The Road Ahead: P-C Insurance in the Post-Crisis World

Focus on Texas Markets

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Presentation Outline

- Reasons for Optimism, Causes for Concern
- Insurance Industry Financial Overview & Outlook
  - Profitability
  - Premium Growth
  - Underwriting Performance: Commercial & Personal Lines
  - Financial Market Impacts
- Profitability in Texas P/C Insurance Markets
- Financial Services Reform: Impacts on the Insurance Industry
- Capital & Capacity
- Tort System Review: Overview and Causes for Concern
- Performance by Segment/Line
  - Focus Medical Professional Liability Insurance and Workers Comp
- Financial Strength & Ratings
- The Global Economic Storm: Financial Crisis & Recession
  - Crisis-Driven Exposure Issues: Personal & Commercial Lines
  - Exposure, Growth & Profitability
- Catastrophe Losses
Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- Economic Recovery in US is Self-Sustaining: No Double Dip Recession
- European Debt Crisis Will Pass; Concerns are Overblown
  - Volatility will remain a reality, however
- Era of Mass P/C Insurance Exposure Destruction Has Ended
  - But restoration of destroyed exposure will take 3+ years in US
- No Secondary Spike in Unemployment or Swoon in Payrolls/WC Exposure
  - But job and wage growth remains sluggish
- Exposure Growth Will Begin in Earnest in 2nd Half 2010, Accelerate in 2011
- Increase in Demand for Commercial Insurance is in its Earliest Stages and Will Accelerate in 2011
  - Includes workers comp, commercial auto, marine, many liability coverages, D&O
  - Laggards: Property, inland marine, aviation
  - Personal Lines: Auto leads, homeowners lags
- P/C Insurance Industry Will See Growth in 2011 for the First Time Since 2006
- Investment Environment Is/Remains Much More Favorable
  - Volatility, however, will persist and yields remain low
  - Both are critical issues in long-tailed commercial lines like WC, Med Mal, D&O

Source: Insurance Information Institute.
Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- P/C Insurance Industry Capacity as of 3/31/10 is at Record Levels and Has Recovered 100%+ of the Capital Lost During the Financial Crisis
  - As of 12/31/09 capacity was within 2% of pre-crisis high

- Record Capacity, Depressed Exposures Mean that Generally Soft Market Conditions Will Persist through 2010 and Potentially into 2011

- There is No Catalyst for a Robust Hard Market at the Current Time

- High Global First Half 2010 CAT Losses Insufficient to Trigger Hard Market
  - Localized insurance and reinsurance impacts are occurring, especially earthquake coverage in Latin/South America, Offshore Energy Markets, European Wind Cover

- Inflation Outlook for US and Major European Economies and Japan is Tame
  - Will temper claims inflation

- Financial Strength & Ratings of Global (Re)Insurance Industries Remained Strong Throughout the Financial Crisis in Sharp Contrast With Banks

- Insurers Have Avoided (So Far) the Most Draconian Outcomes in Financial Services Reform Legislation

- Tort Environment in US is Beginning to Deteriorate; No Tort Reform in US

- Major Transformation of US Economy Underway with Major Opportunities for Insurers through 2020 in Health, Tech, Natural Resources, Energy

Source: Insurance Information Institute.
Profitability

Historically Volatile
## P/C Net Income After Taxes
### 1991–2010:Q1 ($ Millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>$5,840</td>
</tr>
<tr>
<td>1992</td>
<td>$19,316</td>
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<tr>
<td>1993</td>
<td>$10,870</td>
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<td>1994</td>
<td>$20,598</td>
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<td>1995</td>
<td>$24,404</td>
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<tr>
<td>1996</td>
<td>$36,81</td>
</tr>
<tr>
<td>1997</td>
<td>$30,773</td>
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<tr>
<td>1998</td>
<td>$21,865</td>
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<tr>
<td>1999</td>
<td>$20,598</td>
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<tr>
<td>2000</td>
<td>$30,029</td>
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<tr>
<td>2001</td>
<td>$3,046</td>
</tr>
<tr>
<td>2002</td>
<td>$3,046</td>
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<td>2003</td>
<td>$3,046</td>
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<td>2004</td>
<td>$3,046</td>
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<td>$3,046</td>
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<td>2007</td>
<td>$3,046</td>
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<tr>
<td>2008</td>
<td>$3,046</td>
</tr>
<tr>
<td>2009</td>
<td>$3,046</td>
</tr>
<tr>
<td>2010:Q1</td>
<td>$3,046</td>
</tr>
</tbody>
</table>

* ROE figures are GAAP; 1Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields an 8.3% ROAS for 2010:Q1, 7.3% for 2009 and 4.4% for 2008. 2009 net income was $34.5 billion and $20.8 billion in 2008 excluding M&FG.

Sources: A.M. Best, ISO, Insurance Information Institute
P/C Profitability Is Cyclical and Volatile

Sources: ISO, Fortune; Insurance Information Institute.
US P/C Insurers Missed Their Cost of Capital by an Average 6.7 Points from 1991 to 2002, but on Target or Better 2003-07, Fell Short in 2008/09

The Cost of Capital is the Rate of Return Insurers Need to Attract and Retain Capital to the Business

* Return on average surplus in 2008/09 excluding mortgage and financial guaranty insurers.

Source: The Geneva Association, Insurance Information Institute
Median ROE for Insurers vs. Financial Firms & Other Key Industries 2009

(Profits as a % of Stockholders’ Equity)

- Food Consumer Products: 21%
- Pharmaceuticals: 21%
- Computers, Office Equip.: 19%
- Health Insurance & Mgd. Care: 14%
- Specialty Retailers: 14%
- Energy: 12%
- All Industries: 10.5%
- Diversified Financials: 9%
- Telecommunications: 9%
- Utilities: 9%
- P/C Insurance (Stock): 7%
- L/H Insurance (Stock): 7%
- Entertainment: 5%
- Commercial Banks: 4%
- P/C Insurance (Mutual)*: 3.5%
- L/H Insurance (Mutual): 0%

Stock P/C insurers earned a 7% ROE in 2009, below the 10.5% earned by the Fortune 500 as a whole and well below health insurers’ 14%. P/C Mutuals’ average ROE was 3.5%.

Commercial bank ROE was 4% in 2009.

A 100 Combined Ratio Isn’t What It Once Was: 90-95 Is Where It’s At Now

A combined ratio of about 100 generated a 7% ROE in 2009, 10% in 2005 and 16% in 1979.

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

Profitability in Texas P/C Insurance Markets

Analysis by Line and Nearby State Comparisons
P/C Insurer profitability in TX is highly variable and below that of the US overall over the past decade
US: 7.0%
TX: 3.6%

Sources: NAIC.
Pvt. Passenger Auto profitability in TX is has been somewhat below the US in recent years.

Average 1999-2008

US: 7.5%
TX: 6.1%

Sources: NAIC.
Commercial Auto profitability in TX is generally below the US average.

Average 1999-2008
US: 7.9%
TX: 5.0%

Sources: NAIC.
Hurricane Ike put a big dent in CMP profitability in 2008

Average 1999-2008
US: 7.4%
TX: 0.5%

Sources: NAIC.

Homeowners profitability: Mold, Hurricanes, Hail & Tornadoes
(Need I say More?)

Average 1999-2008
US: 4.8%
TX: -0.8%

Sources: NAIC.
Texans Have Found the Solution to Reducing Hurricane Loss Frequency

Though still in the testing phase, some property owners along the Texas Gulf coast are erecting “Private Property” signs to keep hurricanes out. They are said to be filing a request for a mitigation credit with TDI.

Me on vacation, July 4, 2010, in Port Aransas, TX, at “Virginia’s On the Bay” Restaurant
Texas Tar Balls: Long a Fixture on Texas Beaches

Tar balls gathered on Port Aransas Beach on July 3, 2010. These have nothing to do with the Deepwater Horizon event.
Workers comp profitability in TX has generally outperformed the US.

Average 1999-2008
US: 6.4%
TX: 8.3%

Sources: NAIC.
Texas All Lines profitability is below the US and regional average.

- New Mexico: 10.8%
- U.S.: 7.0%
- Arkansas: 6.3%
- Oklahoma: 5.6%
- Texas: 3.6%
- Mississippi: -13.8%
- Louisiana: -20%

Source: NAIC, Insurance Information Institute
Texas PP Auto profitability is below the US and regional average.
Top Ten Most Expensive And Least Expensive States For Automobile Insurance, 2007 (1)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Most expensive states</th>
<th>Average expenditure</th>
<th>Rank</th>
<th>Least expensive states</th>
<th>Average expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>D.C.</td>
<td>$1,140</td>
<td>1</td>
<td>North Dakota</td>
<td>$512</td>
</tr>
<tr>
<td>2</td>
<td>New Jersey</td>
<td>1,104</td>
<td>2</td>
<td>Iowa</td>
<td>518</td>
</tr>
<tr>
<td>3</td>
<td>Louisiana</td>
<td>1,096</td>
<td>3</td>
<td>South Dakota</td>
<td>534</td>
</tr>
<tr>
<td>4</td>
<td>New York</td>
<td>1,047</td>
<td>4</td>
<td>Nebraska</td>
<td>554</td>
</tr>
<tr>
<td>5</td>
<td>Florida</td>
<td>1,043</td>
<td>5</td>
<td>Idaho</td>
<td>564</td>
</tr>
<tr>
<td>6</td>
<td>Rhode Island</td>
<td>1,017</td>
<td>6</td>
<td>Kansas</td>
<td>568</td>
</tr>
<tr>
<td>7</td>
<td>Delaware</td>
<td>1,012</td>
<td>7</td>
<td>Wisconsin</td>
<td>582</td>
</tr>
<tr>
<td>8</td>
<td>Nevada</td>
<td>1,000</td>
<td>8</td>
<td>North Carolina</td>
<td>591</td>
</tr>
<tr>
<td>9</td>
<td>Massachusetts</td>
<td>981</td>
<td>9</td>
<td>Maine</td>
<td>611</td>
</tr>
<tr>
<td>10</td>
<td>Connecticut</td>
<td>964</td>
<td>10</td>
<td>Indiana</td>
<td>618</td>
</tr>
</tbody>
</table>

Texas ranked 19th in 2007, with an average expenditure for auto insurance of $808.

(1) Based on average automobile insurance expenditures.

Source: © 2009 National Association of Insurance Commissioners.
Texas Commercial Auto profitability is below the US and regional average.
Texas Commercial Multi-Peril profitability is below the US and regional average.

1999-2008

- New Mexico: 12.7%
- U.S.: 7.4%
- Arkansas: 4.8%
- Oklahoma: 8.8%
- Texas: 0.5%
- Louisiana: -11.1%
- Mississippi: -21.5%
- Other: -21.5%

Source: NAIC, Insurance Information Institute
Homeowners: 10-Year Average RNW TX & Nearby States

1999-2008

-40% -30% -20% -10% 0% 10% 20%

-34.4% -30.1% -6.1% -5.2% -0.8%

Texas Homeowners profitability is below the US and regional average

Source: NAIC, Insurance Information Institute
Texas ranked as the second most expensive state for homeowners insurance in 2007, with an average expenditure of $1,448.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Most expensive states</th>
<th>Average expenditure</th>
<th>Rank</th>
<th>Least expensive states</th>
<th>Average expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Florida (2)</td>
<td>$1,534</td>
<td>1</td>
<td>Idaho</td>
<td>$422</td>
</tr>
<tr>
<td>2</td>
<td>Texas (3)</td>
<td>1,448</td>
<td>2</td>
<td>Wisconsin</td>
<td>491</td>
</tr>
<tr>
<td>3</td>
<td>Louisiana</td>
<td>1,400</td>
<td>3</td>
<td>Oregon</td>
<td>496</td>
</tr>
<tr>
<td>4</td>
<td>D.C.</td>
<td>1,089</td>
<td>4</td>
<td>Utah</td>
<td>505</td>
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<tr>
<td>5</td>
<td>Oklahoma</td>
<td>1,054</td>
<td>5</td>
<td>Washington</td>
<td>506</td>
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<tr>
<td>6</td>
<td>Massachusetts</td>
<td>1,023</td>
<td>6</td>
<td>Ohio</td>
<td>540</td>
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<tr>
<td>7</td>
<td>Mississippi</td>
<td>1,019</td>
<td>7</td>
<td>Delaware</td>
<td>559</td>
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<tr>
<td>8</td>
<td>Rhode Island</td>
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<td>8</td>
<td>Kentucky</td>
<td>578</td>
</tr>
<tr>
<td>9</td>
<td>New York</td>
<td>936</td>
<td>9</td>
<td>Maine</td>
<td>596</td>
</tr>
<tr>
<td>10</td>
<td>Connecticut</td>
<td>929</td>
<td>10</td>
<td>Iowa</td>
<td>610</td>
</tr>
</tbody>
</table>

(1) Based on the HO-3 homeowner package policy for owner-occupied dwellings, 1 to 4 family units. Provides “all risks” coverage (except those specifically excluded in the policy) on buildings and broad named-peril coverage on personal property, and is the most common package written.

(2) Florida data excludes policies written by Citizen’s Property Insurance Corporation, the state’s insurer of last resort, and therefore are not directly comparable to other states.

(3) The Texas Department of Insurance developed home insurance policy forms that are similar but not identical to the standard forms.

Note: Average premium=Premiums/exposure per house years. A house year is equal to 365 days of insured coverage for a single dwelling. The NAIC does not rank State Average Expenditures and does not endorse any conclusions drawn from this data.

Source: © 2009 National Association of Insurance Commissioners (NAIC). Reprinted with permission. Further reprint or distribution strictly prohibited without written permission of NAIC.
Texas Workers Comp profitability is above the US average but similar to the regional average.

Source: NAIC, Insurance Information Institute
Percentage of Subprime Mortgages in Foreclosure, as of April 2010*

- U.S.: 33%
- Texas: 19%
- North Carolina: 26%
- Arizona: 36%
- California: 38%
- New York: 39%
- Nevada: 45%
- Florida: 48%

Foreclosures on subprime mortgages in TX are running well below the US and regional average.

*Or at least 90 days delinquent

Source: New York Federal Reserve; Wall Street Journal, *Housing’s Fragile States*, 06/30/10
Financial Services Reform

Insurers Are Impacted, But Not Significantly
Financial Services Reform: Impact on Insurers

- **Resolution Authority/Systemic Risk:** Regulators may seize and break-up troubled financial firms whose collapse might cause widespread damage (i.e., systemically important companies)
  - Regulator would recoup fees with more than $50B in assets
  - Sets up liquidation procedure run by FDIC
  - Establishes 10-member oversight council to monitor and address risks to financial stability
  - Eliminates Office of Thrift Supervision (regulator of AIG’s holding company, not its insurance units which were (are) state regulated)

- **Volcker Rule:** Largely bars largest firms largest investment firms from trading with their own funds
  - Exempts insurers, asset managers and trust/custody banks, though Fed could impose Volcker Rule and capital standards on individual firms if warranted

- **Derivatives:** Requires routine derivatives to be traded on exchanges and routed through clearinghouses
  - Imposes capital, margin, reporting and record keeping and business conduct rules on firms that deal in derivatives

- **Consumer Financial Protection Bureau:** To housed within Fed
  - Will it be limited to banks/creditors

- **Office of National Insurance:** To be established within Treasury to monitor and gather information in the insurance industry

2010 Property and Casualty Insurance Report Card

Source: Heartland Institute, May 2010

Not Graded: District of Columbia
Mississippi
Louisiana
Critical Differences Between P/C Insurers and Banks

Superior Risk Management Model and Low Leverage Make a Big Difference
How P/C 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 258 banks have gone under as of 7/9/10) – *The promise is being fulfilled*
  - Renew existing policies (*banks are reducing and eliminating lines of credit*)
  - Write new policies (*banks are turning away people and businesses who want or need to borrow*)
  - Develop new products (*banks are scaling back the products they offer*)
  - Compete intensively (*banks are consolidating, reducing consumer choice*)

Source: Insurance Information Institute
Reasons Why P/C Insurers Have Fewer Problems Than Banks

A Superior Risk Management Model

- **Emphasis on Underwriting**
  - Matching of risk to price (via experience and modeling)
  - Limiting of potential loss exposure
  - *Some banks sought to maximize volume and fees and disregarded risk*

- **Strong Relationship Between Underwriting and Risk Bearing**
  - *Insurers always maintain a stake in the business they underwrite, keeping “skin in the game” at all times*
  - *Banks and investment banks package up and securitize, severing the link between risk underwriting and risk bearing, with (predictably) disastrous consequences – straightforward moral hazard problem from Econ 101*

- **Low Leverage**
  - Insurers do not rely on borrowed money to underwrite insurance or pay claims → *There is no credit or liquidity crisis in the insurance industry*

- **Conservative Investment Philosophy**
  - High quality portfolio that is relatively less volatile and more liquid

- **Comprehensive Regulation of Insurance Operations**
  - The business of insurance remained comprehensively regulated whereas a separate banking system had evolved largely outside the auspices and understanding of regulators (e.g., hedge funds, private equity, complex securitized instruments, credit derivatives – CDS’s)

- **Greater Transparency**
  - Insurance companies are an open book to regulators and the public

Source: Insurance Information Institute
Obama Administration Proposal to Scale Back Terrorism Risk Insurance Program

Administration’s Budget Proposal for FY 2011:

- Includes proposal to scale back federal support for terrorism risk insurance program
- Proposal projects savings of $249 million from 2011-2020
- Administration’s justification is that this would “encourage the private sector to better mitigate terrorism risk through other means, such as developing alternative reinsurance options and building safer buildings.”

<table>
<thead>
<tr>
<th>Key Concerns</th>
<th>Among Industry Observers Over Proposed Reduction in Federal Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suggestion of changes to law would have detrimental effect on availability and affordability of terrorism insurance</td>
<td></td>
</tr>
<tr>
<td>A 2009 Aon study estimated some 70-80 percent of the commercial property insurance market would revert to absolute exclusions for terrorism, if TRIA is changed.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Budget of the U.S. Government Fiscal Year 2011
## Reasons Why Concerns Are Mounting in 2010

- Perception (Reality) that U.S. vulnerability is rising
- Thwarted Christmas Day attack by “underwear bomber”
  - And new bin Laden tape claiming al Qaeda is responsible
- Foiled NYC Subway Bomber Plot (Zazi case)
- *Failed Times Square Car Bombing on May 1*
- Trials of Guantanamo 9/11 suspects in Manhattan Court (?)
- U.K. in January Raised Terror Alert Status to 2nd Highest Level
- Increased anti-terror efforts, including full-body scans
- Effort by government to appear more vigilant, prepared
- Rise of groups such as al Qaeda in the Arabian Peninsula
- U.S. military surge in Afghanistan operations
- Most buyers/producers haven’t thought about coverage recently
- *Obama Administration’s Intent to Reduce Support for TRIA*
Financial Strength & Ratings

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

Source: A.M. Best; Insurance Information Institute.
2009 estimated impairment rate rose to 0.36% up from a near record low of 0.23% in 2008 and the 0.17% record low in 2007; Rate is still less than one-half the 0.79% average since 1969

Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007/08

Source: A.M. Best; Insurance Information Institute
Summary of A.M. Best’s P/C Insurer Ratings Actions in 2009

Despite financial market turmoil and a soft market in 2009, 76% of ratings actions by A.M. Best were affirmations; just 2.9% were downgrades and 3.2% were upgrades.

- Affirm – 1,375
- Downgraded – 53
- Upgraded – 59
- Initial – 44
- Under Review – 69
- Other – 216
- 75.7%
- 11.9%
- 3.2%
- 2.4%
- 3.8%


Source: A.M. Best.

Deficient Loss Reserves and Inadequate Pricing Are the Leading Cause of Insurer Impairments, Underscoring the Importance of Discipline. Investment Catastrophe Losses Play a Much Smaller Role.

P/C Premium Growth Primarily Driven by the Industry’s Underwriting Cycle, Not the Economy
Soft Market Appears to Persist in 2010. Relief in 2011?

Net Written Premiums Fell 0.7% in 2007 (First Decline Since 1943) by 2.0% in 2008, and 4.2% in 2009, the First 3-Year Decline Since 1930-33.

Shaded areas denote “hard market” periods

Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.
**Countrywide Auto Insurance Expenditures Increased**
2.6% in 2008 and 3.5% Pace in 2009 (est.) and 4% in 2010 (est.)

* Insurance Information Institute Estimates/Forecasts
Source: NAIC, Insurance Information Institute estimates 2008-2010 based on CPI data.
Auto Insurance Price Increases Seem to Have Leveled Off in Recent Months, Averaging 4.5% for All of 2009

* Percentage change from same month in prior year.
Average Premium for Home Insurance Policies**

* Insurance Information Institute Estimates/Forecasts  **Excludes state-run insurers.
Source: NAIC, Insurance Information Institute estimates 2008-2010 based on CPI data.
Average Commercial Rate Change, All Lines, (1Q:2004–1Q:2010)

(Percent)

Source: Council of Insurance Agents & Brokers; Insurance Information Institute
Change in Commercial Rate Renewals, by Line: 2010:Q1

Percentage Change (%)

Most Major Commercial Lines Renewed Down in Q1:2010 by Roughly the Same Margin as a Year Earlier

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2010:Q1

Percentage Change (%)

- **Peak = 2004:Q4 +28.5%**
- **Trough = 2007:Q3 -13.6%**
- Pricing Turned Negative in Early 2004 and Has Been Negative Ever Since
- Market has Been Soft for 6 years and Remains Soft as Capital is Restored and Underwriting Losses Fall

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2010:Q1

1999:Q4 = 100

Pricing today is where is was in Q4:2000 (pre-9/11)

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Capital/Policyholder Surplus (US)

Shrinkage, but Not Enough to Trigger Hard Market
Surplus as of 3/31/10 was a record $540.7B, up from $437.1B at the crisis trough at 3/31/09. Prior peak was $521.8 as of 9/30/07. Surplus as of 3/31/10 is now 3.6% above 2007 peak; Crisis trough was as of 3/31/09→16.2% below 2007 peak.

“Surplus” is a measure of underwriting capacity. It is analogous to “Owners Equity” or “Net Worth” in non-insurance organizations.

The Premium-to-Surplus Ratio Stood at $0.82:$1 as of 12/31/09, A Record Low (at Least in Recent History)

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

Surplus set a new record in 2010: Q1*

Quarterly Surplus Changes Since 2007:Q3 Peak

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Change</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>08:Q2</td>
<td>-$16.6B</td>
<td>-3.2%</td>
</tr>
<tr>
<td>08:Q3</td>
<td>-$43.3B</td>
<td>-8.3%</td>
</tr>
<tr>
<td>08:Q4</td>
<td>-$66.2B</td>
<td>-12.9%</td>
</tr>
<tr>
<td>09:Q1</td>
<td>-$84.7B</td>
<td>-16.2%</td>
</tr>
<tr>
<td>09:Q2</td>
<td>-$58.8B</td>
<td>-11.2%</td>
</tr>
<tr>
<td>09:Q3</td>
<td>-$31.8B</td>
<td>-5.9%</td>
</tr>
<tr>
<td>09:Q4</td>
<td>-$10.3B</td>
<td>-2.0%</td>
</tr>
<tr>
<td>10:Q1</td>
<td>+$18.9B</td>
<td>+3.6%</td>
</tr>
</tbody>
</table>

*Includes $22.5B of paid-in capital from a holding company parent for one insurer’s investment in a non-insurance business

Sources: ISO, A.M. Best.

Paid-in capital for insurance operations in 2009:Q1 was $1B. In 2010:Q1 it was $0.2B.

In 2010:Q1 One Insurer’s Paid-in Capital Rose by $22.5B as Part of an Investment in a Non-insurance Business.

Source: ISO.
Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

Global Reinsurance Capacity

- 2007: $360
- 2008: $300
- 2009E: $350

Source of Decline in 2008

- Realized Capital Losses: 31%
- Change in Unrealized Capital Losses: 55%
- Hurricanes: 14%

Global Reinsurance Capacity Fell by an Estimated 17% in 2008

The Financial Crisis at its Peak Ranks as the Largest “Capital Event” Over the Past 20+ Years

<table>
<thead>
<tr>
<th>Event</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hurricane Hugo</td>
<td>3.3%</td>
</tr>
<tr>
<td>Hurricane Andrew</td>
<td>9.6%</td>
</tr>
<tr>
<td>Northridge Earthquake</td>
<td>6.9%</td>
</tr>
<tr>
<td>6/30/01 Sept. 11 Attacks</td>
<td>10.9%</td>
</tr>
<tr>
<td>Florida Hurricanes</td>
<td>6.2%</td>
</tr>
<tr>
<td>Hurricane Katrina</td>
<td>13.8%</td>
</tr>
<tr>
<td>Financial Crisis as of 3/31/09**</td>
<td>16.2%</td>
</tr>
</tbody>
</table>

* Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event.
** Date of maximum capital erosion; As of 9/30/09 (latest available) ratio = 5.9%
Source: PCS; Insurance Information Institute
Historically, Hard Markets Follow When Surplus “Growth” is Negative*

Surplus growth is now positive but premiums continue to fall, a departure from the historical pattern.

Sharp Decline in Capacity is a Necessary but Not Sufficient Condition for a True Hard Market

* 2010 NWP and Surplus figures are % changes as of Q1:10 vs Q1:09. Adjusting for unique transaction of insurer the increase is 18.4%.
Sources: A.M. Best, ISO, Insurance Information Institute
Barriers to Consolidation Will Diminish in 2010

$ Value of Deals Down 78% in 2009, Volume Up 7%

2010: No Mega Deals So Far, Despite Record Capital, Slow Growth and Improved Financial Market Conditions

Note: U.S. Company was the acquirer and/or target.
Source: Conning Research & Consulting.
Investment Performance

Investments Are a Principle Source of Declining Profitability
In 2008, Investment Gains Fell by 50% Due to Lower Yields and Nearly $20B of Realized Capital Losses

2009 Saw Smaller Realized Capital Losses But Declining Investment Income

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

* 2005 figure includes special one-time dividend of $3.2B.
Sources: ISO; Insurance Information Institute.
P/C Insurer Net Realized Capital Gains, 1990-2010:Q1

Realized Capital Losses Were the Primary Cause of 2008/2009’s Large Drop in Profits and ROE

Sources: A.M. Best, ISO, Insurance Information Institute.
Treasury yield curve is near its most depressed level in at least 45 years. Investment income is falling as a result of stock dividend cuts.

Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.
Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line*

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

*Based on 2008 Invested Assets and Earned Premiums
**US domestic reinsurance only
Source: A.M. Best; Insurance Information Institute.
Invested assets totaled $1.214 trillion as of 12/31/08.

Insurers are generally conservatively invested, with more than 2/3 of assets invested in bonds as of 12/31/08.

Only about 15% of assets were invested in common stock as of 12/31/08.

Even the most conservative of portfolios was hit hard in 2008.

Sources: NAIC; Insurance Information Institute research.
Underwriting Trends – Financial Crisis Does Not Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008’s Drivers
As Recently as 2001, Insurers Paid Out Nearly $1.16 for Every $1 in Earned Premiums

Heavy Use of Reinsurance Lowered Net Losses

Relatively Low CAT Losses, Reserve Releases

Relatively Low CAT Losses, Reserve Releases

Best Combined Ratio Since 1949 (87.6)

Cyclical Deterioration

Lower CAT Losses, More Reserve Releases


Sources: A.M. Best, ISO.
Large Underwriting Losses Are *NOT* Sustainable in Current Investment Environment

* Includes mortgage and financial guarantee insurers.
Sources: A.M. Best, ISO; Insurance Information Institute.
Reserve Releases Will Expected to Taper Off in 2010 and Drop Significantly in 2011

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

Sources: Barclay's Capital; A.M. Best.
Calendar Year vs. Accident Year
P/C Combined Ratio: 1992–2010E\(^1\)

Accident Year Results Show a More Significant Deterioration in Underwriting Performance. Calendar Year Results Are Helped by Reserve Releases

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

Sources: Barclay's Capital; A.M. Best.
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

* 2000 through 2009. 2009 combined ratio excluding mortgage and financial guaranty insurers was 99.3, which would bring the 2000s total to 4 years with an underwriting profit.

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

Sources: Insurance Information Institute research from A.M. Best Data.
Performance by Segment: Commercial/Personal Lines & Reinsurance
Personal lines combined ratio is expected to improve in 2010 while commercial lines and reinsurance deteriorate.

Overall deterioration in 2010 underwriting performance is due to expected return to normal catastrophe activity along with deteriorating underwriting performance related to the prolonged commercial soft market.

Sources: A.M. Best (historical and estimates/projected for 2009 and 2010); Insurance Information Institute.
Calendar vs. Accident Year Combined Ratios by Segment: 2008-2010P*

CY commercial lines combined ratios are lower than AY due to reserve releases.

The ability of reserves releases to favorably impact calendar year results will diminish over time reserved redundancies fall.

*Normalized to reflect average/typical level of catastrophe losses.
Sources: A.M. Best (historical and estimates/projected for 2009 and 2010); Insurance Information Institute.
Personal lines ROEs should improve in 2010 and remain flat in commercial lines and reinsurance.

Profitability will rise or stabilize across most p/c lines, barring a financial crisis relapse or major catastrophic losses.

Sources: A.M. Best (historical and estimates/projected for 2009 and 2010); Insurance Information Institute.
After a steep decline in capacity during the crisis, most of that capacity was restored in 2009. Virtually is expected to be restored in 2010.

Rapid growth in policyholder surplus to pre-crisis levels combined with ongoing slow growth or declines in premiums (esp. in commercial lines) implies a build-up of excess capacity—a major factor in weak commercial lines and reinsurance pricing.

Sources: A.M. Best (historical and estimates/projected for 2009 and 2010); Insurance Information Institute.
Net Written Premium Growth by Segment: 2008-2010P

Personal lines will return to growth in 2010 while commercial lines and reinsurance are expected to continue to shrink.

Rate and exposure are more favorable in personal lines, whereas a prolonged soft market and sluggish recovery from the recession weigh on commercial lines. Low catastrophe losses and ample capacity are holding down reinsurance prices while higher insurer retentions impact premiums.

Sources: A.M. Best (historical and estimates/projected for 2009 and 2010); Insurance Information Institute.
Net investment income is expected to begin to recover in all segments in 2010.

Investment income consists primarily of interest on bonds and stock dividends. Both were hit hard during the financial crisis as the Fed slashed interest rates to near zero and corporations cut dividends. A recovery in investment asset values beginning in Q2 2009—which reduced realized capital losses—has helped offset some of the decrease in investment income.

Sources: A.M. Best (historical and estimates/projected for 2009 and 2010); Insurance Information Institute.
Investment Yield by Segment: 2008-2010P*

Investment yields are shrinking across all segments—down 10 to 100 basis points since 2008.

The Fed slashed interest rates in 2008 and has kept them low since, eroding the yield on all types of bonds, especially US Treasury securities. Yields will not recover until the Fed begins monetary policy tightening.

Sources: A.M. Best (historical and estimates/projected for 2009 and 2010); Insurance Information Institute.
Reinsurance Combined Ratio: 1990–2010P

Reinsurance is a Highly Volatile Line and the Future is Unlikely to be Any Different

Note: 2008-2010 figures are from A.M. Best’s P/C Review and Preview, February 8, 2010.
Homeowners Insurers Combined Ratio: 1990–2010P

Homeowners Line Is Expected to Be Marginally Profitable Overall in 2010, but in Many States Could Be Quite Profitable. Volatility Due to Catastrophe Losses Will Persist.

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

Private Passenger Auto Accounts for 34% of Industry Premiums and Remains the Profit Juggernaut of the P/C Insurance Industry

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

Commercial Multi-Peril is Expected to Continue to Perform Reasonably Well

*2009E and 2010P figures are for the combined liability and non-liability components.
Sources: A.M. Best; Insurance Information Institute.

Commercial Auto is Expected to Remain Reasonably Profitable in 2010

Sources: A.M. Best; Insurance Information Institute.
Inland Marine Combined Ratio: 1999–2010P

Inland Marine is Expected to Remain Among the Most Profitable of All Lines

Sources: A.M. Best; Insurance Information Institute.
Workers Compensation Combined Ratio: 1994–2010P

Workers Comp Underwriting Results Are Deteriorating Markedly

Sources: A.M. Best; Insurance Information Institute.
Workers Compensation Operating Environment

The Weak Economy and Soft Market Have Made the Workers Comp Operating Increasingly Challenging
Workers Compensation Net Premiums Written and Annual Growth Rates: 1970-2010P

WC premium growth hit a 40+ year low in 2009 at -13%. Improving labor market should help beginning in 2010.

Sources: A.M. Best (1973-2009); Insurance Information Institute calculations and estimates for 2010.
Workers Compensation Combined Ratio: 1973–2010P

Workers Comp Underwriting Results Are Deteriorating Markedly

Sources: A.M. Best; Insurance Information Institute.
Calendar Year Reserve Deficiency Increased in 2009

WC Loss and LAE Reserve Deficiency: Private Carriers

2009 Tabular Discount Is $5.3 Billion

Considers all reserve discounts as deficiencies
Loss and LAE figures are based on NAIC Annual Statement data for each valuation date and NCCI latest selections
Source: NCCI analysis
Workers Compensation Medical & Indemnity Claim Cost Trends

Rising Medical Costs Exert Pressure While Indemnity Costs Rise Well Ahead of Wage Inflation
Workers Comp Medical Claim Costs Continue to Rise

Medical Claim Cost ($000s)

- Annual Change 1991–1993: +1.9%
- Annual Change 1994–2001: +8.9%
- Annual Change 2002-2009: +6.6%

Cumulative Change = 224% (1993-2009p)

2009p: Preliminary based on data valued as of 12/31/2009
1991-2008: Based on data through 12/31/2008, developed to ultimate
Based on the states where NCCI provides ratemaking services; Excludes the effects of deductible policies
WC Medical Severity Rising at Nearly Twice the Medical CPI Rate

Average annual increase in WC medical severity from 1995 through 2008 was nearly double medical CPI (7.6% vs. 3.9%). New healthcare reform legislation is unlikely to have any impact on the gap.

Workers Compensation Lost-Time Claim Frequency Continues to Decline*

(Percent)

Lost-Time Claims

Cumulative Change of -54.7%

Claim frequency fell in 4.0% in 2009, in part due to the recession

2009p: Preliminary based on data valued as of 12/31/2009;
1991-2008: Based on data through 12/31/2008, developed to ultimate
Based on the states where NCCI provides ratemaking services including state funds; Excludes the effects of deductible policies

*Frequency is defined as the number of lost-time claims per 100,000 workers.
Med Costs Share of Total Costs is Increasing Steadily

1988
- Indemnity: 54%
- Medical: 46%

1998
- Indemnity: 47%
- Medical: 53%

2008p
- Indemnity: 42%
- Medical: 58%

Source: NCCI (based on states where NCCI provides ratemaking services).
WC Med Cost Will Equal 70% of Total by 2018 if Trends Hold

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

Source: Insurance Information Institute.
Indemnity Claim Cost Trends

Indemnity Costs Continue to Rise at a Pace Above Wage Inflation
Workers Comp Indemnity Claim Costs Continue to Grow

Indemnity Claim Cost ($000s)

Annual Change 1991–1993: -1.7%
Annual Change 1994–2001: +7.3%
Annual Change 2002–2008: +4.0%

2009p: Preliminary based on data valued as of 12/31/2009
1991–2008: Based on data through 12/31/2008, developed to ultimate
Based on the states where NCCI provides ratemaking services
Excludes the effects of deductible policies
WC indemnity severity is once again outpacing wage inflation.


Source: NCCI
Where Will the Growth in WC Exposure Come From?

Industry and Occupation Growth Analysis

<table>
<thead>
<tr>
<th>Occupations</th>
<th>Percent change</th>
<th>Number of new jobs (in thousands)</th>
<th>Wages (May 2008 median)</th>
<th>Education/ training category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biomedical engineers</td>
<td>72</td>
<td>11.6</td>
<td>$ 77,400</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Network systems and data communications analysts</td>
<td>53</td>
<td>155.8</td>
<td>71,100</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Home health aides</td>
<td>50</td>
<td>460.9</td>
<td>20,460</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Personal and home care aides</td>
<td>46</td>
<td>375.8</td>
<td>19,180</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Financial examiners</td>
<td>41</td>
<td>11.1</td>
<td>70,930</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Medical scientists, except epidemiologists</td>
<td>40</td>
<td>44.2</td>
<td>72,590</td>
<td>Doctoral degree</td>
</tr>
<tr>
<td>Physician assistants</td>
<td>39</td>
<td>29.2</td>
<td>81,230</td>
<td>Master's degree</td>
</tr>
<tr>
<td>Skin care specialists</td>
<td>38</td>
<td>14.7</td>
<td>28,730</td>
<td>Postsecondary vocational award</td>
</tr>
<tr>
<td>Biochemists and biophysicists</td>
<td>37</td>
<td>8.7</td>
<td>82,840</td>
<td>Doctoral degree</td>
</tr>
<tr>
<td>Athletic trainers</td>
<td>37</td>
<td>6.0</td>
<td>39,640</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Physical therapist aides</td>
<td>36</td>
<td>16.7</td>
<td>23,760</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Dental hygienists</td>
<td>36</td>
<td>62.9</td>
<td>66,570</td>
<td>Associate degree</td>
</tr>
<tr>
<td>Veterinary technologists and technicians</td>
<td>36</td>
<td>28.5</td>
<td>28,900</td>
<td>Associate degree</td>
</tr>
<tr>
<td>Dental assistants</td>
<td>36</td>
<td>105.6</td>
<td>32,380</td>
<td>Moderate-term on-the-job training</td>
</tr>
<tr>
<td>Computer software engineers, applications</td>
<td>34</td>
<td>175.1</td>
<td>85,430</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Medical assistants</td>
<td>34</td>
<td>163.9</td>
<td>28,300</td>
<td>Moderate-term on-the-job training</td>
</tr>
<tr>
<td>Physical therapist assistants</td>
<td>33</td>
<td>21.2</td>
<td>46,140</td>
<td>Associate degree</td>
</tr>
<tr>
<td>Veterinarians</td>
<td>33</td>
<td>19.7</td>
<td>79,050</td>
<td>First professional degree</td>
</tr>
<tr>
<td>Self-enrichment education teachers</td>
<td>32</td>
<td>81.3</td>
<td>35,720</td>
<td>Work experience in a related occupation</td>
</tr>
<tr>
<td>Compliance officers, except agriculture,</td>
<td>31</td>
<td>80.8</td>
<td>48,890</td>
<td>Long-term on-the-job training</td>
</tr>
</tbody>
</table>

WC exposure growth the fastest in the health, science and tech areas


Dollar growth in WC exposures should grow the most (at current rate levels) in the health and services industries

<table>
<thead>
<tr>
<th>Occupations</th>
<th>Number of new jobs (in thousands)</th>
<th>Percent change</th>
<th>Wages (May 2008 median)</th>
<th>Education/ training category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered nurses</td>
<td>581.5</td>
<td>22</td>
<td>$ 62,450</td>
<td>Associate degree</td>
</tr>
<tr>
<td>Home health aides</td>
<td>460.9</td>
<td>50</td>
<td>20,460</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Customer service representatives</td>
<td>399.5</td>
<td>18</td>
<td>29,860</td>
<td>Moderate-term on-the-job training</td>
</tr>
<tr>
<td>Combined food preparation and serving workers, including fast food</td>
<td>394.3</td>
<td>15</td>
<td>16,430</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Personal and home care aides</td>
<td>375.8</td>
<td>46</td>
<td>19,180</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Retail salespersons</td>
<td>374.7</td>
<td>8</td>
<td>20,510</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Office clerks, general</td>
<td>358.7</td>
<td>12</td>
<td>25,320</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Accountants and auditors</td>
<td>279.4</td>
<td>22</td>
<td>59,430</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Nursing aides, orderlies, and attendants</td>
<td>276.0</td>
<td>19</td>
<td>23,850</td>
<td>Postsecondary vocational award</td>
</tr>
<tr>
<td>Postsecondary teachers</td>
<td>256.9</td>
<td>15</td>
<td>58,830</td>
<td>Doctoral degree</td>
</tr>
<tr>
<td>Construction laborers</td>
<td>255.9</td>
<td>20</td>
<td>28,520</td>
<td>Moderate-term on-the-job training</td>
</tr>
<tr>
<td>Elementary school teachers, except special education</td>
<td>244.2</td>
<td>16</td>
<td>49,330</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Truck drivers, heavy and tractor-trailer</td>
<td>232.9</td>
<td>13</td>
<td>37,270</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Landscaping and groundskeeping workers</td>
<td>217.1</td>
<td>18</td>
<td>23,150</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Bookkeeping, accounting, and auditing clerks</td>
<td>212.4</td>
<td>10</td>
<td>32,510</td>
<td>Moderate-term on-the-job training</td>
</tr>
<tr>
<td>Executive secretaries and administrative assistants</td>
<td>204.4</td>
<td>13</td>
<td>40,030</td>
<td>Work experience in a related occupation</td>
</tr>
<tr>
<td>Management analysts</td>
<td>178.3</td>
<td>24</td>
<td>73,570</td>
<td>Bachelor's or higher degree, plus work experience</td>
</tr>
<tr>
<td>Computer software engineers, applications</td>
<td>175.1</td>
<td>34</td>
<td>85,430</td>
<td>Bachelor's degree</td>
</tr>
<tr>
<td>Receptionists and information clerks</td>
<td>172.9</td>
<td>15</td>
<td>24,550</td>
<td>Short-term on-the-job training</td>
</tr>
<tr>
<td>Carpenters</td>
<td>165.4</td>
<td>13</td>
<td>38,940</td>
<td>Long-term on-the-job training</td>
</tr>
</tbody>
</table>

SOURCE: BLS Occupational Employment Statistics and Division of Occupational Outlook
Numeric Change in Wage and Salary Employment in Service-Providing Industries: 2008-2018P

(Thousands)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Change (Thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health Care and Social Assistance</td>
<td>4,017</td>
</tr>
<tr>
<td>Professional, Scientific, Tech. Srvs.</td>
<td>2,657</td>
</tr>
<tr>
<td>Education Services</td>
<td>1,683</td>
</tr>
<tr>
<td>Administration, Support, Waste Mgmt &amp; Removal</td>
<td>1,431</td>
</tr>
<tr>
<td>Accomodation &amp; Food Services</td>
<td>838</td>
</tr>
<tr>
<td>Government</td>
<td>788</td>
</tr>
<tr>
<td>Other Services (excl. Govt.)</td>
<td>704</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>654</td>
</tr>
<tr>
<td>Transportation and Warehousing</td>
<td>446</td>
</tr>
<tr>
<td>Finance &amp; Insurance</td>
<td>322</td>
</tr>
<tr>
<td>Arts, Entertainment &amp; Recreation</td>
<td>304</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>256</td>
</tr>
<tr>
<td>Real Estate, Rental &amp; Leasing</td>
<td>236</td>
</tr>
<tr>
<td>Information</td>
<td>118</td>
</tr>
<tr>
<td>Mgmt. of Companies &amp; Enterprises</td>
<td>102</td>
</tr>
</tbody>
</table>


Health, Science and Education will be important sources of exposure growth for WC insurers this decade.
Employment in high WC frequency/severity occupational classes will be flat over the next decade. Construction is expected to rebound from its recession lows but the long-term decline in US manufacturing employment will continue.

*Category includes truck drivers and drivers/sales personnel.
Many High Hazard Occupations Have Declined Disproportionately Over the Past Decade

Change in Employment (%), 2000 vs. 2009*

Most of the Loss of Jobs in High Hazard Classes Occurred Since 2007 with the Onset of the “Great Recession”

*I.I.I. calculations based on monthly seasonally adjusted data converted to annual averages.
Medical Professional Liability

What a Difference a Few Years Makes
Continued Stable/Moderate Loss Frequency

Minimal/Small Growth in Claim Severity

Continued Prior-Year Reserve Development Leading to Reserve Releases

Continued Improvements in Loss Control and Risk Management Among Medical Professionals

Investments More Stable than Industry Overall

Very Price Competitive Environment

Challenges to Tort Reform in Several Jurisdictions (e.g. IL, GA)
  - Caps were struck down in the past in OR, NH and WI
  - WA Supreme Court: No certificate of merit needed for plaintiff to pursue suit
Med Mal Insurers in 2009 paid out an estimated $0.83 in loss and expense for every $1 they earned in premiums.

The dramatic improvement in recent years has restored med mal's viability.

In 2001, med mal insurers paid out $1.55 for every dollar earned.

Source: AM Best, Insurance Information Institute
Medical Malpractice Tort Cost: Growth Continues, Though Modestly

($ Billions)

Over the period from 1990 through 2008, medical malpractice tort costs rose 224%, more than double the 101% increase in tort costs generally.

Med mal tort costs actually declined in 2008 for the first time since 1985.

Sources: Towers Perrin; Insurance Information Institute
The average Medical Malpractice jury award has been relatively flat in recent years.
Medical Care inflation has been surging ahead of general inflation (CPI) for 25 years. Since 1982-84, the cost of medical care has more than tripled.

Medical Costs Will Continue to Rise Relatively Rapidly Despite Healthcare Reform

* Through June 30, 2009

Sources: Bureau of Labor Statistics, Insurance Information Institute
Healthcare expenditures as a share of GDP consumed an estimated 16.6% of GDP in 2008 and are expected to rise to 20.3% by 2018.

Sources: Centers for Medicare and Medicaid, Office of the Actuary; Insurance Information Institute.
The 1970s were the most inflationary decade for medical costs, rising at nearly 21% per year.

Over the decade, health expenditures will likely increase well ahead of the general pace of inflation.

Source: Insurance Information Institute calculations based on data from the Centers for Medicare & Medicaid Services, Office of the Actuary.
The Economic Storm

What the Financial Crisis and Recession Mean for the Industry’s Exposure Base, Growth and Profitability
US Real GDP Growth: Exerts a Strong Influence on Energy Demand*

Real GDP Growth (%)

The Q1:2009 decline was the steepest since the Q1:1982 drop of 6.4%

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

Economic growth up sharply in Q4:09 with rebuilding of inventories and stimulus. More moderate growth expected in 2010/11

Demand for Energy and Commercial Insurance Have Been Impacted by Sluggish Economic Conditions

* Estimates/Forecasts from Blue Chip Economic Indicators.
Source: US Department of Commerce, Blue Economic Indicators 7/10; Insurance Information Institute.
Length of US Business Cycles, 1929–Present*

Length of Expansions Greatly Exceeds Contractions

Average Duration**
Recession = 10.4 Mos
Expansion = 60.5 Mos

Emerging economies (led by China) are expected to grow by 6.8% in 2010 and 6.4% in 2011.

World output is forecast to grow by 4.6% in 2010 and 4.3% in 2011, following a -0.6% drop in 2009.

Advanced economies will grow slowly in 2010 (2.6%) and 2011 (2.4%), dampening insurance and energy demand.

Weak growth among most major US trading partners means more tepid export activity in the US and weaker energy and insurance demand.

Outlook uncertain: The world economy is recovering from the global crisis, but at different speeds in different parts of the world. Insurance and energy demand will vary regionally and by industry.

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

Real GDP Growth vs. Real P/C (%)

P/C Insurance Industry’s Growth is Influenced Modestly by Growth in the Overall Economy

Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 7/10; Insurance Information Institute
Regional Differences Will Significantly Impact P/C Markets

Recovery in Some Areas Will Begin Years Ahead of Others and Speed of Recovery Will Differ by Orders of Magnitude
State Economic Growth Varied Tremendously in 2008

Percent Change in Real GDP by State, 2007–2008

Mountain, Plains States Growing the Fastest

Rocky Mountain 2.2
Plains 2.0
Southwest 1.7
Southeast 0.0
Far West 0.6

US = 0.7

Highest Quintile
Fourth Quintile
Third Quintile
Second Quintile
Lowest Quintile

US Bureau of Economic Analysis
Fastest Growing States in 2008: Plains, Mountain States Lead

Real State GDP Growth (%)

7.3% 4.4% 3.5% 2.9% 2.7% 2.5% 2.1% 2.0%
ND WY SD CO OK WV IA TX, MN, NM, WA

Natural Resource and Agricultural States Have Done Better Than Most Others Recently, Helping Insurance Exposure in Those Areas

Slowest Growing States in 2008: Diversity of States Suffering

Real State GDP Growth (%)

Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend is Improving
Unemployment and Underemployment Rates: Rocketed Up in 2008-09; Stabilizing in 2010?

January 2000 through June 2010, Seasonally Adjusted (%)

- Traditional Unemployment Rate U-3
- Unemployment + Underemployment Rate U-6

Recession ended in November 2001
Unemployment kept rising for 19 more months
Recession began in December 2007

U-6 went from 8.0% in March 2007 to 17.5% in Oct 2009; Stood at 16.5% in June 2010

Unemployment rate was 9.5% in June
Unemployment peaked at 10.1% in Oct. 2009, highest monthly rate since 1983.
Peak rate in the last 30 years: 10.8% in Nov-Dec 1982

US Unemployment Rate

2007:Q1 to 2011:Q4F*

Rising unemployment eroded payrolls and workers comp’s exposure base. 
Unemployment likely peaked at 10% in late 2009.

Unemployment forecasts are being revised downward for the first time in years

* = actual;      = forecasts
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (7/10); Insurance Information Institute
US Unemployment Rate Forecasts

Quarterly, 2010:Q1 to 2011:Q4

10 Most Pessimistic
9.9% 10.0% 9.9% 9.8%
9.6% 9.5% 9.8%
9.9%
10.0%
10.5%
10.0%
9.5%
9.0%
8.5%
8.0%
7.5%
7.0%

10 Most Optimistic
9.9% 10.0% 9.9% 9.8%
9.6% 9.5% 9.3% 9.6%
9.1% 8.9% 8.1% 9.3% 8.7% 8.4% 8.7% 7.8%

Stubbornly High Unemployment Will Slow the Recovery of the Workers Comp Exposure Base

Sources: Blue Chip Economic Indicators (6/10); Insurance Information Institute
Unemployment Rates Vary Widely by State and Region*

*Provisional figures for May 2010, seasonally adjusted.
Unemployment Rates Vary Widely by State and Region* (cont’d)

*Provisional figures for May 2010, seasonally adjusted.
May’s gain of 433,000 jobs was distorted by the hiring of 411,000 temporary Census workers. June’s loss of 125,000 jobs was distorted by the end of 225,000 Census jobs. Private sector employment was up 41,000 in May and 83,000 in June.

Monthly Losses in Dec. 08–Mar. 09 Were the Largest in the Post-WW II Period

Job Losses Since the Recession Began in Dec. 2007 Peaked at 8.4 Mill in Dec. 09; Stands at 7.4 Million Through June 2010; 14.6 Million People are Now Defined as Unemployed

*Estimate based on Reuters poll of economists.
Labor Underutilization: Broader than Just Unemployment

% of Labor Force

NOTE: Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not looking currently for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule.

The US Economy Lost About 8.4 Million Jobs in the Two Years from Dec. 07 – Dec. 09.

As employment expands, workers comp will be among the first lines to see exposure gains.

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

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

* Average Wage and Salary data as of 10/1/2009. Shaded areas indicate recessions

Estimated Effect of Recessions* on Payroll (Workers Comp Exposure)

Recessions in the 1970s and 1980s saw smaller exposure impacts because of continued wage inflation, a factor not present during the 2007-2009 recession.

The Dec. 2007 to mid-2009 recession caused the largest impact on WC exposure in 60 years.

*Data represent maximum recorded decline over 12-month period using annualized quarterly wage and salary accrual data.
Source: Insurance Information Institute research; Federal Reserve Bank of St. Louis (wage and salary data); National Bureau of Economic Research (recession dates).
Frequency: 1926–2008
A Long-Term Drift Downward

Manufacturing – Total Recordable Cases
Rate of Injury and Illness Cases per 100 Full-Time Workers

Note: Recessions indicated by gray bars.
Sources: NCCI from US Bureau of Labor Statistics; National Bureau of Economic Research
Crisis-Driven Exposure Drivers

Economic Obstacles to Growth in P/C Insurance
New auto/light truck sales fell to the lowest level since the late 1960s. Forecast for 2010-11 is still far below 1999-2007 average of 17 million units.

“Cash for Clunkers” generated about $300M in net new personal auto premiums.

Sharply lower auto sales will have a smaller effect on auto insurance exposure level than problems in the housing market will on home insurers.

Car/Light Truck Sales Will Recover from the 2009 Low Point, but High Unemployment, Tight Credit Are Still Restraining Sales; Gas Prices Could Once Again Become a Factor, Too.

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (7/10); Insurance Information Institute.
New Private Housing Starts, 1990-2011F

New home starts plunged 34% from 2005-2007; drop through 2009 was 72% (est.); A net annual decline of 1.49 million units, lowest since records 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 $1.3 billion.

Little Exposure Growth Likely for Homeowners Insurers Due to Weak Home Construction Forecast for 2010-2011. Also Affects Commercial Insurers with Construction Risk Exposure, Surety

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (7/10); Insurance Information Institute.
Percent Changes in Residential Fixed Investment, 2006:Q2-2010:Q1*

The Drop in 2006 is in Relation to the Record 2.07 Million Units Started in 2005; 1.8 Million Units Were Started That Year. The 2010:Q1 Drop Supports the Weak Home Construction Forecast for 2010-2011.

*seasonally adjusted
Source: U.S. Department of Commerce, Bureau of Economic Analysis
Average Square Footage of Completed New Homes in U.S., 1973-2010:Q1

Average size of completed new homes often falls in recessions (yellow bars), but historically bounces back in expansions.

The trend to building larger homes reversed in 2009, affecting exposure growth beyond the decline in number of units built.

The unemployment rate appears to be closely correlated with the uninsured motorist percentage.

In 2010 roughly 18% of motorists are expected to be driving without insurance as high unemployment prompts some people to drop coverage.

Source: Uninsured Motorists, 2008 Edition, Insurance Research Council; Blue Chip Economic Indicators (Unemployment data, including forecasts); Insurance Information Institute.
New Boat Sales Symptomatic of Decline in Insured Exposure Growth for Luxury/Discretionary Items

Boat sales fell by 16% in 2008 and the value of those sales plunged by 21%.

Business Bankruptcy Filings, 1980-2010:Q1

There were 60,837 business bankruptcies in 2009, up 40% from 2008 and the most since 1993. 2010:Q1 bankruptcies totaled 14,607, up 18% from Q1:2009.

% Change Surrounding Recessions

- 1980-82: 58.6%
- 1980-87: 88.7%
- 1990-91: 10.3%
- 2000-01: 13.0%
- **2006-09: 208.9%***

Significant Exposure Implications for All Commercial Lines

Source: American Bankruptcy Institute; Insurance Information Institute
169,000 businesses started in 2009:Q3, actually declining during form the prior quarter. The figure is the lowest level since 1993.

**Business Starts Are Down Nearly 20% in the Current Downturn, Holding Back Most Types of Commercial Insurance Exposure**

*Latest available as of June 7, 2010, seasonally adjusted
Net New Business Formations* 1999:Q1-2008:Q4*

In 2008, over 110,000 more businesses disappeared than started.


April 2010: Many banks are maintaining tight loan standards; some are tightening further; virtually no one loosening; Hurts business formation/expansion and commercial exposure

FDIC-Insured Institutions Had $541.1B (-13.1%) Less in Outstanding Loans in These Three Categories at Year-end 2009 vs. 2008, and Even Less at End of 2010:Q1

Source: FDIC Quarterly Banking Profile, First Quarter 2010, Table II-A
Business Fixed Investment
2008:Q1 to 2011:Q4F

Investment in Equipment & Software is forecast to be positive in both 2010 and 2011.

Investment in Structures is forecast to be down in 2010 and low in 2011. This will hold exposure in many commercial lines down.

Sources: Bureau of Economic Analysis, U.S. Department of Commerce (history); Wells Fargo Securities Economics Group, Monthly Outlook, April 7, 2010 (forecasts)
Total Industrial Production

2007:Q1 to 2011:Q4F (%)

Industrial Production is Aided by a Rebuild of Inventories, Gradual Economic Recovery and Stimulus Program (Q2:09 through 2010)

End of Recession in mid-2009, Stimulus Program Benefited Industrial Production and Insurance Exposure Both Directly and Indirectly, Albeit it Very Modestly; Stimulus Effect is Waning in 2010 and Will Be Gone in 2011.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (7/10); Insurance Information Institute
Recovery in Capacity Utilization is a Positive Sign for Energy & Insurance

Percent of Manufacturing Capacity

Manufacturing capacity stood at 74.7% in May 2010, above the June 2009 low of 68.3% but well below the pre-crisis peak of 80%+

The closer the economy is to operating at “full capacity,” the greater the demand for insurance

Recession began December 2007

But Some Industrial Production Capacity Has Vanished

Some unused capacity is gone, and in other industries new capacity is needed, so the economy might be closer to full capacity than the industrial production numbers indicate. If so, this might spur inflation sooner than expected.

State & Local Government Finances in Dire Straits

Large, Long-Term Cuts Necessary to Align Spending with Shrinking Tax Revenues
States Revenues Were Down 4.4% in Q4 2009, the 5th Consecutive Quarter of Revenue Decline. This Will Impact Public Infrastructure Spending Significantly and Related Insurance Exposures and Demand.

Nationwide, state-tax collections for fiscal year 2009 declined by a record $63 billion, or 8.2 percent from the previous year. That loss is roughly twice the amount states gained in fiscal relief from the federal stimulus package.
State and Local Debt Outstanding, 1975-2009

Debt issued by state and local governments has soared by 100% between 1999 and 2009.

Many States/Localities Are in Dire Fiscal Straights, but the Default Rate on Moody’s-Rated Muni Debt is Just 0.09% over the Past 10 Years. Just 1 State Has Defaulted in the Past 100 Years (AR). Default Rate on Munis During the Great Depression was 1.8%, 97% of Which Was Ultimately Recovered.

Source: Federal Reserve Board of Governors, Flow of Funds Accounts from Credit Suisse.
State and Local Expenditures vs. Tax Receipts, 1960-2010:Q1

The gap between state and local governments revenues and expenditures is at a 50-year high and is widening.

Many States/Localities Are in Dire Fiscal Straights, but the Default Rate on Moody’s-Rated Muni Debt is Just 0.09% over the Past 10 Years. Just 1 State Has Defaulted in the Past 100 Years (AR). Default Rate on Munis During the Great Depression was 1.8%, 97% of Which Was Ultimately Recovered.

Source: Bureau of Economic Analysis and Credit Suisse estimates.
Inflation Trends: Concerns Over Stimulus Spending and Monetary Policy

Mounting Pressure on Claim Cost Severities?
Annual Inflation Rates (CPI-U, %), 1990–2011F

Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble have reduced inflationary pressures.

There is So Much Slack in the US Economy Inflation Should Not Be a Concern Through 2010/11, but Deficits and Monetary Policy Remain Longer Run Concerns

P/C Insurers Experience Inflation More Intensely than 2009 CPI Suggests

Healthcare and Legal/Tort Costs Are a Major P/C Insurance Cost Driver. These Are Expected to Increase Above the Overall Inflation Rate (CPI) Indefinitely

Source: CPI is Blue Chip Economic Indicator 2009 estimate, 12/09; Legal services, medical care and motor vehicle body work are avg. monthly year-over-year change from BLS; BI and no-fault figures from ISO Fast Track data for 4 quarters ending 09:Q3. Tort costs is 2009 Towers-Perrin estimate. WC figure is I.I.I. estimate based on historical NCCI data.
WC Insurers Experience Inflation More Intensely than 2009 CPI Suggests

(PERCENT INCREASE DEC 08 TO DEC 09)

- **2.7%** Overall CPI
- **1.8%** "Core" CPI
- **6.9%** Hospital Services
- **3.0%** Physicians' Services
- **3.0%** Dental Services
- **3.4%** Prescription Drugs
- **3.1%** Medical Care Commodities
- **3.4%** Medical CPI

Excludes Food and Energy

Inpatient Services Rose 6.7%; Outpatient Services Rose 7.4%

**HEALTHCARE COSTS ARE A MAJOR WC INSURANCE COST DRIVER. THEY ARE LIKELY TO INCREASE FASTER THAN THE CPI FOR THE NEXT FEW YEARS, AT LEAST**

Average annual increase in WC medical severity form 1995 through 2009 was nearly twice the medical CPI (7.6% vs. 3.9%). New healthcare reform legislation is unlikely to have any impact on the gap.

The Federal Reserve Has Flooded Financial System with Cash (Turned on the Printing Presses), the Federal Gov’t Has Approved a $787B Stimulus and the Deficit is Expected to Mushroom to $1.8 Trillion. All Are Potentially Inflationary.

- What are the potential impacts for insurers?
- What can/should insurers do to protect themselves from the risks of inflation?

Key Risks From Sustained/Accelerating Inflation

- **Rising Claim Severities**
  - Cost of claims settlement rises across the board (property and liability)

- **Rate Inadequacy**
  - Rates inadequate due to low trend assumptions arising from use of historical data

- **Reserve Inadequacy**
  - Reserves may develop adversely and become inadequate (deficient)

- **Burn Through on Retentions**
  - Retentions, deductibles burned through more quickly

- **Reinsurance Penetration/Exhaustion**
  - Higher costs risks burn through their retentions more quickly, tapping into reinsurance more quickly and potentially exhausting their reinsurance more quickly

Source: Insurance Information Institute.
Tort Cost Growth & Medical Cost Inflation vs. Overall Inflation (CPI-U), 1961-2009E*

Tort costs move with inflation but at twice the rate of inflation

Tort system is an inflation amplifier
Tort costs: +8.4%
Med costs: +5.9%
Overall inflation: +4.2%

Are there healthcare reform spillover effects?

* CPI-U and medical costs as of Sept 2009; Tort figure is for full-year 2009 from Tillinghast.
Claim Trends in Auto Insurance

Rising Costs Held in Check by Falling Frequency: Can That Pattern Be Sustained?
Bodily Injury: Severity Trends Generally Above Decline in Frequency

Annual Change, 2005 through 2009

Cost Pressures Will Increase if Current BI Frequency and Severity Trends Continue

Source: ISO/PCI Fast Track data; Insurance Information Institute
Property Damage Liability: Frequency and Severity Trends Nearly Offset in 2009

Annual Change, 2005 through 2009

Source: ISO/PCI Fast Track data; Insurance Information Institute

Favorable Severity/Frequency Trends Keeping PD Costs in Check, But Are These Trends Sustainable?
No-Fault (PIP) Liability: Frequency and Severity Trends Are Adverse*

Annual Change, 2005 through 2009

Multiple States Are Experiencing Severe Fraud and Abuse Problems in their No-Fault Systems, Especially FL, MI, NY and NJ

*No-fault states included are: FL, HI, KS, KY, MA, MI, MN, NY, ND and UT.
Source: ISO/PCI Fast Track data; Insurance Information Institute
Collision Coverage: Frequency and Severity Trends Have Been Favorable

Annual Change, 2005 through 2009

The Recession, High Fuel Prices Have Helped Push Down Frequency and Temper Severity, But this Trend Will Likely Be Reversed Based on Evidence from Past Recoveries

Source: ISO/PCI Fast Track data; Insurance Information Institute
Comprehensive Coverage: Frequency and Severity Trends Favorable in 2009

Annual Change, 2005 through 2009

Weather Creates Volatility for Comprehensive Coverage; Recession Has Helped Push Down Frequency and Temper Severity, But This Factors Will Weaken as Economy Recovers

Source: ISO/PCI Fast Track data; Insurance Information Institute
Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?
Important Issues & Threats Facing Insurers: 2010–2015

Emerging Tort Threat

- No tort reform (or protection of recent reforms) is forthcoming from the current Congress or Administration
- Erosion of recent reforms is a certainty (already happening)
- Innumerable legislative initiatives will create opportunities to undermine existing reforms and develop new theories and channels of liability
- Torts twice the overall rate of inflation
- Influence personal and commercial lines, esp. auto liability
- Historically *extremely* costly to p/c insurance industry
- Leads to reserve deficiency, rate pressure

*Bottom Line:* Tort “crisis” is on the horizon and will be recognized as such by 2012–2014

Source: Insurance Information Institute
Trial Bar Priorities

- Reverse U.S. Supreme Court decisions on pleadings
- Eliminate pre-dispute arbitration
- Erode federal preemption
- Expand securities litigation
- Pass Foreign Manufactures Legal Accountability Act
- Confirm pro-trial lawyer judges – “Federalize Madison County”
- Grant enforcement authorities to state
- Roll back existing legal reforms

Source: Institute for Legal Reform.
## Trial Lawyer Poll: Which Areas Offer the Greatest Potential Benefit?

<table>
<thead>
<tr>
<th>Top Categories</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental</td>
<td>14%</td>
</tr>
<tr>
<td>Insurance coverage</td>
<td>13%</td>
</tr>
<tr>
<td>Mortgage fraud</td>
<td>12%</td>
</tr>
<tr>
<td>Nursing home/ seniors issues</td>
<td>11%</td>
</tr>
<tr>
<td>Bad-faith against insurance companies</td>
<td>10%</td>
</tr>
</tbody>
</table>

41 different practice areas were included as categories

Source: Institute for Legal Reform poll, December 2009.
Cost of US Tort System ($ Billions)

Tort costs consumed 1.79% of GDP in 2008, down from 2.24% in 2003

Per capita “tort tax” was $? in 2009, up from $838 in 2008 and $636 in 2000

Over the Last Three Decades, Total Tort Costs* as a % of GDP Appear Somewhat Cyclical

$300 2.50%
$250 2.25%
$200 2.00%
$150 1.75%
$100 1.50%

2009–2010 Growth in Tort Costs as % of GDP is Due in Part to Shrinking GDP

* Excludes the tobacco settlement, medical malpractice

Sources: Tillinghast-Towers Perrin, 2008 Update on US Tort Cost Trends, Appendix 1A; I.I.I. calculations/estimates for 2009 and 2010
## Business Leaders Ranking of Liability Systems in 2009*

<table>
<thead>
<tr>
<th><strong>Best States</strong></th>
<th><strong>New in 2009</strong></th>
<th><strong>Worst States</strong></th>
<th><strong>Newly Notorious</strong></th>
<th><strong>Rising Above</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Delaware</td>
<td>North Dakota</td>
<td>41. New Mexico</td>
<td>New Mexico</td>
<td>Texas</td>
</tr>
<tr>
<td>2. North Dakota</td>
<td>Massachusetts</td>
<td>42. Florida</td>
<td>Montana</td>
<td>South Carolina</td>
</tr>
<tr>
<td>3. Nebraska</td>
<td>South Dakota</td>
<td>43. Montana</td>
<td>Arkansas</td>
<td>Hawaii</td>
</tr>
<tr>
<td>4. Indiana</td>
<td></td>
<td>44. Arkansas</td>
<td></td>
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</tr>
<tr>
<td>5. Iowa</td>
<td></td>
<td>45. Illinois</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Virginia</td>
<td></td>
<td>46. California</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Utah</td>
<td></td>
<td>47. Alabama</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Colorado</td>
<td></td>
<td>48. Mississippi</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Massachusetts</td>
<td></td>
<td>49. Louisiana</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. South Dakota</td>
<td></td>
<td>50. West Virginia</td>
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</tr>
</tbody>
</table>

**Drop-offs**
- Maine
- Vermont
- Kansas

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

The Nation’s Judicial Hellholes: 2010

**Watch List**
- California
- Alabama
- Madison County, IL
- Jefferson County, MS
- Texas Gulf Coast
- Rio Grande Valley, TX

**Dishonorable Mention**
- AR Supreme Court
- MN Supreme Court
- ND Supreme Court
- PA Governor
- MA Supreme Judicial Court
- Sacramento County

Source: American Tort Reform Association; Insurance Information Institute
Average Jury Awards 1999 - 2008

Source: Jury Verdict Research; Insurance Information Institute.

*Award trends in wrongful deaths of adult males.
Source: Jury Verdict Research; Insurance Information Institute.
Sum of Top 10 Jury Awards 2004-2009

# 2009 Top Ten Verdicts

<table>
<thead>
<tr>
<th>Value</th>
<th>Issue</th>
<th>State</th>
</tr>
</thead>
<tbody>
<tr>
<td>$370 Million</td>
<td>Defamation</td>
<td>California</td>
</tr>
<tr>
<td>$330 Million</td>
<td>Personal Injury (Drunk driving case)</td>
<td>Florida</td>
</tr>
<tr>
<td>$300 Million</td>
<td>Personal Injury (Tobacco verdict)</td>
<td>Florida</td>
</tr>
<tr>
<td>$89 Million</td>
<td>Personal Injury (Drunk driving case)</td>
<td>Missouri</td>
</tr>
<tr>
<td>$78.75 Million</td>
<td>Personal Injury (Prempro)</td>
<td>New Jersey</td>
</tr>
<tr>
<td>$77.4 Million</td>
<td>Medical Malpractice</td>
<td>New York</td>
</tr>
<tr>
<td>$71 Million</td>
<td>Conversion and Breach of Fiduciary Duty</td>
<td>Texas</td>
</tr>
<tr>
<td>$70 Million</td>
<td>Workers Comp Case</td>
<td>Texas</td>
</tr>
<tr>
<td>$65 Million</td>
<td>Personal Injury</td>
<td>Florida</td>
</tr>
<tr>
<td>$60 Million</td>
<td>Medical Malpractice</td>
<td>New York</td>
</tr>
</tbody>
</table>

Source: Lawyers USA, January 15, 2010.
## 2008 Top Ten Verdicts

<table>
<thead>
<tr>
<th>Value</th>
<th>Issue</th>
<th>State</th>
</tr>
</thead>
<tbody>
<tr>
<td>$388 Million</td>
<td>Fraud, Intentional Infliction of Emotional Distress</td>
<td>Nevada</td>
</tr>
<tr>
<td>$316 Million</td>
<td>Breach of Contract</td>
<td>Georgia</td>
</tr>
<tr>
<td>$188 Million</td>
<td>Defamation</td>
<td>New York</td>
</tr>
<tr>
<td>$85 Million</td>
<td>Premises Liability</td>
<td>Pennsylvania</td>
</tr>
<tr>
<td>$84 Million</td>
<td>Negligence, Personal Injury</td>
<td>Texas</td>
</tr>
<tr>
<td>$66 Million</td>
<td>Breach of Fiduciary Duty</td>
<td>Oklahoma</td>
</tr>
<tr>
<td>$60 Million</td>
<td>Insurance Bad Faith</td>
<td>Nevada</td>
</tr>
<tr>
<td>$55 Million</td>
<td>Negligence</td>
<td>California</td>
</tr>
<tr>
<td>$54 Million</td>
<td>Wrongful Death</td>
<td>Georgia</td>
</tr>
<tr>
<td>$48 Million</td>
<td>Negligence</td>
<td>Indiana</td>
</tr>
</tbody>
</table>

Source: Lawyers USA, January 13, 2009.
How the Risk Dollar is Spent (2008)

Total liability costs account for about 30% of the risk dollar

Firms w/Revenues < $1 Billion
- Other Costs, 21%
- Admin Costs, 9%
- Prof. Liability Costs, 9%
- Retained WC Losses, 10%
- WC Premiums, 7%
- Total Mgmt. Liab., 9%
- Liability Retained Losses, 12%
- Property Premiums, 15%

Firms w/Revenues > $1 Billion
- Other Costs, 15%
- Admin Costs, 7%
- Prof. Liability Costs, 3%
- Retained WC Losses, 22%
- WC Premiums, 6%
- Total Mgmt. Liab., 12%
- Liability Premiums, 11%
- Property Premiums, 12%
- Retained Property Losses, 5%
- Retained Liability Losses, 6%

Source: 2009 RIMS Benchmark Survey; Insurance Information Institute
Average Total Limits Purchased by All U.S. Firms* ($ Millions)

Limits fell by 45% between 2000 and 2008. Price/capacity are issues.

*Includes underlying primary limits
Source: Limits of Liability 2008, Marsh, Inc.
Excess Liability Market Capacity North America ($ Billions)

In 2008, capacity is back to 2000 levels.

Source: Marsh, 2008 Limits of Liability Report
Insurer Defense & Cost Containment Expenses as a % of Incurred Losses, 2005-2008*

*Net of reinsurance, excl. state funds. **Liability portion only. ***Excludes products liability.
Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data, LLC; Insurance Information Institute.
After surging in 2007 and 2008, litigation activity related to the financial crisis began to ebb after financial markets began to recover in the 2nd quarter of 2009.

Source: Stanford University School of Law (securities.stanford.edu); Insurance Information Institute
The Financial Crisis and Poor Labor Market Conditions Have Contributed to a Surge Employment Discrimination Charges

Catastrophic Loss – Catastrophe Losses Trends Are Trending Adversely
2010 CAT Losses Are Running Below 2009, So Far
Figures Do Not Include an Estimate of Deepwater Horizon Loss


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.

Sources: Property Claims Service/ISO; Munich Re; Insurance Information Institute.
Global Natural Catastrophes: January – June 2010

The 12 Jan. Haiti quake killed 225,500 people, caused $8B+ in economic damage, but little in the way of insured losses.

The Chilean earthquake (mag. 8.8) on 27 Feb. produced at least $4 billion in insured losses, $20 billion in economic losses. Most costly insurance event in 2010.

Severe winter weather in the Eastern US produced insured losses of at least $1B in insured losses and $2B in economic losses.

Winter Storm Xynthia produced at least $2B in insured losses and $4B in economic losses.

- Global natural catastrophes
- Geophysical events (earthquake, tsunami, volcanic activity)
- Hydrological events (flood, mass movement)
- Meteorological events (storm)
- Climatological events (extreme temperature, drought, wildfire)

© 2010 Münchener Rückversicherungs-Gesellschaft, Geo Risks Research, NatCatSERVICE – As at 16 June 2010
## Probability of Landfall of at Least One Major Hurricane (CAT 3-4-5) in 2010*

<table>
<thead>
<tr>
<th>Region</th>
<th>Average Over Last Century</th>
<th>2010 Forecast*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entire U.S. Coastline</td>
<td>52%</td>
<td>76%</td>
</tr>
<tr>
<td>U.S. East Coast Incl. FL Peninsula</td>
<td>31%</td>
<td>51%</td>
</tr>
<tr>
<td><strong>Gulf Coast from FL Panhandle to Brownsville, TX</strong></td>
<td><strong>30%</strong></td>
<td><strong>50%</strong></td>
</tr>
<tr>
<td>Caribbean</td>
<td>42%</td>
<td>65%</td>
</tr>
</tbody>
</table>

*Forecast as of June 2, 2010.
Source: Colorado State University, Department of Atmospheric Sciences; Insurance Information Institute.

The Probability of a Major Hurricane Making Landfall Somewhere Along the US Coast is Greatly Elevated in 2010, Including a 50% Chance Along the Oil Spill-Impacted Gulf Coast
Outlook for 2010 North Atlantic Hurricane Season*

<table>
<thead>
<tr>
<th>Forecast Parameter</th>
<th>Average (1950-2000)</th>
<th>2010 Forecast*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Named Storms</td>
<td>9.6</td>
<td>18</td>
</tr>
<tr>
<td>Named Storm Days</td>
<td>49.1</td>
<td>90</td>
</tr>
<tr>
<td>Hurricanes</td>
<td>5.9</td>
<td>10</td>
</tr>
<tr>
<td>Hurricane Days</td>
<td>24.5</td>
<td>40</td>
</tr>
<tr>
<td>Major Hurricanes</td>
<td>2.3</td>
<td>5</td>
</tr>
<tr>
<td>Major Hurricane Days</td>
<td>5.0</td>
<td>13</td>
</tr>
<tr>
<td>Accumulated Cyclone Energy</td>
<td>96.1</td>
<td>185</td>
</tr>
<tr>
<td><strong>Net Tropical Cyclone Activity</strong></td>
<td><strong>100%</strong></td>
<td><strong>195%</strong></td>
</tr>
</tbody>
</table>

The 2010 Hurricane Season is Expected to Be Nearly Twice as Active as the Long-Run Average (195% of Normal)

*Forecast as of June 2, 2010.
Source: Colorado State University, Department of Atmospheric Sciences; Insurance Information Institute.
Number of events in first half of 2010 is close to the annual totals from five of past ten years.
Thunderstorm losses have quadrupled since 1980.

First Half 2010
$3.0 Bn

Source: Property Claims Service, MR NatCatSERVICE  © 2010 Munich Re
Average annual winter storm losses have increased over 50% since 1980.

Severe winter storms in early 2010 caused major damage to energy infrastructure.

First Half 2010
$2.4 Bn

Source: Property Claims Service, MR NatCatSERVICE
© 2010 Munich Re
There were 7 Significant Natural Catastrophes in the United States in 2009.
Distribution of US Insured CAT Losses: TX, FL, LA vs. US, 1980-2008*

($ Billions)

- **Texas**: $31.20, 10%
- **Louisiana**: $33.60, 11%
- **Rest of US**: $176, 60%
- **Florida**: $57.10, 19%

Florida Accounted for 19% of All US Insured CAT Losses from 1980-2008: $57.1B out of $297.9B

* All figures (except 2006-2008 loss) have been adjusted to 2005 dollars.

Source: PCS division of ISO.
Top 12 Most Costly Disasters in US History

(Insured Losses, 2009, $ Billions)

Hurricane Katrina Remains, By Far, the Most Expensive Insurance Event in US and World History

8 of the 12 Most Expensive Disasters in US History Have Occurred Since 2004;
8 of the Top 12 Disasters Affected FL

Sources: PCS; Insurance Information Institute inflation adjustments.
Share of Losses Paid by Reinsurers for Major Catastrophic Events

Reinsurance plays a very large role in claims payouts associated with major catastrophes.

- Hurricane Hugo (1989): 30%
- Hurricane Andrew (1992): 25%
- Sept. 11 Terrorist Attack (2001): 60%
- 2004 Hurricane Season: 20%
- 2005 Hurricane Season: 45%
- 2008 Texas Hurricane: 33%

Source: Wharton Risk Center, Disaster Insurance Project, Renaissance Re, Insurance Information Institute.
2007, $ Billions

In 2007, Florida Still Ranked as the #1 Most Exposed State to Hurricane Loss, with $2.459 Trillion Exposure, but Texas is very exposed too, and ranked #3 with $895B in insured coastal exposure.

The Insured Value of All Coastal Property Was $8.9 Trillion in 2007, Up 24% from $7.2 Trillion in 2004.

Source: AIR Worldwide
In the 19-year period between 1990 and 2008, total exposure to loss in the residual market (FAIR & Beach/Windstorm) plans has surged from $54.7B in 1990 to $696.4B in 2008.

Source: PIPSO; Insurance Information Institute
The Deepwater Horizon Disaster

Insurance and Energy Market Implications
<table>
<thead>
<tr>
<th>Date</th>
<th>Well</th>
<th>Location</th>
<th>Bbl Spilled</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 20 2010-present</td>
<td>Deepwater Horizon</td>
<td>Gulf of Mexico, USA</td>
<td>est. 4,050,000 thru July 12*</td>
</tr>
<tr>
<td>June 1979-April 1980</td>
<td>Ixtoc I</td>
<td>Bahia del Campeche, Mexico</td>
<td>3,300,000</td>
</tr>
<tr>
<td>October 1986</td>
<td>Abkatun 91</td>
<td>Bahia del Campeche, Mexico</td>
<td>247,000</td>
</tr>
<tr>
<td>April 1977</td>
<td>Ekofisk Bravo</td>
<td>North Sea, Norway</td>
<td>202,381</td>
</tr>
<tr>
<td>January 1980</td>
<td>Funiwa 5</td>
<td>Forcados, Nigeria</td>
<td>200,000</td>
</tr>
<tr>
<td>October 1980</td>
<td>Hasbah 6</td>
<td>Gulf, Saudi Arabia</td>
<td>105,000</td>
</tr>
<tr>
<td>December 1971</td>
<td>Iran Marine International</td>
<td>Gulf, Iran</td>
<td>100,000</td>
</tr>
<tr>
<td>January 1969</td>
<td>Alpha Well 21 Platform A</td>
<td>Pacific, CA, USA</td>
<td>100,000</td>
</tr>
<tr>
<td>March 1970</td>
<td>Main Pass Block 41</td>
<td>Gulf of Mexico</td>
<td>65,000</td>
</tr>
<tr>
<td>October 1987</td>
<td>Yum II/Zapoteca</td>
<td>Bahia del Campeche, Mexico</td>
<td>58,643</td>
</tr>
<tr>
<td>December 1970</td>
<td>South Timbalier B-26</td>
<td>Gulf of Mexico, USA</td>
<td>53,095</td>
</tr>
</tbody>
</table>

*Based on estimate of 50,000 barrels per day for 78 days derived from Flow Rate Technical Group whose members include U.S. Geological Survey (USGS), NOAA, Bureau of Ocean Energy Management (part of DOE) and outside academics. Does not include offset for any amounts recovered.

On April 20, 2010, an explosion and fire occurred on the offshore drilling rig Deepwater Horizon, which had been drilling an exploratory well in approx. 5,000 ft of water in the Gulf of Mexico, 52 miles SE of Venice, Louisiana.

The platform subsequently sank, with 11 crewmembers presumed dead, and the uncompleted well leaking oil.

Sources: Energy Information Administration
The operating group for Deepwater Horizon is a joint venture led by BP.

BP has said it will assume liability for all “legitimate claims caused by the oil spill.

BP is self-insured, so a large portion of losses will not hit the insurance industry.

On June 1, 2010, U.S. Attorney General said federal authorities have opened criminal and civil investigations into the spill.

As of early July, BP says that its costs have exceeded $3 billion, including $105 million paid on 32,000 claims. BP CEO Tony Hayward is insisting “Other parties besides BP may be responsible for costs and liabilities arising from the oil spill, and we expect those parties to live up to their obligations.” But Anadarko accuses BP of gross negligence.

Source: Barclays Capital research note 05/10/10; I.I.I. research.
Oil Spill Testimony by I.I.I.

Hearing on the Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes

House Committee on Transportation and Infrastructure

Testimony of
Robert P. Hartwig, Ph.D., CPCU
President & Economist
Insurance Information Institute
New York, NY

June 9, 2010
Washington, DC
The Deepwater Horizon Disaster: Insurance Market Impacts

Insurance Information Institute
June 28, 2010

Download at www.iii.org/presentations

Robert P. Hartwig, Ph.D., CPCU, President & Economist
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Tel: 212.346.5520 ♦ Cell: 917.453.1885 ♦ bobh@iii.org ♦ www.iii.org
Insured Losses Significant, But Manageable

- **Insured Loss:**
  - The loss is a major event for the offshore energy insurance and reinsurance market.
  - Companies with direct exposure to the Deepwater Horizon oil rig are insured for losses totaling between $1.4 billion and $3.5 billion, according to initial reports.
  - The risks are well-syndicated, with the insured loss spread across a broad range of insurers and reinsurers on a global scale.
  - Since BP, which owns 65% of the Deepwater Horizon consortium self insures, a large portion of the losses will not hit the insurance industry.
  - Lawsuits against equipment manufacturers, suppliers and subcontractors, and business interruption claims, will likely increase total insured losses.
  - BP said it will assume liability for all legitimate claims caused by the oil spill. Primary liability for clean up costs will be with BP consortium.

Source: Insurance Information Institute (I.I.I.); Barclays Capital research note 05/10/10; Credit Suisse research note 05/11/10
Insured Implications of the Deepwater Horizon Oil Spill in the Gulf

- Direct Insurance Payouts from Insured Deepwater Parties
- Other Indemnification Processes
  - BP claims process
  - $20B Feinberg-administered fund
  - Litigation
- Coverage Issues
  - Oil contaminated water from flood/storm surge
  - Wind-blown oil
  - Business Interruption
- Price and Availability of Coverage for Offshore Operators
- Hostile Regulatory Environment for Offshore Oil & Gas Concerns
  - Revisions to Oil Pollution Act of 1990
  - Increased financial responsibility requirements
  - Impacts demand for energy insurance products and ancillary services/coverages
- Carryover to Onshore Oil & Gas Operators and Utilities
- Politicization of the Issue
- Impact on Carbon Legislation
Insured Implications of the Deepwater Horizon Oil Spill in the Gulf

- Coverage Questions

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Insurance Information Institute Online:

www.iii.org

Thank you for your time and your attention!

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