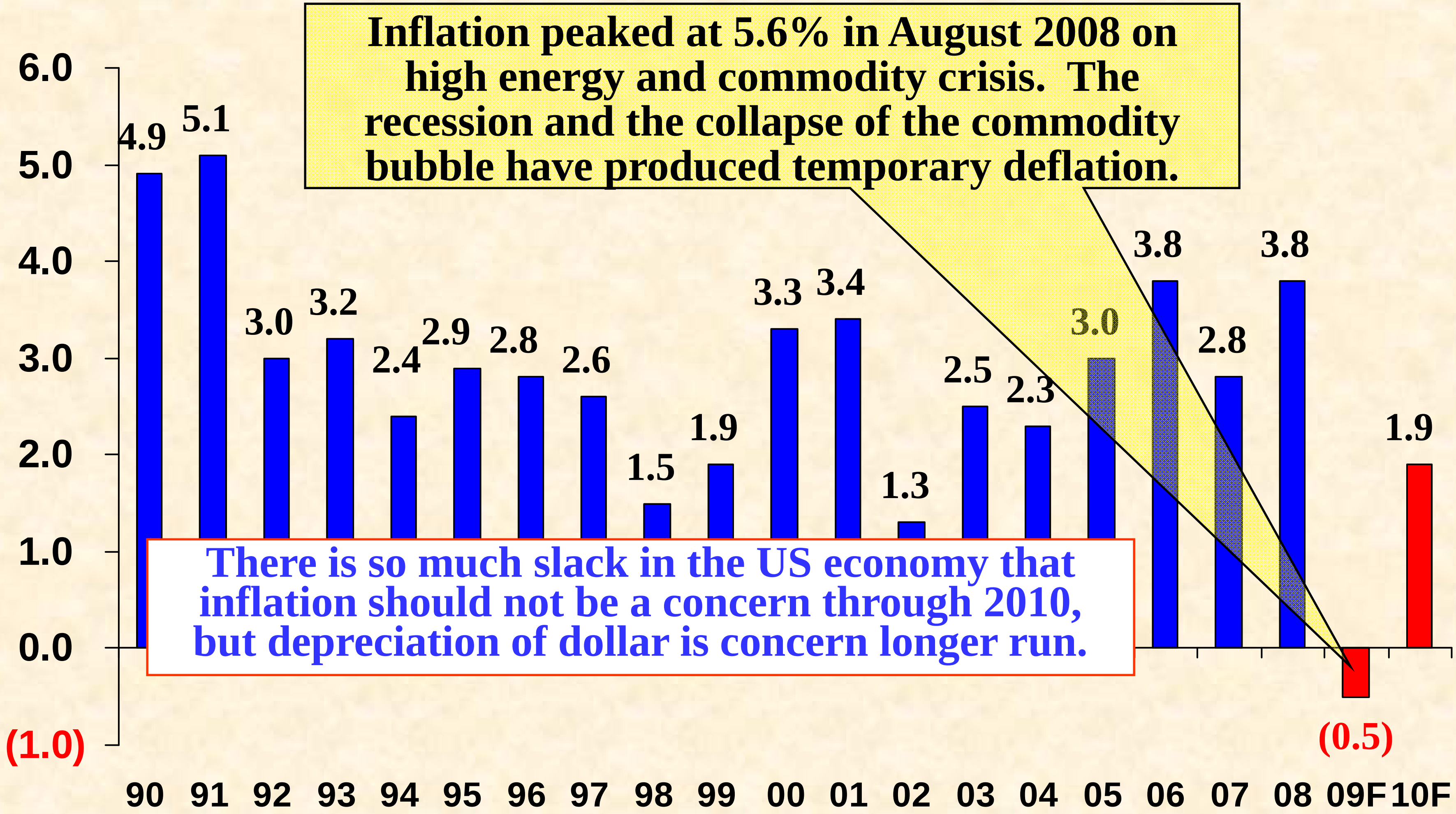
11 Industries for the Next 10 Years: Insurance Solutions Needed

Government
Education
Health Care
Energy (Traditional)
Alternative Energy
Agriculture
Natural Resources
Environmental
Technology
Light Manufacturing
Export Oriented Industries

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

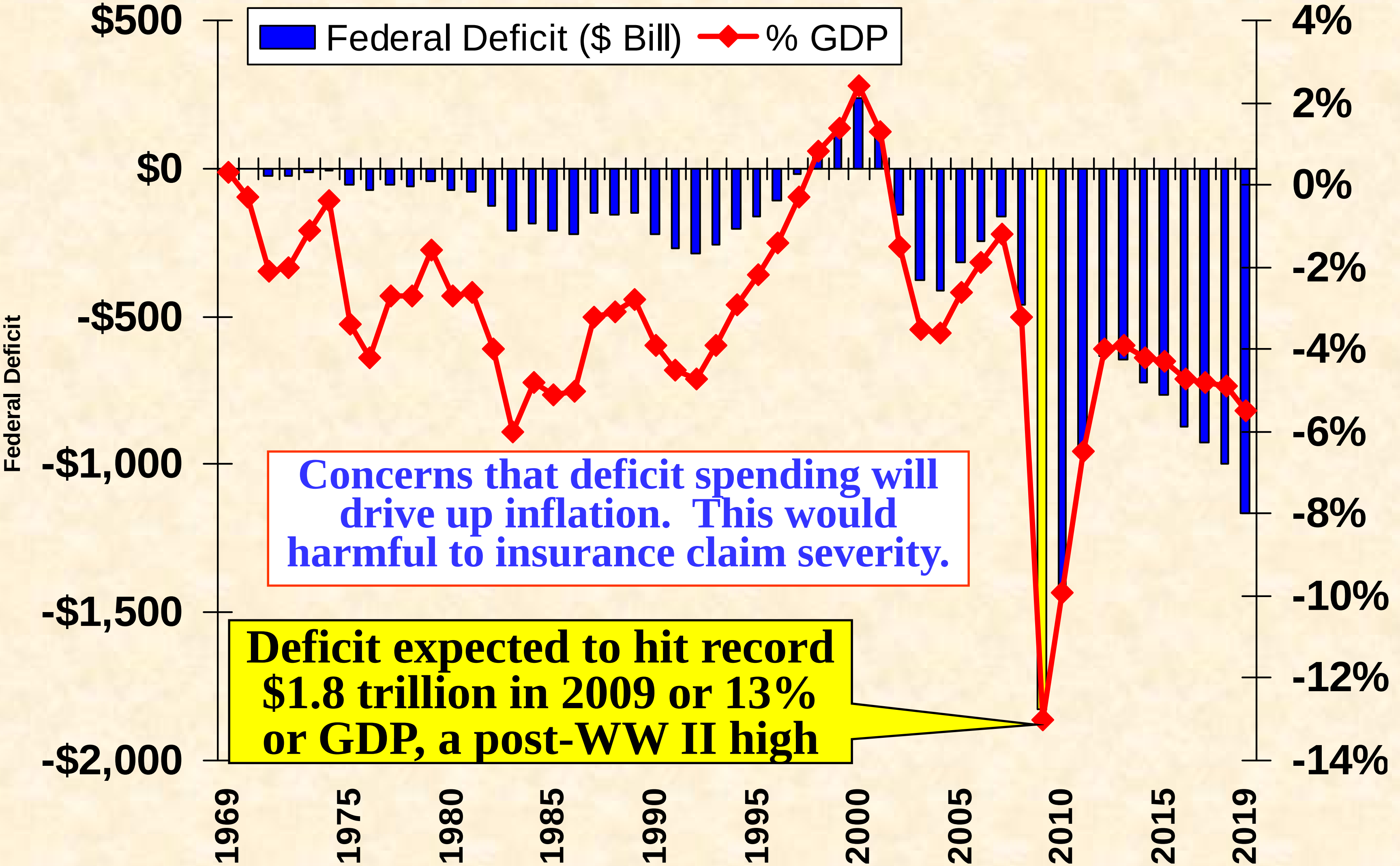
Mounting Pressure on Claim Cost Severities?

Annual Inflation Rates (CPI-U, %), 1990-2010F



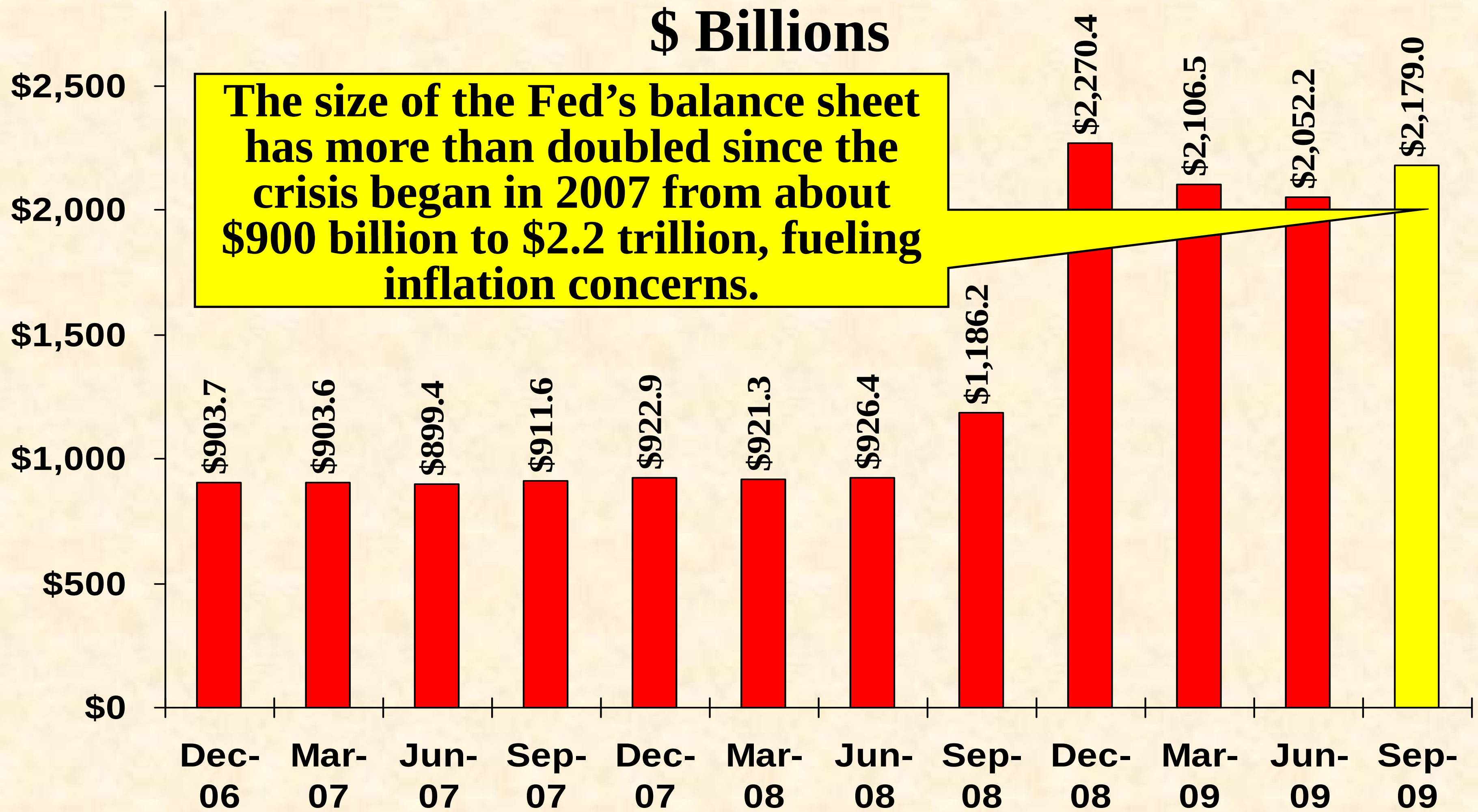
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, Oct. 10, 2009 (forecasts).

US Budget Deficit, 1969-2019F



Sources: Congressional Budget Office analysis of President's budget, March 2009; Insurance Information Institute.

*Balance Sheet of the Federal Reserve, Dec. 2006- Sept. 2009**



*As of final Friday in each quarter.

Source: Federal Reserve: http://www.federalreserve.gov/releases/h41/hist/h41hist1.htm

Top Concerns/Risks for Insurers if Inflation is Reignited

CONCERNS: The Federal Reserve Has Flooded Financial System with Cash (Turned on the Printing Presses), the Federal Govt. 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 re-insurance more quickly and potential exhausting their reinsurance more quickly**

Source: Ins. Info. Inst.

Key Threats Facing Insurers Amid Financial Crisis

Challenges for the Next 5-8 Years

Important Issues & Threats Facing Insurers: 2009 - 2015

1. Erosion of Capital

- Losses were larger and occurred more rapidly than is commonly understood or presumed
- Max surplus loss at 3/31/09 was 16%=$85B from 9/30/07 peak
- P/C policyholder surplus loss could have been much larger
- Decline in PHS of 1999-2002 was 15% over 3 years and was entirely made up and them some in 2003. Current decline was ~16% in 5 qtrs.
- During the opening years of the Great Depression (1929-1933) PHS fell 37%, Assets fell 28% and Net Written Premiums fell by 35%. It took until 1939-40 before these key measures returned to their 1929 peaks.
- **BOTTOM LINE: Capital and assets fell farther and faster than many believed possible. It will take years to return to the 2007 peaks—likely 2011 (without market relapse).**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

2. Reloading Capital After "Capital Event"

- **Continued asset price erosion coupled with major "capital event" would have led to shortage of capital among *some* companies**
- **Possible Consequences: Insolvencies, forced mergers, calls for govt. aid, requests to relax capital requirements**
- **P/C insurers have come to assume that large amounts of capital can be raised quickly and cheaply after major events (post-9/11, Katrina).**
  - ***This assumption may be incorrect in the current environment***
- **Cost of capital is *much* higher today (relative "risk-free" rates), reflecting both scarcity & risk**
- **Implications: P/C (re)insurers need to protect capital today and develop detailed contingency plans to raise fresh capital & generate internally. Already a reality for some life insurers.**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

3. Long-Term Reduction in Investment Earnings

- **Low interest rates, risk aversion toward equities and many categories of fixed income securities lock in a multi-year trajectory toward ever lower investment gains**
- **Fed actions in Treasury markets keep yields low**
- **Many insurers have not adjusted to this new investment paradigm of a sustained period of low investment gains**
- ***Regulators will not readily accept it*; Many will reject it**
- **Implication 1: Industry must be prepared to operate in environment with investment earnings accounting for a smaller fraction of profits**
- **Implication 2: Implies underwriting discipline of a magnitude not witnessed in this industry in more than 30 years. Yet to manifest itself.**
- **Lessons from the period 1920-1975 need to be relearned**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 – 2???

4. Regulatory Overreach

- **Principle danger is that P/C insurers get swept into vast federal regulatory overhaul and subjected to inappropriate, duplicative and costly regulation (Dual Regulation)**
- **Strong arguments for Optional Federal Charter, but…**
- **Pushing for major change is not without risk in the current highly charged political environment**
- **Dangers exist if feds get their nose under the tent**
- **Status Quo is viewed as unacceptable by all**
- **Disunity within the insurance industry**
- **Insurance & systemic risk—Who is important?**
- **Impact of regulatory changes will be felt for <u>decades</u>**
- **Bottom Line: Regulatory outcome is uncertain and risk of adverse outcome exists**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 -2015

5. Emerging Tort Threat

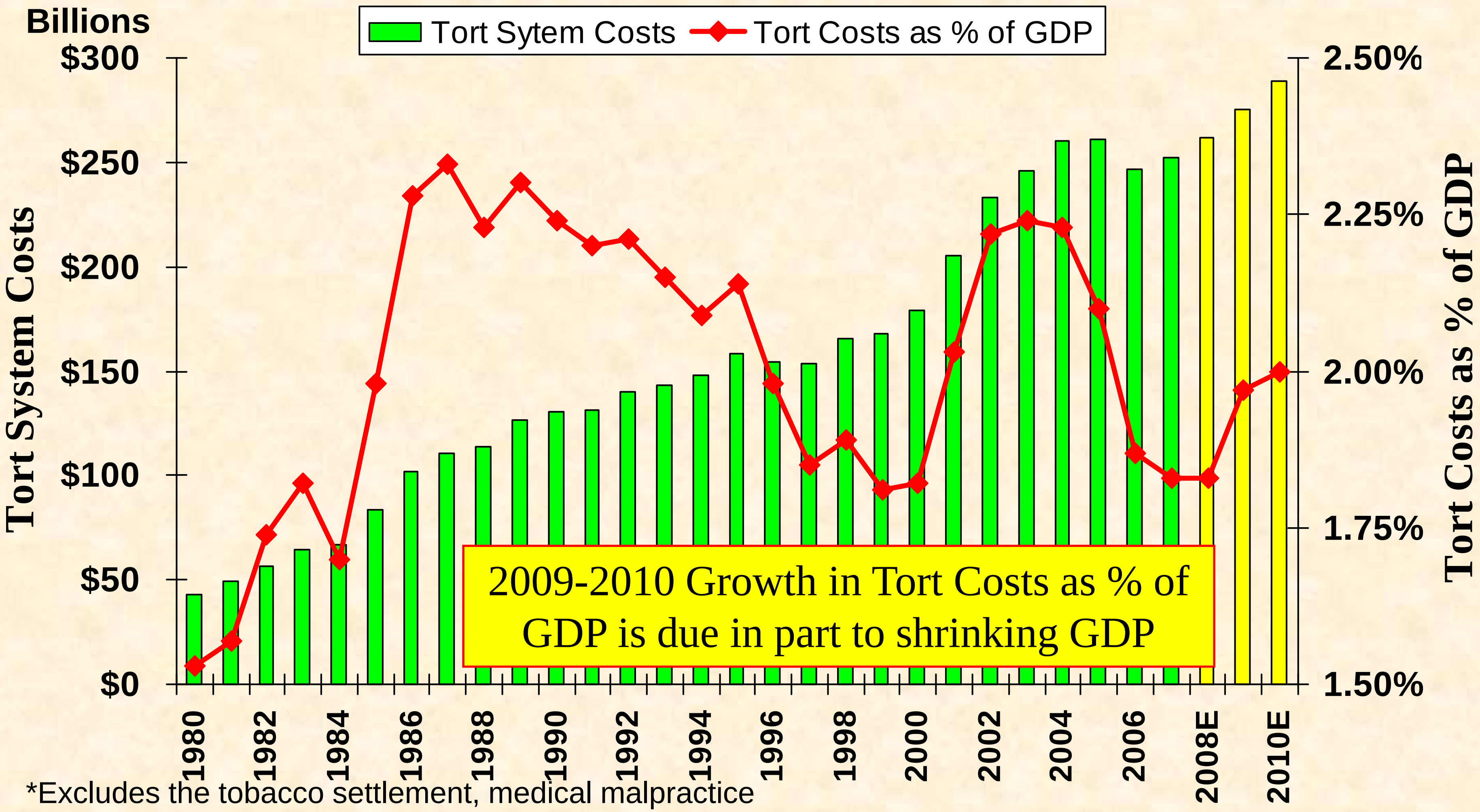
- **No tort reform (or protection of recent reforms) is forthcoming from the current Congress or Administration**
- **Erosion of recent reforms is a certainty (already happening)**
- **Innumerable legislative initiatives will create opportunities to undermine existing reforms and develop new theories and channels of liability**
- **Torts twice the overall rate of inflation**
- **Influence personal and commercial lines, esp. auto liab.**
- **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 Inst.

Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

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



*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

The Nation's Judicial Hellholes (2008/2009)

Watch List

Rio Grande Valley & Gulf Coast, TX

Madison County, IL

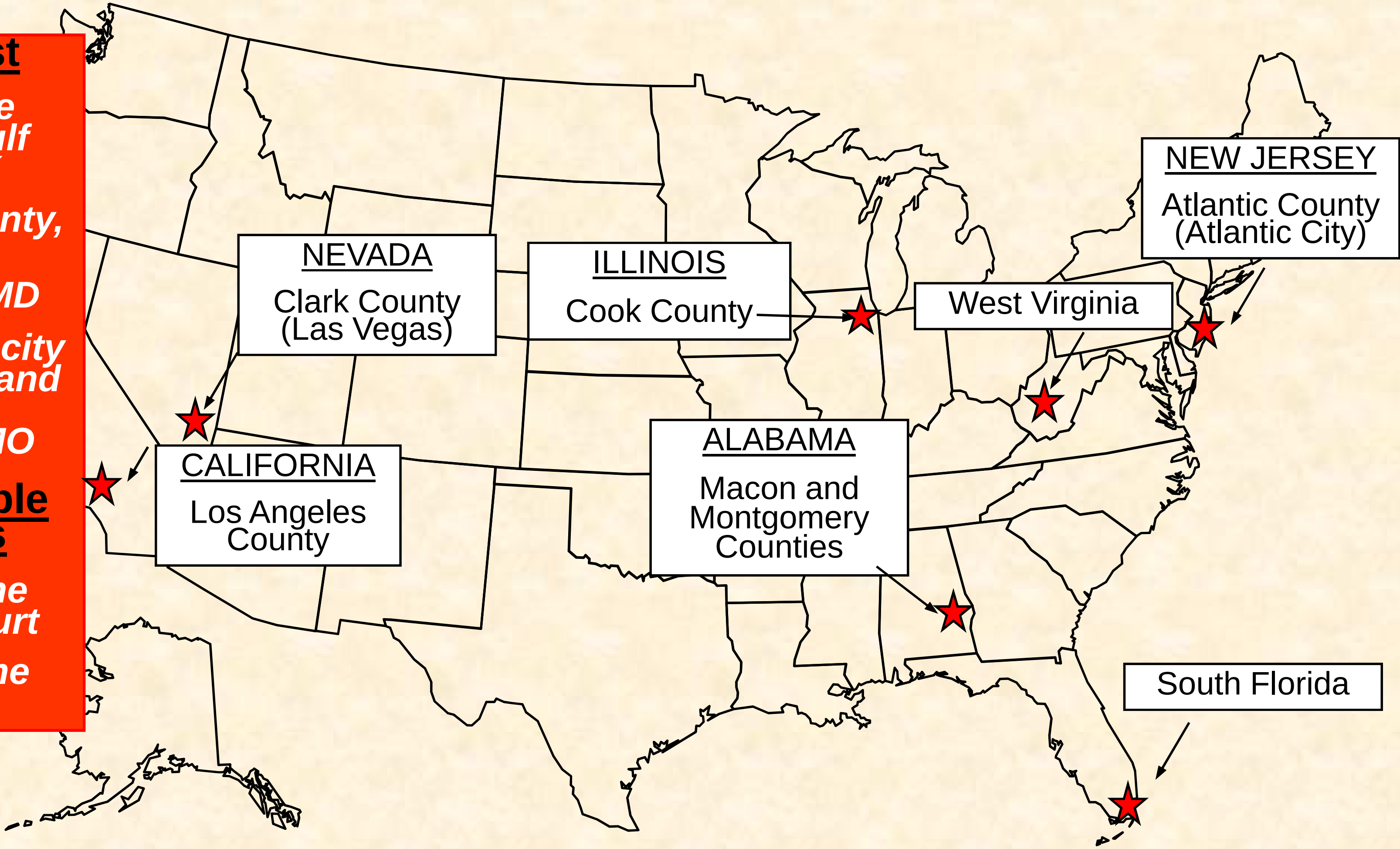
Baltimore, MD

St Louis (the city of), St Louis and Jackson Counties, MO

Dishonorable Mentions

MA Supreme Judicial Court

MO Supreme Court



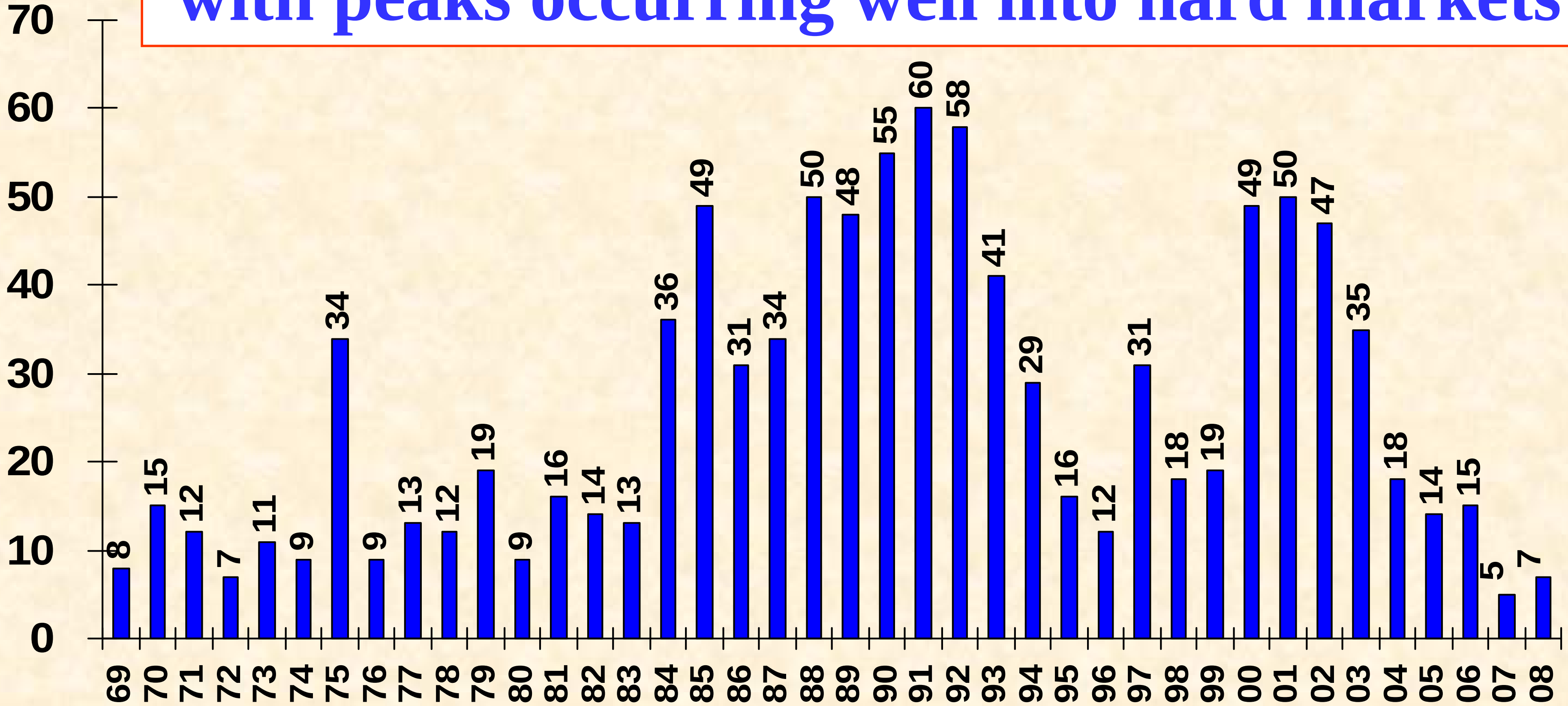
Source: American Tort Reform Association; Insurance Information Institute

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well

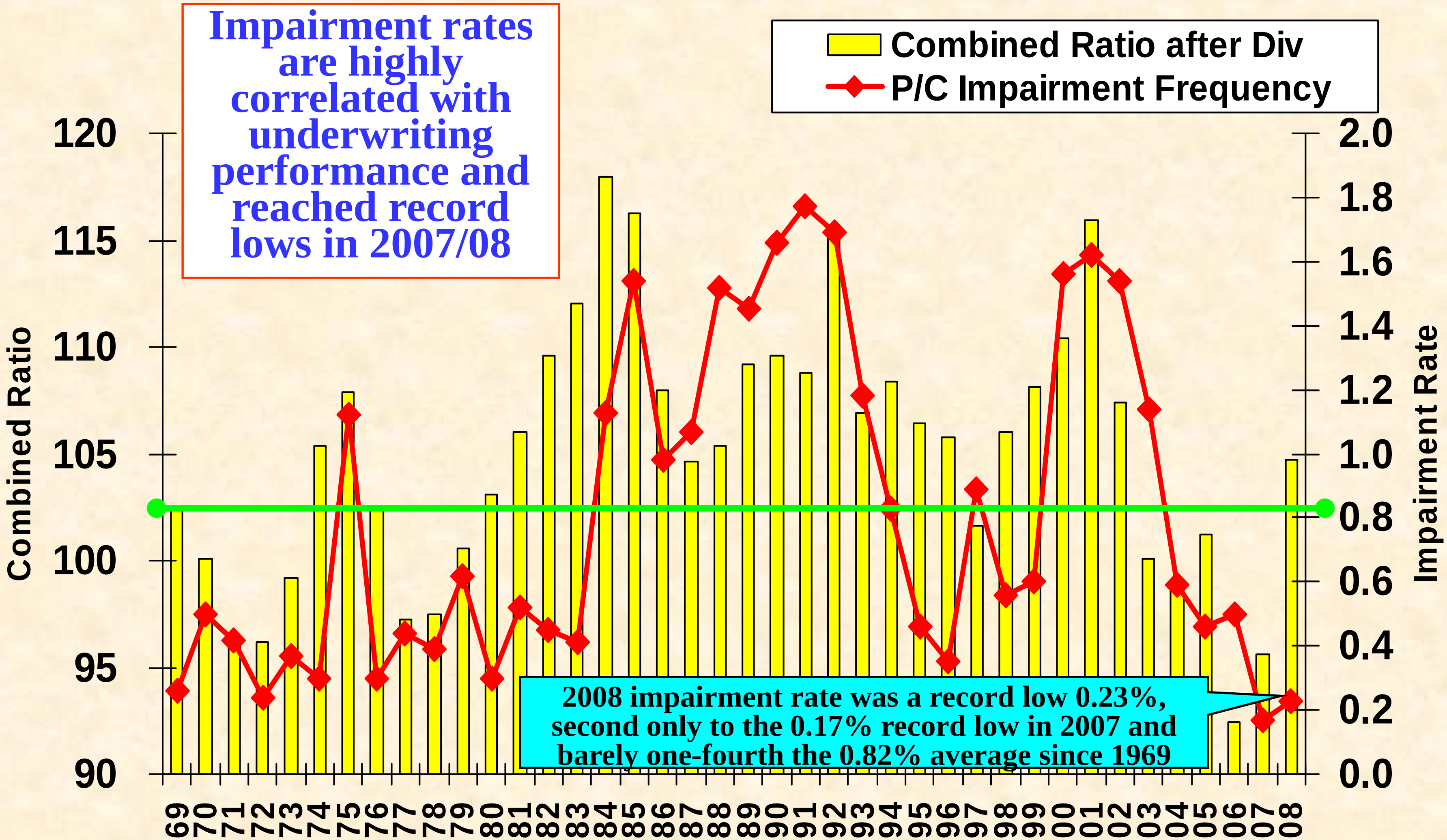
P/C Insurer Impairments, 1969-2008

The number of impairments varies significantly over the p/c insurance cycle, with peaks occurring well into hard markets



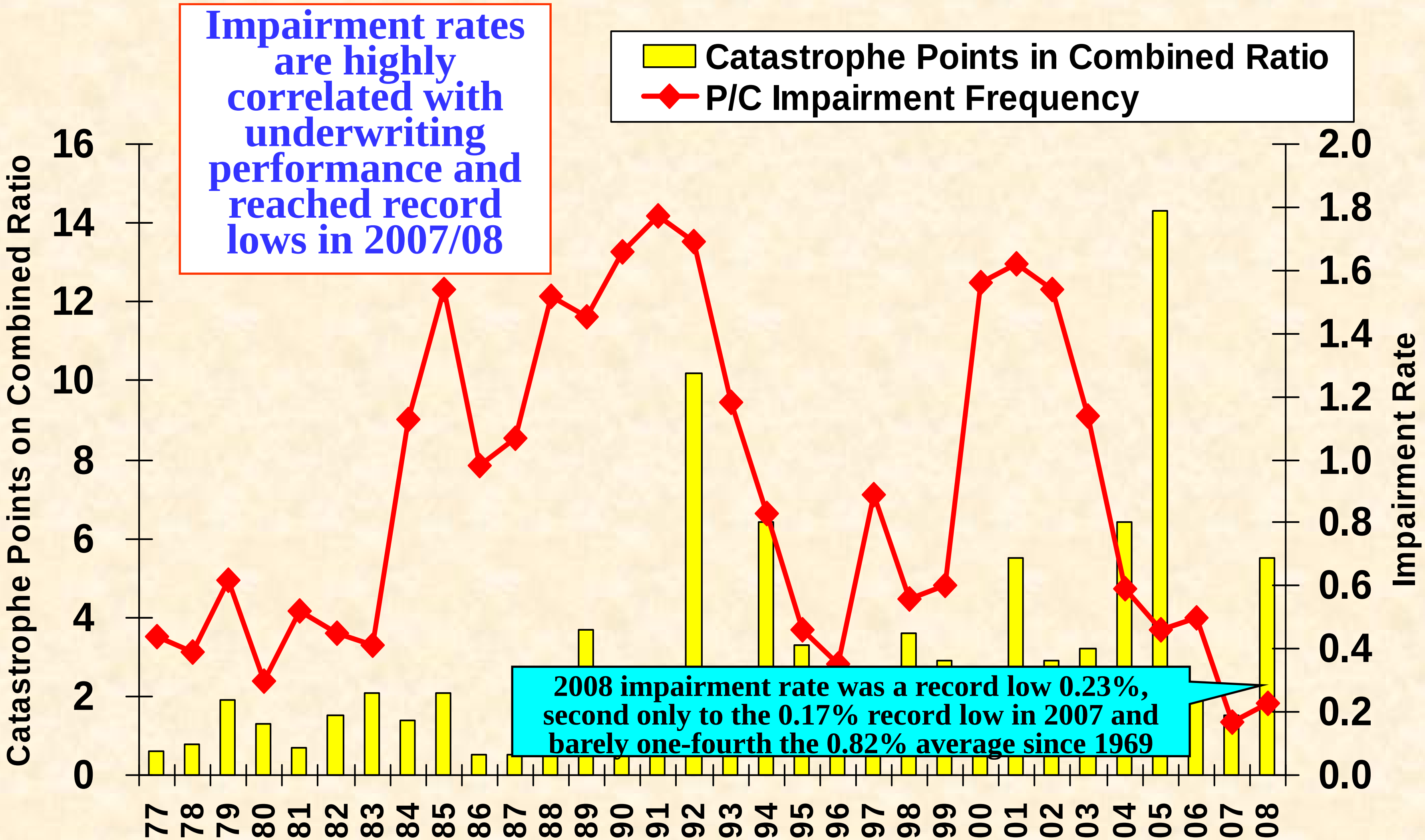
Source: A.M. Best; Insurance Information Institute

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2008



Source: A.M. Best; Insurance Information Institute

P/C Impairment Frequency vs. Catastrophe Points in Combined Ratio, 1977-2008

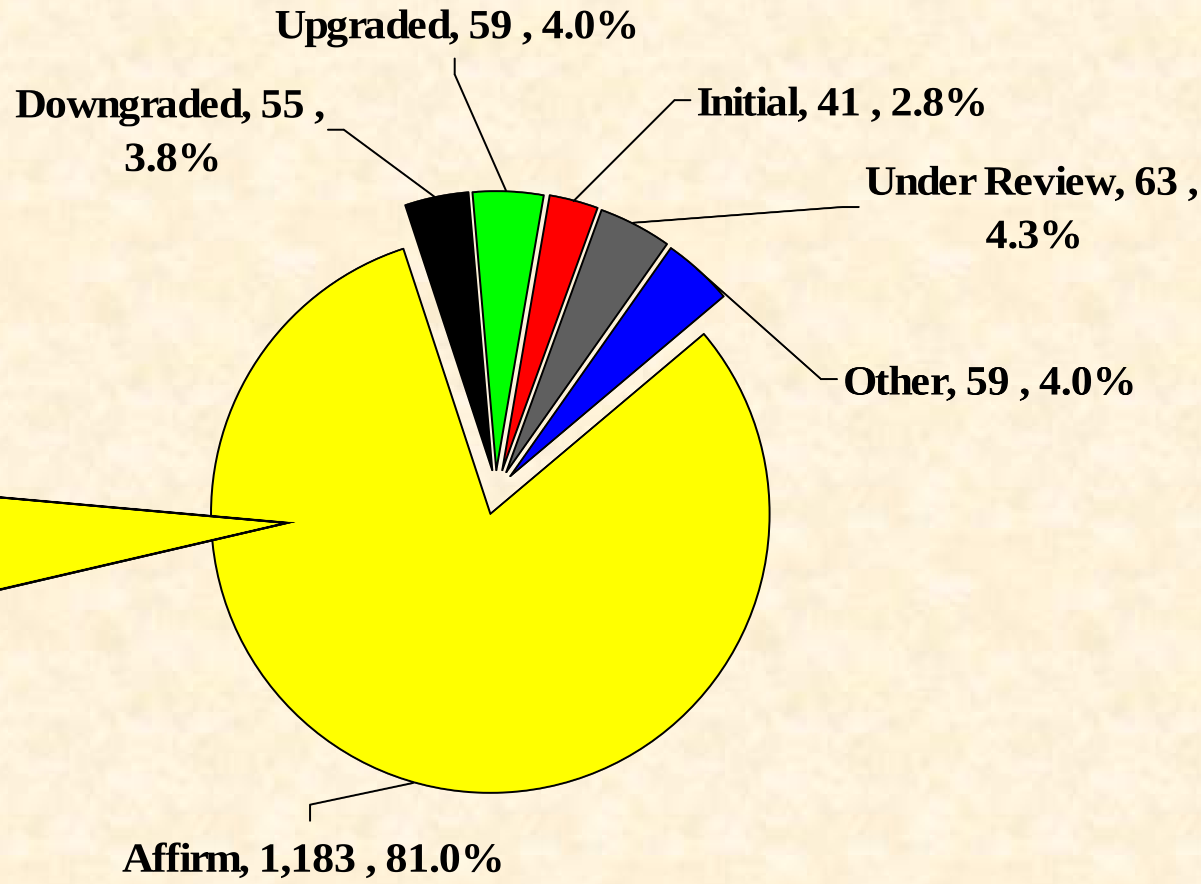


Source: A.M. Best, PCS; Insurance Information Institute

Summary of A.M. Best's P/C Insurer Ratings Actions in 2008*

P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.

Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades

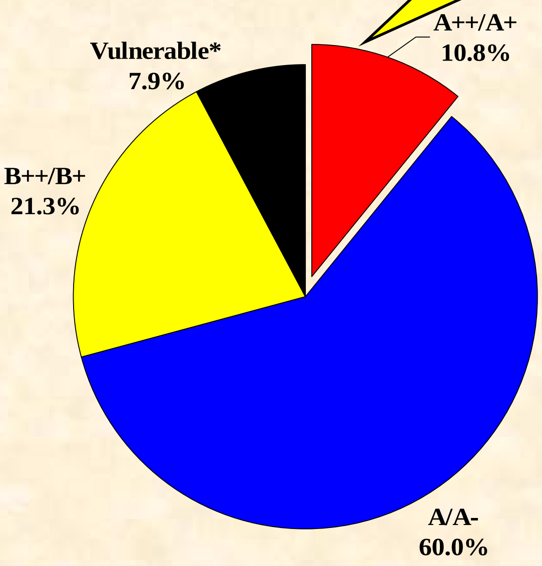


*Through December 19.
Source: A.M. Best.

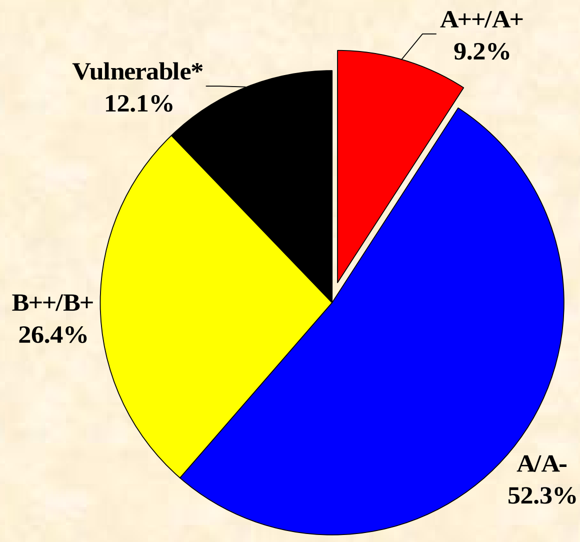
Historical Ratings Distribution, US P/C Insurers, 2008 vs. 2005 and 2000

2008

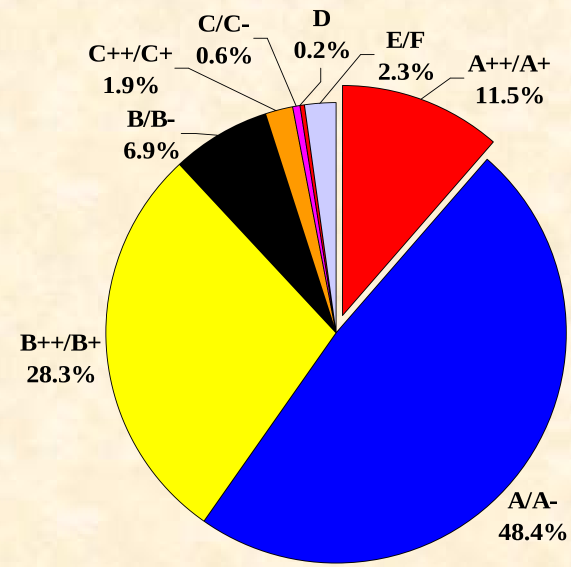
A++/A+ and A/A- gains



2005



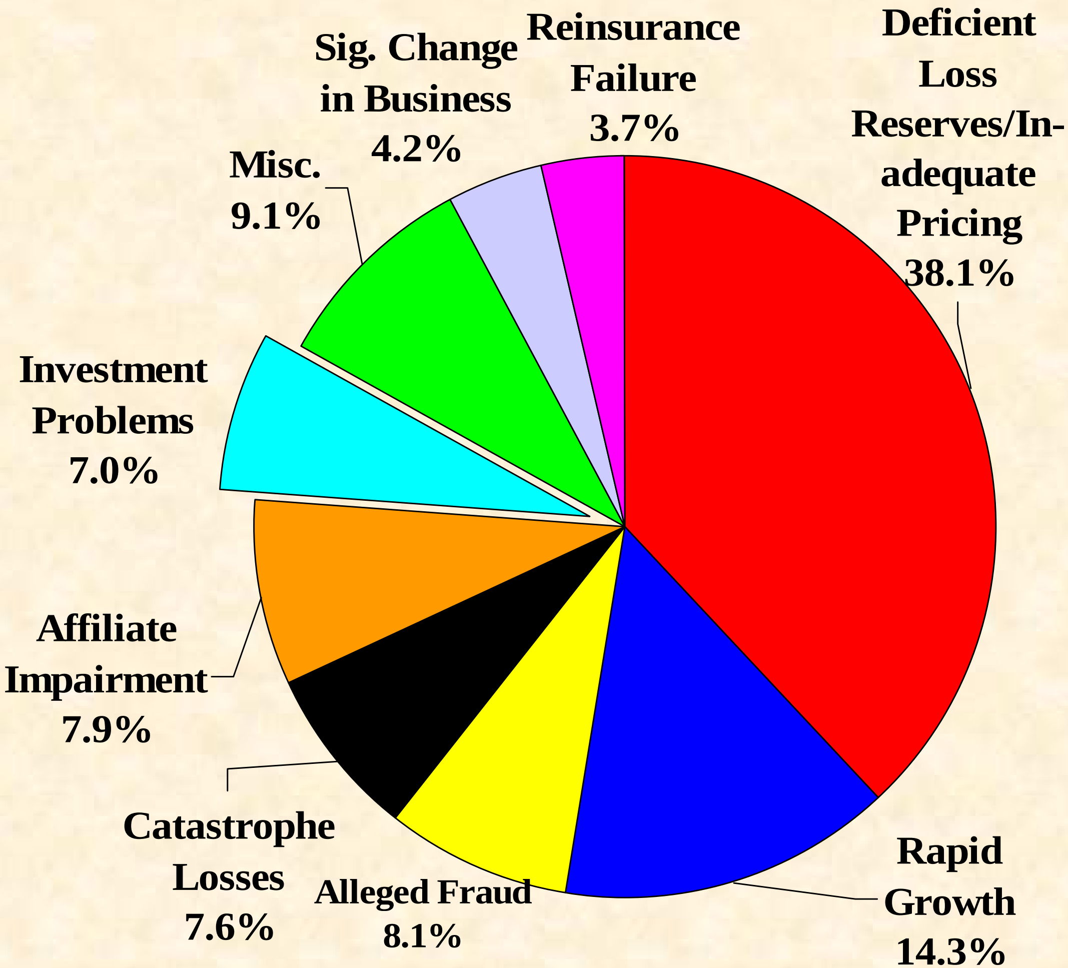
2000



P/C insurer financial strength has improved since 2005 despite financial crisis

Source: A.M. Best: *Rating Downgrades Slowed but Outpaced Upgrades for Fourth Consecutive Year,* Special Report, November 8, 2004 for 2000; 2006 and 2009 *Review & Preview*. *Ratings 'B' and lower.

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



Deficient loss reserves and inadequate pricing are the leading cause of insurer impairments, underscoring the importance of discipline. Investment catastrophe losses play a much smaller role.

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

Critical Differences Between P/C Insurers and Banks

Superior Risk Management Model & Low Leverage Make a Big Difference

How Insurance Industry Stability Has Benefitted Consumers

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 123 banks have gone under as of 10/2/09)**
    - ***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

Regulatory Reform

Obama Administration's Plan for Reforming Financial Services Industry Regulation Will Impact Insurers

Status: Stalled in Congress

Obama Regulatory Reform Proposal: Plan Components

I. Office of National Insurance (ONI) Duties

1. Monitor “all aspects of the insurance industry”
2. Gather information
3. Identify the emergence of any problems or gaps in regulation that could contribute to a future crisis
4. Recommend to the Federal Reserve insurance companies it believes should be supervised as Tier 1 FHCs
5. Administer the Terrorism Risk Insurance Program
6. Authority to enter into international agreements and increase international cooperation on insurance regulation

Source: “Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation,” US Department of the Treasury, June 2009.

Obama Regulatory Reform Proposal: Plan Components (cont'd)

II. Systemic Risk Oversight & Resolution Authority

- Federal Reserve given authority to oversee systemic risk of large financial holding companies (Tier 1 FHCs)
  - Insurers are explicitly included among the types of entities that could be found to be a Tier 1 FHC
  - ONI given authority to "recommend to the Federal Reserve any insurance companies that the ONI believes should be supervised as Tier 1 FHC."
- Proposal also recommends "creation of a resolution regime to avoid disorderly resolution of failing bank holding companies, including Tier 1 FHCs "…in situations where the stability of the financial system is at risk." Directly affects insurers in 2 ways:
  - Resolution authority may extend to an insurer within the BHC structure if the BHC is failing
  - If systemically important insurer is failing (as identified by ONI as Tier 1 FHC) resolution authority may apply

Source: "Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation," US Department of the Treasury, June 2009.

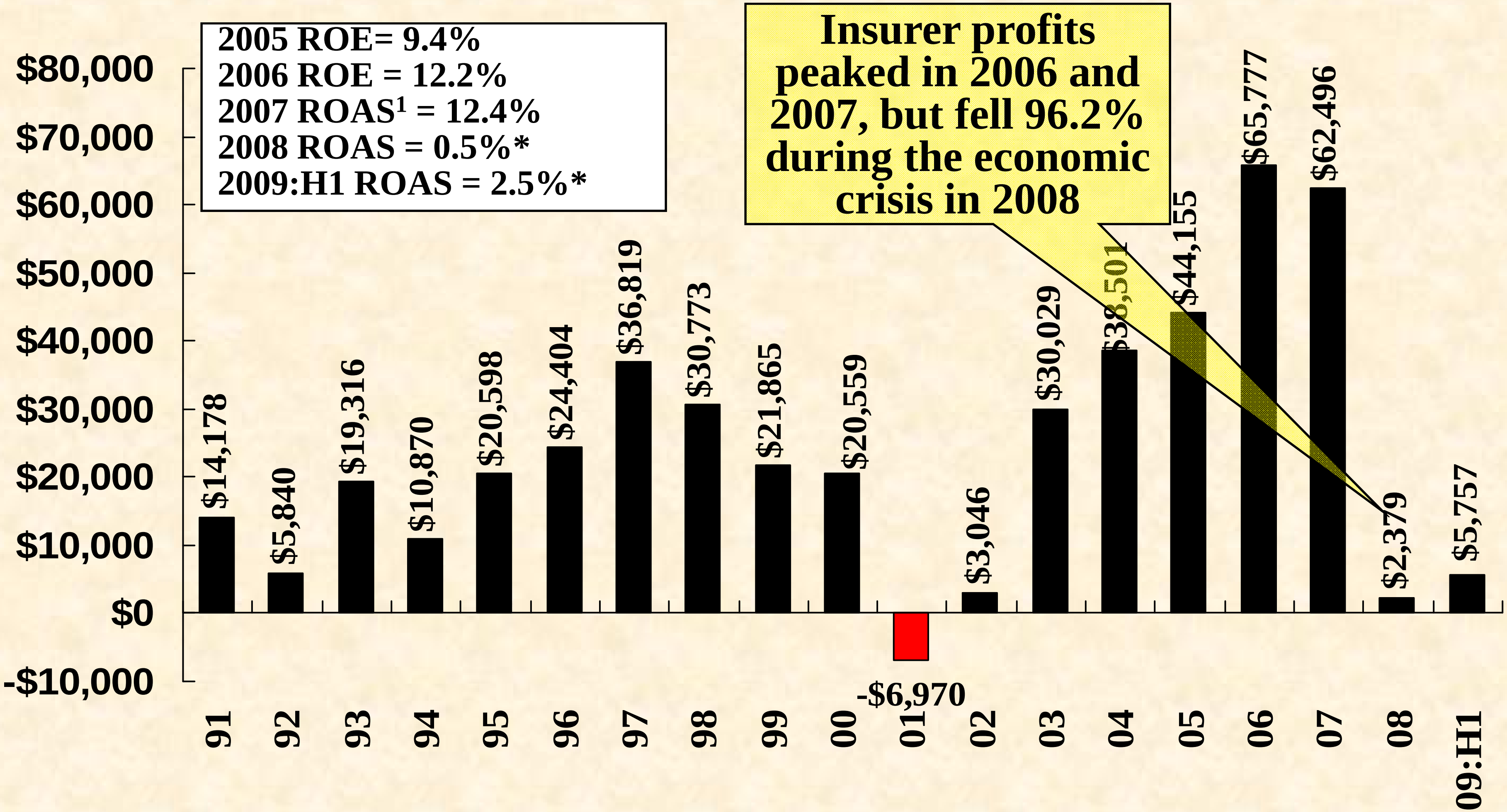
P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

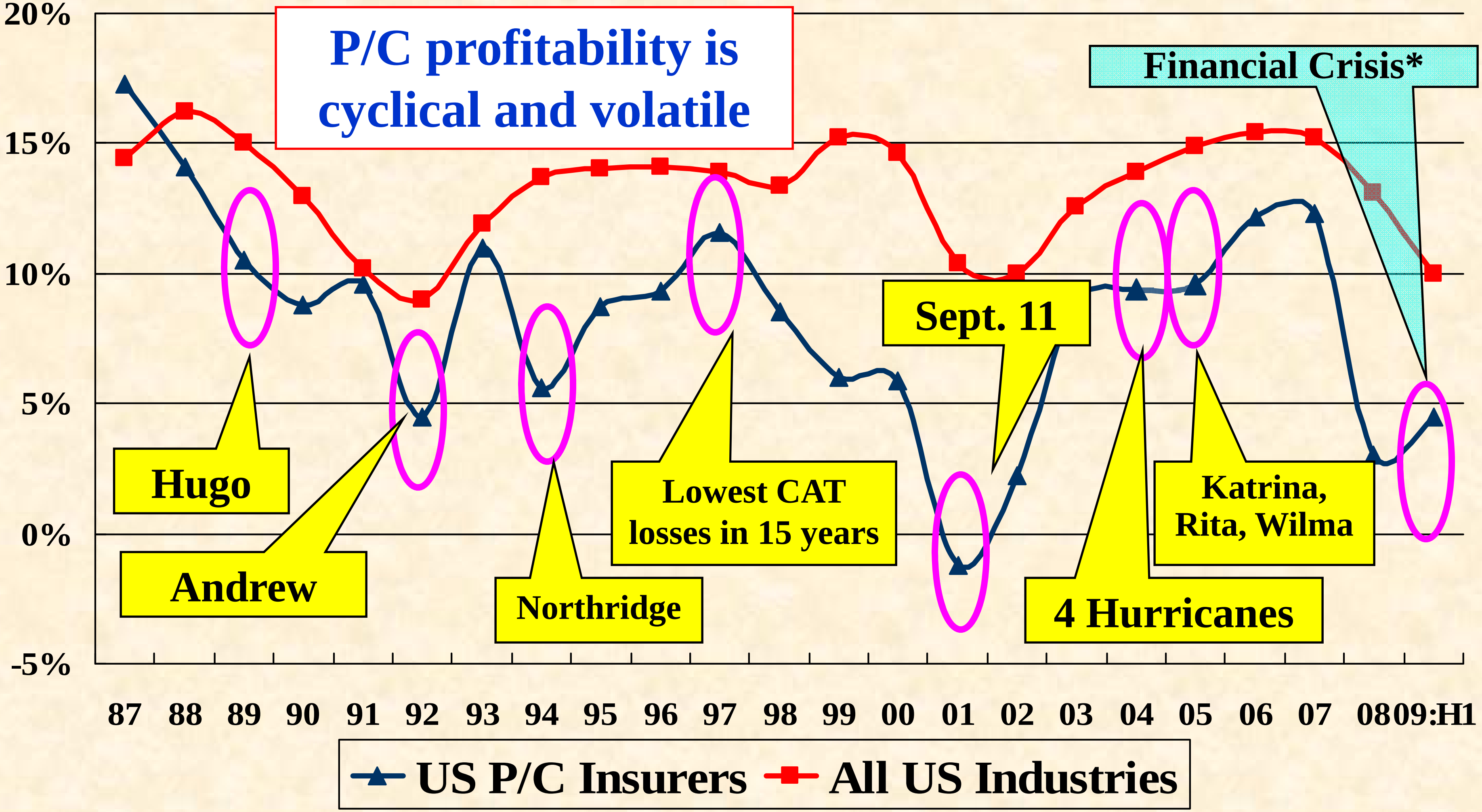
Historically Volatile

P/C Net Income After Taxes 1991-2009:H1 ($ Millions)*



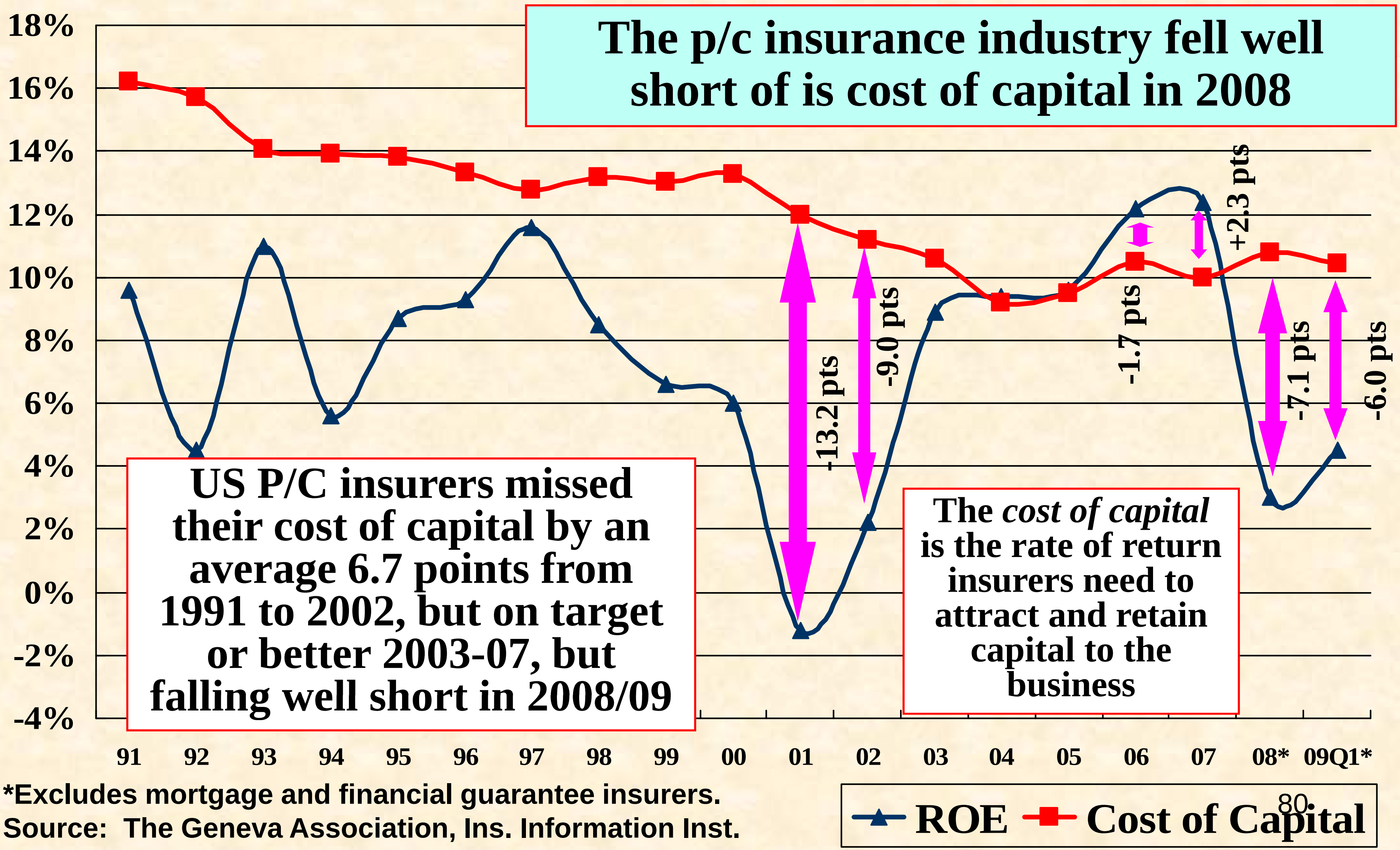
***ROE figures are GAAP; [1]Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields an 4.5% ROAS for 2008 and 2.2%. 2009:Q1 net income was $10.0 billion excl. M&FG.**
Sources: A.M. Best, ISO, Insurance Information Inst.

ROE: P/C vs. All Industries 1987–2009: H1*



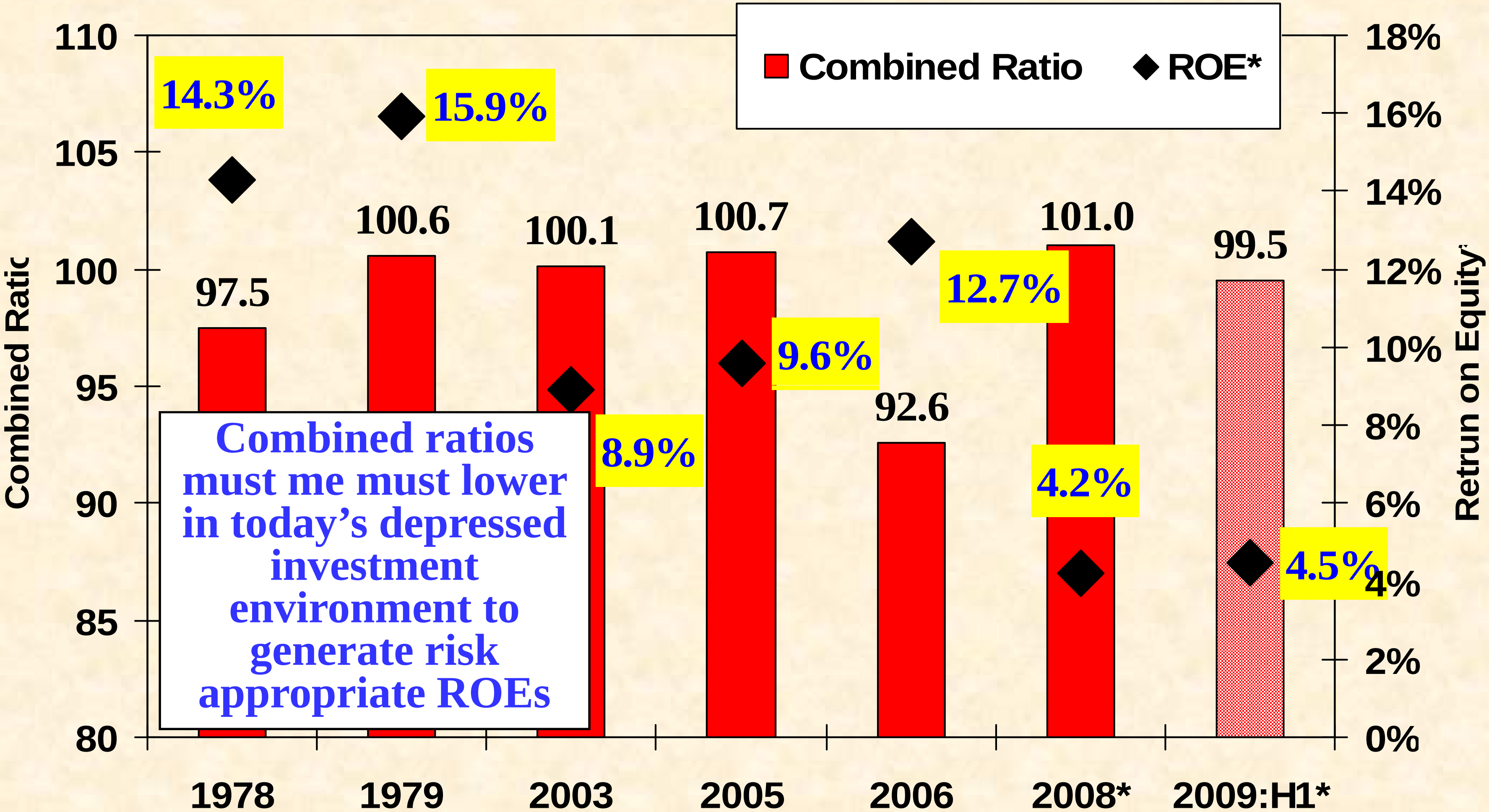
*Excludes Mortgage & Financial Guarantee in 2008 and 2009
Sources: ISO, *Fortune;* Insurance Information Institute.

ROE vs. Equity Cost of Capital: US P/C Insurance:1991-2009:H1*



*Excludes mortgage and financial guarantee insurers.
Source: The Geneva Association, Ins. Information Inst.

A 100 Combined Ratio Isn't What it Used to Be: 95 is Where It's At



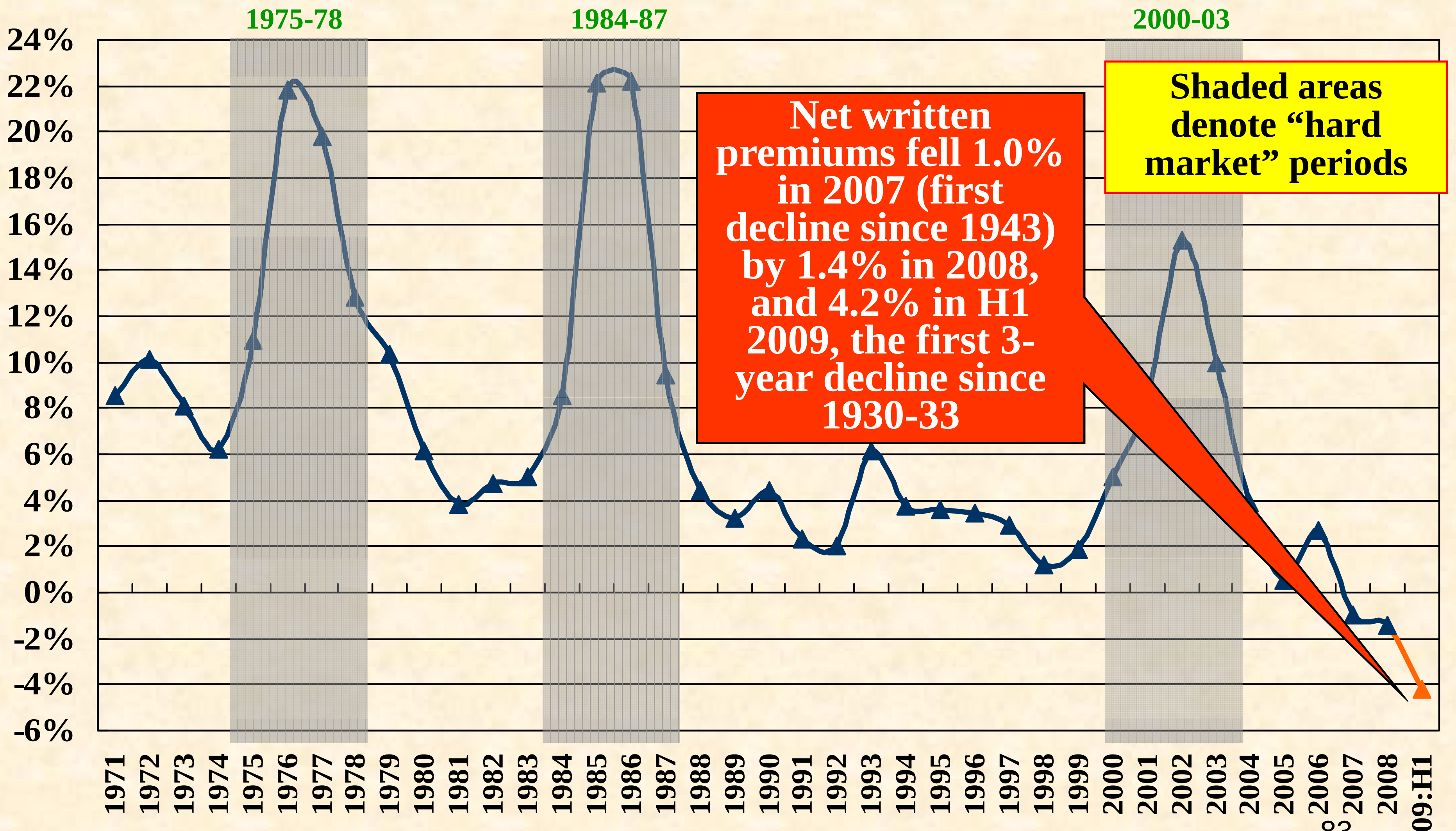
* 2008/9 figures are return on average statutory surplus. Excludes mortgage and financial guarantee insurers.

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

P/C Premium Growth

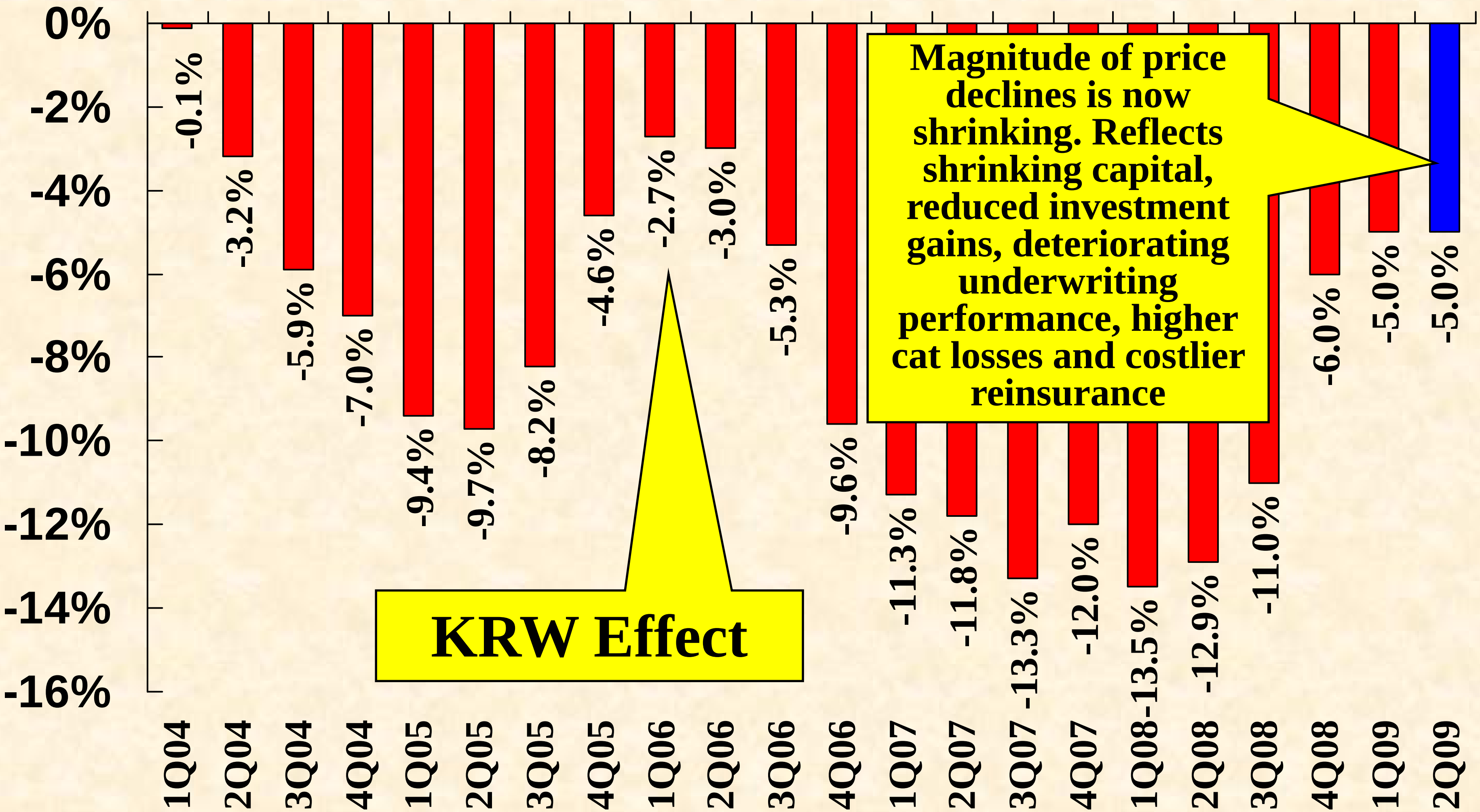
Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Strength of Recent Hard Markets by NWP Growth



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

Average Commercial Rate Change, All Lines, (1Q:2004 – 2Q:2009)

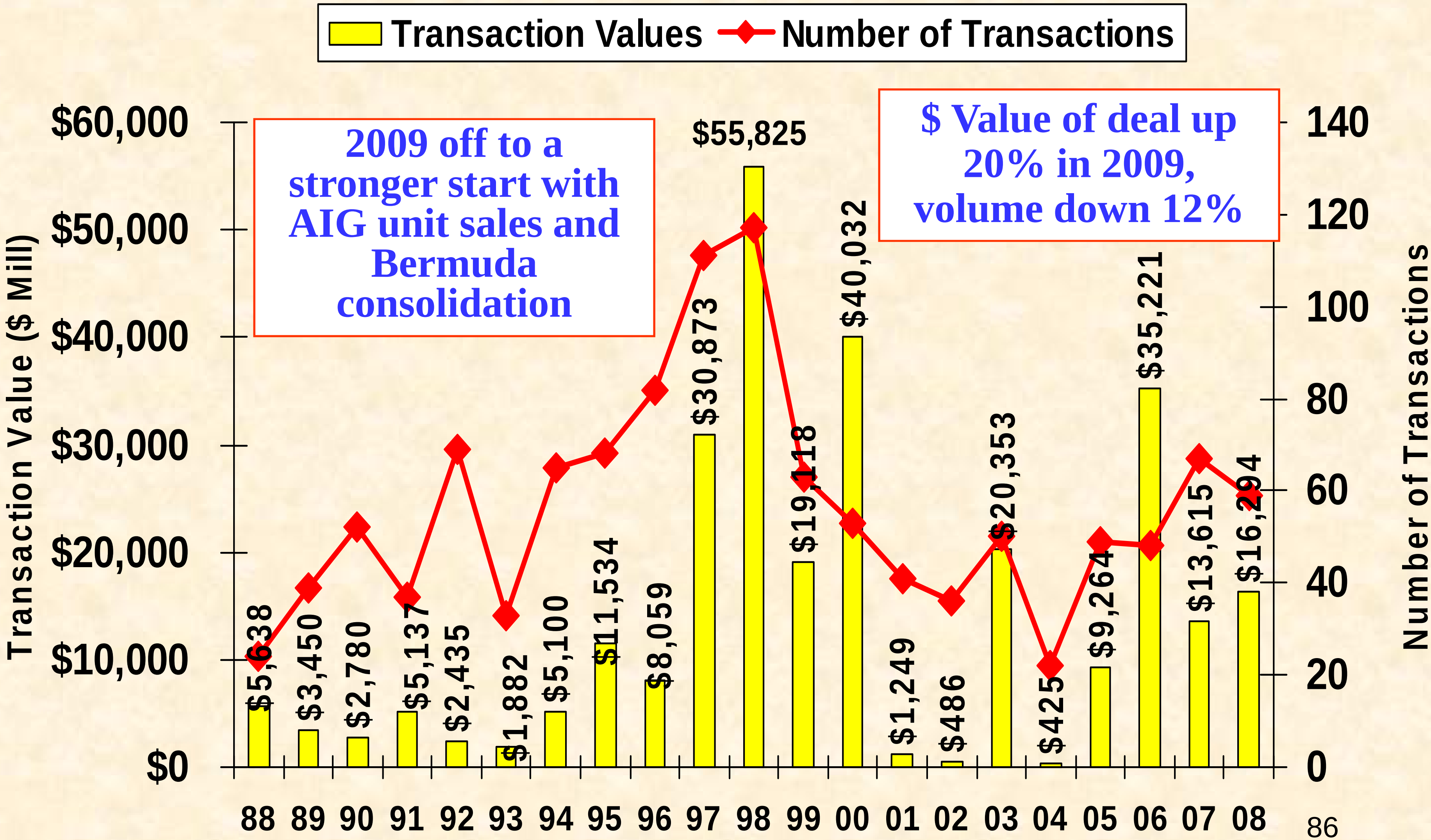


Source: Council of Insurance Agents & Brokers; Insurance Information Institute

Merger & Acquisition

Barriers to Consolidation Will Diminish in 2010

P/C Insurance-Related M&A Activity, 1988-2008

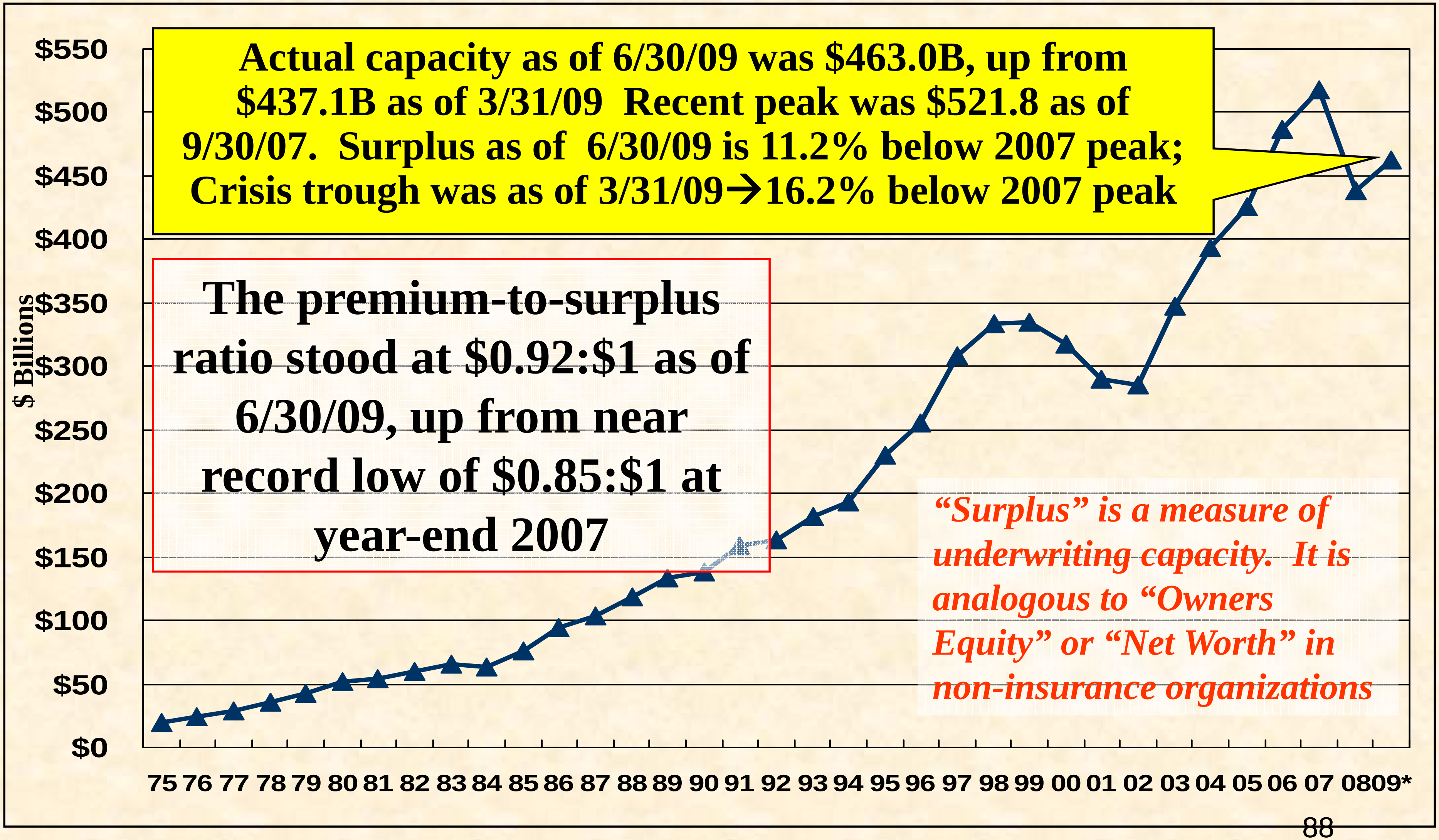


Source: Conning Research & Consulting.

Capital/ Policyholder Surplus (US)

Shrinkage, but Capital is Within Historic Norms

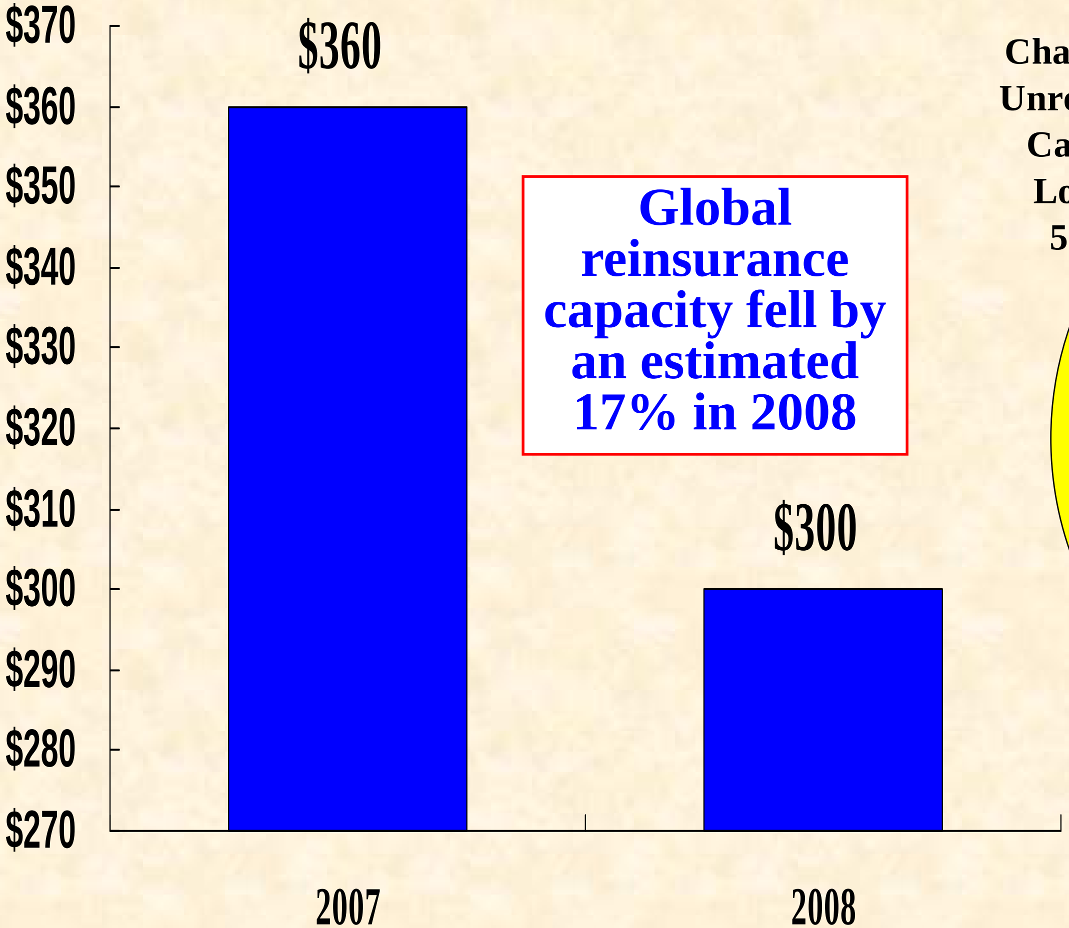
*U.S. Policyholder Surplus: 1975-2009:H1**



Source: A.M. Best, ISO, Insurance Information Institute. *As of 6/30/09

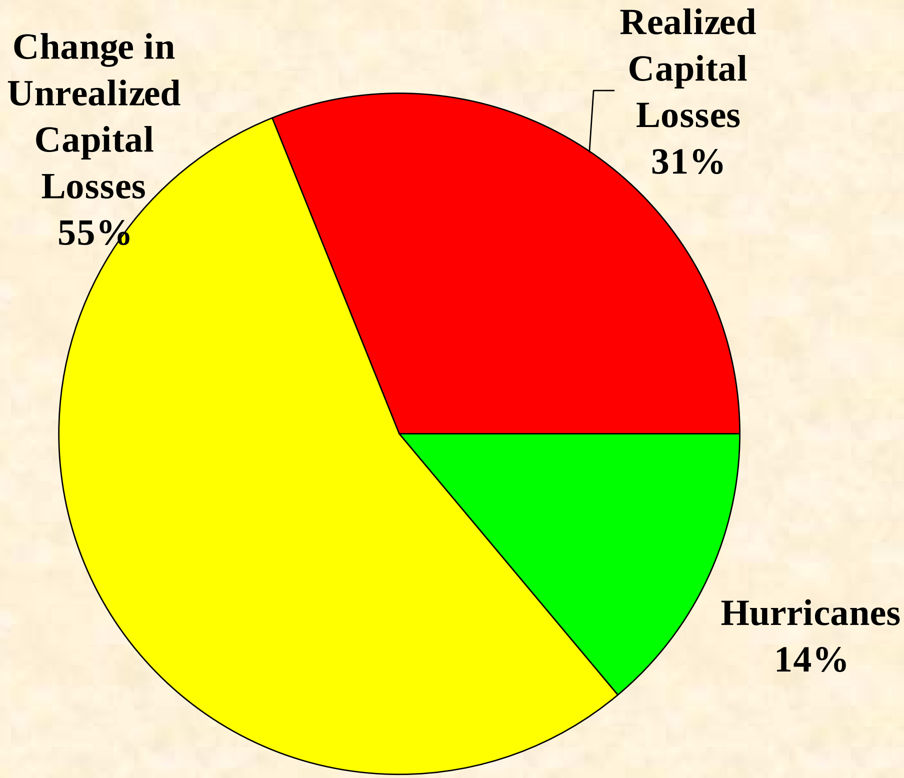
Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

Global Reinsurance Capacity



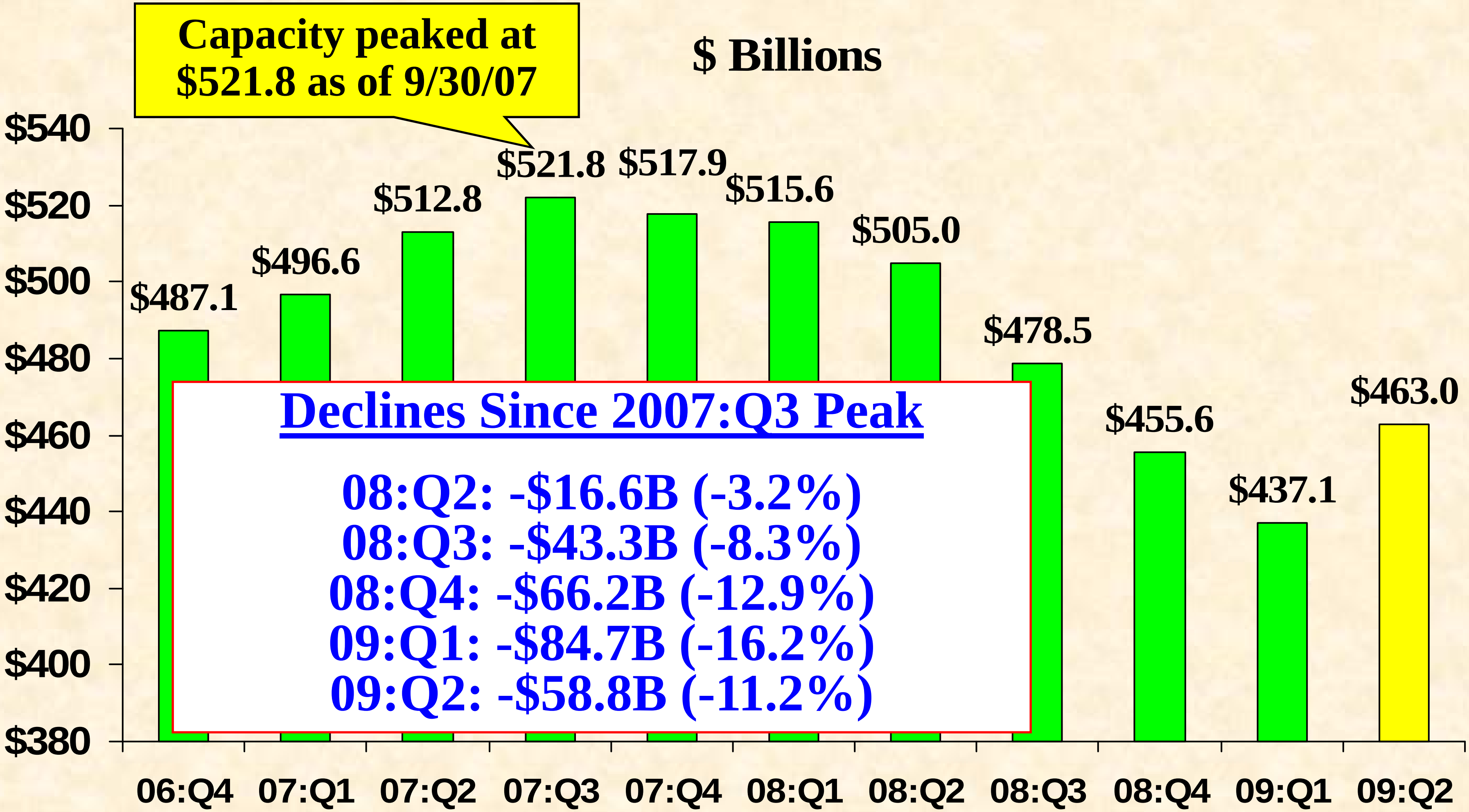
Global reinsurance capacity fell by an estimated 17% in 2008

Source of Decline



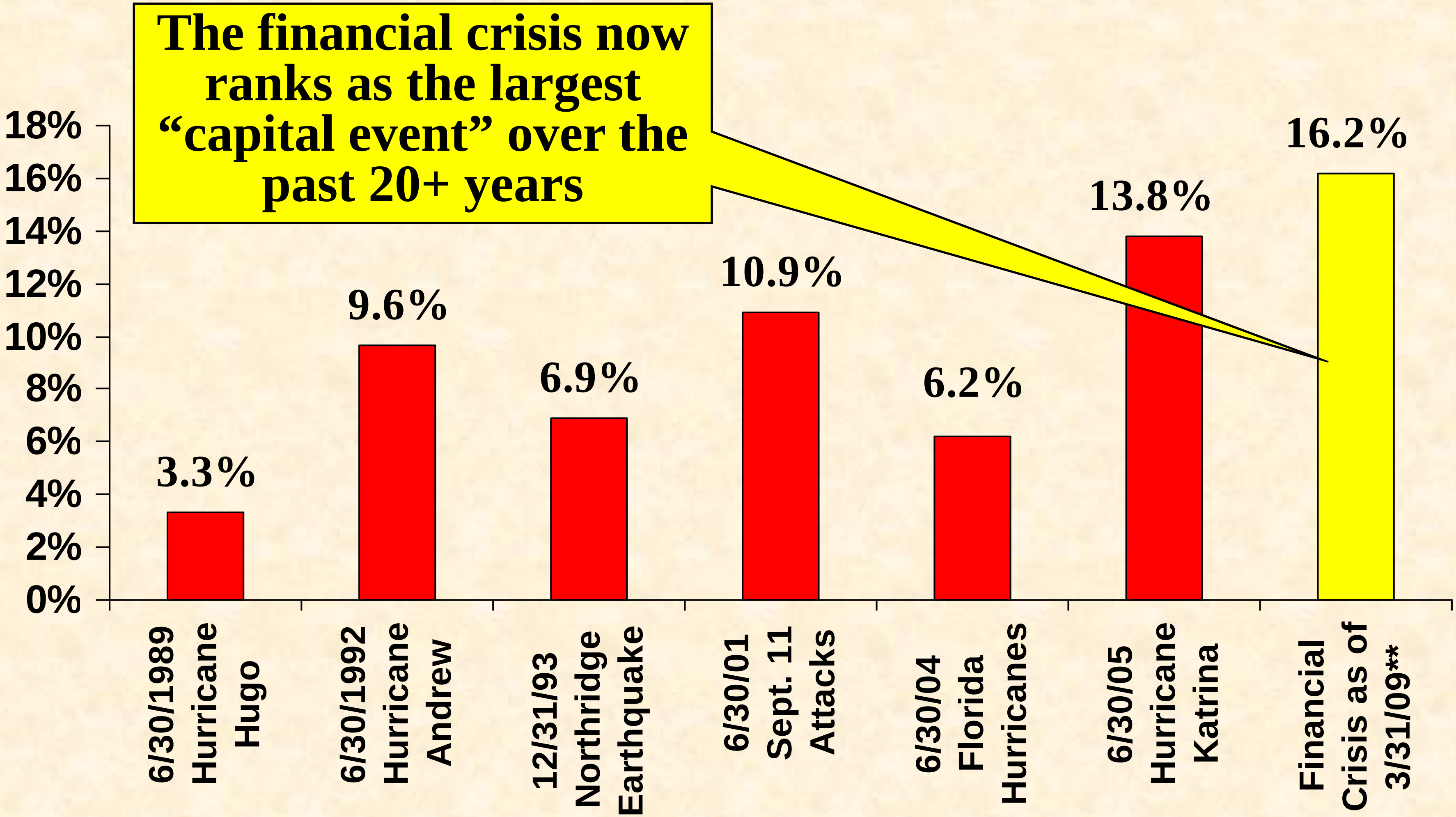
Source: AonBenfield Reinsurance Market Outlook 2009; Insurance Information Institute.

Policyholder Surplus,
2006:Q4 – 2009:H1



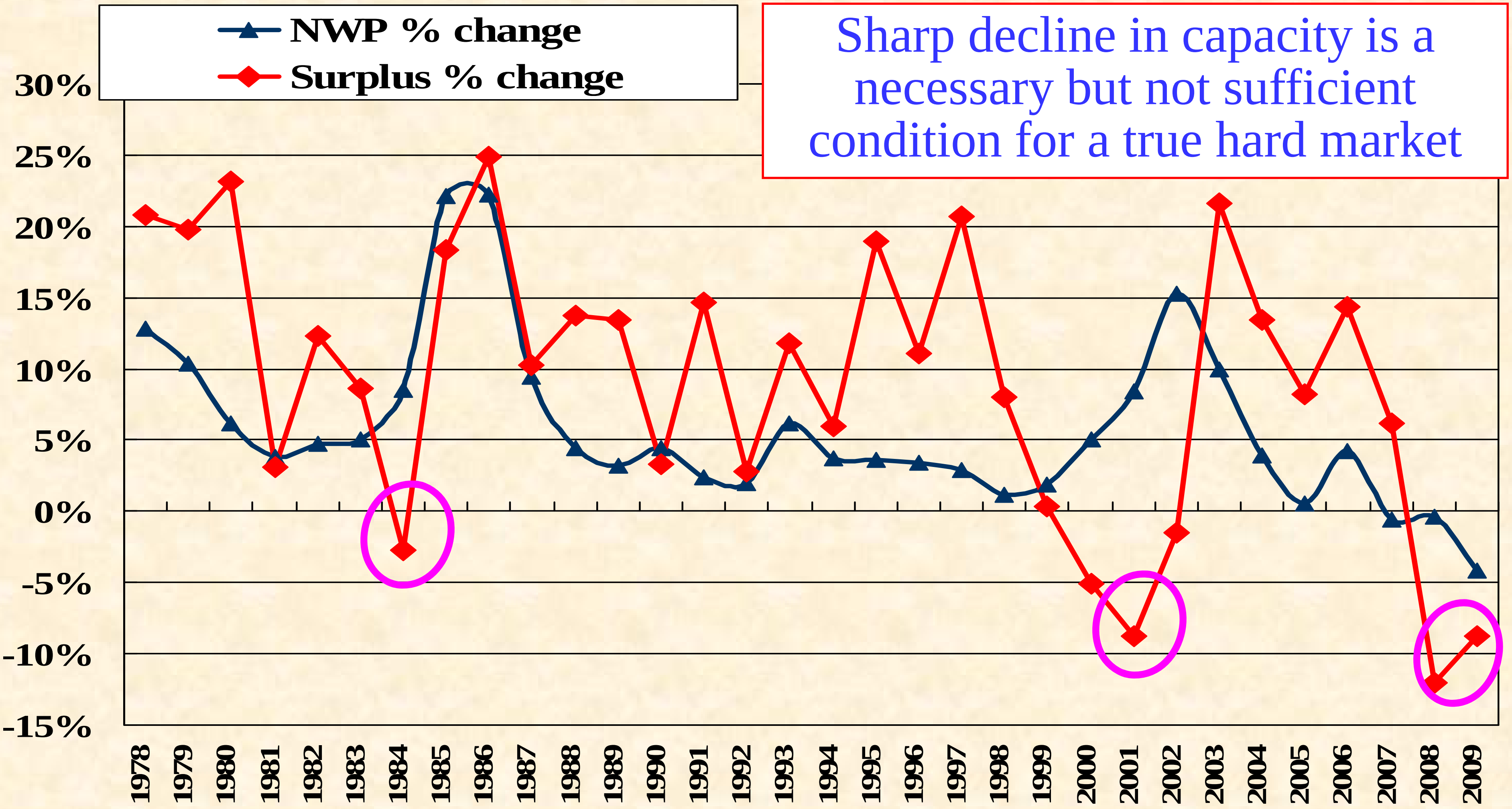
Source: ISO, AM Best.

*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 6/30/09 (latest available) ratio = 11.2%.**
Source: PCS; Insurance Information Institute.

Historically, Hard Markets Follow When Surplus "Growth" is Negative*



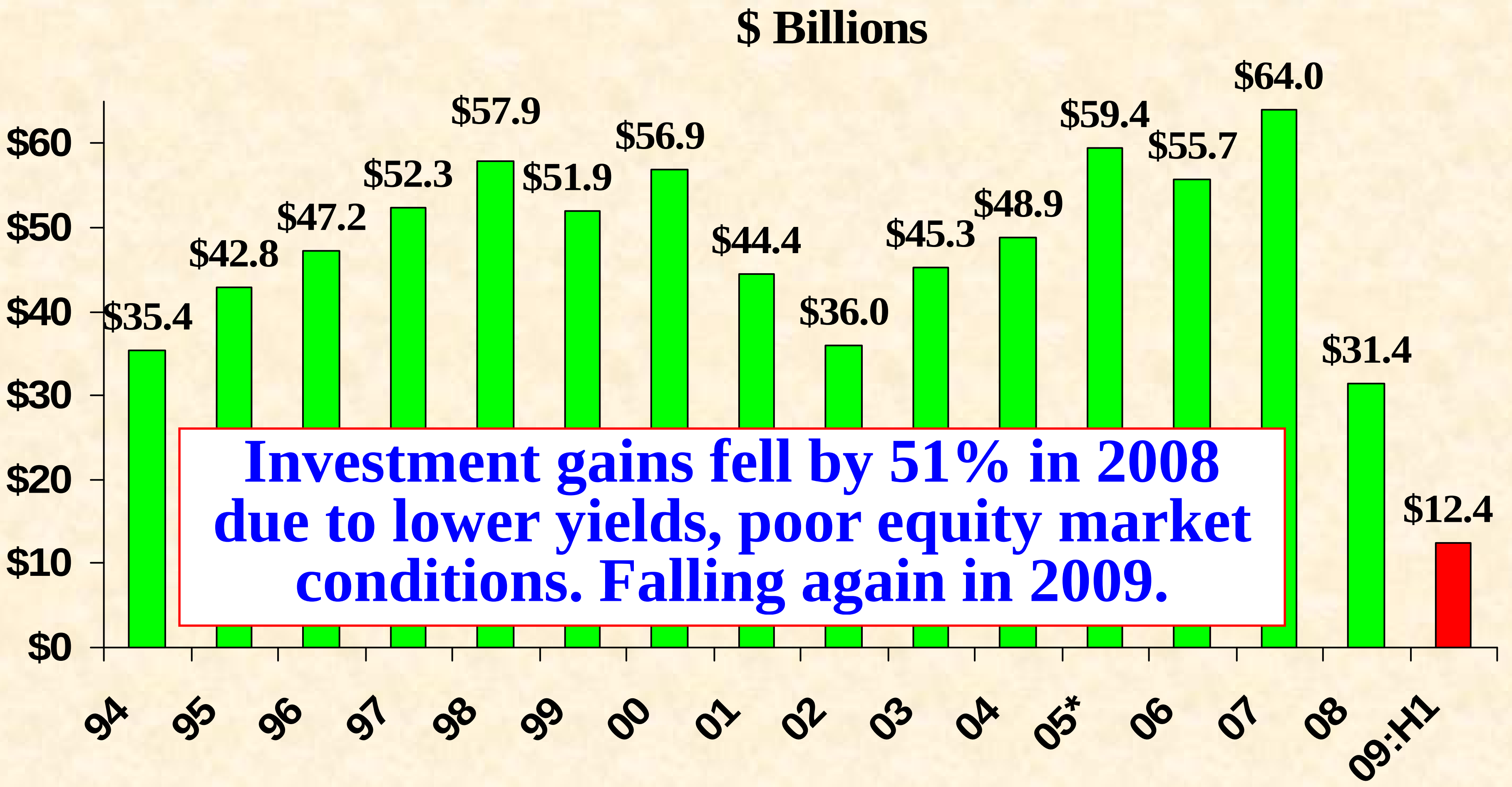
*2009 NWP and Surplus figures are % changes for H1:09 vs H1:08

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

Investment Performance

Investments are a Principle Source of Declining Profitability

Property/Casualty Insurance Industry Investment Gain: 1994- 2009:H1[1]

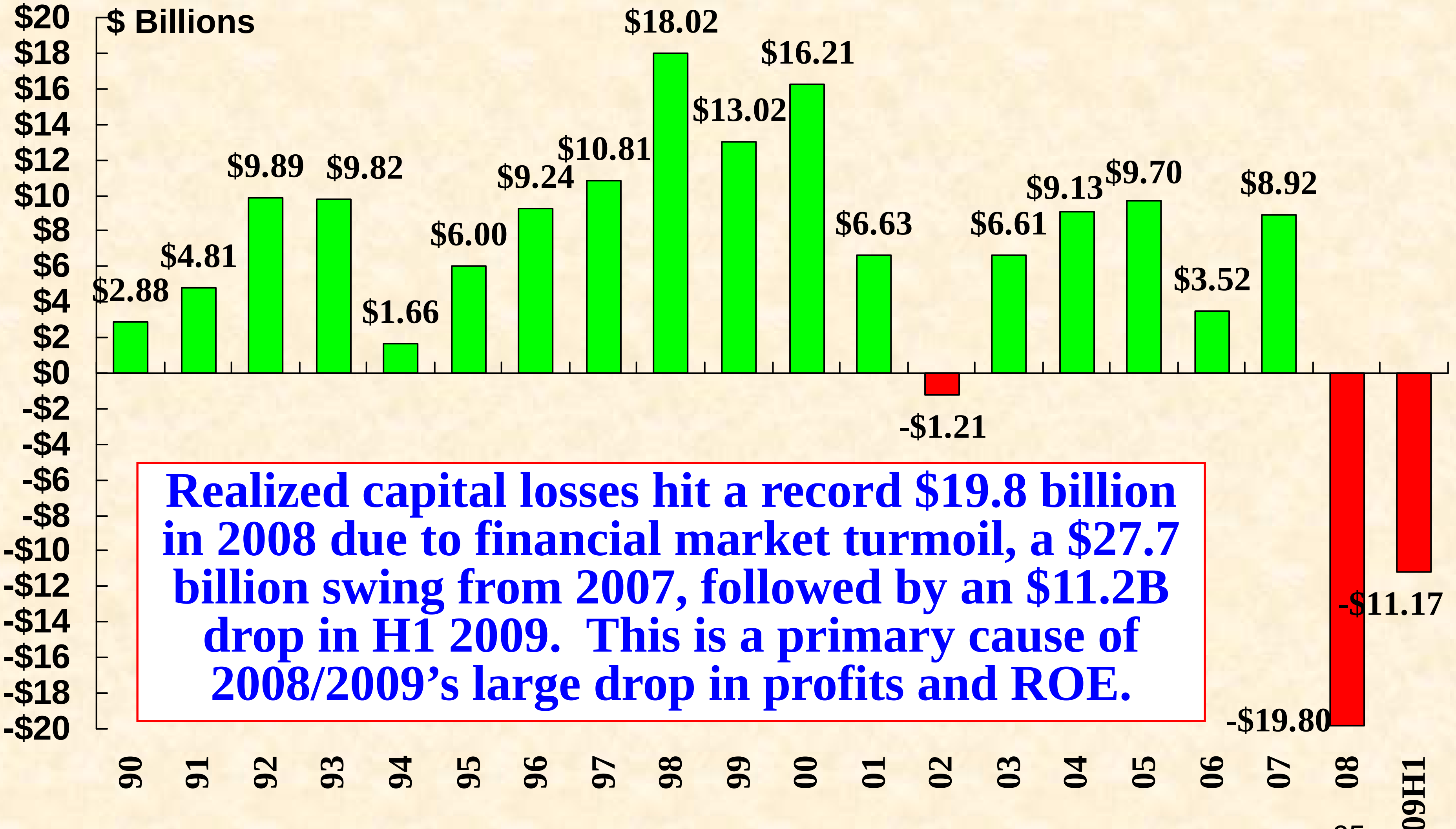


[1]Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of $52.3B net investment income and $3.4B realized investment gain.

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

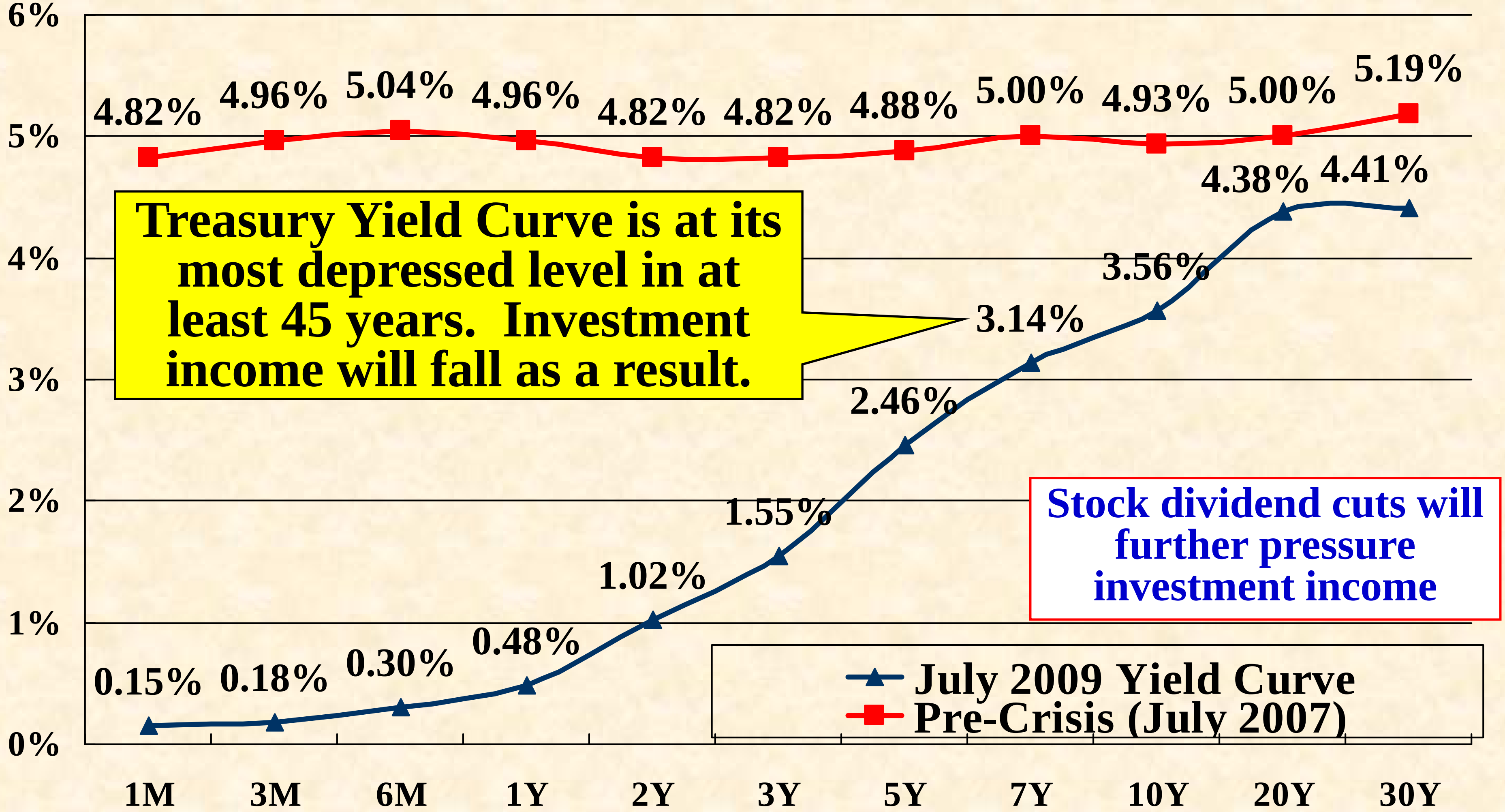
Sources: ISO; Insurance Information Institute.

P/C Insurer Net Realized Capital Gains, 1990-2009:H1



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

Treasury Yield Curves: Pre-Crisis (July 2007) vs. July 2009



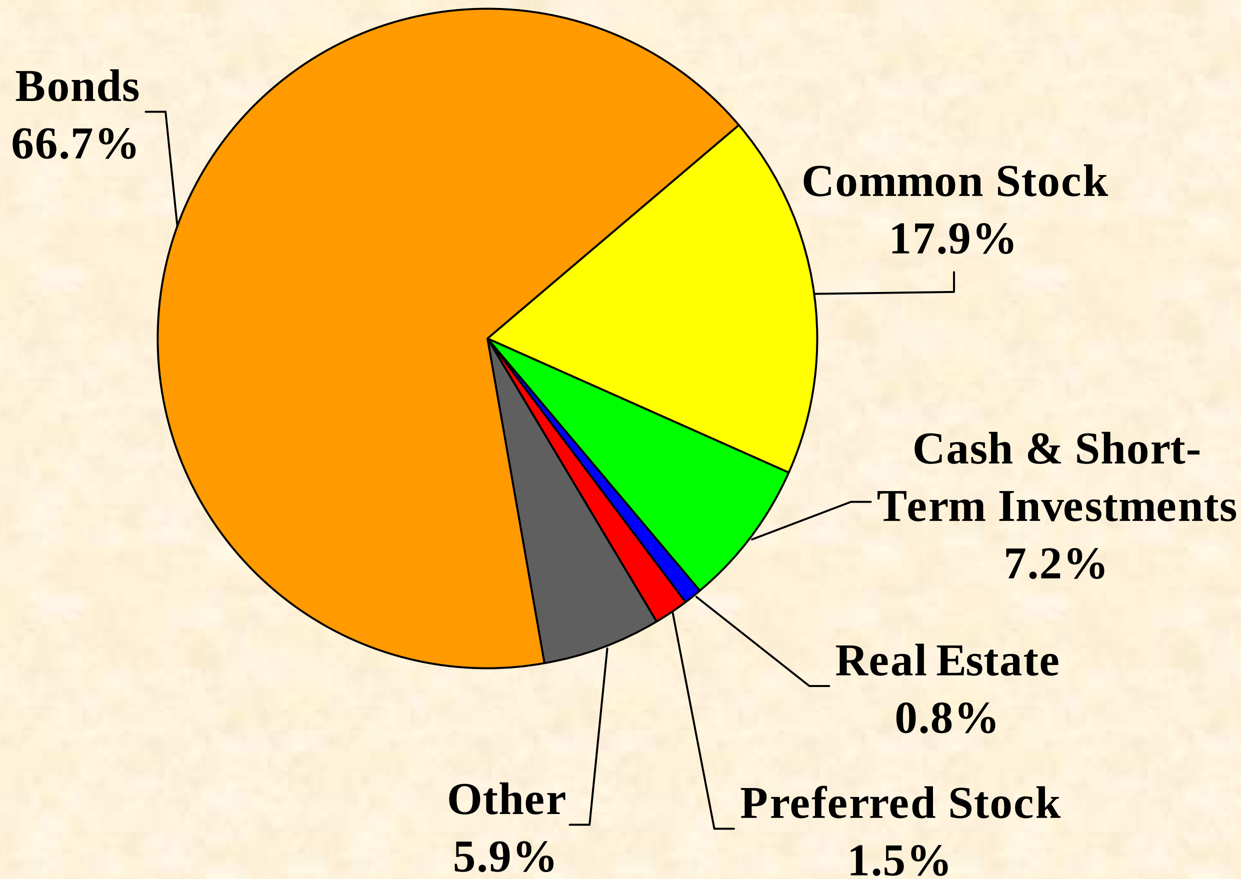
Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2007

Portfolio Facts

- Invested assets totaled $1.3 trillion as of 12/31/07
- Insurers are generally conservatively invested, with 2/3 of assets invested in bonds as of 12/31/07
- Only about 18% of assets were invested in common stock as of 12/31/07
- Even the most conservative of portfolios was hit hard in 2008



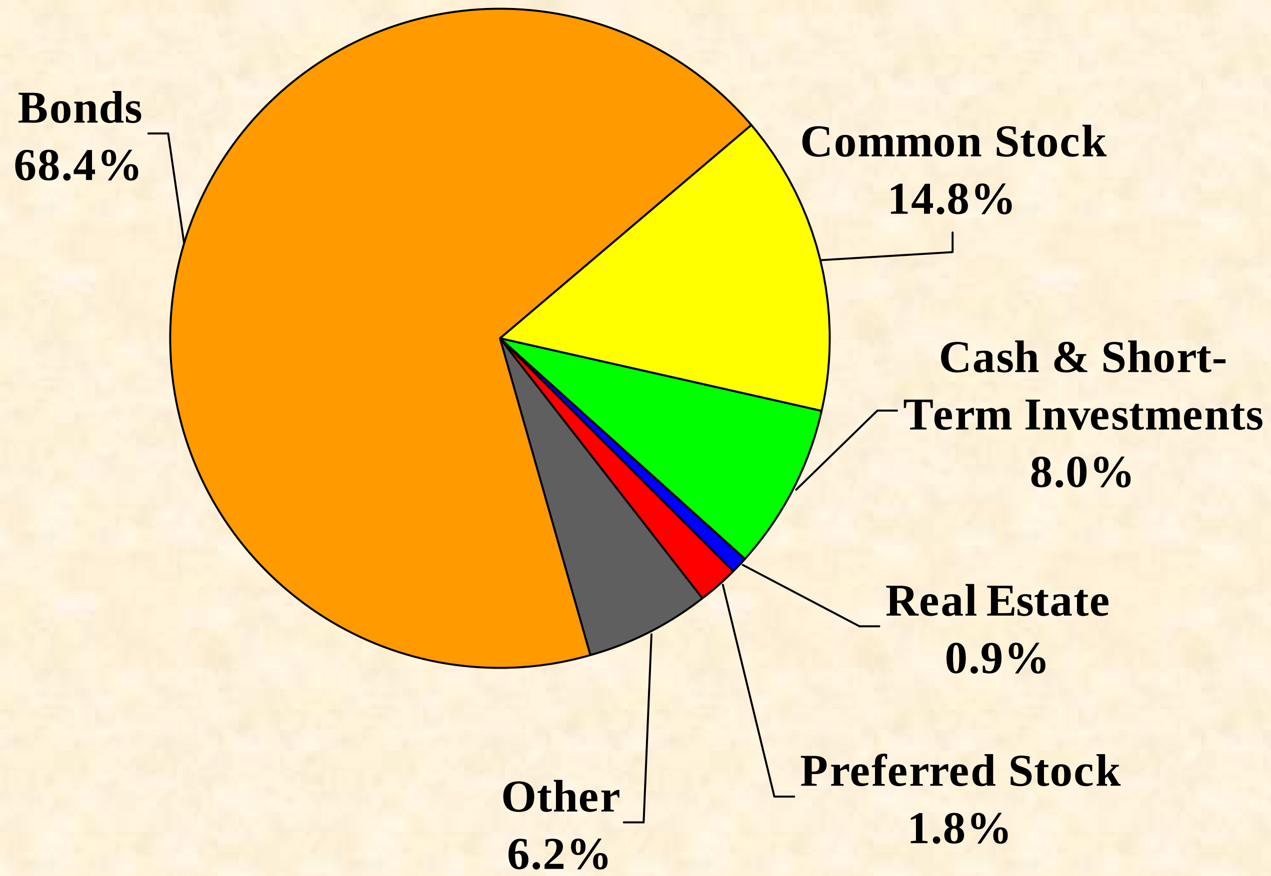
Source: NAIC; Insurance Information Institute research;.

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2008

Portfolio Facts

- Invested assets totaled $1.2 trillion as of 12/31/08, down from $1.3 trillion as of 12/31/07
- Insurers are generally conservatively invested, with 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, down from 18% one year earlier
- Even the most conservative of portfolios were hit hard in 2008

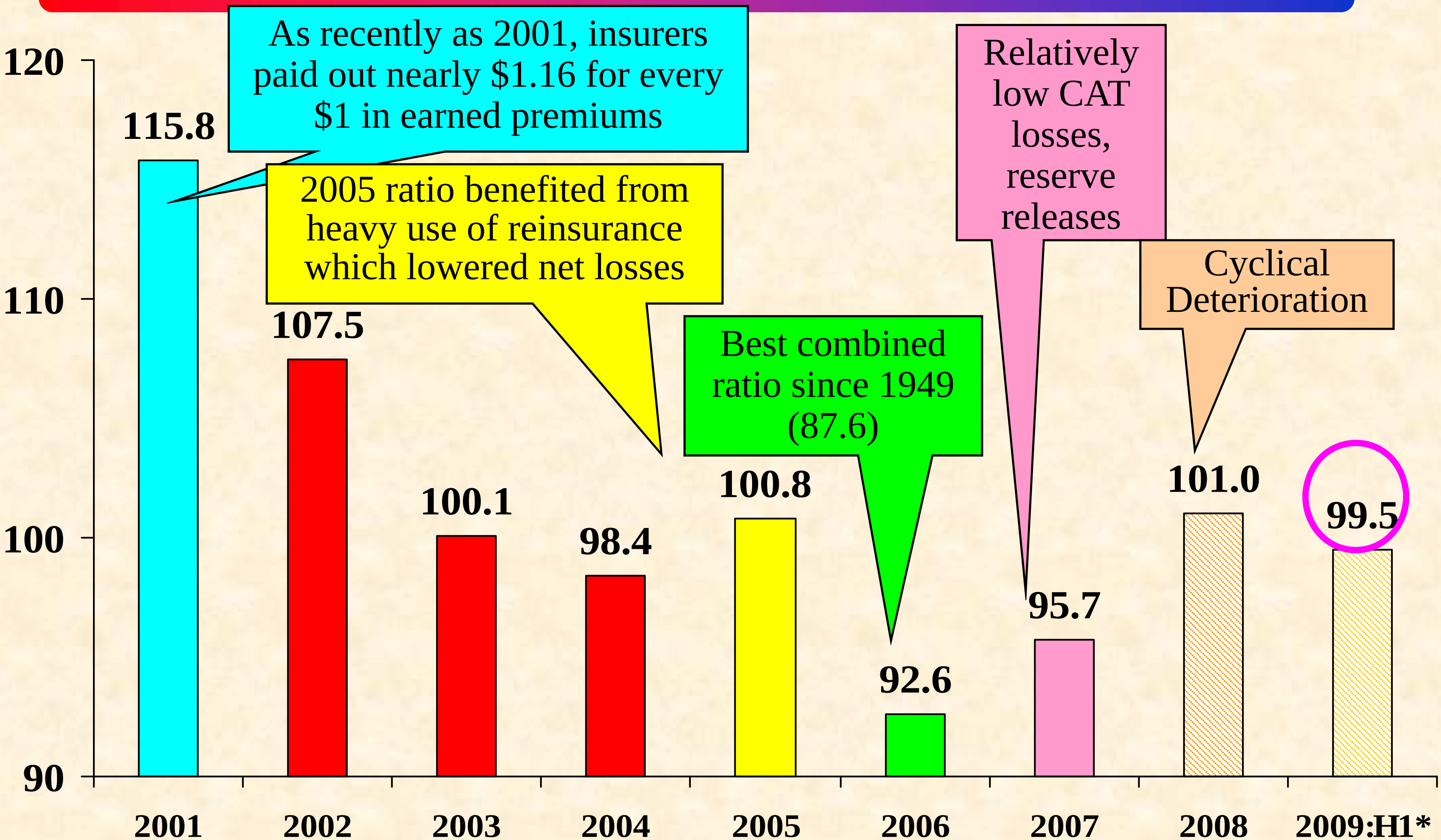


Source: NAIC; Insurance Information Institute research;.

Underwriting Trends

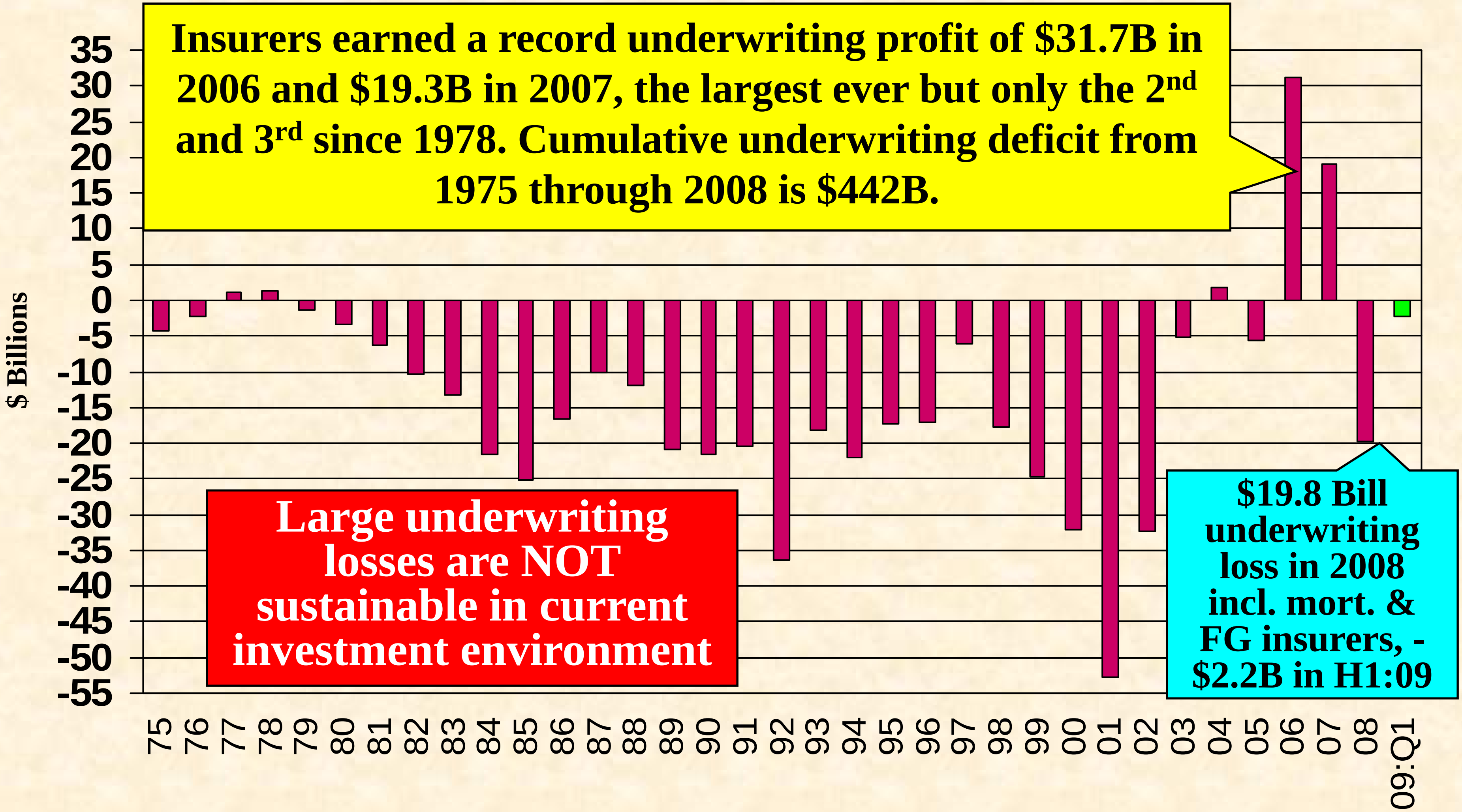
Financial Crisis Does *<u>Not</u>* Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

P/C Insurance Industry Combined Ratio, 2001-2009:H1*



*Excludes Mortgage & Financial Guaranty insurers in 2008. Including M&FG, 2008=105.1, 2009=100.9
Sources: A.M. Best, ISO.

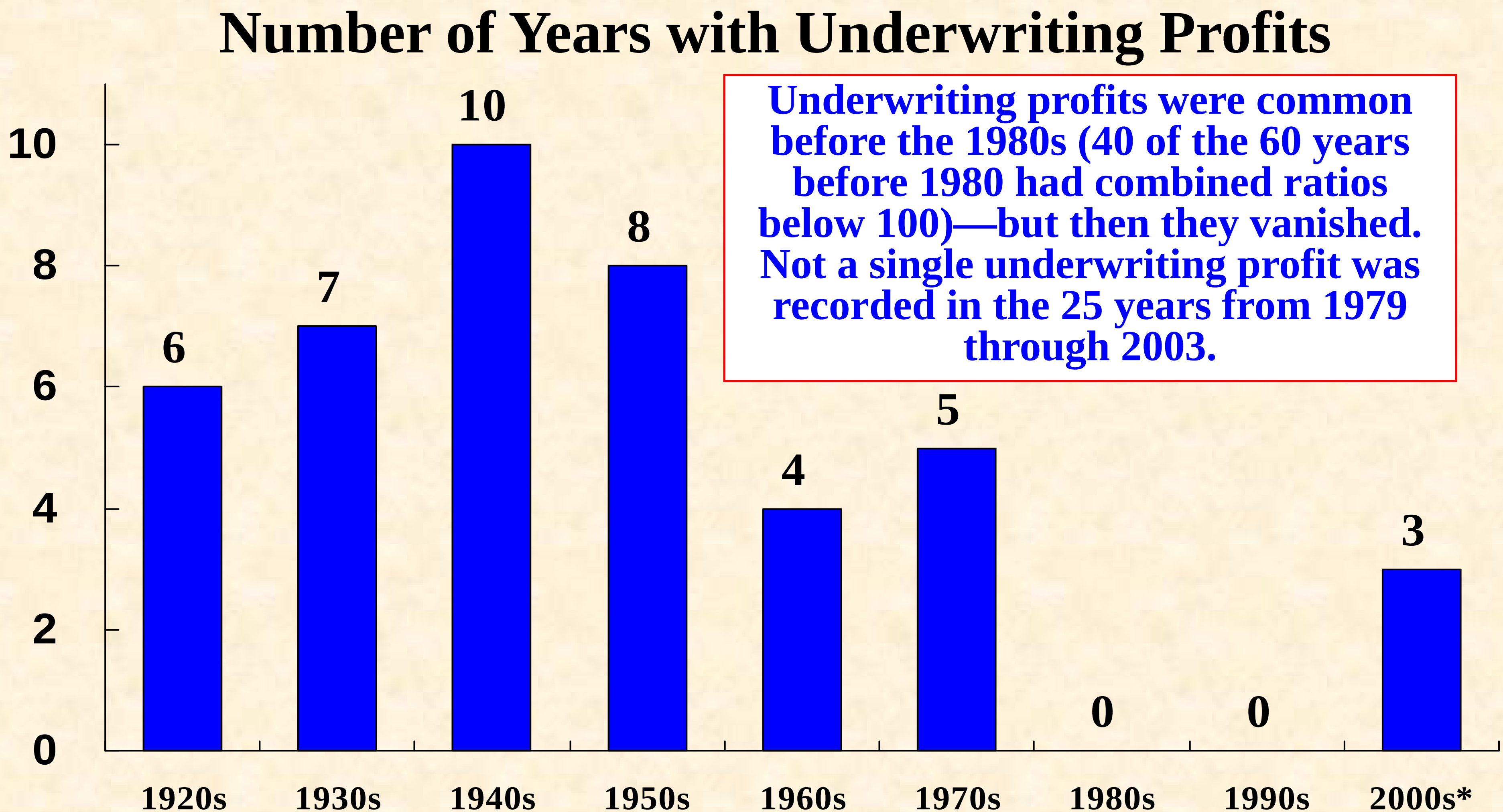
Underwriting Gain (Loss) 1975-2009:H1*



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

* Includes mortgage & finl. guarantee insurers

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



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

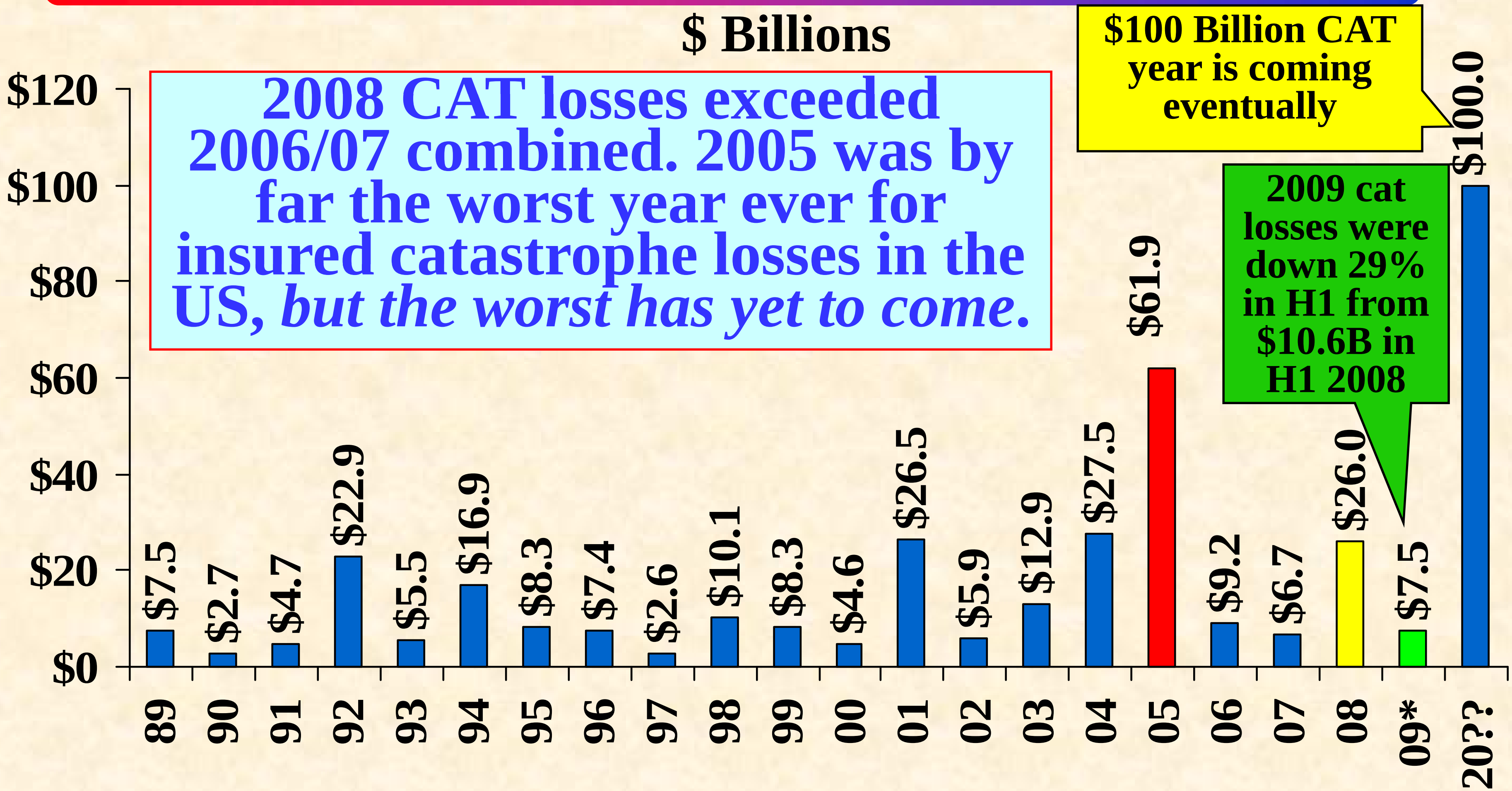
Sources: Insurance Information Institute research from A.M. Best Data.

*2000 through 2008.

Catastrophic Loss

Catastrophe Losses Trends Are Trending Adversely

U.S. Insured Catastrophe Losses

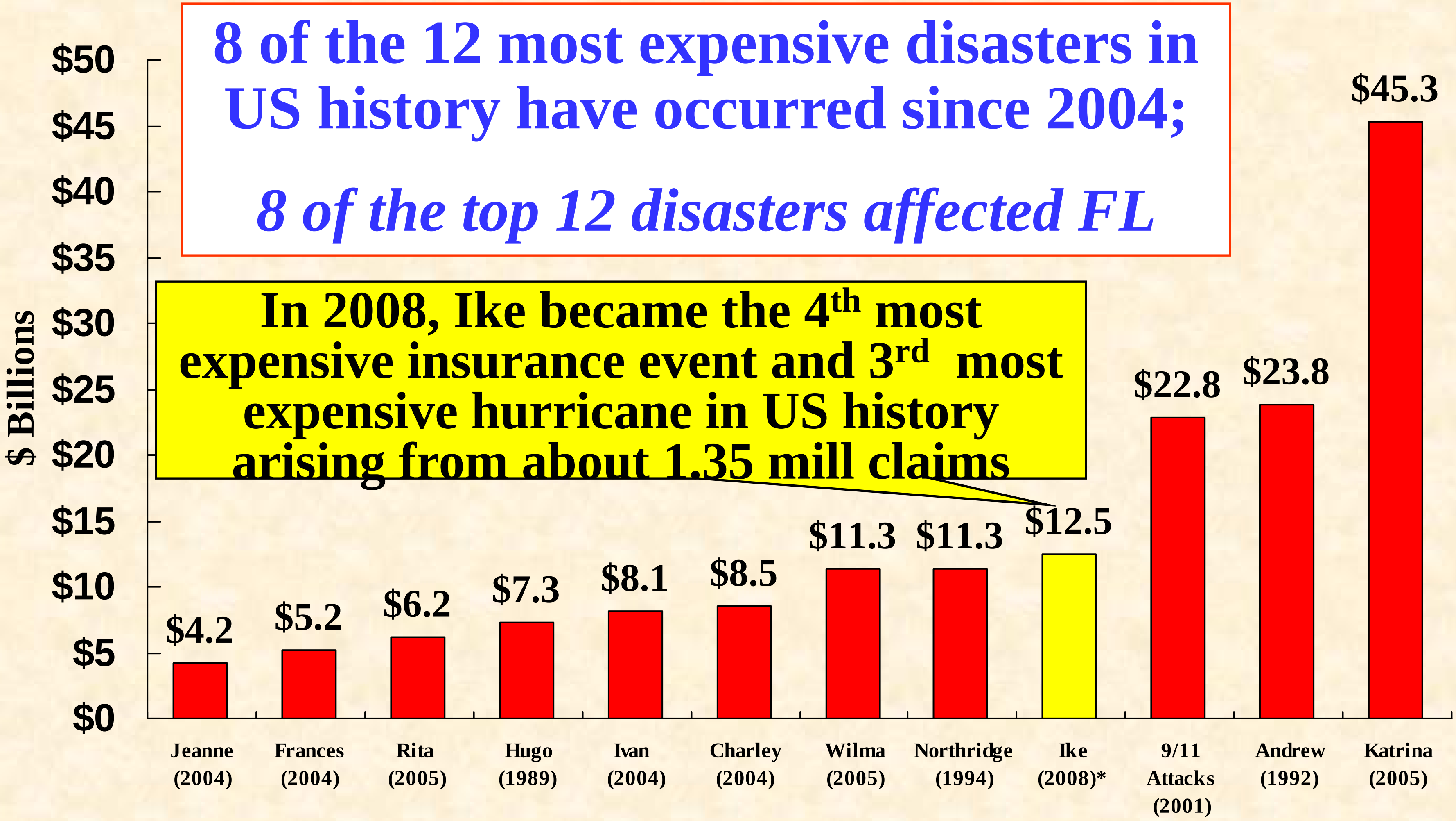


*Based on PCS data through June 30 = $7.5 billion.

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.

Source: Property Claims Service/ISO; Insurance Information Institute

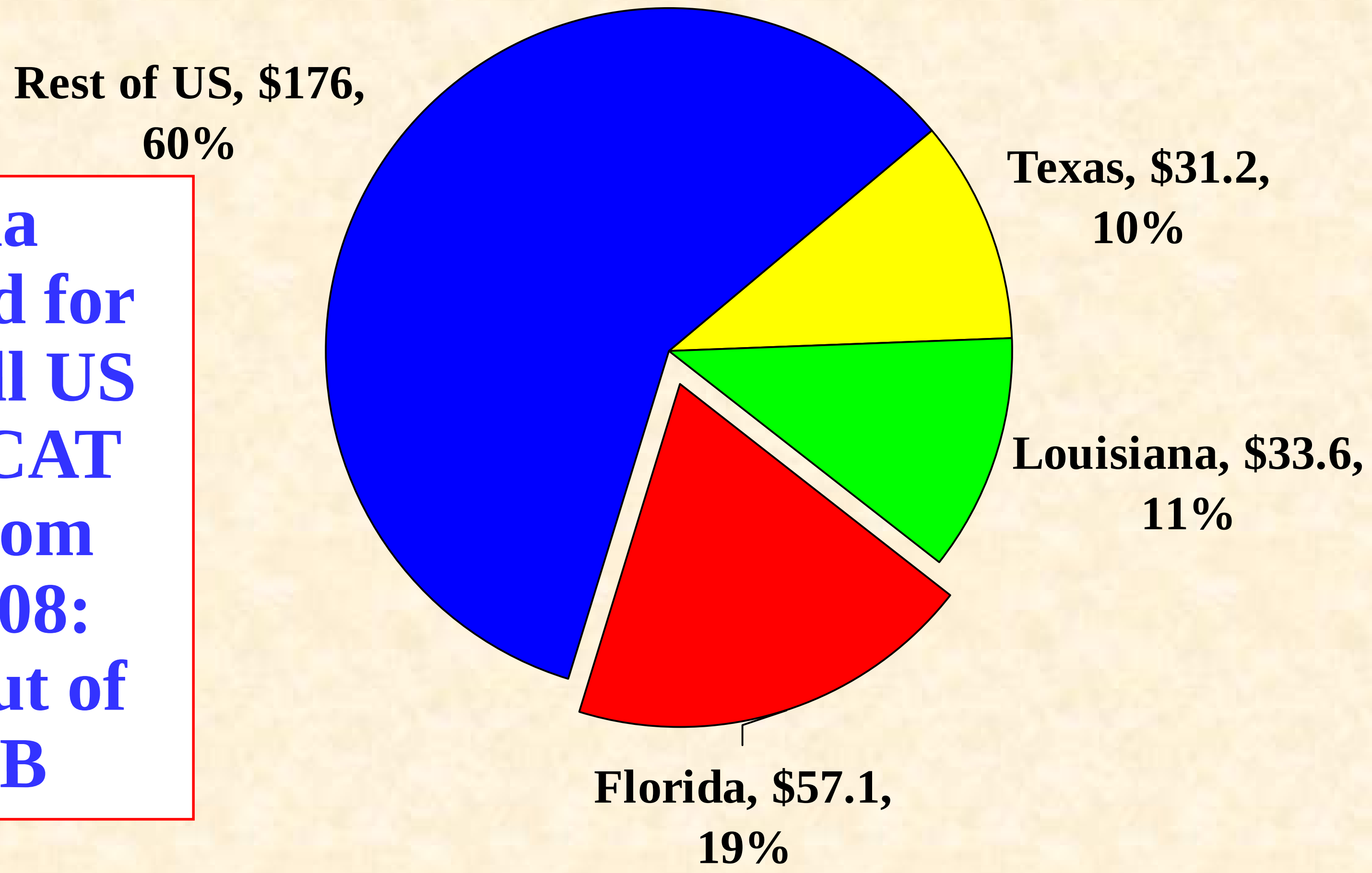
Top 12 Most Costly Disasters in US History, (Insured Losses, $2008)



*PCS estimate as of August 1, 2009.
Sources: PCS; Insurance Information Institute inflation adjustments.

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

$ Billions of Dollars

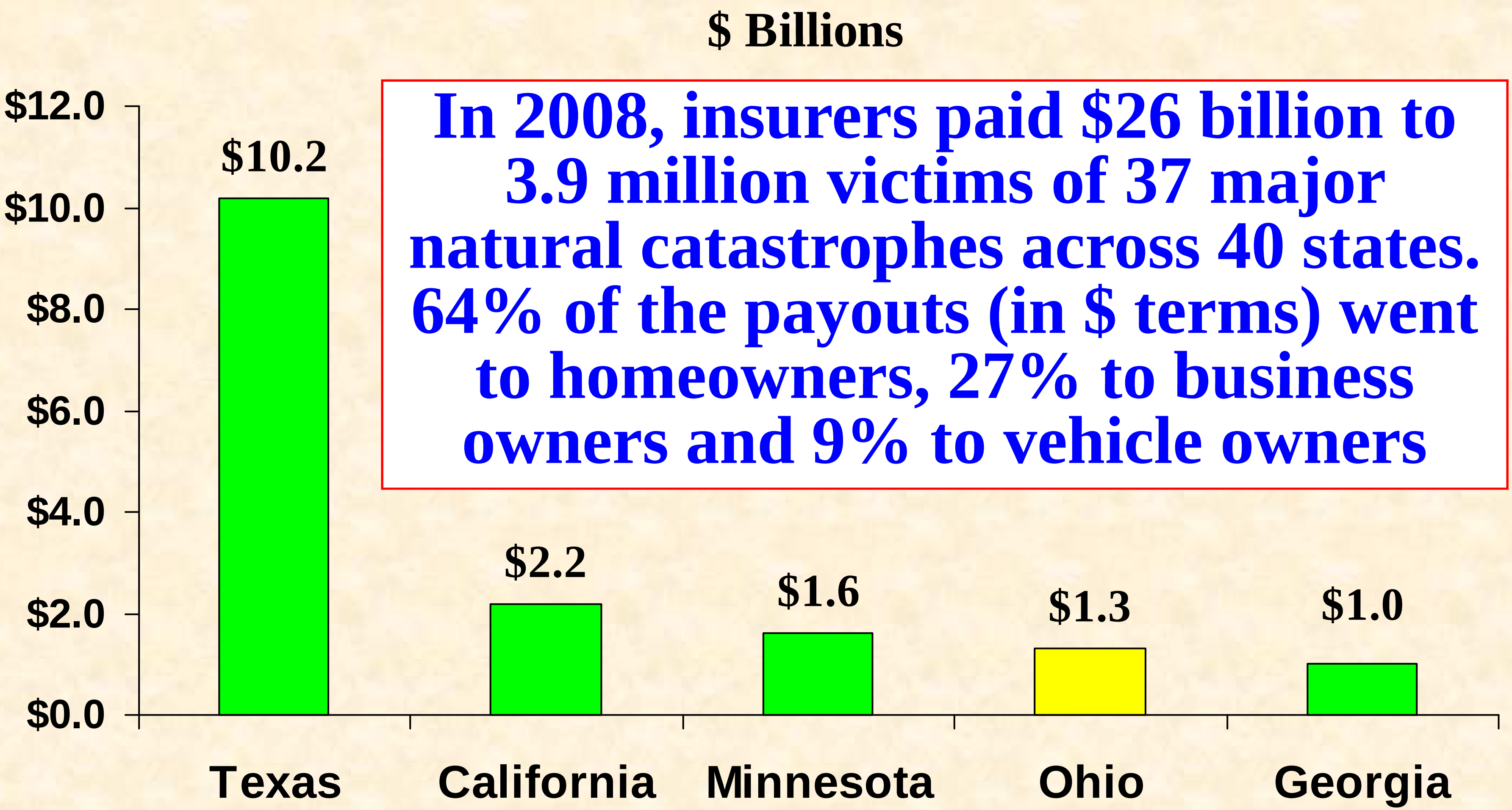


Florida accounted for 19% of all US insured CAT losses from 1980-2008: $57.1B out of $297.9B

*All figures (except 2006-2008 loss) have been adjusted to 2005 dollars.

Source: PCS division of ISO.

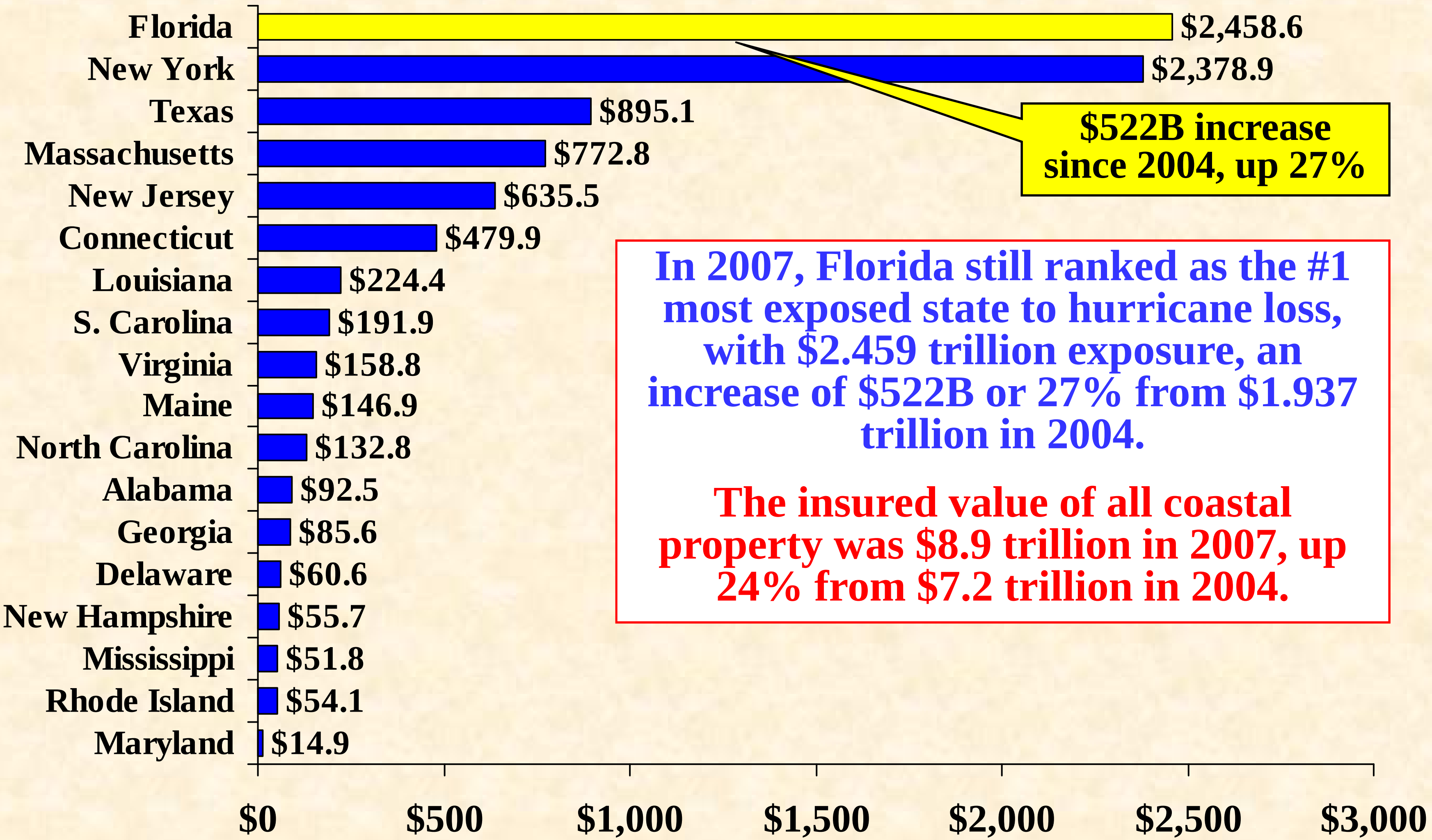
States With Highest Insured Catastrophe Losses in 2008



In 2008, insurers paid $26 billion to 3.9 million victims of 37 major natural catastrophes across 40 states. 64% of the payouts (in $ terms) went to homeowners, 27% to business owners and 9% to vehicle owners

Source: PCS; Insurance Information Institute.

Total Value of Insured Coastal Exposure *(2007, $ Billions)*

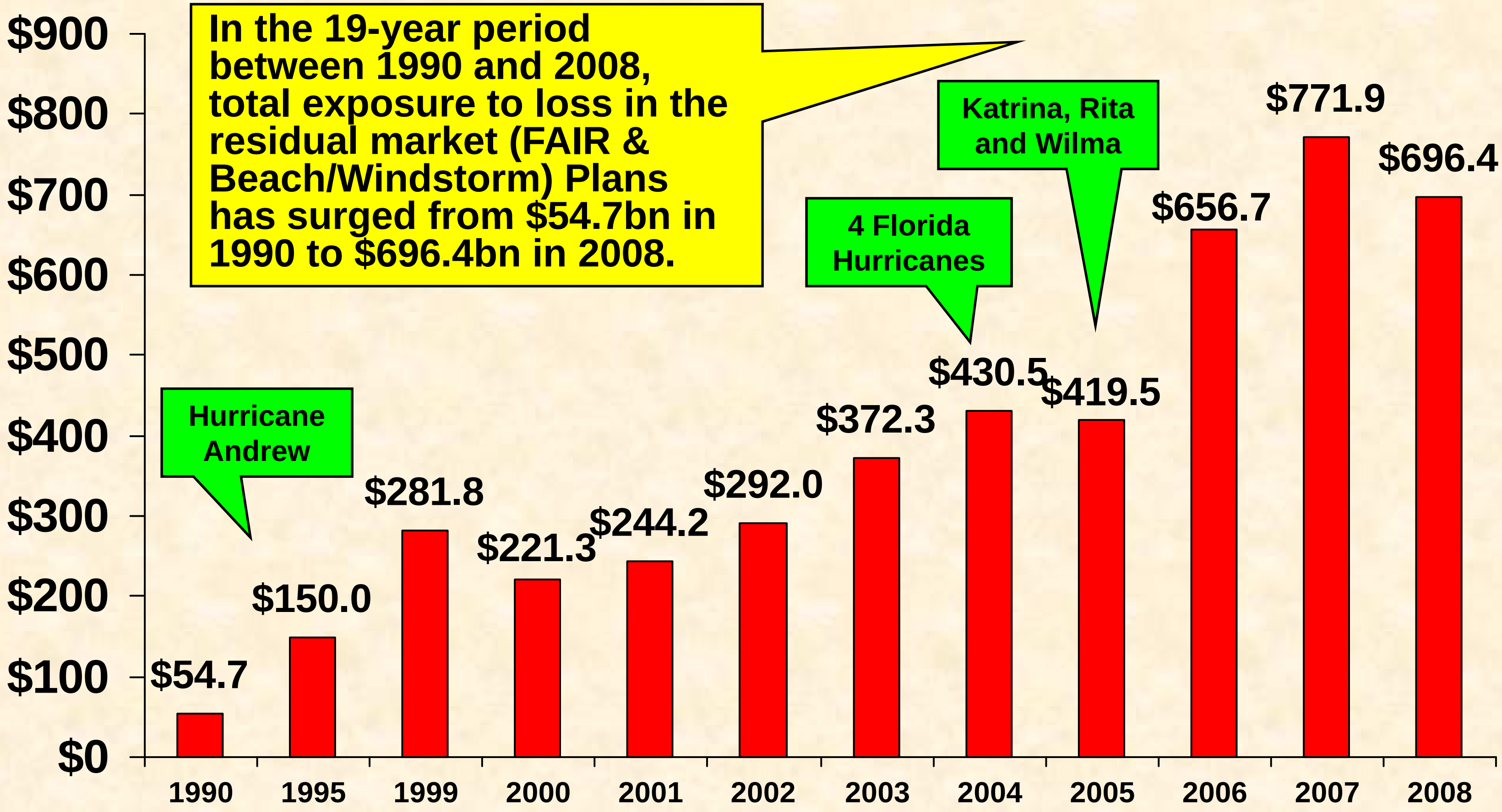


In 2007, Florida still ranked as the #1 most exposed state to hurricane loss, with $2.459 trillion exposure, an increase of $522B or 27% from $1.937 trillion in 2004.

The insured value of all coastal property was $8.9 trillion in 2007, up 24% from $7.2 trillion in 2004.

Source: AIR Worldwide

U.S. Residual Market Exposure to Loss (Billions of Dollars)



Source: PIPSO; Insurance Information Institute

Insurance Information Institute On-Line

WWW.III.ORG

THANK YOU FOR YOUR TIME AND

YOUR ATTENTION!

Download at: www.iii.org/presentations/PRIMA-102809.html