



Workers Compensation: Overview & Outlook for New York and US Markets

AmComp New York Seminar

New York, NY

September 24, 2012

Download at www.iii.org/presentations

Robert P. Hartwig, Ph.D., CPCU, President & Economist

Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038

Tel: 212.346.5520 ♦ Cell: 917.453.1885 ♦ bobh@iii.org ♦ www.iii.org

Presentation Outline

- **U.S. Economic Overview and Outlook**
 - ◆ US and NY Growth History and Outlook
- **Labor Market Overview**
 - ◆ US, NY State, Metro Areas
- **Workers Compensation Operating Environment**
 - ◆ US and NY State
- **Summary of Recent P/C Financial Performance**
- **Challenges of Low Interest Rate Environment**
 - ◆ Global, US
- **Workers Comp Market Conditions**
- **Q&A**

Economic Overview & Outlook

**Growth Opportunities for Business and
Insurers Are Uneven But Exist**

Workers Comp Exposure Up

America's Manufacturing Renaissance?

Construction Activity About to Turn?

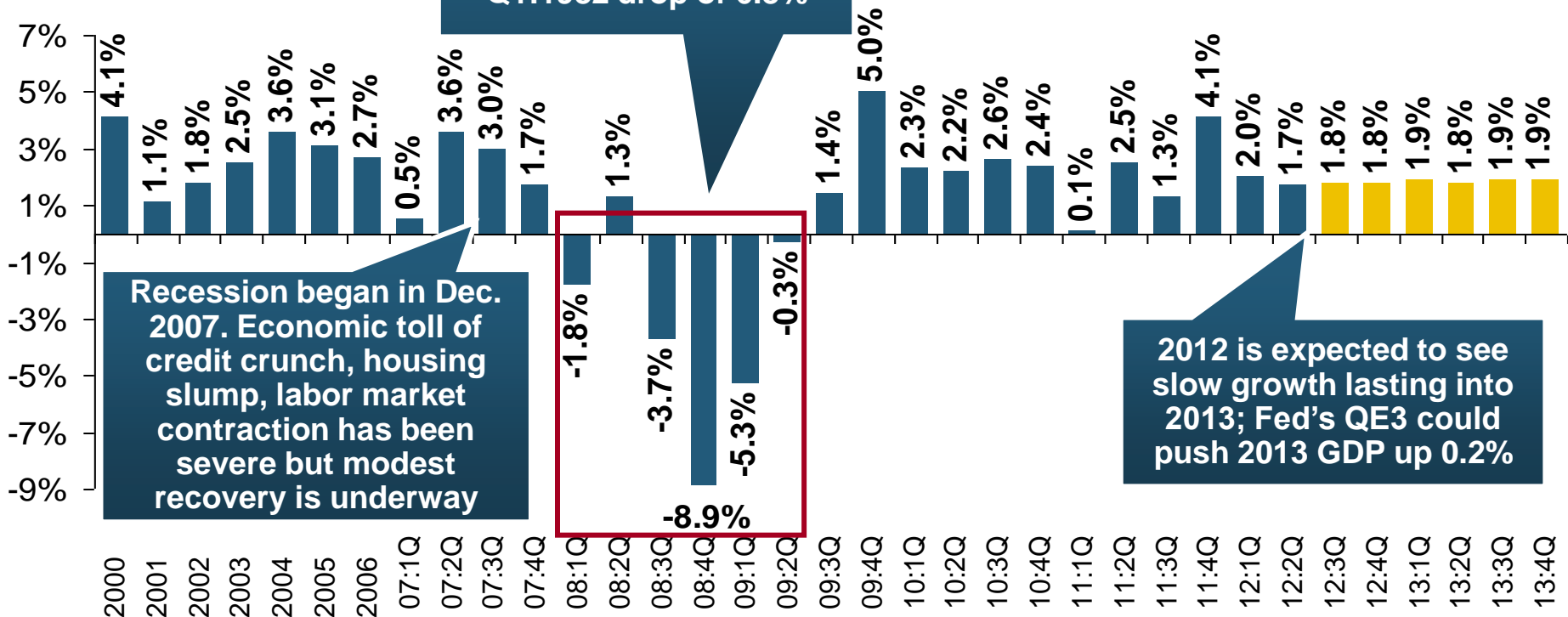
US Real GDP Growth*

Real GDP Growth (%)

The Q4:2008 decline was the steepest since the Q1:1982 drop of 6.8%

Recession began in Dec. 2007. Economic toll of credit crunch, housing slump, labor market contraction has been severe but modest recovery is underway

2012 is expected to see slow growth lasting into 2013; Fed's QE3 could push 2013 GDP up 0.2%



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

* Estimates/Forecasts from Blue Chip Economic Indicators.

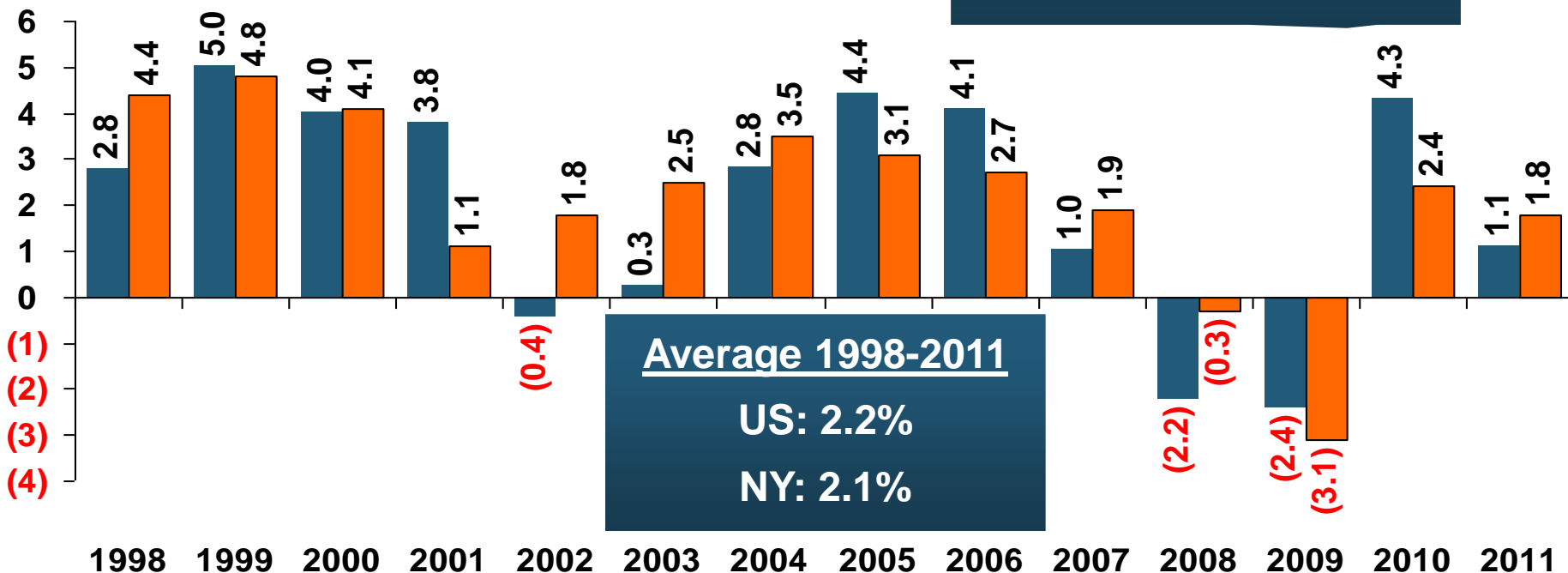
Source: US Department of Commerce, Blue Economic Indicators 9/12; Insurance Information Institute.

Real GDP Growth: New York State vs. US

Real GDP Growth (%)

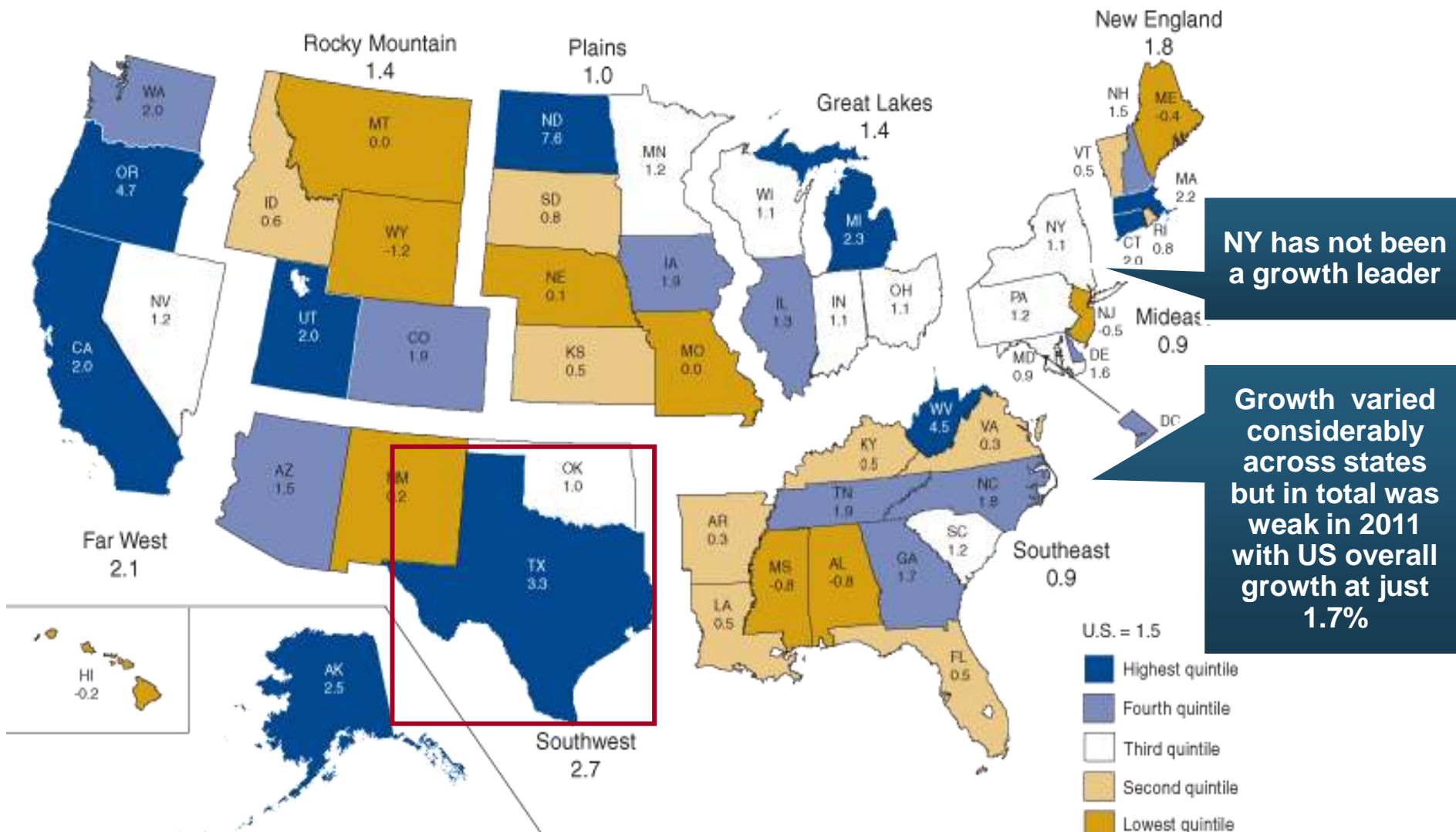
■ New York State ■ US

NY State's economy has grown at a similar pace to the US overall since 1998



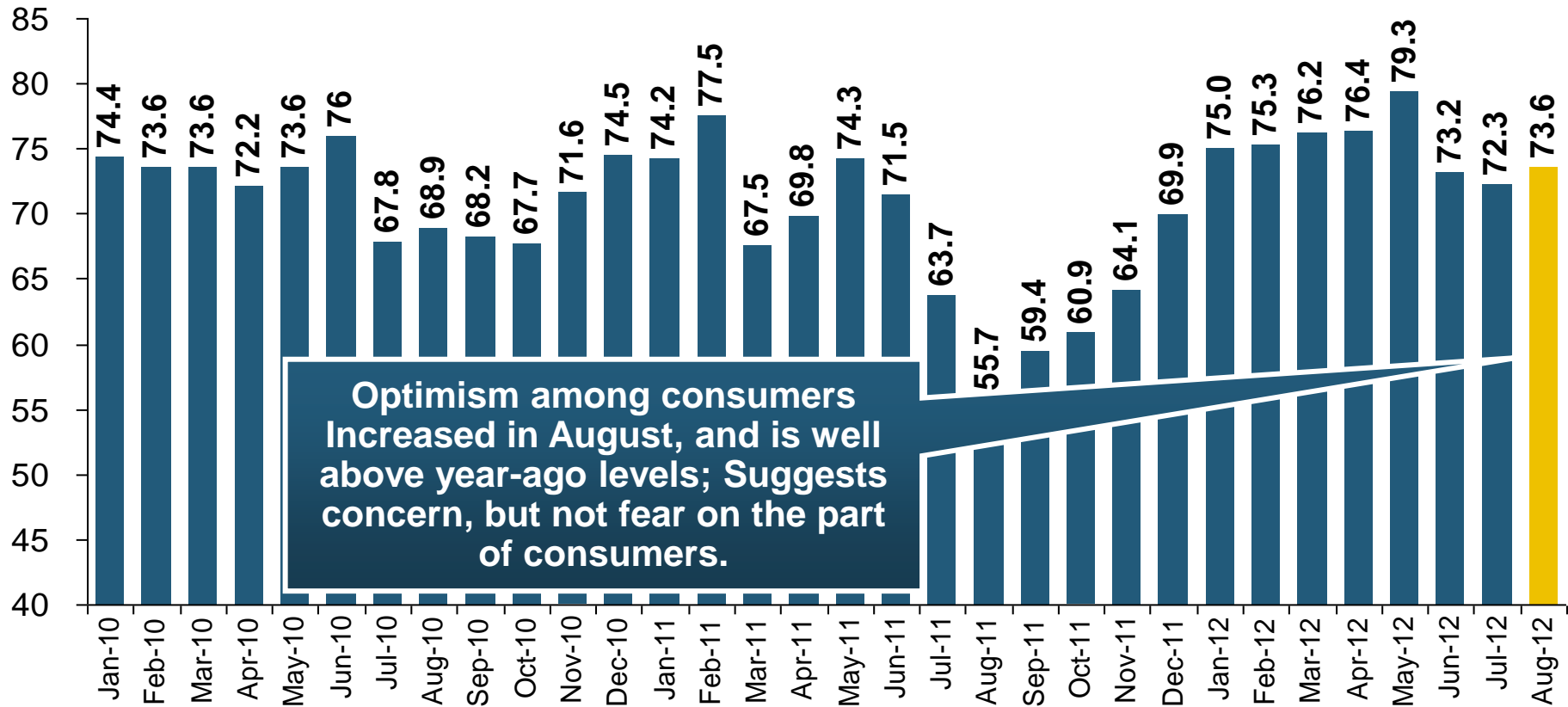
NY State Did Well During the Tech Bubble Years of the Late 1990s and Mid-2000s Until the Financial Collapse

Percent Change in Real GDP by State, 2011



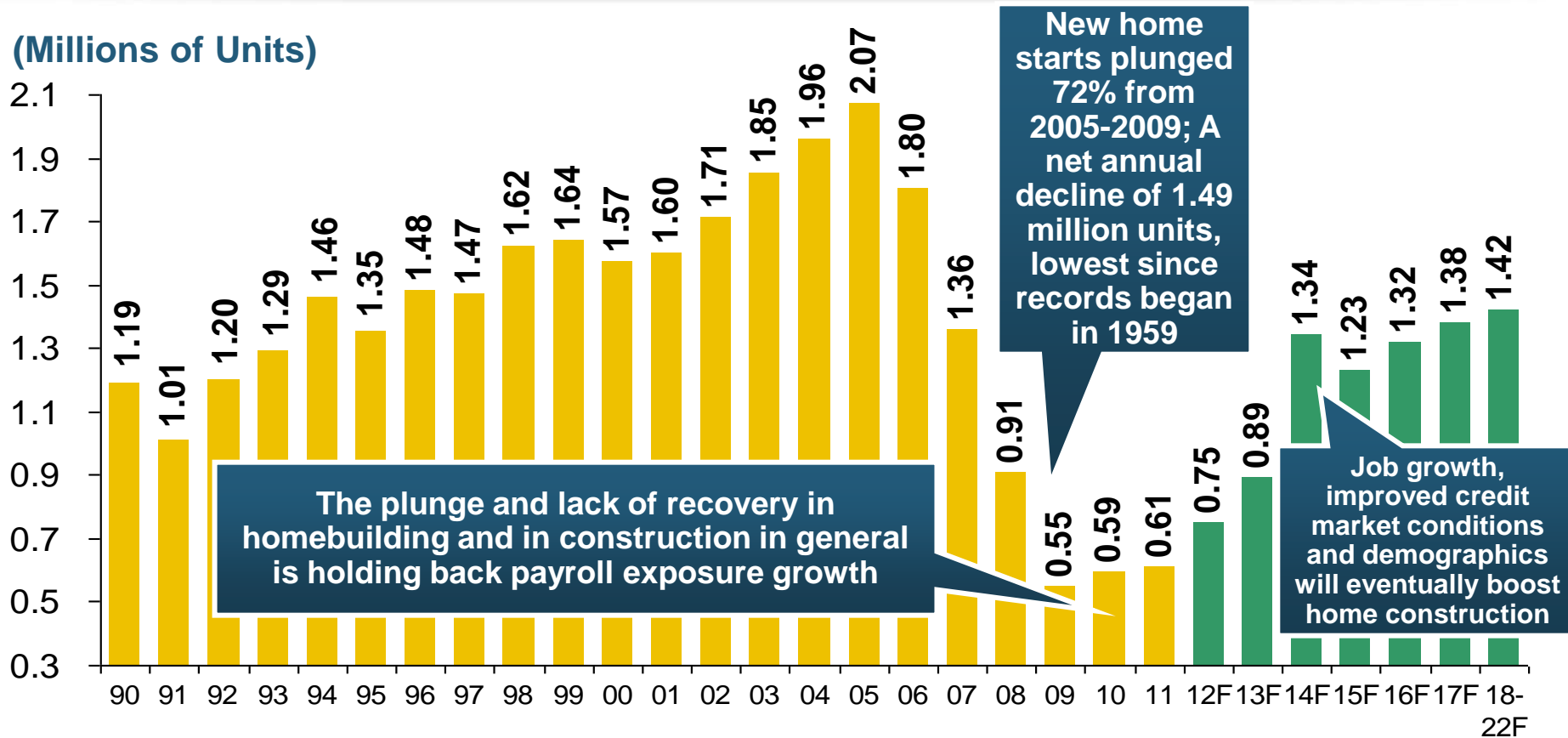
Consumer Sentiment Survey (1966 = 100)

January 2010 through August 2012



Consumer confidence has been low for years amid high unemployment, falling home prices and other factors adversely impact consumers, but improved substantially in late 2011 and early 2012

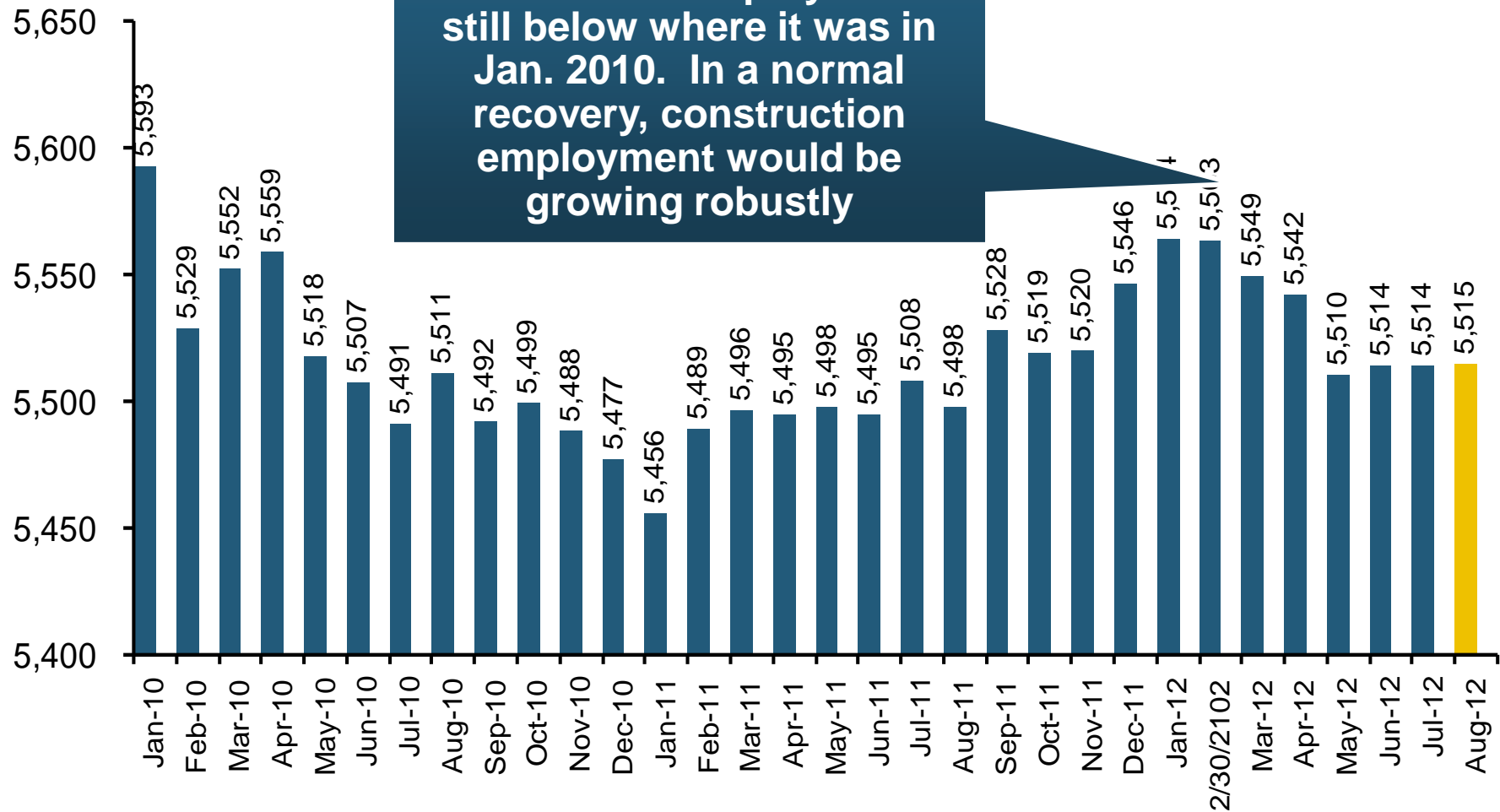
New Private Housing Starts, 1990-2022F



Little Exposure Growth Likely for Homeowners Insurers Until at least 2014. Also Affects Commercial Insurers with Construction Risk Exposure, Surety

Construction Employment, Jan. 2010—August 2012*

(Thousands)

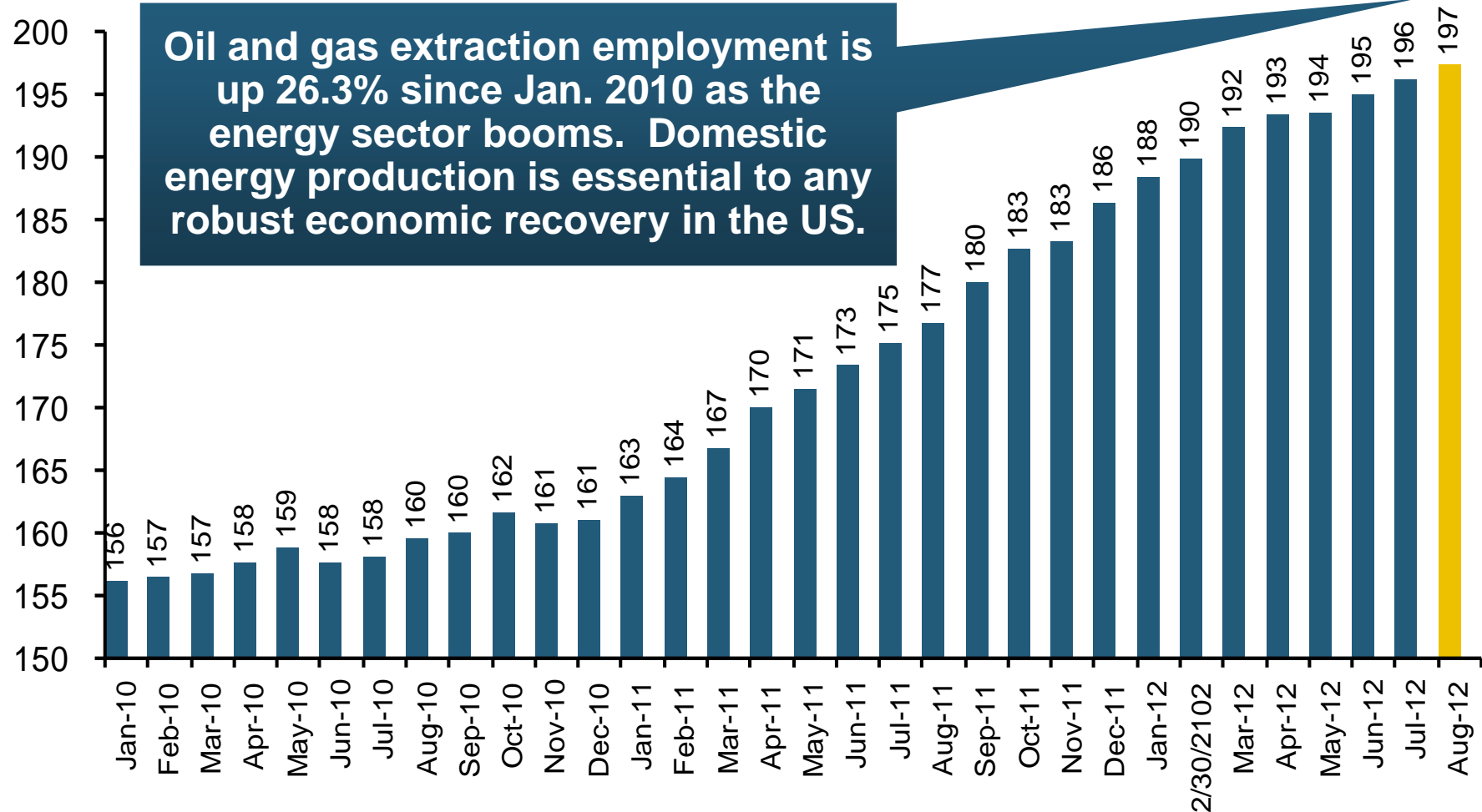


*Seasonally adjusted

Sources: US Bureau of Labor Statistics at <http://data.bls.gov>; Insurance Information Institute.

Oil & Gas Extraction Employment, Jan. 2010—August 2012*

(Thousands)



*Seasonally adjusted

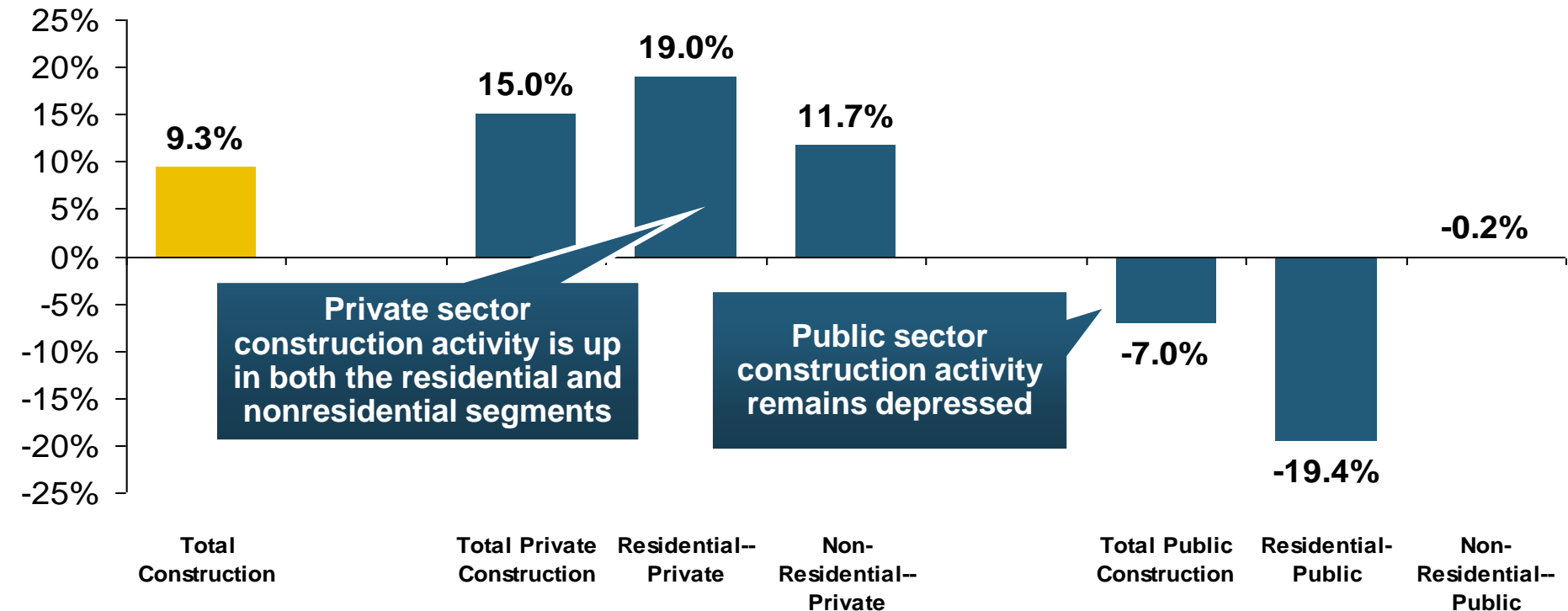
Sources: US Bureau of Labor Statistics at <http://data.bls.gov>; Insurance Information Institute.

Value of Construction Put in Place, June 2012 vs. July 2011*

Growth (%)

Private: +15.0%

Public: -0.7%



Overall Construction Activity is Up, But Growth Is Entirely in the Private Sector as State/Local Government Budget Woes Continue

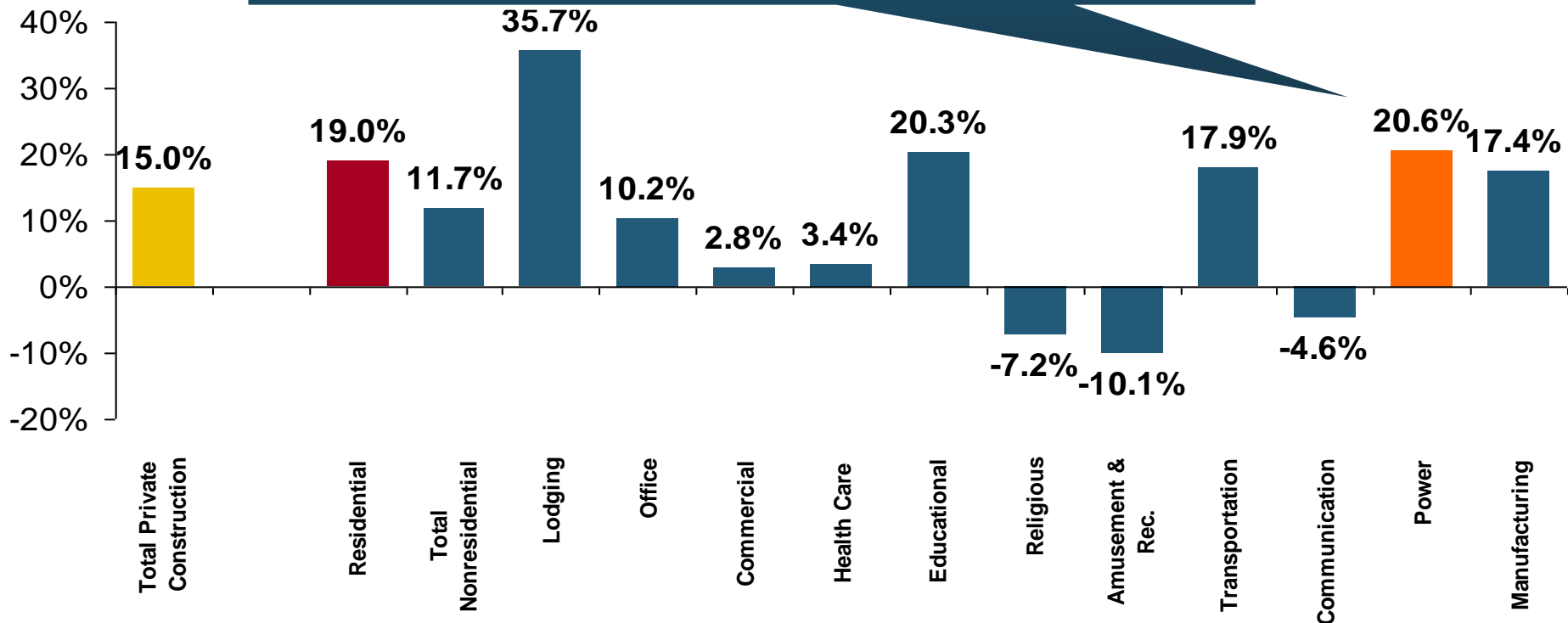
*seasonally adjusted

Source: U.S. Census Bureau, <http://www.census.gov/construction/c30/c30index.html> ; Insurance Information Institute.

Value of Private Construction Put in Place, by Segment, June 2012 vs. July 2011*

Growth (%)

Led by the Lodging and Power industries, Private sector construction activity is up by double digits in many segments after plunging during the “Great Recession”

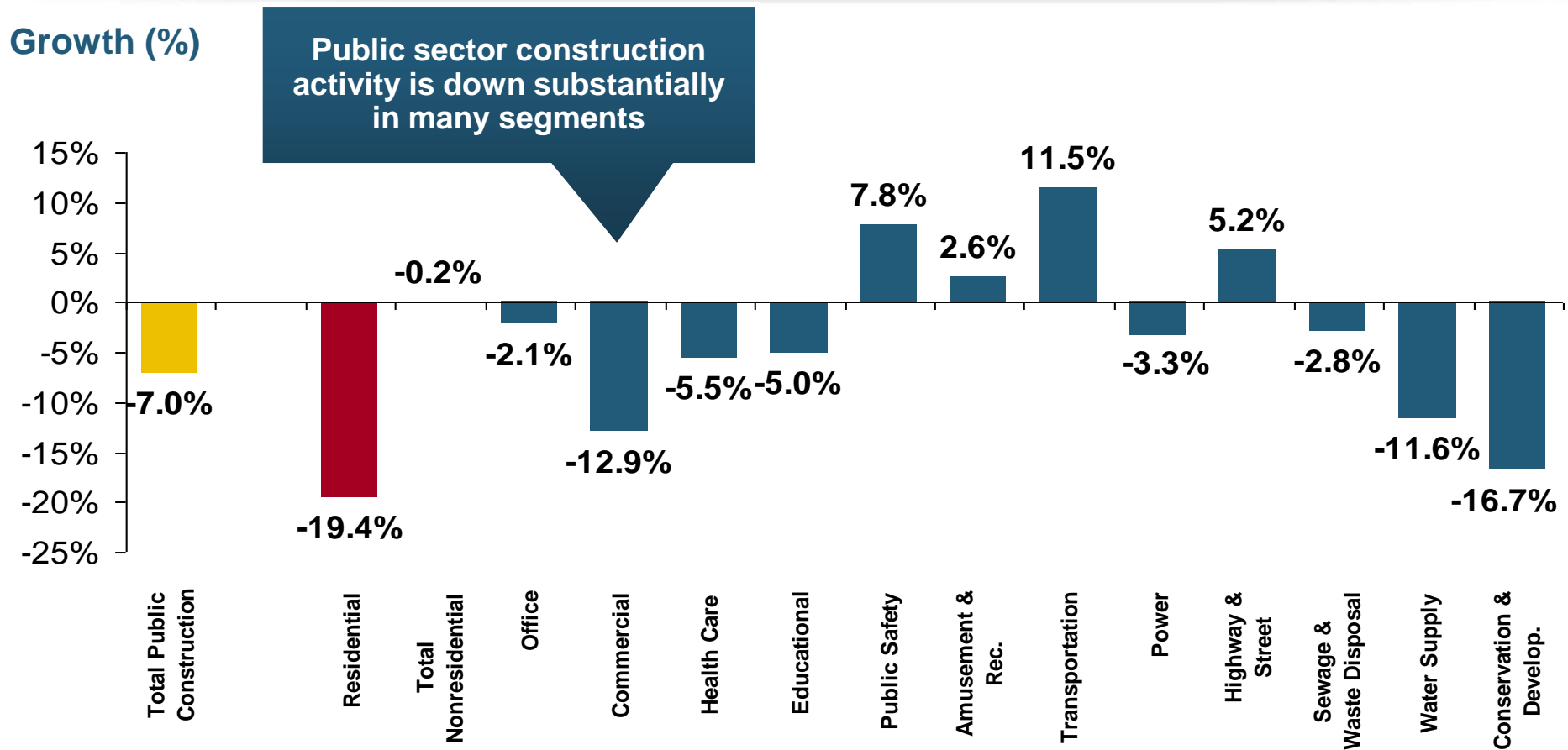


Private Construction Activity is Up in Most Segments, Including Residential Construction but Led by Power

*seasonally adjusted

Source: U.S. Census Bureau, <http://www.census.gov/construction/c30/c30index.html> ; Insurance Information Institute.

Value of Public Construction Put in Place, by Segment, June 2012 vs. July 2011*



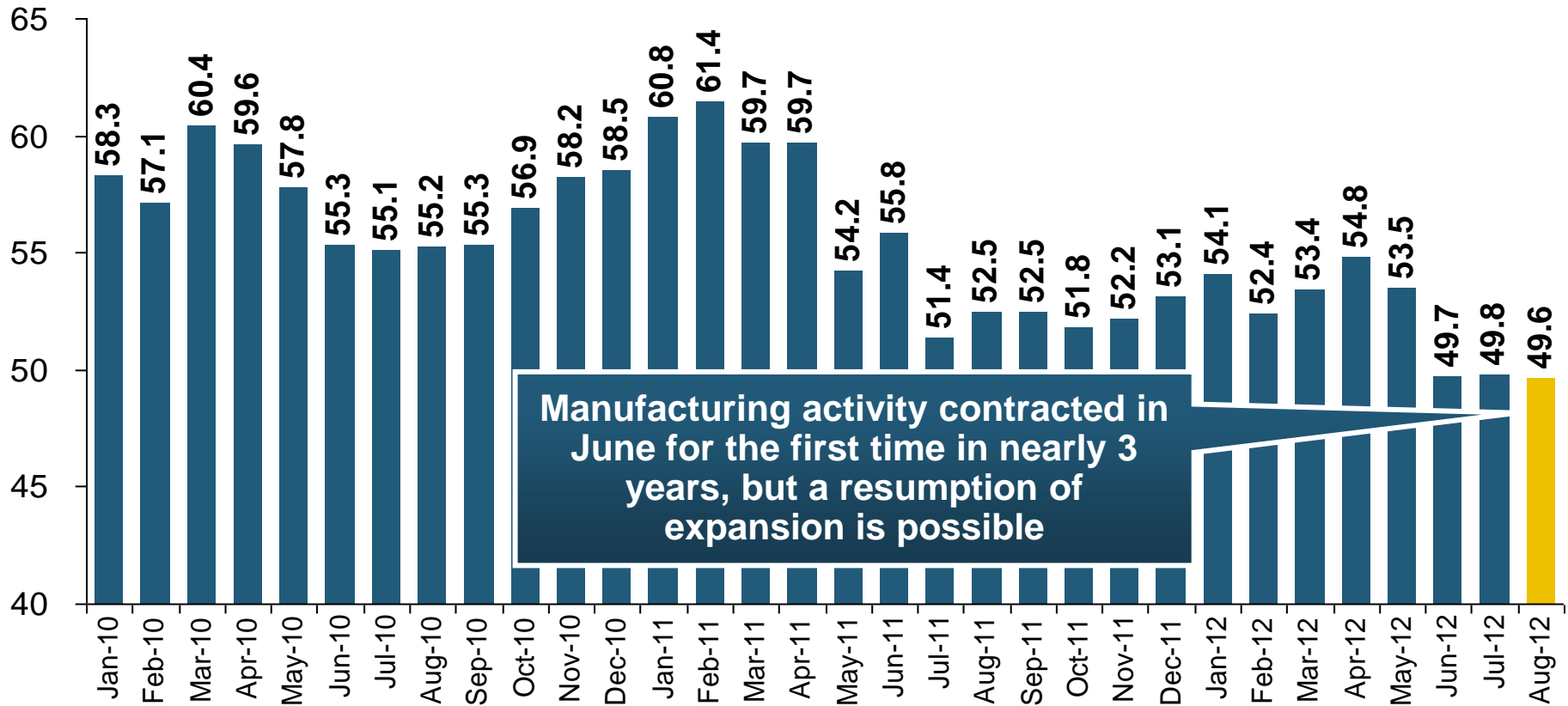
Public Construction Activity is Up Down in Many Segments as State, City and County Budgets Remain Under Stress

*seasonally adjusted

Source: U.S. Census Bureau, <http://www.census.gov/construction/c30/c30index.html> ; Insurance Information Institute.

ISM Manufacturing Index (Values > 50 Indicate Expansion)

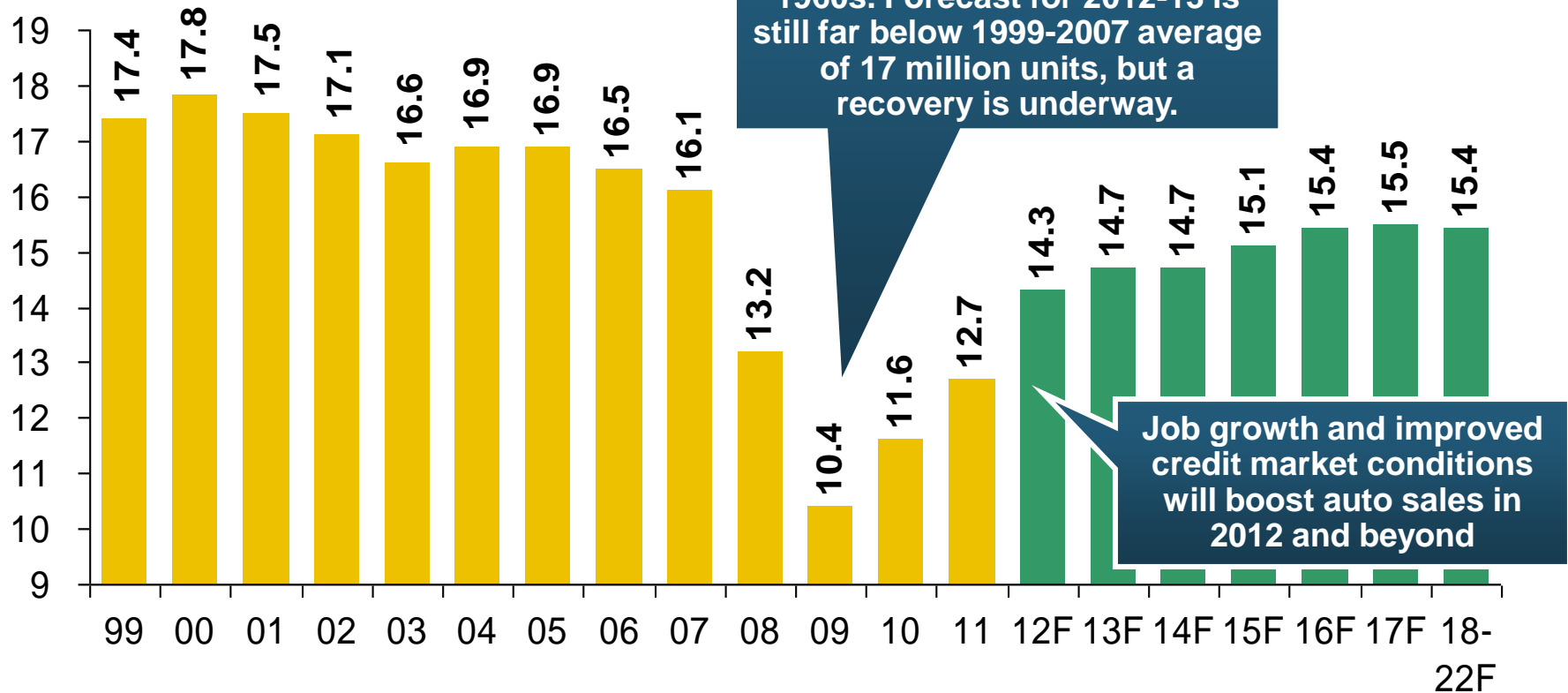
January 2010 through August 2012



The manufacturing sector expanded for 34 consecutive months until June 2012 and added jobs. The question is whether this will continue.

Auto/Light Truck Sales, 1999-2022F

(Millions of Units)



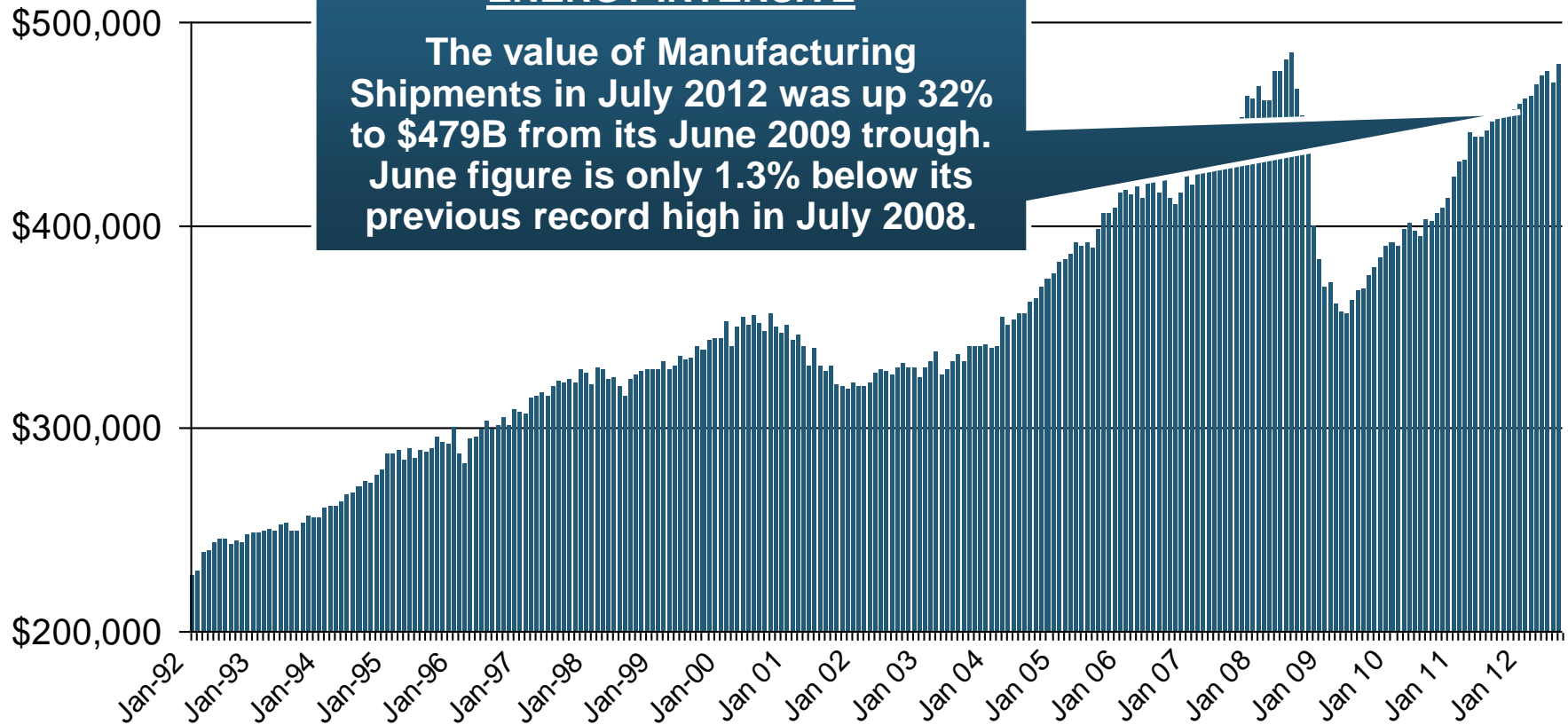
Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, Bolstering the Auto Insurer Growth and the Manufacturing Sector.

Dollar Value* of Manufacturers' Shipments Monthly, Jan. 1992—July 2012

\$ Millions

ENERGY INTENSIVE

The value of Manufacturing Shipments in July 2012 was up 32% to \$479B from its June 2009 trough. June figure is only 1.3% below its previous record high in July 2008.



Monthly shipments are nearly back to peak (in July 2008, 8 months into the recession). Trough in May 2009. Growth from trough to July 2012 was 35%. Manufacturing is an energy intensive activity and growth leads to gains in many commercial exposures: WC, Commercial Auto, Marine, Property and Various Liability Coverages

*seasonally adjusted

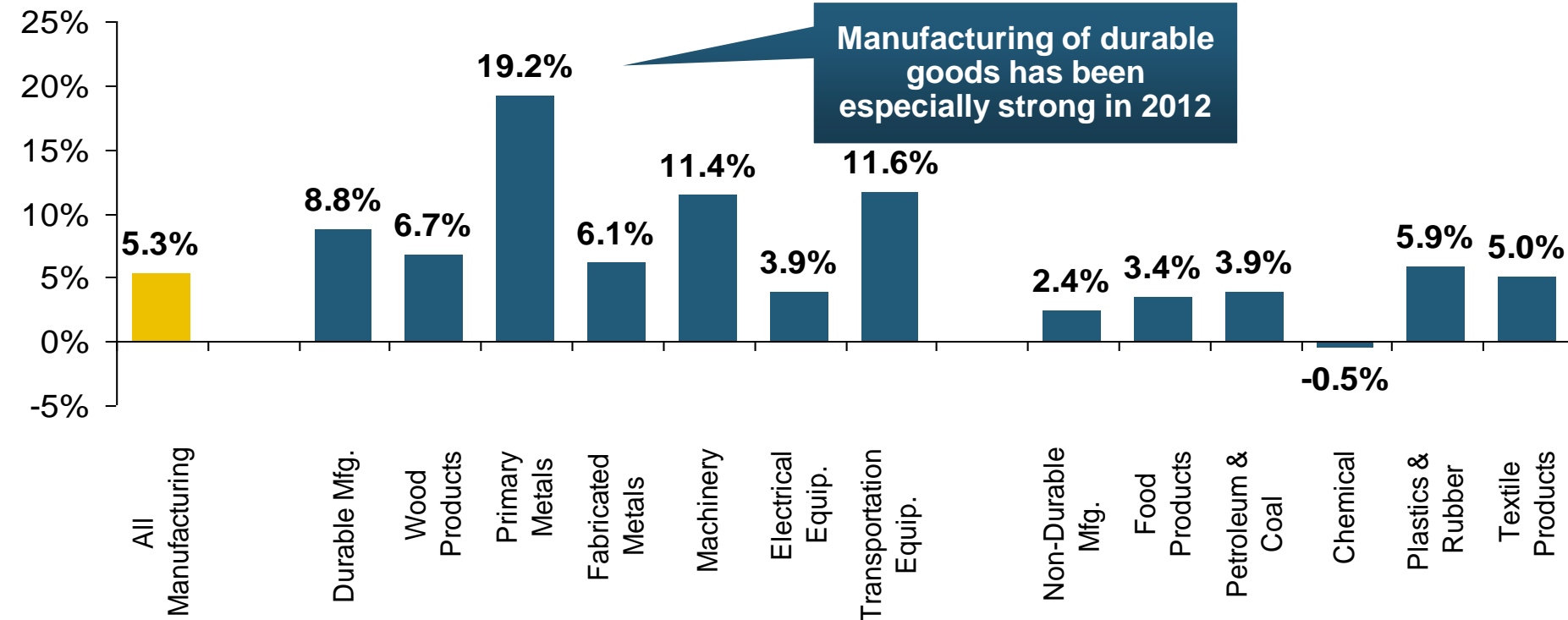
Source: U.S. Census Bureau, *Full Report on Manufacturers' Shipments, Inventories, and Orders*, <http://www.census.gov/manufacturing/m3/>

Manufacturing Growth for Selected Sectors, 2012 vs. 2011*

Growth (%)

Durables: +8.8%

Non-Durables: +2.4%



Manufacturing Is Expanding Across a Wide Range of Sectors that Will Contribute to Growth in Energy Demand and Insurable Exposures Including: WC, Commercial Property, Commercial Auto and Many Liability Coverages

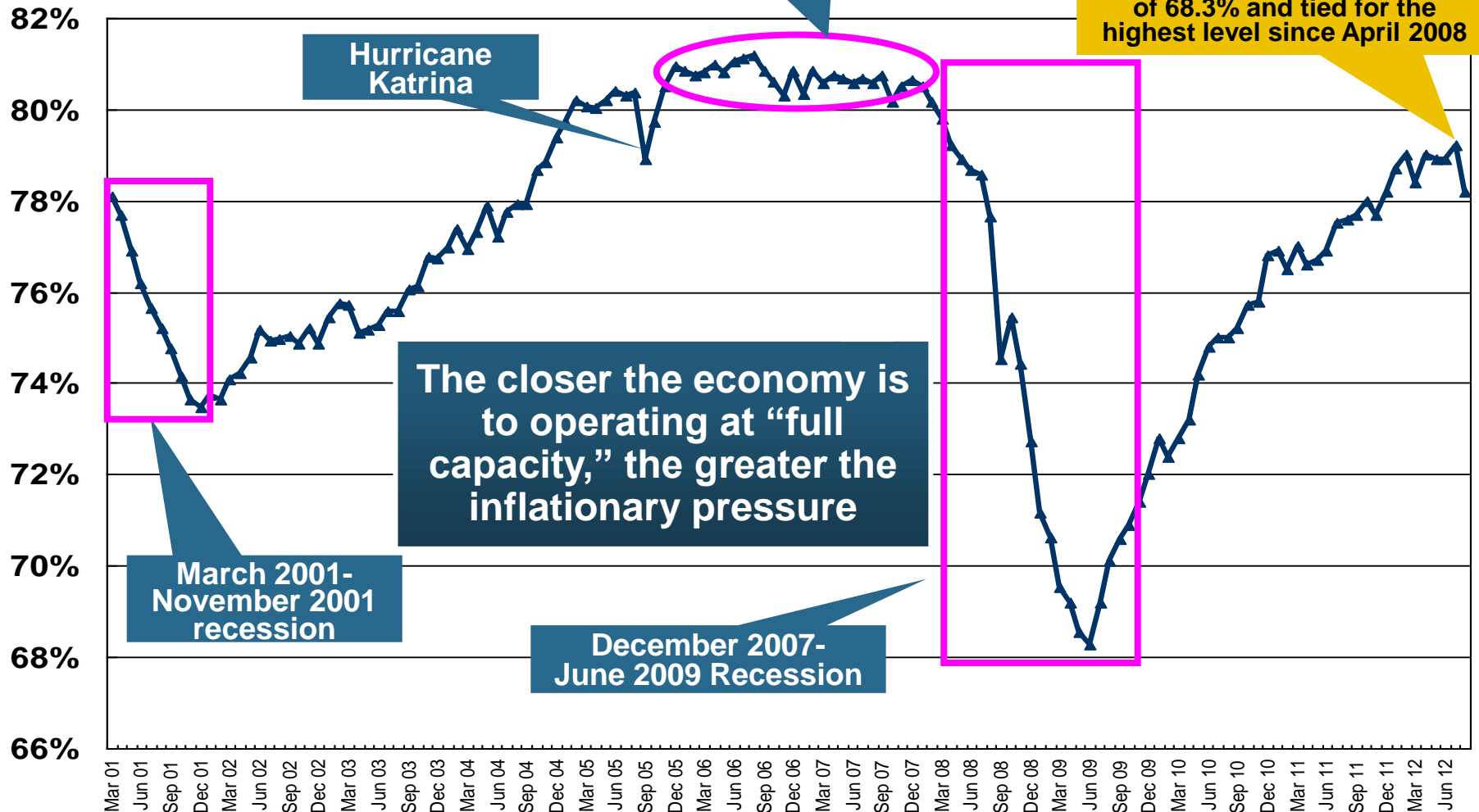
*Seasonally adjusted; Date are YTD comparing data through July 2012 to the same period in 2011.

Source: U.S. Census Bureau, *Full Report on Manufacturers' Shipments, Inventories, and Orders*, <http://www.census.gov/manufacturing/m3/>

Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

March 2001 through August 2012

Percent of Industrial Capacity

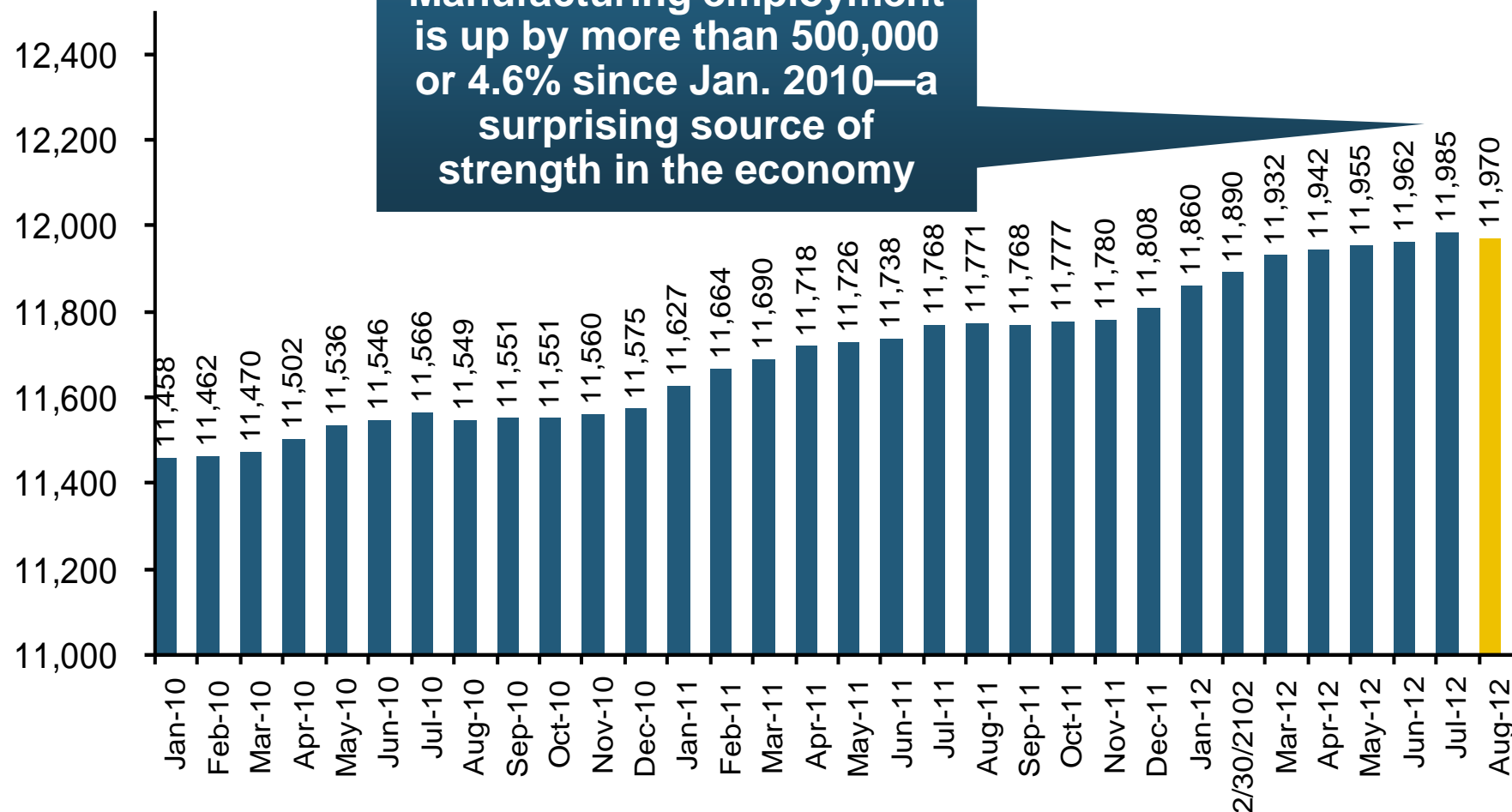


Source: Federal Reserve Board statistical releases at <http://www.federalreserve.gov/releases/q17/Current/default.htm>.

Manufacturing Employment, Jan. 2010—August 2012*

(Thousands)

Manufacturing employment
is up by more than 500,000
or 4.6% since Jan. 2010—a
surprising source of
strength in the economy

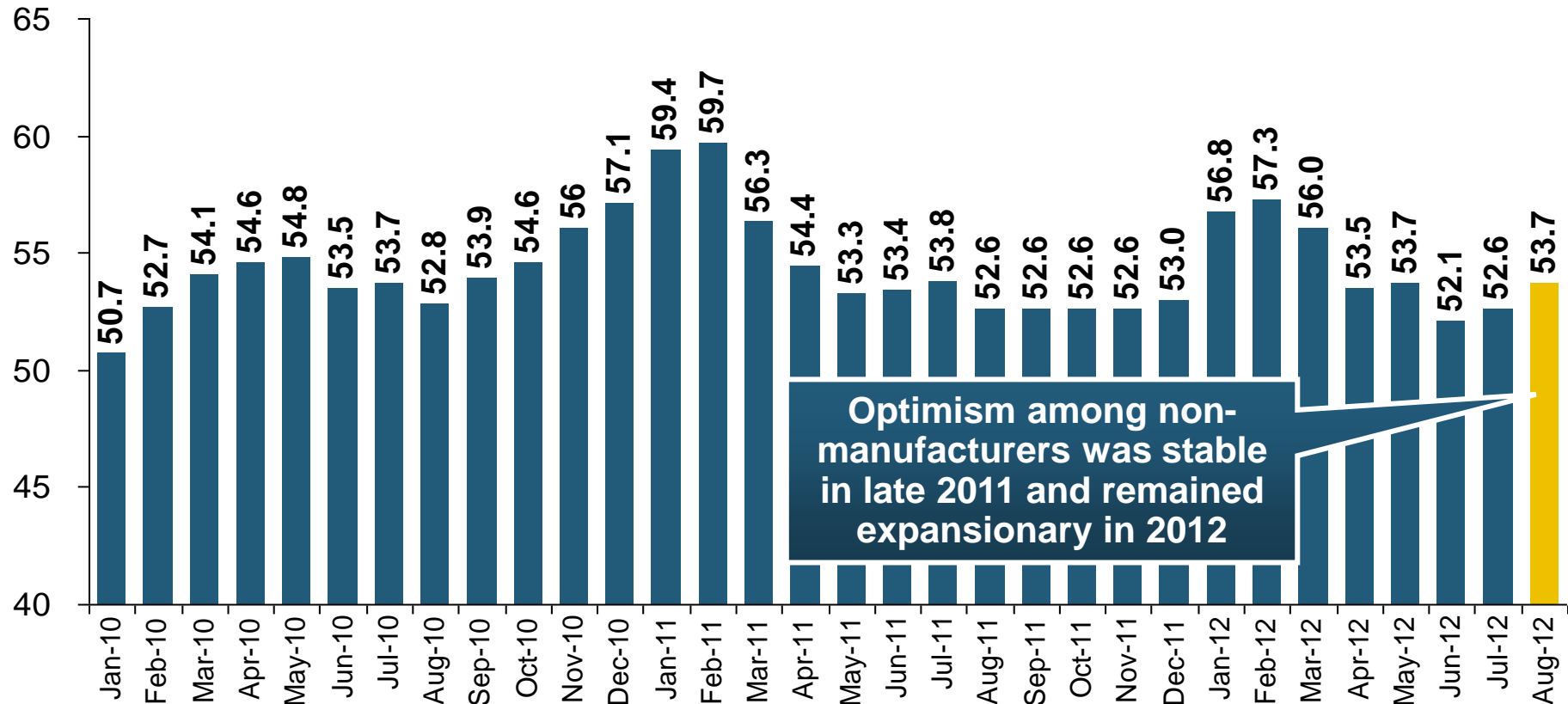


*Seasonally adjusted

Sources: US Bureau of Labor Statistics at <http://data.bls.gov>; Insurance Information Institute.

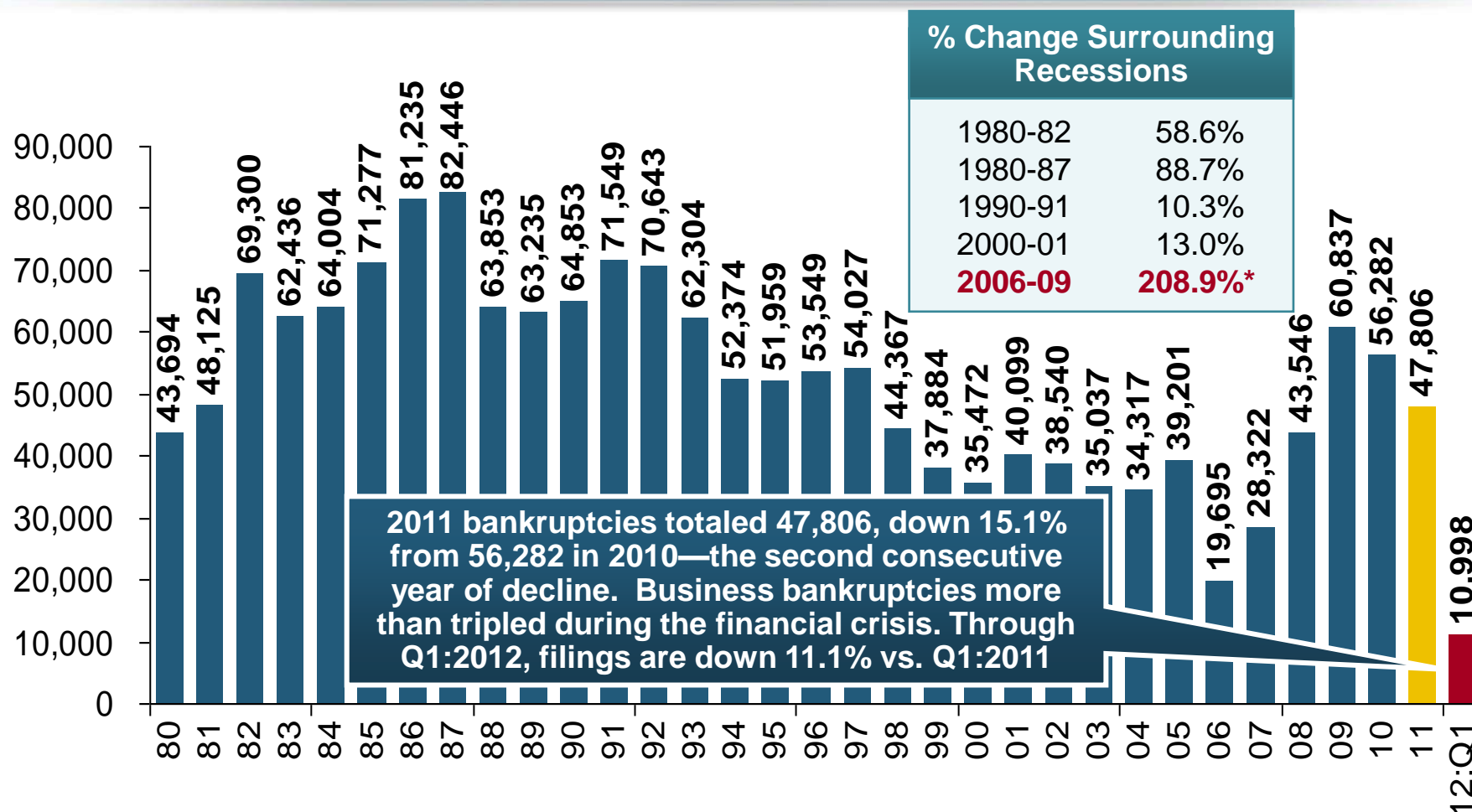
ISM Non-Manufacturing Index (Values > 50 Indicate Expansion)

January 2010 through August 2012



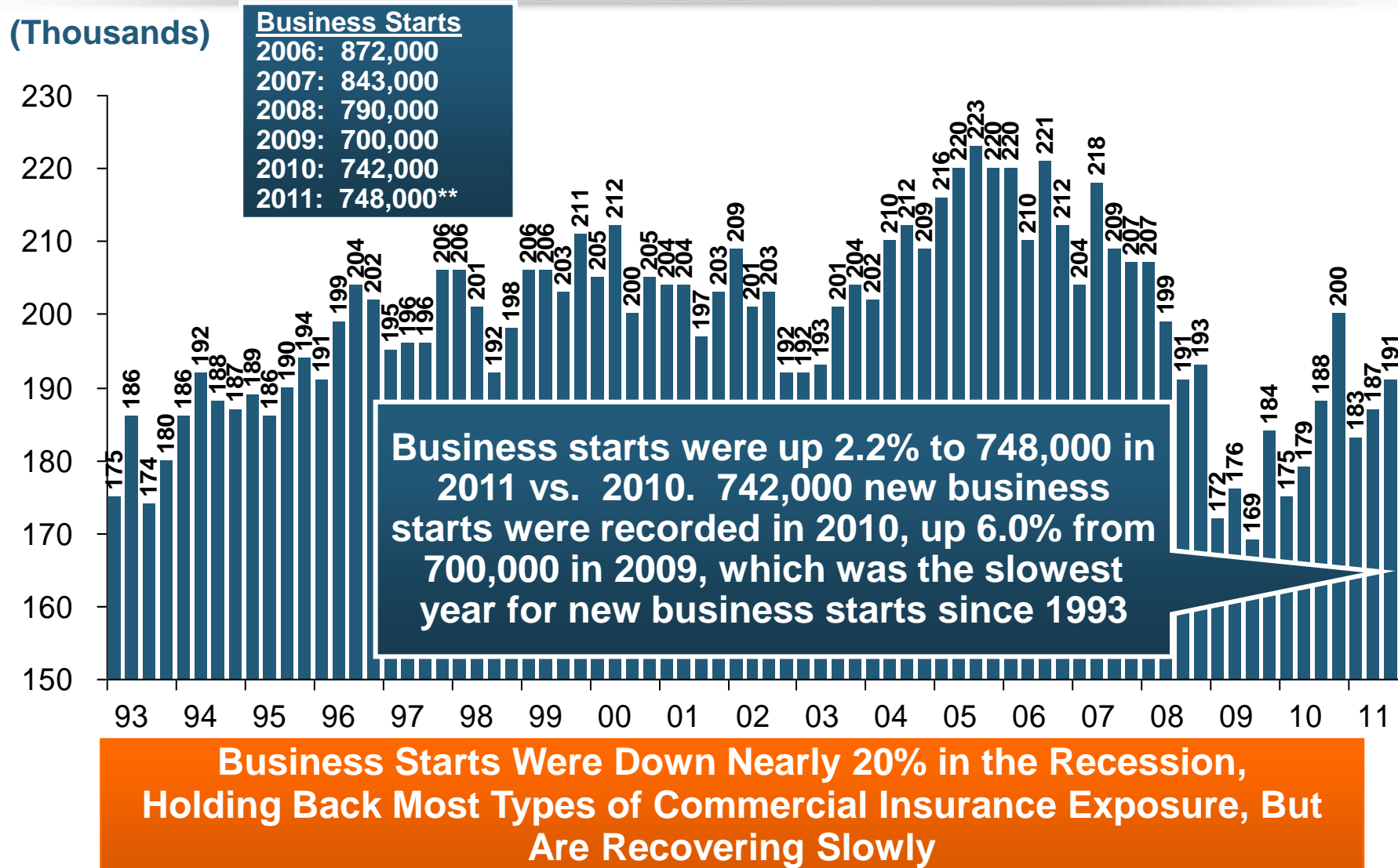
Non-manufacturing industries have been expanding and adding jobs. The question is whether this will continue.

Business Bankruptcy Filings, 1980-2012: Q1



Significant Exposure Implications for All Commercial Lines as Business Bankruptcies Begin to Decline

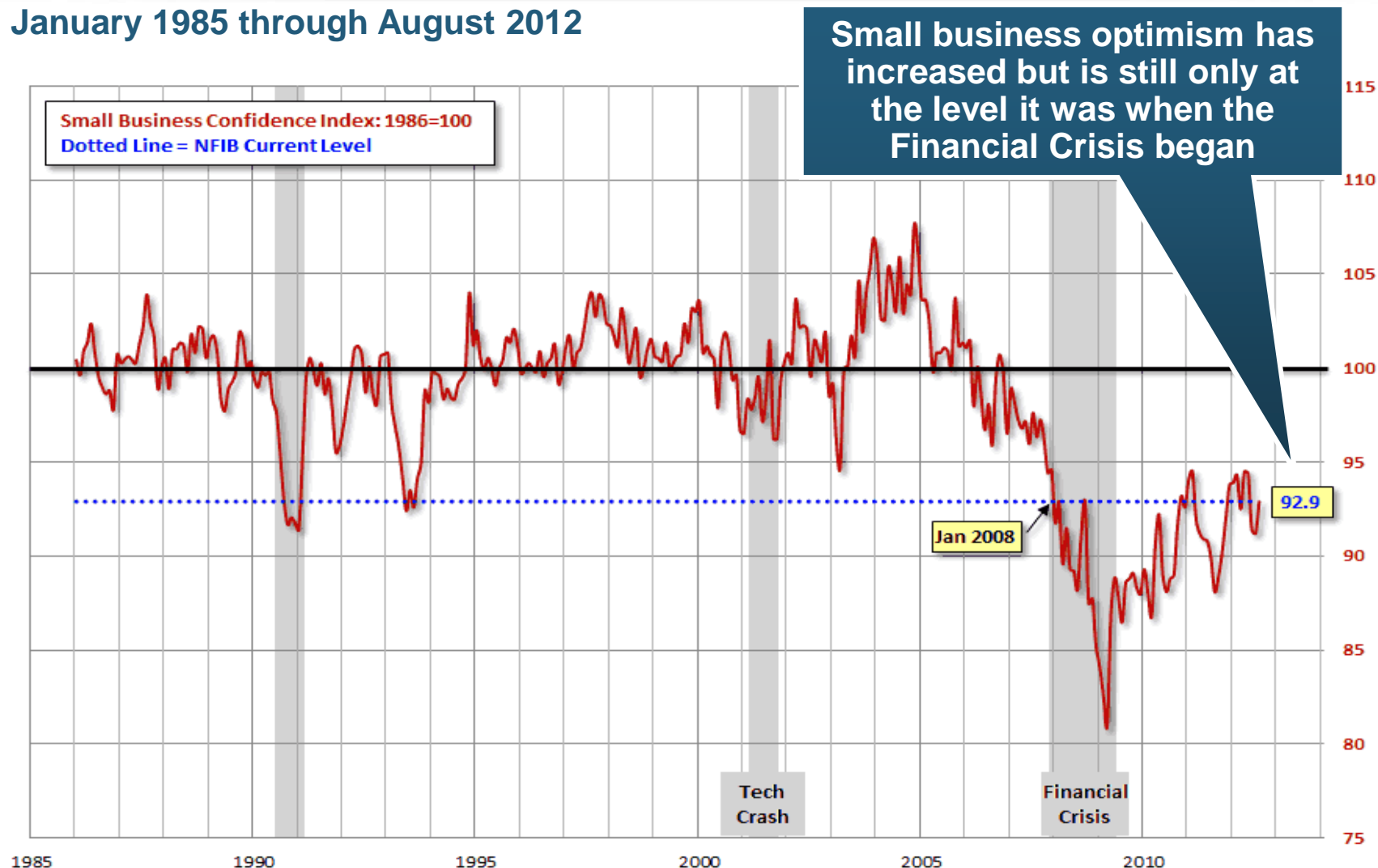
Private Sector Business Starts, 1993:Q2 – 2011:Q3*



* Data through Dec. 31, 2011 are the latest available as of Sept. 20, 2012; Seasonally adjusted. **Annualized based on data through Q3:2011.
 Source: Bureau of Labor Statistics, <http://www.bls.gov/news.release/cewbd.t08.htm>.

NFIB Small Business Optimism Index

January 1985 through August 2012



12 Industries for the Next 10 Years: Insurance Solutions Needed

Health Care
Health Sciences
Energy (Traditional)
Alternative Energy
Petrochemical
Agriculture
Natural Resources
Technology (incl. Biotechnology)
Light Manufacturing
Insourced Manufacturing
Export-Oriented Industries
Shipping (Rail, Marine, Trucking)

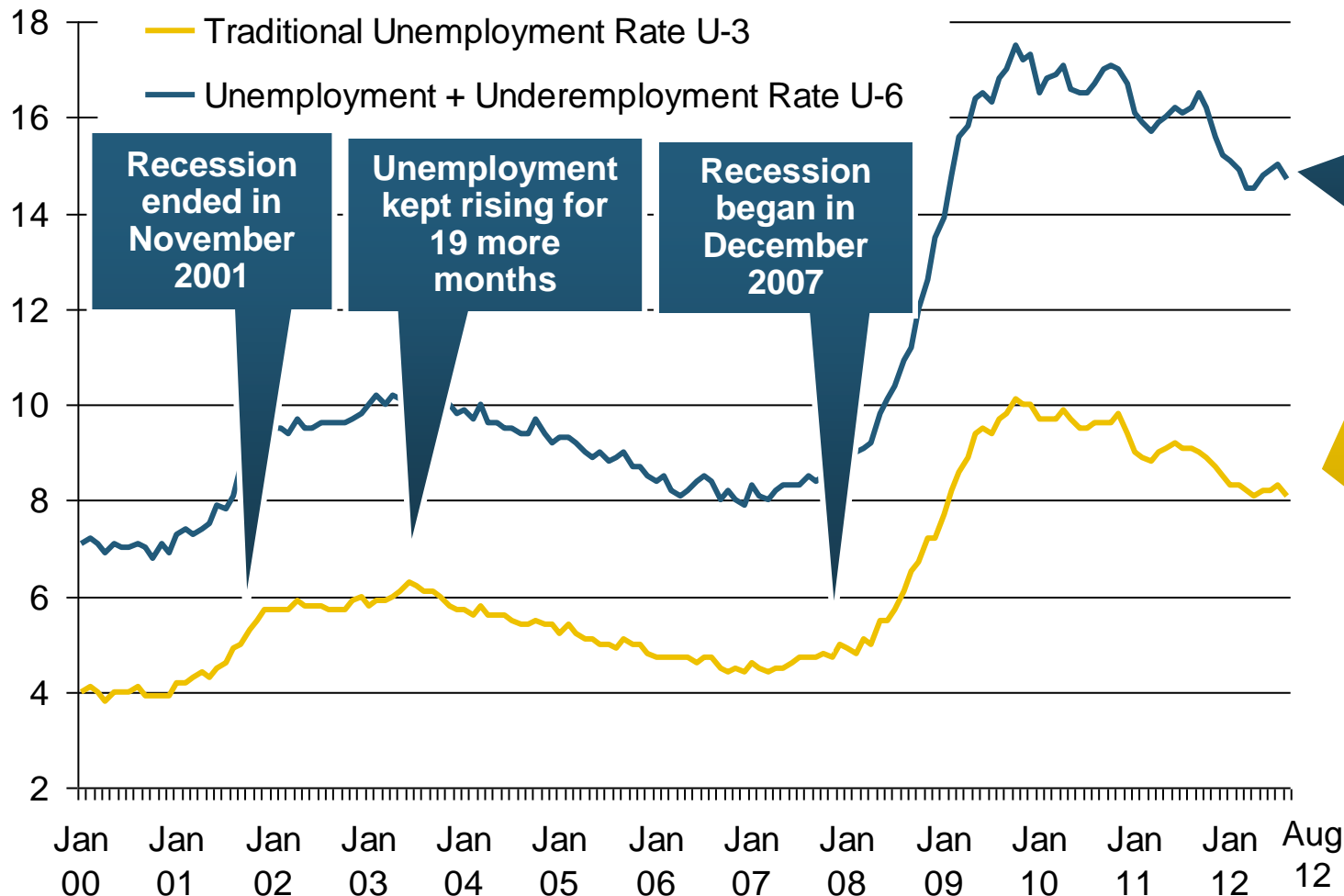
Many industries are poised for growth, though insurers' ability to capitalize on these industries varies widely

Labor Market Trends

Massive Job Losses Sapped the Economy and Commercial Lines Exposure, But Trend is Improving, Including Workers Comp

Unemployment and Underemployment Rates: Stubbornly High in 2012, But Falling

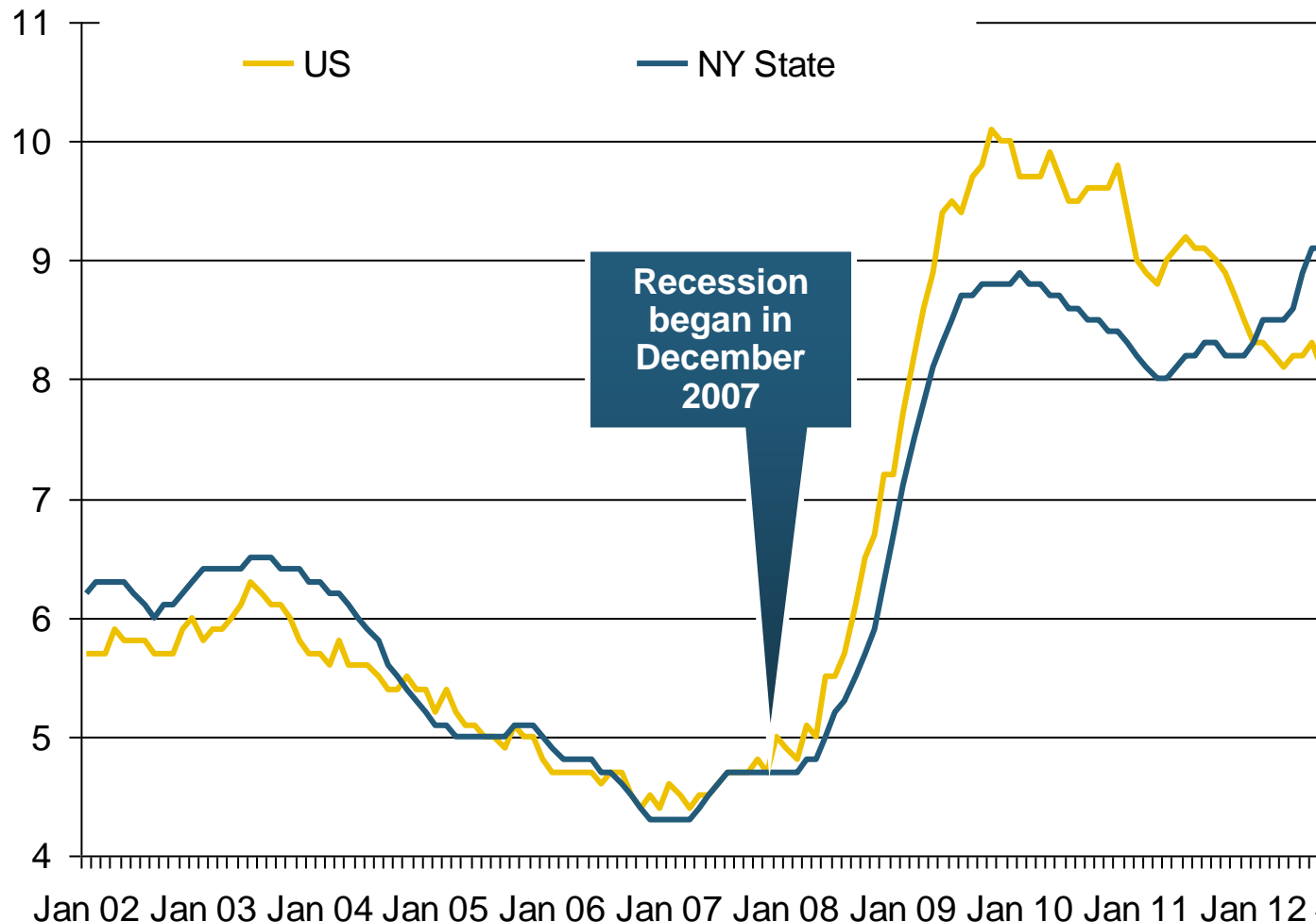
January 2000 through August 2012, Seasonally Adjusted (%)



Stubbornly high unemployment and underemployment constrain overall economic growth, but the job market is now clearly improving

Unemployment in NY State is Rising in 2012, But Falling Nationally

January 2002 through August 2012, Seasonally Adjusted (%)



NY's unemployment rate is now a full point above the US (9.1% vs. 8.1%) as of Aug. 2012

US unemployment stood at 8.1% in Aug. 2012

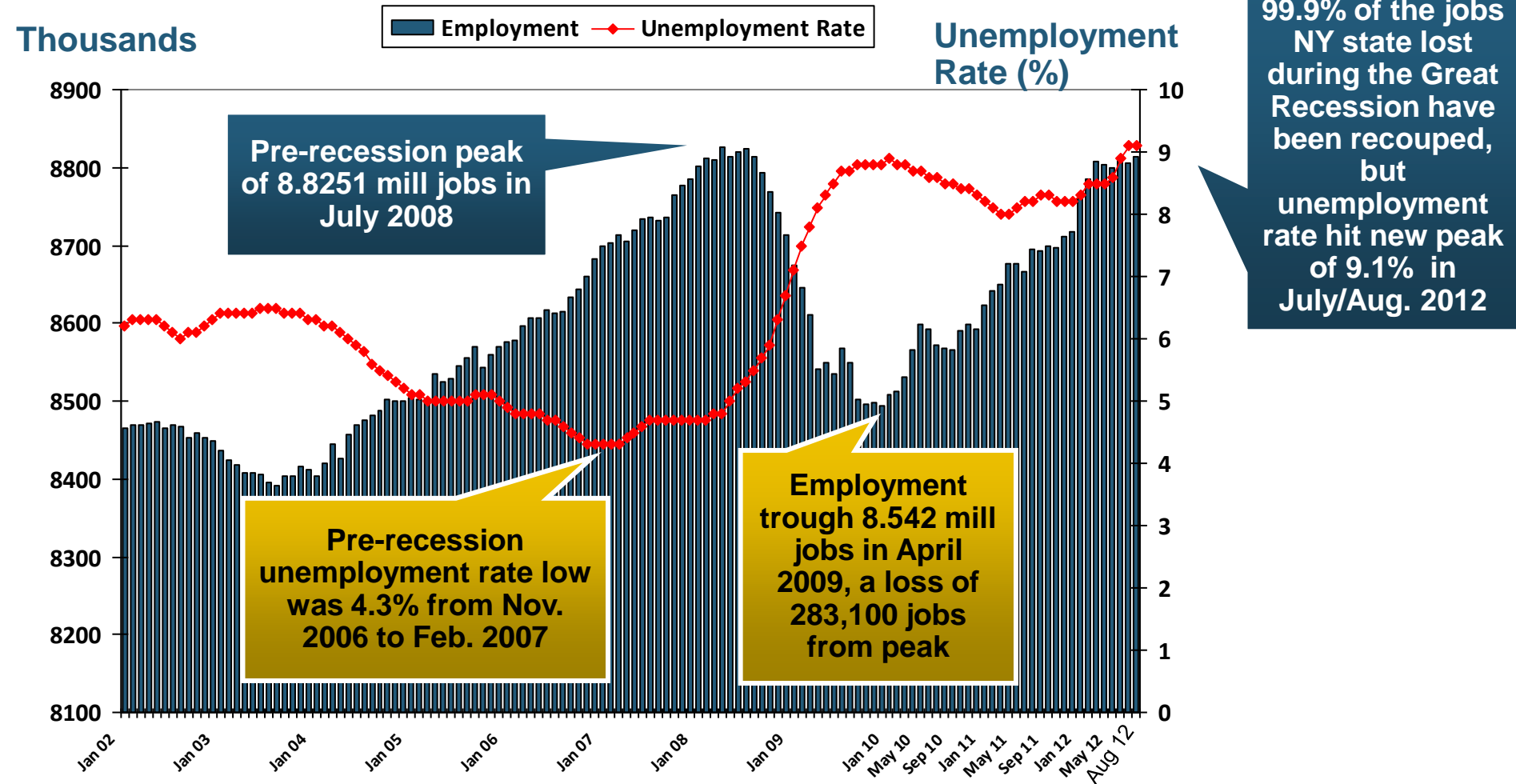
Unemployment peaked at 10.1% in October 2009, highest monthly rate since 1983.

Peak rate in the last 30 years: 10.8% in November - December 1982

NY State's Unemployment Rate is Now Higher Than at Any Point During or After the Financial Crisis

NY State Has Recouped Lost Jobs, But Unemployment is Rising

January 2002 through August 2012, Seasonally Adjusted (%)



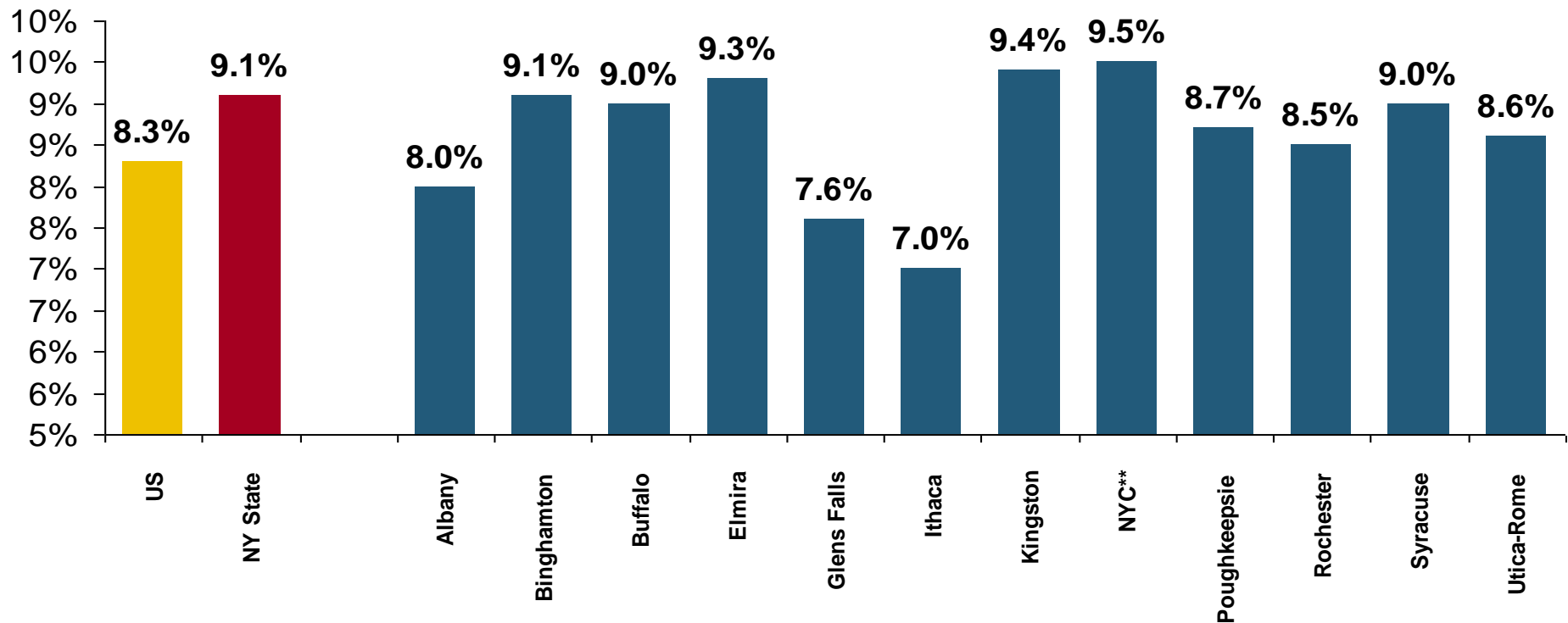
Like Many States, NY Has Recouped Jobs Lost in the Recession, But Net New Entrants to the Labor Force is Pushing Unemployment Rate Up

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

Unemployment Rates by Metropolitan Areas in NY State, July 2012*

Unemployment
Rate (%)

Unemployment in most NY MSAs remains high, including the NYC MSA.



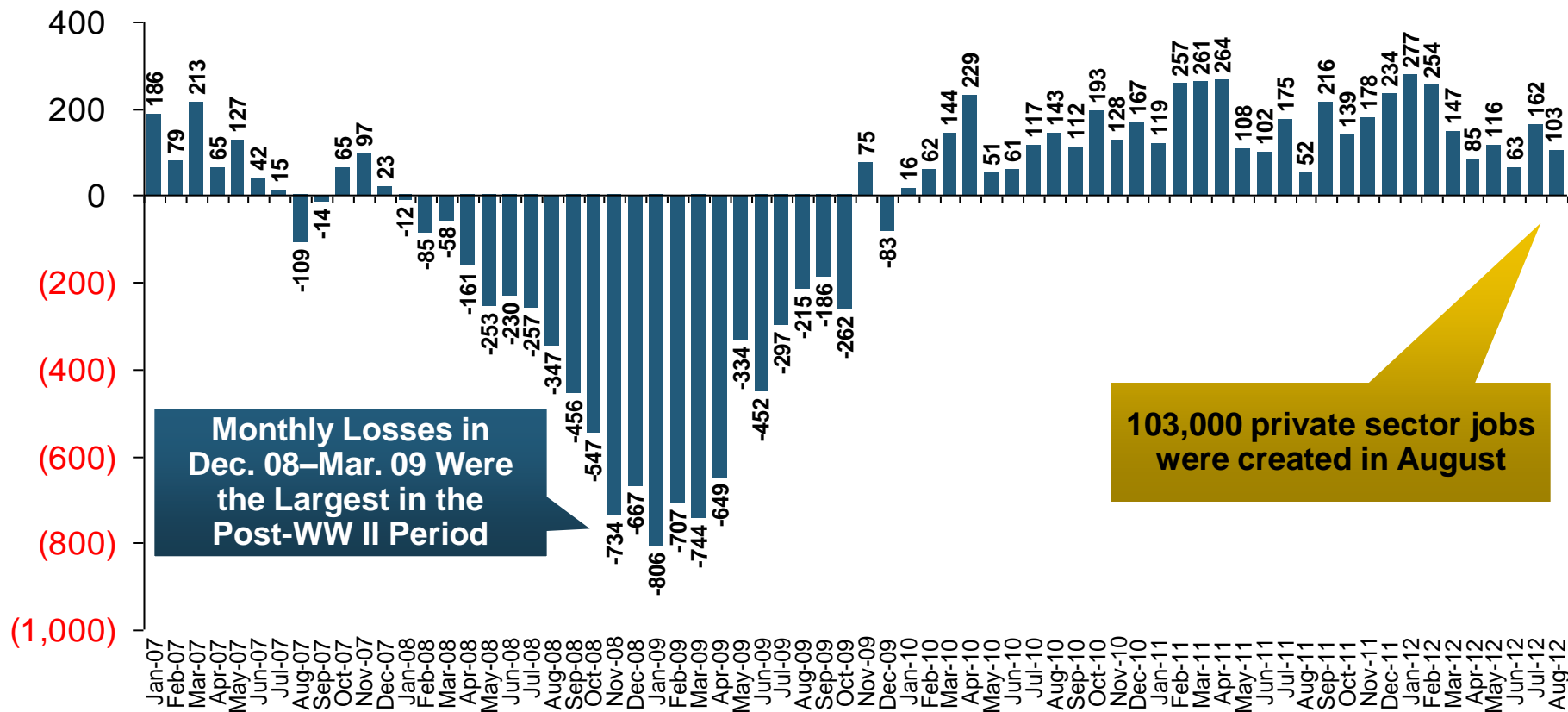
*Most recent available. Metro area data are not seasonally adjusted.

**The NYC MSA includes Northern NJ and parts of Eastern PA.

Source: U.S. Bureau of Labor Statistics; Insurance Information Institute.

Monthly Change in Private Employment

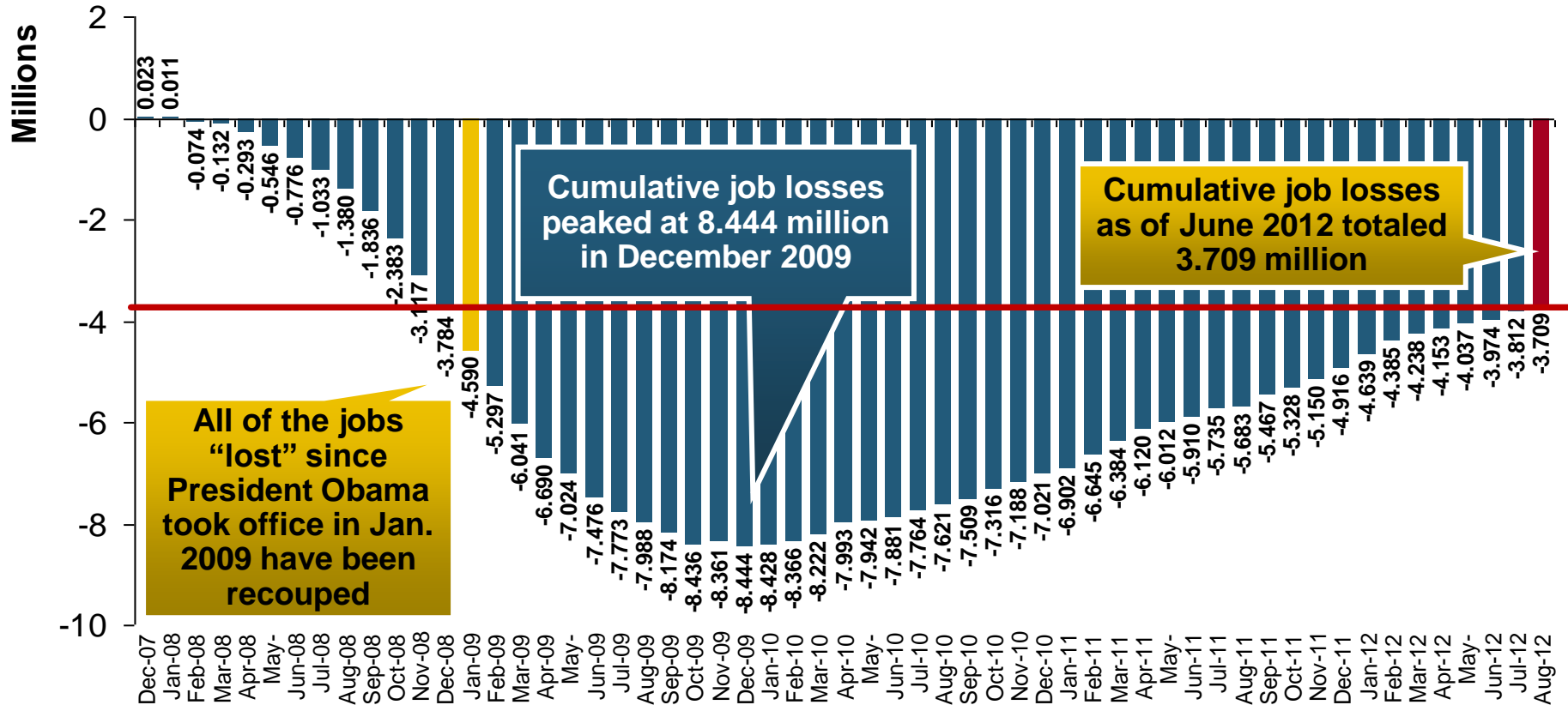
January 2008 through August 2012 (Thousands)



Private Employers Added 4.65 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)

Cumulative Change in Private Employment: Dec. 2007—August 2012

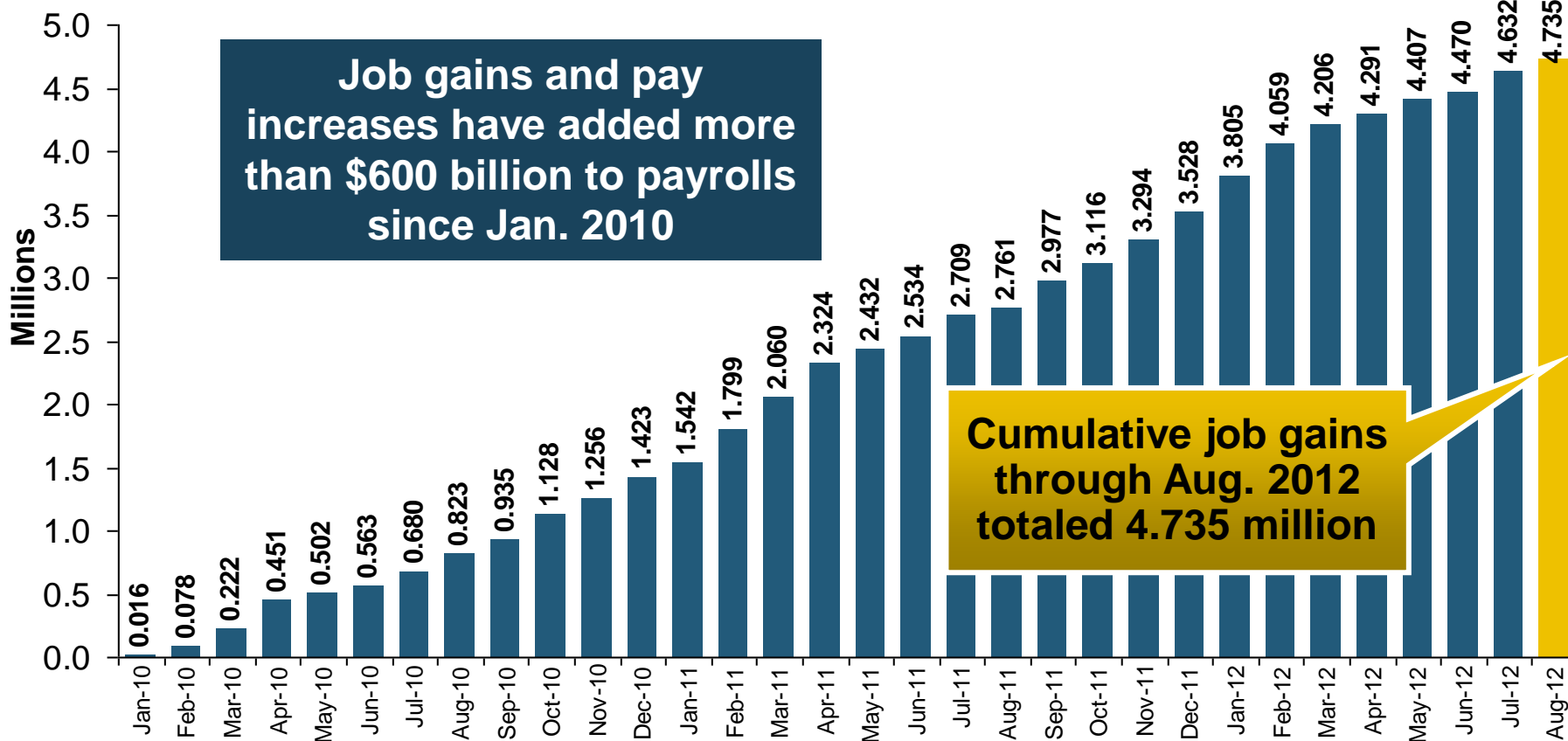
December 2007 through August 2012 (Millions)



Private Employers Added 4.74 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)

Cumulative Change in Private Sector Employment: Jan. 2010—August 2012

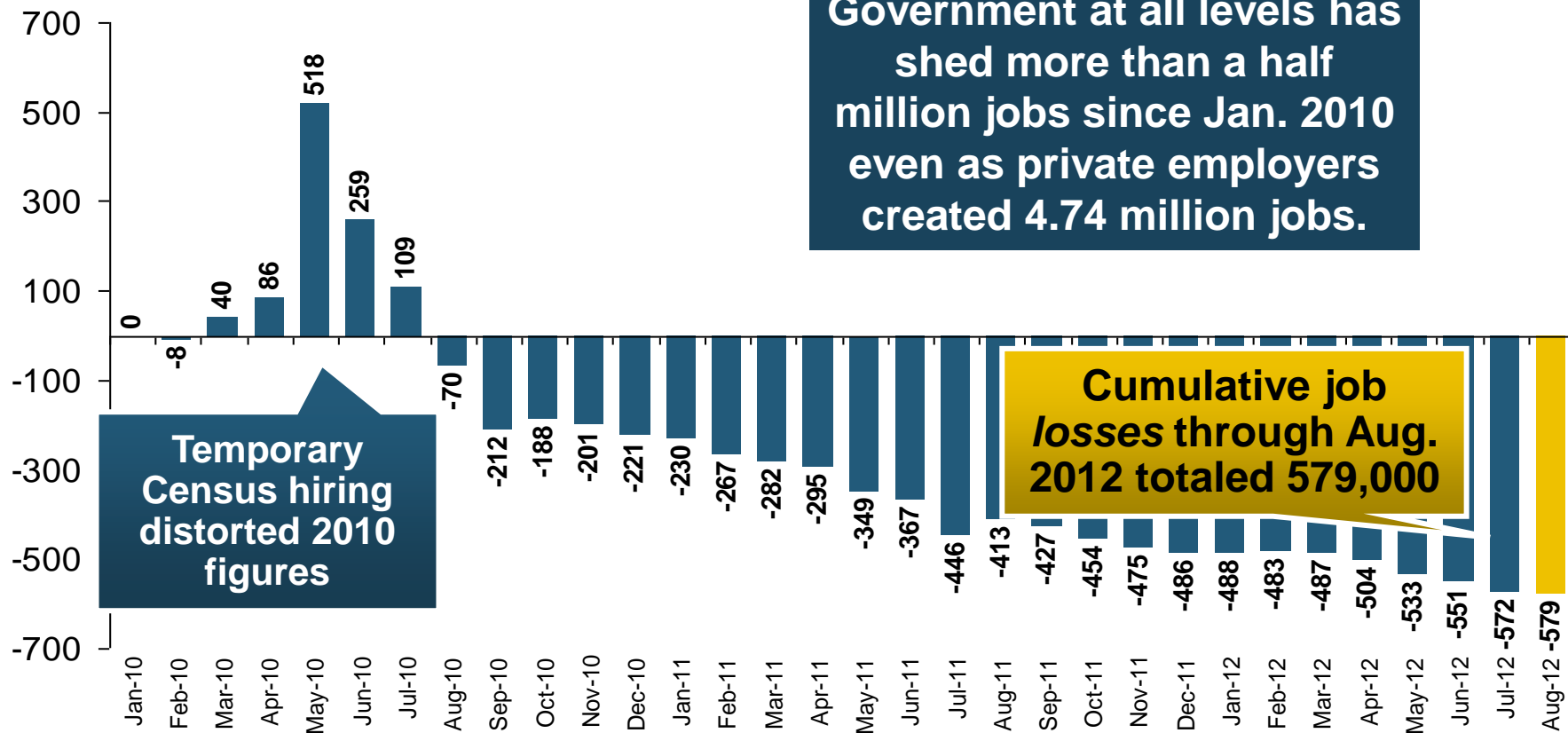
January 2010 through August 2012* (Millions)



Private Employers Added 4.74 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)

Cumulative Change in Government Employment: Jan. 2010—August 2012

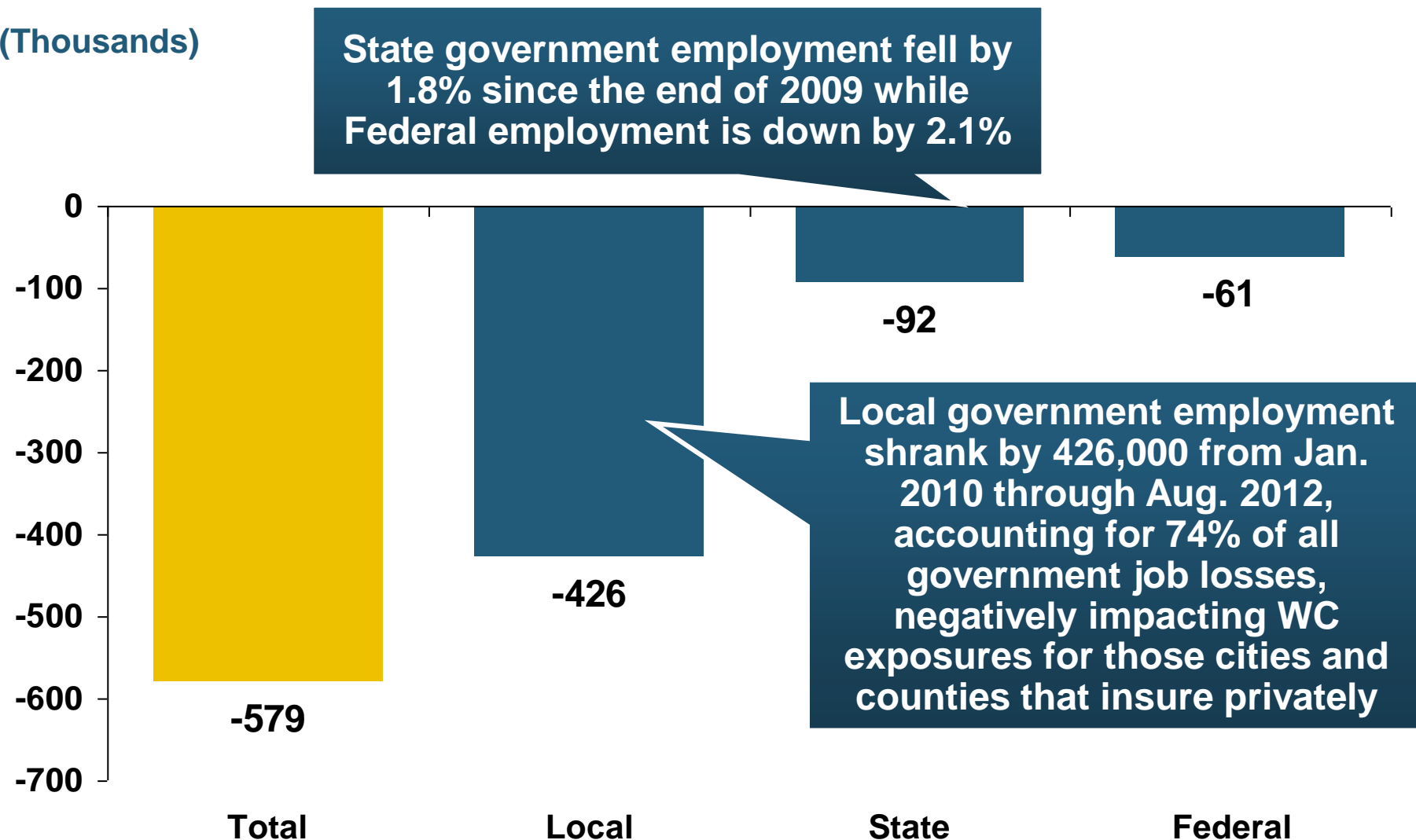
January 2010 through August 2012* (Millions)



Governments at All Levels are Under Severe Fiscal Strain As Tax Receipts Plunged and Pension Obligations Soared During the Financial Crisis, Causing Them to Reduce Staff

Net Change in Government Employment: Jan. 2010—August 2012*

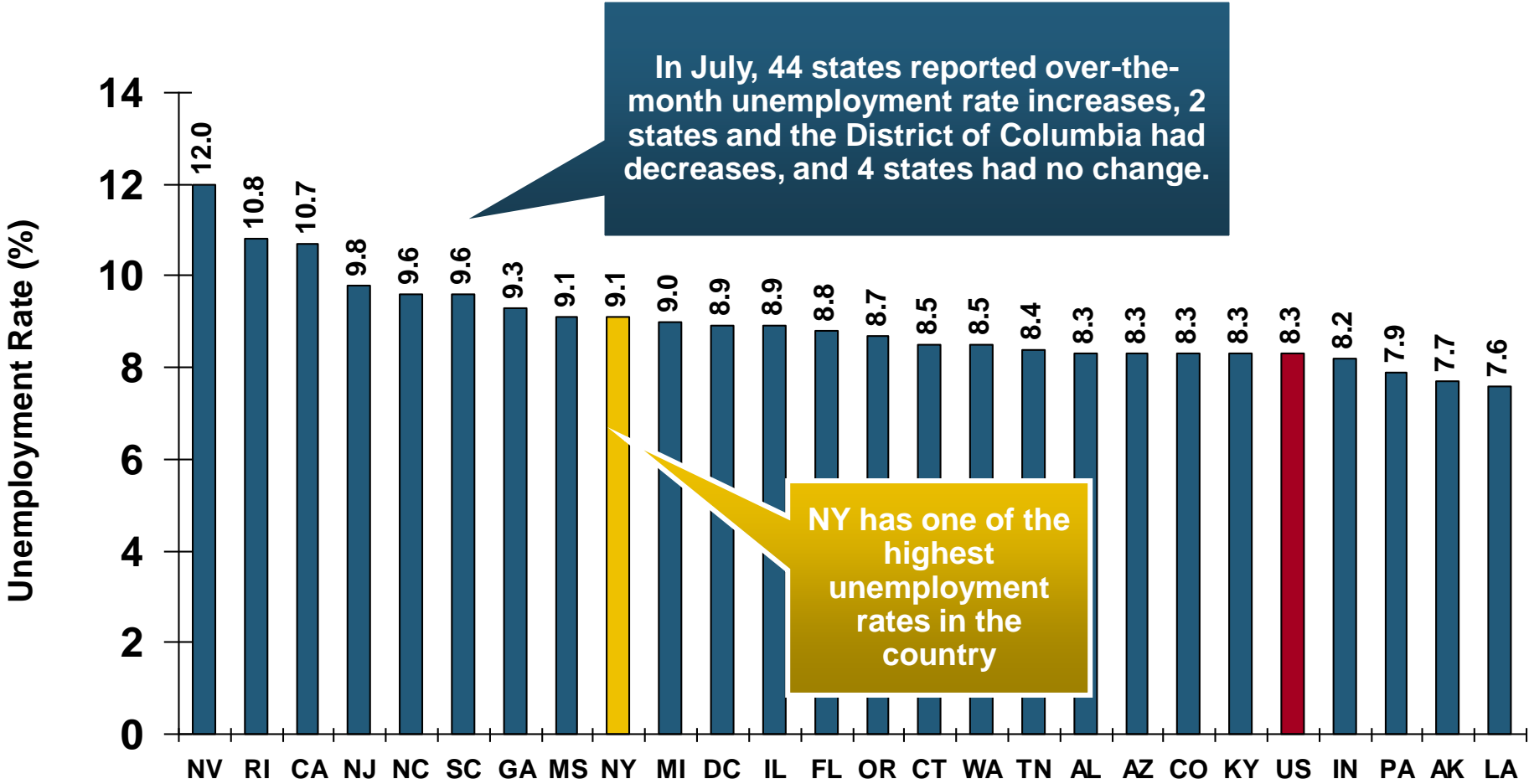
(Thousands)



*Cumulative change from prior month; Base employment date is Dec. 2009.

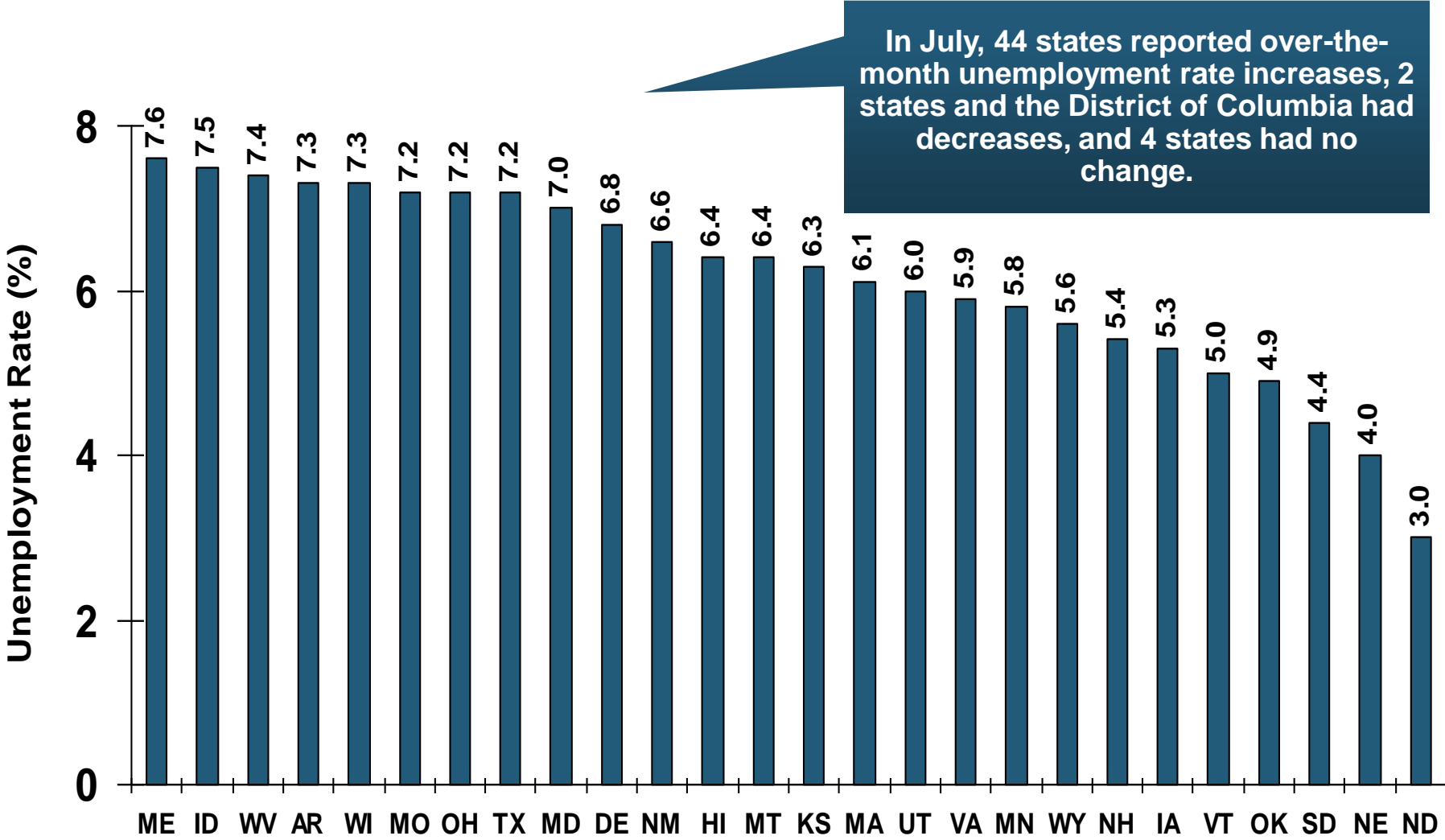
Source: US Bureau of Labor Statistics <http://www.bls.gov/data/#employment>; Insurance Information Institute

Unemployment Rates by State, July 2012: Highest 25 States*



*Provisional figures for July 2012, seasonally adjusted.
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

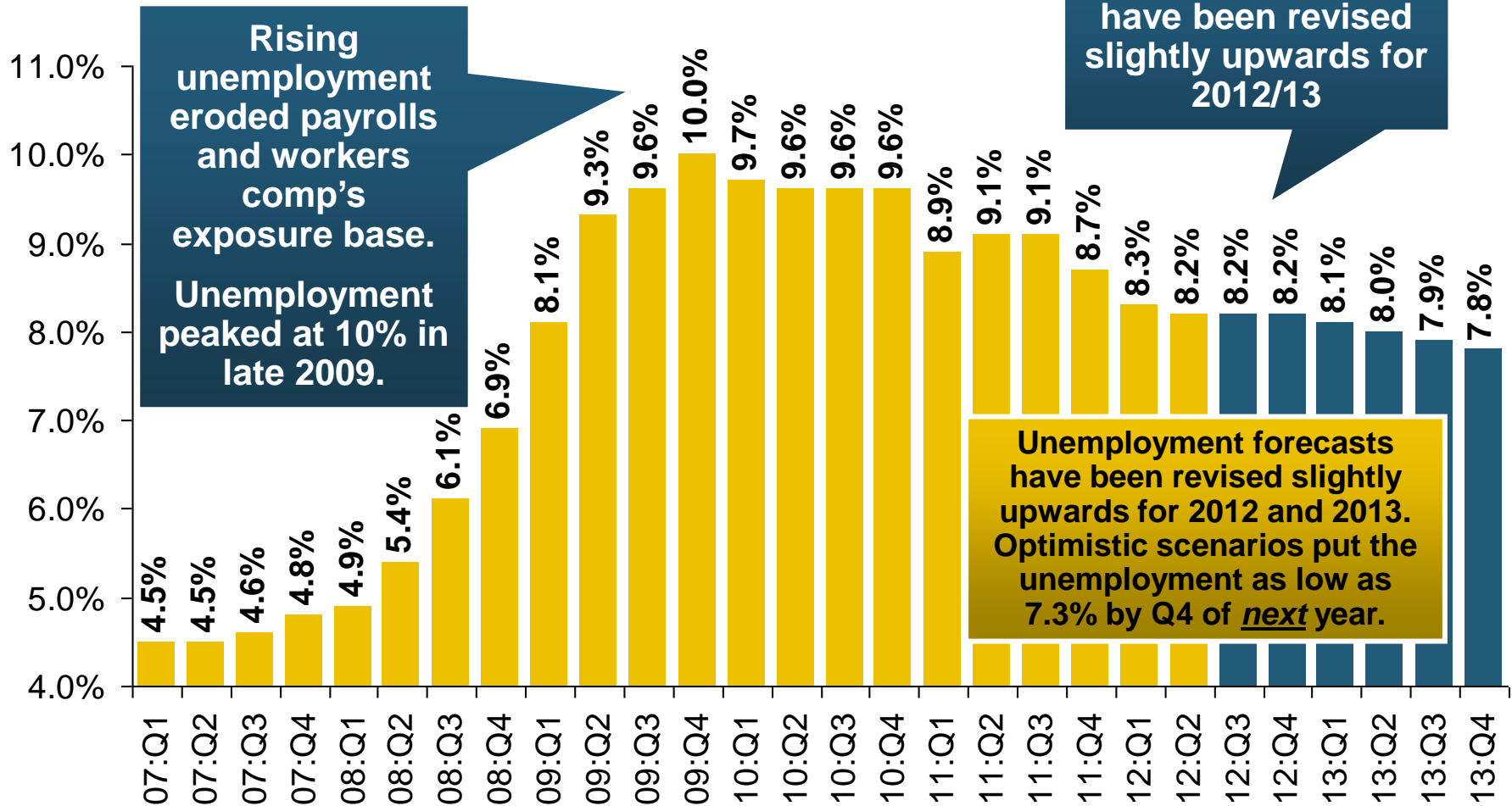
Unemployment Rates by State, July 2012: Lowest 25 States*



*Provisional figures for July 2012, seasonally adjusted.
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

US Unemployment Rate Forecast

2007:Q1 to 2013:Q4F*

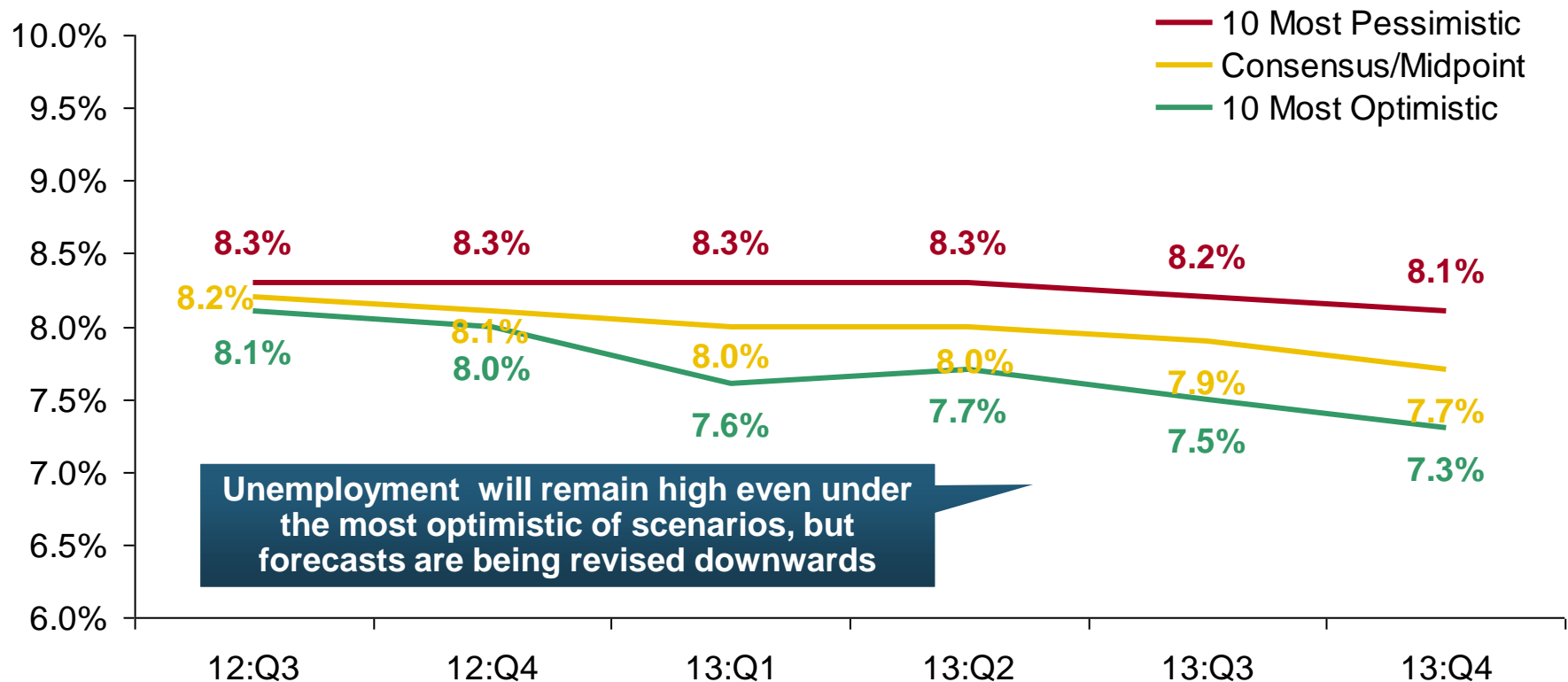


* ■ = actual; ■ = forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (9/12 edition); Insurance Information Institute.

US Unemployment Rate Forecasts

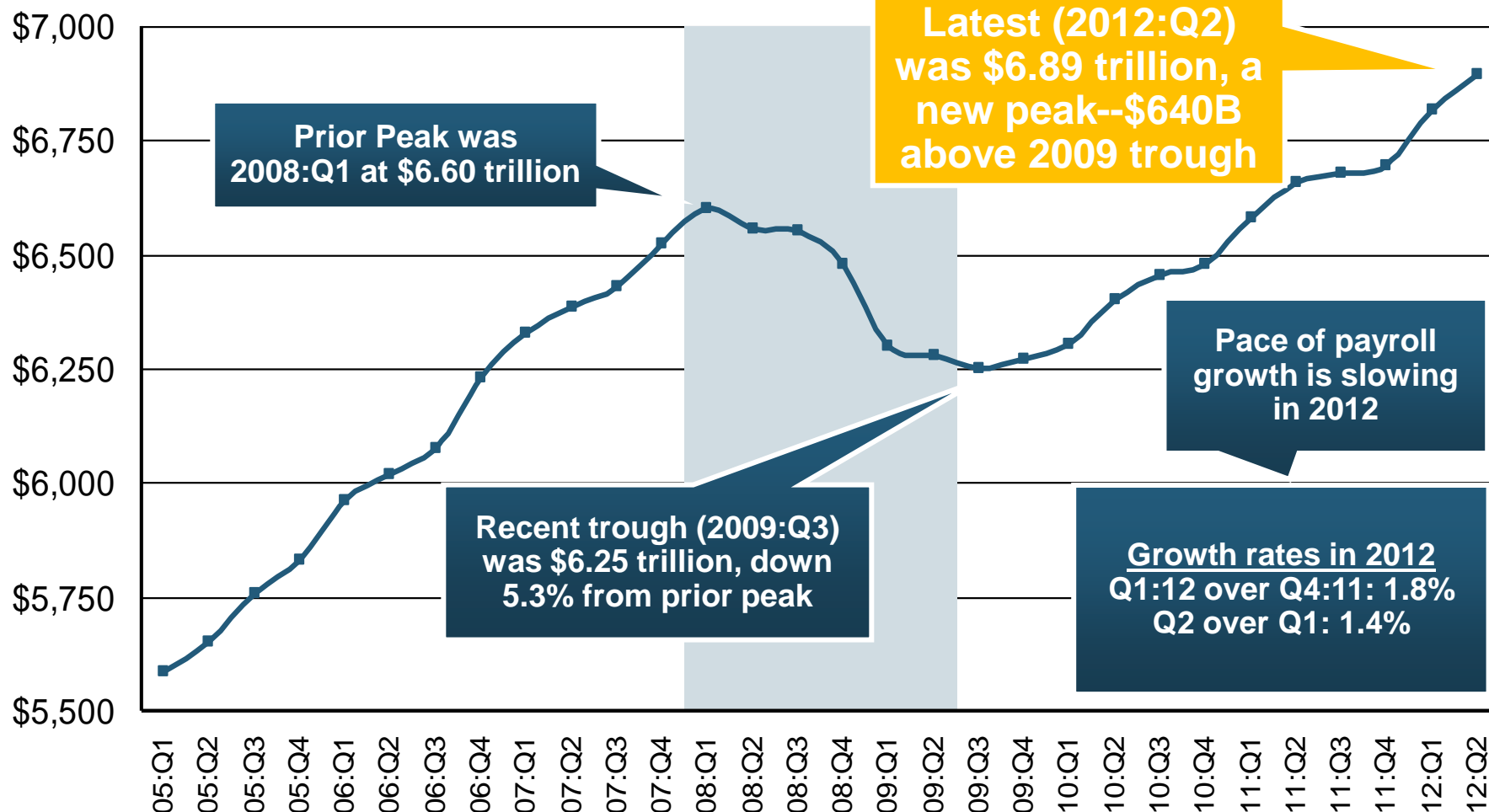
Quarterly, 2012:Q2 to 2013:Q4



Steadily Decreasing Unemployment Should Benefit the Workers Comp Exposure Base at Least Through 2013

Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2012:Q2

Billions



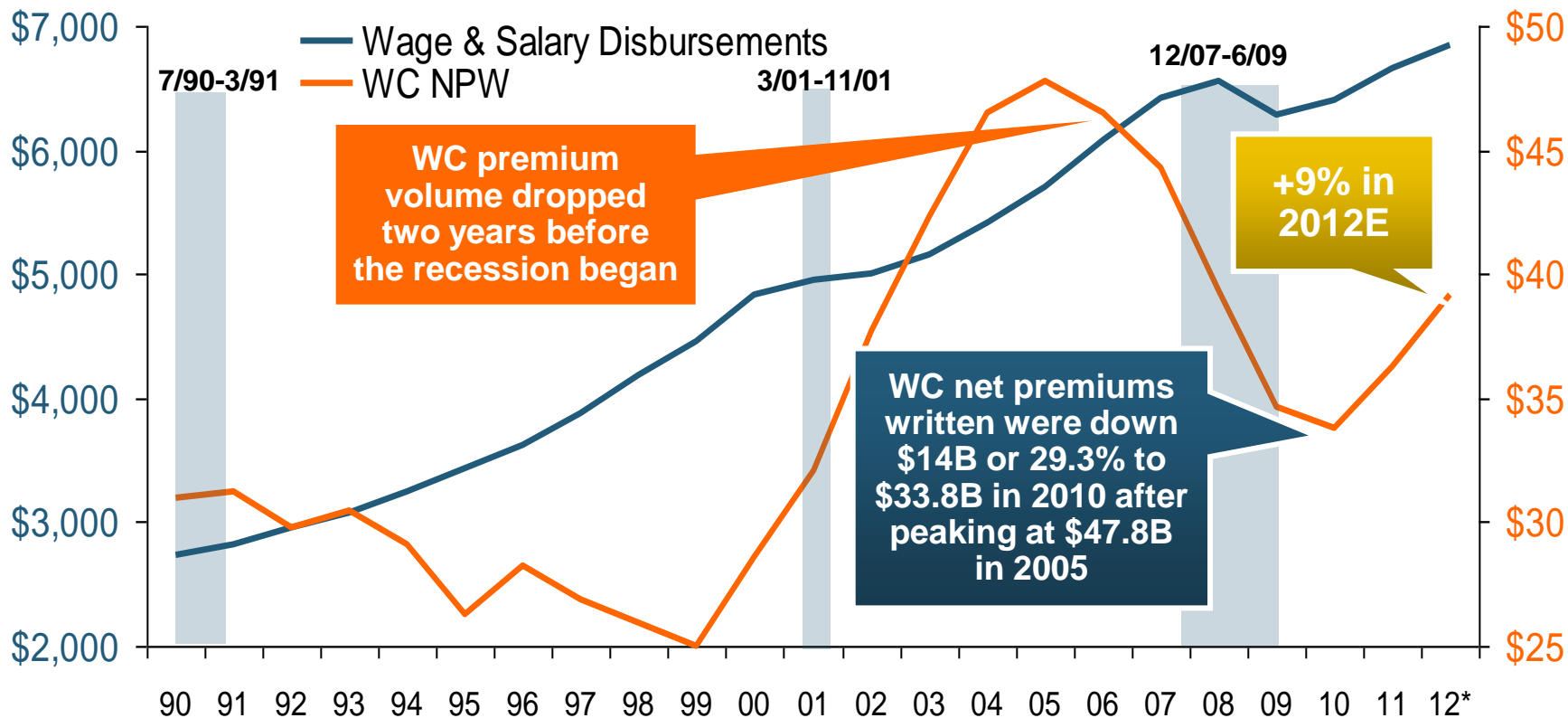
Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

Sources: <http://research.stlouisfed.org/fred2/series/WASCUR>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Payroll vs. Workers Comp Net Written Premiums, 1990-2012E

Payroll Base*
\$Billions

WC NWP
\$Billions



Continued Payroll Growth and Rate Increases Suggest WC NWP Will Grow Again in 2012; +7.9% Growth in 2011 Was the First Gain Since 2005

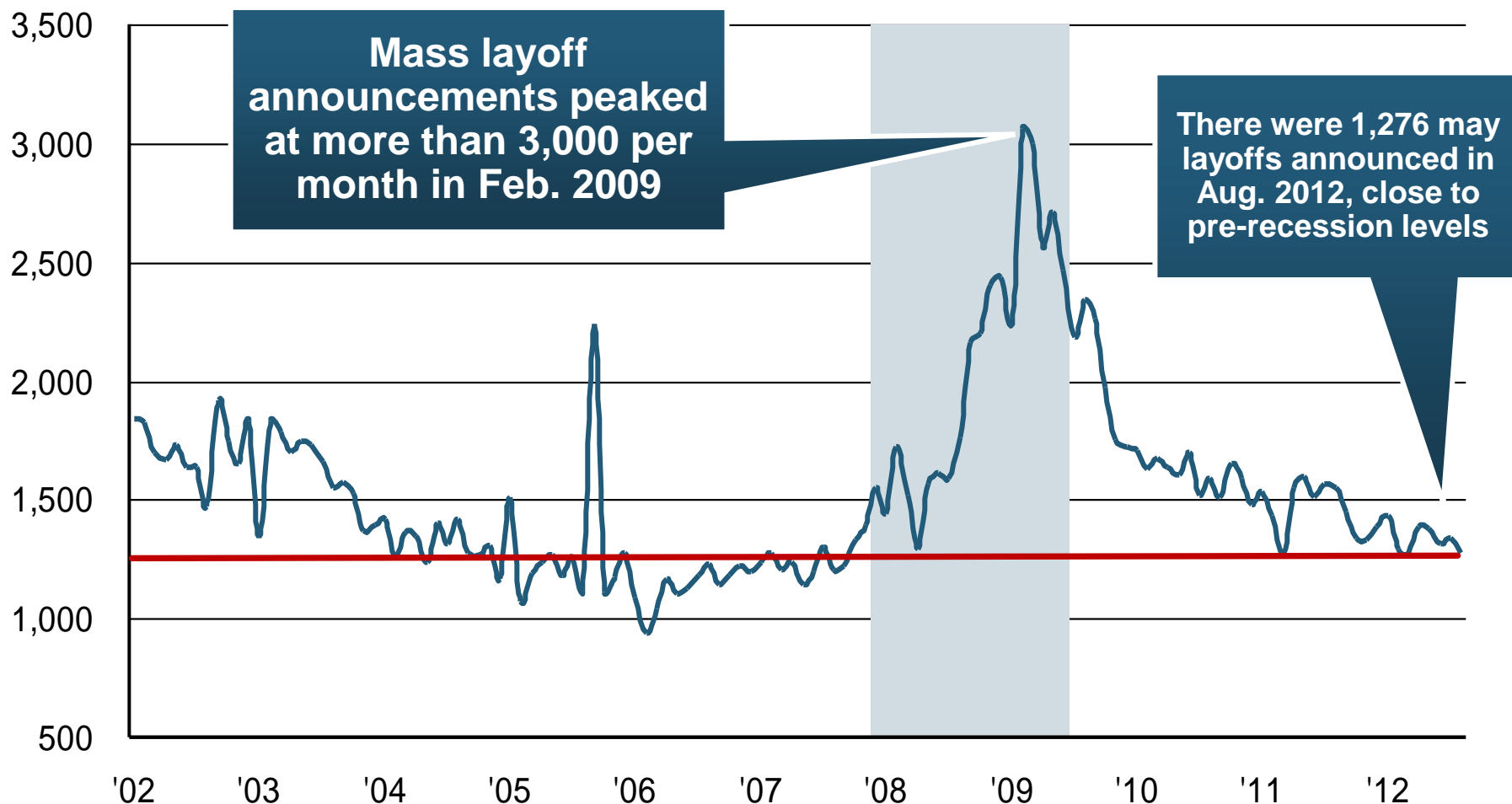
*Private employment; Shaded areas indicate recessions. Payroll and WC premiums for 2012 is I.I.I. estimate based YTD 2012 actuals. Sources: NBER (recessions); Federal Reserve Bank of St. Louis at <http://research.stlouisfed.org/fred2/series/WASCUR> ; NCCI; I.I.I.



POSITIVE LABOR MARKET DEVELOPMENTS

Key Factors Driving Workers Compensation Exposure

Mass Layoff Announcements, Jan. 2002—August 2012*



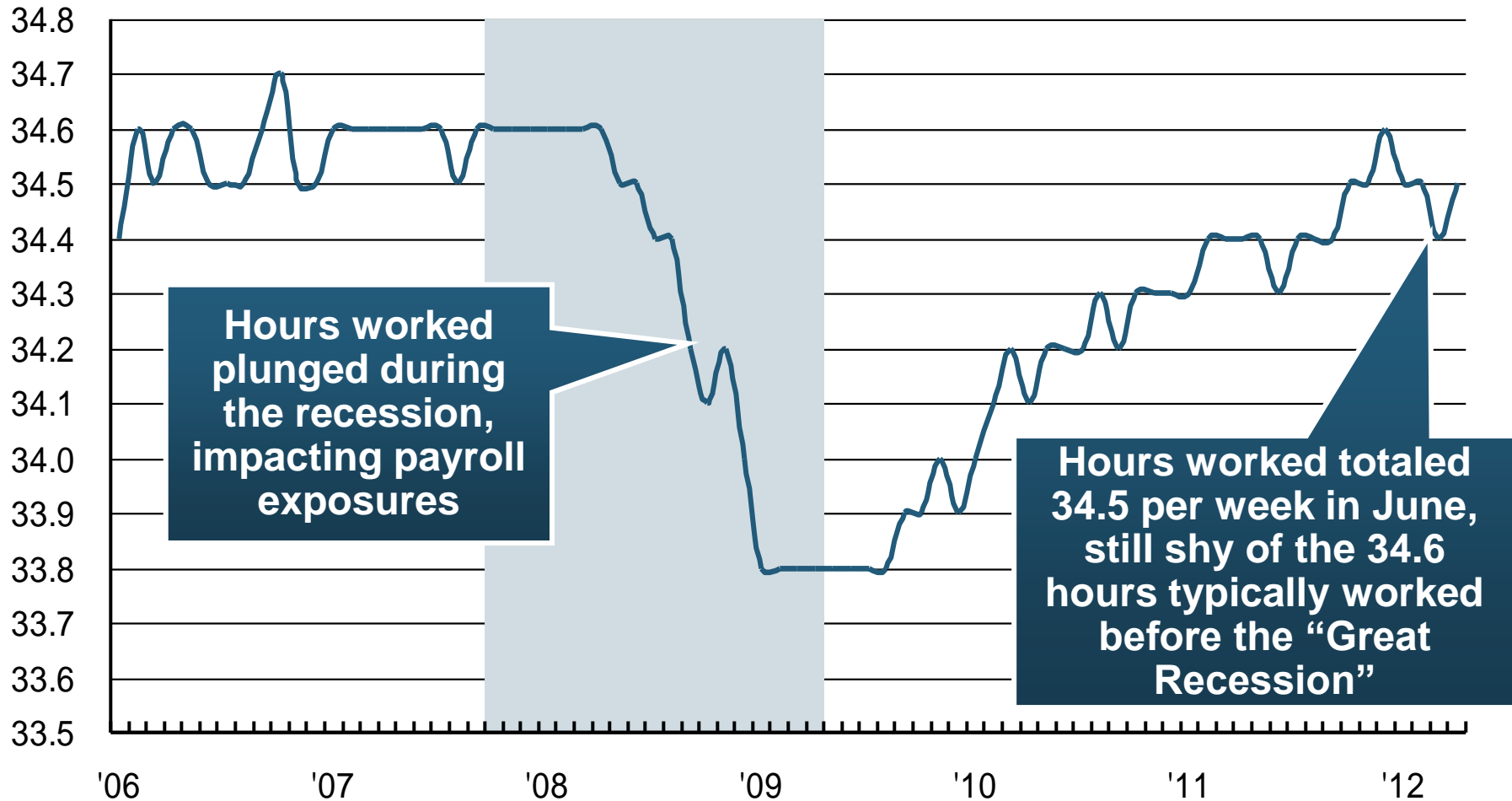
*Seasonally adjusted.

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics at <http://www.bls.gov/mls/>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Average Weekly Hours of All Private Workers, Mar. 2006—June 2012

(Hours Worked)



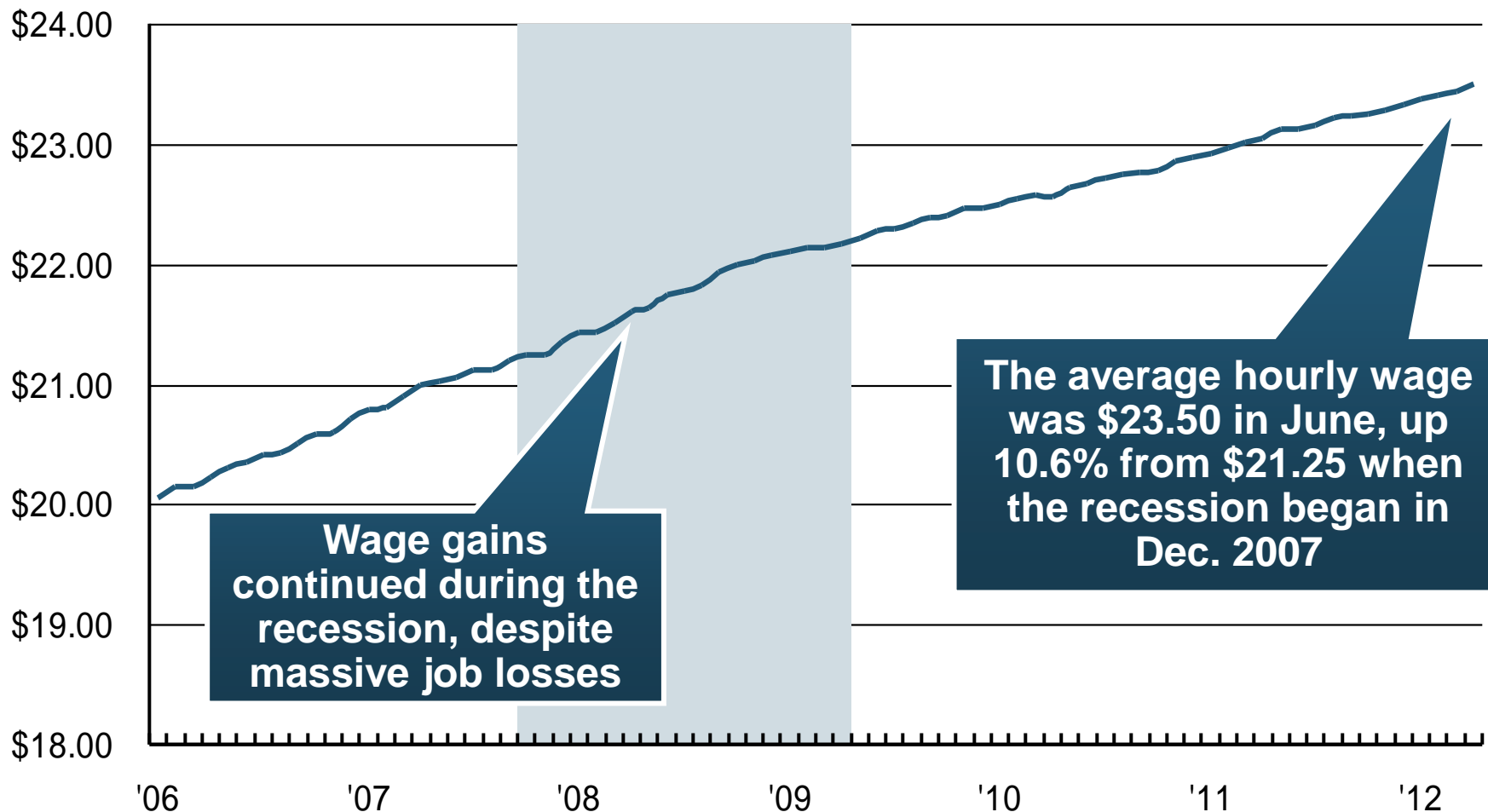
*Seasonally adjusted

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics at <http://www.bls.gov/data/#employment>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Average Hourly Wage of All Private Workers, Mar. 2006—June 2012

(Hourly Wage)



*Seasonally adjusted

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics at <http://www.bls.gov/data/#employment>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

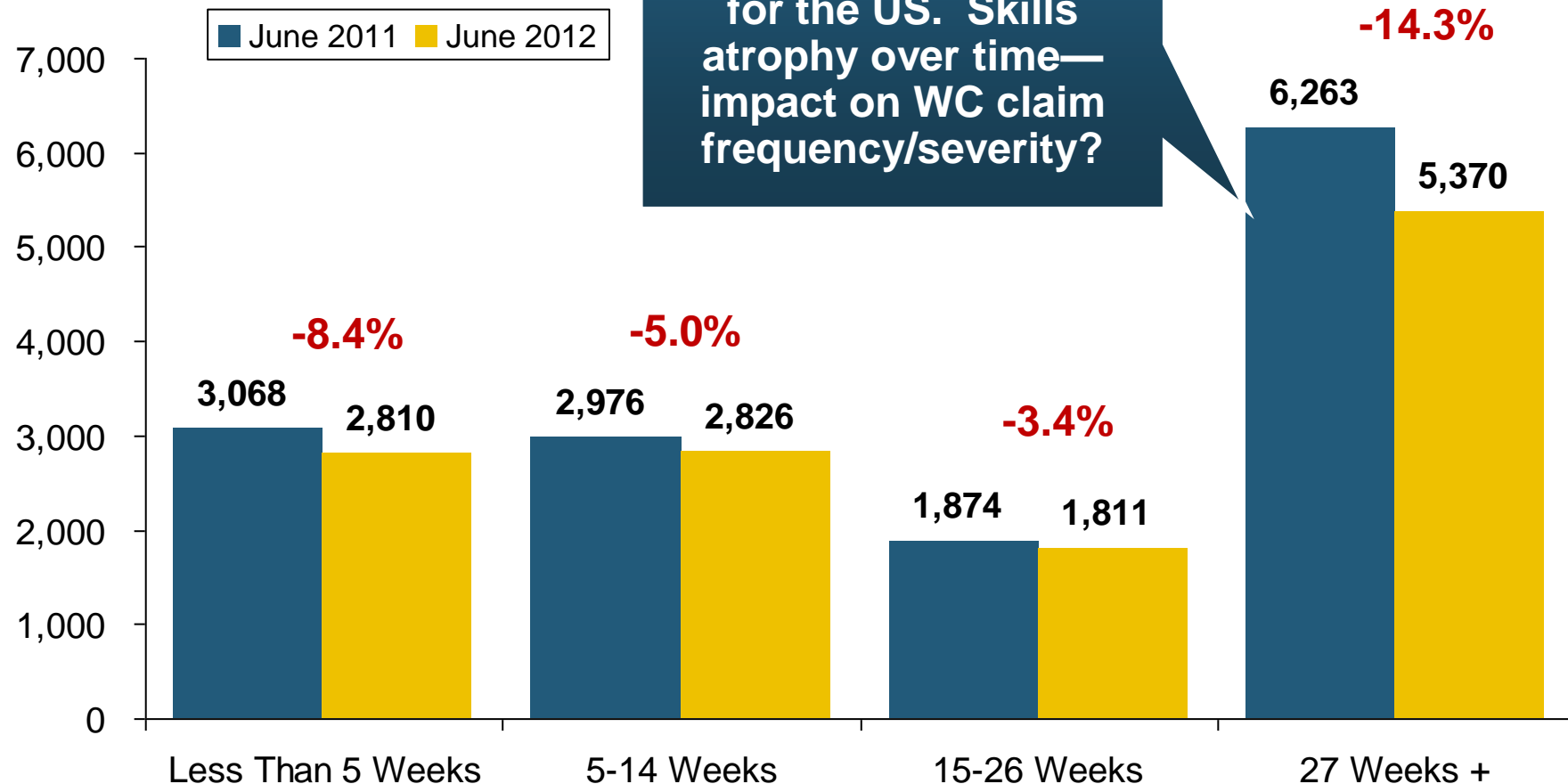


ADVERSE LONG-TERM LABOR MARKET DEVELOPMENTS

**Key Factors Harming Workers
Compensation Exposure and the
Overall Economy**

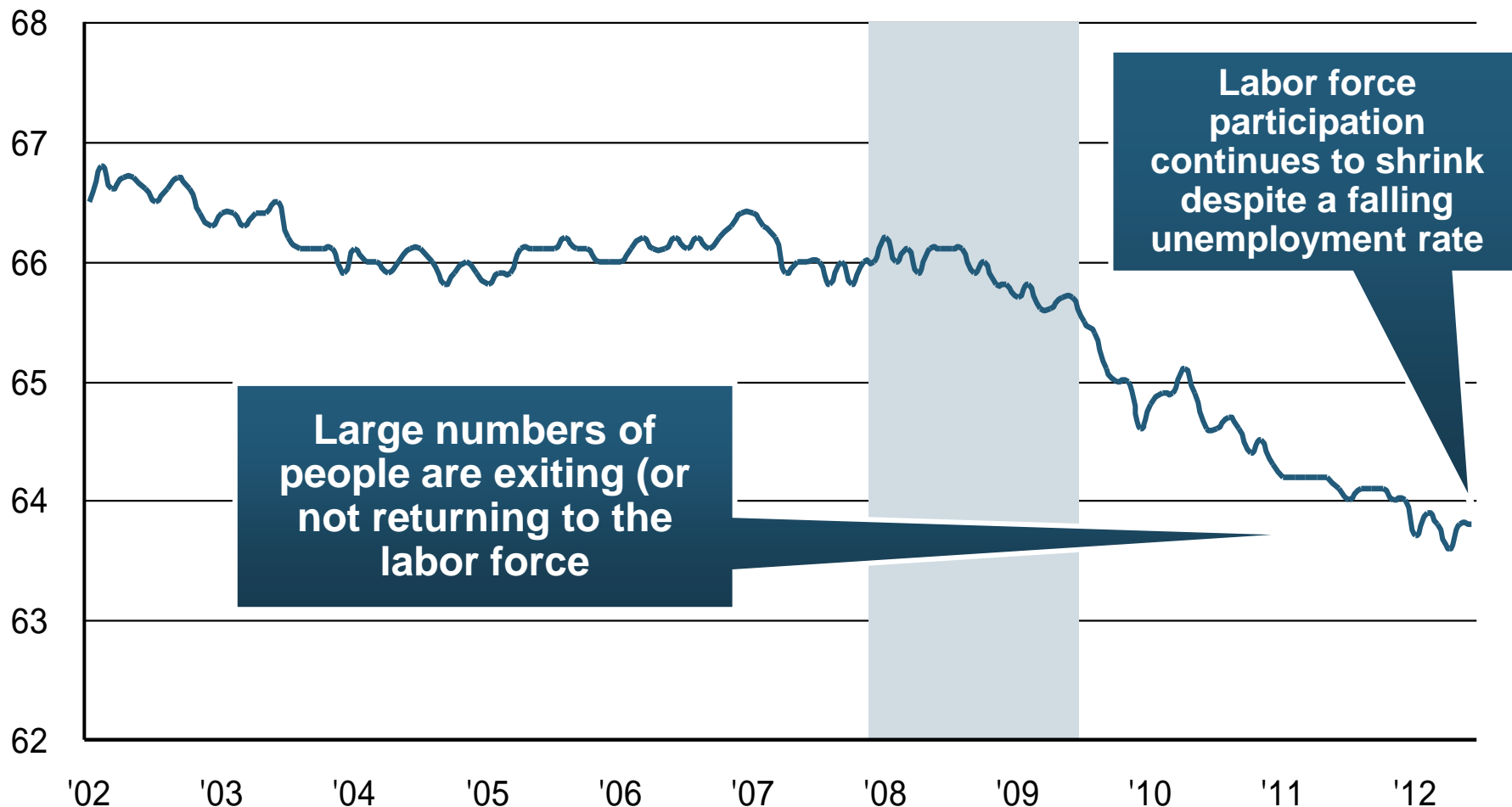
Duration of Unemployment, June 2011 vs. June 2012

(Thousands)



Labor Force Participation Rate, Jan. 2002—June 2012*

Labor Force Participation as a % of Population



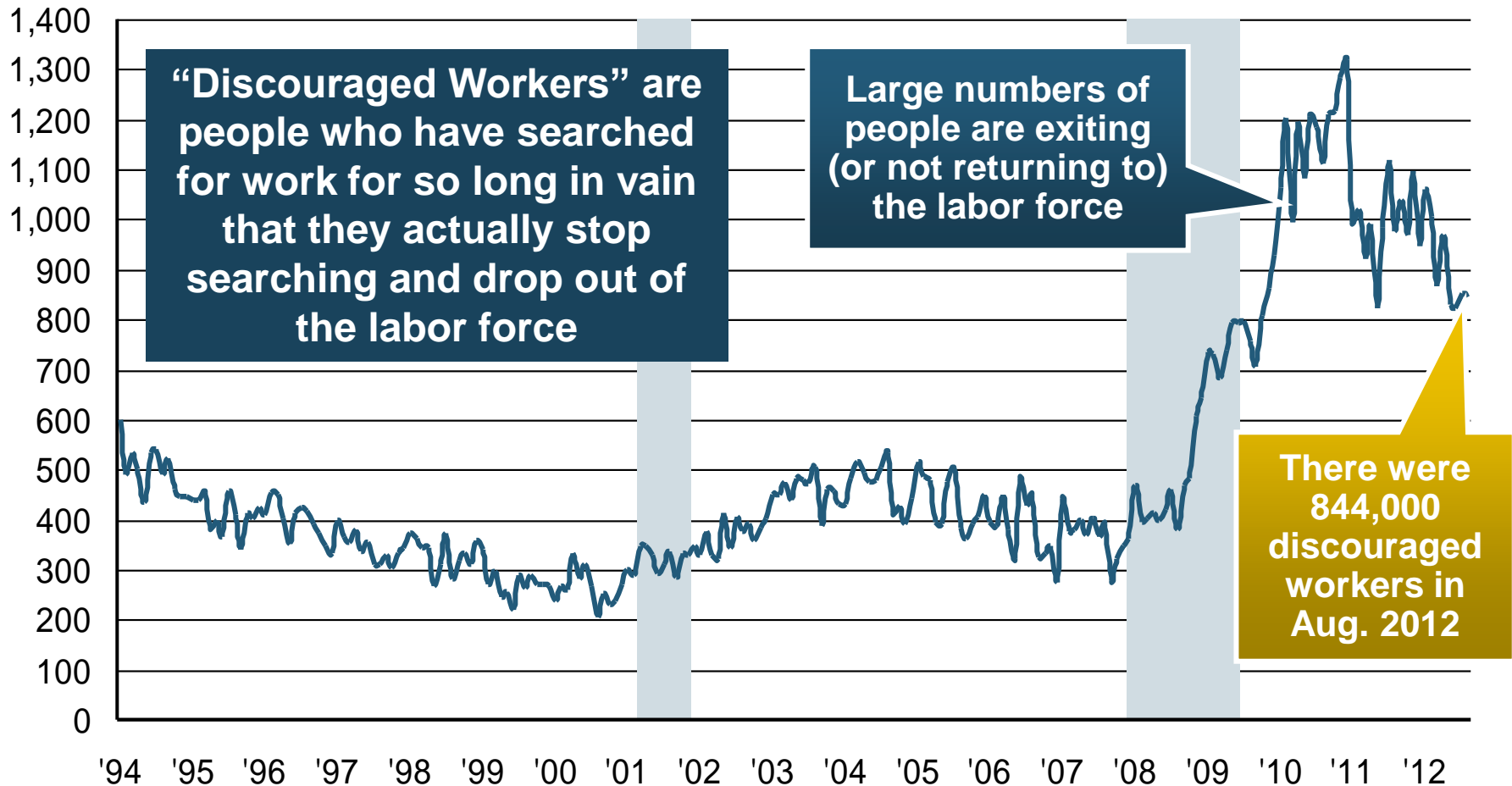
*Defined as the percentage of working age persons in the population who are employed or actively seeking work.

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics at <http://data.bls.gov/timeseries/LNS11300000>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Number of “Discouraged Workers,” Jan. 2002—August 2012

Thousands



In recent good times, the number of discouraged workers ranged from 200,000-400,000 (1995-2000) or from 300,000-500,000 (2002-2007).

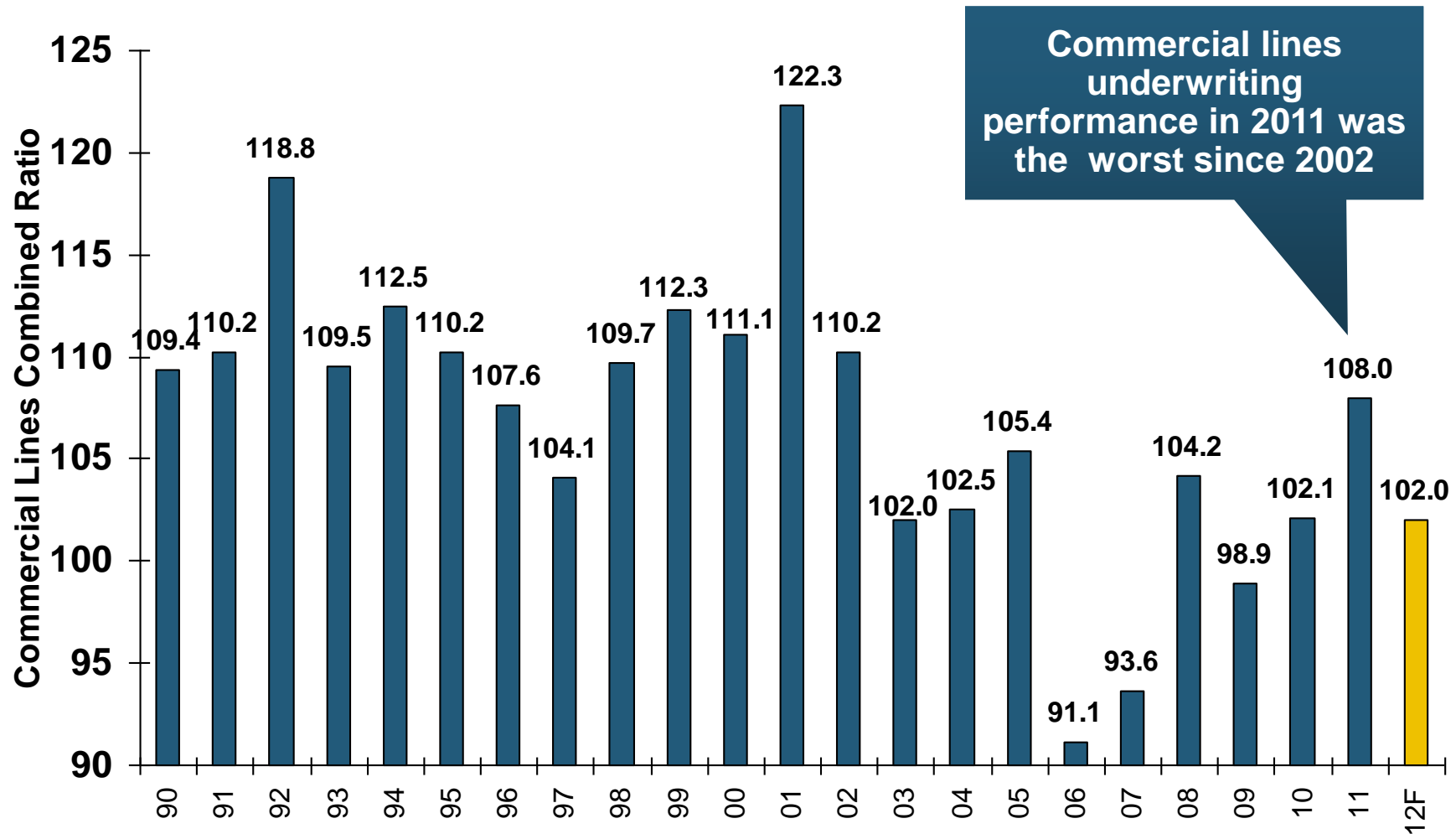
Notes: Recessions indicated by gray shaded columns. Data are seasonally adjusted.

Sources: Bureau of Labor Statistics <http://www.bls.gov/news.release/empsit.a.htm>; NBER (recession dates); Ins. Info. Inst.

Workers Compensation Operating Environment

**The Workers Comp Market Is Growing
But Underwriting Challenges Remain
Significant**

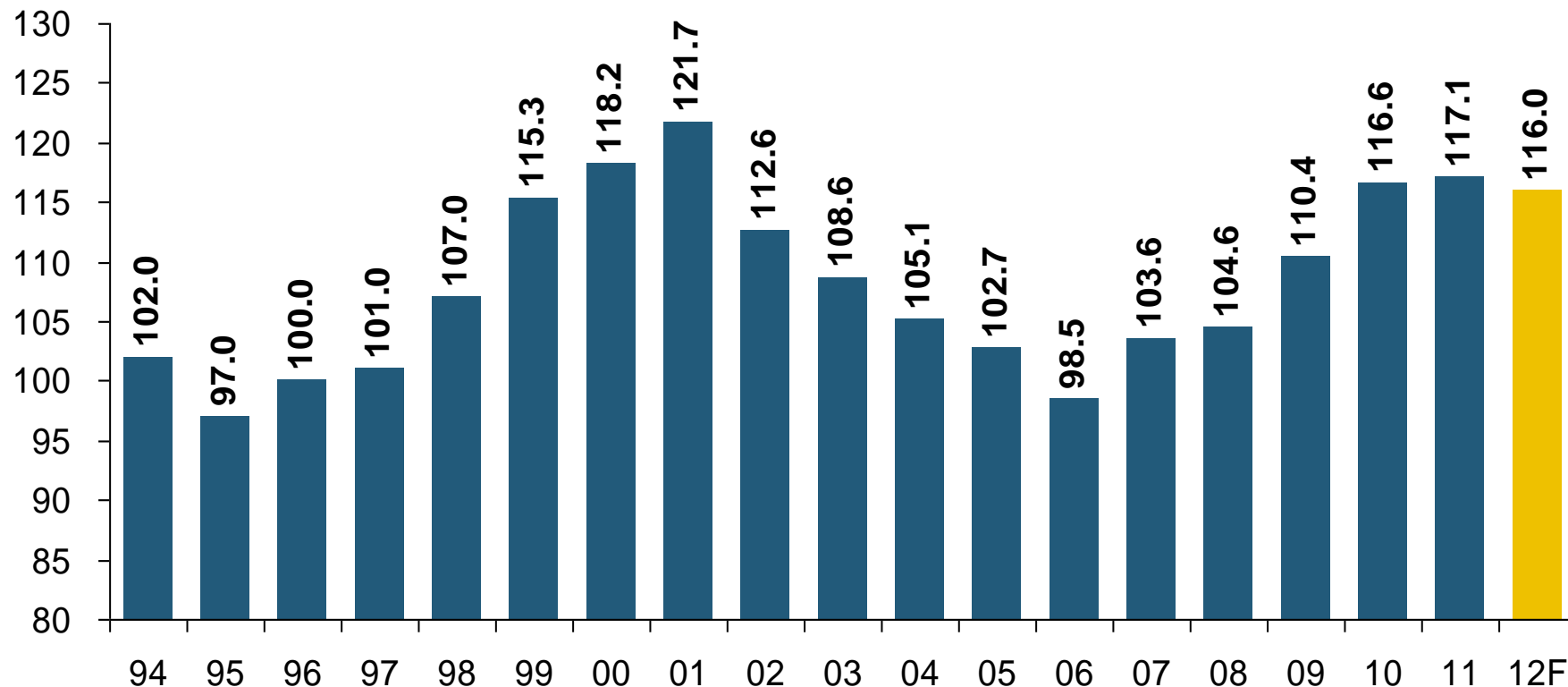
Commercial Lines Combined Ratio, 1990-2012F*



*2007-2012 figures exclude mortgage and financial guaranty segments.

Source: A.M. Best; Insurance Information Institute

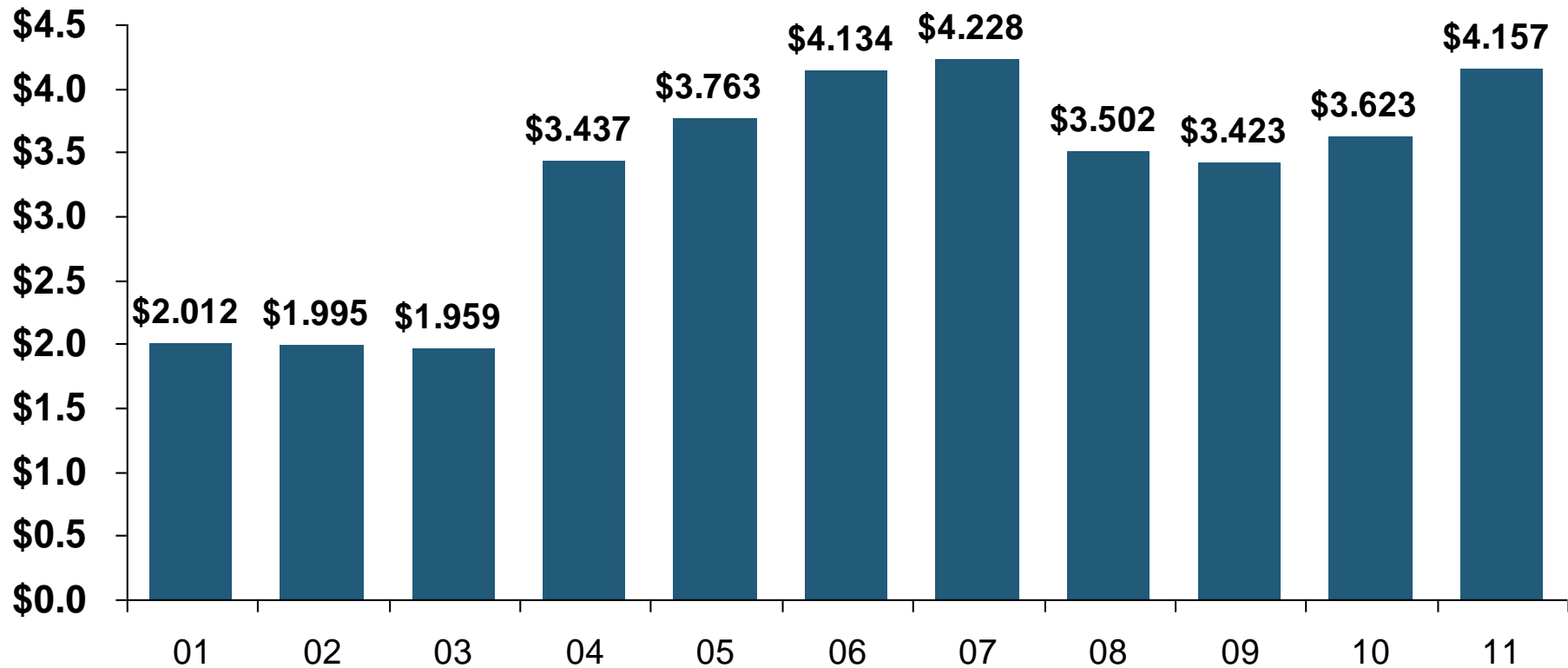
Workers Compensation Combined Ratio: 1994–2012F



Workers Comp Underwriting Results Are Deteriorating Markedly and the Worst They Have Been in a Decade

NY State Workers Compensation DPW: 2001–2011

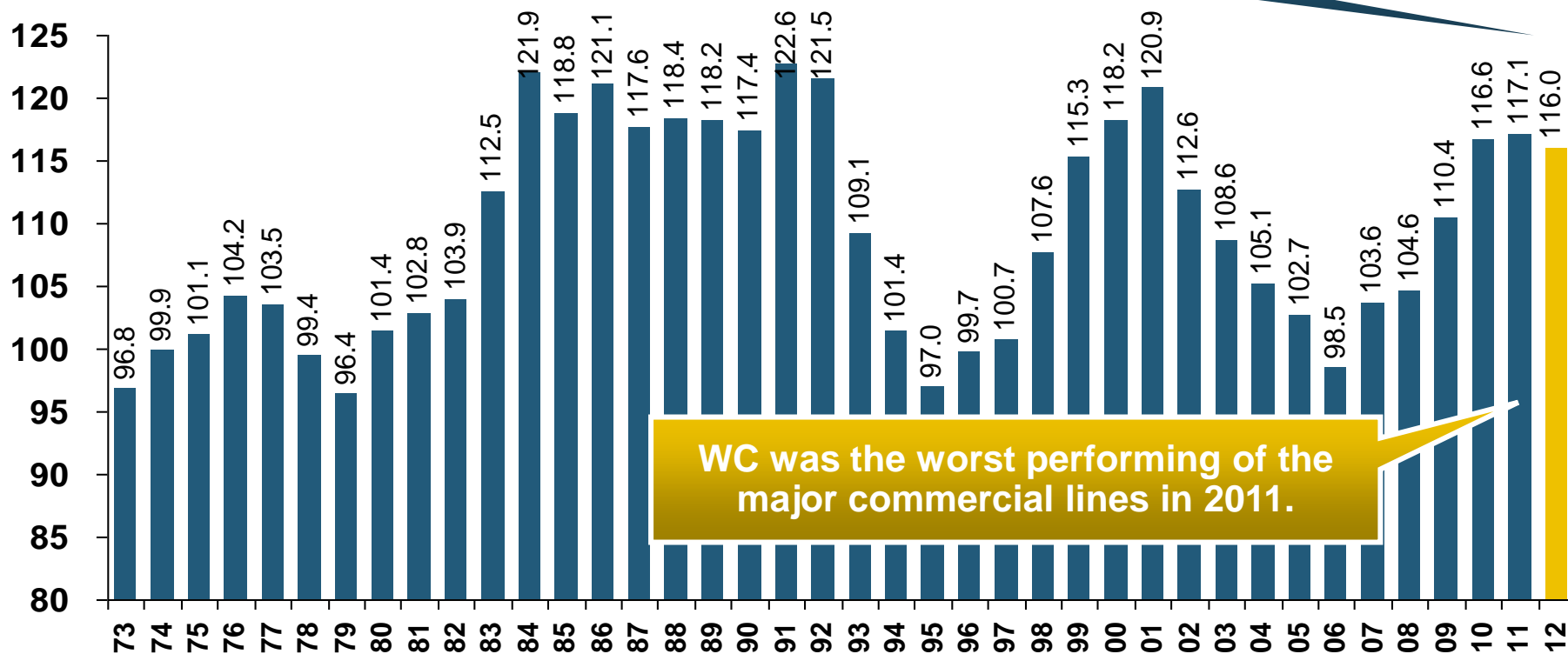
\$ Billions



Premium Volume in NY State is Still Recovering After a 19% Decline During the Financial Crisis/Soft Market

Workers Compensation Combined Ratio: 1973–2012P*

This is the 3rd time in 30 years that WC has suffered from very poor underwriting performance



WC was the worst performing of the major commercial lines in 2011.

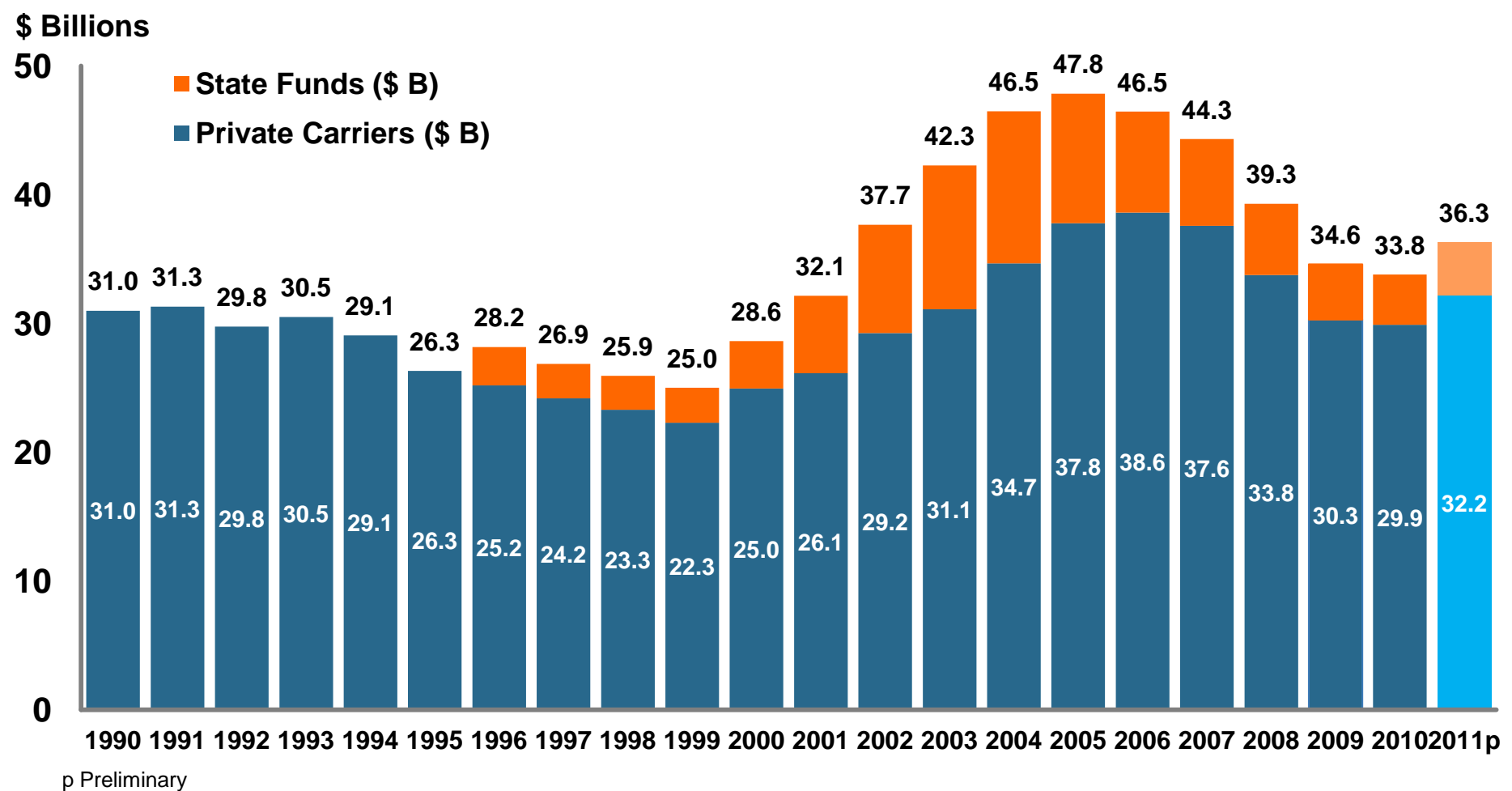
**Workers Comp Underwriting Results
Deteriorated Markedly in Recent Years**

*Data are on a calendar year basis.

Sources: Insurance Information Institute from A.M. Best (1973-1979; A.M. Best *Aggregates & Averages*, 1980-2011 (annual editions); A.M. Best *Review & Preview* for 2012F..

Workers Compensation Premium: First Increase in Years

Net Written Premium



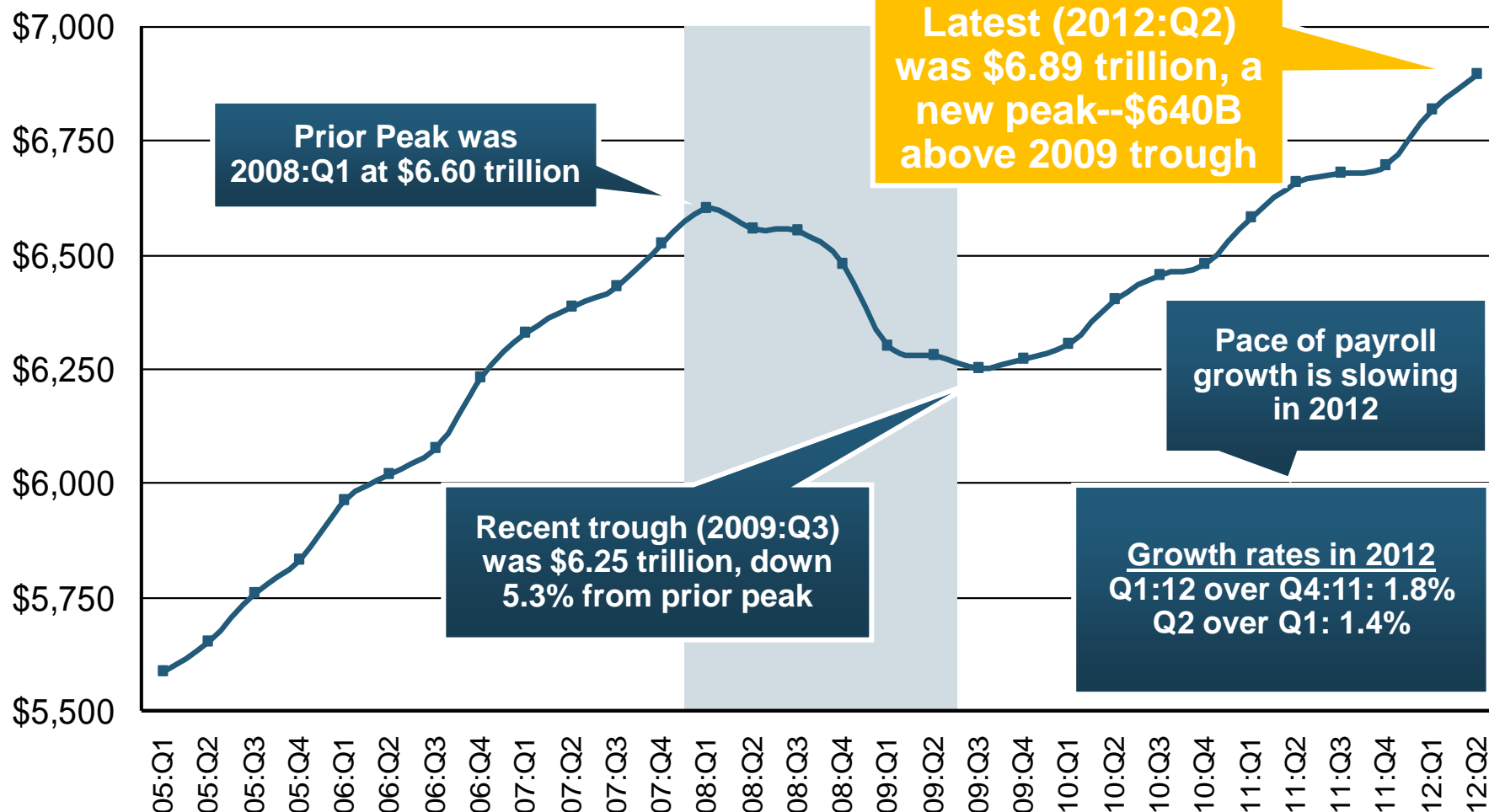
Source: 1990–2010 Private Carriers, *Best's Aggregates & Averages*; 2011p, NCCI

1996–2011p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements

State Funds available for 1996 and subsequent

Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2012:Q2

Billions



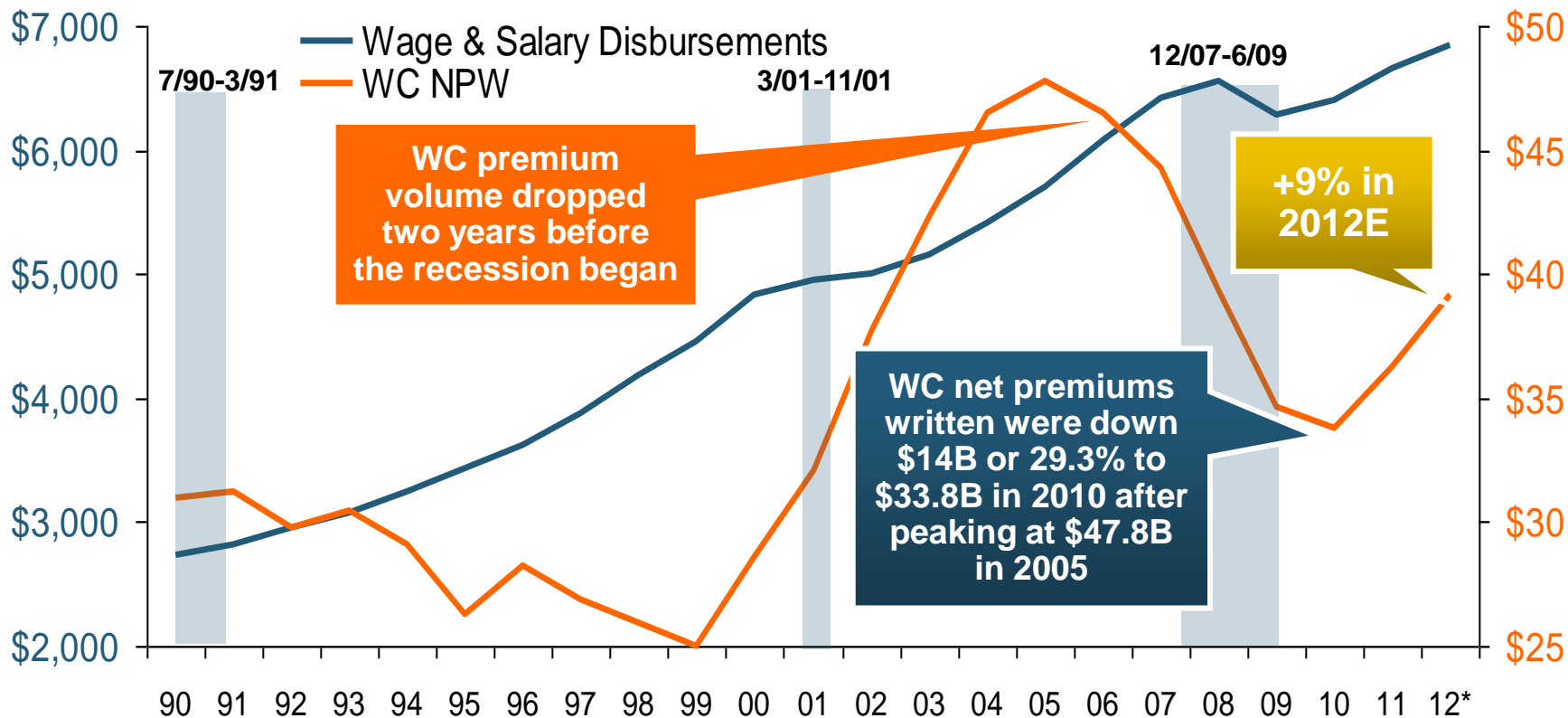
Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

Sources: <http://research.stlouisfed.org/fred2/series/WASCUR>; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Payroll vs. Workers Comp Net Written Premiums, 1990-2012E

Payroll Base*
\$Billions

WC NWP
\$Billions

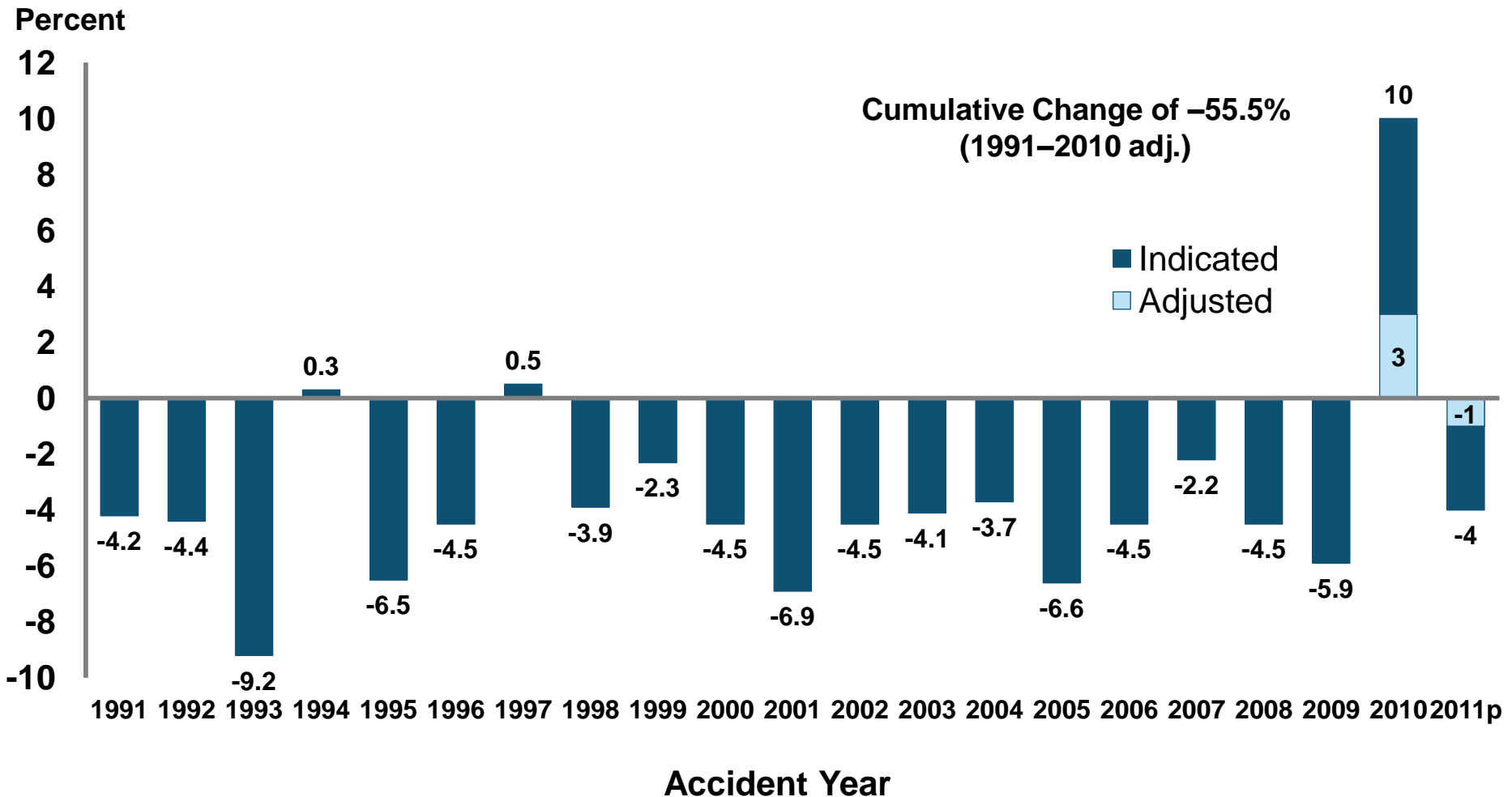


Continued Payroll Growth and Rate Increases Suggest WC NWP Will Grow Again in 2012; +7.9% Growth in 2011 Was the First Gain Since 2005

*Private employment; Shaded areas indicate recessions. Payroll and WC premiums for 2012 is I.I.I. estimate based YTD 2012 actuals. Sources: NBER (recessions); Federal Reserve Bank of St. Louis at <http://research.stlouisfed.org/fred2/series/WASCUR> ; NCCI; I.I.I.

Workers Compensation Lost-Time Claim Frequency Declined in 2011

Lost-Time Claims



2011p: Preliminary based on data valued as of 12/31/2011

1991–2010: Based on data through 12/31/2010, developed to ultimate

Based on the states where NCCI provides ratemaking services, including state funds; excludes high deductible policies

Frequency is the number of lost-time claims per \$1M pure premium at current wage and voluntary loss cost level

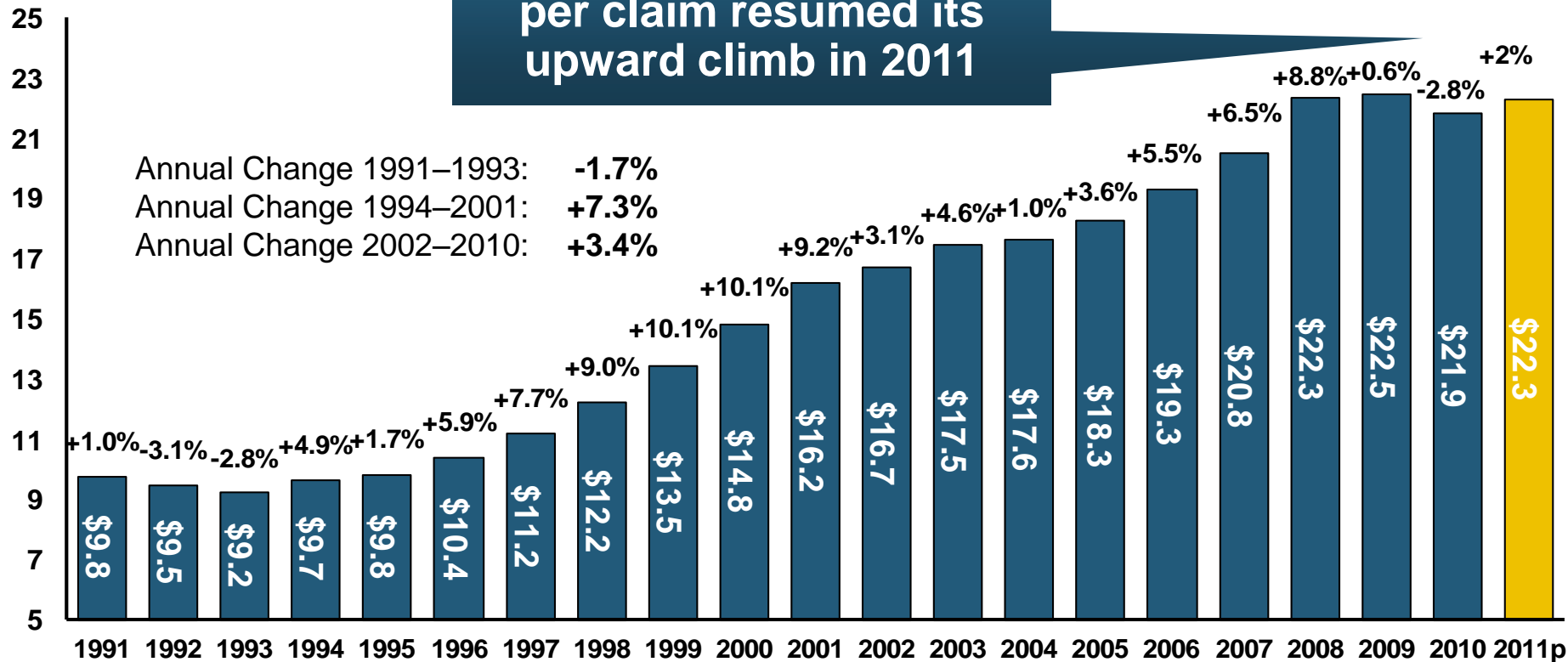
Source: NCCI.

Workers Comp Indemnity Claim Costs: Modest Increase in 2011

Average Indemnity Cost per Lost-Time Claim

Indemnity
Claim Cost (\$ 000s)

**Average indemnity costs
per claim resumed its
upward climb in 2011**



2010p: Preliminary based on data valued as of 12/31/2011

1991–2010: Based on data through 12/31/2010, developed to ultimate

Based on the states where NCCI provides ratemaking services

Excludes high deductible policies

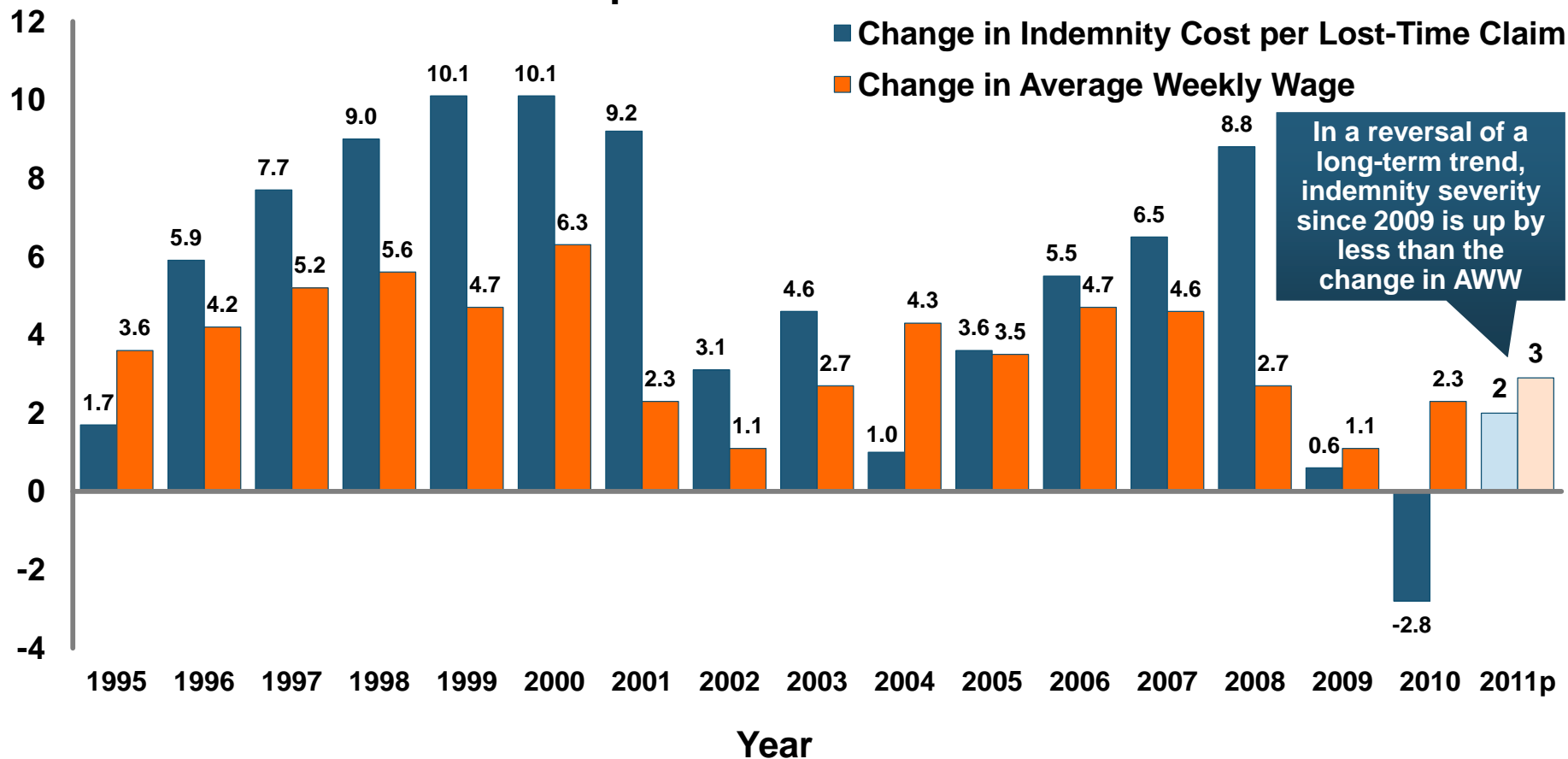
Source: NCCI

Accident Year

Workers Compensation Indemnity Severity: Modest Increase in 2011

Average Indemnity Cost per Lost-Time Claim

Percent Change



p Preliminary

Based on the states where NCCI provides ratemaking services, including state funds; excludes high deductible policies

Source: Average Weekly Wage 1995–2008: Quarterly Census of Employment and Wages, Economy.com; 2009–2011p, NCCI
Accident year indemnity severity—NCCI states, NCCI.

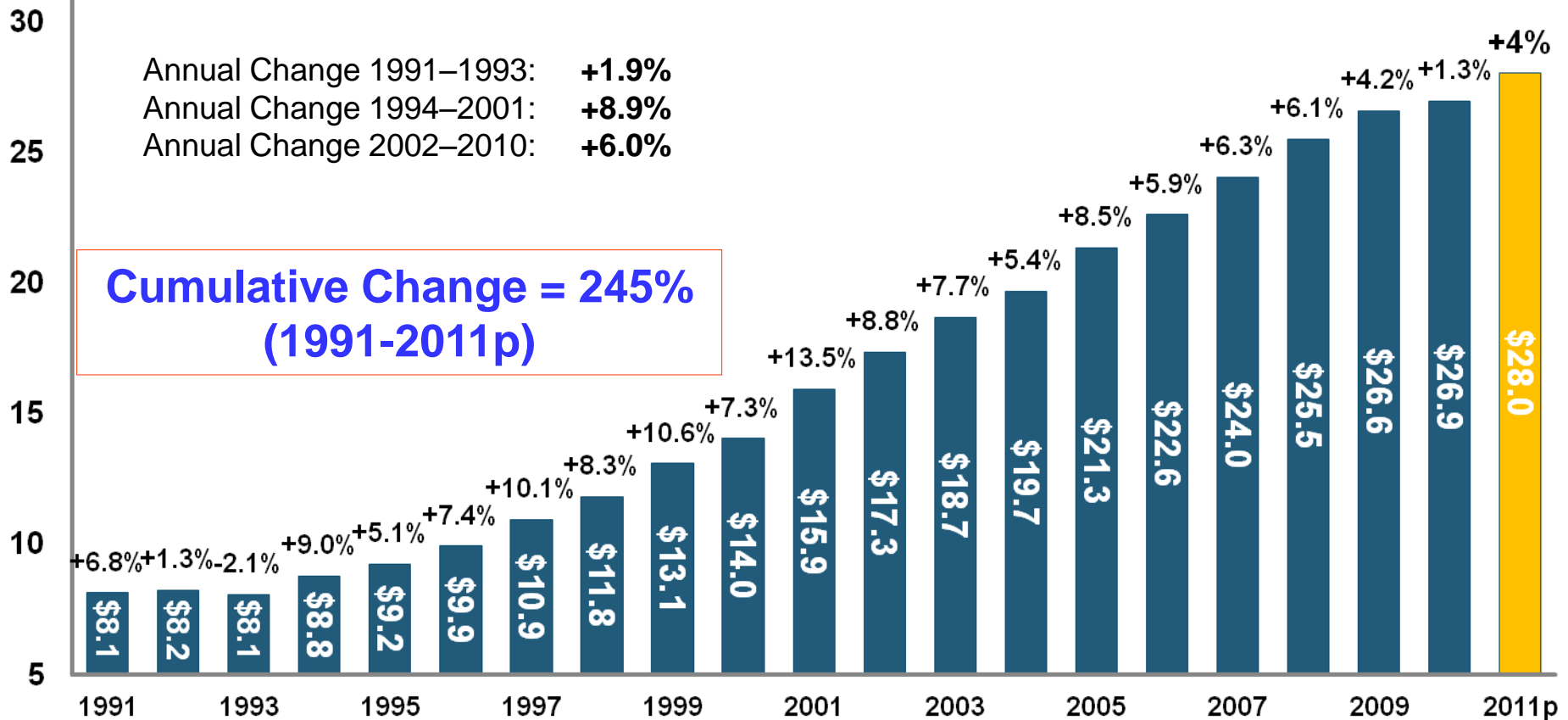
Workers Compensation Medical Severity Moderate Increase in 2011

Average Medical Cost per Lost-Time Claim

Medical
Claim Cost (\$000s)

Annual Change 1991–1993: **+1.9%**
Annual Change 1994–2001: **+8.9%**
Annual Change 2002–2010: **+6.0%**

Cumulative Change = 245%
(1991-2011p)



2011p: Preliminary based on data valued as of 12/31/2011

1991-2010: Based on data through 12/31/2010, developed to ultimate

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

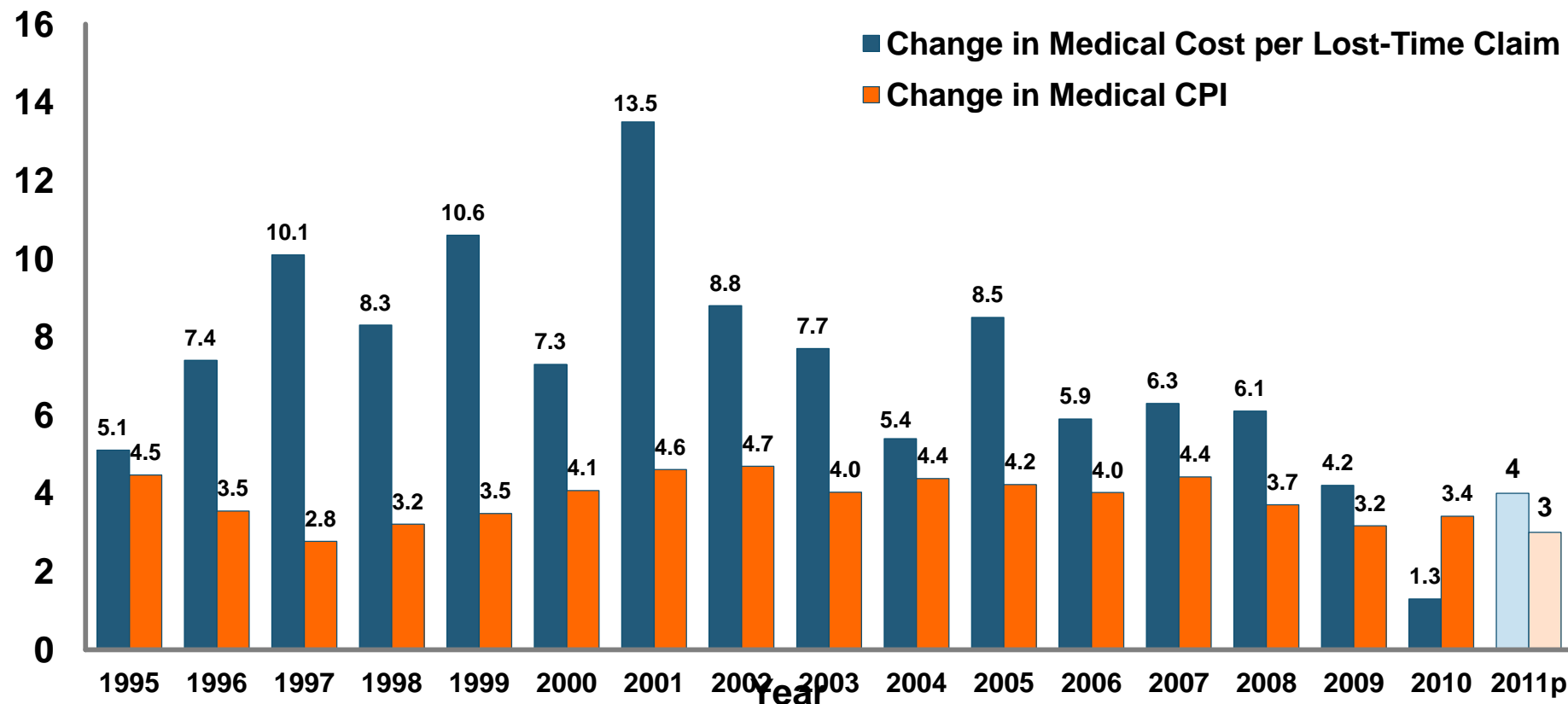
Source: NCCI.

Accident Year

Workers Compensation Medical Severity Moderate Increase in 2011

Average Medical Cost per Lost-Time Claim vs. Medical CPI

Percent Change



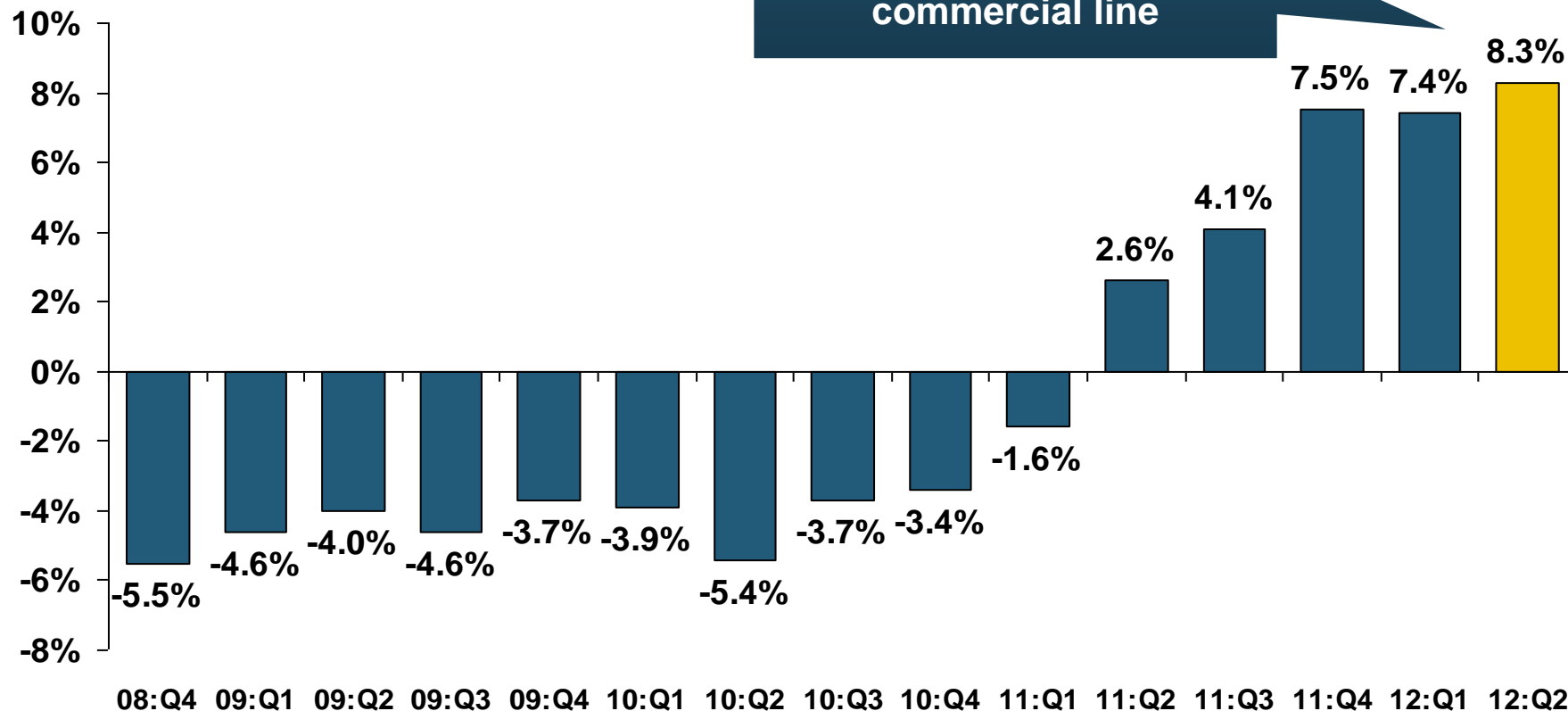
p Preliminary

Based on the states where NCCI provides ratemaking services, including state funds; excludes high deductible policies

Source: Medical CPI—All states, Economy.com; Accident year medical severity—NCCI states, NCCI

Workers Comp Rate Changes, 2008:Q4 – 2012:Q2

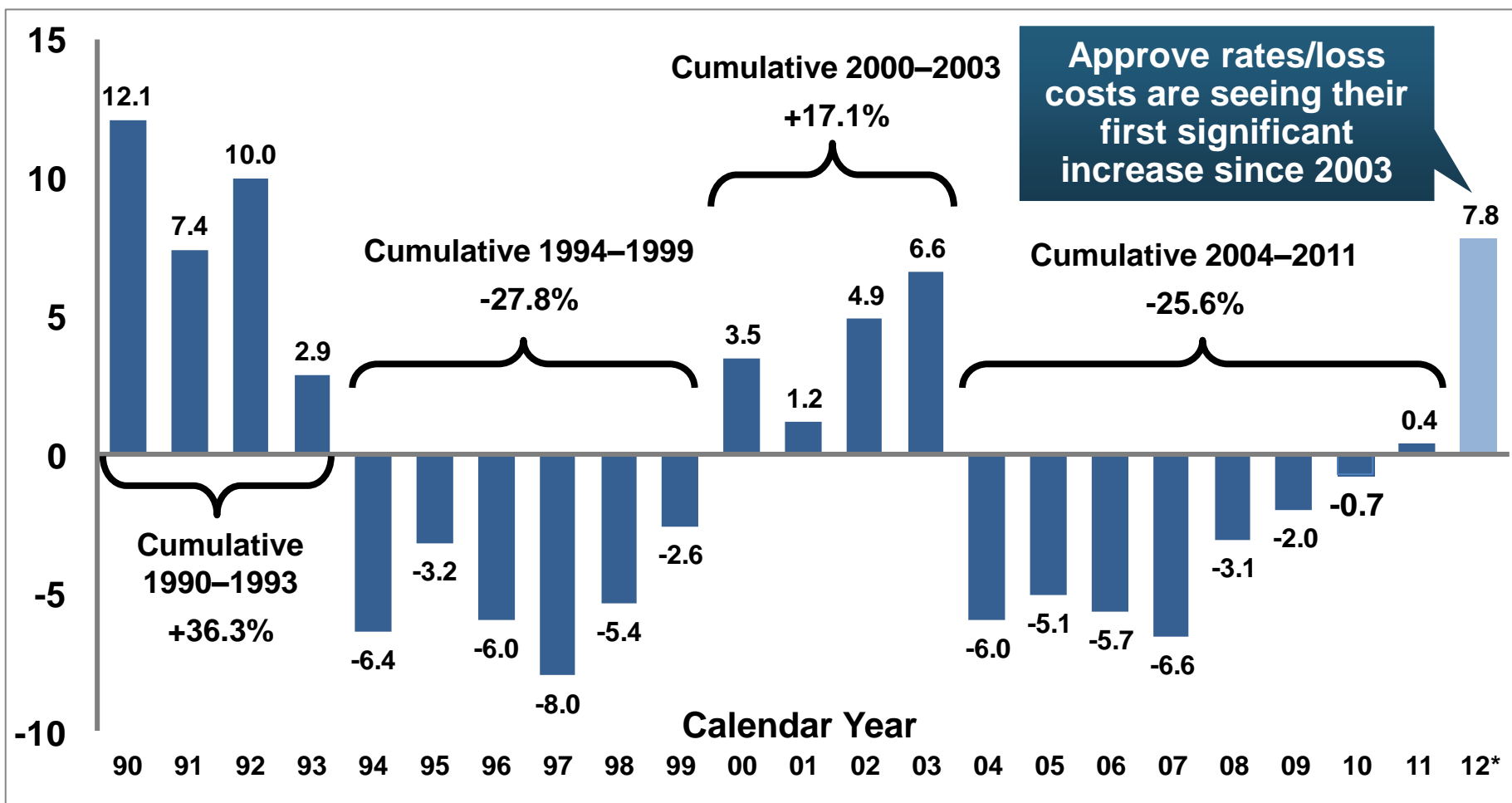
(Percent
Change)



Average Approved Bureau Rates/Loss Costs

History of Average WC Bureau Rate/Loss Cost Level Changes

Percent



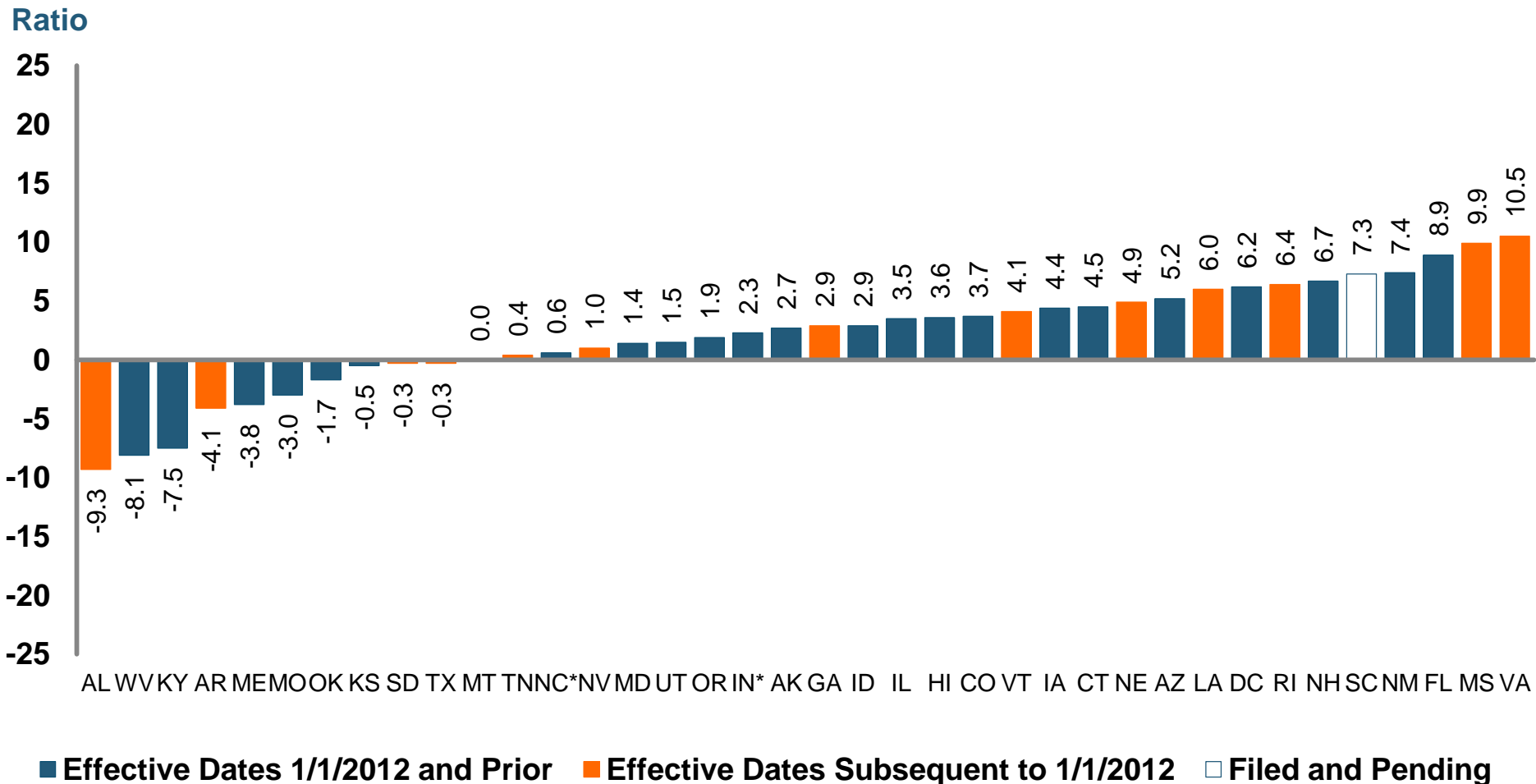
*States approved through 7/31/12.

Note: Countrywide approved changes in advisory rates, loss costs and assigned risk rates as filed by applicable rating organization.

Source: NCCI.

Current NCCI Voluntary Market Filed Rate/Loss Cost Changes

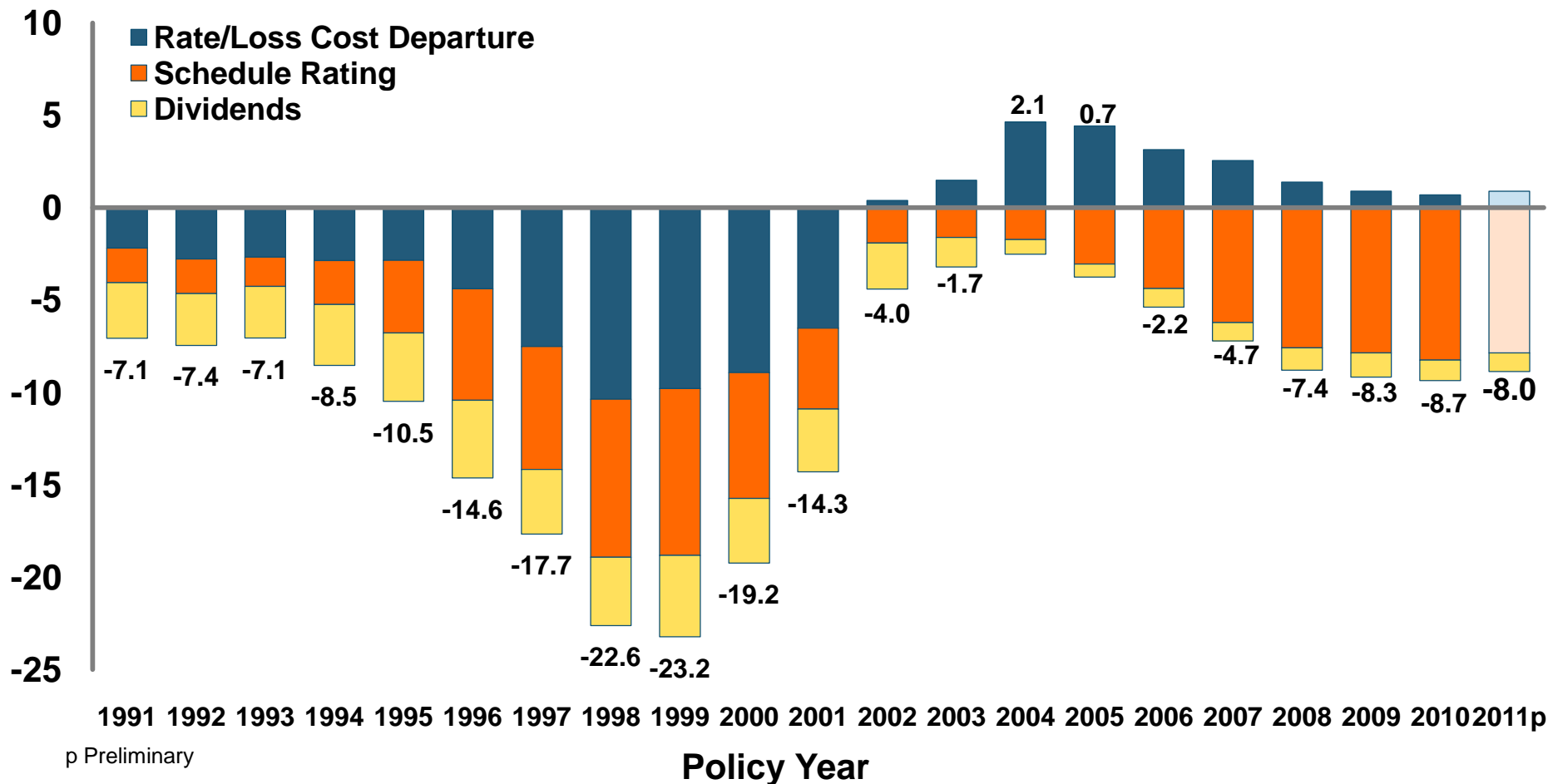
(Excludes Law-Only Filings)



Impact of Discounting on Workers Compensation Premium

NCCI States—Private Carriers

Percent



p Preliminary

Dividend ratios are based on calendar year statistics

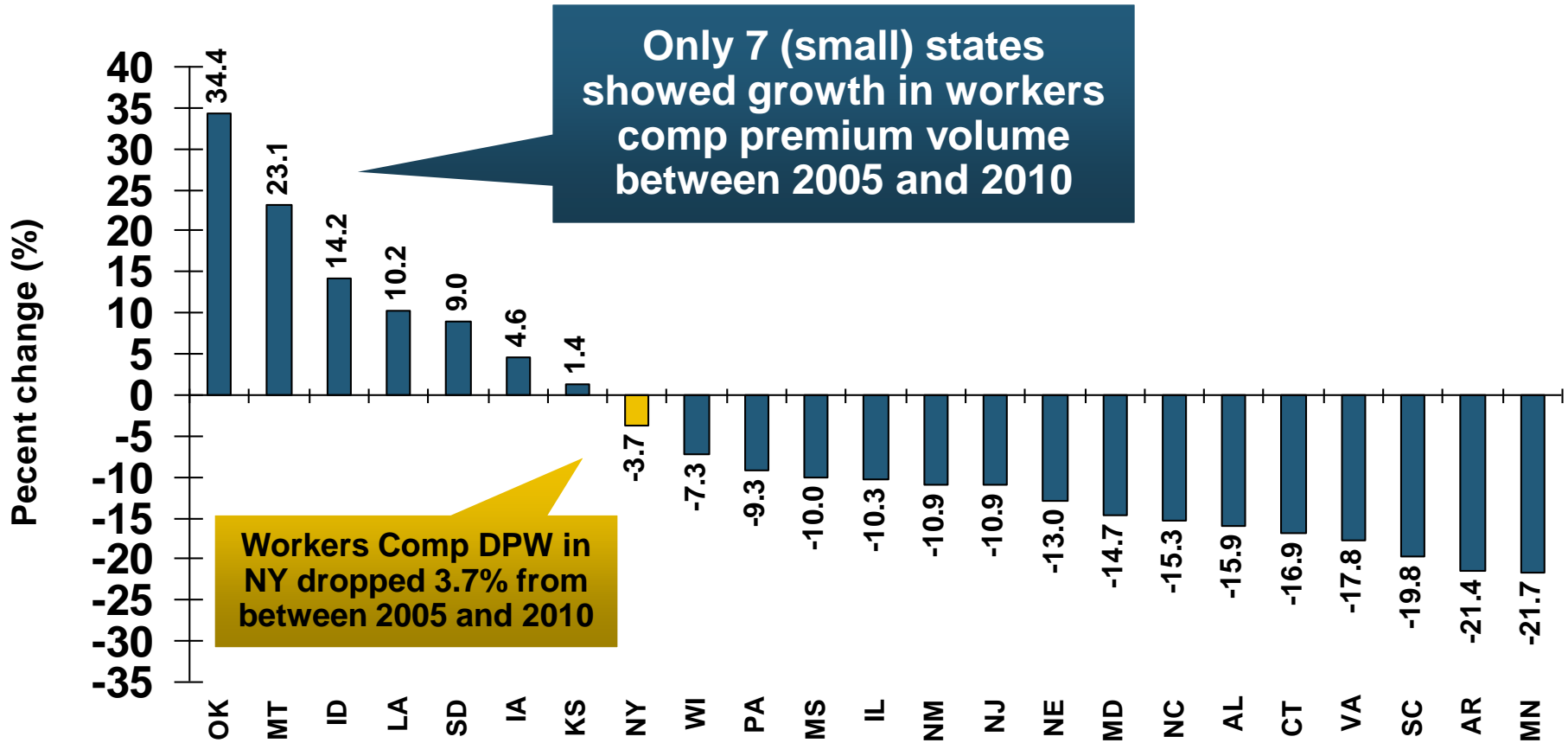
NCCI benchmark level does not include an underwriting contingency provision

Based on data through 12/31/2011 for the states where NCCI provides ratemaking services

Source: NCCI.

Direct Premiums Written: Worker's Comp Percent Change by State, 2005-2010*

Top 25 States

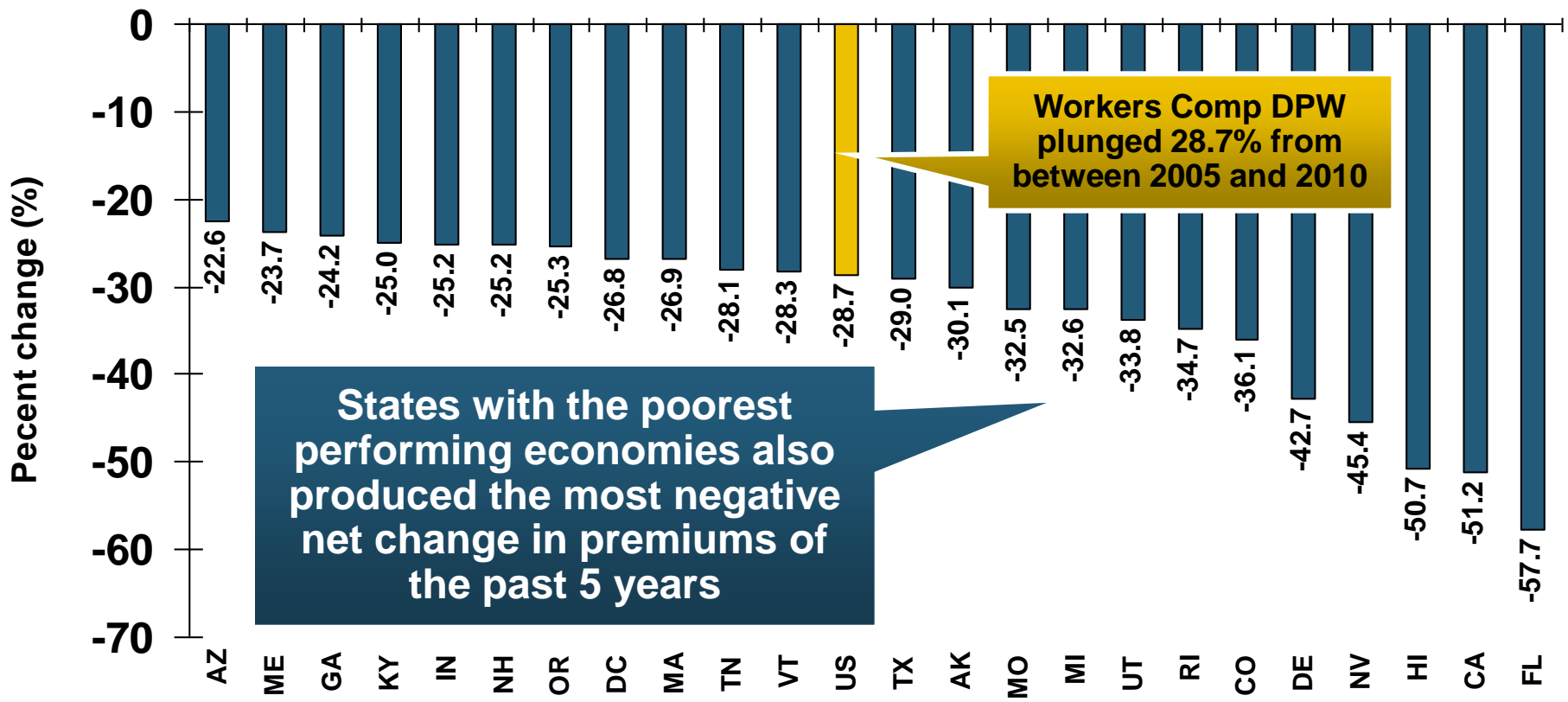


*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.

Direct Premiums Written: Worker's Comp Percent Change by State, 2005-2010*

Bottom 25 States



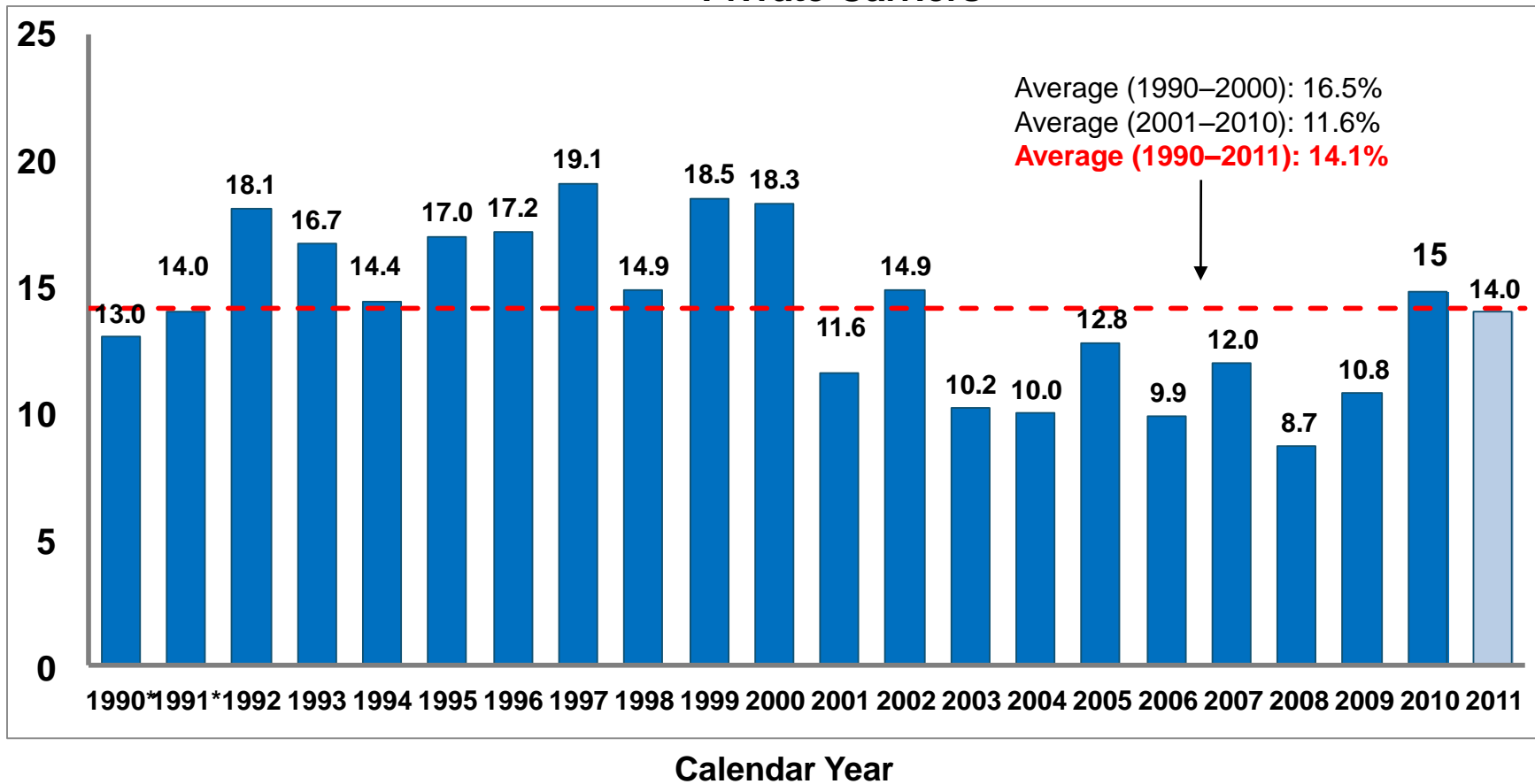
*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.

Workers Compensation Investment Returns

Investment Gain on Insurance Transactions-to-Premium Ratio Private Carriers

Percent



p=Preliminary

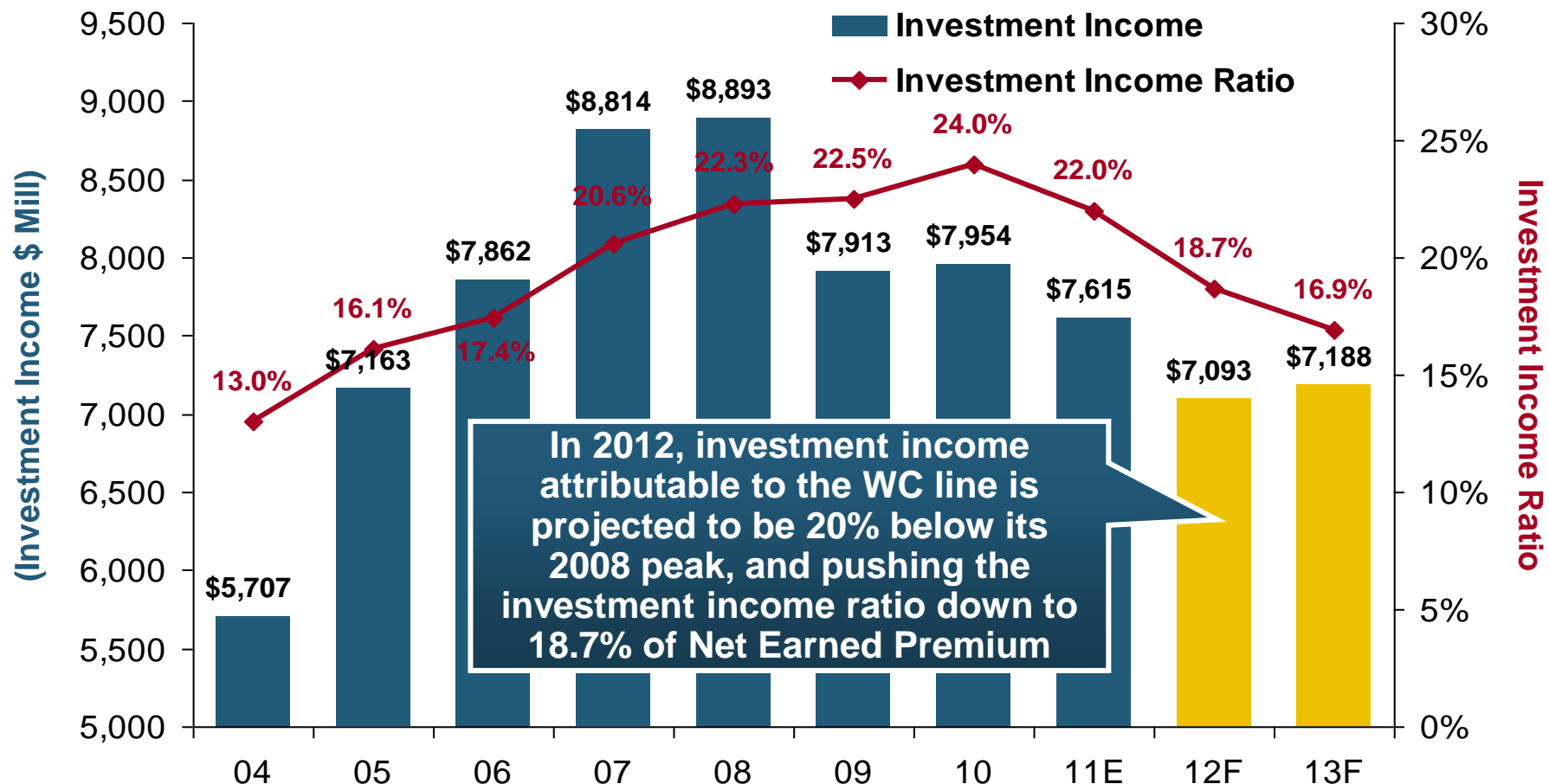
Source: 1990–2009, Annual Statement Data; 2010p, NCCI

Investment Gain on Insurance Transactions includes Other Income

*Adjusted to include realized capital gains to be consistent with 1992 and after

Source: NCCI

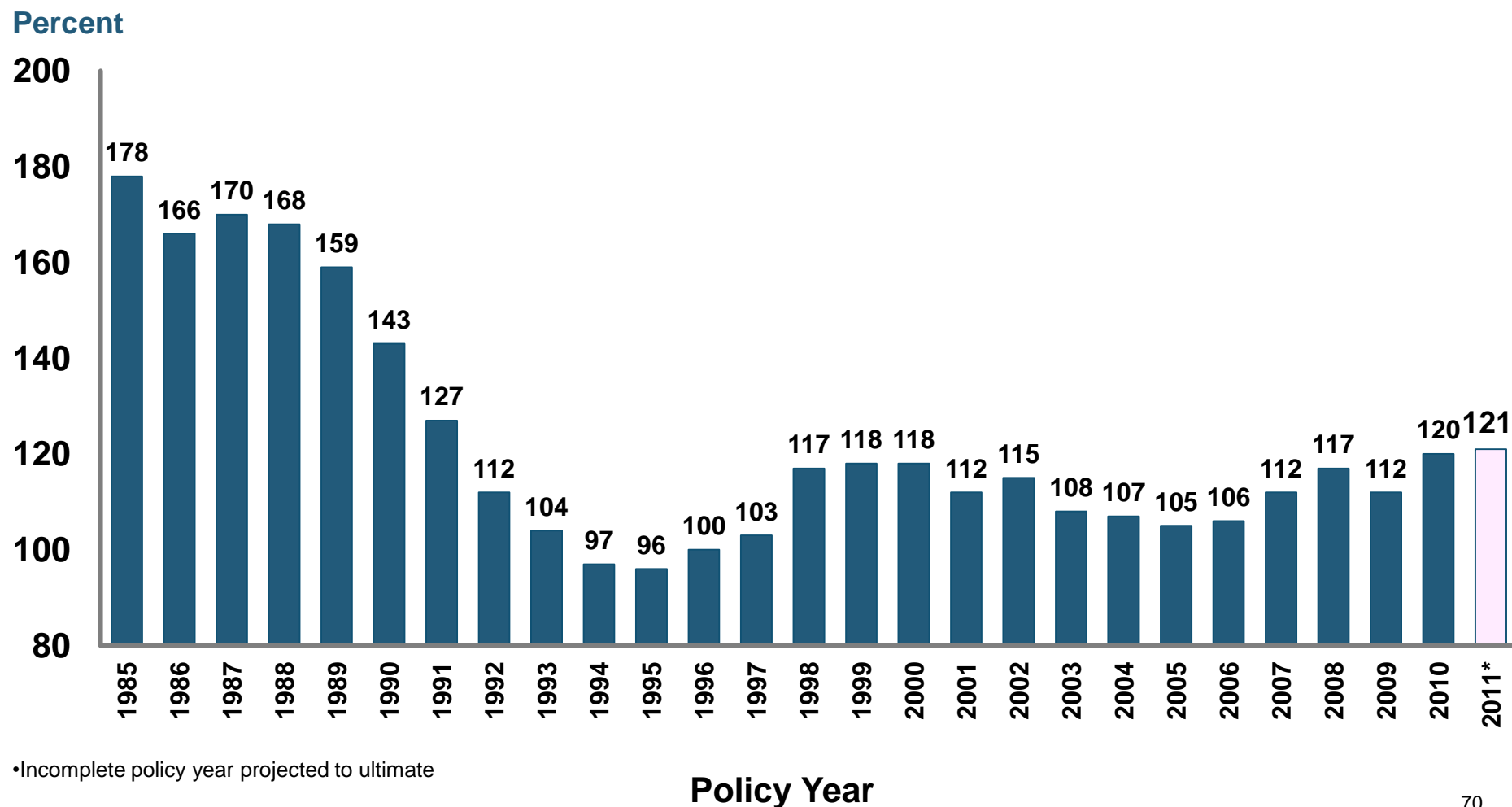
Workers Comp Investment Income Earned and Investment Income Ratio, 2004-2013F



Restoring the Workers Comp Line to Profitability Will Be Made More Difficult Because Investments Will Provide Little Lift, Requiring More of an Emphasis on Underwriting Profitability

Workers Compensation Residual Market Combined Ratio

NCCI-Serviced Workers Compensation Residual Market Pools as of Dec. 31, 2011



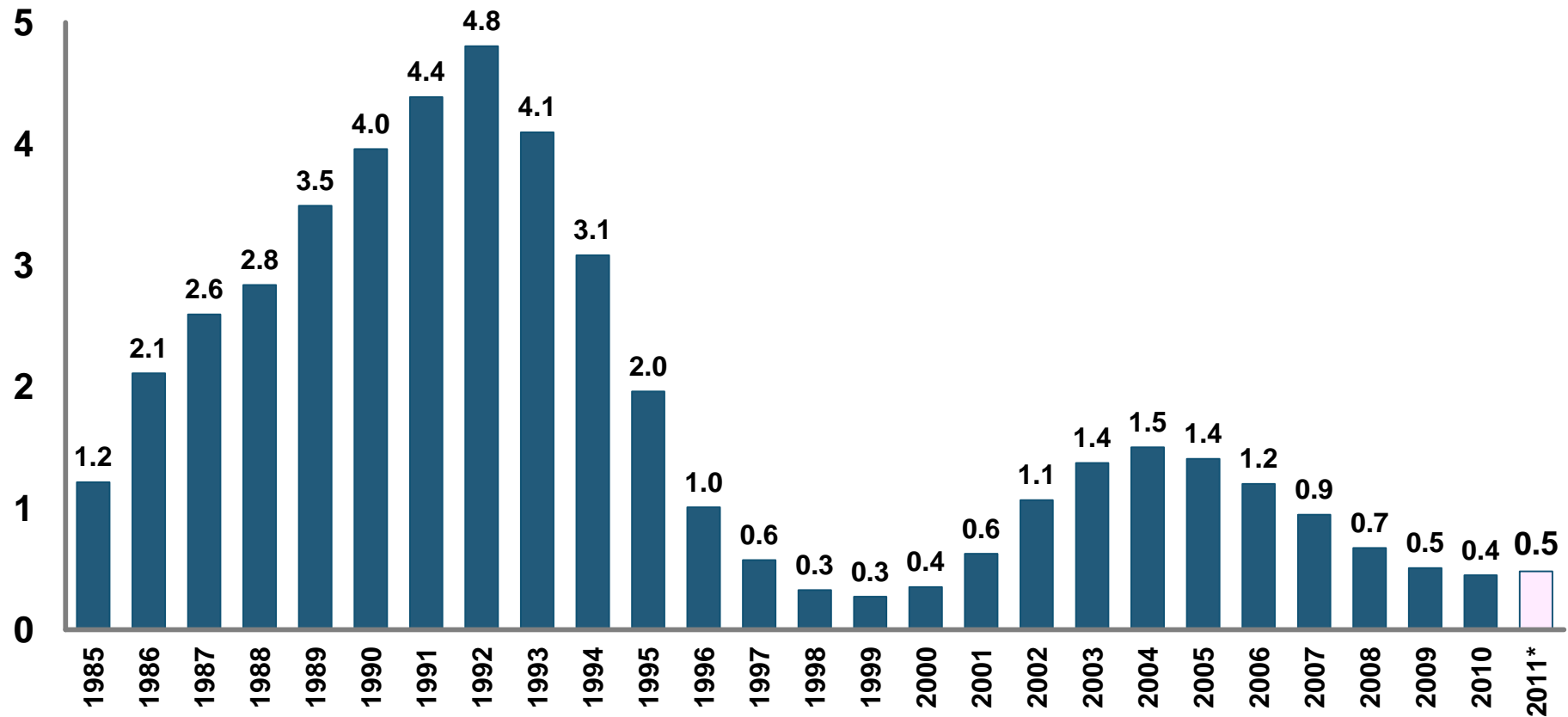
*Incomplete policy year projected to ultimate

•Source: NCCI.

Workers Compensation Residual Market Premium—First Increase Since 2004

**NCCI-Serviced Workers Compensation Residual Market Pools
as of Dec. 31, 2011**

\$ Billions



*Incomplete policy year projected to ultimate

Policy Year

Source: NCCI/

Residual Market Growth by Policy Size, 2010 vs. 2011

Size of Risk	2010	2011	Change
\$ 0 – \$ 2,499	83.0 M	83.1 M	0%
\$ 2,500 – \$ 4,999	40.3 M	42.1 M	4%
\$ 5,000 – \$ 9,999	47.0 M	50.6 M	8%
\$ 10,000 – \$49,999	103.8 M	122.5 M	18%
\$ 50,000 – \$99,999	36.0 M	40.5 M	13%
\$100,000 and over	33.5 M	49.7 M	48%
Total	343.7 M	388.5 M	13%

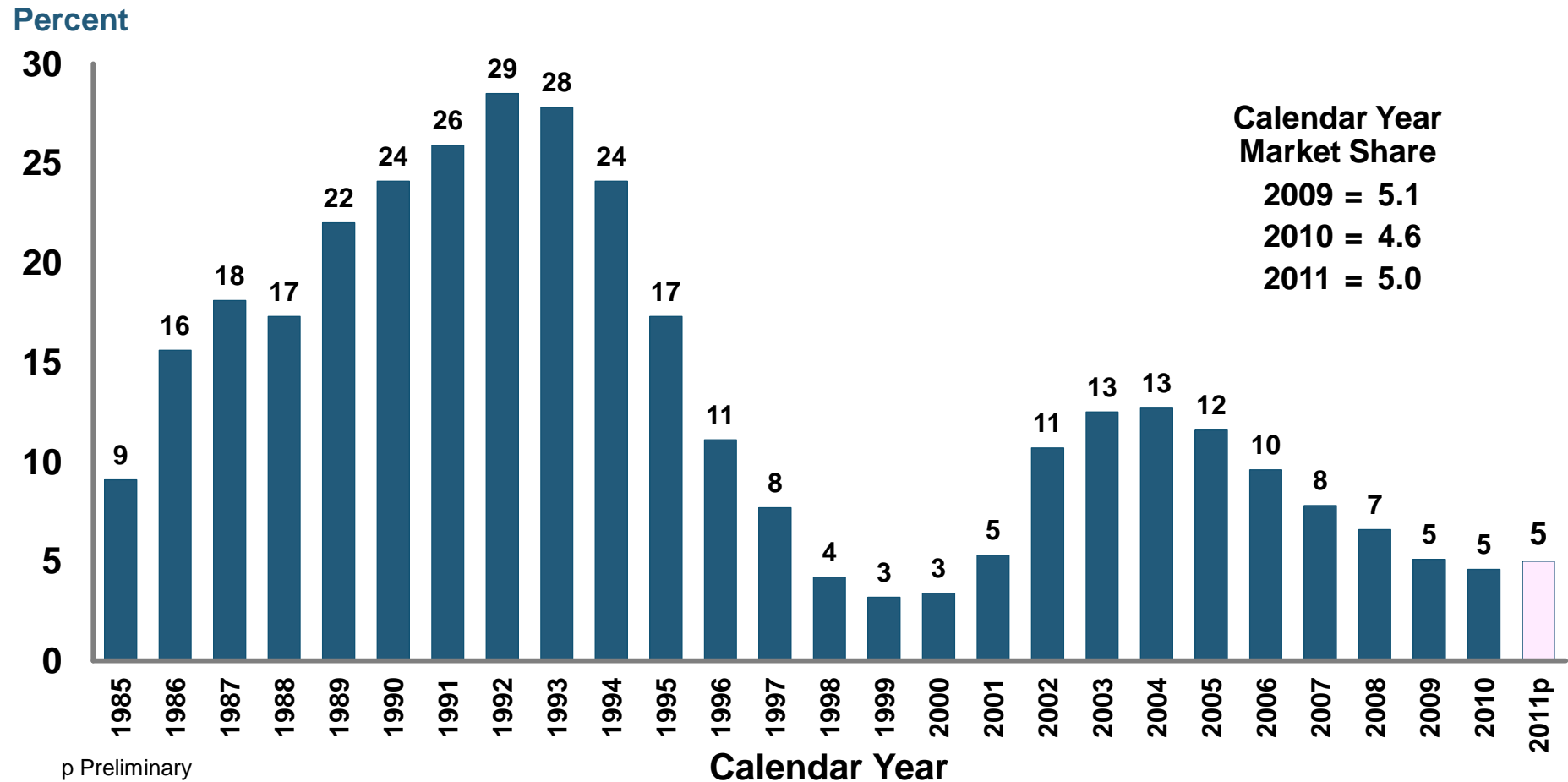
Total estimated annual premium on policies

Includes residual market policies for:

AK, AL, AR, AZ, CT, DC, GA, IA, ID, IL, IN, KS, MS, NH, NM, NV, OR, SC, SD, VA, VT, WV

Workers Compensation Residual Market Share Increases

Workers Compensation Insurance Plan States* Premium as a Percentage of Direct Written Premium



*NCCI Plan states plus DE, IN, MA, MI, NC, NJ

Source: NCCI.

Residual Market Growth Accelerates During First Quarter 2012 (vs. Q1 2012)

Size of Risk	2011	2012	Change
\$ 0 – \$ 2,499	19.8 M	20.9 M	6%
\$ 2,500 – \$ 4,999	9.7 M	11.5 M	19%
\$ 5,000 – \$ 9,999	11.9 M	15.3 M	29%
\$ 10,000 – \$49,999	29.6 M	41.5 M	40%
\$ 50,000 – \$99,999	10.0 M	17.4 M	74%
\$100,000 and over	10.8 M	28.3 M	162%
Total	91.8 M	134.9 M	47%

Total estimated annual premium on policies

Includes residual market policies for:

AK, AL, AR, AZ, CT, DC, GA, IA, ID, IL, IN, KS, MS, NH, NM, NV, OR, SC, SD, VA, VT, WV

Residual Market Growth Accelerates During Second Qtr. 2012 (vs. Q2 2011)

Size of Risk	2011	2012	Change
\$ 0 – \$ 2,499	23.4 M	24.3 M	4%
\$ 2,500 – \$ 4,999	12.1 M	13.0 M	7%
\$ 5,000 – \$ 9,999	13.8 M	16.3 M	18%
\$ 10,000 – \$ 49,999	30.3 M	42.0 M	39%
\$ 50,000 – \$ 99,999	9.9 M	16.5 M	67%
\$ 100,000 and over	11.6 M	20.9 M	80%
Total	101.0 M	132.8 M	31%

Total estimated annual premium on policies

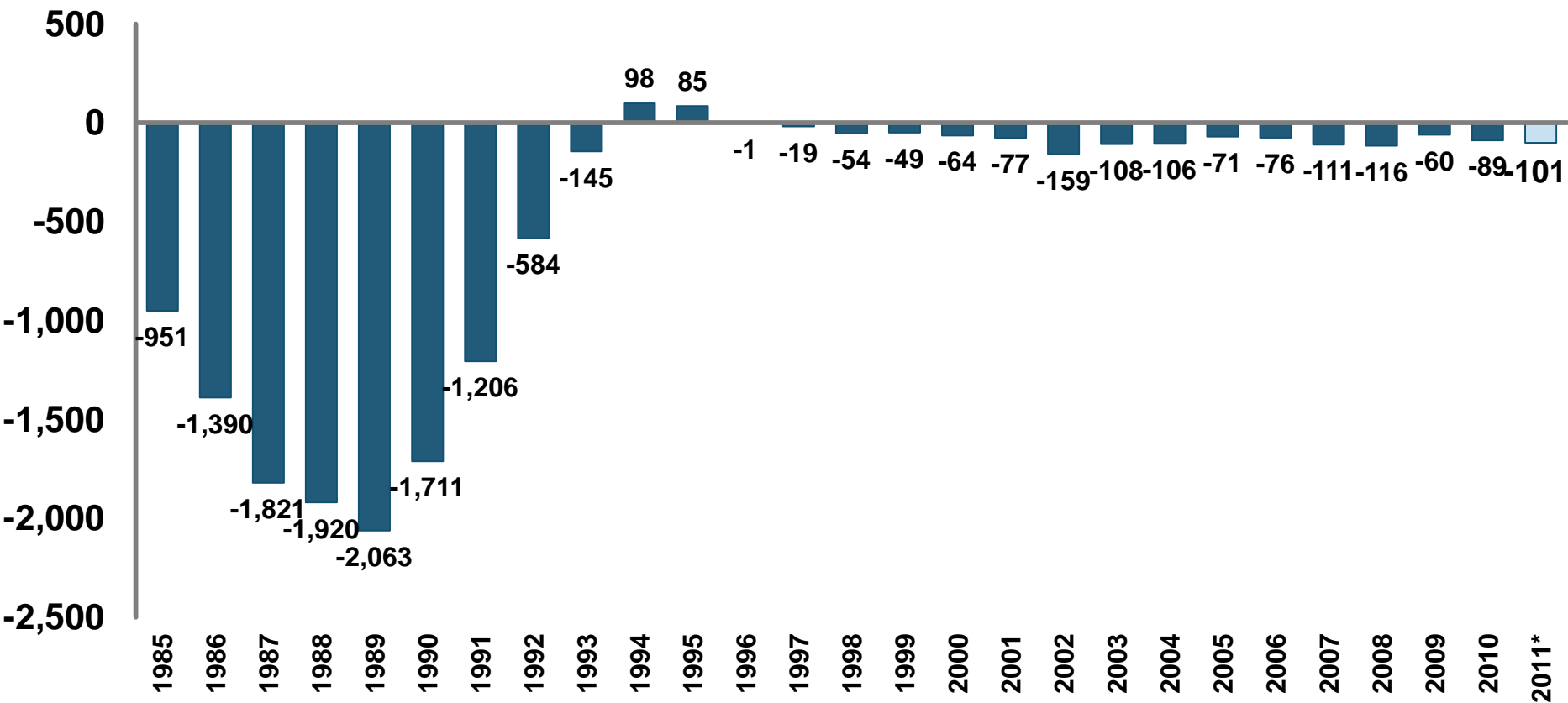
Includes residual market policies for:

AK, AL, AR, AZ, CT, DC, GA, IA, ID, IL, IN, KS, MS, NH, NM, NV, OR, SC, SD, VA, VT, WV

Workers Compensation Residual Market Underwriting Results

NCCI-Serviced Workers Compensation Residual Market Pools as of December 31, 2011

\$ Millions

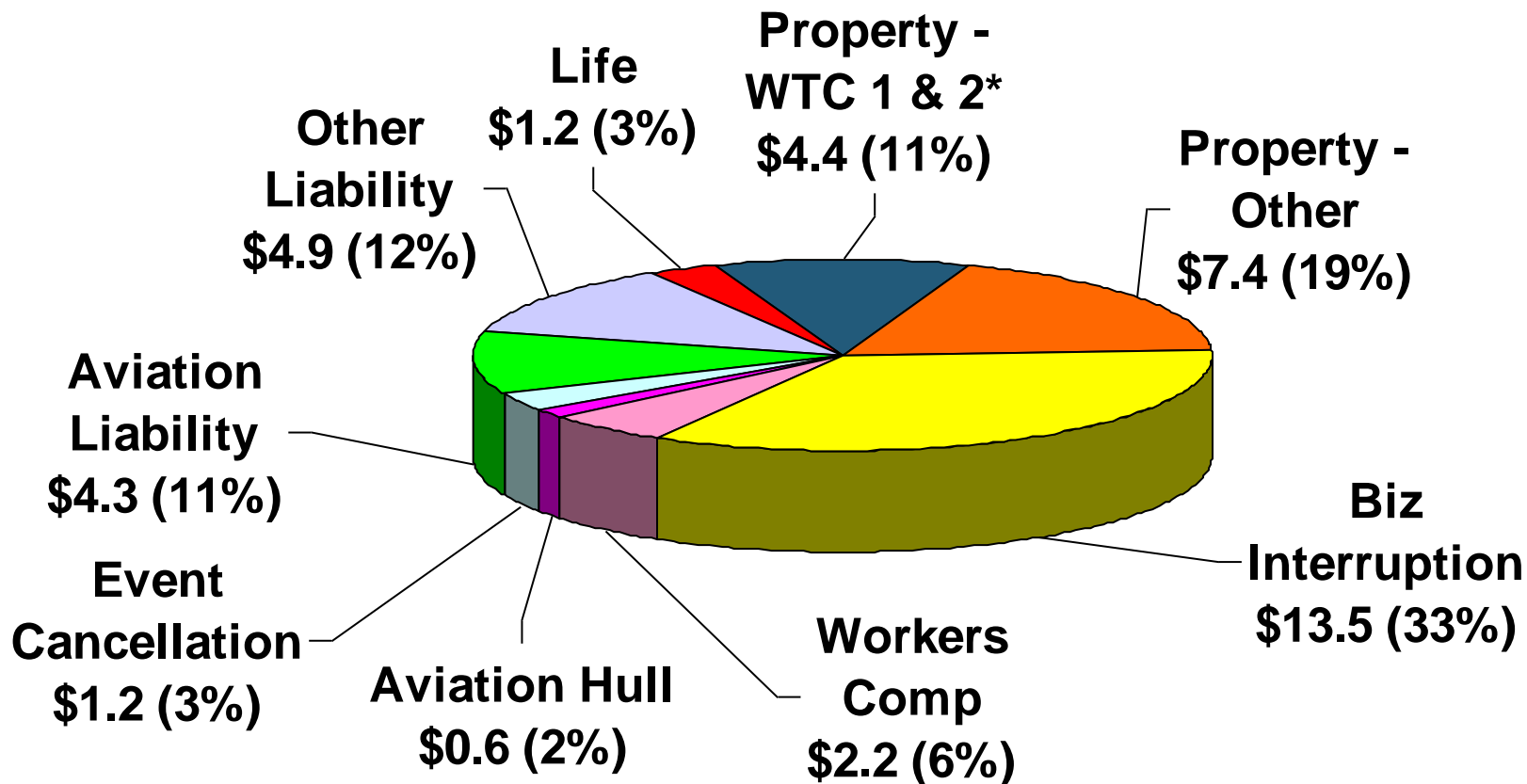


•Incomplete policy year projected to ultimate
Source: NCCI.

Policy Year

Loss Distribution by Type of Insurance from Sept. 11 Terrorist Attack (\$ 2011)

(\$ Billions)



Total Insured Losses Estimate: \$40.0B**

*Loss total does not include March 2010 New York City settlement of up to \$657.5 million to compensate approximately 10,000 Ground Zero workers or any subsequent settlements.

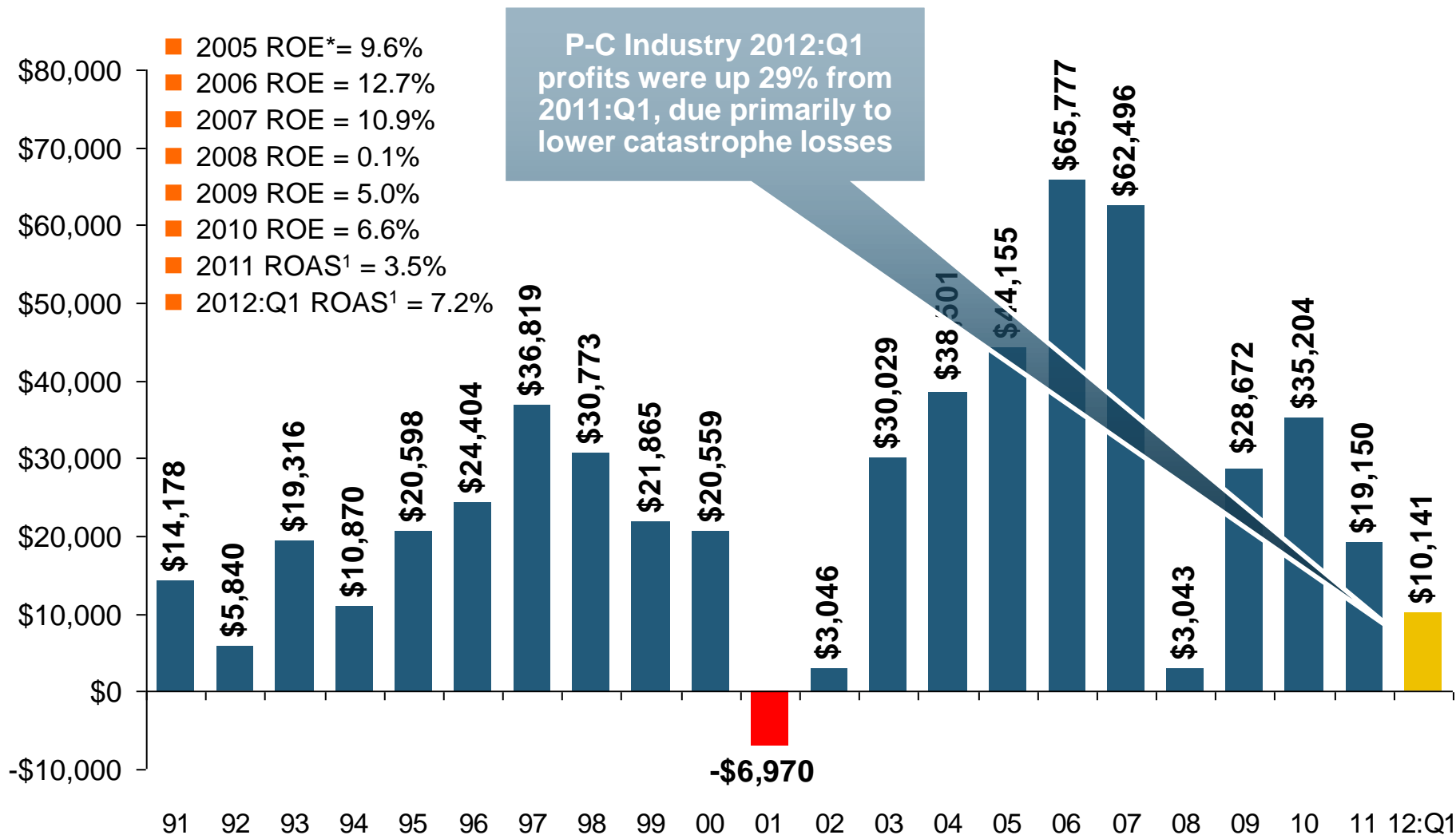
**\$32.5 billion in 2001 dollars.

Source: Insurance Information Institute.

P/C Insurance Industry Financial Overview

**Profit Recovery Was Set Back
in 2011 by High Catastrophe
Loss & Other Factors**

P/C Net Income After Taxes 1991–2012:Q1 (\$ Millions)



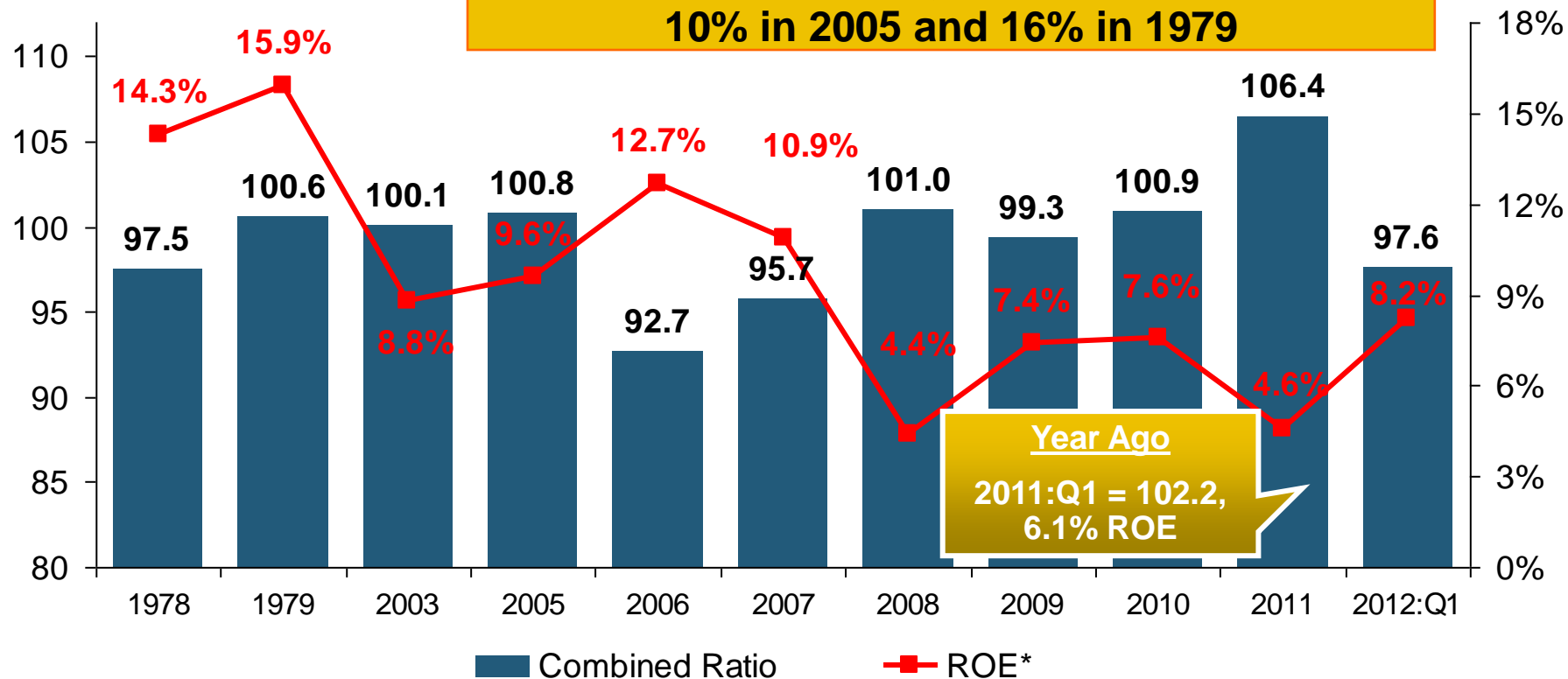
* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 8.2% ROAS for 2012:Q1, 4.6% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

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

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

Combined Ratio / ROE

A combined ratio of about 100 generates an ROE of ~6.7% in 2012, ~7.5% ROE in 2009/10, 10% in 2005 and 16% in 1979

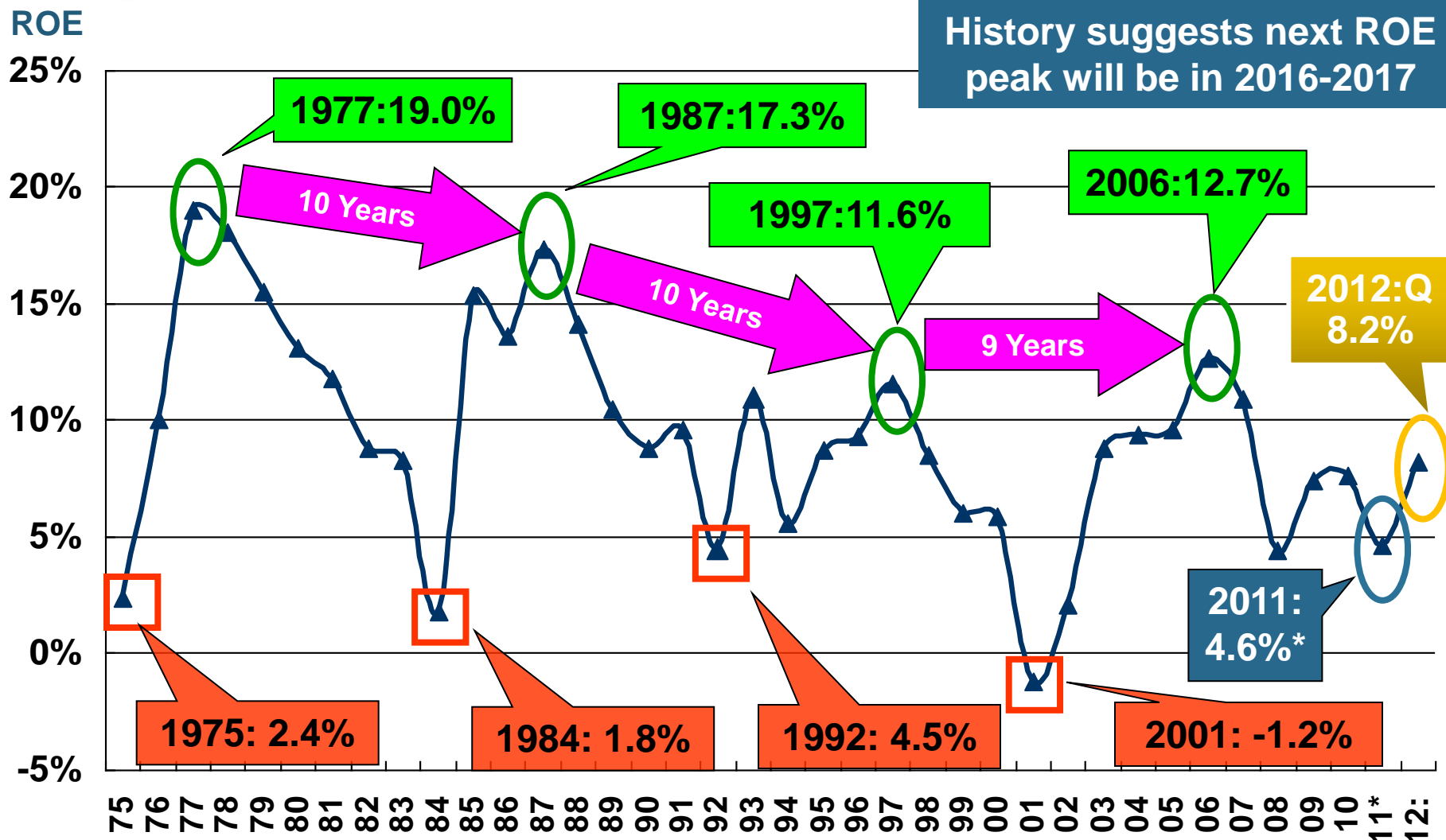


Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs

* 2008 -2012 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2012:Q1 combined ratio including M&FG insurers is 99.0, ROAS = 7.2%; 2011 combined ratio including M&FG insurers is 108.2, ROAS = 3.5%.

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

Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2012:Q1*

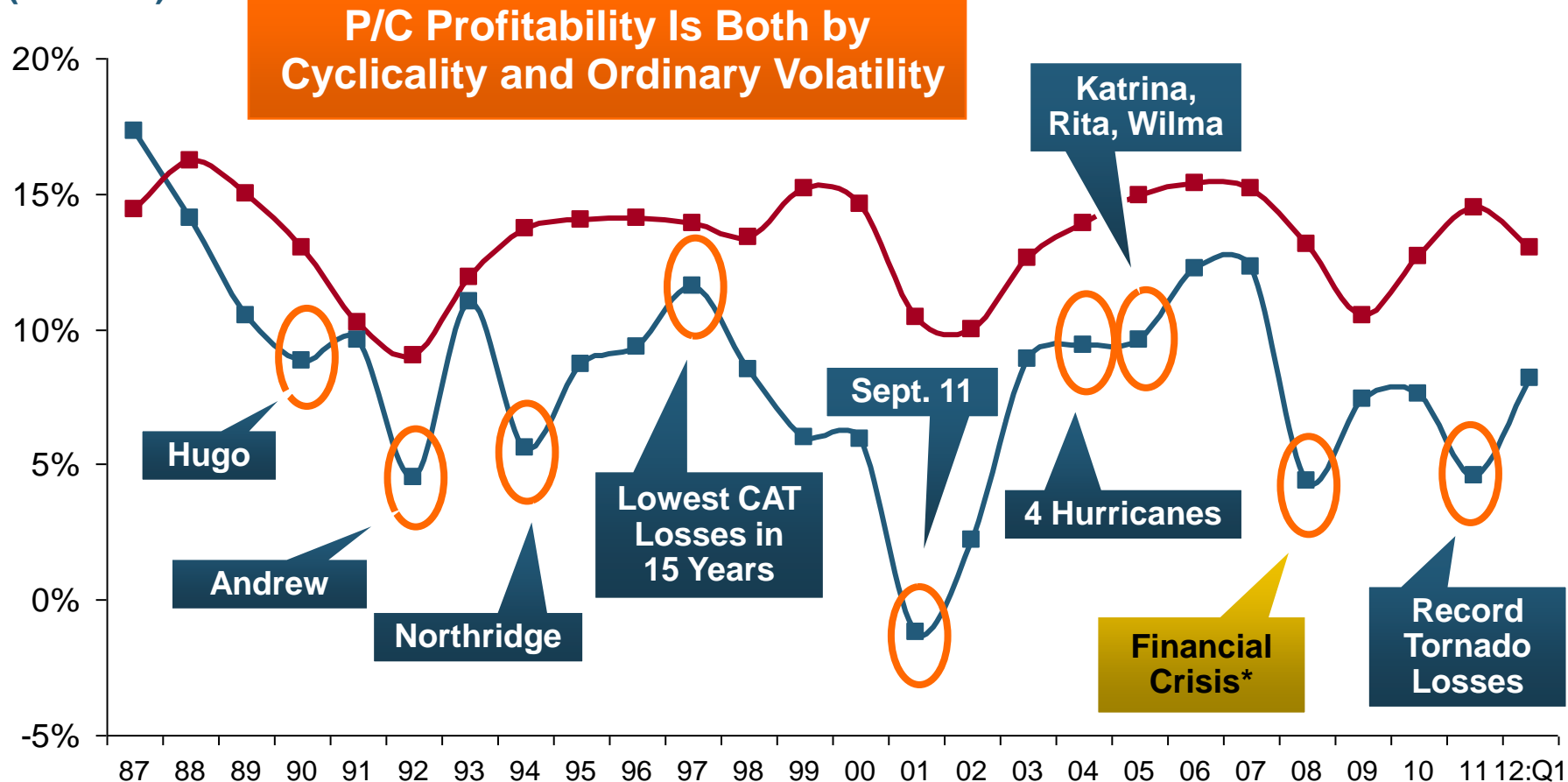


*Profitability = P/C insurer ROEs. 2011 figure is an estimate based on ROAS data. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. 2012:Q1 ROAS = 7.2% including M&FG.

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

ROE: Property/Casualty Insurance vs. Fortune 500, 1987–2012:Q1*

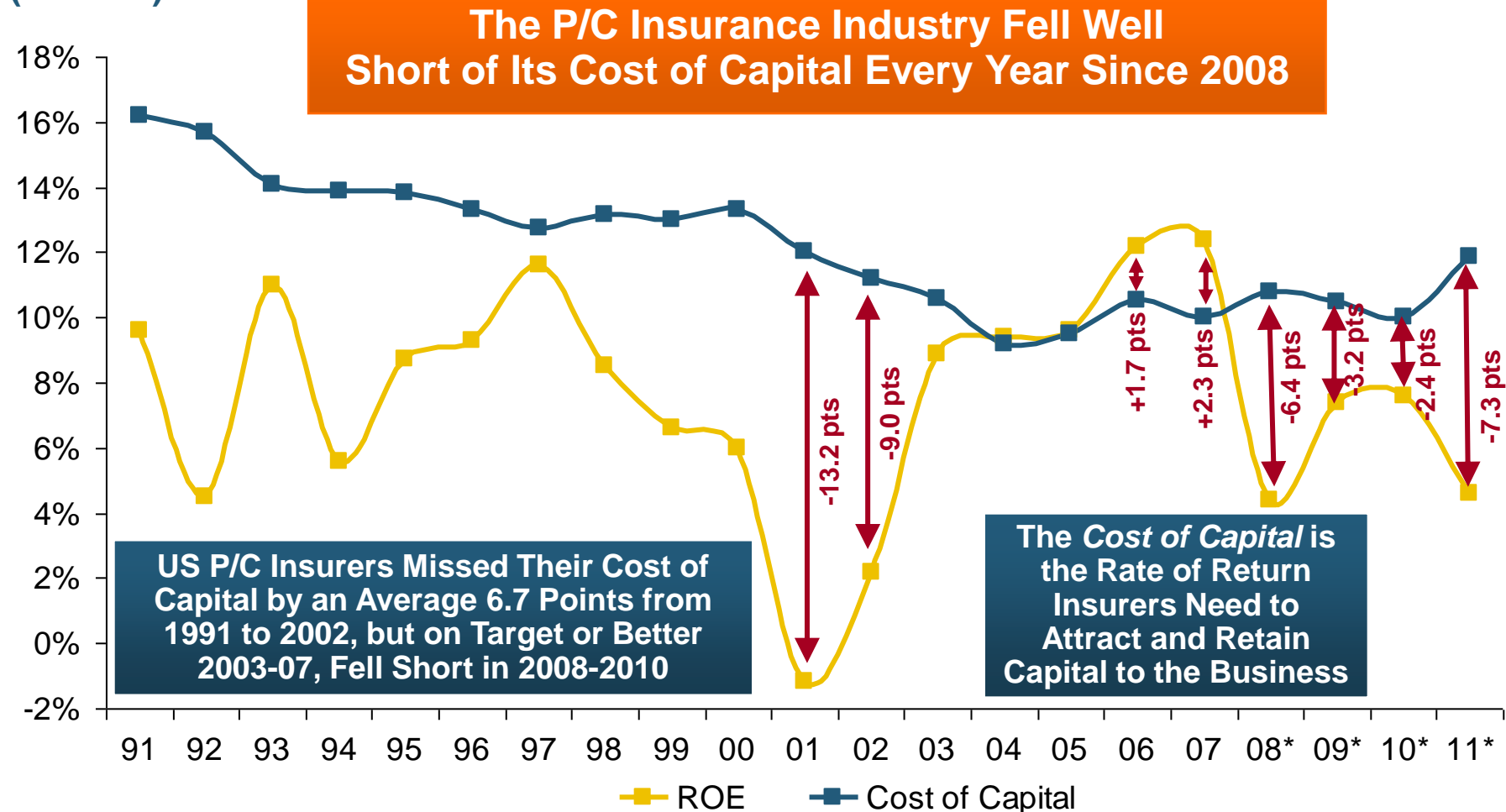
(Percent)



* Excludes Mortgage & Financial Guarantee in 2008 – 2012. 2012 Fortune 500 figure is III estimate.
Sources: ISO, *Fortune*; Insurance Information Institute.

ROE vs. Equity Cost of Capital: U.S. P/C Insurance:1991-2011*

(Percent)

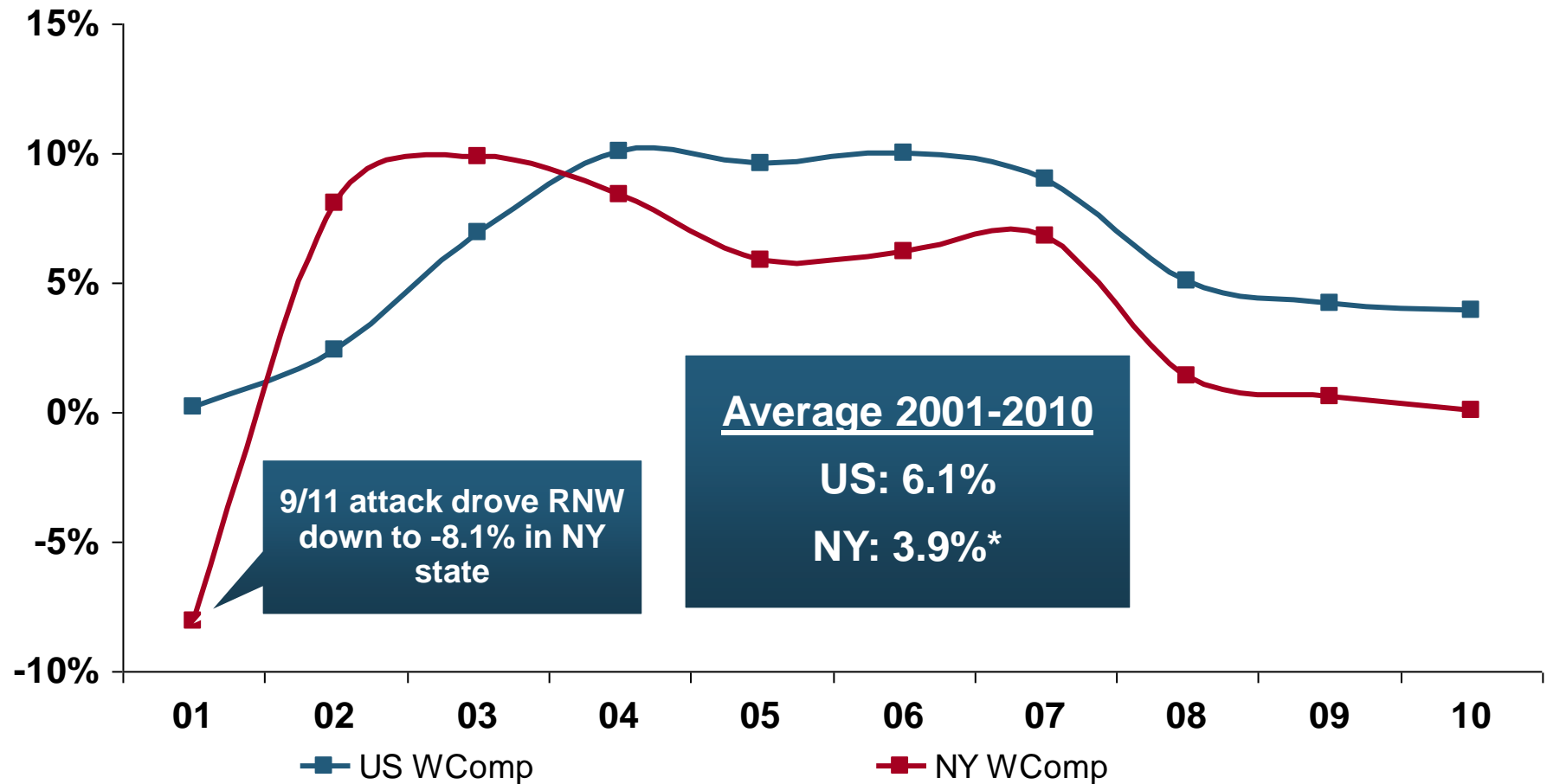


* Return on average surplus in 2008-2011 excluding mortgage and financial guaranty insurers.

Source: The Geneva Association, Insurance Information Institute

RNW Workers Comp: NY vs. U.S., 2001-2010

(Percent)



*Excluding 2001 (9/11 effect), RNW for the period 2002-2010 is 5.3%.
Sources: NAIC.

The BIG Question: When Will the Market Turn?

**Catastrophes and Other Factors Are
Pressuring Insurance Markets**

***New Factor: Record Low Interest
Rates Are Contributing to
Underwriting and Pricing Pressures***

Historical Criteria for a “Market Turn”: Low Interest Rates Add New Pressure

Criteria	Status	Comments
Sustained Period of Large Underwriting Losses	<i>Large in 2011, Breakeven in 2012; Will Likely Grow</i>	<ul style="list-style-type: none"> • Apart from 2011 CAT losses, overall p/c underwriting losses remain modest • Combined ratios (ex-CATs) still in low 100s (vs. 110+ at onset of last hard market); CR= 97.6 in Q1:2012 (ex-M&FG) • Prior-year reserve releases continue to reduce u/w losses, boost ROEs, though more modestly
Material Decline in Surplus/ Capacity	<i>Only Small Decline Due to 2011 Cats; Record Highs in 2012</i>	<ul style="list-style-type: none"> • Surplus hit a record \$570.7B as of 3/31/12 • Fell just 1.6% in 2011 due to CATs • Will likely see new records later in 2012 • Little excess capacity remains in reinsurance markets • Modest growth in demand for insurance is insufficient to absorb much excess capacity
Tight Reinsurance Market	<i>Somewhat in Place</i>	<ul style="list-style-type: none"> • Much of the global “excess capacity” was eroded by cats • Higher prices in Asia/Pacific • Modestly higher pricing for US risks
Renewed Underwriting & Pricing Discipline	<i>Firming Broad, Sustained, esp. in Property, WC</i>	<ul style="list-style-type: none"> • Commercial lines pricing trends have turned from negative to flat and now positive, esp. Property & WC; • Competition remains intense as many seek to maintain market share

INVESTMENTS: THE NEW REALITY

**Investment Performance is a Key
Driver of Profitability**

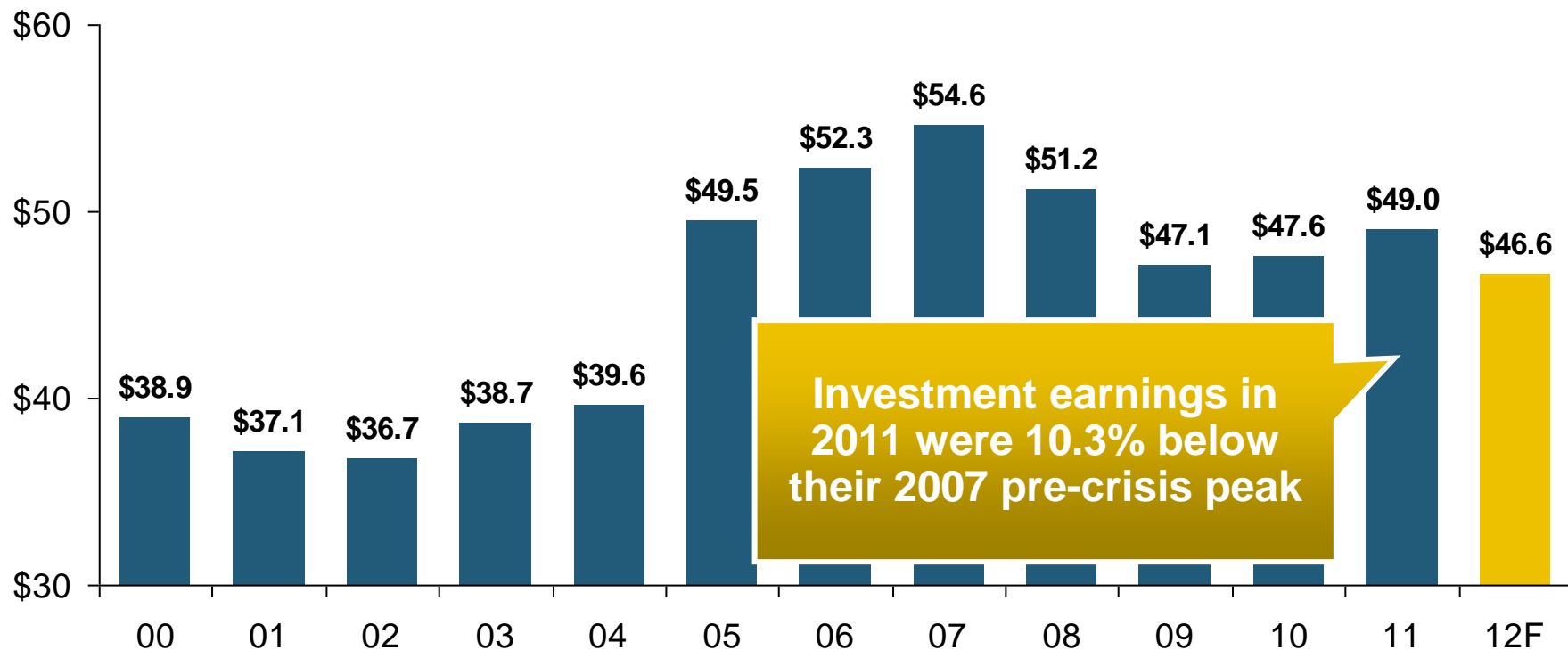
***Depressed Yields Will Necessarily
Influence Underwriting & Pricing***

Insurers Have Not Yet Fully Adapted to a Persistently Low Interest Rate Environment

- **No Expectation that Rates Would Be:**
 - ◆ **Pushed to Such Low Levels**
 - ◆ **Pushed Down so Rapidly**
 - ◆ **Held to Such Low Levels for So Long**
 - ◆ **Suppressed via Unprecedented Aggressiveness of the Federal Reserve**
 - **Use of traditional and unconventional tools (QE)**
 - **Unconventional 's policies couldn't be anticipated, esp. QE1, 2 (3?)**
- **Competitive Pressure → Protracted Soft Market**
- **Ability to Release Prior Reserves Eases Urgency**
- **Realization of Capital Gains**

Property/Casualty Insurance Industry Investment Income: 2000–2012F¹

(\$ Billions)



Investment Income in 2011 Was Surprisingly Strong, Though Investment Income Is Likely to Weaken in 2012 Due to Persistently Low Interest Rates

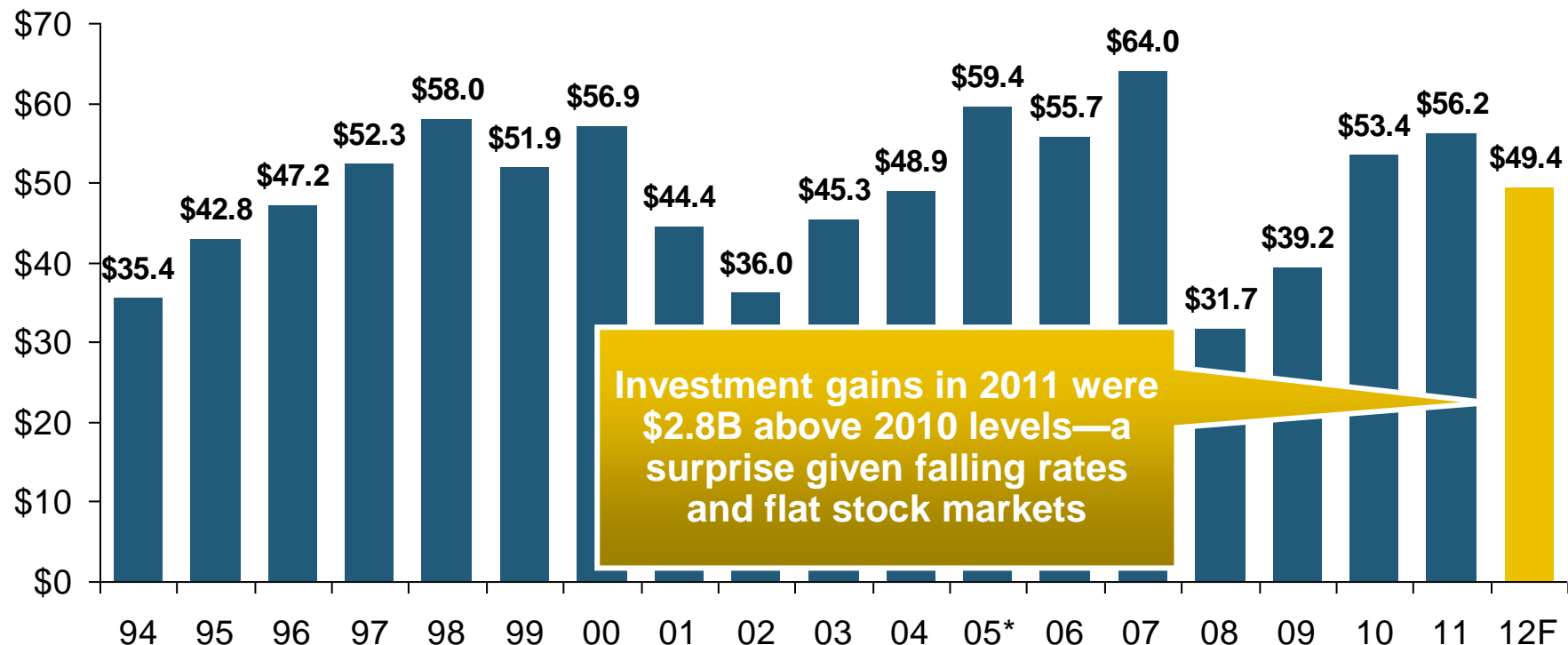
¹ Investment gains consist primarily of interest and stock dividends.

*2012F is based on annualized Q1:2012 actual figure of \$11.656B.

Sources: ISO; Conning Research & Consulting; Insurance Information Institute.

Property/Casualty Insurance Industry Investment Gain: 1994–2012F¹

(\$ Billions)



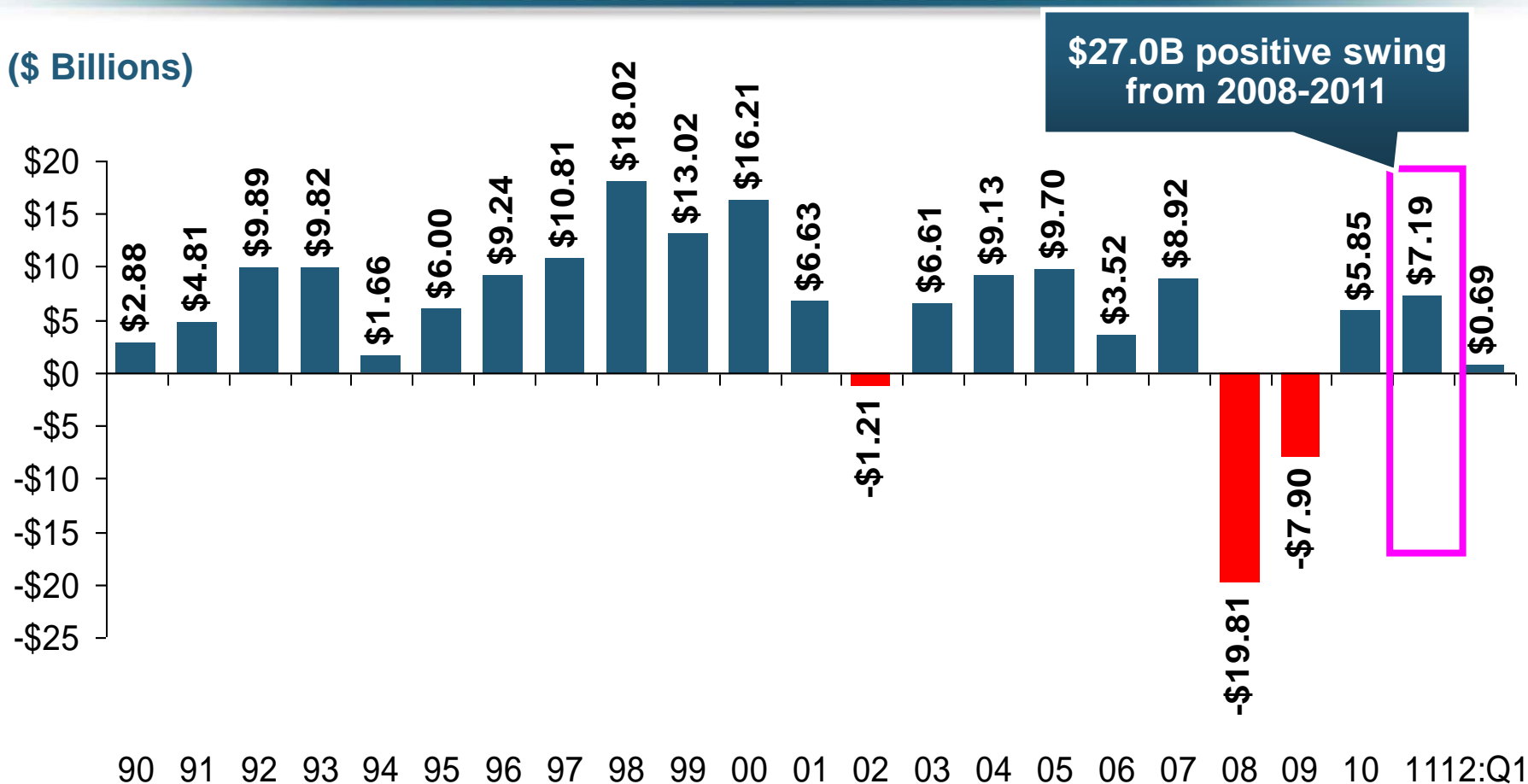
Investment Gains in 2011 Were Surprisingly Robust. Investment Gains Recovered Significantly in 2011 Due to Realized Investment Gains; The Financial Crisis Caused Investment Gains to Fall by 50% in 2008

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

* 2005 figure includes special one-time dividend of \$3.2B; 2012F figure is III estimate based on annualized actual Q1:2012 result of \$12.341B.
Sources: ISO; Insurance Information Institute.

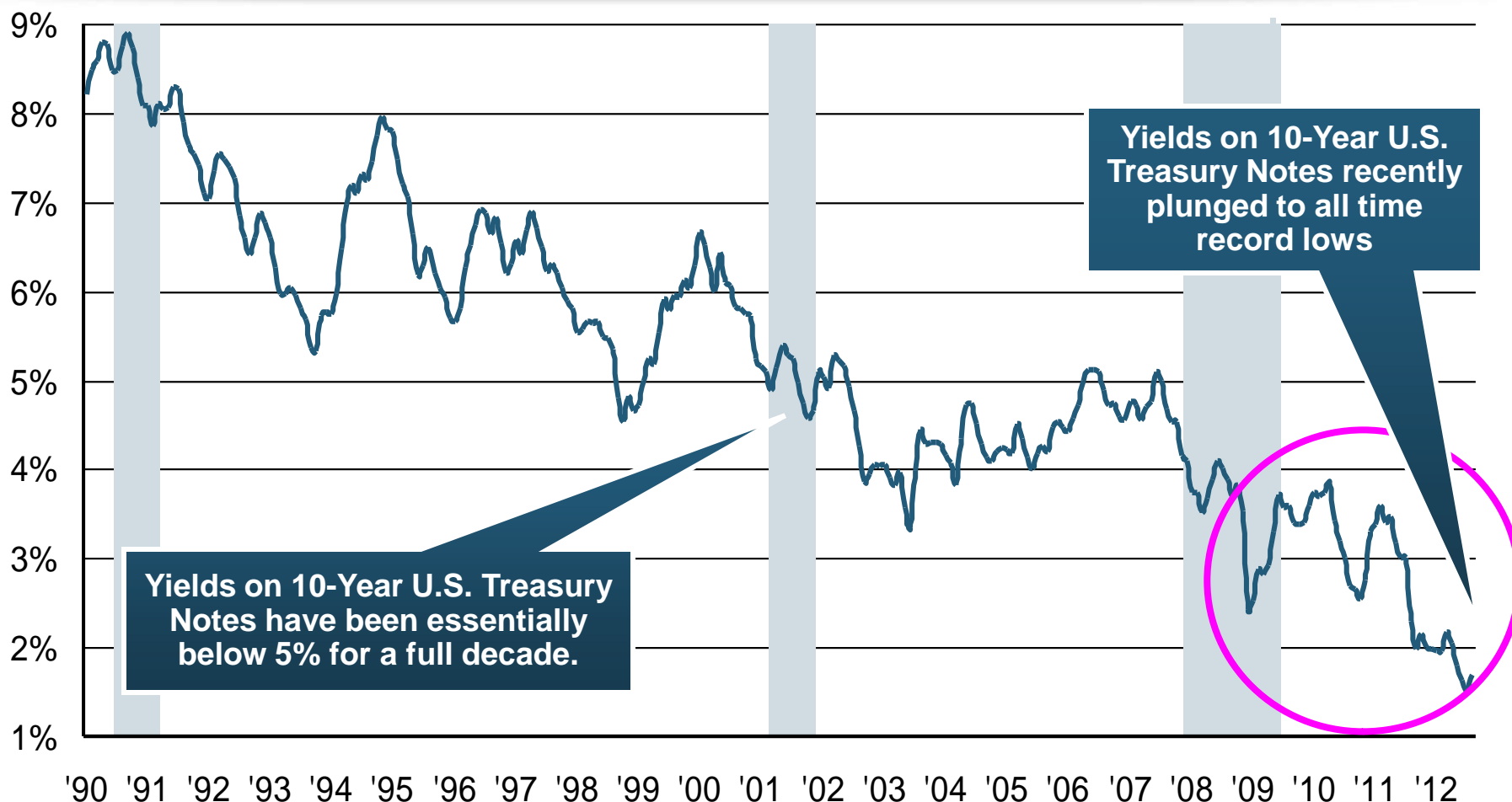
P/C Insurer Net Realized Capital Gains/Losses, 1990-2012:Q1

(\$ Billions)



Insurers Posted Net Realized Capital Gains in 2010 and 2011 After Following Two Years of Realized Losses During the Financial Crisis. Realized Capital Losses Were the Primary Cause of 2008/2009's Large Drop in Profits and ROE

U.S. 10-Year Treasury Note Yields: A Long Downward Trend, 1990–2012*



Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

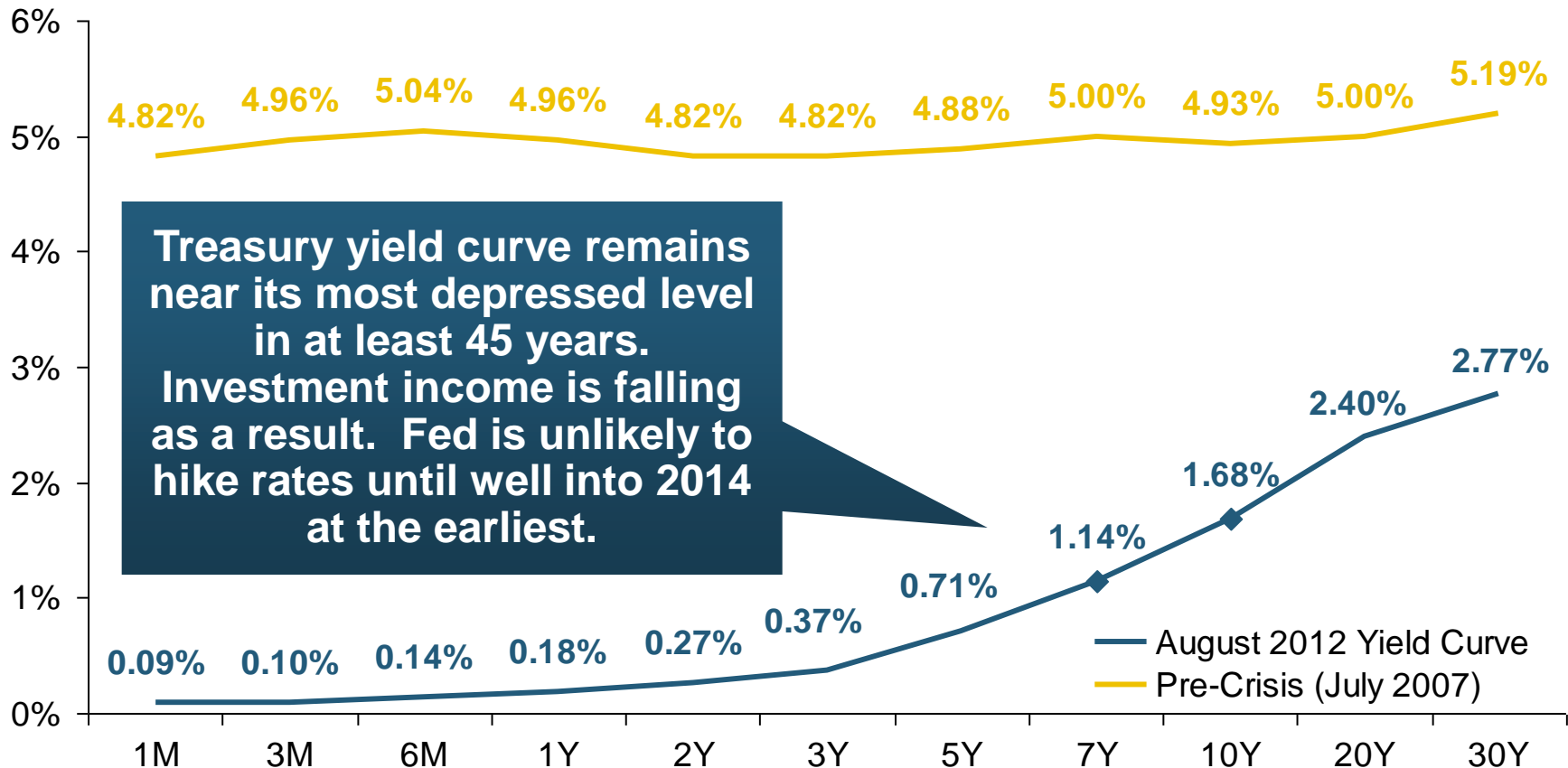
*Monthly, through Aug. 2012.

Note: Recessions indicated by gray shaded columns.

Sources: Federal Reserve Bank at <http://www.federalreserve.gov/releases/h15/data.htm>.

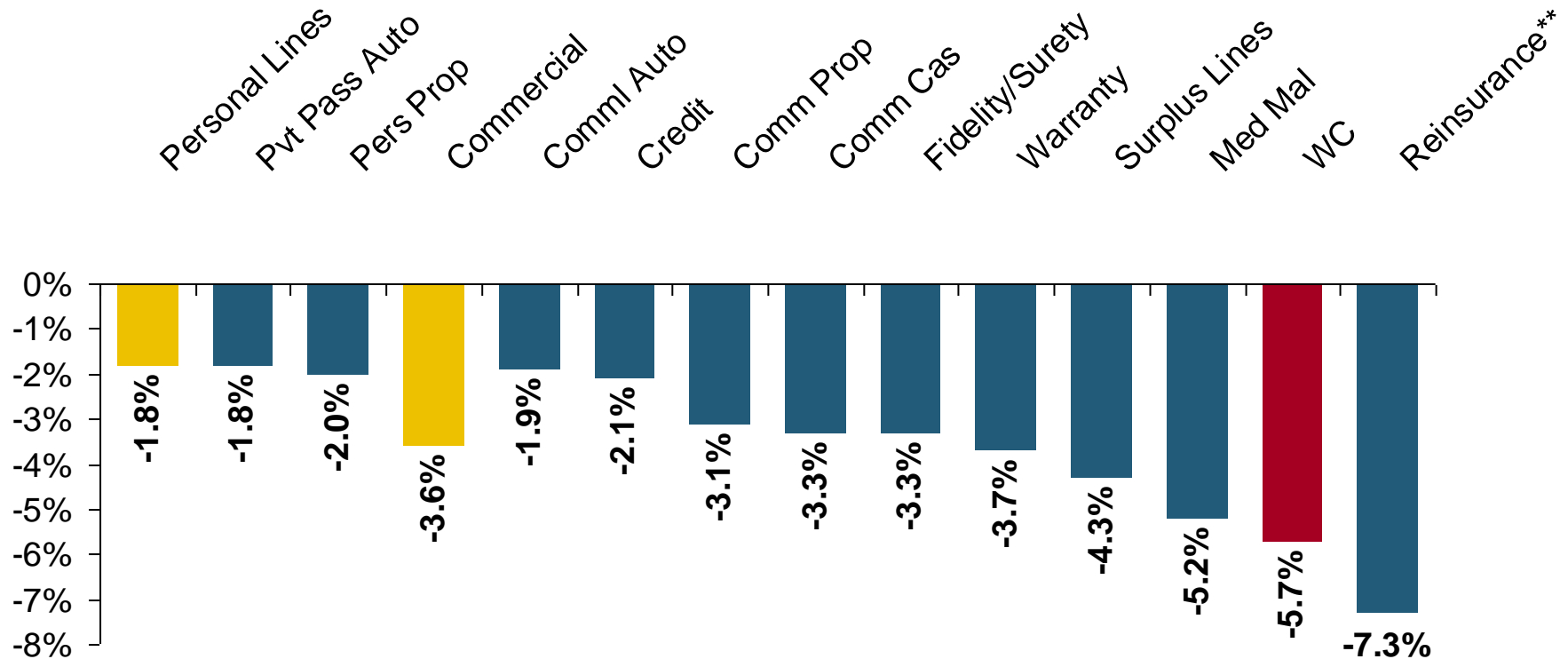
National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Treasury Yield Curves: Pre-Crisis (July 2007) vs. August 2012



The Fed Is Actively Signaling that it Is Determined to Keep Rates Low Through Mid-2015; This Adds to Pricing Pressure for Insurers.

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



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

*Based on 2008 Invested Assets and Earned Premiums

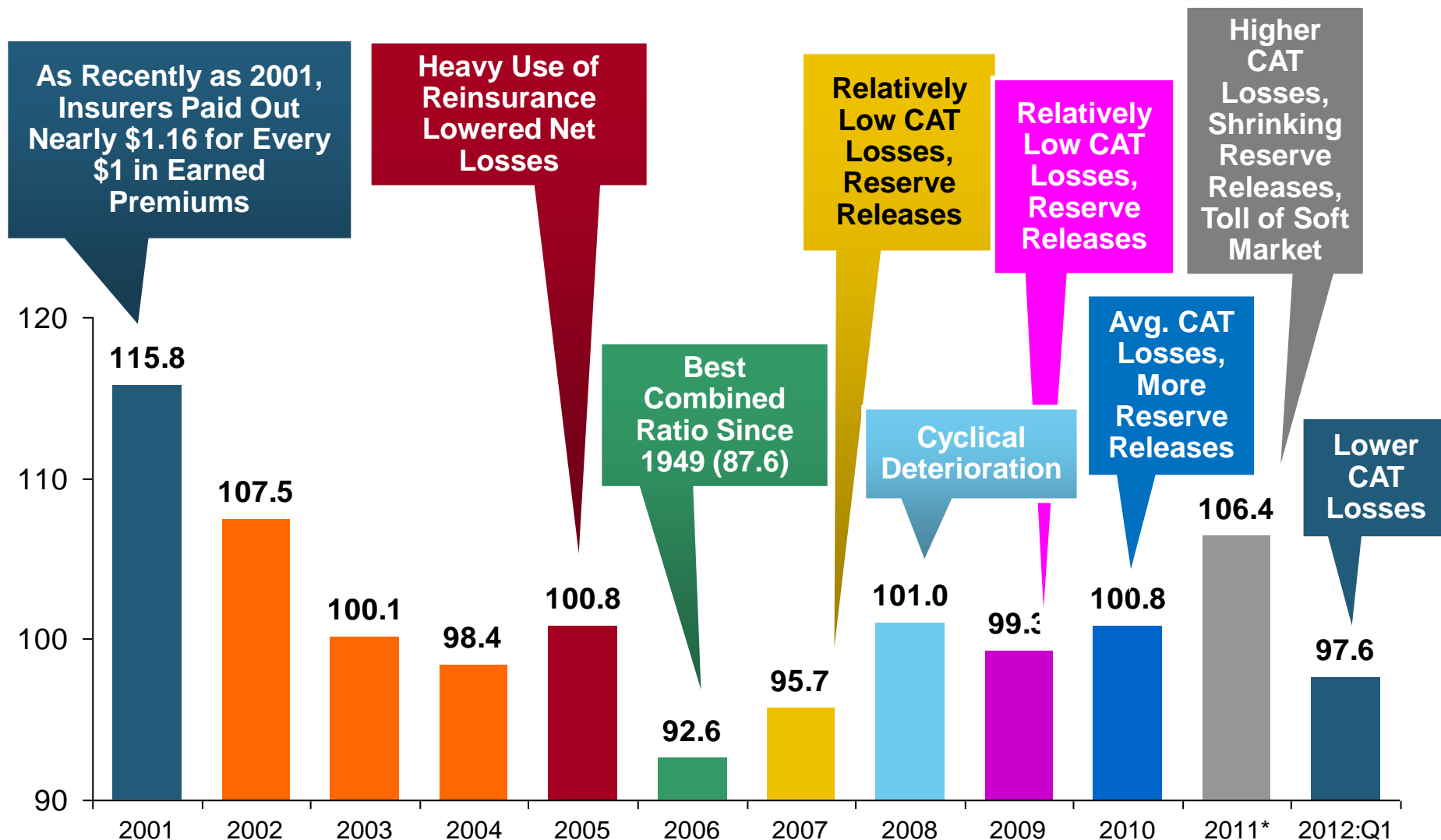
**US domestic reinsurance only

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

UNDERWRITING

**Have Underwriting Losses
Been Large Enough for Long
Enough to Turn the Market?**

P/C Insurance Industry Combined Ratio, 2001–2012:Q1*

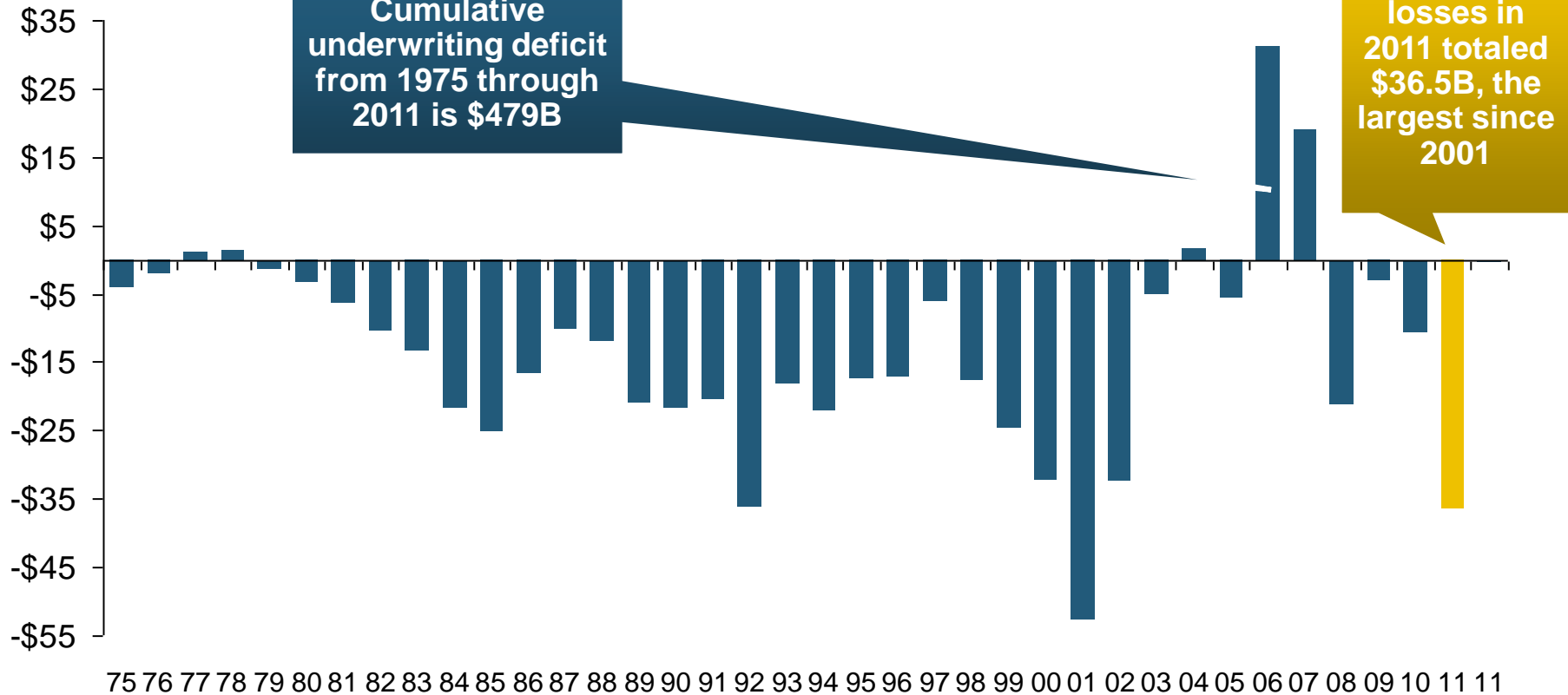


* Excludes Mortgage & Financial Guaranty insurers 2008--2012. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.2; 2012:Q1=99.0.

Sources: A.M. Best, ISO.

Underwriting Gain (Loss) 1975–2012:Q1*

(\$ Billions)



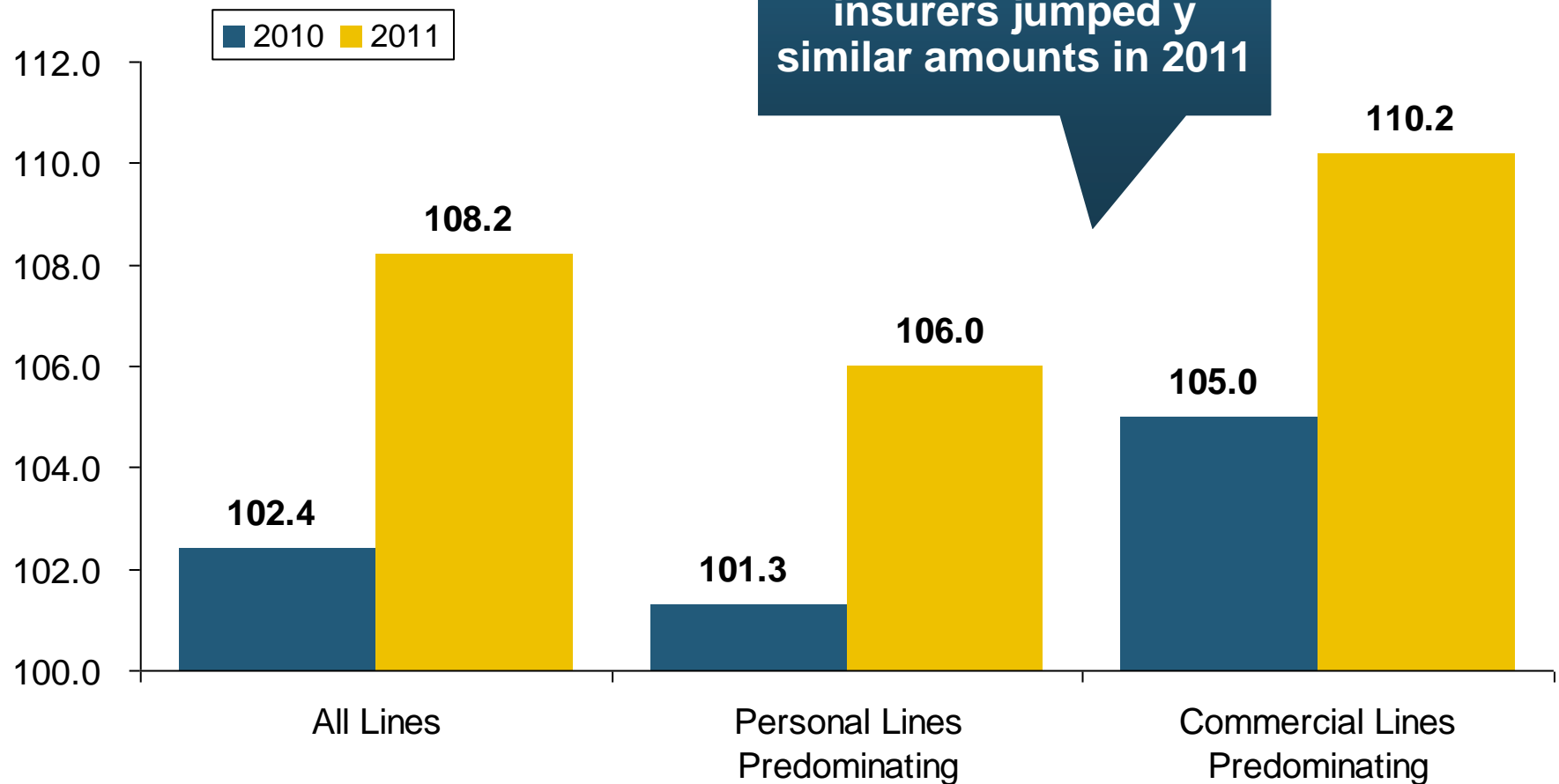
**Large Underwriting Losses Are *NOT* Sustainable
in Current Investment Environment**

* Includes mortgage and financial guaranty insurers in all years.

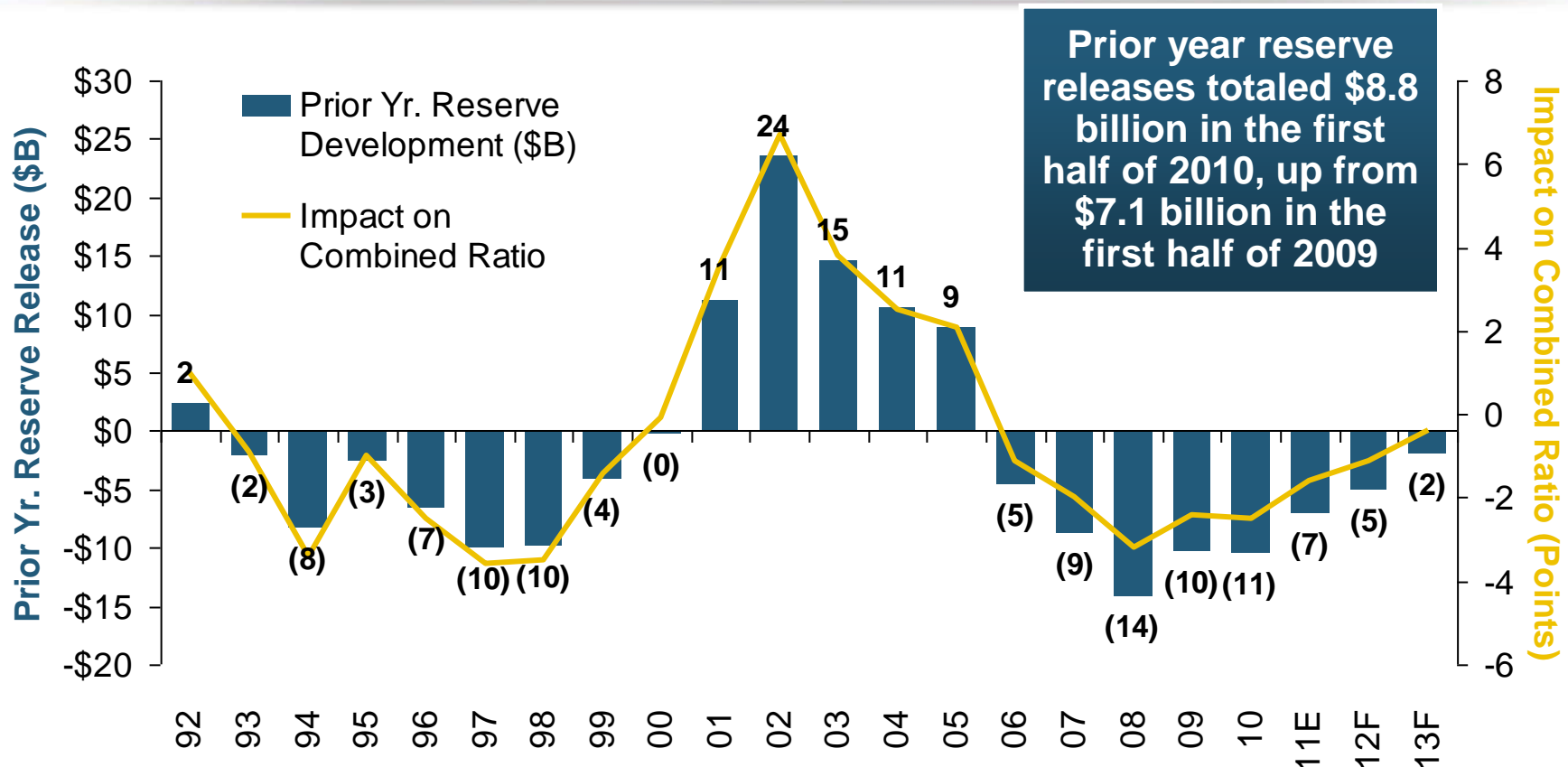
Sources: A.M. Best, ISO; Insurance Information Institute.

Combined Ratios by Predominant Business Segment, 2011 vs. 2010

(Percent)



P/C Reserve Development, 1992–2013F



Reserve Releases Remained Strong in 2010 But Tapered Off in 2011. Releases Are Expected to Further Diminish in 2012 and 2103

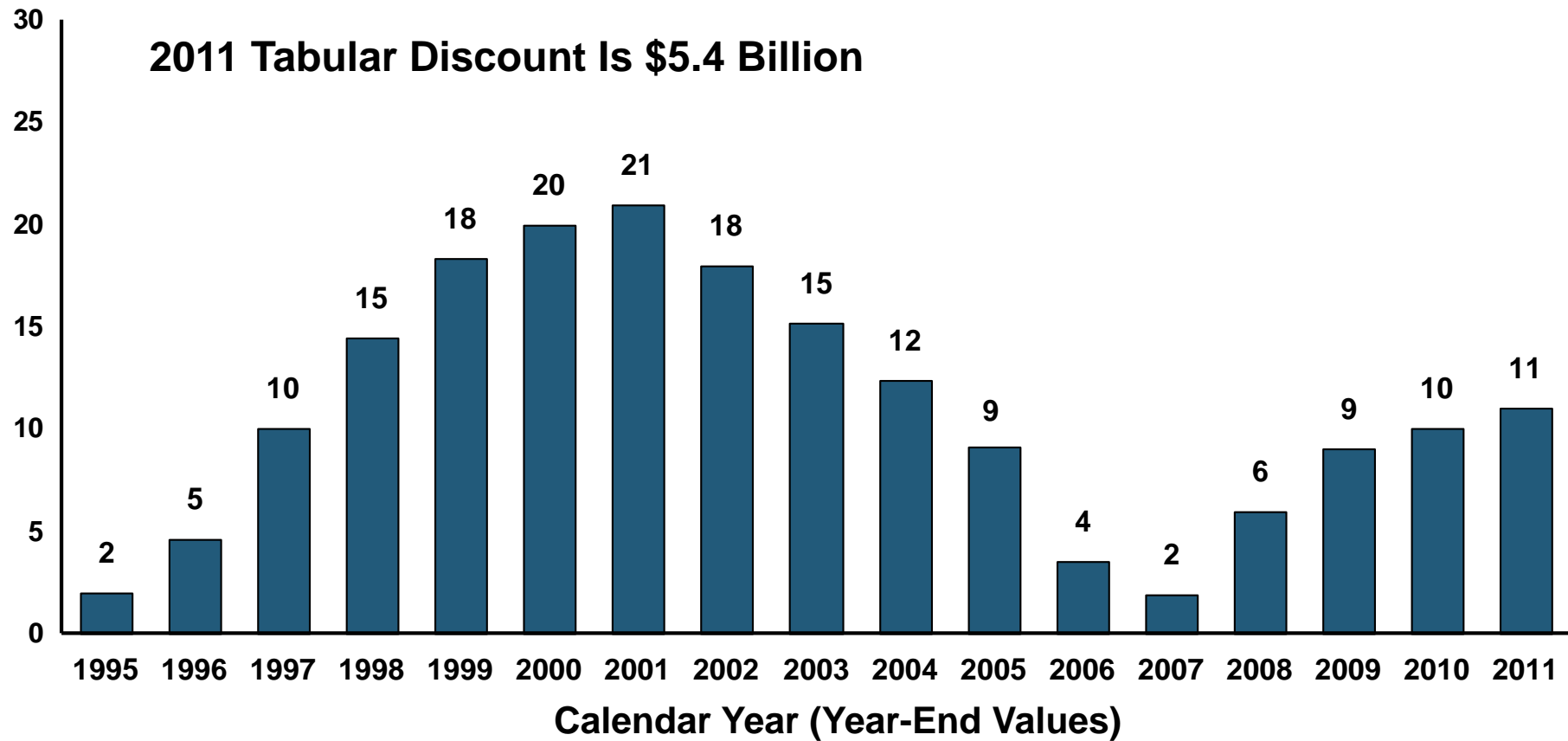
Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.

Sources: Barclays Capital; A.M. Best.

Workers Compensation Loss and LAE Reserve Deficiencies, 1995-2011

WC Loss and LAE Reserve Deficiency: Private Carriers

\$ Billions



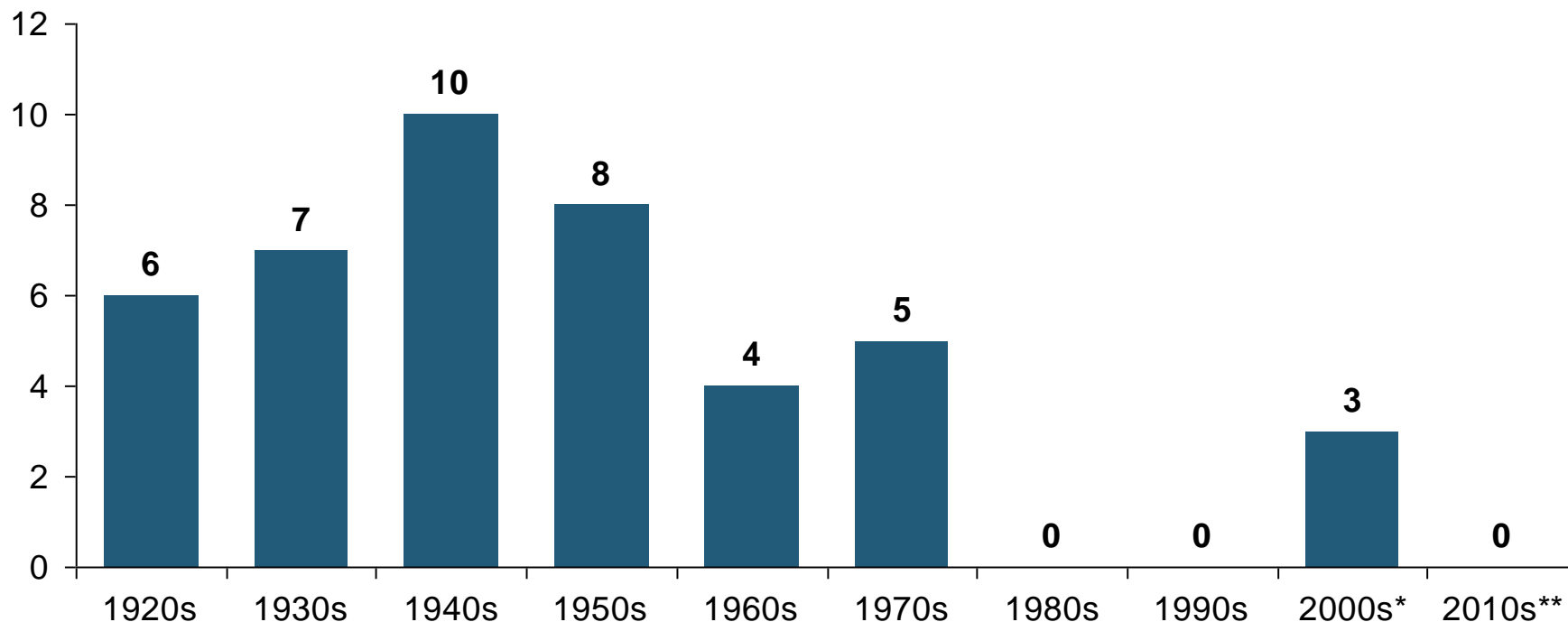
Considers all reserve discounts as deficiencies

Loss and LAE figures are based on NAIC Annual Statement data for each valuation date and NCCI latest selections

Source: NCCI analysis

Number of Years with Underwriting Profits by Decade, 1920s–2010s

Number of Years with Underwriting Profits



Underwriting Profits Were Common Before the 1980s (40 of the 60 Years Before 1980 Had Combined Ratios Below 100) – But Then They Vanished. Not a Single Underwriting Profit Was Recorded in the 25 Years from 1979 Through 2003

* 2009 combined ratio excl. mort. and finl. guaranty insurers was 99.3, which would bring the 2000s total to 4 years with an u/w profit.

**Data for the 2010s includes 2010 and 2011.

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

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

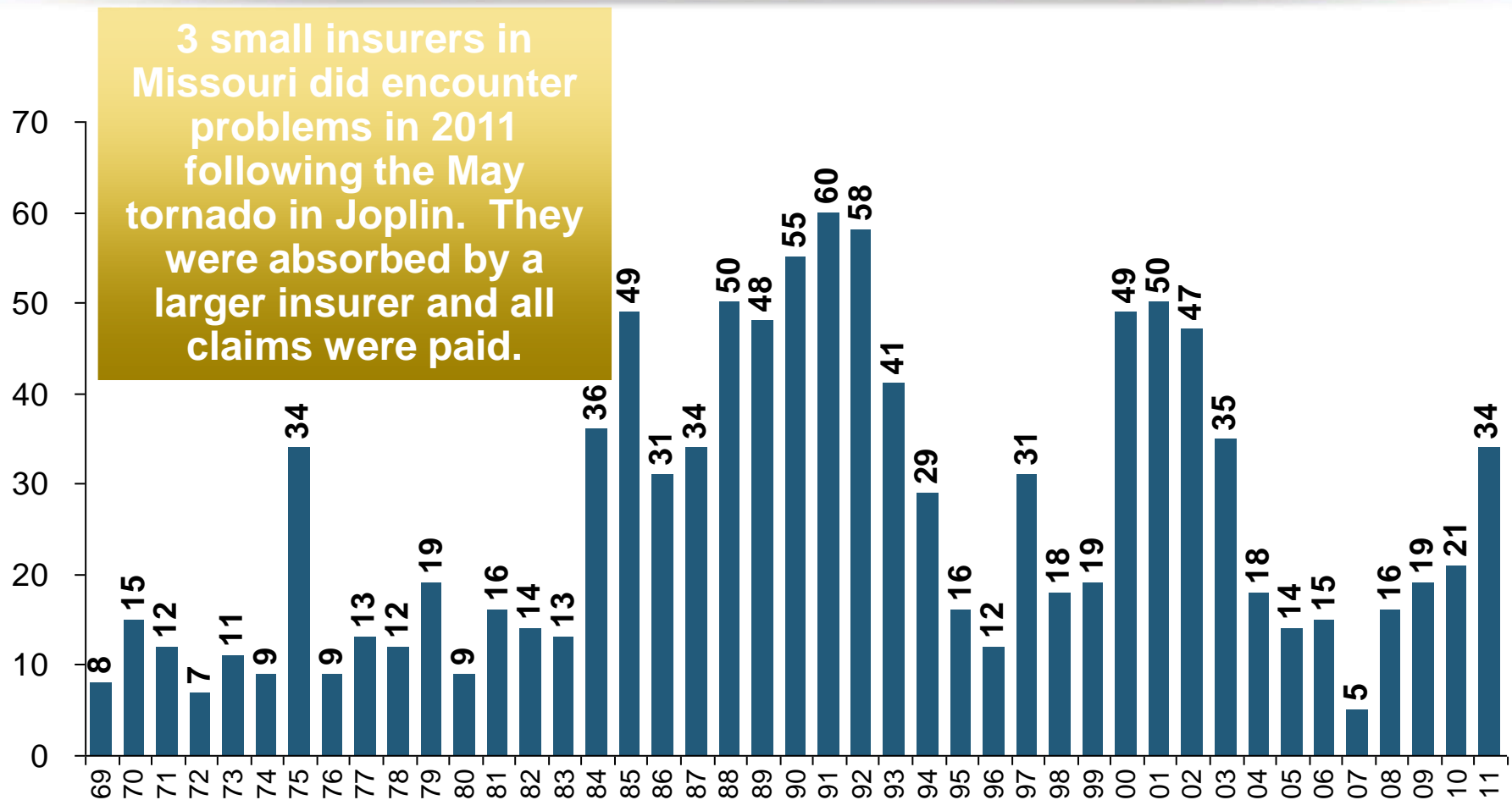
P/C Estimated Loss Reserve Deficiency/ (Redundancy), Excl. Statutory Discount

Line of Business	2011
Personal Auto Liability	-\$1.8B
Homeowners	-\$0.2
Other Liab (incl. Prod Liab)	\$4.0
Workers Compensation	\$8.2
Commercial Multi Peril	\$1.5
Commercial Auto Liability	\$0.0
Medical Malpractice	-\$4.0
Reinsurance—Nonprop Assumed	\$3.4
All Other Lines*	-\$2.2
Total Core Reserves	\$8.9
Asbestos & Environmental	\$7.4
Total P/C Industry	\$16.3B

Financial Strength & Underwriting

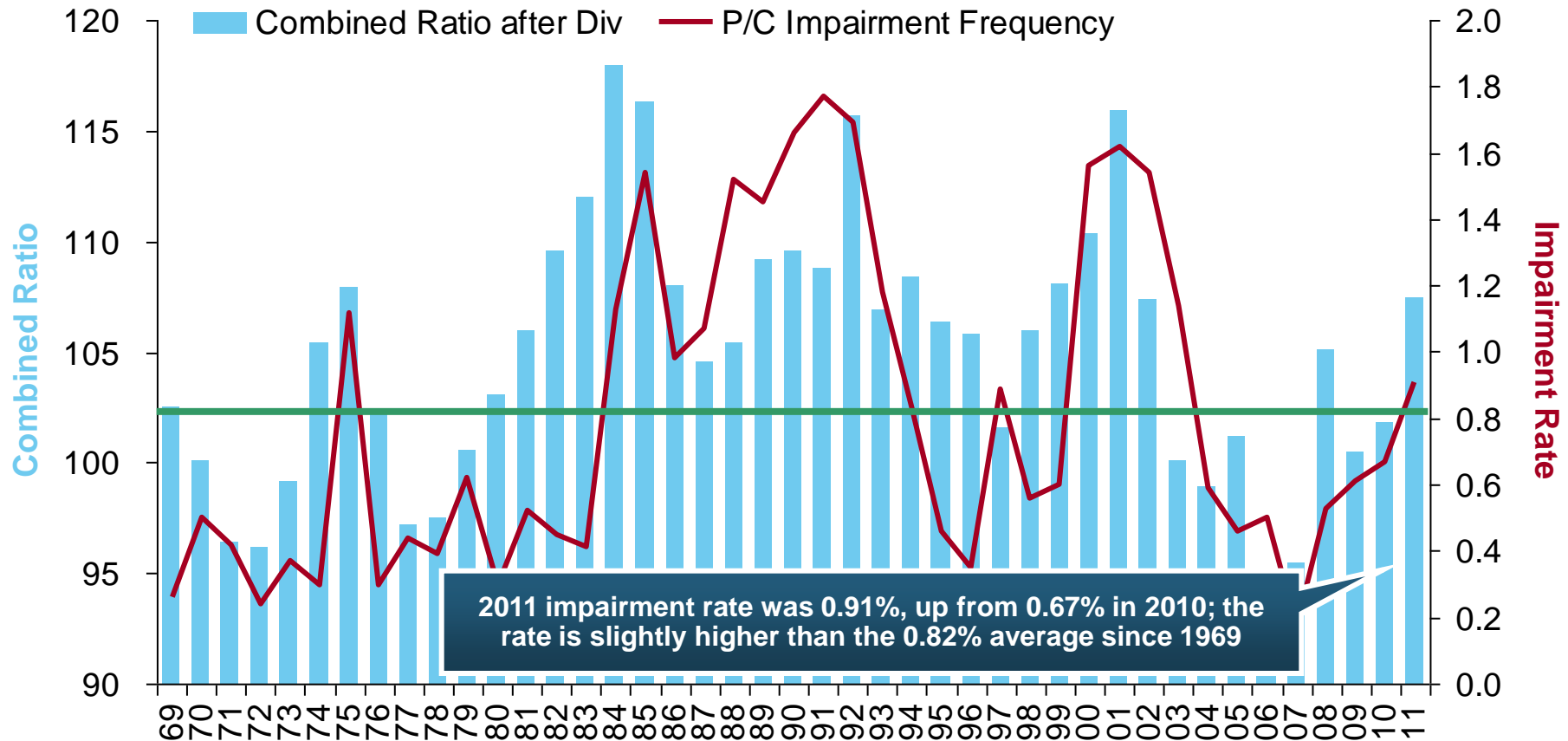
**Cyclical Pattern is P-C Impairment
History is Directly Tied to
Underwriting, Reserving & Pricing**

P/C Insurer Impairments, 1969–2011



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

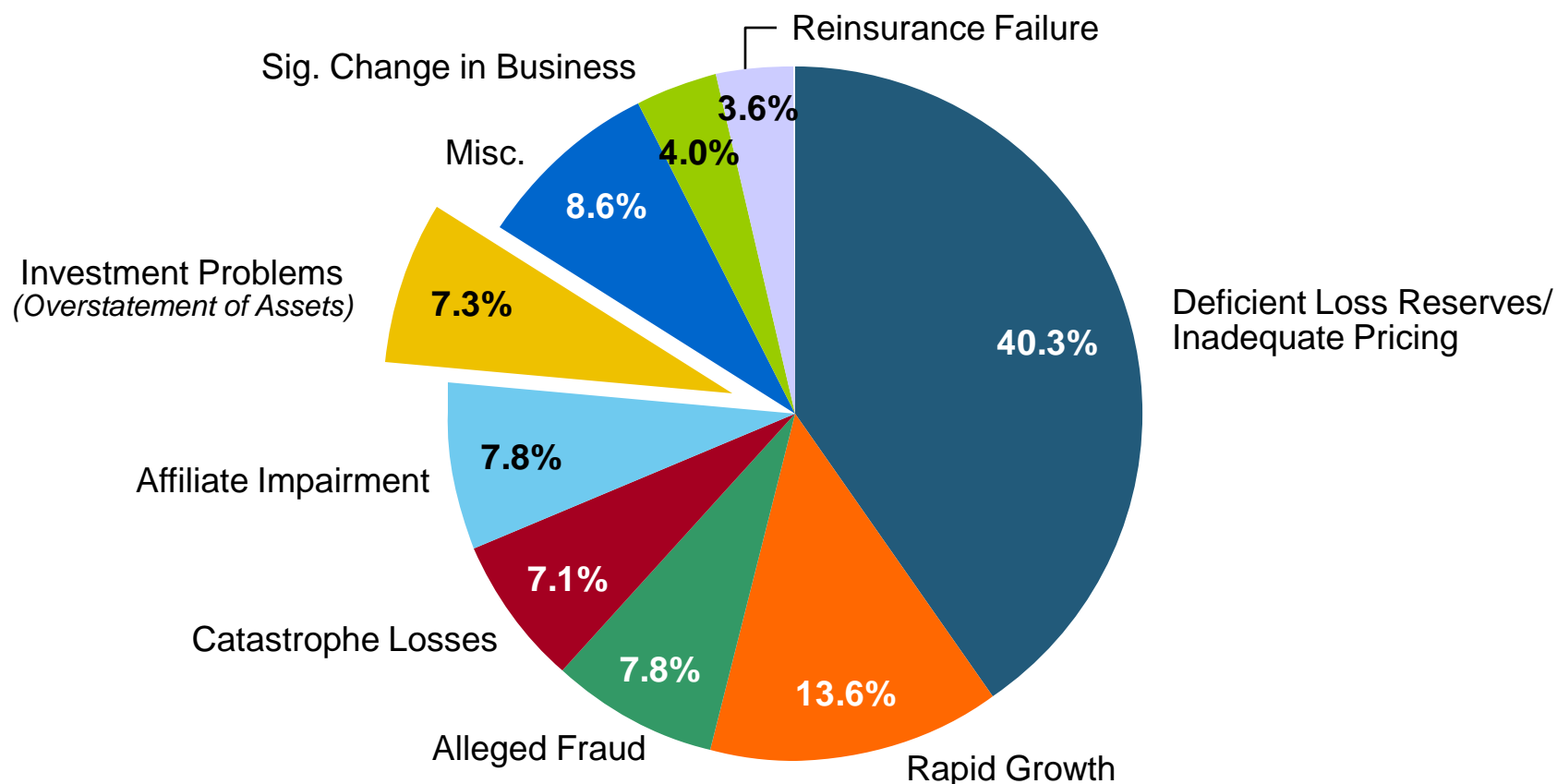
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2011



Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007; Recent Increase Was Associated Primarily With Mortgage and Financial Guaranty Insurers and Not Representative of the Industry Overall

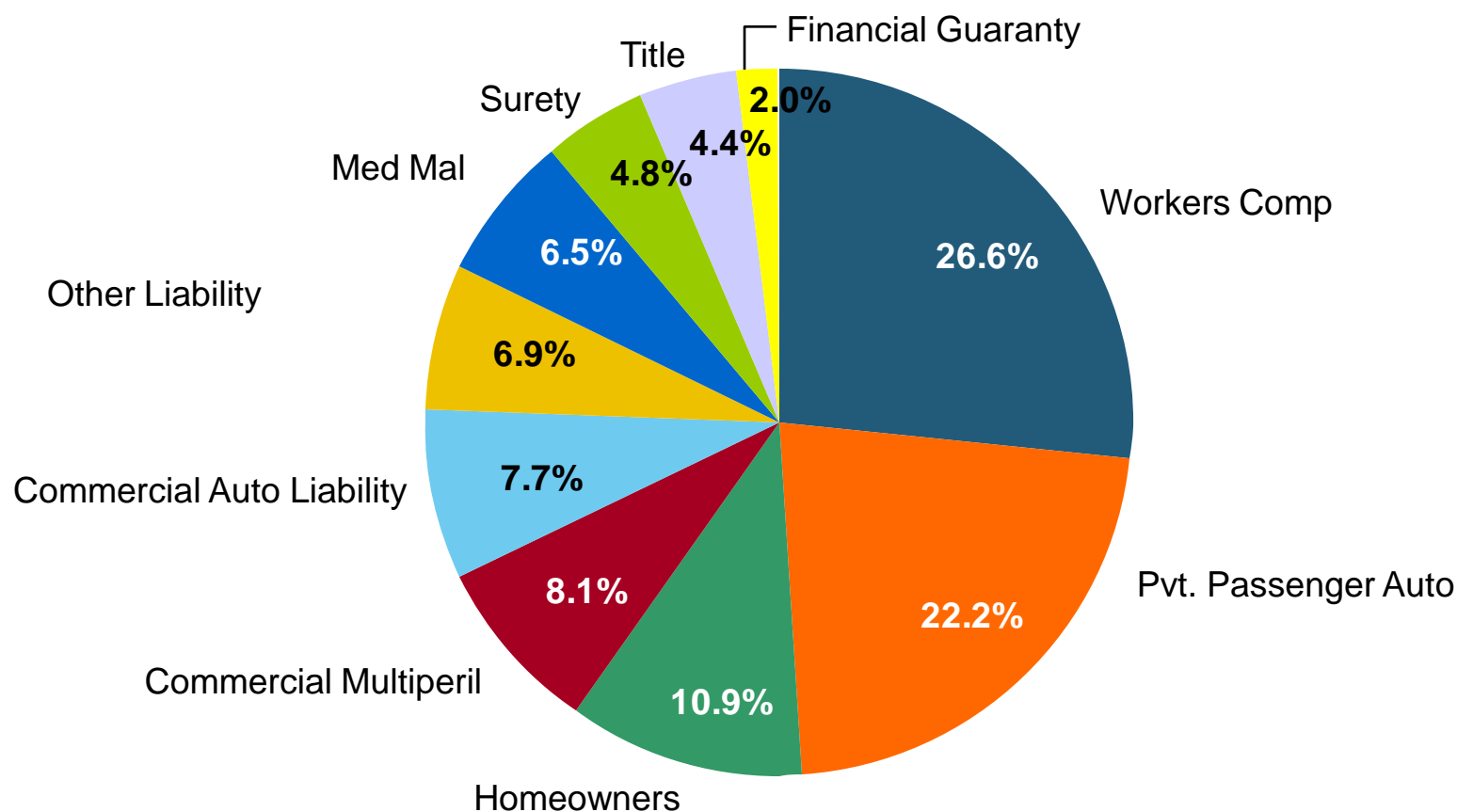
Reasons for US P/C Insurer Impairments, 1969–2010

Historically, Deficient Loss Reserves and Inadequate Pricing Are By Far the Leading Cause of P-C Insurer Impairments. Investment and Catastrophe Losses Play a Much Smaller Role



Top 10 Lines of Business for US P/C Impaired Insurers, 2000–2010

Workers Comp and Pvt. Passenger Auto Account for Nearly Half of the Premium Volume of Impaired Insurers Over the Past Decade

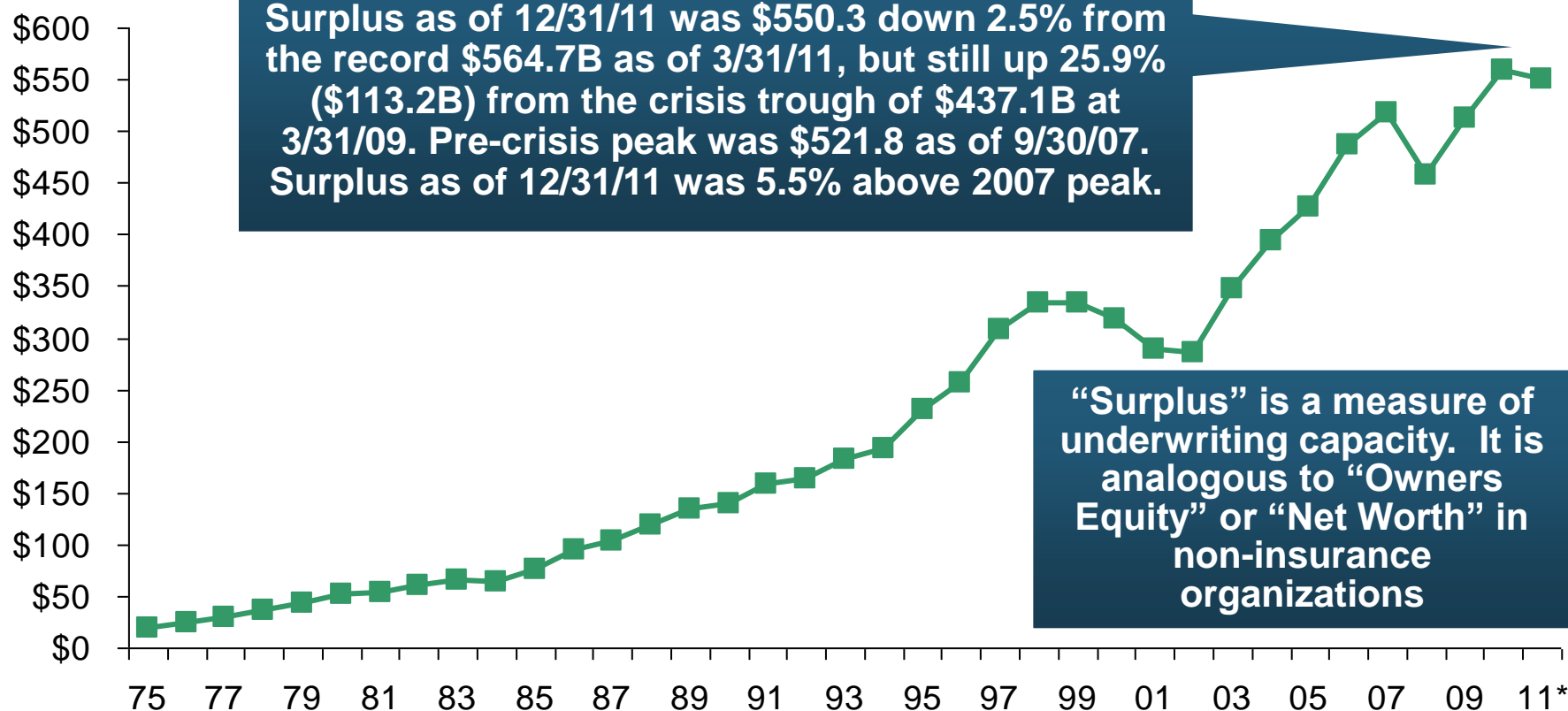


SURPLUS/CAPITAL/CAPACITY

**Have Large Global Losses Reduced
Capacity in the Industry, Setting
the Stage for a Market Turn?**

US Policyholder Surplus: 1975–2011*

(\$ Billions)



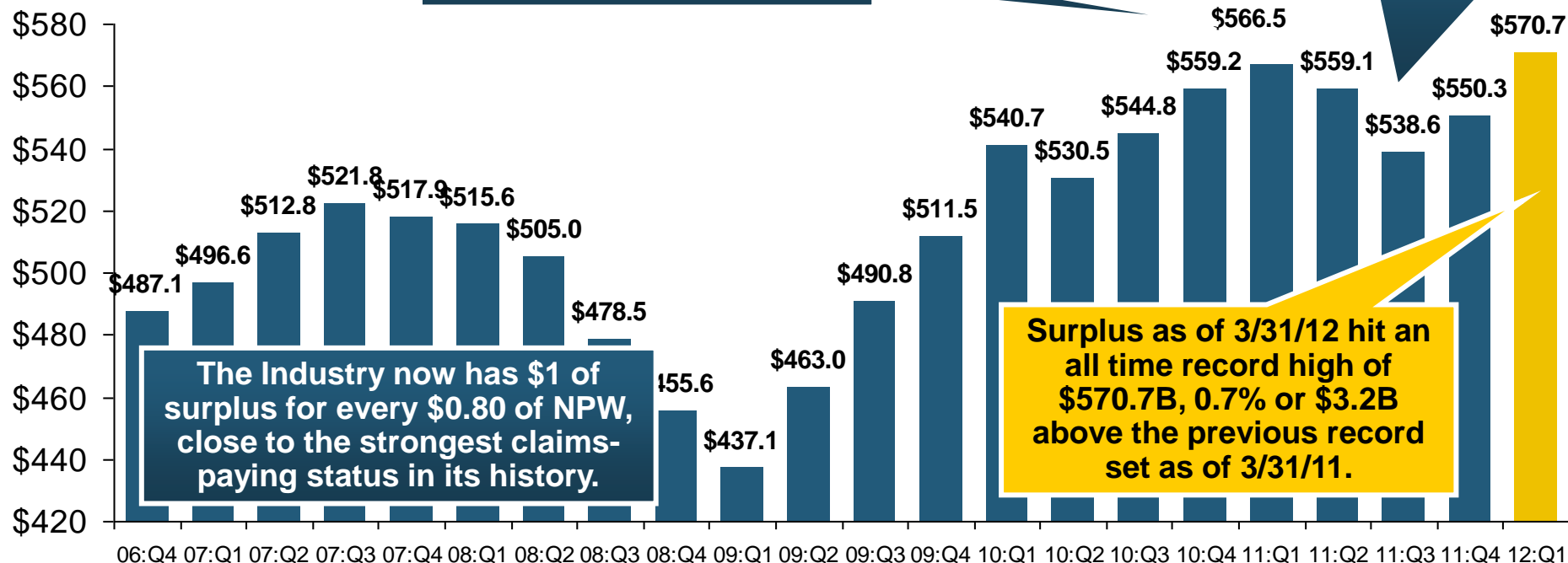
The Premium-to-Surplus Ratio Stood at \$0.80:\$1 as of 12/31/11, A Near Record Low (at Least in Recent History)*

* As of 12/31/11.

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

Policyholder Surplus, 2006:Q4–2012:Q1

(\$ Billions)



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

Quarterly Surplus Changes Since 2011:Q1 Peak

11:Q2: -\$7.4B (-1.0%)
11:Q3: -\$27.9B (-4.6%)
11:Q4: -\$16.2B (-2.5%)
12:Q1: +\$3.2B (+0.7%)

RENEWED PRICING DISCIPLINE

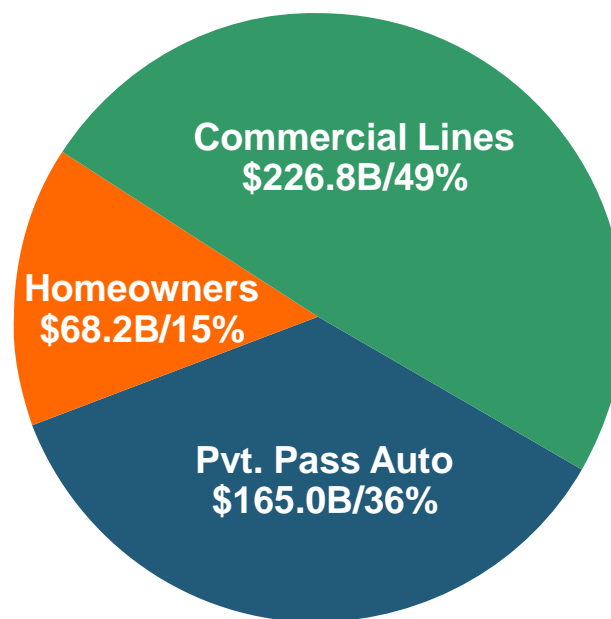
**Is There Evidence of a Broad
and Sustained Shift in Pricing?**

Distribution of Direct Premiums Written by Segment/Line, 2010

Distribution Facts

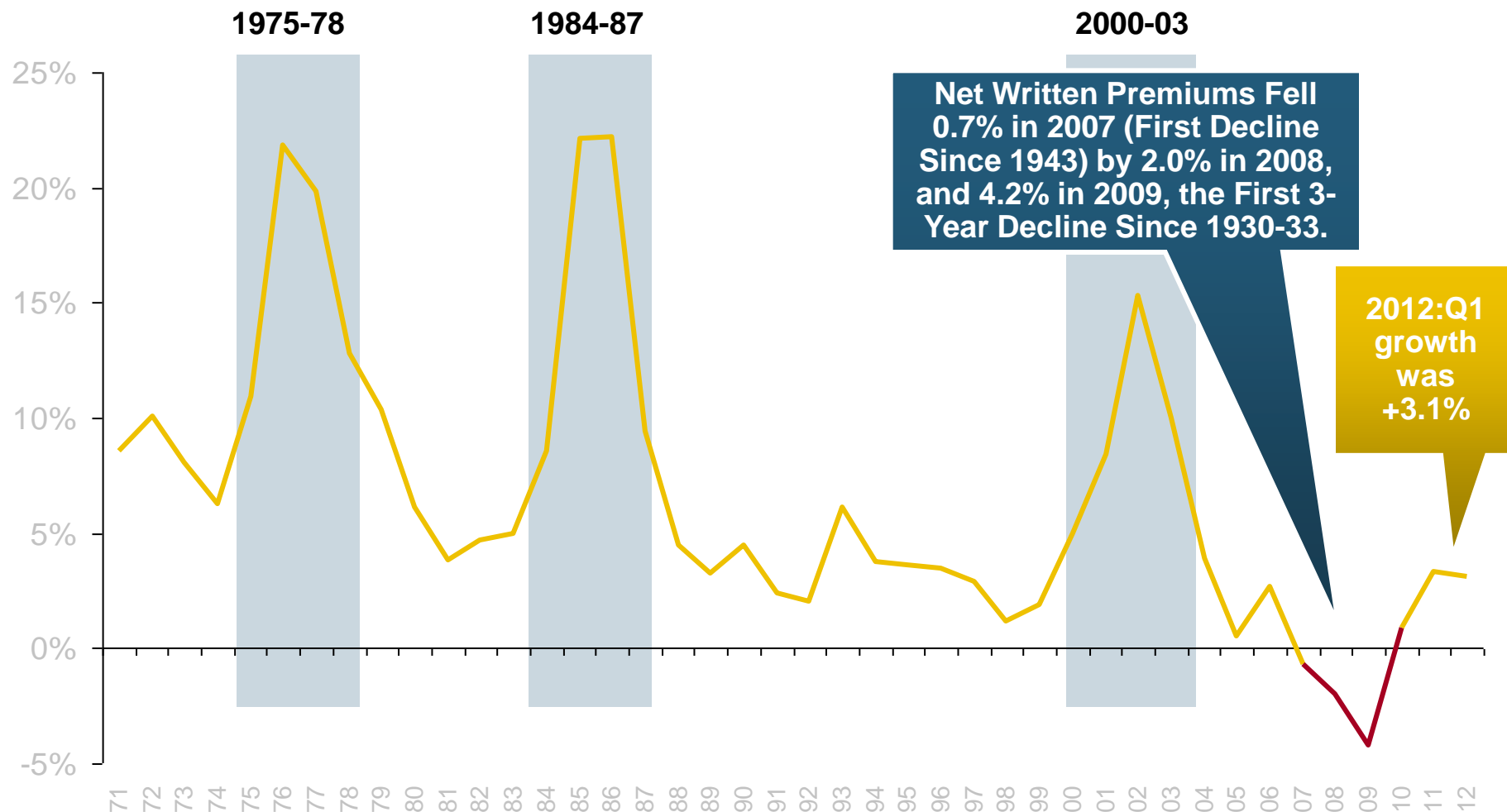
- Personal/Commercial lines split has been about 50/50 for many years; Personal Lines overtook Commercial Lines in 2010
- Pvt. Passenger Auto is by far the largest line of insurance and is currently the most important source of industry profits
- Billions of additional dollars in homeowners insurance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

2010



Premium Growth Is Up Modestly: More in 2012?

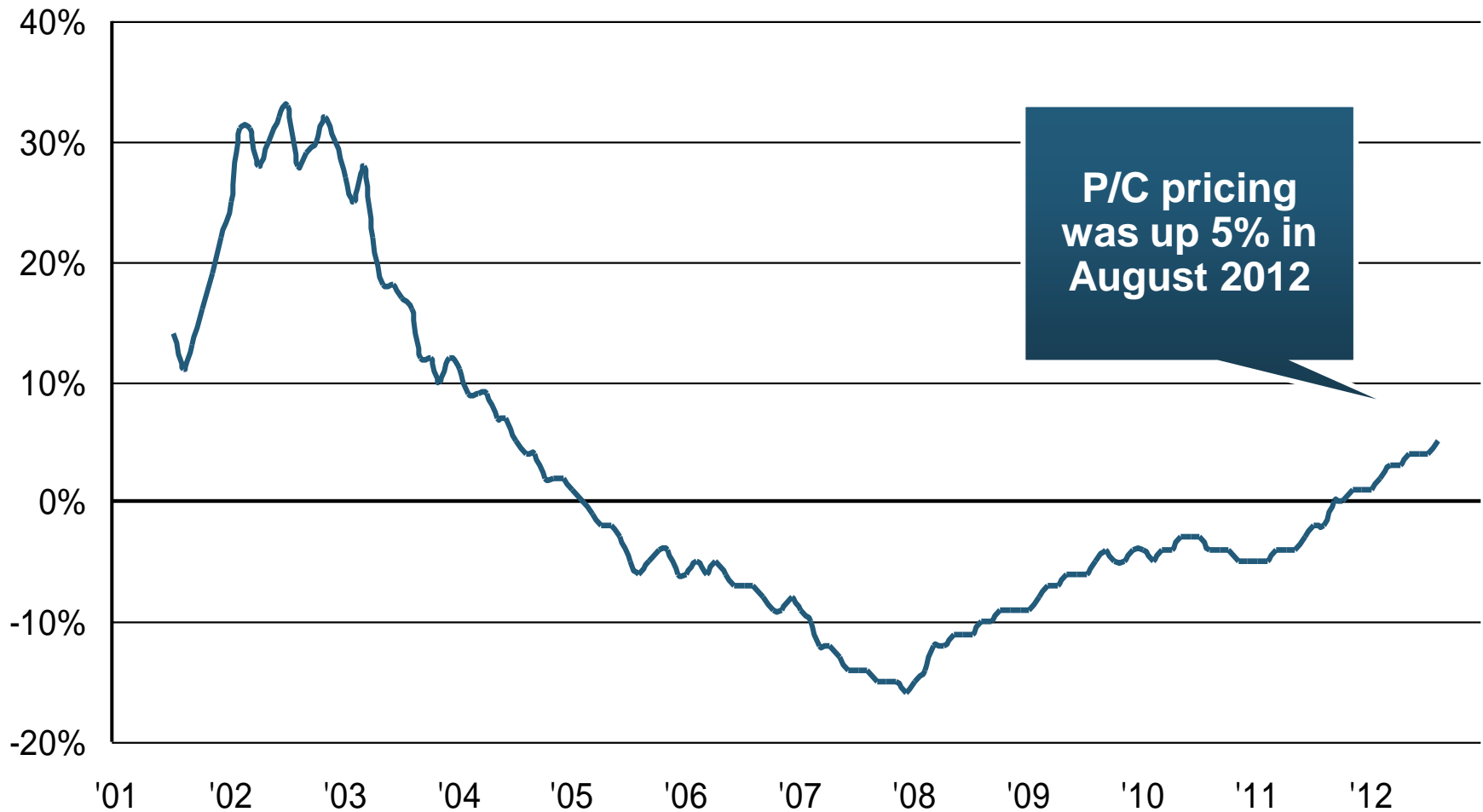
(Percent)



Shaded areas denote "hard market" periods

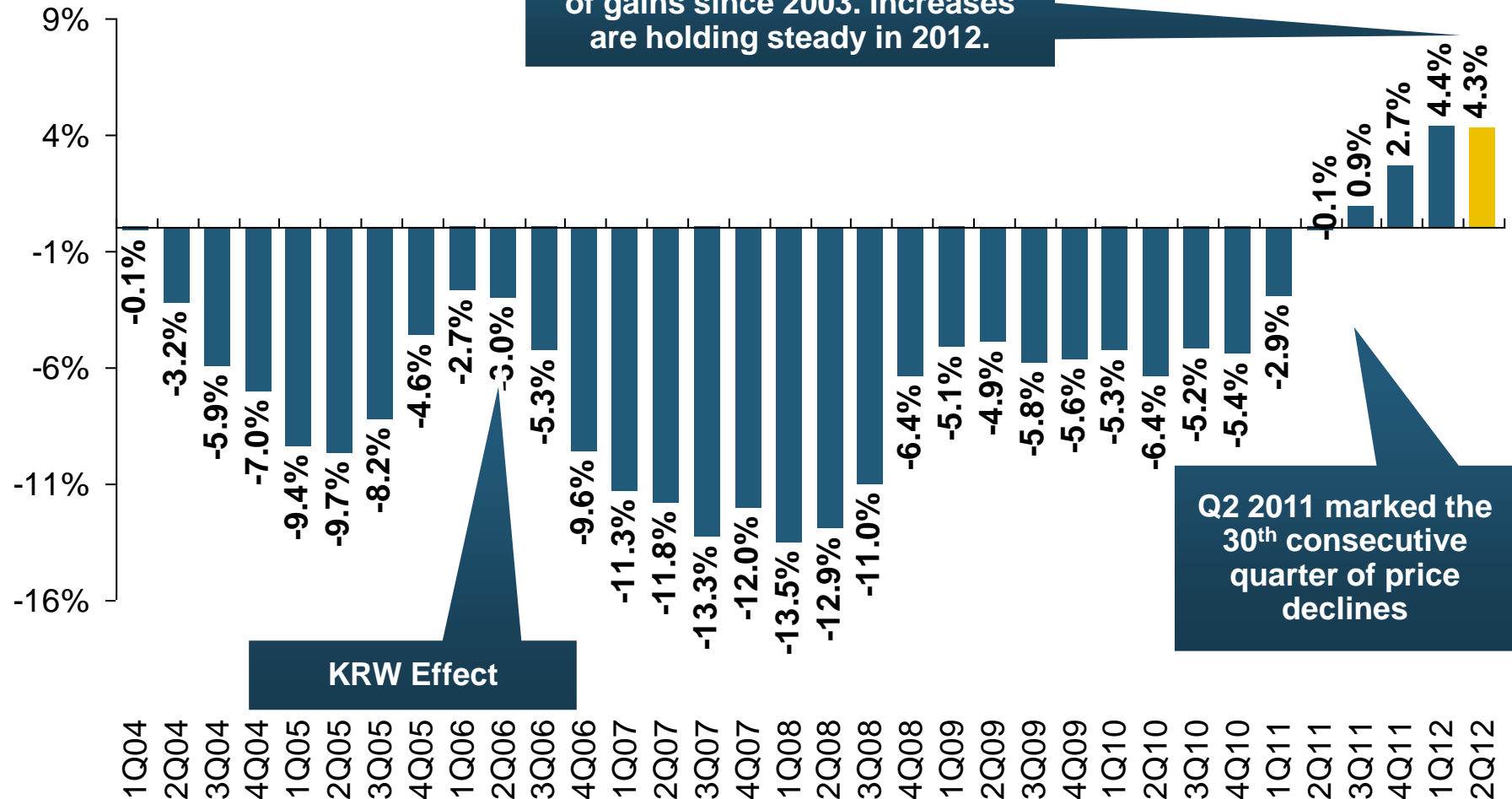
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

Monthly Average P&C Rate Change, 2001—Aug. 2012



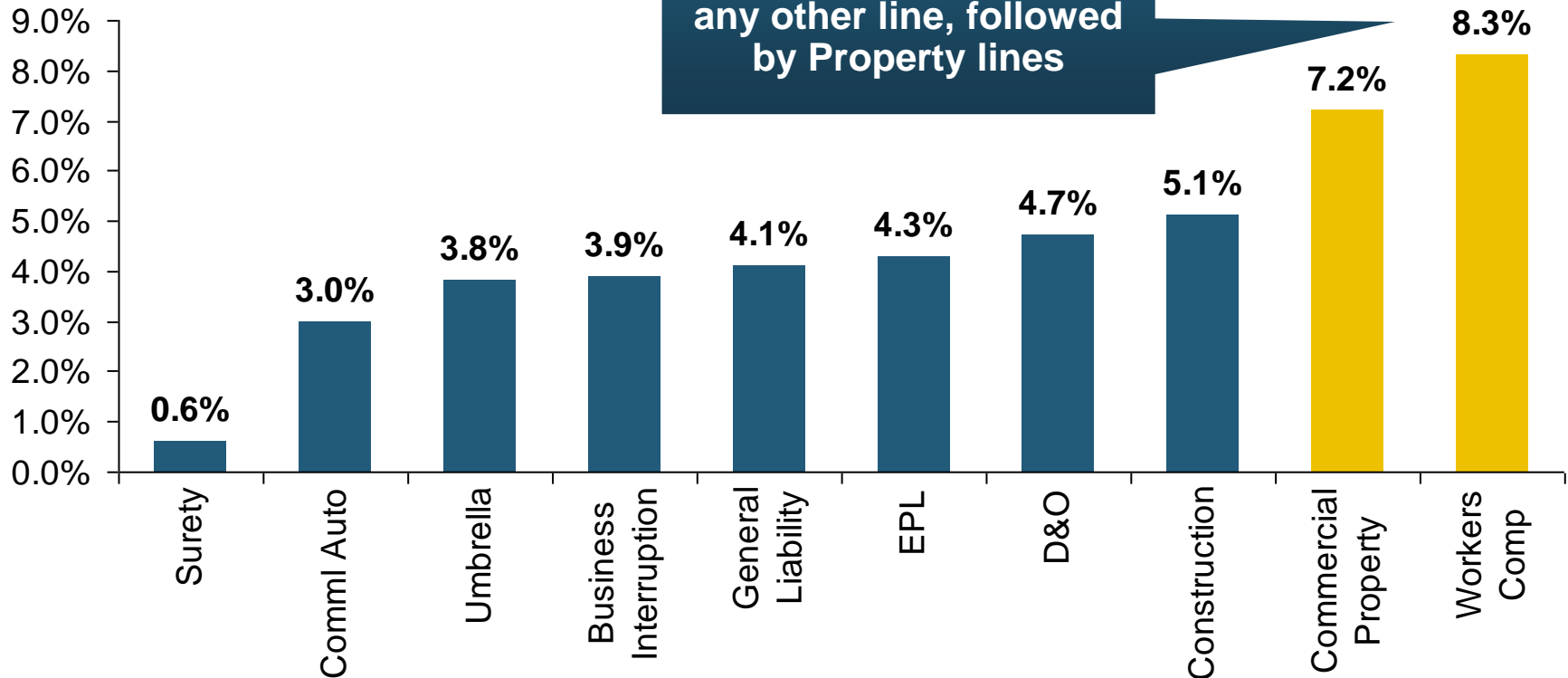
Average Commercial Rate Change, All Lines, (1Q:2004–2Q:2012)

(Percent)



Change in Commercial Rate Renewals, by Line: 2012:Q2

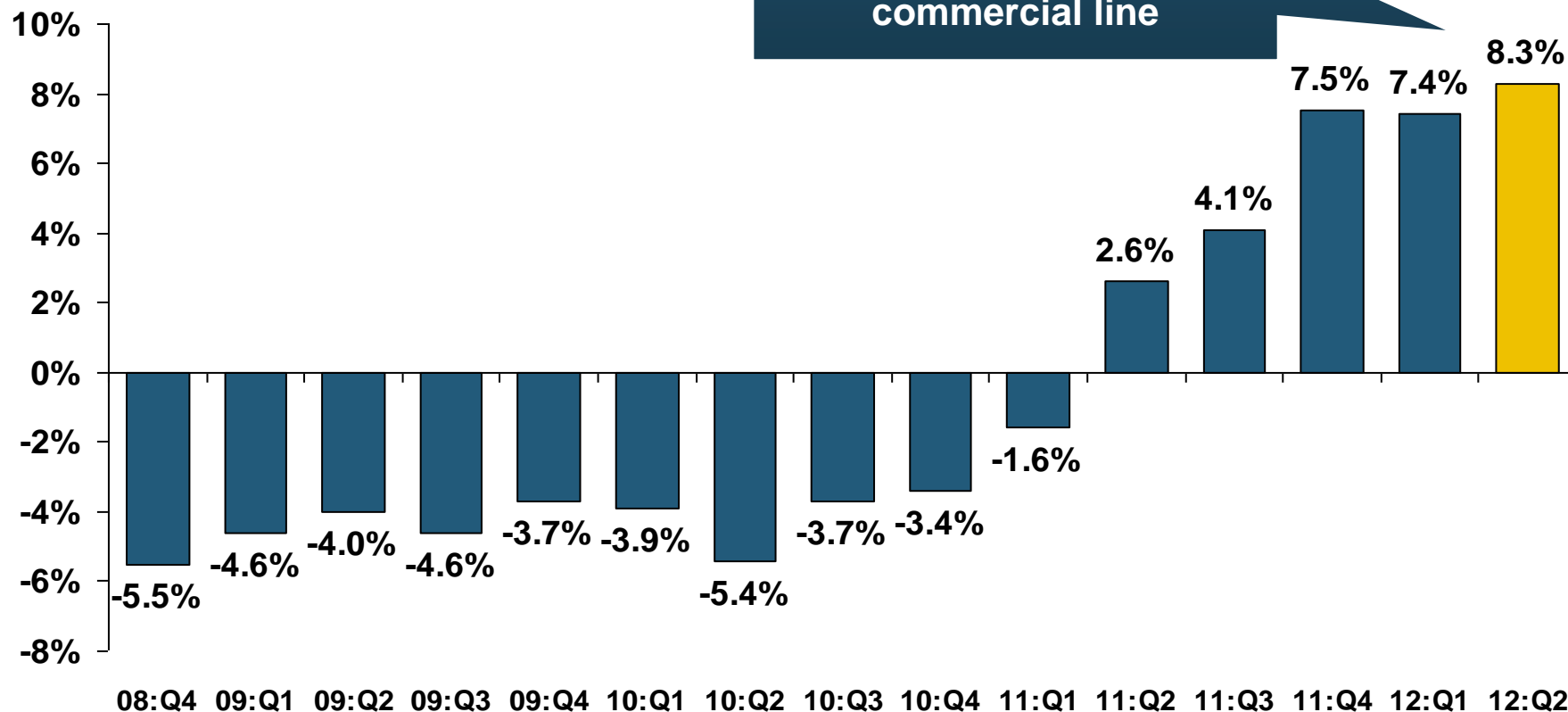
Percentage Change (%)



Major Commercial Lines Renewed Uniformly Upward in Q2:2012 for Only the Fourth Time Since 2003; Property Lines & Workers Comp Leading the Way; Cat Losses and Low Interest Rates Provide Momentum Going Forward

Workers Comp Rate Changes, 2008:Q4 – 2012:Q2

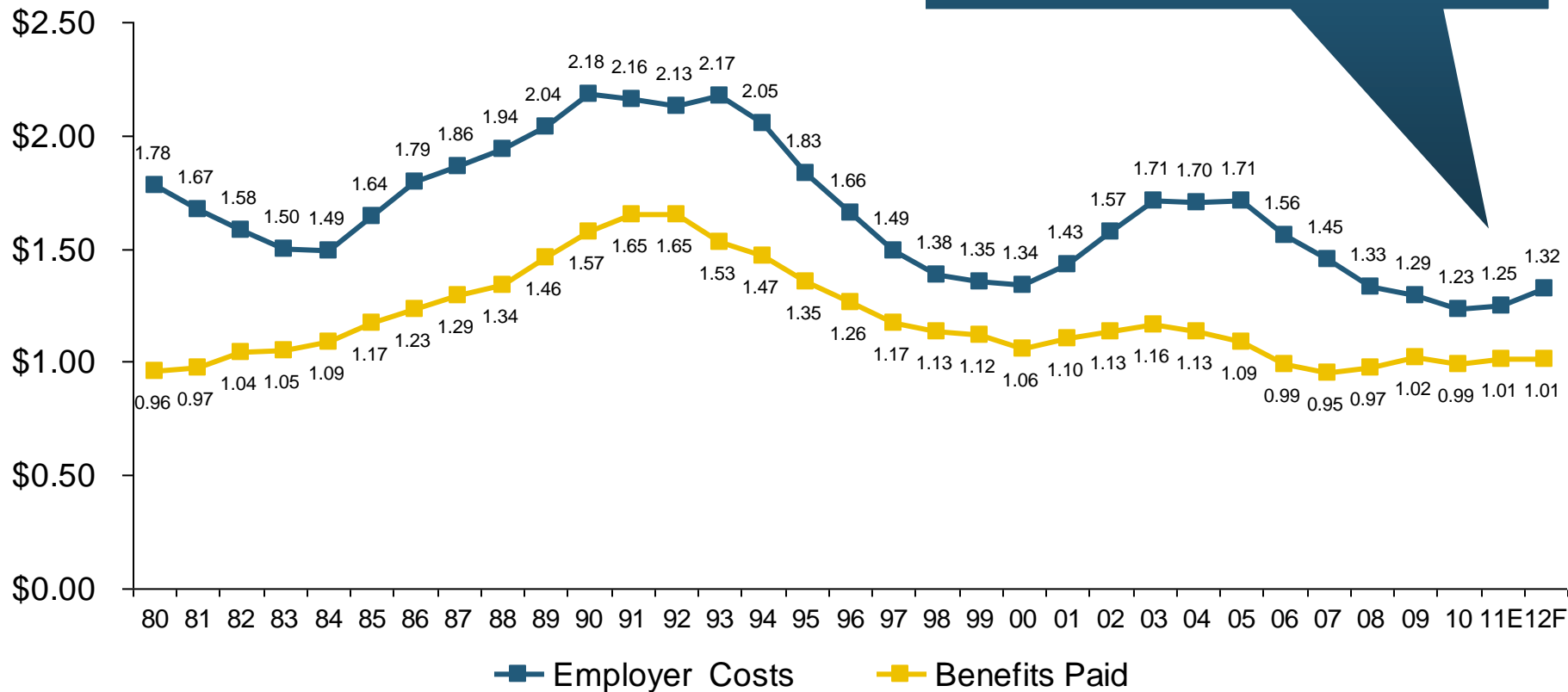
(Percent
Change)



Workers Comp Benefits* and Costs** per \$100 of Covered Wages, 1980-2012F

(Dollars per \$100 of Covered Wages)

**WC costs to employers began
to rise in 2011/12 for the first
time since 2003**



* Benefits paid during calendar year to injured workers and to providers of their medical care.

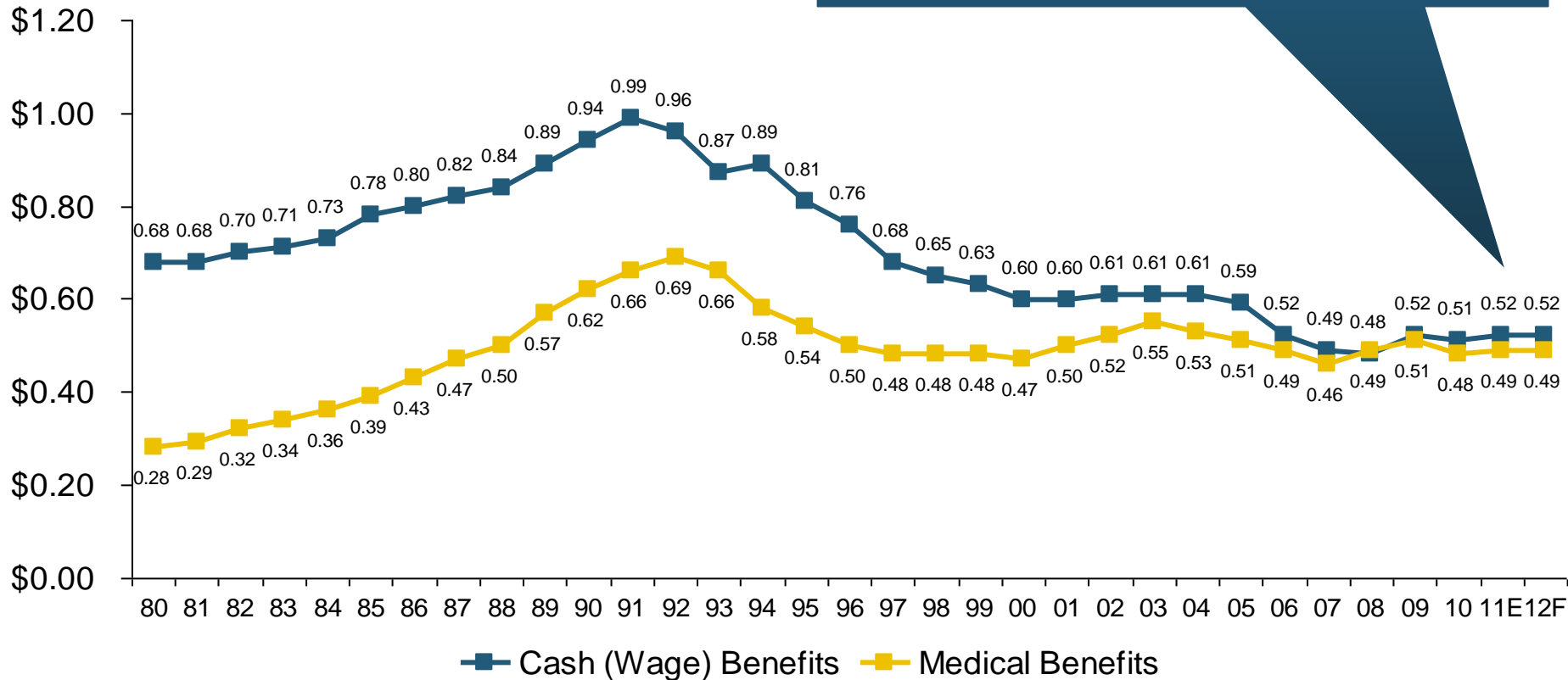
**Costs are employer expenditures for WC benefits, associated administrative costs and insurance premiums. Includes self-insured employers and payments of benefits under large insurance programs.

Sources: National Academy of Social Insurance (1980-2010); Insurance Information Institute estimates for 2011-2012.

Workers Comp Medical and Cash Benefits per \$100 of Covered Wages, 1980-2012F

(Dollars per \$100 of Covered Wages)

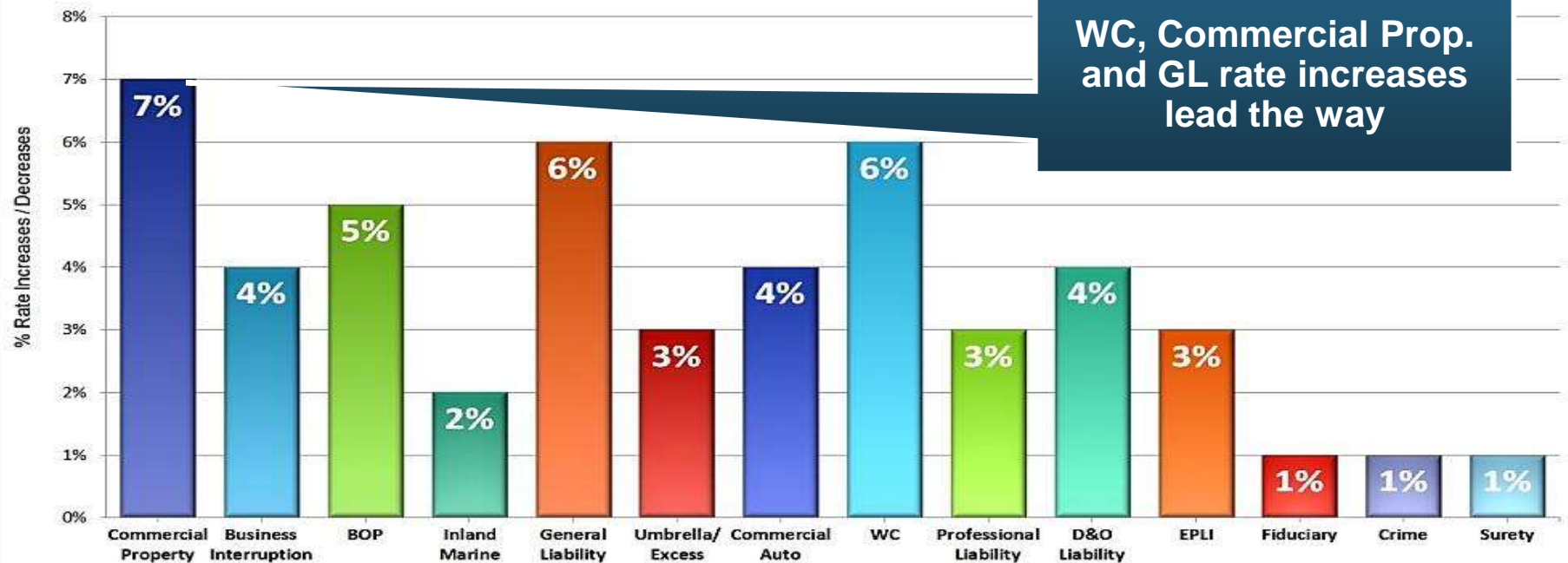
Medical benefits as a share of total benefits has increased dramatically over the past 20 years



Change in Commercial Rate Renewals, by Line: August 2012

Percentage Change (%)

Premium Trends by Coverage Class
August 2012

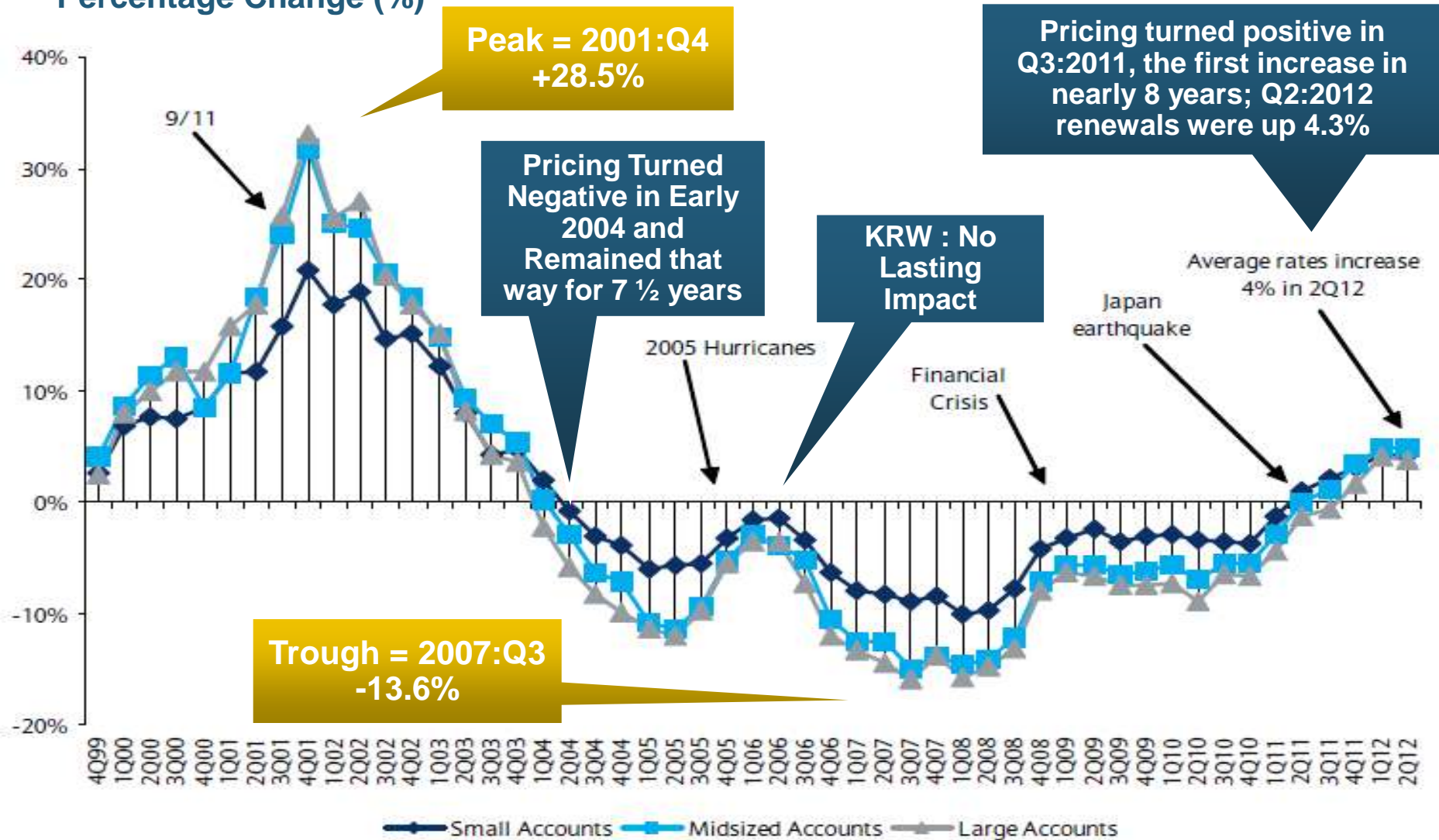


Source: MarketScout Corporation

Major Commercial Lines Are Renewed Upward in Aug. 2012

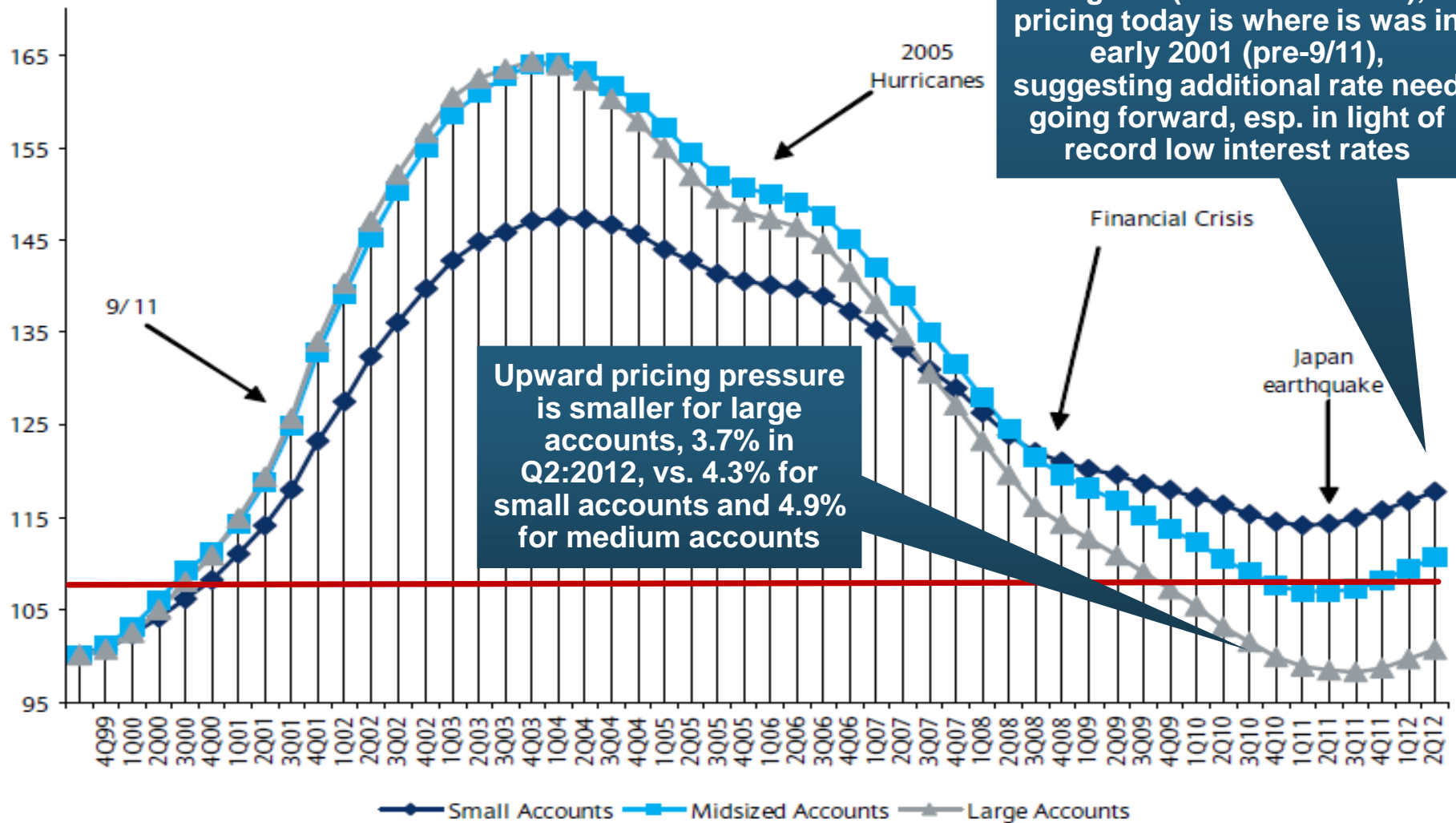
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2012:Q2

Percentage Change (%)



Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2012:Q2

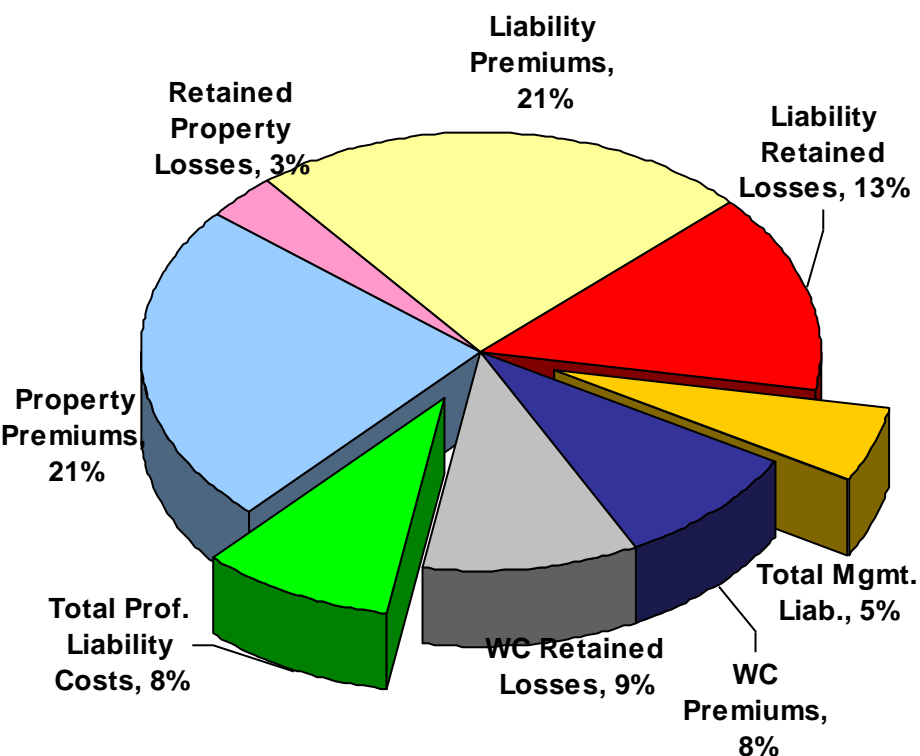
1999:Q4 = 100



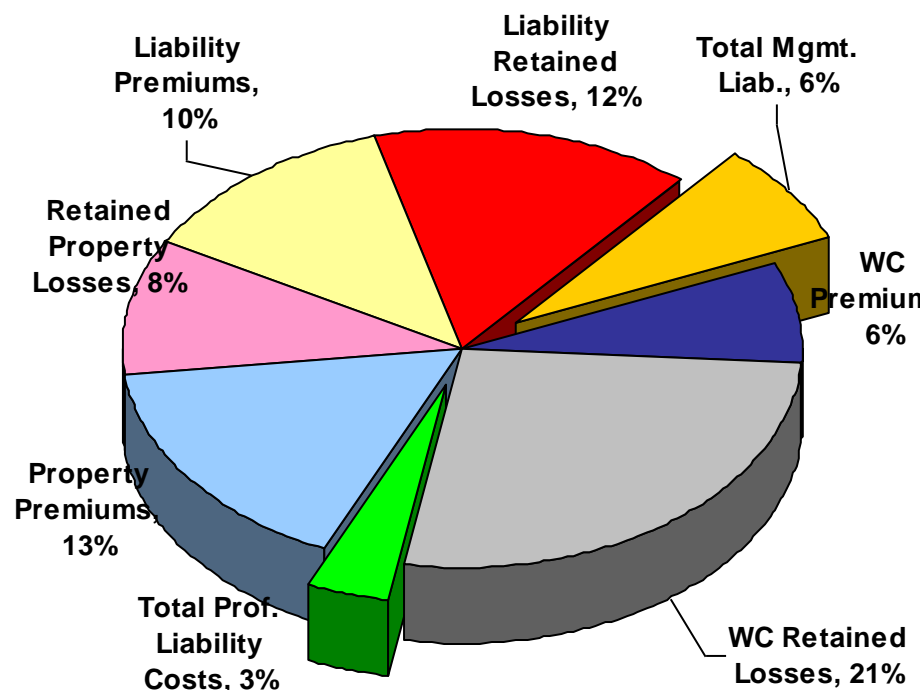
How the Risk Dollar is Spent (2011)

Management & Professional Liability Costs Account for 9% - 13% of the Risk Dollar

Firms w/Revenues < \$1 Billion



Firms w/Revenues > \$1 Billion

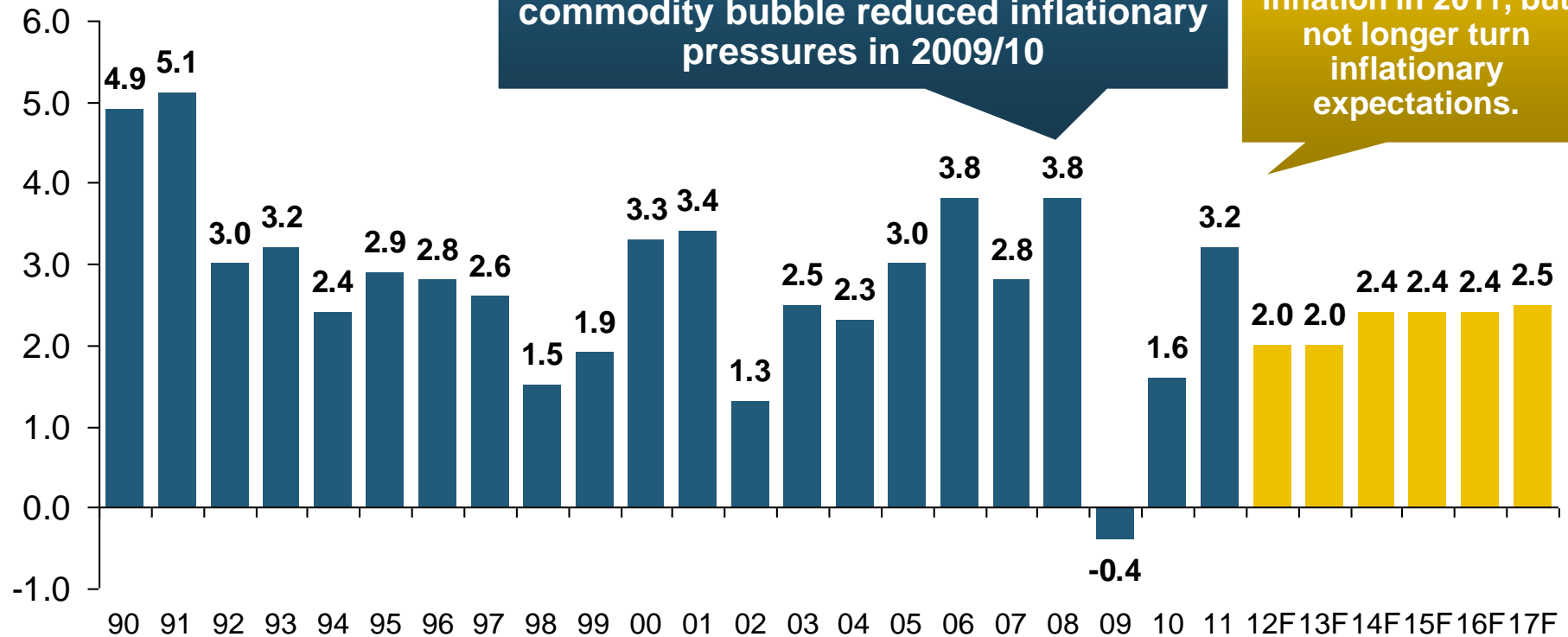


Inflation

**Is it a Threat to Claim Cost
Severities**

Annual Inflation Rates, (CPI-U, %), 1990–2017F

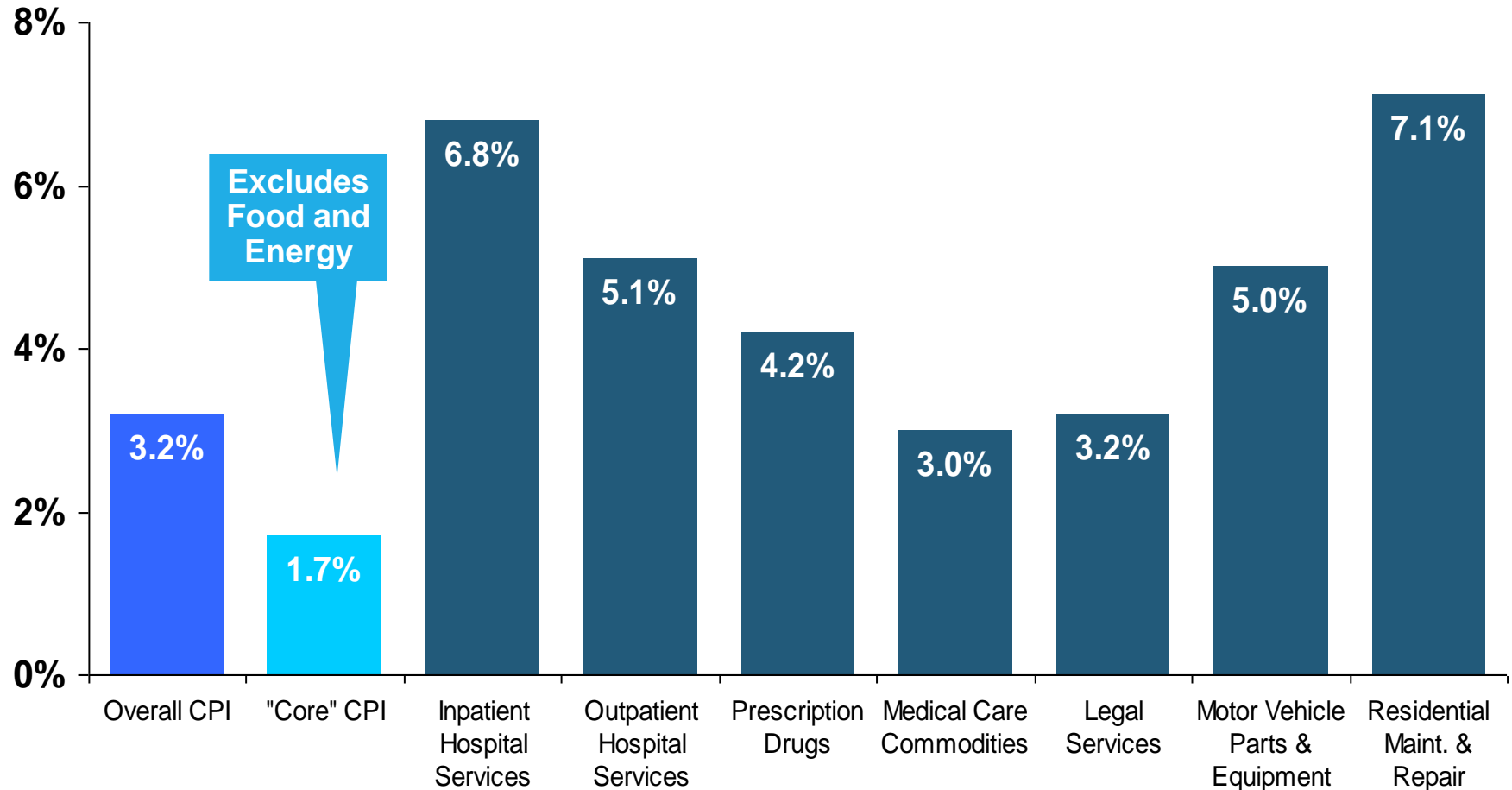
Annual Inflation Rates (%)



The slack in the U.S. economy suggests that inflationary pressures should remain subdued for an extended period of times. Energy, health care and commodity prices, plus U.S. debt burden, remain longer-run concerns

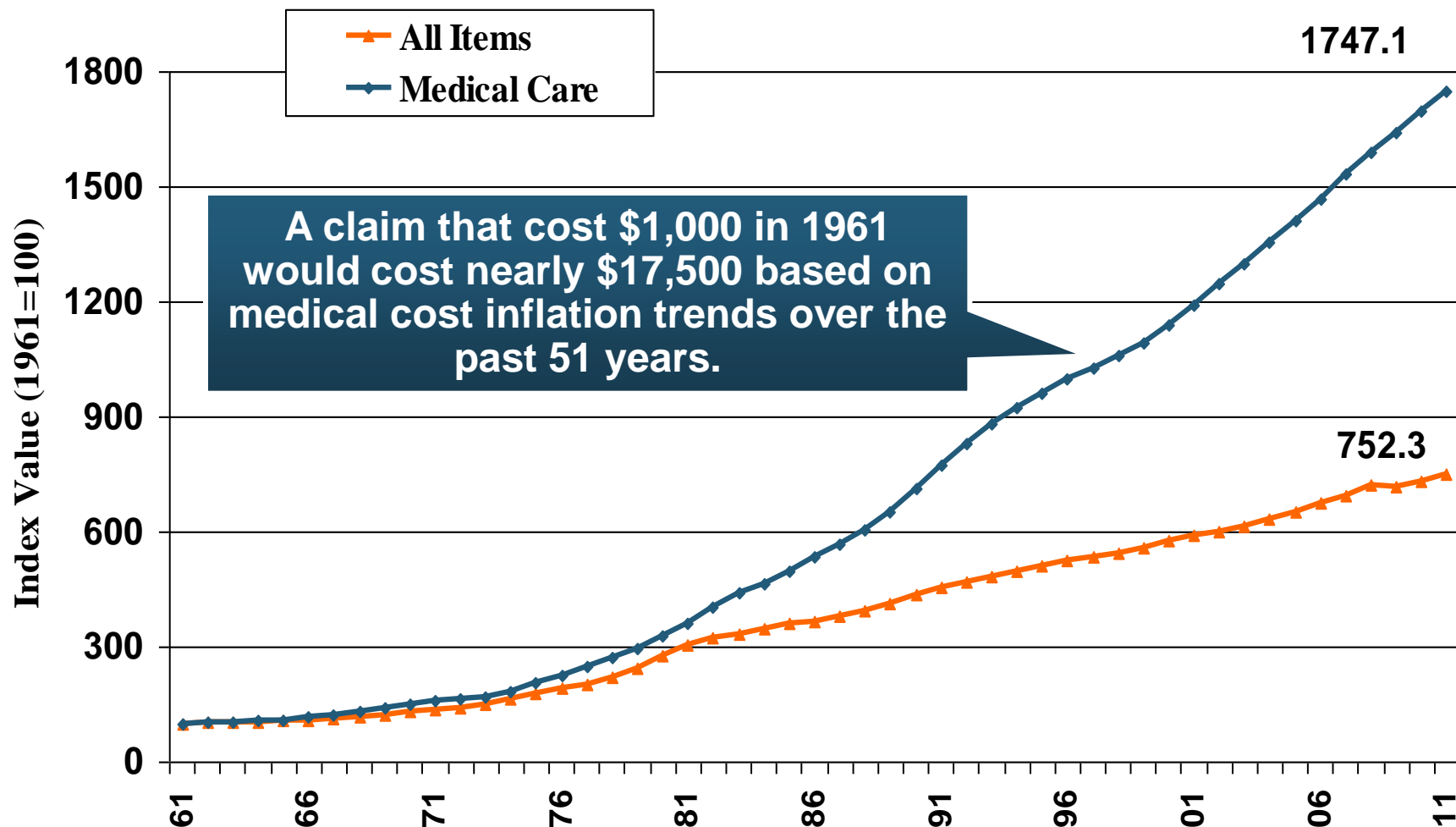
P/C Personal Insurance Claim Cost Drivers Grow Faster Than the Core CPI Suggests

Price Level Change: 2011 vs. 2010



Healthcare costs are a major liability, med pay, and PIP claim cost driver. They are likely to grow faster than the CPI for the next few years

Medical Cost Inflation Has Outpaced Overall Inflation For Over 50 Years



Source: Department of Labor (Bureau of Labor Statistics)

Insurance Information Institute Online:

www.iii.org

*Thank you for your time
and your attention!*

Twitter: twitter.com/bob_hartwig

Download at www.iii.org/presentations