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

Challenges Amid the Global Economic Storm

Association of Professional Insurance Women
New York, NY

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Presentation Outline

- **Financial Crisis & The Weakening Global Economy: Insurance Impacts**
  - **Banks vs. Insurers**
  - **Economic Growth & Recession**
  - **Financial Strength & Ratings**
- **P/C Insurance Industry Overview & Outlook**
  - **Profitability**
  - **Premium Growth**
  - **Underwriting Performance**
  - **Financial Market Impacts**
- **Capital & Capacity**
- **Regulatory Response to Crisis**
  - **Emerging Blueprint of Regulatory Overhaul**
- **Important Threats Facing P/C Insurers in 2009**

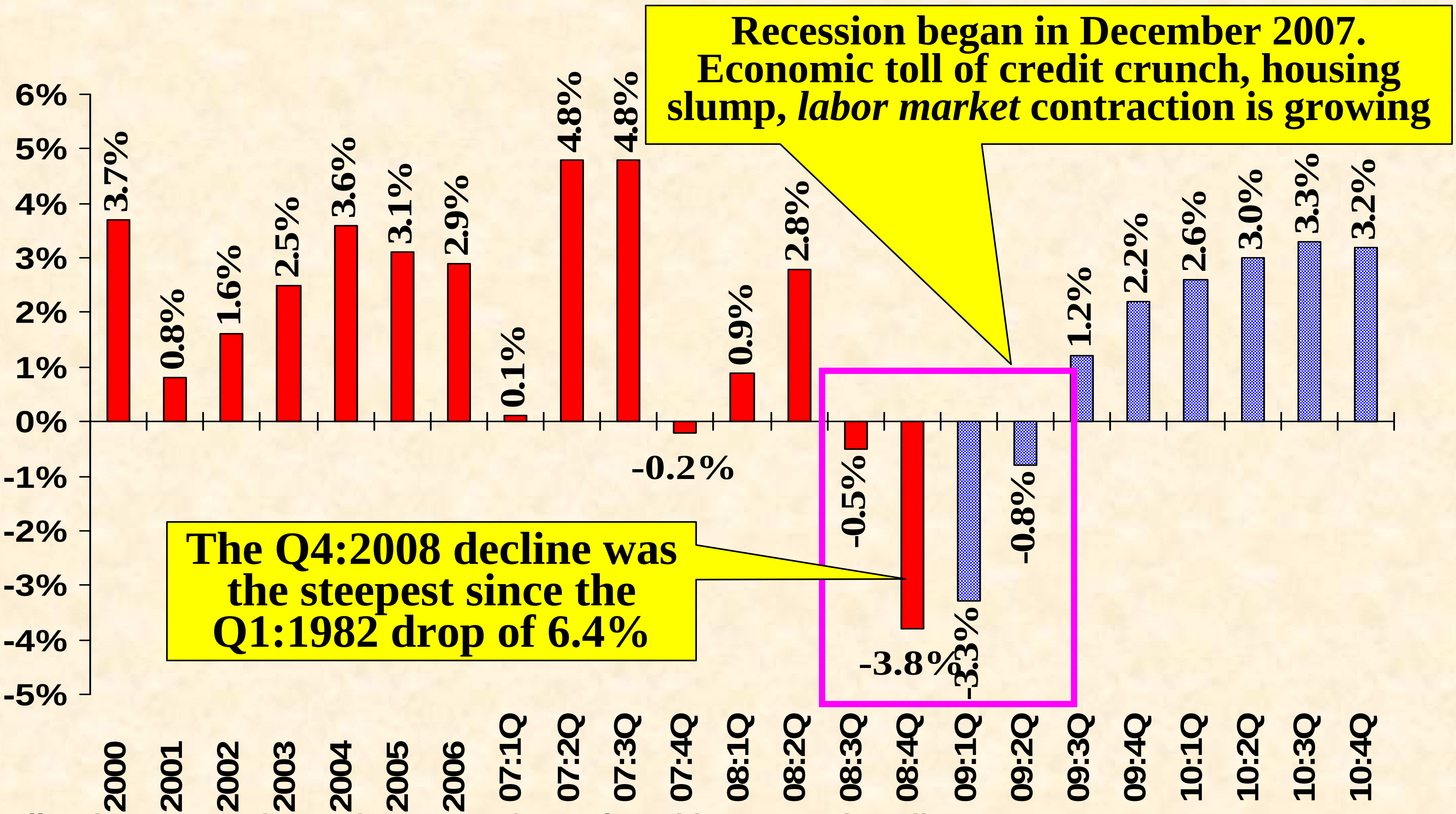
Q & A

THE ECONOMIC STORM

What a Weakening Economy and Financial Crisis Mean for the Insurance Industry

Exposure & Claim Cost Effects

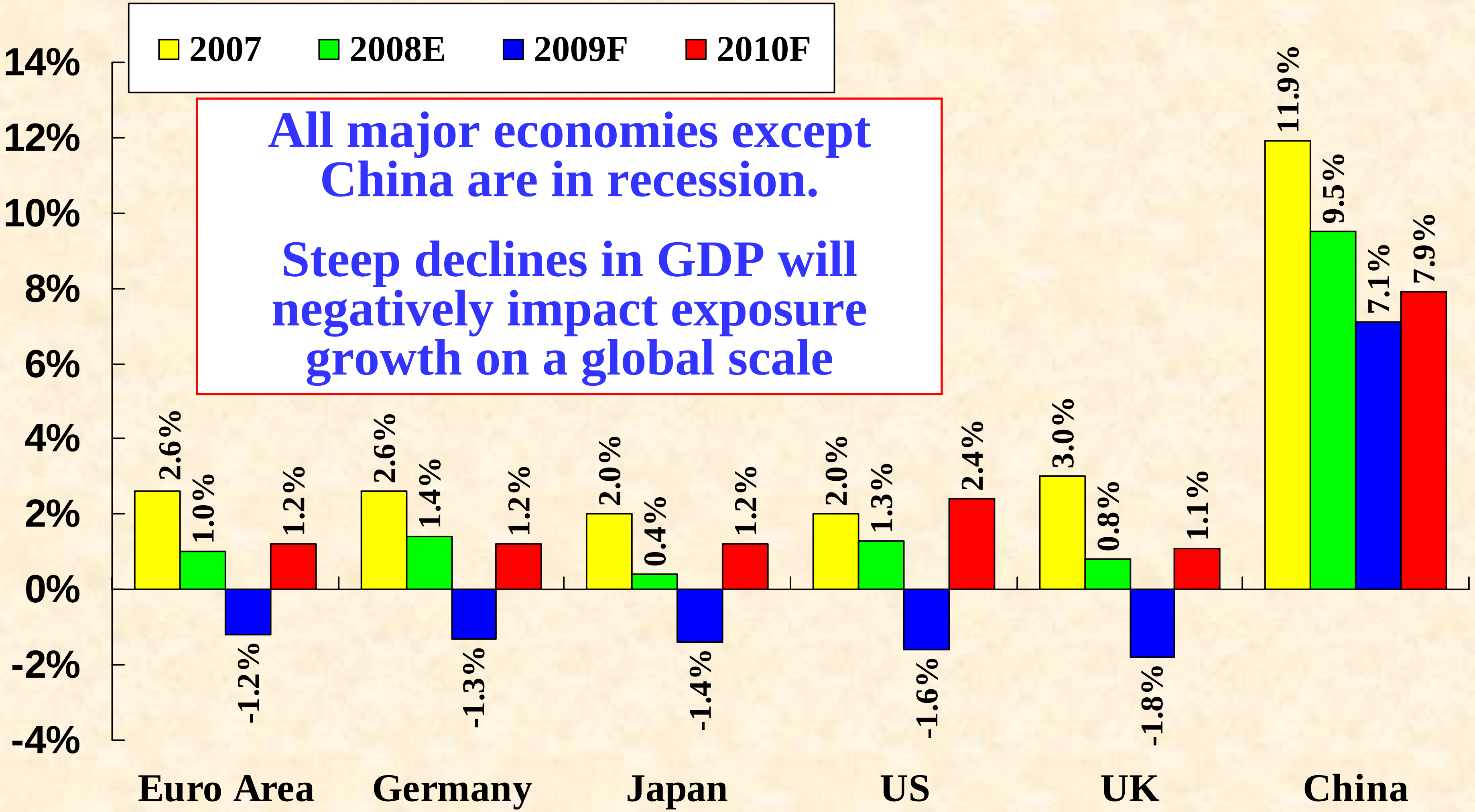
Real GDP Growth*



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

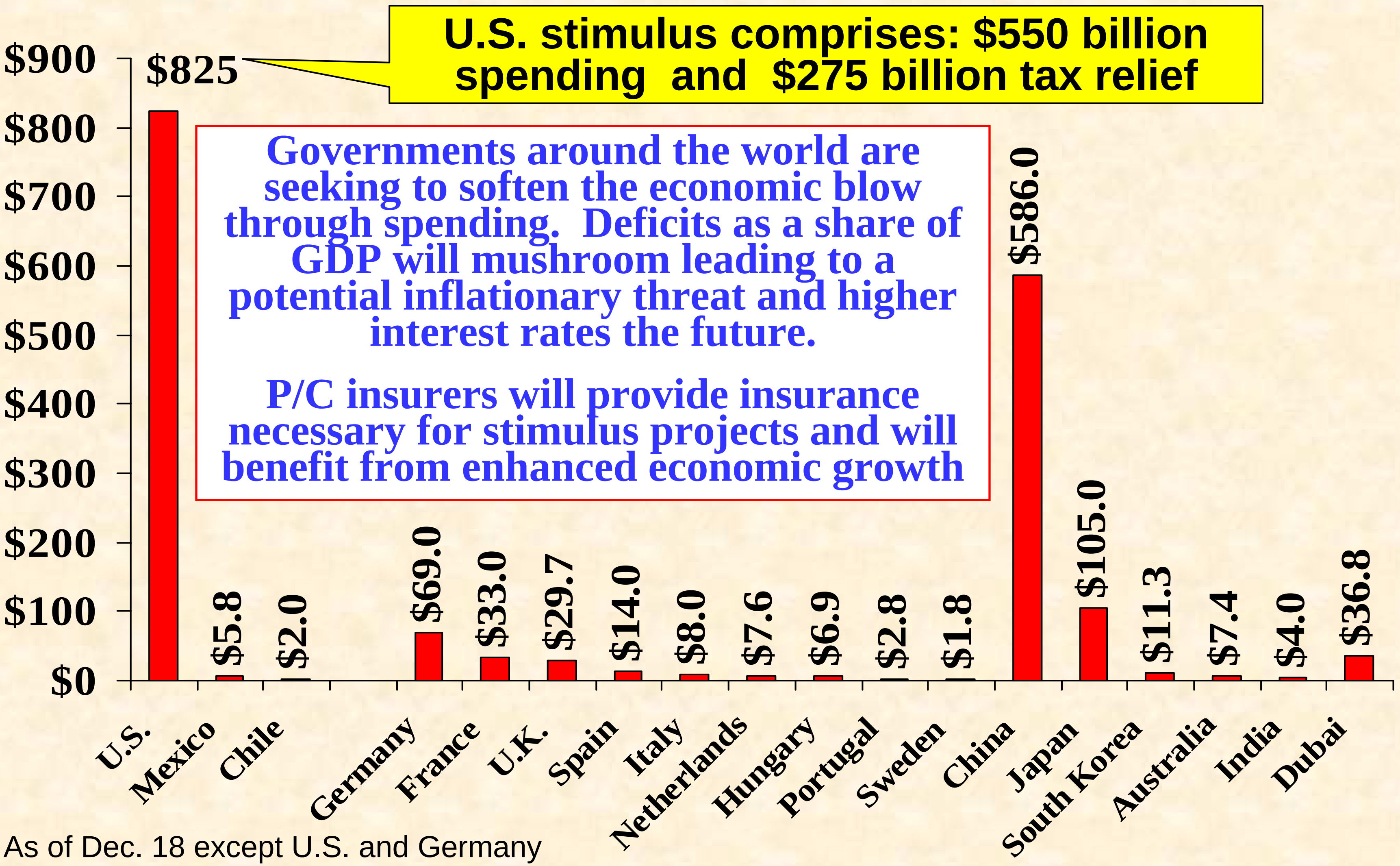
Source: US Department of Commerce, Blue Economic Indicators 1/09; Insurance Information Institute.

Real GDP By Market 2007-2010F (% change from previous year)



Source: Blue Chip Economic Indicators, 1/10/09 edition.

Announced Economic Stimulus Packages Worldwide ($ Billions)*

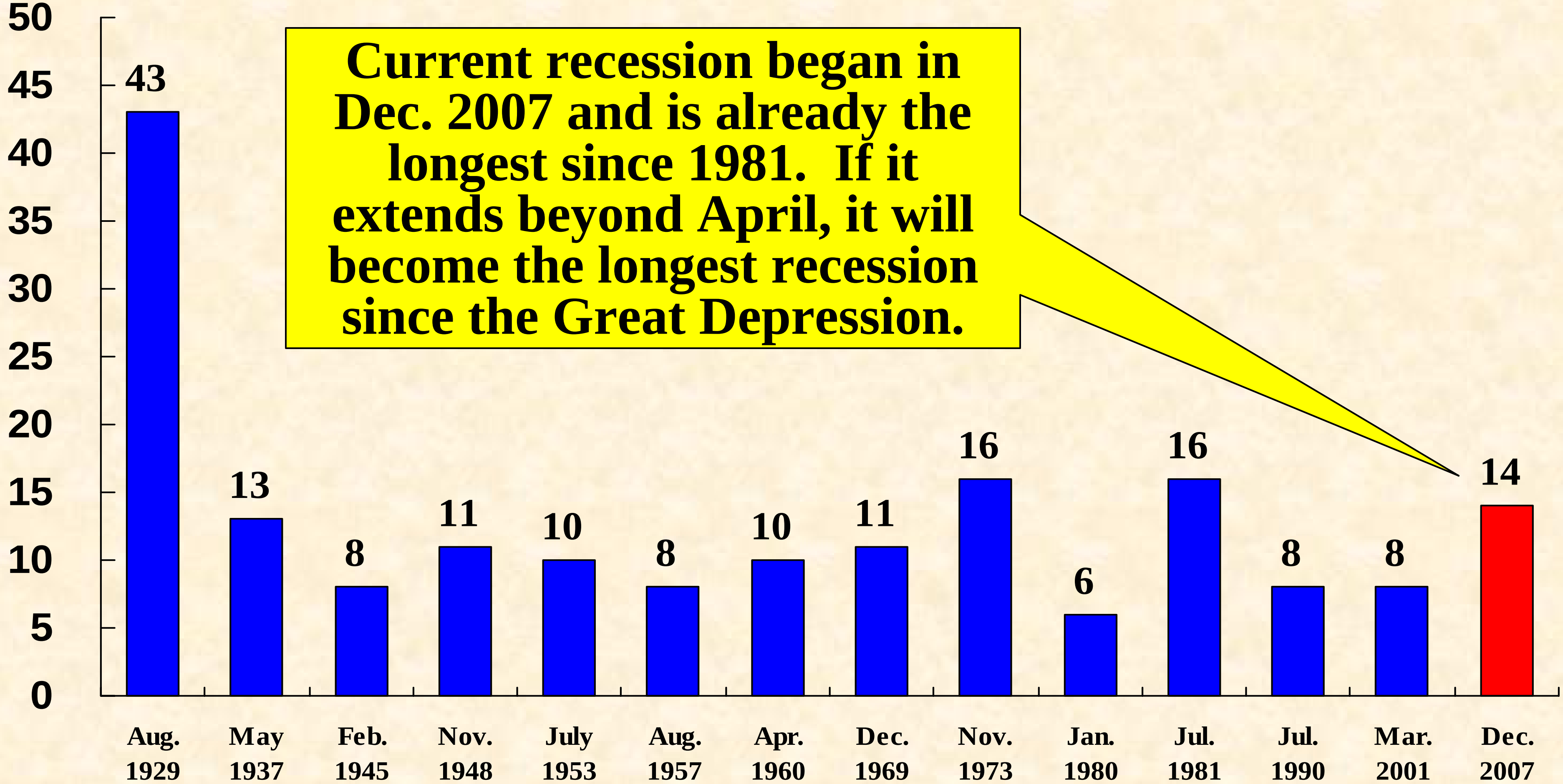


As of Dec. 18 except U.S. and Germany

Sources: Wall Street Journal, January 8, 2009; Institute of International Finance.

*Length of US Recessions, 1929-Present**

Months in Duration

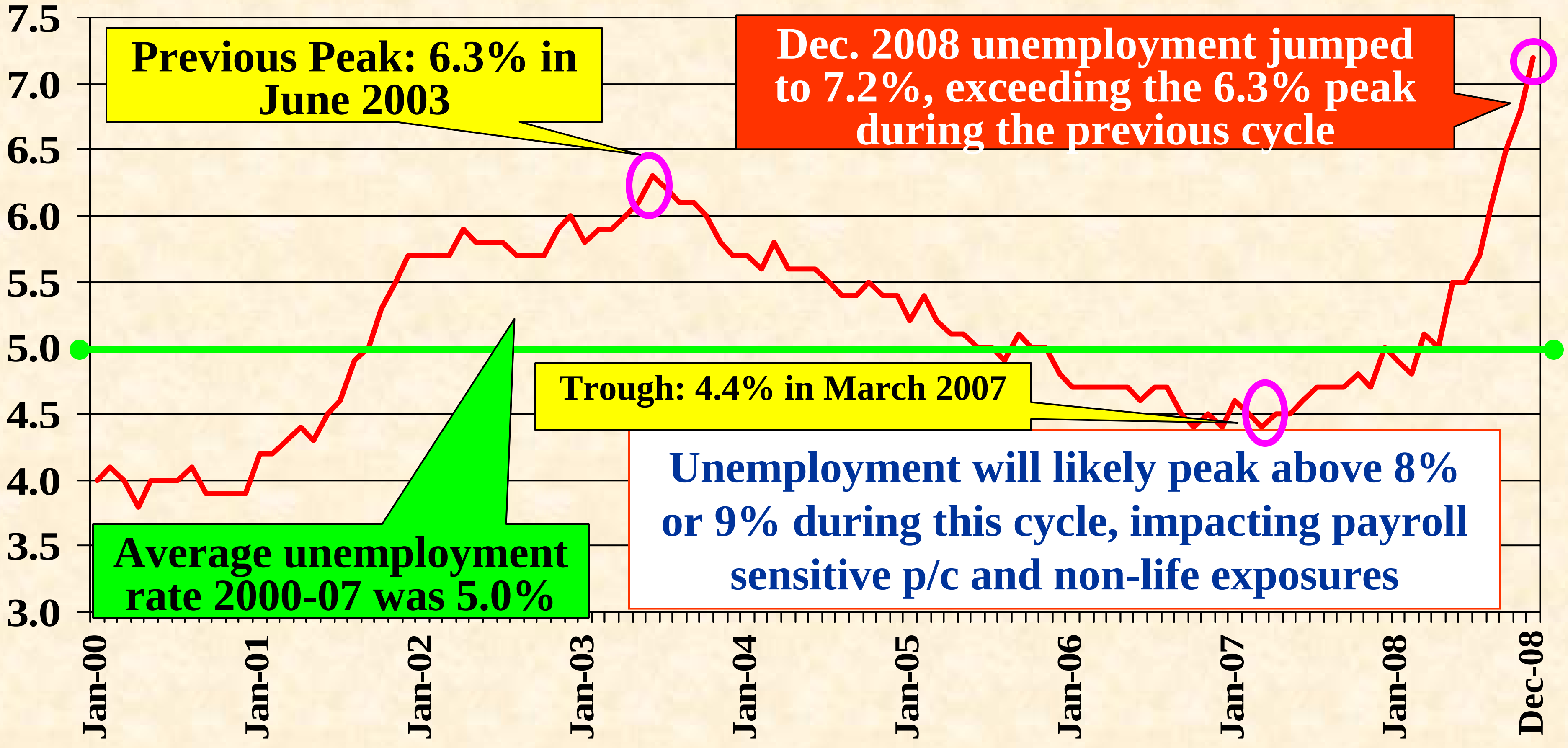


* As of February 2009

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

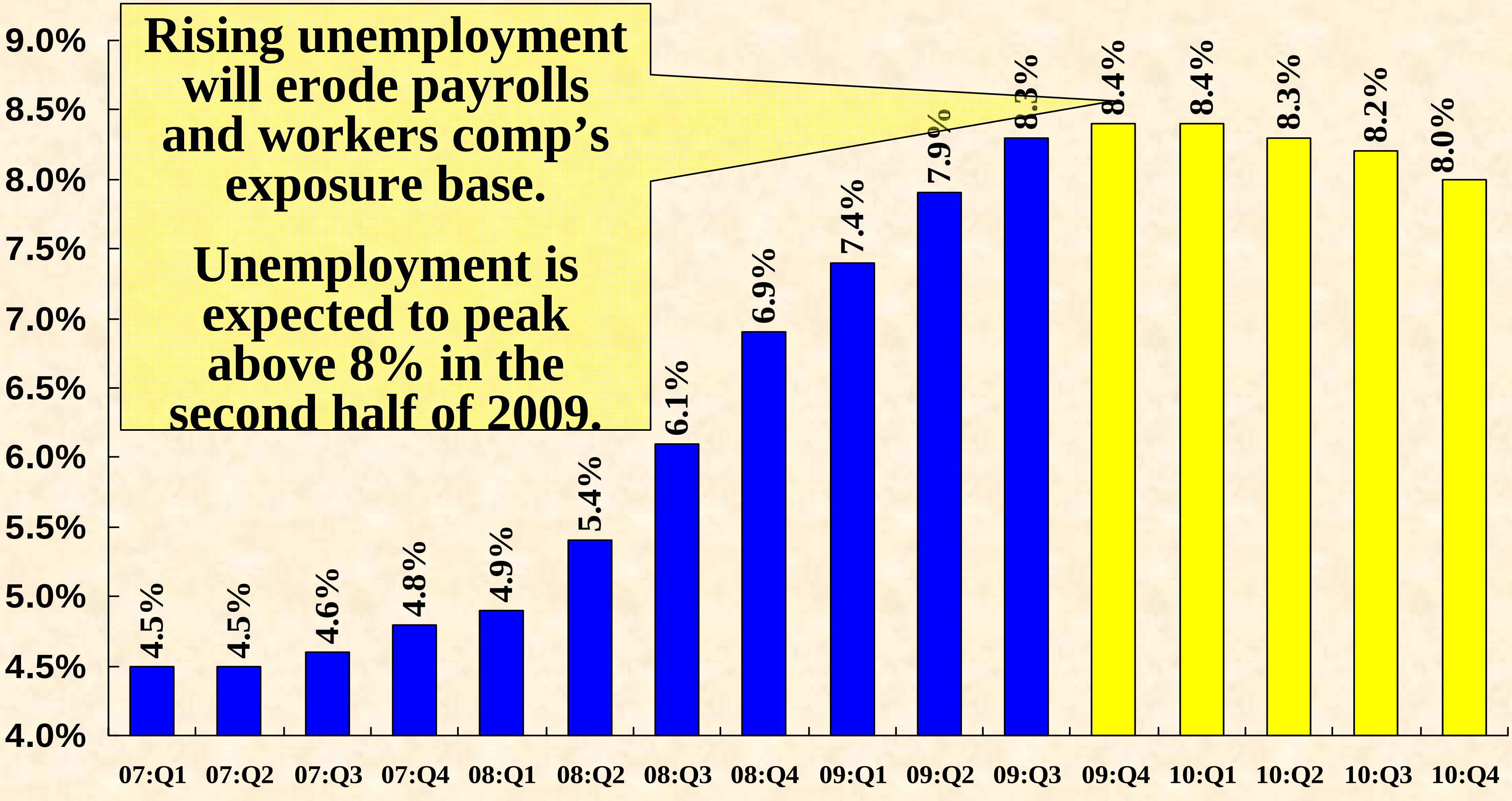
Unemployment Rate: On the Rise

January 2000 through December 2008



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

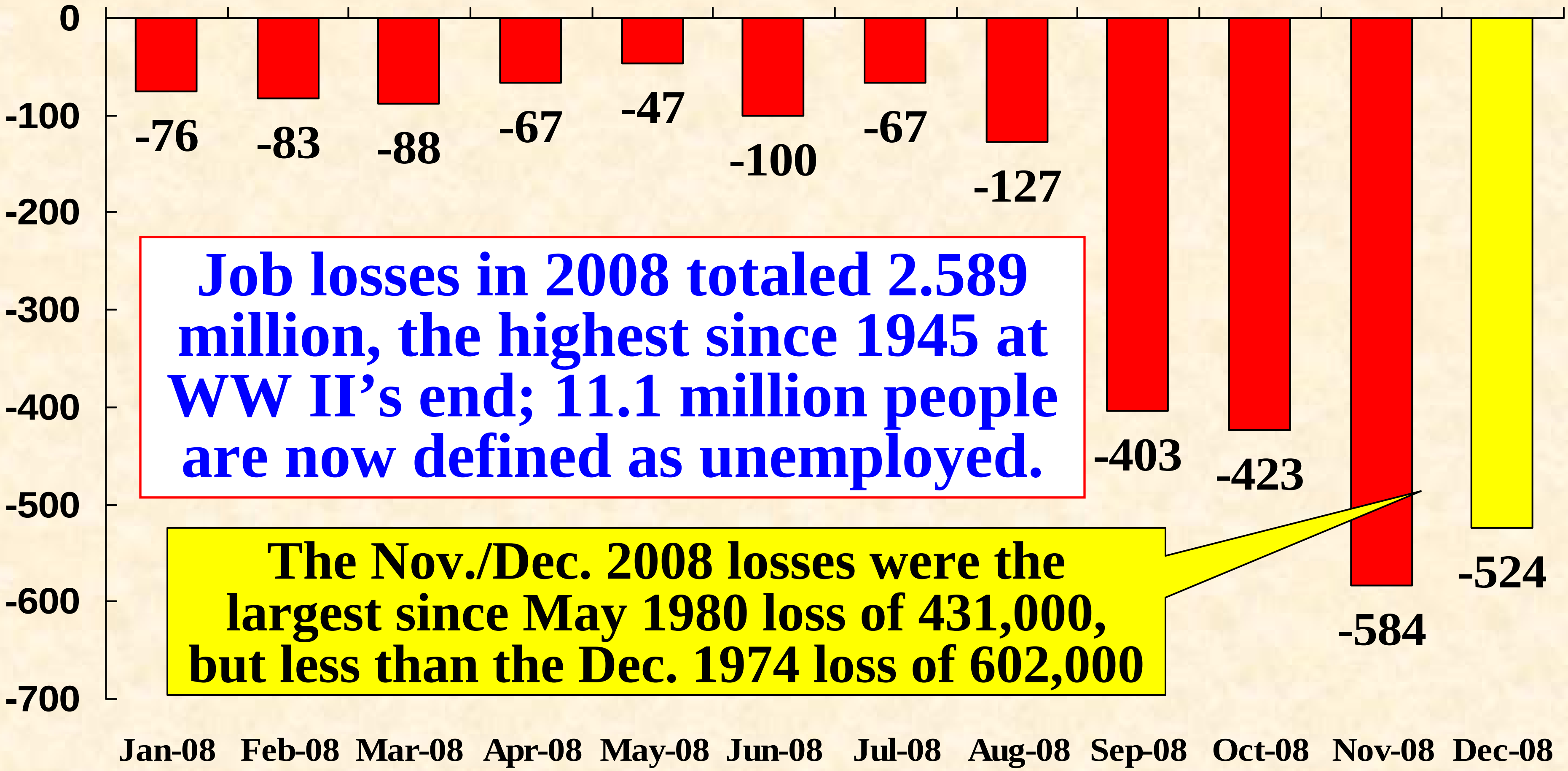
U.S. Unemployment Rate, (2007:Q1 to 2010:Q4F)*



* Blue bars are actual; Yellow bars are forecasts

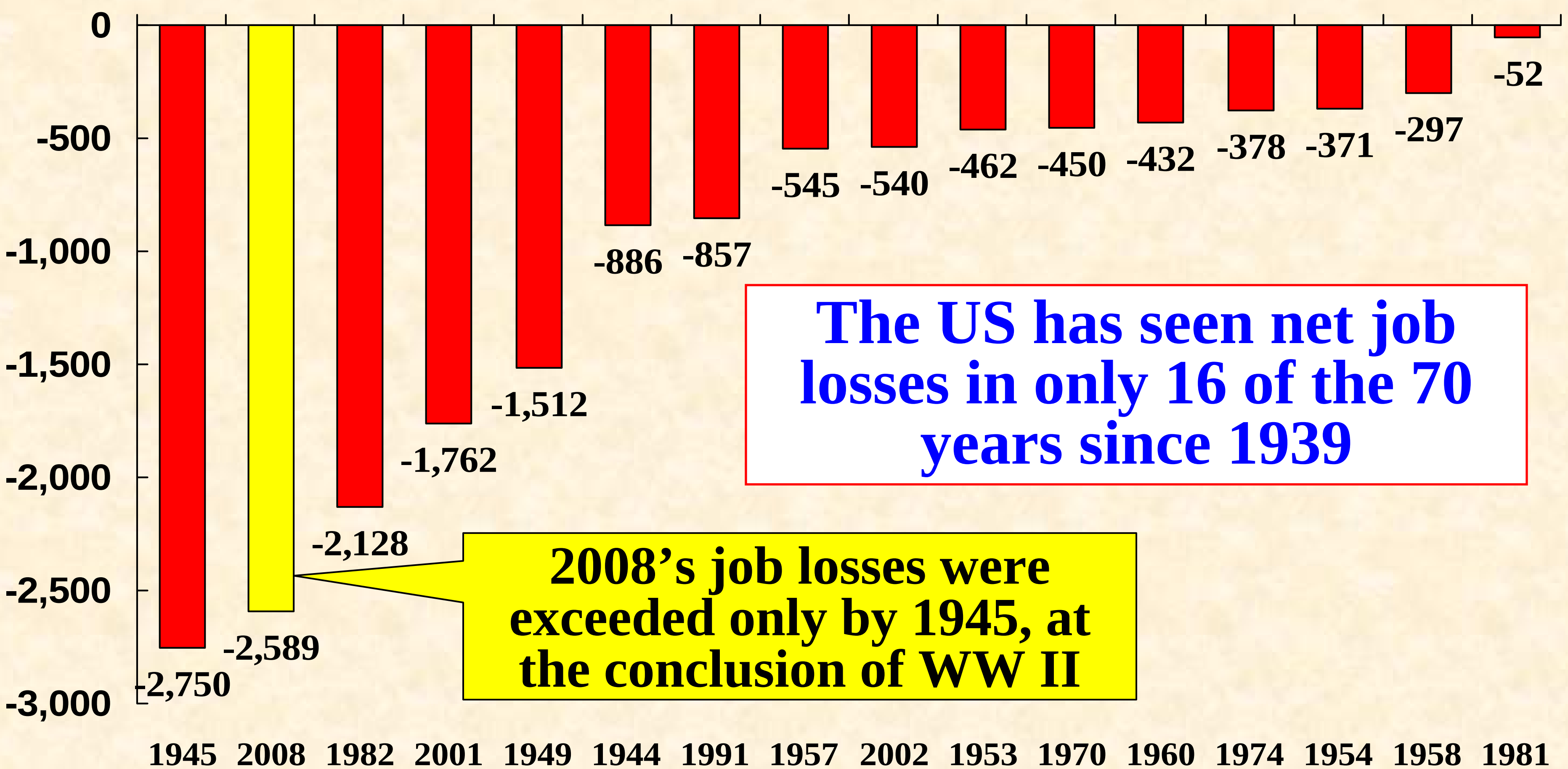
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (1/09); Insurance Info. Inst.

Monthly Change Employment (Thousands)*



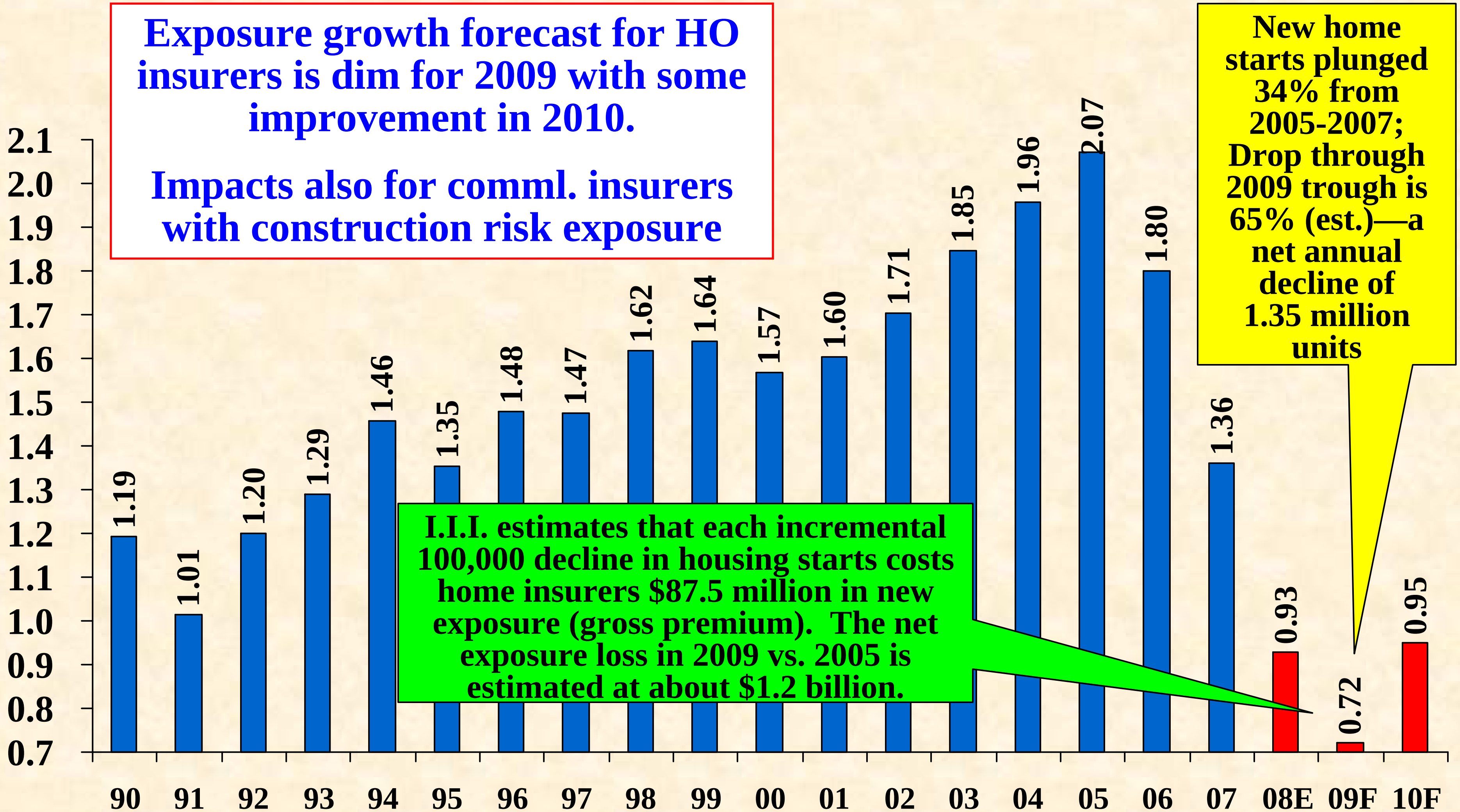
Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Info. Institute

Years With Job Losses: 1939-2008 (Thousands)*



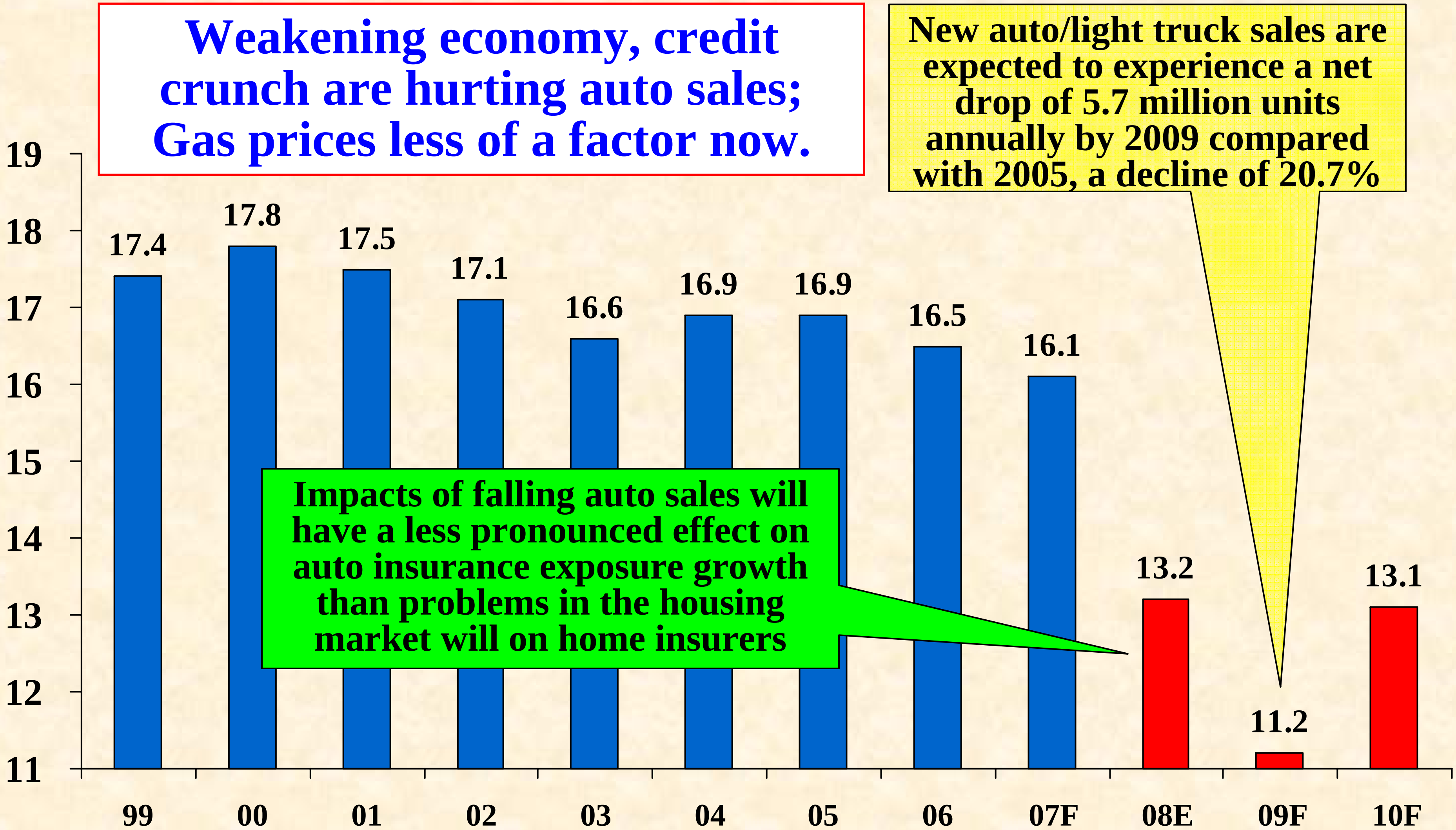
Source: Insurance Information Institute research from US Bureau of Labor Statistics data: http://www.bls.gov/ces/home.htm.

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



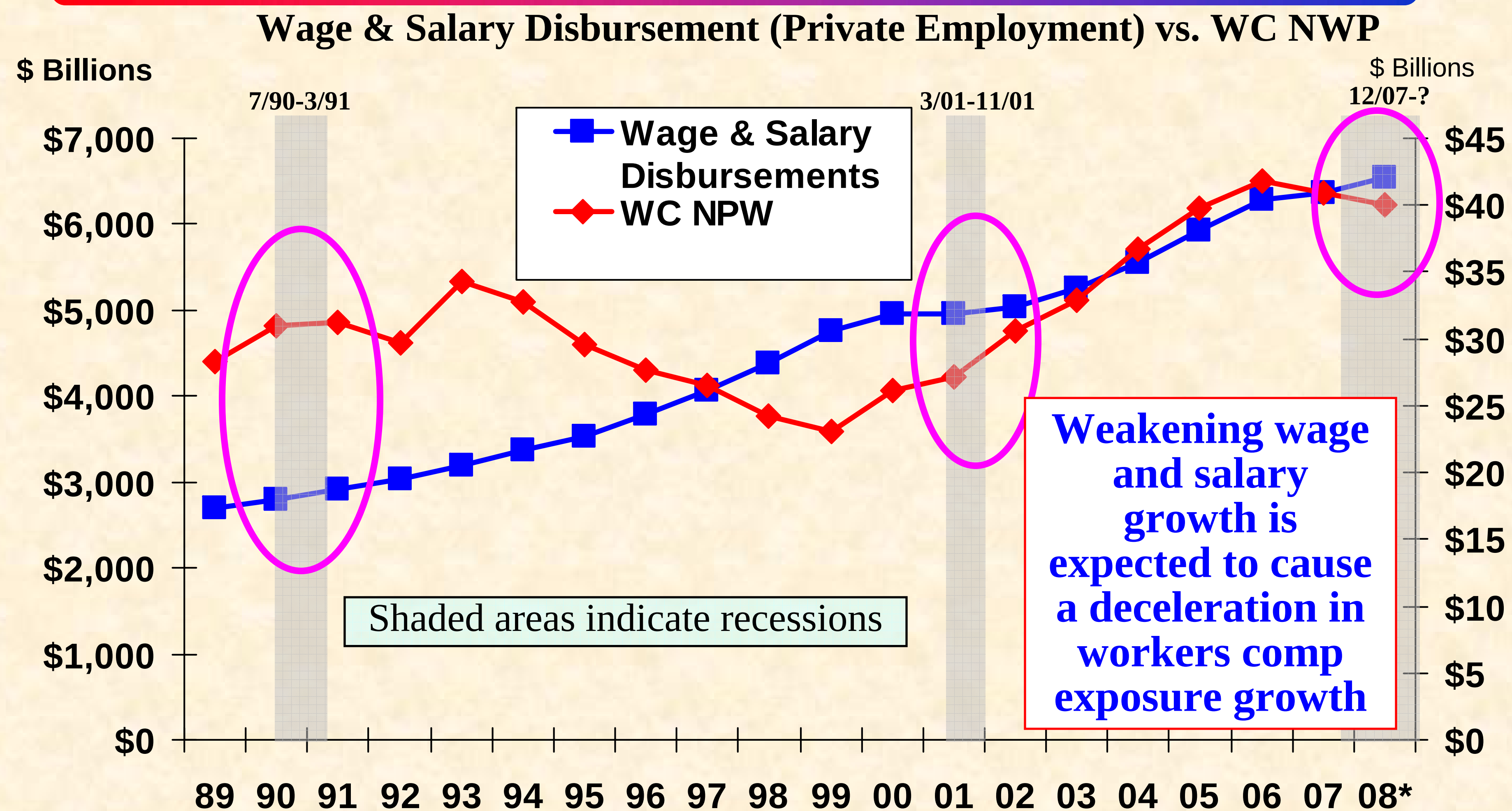
Source: US Department of Commerce; Blue Chip Economic Indicators (1/09); Insurance Information Inst.

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



Source: US Department of Commerce; Blue Chip Economic Indicators (1/09); Insurance Information Inst.

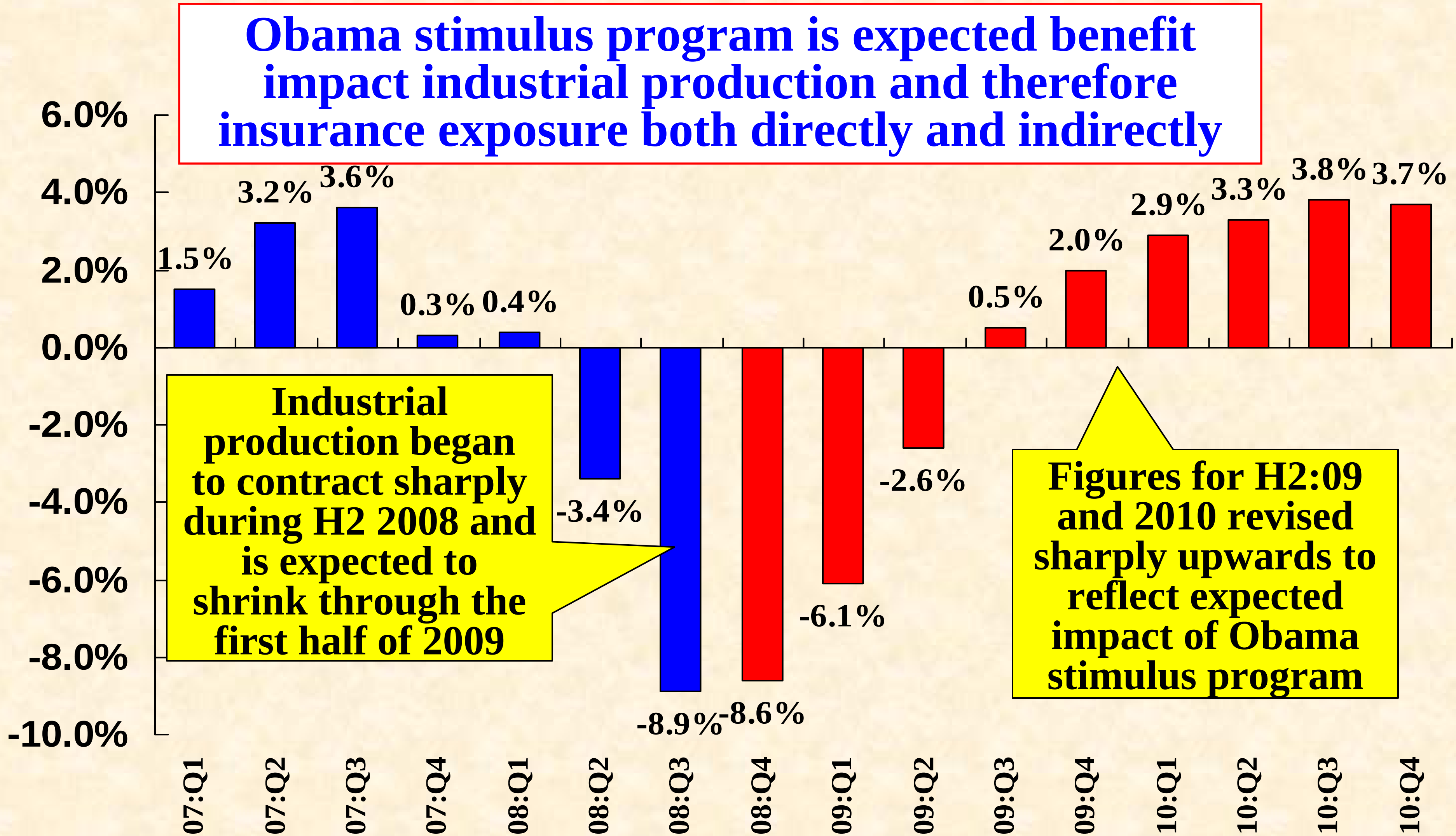
Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums



*9-month data for 2008

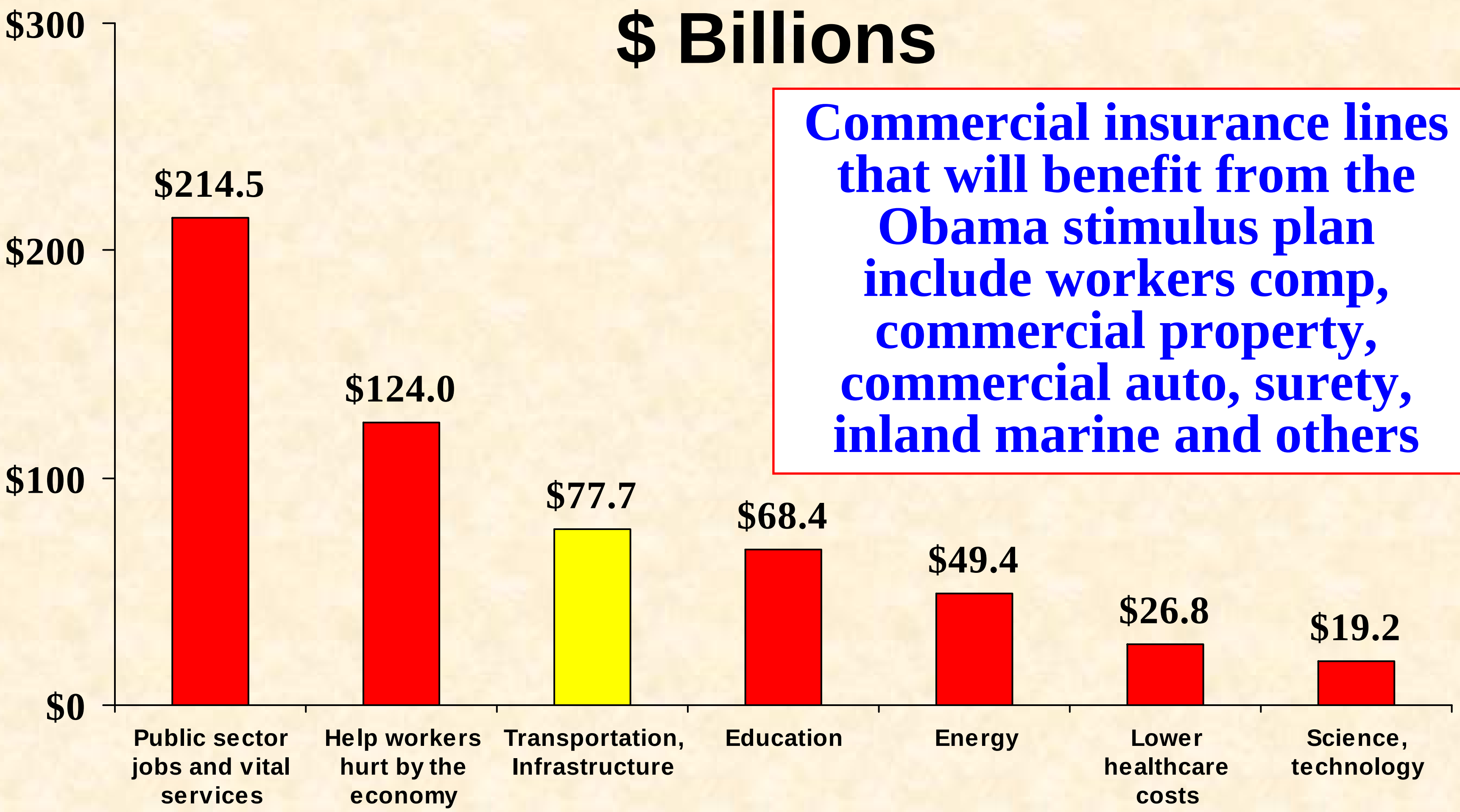
Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR; I.I.I. Fact Books

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



Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (1/09); Insurance Info. Inst.

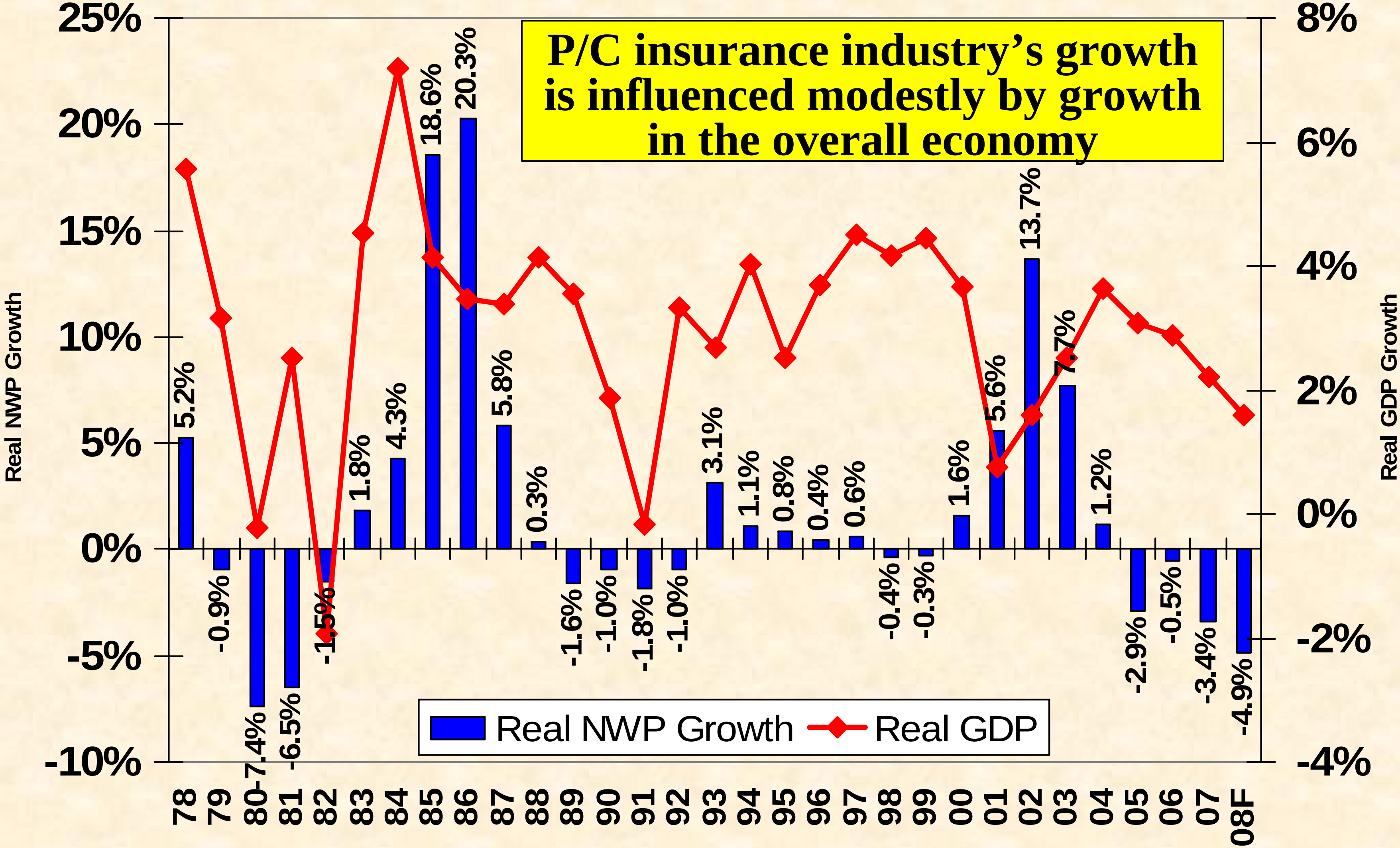
U.S. $825B Economic Stimulus Package, By Category



Commercial insurance lines that will benefit from the Obama stimulus plan include workers comp, commercial property, commercial auto, surety, inland marine and others

Sources: House Appropriations Committee; Wall Street Journal, January 16, 2009

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



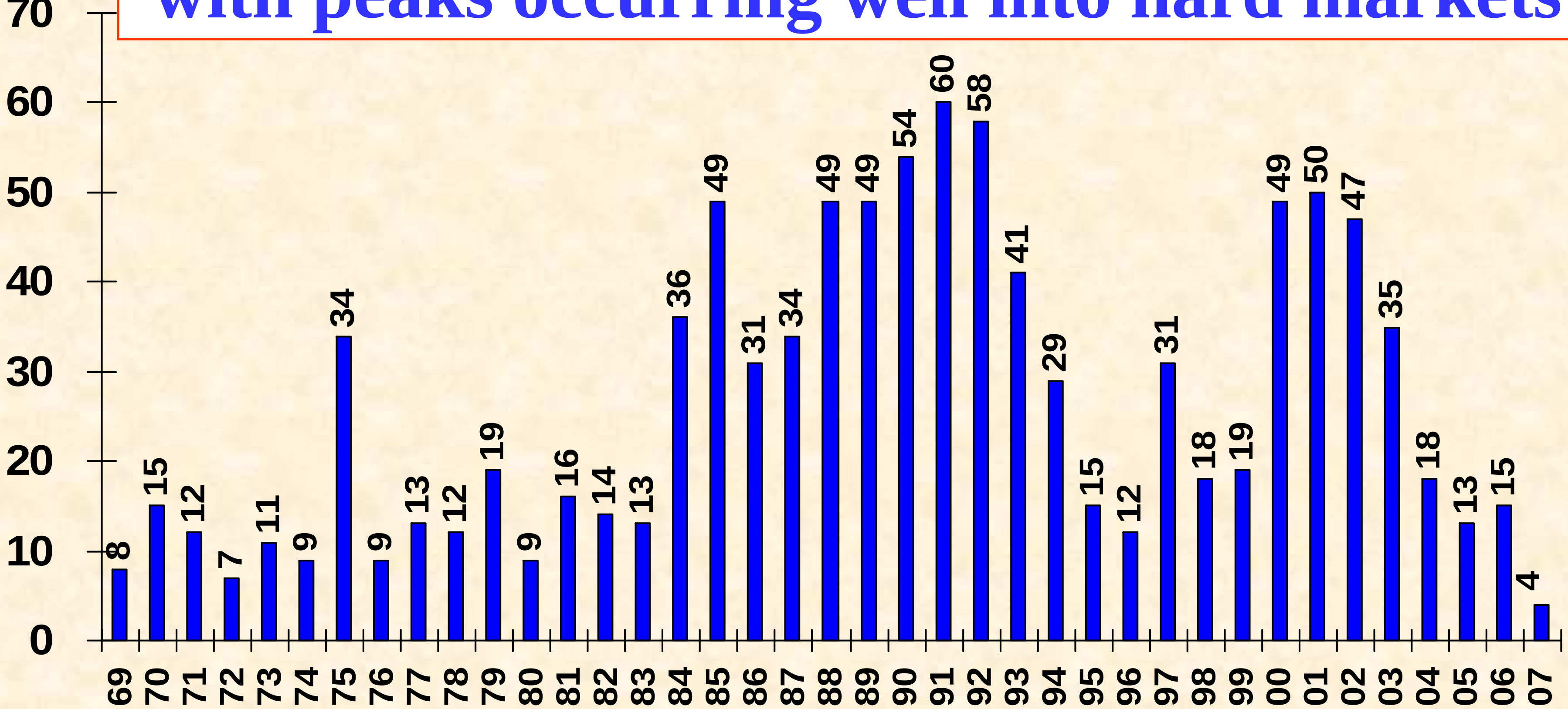
Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 8/08; Insurance Information Inst.

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well

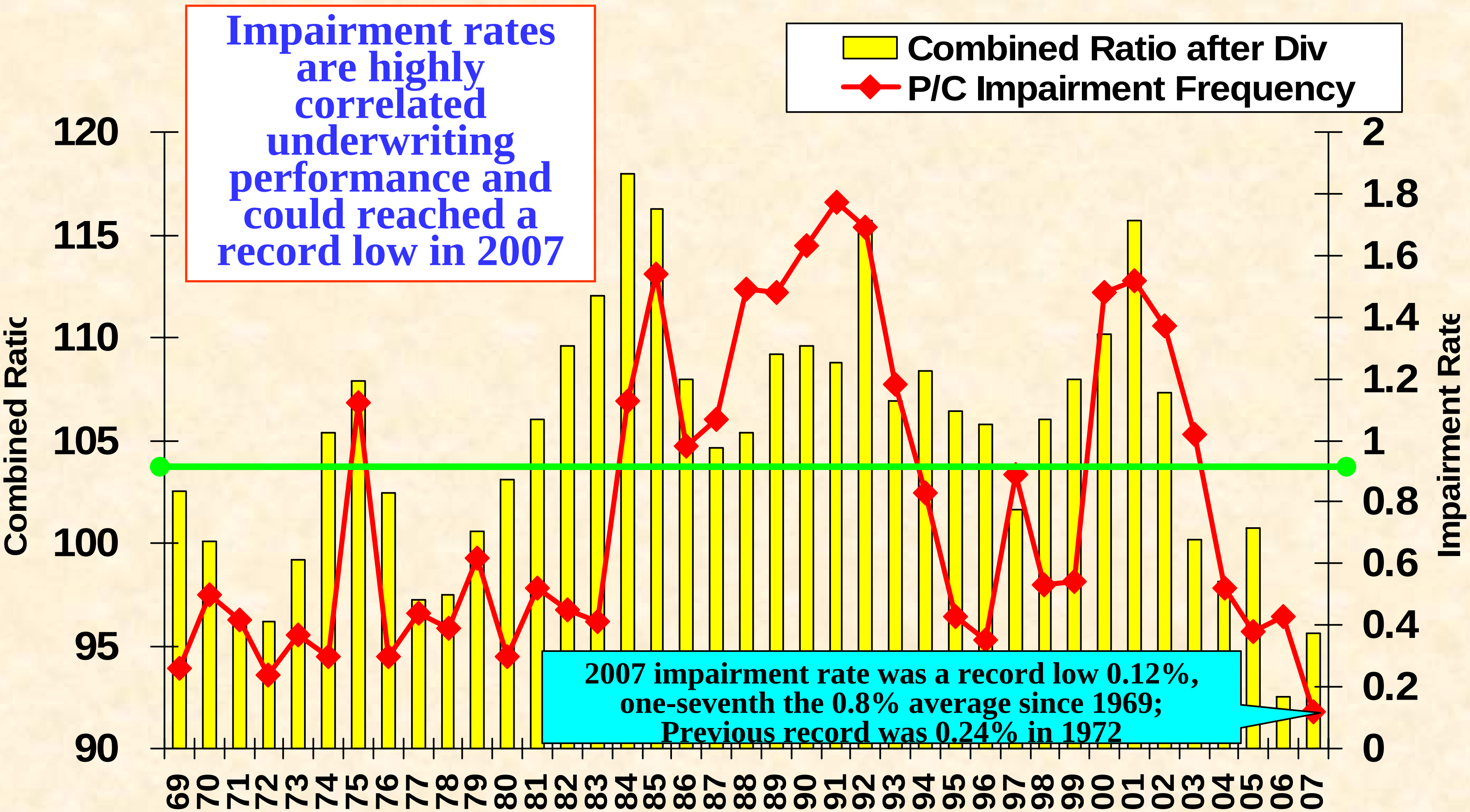
P/C Insurer Impairments, 1969-2007

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



Source: A.M. Best; Insurance Information Institute

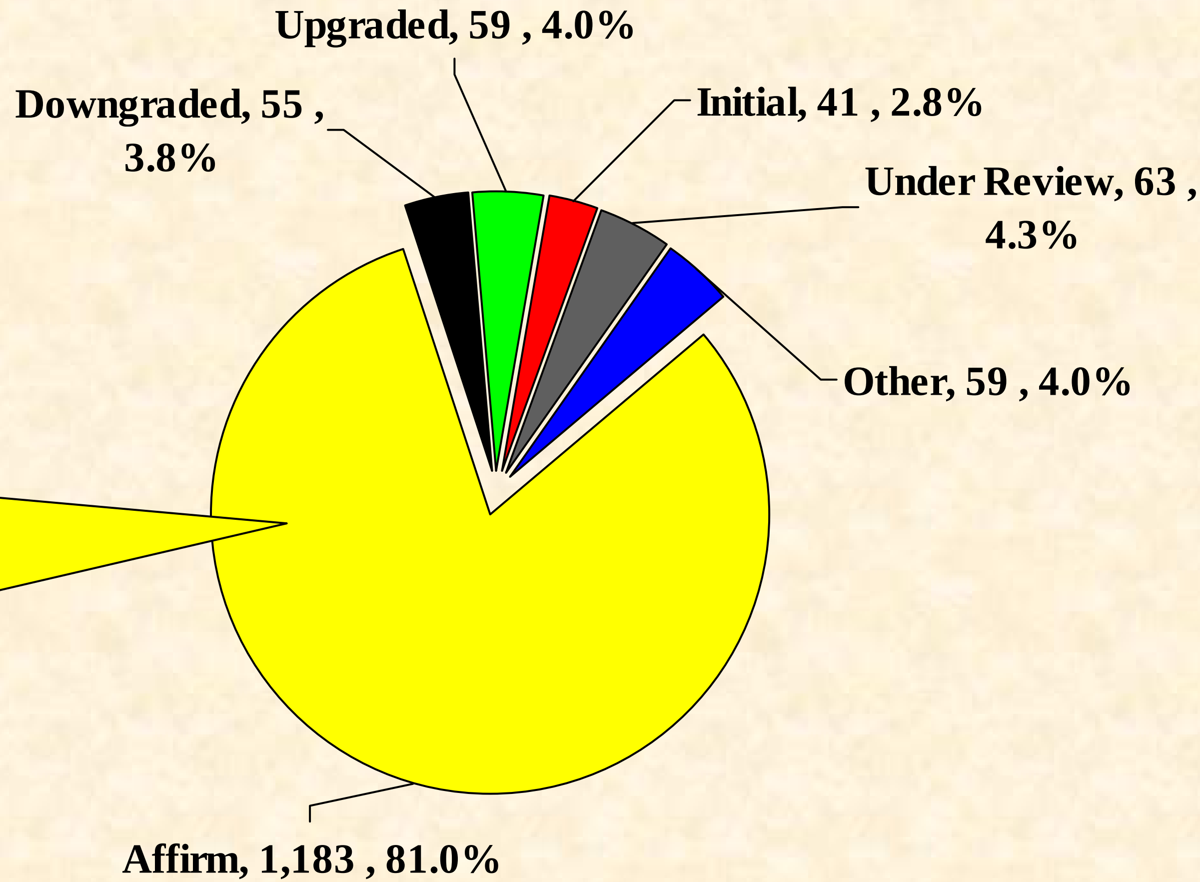
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2007



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.

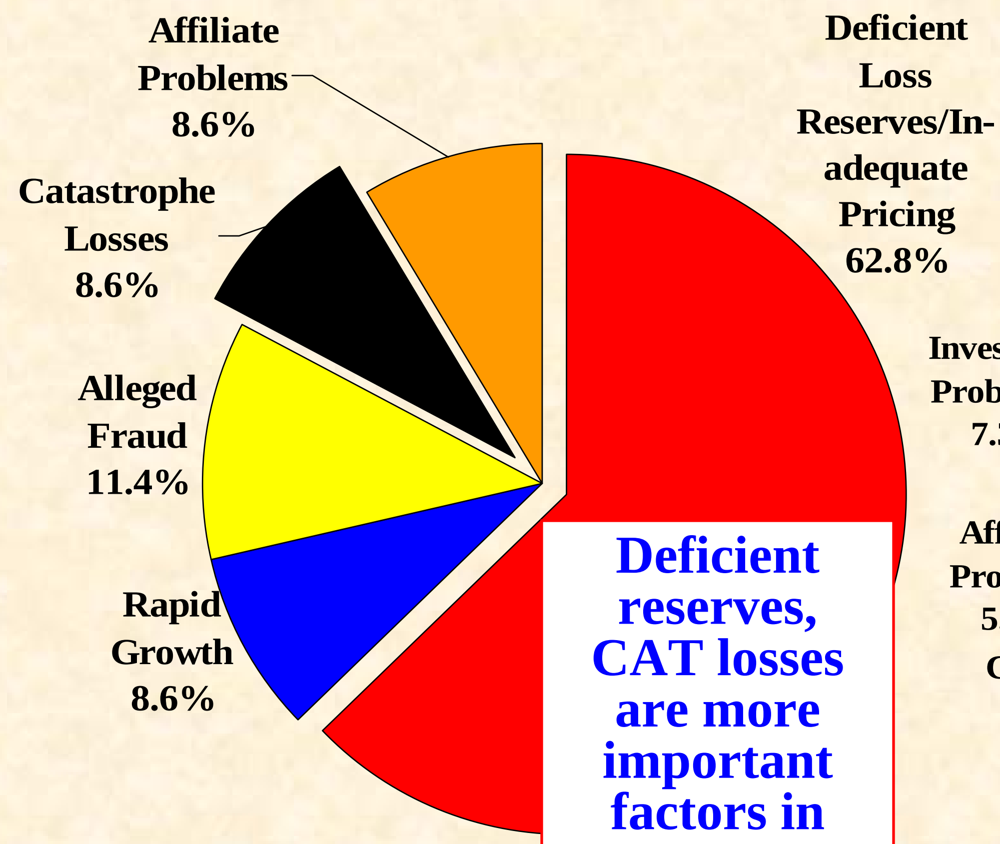


Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades

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

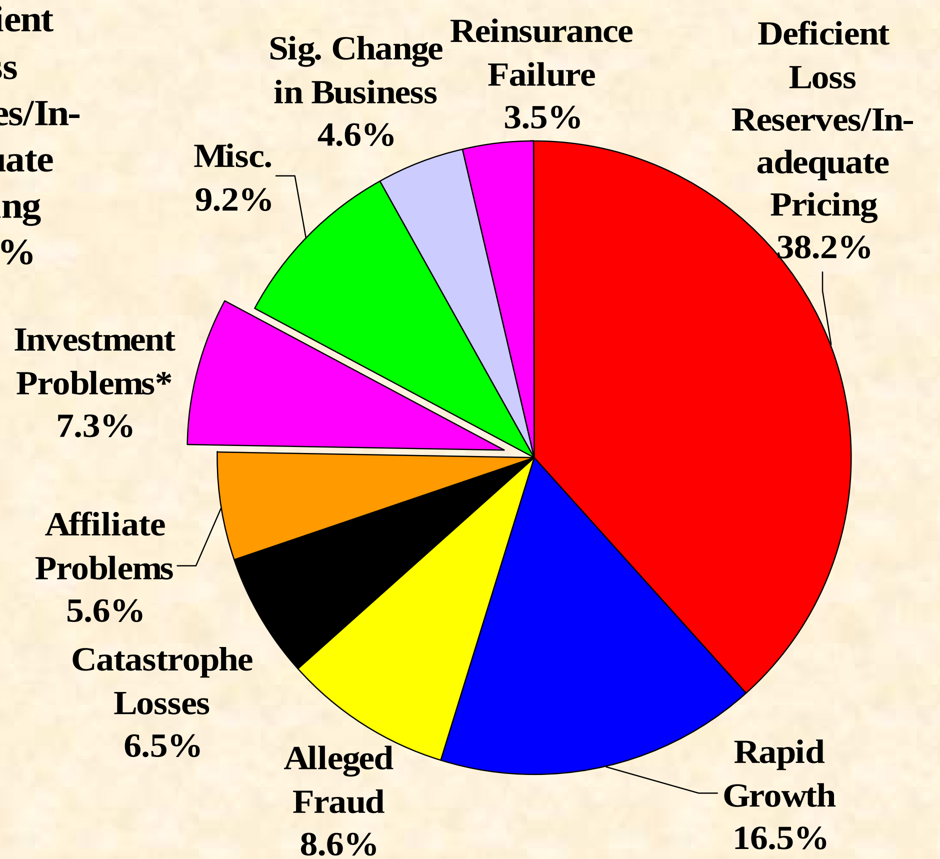
Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



Deficient reserves, CAT losses are more important factors in recent years

1969-2005



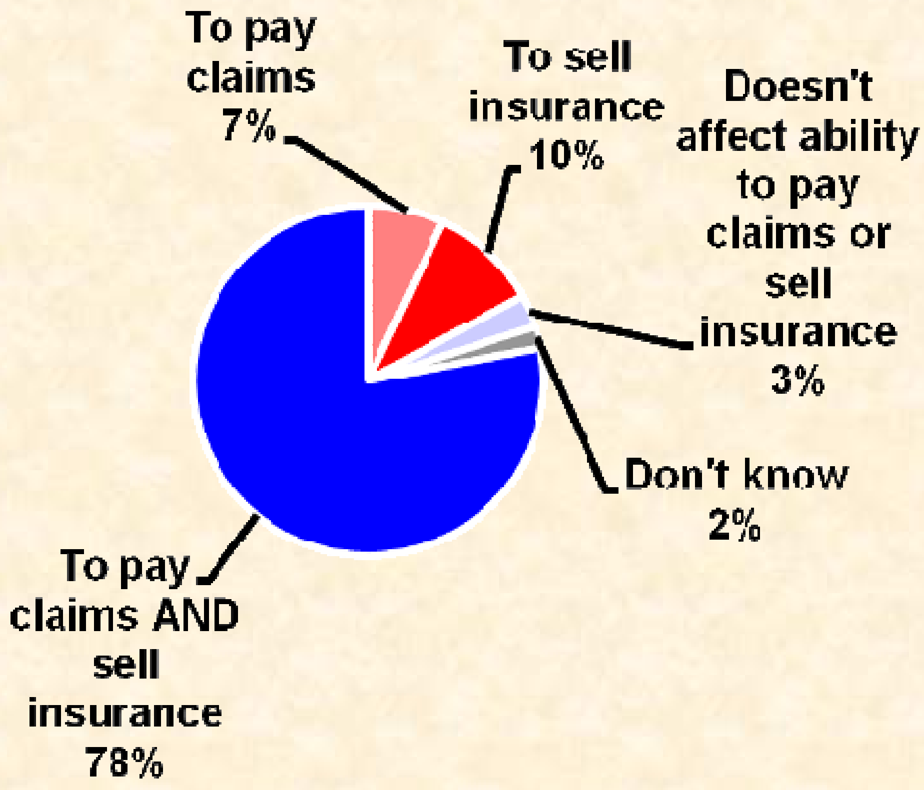
*Includes overstatement of assets.

Source: A.M. Best: *P/C Impairments Hit Near-Term Lows Despite Surging Hurricane Activity*, Special Report, Nov. 2005;

CONSUMER POLL: 2008 I.I.I. PULSE SURVEY

Q. DO YOU THINK THAT THESE PROBLEMS (THE MORTGAGE PROBLEMS SOME AMERICANS FACE, THE DROP IN THE STOCK MARKET AND JOB LAYOFFS) AFFECT THE ABILITY OF INSURANCE COMPANIES TO PAY THEIR CLAIMS, TO SELL MORE INSURANCE, BOTH, NONE OF THESE (DOESN'T AFFECT ABILITY TO PAY CLAIMS OR SELL INSURANCE) OR DON'T KNOW?

95% Americans think that the downturn in the economy affects the basic business of the insurance industry: the ability to pay claims and/or sell insurance



Source: Insurance Information Institute, 2008 *Pulse* Survey, November 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 27 banks have gone under)**
    - ***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

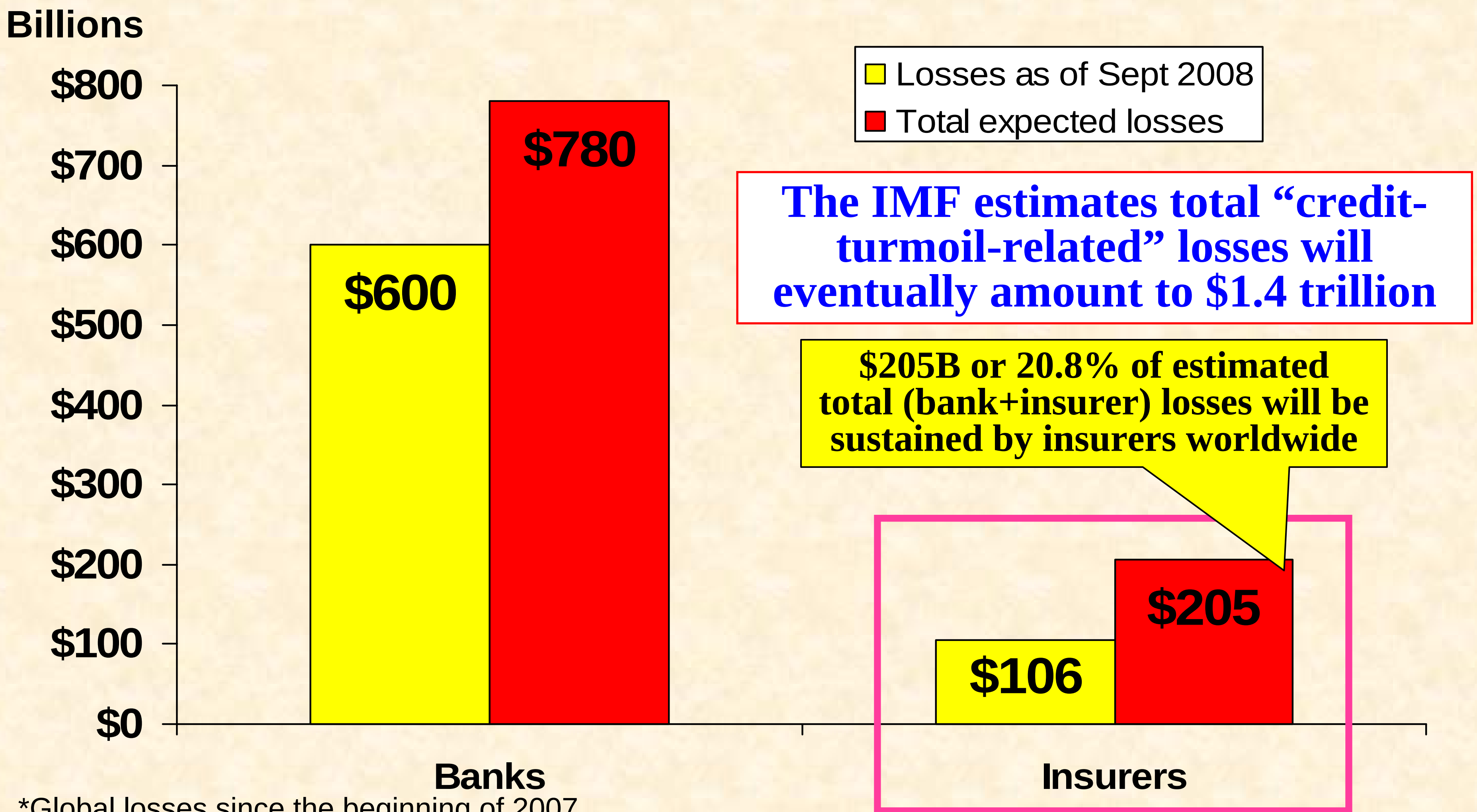
- ***Emphasis on Underwriting***
  - **Matching of risk to price (via experience and modeling)**
  - **Limiting of potential loss exposure**
  - ***Some banks sought to maximize volume and fees and disregarded risk***
- ***Strong Relationship Between Underwriting and Risk Bearing***
  - **Insurers always 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

The Financial Crisis in Perspective

Bank vs. Insurer Impacts

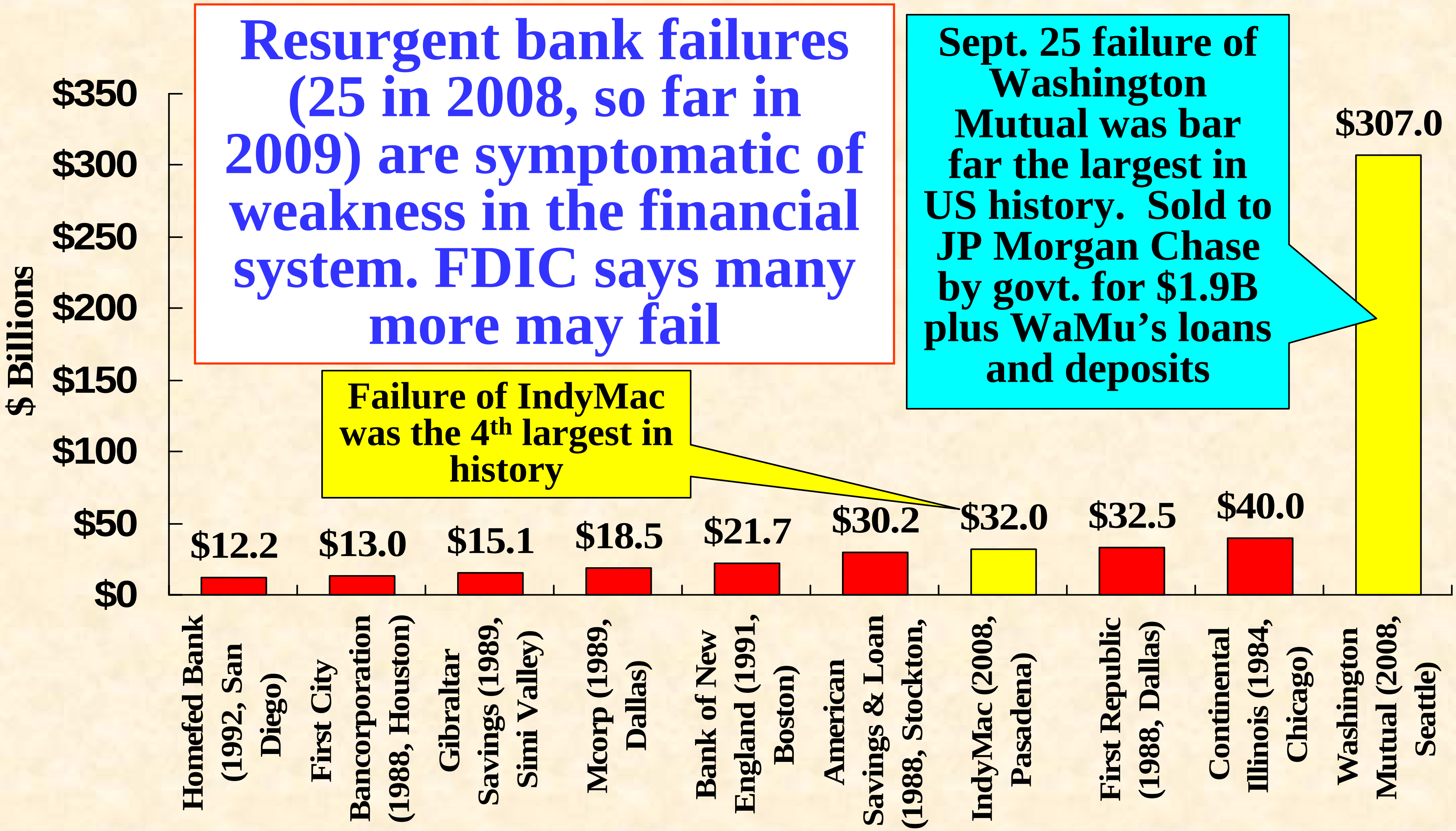
*Financial Institutions Globally Facing Huge Losses from the Credit Crunch**



*Global losses since the beginning of 2007.

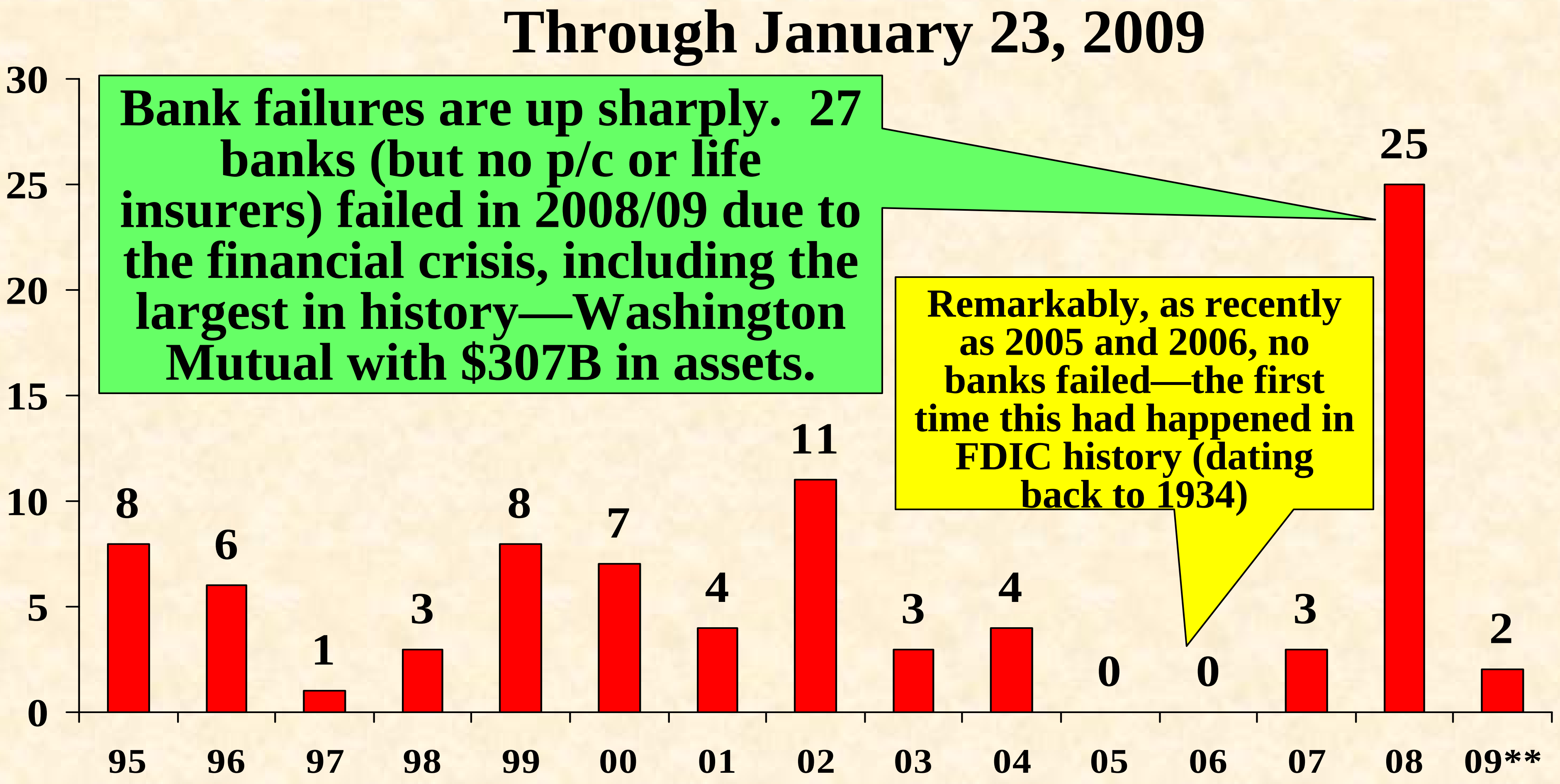
Source: IMF Global Financial Stability Report, October 2008, IIF, Bloomberg, cited in a presentation by Thomas Hess (Chief Economist, Swiss Re) October 23, 2008, accessed via Geneva Association web site.

Top 10 Largest Bank Failures



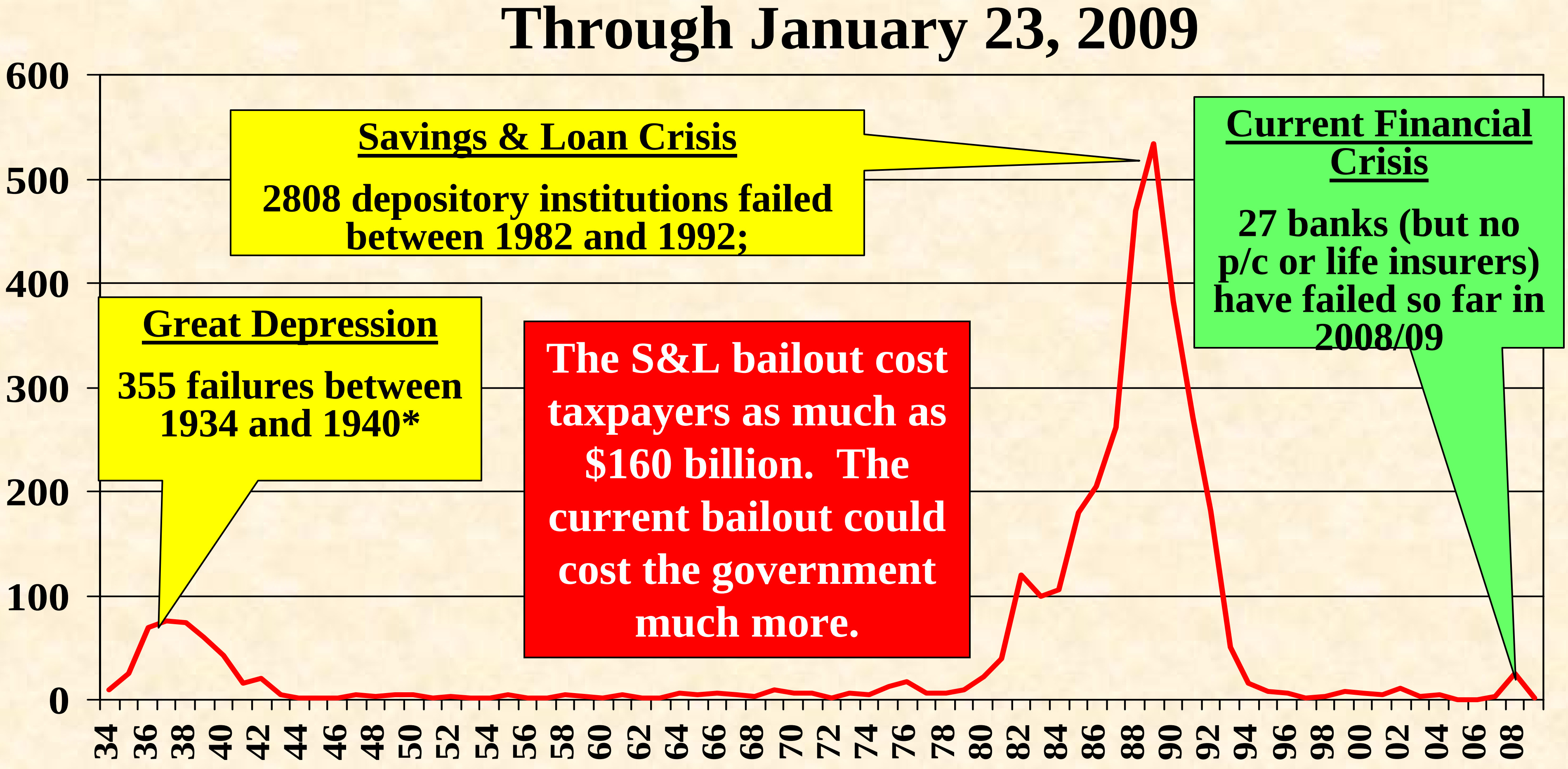
Source: FDIC; Insurance Information Institute research.

US Bank Failures:* 1995-2009**



*Includes all commercial banking and savings institutions. **Through Jan. 23.
Source: FDIC: http://www.fdic.gov/bank/historical/bank/index.html; Insurance Info. Institute

US Bank Failures:* 1934-2009**

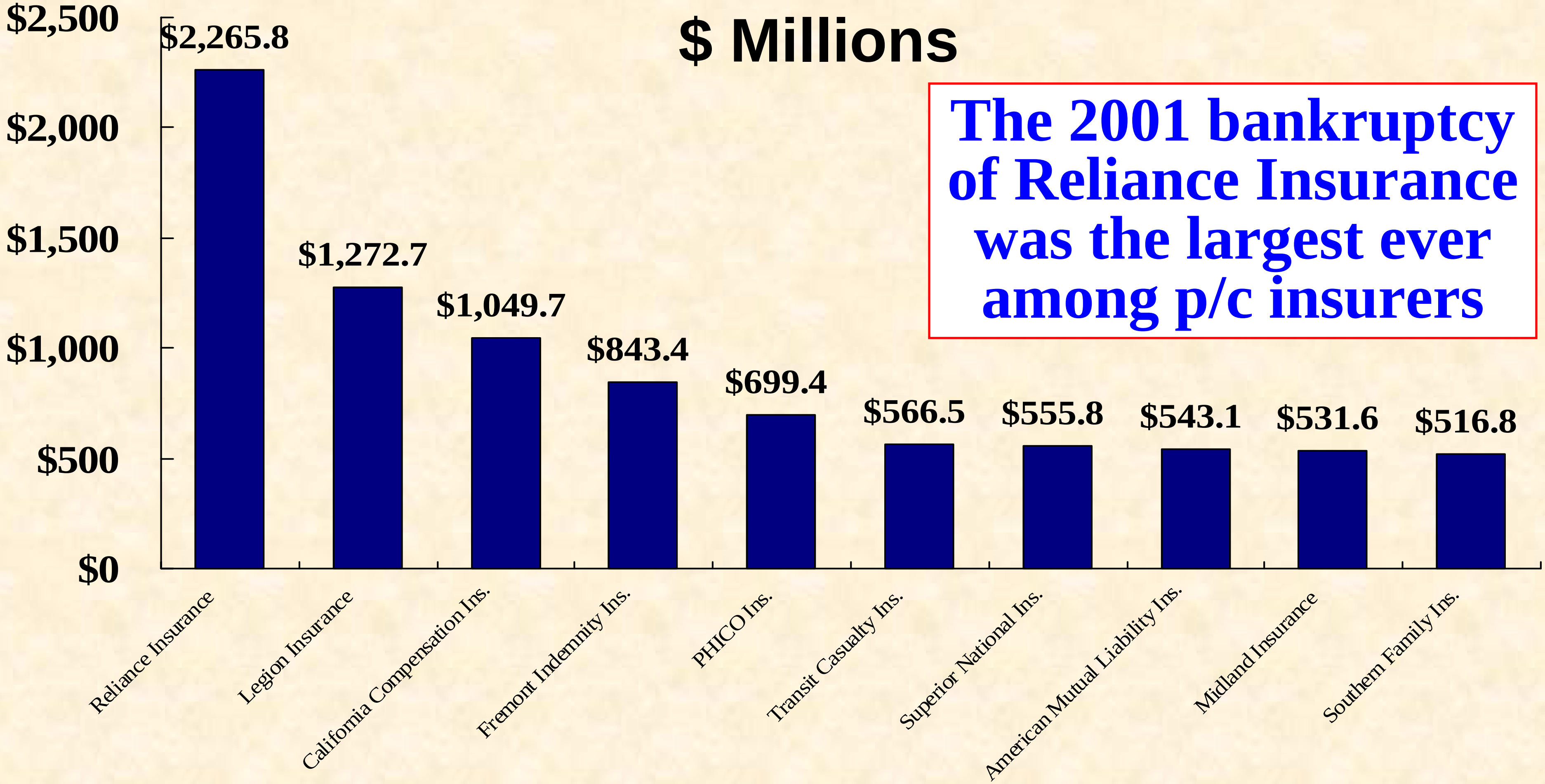


*Includes all commercial banking and savings institutions.

**Data begin in 1934, the year the FDIC was established.

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.

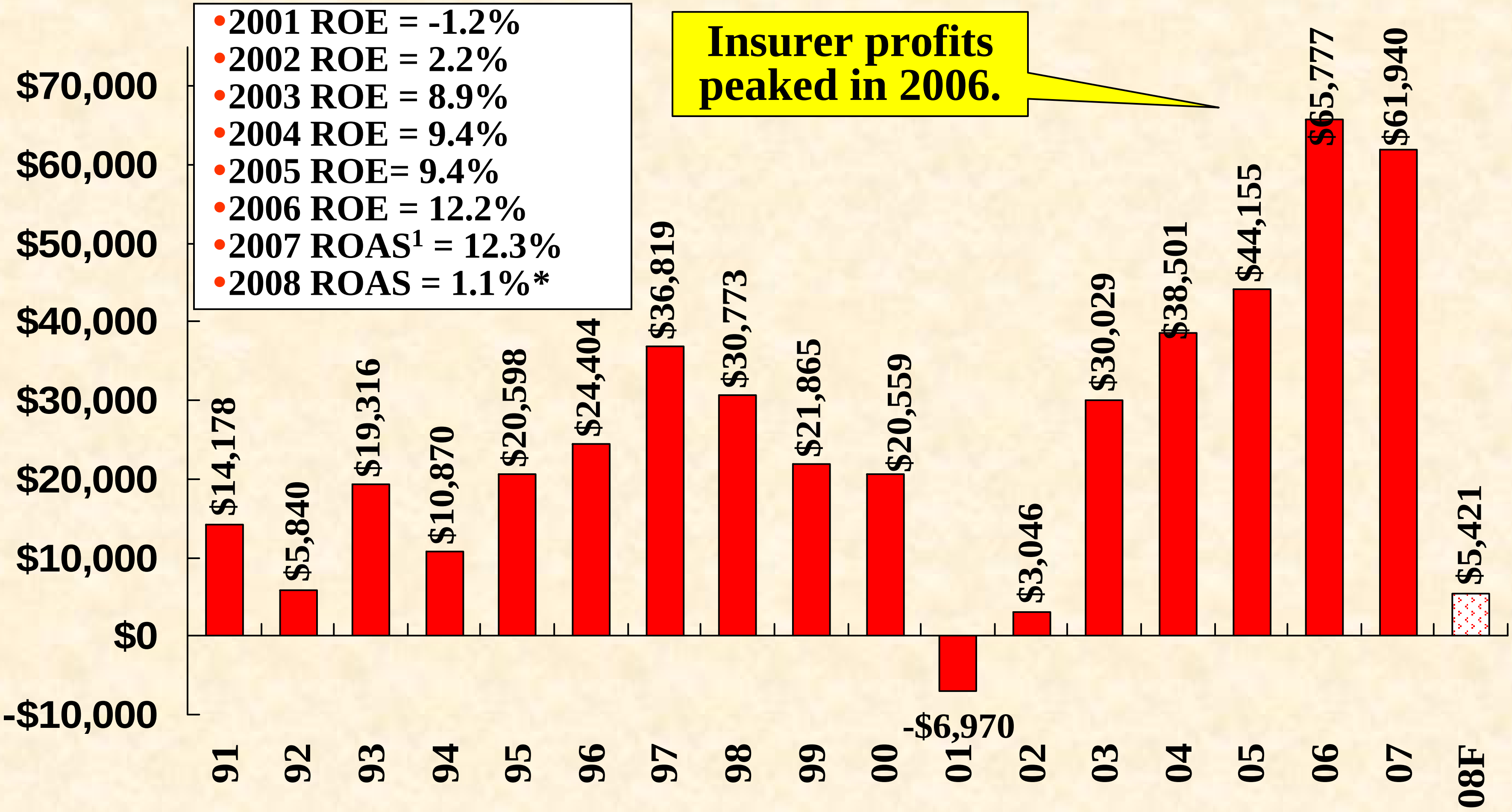
P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

Historically Volatile

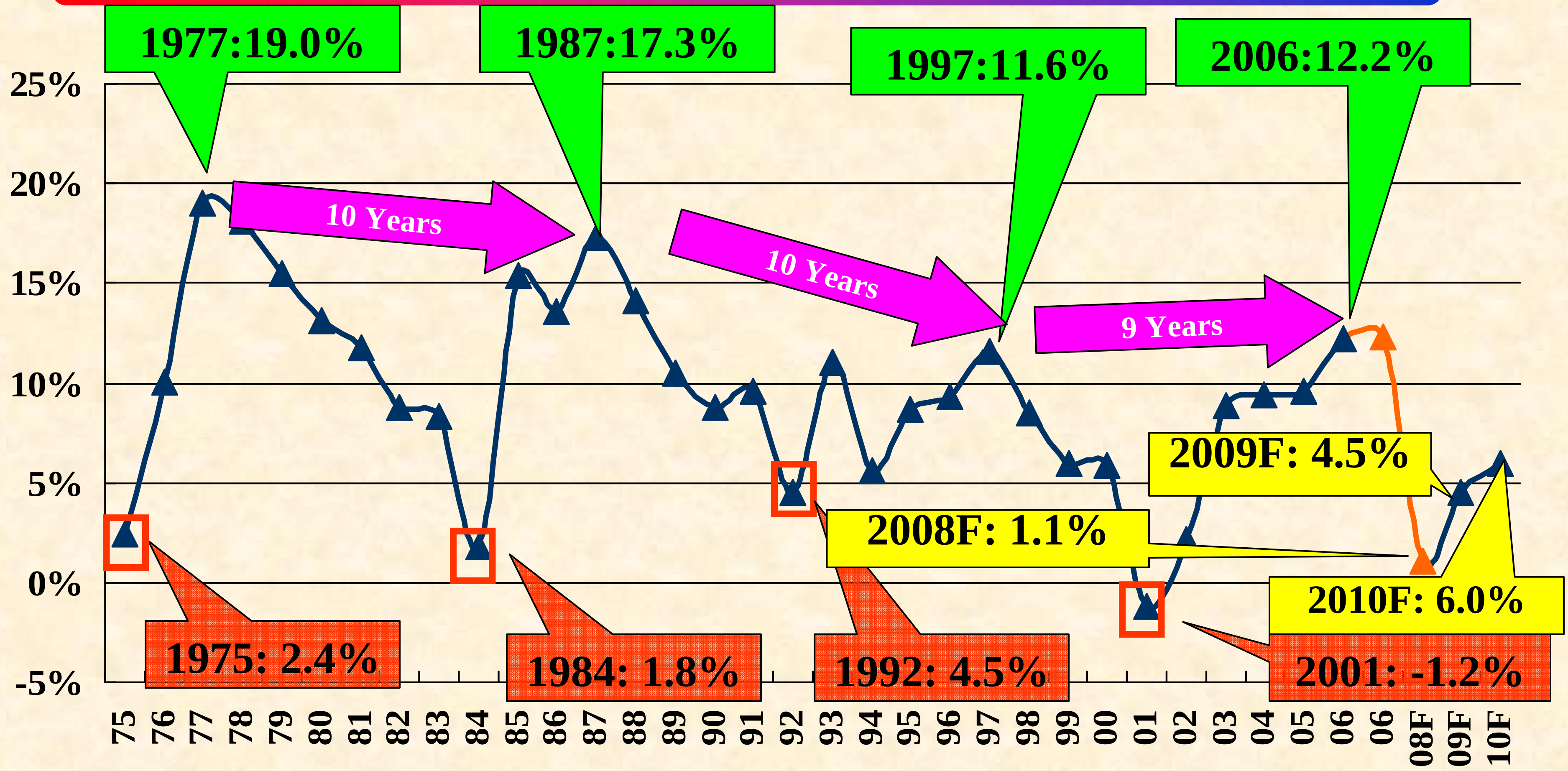
P/C Net Income After Taxes 1991-2009F ($ Millions)*



***ROE figures are GAAP; [1]Return on avg. surplus. 2008 numbers are annualized based on 9-mos. Actual of $4.066 billion.**

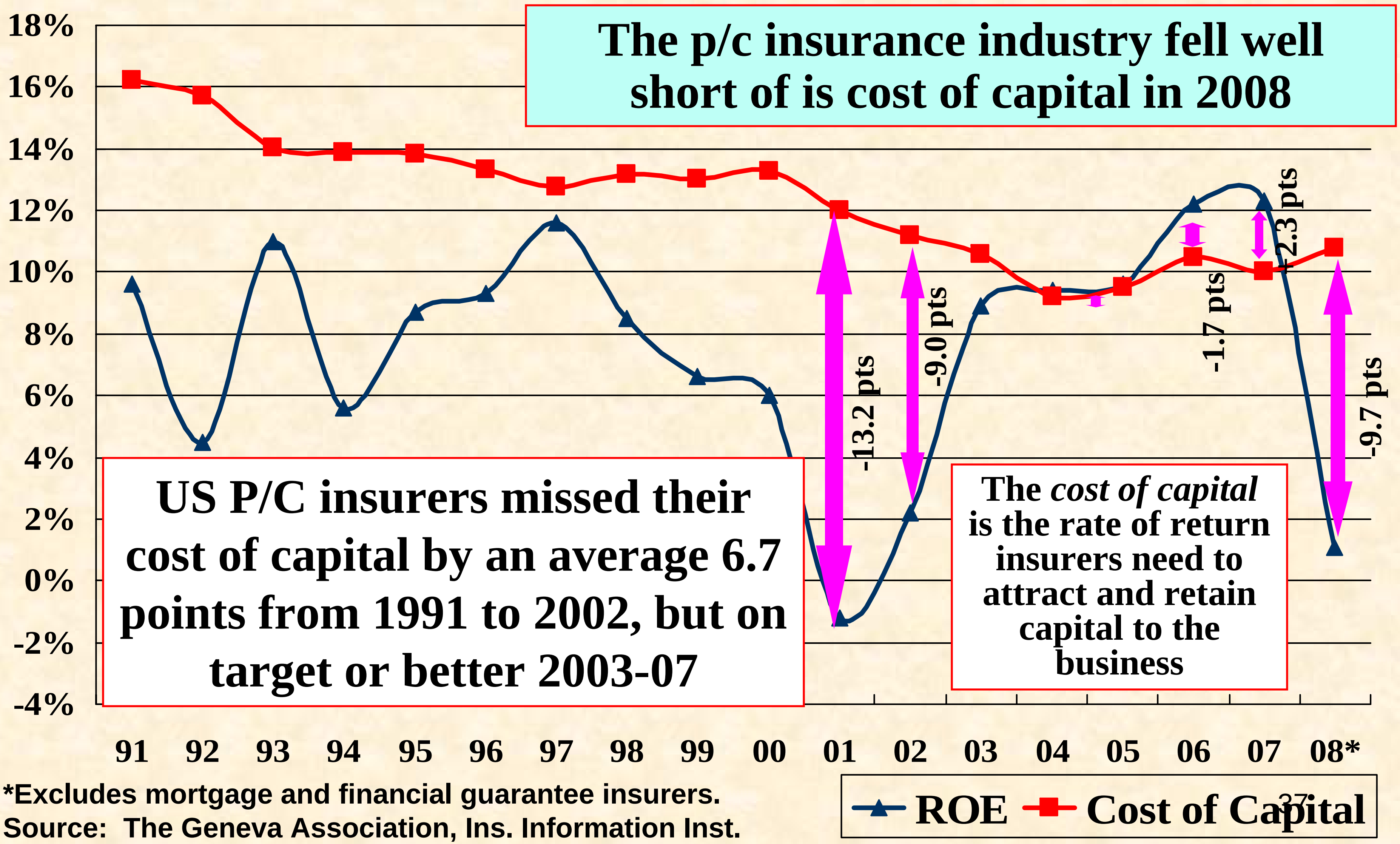
Sources: A.M. Best, ISO, Insurance Information Inst.

*P/C Insurance Industry ROEs, 1975 – 2010F**



Note: 2009 figure is actual 9-month result.
Sources: ISO; Insurance Information Institute.

ROE vs. Equity Cost of Capital: US P/C Insurance:1991-2008:Q3

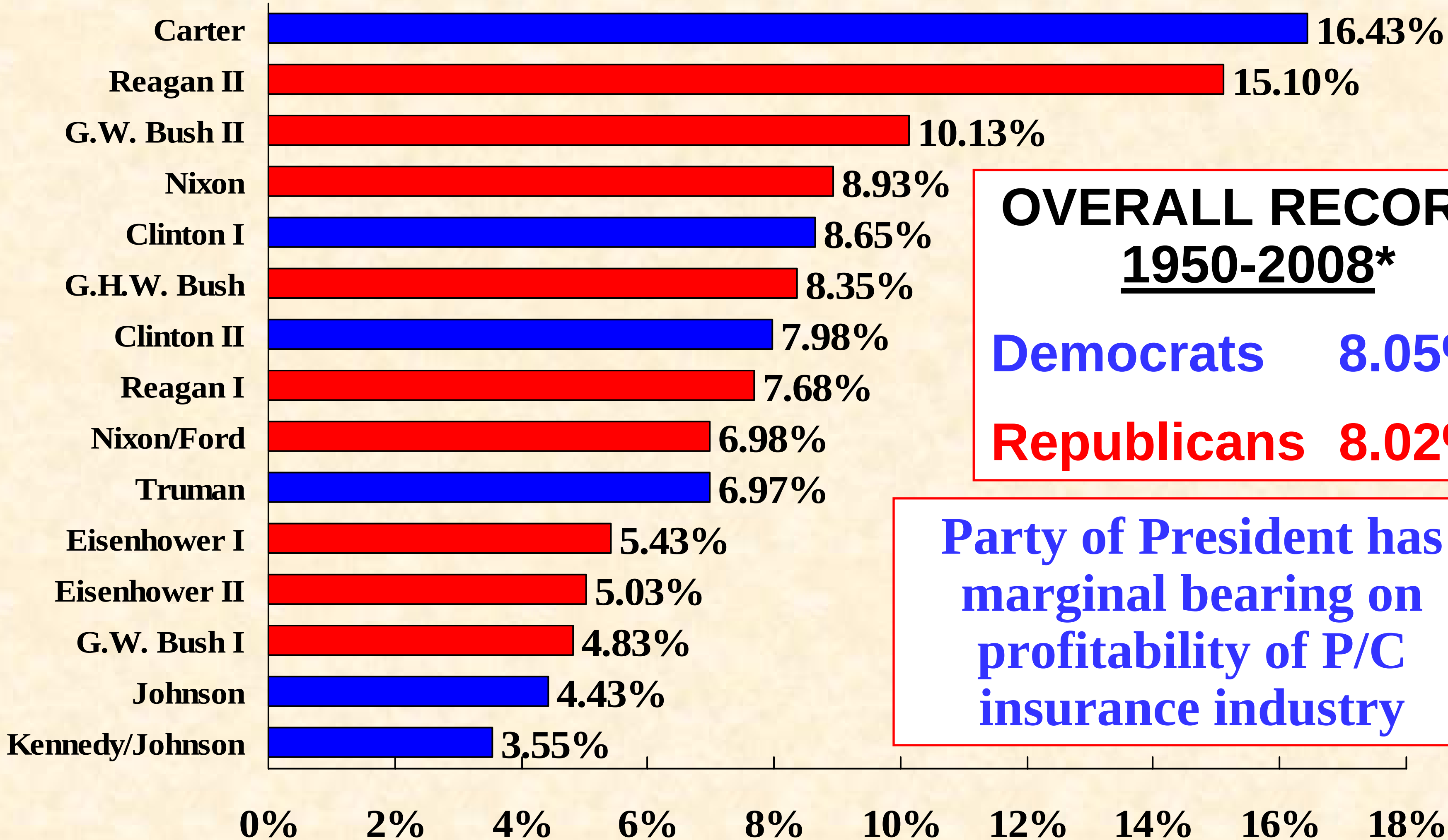


*Excludes mortgage and financial guarantee insurers.
Source: The Geneva Association, Ins. Information Inst.

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*



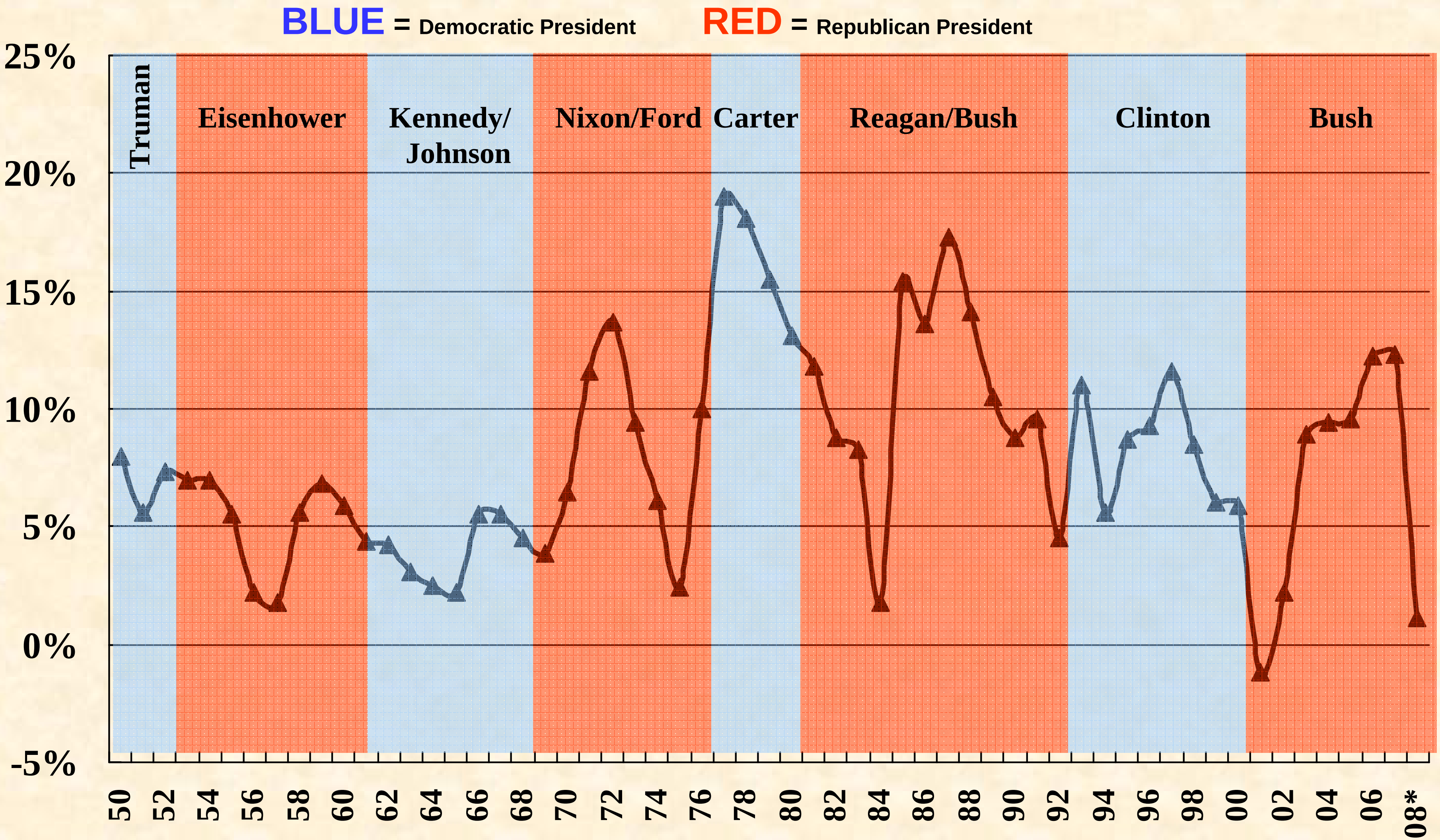
OVERALL RECORD: 1950-2008*

Democrats	8.05%
Republicans	8.02%

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

*ROE for 2008 based on H1 data. Truman administration ROE of 6.97% based on 3 years only, 1950-52.
Source: Insurance Information Institute

P/C Insurance Industry ROE by Presidential Party Affiliation, 1950–2008*



Source: Insurance Information Institute. *2008 based 9-month data.

Investment Performance

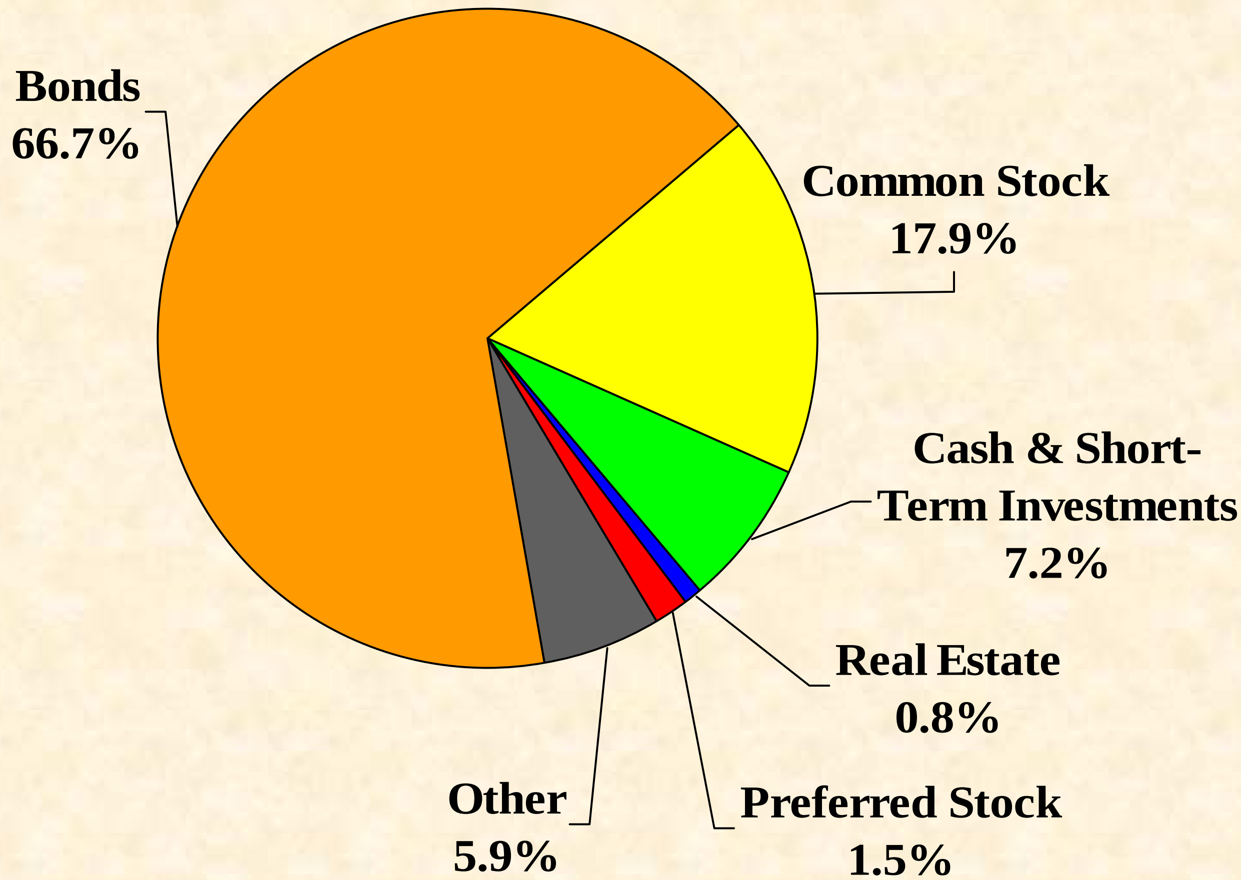
Investments are the Principle Source of Declining Profitability

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2007

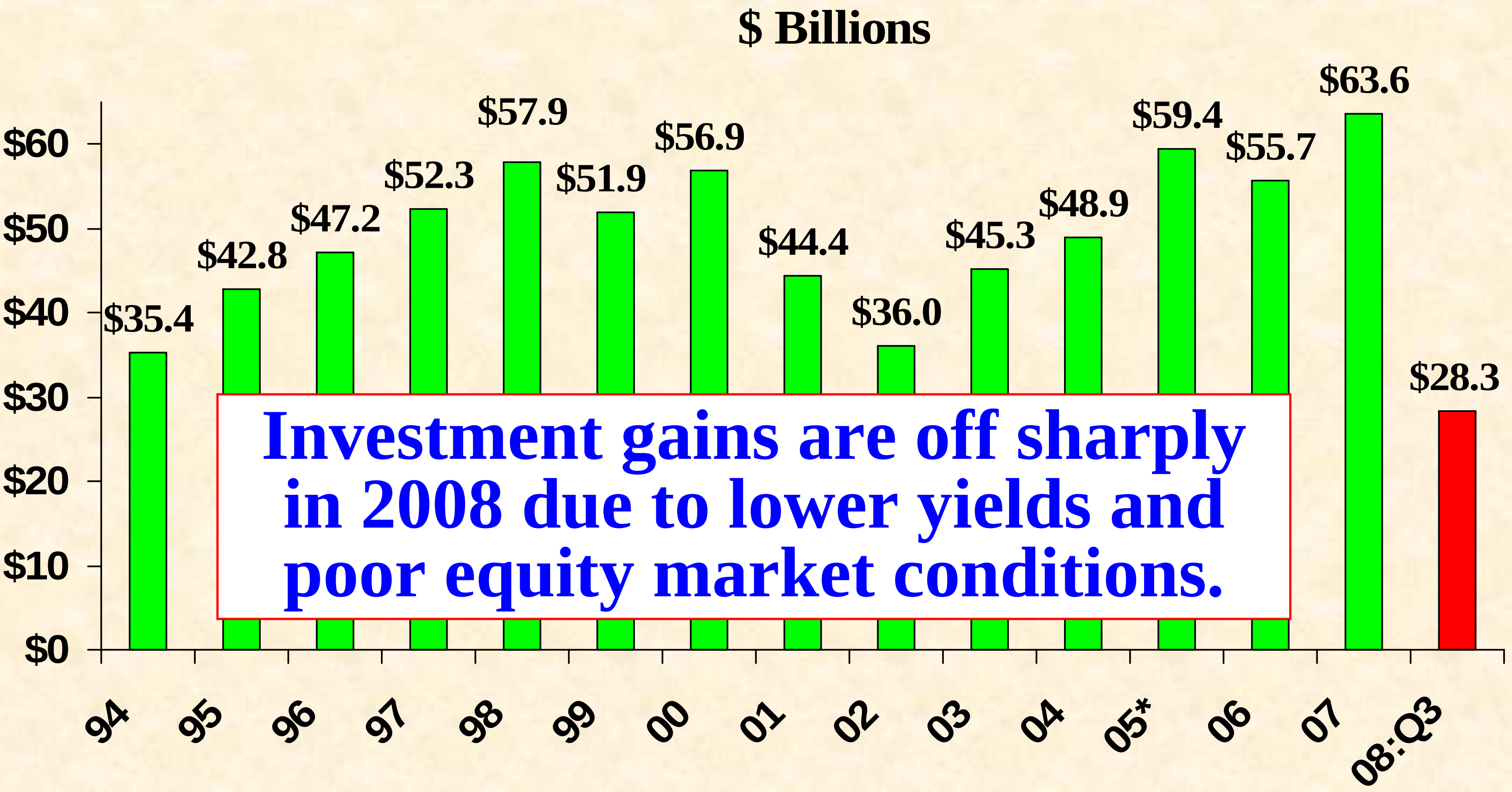
Portfolio Facts

- 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:Q3 [1]

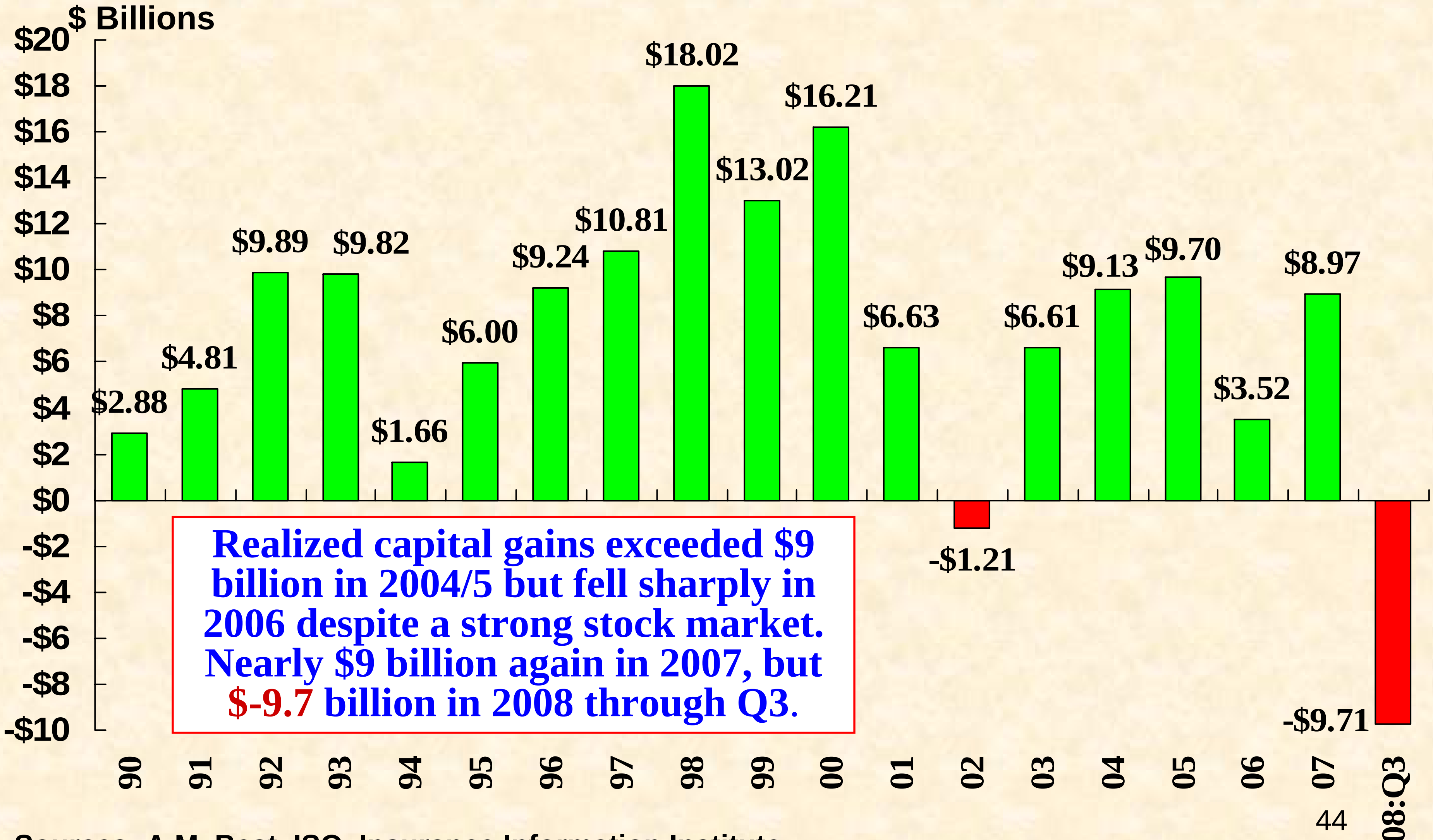


[1]Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of $52.3B net investment income and $3.4B realized investment gain.

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

Sources: ISO; Insurance Information Institute.

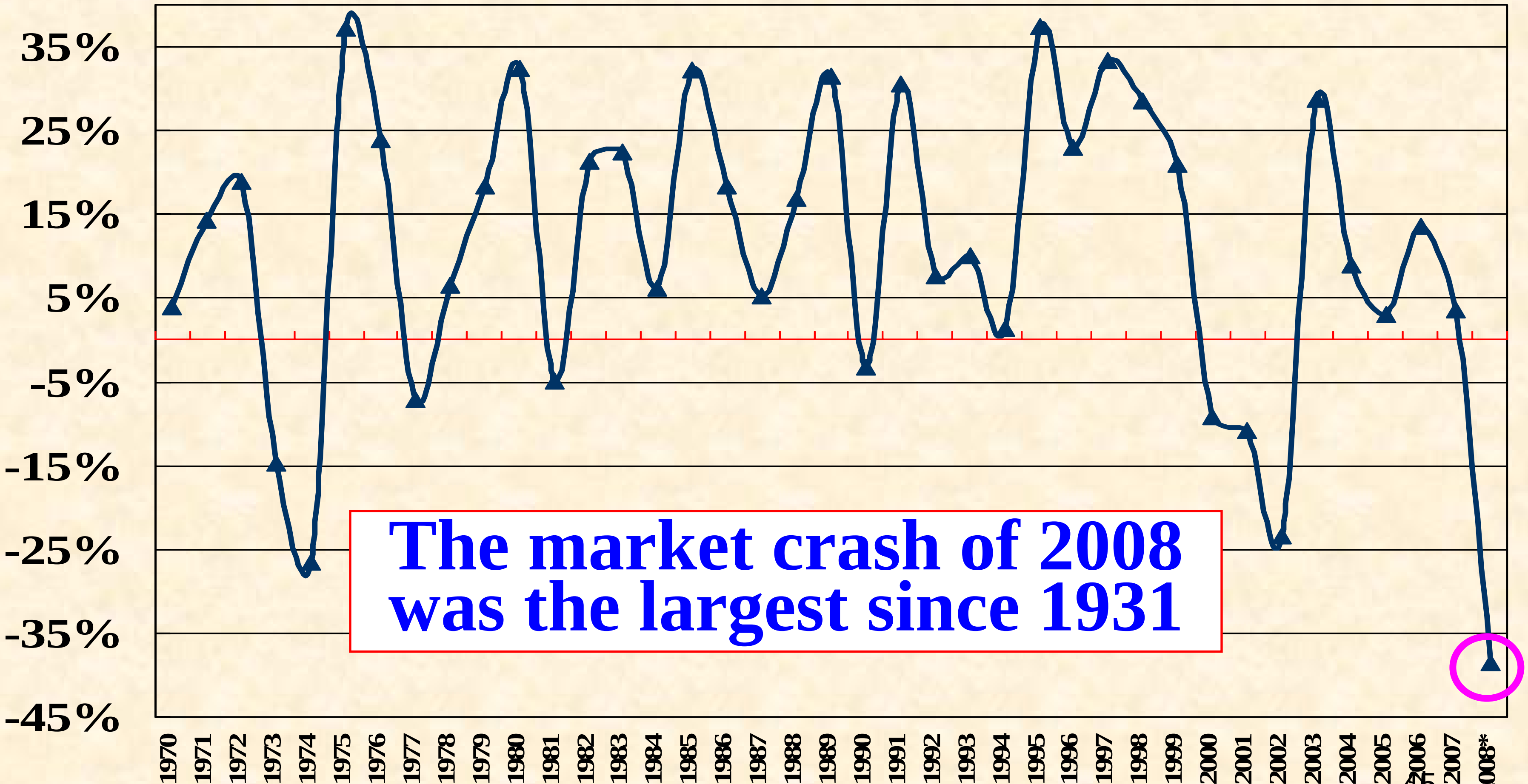
P/C Insurer Net Realized Capital Gains, 1990-2008:Q3



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

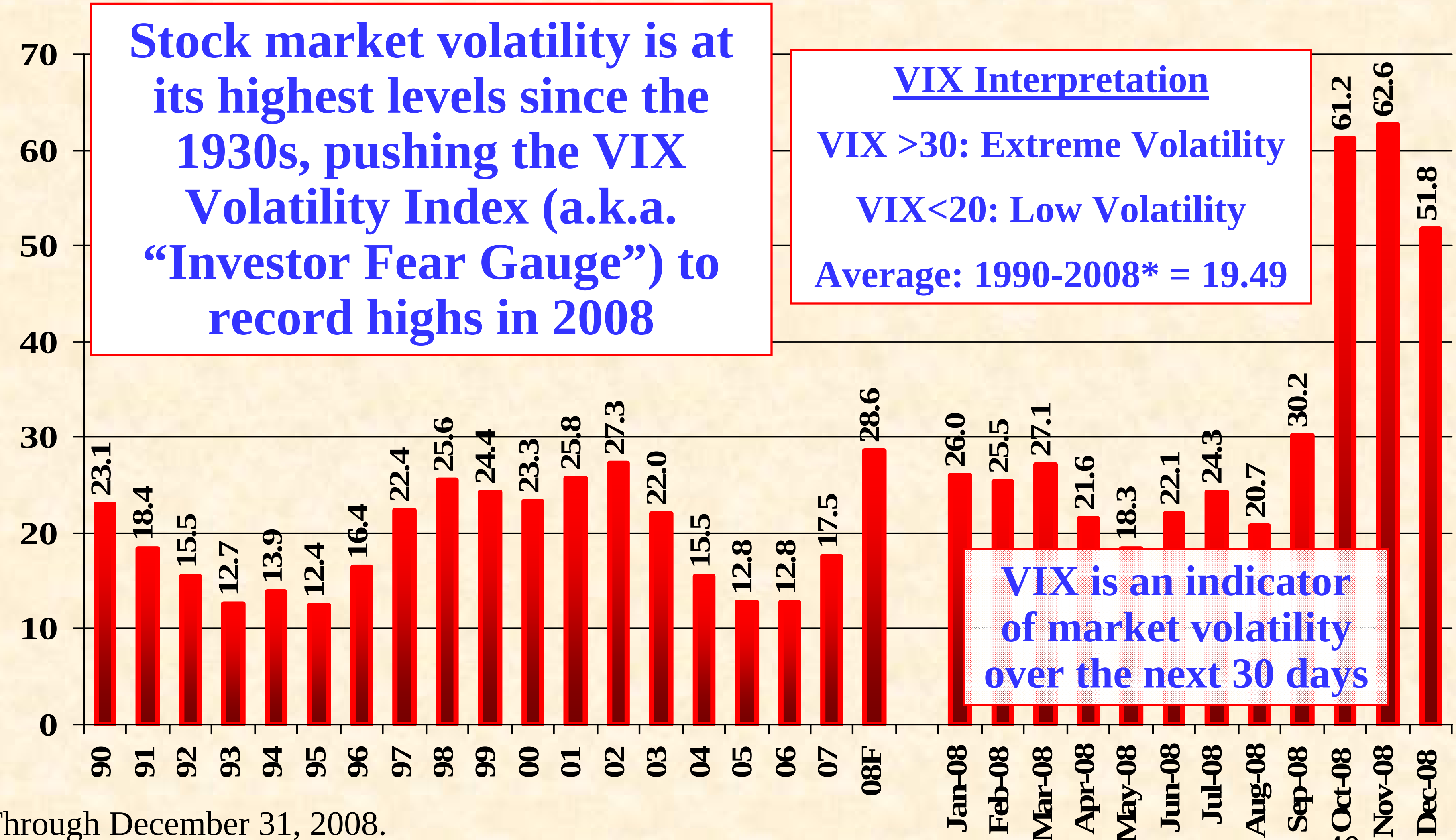
Total Returns for Large Company Stocks: 1970-2008*

S&P 500 was down 38.5% in 2008*



Source: Ibbotson Associates, Insurance Information Institute. *Through December 31, 2008.

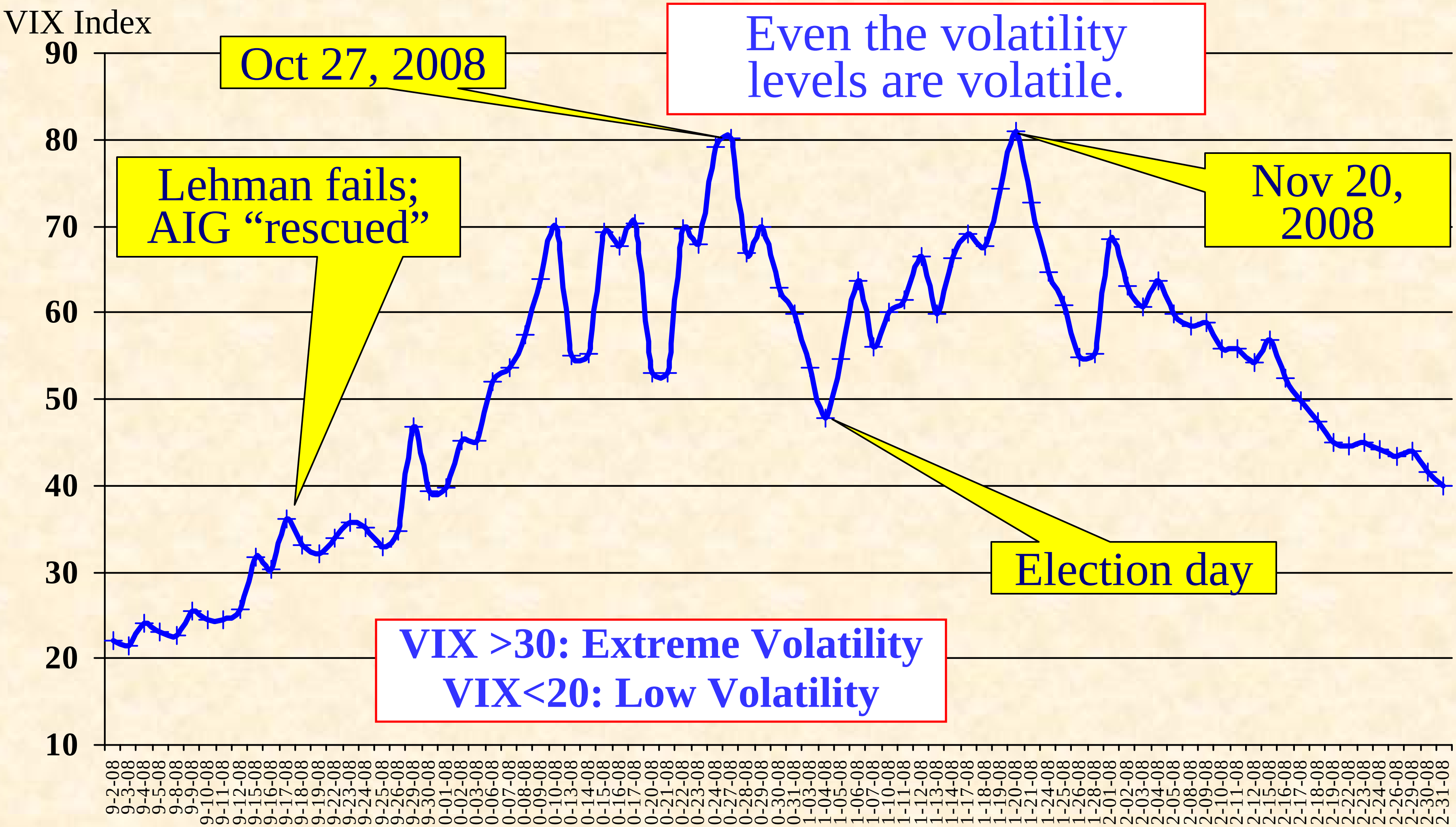
VIX Volatility Index: Stock Market Volatility at Record Highs in 2008*



*Through December 31, 2008.

Sources: Chicago Board Options Exchange: http://www.cboe.com/micro/vix/historical.aspx

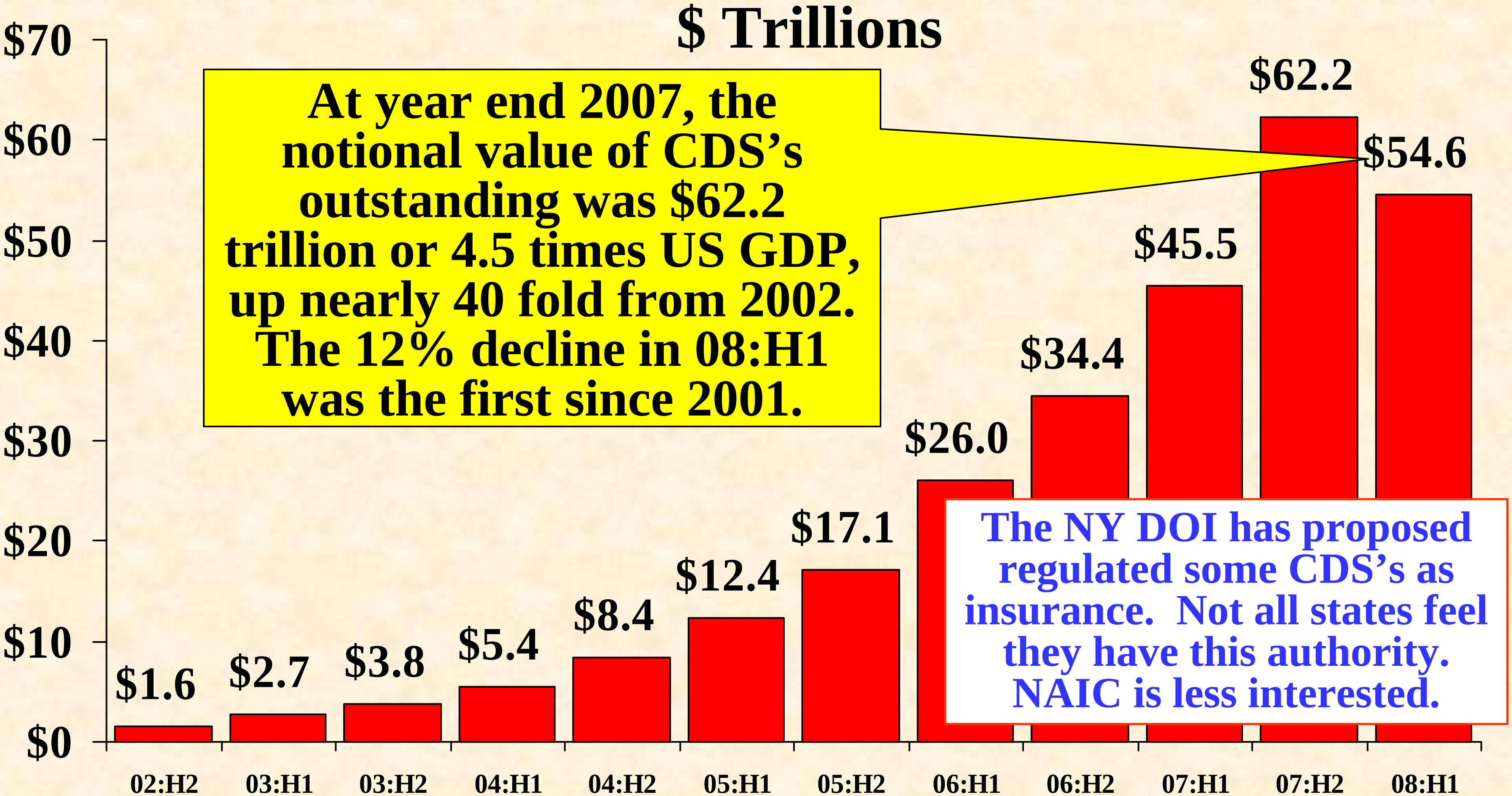
Stock Market Daily Volatility in 2008: Heading to "Normal"?*



*September 2 to December 31, 2008.

Source: Chicago Board Options Exchange: http://www.cboe.com/micro/vix/historical.aspx

*Credit Default Swaps: Notional Value Outstanding, 2002:H2 – 2008:H1**



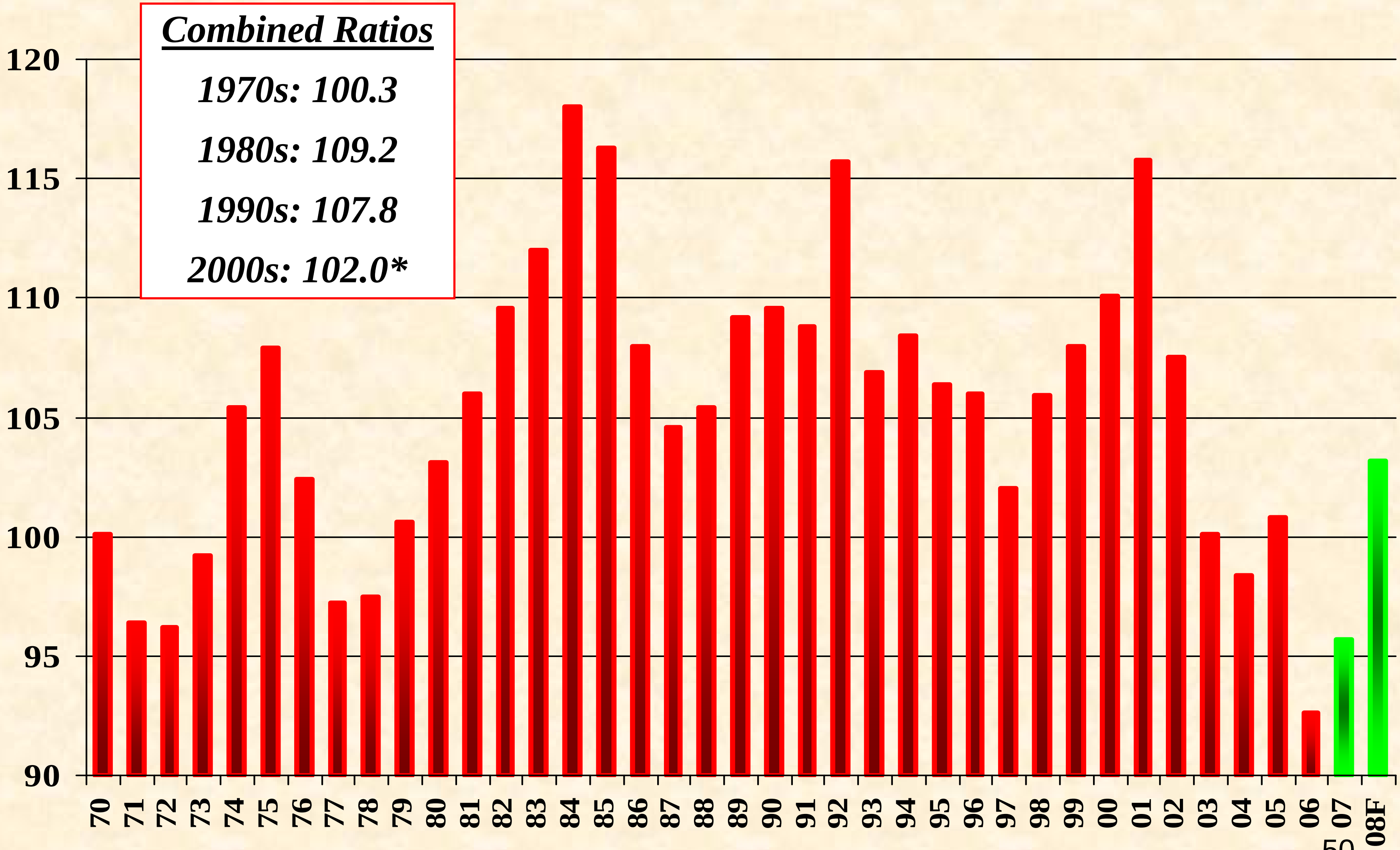
*End of calendar half (H1 = June 30, H2 = December 31).

Source: International Swaps and Derivatives Association: http://www.isda.org/statistics/recent.html

Underwriting Trends

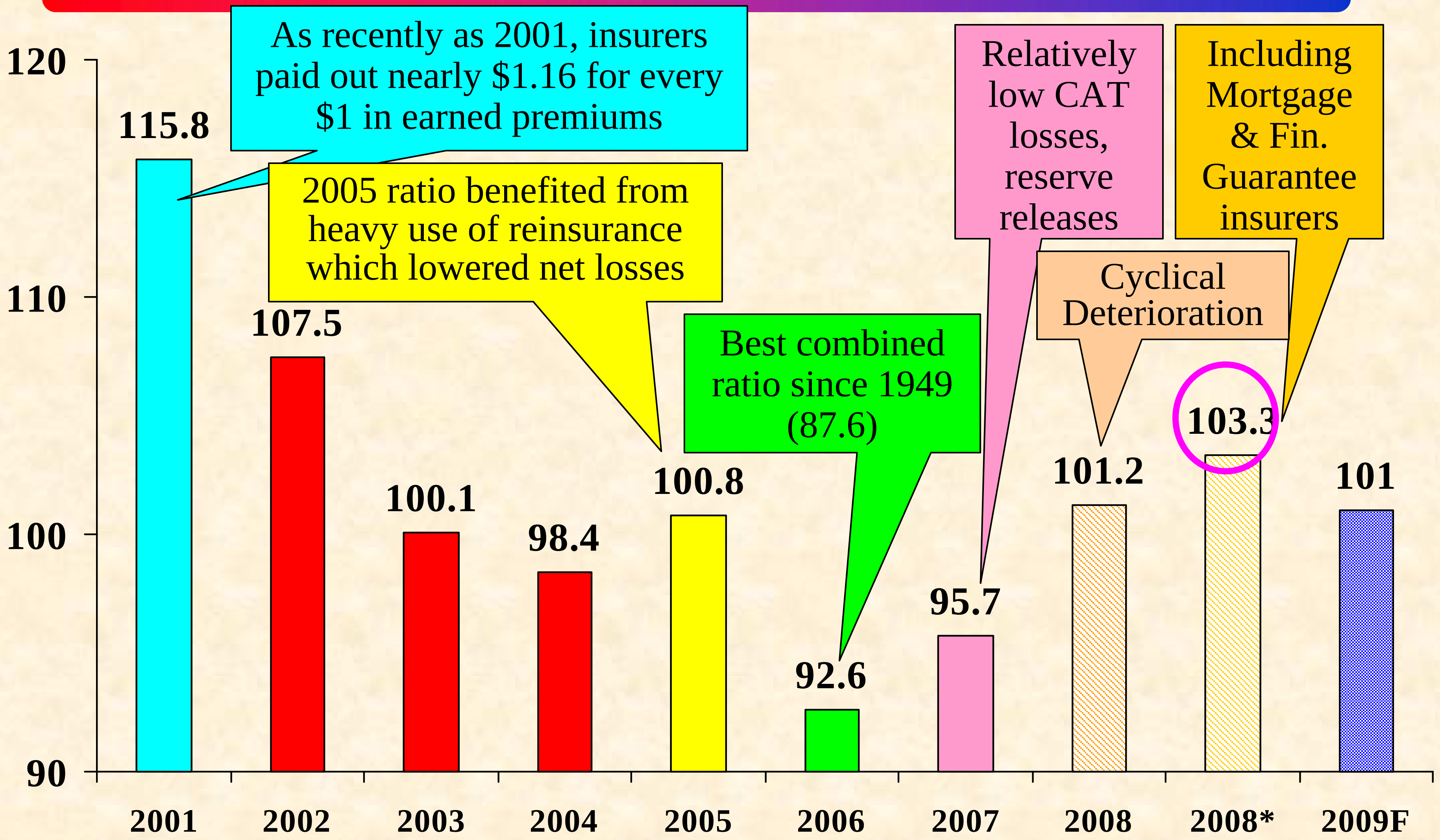
Financial Crisis Does *Not* Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

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



Sources: A.M. Best; ISO, III *A.M. Best year end estimate of 103.2; Actual 9-mos. result was 105.6.

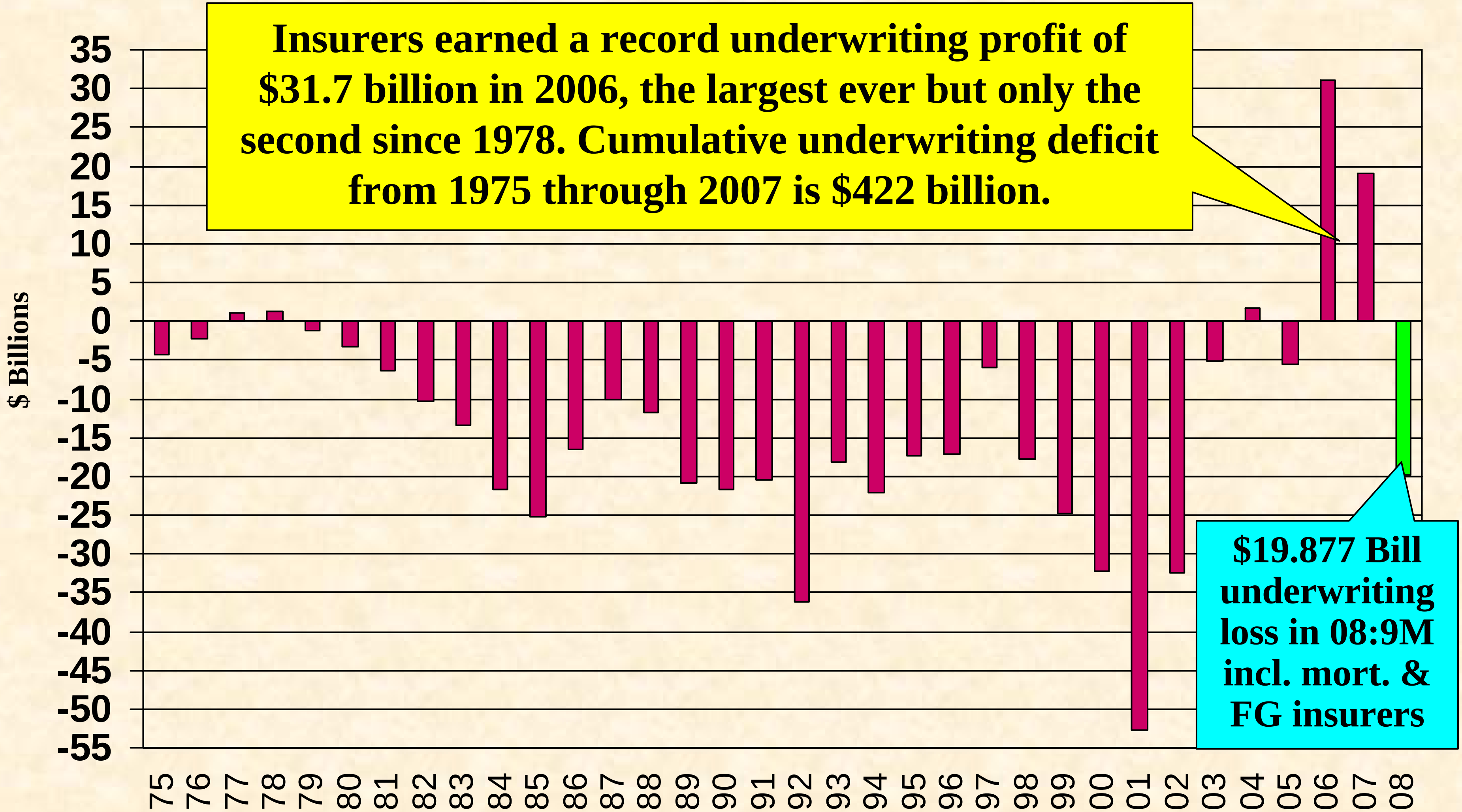
P/C Insurance Industry Combined Ratio, 2001-2009E



*Includes Mortgage & Financial Guarantee insurers.

Sources: A.M. Best.

Underwriting Gain (Loss) 1975-2008:Q3*

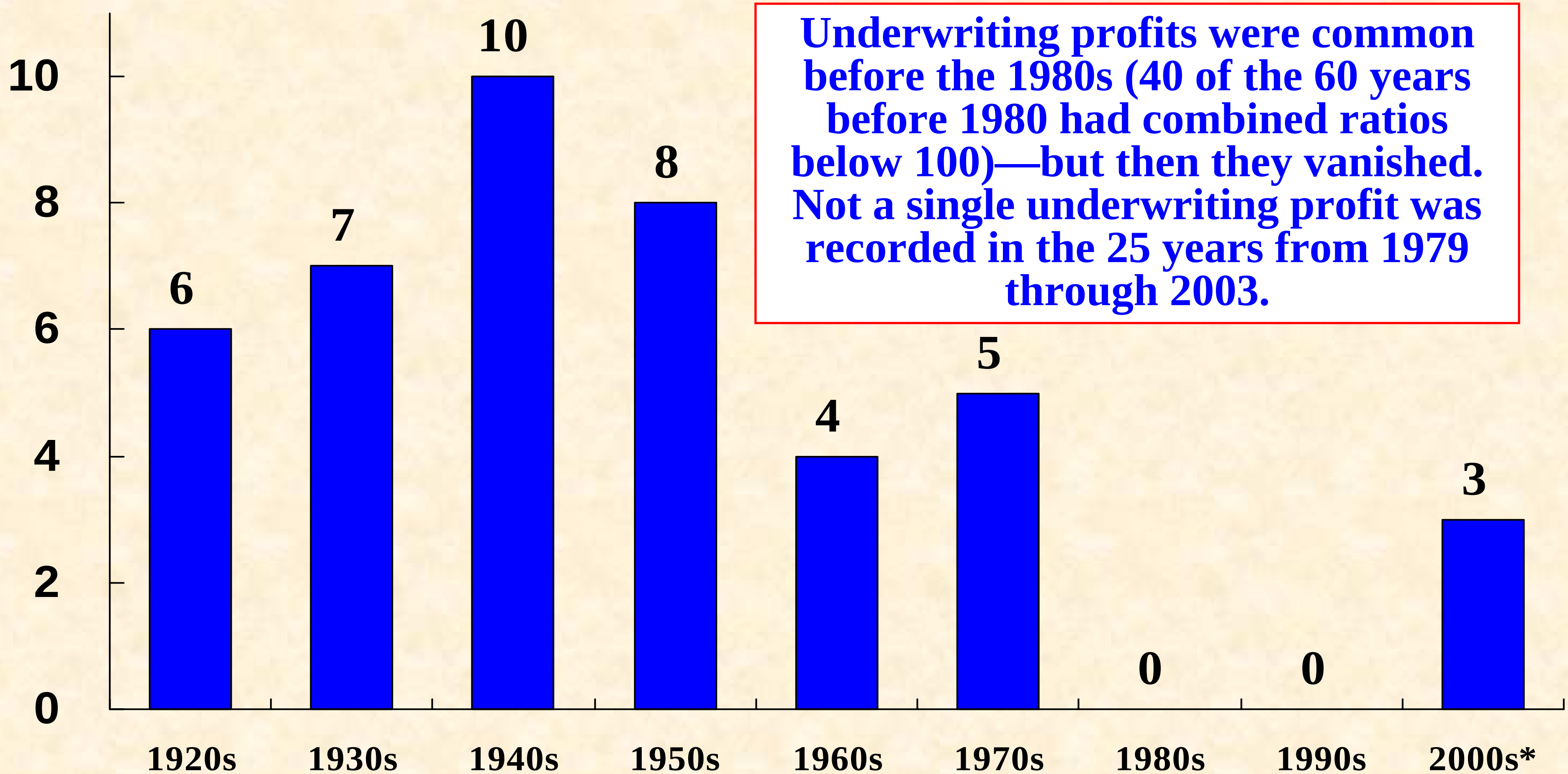


Source: A.M. Best, ISO; Insurance Information Institute

* Includes mortgage & finl. guarantee insurers

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

Number of Years with Underwriting Profits



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

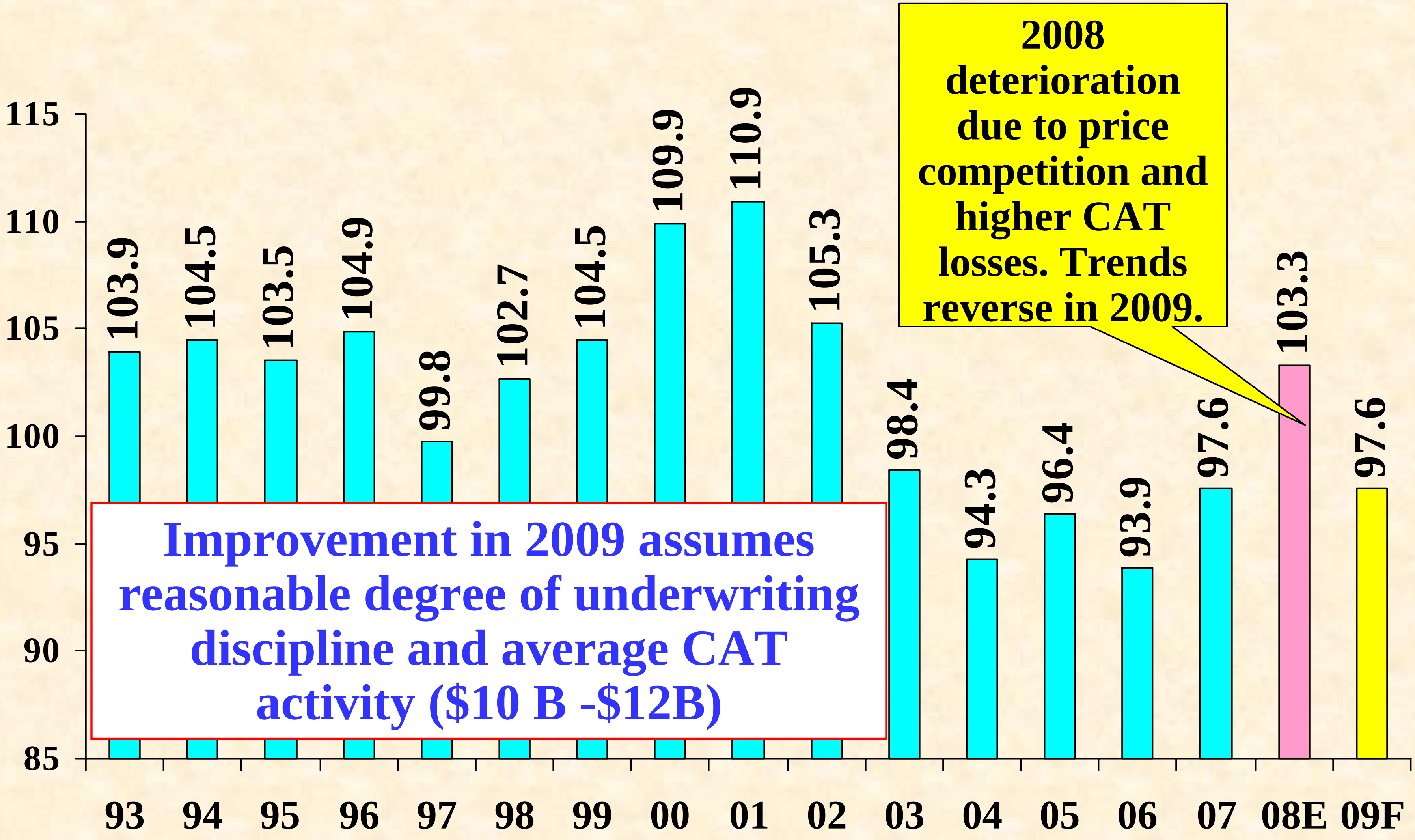
Sources: Insurance Information Institute research from A.M. Best Data.

*2000 through 2008.

Personal Lines

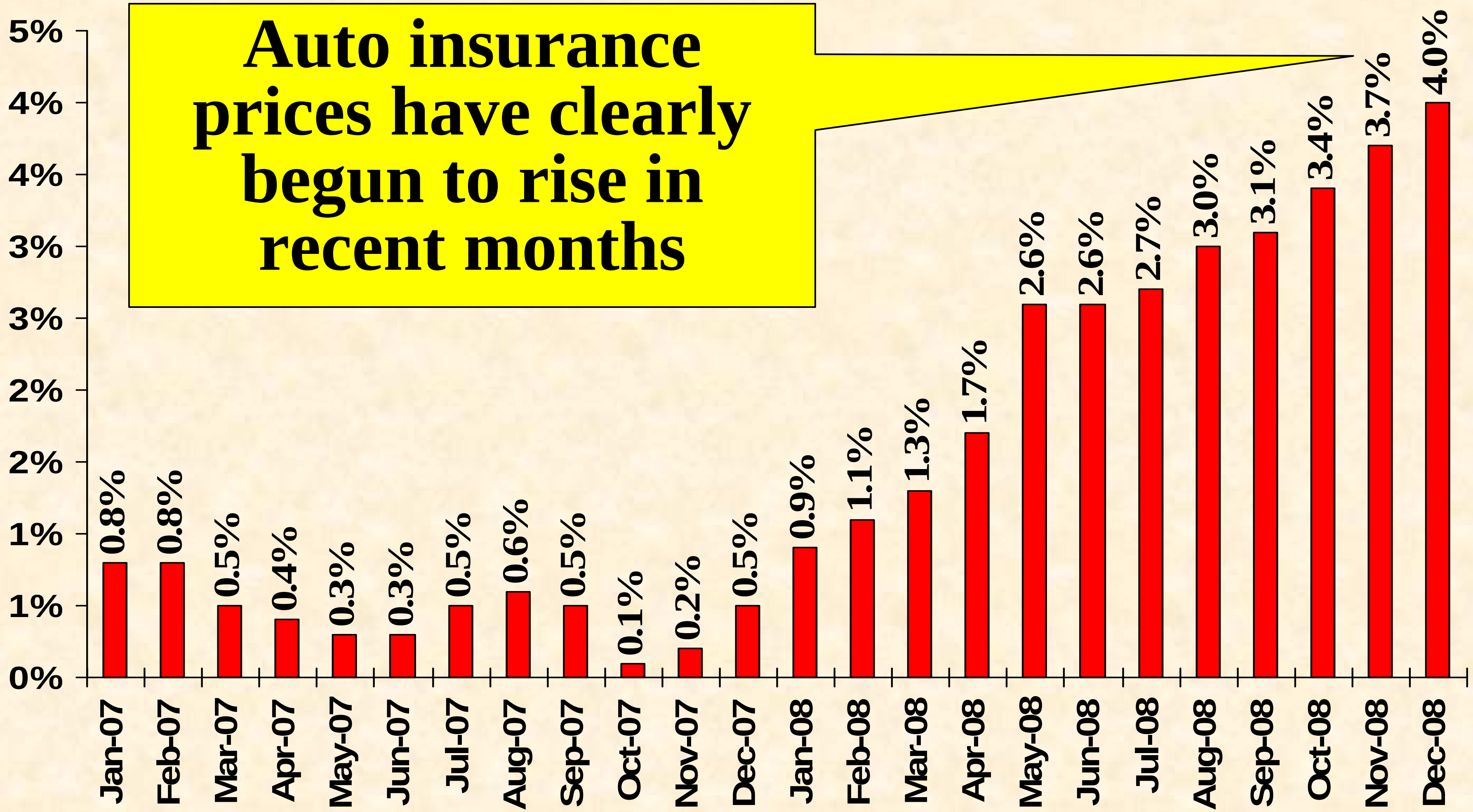
Auto (~75% of Market)
Home (~25%)

Personal Lines Combined Ratio, 1993-2009F



Source: A.M. Best (historical and forecast).

Monthly Change in Auto Insurance Prices*

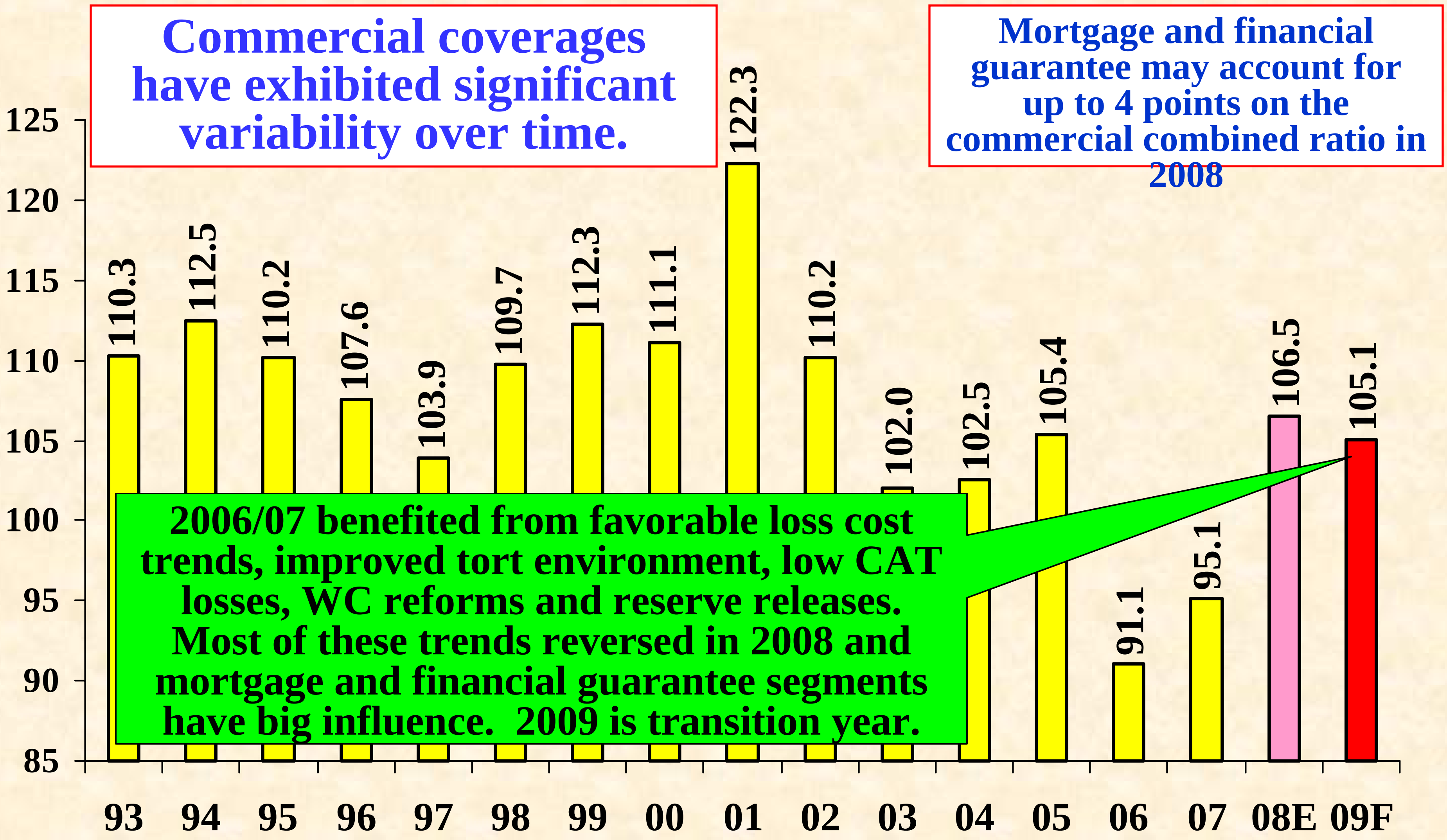


*Percentage change from same month in prior year.

Source: US Bureau of Labor Statistics

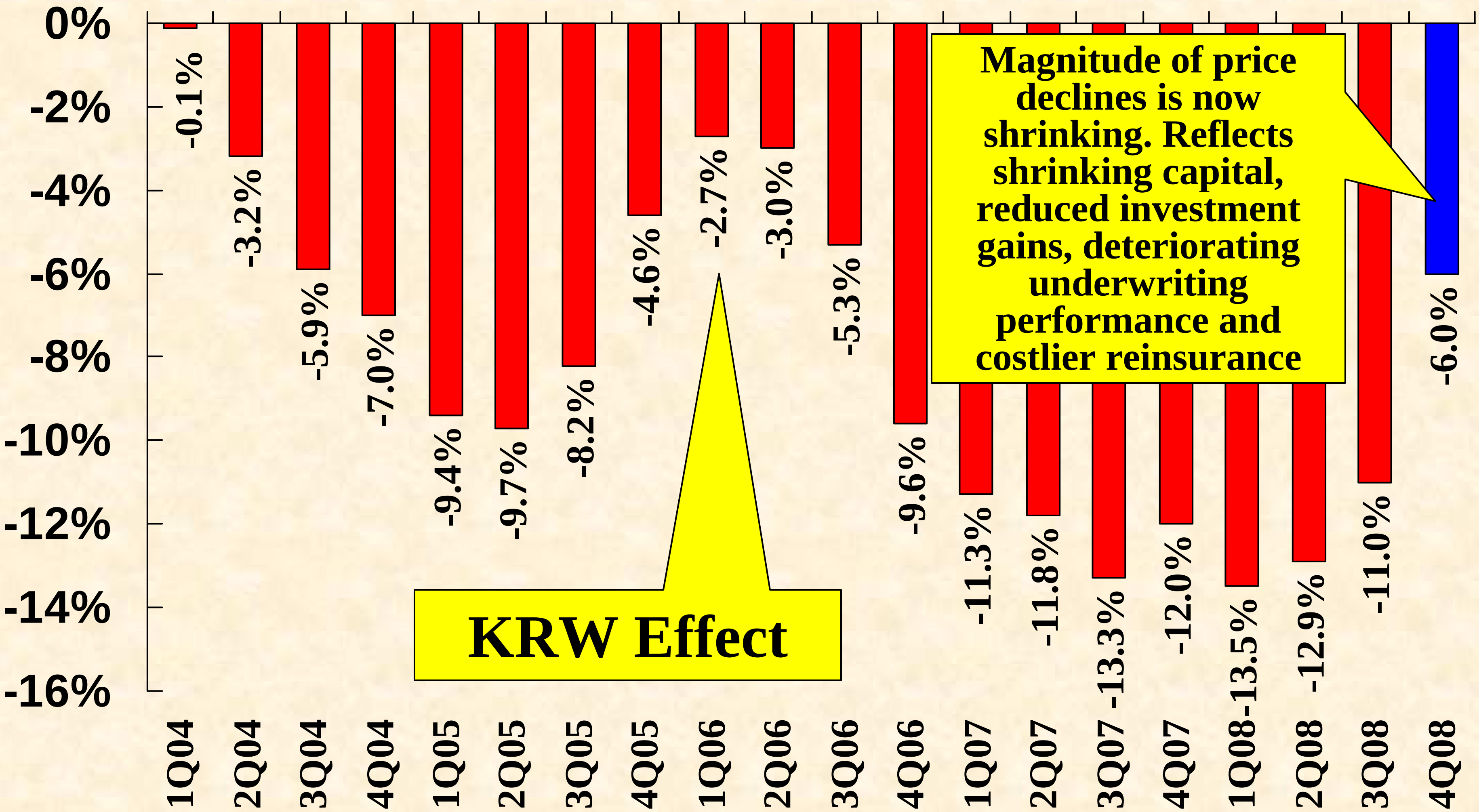
Commercial Lines

Commercial Lines Combined Ratio, 1993-2009F



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

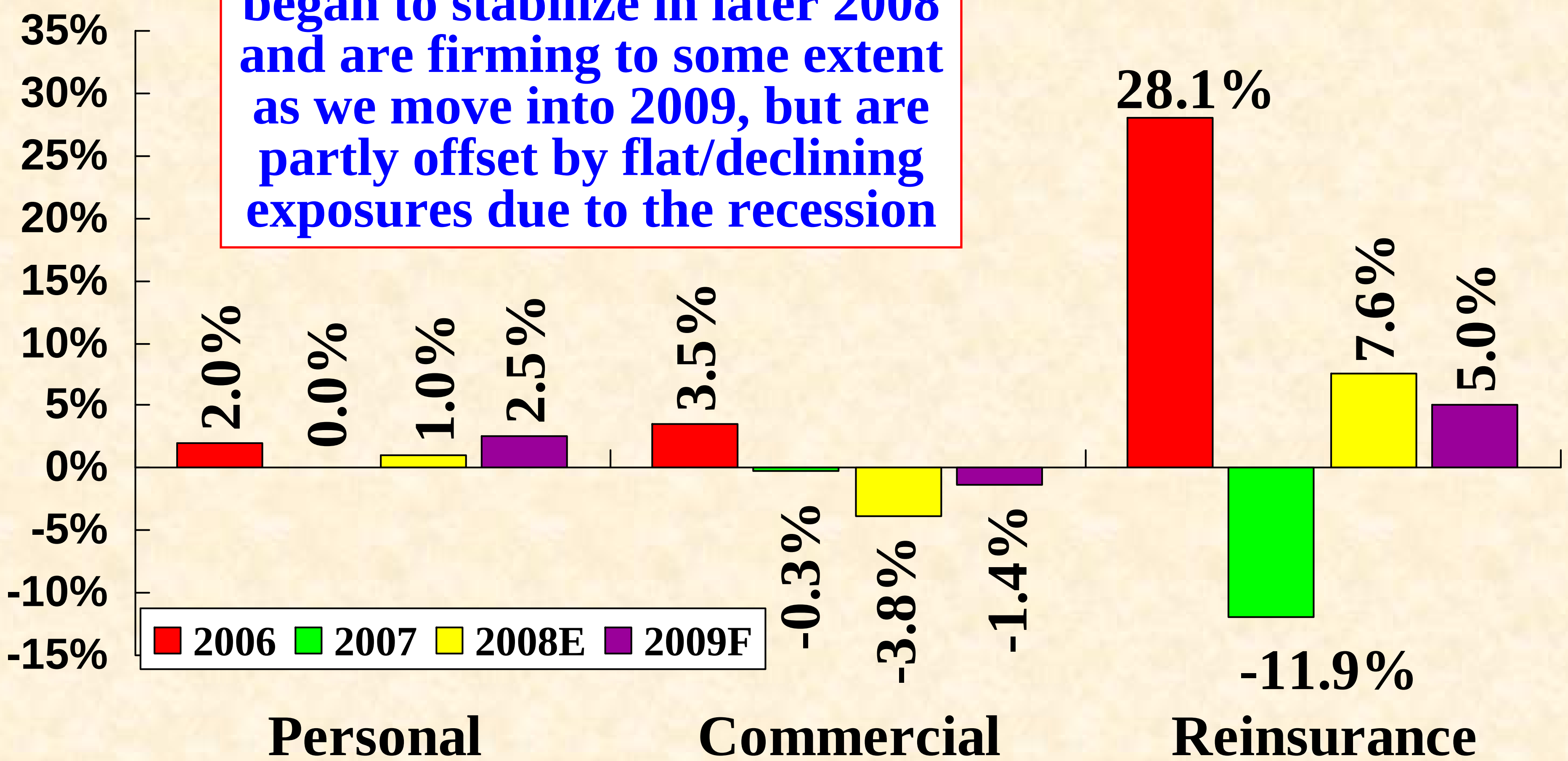
Average Commercial Rate Change, All Lines, (1Q:2004 – 4Q:2008)



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

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

Declines in premium growth began to stabilize in later 2008 and are firming to some extent as we move into 2009, but are partly offset by flat/declining exposures due to the recession

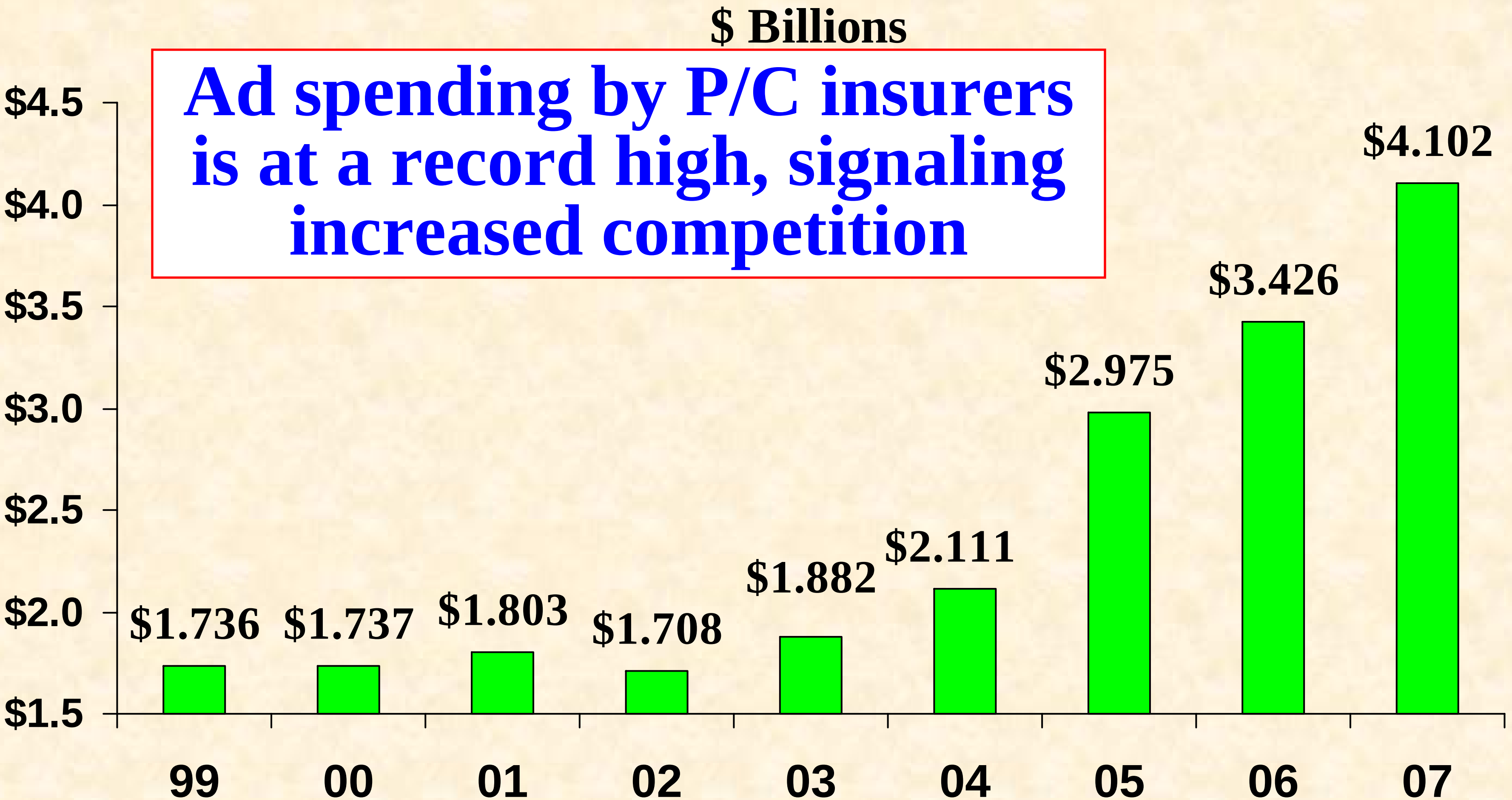


Sources: A.M. Best Review & Preview (historical and revised year-end 2008 forecast as of 1/20/09

Advertising

Unlike in Post 9/11 Period, Insurer Advertising Likely to Remain Strong

Advertising Expenditures by P/C Insurance Industry, 1999-2007



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

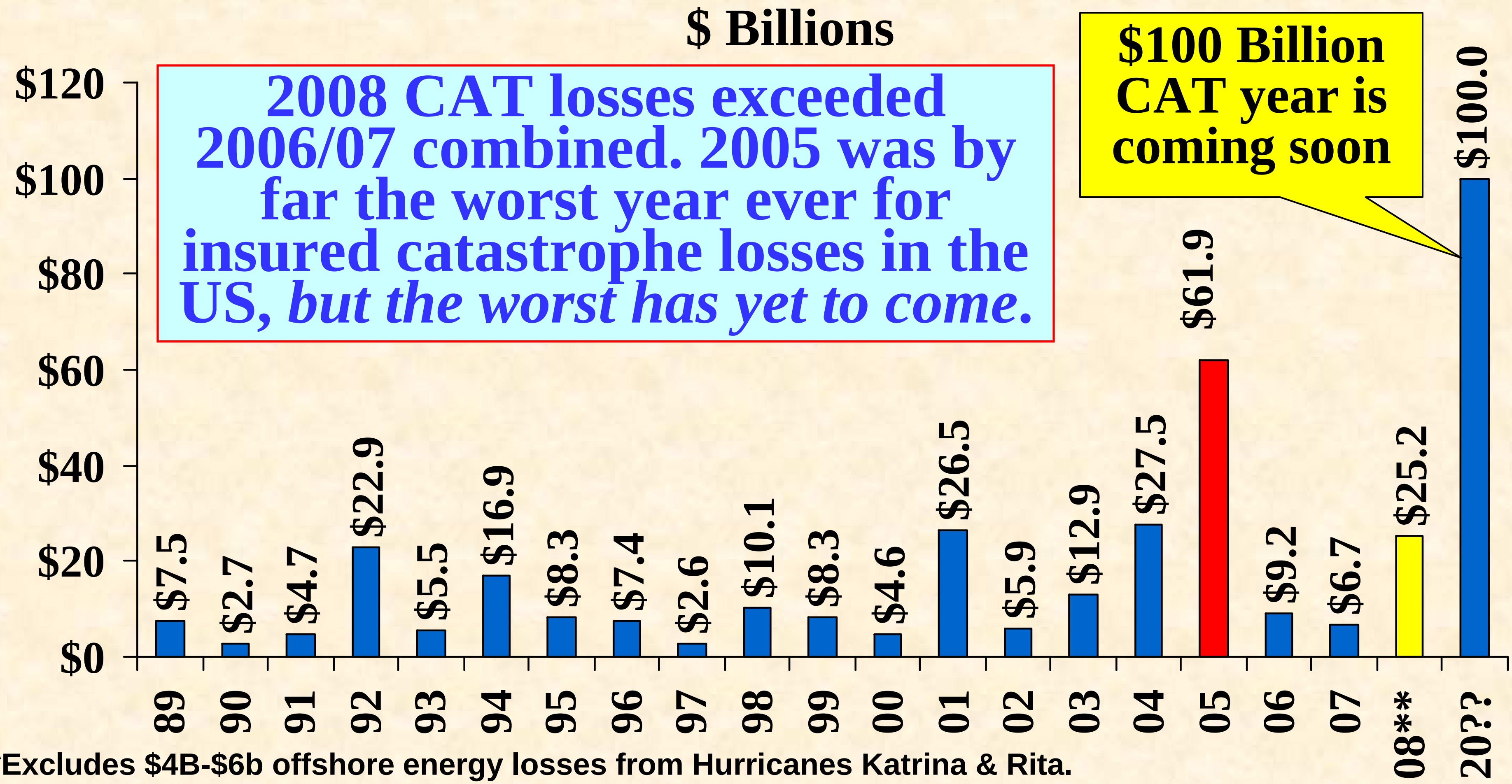
Why Advertising Will Likely Remain Strong?

- **DIRECT MARKETERS: No Agents = Advertising**
  - **Collectively, direct marketers have a larger market share**
  - **GEICO, 21st Century (formerly AIG Direct) and others are committed to the direct model**
  - **EA/IA companies sometimes have direct channels (some which bypass the agent, some which complement the agent)**
- **PERFORMANCE: U/W Results Not that Bad**
  - **Advertising is cut back when line is performing poorly from an underwriting perspective; Not generally the case today.**
- **SLOW GROWTH: Hope to Stimulate Demand**
- **INTERNET: Advertising Must Include New Media**
  - **Will appear more ubiquitous even if ad spend flat**
- **REBRANDING: Some Insurers Recasting Themselves**
  - **Want to emphasize affordability in down economy**

Catastrophe Losses

Impacting Underwriting Results and the Bottom Line

U.S. Insured Catastrophe Losses*



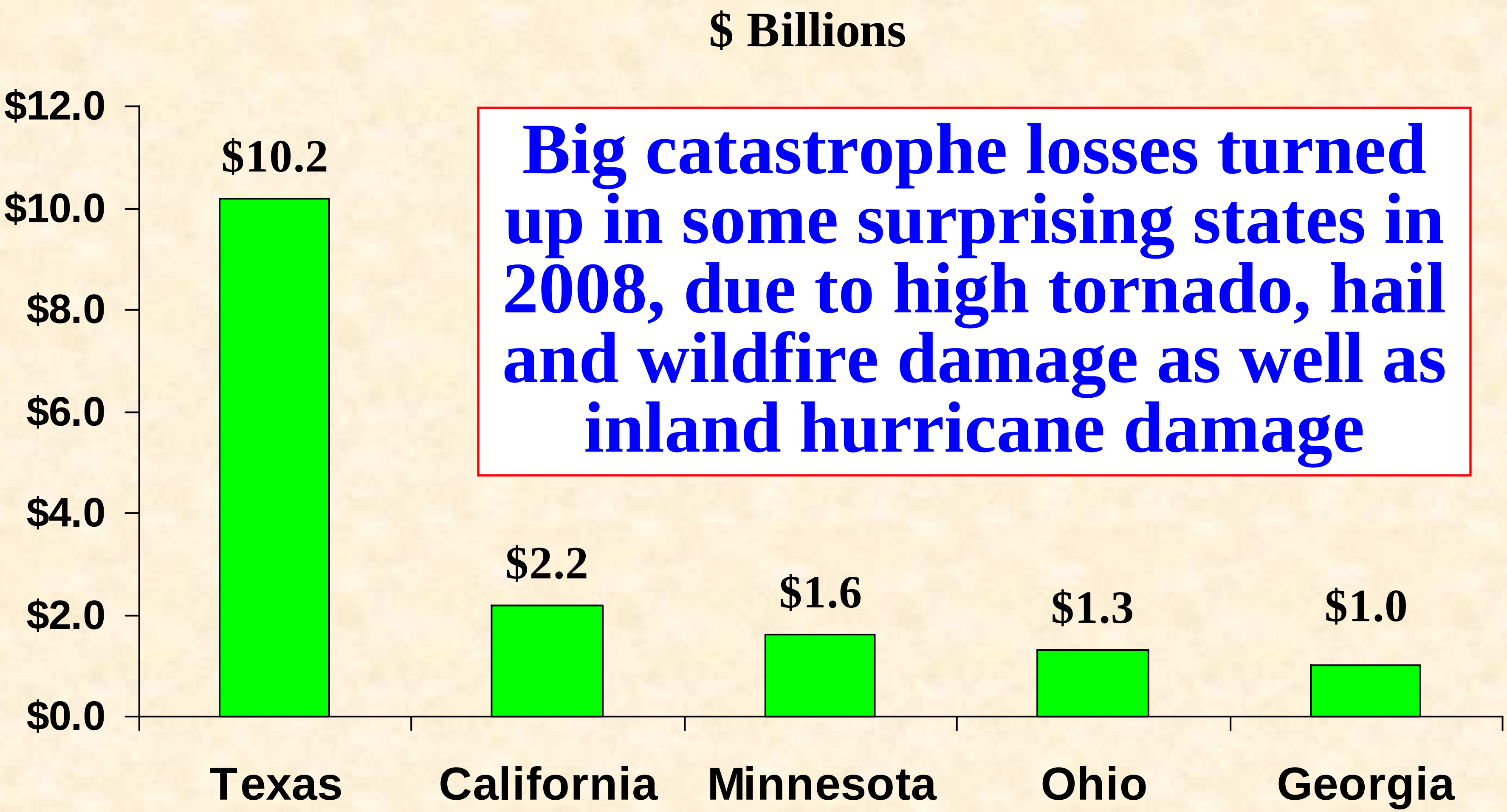
*Excludes $4B-$6b offshore energy losses from Hurricanes Katrina & Rita.

**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

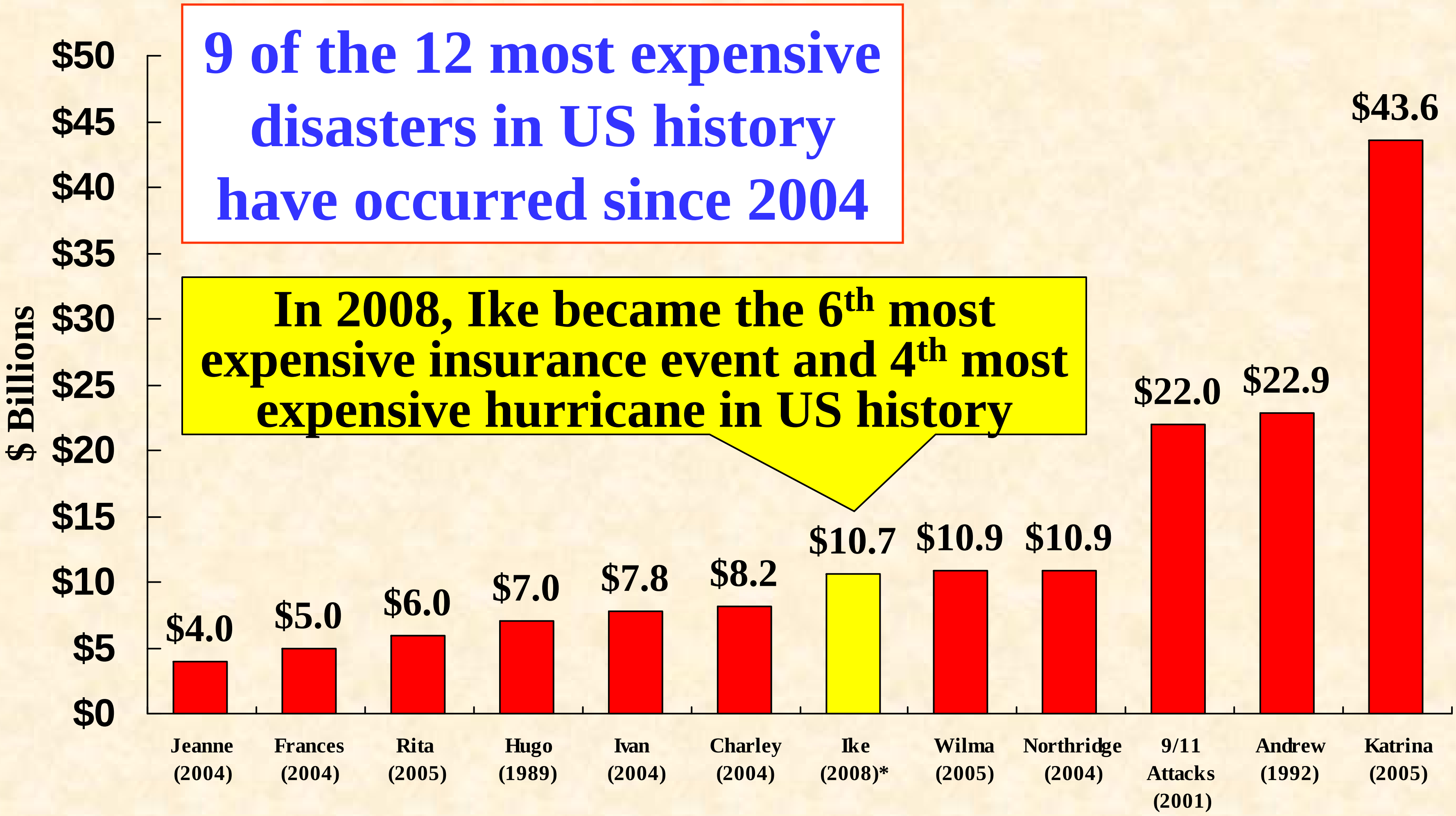
States With Highest Insured Catastrophe Losses in 2008



Big catastrophe losses turned up in some surprising states in 2008, due to high tornado, hail and wildfire damage as well as inland hurricane damage

Source: PCS; Insurance Information Institute.

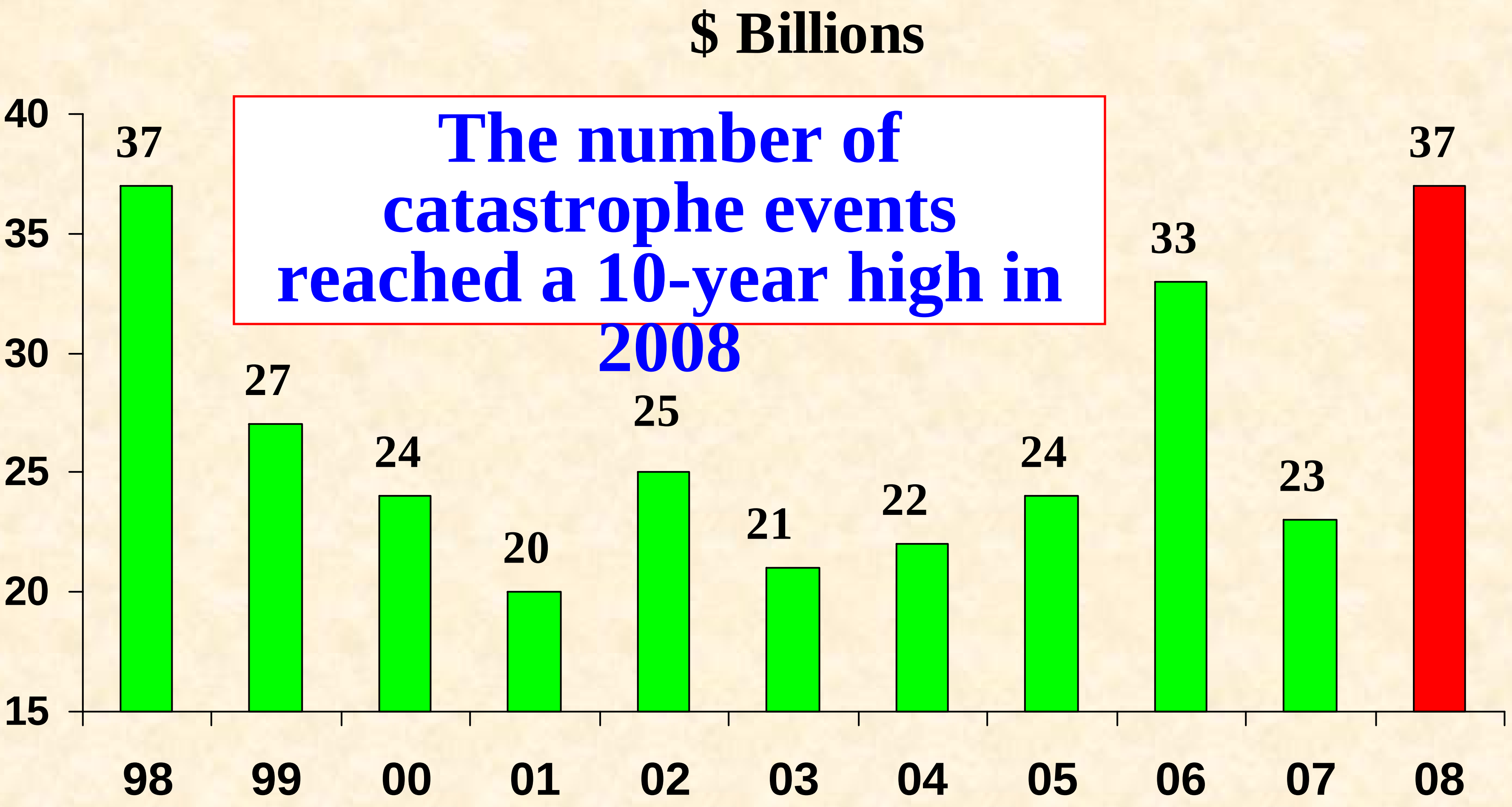
Top 12 Most Costly Disasters in US History, (Insured Losses, $2007)



*PCS estimate as of 12/15/08.

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

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.

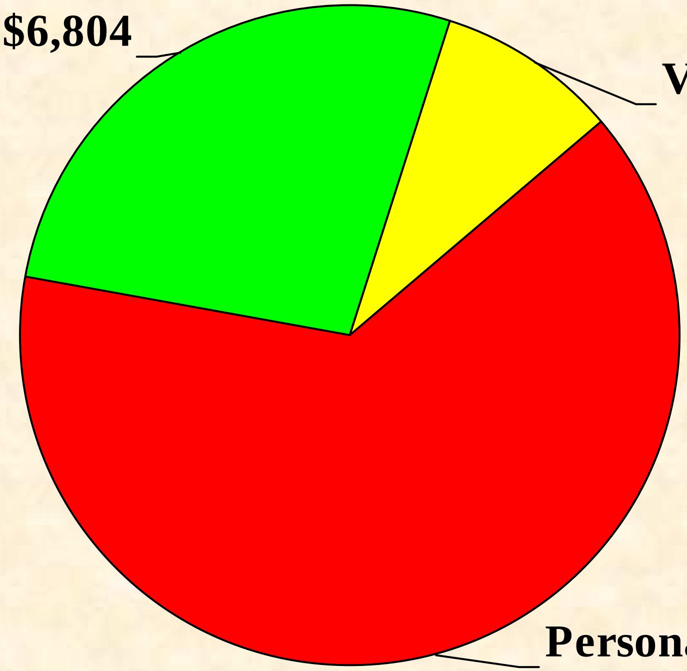
Source: PCS; Insurance Information Institute

2008 Insured Catastrophe Loss Distribution by Category

$ Millions

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



*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

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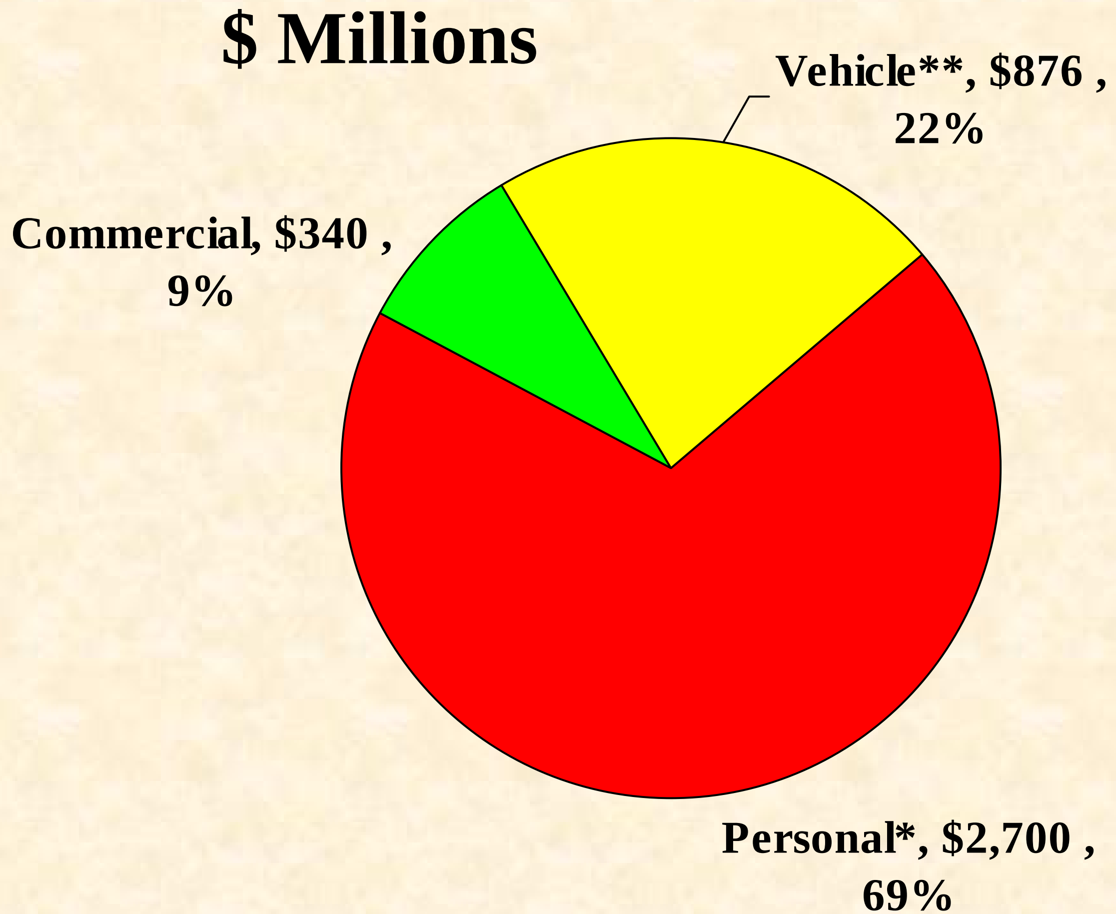
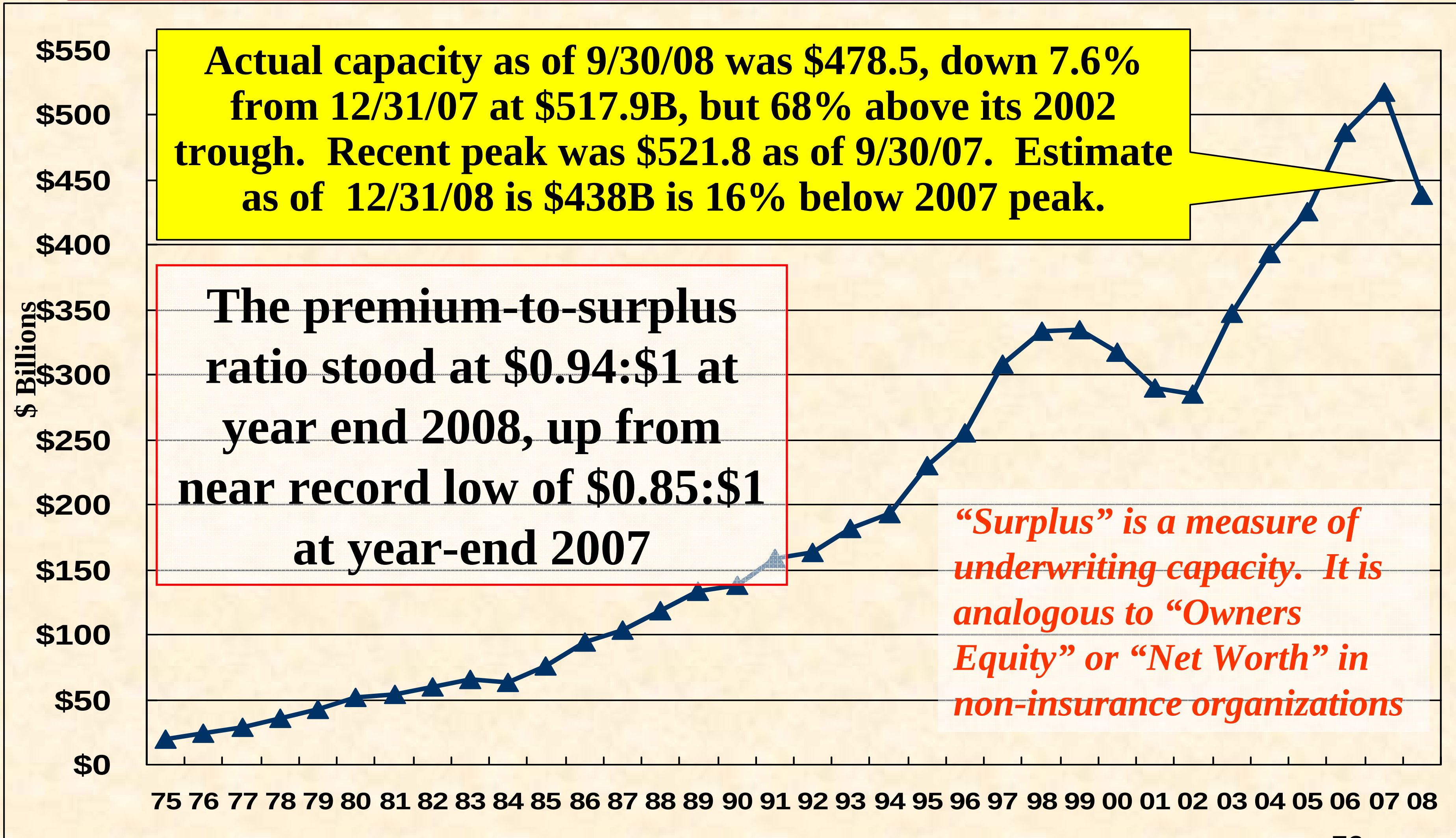


*Includes homeowers, condominium and rental policies.
**Includes commercial and private passenger vehicles
Source: PCS; Insurance Information Institute research.

Capital/ Policyholder Surplus

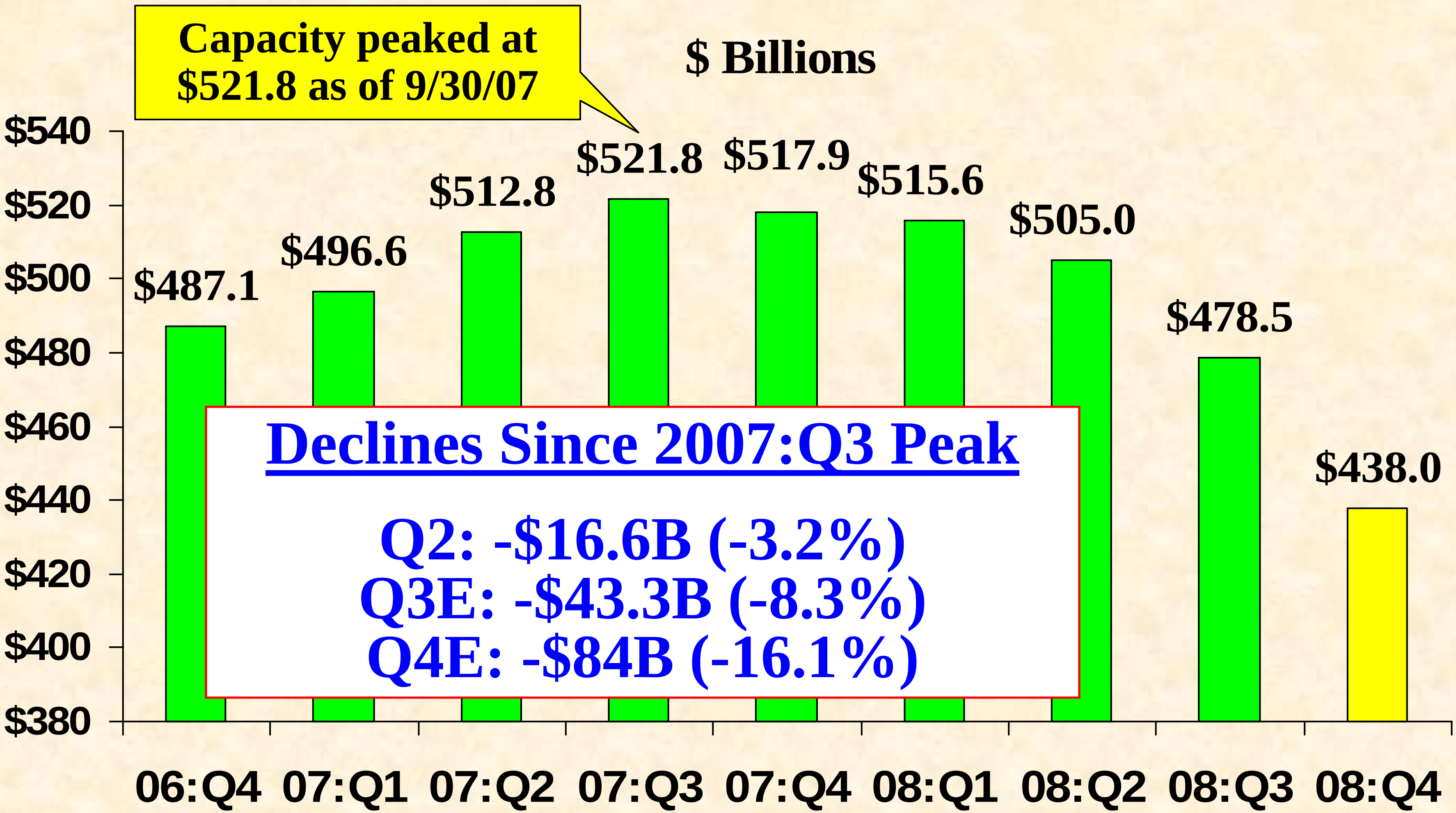
Shrinkage, but Capital is Within Historic Norms

U.S. Policyholder Surplus: 1975-2008*



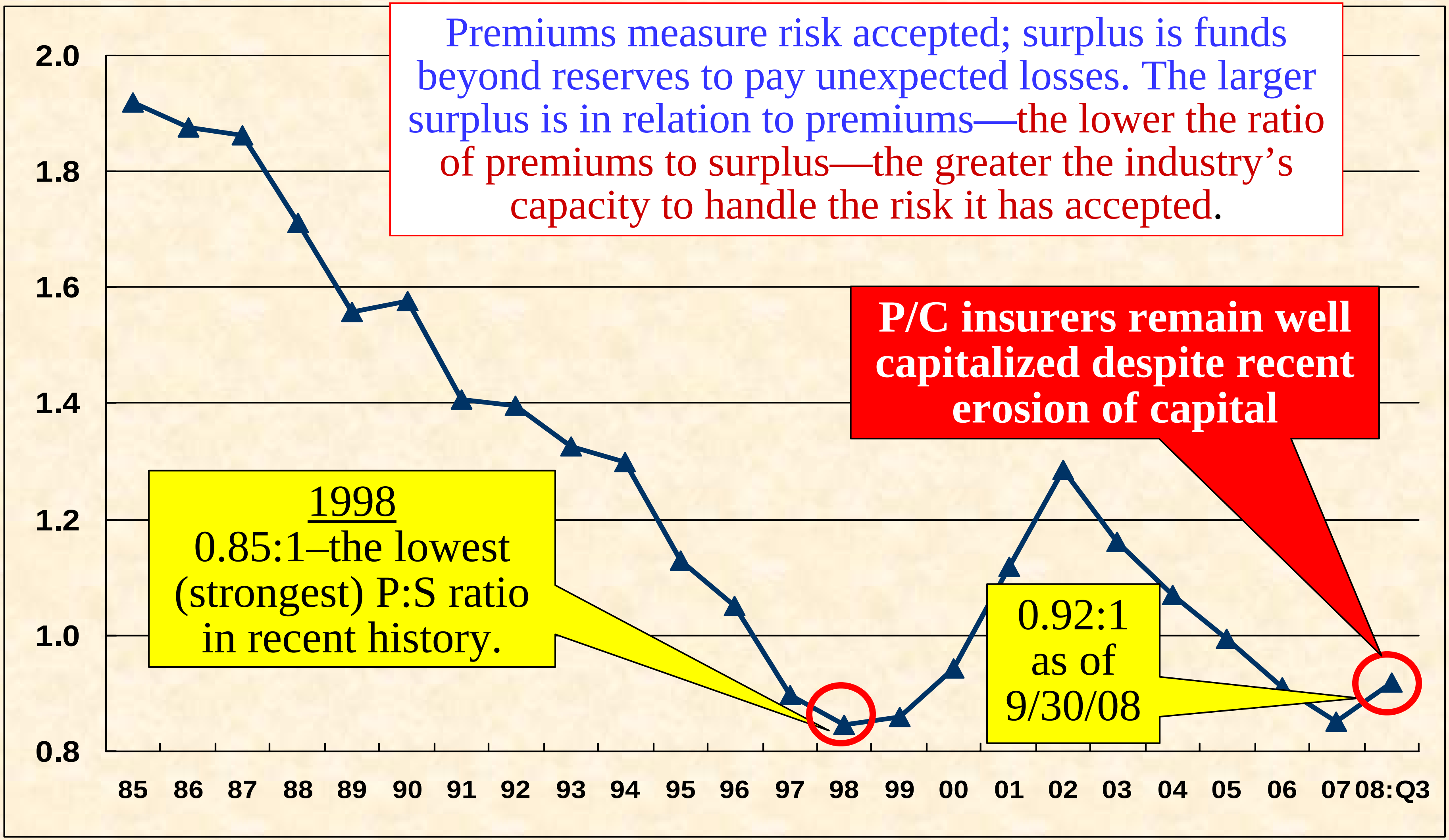
Source: A.M. Best, ISO, Insurance Information Institute. *Towers Perrin estimate as of 12/31/08

Policyholder Surplus,
2006:Q4 – 2008:Q4(Est.)



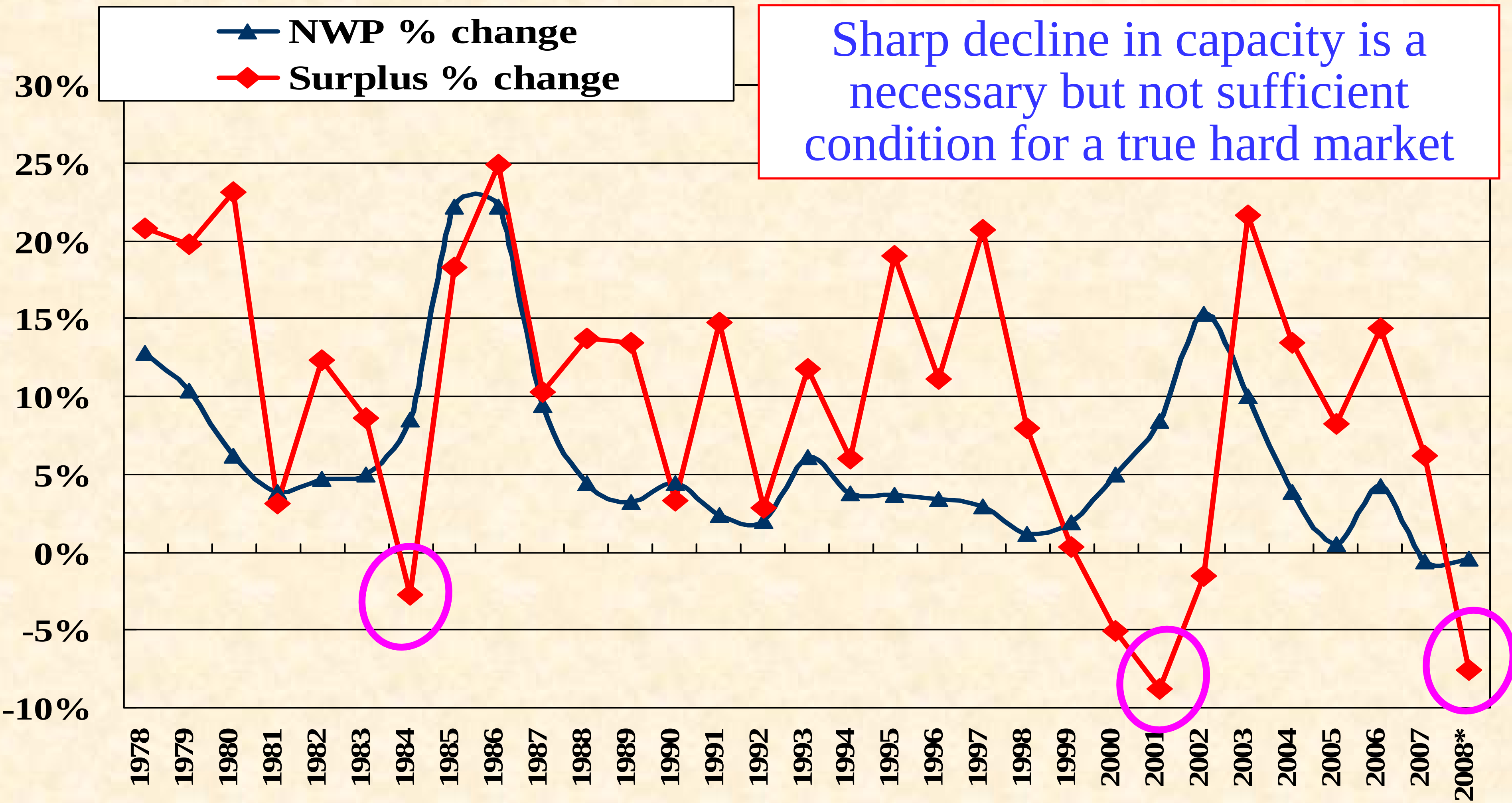
Source: ISO (historical); Towers Perrin (Oct. 21) estimates for Q4 2008. Q4 assumes no major Investment market recovery before year-end 2008.

U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2008:Q3



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

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



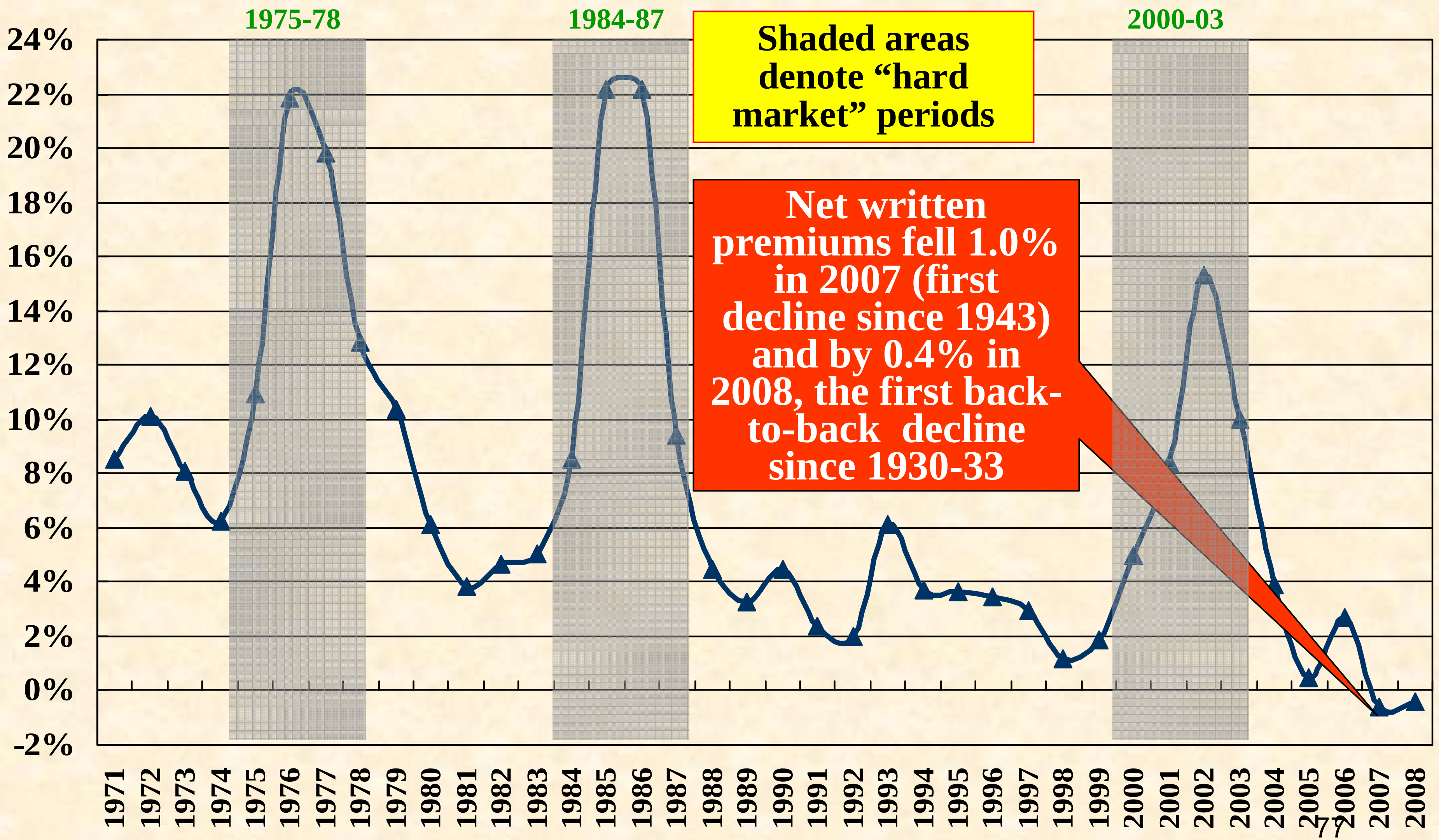
*Actual 9-month 2008 result.

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

P/C Premium Growth

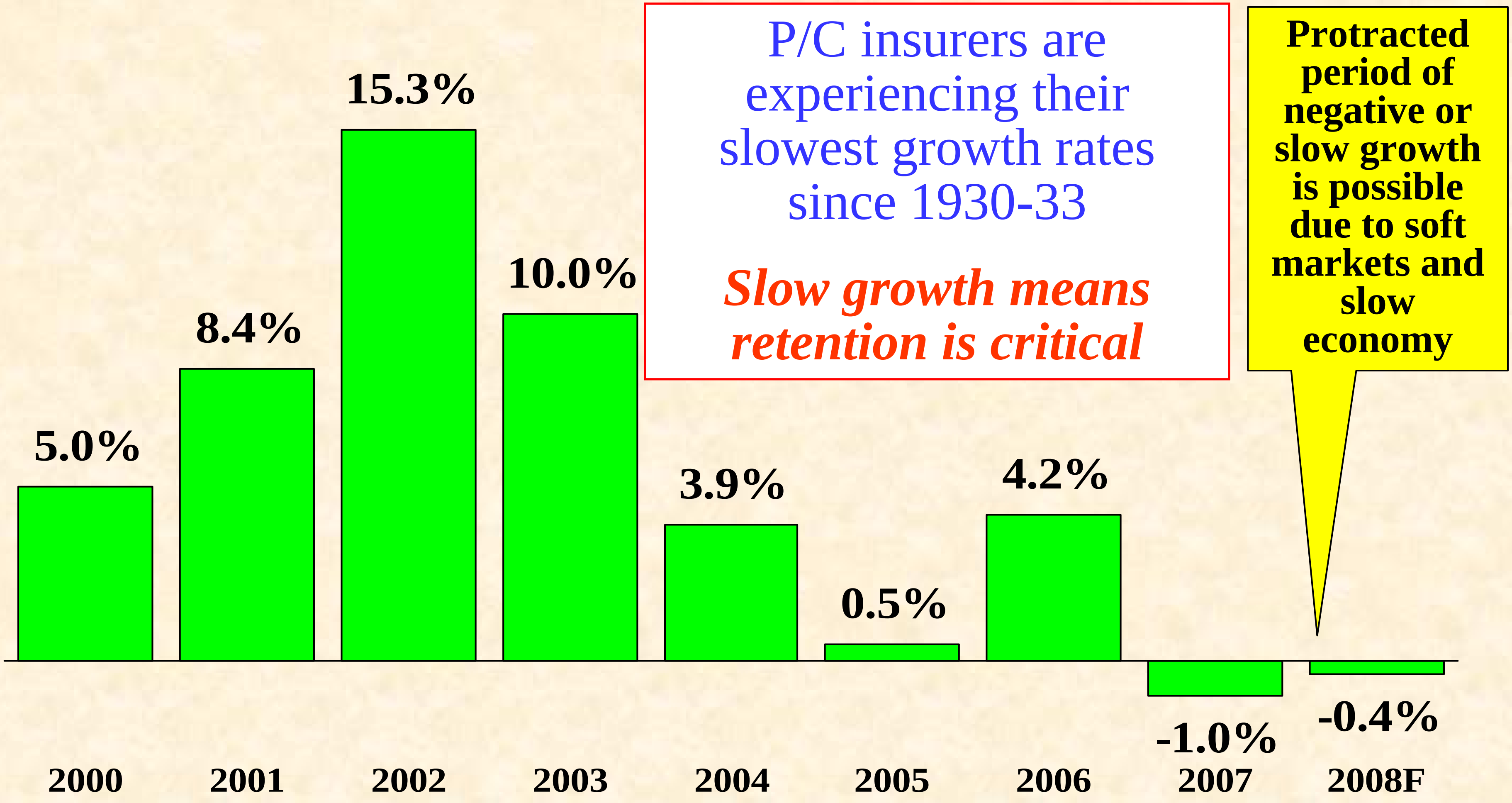
Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Strength of Recent Hard Markets by NWP Growth



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

Year-to-Year Change in Net Written Premium, 2000-2008E*



*2008 figure is 9-month actual result from ISO.
Source: A.M. Best (historical)

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

5. **Disintermediation**
   - Alternative forms of risk transfer are taking an ever-larger share of the (commercial) p/c insurance pie (e.g., 40%+ of workers comp)
   - Soft market did not bring it back
   - Trend toward state-sponsored insurance and reinsurance (e.g., FL) drains premium out of private insurance markets

Source: Insurance Information Inst.

AFTERSHOCK: Regulatory Response Could Be Harsh

All Financial Segments Including Insurers Will Be Impacted

Post-Crunch: Fundamental Issues To Be Examined Globally

- **Failure of Risk Management, Control & Supervision at Financial Institutions Worldwide: Global Impact**
  - Colossal failure of risk management (and regulation)
  - Counterparty risk and collateral management were systemic failure points
  - Implications for Enterprise Risk Management (ERM)?
  - Misalignment of management financial incentives
- **Focus Will Be on Risk Controls: Implies More Stringent Capital & Liquidity Requirements; *Prevention of Systemic Risks***
  - Data reporting requirements also likely to be expanded
  - Non-Depository Financial Institutions in for major regulation
  - Changes likely under US and European regulatory regimes
  - Will new regulations be globally consistent?
  - Can overreactions be avoided?
- **Accounting Rule Changes??**
  - Problems arose under FAS, IAS
  - Asset Valuation, including Mark-to-Market
  - Structured Finance & Complex Derivatives
- **Ratings on Financial Instruments**
  - New approaches to reflect type of asset, nature of risk

Source: Ins. Info. Inst.

CFO Turnover Rate: The Fall Guy in Risk Management Failures

CFO turnover reached a 13-year high of 19.5% in 2007. The CFO's office often is responsible for risk management. Insurers will need to consider the risk management skills and experience of new CFOs.

CFO is *"the least secure job in corporate America."*

-Gordon Grand, head of CFO recruiting for Russell Reynolds Associates

*2008 figure based on data for first 7 months of 2008.

Source: Crist|Kolder Associates from "Corporate Financial Chiefs Face New Pressures," *WSJ*, 12/1/08, p. B5; I.I.I.

Emerging Blueprint for Financial Services Regulatory Overhaul

Phase I: Systemic Risk Regulation/Regulator

- ➢ Identification of systemic risk points in the financial system
- ➢ Design of appropriate regulation to prevent future collapses
- ➢ Will require international consultation (US can't manage systemic risk alone)

- **Oversight Responsibility: Likely With Federal Reserve**
  - ➢ Fed would have capacity and power to assess risk across financial markets regardless of corporate form and to intervene when appropriate*
  - ➢ Fed could oversee (according to House FS Committee Chairman Barney Frank:
    - ➢ Hedge funds (need to ensure "complete transparency")
    - ➢ Credit ratings agencies
    - ➢ Executive compensation (to curb "perverse risk incentives")
  - ➢ TIMELINE: Frank wants "general outline" by April 2 meeting of G20 industrialized and developing nations

*http://financialservices.house.gov/press110/press0320082.shtml

Source: *Wall Street Journal*, "Frank Backs Regulator for Systemic Risk," 2/4/09, p. C3; I.I.I. research.

Emerging Blueprint for Financial Services Regulatory Overhaul *(cont'd)*

Phase I: Systemic Risk Regulation/Regulator: OTHER (cont'd)

- Unification of federal bank regulatory agencies
- Creation of a Financial Products Safety Commission to vet products before sold to investors
- Creation of federal insurance program for muni bonds paid via premiums
- Support for status quo on mark-to-market

Phase II: Sectoral Reform/Overhaul

- Each segment of the financial services industry will be examined and subject to regulation specific to its function, risks and other factors
- TIMELINE: August 2009 or later

Source: *Wall Street Journal*, "Frank Backs Regulator for Systemic Risk," 2/4/09, p. C3; I.I.I. research.

Post-Crunch: Fundamental Regulatory Issues & Insurance

- **Federal Encroachment on Regulation of Insurance in Certain Amid a Regulatory Tsunami**
  - **$150 billion in aid to AIG makes increased federal involvement in insurance regulation a certainty**
  - **States will lose some of their regulatory authority**
  - **What Feds get/what states lose is unclear**
- **Removing the "O" from "OFC"?**
  - **Treasury in March proposed moving solvency and consumer protection authority to a federal "Office of National Insurance"**
  - **Moving toward more universal approach for regulation of financial services, perhaps under Fed/Treasury?**
  - **Is European (e.g., FSA) approach in store?**
  - **Treasury proposed assuming solvency and consumer protection roles while also eliminating rate regulation**
  - **Expect battle over federal regulatory role to continue to be a divisive issue within the industry**
  - **States will fight to maximize influence, arguing that segments of the financial services industry under their control had the least problems**

Source: Insurance Information Institute

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.

Major Regulatory Considerations for Insurance Regulation in 2009

- Power Sharing: Will Feds and States Divide Regulatory Authority & How?
  - Holding company (federal) and operating company/insurer (state)?
- Pre-Emption: Will Congress Pass Legislation Pre-Empting State Authority?
- Regulatory Consolidation: Will Regulatory Authority (now spread over 4+ agencies) be Consolidated Into One Entity? Will it Involve States?
- Life vs. P/C: Will Separate Regulatory Structures Emerge?
- Guaranty Fund System: FDIC has suggested federalization of system
- State Run Insurers: Who Would Regulate State-Run Insurers (Property, WC)?
  - Many coastal states have large state-run entities
  - About 25 states operate workers comp state funds or monopolistic insurers
- Regulation of Credit Default Swaps as Insurance: Will Feds take this up?
- Insurer Divisiveness: Industry is Not United on Many Key Issues

Source: Insurance Information Institute research.

Insurance Information Institute On-Line

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THANK YOU FOR YOUR TIME AND YOUR ATTENTION!