



Personal Lines P-C Insurance Markets: *Challenges & Opportunities for 2011 & Beyond*

January 18, 2011

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

- **Personal Lines Growth Overview**
 - ◆ Auto, Home: US and by State
 - ◆ Average Premium/Expenditures
- **Personal Lines Growth Drivers**
 - ◆ Exposure, Pricing Factors
- **Personal Lines Profitability Analysis**
- **Cyclical Drivers in Personal Lines**
 - ◆ Loss as a Cyclical Driver
 - ◆ Reserving
- **Private Passenger Auto Performance**
- **Distribution Trends**
- **P/C Financial Overview & Outlook: The Role of Cyclicity**
 - ◆ Profitability
 - ◆ Premium Growth
 - ◆ Capital, Capacity and Financial Strength
 - ◆ Underwriting Performance
 - ◆ Investment Performance & Muni Bond Concerns
- **Financial Crisis, Recession & Recovery: P/C Insurer Impacts**
- **Catastrophe Losses: 2010 in Review**
- **Q&A**

Personal Lines Growth Analysis

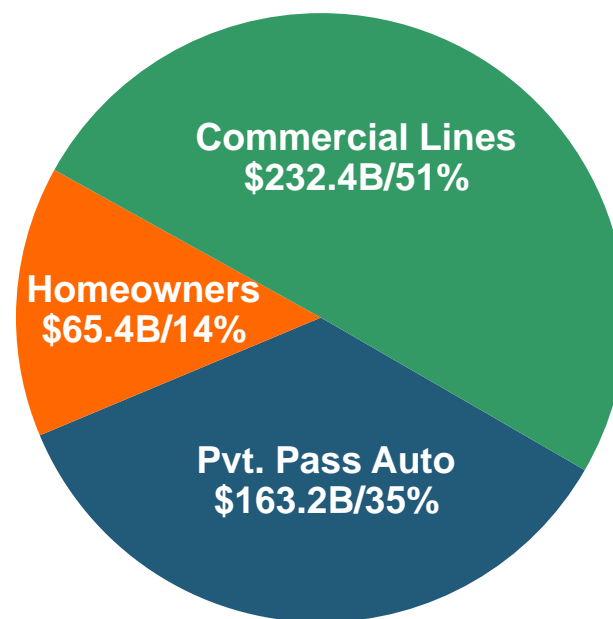
**Growth Trajectories Differ
Substantially by Line, by
State and Over Time**

Distribution of Direct Premiums Written by Segment/Line, 2009

Distribution Facts

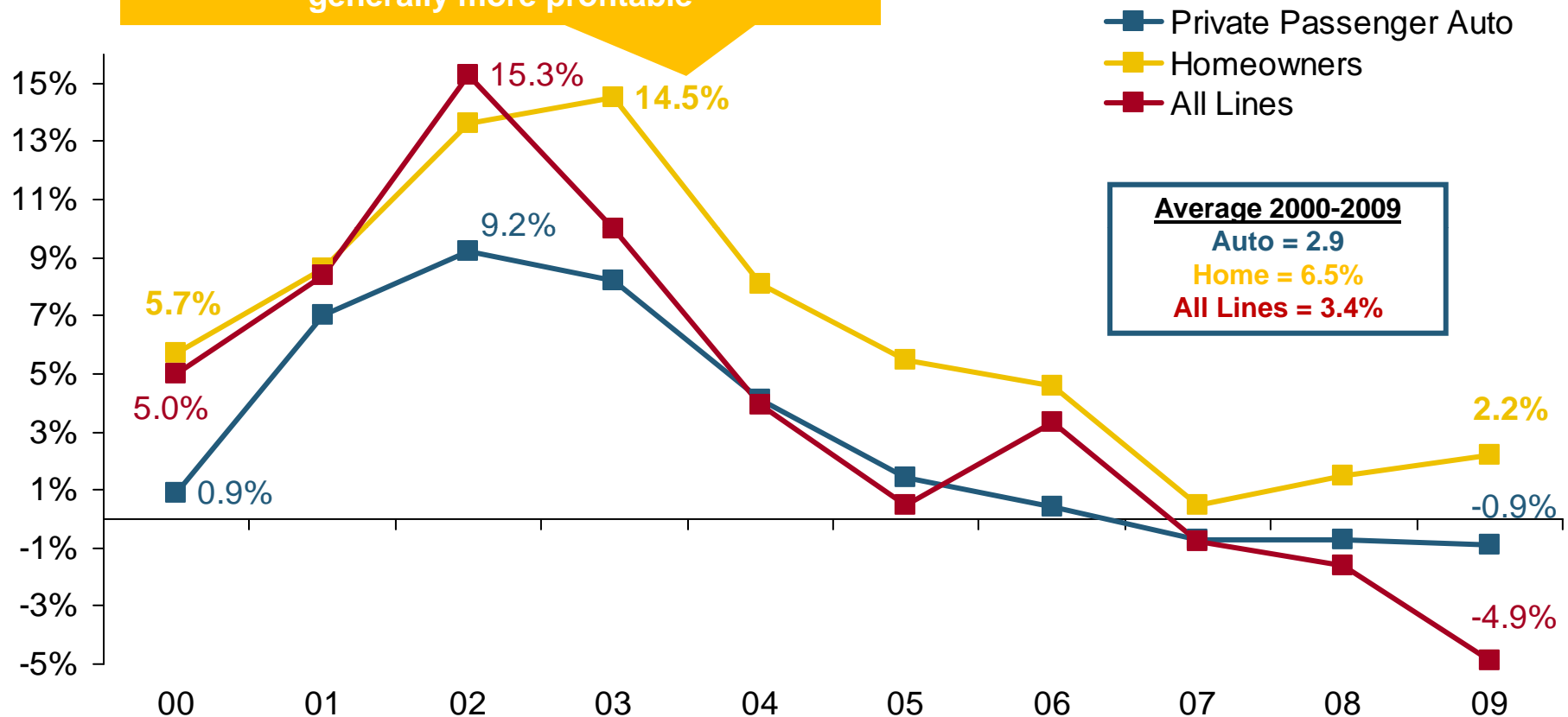
- Personal/Commercial lines split has been about 50/50 for many years; Personal Lines likely overtook Commercial Lines in 2010
- Pvt. Passenger Auto is by far the largest line of insurance and is currently the most important source of industry profits
- Billions of additional dollars in homeowners insurance premiums are written by state-run residual market plans

2009

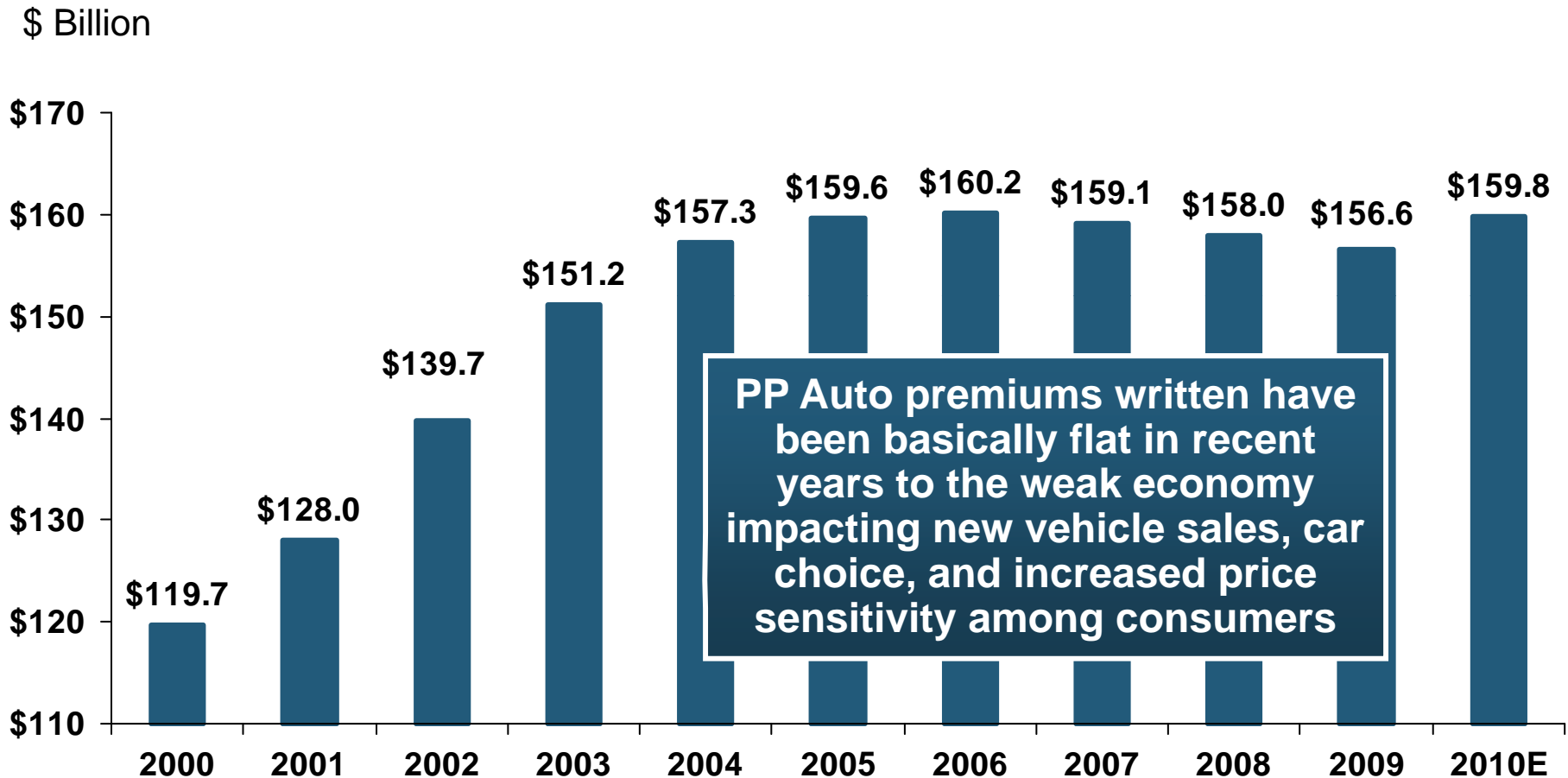


Auto & Home vs. All Lines, Net Written Premium Growth, 2000–2009

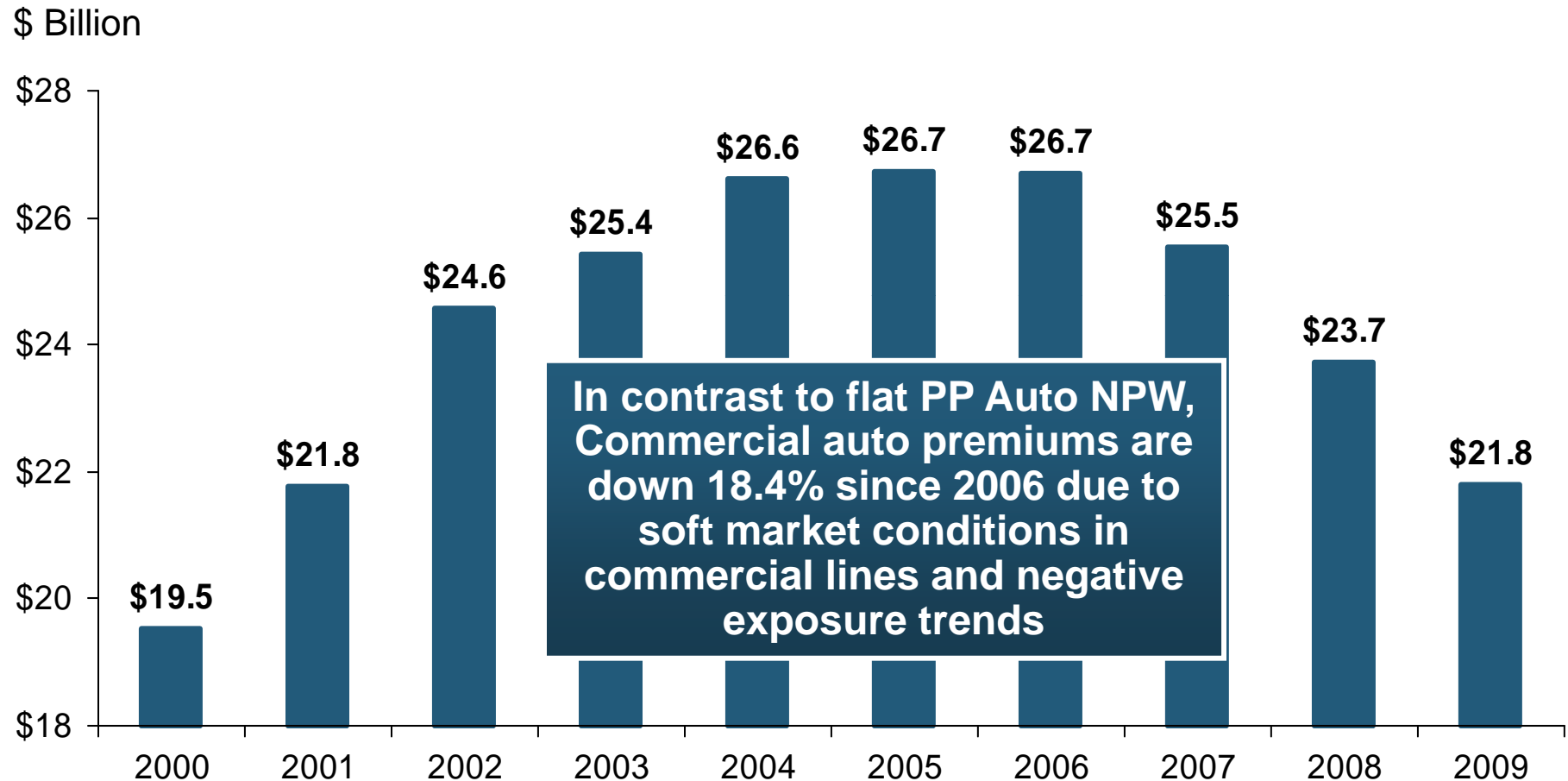
While homeowners insurance has grown faster than auto over the past decade, auto is generally more profitable



Private Passenger Auto Insurance Net Written Premium, 2000–2009

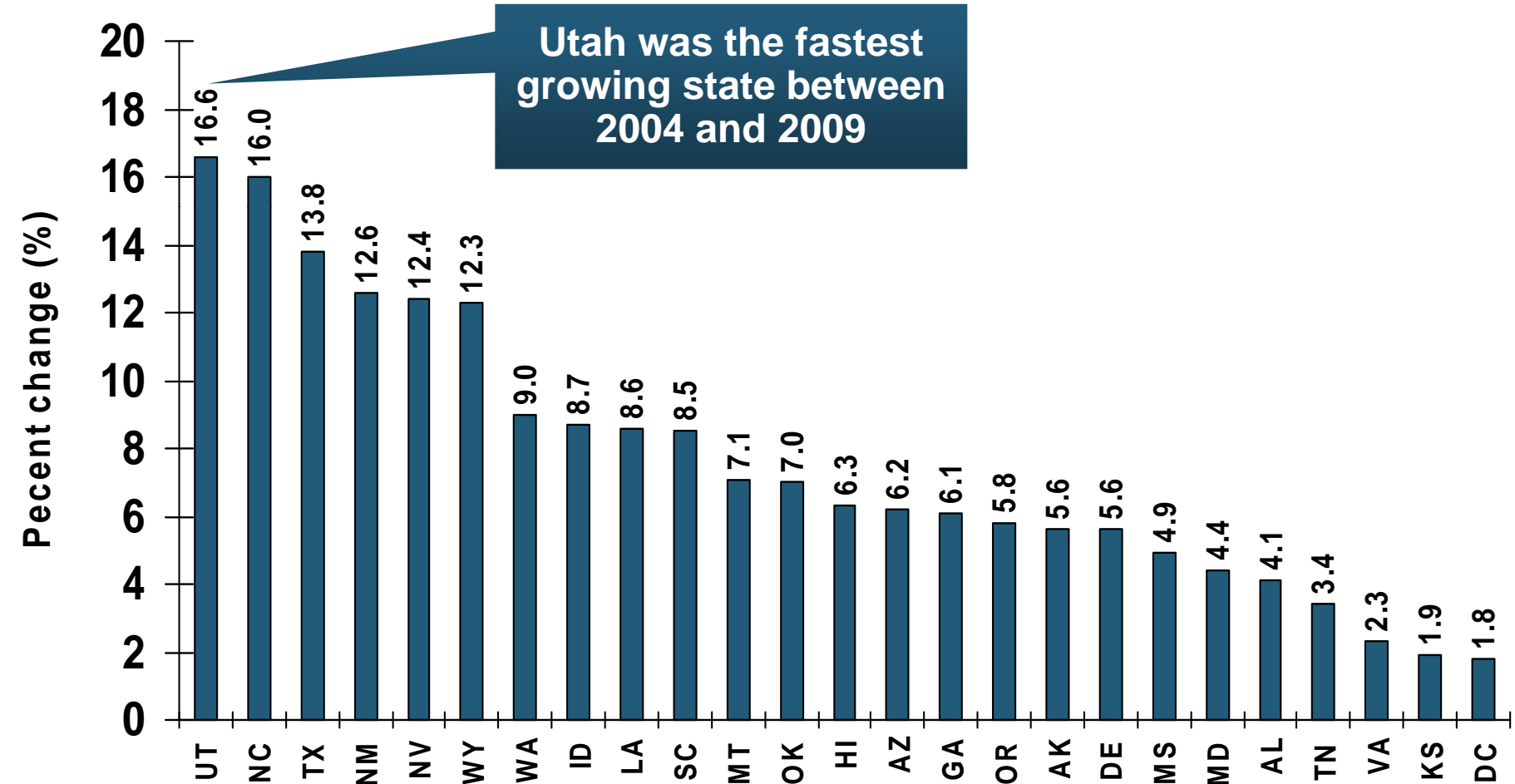


Commercial Auto Insurance Net Written Premium, 2000–2009



Percent Change in NPW: Pvt. Pass. Auto by State, 2004-2009

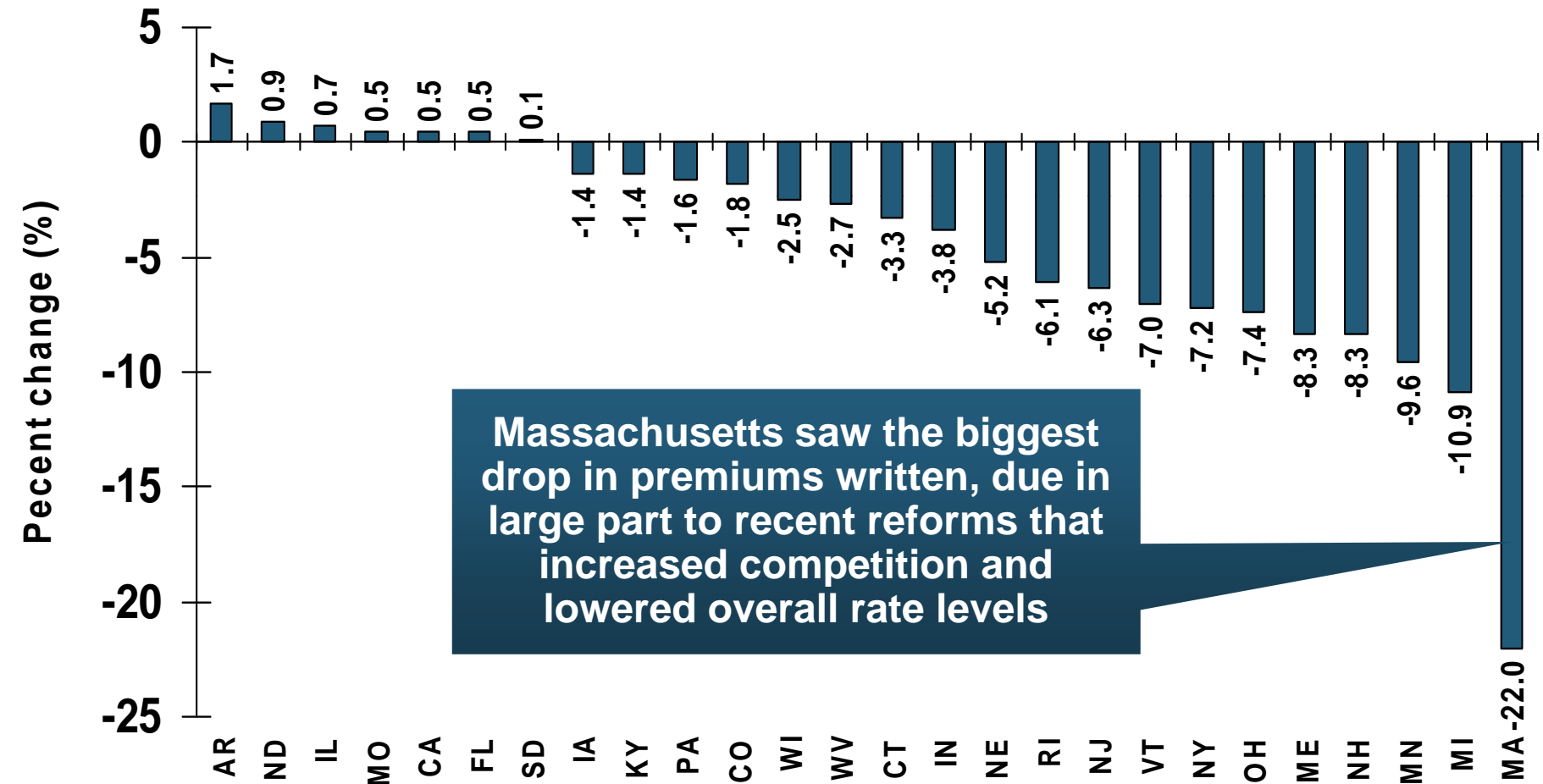
Top 25 States



Sources: SNL Financial LC.; Insurance Information Institute.

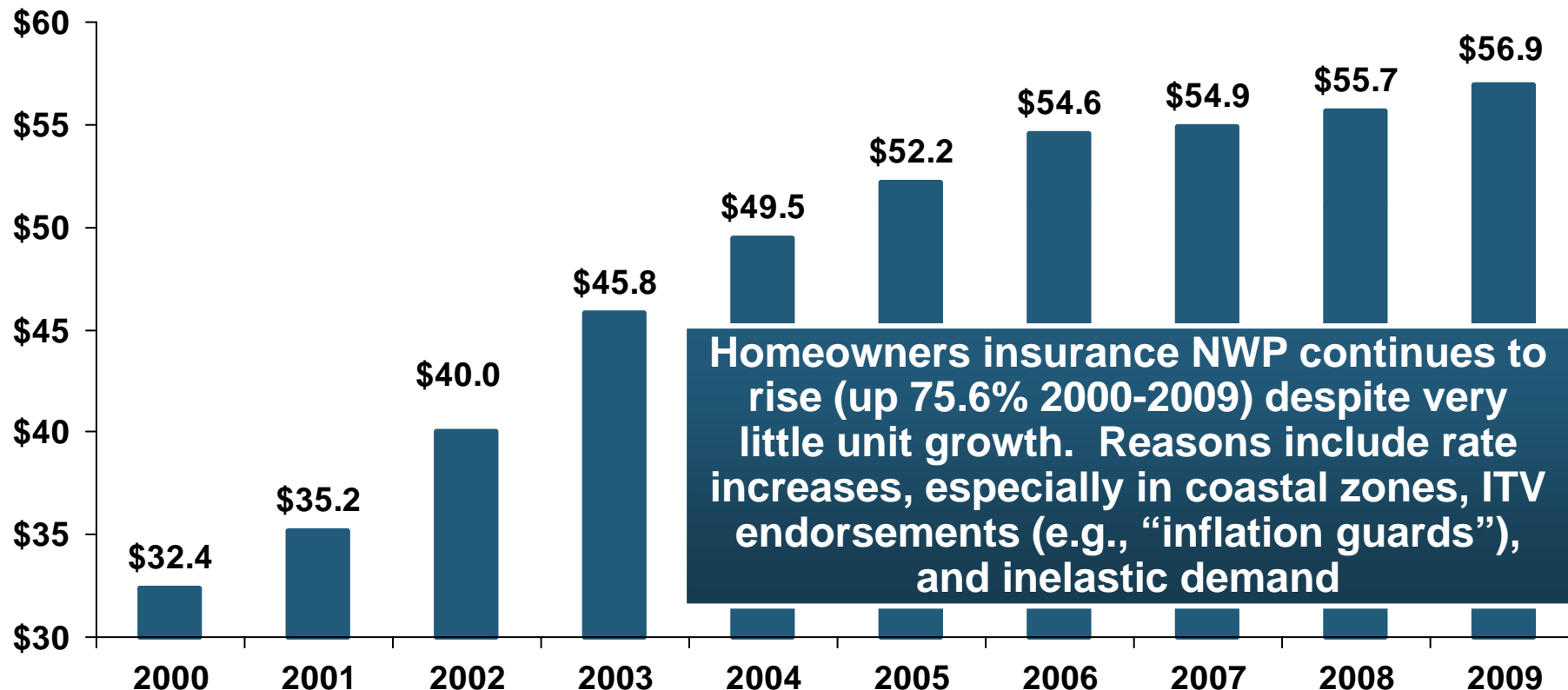
Percent Change in NPW: Pvt. Pass. Auto by State, 2004-2009

Bottom 25 States

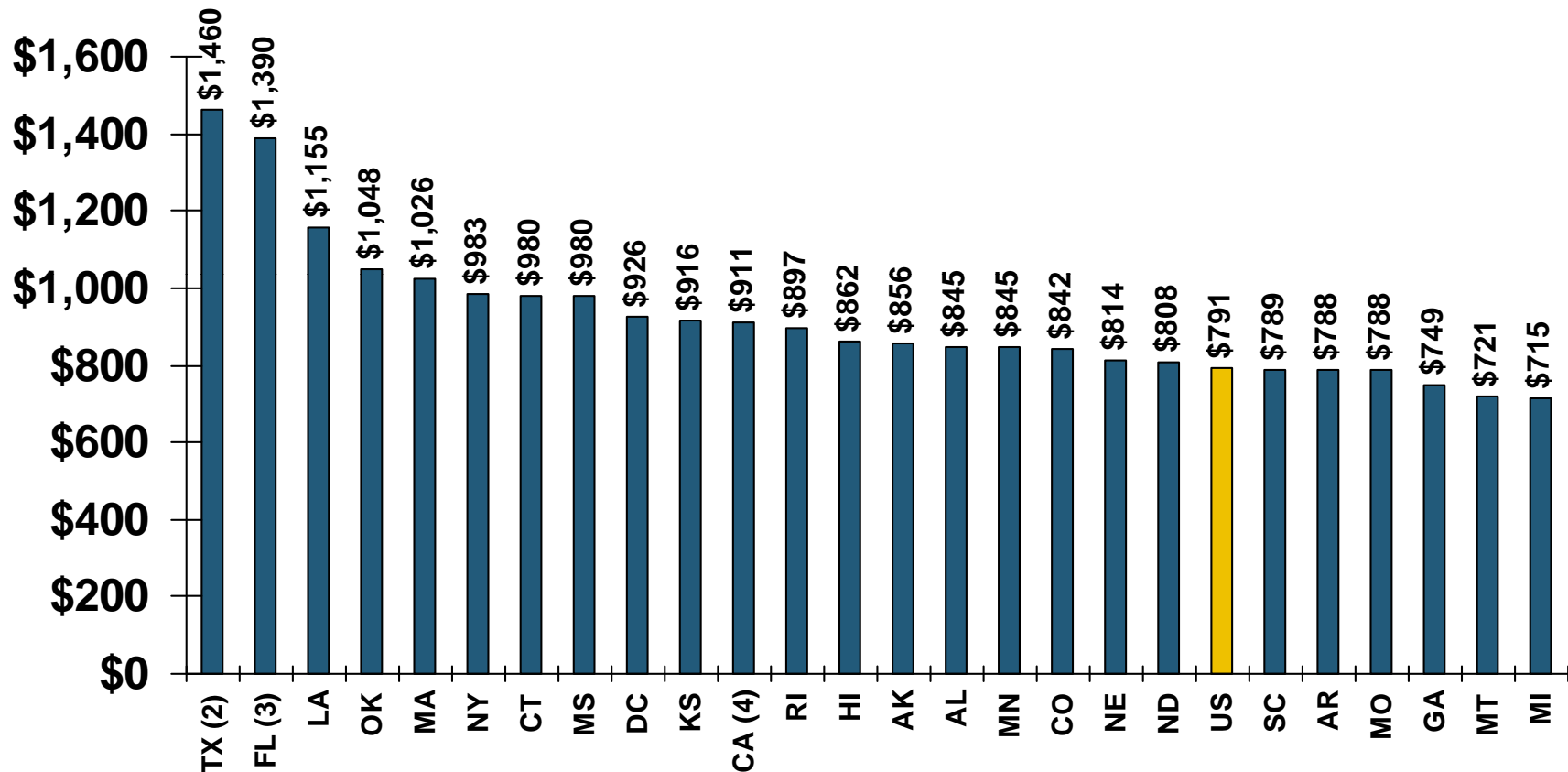


Homeowners Insurance Net Written Premium, 2000–2009

\$ Billions



Average Premiums For Home Insurance By State, 2008 (1)

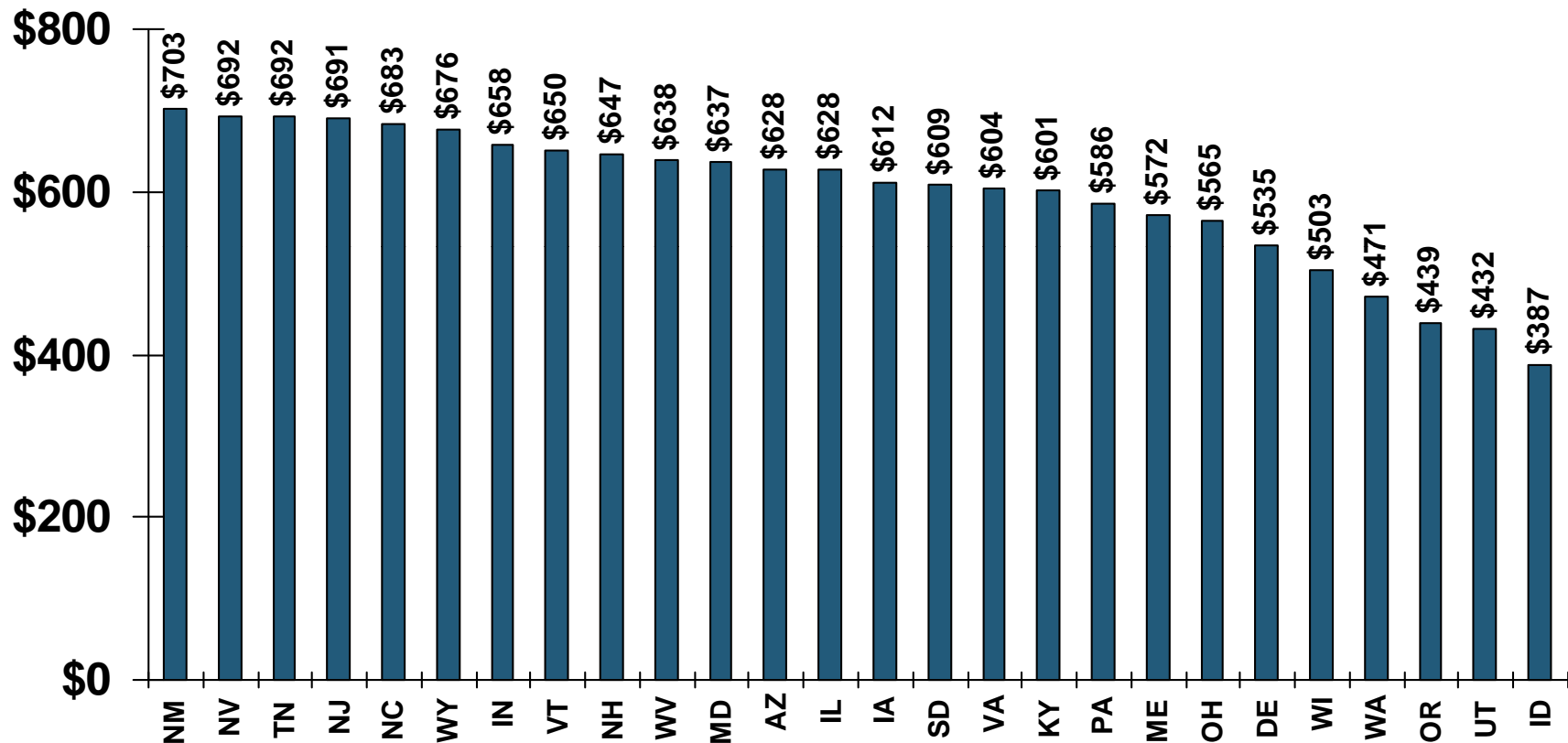


(1) Based on the HO-3 homeowner package policy for owner-occupied dwellings, 1 to 4 family units. Provides "all risks" coverage (except those specifically excluded in the policy) on buildings and broad named-peril coverage on personal property, and is the most common package written. (2) The Texas Department of Insurance developed home insurance policy forms that are similar but not identical to the standard forms. (3) Florida data exclude policies written by Citizens Property Insurance Corporation, the state's insurer of last resort, and therefore are not directly of comparable with other states. (4) California data were provided by the California Department of Insurance.

Note: Average premium=Premiums/exposure per house years. A house year is equal to 365 days insured coverage for a single dwelling.

Source: © 2010 National Association of Insurance Commissioners (NAIC). Reprinted with permission. Further reprint or distribution strictly prohibited without written permission of NAIC.

Average Premiums For Home Insurance By State, 2008 (1) (con't)



(1) Based on the HO-3 homeowner package policy for owner-occupied dwellings, 1 to 4 family units. Provides "all risks" coverage (except those specifically excluded in the policy) on buildings and broad named-peril coverage on personal property, and is the most common package written.

Note: Average premium = Premiums / exposure per house years. A house year is equal to 365 days insured coverage for a single dwelling.

Source: © 2010 National Association of Insurance Commissioners (NAIC). Reprinted with permission. Further reprint or distribution strictly prohibited without written permission of NAIC.

Personal Lines Growth Drivers

**Rate is Presently a Bigger
Driver than Exposure**

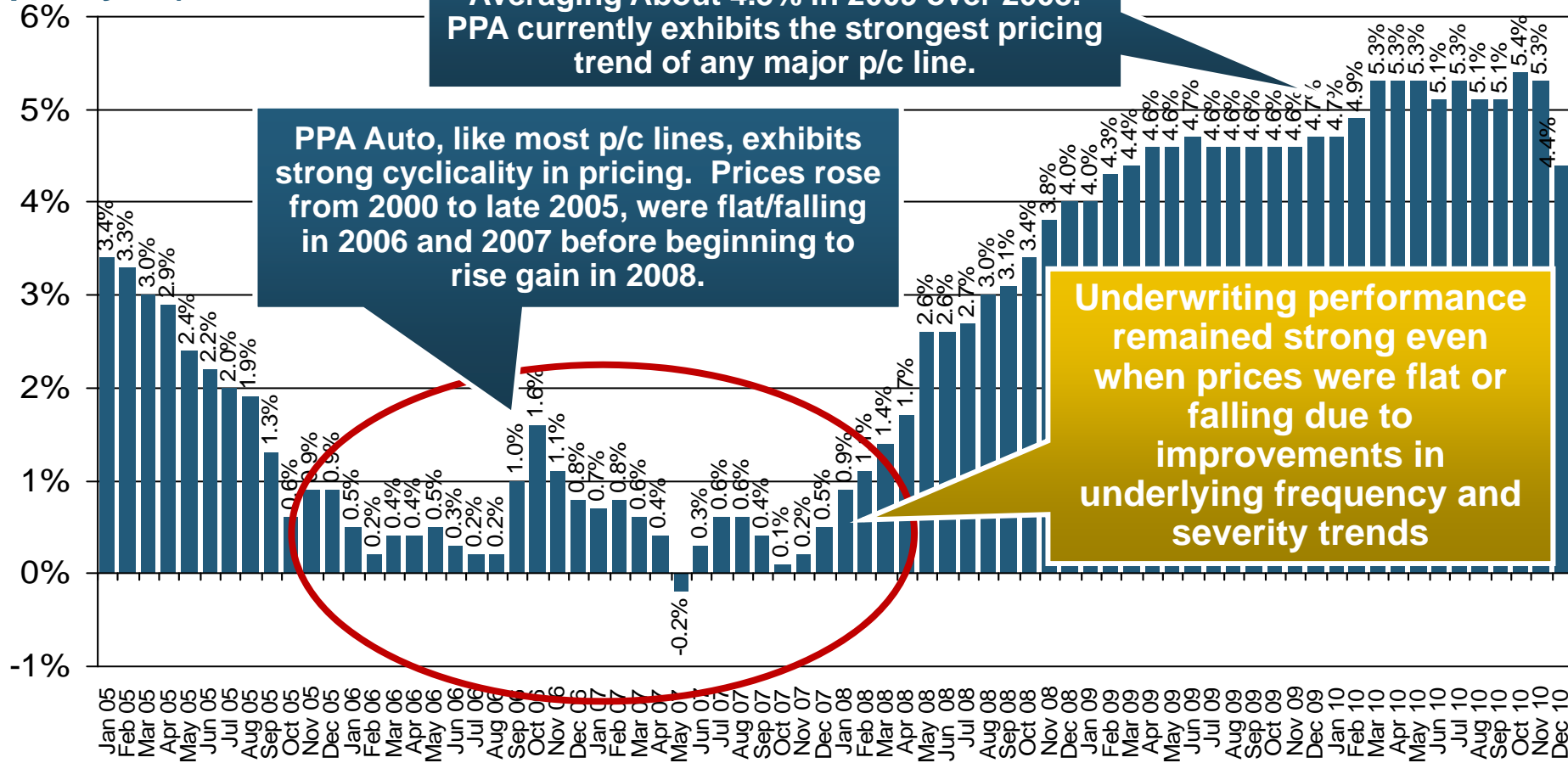
Monthly Change* in Auto Insurance Prices, January 2005 - December 2010

(Percent Change
from same month,
prior year)

Auto Insurance Price Increases Have Averaged About 5% in 2010 over 2009, After Averaging About 4.5% in 2009 over 2008. PPA currently exhibits the strongest pricing trend of any major p/c line.

PPA Auto, like most p/c lines, exhibits strong cyclical pricing. Prices rose from 2000 to late 2005, were flat/falling in 2006 and 2007 before beginning to rise again in 2008.

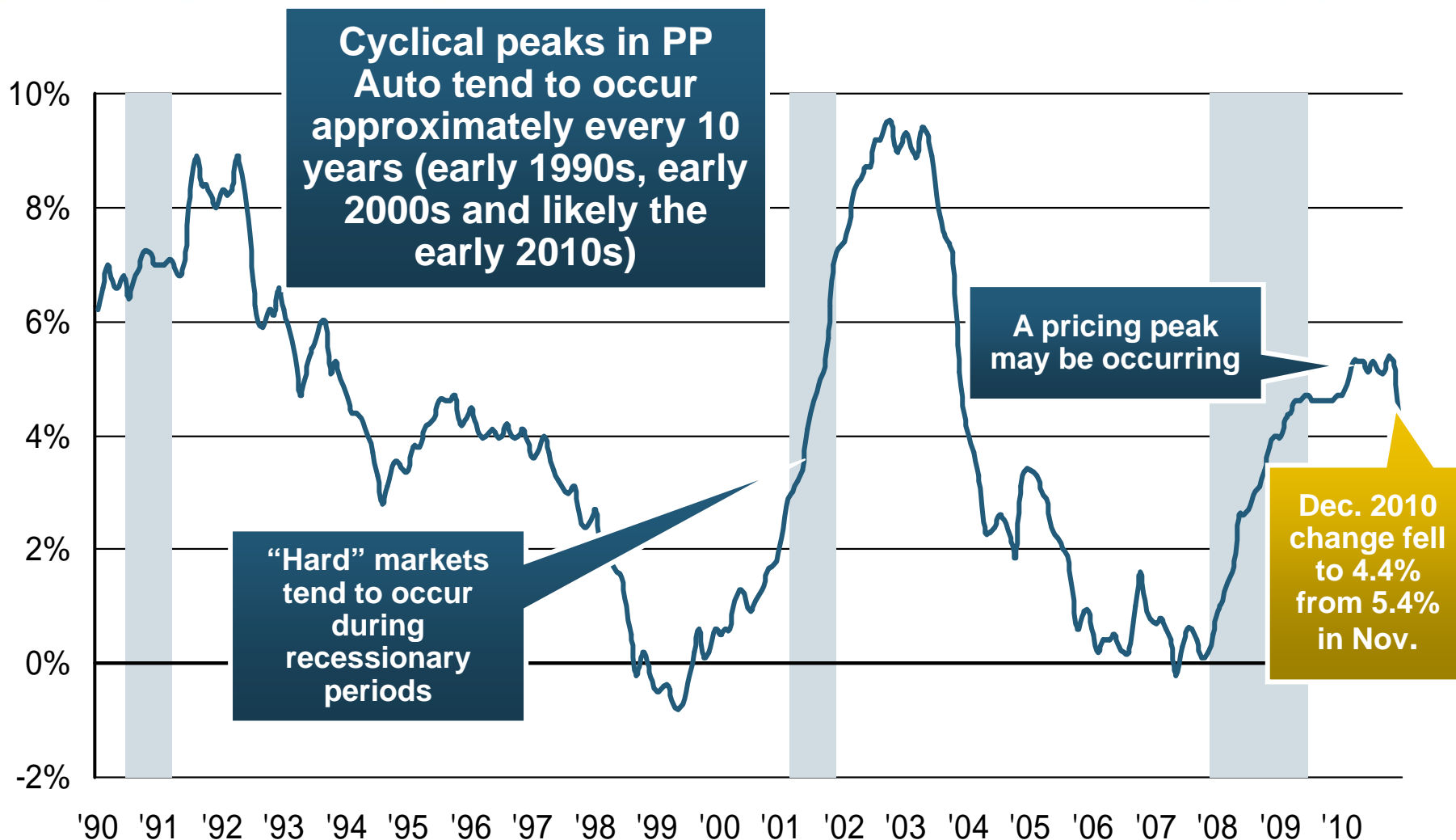
Underwriting performance remained strong even when prices were flat or falling due to improvements in underlying frequency and severity trends



*Percentage change from same month in prior year, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute

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

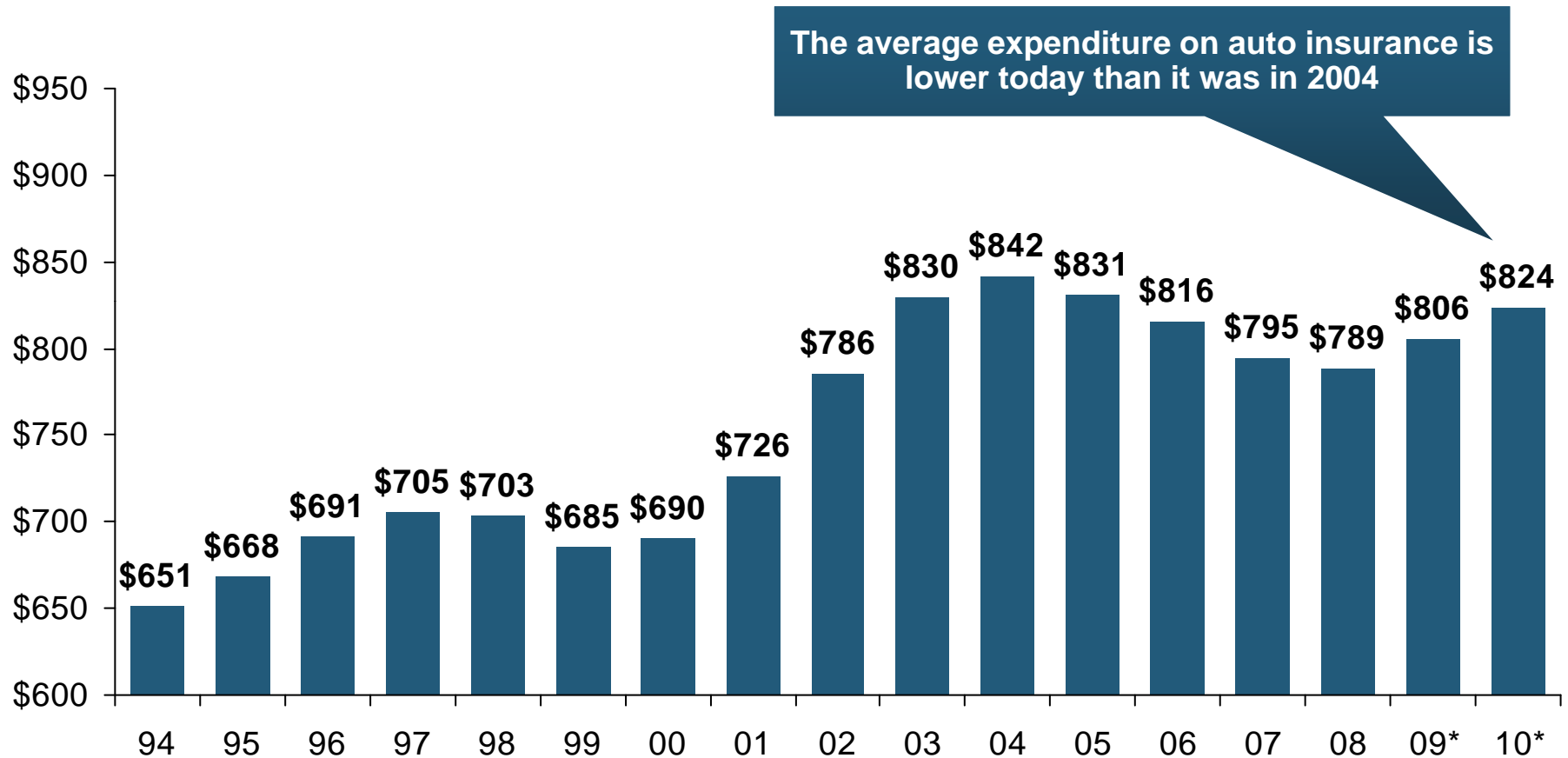


*Percentage change from same month in prior year; through December 2010; seasonally adjusted

Note: Recessions indicated by gray shaded columns.

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

Average Expenditures on Auto Insurance

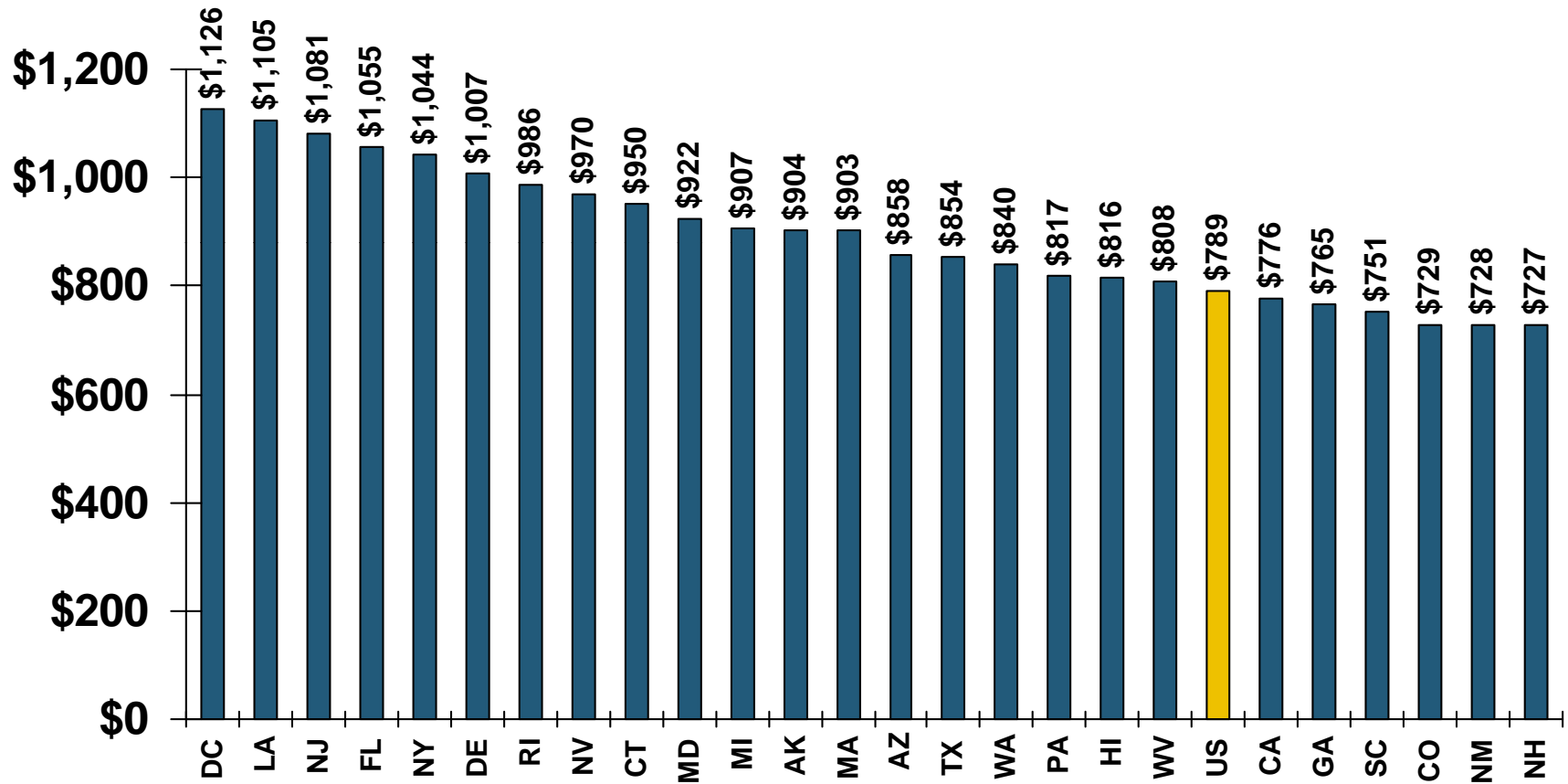


Countrywide Auto Insurance Expenditures Decreased 0.8% in 2008 and Increased 2.2% in 2009 (est.) and 2010 (est.)

* Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute estimates 2009-2010 based on CPI and other data.

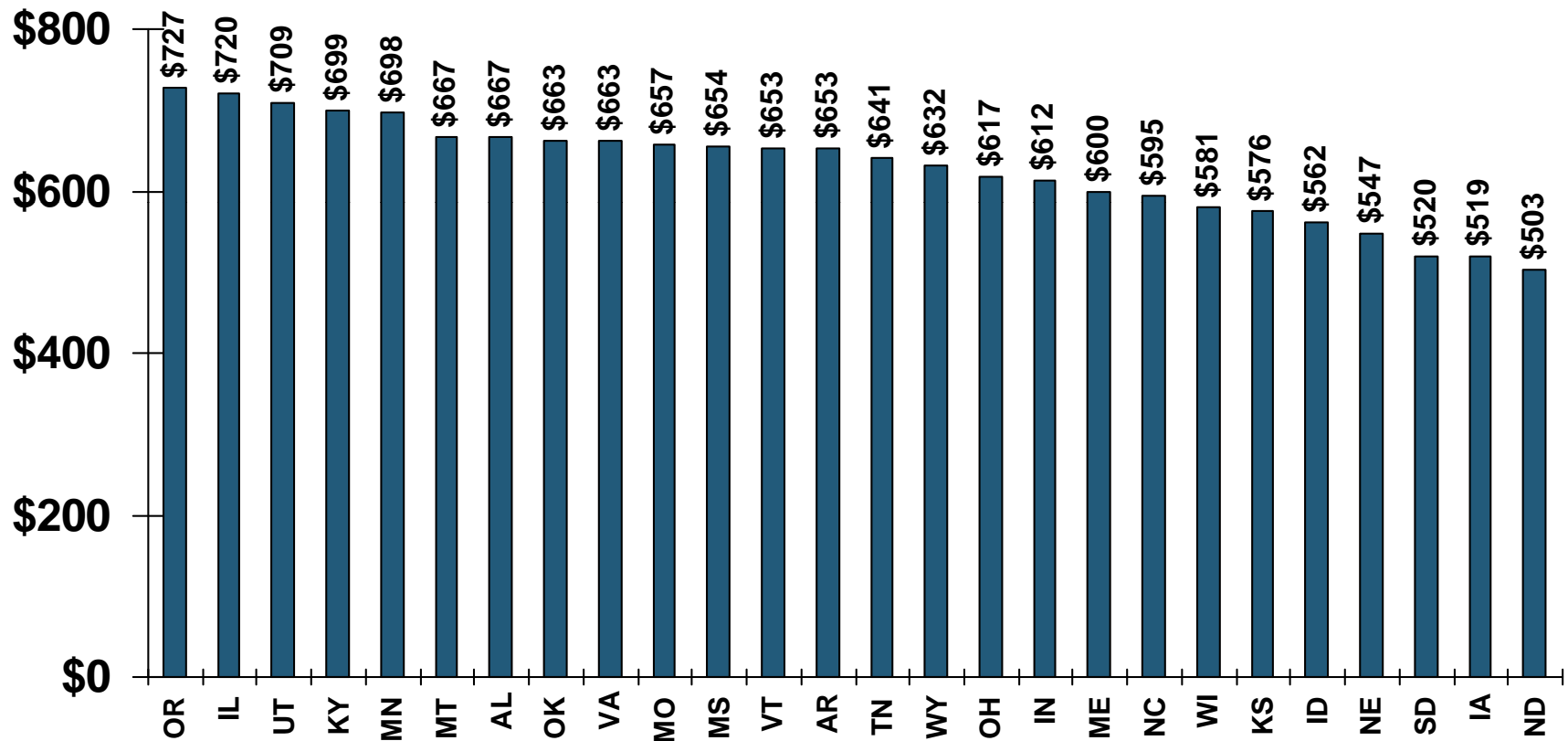
Average Expenditures For Auto Insurance By State, 2008



Note: Average expenditure=Total written premium/liability car years. A car year is equal to 365 days of insured coverage for a single vehicle.

Source: © 2010 National Association of Insurance Commissioners.

Average Expenditures For Auto Insurance By State, 2008 (con't)

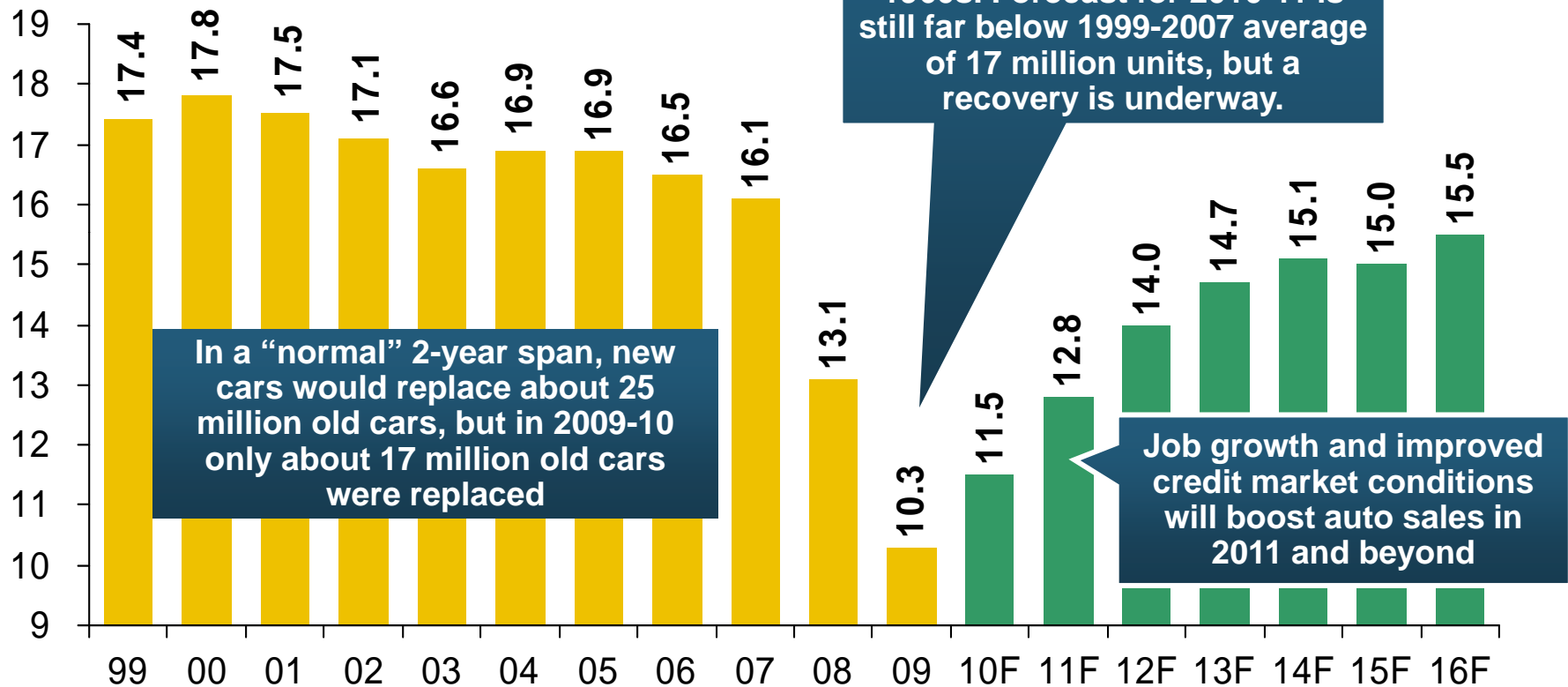


Note: Average expenditure=Total written premium/liability car years. A car year is equal to 365 days of insured coverage for a single vehicle.

Source: © 2010 National Association of Insurance Commissioners.

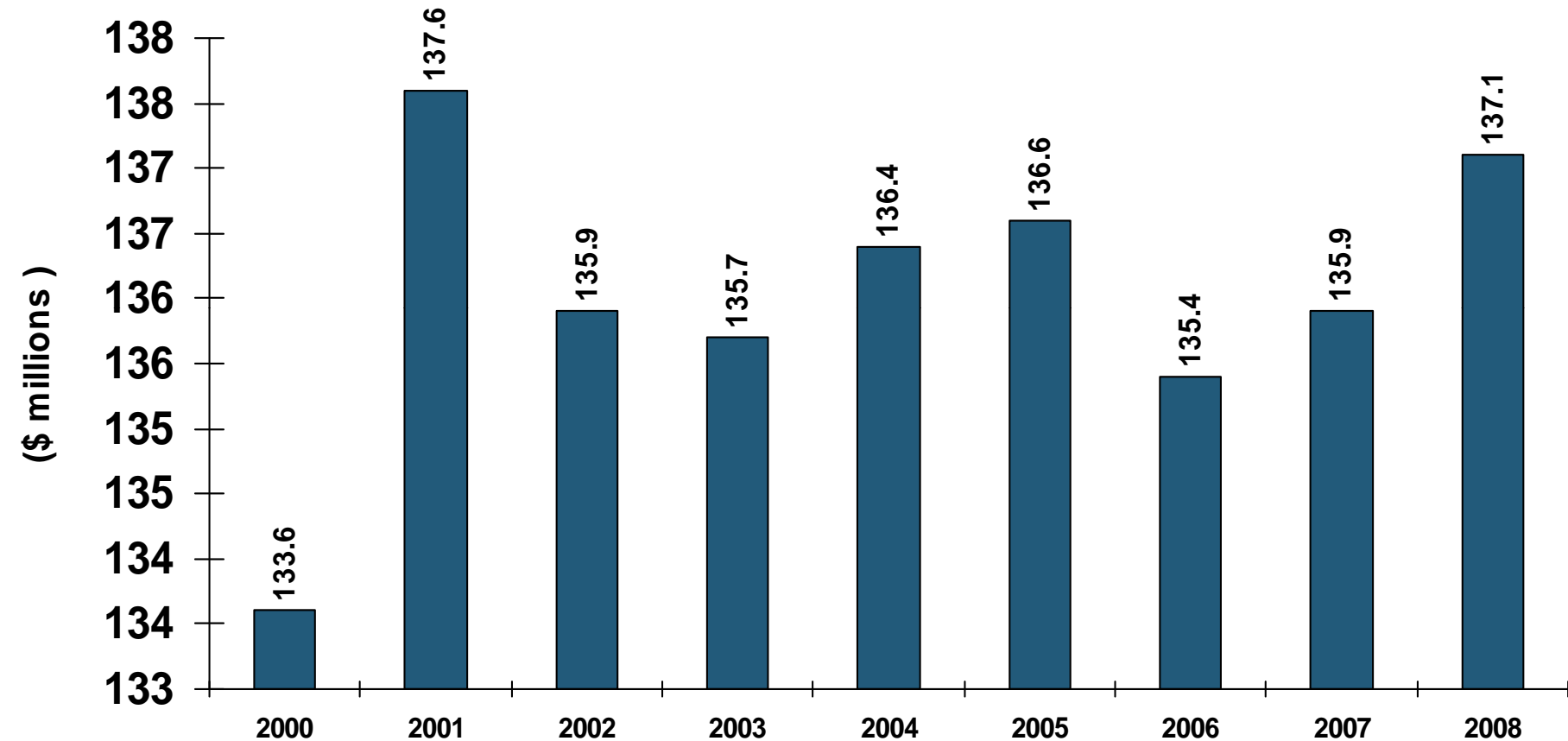
Auto/Light Truck Sales, 1999-2016F

(Millions of Units)



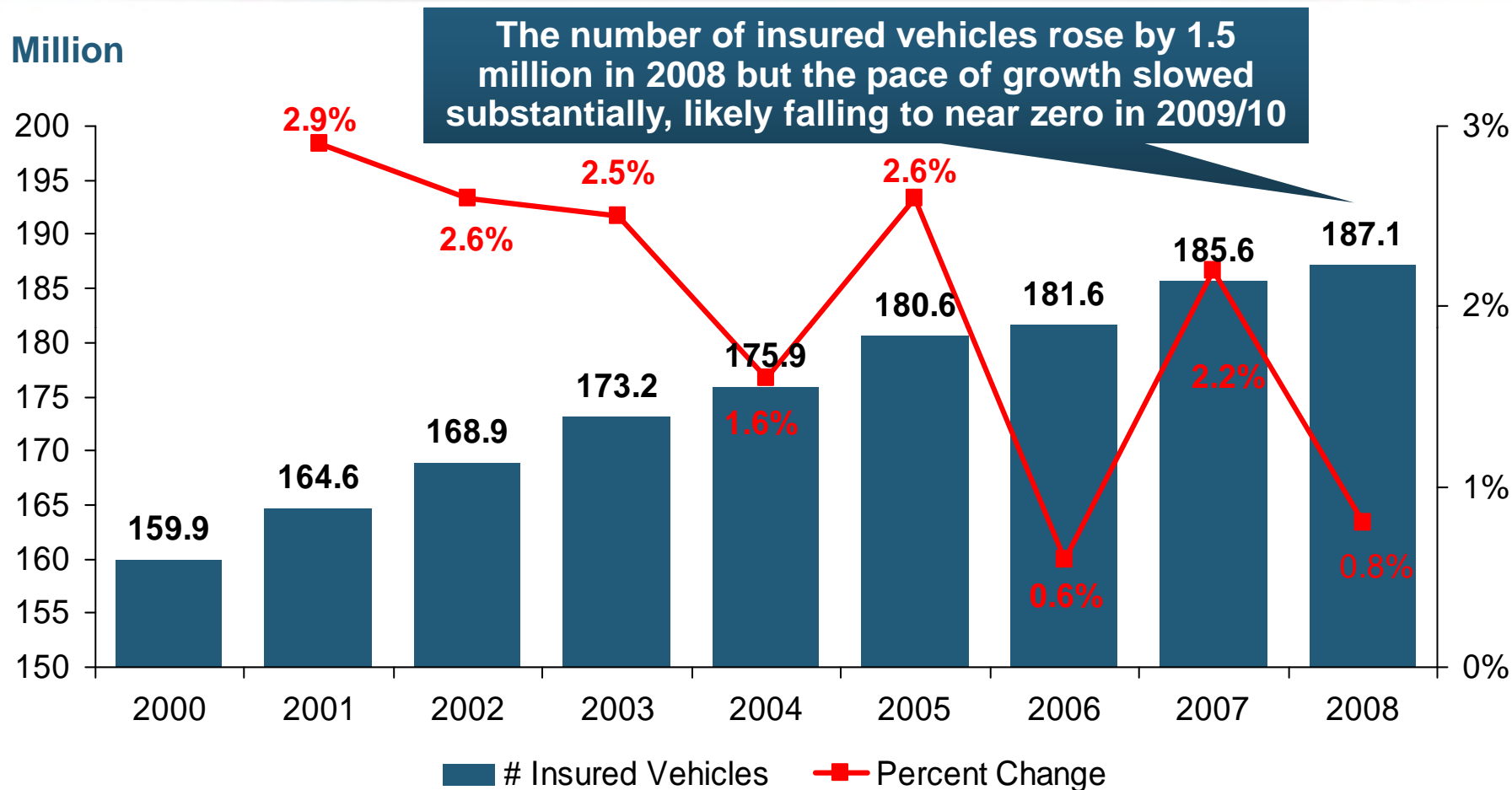
Car/Light Truck Sales Will Recover from the 2009 Low Point, but High Unemployment, Tight Credit Are Still Restraining Sales in 2010

Number of Registered Passenger Vehicles in the US, 2000-2008



The Number of Registered Passenger Vehicles Has Remain Basically Flat Since 2001

Insured Vehicles in the U.S.: Shared and Voluntary Market. 2000-2008*



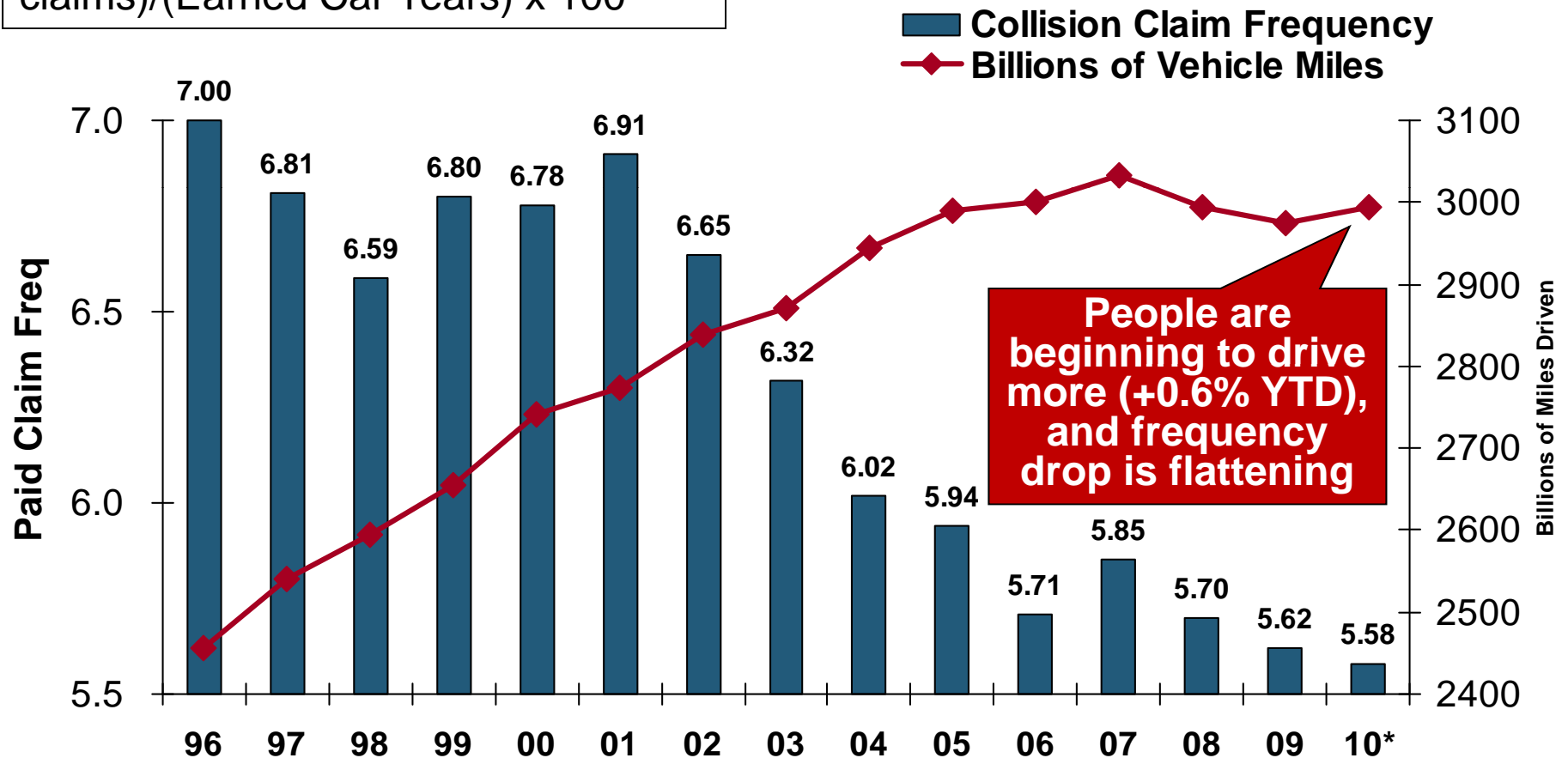
The number of insured vehicles on the road increased by 2%+ for many years, but growth slowed substantially during the recession. While a modest rebound is likely in 2011, but most premium growth is attributable to rate

*Latest available.
Source: AIPSO.

Do Changes in Miles Driven Affect Auto Collision Claim Frequency?

Paid Claim Frequency = (No. of paid claims)/(Earned Car Years) x 100

“Pay-As-You-Go” Auto Insurance: Fluctuations in miles driven will impact exposure

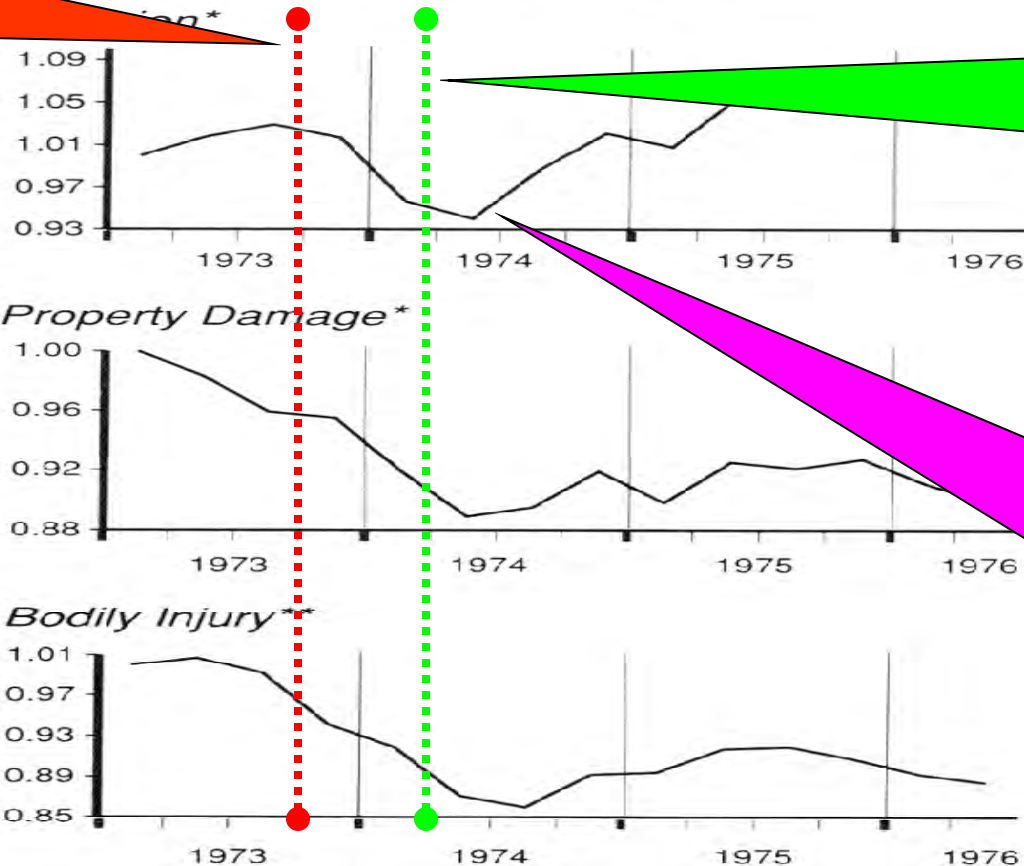


Sources: Federal Highway Administration (<http://www.fhwa.dot.gov/ohim/tvtw/tvtpage.cfm>); ISO Fast Track Monitoring System, *Private Passenger Automobile Fast Track Data*: 3rd Qtr. 2010, published Jan. 7, 2011 and earlier reports. *2010 ISO figure is for 12 months ending 9/30/2010; FHA data is for 12 months ending Oct. 2010.

Auto Insurance: Claim Frequency Impacts of Energy Crisis/Recession of 1973/74

Figure 6

The First Crisis—Frequency



Oct. 17, 1973: Arab oil embargo begins

Frequency Impacts
Collision: -7.7%
PD: -9.5%
BI: -13.3%

Driving Stats
• Gas prices rose 35-40%
• Miles driven fell 6.7% in 1974

March 17, 1974: Arab oil states announce end to embargo

Frequency began to rebound almost immediately after the embargo ended

*Seasonally Adjusted, Quarterly Paid Fast Track data indexed to First Quarter 1973.

**ISO Paid Data, year-ended quarter indexed to First Quarter 1973.

Auto Insurance: Claim Severity Impacts of Energy Crisis/Recession of 1973/74

**Oct. 17,
1973: Arab
oil
embargo
begins**

**Severity
Impacts**
**Collision: -
7.5%**
PD: +15.9%
BI: N/A*

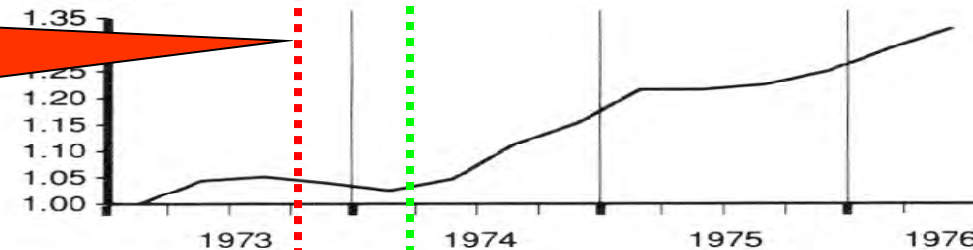
Driving Stats
•Gas prices
rose 35-40%
•Miles driven
fell 6.7% in
1974

Source: ISO.

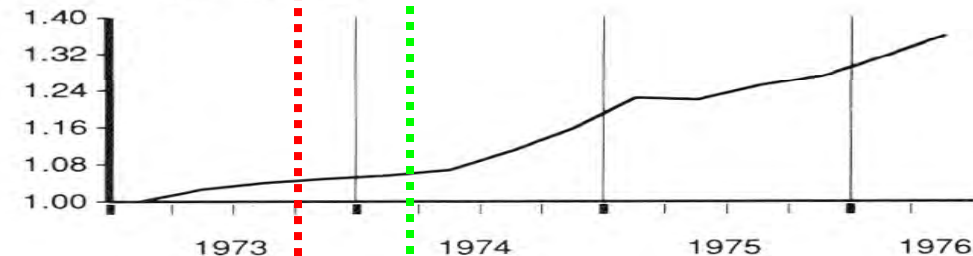
Figure 7

*The First Crisis—Severity**

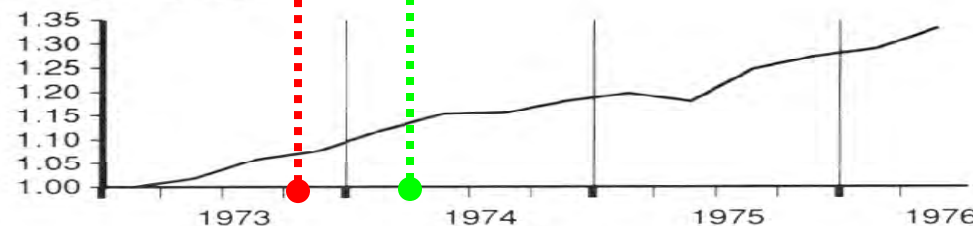
Collision



Property Damage



Bodily Injury

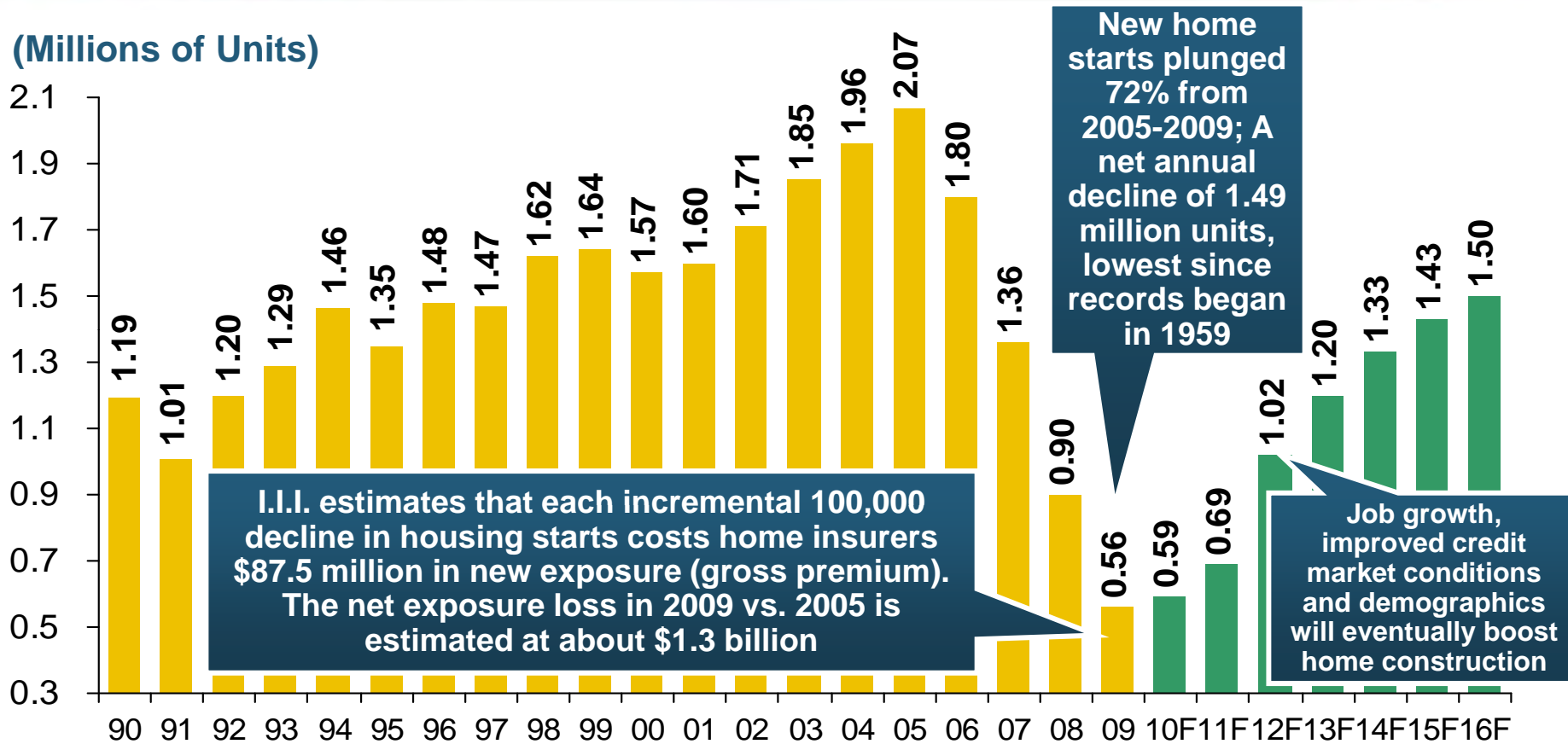


*Seasonally Adjusted, Quarterly Paid Fast Track data indexed to First Quarter 1973.

**March 17,
1974: Arab
oil states
announce
end to
embargo**

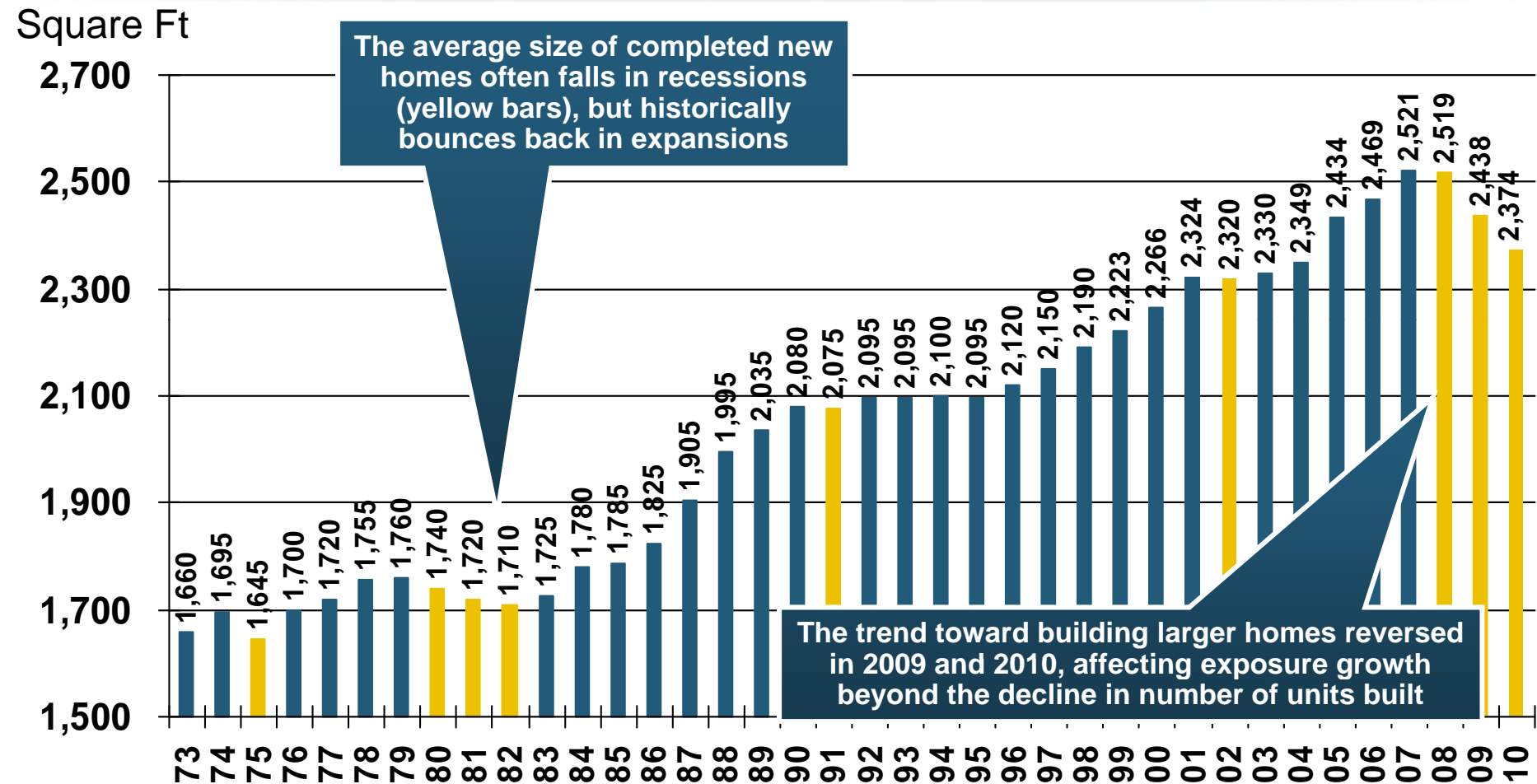
**Collision
severity
began to
rebound
almost
immediately
after the
embargo
ended; PD
accelerated
as inflation
rose; No
discernable
trend change
in BI.**

New Private Housing Starts, 1990-2016F



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

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

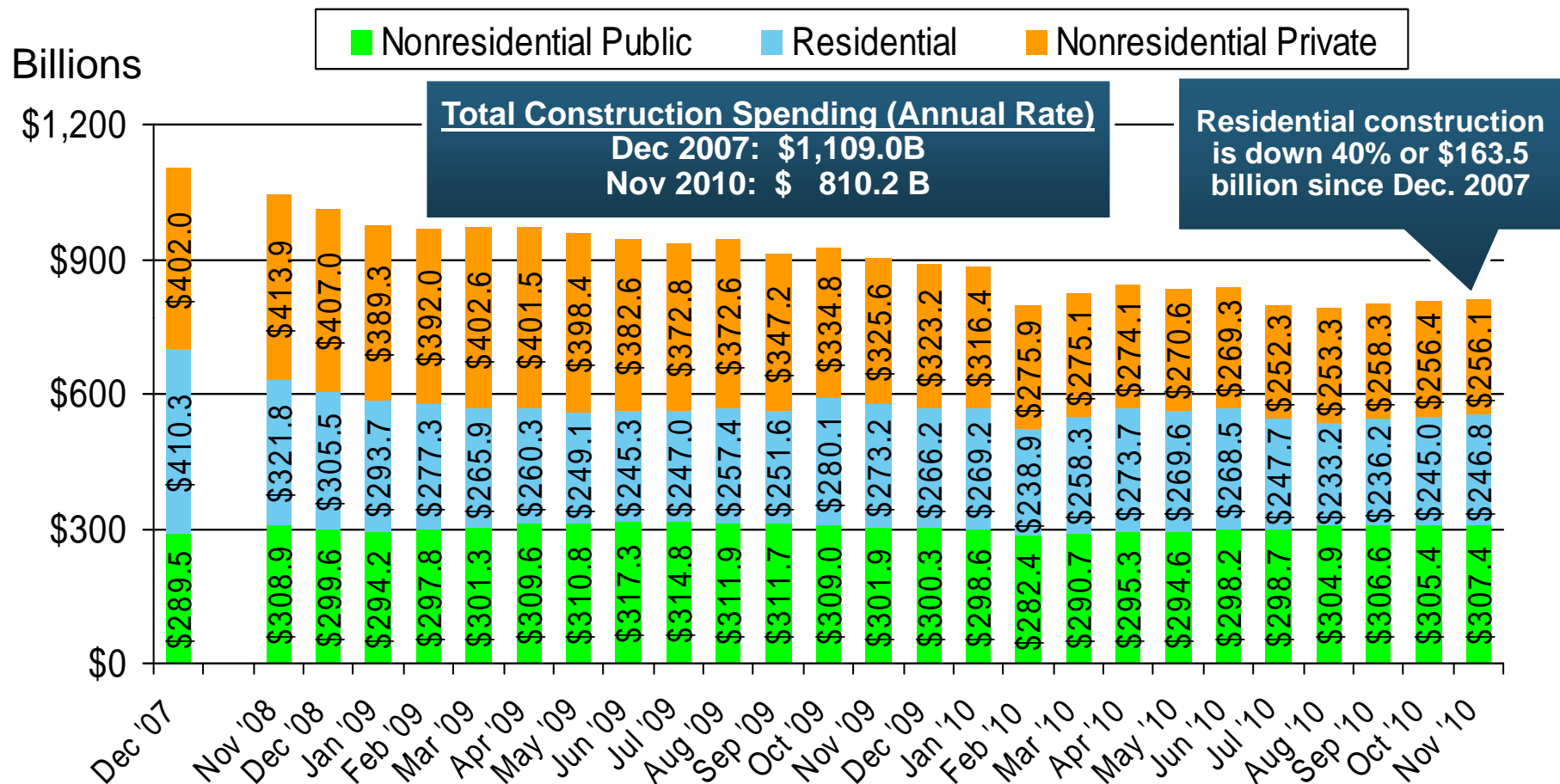


The average size of completed new homes fell by 147 square feet (5.75%) from 2008-2010. This is the largest recession-based drop in nearly four decades.

*2010 figure is weighted average square feet of completed homes in first three quarters of 2010

Source: U.S. Census Bureau: http://www.census.gov/construction/quarterly/starts_completions.pdf; Insurance Information Institute.

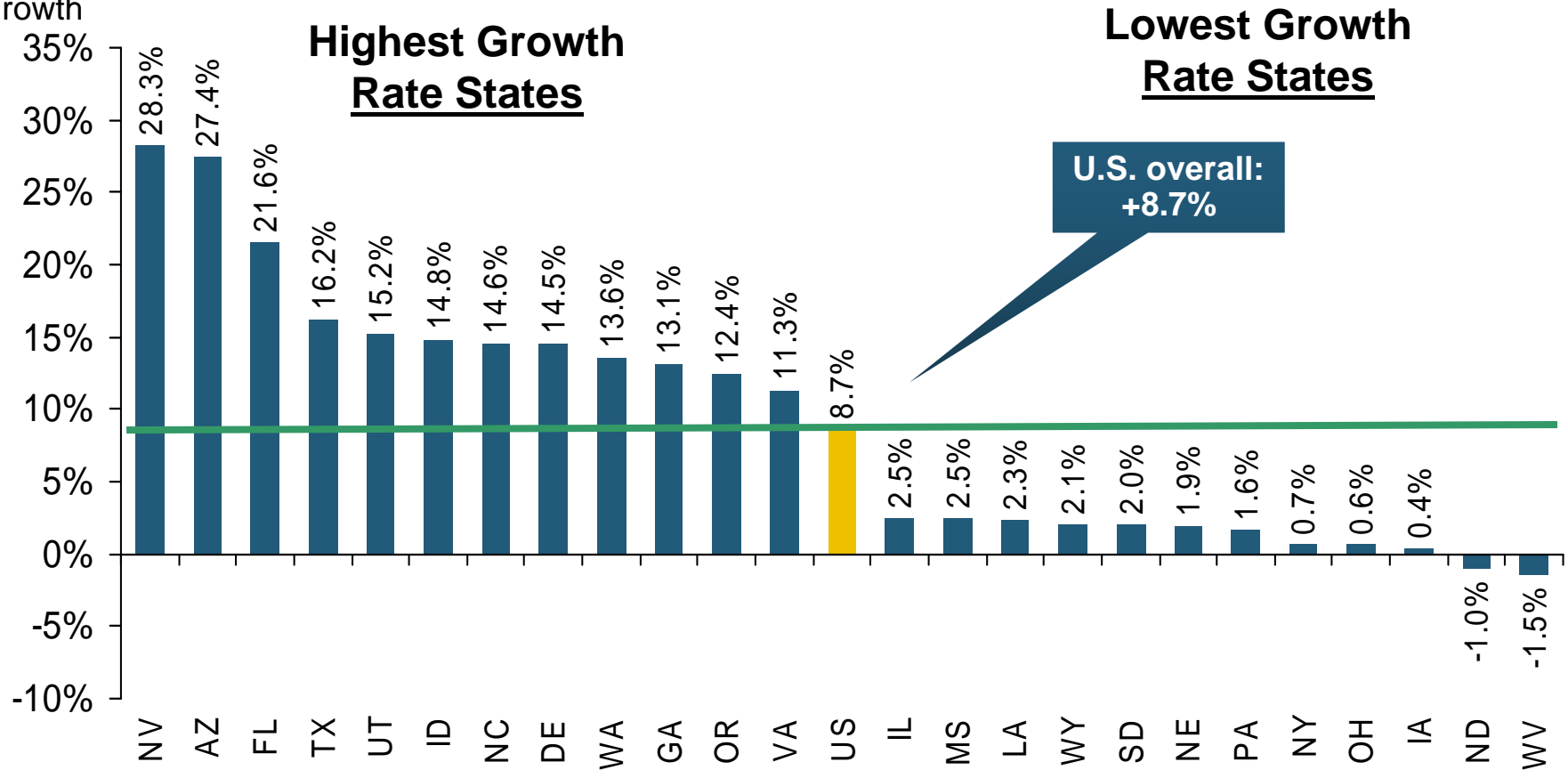
Value* of Construction Put In Place



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

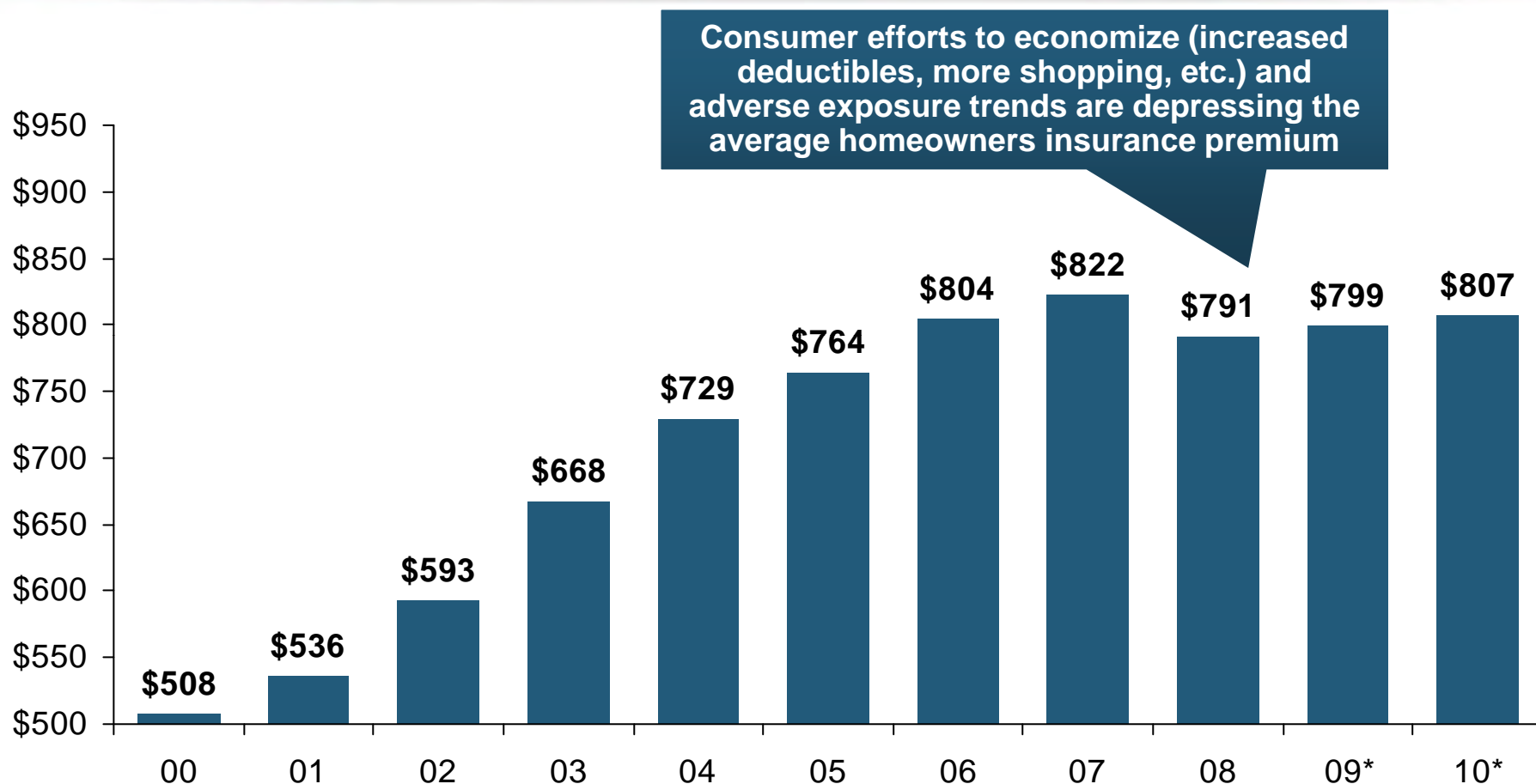
State Population Growth Rate Projections, 2010-2020*

Projected Population
Growth



The Mountain West region is projected to grow the most from now to 2020 (up 17.6%), followed by the South Atlantic (up 14.5%) and Pacific (up 11.2%). The Mid-Atlantic is projected to be the slowest-growing region (up 1.9%).

Average Premium for Home Insurance Policies**

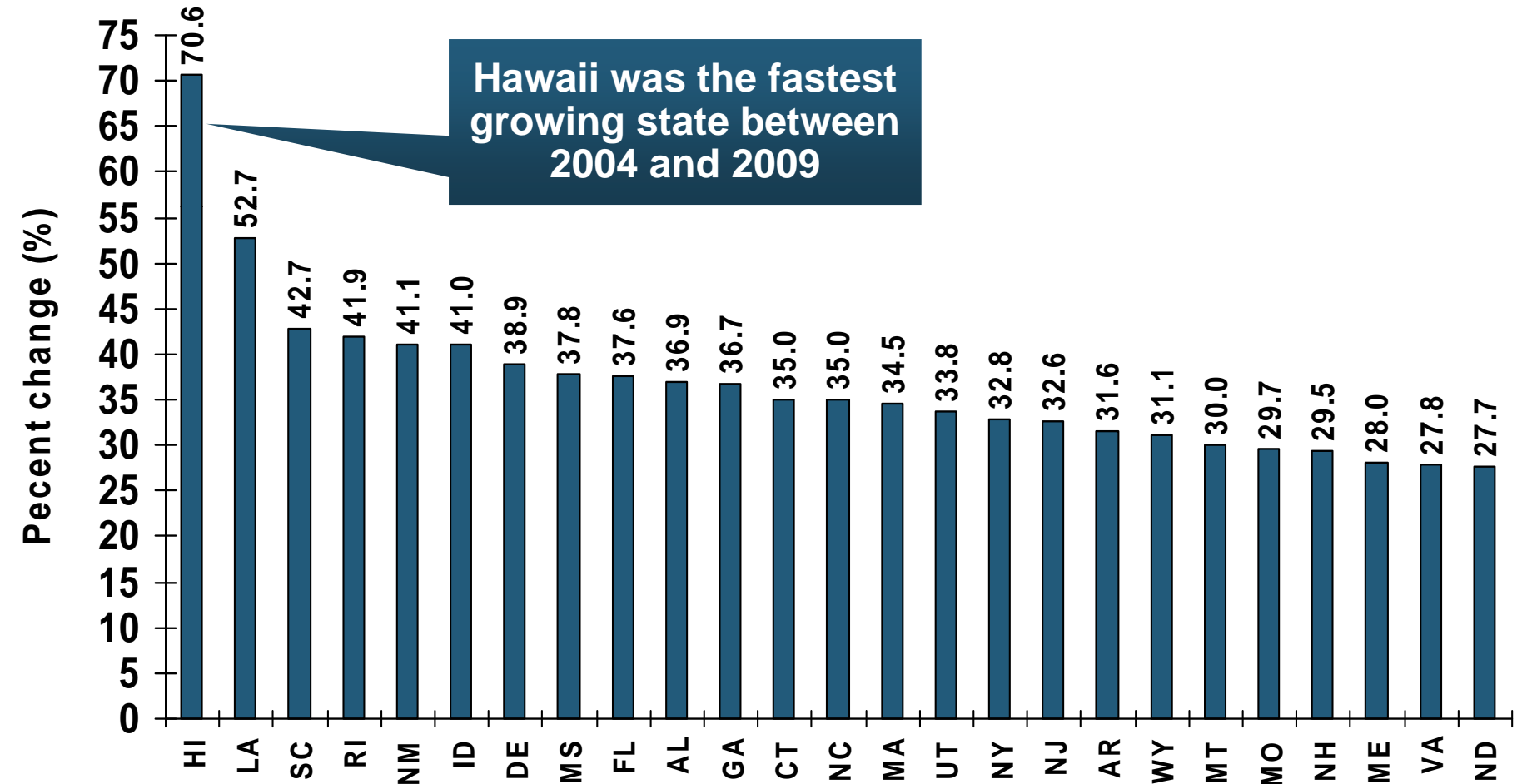


* Insurance Information Institute Estimates/Forecasts **Excludes state-run insurers.

Source: NAIC, Insurance Information Institute estimates 2009-2010 based on CPI and other data.

Percent Change in NPW: Homeowners, by State, 2004-2009

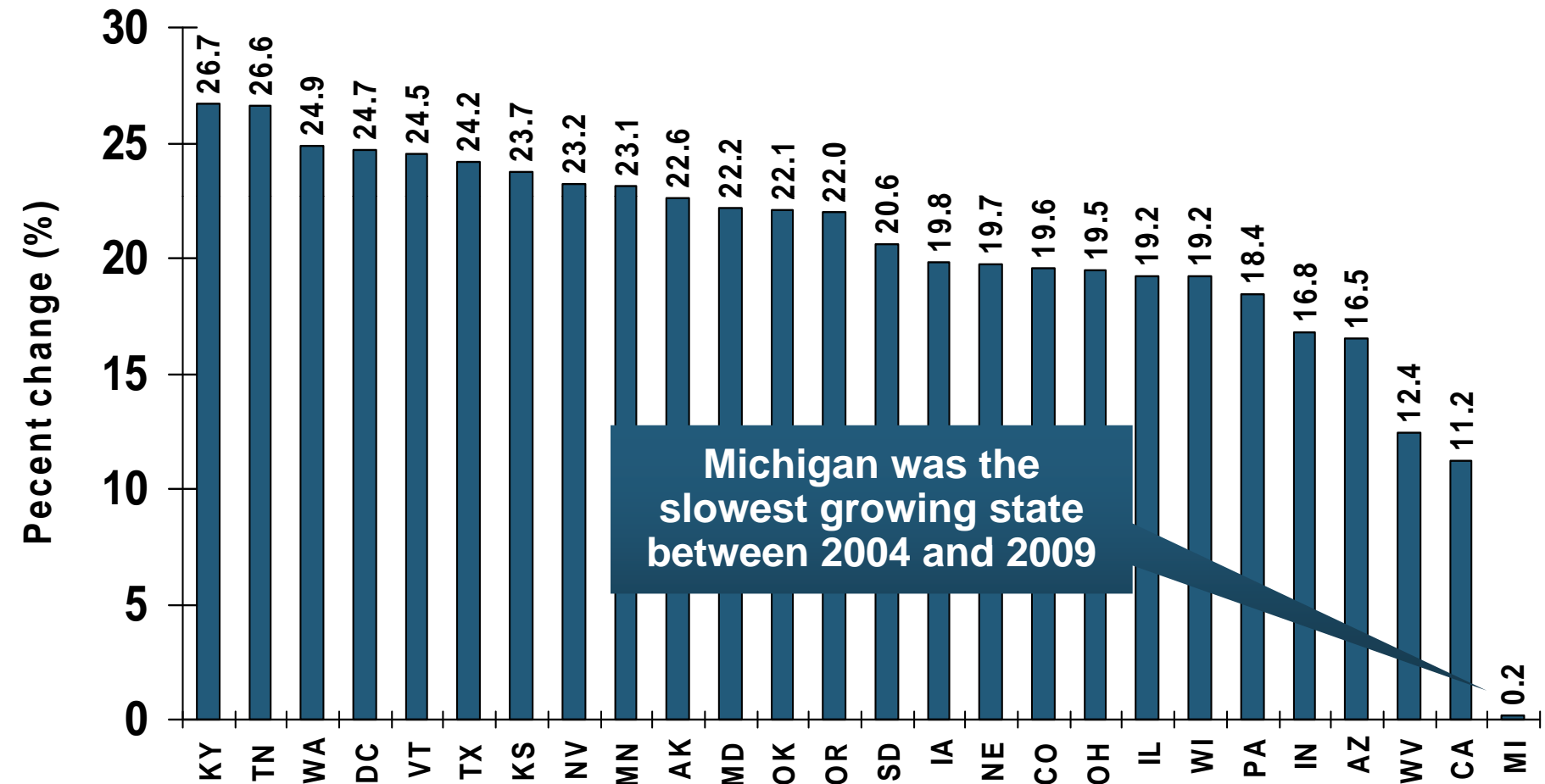
Top 25 States



Sources: SNL Financial LC.; Insurance Information Institute.

Percent Change in NPW: Homeowners, by State, 2004-2009

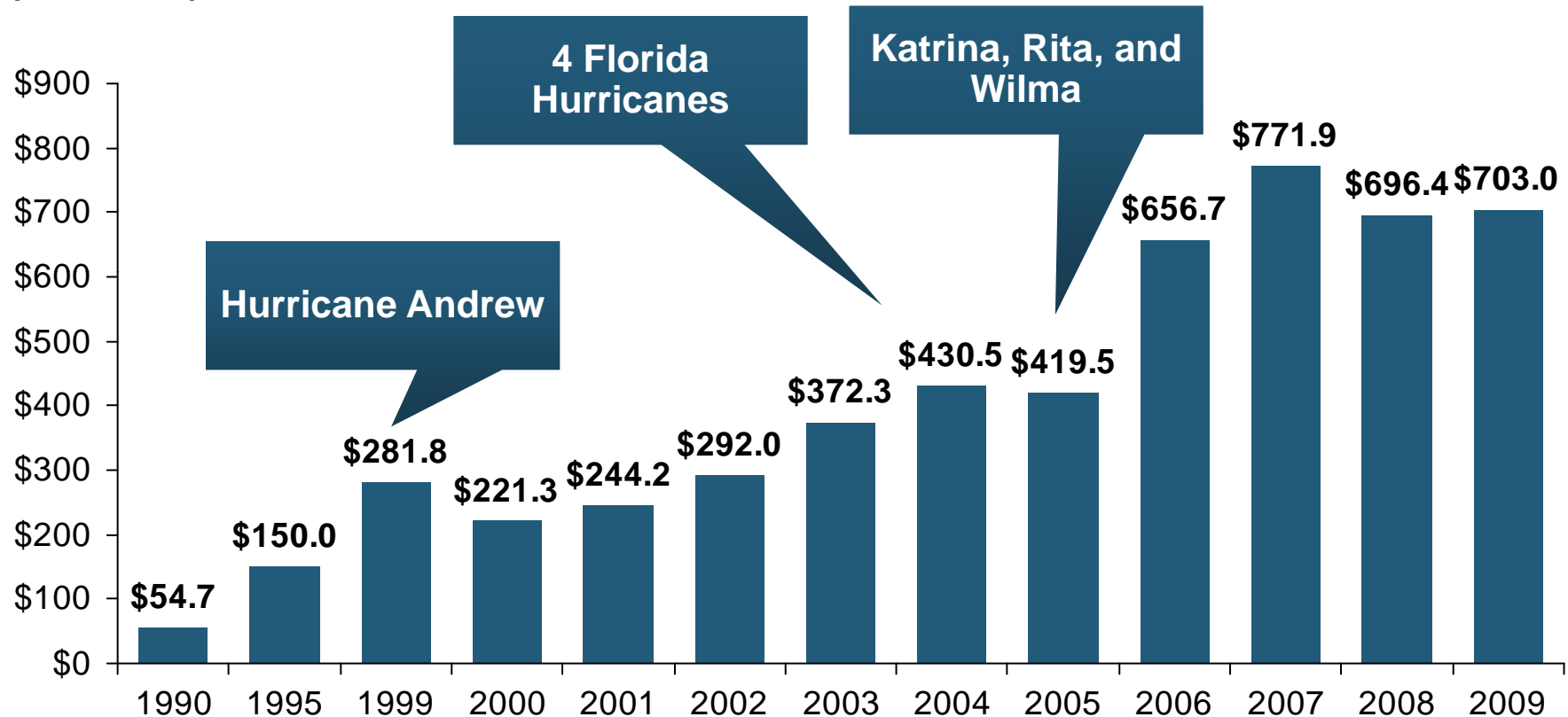
Bottom 25 States



Sources: SNL Financial LC.; Insurance Information Institute.

US Residual Market Exposure to Loss: Can Drain Private Insurer Premium

(\$ Billions)



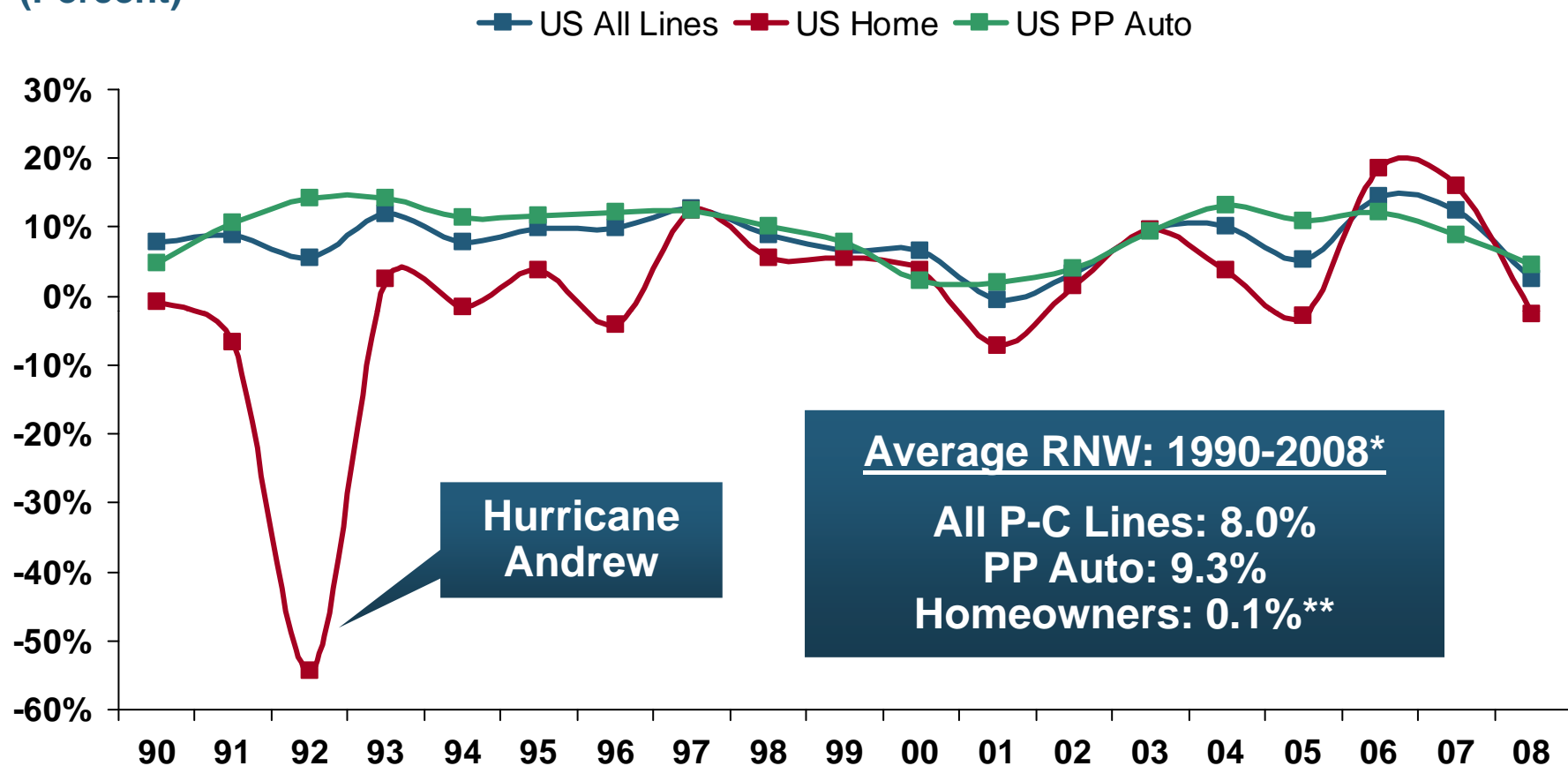
In the 20-year Period From 1990 and 2009, Total Exposure to Loss in the Residual Market (FAIR & Beach/Windstorm) Plans Has Surged from \$54.7B in 1990 to \$703.0B in 2008

Personal Lines Profitability Analysis

**Significant Variability Over
Time and Across States**

Return on Net Worth: All P-C Lines vs. Homeowners & Pvt. Pass. Auto, 1990-2008*

(Percent)



Pvt.Pass. Auto Has Consistently Outperformed the P-C Industry as a Whole. Homeowners Volatility is Associated Primarily With Coastal Exposure Issues

*Latest available.

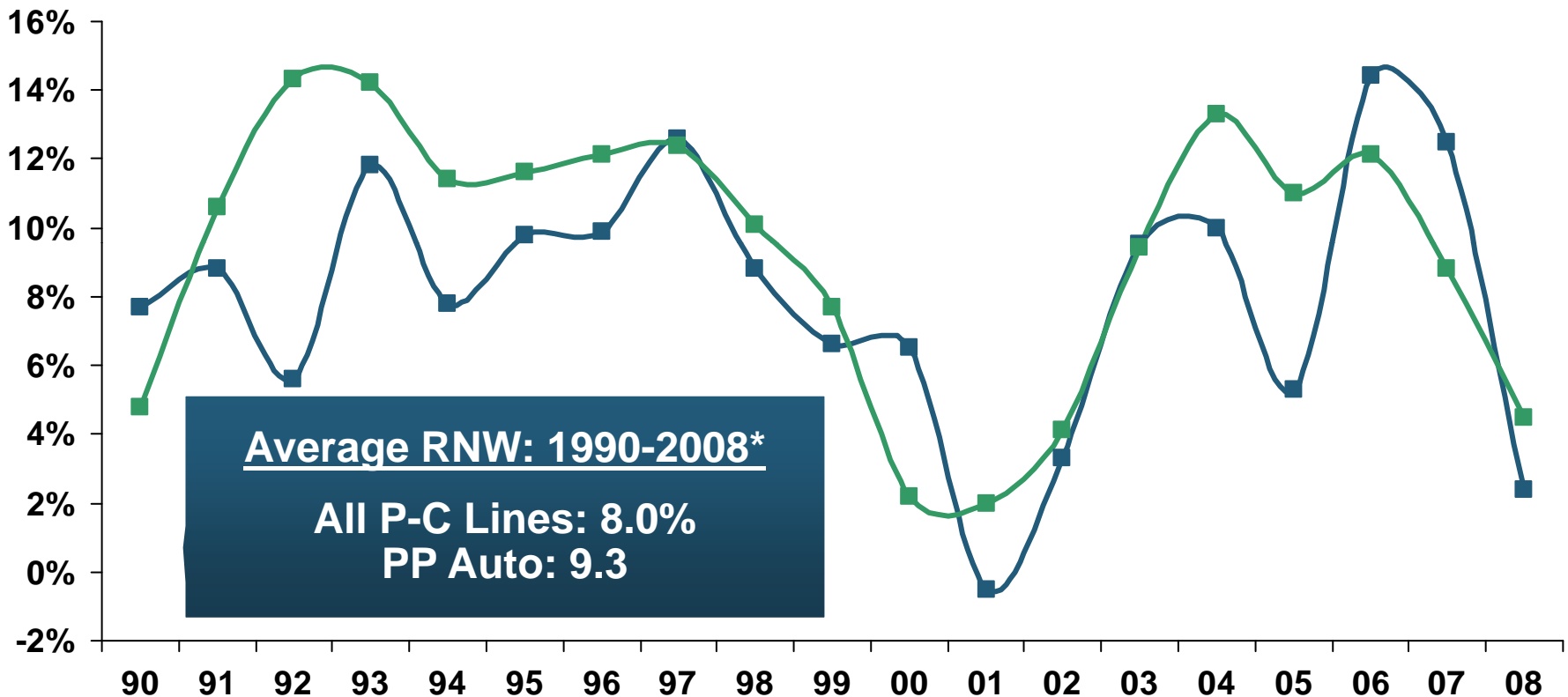
**Excluding 1992, the Hurricane Andrew, produces a homeowners RNW of 3.1%.

Sources: NAIC.

Return on Net Worth: All P-C Lines vs. Pvt. Pass. Auto, 1990-2008*

(Percent)

—■ US All Lines —■ US PP Auto



Pvt.Pass. Auto Profitability Has Exceeded the P-C Industry as a Whole in 13 of the 19 Years from 1990-2008 (Inclusive)

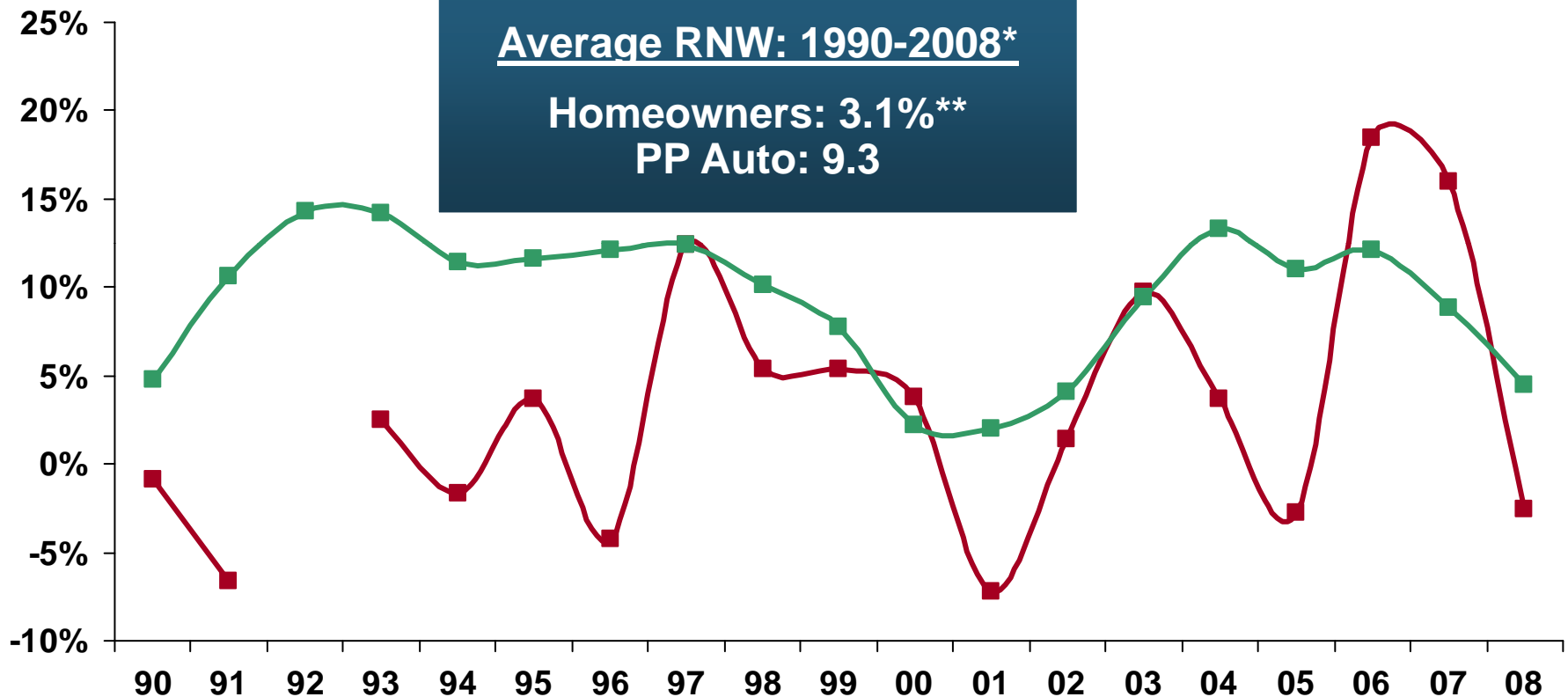
Return on Net Worth: Pvt. Pass. Auto vs. Homeowners, 1990-2008* (excl. 1992)

(Percent)

—■— US Home —■— US PP Auto

Average RNW: 1990-2008*

Homeowners: 3.1%**
PP Auto: 9.3



Pvt.Pass. Auto Profitability Has Exceeded the P-C Industry as a Whole in 13 of the 19 Years from 1990-2008 (Inclusive)

*Latest available.

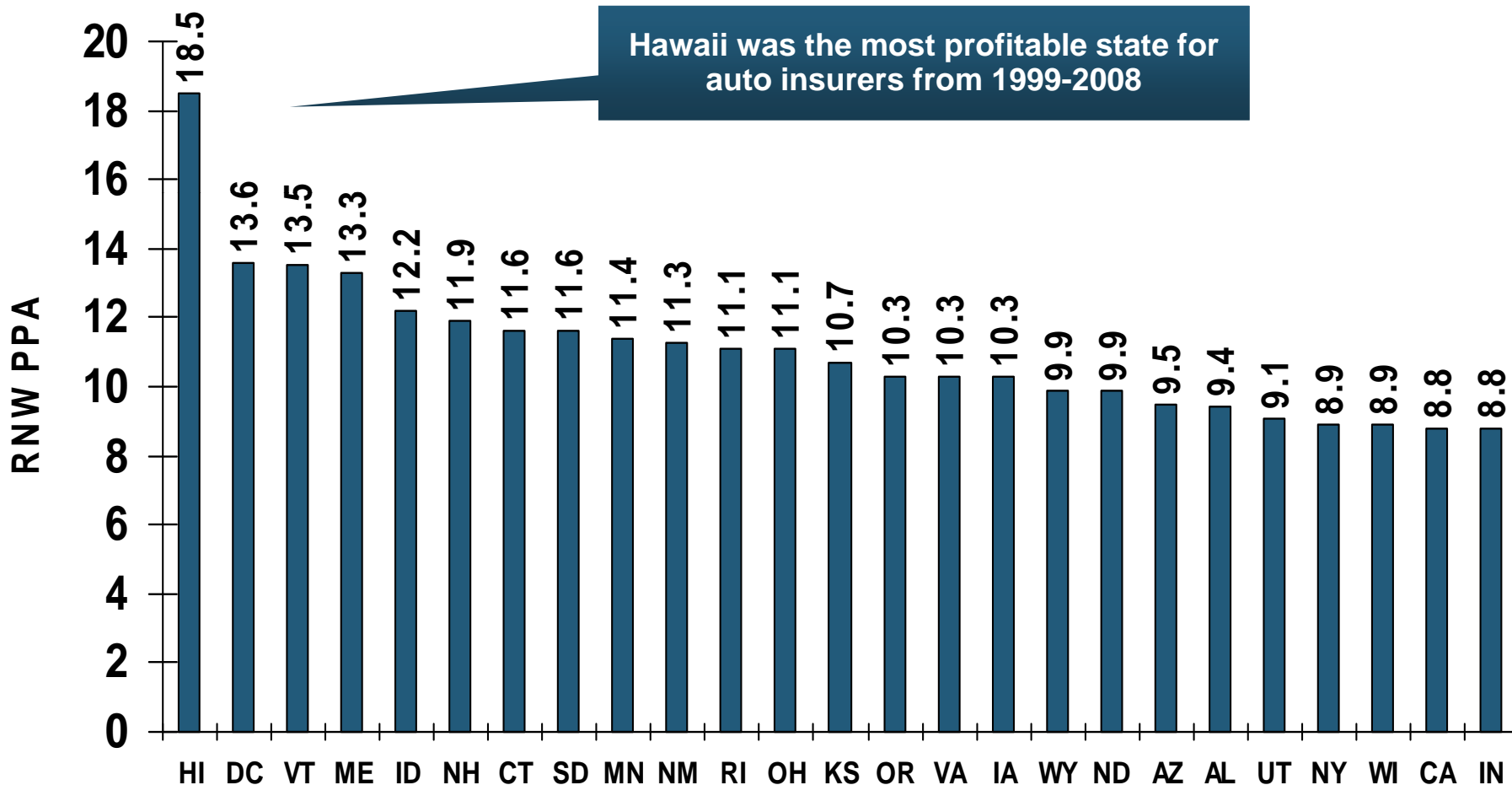
**Excluding 1992, the year of Hurricane Andrew. Including 1992 produces a homeowners RNW of 0.1%.

Sources: NAIC.

Return on Net Worth: Pvt. Passenger Auto, 10-Year Average (1999-2008*)

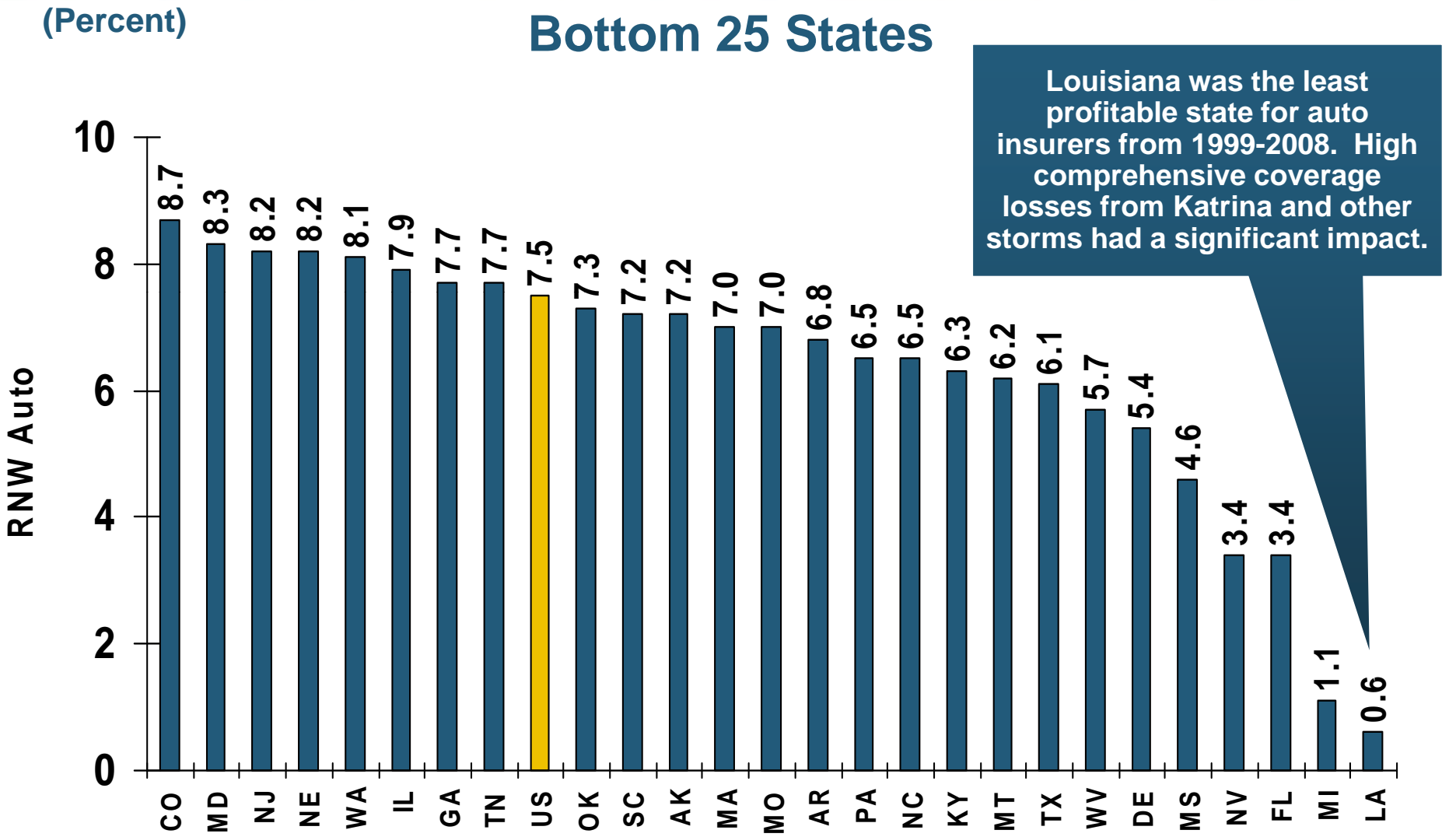
Top 25 States

(Percent)



Sources: NAIC

Return on Net Worth: Pvt. Passenger Auto, 10-Year Average (1999-2008*)

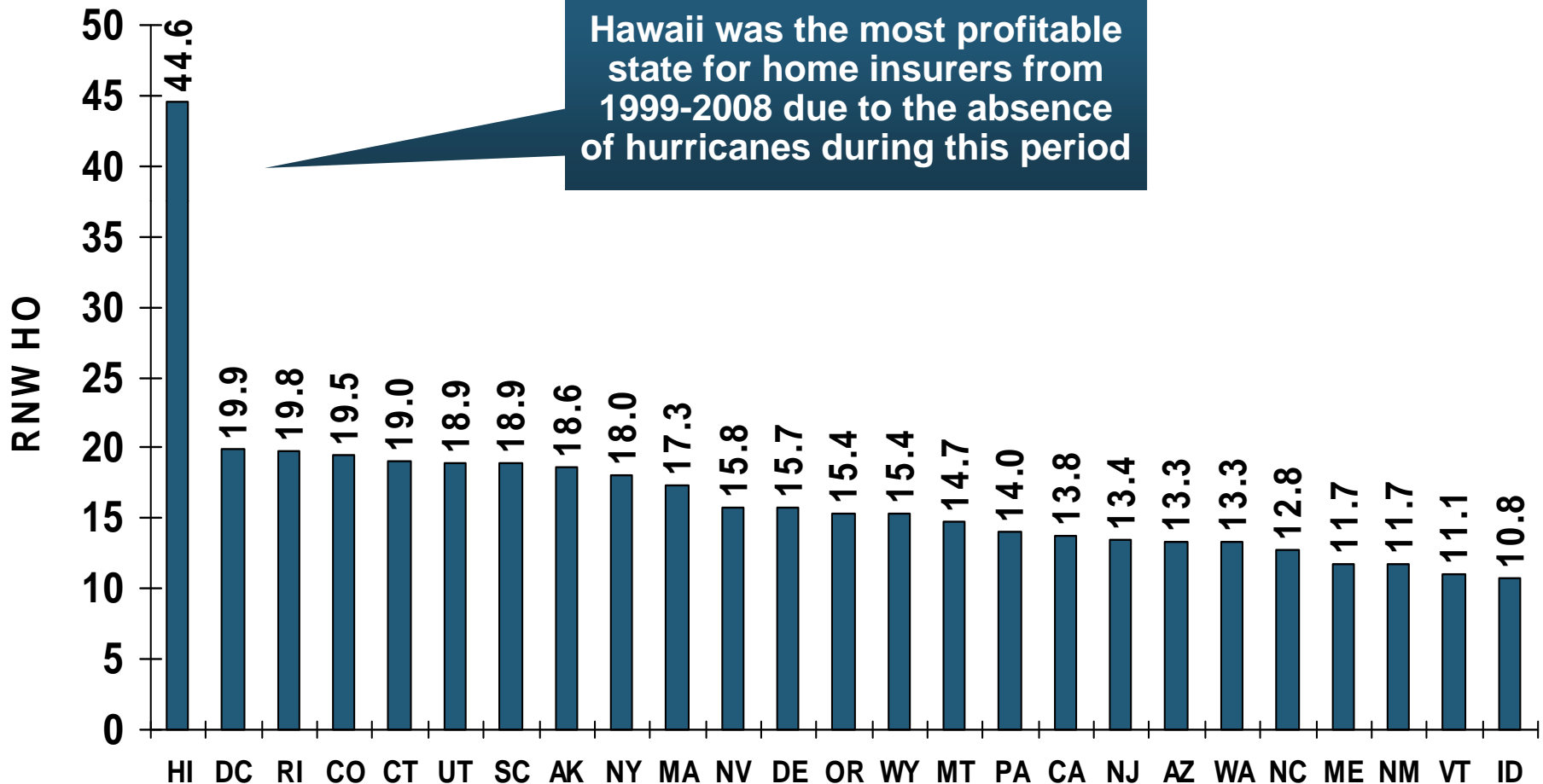


*Latest available.
Sources: NAIC

Return on Net Worth: Homeowners Insurance, 10-Year Average (1999-2008*)

Top 25 States

(Percent)

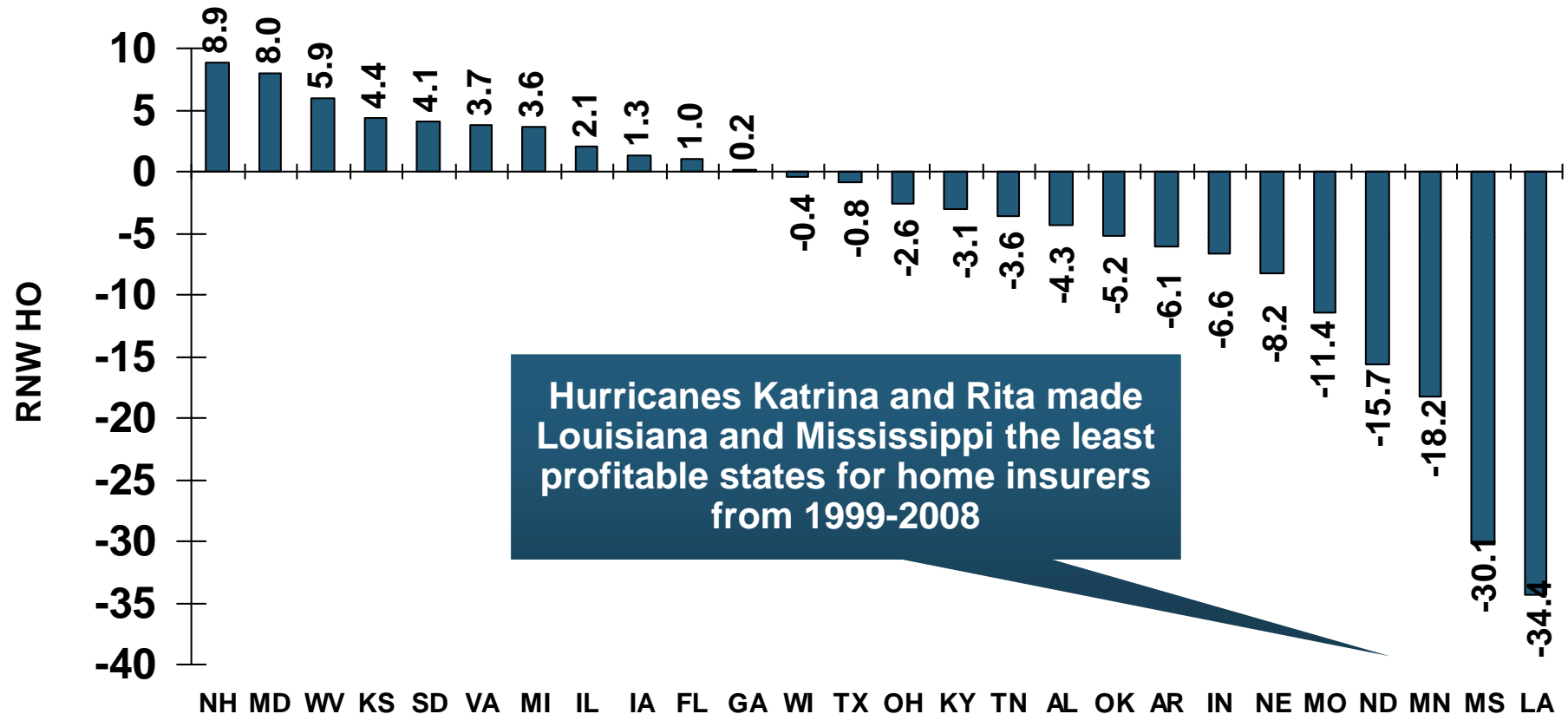


Hawaii was the most profitable state for home insurers from 1999-2008 due to the absence of hurricanes during this period

Return on Net Worth: Homeowners Insurance, 10-Year Average (1999-2008*)

Bottom 25 States

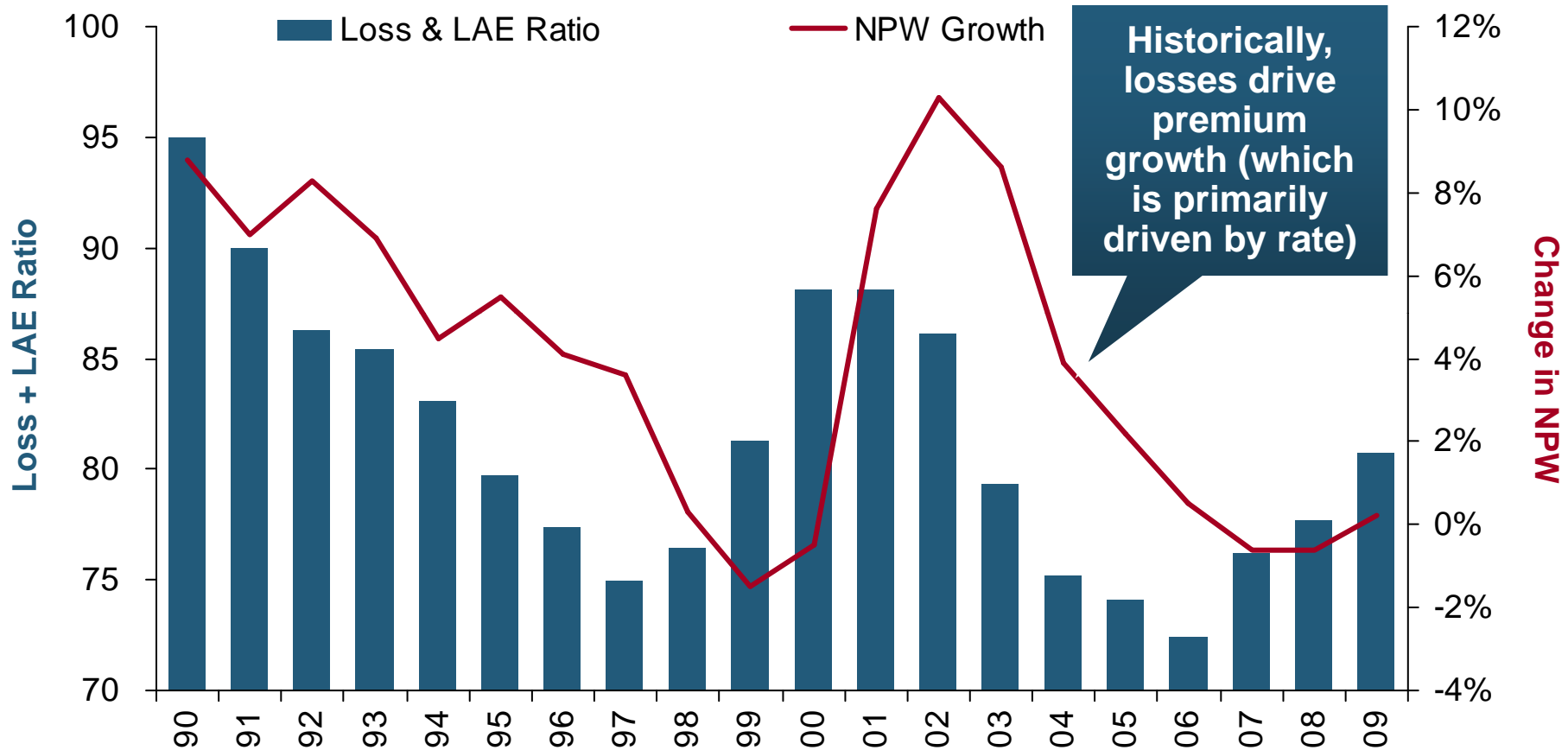
(Percent)



Cycle Drivers

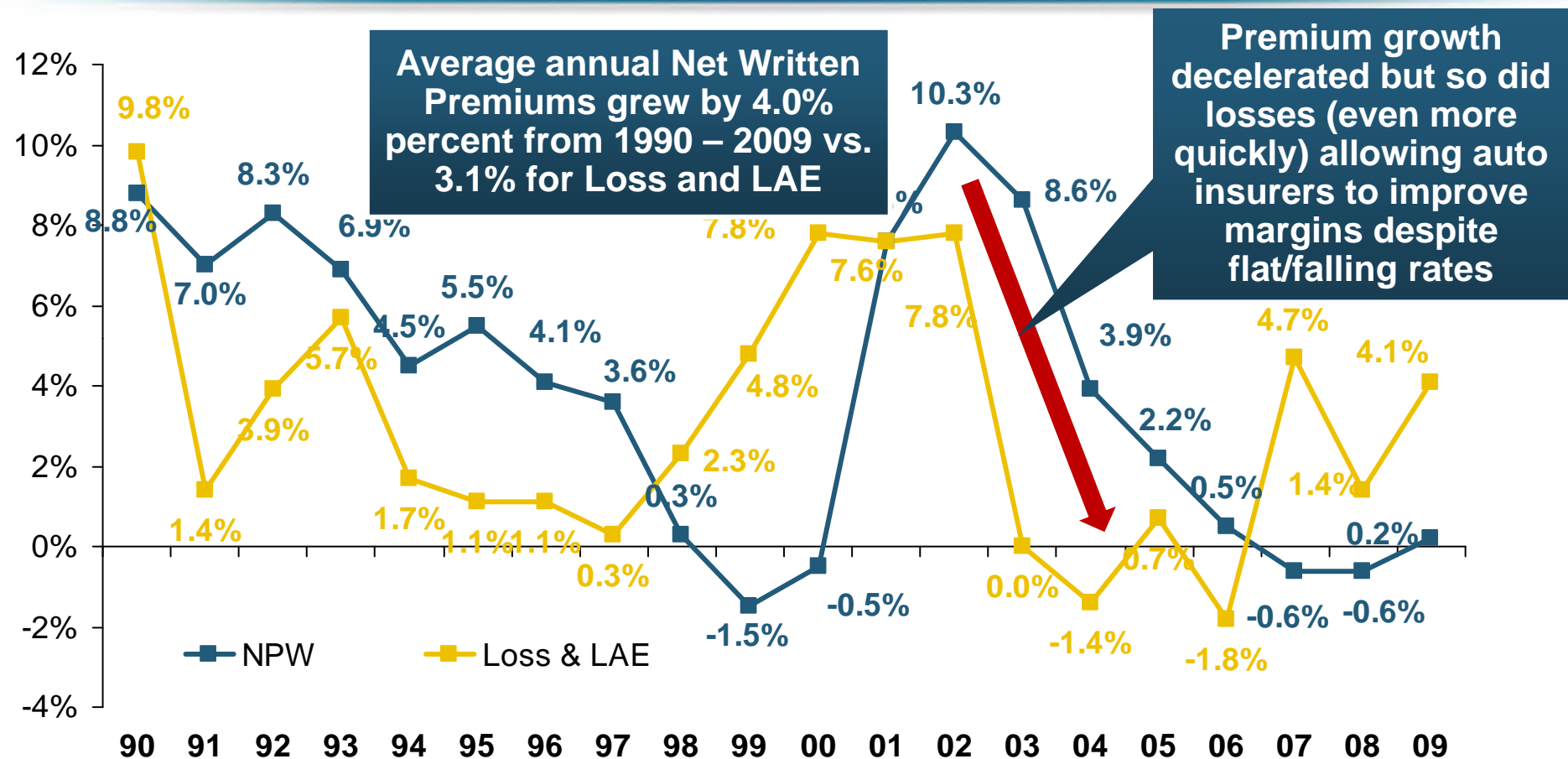
The Role of Losses and Reserves in the Underwriting Cycle

PP Auto Liability: Loss and LAE vs. Net Premiums Written, 1990-2009



While Premium Growth Decelerated, the Driver Was Primarily Lower Losses, Allowing Auto Insurers to Maintain String Margins

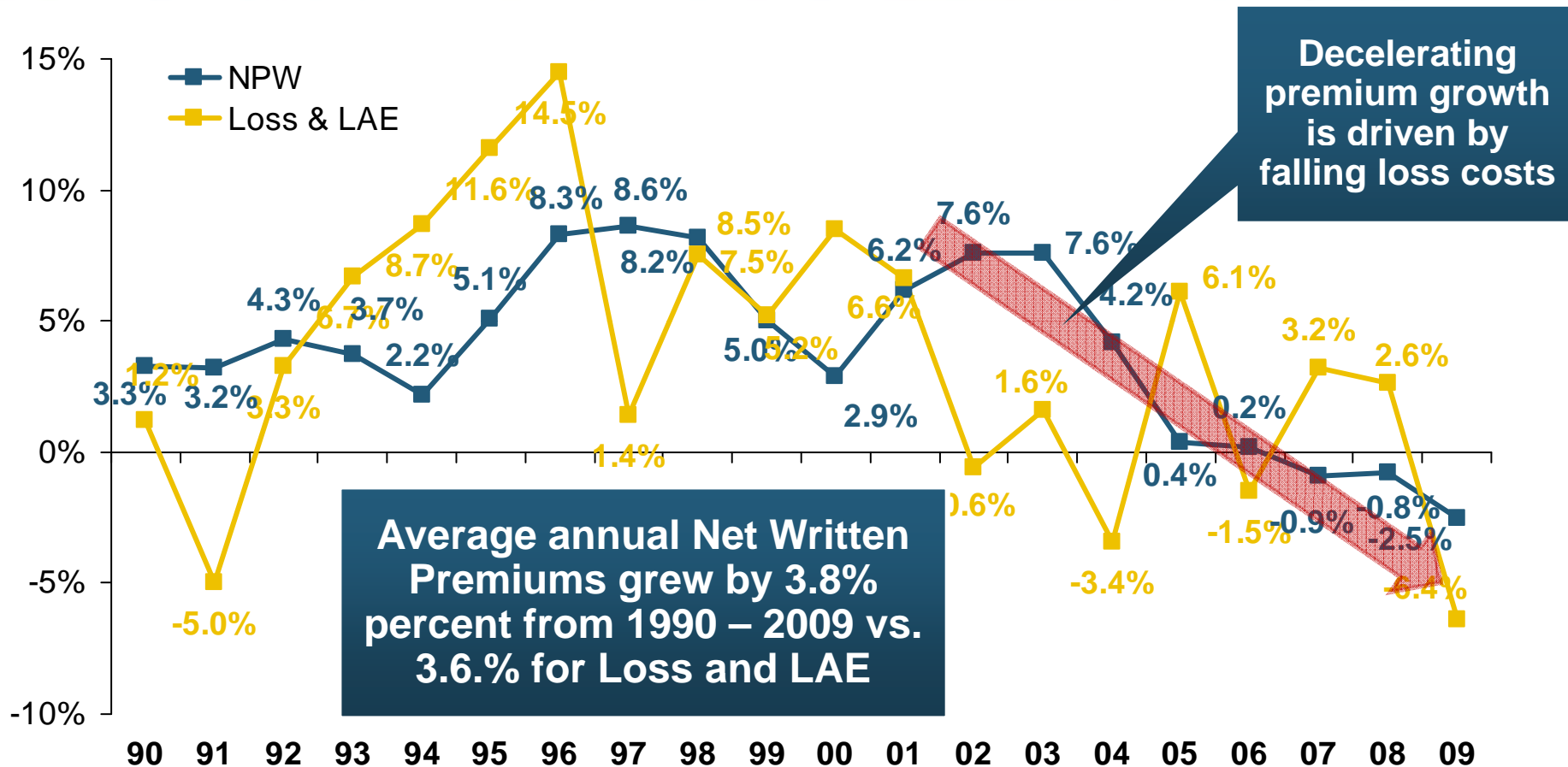
PP Auto Liability: % Change in NPW vs. % Change in Loss & LAE, 1990 - 2009



Losses Drive Premiums

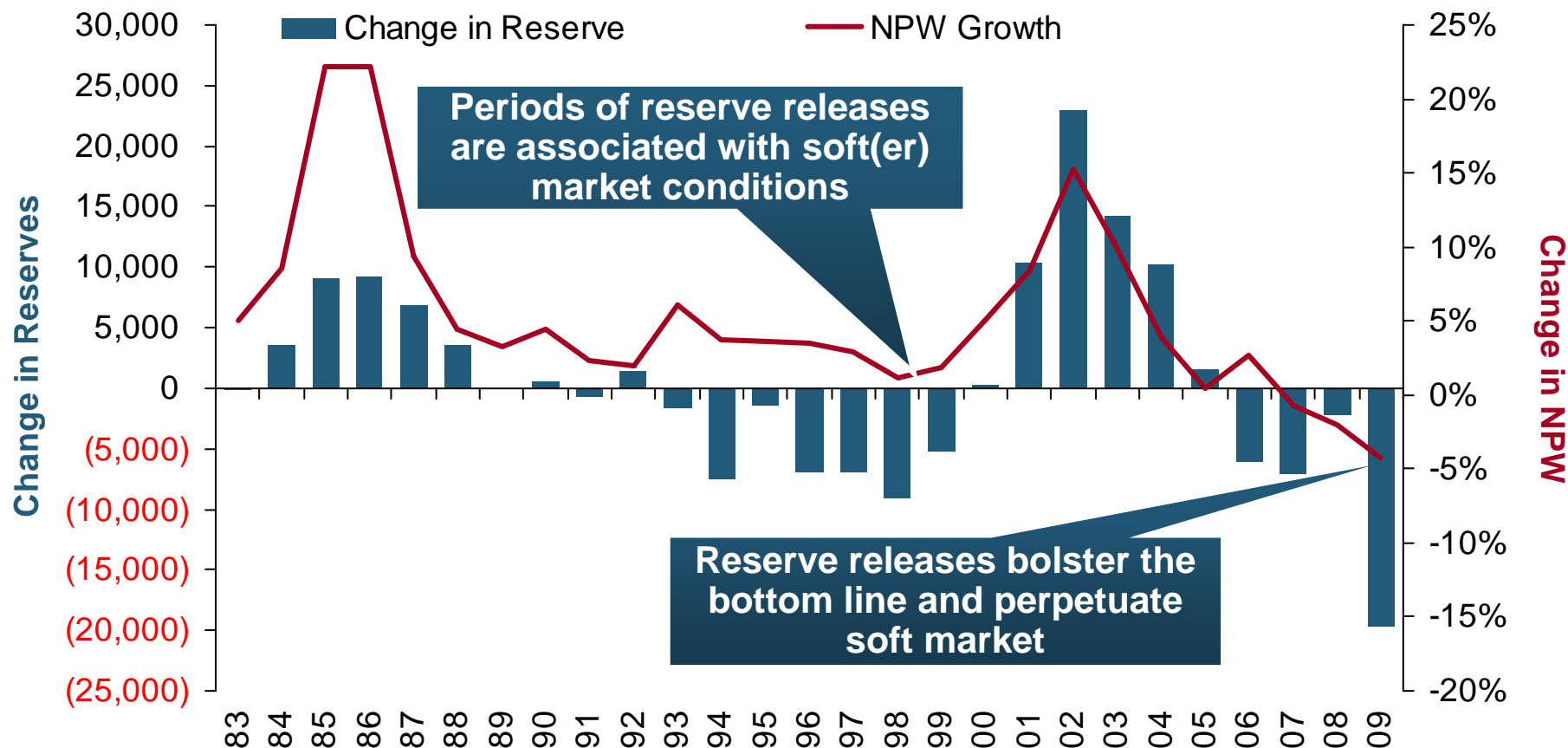
Premiums Exhibit an Elastic Response (with a Lag) to Changes in Losses

PP Auto Physical Damage: Change in NPW vs. Change in Loss & LAE, 1990 - 2009



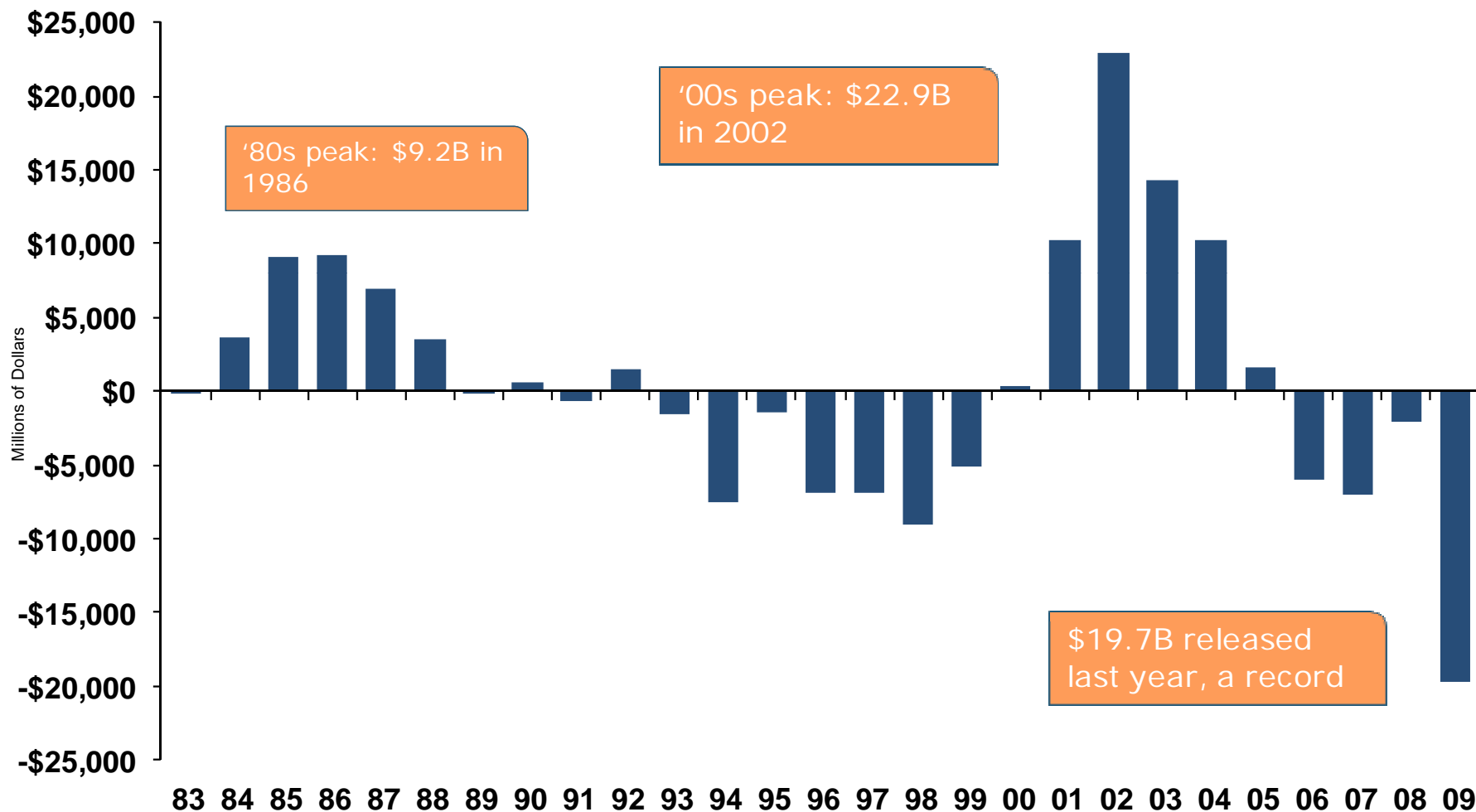
Loss Trends Ultimately Drive Premium Trends

Loss Development vs. Change in NPW, 1983-2009

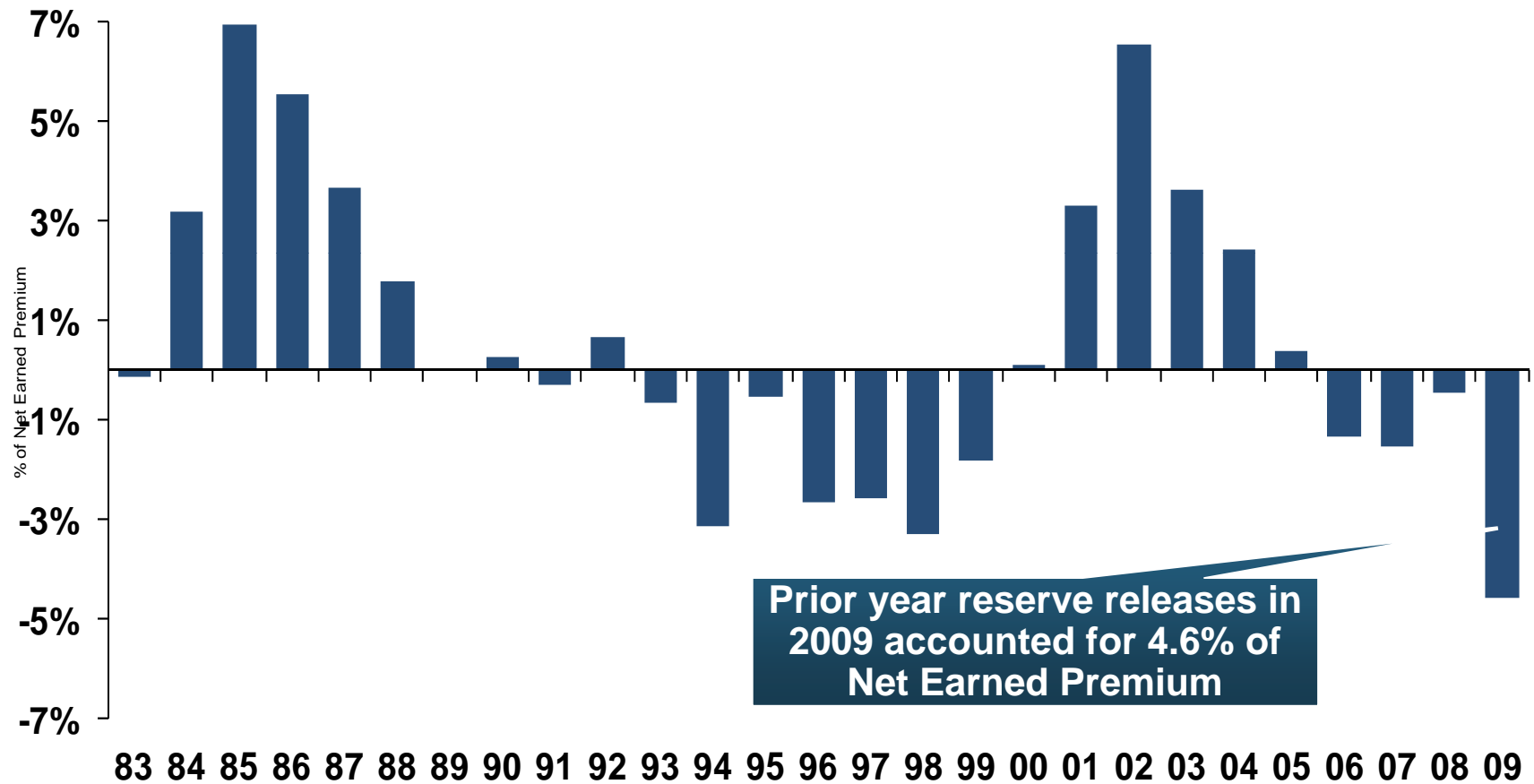


Reserve Releases, in Addition to Losses, Drive Pricing Cycles

P-C Industry Loss Development, 1983-2009 (\$ Millions)



Industry Loss Development as % of Net Earned Premium, 1983-2009



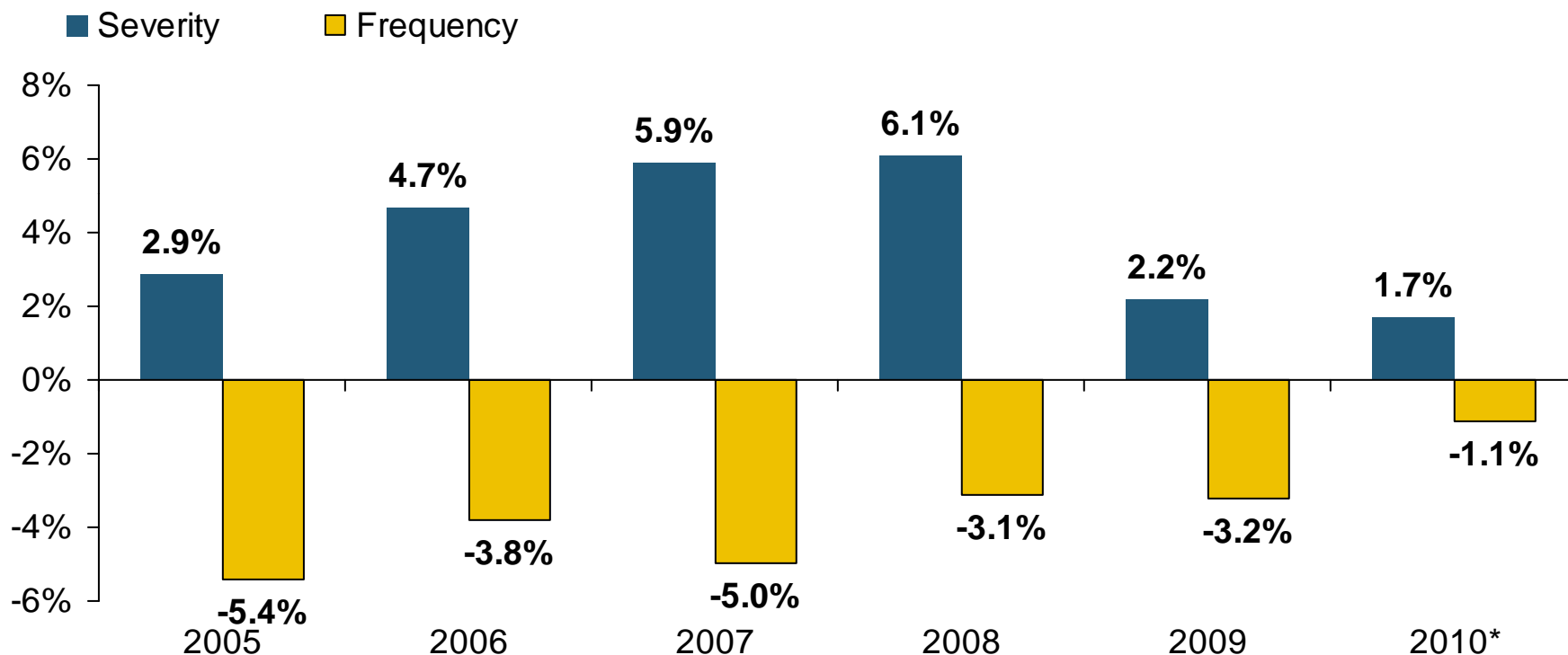
Sources: A.M. Best, Insurance Information Institute

Claim Trends in Auto Insurance

**Rising Costs Held in Check by
Falling Frequency:
Can That Pattern Be Sustained?**

Bodily Injury: Severity Trend Moderating, Frequency Decline Continues

Annual Change, 2005 through 2010*



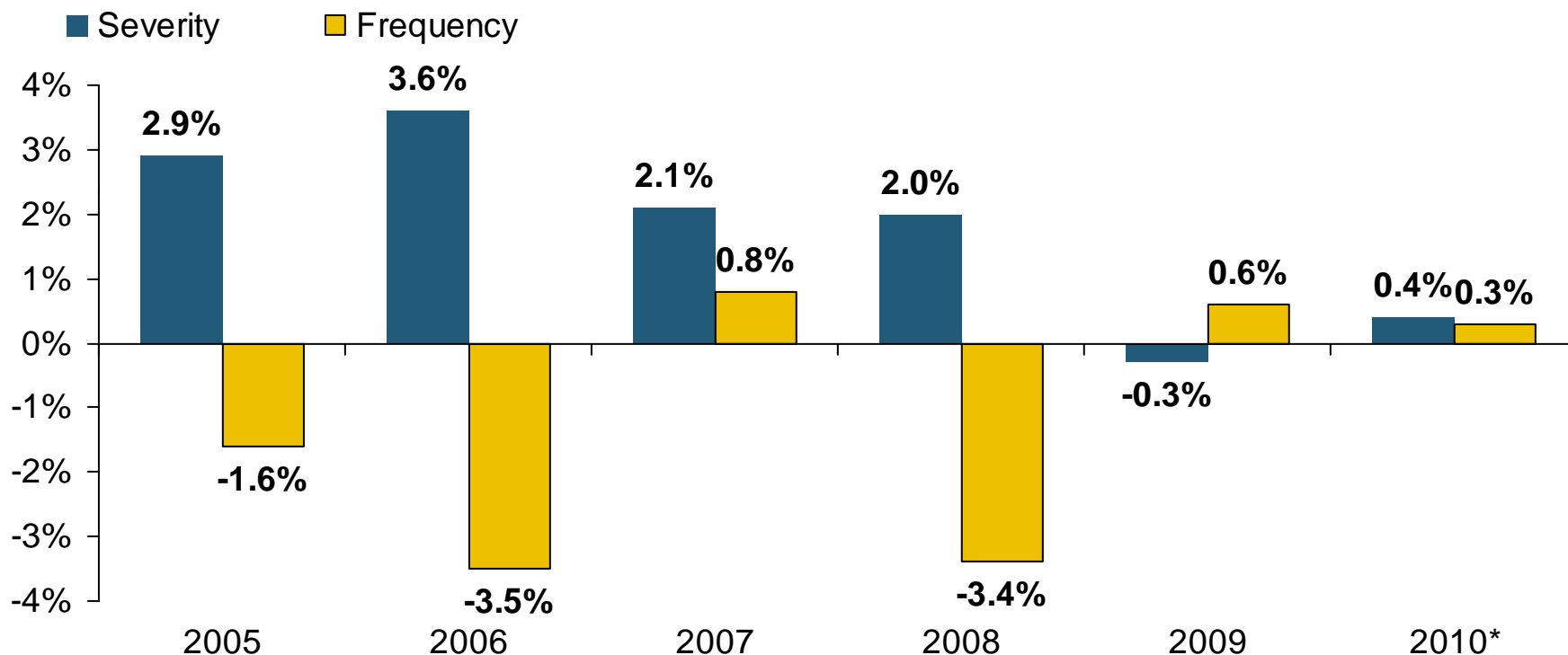
**Cost Pressures Will Increase if BI Severity Increases
Outpace Declines in Frequency**

*For 2010, data are for the 4 quarters ending with 2010:Q3.

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

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

Annual Change, 2005 through 2010*



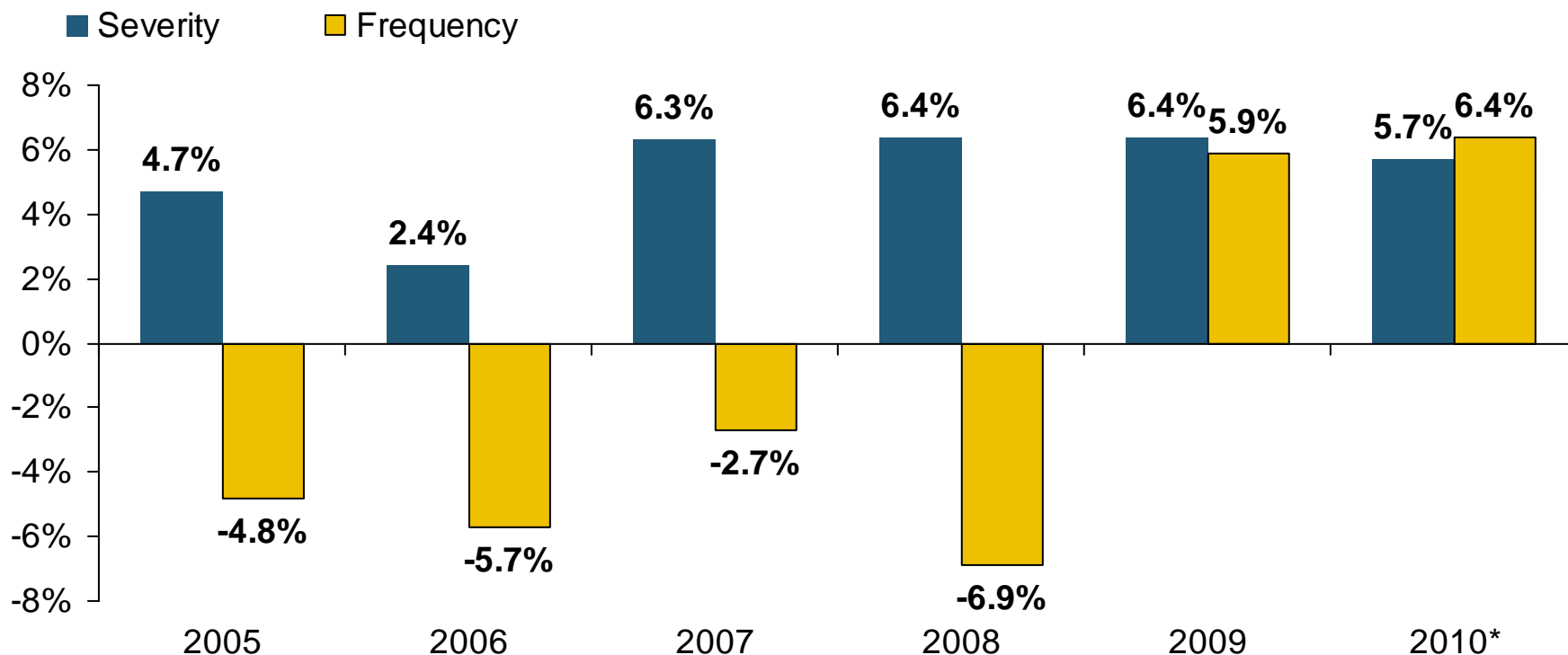
Stable Severity/Frequency Trends Keeping PD Costs in Check, But Are These Trends Sustainable?

*For 2010, data are for the 4 quarters ending with 2010:Q3.

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

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

Annual Change, 2005 through 2010*



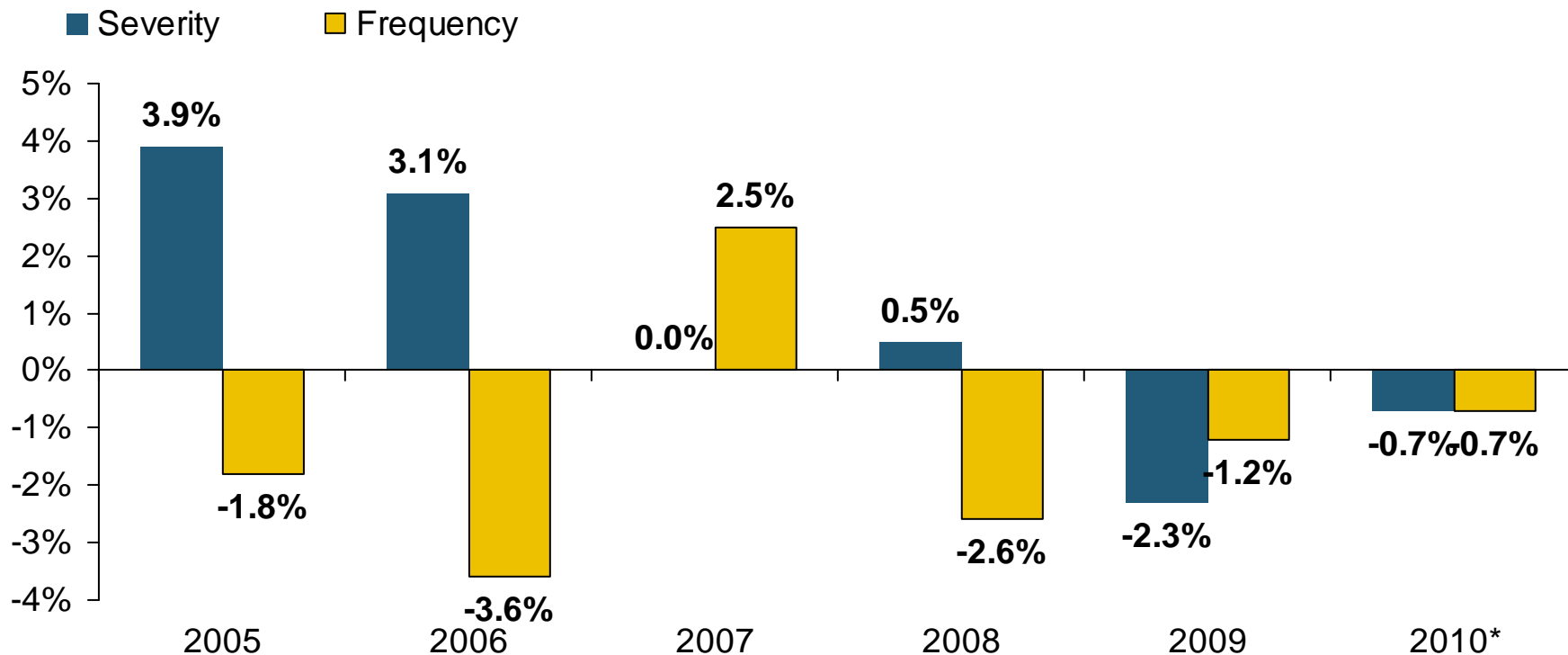
Multiple States Are Experiencing Severe Fraud and Abuse Problems in their No-Fault Systems, Especially FL, MI, NY and NJ

*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:Q3.

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

Collision Coverage: Frequency and Severity Trends Have Been Favorable

Annual Change, 2005 through 2010*



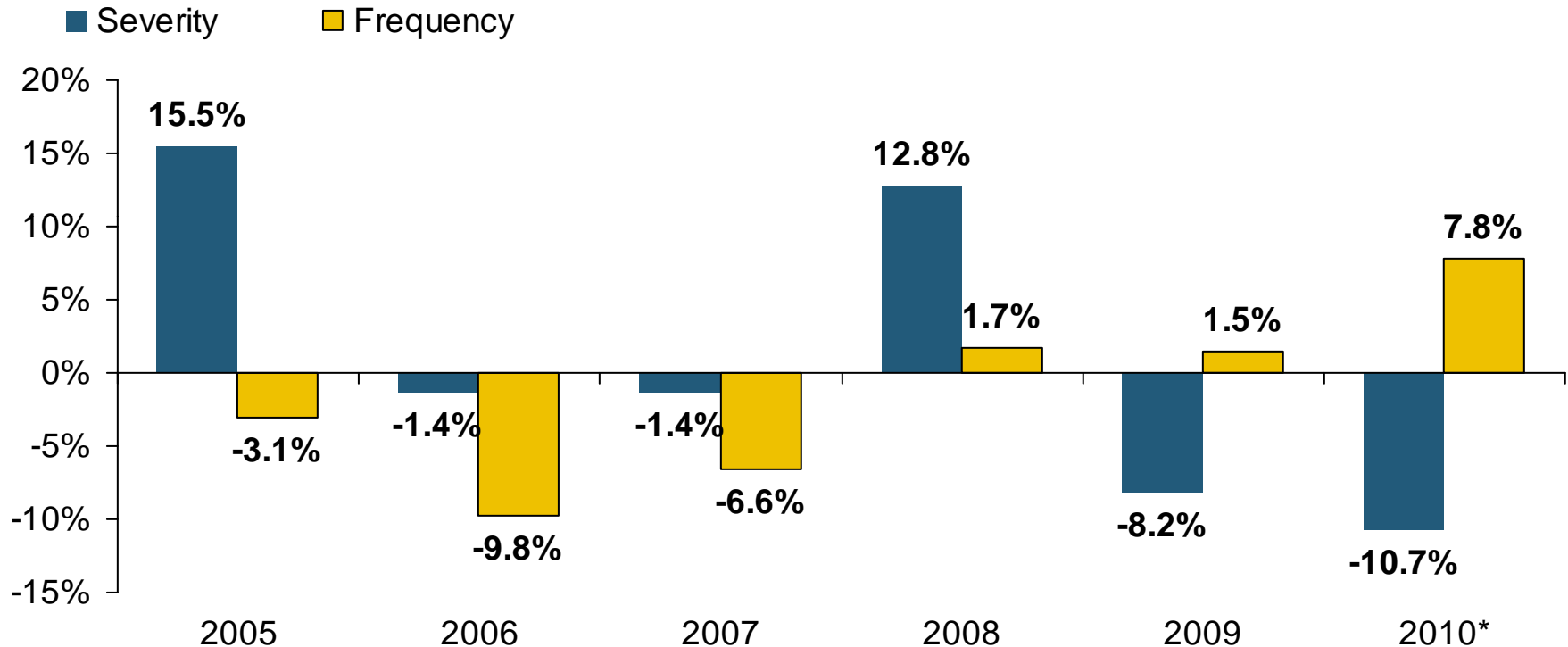
The Recession, High Fuel Prices Have Helped Push Down Frequency and Temper Severity, But this Trend Will Likely Be Reversed Based on Evidence from Past Recoveries

*For 2010, data are for the 4 quarters ending with 2010:Q3.

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

Comprehensive Coverage: Recent Severity Trends Favorable, Frequency is Up in 2010

Annual Change, 2005 through 2010*

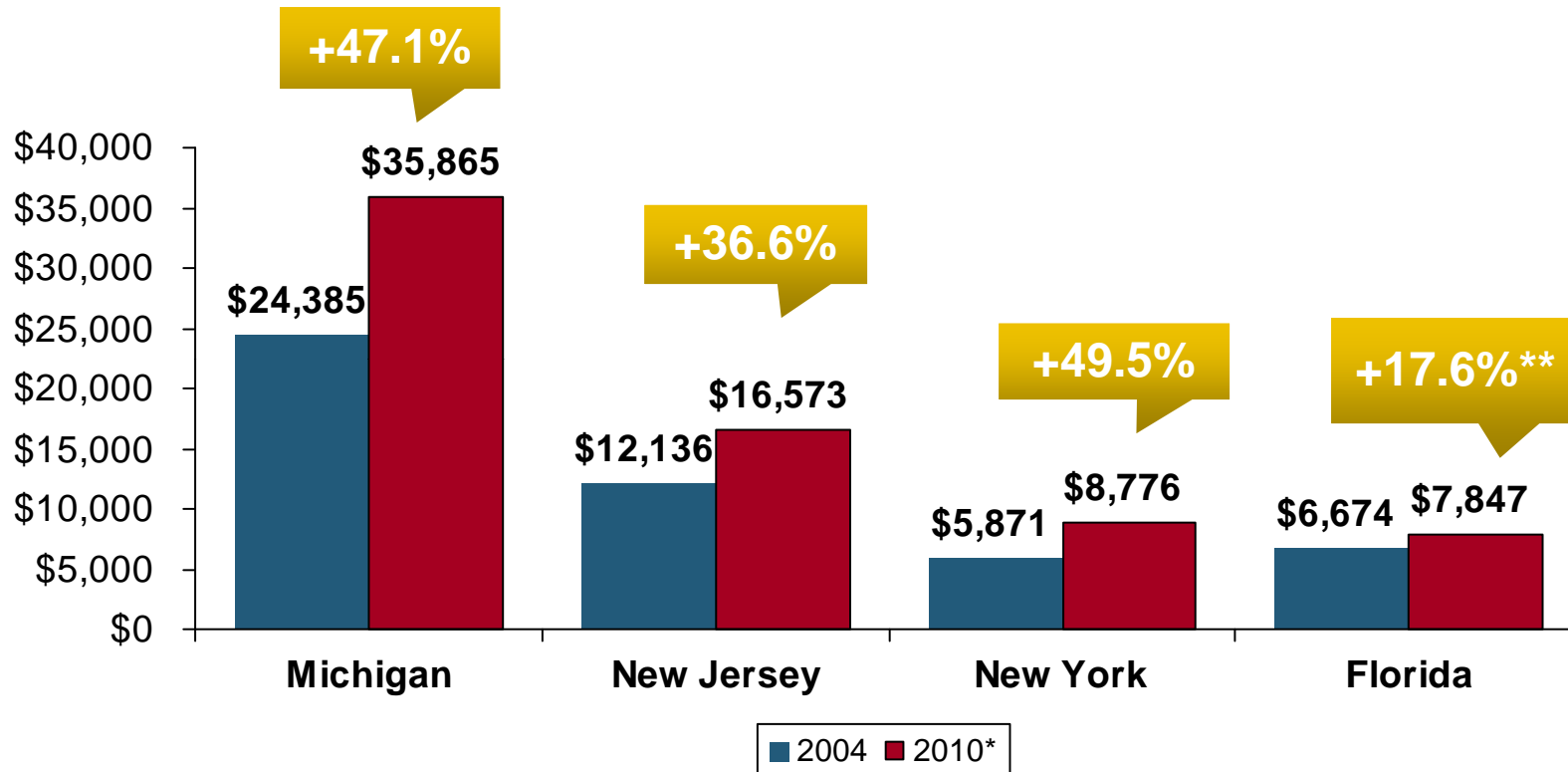


Weather Creates Volatility for Comprehensive Coverage; Recession Has Helped Push Down Frequency and Temper Severity, But This Factors Will Weaken as Economy Recovers

*For 2010, data are for the 4 quarters ending with 2010:Q3.

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

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



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

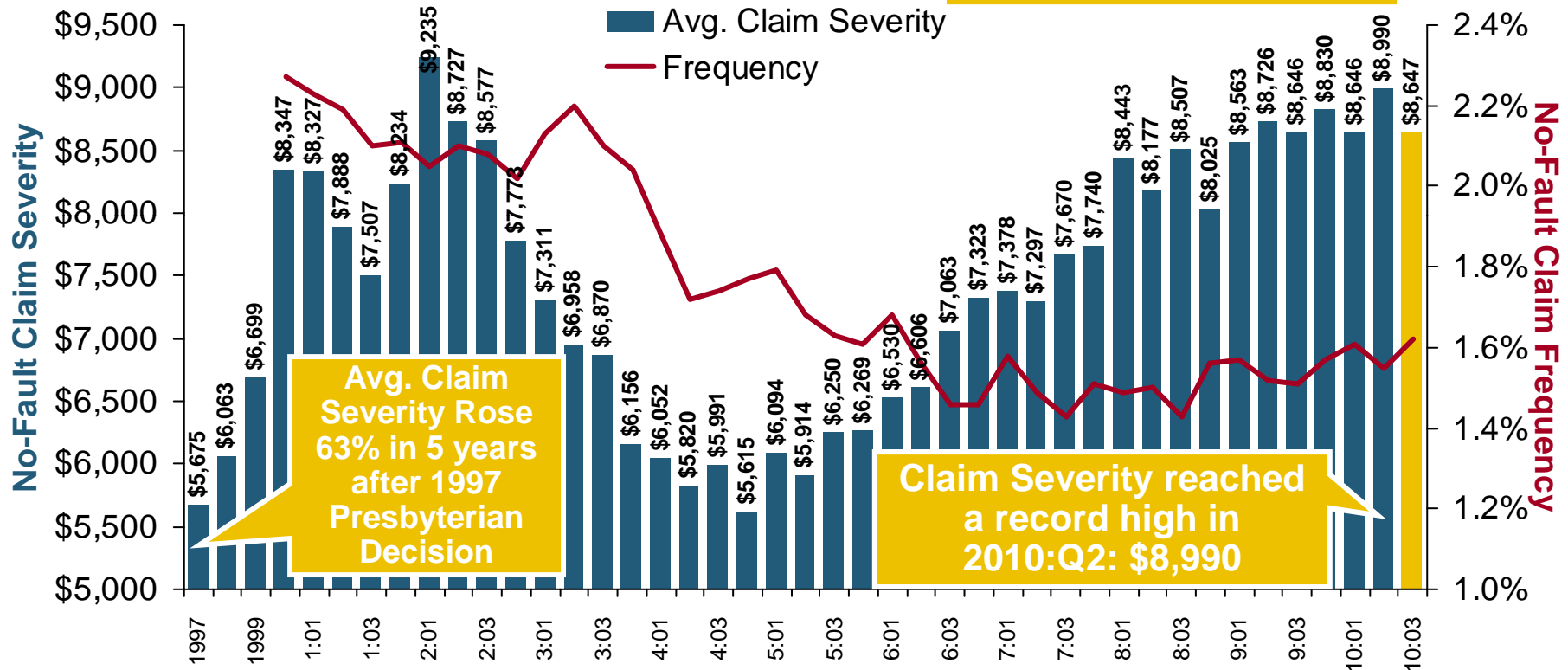
*2009 figure is for the 4 quarters ending 2010:Q3.

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

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

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

No-Fault Claim Severity

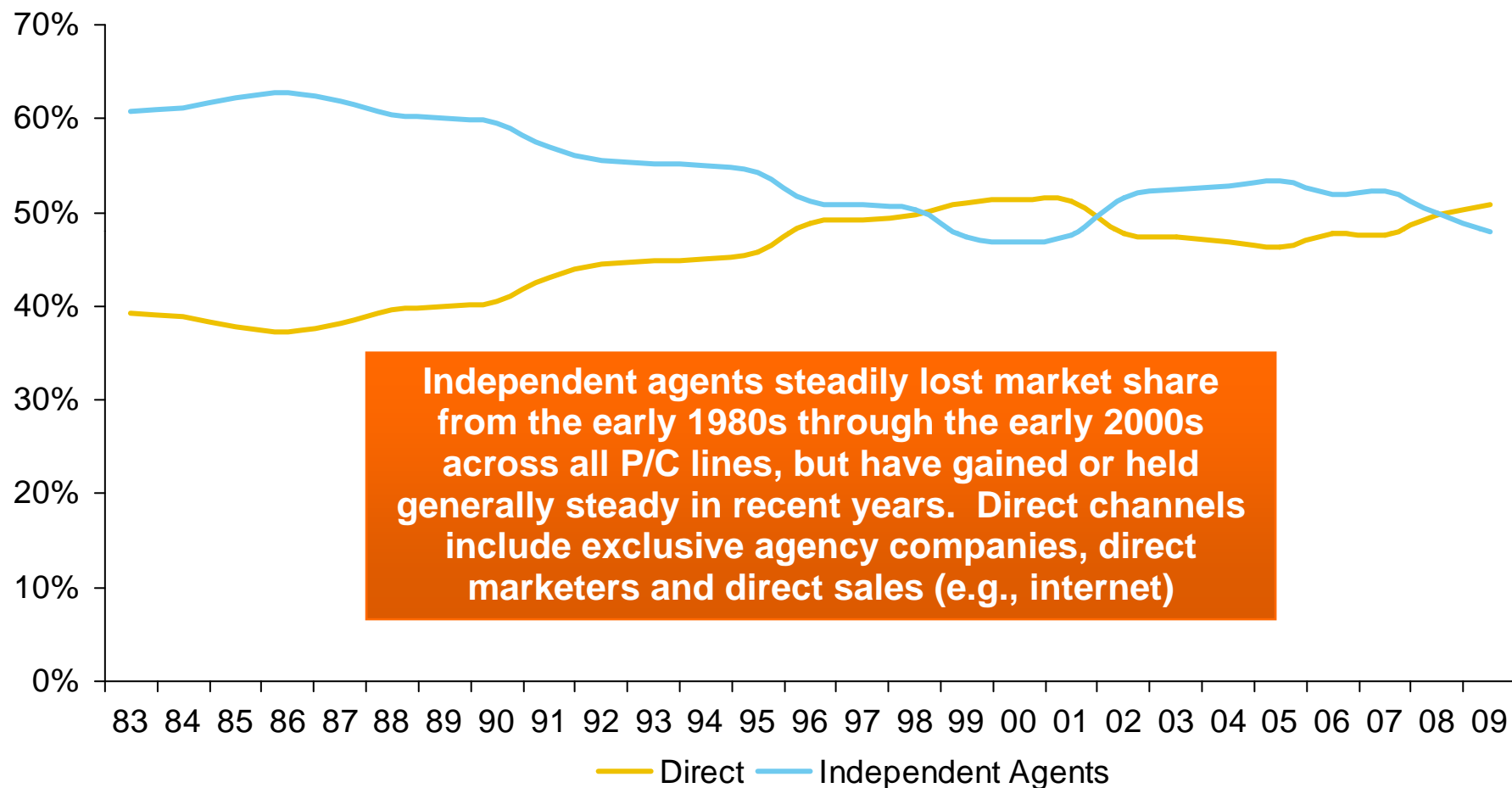


About 20% of No-Fault Claim Costs Are Attributable to Fraud and Abuse

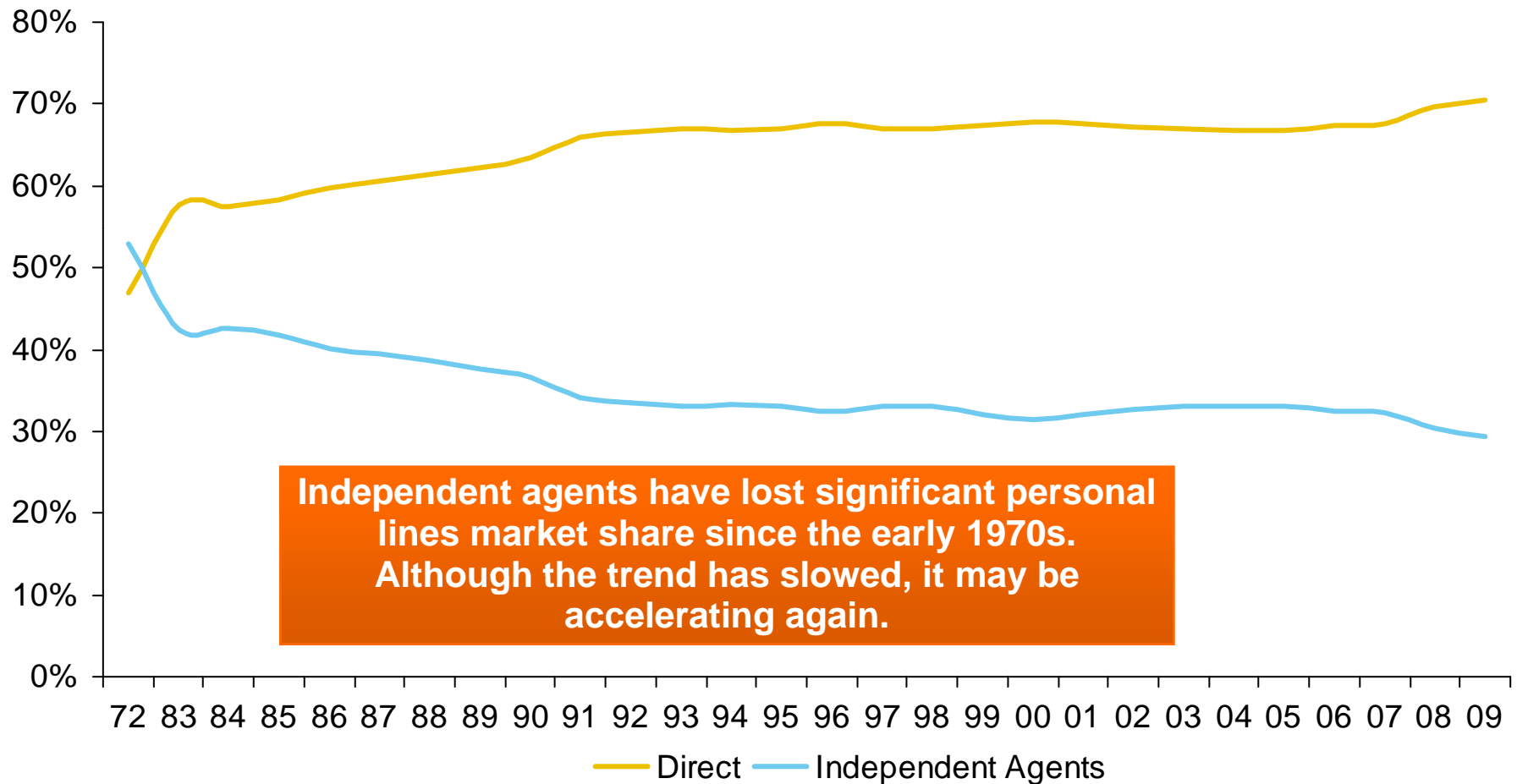
Distribution Trends

**Distribution by Channel Type
Continues to Evolve**

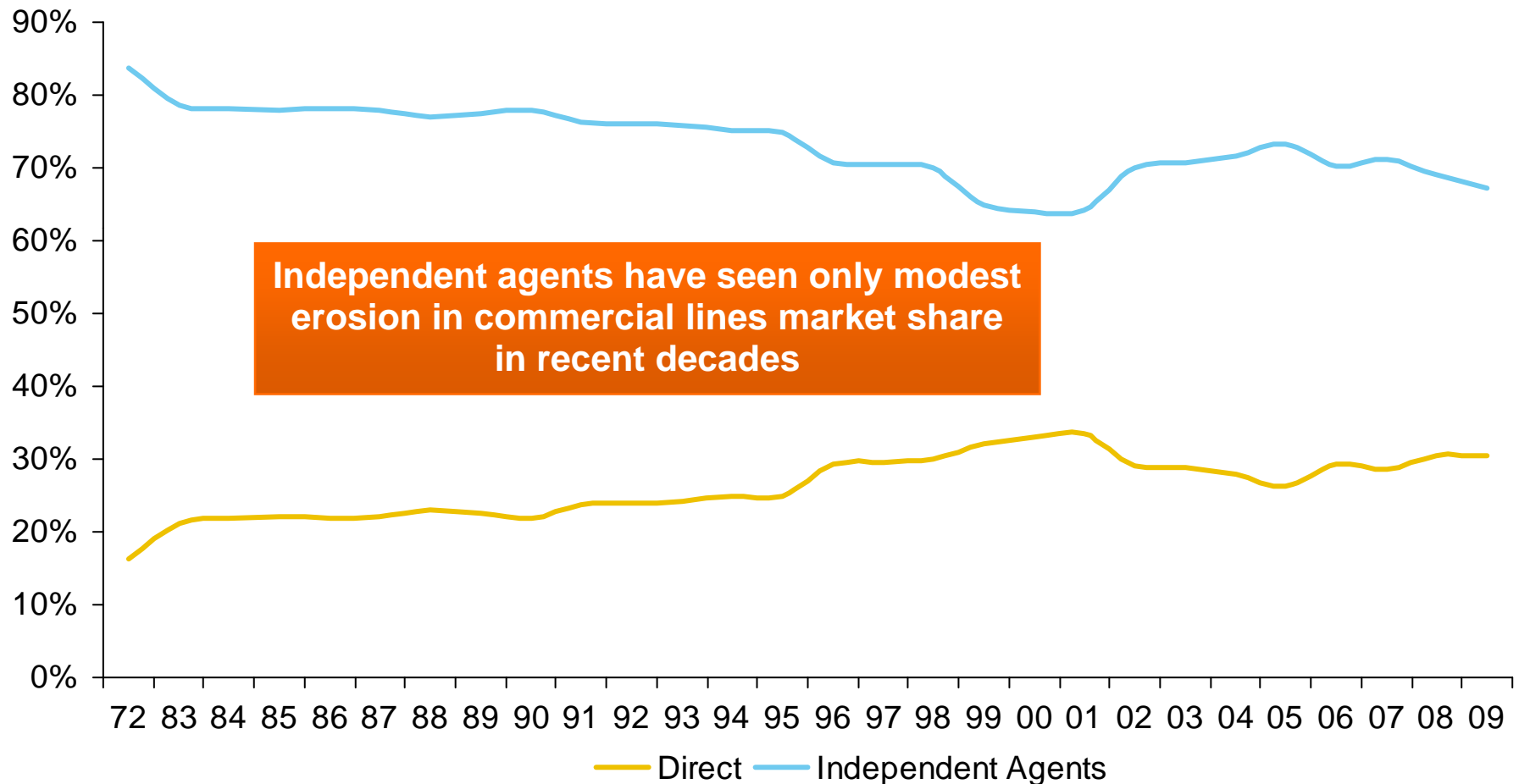
All P/C Lines Distribution Channels, Direct vs. Independent Agents



Personal Lines Distribution Channels, Direct vs. Independent Agents



Commercial P/C Distribution Channels, Direct vs. Independent Agents



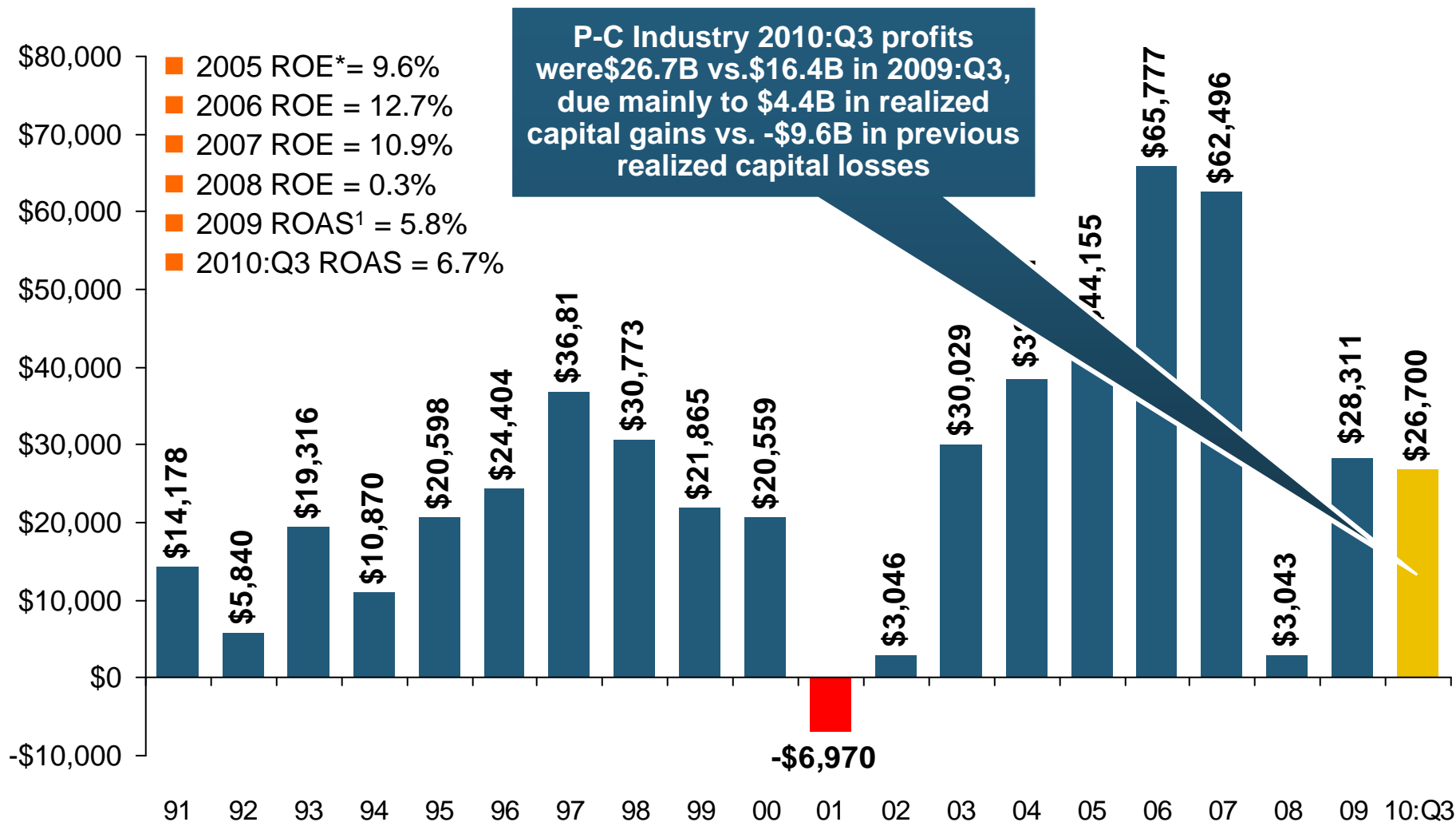
P/C Insurance Industry Financial Overview

**Profit Recovery Continues
Early Stage Growth Begins**

Profitability

Exhibits Strong Cyclicalality

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

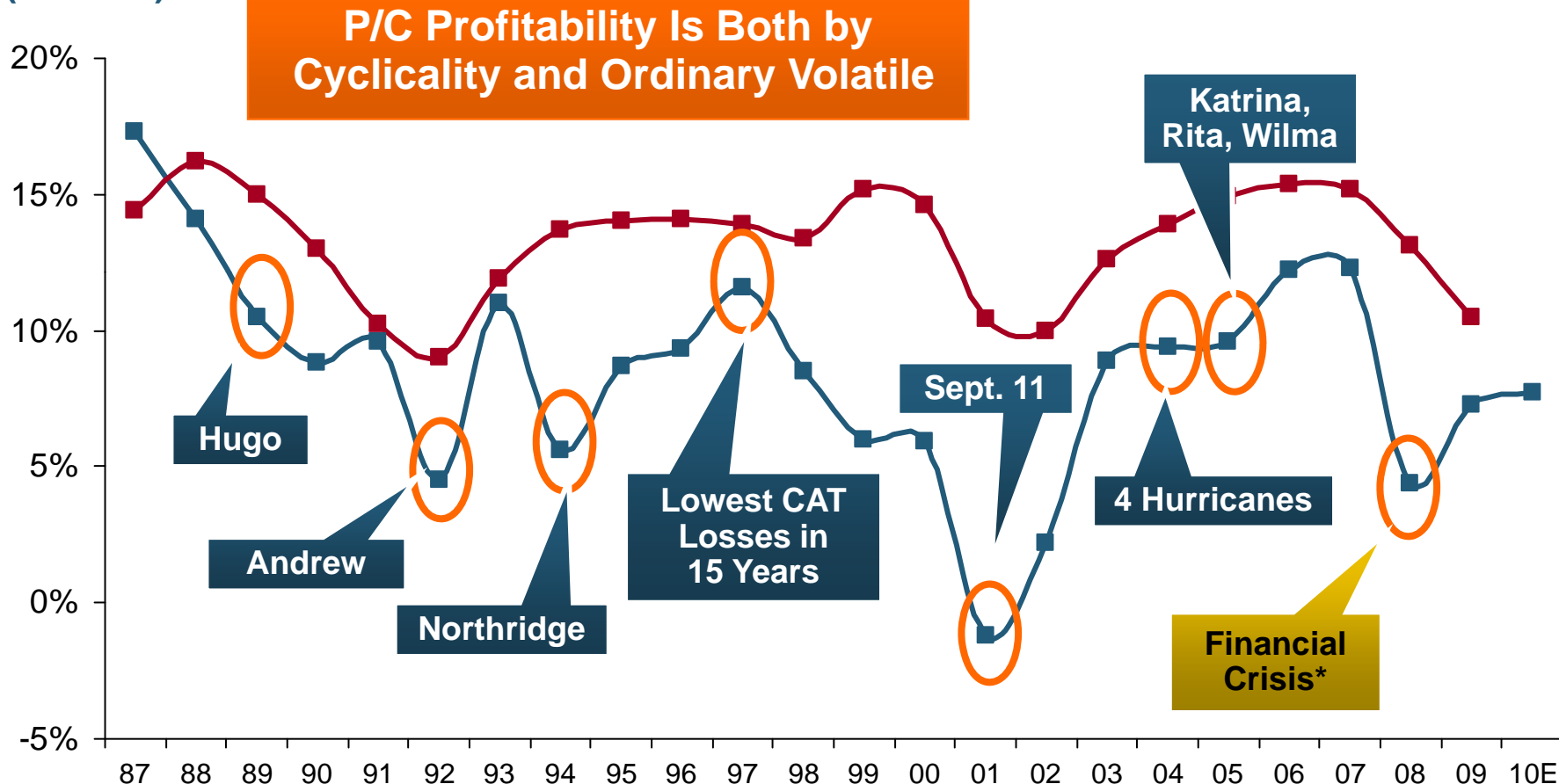


* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.7% ROAS for 2010:Q3 and 4.6% for 2009. 2009:Q3 net income was \$29.8 billion excluding M&FG.

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

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

(Percent)

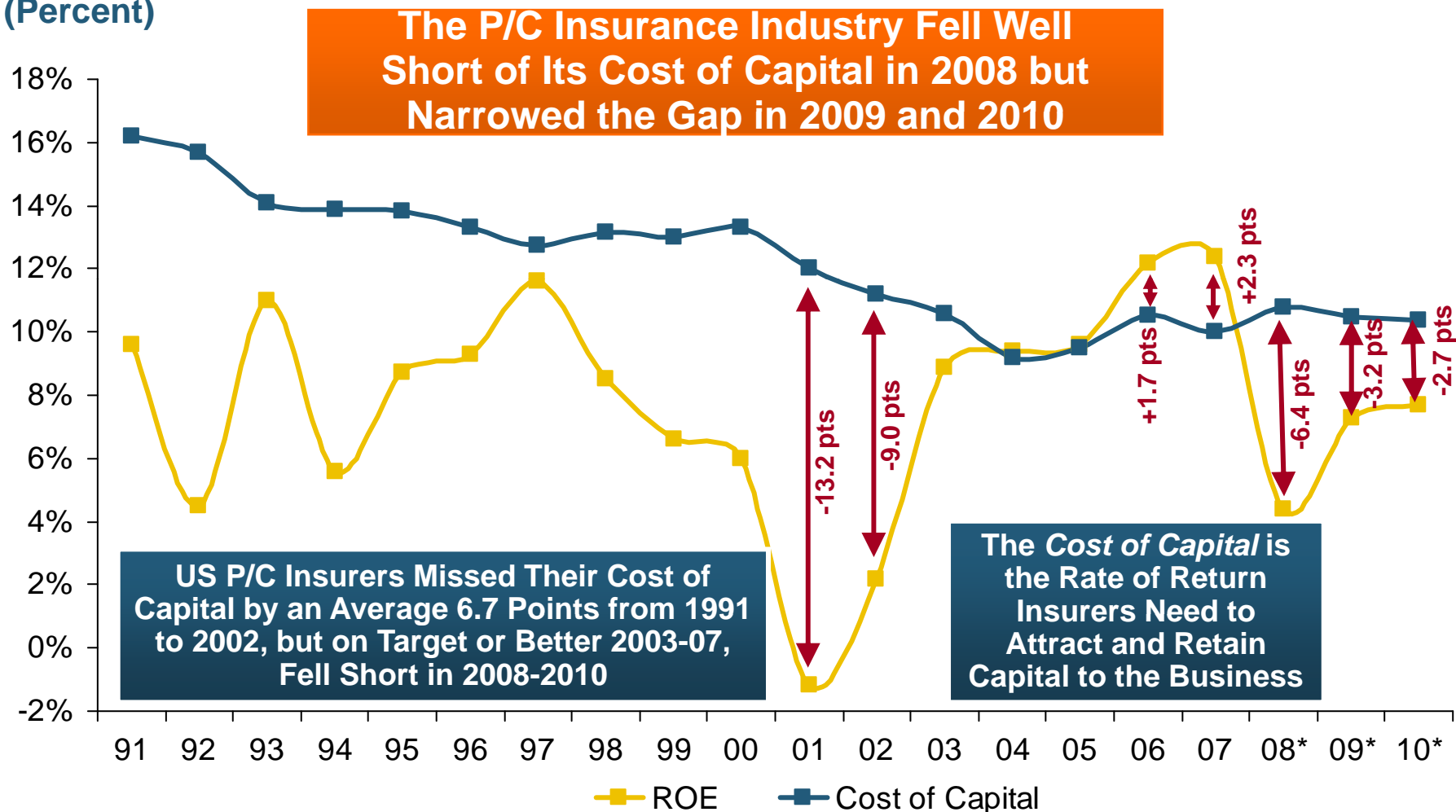


* Excludes Mortgage & Financial Guarantee in 2008 - 2010.

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

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

(Percent)

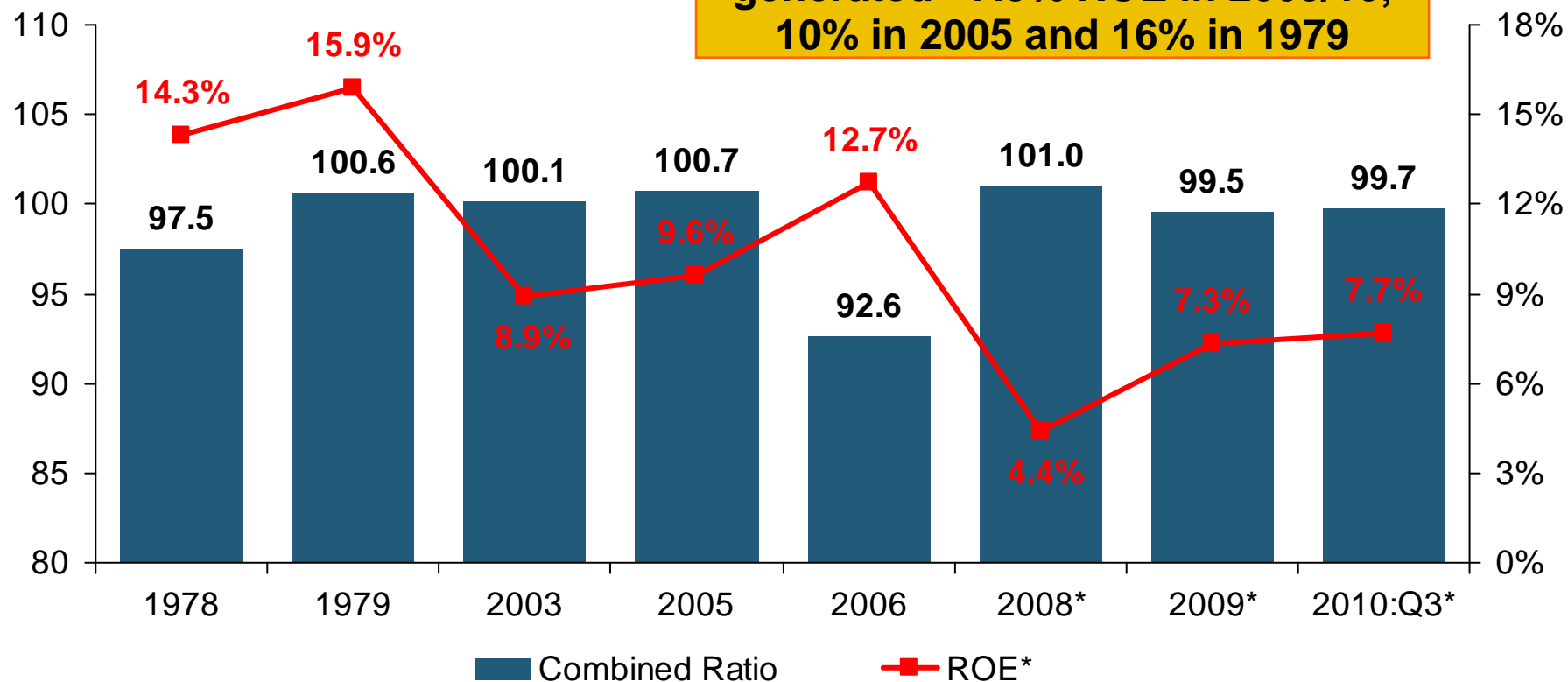


* Return on average surplus in 2008-2010 excluding mortgage and financial guaranty insurers.

Source: The Geneva Association, Insurance Information Institute

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

Combined Ratio / ROE



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

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

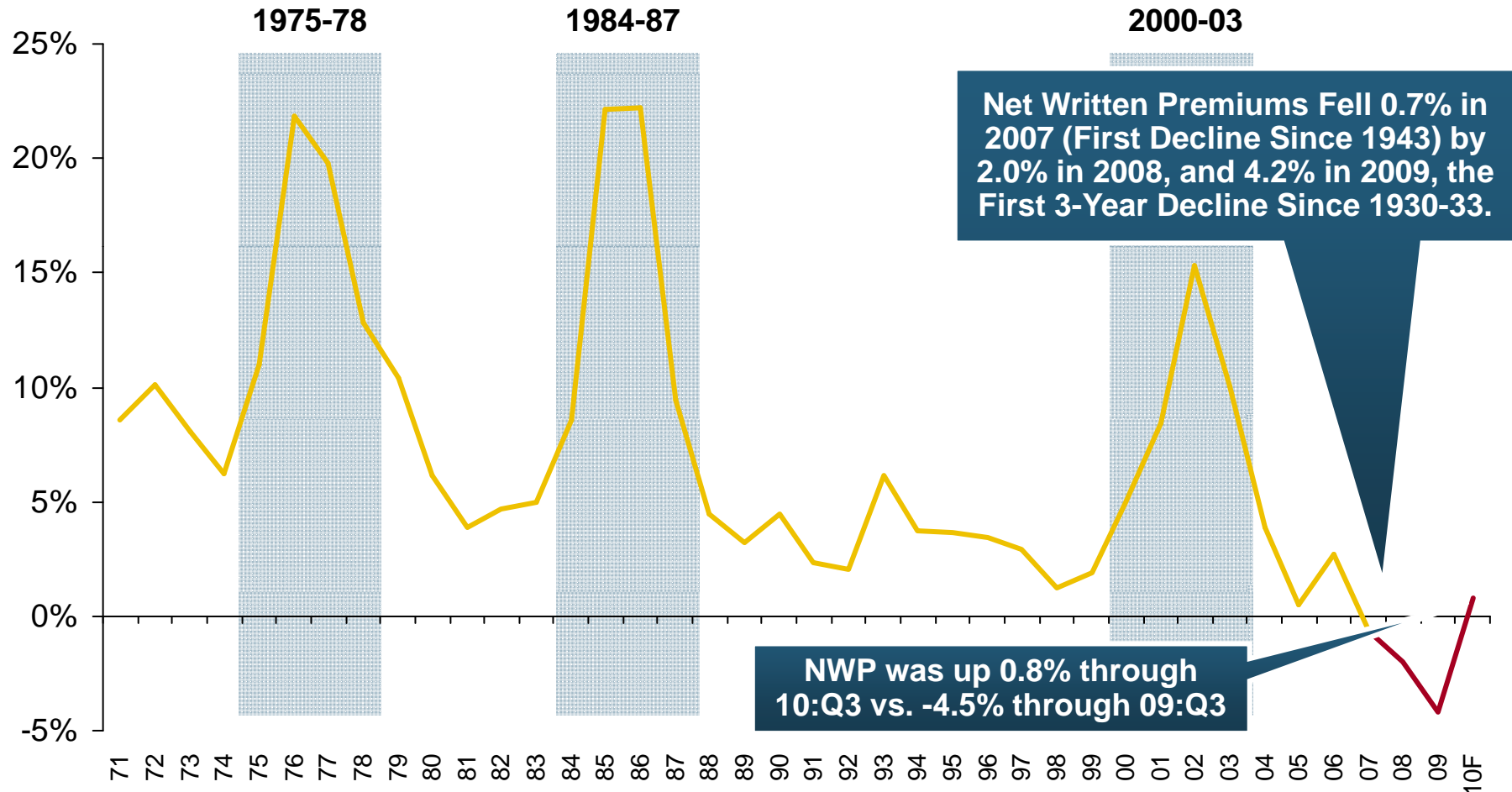
Source: Insurance Information Institute from A.M. Best and ISO data.

P/C Premium Growth Cycles

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

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

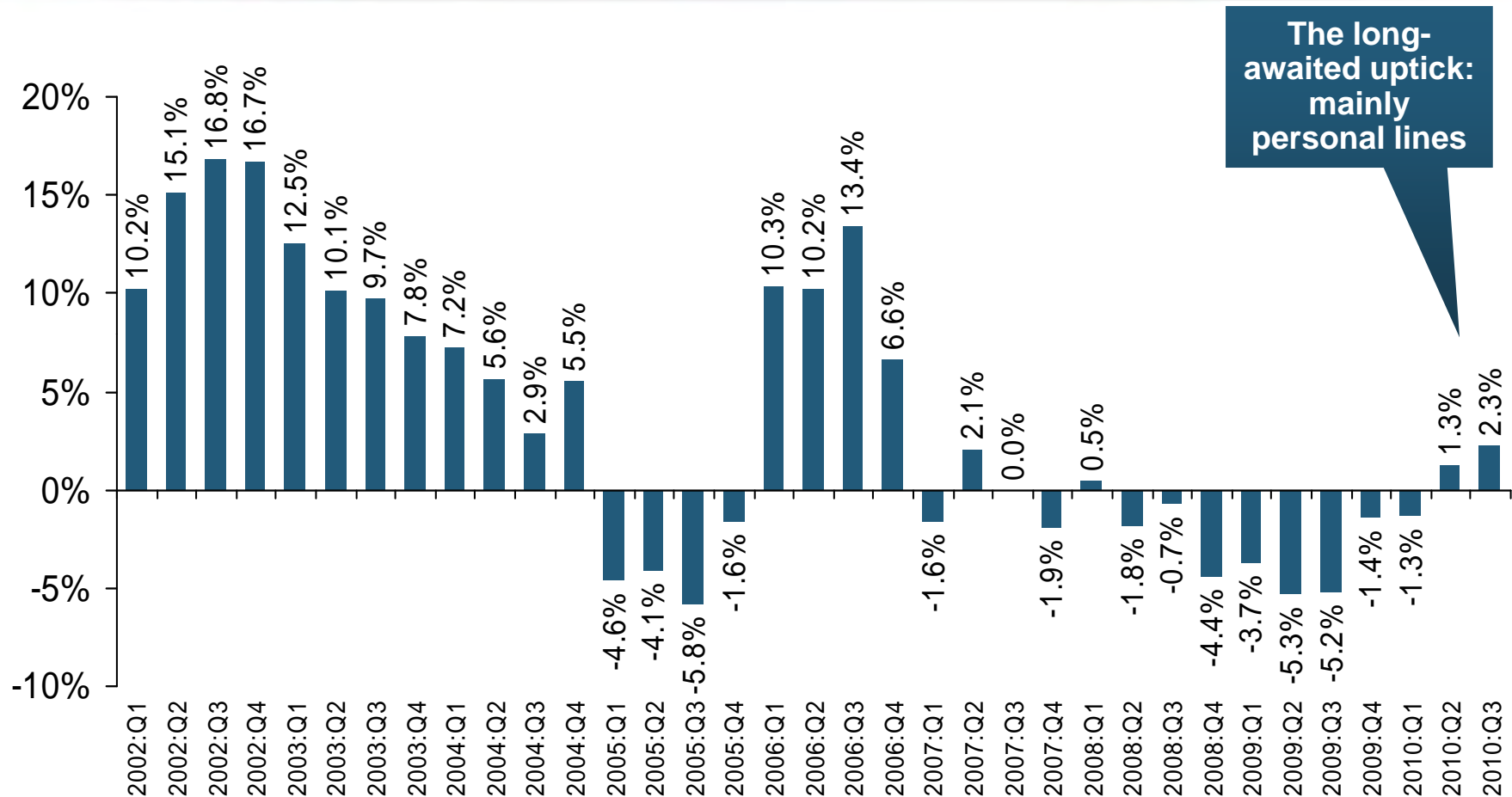
(Percent)



Shaded areas denote "hard market" periods

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

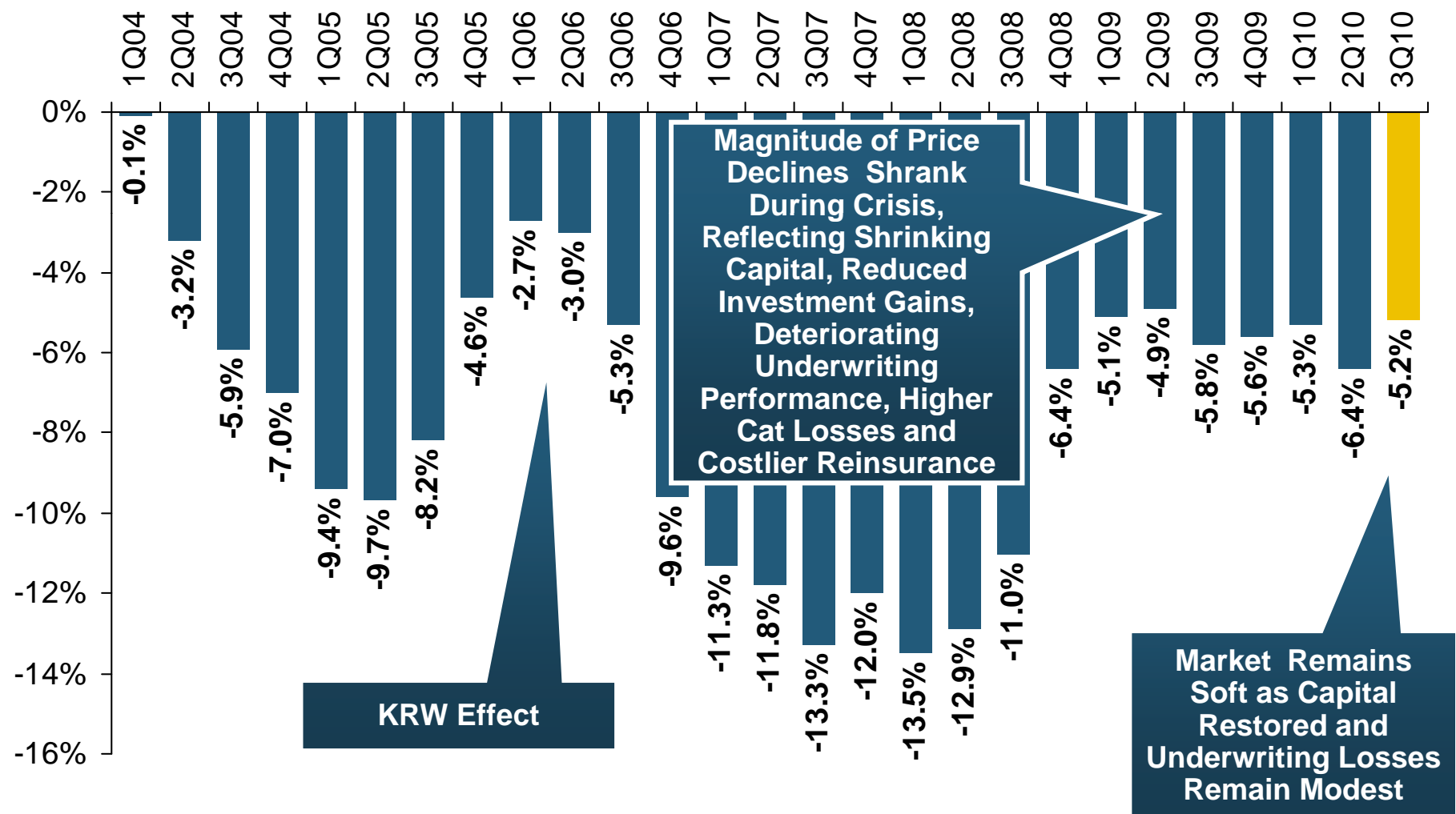
P/C Net Premiums Written: % Change, Quarter vs. Year-Prior Quarter



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

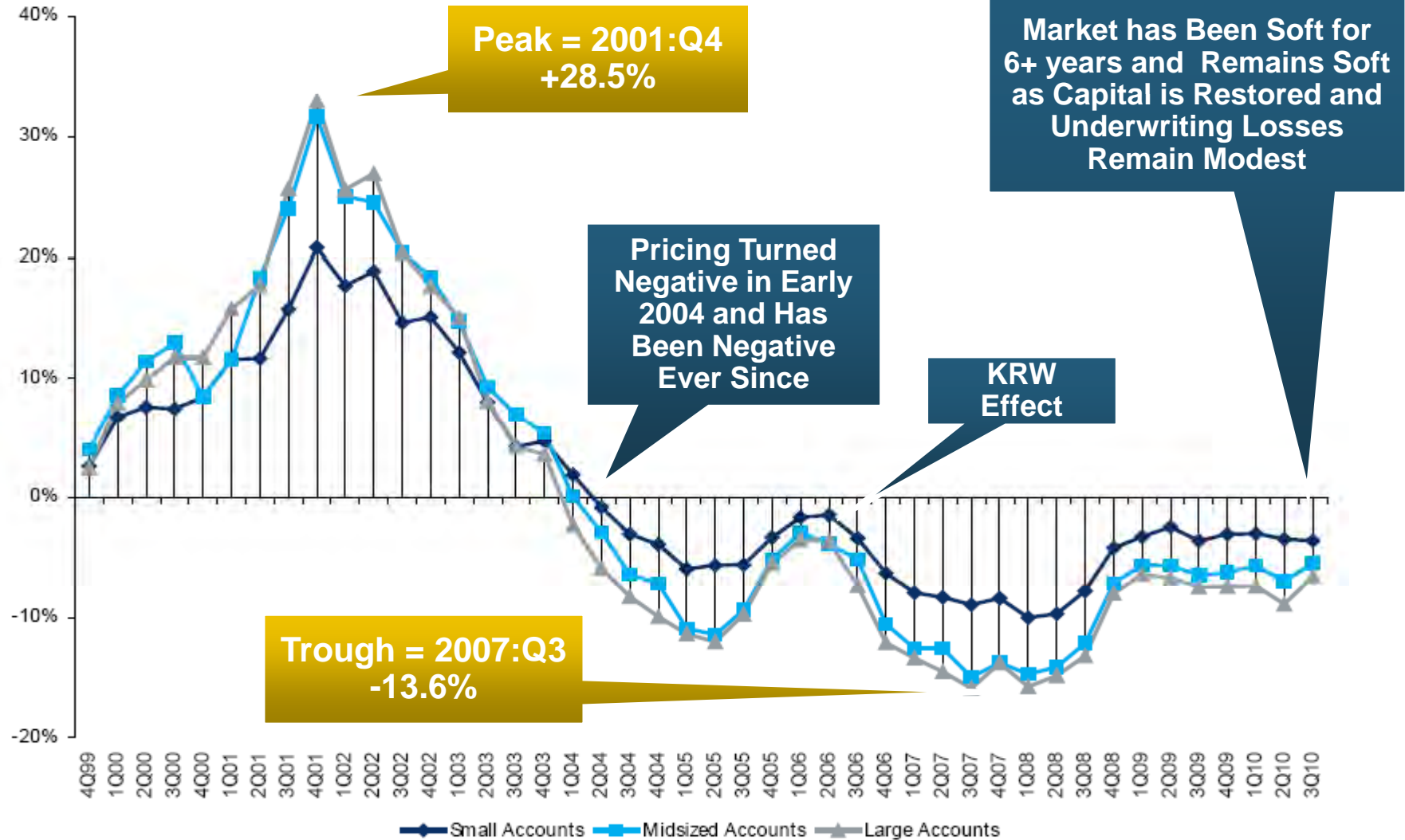
Average Commercial Rate Change, All Lines, (1Q:2004–3Q:2010)

(Percent)



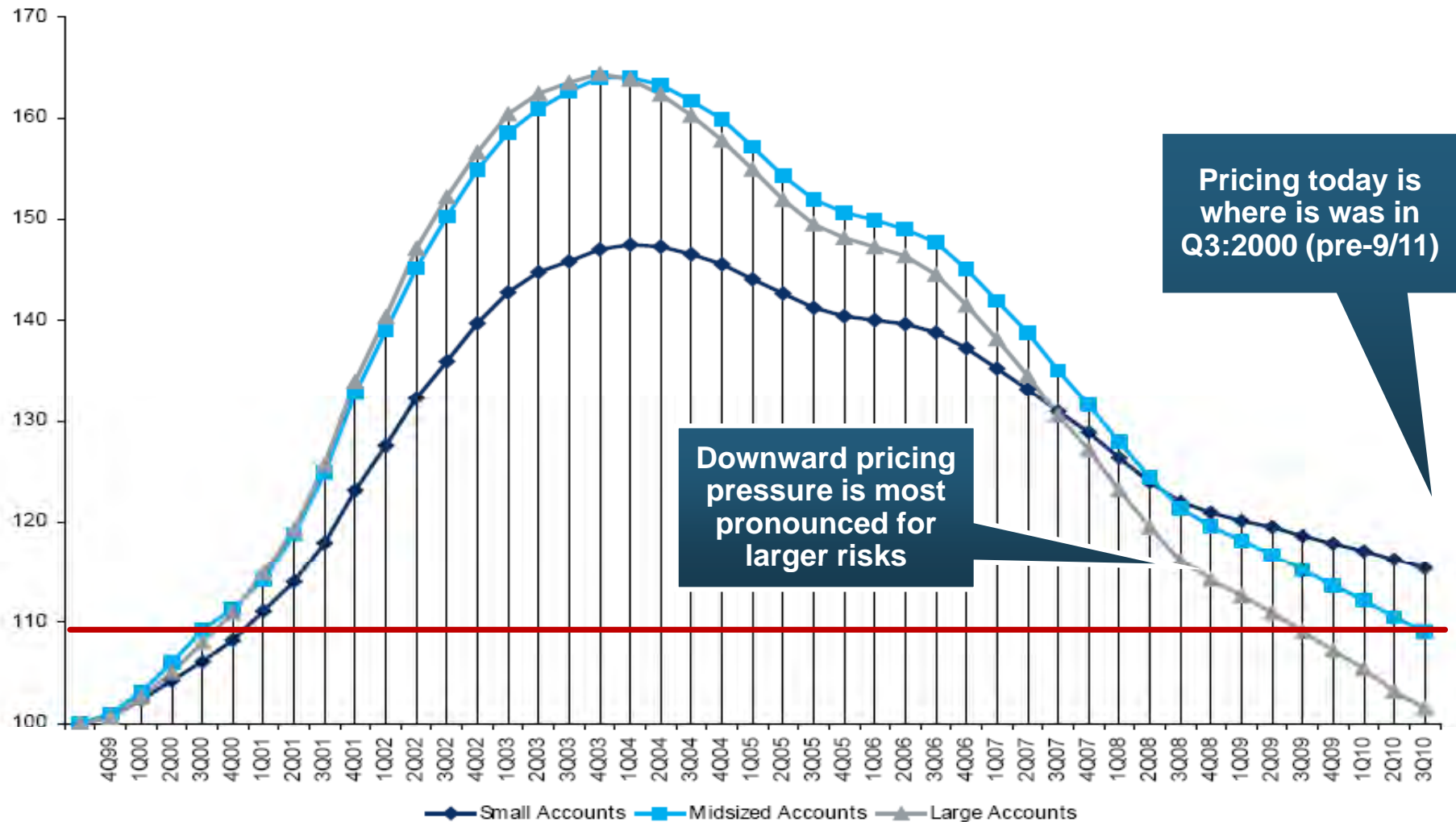
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2010:Q3

Percentage Change (%)



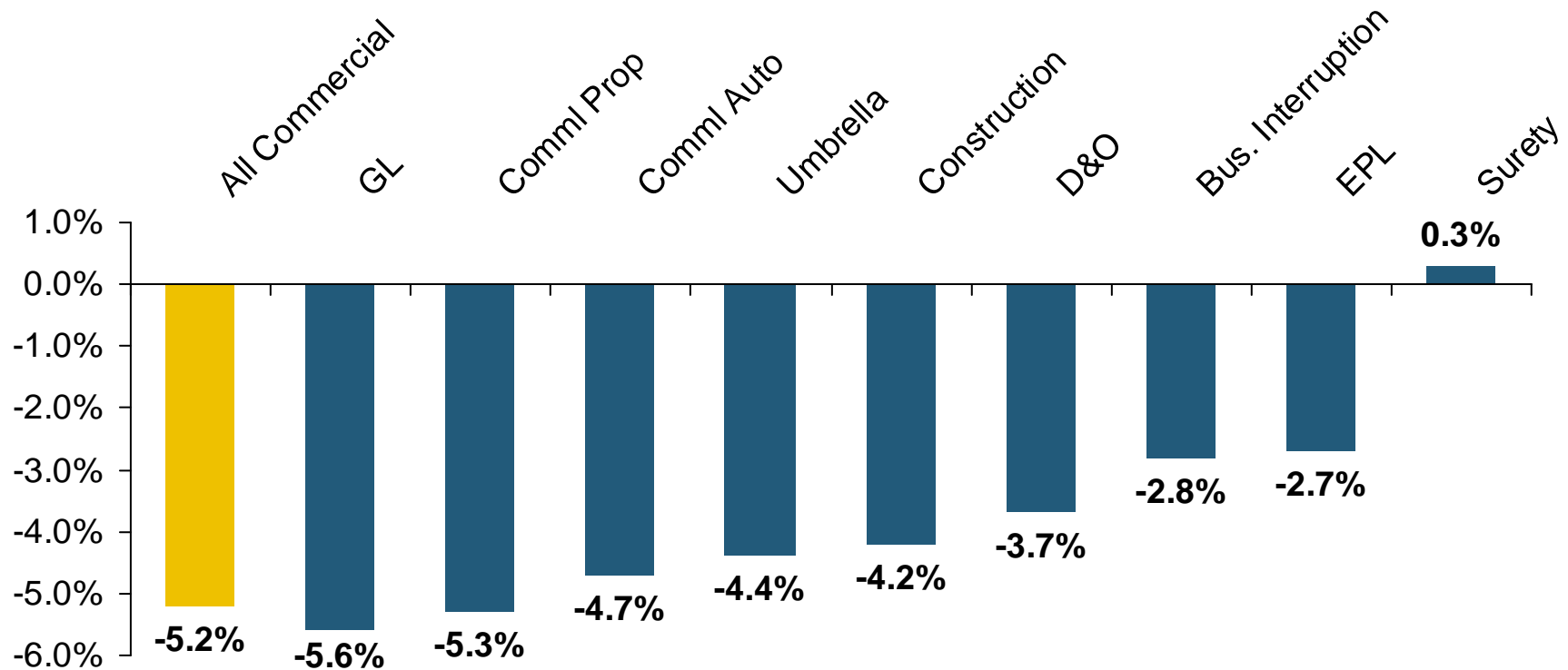
Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2010:Q3

1999:Q4 = 100



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

Percentage Change (%)



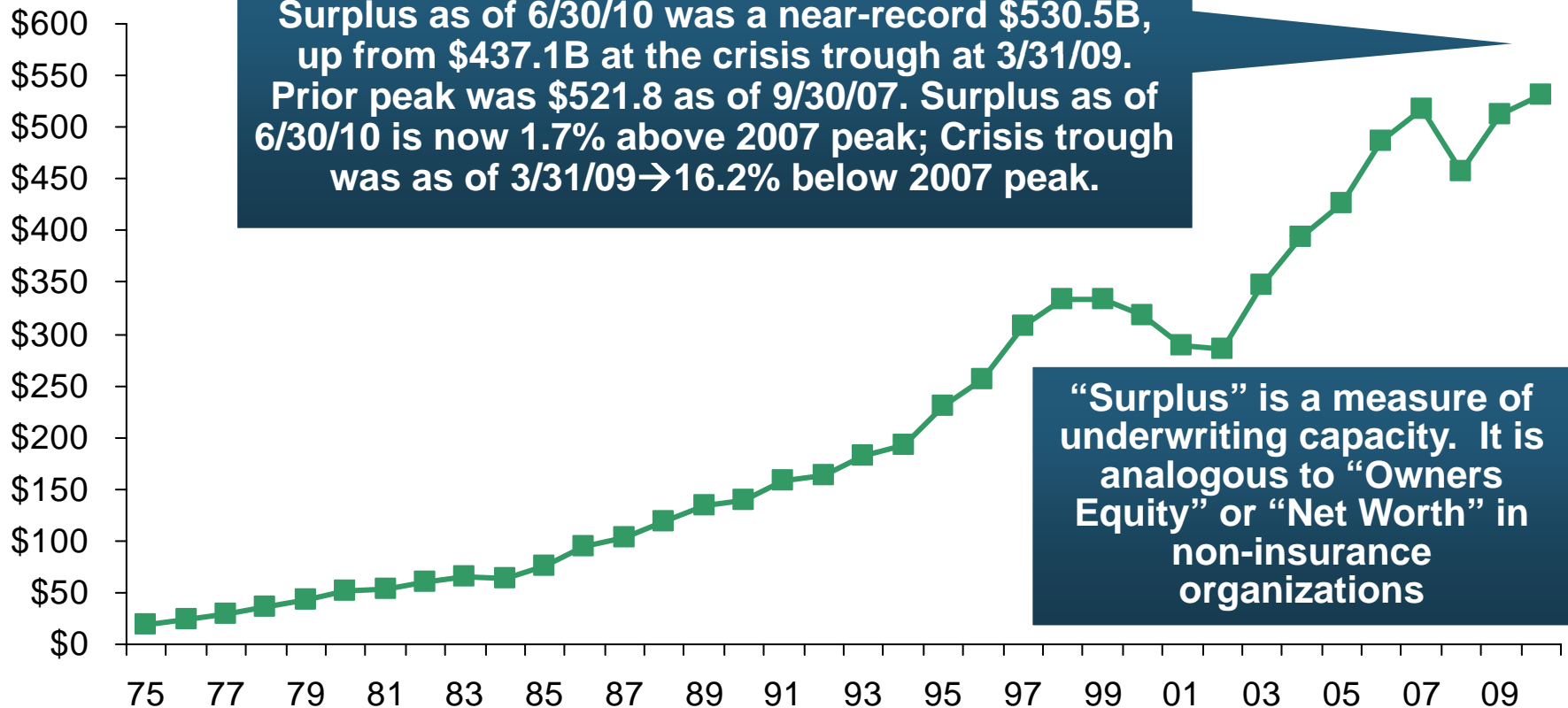
Most Major Commercial Lines Renewed Down in Q3:2010 at a Pace Similar to that of a Year Earlier

Capital/Policyholder Surplus (US)

**Total Surplus Exhibits Little
Cyclicality, While Surplus Leverage
Ratios Influence Cycle**

US Policyholder Surplus: 1975–2010*

(\$ Billions)

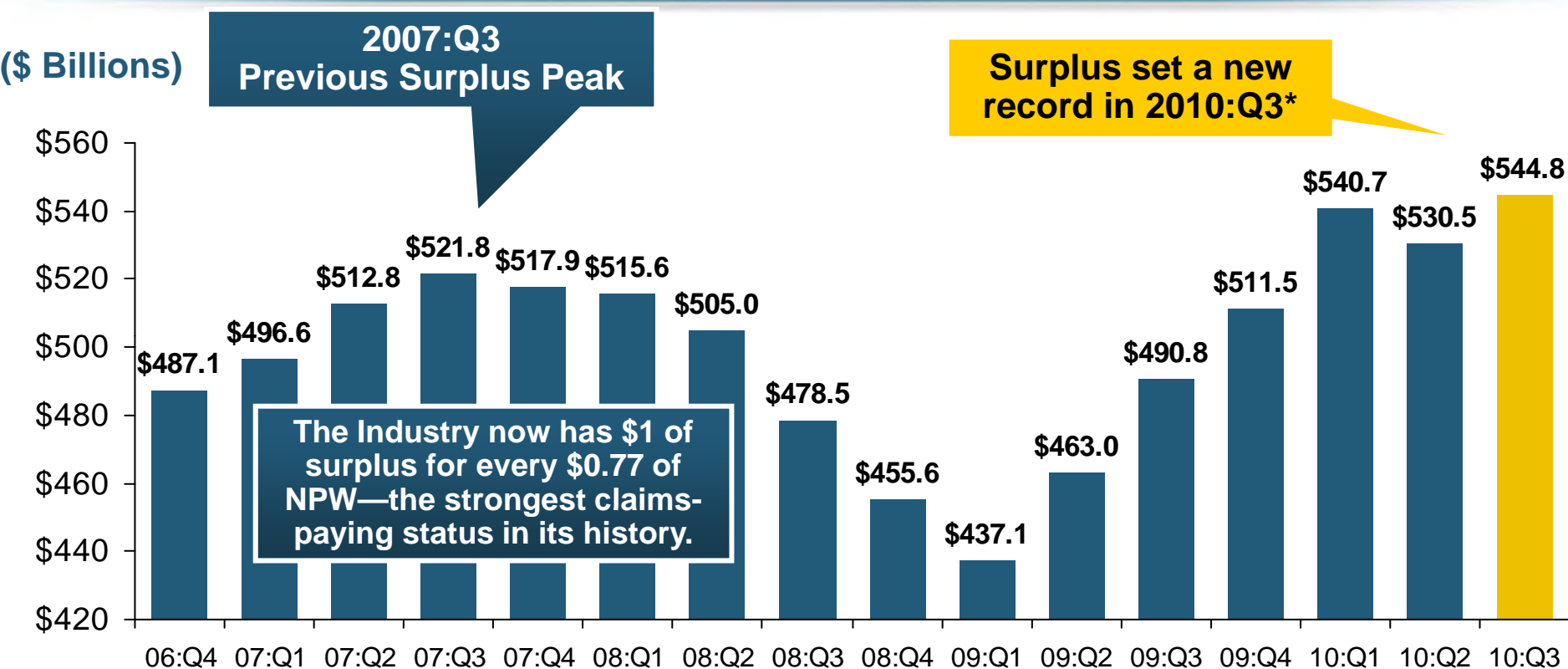


The Premium-to-Surplus Ratio Stood at \$0.80:\$1 as of 6/30/10, A Record Low (at Least in Recent History)**

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

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

Policyholder Surplus, 2006:Q4–2010:Q3



Quarterly Surplus Changes Since 2007:Q3 Peak

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

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

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

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

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

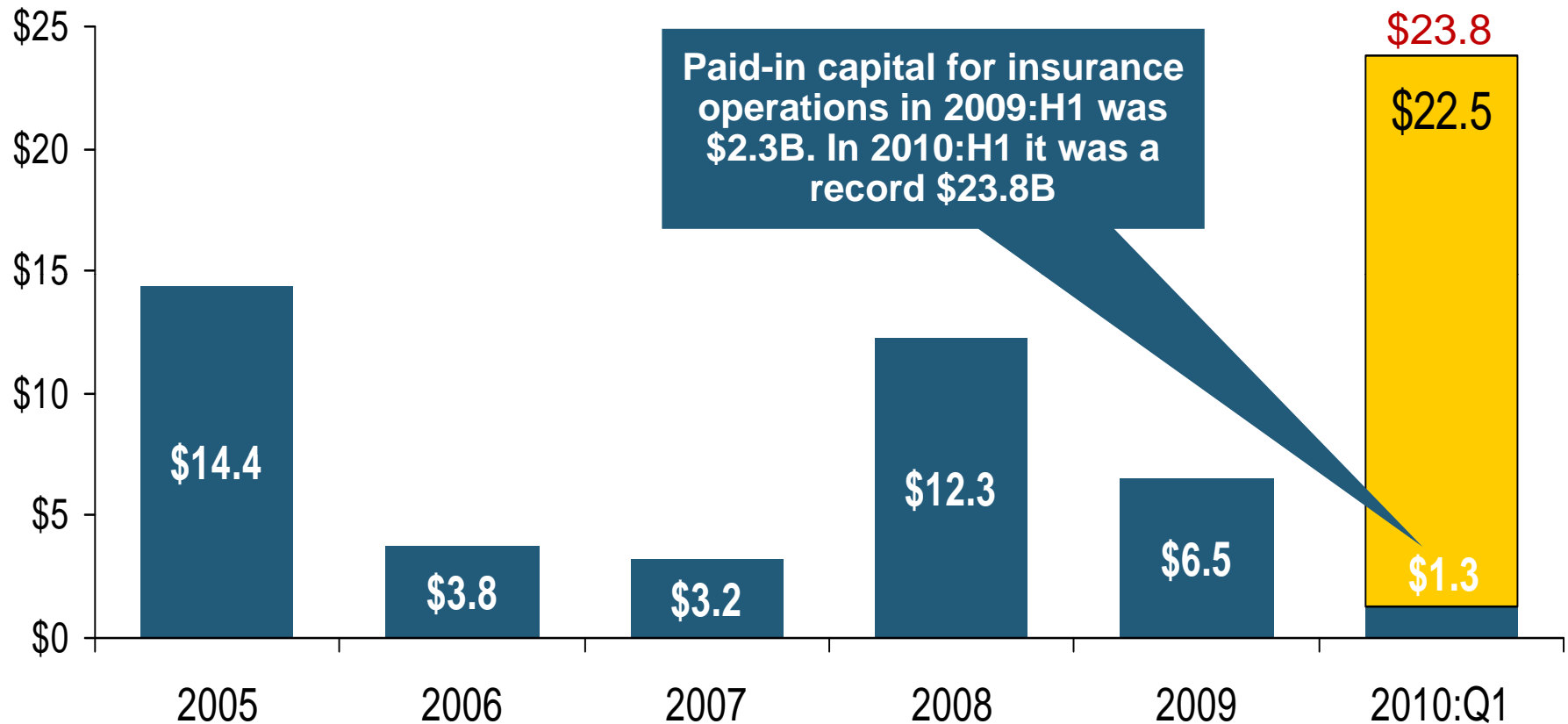
10:Q2: +\$8.7B (+1.7%)

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

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

Paid-in Capital, 2005–2010:H1

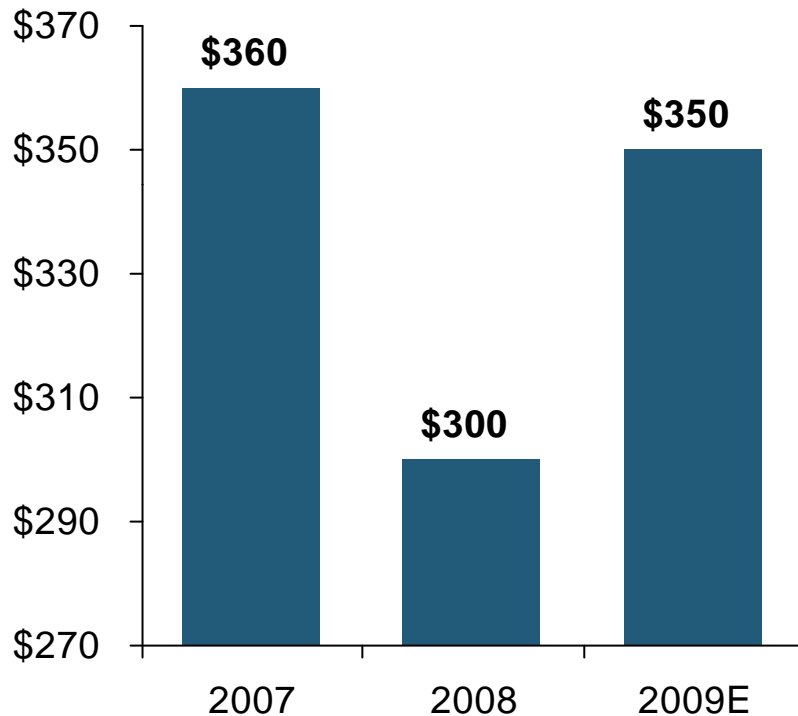
(\$ Billions)



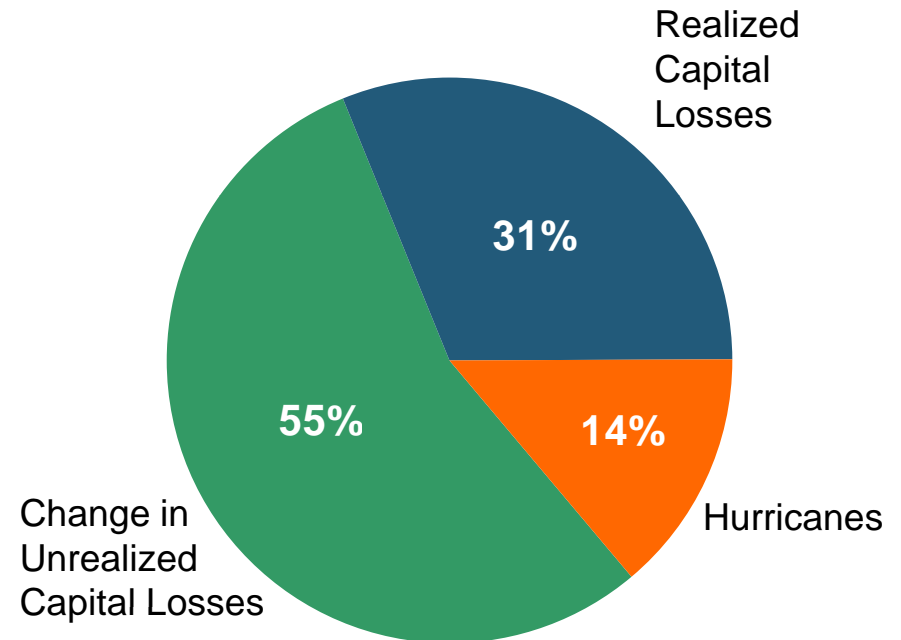
In 2010:H1 One Insurer's Paid-in Capital Rose by \$22.5B as Part of an Investment in a Non-insurance Business

Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

Global Reinsurance Capacity



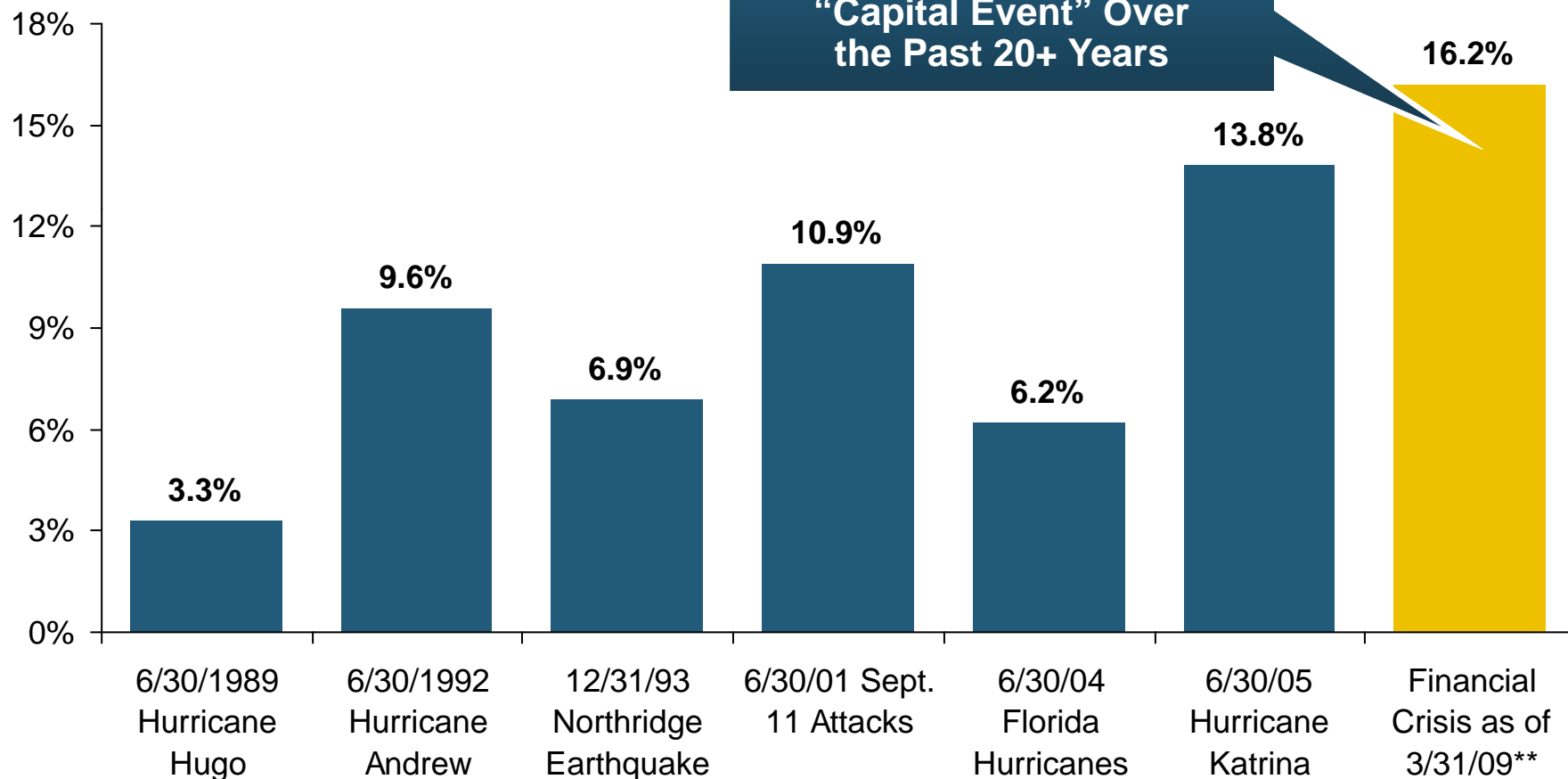
Source of Decline in 2008



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

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

(Percent)



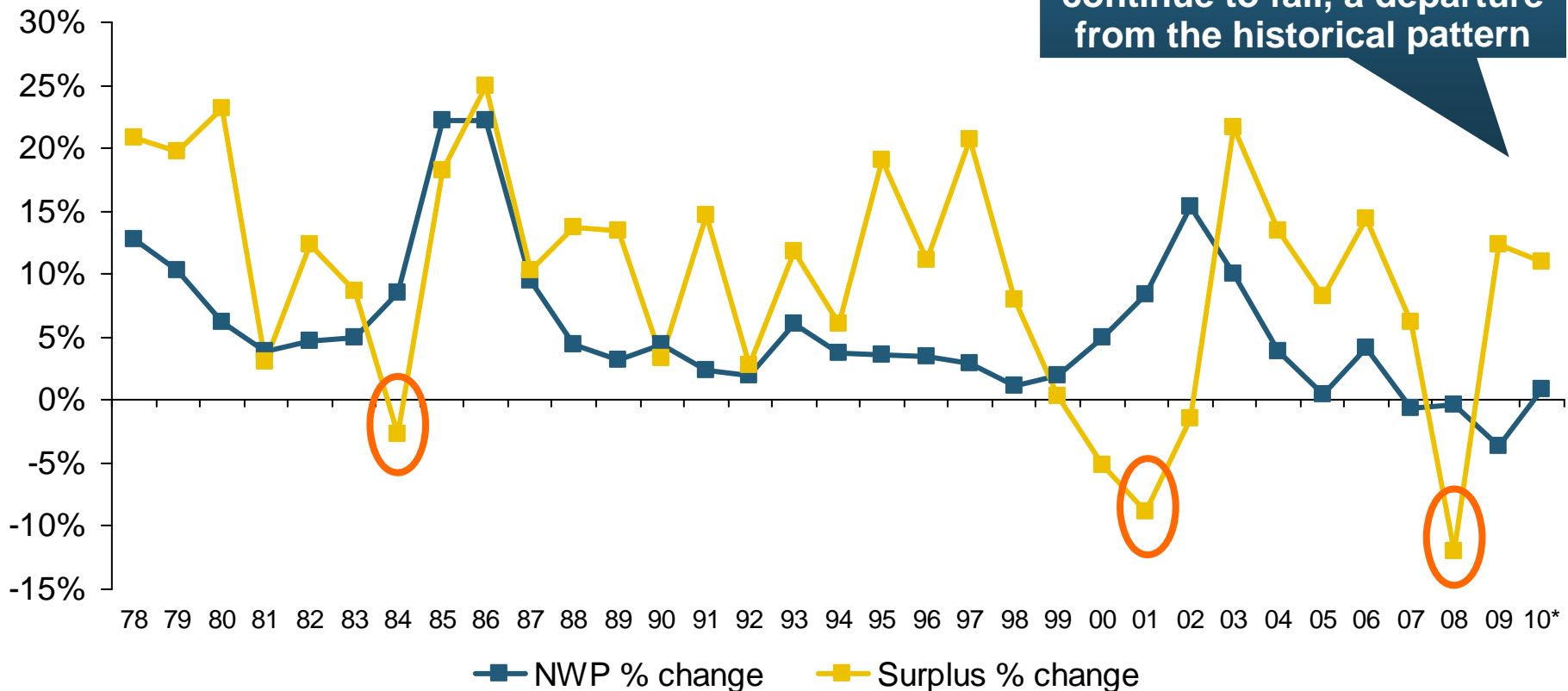
* Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event

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

Source: PCS; Insurance Information Institute

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

(Percent)



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

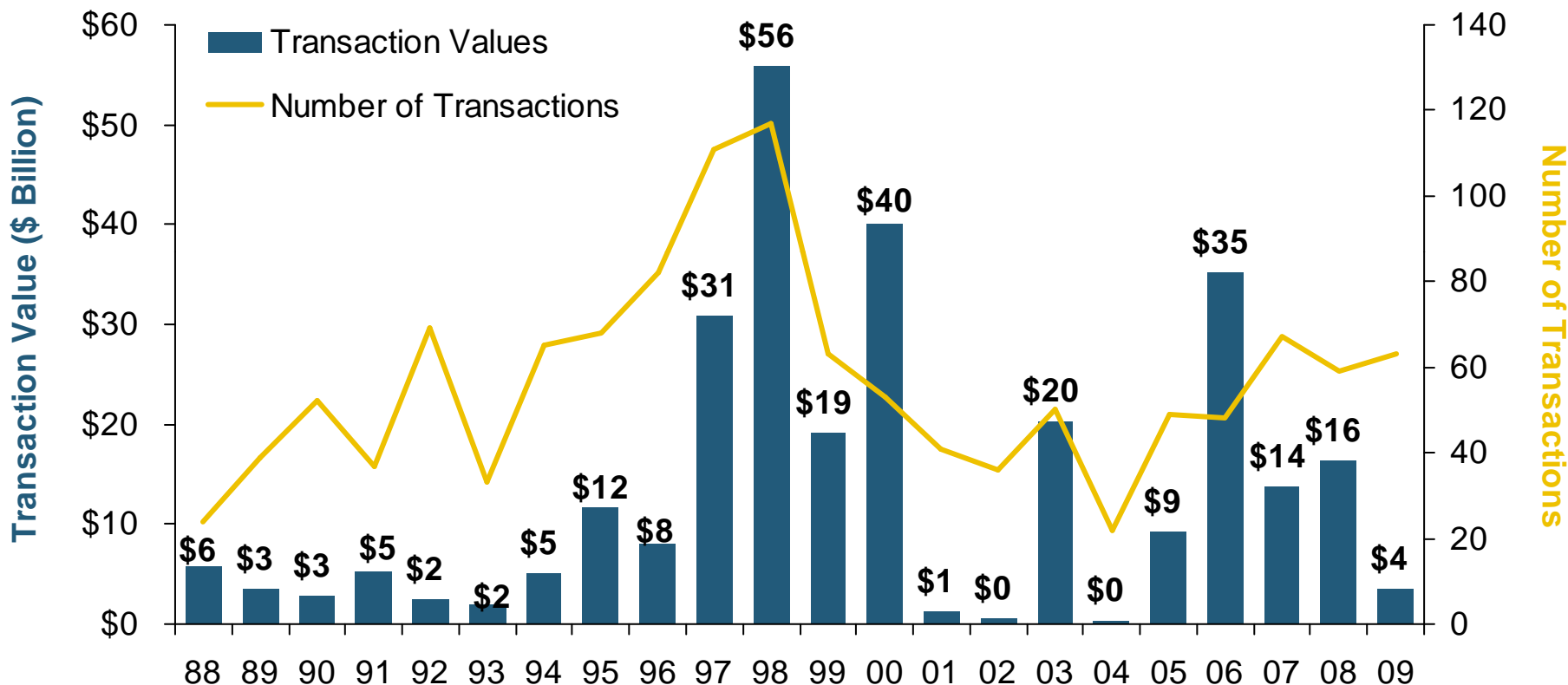
* 2010 NWP and Surplus figures are % changes as of Q3:10 vs Q3:09.

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

Merger & Acquisition

**Capital Cycles Can
Drive Consolidation**

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.

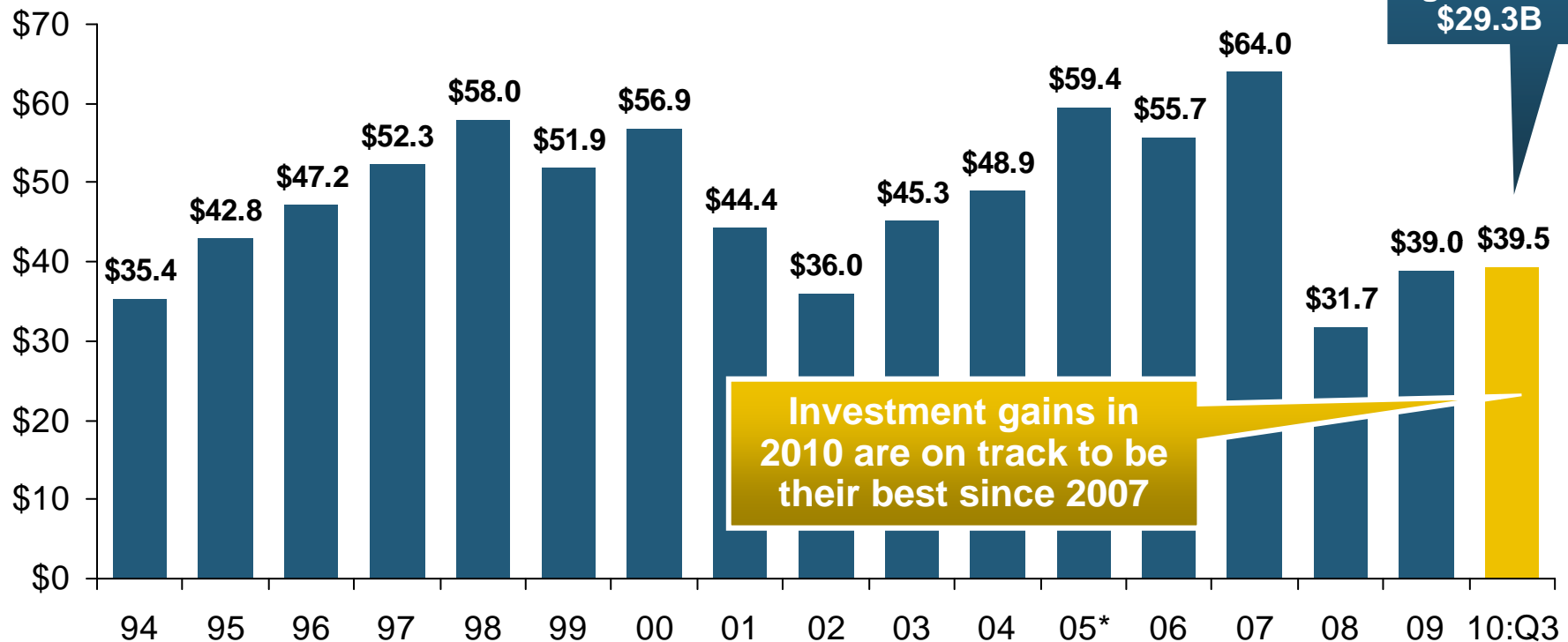
Source: Conning Research & Consulting.

Investment Performance

**Investments Cycles Also Influence
P/C Insurer Profitability**

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

(\$ Billions)



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

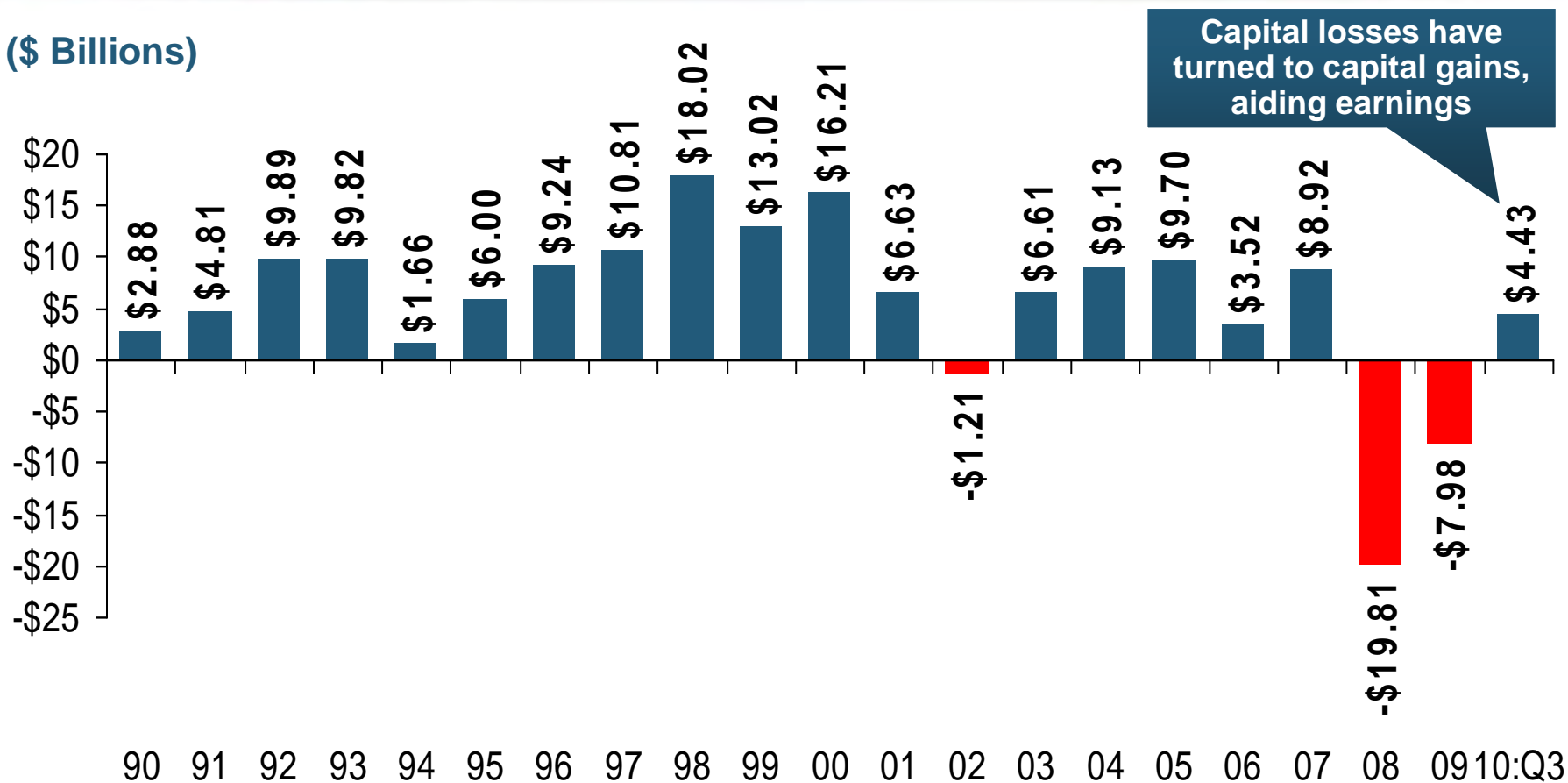
¹ Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

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

Sources: ISO; Insurance Information Institute.

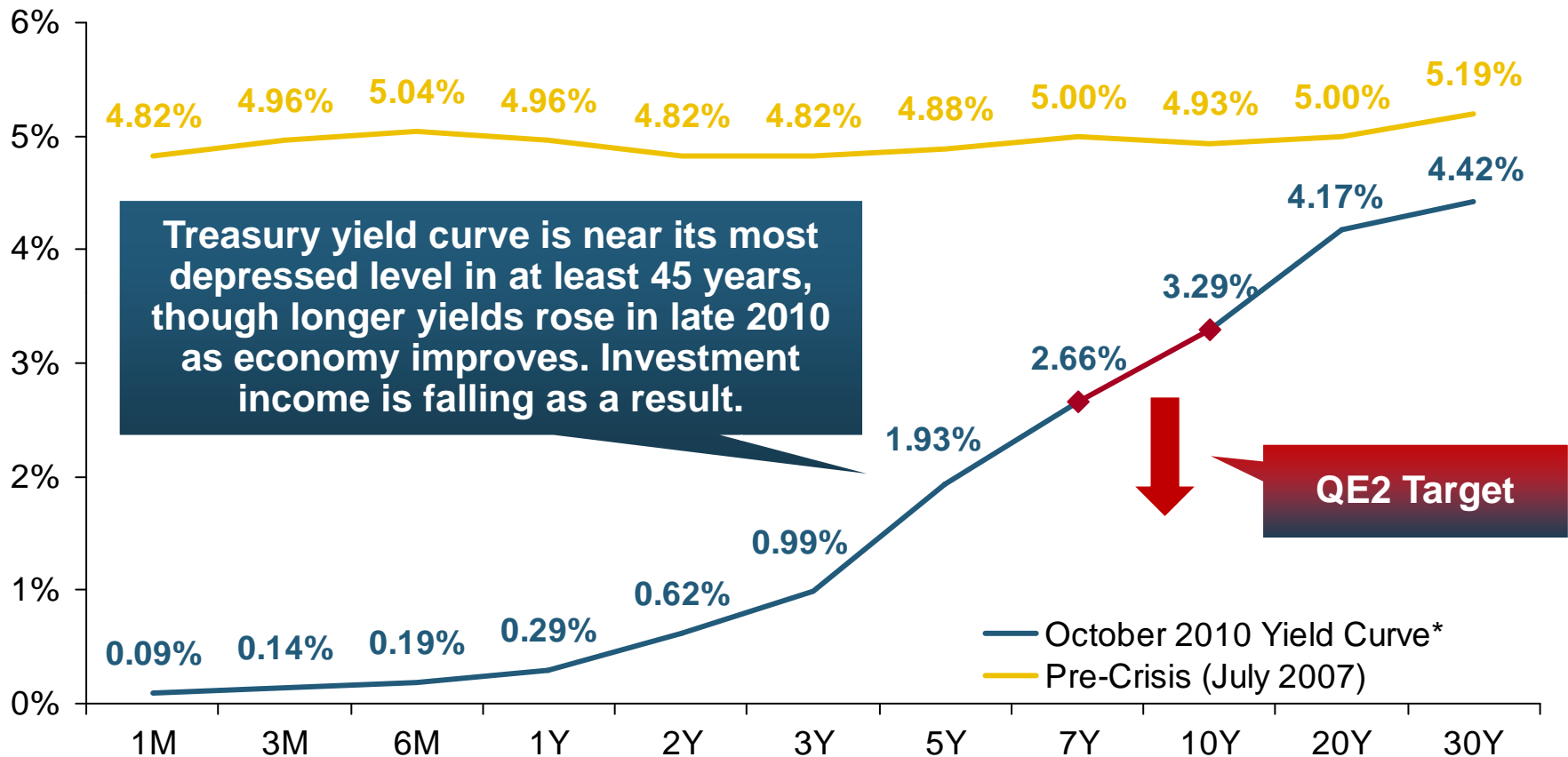
P/C Insurer Net Realized Capital Gains, 1990-2010:Q3

(\$ Billions)



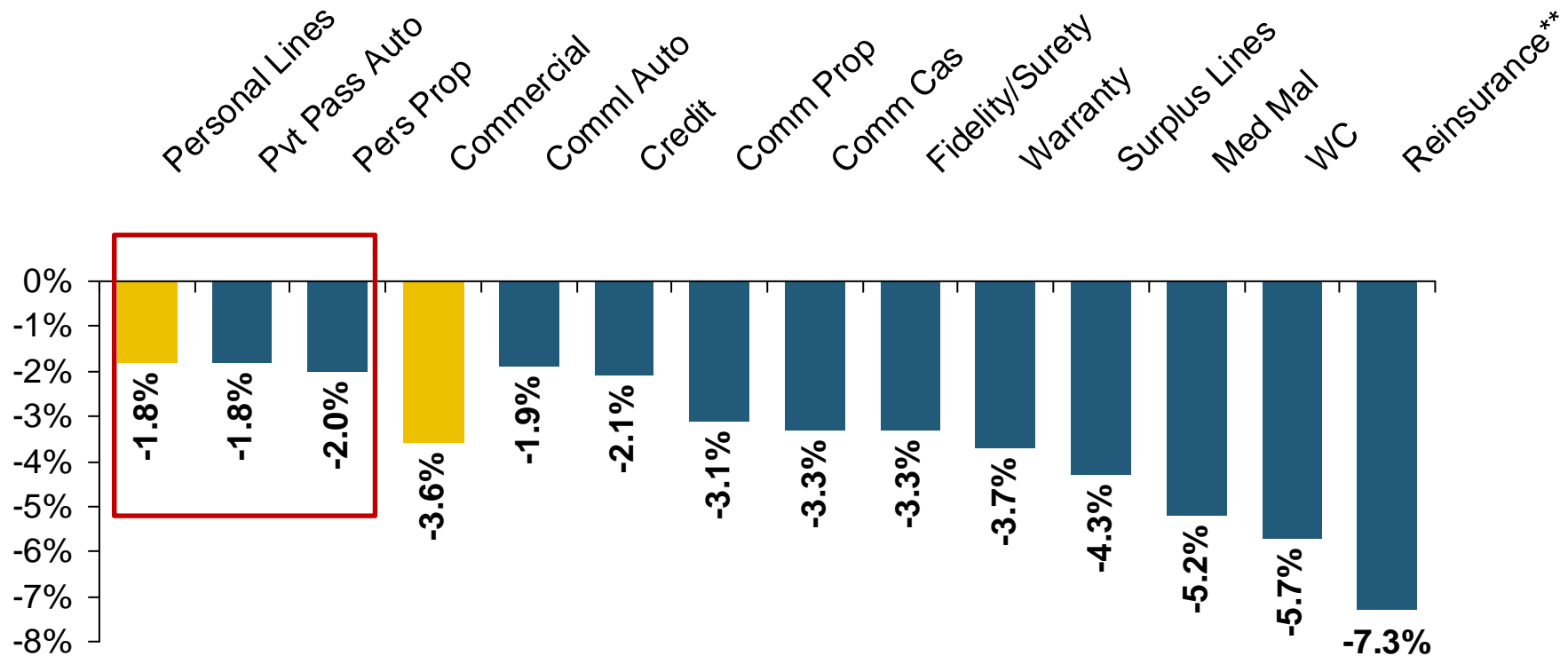
Realized Capital Losses Were the Primary Cause of 2008/2009's Large Drop in Profits and ROE and Were a Major Driver of Its Recovery in 2010

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



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

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



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

*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

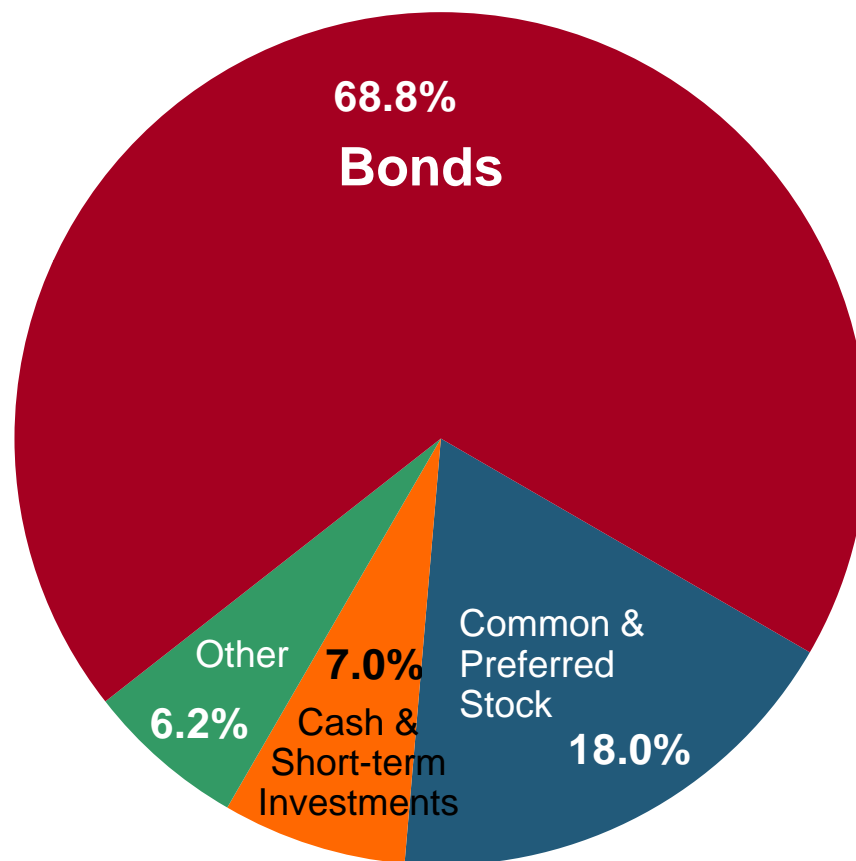
Source: A.M. Best; Insurance Information Institute.

Distribution of P/C Insurance Industry's Investment Portfolio

Portfolio Facts as of 12/31/2009

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

As of December 31, 2009



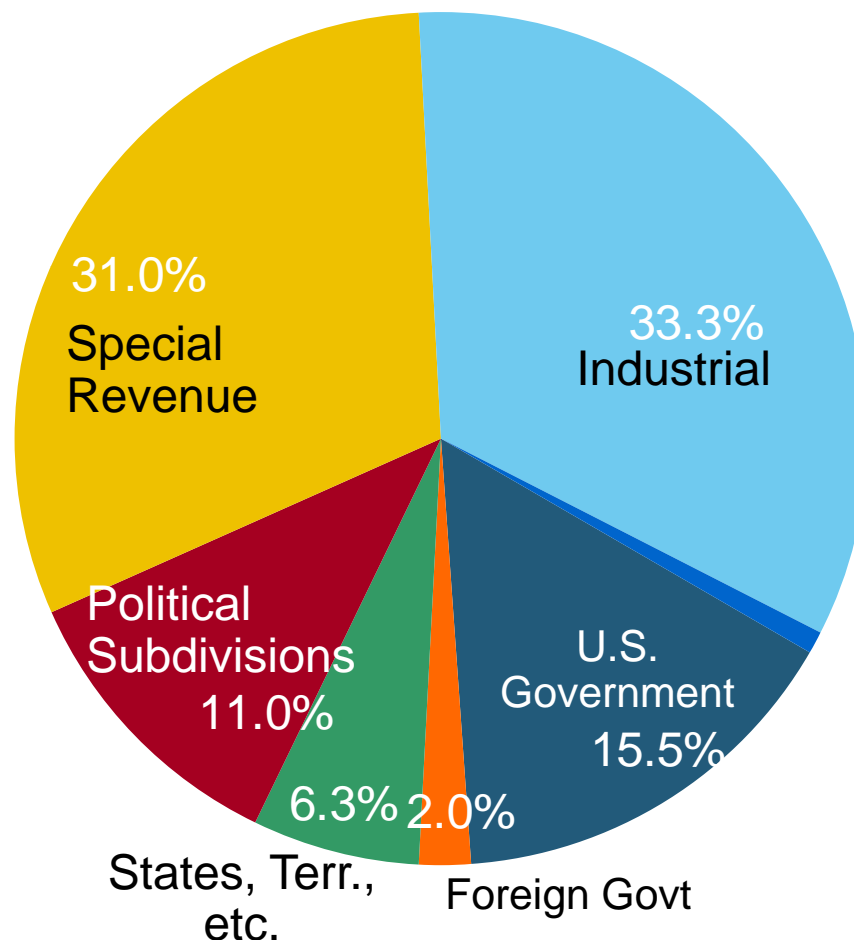
2011 Financial Overview

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

Bond Investment Facts as of 12/31/09

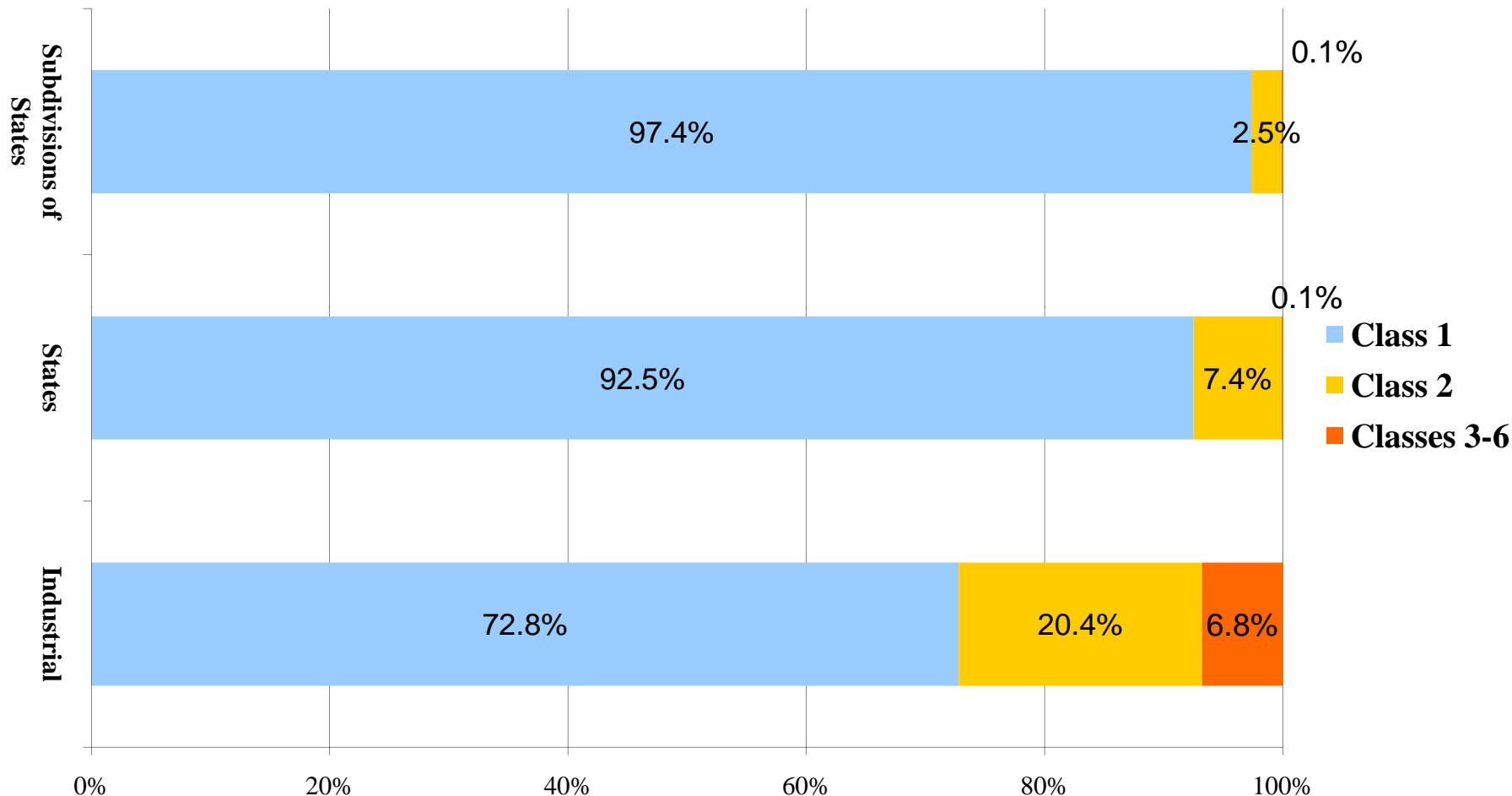
- Investments in "Political Subdivision [of states]" bonds were \$102.5 billion
- Investments in "States, Territories, & Possessions" bonds were \$58.9 billion
- Investments in "Special Revenue" bonds were \$288.2 billion
- All state, local, and special revenue bonds totaled 48.2% of bonds, about 35.7%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

As of December 31, 2009



2011 Financial Overview

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

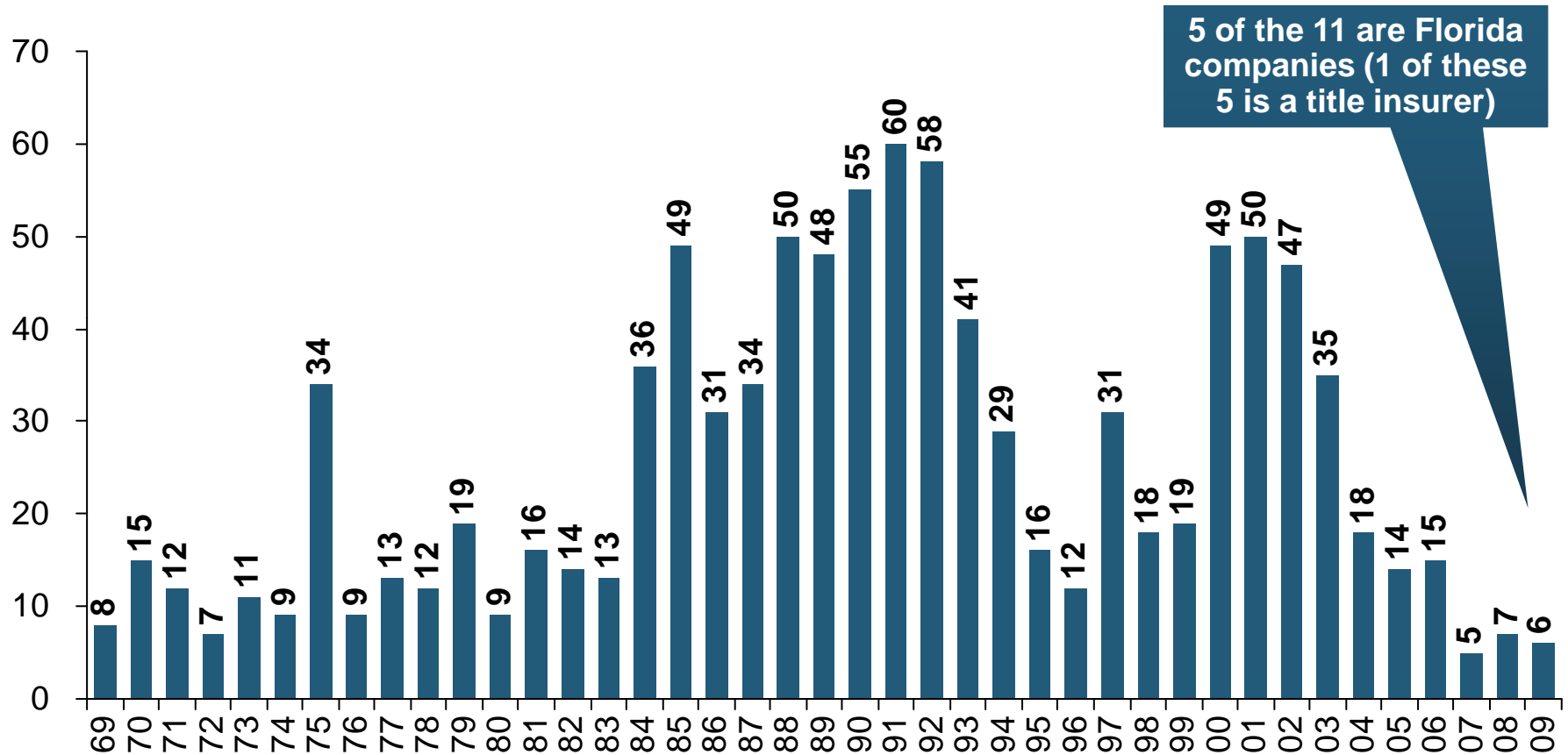


The NAIC's Securities Valuation Office puts bonds into one of 6 classes: class 1 has the lowest expected impairments; successively higher numbered classes imply increasing impairment likelihood.

Financial Strength & Underwriting

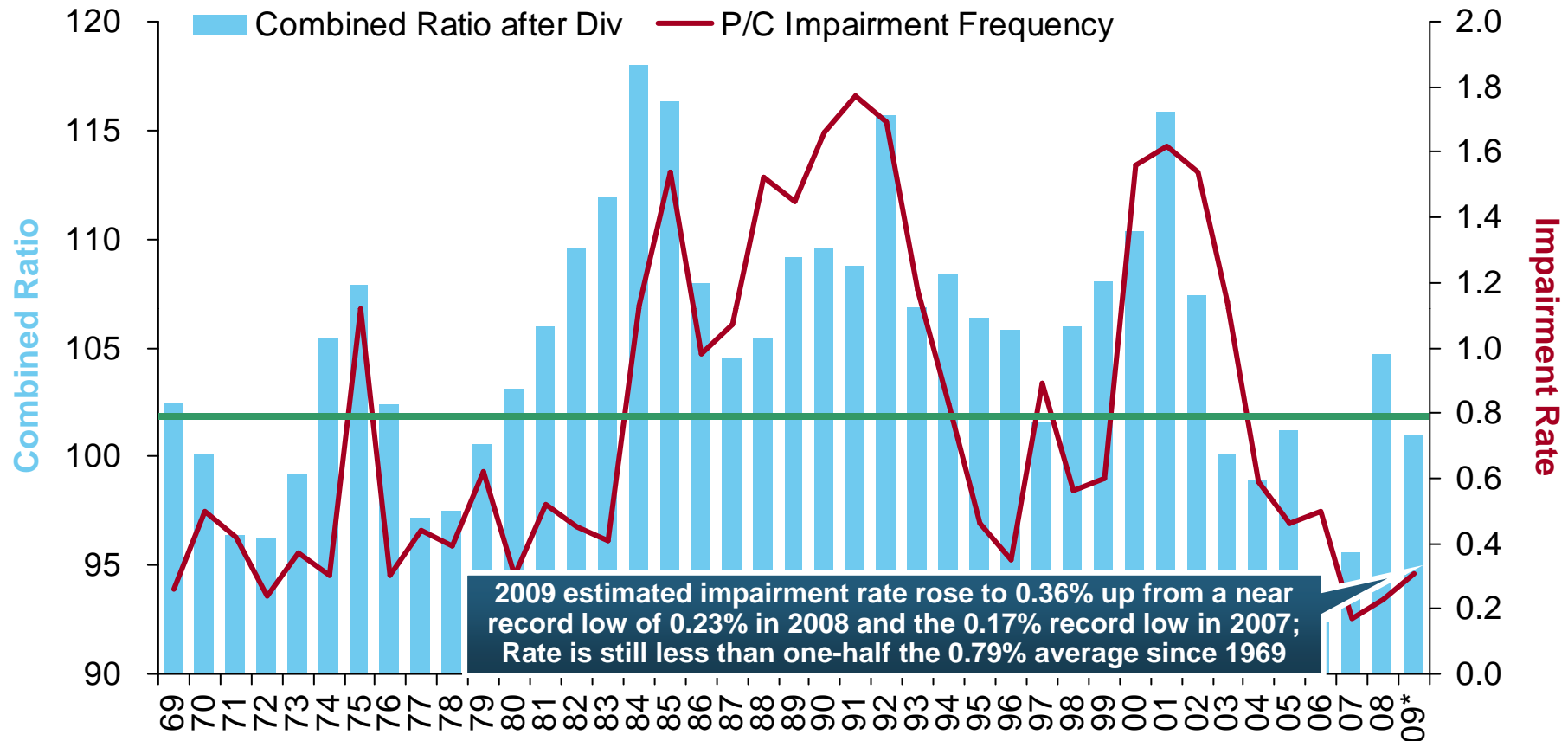
**Cyclical Pattern is P-C Impairment
History is Directly Tied to
Underwriting, Reserving & Pricing**

P/C Insurer Impairments, 1969–2009



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

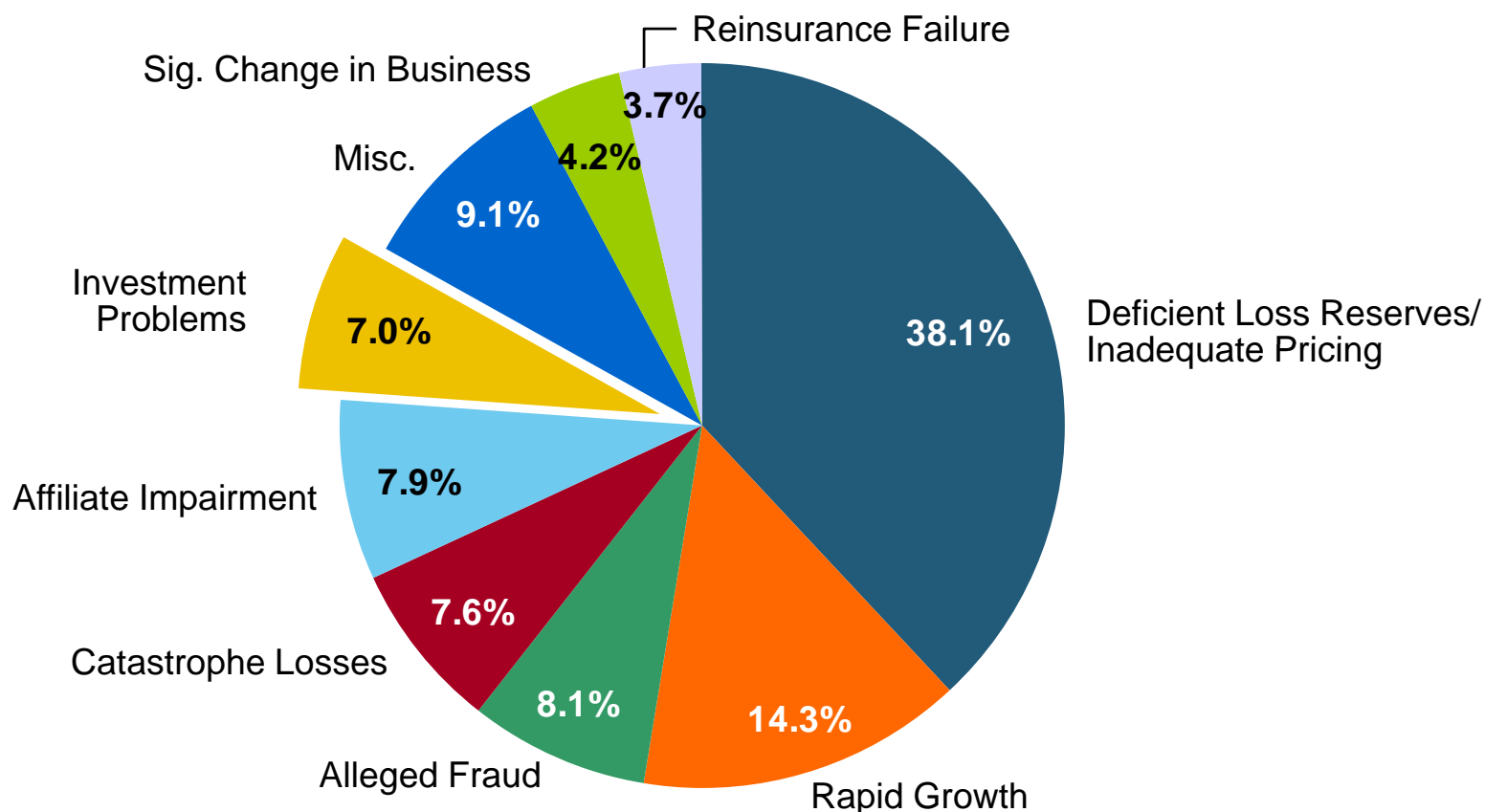
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2009



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

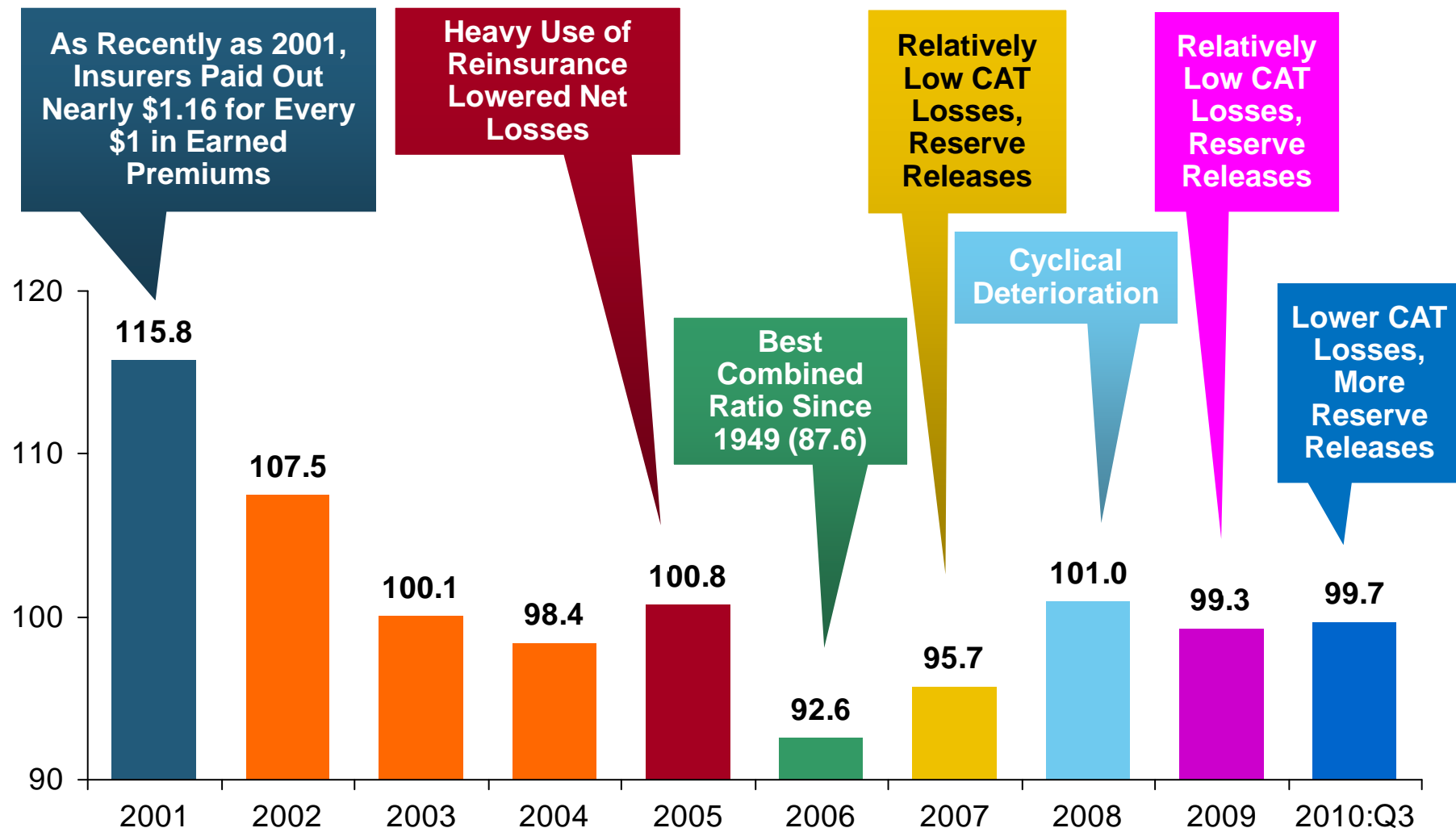
Reasons for US P/C Insurer Impairments, 1969–2008

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



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

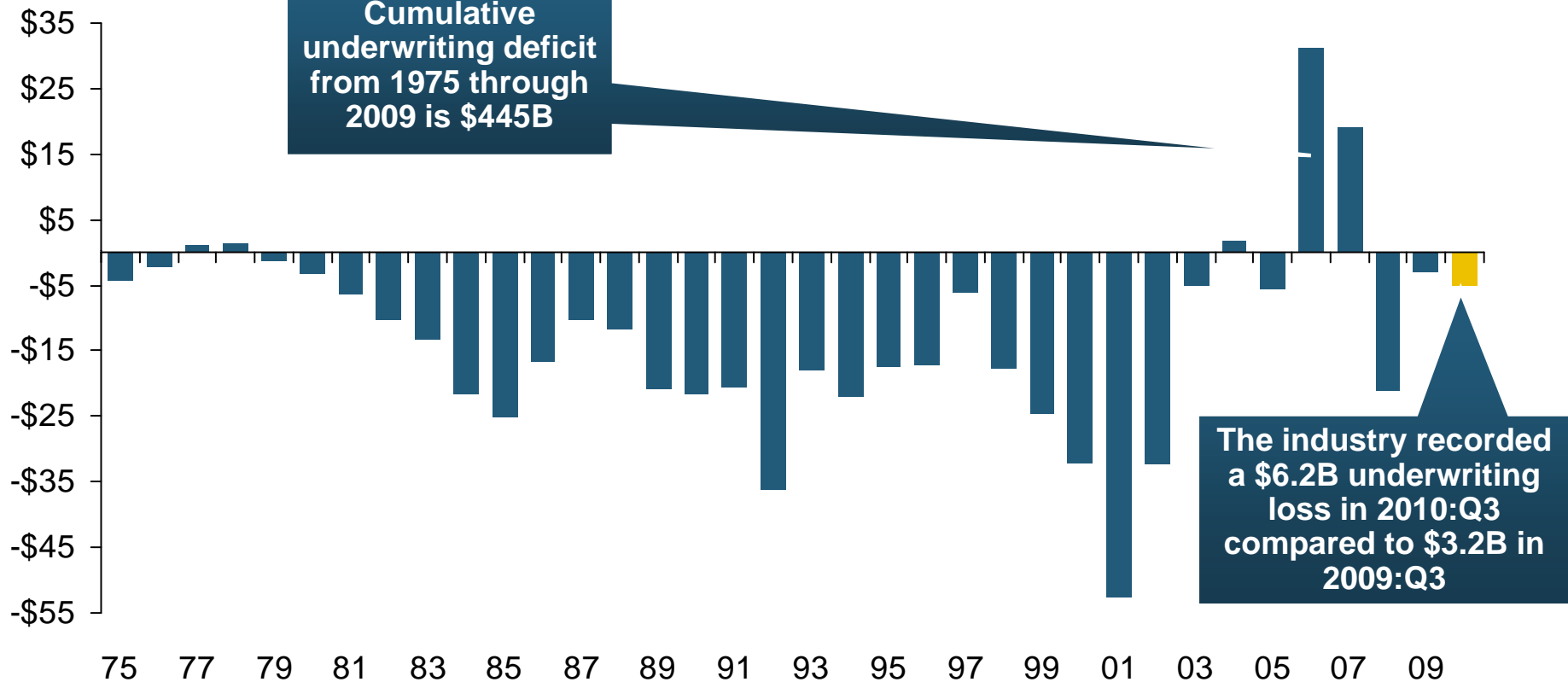
P/C Insurance Industry Combined Ratio, 2001–2010:Q3*



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

Underwriting Gain (Loss) 1975–2010:Q3*

(\$ Billions)

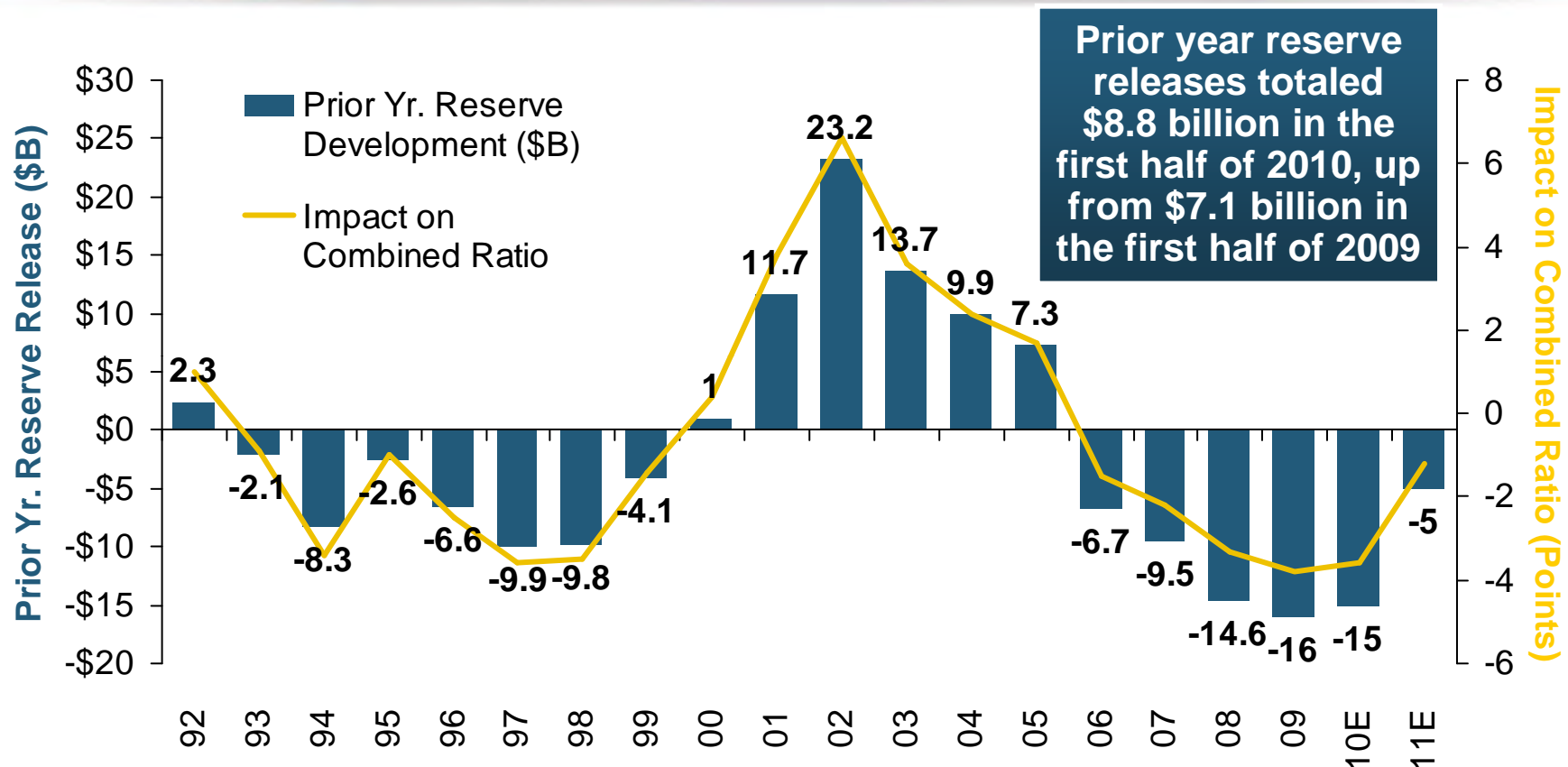


**Large Underwriting Losses Are *NOT* Sustainable
in Current Investment Environment**

* Includes mortgage and financial guarantee insurers.

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

P/C Reserve Development, 1992–2011E

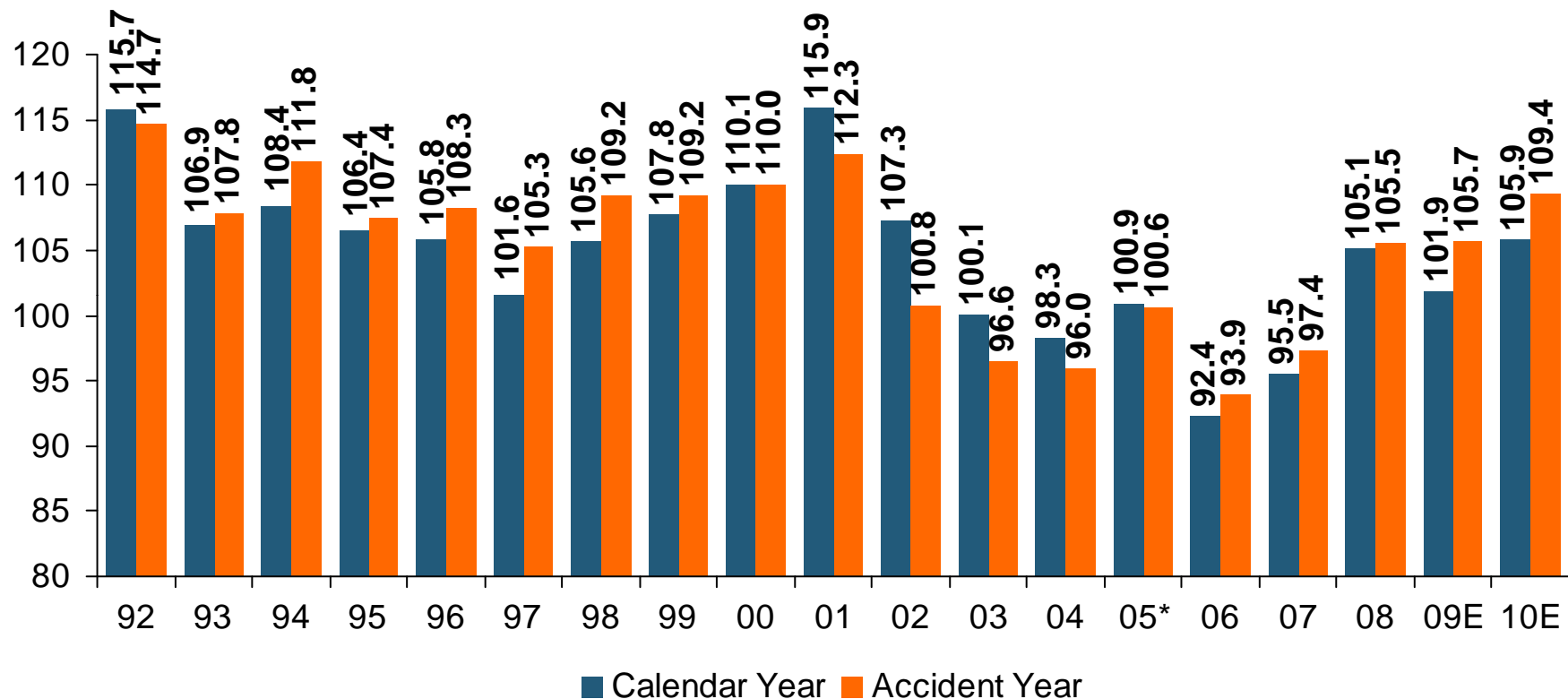


Reserve Releases Are Continuing Strong in 2010 But Should Begin to Taper Off in 2011

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: 1992–2010E¹



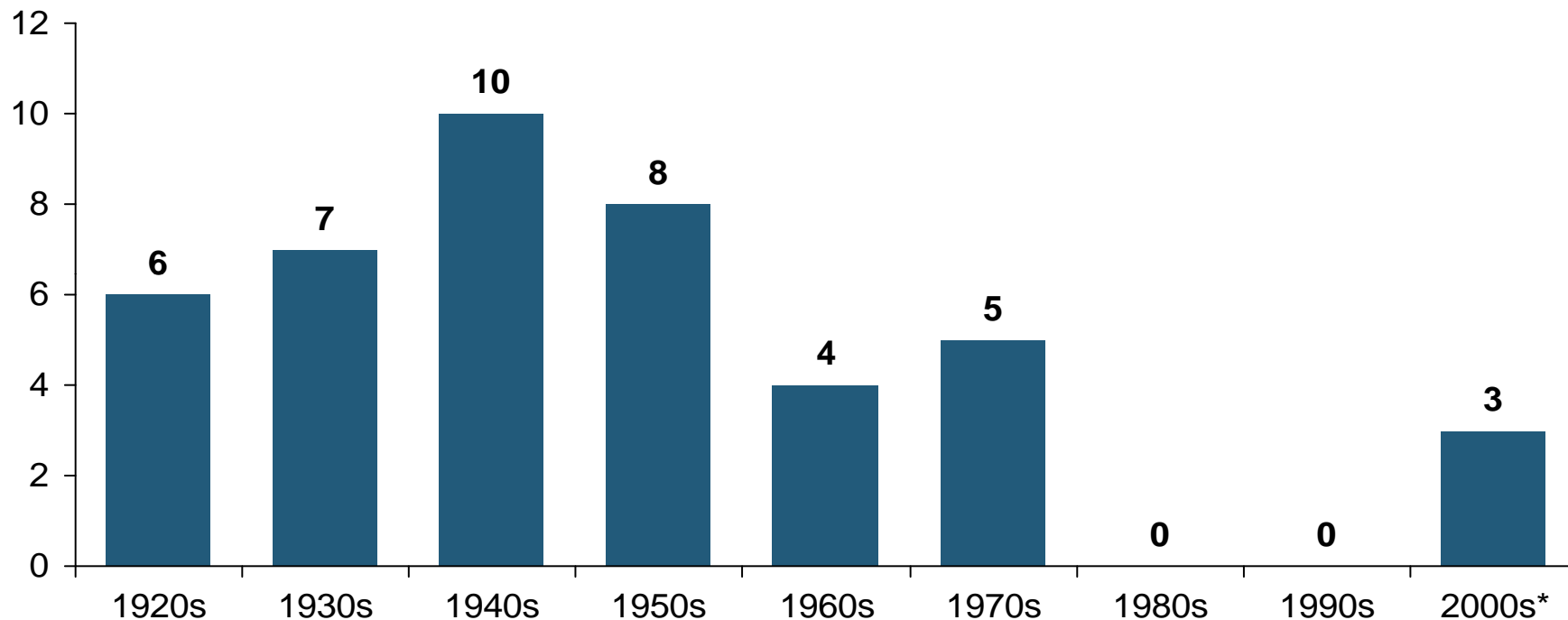
Accident Year Results Show a More Significant Deterioration in Underwriting Performance. Calendar Year Results Are Helped by Reserve Releases

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

Number of Years with Underwriting Profits



**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.

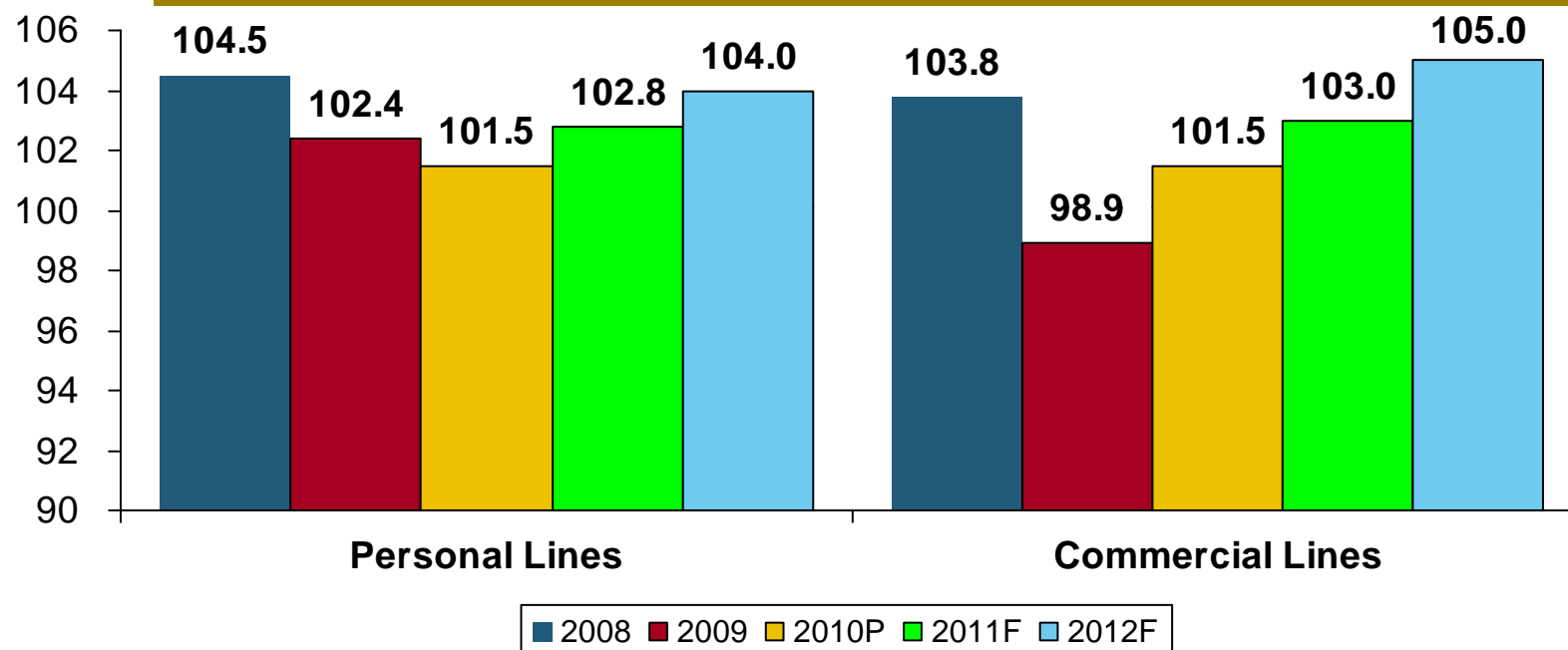
Note: Data for 1920–1934 based on stock companies only.

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

Performance by Segment: Personal Lines

Calendar Year Combined Ratios by Segment: 2008-2012F

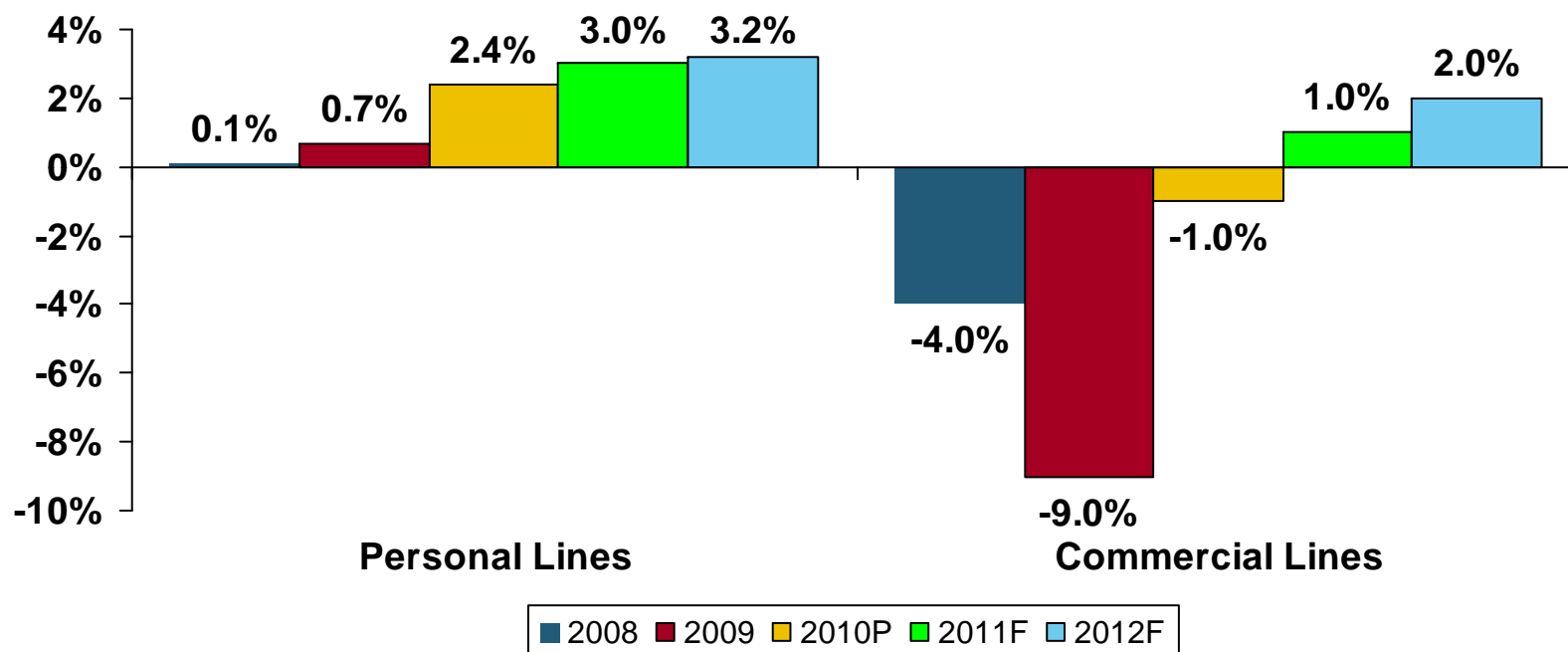
Personal and Commercial lines combined ratios are expected to remain to deteriorate in 2011 and 2012



Overall deterioration in 2011 underwriting performance is due to expected return to normal catastrophe activity along with deteriorating underwriting performance related to the prolonged commercial soft market and diminished prior-year reserve releases.

Direct Written Premium Growth by Segment: 2008-2012F

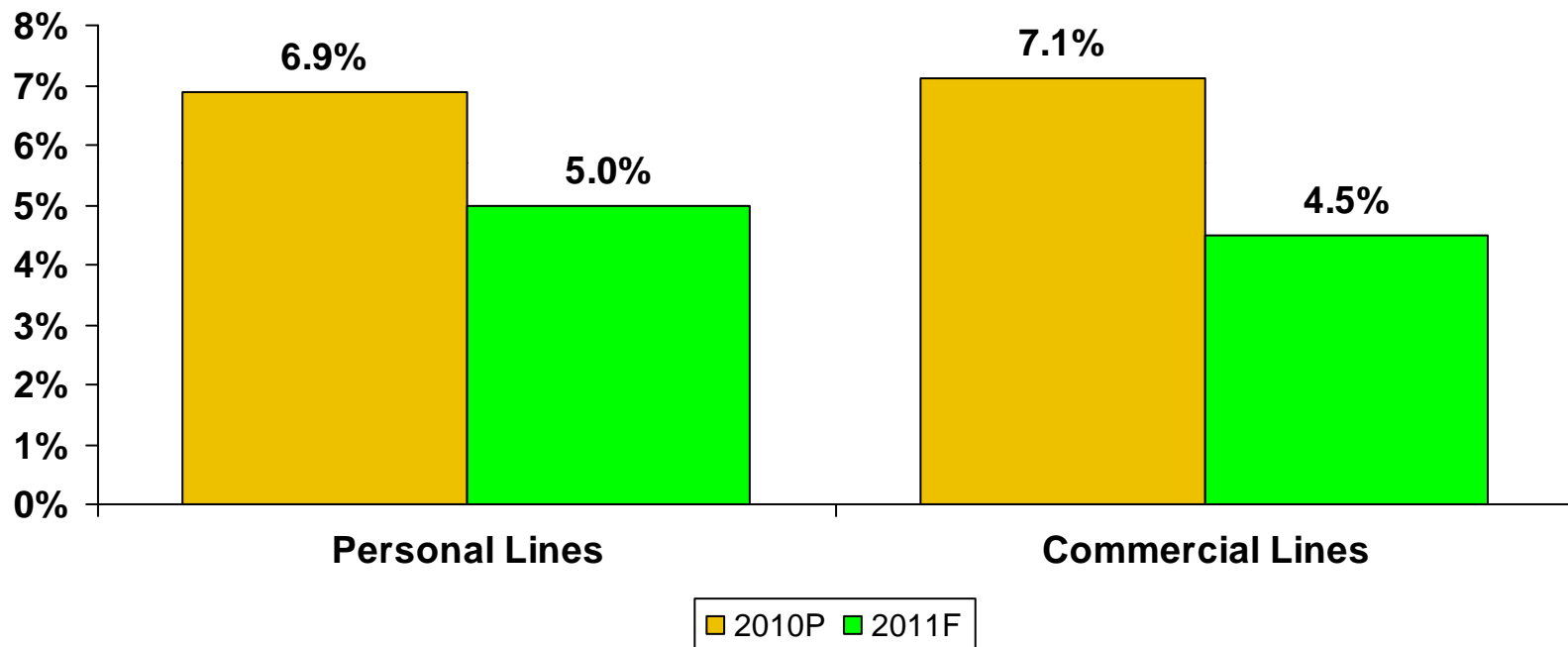
Personal lines will grow in 2011 while commercial could should growth for the first time in years



Rate and exposure are more favorable in personal lines, whereas a prolonged soft market and sluggish recovery from the recession weigh on commercial lines. In 2011, improving economic conditions should stimulate exposure growth, especially in commercial lines

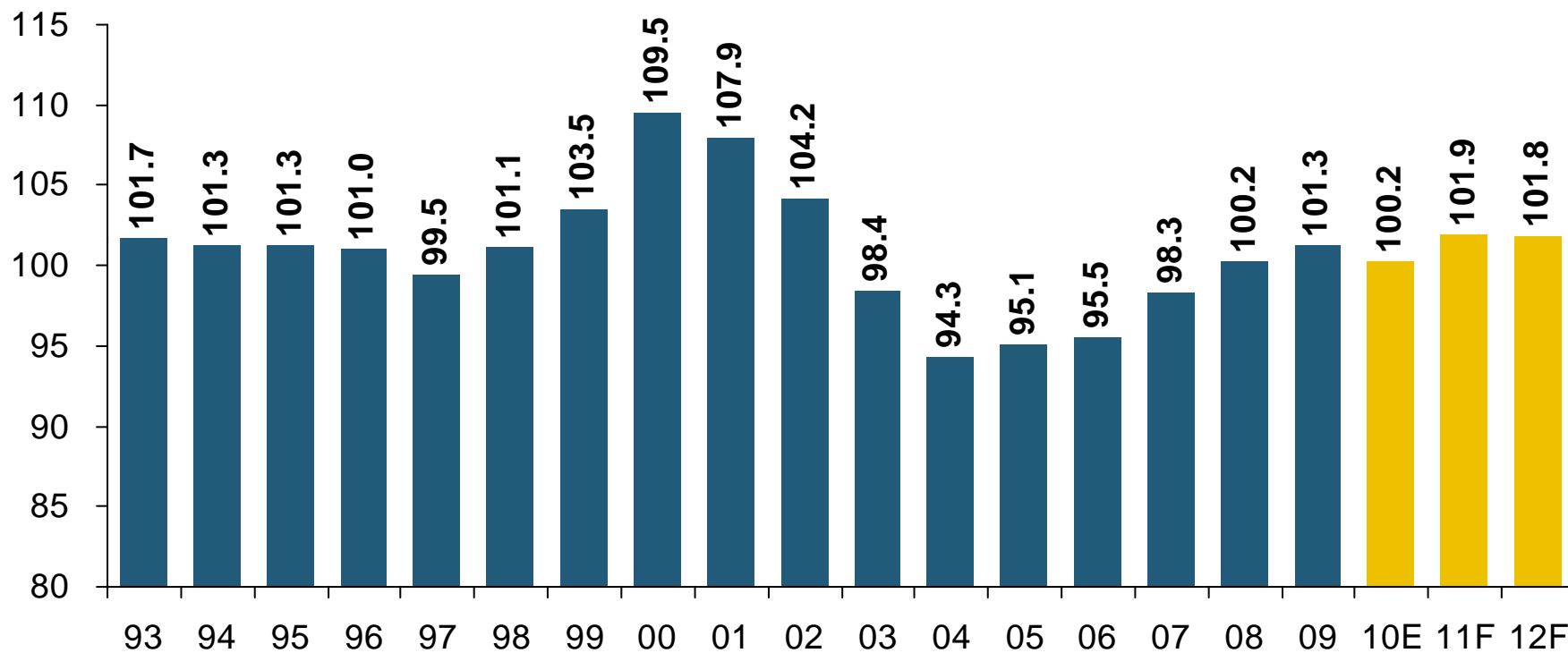
ROE by Segment: 2010E-2011F

Industry ROE's may have peaked at about 7% in 2010



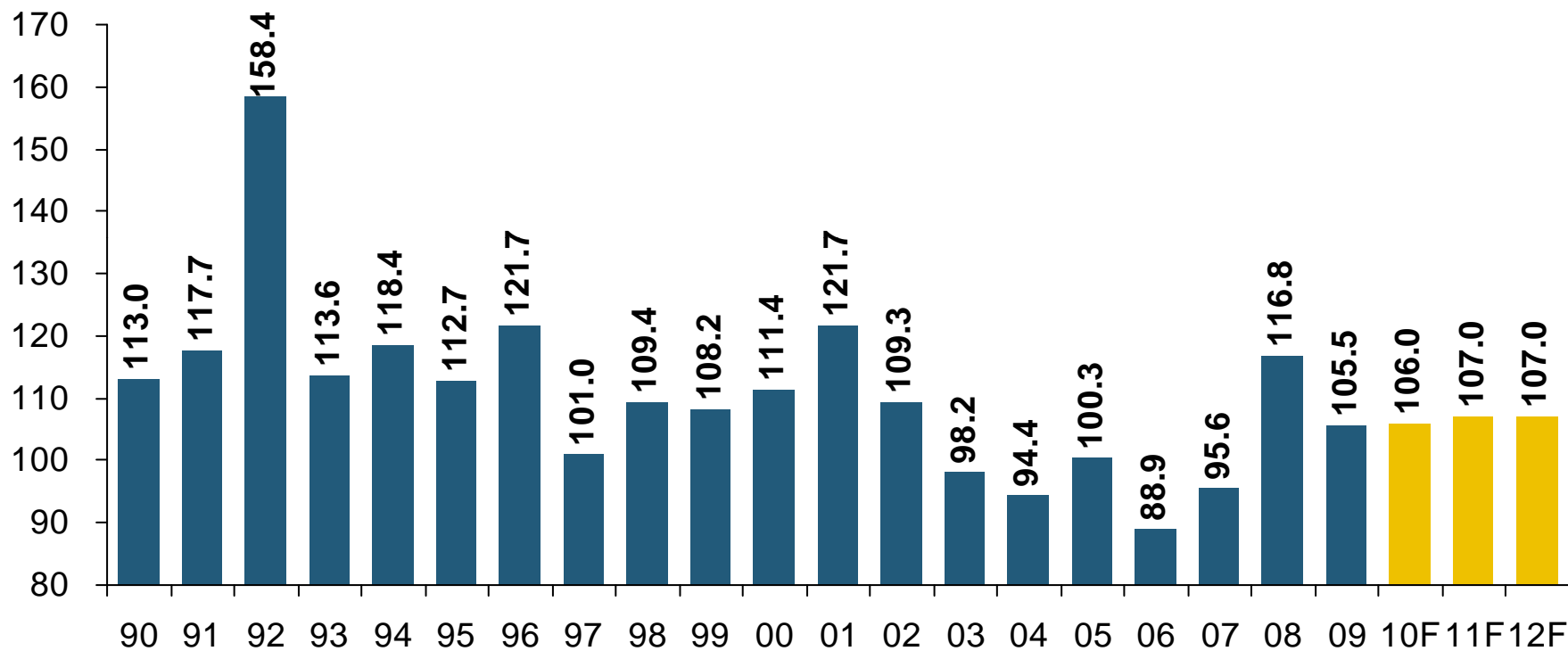
ROEs in 2011 are likely to fall in 2011 as rising capacity and deteriorating underwriting results erode profitability. Big wildcards for 2011 include investment performance and the magnitude of prior year reserve releases.

Private Passenger Auto Combined Ratio: 1993–2012F



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

Homeowners Insurance Combined Ratio: 1990–2012F



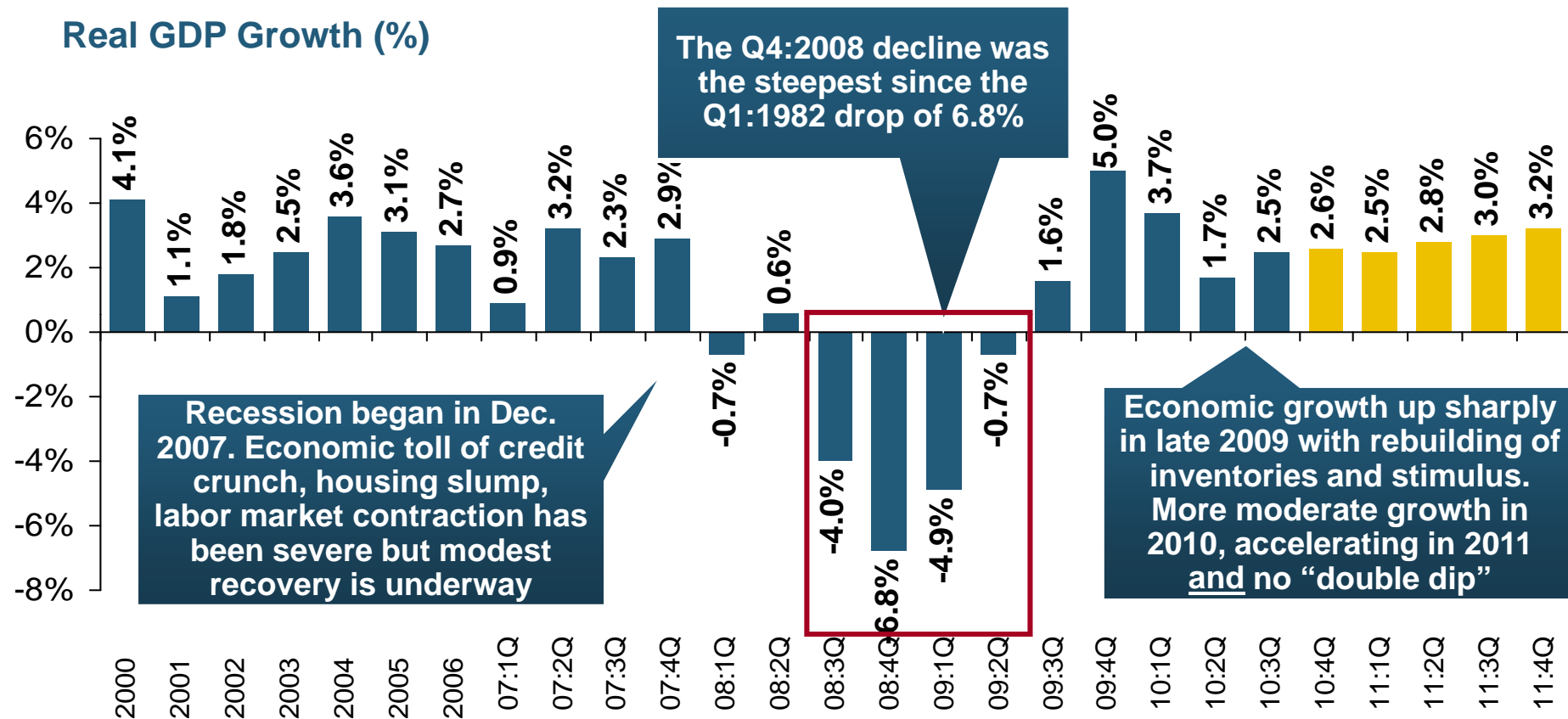
Homeowners Line Is Expected to Be Unprofitable Overall in 2010, but in Many States Could Be Quite Profitable. Volatility Due to Catastrophe Losses Will Persist

The Economic Storm

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

US Real GDP Growth*

Real GDP Growth (%)



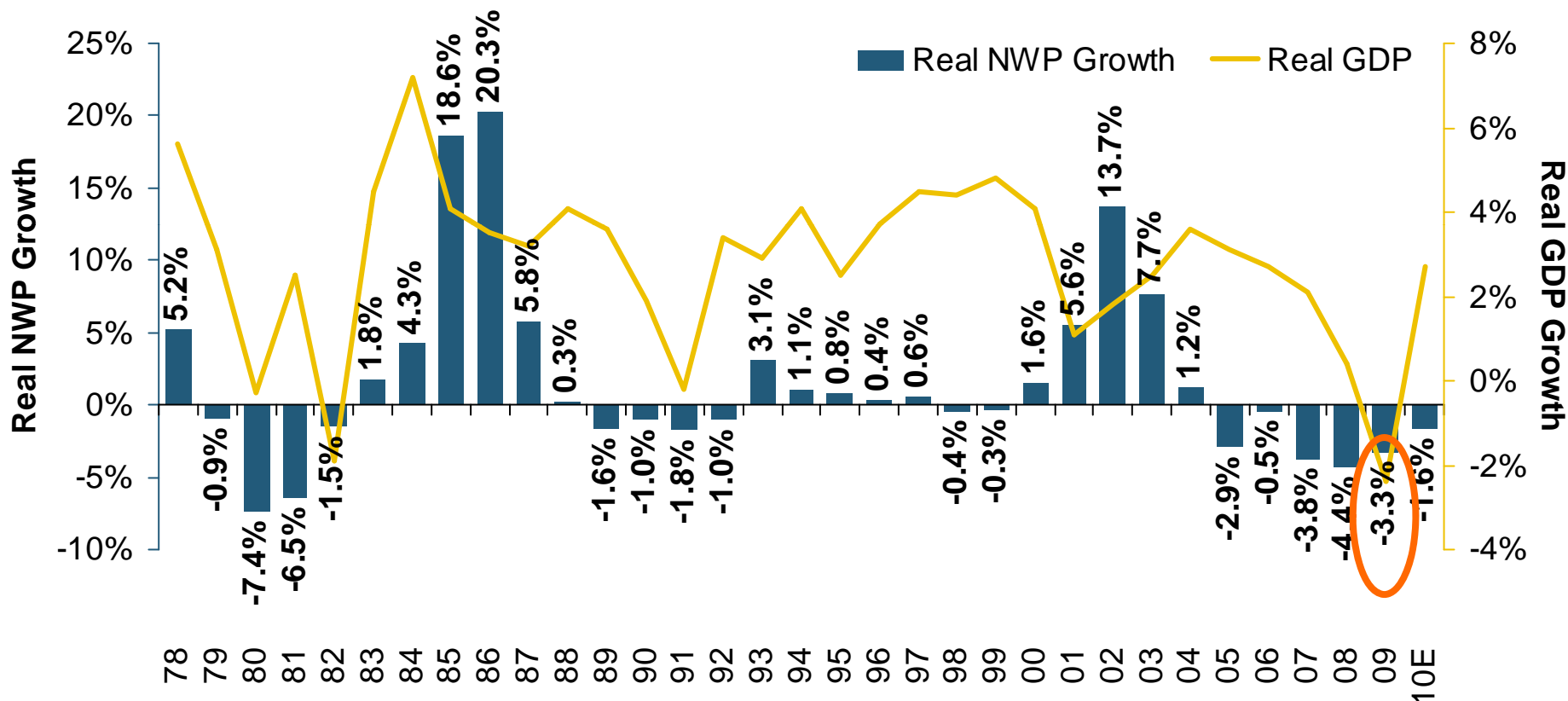
Demand for Insurance Continues To Be Impacted by Sluggish Economic Conditions, but the Benefits of Even Slow Growth Will Compound and Gradually Benefit the Economy Broadly

* Estimates/Forecasts from Blue Chip Economic Indicators.

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

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

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



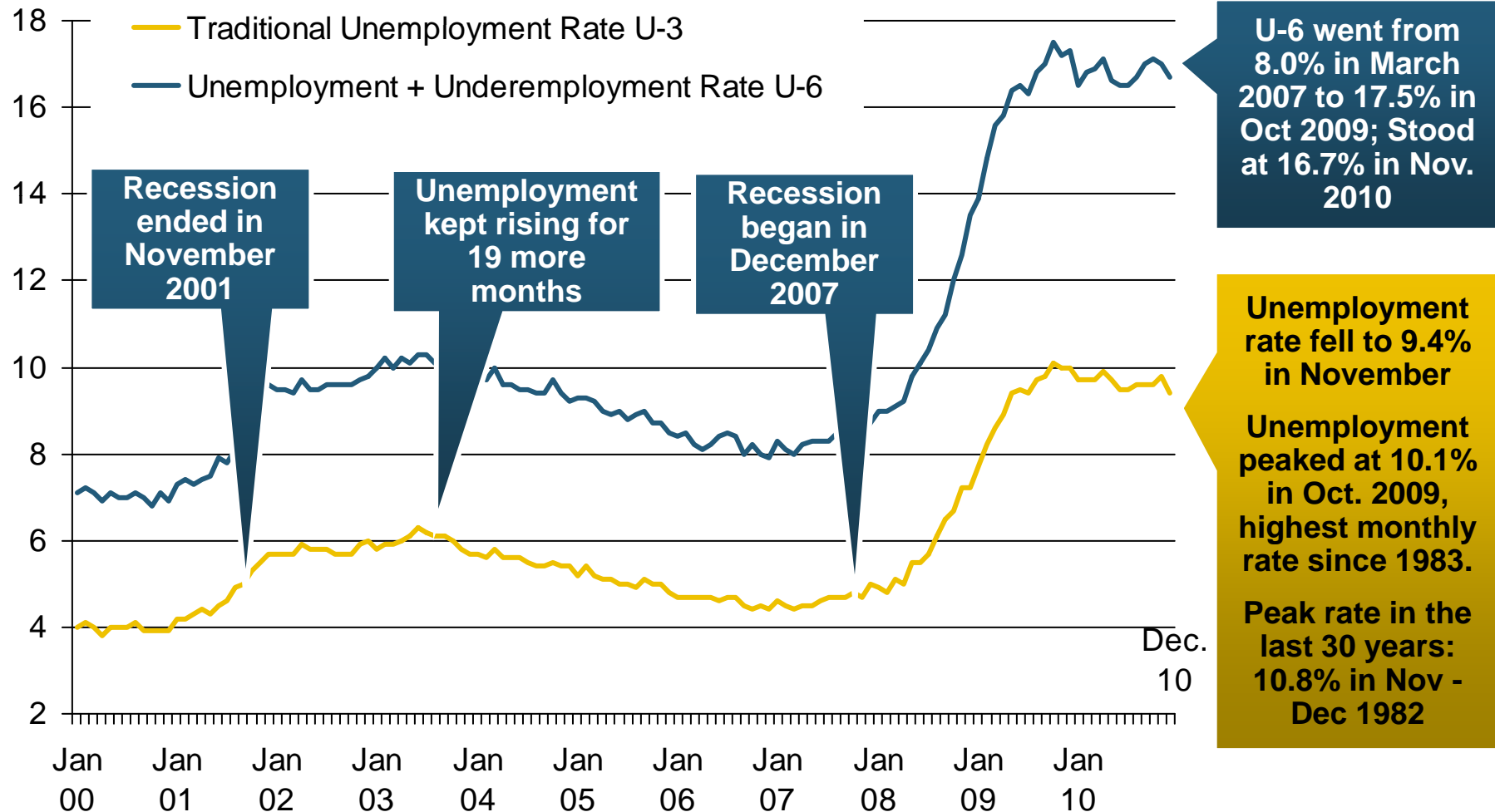
**P/C Insurance Industry's Growth is Influenced Modestly
by Growth in the Overall Economy**

Labor Market Trends

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

Unemployment and Underemployment Rates: Rocketed Up in 2008-09; Stabilized in 2010

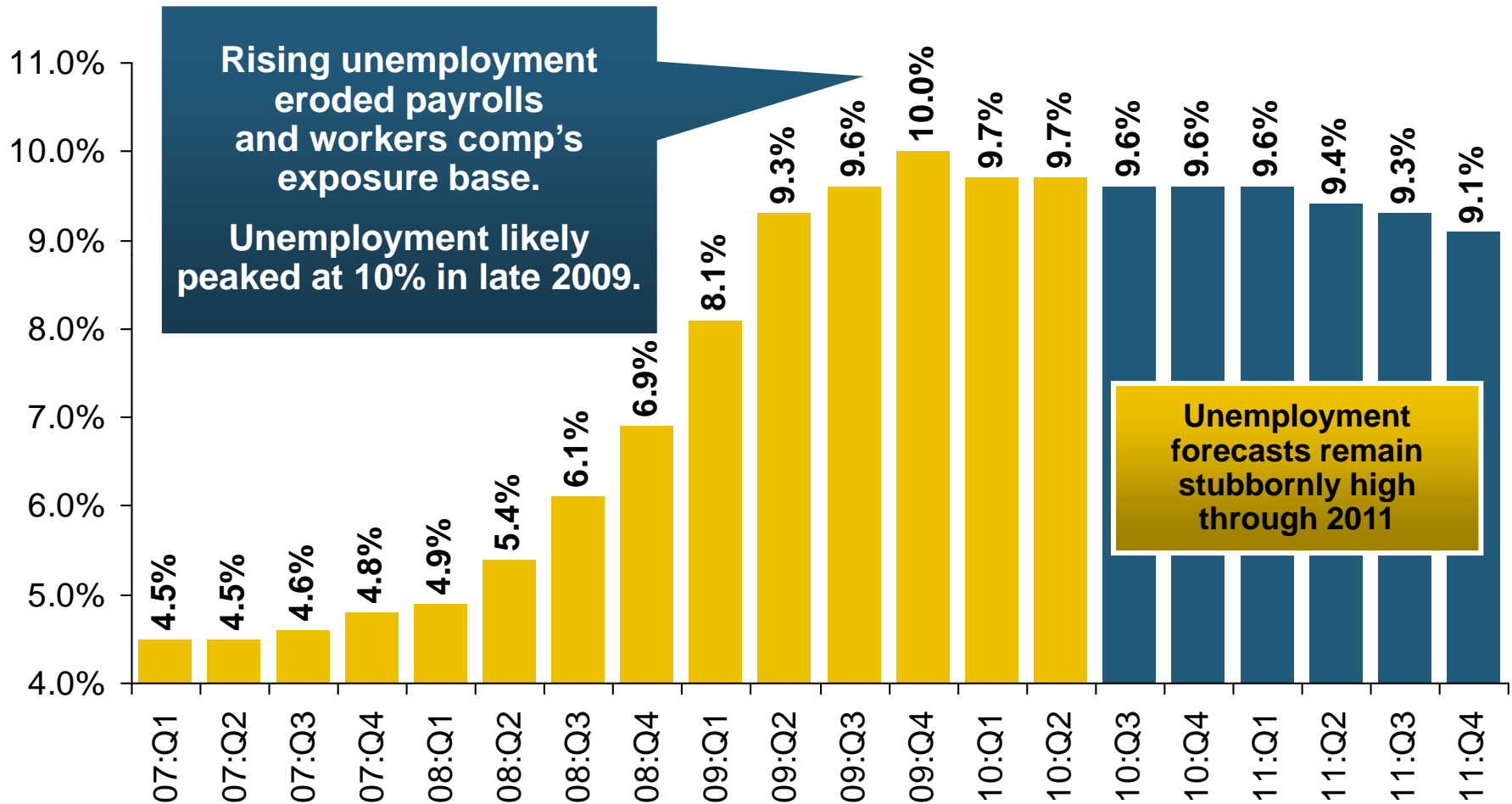
January 2000 through December 2010, Seasonally Adjusted (%)



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

US Unemployment Rate

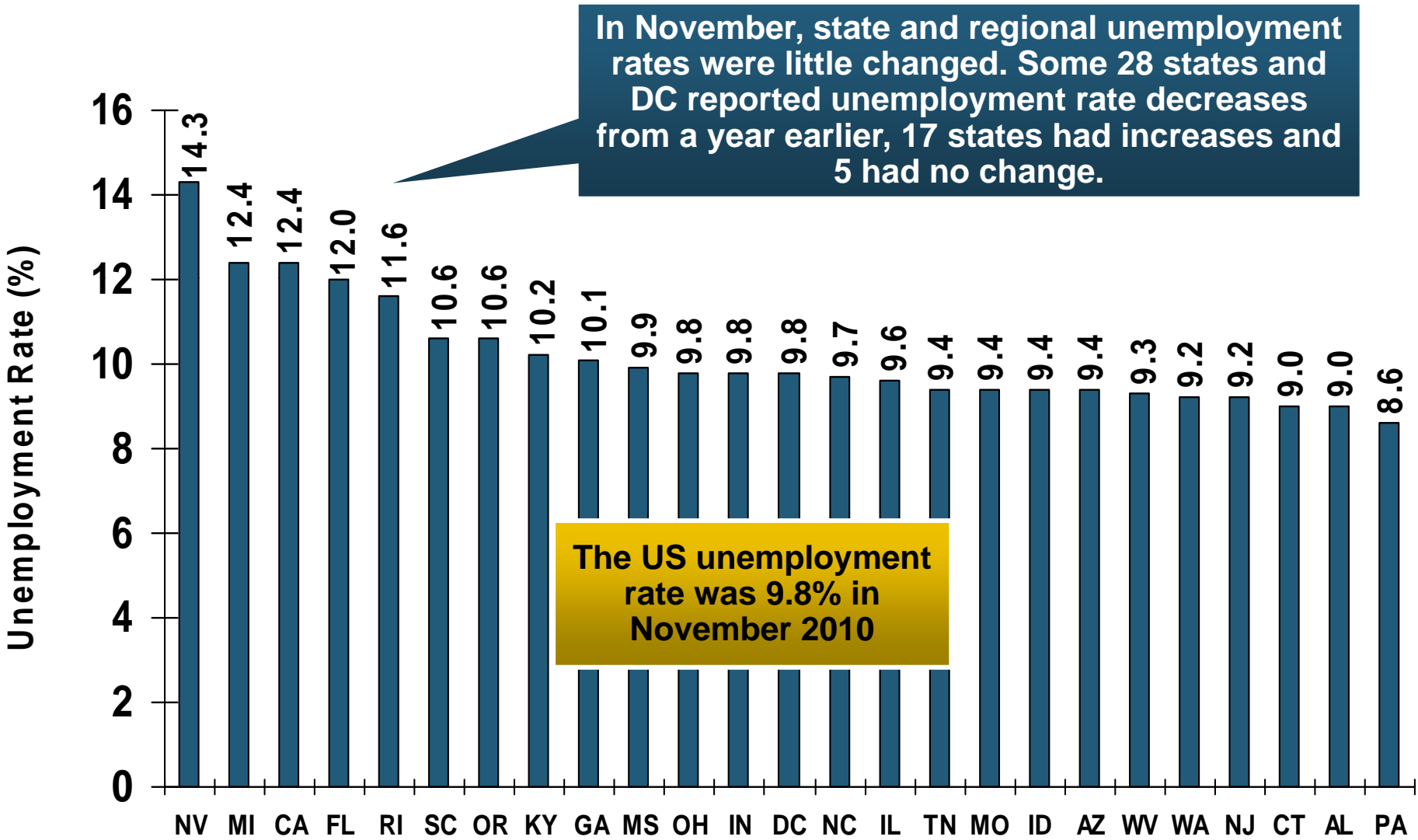
2007:Q1 to 2011:Q4F*



* ■ = actual; ■ = forecasts

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

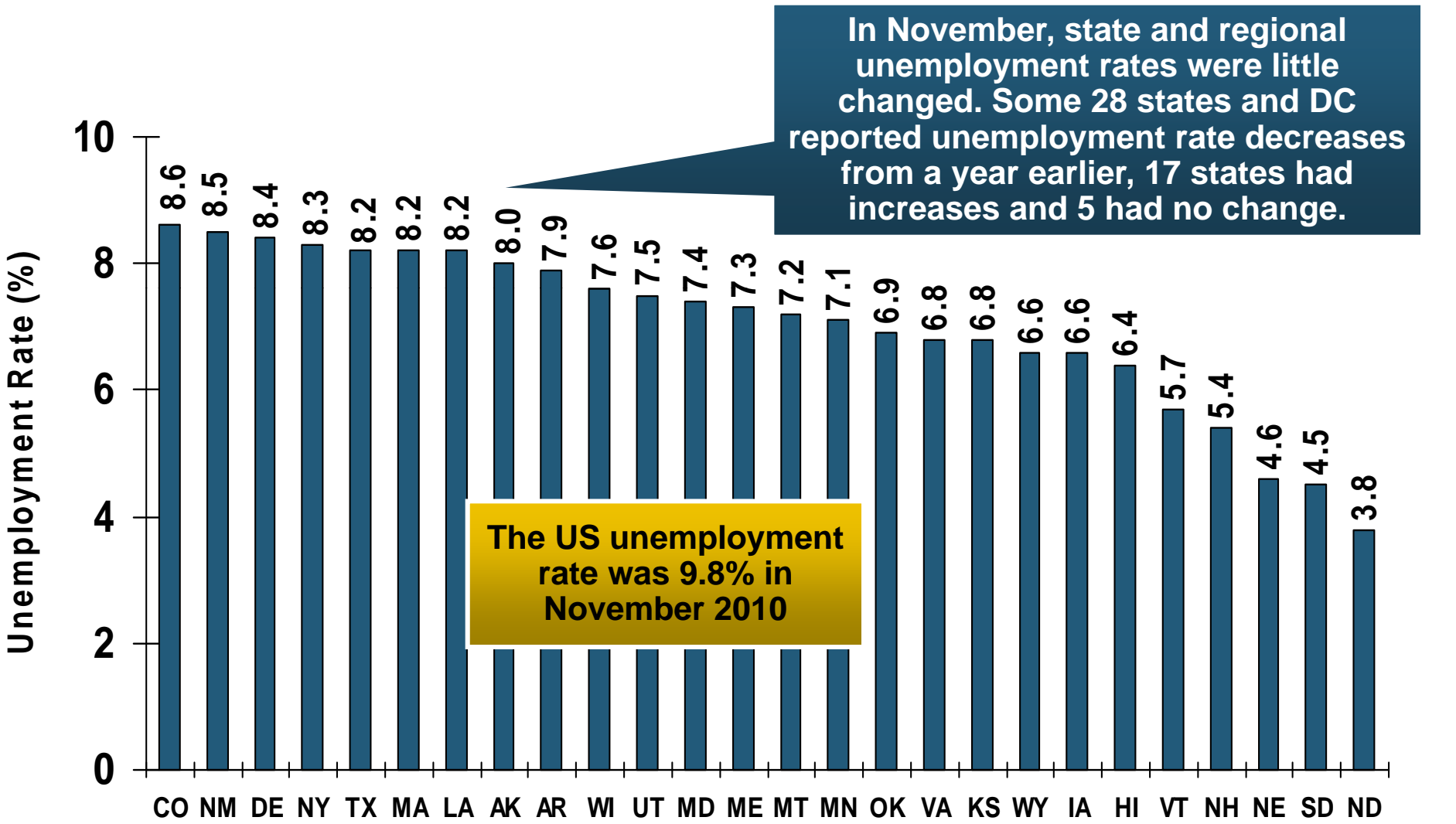
Unemployment Rates by State, November 2010: Highest 25 States*



*Provisional figures for November 2010, seasonally adjusted.

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

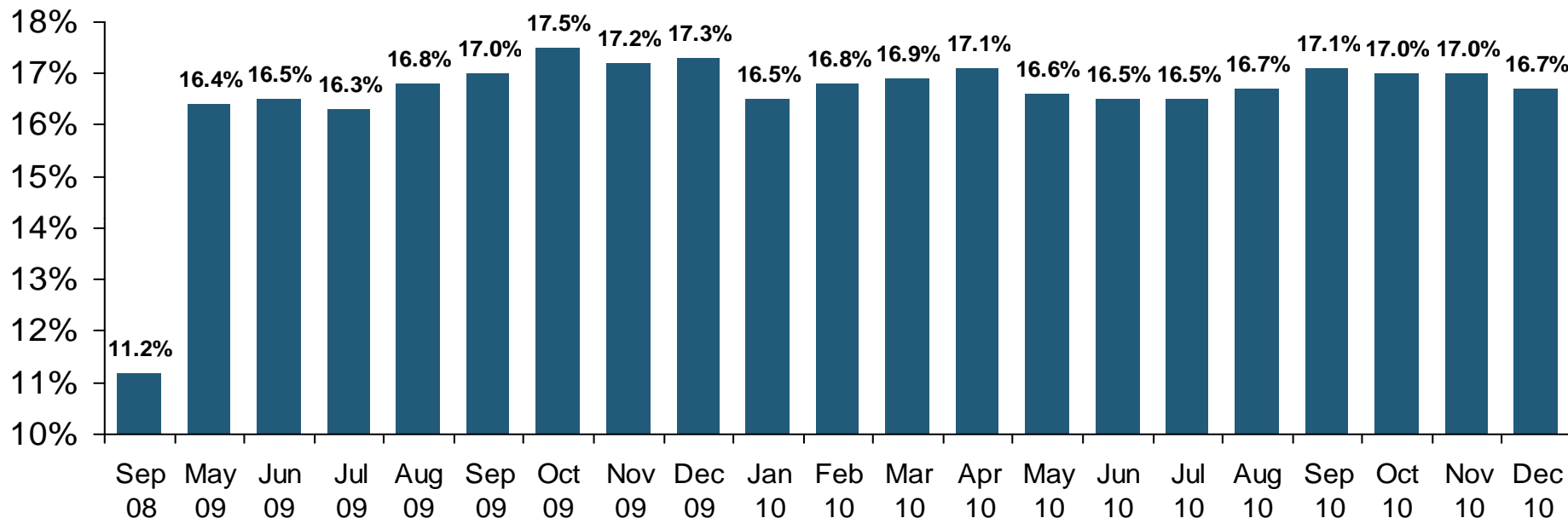
Unemployment Rates By State, November 2010: Lowest 25 States*



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

Labor Underutilization: Broader than Just Unemployment

% of Labor Force



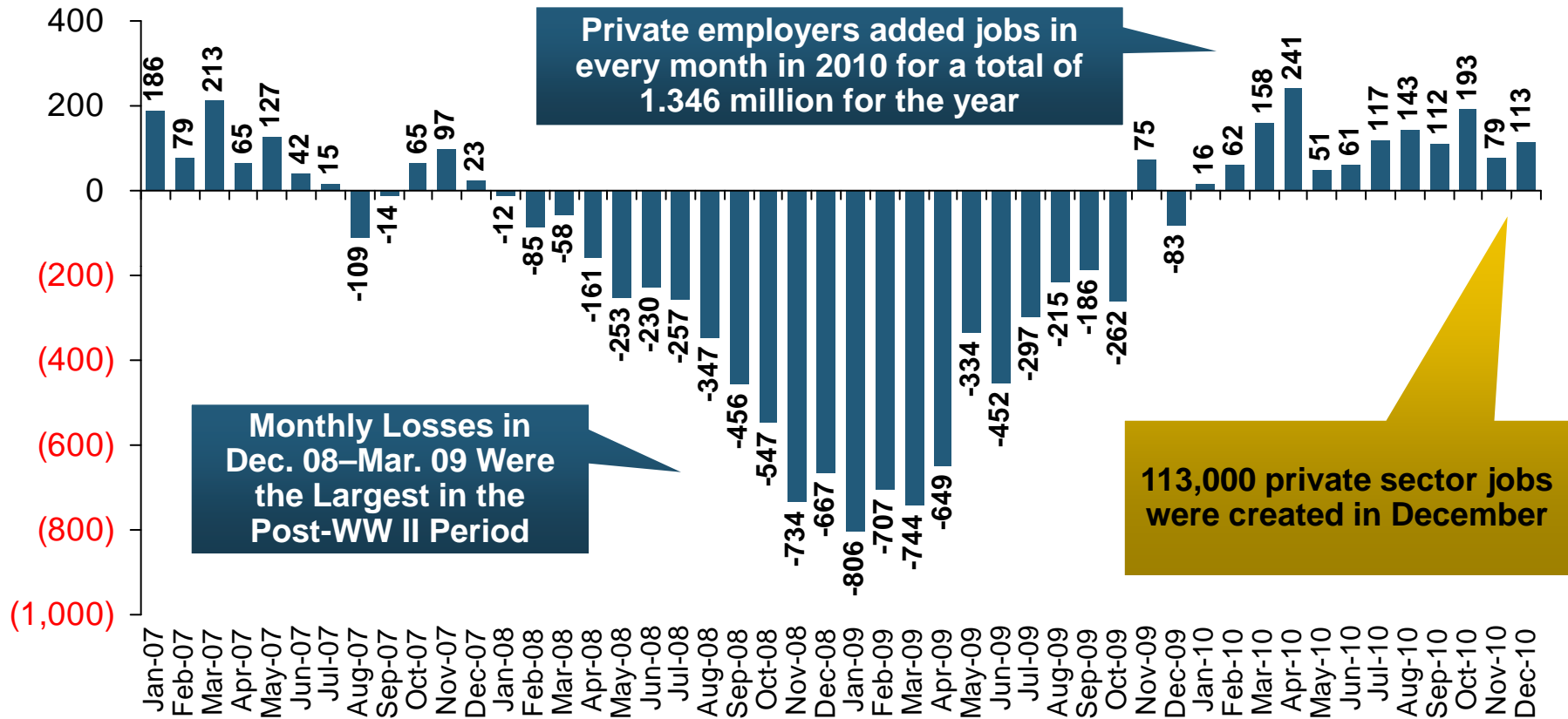
Marginally Attached and Unemployed Persons Account for 16.7% of the Labor Force in December 2010 (1 Out of 6 People). Unemployment Rate Alone was 9.4%. Underutilization Shows a Broader Impact on WC and Other Commercial Exposures

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.

Monthly Change in Private Employment

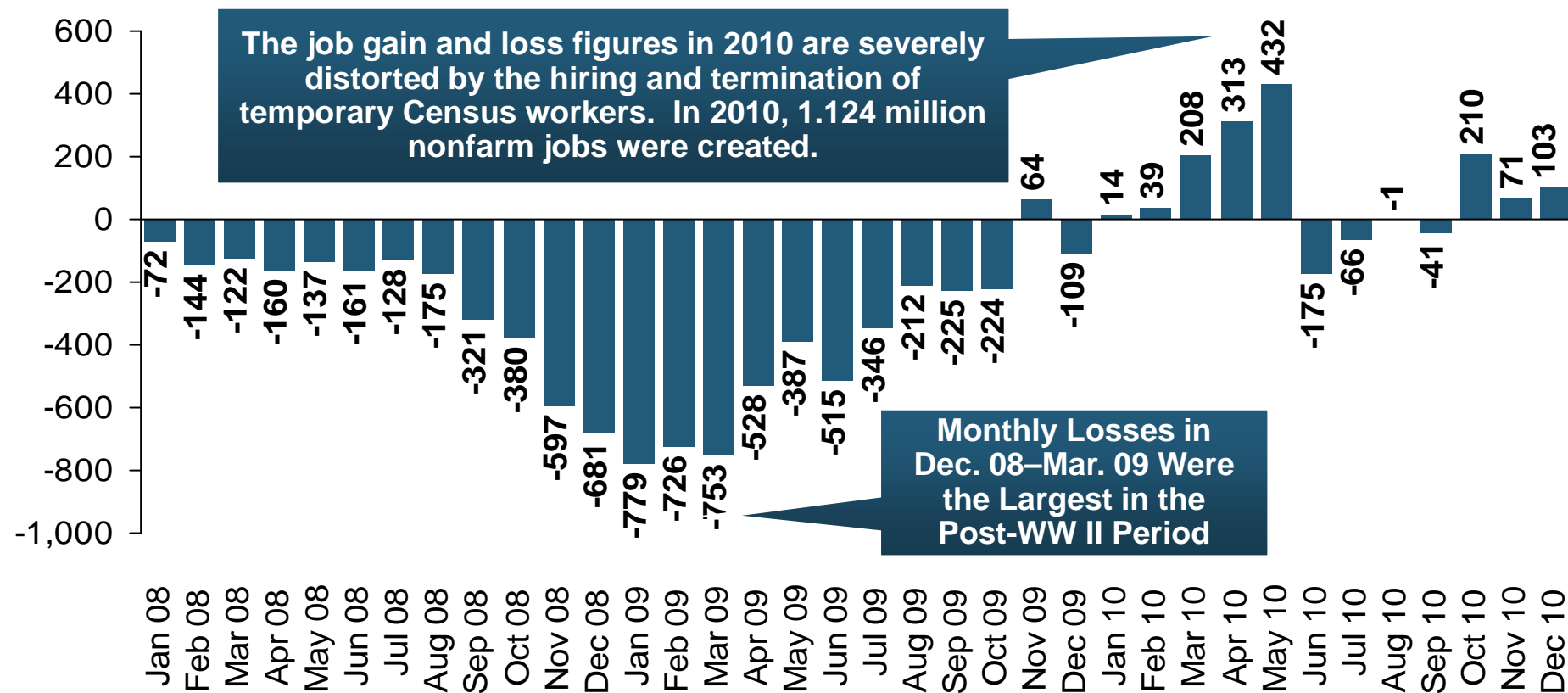
January 2008 through December 2010* (Thousands)



Private Employers Added 1.346 million Jobs in 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008

Monthly Change Employment*

January 2008 through December 2010* (Thousands)



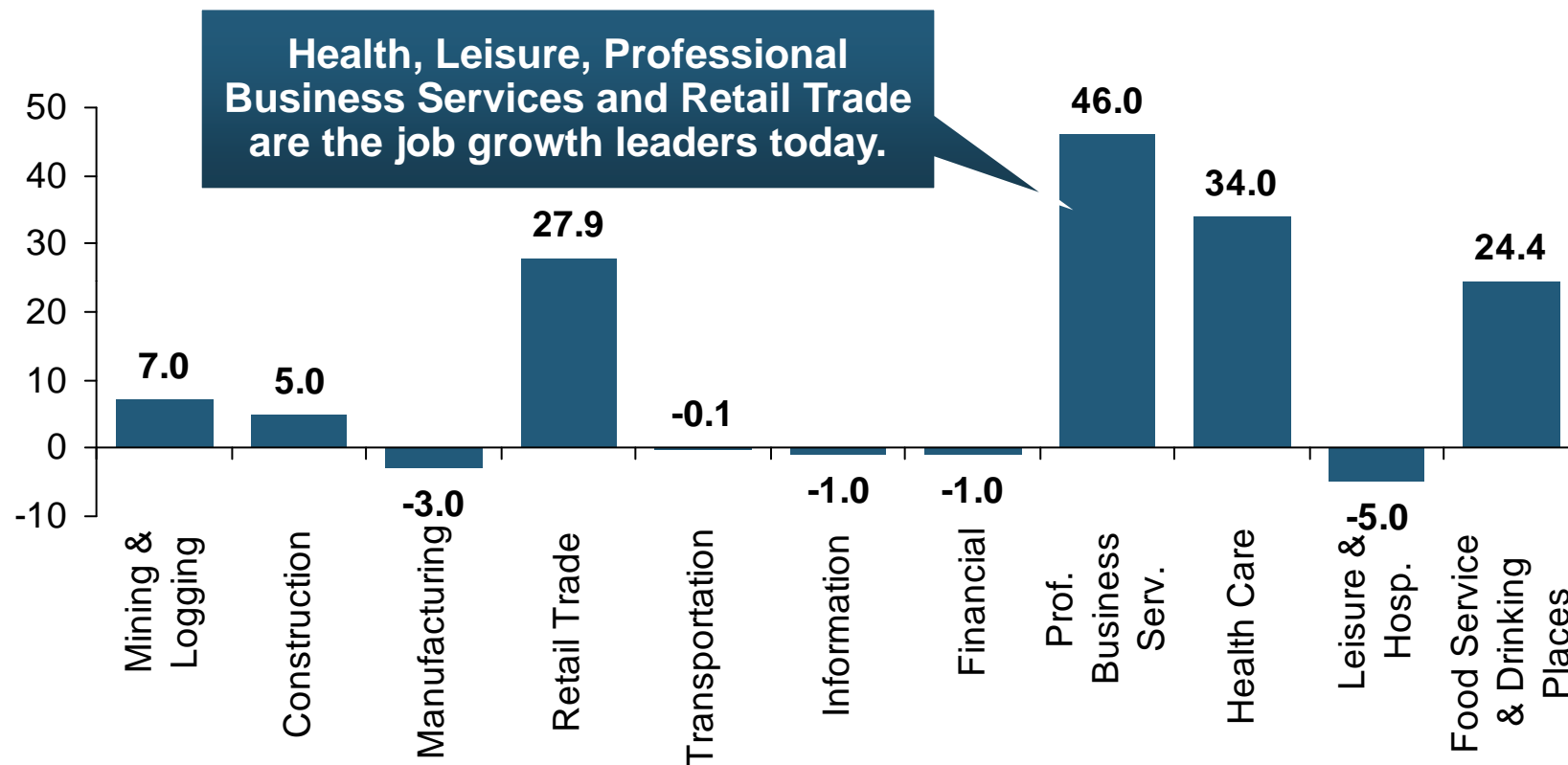
Job Losses Since the Recession Began in Dec. 2007 Peaked at 8.4 Mill in Dec. 09; Stands at 7.5 Million Through October 2010; 14.5 Million People are Now Defined as Unemployed

*Estimate based on Reuters poll of economists.

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

Change in Employment Level for Select Industries, Oct. 2010 vs. Sept. 2010

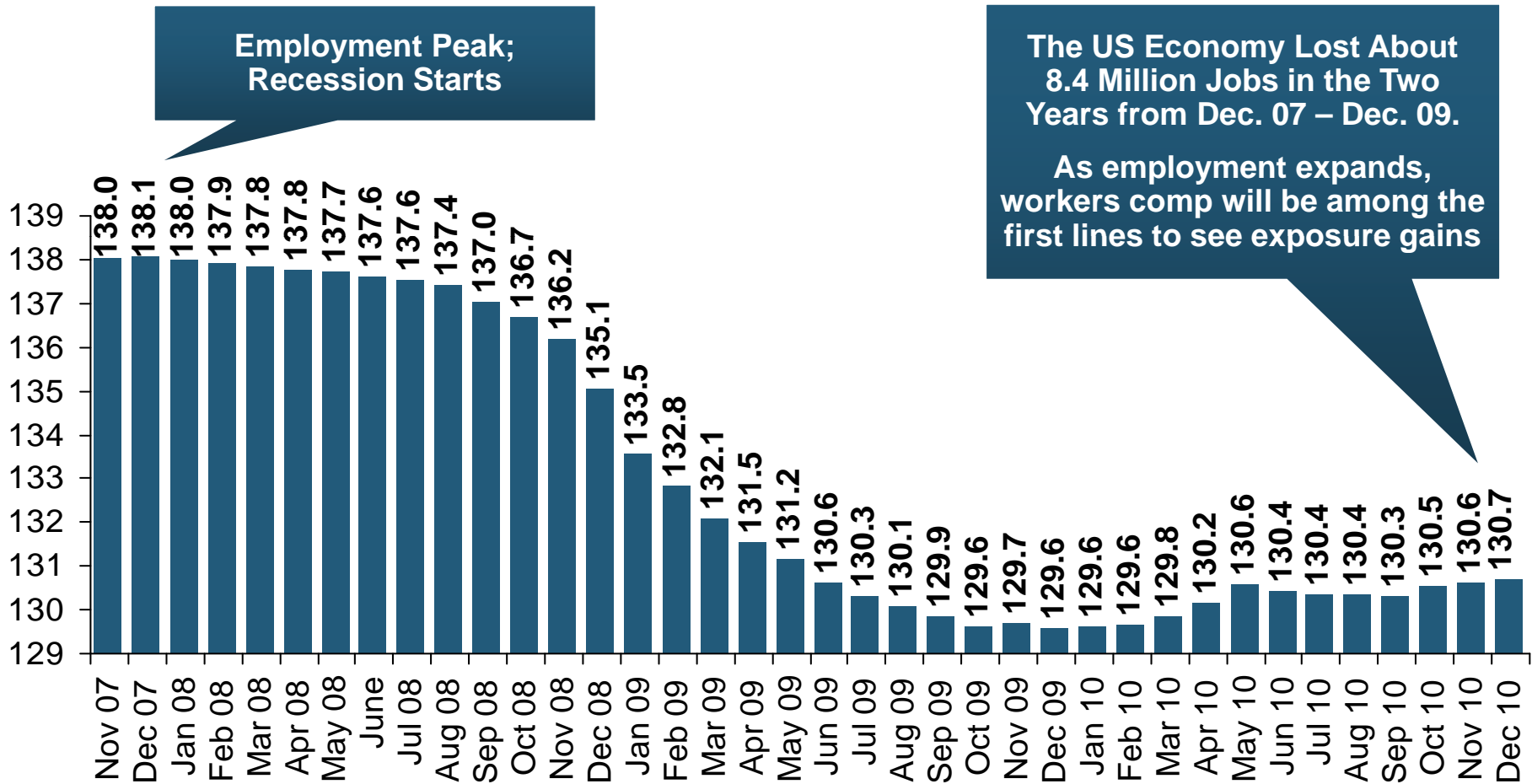
Change in Thousands



There is a great deal of variation in employment growth by industry, indicating a very uneven and slow recovery

US Nonfarm Private Employment

Monthly, Nov 2007 – December 2010 (Millions)



Seasonally adjusted.

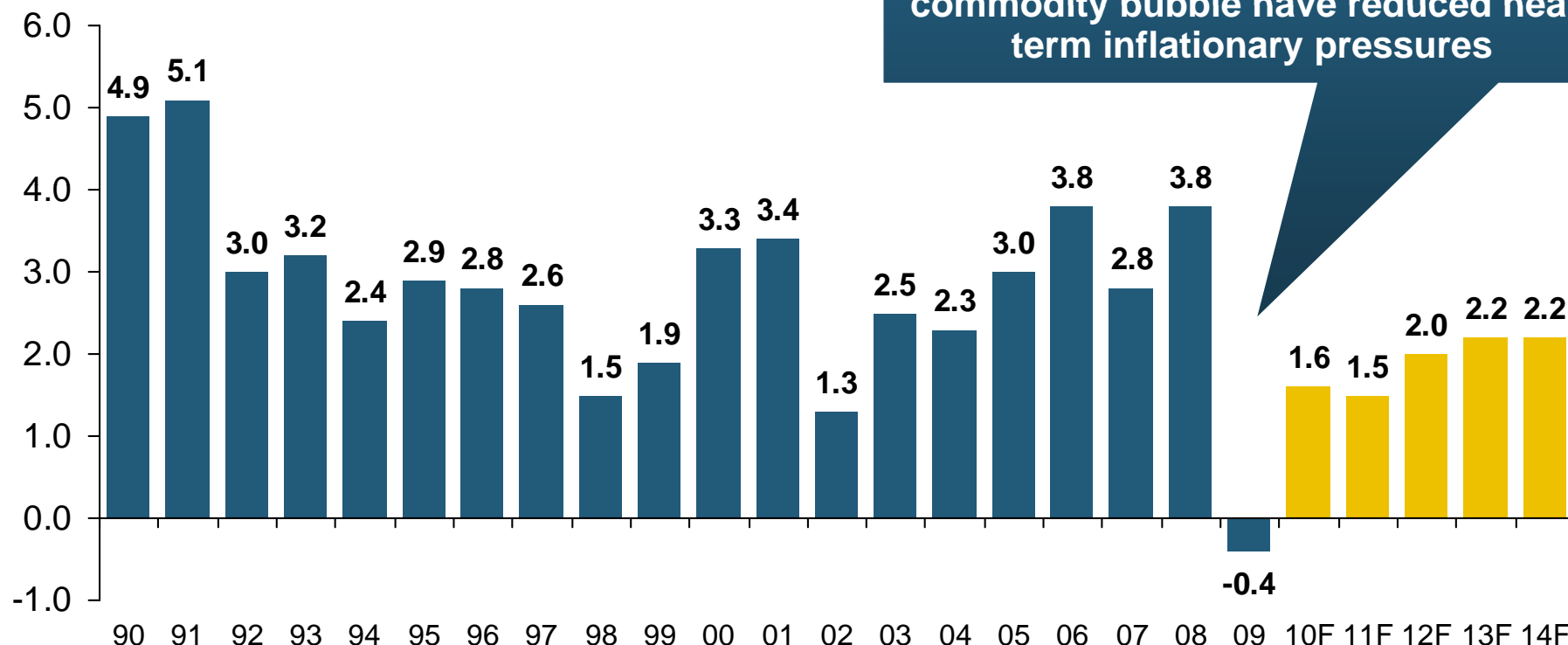
Source: US Bureau of Labor Statistics

**Inflation Trends:
Benign Inflation Tempers
Claim Severity**

**Fed Efforts to Stimulate Inflation Will
Ultimately Pressure Claim
Cost Severities**

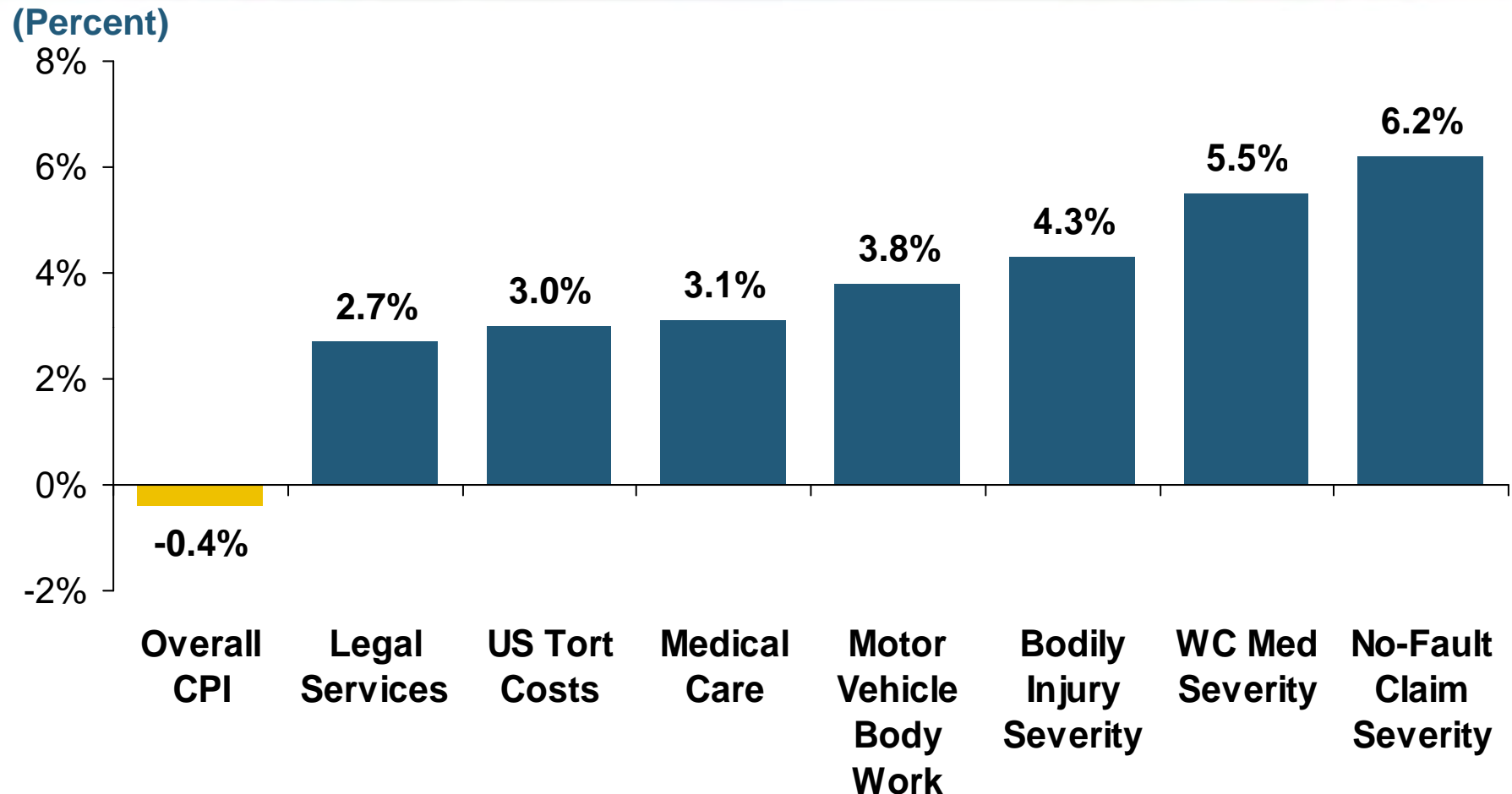
Annual Inflation Rates (CPI-U, %), 1990–2016F

Annual
Inflation
Rates (%)



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

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

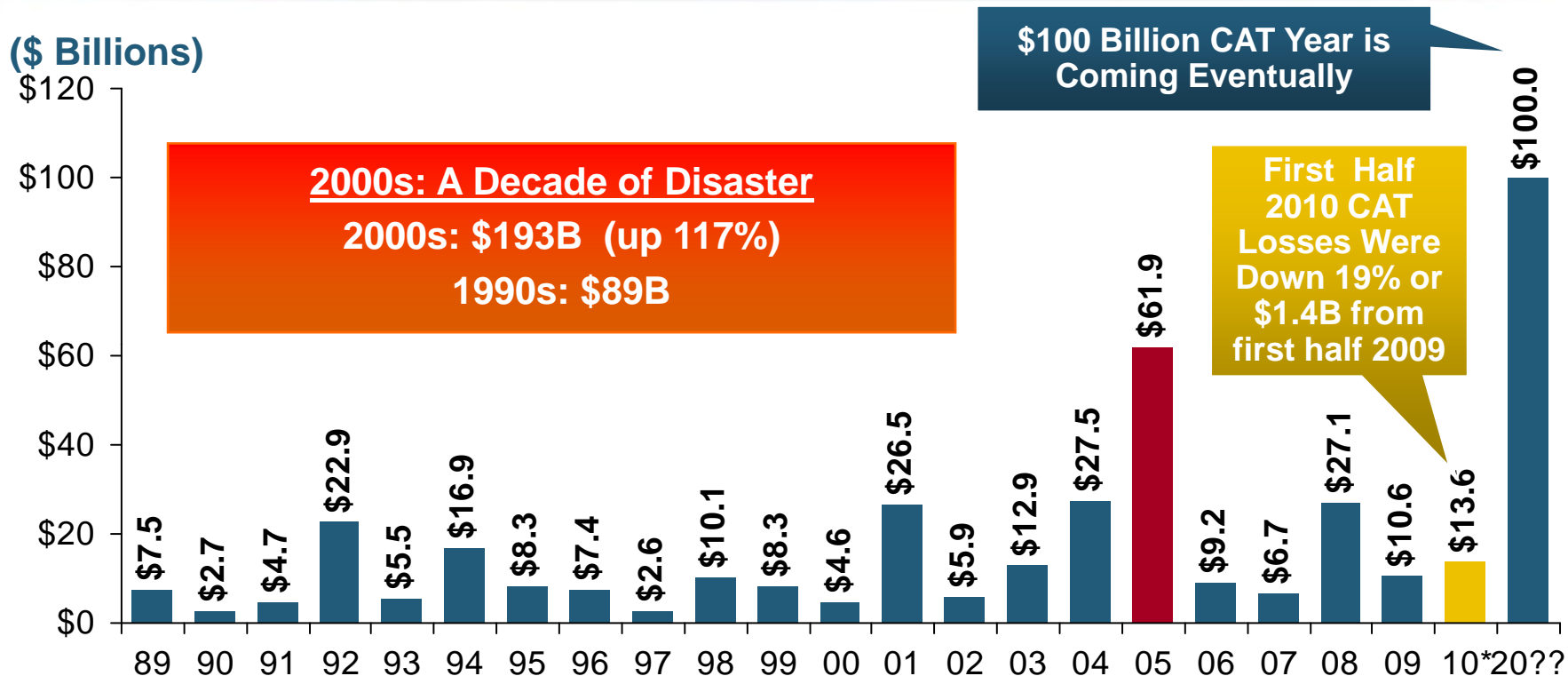


Healthcare and Legal/Tort Costs Are a Major P/C Insurance Cost Driver. These Are Expected to Increase Above the Overall Inflation Rate (CPI) Indefinitely

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.

Catastrophic Loss – Catastrophe Losses Trends Are Trending Adversely

US Insured Catastrophe Losses



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

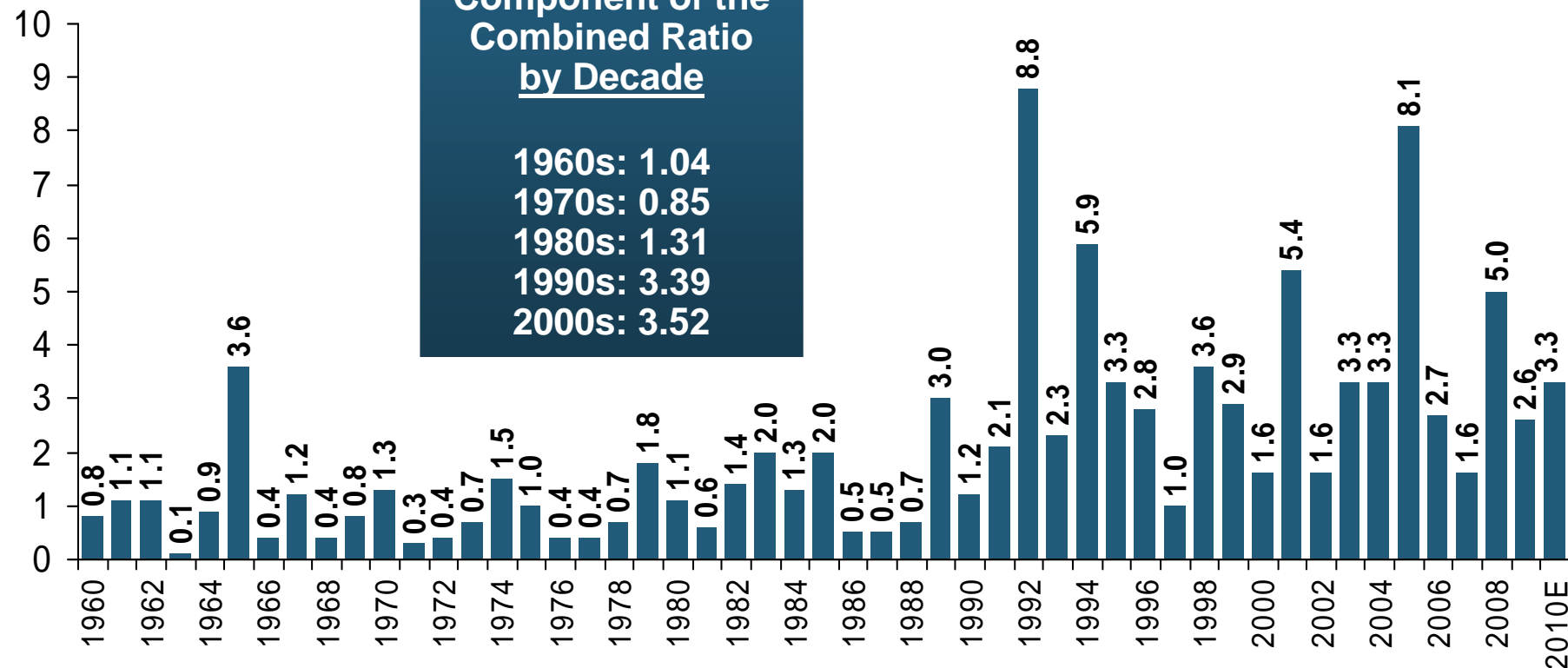
*Estimate from Munich Re.

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

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

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

Combined Ratio Points



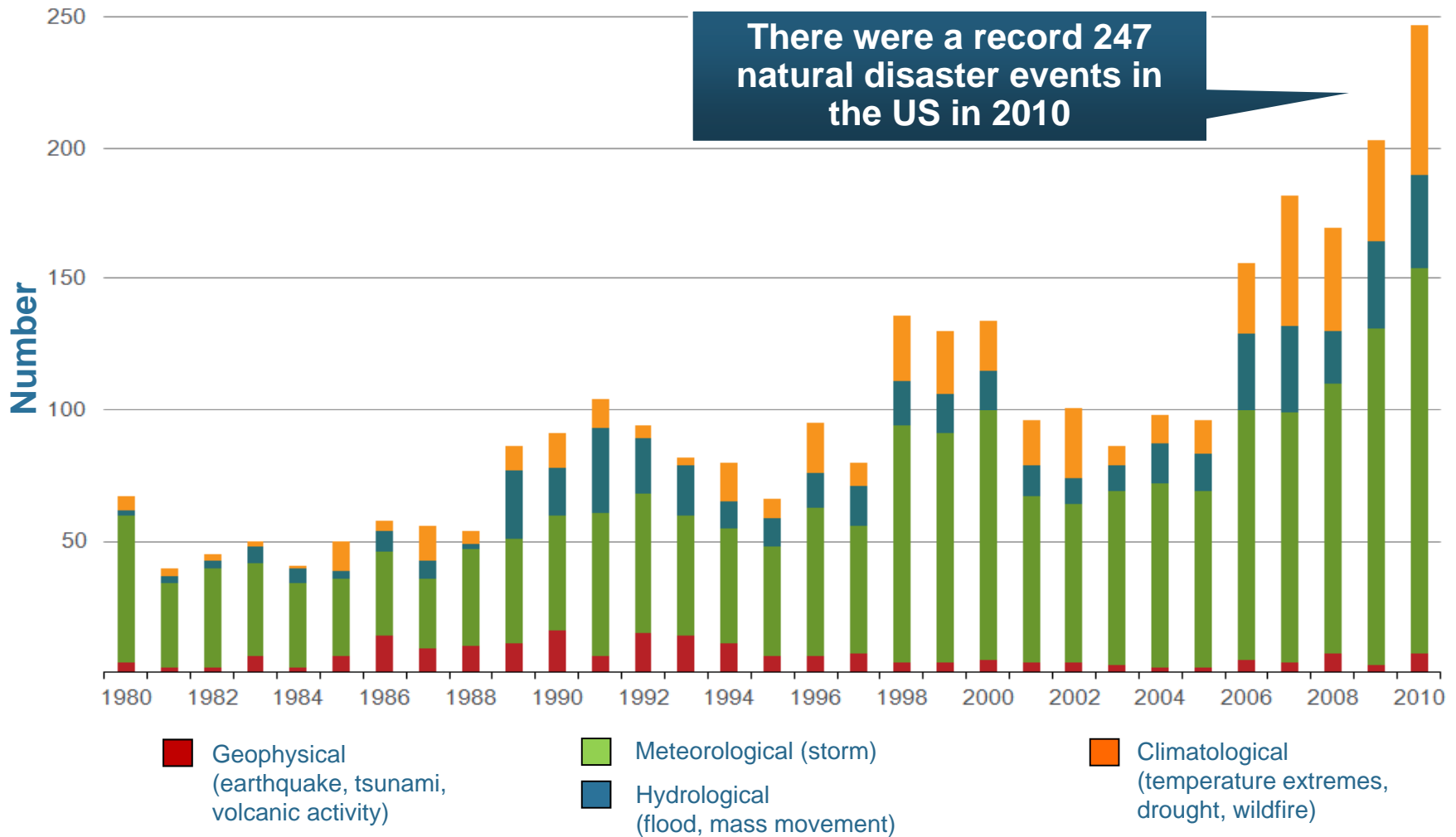
The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

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

Source: ISO; Insurance Information Institute estimate for 2010.

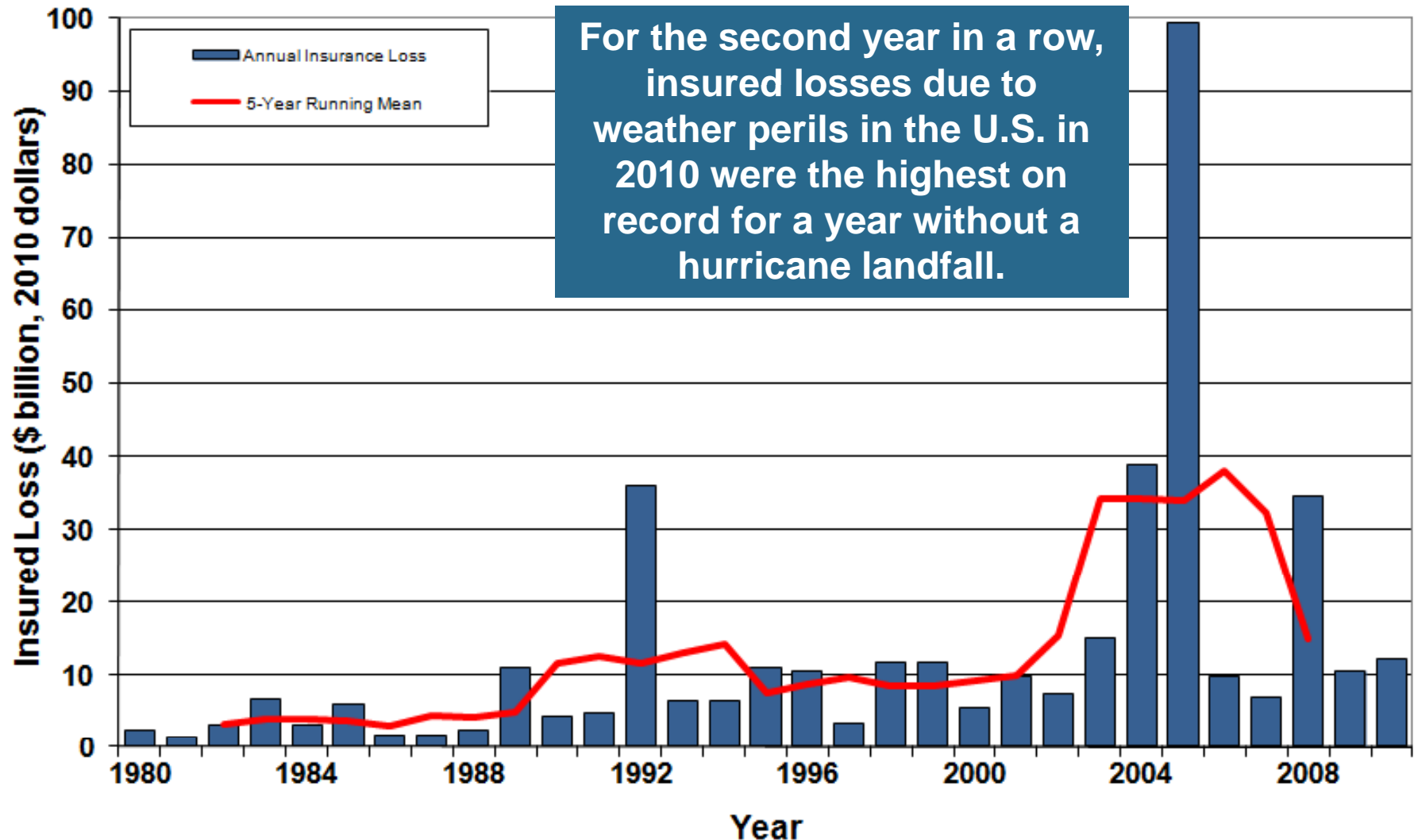
Natural Disasters in the United States, 1980 – 2010

Number of Events (Annual Totals 1980 – 2010)



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

(Tropical Cyclone, Thunderstorm, and Winter Storm only)



Significant Natural Catastrophes, 2010

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

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

Sources: MR NatCat *SERVICE*,

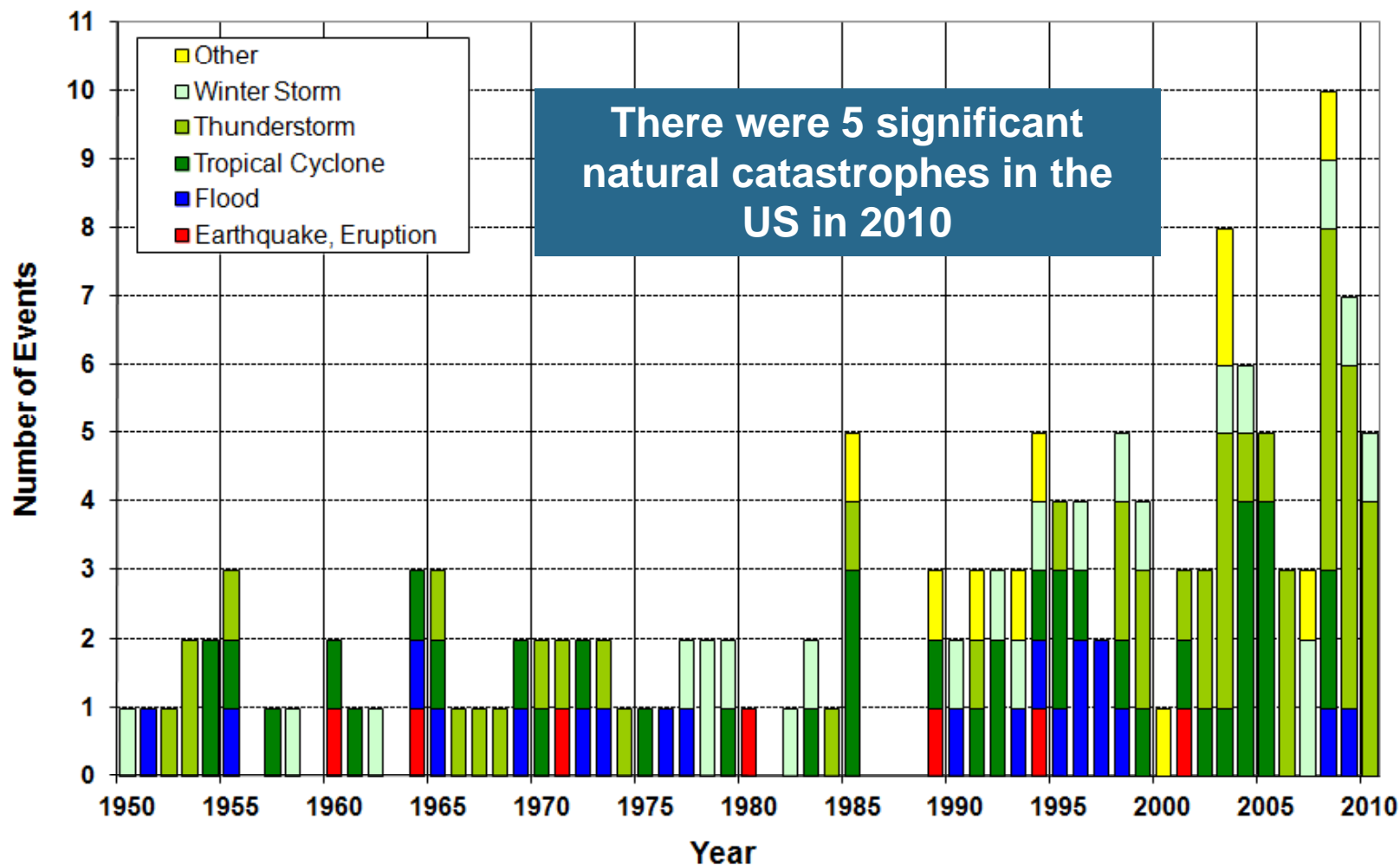
[†] - Property Claims Services (PCS)

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

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

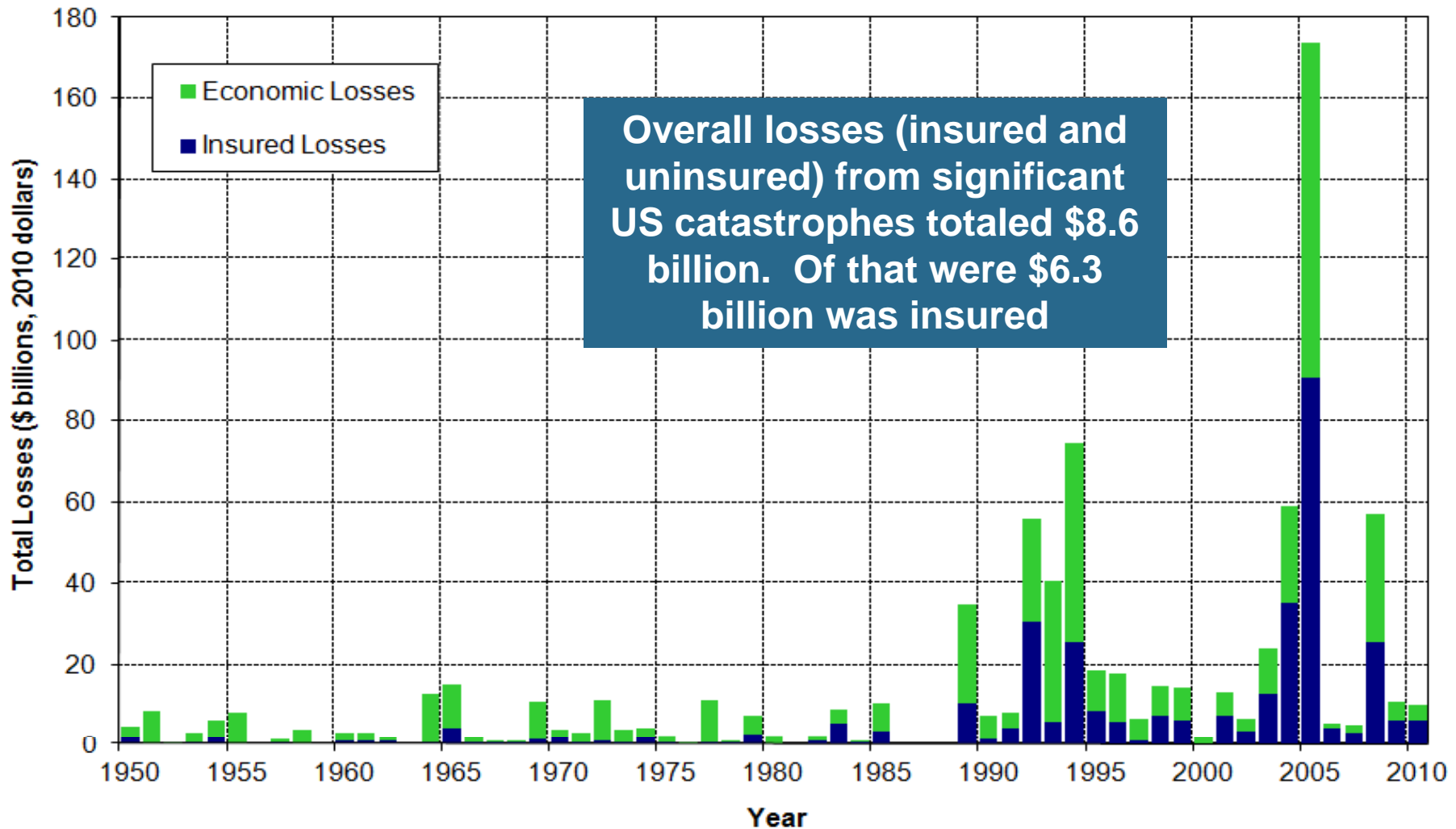
Significant Natural Catastrophes, 1950 – 2010

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

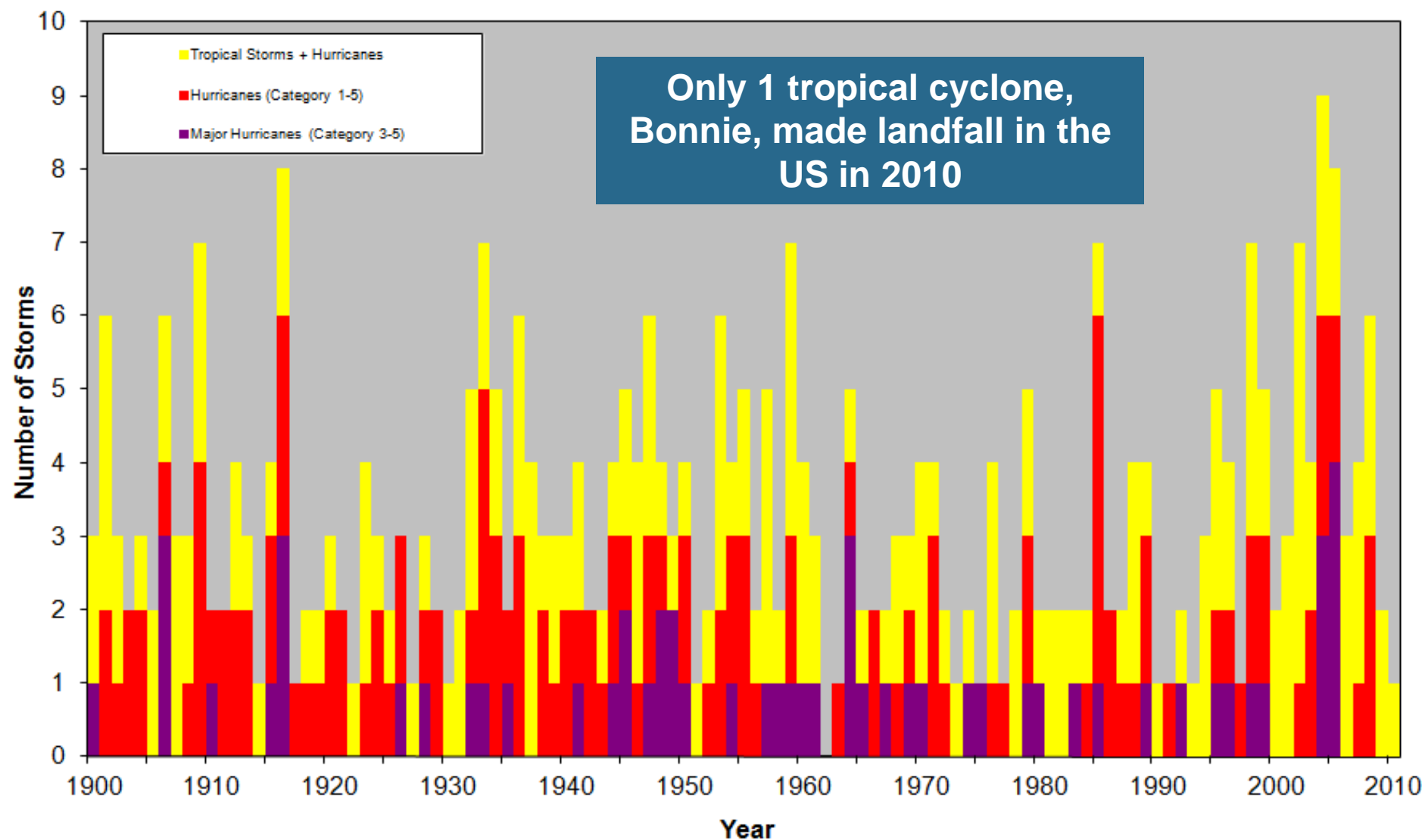


Significant Natural Catastrophes, 1950 – 2010

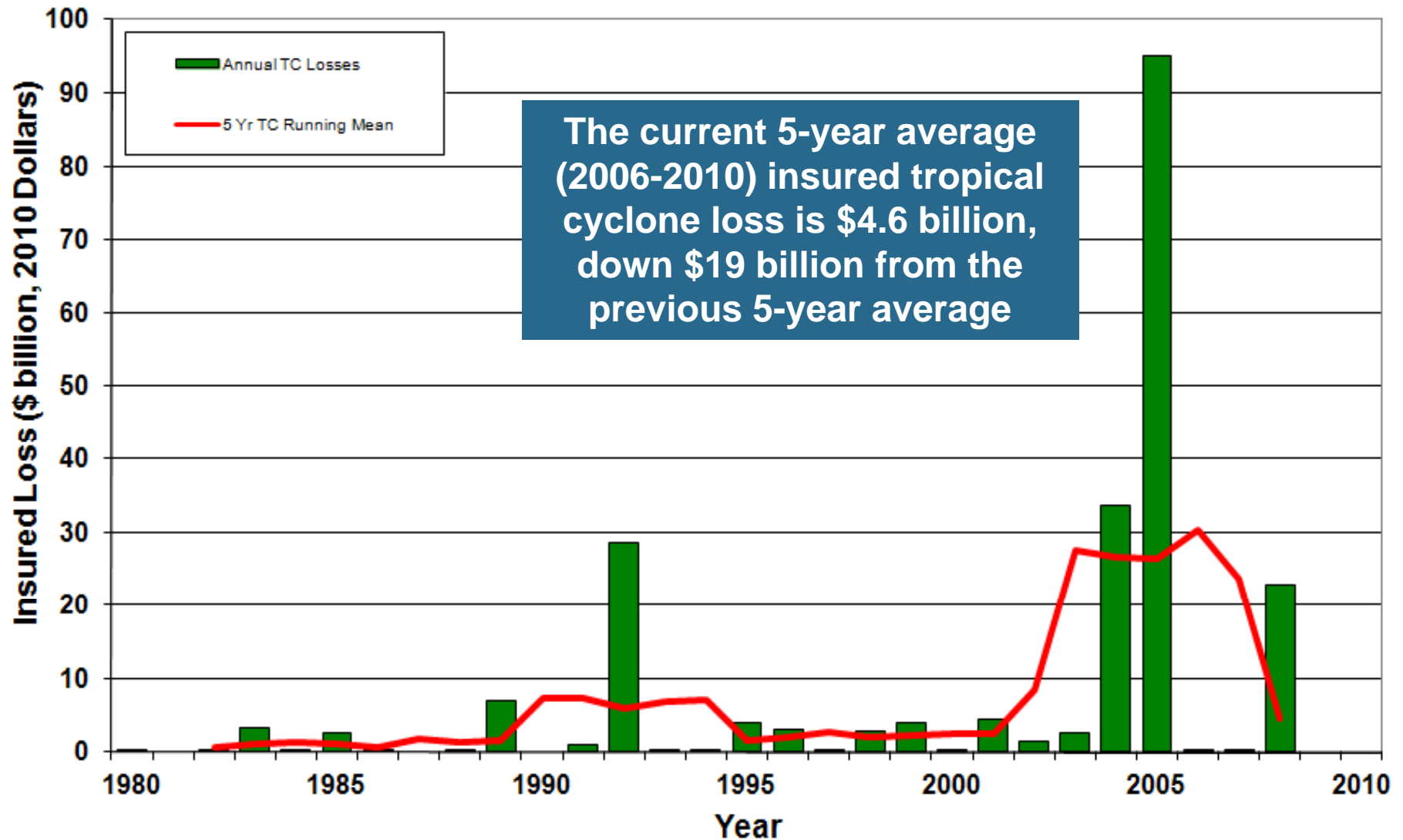
Losses (\$1 billion economic loss and/or 50 fatalities)



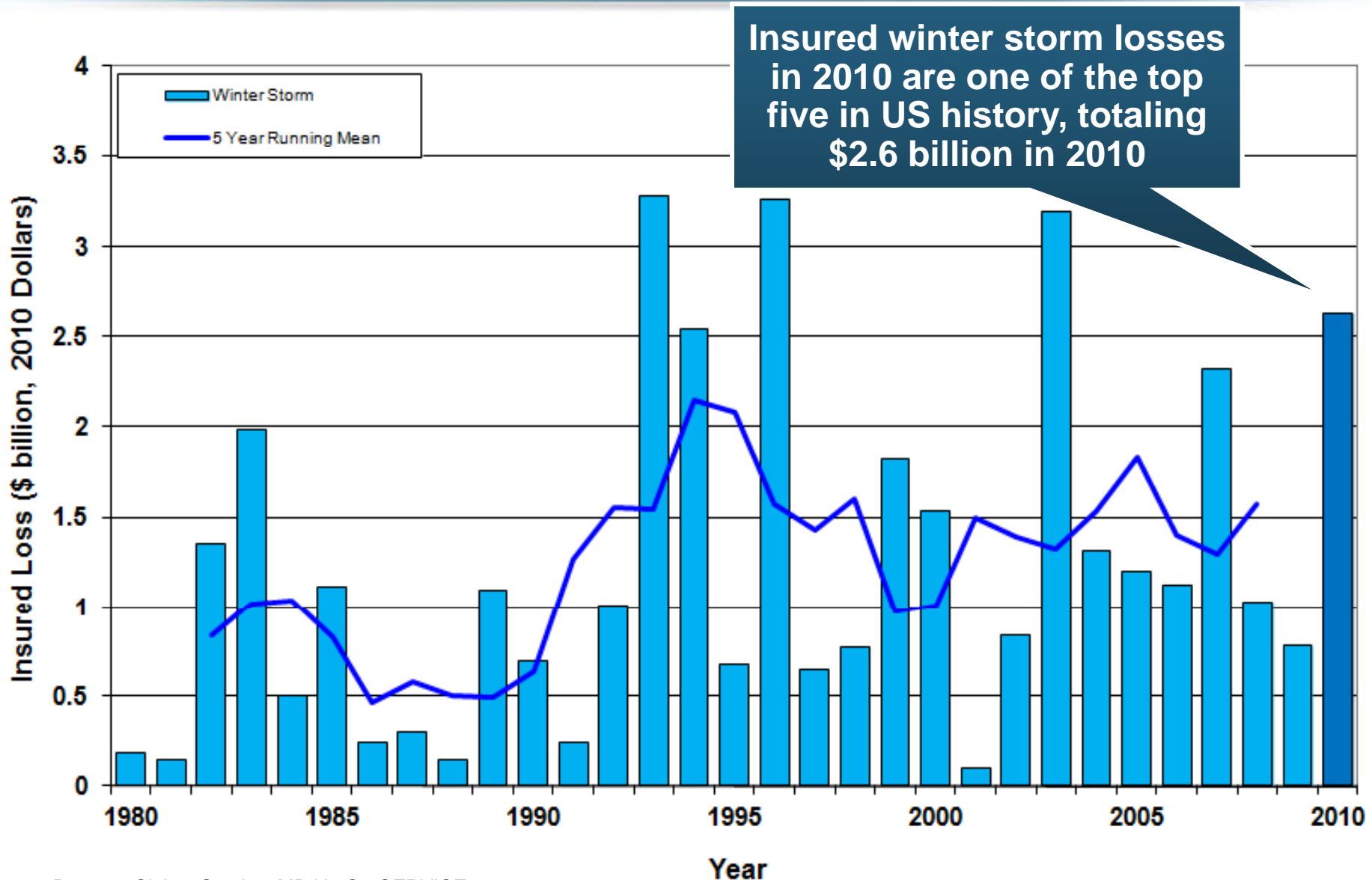
Number of U.S. Landfalling Tropical Cyclones, 1900 – 2010



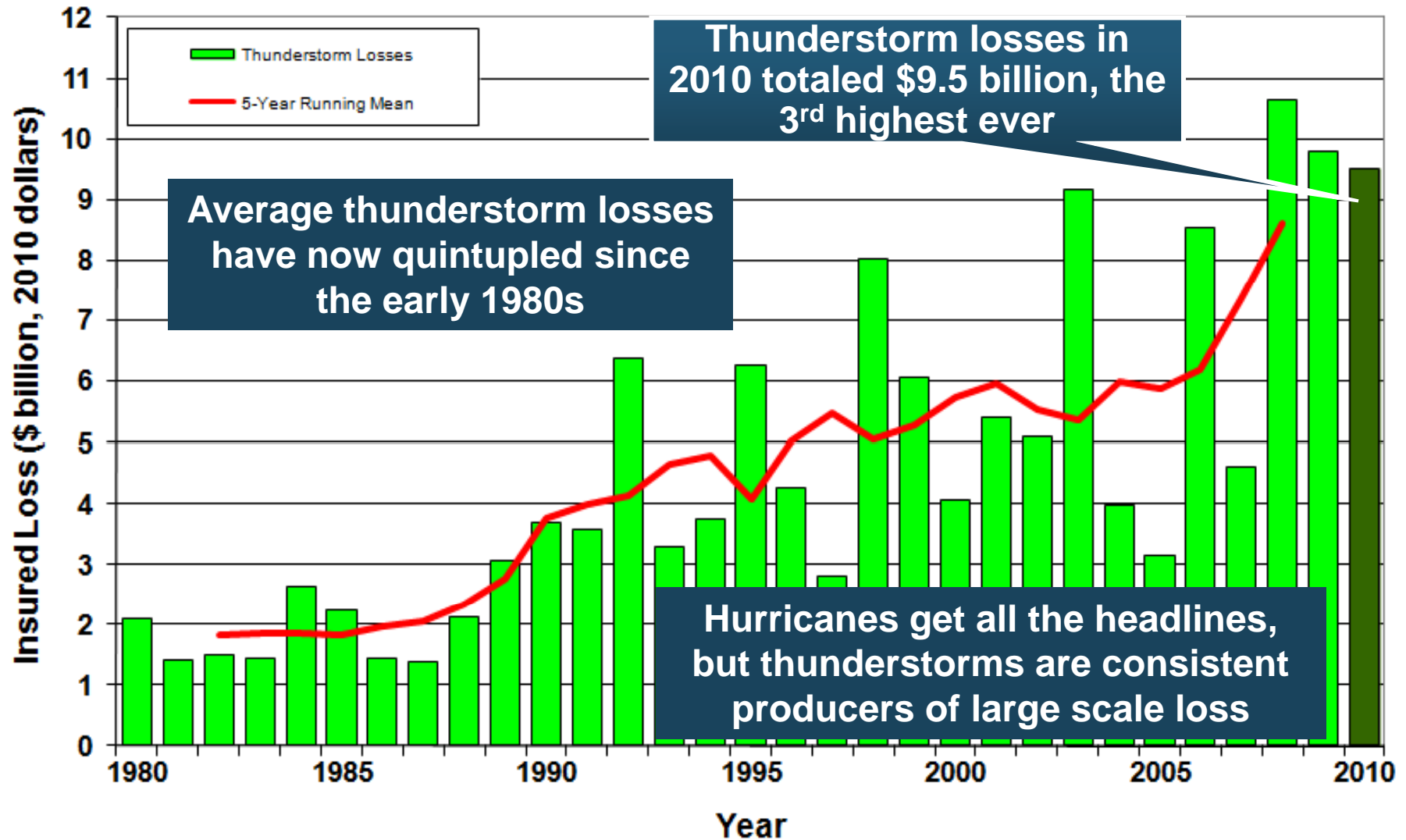
Insured U.S. Tropical Cyclone Losses, 1980 – 2010



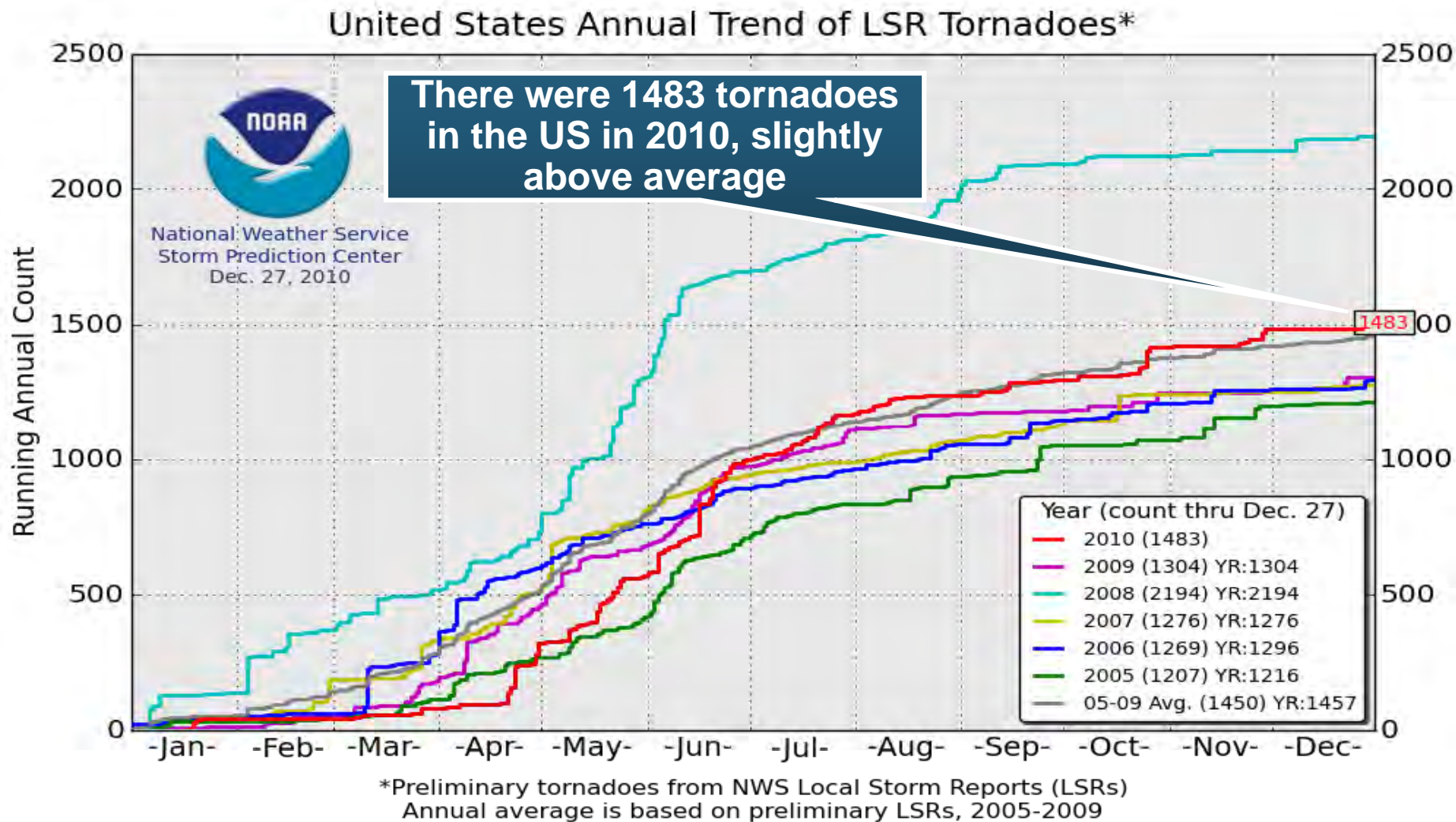
U.S. Winter Storm Loss Trends, 1980 – 2010 (Annual Totals)



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

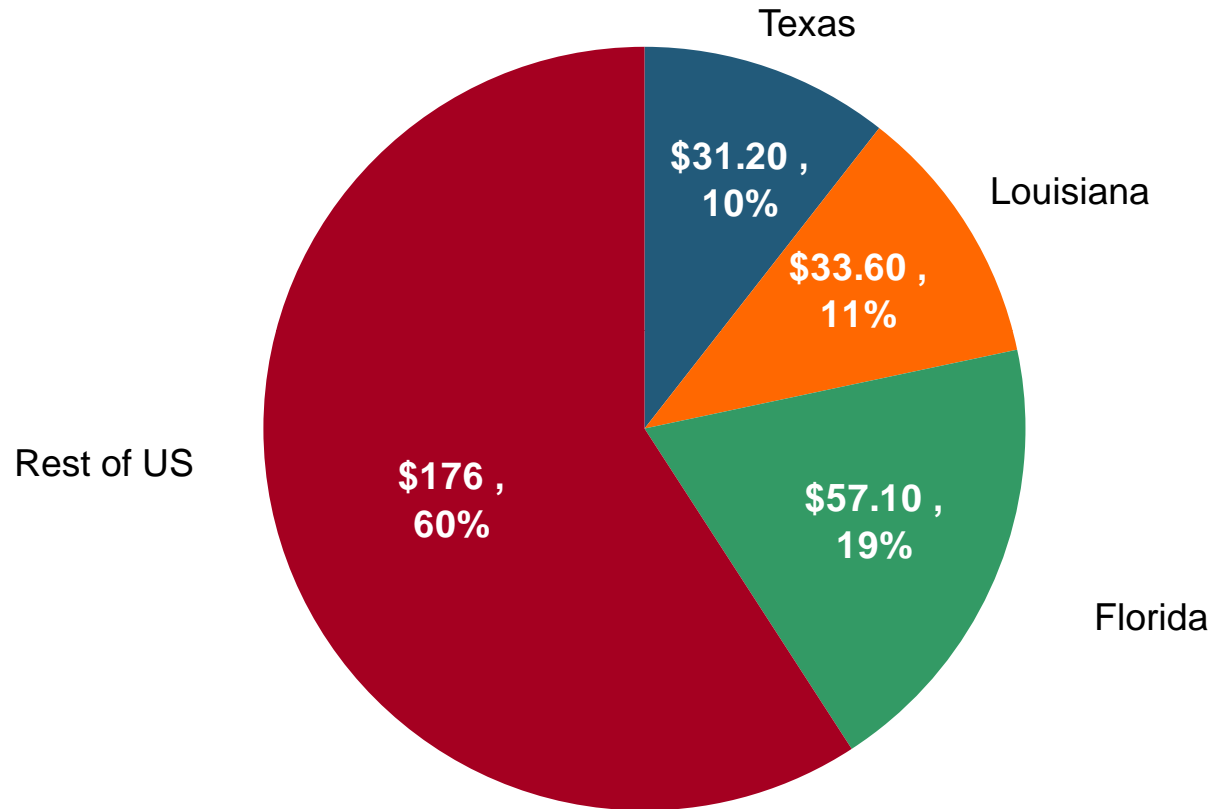


U.S. Tornado Count, 2010



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

(\$ Billions)



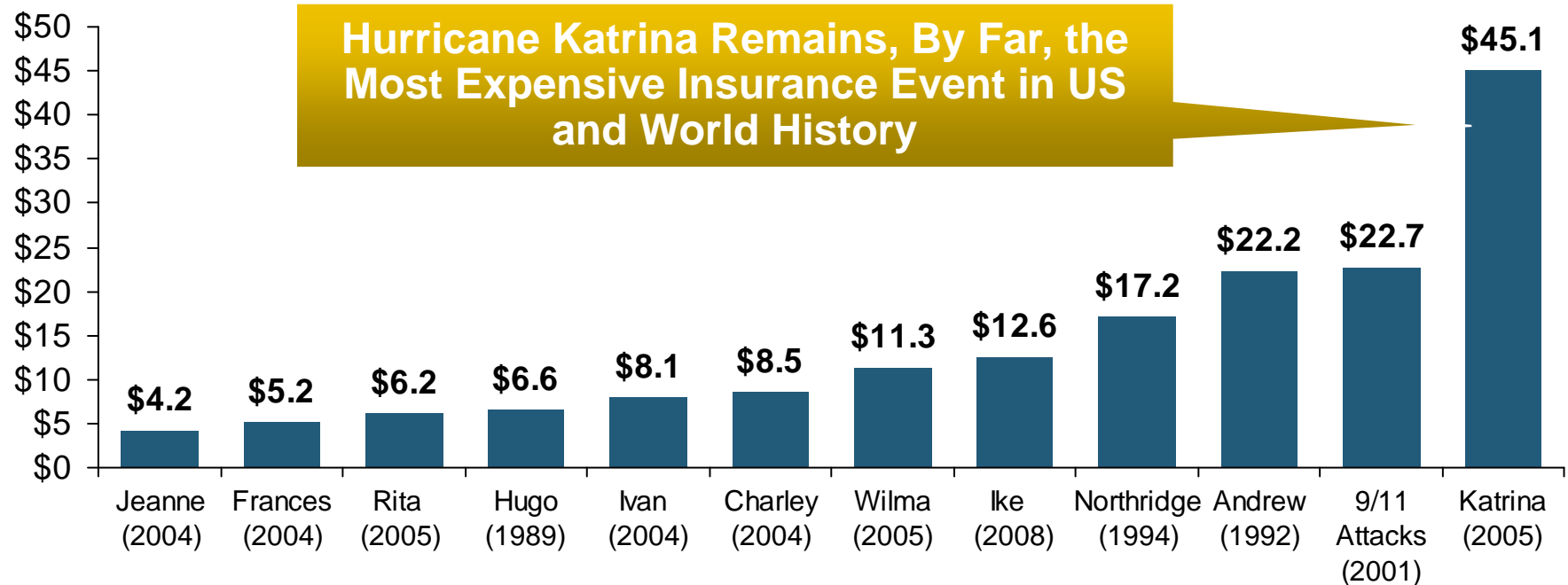
**Texas Accounted for 10% of All US Insured CAT Losses
from 1980-2008: \$57.1B out of \$297.9B**

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

Source: PCS division of ISO.

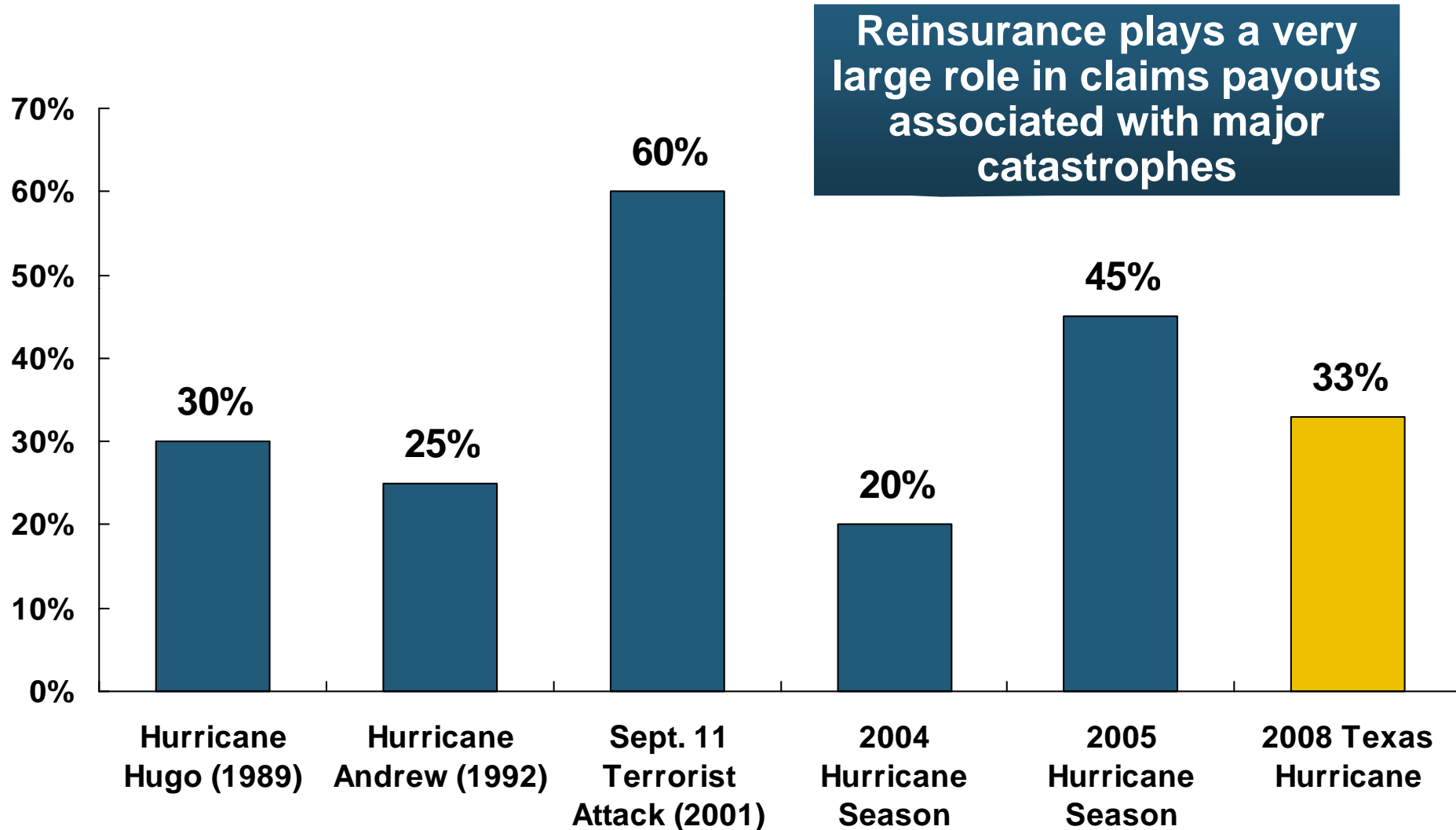
Top 12 Most Costly Disasters in US History

(Insured Losses, 2009, \$ Billions)



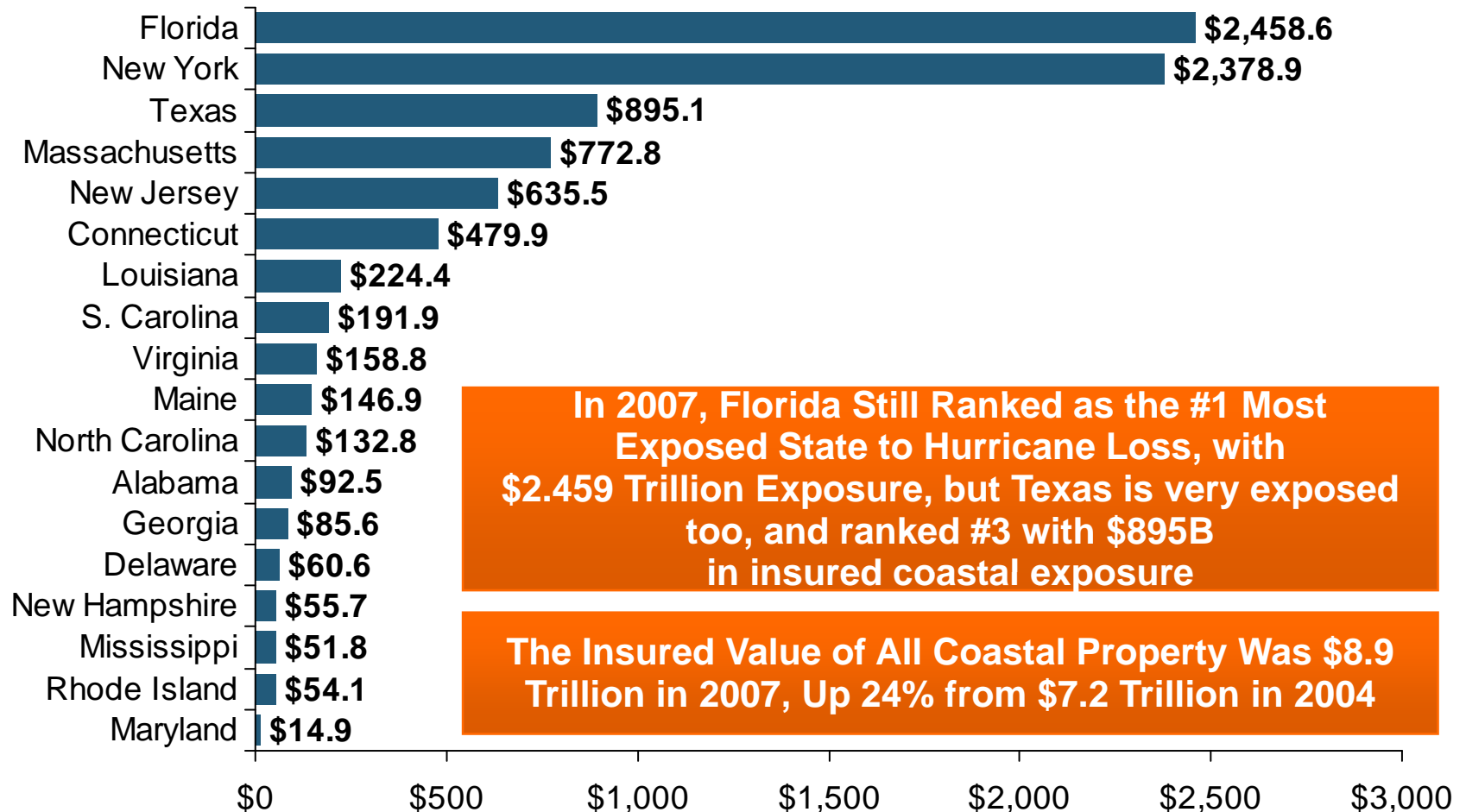
**8 of the 12 Most Expensive Disasters in US History
Have Occurred Since 2004;
*8 of the Top 12 Disasters Affected FL***

Share of Losses Paid by Reinsurers for Major Catastrophic Events



Total Value of Insured Coastal Exposure

(2007, \$ Billions)



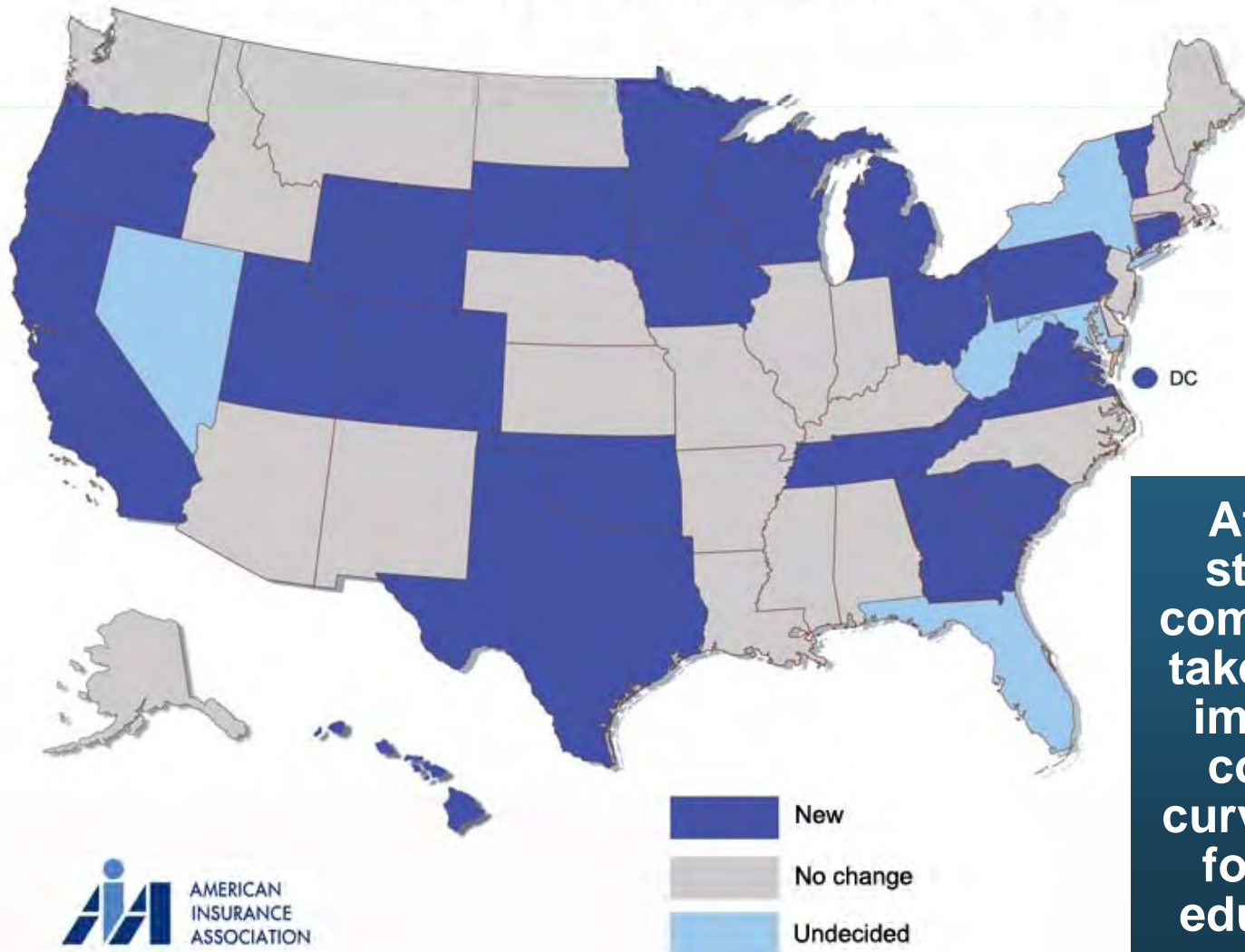
Regulatory Concerns

**Very High State Regulator
Turnover in 2011**

**Federal Insurance Office—
A New Unknown**

Turnover Among Insurance Regulators is Very High in 2011

2011 Insurance Commissioners Chart



Insurance Information Institute Online:

www.iii.org

***Thank you for your time
and your attention!***

Twitter: twitter.com/bob_hartwig