

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

Trends, Challenges & Opportunities

**Alamo CPCU Society, RIMS &
San Antonio Agents Association**



**San Antonio, TX
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Presentation Outline

- **Financial Crisis & The Weakening Economy: Insurance Impacts for the P/C Insurance Industry**
 - Recession, Growth & Insurance
- **Economic Stimulus Package**
 - Impacts & Implications for P/C Insurers
- **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

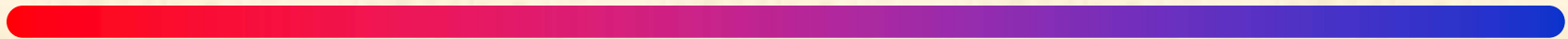
Q & A

THE ECONOMIC STORM

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

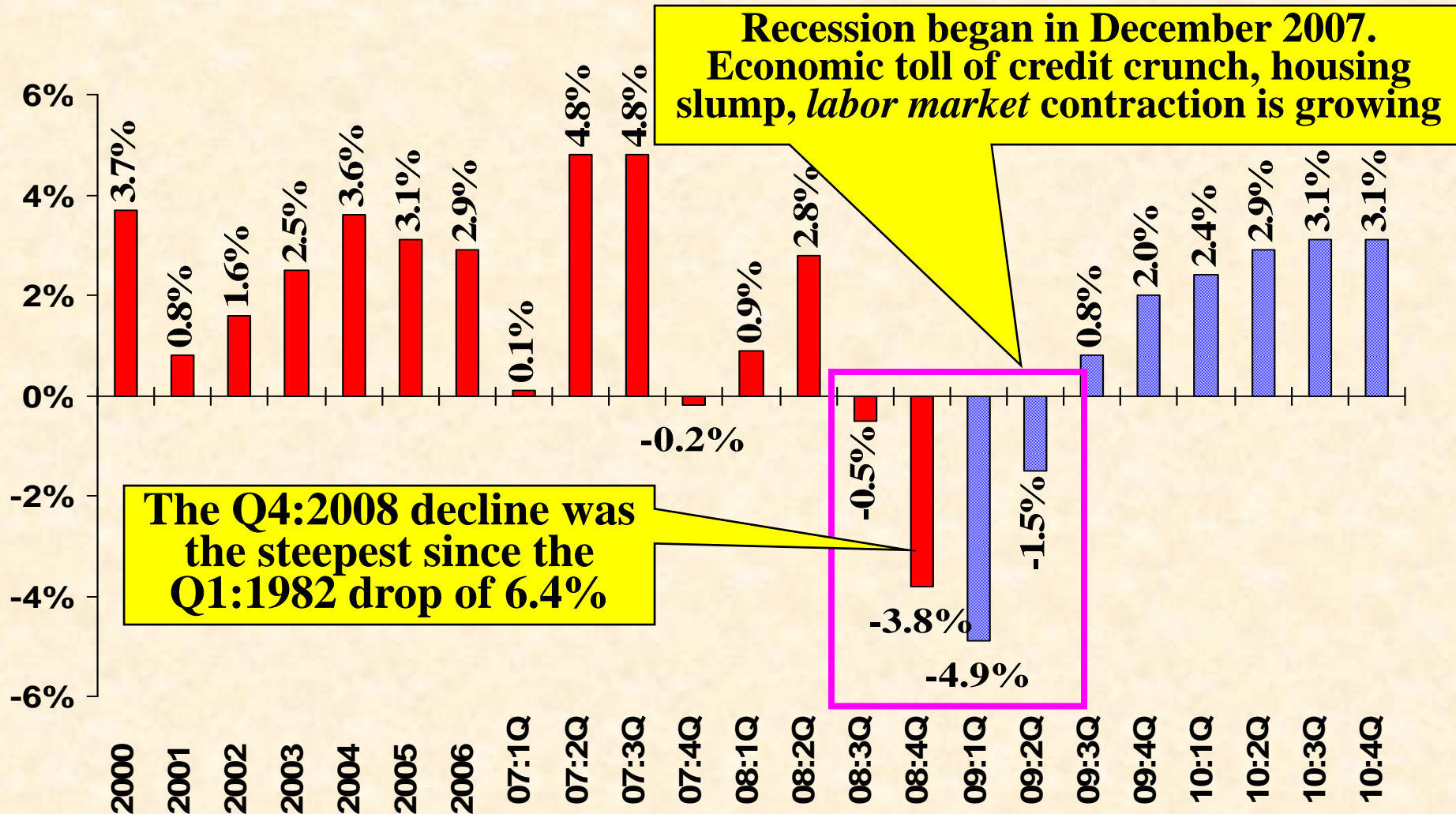


**Exposure & Claim
Cost Effects**





Real GDP Growth*



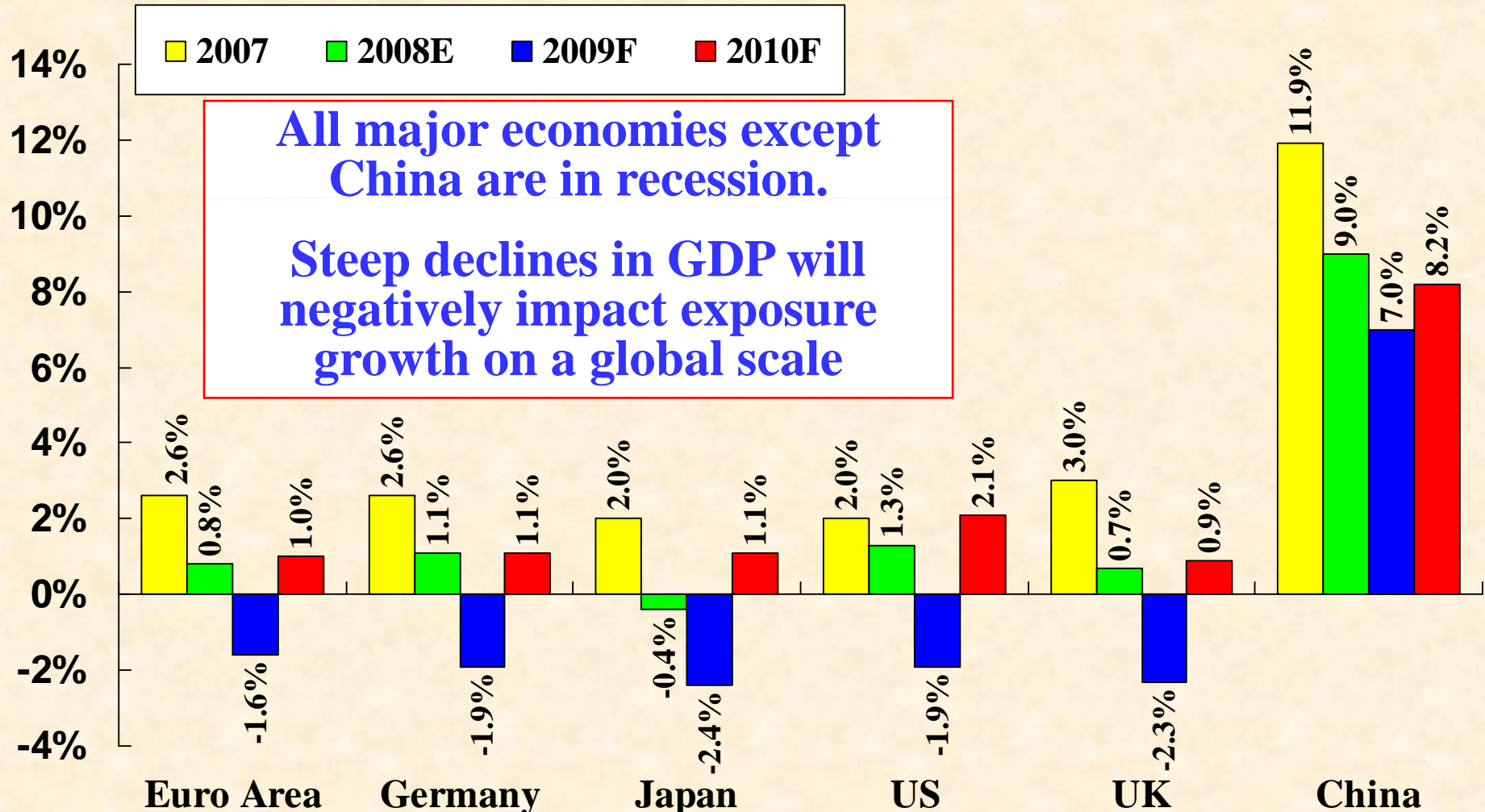
*Yellow bars are Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 2/09; Insurance Information Institute.



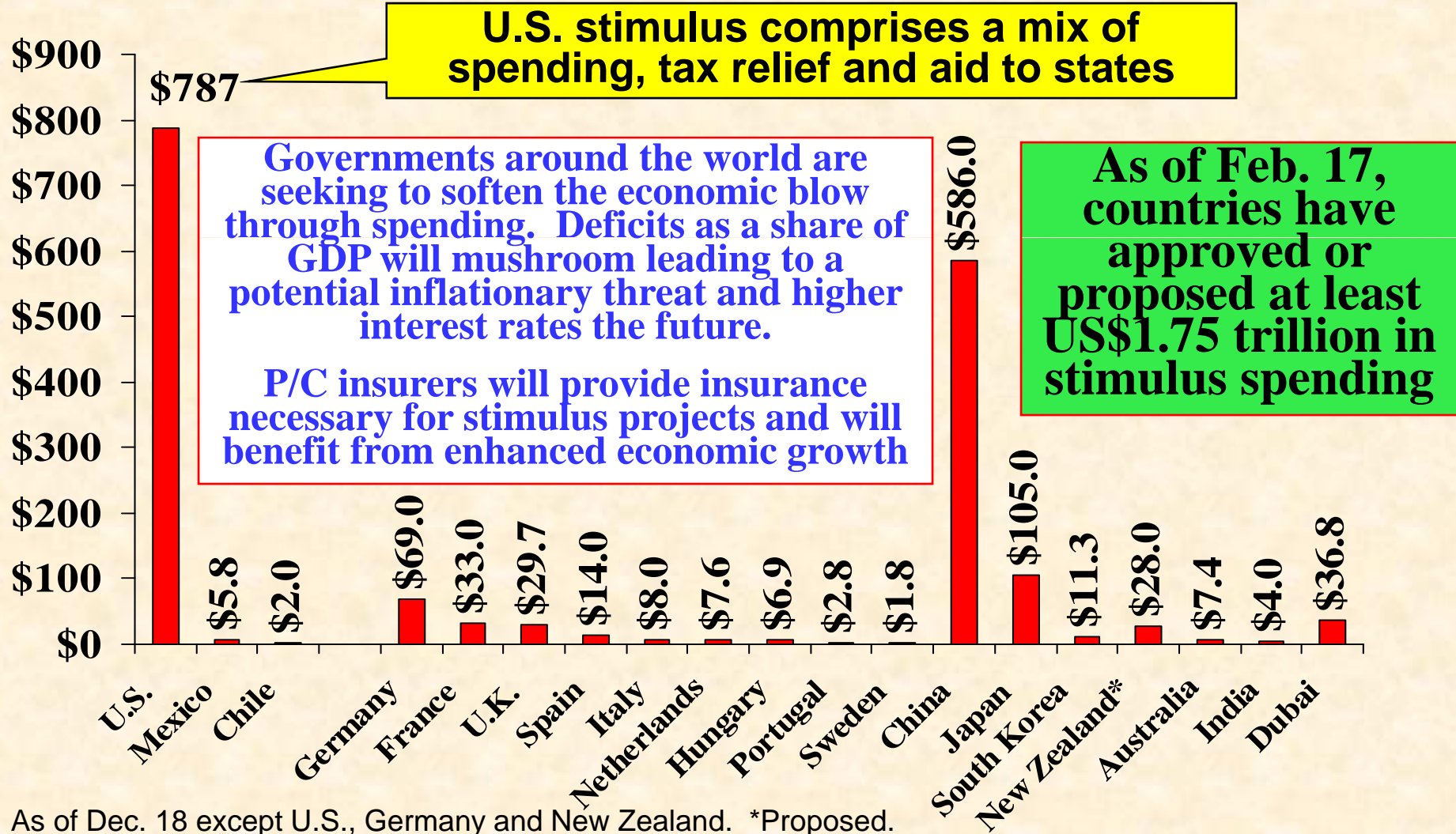
Real GDP By Market 2007-2010F

(% change from previous year)





*Announced Economic Stimulus Packages Worldwide (US\$ Bill)**

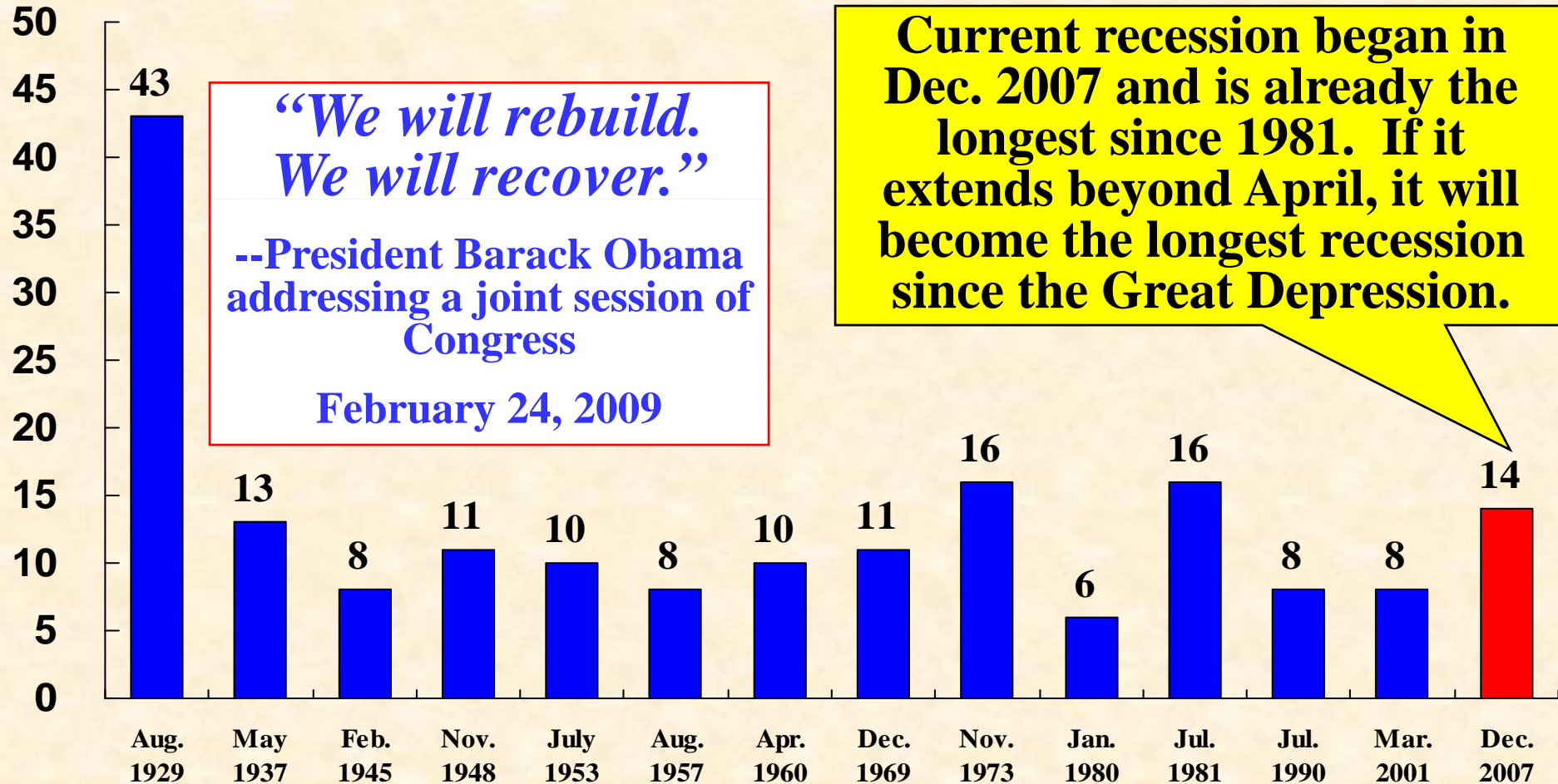


Sources: Wall Street Journal, January 8, 2009 with updates by I.I.I.; Institute of International Finance.



Length of US Recessions, 1929-Present*

Months in Duration



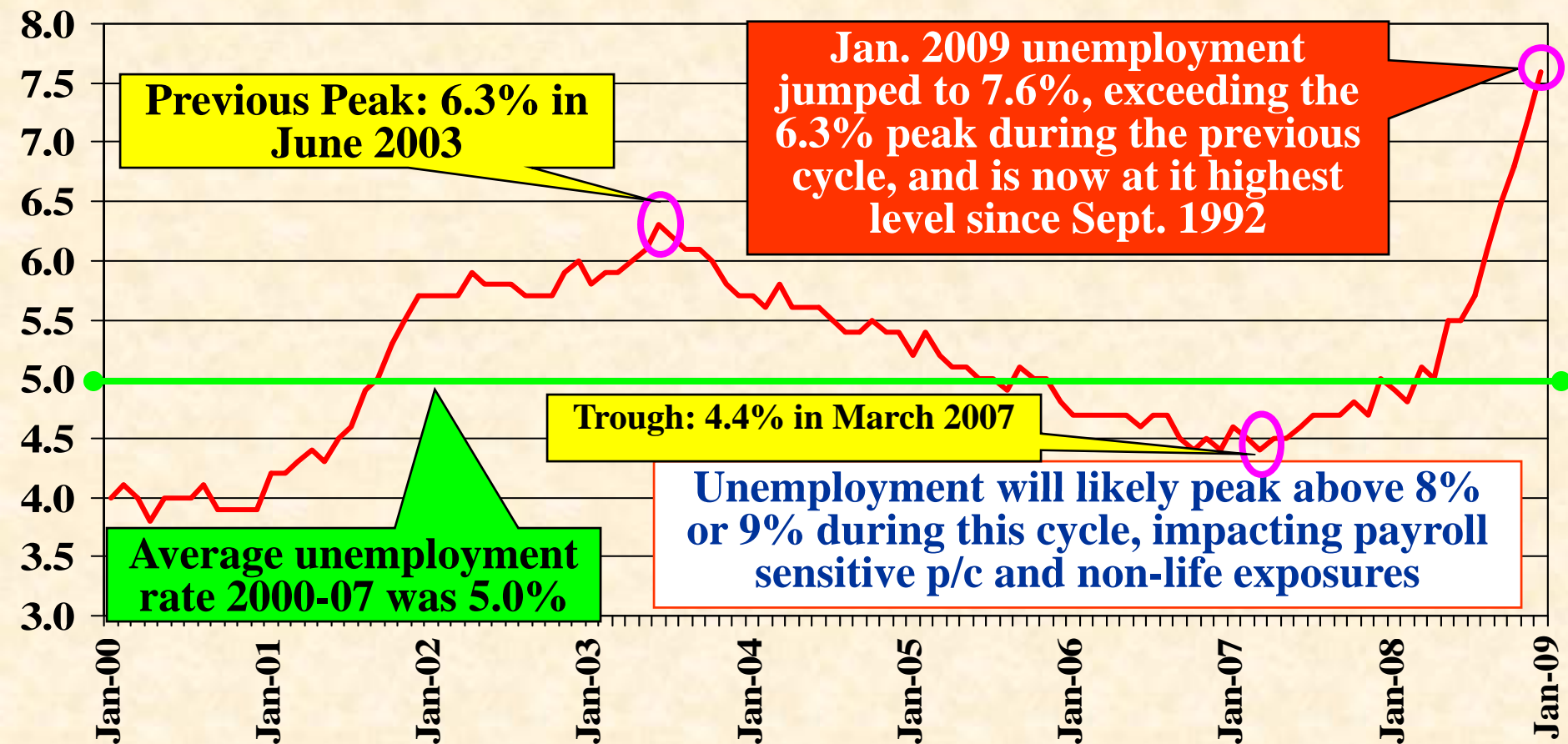
* As of February 2009

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



Unemployment Rate: On the Rise

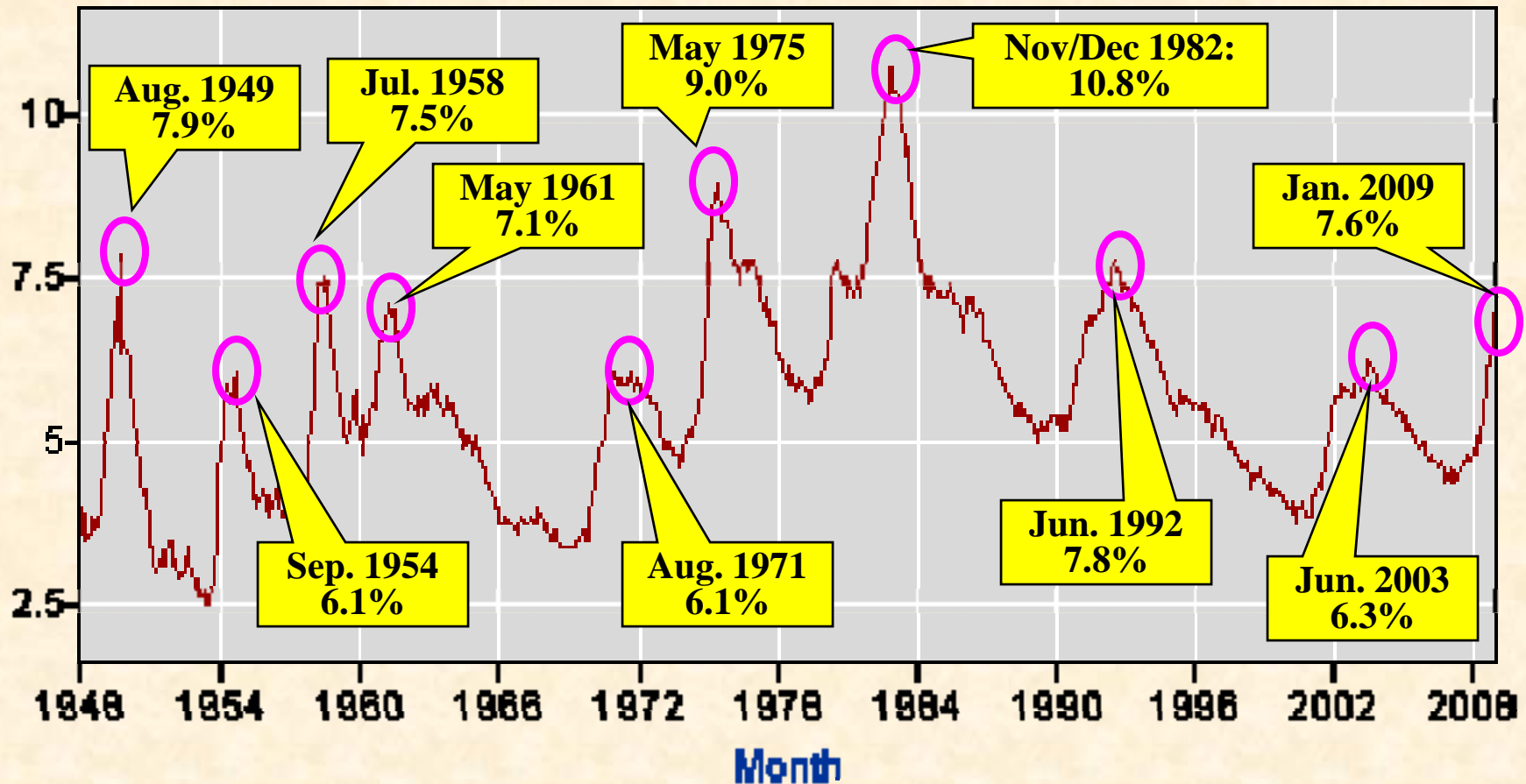
January 2000 through January 2009





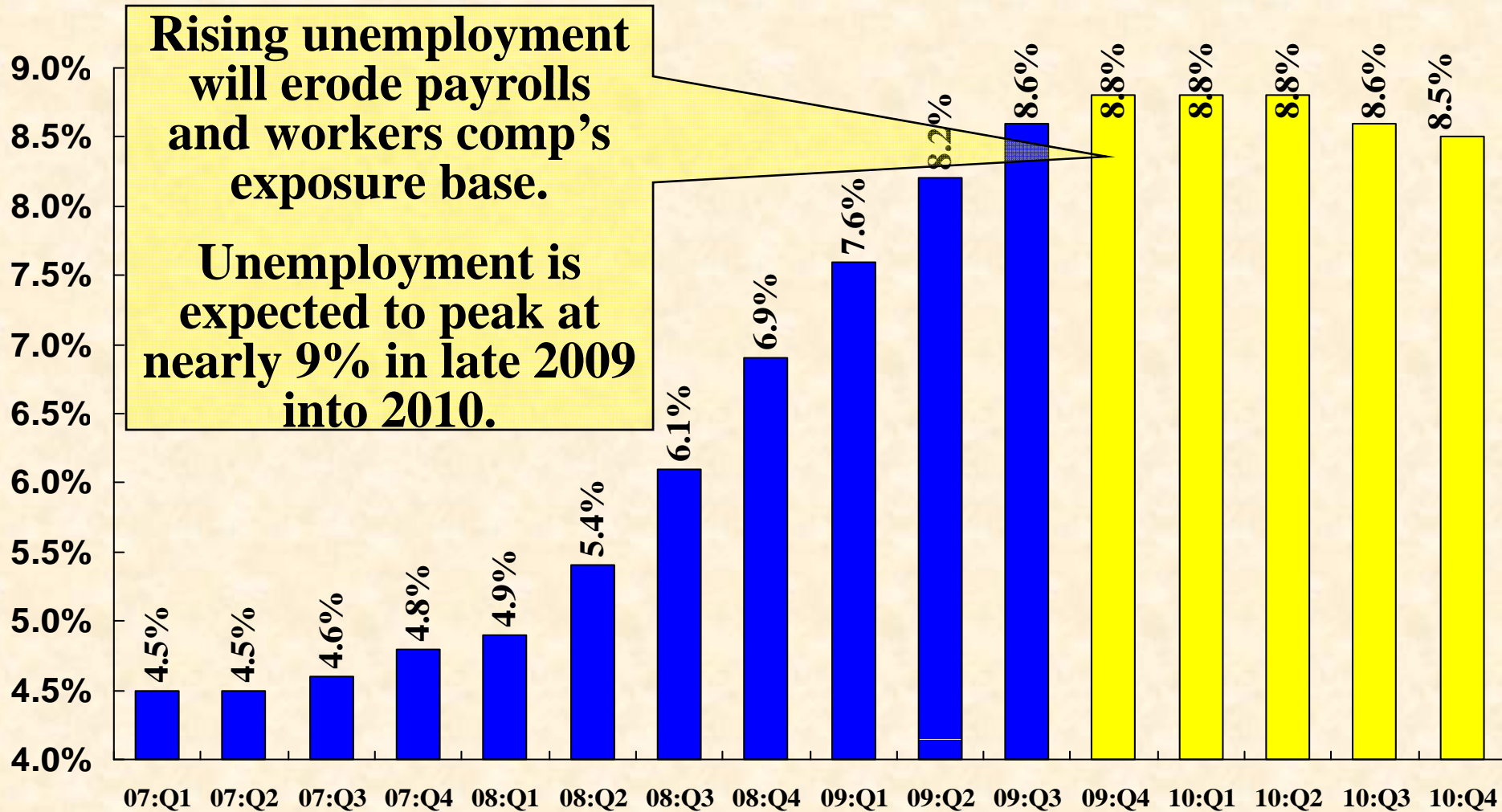
US Unemployment Rate: A Volatile History

January 1948 through January 2009





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

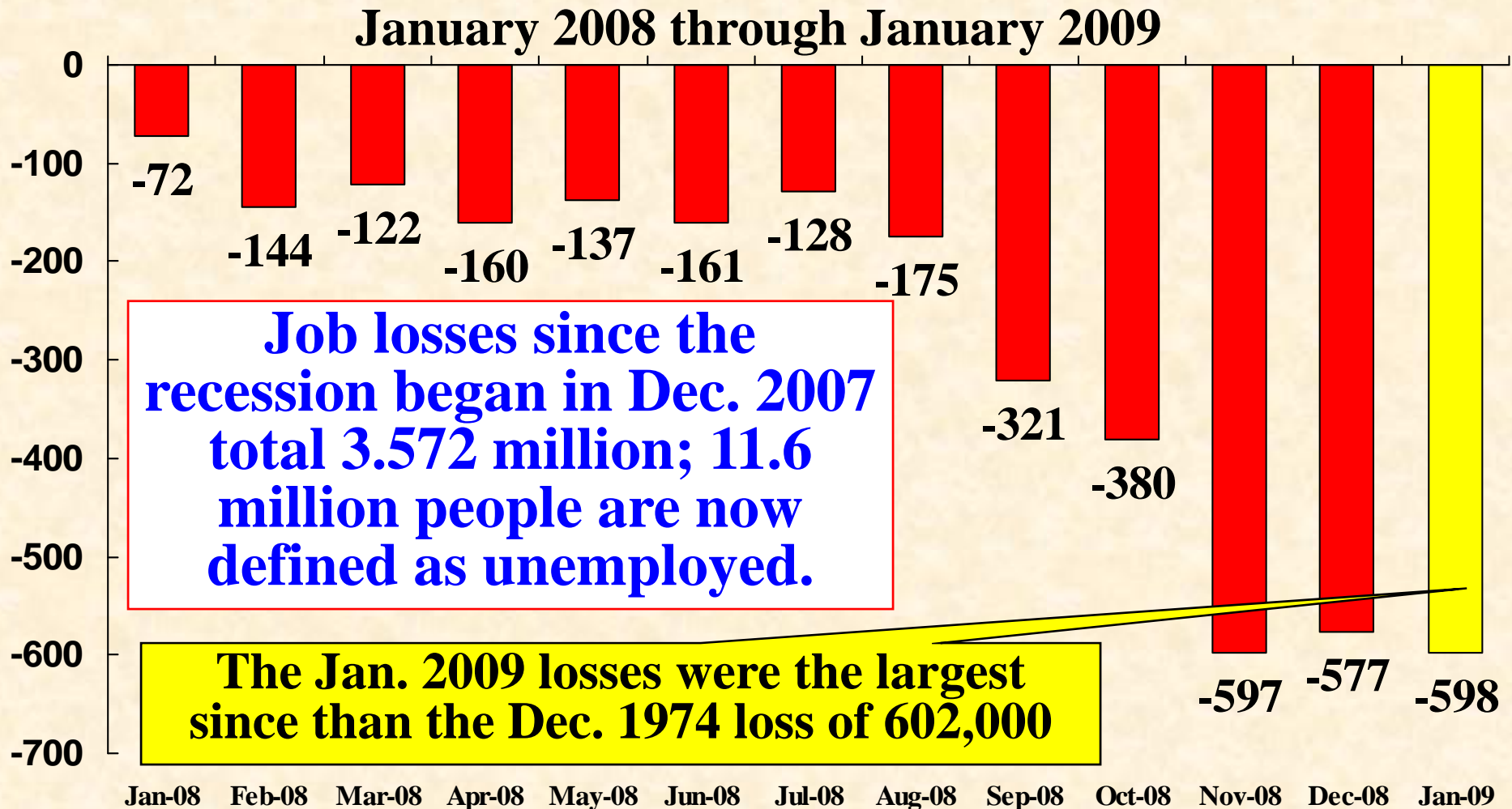


* Blue bars are actual; Yellow bars are forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (2/09); Insurance Info. Inst.



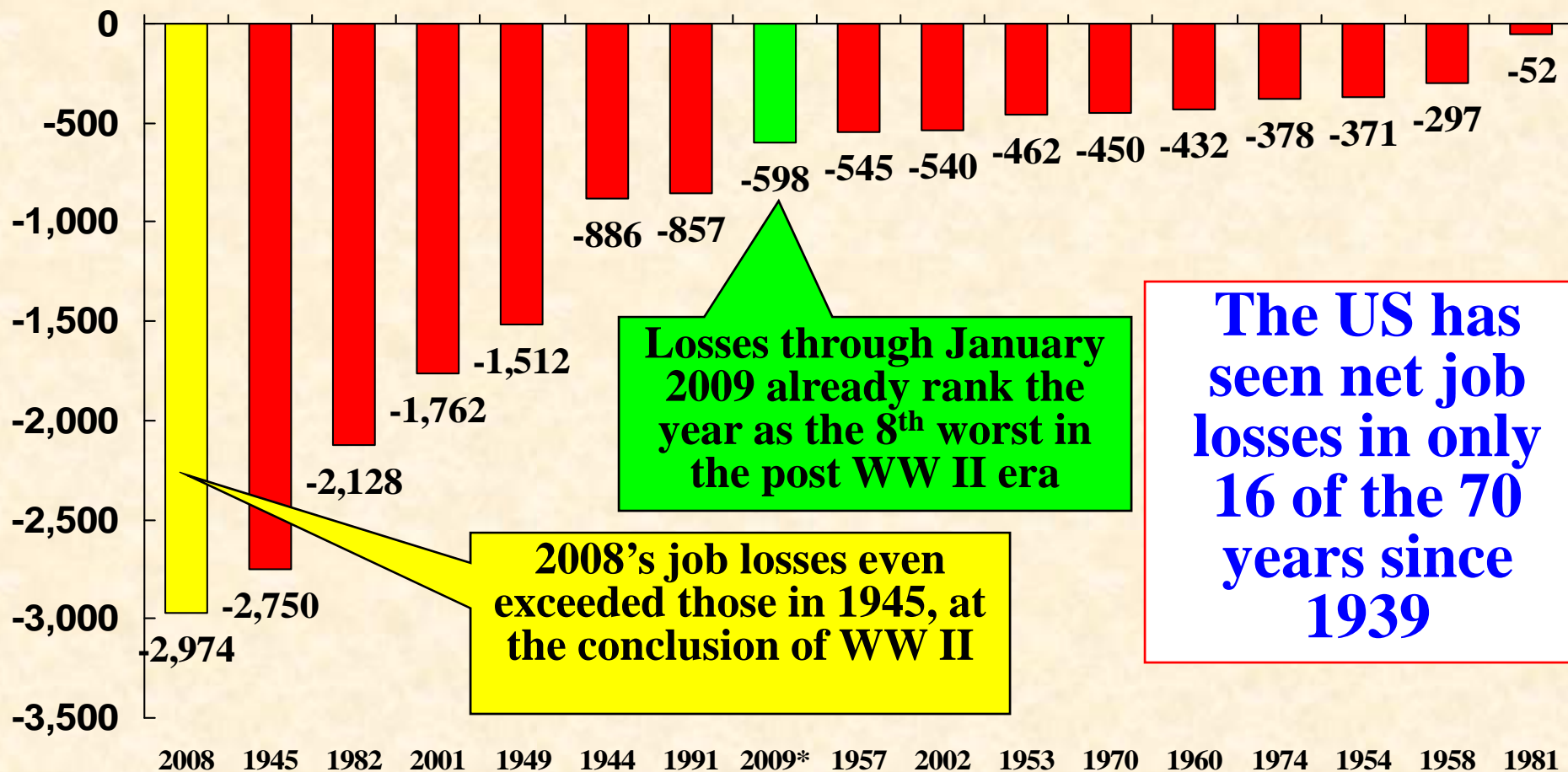
Monthly Change Employment* (Thousands)





*Years With Job Losses: 1939-2009**

(Thousands)



*Through January 2009.

Source: Insurance Information Institute research from

US Bureau of Labor Statistics data: <http://www.bls.gov/ces/home.htm>.

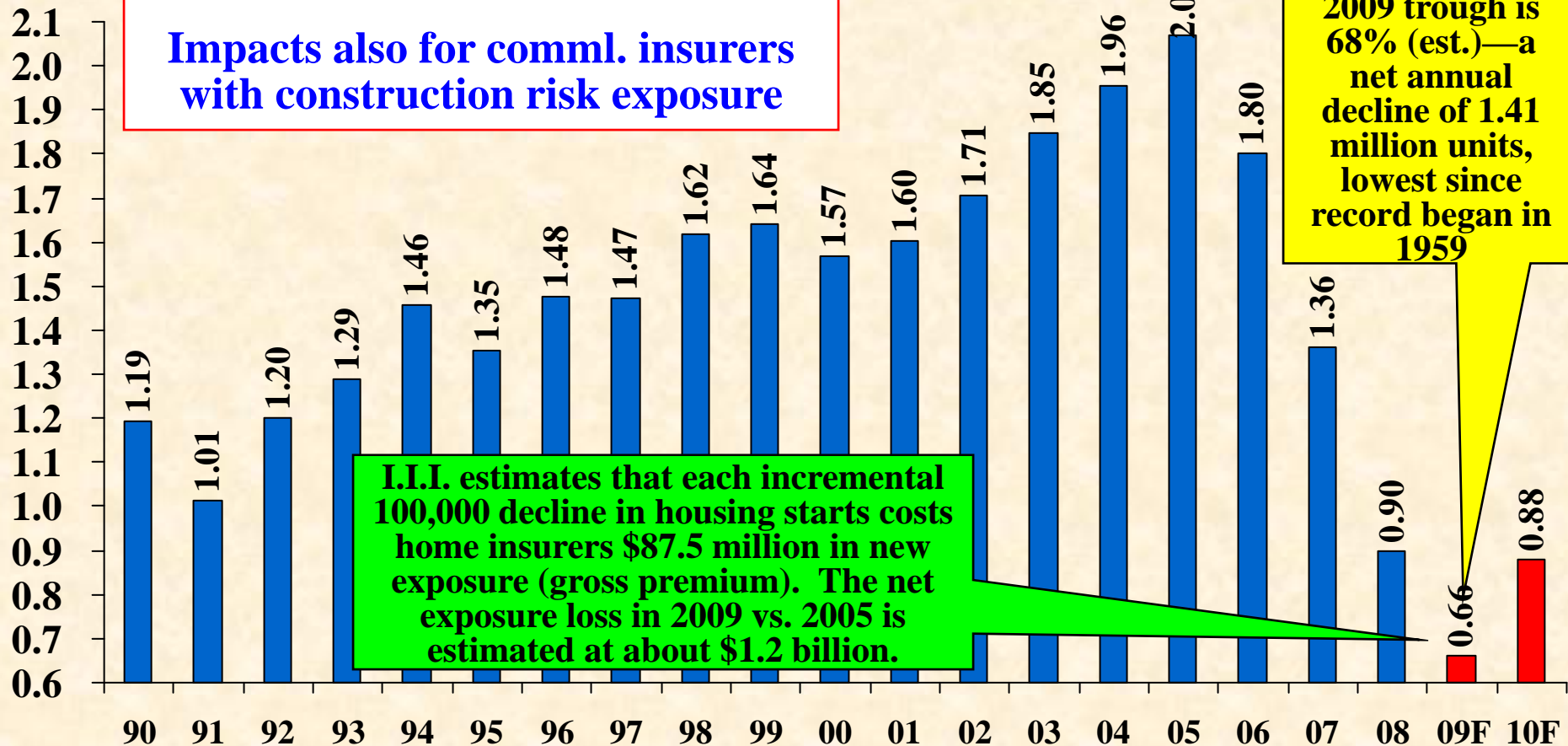


New Private Housing Starts, 1990-2010F (Millions of Units)

**Exposure growth forecast for HO
insurers is dim for 2009 with some
improvement in 2010.**

**Impacts also for comml. insurers
with construction risk exposure**

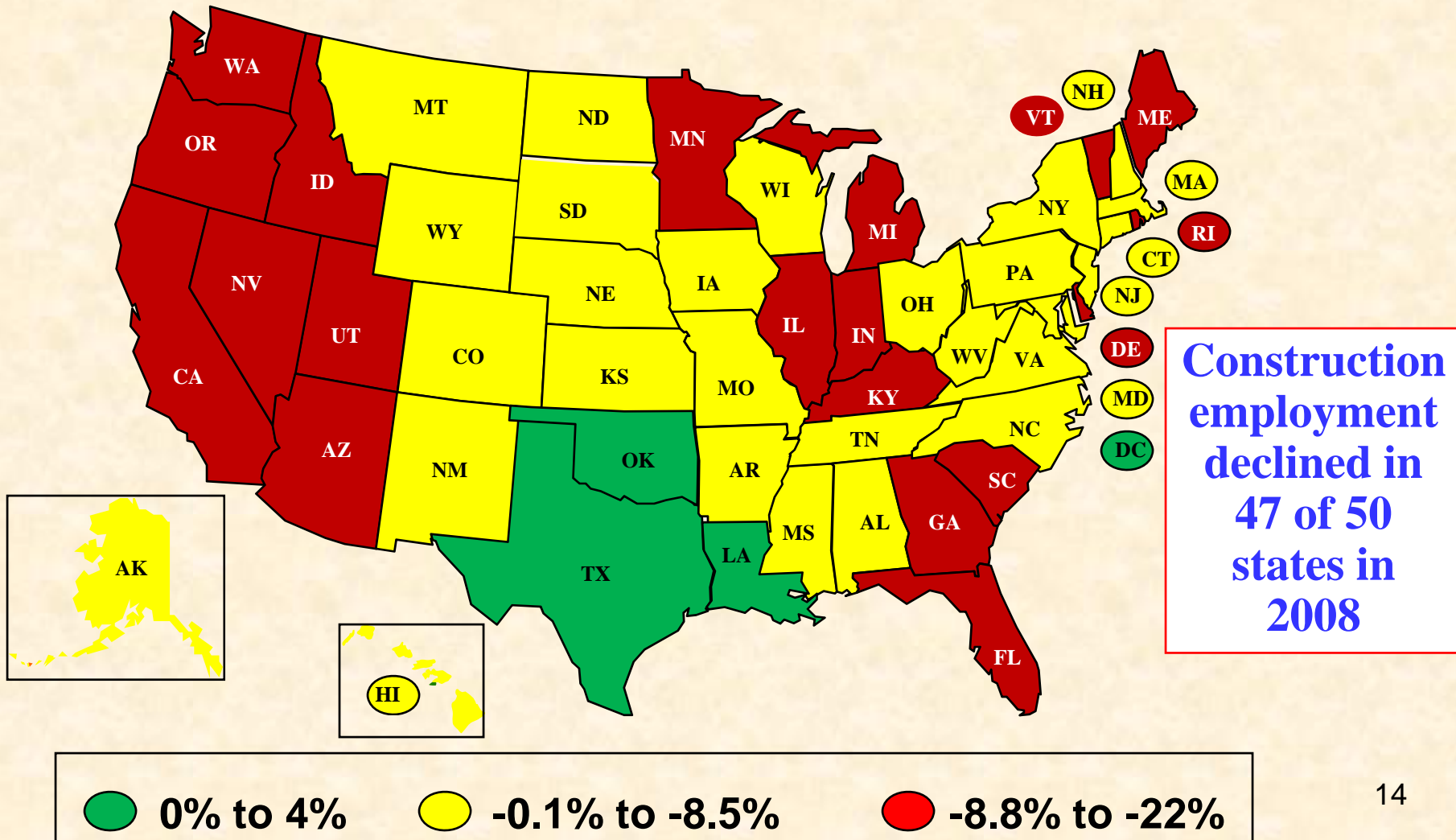
**New home starts
plunged 34%
from 2005-2007;
Drop through
2009 trough is
68% (est.)—a
net annual
decline of 1.41
million units,
lowest since
record began in
1959**



**I.I.I. estimates that each incremental
100,000 decline in housing starts costs
home insurers \$87.5 million in new
exposure (gross premium). The net
exposure loss in 2009 vs. 2005 is
estimated at about \$1.2 billion.**



State Construction Employment, Dec. 2007 – Dec. 2008





State Construction Employment, Dec. 2007 – Dec. 2008

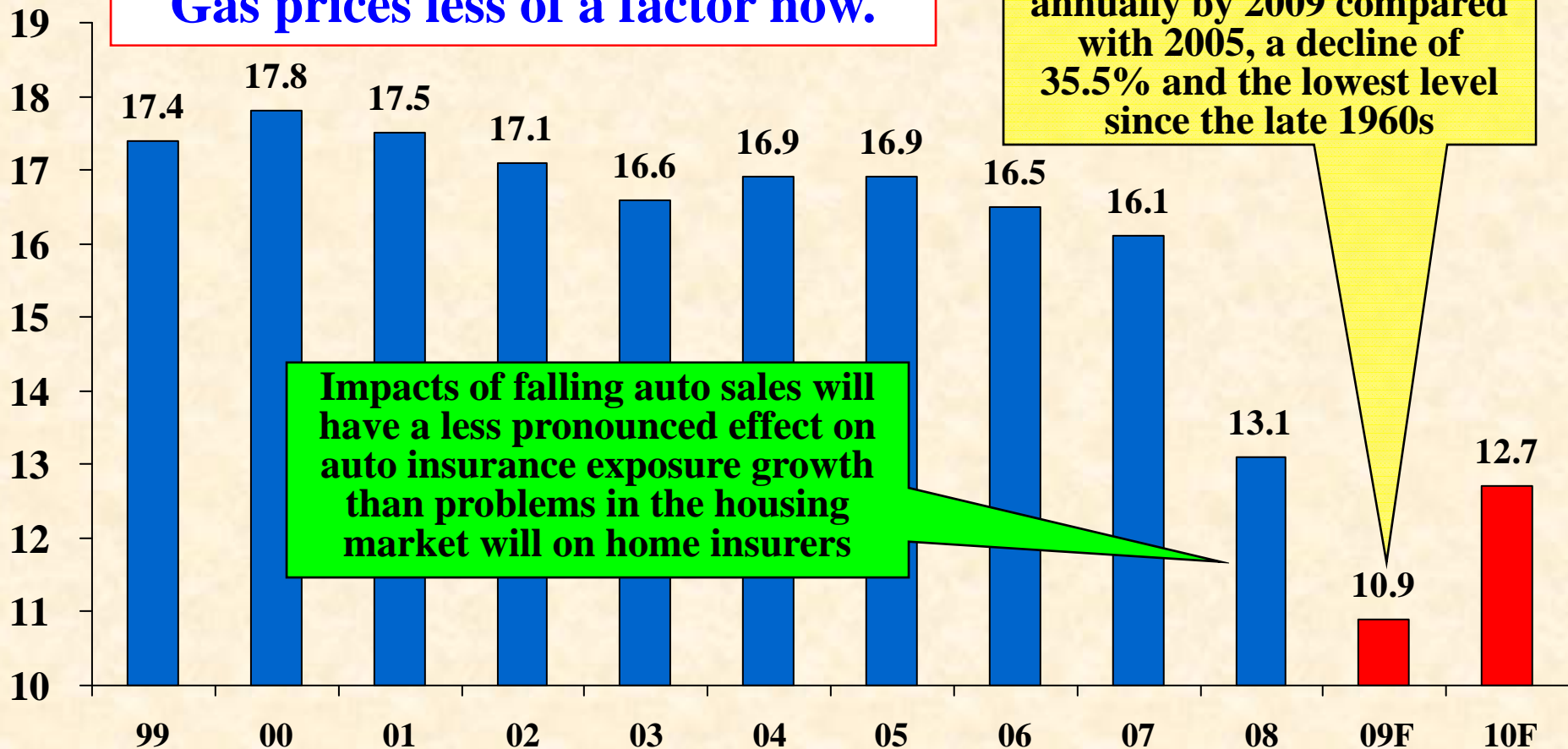
State	%	State	%	State	%	State	%
Alabama	-4	Illinois	-13	Montana	-8	Rhode Island	-12
Alaska	-1	Indiana	-13	Nebraska	-1	South Carolina	-17
Arizona	-21	Iowa	-5	Nevada	-15	South Dakota	-5
Arkansas	-3	Kansas	-3	New Hampshire	-8	Tennessee	-4
California	-11	Kentucky	-12	New Jersey	-5	Texas	+1
Colorado	-5	Louisiana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



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

**Weakening economy, credit
crunch are hurting auto sales;
Gas prices less of a factor now.**

**New auto/light truck sales
are expected to experience a
net drop of 6.0 million units
annually by 2009 compared
with 2005, a decline of
35.5% and the lowest level
since the late 1960s**

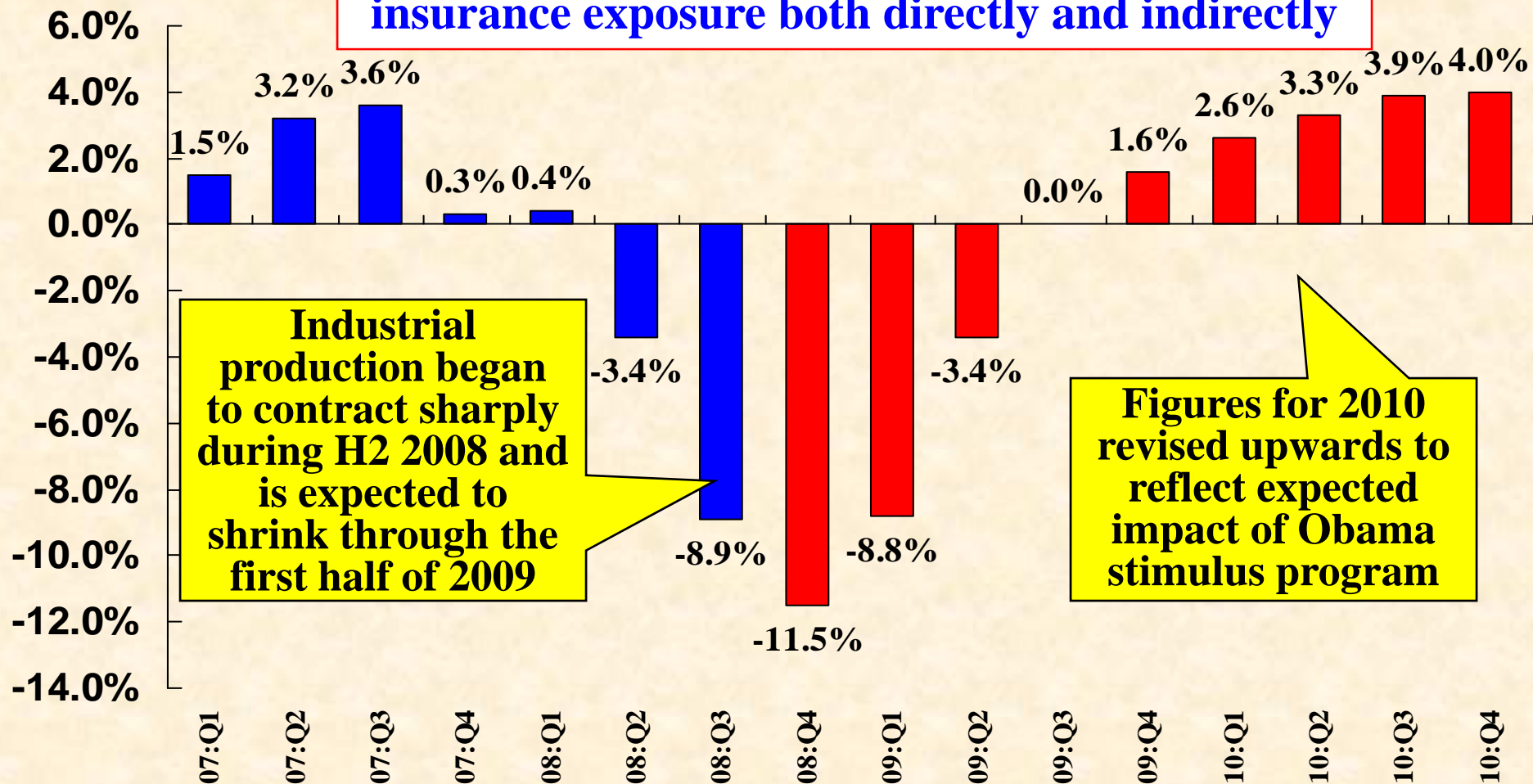


**Impacts of falling auto sales will
have a less pronounced effect on
auto insurance exposure growth
than problems in the housing
market will on home insurers**



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

**Obama stimulus program is expected benefit
impact industrial production and therefore
insurance exposure both directly and indirectly**



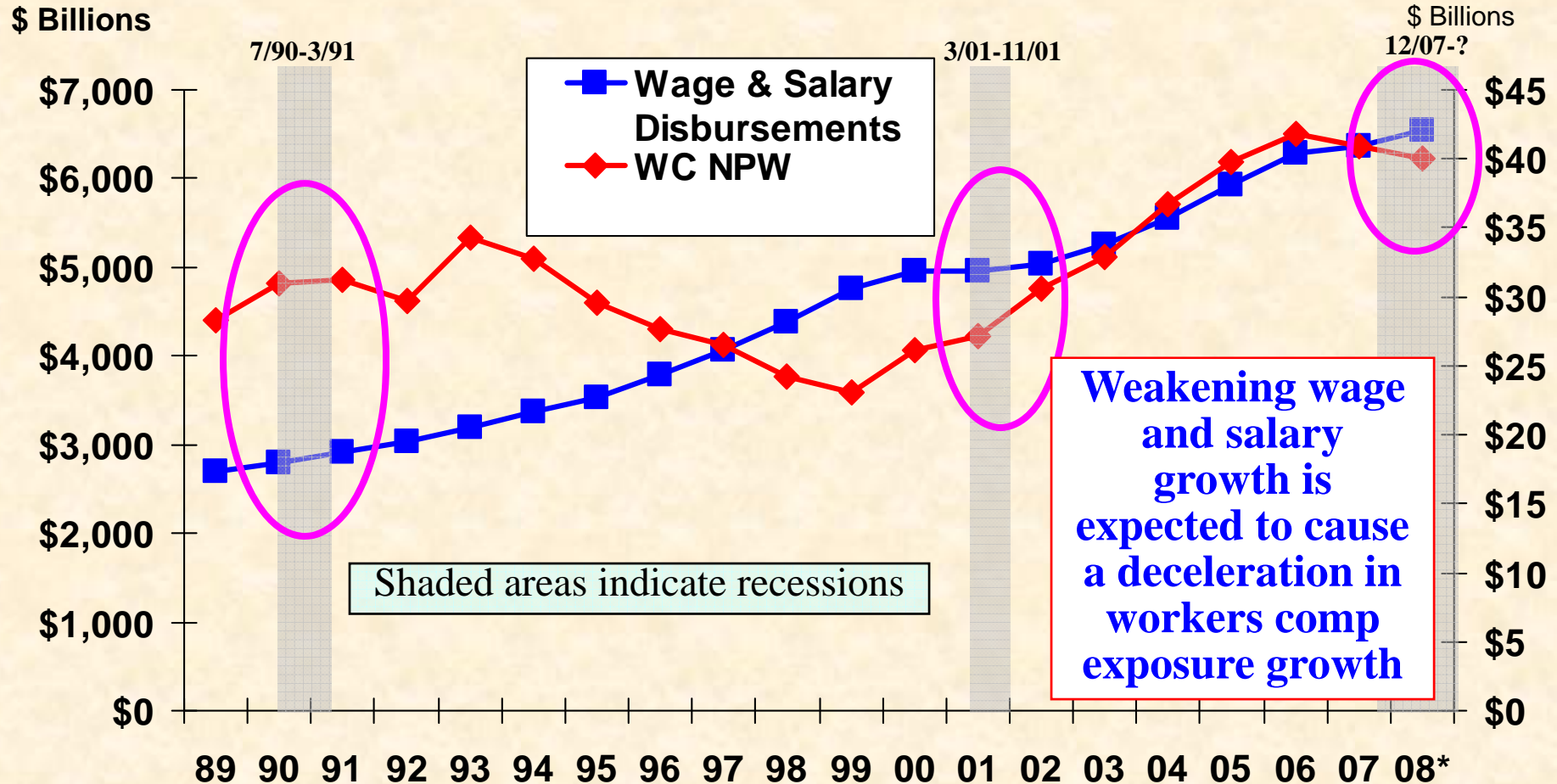
**Industrial
production began
to contract sharply
during H2 2008 and
is expected to
shrink through the
first half of 2009**

**Figures for 2010
revised upwards to
reflect expected
impact of Obama
stimulus program**



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

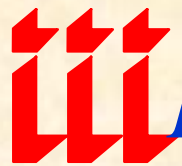
Wage & Salary Disbursement (Private Employment) vs. WC NWP



*9-month data for 2008

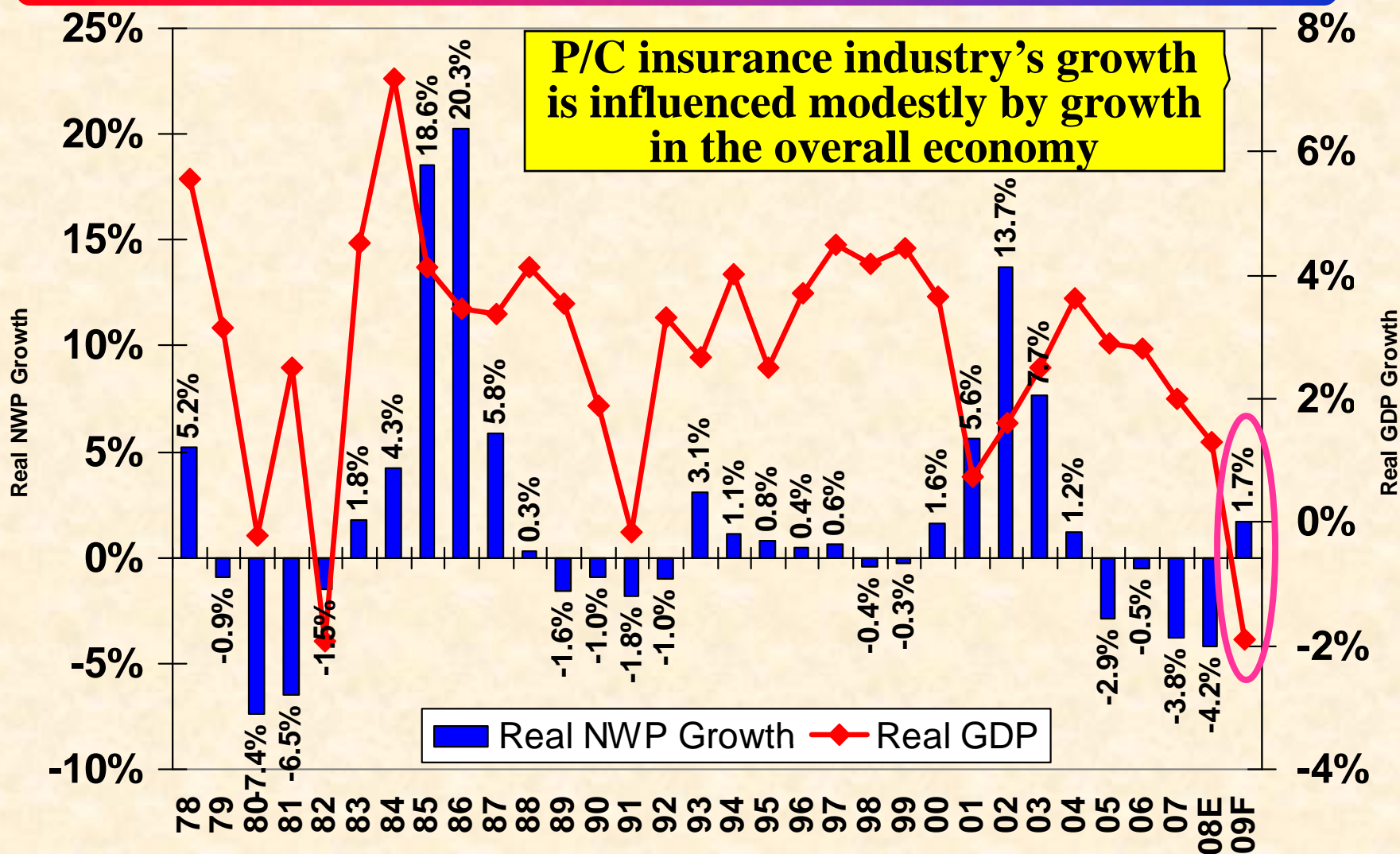
Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at

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



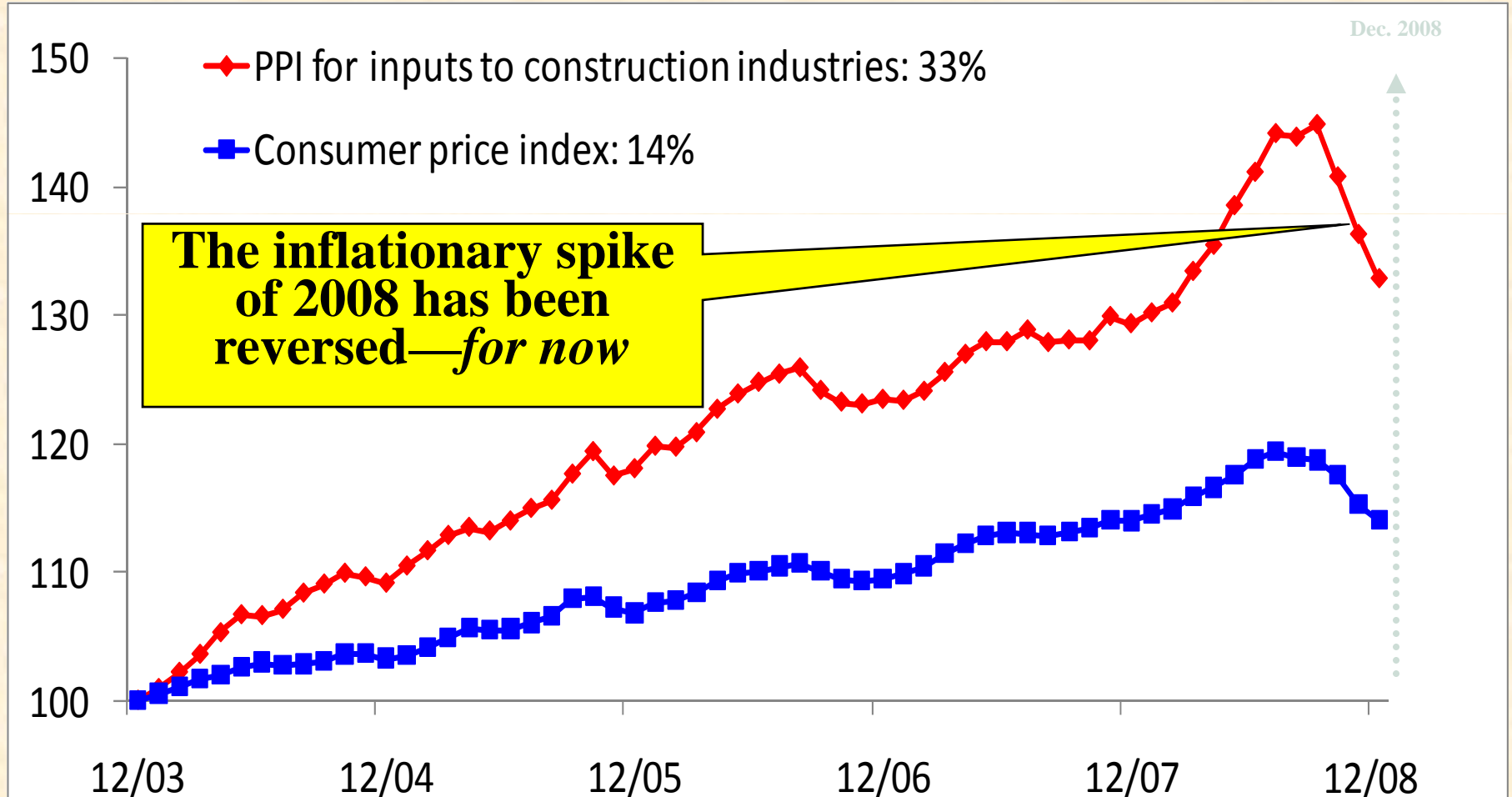
Real GDP Growth vs. Real P/C

Premium Growth: Modest Association



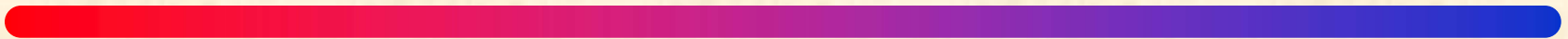


Change in Producer Prices for Construction vs. Consumer Prices, 2003 - 2008



THE \$787 BILLION ECONOMIC STIMULUS

**Sectoral Impacts &
Implications for P/C
Insurance**





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

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



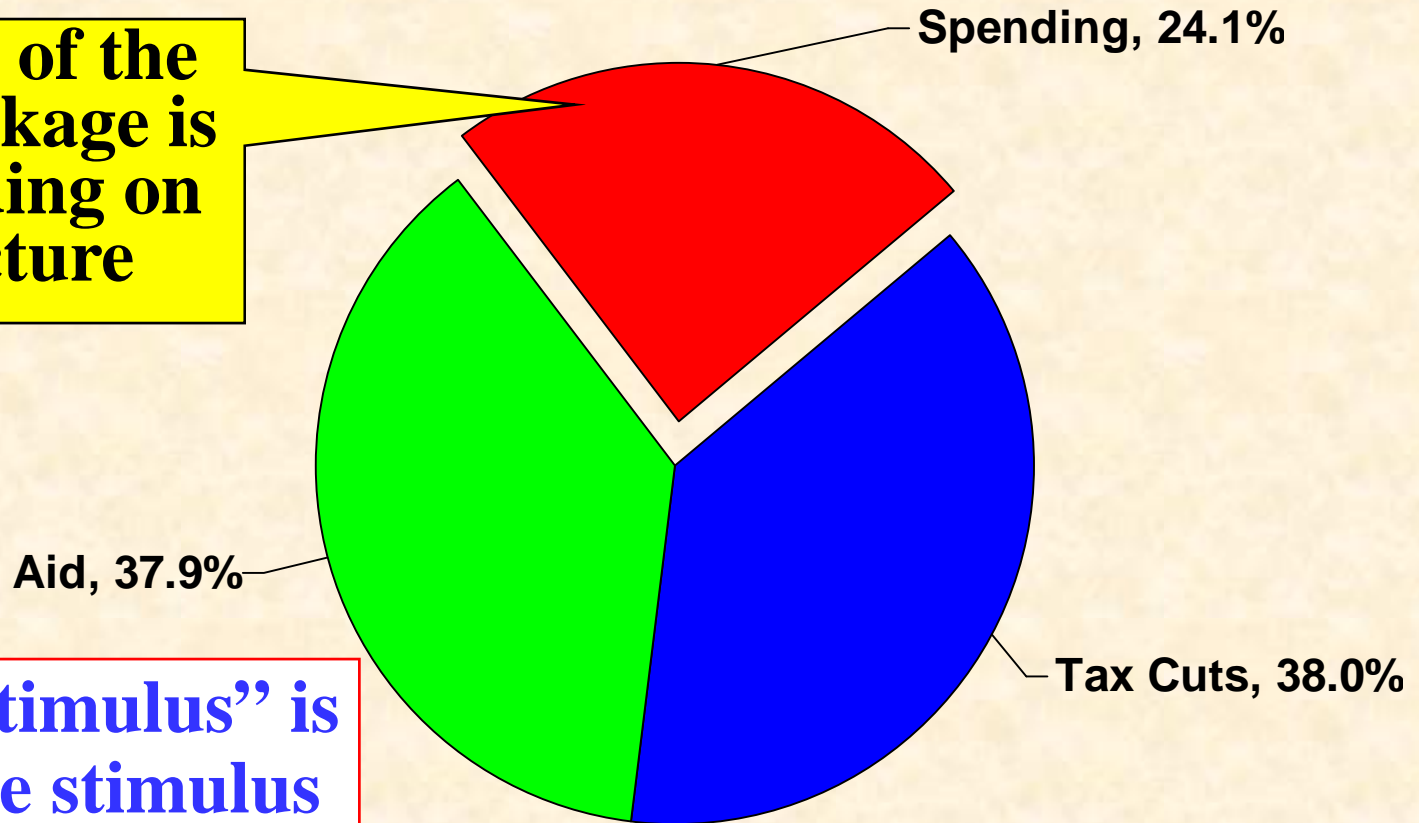
Summary of Short-Run Impacts of Stimulus Package on P/C Insurance (cont'd)

- **“Indirect” Impacts: Limited Gains for P/C Insurers**
 - If stimulus is successful at increasing disposable and corporate income via tax reductions and “multiplier” income and employment effects, then spending could rise and produce some additional insurable exposure growth for p/c insurers
- **Investment Portfolio Impacts**
 - It is impossible to discern what, if any, impact the stimulus will have on stock and bond performance
 - If successful, the stimulus package (along with other initiatives) should help stabilize and reinvigorate the economy, increasing stock prices and bolstering the value of corporate and asset-backed bonds
 - The stimulus could be viewed as inflationary. Combined with existing large deficits and other spending initiatives, an expectation of inflation could push interest rates upward



Economic Stimulus Package: Where the \$787B Goes

Less than $\frac{1}{4}$ of the stimulus package is direct spending on infrastructure



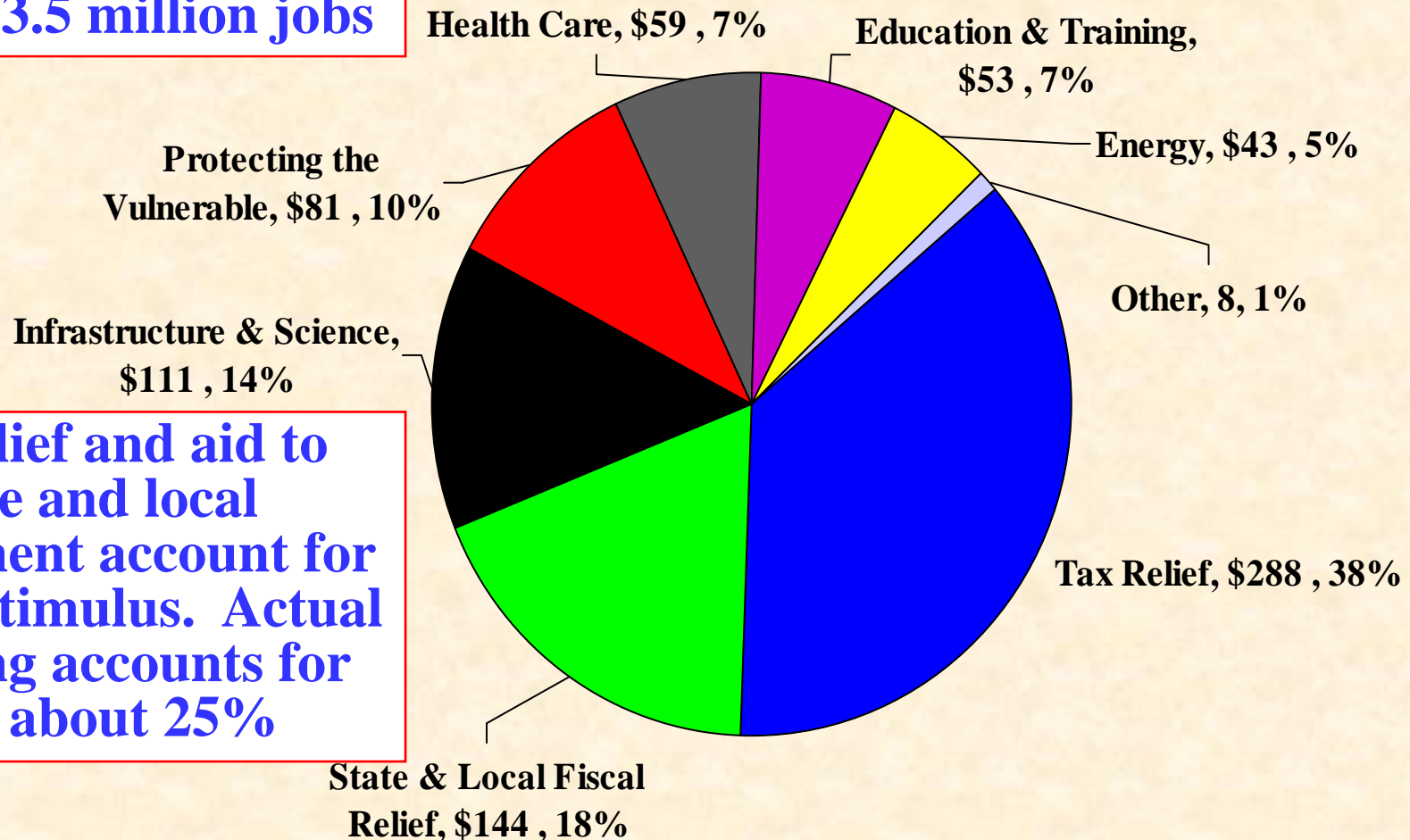
How much “stimulus” is actually in the stimulus package is open to debate and dispute



Economic Stimulus Package: Where the \$787B Goes

**Objective is to create or
preserve 3.5 million jobs**

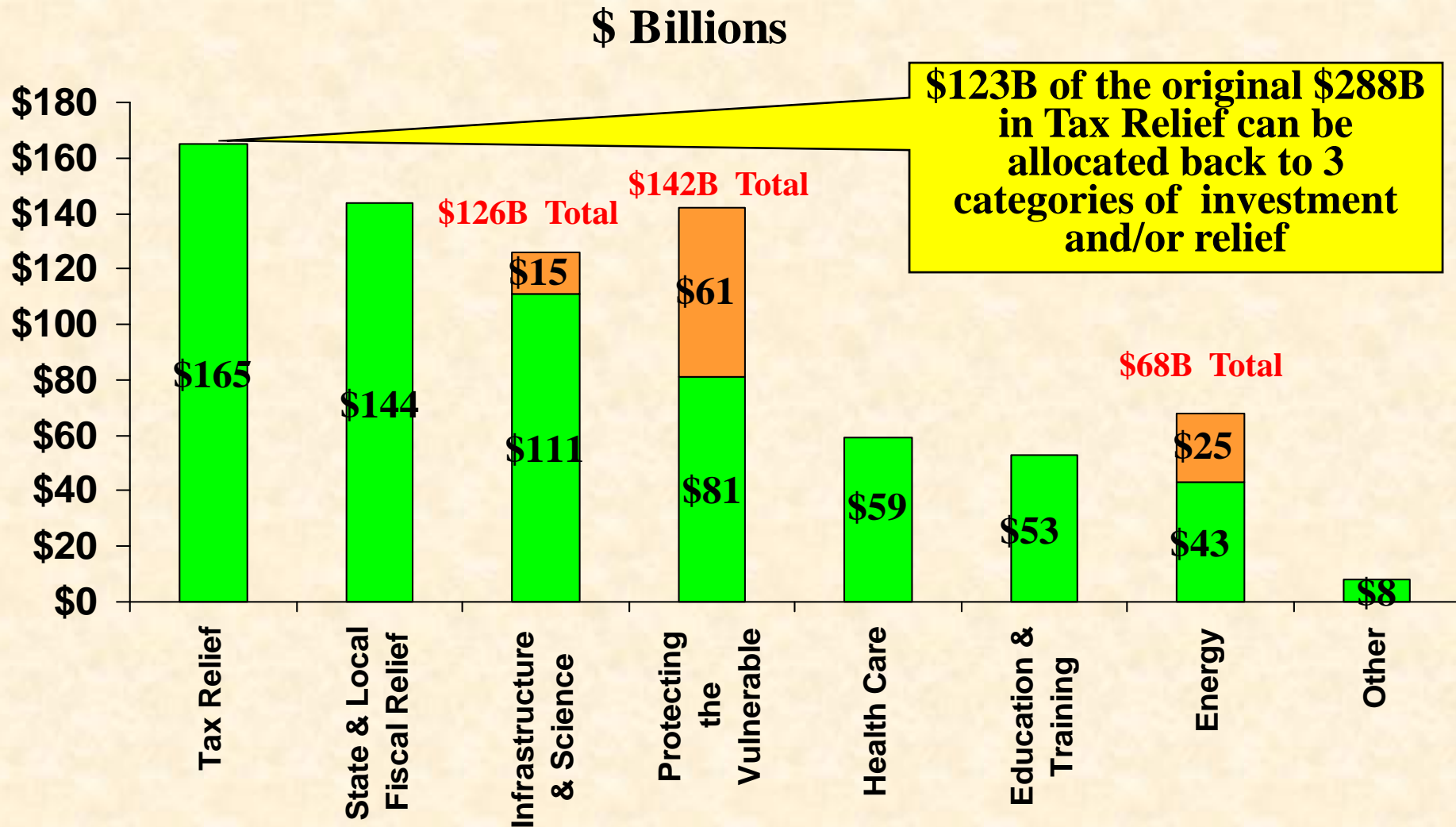
\$ Billions



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



Economic Stimulus Package: Where the \$787B Goes After Tax Reallocations





U.S. Economic \$787B Stimulus Package: Major Spending Components

\$ Billions



Objective is to create or preserve 3.5 million jobs

24.1% or \$132.2B of the stimulus package is allocated toward direct spending. This is the component that will most directly benefit p/c insurers.

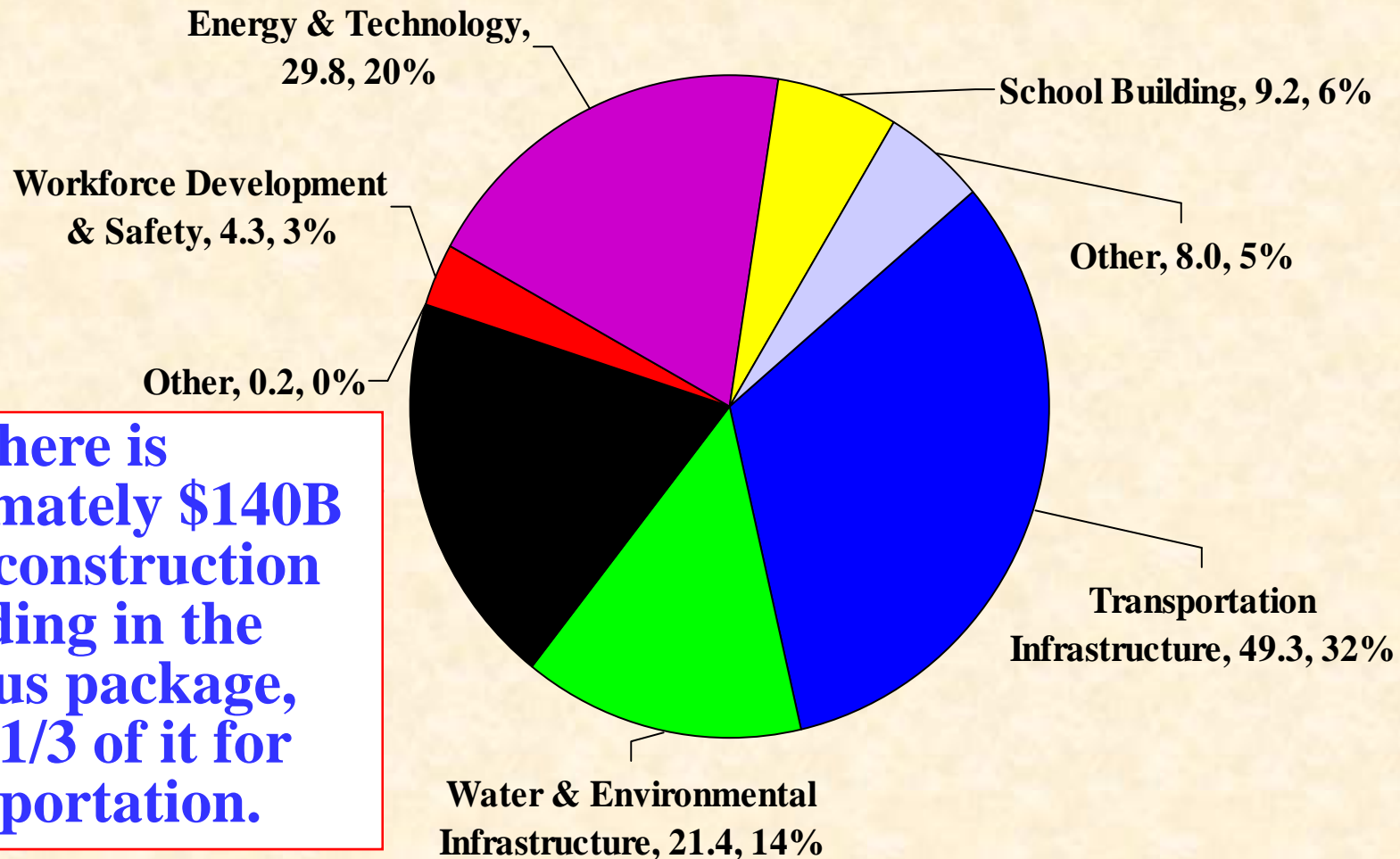
Lines Most Likely to Benefit:

**Workers Comp
Commercial Auto
Inland Marine
Commercial Property & Liability
Surety**



Economic Stimulus Package: \$143.4 in Construction Spending

\$ Billions



There is approximately \$140B in new construction spending in the stimulus package, about 1/3 of it for transportation.

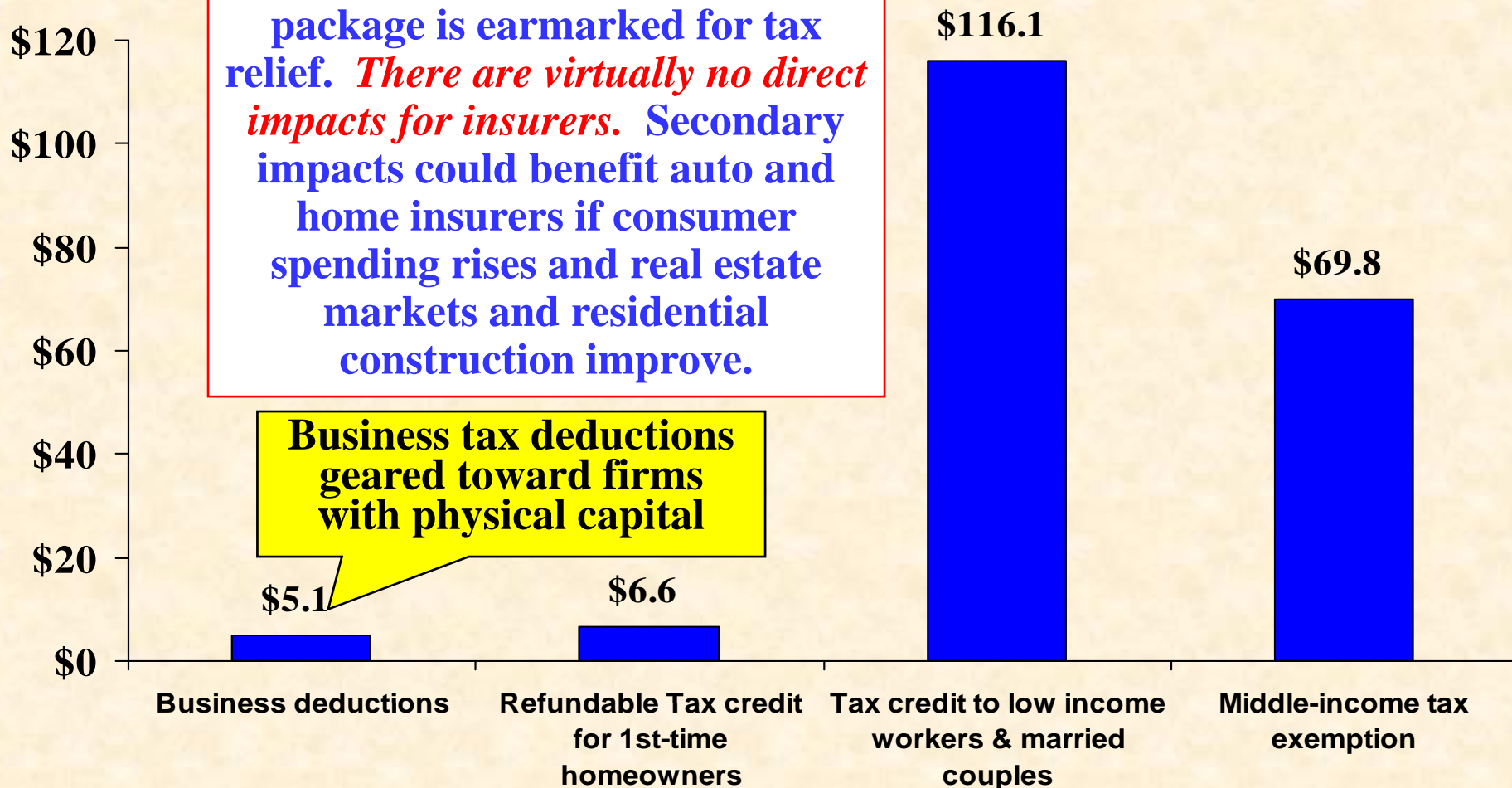


U.S. Economic \$787B Stimulus Package: Major Tax Cut Components

\$ Billions

38% or \$288 of the stimulus package is earmarked for tax relief. *There are virtually no direct impacts for insurers.* Secondary impacts could benefit auto and home insurers if consumer spending rises and real estate markets and residential construction improve.

Business tax deductions geared toward firms with physical capital

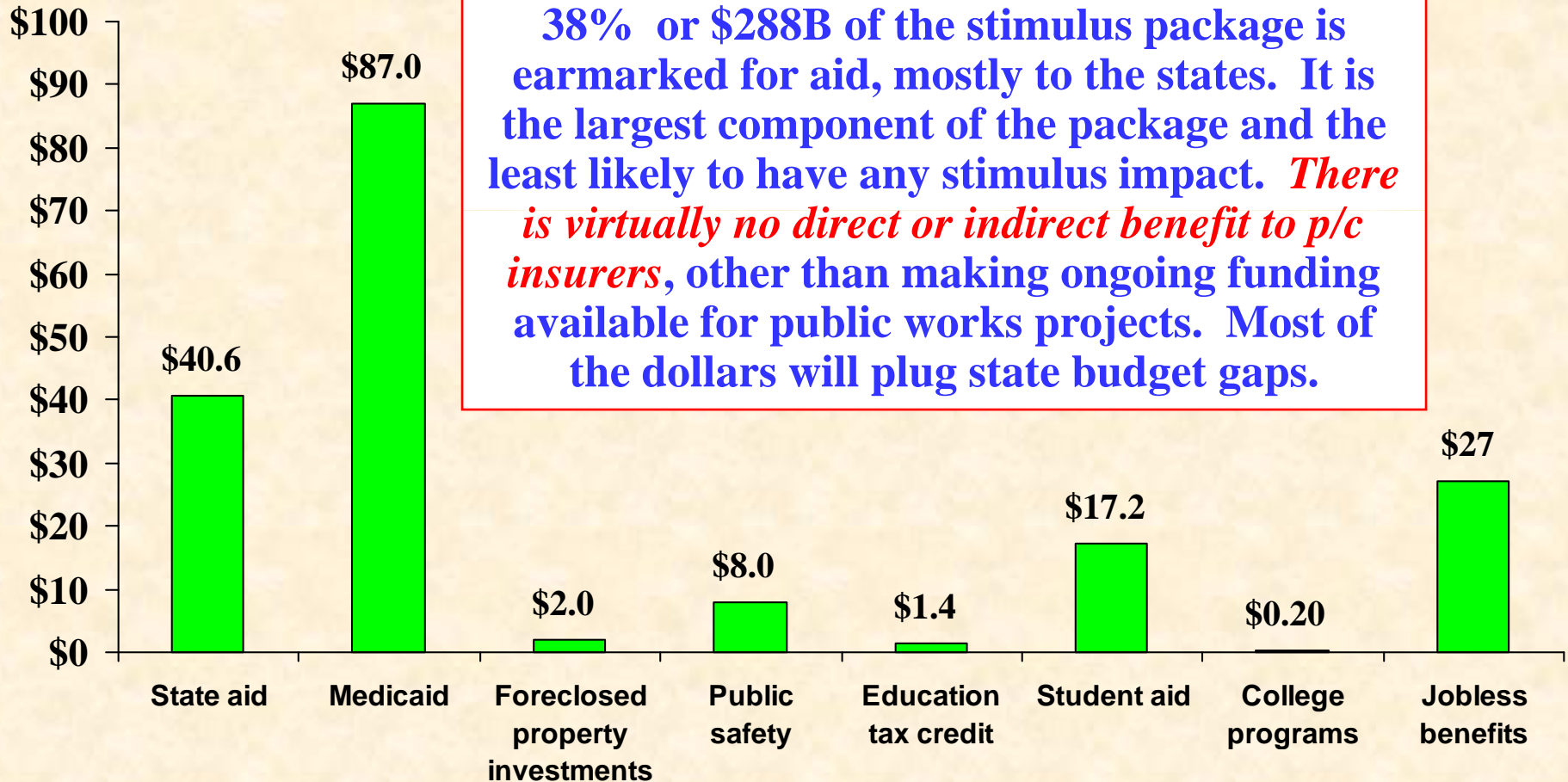


Sources: The Wall Street Journal 2/13/09; Speaker of the House; House Ways and Means Committee; Senate Finance Committee; Insurance Information Institute.



U.S. Economic \$787B Stimulus Package: Major Aid Components

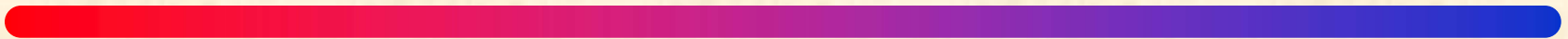
\$ Billions



Sources: The Wall Street Journal 2/13/09; Speaker of the House; House Ways and Means Committee; Senate Finance Committee; Insurance Information Institute.

State-by-State Infrastructure Spending

**Bigger States Get More, Should Benefit
Commercial Insurer Exposure**





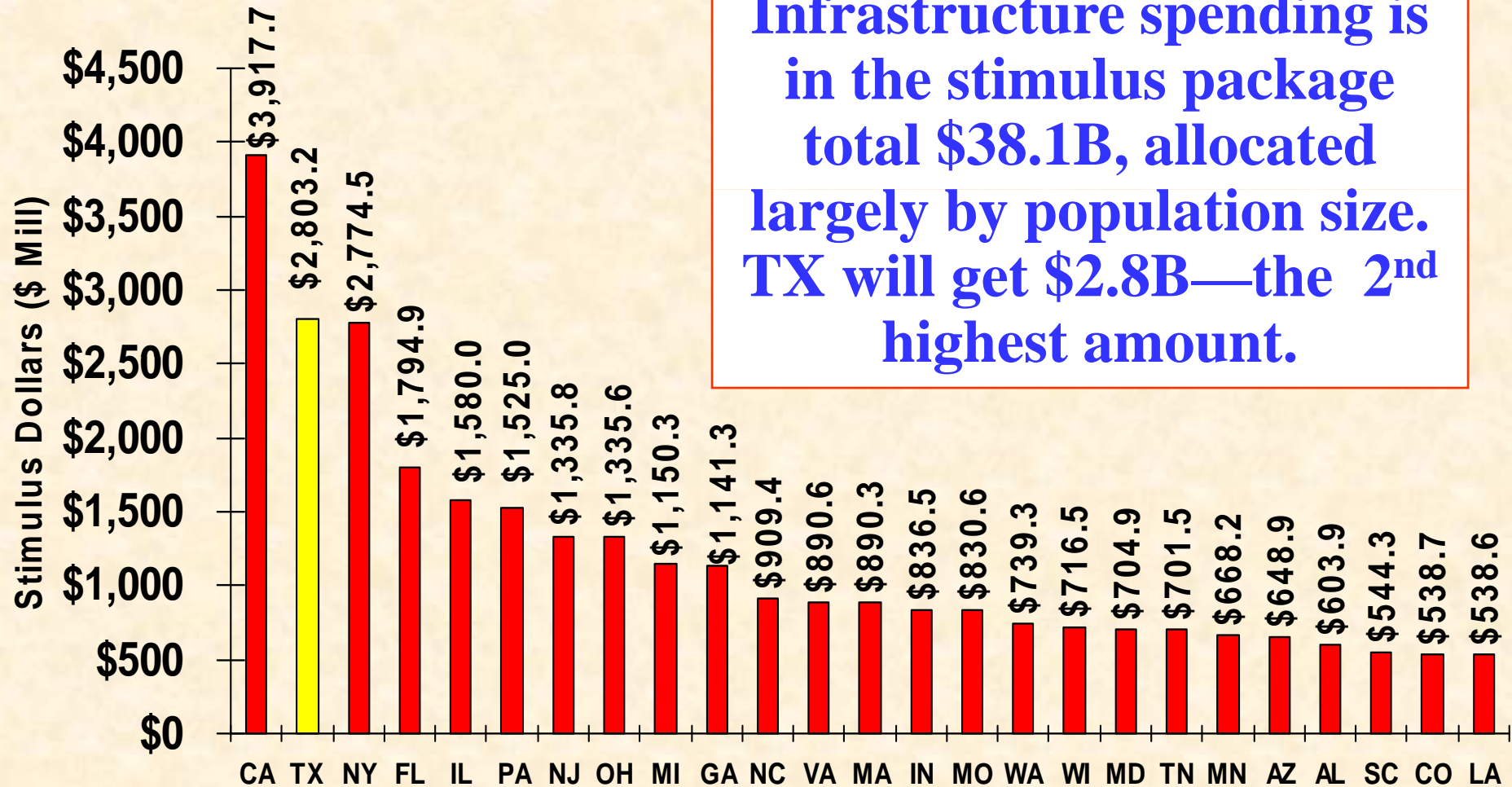
Infrastructure Stimulus Spending by State (Total = \$38.1B)

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

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



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

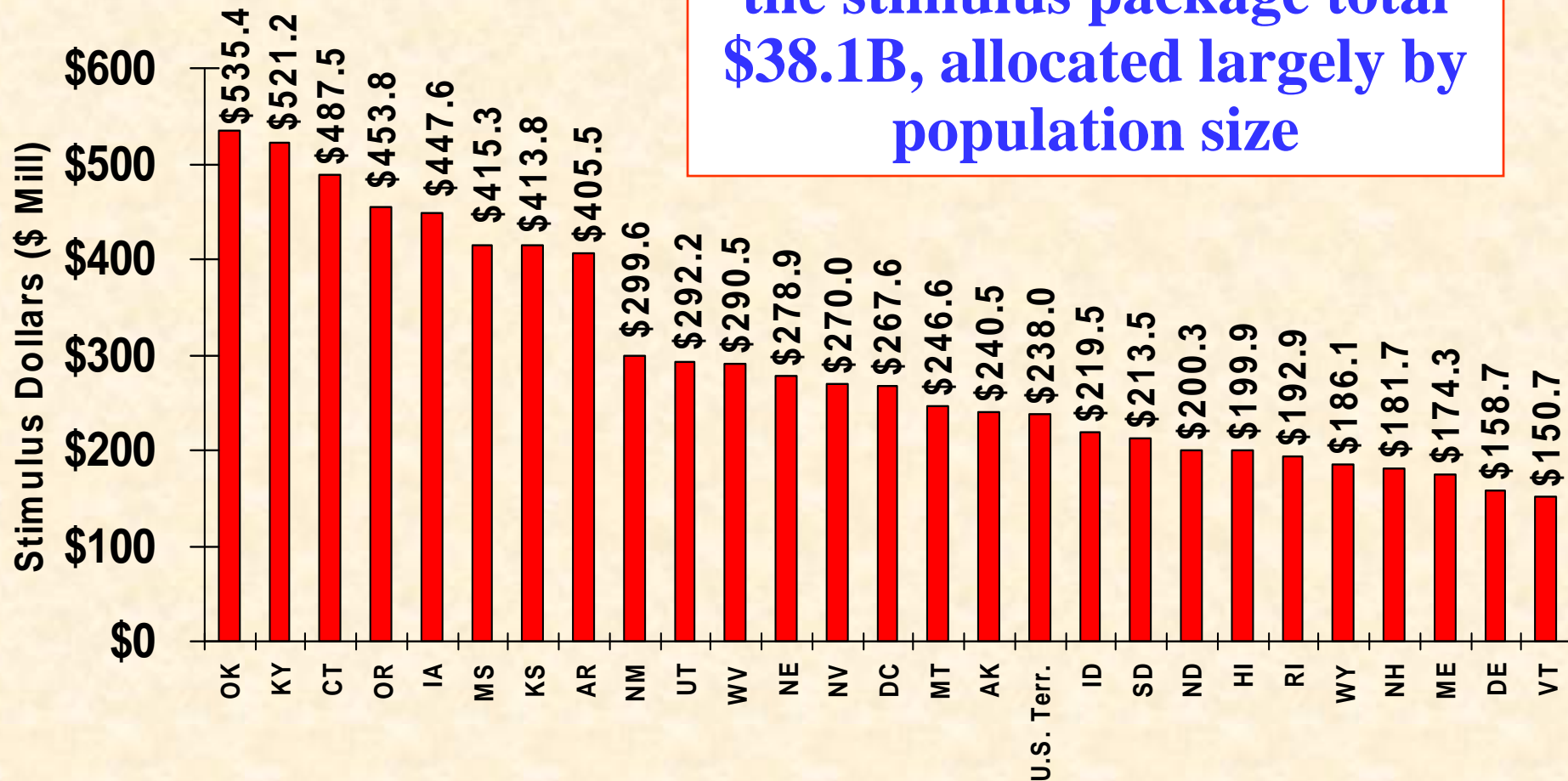


Infrastructure spending is in the stimulus package total \$38.1B, allocated largely by population size. TX will get \$2.8B—the 2nd highest amount.



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

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



Expected Number of Jobs Gained or Preserved by Stimulus Spending

*Larger States = More Jobs
Workers Comp Benefits*





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

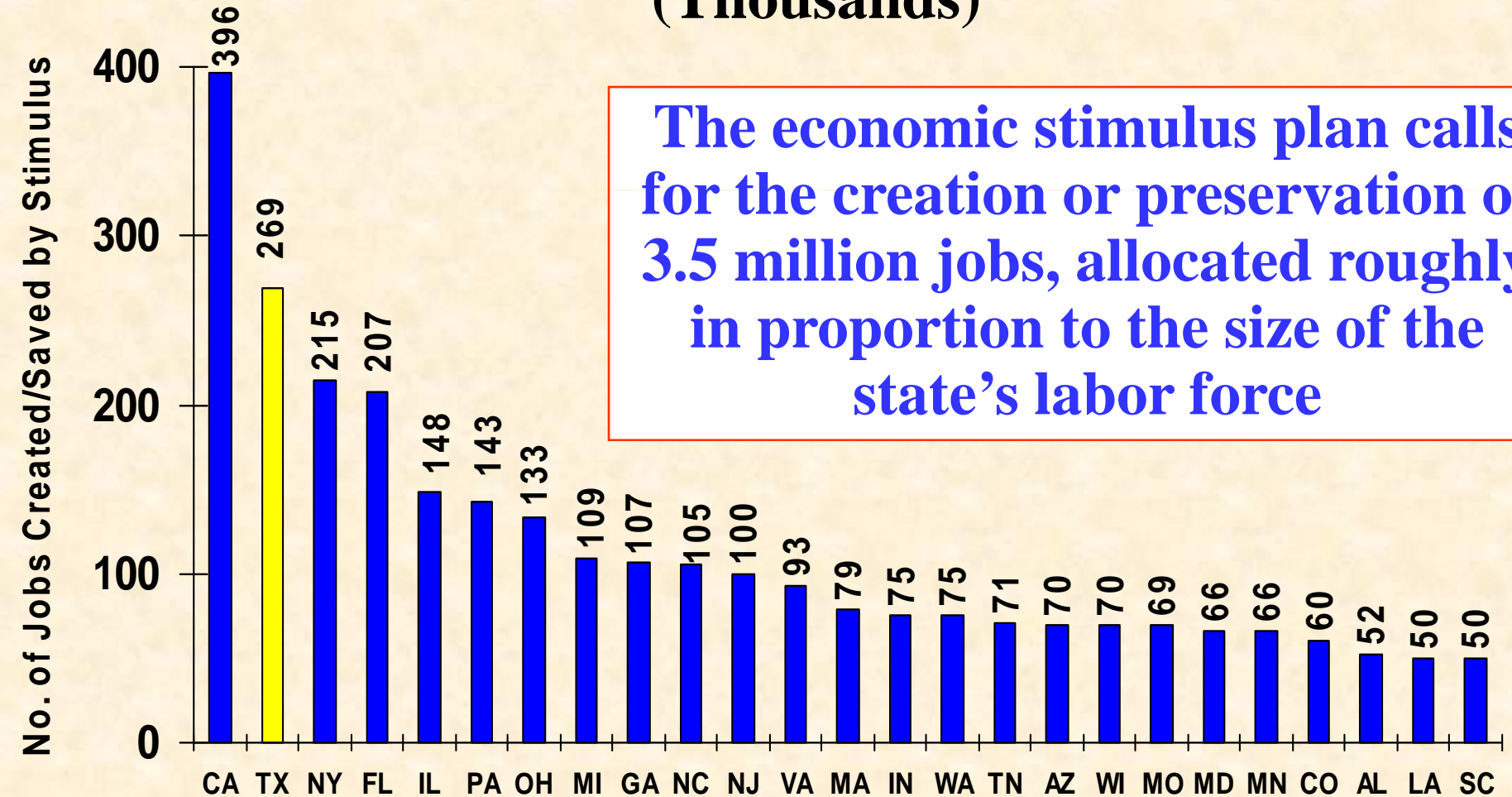
State	Jobs Created	State	Jobs Created	State	Jobs Created
AL	52,000	LA	50,000	OK	40,000
AK	8,000	ME	15,000	OR	44,000
AZ	70,000	MD	66,000	PA	143,000
AR	32,000	MA	79,000	RI	12,000
CA	396,000	MI	109,000	SC	50,000
CO	60,000	MN	66,000	SD	10,000
CT	41,000	MS	30,000	TN	71,000
DE	11,000	MO	69,000	TX	269,000
DC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

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



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

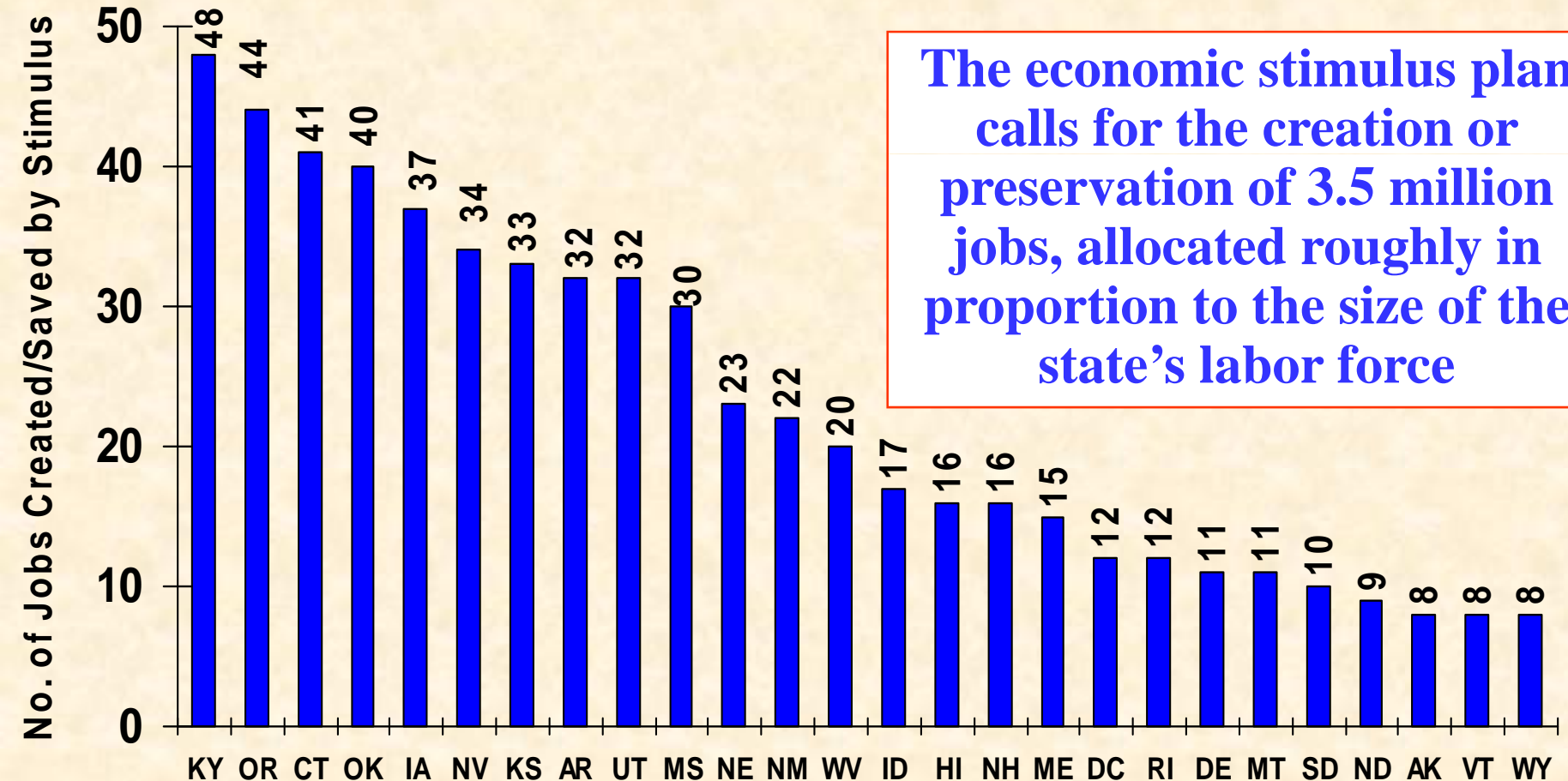
(Thousands)





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

(Thousands)



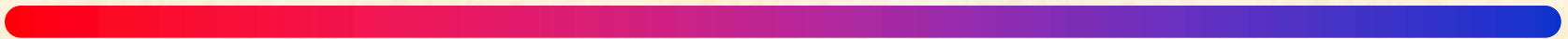


Stimulus: Reading The Economic Tea Leaves for the Next 4 to 8 Years

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

FINANCIAL STRENGTH & RATINGS

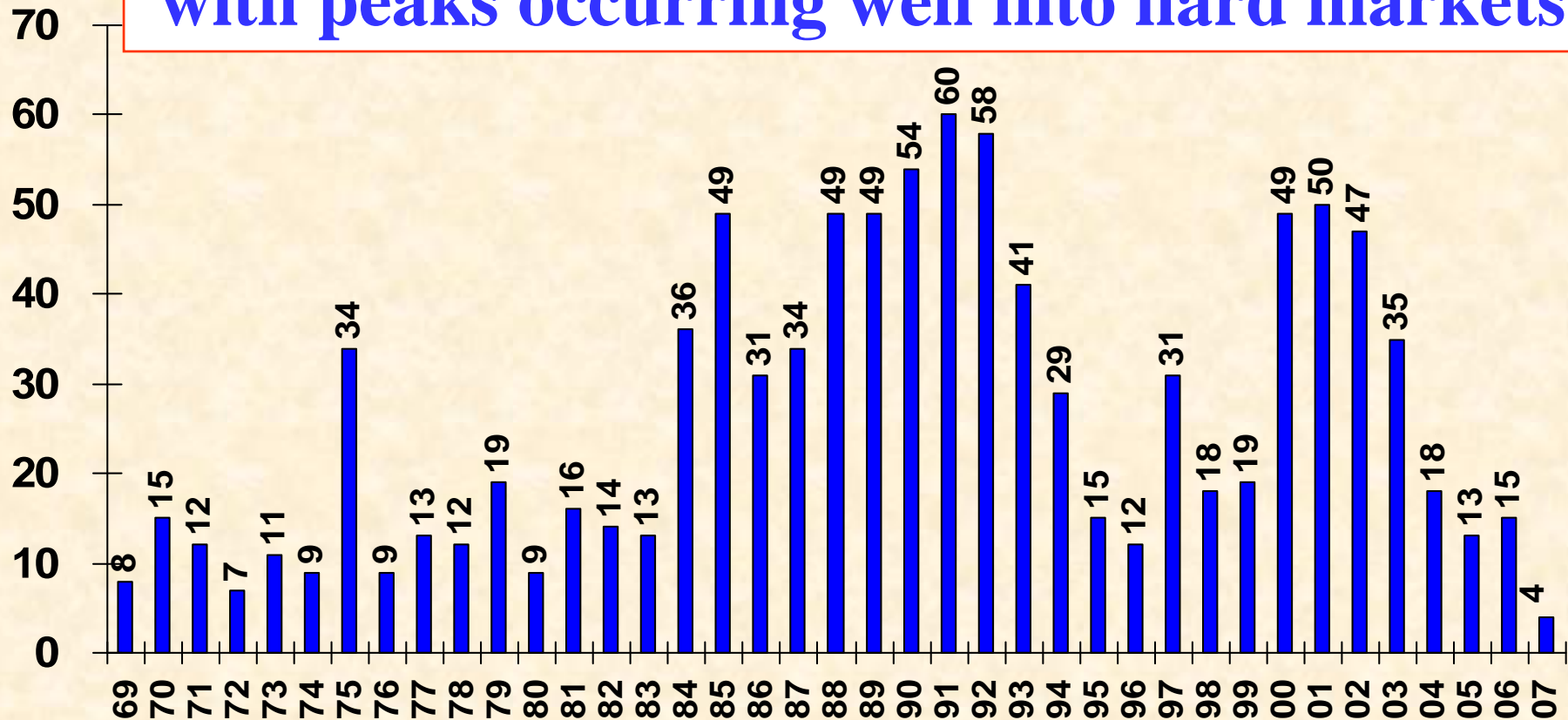
**Industry Has Weathered
the Storms Well**





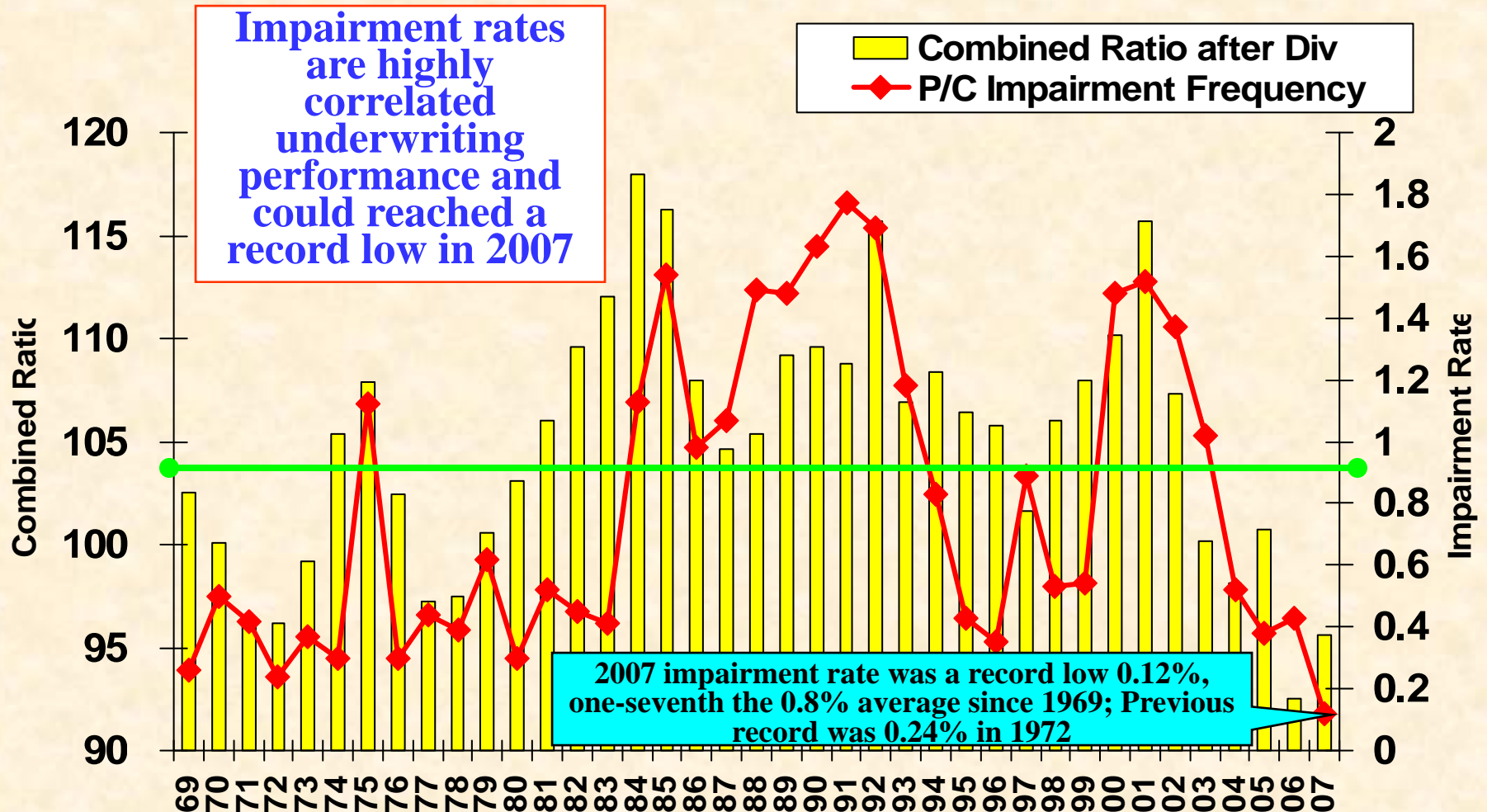
P/C Insurer Impairments, 1969-2007

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





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

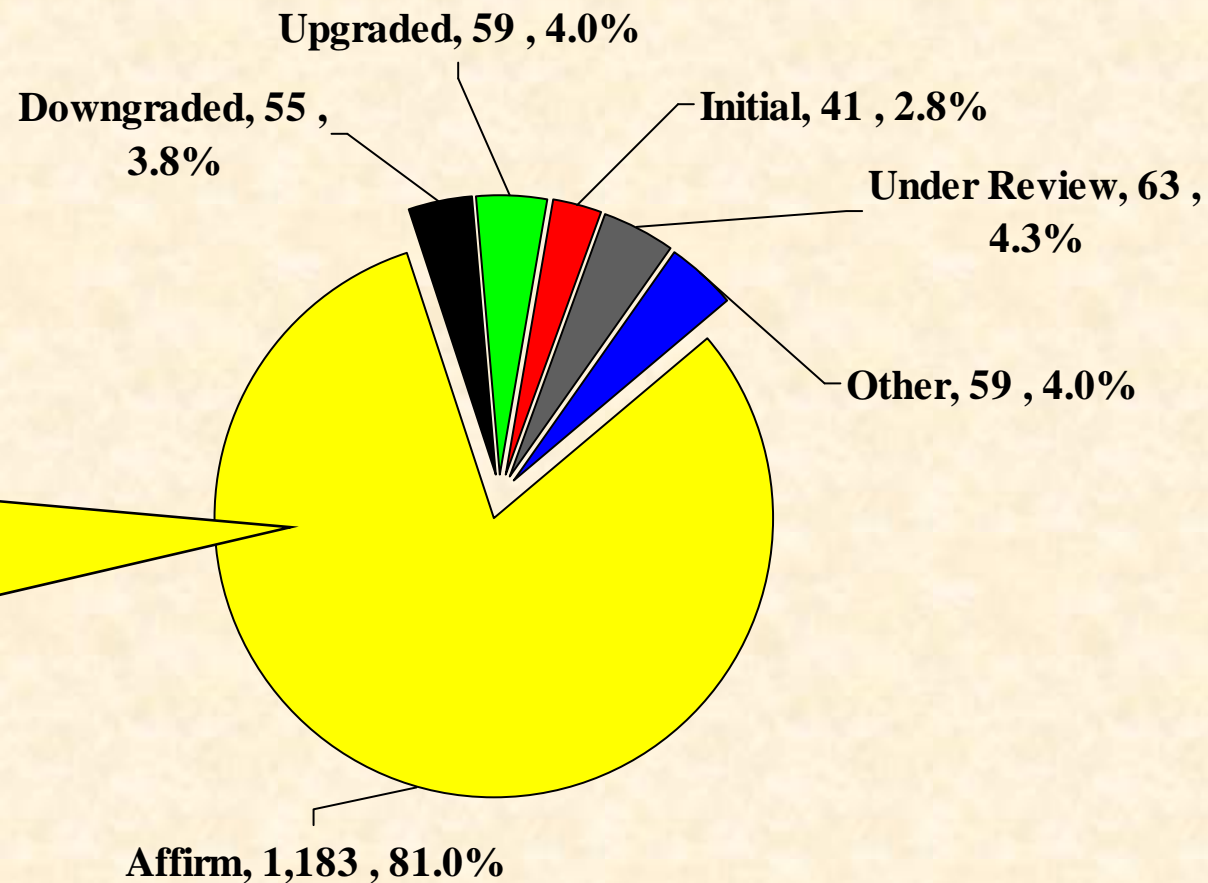




Summary of A.M. Best's P/C Insurer Ratings Actions in 2008*

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

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



*Through December 19.

Source: A.M. Best.



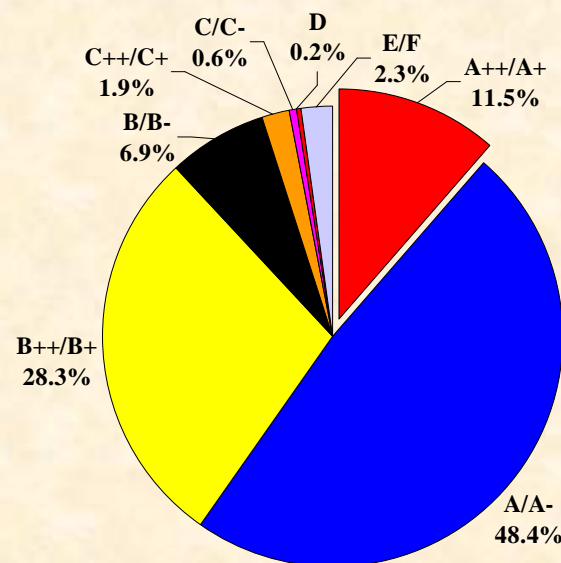
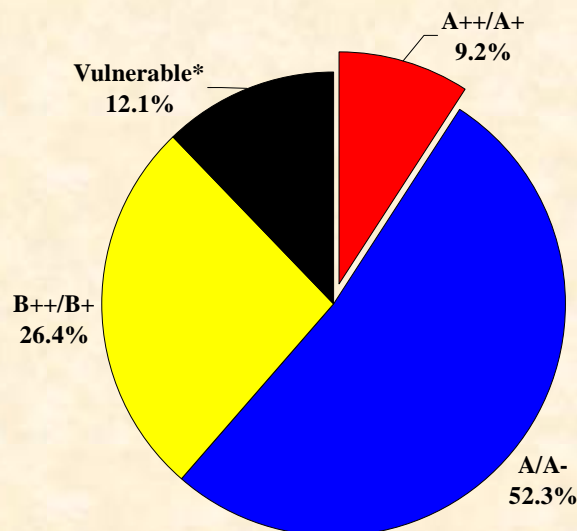
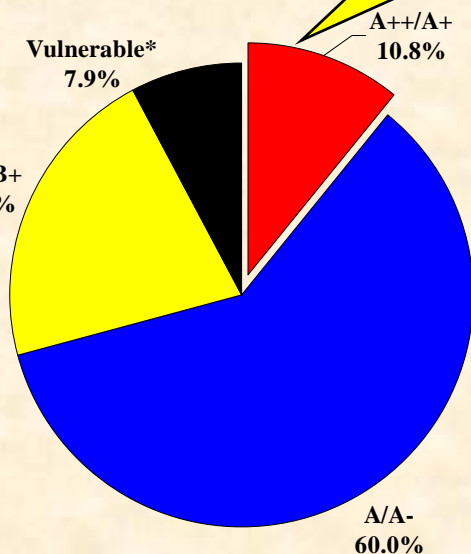
Historical Ratings Distribution, US P/C Insurers, 2008 vs. 2005 and 2000

2008

**A++/A+ and
A/A- gains**

2005

2000

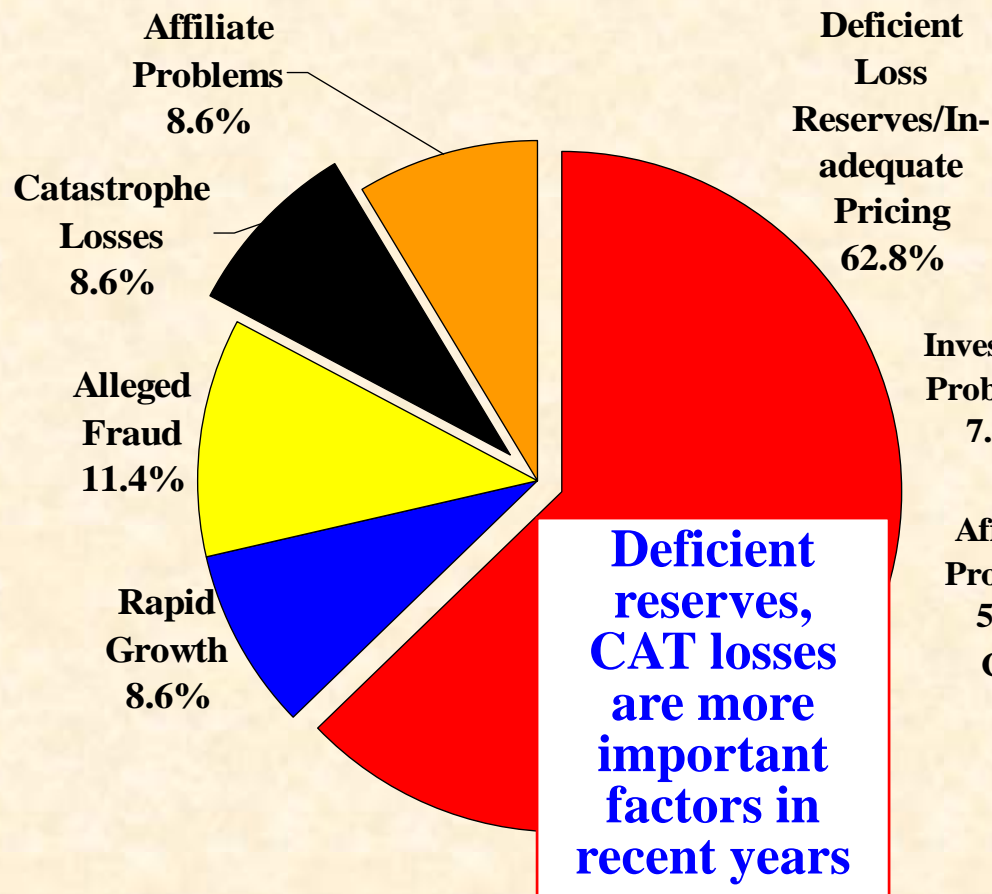


**P/C insurer financial strength
has improved since 2005
despite financial crisis**

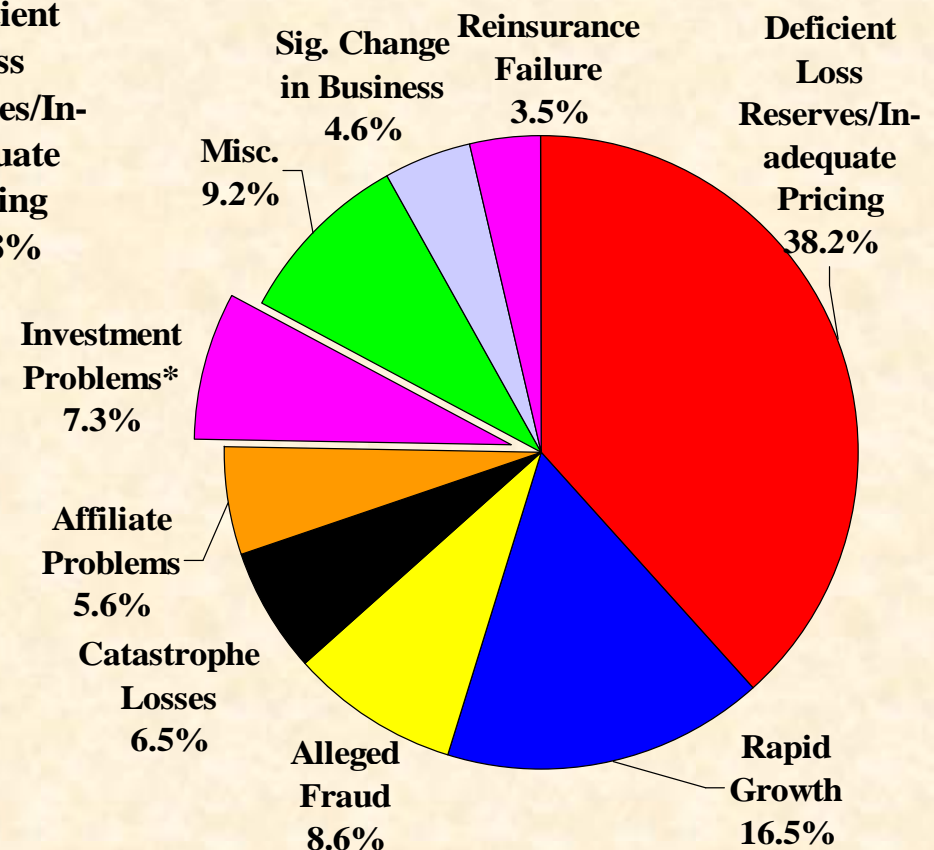


Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



1969-2005



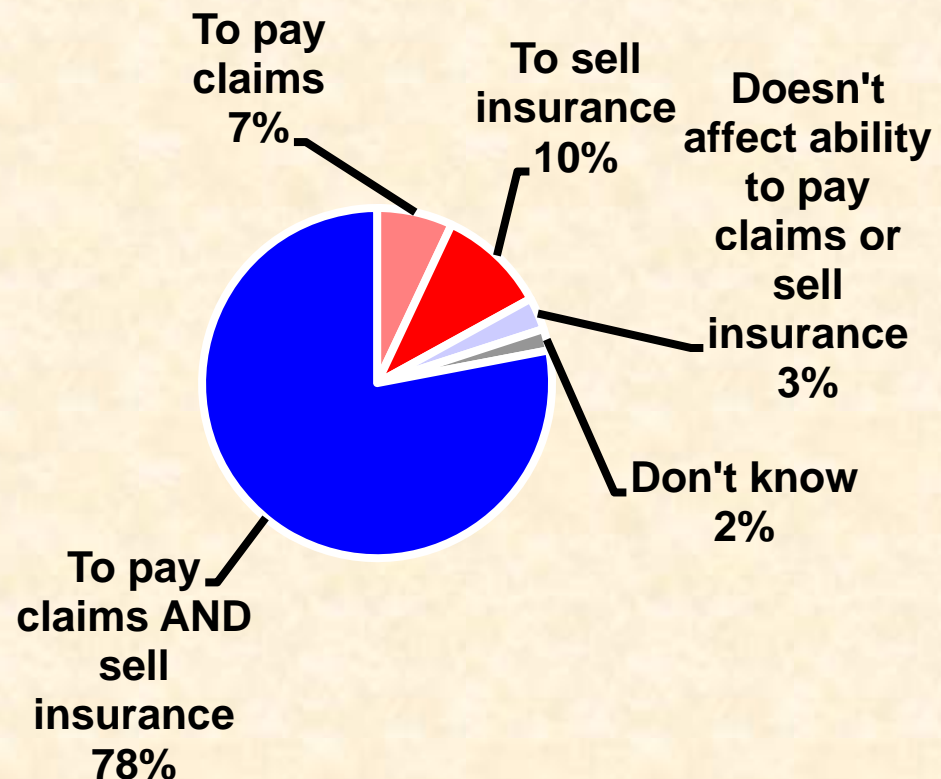
*Includes overstatement of assets.



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



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 41 banks have gone under as of 2/28)**
 - *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)**



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

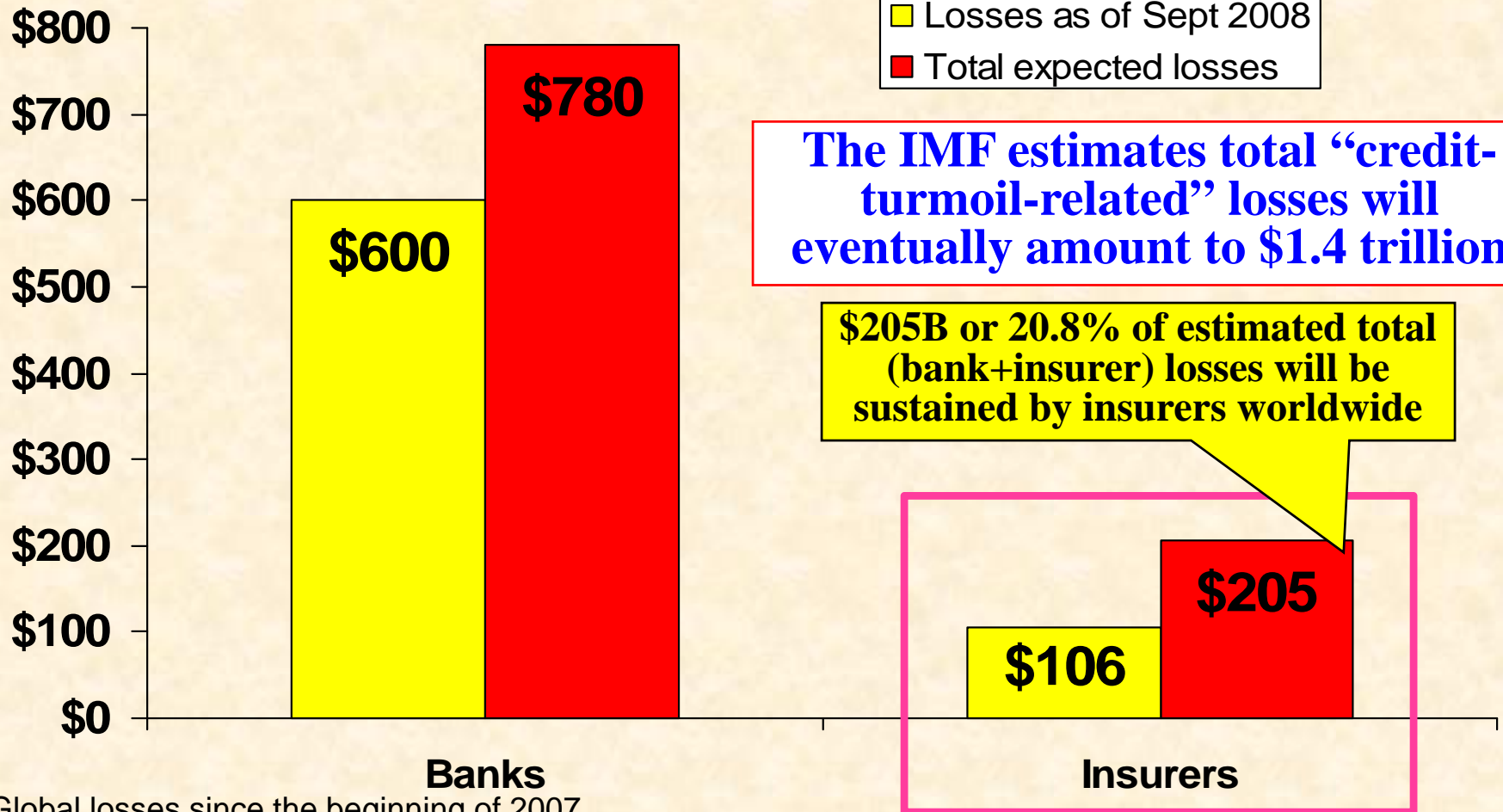
The Financial Crisis in Perspective

Bank vs. Insurer Impacts



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

Billions

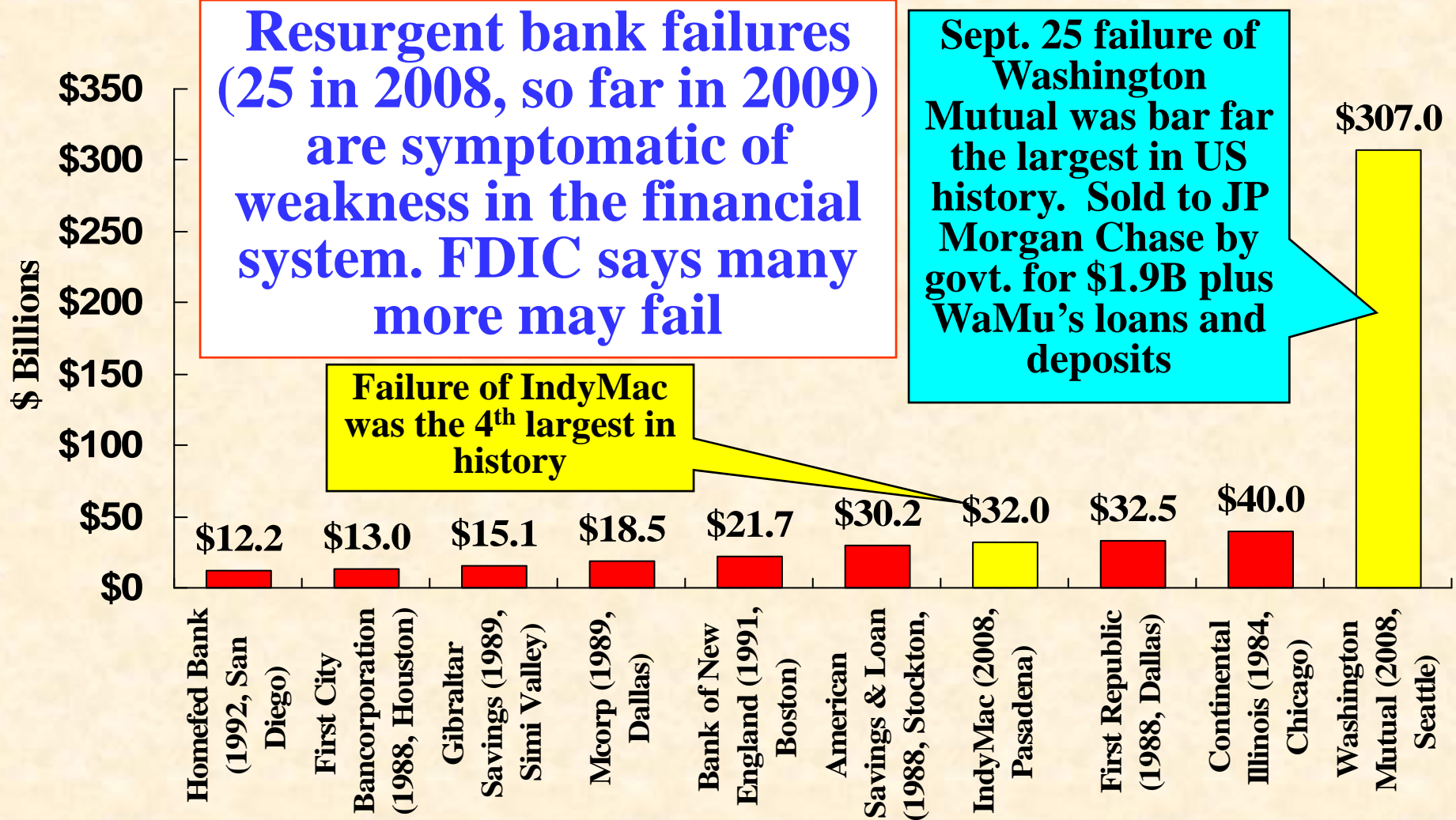


*Global losses since the beginning of 2007.

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

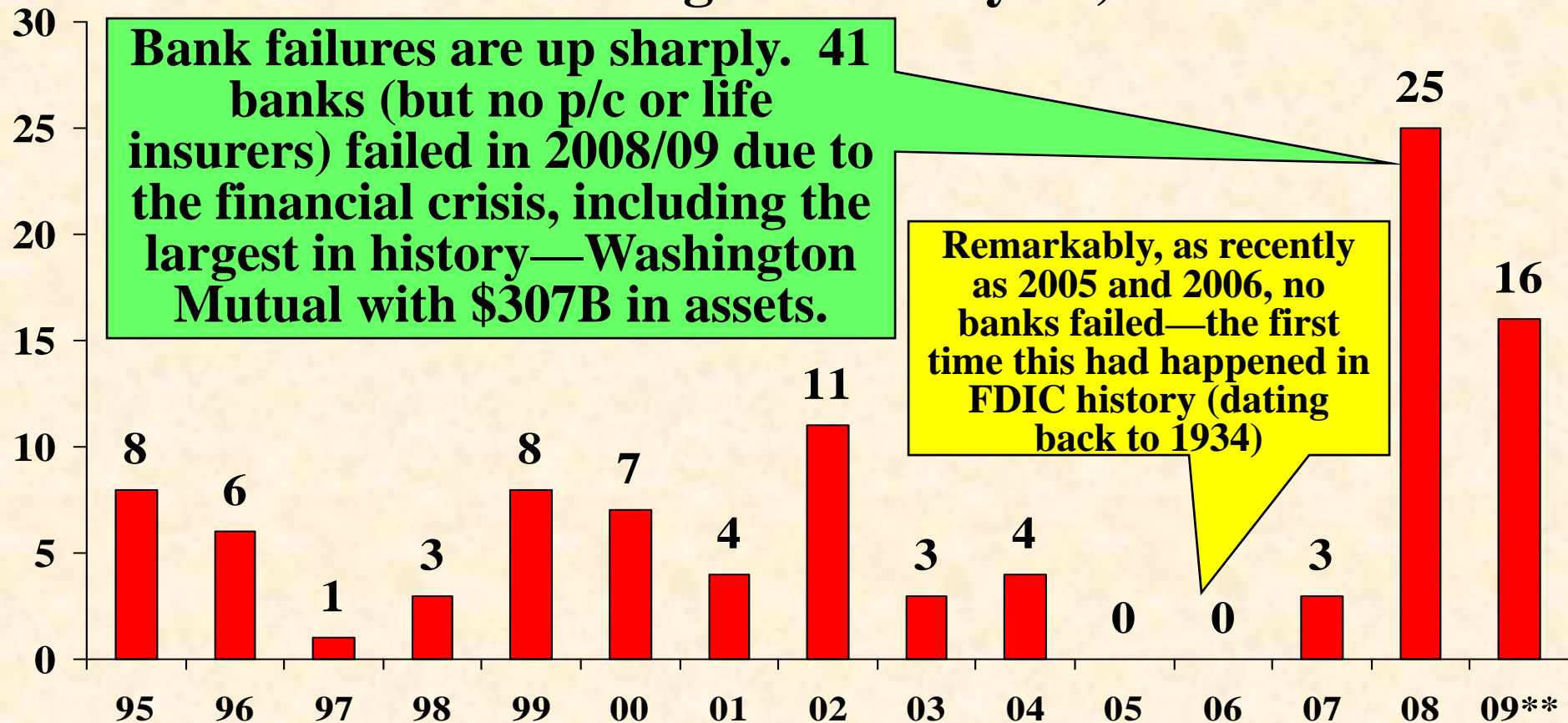




*US Bank Failures:**

*1995-2009***

Through February 28, 2009



*Includes all commercial banking and savings institutions. **Through Feb. 28.

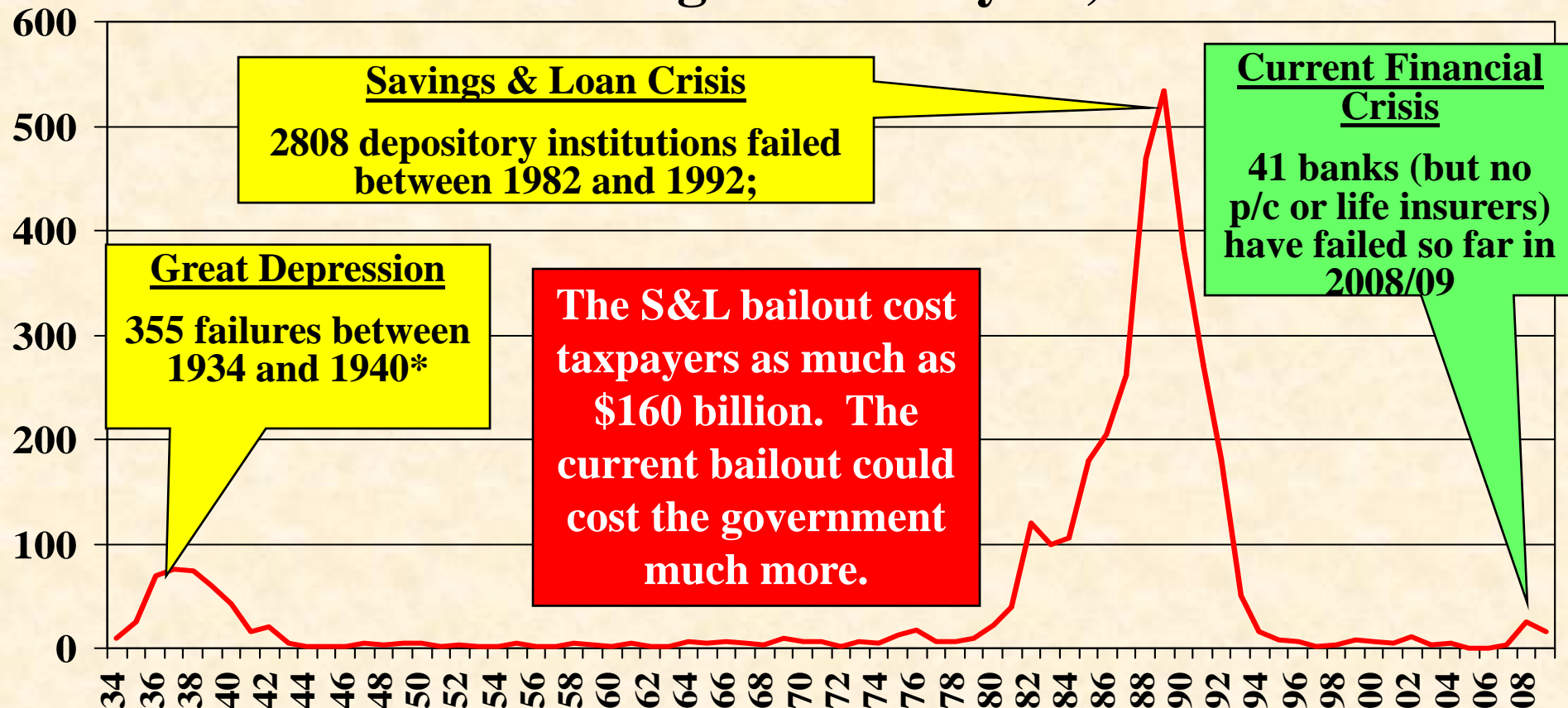
Source: FDIC: <http://www.fdic.gov/bank/historical/bank/index.html>; Insurance Info. Institute



*US Bank Failures:**

*1934-2009***

Through February 28, 2009

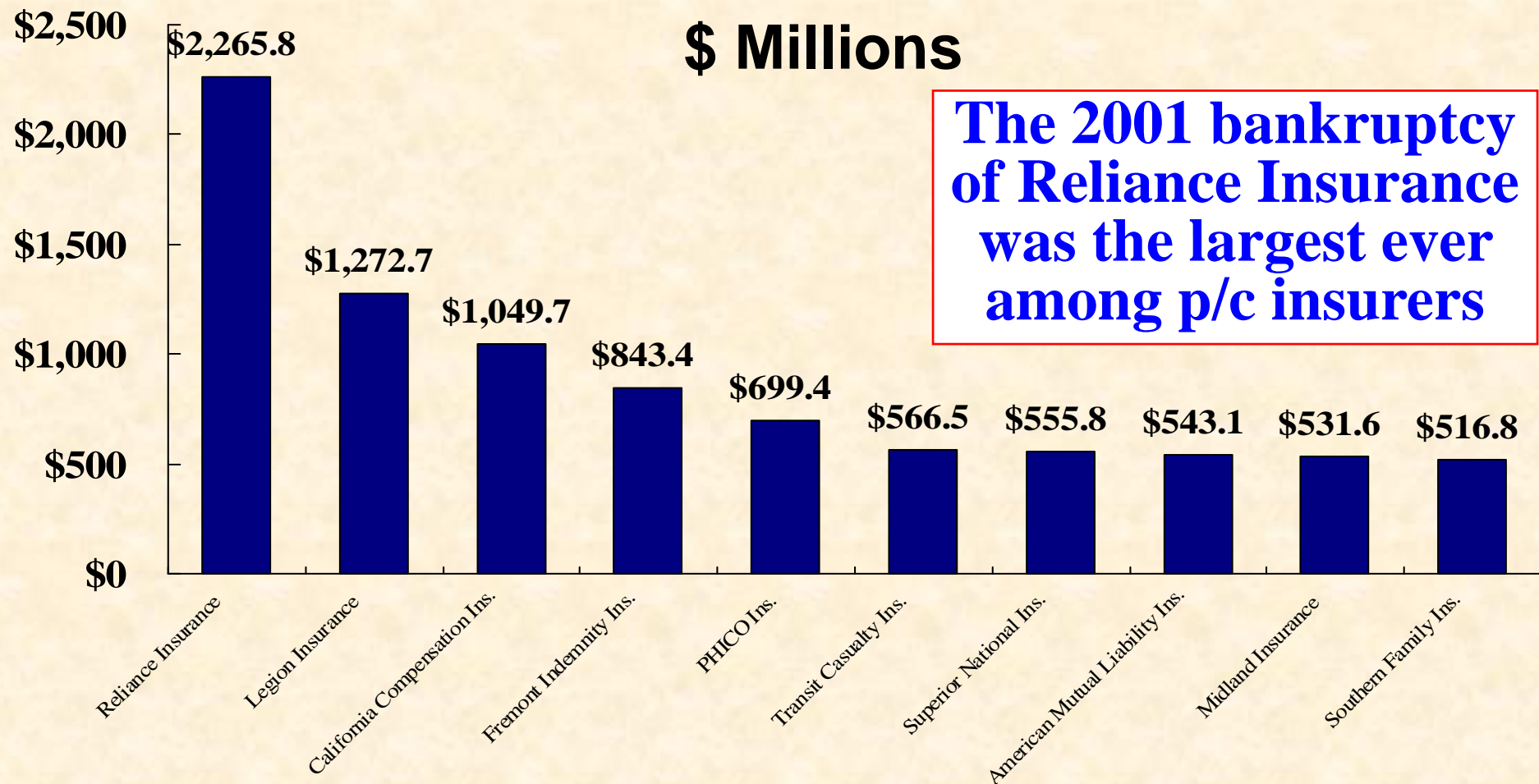


*Includes all commercial banking and savings institutions.

**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**



* 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**

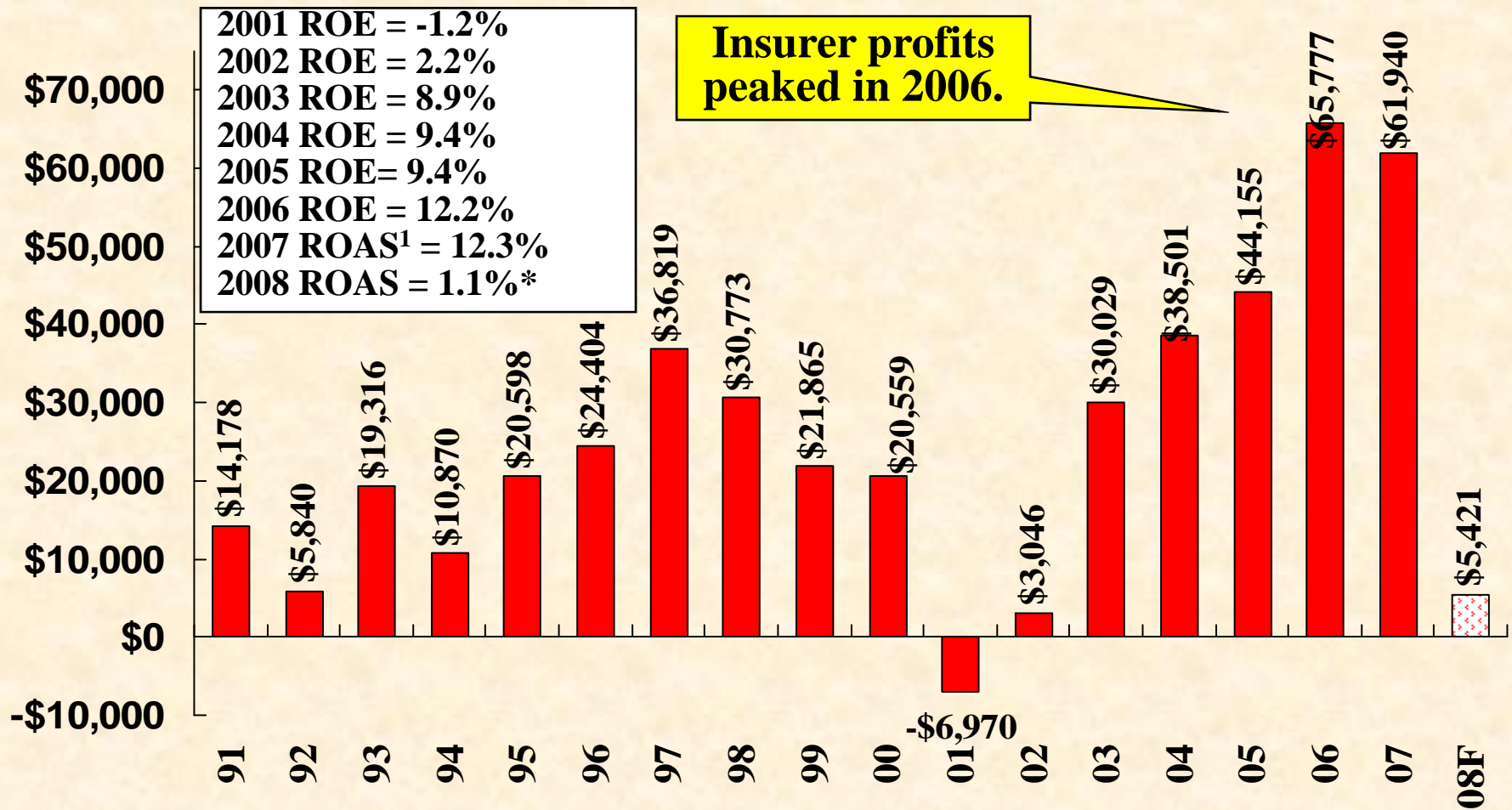
Profitability

Historically Volatile





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

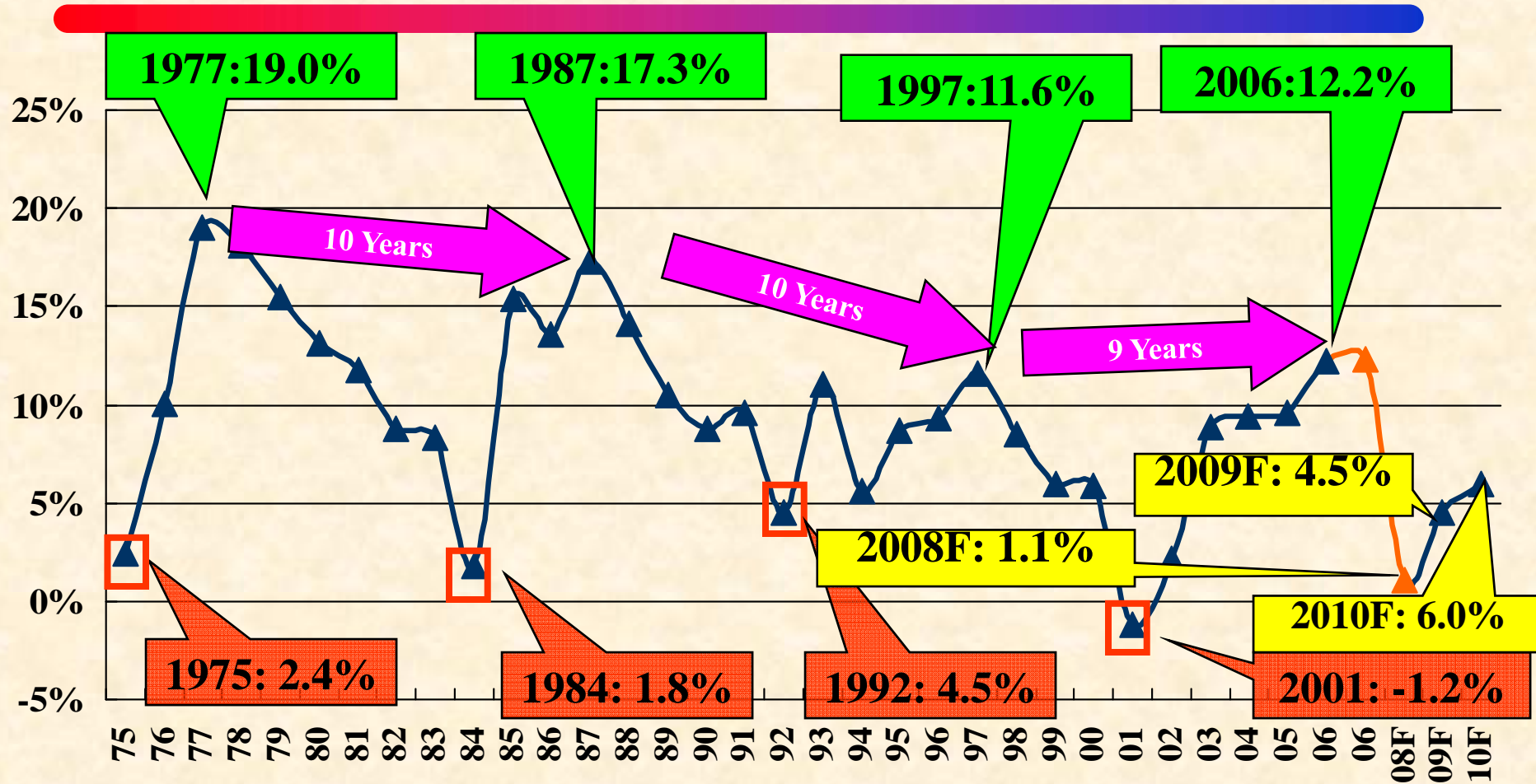


*ROE figures are GAAP; ¹Return on avg. surplus. 2008 numbers are annualized based on 9-mos. Actual of \$4.066 billion.

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



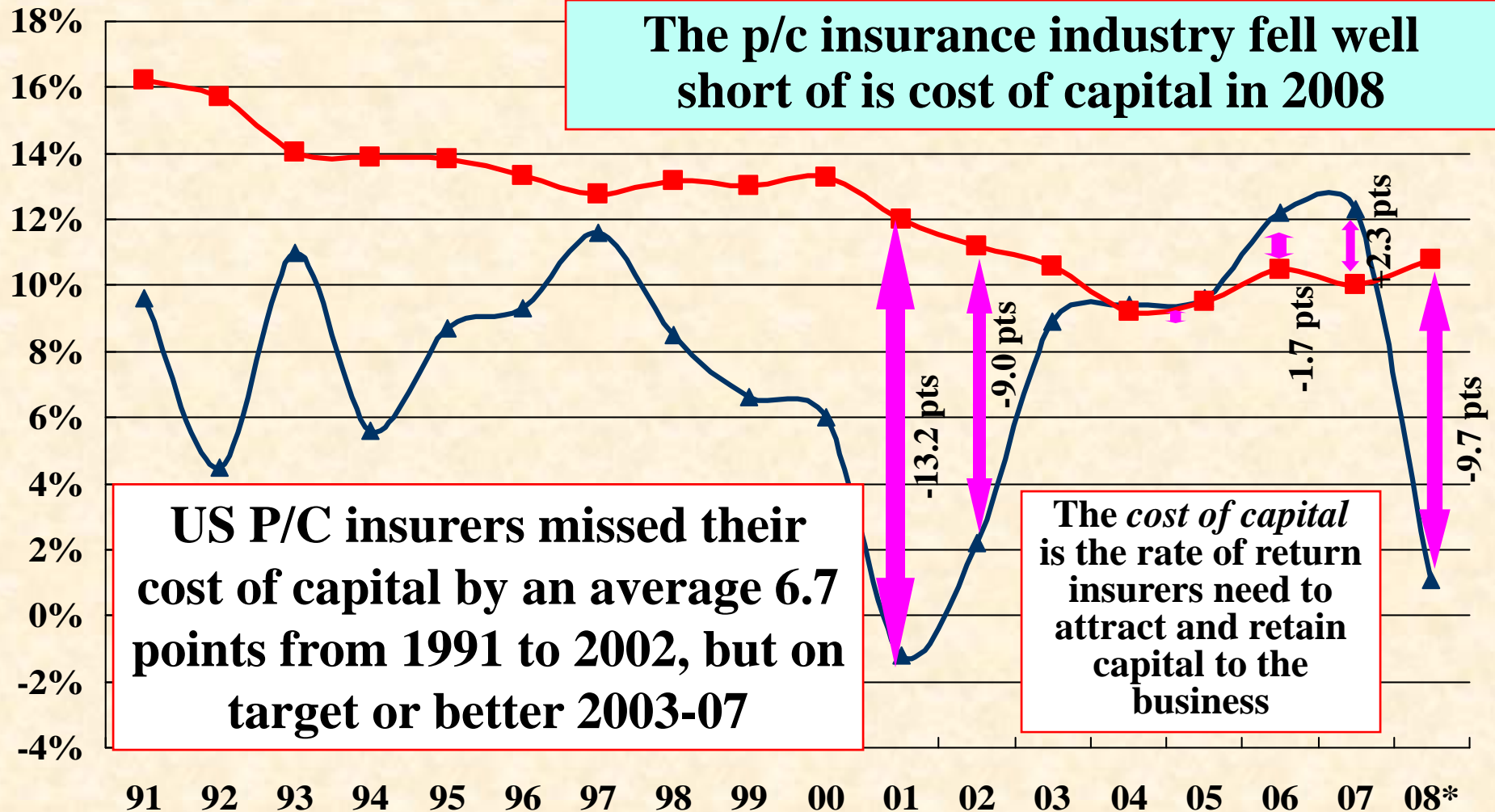
*P/C Insurance Industry ROEs, 1975 – 2010F**



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

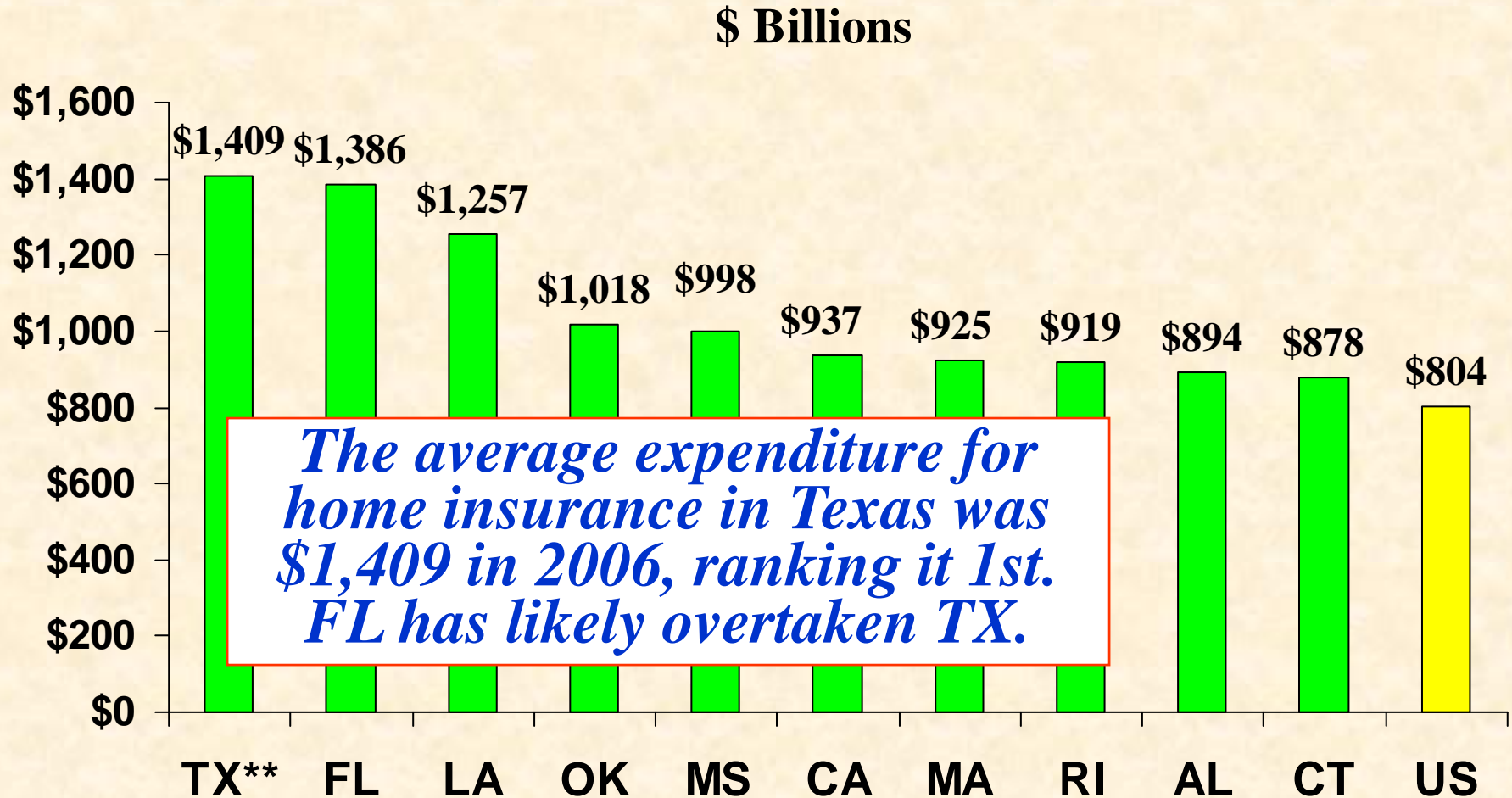


*Excludes mortgage and financial guarantee insurers.
Source: The Geneva Association, Ins. Information Inst.

—●— ROE —■— Cost of Capital



*Top 10 Most Expensive States for Homeowners Insurance vs. US (2006)**



*Most recent available.

**The Texas Dept. of Insurance developed HO policy forms that are similar but not identical to the standard forms.
Source: NAIC, Insurance Information Institute

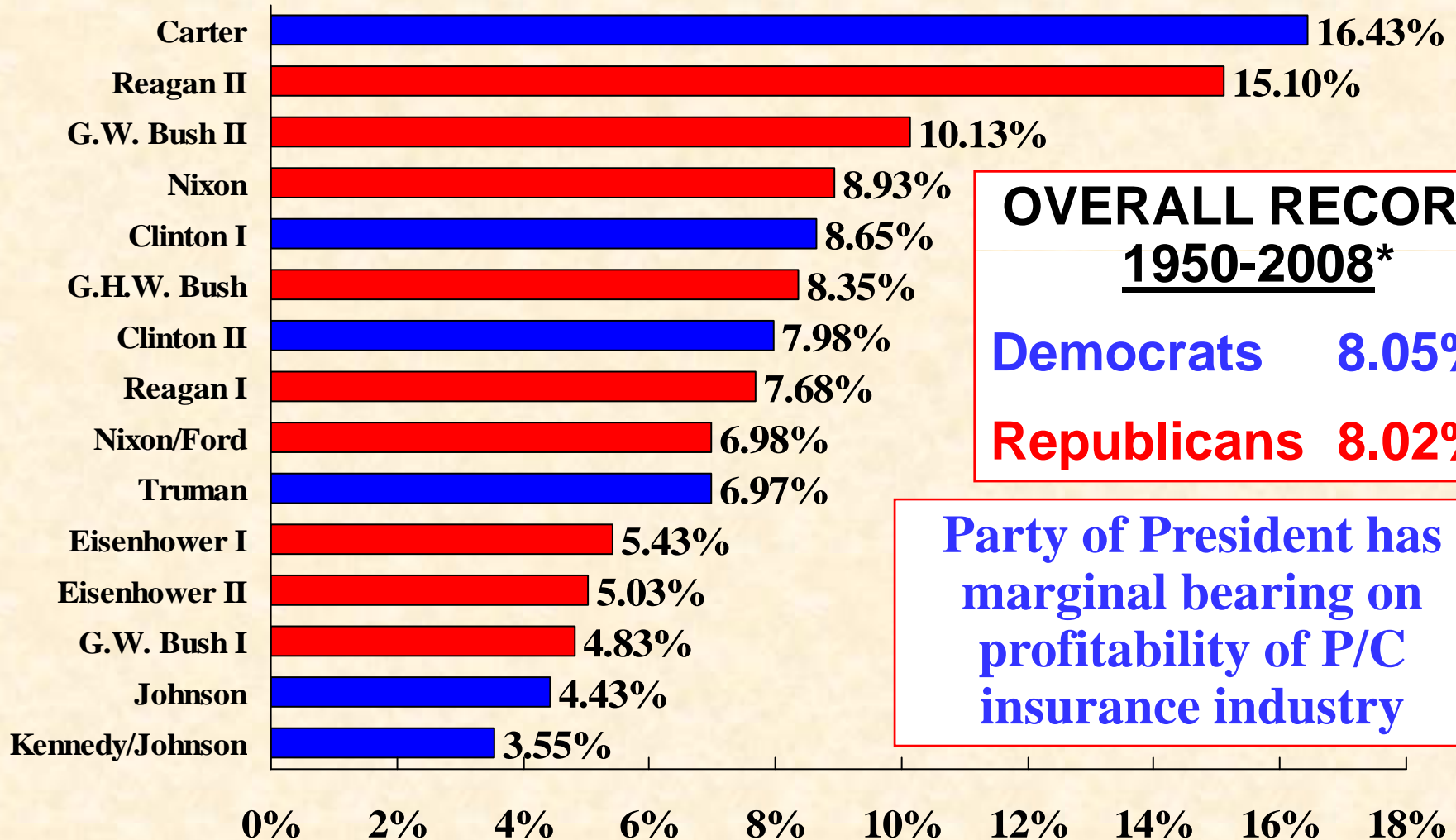
Presidential Politics & P/C Insurance

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





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



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

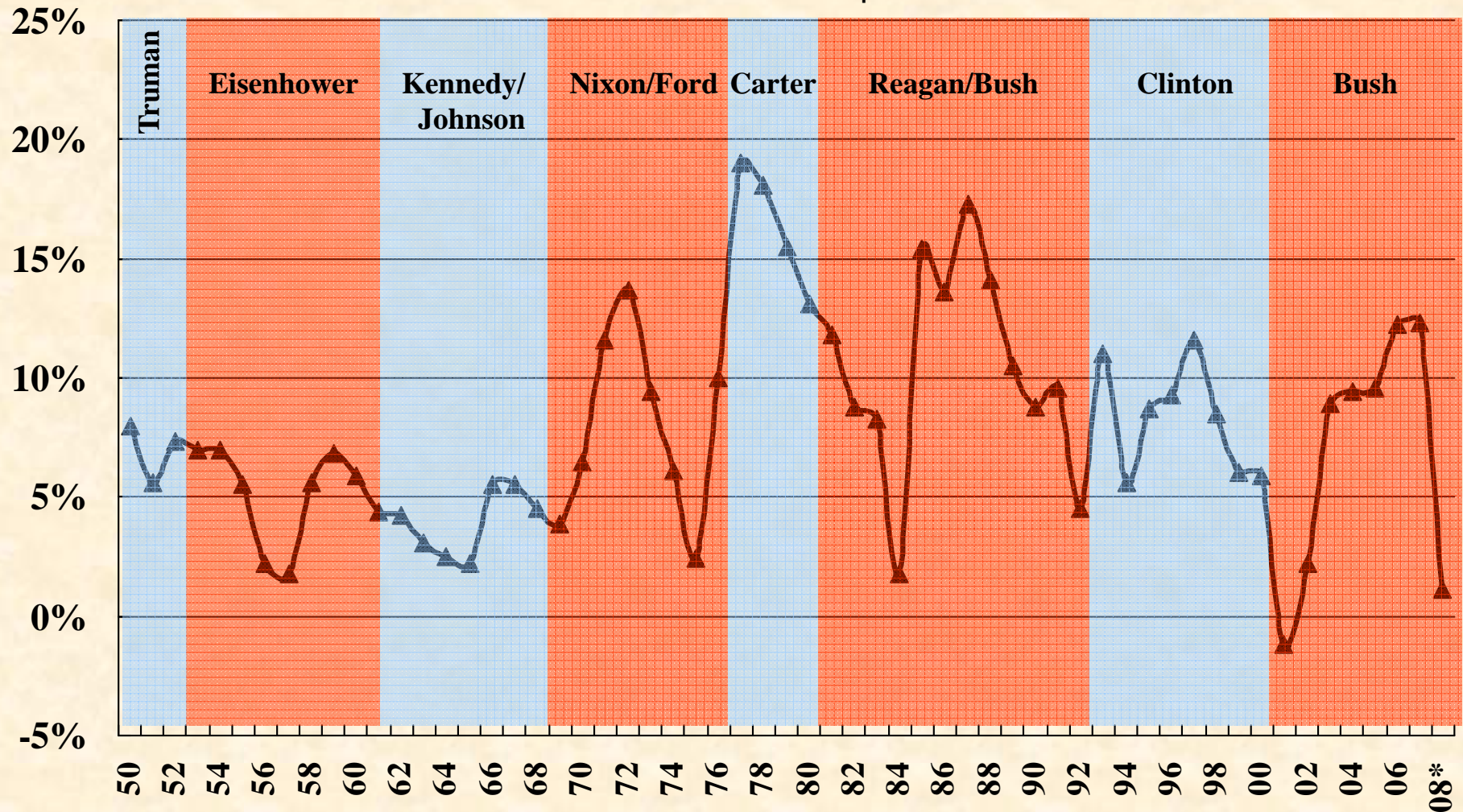
Source: Insurance Information Institute



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

BLUE = Democratic President

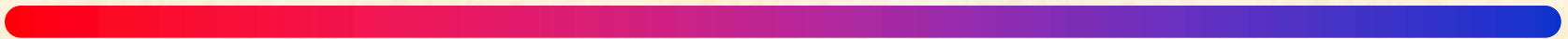
RED = Republican President



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

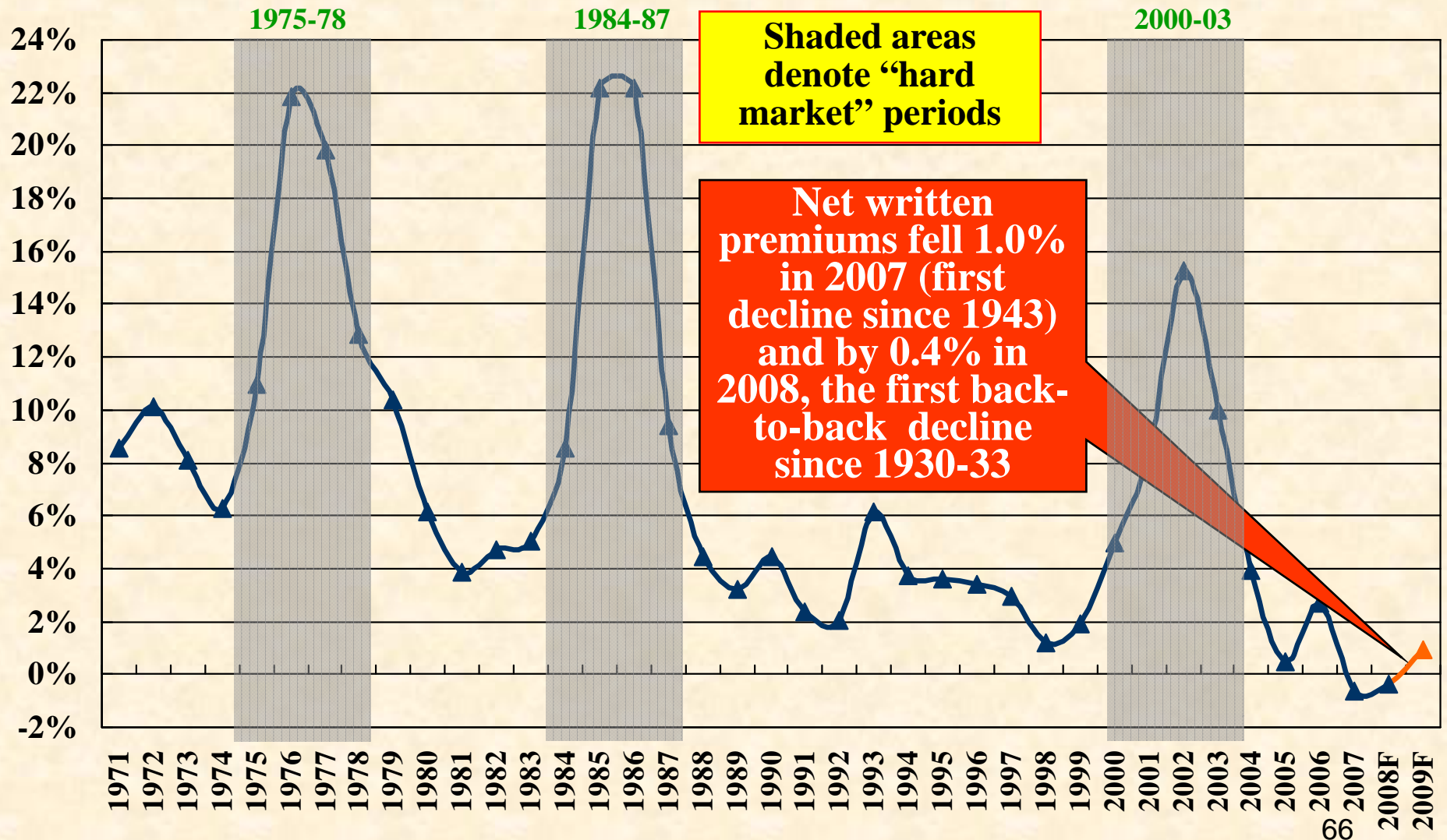
P/C Premium Growth

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



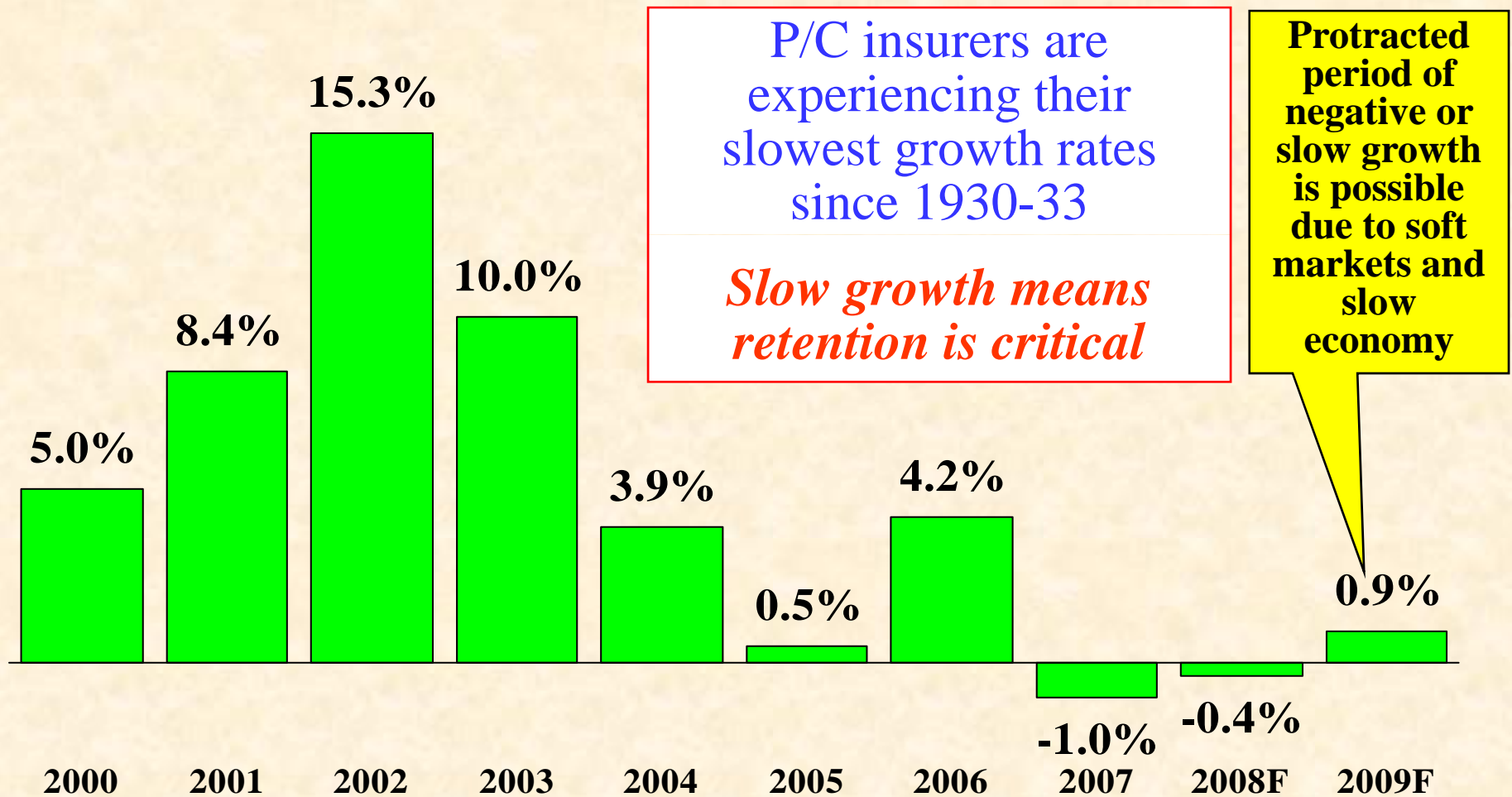


Strength of Recent Hard Markets by NWP Growth





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

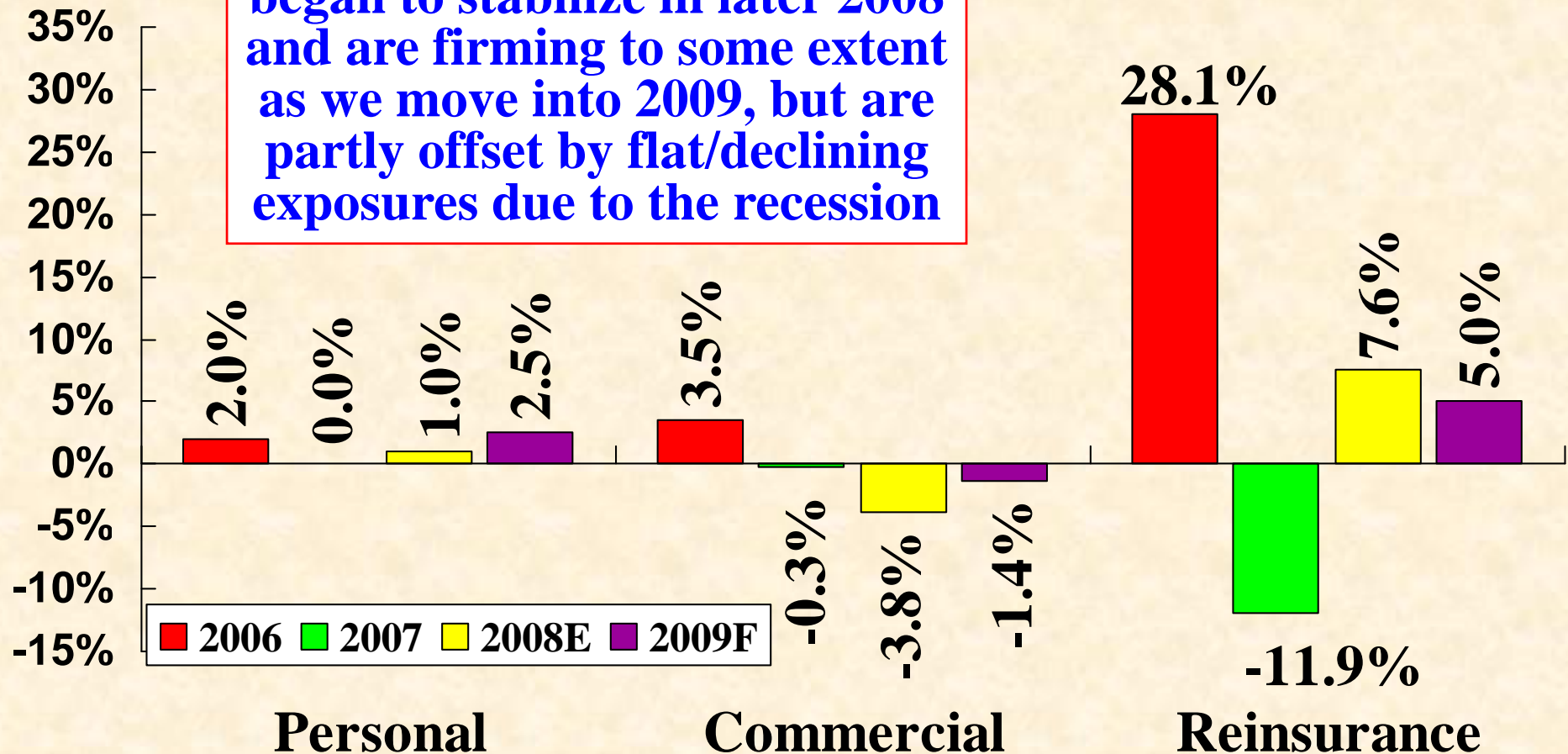


*2008 figure is 9-month actual result from ISO.
Source: A.M. Best (historical and forecast)



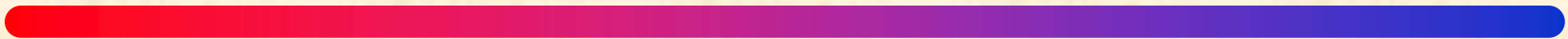
Personal/Commercial Lines & Reinsurance NPW Growth, 2006-2009F

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



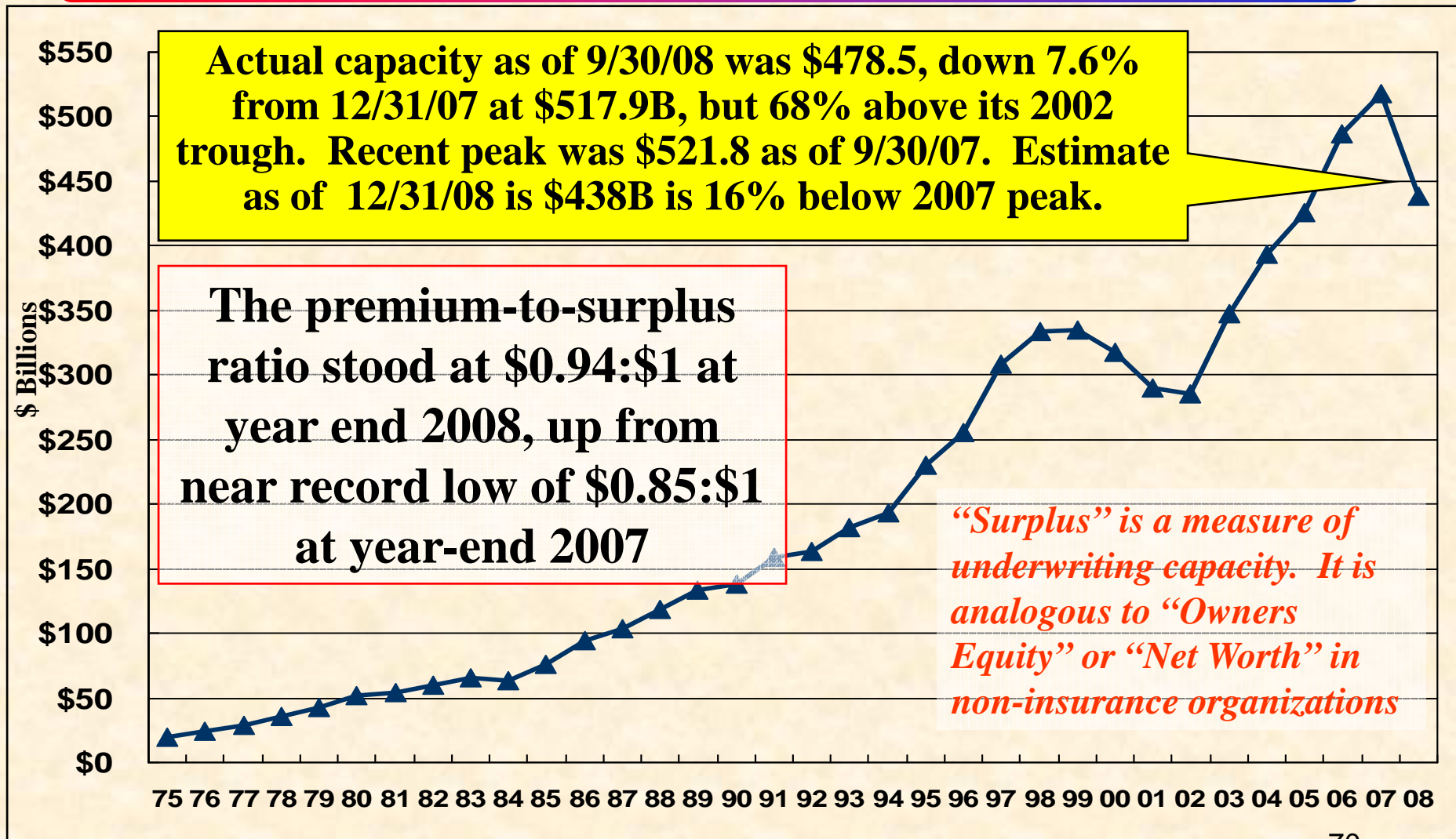
Capital/ Policyholder Surplus

Shrinkage, but
Capital is Within
Historic Norms



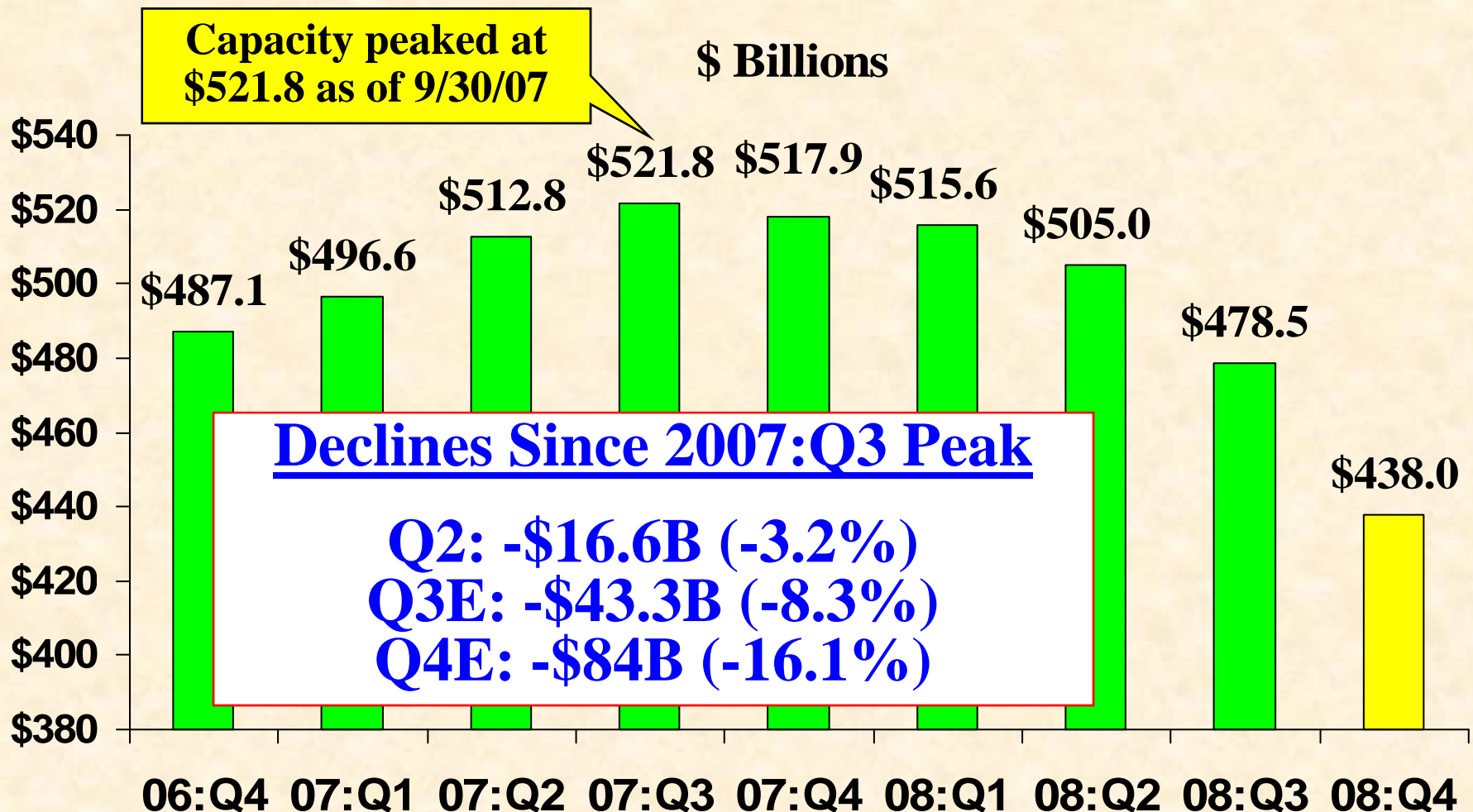


*U.S. Policyholder Surplus: 1975-2008**



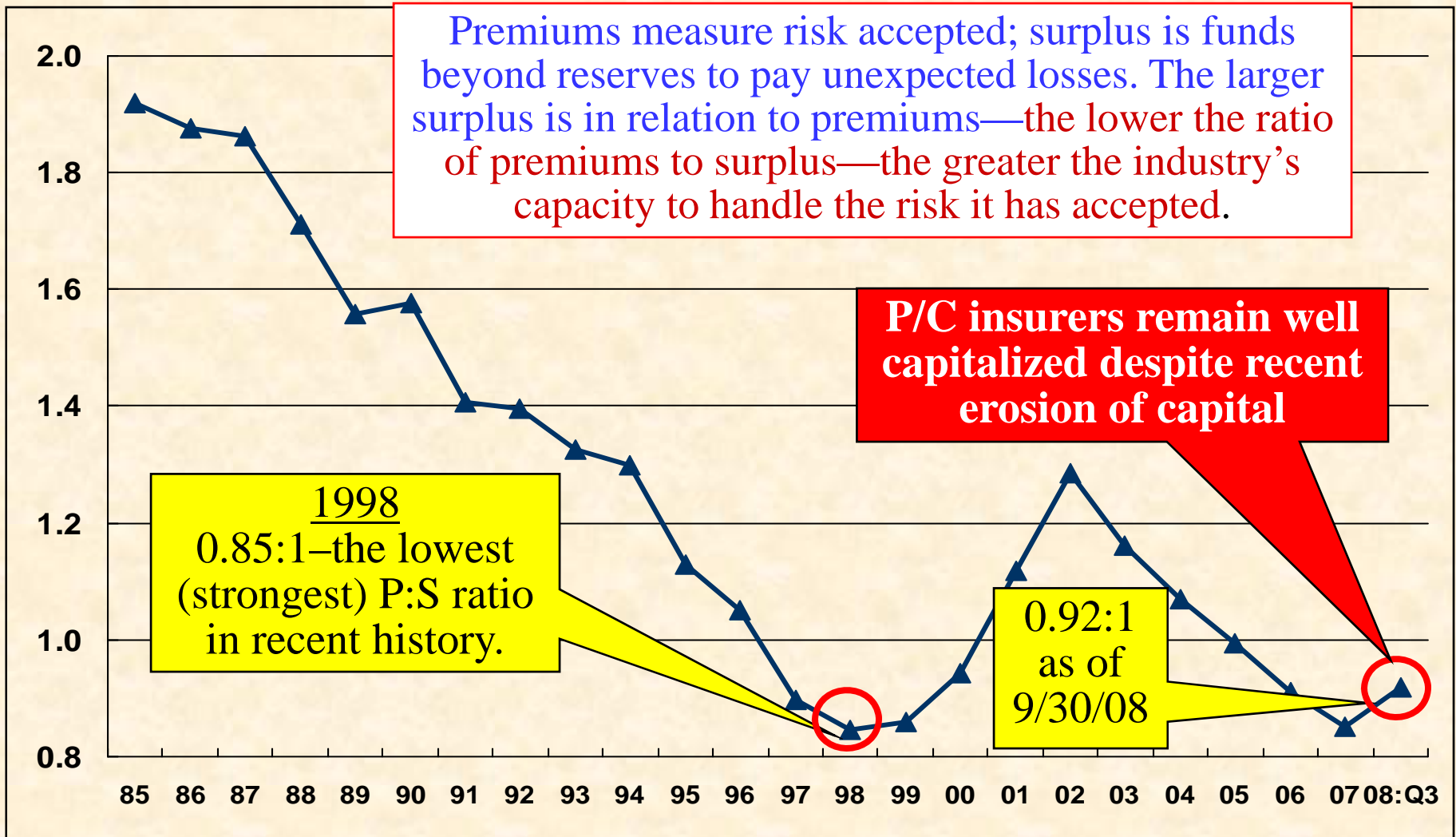


Policyholder Surplus, 2006:Q4 – 2008:Q4(Est.)



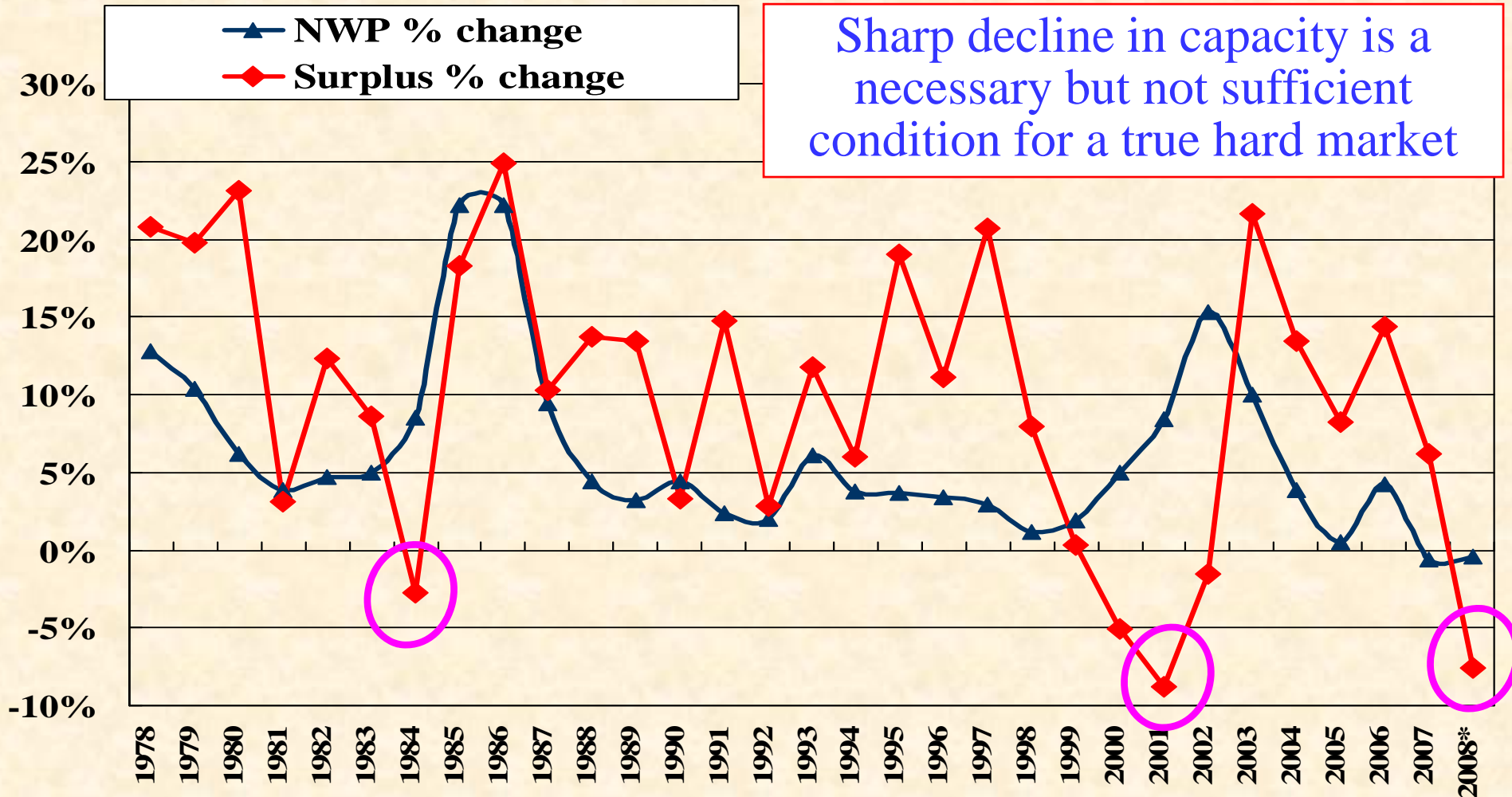


U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2008:Q3





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

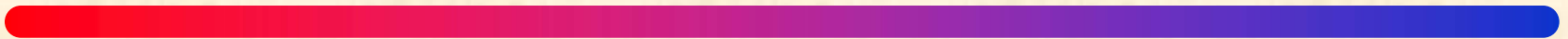


*Actual 9-month 2008 result.

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

Investment Performance

*Investments are the Principle
Source of Declining
Profitability*



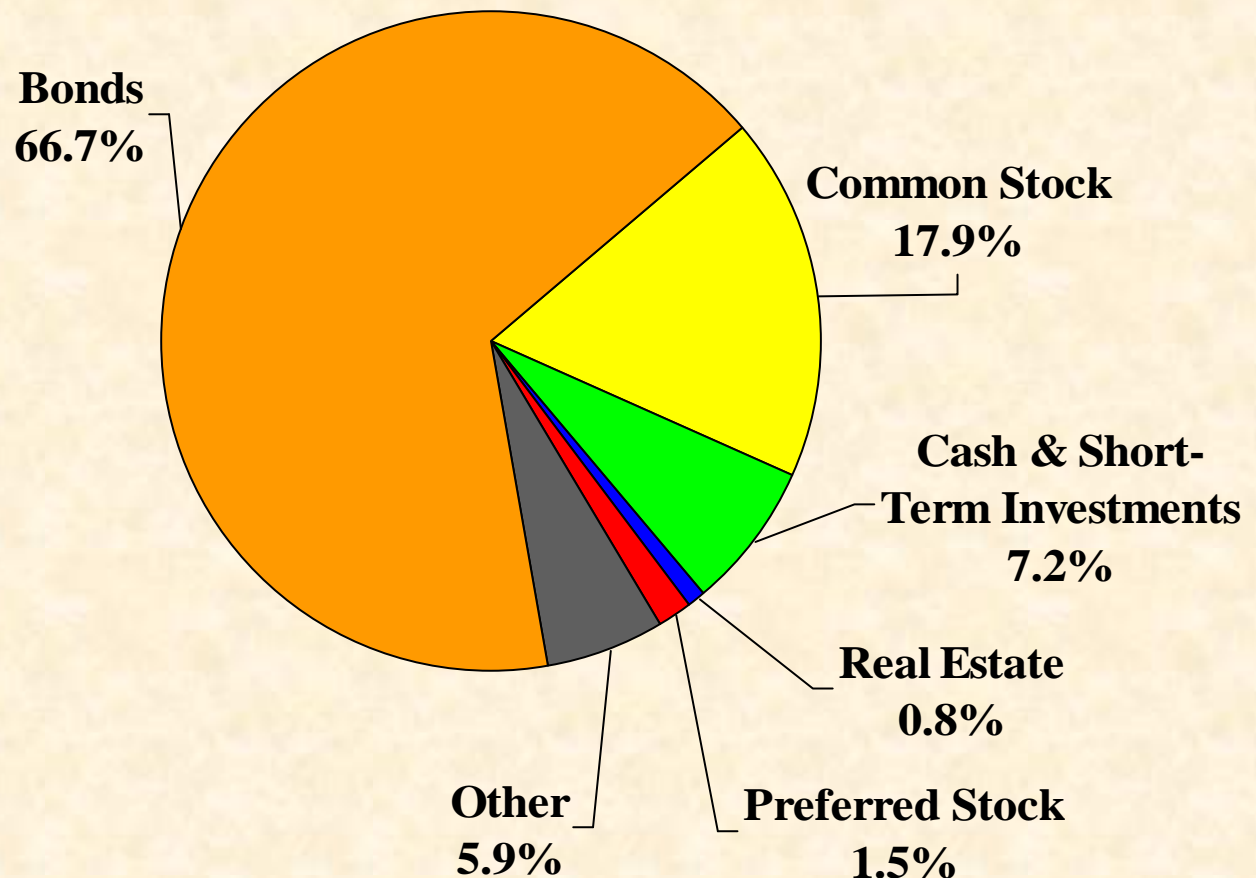


Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2007

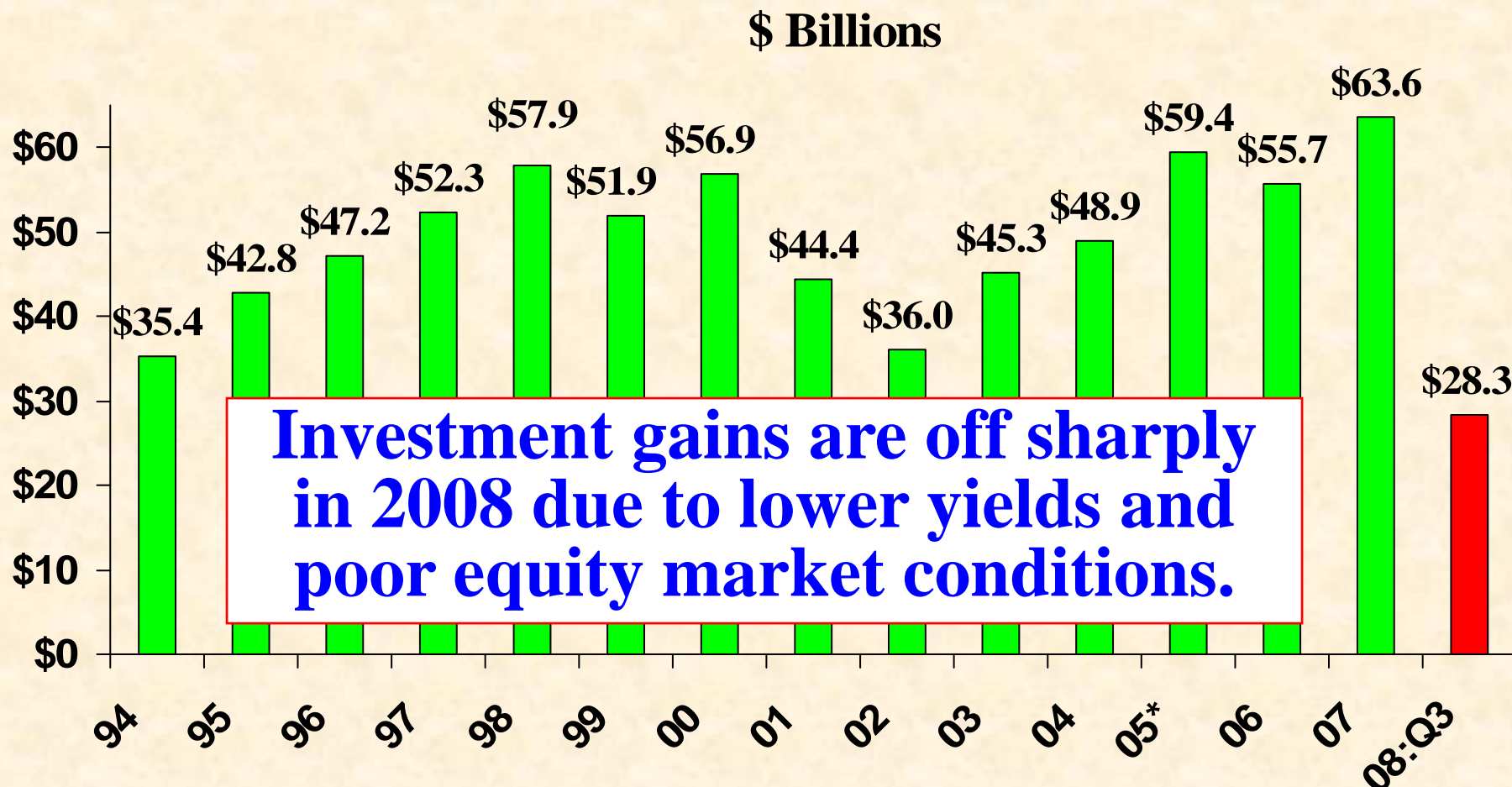
Portfolio Facts

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





Property/Casualty Insurance Industry Investment Gain: 1994- 2008:Q3 ¹



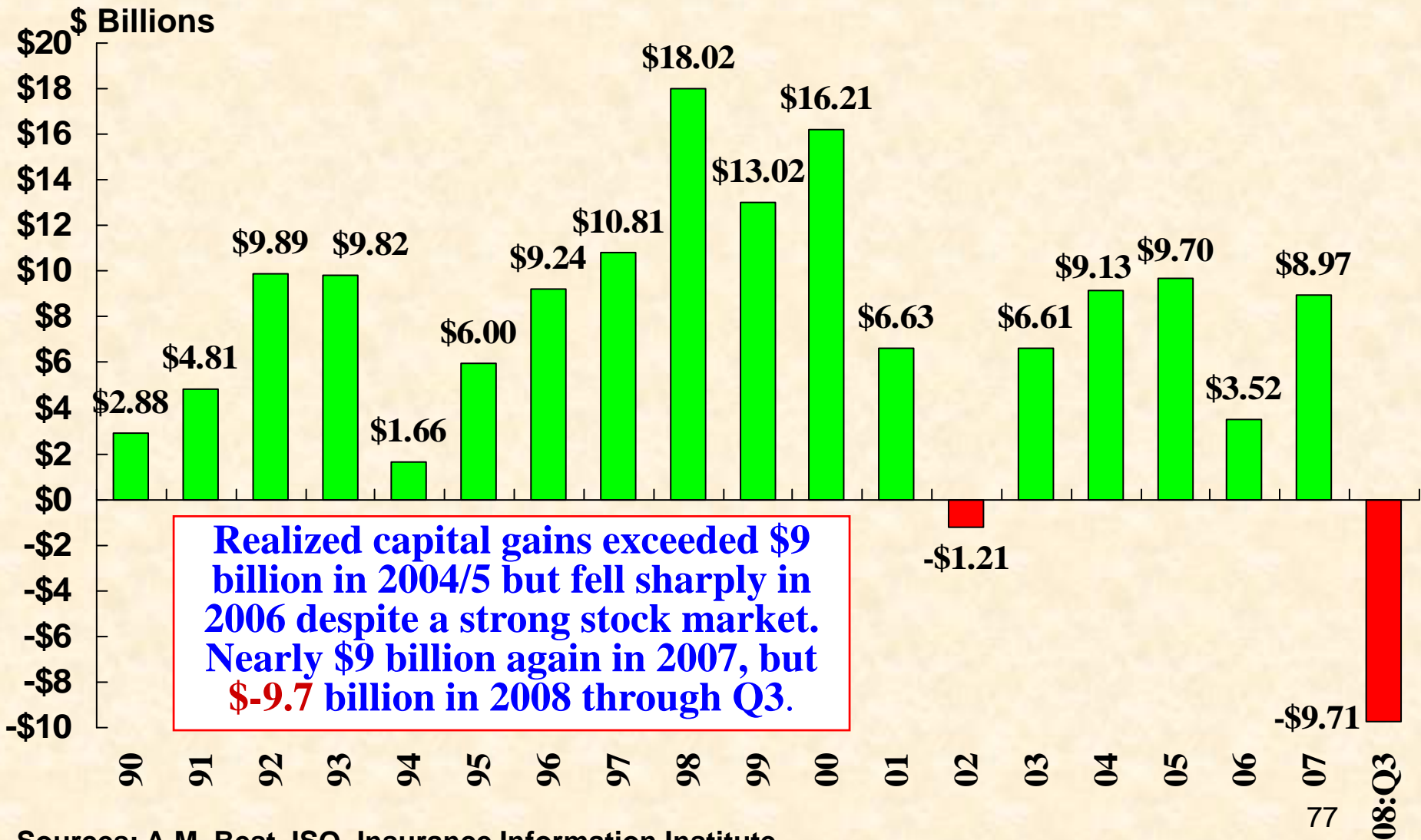
¹Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain.

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

Sources: ISO; Insurance Information Institute.



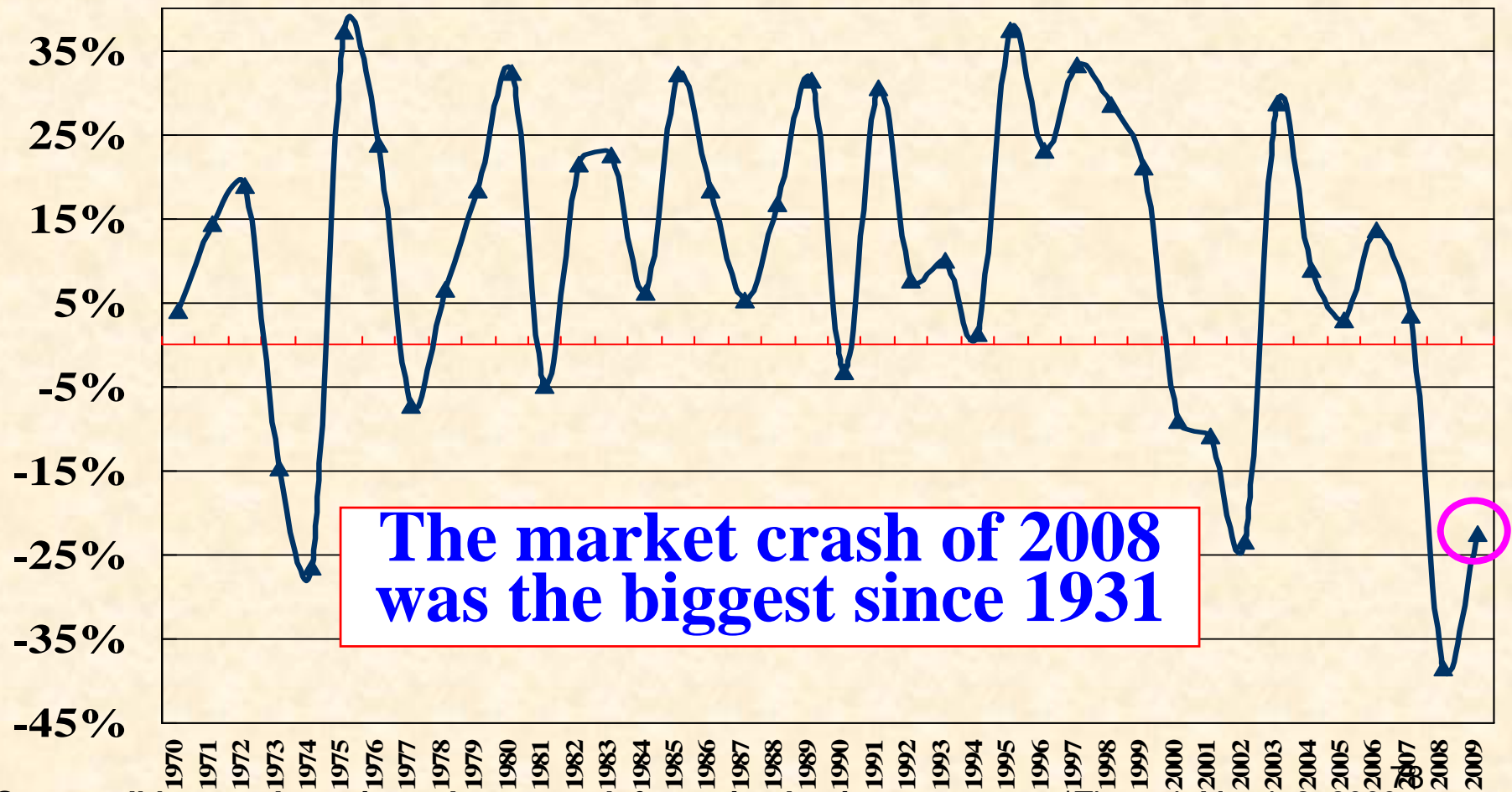
P/C Insurer Net Realized Capital Gains, 1990-2008:Q3





Total Returns for Large Company Stocks: 1970-2009*

S&P 500 was down 22.4% in 2009*

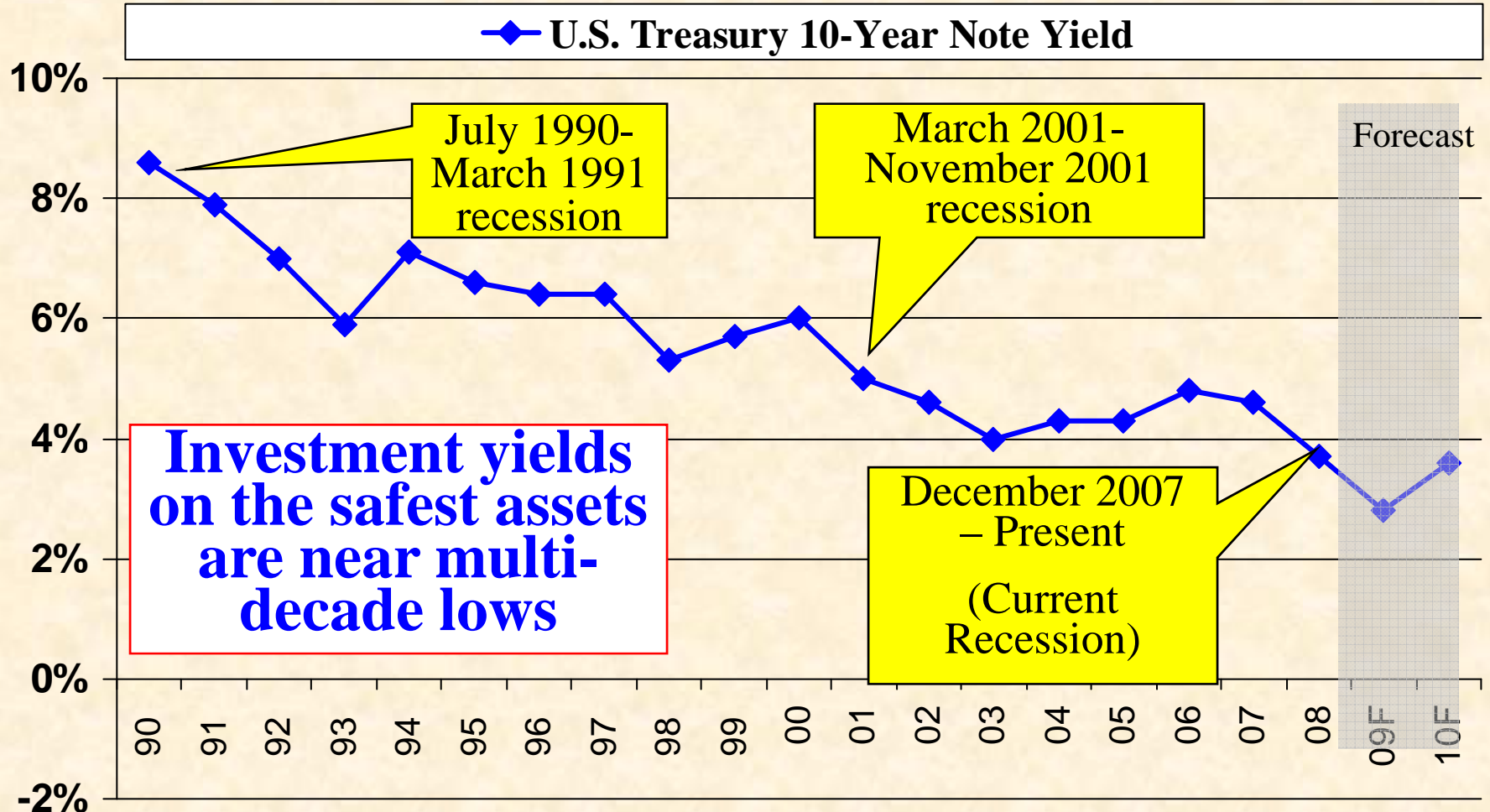


Source: Ibbotson Associates, Insurance Information Institute.

*Through March 2, 2009.



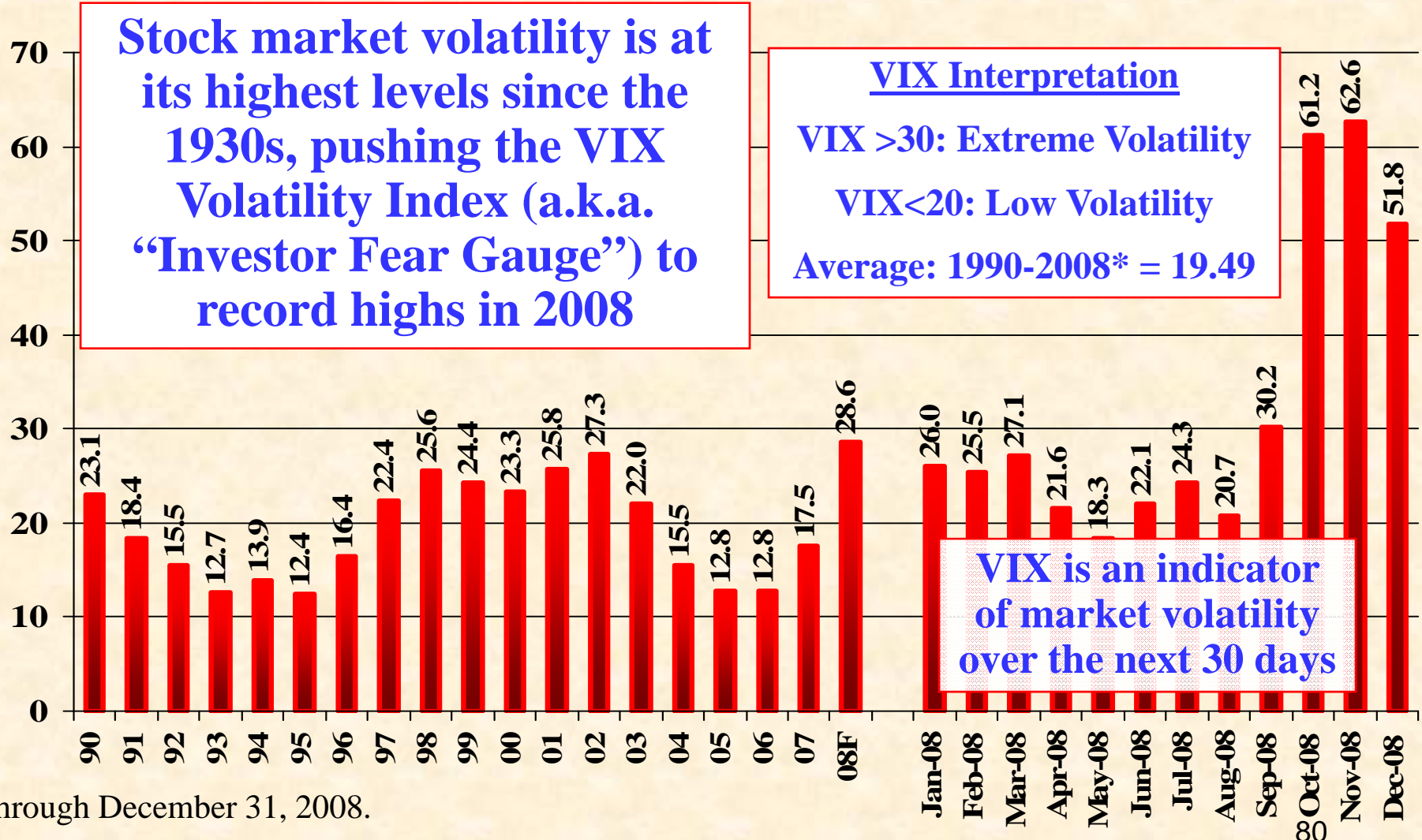
Treasury Bond Yields Have Generally Been Falling



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



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

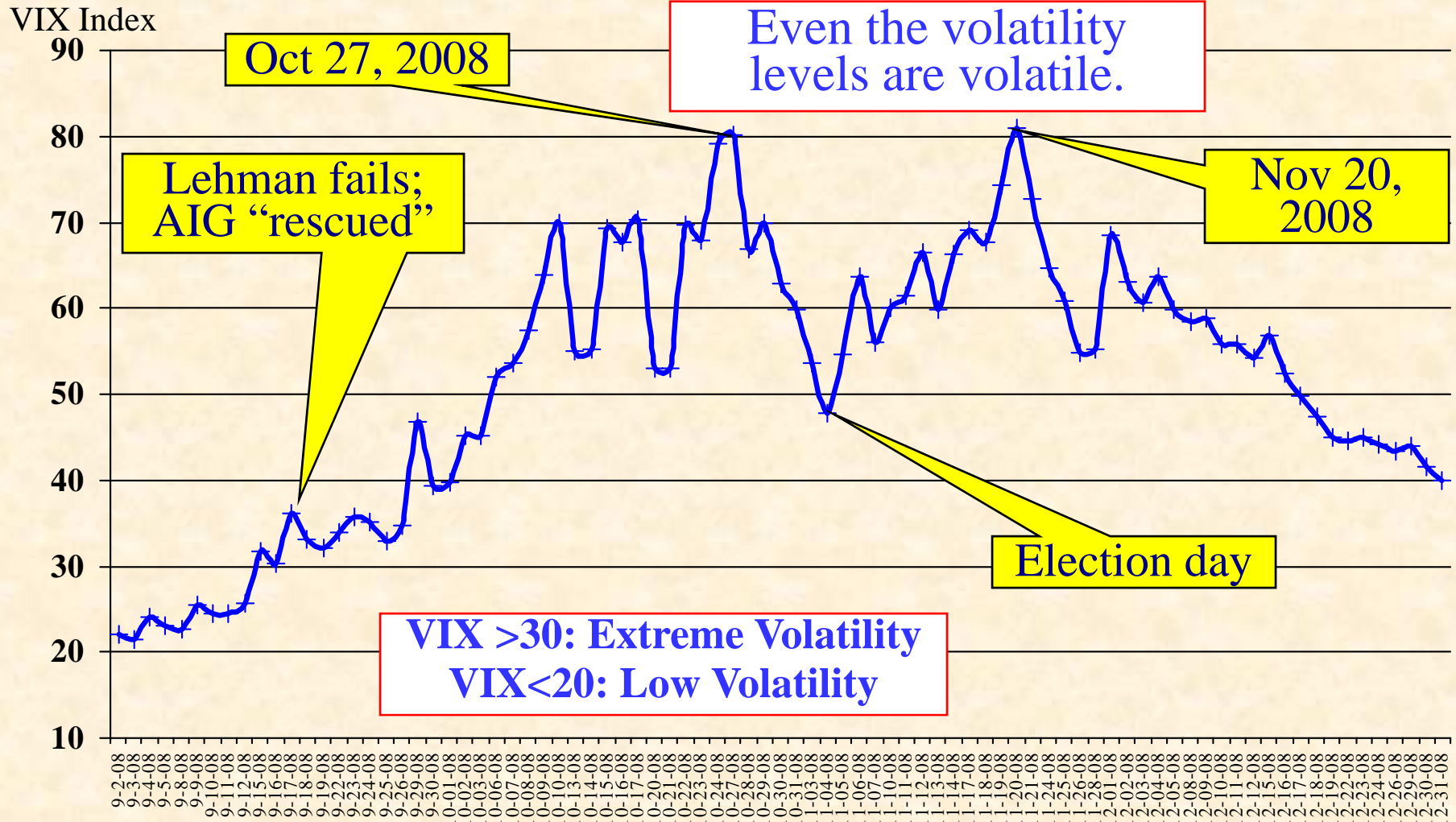


*Through December 31, 2008.

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



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

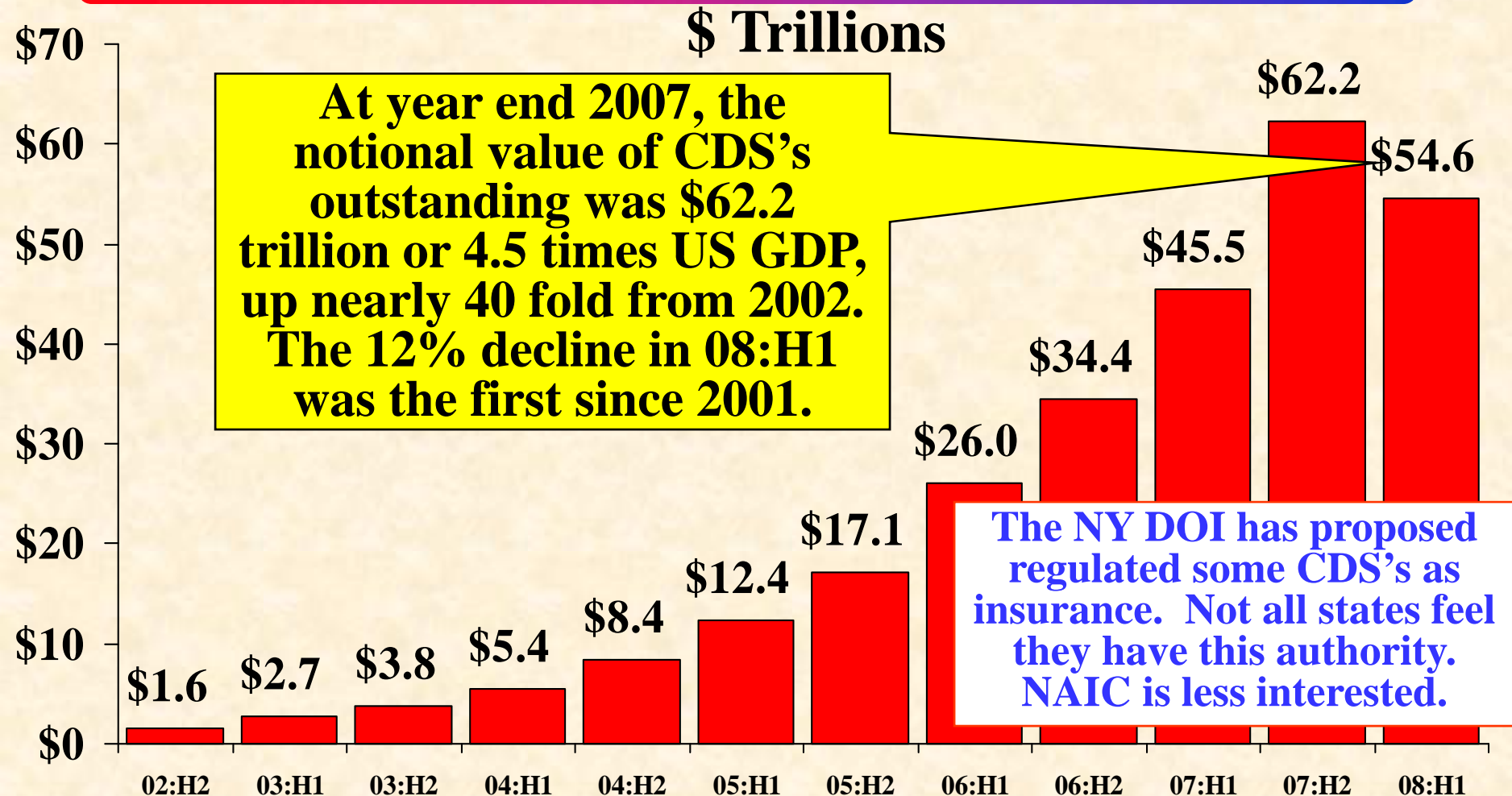


*September 2 to December 31, 2008.

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>

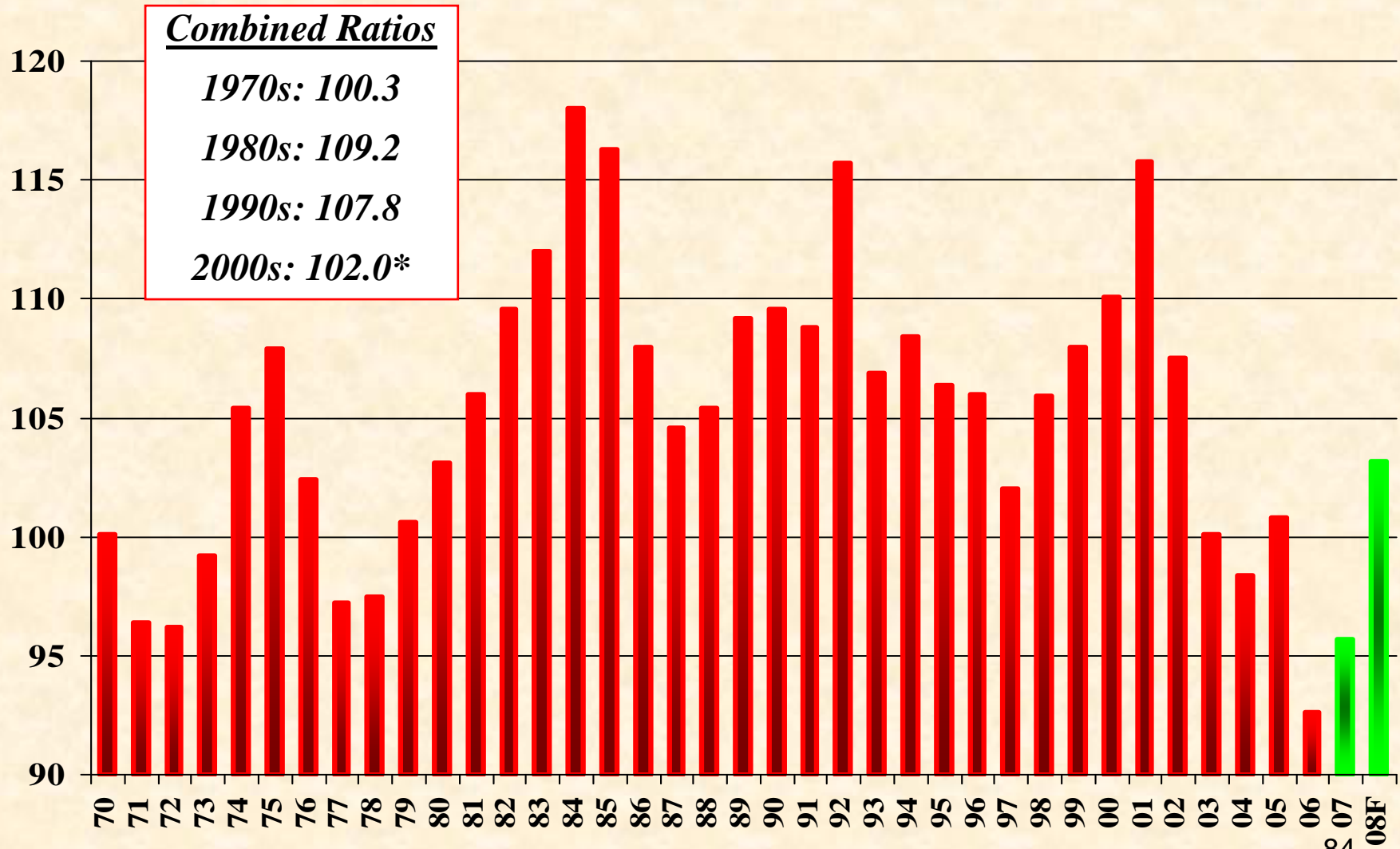
Underwriting Trends

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





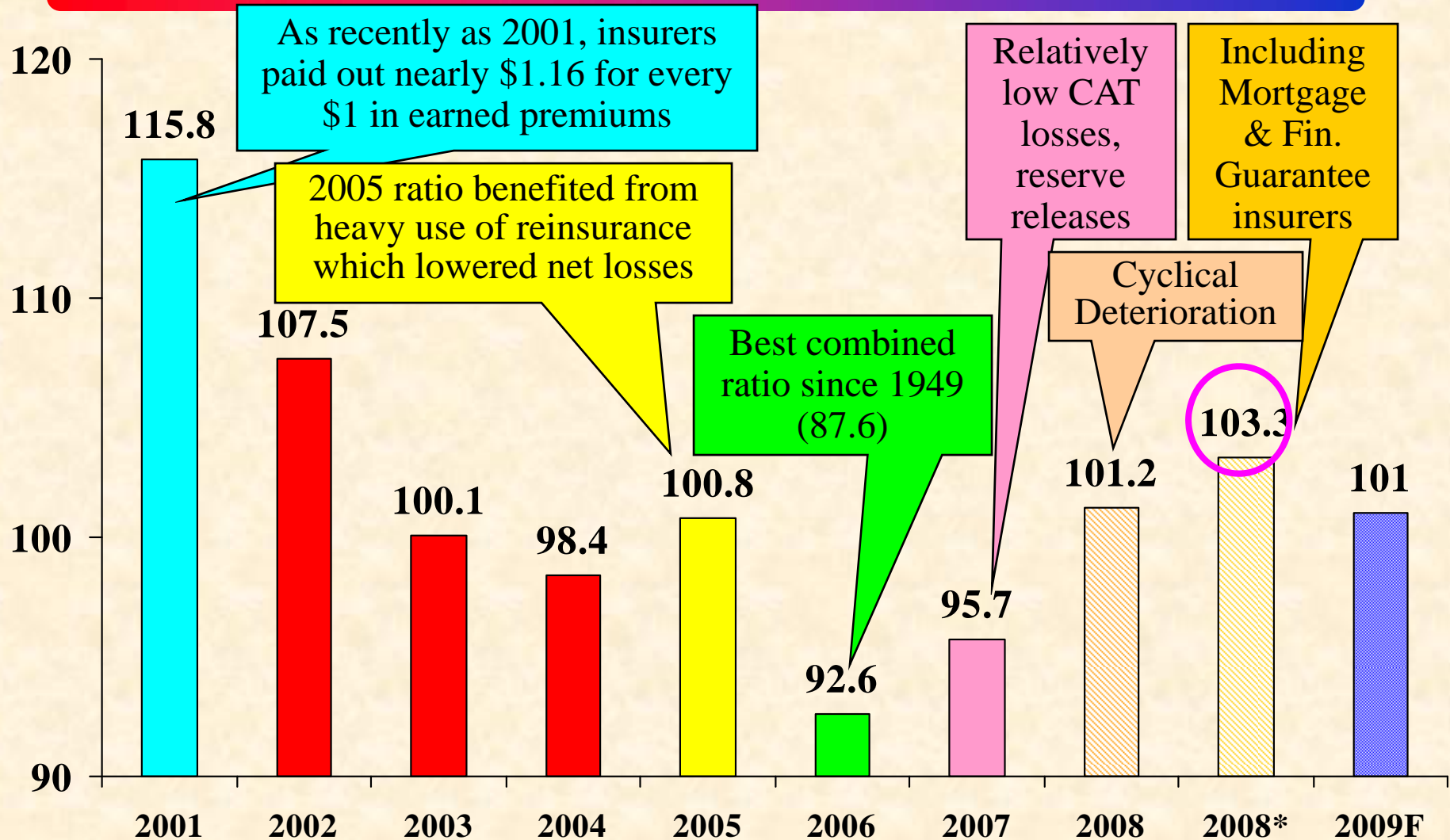
*P/C Insurance Combined Ratio, 1970-2008F**



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.

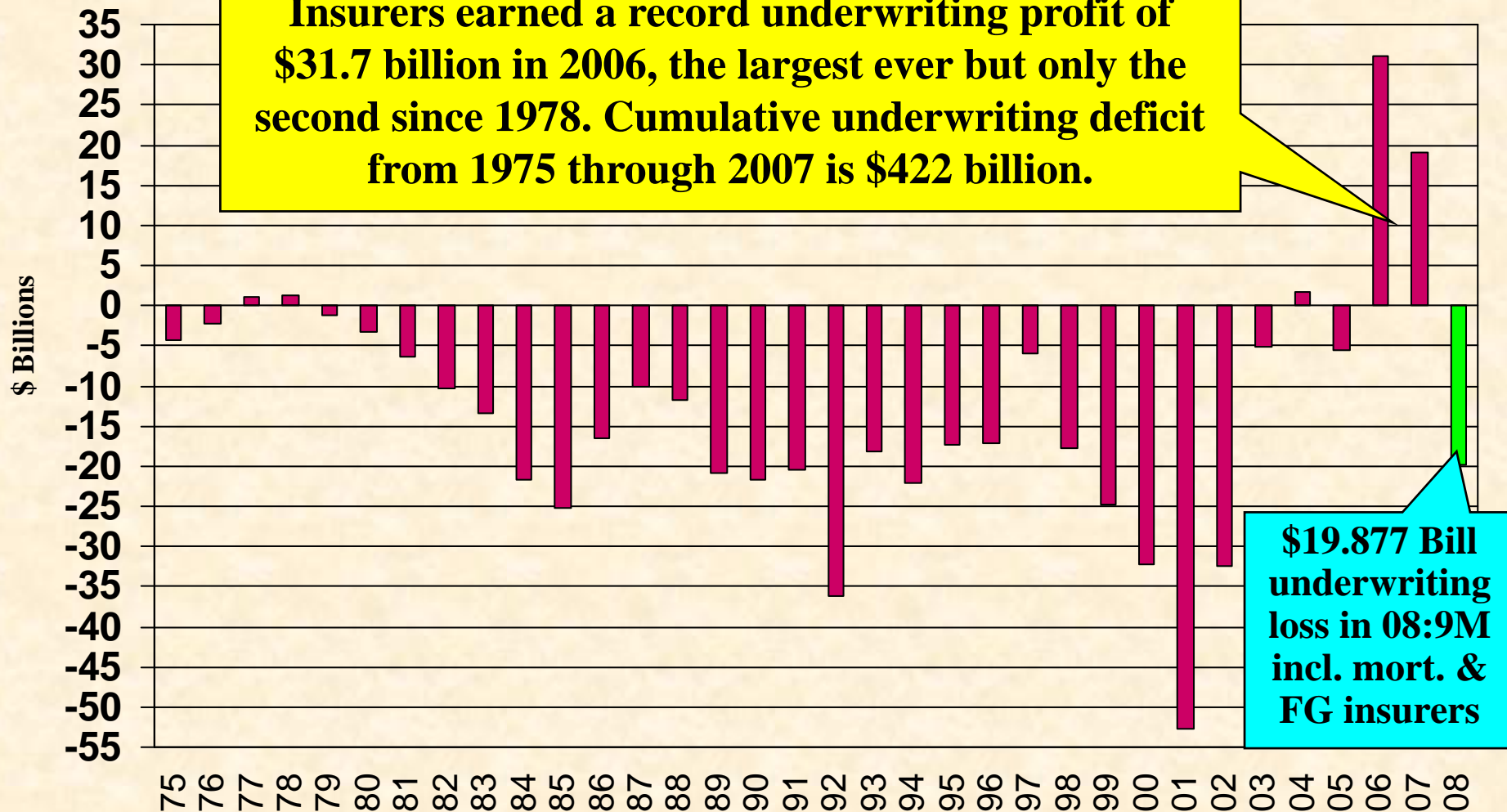
Sources: A.M. Best.



Underwriting Gain (Loss)

*1975-2008:Q3**

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.

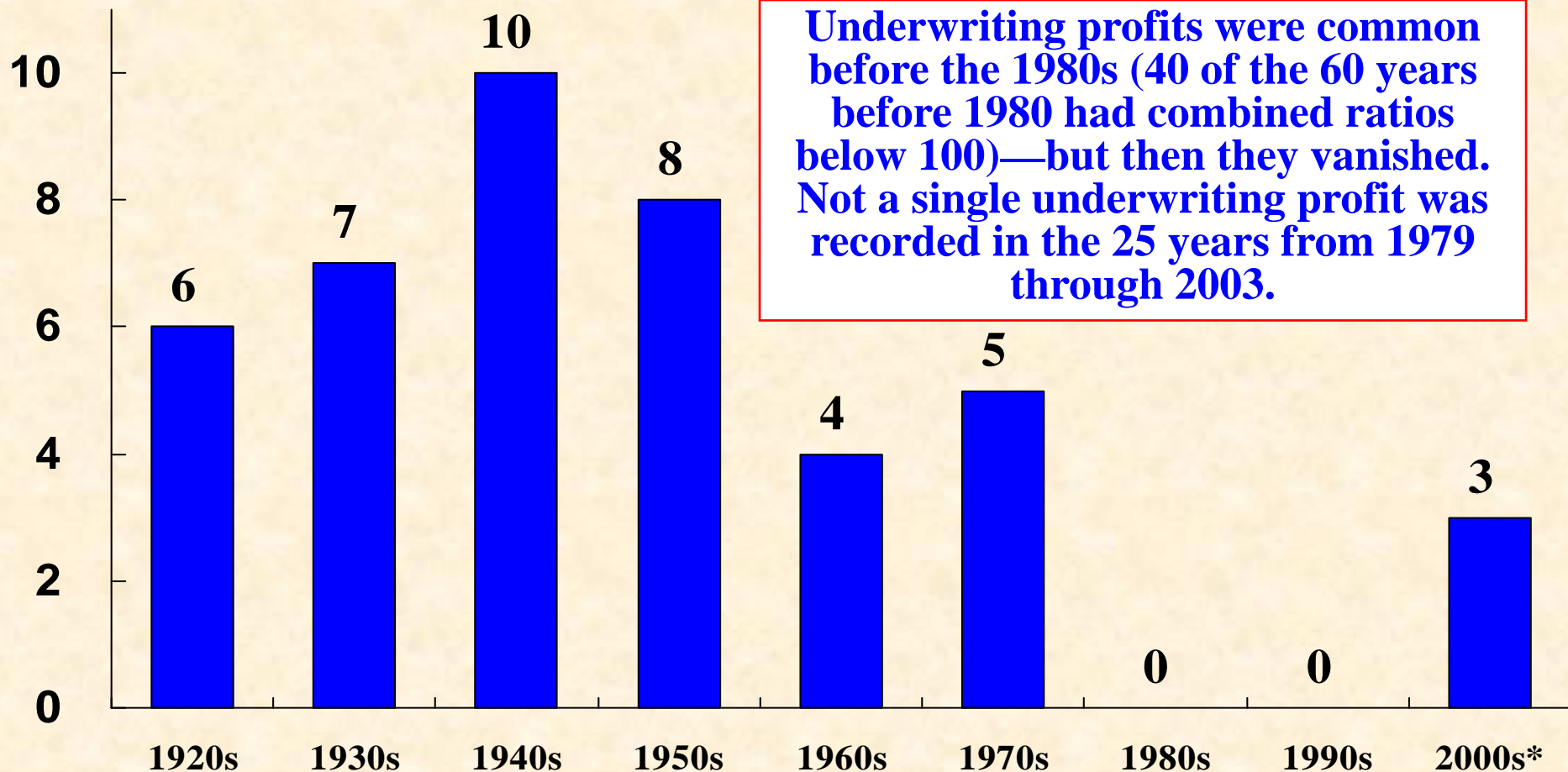


**\$19.877 Bill
underwriting
loss in 08:9M
incl. mort. &
FG insurers**



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

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.

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

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

87

*2000 through 2008.

Personal Lines

Auto (~75% of Market)

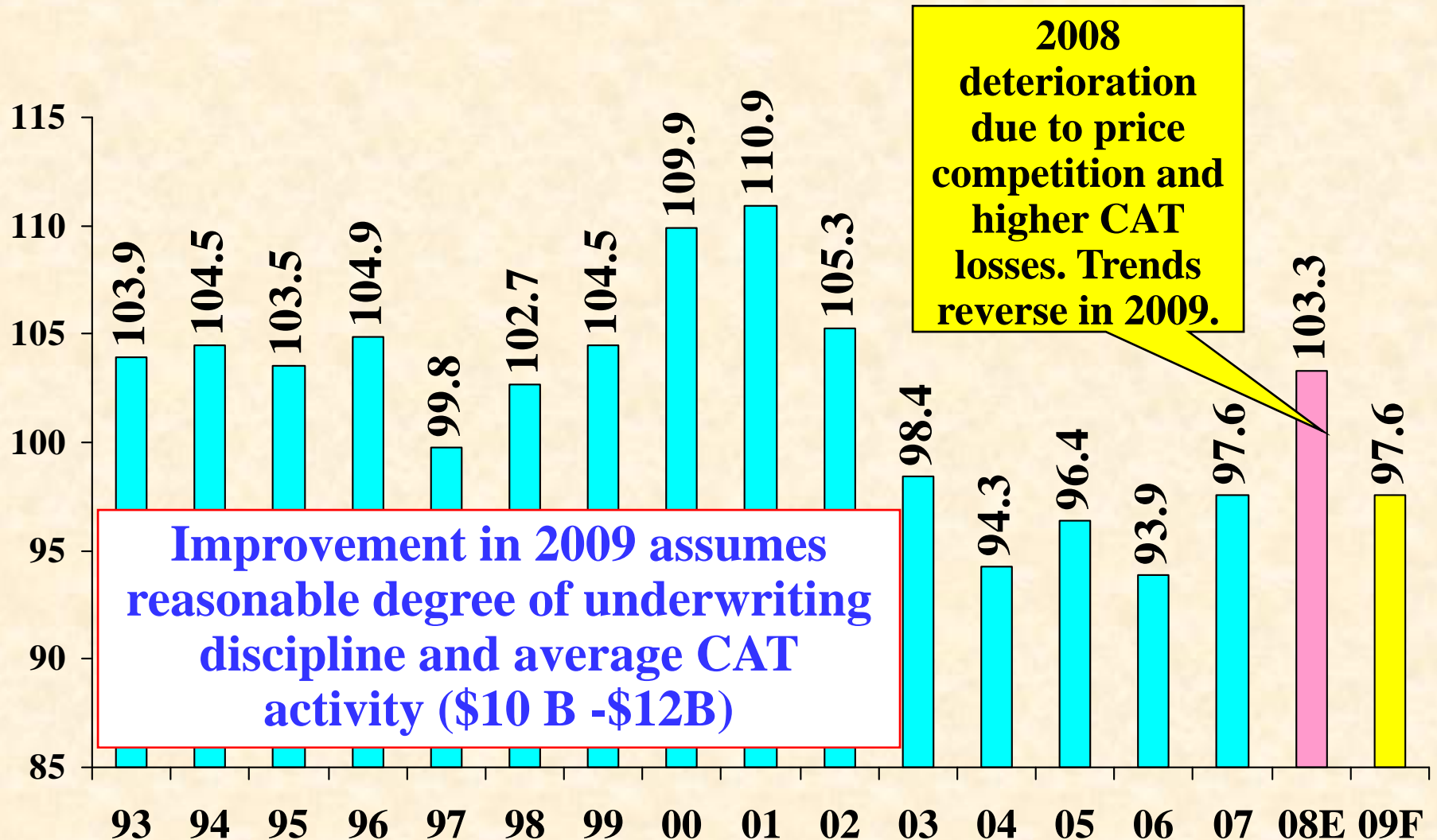
Home (~25%)





Personal Lines

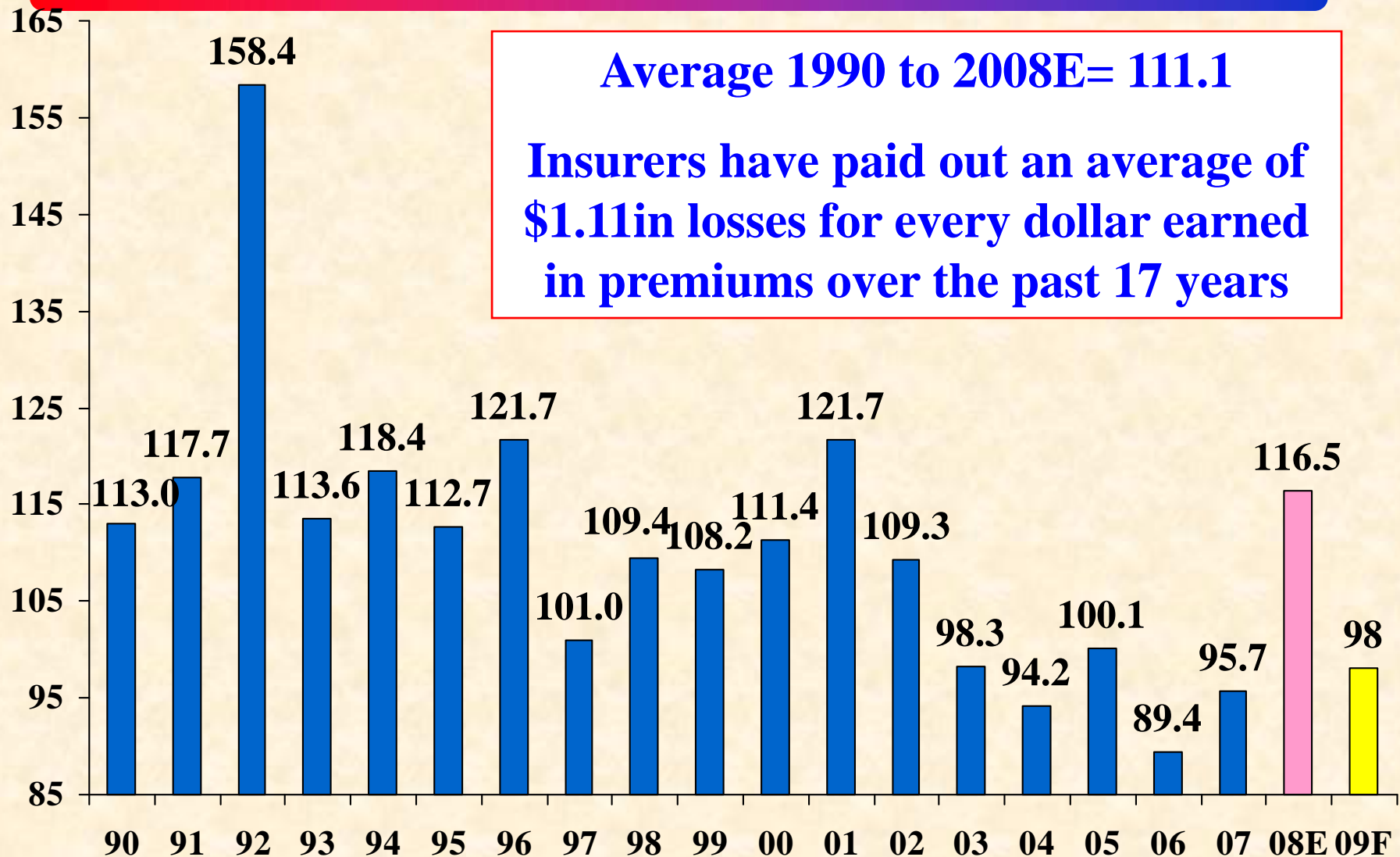
Combined Ratio, 1993-2009F



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



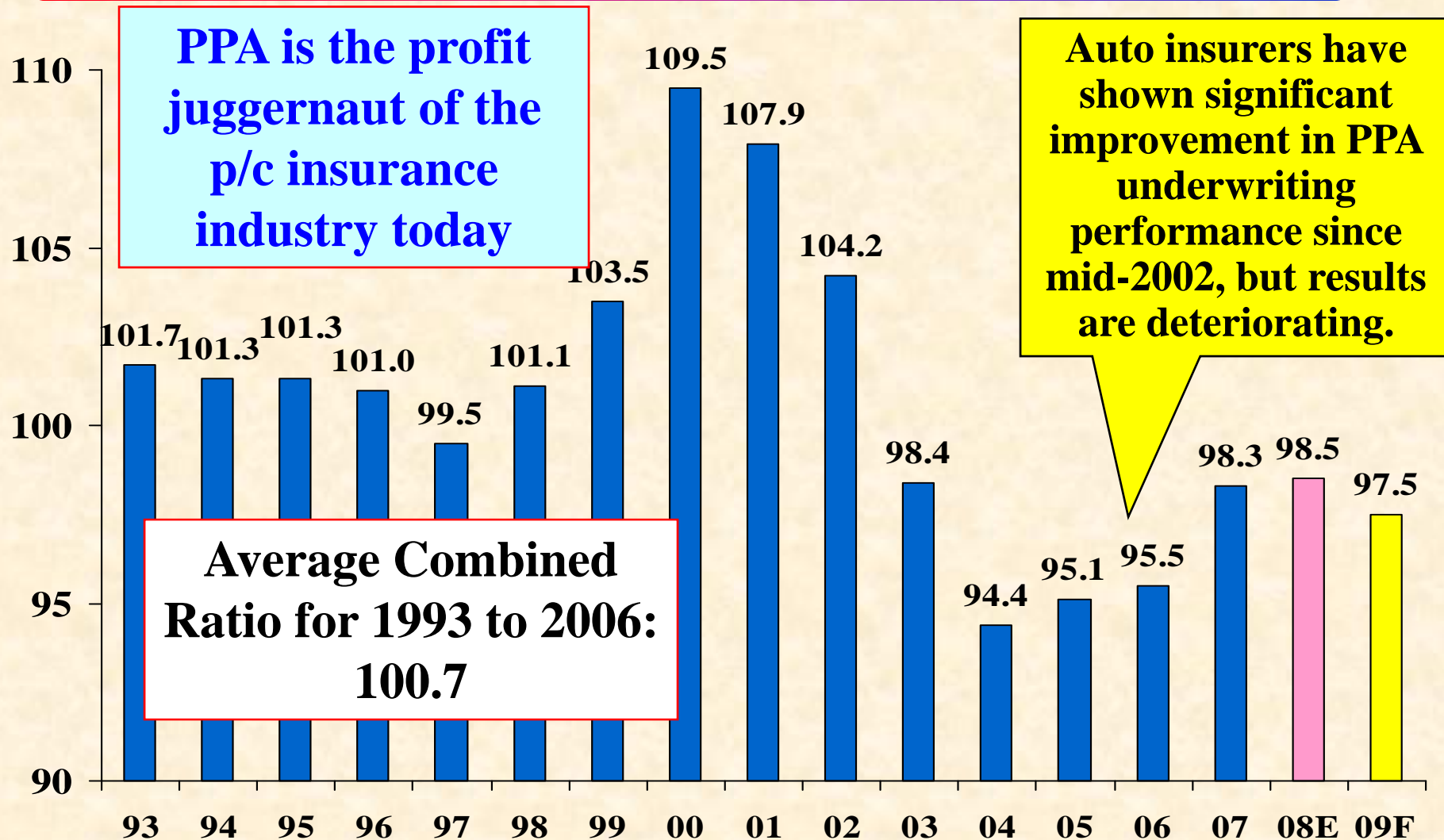
Homeowners Insurance Combined Ratio



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



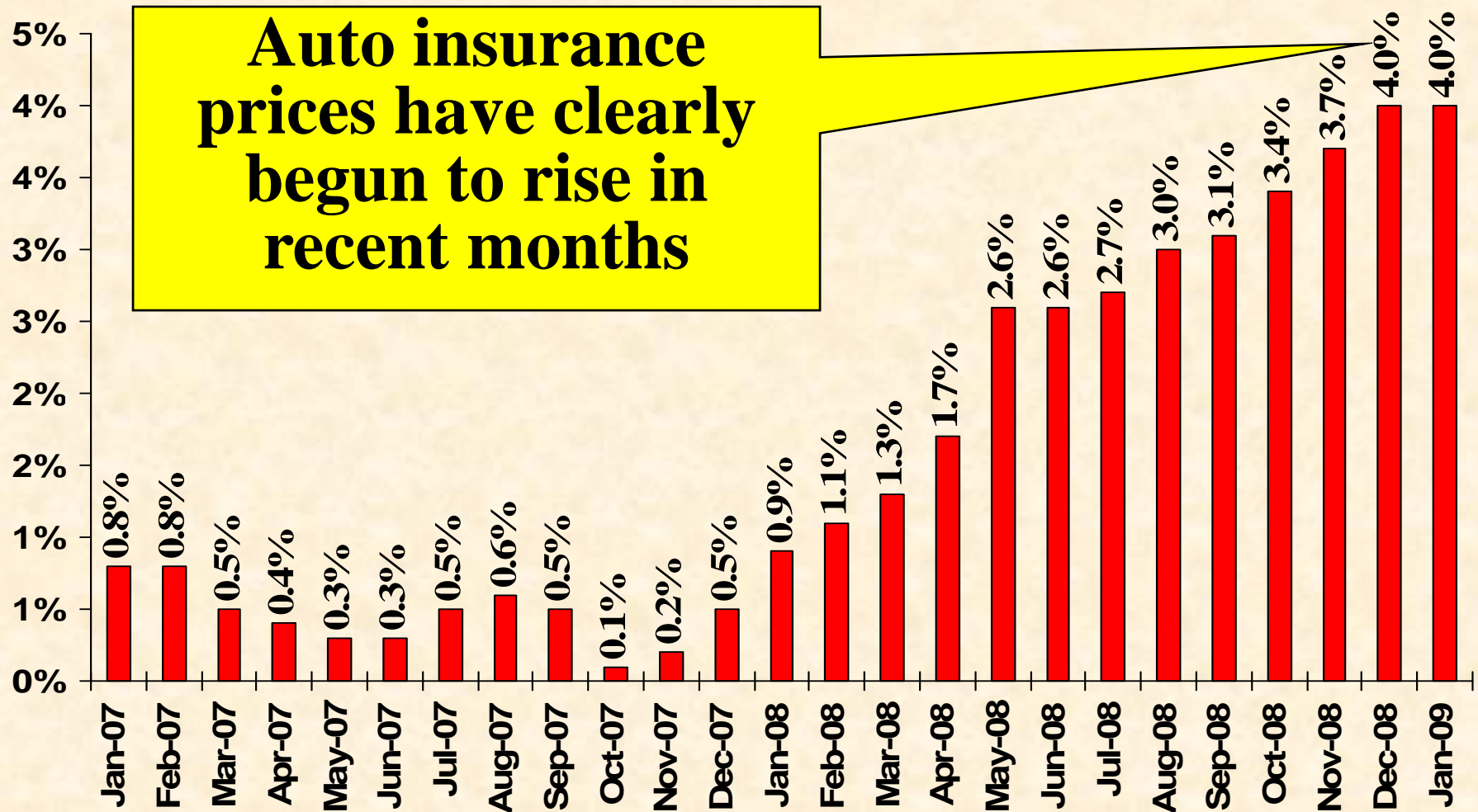
Private Passenger Auto (PPA) Combined Ratio



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



*Monthly Change in Auto Insurance Prices**



*Percentage change from same month in prior year.

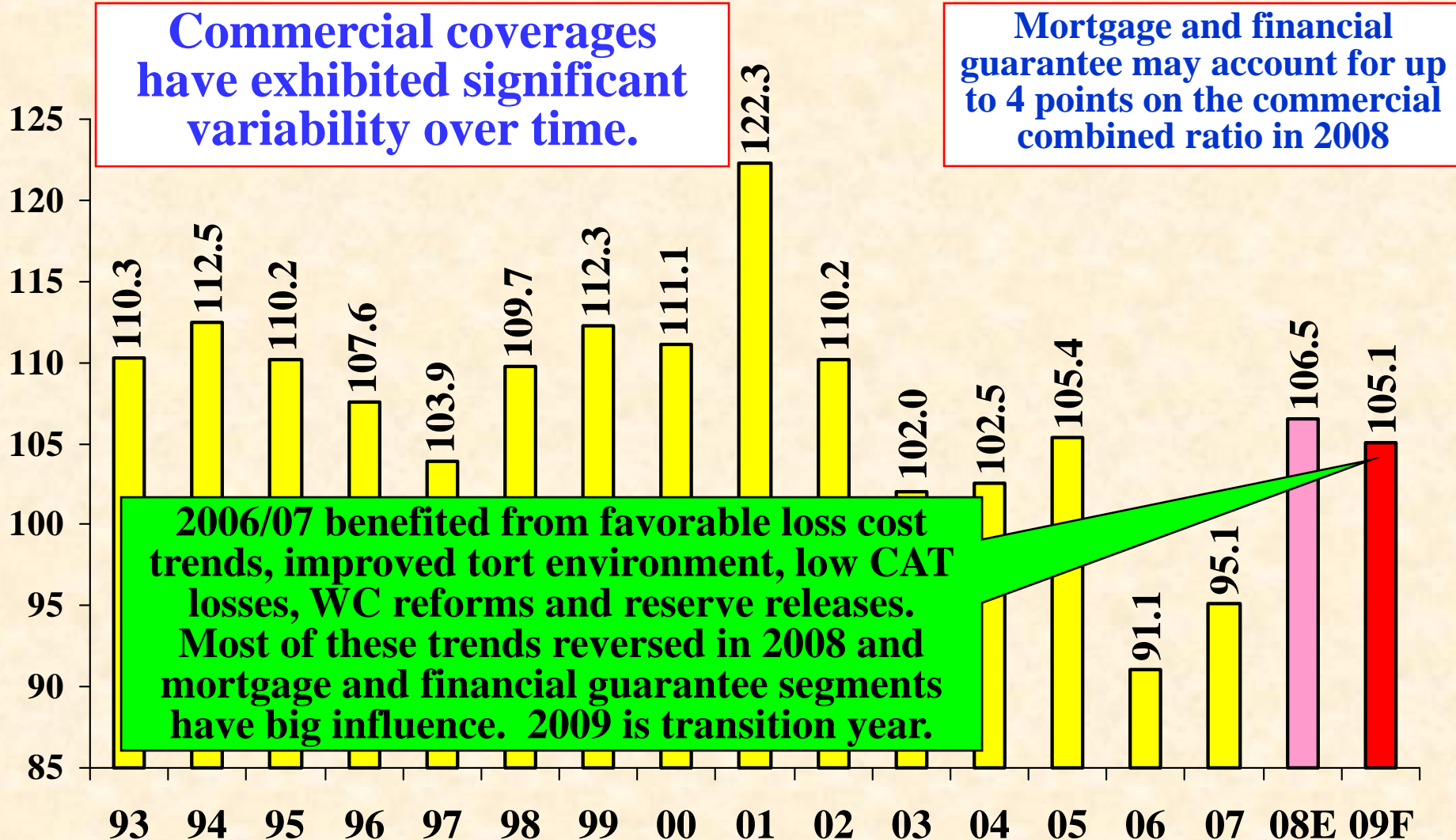
Source: US Bureau of Labor Statistics

Commercial Lines



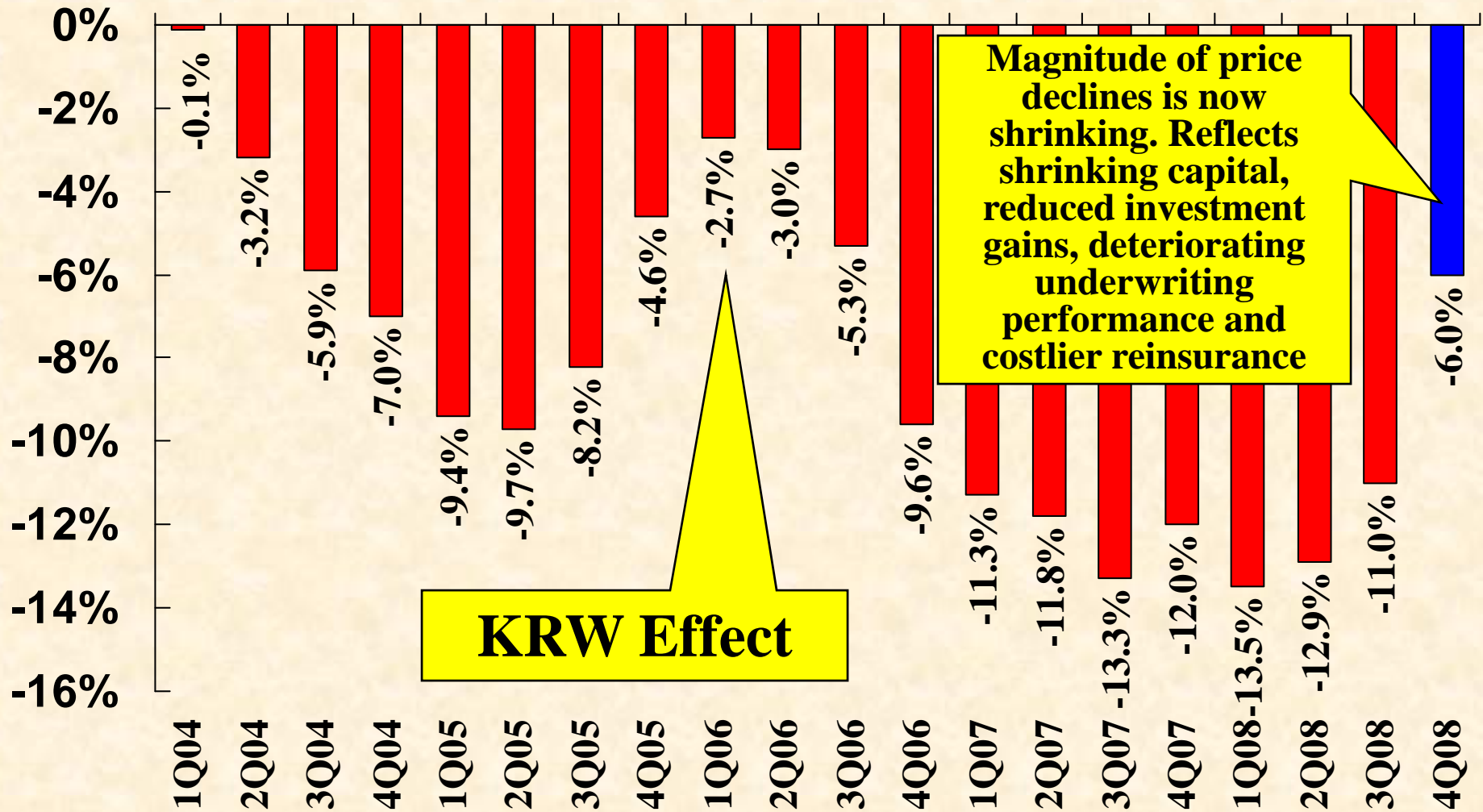


Commercial Lines Combined Ratio, 1993-2009F





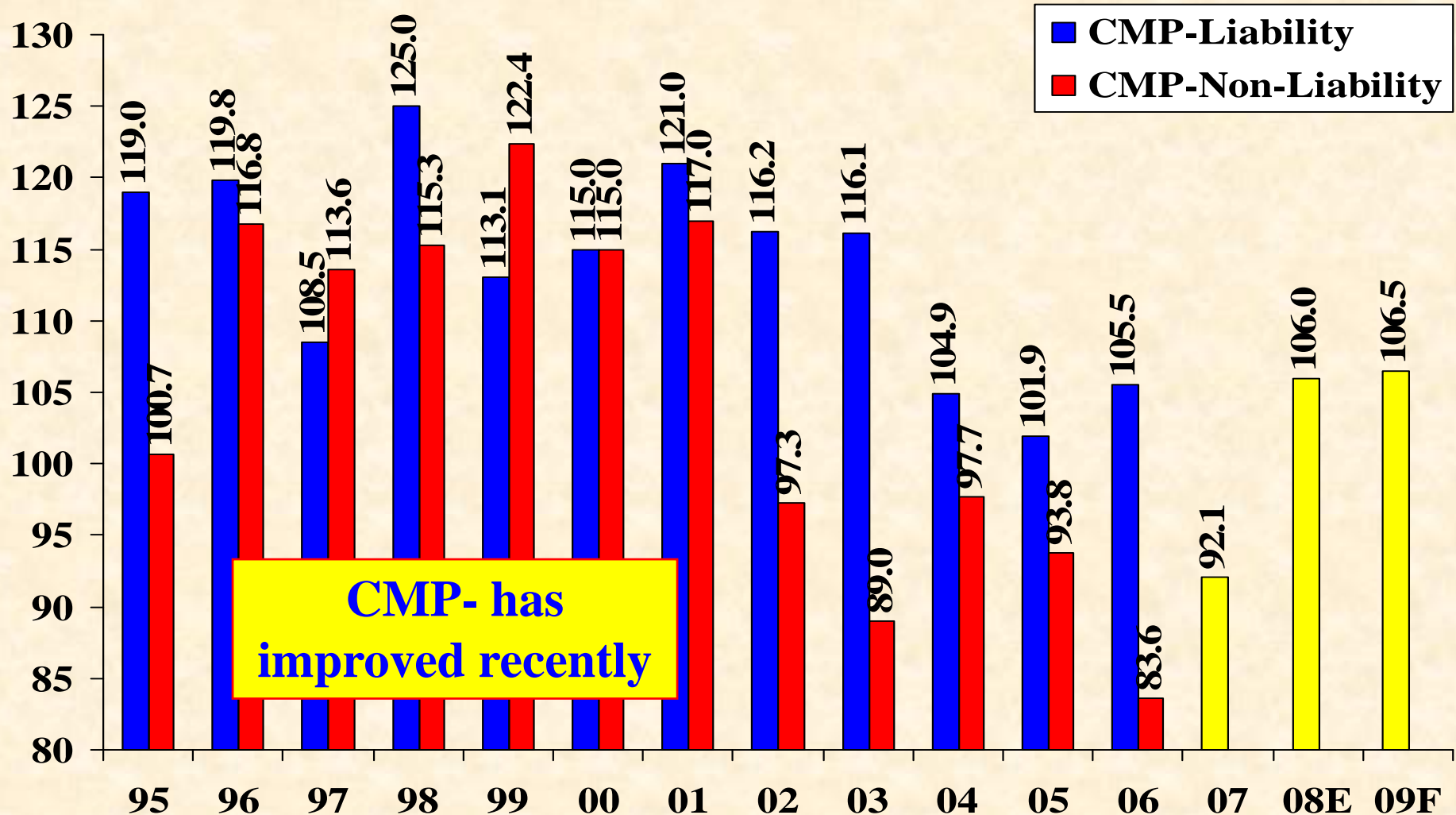
Average Commercial Rate Change, All Lines, (1Q:2004 – 4Q:2008)





Commercial Multi-Peril Combined

(Liability vs. Non-Liability Portion)*

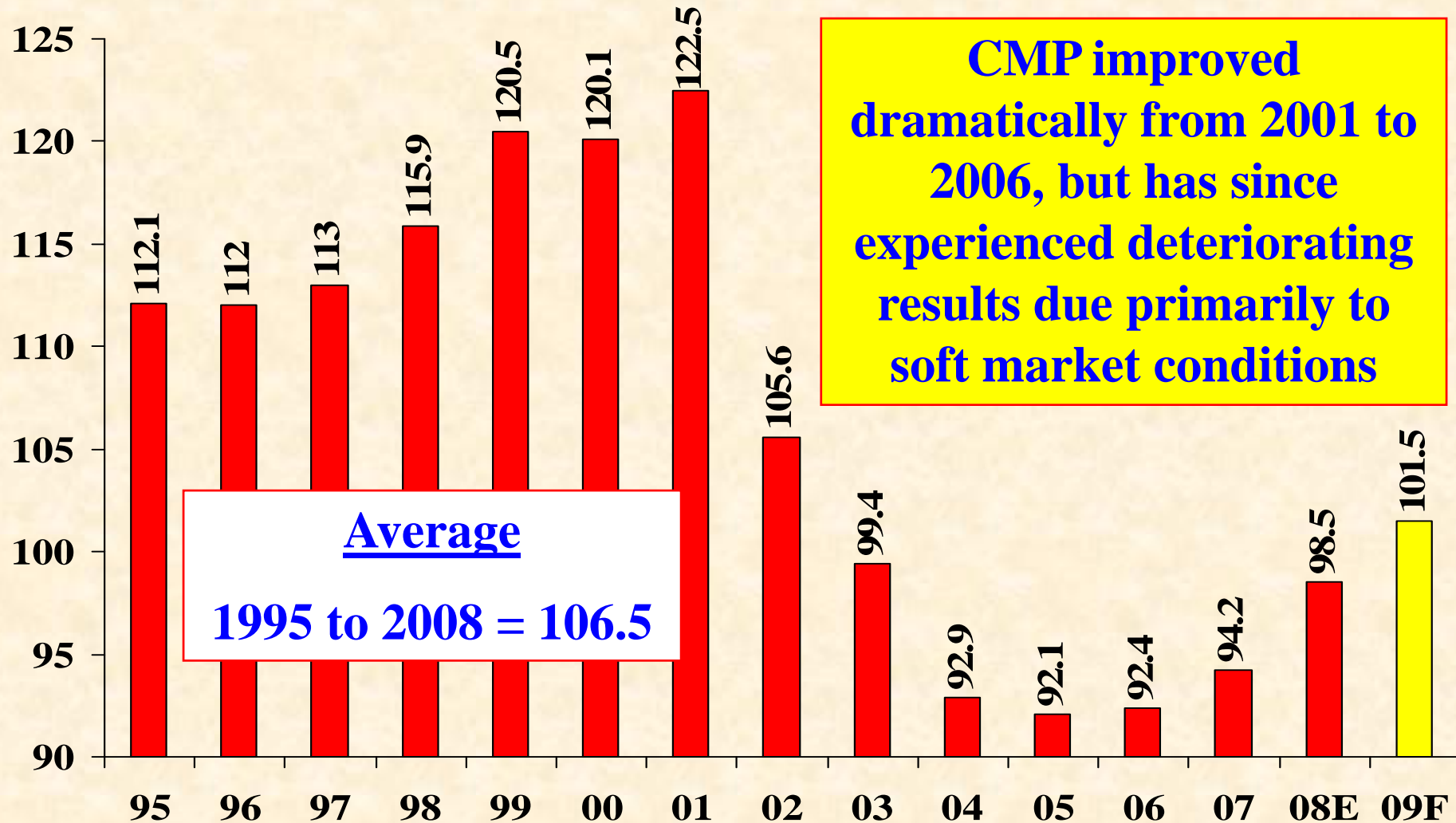


Sources: A.M. Best (historical and forecasts)

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

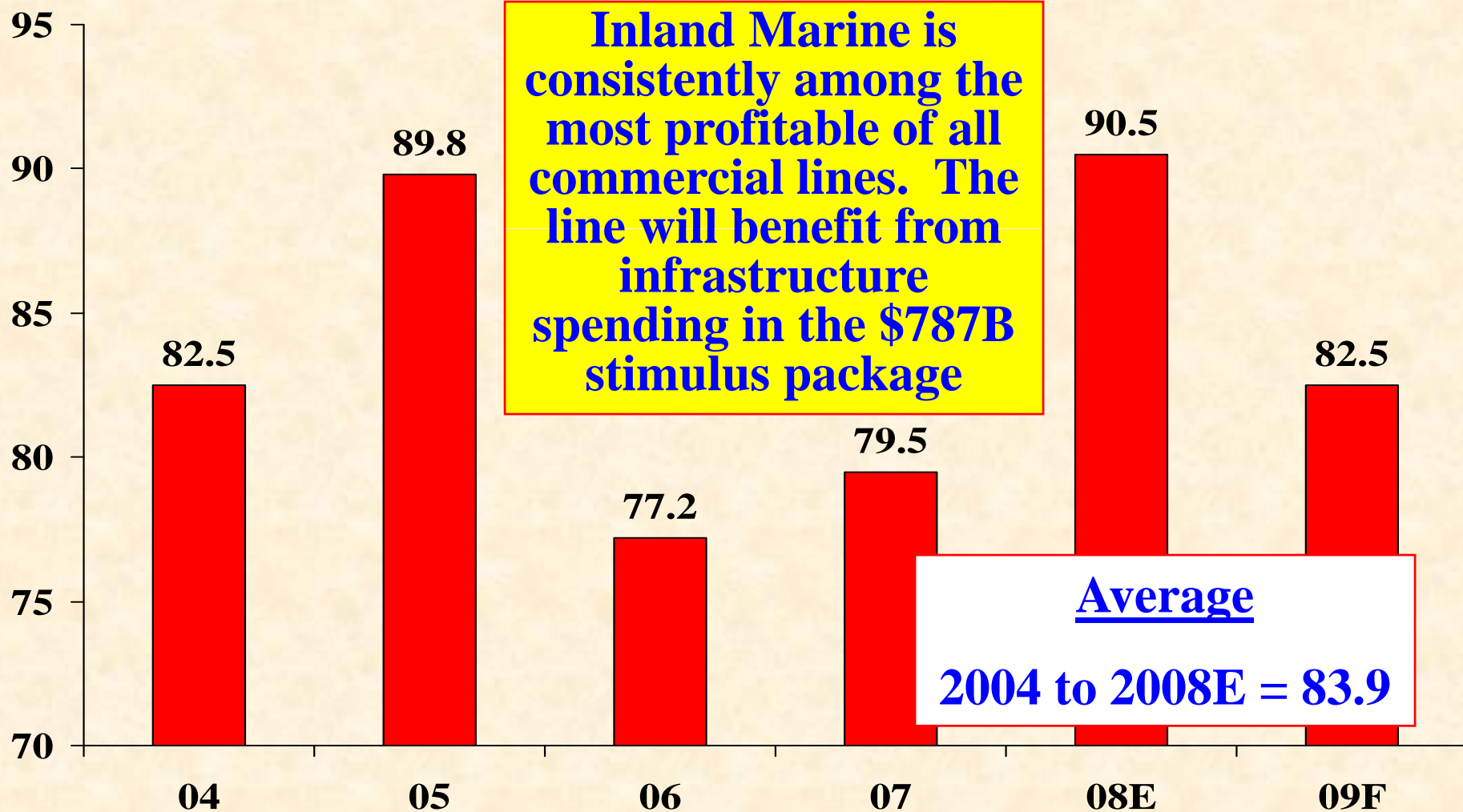


Commercial Auto Combined Ratio (1995-2009F)



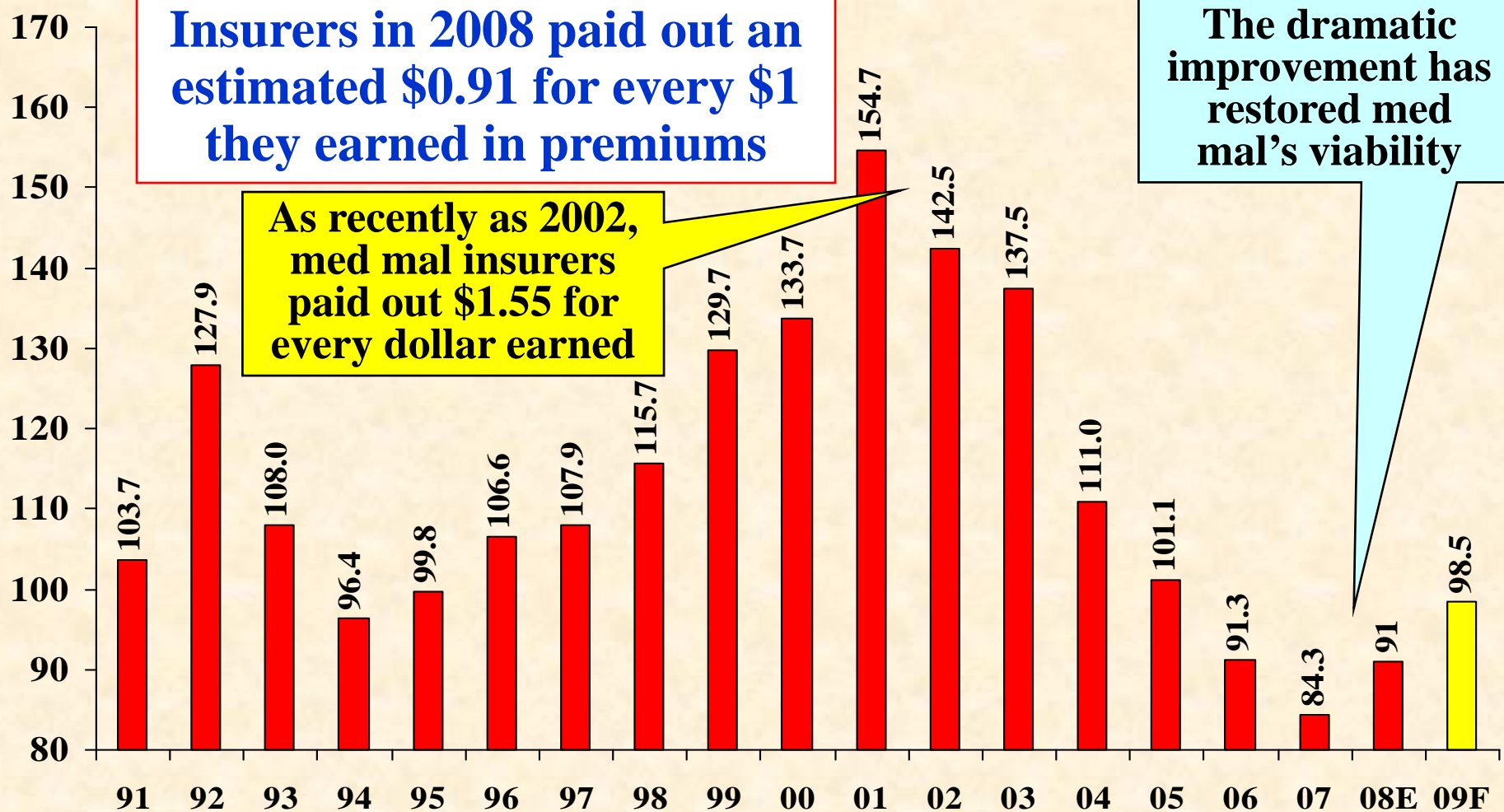


Inland Marine Combined Ratio (2004-2009F)





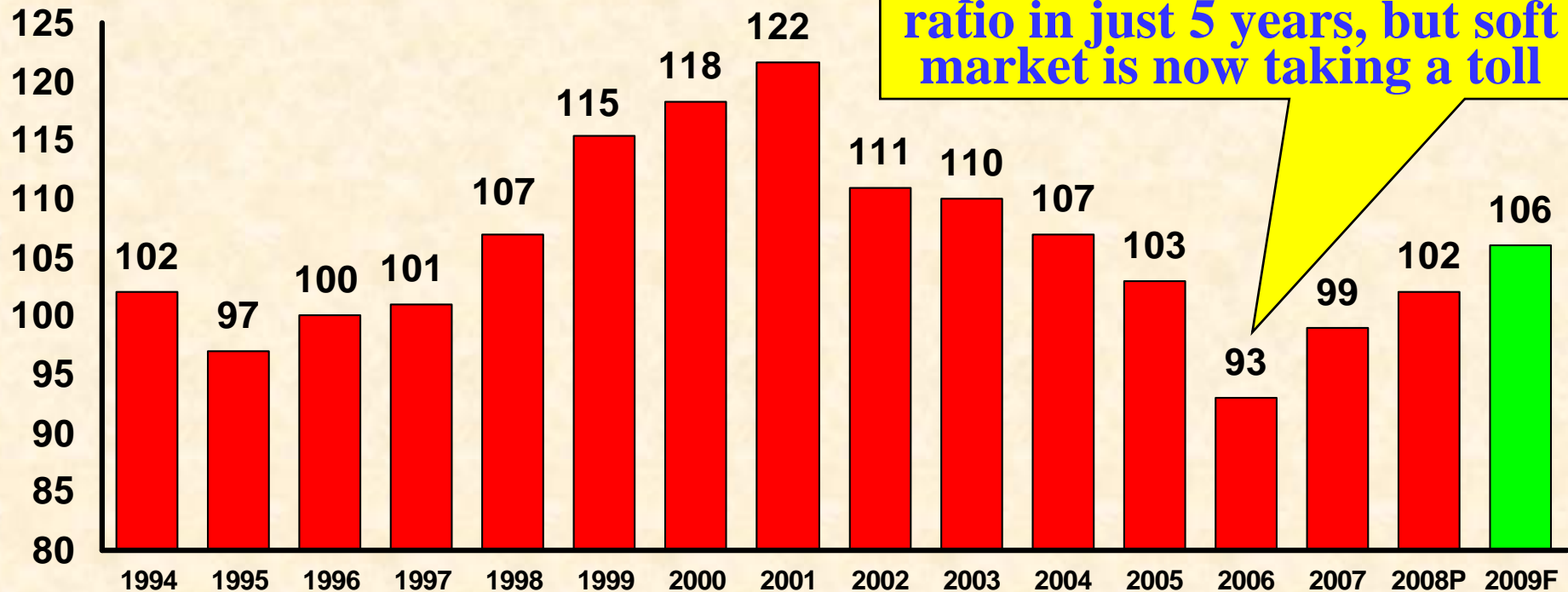
Medical Malpractice Combined Ratio





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

Percent



WC insurers lopped 30 points off the combined ratio in just 5 years, but soft market is now taking a toll

p Preliminary.

Sources: Calendar Years 1994-2007, A.M. Best Aggregates & Averages; Calendar Year 2008p and 2009F are I.I.I. estimates for private carriers based A.M. Best Review and Preview 2009; NCCI

Includes dividends to policyholders

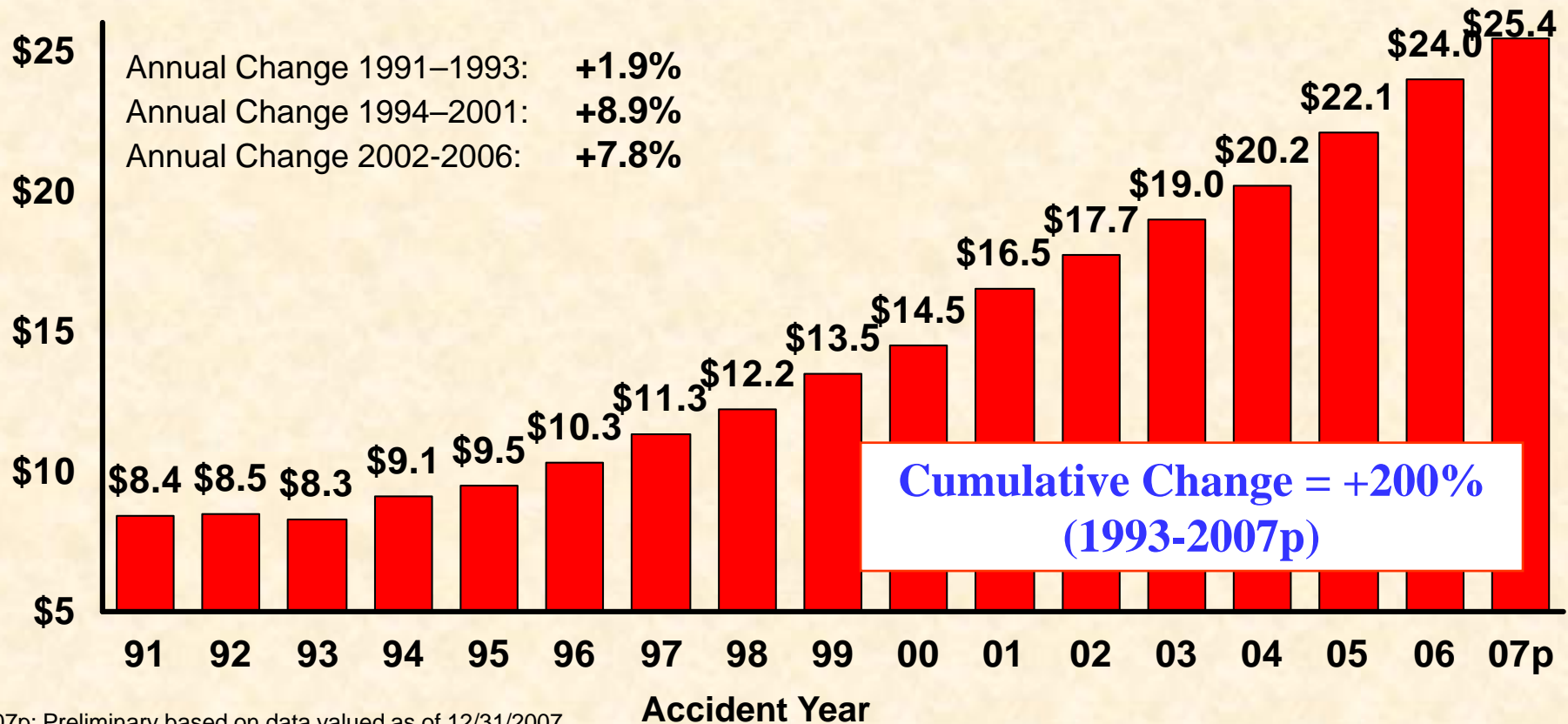
Workers Compensation Medical Claim Trends





Workers Comp Medical Claims Costs Continue to Climb

Medical
Claim Cost (\$000s)



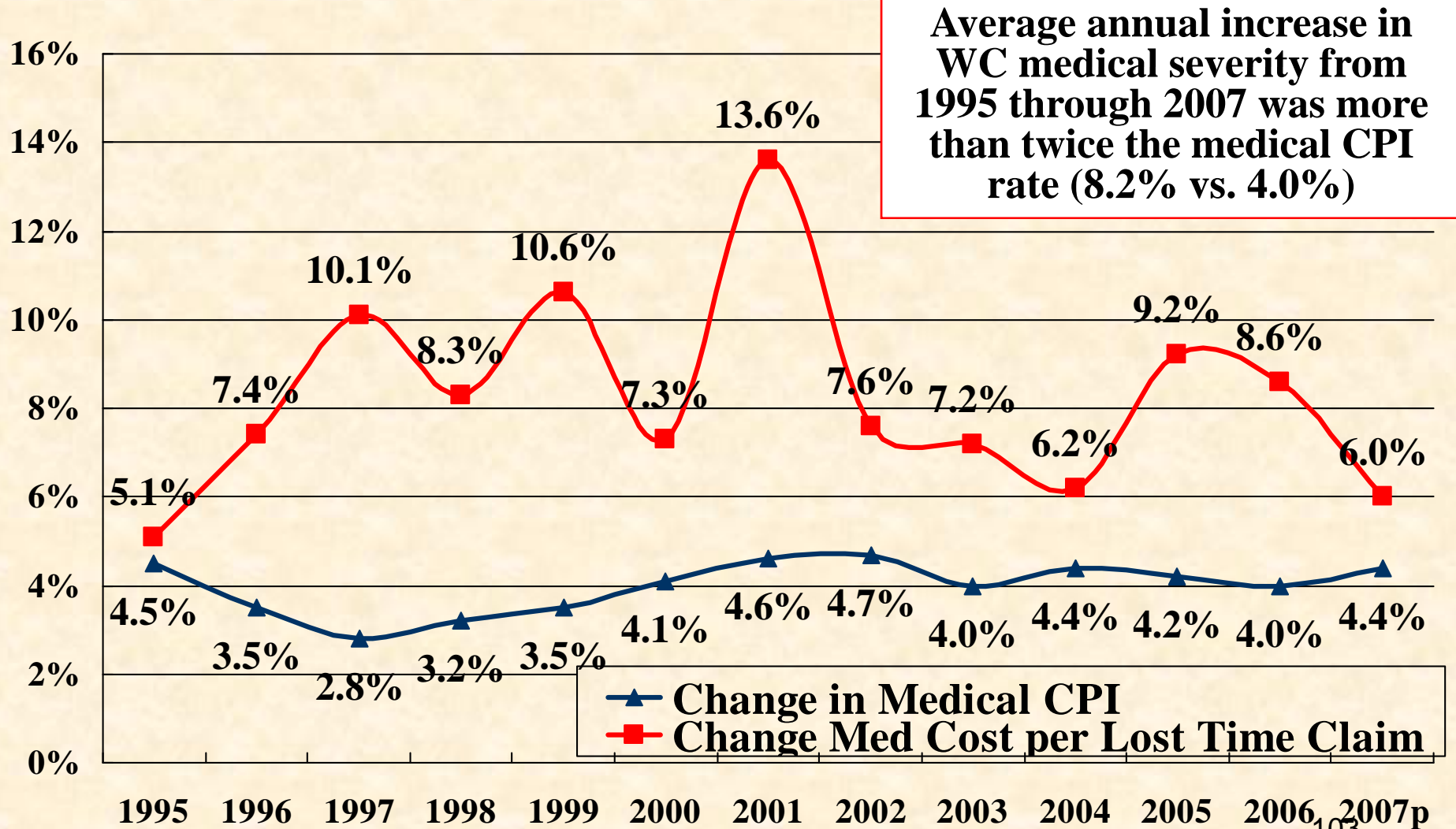
2007p: Preliminary based on data valued as of 12/31/2007

1991–2006: Based on data through 12/31/2006, developed to ultimate

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



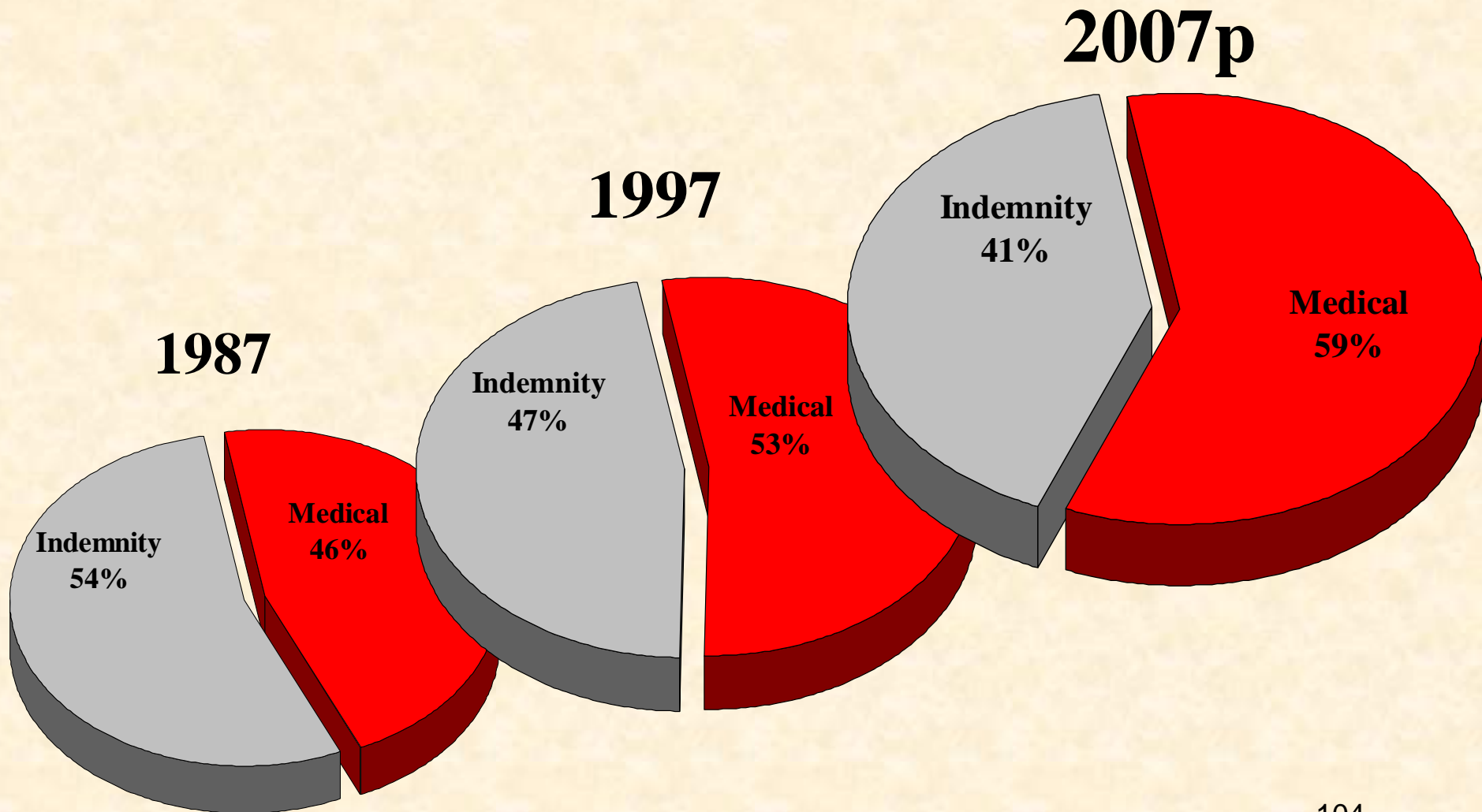
WC Medical Severity Rising at Double the Medical CPI Rate



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



Med Costs Share of Total Costs is Increasing Steadily

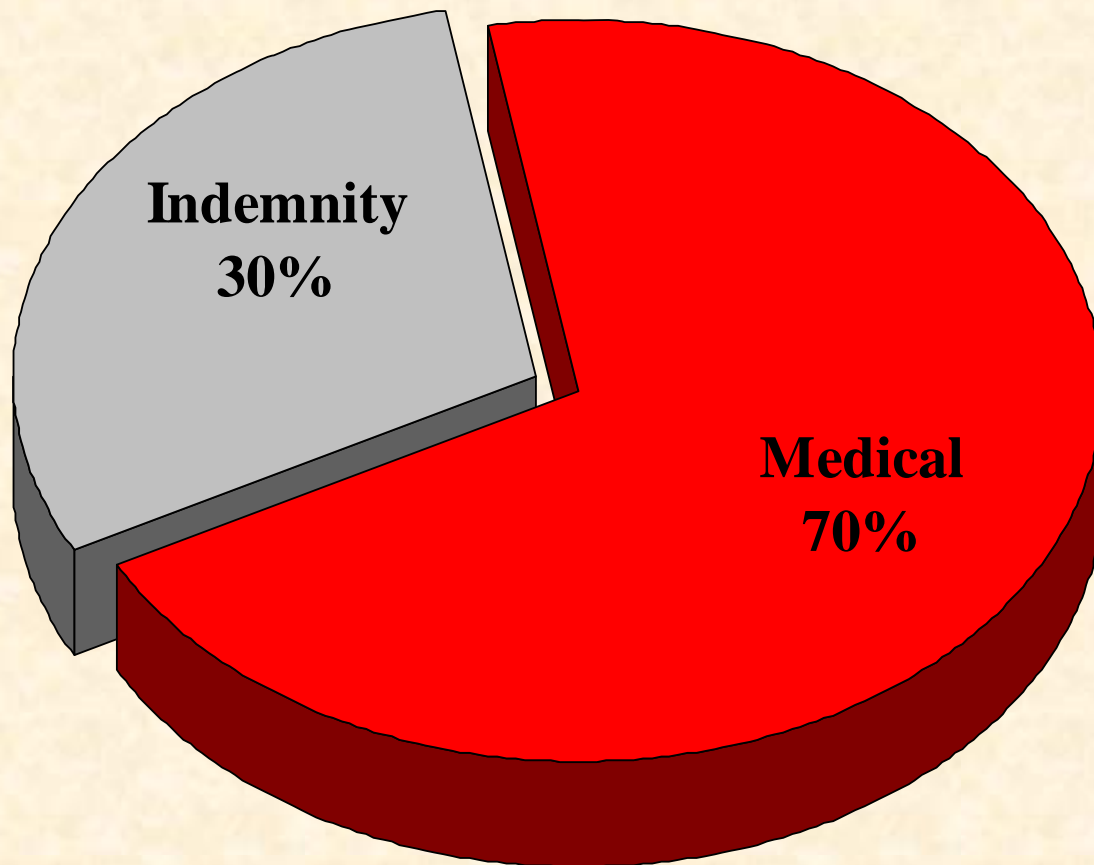


Source: NCCI (based on states where NCCI provides ratemaking services).



WC Med Cost Will Equal 70% of Total by 2017 if Trends Hold

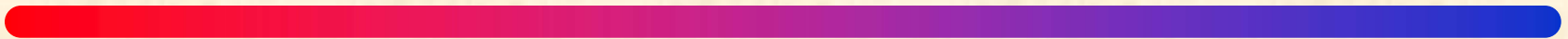
2017 Estimate



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

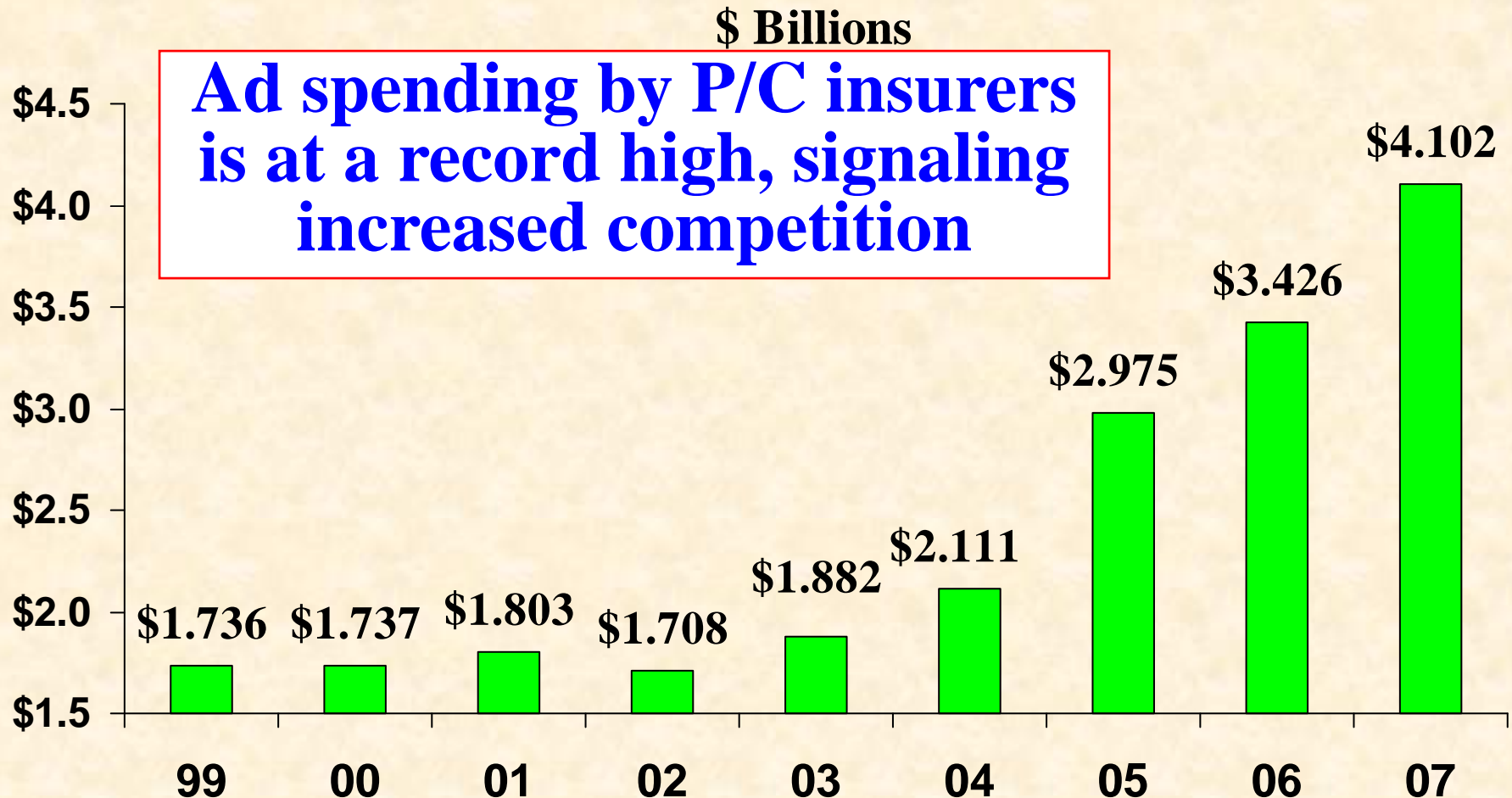
Advertising

**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.

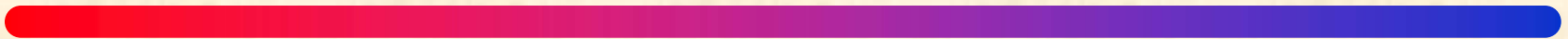


Why Advertising Will Likely Remain Strong?

- **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

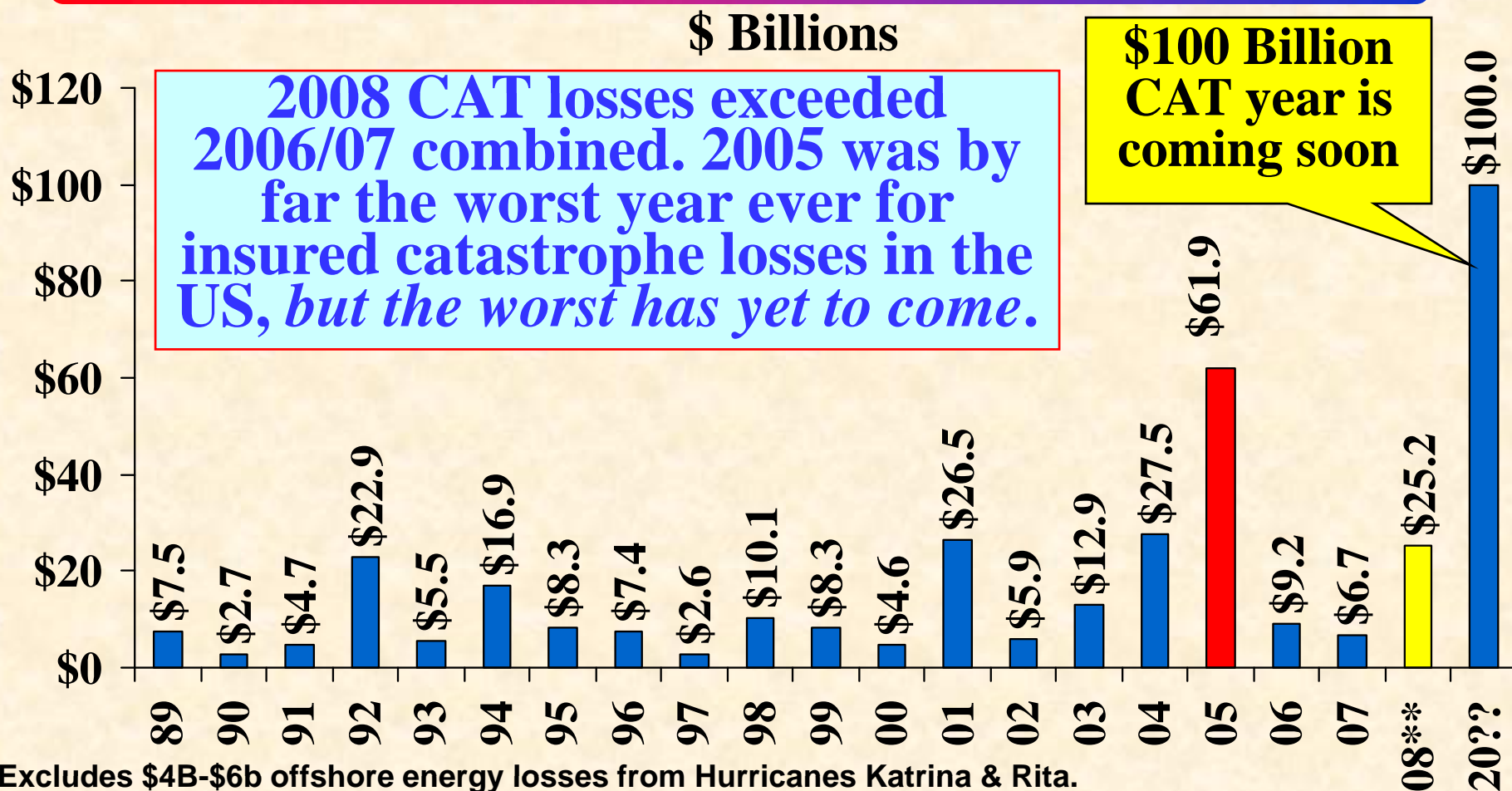
Catastrophe Losses

**Impacting Underwriting
Results and the Bottom Line**





U.S. Insured Catastrophe Losses*



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

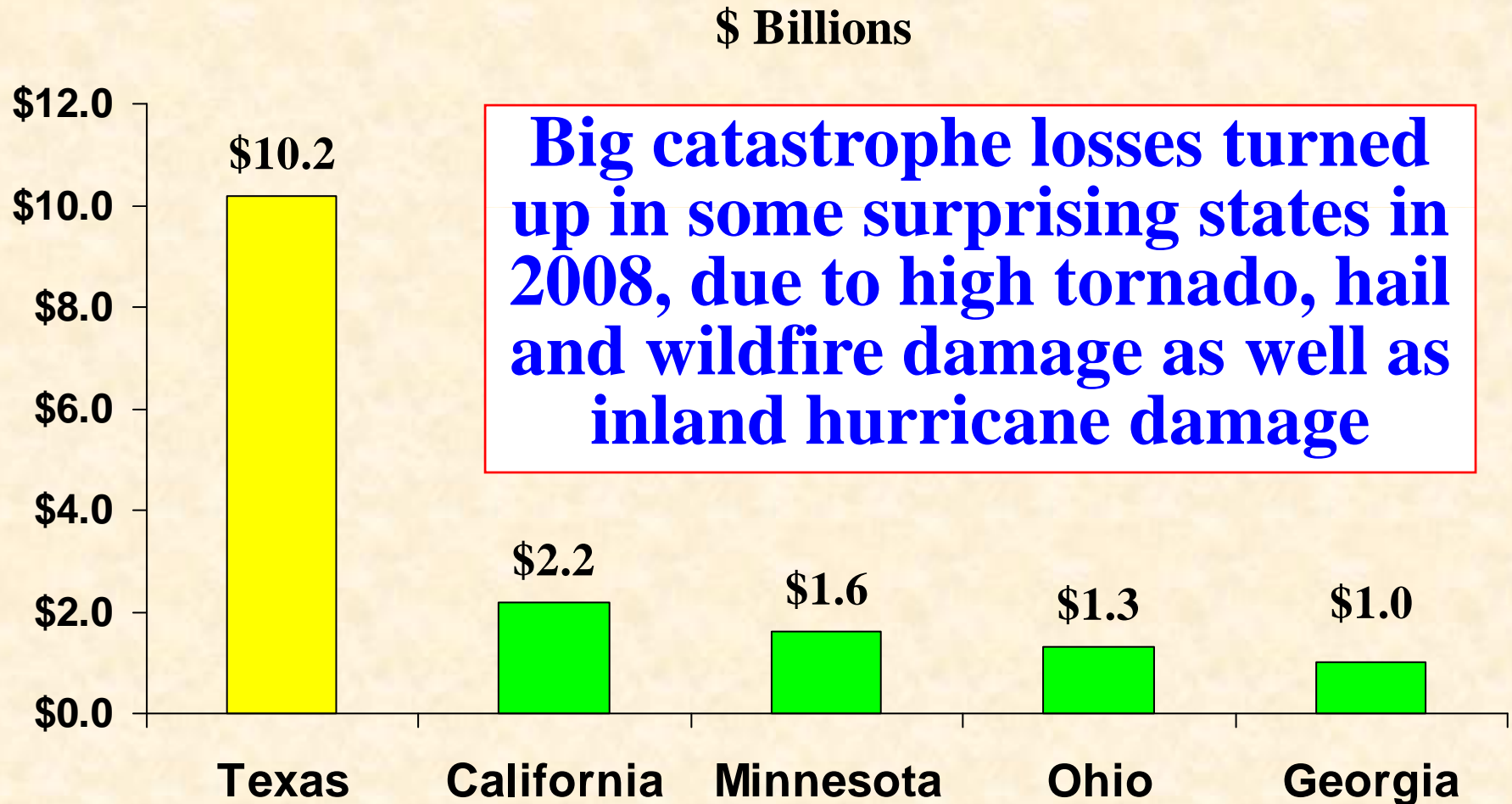
**Based on PCS data through Dec. 31. PCS \$2.1B loss of for Gustav. \$10.655B for Ike of 12/05/08.

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.¹¹⁰

Source: Property Claims Service/ISO; Insurance Information Institute



States With Highest Insured Catastrophe Losses in 2008





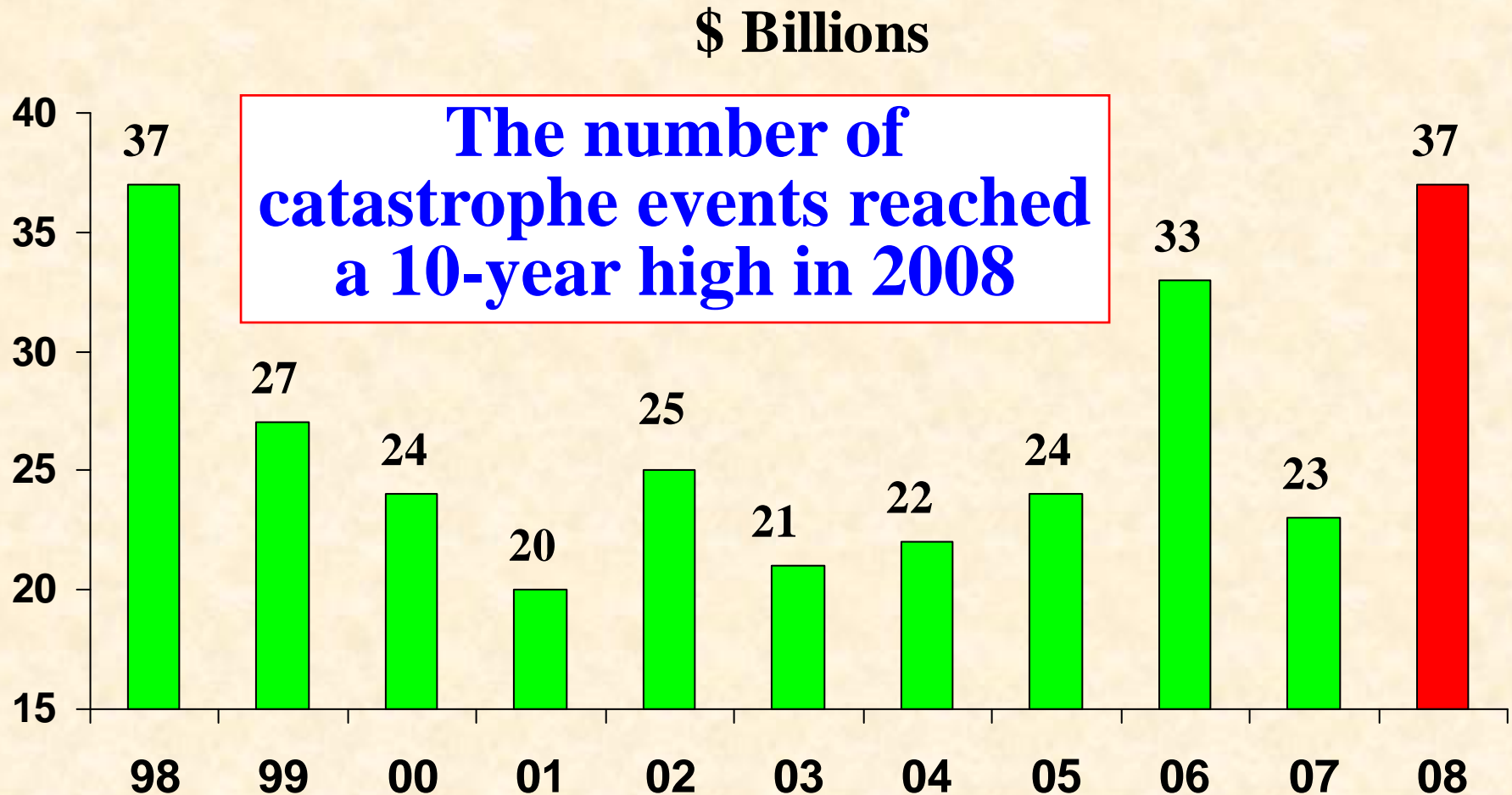
Top 12 Most Costly Disasters in US History, (Insured Losses, \$2007)



*PCS estimate as of 12/15/08.



*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

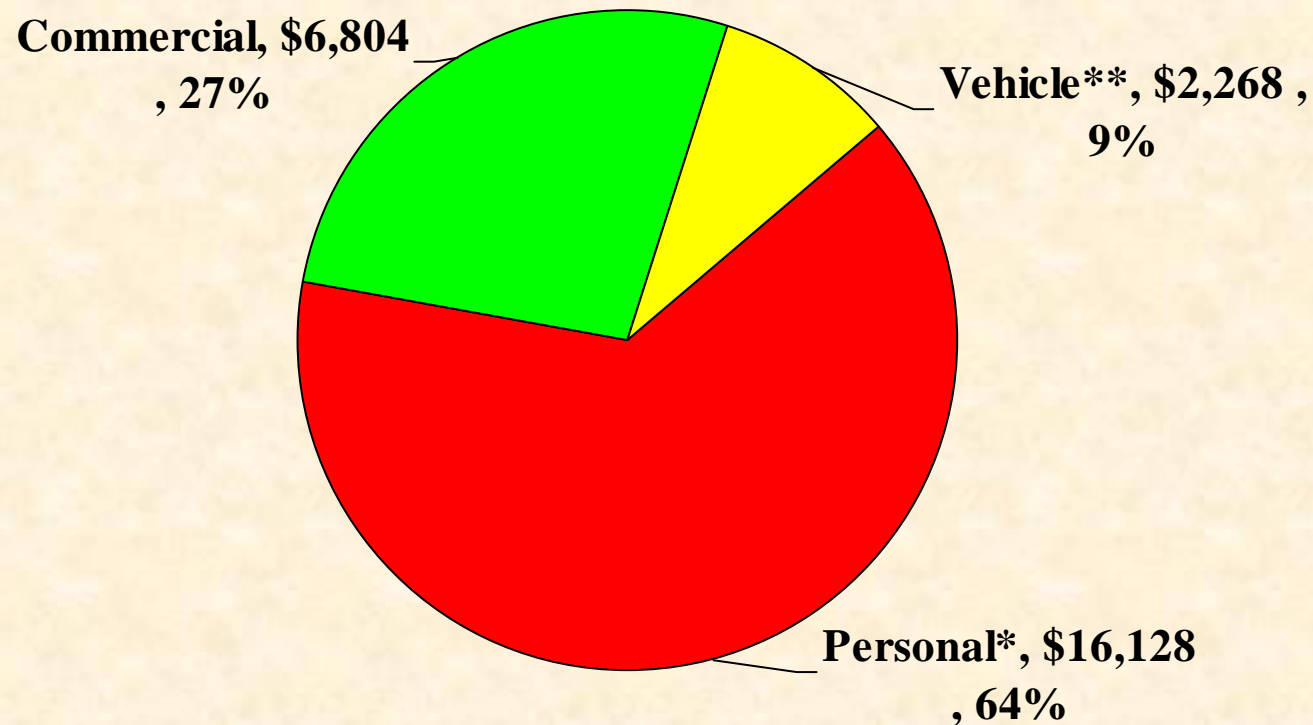


2008 Insured Catastrophe Loss Distribution by Category

2008 CAT FACTS

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

\$ Millions



*Includes homeowners, condominium and rental policies.

**Includes commercial and private passenger vehicles

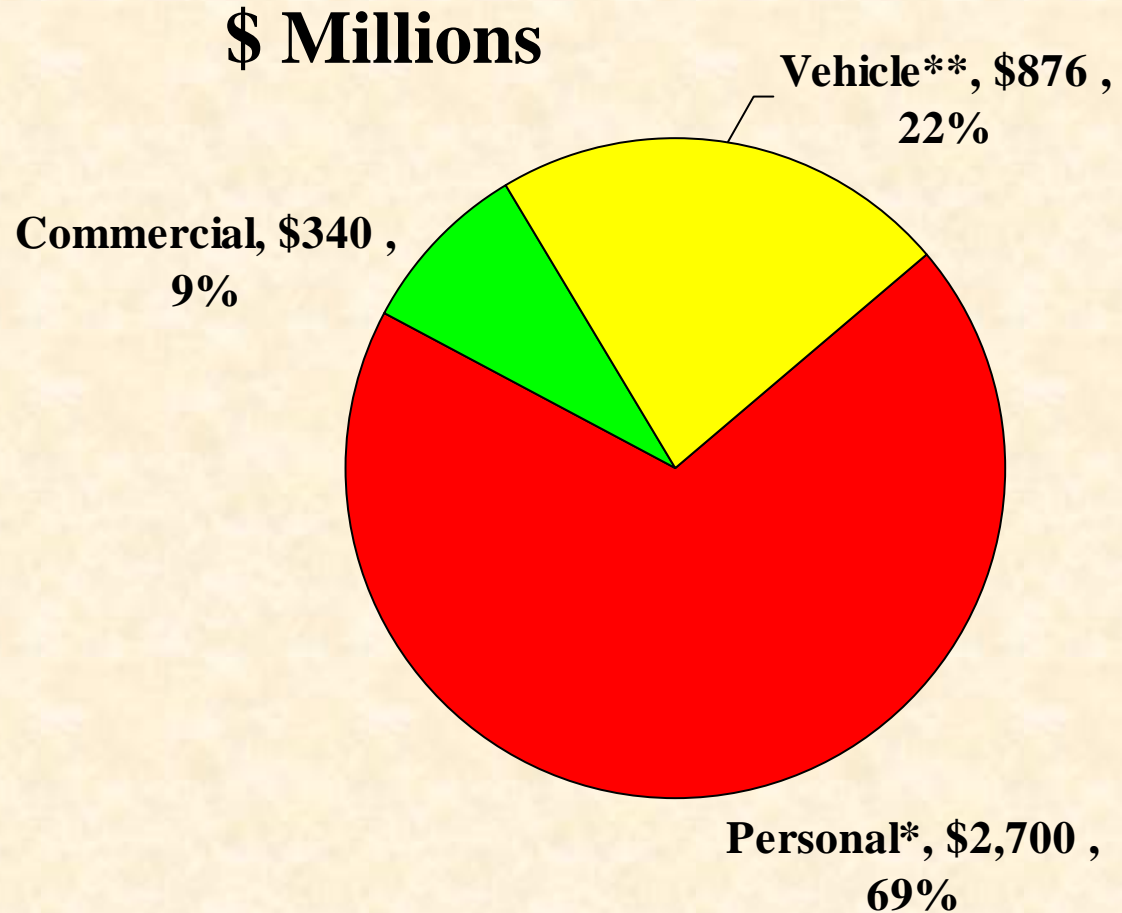
Source: PCS; Insurance Information Institute research.



2008 Insured Catastrophe Loss Distribution by Number of Claims

2008 CAT FACTS

- 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



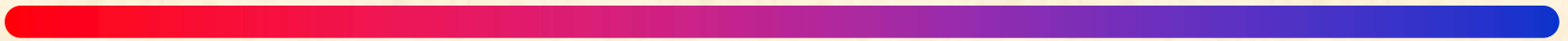
*Includes homeowners, condominium and rental policies.

**Includes commercial and private passenger vehicles

Source: PCS; Insurance Information Institute research.

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

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

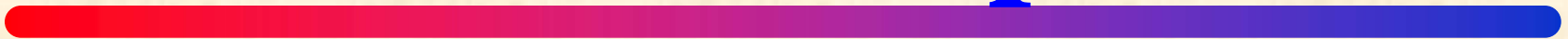
- No tort reform (or protection of recent reforms) is forthcoming from the current Congress or Administration
- Erosion of recent reforms is a certainty (already happening)
- Innumerable legislative initiatives will create opportunities to undermine existing reforms and develop new theories and channels 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

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



CFO Turnover Rate: The Fall Guy in Risk Management Failures



*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>



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**



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



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?

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



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