Financial Crisis, Recession, and the Future of the P/C Insurance Industry

Trends, Challenges & Opportunities

2009 Annual Farm Bureau Insurance Managers Conference

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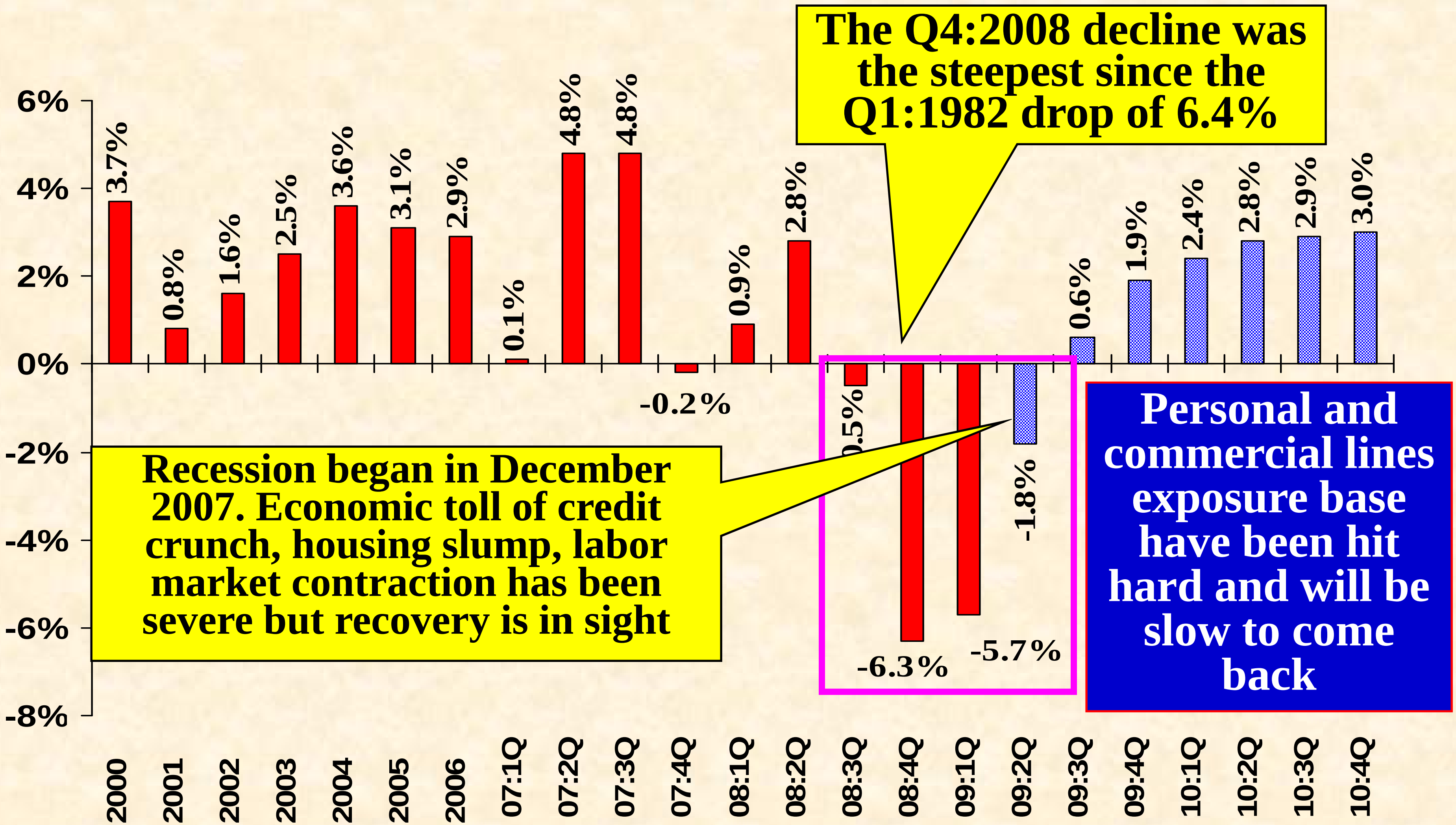
Presentation Outline

- **The Economic Storm: Financial Crisis & Recession**
- **Economic Trends: Personal, Commercial Exposure Implications**
- **Aftershock: P/C Insurance *After* the Financial Crisis**
- **Key Threats and Issues Facing P/C Insurers Through 2015**
- **Financial Strength & Ratings**
- **P/C Insurance Industry Overview & Outlook**
  - **Profitability**
  - **Premium Growth**
  - **Underwriting Performance**
  - **Financial Market Impacts**
  - **Merger & Acquisition Activity**
- **Capital & Capacity**
- **Catastrophe Loss Trends**

THE ECONOMIC STORM

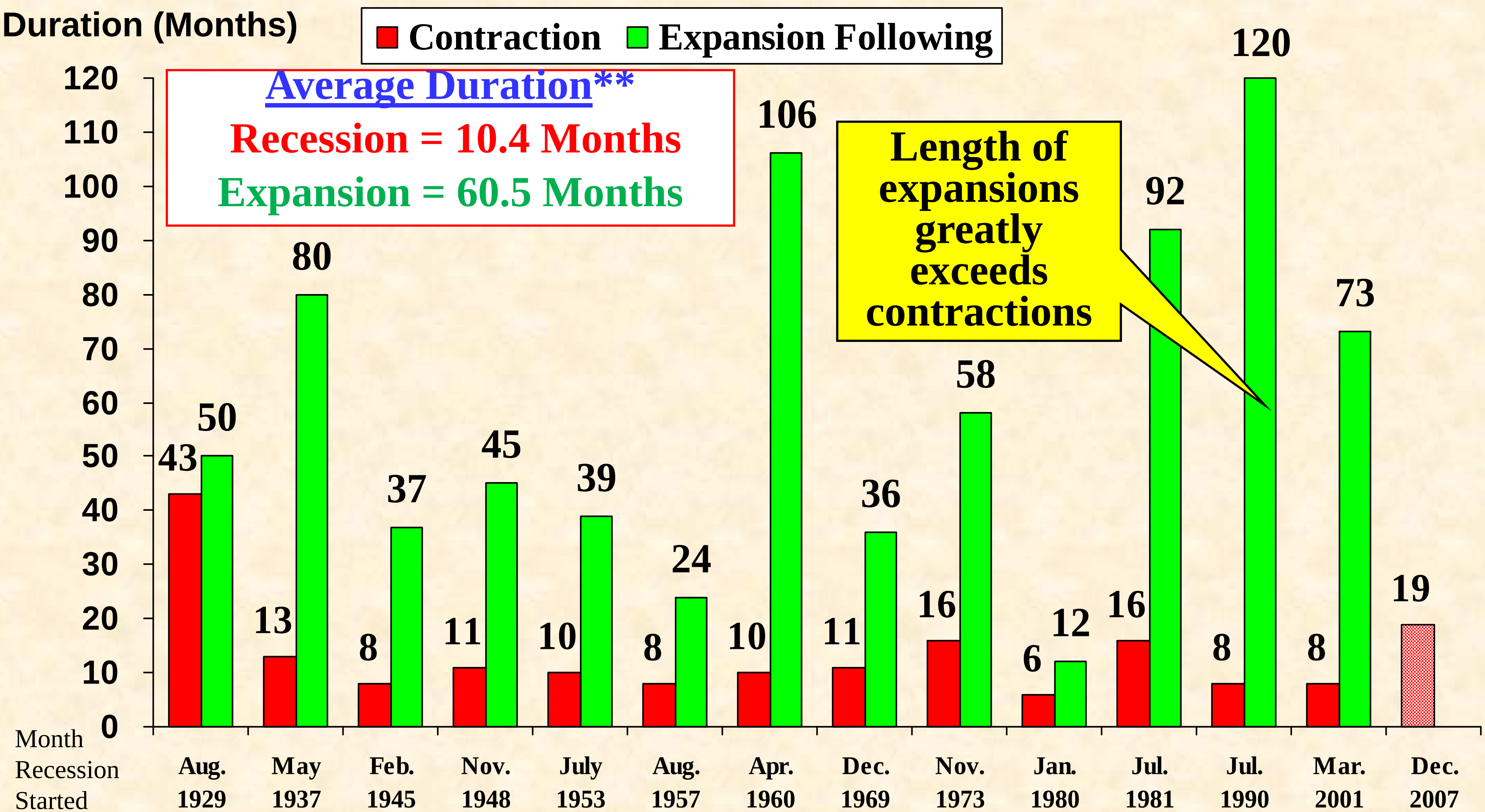
What the Financial Crisis and Recession Mean for the Industry's Exposure Base and Growth

*Real GDP Growth**



***Blue bars are Estimates/Forecasts from Blue Chip Economic Indicators.**
Source: US Department of Commerce, Blue Economic Indicators 6/09; Insurance Information Institute.

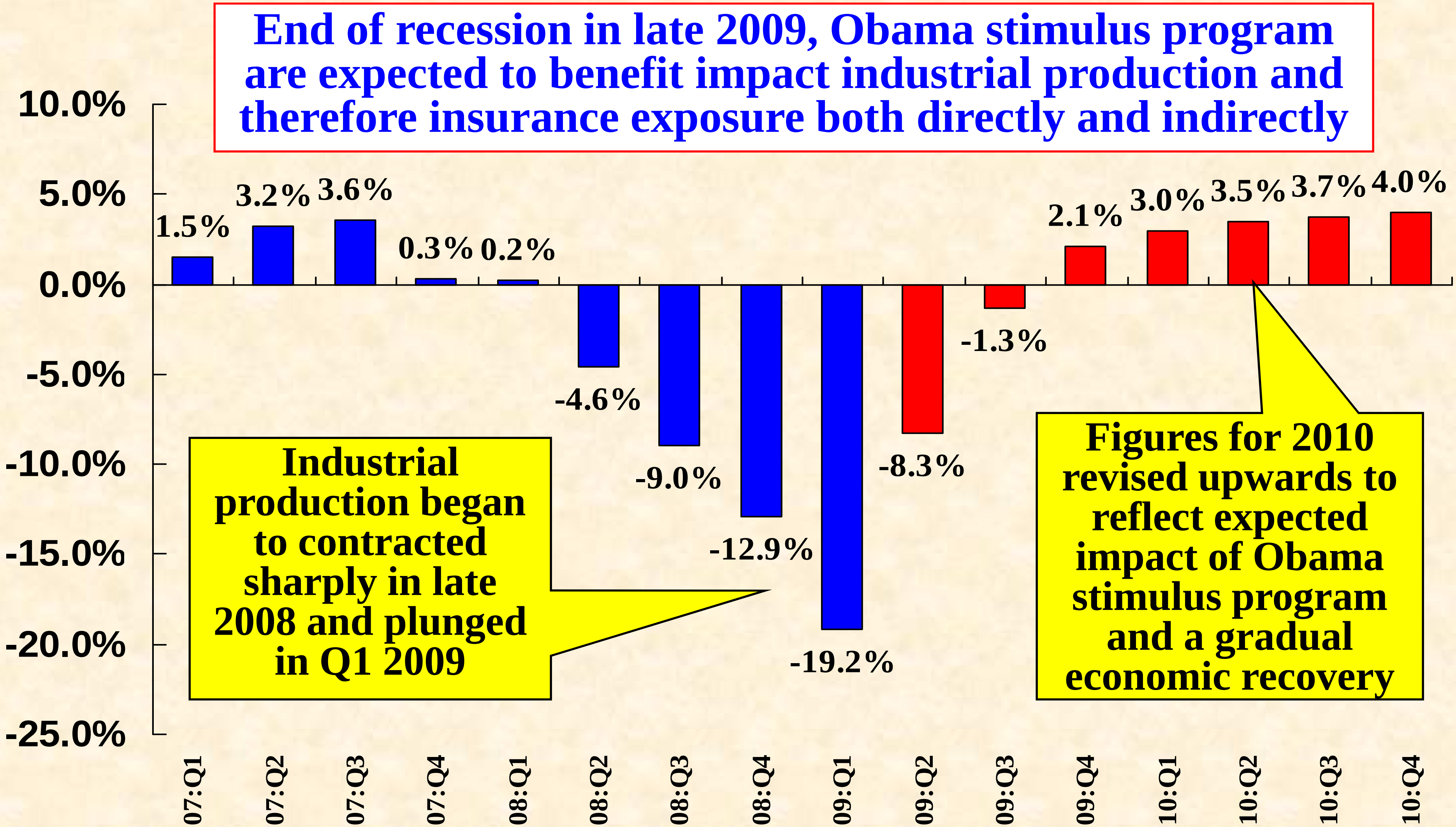
*Length of U.S. Business Cycles, 1929-Present**



* As of June 2009, inclusive; **Post-WW II period through end of most recent expansion.

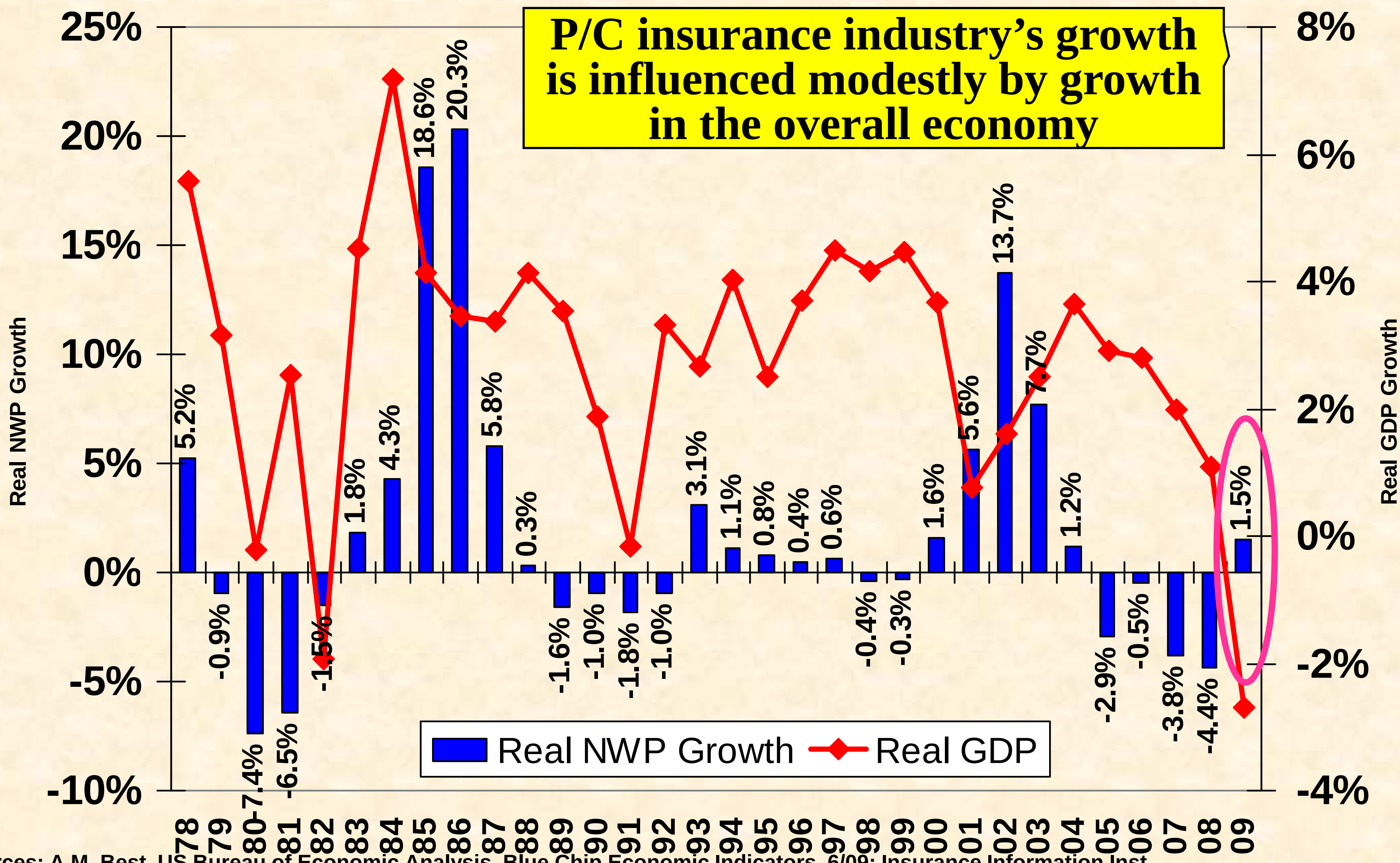
Sources: National Bureau of Economic Research; Insurance Information Institute.

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



Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (6/09); Insurance Info. Inst.

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

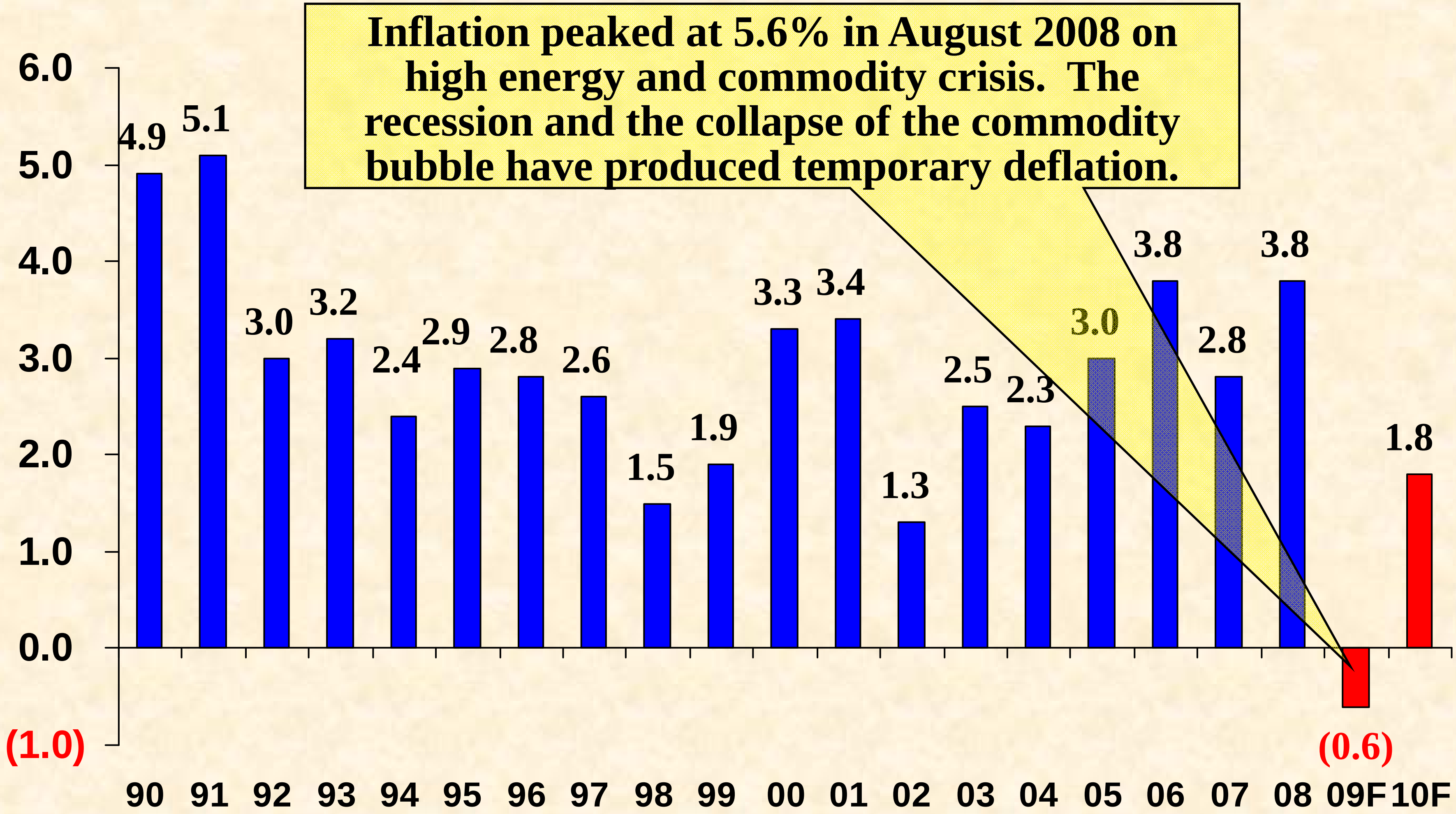


Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 6/09; Insurance Information Inst.

Inflation Trends

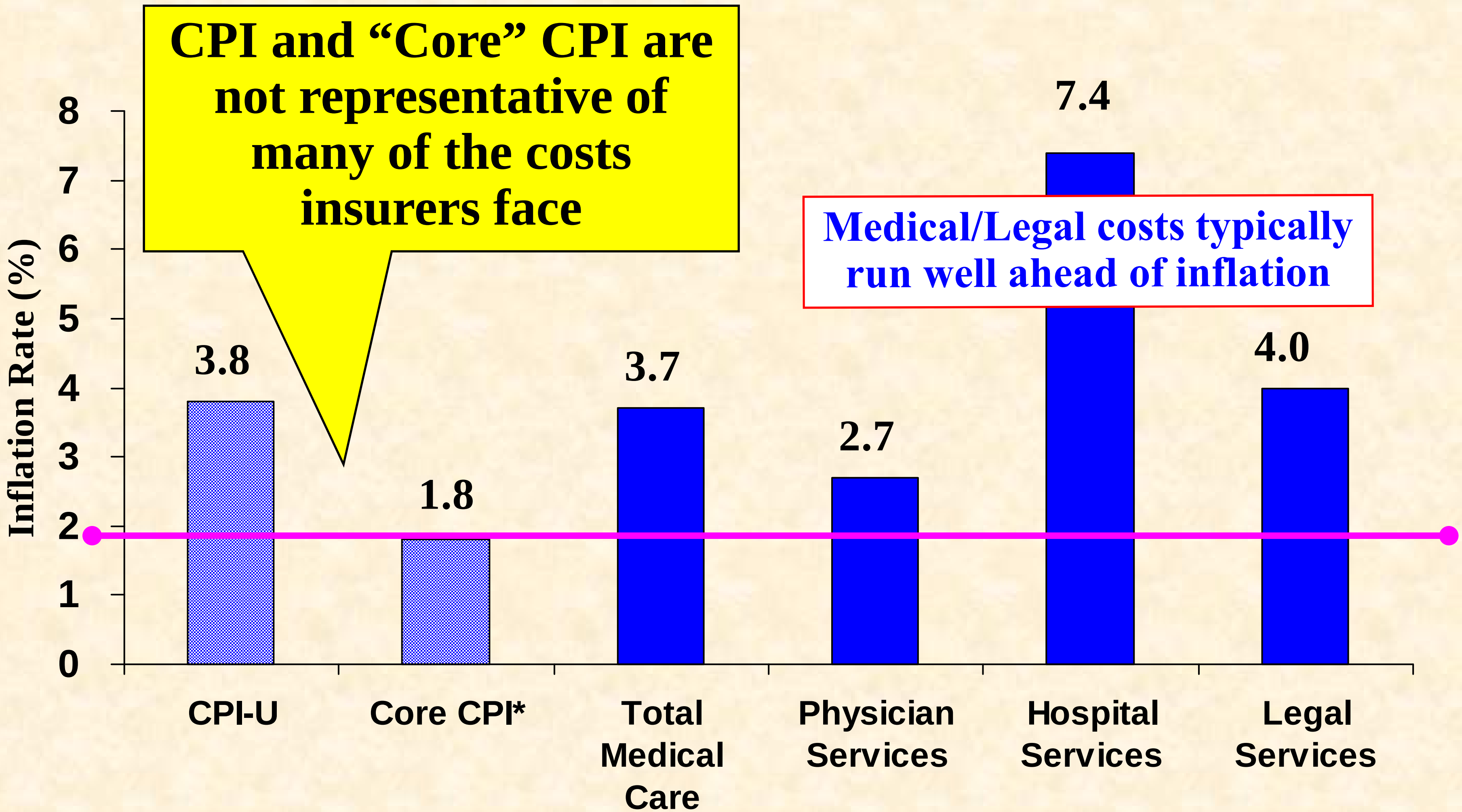
Pressures Claim Cost Severities via Medical and Tort Channels

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



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

Comparative 2008 Inflation Statistics Important to Insurers (%)



*Core CPI is the Consumer Price Index for all Urban Consumers (CPI-U) less food and energy costs.

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

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

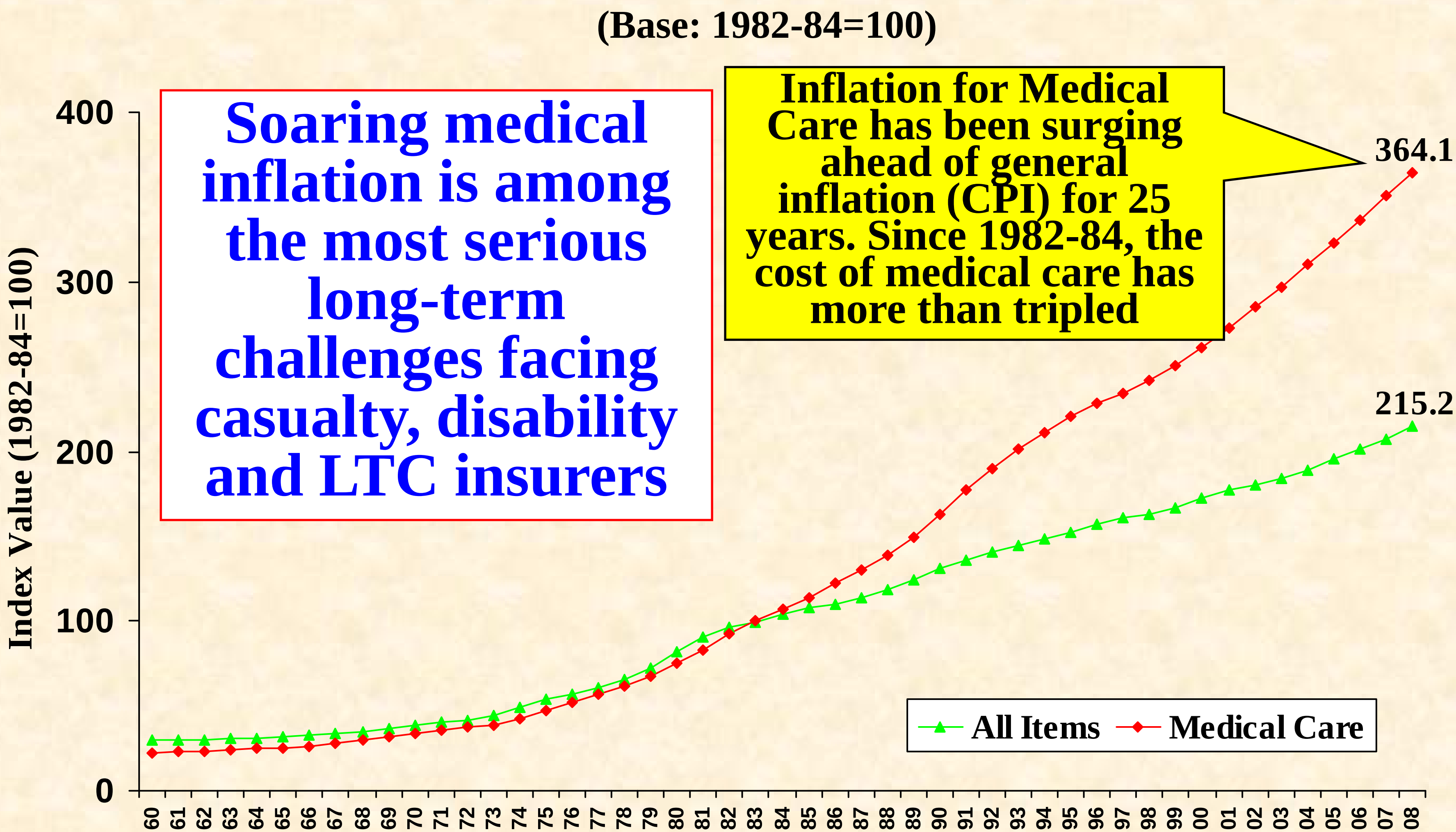
- Rising Claim Severities
  - **Cost of claims settlement rises across the board (property and liability)**
- Rate Inadequacy
  - **Rates inadequate due to low trend assumptions arising from use of historical data**
- Reserve Inadequacy
  - **Reserves may develop adversely and become inadequate (deficient)**
- 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.

Medical & Tort Cost Inflation

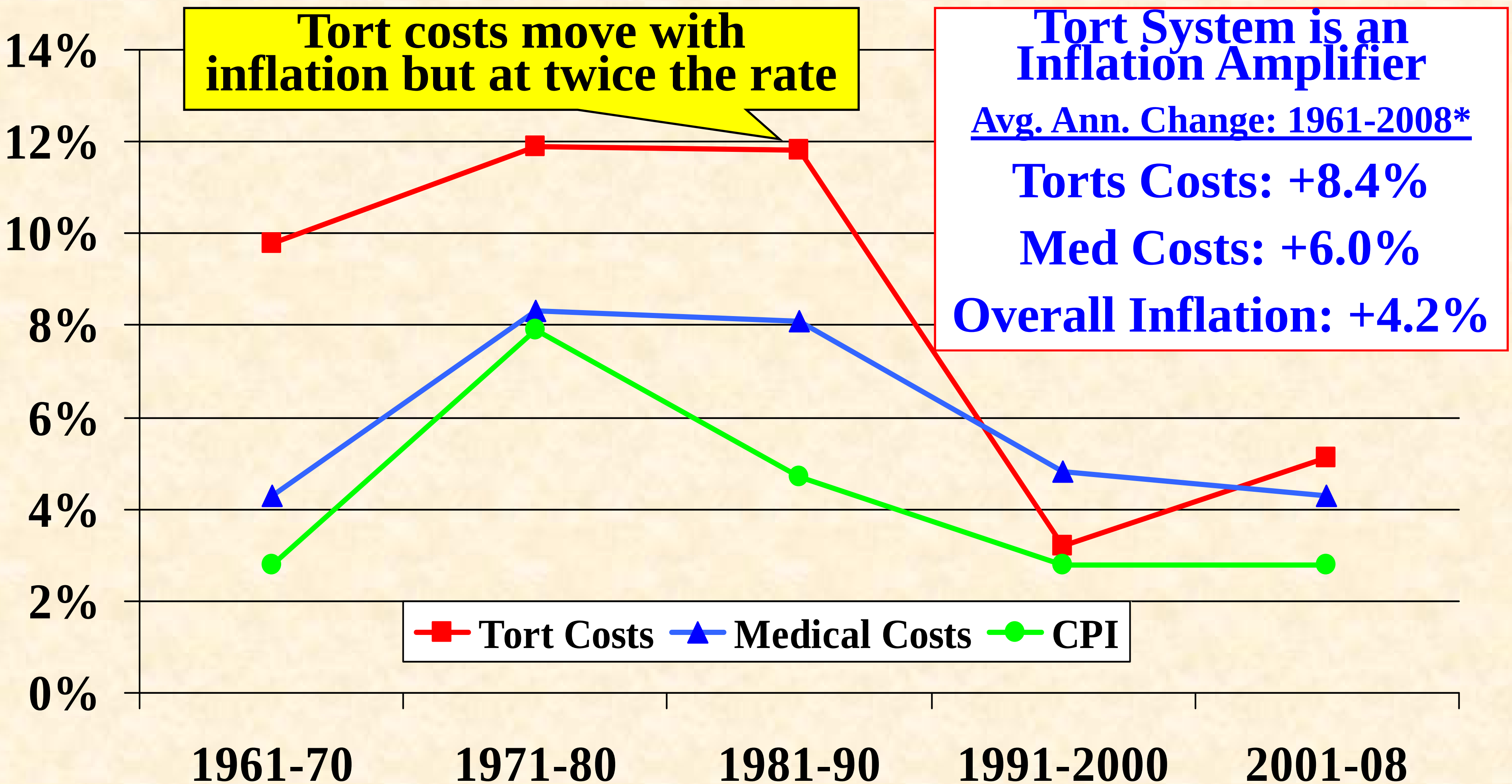
Amplifiers of Inflation, Major Insurance Cost Driver

Consumer Price Index for Medical Care vs. All Items, 1960-2008



Source: Department of Labor (Bureau of Labor Statistics; Insurance Information Institute.

Tort Cost Growth & Medical Cost Inflation vs. Overall Inflation (CPI-U), 1961-2008*



*Medical cost and CPI-U from BLS. Tort figure is for full-year 2008 from Tillinghast.

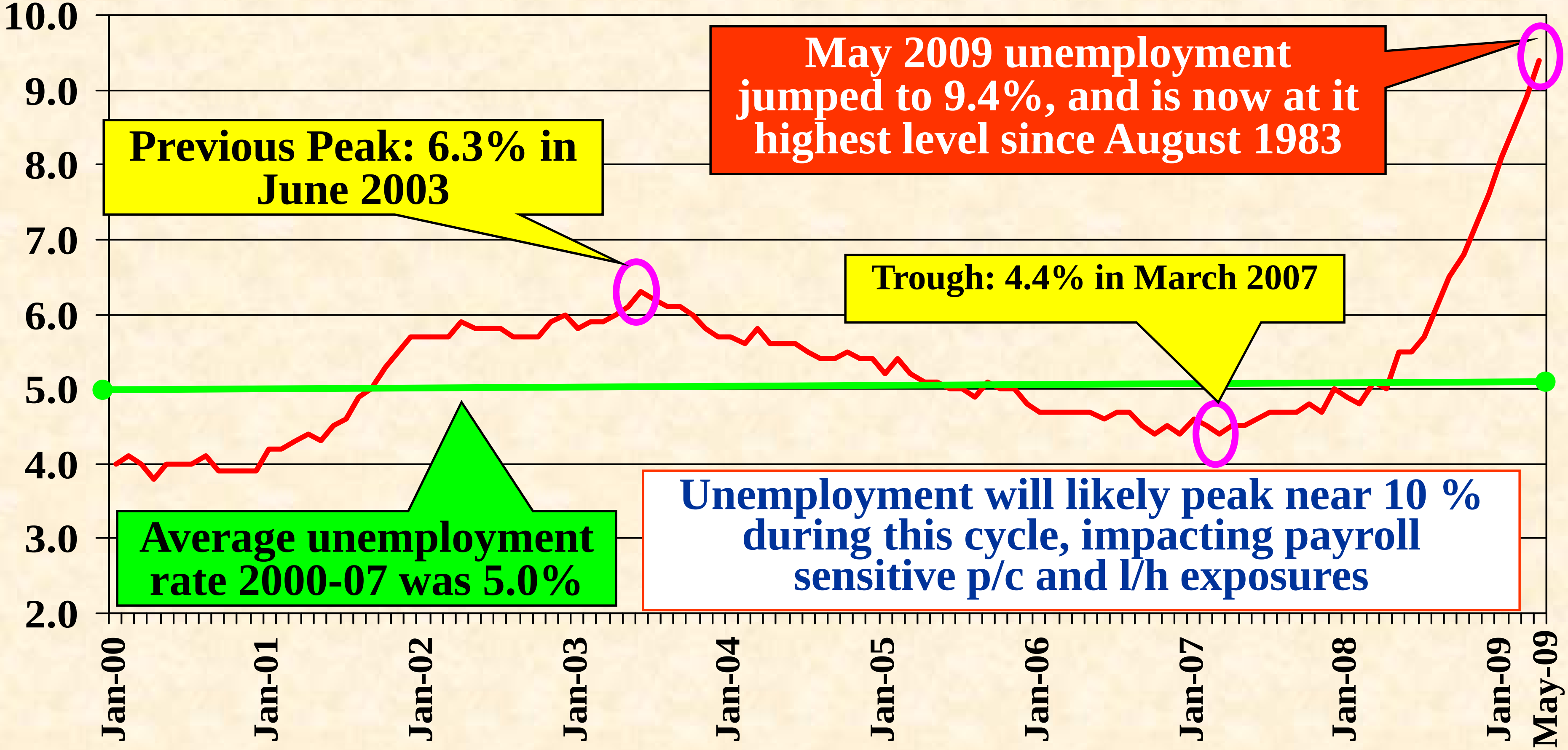
Sources: US Bureau of Labor Statistics, Tillinghast-Towers Perrin, *2007 Update on U.S. Tort Costs;* Insurance Info. Inst.

Labor Market Trends

Fast & Furious: Massive Job Losses Sap the Economy Workers Comp & Other Commercial Exposure

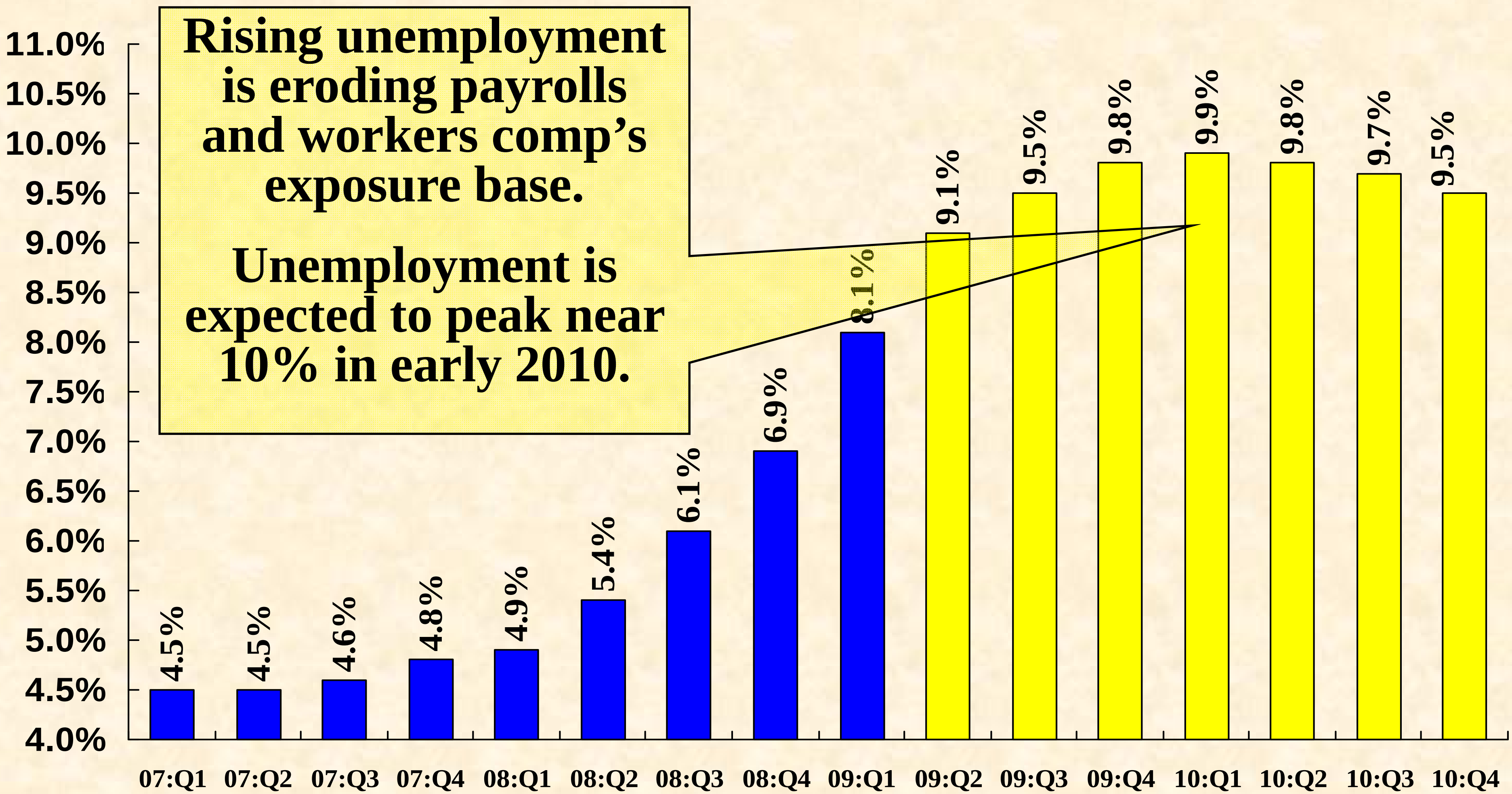
Unemployment Rate: On the Rise

January 2000 through May 2009



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

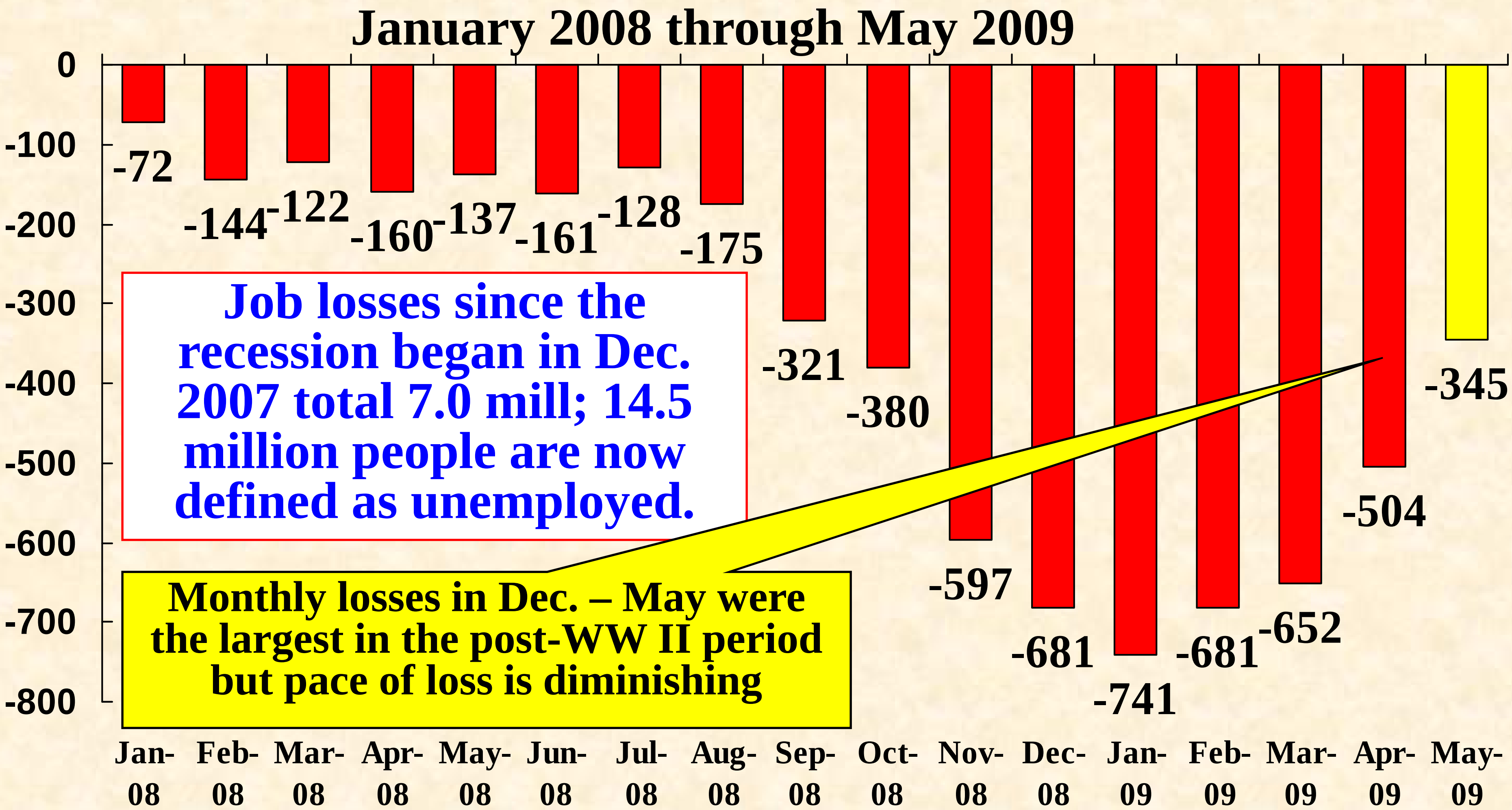
U.S. Unemployment Rate, (2007:Q1 to 2010:Q4F)*



* Blue bars are actual; Yellow bars are forecasts

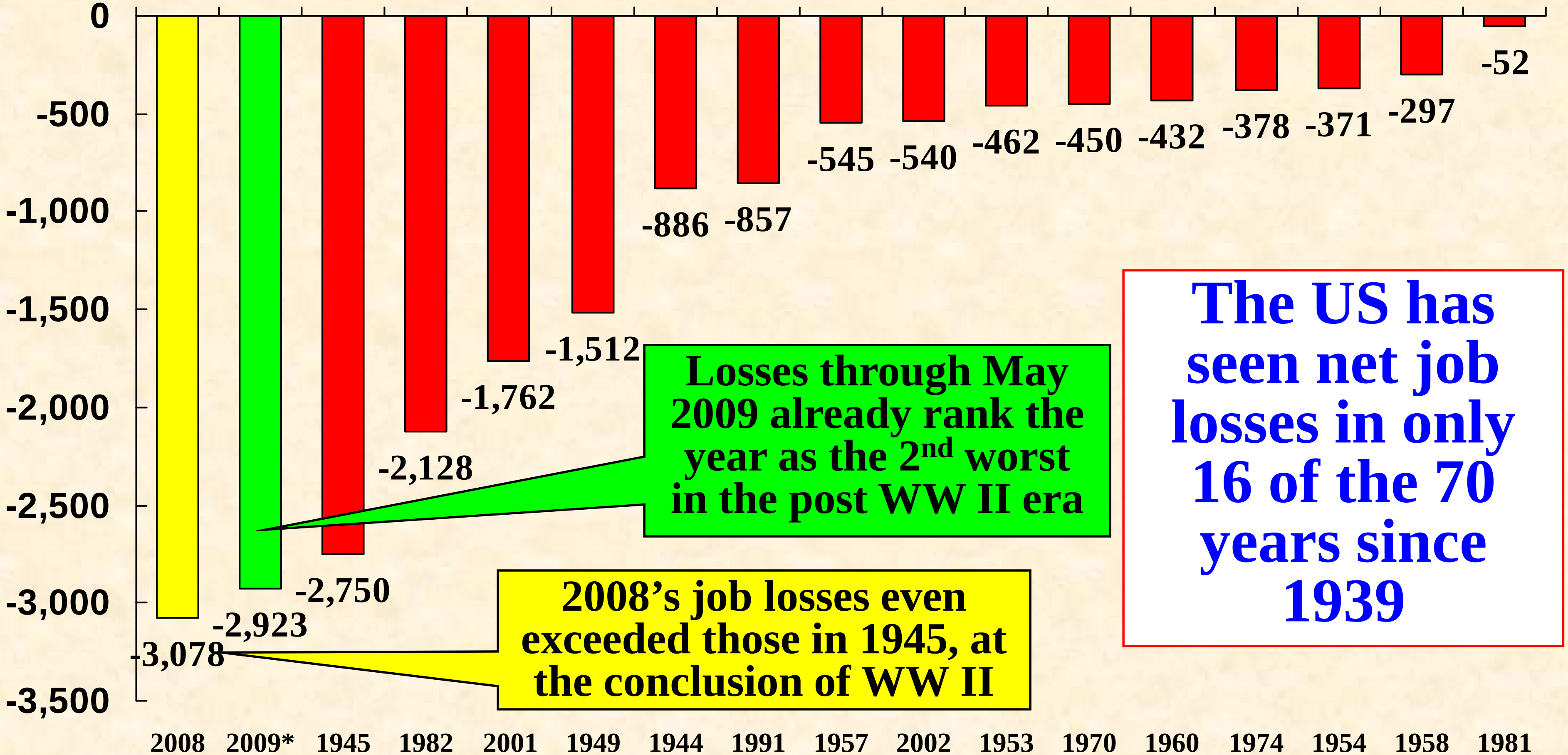
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (6/09); Insurance Info. Inst.

*Monthly Change Employment**
(Thousands)



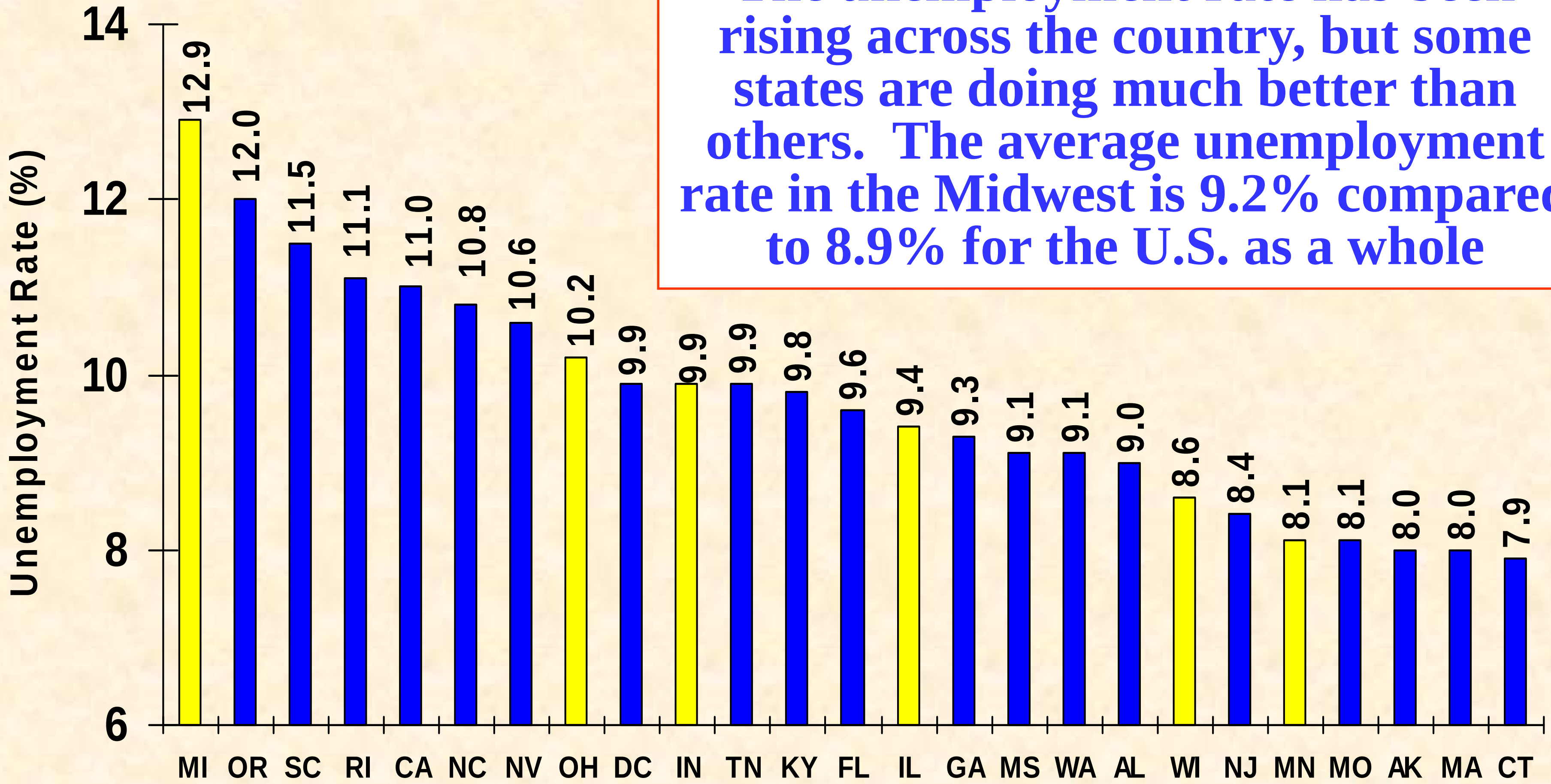
Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Info. Institute

Years With Job Losses: 1939-2009 (Thousands)*



*Through May 2009.
Source: Insurance Information Institute research from US Bureau of Labor Statistics data: http://www.bls.gov/ces/home.htm.

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

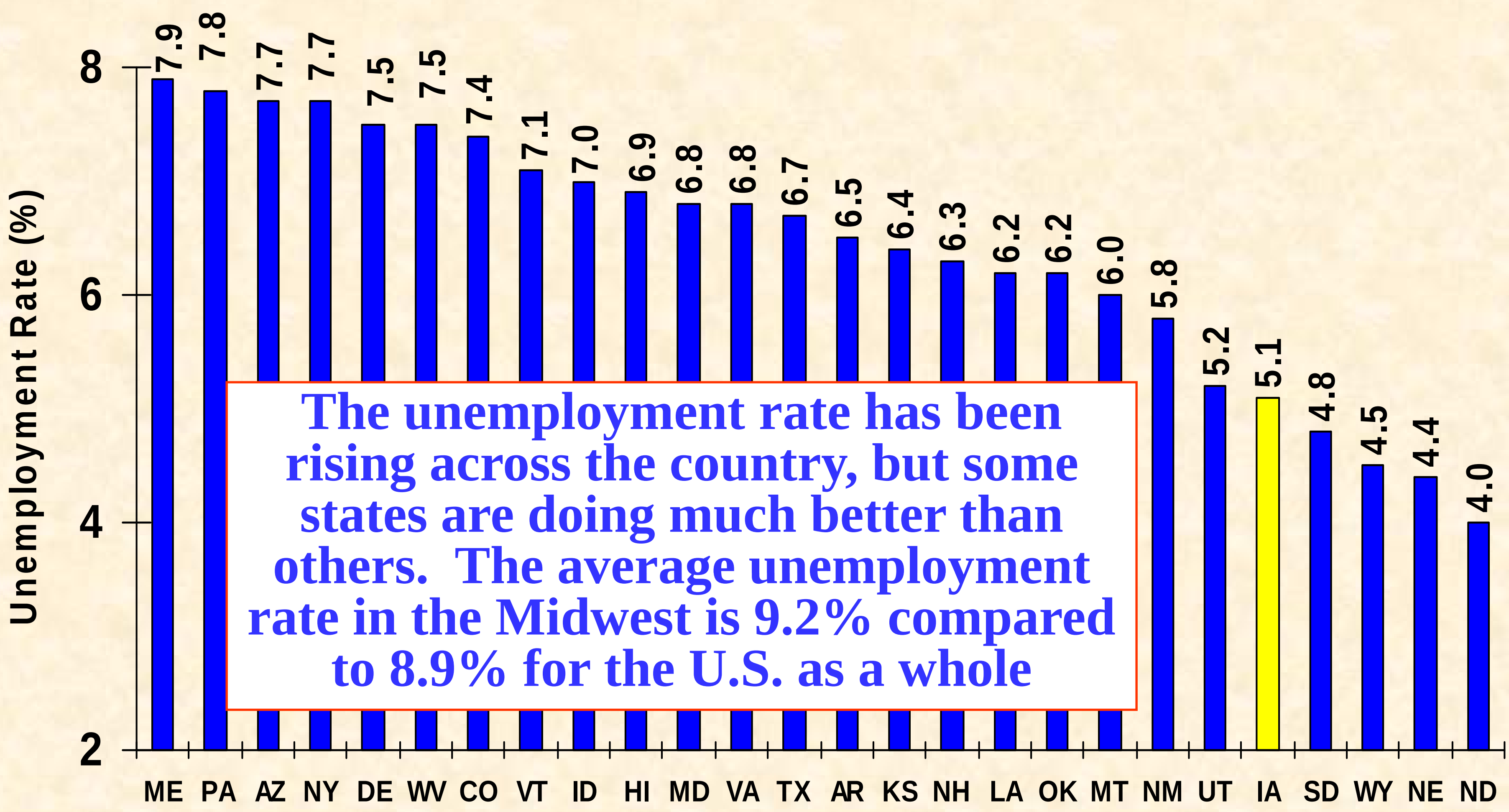


The unemployment rate has been rising across the country, but some states are doing much better than others. The average unemployment rate in the Midwest is 9.2% compared to 8.9% for the U.S. as a whole

*Provisional figures for April 2009, seasonally adjusted.

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

Unemployment Rates by State: Lowest 25 States, April 2009*



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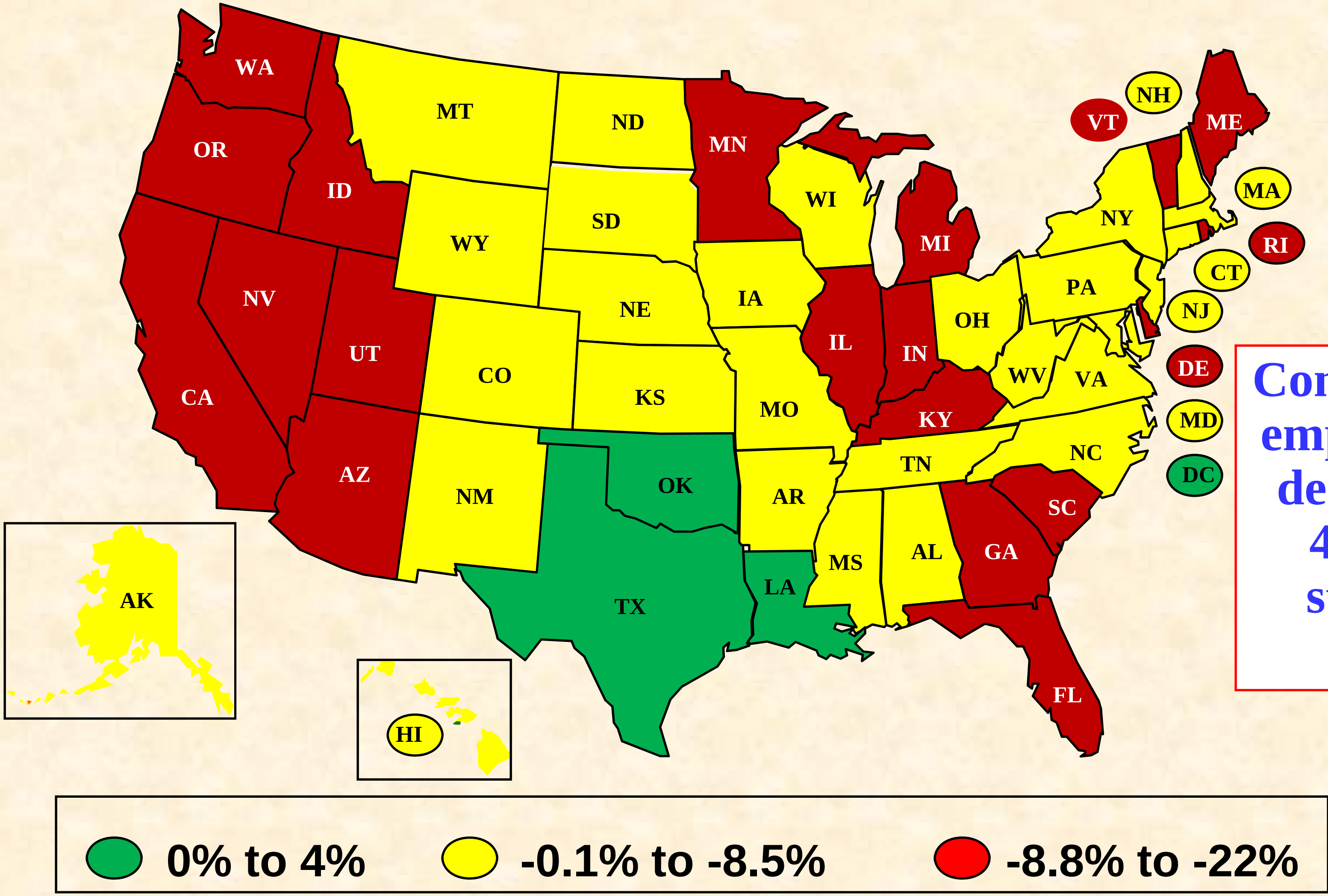
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

State Construction Employment, Dec. 2007 – Dec. 2008



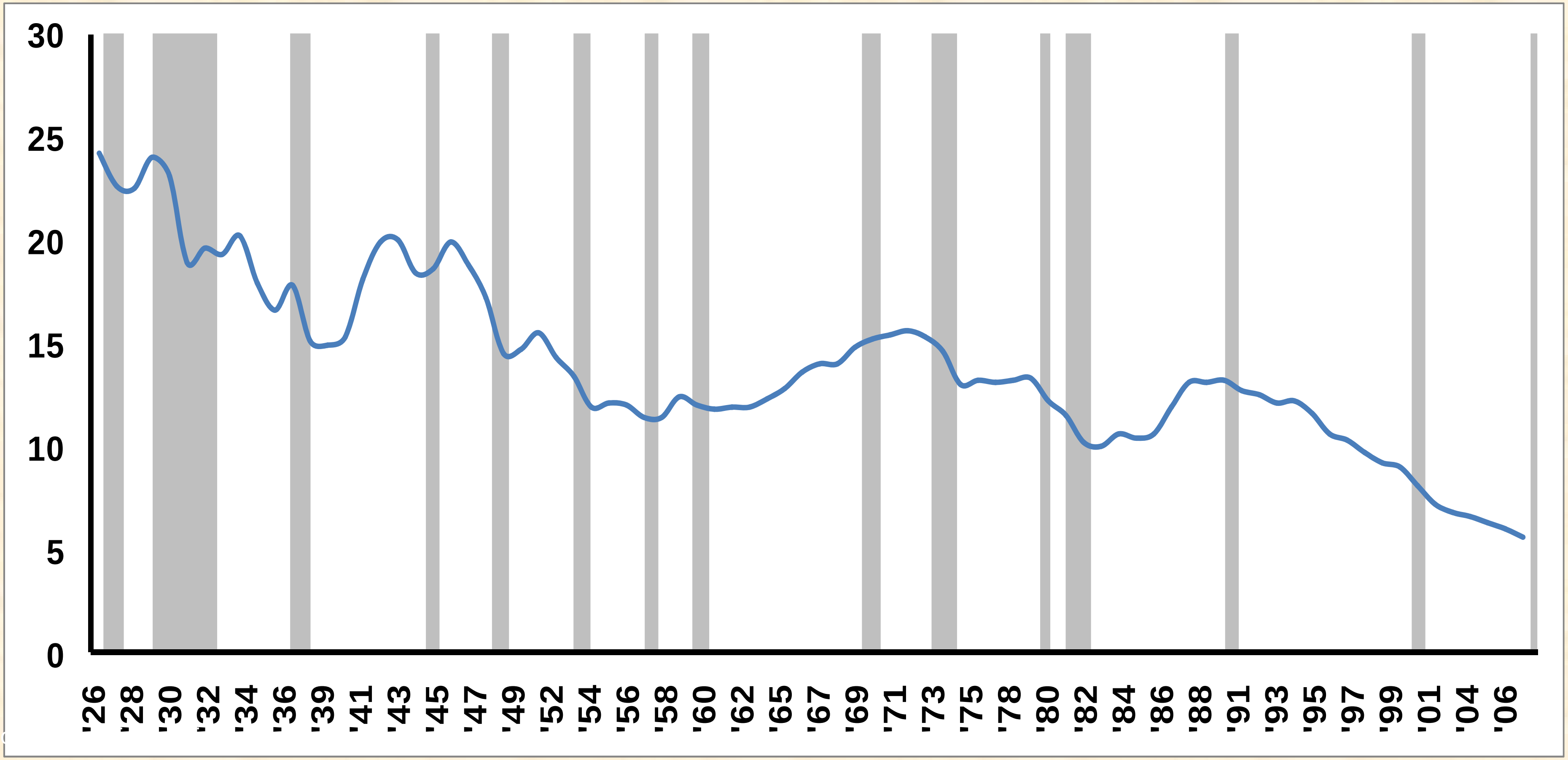
Construction employment declined in 47 of 50 states in 2008

Sources: Associated General Contractors of America from Bureau of Labor Statistics; Insurance Information Institute.

Occup. Injury Freq.: 1926-2008 A Long-Term Drift Downward

Manufacturing—Total Recordable Cases

Rate of Injury and Illness Cases per 100 Full-Time Workers

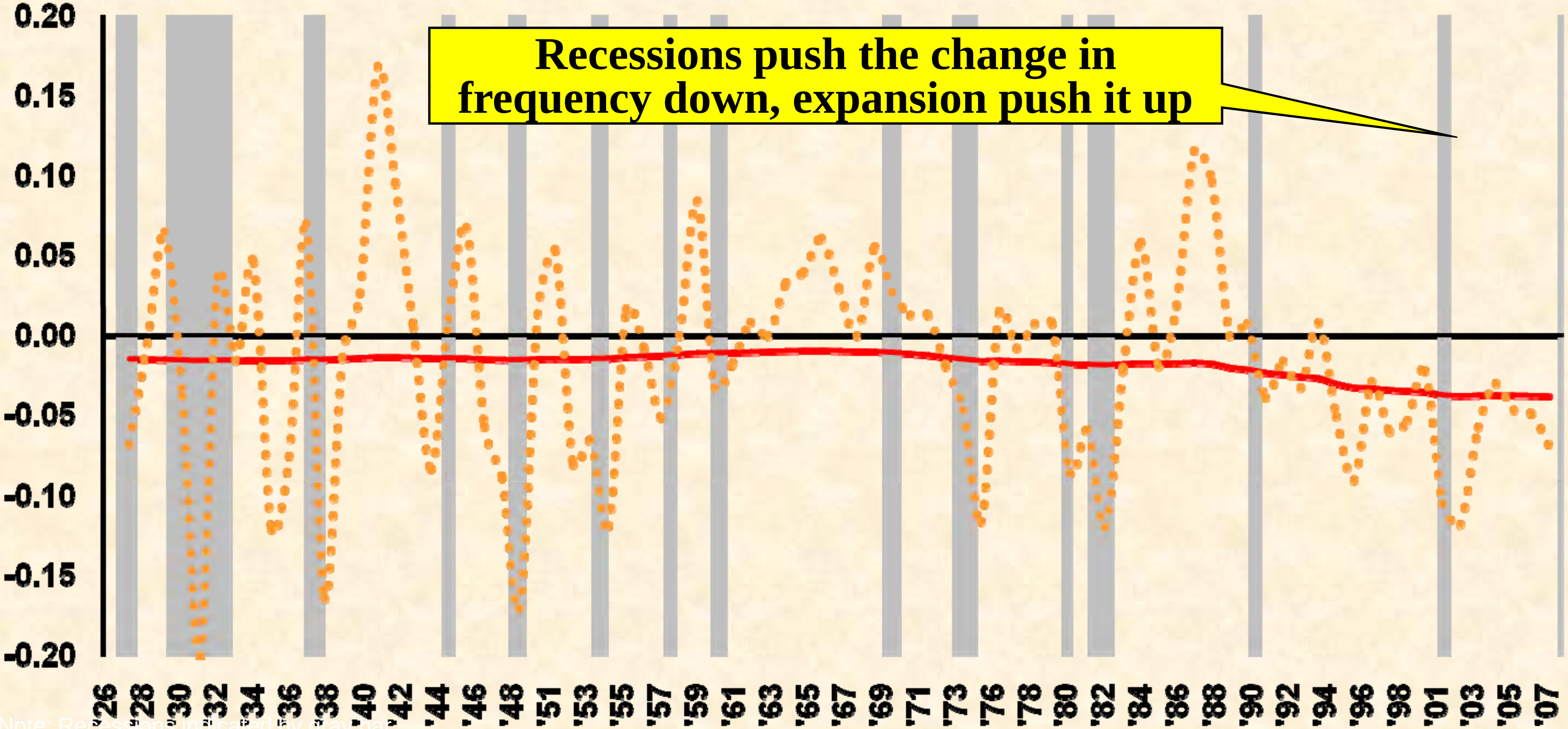


Note: Recessions indicated by gray bar.

Sources: NCCI from U.S. Bureau of Labor Statistics; National Bureau of Economic Research

Change in Frequency: Business Cycle Impacts are Clear

Growth Rates, Workplace Illness and Injury—Manufacturing



Note: Recessions indicated by gray bar

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Sources: NCCI from U.S. Bureau of Labor Statistics; National Bureau of Economic Research

GREEN SHOOTS

Is the Recession Nearing an End?

Hopeful Signs That the Economy Will Begin to Recover Soon

- 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 credit worthy people & businesses
- Housing Sector Likely to Find Bottom Soon
  - 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.

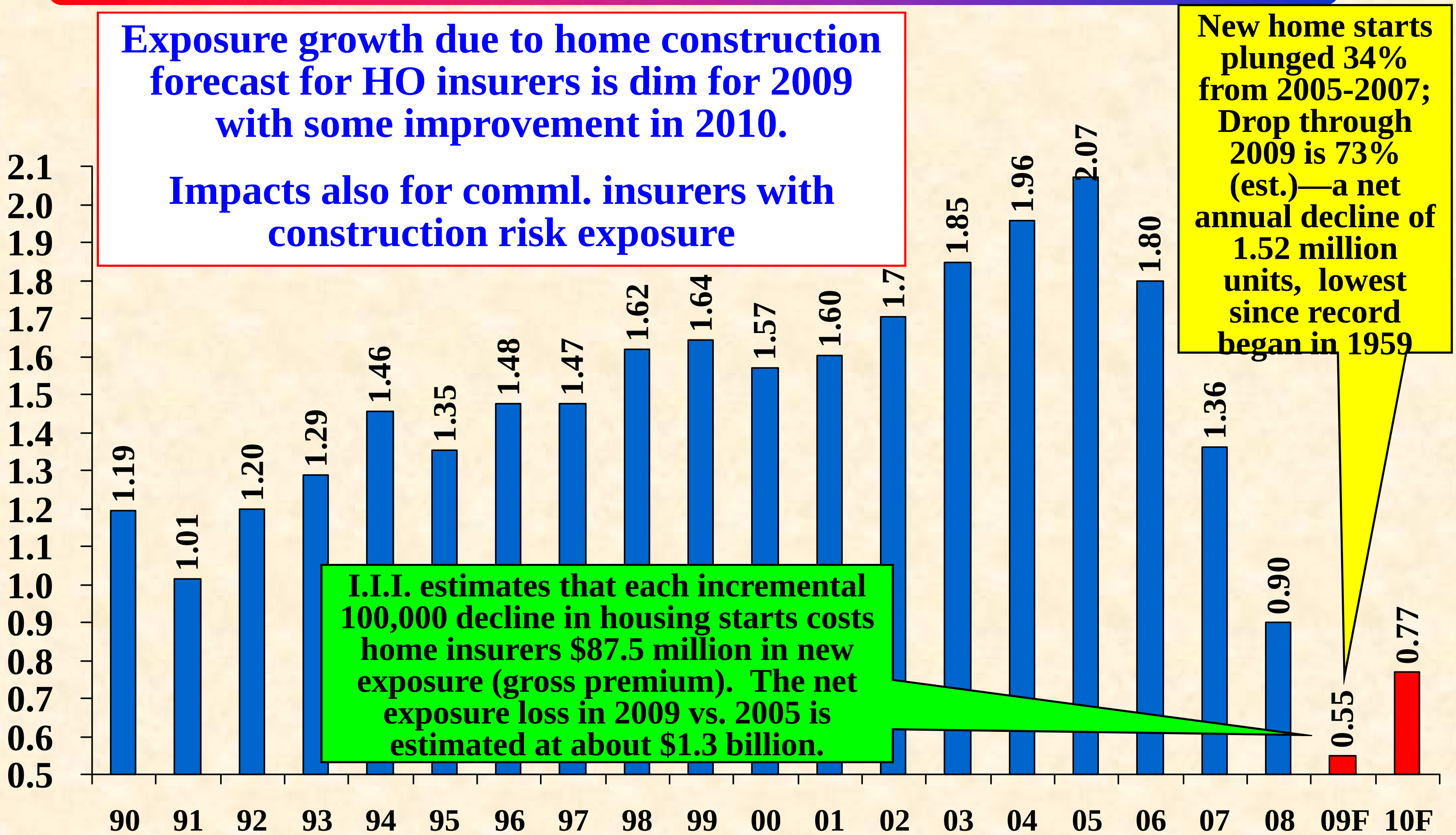
11 Industries for the Next 10 Years: Insurance Solutions Needed

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

Crisis-Driven Exposure Implications

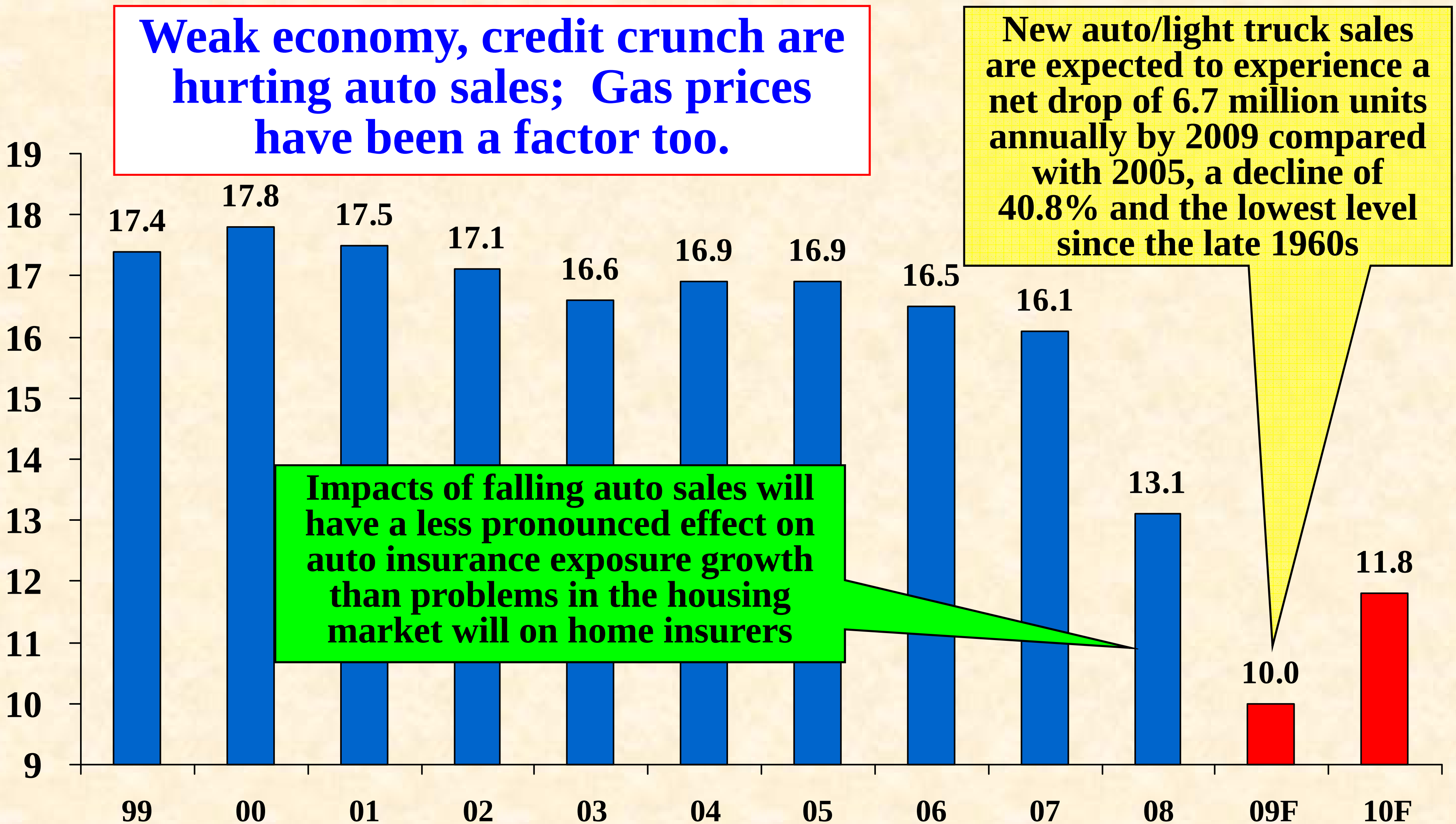
Home, Contractor, Auto, Exposure Growth Slows as Sales Nosedive

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



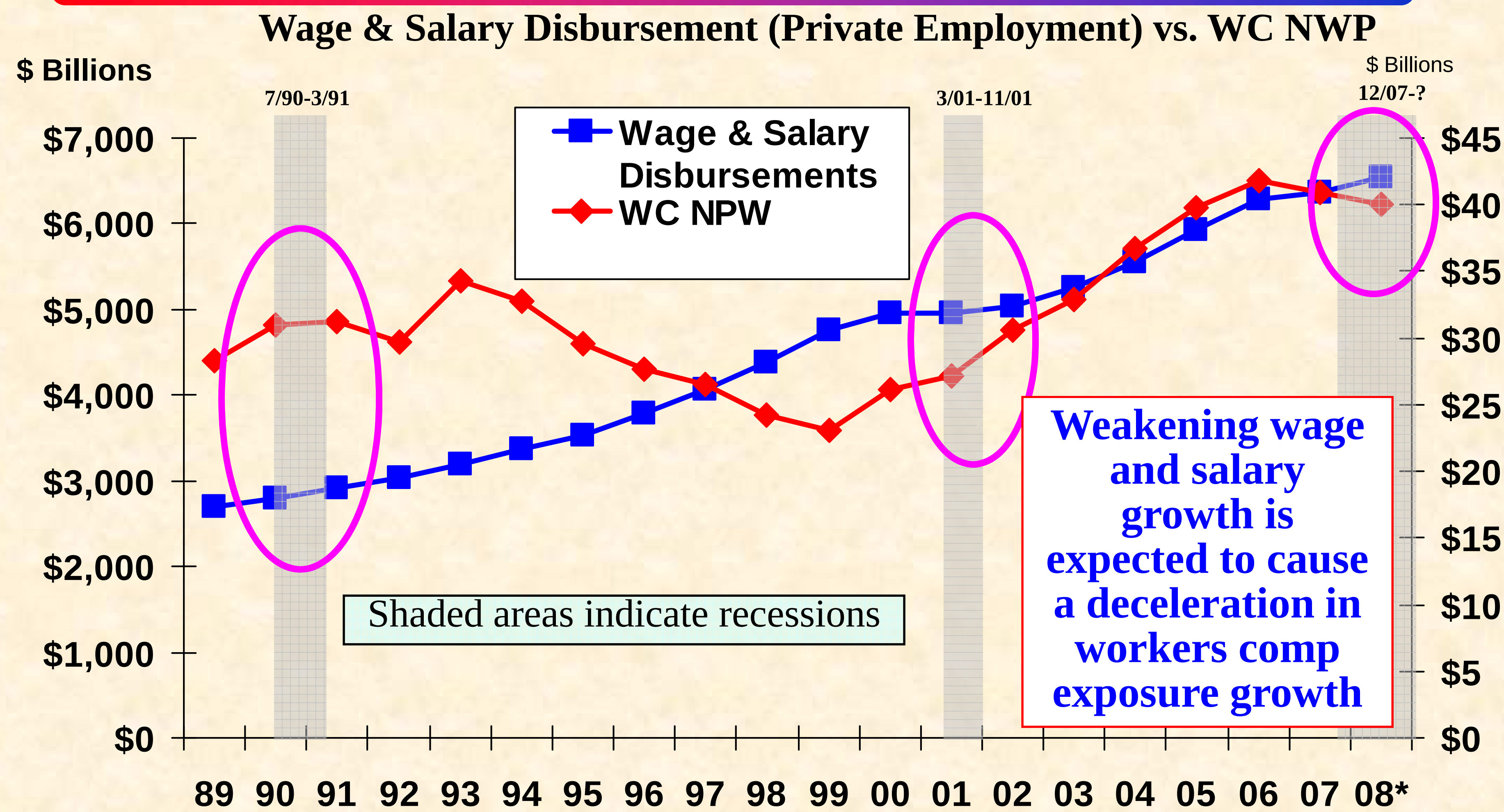
Source: US Department of Commerce; Blue Chip Economic Indicators (6/09); Insurance Information Inst.

Auto/Light Truck Sales, 1999-2010F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (6/09); Insurance Information Inst.

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



*9-month data for 2008

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

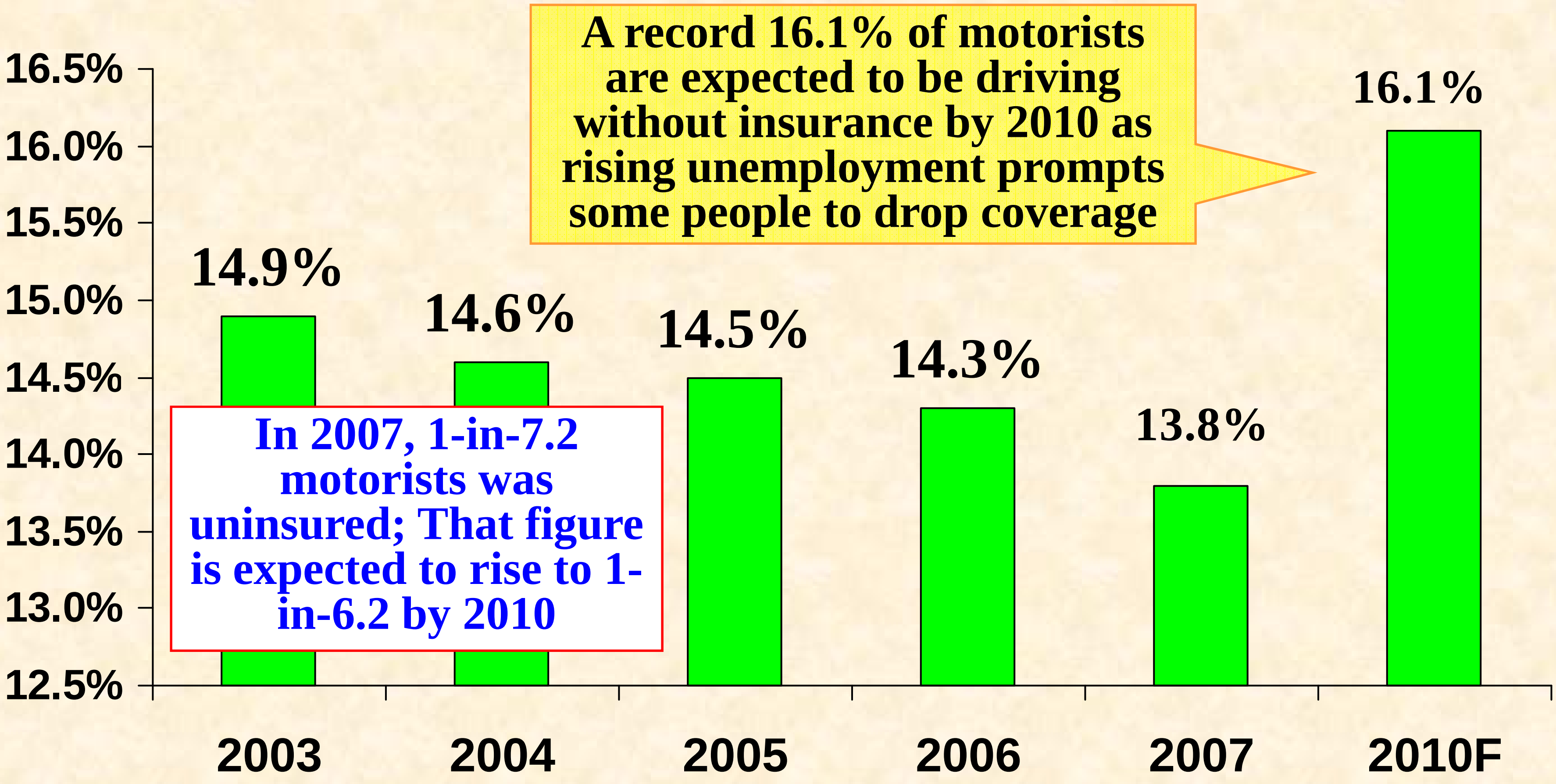
Crisis Implications

Top Crisis-Driven Claim Issues for Personal Lines Insurers

Summary of Short-Run Changes in Claiming Behavior Due to Economy

- **CLAIMING BEHAVIOR**
  - **Claim frequency falls with miles driven. History: Drop is temporary.**
  - **Claim severity continues to rise: med costs, collisions repair costs up**
  - **Likely maintenance on homes, cars deferred→claim. freq/sev. impact?**
- **PURCHASING BEHAVIOR: Efforts to Economize**
  - **More shopping around**
  - **Increased deductibles**
  - **Dropping optional coverages (collision, comprehensive)**
  - **Lower limits**
  - **Insuring fewer vehicles (3 or 4th vehicle sold)**
  - **Insuring older vehicles (old cars retained, new car purchases deferred)**
- **UNINSURED/UNDERINSURED MOTORIST % RISES**
  - **Expected to rise from 13.8% in 2007 to 16.1% in 2010**
- **FRAUD & ABUSE:**
  - **Evidence emerging of increased frequency of "give-ups" where car owners underwater on payments commit fraud to obtain insurance money (e.g., car arson, fabricated theft, etc.)**
  - **Anecdotal evidence of owner-caused home arson**

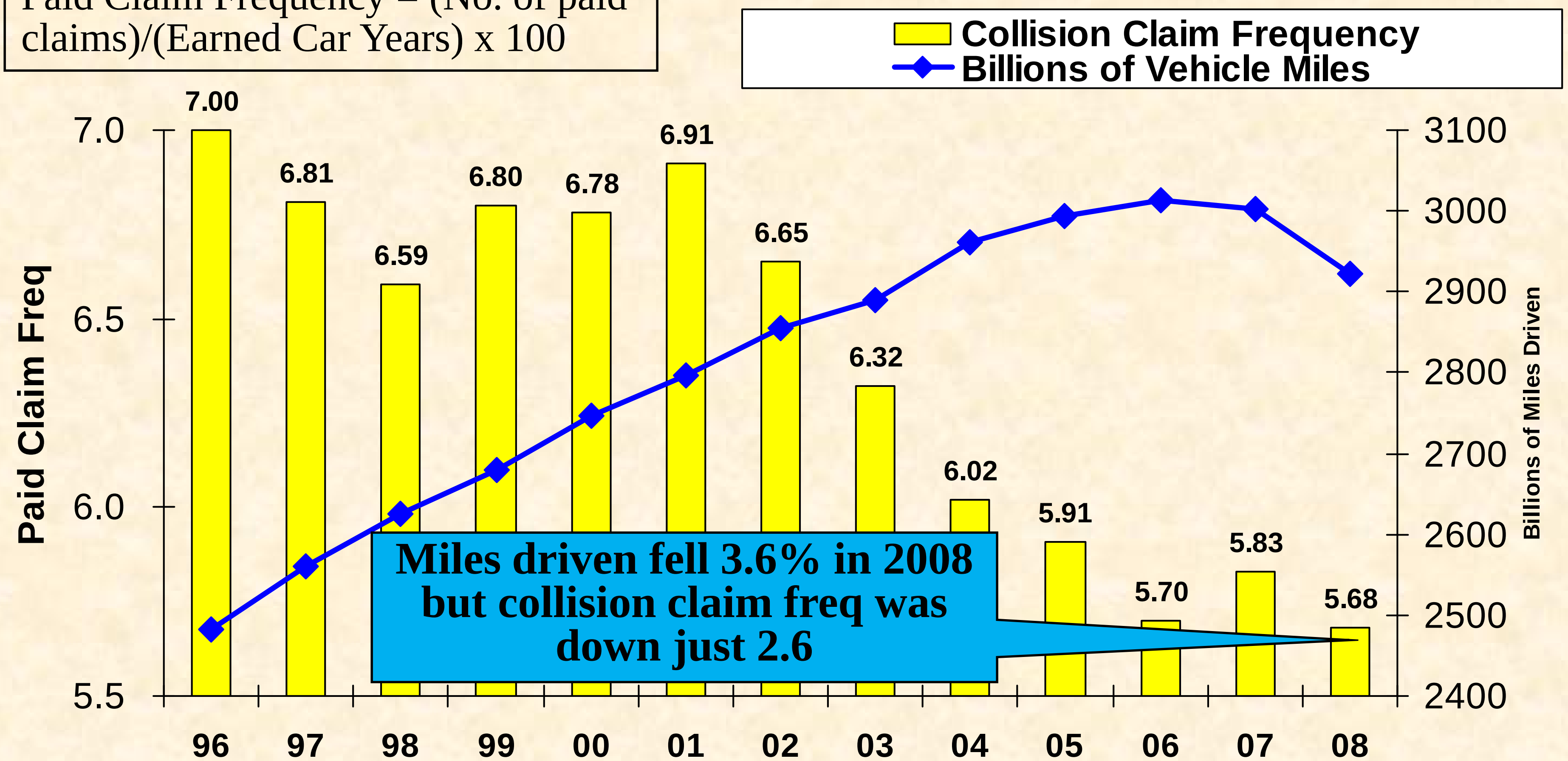
Percentage Motorists Driving Without Insurance, 2003-2010F



Source: *Uninsured Motorists, 2008* Edition, Insurance Research Council; Insurance Information Institute

Do Changes in **Miles Driven** Affect Auto Collision Claim Frequency?

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



Sources: Federal Highway Administration (http://www.fhwa.dot.gov/ohim/tvtw/08septvt/index.cfm; ISO Fast Track Monitoring System, *Private Passenger Automobile Fast Track Data*: Nine Months 2008, published April 1, 2009 and earlier reports. *2008 ISO figure is for 4 quarters ending Q4 2008.

Auto Insurance: Claim Frequency Impacts of Energy Crisis of 1973/4

Oct. 17, 1973: Arab oil embargo begins

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

Frequency Impacts

Collision: -7.7%

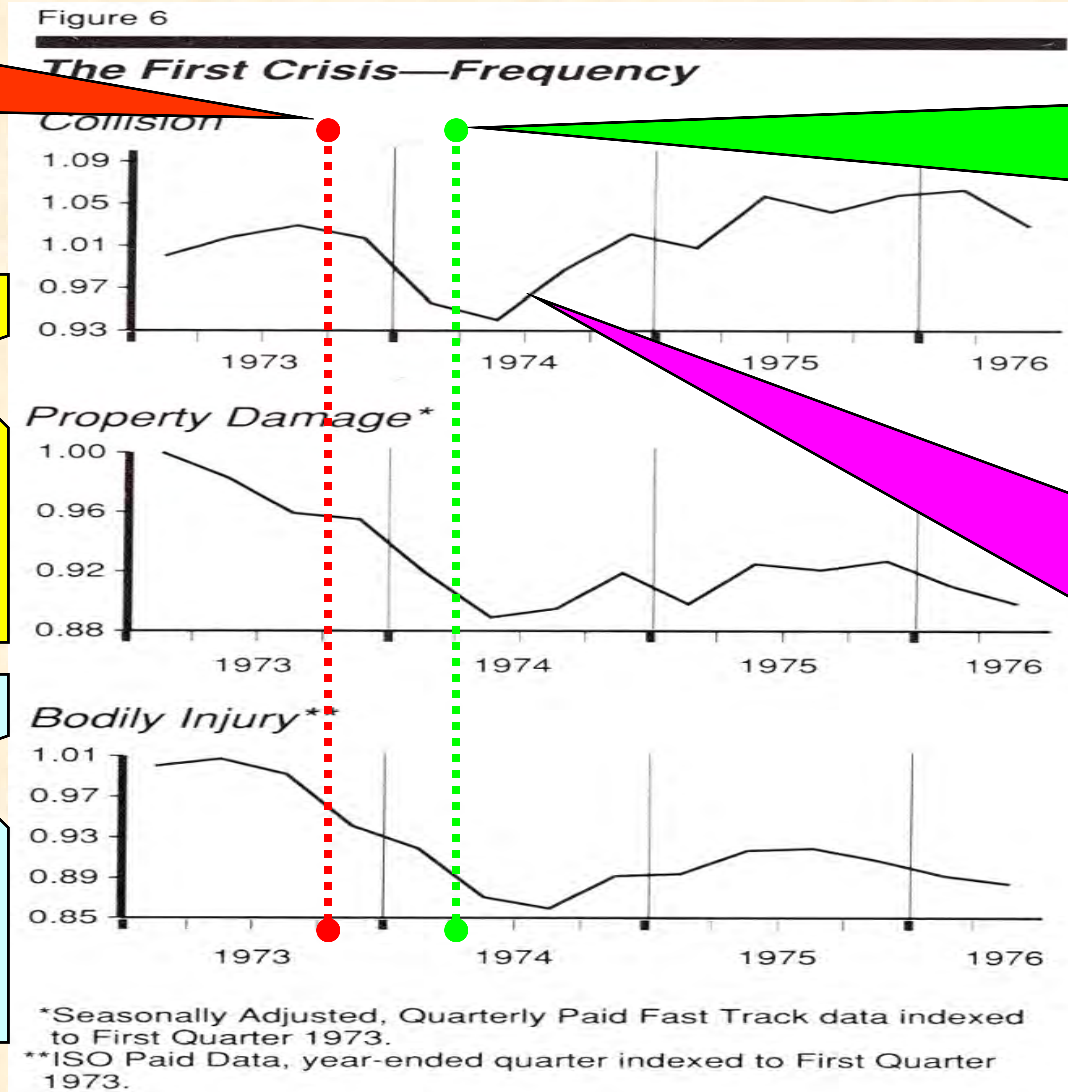
PD: -9.5%

BI: -13.3%

Driving Stats

Gas prices rose 35-40%

Miles driven fell 6.7% in 1974



Frequency began to rebound almost immediately after the embargo ended

Source: ISO, US DOT.

AFTERSHOCK

What Will the P/C Insurance Industry Look Like After the Crisis?

6 Key Differences

6 Key Differences: P/C Insurance in the Post-Financial Catastrophe World

1. **The P/C Insurance Industry Will Be Smaller: The Industry Will Have Shrunk by About 3% in Dollar Terms and by 7% on an Inflation Adjusted Basis, 2007-09**
   - Falling prices, weak exposure growth, increasing government intervention in private (re)insurance markets, large retentions and alternative forms of risk transfer have siphoned away premium
   - There will be fewer competitors after a mini consolidation wave

2. **P/C Industry Will Emerge With Its Risk Mgmt. Model More Intact than Most other Financial Service Segments**
   - Benefits of risk-based underwriting, pricing and low leverage clear

3. **There Will Be Federal Regulation of Insurers: Now in Waning Months of Pure State-Based Regulation**
   - Federal regulation of "systemically important" firms seems certain
   - Solvency and Rates regulation, Consumer Protection may be shared
   - Dual regulation likely; federal/state regulatory conflicts are likely
   - With the federal nose under the tent, anything is possible
   - Life insurers want federal regulation

Source: Insurance Info. Inst.

6 Key Differences: P/C Insurance in the Post-Financial Catastrophe World

4. **Investment Earnings Will Shrink Dramatically for an Extended Period of Time: Federal Reserve Policy, Shrinking Dividends, Aversion to Stocks**
   - **Trajectory toward lower investment earnings is being locked in**

5. **Back to Basics: Insurers Return to Underwriting Roots: Extended Period of Low Investments Exert Greatest Pressure to Generate Underwriting Profits Since 1960s**
   - **Chastened and "derisked" but facing the same (or higher) expected losses, insurers must work harder to match risk to price**

6. **P/C Insurers: Profitable Before, During & *After* Crisis: Resiliency Once Again Proven**
   - **Directly the result of industry's risk management practices**

Source: Insurance Information 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 are larger and occurring more rapidly than is commonly understood or presumed
- Surplus down 13%=$66B since 9/30/07 peak; 12% ($80B) in 2008
- P/C policyholder surplus could be even more by year-end 2009
- Some insurers propped up results by reserve releases
- Decline in PHS of 1999-2002 was 15% over 3 years and was entirely made up and them some in 2003. Current decline is ~13% 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 could fall much farther and faster than many believe. It will take years to return to the 2007 peaks (likely until 2011 with a sharp hard market and 2015 without one)

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" could lead 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, 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**
- **Price bubble in Treasury securities keeps yields low**
- **Many insurers have not adjusted to this new investment paradigm of a sustained period of low investment gains**
- ***Regulators will <u>not</u> 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)**
- **Danger is high as feds get their nose under the tent**
- **Status Quo is viewed as unacceptable by all**
- **Pushing for major change is not without *significant* risk in the current highly charged political environment**
- **Insurance & systemic risk**
- **Disunity within the insurance industry**
- **Impact of regulatory changes will be felt for decades**
- **Bottom Line: Regulatory outcome is uncertain and risk of adverse outcome is high**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

5. Creeping Restrictions on Underwriting

- Attacks on underwriting criteria such as credit, education, occupation, territory increasing
- Industry will lose some battles
- View that use of numerous criteria are discriminatory and create an adverse impact on certain populations
- Impact will be to degrade the accuracy of rating systems to increase subsidies
- Predictive modeling also at risk
- Current social and economic environment could accelerate these efforts
- Danger that bans could be codified at federal level during regulatory overhaul
- **Bottom Line: Industry must be prepared to defend existing and new criteria indefinitely**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 -2015

6. **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**

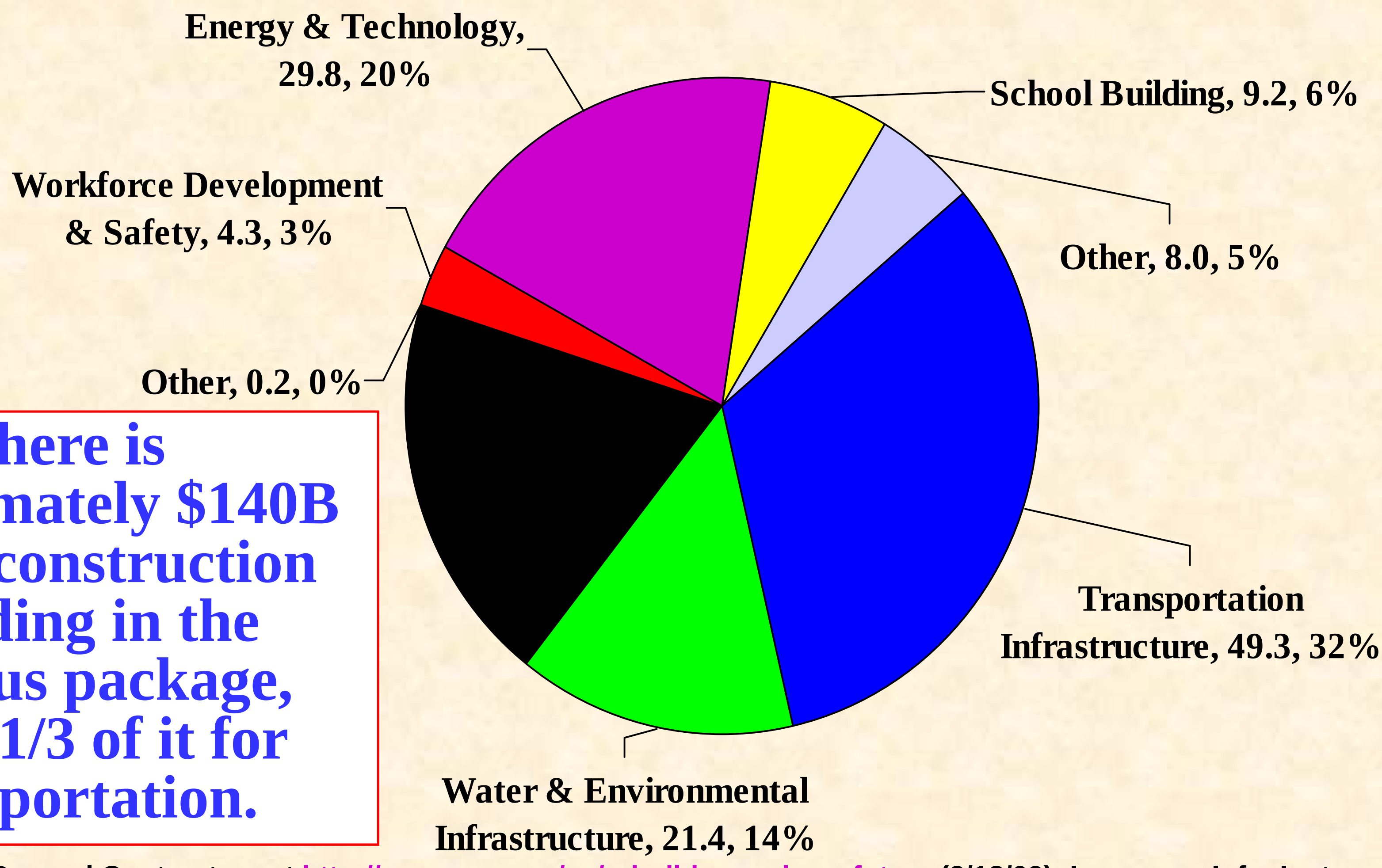
Source: Insurance Information Inst.

THE $787 BILLION ECONOMIC STIMULUS

Sectoral Impacts & Implications for P/C Insurance

Economic Stimulus Package: $143.4 in Construction Spending

$ Billions



There is approximately $140B in new construction spending in the stimulus package, about 1/3 of it for transportation.

Source: Associated General Contractors at http://www.agc.org/cs/rebuild_americas_future (2/18/09); Insurance Info. Inst..

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

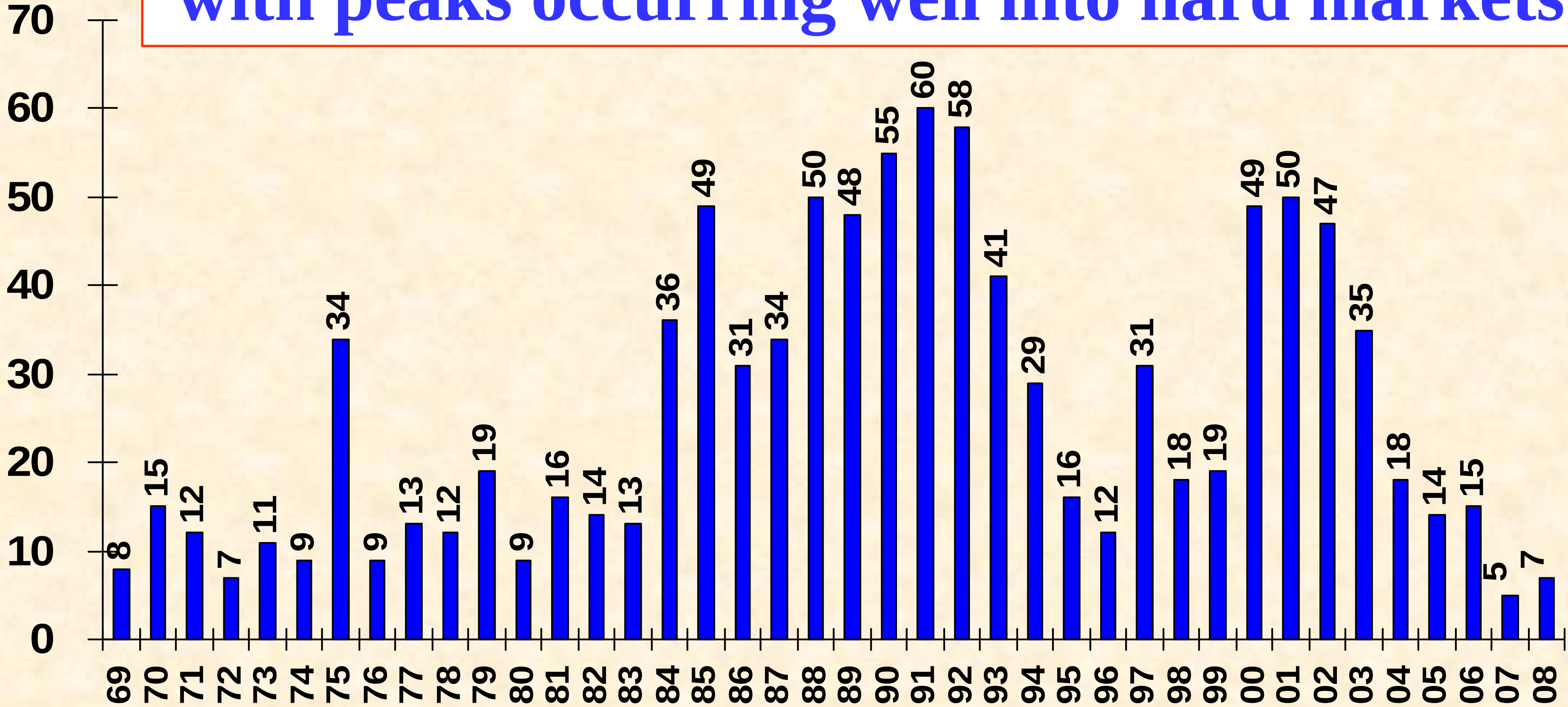
Sources: http://www.recovery.gov/; Council of Economic Advisers Insurance Information Institute.

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well

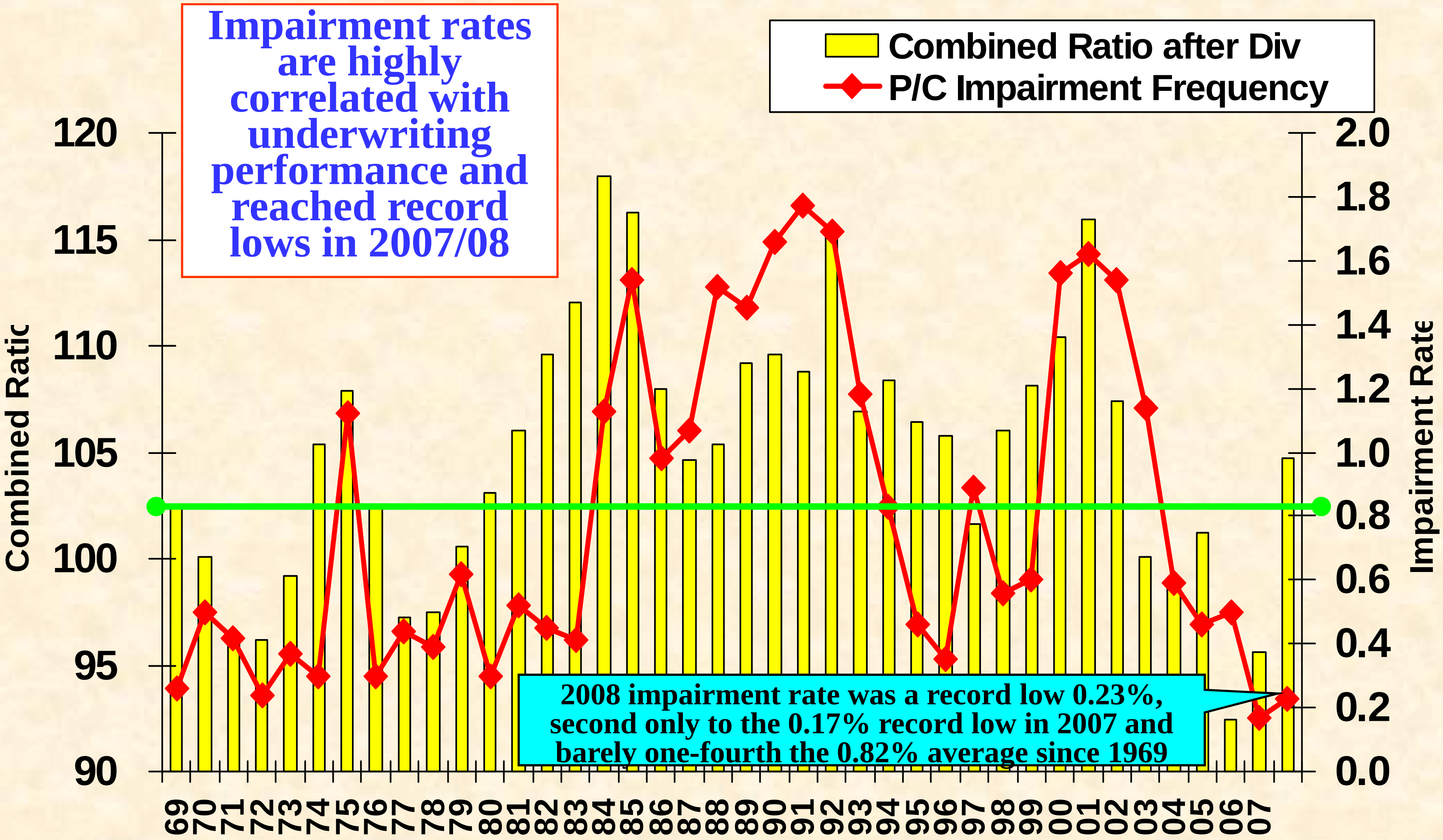
P/C Insurer Impairments, 1969-2008

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

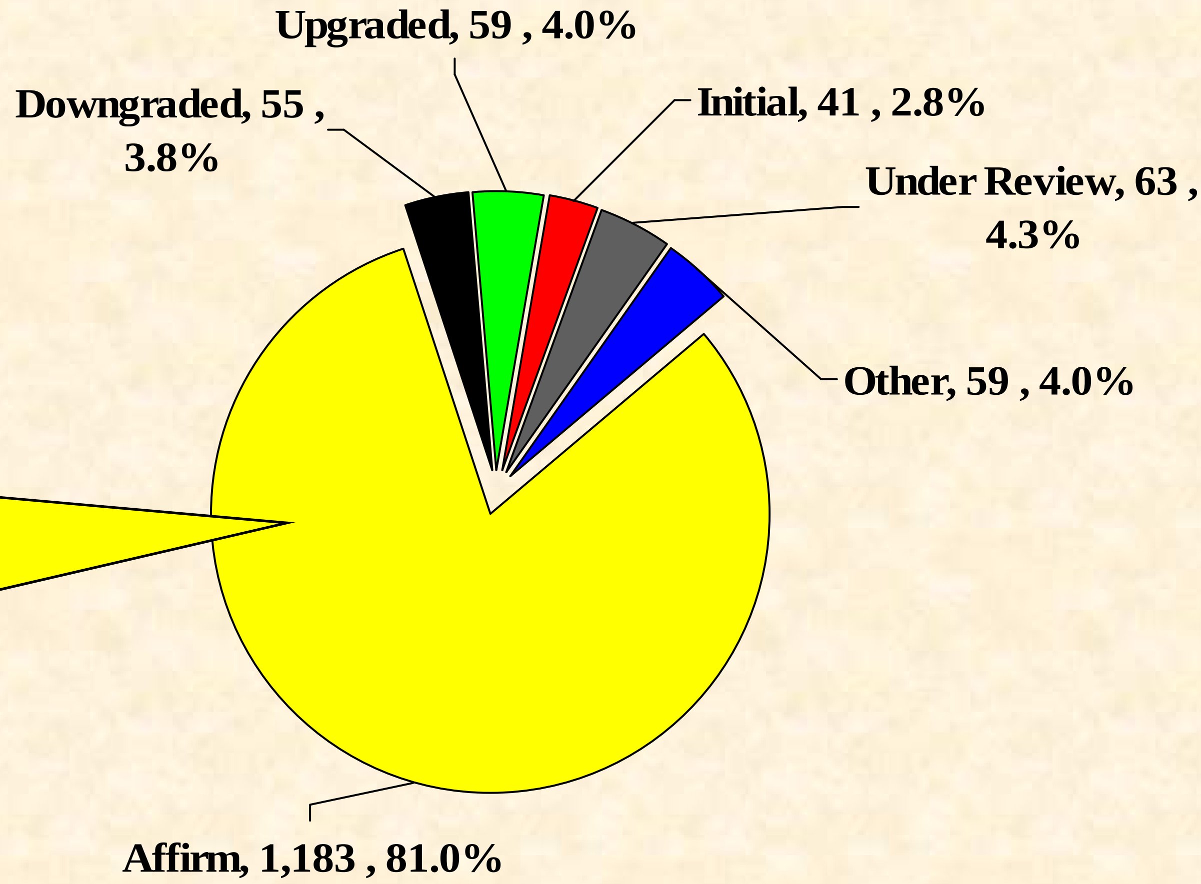


Source: A.M. Best; Insurance Information Institute

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

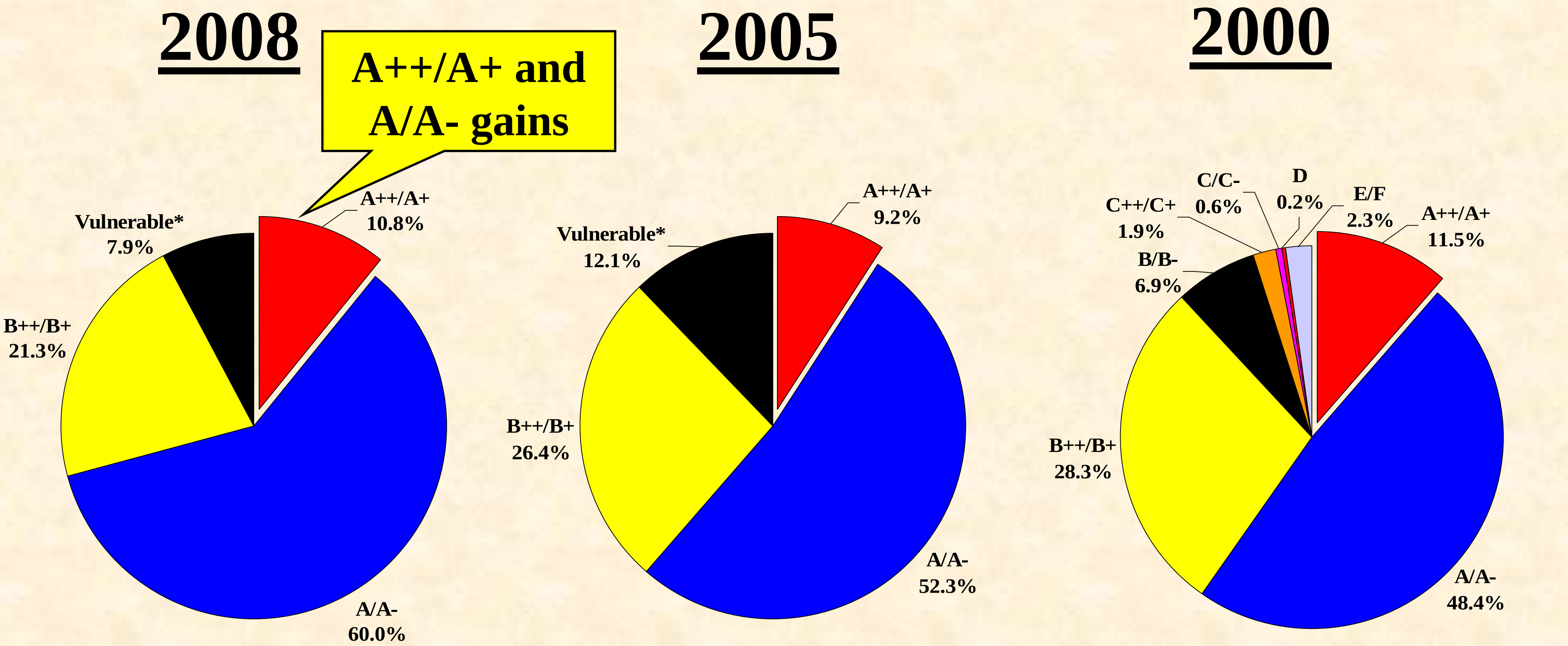
P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.

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.

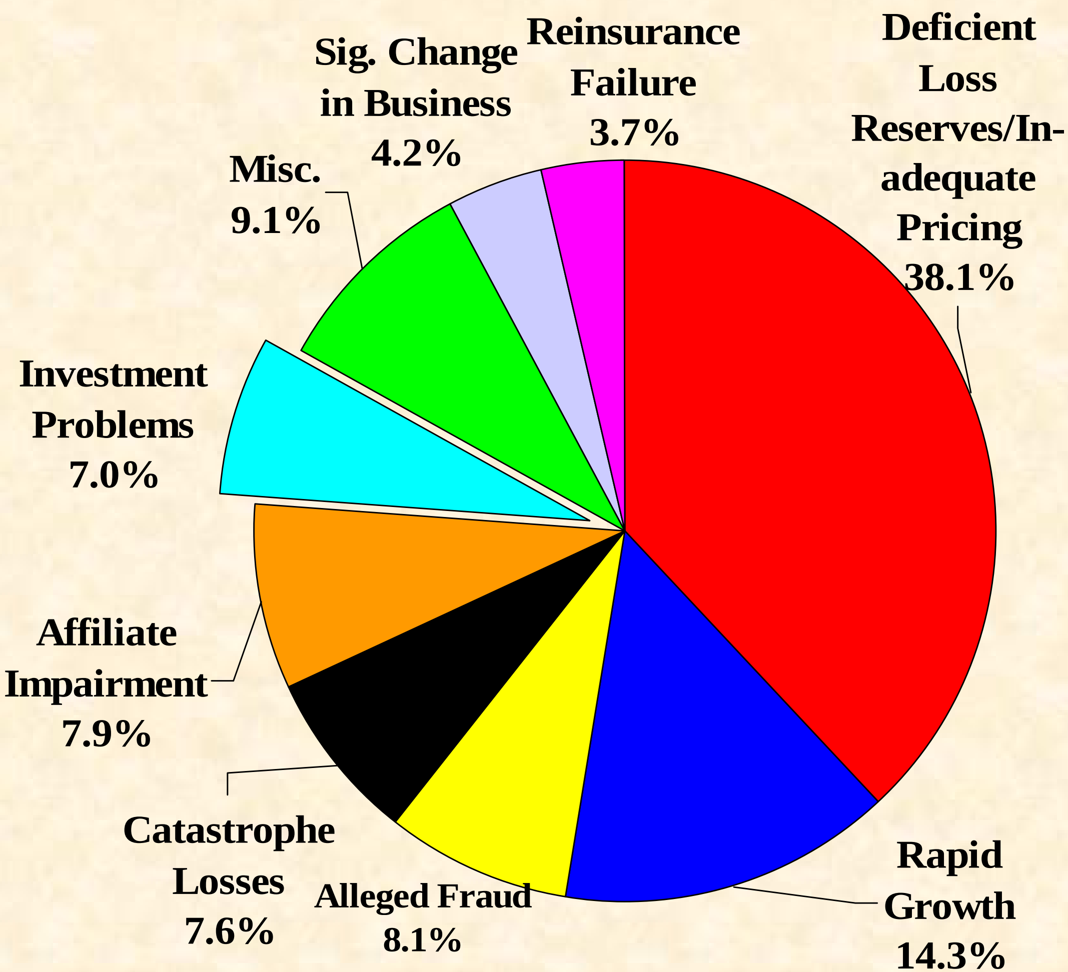
Historical Ratings Distribution, US P/C Insurers, 2008 vs. 2005 and 2000



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 61 banks have gone under as of 5/31)**
    - ***The Promise is Being Fulfilled***
  - **Renew existing policies (banks are reducing and eliminating lines of credit)**
  - **Write new policies (banks are turning away people who want or need to borrow)**
  - **Develop new products (banks are scaling back the products they offer)**

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

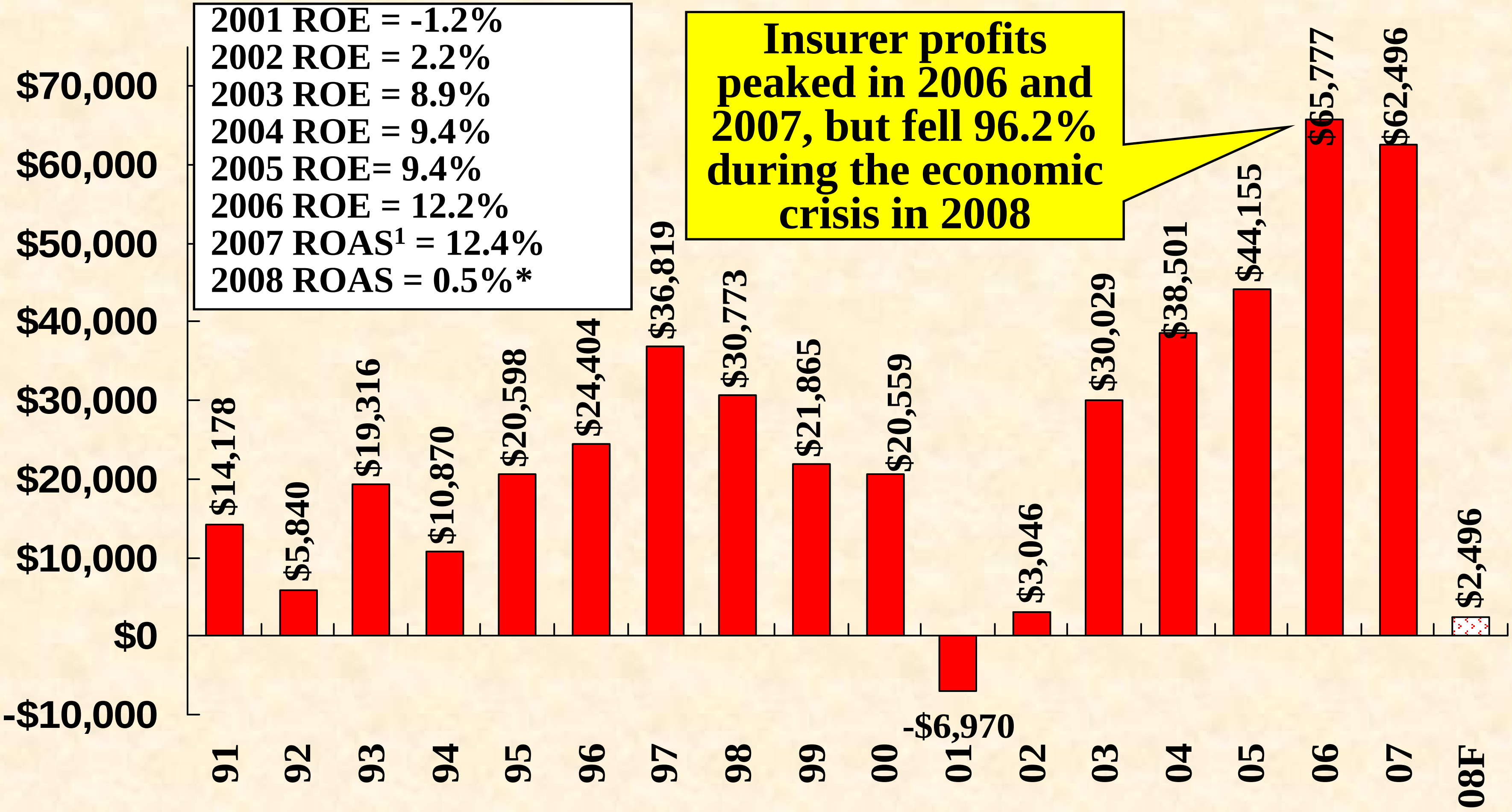
P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

Historically Volatile

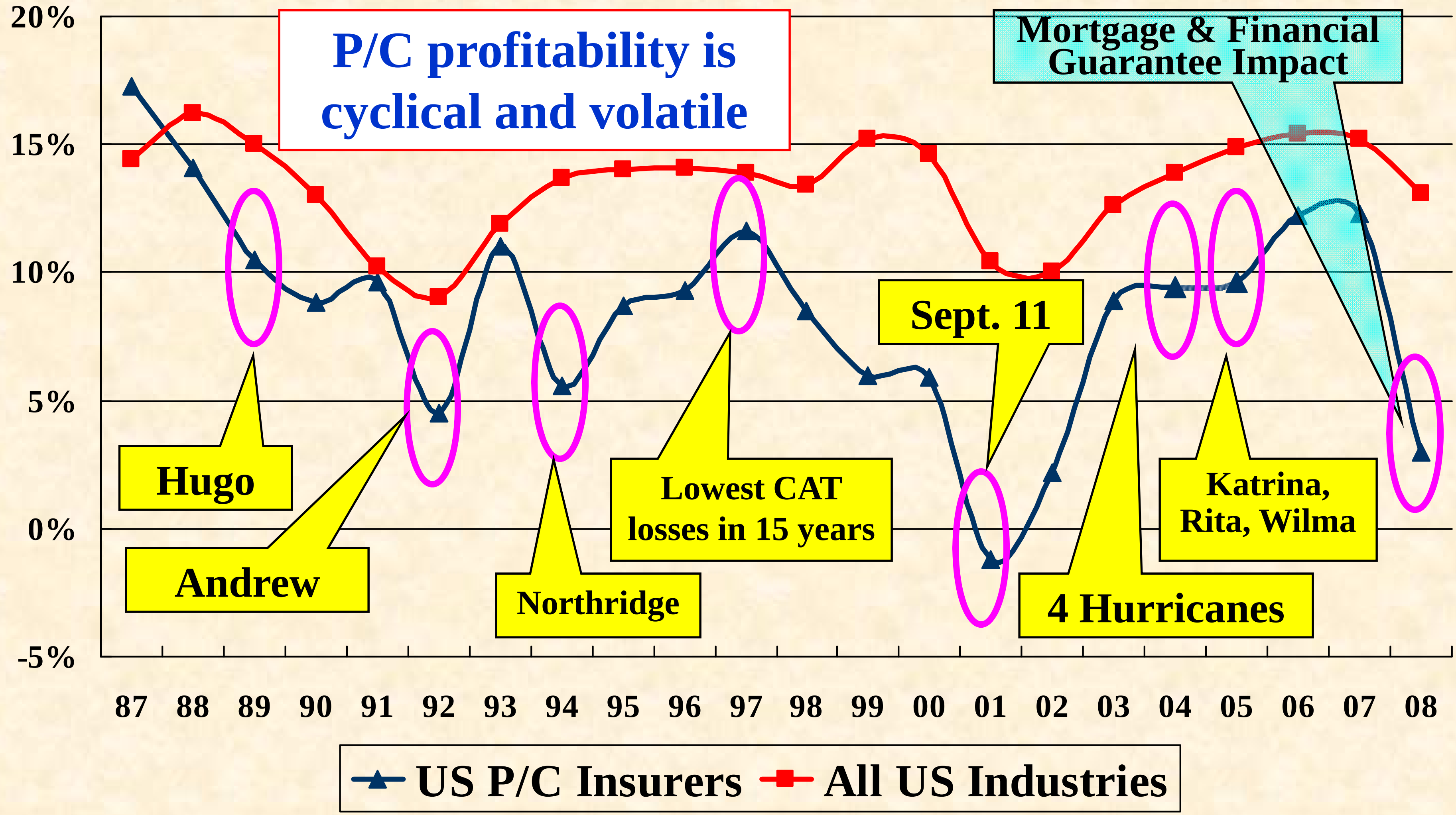
P/C Net Income After Taxes 1991-2008F ($ Millions)*



***ROE figures are GAAP; [1]Return on avg. Surplus. Excluding Mortgage & Financial Guarantee insurers yields an 4.2% ROAS for 2008.**

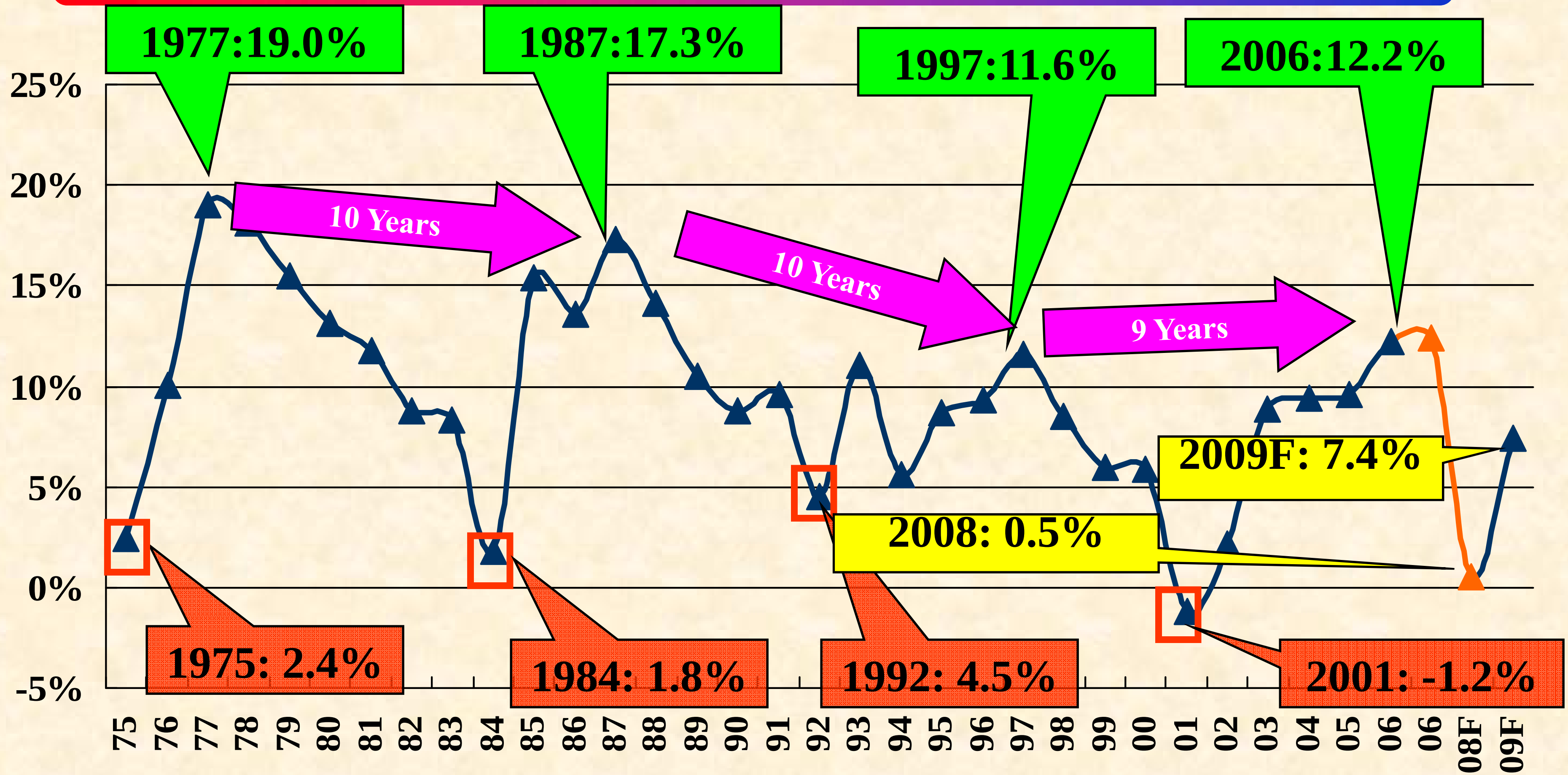
Sources: A.M. Best, ISO, Insurance Information Inst.

ROE: P/C vs. All Industries 1987–2008



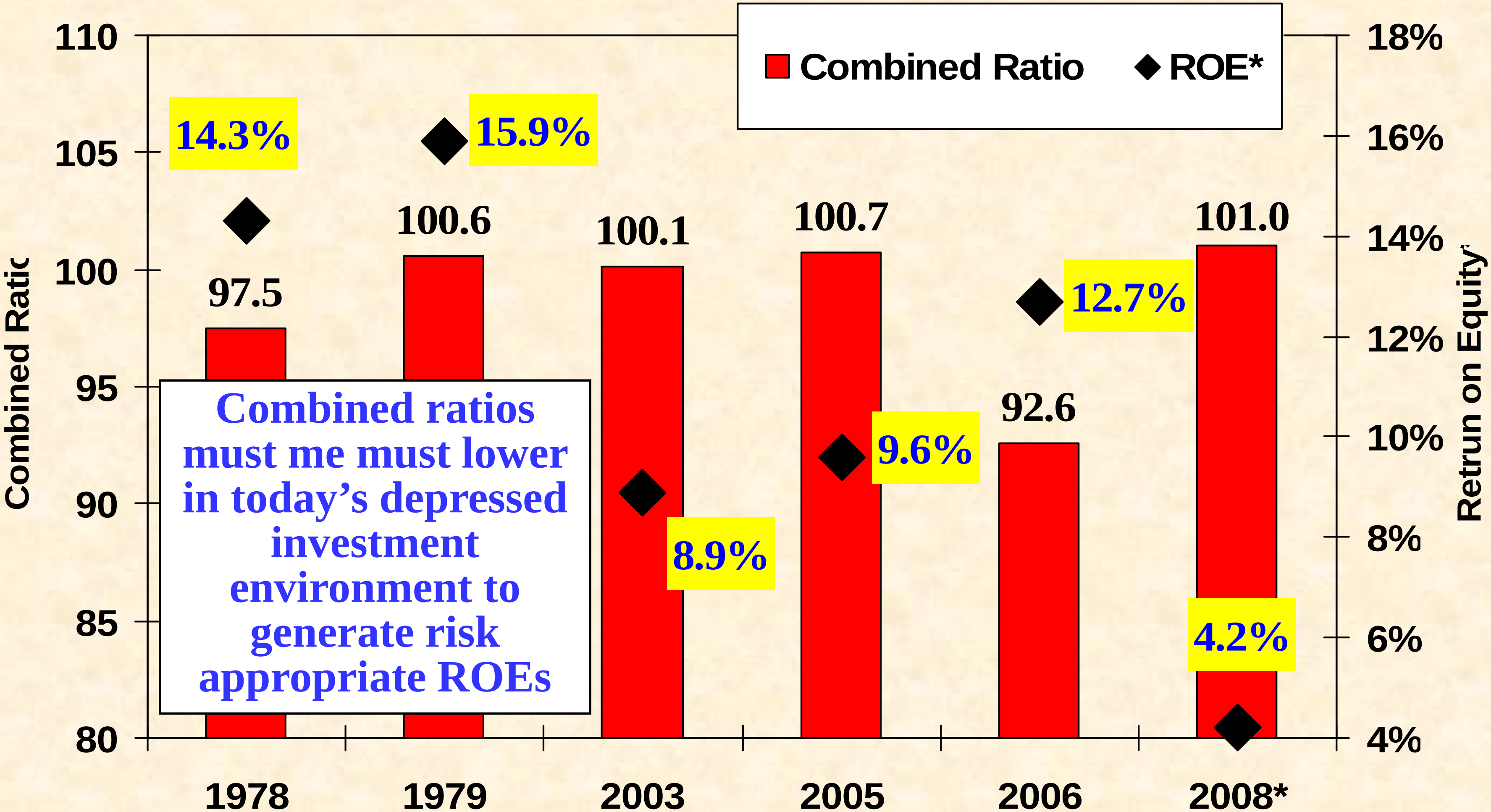
Sources: ISO, *Fortune;* Insurance Information Institute.

P/C Insurance Industry ROEs, 1975 – 2009F*



Note: 2008 result excluding Mortgage & Financial Guarantee insurers is 4.2%.
Sources: ISO; A.M. Best (2009F); Insurance Information Institute.

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

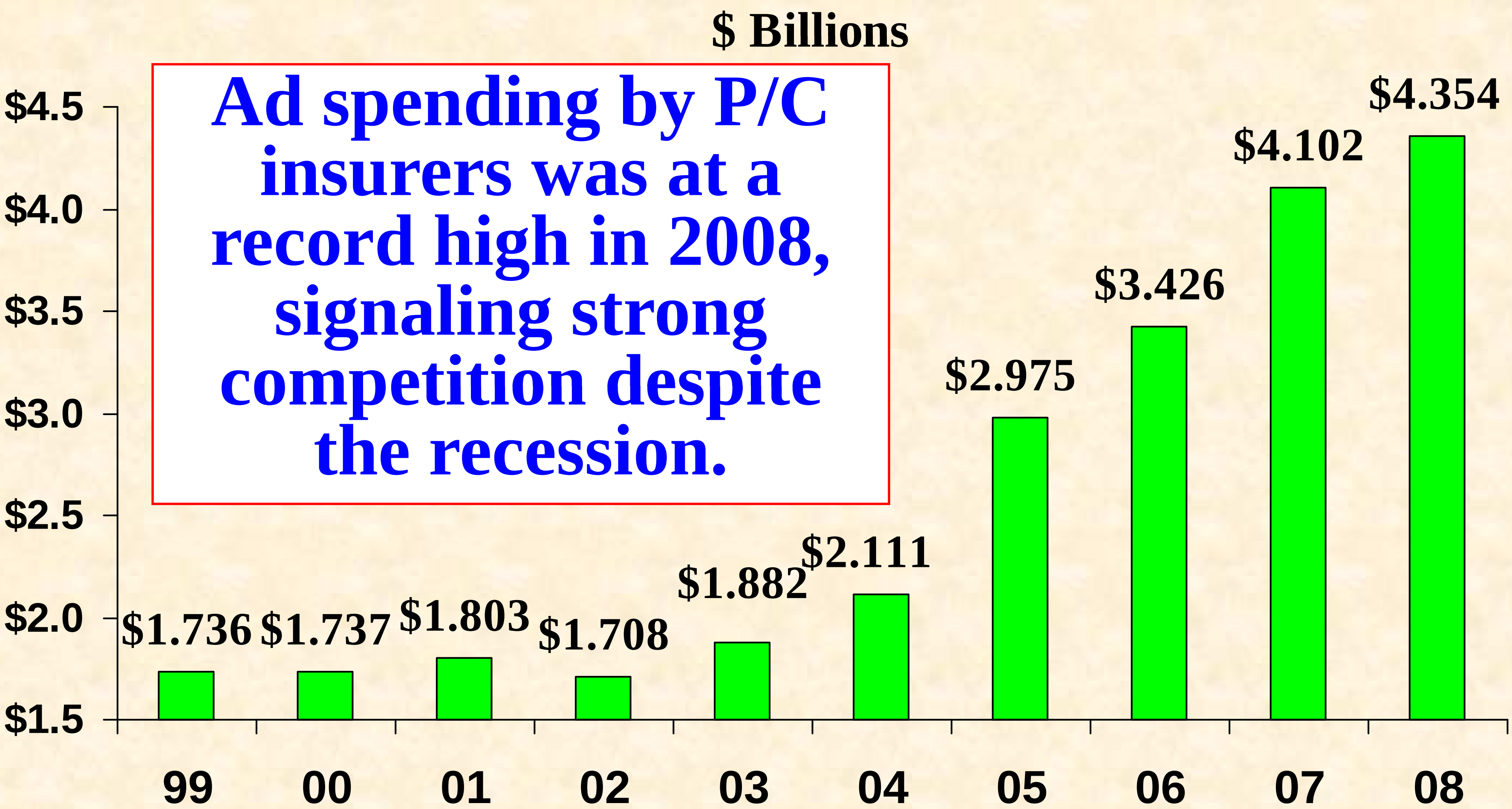


* 2008 figure is return on average statutory surplus. Excludes mortgage and financial guarantee insurers.

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

Advertising Trends

Advertising Expenditures by P/C Insurance Industry, 1999-2008

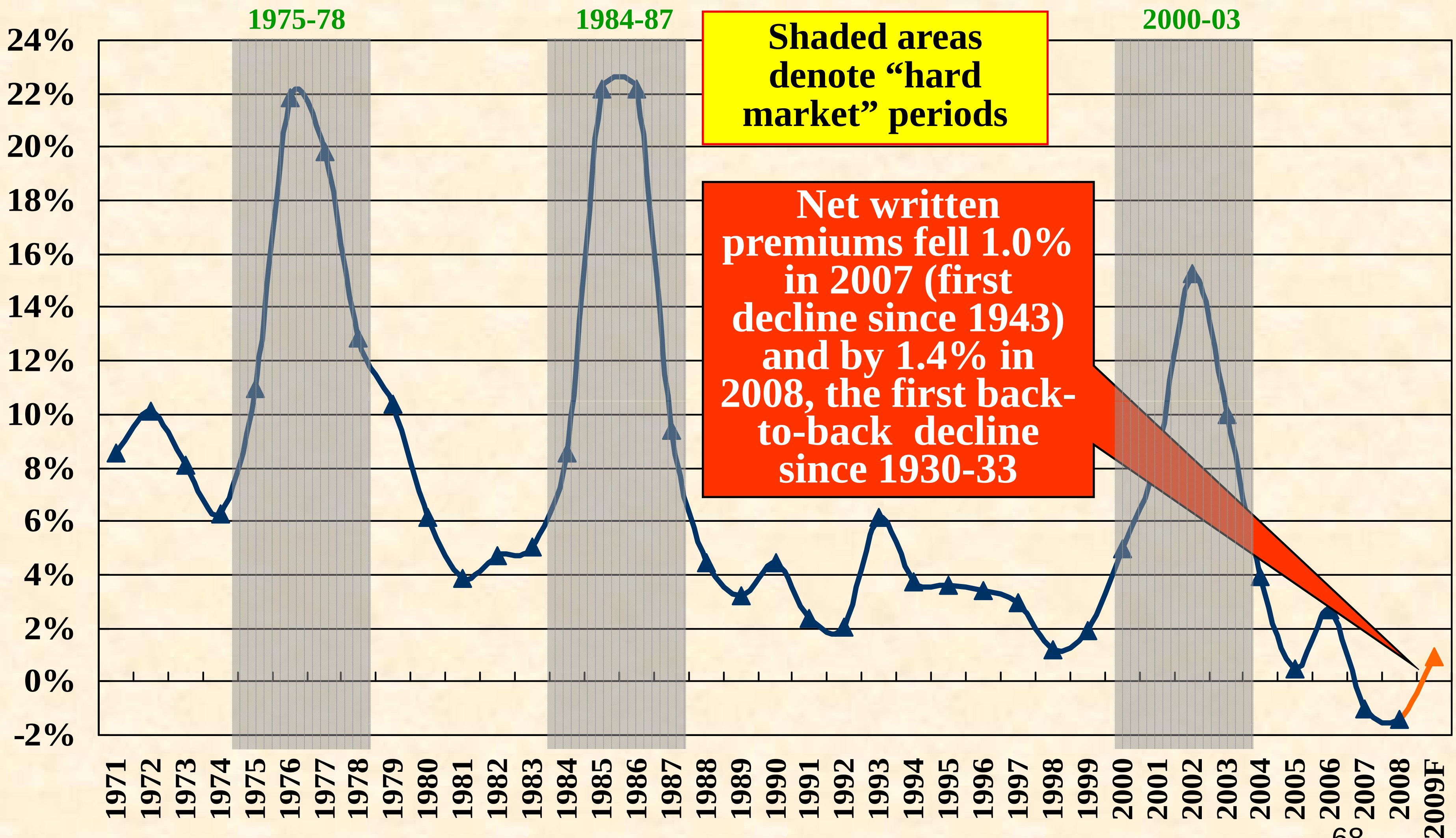


Source: Insurance Information Institute from consolidated P/C Annual Statement data.

P/C Premium Growth

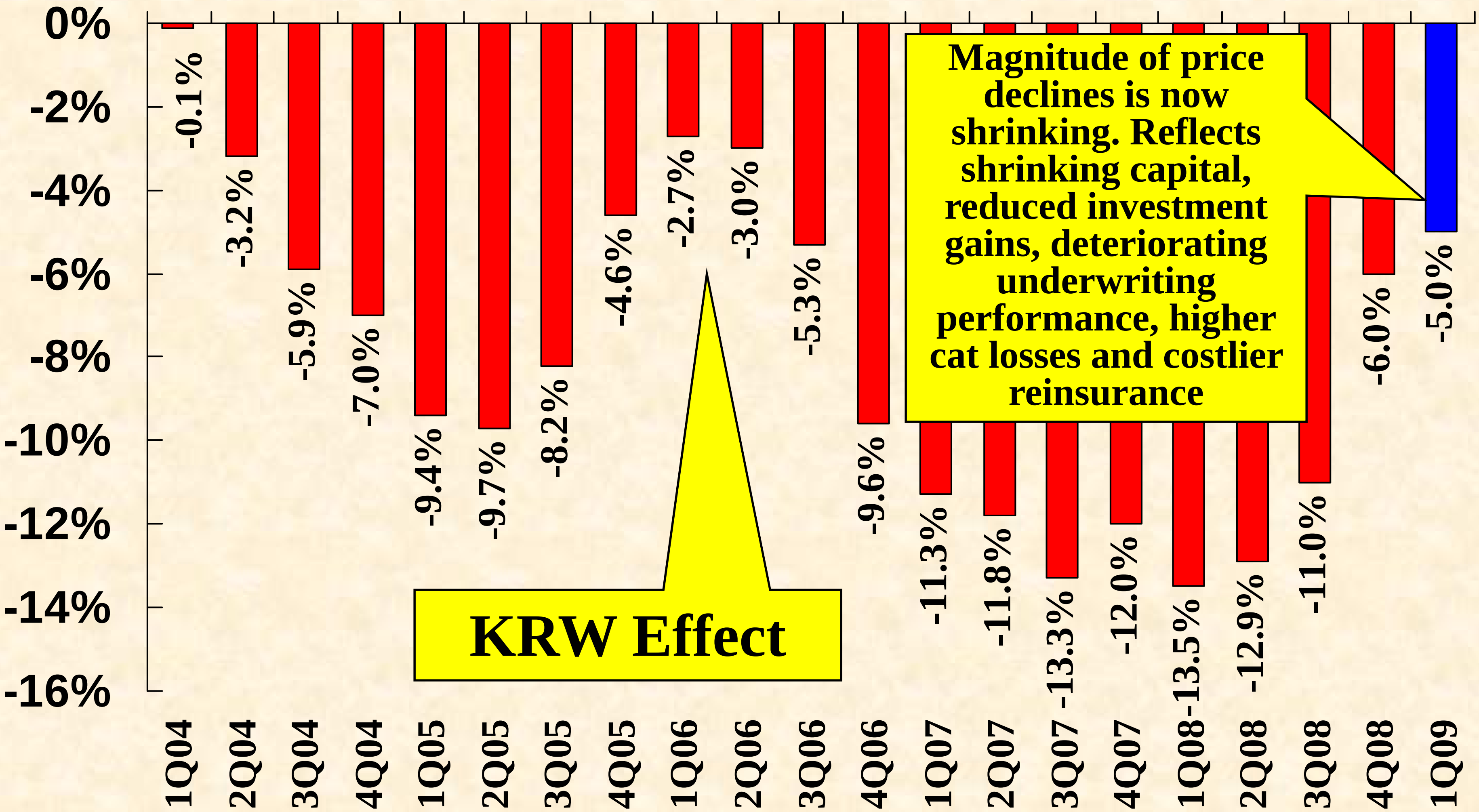
Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Strength of Recent Hard Markets by NWP Growth



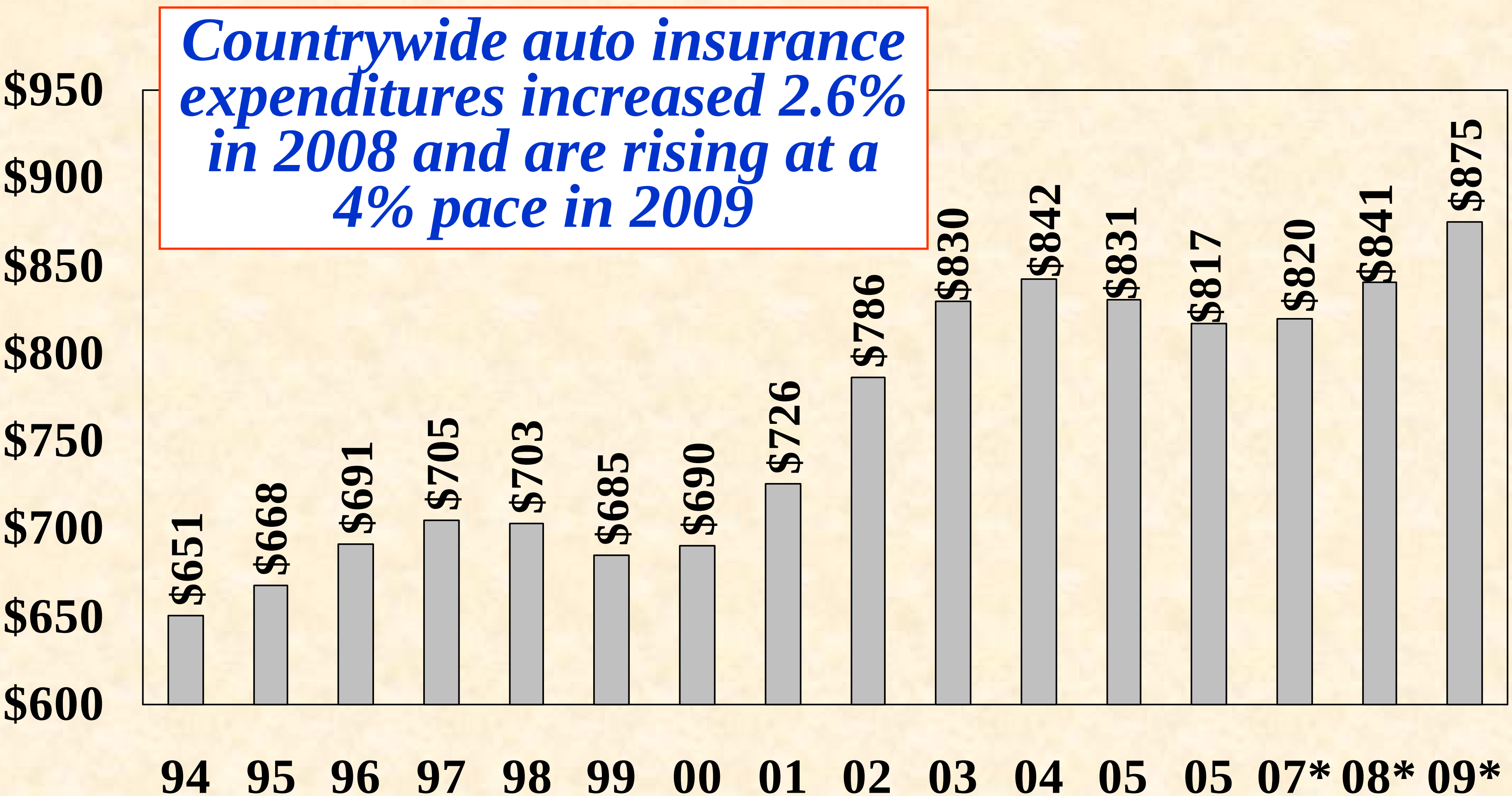
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute

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



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

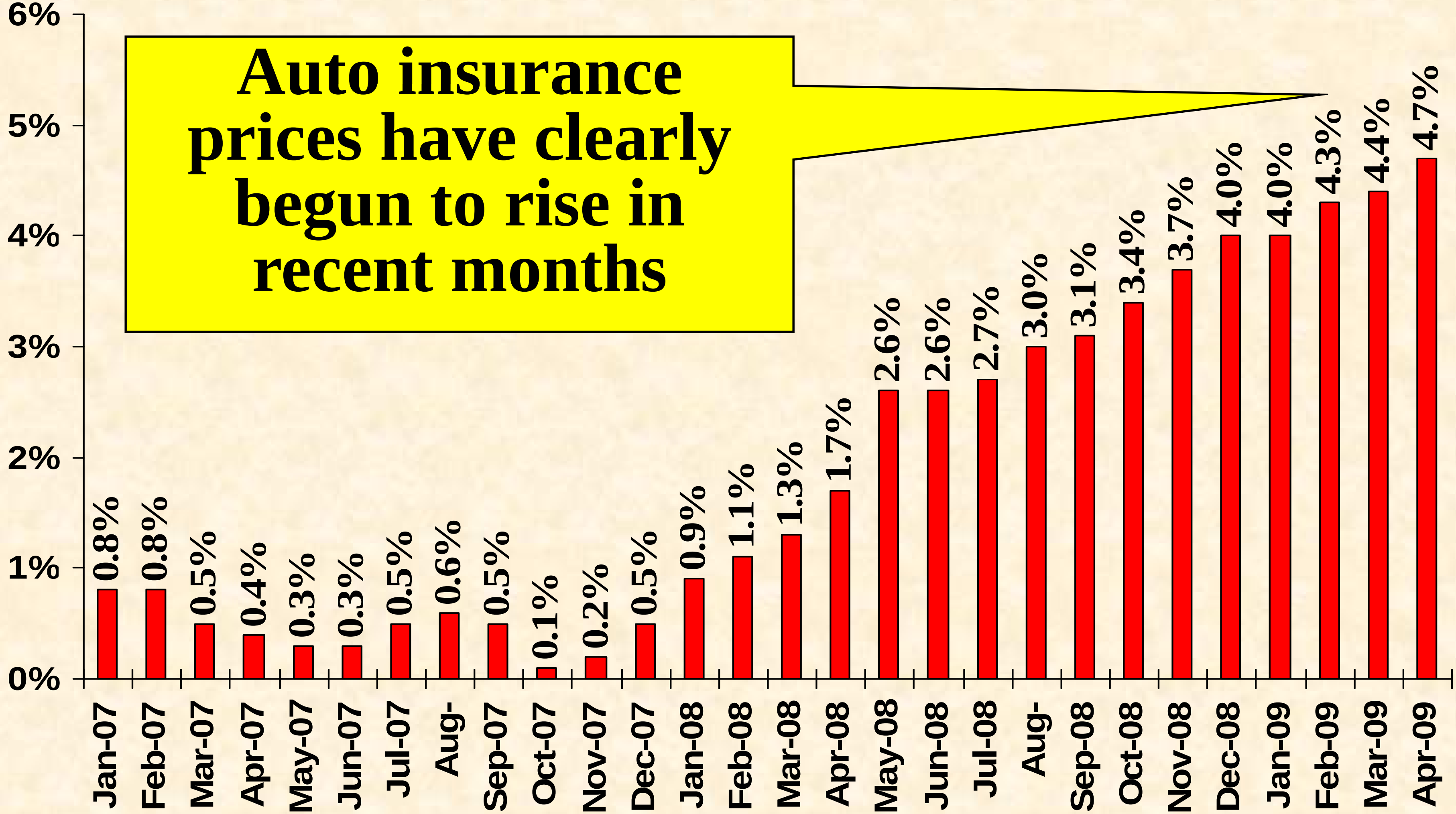
Average Expenditures on Auto Insurance



*Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute estimates 2007-2009 based on CPI data.

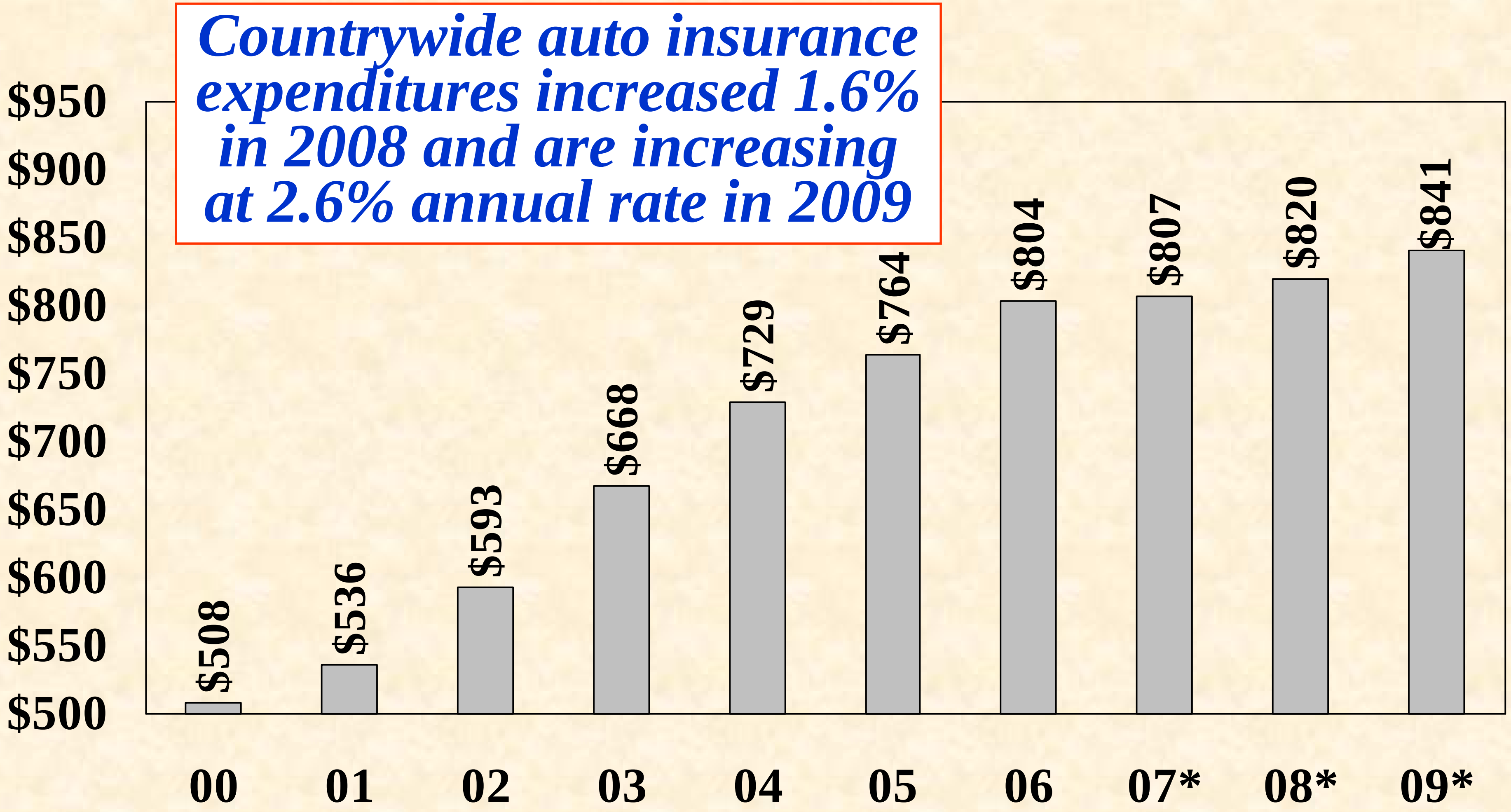
*Monthly Change in Auto Insurance Prices**



*Percentage change from same month in prior year.

Source: US Bureau of Labor Statistics

Average Premium for Home Insurance Policies**



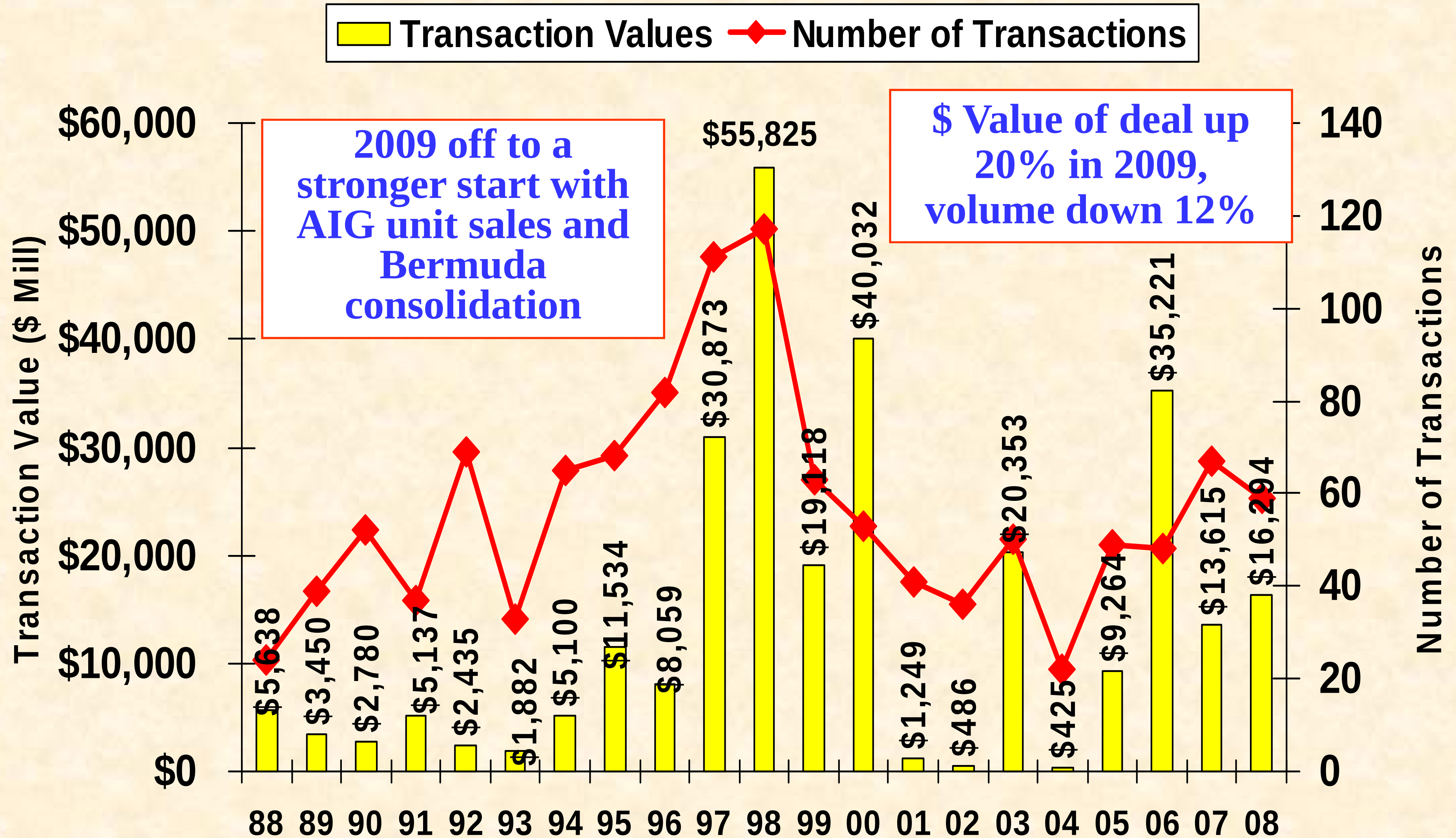
*Insurance Information Institute Estimates/Forecasts **Excludes state-run insurers.

Source: NAIC, Insurance Information Institute estimates 2007-2009 based on CPI data.

Merger & Acquisition

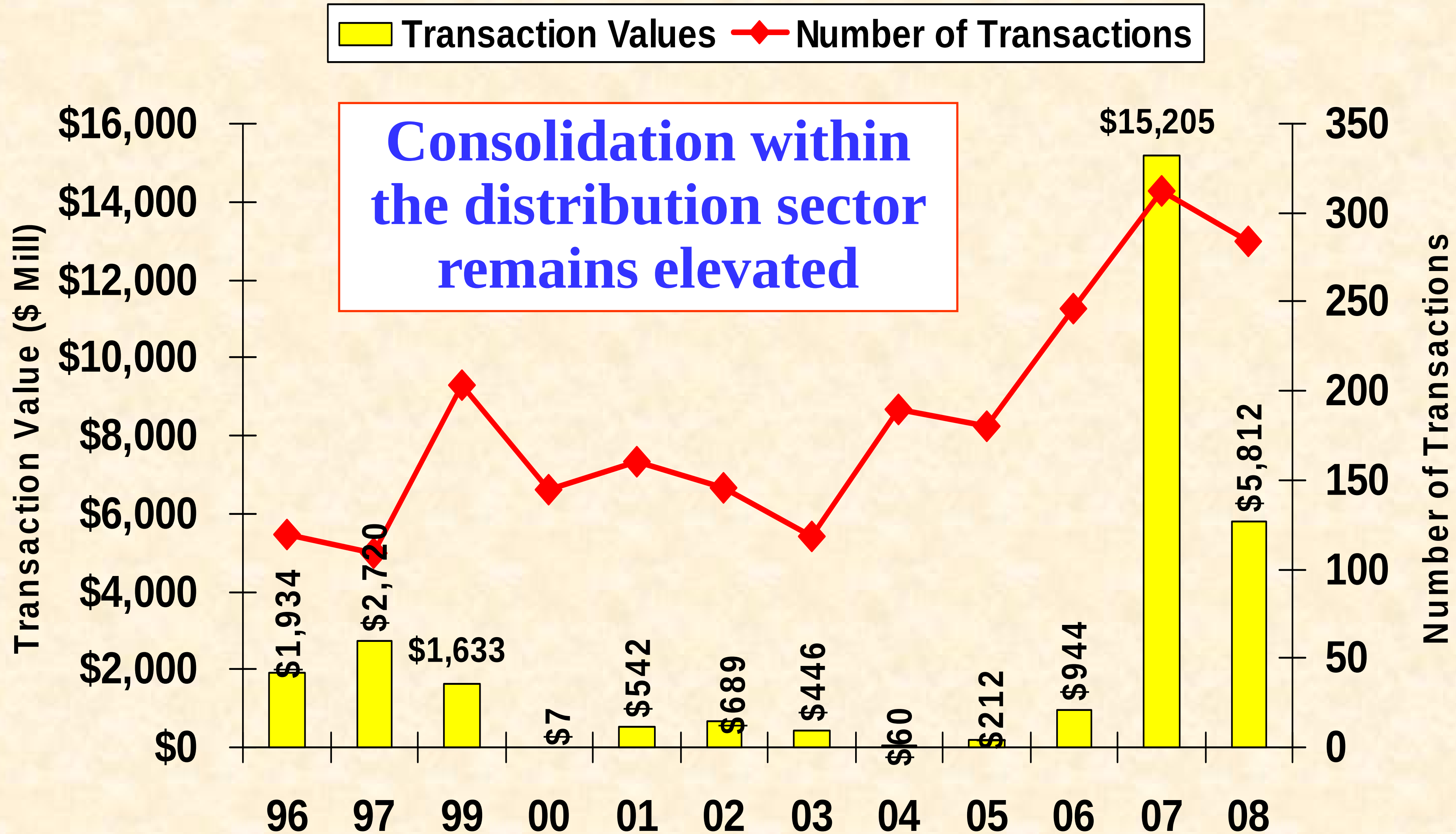
Barriers to Consolidation Will Diminish in 2009/10

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



Source: Conning Research & Consulting.

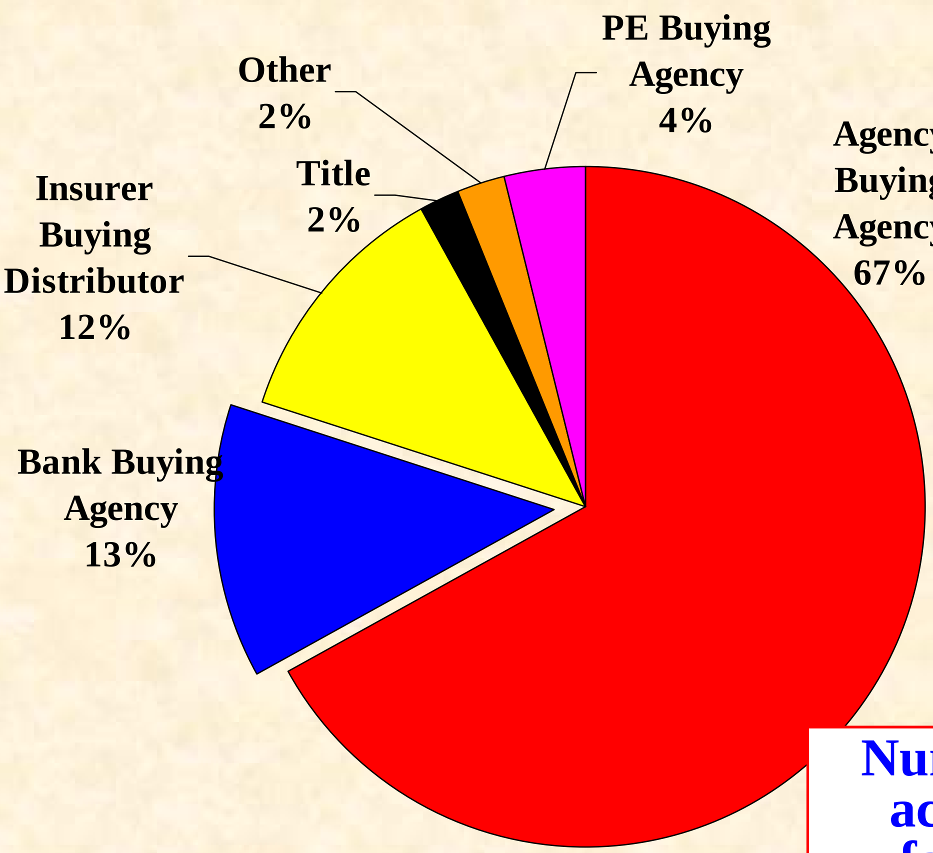
Distribution Sector: Insurance-Related M&A Activity, 1988-2008



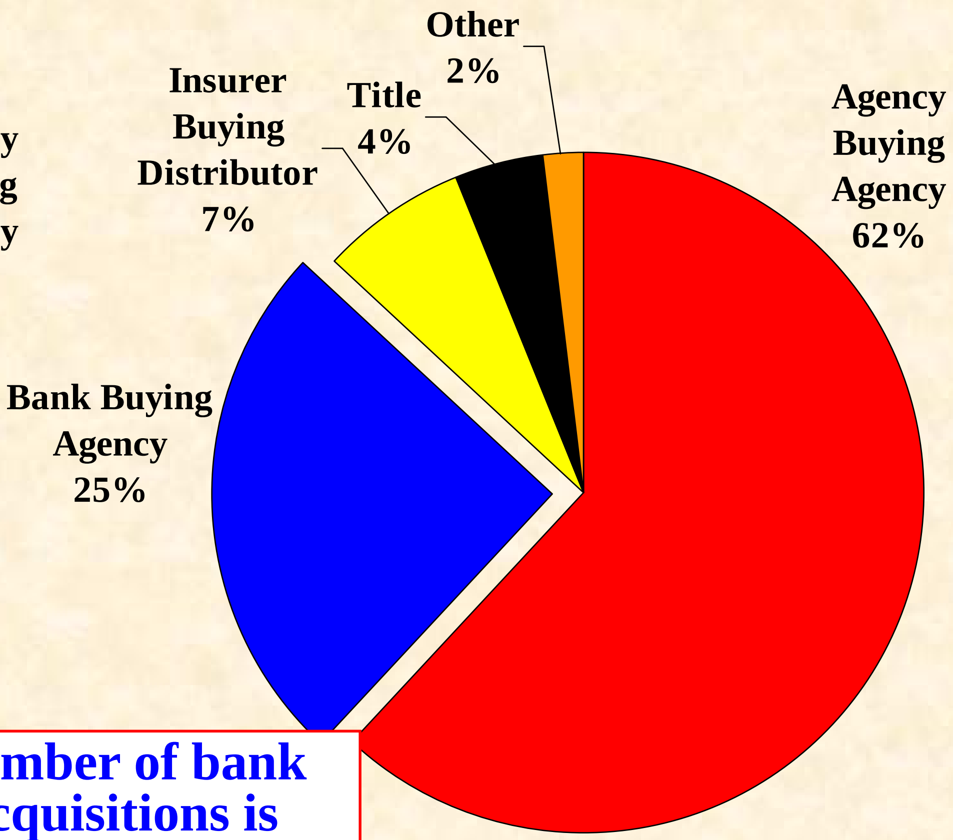
Source: Conning Research & Consulting.

Distribution Sector M&A Activity, 2008 vs. 2006

2008



2006



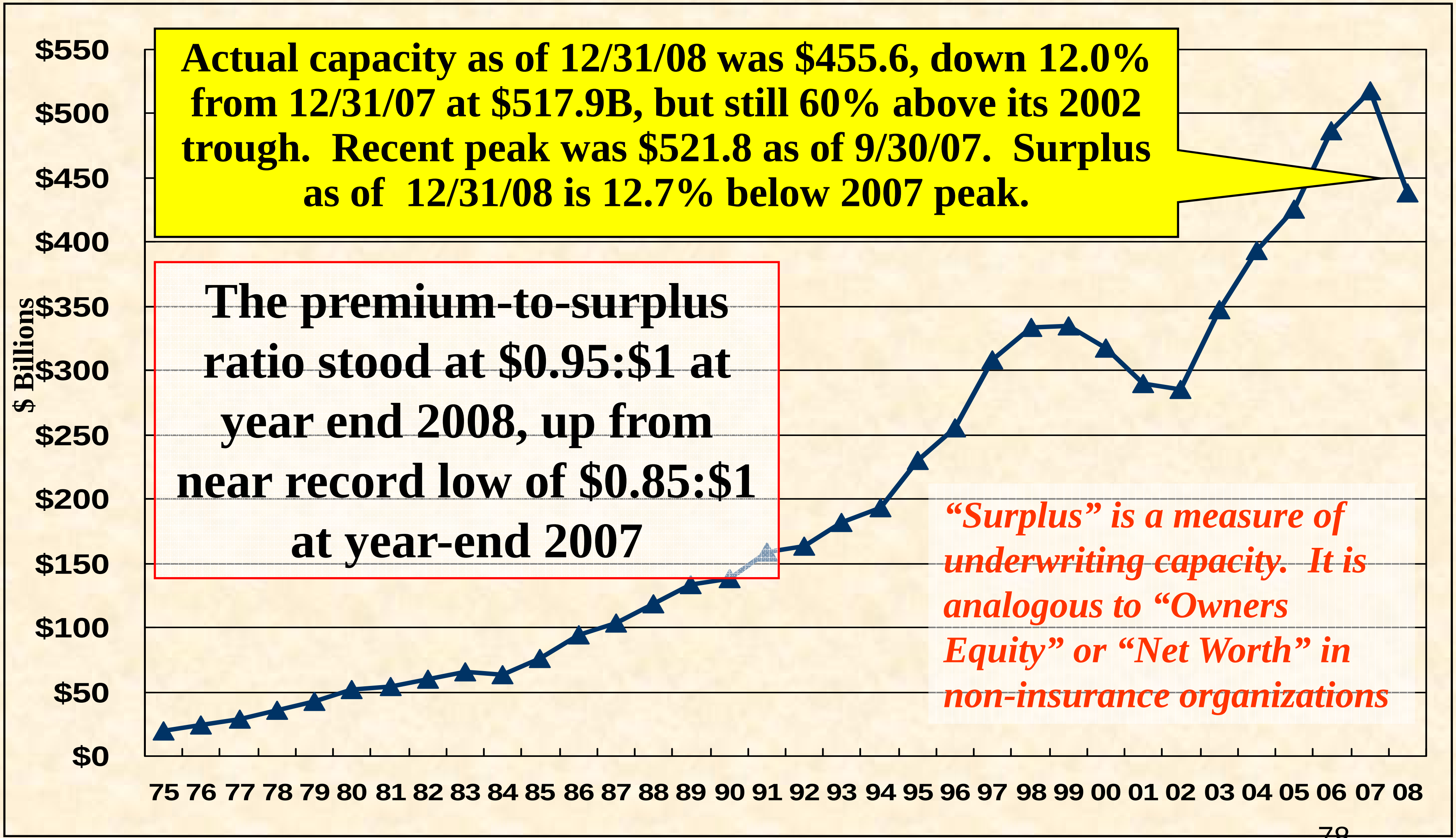
Number of bank acquisitions is falling; More private equity interest

Source: Conning Research & Consulting

Capital/ Policyholder Surplus

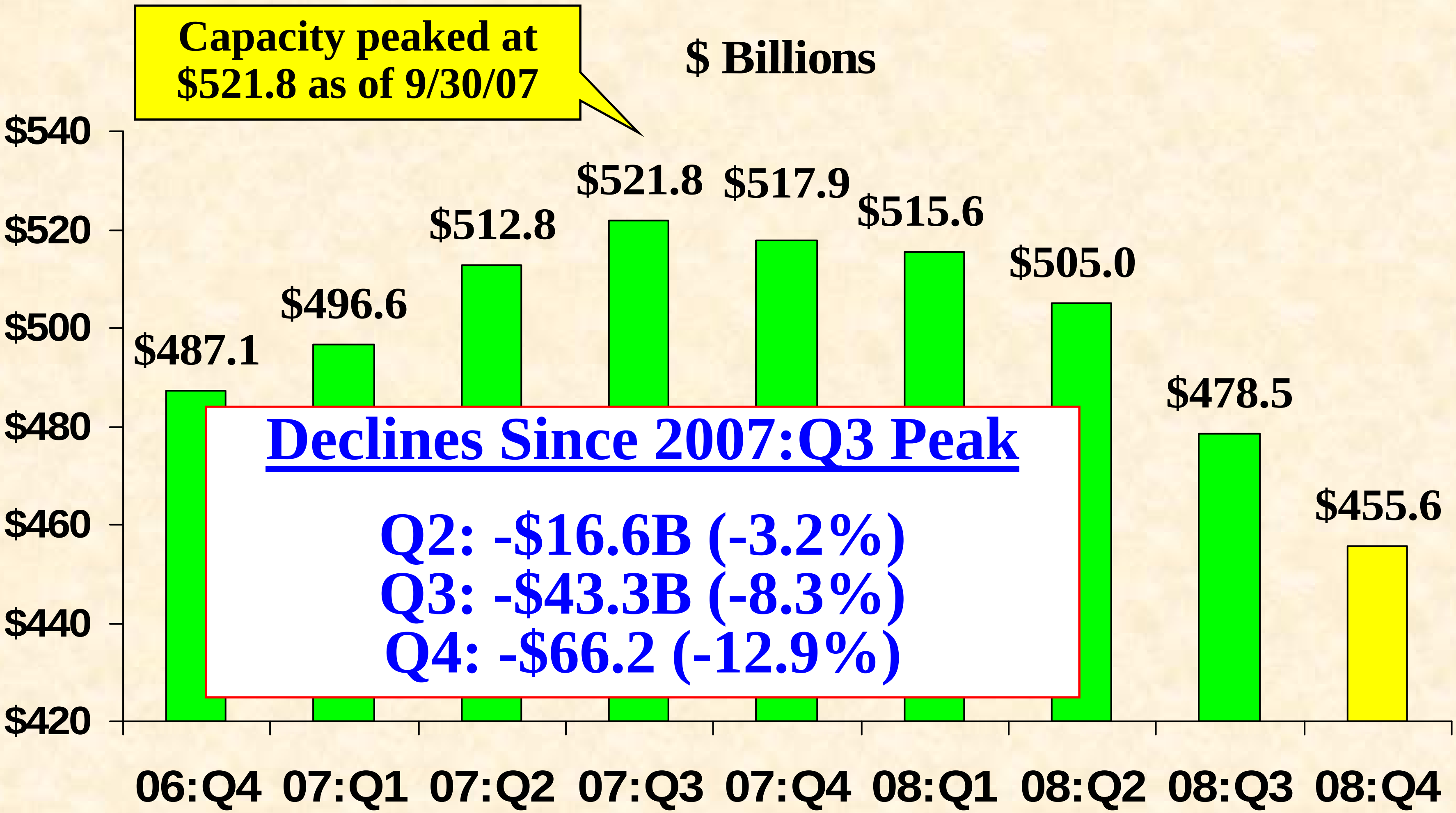
Shrinkage, but Capital is Within Historic Norms

U.S. Policyholder Surplus: 1975-2008*



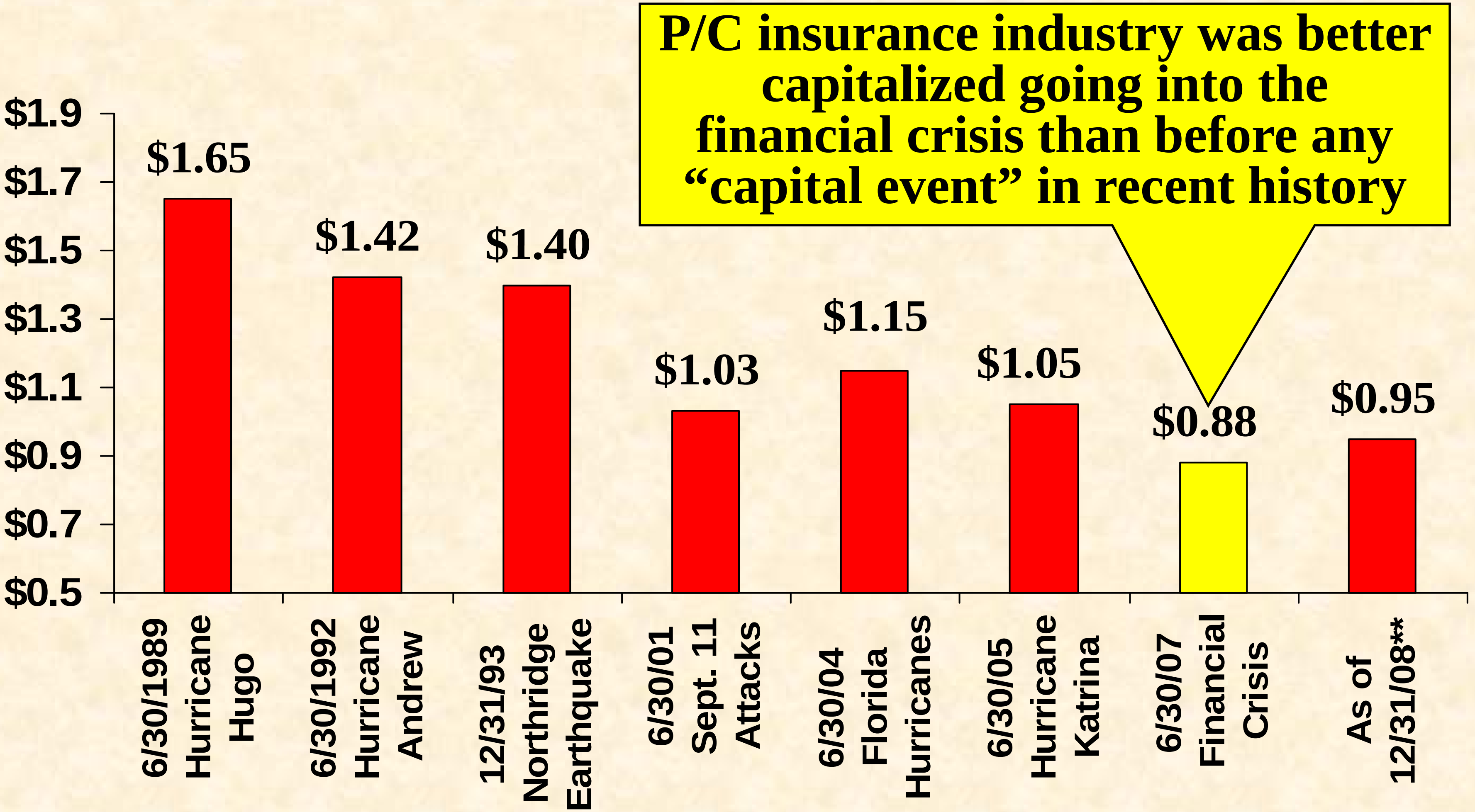
Source: A.M. Best, ISO, Insurance Information Institute. *As of 12/31/08

Policyholder Surplus, 2006:Q4 – 2008:Q4



Source: ISO.

Premium-to-Surplus Ratios Before Major Capital Events*

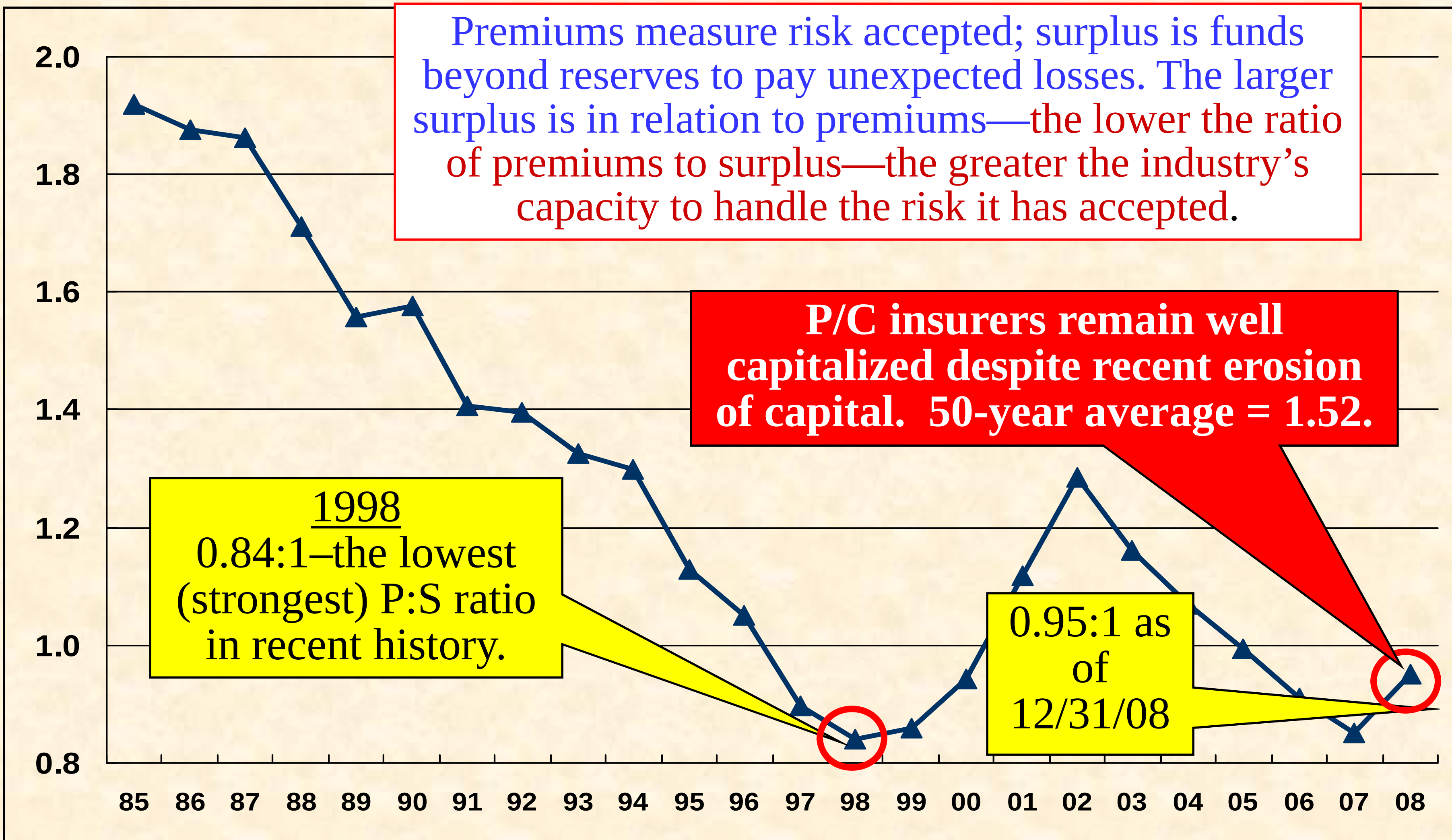


*Ratio is for end of quarter immediately prior to event. Date shown is end of quarter prior to event.

**Latest available

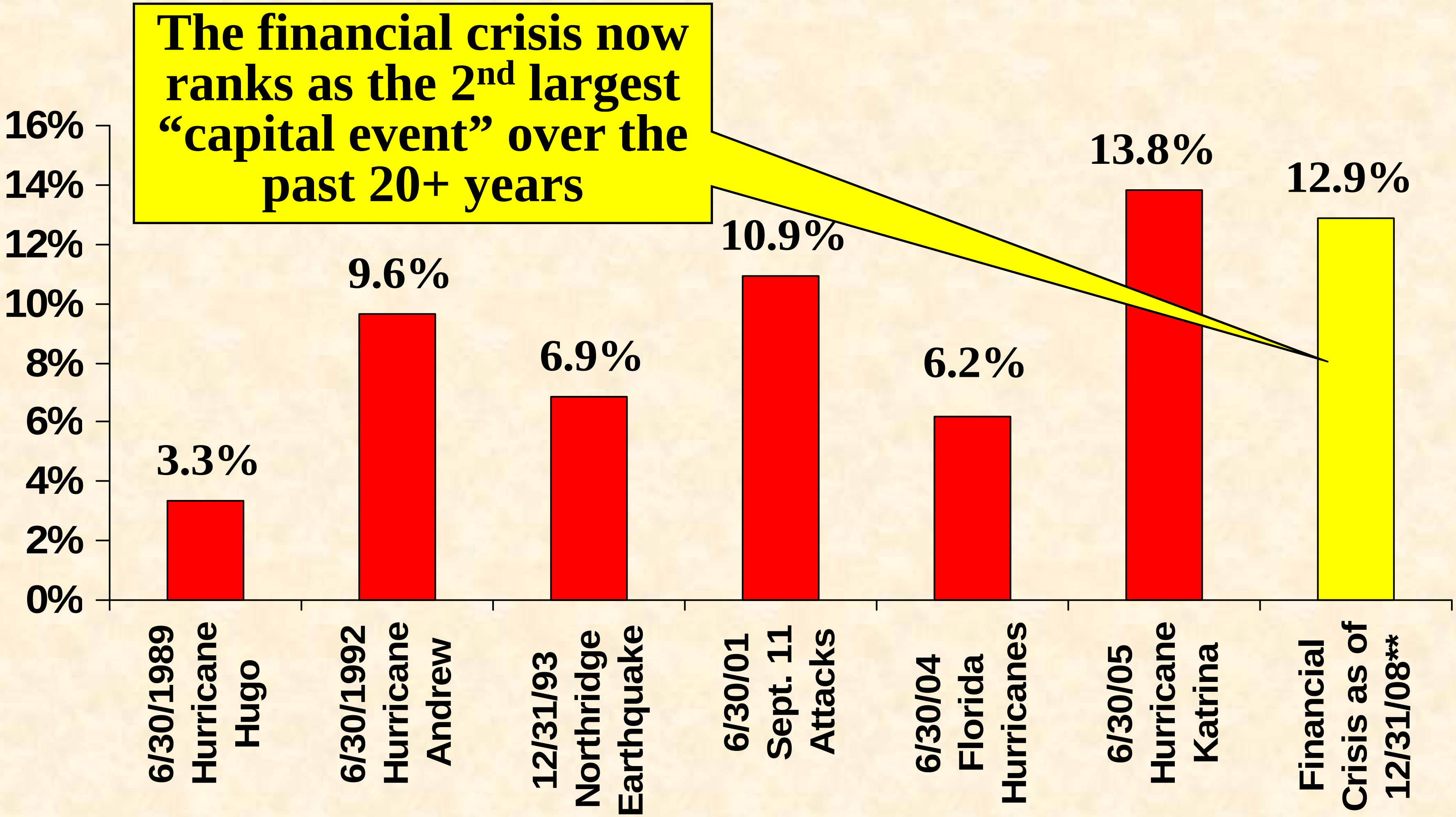
Source: PCS; Insurance Information Institute.

U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2008



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

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

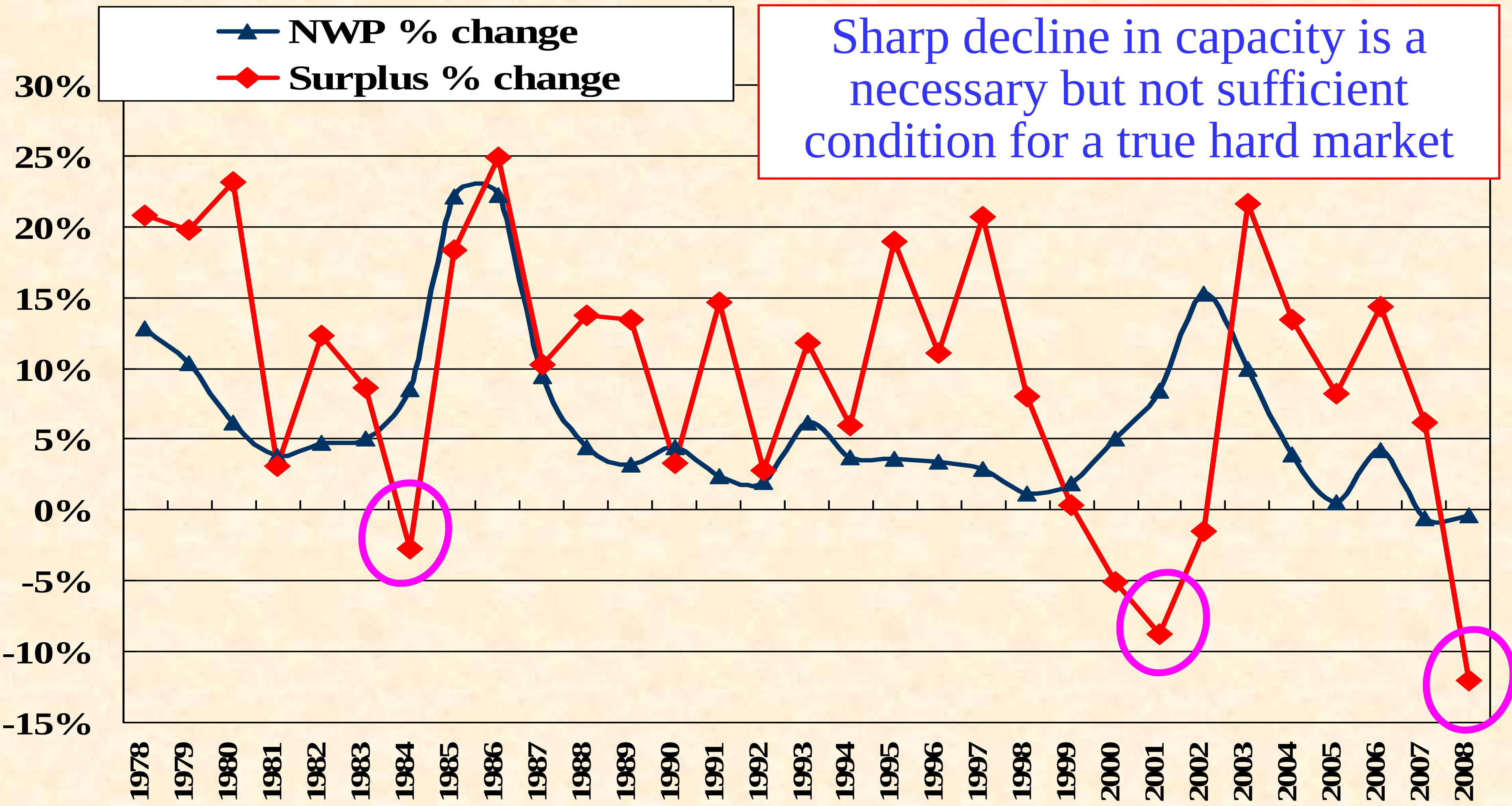


*Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event.

**Latest available

Source: PCS; Insurance Information Institute.

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

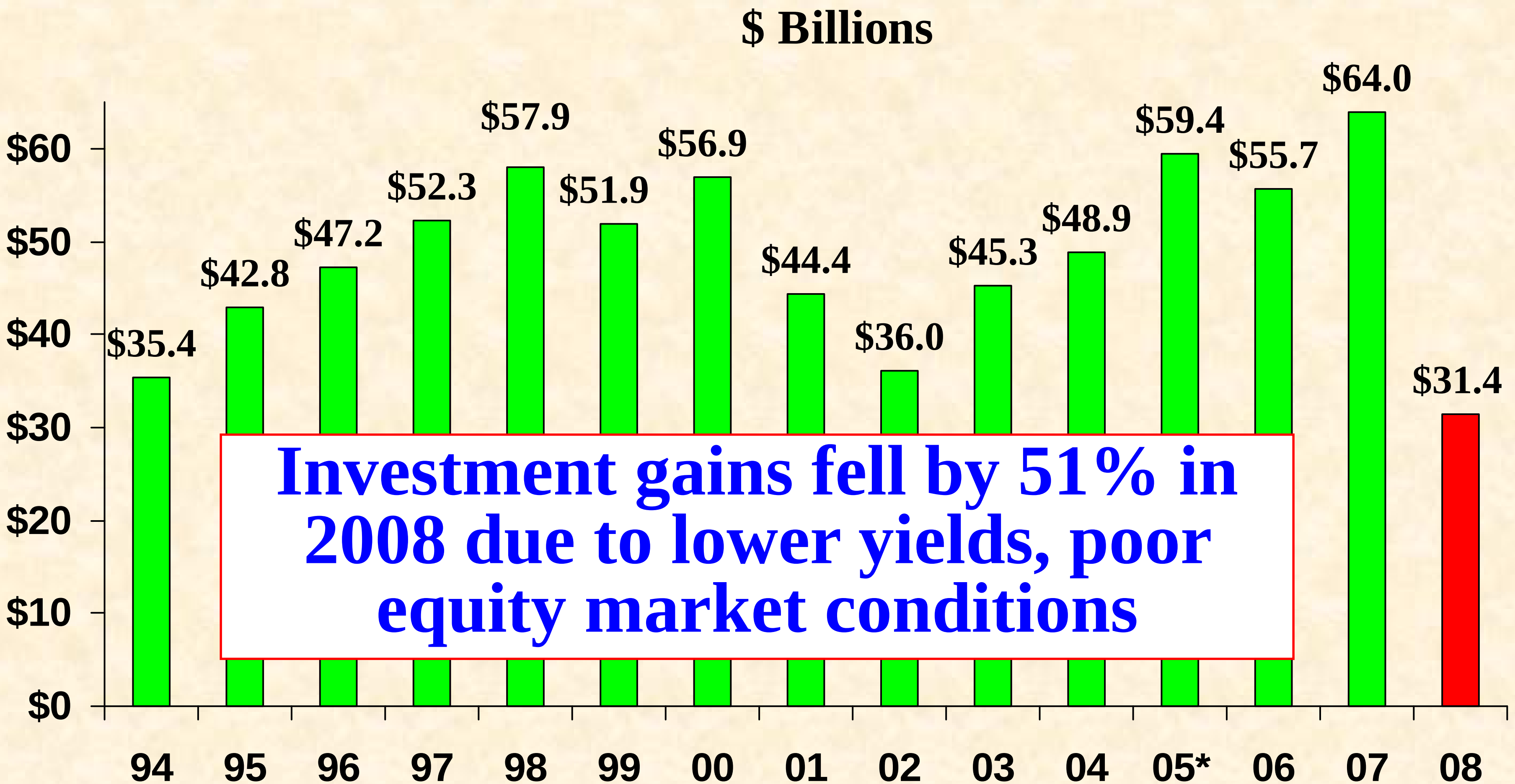


Sources: A.M. Best, ISO, Insurance Information Institute

Investment Performance

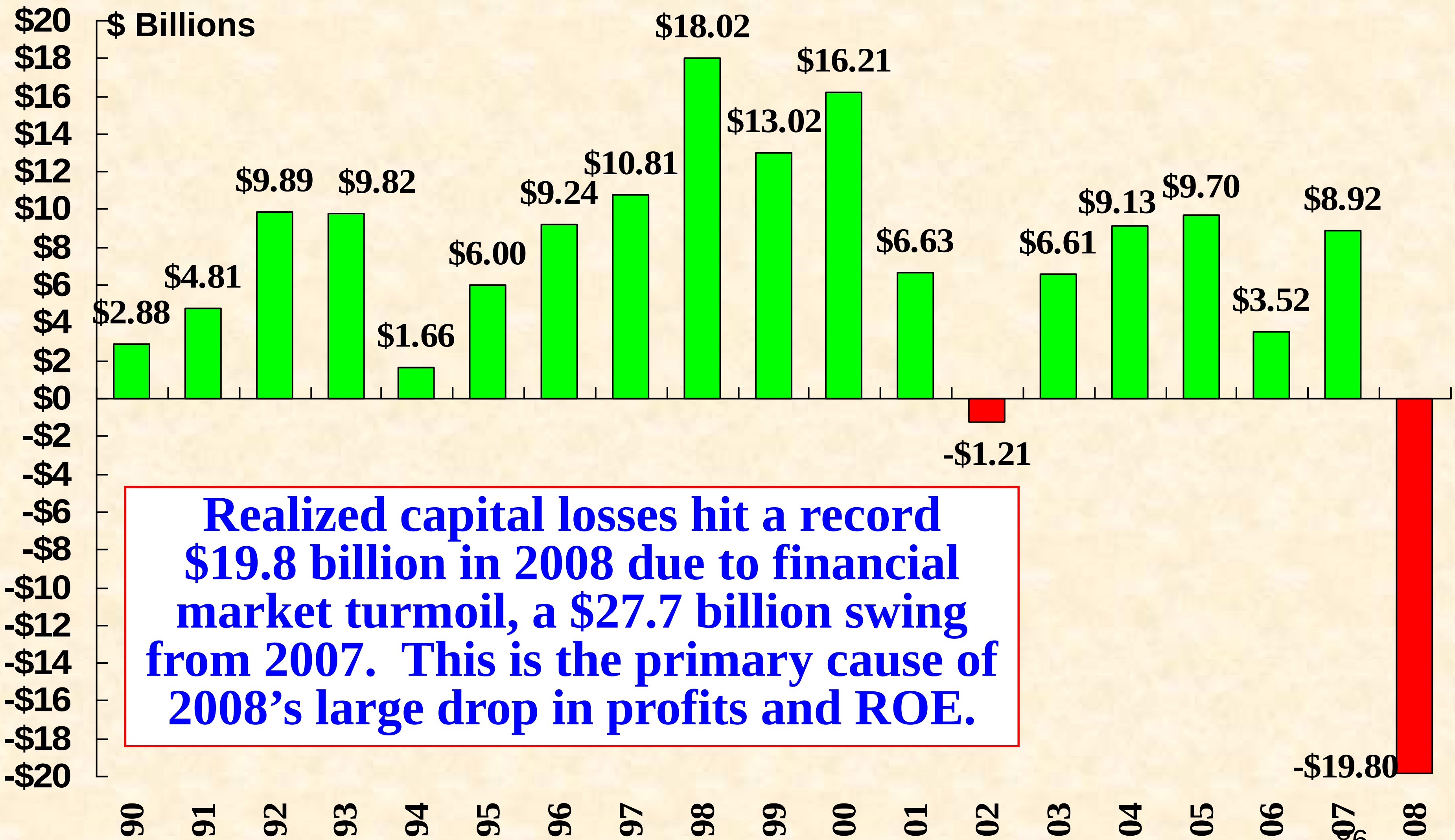
Investments are the Principle Source of Declining Profitability

Property/Casualty Insurance Industry Investment Gain:1994- 2008[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.

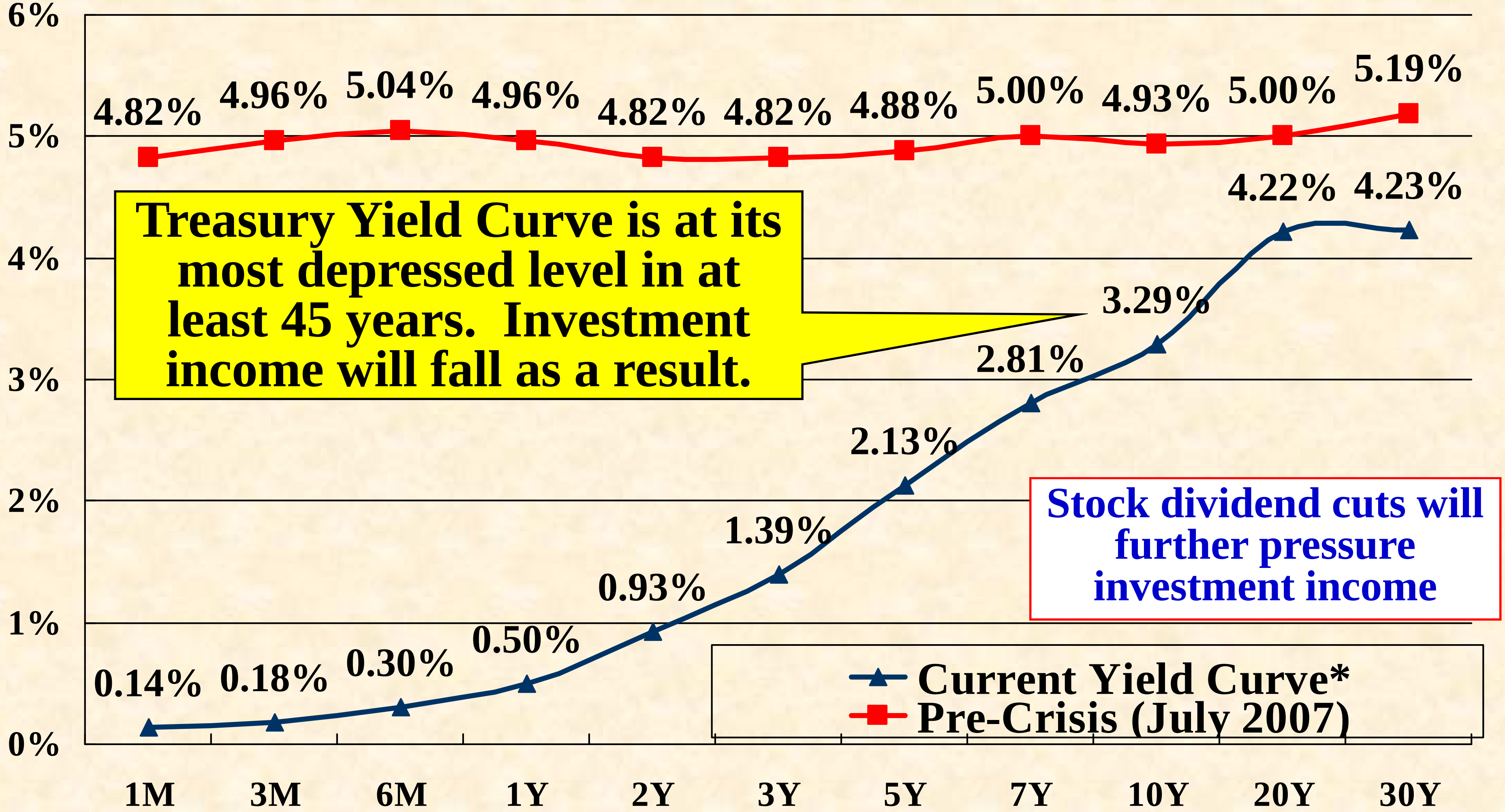
P/C Insurer Net Realized Capital Gains, 1990-2008



Realized capital losses hit a record $19.8 billion in 2008 due to financial market turmoil, a $27.7 billion swing from 2007. This is the primary cause of 2008's large drop in profits and ROE.

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

Treasury Yield Curves: Pre-Crisis vs. Current*



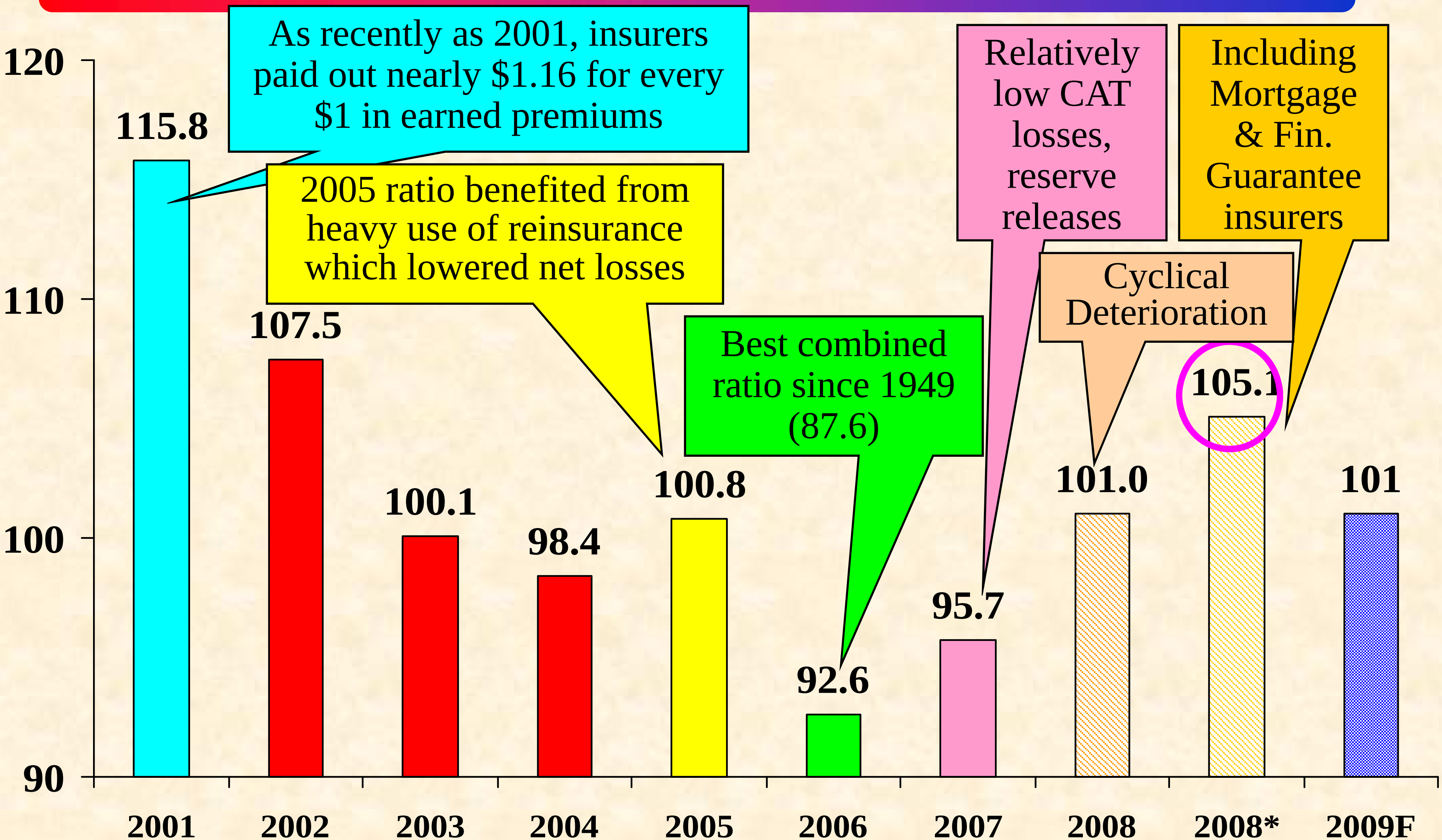
*May 2009.

Sources: Federal Reserve; Insurance Information Institute.

Underwriting Trends

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

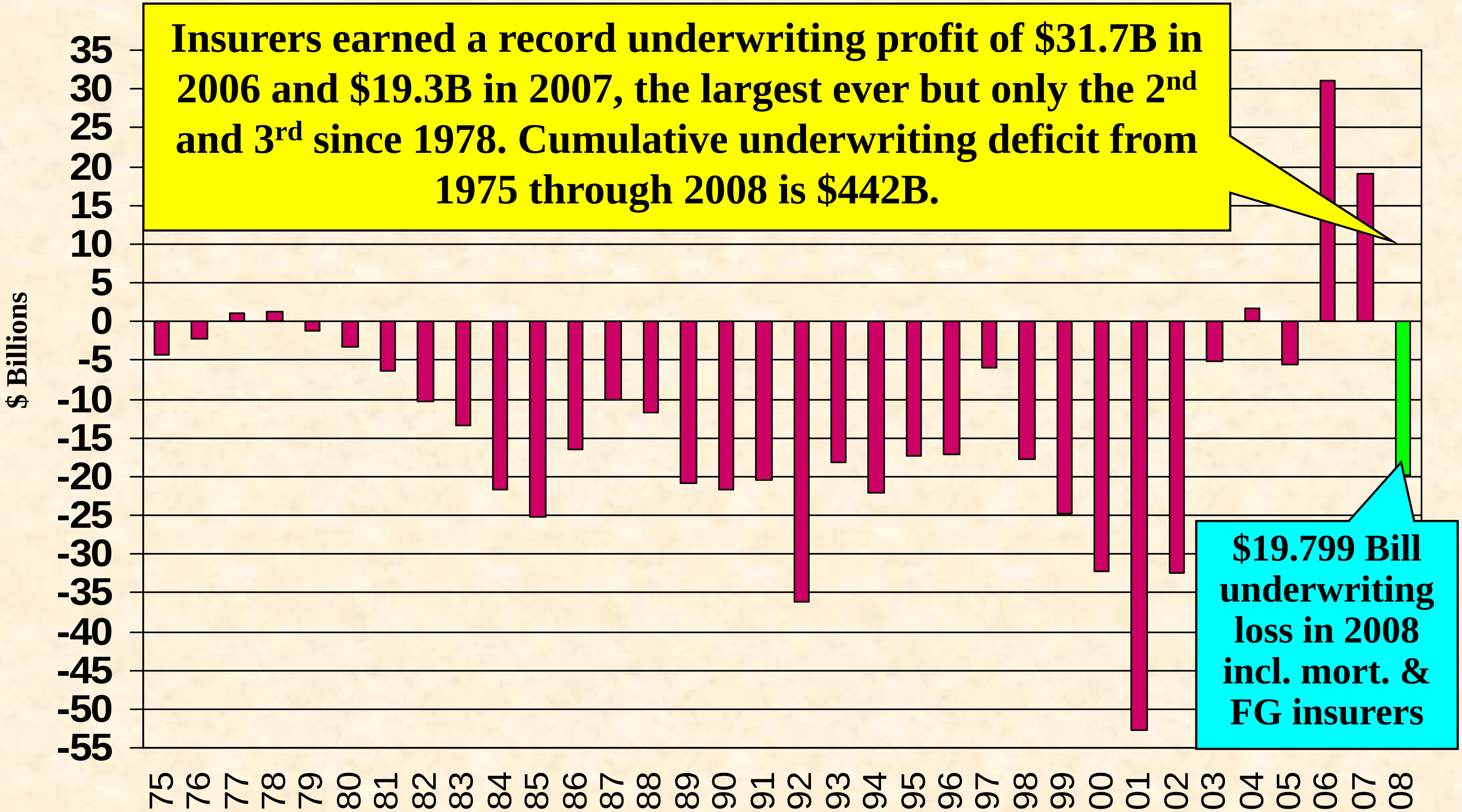
P/C Insurance Industry Combined Ratio, 2001-2009E



*Includes Mortgage & Financial Guarantee insurers.

Sources: A.M. Best.

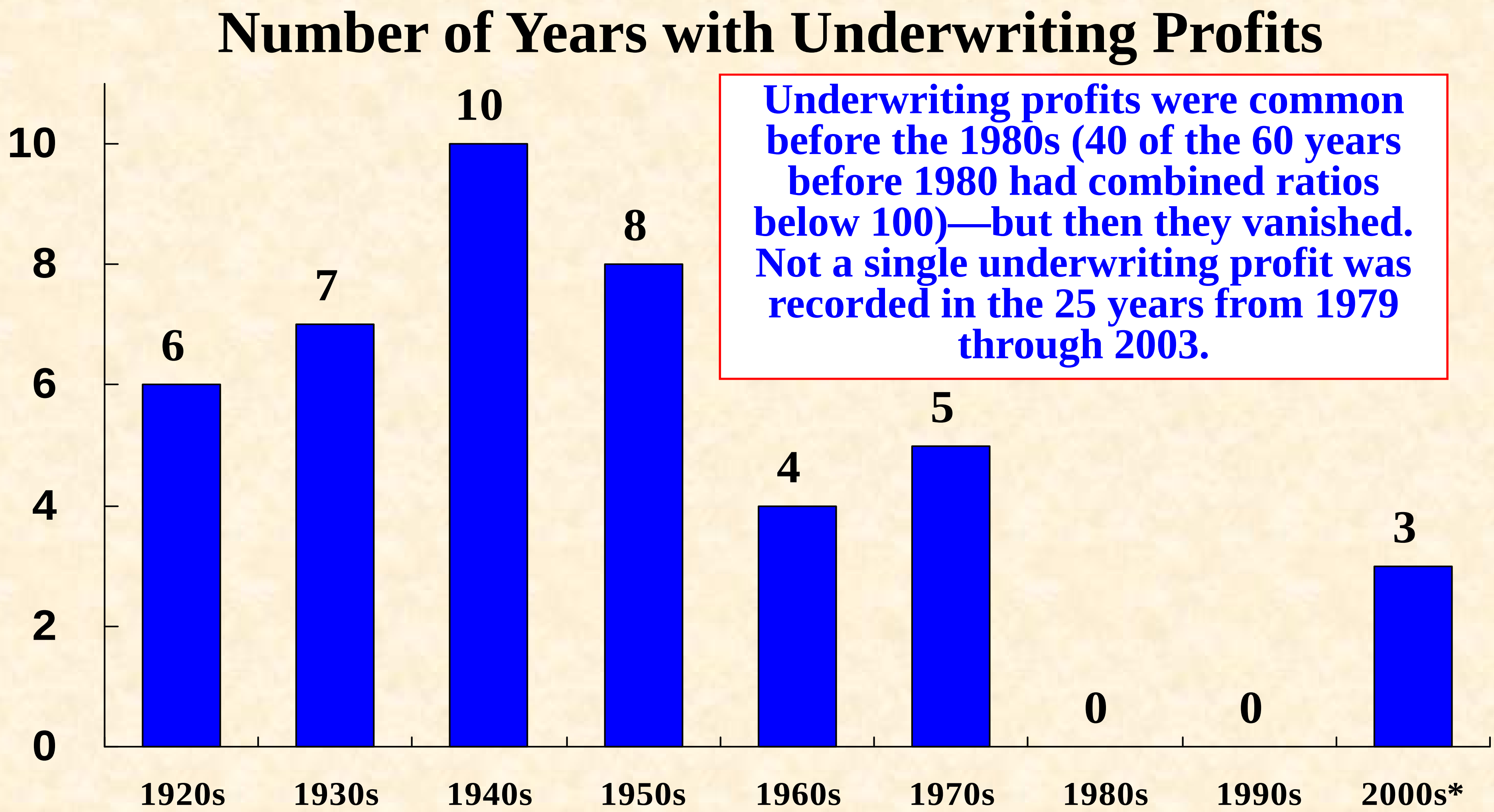
*Underwriting Gain (Loss) 1975-2008**



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

* Includes mortgage & finl. guarantee insurers

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



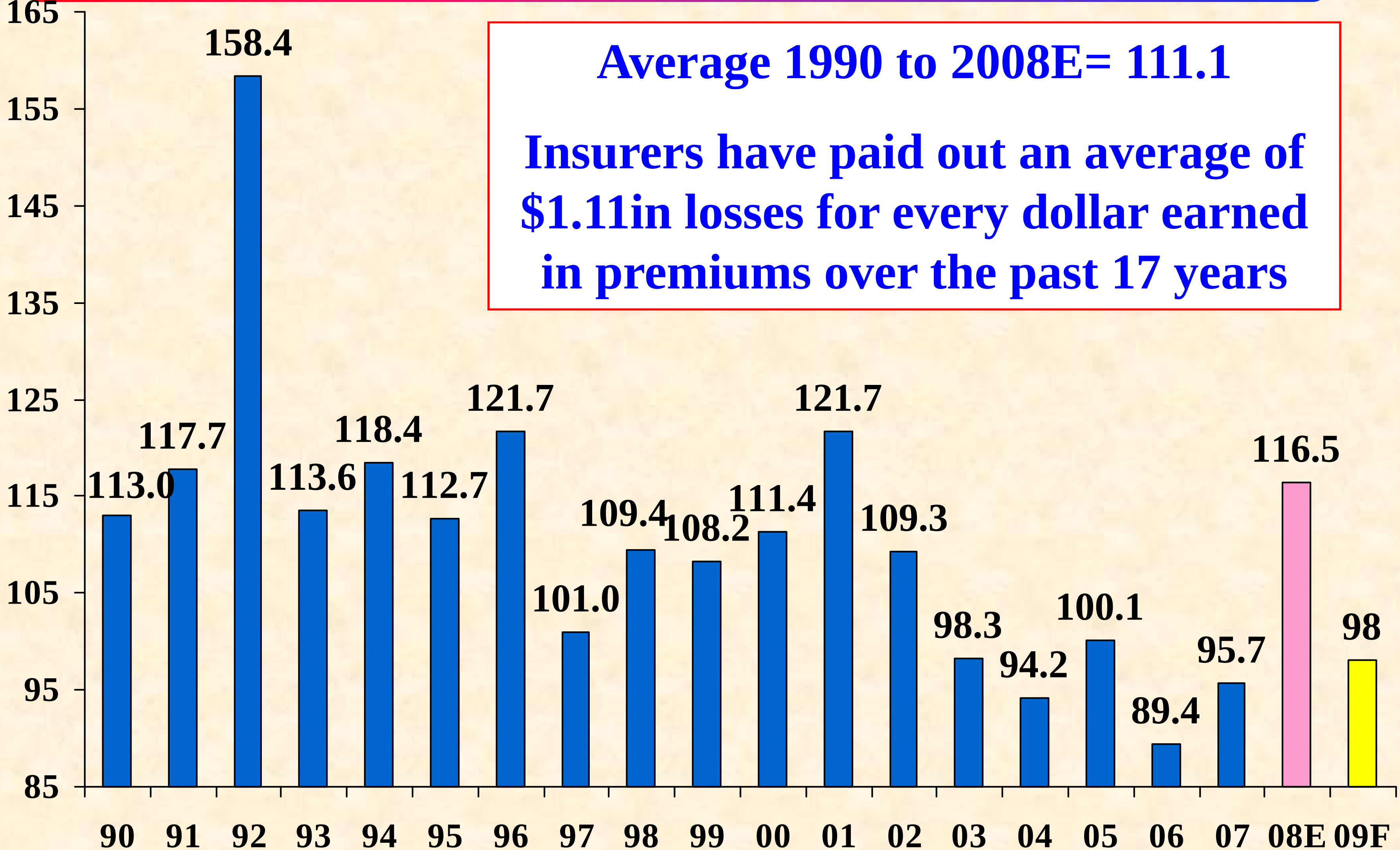
Underwriting profits were common before the 1980s (40 of the 60 years before 1980 had combined ratios below 100)—but then they vanished. Not a single underwriting profit was recorded in the 25 years from 1979 through 2003.

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

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

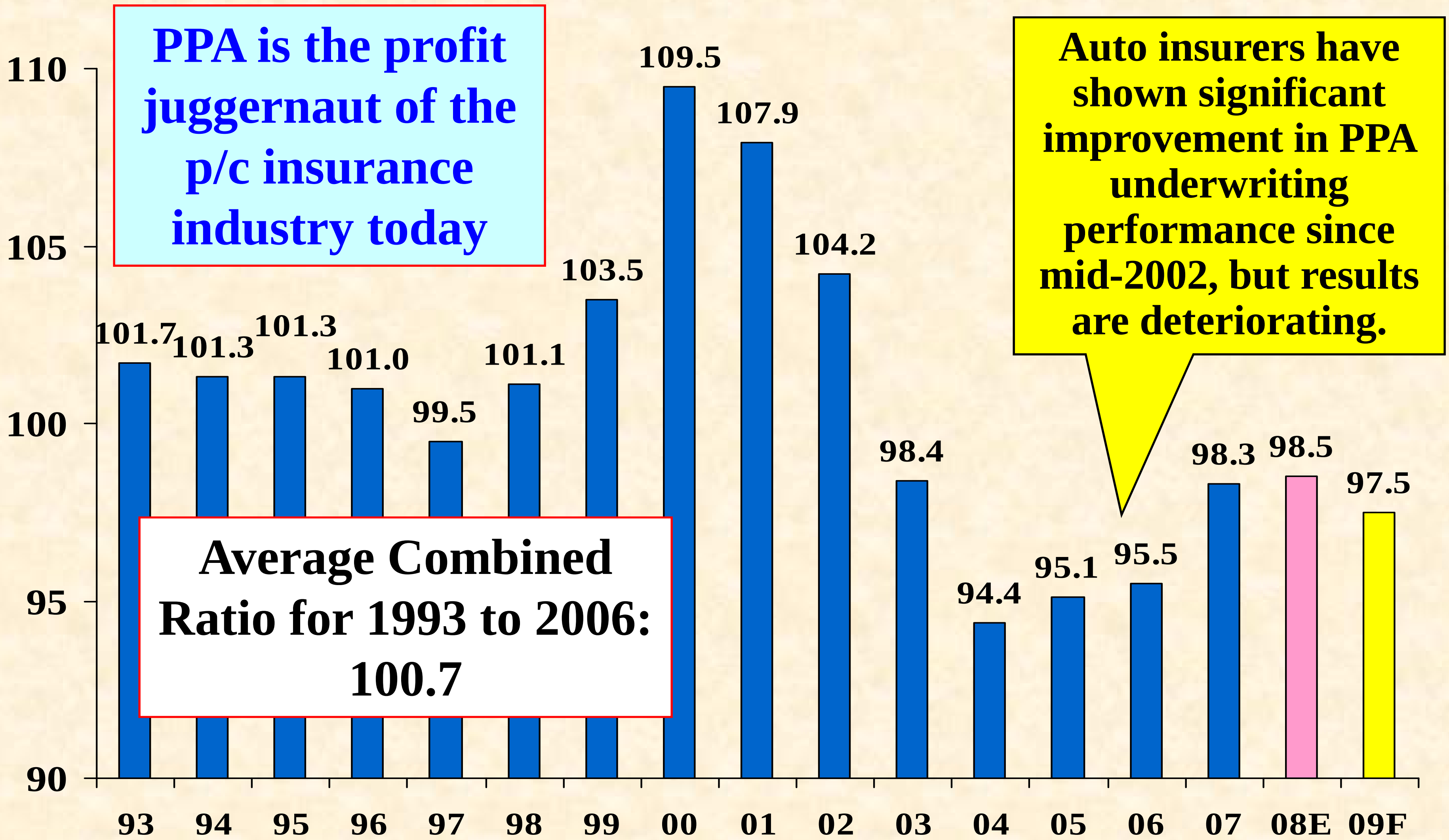
*2000 through 2008.

Homeowners Insurance Combined Ratio



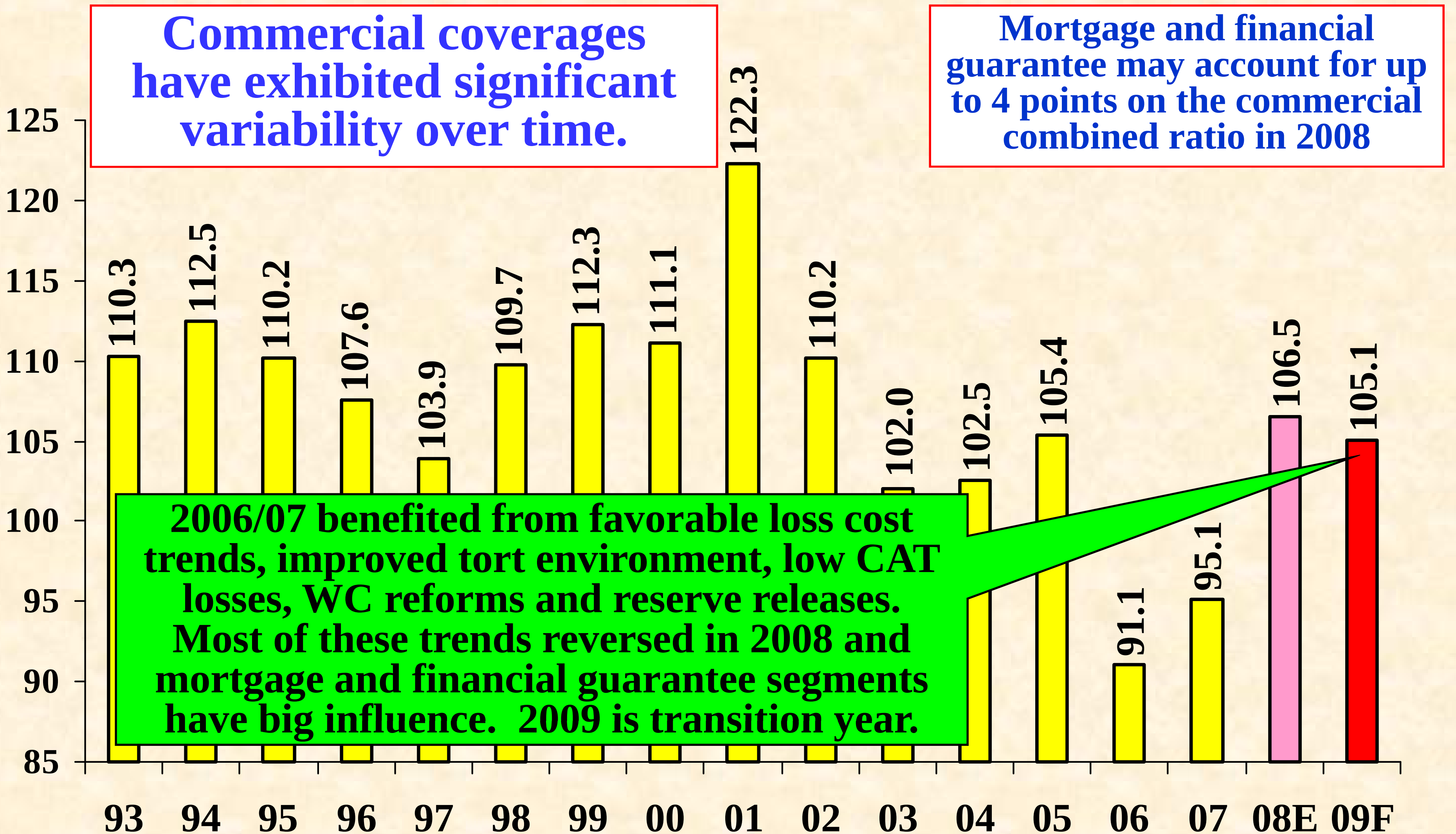
Sources: A.M. Best (historical and forecasts)

Private Passenger Auto (PPA) Combined Ratio



Sources: A.M. Best (historical and forecasts)

Commercial Lines Combined Ratio, 1993-2009F

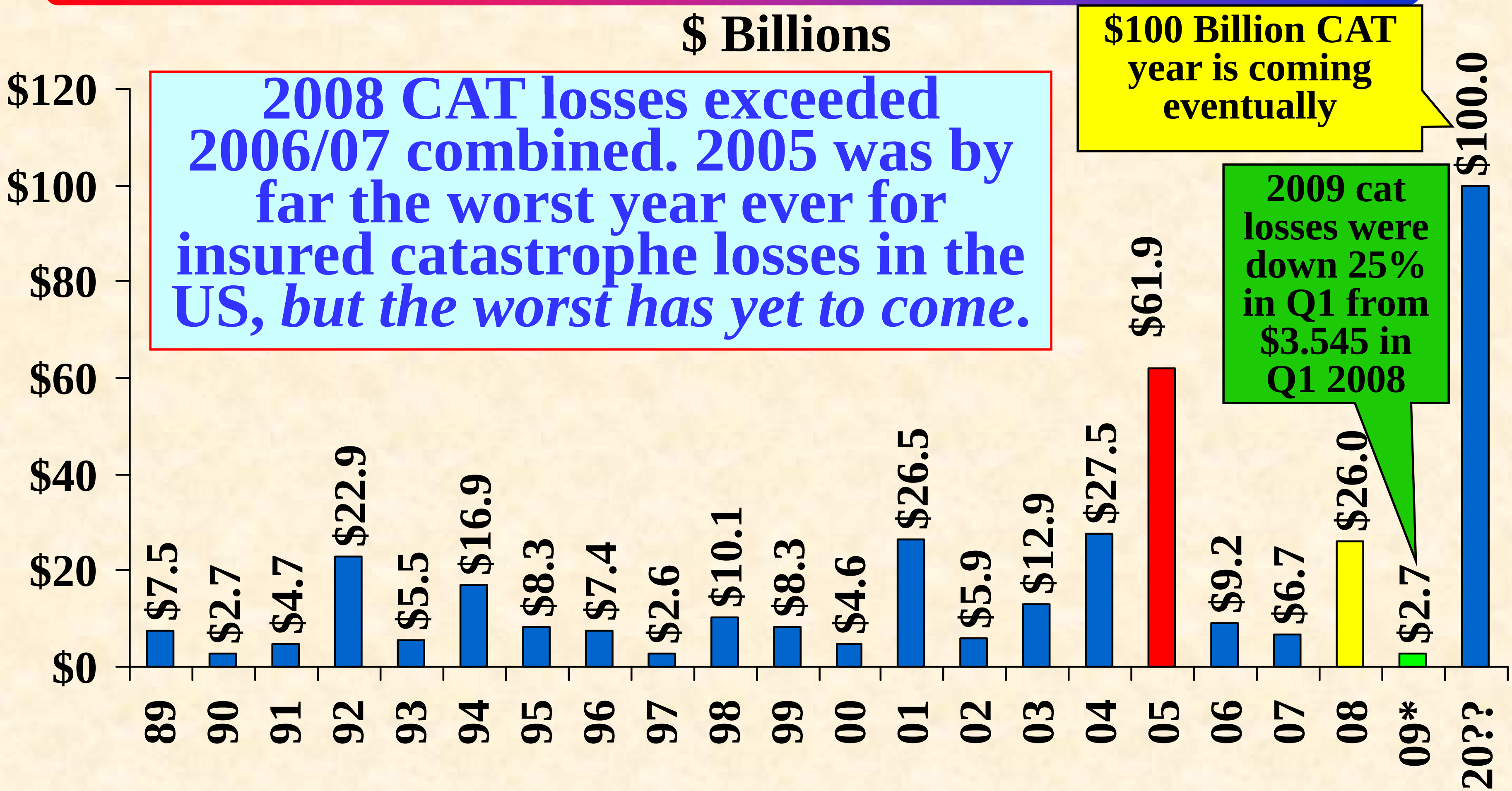


Sources: A.M. Best (historical and forecasts)

Catastrophic Loss

Catastrophe Losses Trends Are Trending Adversely

U.S. Insured Catastrophe Losses



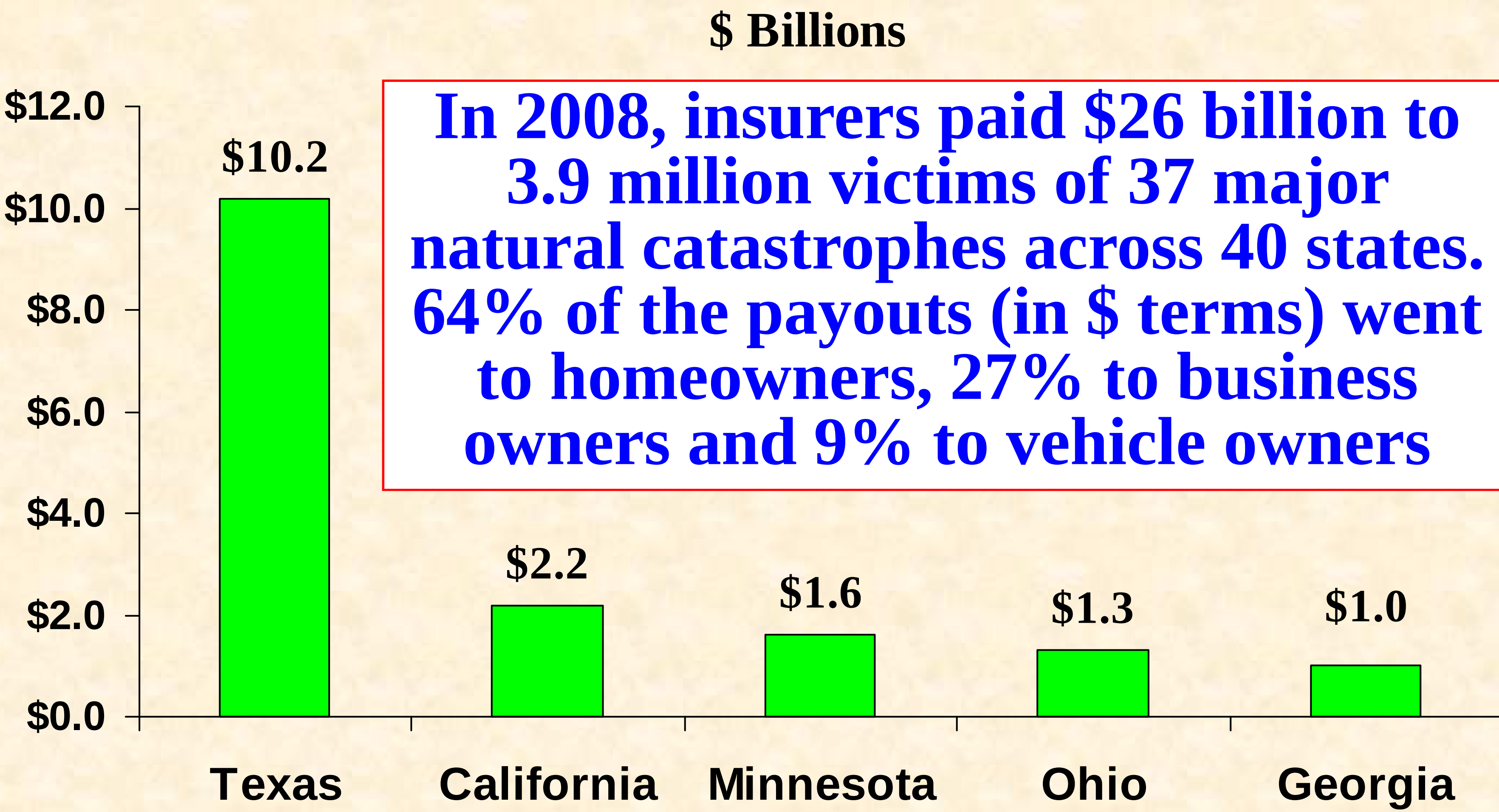
*Based on PCS data through March 31 = $2.66 billion.

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

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.

Number of PCS Catastrophe Events, 1998-2008*

*PCS defines a catastrophe as an even that caused at least $25 million in insured property damage and affects and significant number of policyholders and insurers.

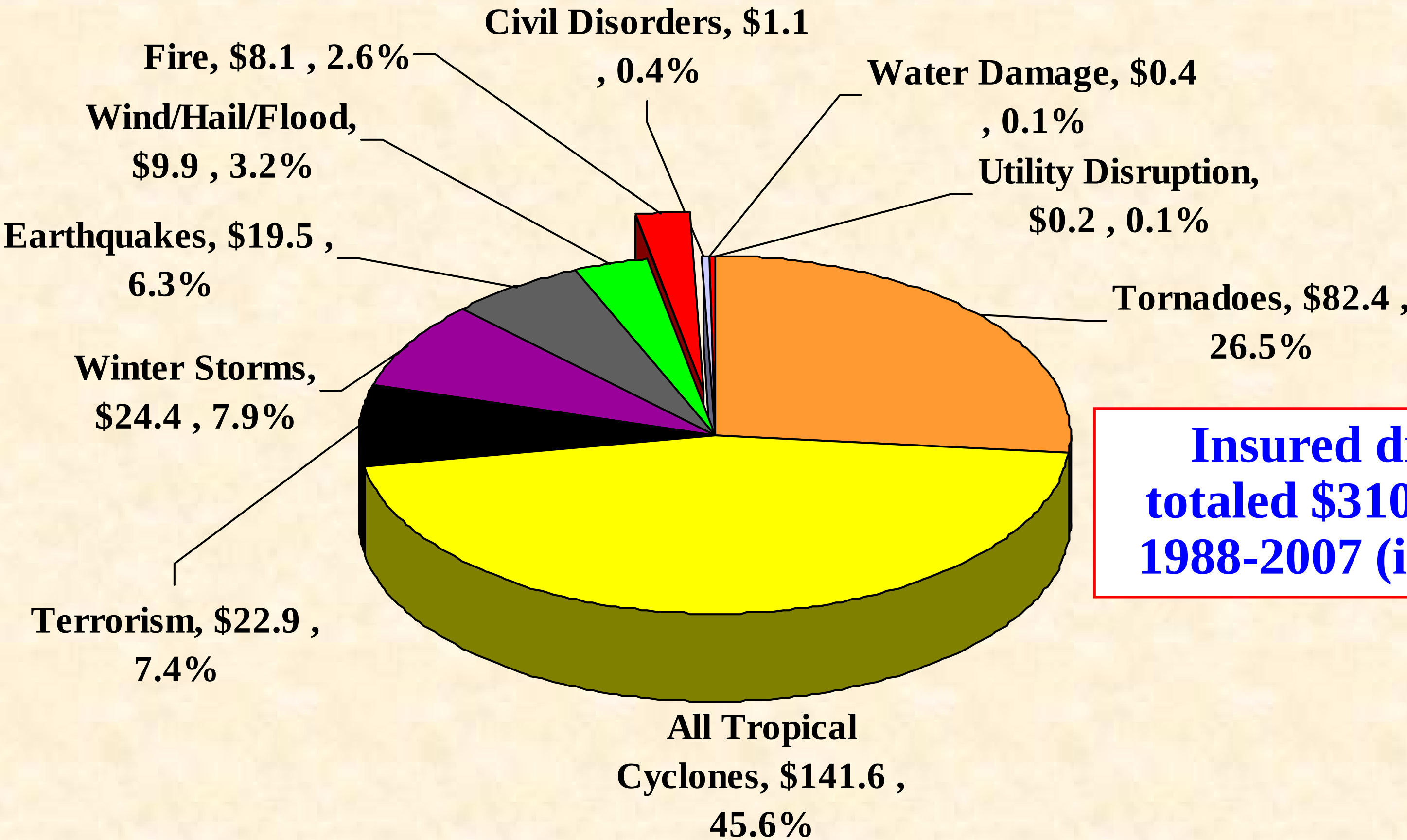
Source: PCS; Insurance Information Institute

Top 12 Most Costly Disasters in US History, (Insured Losses, $2007)

***PCS estimate as of 12/15/08.**

Sources: ISO/PCS; AIR Worldwide, RMS, Eqecat; Insurance Information Institute inflation adjustments.

Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1988-2007[1]



Insured disaster losses totaled $310.5 billion from 1988-2007 (in 2007 dollars)

[1] Catastrophes are all events causing direct insured losses to property of $25 million or more in 2007 dollars. Catastrophe threshold changed from $5 million to $25 million beginning in 1997. Adjusted for inflation by the III. [2] Excludes snow. [3] Includes hurricanes and tropical storms. [4] Includes other geologic events such as volcanic eruptions and other earth movement. [5] Does not include flood damage covered by the federally administered National Flood Insurance Program. [6] Includes wildland fires.

Source: Insurance Services Office (ISO)..

Insurance Information Institute On-Line

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