

Financial Strength, Security, Solvency in the P/C Insurance Industry *The Critical Role of State Guarantee Funds*

**National Conference of Insurance Guarantee Funds
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Presentation Outline

- **Weakening Economy: *Insurance Impacts & Implications***
 - Implications of Treasury “Blueprint” for insurers
- **Profitability**
- **Financial Strength & Ratings**
- **Guarantee Funds, the Insurance Cycle & CATs**
- **Underwriting Trends**
- **Premium Growth**
- **Rising Expenses**
- **Capacity**
- **Investment Overview**
- **Catastrophic Loss**
- **Shifting Legal Liability & Tort Environment**
- **Regulatory and Legislative Environment**

Q&A



Key Issues for Guarantee Funds to Consider Over the Next 5 Years

- **Soft Market Leads to Increased in Impairments**
 - Effect occurs with a lag (perhaps as far as the next hard market)
 - Need for assessments increases eventually as well
- **Weakening Economy: Muted Impact**
 - Should have little impact on impairments/need for assessments
- **Profits: A Profitable Industry is in Everyone's Best Interest**
 - Profitability through 2007 remained fairly strong, suggesting need for cycle-driven assessments is some ways off
- **Investment Volatility is the Norm**
 - Historically insurers rarely fail/become impaired due to bad investments
- **Catastrophes**
 - Surge in assessment could result if small, poorly capitalized insurers hit hard
- **Reserves**
 - Currently strong
 - Deficiencies associated with insolvency/impairments

A STORMY ECONOMIC FORECAST

*What a Weakening Economy
& Credit Crunch Mean for
the Insurance Industry*





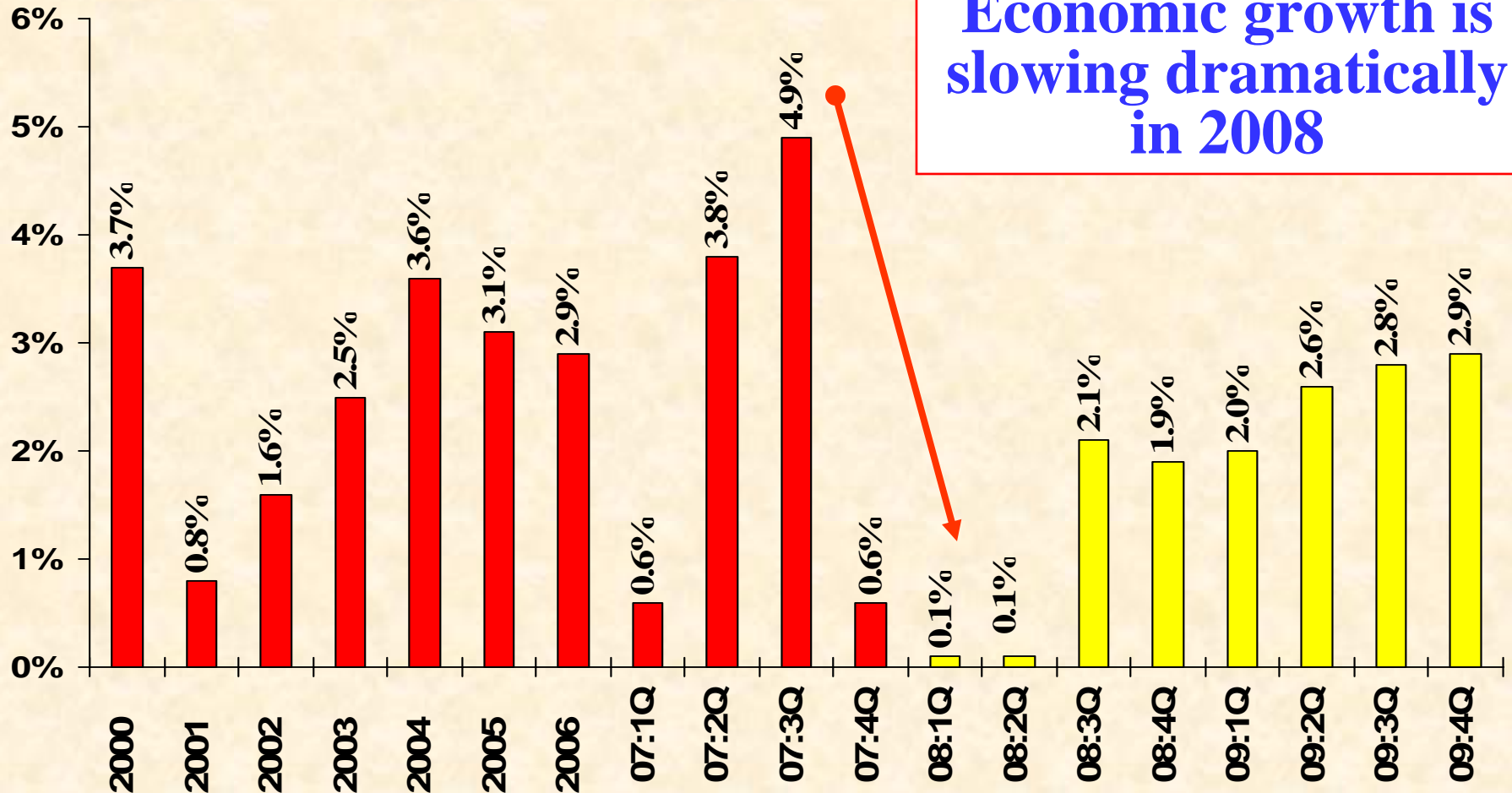
What's Going On With the US and Global Economies Today?

Fundamental Factors Affecting Global Economy in 2008

- **Puncture of Two Bubbles:** Credit and Housing in US
 - Burst Bubble → Asset Price Deflation
 - Subprime mortgage market was first part of credit bubble to burst
- **Credit Crunch:** Some credit markets have effectively seized
- **Global Contagion Effect:** Securitization of asset back securities, derivatives based on those securities amplified via leverage produced contagion effect
 - Many financial institutions around the world found they are exposed
 - Many hedge funds, banks caught holding CDOs, credit default swaps and other instruments against which they borrowed heavily (sometimes 10:1)
 - Some face margin calls, distressed selling of every type of asset except Treasuries
- **Global Economic Impacts:** Global Economic Slowdown
 - GDP growth in US down sharply, employment falling; Deceleration abroad too
 - “Decoupling” theory was naïve
 - Crashing dollar is symptom of irresponsible US fiscal policy, trade deficits. IOUs are being redeemed for hard assets or states in corporations
 - New bubbles forming in commodities and currencies



*Real GDP Growth**



*Yellow bars are Estimates/Forecasts.

Source: US Department of Commerce, Blue Economic Indicators 4/08; Insurance Information Institute.



Toward a New World Economic Order

- 1. Credit Crunch (incl. Subprime) Issue Will Ultimately Cost Hundreds of Billions Globally (est. up to \$600B)**
 - Problem exacerbated by leveraged bets taken by some financial institutions therefore its reach extends beyond simple defaults
- 2. Heavy Toll on Capital Base of Some Large Financial Institutions Worldwide (e.g., Bear Stearns)**
 - Cash infusions necessary; Sovereign Wealth Funds important source
 - Federal Reserve forced into playing a larger role; must improvise
- 3. Most Significant Economic Event in a Generation**
 - US economy will recover, but will take 18-24 months
- 4. Shuffling of Global Economic Deck; Economic Pecking Order Shifting**
 - China, oil producing countries hold the upper hand
- 5. IOUs are Being Redeemed**
 - Stakes in hard assets/institutions demanded
- 6. Good News: No Shortage of Available Capital**
 - Central banks are (generally) making right decisions; Dollar sinks



What's Being Done to Fix the Economy? → Impacts on Insurers

Economic Fix

Impacts on Insurers

Fed Rate Cuts

- Reduces bond yields (65% - 80% of portfolio)
- Potentially contributes to inflation longer run

Fed Debt Swap

- Fed will swap up to \$200B in bank holdings of mortgage back securities for Treasuries up to 28 days; Improves bank finances

Fed Bailout of Bear Stearns

- Fed on 3/14 (via J.P. Morgan) provided Bear with cash after what is effectively a “run on the bank”
- “Too Big to Fail” doctrine is activated
- Fed acting to prevent broader loss of confidence
- 3/17: J.P. Morgan buys Bear for \$236 million (\$2/share); Price increased to \$10 on 3/24



What's Being Done to Fix the Economy? → Impacts on Insurers (cont'd)


Economic Fix	Impacts on Insurers
Stimulus Package	<ul style="list-style-type: none">• Hope is that \$168B plan boosts overall economic activity and employment (by 500,000 jobs) and therefore p/c personal and commercial exposures• Contributes to already exploding budget deficits—Washington may expand its search for people and industries to tax
Housing Bailout (?)	<ul style="list-style-type: none">• Keeps more people in their homes and hopefully paying HO insurance premiums• Abandoned and neglected homes have demonstrably worse loss performance
Regulatory/ Legislative Action (?)	<ul style="list-style-type: none">• Treasury March 31 “Blueprint” affects all financial firms• For insurers, major recommendation is established of Optional Federal Charter under Office of National Insurance within Treasury



Post-Crunch: Fundamental Issues To Be Examined Globally

- **Adequacy of Risk Management, Control & Supervision at Financial Institutions Worldwide**
 - Colossal failure of risk management (and regulation)
 - Implications for ERM?
 - Includes review of incentives
- **Effectiveness and Nature of Regulation**
 - What sort of oversight is optimal given recent experience?
 - Credit problems arose under US and European (Basel II) regulatory regimes
 - Will new regulations be globally consistent?
 - Can overreactions be avoided?
 - Capital adequacy & liquidity
- **Accounting Rules**
 - 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

Summary of Treasury “Blueprint” for Financial Services Modernization

 Impacts on Insurers



Treasury Regulatory

Recommendations Affecting Insurers

- **Establishment of an Optional Federal Charter (OFC)**
 - **Would provide system for federal chartering, licensing, regulation and supervision of insurers, reinsurer and producers (agents & brokers)**
 - **OFC insurers would still be subject to state taxes, provisions for compulsory coverage, residual market and guarantee funds**
 - **OFC would specify specific lines covered by charter; Separate charters needed for P/C and Life**
- **OFC Would Incorporate Several Regulatory Concepts**
 - **Ensure safety and soundness**
 - **Enhance competition in national and international markets**
 - **Increase efficiency through elimination of price controls, promote more rapid technological change, encourage product innovation, reduce regulatory costs and provide consumer protection**

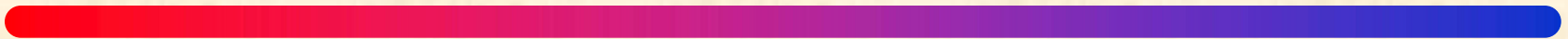


Treasury Regulatory Recommendations Affecting Insurers (cont'd)

- **Establishment of Office of National Insurance (ONI)**
 - Department within Treasury to regulate insurance pursuant to OFC
 - Headed by Commissioner of National Insurance
 - Commissioner has regulatory, supervisory, enforcement and rehabilitative powers to oversee organization, incorporation, operation, regulation of national insurers and national agencies
- **Establishment of Office of Insurance Oversight (OIO)**
 - Department within Treasury to handle issues needing immediate attention such “reinsurance collateral”; OIO could focus immediately on “key areas of federal interest in the insurance sector”
 - OIO: lead regulatory voice on international regulatory policy
 - Would have authority to ensure states achieved uniform implementation of declared US international insurance policy goals
 - OIO would also serve as advisor to Treasury Secretary on major domestic and international policy issues
- **UPDATE: HR 5840 Introduced April 17 Would Establish Office of Insurance Information (OII)**
 - Very similar to OIO

Insurance & The Economy

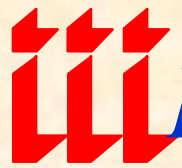
Important But Somewhat
Muted Impacts





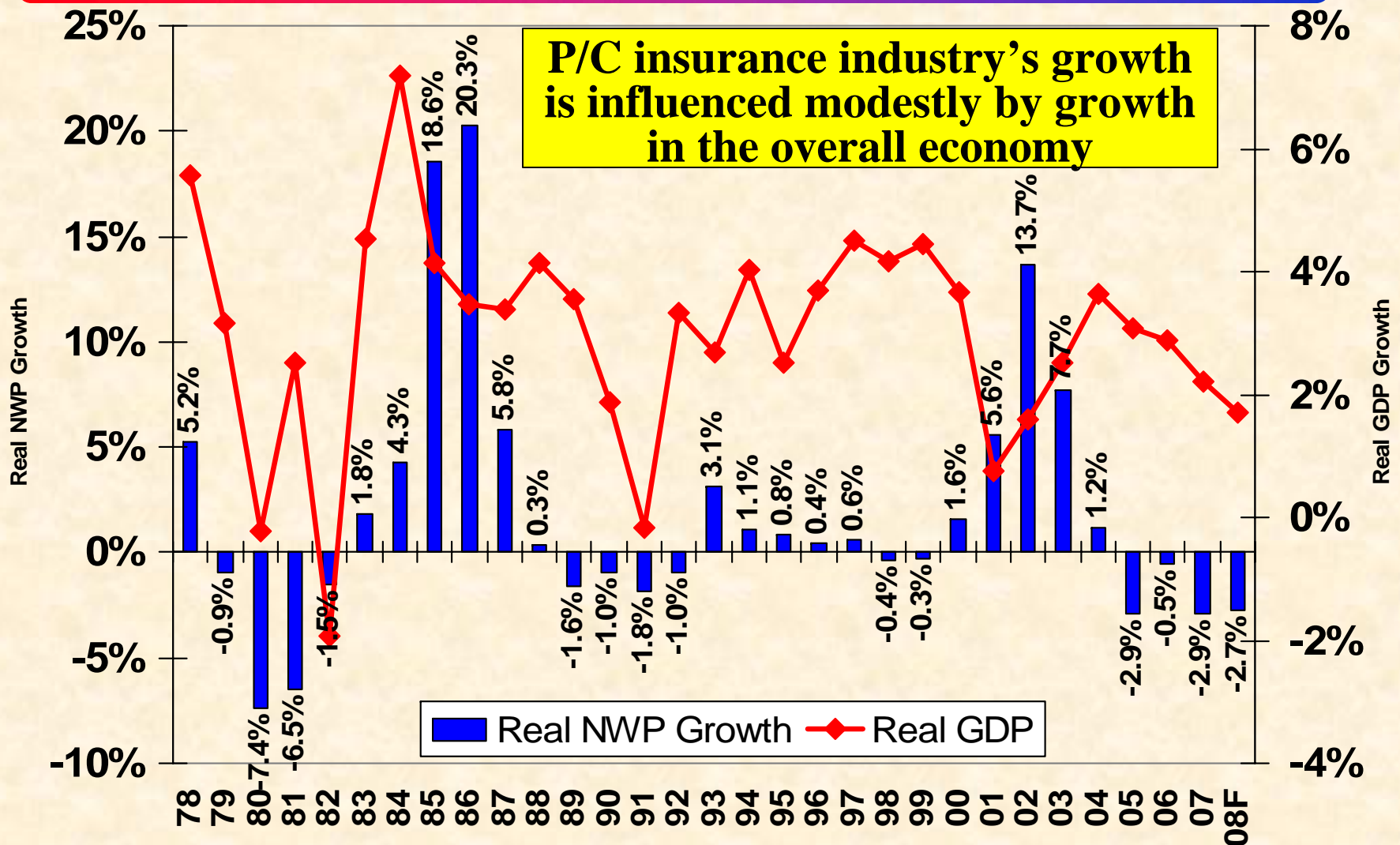
A Few Facts About the Relationship Between Insurance & Economy

- **Vast Majority of Insurance Business is Tied to Renewals**
 - Approximately 98+% of P/C business (units) is linked to renewals
 - A very large share of p/c insurance premiums are statutorily or *de facto* compulsory (e.g., WC, auto liability, surety, usually HO...)
 - P/C insurers have marginal exposure impact due to economy
 - Most life revenues and units are renewals, but some products (e.g., variable annuities are sensitive to market volatility)
 - Life insurers who manage 401(k) assets seeing more loans and hardship withdrawals;
- **Insurers are Sensitive to Interest Rates**
 - About 2/3 of P/C invested assets and 75% if Life assets are fixed income
 - Historically, yield on industry portfolios has tracked 10-year note closely
 - All else equal, lower total investment gain implies greater emphasis on underwriting
 - Historically, industry's best underwriting performances are rooted in periods when interests rates were low and/or equity market performance poor (1930s – 1950s, early 2000s gave rise to strong 2006/07)



Real GDP Growth vs. Real P/C

Premium Growth: Modest Association



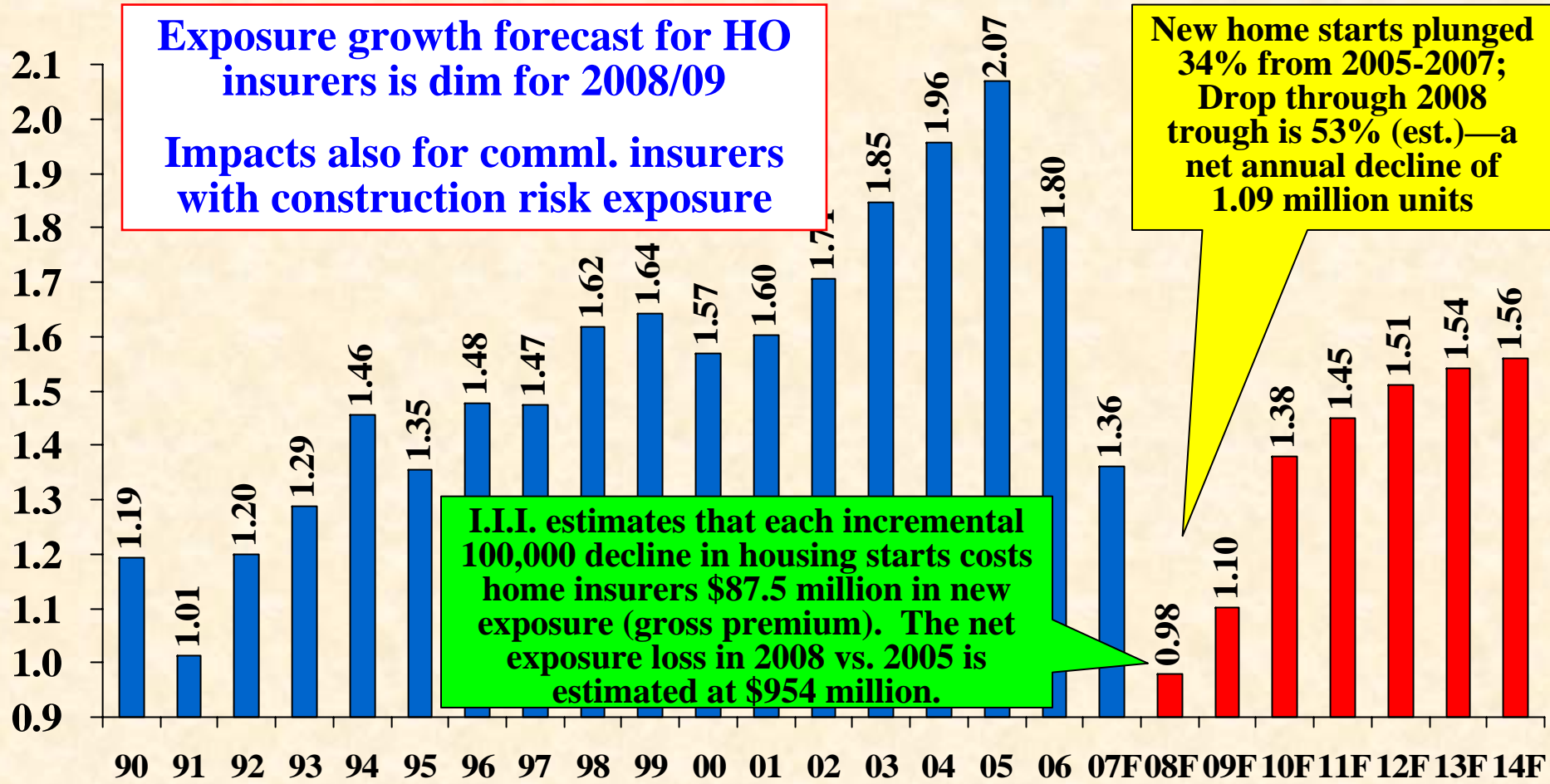


Summary of Economic Risks and Implications for (Re) Insurers

Economic Concern	Risks to Insurers
Subprime Meltdown/ Credit Crunch	<ul style="list-style-type: none">• <i>Some</i> insurers have <i>some</i> asset risk• D&O/E&O exposure for <i>some</i> insurers• Client asset management liability for <i>some</i>• Bond insurer problems; Muni credit quality
Housing Slump	<ul style="list-style-type: none">• Reduced exposure growth• Deteriorating loss performance on neglected, abandoned and foreclosed properties
Lower Interest Rates	<ul style="list-style-type: none">• Lower investment income
Stock Market Slump	<ul style="list-style-type: none">• Decreased capital gains (which are usually relied upon more heavily as a source of earnings as underwriting results deteriorate)
General Economic Slowdown/Recession	<ul style="list-style-type: none">• Reduced commercial lines exposure growth• Surety slump• Increased workers comp frequency



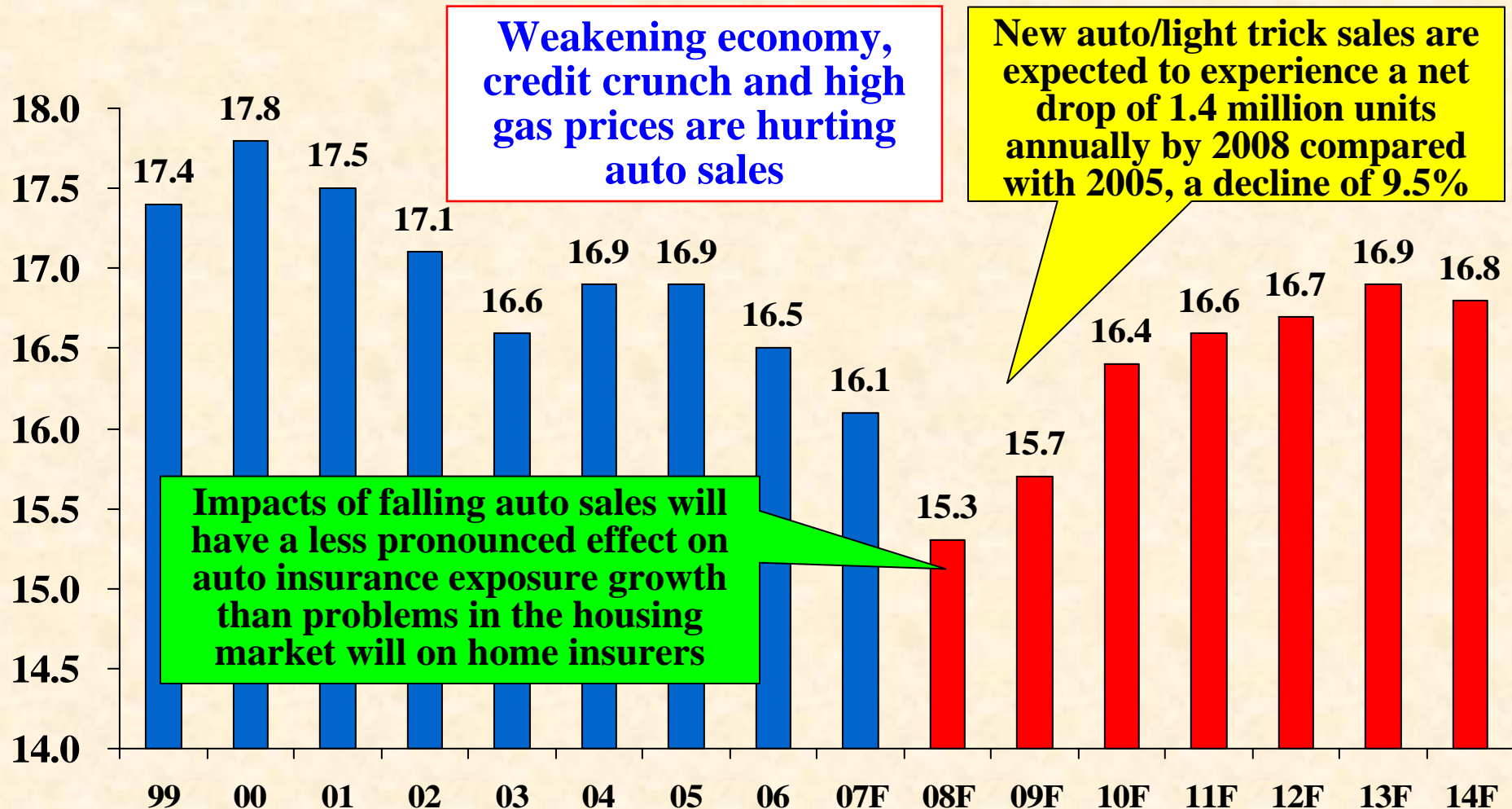
New Private Housing Starts, 1990-2014F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (10/07), except 2008/09 figures from 4/08 edition of BCEF; Insurance Info. Institute



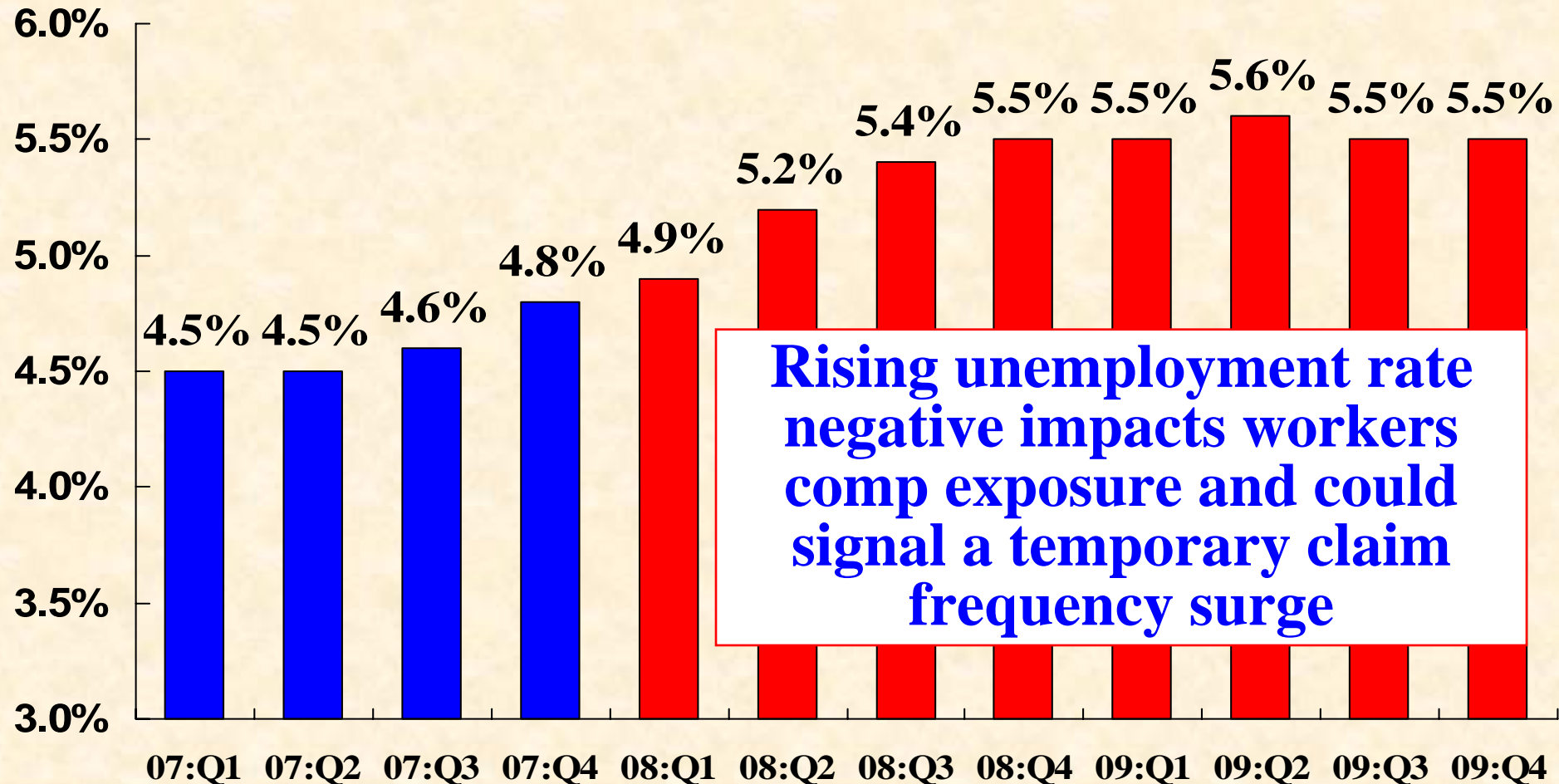
Auto/Light Truck Sales, 1999-2014F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (10/07), except 2008/09 figures from 4/08 edition of BCEF; Insurance Info. Institute



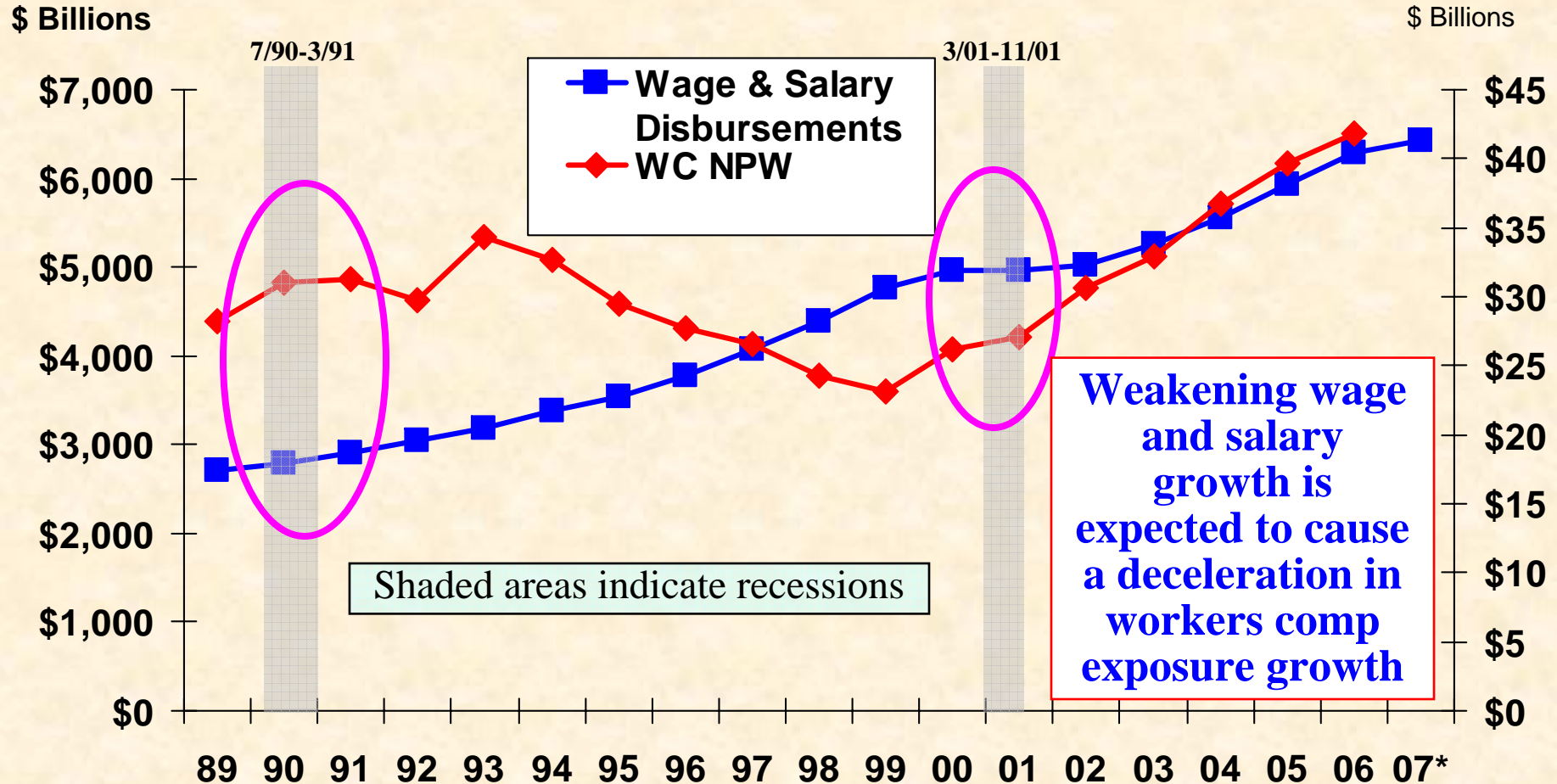
US Unemployment Rate, (2007:Q1 to 2009:Q4F)





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

Wage & Salary Disbursement (Private Employment) vs. WC NWP



*As of 7/1/07 (latest available).

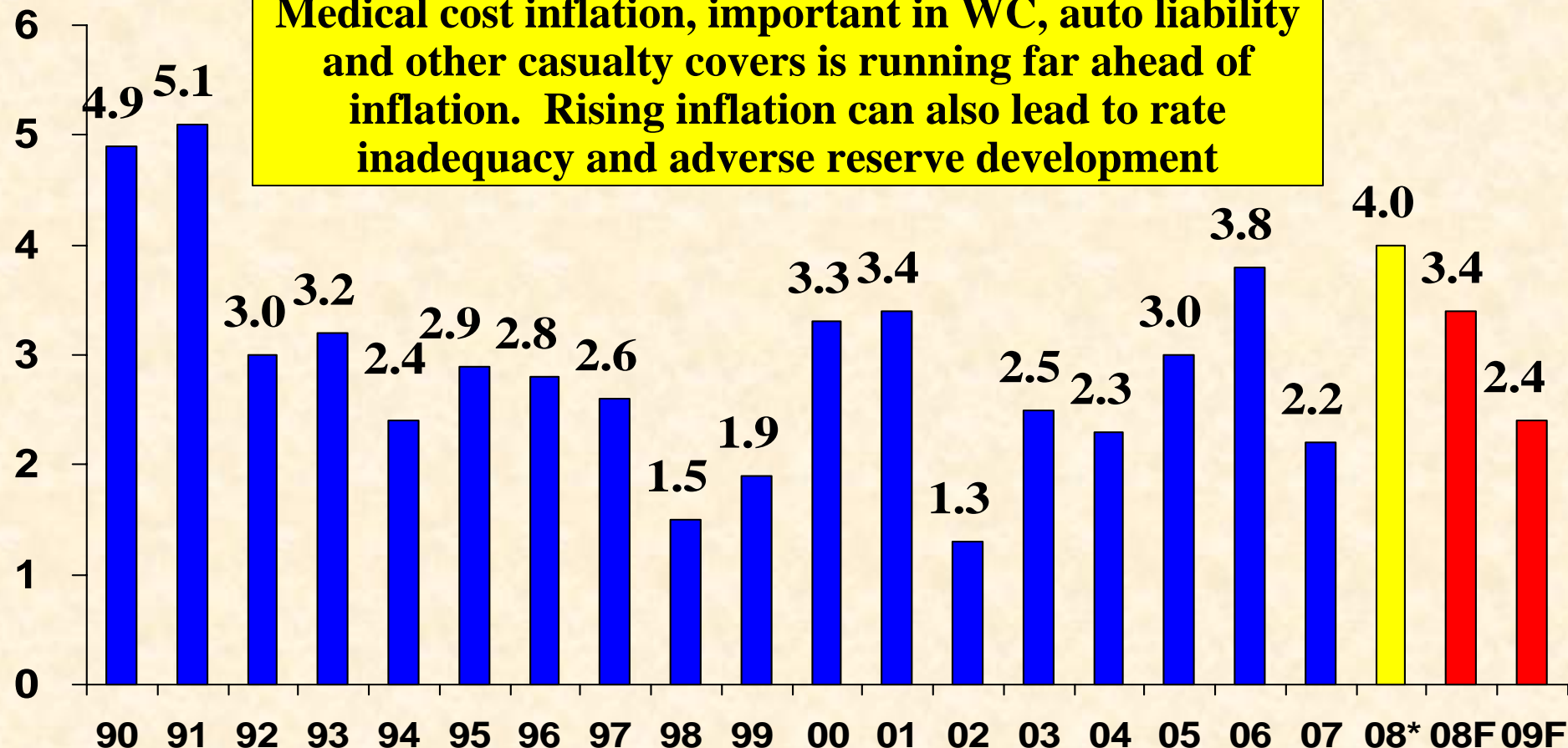
Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at

<http://research.stlouisfed.org/fred2/series/WASCUR>; I.I.I. Fact Books



Inflation Rate (CPI-U, %), 1990 – 2009F

Inflation was just 2.2% in 2007 but is accelerating. Medical cost inflation, important in WC, auto liability and other casualty covers is running far ahead of inflation. Rising inflation can also lead to rate inadequacy and adverse reserve development



*12-month change Feb. 2008 vs. Feb. 2007;

Source: US Bureau of Labor Statistics; Blue Chip Economic Indicators, Mar. 10, 2008; Ins. Info. Institute.



Favored Industry Groups for Insurer Exposure Growth

Industry	Rationale
Health Care	<ul style="list-style-type: none">•Economic Necessity→Recession Resistant•Demographics: aging/immigration→Growth
Energy (incl. Alt.)	<ul style="list-style-type: none">•Fossil, Solar, Wind, Bio-Fuels, Hydro & Other
Agriculture & Food Processing & Manufacturing	<ul style="list-style-type: none">•Consumer Staple→Recession Resistant•Grain and land prices high due to global demand, weak dollar (exports)•Acreage Growing→Farm Equipment, Transport•Benefits many other industries
Export Driven	<ul style="list-style-type: none">•Weak dollar, globalization persist; Cuba angle?
Natural Resources & Commodities	<ul style="list-style-type: none">•Strong global demand,•Supplies remain tight...<i>but beware of bubbles</i>•Significant investments in R&D, plant & equip required

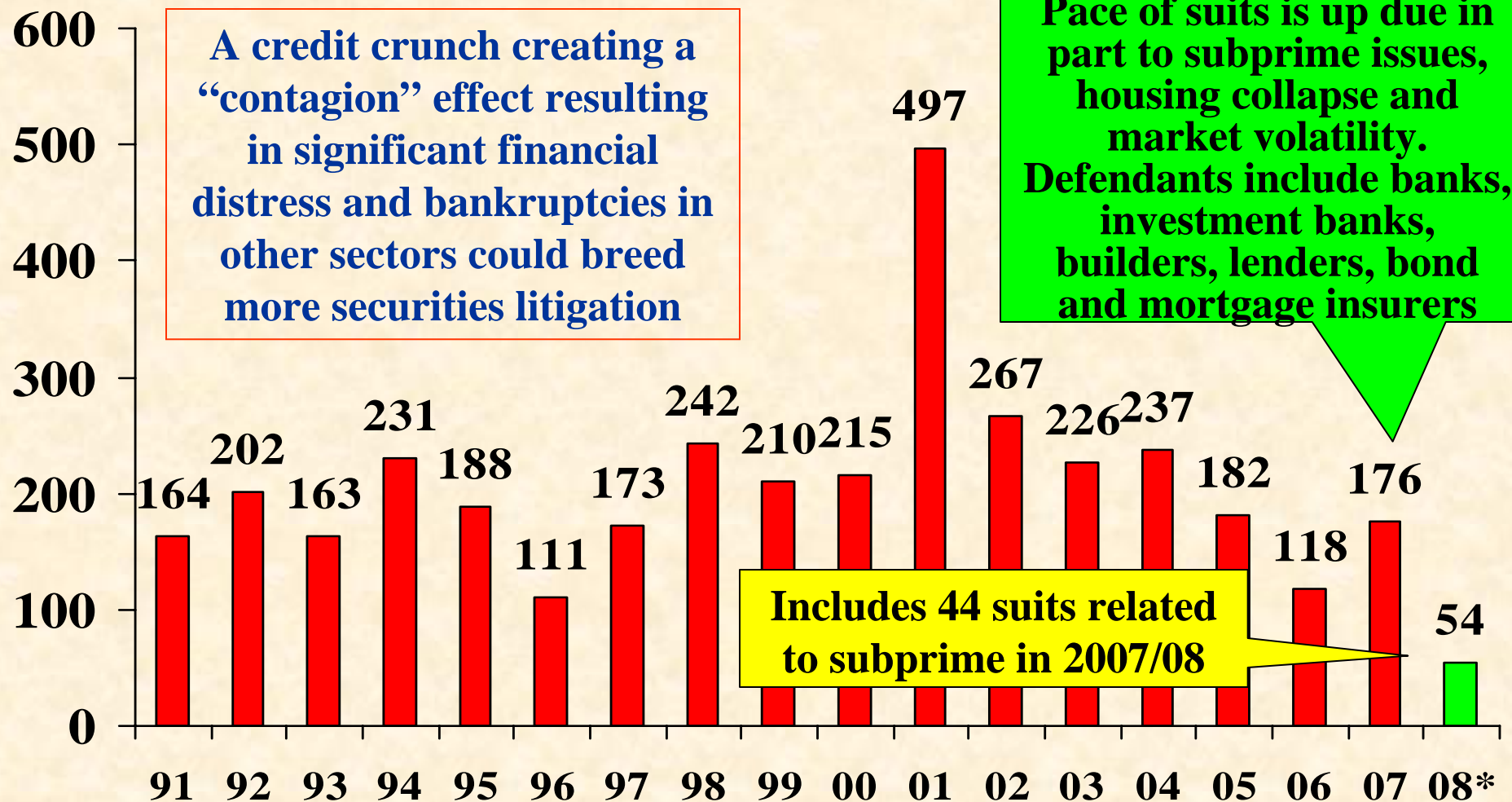
D&O/E&O

**Turbulent Markets,
Bankruptcies Can Give
Rise to Suits**





Shareholder Class Action Lawsuits*



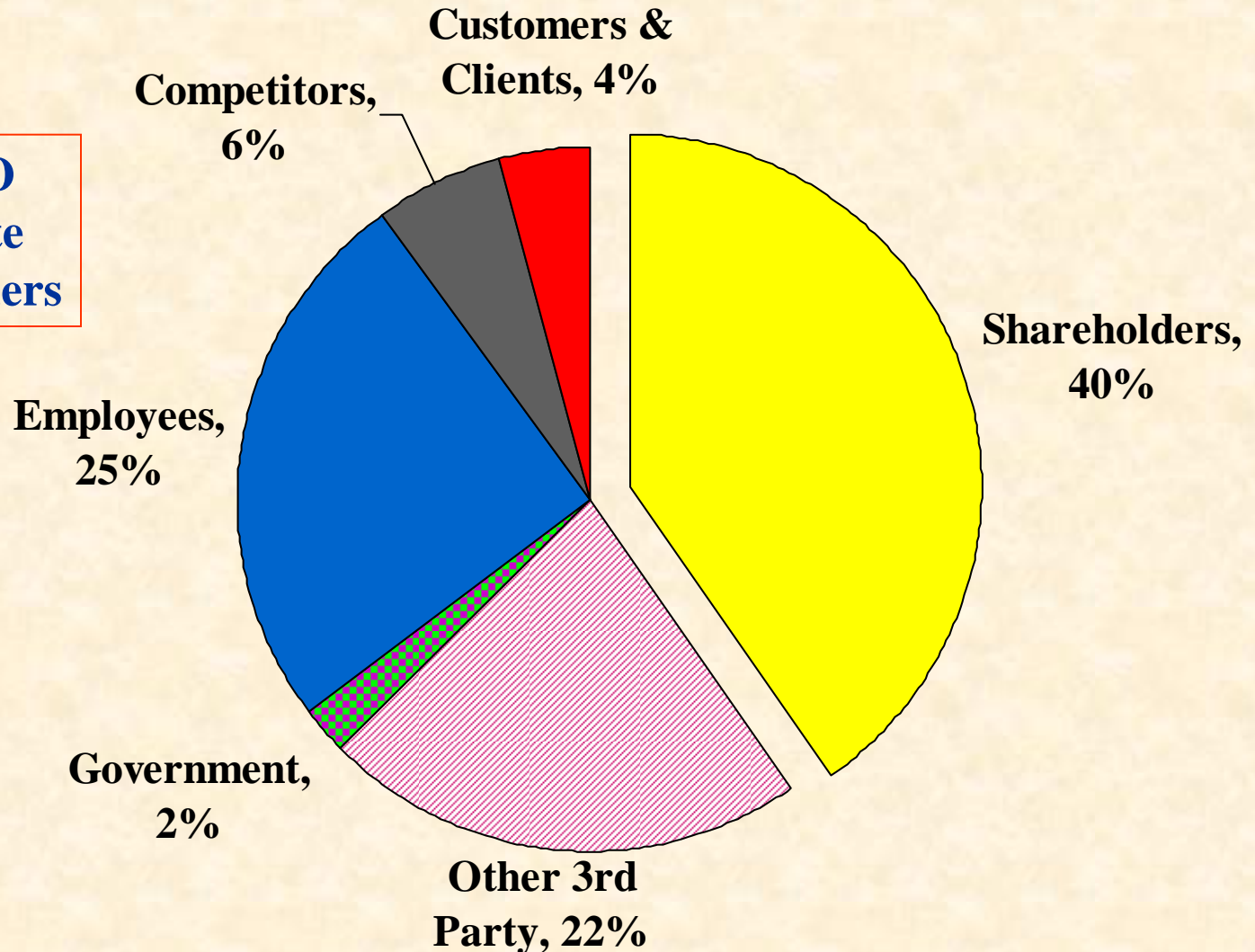
*Securities fraud suits filed in U.S. federal courts; 2008 figure is current through March 31.

Source: Stanford University School of Law (securities.stanford.edu); Insurance Information Institute



Origin of D&O Claims for Public Companies, 2006

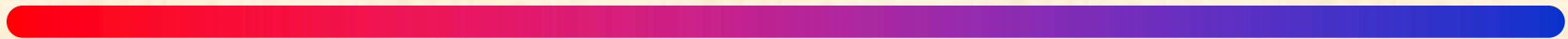
**40% of D&O
suits originate
with shareholders**



PROFITABILITY

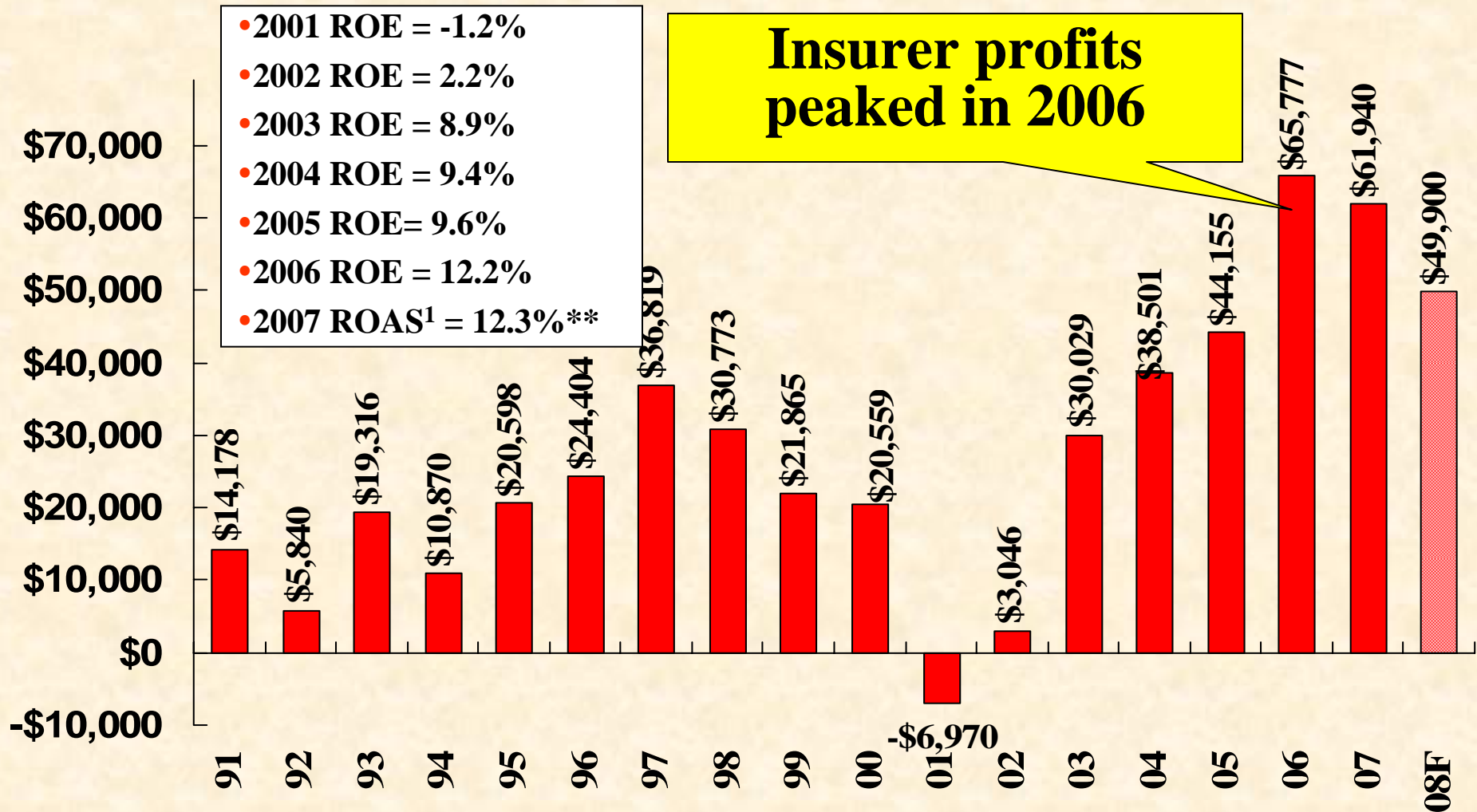
**Profits in 2006/07 Reached
Their Cyclical Peak;**

**By No Reasonable Standard Can
Profits Be Deemed Excessive**





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

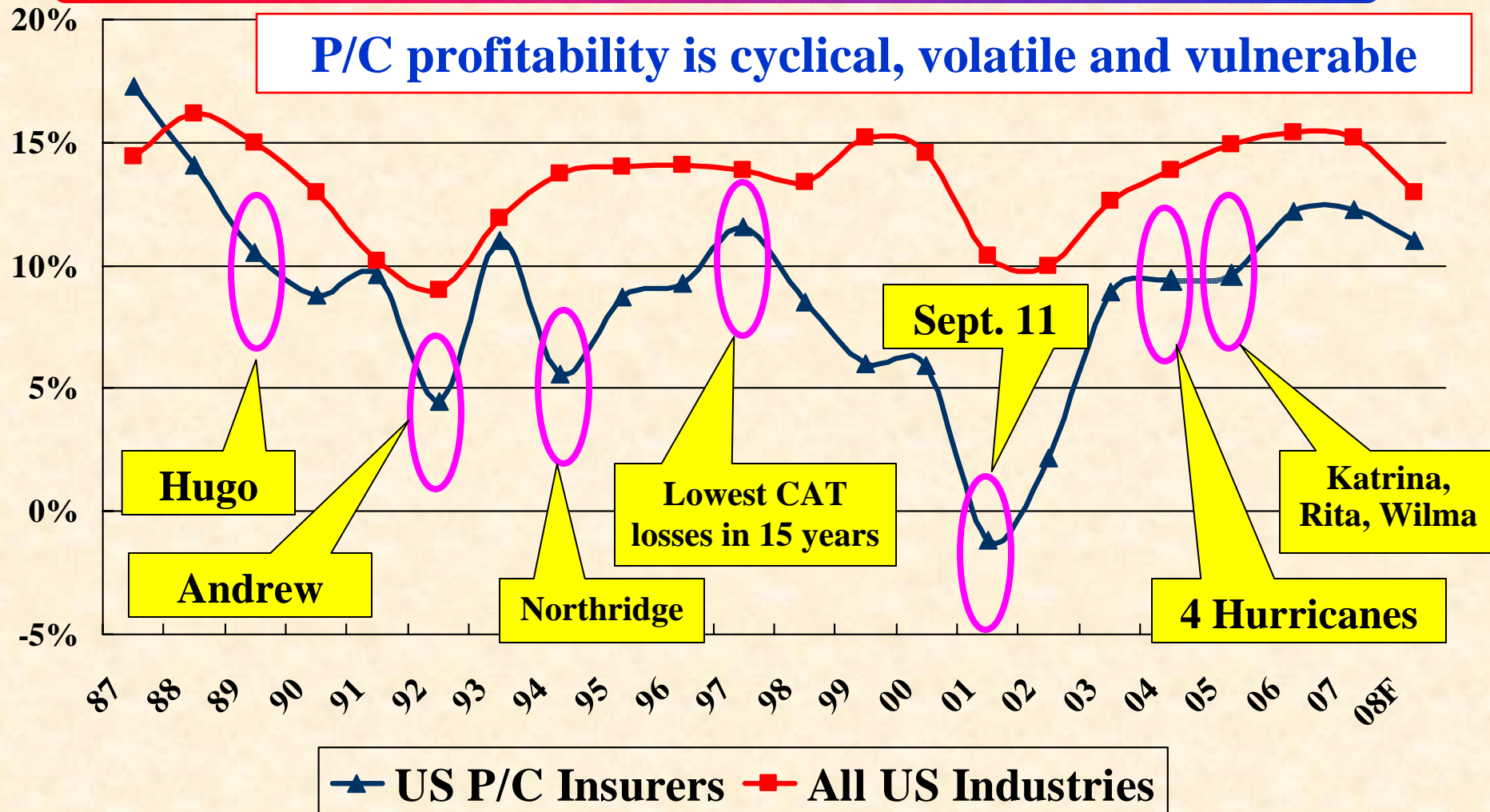


*ROE figures are GAAP; ¹Return on avg. surplus. **Return on Average Surplus; Sources: A.M. Best, ISO, Insurance Information Inst.



ROE: P/C vs. All Industries

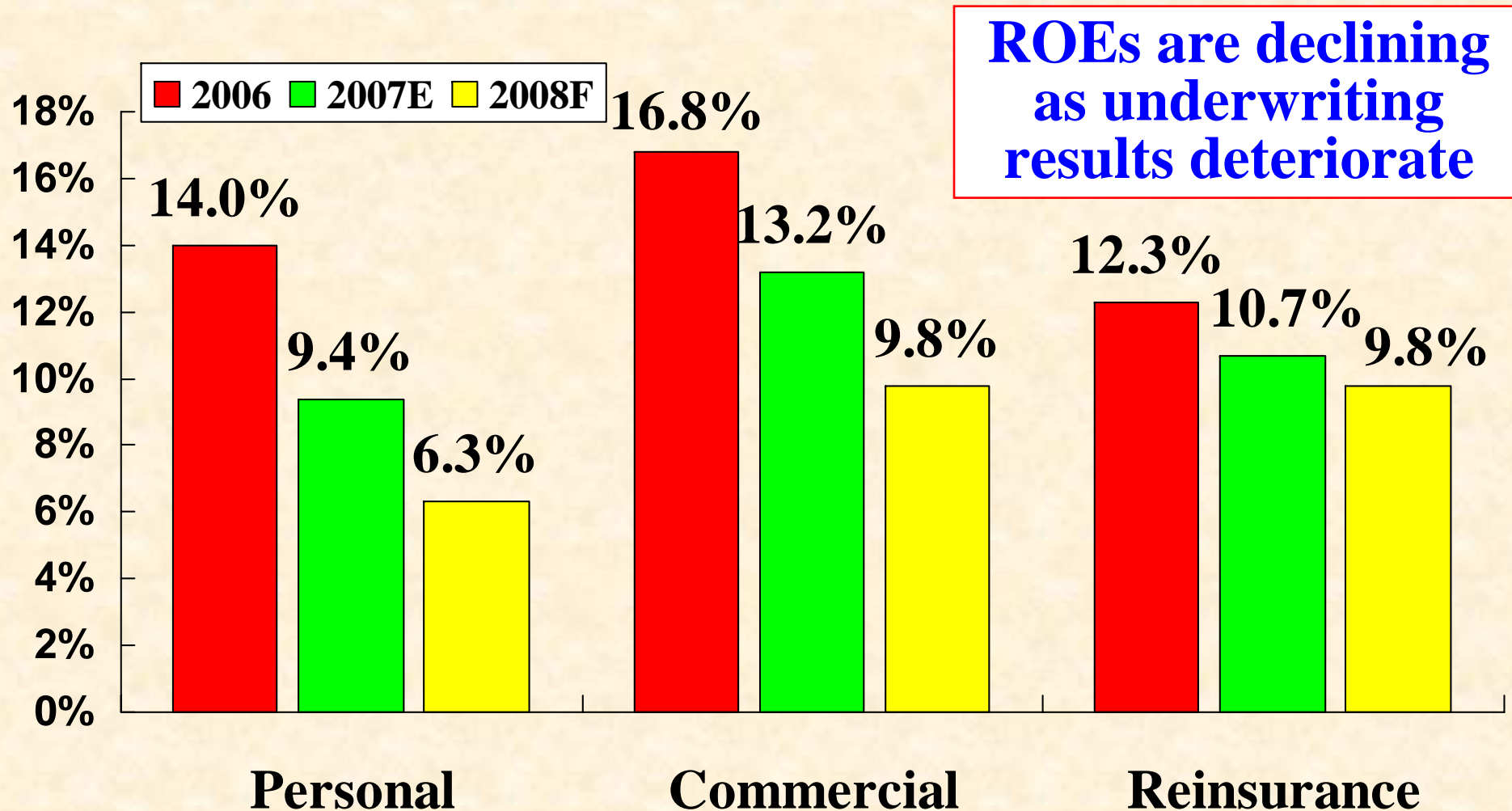
1987–2008E



2008 P/C insurer ROE is I.I.I. estimate.

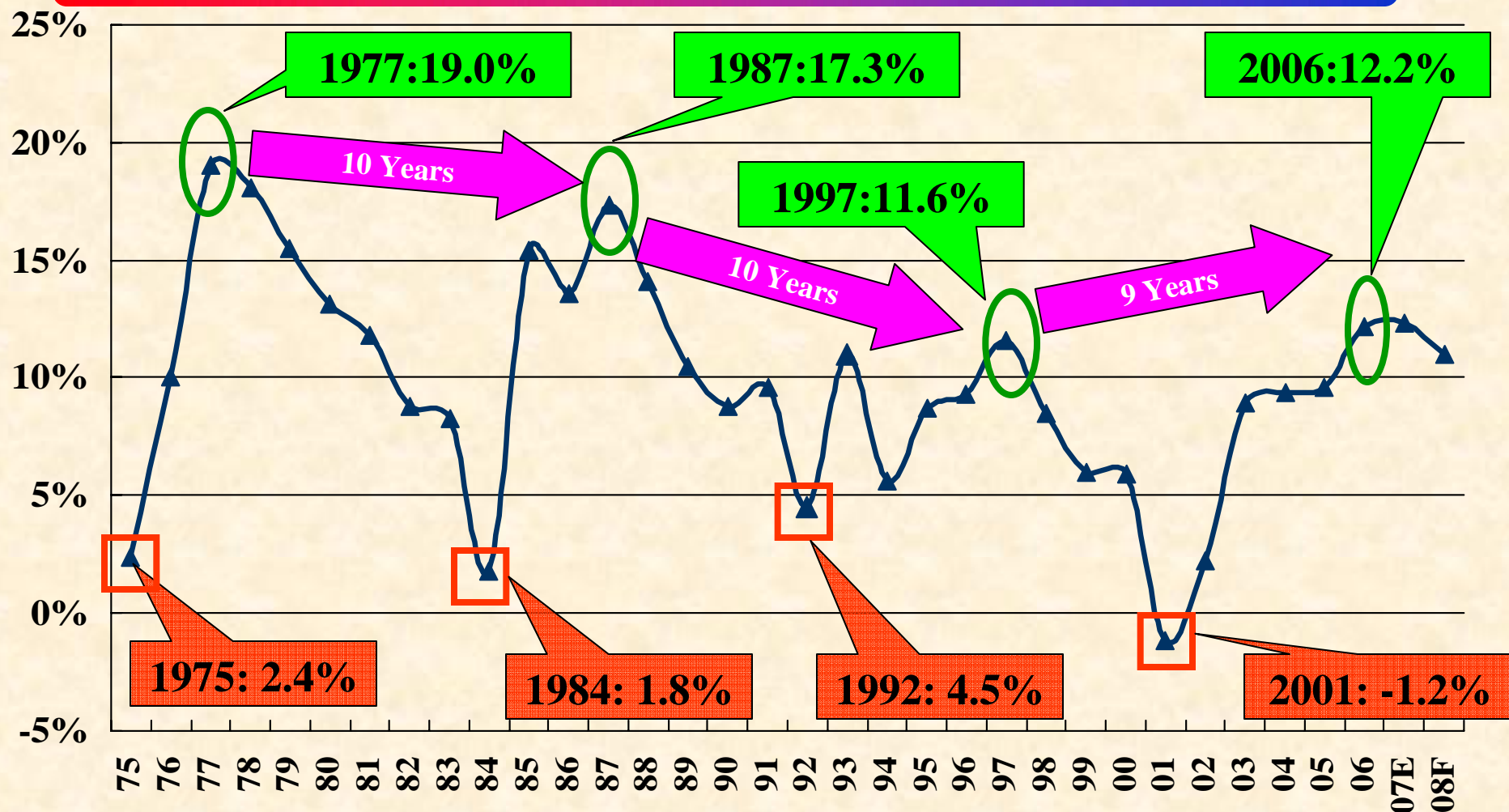
Source: Insurance Information Institute; *Fortune*

*Personal/Commercial Lines & Reinsurance ROEs, 2006-2008F**





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



*GAAP ROE for all years except 2007 which is actual ROAS of 12.3%. 2008 P/C insurer ROE is I.I.I. estimate.

Source: Insurance Information Institute, ISO; *Fortune*

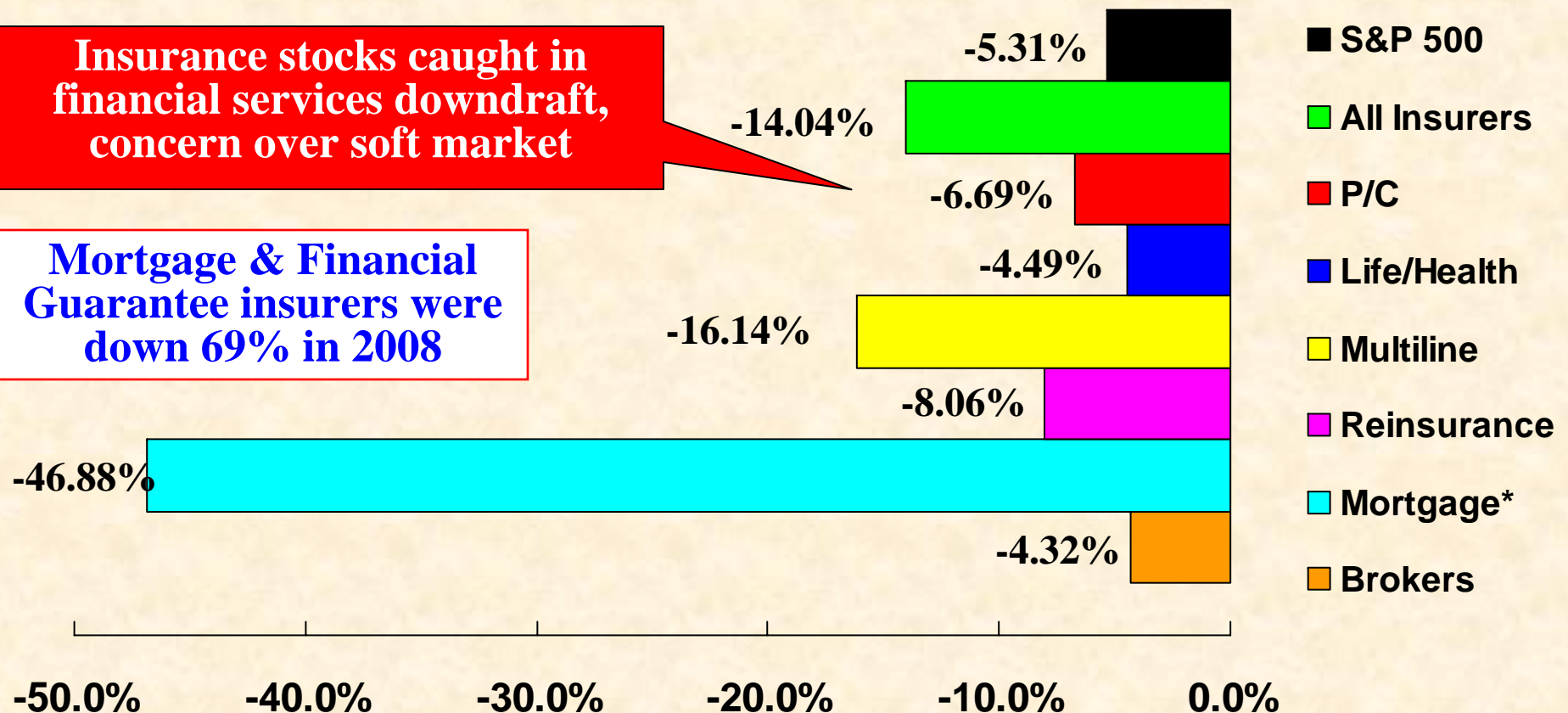


Insurance Stocks: Mixed Performance Compared to S&P 500 Index in 2008

Total YTD Returns Through April 18, 2008

**Insurance stocks caught in
financial services downdraft,
concern over soft market**

**Mortgage & Financial
Guarantee insurers were
down 69% in 2008**



*Includes Financial Guarantee.

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



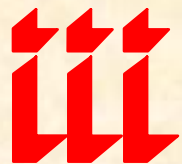
Factors that Will Influence the Length and Depth of the Cycle

- **Capacity**: Rapid surplus growth in recent years has left the industry with between \$85 billion and \$100 billion in excess capital, according to analysts
 - All else equal, rising capital leads to greater price competition and a liberalization of terms and conditions
- **Reserves**: Reserves are in the best shape (in terms of adequacy) in decades, which could extend the depth and length of the cycle
 - Looming reserve deficiencies are not hanging over insurers the way they did during the last soft market in the late 1990s
 - Many companies have been releasing redundant reserves, which allows them to boost net income even as underwriting results deteriorate
 - Reserve releases will diminish in 2008; Even more so in 2009
- **Investment Gains**: 2007 was the 5th consecutive up year on Wall Street. With sharp declines in stock prices and falling interest rates, portfolio yields are certain to fall → Contributes to discipline
 - Realized capital gains are already rising as underwriting profits shrink, but like redundant reserves, realized capital gains are a finite resource
 - A sustained equity market decline (and potentially a drop in bond prices at some point) could reduce policyholder surplus

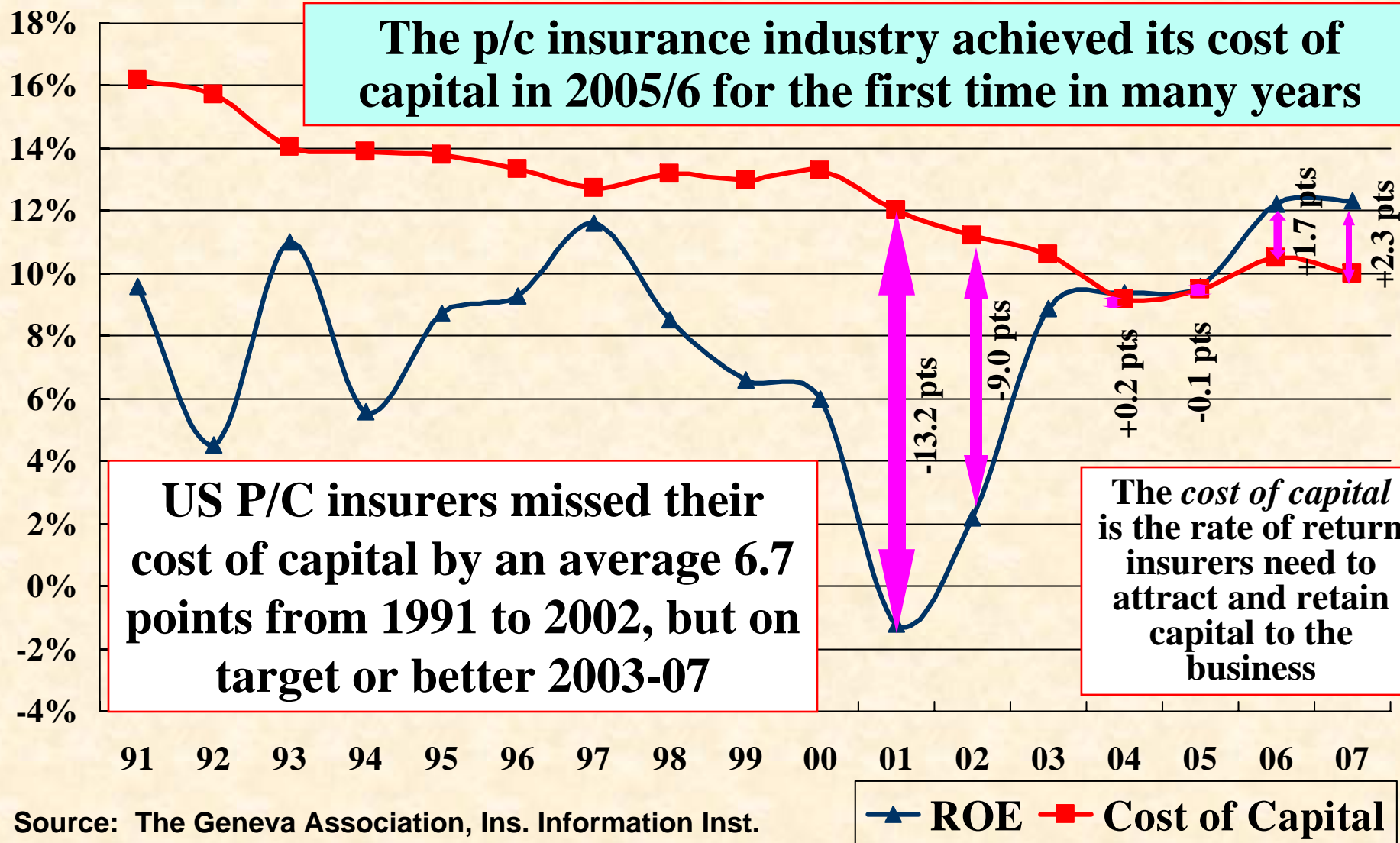


Factors that Will Influence the Length and Depth of the Cycle (cont'd)

- **Sarbanes-Oxley**: Presumably SOX will lead to better and more conservative management of company finances, including rapid recognition of deficient or redundant reserves
 - With more “eyes” on the industry, the theory is that cyclical swings should shrink
- **Ratings Agencies**: Focus on Cycle Management; Quicker to downgrade
 - Ratings agencies more concerned with successful cycle management strategy
 - Many insurers have already had ratings “haircut” over the last several years the way they did during the last soft market in the late 1990s; Less of a margin today
- **Finite Reinsurance**: Had smoothing effect on earnings; Finite market is gone
- **Information Systems**: Management has more and better tools that allow faster adjustments to price, underwriting and changing market conditions than it had during previous soft markets
- **Analysts/Investors**: Less fixated on growth, more on ROE through soft mkt.
 - Management has backing of investors of Wall Street to remain disciplined
- **M&A Activity**: More consolidation implies greater discipline
 - Liberty Mutual/Safeco deal creates 5th largest p/c insurer. More to come?



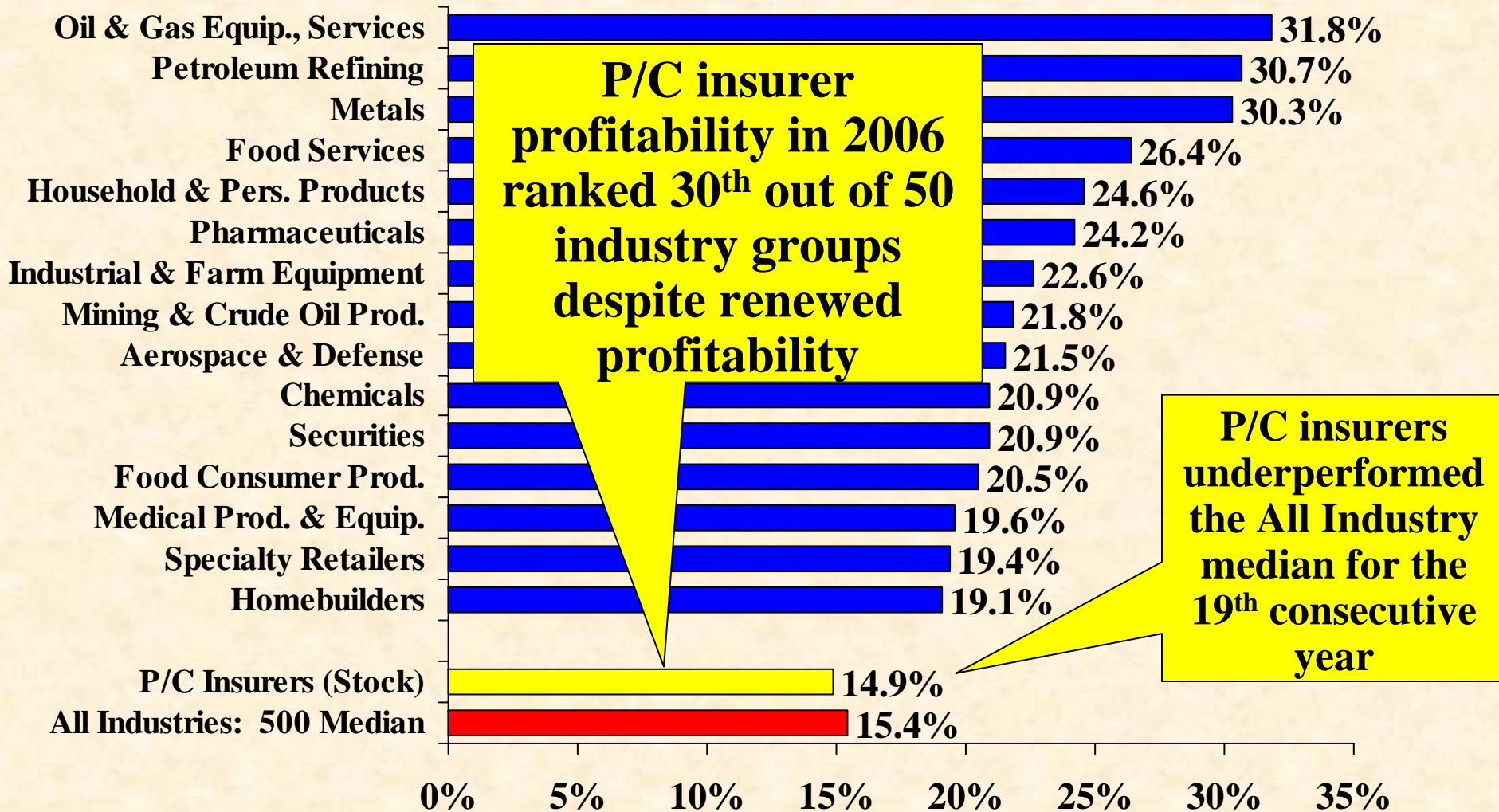
ROE vs. Equity Cost of Capital: *US P/C Insurance: 1991-2007*



Source: The Geneva Association, Ins. Information Inst.



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

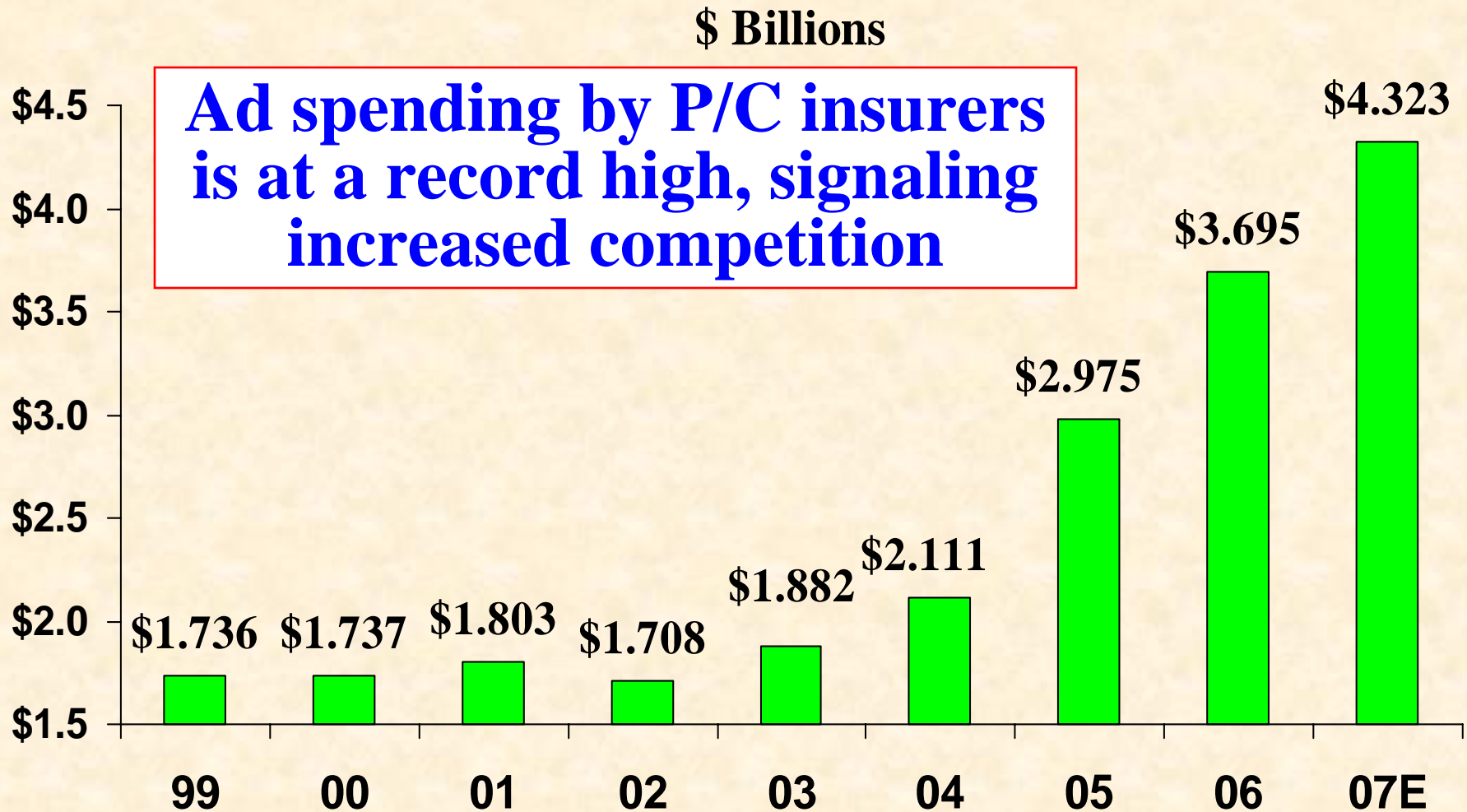


*Excludes #1 ranked Airline category at 65.1% due to special one-time bankruptcy-related factors.

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



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



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

FINANCIAL STRENGTH & RATINGS

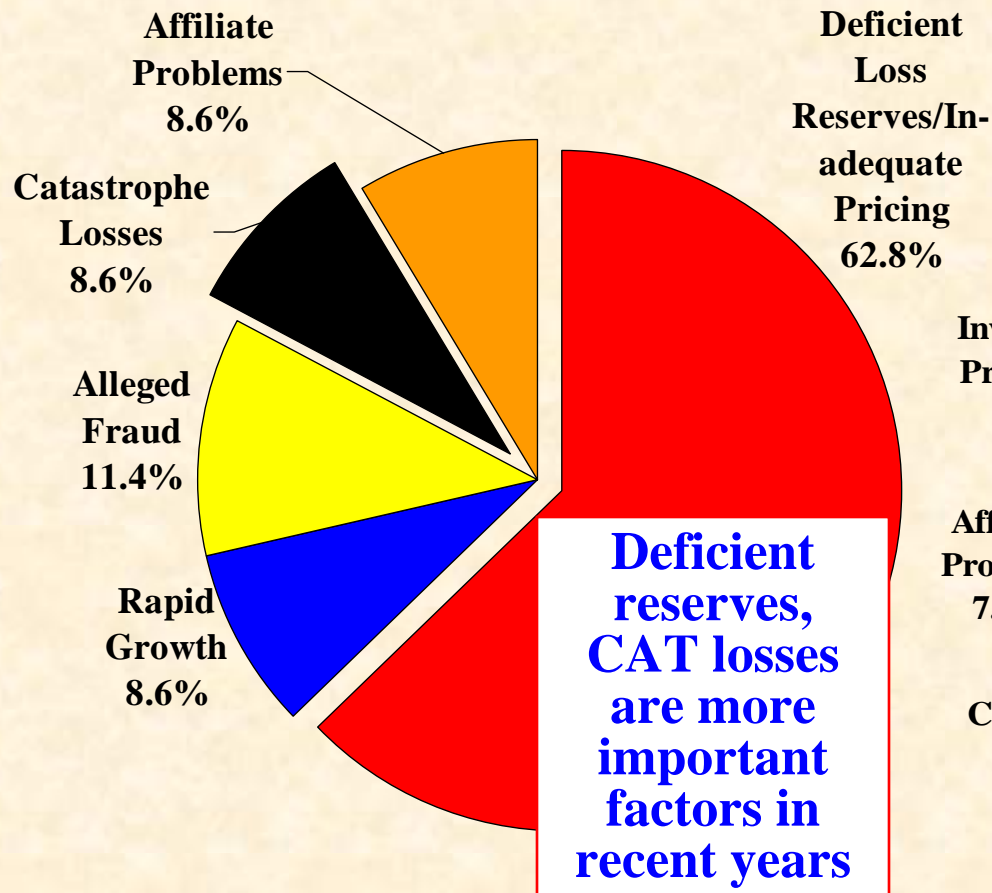
Industry Has Weathered
the Storms Well, But Cycle
 May Takes Its Toll



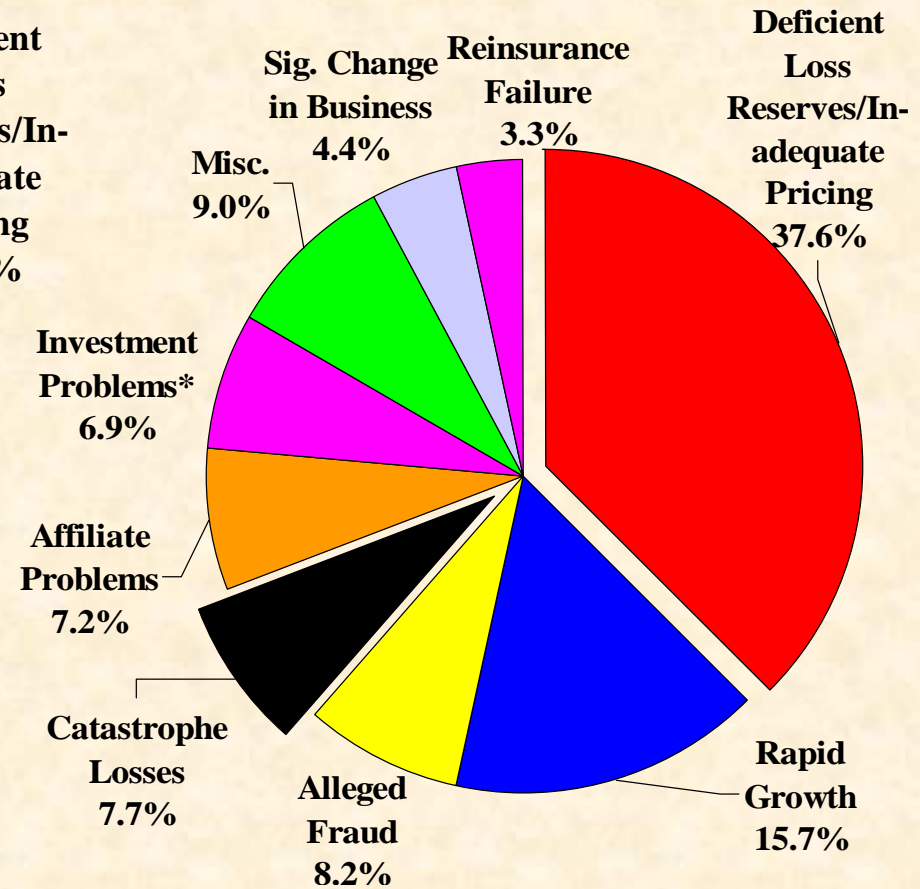


Reasons for US P/C Insurer Impairments, 1969-2005/6

2003-2005



1969-2006

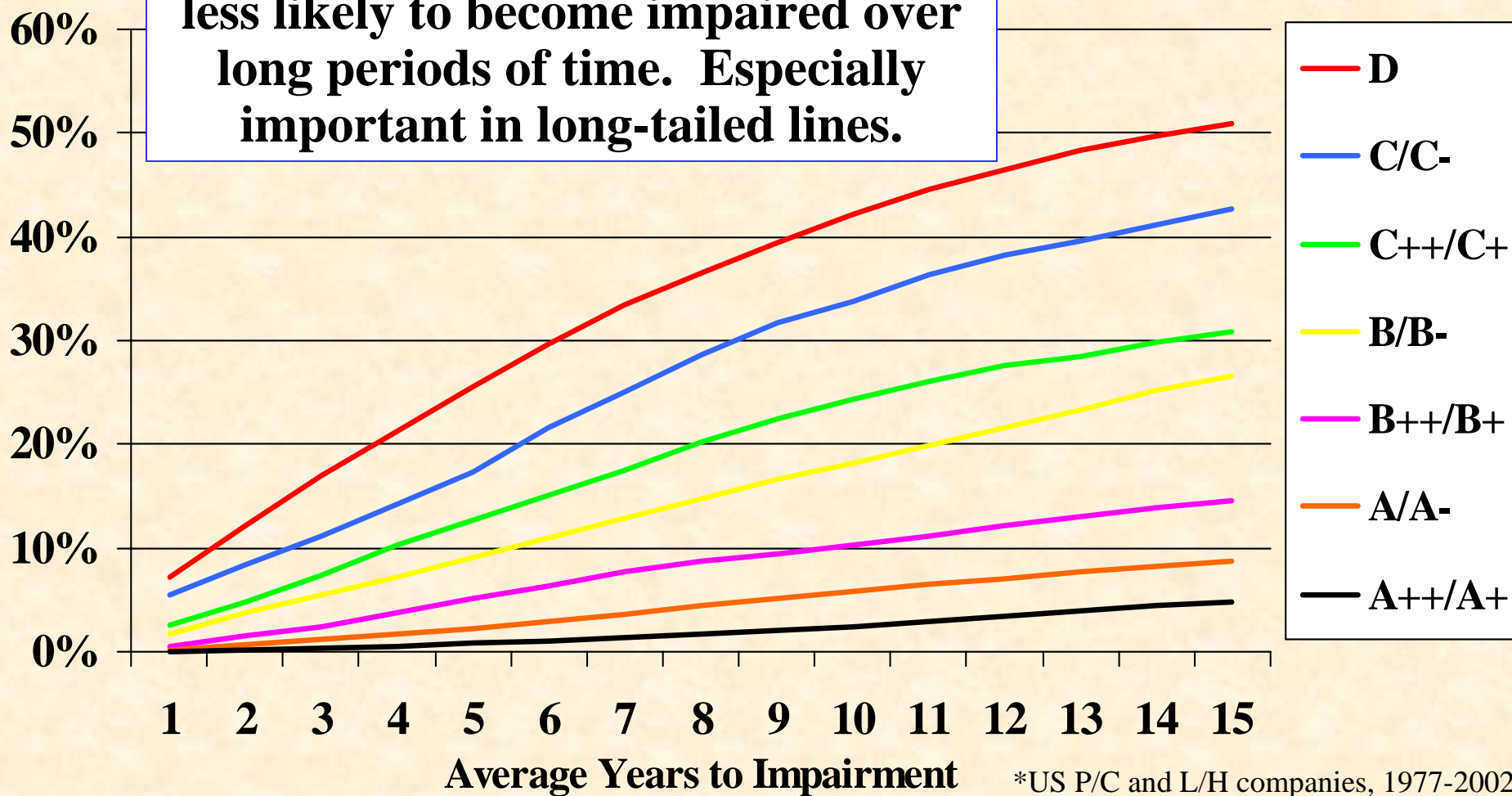


*Includes overstatement of assets.



Cumulative Average Impairment Rates by Best Financial Strength Rating*

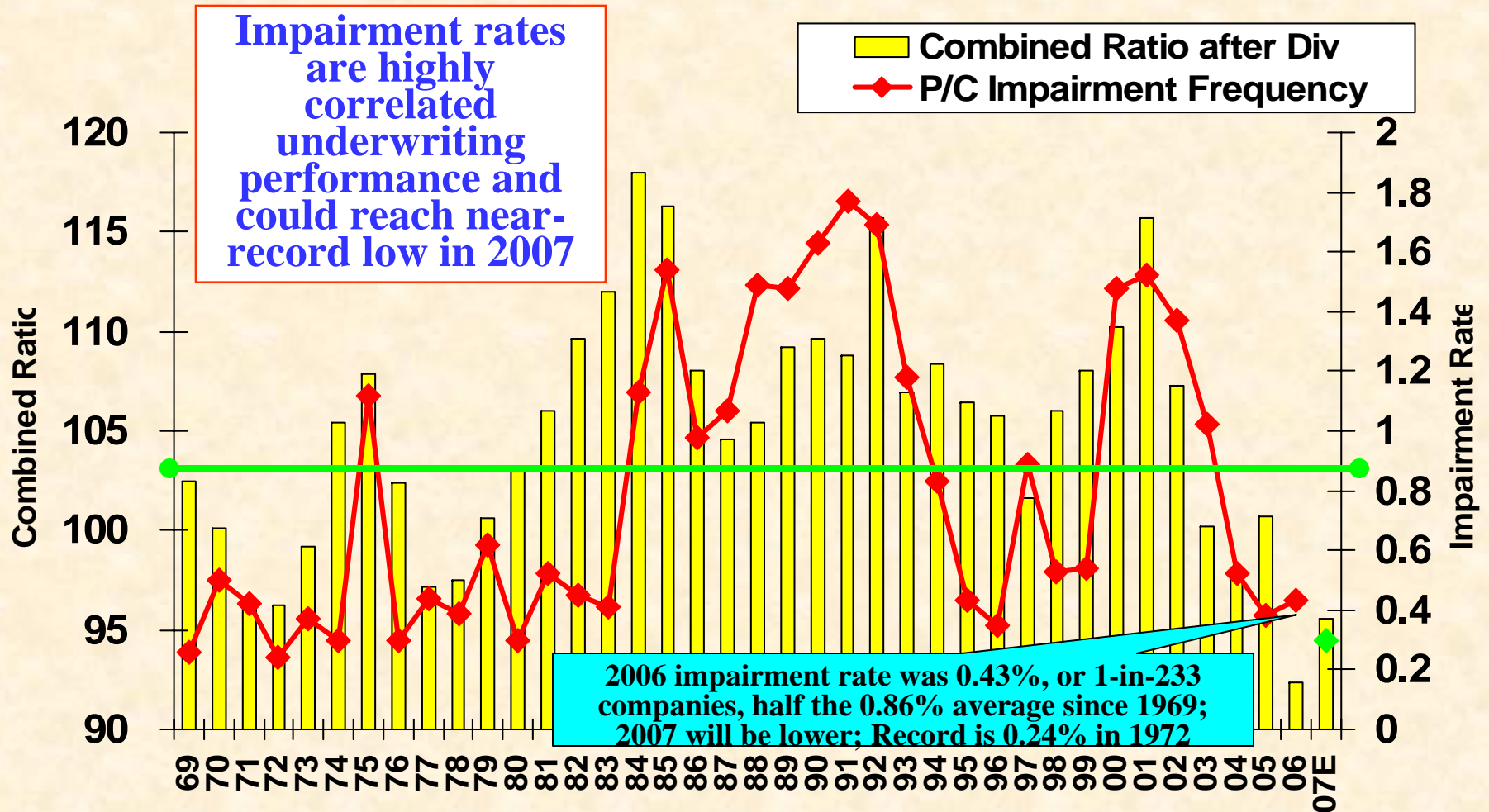
Insurers with strong ratings are far less likely to become impaired over long periods of time. Especially important in long-tailed lines.



*US P/C and L/H companies, 1977-2002



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



Guarantee Funds, The Insurance Cycle & CATs

**Assessment Activity
Follows Cycle, CATs**

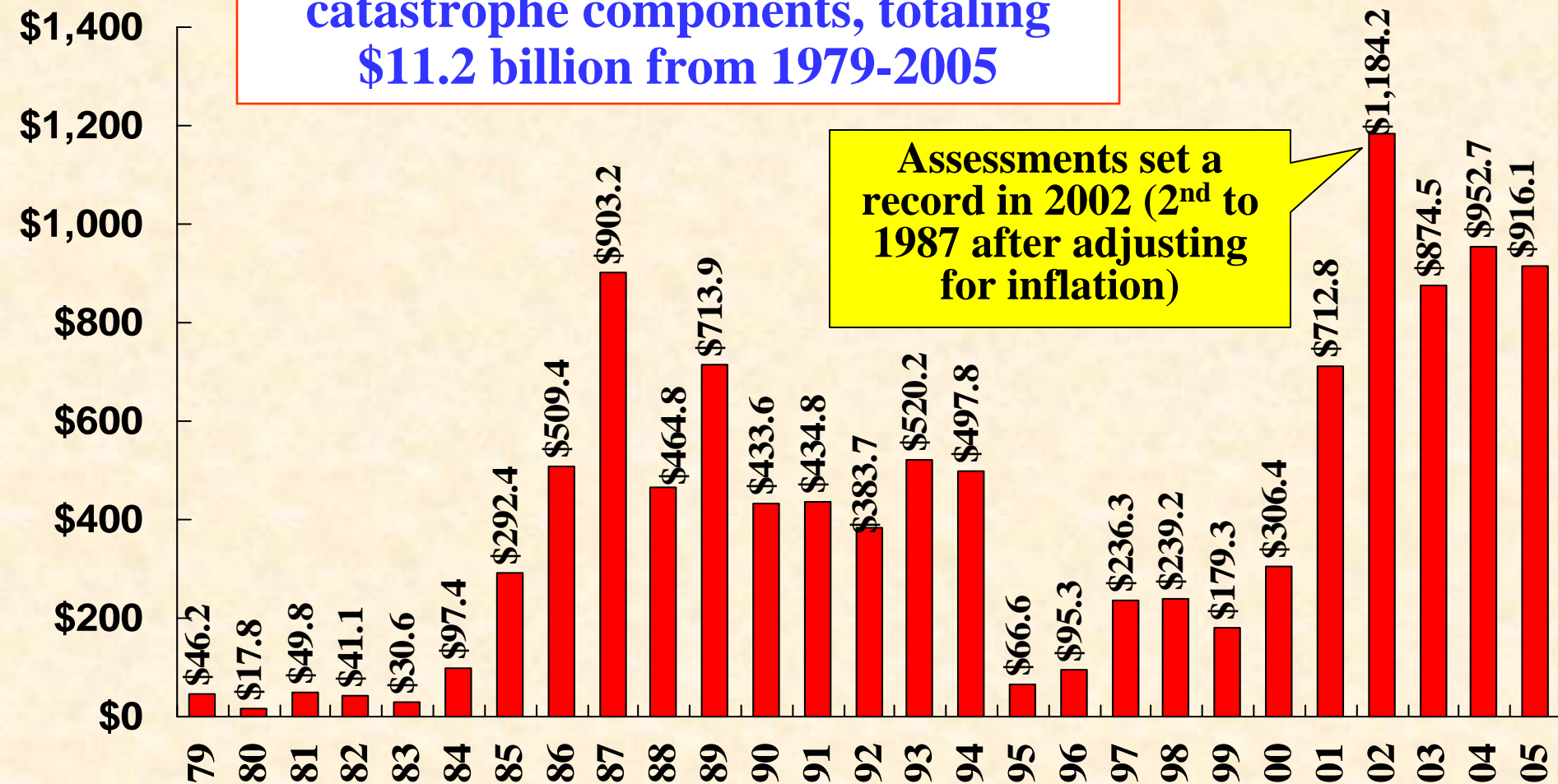




Guarantee Fund Assessments, 1979 - 2005 (\$ Millions)

**Assessments have both cyclical and
catastrophe components, totaling
\$11.2 billion from 1979-2005**

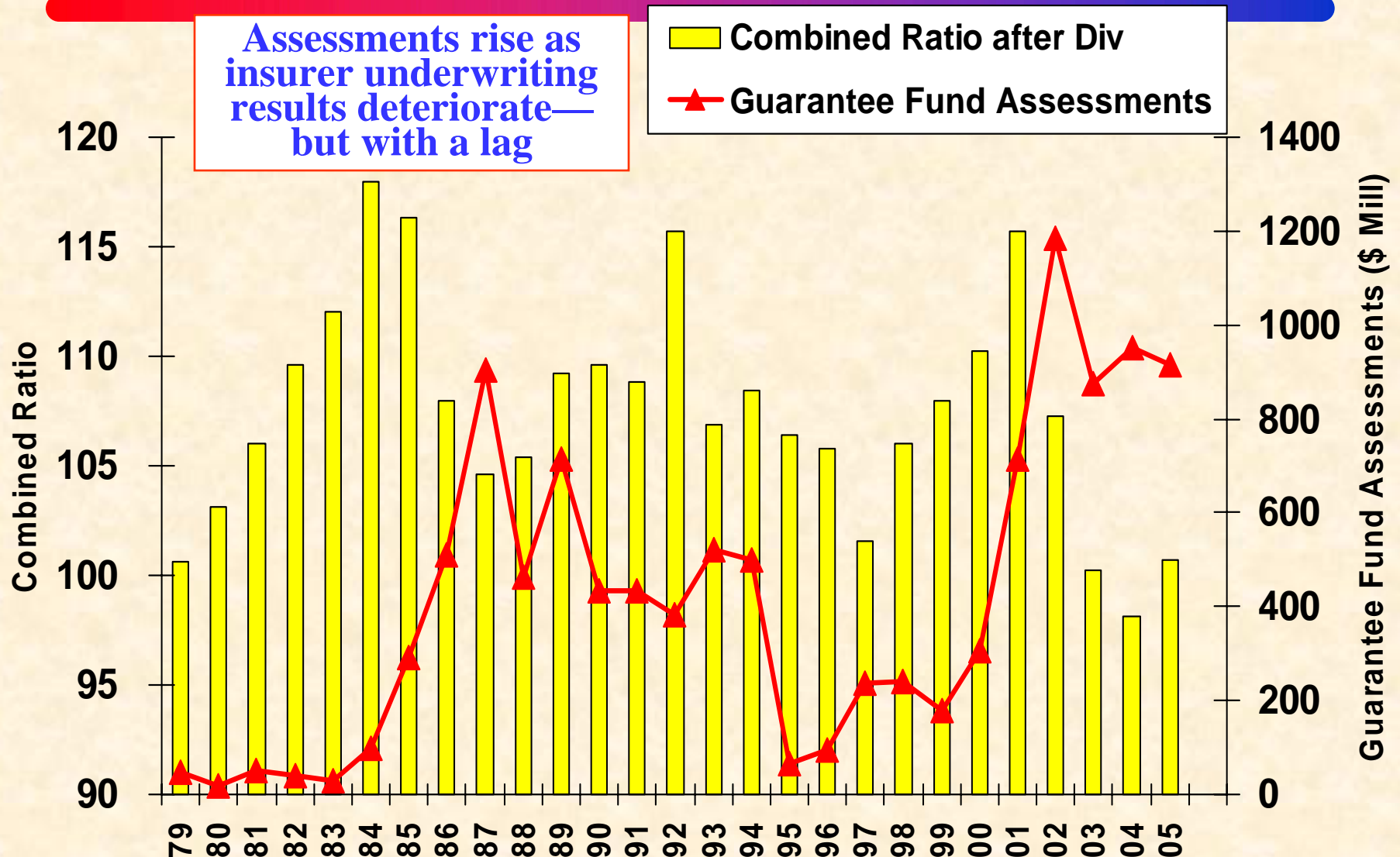
**Assessments set a
record in 2002 (2nd to
1987 after adjusting
for inflation)**





Guarantee Fund Assessments vs. Combined Ratio, 1979-2005

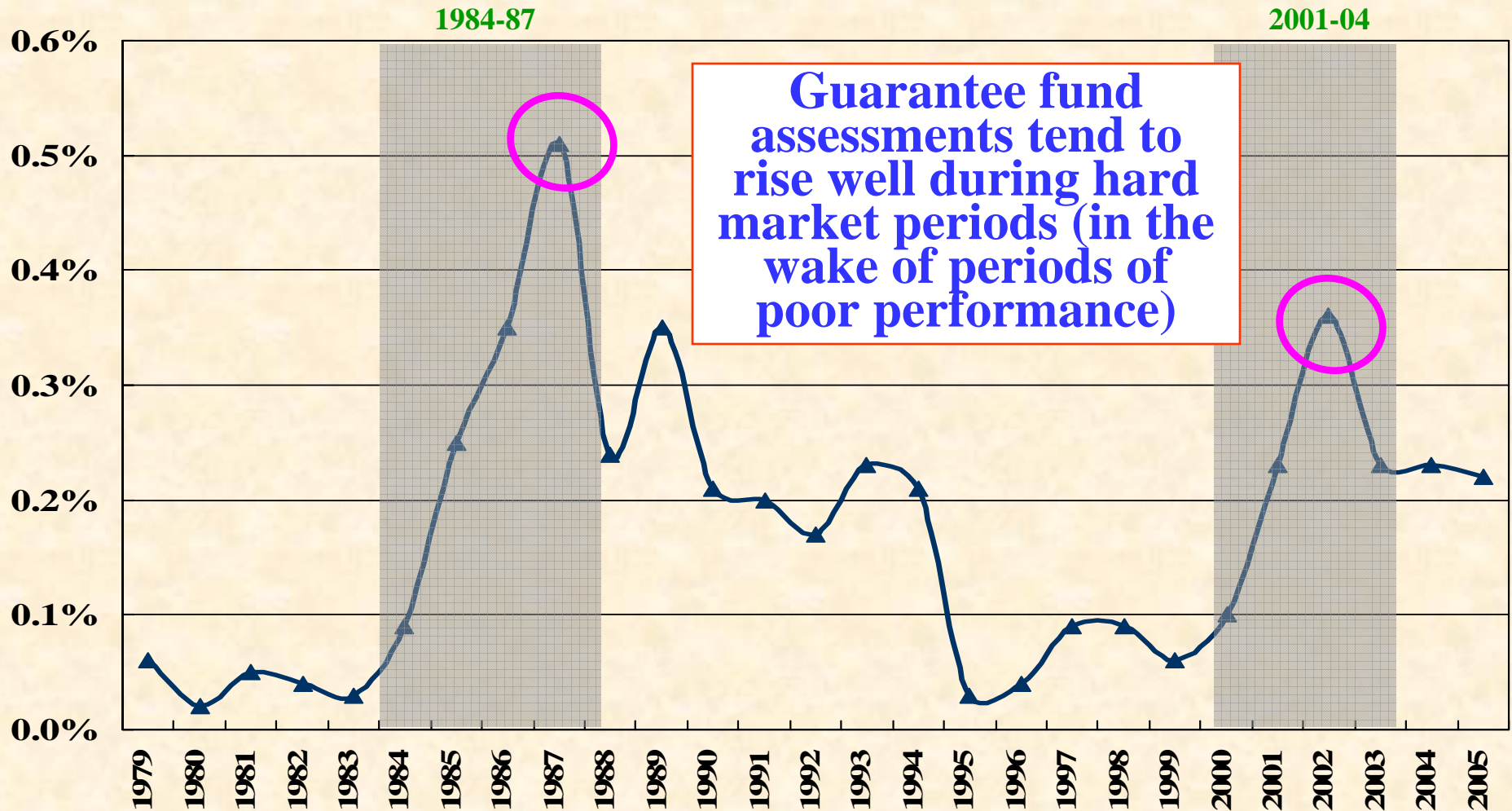
Assessments rise as
insurer underwriting
results deteriorate—
but with a lag



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



Guarantee Fund Assessments as a Percentage of Net Written Premium



Note: Shaded areas denote hard market periods.

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

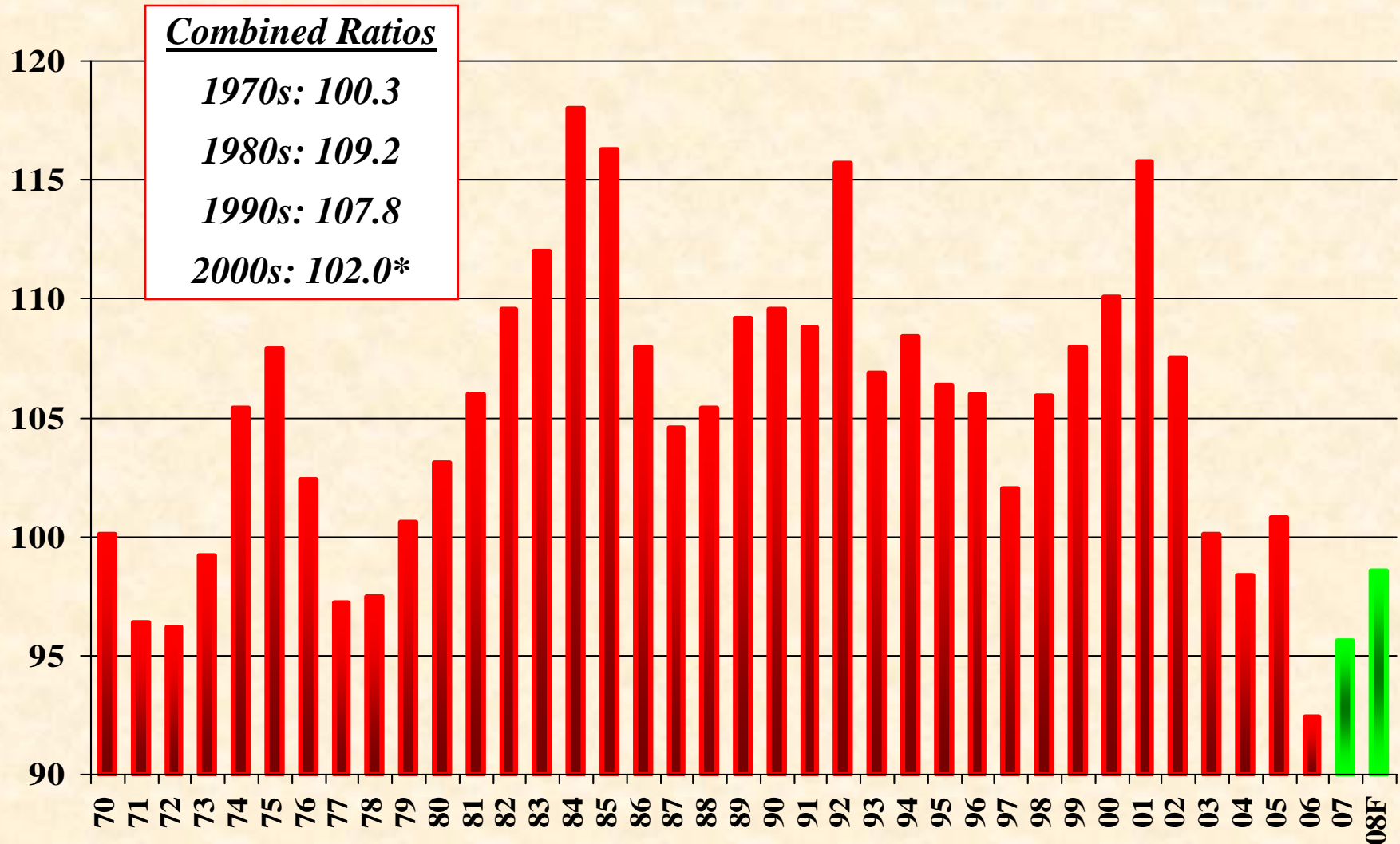
UNDERWRITING TRENDS

**Extremely Strong 2006/07;
Relying on Momentum &
Discipline for 2008**





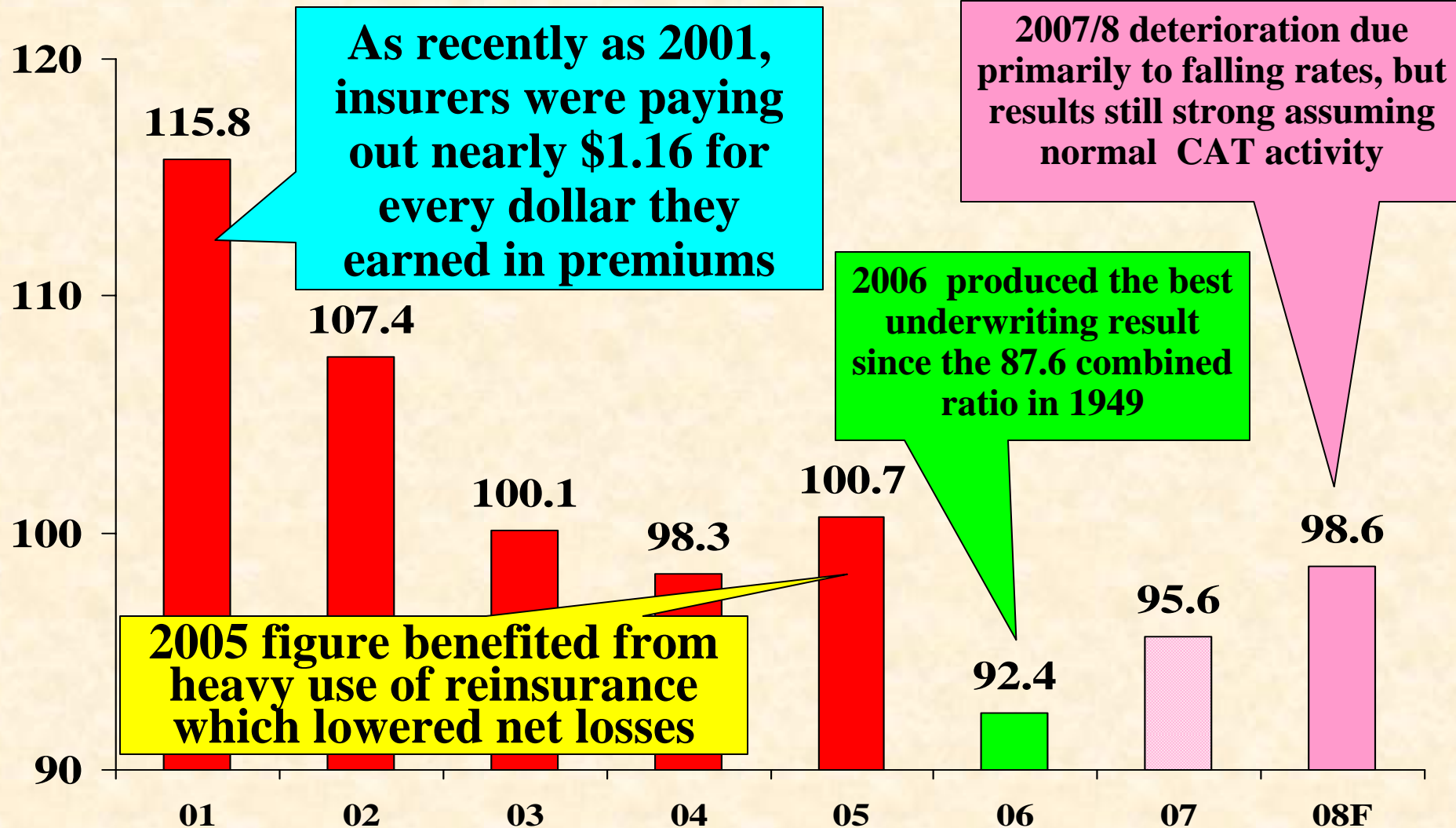
*P/C Insurance Combined Ratio, 1970-2008F**



Sources: A.M. Best; ISO, III *Full year 2008 estimates from III.

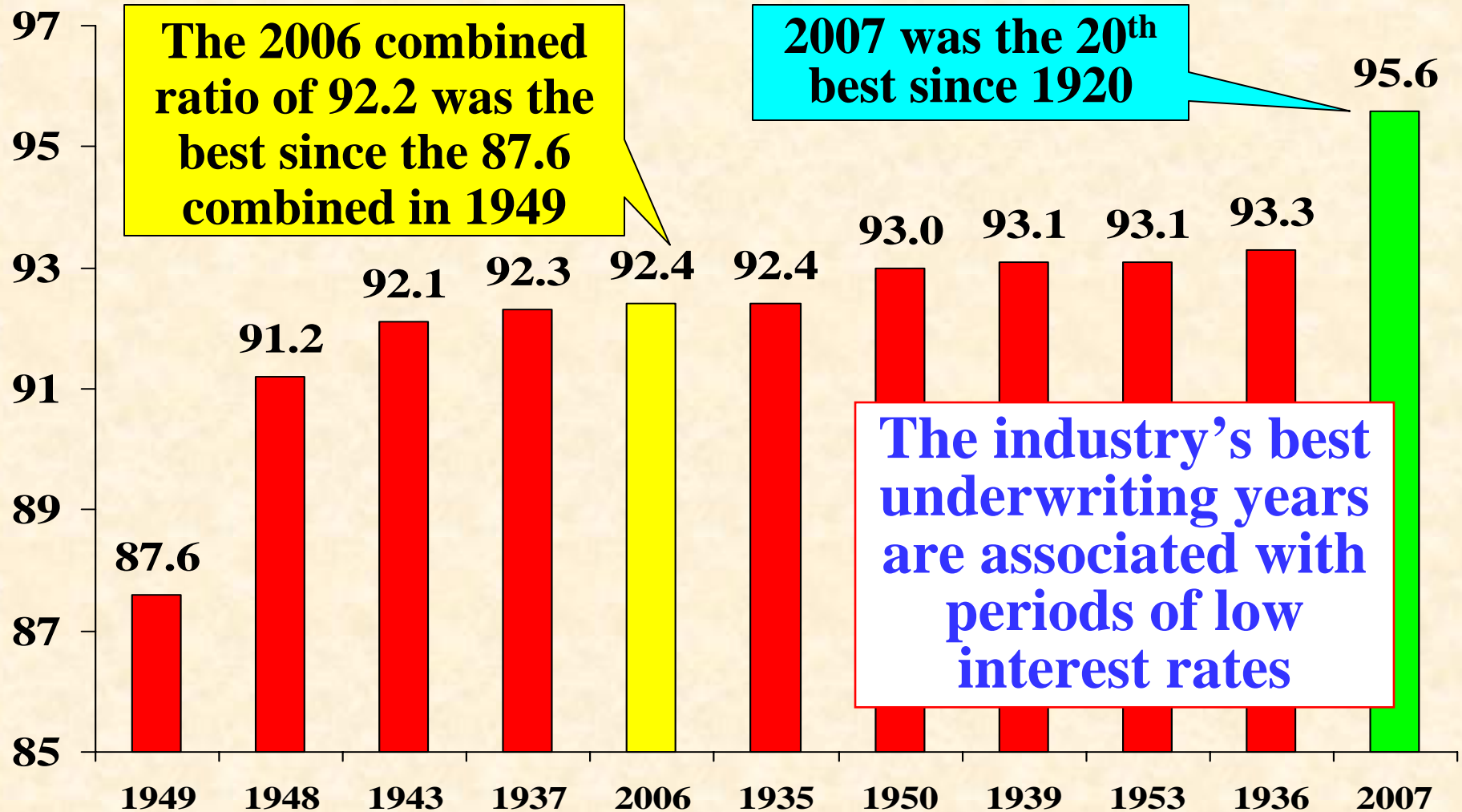


P/C Insurance Combined Ratio, 2001-2008F





Ten Lowest P/C Insurance Combined Ratios Since 1920 vs. 2007

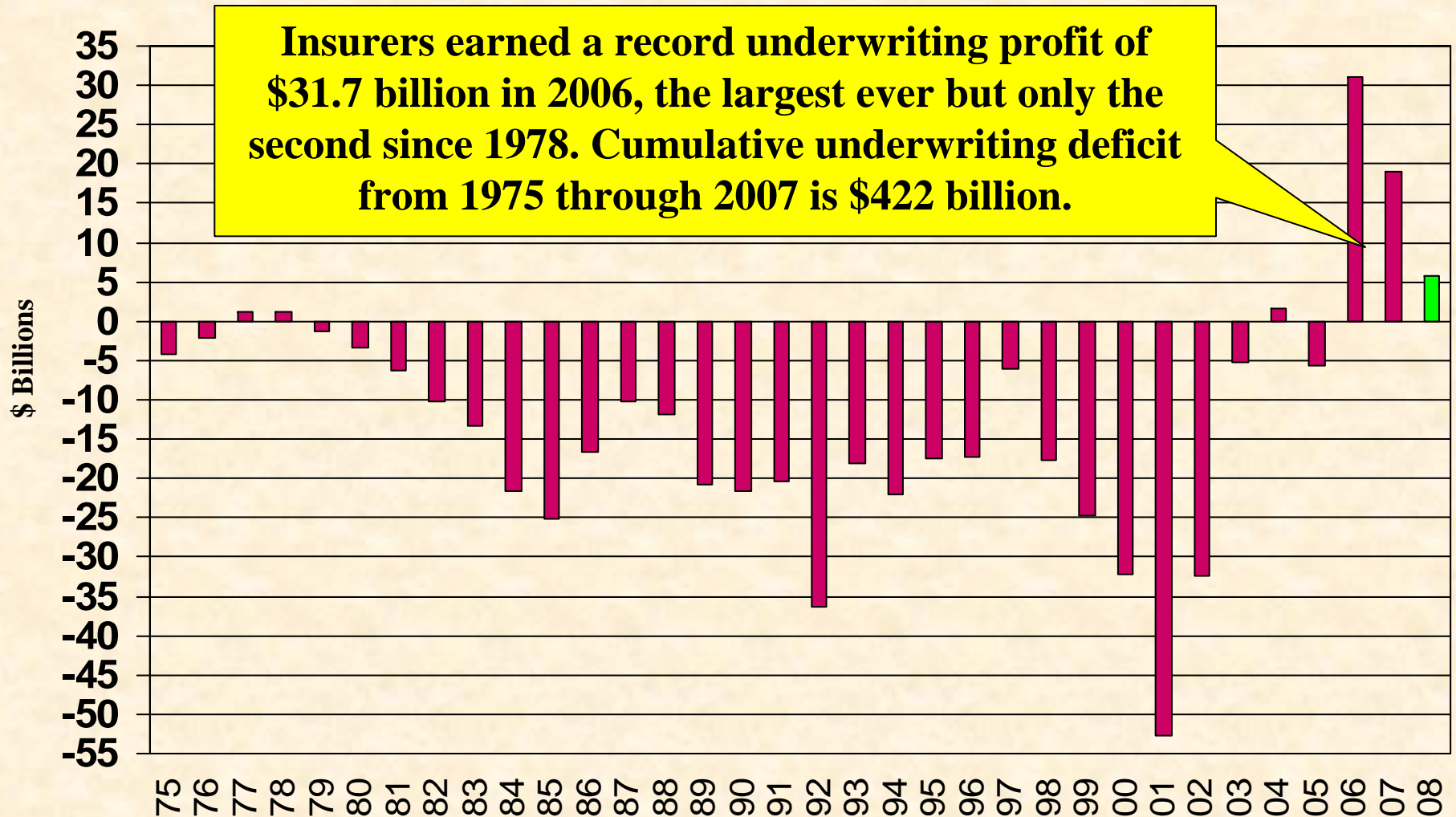




Underwriting Gain (Loss)

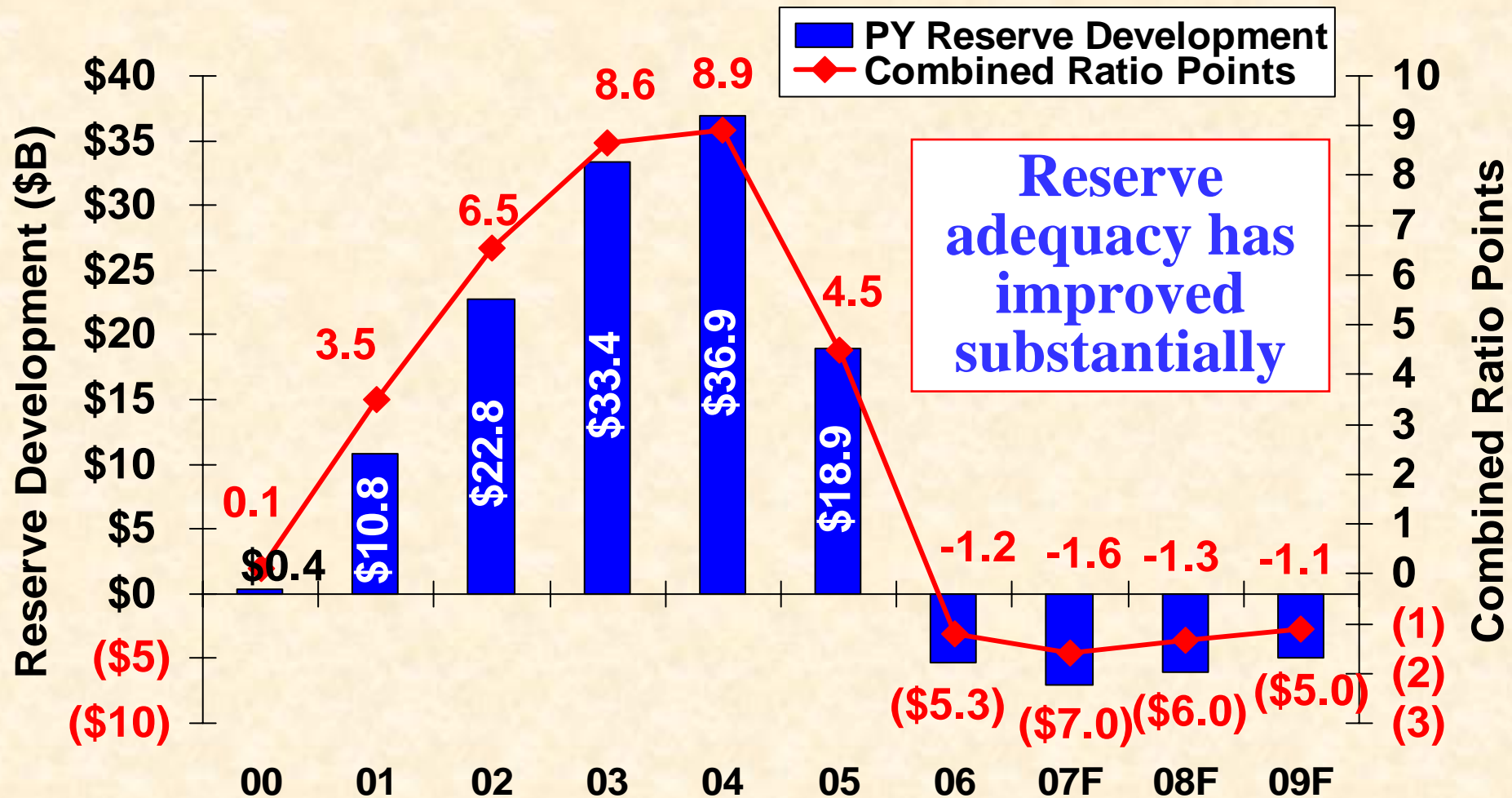
*1975-2008F**

Insurers earned a record underwriting profit of \$31.7 billion in 2006, the largest ever but only the second since 1978. Cumulative underwriting deficit from 1975 through 2007 is \$422 billion.





Impact of Reserve Changes on Combined Ratio



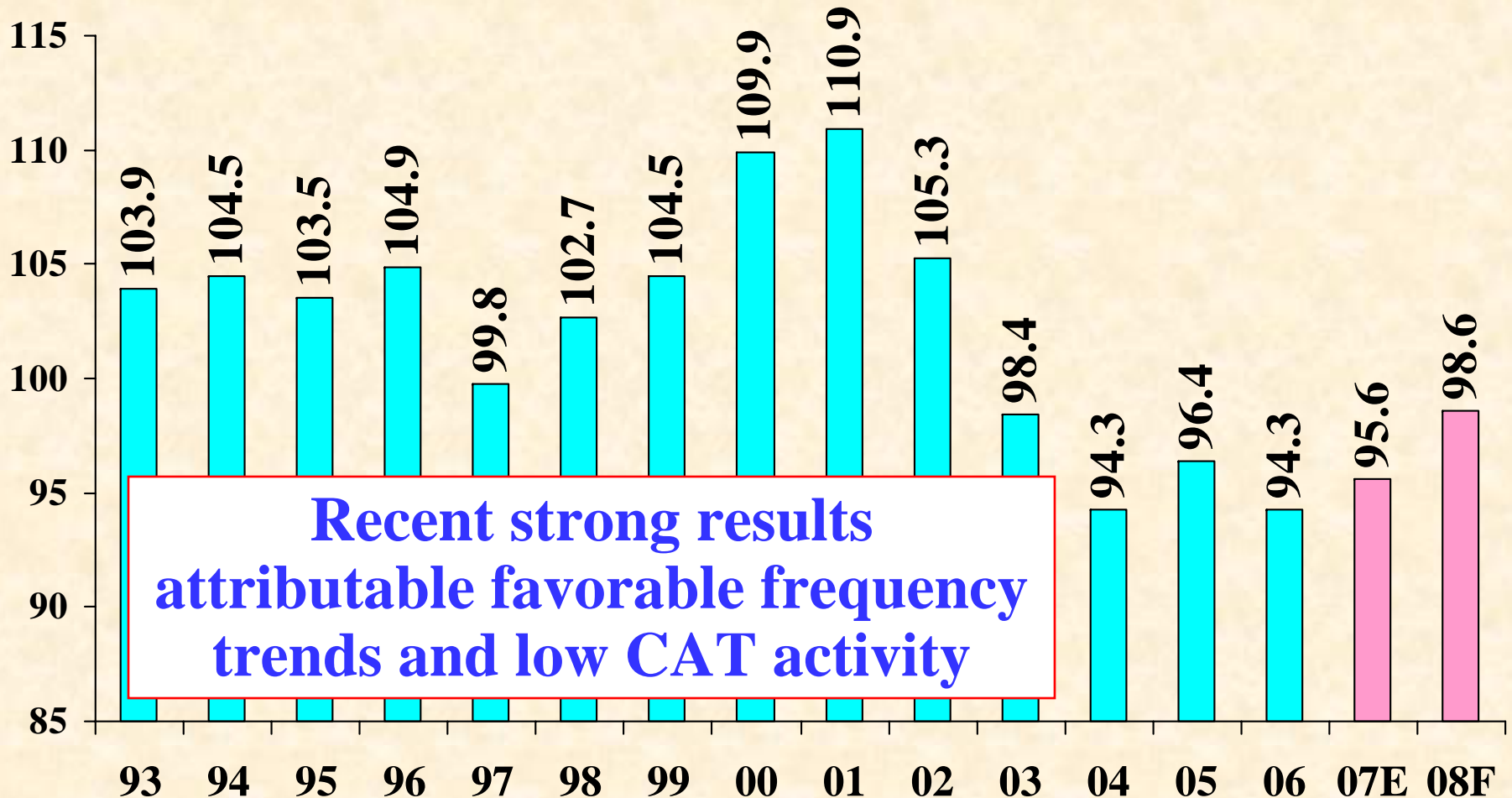
PERSONAL LINES





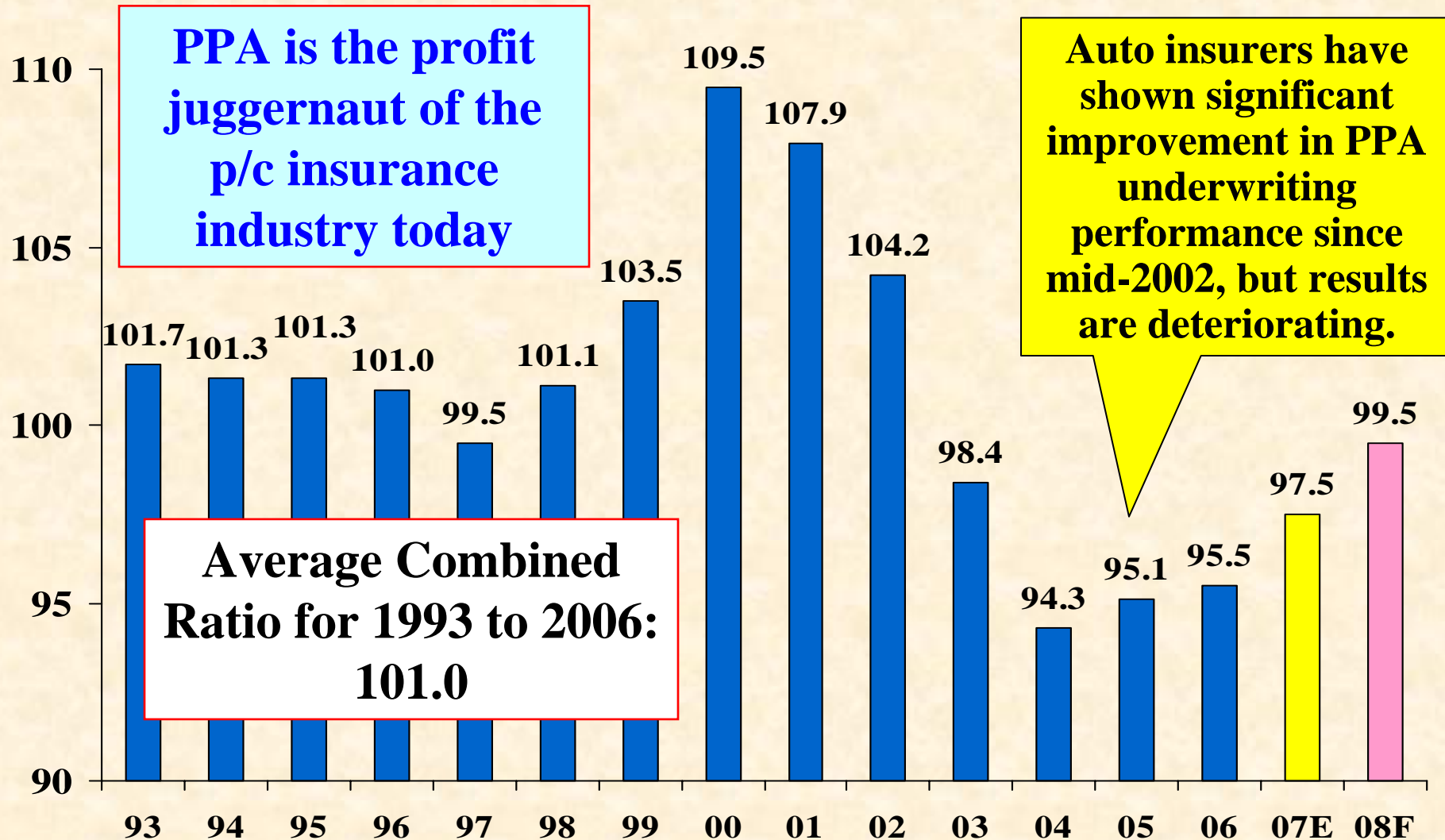
Personal Lines

Combined Ratio, 1993-2007E





Private Passenger Auto (PPA) Combined Ratio

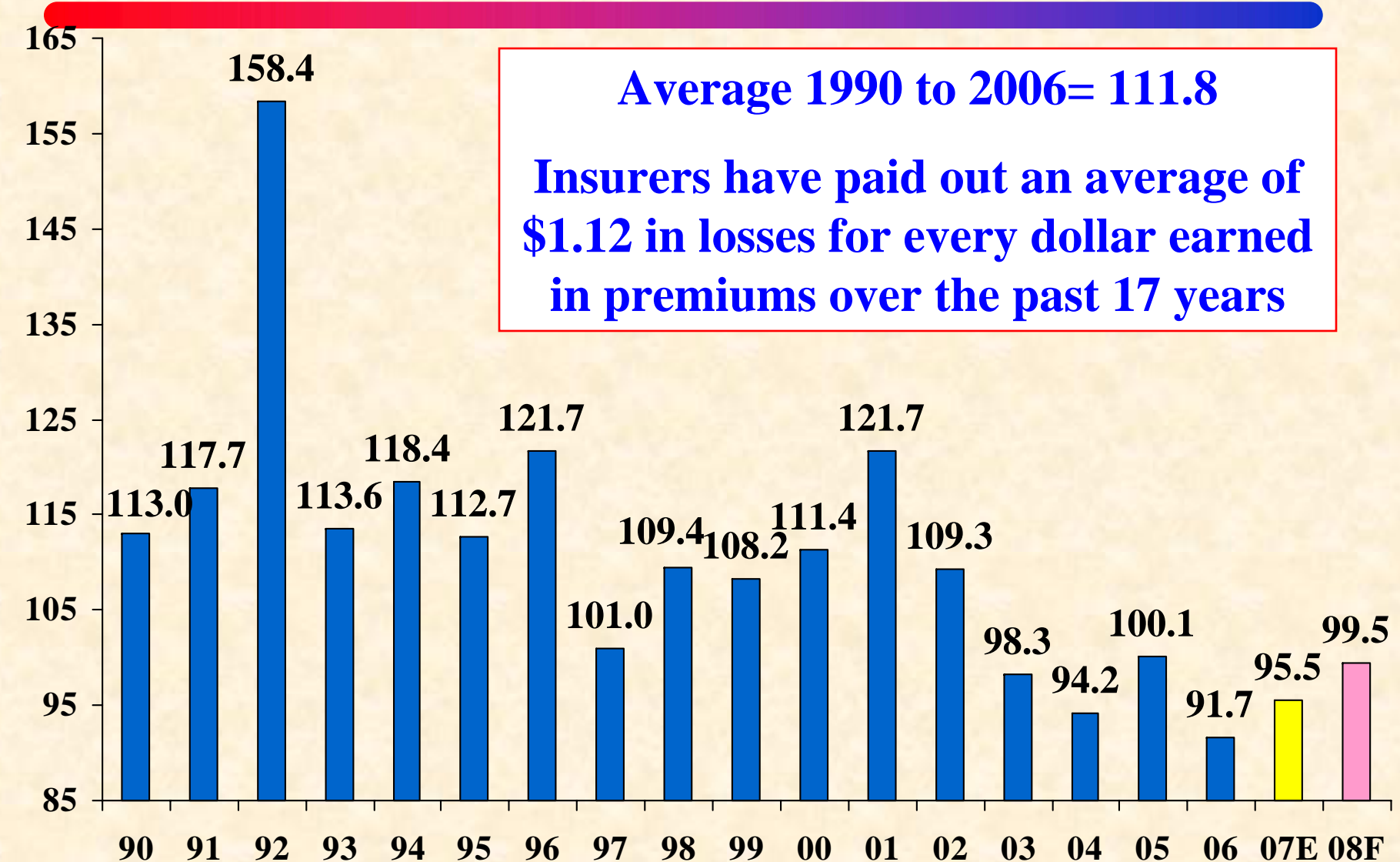


Homeowners Insurance





Homeowners Insurance Combined Ratio



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

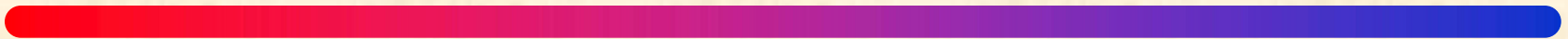
COMMERCIAL LINES

Commercial Auto

Commercial Multi-Peril



Workers Comp

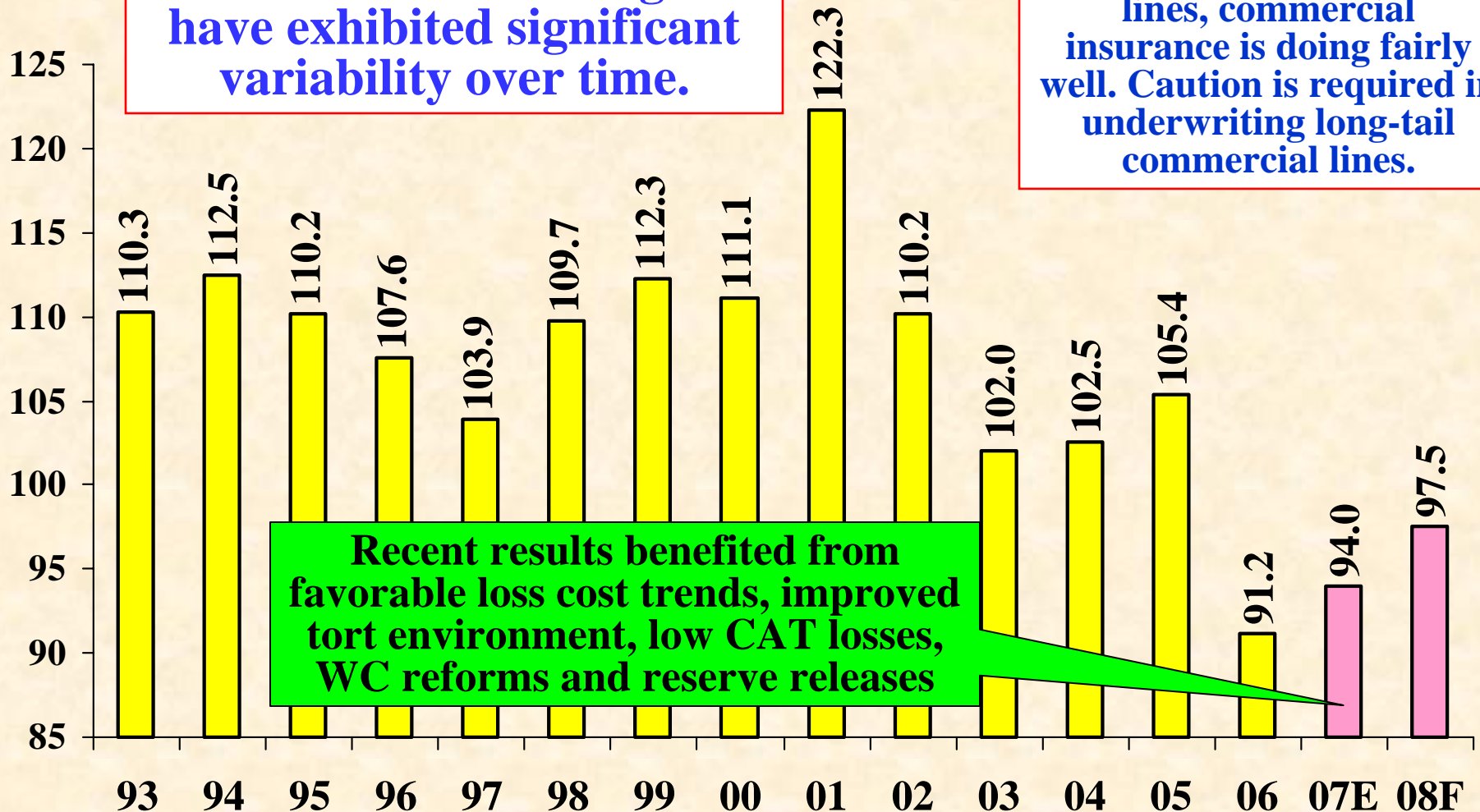




Commercial Lines Combined Ratio, 1993-2008F

**Commercial coverages
have exhibited significant
variability over time.**

**Outside CAT-affected
lines, commercial
insurance is doing fairly
well. Caution is required in
underwriting long-tail
commercial lines.**

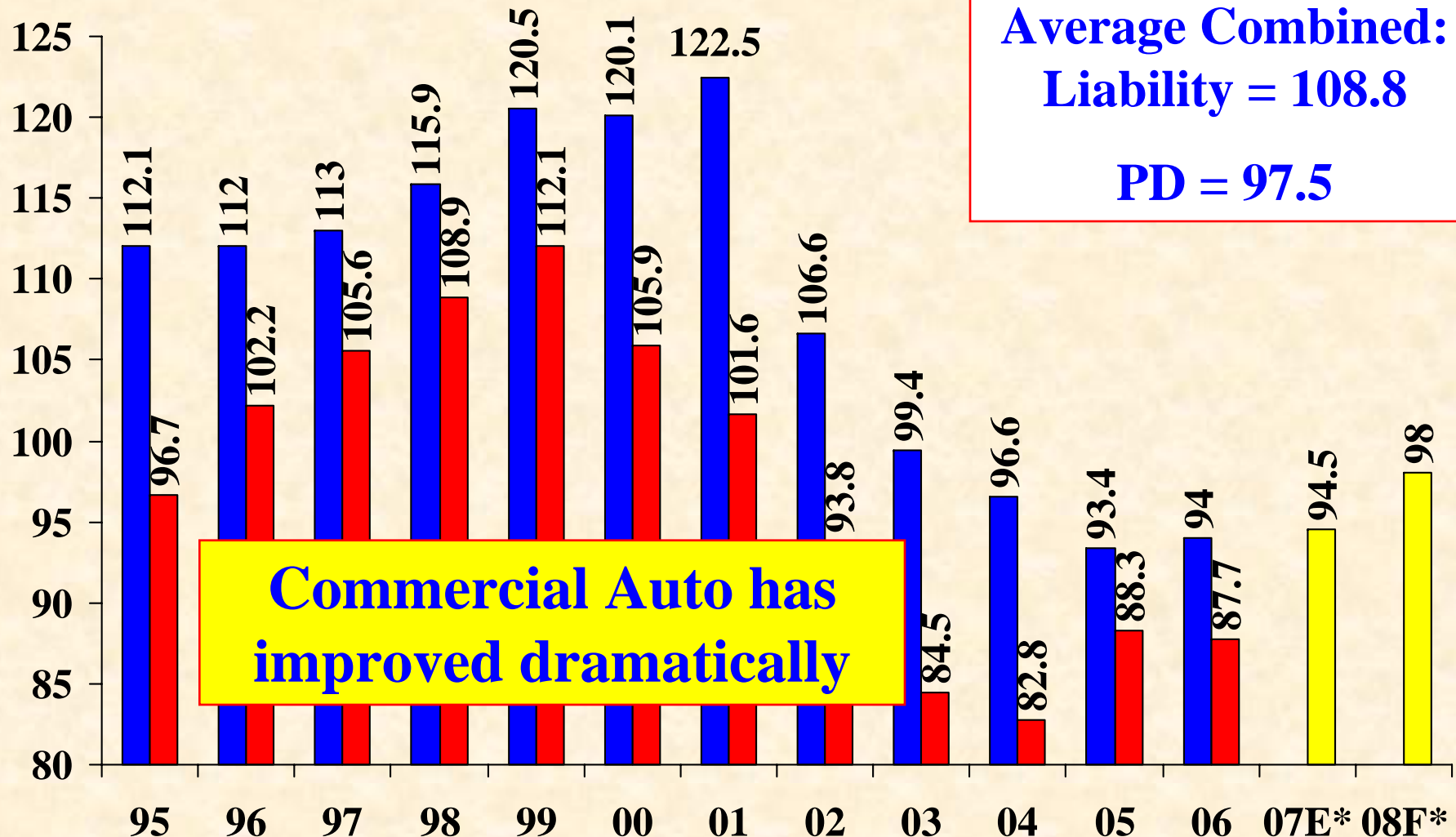


**Recent results benefited from
favorable loss cost trends, improved
tort environment, low CAT losses,
WC reforms and reserve releases**



Commercial Auto Liability & PD Combined Ratios

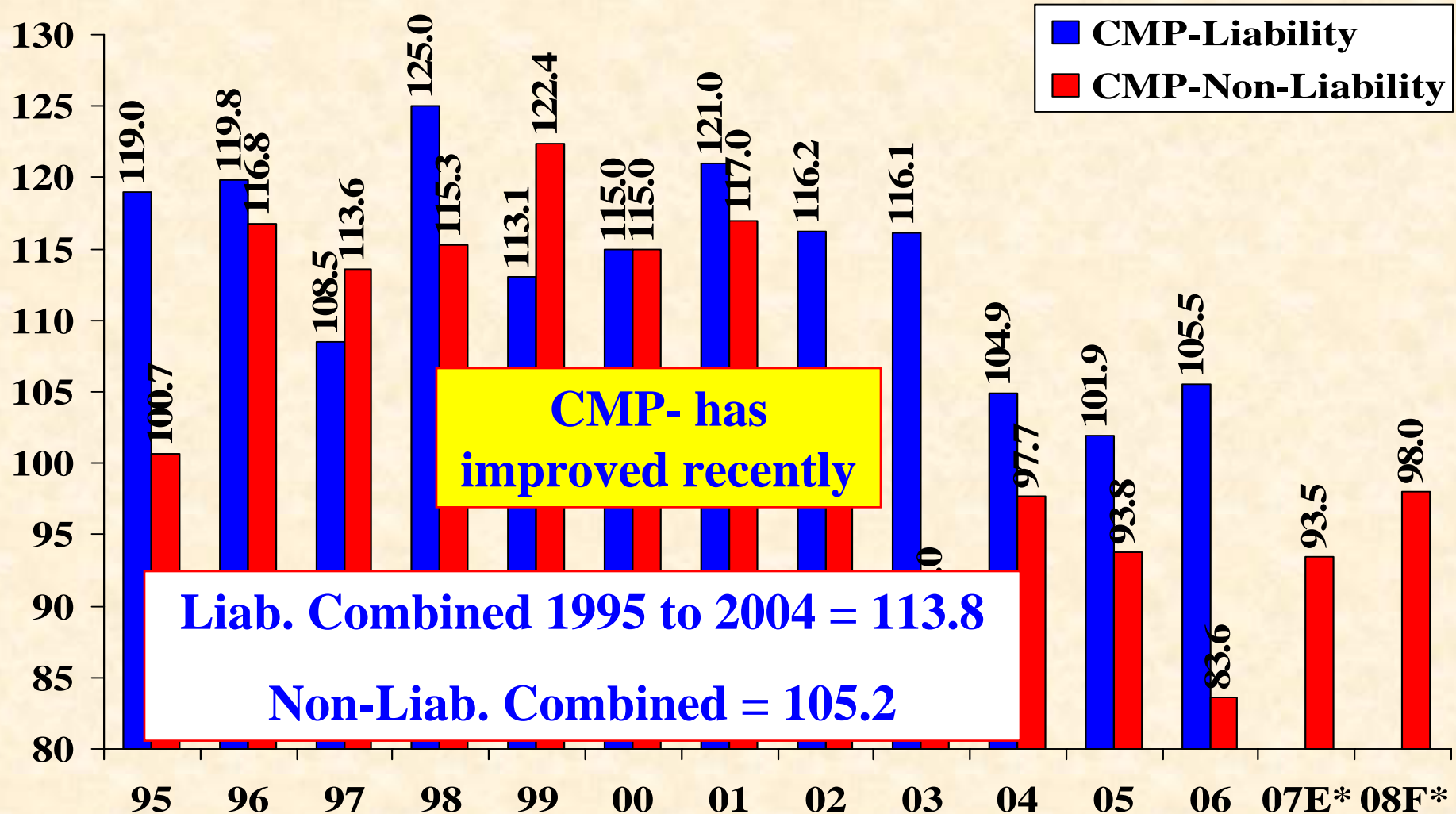
■ Comm Auto Liab ■ Comm Auto PD



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

*Includes both liability and property damage.

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



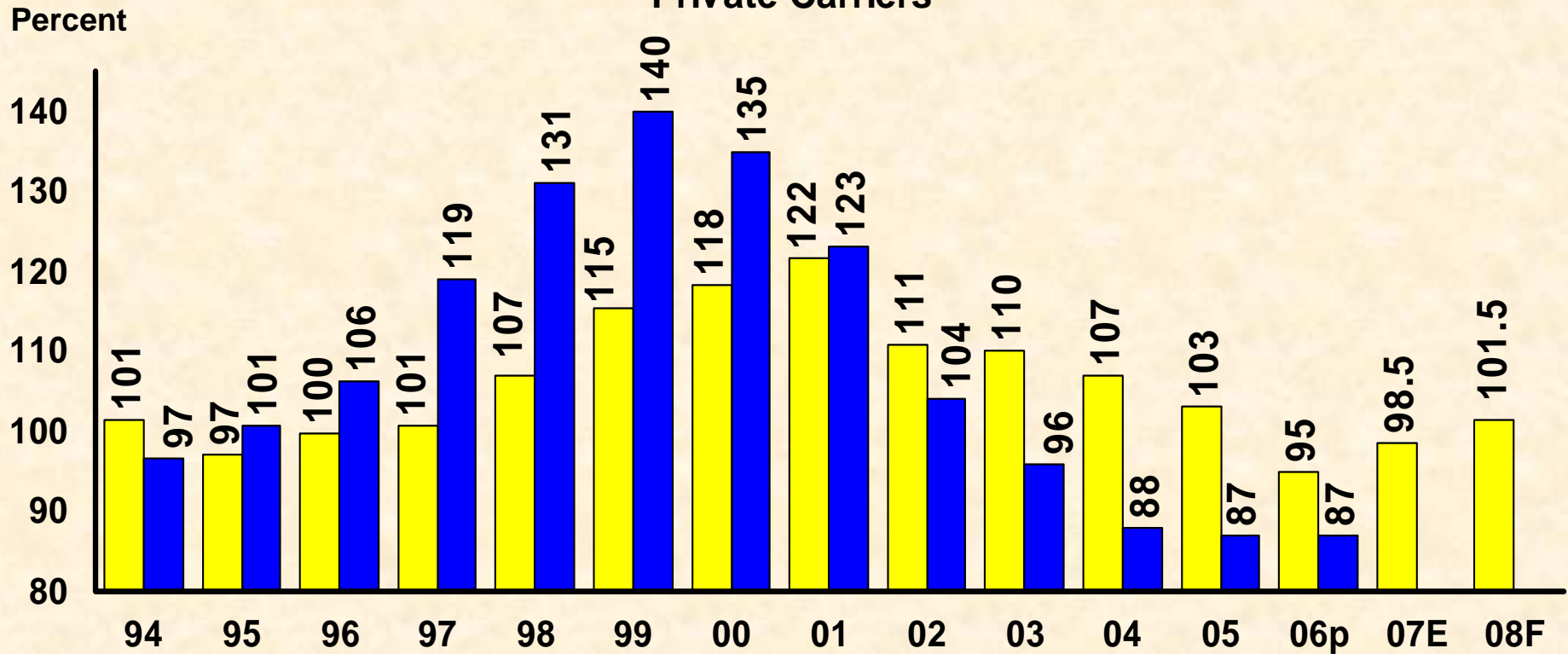
WORKERS COMPENSATION OPERATING ENVIRONMENT





Workers Comp Combined Ratios, 1994-2008F*

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



■ Calendar Year ■ Accident Year

p Preliminary AY figure.

Accident Year data is evaluated as of 12/31/2006 and developed to ultimate

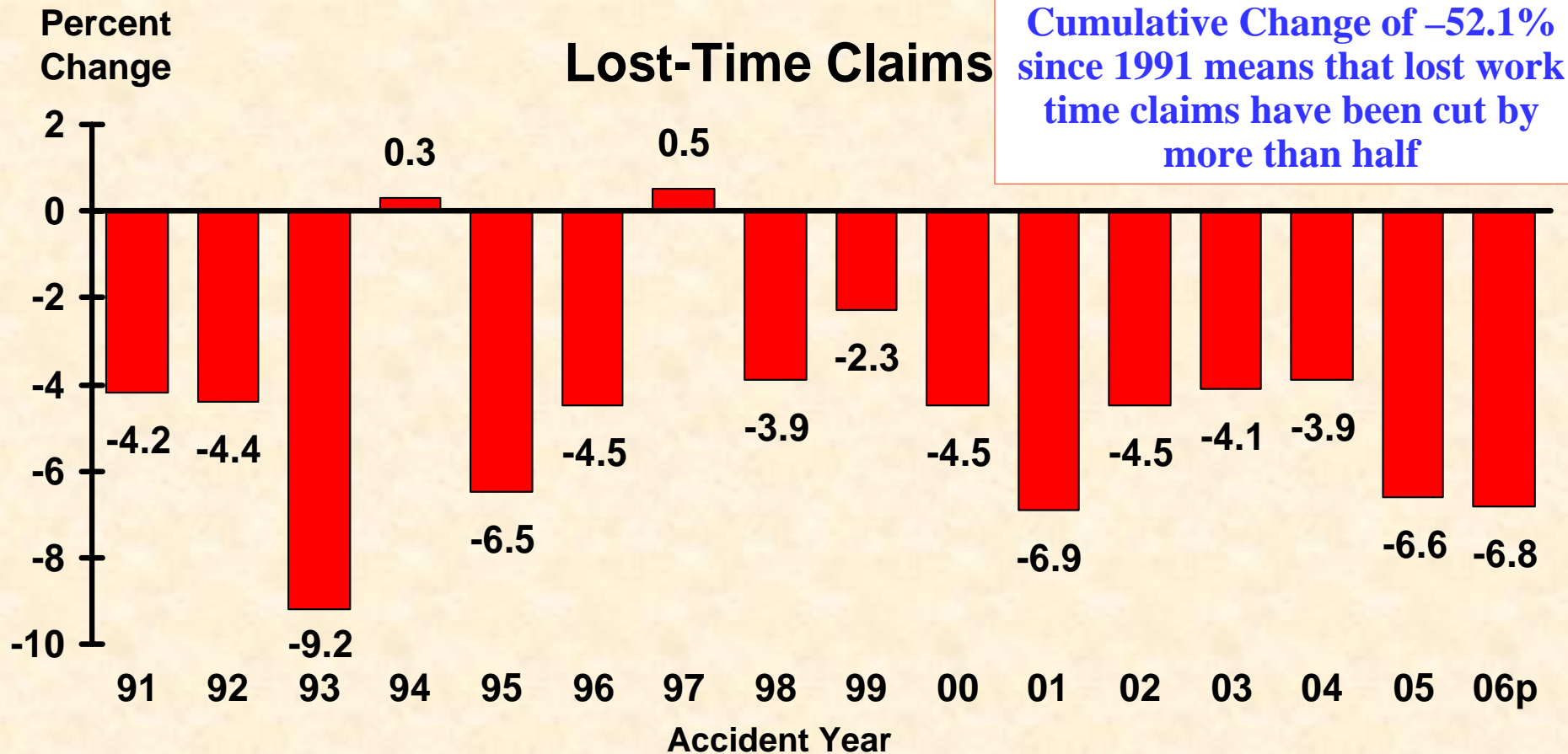
Source: Calendar Years 1994-2005, A.M. Best Aggregates & Averages; Calendar Year 2006p and Accident Years 1994-2006pbased on NCCI Annual Statement Analysis.

Includes dividends to policyholders

*2007/2008 figures are A.M. Best estimates/forecasts.



Workers Comp Lost-Time Claim Frequency (% Change)

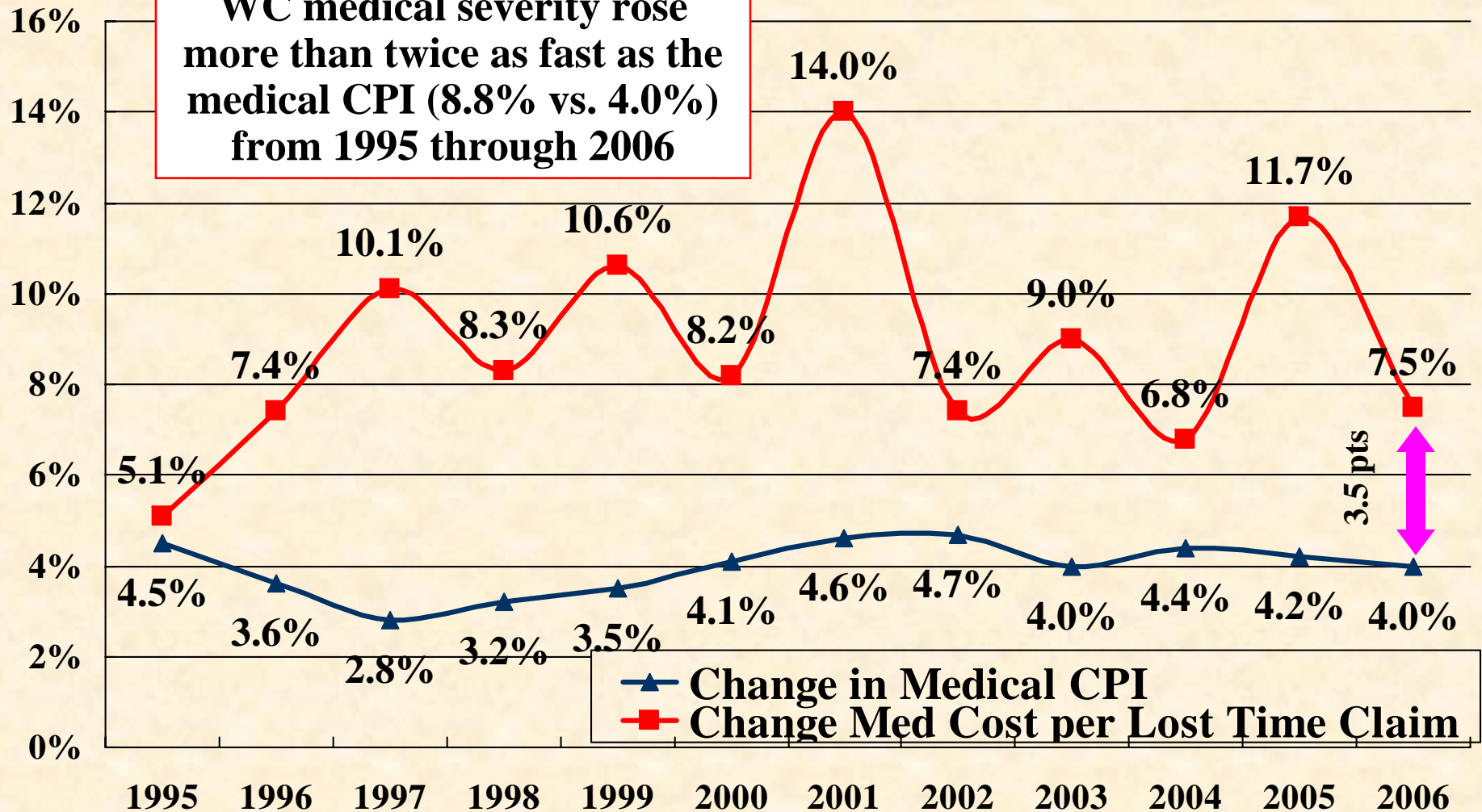


2003p: Preliminary based on data valued as of 12/31/2006
1991-2005: Based on data through 12/31/2005, developed to ultimate
Based on the states where NCCI provides ratemaking services
Excludes the effects of deductible policies
Source: NCCI



WC Medical Severity Rising Far Faster than Medical CPI

WC medical severity rose more than twice as fast as the medical CPI (8.8% vs. 4.0%) from 1995 through 2006

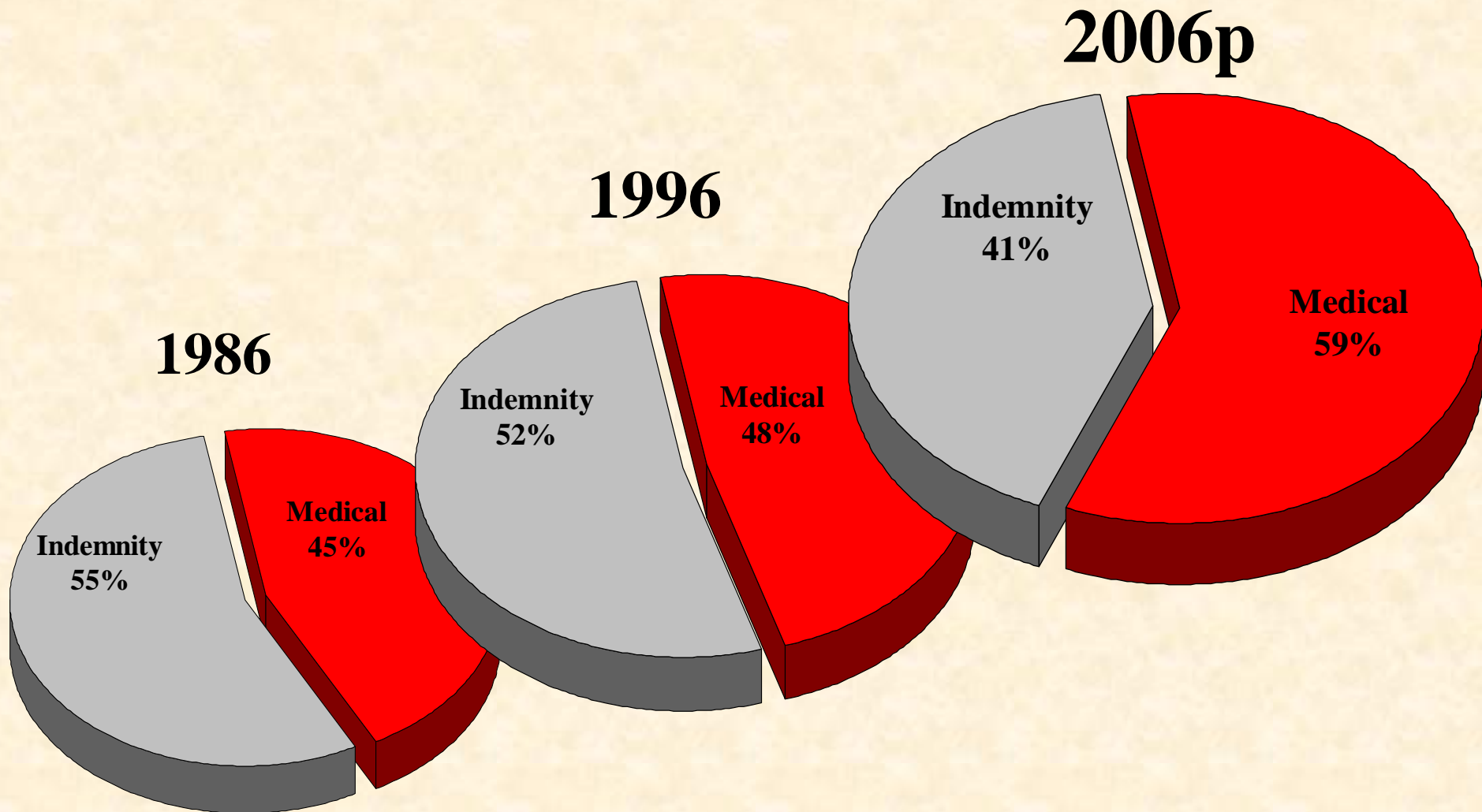


3.5 pts

— Change in Medical CPI
— Change Med Cost per Lost Time Claim



Med Costs Share of Total Costs is Increasing Steadily



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

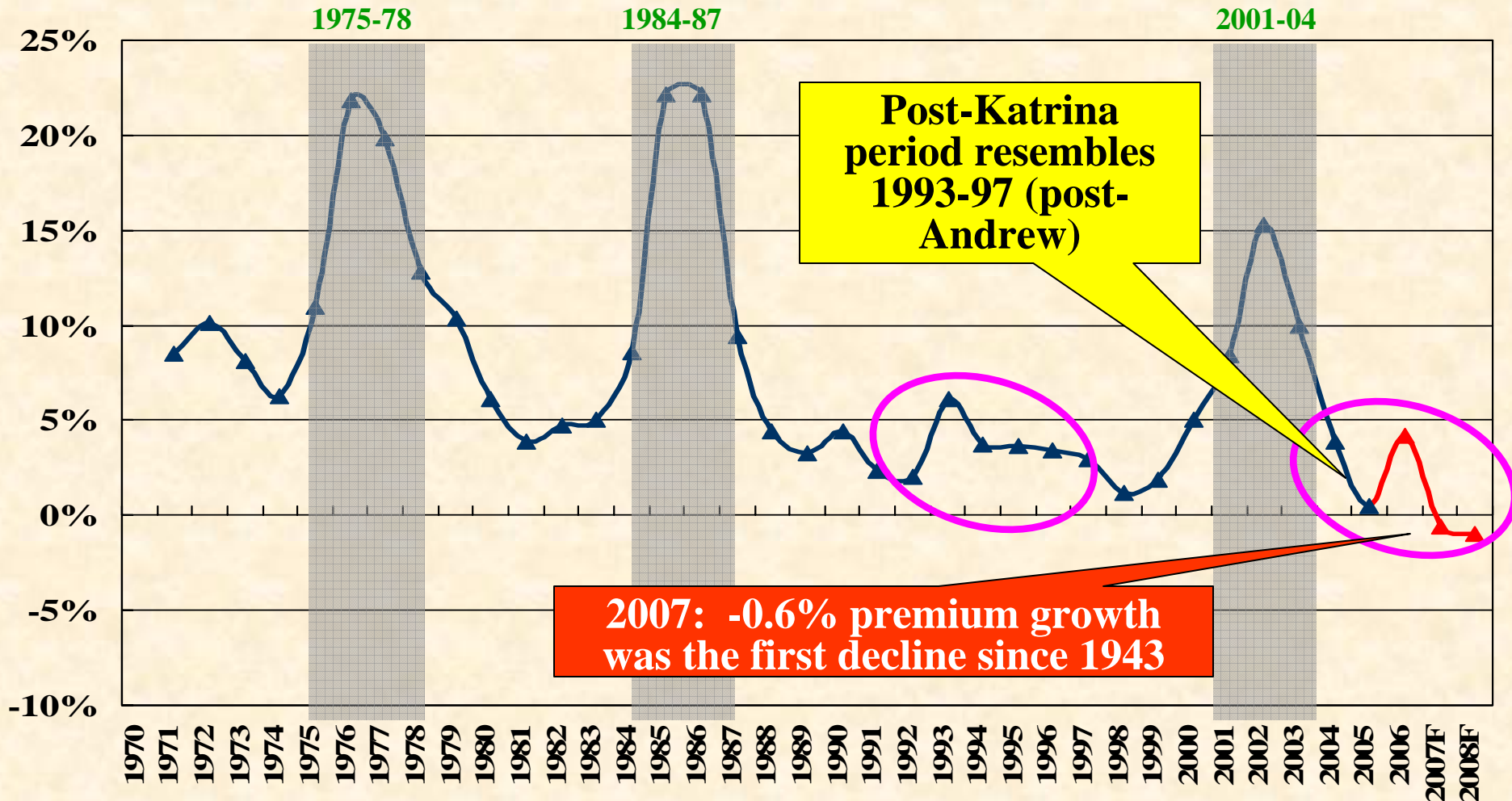
PREMIUM GROWTH

**At a Virtual Standstill
in 2007/08**





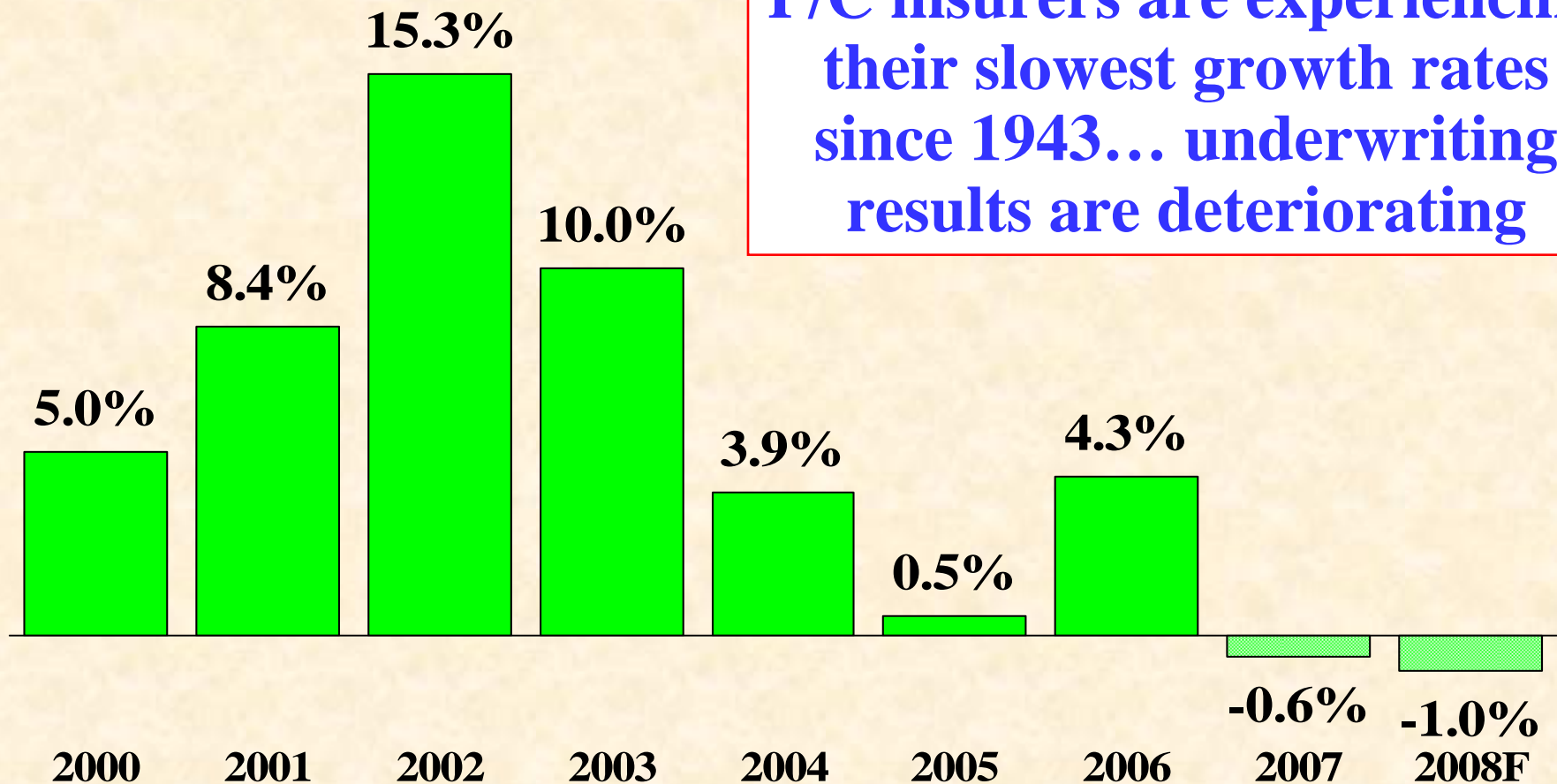
Strength of Recent Hard Markets by NWP Growth*



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



Growth in Net Written Premium, 2000-2008F

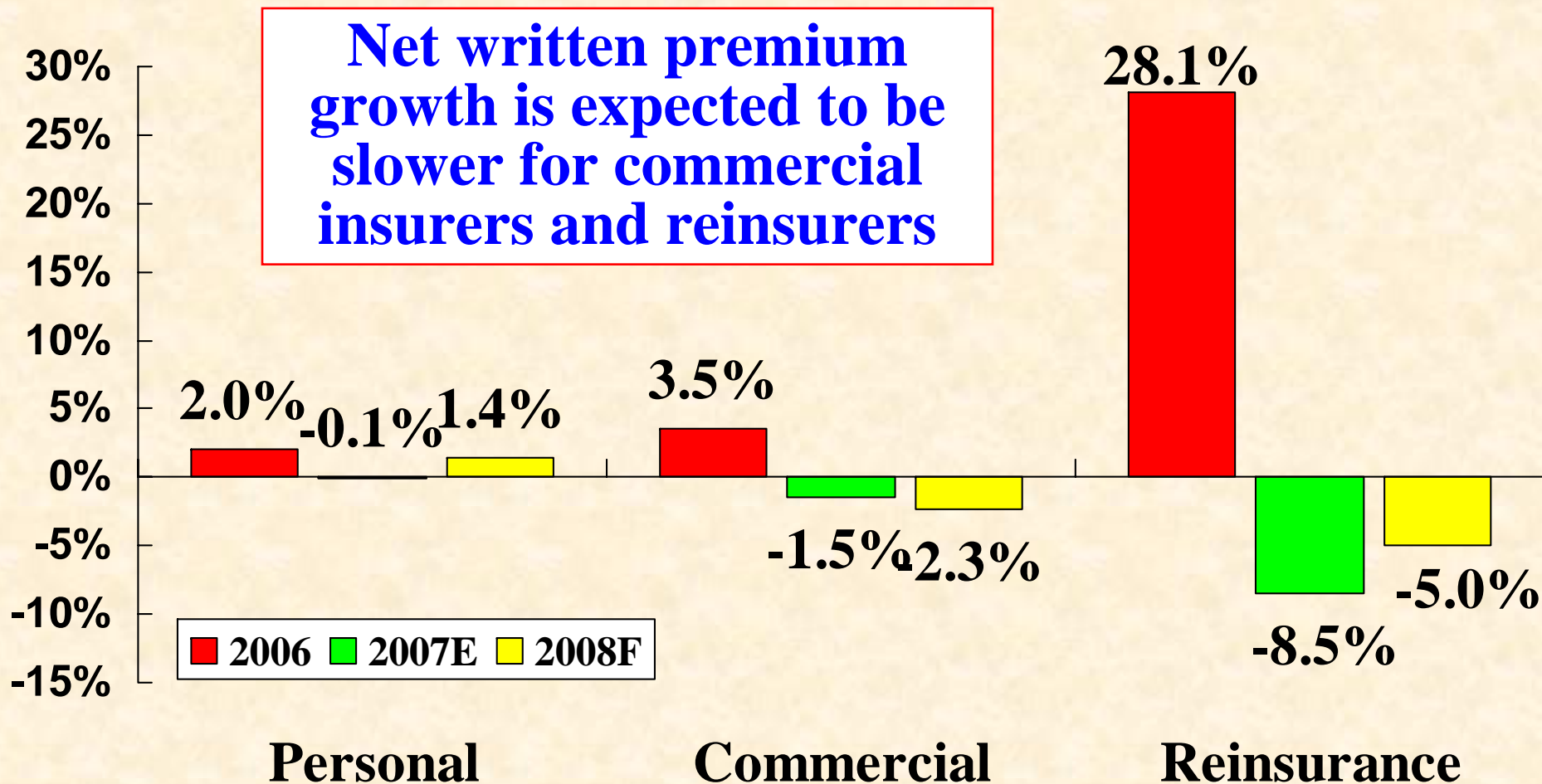


*2008 forecast from A.M. Best.


Source: A.M. Best; Forecasts from the Insurance Information Institute.



Personal/Commercial Lines & Reinsurance NPW Growth, 2006-2008F



WEAK PRICING

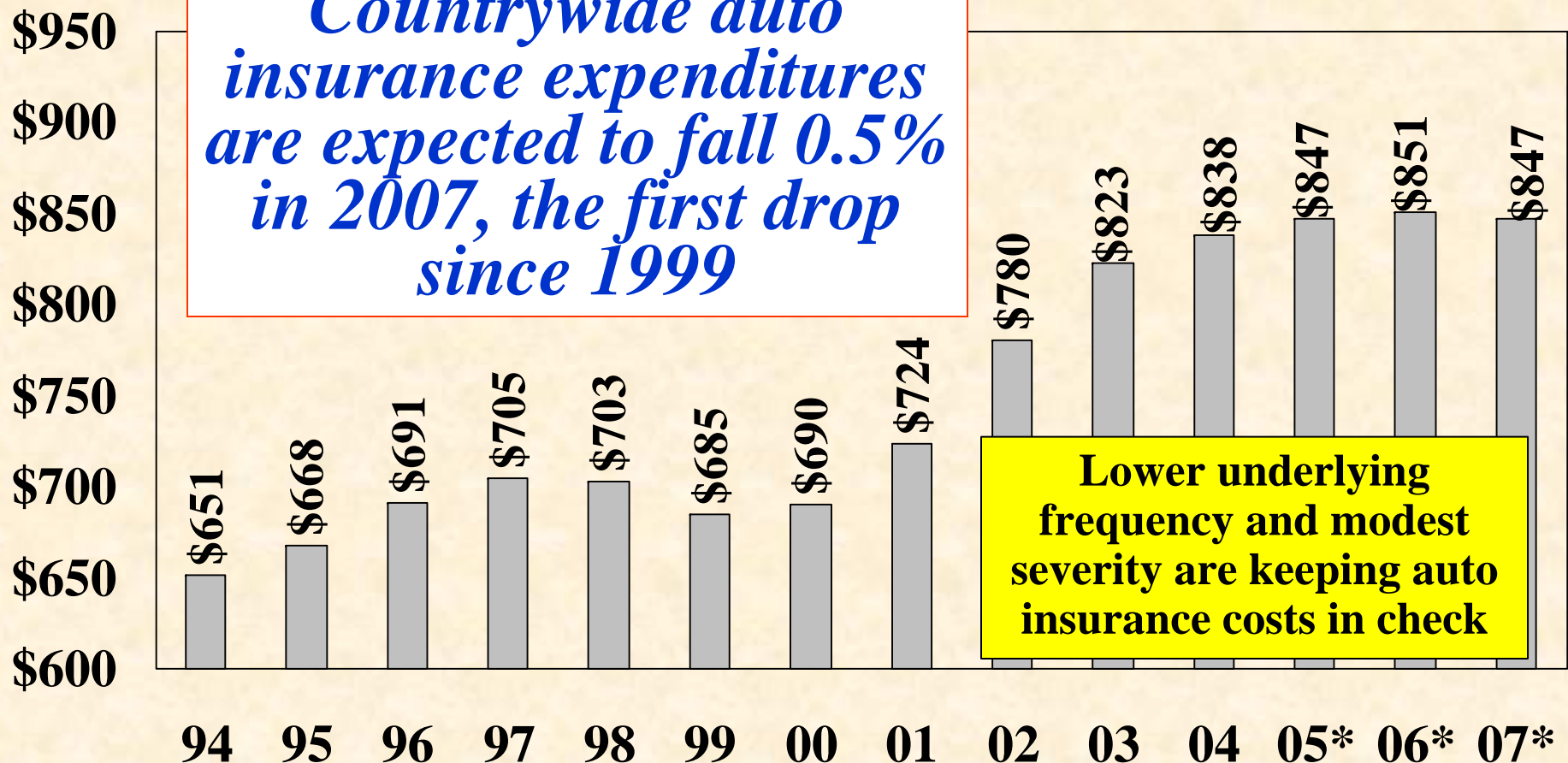
Under Pressure in
2007/08, Especially
 Commercial Lines





Average Expenditures on Auto Insurance

Countrywide auto insurance expenditures are expected to fall 0.5% in 2007, the first drop since 1999

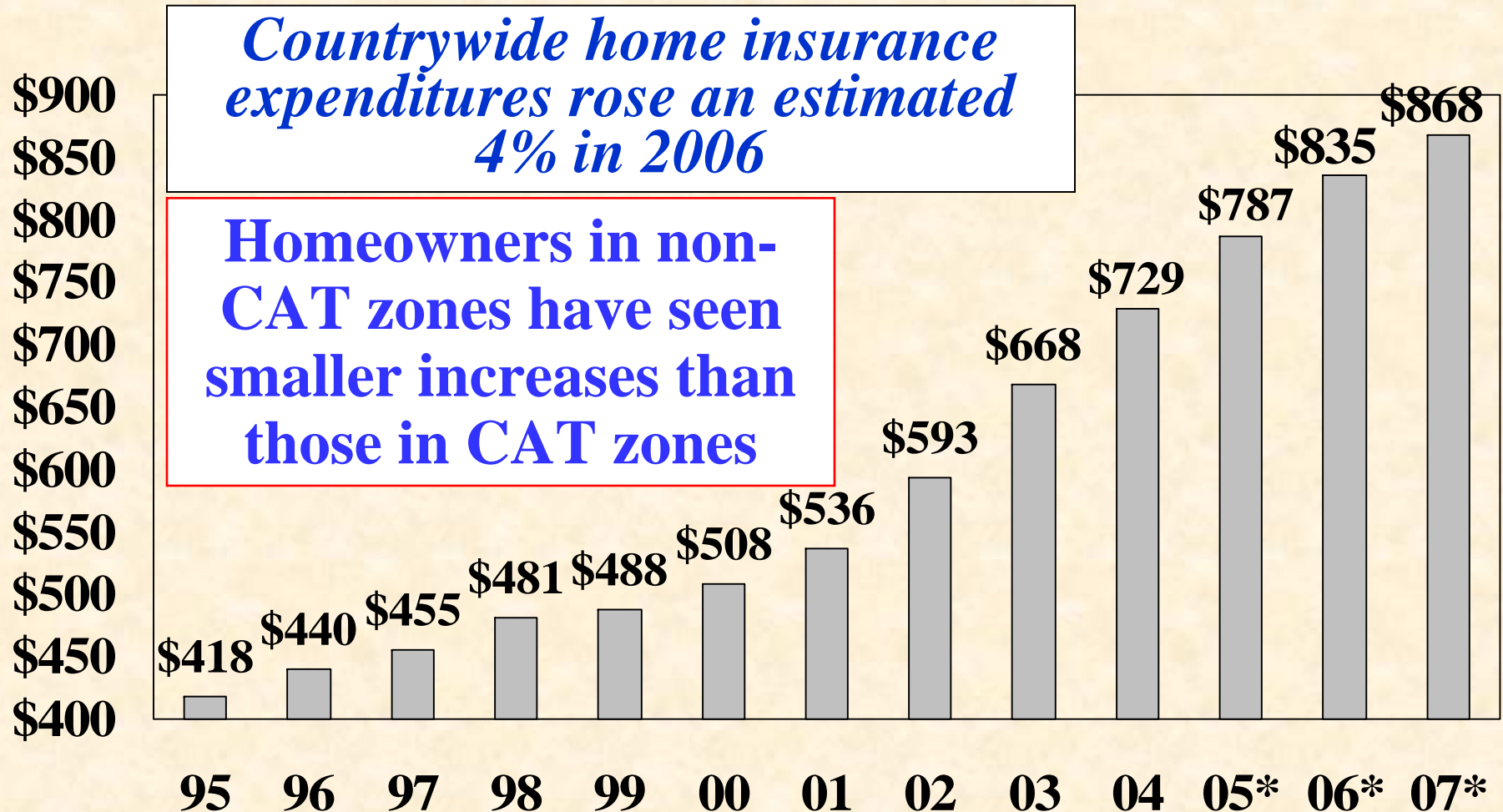


*Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute



Average Expenditures on Homeowners Insurance**



*Insurance Information Institute Estimates/Forecasts

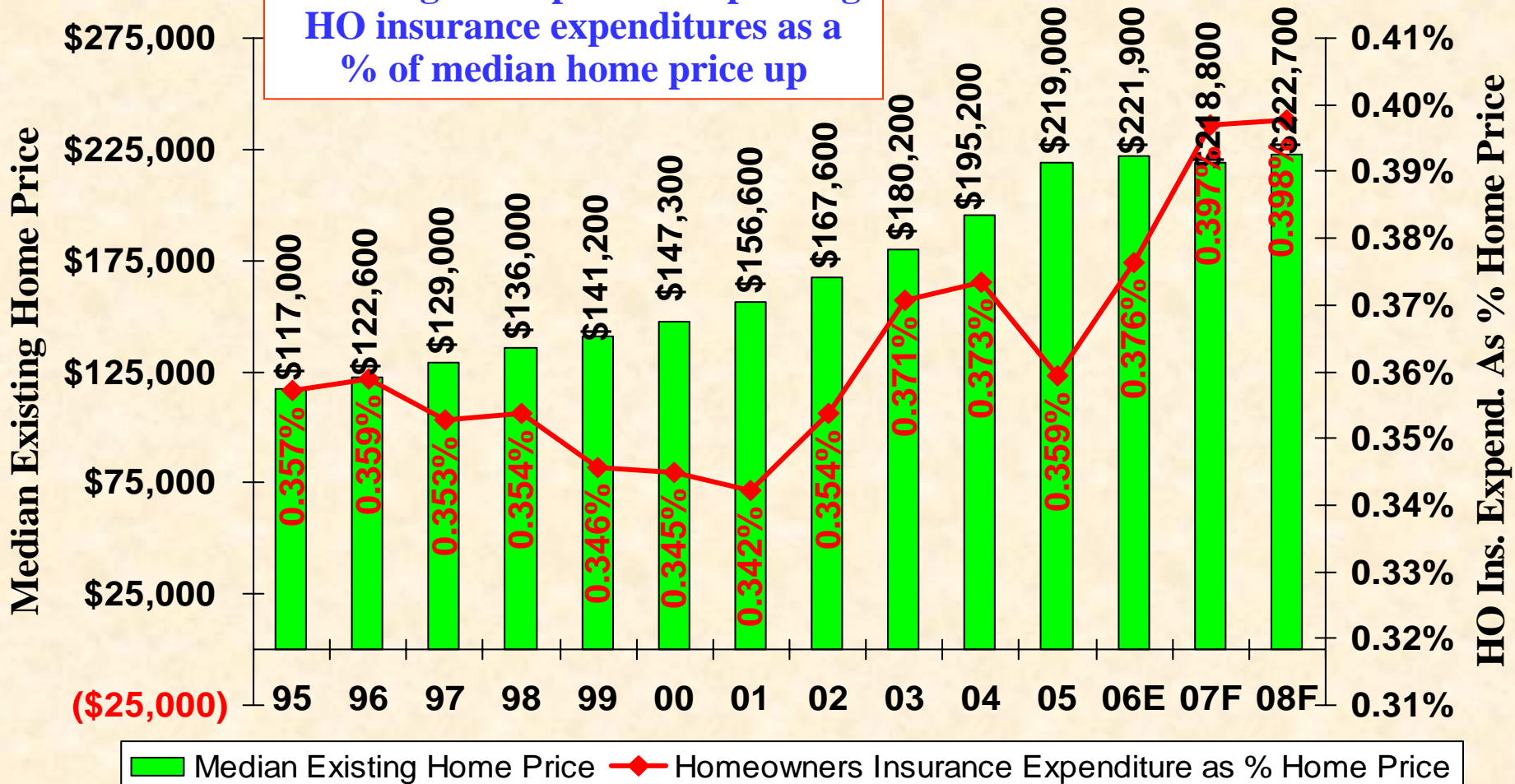
**Excludes cost of flood and earthquake coverage.

Source: NAIC, Insurance Information Institute



Homeowners Insurance Expenditures as a % of Median Existing Home Prices, 1995-2008F

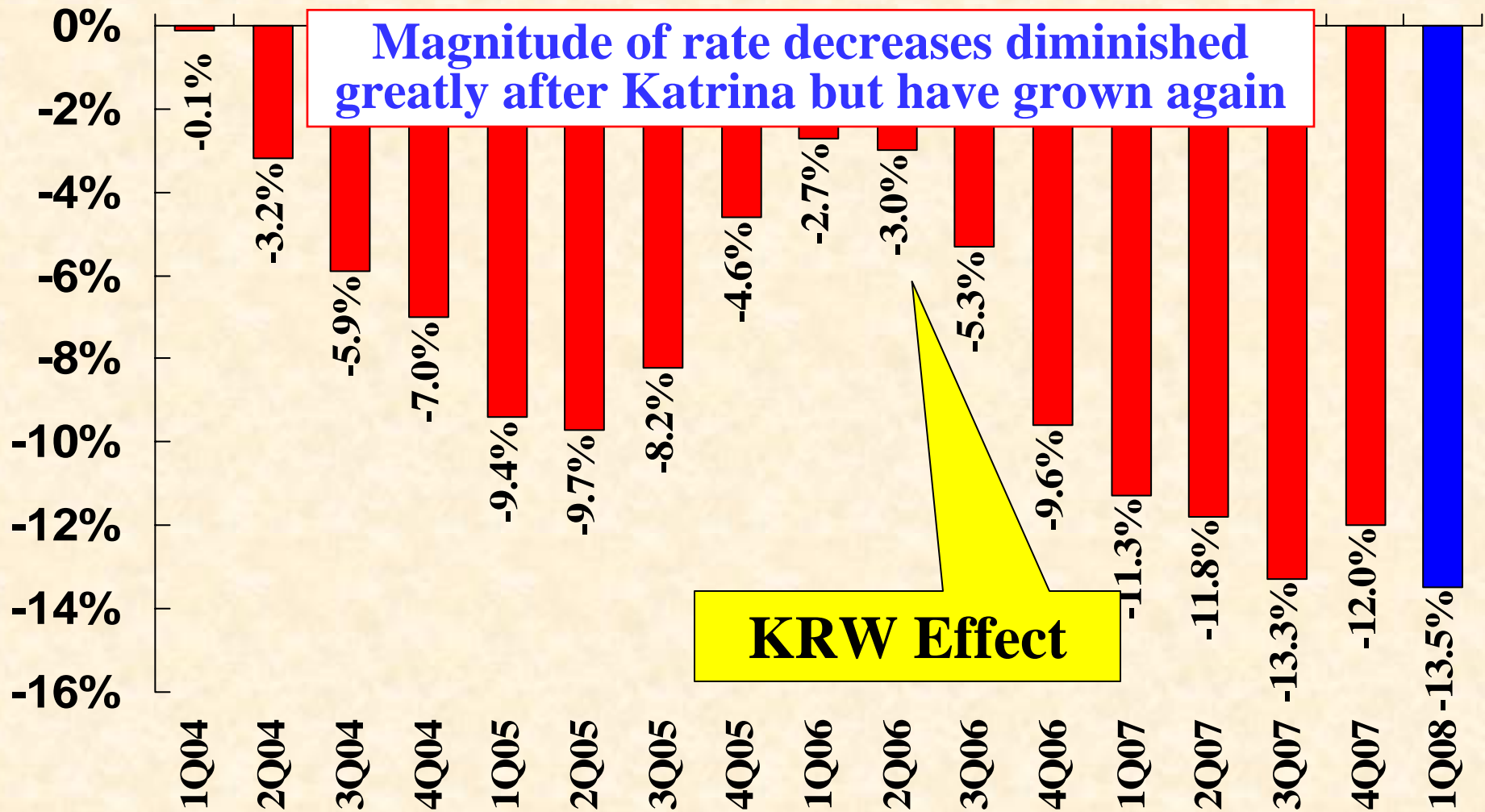
Record catastrophe losses and
declining home prices are pushing
HO insurance expenditures as a
% of median home price up



Source: National Association of Realtors, NAIC; Insurance Info. Institute calculations and HO expenditure estimates/forecasts for years 2005-2008.

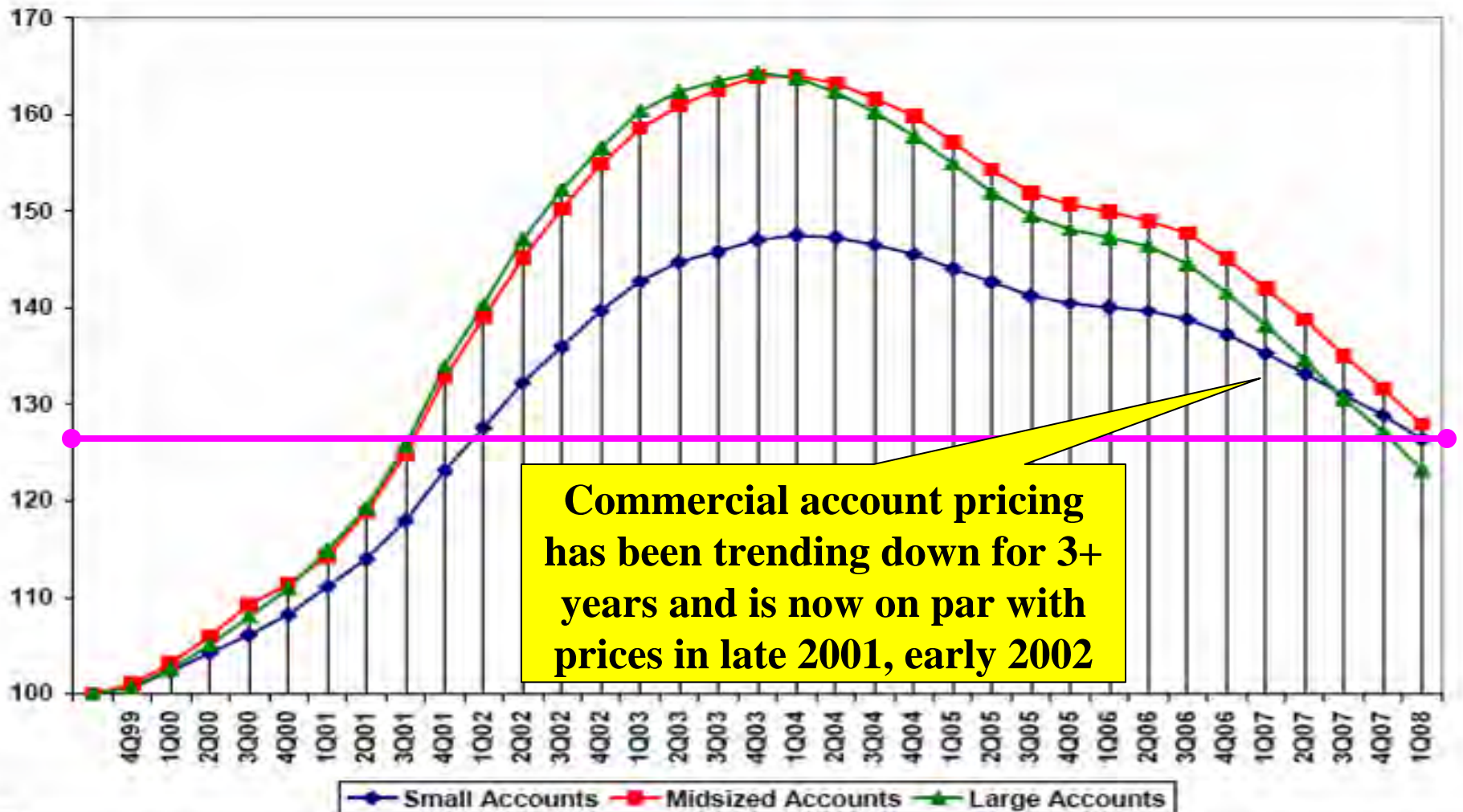


Average Commercial Rate Change, All Lines, (1Q:2004 – 1Q:2008)



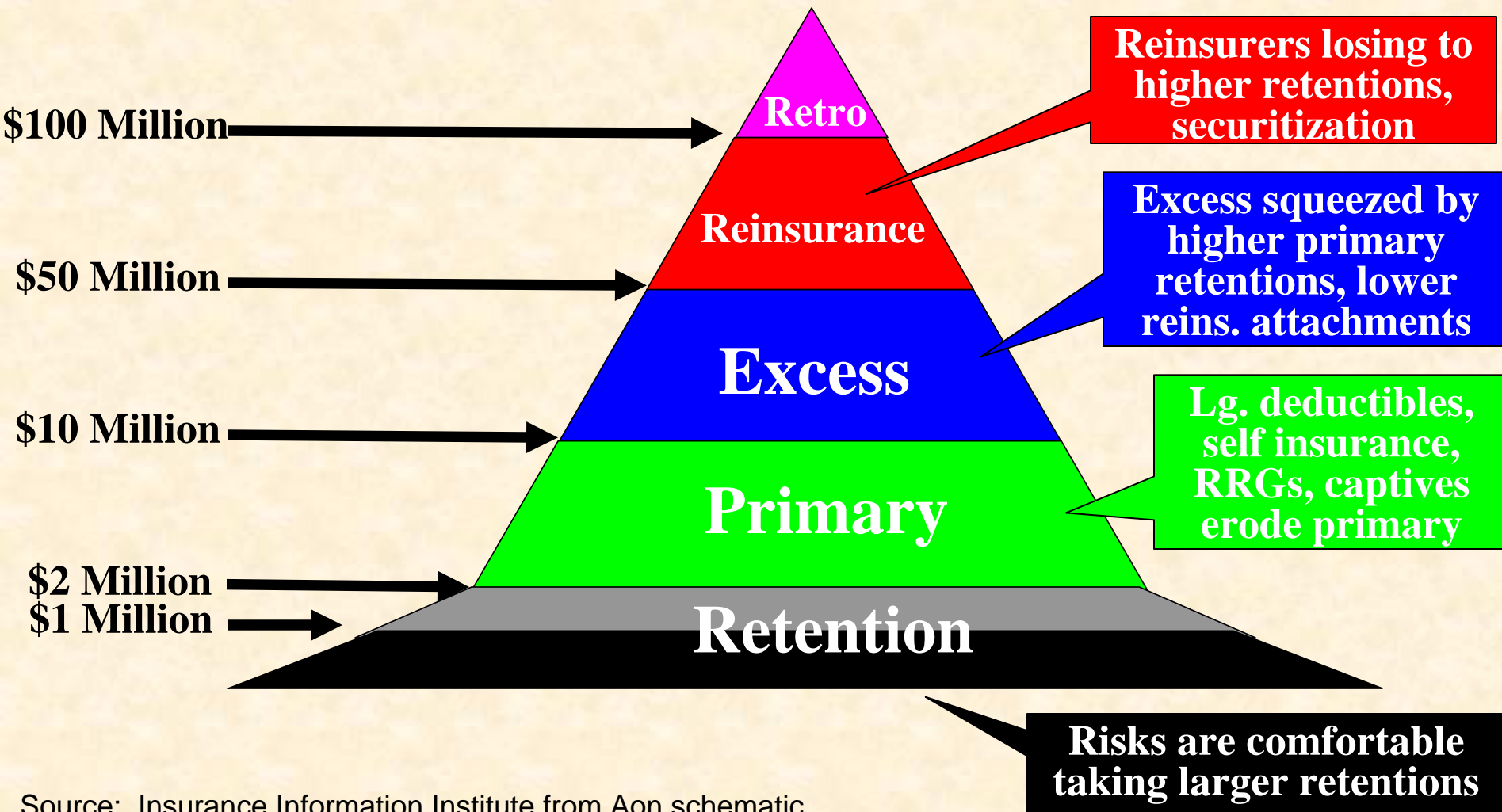


Cumulative Commercial Rate Change by Line: 4Q99 – 1Q08





Most Layers of Coverage are Being Challenged/Leaking



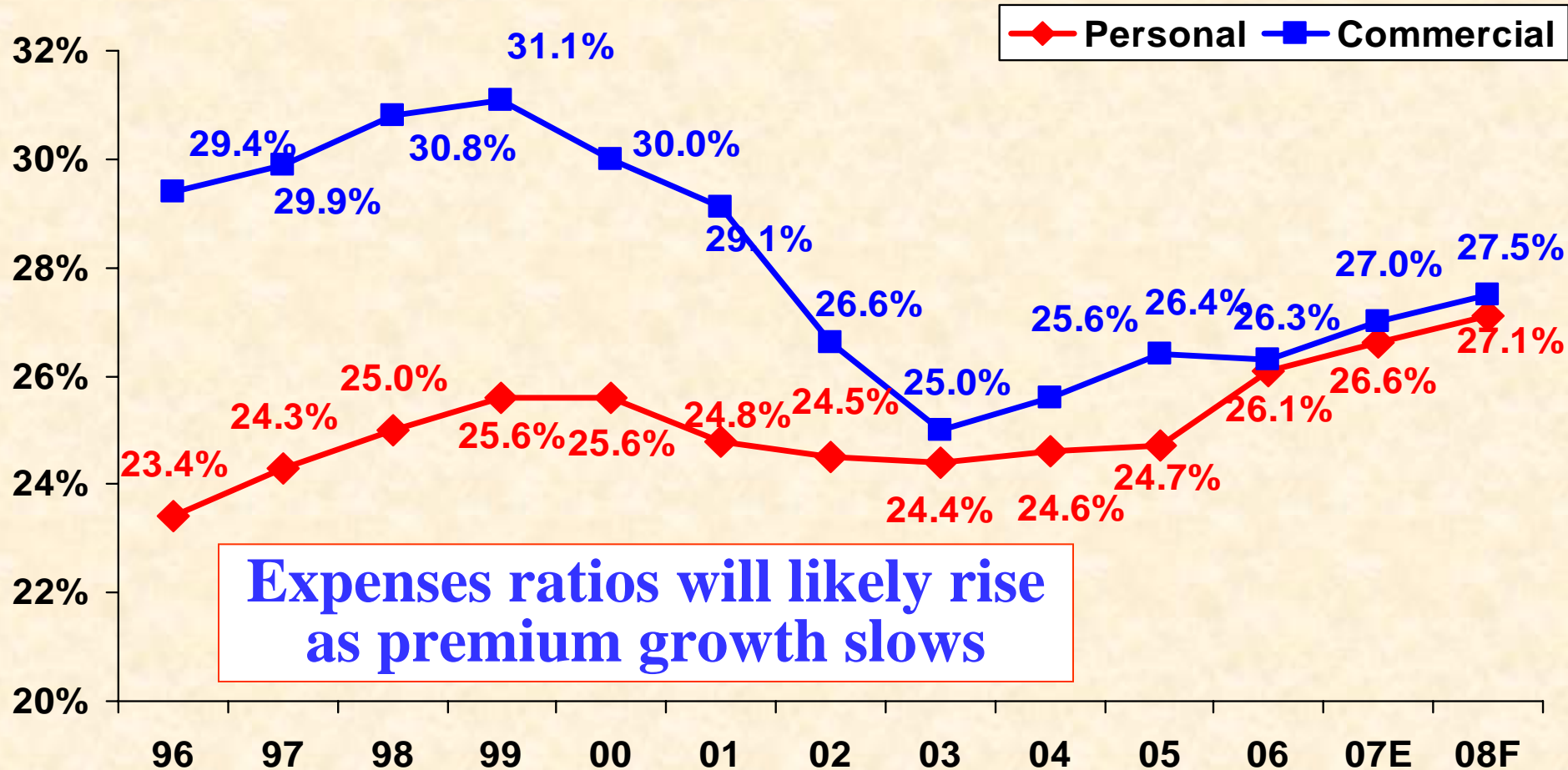
RISING EXPENSES

*Expense Ratios Will Rise as
Premium Growth Slows*





*Personal vs. Commercial Lines Underwriting Expense Ratio**

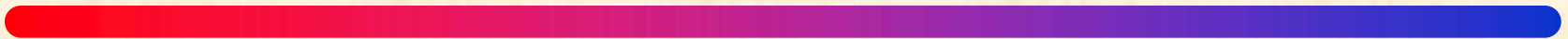


*Ratio of expenses incurred to net premiums written.

Source: A.M. Best; Insurance Information Institute

CAPACITY/ SURPLUS

**Accumulation of Capital/
Surplus Depresses ROEs**

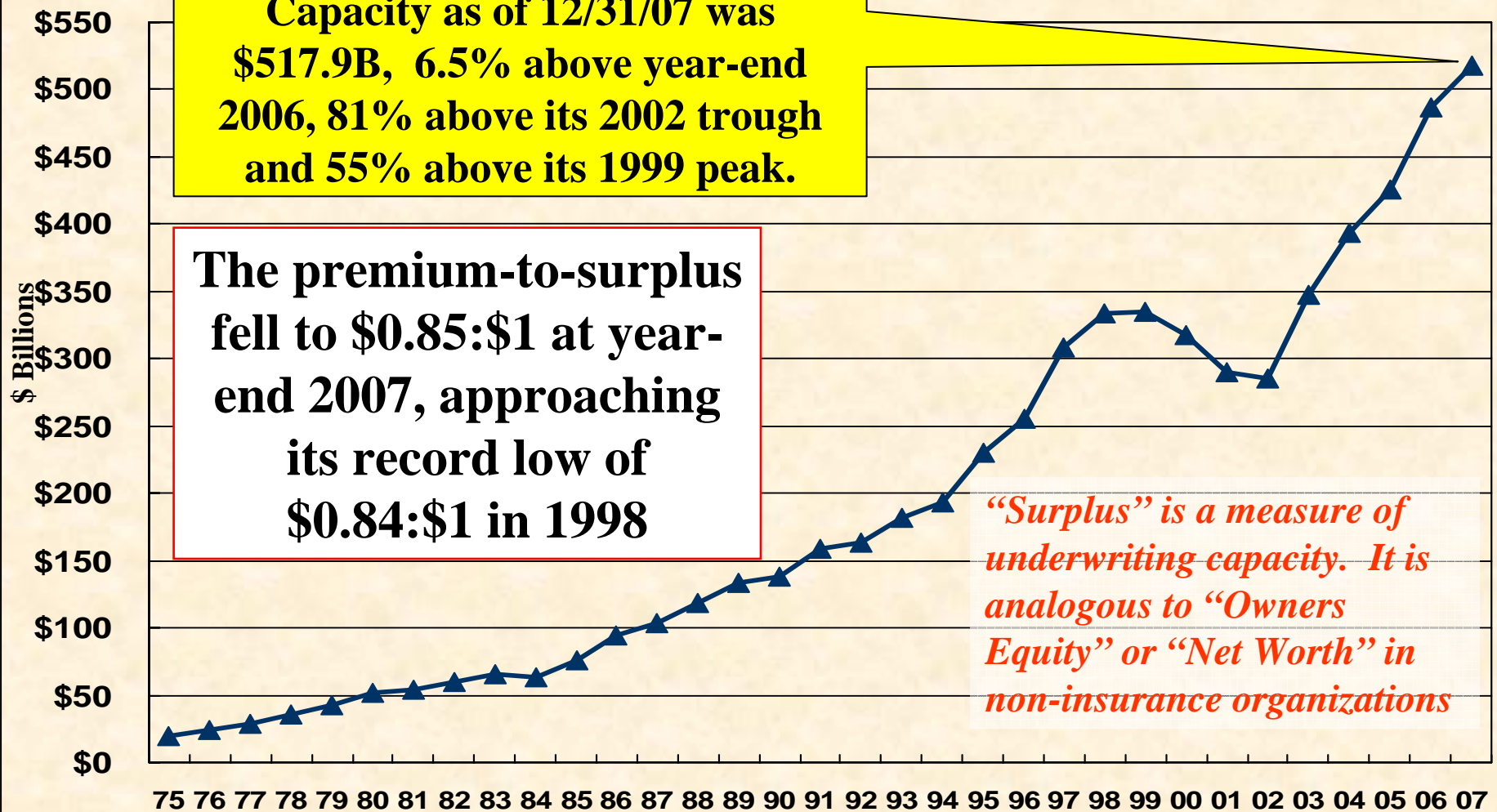




*U.S. Policyholder Surplus: 1975-2007**

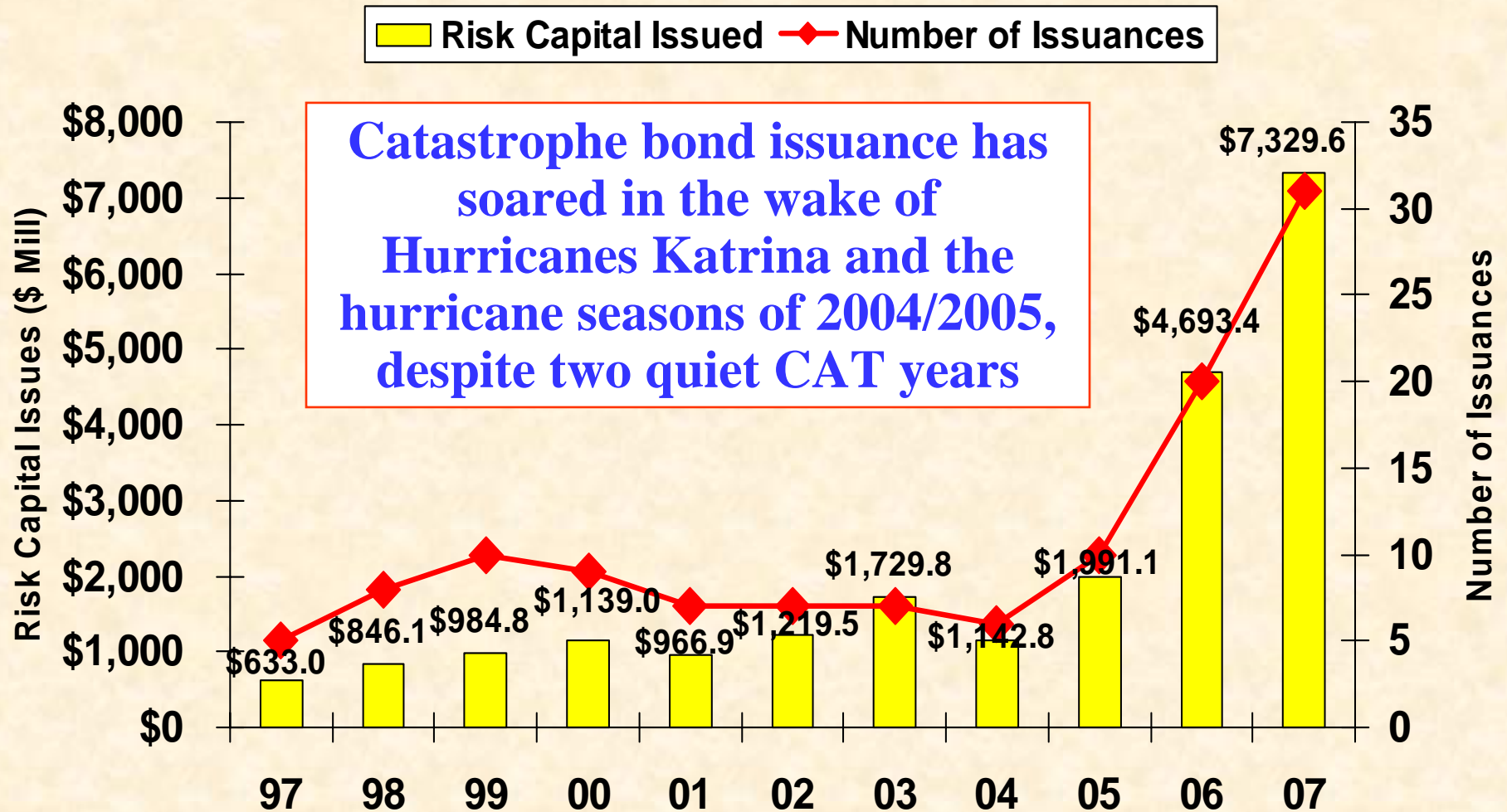
Capacity as of 12/31/07 was \$517.9B, 6.5% above year-end 2006, 81% above its 2002 trough and 55% above its 1999 peak.

The premium-to-surplus fell to \$0.85:\$1 at year-end 2007, approaching its record low of \$0.84:\$1 in 1998





Annual Catastrophe Bond Transactions Volume, 1997-2007





P/C Insurer Share Repurchases, 1987- Through Q4 2007 (\$ Millions)

Reasons Behind Capital Build-Up & Repurchase Surge

- Strong underwriting results
- Moderate catastrophe losses
- Reasonable investment performance
- Lack of strategic alternatives (M&A, large-scale expansion)

Returning capital owners (shareholders) is one of the few options available

2007 share buybacks shattered the 2006 record, up 214%

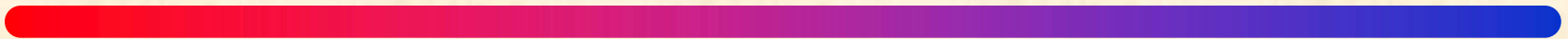
2007 repurchases to date equate to 3.9% of industry surplus, the highest in 20 years

\$22,322.6



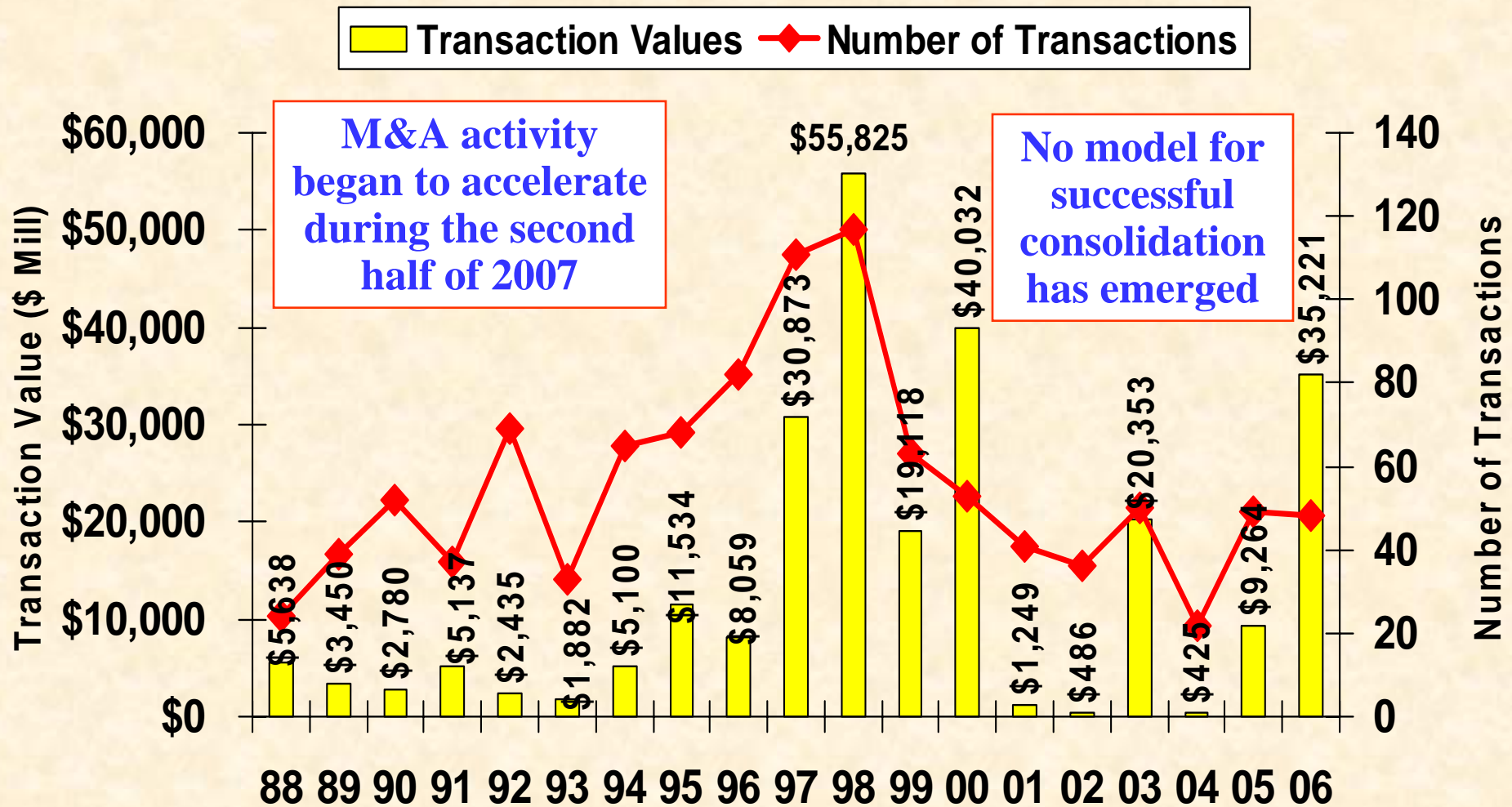
MERGER & ACQUISITION

Catalysts for P/C
Consolidation Growing
in 2008



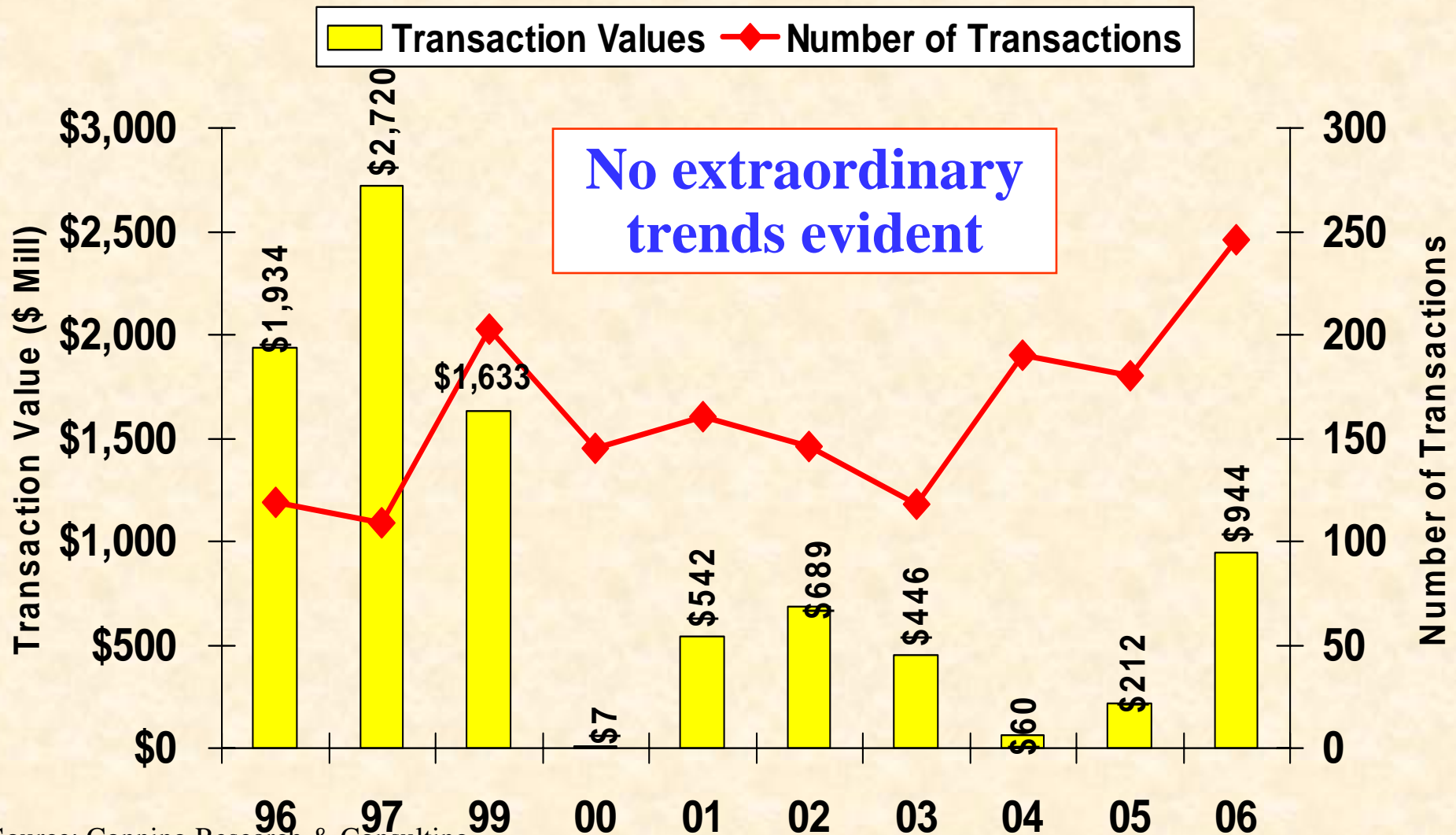


P/C Insurance-Related M&A Activity, 1988-2006





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

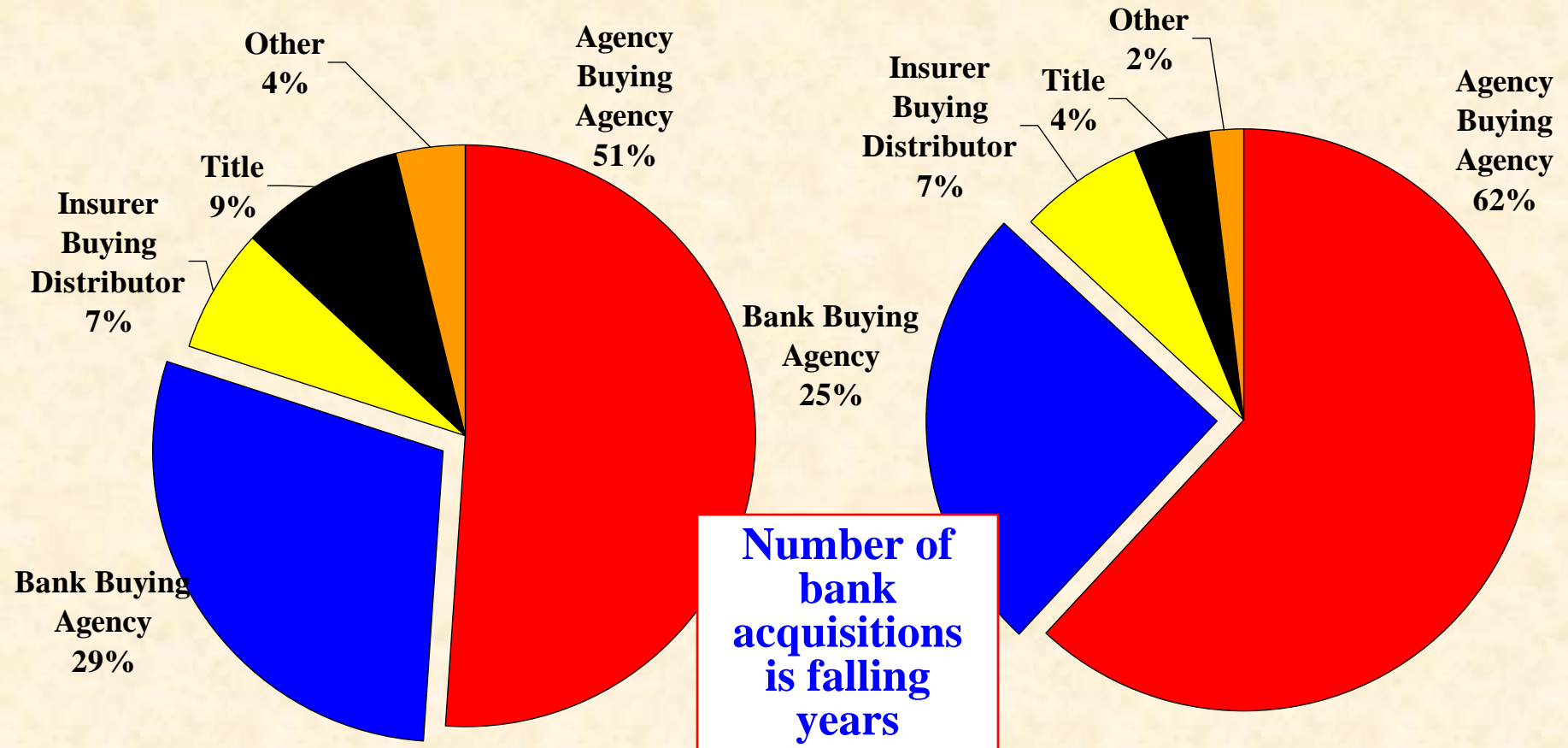




Distribution Sector M&A Activity, 2005 vs. 2006

2005

2006





Motivating Factors for Increased P/C Insurer Consolidation

Motivating Factors for P/C M&As

- **Slow Growth**: Growth is at its lowest levels since the late 1990s
 - NWP growth was 0% in 2007; Appears similarly flat in 2008
 - Prices are falling or flat in most non-coastal markets
- **Accumulation of Capital**: Excess capital depresses ROEs
 - Policyholder Surplus up 6-7%% in 2007 and up 80% since 2002
 - Insurers hard pressed to maintain earnings momentum
 - Options: Share Buybacks, Boost Dividends, Invest in Operation, Acquire
 - Option B: Engage in destructive price war and destroy capital
- **Reserve Adequacy**: No longer a drag on earnings
 - Favorable development in recent years offsets pre-2002 adverse develop.
- **Favorable Fundamentals/Drop-Off in CAT Activity**
 - Underlying claims inflation (frequency and severity trends) are benign
 - Lower CAT activity took some pressure of capital base

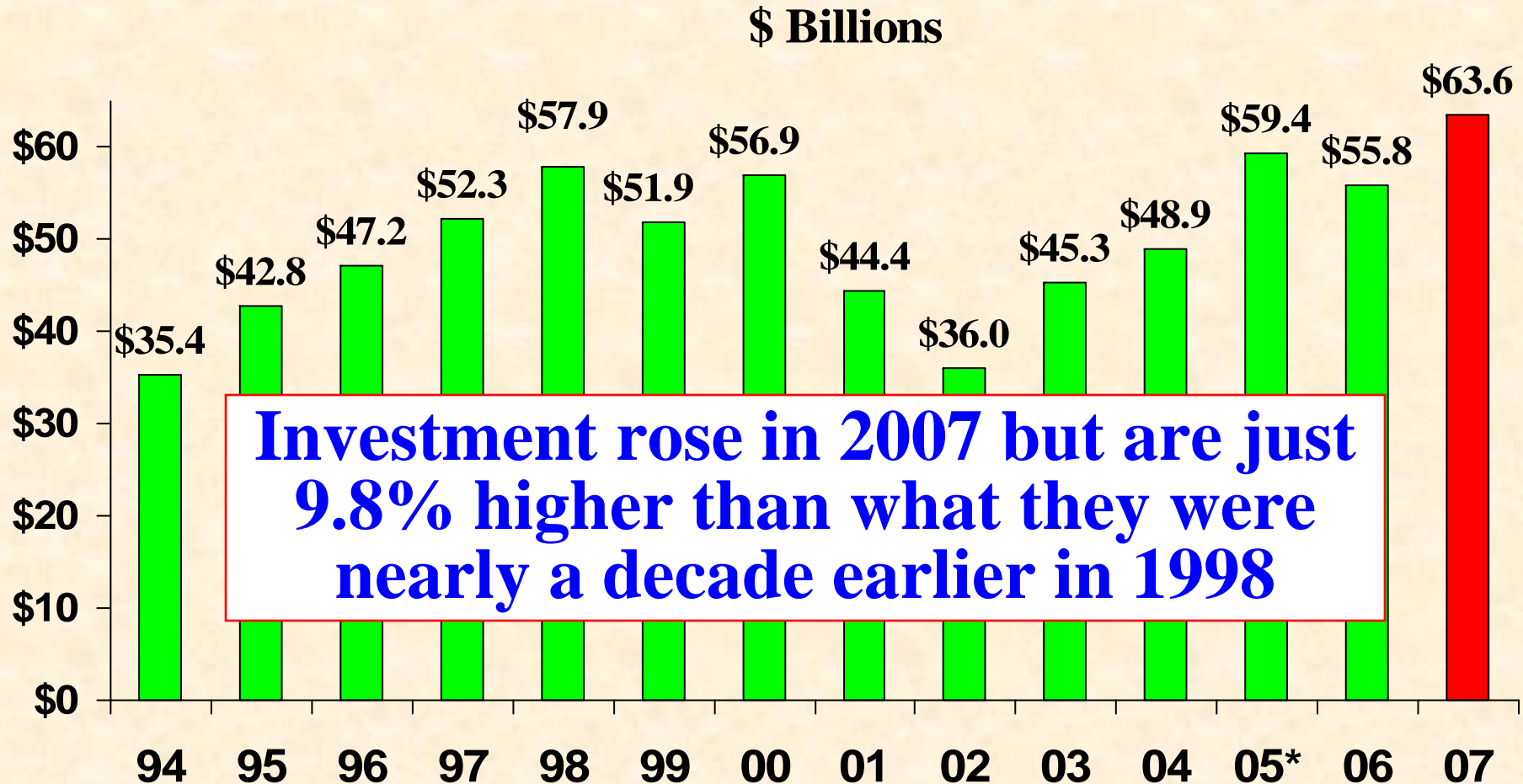
INVESTMENT OVERVIEW

*More Pain,
Little Gain*





Property/Casualty Insurance Industry Investment Gain¹



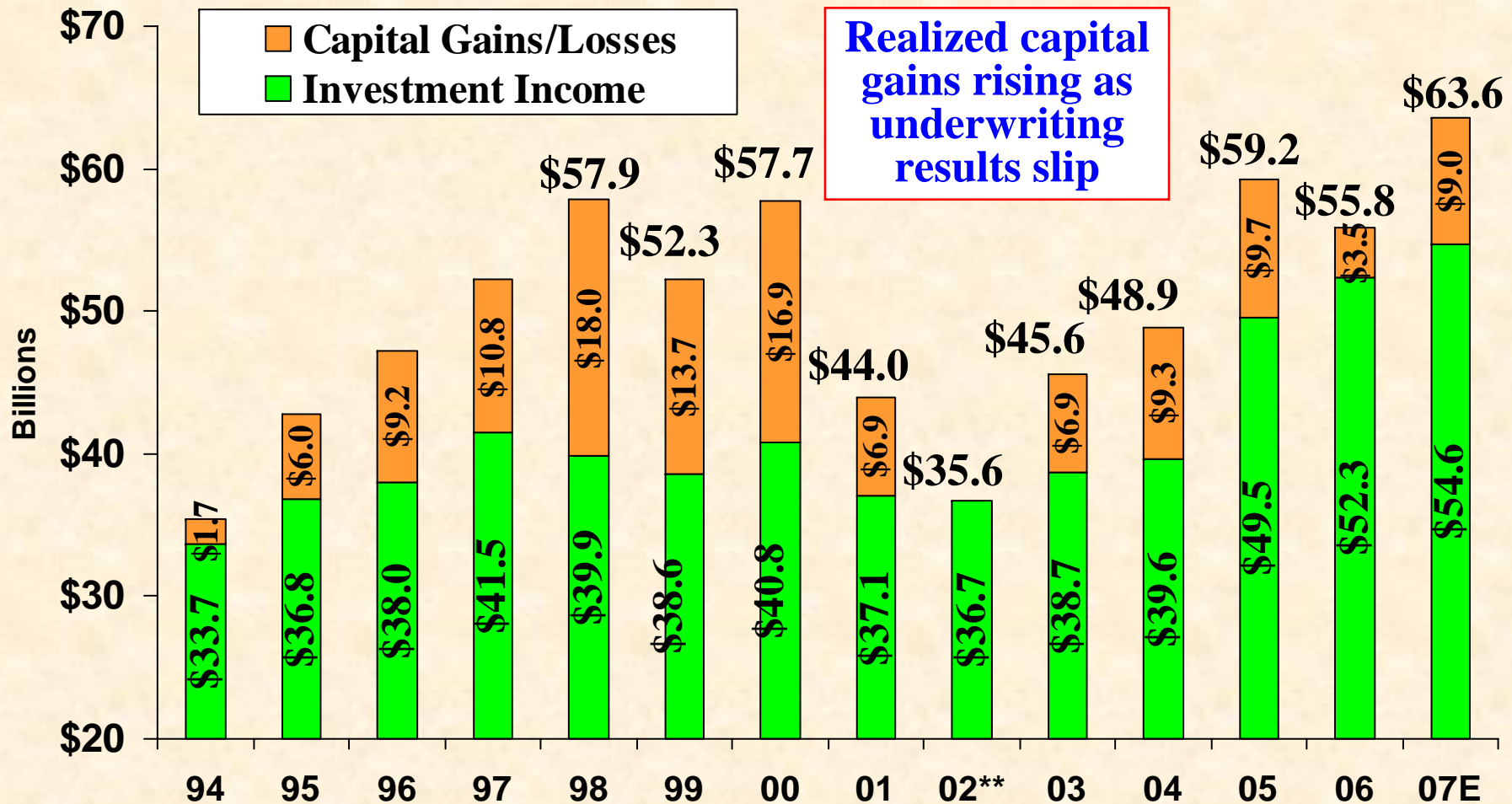
¹Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain.

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

Sources: ISO; Insurance Information Institute.



Property/Casualty Industry Investment Results, 1994-2007



*Primarily interest, stock dividends, and realized capital gains and losses.

**Not shown: \$1.1B capital loss in 2002.

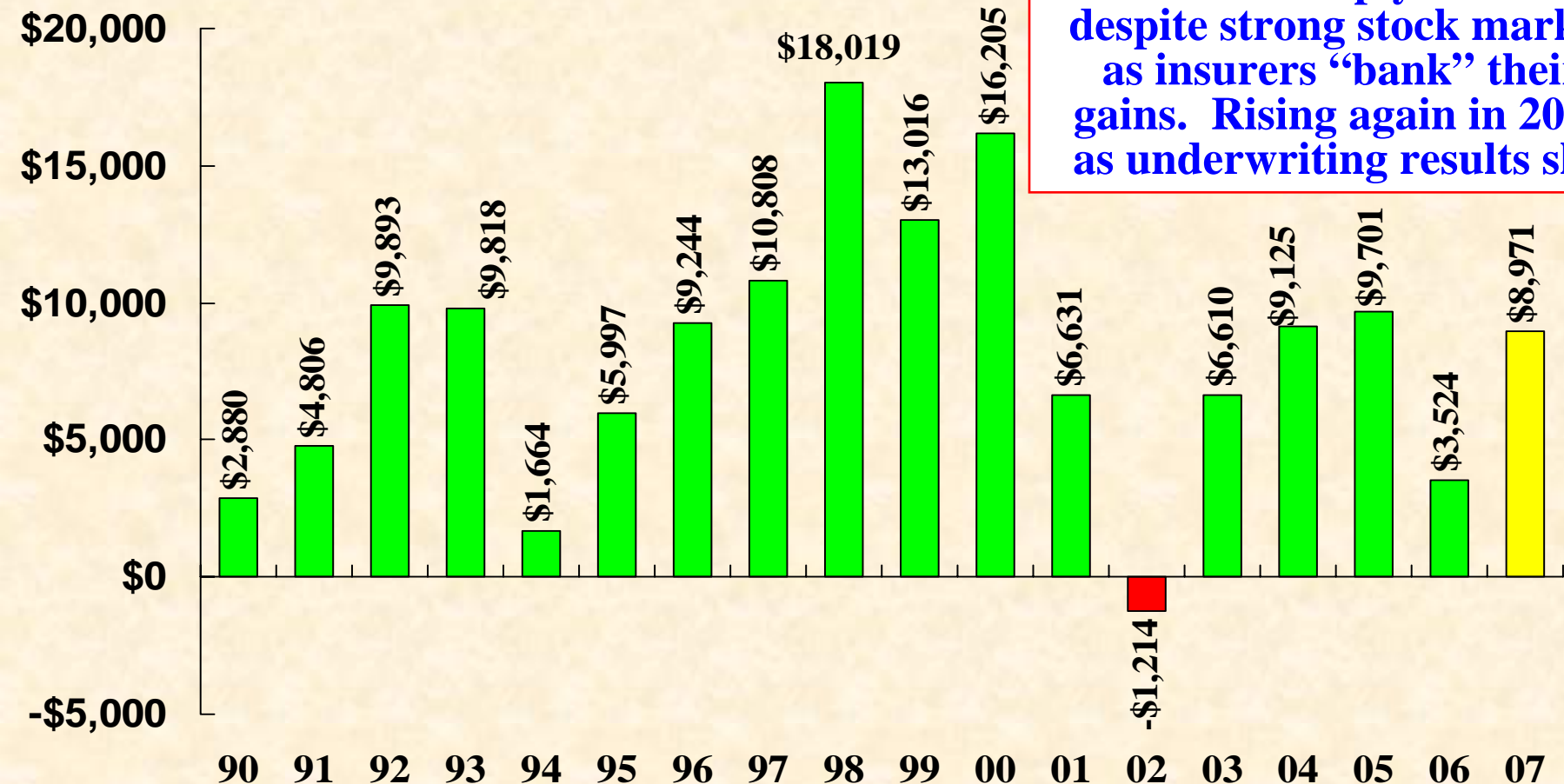
2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.



US P/C Net Realized Capital Gains, 1990-2007 (\$ Millions)

Realized capital gains rebounded strongly in 2004/5 but fell sharply in 2006 despite strong stock market as insurers “bank” their gains. Rising again in 2007 as underwriting results slip

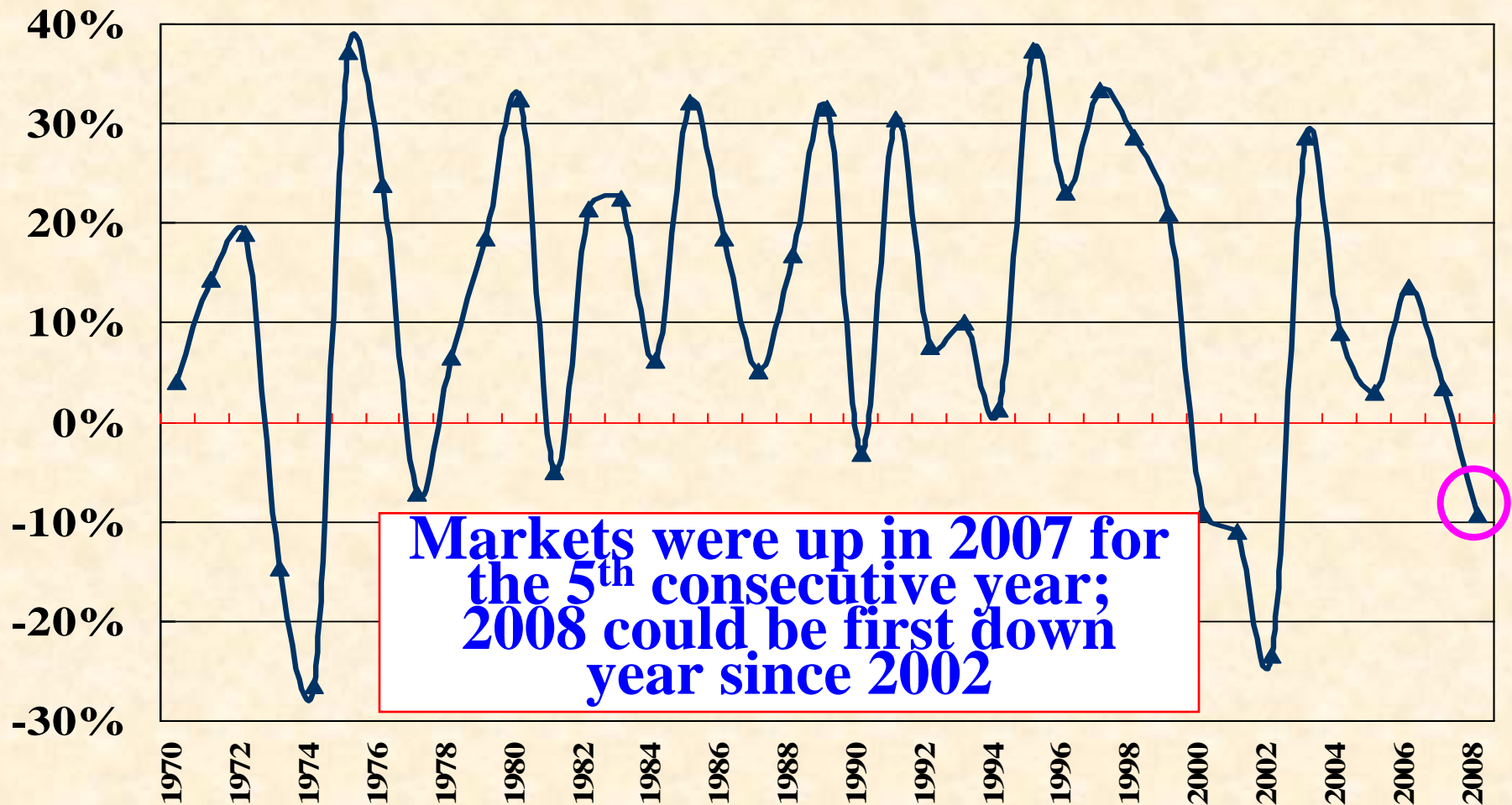


Sources: A.M. Best, ISO, Insurance Information Institute.



*Total Returns for Large Company Stocks: 1970-2008**

S&P 500 was up 3.5% in 2007, down 6.0% YTD 2008*



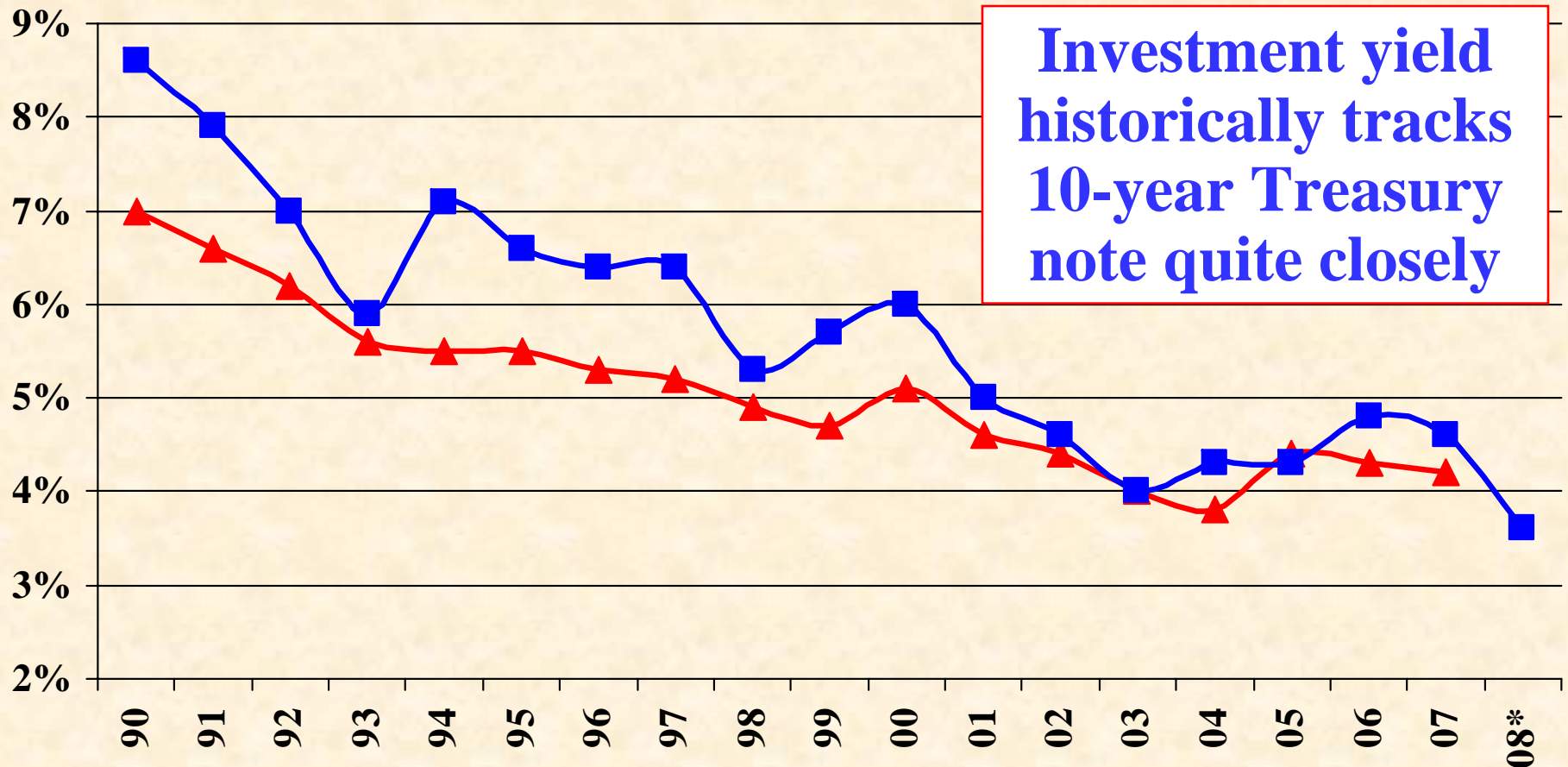
Source: Ibbotson Associates, Insurance Information Institute.

*Through April 23, 2008.



P/C Investment Income as a % of Invested Assets Follows 10-Year US T-Note

—▲ P-C Inv Income/Inv Assets —■ 10-Year Treasury Note



*As of January 2008 month-end.

Sources: Board of Governors, Federal Reserve System; A.M.Best; Insurance Information Institute.

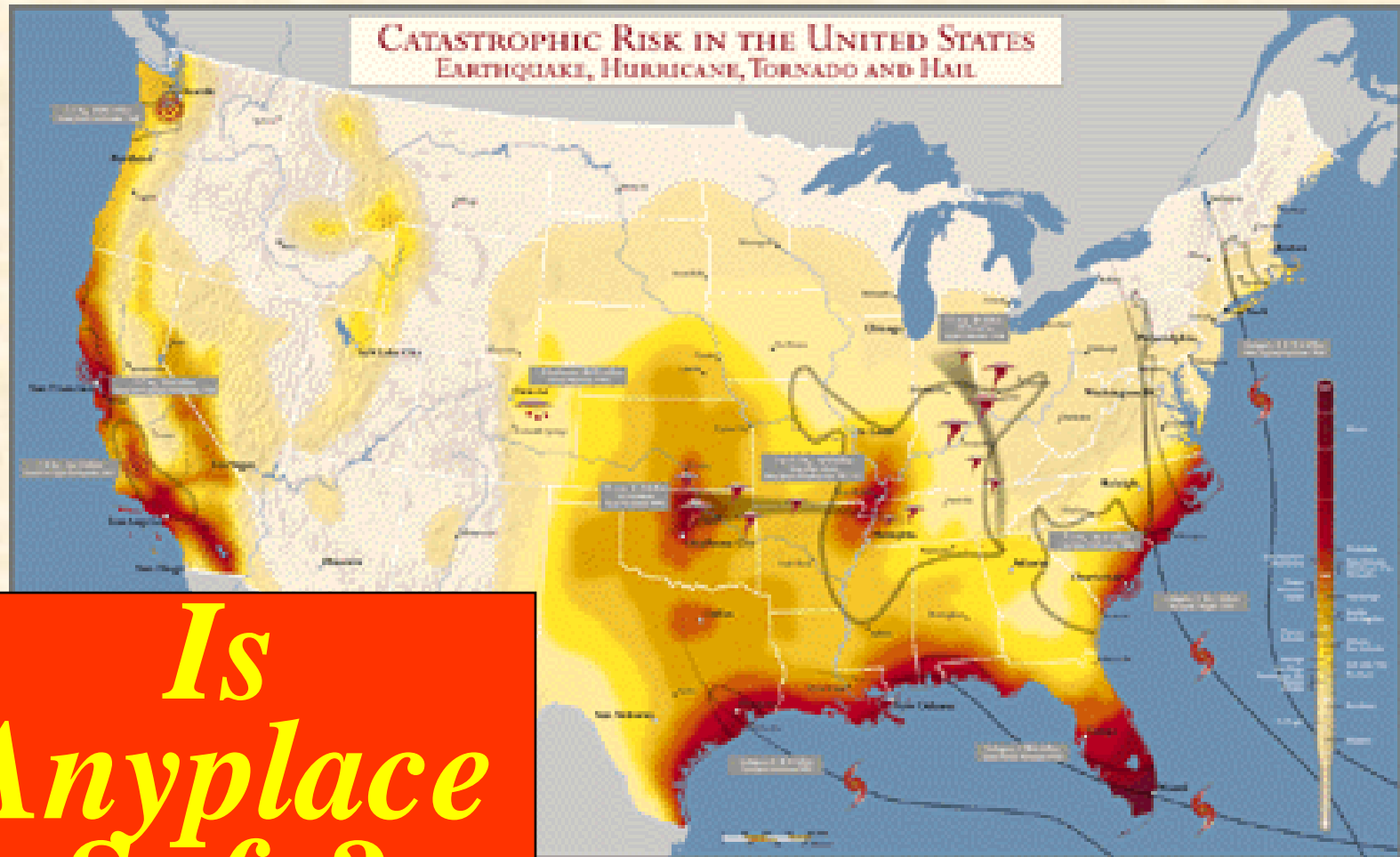
CATASTROPHIC LOSS

What Will 2008 Bring?





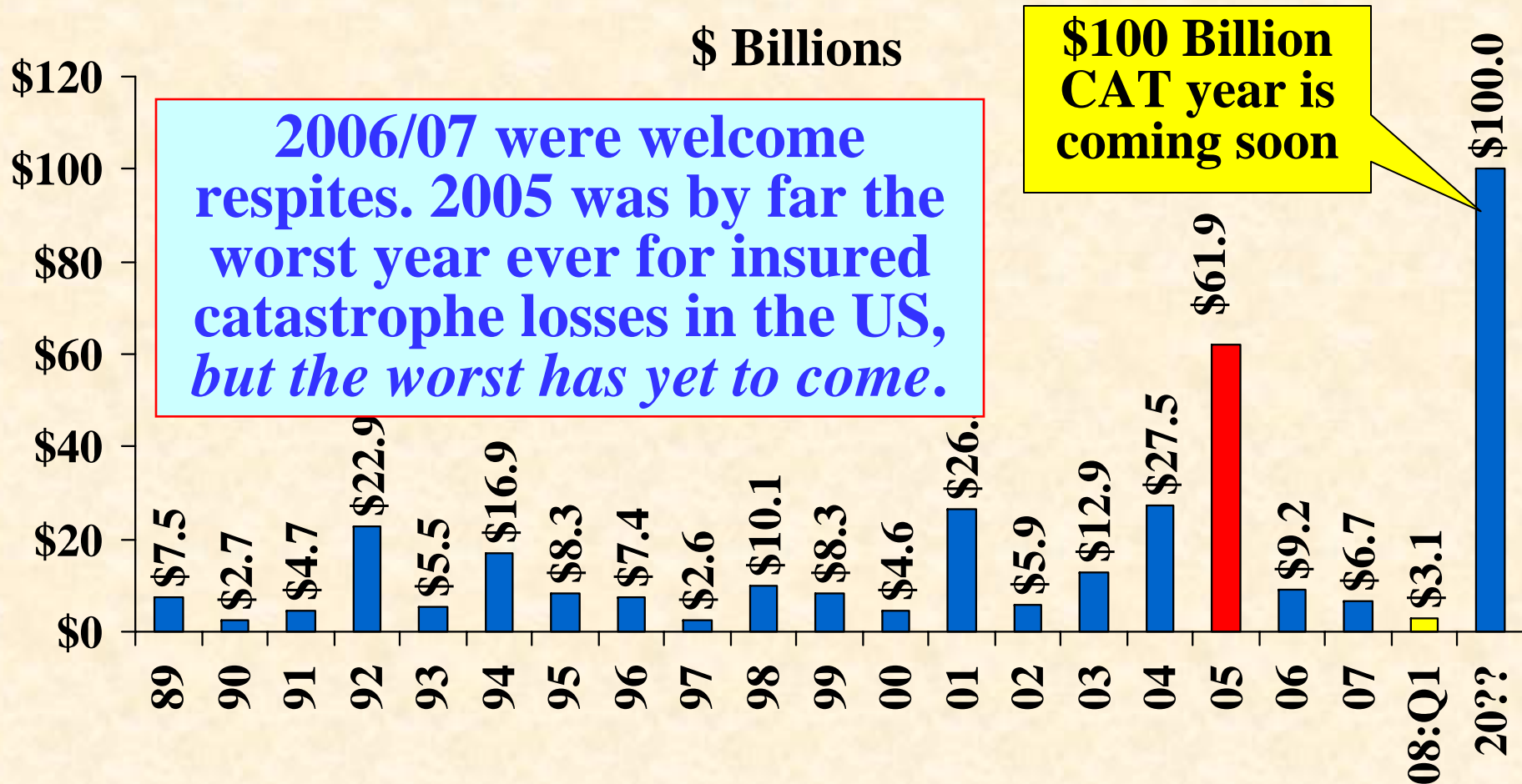
Most of US Population & Property Has Major CAT Exposure



*Is
Anyplace
Safe?*



U.S. Insured Catastrophe Losses*



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

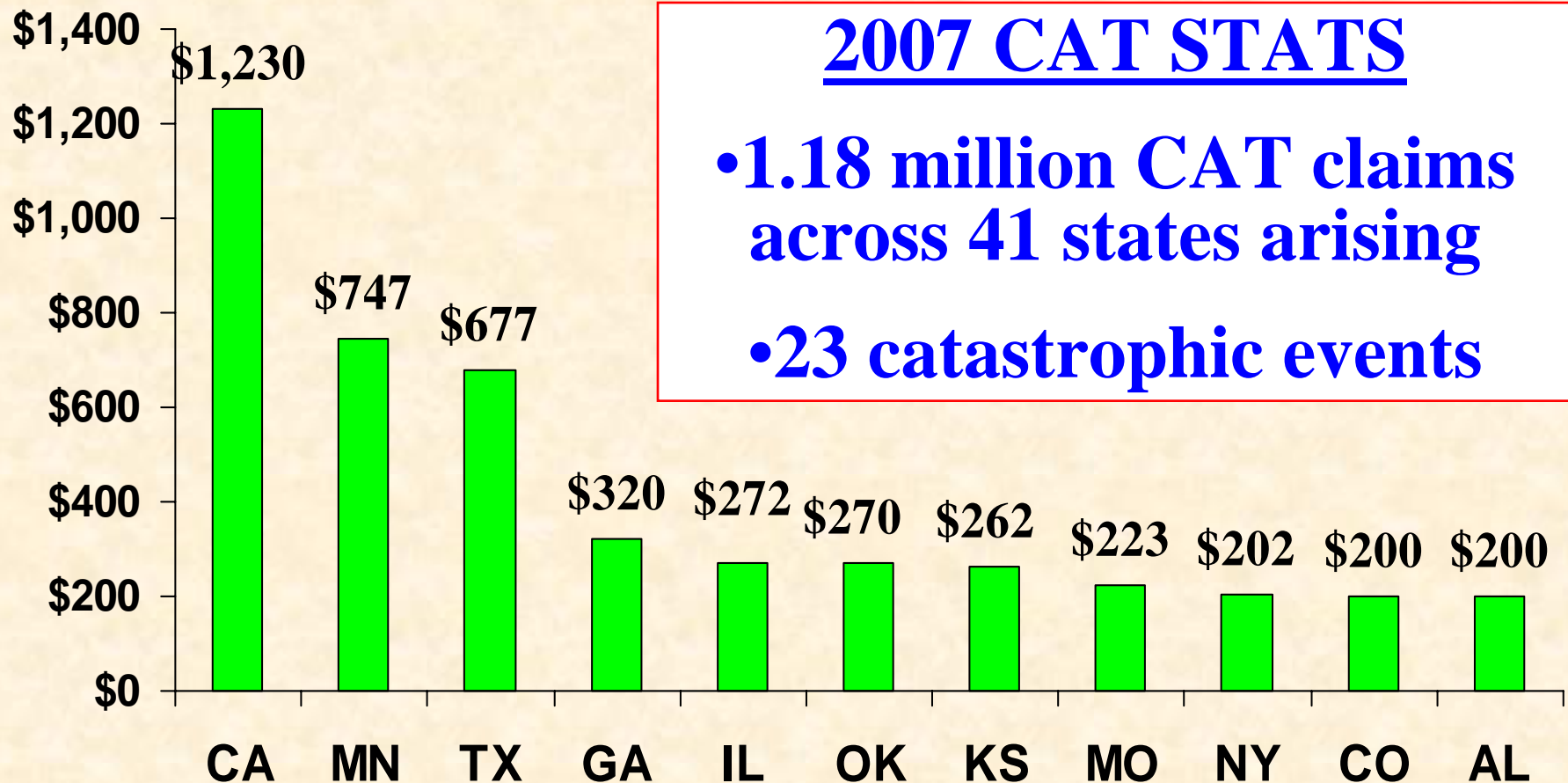
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B.

Source: Property Claims Service/ISO; Insurance Information Institute



States With Largest Insured Catastrophe Losses in 2007

\$ Millions





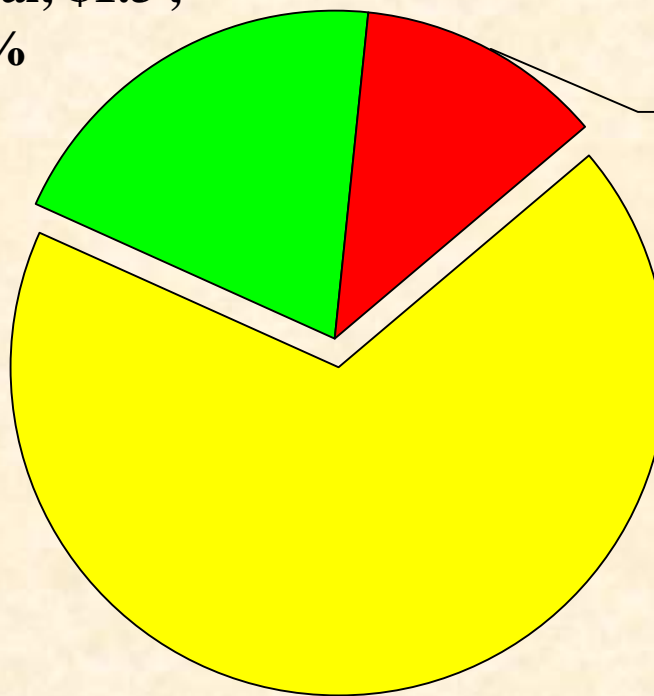
Distribution of 2007 US CAT Losses, by Type and Insured Loss

\$ Billions

**Commercial, \$1.3 ,
20%**

Vehicle, \$0.8 , 12%

**Personal (home,
condo, rental,
contents etc.)
accounted for 68%
of all US insured
CAT losses paid in
2007. CAT claim
count was 1.18
million.**

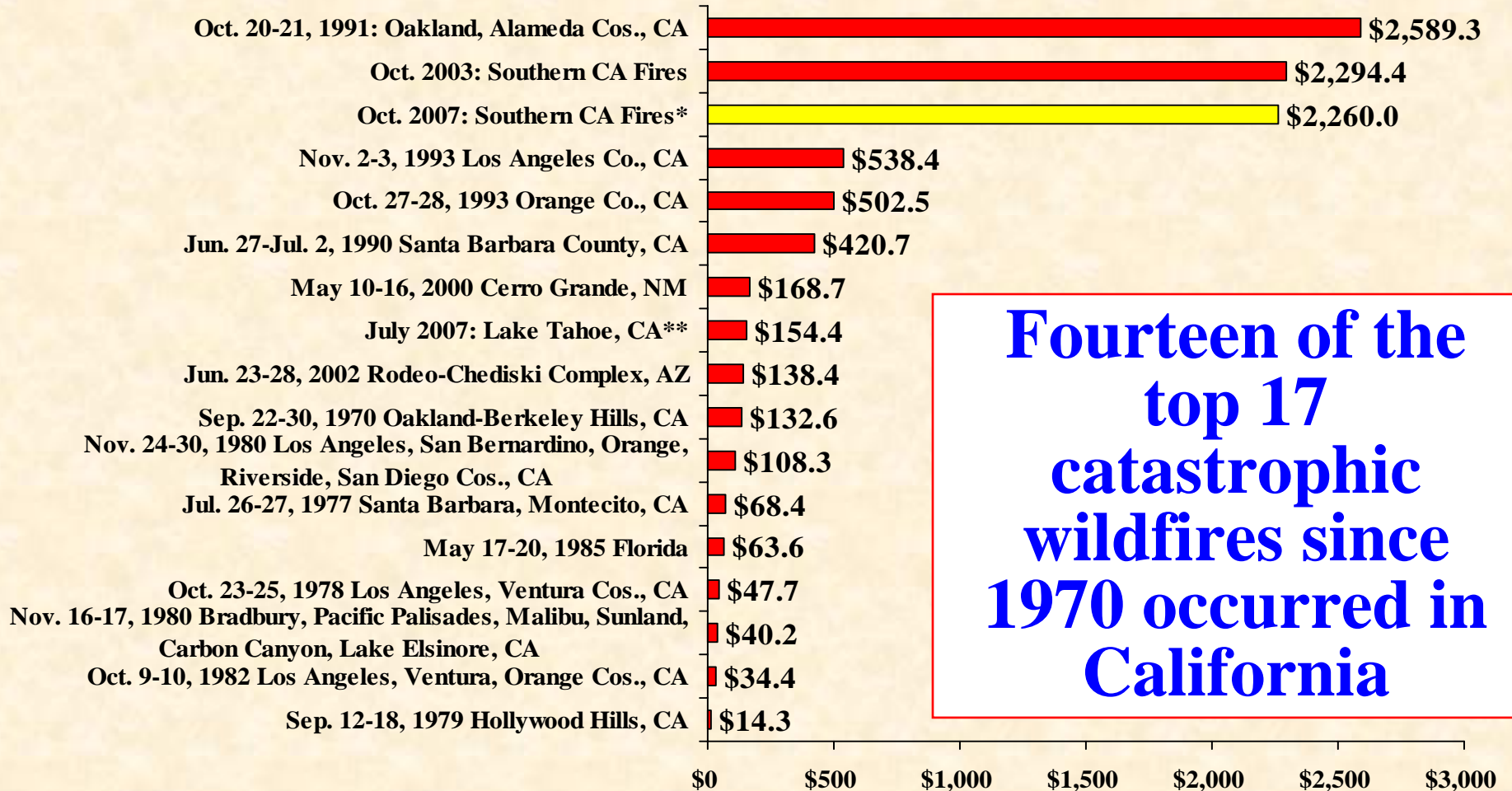


**Personal, \$4.4 ,
68%**



Top Catastrophic Wildland Fires In The United States, 1970-2007

Insured Losses (Millions 2007 \$)



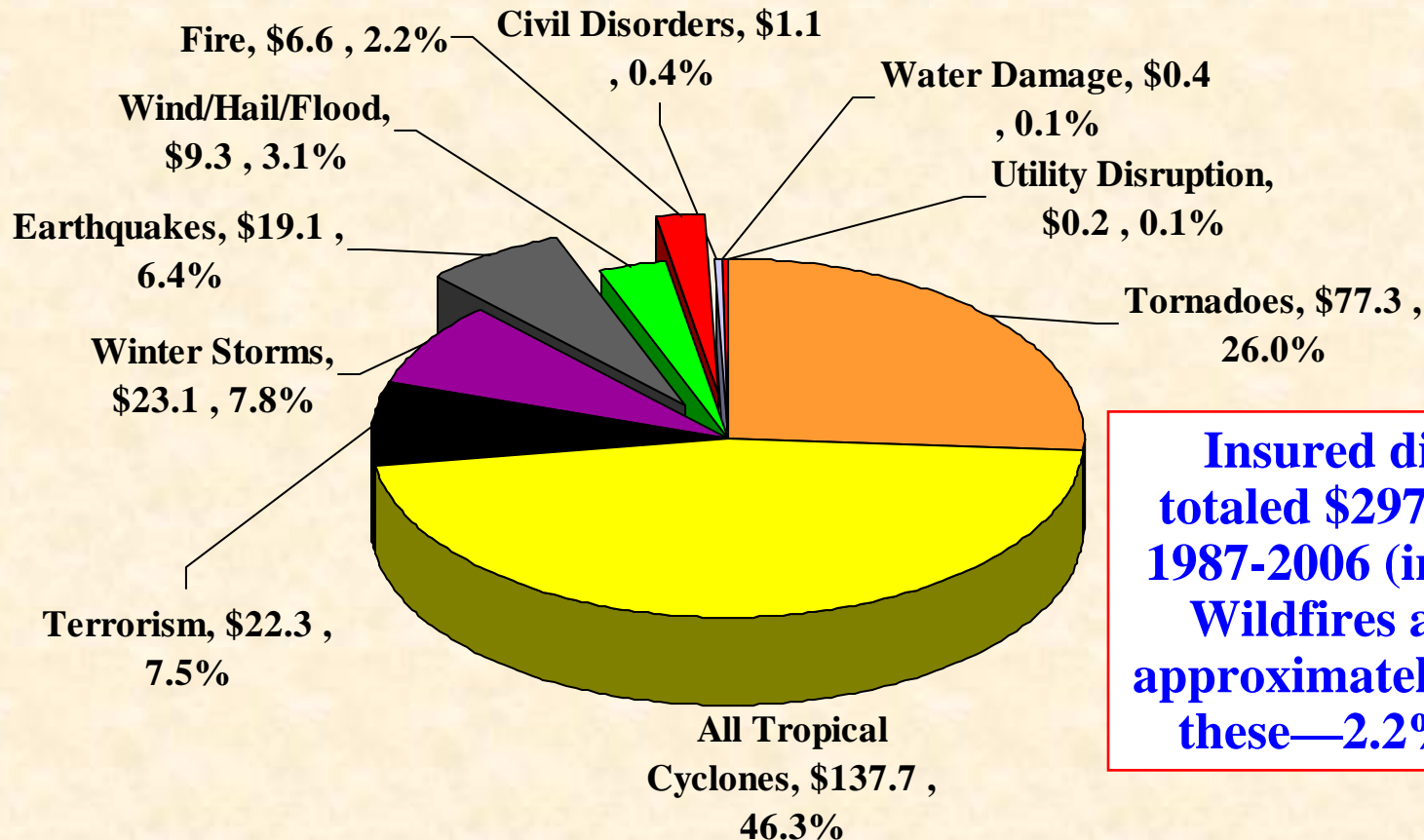
**Fourteen of the
top 17
catastrophic
wildfires since
1970 occurred in
California**

*Estimate from CA Insurance Dept., Jan. 10, 2008.

Source: ISO's Property Claim Services Unit; California Department of Insurance; Insurance Information Institute.



Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1987-2006¹



Insured disaster losses totaled \$297.3 billion from 1987-2006 (in 2006 dollars). Wildfires accounted for approximately \$6.6 billion of these—2.2% of the total.

¹ Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2006 dollars.

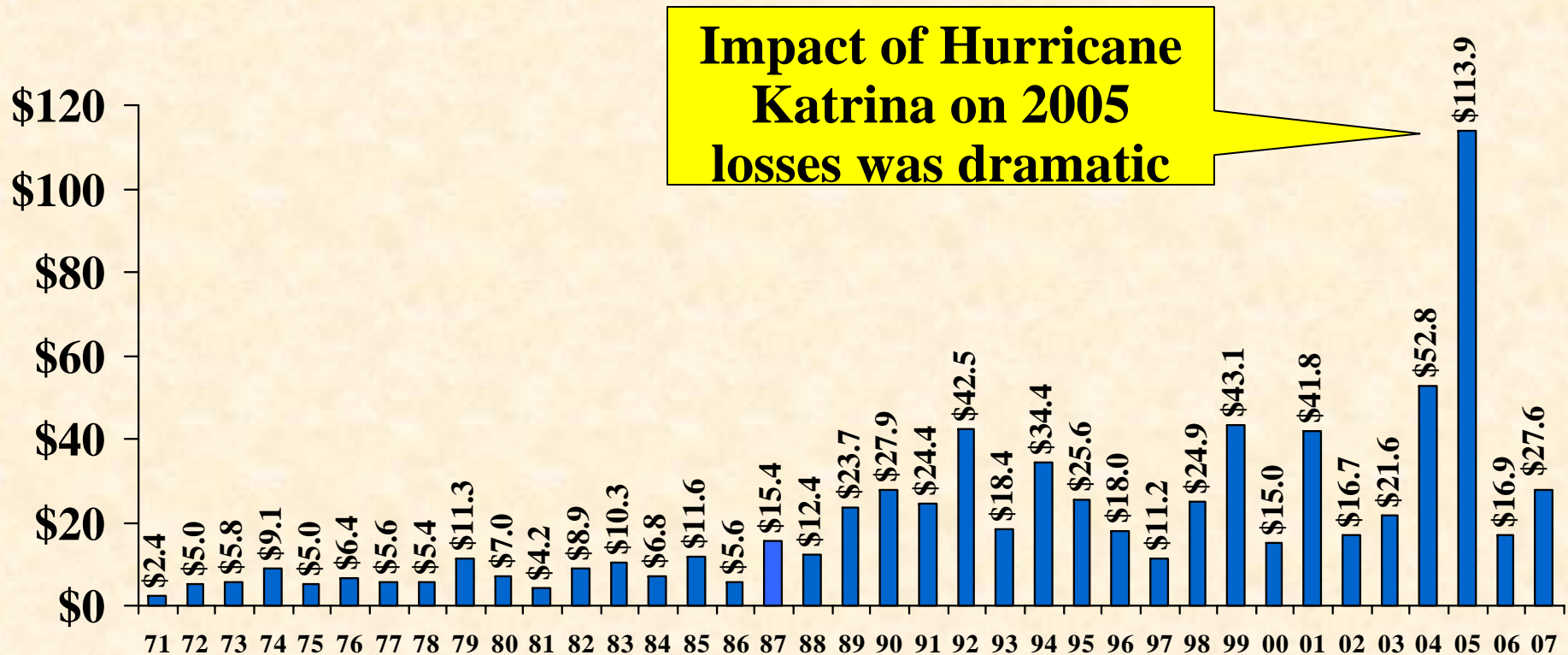
Catastrophe threshold changed from \$5 million to \$25 million beginning in 1997. Adjusted for inflation by the III.

² Excludes snow. ³ Includes hurricanes and tropical storms. ⁴ Includes other geologic events such as volcanic eruptions and other earth movement. ⁵ Does not include flood damage covered by the federally administered National Flood Insurance Program. ⁶ Includes wildland fires.



Global Insured Catastrophe Losses 1970-2007 (\$ 2007)

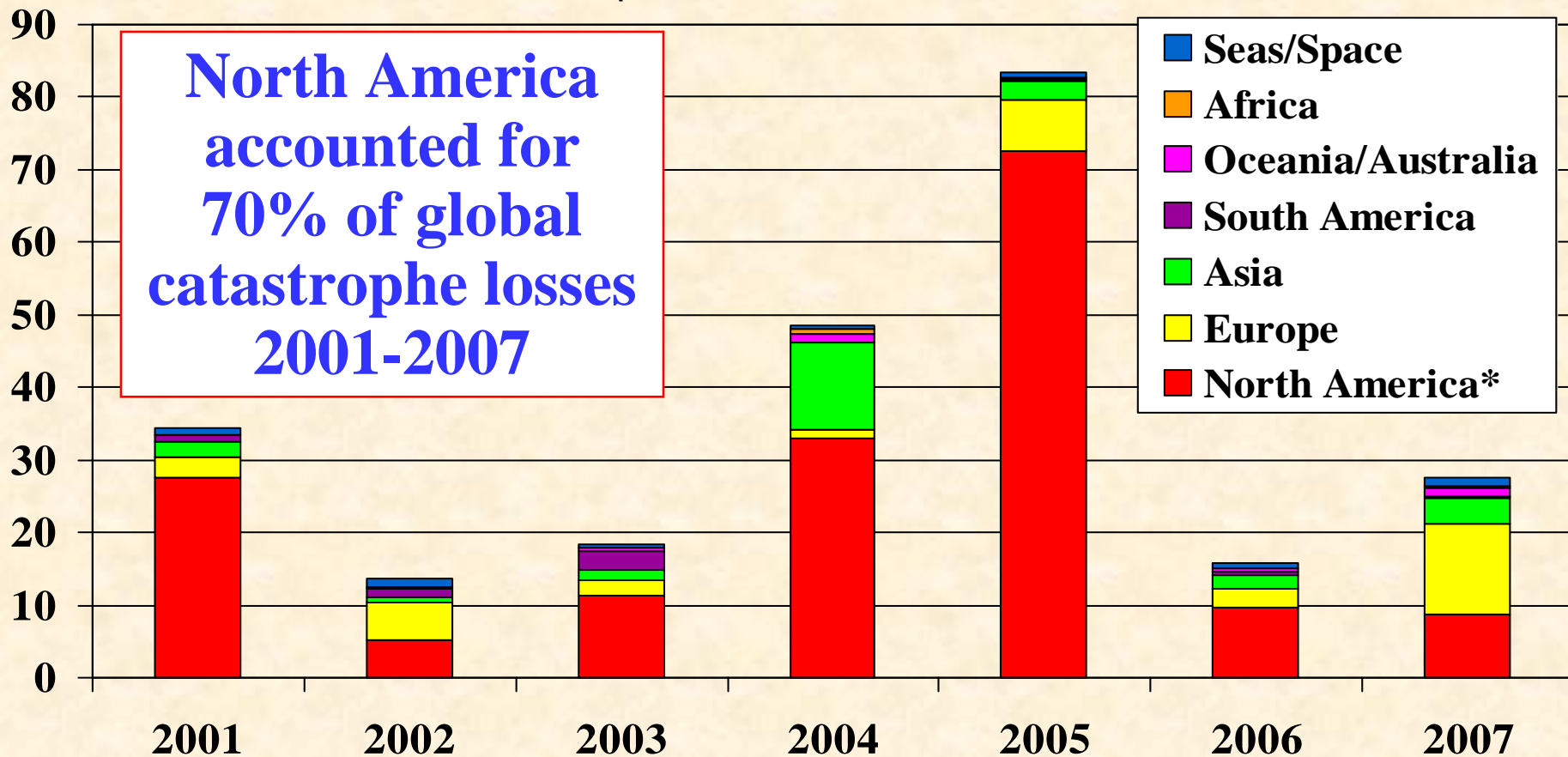
\$ Billions





Global Insured Catastrophe Losses by Region, 2001-2007

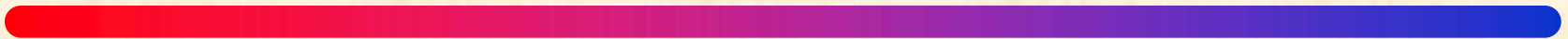
\$ Billions



Notes: 2001-03 figures for N. America include US only. 2001 figure includes only property losses from 9/11.
Source: Insurance Information Institute compiled from Swiss Re *sigma* issues.

The 2008 Hurricane Season:

Preview to Disaster?





Outlook for 2008 Hurricane Season: 60% Worse Than Average

	Average*	2005	2008F
Named Storms	9.6	28	15
Named Storm Days	49.1	115.5	80
Hurricanes	5.9	14	8
Hurricane Days	24.5	47.5	40
Intense Hurricanes	2.3	7	4
Intense Hurricane Days	5	7	9
Accumulated Cyclone Energy	96.2	NA	150
Net Tropical Cyclone Activity	100%	275%	160%

*Average over the period 1950-2000.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, April 9, 2007.



Landfall Probabilities for 2008 Hurricane Season: Above Average

	Average*	2008F
Entire US East & Gulf Coasts	52%	69%
US East Coast Including Florida Peninsula	31%	45%
Gulf Coast from Florida Panhandle to Brownsville	30%	44%
Caribbean	NA	Above Average

*Average over the past century.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, April 9, 2007.

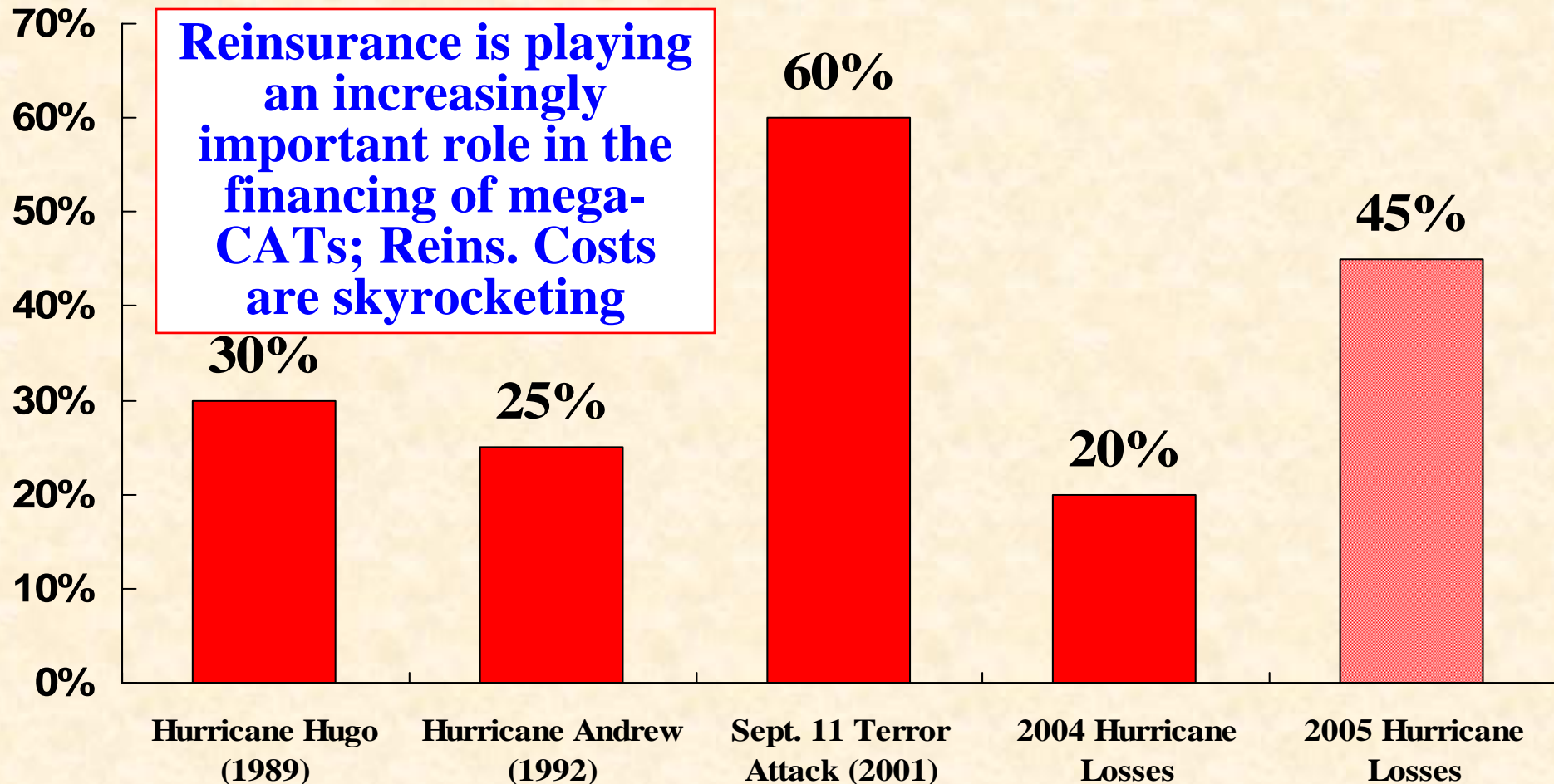
REINSURANCE MARKETS

*Reinsurance Prices are
Falling in Non-Coastal
Zones, Casualty Lines*





*Share of Losses Paid by Reinsurers, by Disaster**



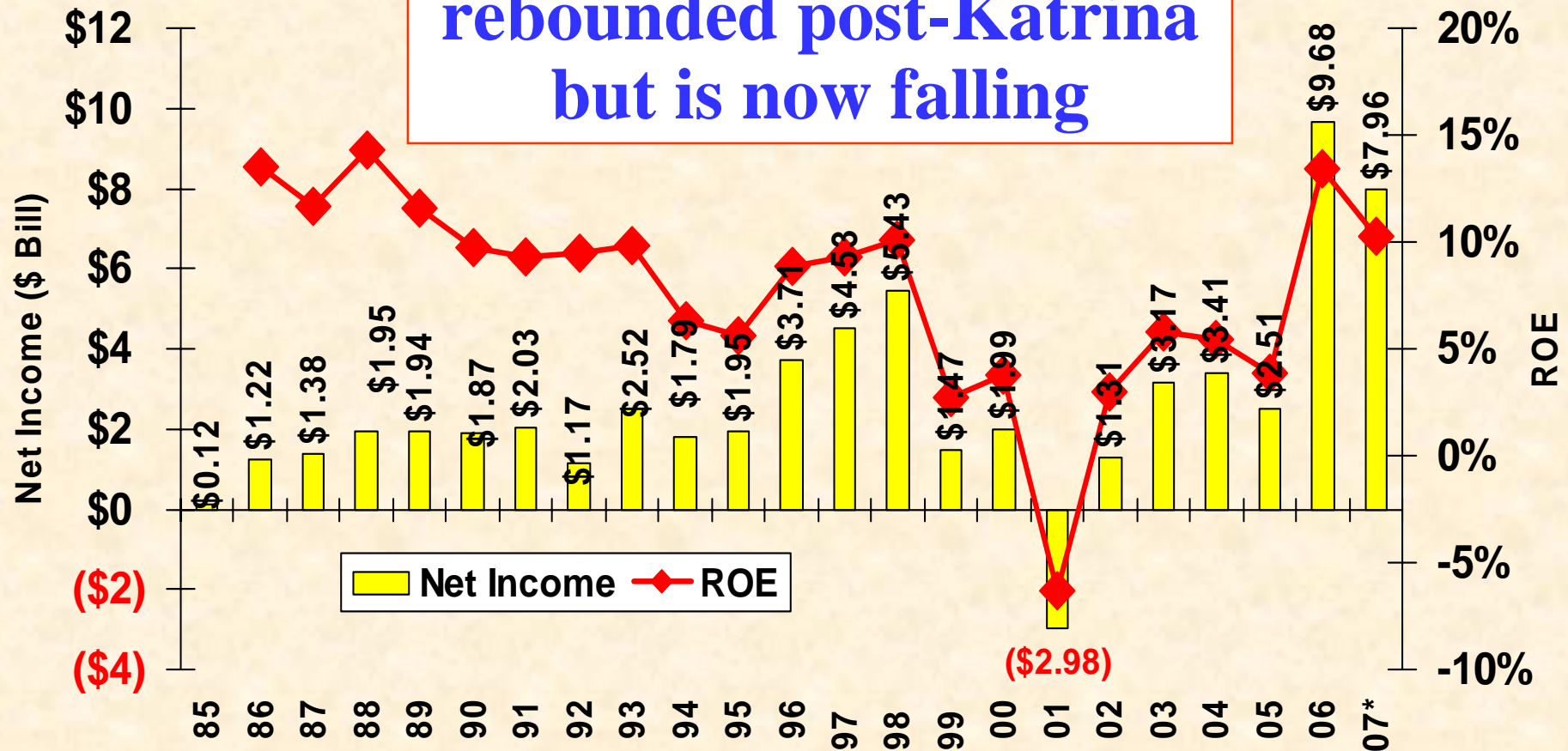
*Excludes losses paid by the Florida Hurricane Catastrophe Fund, a FL-only windstorm reinsurer, which was established in 1994 *after* Hurricane Andrew. FHCF payments to insurers are estimated at \$3.85 billion for 2004 and \$4.5 billion for 2005.

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



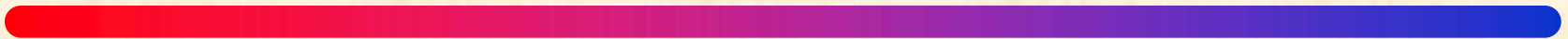
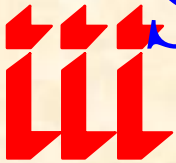
*US Reinsurer Net Income & ROE, 1985-2007**

**Reinsurer profitability
rebounded post-Katrina
but is now falling**



Shifting Legal Liability & Tort Environment

*Is the Tort Pendulum
Swinging Against Insurers?*





*Bad Year for Tort Kingpins** (Continued)



“King of Class Actions” Bill Lerach

- **Former partner in class action firm Milberg Weiss**
- **Admitted felon. Guilty of paying 3 plaintiffs \$11.4 million in 150+ cases over 25 years & lying about it repeatedly to courts**
- **Will serves 1-2 years in prison and forfeit \$7.75 million; \$250,000 fine**



“King of Torts” Dickie Scruggs

- **Won billions in tobacco, asbestos and Katrina litigation**
- **Pleaded guilty for attempting to offer a judge \$40,000 bribe to resolve attorney fee allocation from Katrina litigation in his firm's favor. His son/others → guilty on related charges**
- **Could get 5 years in prison, \$250,000 fine**



*Bad Year for Tort Kingpins** (Continued)



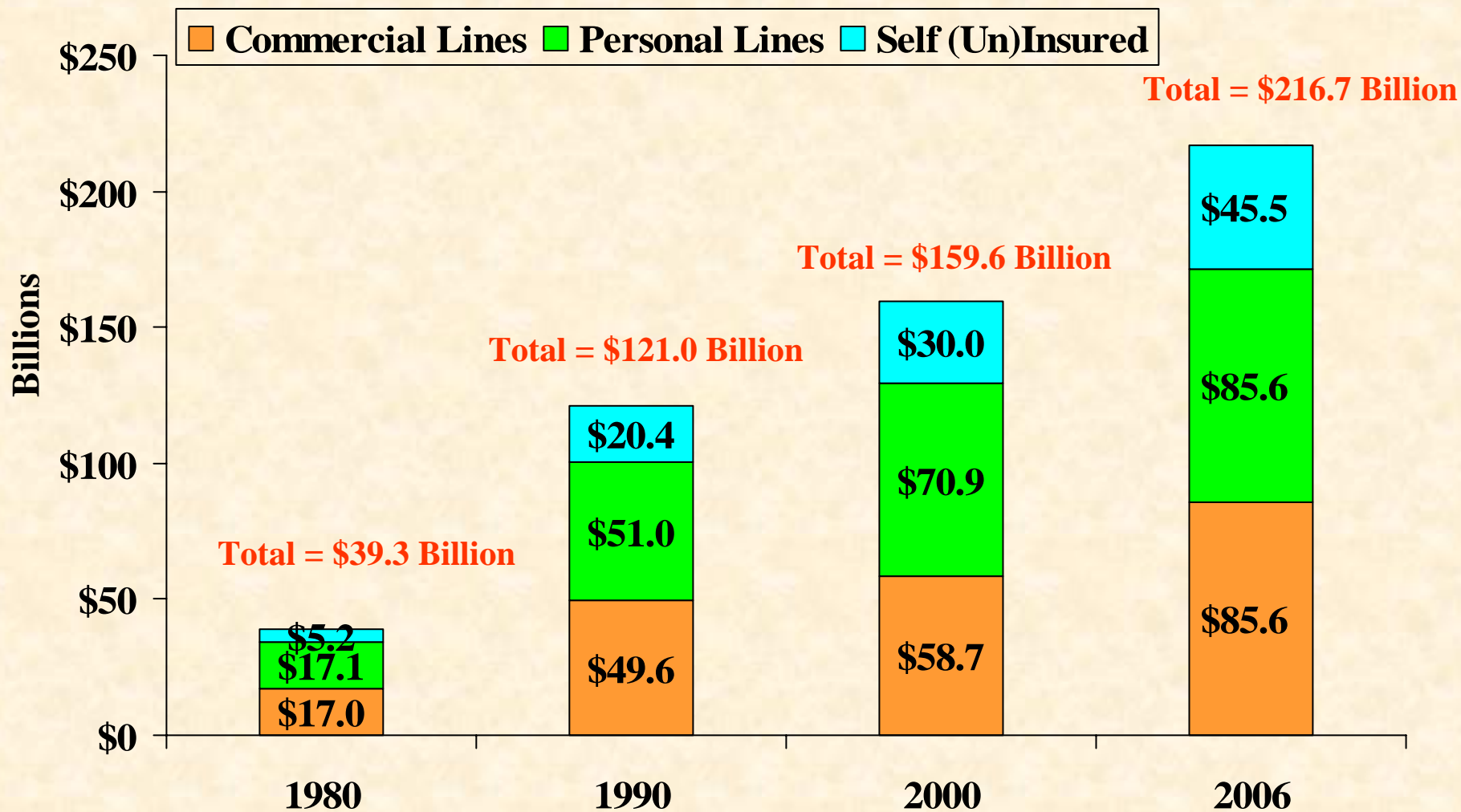
“King of Class Actions” Melvyn Weiss

- **Former partner in class action firm Milberg Weiss; Earned \$251 million in legal fees**
- **Pled guilty to federal charges of racketeering and conspiracy for paying kickbacks to professional plaintiffs**
- **Will serve 18-33 months in prison, pay \$9.75 million in restitution; \$250,000 fine**

**This Space
Available**



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

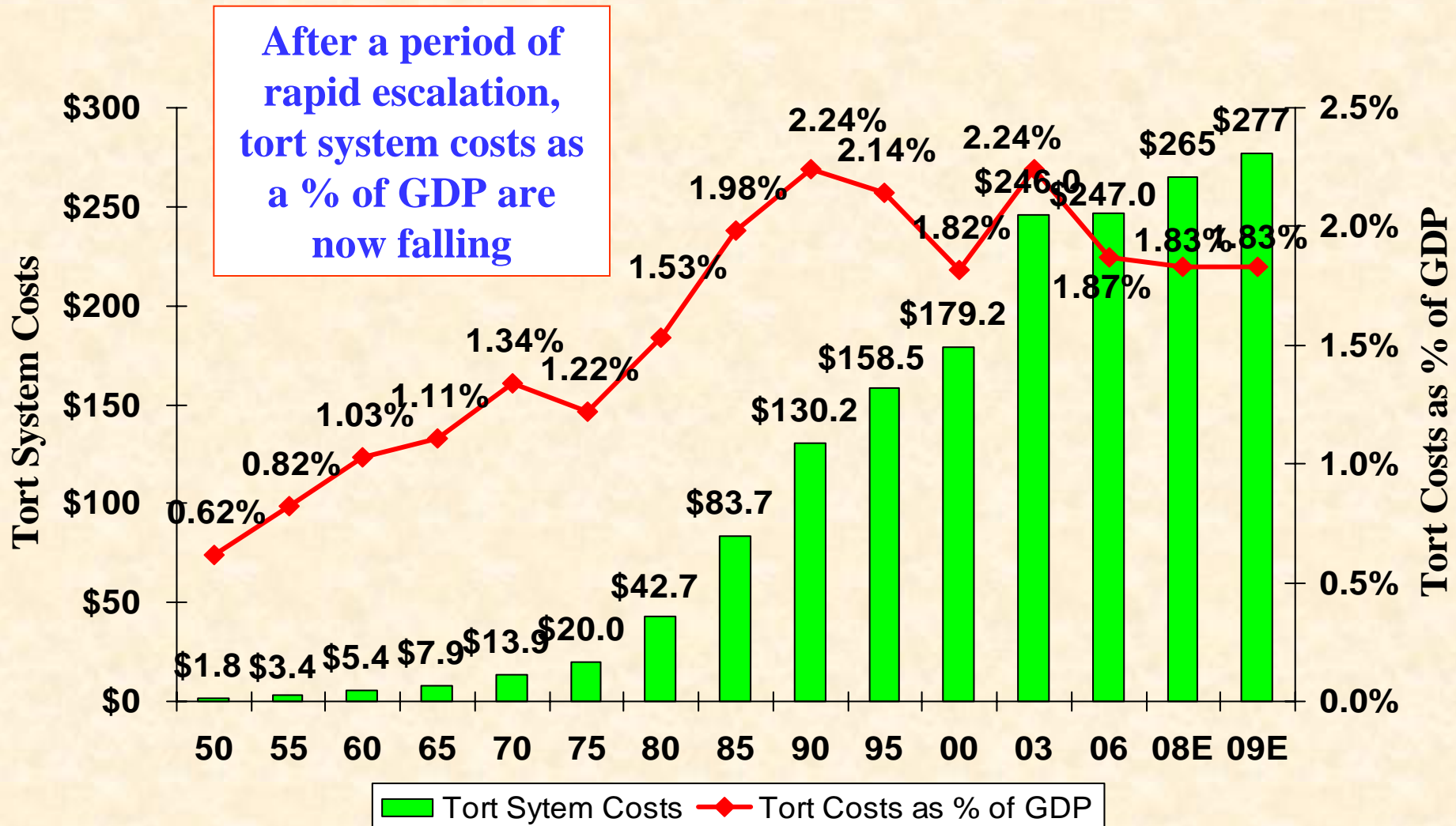


*Excludes medical malpractice

Source: Tillinghast-Towers Perrin, 2007 Update on US Tort Cost Trends.



Tort System Costs, 1950-2009E





The Nation's Judicial Hellholes (2007)

Watch List

Madison County, IL

St. Clair County, IL

Northern New Mexico

Hillsborough County, FL

Delaware

California

Dishonorable Mentions

District of Columbia

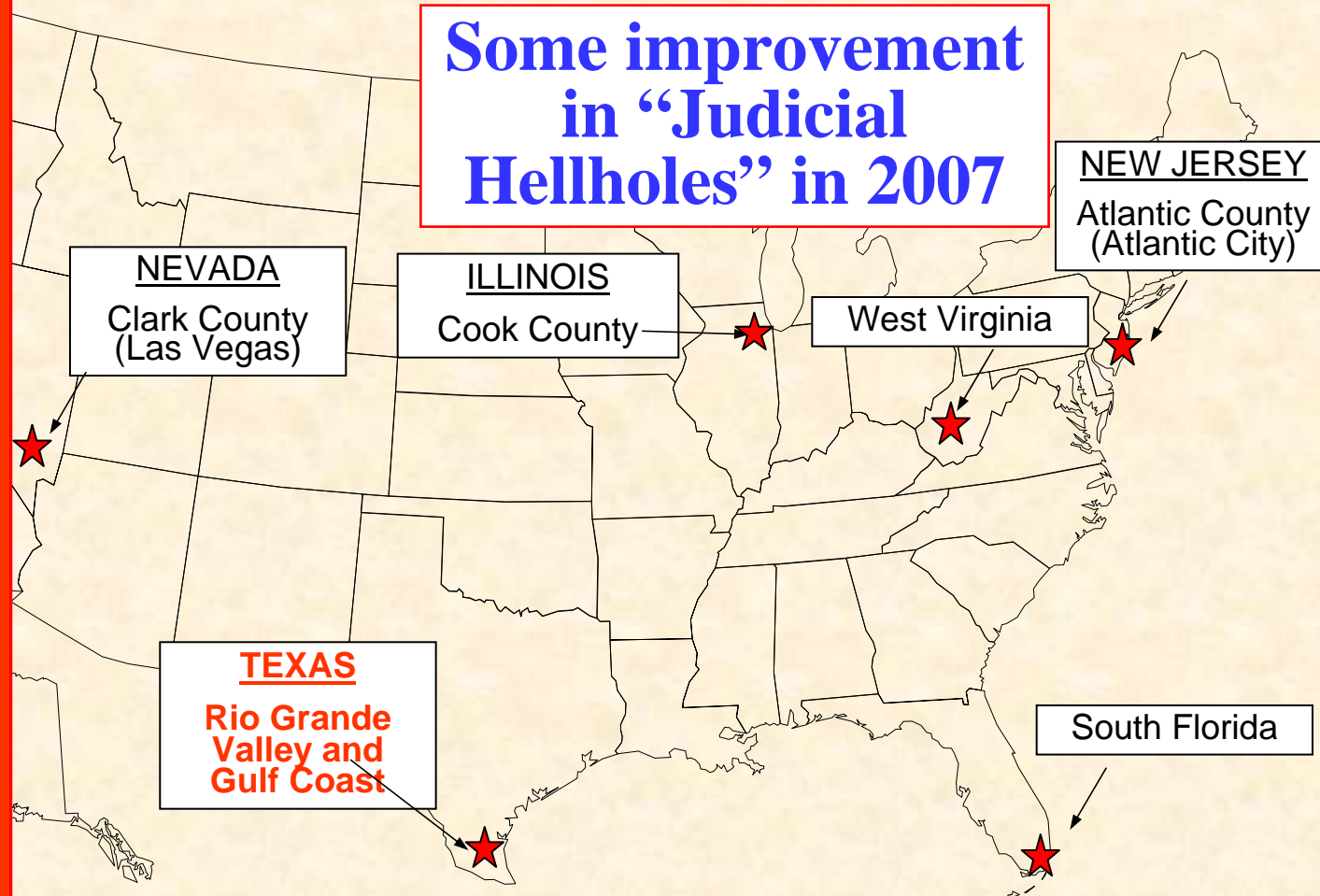
MO Supreme Court

MI Legislature

GA Supreme Court

Oklahoma

**Some improvement
in “Judicial
Hellholes” in 2007**





Business Leaders Ranking of Liability Systems for 2007

Best States

1. Delaware
2. Minnesota
3. Nebraska
4. Iowa
5. Maine
6. New Hampshire
7. Tennessee
8. Indiana
9. Utah
10. Wisconsin

New in 2007

***ME, NH, TN,
UT, WI***

Drop-Offs

***ND, VA, SD,
WY, ID***

***Midwest/West
has mix of good
and bad states***

Worst States

41. Arkansas
42. Hawaii
43. Alaska
44. Texas
45. California
46. Illinois
47. Alabama
48. Louisiana
49. Mississippi
50. West Virginia

Newly Notorious

AK

***Rising
Above***

FL

REGULATORY & LEGISLATIVE ENVIRONMENT

*Isolated Improvements,
iii Mounting Zealoutry*



Legal, Legislative & Regulatory Issues

- **Florida “Seeing the Light”**: State finally recognizing that it is overexposed with its 2007 legislation having failed to deliver on political promises made
 - Size of FL Hurricane Catastrophe Fund may be scaled back
 - Private reinsurance sector role may expand
- **Massachusetts Auto**: Reforms have led to more competition, lower rates
- **Optional Federal Chartering**: Recommended in Treasury plan; Still divisive issue
- **Risk Retention Groups**: Could be expanded to allow property RRGs
- **Tax Issue**: Treatment of locales like Bermuda; Effort to “level the playing field”
- **National CAT Plan**: Hearing in February and in 2007, but no current catalyst
- **Flood Reform**: Likely to happen, but MS Rep. Gene Taylor unsuccessful pushing for NFIP to cover wind. Sen. Clinton supports idea.
- **Antitrust**: Though Trent Lott is gone, some may still push for scaling back of M-F; States push own laws (FL)
- **Profusion of Quasi-Regulators**: AGs, Governors, Congressional representatives
- **Bad Faith Legislation**: Attempts by trial lawyers and legislative allies to open new tort channels (WA referendum, Florida SB 2862)

PRESIDENTIAL POLITICS & P/C PROFITABILITY



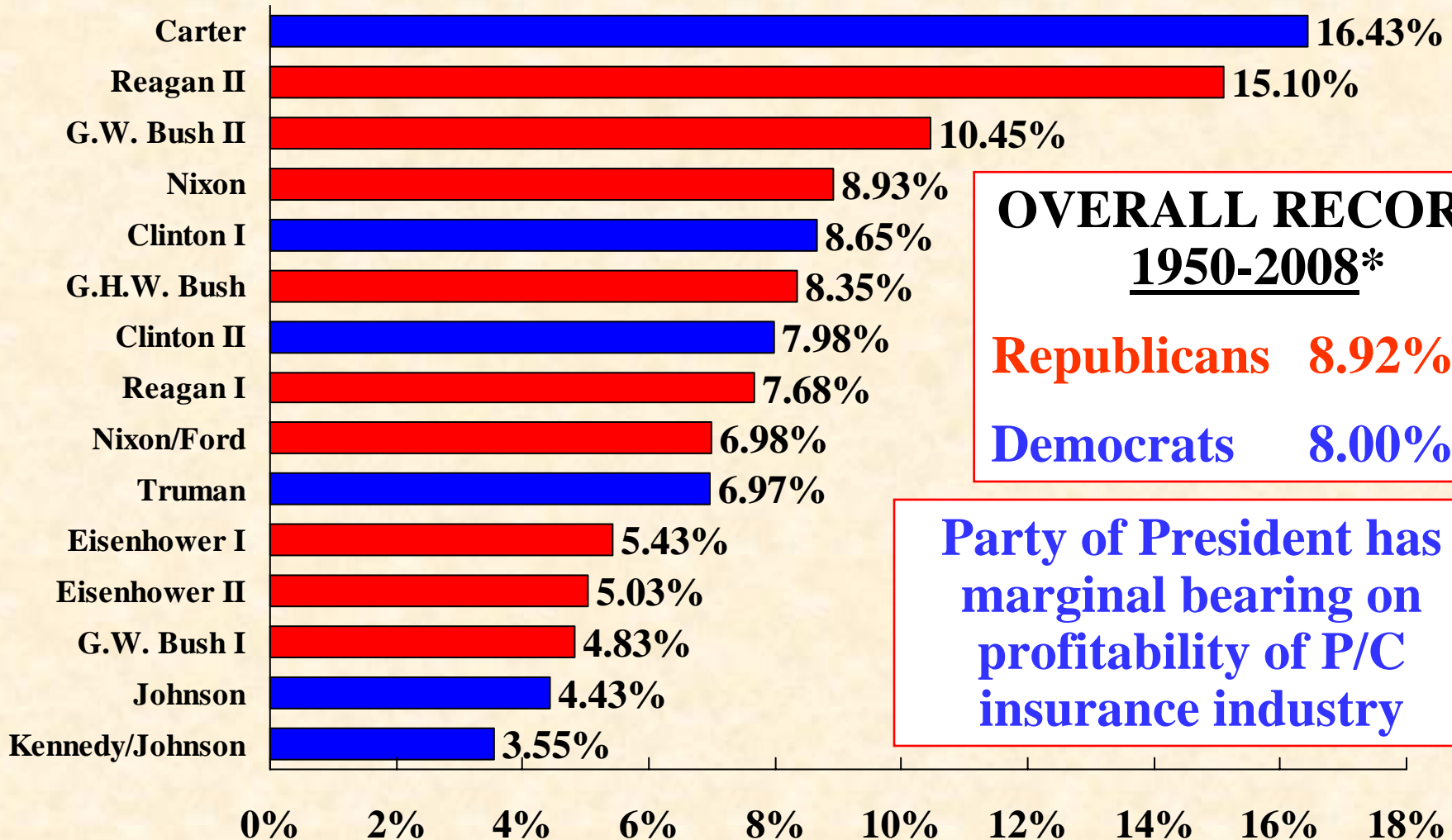


Political Quiz

- **Does the P/C insurance industry perform better (as measured by ROE) under Republican or Democratic administrations?**
- **Under which President did the industry realize its highest ROE (average over 4 years)?**
- **Under which President did the industry realize its lowest ROE (average over 4 years)?**



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



**OVERALL RECORD:
1950-2008***

Republicans 8.92%

Democrats 8.00%

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

*ROE for 2007/8 estimated by III. Truman administration ROE of 6.97% based on 3 years only, 1950-52.

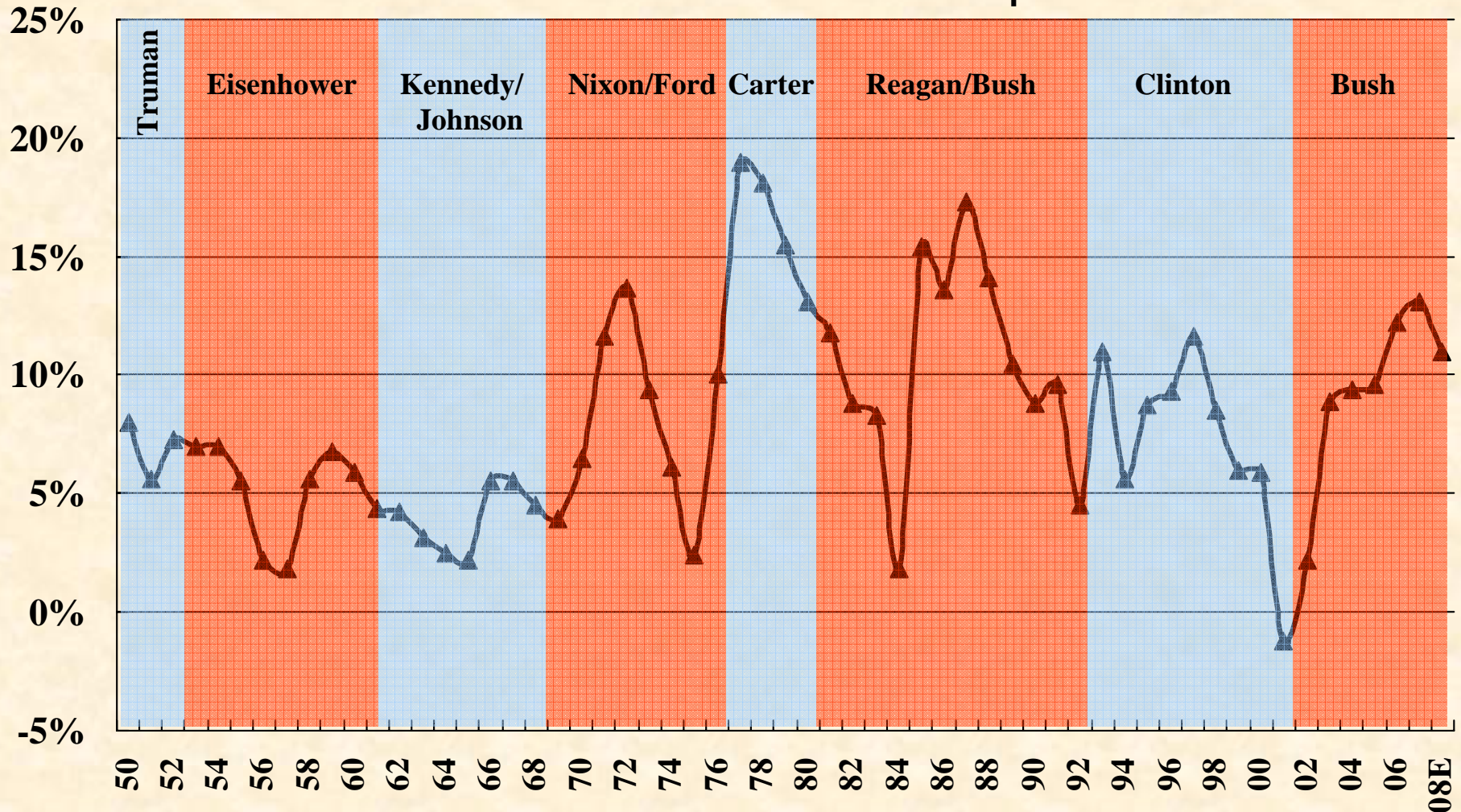
Source: Insurance Information Institute



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

BLUE = Democratic President

RED = Republican President



Source: Insurance Information Institute



Summary

- **Results were excellent in 2006/07; Overall profitability reached its highest level (est. 13-14%) since 1988**
 - **Strong 2007 but ROEs slipping; Momentum for 2008**
- **Underwriting results were aided by lack of CATs & favorable underlying loss trends, including tort system improvements**
- **Property cat reinsurance markets past peak & more competitive**
- **Premium growth rates are slowing to their levels since WW II; Commercial leads decreases. Firming in personal lines?**
- **Rising investment returns insufficient to support deep soft market in terms of price, terms & conditions as in 1990s**
- **How/where to deploy/redeploy capital??**
- **Major Challenges:**
 - **Slow Growth Environment Ahead; Cyclical & Economic**
 - **Maintaining price/underwriting discipline**
 - **Managing variability/volatility of results**
 - **Managing regulatory/legislative activism**



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