

Property/Casualty Insurance in a Post-Katrina World

An Industry at the Crossroads

Insurance Information Institute



May 9, 2007

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

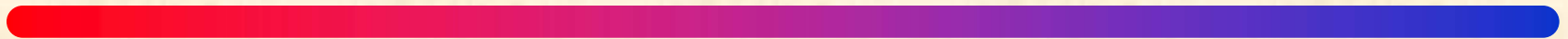


Presentation Outline

- **P/C Profit Overview—2006, A Cyclical Peak**
- **Underwriting Trends: *Unsustainable?***
- **Premium Growth: *Approaching a Standstill***
- **Pricing: Competitive Pressures Mounting**
- **Expenses: Will Ratios Rise a Growth Slows?**
- **Capital & Capacity: Underleveraged → ROE Pressure**
- **Catastrophe Loss Management**
 - **What is the Appropriate Role for Government?**
- **Reinsurance Summary**
- **Financial Strength & Ratings**
- **Investments: Less Bang for the Buck**
- **Tort System: Great News for a Change (Mostly)**
- **Legislative & Regulatory Update**
- **Q&A**

P/C PROFIT: *An Historical Perspective*

*Profits in 2006 Reached
Their Cyclical Peak*





Highlights: Property/Casualty, 2006 vs. 2005

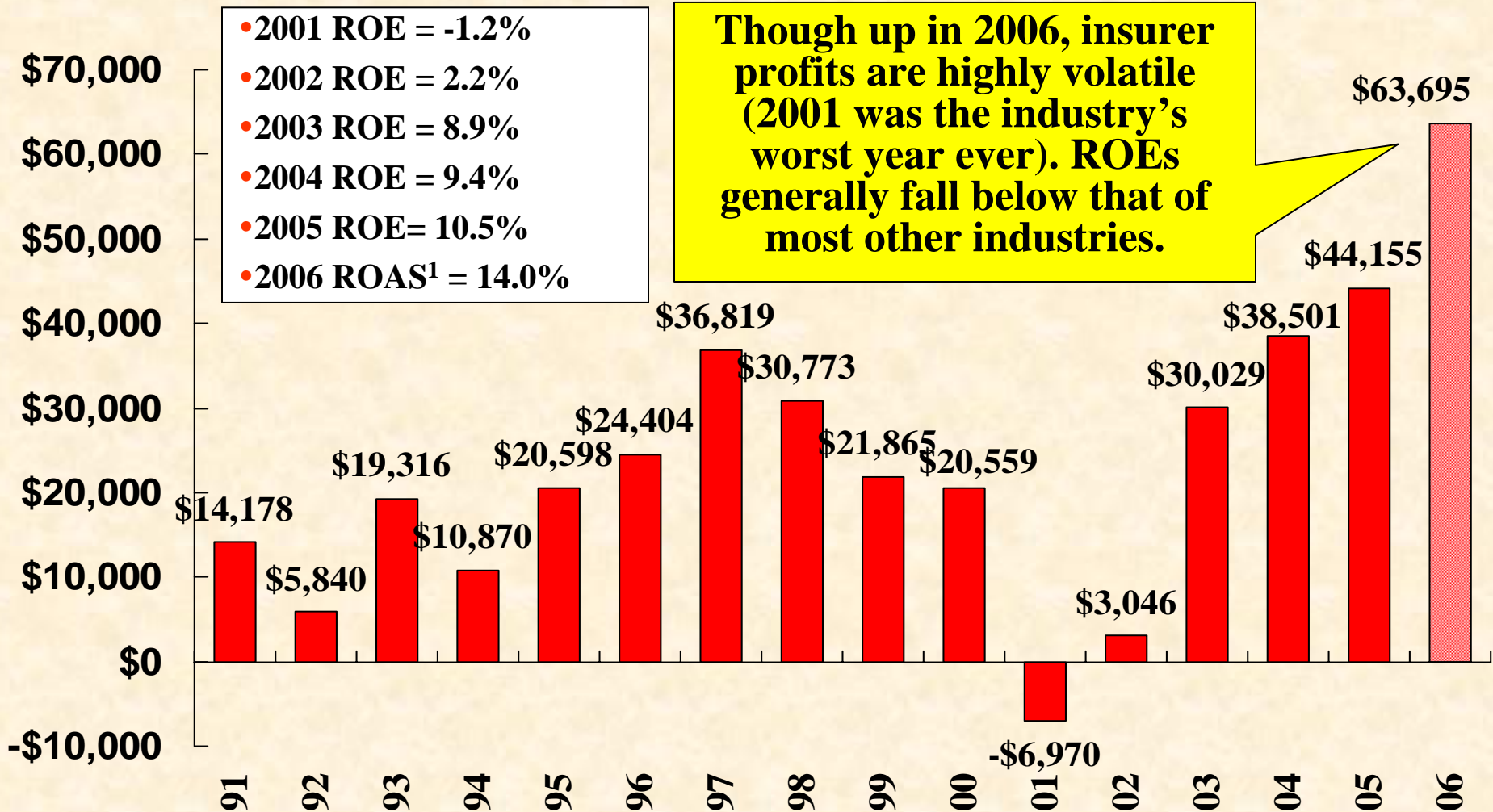
**Growth up due to coastal
property premiums**

	2006	2005	Change
Net Written Prem.	443,778	425,500	+4.3%
Loss & LAE	283,700	311,624	-9.0%
Net UW Gain (Loss)	31,232	(5,612)	N/A
Record underwriting profit: Unsustainable	55,561	59,430	-6.4%
Net Income (a.t.)	63,695	44,155	+44.3%
Surplus*	487,123	425,760	+14.4%
Combined Ratio*	92.4	100.9	-8.5 pts.

*Comparison is with year-end 2004 value. **Includes invest income and realized investment gains/losses.
Source: ISO, Insurance Information Institute



P/C Net Income After Taxes *1991-2006 (\$ Millions)**

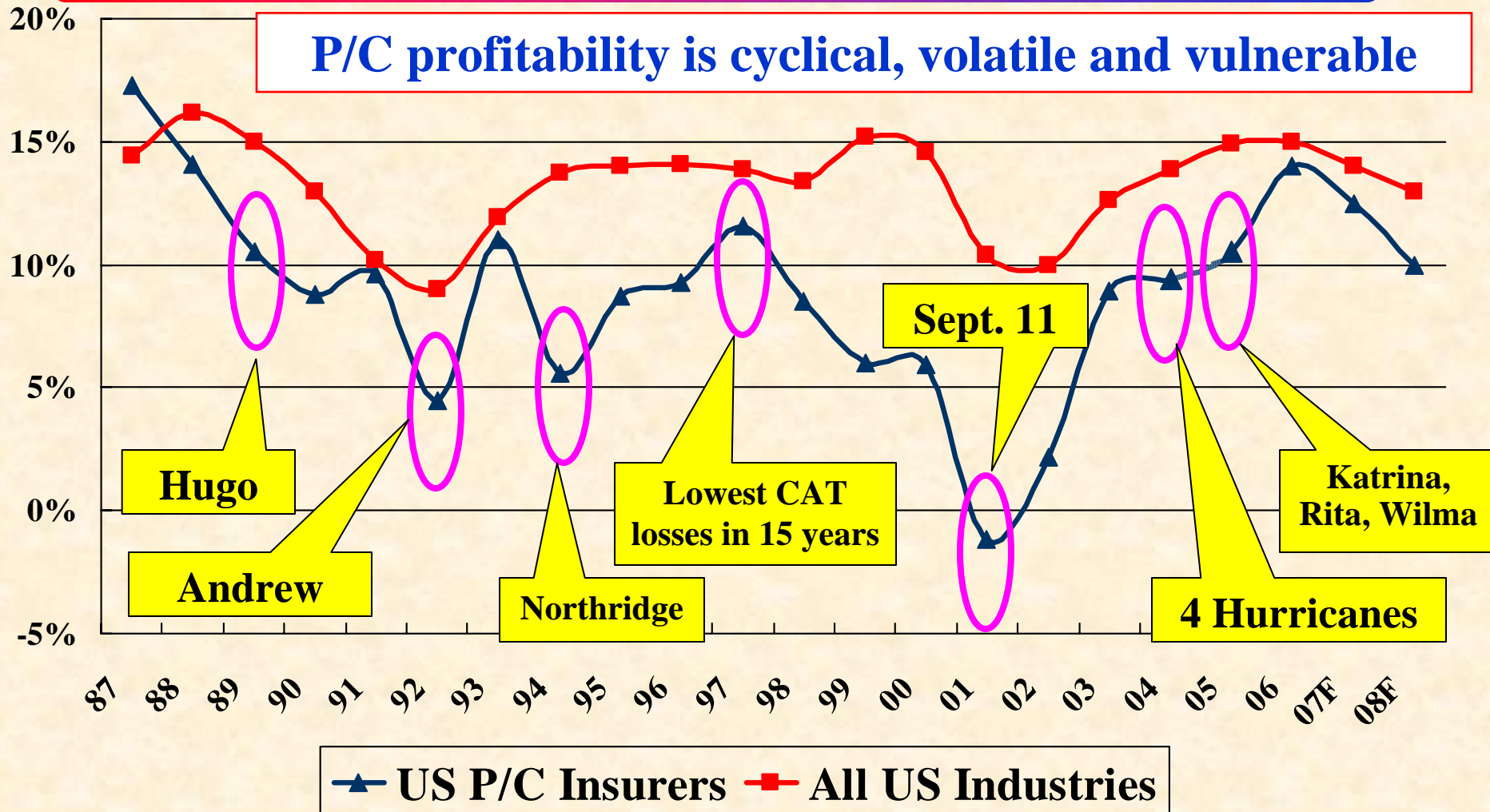


*ROE figures are GAAP; ¹Return on avg. Surplus.
Sources: A.M. Best, ISO, Insurance Information Inst.



ROE: P/C vs. All Industries

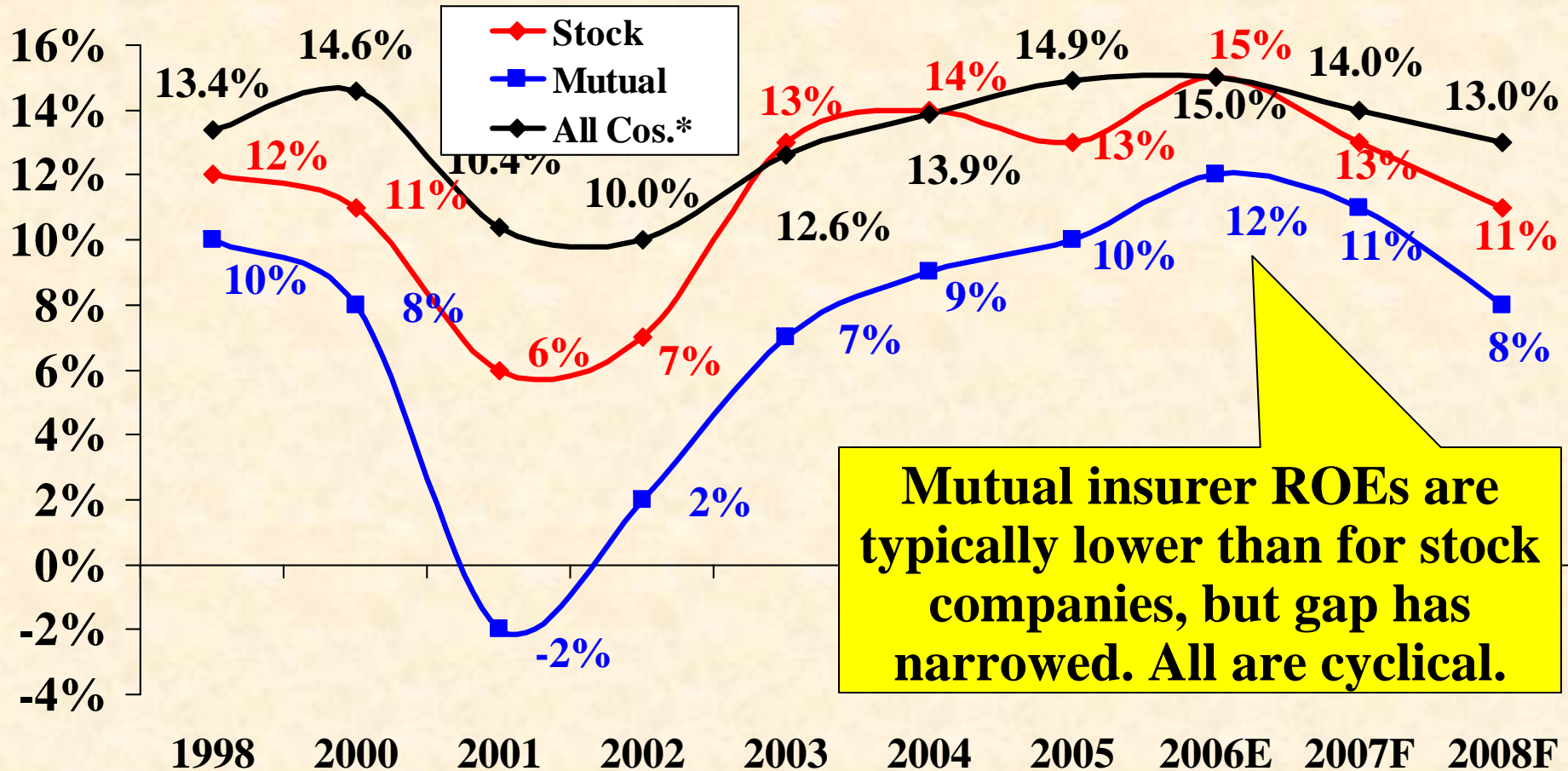
1987–2008E



*2007-08 P/C insurer ROEs are I.I.I. estimates.
Source: Insurance Information Institute; *Fortune*



RETURN ON EQUITY (Fortune): Stock & Mutual vs. All Companies*



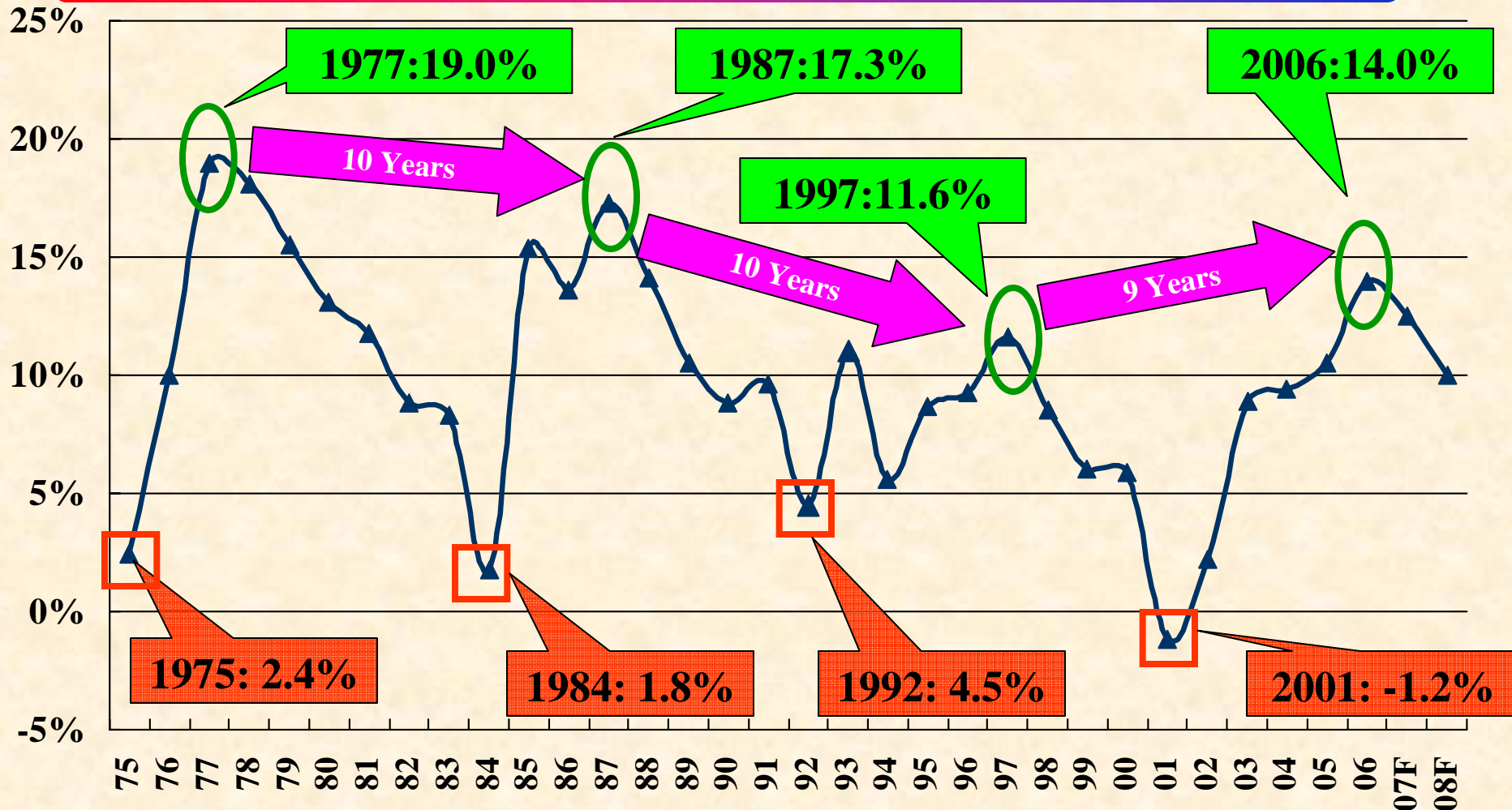
Mutual insurer ROEs are typically lower than for stock companies, but gap has narrowed. All are cyclical.

*Fortune 1,000 group.

Source: *Fortune Magazine*, Insurance Information Institute.



Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2008F

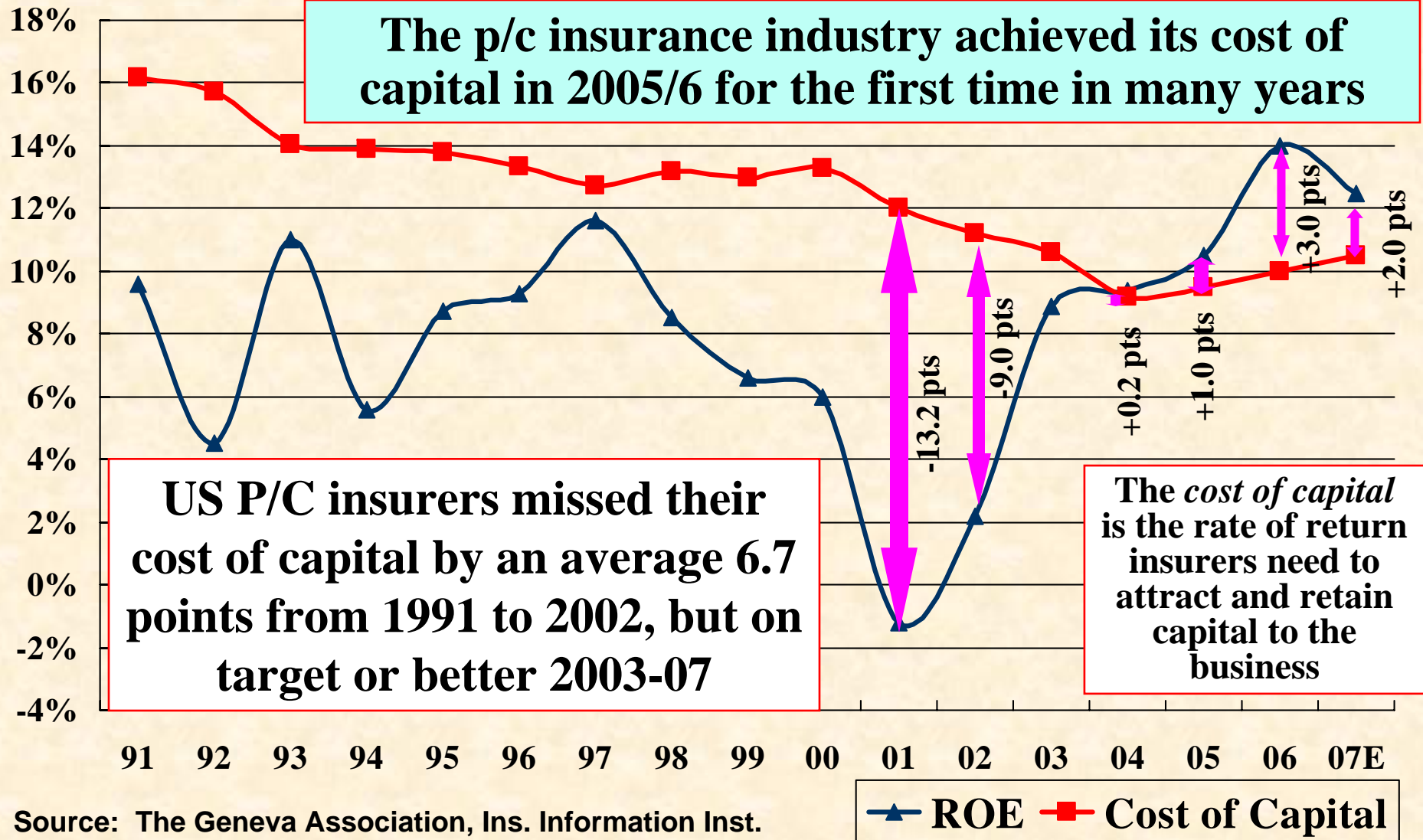


*2007-08 P/C insurer ROEs are I.I.I. estimates.

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



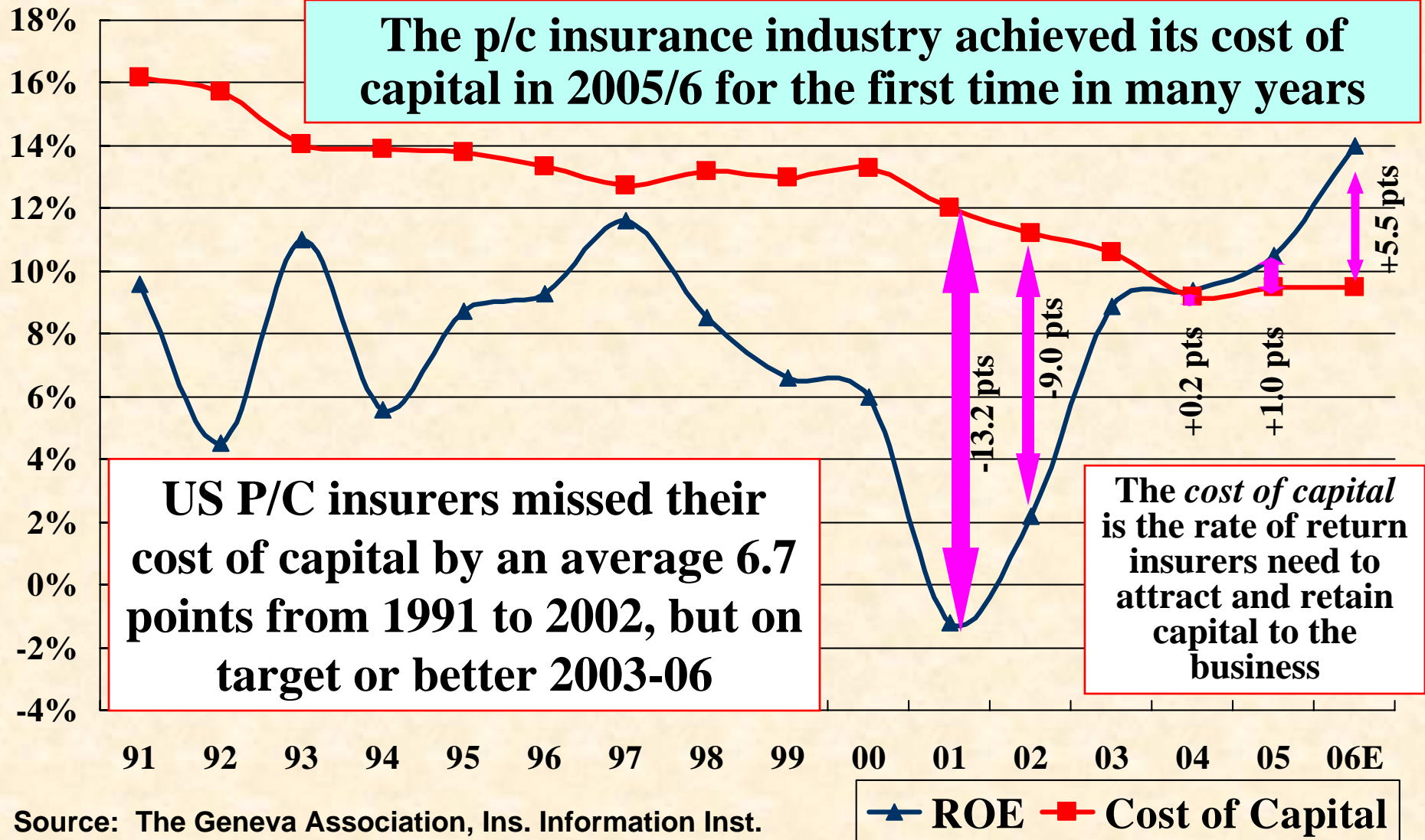
ROE vs. Equity Cost of Capital: US P/C Insurance: 1991-2007E



Source: The Geneva Association, Ins. Information Inst.



ROE vs. Equity Cost of Capital: US P/C Insurance: 1991-2006

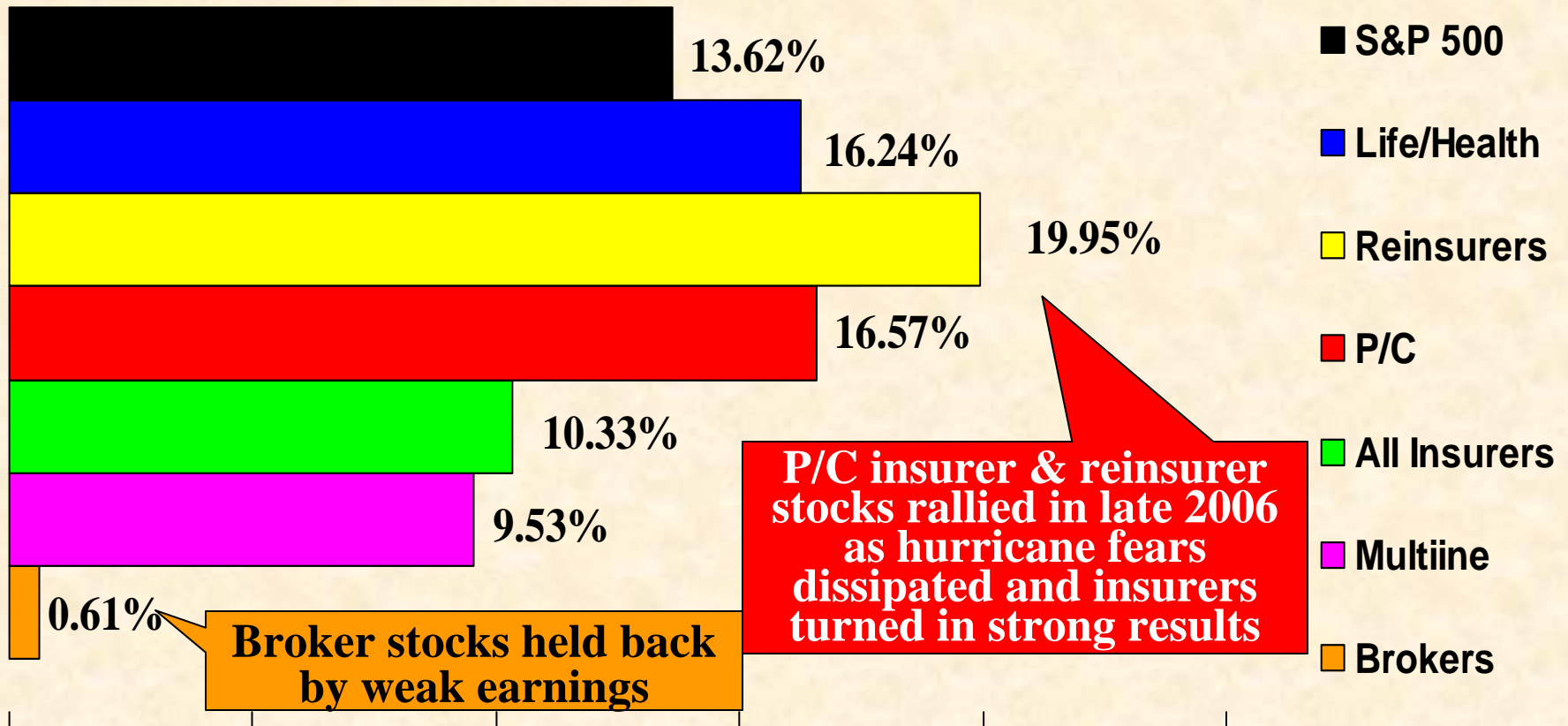


Source: The Geneva Association, Ins. Information Inst.



Insurance & Reinsurance Stocks: Strong Finish in 2006

Total Returns for 2006

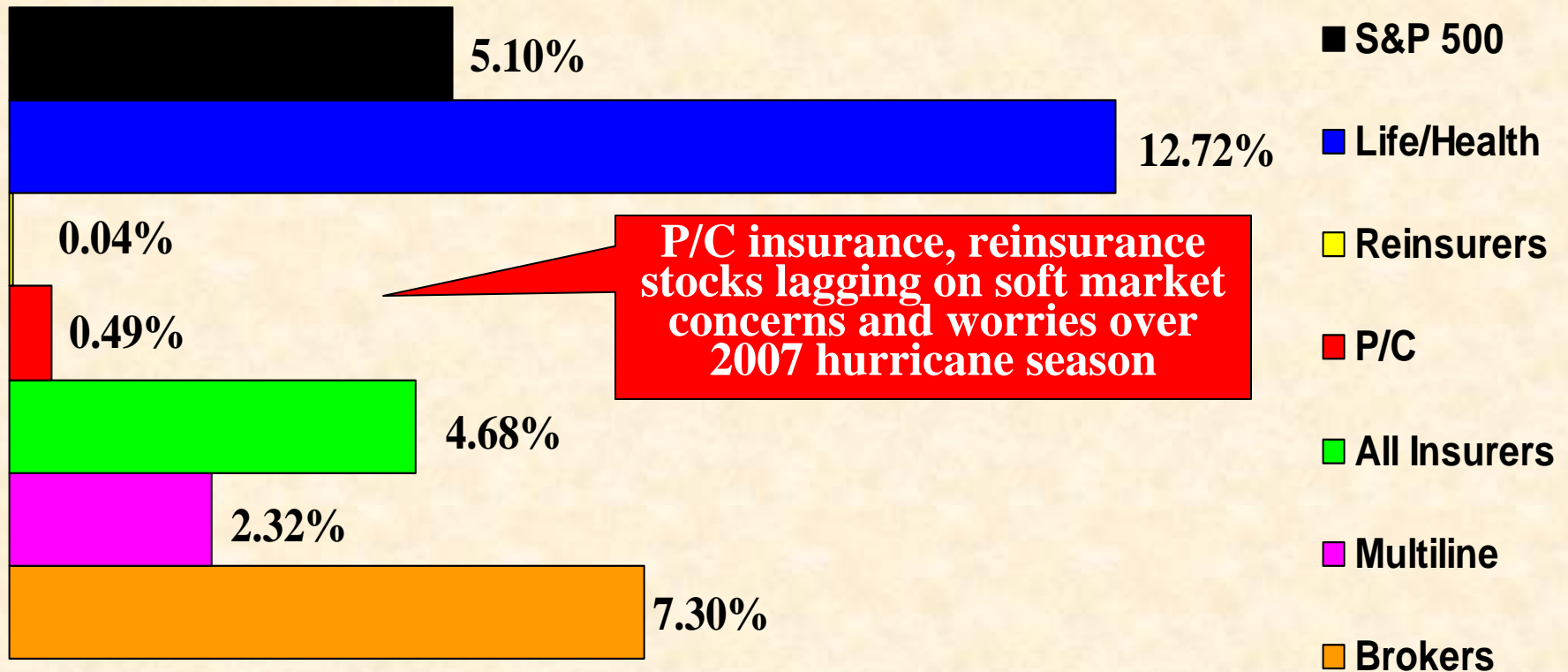


0.0% 5.0% 10.0% 15.0% 20.0% 25.0%



Insurance & Reinsurance Stocks: Slow Start in 2007 in P/C, Reins

Total YTD Returns Through May 4, 2007

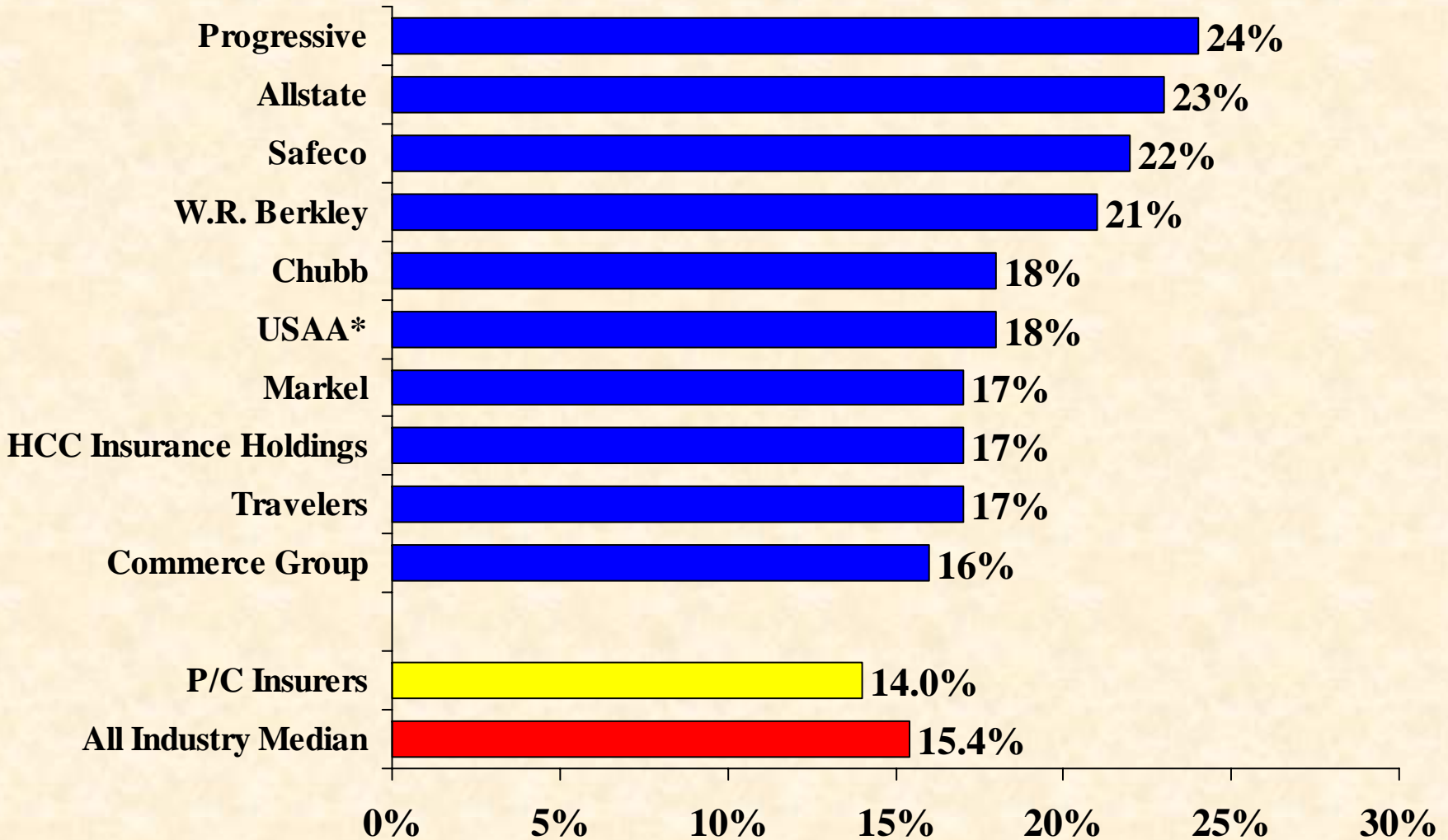


0.0% 2.0% 4.0% 6.0% 8.0% 10.0% 12.0% 14.0%

Source: SNL Securities, Standard & Poor's, Insurance Information Institute



Top 10 Most Profitable P/C Insurers Ranked by 2006 ROE

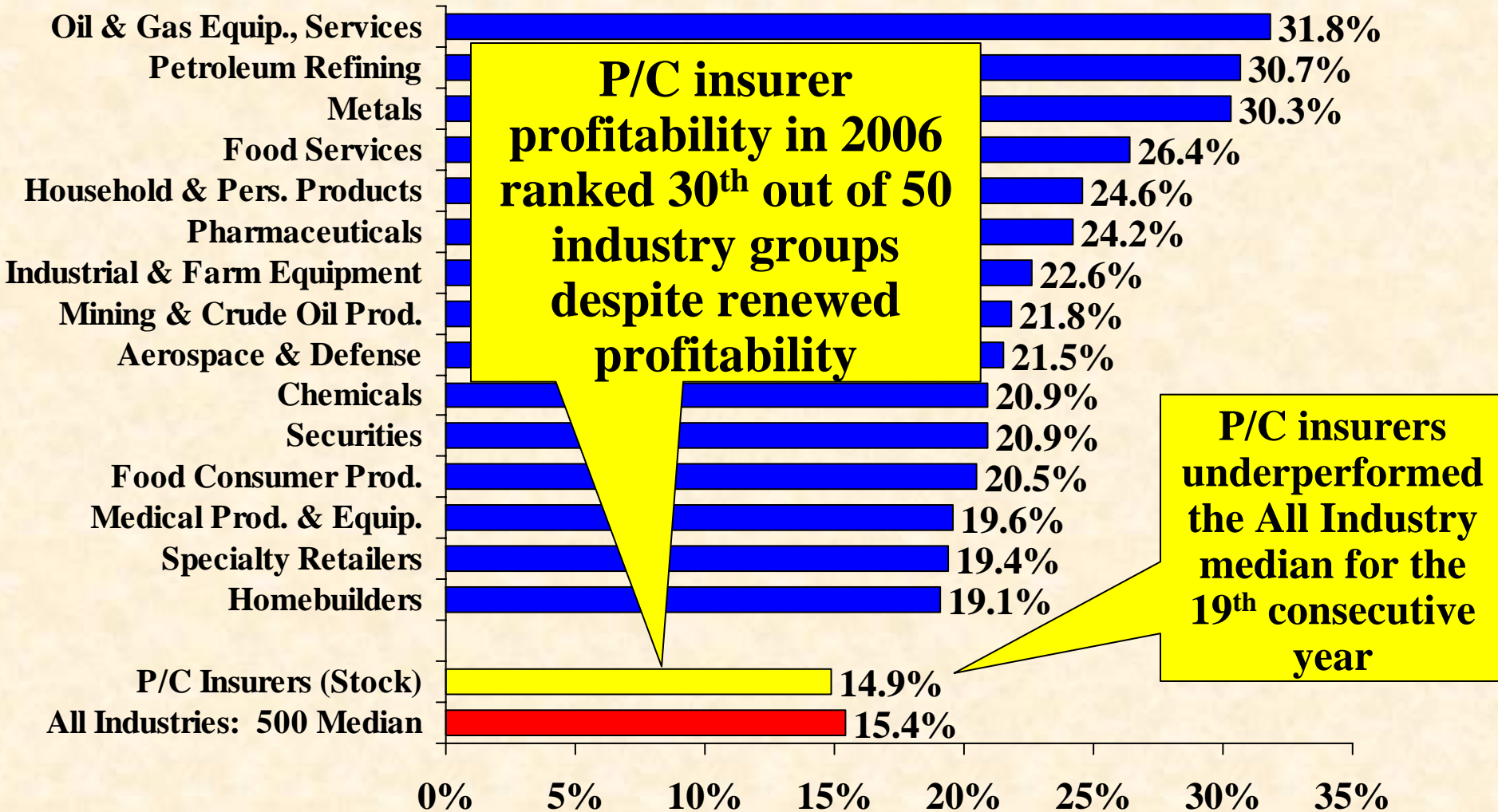


*Not a stock company, but reported results under GAAP.

Source: Fortune, April 30, 2007 edition; Insurance Information Institute



Top Industries by ROE: P/C Insurers Still Underperformed in 2006*

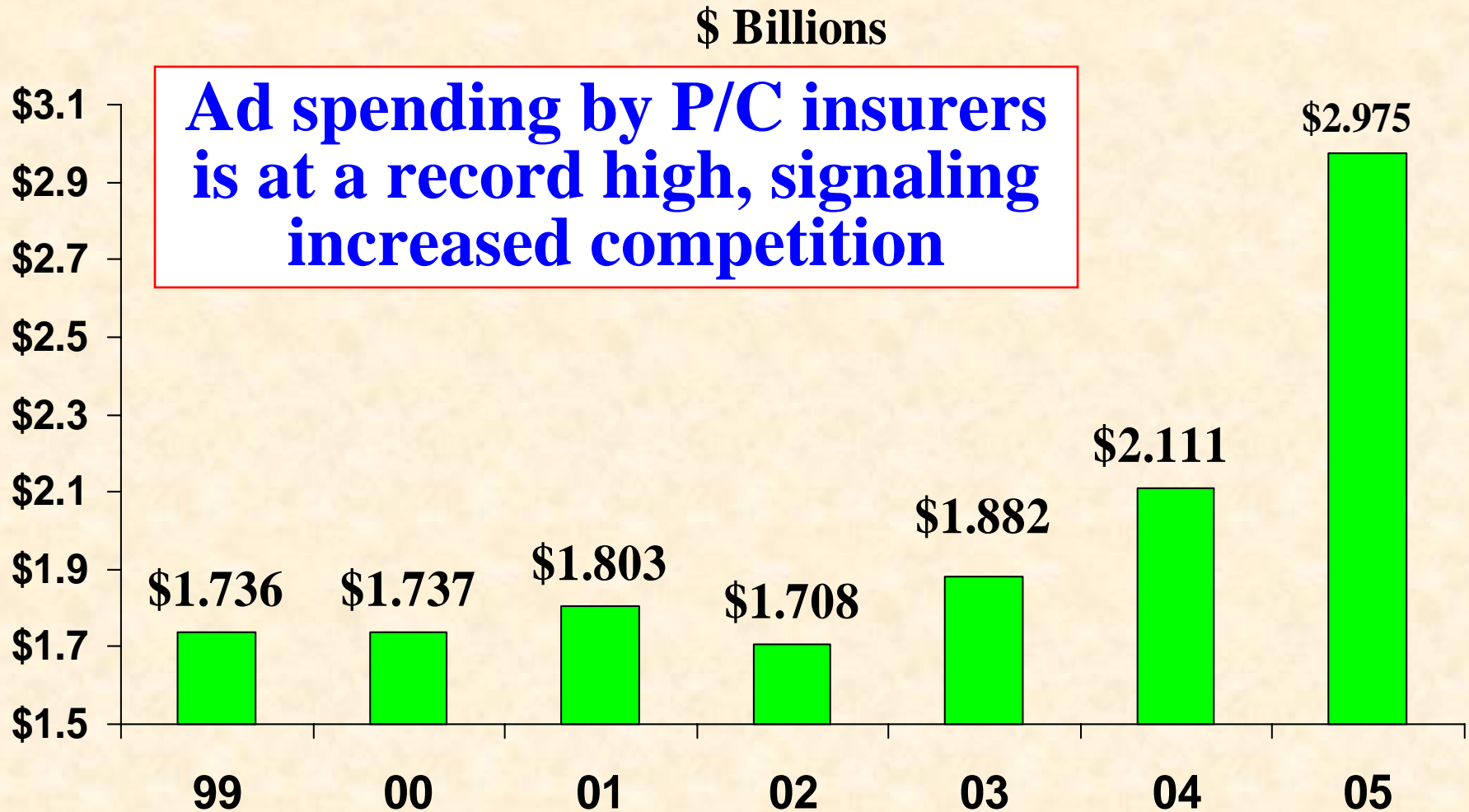


*Excludes #1 ranked Airline category at 65.1% due to special one-time bankruptcy-related factors.

Source: Fortune, April 30, 2007 edition; Insurance Information Institute



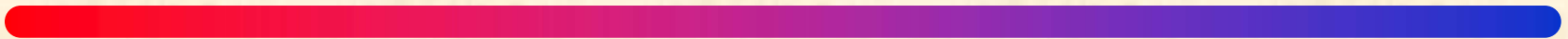
Advertising Expenditures by P/C Insurance Industry, 1999-2005



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

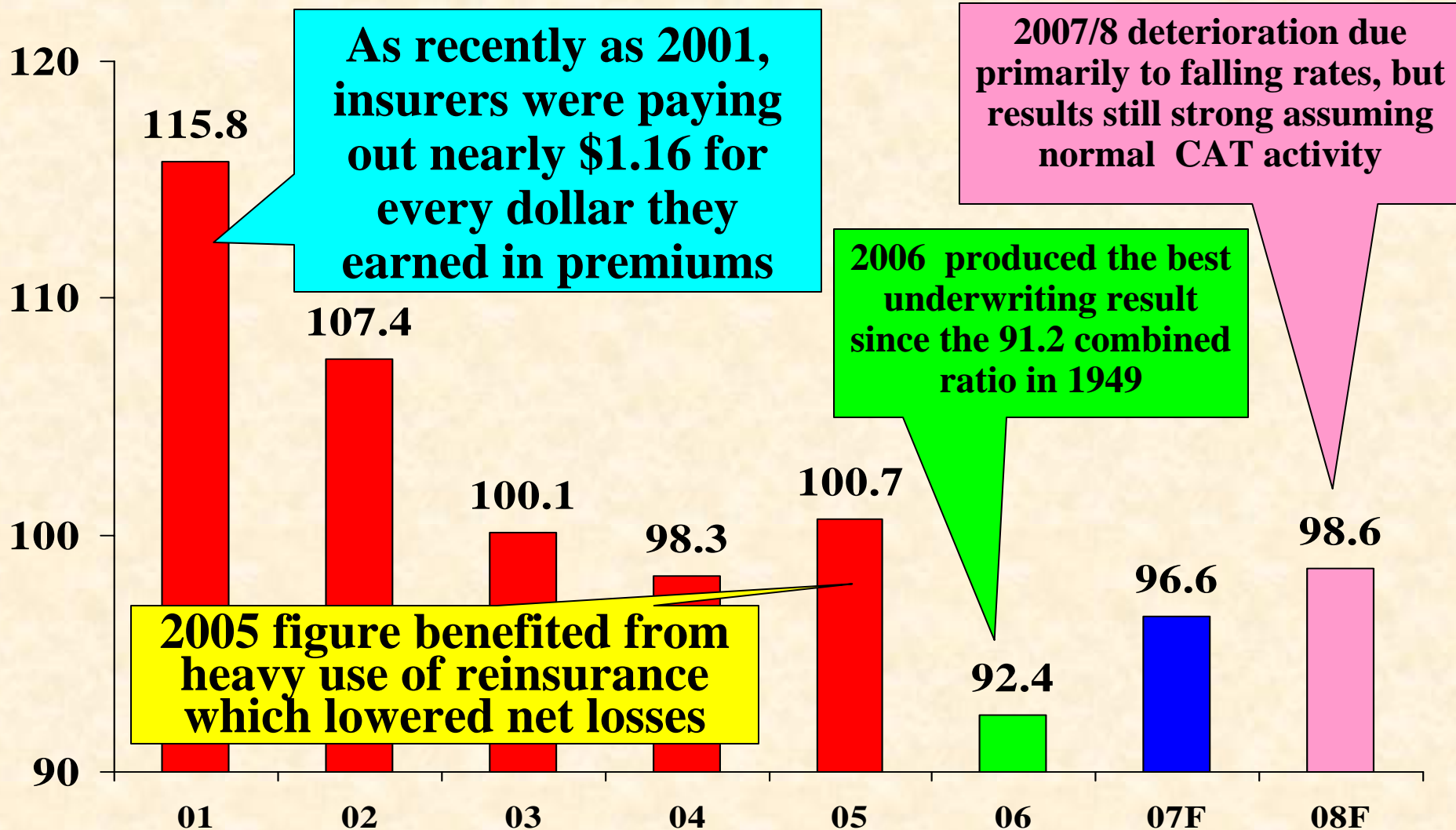
UNDERWRITING

**Extremely Strong 2006,
Momentum for 2007/08**





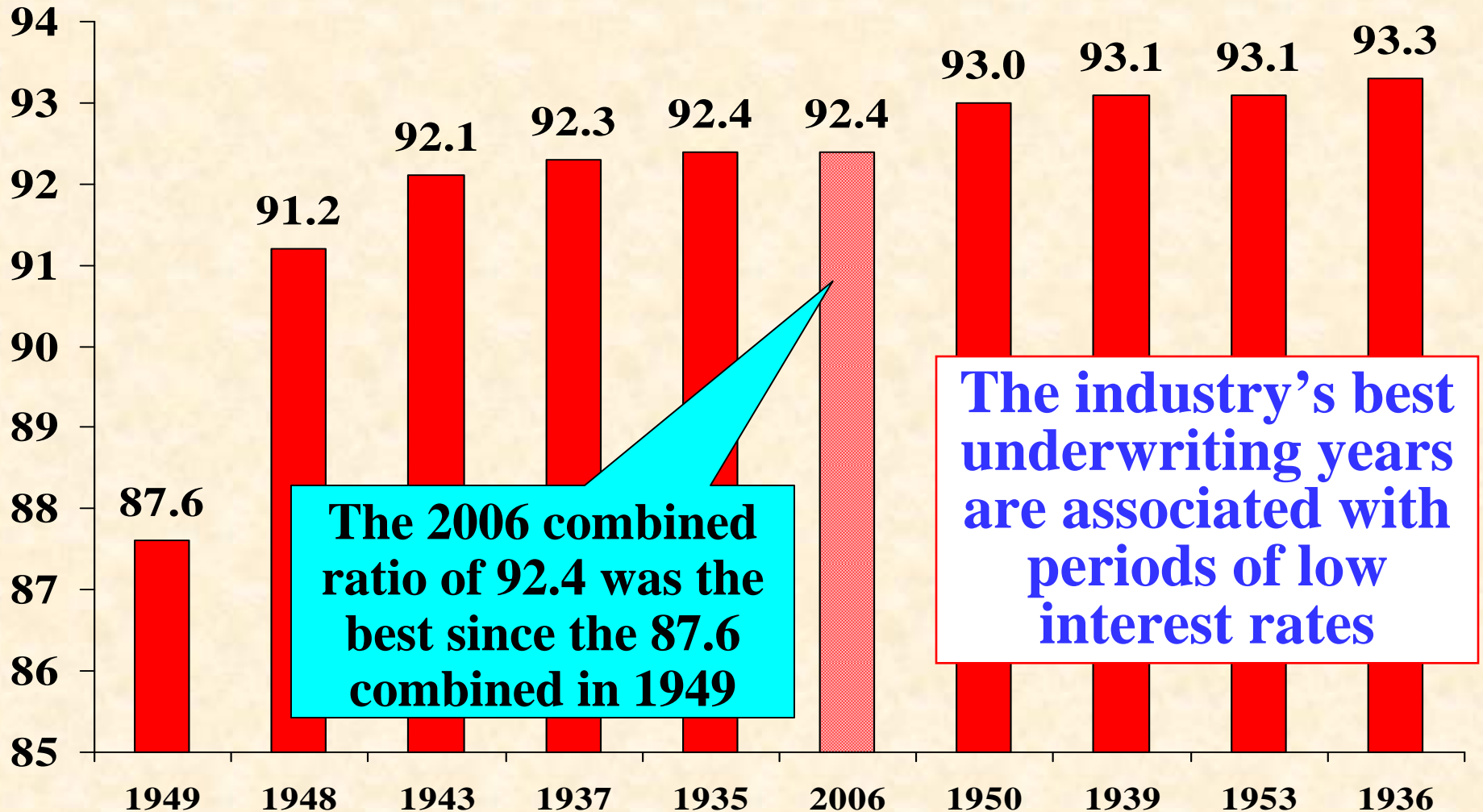
P/C Industry Combined Ratio



Sources: A.M. Best; ISO, III. *Estimates/forecasts based on III's 2007 Early Bird survey.



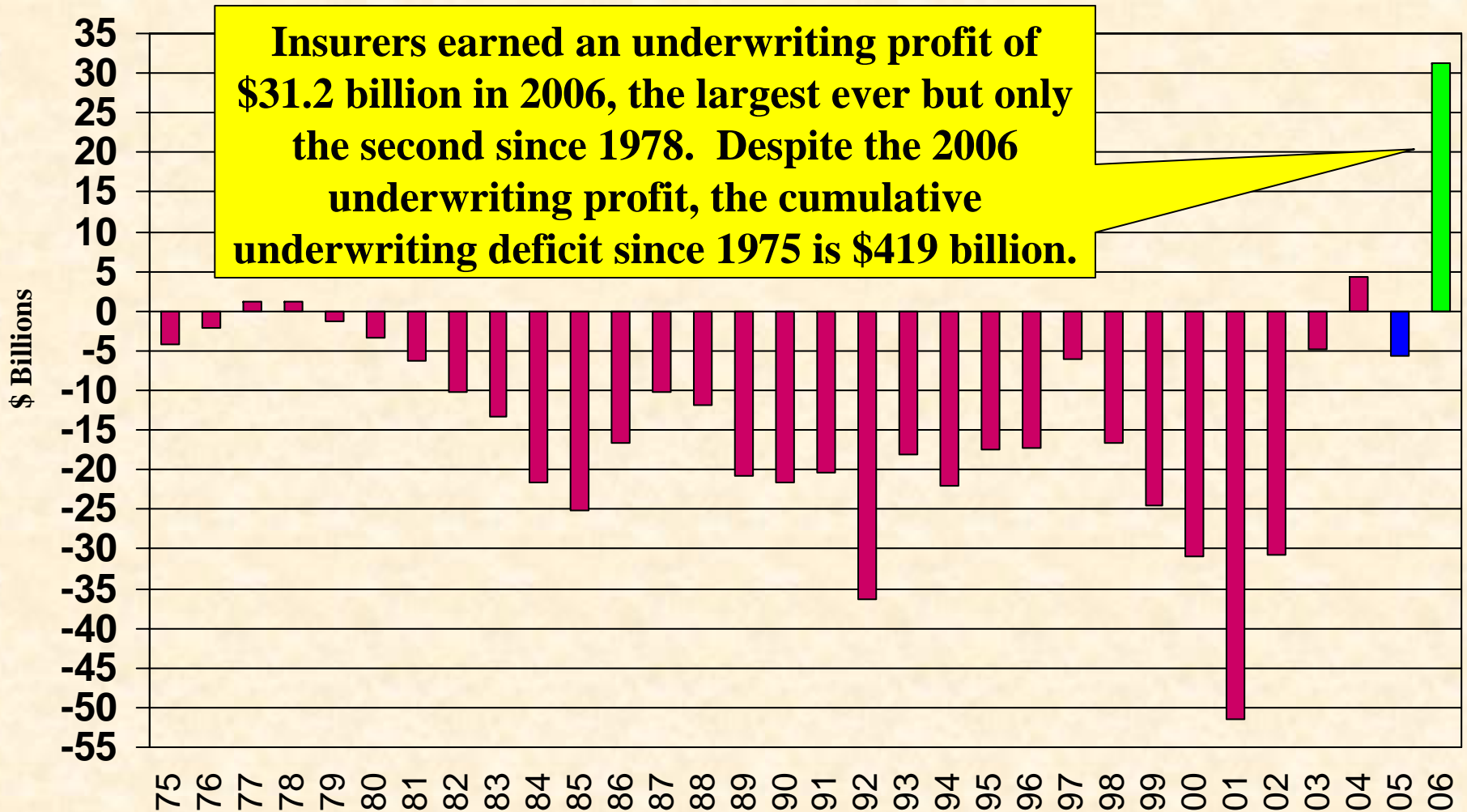
Ten Lowest P/C Insurance Combined Ratios Since 1920





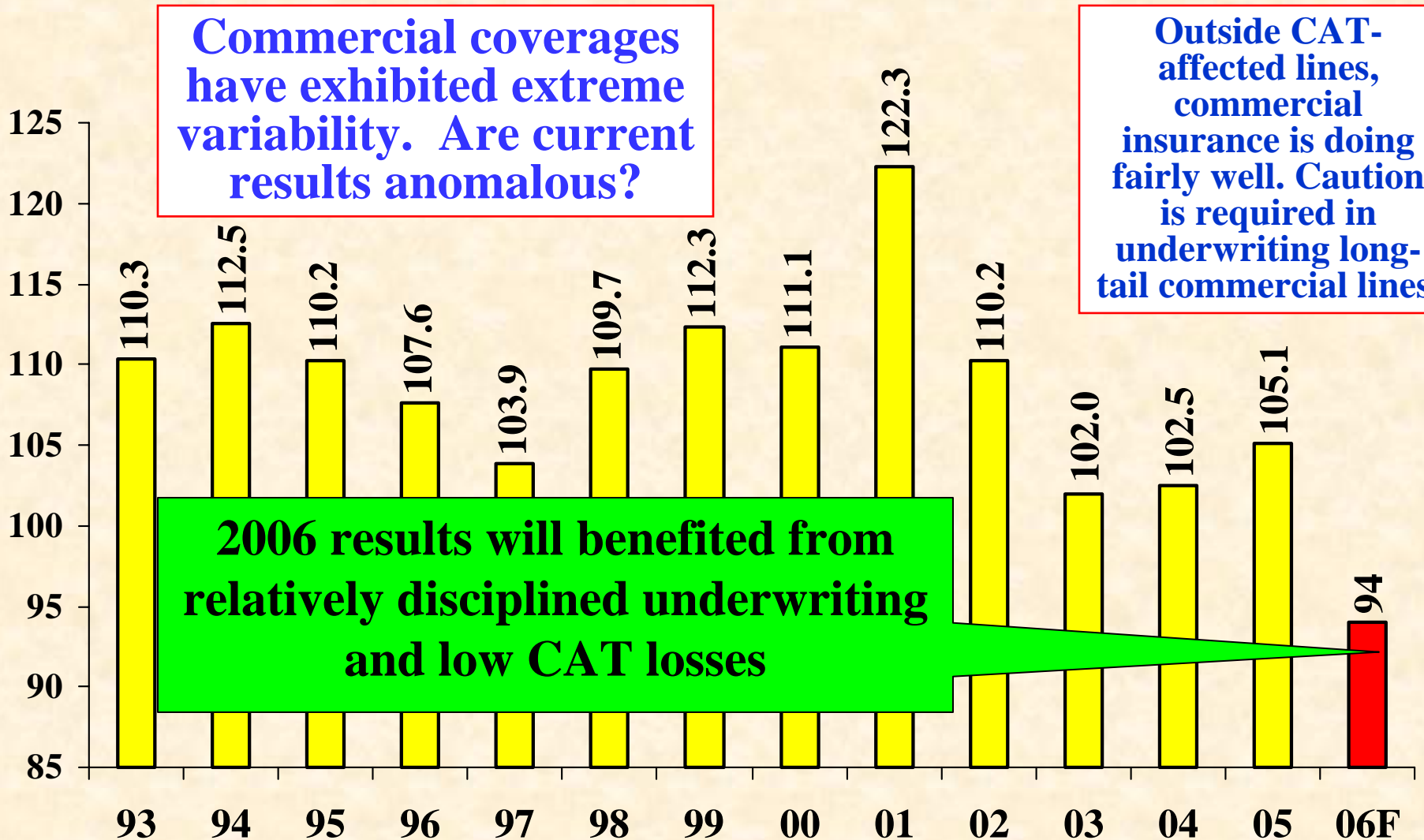
Underwriting Gain (Loss)

1975-2006



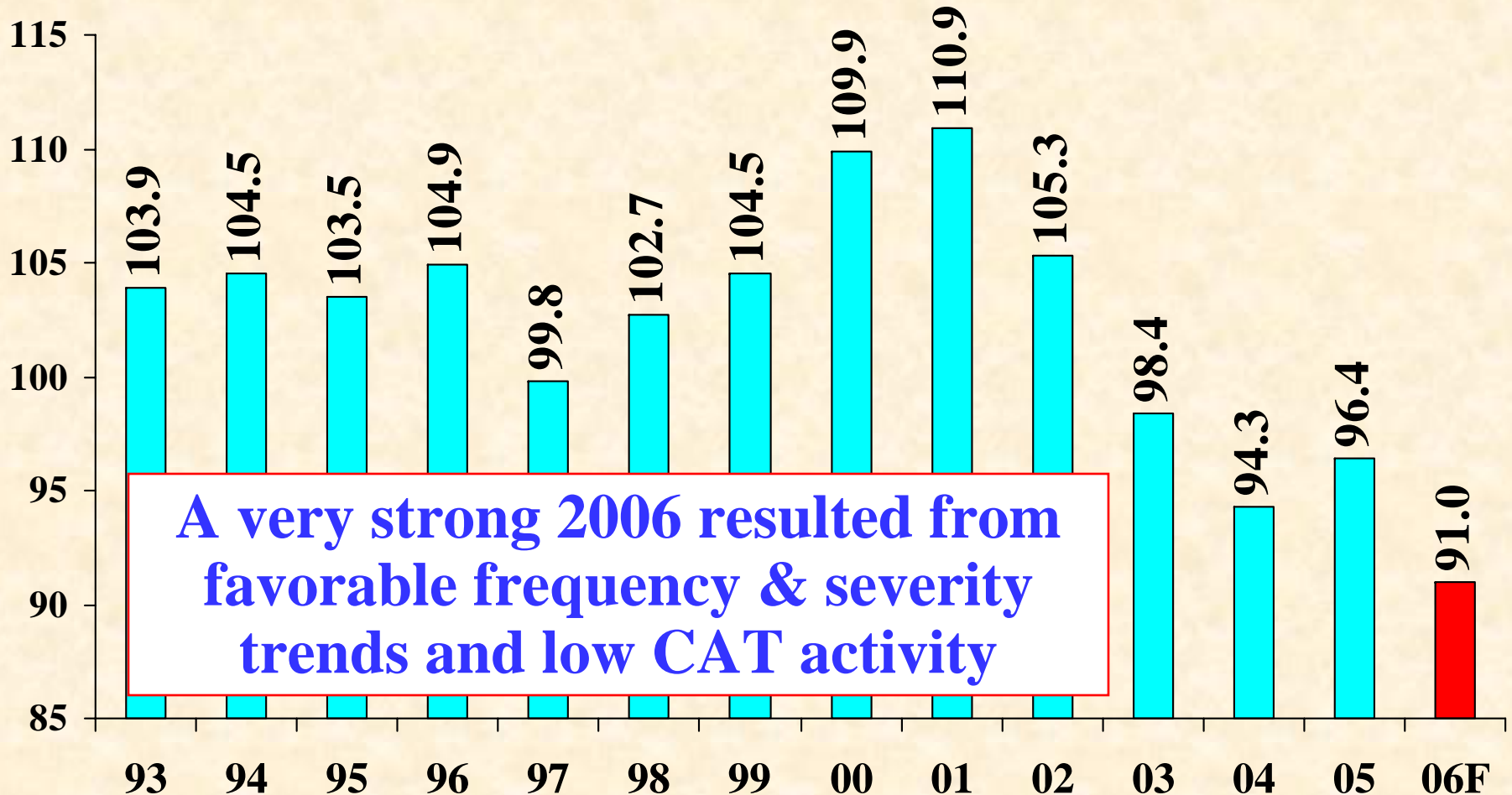


Commercial Lines Combined Ratio, 1993-2006E*



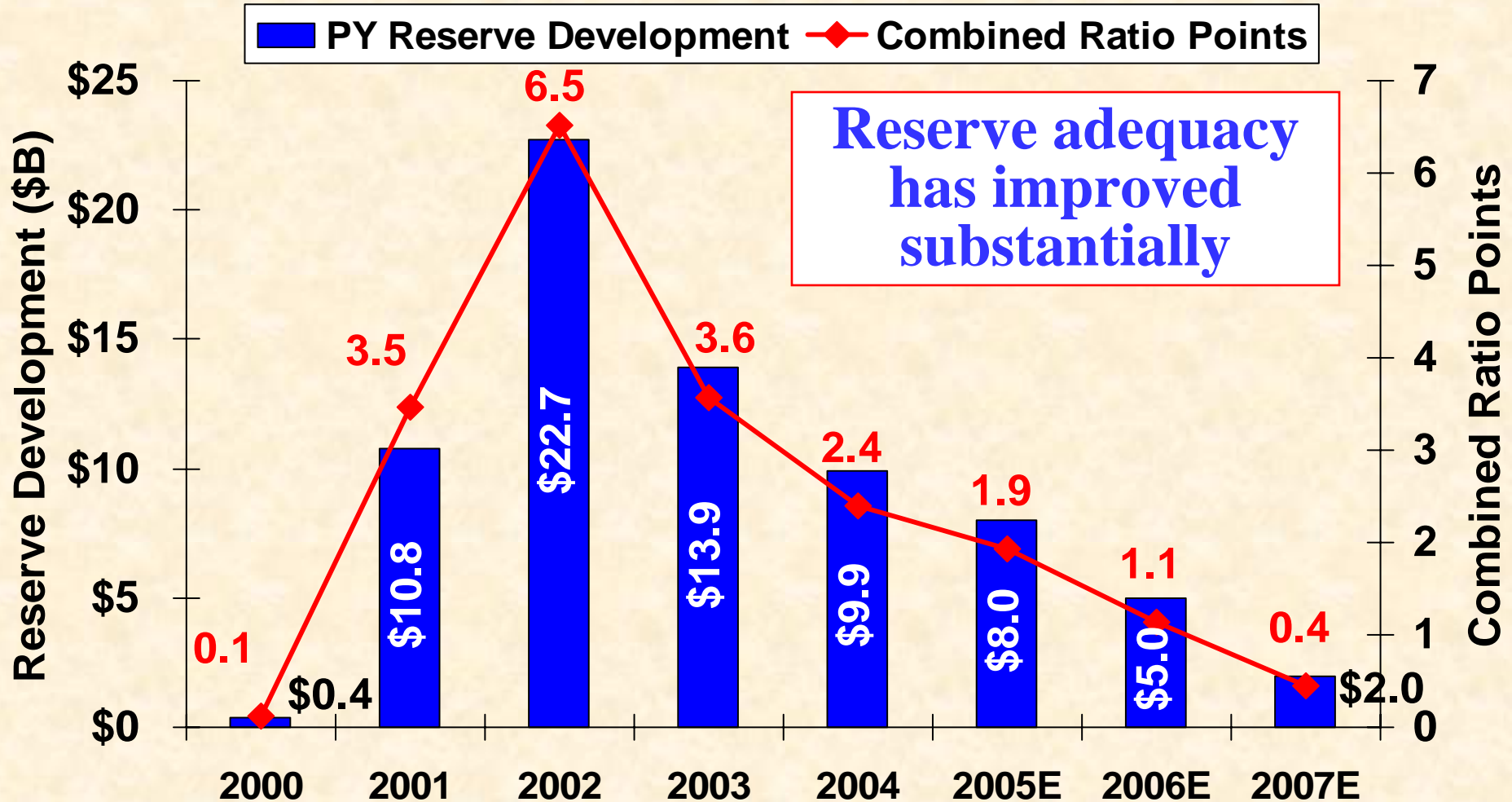


Personal Lines Combined Ratio, 1993-2006E





Impact of Reserve Changes on Combined Ratio



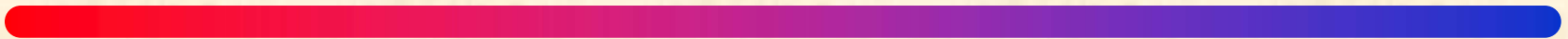


The Big Question: Is the Industry More Disciplined Today?

- **Signs suggest that the answer is *yes***
- **Current period of sustained underwriting profitability is the first since the 1950s**
- **While prices are falling, underlying lost cost trends (frequency and severity trends) are generally favorable to benign**
 - **Suggest impact of falling prices will be less pronounced than late 1990s**
- **Reserve situation appears much improved and under control**
- **Management Information Systems: Much More Sophisticated**
 - **Insurers can monitor and make adjustments much more quickly**
 - **Adjustments made quickly by line, geographic area, producer, etc.**
- **Investment Income**
 - **Relative to late 1990s, interest rates and stock markets returns are lower**
 - **Has effect of imposing (some) discipline**
- **Ratings Agencies**
 - **More stringent capital requirements**
 - **Quicker to downgrade**

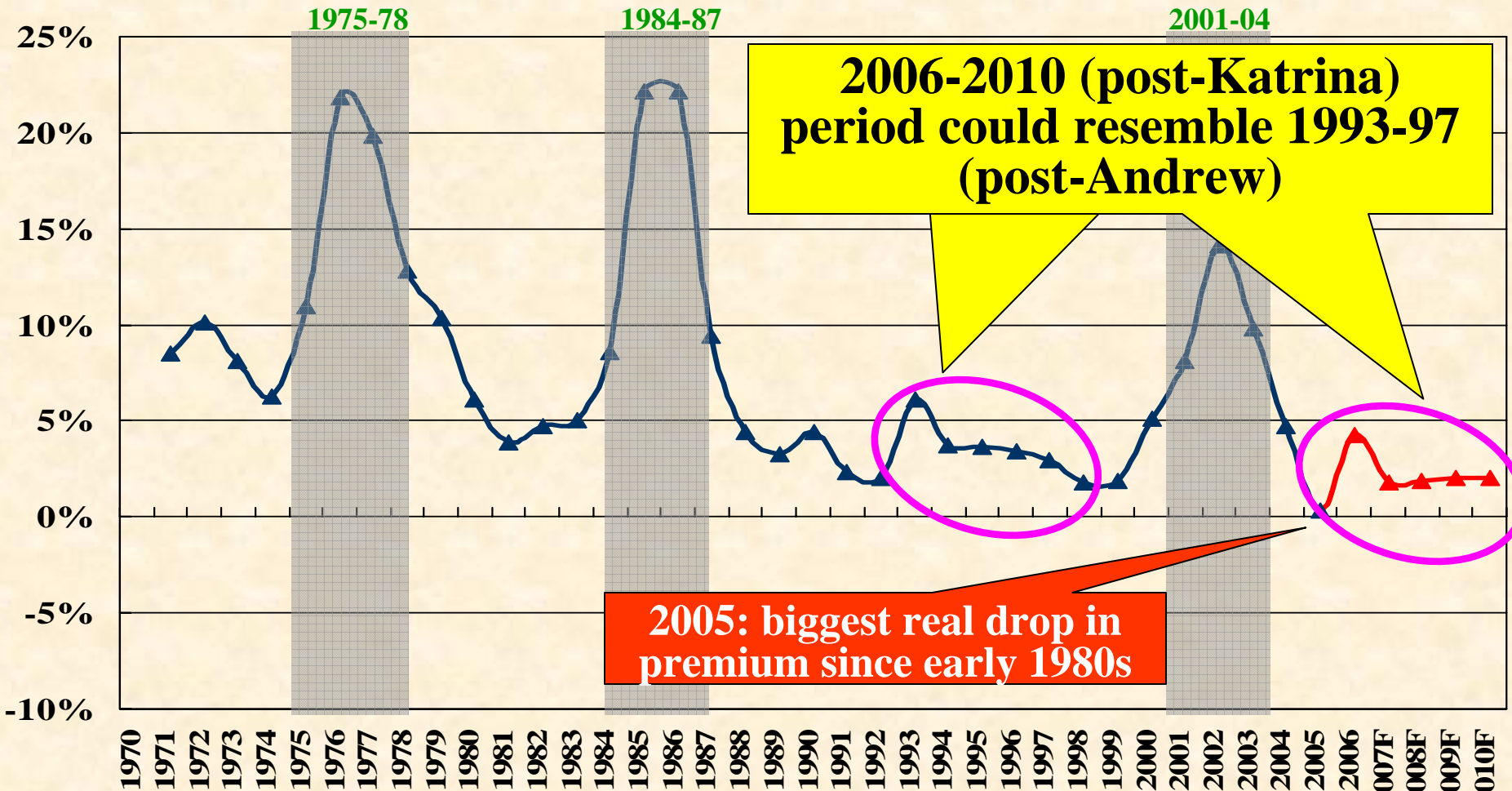
PREMIUM GROWTH

**Deceleration in 2006,
Even Slower in 2007**





Strength of Recent Hard Markets by NWP Growth*

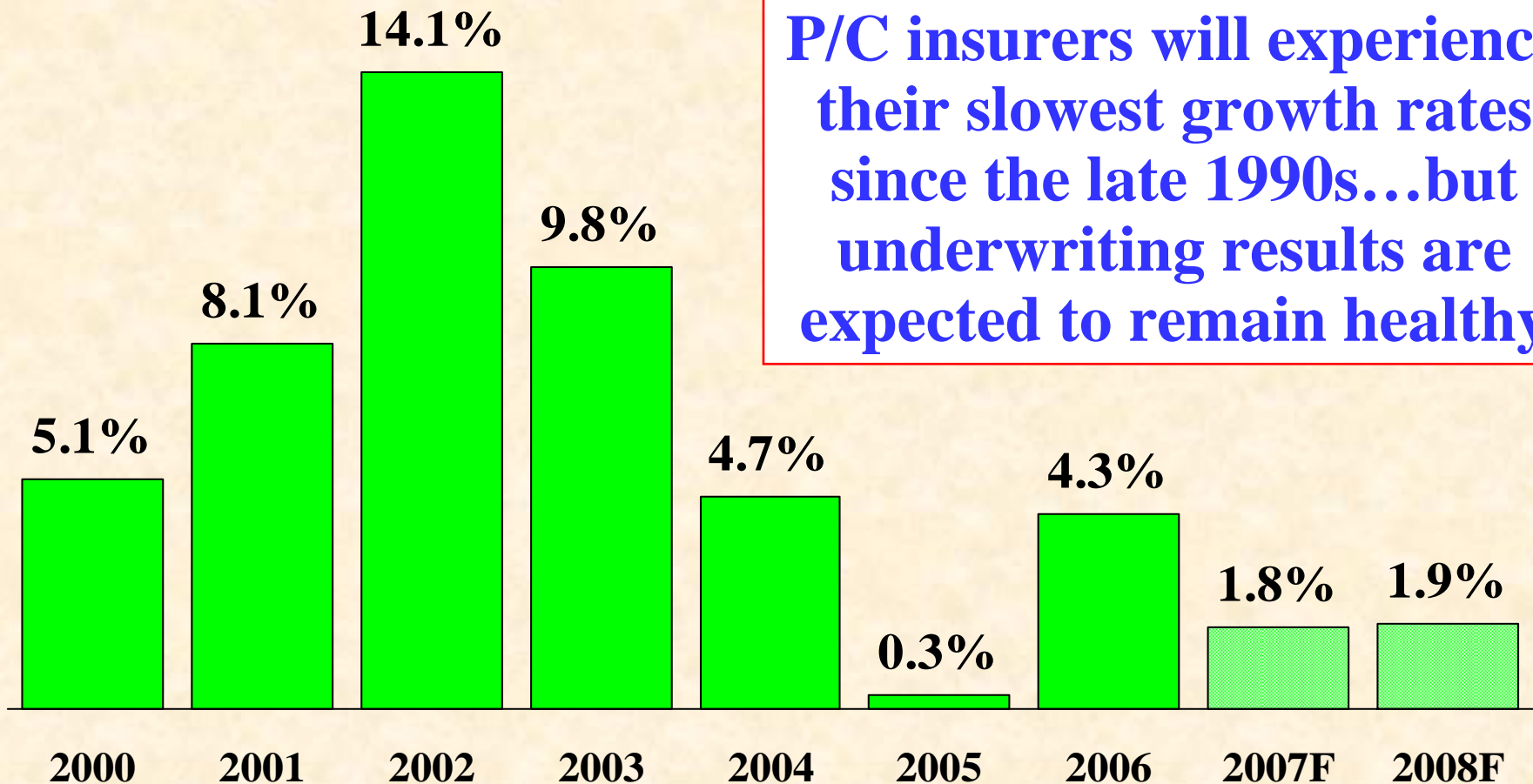


*2007-10 figures are III forecasts/estimates. 2005 growth of 0.4% equates to 1.8% after adjustment for a special one-time transaction between one company and its foreign parent. 2006-2008 figures from III Groundhog Survey.

Note: Shaded areas denote hard market periods.
Source: A.M. Best, Insurance Information Institute



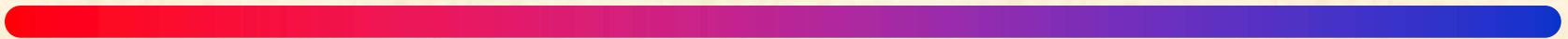
Growth in Net Written Premium, 2000-2008F



P/C insurers will experience their slowest growth rates since the late 1990s...but underwriting results are expected to remain healthy

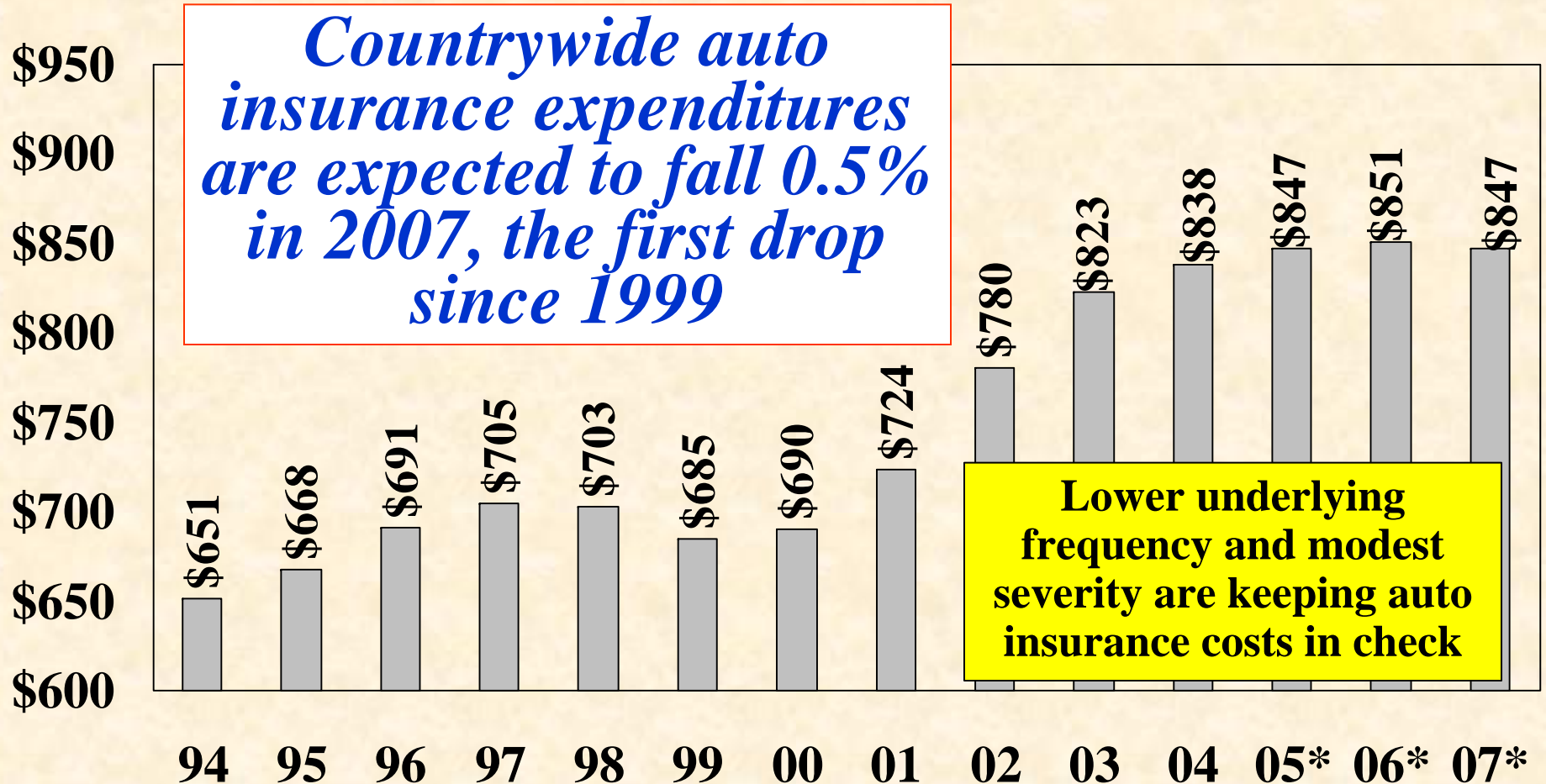
PRICING

Under Pressure in 2007





Average Expenditures on Auto Insurance

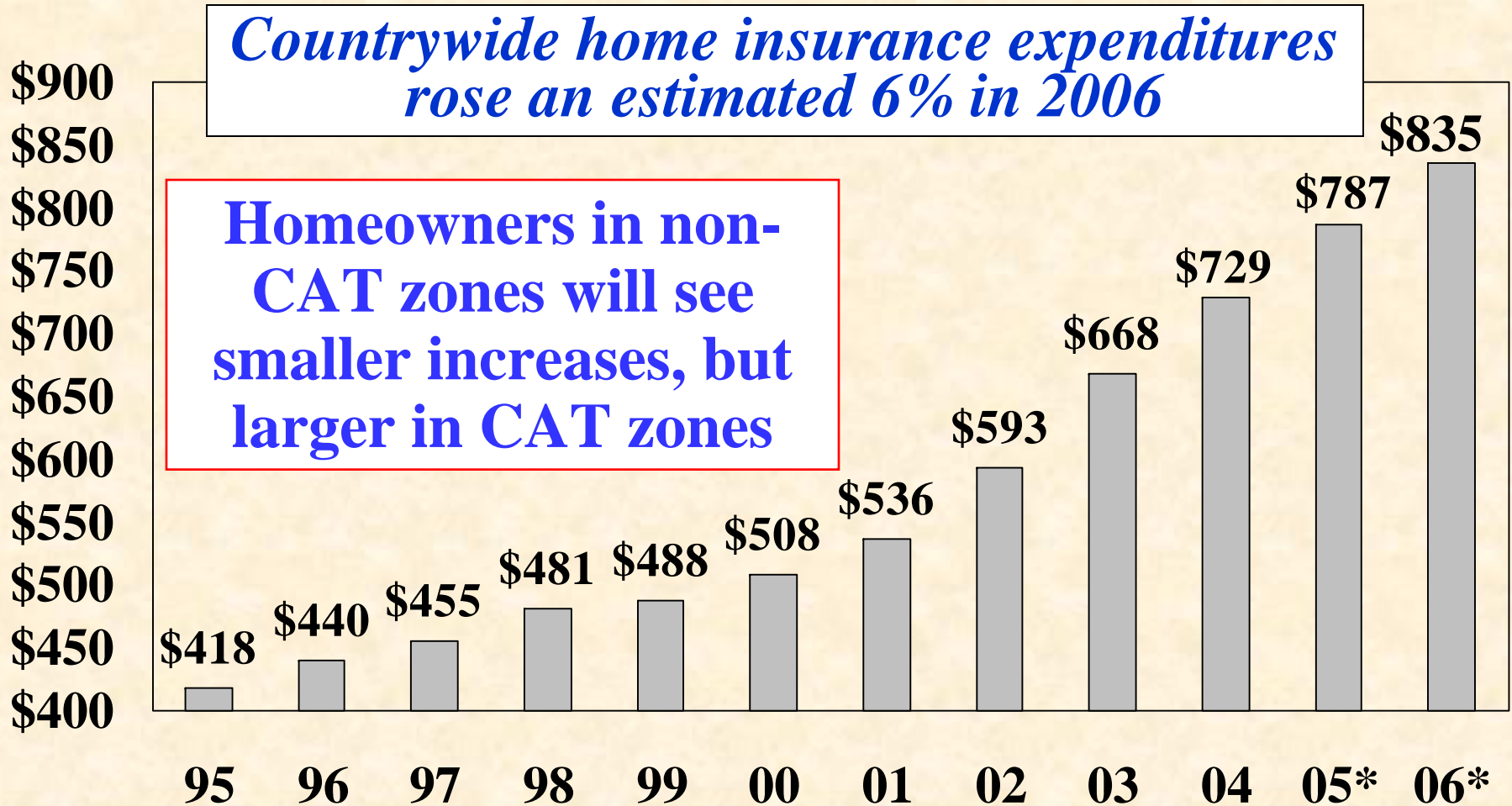


*Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute



Average Expenditures on Homeowners Insurance**



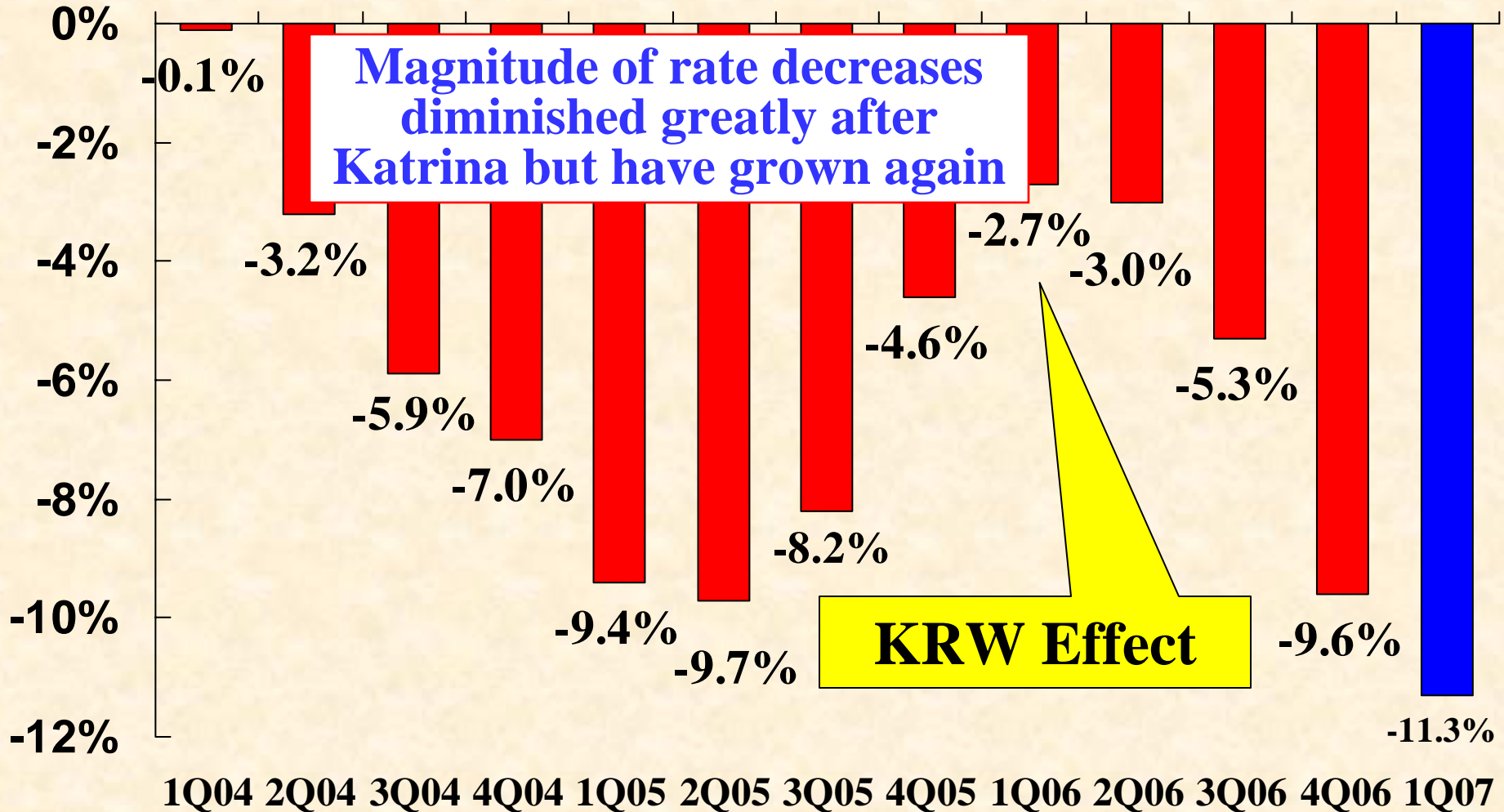
*Insurance Information Institute Estimates/Forecasts

**Excludes cost of flood and earthquake coverage.

Source: NAIC, Insurance Information Institute

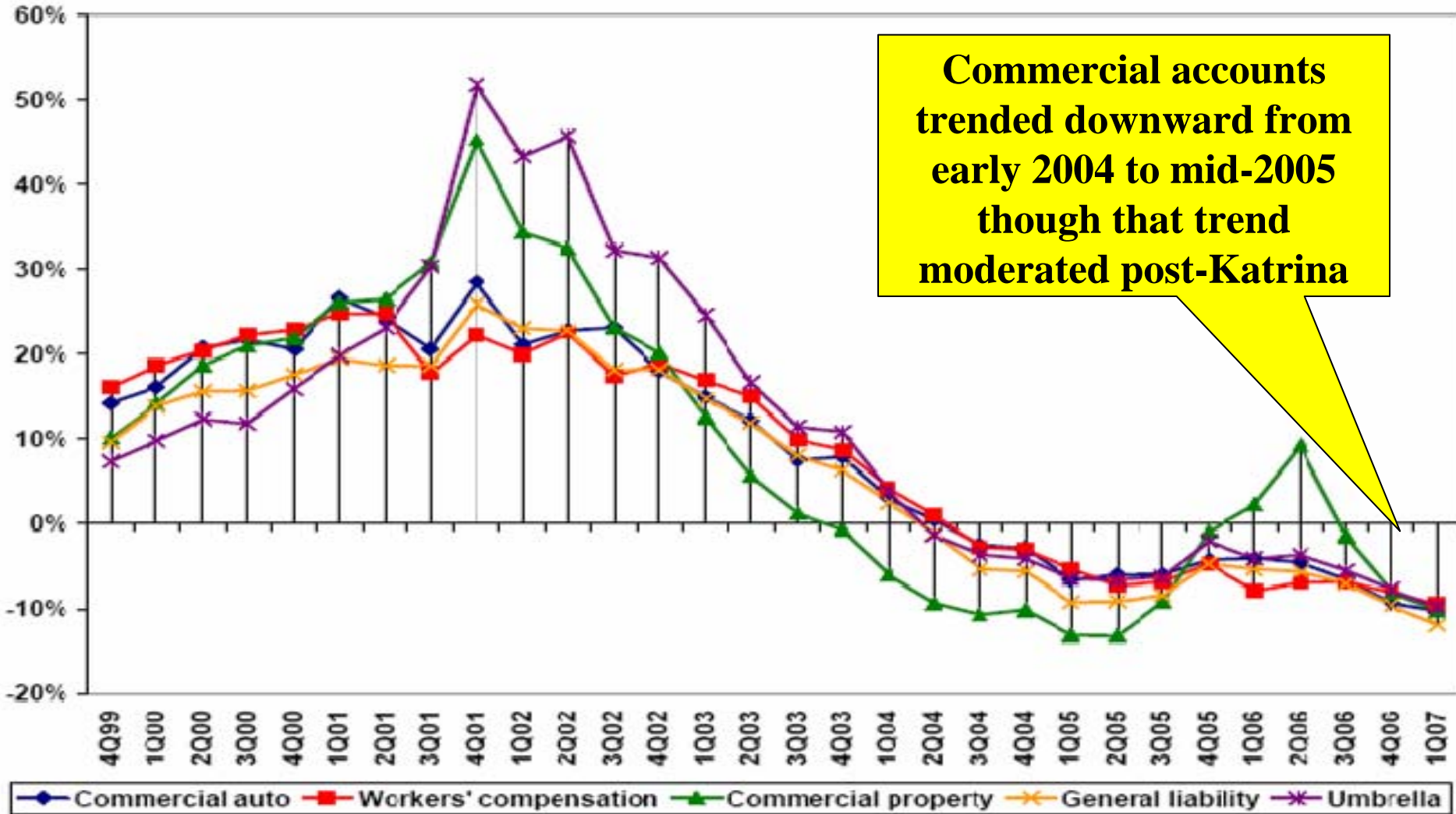


Average Commercial Rate Change, All Lines, (1Q:2004 – 1Q:2007)





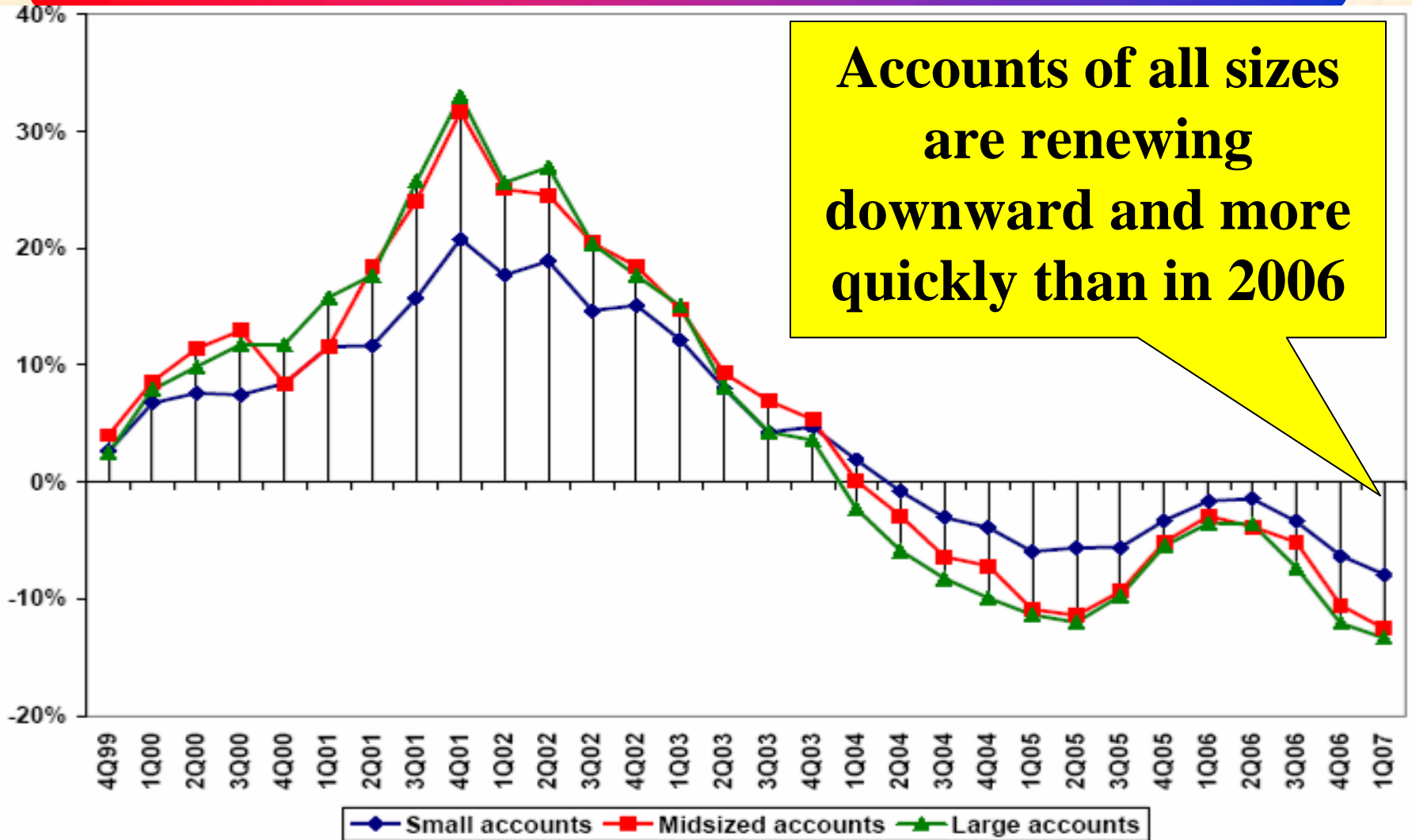
Average Commercial Rate Change by Line: 4Q99 – 1Q07



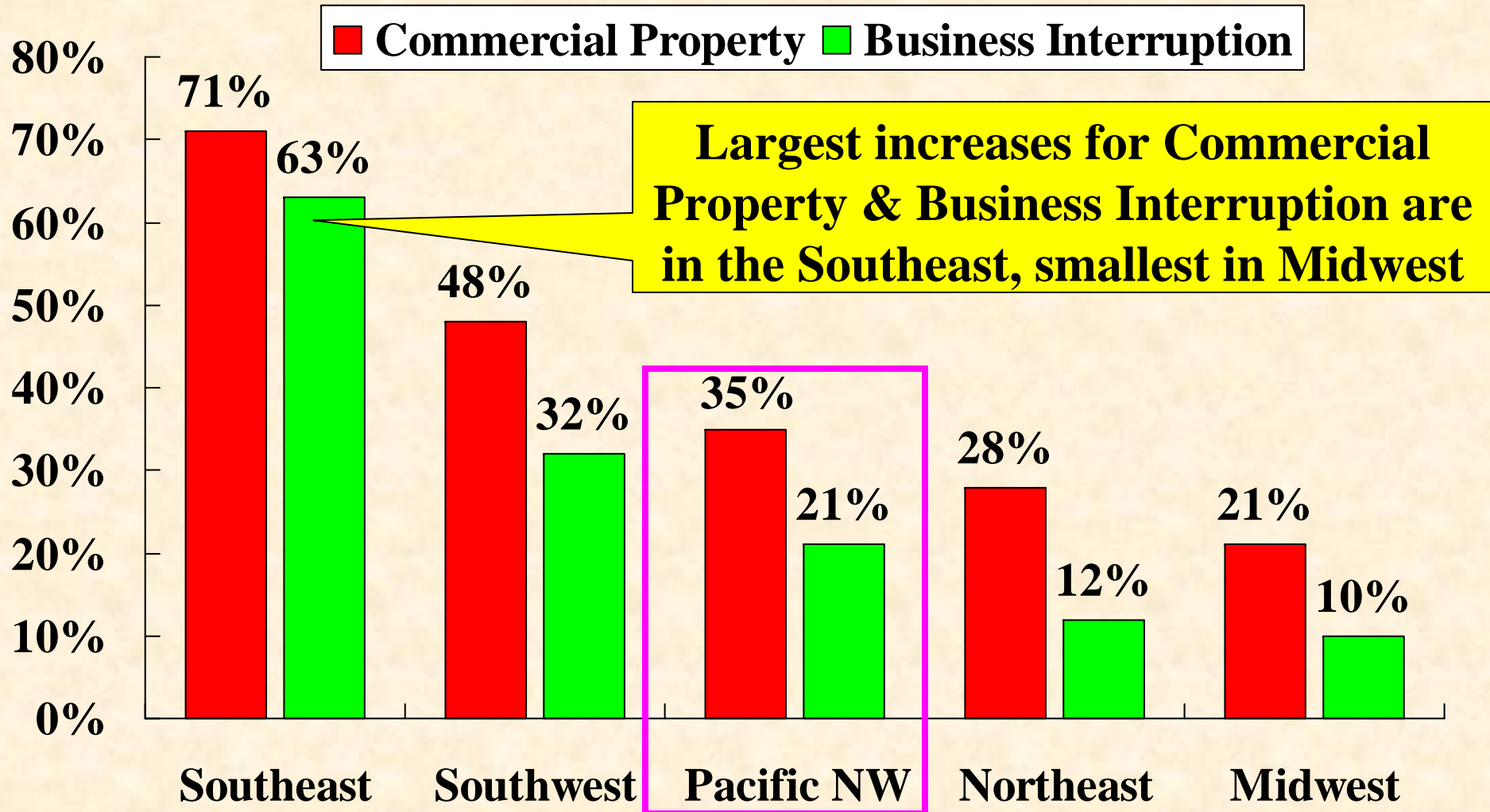
Source: Council of Insurance Agents & Brokers



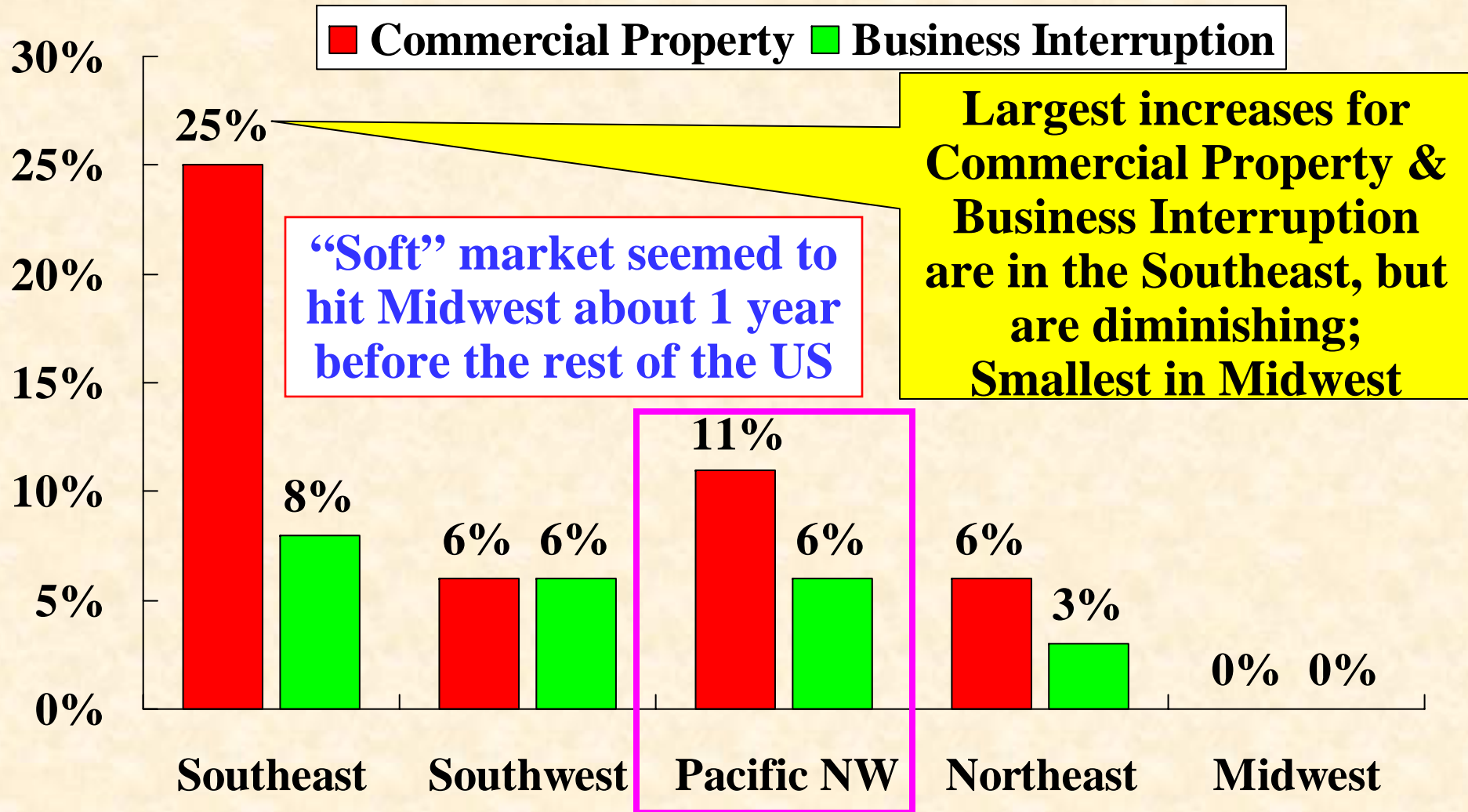
Average Commercial Rate Change by Account Size: 4Q99 – 1Q07



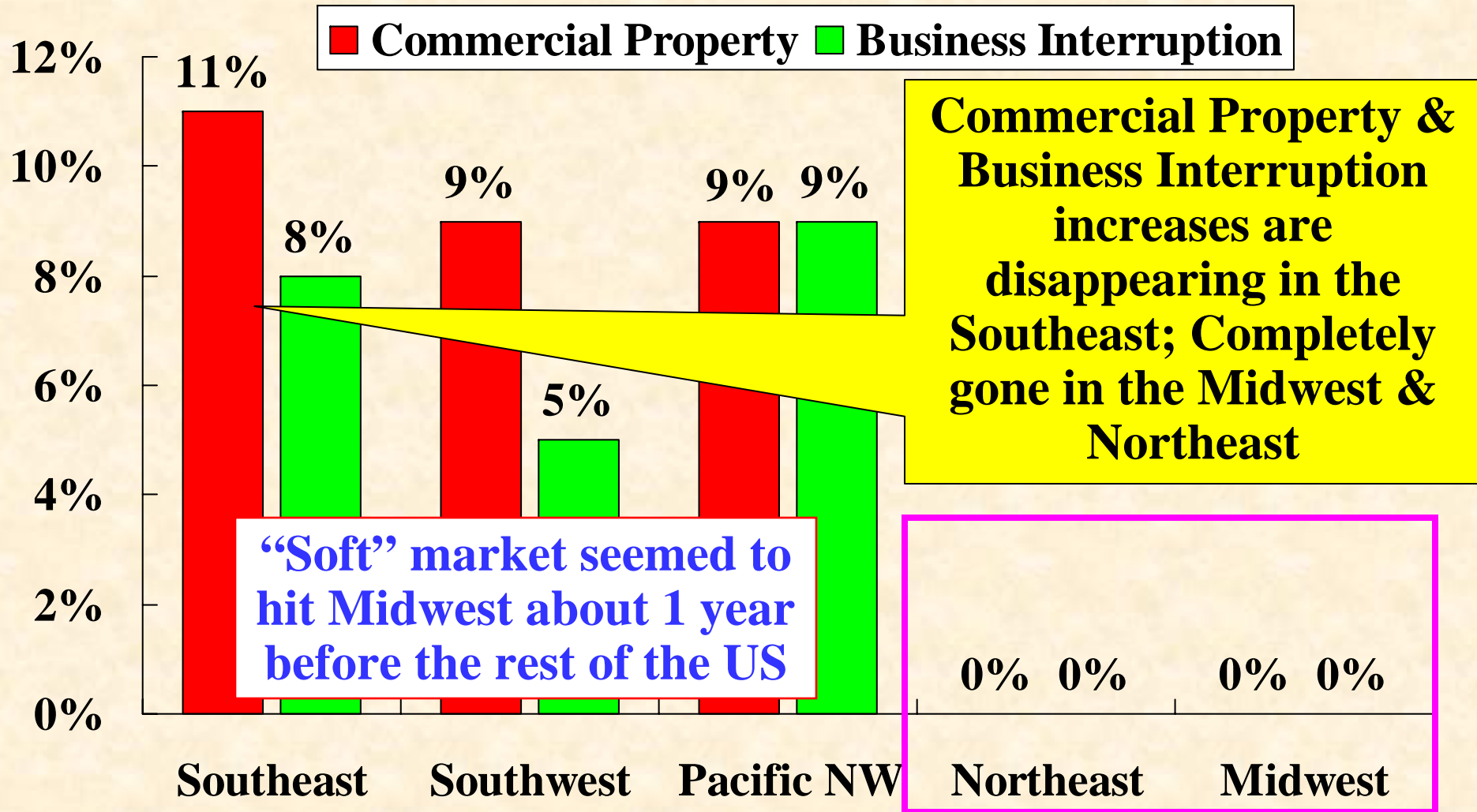
Percent of Commercial Accounts Renewing with/Positive Rate Changes, 2nd Qtr. 2006



Percent of Commercial Accounts Renewing w/Positive Rate Changes, 4th Qtr. 2006



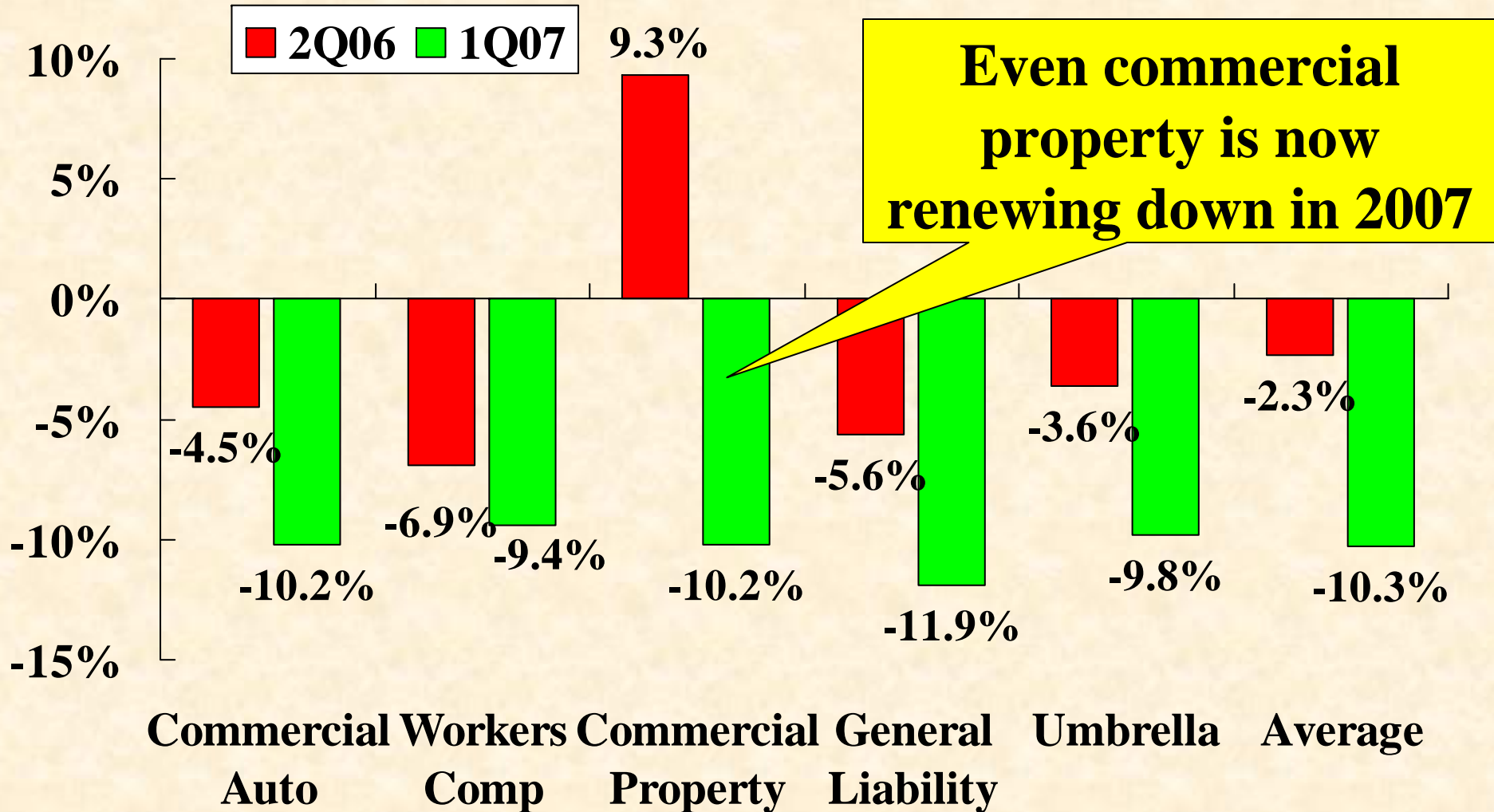
Percent of Commercial Accounts Renewing w/Positive Rate Changes, 1st Qtr. 2007





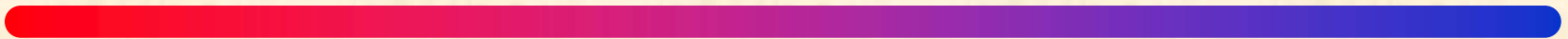
Commercial Accounts Rate Changes,

2nd Qtr. 2006 vs. 1st Qtr. 2007



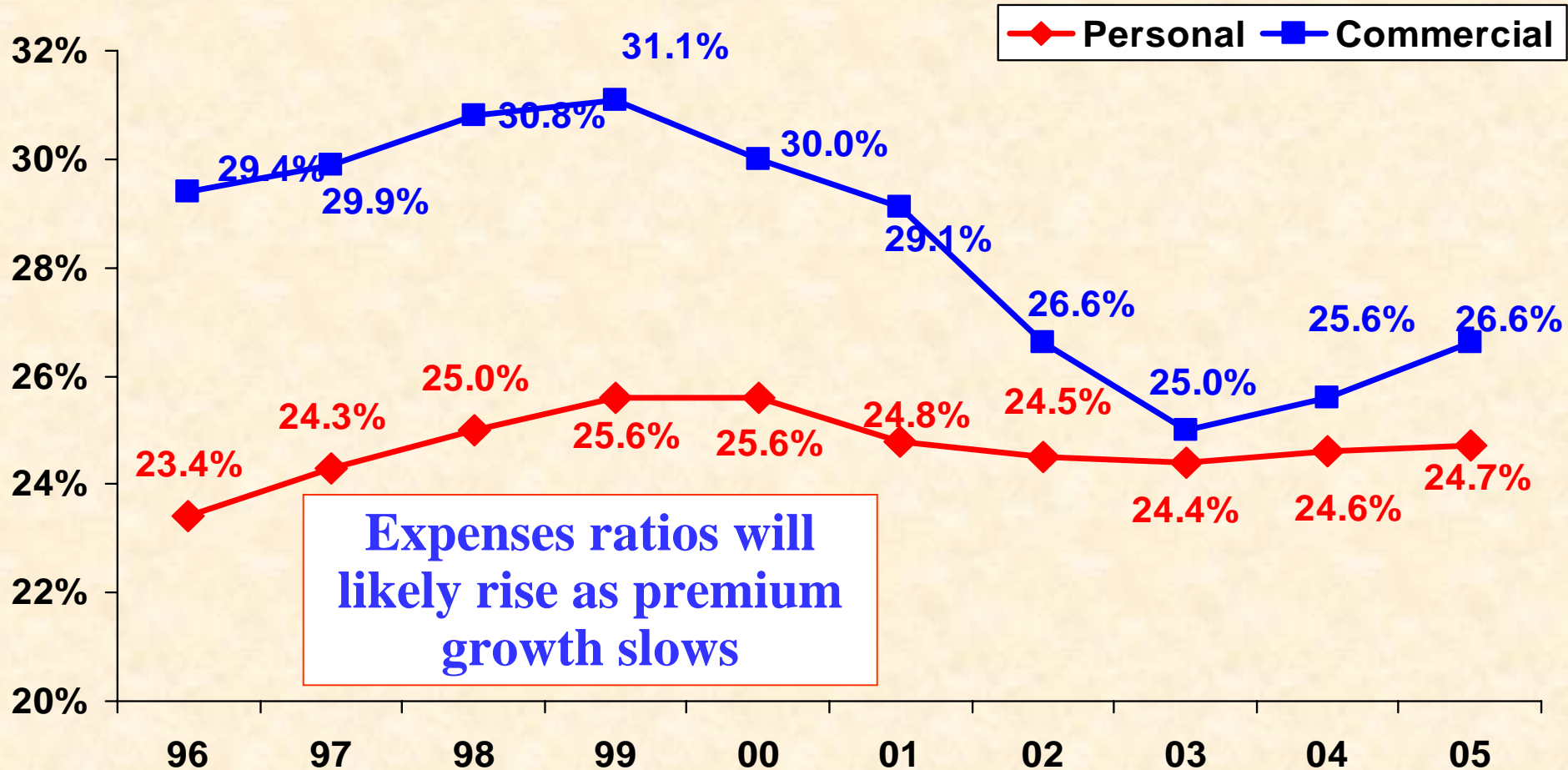
EXPENSES

*Will Expense Ratio Rise as
Premium Growth Slows?*





Personal vs. Commercial Lines Underwriting Expense Ratio*



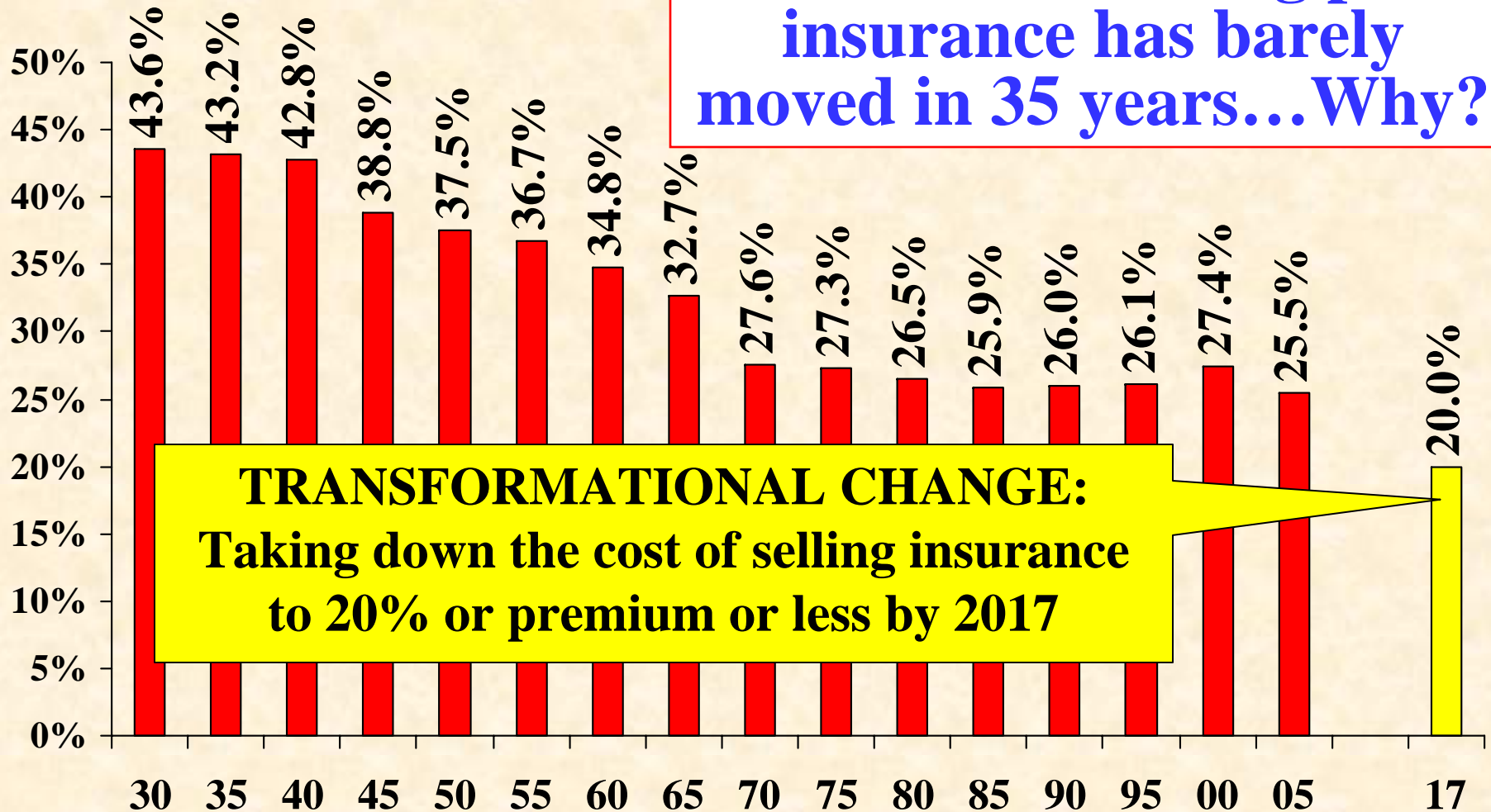
*Ratio of expenses incurred to net premiums written.

Source: A.M. Best; Insurance Information Institute



Underwriting Expense Ratio, P/C Insurance, 1930-2005

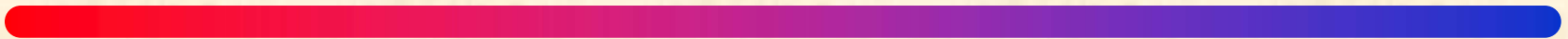
The cost of selling p/c insurance has barely moved in 35 years... Why?



**TRANSFORMATIONAL CHANGE:
Taking down the cost of selling insurance
to 20% or premium or less by 2017**

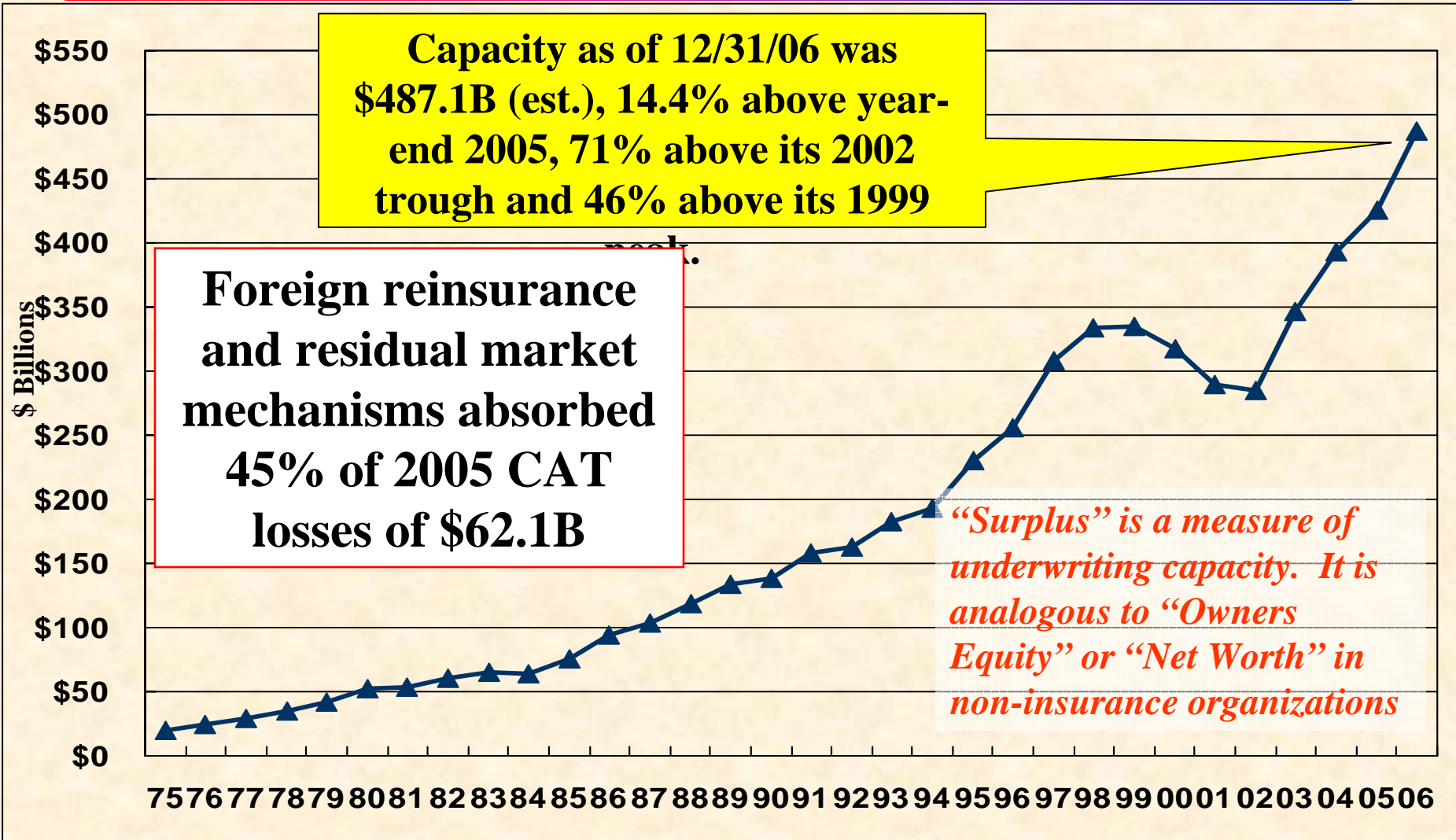
CAPACITY/ SURPLUS

**The Industry in
Underleveraged**





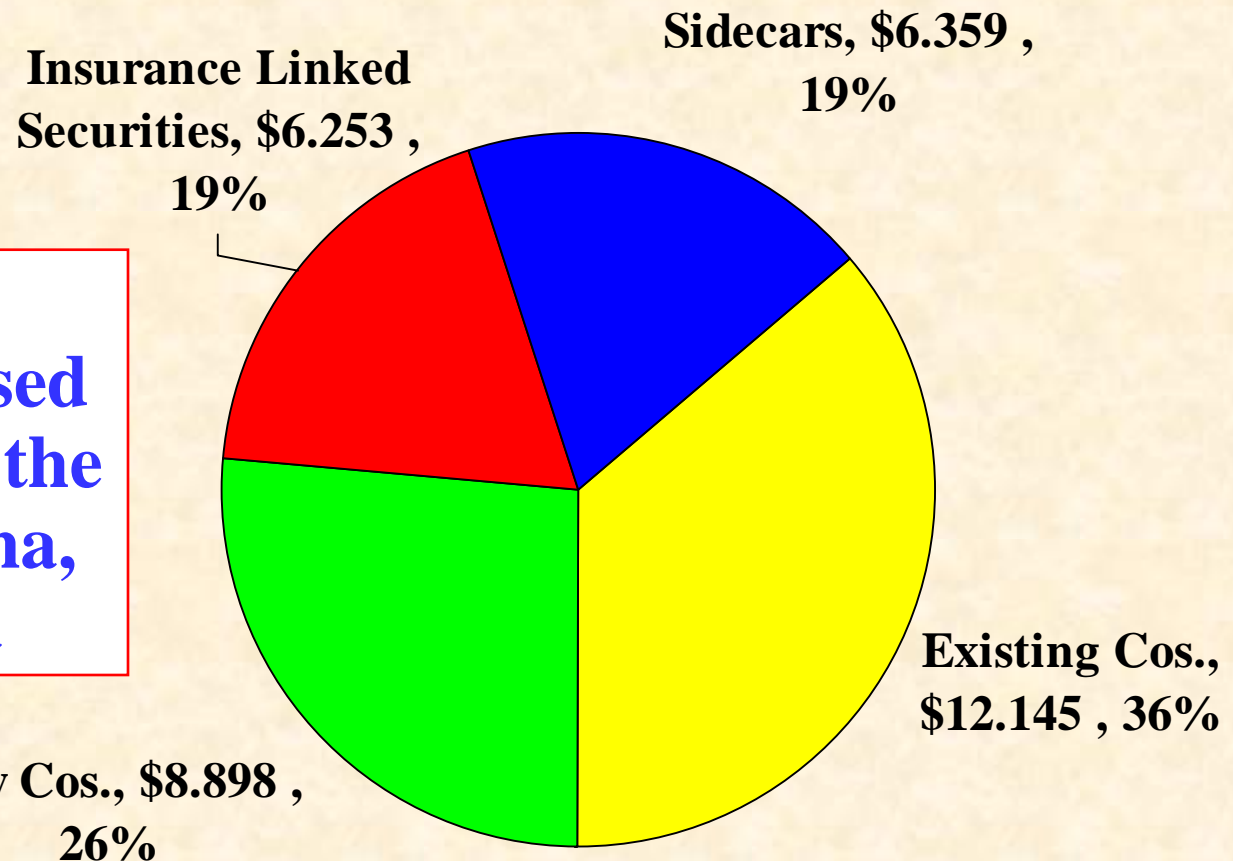
U.S. Policyholder Surplus: 1975-2006





Capital Raising by Class Within 15 Months of KRW

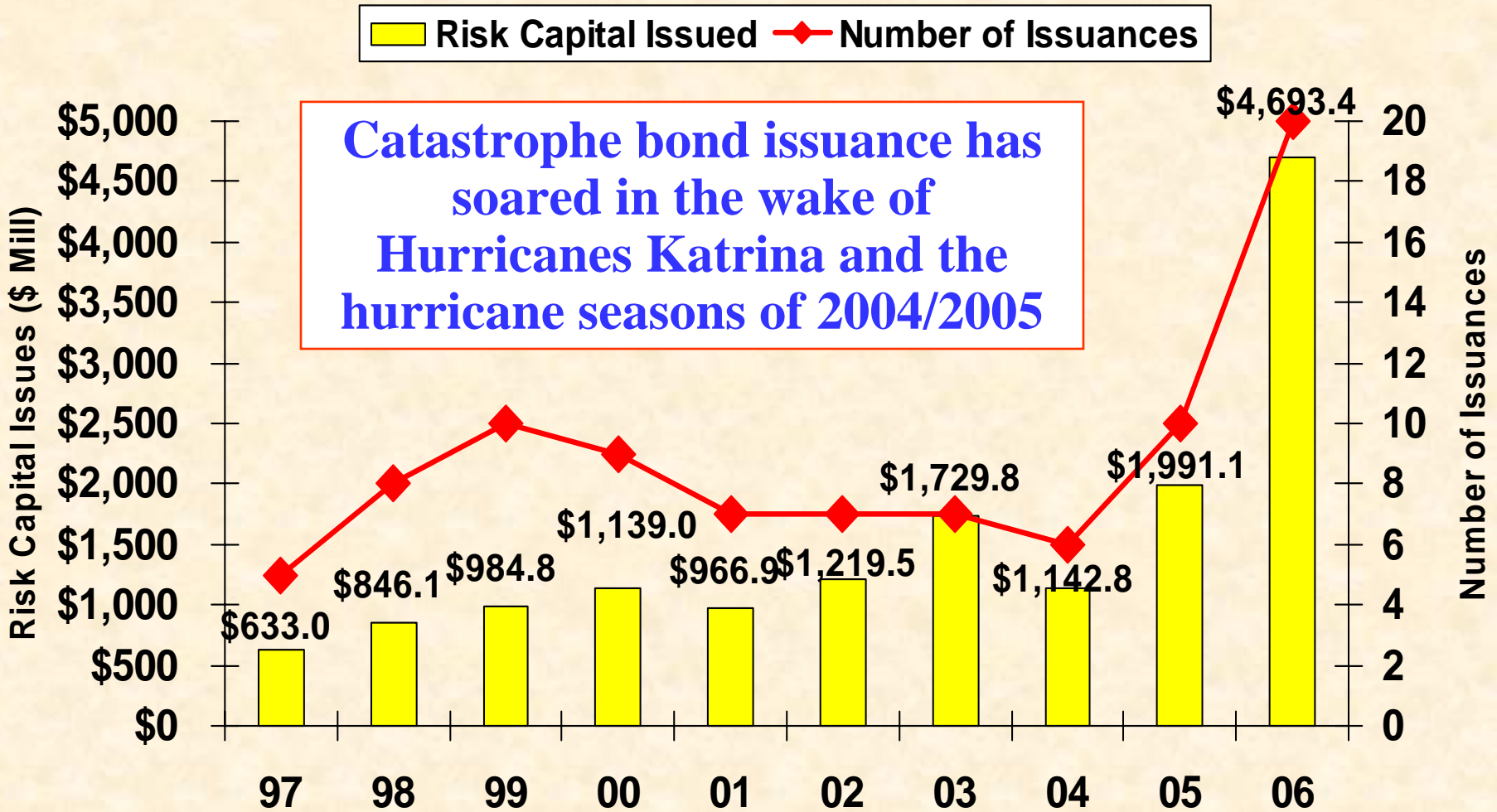
\$ Billions



**Insurers &
Reinsurers raised
\$33.7 billion in the
wake of Katrina,
Rita, Wilma**

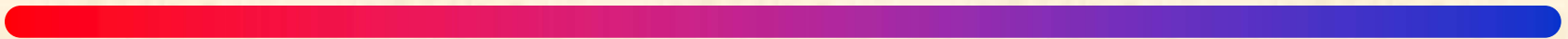


Annual Catastrophe Bond Transactions Volume, 1997-2006



MERGER & ACQUISITION

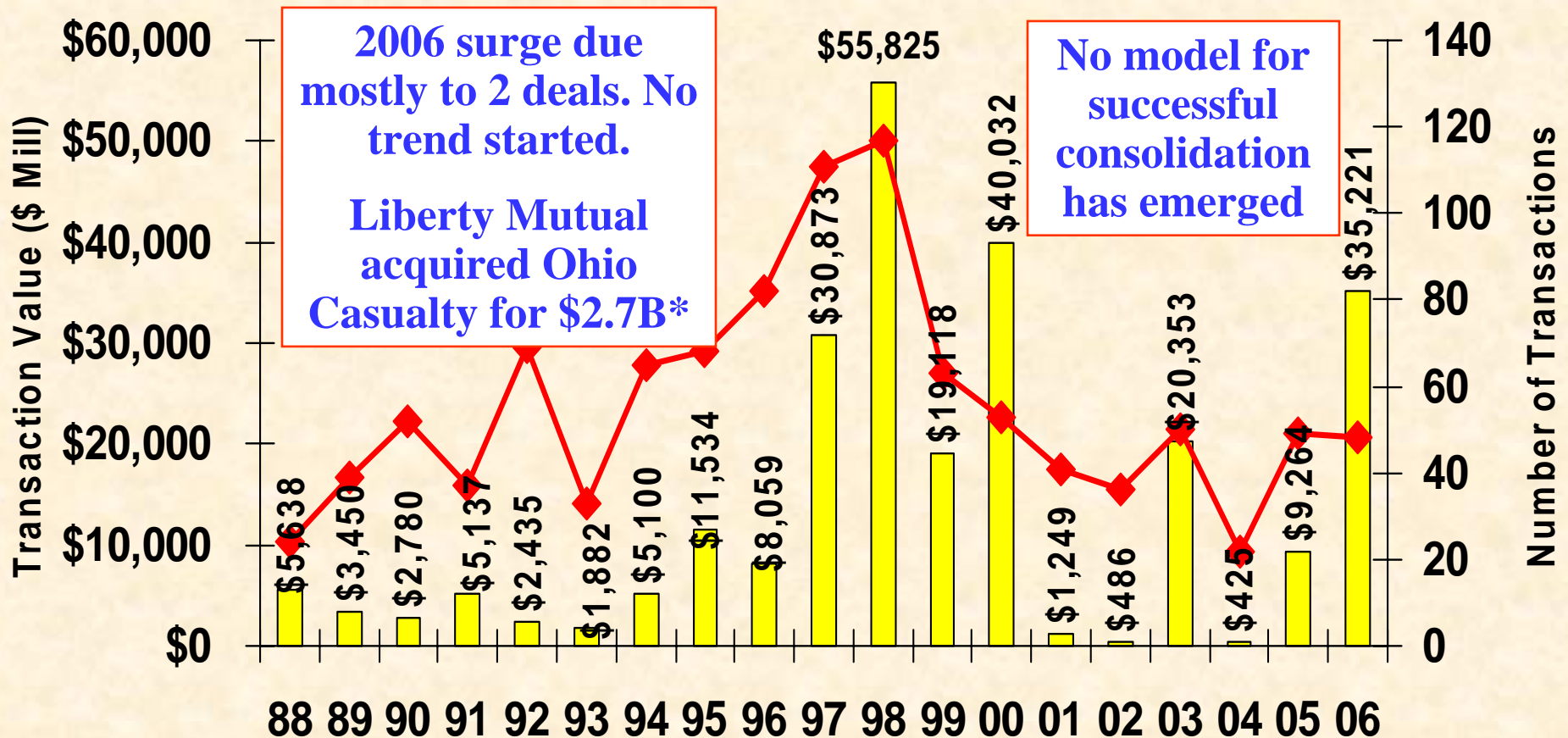
**More Catalysts for Major
P/C Consolidation?**





P/C Insurance-Related M&A Activity, 1988-2006

Transaction Values ◆ Number of Transactions



2006 surge due mostly to 2 deals. No trend started.

Liberty Mutual acquired Ohio Casualty for \$2.7B*

No model for successful consolidation has emerged

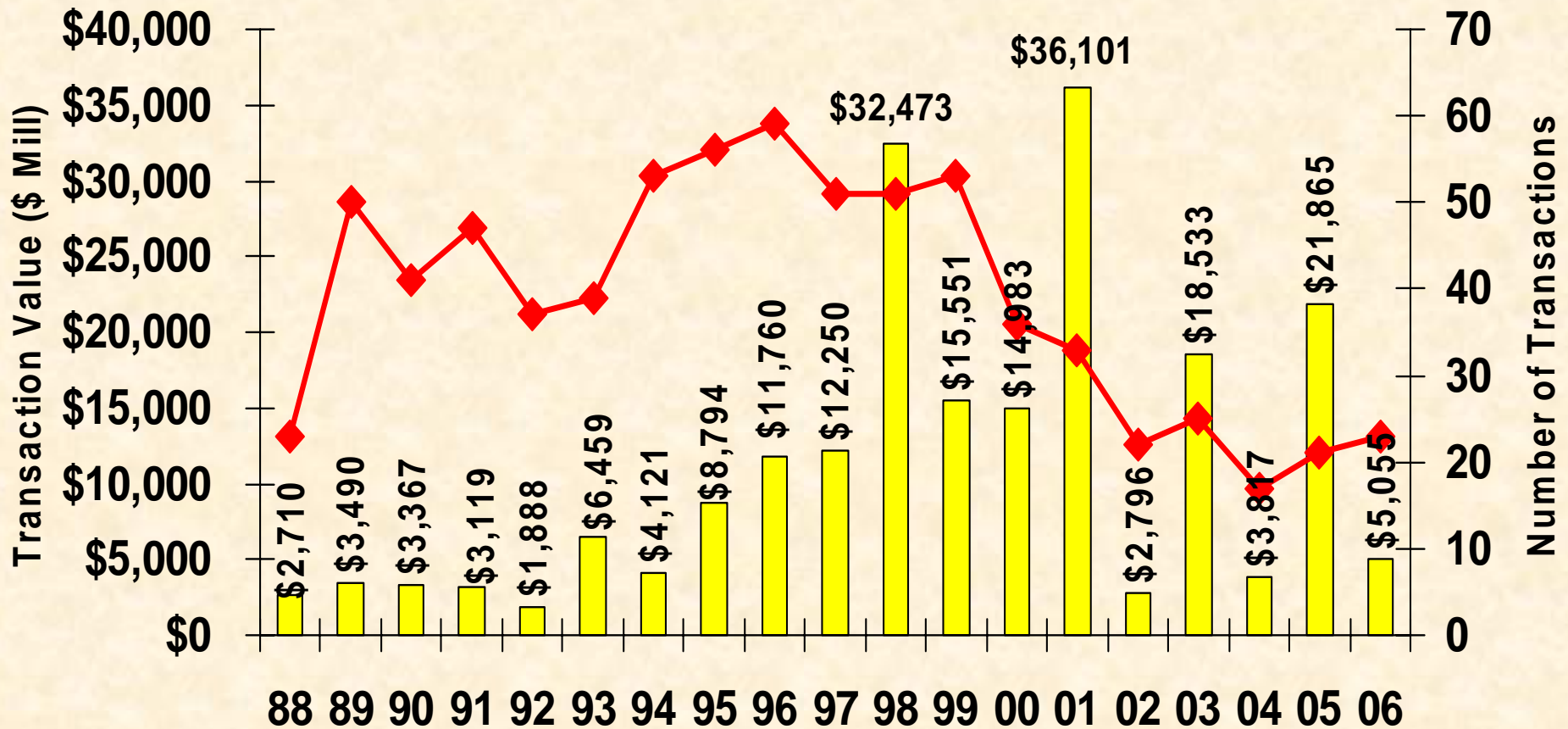
*Announced May 7, 2007.

Source: Conning Research & Consulting.



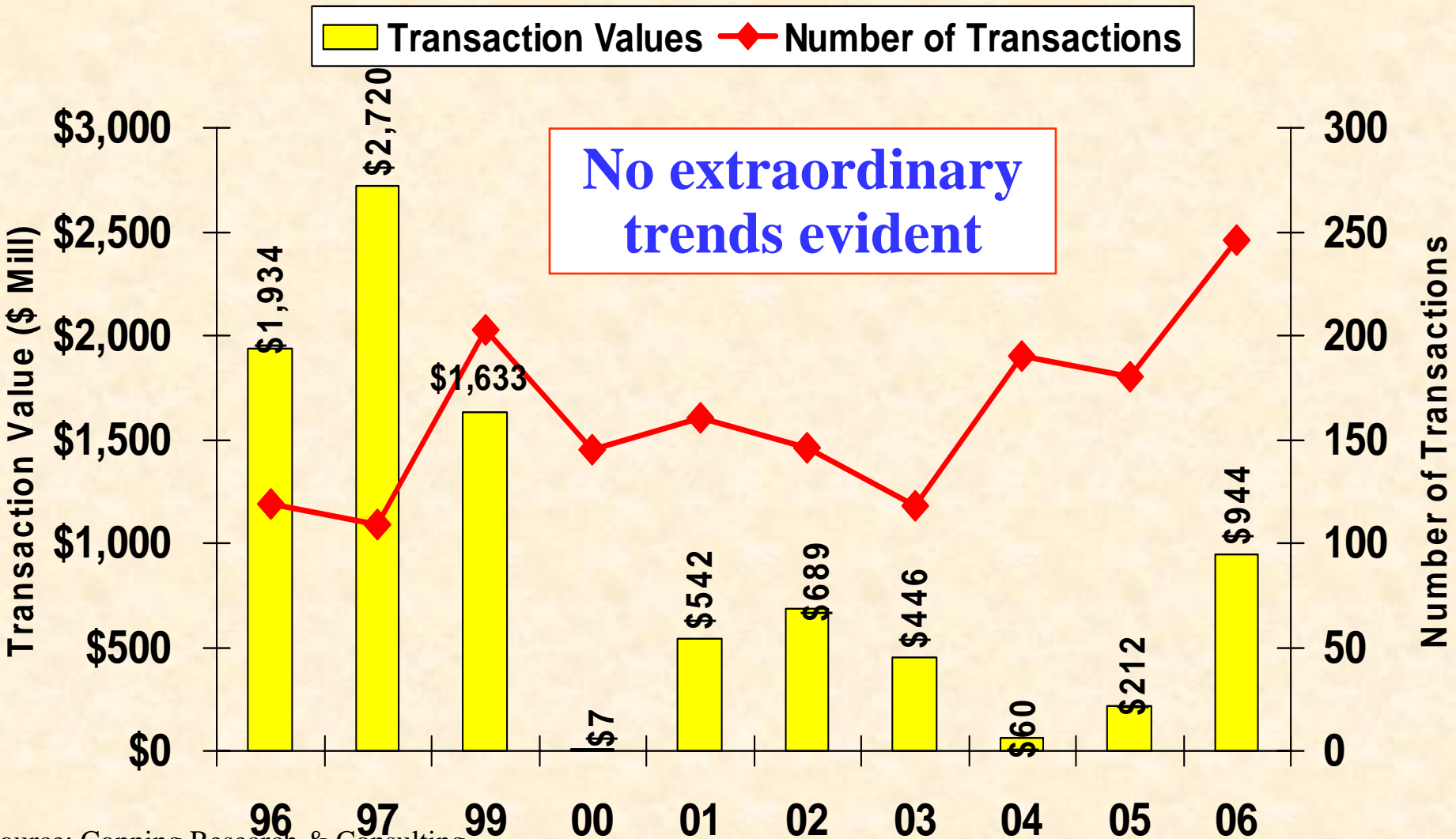
Life Insurance-Related M&A Activity, 1988-2006

Transaction Values ◆ Number of Transactions





Distribution Sector: Insurance-Related M&A Activity, 1988-2006



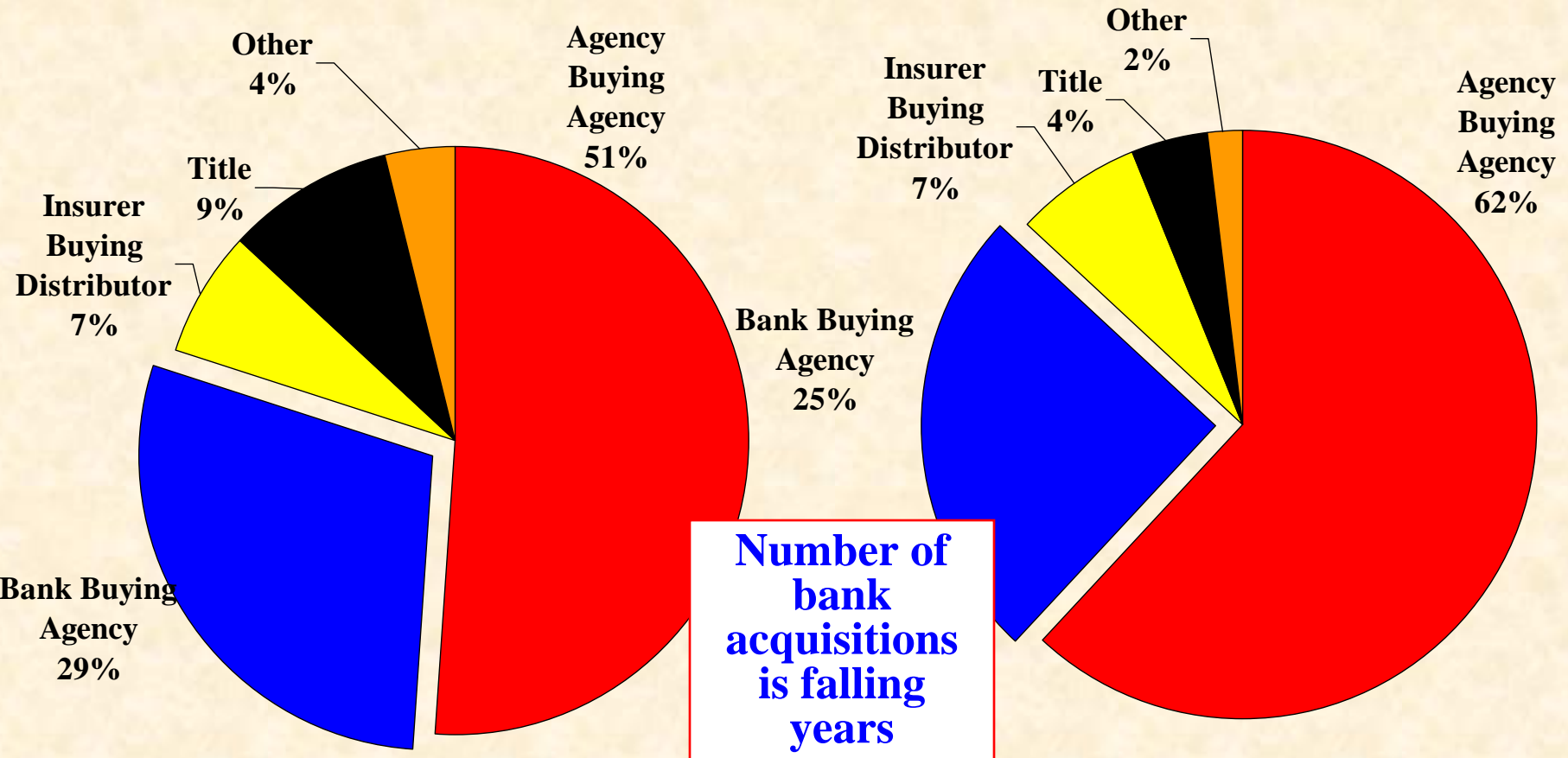


Distribution Sector M&A

Activity, 2005 vs. 2006

2005

2006





Motivating Factors for Increased P/C Insurer Consolidation in 2007

Motivating Factors for P/C M&As

- **Slow Growth**: Growth is at its lowest levels since the late 1990s
 - NWP growth is forecast at 1.8% in 2007 and 1.9% in 2008
 - Prices are falling or flat in most non-coastal markets
- **Accumulation of Capital**: Excess capital depresses ROEs
 - Policyholder Surplus up 14.4% in 2006 and up 71% since 2002
 - Insurers hard pressed to maintain earnings momentum
 - Options: Share Buybacks, Boost Dividends, Invest in Operation, Acquire
 - Option B: Engage in destructive price war and destroy capital
- **Reserve Adequacy**: No longer a drag on earnings
 - Favorable development in recent years offsets pre-2002 adverse develop.
- **Favorable Fundamentals/Drop-Off in CAT Activity**
 - Underlying claims inflation (frequency and severity trends) are benign
 - Lower CAT activity took some pressure of capital base



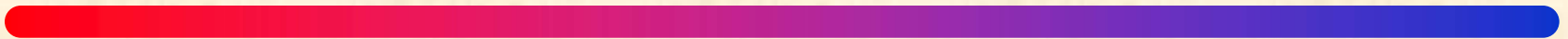
Limiting Factors for Increased P/C Insurer Consolidation in 2007

Limiting Factors for P/C M&As

- **Ownership Structure**
 - Mutualls are generally not targets (but can be buyers: Liberty & OCAS)
 - P/C demutualizations are very difficult
 - Inside Ownership: e.g., family involvement or entrenched management could make deal unwieldy, complex
- **Size**
 - Larger Insurer = Fewer Buyers
- **Price**
 - More Expensive Share Price = Fewer Buyers, all else equal (but rising share price for acquiring company can serve as currency for acquisitions)
- **Growth Opportunities**
 - Better Growth Opportunities = Less Likely Management Will Sell
- **Culture**
 - Unique/distinct culture makes sale less likely
- **Fear**
 - Many M&As in the 1990s went badly

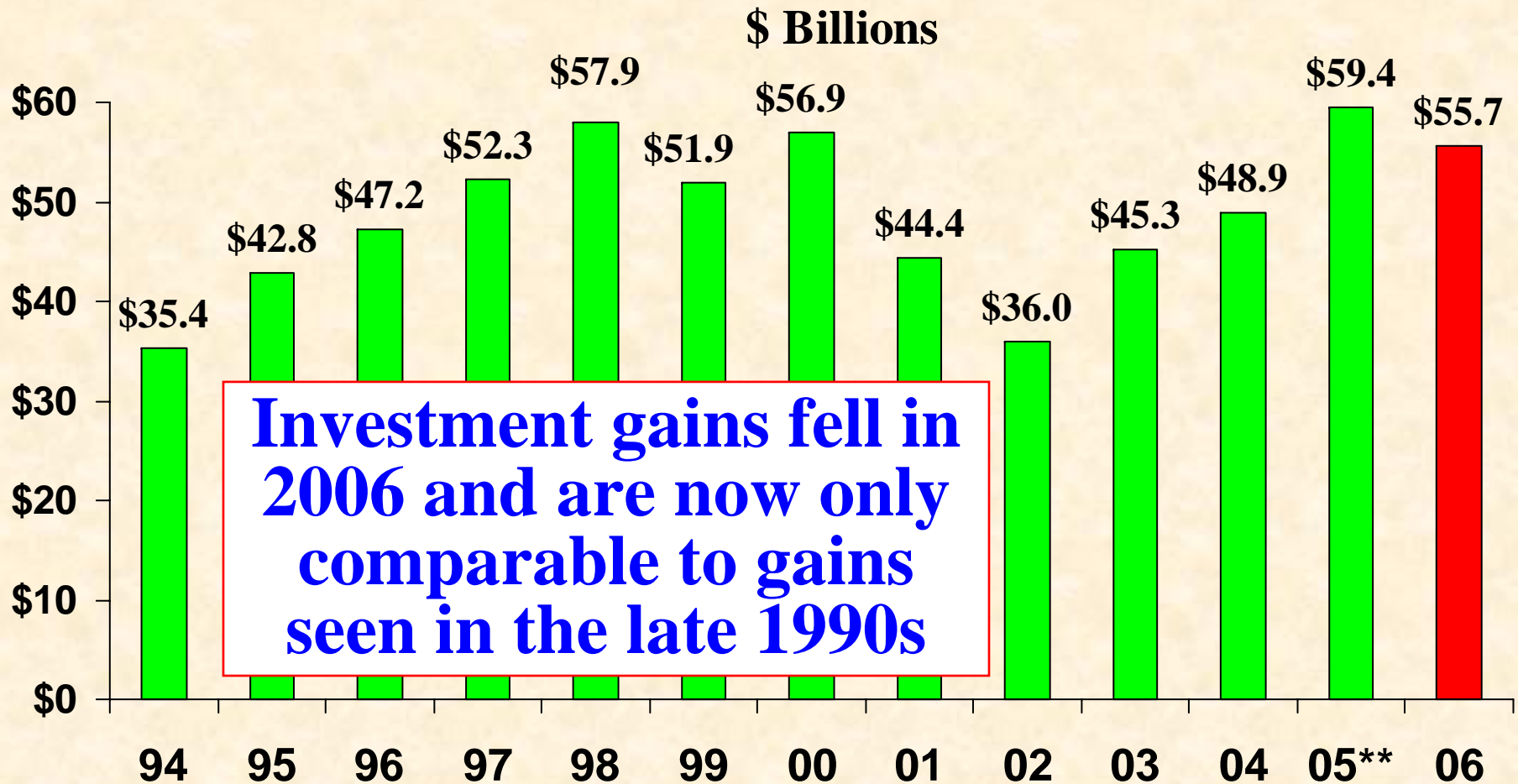
INVESTMENT IRONY

*Markets & Interest
Rates Up, Returns Flat*





Property/Casualty Insurance Industry Investment Gain*

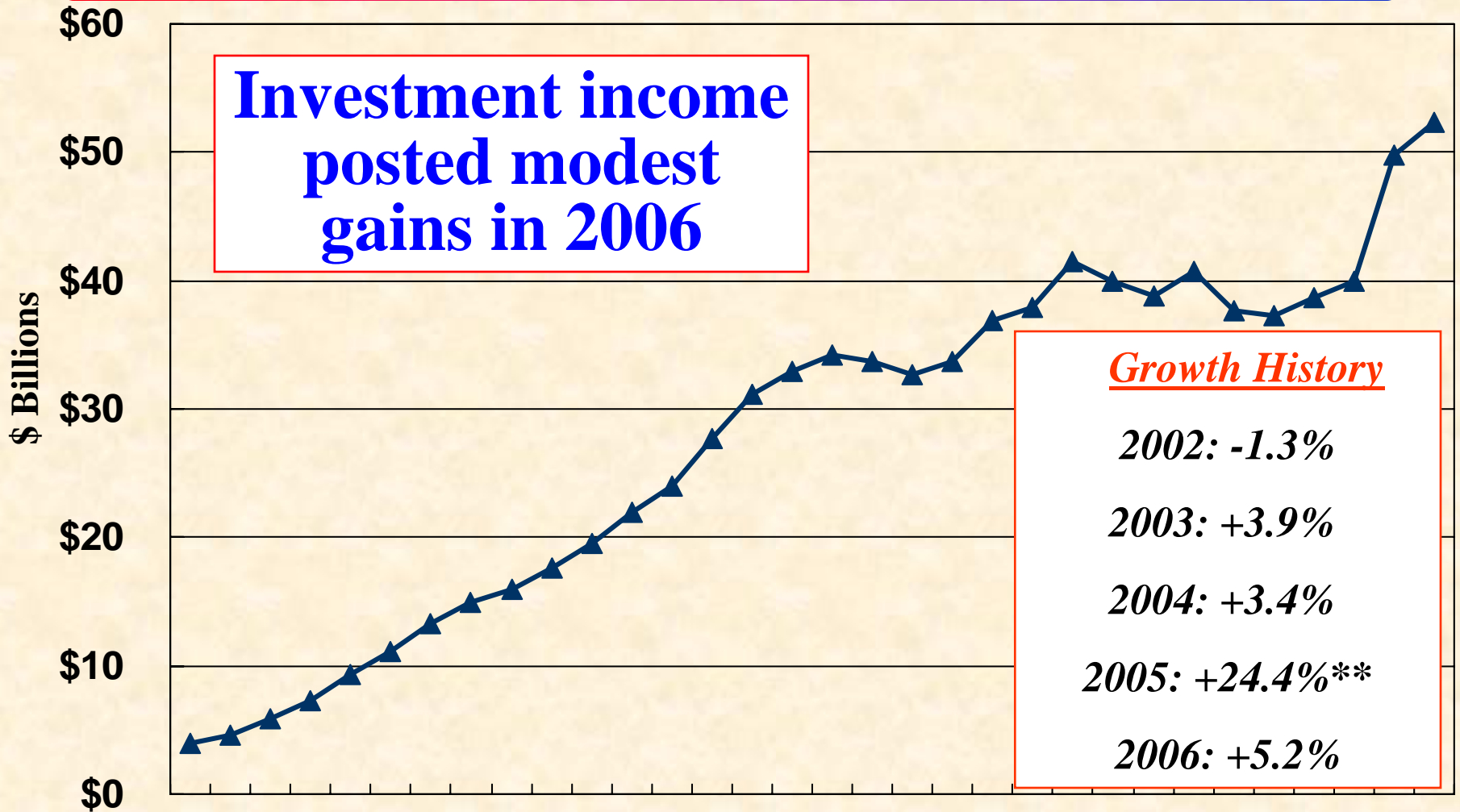


*Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain.

**2005 figure includes special one-time dividend of \$3.2B. Source: ISO; Insurance Information Institute.



Net Investment Income



75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06

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

**Includes special dividend of \$3.2B. Increase is 15.7% excluding dividend.



Total Returns for Large Company Stocks: 1970-2007*

S&P 500 was up 13.62% in 2006, Up 5.1% YTD 2007*

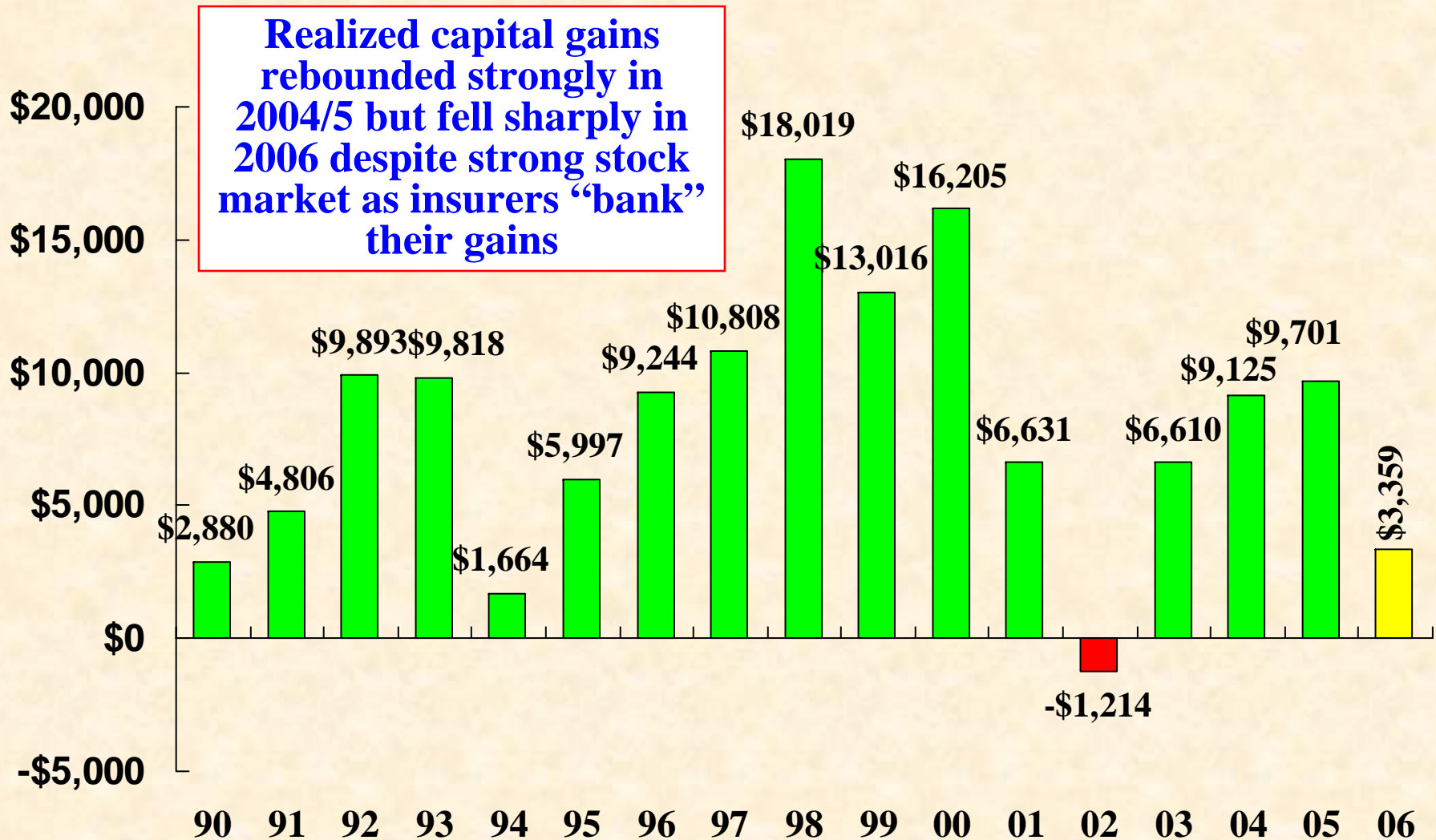


Source: Ibbotson Associates, Insurance Information Institute.

*Through May 4, 2007.

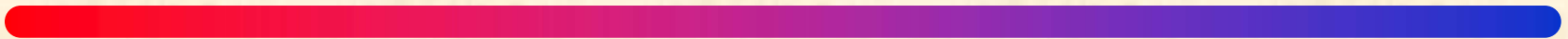


US P/C Net Realized Capital Gains, 1990-2006 (\$ Millions)



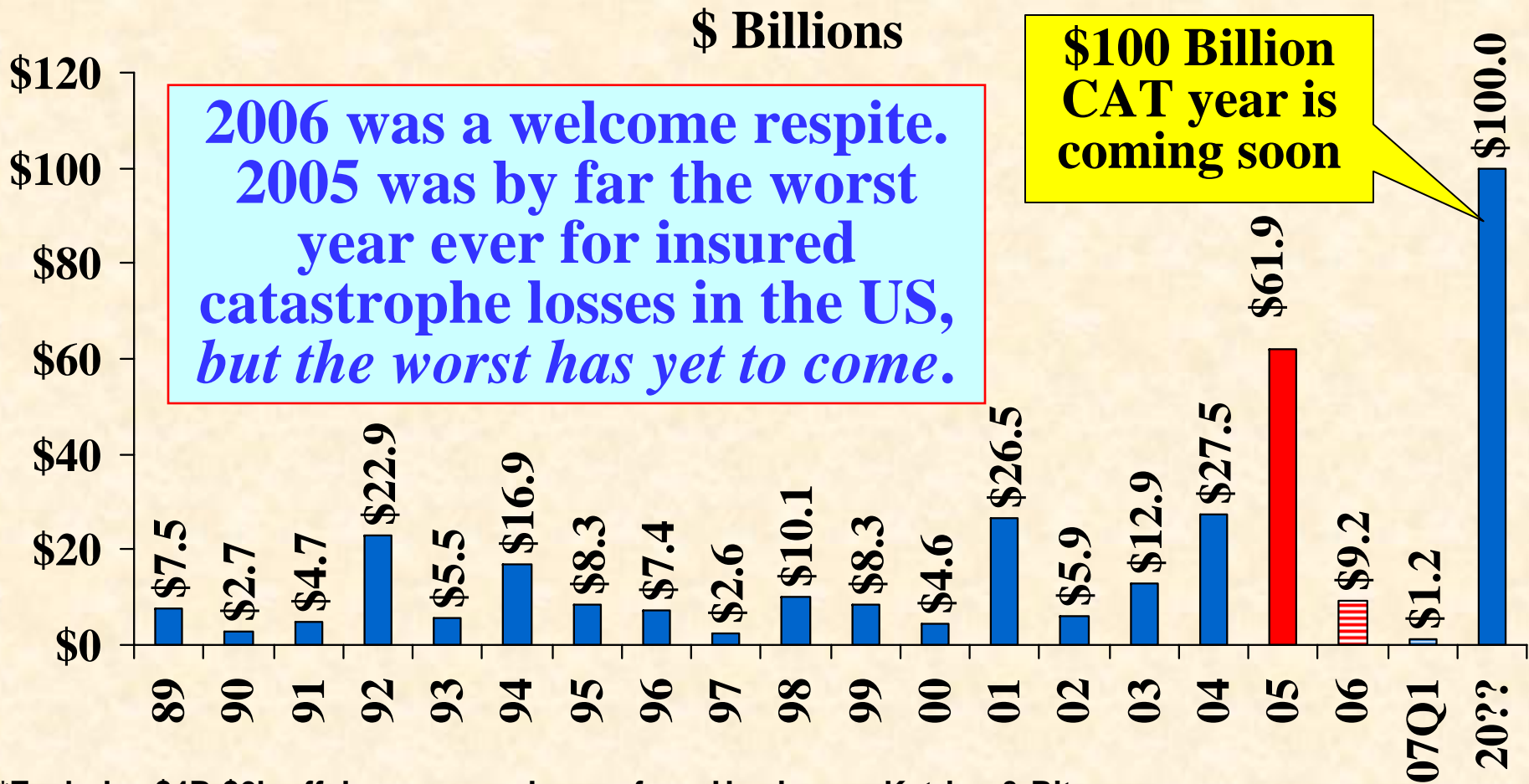
CATASTROPHIC LOSS

**Insurers Accused of
Crying Wolf Over Cats**





U.S. Insured Catastrophe Losses*



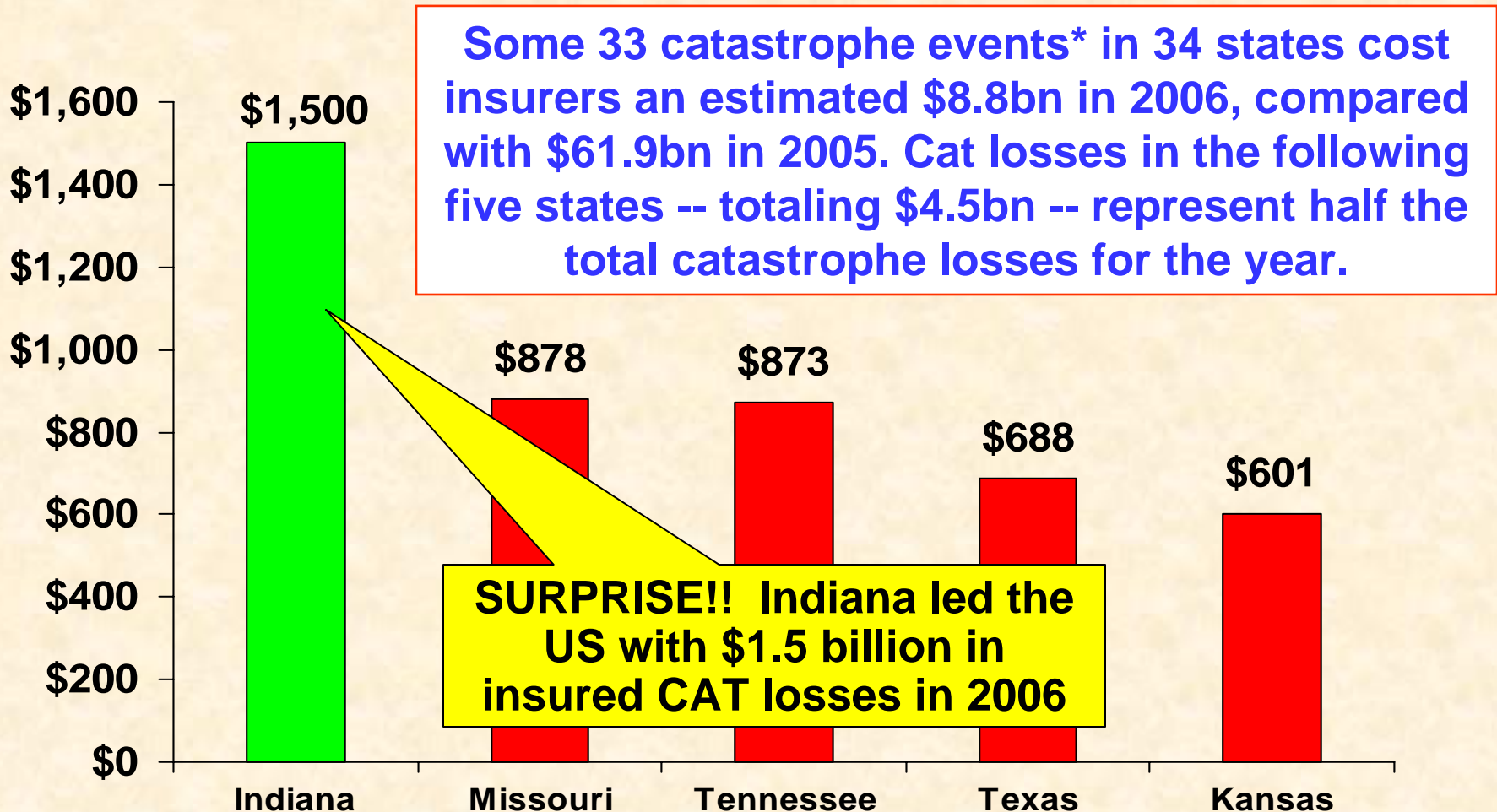
*Excludes \$4B-\$6b offshore energy losses from Hurricanes Katrina & Rita.

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



U.S. Catastrophe Losses 2006: States With Largest Losses (\$ Millions)

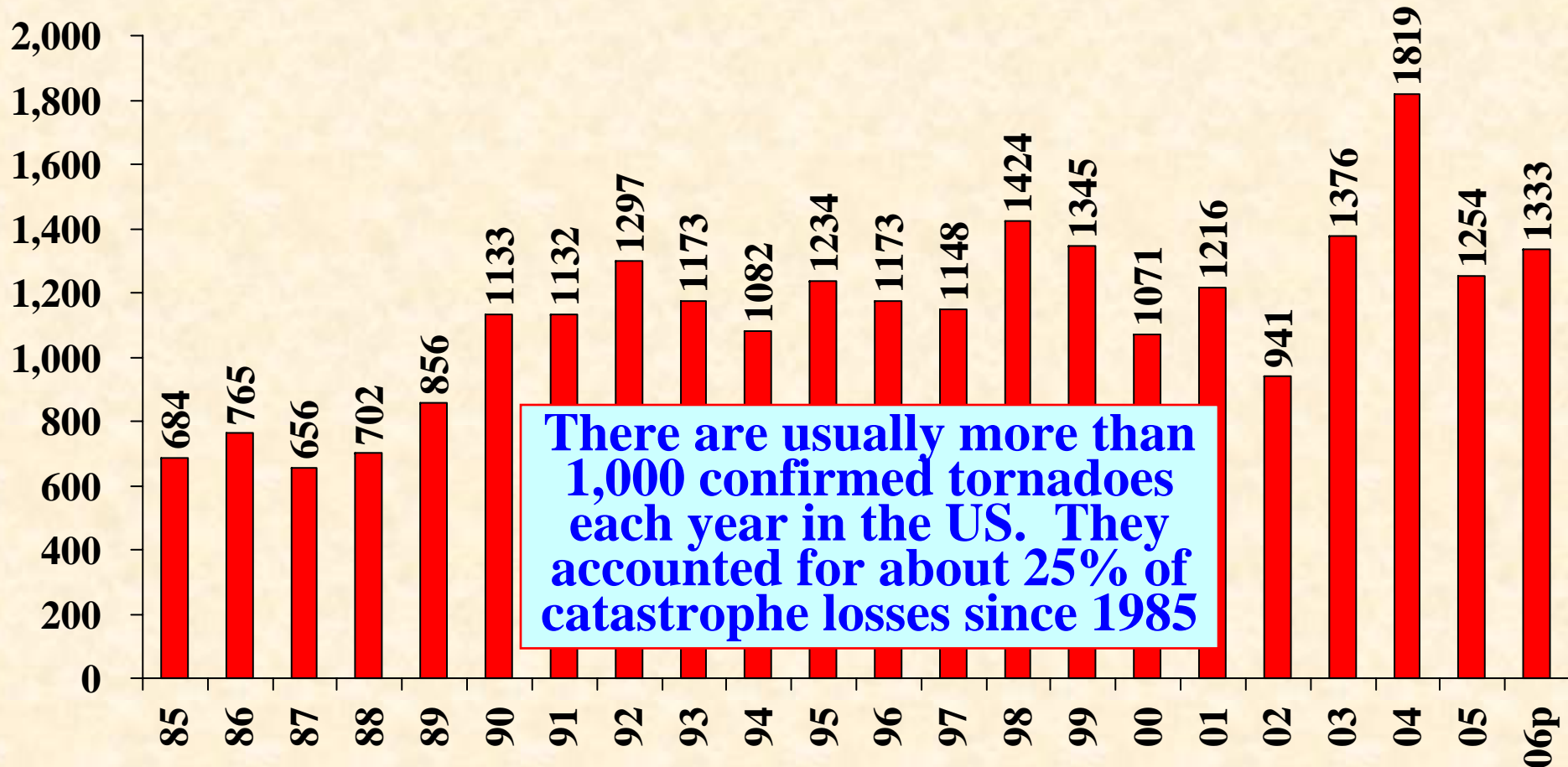


*ISO defines a catastrophe event as an event causing \$25 million or more in insured property losses.

Source: ISO; Insurance Information Institute



Number of Tornadoes, 1985 – 2006p

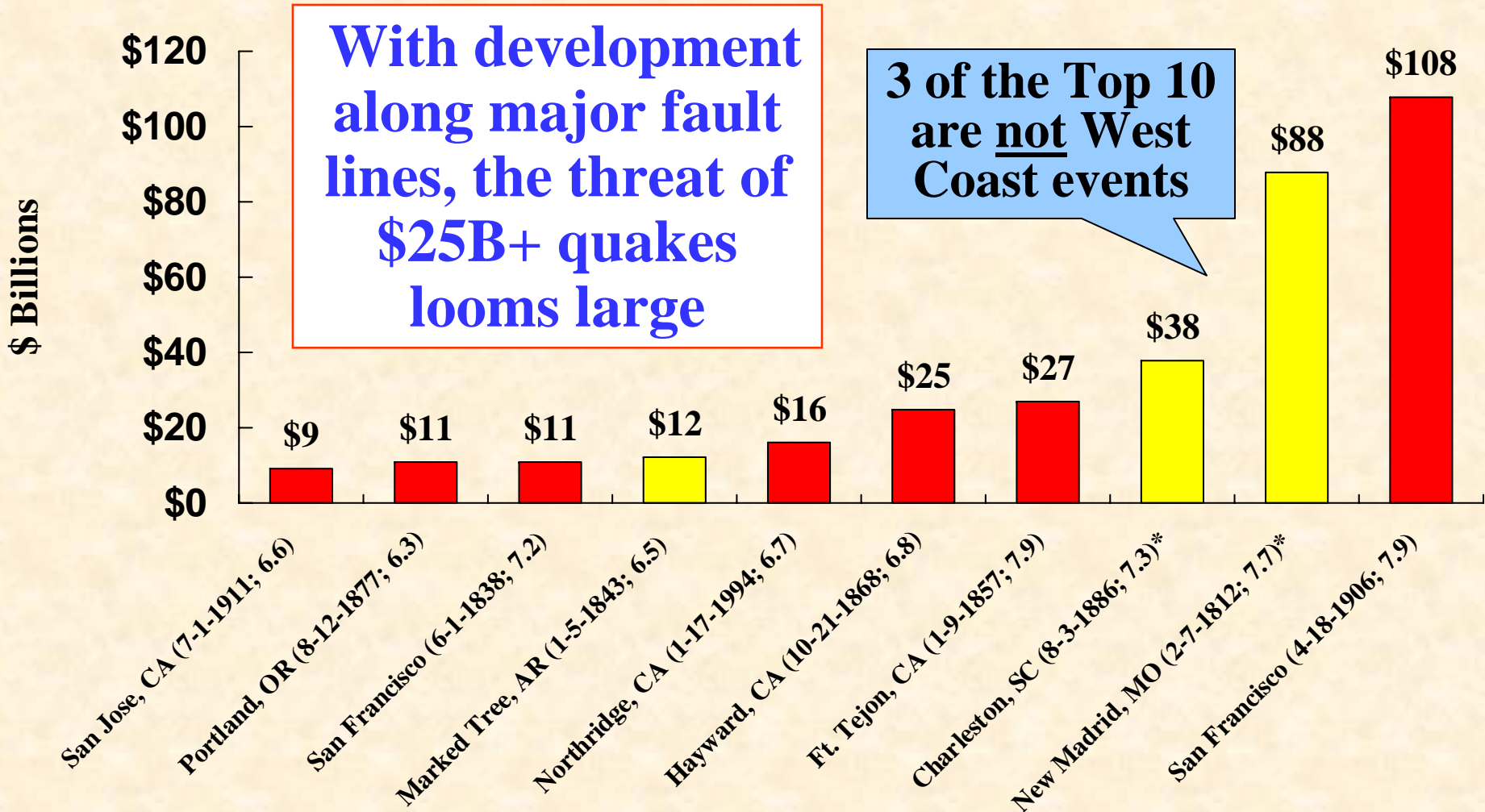


Source: US Dept. of Commerce, Storm Prediction Center, National Weather Service; Ins. Info. Inst.



Insured Losses from Top 10 Earthquakes Adjusted to 2005 Exposure Levels

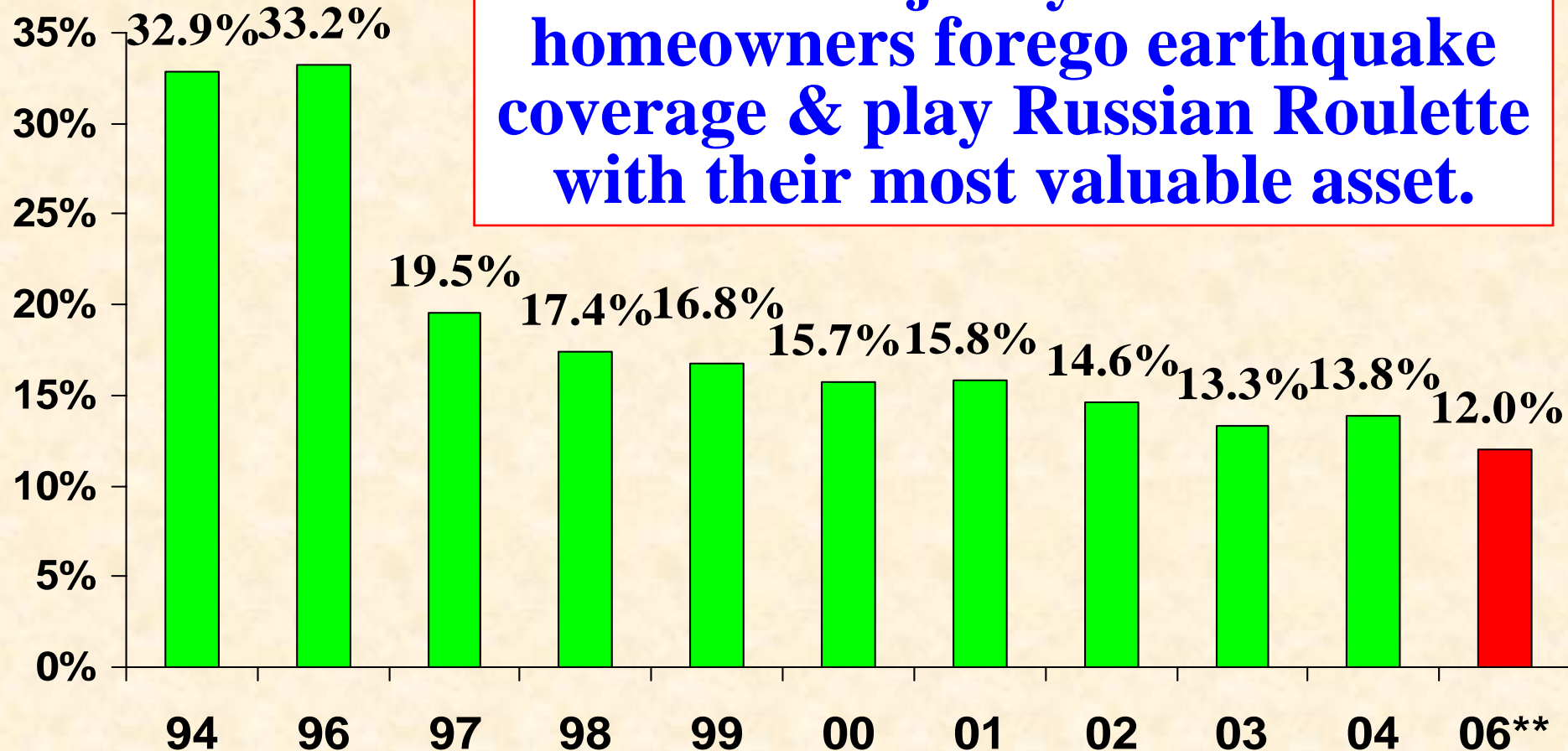
(Billions of 2005 Dollars)





Percentage of California Homeowners with Earthquake Insurance, 1994-2004*

The vast majority of California homeowners forego earthquake coverage & play Russian Roulette with their most valuable asset.

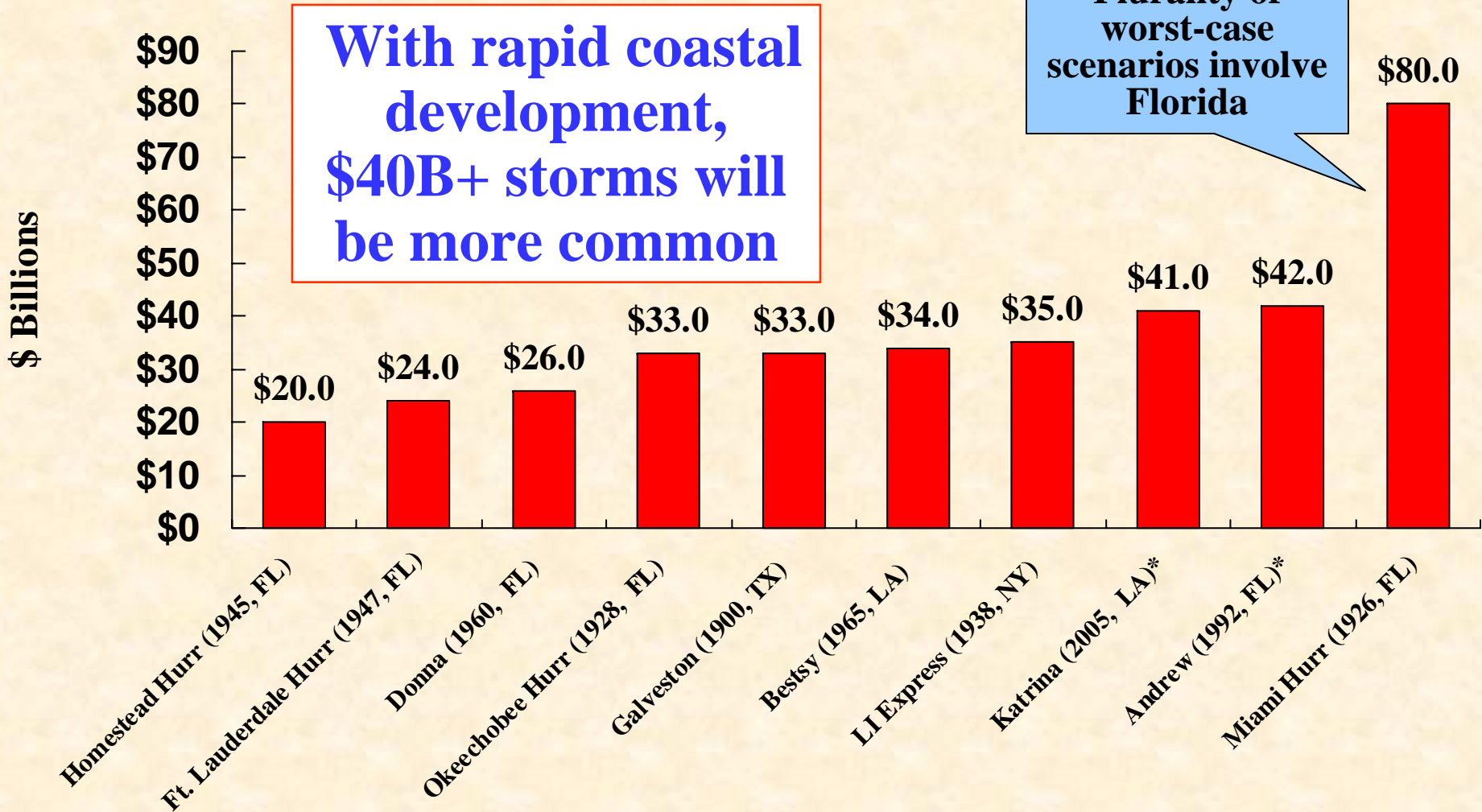


*Includes CEA policies beginning in 1996. **2006 estimate from Insurance Information Network of CA.
Source: California Department of Insurance; Insurance Information Institute.



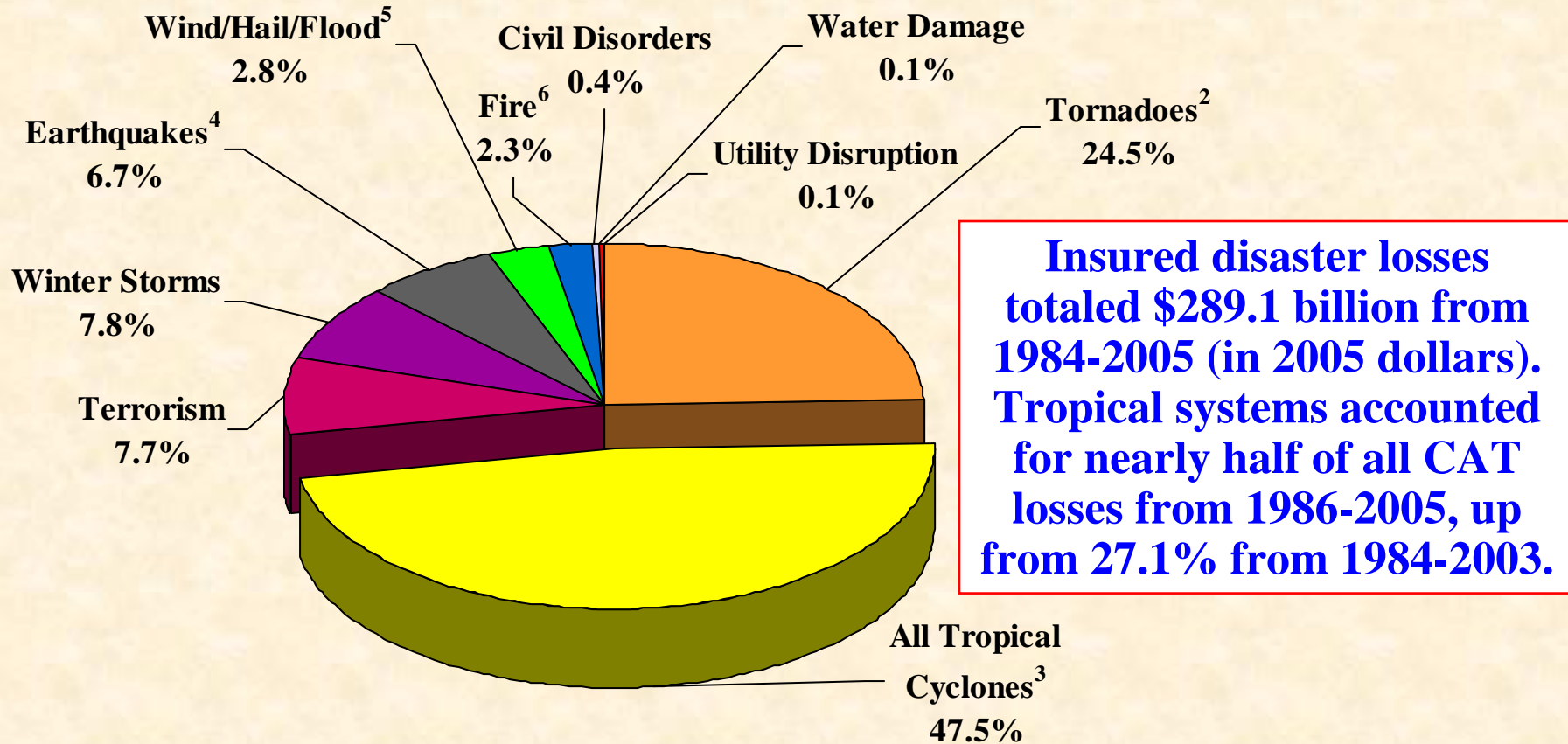
Insured Losses from Top 10 Hurricanes Adjusted to 2005 Exposure Levels

(Billions of 2005 Dollars)





Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1986-2005¹



¹ Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2005 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.



Total Value of Insured Coastal Exposure (2004, \$ Billions)

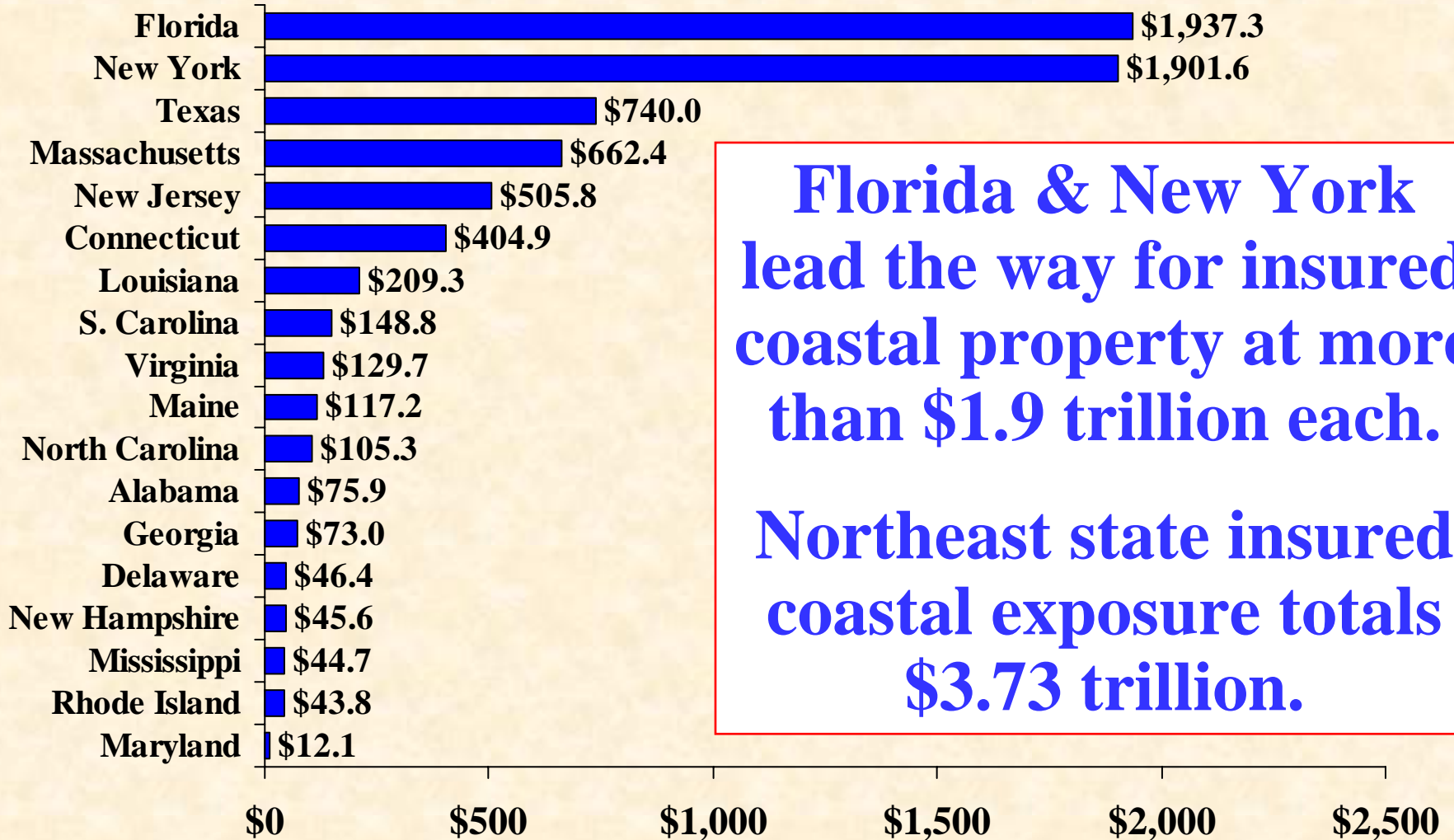


Figure 14.



New Condo Construction in South Miami Beach, 2007-2009

- **Number of New Developments: 15**
- **Number of Individual Units: 2,111**
- **Avg. Price of Cheapest Unit: \$940,333**
- **Avg. Price of Most Expensive Unit: \$6,460,000**
- **Range: \$395,000 - \$16,000,000**
- **Overall Average Price per Unit: \$3,700,167***
- **Aggregate Property Value: At least \$6 Billion**

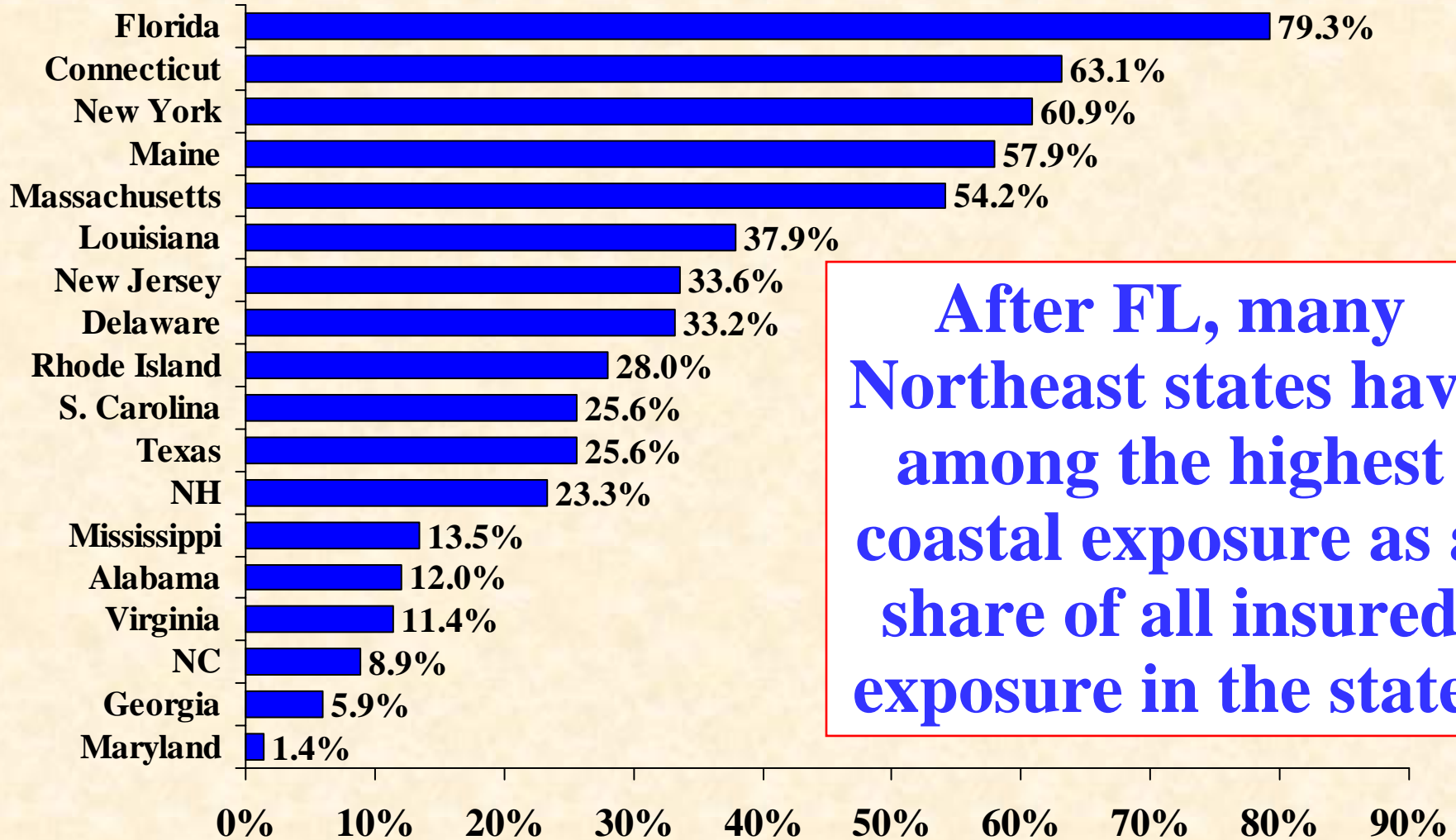


*Based on average of high/low value for each of the 15 developments

Source: Insurance Information Institute from www.miamicondolifestyle.com accessed April 5, 2007.



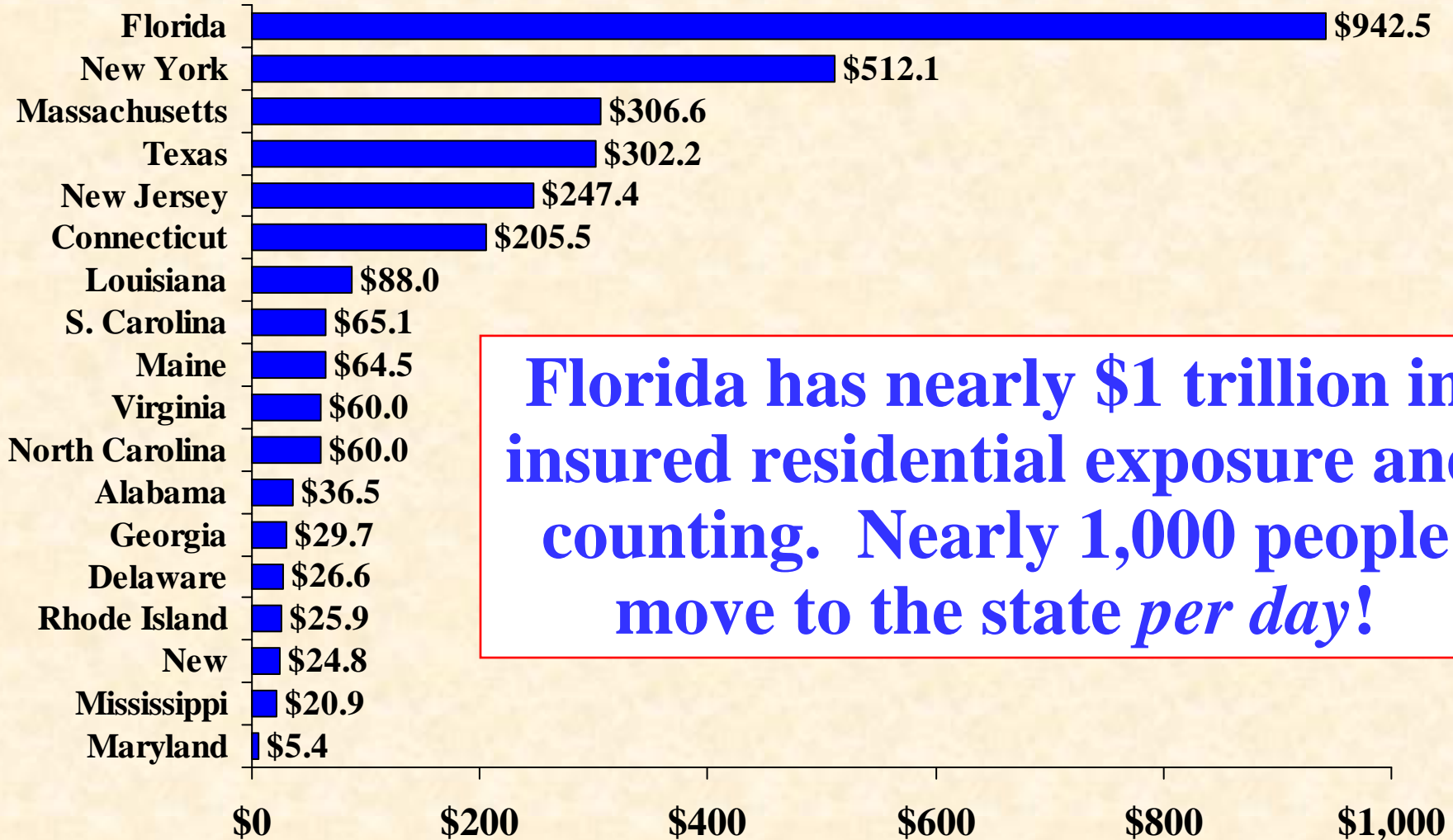
Insured Coastal Exposure as a % of Statewide Insured Exposure (2004, \$ Billions)



**After FL, many
Northeast states have
among the highest
coastal exposure as a
share of all insured
exposure in the state.**



Value of Insured Residential Coastal Exposure (2004, \$ Billions)





Value of Insured Commercial Coastal Exposure (2004, \$ Billions)

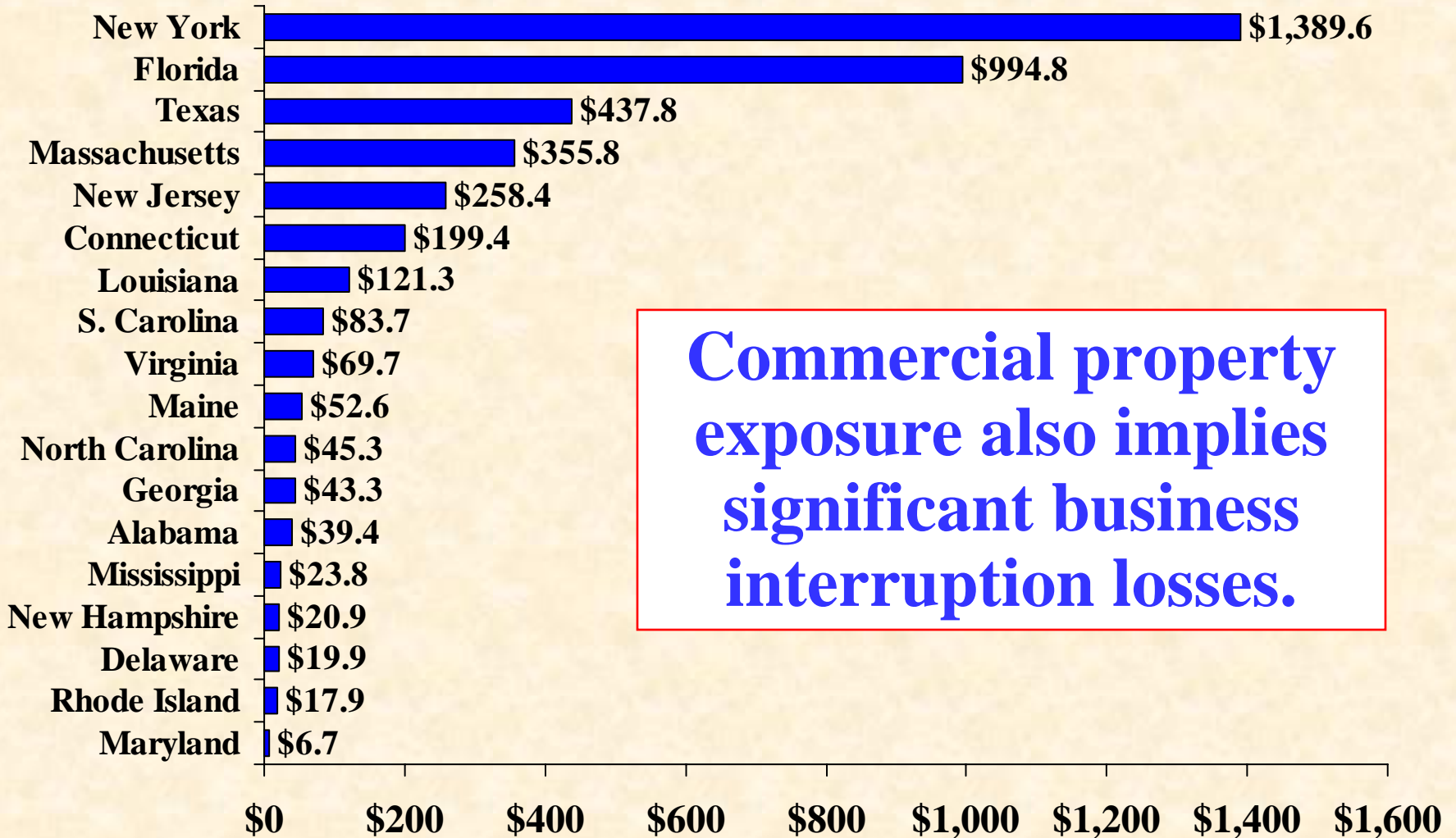


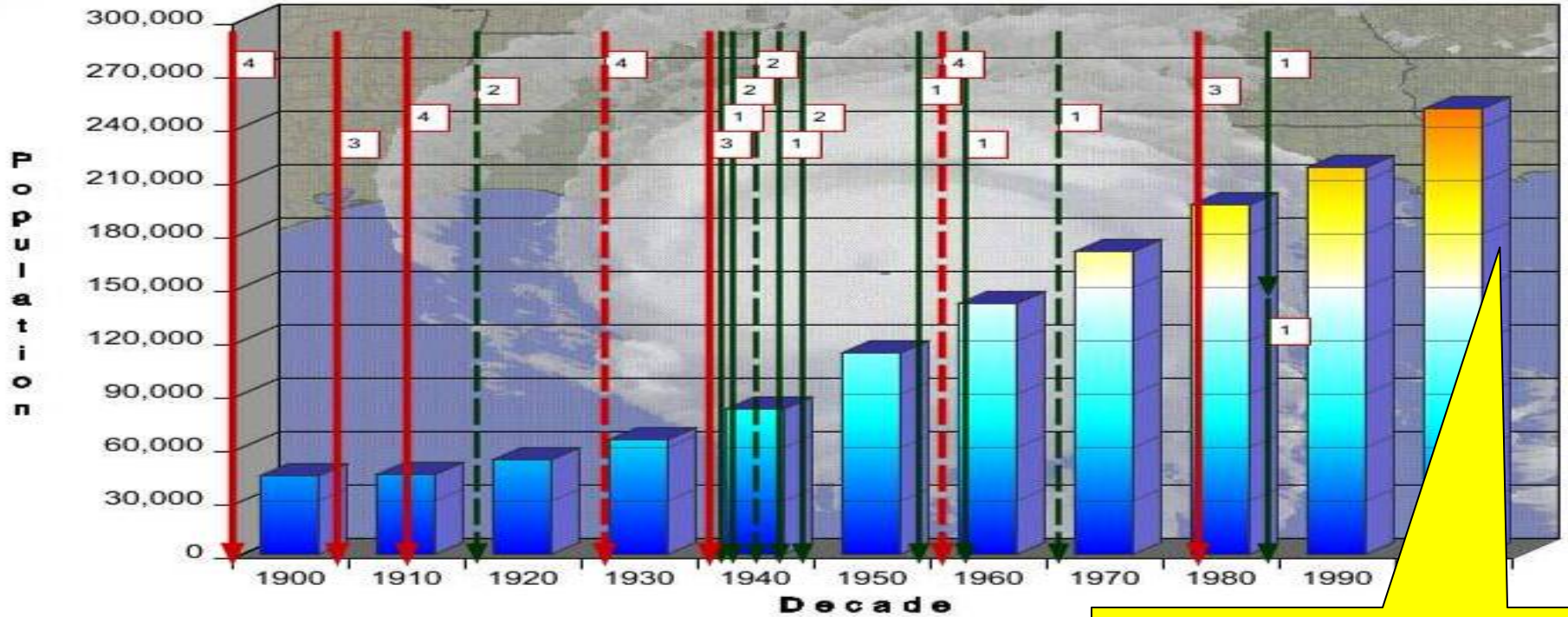
Figure 7.



Historical Hurricane Strikes in Galveston County, TX, 1900-2002



Galveston, TX



Population of Galveston County is 5 times what it was when the hurricane of 1900 struck, killing 8,000

Figure 8.



Historical Hurricane Strikes in Suffolk County, NY, 1900-2002

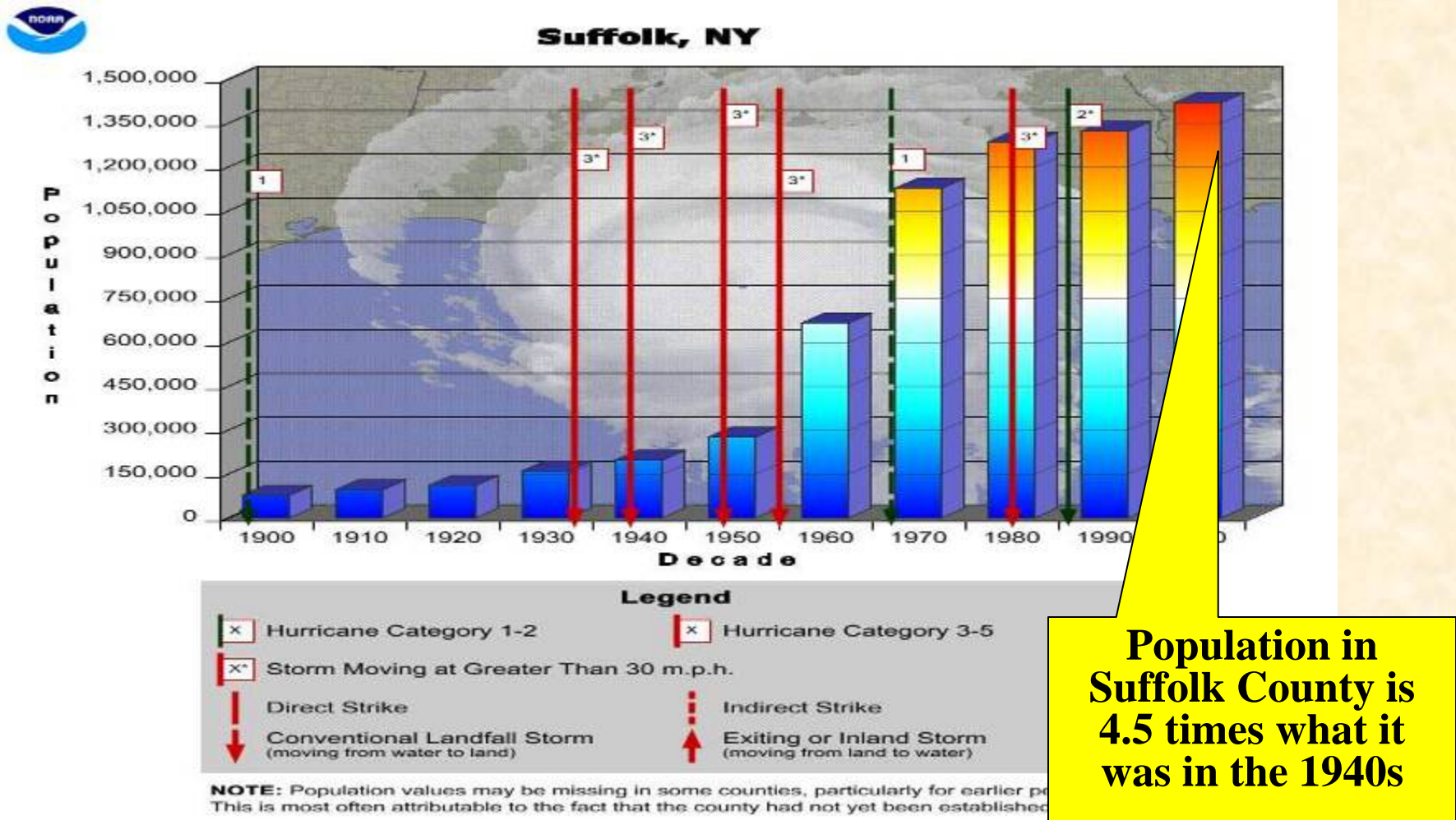


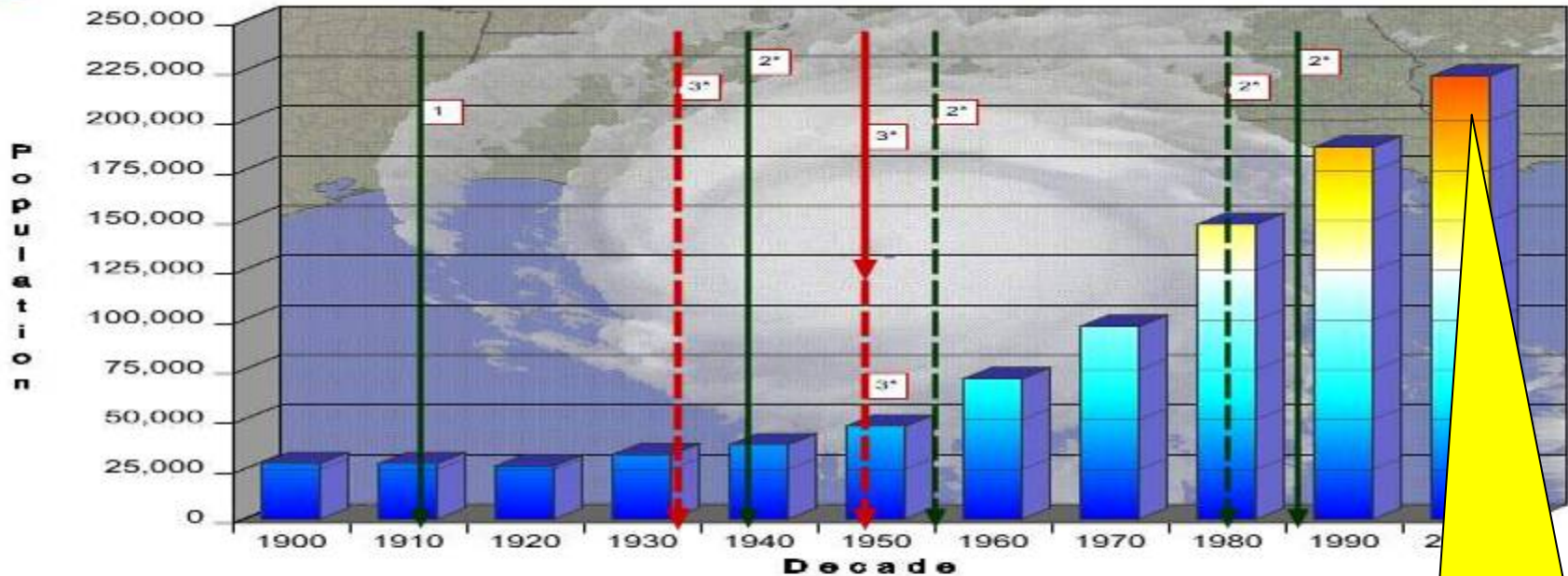
Figure 9.



Historical Hurricane Strikes in Barnstable County, MA, 1900-2002



Barnstable, MA



Legend

Hurricane Category 1-2	Hurricane Category 3*
Storm Moving at Greater Than 30 m.p.h.	Direct Strike
Conventional Landfall Storm (moving from water to land)	Exiting or Inland Storm (moving from land to water)

NOTE: Population values may be missing in some counties, particularly for earlier periods. This is most often attributable to the fact that the county had not yet been established.

Population in Barnstable County (Cape Cod) is 5 times what it was in the 1950s

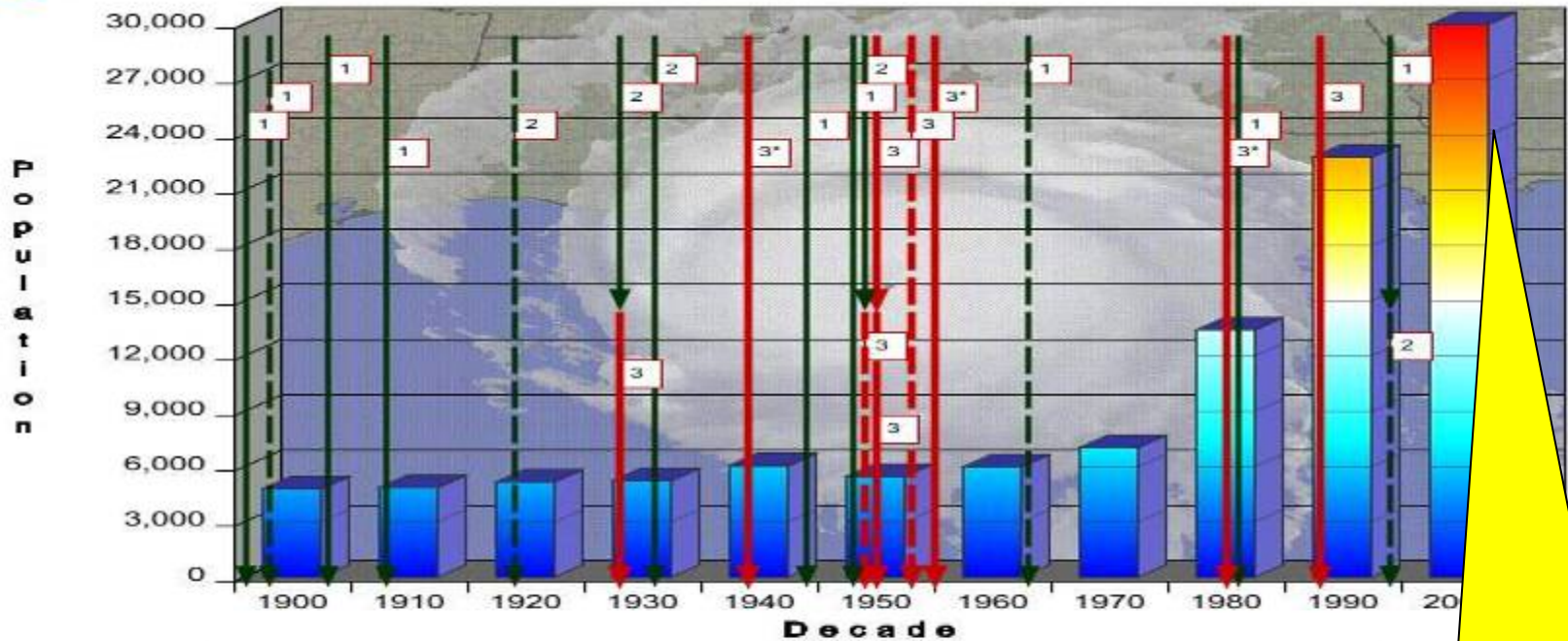
Figure 10.



Historical Hurricane Strikes in Dare County, NC, 1900-2002



Dare, NC



Legend

Hurricane Category 1-2	Hurricane Category 3
Storm Moving at Greater Than 30 m.p.h.	
Direct Strike	Indirect Strike
Conventional Landfall Storm (moving from water to land)	Exiting or Inland Storm (moving from land to water)

NOTE: Population values may be missing in some counties, particularly for earlier periods. This is most often attributable to the fact that the county had not yet been established.

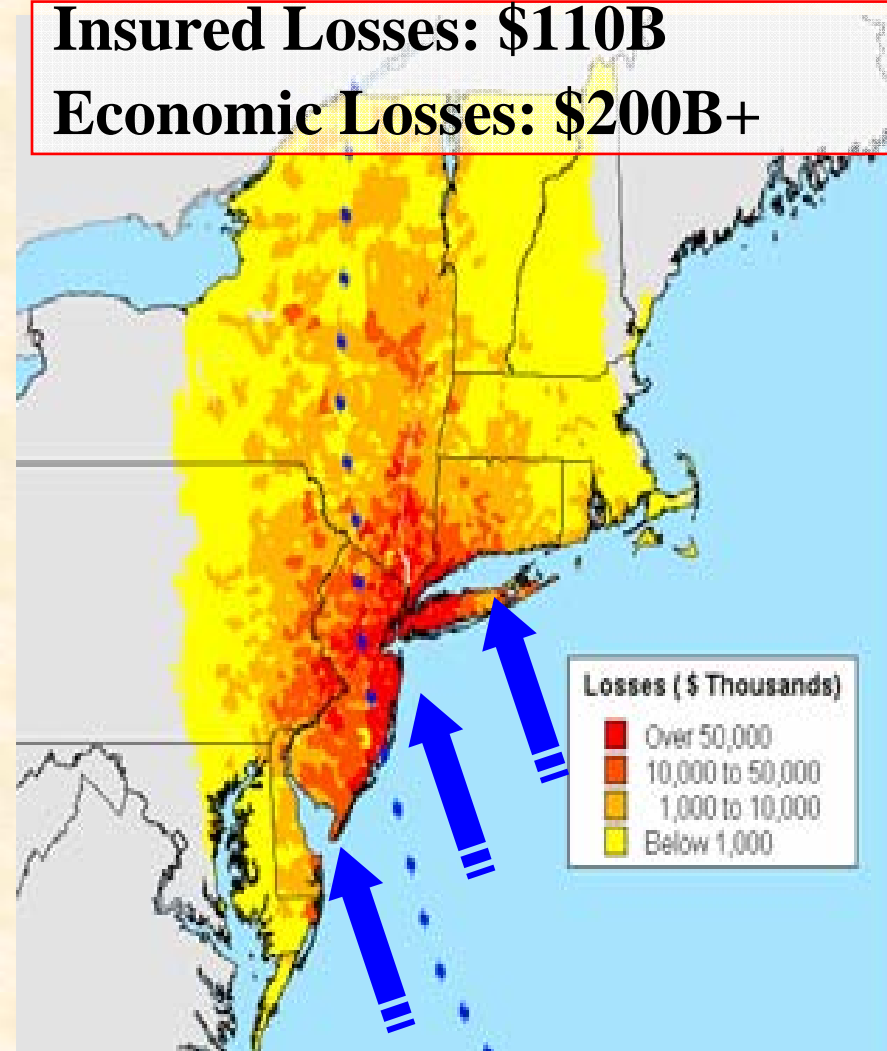
Population in Dare County is 6 times what it was in the 1950s



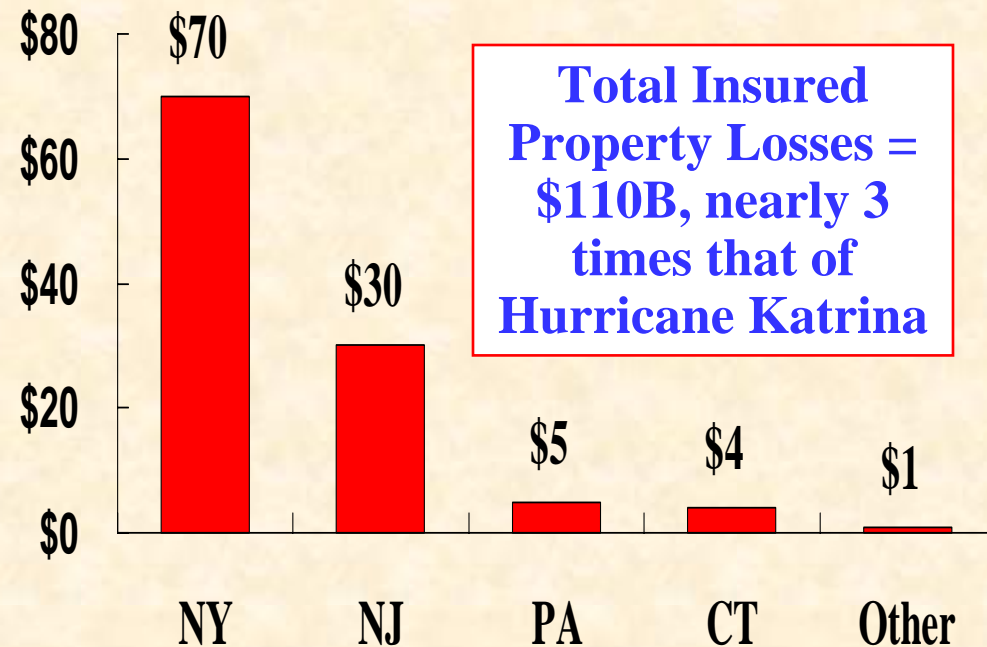
Nightmare Scenario: Insured Property Losses for NJ/NY CAT 3/4 Storm

Insured Losses: \$110B

Economic Losses: \$200B+



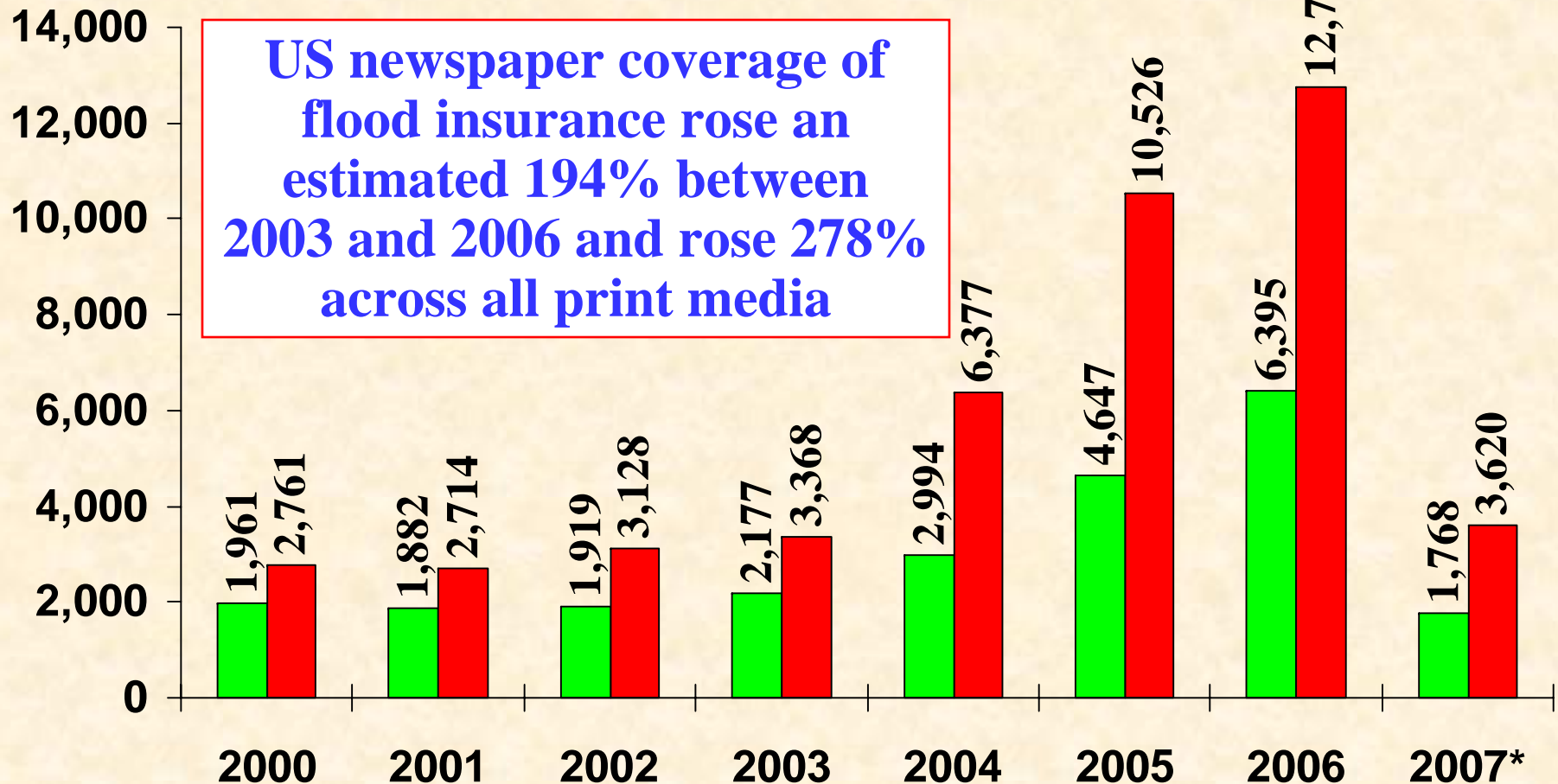
Distribution of Insured Property Losses, by State, (\$ Billions)





Media Coverage of Flood Insurance in the US Overall, 2000-2007*

■ US* ■ US-All Print Media**

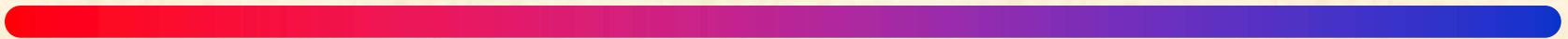


*Newspaper coverage as of May 2, 2007. **Includes newspapers, magazines, wire services, etc.

Source: Insurance Information Institute analysis based on Nexis search.

The 2007 Hurricane Season:

Preview to Disaster?





Outlook for 2007 Hurricane

Season: 85% Worse Than Average

	Average*	2005	2007F
Named Storms	9.6	28	17
Named Storm Days	49.1	115.5	85
Hurricanes	5.9	14	9
Hurricane Days	24.5	47.5	40
Intense Hurricanes	2.3	7	5
Intense Hurricane Days	5	7	11
Accumulated Cyclone Energy	96.2	NA	170
Net Tropical Cyclone Activity	100%	275%	185%

*Average over the period 1950-2000.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, April 3, 2007.



Probability of Major Hurricane Landfall (CAT 3, 4, 5) in 2007

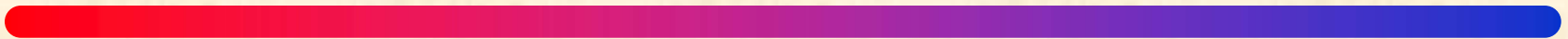
	Average*	2007F
Entire US Coast	52%	74%
US East Coast Including Florida Peninsula	31%	50%
Gulf Coast from FL Panhandle to Brownsville, TX	30%	49%
<i>ALSO...Above-Average Major Hurricane Landfall Risk in Caribbean for 2007</i>		

*Average over the period 1950-2000.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, April 3, 2007.

REINSURANCE MARKETS

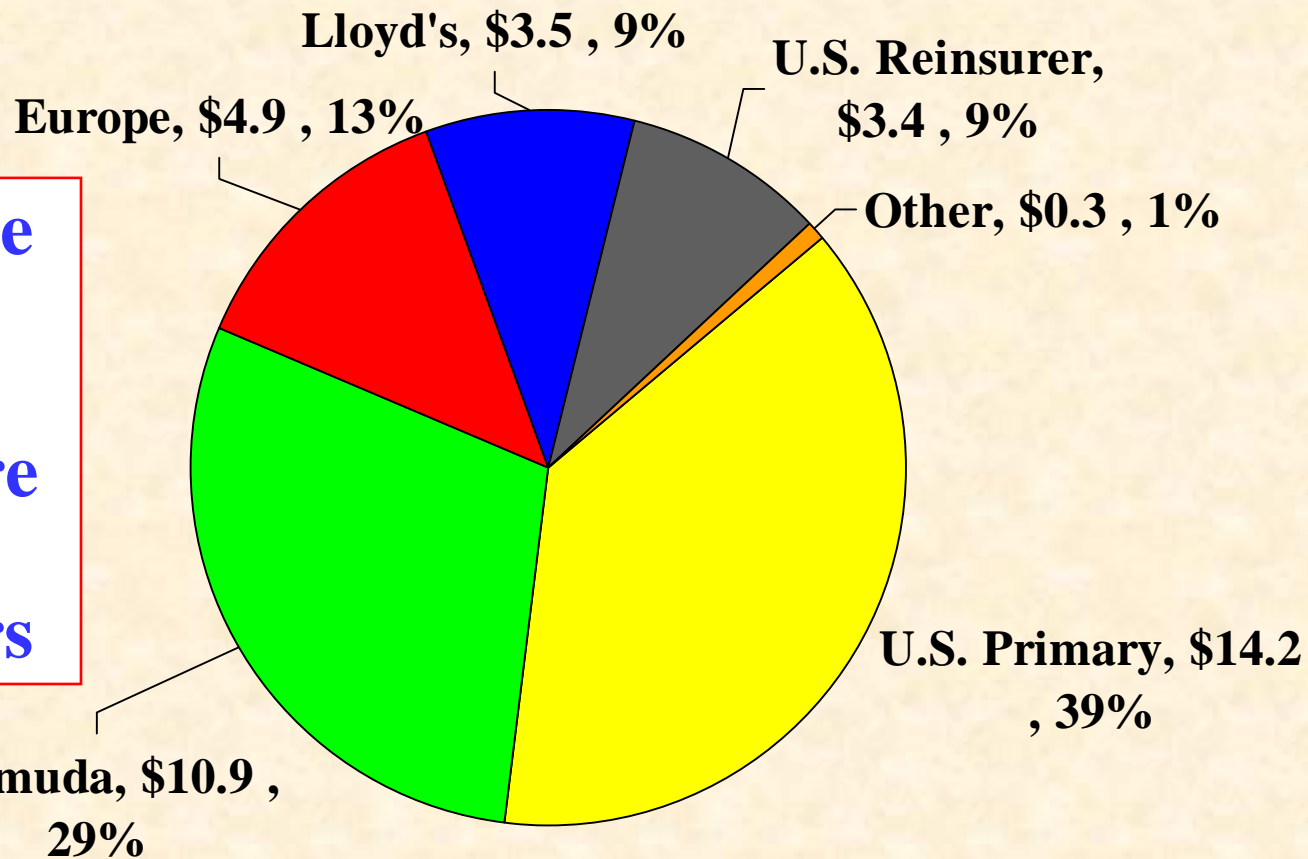
*Big Risk, Big Reward or
Big Government?*





Announced Katrina, Rita, Wilma *Losses by Segment*

\$ Billions



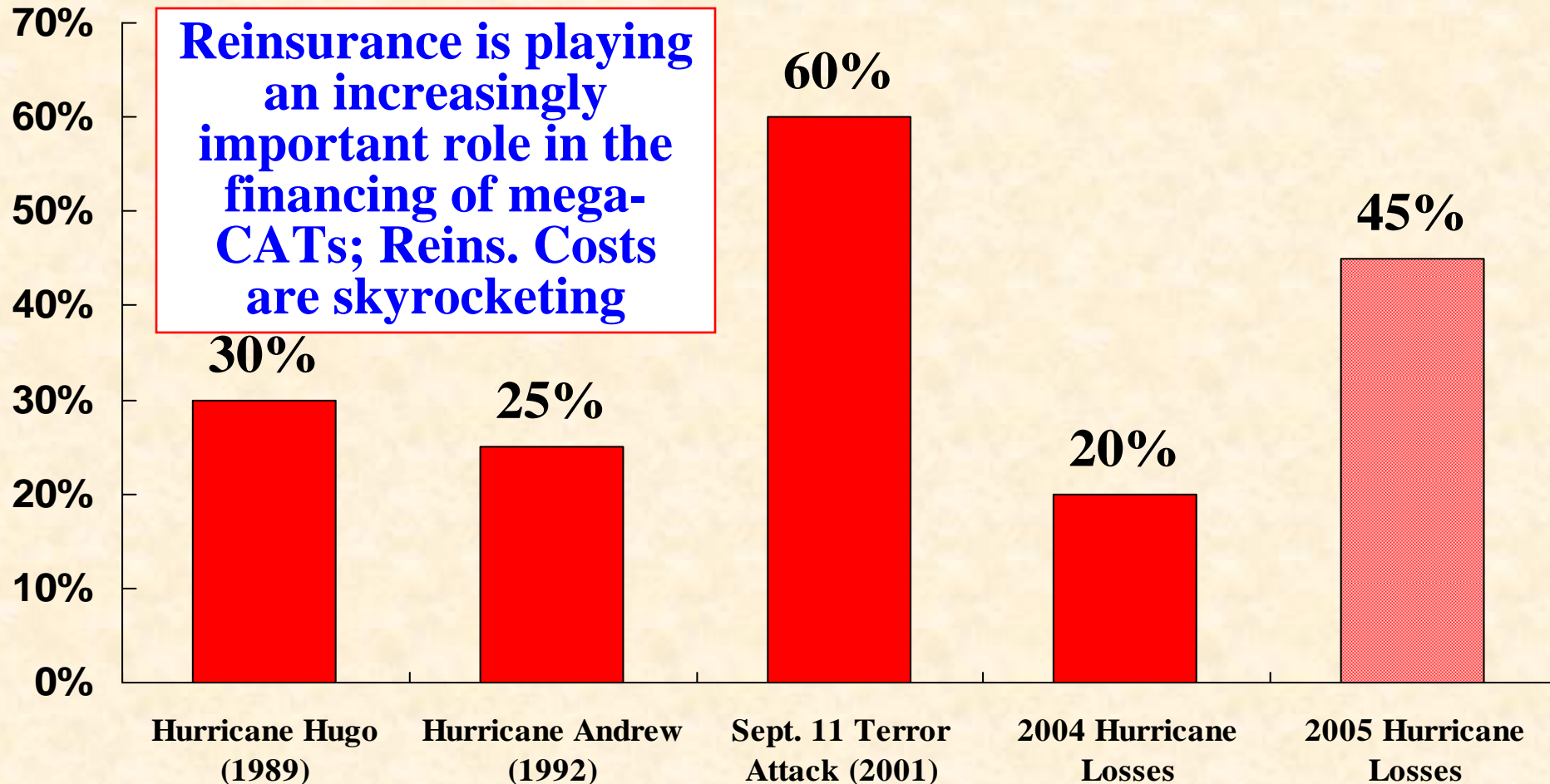
**Catastrophes are
global events.
Only 39% of
KRW losses were
borne by US
primary insurers**

*As of 2/21/06

Source: Dowling & Partners, RAA.



Share of Losses Paid by Reinsurers, by Disaster*



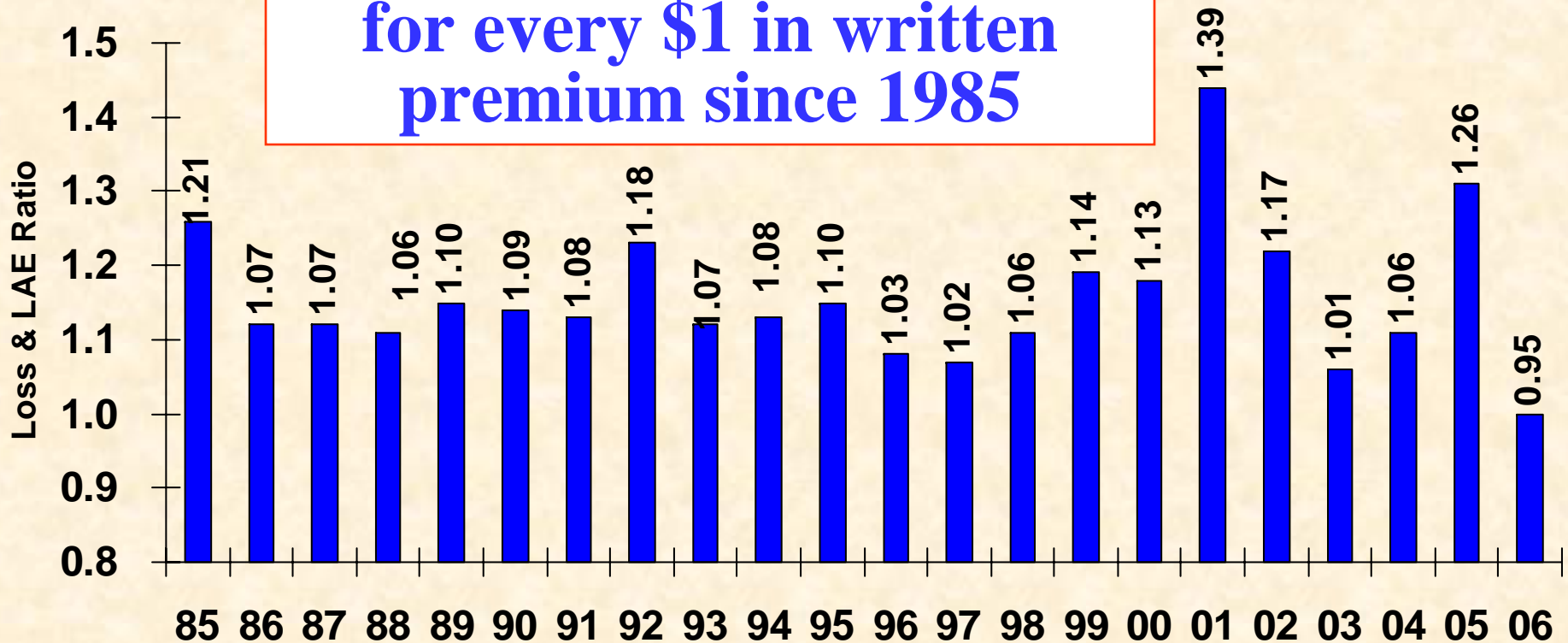
*Excludes losses paid by the Florida Hurricane Catastrophe Fund, a FL-only windstorm reinsurer, which was established in 1994 *after* Hurricane Andrew. FHCF payments to insurers are estimated at \$3.85 billion for 2004 and \$4.5 billion for 2005.

Sources: Wharton Risk Center, Disaster Insurance Project; Insurance Information Institute.



Ratio of Reinsurer Loss & Underwriting Expense to Premiums Written, 1985-2006

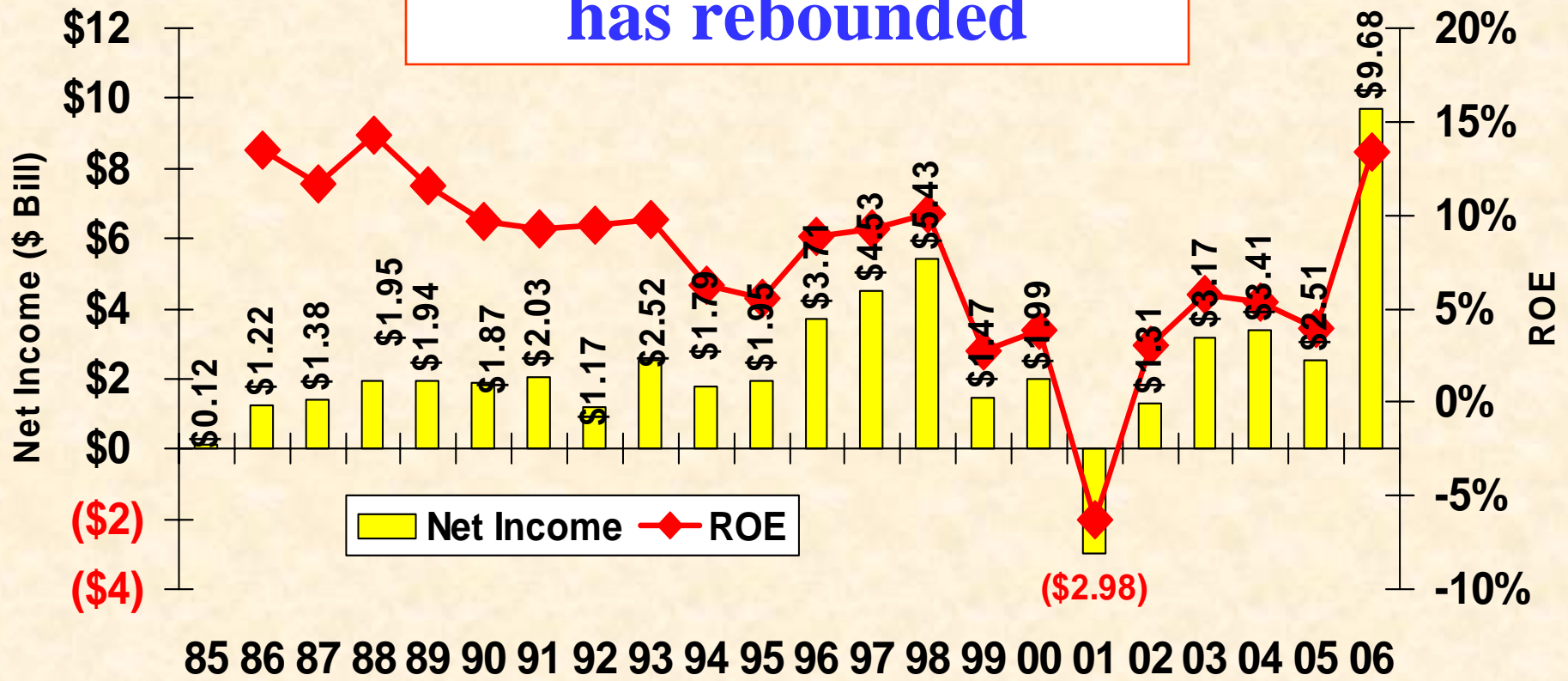
Despite the respite in 2006, reinsurers paid an average of \$1.11 in loss and expense for every \$1 in written premium since 1985



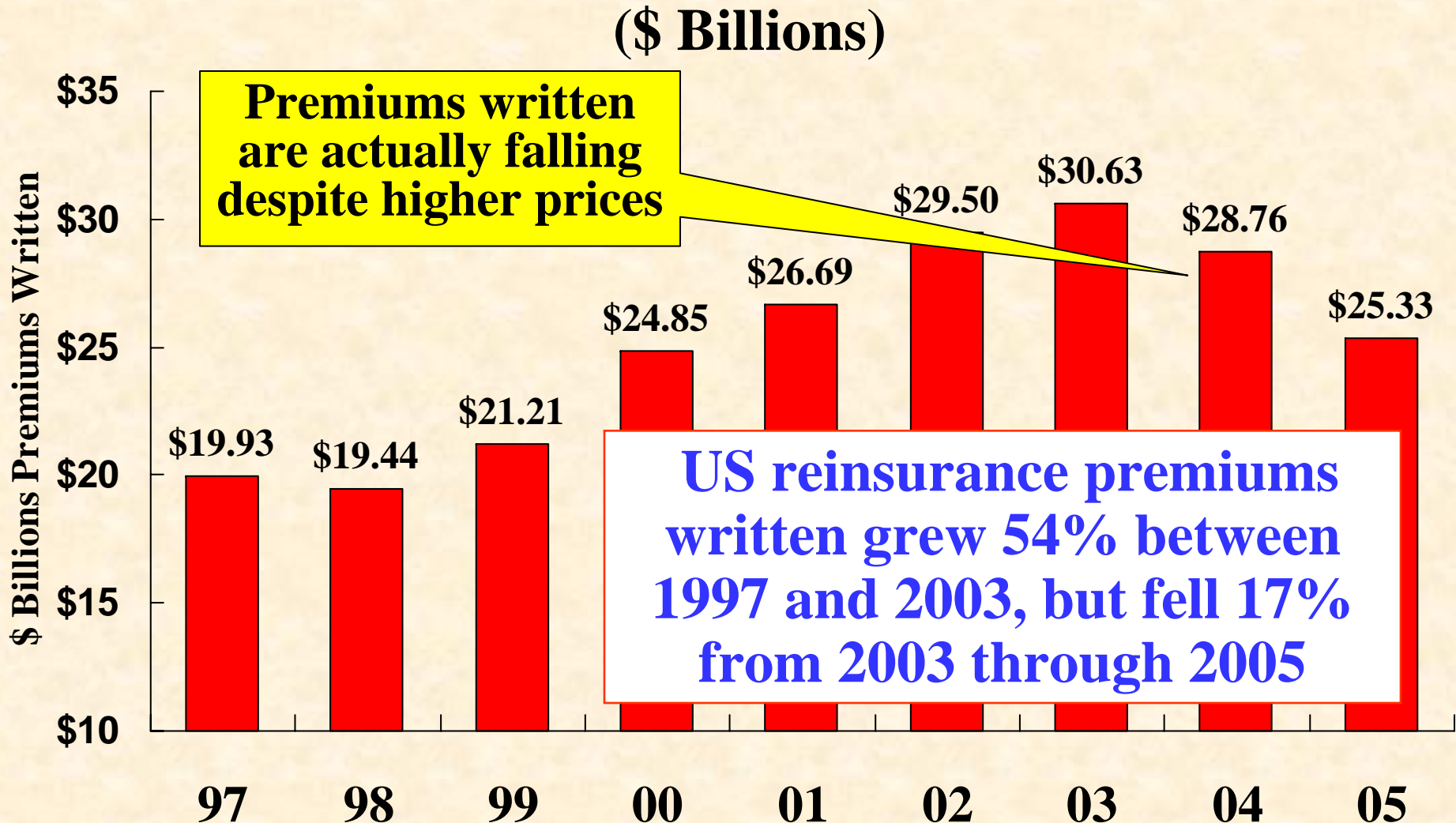


US Reinsurer Net Income & ROE, 1985-2006

Reinsurer profitability
has rebounded



Reinsurers Net Written Premiums, US Business, 1997 - 2005



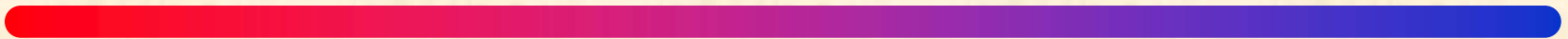


Debate Over Reinsurance Market Performance & Government

- Reinsurance markets typically suffer large shocks, followed by a period of higher prices and transient capacity constraints
- A new equilibrium between Supply and Demand is typically found within 18 months, commensurate with changes in the risk landscape. This is Economics 101 and is a textbook illustration of how capitalism works.
- A competing hypothesis suggests that reinsurance markets “fail” because they do not provide a stable price or quantity of protection as is required in an economy with *continuously exposed fixed assets, especially one that is growth oriented*
- Public Policy Solution: Acting on this hypothesis generally results in displacement of private (re)insurance capital by government intermediaries
- **Question Asked**: Are policyholders and the economy better served through free markets, government or some hybrid?

FINANCIAL STRENGTH & RATINGS

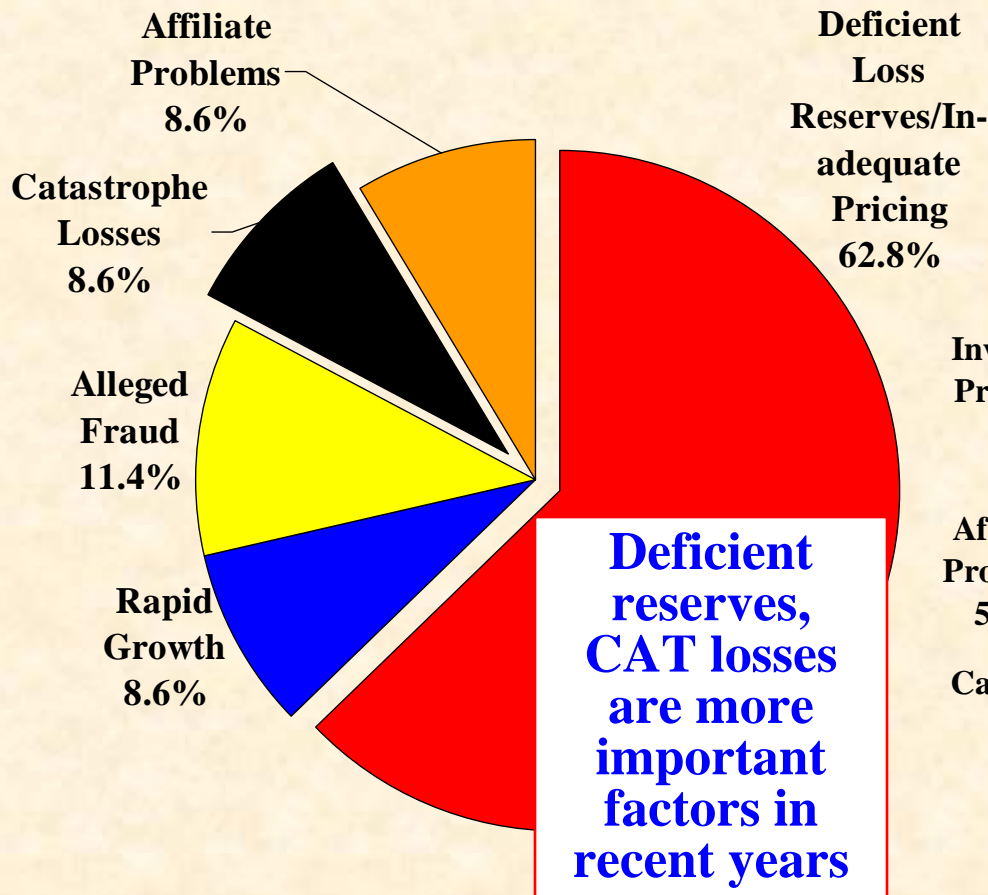
**Industry Has Weathered
the Storms Well**



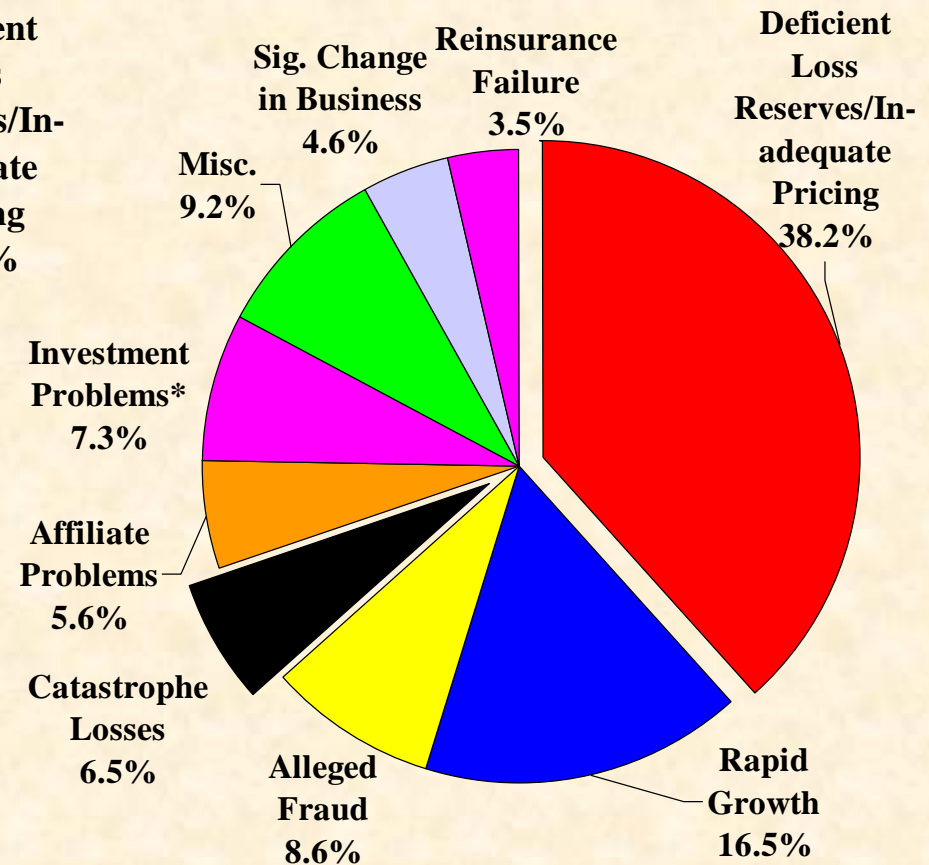


Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



1969-2005



*Includes overstatement of assets.



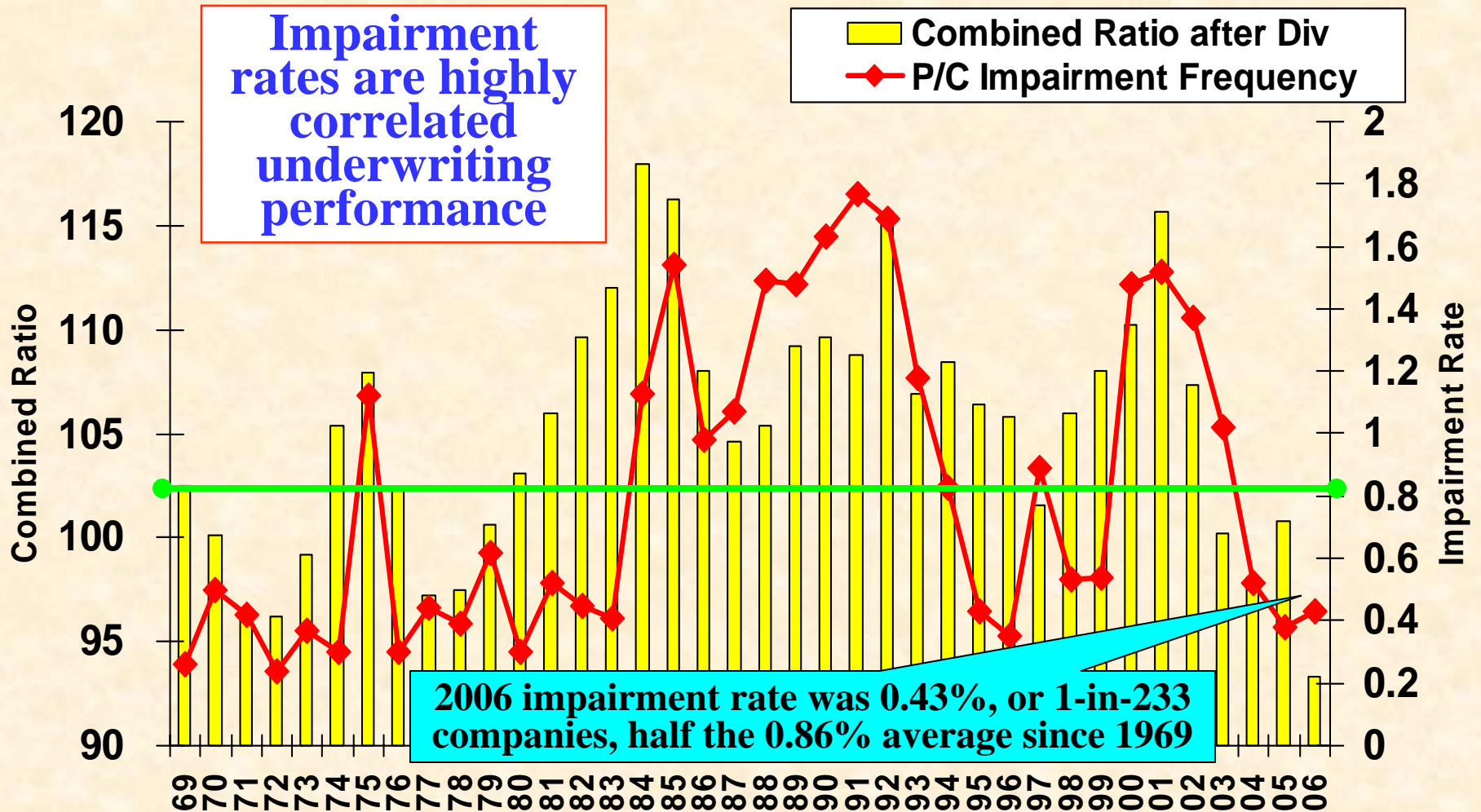
P/C Insurer Impairments, 1969-2006

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



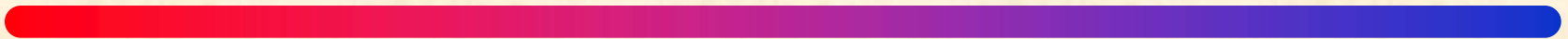


P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2006



STATE RESIDUAL MARKETS

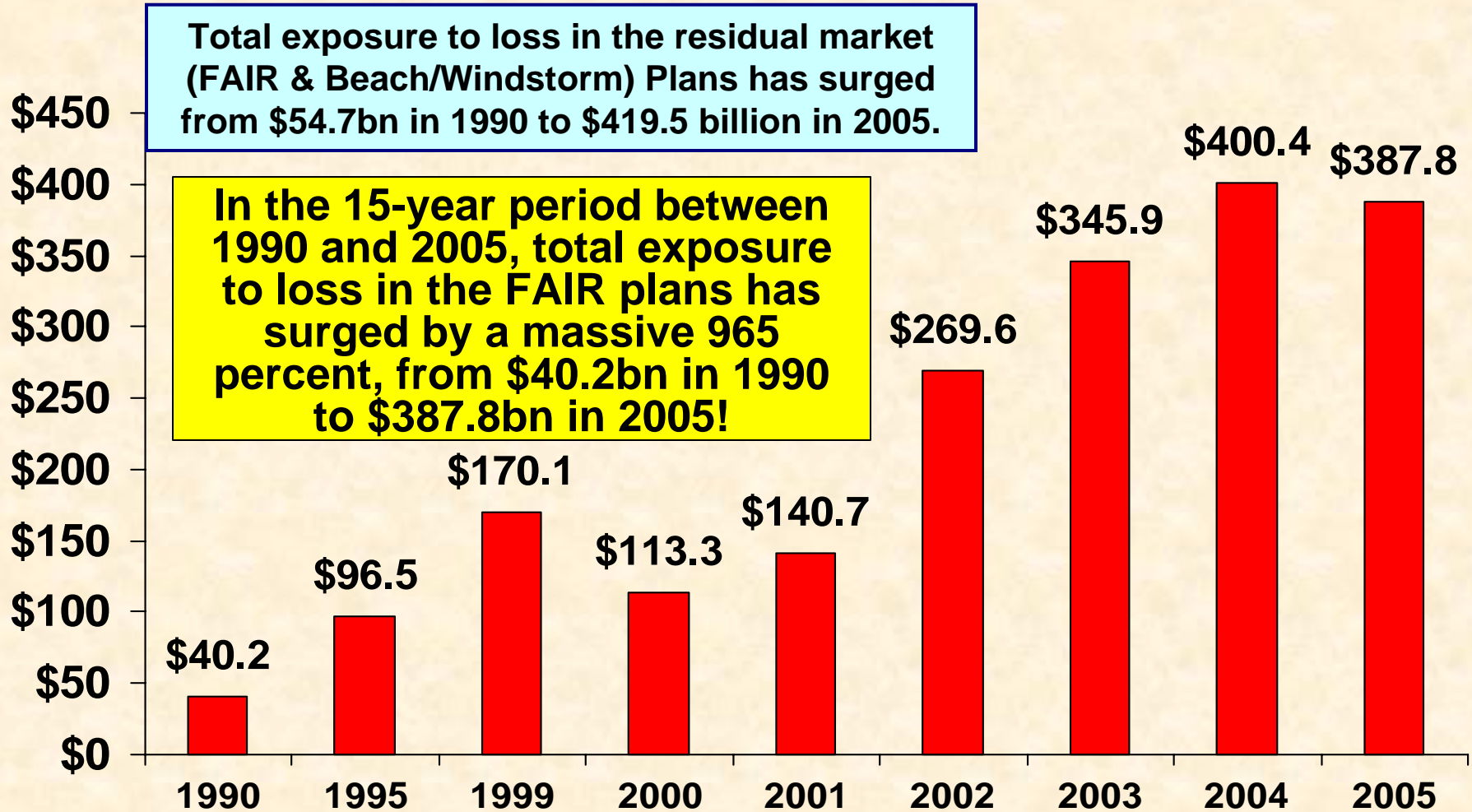
How Big is Too Big?





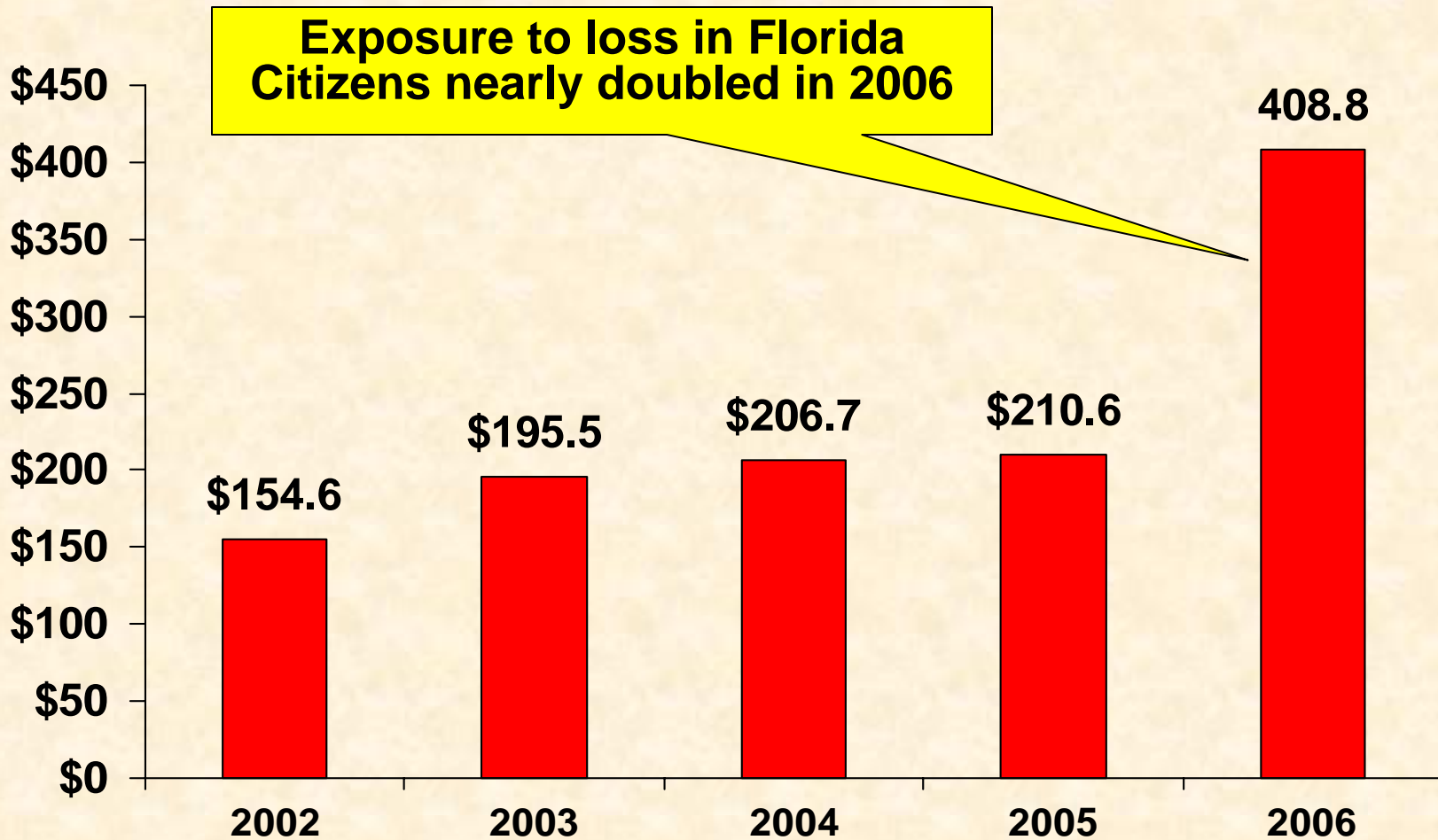
*US FAIR Plans Exposure to Loss**

(Billions of Dollars)



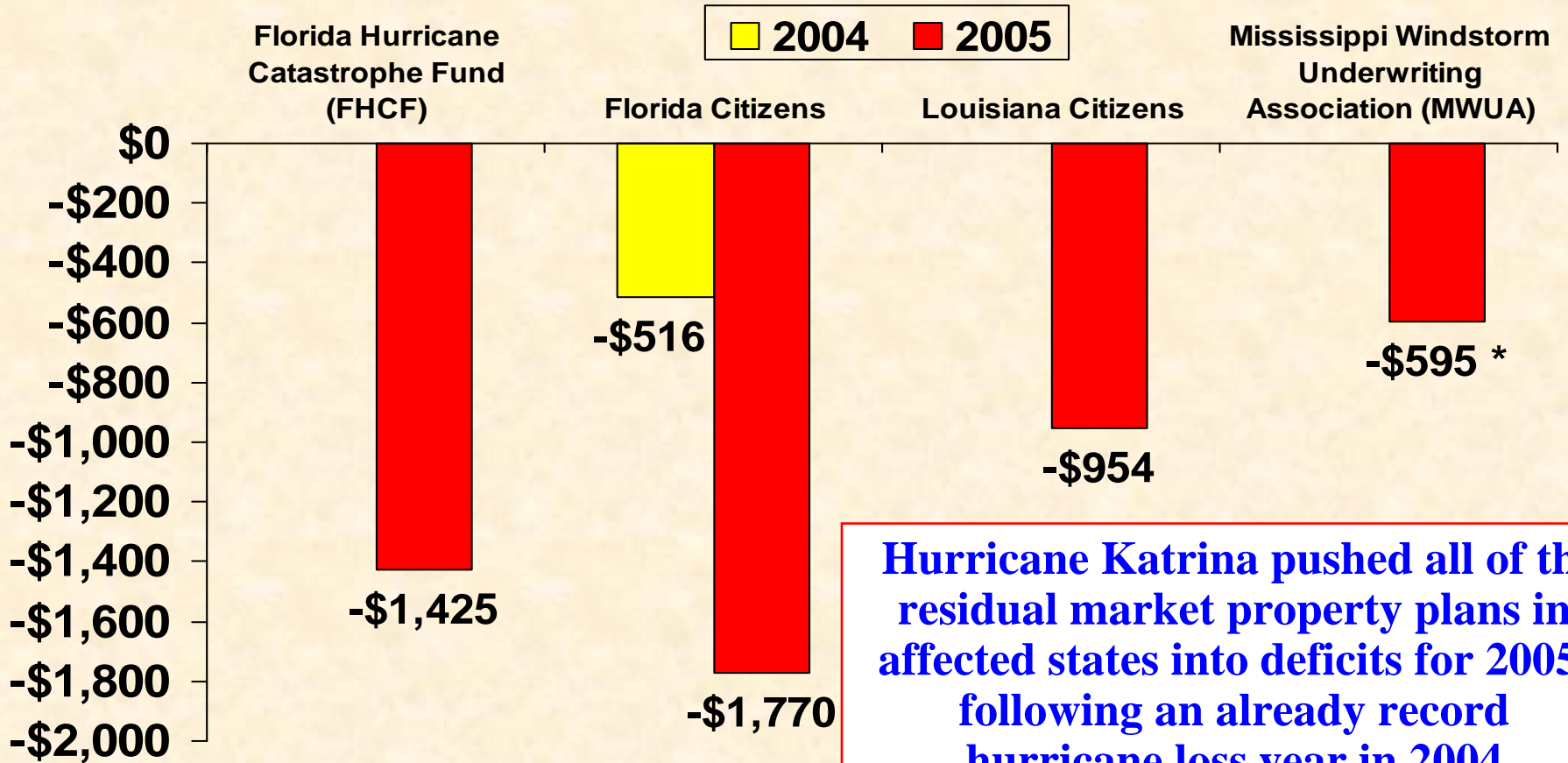


Florida Citizens Exposure to Loss (Billions of Dollars)





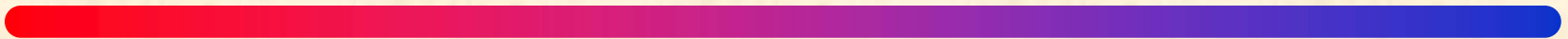
Major Residual Market Plan Estimated Deficits 2004/2005 (Millions of Dollars)



Hurricane Katrina pushed all of the residual market property plans in affected states into deficits for 2005, following an already record hurricane loss year in 2004

* MWUA est. deficit for 2005 comprises \$545m in assessments plus \$50m in Federal Aid.

What Role Should the Federal Government Play in Insuring Against Natural Disaster Risks?





NAIC's Comprehensive National Catastrophe Plan

- **Proposes Layered Approach to Risk**
- **Layer 1: Maximize resources of private insurance & reinsurance industry**
 - Includes “All Perils” Residential Policy
 - Encourage Mitigation
 - Create Meaningful, Forward-Looking Reserves
- **Layer 2: Establishes system of state catastrophe funds (like FHCF)**
- **Layer 3: Federal Catastrophe Reinsurance Mechanism**



Guiding Principles of NAIC's National Catastrophe Plan

- **National program should promote personal responsibility among policyholders**
- **National program should support reasonable building codes, development plans & mitigation tools**
- **National program should maximize risk-bearing capacity of private markets, and**
- **National plan should provide quantifiable risk management to the federal government**



Comprehensive National Catastrophe Plan Schematic

1:500 Event

National Catastrophe Contract Program

1:50 Event

State Regional Catastrophe Fund

State Attachment

**Personal
Disaster
Account**

Private Insurance

Private Reinsurance



Legislation has been introduced and ideas espoused by ProtectingAmerica.org will likely get a more thorough airing in 2007/8

A VULNERABLE AMERICA

HURRICANES EARTHQUAKES

WHAT ARE YOU AT RISK FOR?

OUR MISSION IS TO RAISE AWARENESS, EDUCATE THE PUBLIC AND POLICYMAKERS, AND OFFER SOLUTIONS THAT WILL BETTER PREPARE AND PROTECT AMERICA FROM MAJOR CATASTROPHE IN A SENSIBLE, COST-EFFECTIVE FASHION.

REPLAY

- HELP PROTECT AMERICA
- UNDERSTAND YOUR RISKS >
 - STRENGTHEN 1ST RESPONDERS >
 - BUILD SMARTER & STRONGER >
 - ADVOCATE CATASTROPHE FUNDS >

PREPARE YOURSELF:

HOW YOU CAN BETTER PREPARE
tips for average americans >

- RECENT NEWS:
- Teaching Earthquake Science Made Easy: USGS Partnership Puts Curriculum into the Classroom
2.1.06
 - Faculty Senate hears report on emergency-preparedness plan
2.1.06
 - It's Earthquake Preparedness Week In Kentucky
2.1.06

AMERICA NEEDS YOUR VOICE!

Our current system leaves too many people unprotected and unable to rebuild their lives following a catastrophe. We need to prepare for future catastrophes and protect ourselves.

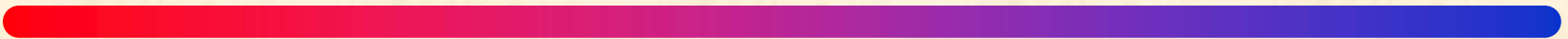
CONTACT YOUR ELECTED OFFICIALS > **JOIN OUR CAUSE >**

STATS & FIGURES:

repeat of the 1886 Charleston, South Carolina, earthquake today would cause

KEY LINES

**Discipline Will Remain
(Mostly) Intact in 2007**



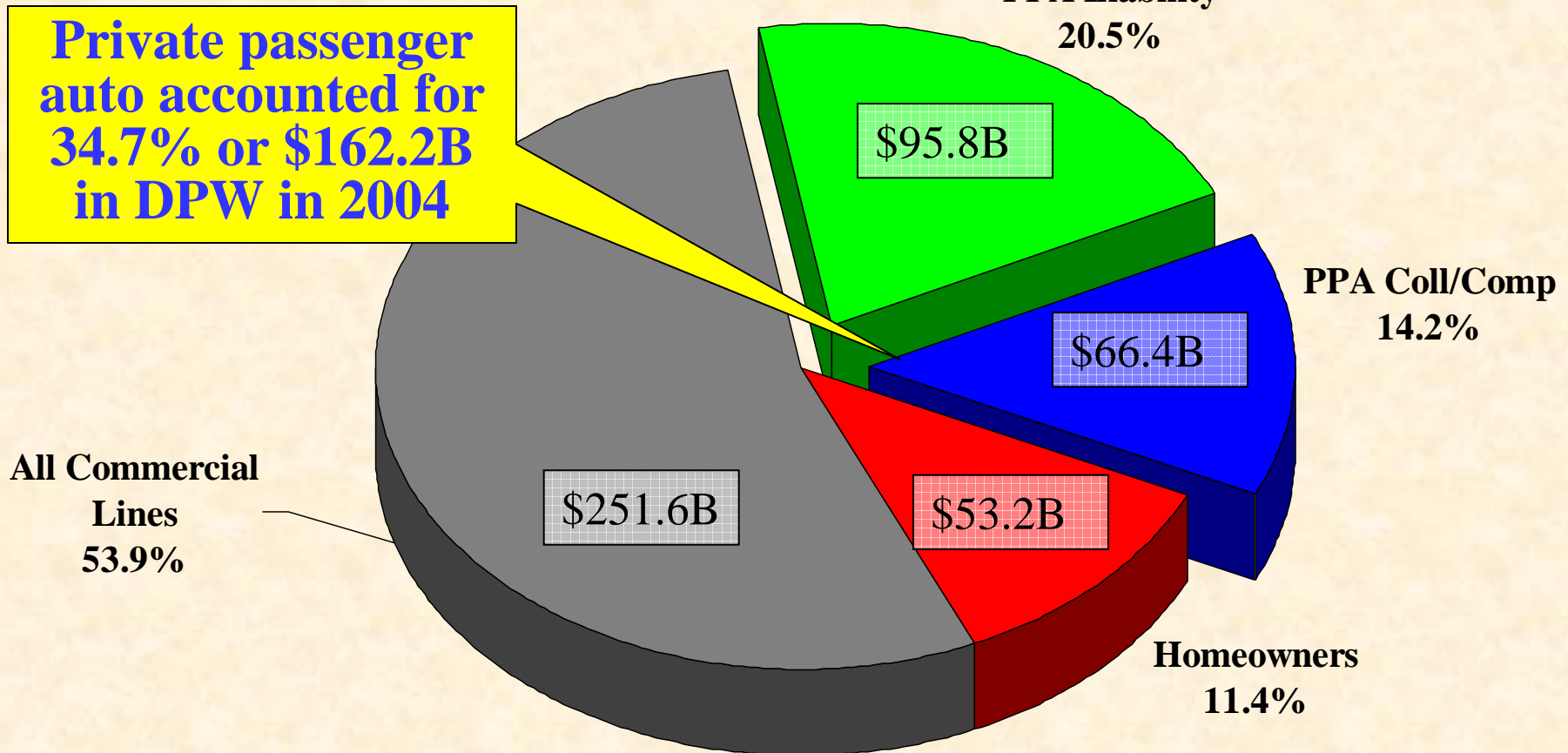
Private Passenger Auto





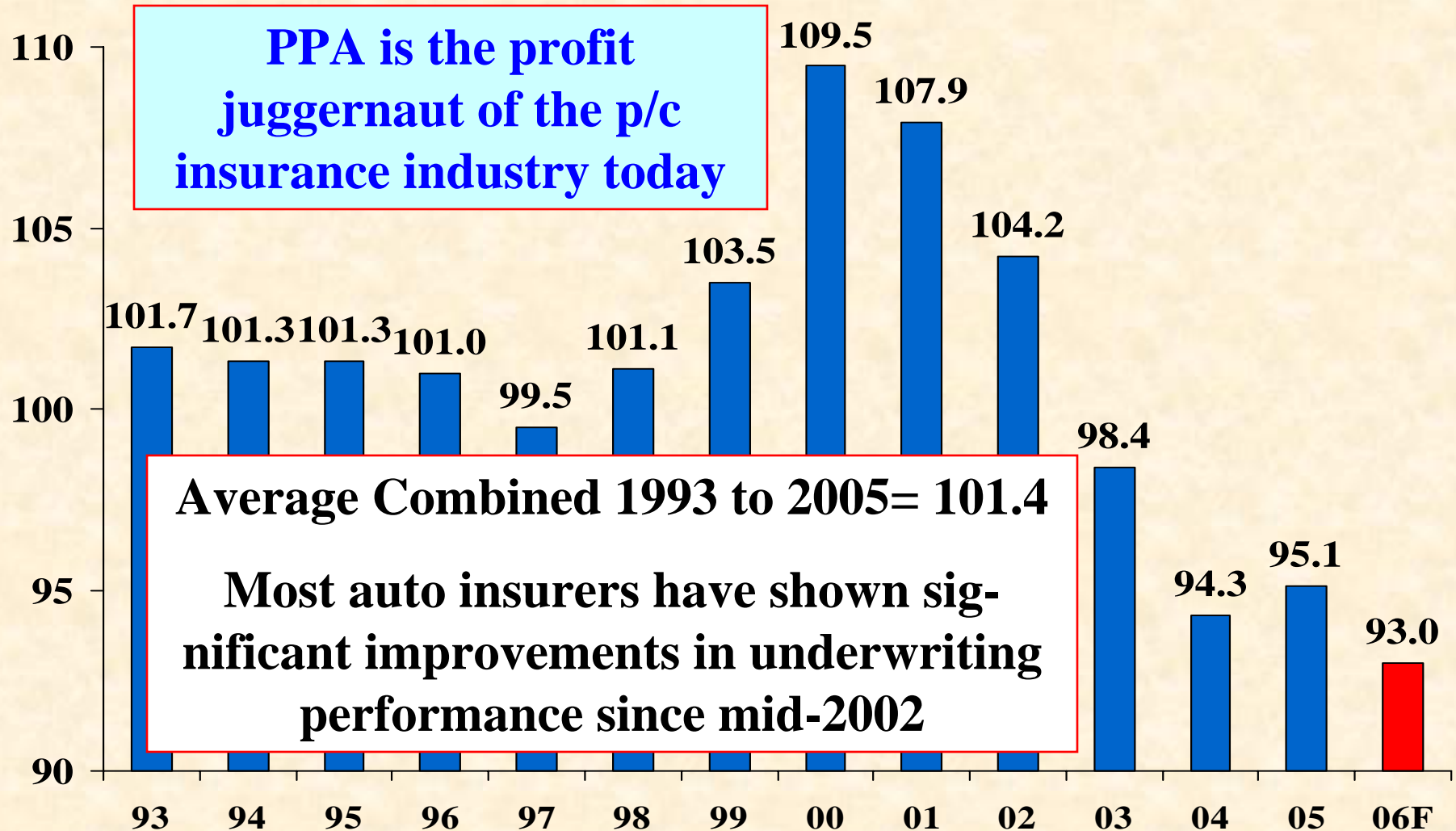
Private Passenger Auto is Enormous Part of P/C Industry

**Total 2004 Direct Personal + Commercial Premiums Written
= \$467.0 Billion**



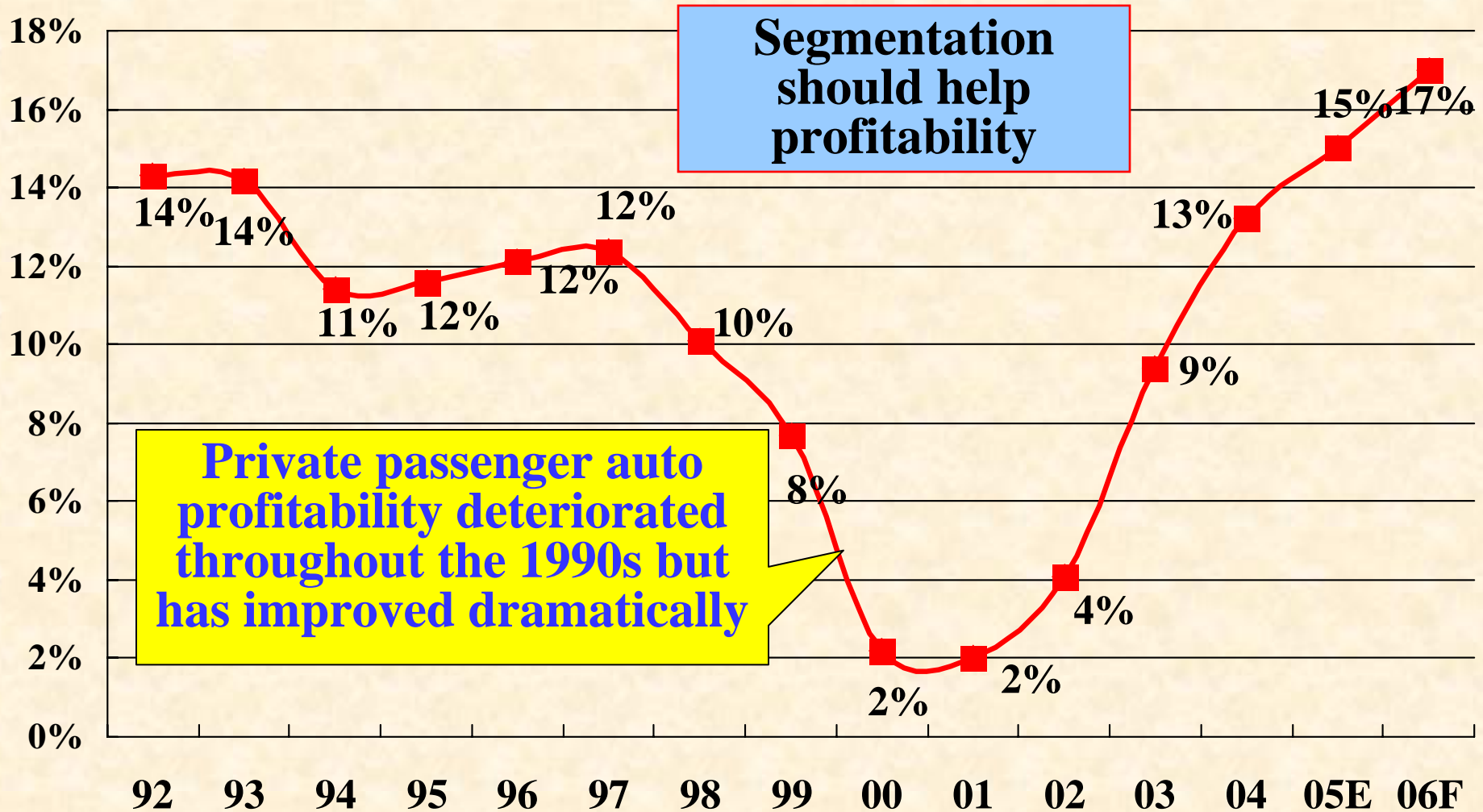


Private Passenger Auto Combined Ratio





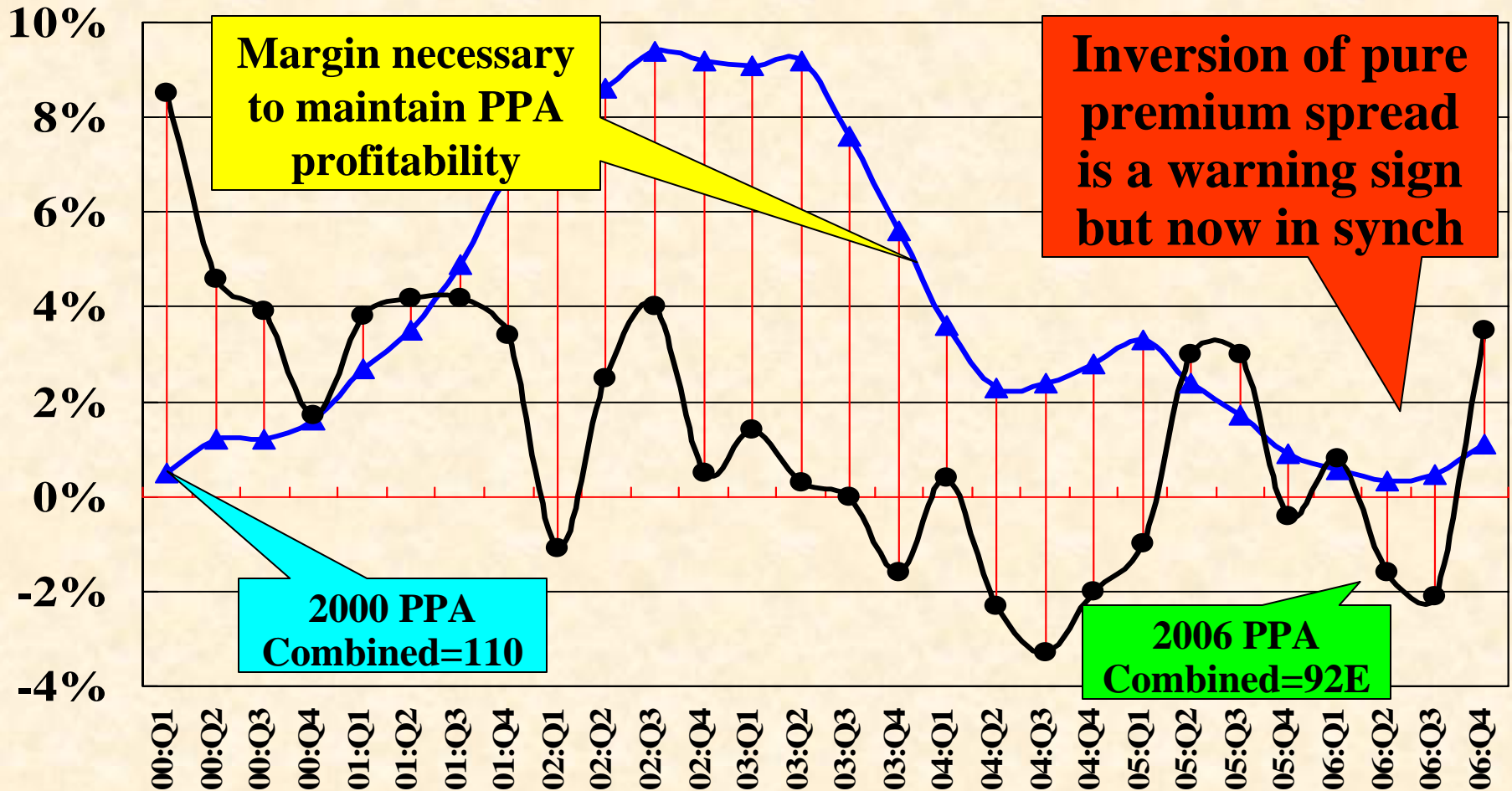
RNW: Private Passenger Auto, United States, 1992-2006E





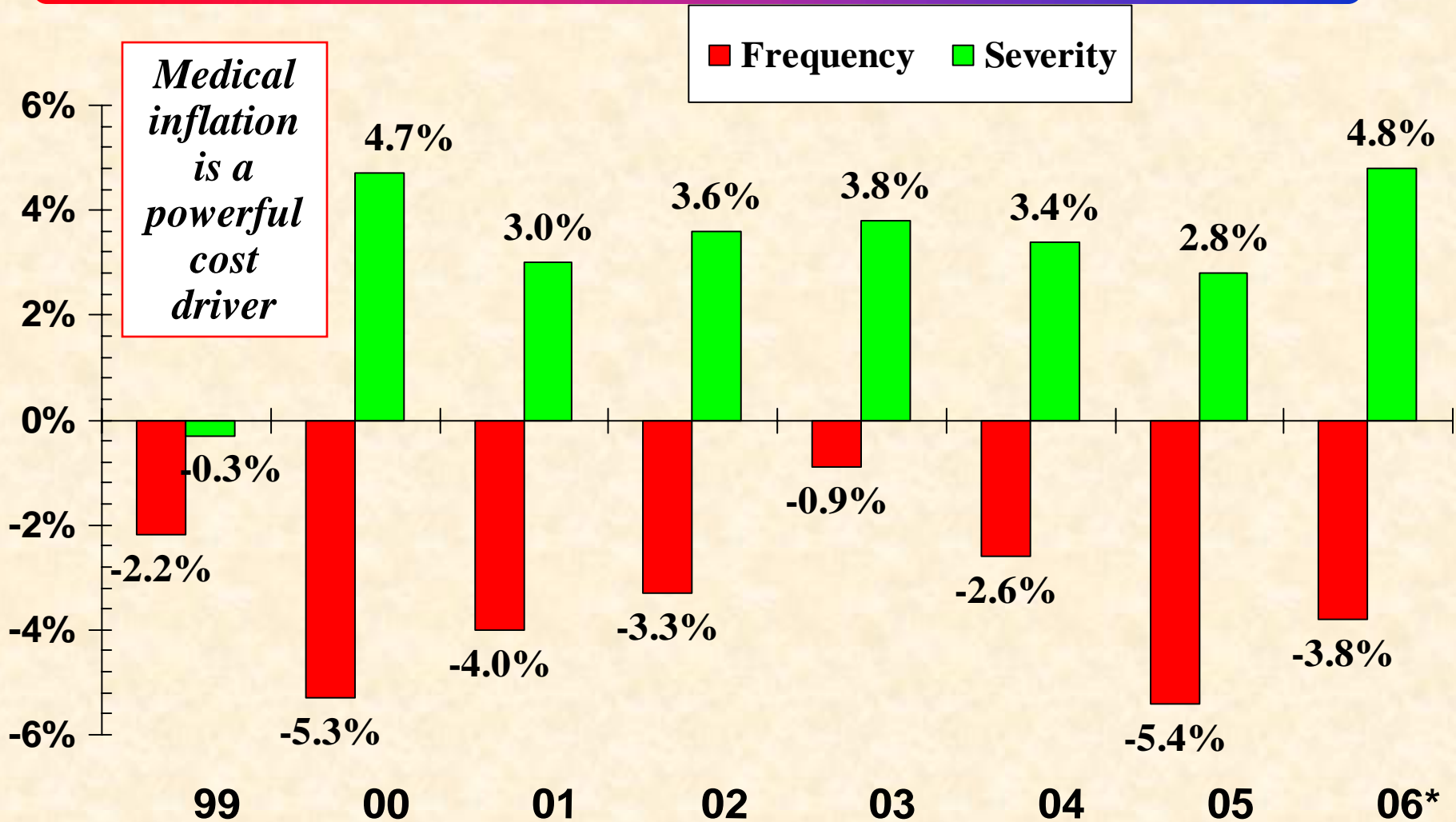
Pure Premium Spread: Personal Auto PD Liability, 2000-2006:Q4

▲ Auto Insurance Component of CPI ● Personal Auto-PD Pure Premium





Bodily Injury: Severity Trend Running Ahead of Frequency



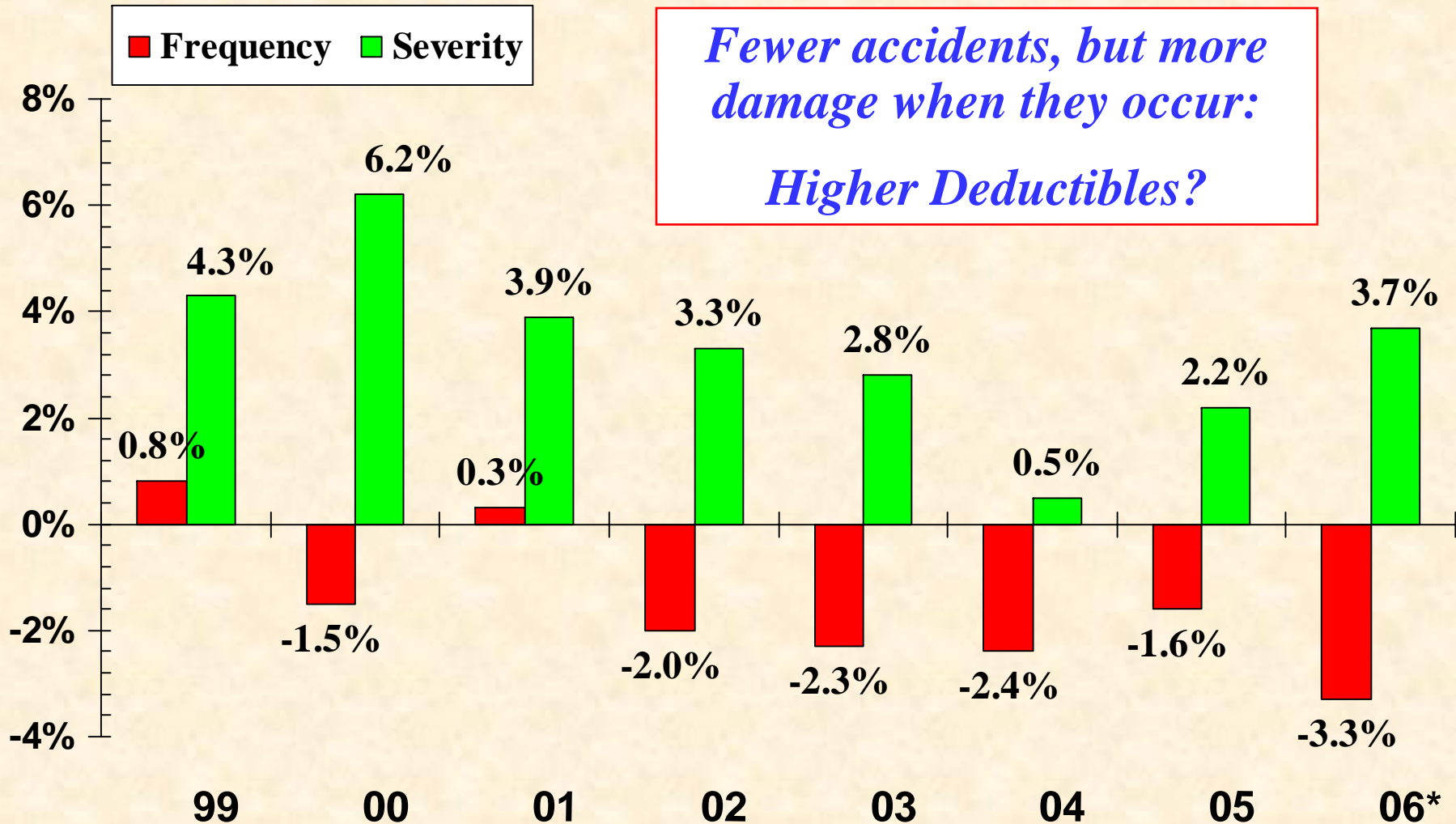
*Average of 4 quarters ending with 4th quarter 2006.

Source: ISO Fast Track data.



PD Liability: Frequency Trend

Roughly Offsets Severity



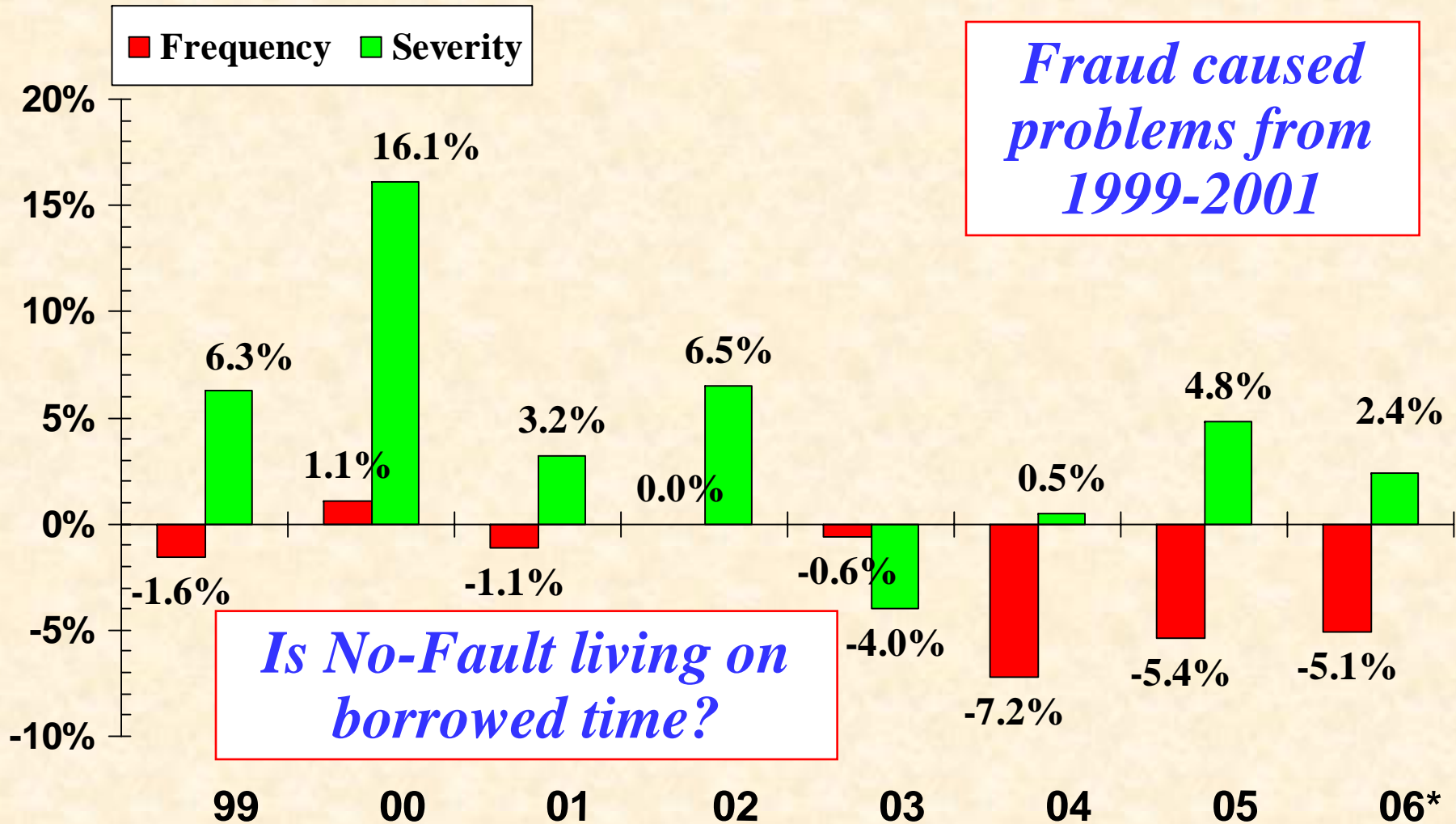
*Fewer accidents, but more damage when they occur:
Higher Deductibles?*

*Average of 4 quarters ending with 4th quarter 2006.

Source: ISO Fast Track data.



PIP: Frequency Trend Now Offsets Rising Claim Severity



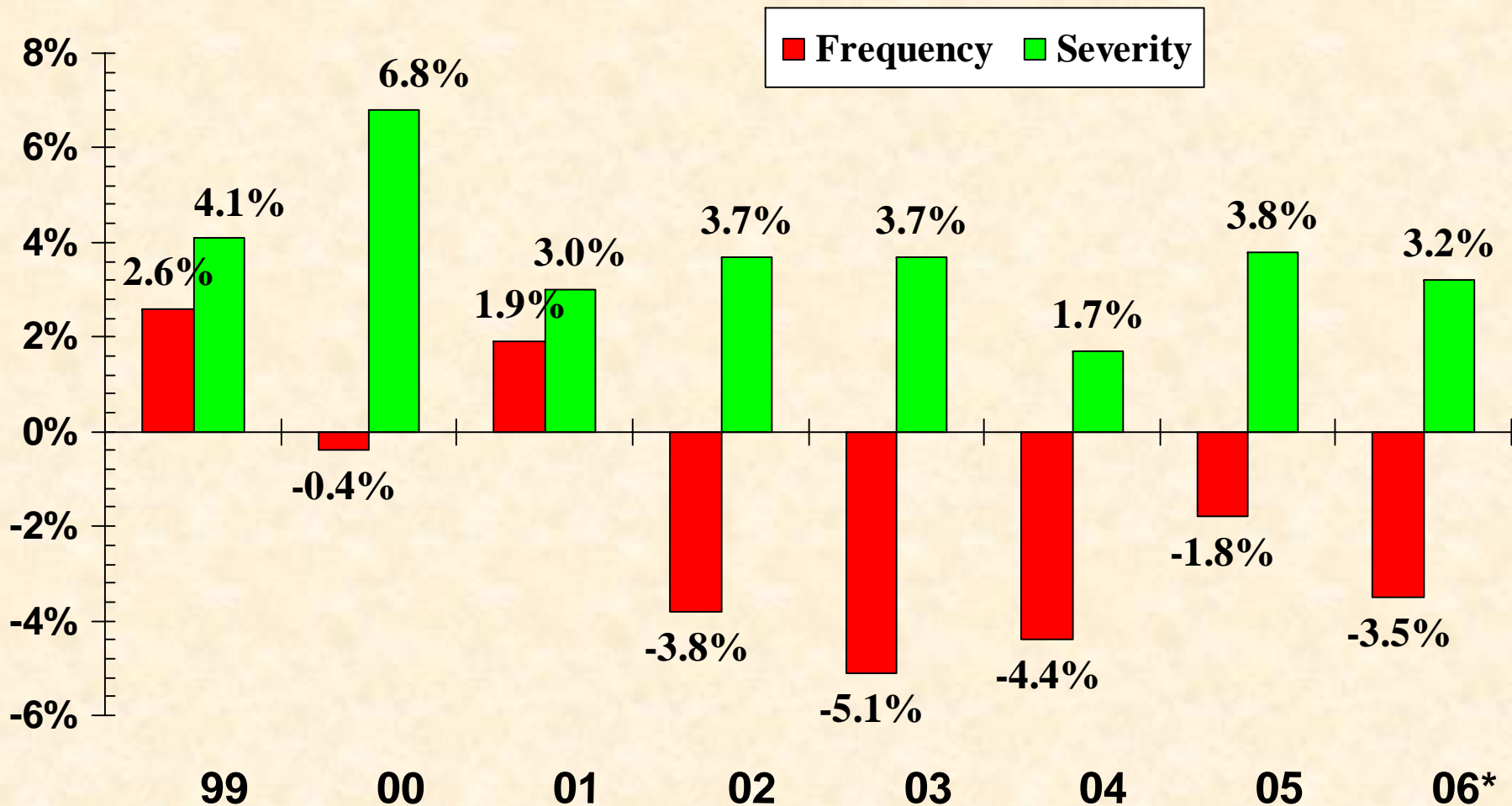
*Average of 4 quarters ending with 4th quarter 2006.

Source: ISO Fast Track data.



Collision: Frequency Trend

Offsetting Rising Claim Severity

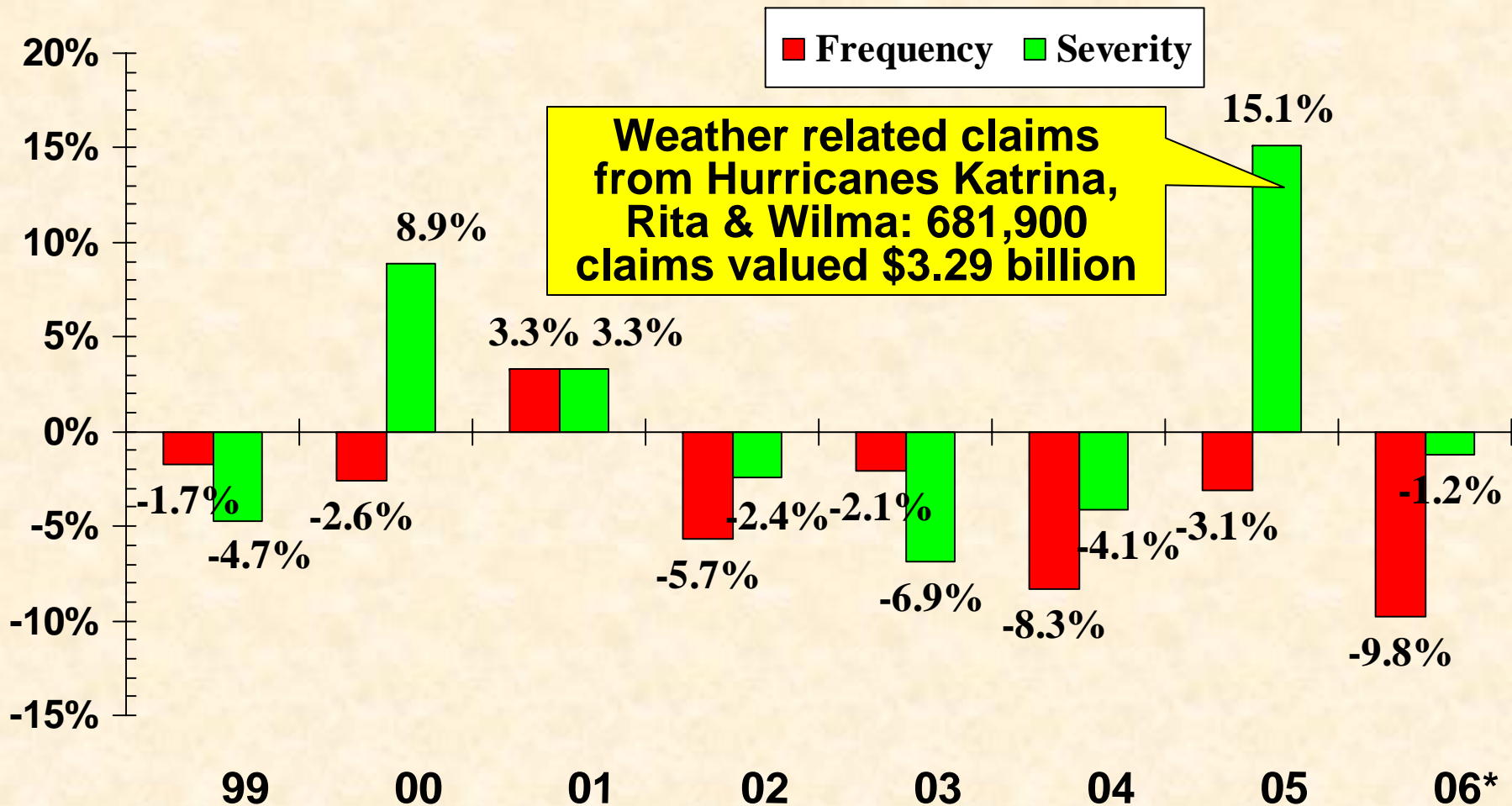


*Average of 4 quarters ending with 4th quarter 2006.

Source: ISO Fast Track data.



Comprehensive: Favorable Frequency and Severity Trends



*Average of 4 quarters ending with 3rd quarter 2006.

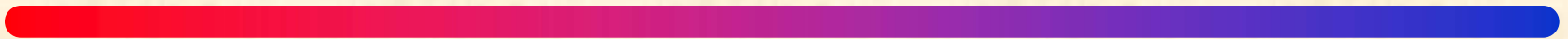
Source: ISO Fast Track data.



Private Passenger Auto: Future Shock

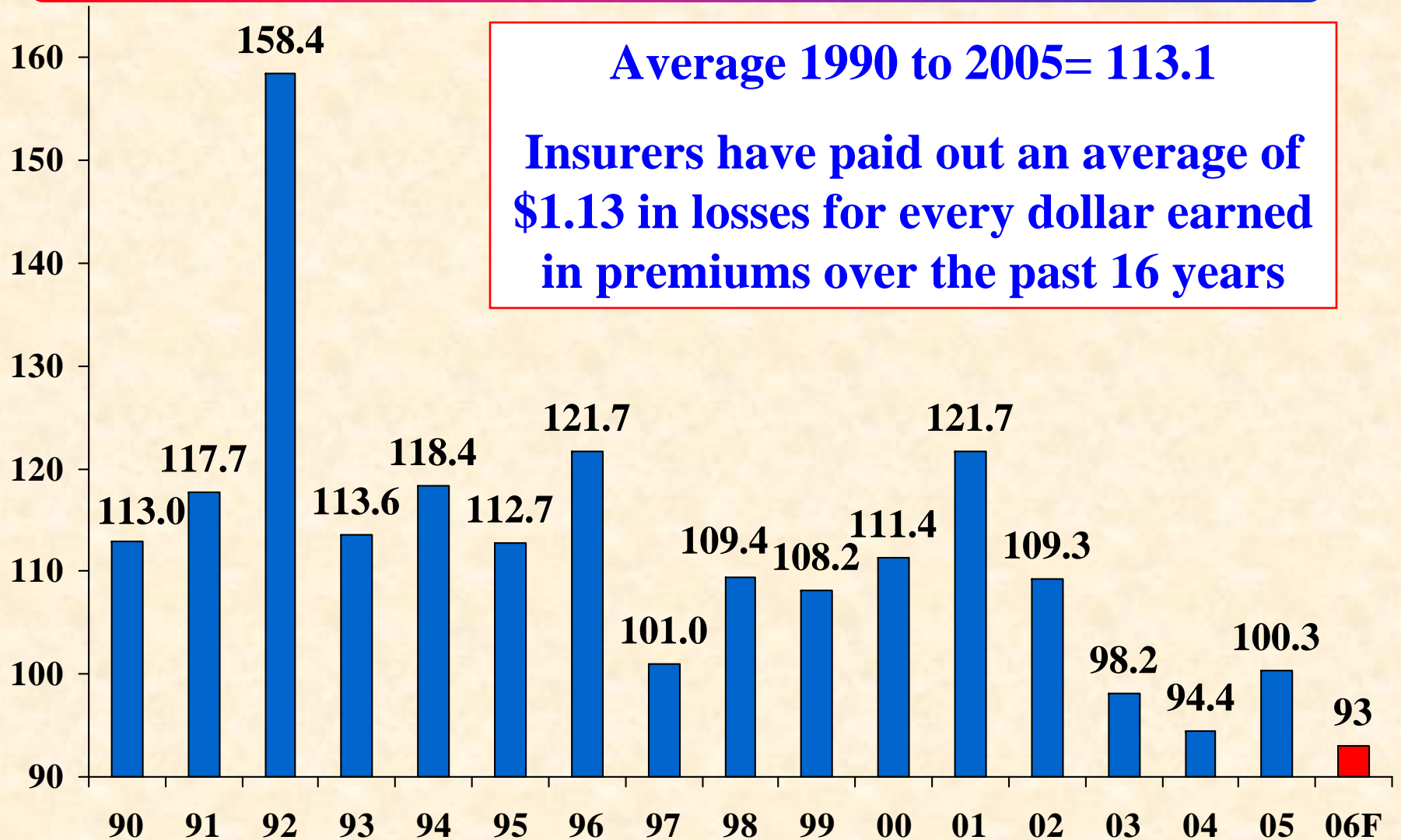
- **Underwriting acumen is ultimate determinant of success**
- **Innovations in technology, computing power, data retrieval/storage and new data/criteria will increase the number and quality of rating factors and lead to increasingly sophisticated underwriting models and a ever expanding number of price points; Integrate with new auto safety features**
- **Buzz Words: “Predictive Modeling” & “Segmentation”**
- **Impact is to create a rating system that is more accurate and therefore more fair, equitable to all**
- **Risk is more accurately and reliably mapped to a price across a broader range of circumstances**
- **Life-cycle approach to underwriting**
 - **Can underwriting customer under almost any circumstance**
 - **Recognizes fact that customer acquisition costs are high and new accounts perform less well than seasoned accounts**
- **Agents will need to be intimately familiar with new approaches in order to communicate impact to customer**

Homeowners Insurance



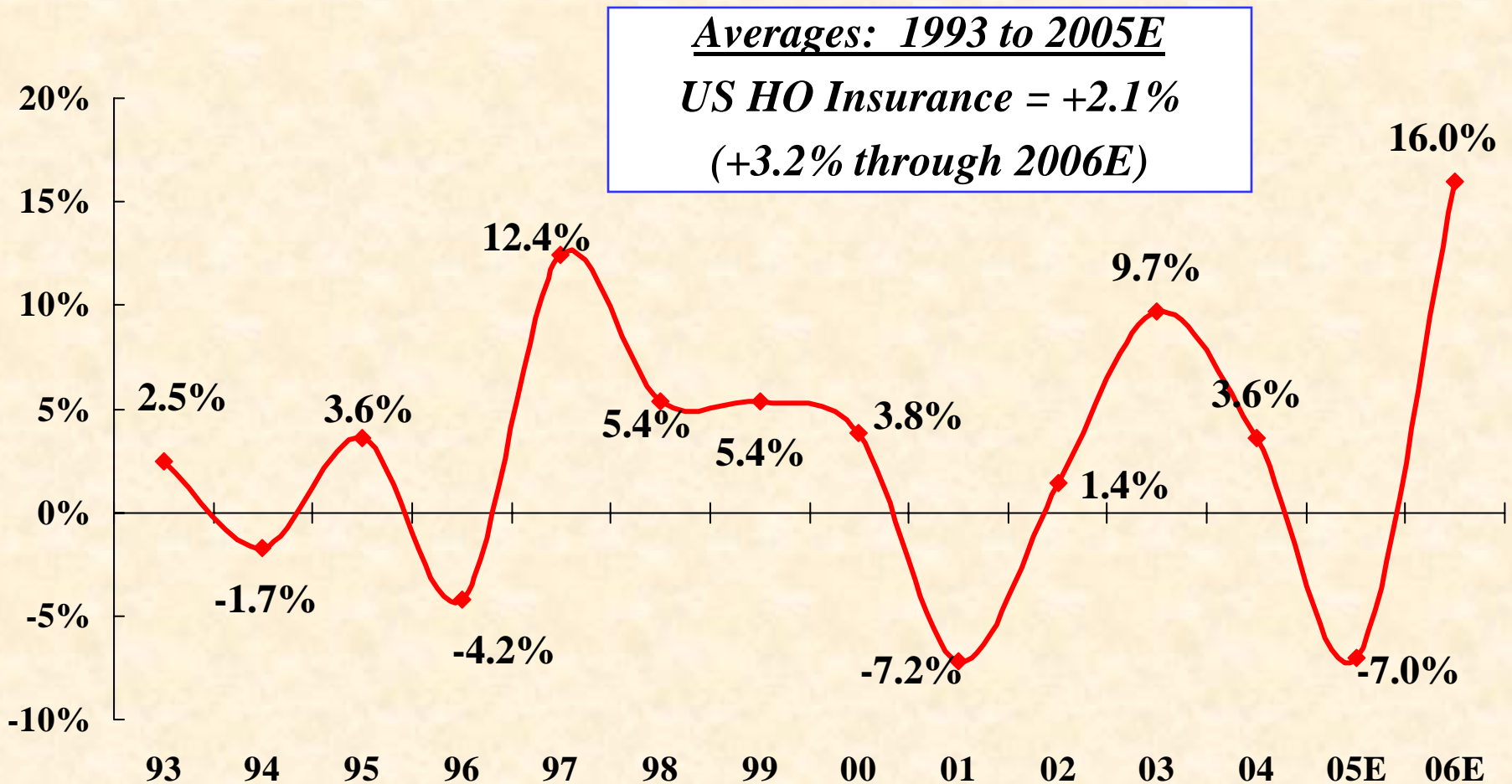


Homeowners Insurance Combined Ratio

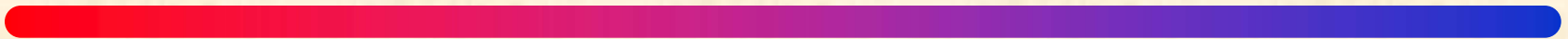




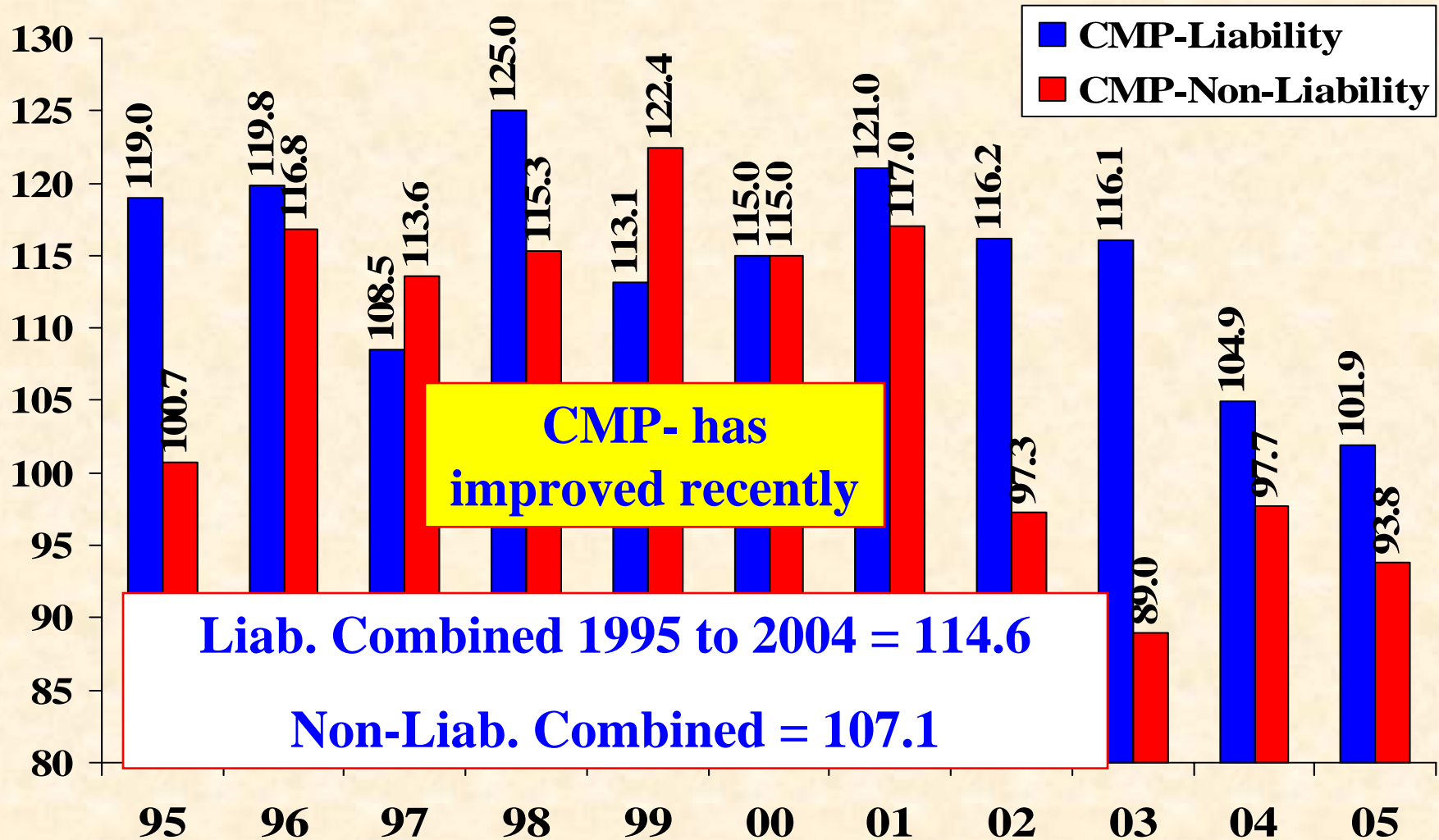
Rates of Return on Net Worth for Homeowners Ins: US



COMMERCIAL MULTI-PERIL & COMMERCIAL AUTO



Commercial Multi-Peril Combined (Liability vs. Non-Liability Portion)



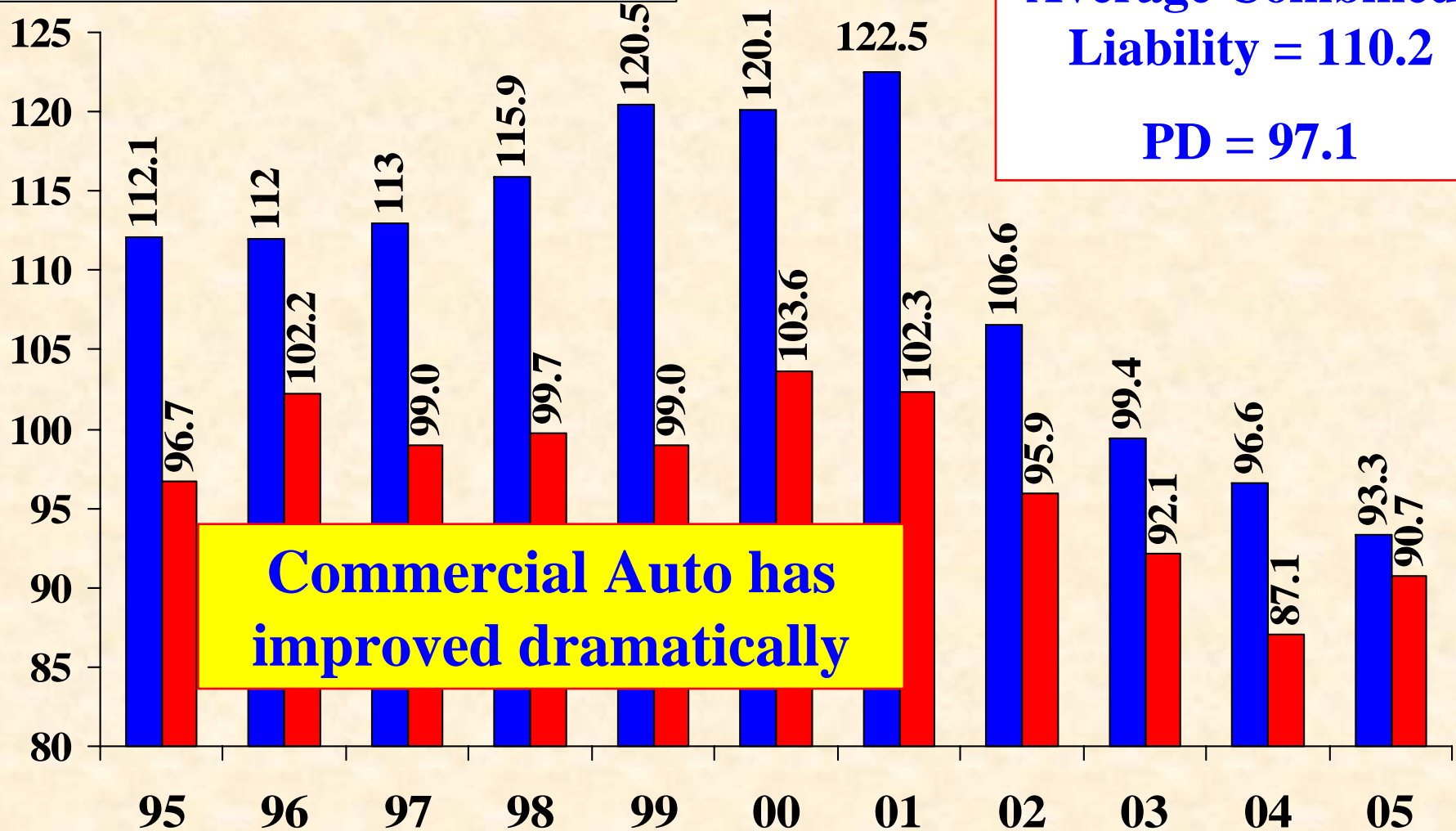


Commercial Auto Liability & PD Combined Ratios

■ Comm Auto Liab ■ Comm Auto PD

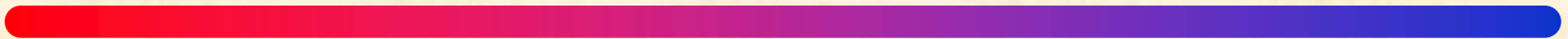
**Average Combined:
Liability = 110.2**

PD = 97.1



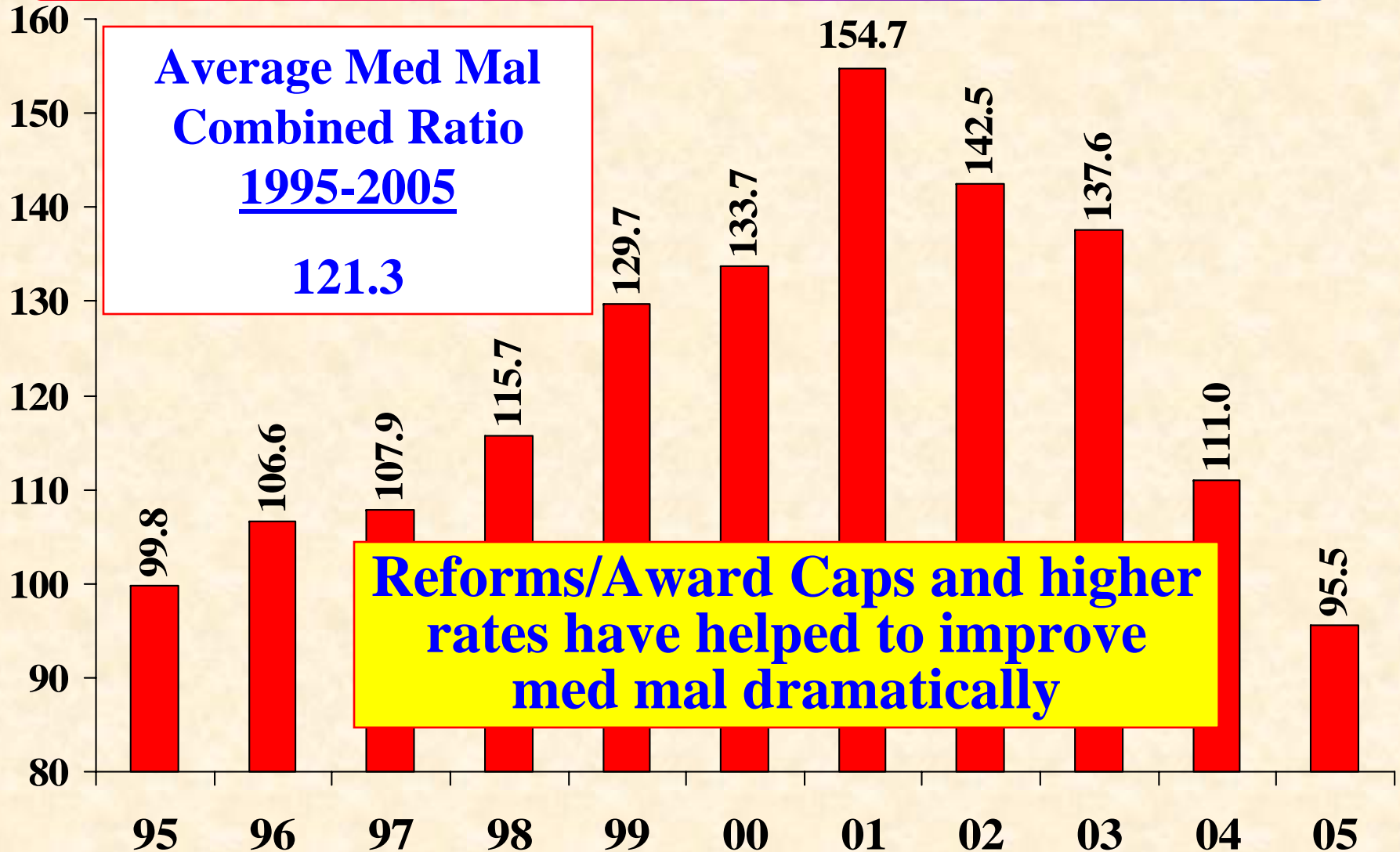
**Commercial Auto has
improved dramatically**

MEDICAL MALPRACTICE





Medical Malpractice Combined Ratios



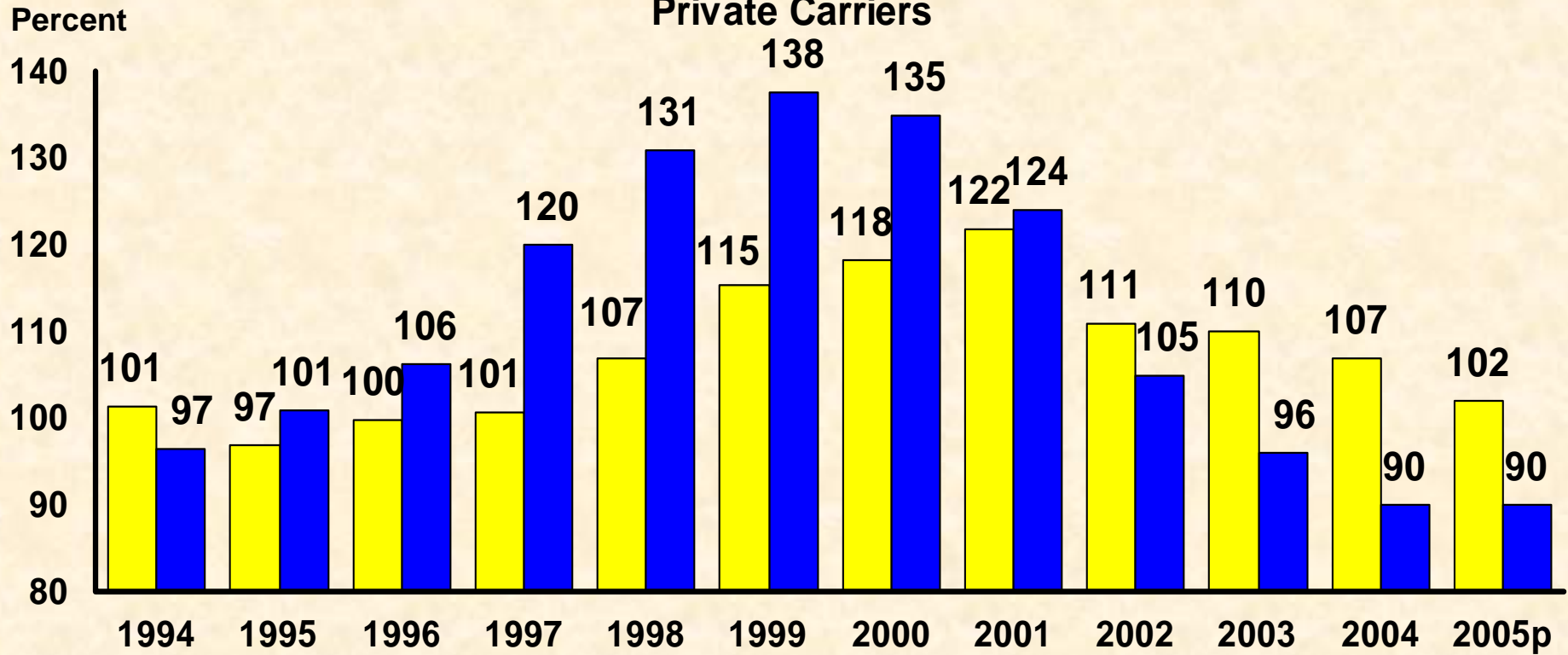
WORKERS COMPENSATION OPERATING ENVIRONMENT





Workers Comp Combined Ratios, 1994-2005P

Workers Comp Calendar Year vs. Ultimate Accident Year – Private Carriers



■ Calendar Year ■ Accident Year

p Preliminary AY figure.

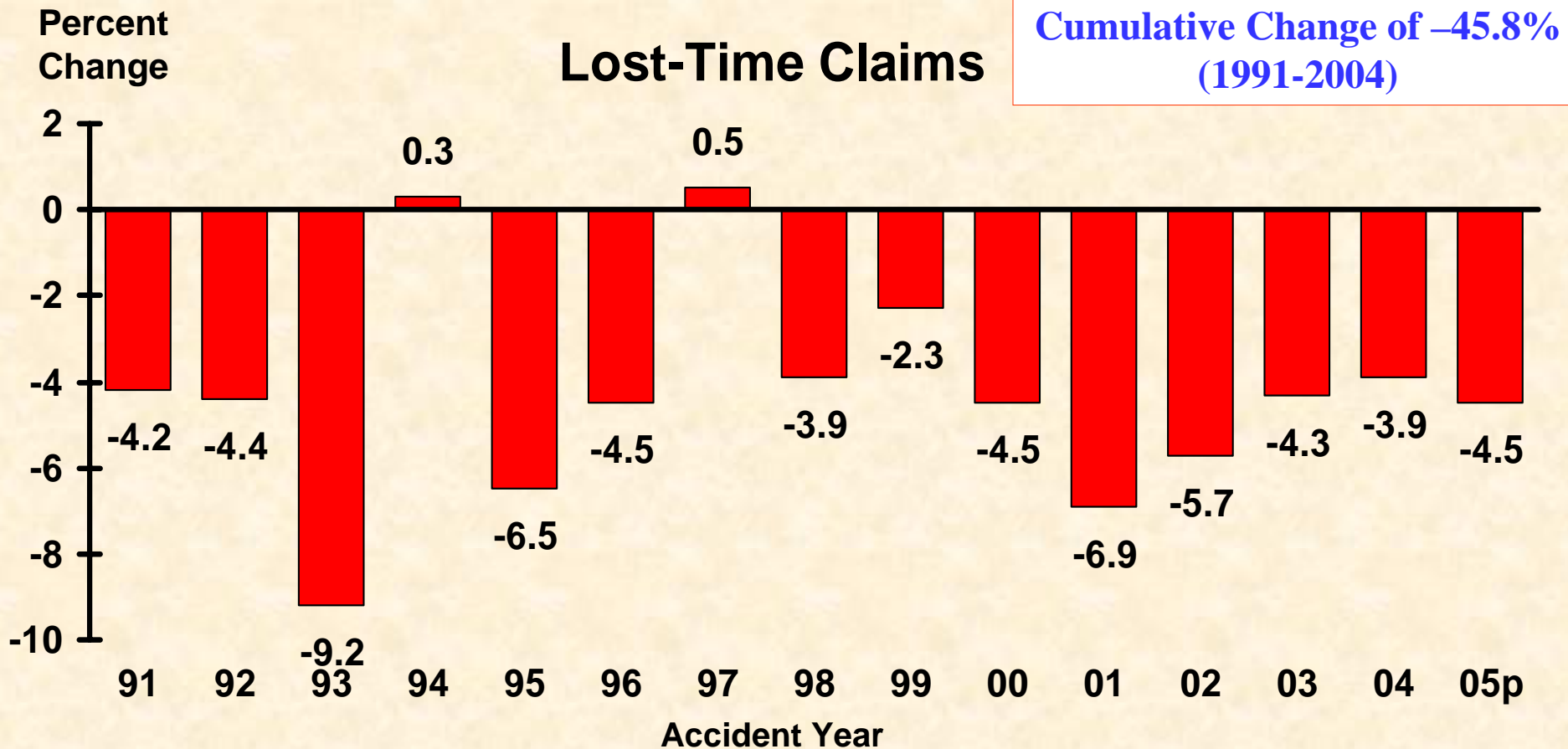
Accident Year data is evaluated as of 12/31/2005 and developed to ultimate

Source: Calendar Years 1994-2004, A.M. Best Aggregates & Averages; Calendar Year 2005p and Accident Years 1994-2005p based on NCCI Annual Statement Analysis.

Includes dividends to policyholders



Workers Comp Lost-Time Claim Frequency (% Change)



2003p: Preliminary based on data valued as of 12/31/2005
1991-2003: Based on data through 12/31/2004, developed to ultimate
Based on the states where NCCI provides ratemaking services
Excludes the effects of deductible policies
Source: NCCI

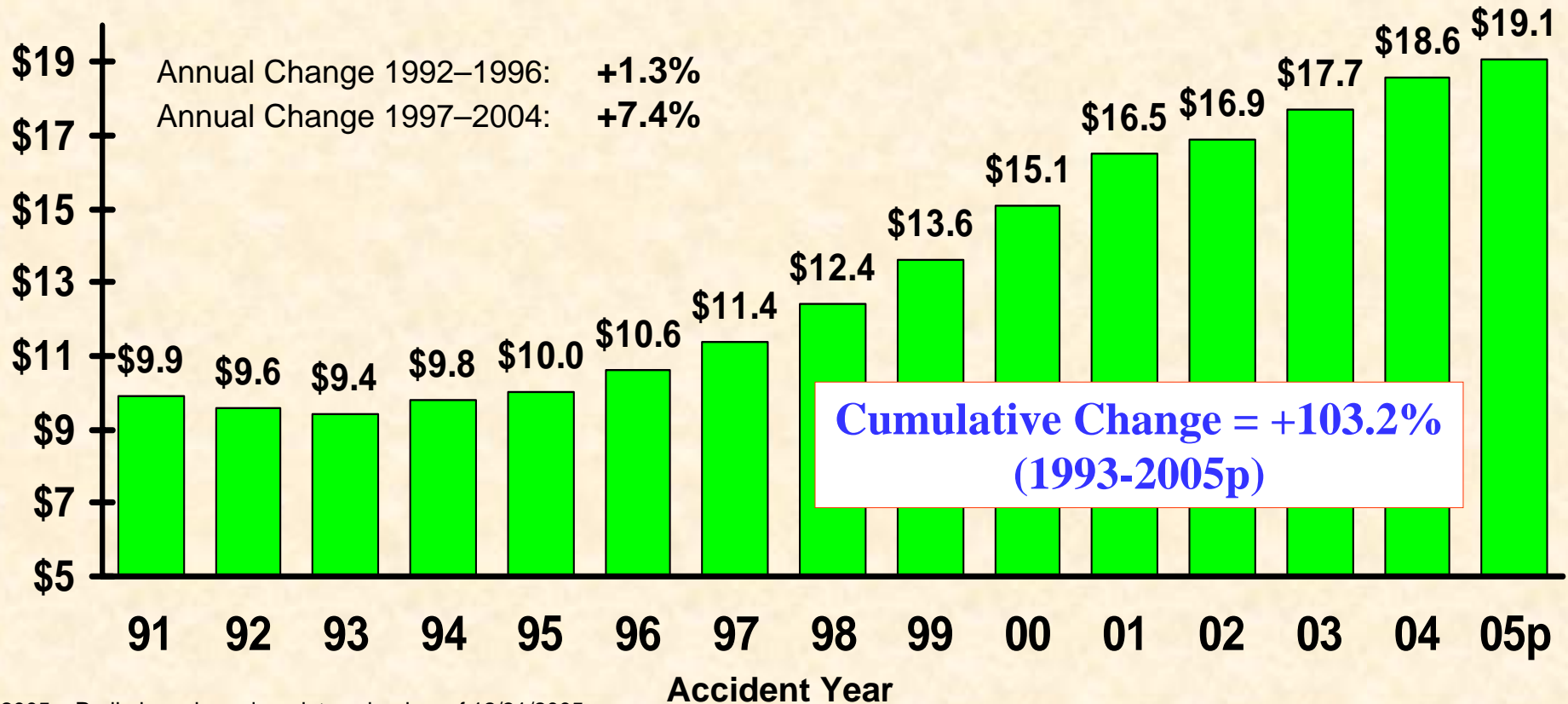


Workers Comp Indemnity Claims

Costs Have Accelerated, 1993-2005p

Indemnity
Claim Cost (000s)

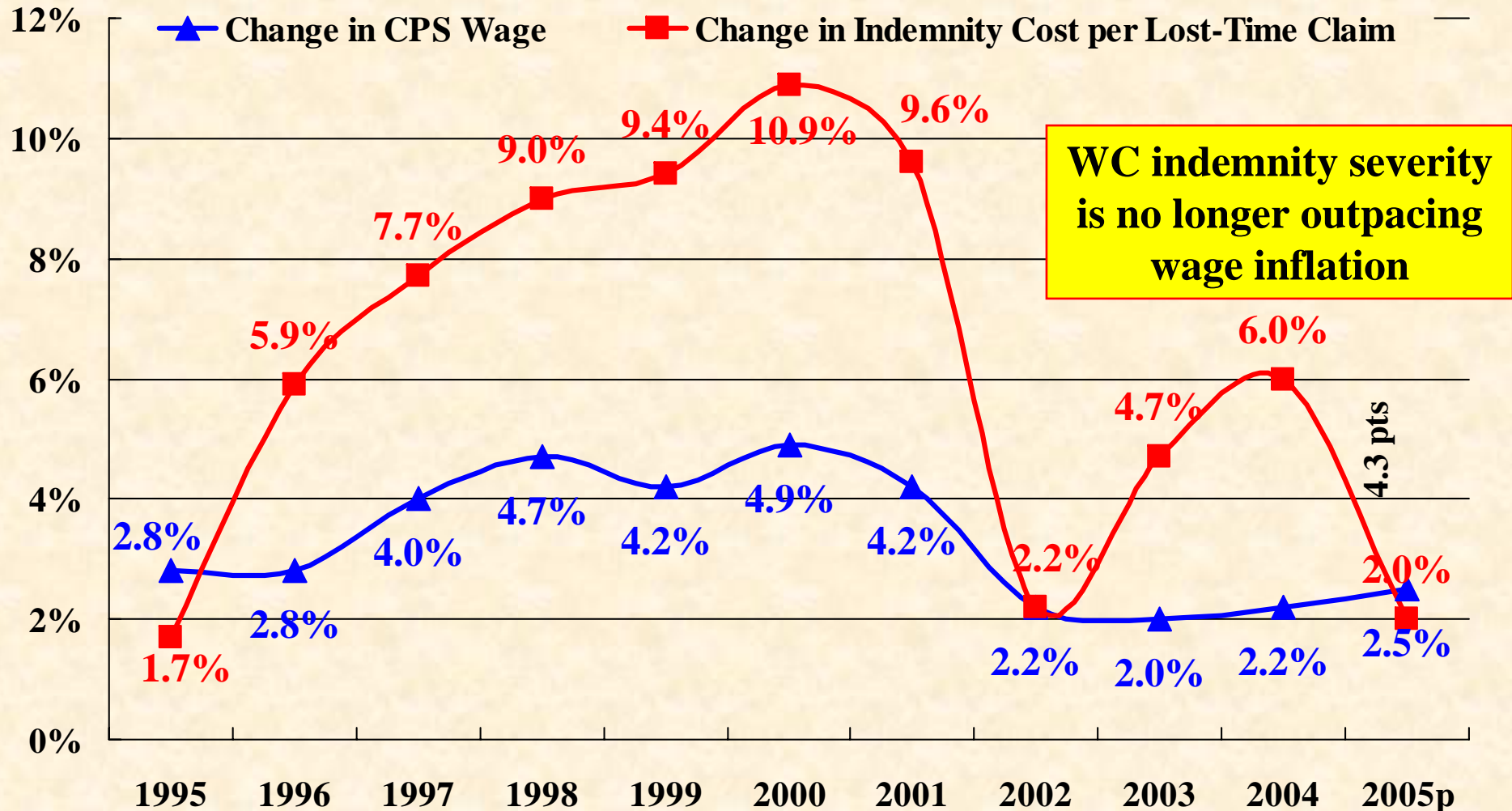
Lost-Time Claims



2005p: Preliminary based on data valued as of 12/31/2005
1991-2004: Based on data through 12/31/2004, developed to ultimate
Based on the states where NCCI provides ratemaking services
Excludes the effects of deductible policies
Source: NCCI



WC Indemnity Severity vs. Wage Inflation



2005p: Preliminary based on data valued as of 12/31/2005; 1991-2004: Based on data through 12/31/2004, developed to ultimate. Based on the states where NCCI provides ratemaking services. Excludes the effects of deductible policies. CPS = Current Population Survey.

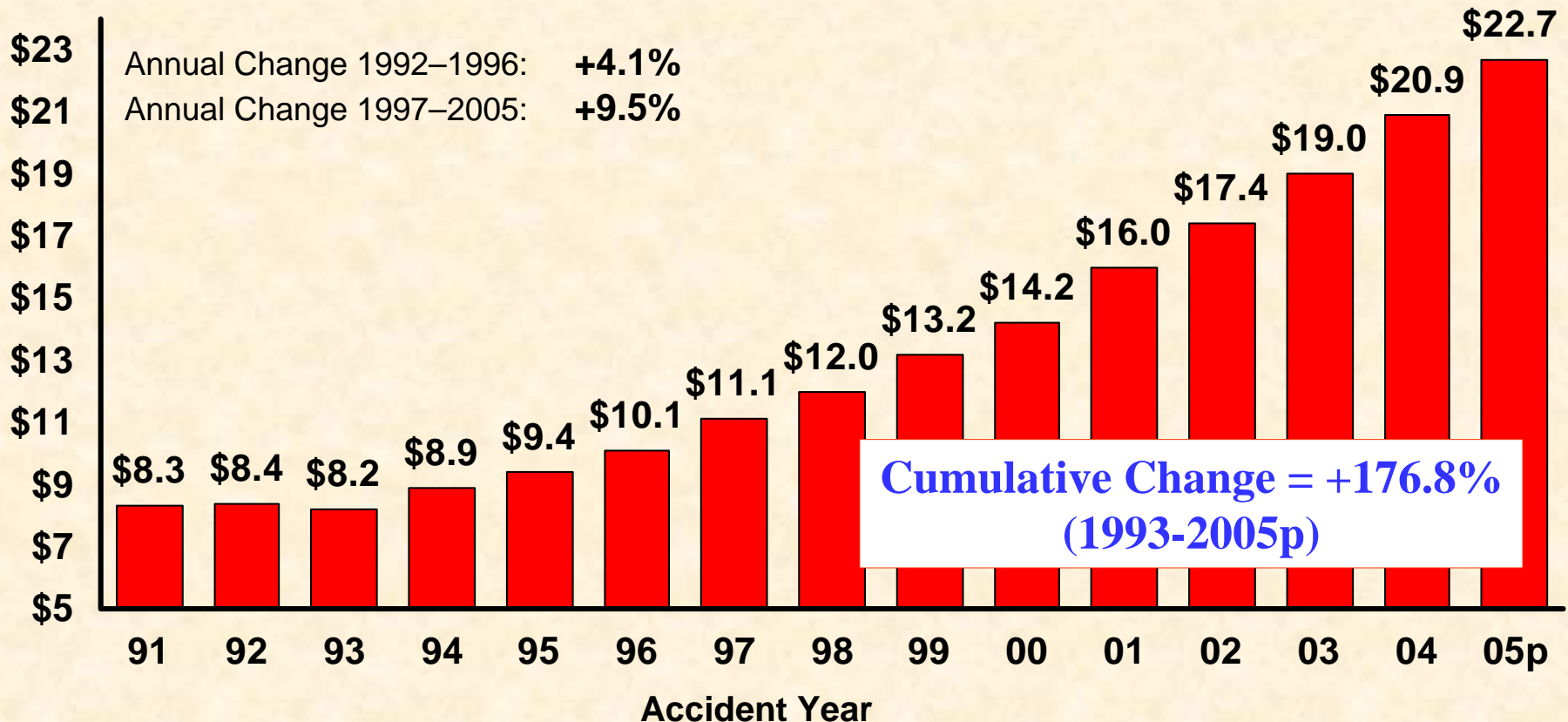
Source: NCCI



Workers Comp Medical Claims Continue to Climb

Medical

Claim Cost (\$000s)



2005p: Preliminary based on data valued as of 12/31/2005

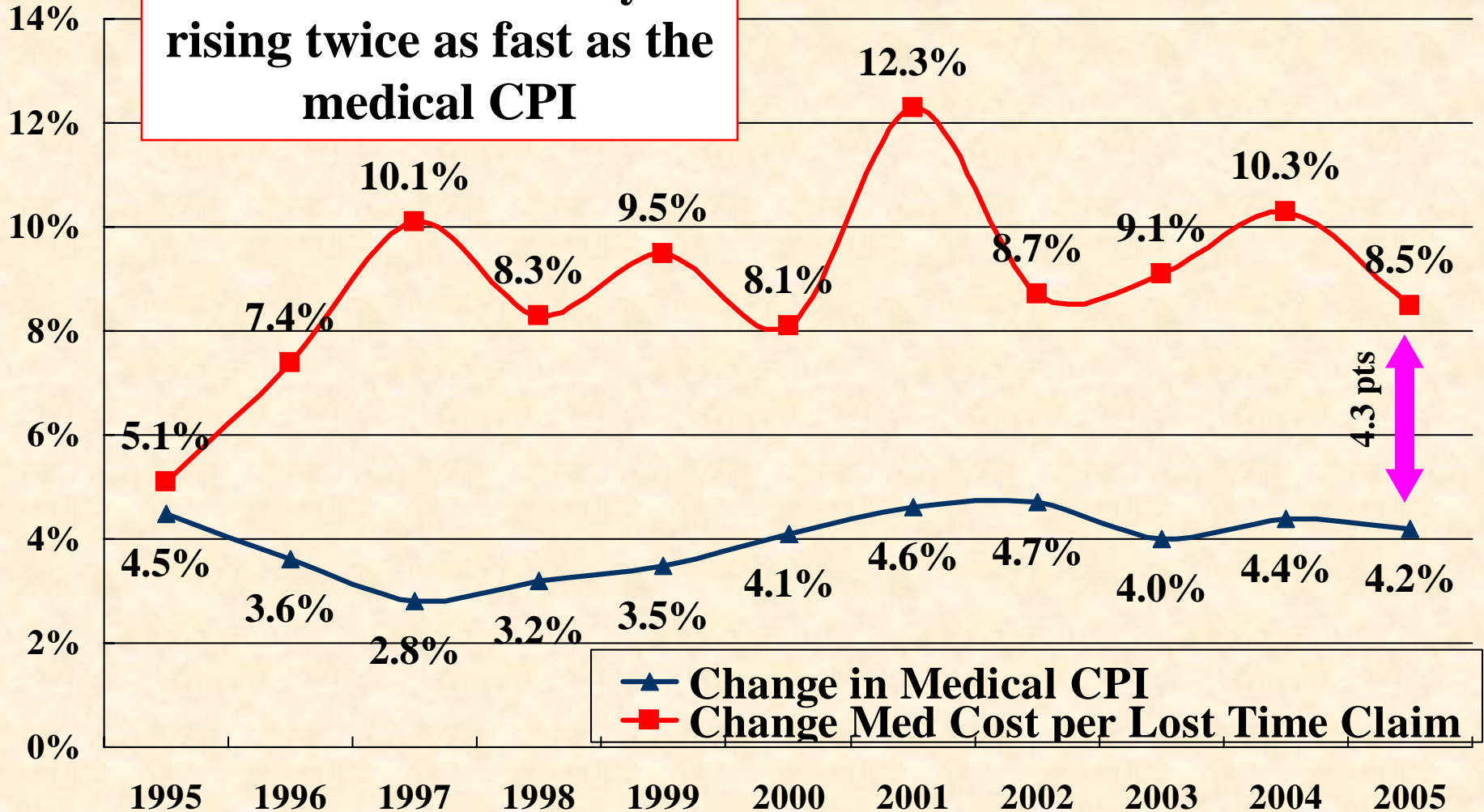
1991-2004: Based on data through 12/31/2004, developed to ultimate

Based on the states where NCCI provides ratemaking services; Excludes the effects of deductible policies



WC Medical Severity Rising Far Faster than Medical CPI

WC medical severity is rising twice as fast as the medical CPI



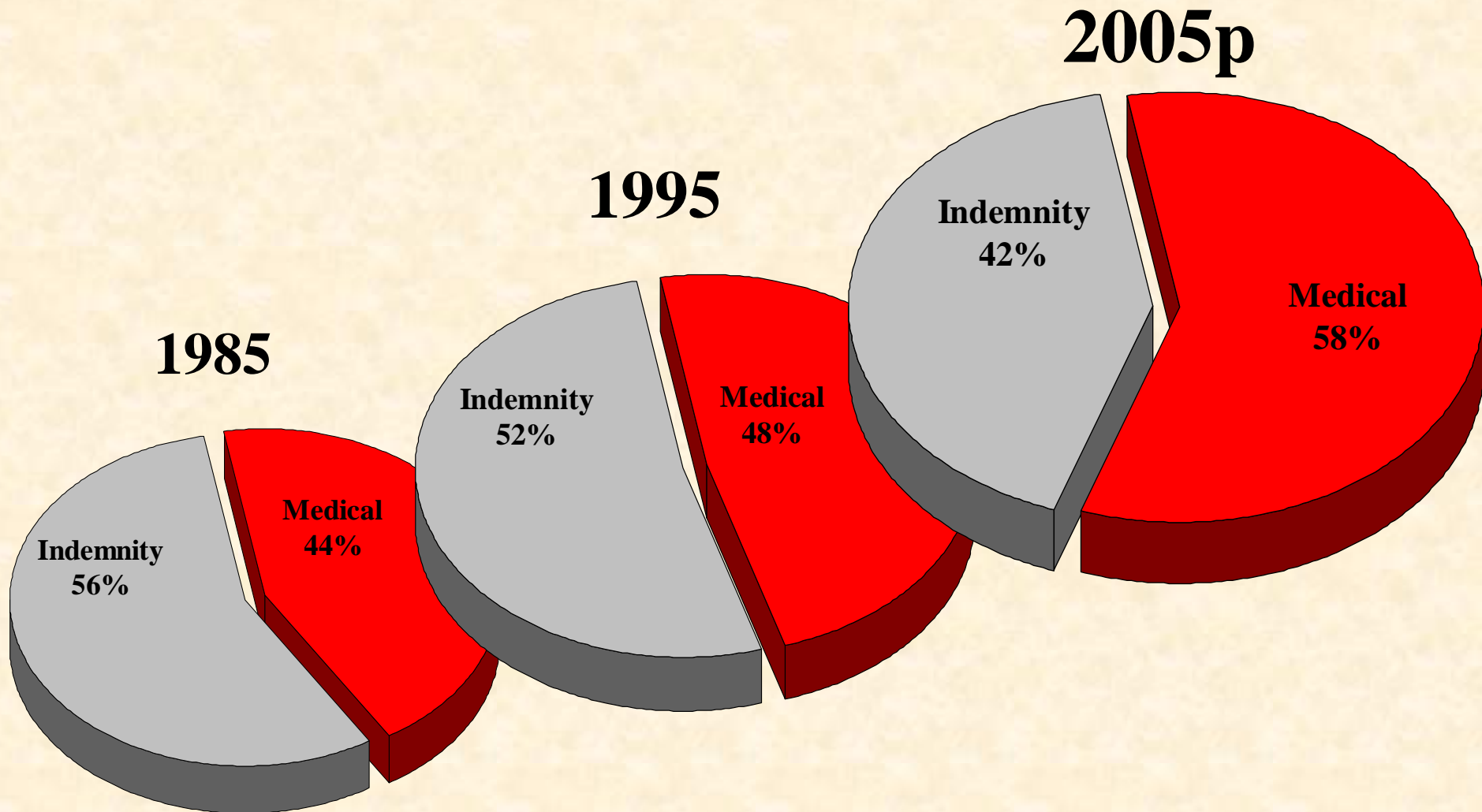
4.3 pts

▲ Change in Medical CPI
■ Change Med Cost per Lost Time Claim

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

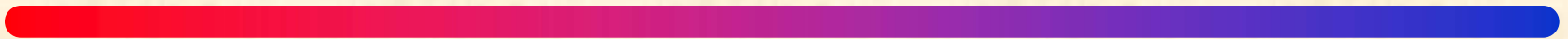


Med Costs Share of Total Costs is Increasing Steadily



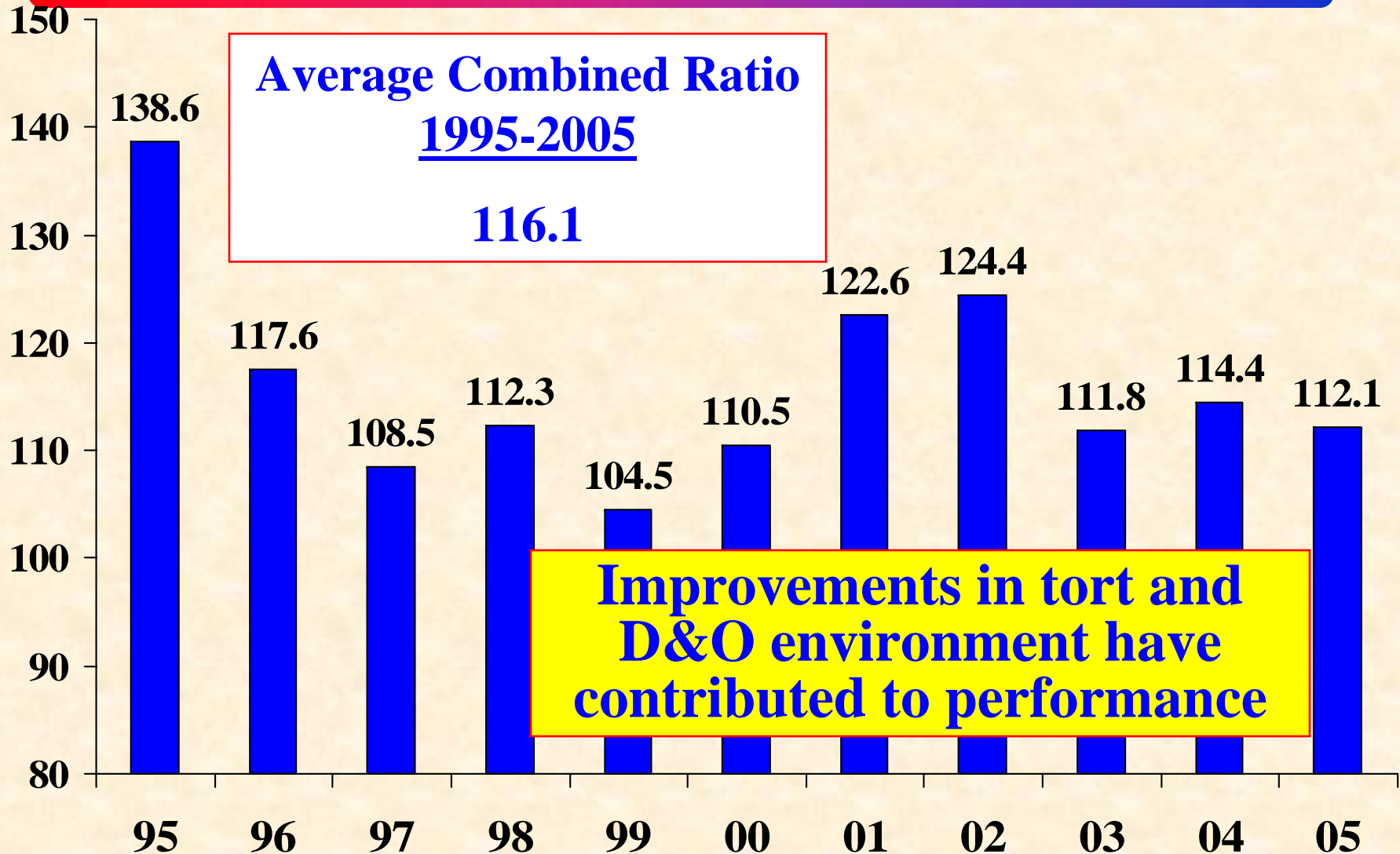
Source: NCCI (based on states where NCCI provides ratemaking services).

OTHER LIABILITY





*Other Liability Combined Ratios**



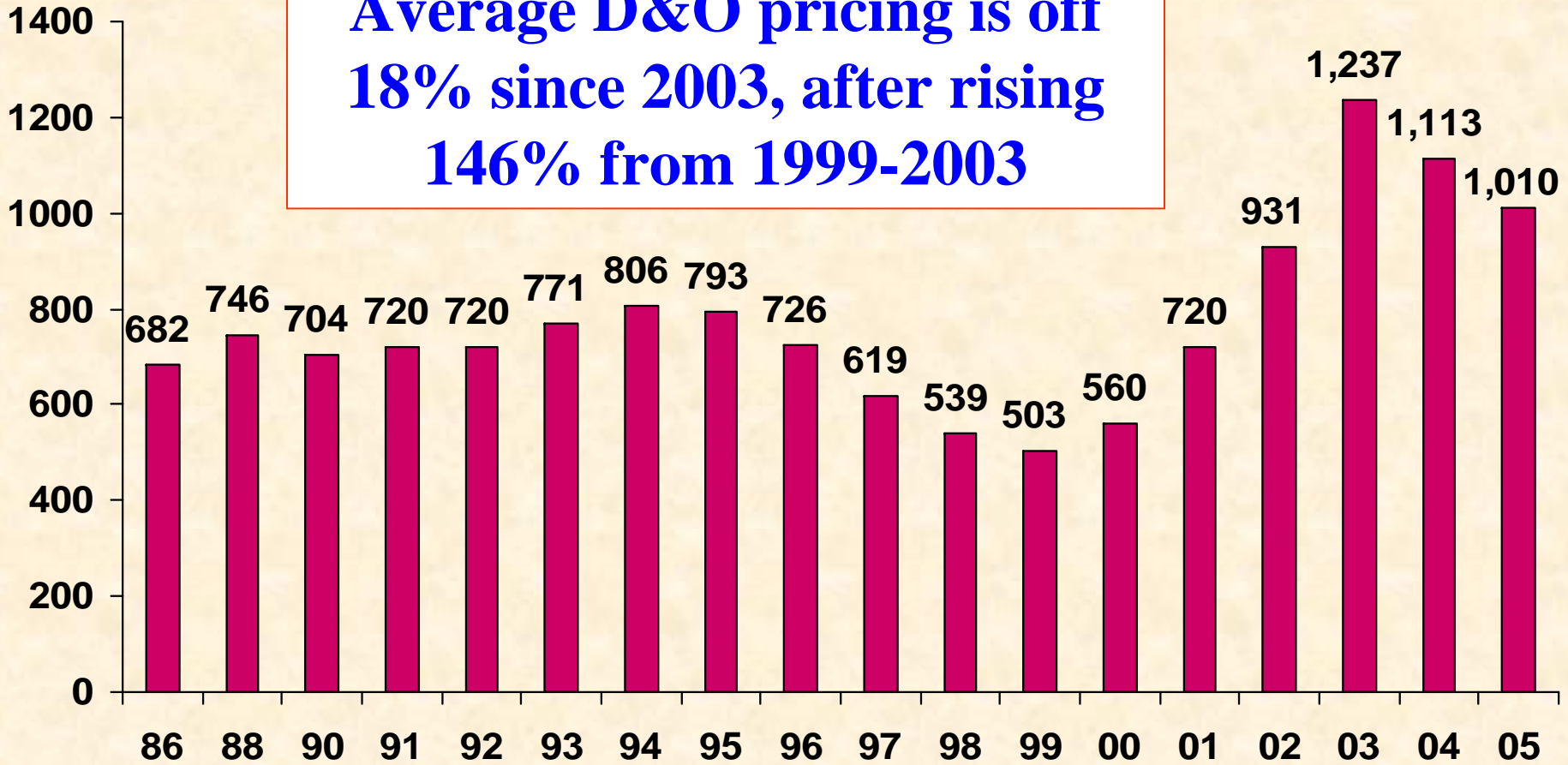
Sources: A.M. Best; III

*Includes Officers' & Directors' coverage.



D&O Premium Index

(1974 Average = 100)

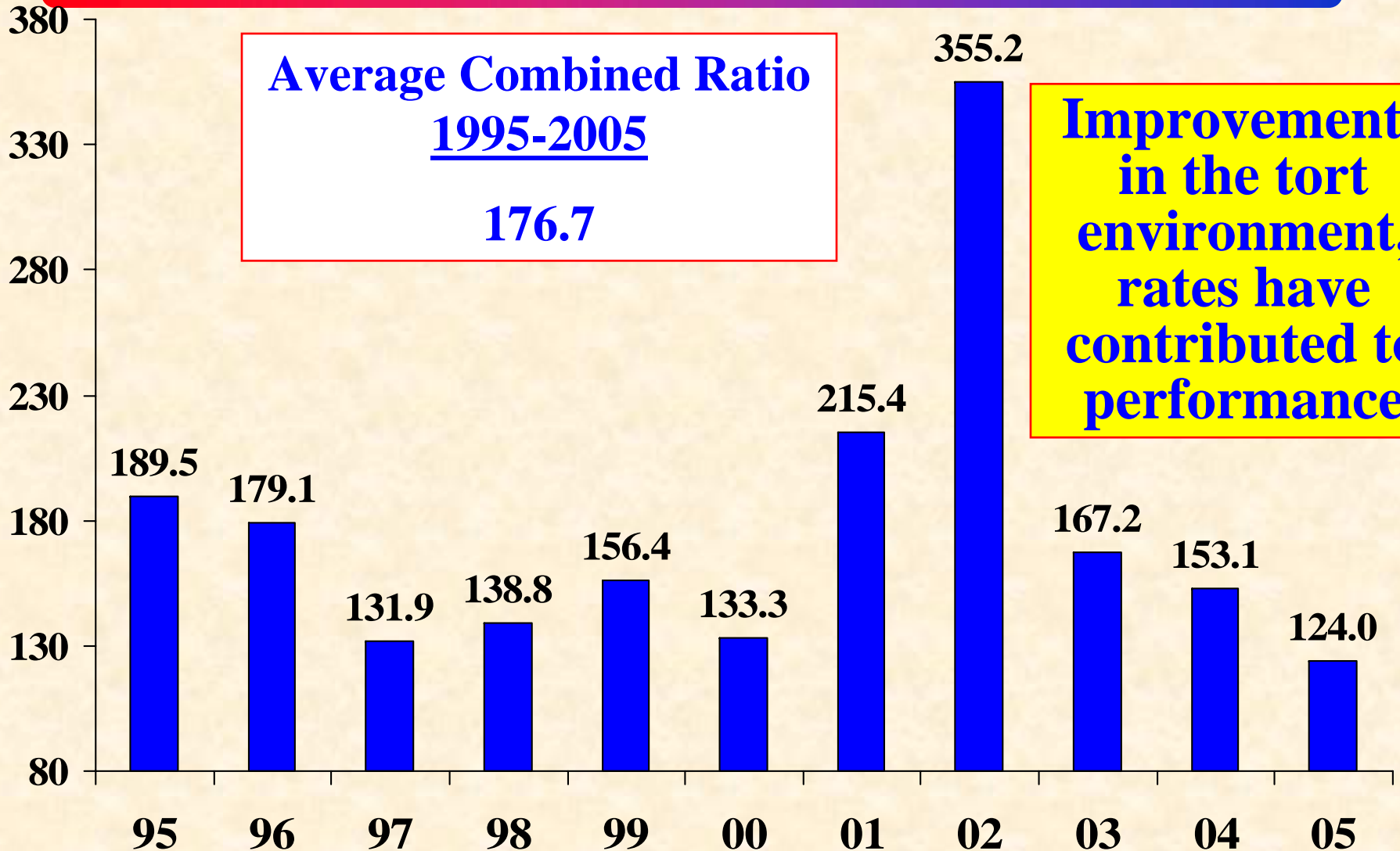


PRODUCTS LIABILITY



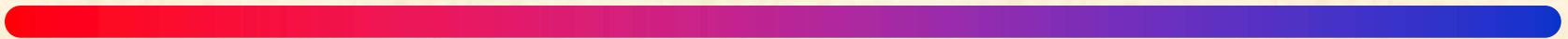


Products Liability Combined Ratios



Legal Liability & Tort Environment

*Definitely Improving But
Not Out of the Woods*

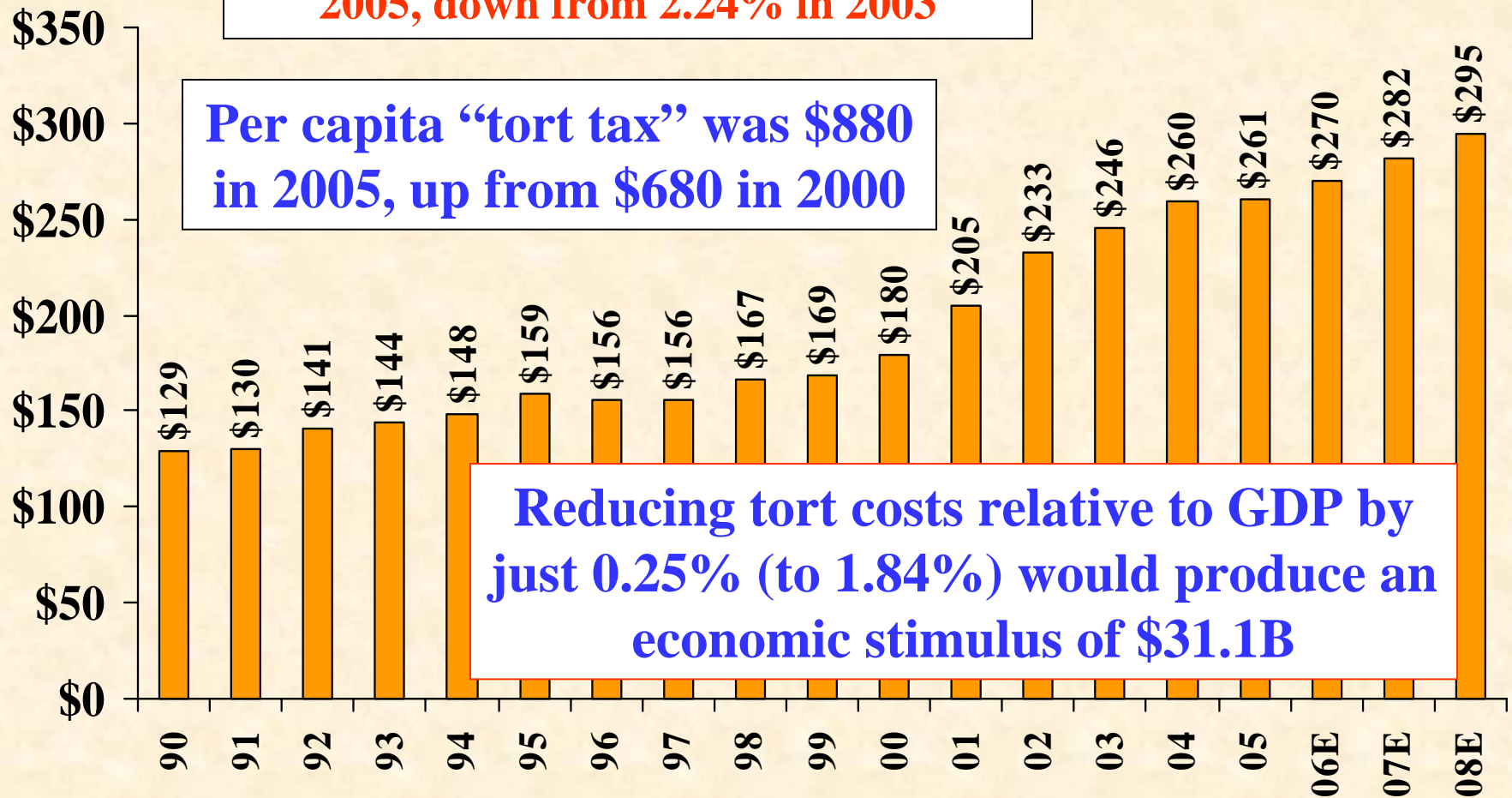




Cost of U.S. Tort System (\$ Billions)

Tort costs consumed 2.09% of GDP in 2005, down from 2.24% in 2003

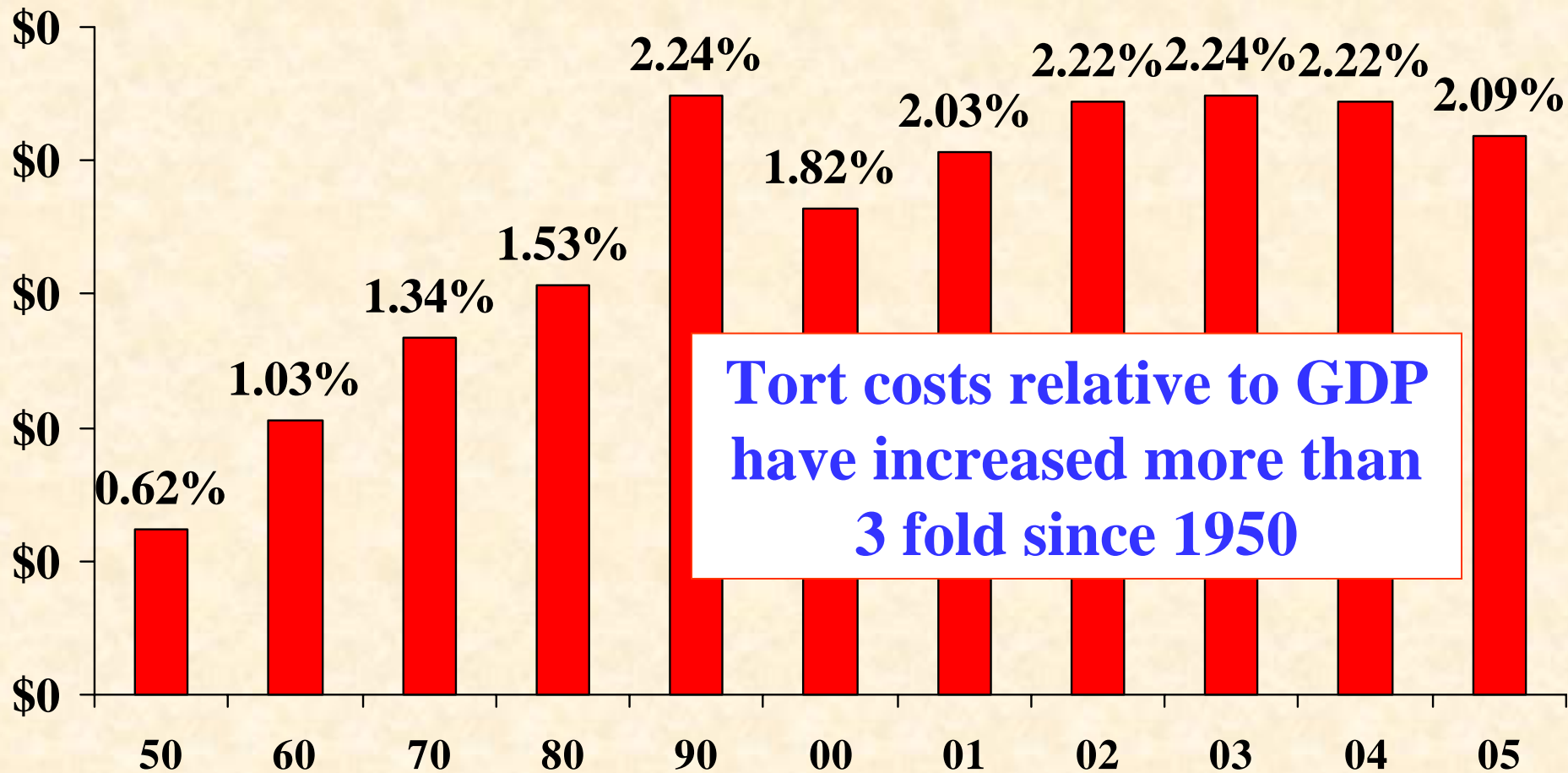
Per capita "tort tax" was \$880 in 2005, up from \$680 in 2000



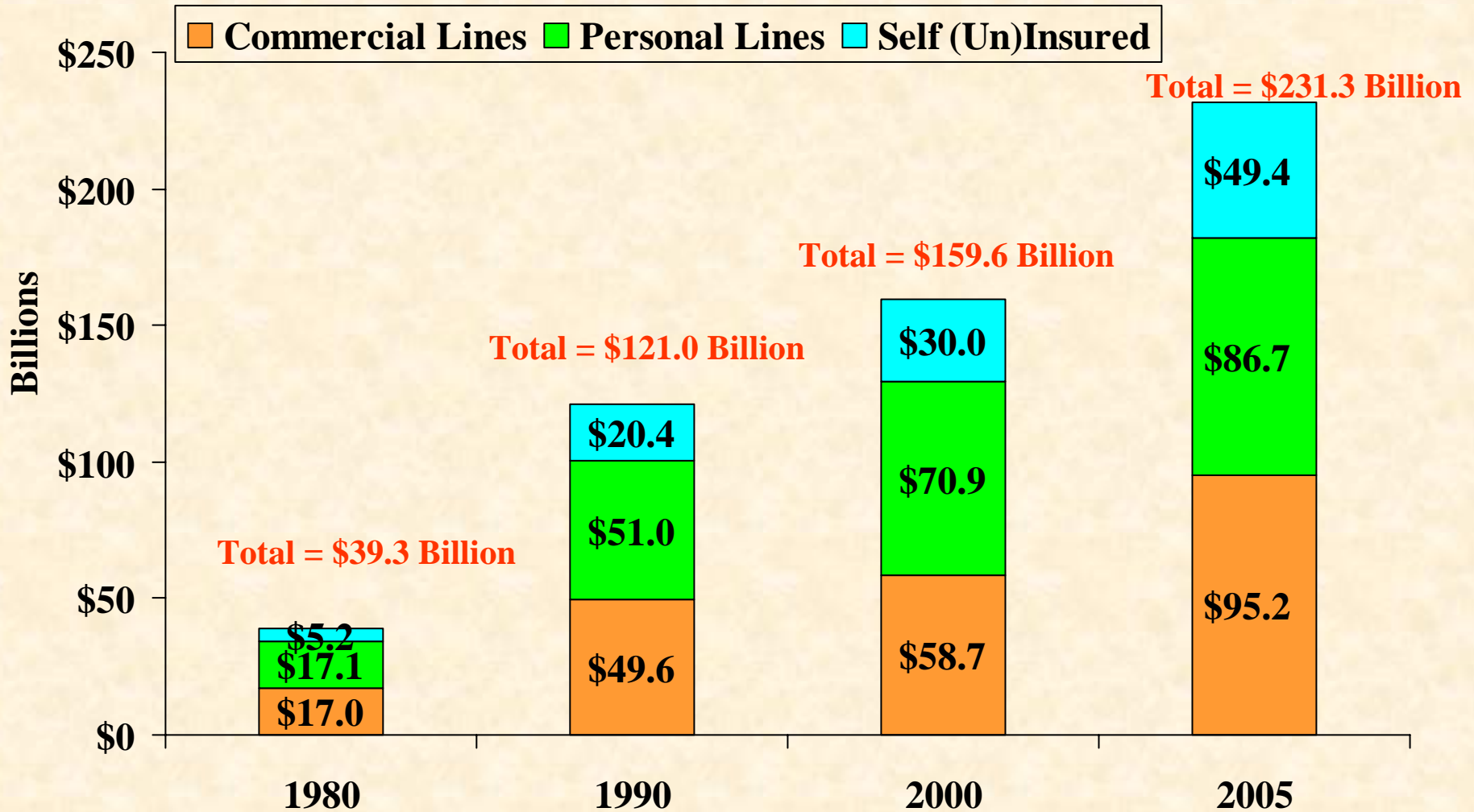
Reducing tort costs relative to GDP by just 0.25% (to 1.84%) would produce an economic stimulus of \$31.1B



Tort Costs Relative to GDP, 1950-2005



*Personal, Commercial & Self (Un) Insured Tort Costs**

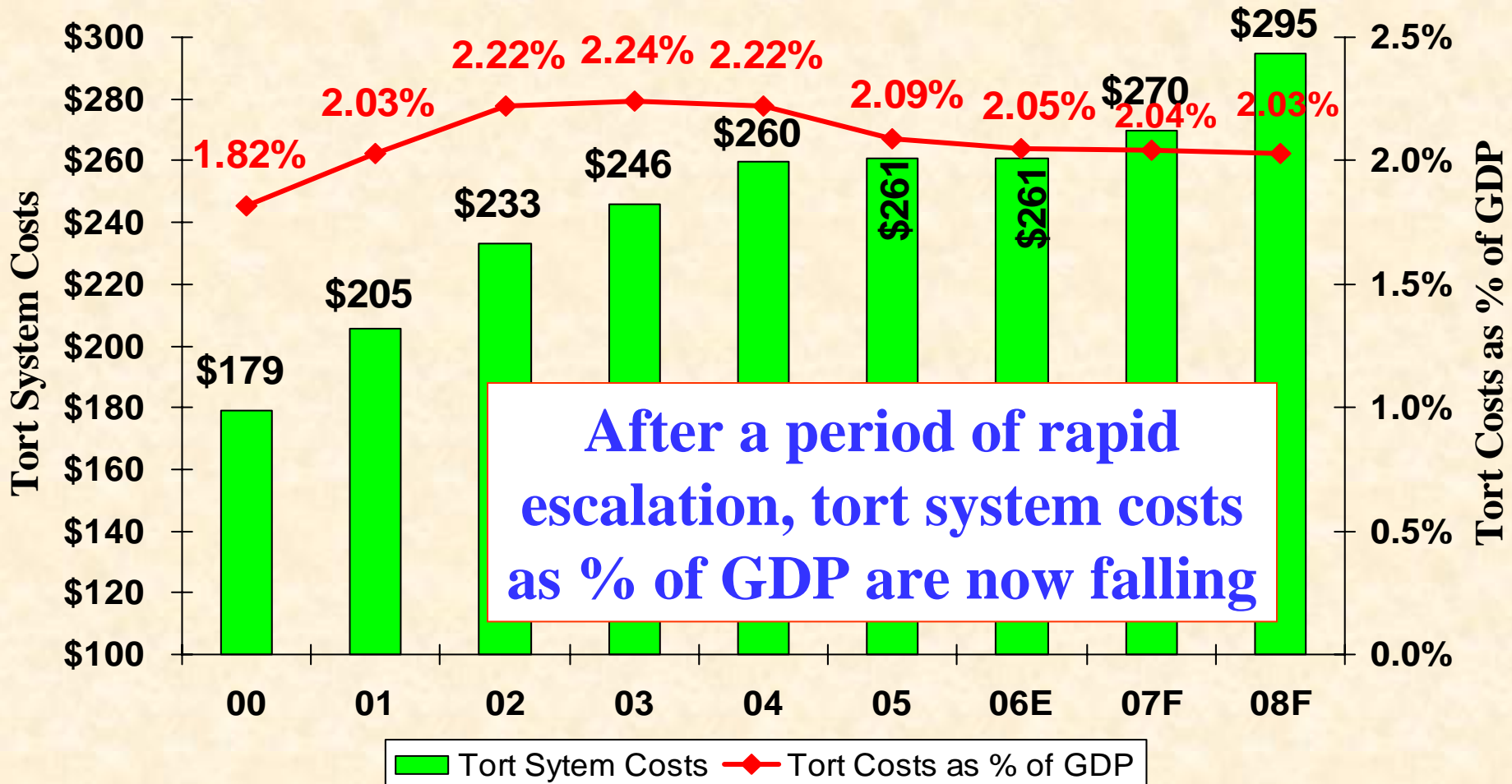


*Excludes medical malpractice

Source: Tillinghast-Towers Perrin, 2006 Update on US Tort Cost Trends.



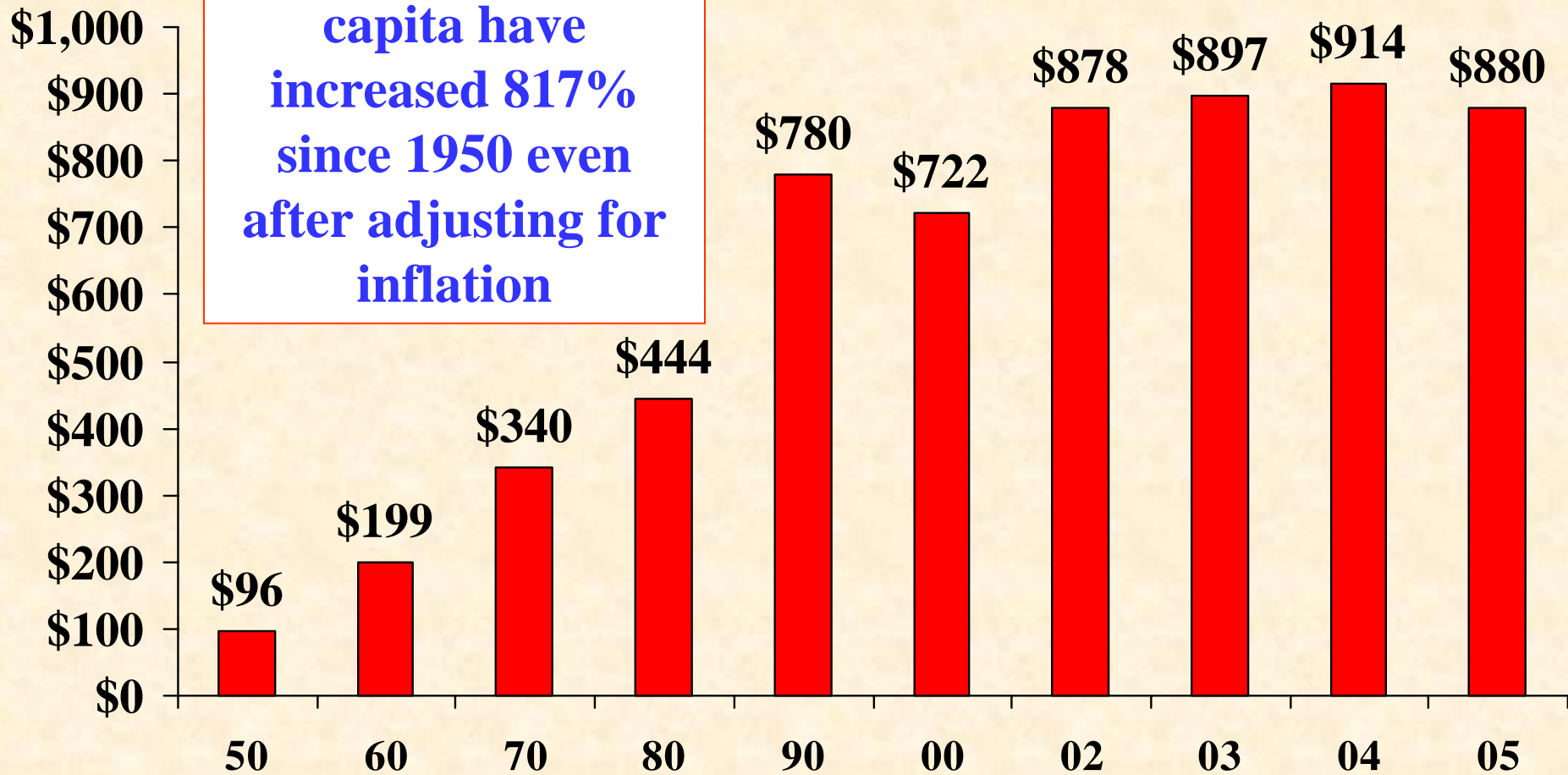
Tort System Costs, 2000-2008F





Inflation Adjusted Tort Costs Per Capita, 1950-2005

Tort costs per capita have increased 817% since 1950 even after adjusting for inflation



KATRINA TORT UPDATE

Suits Add to

iii *Uncertainty, Expense*



Katrina Litigation Timeline for Significant Wind/Flood Disputes

Date	Case	State	Judge	Outcome for Industry	Ruling
9/05	Hood v. State Farm, et al	MS	State/Fed*	Negative	Suit was held up for 15 months on jurisdictional grounds, but ultimately remanded back to a MS state court in Dec. 2006.
4/06	Buente v. Allstate	MS	Senter	Positive	Upheld flood exclusion. Rules flood exclusions in policy are “clear are unambiguous”
5/06	Tuepker v. State Farm	MS	Senter	Negative	Storm surge as excludable flood loss upheld, but ruled that policy language on losses caused by both wind and water was ambiguous and therefore unenforceable

*Originally filed 9/15/05 in MS state court, but jurisdiction challenged by insurers because suit also references the federal government’s National Flood Insurance Program.

Sources: Lehman Brothers, Insurance Information Institute.



Katrina Litigation Timeline for Significant Wind/Flood Disputes (cont'd)

Date	Case	State	Judge	Outcome for Industry	Ruling
5/06	Turk, <i>et al</i> v. Louisiana Citizens, <i>et al</i>	LA	Haik	Positive	Upheld flood exclusion. Ruling says that if policy only covered wind damage then flood-related damage not covered
8/06	Class Action Certification	MS	Senter	Positive	Refuses to certify class actions cases involving State Farm Katrina cases
8/06	Leonard v. Nationwide	MS	Senter	Positive	Flood exclusion upheld. Nationwide ordered to pay only for wind damage of \$1,228.
11/06	Levee Breaks	LA	Duval	Negative	Losses from levee breaks should be covered by insurers
1/19/07	Broussard v. State Farm	MS	Senter	Negative	Rules against State Farm for refusal to cover Katrina damage for \$1M. Ruling reduced to \$1M. 1/31

Reduced to \$1M. 1/31



Katrina Litigation Timeline for Significant Wind/Flood Disputes (cont'd)

Date	Case	State	Judge	Outcome for Industry	Ruling
1/07	Congressional Investigations	MS	NA	Negative	Rep, Gene Taylor (D-MS) calls for Congressional investigations into insurer claims handling practices. Separately, Dept. of Homeland Security inspector general must submit results of investigation by 4/1/07.
1/23/07	Tejedor v. State Farm	MS	Senter	Negative	State Farm settles for an estimated \$1 million based on \$96,000 in uncovered losses. Home insured for \$260,000; recovered \$200,000 from NFIP and \$13,944 from SF on structure. Also recovered \$80,000 from NFIP on \$130,000 contents



Katrina Litigation Timeline for Significant Wind/Flood Disputes (cont'd)

Date	Case	State	Judge	Outcome for Industry	Ruling
<p>Scruggs legal team will earn as much as \$46 million from these settlements, paid in addition to sums offered to plaintiffs (\$26M for the “Woullard Agreement” and up to \$20M for the class action case)</p>					<p>State Farm settles civil suit with MS AG Hood for at least \$50 million. SF will offer about 1000 homeowners whose homes were completely destroyed at least 50% of the policy's value for some time. As many as many families can be affected and seek arbitration. Settlement also resolves a criminal investigation by AG into allegations that claims were fraudulently denied. Settlement does not involve any other insurers.</p>
1/23/07	State Farm Class Action Settlement	MS	Senter*	Negative	
1/23/07	“Woullard Agreement”	MS	NA	Negative	State Farm agrees to pay \$79.5 million to 639 families in private suit. Suit handled by Richard Scruggs. Sen. Trent Lott (R-MS) was party to this suit.

Refused!!!

Sources: Insurance Information Institute. *Pending certification of settlement. Refused to certify 1/26/07.

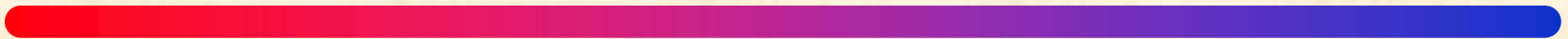


Likely Market Impacts of Post-Katrina Litigation

- **Litigation Creates an Additional Layer of Uncertainty in What is Already a Very Difficult Market**
 - **Ultimate Thrust of Litigation is to Compel Insurers to Pay Water Damage (Flood/Surge) Losses for Which They Have Never Received A Penny in Premium**
- **Some Courts' Apparent Willingness to Retroactively Rewrite Long-Standing, Regulator Approved Terms & Conditions of Insurance Contracts Creates an Unpriceable Risk**
 - **Compounded by juries willing to award millions in punitives**
- **People Discouraged from Buying Flood Coverage**
- **BOTTOM LINE: Weather, Courts, Juries Together Create Nearly Impossible Operating Environment**
- **Coverage Under These Circumstances Will Necessarily Become More Expensive, Less Available**

REGULATORY UPDATE

*Busy Year for Insurers
in Washington*





Federal Legislative Update

Federal Terrorism Reinsurance (TRIA)

- **TRIA expires 12/31/07. The current federal program offers \$100 billion of coverage subject to a \$27.5B industry aggregate retention.**
- **New Democratic Congress (with Committee chairs from urban Northeast states) predisposed to extend. Despite resistance/lackluster Administration support TRIA will likely be extended for a multi-year period, perhaps 6-8 but potentially as long as 15 years (last extension in 2005 was for 2 years)**
- **Potential changes include extensions of coverage for domestic terrorism losses (not included currently), and a lower industry retention for nuclear, biological, chemical, or radiological (NBCR) attacks. There could possibly be a modestly higher industry retention for non-NBCR losses, and it needs to be resolved whether liability and group life losses will be covered.**
- **Original hope for first-half 2007 extension have faded. Now looking at fall or even 11th-hour extension as in 2005.**



Federal Legislative Update

Natural Disaster Coverage

- **Some insurers are pushing for federal catastrophic risk fund coverage in the wake of billions of dollars of losses suffered by insurers from the 2004-2005 hurricane seasons.**
- **Legislative relief addressing property/casualty insurers' exposure to natural catastrophes, such as the creation of state and federal catastrophe funds, has been advocated by insurers include Allstate and State Farm recently. However, there is active opposition many other insurers and all reinsurers.**
- **There are supporters in Congress, mostly from CAT-prone states. Skeptics in Congress believe such a plan would be a burden on taxpayers like the NFIP and that the private sector can do a better job. Unlike TRIA, the industry is not unified on this issue.**
- **Allowing insurers to establish tax free reserves for future catastrophe losses has also been proposed, but Congress has not yet indicated much support.**



Federal Legislative Update

Optional Federal Charter (OFC)

- **Large P&C and life insurers are the major supporters of OFC. Supporters argue that the current patchwork of 50 state regulators reduces competition, is redundant, slows new product introductions and adds cost to the system.**
- **In general, global P/C insurers, reinsurers and large brokers mostly support the concept, while regulators (state insurance commissioners), small single-state and regional insurers, and independent agency groups largely oppose the idea. An optional federal charter is more favorable for global P&C insurers, because an insurer that operates in multiple states could opt to be regulated under federal rules rather than multiple state regulations. As a result, this could increase innovation in the industry.**
- **A new bill should be introduced in May or June. Currently appears to be more momentum for OFC for life than for P&C insurers based on the homogeneous nature of many life products. The debate should intensify and although passage may not occur in the current session of Congress, it may lay the groundwork for passage in the 2009-2010 session.**



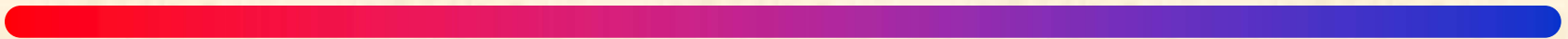
Federal Legislative Update

McCarran-Ferguson Insurance Antitrust Exemption

- **Under McCarran-Ferguson Act of 1945, insurers have limited immunity under federal anti-trust laws allowing insurers to pool past claims information to develop accurate (actuarially credible) rates.**
- **Very low level of understanding of M-F in Washington**
- **Certain legislators threaten to revoke McCarran-Ferguson because of alleged collusion in the wake of Hurricane Katrina. However, the view among some Washington insiders is that such a move would hurt small insurers with less resources rather than the large insurers perhaps being targeted. The current bills designed to revoke McCarran-Ferguson are S.618 and H.R. 1081.**
- **The government appointed Antitrust Modernization Commission in an April 2007 report strongly encouraged Congress to re-examine the McCarran-Ferguson Act. Notably, 4 of the commissions 12 members called for a full repeal of the law. Sources: Lehman Brothers, Insurance Info. Institute**

TRIA EXTENSION

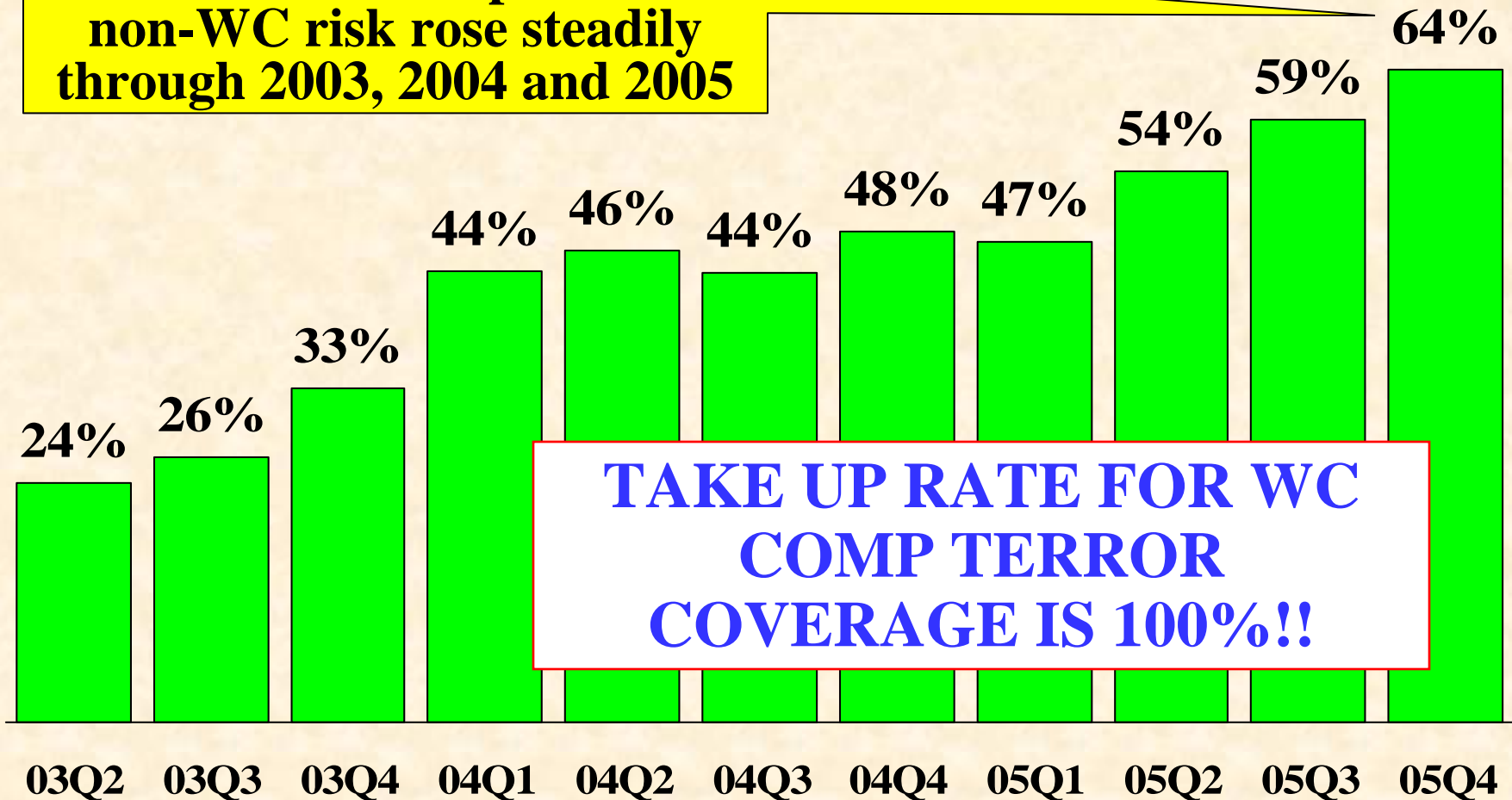
*The Burden Grows, and the
Clock is Ticking*





Terrorism Coverage Take-Up Rate Continues to Rise

Terrorism take-up rate for non-WC risk rose steadily through 2003, 2004 and 2005

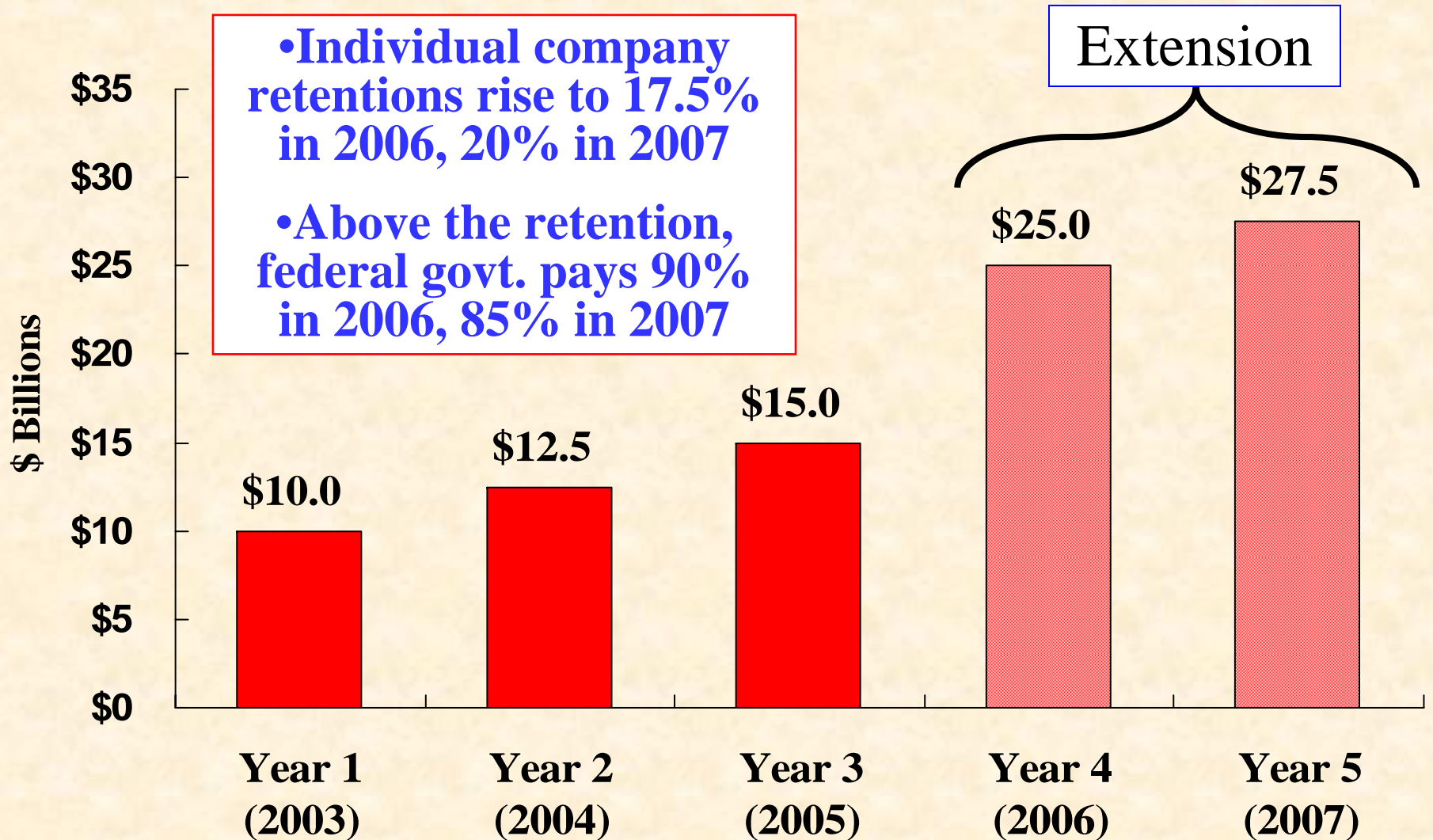


**TAKE UP RATE FOR WC
COMP TERROR
COVERAGE IS 100%!!**



Insurance Industry Retention

Under TRIA (\$ Billions)





Insured Loss Estimates:

Large CNBR Terrorist Attack (\$ Bill)

Type of Coverage	New York	Washington	San Francisco	Des Moines
Group Life	\$82.0	\$22.5	\$21.5	\$3.4
General Liability	14.4	2.9	3.2	0.4
Workers Comp	483.7	126.7	87.5	31.4
Residential Prop.	38.7	12.7	22.6	2.6
Commercial Prop.	158.3	31.5	35.5	4.1
Auto	1.0	0.6	0.8	0.4
TOTAL	\$778.1	\$196.8	\$171.2	\$42.3

Source: American Academy of Actuaries, Response to President's Working Group, Appendix II, April 26, 2006.

FLORIDA SPECIAL SESSION LEGISLATIVE CHANGES

iii Insurer, Policyholder &
State Impacts



Summary: Florida Legislature Special Session (January 2007)

1. Exponential Expansion of the Role of the State in Insuring Homes & In Reinsurance Markets

- **More than doubles exposure of Florida Hurricane Catastrophe Fund to \$35 billion from \$16 billion (FHCF only has \$1B cash), greatly displacing private reinsurers**
- **Allows Florida Citizens to compete with private insurers by lowering rates and lowering eligibility standards**
- **Allows Florida Citizens to displace private insurers by expanding into non-wind coastal business**
- **Disbands disciplined, small and adequately priced Commercial JUA and transfers business to poorly run, underpriced, Citizens Commercial Account**



Summary: Florida Legislature Special Session (January 2007)

2. Dramatically Increases Exposure of Florida Policyholders to Post-Catastrophe Taxes

- **Expands the Citizens assessment base more than 4 fold**
- **Increases maximum annual assessment facing Florida policyholders from \$9.2 billion to \$25 billion**
- **Increases maximum general liability and commercial auto assessment exposure from 14% to 74% (*These are 2 types of insurance that having nothing to do with hurricane risk*)**
- **Accelerates growth of Citizens, already the largest home insurers in the state and which doubled in size in 2006, by lowering rates and making access easier**
- **Freezes Citizens' rates through end of 2008 (May 2007 prop.)**



Summary: Florida Legislature Special Session (January 2007)

3. Disincentives for Insurers to Offer Policies in Florida

- **Introduces “excess profits law” (a virtual oxymoron in FL)**
- **Requires Executive Officer review on routine rate filings**
 - **Threatens perjury charges and administrative penalties**
- **Requires “premium discounts” even if not actuarially justified**
- **Proposal to ban new “PUP” companies (May 2007 proposal)**

4. Threatens State of Florida’s Credit Rating

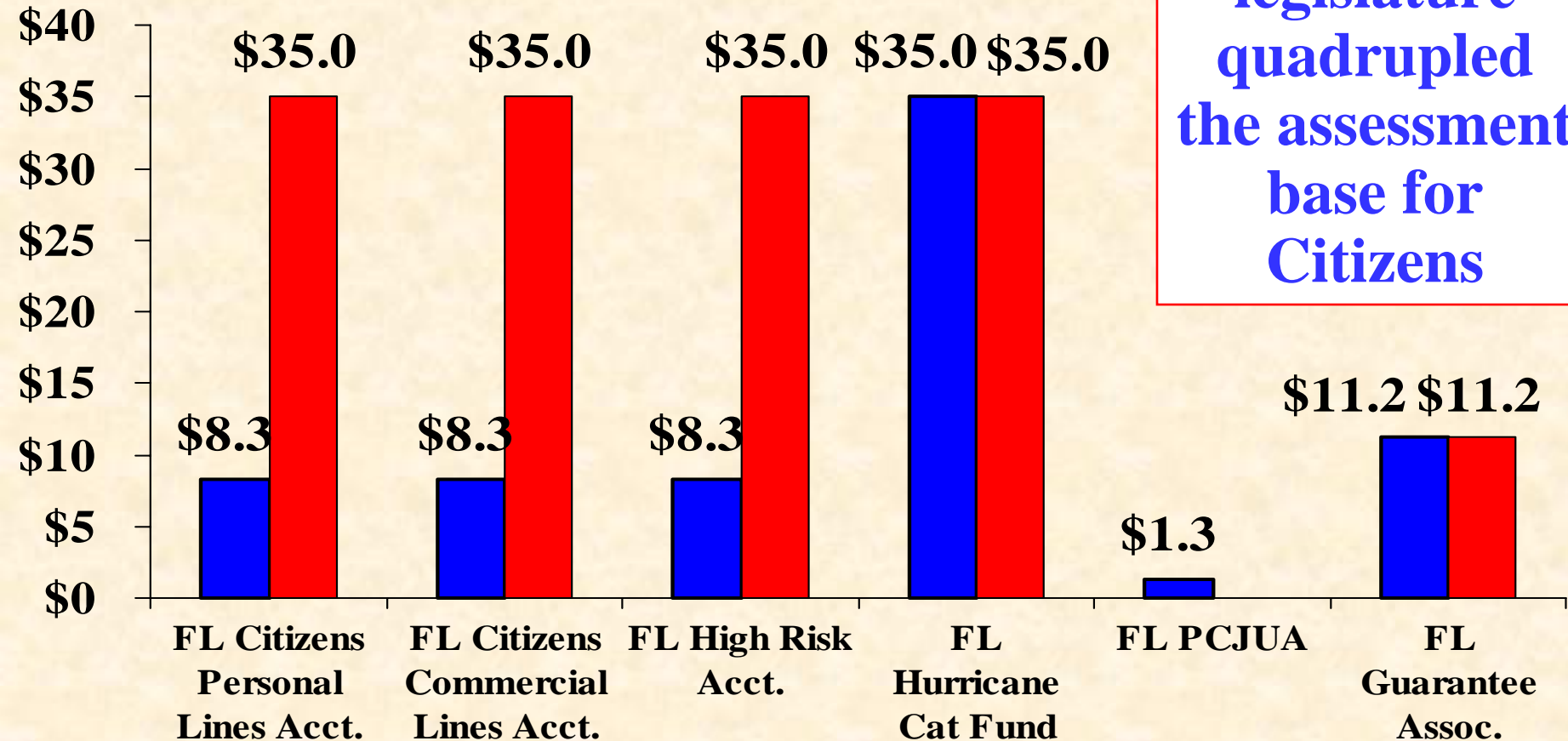
- **Major event could result in simultaneous issuance of \$40+ billion in debt from Cat Fund, Citizens and Guarantee Fund**
- **Governor’s promise to cut property taxes could compound state’s fiscal problems after an event**



Florida Hurricane Assessment

Base, 2006 vs. 2007* (\$ Bill)

■ 2006 ■ 2007



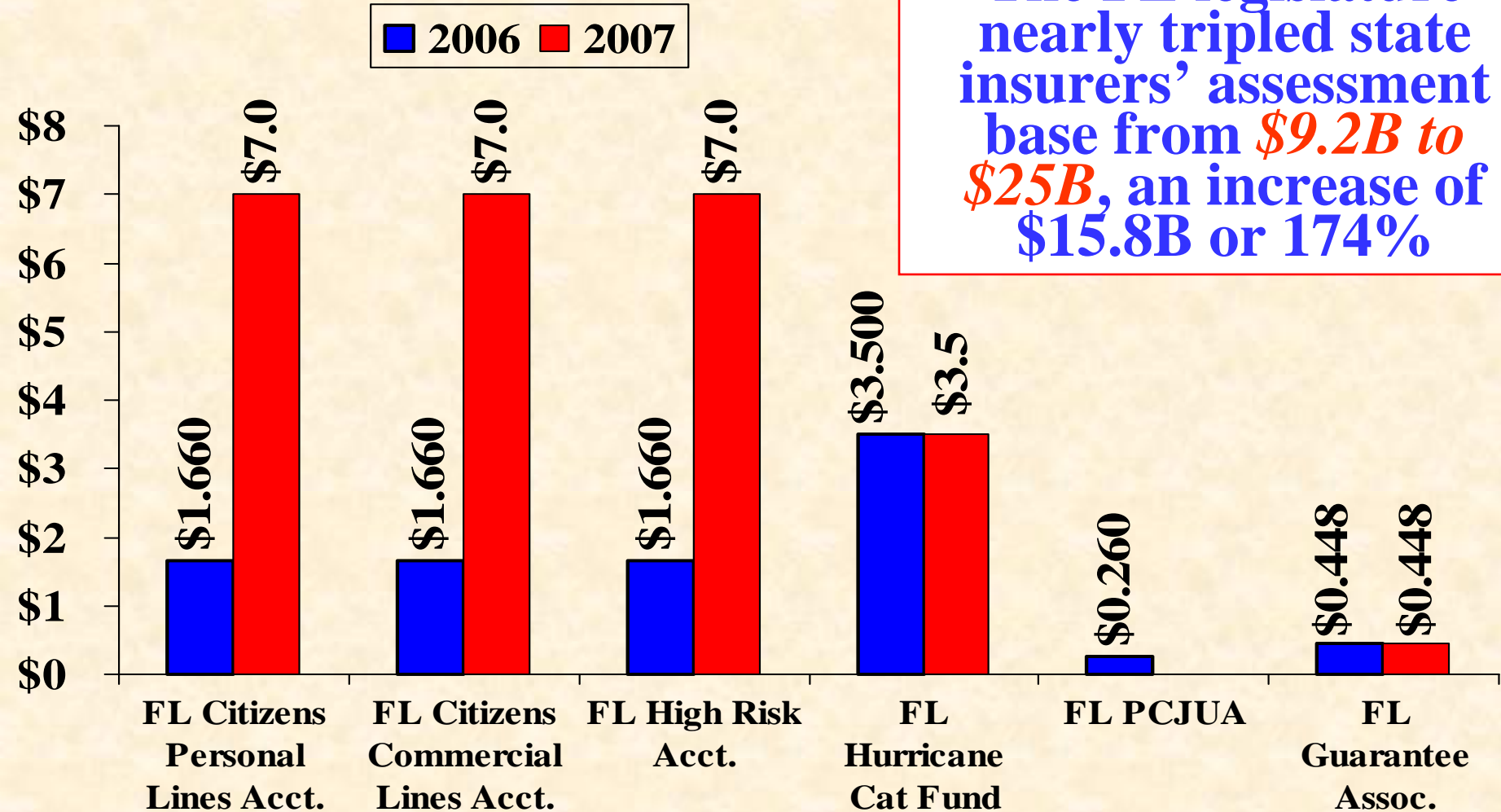
The FL legislature quadrupled the assessment base for Citizens

Sources: Zurich Insurance Technical Center; Ins. Info. Inst. *Per special legislative session, Jan. 2007.



Florida Hurricane Max. Policyholder Annual Burden, 2006 vs. 2007* (\$ Bill)

The FL legislature nearly tripled state insurers' assessment base from **\$9.2B** to **\$25B**, an increase of **\$15.8B** or **174%**



Sources: Zurich Insurance Technical Center; Ins. Info. Inst. *Per special legislative session, Jan. 2007.

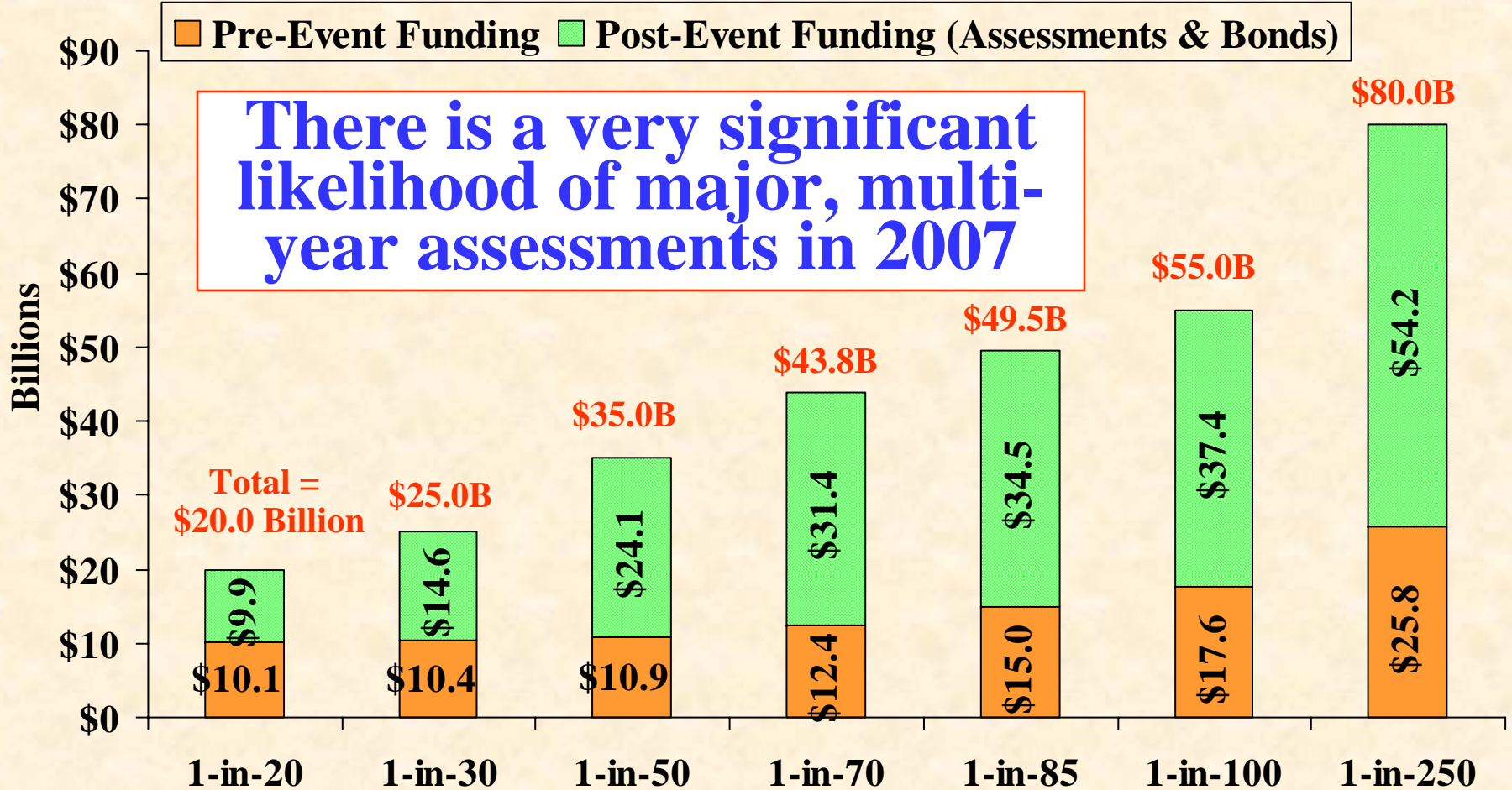


Why There is Concern Over the Florida Legislature's & Governor's Changes

- **Risk is Now Almost Entirely Borne Within State**
- **Virtually Nothing Done to Reduce Actual Vulnerability**
- **Creates Likelihood of Very Large Future Assessments**
- **Potentially Crushing Debt Load**
- **State May be Forced to Raise/Levy Taxes to Avoid Credit Downgrades**
- **Many Policyholder Will See Minimal Price Drop**
 - **“Savings” came from canceling recent/planned rate hikes**
- **Residents in Lower-Risk Areas, Drivers, Business Liability Policyholders Will Come to Resent Subsidies to Coastal Dwellers**
- **Governor's Emergency Order for Rate Freezes & Rollbacks Viewed as Unfair & Capricious**



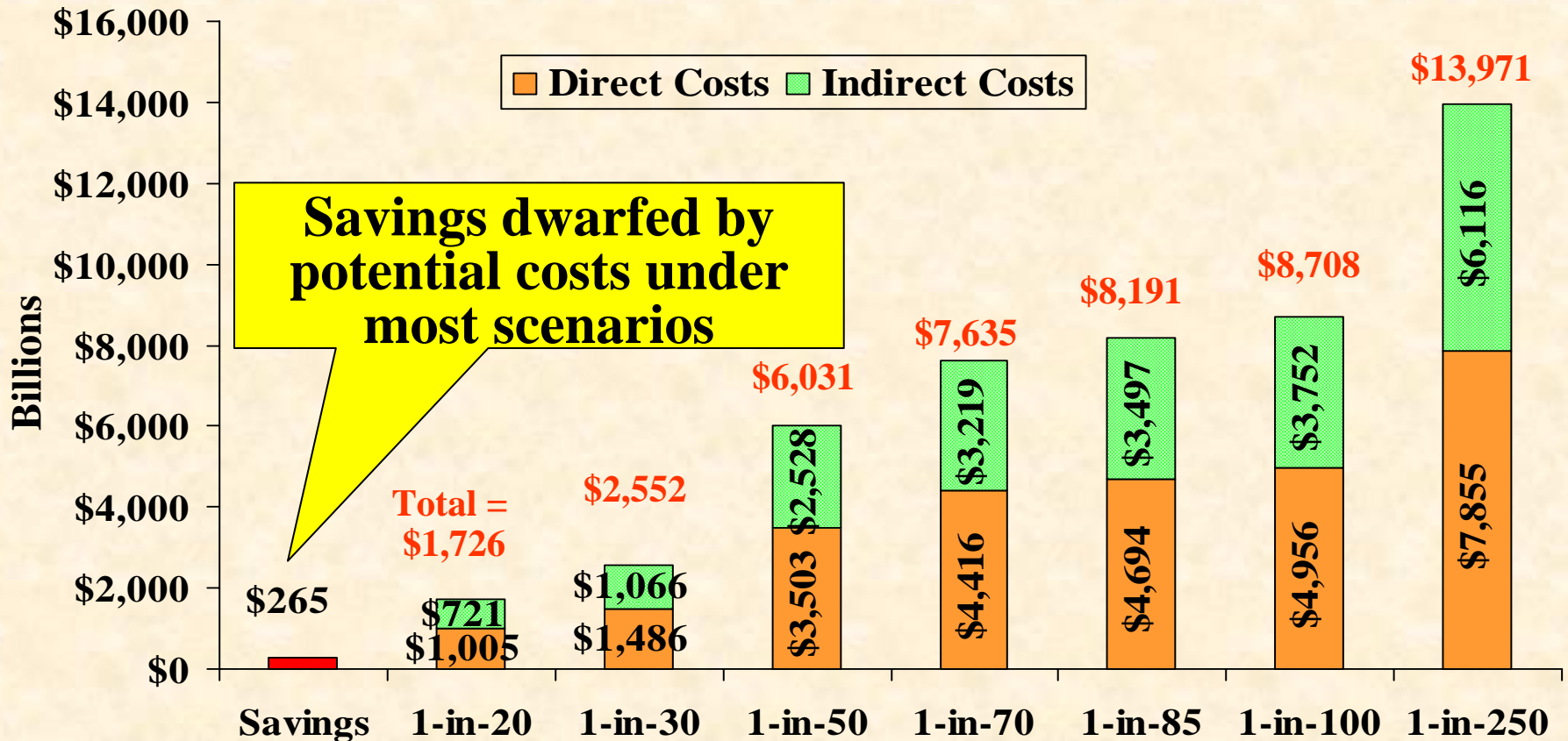
Pre- vs. Post-Event in FL for 2007 Hurricane Season



Notes: Pre-event funding includes funds available to Citizens, FHCFC and private carriers plus contingent funding available through private reinsurance to pay claims in 2007. Post-event funding is on a present value basis and does not include financing costs. Probabilities are expressed as “odds of a single storm of this magnitude or greater happening in 2007.”
Source: Tillinghast Towers Perrin, *Study of Recent Legislative Changes to Florida’s Property Insurance Mechanisms*, 3/07.



Per Household Savings vs. Long-Term Costs of FL Legislation for 2007 Hurricane Season



Notes: Assumes average homeowners insurance premium of \$1300 in 2007. Savings for 2007 reflects 24.3% savings on hurricane costs, assumed to be 63% of premium. Savings based on statewide OIR estimate. Actual savings may be less. Direct costs include assessments paid by policyholders on home and personal auto premiums. Indirect costs include assessments on commercial lines passed on to policyholders via higher prices. Amounts are in nominal dollars, or the total cost of borrowing including finance charges over the term of the bond.

Source: Tillinghast Towers Perrin, *Study of Recent Legislative Changes to Florida's Property Insurance Mechanisms*, 3/07.



Savings vs. Costs by Region: *Neither Equitable nor Proportionate*

STATEWIDE AVERAGE

Average Savings: \$265
Cost of 1-in-30 Storm: \$2,550
Cost is 10 times avg. savings

ORLANDO

Average Savings: \$30
Cost of 1-in-30 Storm: \$2,075
Cost is 69 times avg. savings

TALLAHASSEE

Average Savings: \$20
Cost of 1-in-30 Storm: \$2,000
Cost is 100 times avg. savings

TAMPA

Average Savings: \$100
Cost of 1-in-30 Storm: \$2,300
Cost is 23 times avg. savings

MIAMI

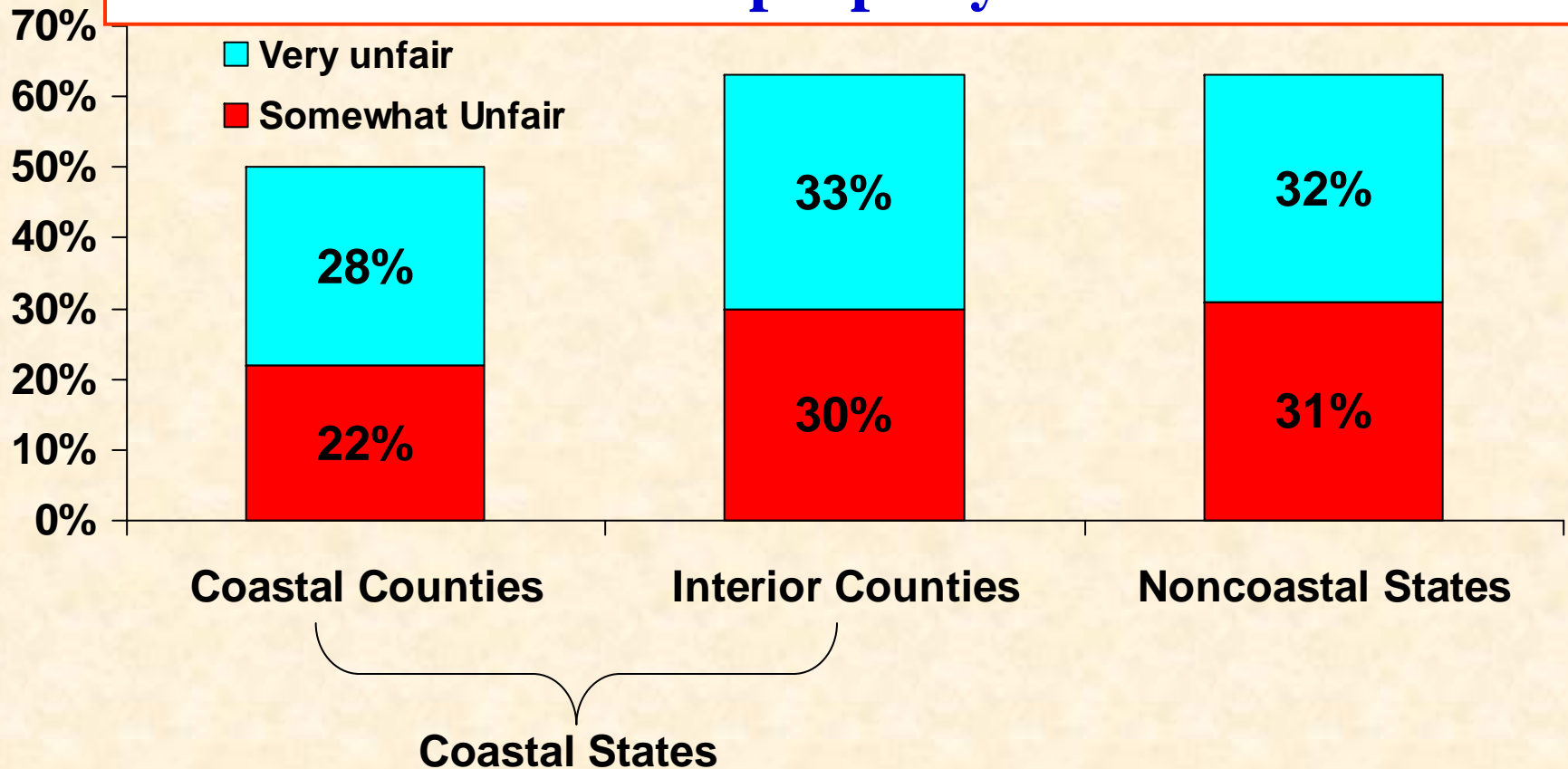
Average Savings: \$1,120
Cost of 1-in-30 Storm: \$3,375
Cost is 3 times avg. savings



Public Attitude Monitor 2006:

Unfairness of Policyholder Subsidies

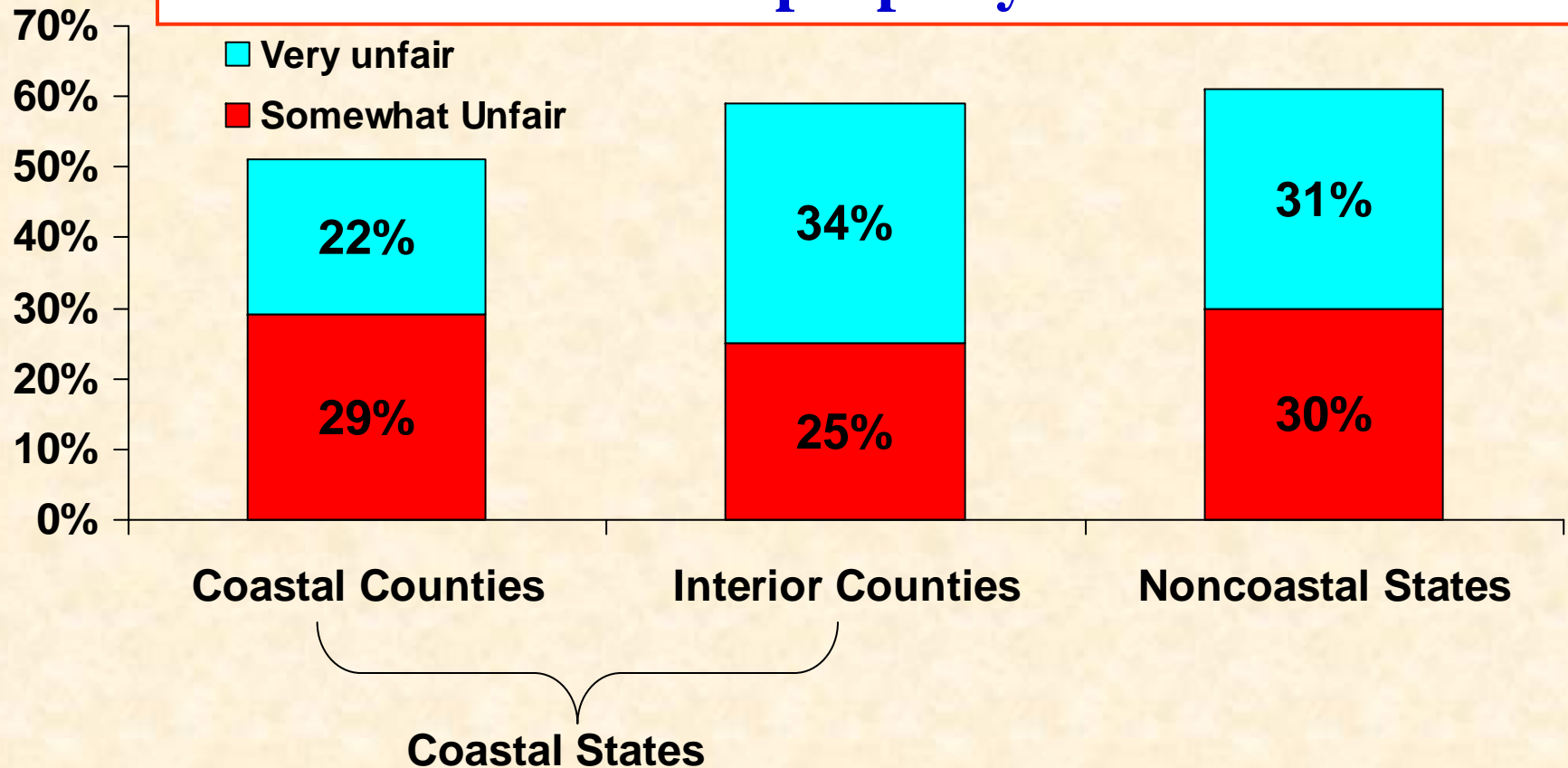
Most non-coastal policyholders believe premium subsidies for coastal property owners are unfair





Public Attitude Monitor 2006: *Unfairness of Taxpayer Subsidies*

Most non-coastal dwellers believe taxpayer subsidies for coastal property owners are unfair





Summary

- **Personal & Commercial lines results were *unsustainably* good 2006; Overall profitability reached its highest level (est. 14%) since 1988**
- **Underwriting results were aided by lack of CATs & favorable underlying loss trends, including tort system improvements**
- **Property cat reinsurance markets peaking & more competitive**
- **Premium growth rates are slowing to their levels since the late 1990s; Commercial leads decreases**
- **Rising investment returns insufficient to support deep soft market in terms of price, terms & conditions**
- **Clear need to remain underwriting focused**
- **How/where to deploy/redeploy capital??**
- **Major Challenges:**
 - **Slow Growth Environment Ahead**
 - **Maintaining price/underwriting discipline**
 - **Managing variability/volatility of results**



Insurance Information Institute On-Line

WWW.III.ORG

*If you would like a copy of this presentation, please
give me your business card with e-mail address*