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

Trends, Challenges & Opportunities

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Presentation Outline

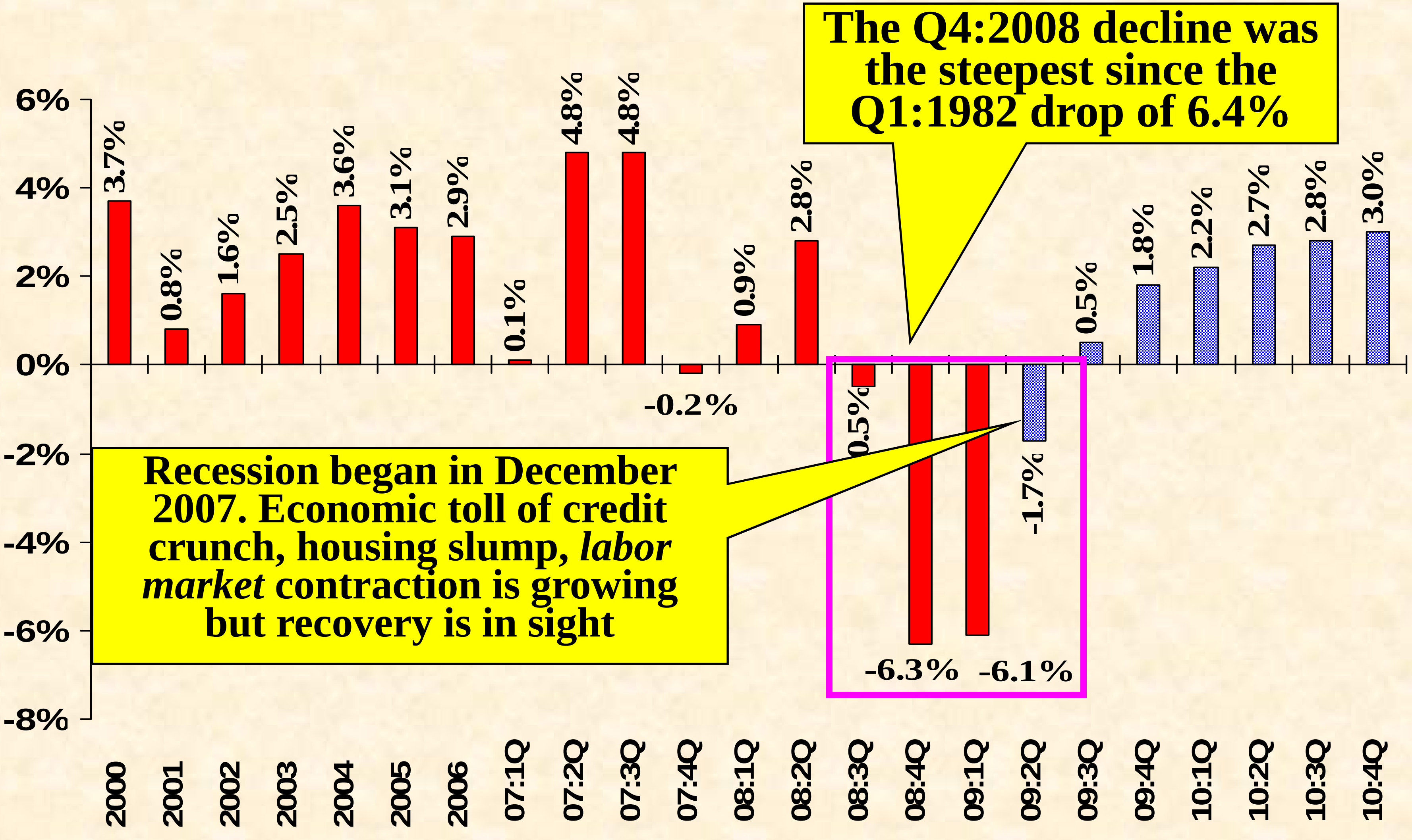
- **Financial Crisis & The Weakening Economy: Insurance Impacts for the P/C Insurance Industry**
  - **Recession, Growth & Insurance**
  - **Economic Stimulus Impacts**
- **Aftershock: The P/C Insurance Landscape After the Crisis**
  - **Impacts & Implications for P/C Insurers**
- **Key Risks for P/C Insurers**
- **Financial Strength & Ratings**
  - **Critical Differences Between P/C Insurers and Banks**
- **P/C Insurance Industry Overview & Outlook**
  - **Profitability**
  - **Premium Growth**
  - **Underwriting Performance**
  - **Financial Market Impacts**
- **Capital & Capacity**
- **Catastrophe Losses**

Q&A

THE ECONOMIC STORM

What the Financial Crisis and Deep Recession Mean for the P/C Insurance Industry

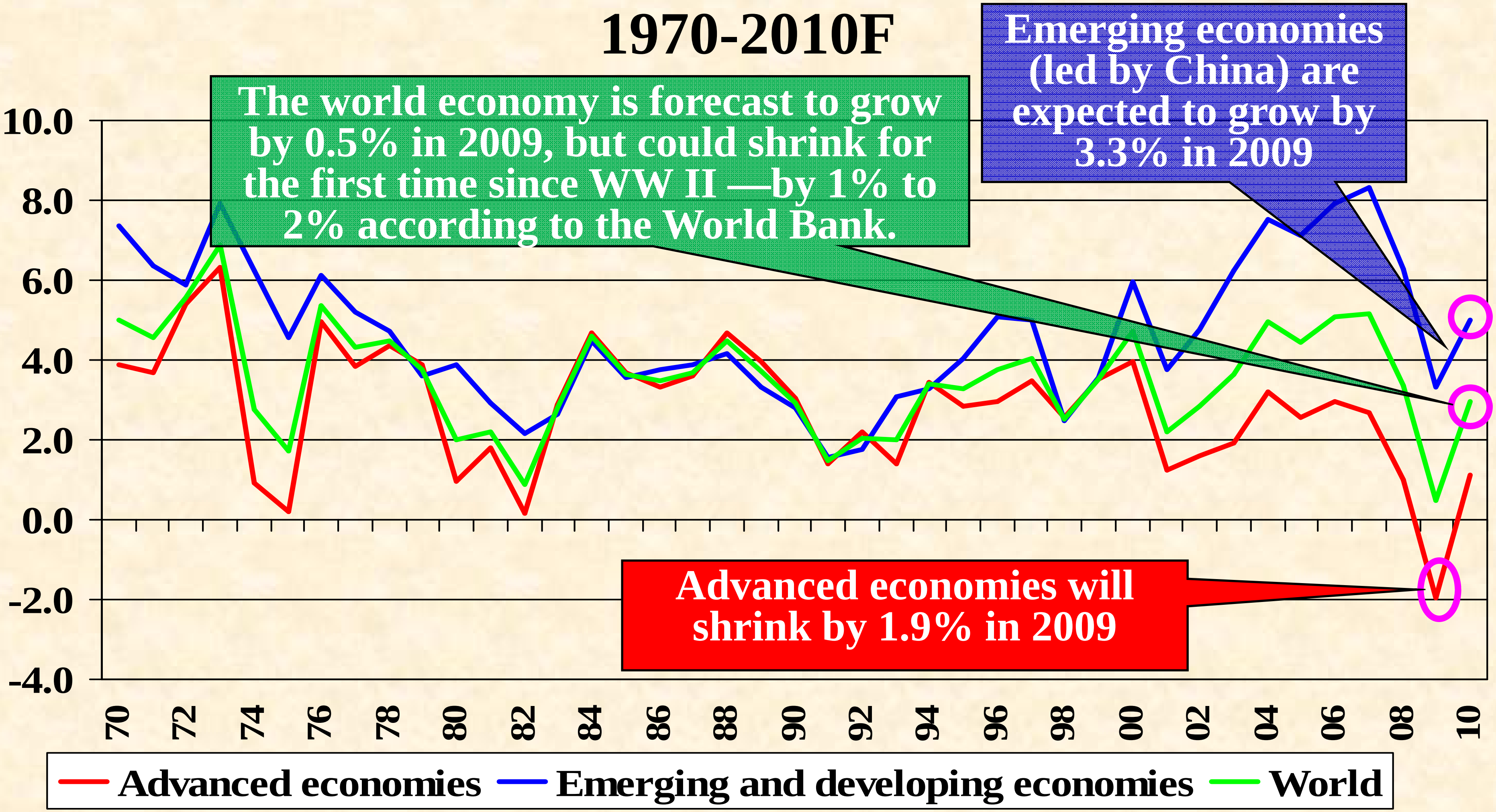
*Real GDP Growth**



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

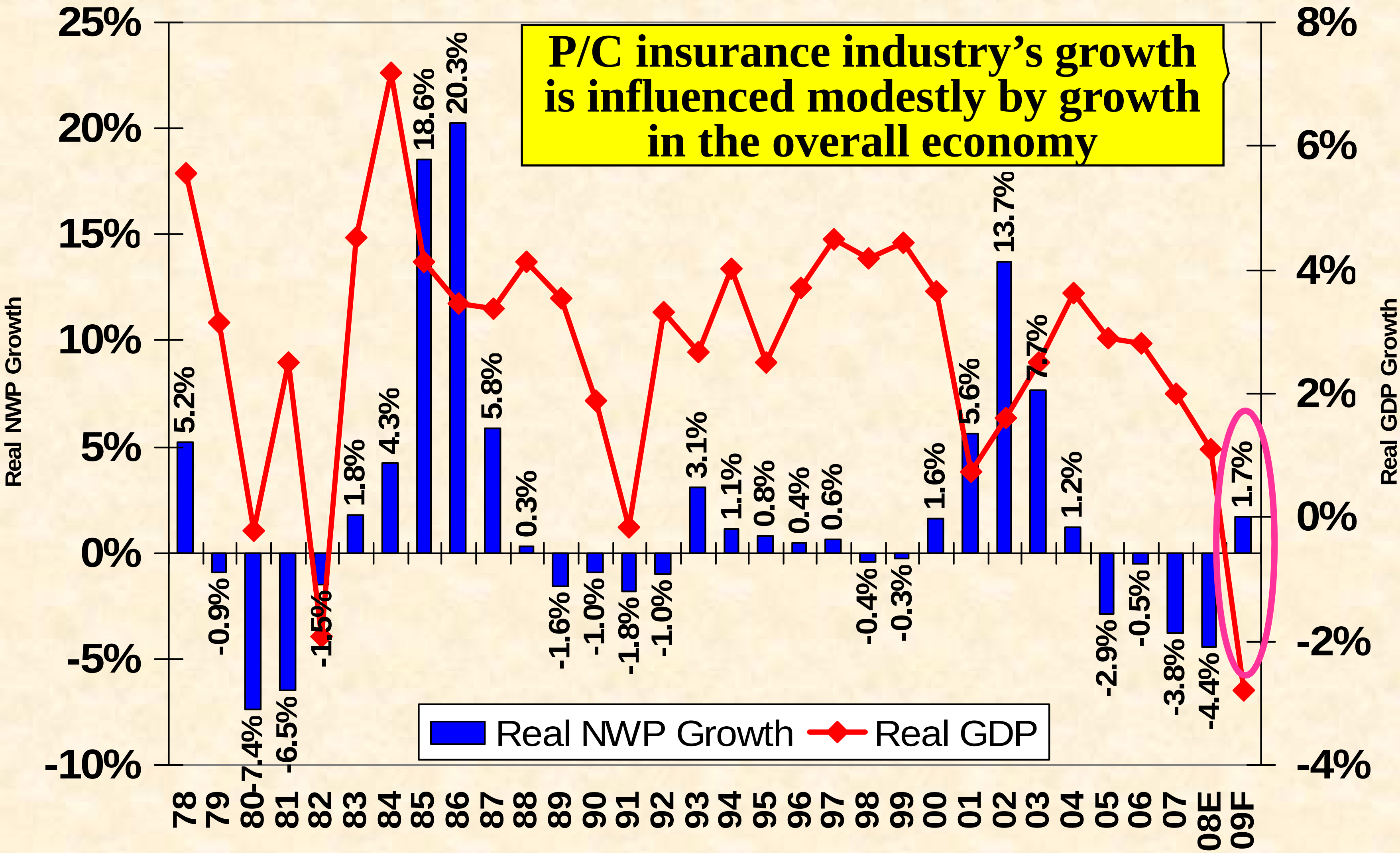
Source: US Department of Commerce, Blue Economic Indicators 5/09; Insurance Information Institute.

GDP Growth: Advanced & Emerging Economies vs. World



Source: International Monetary Fund, World Economic Outlook Update, Jan. 28, 2009; Ins. Info. Institute.

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



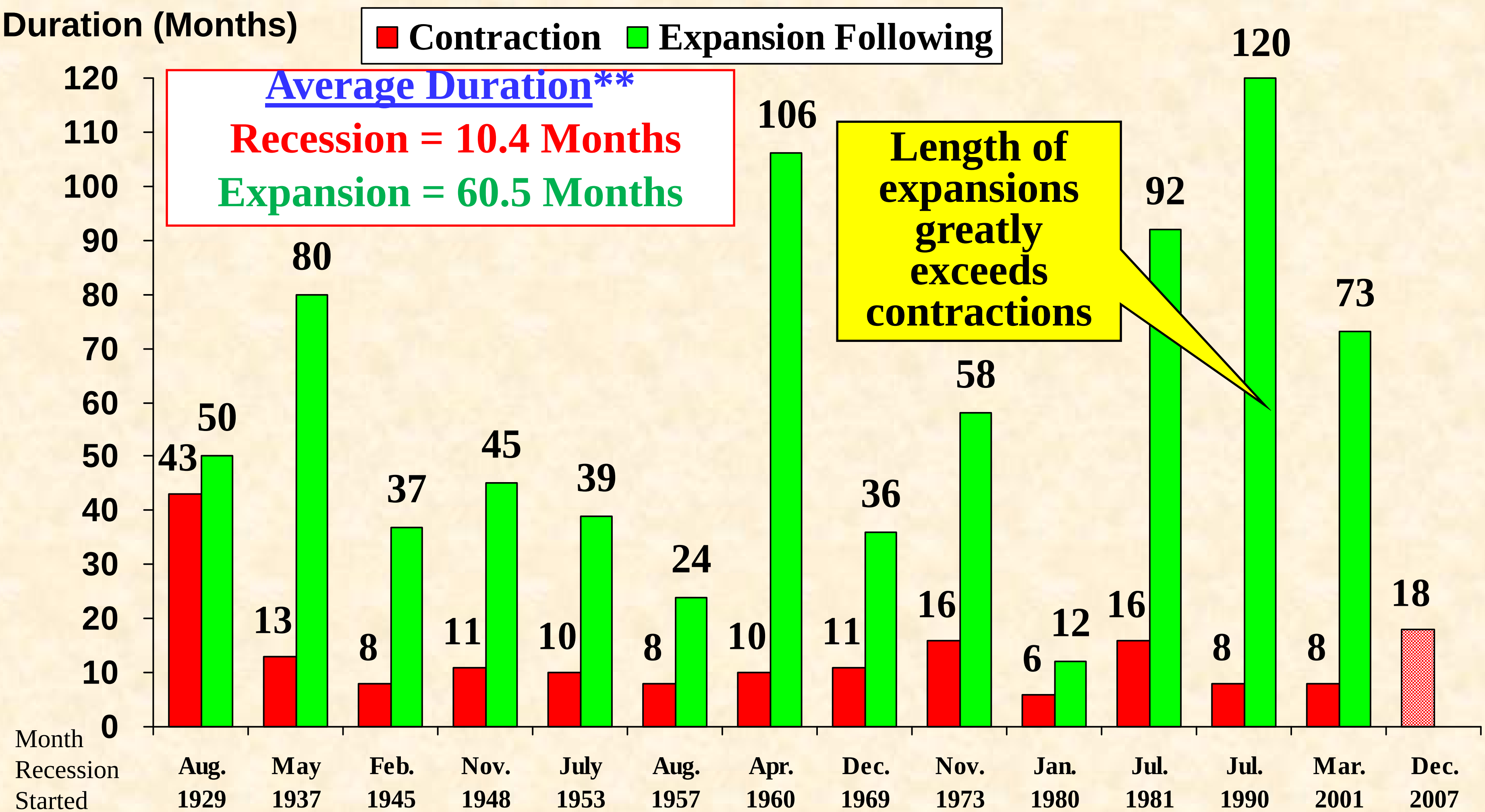
Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 5/09; Insurance Information Inst.

Length of US Recessions, 1929-Present*

* As of May 2009, inclusive

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

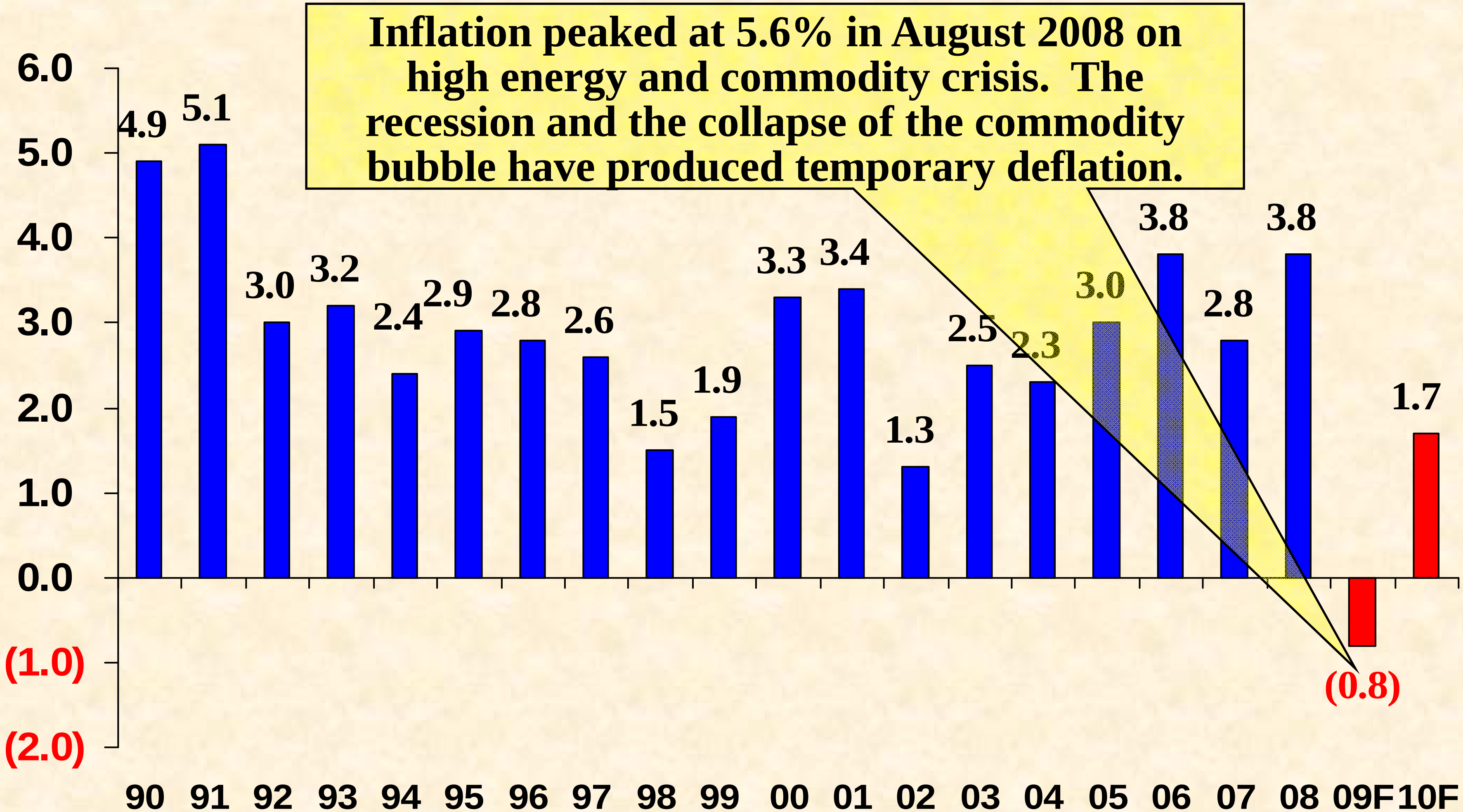
*Length of U.S. Business Cycles, 1929-Present**



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

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

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



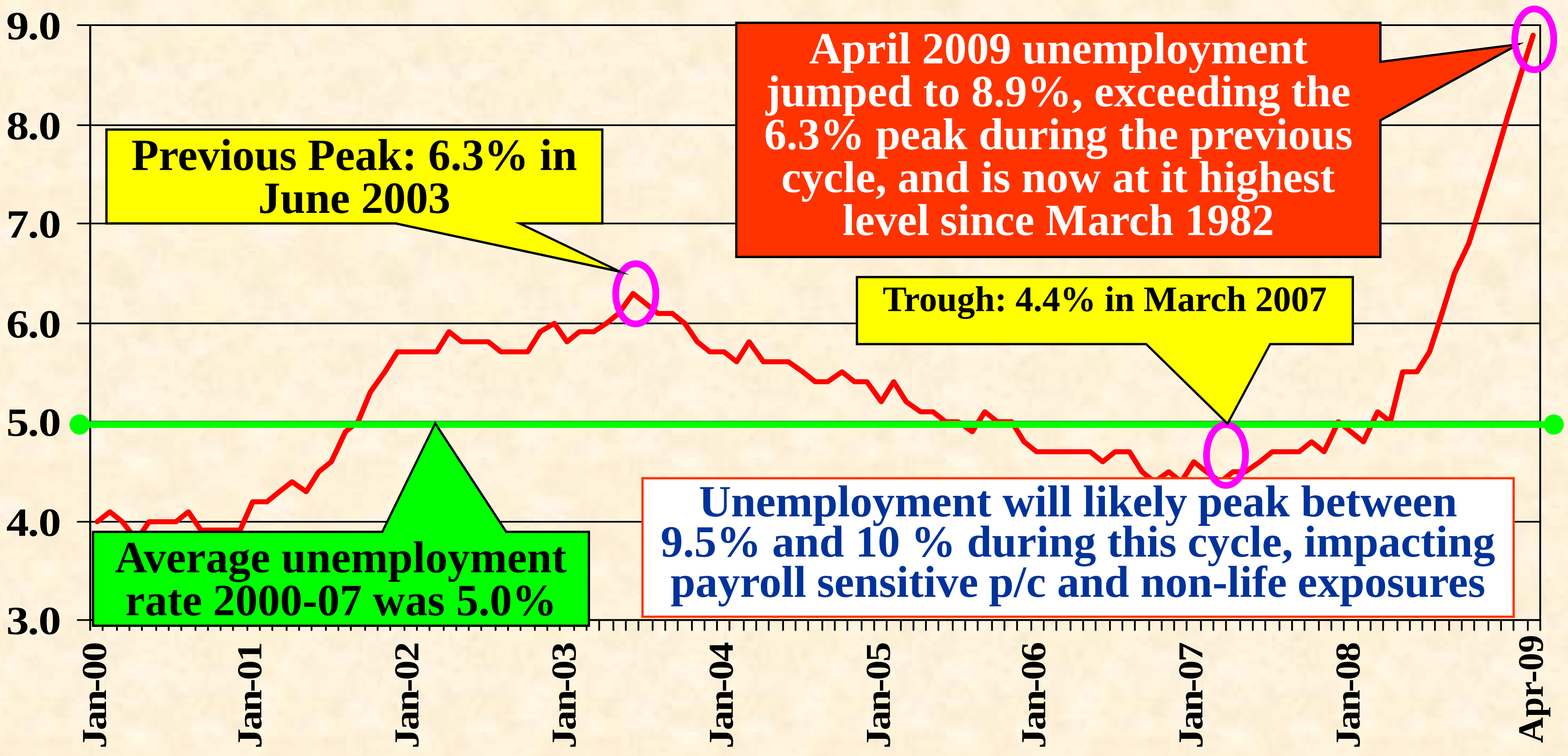
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, May 10, 2009 (forecasts).

Labor Market Trends

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

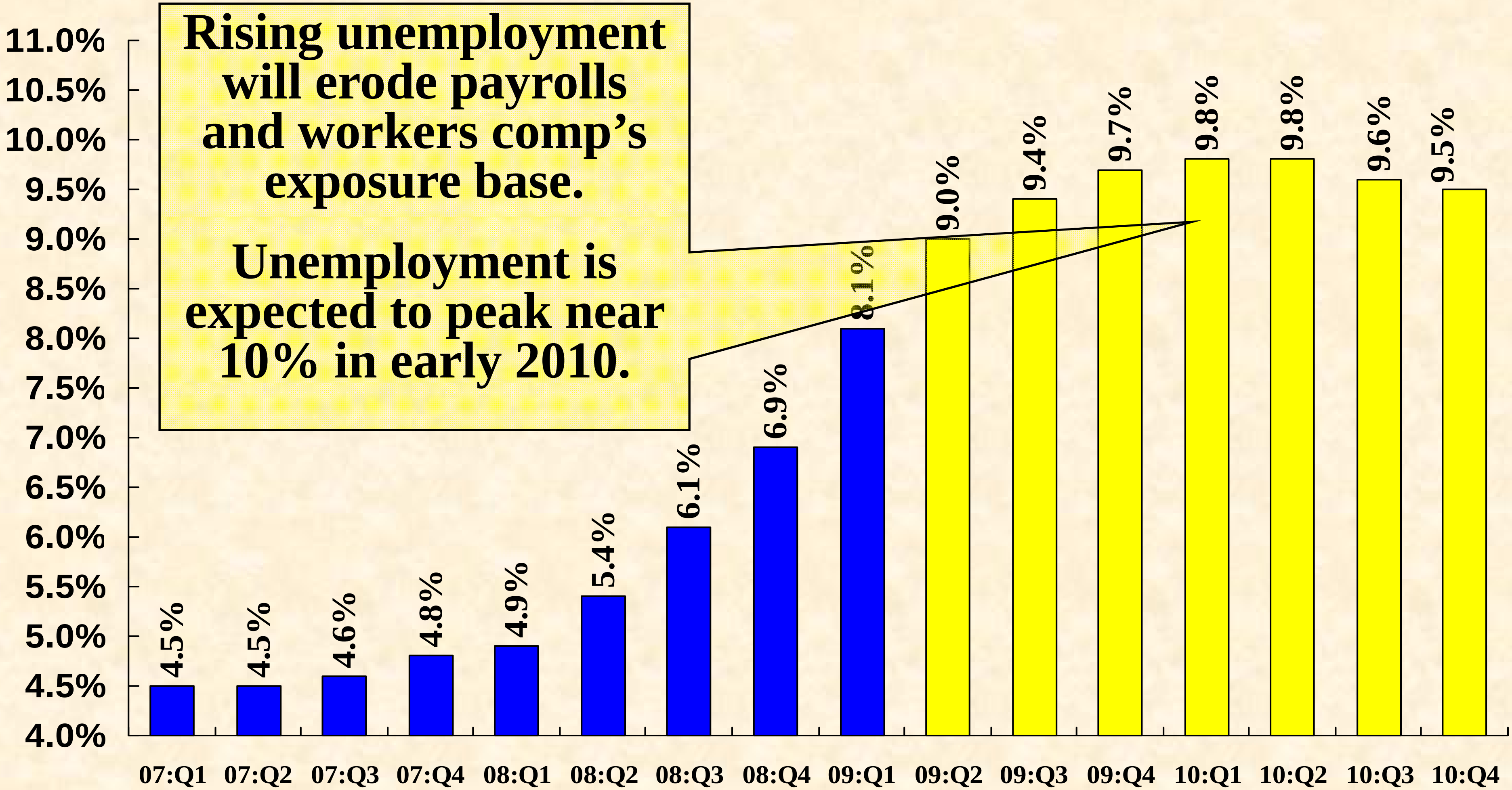
Unemployment Rate: On the Rise

January 2000 through April 2009



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

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

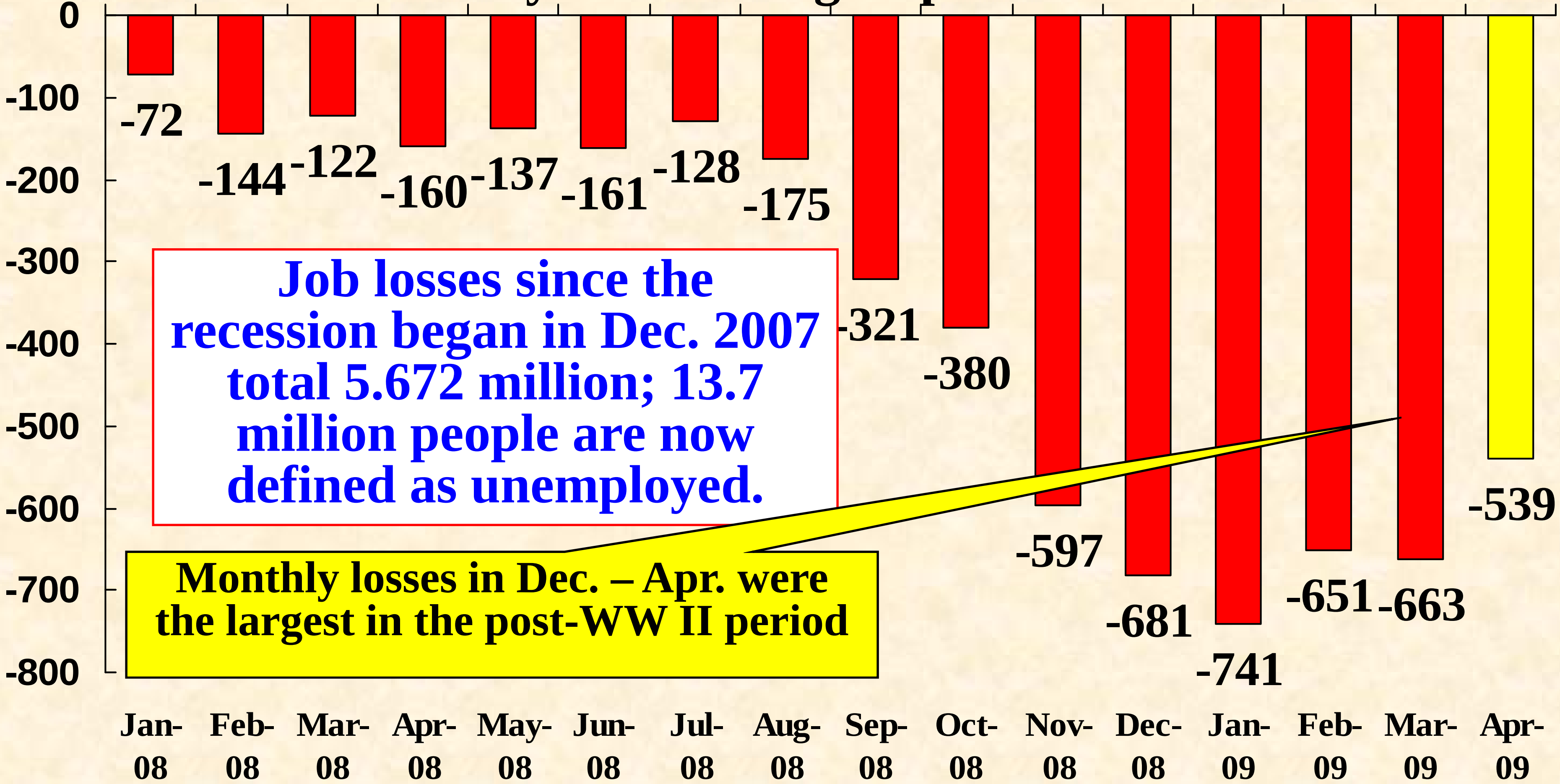


* Blue bars are actual; Yellow bars are forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (5/09); Insurance Info. Inst.

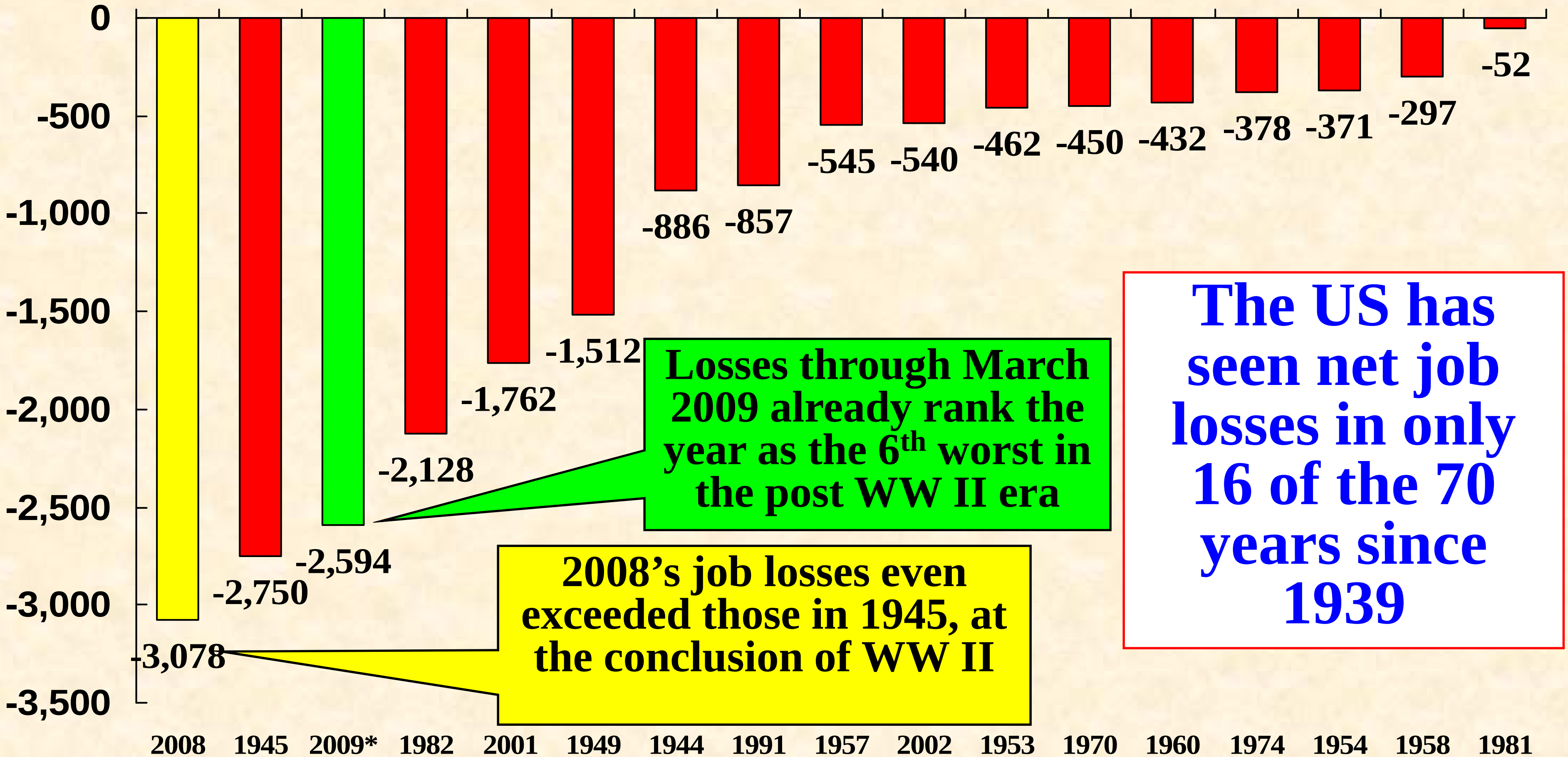
Monthly Change Employment (Thousands)*

January 2008 through April 2009



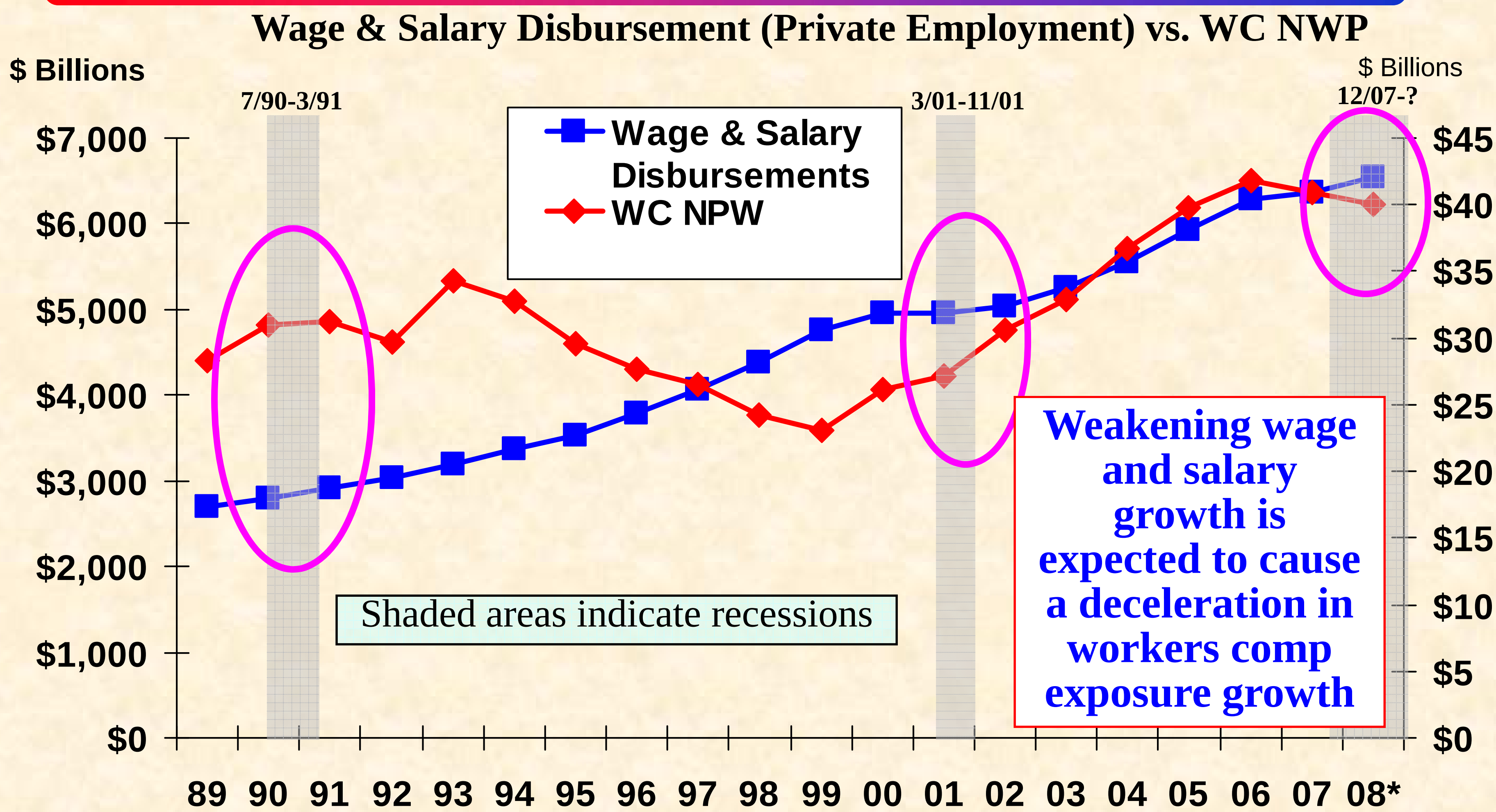
Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Info. Institute

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



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

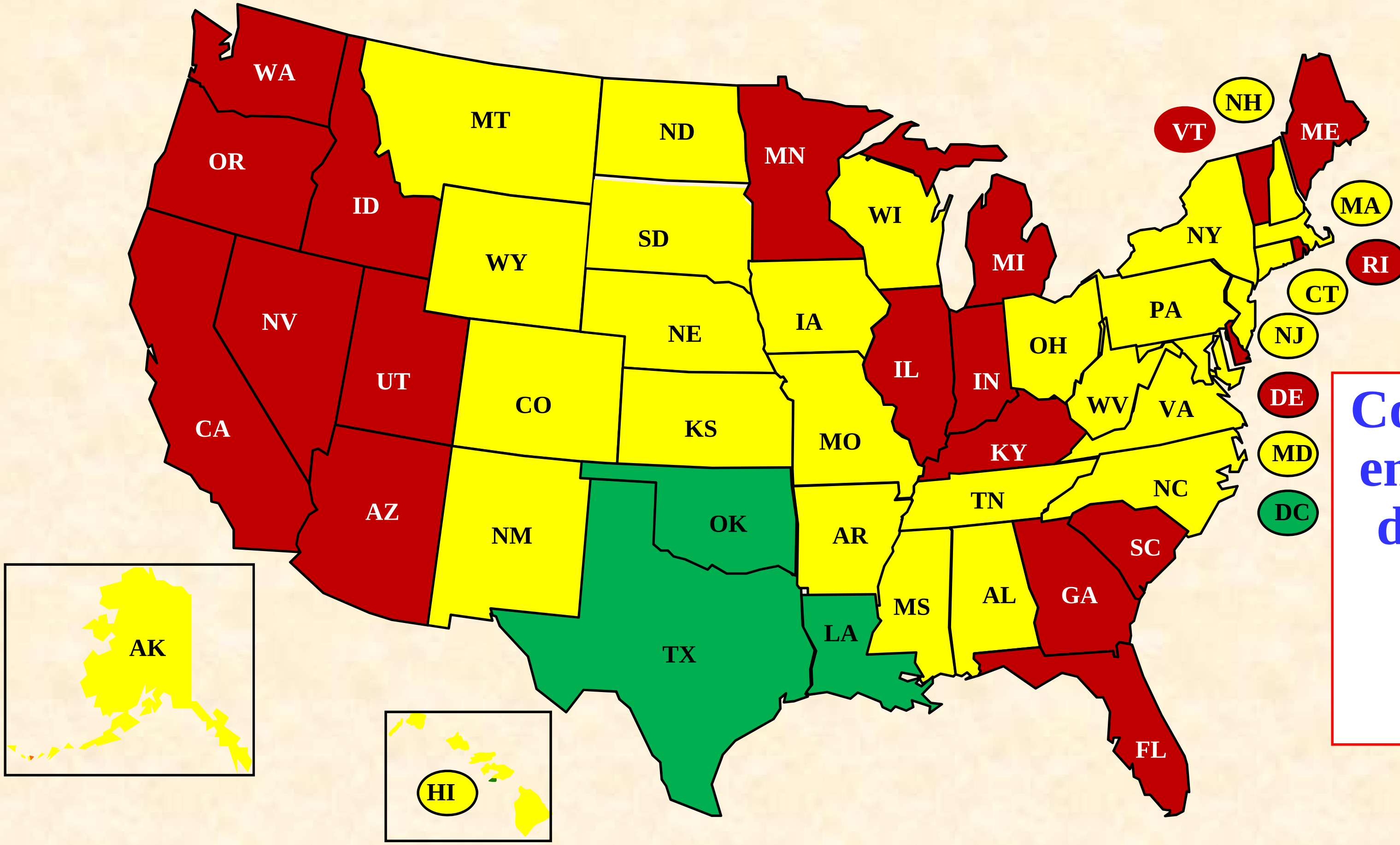
Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums



*Wage and Salary data though October 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

State Construction Employment, Dec. 2007 – Dec. 2008



Construction employment declined in 47 of 50 states in 2008

0% to 4% -0.1% to -8.5% -8.8% to -22%

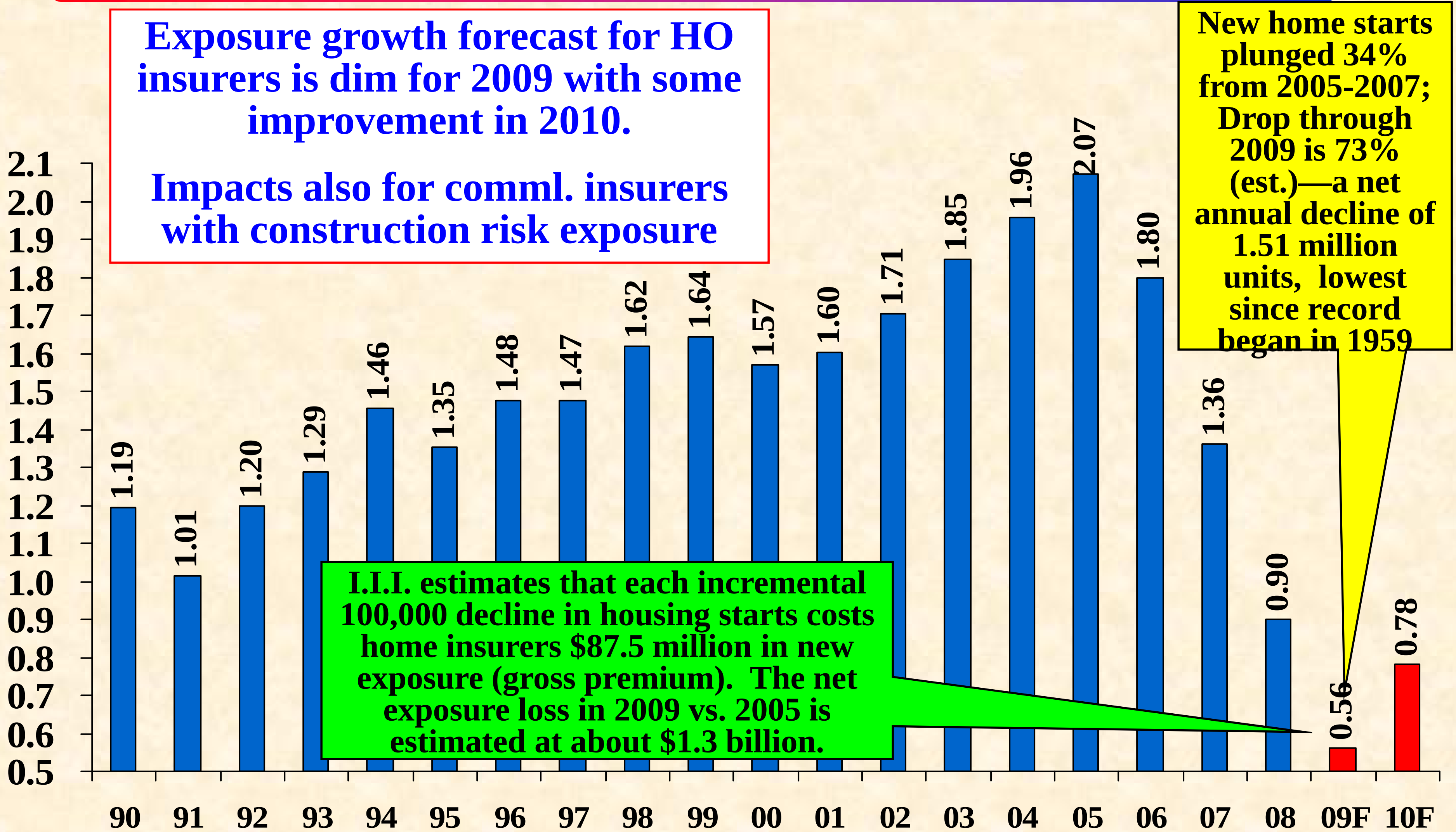
Sources: Associated General Contractors of America from Bureau of Labor Statistics; Insurance Information Institute.

State Construction Employment, Dec. 2007 – Dec. 2008

State	%		State	%		State	%		State	%	
Alabama	-4		Illinois	-13		Montana	-8		Rhode Island	-12	
Alaska	-1		Indiana	-13		Nebraska	-1		South Carolina	-17	
Arizona	-21		Iowa	-5		Nevada	-15		South Dakota	-5	
Arkansas	-3		Kansas	-3		New Hampshire	-8		Tennessee	-4	
California	-11		Kentucky	-12		New Jersey	-5		**Texas**	**+1**	
Colorado	-5		**Louisiana**	**+4**		New Mexico	-2		Utah	-22	
Connecticut	-8		Maine	-10		New York	-5		Vermont	-13	
Delaware	-11		Maryland	-6		North Carolina	-7		Virginia	-6	
District of Columbia	**+2**		Massachusetts	-9		North Dakota	-1		Washington	-10	
Florida	-16		Michigan	-16		Ohio	-9		West Virginia	-6	
Georgia	-10		Minnesota	-10		**Oklahoma**	**+4**		Wisconsin	-7	
Hawaii	-8		Mississippi	-1		Oregon	-13		Wyoming	-1	
Idaho	-15		Missouri	-1		Pennsylvania	-5				

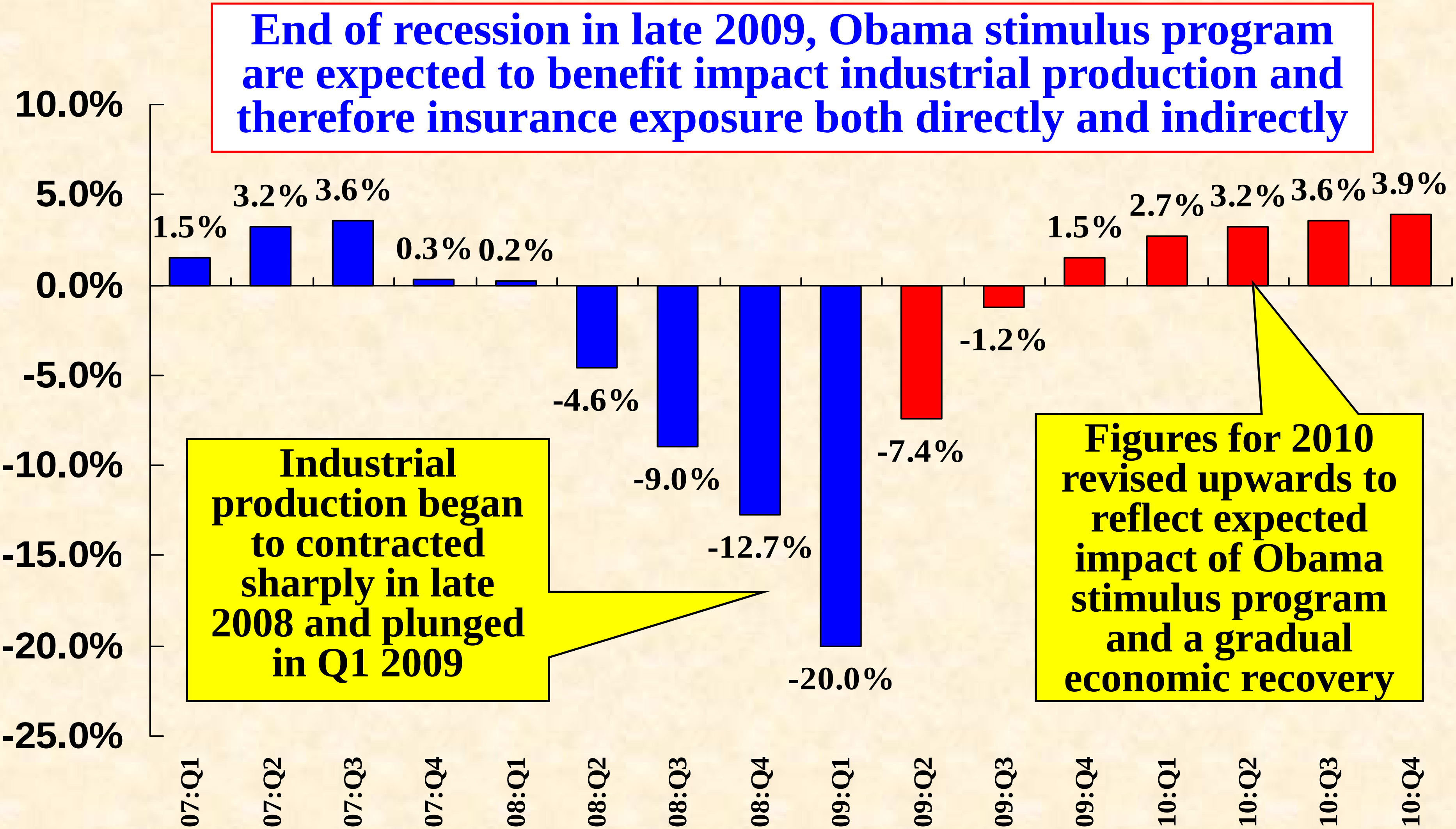
Sources: Associated General Contractors of America from Bureau of Labor Statistics; Insurance Info. Inst.

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



Source: US Department of Commerce; Blue Chip Economic Indicators (5/09); Insurance Information Inst.

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



Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (5/09); Insurance Info. Inst.

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**

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**

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. **Insurers Will Return to Their Underwriting Roots: Extended Period of Low Investment Exert 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.

Possible Regulatory Scenarios for P/C Insurers as of Year-End 2009

- **Status Quo: P/C Insurers Remain Entirely Under Regulatory Supervision of the States**
  - **Unlikely, but some segments of the industry might welcome this outcome above all others**
- **Federal Regulation: Everything is Regulated by Feds**
  - **Unlikely that states will be left totally in the cold**
- **Optional Federal Charter (OFC): Insurers Could Choose Between Federal and State Regulation**
  - **Unlikely to be implemented as envisioned for past several years by OFC supporters**
- **Dual Regulation: Federal Regulation Layer Above State**
  - **Feds assume solvency regulation, states retain rate/form regulation**
- **Hybrid Regulation: Feds Assume Regulation of Large Insurers at the Holding Company Level**
- **Systemic Risk Regulator: Feds Focus on Regulation of Systemic Risk Points in Financial Services Sector**
  - **What are these points for insurers? P/C vs. Life?**

Source: Insurance Information Inst.

Key Issues & Threats Facing P/C Insurers Amid Financial Crisis

Manageable Challenges

Important Issues & Threats Facing P/C Insurers in 2009

1. **Reloading Capital After "Capital Event"**
   - Continued asset price erosion coupled with major "capital event" could lead to shortage of capital among *some* companies
   - 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 insurers need to protect capital today and develop detailed contingency plans to raise fresh capital & generate internally
2. **Long-Term Loss of Investment Return**
   - 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
   - Many insurers have not adjusted to this new investment paradigm
   - Regulators will not readily accept it; Many will reject it
   - Implication 1: Industry must be prepared to operate in environment with investment earnings accounting for a smaller fraction of profits
   - Implication 2: Implies underwriting discipline of a magnitude not witnessed in this industry in more than 30 years
   - Lessons from the period 1920-1975

Source: Insurance Information Inst.

Important Issues & Threats Facing P/C Insurers in 2009 (cont'd)

3. **Regulatory Overreach**
   - **P/C insurers get swept into vast federal regulatory overhaul and subjected to inappropriate , duplicative and costly regulation**

4. **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**
   - **Historically extremely costly to p/c insurance industry**

Source: Insurance Information Inst.

10 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
- "Price Elasticity of Capital" is too weak (low)
- 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 Loss of Investment Return

- **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 not readily accept it*; Many will reject it**
- **Implication 1: Industry must be prepared to operate in environment with investment earnings accounting for a smaller fraction of profits**
- **Implication 2: Implies underwriting discipline of a magnitude not witnessed in this industry in more than 30 years. Yet to manifest itself.**
- **Lessons from the period 1920-1975 need to be relearned**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

4. Economic Collapse

- Long-term decline in industry growth prospects similar to the 1930s
- Collapse does *not* imply inability to remain profitable
- Industry in 1930s shrank but became profitable
- Some insurers will not survive due to combination of poor investment environment, operating underwriting challenges and capital depletion
- Policyholder behavior will change; <u>*Need Mitigation Strategies*</u>
  - Coverages dropped, limits lowered, higher deductibles
  - Properties not well maintained; more vacant/abandoned properties
  - More uninsured motorists (already happening)
  - Insurance fraud will increase (anecdotal evidence mounting)
- Property crime will increase (burglary, auto theft)
- Wholesale destruction of wealth (happening now)
- Loss of retirement security (deepening)
- **Bottom Line: Industry can survive deep and prolonged economic downturn, but not without casualties**

Source: Insurance Information Inst.

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

5. 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 (e.g., AIG)**
- ➢ **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

6. 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

7. Exploitation of Insurance as a Wealth Redistribution Mechanism

- There is a longstanding history of attempts to use insurance to advance wealth redistribution/economic agendas
- Attacks on underwriting criteria such as credit, education, occupation and territory have been targeted in the past
- Urban subsidies; Coastal subsidies
- Insurer focus on underwriting profitability (resulting in higher rates) coupled with poor economic conditions could raise profile of affordability issue
- Calls for "excess profits tax" on insurers (during next cycle or post-cat)
- Increased government involvement in insurance (including ownership stakes) make this more likely
- Federal regulation could impose such redistribution schemes
- Bottom Line: Expect efforts to address social and economic inequities through insurance

Source: Insurance Information Inst.

Important Issues & Threats Facing P/C Insurers: 2009 - 2015

8. Mega-Catastrophe Losses

- **$100B CAT year is not improbably over the next 5-7 year**
- **Severity trend remains upward**
- **Frequency trends highly variable but more prone to spikes**
- **FINANCING: Unclear if sufficient capital exists to finance mega-cats in current capital constrained environment**
- **Concern over reinsurance capacity and pricing**
- **Alternative sources of CAT financing have dried up**
- **CAT bonds less attractive; *Willow Re example***
- **Some regulators will continue to suppress rates**
- **Residual markets shares remain high**
- **Loss of volume for private insurers in key states (e.g., FL)**
- ***Serves as entry point for socialization of insurance***
- **Bottom Line: Capacity to finance mega-cats is diminished. Government may fill the void, sometimes with the industry's support; sometimes in spite of opposition**

Important Issues & Threats Facing Insurers: 2009 -2015

9. Creeping Socialization and Partial Nationalization of Insurance System

- CAT risk is, on net, being socialized directly via state-run insurance and reinsurance mechanisms or via elaborate subsidy schemes involving assessments, premium tax credits, etc.
- Some (life) insurers beyond AIG asking for TARP money
- Efforts to expand flood program to include wind
- Health insurance may be substantively socialized
- Terrorism risk—already a major federal role backed by insurers
- Eventually impacts for other lines such as personal auto liability,WC?
- Feds may open to more socialization of private insurance risk
- Ownership stakes in some insurers could be a slippery slope
- Despite best efforts of companies like State Farm to charge risk appropriate premiums, withdrawal becomes business imperative and leads to greater socialization
- States like FL will lean heavily on Washington in the event of a mega-cat that threatens state finances
- Bottom Line: Additional socialization likely. Can insurers/will insurers draw the line?

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 -2015

10. 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**

Source: Insurance Information Inst.

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 leveling off
  - 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—Still a Bumpy Ride
  - Home are much more affordable (attracting buyers)
  - Mortgage rates are at multi-decade lows (attracting buyers)
  - Freefall in housing starts and existing home sales is ending
- Inflation & Energy Prices Are Under Control
- Consumer & Business Debt Loads Are Shrinking

Source: Ins. Info. Inst.

10 Industries for the Next 10 Years: Insurance Solutions Needed

Government

Education

Health Care

Energy (Traditional)

Alternative Energy

Agriculture

Natural Resources

Environmental

Technology

Light Manufacturing

THE $787 BILLION ECONOMIC STIMULUS

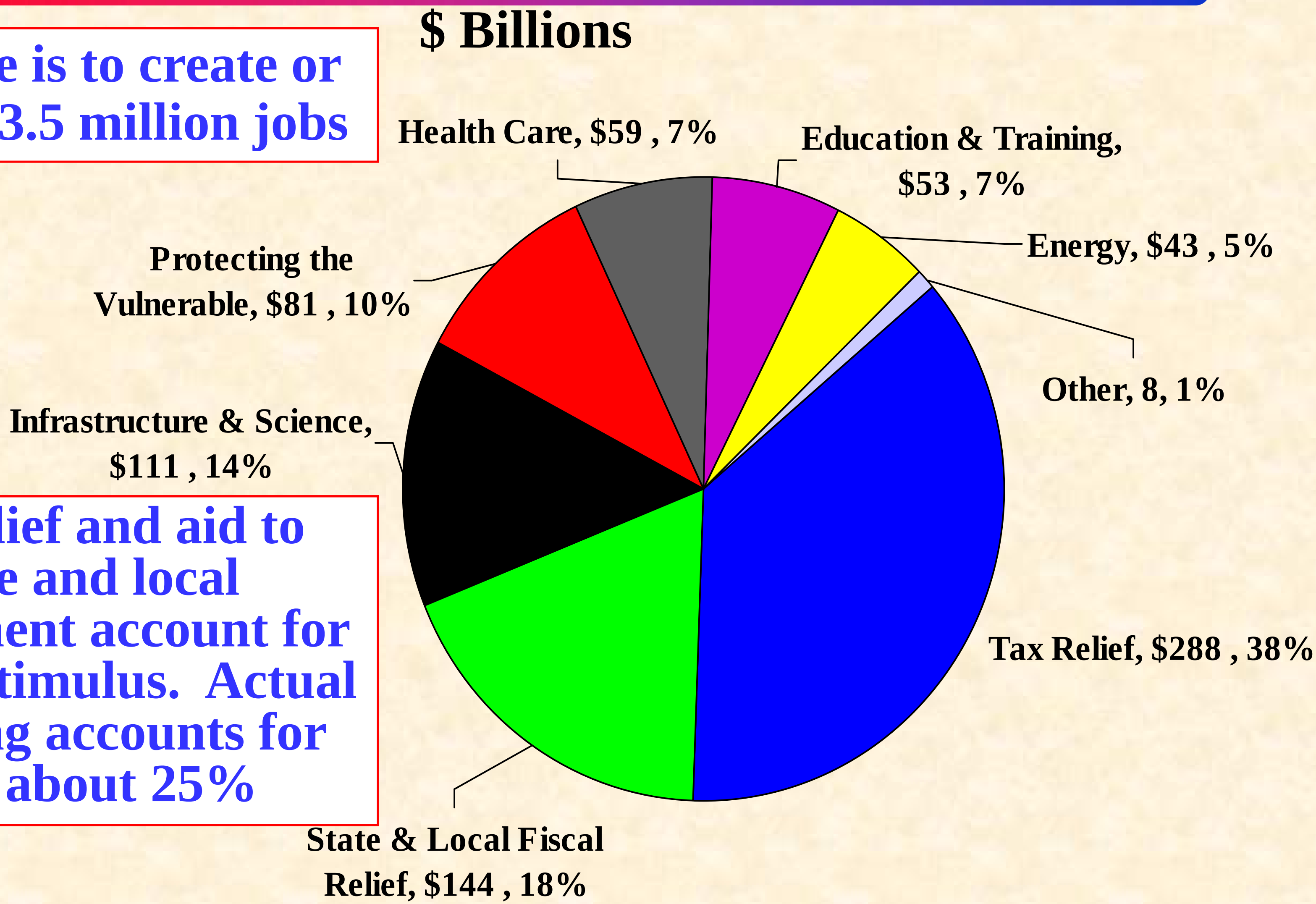
Sectoral Impacts & Implications for P/C Insurance

Summary of Short-Run Impacts of Stimulus Package on P/C Insurance

- **No Stimulus Provisions Specifically Address P/C Insurance**
  - **Spending, Aid and Tax Reductions benefit other industries, state and local governments, as well as individual and some corporate taxpayers**
- **Stimulus Package is Unlikely to Increase Net Premiums Written by More Than 1% or Approx. $4.5 Bill. by Year-End 2010**
- **"Direct" Impact to P/C Insurers Results Primarily from Increased Demand for Commercial Insurance**
  - **Primarily the result of increased infrastructure spending and the resulting need to insure workers, property and protect against liability risks**
  - **Because the primary objective of the stimulus is employment related, workers compensation will be the p/c line that benefits the most**
  - **Assuming the target of 3.5 million jobs created or preserved is achieved, private workers comp NPW (new and preserved) could amount to as much as $1.1 billion**
  - **Other commercial lines to benefit: surety, commercial auto, inland marine**
- **Other "Direct" P/C Demand Benefits Will Be Minimal**
  - **Tax provisions providing incentives to buy cars and homes and accelerate the depreciation of equipment will have little net impact on exposure**
  - **Some additional premium may be generated as older cars and equipment are replaced with new and more valuable (and therefore more expensive to insure)**

Economic Stimulus Package: Where the $787B Goes

Objective is to create or preserve 3.5 million jobs

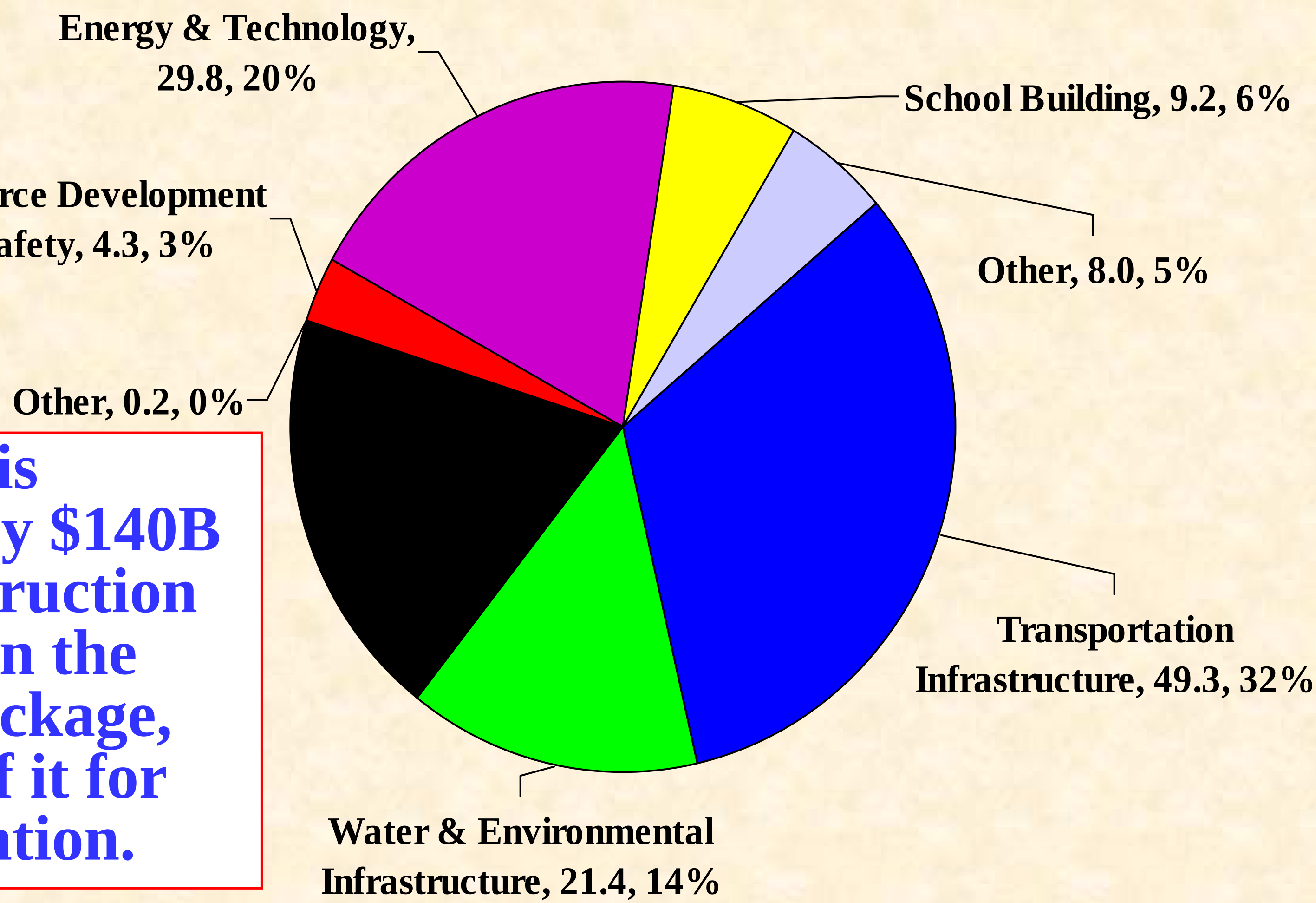


Tax relief and aid to state and local government account for 56% of stimulus. Actual spending accounts for only about 25%

Source: http://www.recovery.gov/ accessed 2/18/09; Insurance Information Institute.

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..

State-by-State Infrastructure Employment & Spending Impacts

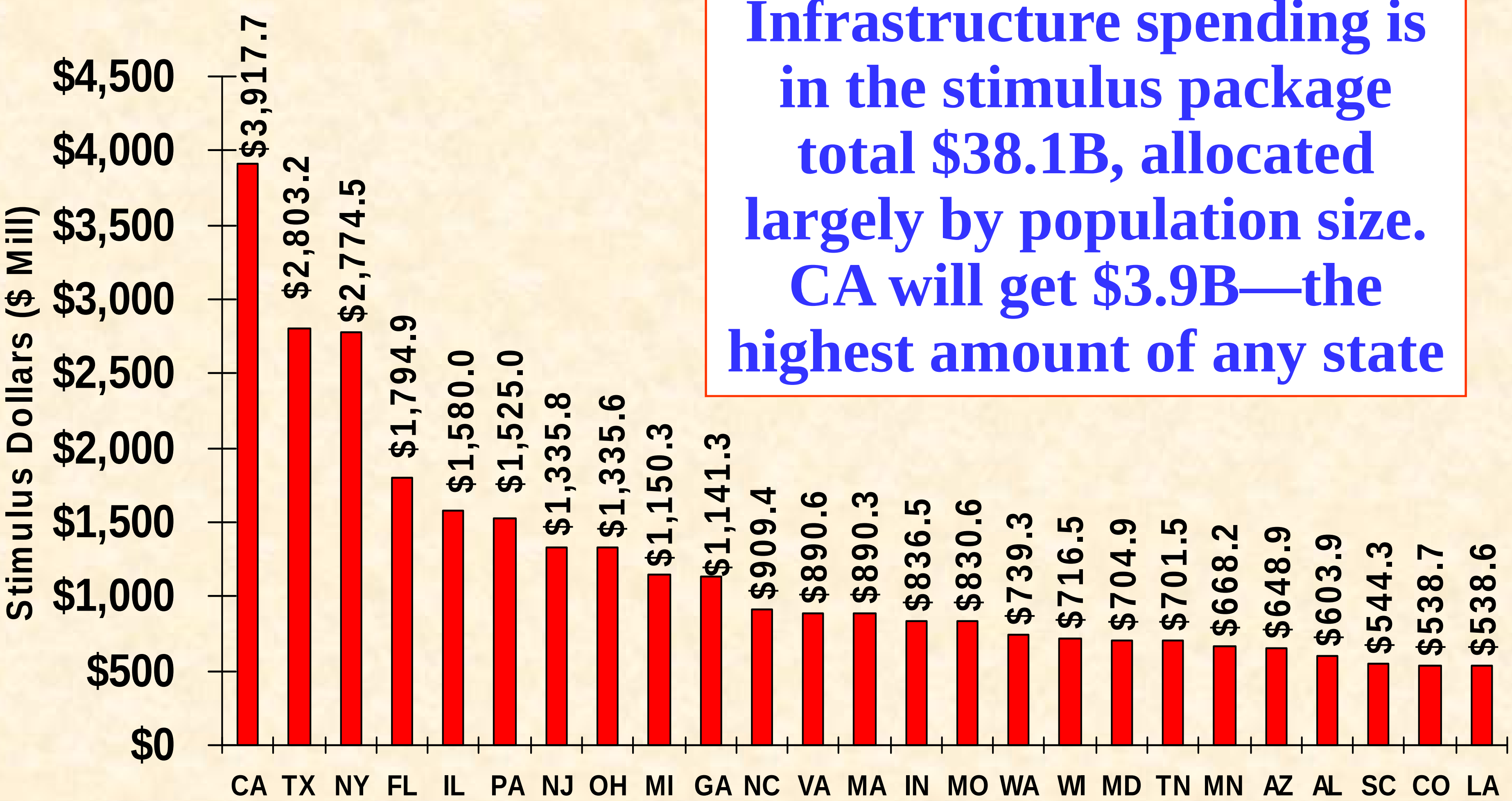
Bigger States Get More, Should Benefit WC Insurers the Most

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

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

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

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

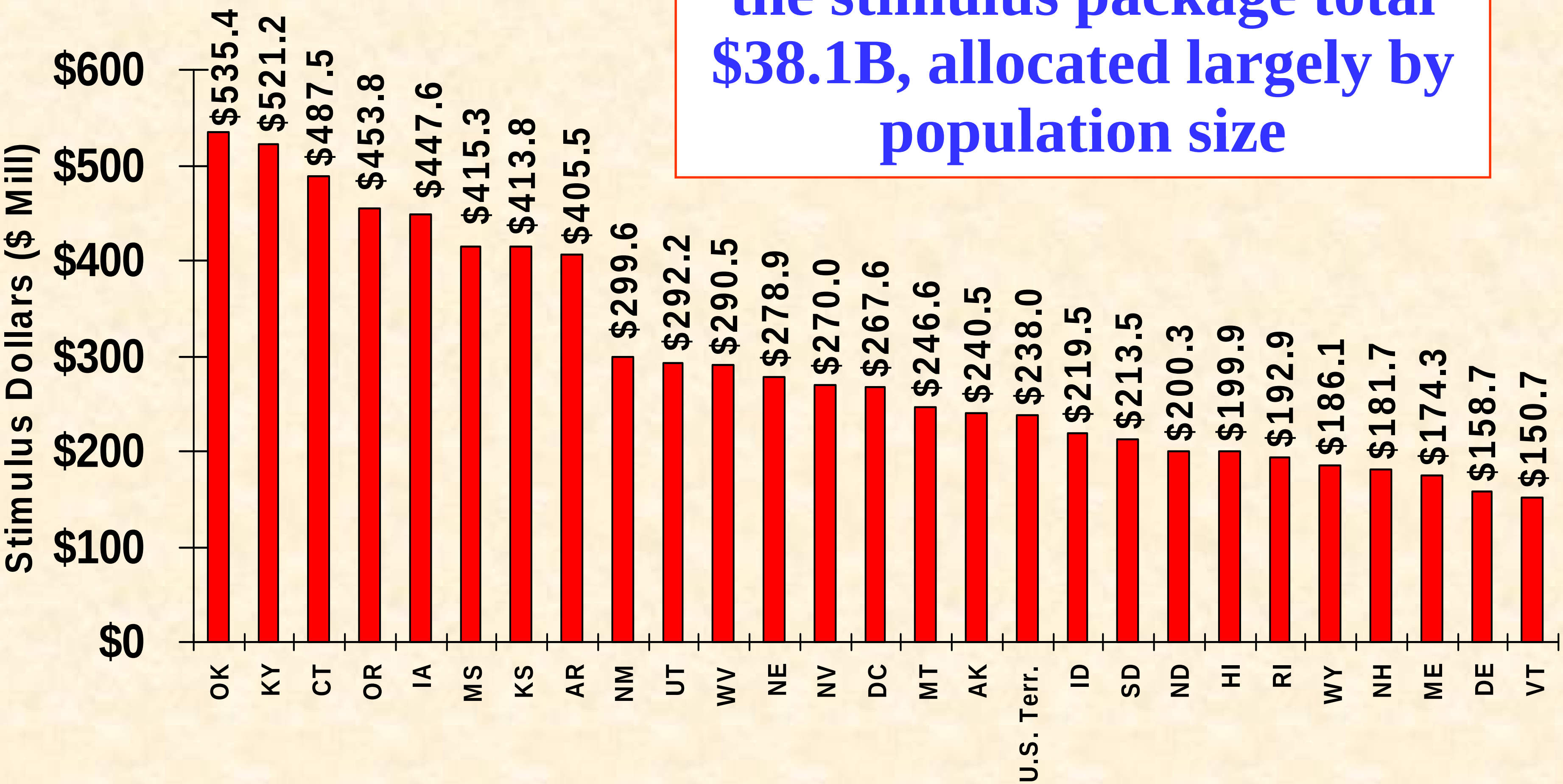


Infrastructure spending is in the stimulus package total $38.1B, allocated largely by population size. CA will get $3.9B—the highest amount of any state

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

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

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



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

Expected Number of Jobs Gained or Preserved by Stimulus Spending

Larger States = More Jobs
Workers Comp Benefits

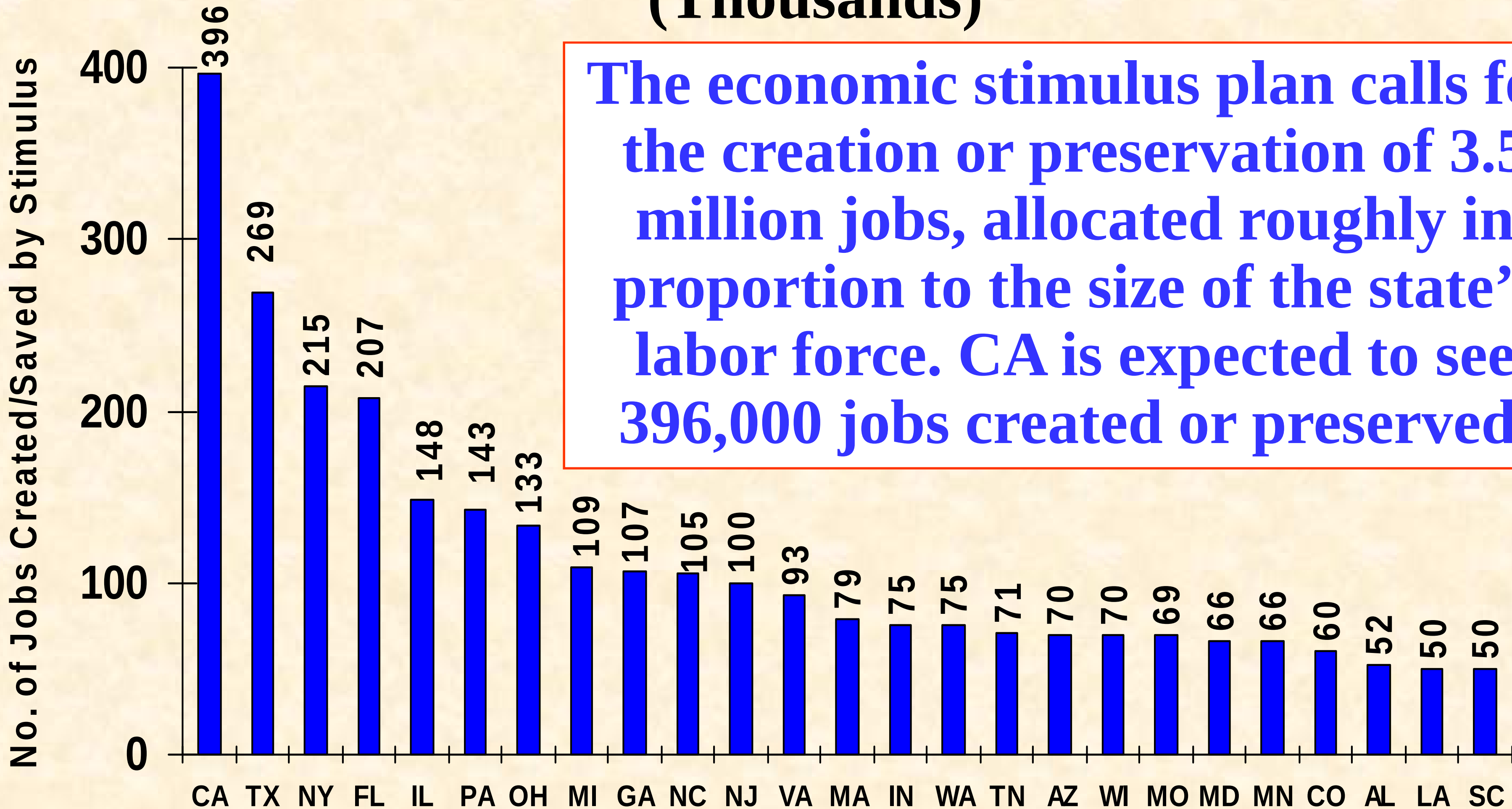
Estimated Job Effect of Stimulus: Jobs Created/Saved By State = 3.5 Mill Total

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

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

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

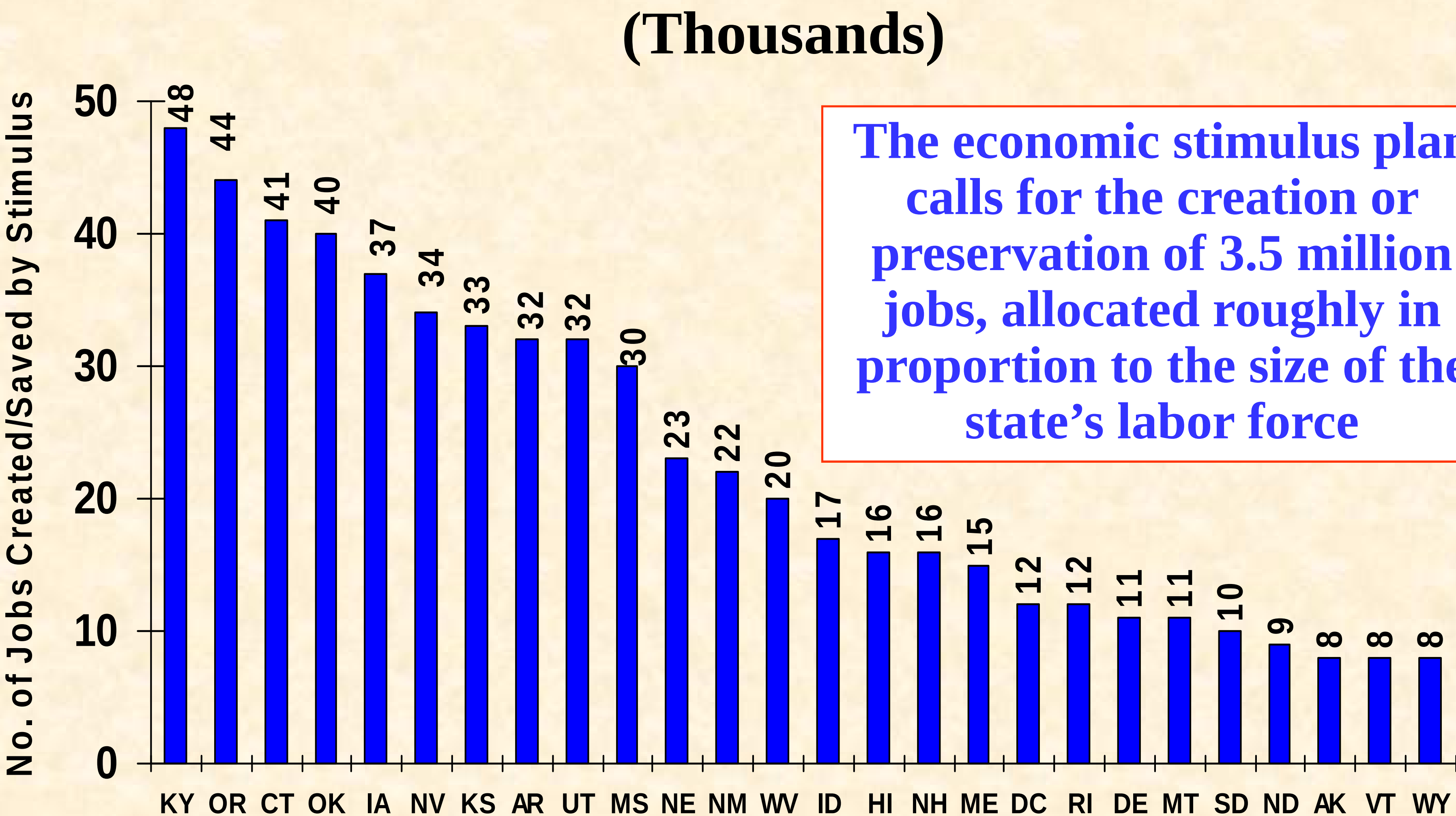
(Thousands)



The economic stimulus plan calls for the creation or preservation of 3.5 million jobs, allocated roughly in proportion to the size of the state's labor force. CA is expected to see 396,000 jobs created or preserved.

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

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



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

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

Stimulus: Reading The Economic Tea Leaves for the Next 4 to 8 Years

- **Growing Role of Government: 2009 Stimulus Package and Other Likely Spending Initiatives Guarantee that Government Will Play a Much Larger Role Than at Any Other Time in Recent History**
  - **Every industry, including insurance, will and must attempt to maximize direct and indirect benefits from this paradigm shift**
- **Obama Administration Priorities: Stimulus Package Acts as "Economic Tea Leaf" on the Administration's Fiscal Priorities for the Next Several Years**
- **These Include:**
  - **Alternative Energy**
  - **Health Care**
  - **Education**
  - **Aging/New Infrastructure**
  - **Environment**
- **Stimulus is Only One Leg of the Stool**
  - **(1) Stimulus; (2) Housing, and (3) Financial Services Reform**

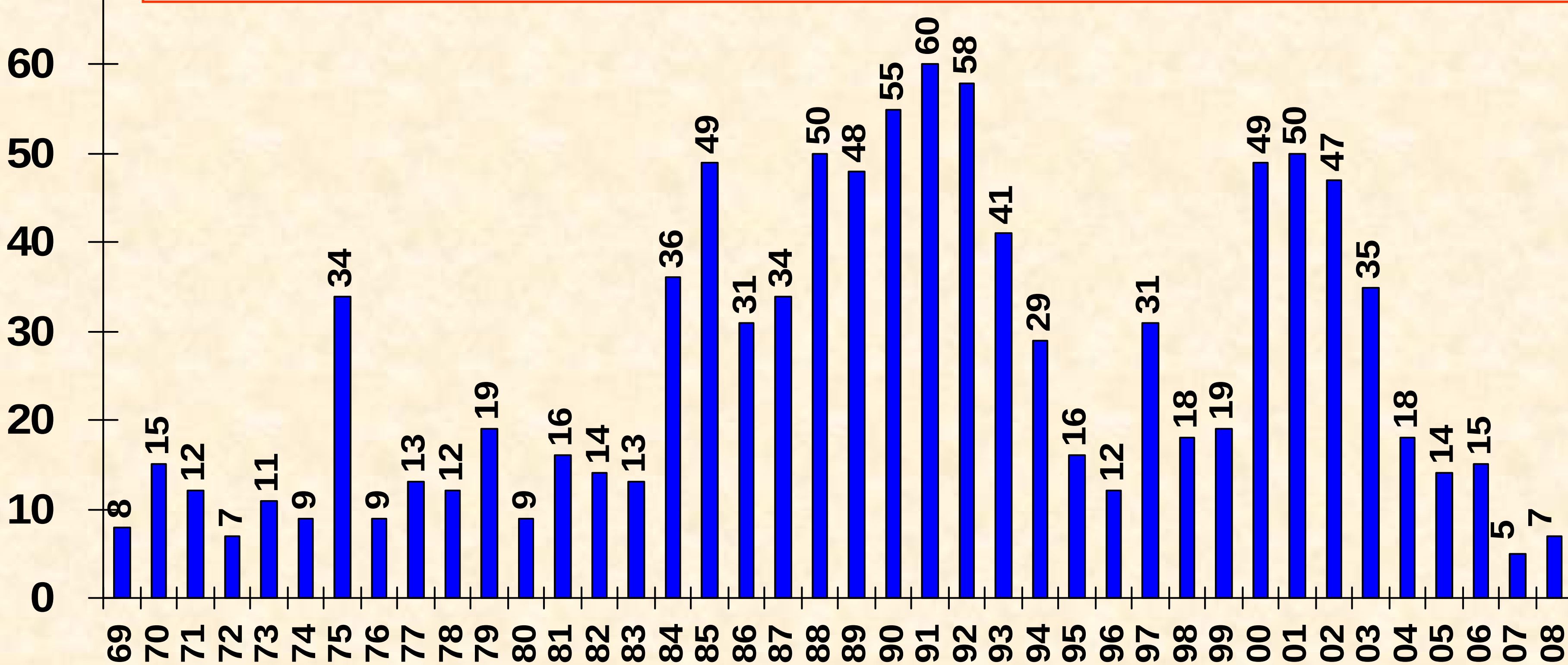
Source: Insurance Information Institute

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well

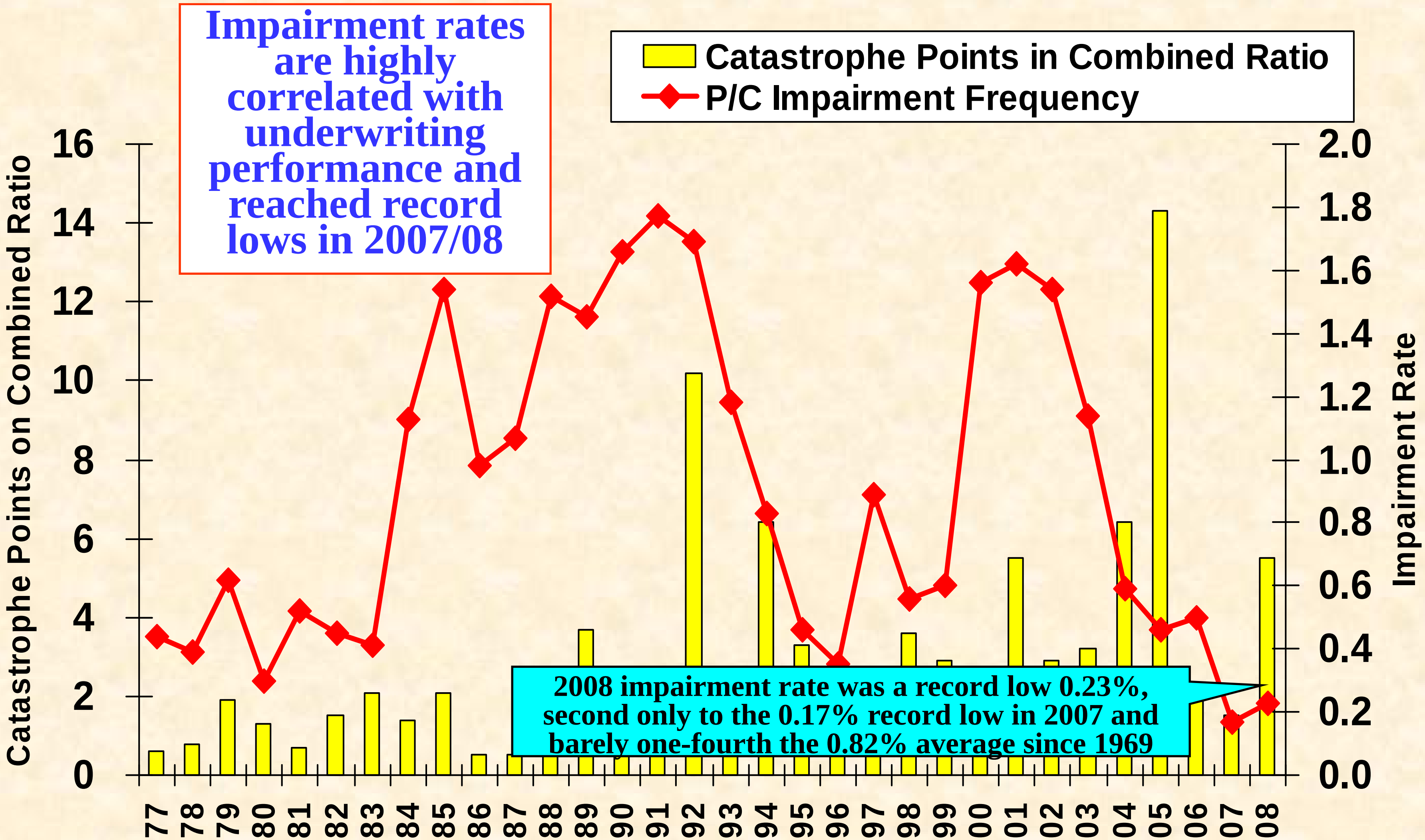
P/C Insurer Impairments, 1969-2008

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



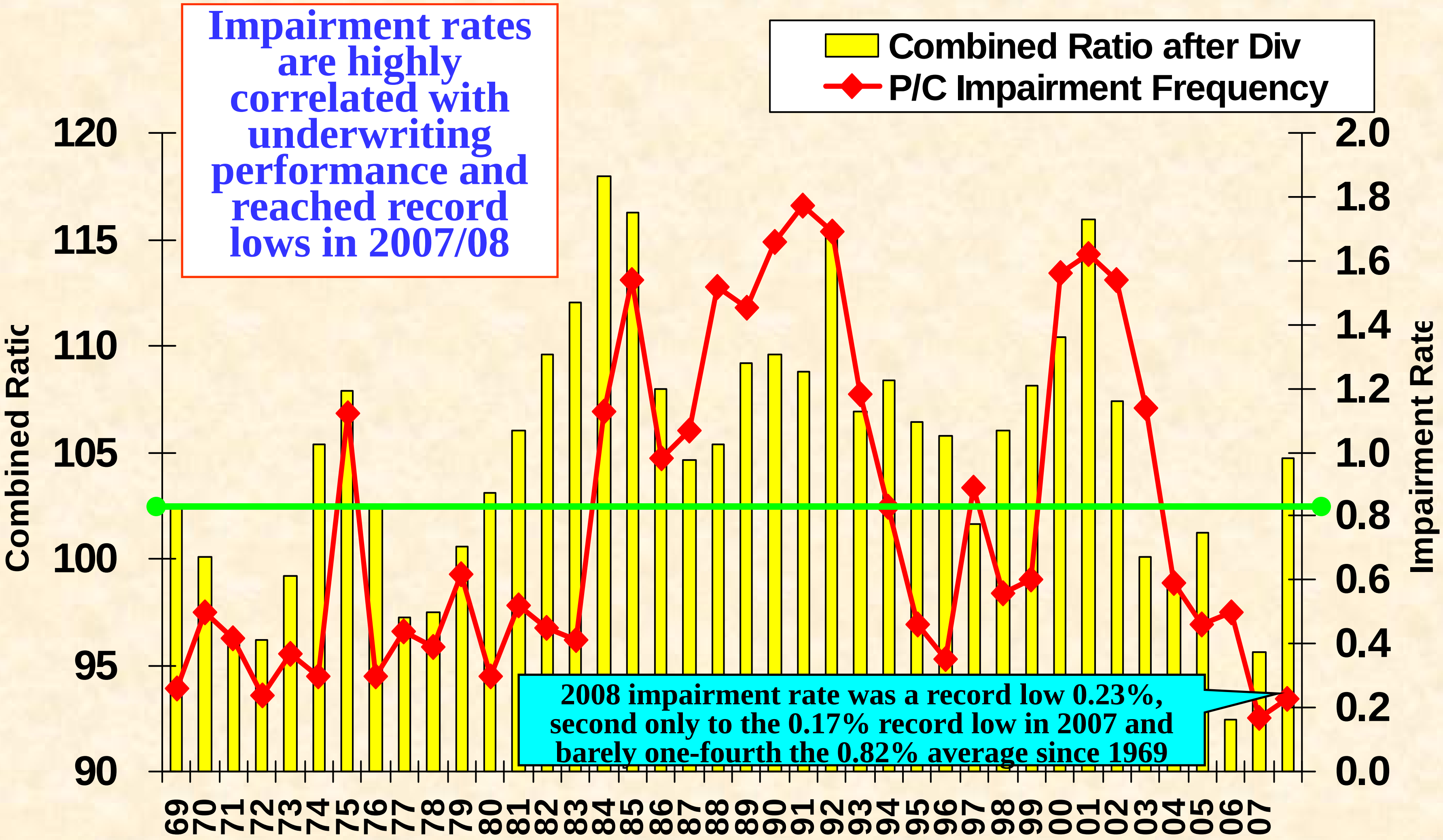
Source: A.M. Best; Insurance Information Institute

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



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

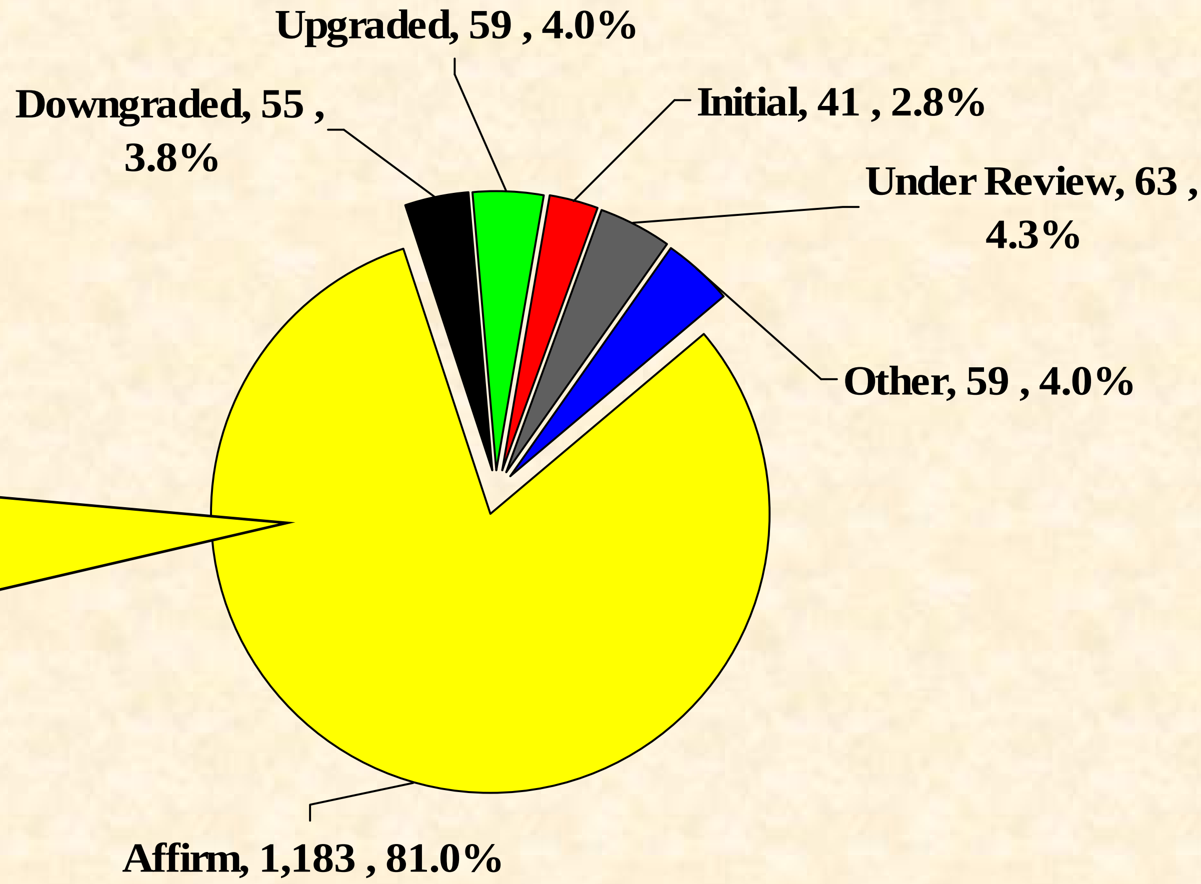
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2008



Source: A.M. Best; Insurance Information Institute

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

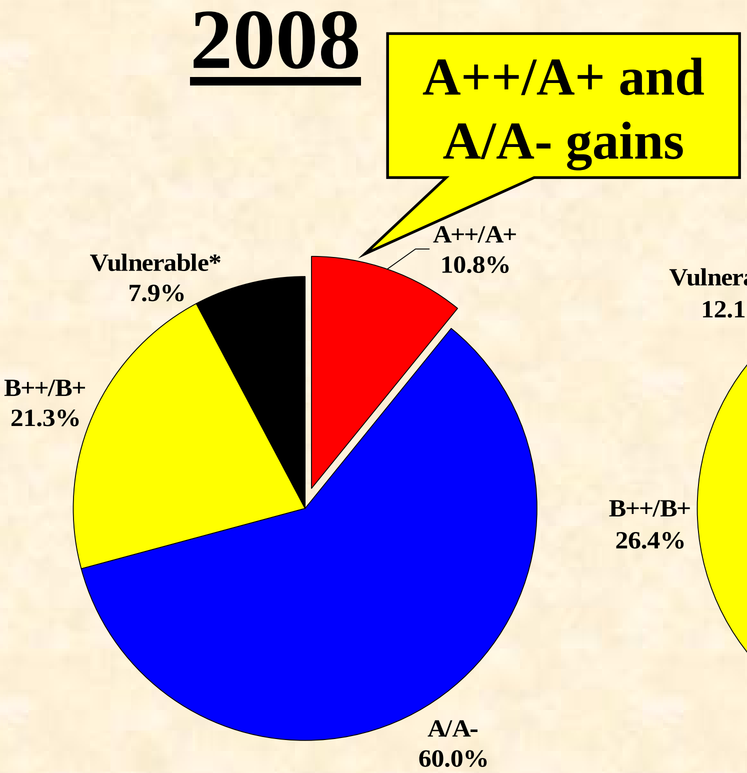
P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.

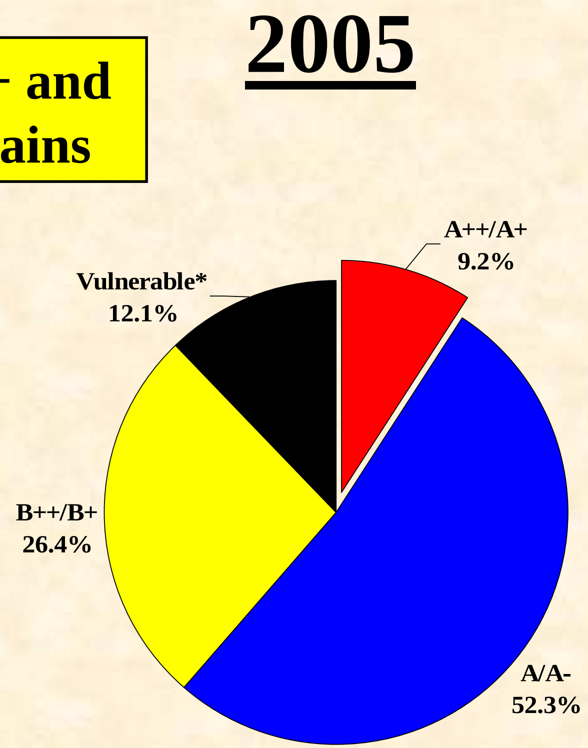


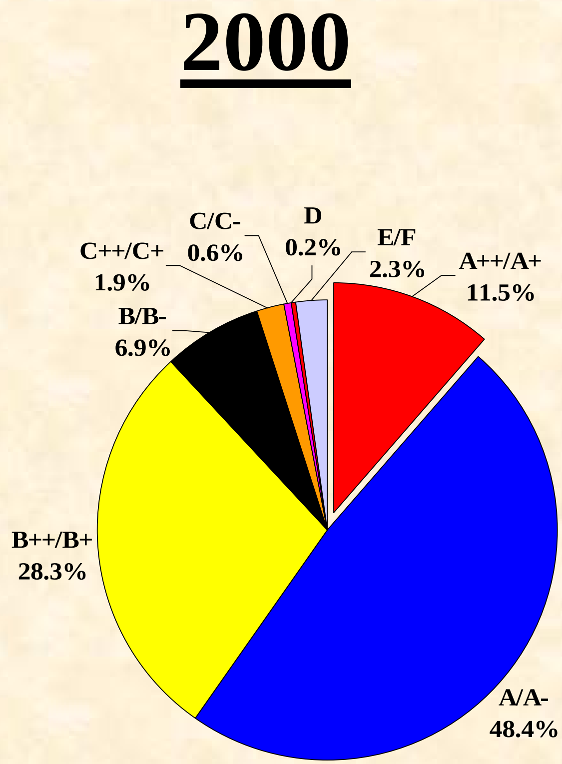
Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades

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

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



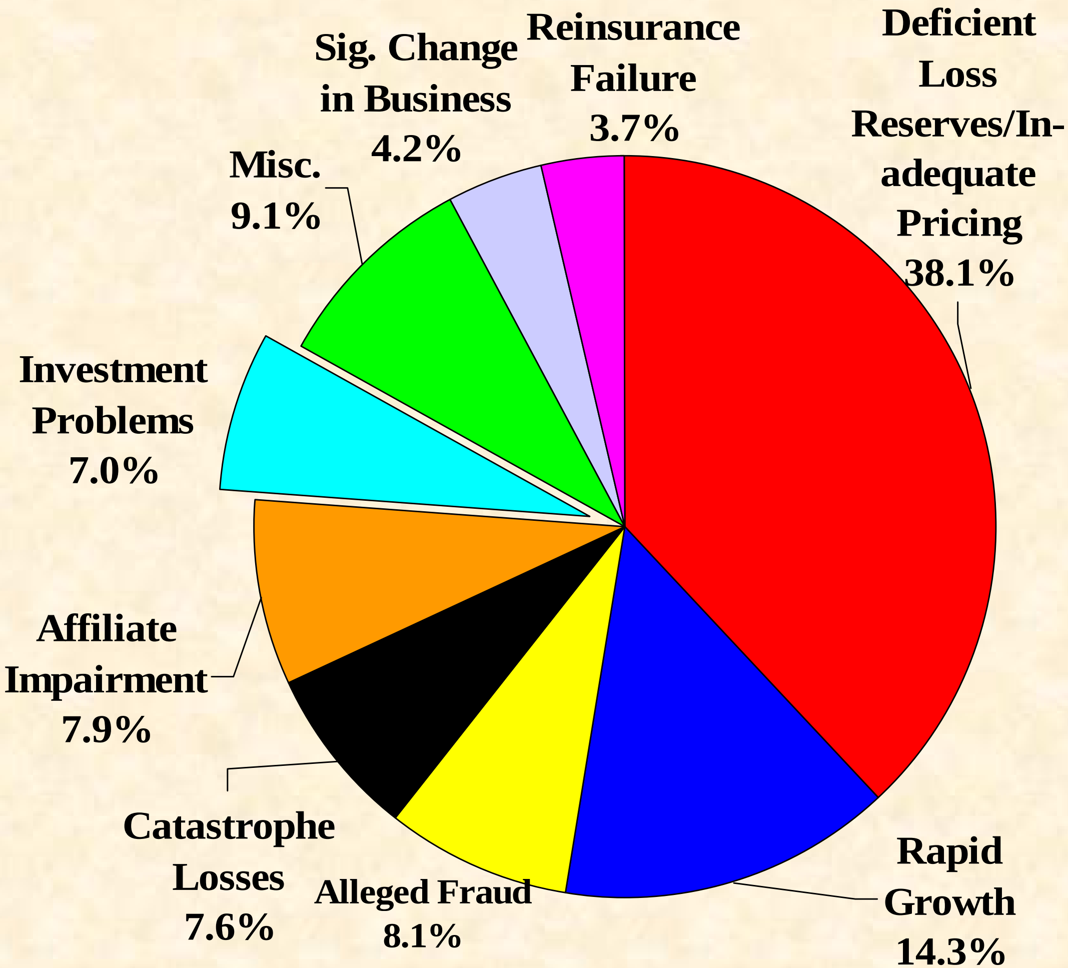




P/C insurer financial strength has improved since 2005 despite financial crisis

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 57 banks have gone under as of 5/1)**
    - ***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

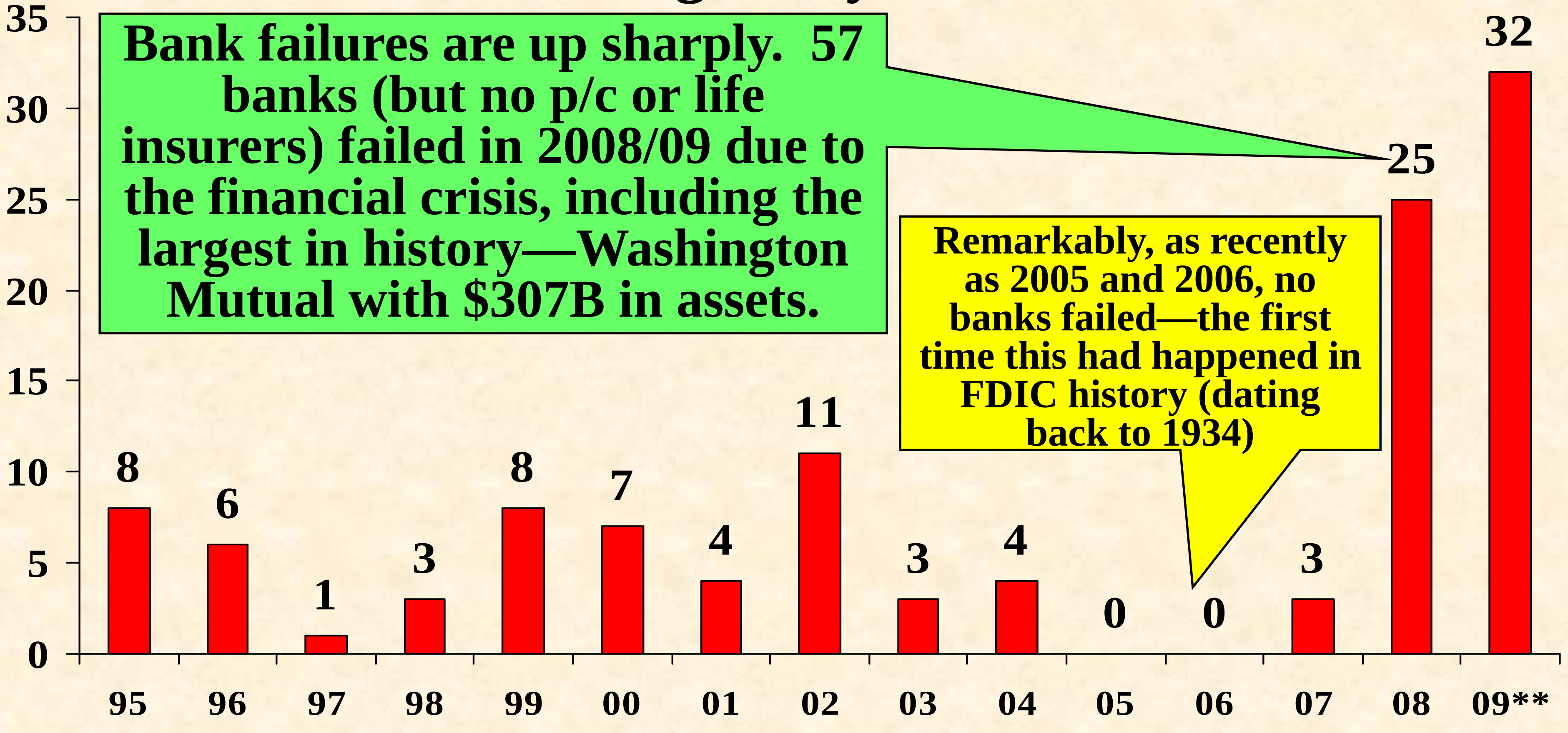
Reasons Why P/C Insurers Have Fewer Problems Than Banks: A Superior Risk Management Model

- ***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

US Bank Failures:* 1995-2009**

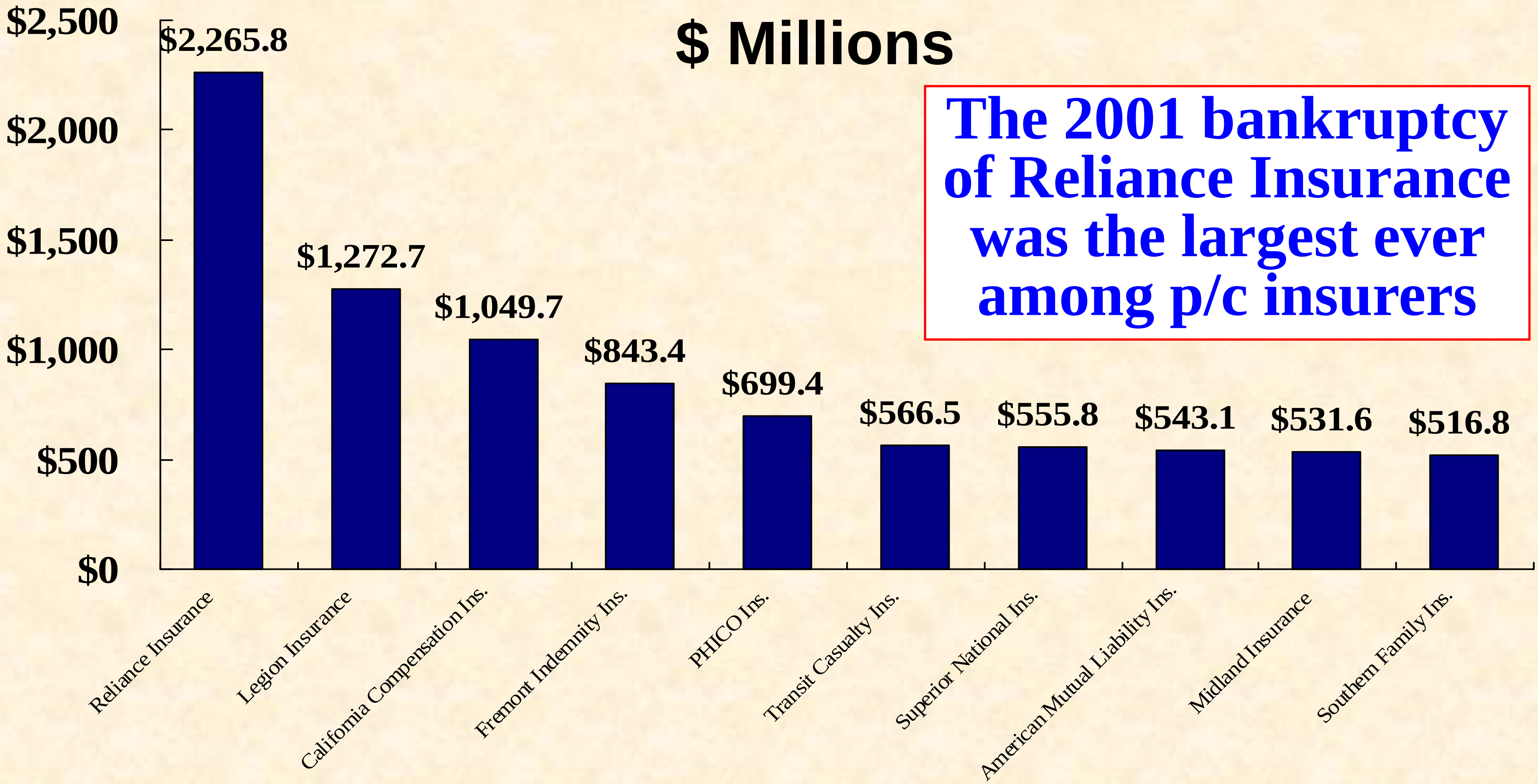
Through May 1, 2009



*Includes all commercial banking and savings institutions. **Through May 1.

Source: FDIC: http://www.fdic.gov/bank/historical/bank/index.html; Insurance Info. Institute

Top 10 P/C Insolvencies, Based Upon Guaranty Fund Payments*



The 2001 bankruptcy of Reliance Insurance was the largest ever among p/c insurers

* Disclaimer: This is not a complete picture. If anything the numbers are understated as some states have not reported in certain years.

Source: National Conference of Insurance Guaranty Funds, as of September 17, 2008.

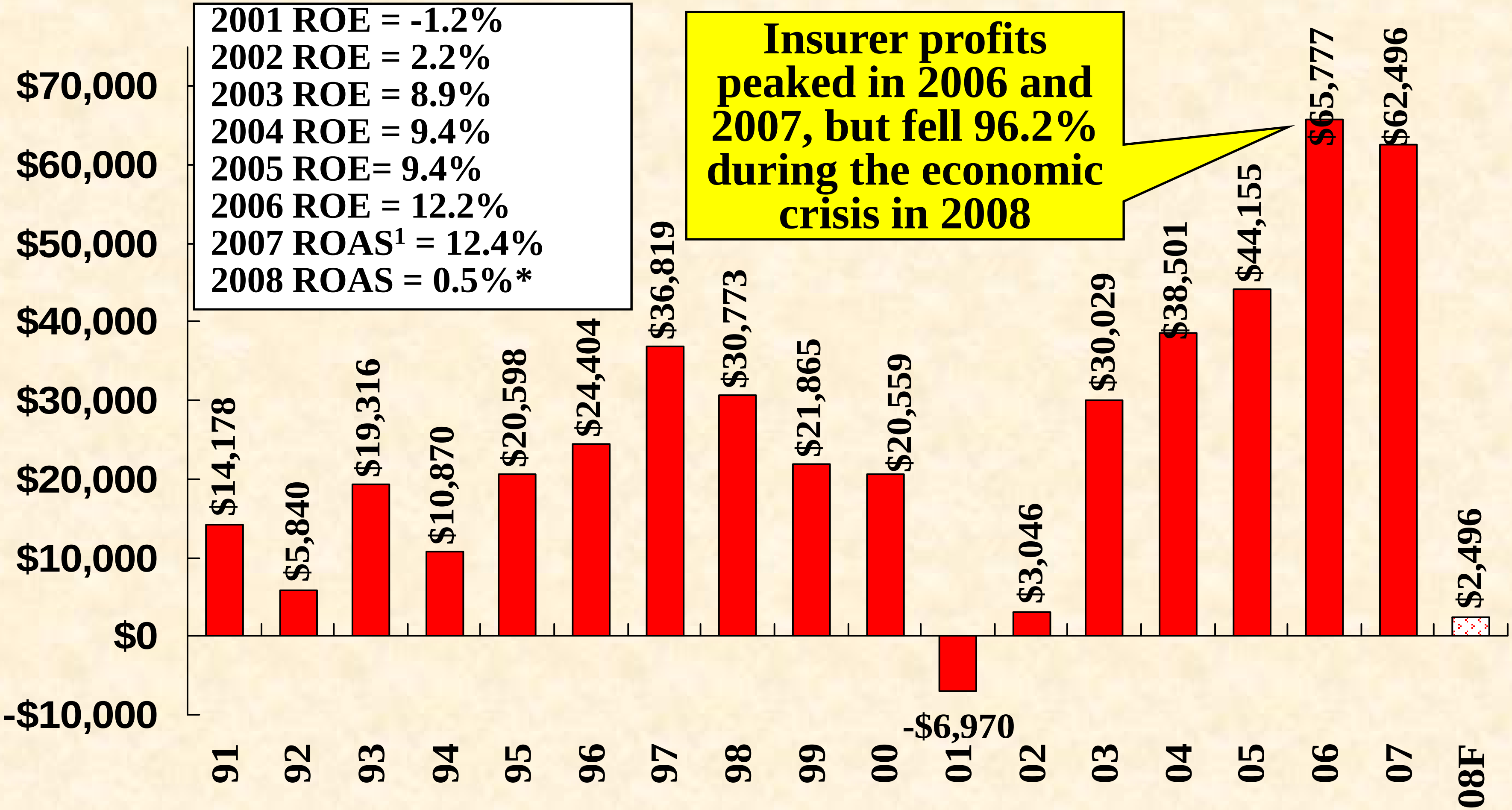
P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

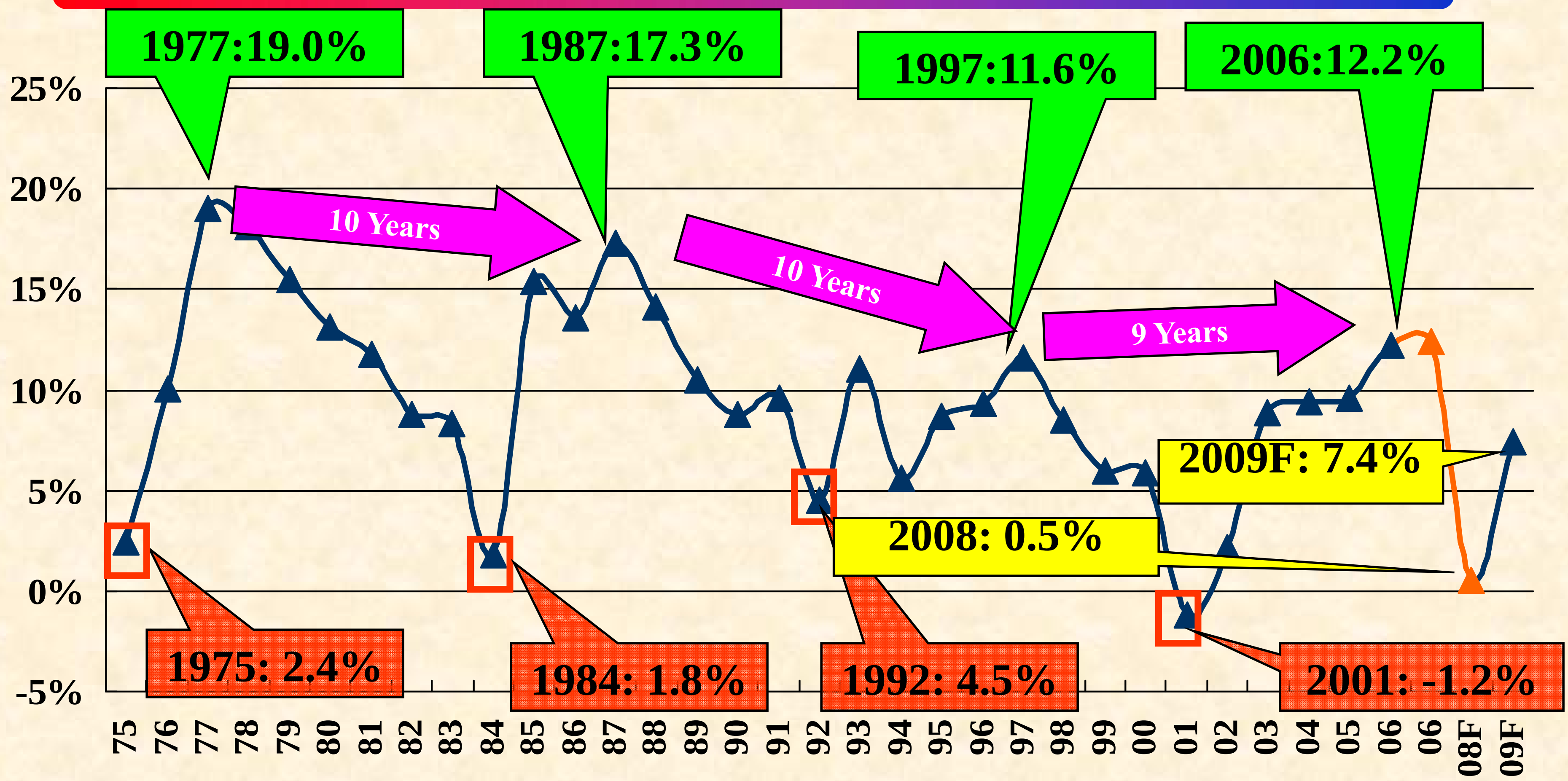
Historically Volatile

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



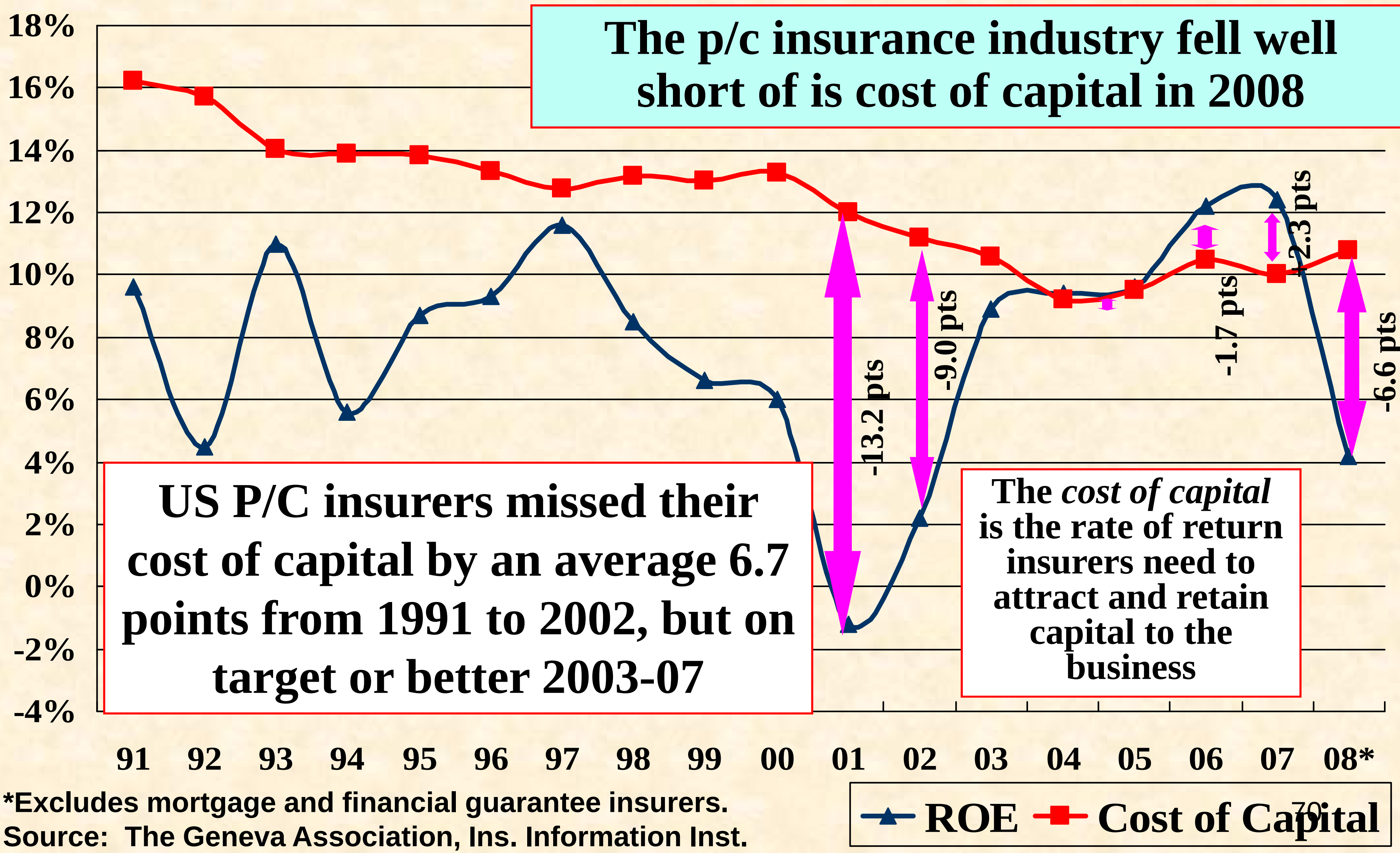
***ROE figures are GAAP; [1]Return on avg. Surplus. Excluding Mortgage & Financial Guarantee insurers yields an 4.2% ROAS for 2008.**
Sources: A.M. Best, ISO, Insurance Information Inst.

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



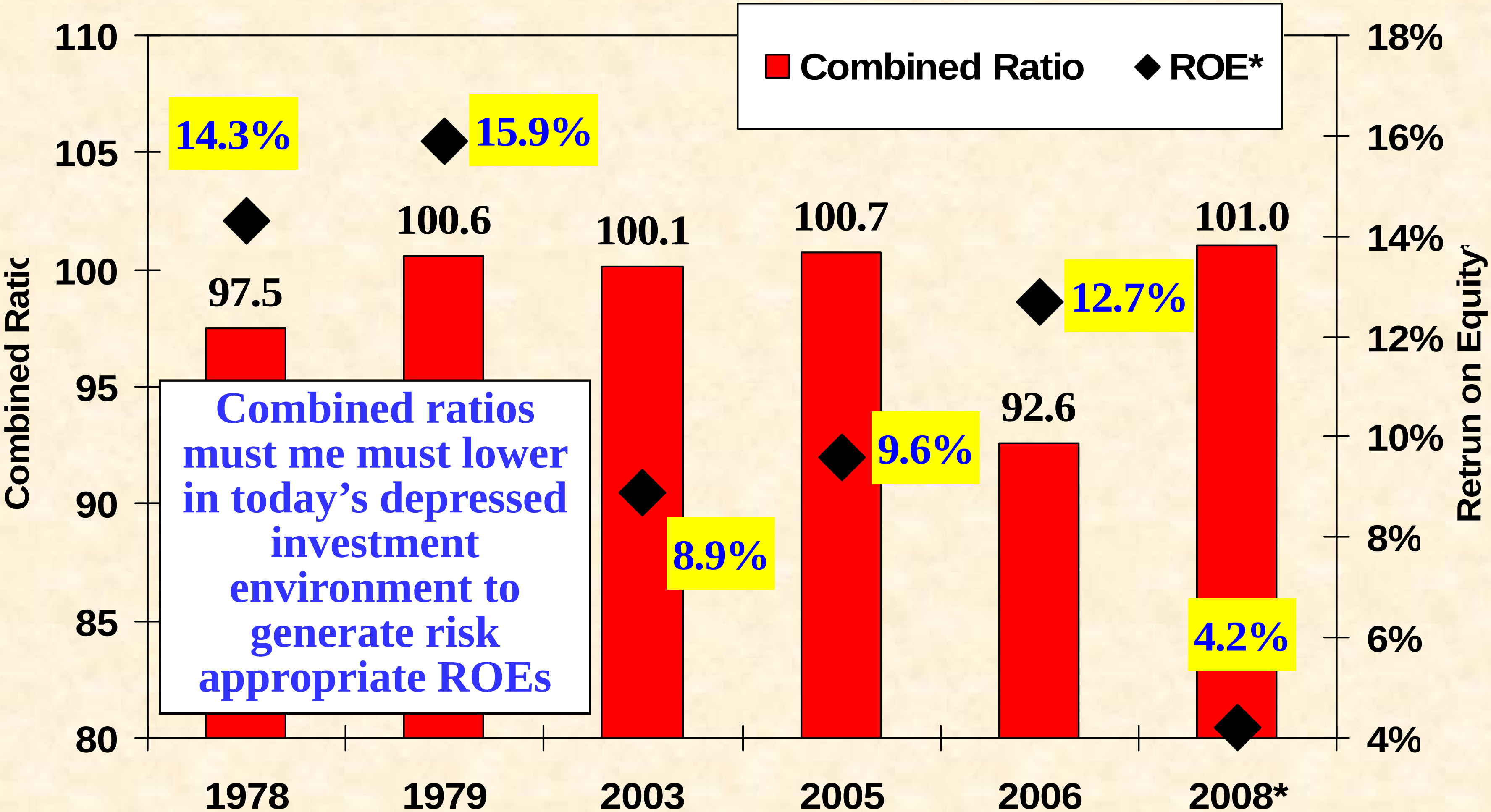
Note: 2008 result excluding Mortgage & Financial Guarantee insurers is 4.2%.
Sources: ISO; A.M. Best (2009F); Insurance Information Institute.

ROE vs. Equity Cost of Capital: US P/C Insurance:1991-2008



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

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



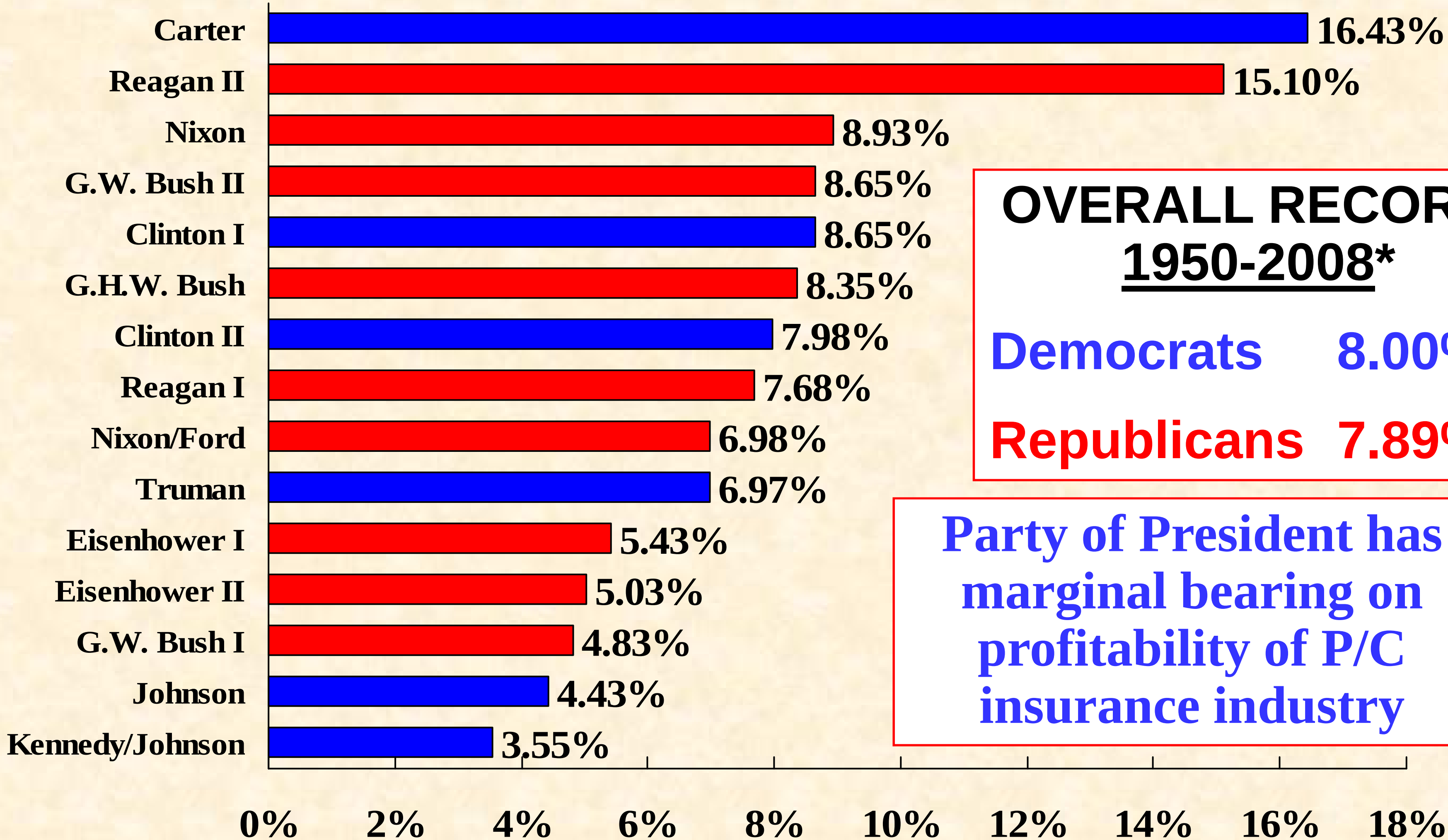
* 2008 figure is return on average statutory surplus. Excludes mortgage and financial guarantee insurers.

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

Presidential Politics & P/C Insurance

How is Profitability Affected by the President's Political Party?

P/C Insurance Industry ROE by Presidential Administration,1950-2008*



OVERALL RECORD: 1950-2008*

Democrats	8.00%
Republicans	7.89%

Party of President has marginal bearing on profitability of P/C insurance industry

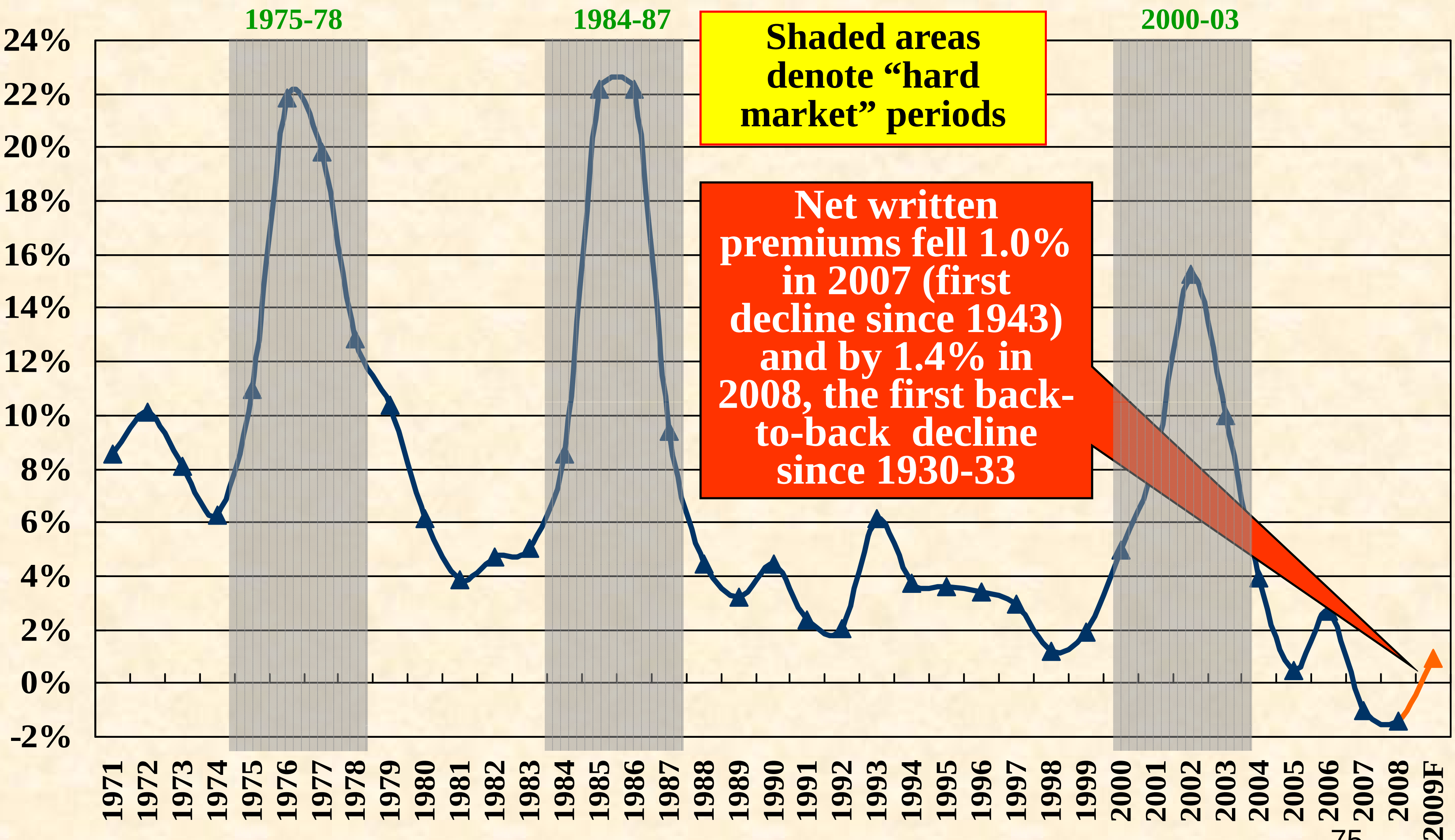
*Truman administration ROE of 6.97% based on 3 years only, 1950-52.

Source: Insurance Information Institute

P/C Premium Growth

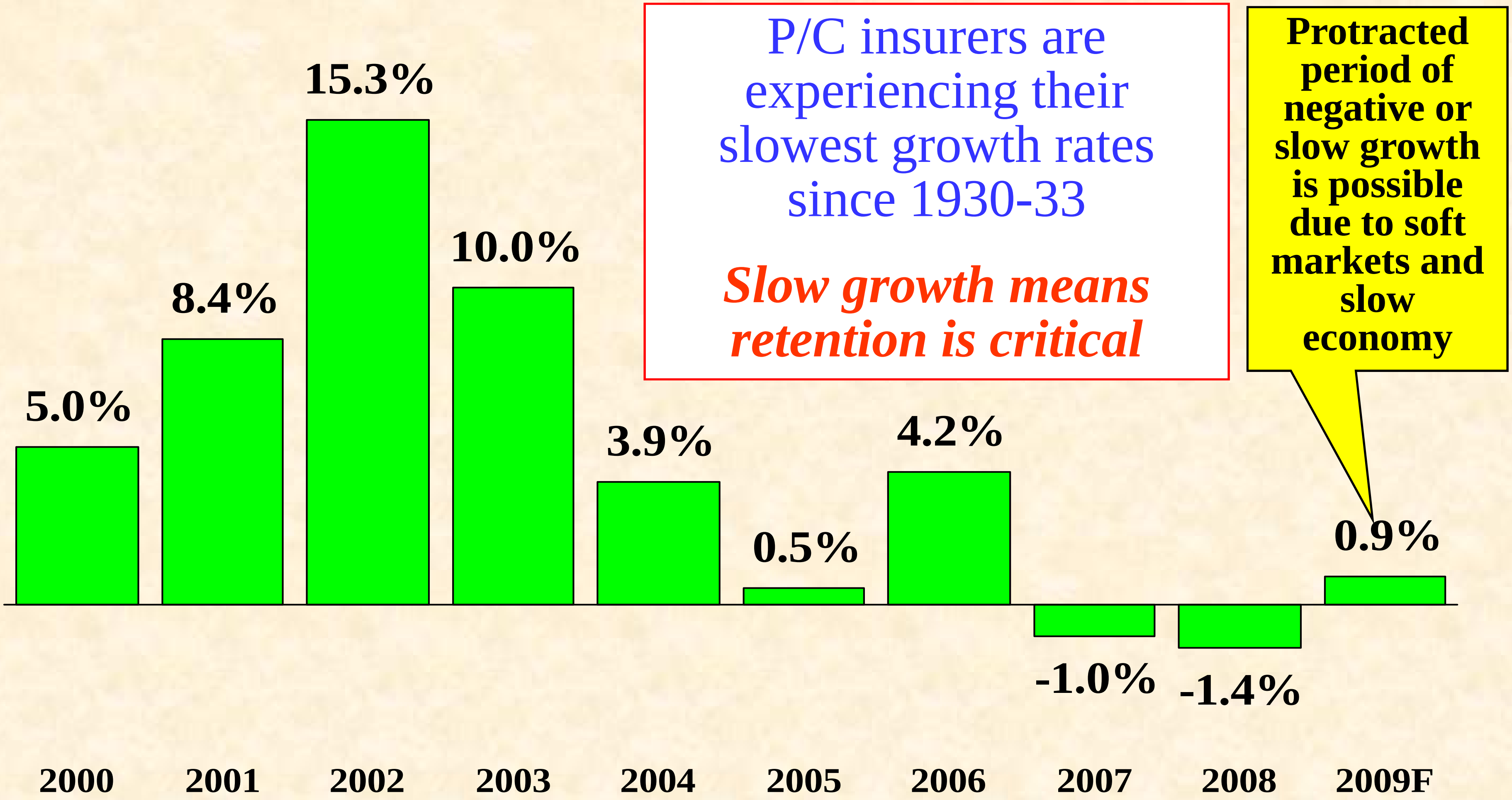
Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Strength of Recent Hard Markets by NWP Growth



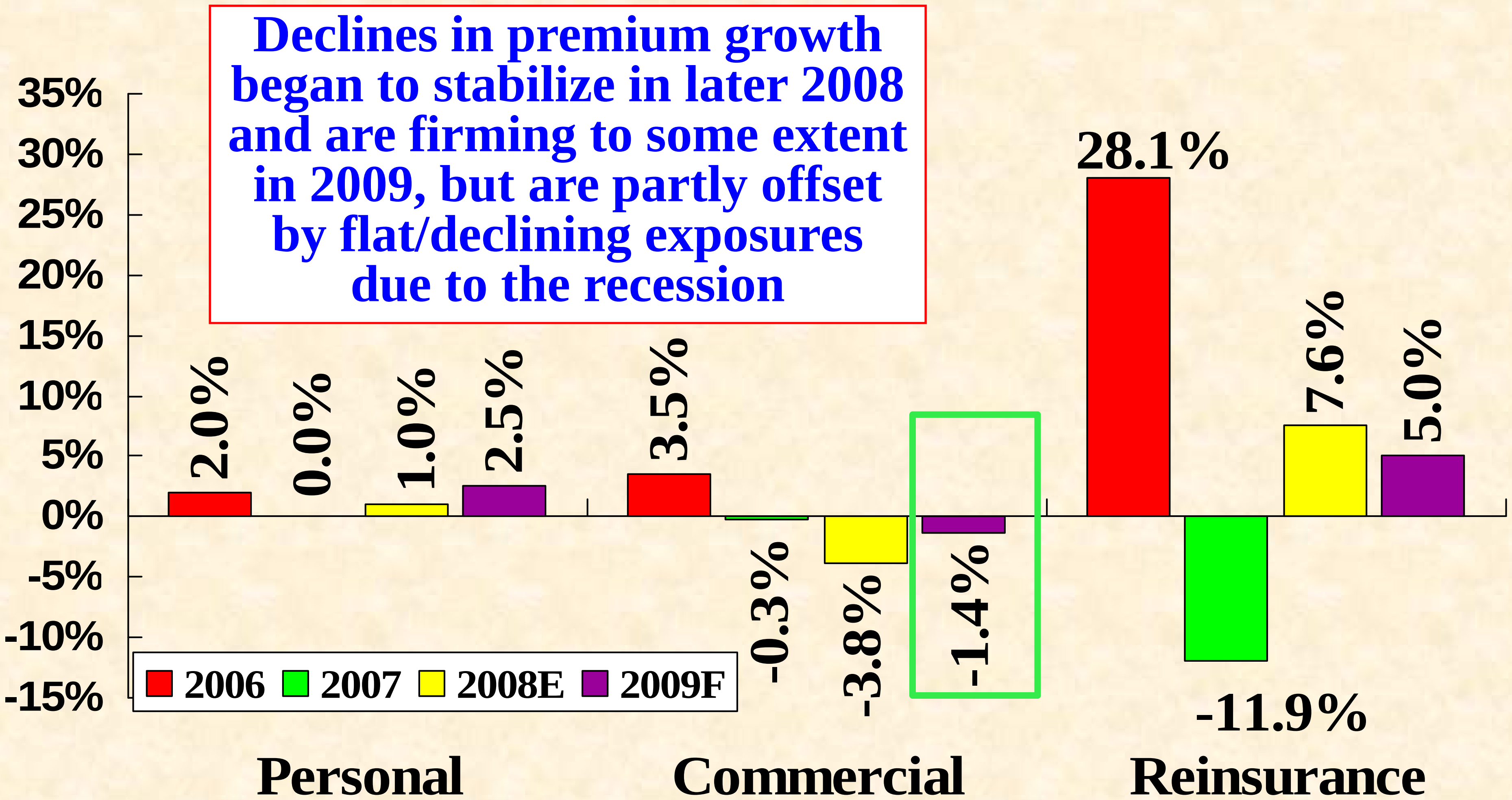
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute

Year-to-Year Change in Net Written Premium, 2000-2009F*



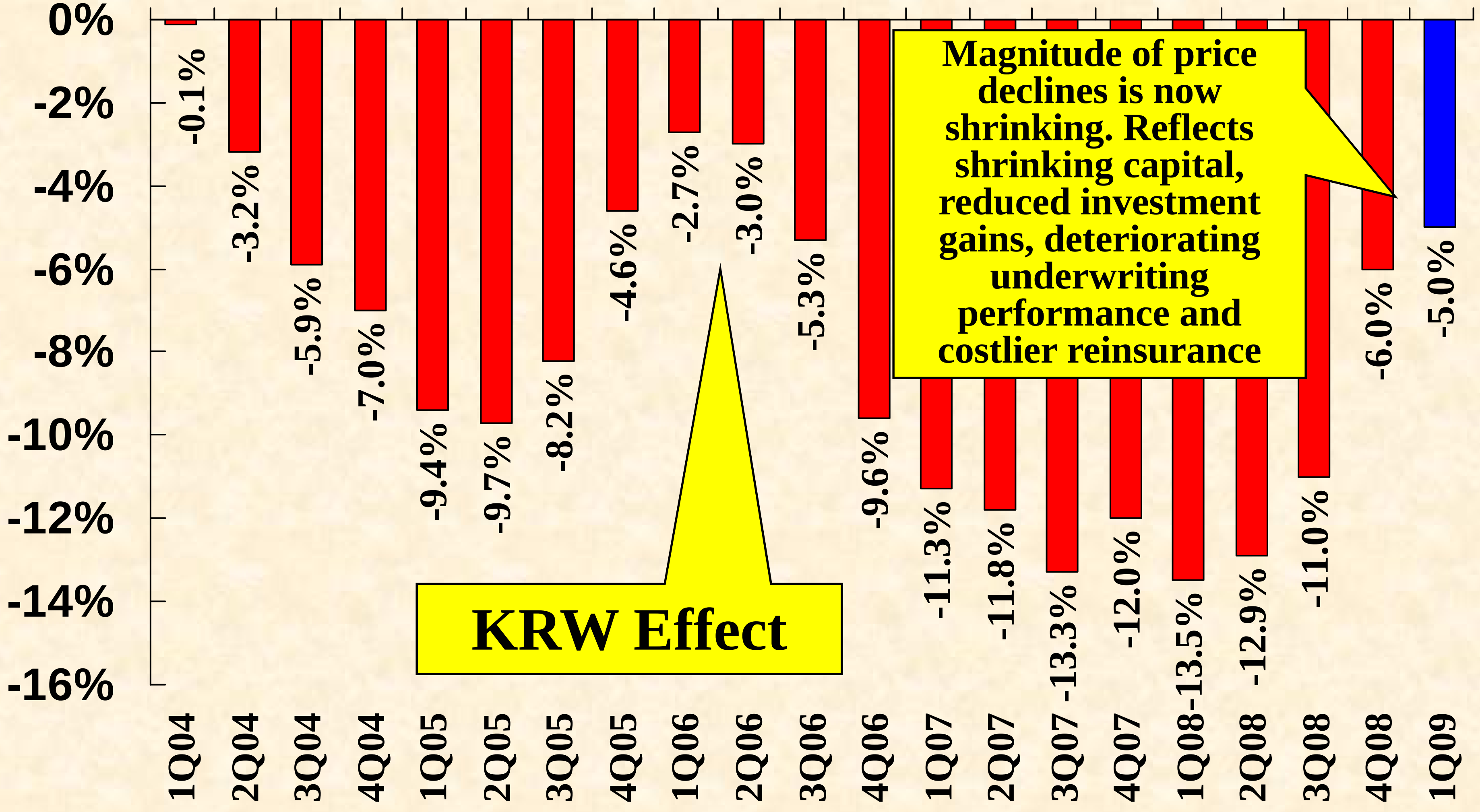
*2008 figure is from ISO. Excluding Mortgage & Financial Guarantee insurers = -1.5%.
Source: A.M. Best (historical and forecast)

Personal/Commercial Lines & Reinsurance NPW Growth, 2006-2009F



Sources: A.M. Best Review & Preview, Feb. 2009

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

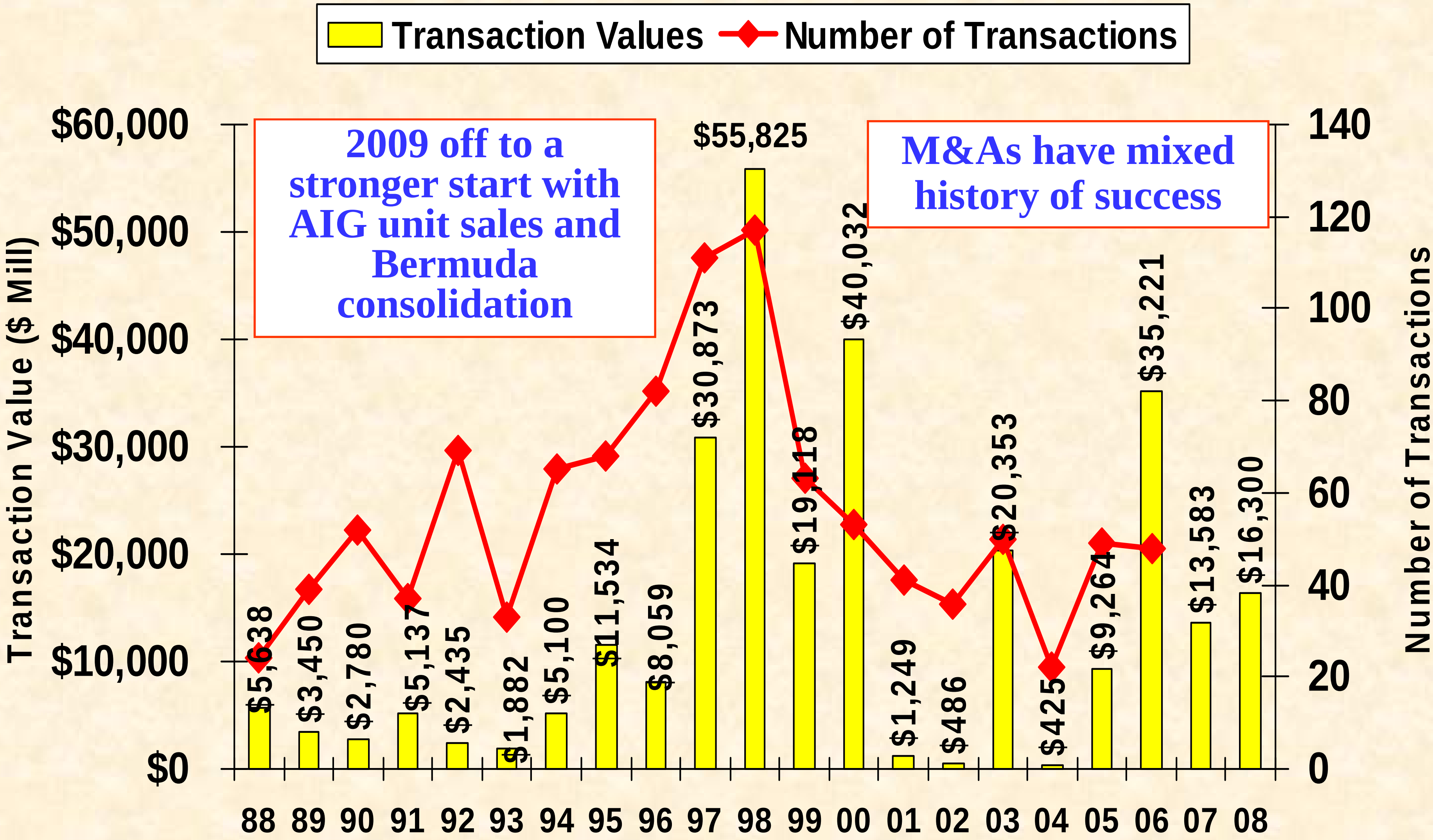


Source: Council of Insurance Agents & Brokers; Insurance Information Institute

Merger & Acquisition

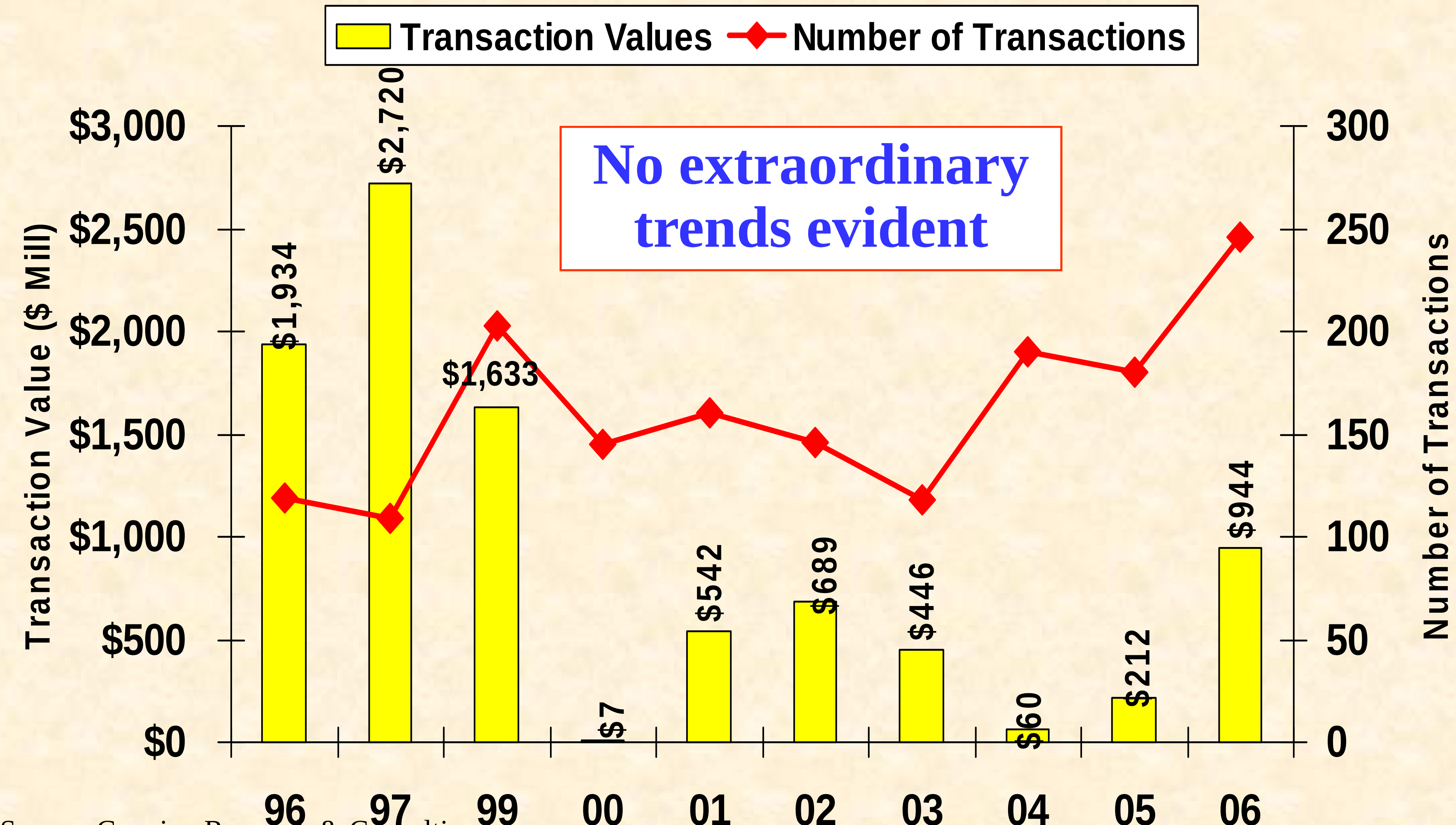
Barriers to Consolidation Will Diminish in 2009/10

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



Source: Conning Research & Consulting. *2007/08 figures approximate.

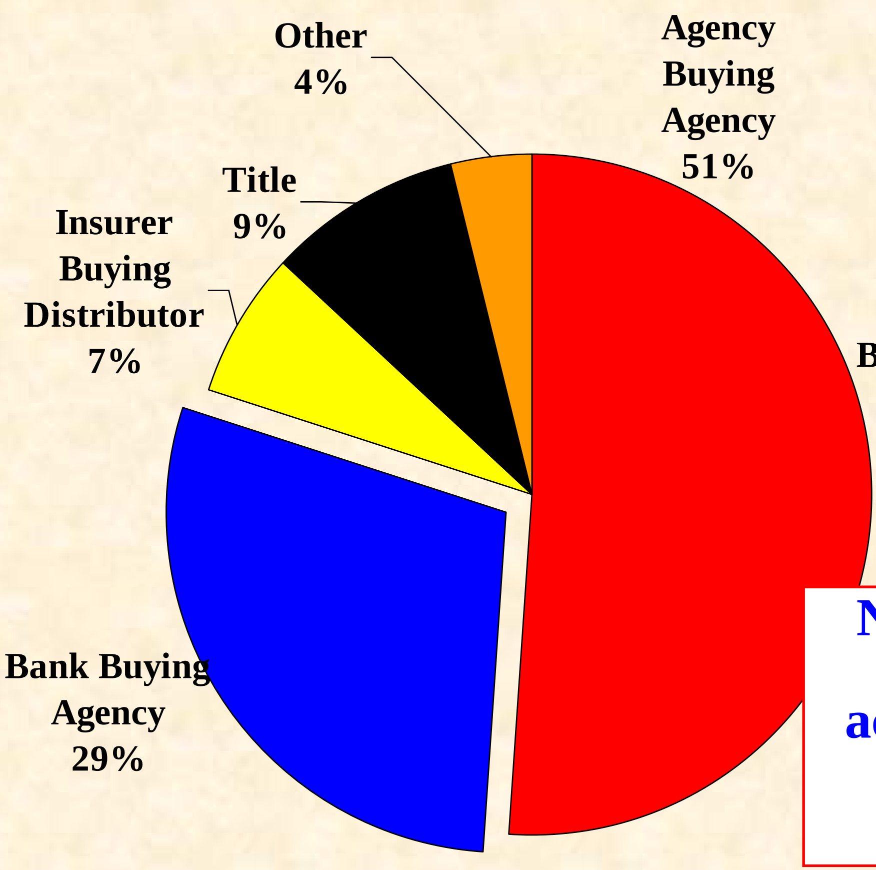
Distribution Sector: Insurance-Related M&A Activity, 1988-2006



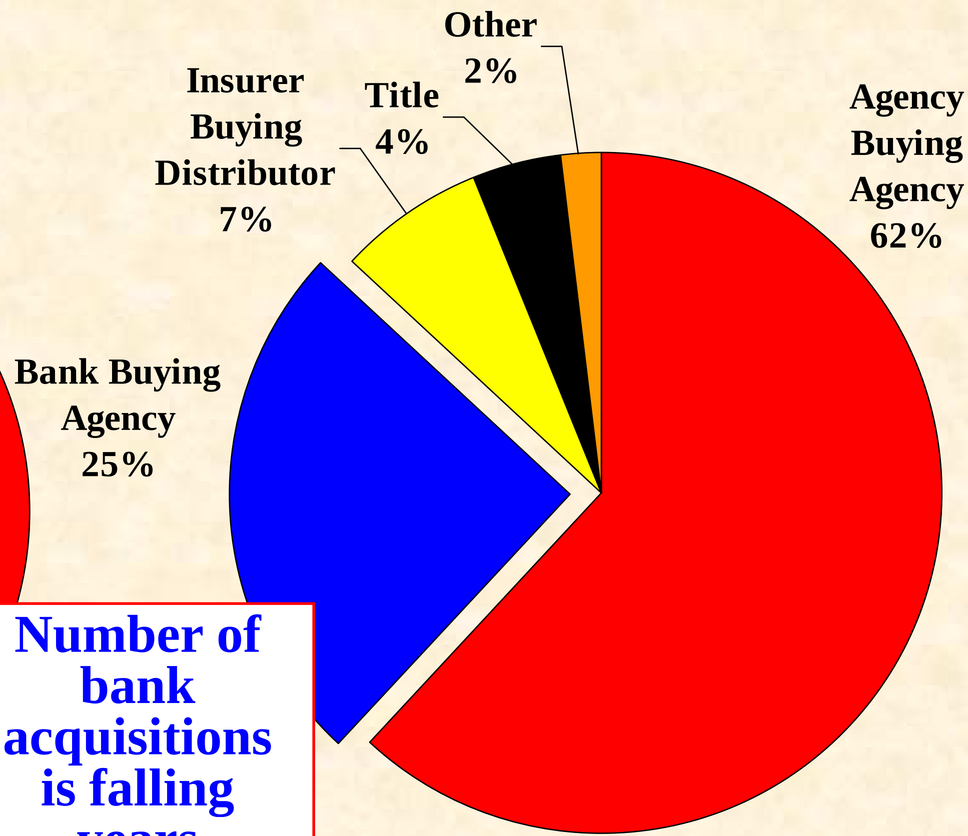
Source: Conning Research & Consulting.

Distribution Sector M&A Activity, 2005 vs. 2006

2005



2006



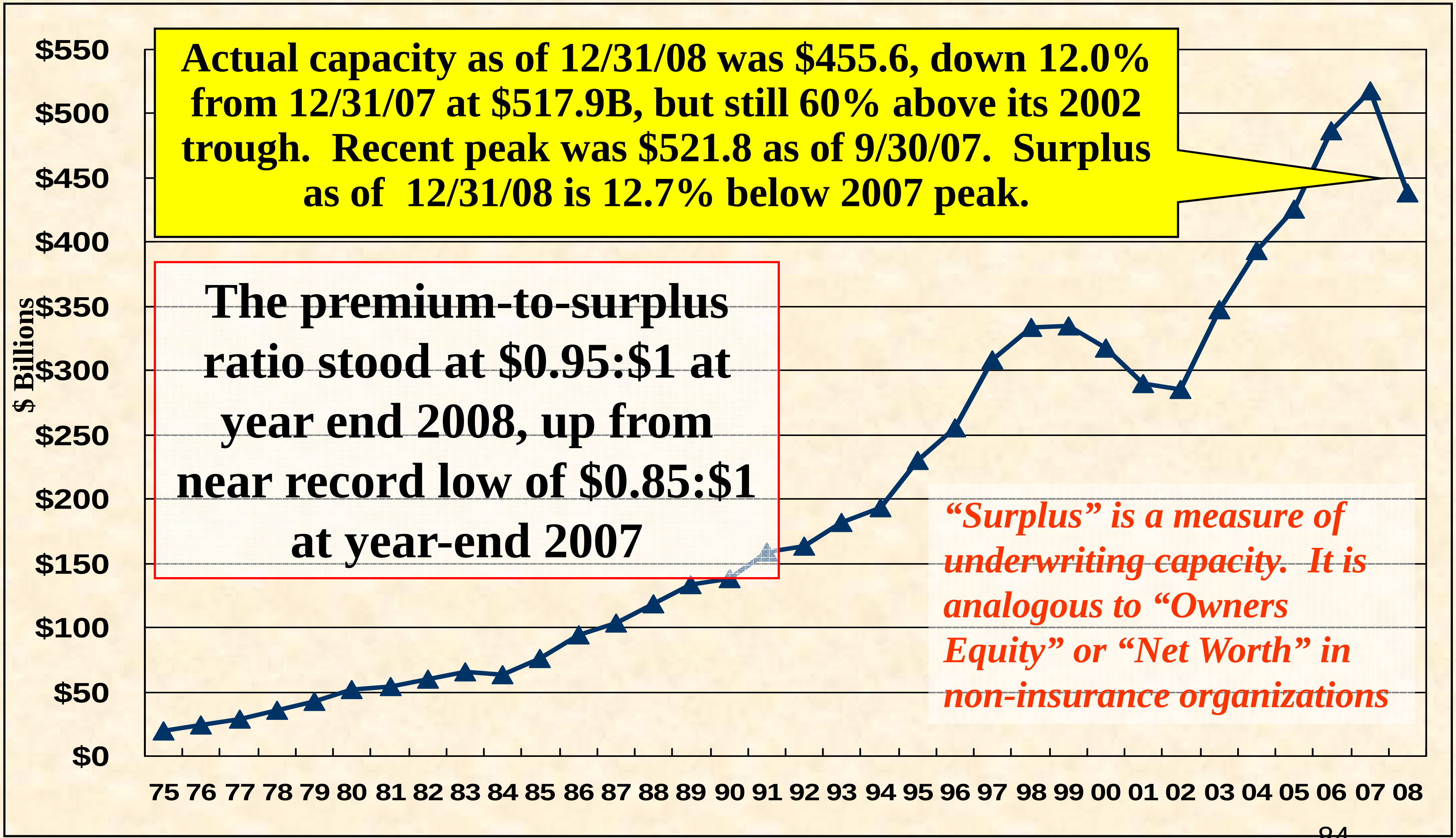
Number of bank acquisitions is falling years

Source: Conning Research & Consulting

Capital/ Policyholder Surplus

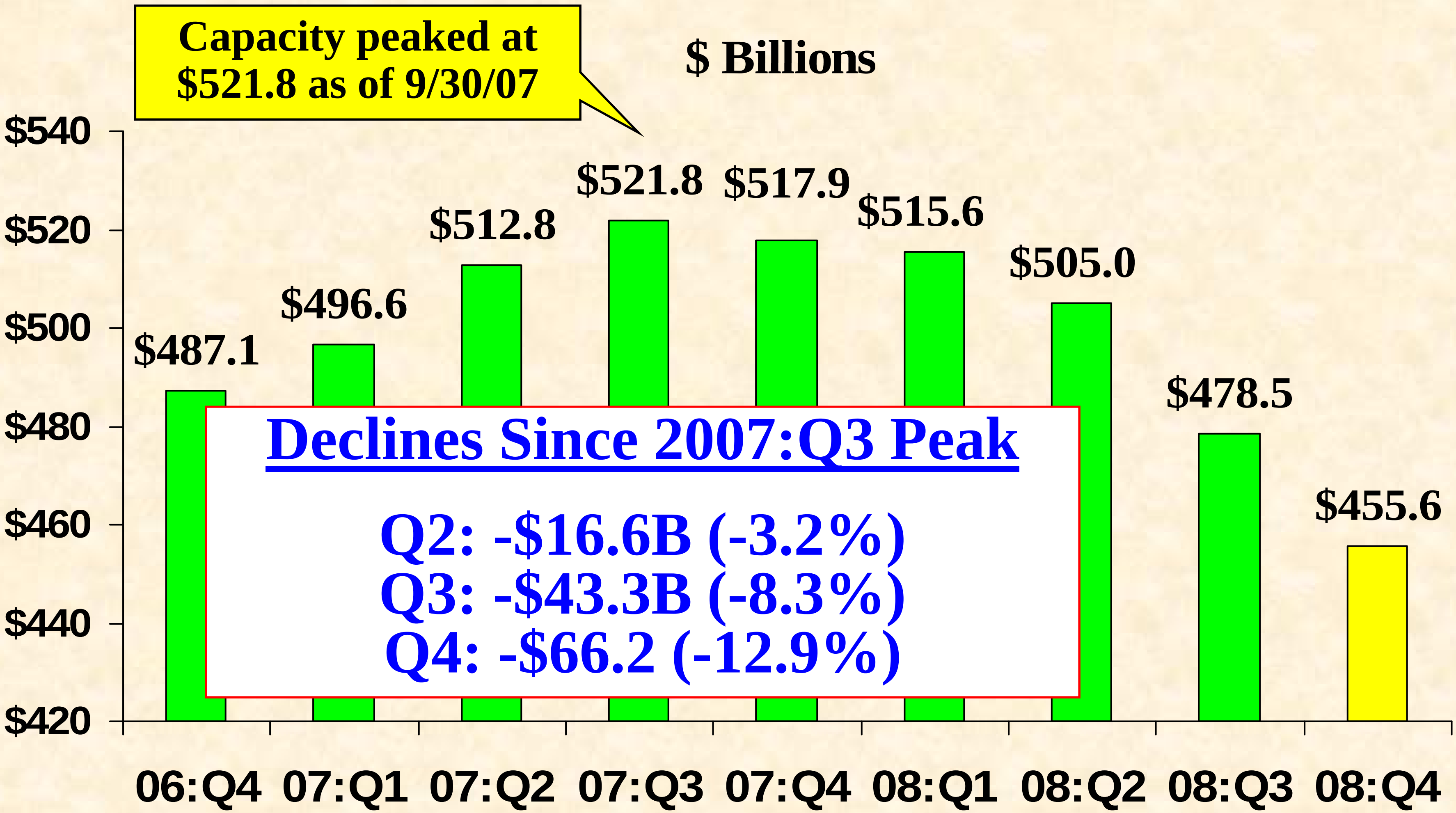
Shrinkage, but Capital is Within Historic Norms

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*

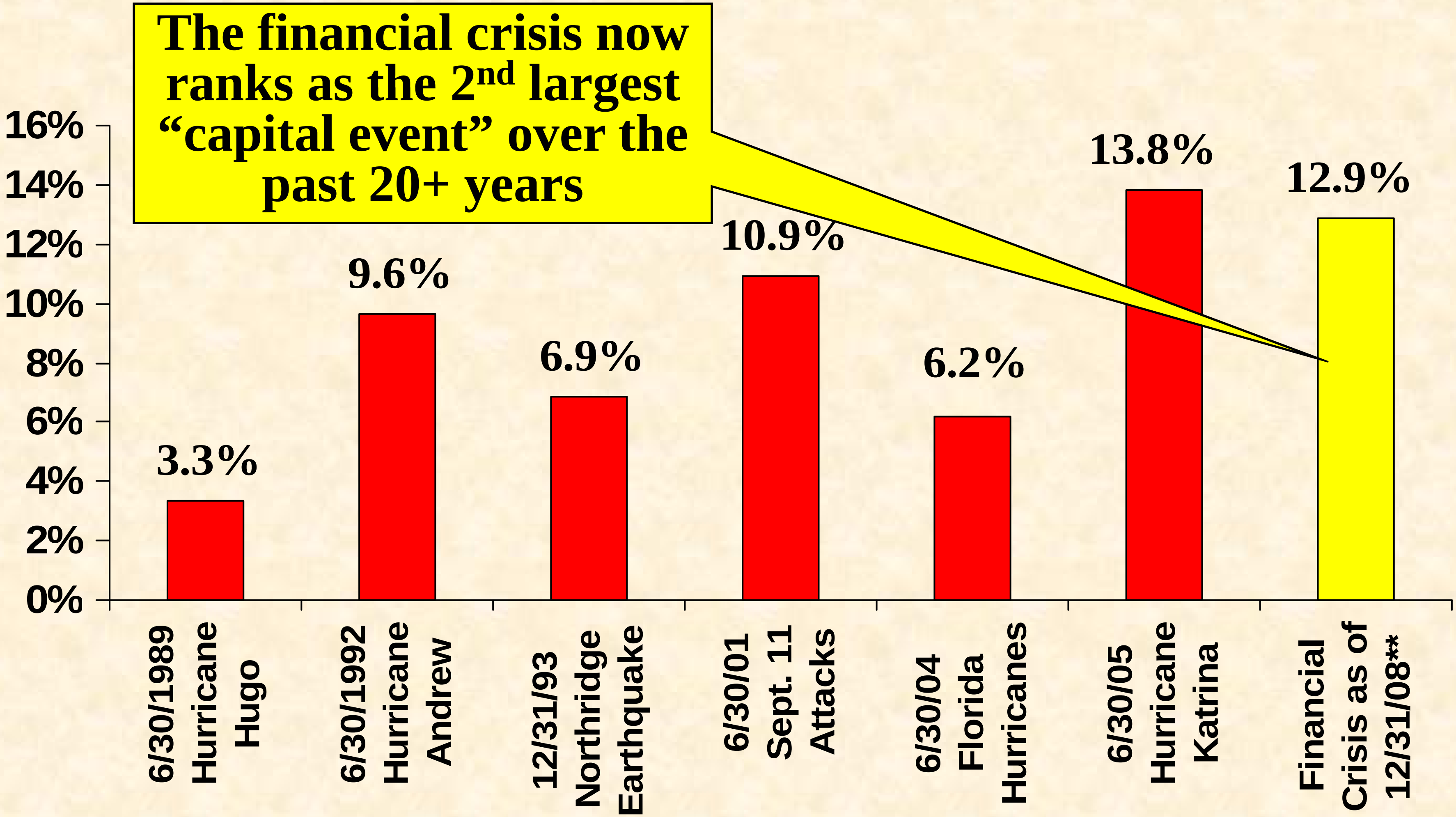
P/C insurance industry was better capitalized going into the financial crisis than before any "capital event" in recent history

*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.

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

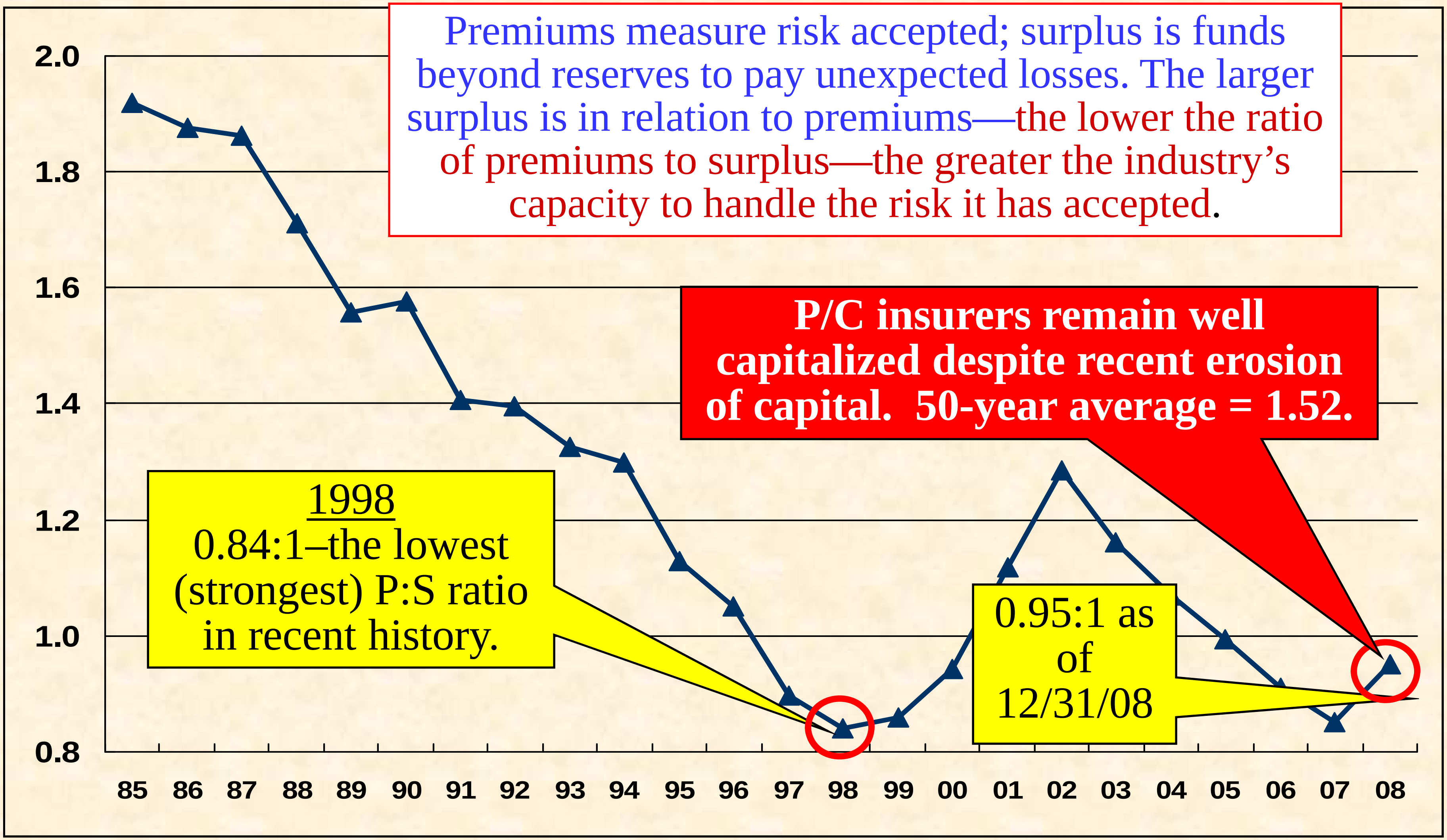


*Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event.

**Latest available

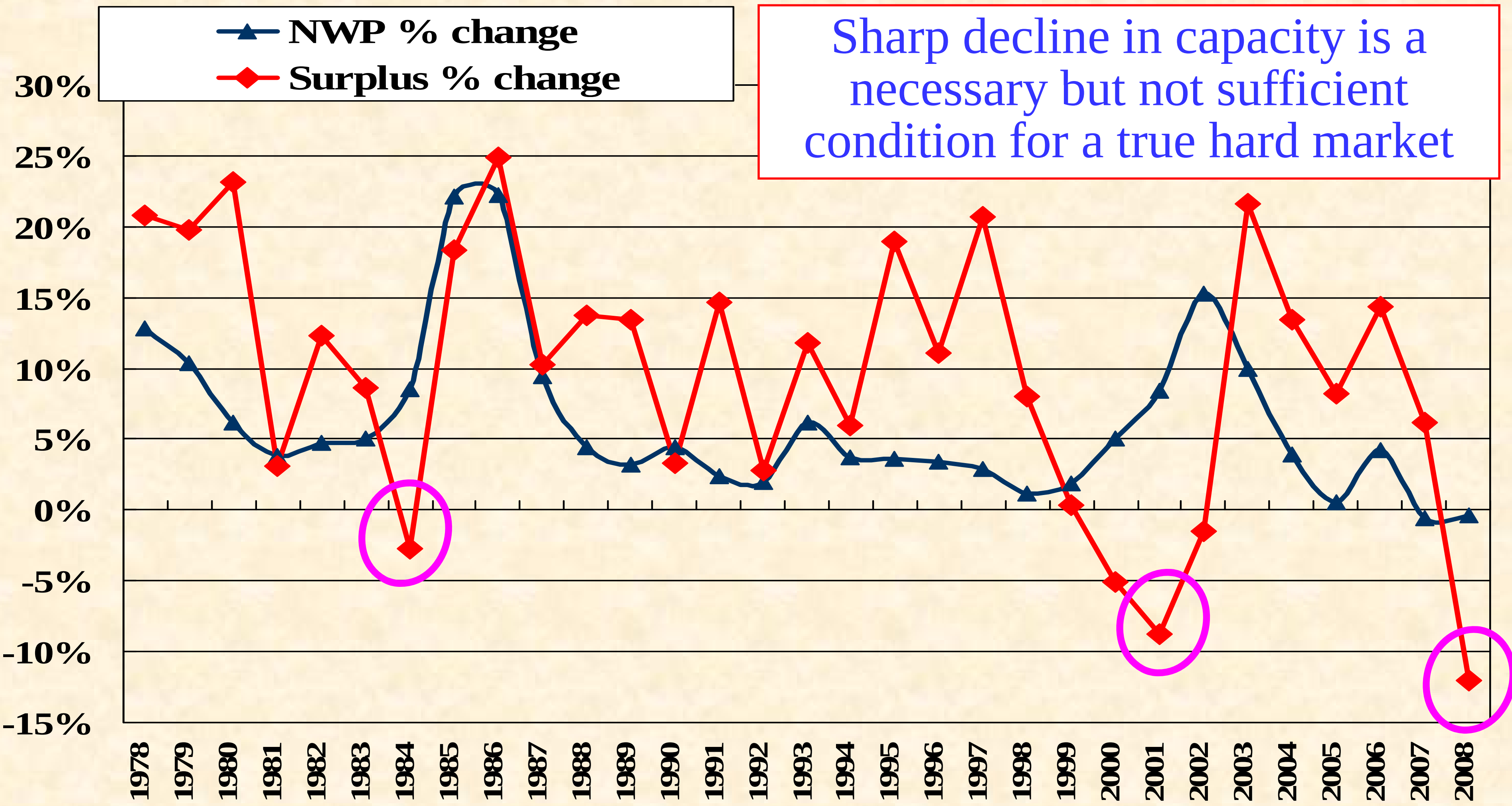
Source: PCS; Insurance Information Institute.

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



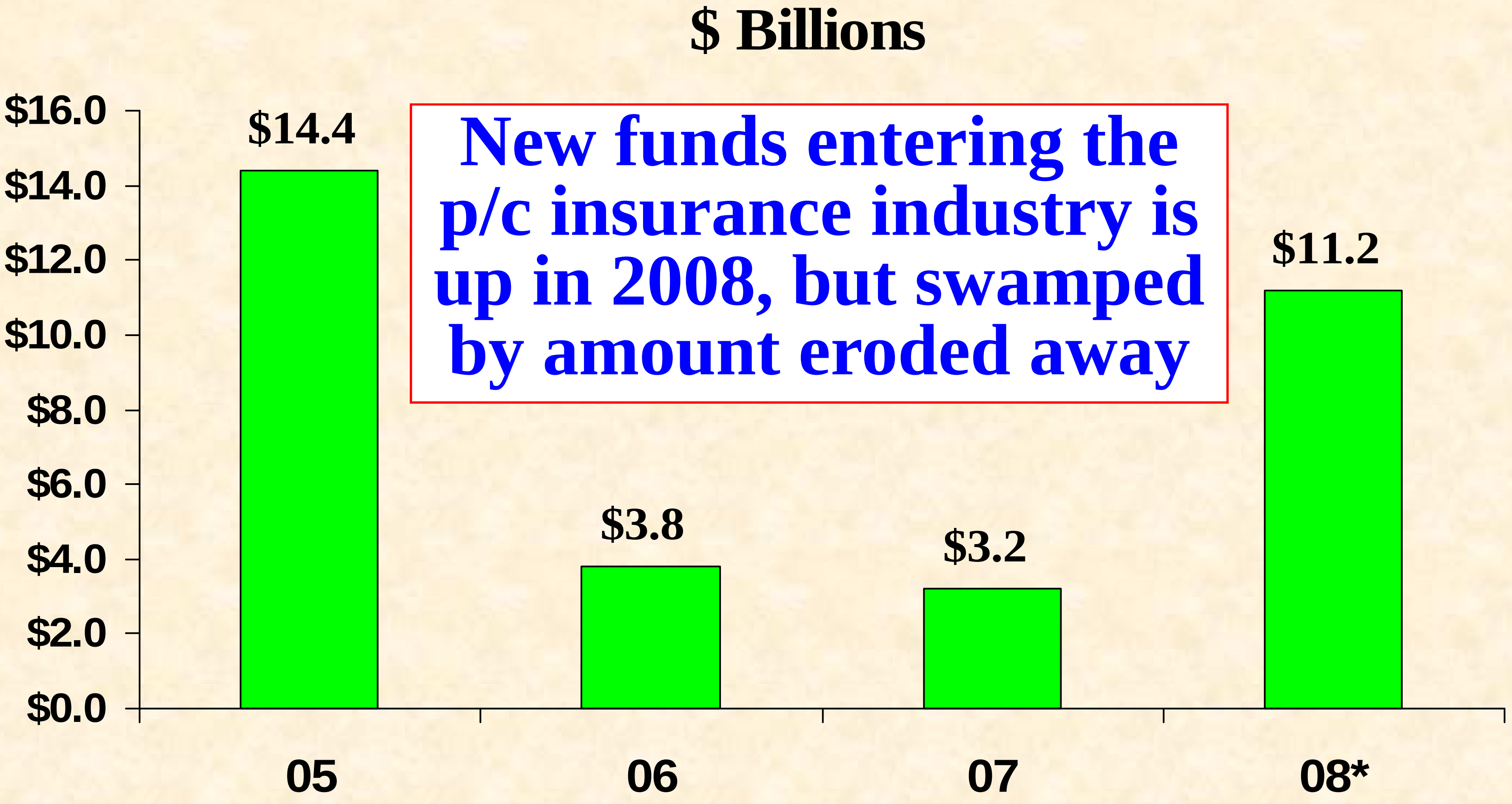
Sources: A.M. Best, ISO, Insurance Information Institute.

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



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

New Funds Contributing to US Policyholder Surplus, 2005-2008



*Through Q4 2009 (latest available).

Source: ISO; Insurance Information Institute

Investment Performance

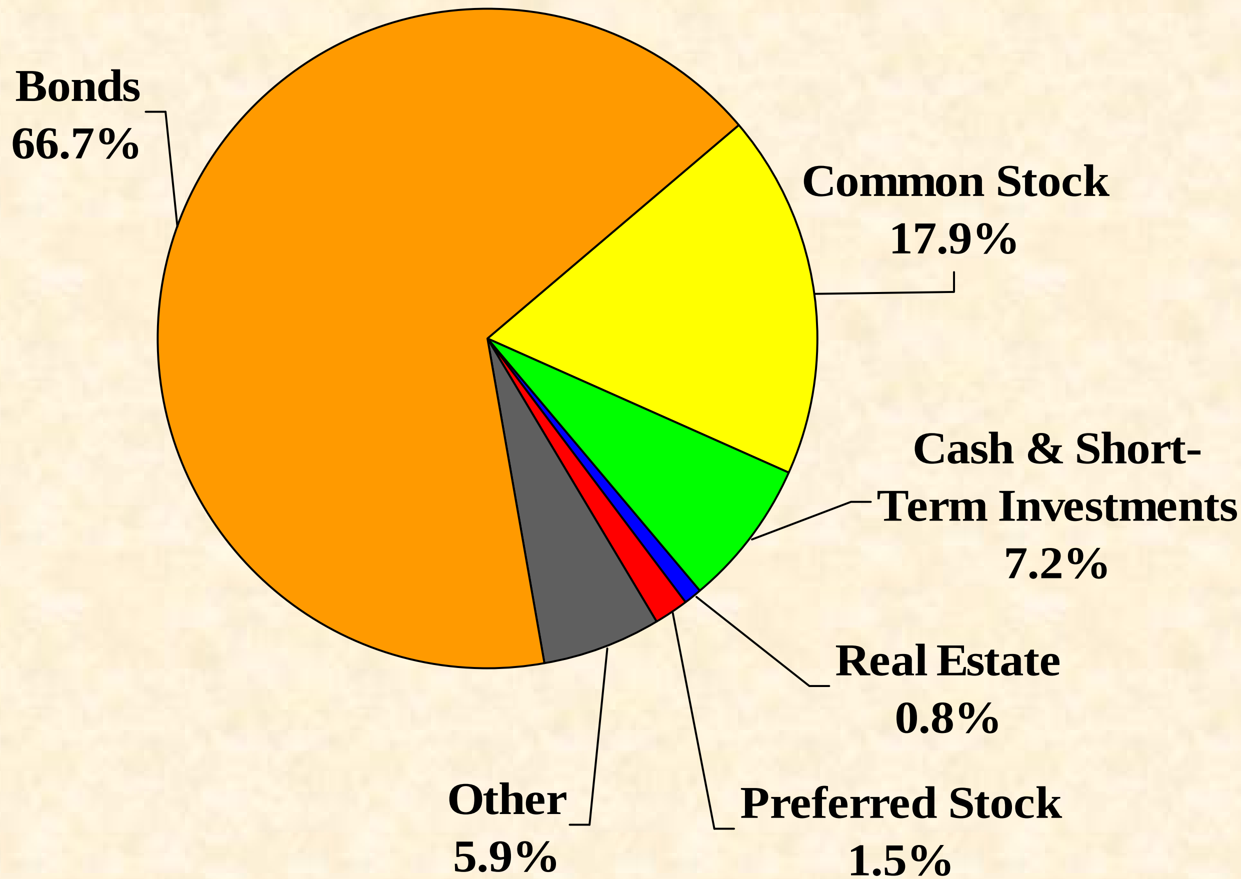
Investments are the Principle Source of Declining Profitability

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2007

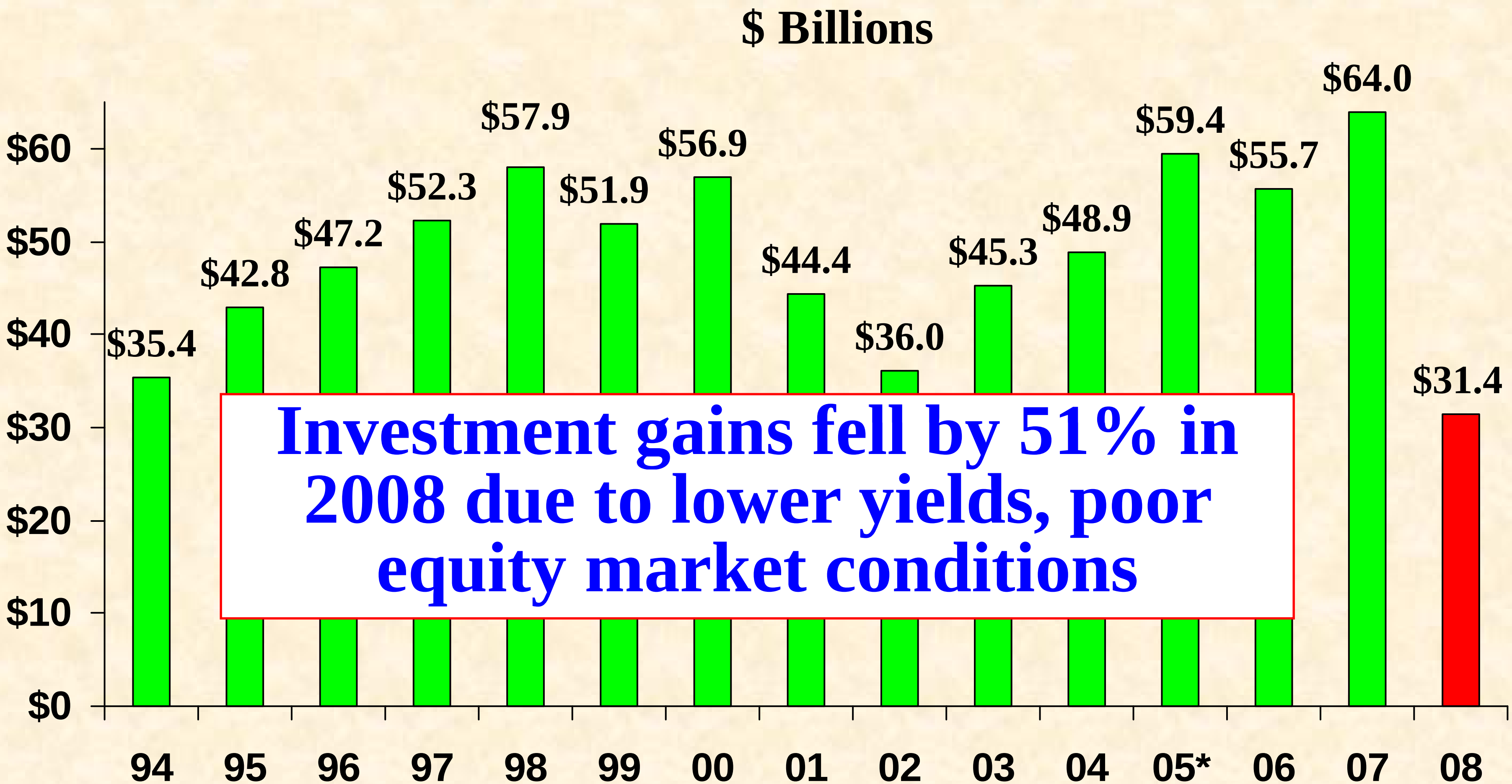
Portfolio Facts

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



Source: NAIC; Insurance Information Institute research;.

Property/Casualty Insurance Industry Investment Gain:1994- 2008[1]

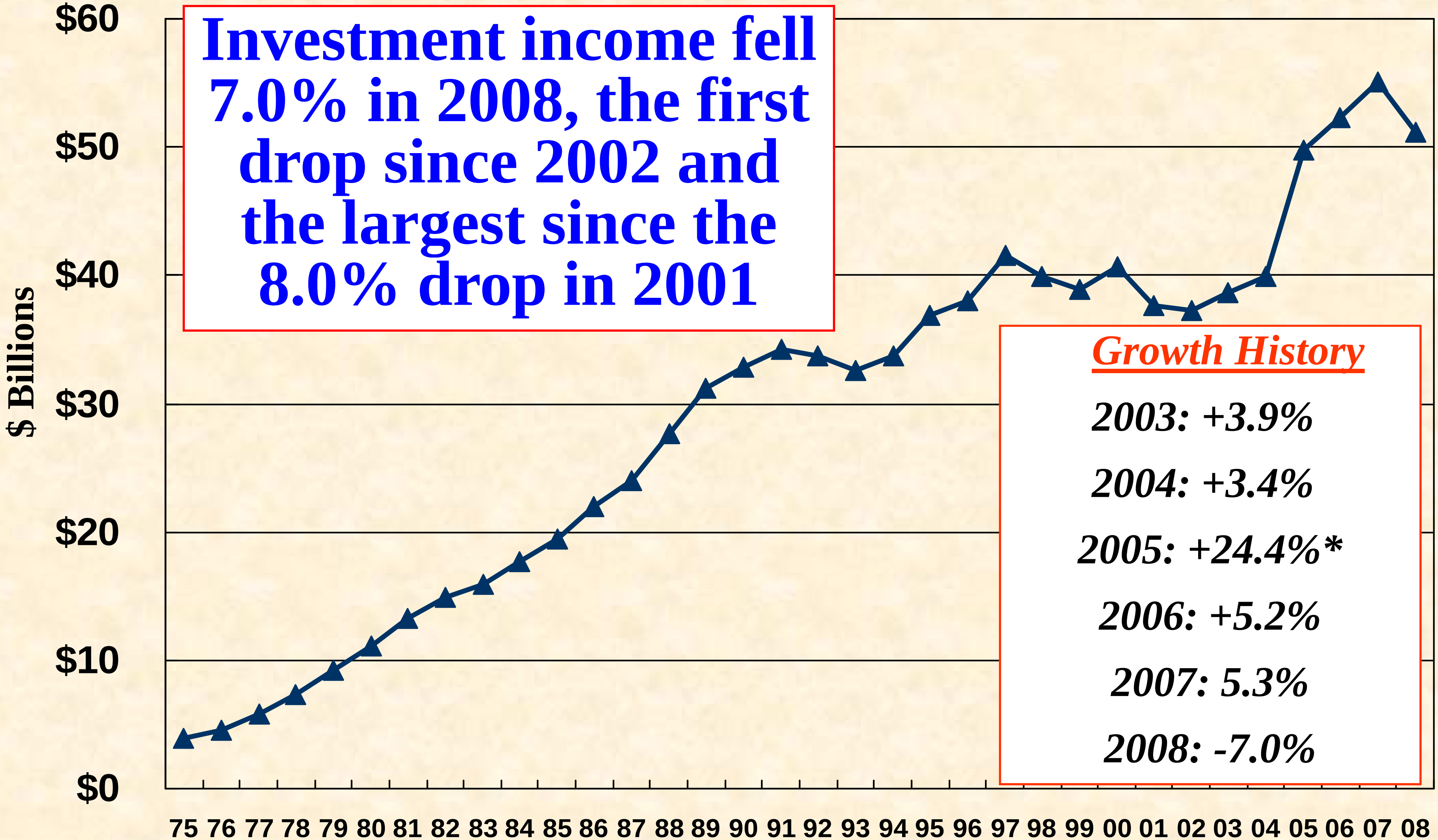


[1]Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of $52.3B net investment income and $3.4B realized investment gain.

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

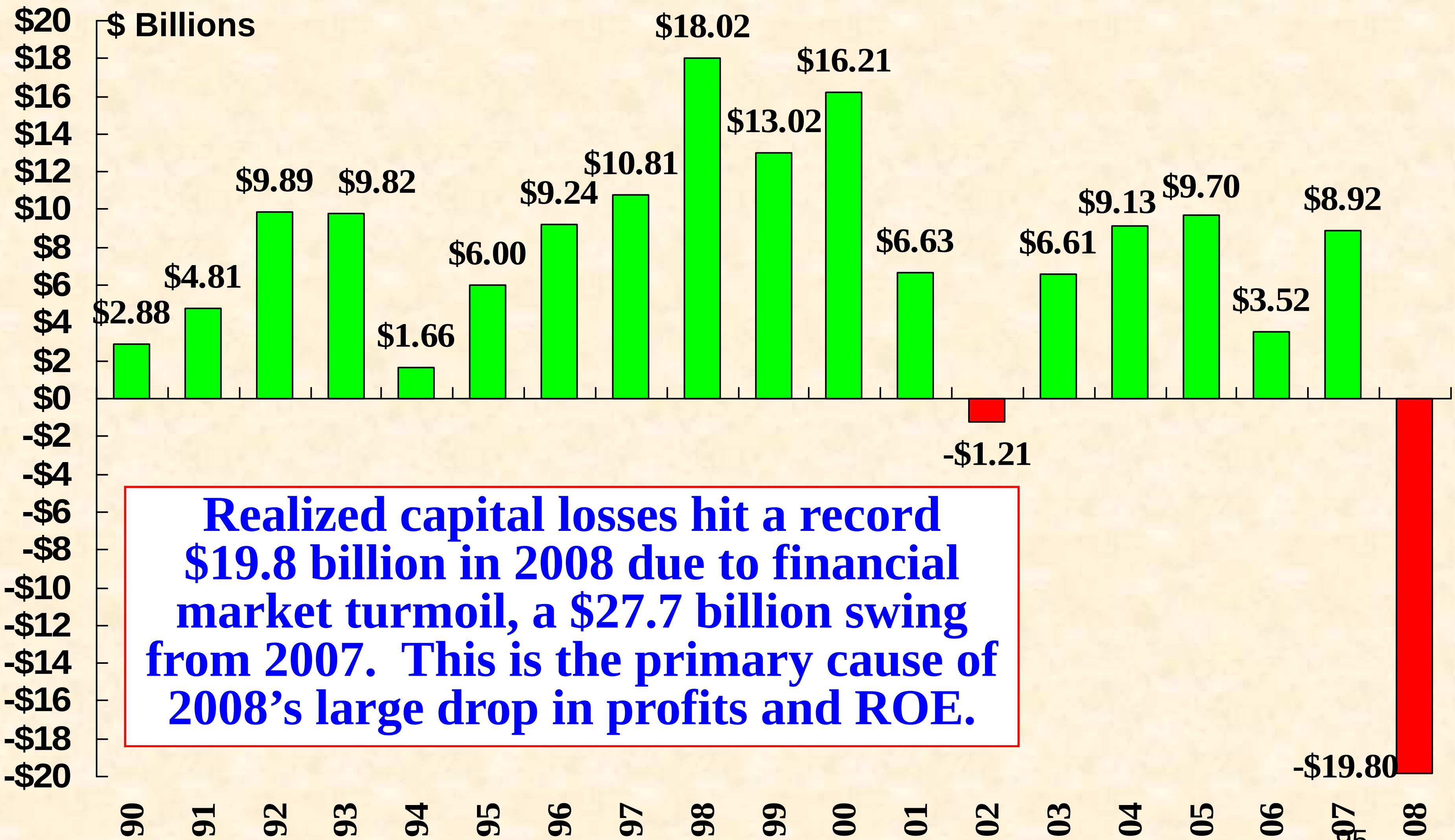
Sources: ISO; Insurance Information Institute.

Net Investment Income



Source: A.M. Best, ISO, Insurance Information Institute;
*Includes special dividend of $3.2B. Increase is 15.7% excluding dividend.

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



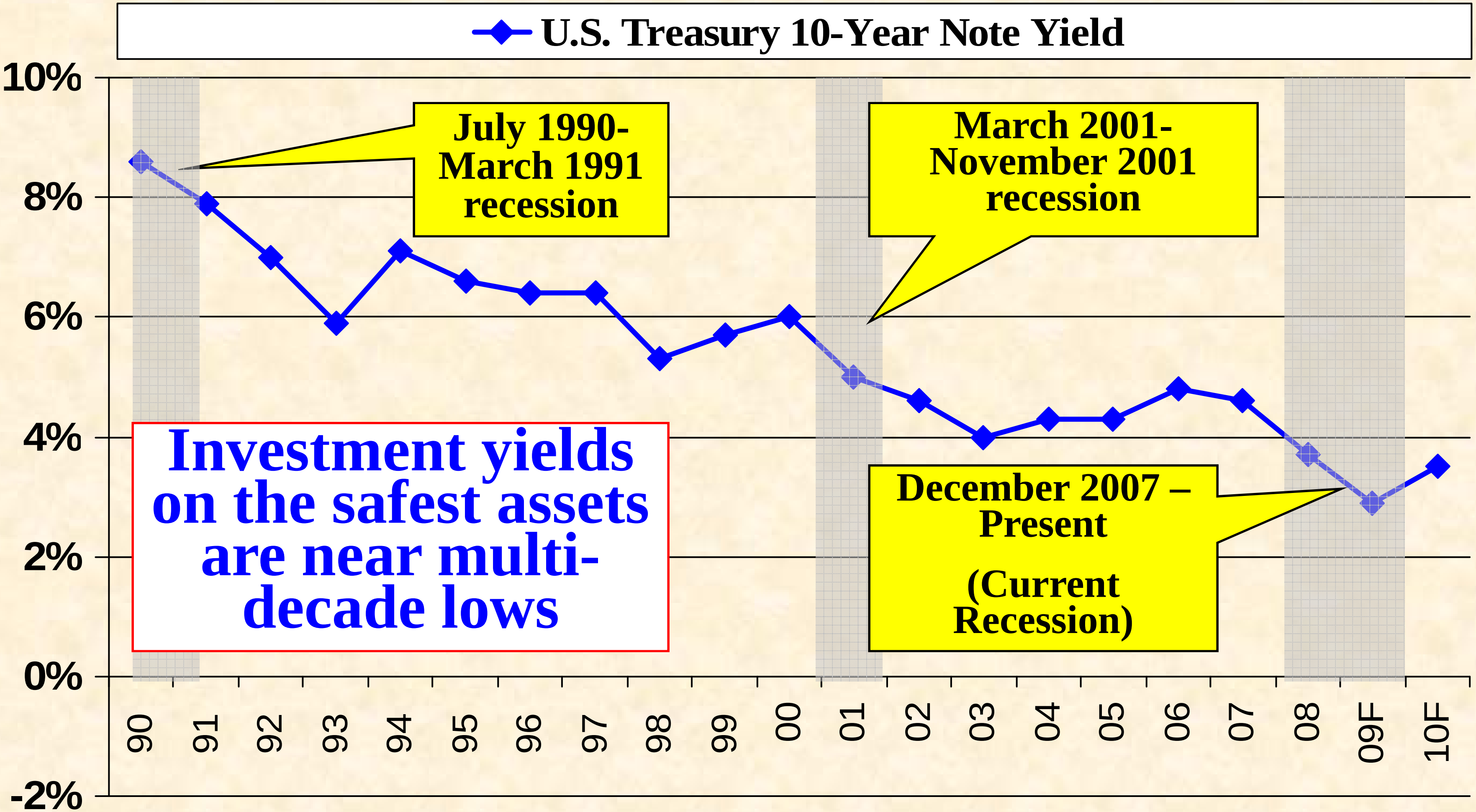
Sources: A.M. Best, ISO, Insurance Information Institute.

Total Returns for Large Company Stocks: 1970-2009*

S&P 500 is UP 0.7% in 2009*

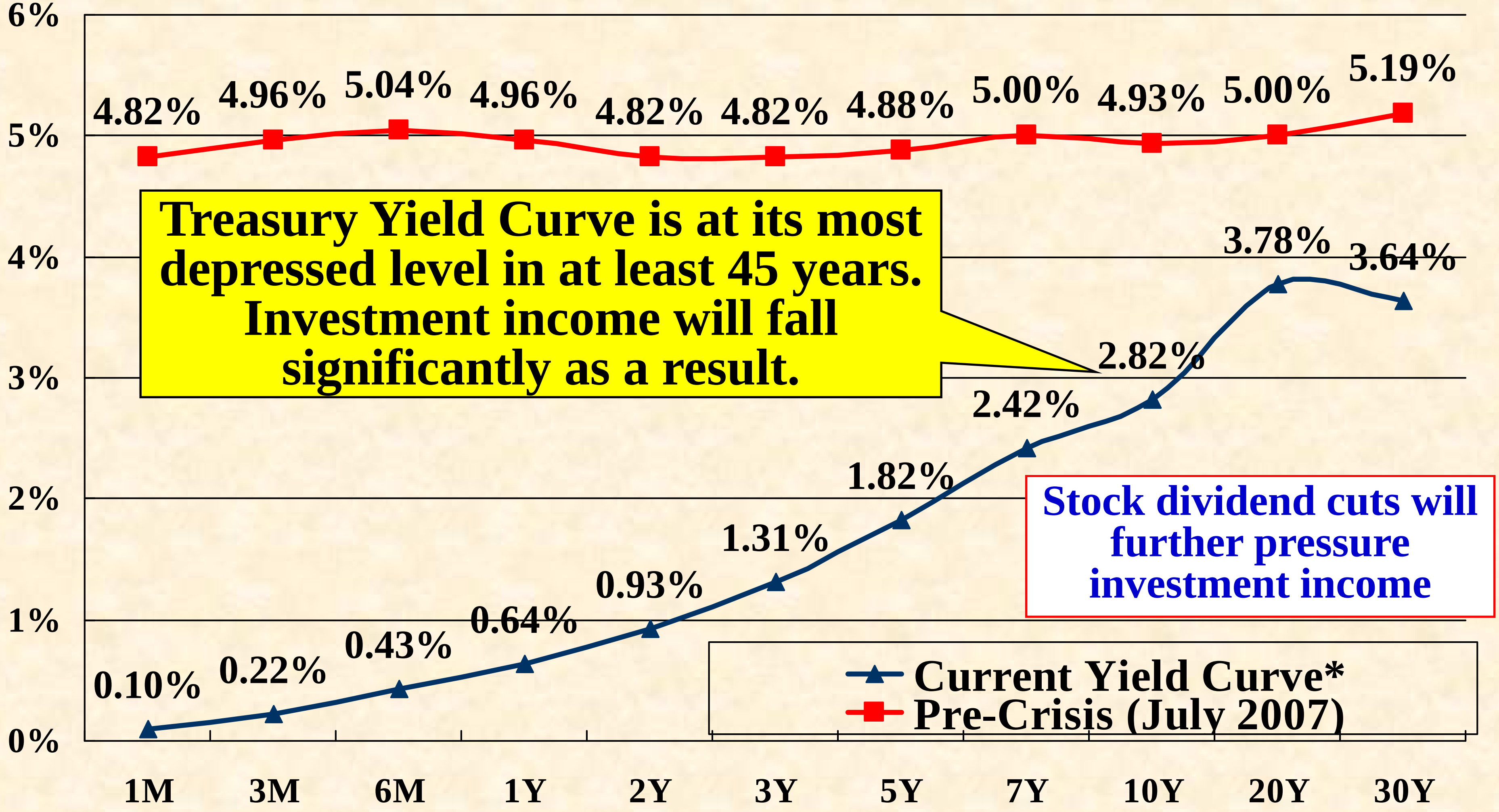
Source: Ibbotson Associates, Insurance Information Institute. *Through May 12, 2009.

Treasury Bond Yields Have Generally Been Falling



Sources: US Bureau of Labor Statistics (history); Blue Chip Economic Indicators, April 2009 issue (forecasts)

Treasury Yield Curves: Pre-Crisis vs. Current*



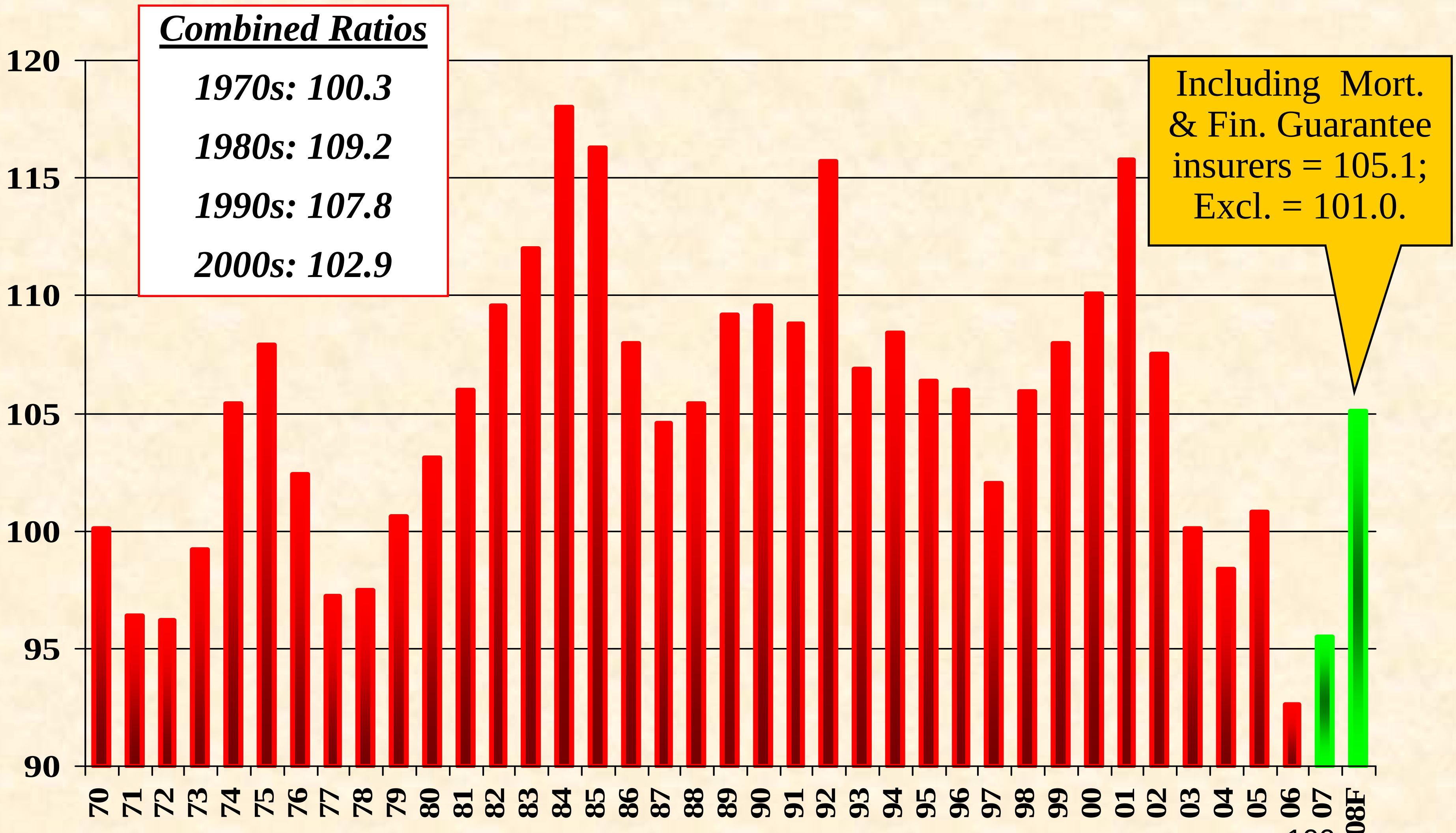
*March 2009.

Sources: Federal Reserve; Insurance Information Institute.

Underwriting Trends

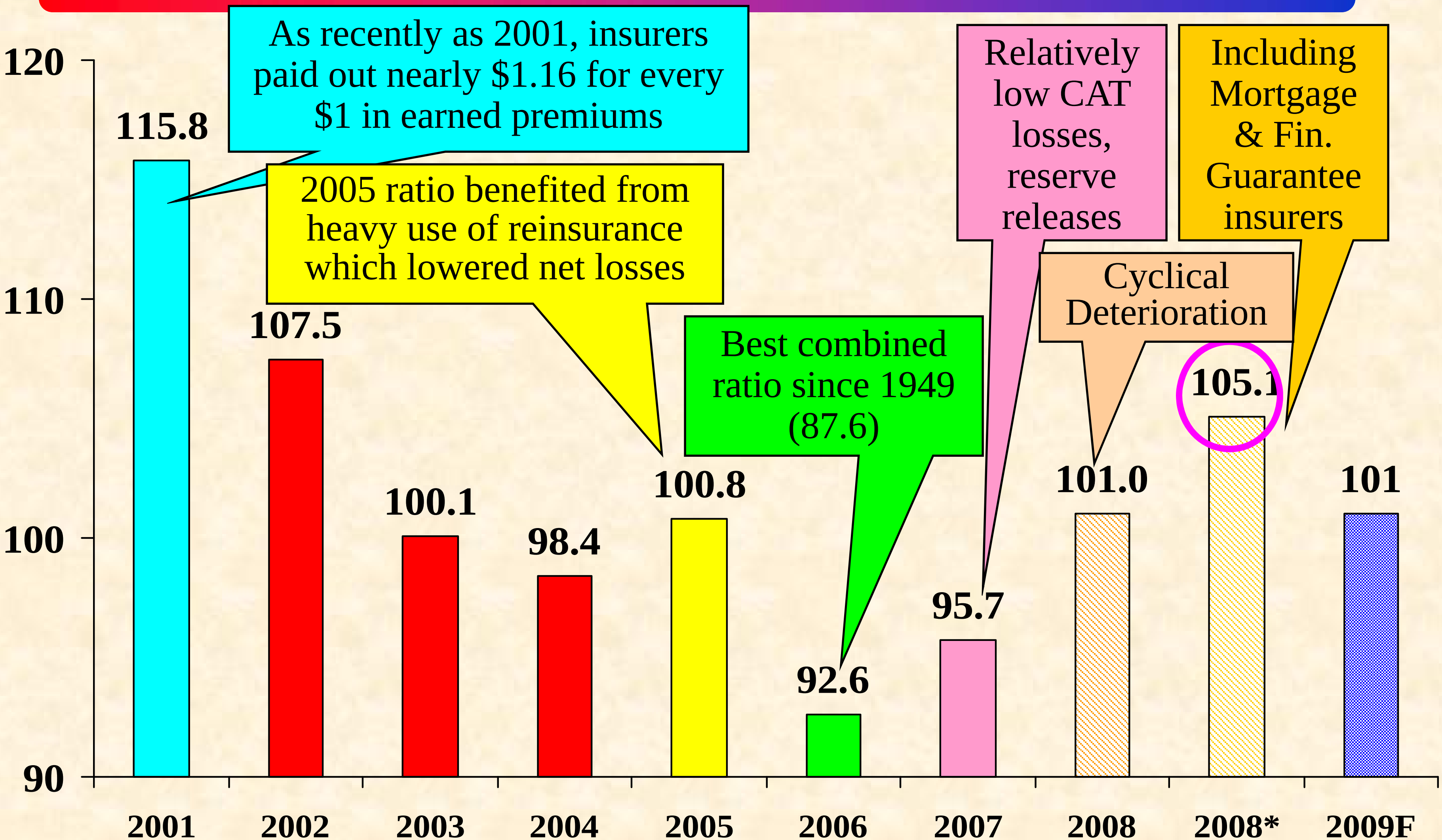
Financial Crisis Does *Not* Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

P/C Insurance Combined Ratio, 1970-2008F*



Sources: A.M. Best; ISO, III *Excluding mortgage & financial guarantee insurers in 2008 = 101.0.

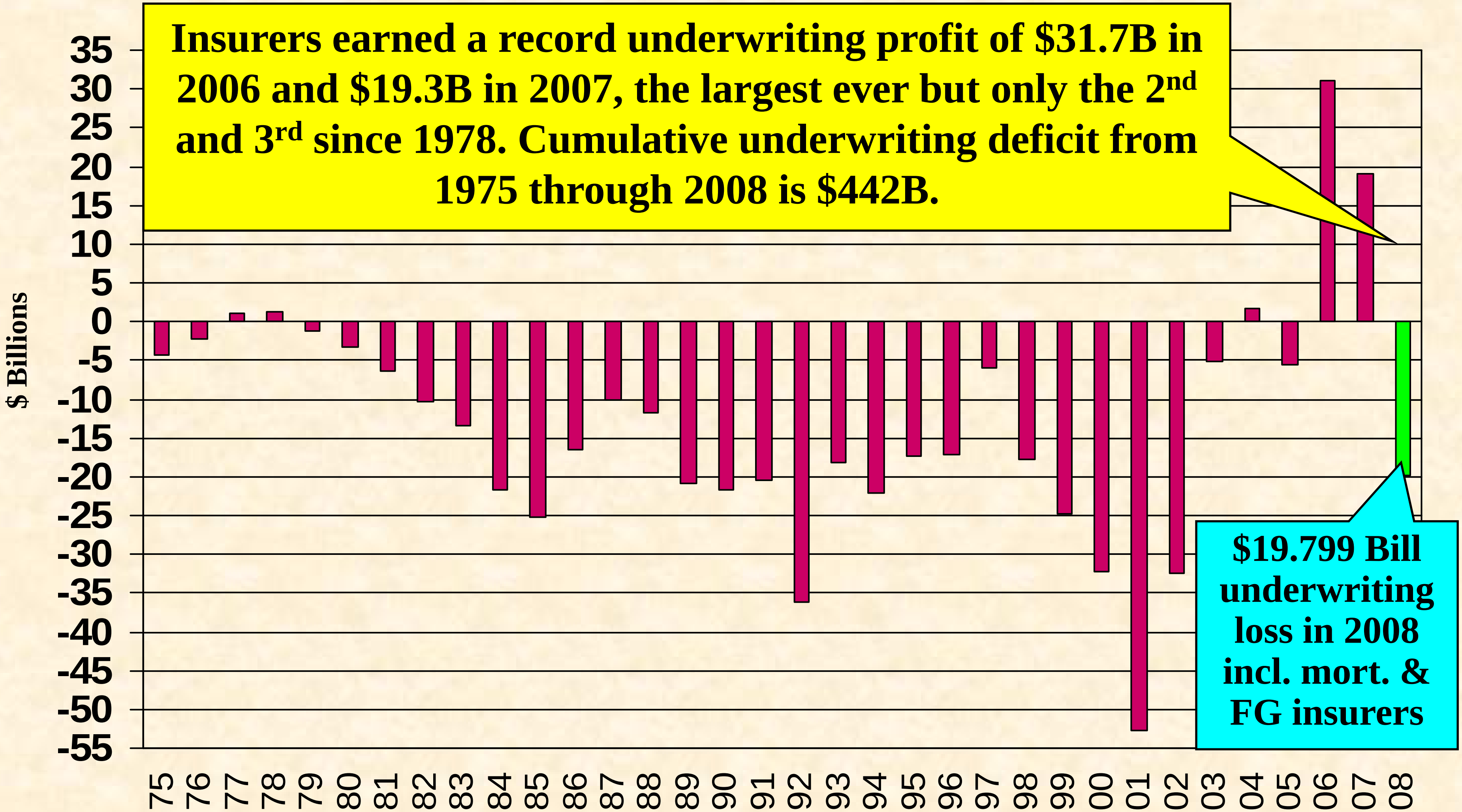
P/C Insurance Industry Combined Ratio, 2001-2009E



*Includes Mortgage & Financial Guarantee insurers.

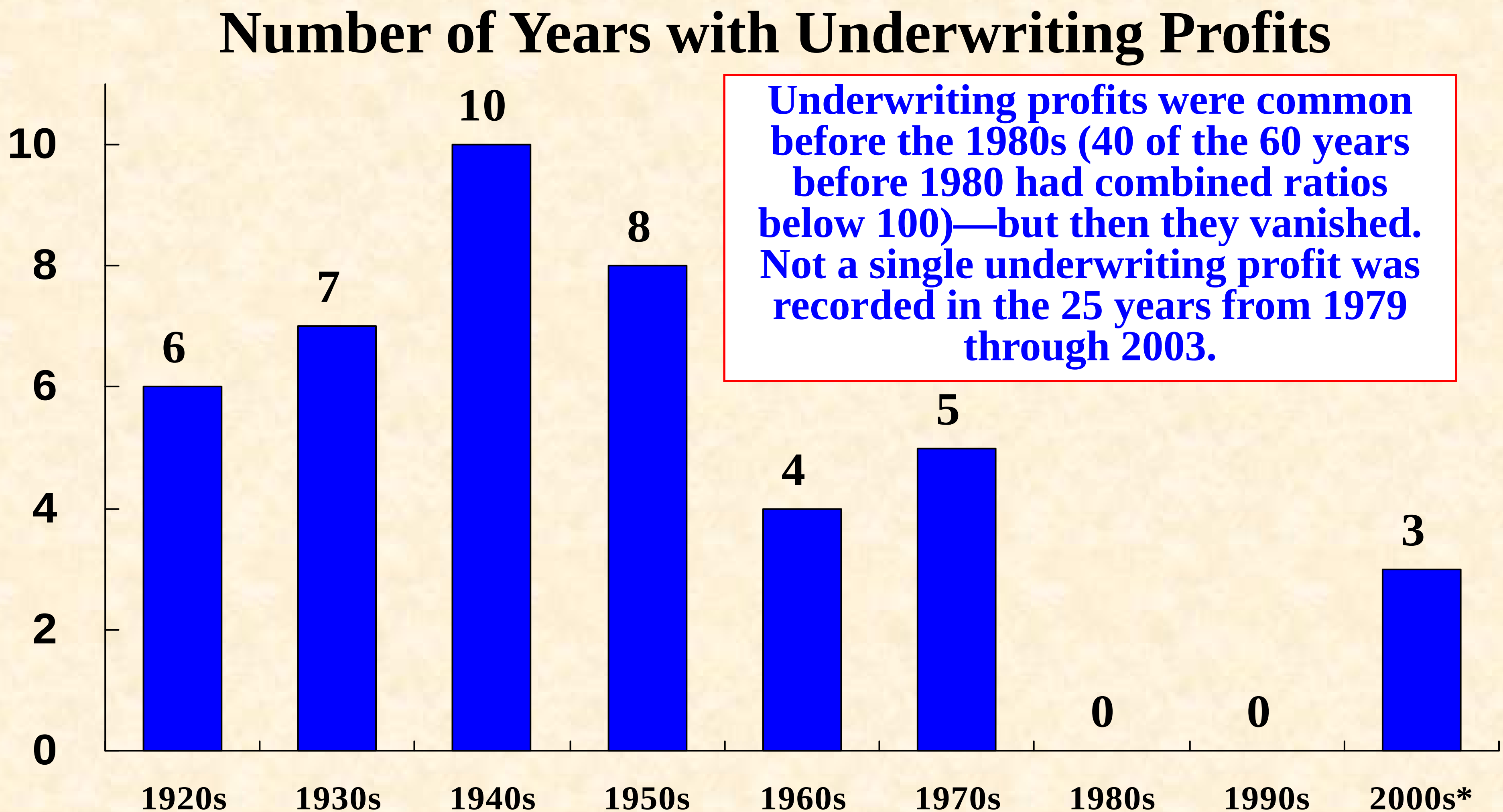
Sources: A.M. Best.

*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



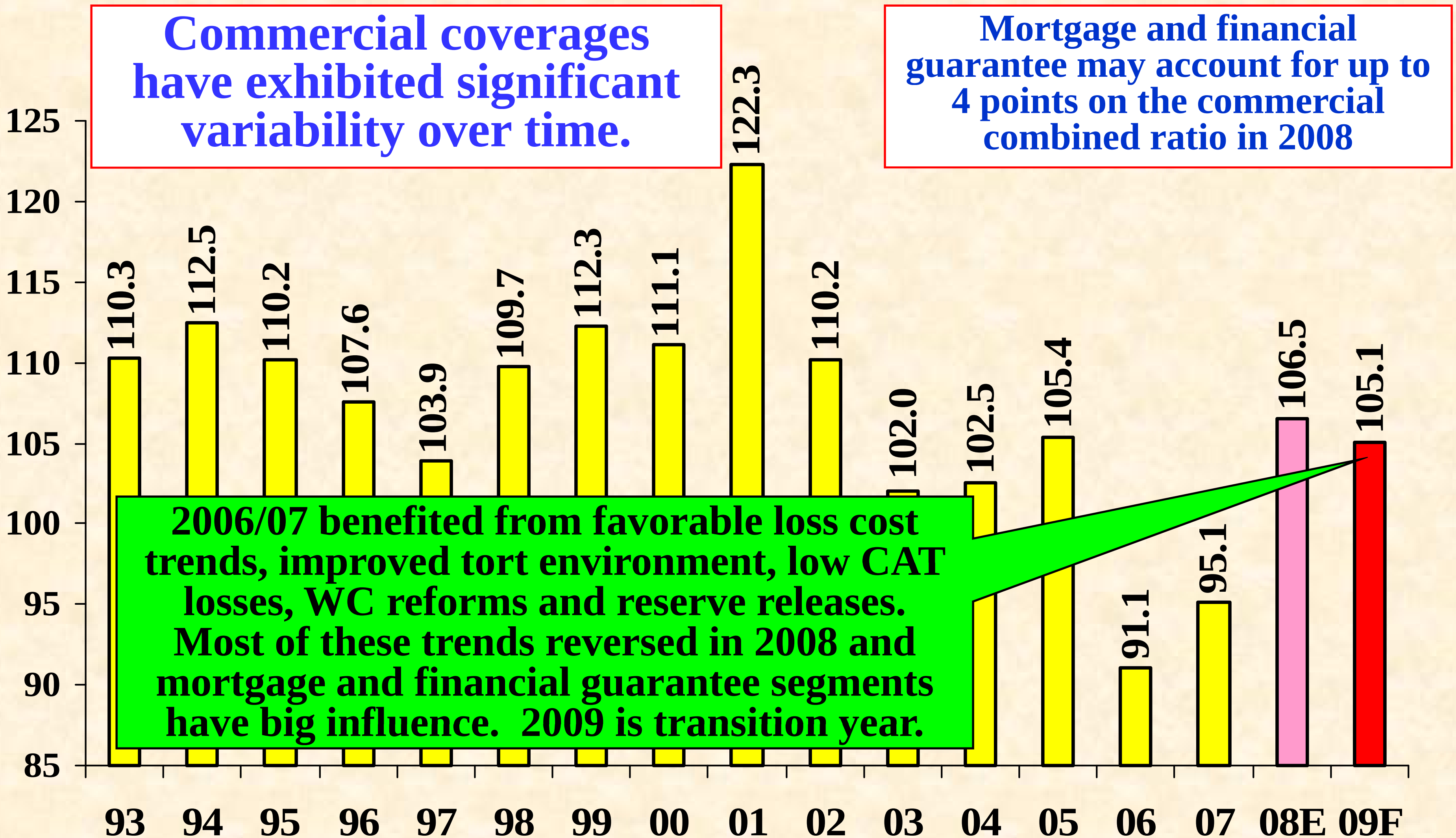
Note: Data for 1920 – 1934 based on stock companies only.

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

*2000 through 2008.

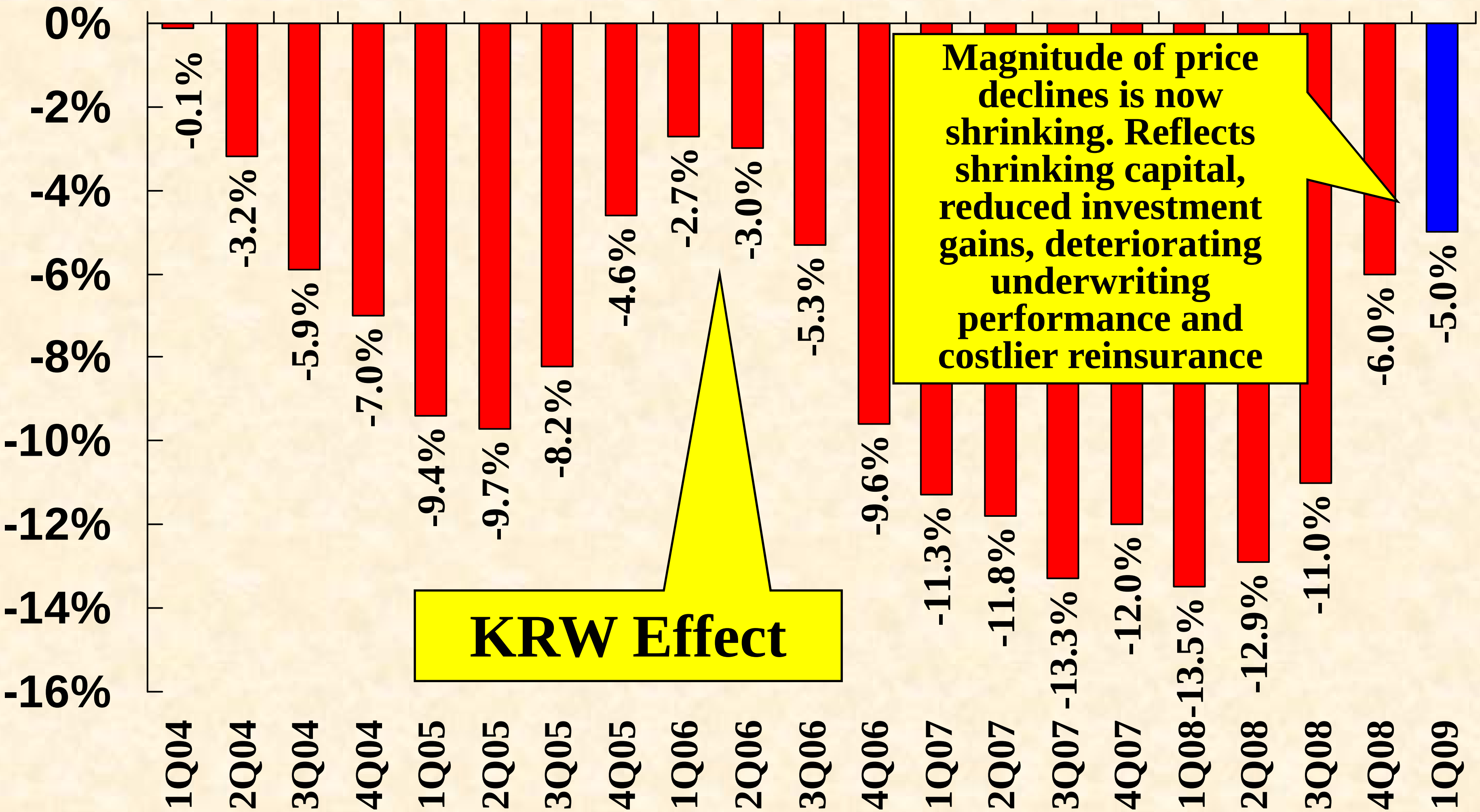
Commercial Lines

Commercial Lines Combined Ratio, 1993-2009F



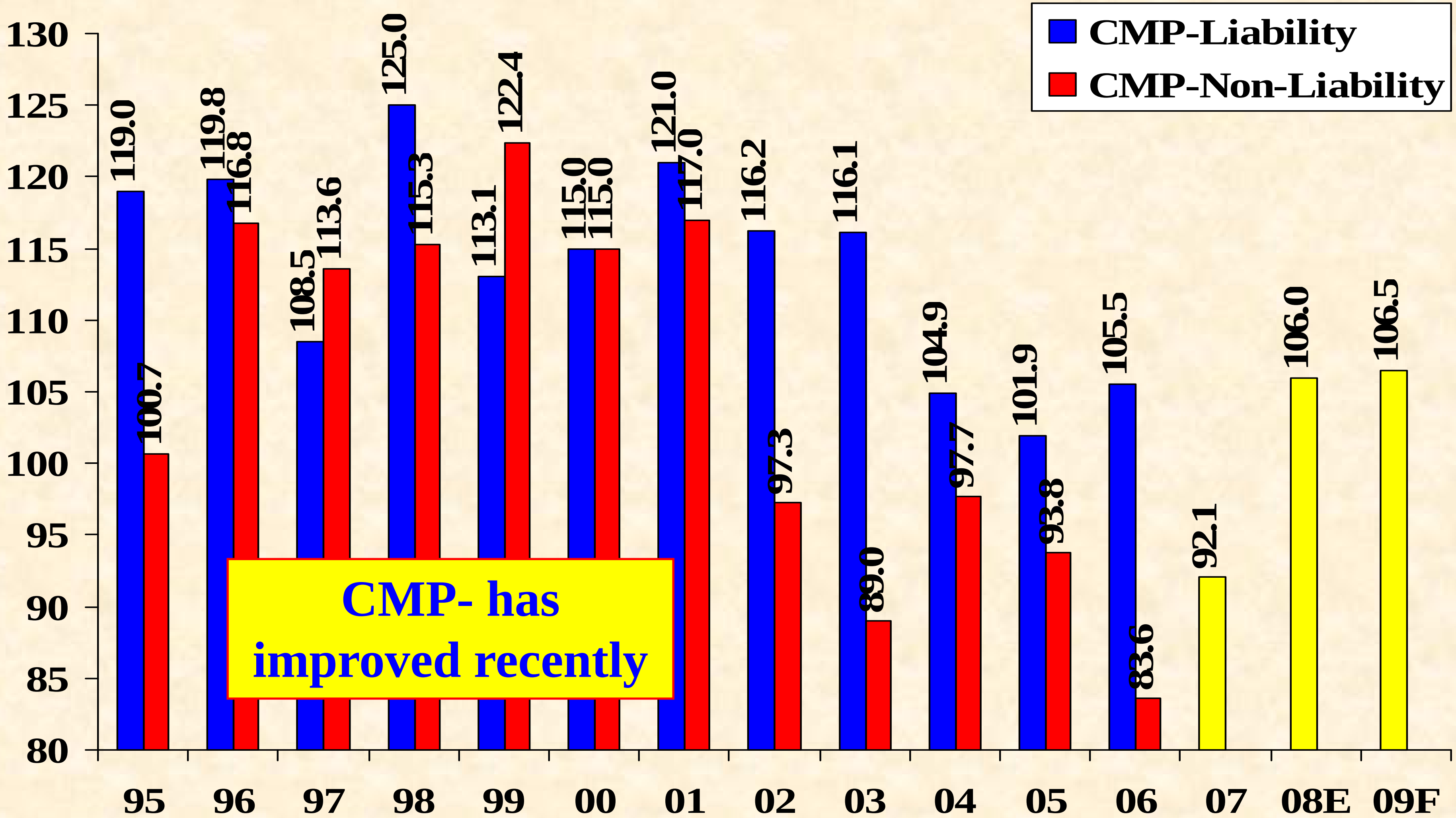
Sources: A.M. Best (historical and forecasts)

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



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

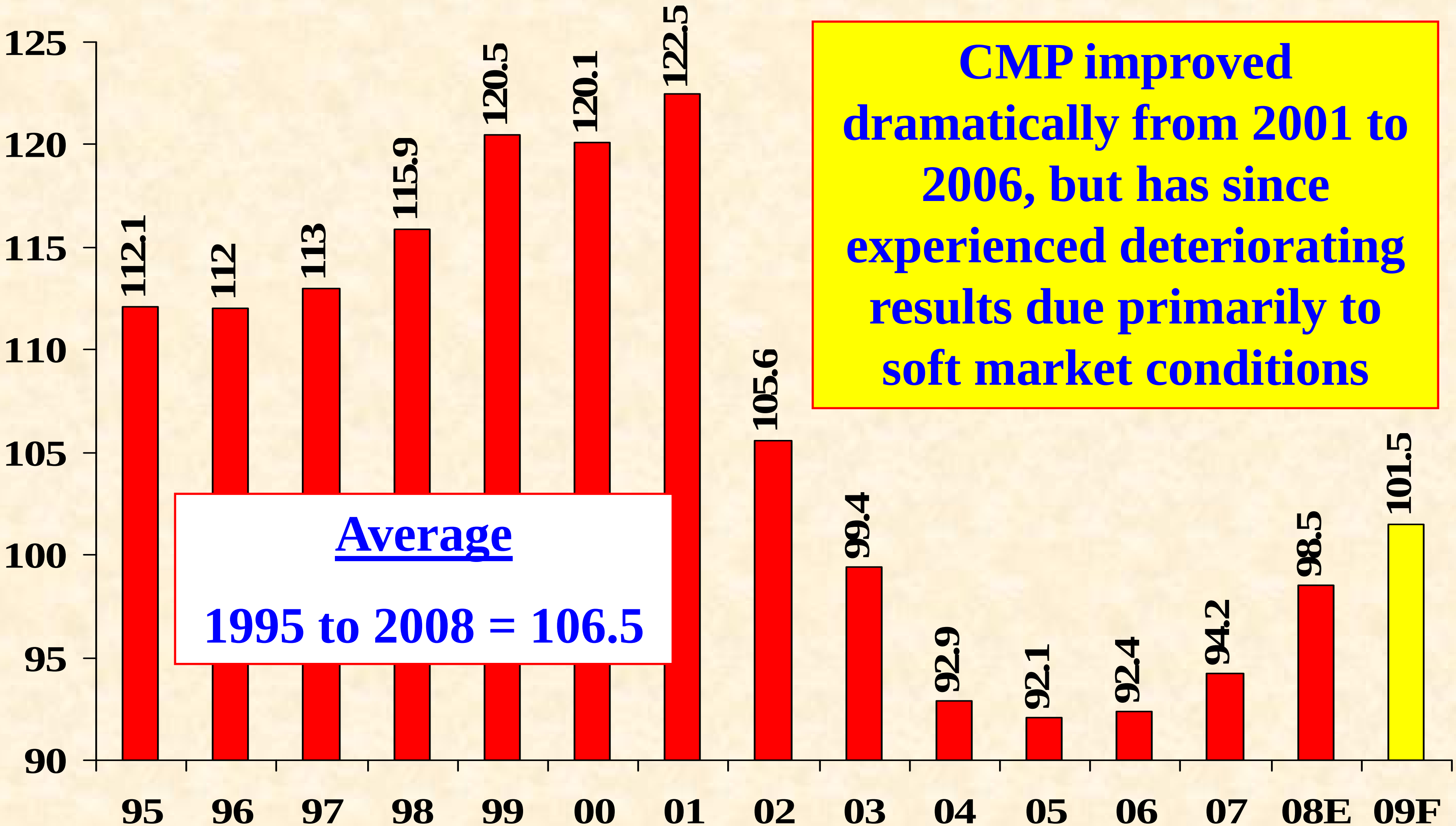
Commercial Multi-Peril Combined
(Liability vs. Non-Liability Portion)*



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

*Includes both liability and property damage for years 2007-2009F.

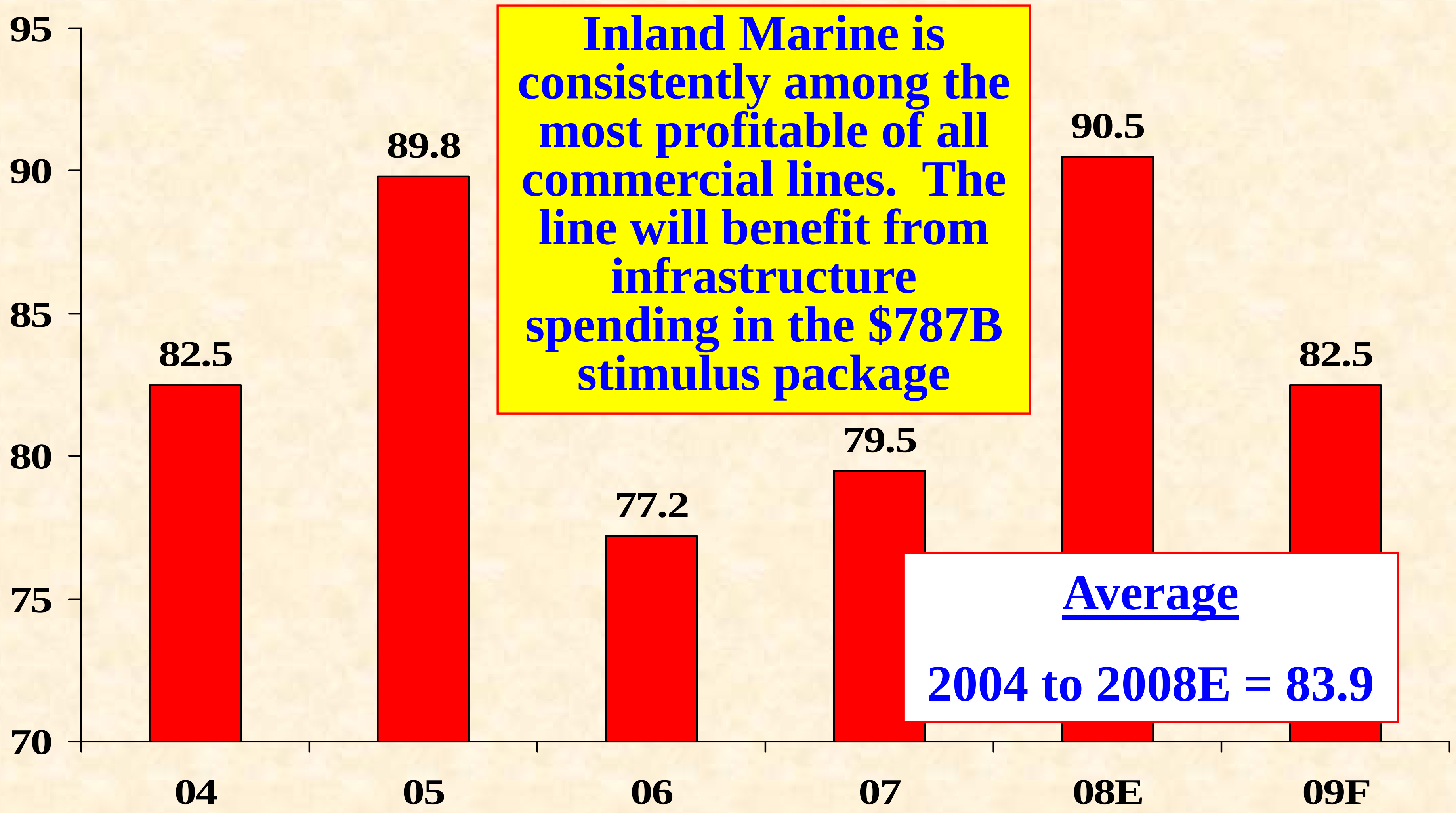
Commercial Auto Combined Ratio (1995-2009F)



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

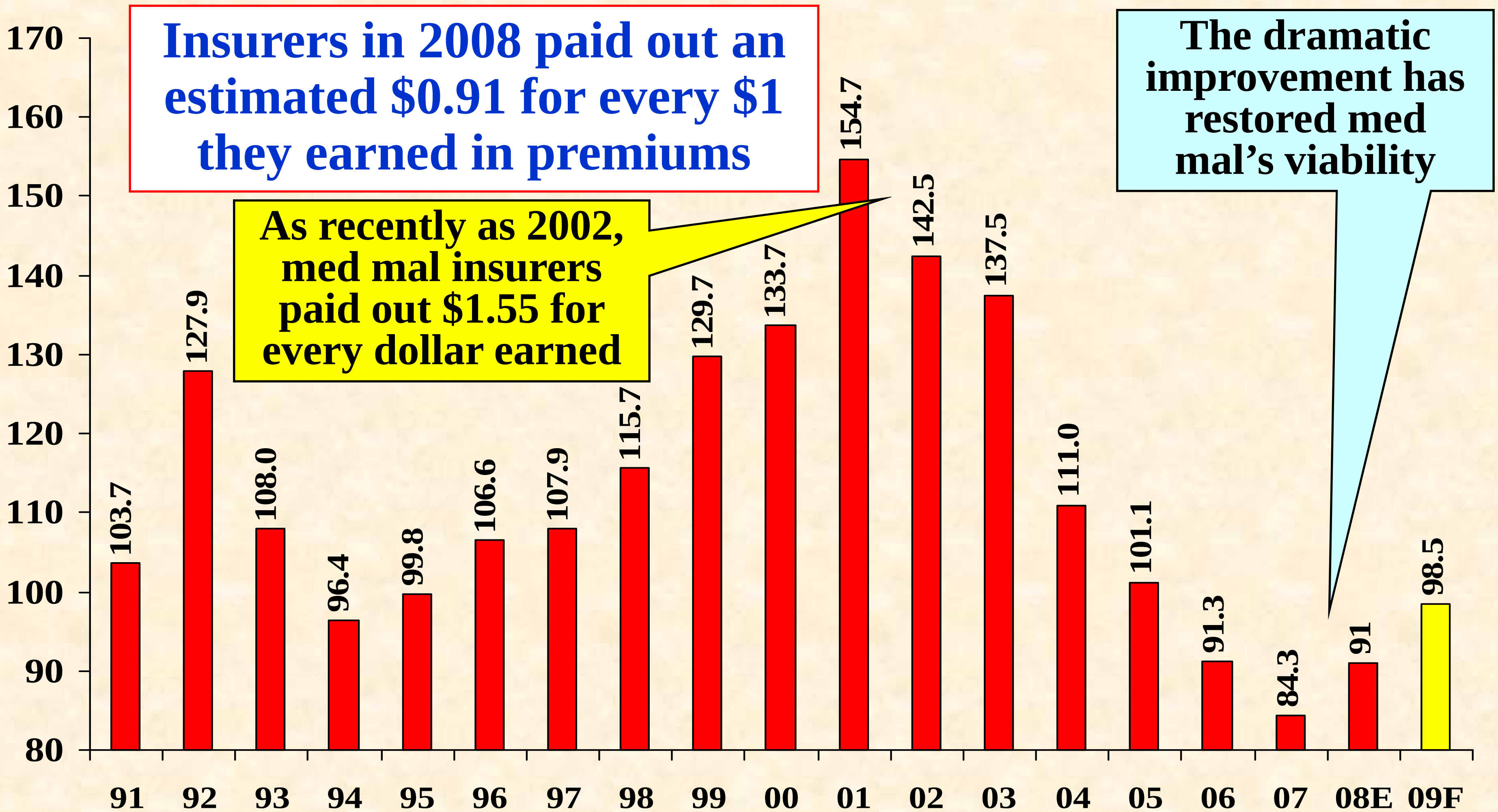
*Includes both liability and property damage.

Inland Marine Combined Ratio (2004-2009F)



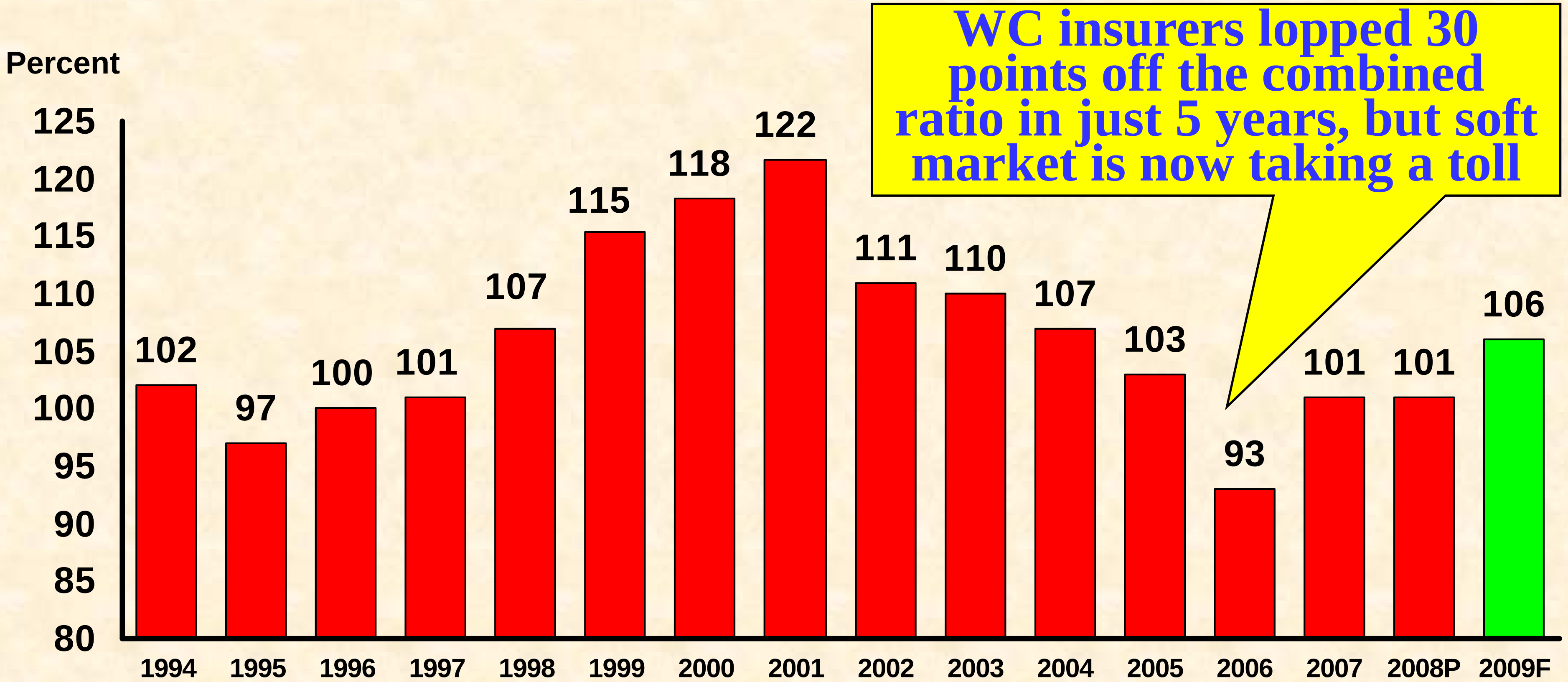
Sources: A.M. Best (historical and forecasts)

Medical Malpractice Combined Ratio



Source: AM Best, Insurance Information Institute

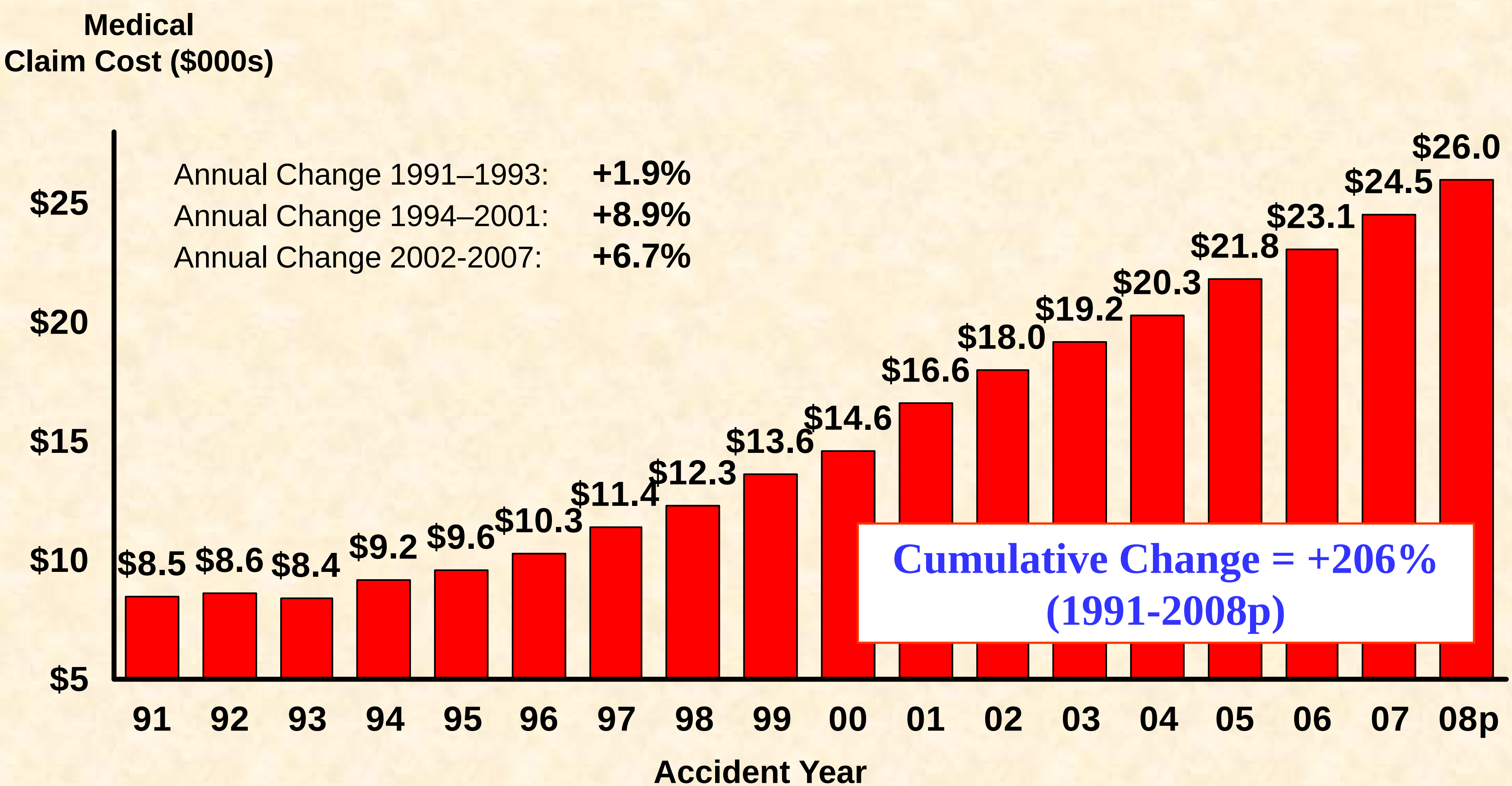
Workers Comp Combined Ratios,
(Calendar Year, Private Carriers) 1994-2009F



p Preliminary.
Sources: Calendar Years 1994-2008p, A.M. Best Aggregates & Averages; Calendar Year 2009F is I.I.I. estimates for private carriers based A.M. Best Review and Preview 2009; NCCI
Includes dividends to policyholders

Workers Compensation Medical Claim Trends

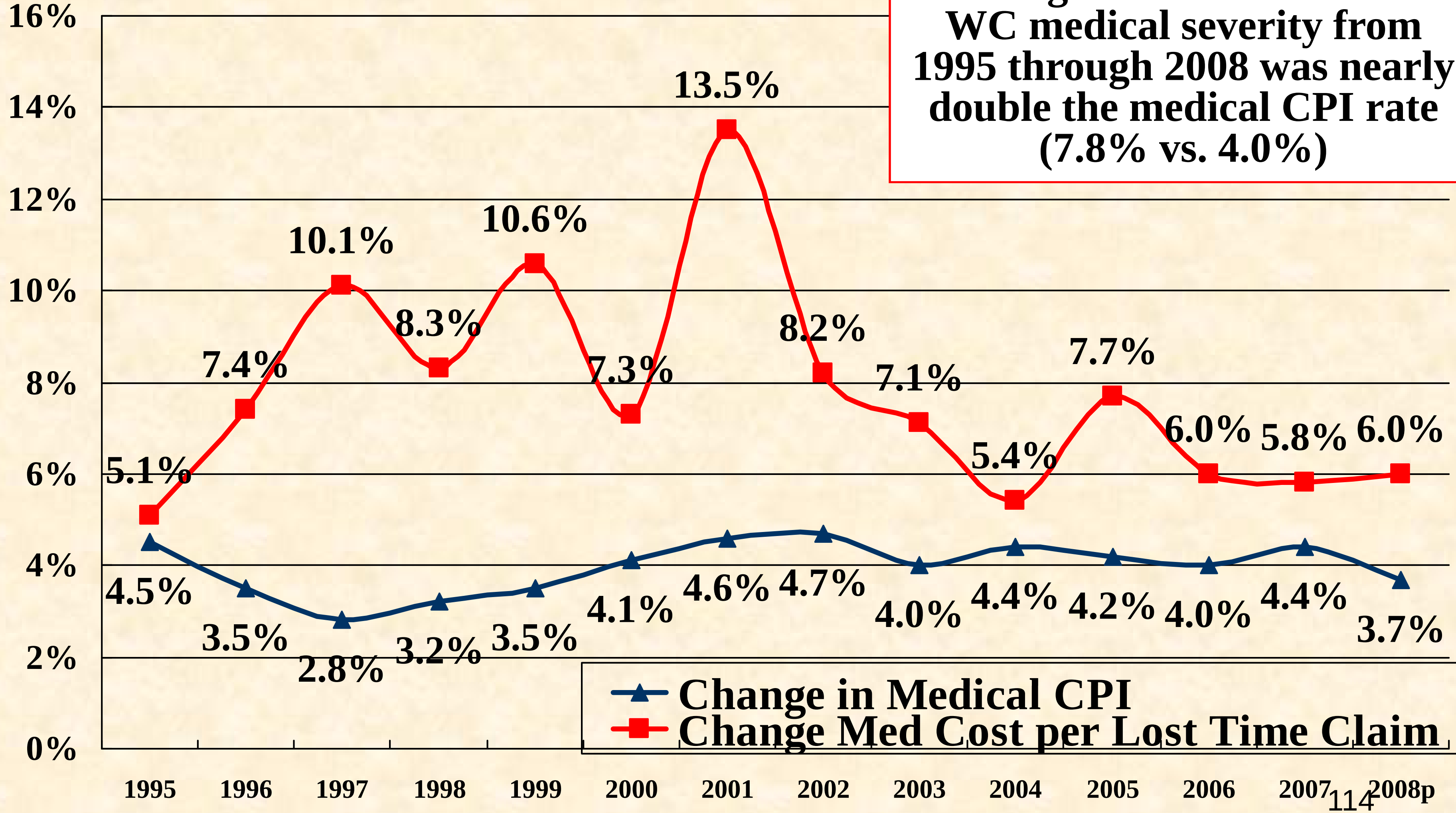
Workers Comp Medical Claims Costs Continue to Climb



200pp: Preliminary based on data valued as of 12/31/2008
1991-2007: Based on data through 12/31/2007 developed to ultimate
Based on the states where NCCI provides ratemaking services; Excludes the effects of deductible policies

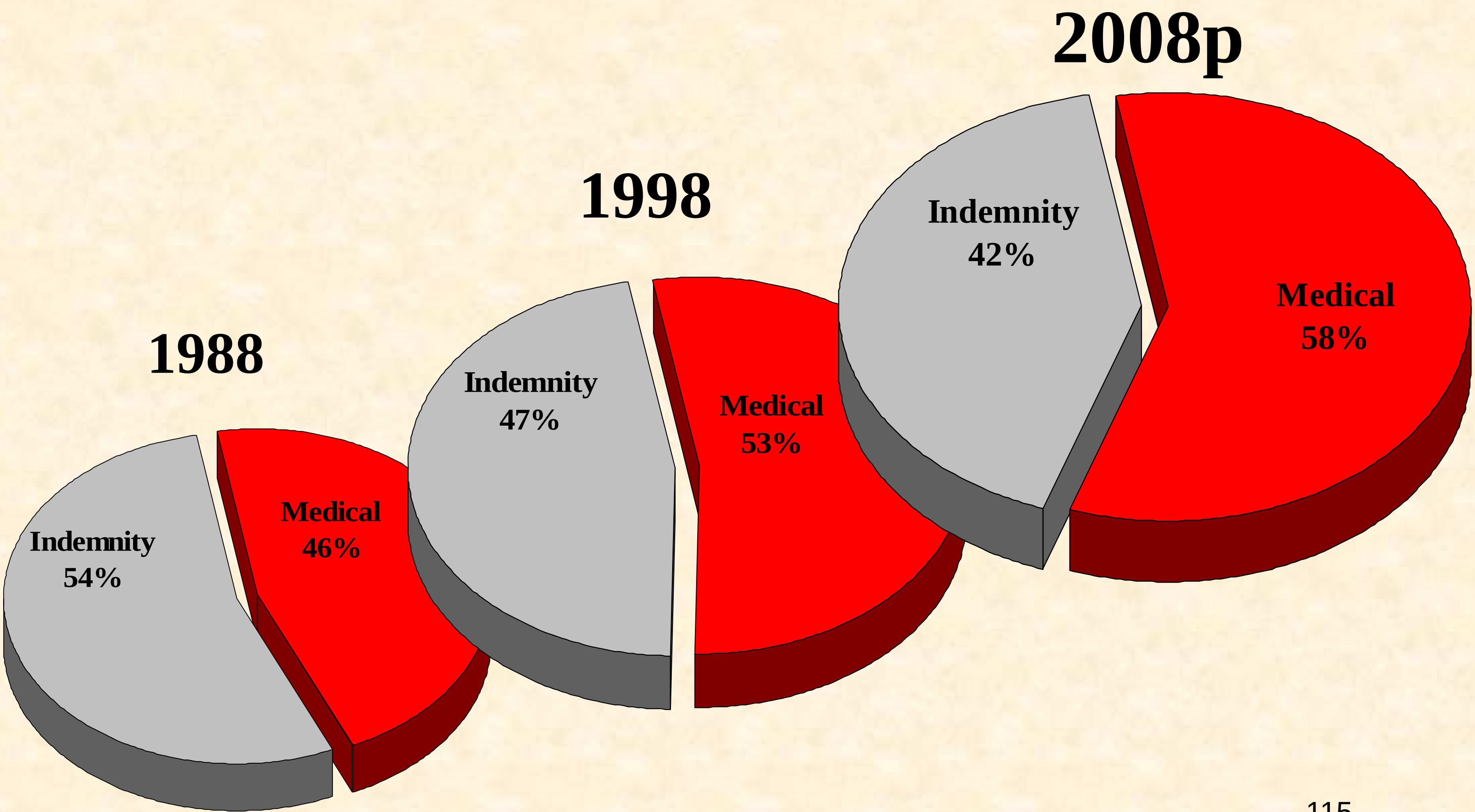
WC Medical Severity Rising at Double the Medical CPI Rate

Average annual increase in WC medical severity from 1995 through 2008 was nearly double the medical CPI rate (7.8% vs. 4.0%)



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

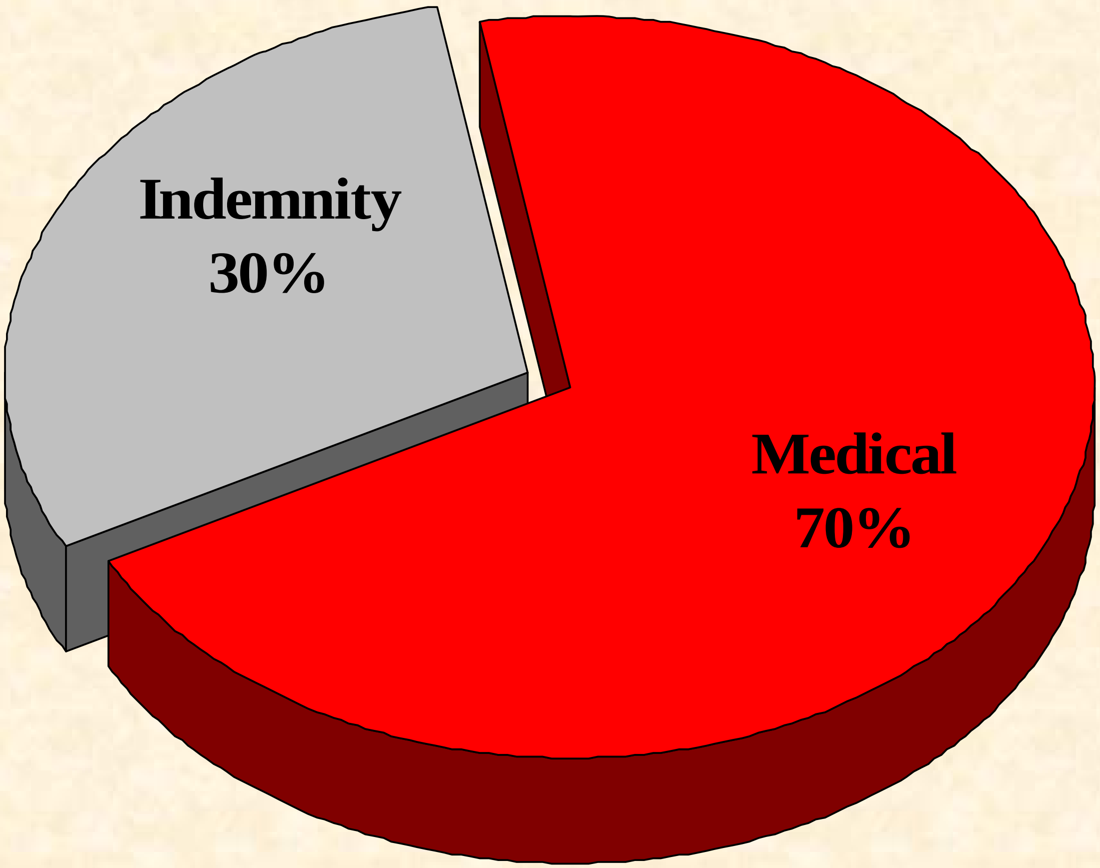
Med Costs Share of Total Costs is Increasing Steadily



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

WC Med Cost Will Equal 70% of Total by 2018 if Trends Hold

2017 Estimate



This trend will likely be supported by the increased labor force participation of workers age 55 and older.

Source: Insurance Information Institute.

Catastrophe Losses

Impacting Underwriting Results and the Bottom Line

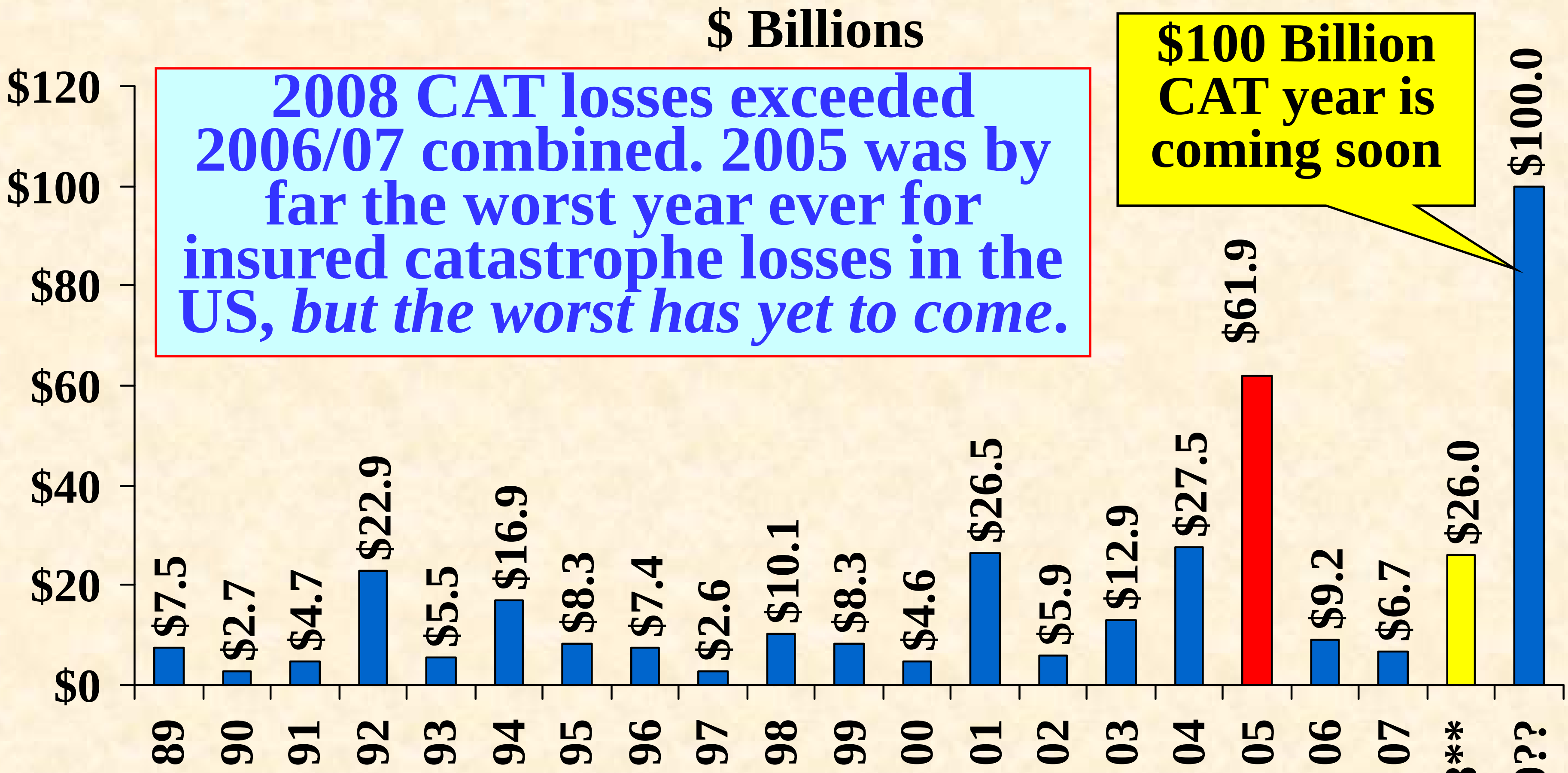
Top 10 Changes in the Financing of Catastrophic Loss

1. **Capital Has Become Much More Scarce**
   - Though still adequate, existing US p/c capital base shrank by an estimated 16% as of year-end 2008 from Q3:07 peak; Global (re)insurance impacted as well as recent deal with Buffett deal with Swiss Re indicates.
   - Speed with which any given amount of capital can be raised has slowed
2. **Capital Has Become More Expensive**
   - Scarcity and volatility have driven cost of capital higher
   - More competition on the open market for the limited amount of capital available
3. **Investment Earnings Can Offset Only a Smaller Share of Catastrophe Losses**
   - Low interest rates, poor equity market performance, write downs eat into returns
4. **Alternative Sources of Capital Have Dried-Up**
   - E.g., hedge fund, private equity money is far less available
5. **Catastrophe Bonds Cannot Be Assumed to Be Uncorrelated With Tradition Financial Market Risk**
   - Example of Willow Re (failed to fully meet Feb. 2 interest payment due to Lehman's failure which caused a total return swap to become worthless, exposing investor principal and interest to market risk); A.M. Best concerned about 3 other Lehman-backed bonds from Ajax Re , Newton Re & Carillon Re
   - Will result in changes in how such instruments are funded and investments held

Top 10 Changes in the Financing of Catastrophic Loss

6. **State Run Residual Markets Are More Vulnerable Due to Shaky Financing Arrangements**
   - **FL's situation is more precarious than ever & growing; Threatens state's finances**
   - **States using assessment mechanism as zero cost lines of credit (e.g., Texas) creating a high opportunity cost for insurers without fixing state's fiscal exposure**
7. **Economics of Start-Ups and Take-Out Companies in CAT Zones Becomes Less Compelling Due to Higher Cost of Capital**
   - **Harder to raise cash**
   - **Tougher to meet target ROI as cost of capital rises**
8. **Financial Services Regulatory Overhaul Will Change How the Business of Insurance Is Regulated**
   - **Unclear how this will affect how cat loss is financed**
   - **Nat Cat legislation is not (currently) part of the overhaul discussion**
   - **Systemic Risk Regulator: What are p/c systemic risk points? (CAT exposure?; Guaranty Funds?)**
   - **Will be impacts on sources of capital as well (e.g., hedge funds)**
9. **Federal Government is Fiscally Constrained**
   - ➢ **Can/would federal play a bigger role in financing CAT risk? Fed backstops to be sought?**
10. **Return on Investment for Mitigation is *Greatly* Increased**
    - ➢ **Investments in mitigation provide a guaranteed high rate of return: up to 500%**
    - ➢ **Mitigation preserves and conserves scarce private capital and government resources**

U.S. Insured Catastrophe Losses*



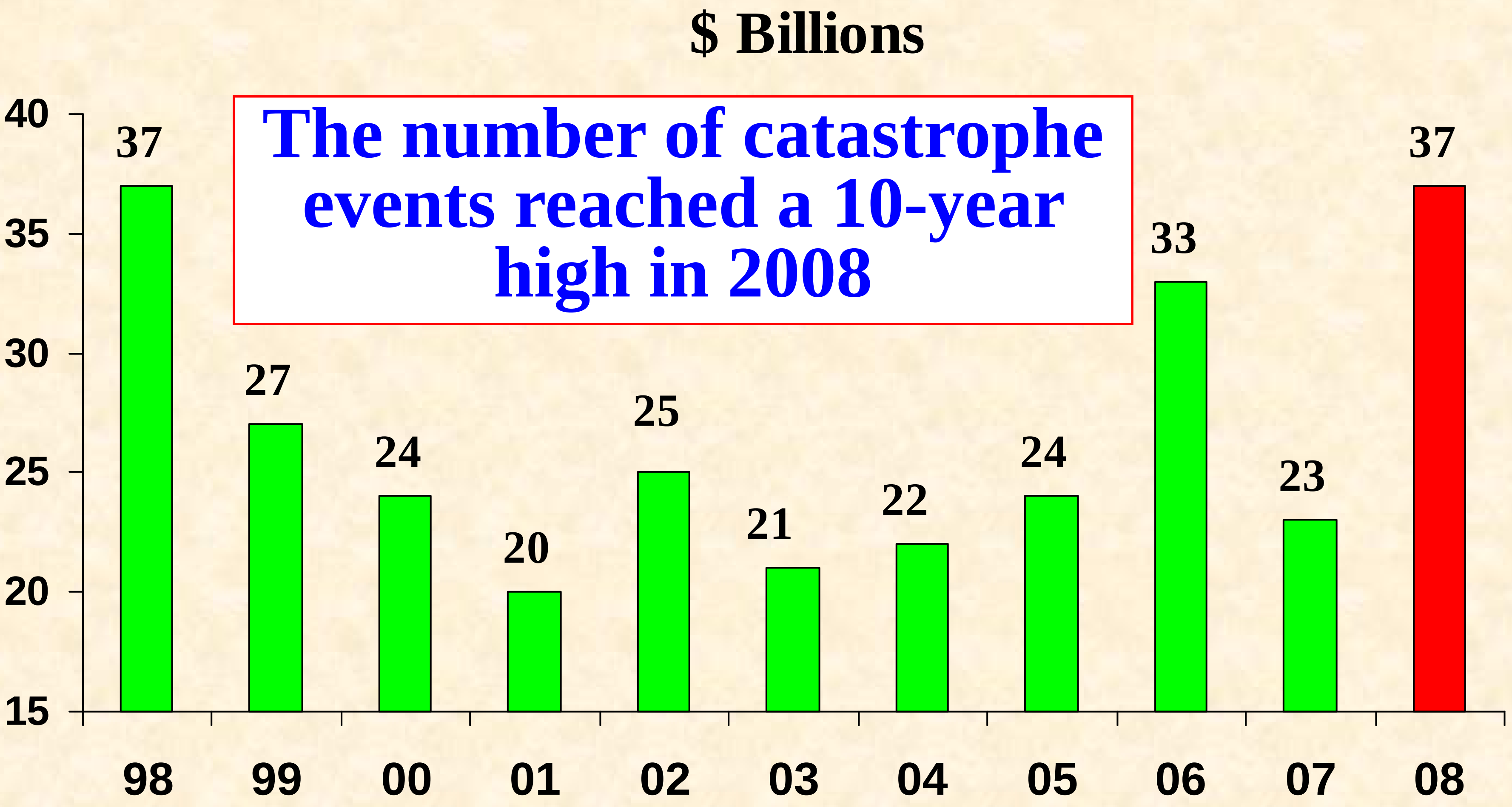
*Excludes $4B-$6b offshore energy losses from Hurricanes Katrina & Rita.

**Based on PCS data through Dec. 31. PCS $2.1B loss of for Gustav. $10.655B for Ike of 12/05/08.

<u>Note</u>: 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

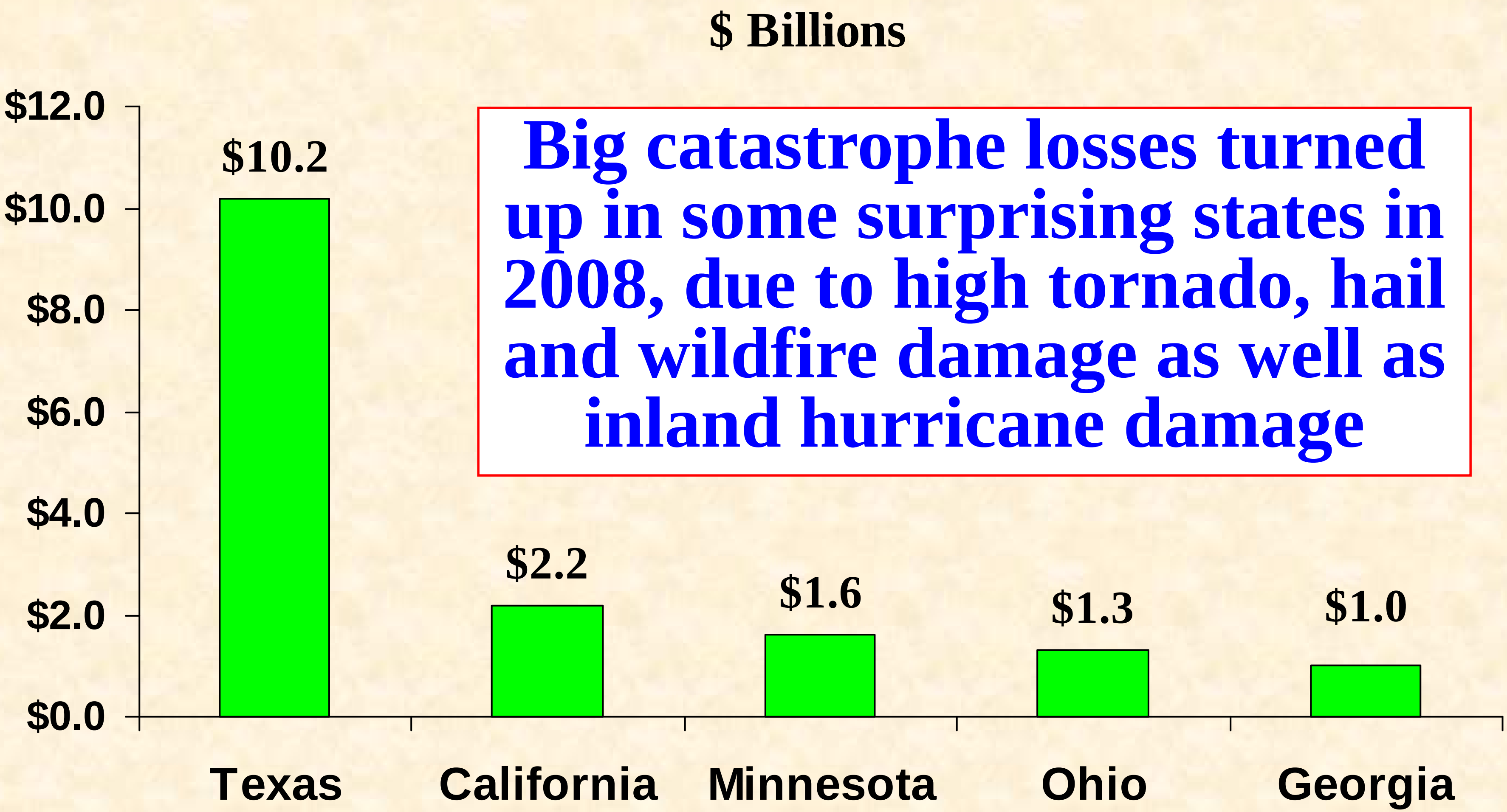
Number of PCS Catastrophe Events, 1998-2008*



*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.

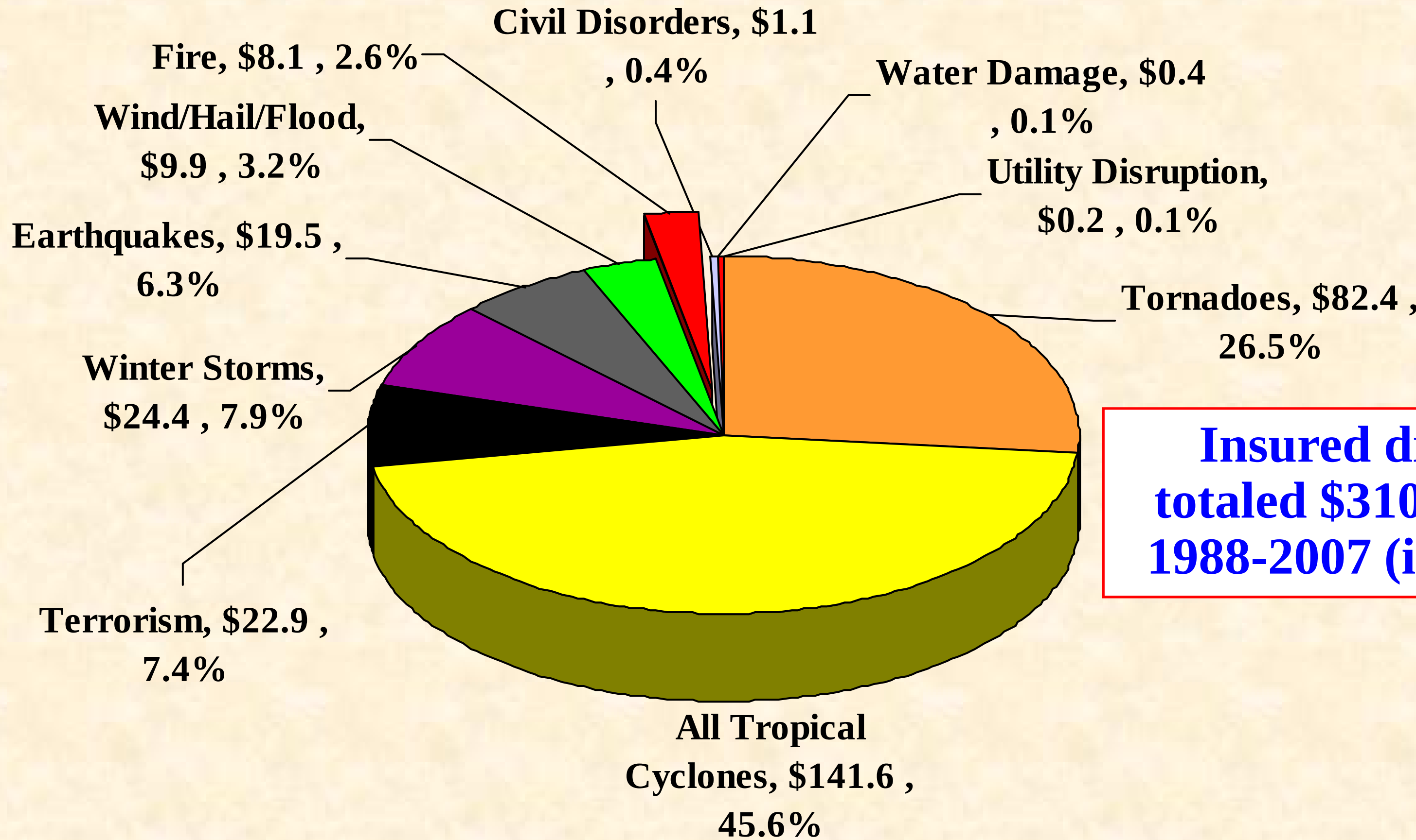
Source: PCS; Insurance Information Institute

States With Highest Insured Catastrophe Losses in 2008



Source: PCS; Insurance Information Institute.

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

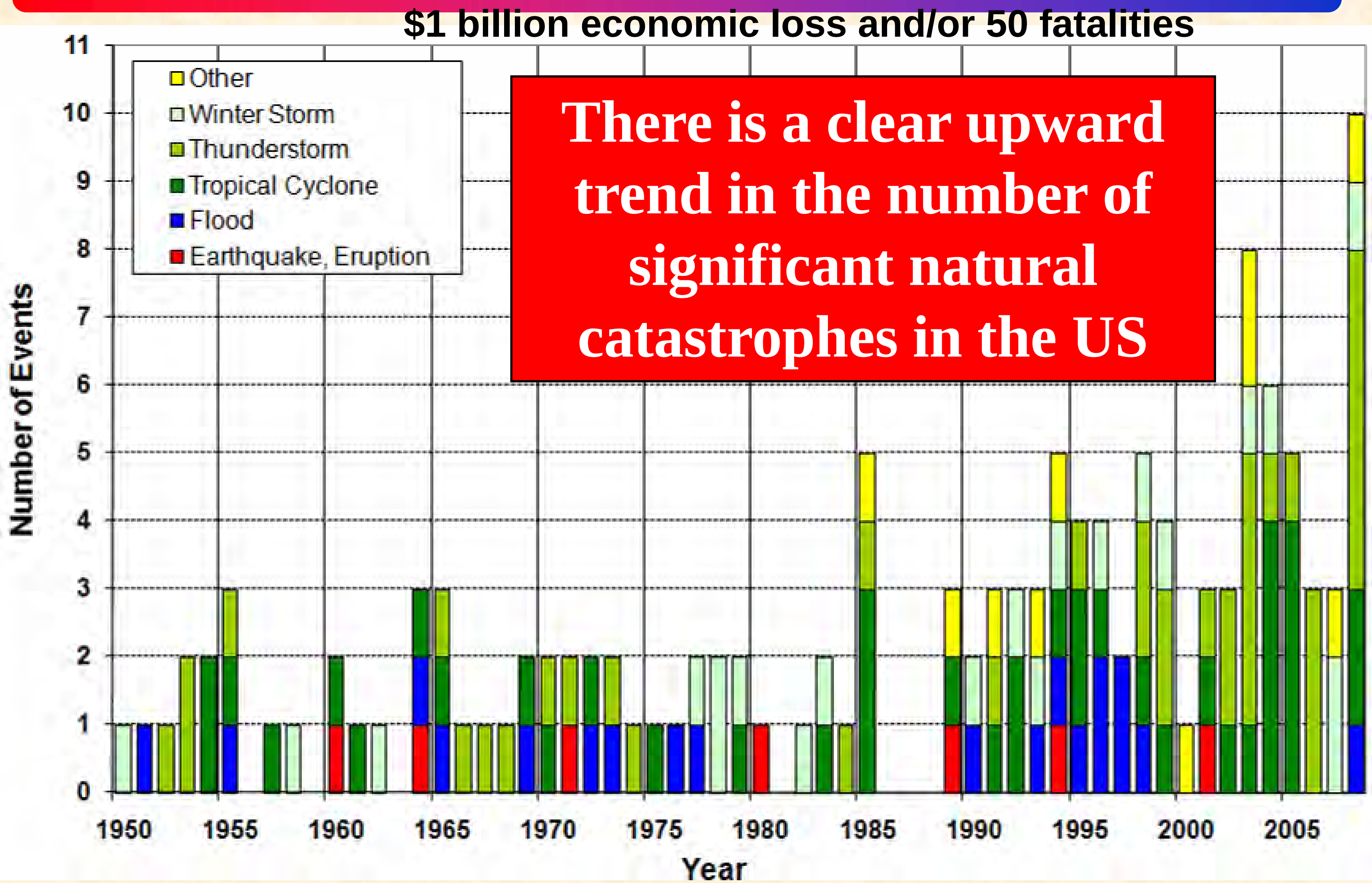


Insured disaster losses totaled $310.5 billion from 1988-2007 (in 2007 dollars)

[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.

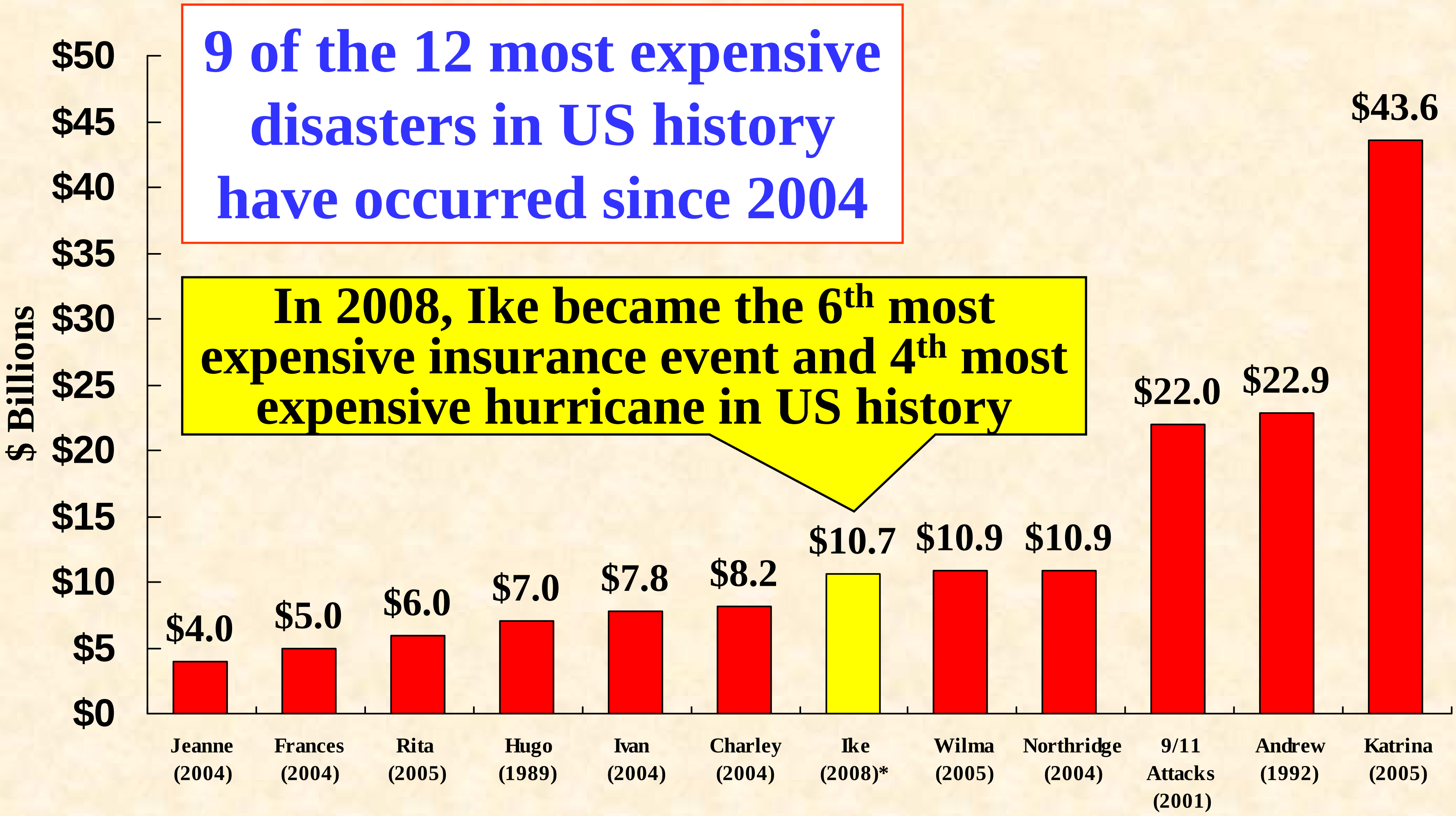
Source: Insurance Services Office (ISO)..

Number of U.S. Significant Natural Catastrophes*,1950 – 2008



Sources: Munich Re NatCat*SERVICE* **$1 billion economic loss and/or 50 fatalities.*

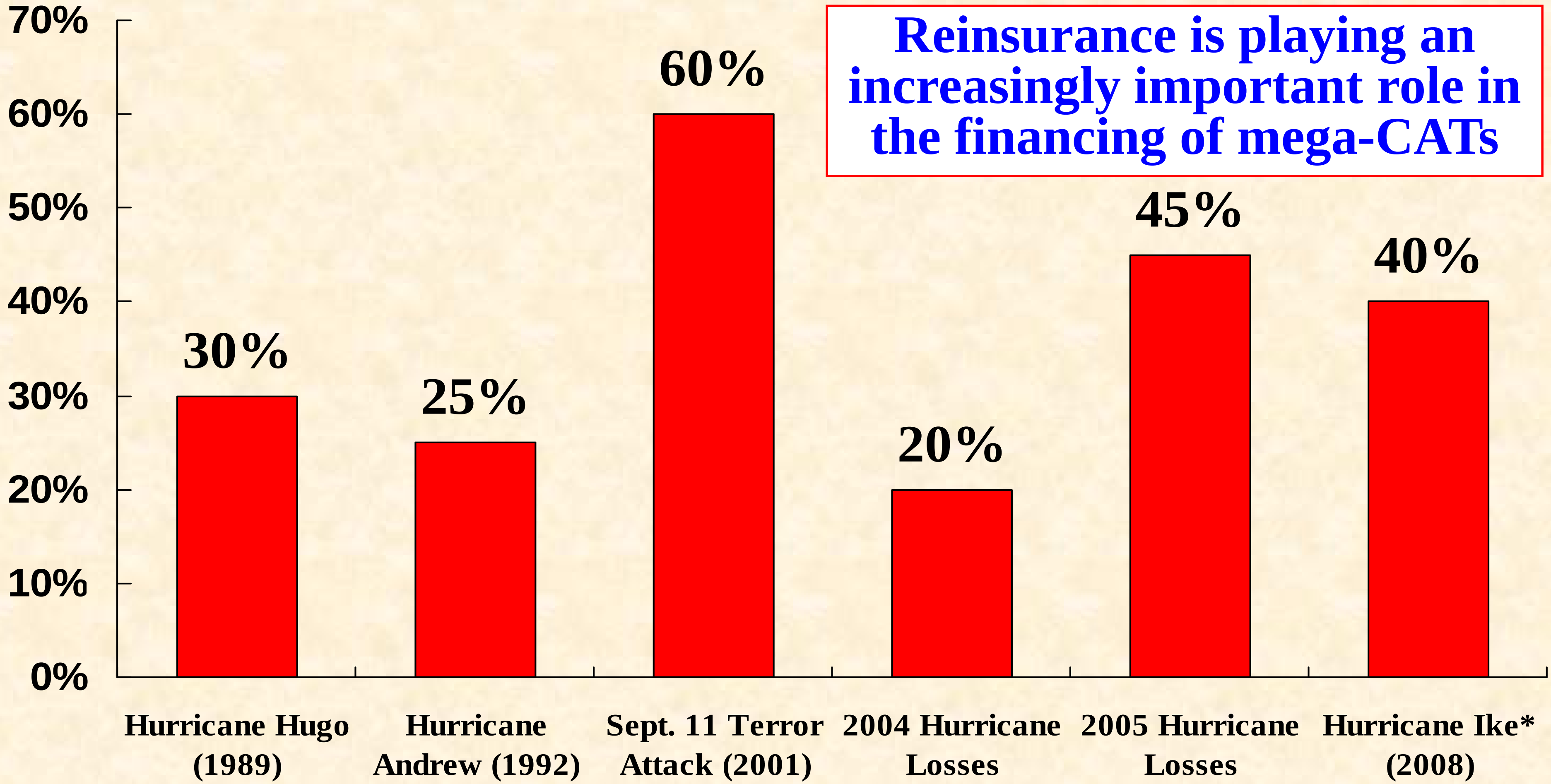
Top 12 Most Costly Disasters in US History, (Insured Losses, $2007)



*PCS estimate as of 12/15/08.

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

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. Ike share is an estimate as of 2/9/09.

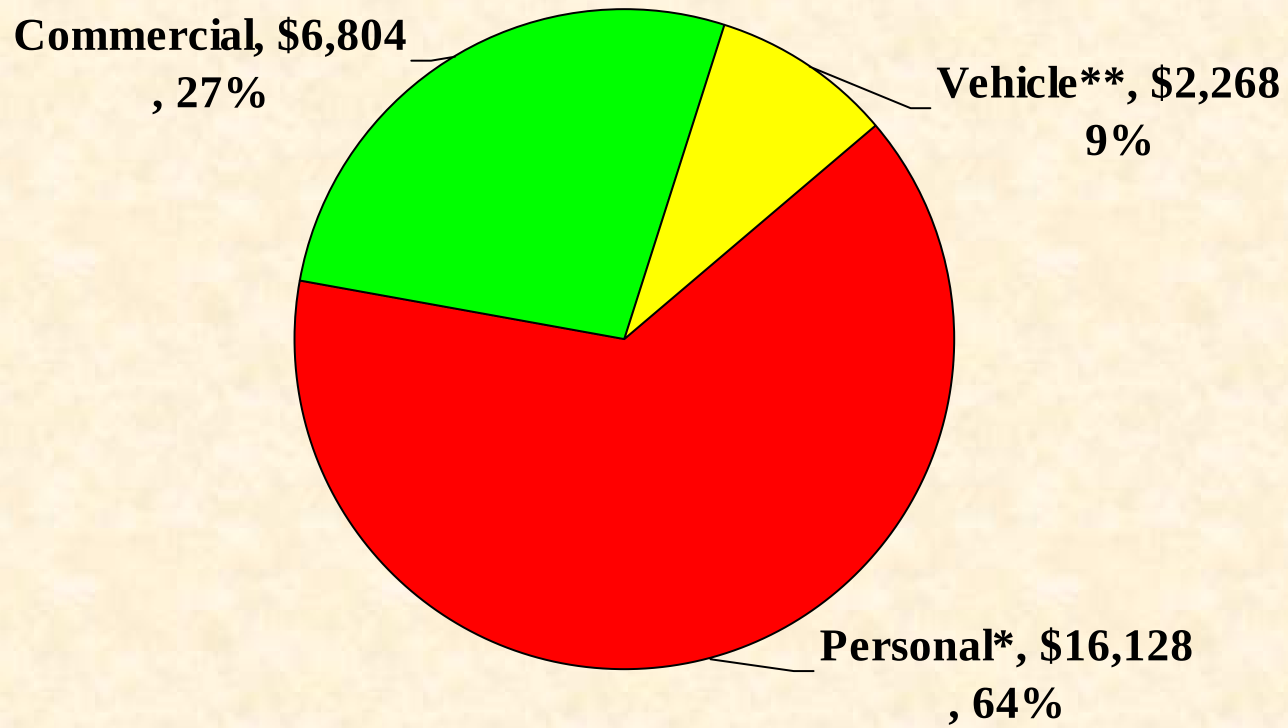
Sources: Wharton Risk Center, Disaster Insurance Project; Insurance Information Institute.

2008 Insured Catastrophe Loss Distribution by Category

2008 CAT FACTS

- The $25.2 billion in insured losses was the 4th highest ever, behind only, 2005, 2004 and 2001
- There were 37 designated catastrophes in 2008, the highest since 1998 (also 37)
- Commercial losses accounted for 27% of insured losses but just 9% of claims

$ Millions



*Includes homeowers, condominium and rental policies.
**Includes commercial and private passenger vehicles
Source: PCS; Insurance Information Institute research.

2008 Insured Catastrophe Loss Distribution by Number of Claims

2008 CAT FACTS

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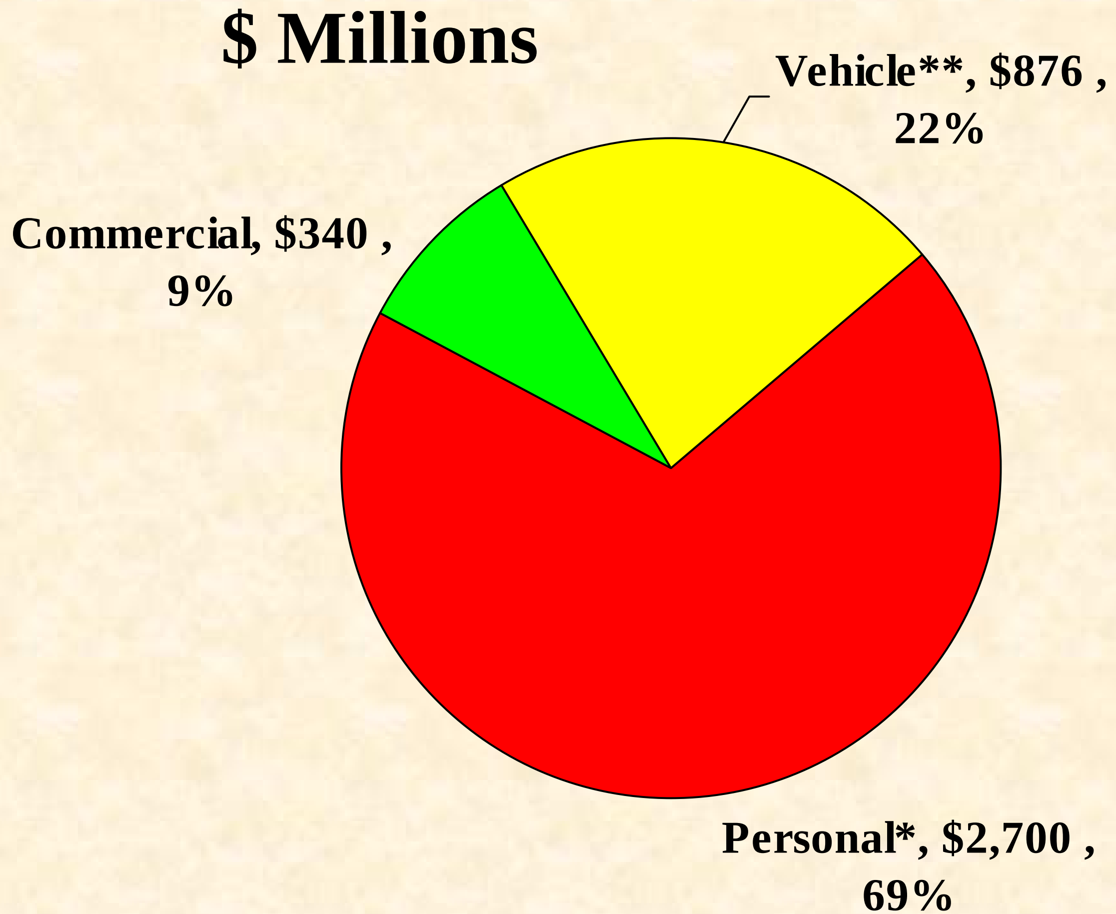
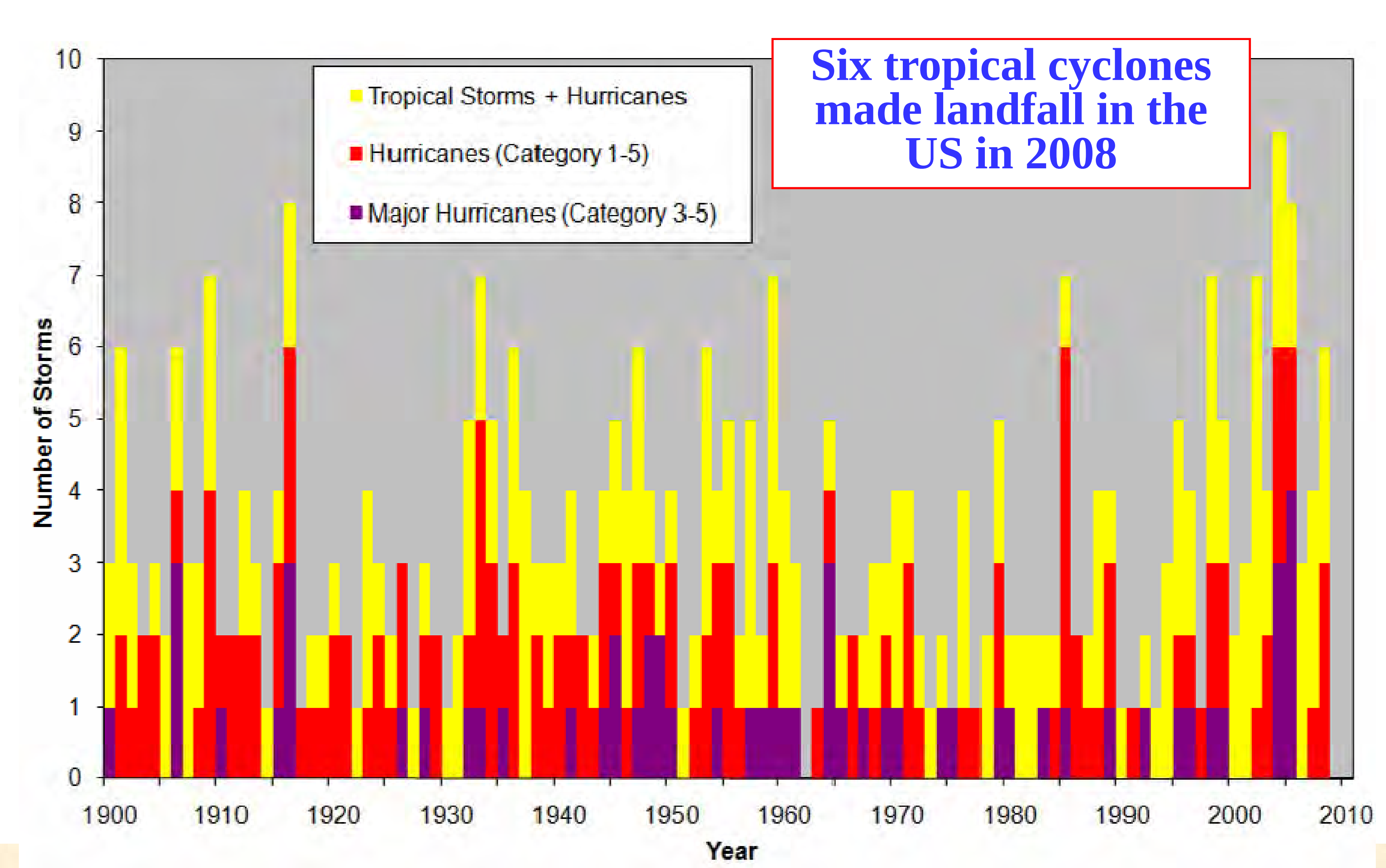


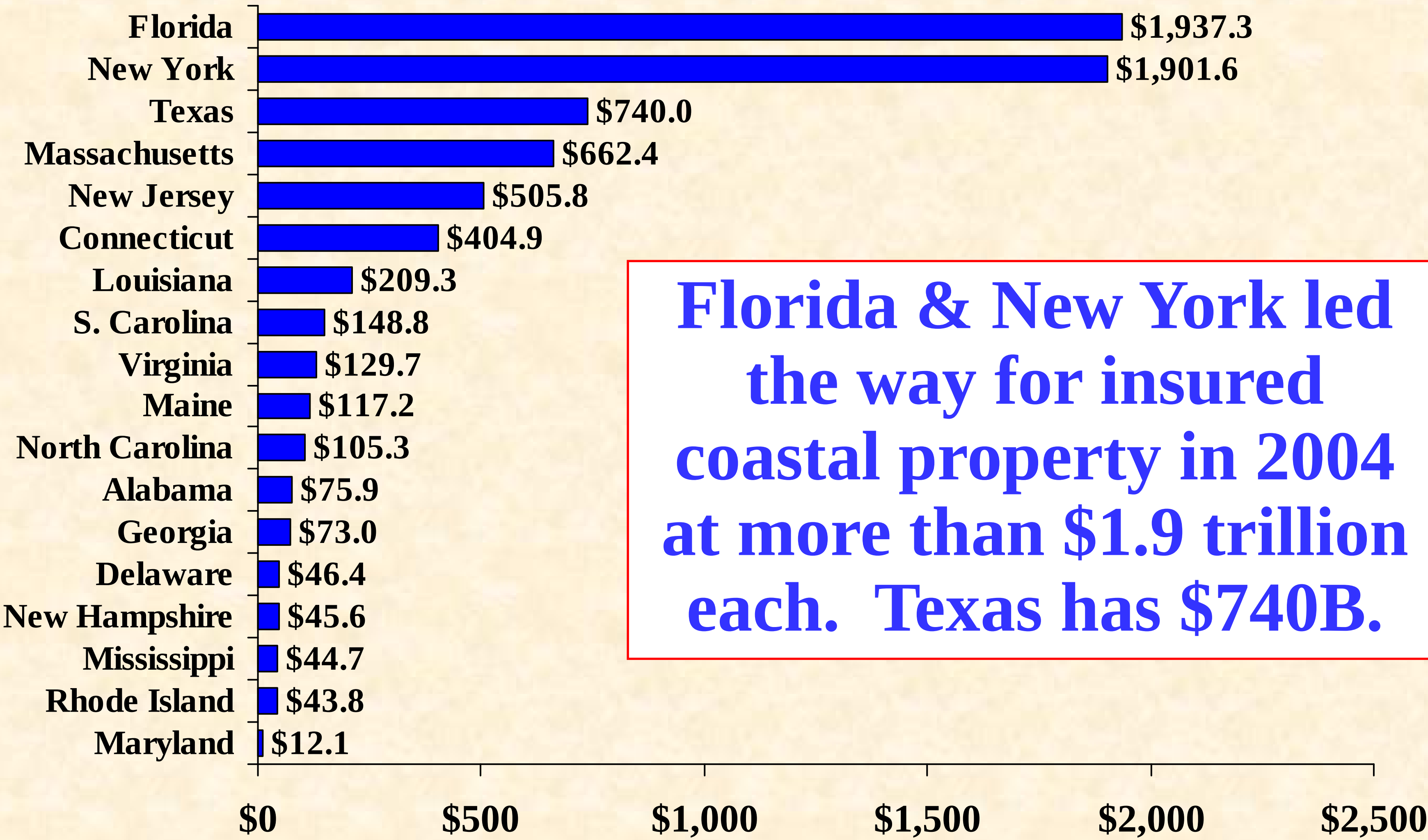
*Includes homeowers, condominium and rental policies.
**Includes commercial and private passenger vehicles
Source: PCS; Insurance Information Institute research.

Rising Number of U.S. Landfalling Tropical Cyclones Has Been Very Costly for Insurers



Source: Munich Re from NOAA

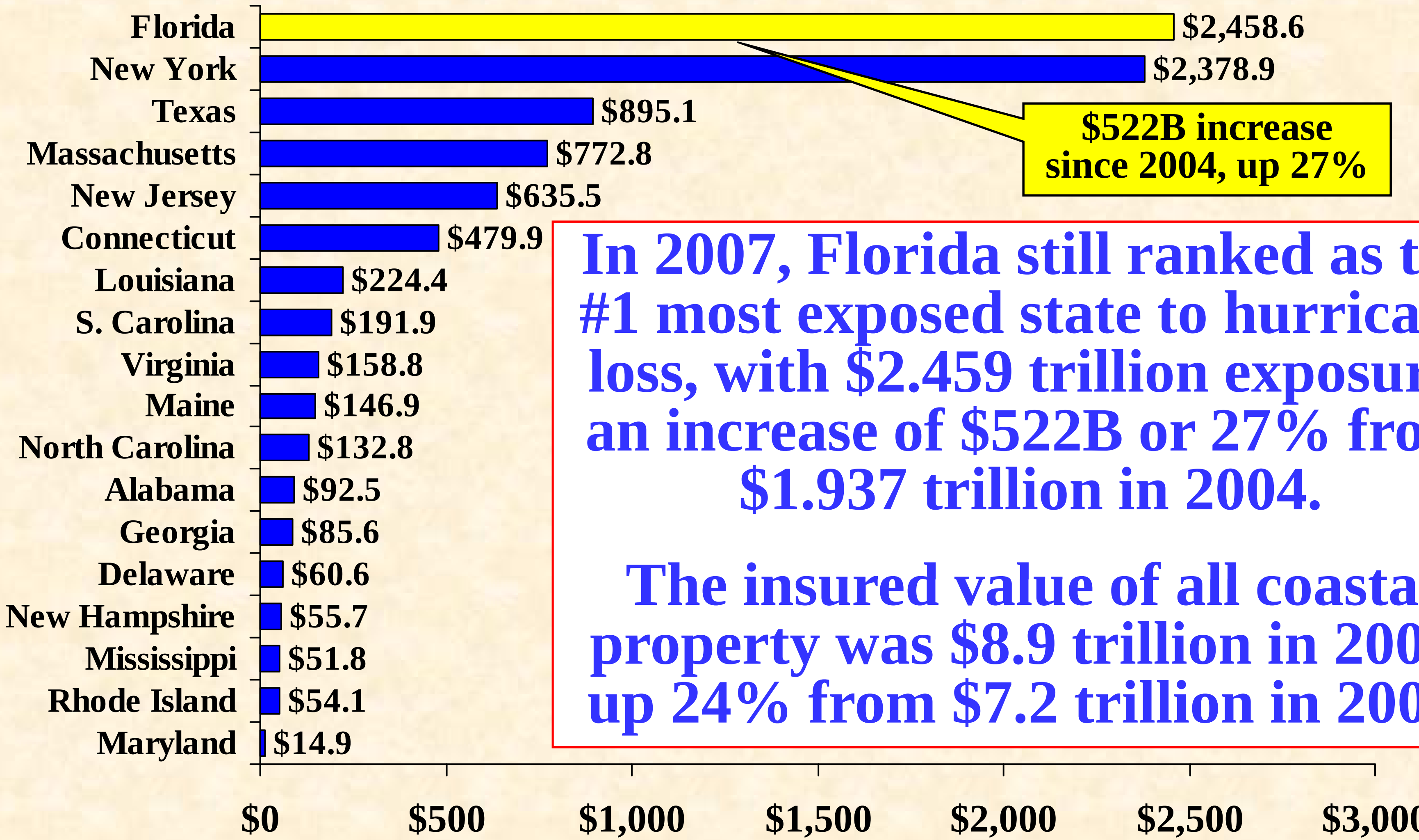
Total Value of Insured Coastal Exposure (2004, $ Billions)



Florida & New York led the way for insured coastal property in 2004 at more than $1.9 trillion each. Texas has $740B.

Source: AIR Worldwide

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



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

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

Source: AIR Worldwide

Insurance Information Institute On-Line

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