Overview and Outlook for the Property/Casualty Insurance Industry

Focus on Missouri Insurance Markets

St. Louis CPCU All Industry Day
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Presentation Outline

- Reasons for Optimism, Causes for Concern in the P/C Insurance Industry
- P/C Profitability Overview & Outlook
  - Missouri P/C Insurance Profitability Overview
- The Elusive Market Turn: When, Why, How and IF
  - Pricing: Up, Down or Sideways?
  - Underwriting Trends: Drivers of Future Market Firming?
  - Investments: New Investment Reality Not Reflected in Pricing
  - Expenses: Cyclical Increase
  - Leverage/Capital Management: Excess Capacity and Squeezing it Out
- M&A Activity in the P/C Insurance Industry
- External Factors Influencing Profitability
  - Tort System Review: Overview and Causes for Concern
  - Inflation
- Growth in the Aftermath of the Great Recession
  - Crisis-Driven Exposure Issues: Personal & Commercial Lines
- Global Issues Impacting P/C Insurance
- Catastrophe Loss Review
- Q&A
Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

The Outlook for the Economy Has Brightened, But the Outlook for P/C Insurance Is Mixed
Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- Economic Recovery in US is Self-Sustaining and Strengthening
  - No Double Dip or Second Recession
  - Economy is more resilient than most pundits presume
- Consumer Confidence is Gradually Improving
- Consumer Spending is Recovering Gradually
- Consumer and Business Lending Are Expanding
- Housing Market Remains Weak, but Some Improvement Expected in 2011
- Inflation Remains Tame
  - Runaway inflation is highly unlikely; Fed has things under control
  - Deflation—threat has disappeared
- Private Sector Hiring is Consistently Positive for 14 Months
  - Acceleration in hiring later in 2011 compared to 2010
  - No significant secondary spike in unemployment
- Japan Threat to Global Economy Overstated
- Sovereign Debt, Muni Bond “Crises” Overblown
- Current Middle East Turmoil Poses Only Moderate Risk to US Economy
- Interest Rates Are Rising but Remain Low by Historical Standards
- Stock and Bond Markets More Stable, Less Volatile
- Political Environment Is More Hospitable to Business Interests
Era of Mass P/C Insurance Exposure Destruction Has Ended
- Personal and commercial exposure growth is virtually certain in 2011
- But restoration of destroyed exposure will take 3-5 years in US

Exposure Growth Returned in 2010, Will Accelerate in 2011

P/C Industry Saw Growth in 2010 (+0.8%) for the First Time Since 2006

Increasing Private Sector Hiring Will Drive Payrolls/WC Exposures
- Wage growth is also positive and could modestly accelerate

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

Investment Environment Is/Remains Much More Favorable
- Return of realized capital gains as a profit driver
- Interest rates are low but are rising → Boost to investment income

Agent Commissions Should Begin to Rise in 2011

Demand, Capital Management Strategies Will Temper Overcapitalization
Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- Economic Recovery Is Not as Broad Based as Past Recoveries
  - Housing, Construction remain weak

- Recovery Is Uneven
  - Certain states remain in recession and recoveries will lag: CA, FL, MI, NV

- Credit Markets Are Not Completely Yet Healed
  - While the financial sector has strengthened, hundreds more banks failures are possible

- Consumers/Businesses Will Remain Cautious in their Borrowing/Spending

- Energy and Commodity Price Volatility Are Serious Economic Risks
  - Effects can be disruptive to a fragile recovery even without igniting overall inflation
  - Concern over serial bubbles in various economic sectors on a global scale

- Financial Markets, While Calm Now, Remain Jittery
  - Markets buy into “crisis du jour” mindset quickly; Another “Flash Crash” possibility
  - Currency risk is elevated

- Minor Muni Bond Default(s) Could Result in Irrational Market Response

- Potential for Botched Implementation of Dodd-Frank
  - Systemic risk definition may be too broad
  - Banks will eventually find a way to screw up the economy—again

- Strength of Admin/Congress Commitment to Pro-Business Policies Unclear
Reasons for Optimism, Causes for Concern in the P/C Insurance Industry

- **Exposure Loss Was Extraordinary, Concentrated in Commercial Lines**
  - Will take years to restore lost capacity
  - Capacity will not be restored in the same industrial or geographic sectors
  - Public sector pain has a long way to go

- **Consumers Emerged from the Crisis Much More Cost Conscious**
  - Quicker to shop/switch; Price elasticity of demand is higher
  - Heightens retention challenge

- **Commercial Customers Remain Comfortable/Able Retaining More Risk**
  - “Leakage” remains a problem (ART, captives, self insurance, large ded. progs.)

- **Strength of Recovery Insufficient to Absorb Excess Capital or Firm Pricing**

- **P/C Insurance Industry Capacity as of 12/31/10 Is at Record Levels and Has Recovered 100%+ of the Capital Lost During the Financial Crisis**
  - The industry is overcapitalized by approximately $100 billion
  - Record capacity, depressed exposures (S>D) mean that generally soft market conditions will persist through 2011

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

- **Pricing Today Does Not Reflect New Investment Realities or Underlying Deterioration in Underwriting Performance Masked by Release of Prior-Year Reserves**

*Source: Insurance Information Institute.*
Summary of Japan Earthquake

The March 11 Quake is Just the Most Recent of Several Large Catastrophe Losses
March 11 Earthquake Facts as of 3/24/2011

- Magnitude 9.0 earthquake struck Japan at 2:46PM local time (2:46AM Eastern) off northeast coast of Honshu, 80 miles east of Sendai.
- Quake is among the 5 strongest in recorded history and the strongest in the 140 years for which records have been kept in Japan.
- 12,000+ fatalities.
- Economic loss: $100 - $300 bn.
- Insured losses up to $35 bn.
- Fukushima Nuclear Plant threat level raised to Category 7 on April 11 (highest, same as Chernobyl).
- Significant tsunami damage was recorded in Japan; relatively minor damage on the U.S. West Coast.

LOCATION
130 km (80 miles) E of Sendai, Honshu, Japan
178 km (110 miles) E of Yamagata, Honshu, Japan
178 km (110 miles) ENE of Fukushima, Honshu, Japan
373 km (231 miles) NE of Tokyo, Japan

Source: US Geological Service; Insurance Information Institute.
Insured Japan Earthquake Loss Estimates*

(Insured Losses, $ Billions)

Economic losses are likely to total in the $200 billion range, meaning only a fraction of the loss is insured.

*As of April 11, 2011. Towers Watson estimate includes $3.0 (low) to $4.9 billion (high) in life insurance losses.
Sources: AIR Worldwide, Eqecat; Insurance Information Institute.
### Top 20 Nonlife Insurance Companies in Japan by DPW, 2008

<table>
<thead>
<tr>
<th>Rank</th>
<th>Companies</th>
<th>Direct premiums written, 2008</th>
<th>Market share</th>
<th>Cumulative Market Share</th>
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<tr>
<td></td>
<td></td>
<td>JPY (millions)</td>
<td>U.S. ($ millions)</td>
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<tr>
<td>1</td>
<td>Tokio &amp; Marine Nichido</td>
<td>$2,032,131.2</td>
<td>$19,660.9</td>
<td>24.0%</td>
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<tr>
<td>2</td>
<td>Sompo Japan</td>
<td>1,504,262.7</td>
<td>14,553.8</td>
<td>17.8%</td>
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<tr>
<td>3</td>
<td>Mitsui Sumitomo</td>
<td>1,455,161.8</td>
<td>14,078.7</td>
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<td>4</td>
<td>Aioi</td>
<td>897,182.6</td>
<td>8,680.3</td>
<td>10.6%</td>
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<td>5</td>
<td>Nipponkoa</td>
<td>728,262.9</td>
<td>7,046.0</td>
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<td>Nisay Dowa</td>
<td>361,530.7</td>
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<td>Fuji</td>
<td>329,345.7</td>
<td>3,186.4</td>
<td>3.9%</td>
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<td>8</td>
<td>AIU</td>
<td>253,522.8</td>
<td>2,452.8</td>
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<td>9</td>
<td>Kyoei</td>
<td>199,393.1</td>
<td>1,929.1</td>
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<td>10</td>
<td>Nisshin</td>
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<td>1,448.7</td>
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<td>11</td>
<td>American Home</td>
<td>82,889.8</td>
<td>802.0</td>
<td>1.0%</td>
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<td>12</td>
<td>Asahi</td>
<td>73,600.1</td>
<td>712.1</td>
<td>0.9%</td>
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<td>13</td>
<td>Sony</td>
<td>60,868.3</td>
<td>588.9</td>
<td>0.7%</td>
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<td>14</td>
<td>ACE</td>
<td>54,876.2</td>
<td>530.9</td>
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<td>15</td>
<td>Zurich</td>
<td>45,471.3</td>
<td>439.9</td>
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<td>16</td>
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<td>18</td>
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<td>20</td>
<td>Daido</td>
<td>15,690.4</td>
<td>151.8</td>
<td>0.2%</td>
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Source: © AXCO 2011.
Recent Major Catastrophe Losses

(Insured Losses, $US Billions)

The March 2011 earthquake in Japan will become among the most expensive in world history in terms of insured losses (current leader is the 1994 Northridge earthquake with $22.5B in insured losses in 2010 dollars).

Insured Losses from Recent Major Catastrophe Events Exceed $50 Billion, an Estimated $48 Billion of that from Earthquakes

*Midpoint of AIR Worldwide estimated insured loss range of $15 billion to $35 billion as of March 13, 2011. Does not include tsunami losses.

Sources: Insurance Council of Australia, Munich Re, AIR Worldwide; Insurance Information Institute.
Nonlife Insurance Market Impacts of Japan Earthquake

- **Primary Insurance: Downgrades of Some Domestic Japanese Insurers**
- **Significant Absorption of Loss by Japanese Government**
  - Residential earthquake damage
  - Nuclear-related property and liability damage
- **Market Share of Foreign Primary Insurers in Japan is Small**
  - Not a capital event for any non-Japanese primary insurer
- **Significant Impacts for Global Reinsurers**
  - Property-Catastrophe covers on Commercial Lines
  - Business Interruption
  - Contingent Business Interruption
- **Currently an Earnings Event for Global Reinsurers**
  - Not a capital event: Global reinsurance markets entered 2011 with record capital
- **Cost of Property/Catastrophe Reinsurance Rising in Japan, New Zealand, Australia**
  - Up for all; Magnitude of increase is sensitive to size of loss
- **Reinsurance Coverage Remains Available in Affected Regions**
- **Marginal Impact of Cost of US Property-Cat Reinsurance**
  - Market remains well capitalized and competitive
  - Elevated global cat activity could halt price declines for property/cat reinsurance
% of Residences in MO Quake-Prone Areas with Earthquake Coverage, 2009 vs. 2002

Between 32% and 63% of MO homeowners buy quake coverage in vulnerable areas compared to 12% of CA homeowners and about 50% in Japan.

Residential Take-Up Rates in Missouri Quake-Prone Counties Have Fallen Significantly in Recent Years, but Compare Favorably to California (12%)

Sources: Missouri Department of Insurance news release, Feb. 11, 2011; Insurance Information Institute.
Change in Cost of Earthquake Policy in MO Quake-Prone Areas, 2009 vs. 2002

The increase in premiums in earthquake prone areas of MO increased between 17% and 125% between 2002 and 2009.

Sources: Missouri Department of Insurance news release, Feb. 11, 2011; Insurance Information Institute.
P/C Insurance Industry
Financial Overview

Profit Recovery Continues
Early Stage Growth Begins
P/C Industry 2010:Q3 profits were $26.7B vs. $16.4B in 2009:Q3, due mainly to $4.4B in realized capital gains vs. -$9.6B in previous realized capital losses.

* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.7% ROAS for 2010:Q3 and 4.6% for 2009. 2009:Q3 net income was $29.8 billion excluding M&FG.

Sources: A.M. Best, ISO, Insurance Information Institute
P/C Profitability Is Both by Cyclicality and Ordinary Volatile

Sources: ISO, Fortune; Insurance Information Institute figure for 2010 is actual through 2010:Q3.
The P/C Insurance Industry Fell Well Short of Its Cost of Capital in 2008 but Narrowed the Gap in 2009 and 2010

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 2008-2010

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

* Return on average surplus in 2008-2010 excluding mortgage and financial guaranty insurers.
Source: The Geneva Association, Insurance Information Institute
A 100 Combined Ratio Isn’t What It Once Was: Investment Impact on ROEs

A combined ratio of about 100 generated ~7.5% ROE in 2009/10, 10% in 2005 and 16% in 1979.

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

* 2009 and 2010:Q3 figures are return on average statutory surplus. 2008, 2009 and 2010:H1 figures exclude mortgage and financial guaranty insurers.

Source: Insurance Information Institute from A.M. Best and ISO data.
10-year returns for some lines are excellent, though homeowners is a major laggard, largely due to major catastrophes. WC returns are slipping.
Profitability Trends in Missouri P/C Insurance Markets

Analysis by Line and Nearby State Comparisons
RNW All Lines: MO vs. U.S., 2000-2009

(Percent)

Sources: NAIC.

Average 2000-2009
US: 7.2%
MO: 7.1%

Sources: NAIC.

(Percent)

Average 2000-2009
US: 8.5%
MO: 8.1%

Sources: NAIC.

Average 2000-2009
US: 8.0%
MO: 7.6%

Sources: NAIC.

(Percent)

Average 2000-2009
US: 4.7%
MO: -11.8%

Sources: NAIC.

Workers comp profitability in MO has generally outperformed the US.

Average 2000-2009
US: 6.4%
MO: 9.3%

Sources: NAIC.
All Lines: 10-Year Average RNW MO & Nearby States

2000-2009

- Kansas: 10.5%
- Missouri: 7.5%
- U.S.: 7.0%
- Iowa: 6.9%
- Arkansas: 6.9%
- Tennessee: 6.5%
- Illinois: 6.3%

Source: NAIC, Insurance Information Institute
The Elusive Market Turn

When, Why, How and IF
PRICING TRENDS

Winds of Change or Moving Sideways?
Soft Market Persisted in 2010 but May Be Easing: 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.

NWP was up 0.5% in 2010 (est.) with forecast growth of 1.4% in 2011.

Shaded areas denote “hard market” periods
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.
While homeowners insurance has grown faster than auto over the past decade, auto is generally more profitable.

Sources: A.M. Best; Insurance Information Institute.
Finally! Back-to-back quarters of net written premium growth (vs. the same quarter, prior year)

Sources: ISO, Insurance Information Institute.
Net Written Premium Growth by Segment: 2008-2011F

Personal lines growth resumed in 2010 and will continue in 2011, while commercial lines contracted again in 2010 and but will stabilize in 2011.

Rate and exposure are more favorable in personal lines, whereas a prolonged soft market and sluggish recovery from the recession weigh on commercial lines.

Sources: A.M. Best; Insurance Information Institute.
Monthly Change* in Auto Insurance Prices, 1991–2011*

Cyclical peaks in PP Auto tend to occur approximately every 10 years (early 1990s, early 2000s and likely the early 2010s)

A pricing peak may be occurring

Feb. 2011 change was 4.2%, down from 5.4% in Nov. 2010

“Hard” markets tend to occur during recessionary periods

*Percentage change from same month in prior year; through February 2011; seasonally adjusted
Note: Recessions indicated by gray shaded columns.
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.
Average Premium for Home Insurance Policies**

Consumer efforts to economize (increased deductibles, more shopping, etc.) and adverse exposure trends are depressing the average homeowners insurance premium.

* Insurance Information Institute Estimates/Forecasts  **Excludes state-run insurers.
Source: NAIC, Insurance Information Institute estimates 2009-2010 based on CPI and other data.
Average Commercial Rate Change, All Lines, (1Q:2004–3Q:2010)

(Percent)

Source: Council of Insurance Agents & Brokers; Insurance Information Institute
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2010:Q3

Peak = 2001:Q4
+28.5%

Trough = 2007:Q3
-13.6%

Market has Been Soft for 6+ years and Remains Soft as Capital is Restored and Underwriting Losses Remain Modest.

Pricing Turned Negative in Early 2004 and Has Been Negative Ever Since.

KRW Effect

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.

1999:Q4 = 100

Pricing today is where it was in Q3:2000 (pre-9/11)

Downward pricing pressure is most pronounced for larger risks

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Change in Commercial Rate Renewals, by Line: 2010:Q3

Percentage Change (%)

Most Major Commercial Lines Renewed Down in Q3:2010 at a Pace Similar to that of a Year Earlier

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Cyclicality is Driven Primarily by the Industry’s Underwriting Cycle, Not the Economy
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

Cyclical Deterioration

Lower CAT Losses, More Reserve Releases


Sources: A.M. Best, ISO.
Personal lines combined ratio is expected to remain stable in 2010 while commercial lines and reinsurance deteriorate.

Overall deterioration in 2011 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, Insurance Information Institute.
Large Underwriting Losses Are *NOT* Sustainable in Current Investment Environment

* Includes mortgage and financial guaranty insurers.
Sources: A.M. Best, ISO; Insurance Information Institute.

Cumulative underwriting deficit from 1975 through 2009 is $445B

The industry recorded a $6.2B underwriting loss in 2010:Q3 compared to $3.2B in 2009:Q3
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.
Prior year reserve releases totaled $8.8 billion in the first half of 2010, up from $7.1 billion in the first half of 2009.

Reserve Releases Are Remained Strong in 2010 But Should Begin to Taper Off 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

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.
Inflation-Adjusted Dollar Value of Claims Paid by P/C Insurers, 1925–2010E*

Since 1925, P/C insurers have paid more than $12.6 trillion in claims to policyholders on an inflation-adjusted basis.

Claim payouts increased exponentially for decades, but more erratically in the post-1980 era.

On an inflation-adjusted basis, claims paid have fallen to 1990s levels, reflecting improved underwriting results, exposure loss during the “Great Recession” and leakage to alternative markets.

Sources: Insurance Information Institute research and calculations from A.M. Best data.
Adjusted for inflation, it took 36 years for the industry to pay its first $1 trillion in claims in the years since 1925. Today, the industry pays $1 trillion in claims every 2 to 3 years after adjusting for inflation.

Sources: Insurance Information Institute research and calculations from A.M. Best data.
$12.5 Trillion of Paid Claims and Someone Still Writes a Book With This Title?

This book by a Rutgers University law professor asserts that insurers do everything possible to avoid paying legitimate claims.

I will be debating the thesis of Prof. Feinman’s book and refuting his allegations in New Orleans on March 24.
INVESTMENTS: THE NEW REALITY

Investment Performance is a Key Driver of Profitability

Does It Influence Underwriting or Cyclicality?
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. Investment gains recovered significantly in 2010.

Investment gains in 2010 are on track to be their best since 2007.

Sources: ISO; Insurance Information Institute.

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.
Capital losses have turned to capital gains, aiding earnings.

Realized Capital Losses Were the Primary Cause of 2008/2009’s Large Drop in Profits and ROE and Were a Major Driver of Its Recovery in 2010

Sources: A.M. Best, ISO, Insurance Information Institute.
Treasury Yield Curve is near its most depressed level in at least 45 years, though longer yields rose in late 2010/early 2011 as economy improved. Investment income is falling as a result.

The Fed’s Announced Intention to Pursue Additional Quantitative Easing Could Depress Rates in the 7 to 10-Year Maturity Range through June

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.
As of December 31, 2009

- **Invested assets totaled $1.26 trillion**
- Generally, insurers invest conservatively, with over 2/3 of invested assets in bonds
- Only 18% of invested assets were in common or preferred stock

*Net admitted assets. Sources: NAIC; Insurance Information Institute research.*
2011 Financial Overview
About Half of the P/C Insurance Industry’s Bond Investments Are in Municipal Bonds

Bond Investment Facts as of 12/31/09

- Investments in “Political Subdivision [of states]” bonds were $102.5 billion
- Investments in “States, Territories, & Possessions” bonds were $58.9 billion
- Investments in “Special Revenue” bonds were $288.2 billion
- All state, local, and special revenue bonds totaled 48.2% of bonds, about 35.7% of total invested assets

As of December 31, 2009

- Special Revenue: 31.0%
- Special Revenue Industrial: 33.3%
- Political Subdivisions: 11.0%
- U.S. Government: 15.5%
- States, Terr., etc.: 6.3%
- Foreign Govt: 2.0%

Sources: NAIC, via SNL Financial; Insurance Information Institute research.
Municipal Bonds: Recent Issues

- **Most Government Entities Are Under Financial Distress**
  - Plunging tax receipts, higher outlays, pension obligations

- **Analyst Meredith Whitney in Dec. 2010 Said (on 60 Minutes) that a “Spate” of 50-100 Sizeable Defaults Totaling “Hundreds of Billions of Dollars”**
  - Few other analysts believe such and outcome is likely, though most acknowledge that some are likely

- **The 3 Major Ratings Agencies Report Cumulative Muni Bond Default Rates Ranging from 0.04% to 0.29% from 2000-2009**
  - These figures indicate that muni defaults are very rare
  - Longer-term review corroborates rarity of such defaults
  - Even in the event of default municipalities often (eventually) make good on the debt

- **Municipalities Have Many Tools to Meet Obligations**

- **Revenues to State and Local Governments Are Starting to Recover**
2011 Financial Overview
When P/C Insurers Invest in Higher Risk Bonds, It’s Corporates, Not Munis

The NAIC’s Securities Valuation Office puts bonds into one of 6 classes: class 1 has the lowest expected impairments; successively higher numbered classes imply increasing impairment likelihood.

Data are as of year-end 2009. Sources: SNL Financial; Insurance Information Institute.
MUNICIPAL BOND CONCERNS

Collapse of Muni Bond Market is Highly Unlikely
Chapter 9 Bankruptcy Filings: 1980-2010:Q3

There was a notable spike in municipal bankruptcy filings in 2009, the highest level since 1994 (year of Orange County bankruptcy), but activity appears to have tapered off in 2010.

Chapter 9 bankruptcy allows for the reorganization of “municipalities,” which include cities, towns, villages, counties, taxing districts, municipal utilities and school districts.

*Through Q3 2010.

Note: Chapter 9 bankruptcy allows for the reorganization of
Source: American Bankruptcy Institute; Insurance Information Institute.
Muni Bond Issuance: 2000 – 2011*

Muni issuance is was down in early 2011 after the end of a special federal program in 2010 and amid the fiscal problems of many states and municipalities.

*Borrowing Slows
Muni-issuance is on pace for lowest quarter in 11 years.
$160 billion

Source: Thompson Reuters; Wall Street Journal; Insurance Information Institute.
Financial Strength & Underwriting

Cyclical Pattern is P-C Impairment
History is Directly Tied to Underwriting, Reserving & Pricing
The Number of Impairments Varies Significantly Over the P/C Insurance Cycle, With Peaks Occurring Well into Hard Markets

*2010 estimate.
Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007/08

Source: A.M. Best; Insurance Information Institute

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

- Deficient Loss Reserves/Inadequate Pricing: 40.1%
- Reinsurance Failure: 3.6%
- Alleged Fraud: 7.8%
- Catastrophe Losses: 7.2%
- Affiliate Impairment: 7.8%
- Investment Problems: 8.8%
- Misc.: 4.0%
- Sig. Change in Business: 7.1%

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 a continued difficult operating environment, 66% of ratings actions in 2010 were affirmations; 6.7% were upgrades and 6.8% downgrades.

Source: A.M. Best.
Performance by Segment: Commercial/Personal Lines & Reinsurance
Homeowners Line Is Expected to Improve in 2011. Extreme Regional Variation Can Be Expected Due to Local Catastrophe Loss Activity

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 Underwriting Performance is Expected to Deteriorate Modestly

*2010E and 2011P figures are for the combined liability and non-liability components.
Sources: A.M. Best; Insurance Information Institute.

Commercial Auto Underwriting Performance is Expected to Deteriorate Modestly

Sources: A.M. Best; Insurance Information Institute.
Inland Marine Combined Ratio: 1999–2011P

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

Sources: A.M. Best; Insurance Information Institute.
Workers Comp Underwriting Results Are Deteriorating Markedly and the Worst They Have Been in a Decade

Sources: A.M. Best; Insurance Information Institute.
Expense Ratios Are Highly Cyclical and Contribute Deteriorating Underwriting Performance
Underwriting Expense Ratio*  
All P/C Lines, 1994-2010E**

*Ratio of expenses incurred to net premiums written.  
**2010 figure based on data through 2010:Q3.  
Source: A.M. Best; Insurance Information Institute.
Underwriting Expense Ratio*: Personal vs. Commercial Lines, 1990-2010E**

Commercial lines expense ratios are highly cyclical

*Ratio of expenses incurred to net premiums written.
**2010 figures are estimates.
Source: A.M. Best; Insurance Information Institute.
Underwriting Expense Ratio*  
Personal Lines (Auto & Home), 1994-2010E**

*Ratio of expenses incurred to net premiums written. 
**2010 figures are estimates. 
Source: A.M. Best; Insurance Information Institute.

Expenses ratios for both auto and home are up from their lows in 2003/04
CAPITAL MANAGEMENT & LEVERAGE

Excess Capital is a Major Obstacle to a Market Turn;
Capital Management Decisions Will Impact Market Direction
US Policyholder Surplus: 1975–2010*

Surplus as of 6/30/10 was a near-record $530.5B, 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 6/30/10 is now 1.7% 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 $0.80:$1 as of 6/30/10, A Record Low (at Least in Recent History)**

* As of 6/30/10; **Calculated using annualized net premiums written based on H1 2010 data.

2007:Q3 Previous Surplus Peak

Surplus set a new record in 2010:Q3*

The Industry now has $1 of surplus for every $0.77 of NPW—the strongest claims-paying status in its history.

Quarterly Surplus Changes Since 2007:Q3 Peak

09:Q1: -$84.7B (-16.2%)  10:Q1: +$18.9B (+3.6%)
09:Q2: -$58.8B (-11.2%)  10:Q2: +$8.7B (+1.7%)
09:Q3: -$31.0B (-5.9%)  10:Q3: +$23.0B (+4.4%)
09:Q4: -$10.3B (-2.0%)

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

Sources: ISO, A.M. Best.
In 2010:Q3 One Insurer’s Paid-in Capital Rose by $22.5B as Part of an Investment in a Non-insurance Business
Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

Global Reinsurance Capacity

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

Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989*

* 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 Q3:10 vs Q3:09.

Sources: A.M. Best, ISO, Insurance Information Institute
The premium-to-surplus ratio (a measure of leverage) hit a record low at just 0.79:1 in 2010. It has decreased as PHS grows more quickly than NPW, with the effect of holding down profitability.

The Premium-to-Surplus Ratio in 2010 Implies that P/C Insurers Held $1 in Surplus Against Each $0.79 Written in Premiums. In 1974, Each $1 of Surplus Backed $2.70 in Premium.

*2010 data are estimated using annualized NWP data through 2010:Q3.
Sources: Insurance Information Institute calculations from A.M. Best data.
Merger & Acquisition

Capital Cycles Can
Drive Consolidation
U.S. activity rebounded from lows recorded in 2009. M&A also made a comeback worldwide, with global activity rising 20%.

Sources: Conning Research Consulting; Insurance Information Institute.
U.S. P/C Insurance-Related M&A Activity, 1988–2010E*

($ Billions)

Transaction Value

Number of Transactions

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

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

Note: U.S. Company was the acquirer and/or target.
Source: Conning Research & Consulting.  *2010E is derived from A.M. Best data for p/c insurers only (excludes brokers/agencies)
After a severe drop due to the capital crunch, M&A volume began to rebound in 2010. Levels remain below 1998-2000 and 2006 peaks.

Sources: Conning Research & Consulting through 2009; 2010 vol. est. from A.M. Best (2010 deal count N/A); Insurance Information Institute.
2009: More M&A activity outside U.S.

Non-U.S. activity exceeded U.S. activity in number and volume. Non-U.S. volume fell, but not as sharply as in U.S.

Sources: Conning Research Consulting; Insurance Information Institute.
2009: Five Largest U.S. Deals

<table>
<thead>
<tr>
<th>Buyer</th>
<th>Target</th>
<th>Value (millions)</th>
<th>Motivation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zurich Financial Services AG</td>
<td>21st Century Insurance Group</td>
<td>$1.900</td>
<td>AIG asset sale</td>
</tr>
<tr>
<td>Fairfax Financial Holdings</td>
<td>Odyssey Re Holding Corp.</td>
<td>960</td>
<td>Topping off ownership</td>
</tr>
<tr>
<td>Medical Professional Mutual Insurance Co.</td>
<td>Fincor Holdings, Inc.</td>
<td>237</td>
<td>Consolidation</td>
</tr>
<tr>
<td>Tower Group, Inc.</td>
<td>Specialty Underwriters Alliance, Inc.</td>
<td>107</td>
<td>Geographic expansion/Diversification of operations</td>
</tr>
<tr>
<td>Emerging Capital Partners</td>
<td>Nouvelle Societe Interafricaine d’Assurance Participatiion S.A. (Cote d’Ivoire)</td>
<td>48</td>
<td>Investment in Africa’s financial sector</td>
</tr>
</tbody>
</table>

Only one deal exceeded $1 Billion in 2009, vs. two in 2008 that exceeded $4 billion apiece (Liberty buying Safeco and Tokio’s acquisition of Philadelphia Insurance Cos.)

Sources: Conning Research Consulting; Insurance Information Institute.
### 2009: Five Largest Non-U.S. Deals

<table>
<thead>
<tr>
<th>Buyer</th>
<th>Target</th>
<th>Value (millions)</th>
<th>Motivation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banque Nationale de Paris Paribas Assurance (France)</td>
<td>Fortis Insurance Belgium (Belgium)</td>
<td>1,861</td>
<td>Fortis Bank forced to sell insurance assets</td>
</tr>
<tr>
<td>Partner Re Ltd. (Bermuda)</td>
<td>Paris Re Holdings Ltd (Switzerland)</td>
<td>1,716</td>
<td>Consolidation</td>
</tr>
<tr>
<td>Validus Holdings, Ltd. (Bermuda)</td>
<td>IPC Holdings Ltd. (Bermuda)</td>
<td>1,650</td>
<td>Consolidation</td>
</tr>
<tr>
<td>Polish State (Poland)</td>
<td>PZU S.A. (Poland)</td>
<td>1,200</td>
<td>Privatization of state assets</td>
</tr>
<tr>
<td>Porto Seguro S.A. (Brazil)</td>
<td>Seguros de Automovel e Residencia S.A (Brazil)</td>
<td>855</td>
<td>Consolidation and access to bank clients</td>
</tr>
</tbody>
</table>

One significant deal had no announced value – combination of Mitsui Sumitomo, Aioi Insurance and Nissay Dowa General in Japan. They merged for economies of scale in shrinking Japanese market.

Sources: Conning Research Consulting; Insurance Information Institute.
2010: Ten Largest U.S. Deals

<table>
<thead>
<tr>
<th>Merger &amp; Acquisition</th>
<th>Approximate Value ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Max Capital/ Harbor Point</td>
<td>3,500</td>
</tr>
<tr>
<td>Fairfax Financial/ Zenith National</td>
<td>1,300</td>
</tr>
<tr>
<td>Ace Ltd./ Rain and Hail Insurance Services</td>
<td>1,100</td>
</tr>
<tr>
<td>QBE/ NAU</td>
<td>565</td>
</tr>
<tr>
<td>Doctors Co./ American Physicians Capital</td>
<td>386</td>
</tr>
<tr>
<td>Fairfax Financial/ General Fidelity Insurance</td>
<td>328</td>
</tr>
<tr>
<td>Fairfax Financial/ First Mercury Financial</td>
<td>294</td>
</tr>
<tr>
<td>QBE/ Renaissance Re U.S. operations</td>
<td>275</td>
</tr>
<tr>
<td>Southwest Insurance Partners/ Lightyear Capital</td>
<td>250</td>
</tr>
<tr>
<td>ProSight Specialty Insurance/ NYMAGIC</td>
<td>230</td>
</tr>
</tbody>
</table>

Mergers were a way to expand in preferred markets amid the slow growth post-recession. Acquirers generally had abundant capital. Terms and conditions for financing were advantageous.

Sources: A.M. Best; Insurance Information Institute.
Valuations may have bottomed out

So far this year, 10 deals have been announced, worth nearly $2 billion.

Sources: SNL Financial; Insurance Information Institute.
Buyers are consistently more profitable than targets, rest of industry

The year before merger, eventual targets have earnings that lag industry average. Buyers’ earnings are higher than the industry.

Sources: SNL Financial; Insurance Information Institute.
Firms on both sides of merger have higher expense ratios than industry.

M&A targets have slightly higher expense ratios than buyers. Both run higher expense ratios than the industry overall.

Sources: SNL Financial; Insurance Information Institute.
Type of acquisition is shifting

2005 to 2007
- Mutual: 8%
- Other: 3%
- Stock: 89%

2008 to 2010
- Mutual: 12%
- Other: 5%
- Stock: 83%

There were 16 mutual targets in 2008-2010, up from 10 in the three prior years.

Sources: SNL Financial; Insurance Information Institute.
2010: Affiliations continue

- NLC Insurance Cos./Hingham Mutual Fire
- Danbury Insurance/Casco Indemnity
- Texas Farm Bureau/Farm Bureau County Mutual (Texas)
- Cooperative Mutual (NE)/Austin Mutual
- Wisconsin America Mutual/Western National

Smaller (sometimes distressed) carriers affiliate with regionals or super-regionals.

Sources: A.M. Best; Insurance Information Institute.
Activity to increase, especially among commercial lines
- Slow economic growth, limited opportunities
- Advantageous financing
- Need to use capital more efficiently

Possible obstacles
- Low valuations deter sellers
- Companies might prefer to wait out soft market
Looking Ahead

- Smaller scale M&A is more likely than “mega deals”
  - Stock valuations remain low
  - Number of actual acquirers and targets is limited
  - Biggest growth opportunities are abroad/life sector

- Incentives for Smaller Size Firms to Merge
  - Economies of scale
  - Inability to make necessary investments in technology
  - Key markets hit hard by economic downturn (e.g., small commercial, contractors, construction, etc.)
  - Poor financials
  - Capital issues
Secondary Considerations
OPERATING ENVIRONMENT
REGULATORY ENVIRONMENT

Many Other Factors Influence
P/C Insurer Profitability
Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?
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
Cost of US Tort System ($ Billions)

Tort costs consumed 1.74% of GDP in 2009, down from 2.21% in 2003

Per capita “tort tax” was $808 in 2009, up from $793 in 2000*

* Restated in 2009 dollars, based on CPI.

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

Tort Costs Have Remained High but Relatively Stable Since the mid-2000s. As a Share of GDP they Should Fall as the Economy Expands.

Sources: Towers Watson, 2010 Update on US Tort Cost Trends, Appendix 1A
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.
# Business Leaders Ranking of Liability Systems in 2010

## Best States

1. Delaware  
2. North Dakota  
3. Nebraska  
4. Indiana  
5. Iowa  
6. Virginia  
7. Utah  
8. Colorado  
9. Massachusetts  
10. South Dakota

## Worst States

41. New Mexico  
42. Florida  
43. Montana  
44. Arkansas  
45. Illinois  
46. California  
47. Alabama  
48. Mississippi  
49. Louisiana  
50. West Virginia

### New in 2010
- North Dakota  
- Massachusetts  
- South Dakota

### Drop-offs
- Maine  
- Vermont  
- Kansas

### Newly Notorious
- New Mexico  
- Montana  
- Arkansas

### Rising Above
- Texas  
- South Carolina  
- Hawaii

---

The Nation’s Judicial Hellholes: 2010

Watch List
- Madison County, IL
- Atlantic County, NJ
- St. Landry Parish, LA
- District of Columbia
- NYC and Albany, NY

Dishonorable Mention
- MI Supreme Court
- City of St. Louis
- CO Supreme Court

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 2004-2010

# 2010 Top Ten Jury Verdicts

<table>
<thead>
<tr>
<th>Value</th>
<th>Issue</th>
<th>State</th>
</tr>
</thead>
<tbody>
<tr>
<td>$505.1 Million</td>
<td>Products Liability</td>
<td>Nevada</td>
</tr>
<tr>
<td>$208.8 Million</td>
<td>Personal Injury (Asbestos/Mesothelioma case)</td>
<td>California</td>
</tr>
<tr>
<td>$152 Million</td>
<td>Wrongful Death (Tobacco verdict)</td>
<td>Massachusetts</td>
</tr>
<tr>
<td>$132.5 Million</td>
<td>Personal Injury (Ford rollover retrial)</td>
<td>Mississippi</td>
</tr>
<tr>
<td>$124.5 Million</td>
<td>Personal Injury (Passenger van rollover case)</td>
<td>Texas</td>
</tr>
<tr>
<td>$103 Million</td>
<td>Legal Malpractice/Breach of Fiduciary Duty</td>
<td>Mississippi</td>
</tr>
<tr>
<td>$90.8 Million</td>
<td>Products Liability, Wrongful Death (Tobacco verdict)</td>
<td>Florida</td>
</tr>
<tr>
<td>$89 Million</td>
<td>Personal Injury, Products Liability</td>
<td>Pennsylvania</td>
</tr>
<tr>
<td>$82.5 Million</td>
<td>Wrongful Death</td>
<td>Texas</td>
</tr>
<tr>
<td>$80 Million</td>
<td>Wrongful Death (Tobacco verdict)</td>
<td>Florida</td>
</tr>
</tbody>
</table>

Source: Lawyers USA, January 18, 2011.
# 2009 Top Ten Jury 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 Jury 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.
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 Med Mal jury award has been relatively flat in recent years.
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%
- WC Premiums, 7%
- Retained WC Losses, 10%
- Total Mgmt. Liab., 5%
- Liability Premiums, 12%
- Total Liability Losses, 9%

Firms w/Revenues > $1 Billion

- Other Costs, 15%
- Admin Costs, 7%
- Prof. Liability Costs, 4%
- WC Premiums, 6%
- Retained WC Losses, 22%
- Total Mgmt. Liab., 12%
- Liability Premiums, 11%
- Total Liability Losses, 5%
- Retained Property Losses, 5%

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 2\textsuperscript{nd} 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

Inflation

Is it a Threat to Claim Cost Severities
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 near-term inflationary pressures.

The slack in the U.S. economy suggests that inflation should not heat up before 2012, but other forces (commodity prices, inflation in countries from which we import, etc.), plus U.S. debt burden, remain longer-run concerns.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 10/10 and 3/11 (forecasts).
P/C Insurance Claim Cost Drivers Grow Faster than even the Medical CPI Suggests

Price Changes in 2010

- Overall CPI: 1.6%
- "Core" CPI: 1.0%
- Medical CPI: 3.4%
- Inpatient Hospital Services: 8.8%
- Outpatient Hospital Services: 6.1%
- Physicians' Services: 3.3%
- Prescription Drugs: 4.3%
- Medical Care Commodities: 3.1%

Excludes Food and Energy

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

Economic Issues for the Next 3-5 Years

Growth in the Wake of the “Great Recession”
US Real GDP Growth *

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

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

Economic growth projections for 2011 have been revised upward. This is a major positive for insurance demand and exposure growth.

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

* Estimates/Forecasts from Blue Chip Economic Indicators.
Source: US Department of Commerce, Blue Economic Indicators 3/11; Insurance Information Institute.
Real GDP Growth vs. Real P/C

Premium Growth: Modest Association

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

Real NWP Growth

Real GDP

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, 3/11; Insurance Information Institute
2011 Financial Overview
State Economic Growth Varied in 2009

Mountain, Plains states still growing the fastest

Some Southeast states growing well, but others among the weakest
Direct Premiums Written: All Lines
Percent Change by State, 2004-2009

Top 25 States

North Dakota is the growth juggernaut of the P/C insurance industry—too bad nobody lives there...

Sources: SNL Financial LC.; Insurance Information Institute.
Direct Premiums Written: All Lines
Percent Change by State, 2004-2009

States with the poorest performing economies also produced the most negative net change in premiums of the past 5 years.

Over the 5 years from 2004-2009, 15 states saw premiums shrink, one had no growth, and 4 others grew premiums by less than 1%.

Sources: SNL Financial LC; Insurance Information Institute.
11 Industries for the Next 10 Years: Insurance Solutions Needed

<table>
<thead>
<tr>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health Care</td>
</tr>
<tr>
<td>Health Sciences</td>
</tr>
<tr>
<td>Energy (Traditional)</td>
</tr>
<tr>
<td>Alternative Energy</td>
</tr>
<tr>
<td>Agriculture</td>
</tr>
<tr>
<td>Natural Resources</td>
</tr>
<tr>
<td>Environmental</td>
</tr>
<tr>
<td>Technology (incl. Biotechnology)</td>
</tr>
<tr>
<td>Light Manufacturing</td>
</tr>
<tr>
<td>Export-Oriented Industries</td>
</tr>
<tr>
<td>Shipping (Rail, Marine)</td>
</tr>
</tbody>
</table>
New auto/light truck sales fell to the lowest level since the late 1960s. Forecast for 2011-12 is still far below 1999-2007 average of 17 million units, but a recovery is underway.

Job growth and improved credit market conditions will boost auto sales in 2011 and beyond.

Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, but High Unemployment, Tight Credit Are Still Restraining Sales in 2011

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (10/10 and 3/11); Insurance Information Institute.
New Private Housing Starts, 1990-2016F

(Millions of Units)

<table>
<thead>
<tr>
<th>Year</th>
<th>Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>90</td>
<td>1.19</td>
</tr>
<tr>
<td>91</td>
<td>1.01</td>
</tr>
<tr>
<td>92</td>
<td>1.20</td>
</tr>
<tr>
<td>93</td>
<td>1.29</td>
</tr>
<tr>
<td>94</td>
<td>1.46</td>
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<tr>
<td>95</td>
<td>1.35</td>
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<tr>
<td>96</td>
<td>1.48</td>
</tr>
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<td>97</td>
<td>1.47</td>
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<tr>
<td>98</td>
<td>1.62</td>
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<tr>
<td>99</td>
<td>1.64</td>
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<td>00</td>
<td>1.57</td>
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<td>01</td>
<td>1.60</td>
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<tr>
<td>02</td>
<td>1.71</td>
</tr>
<tr>
<td>03</td>
<td>1.85</td>
</tr>
<tr>
<td>04</td>
<td>1.96</td>
</tr>
<tr>
<td>05</td>
<td>2.07</td>
</tr>
<tr>
<td>06</td>
<td>1.80</td>
</tr>
<tr>
<td>07</td>
<td>1.36</td>
</tr>
<tr>
<td>08</td>
<td>0.91</td>
</tr>
<tr>
<td>09</td>
<td>0.55</td>
</tr>
<tr>
<td>10</td>
<td>0.59</td>
</tr>
<tr>
<td>11</td>
<td>0.66</td>
</tr>
<tr>
<td>12</td>
<td>0.86</td>
</tr>
<tr>
<td>13</td>
<td>1.20</td>
</tr>
<tr>
<td>14</td>
<td>1.33</td>
</tr>
<tr>
<td>15</td>
<td>1.43</td>
</tr>
<tr>
<td>16</td>
<td>1.50</td>
</tr>
</tbody>
</table>

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.

New home starts plunged 72% from 2005-2009; A net annual decline of 1.49 million units, lowest since records began in 1959.

Little Exposure Growth Likely for Homeowners Insurers Until 2013. Also Affects Commercial Insurers with Construction Risk Exposure, Surety.

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (10/10 and 3/11); Insurance Information Institute.
The average size of completed new homes fell by 145 square feet (5.75%) from 2008-2010, the largest recession-based drop in nearly four decades.

*2010 figure is weighted average square feet of completed homes in first three quarters of 2010 Source: U.S. Census Bureau: [http://www.census.gov/const/wwq/quarterly_starts_completions.pdf](http://www.census.gov/const/wwq/quarterly_starts_completions.pdf); Insurance Information Institute.
2011 Financial Overview
Value* of Construction Put In Place

Since the recession started, private residential and nonresidential construction together are down $300 billion (annual rate), a drop of 38%. This affects property, surety, and other construction-related exposures.

*Seasonally adjusted annual rate

Source: [http://www.census.gov/const/C30/release.pdf](http://www.census.gov/const/C30/release.pdf)
2011 Financial Overview

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

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

<table>
<thead>
<tr>
<th>Period</th>
<th>Wage &amp; Salary Disbursements</th>
<th>WC Net Written Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>7/90-3/91</td>
<td>$6,000</td>
<td>$7,000</td>
</tr>
<tr>
<td>3/01-11/01</td>
<td>$50</td>
<td>$60</td>
</tr>
<tr>
<td>12/07-6/09</td>
<td>$30,000</td>
<td>$40,000</td>
</tr>
<tr>
<td></td>
<td><strong>WC net premiums written</strong></td>
<td><strong>were down $13.7B or 28.7% to $34.1B in 2009 after peaking at $47.8B in 2005</strong></td>
</tr>
</tbody>
</table>

Weakening payrolls have eroded $2B+ in workers comp premiums; nearly 29% of NPW has been eroded away by the soft market and weak economy.

* Average Wage and Salary data as of 7/1/2010. Shaded areas indicate recessions.
**Estimated “official” end of recession June 2009.
Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

The US operated at 76.3% of industrial capacity in Feb. 2011, above the June 2009 low of 68.3%

The closer the economy is to operating at “full capacity,” the greater the inflationary pressure

March 2001- November 2001 recession

December 2007- June 2009 Recession

Hurricane Katrina

There were 60,837 business bankruptcies in 2009, up 40% from 2008 and the most since 1993. 2010:Q3 bankruptcies totaled 29,059, down 5.5% from 2009:Q3.

Sources: American Bankruptcy Institute at http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=61633; Insurance Information Institute
344,000 new business starts were recorded through the first half of 2010, which was likely the slowest year for new business starts since 1993.

Business Starts Were Down Nearly 20% in the Recession, Holding Back Most Types of Commercial Insurance Exposure

* Data through June 30, 2010 are the latest available as of March 10, 2011; Seasonally adjusted
2011 Financial Overview
Weekly Percentage Change in Commercial and Industrial Loans by Large U.S. Banks, 2004-2010

Lending peak: $827.3 billion at mid-October 2008; Trough $600.5 billion at mid-October 2010; Latest (12/20/2010) $619.9 billion

Note: Recession indicated by gray shaded column.
Sources: http://research.stlouisfed.org/fred2/series/CIBOARD/downloaddata?cid=100; National Bureau of Economic Research (recession dates); Insurance Information Institute.
Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend is Improving
Unemployment and Underemployment Rates: Falling Faster in 2011?

January 2000 through March 2011, 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 October 2009; Stood at 15.7% in March 2011

Unemployment rate fell to 8.8% in March
Unemployment peaked at 10.1% in October 2009, highest monthly rate since 1983.
Peak rate in the last 30 years: 10.8% in November - December 1982

Stubbornly high unemployment and underemployment will constrain payroll growth, which directly affects WC exposure

Monthly Change in Private Employment

January 2008 through March 2011* (Thousands)

Private employers added jobs in every month in 2010 for a total of 1.435 million for the year

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

230,000 private sector jobs were created in March


The job gain and loss figures in 2010 were severely distorted by the hiring and termination of temporary Census workers. In 2010, 1.178 million nonfarm jobs were created.

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 6.2 Million Through March 2011; 13.5 Million People are Now Defined as Unemployed

*Estimate based on Reuters poll of economists.
US Unemployment Rate

2007:Q1 to 2012:Q4F*

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

Unemployment forecasts remain stubbornly high through 2011, but still imply millions of new jobs will be created.

* = actual;          = forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (3/11); Insurance Information Institute
Unemployment will remain high even under the most optimistic of scenarios, but forecasts are being revised downwards.

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

Sources: Blue Chip Economic Indicators (2/11); Insurance Information Institute
Unemployment Rates by State, February 2011:
Highest 25 States*

In February, 27 states and the District of Columbia had over-the-month unemployment rate decreases, 7 had increases, and 16 had no change.

23 states + DC had unemployment rates above the US average in Feb. 2011, 17 states were below.

*Provisional figures for February 2011, seasonally adjusted.
In February, 27 states and the District of Columbia had over-the-month unemployment rate decreases, 7 had increases, and 16 had no change.

*Provisional figures for February 2011, seasonally adjusted.

Labor Underutilization: Broader than Just Unemployment

% of Labor Force

Marginally Attached and Unemployed Persons Account for 15.7% of the Labor Force in March 2011 (1 Out Every 6.4 People). Unemployment Rate Alone was 8.8%. Underutilization Shows a Broader Impact on WC and Other Commercial Exposures

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.

Seasonally adjusted.
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
Catastrophic Loss – Catastrophe Losses Trends Are Trending Adversely
US Insured Catastrophe Losses

2000s: A Decade of Disaster
2000s: $193B (up 117%)  
1990s: $89B

$100 Billion CAT Year is Coming Eventually

2010 CAT Losses Were About Average

2010 CAT Losses Were Close to “Average”  
Figures Do Not Include an Estimate of Deepwater Horizon Loss

*First quarter 2011.

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.
Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2010E

The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

Notes: Private carrier losses only. Excludes loss adjustment expenses and reinsurance reinstatement premiums. Figures are adjusted for losses ultimately paid by foreign insurers and reinsurers.

There were a record 247 natural disaster events in the US in 2010.
There were 1483 tornadoes in the US in 2010, slightly above average.

*Preliminary tornadoes from NWS Local Storm Reports (LSRs)
Annual average is based on preliminary LSRs, 2005-2009

Source: NOAA
U.S. Thunderstorm Loss Trends, 1980 – 2010 (Annual Totals)

Thunderstorm losses in 2010 totaled $9.5 billion, the 3rd highest ever.

Average thunderstorm losses have now quintupled since the early 1980s.

Hurricanes get all the headlines, but thunderstorms are consistent producers of large scale loss.

Source: Property Claims Service, MR NatCatSERVICE
Insured winter storm losses in 2010 are one of the top five in US history, totaling $2.6 billion in 2010.
Distribution of US Insured CAT Losses: TX, FL, LA vs. US, 1980-2010*

($ Billions)

Texas
$42.30, 11%

Louisiana
$36.68, 10%

Rest of US
$237.52, 62%

Florida
$62.62, 17%

Louisiana Accounted for 10% of All US Insured CAT Losses from 1980-2010: $36.7B out of $237.5B

* Adjusted to 2010 dollars.
Source: PCS division of ISO; Insurance Information Institute.
Top 12 Most Costly Disasters in US History

(Insured Losses, 2009, $ Billions)

Hurricane KatrinaRemains, 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.

<table>
<thead>
<tr>
<th>Event</th>
<th>Share of Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hurricane Hugo (1989)</td>
<td>30%</td>
</tr>
<tr>
<td>Hurricane Andrew (1992)</td>
<td>25%</td>
</tr>
<tr>
<td>Sept. 11 Terrorist Attack (2001)</td>
<td>60%</td>
</tr>
<tr>
<td>2004 Hurricane Season</td>
<td>20%</td>
</tr>
<tr>
<td>2005 Hurricane Season</td>
<td>45%</td>
</tr>
<tr>
<td>2008 Texas Hurricane</td>
<td>33%</td>
</tr>
</tbody>
</table>

Source: Wharton Risk Center, Disaster Insurance Project, Renaissance Re, Insurance Information Institute.
Total Value of Insured Coastal Exposure (2007, $ Billions)

- Florida: $2,458.6
- New York: $2,378.9
- Texas: $895.1
- Massachusetts: $772.8
- New Jersey: $635.5
- Connecticut: $479.9
- Louisiana: $224.4
- S. Carolina: $191.9
- Virginia: $158.8
- Maine: $146.9
- North Carolina: $132.8
- Alabama: $92.5
- Georgia: $85.6
- Delaware: $60.6
- New Hampshire: $55.7
- Mississippi: $51.8
- Rhode Island: $54.1
- Maryland: $14.9

More than $1.4 Trillion in insured coastal exposure in New England

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.
Insurance Information Institute Online:

www.iii.org

Thank you for your time and your attention!

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