How to Live to Be 100: In the Property/Casualty Insurance Industry

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Presentation Outline

- The Life Cycle of Businesses: Lessons from the Natural World
- Characteristics of the World's Oldest Businesses
- P/C Centenarians: Who Lives to Be 100+ and Why?
- Why Do Insurers Fail?
- Secrets of the Ancients: Leadership Attributes of 100+ Year Old Insurers
- Lesson from the Financial Crisis
- Top Challenges for the Decade Ahead
- Q&A

Lessons from Nature:
What Would Darwin Would Say?

Longevity in the Business World Has Parallels in the Natural World

On the Life Cycle of Businesses: Lessons from Nature

- **Most Businesses, Like Living Species, Eventually Become Extinct**
  - **99.5% of all living species to ever exist on Earth are now extinct; The proportion is higher for business and extinctions occur over a much compressed timespan.**
  - **Changes in the natural environment (not external forces like humans) were responsible for almost all extinctions**
  - **This means that despite millions of years of evolution and adaptation, virtually every species eventually confronts a change in its environment to which it cannot adapt**
  - **It is the same in business**
- **Business Cycle Gives Rise to "Creative Destruction"**
  - **Mass extinctions in business are common**
  - **Economy is constantly reinventing itself**
  - **New industries and businesses spring from the ashes of the previous generation, fill voids and occupy niches**

Mass Extinction: Surge in Business Bankruptcy Filings Amid Crisis Since 2007

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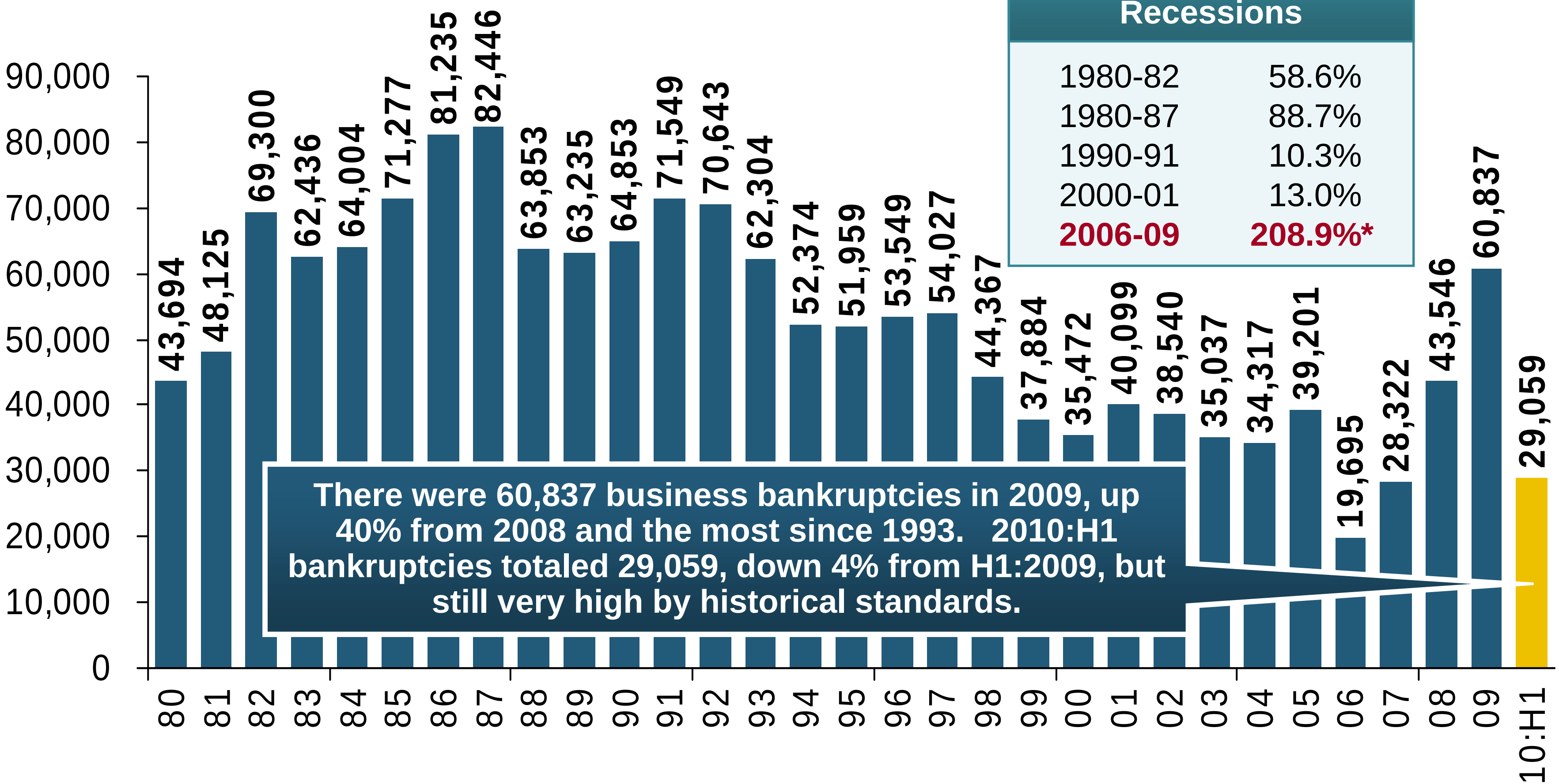
% Change Surrounding Recessions	
1980-82	58.6%
1980-87	88.7%
1990-91	10.3%
2000-01	13.0%
2006-09	**208.9%***



The Crisis Will Destroy Hundreds of Thousands of Businesses, But Few to None Property/Casualty Insurers

Source: American Bankruptcy Institute; Insurance Information Institute

Private Sector Business Starts, 1993:Q2 – 2009:Q4*

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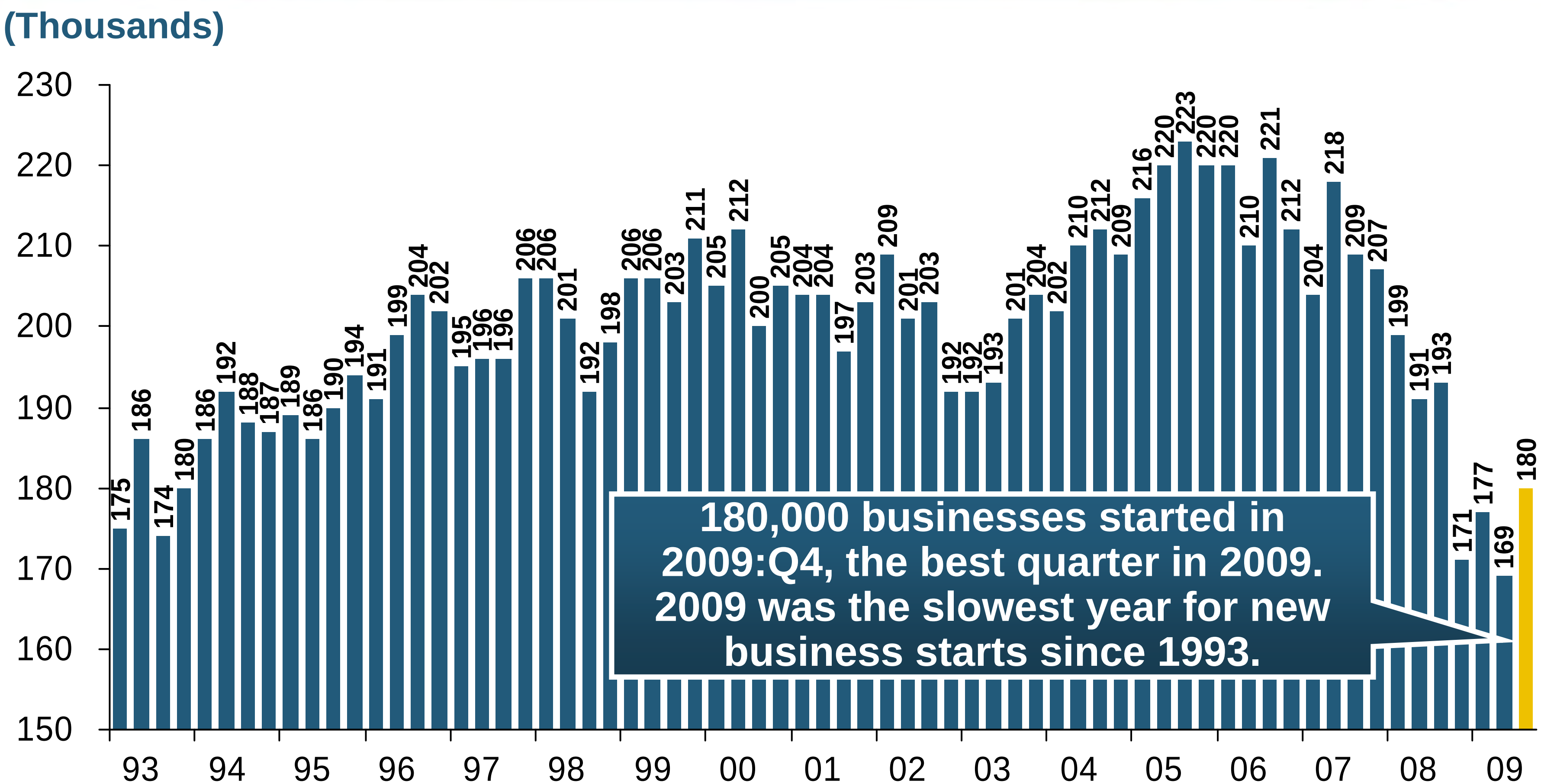

Business Starts Are Down Nearly 20% in the Current Downturn, Holding Back Most Types of Commercial Insurance Exposure

*Latest available as of September 12, 2010, seasonally adjusted

Source: Bureau of Labor Statistics, http://www.bls.gov/news.release/cewbd.t07.htm.

Lessons from History: What Types of Business Live a Very Long Time (500+ Years) and Why?

Longevity in the Business World Requires Focus, Long-Term Objectives

Number of Firms More than 500 Years Old, by Industry*

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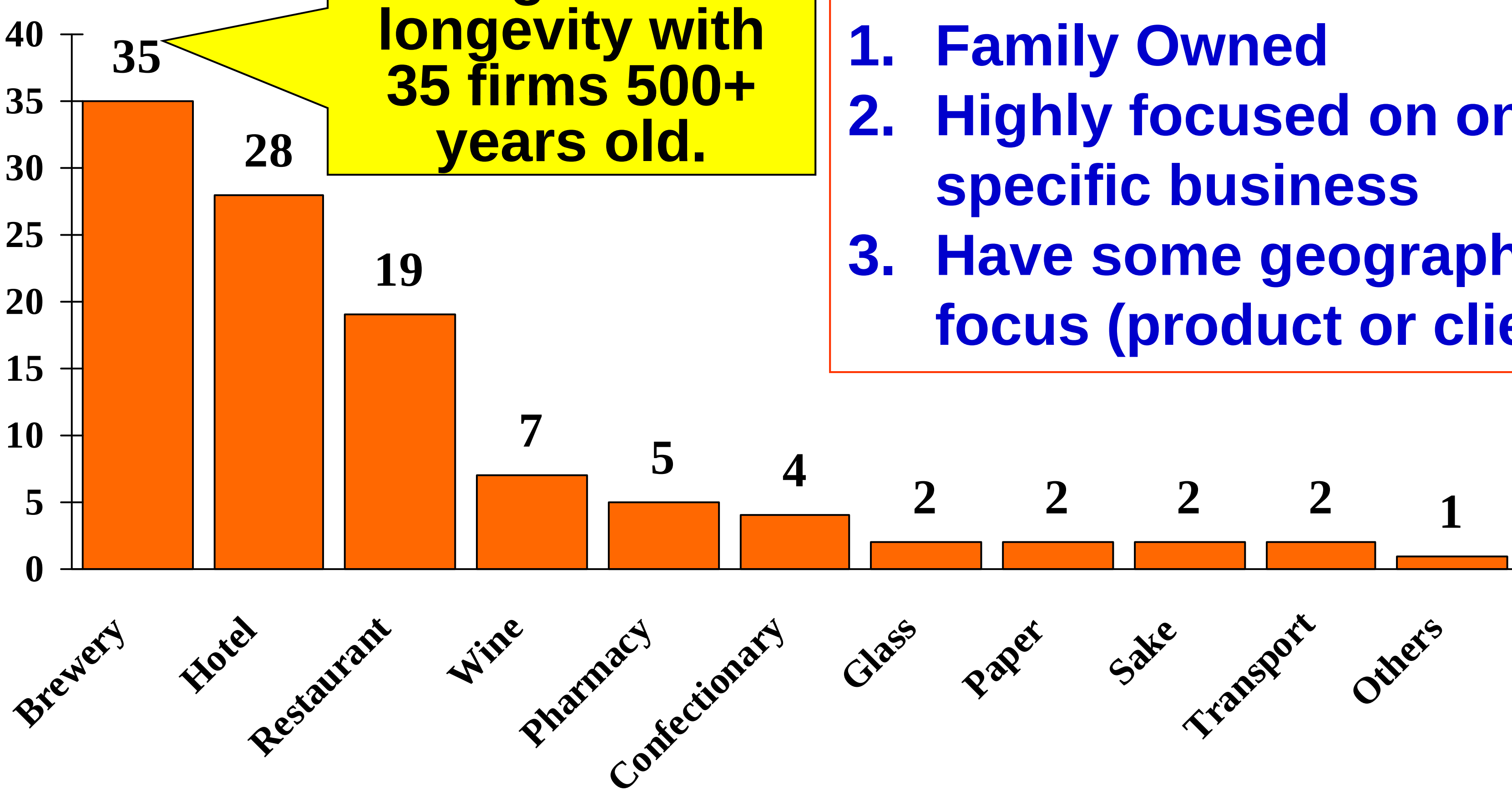
Total Number



The brewery industry appears to have the greatest longevity with 35 firms 500+ years old.

BENEATH THE SURFACE

Most of these companies are:

1. **Family Owned**
2. **Highly focused on one specific business**
3. **Have some geographic focus (product or client)**

Source: http://en.wikipedia.org/wiki/List_of_oldest_companies

Characteristics of Firms That Stand the Test of Time

1. **Business Model: Highly Focused**
   - Firms tend to remain true to core business
   - Avoid businesses you don't understand
   - Some diversification is usually good, but leads to an exponential increase in complexity and unforeseen interactions across units
2. **Ownership Structure: There Exists Some Concept of Mutuality**
   - Some of the world's oldest firms are family owned (artisans, craftsman)
   - Others have some form of cooperative arrangement (agricultural)
   - Such organizations also exhibit *altruistic* behavior, a proven survival trait
3. **Communal Interest: A Concern for the Greater Common Good**
   - Perpetual of the species (i.e., the industry) is evident in behaviors
   - Concept of mutuality extends beyond organization to communal interest
   - A strong willingness to work for the common good

Characteristics of Firms That Stand the Test of Time (cont'd)

4. **Growth: Tend to Grow Slowly**
   - As with living species, the longest lived businesses in the world tend to grow only slowly, if at all

5. **Size: Tend to Be Small Relative to Competition**
   - Size seems to matter when it comes to species longevity: smaller = longer
   - Also true among living species (e.g., bacteria, insects)

6. **Profitability: Tend Not to Be the Most Profitable**
   - Object of continuous profit maximization is not consistent with longevity
   - A "will to survive" is still necessary

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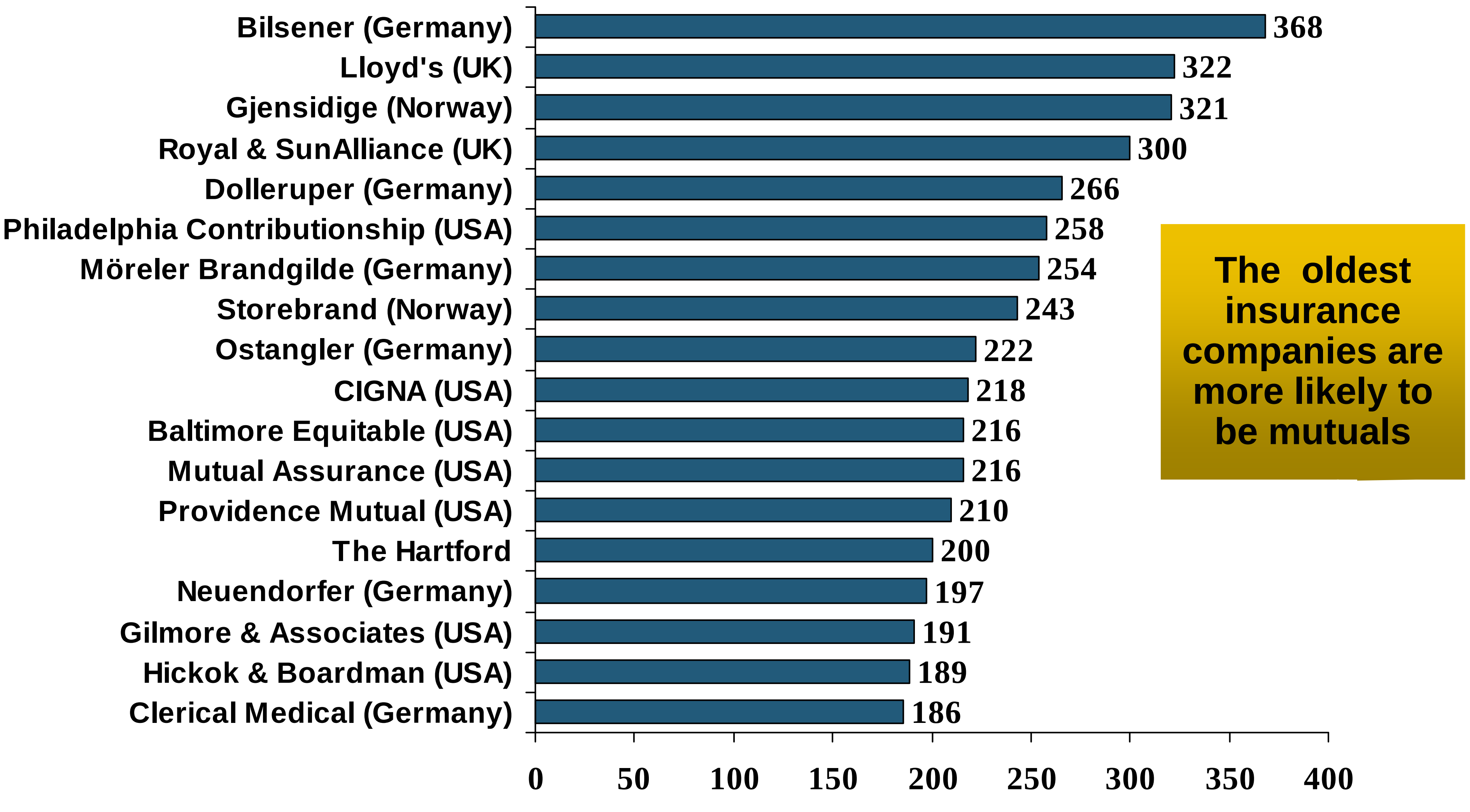
World's Oldest Insurance Companies

Who's Truly Endured?

World’s Oldest Insurance Companies, by Age and Country*



The oldest insurance companies are more likely to be mutuals

*Insurers’ age calculated as number of years from inception date to 2010
Source: http://en.wikipedia.org/wiki/List_of_oldest_companies; III research.

World's Oldest Insurance Companies, by Age and Country* (cont'd)

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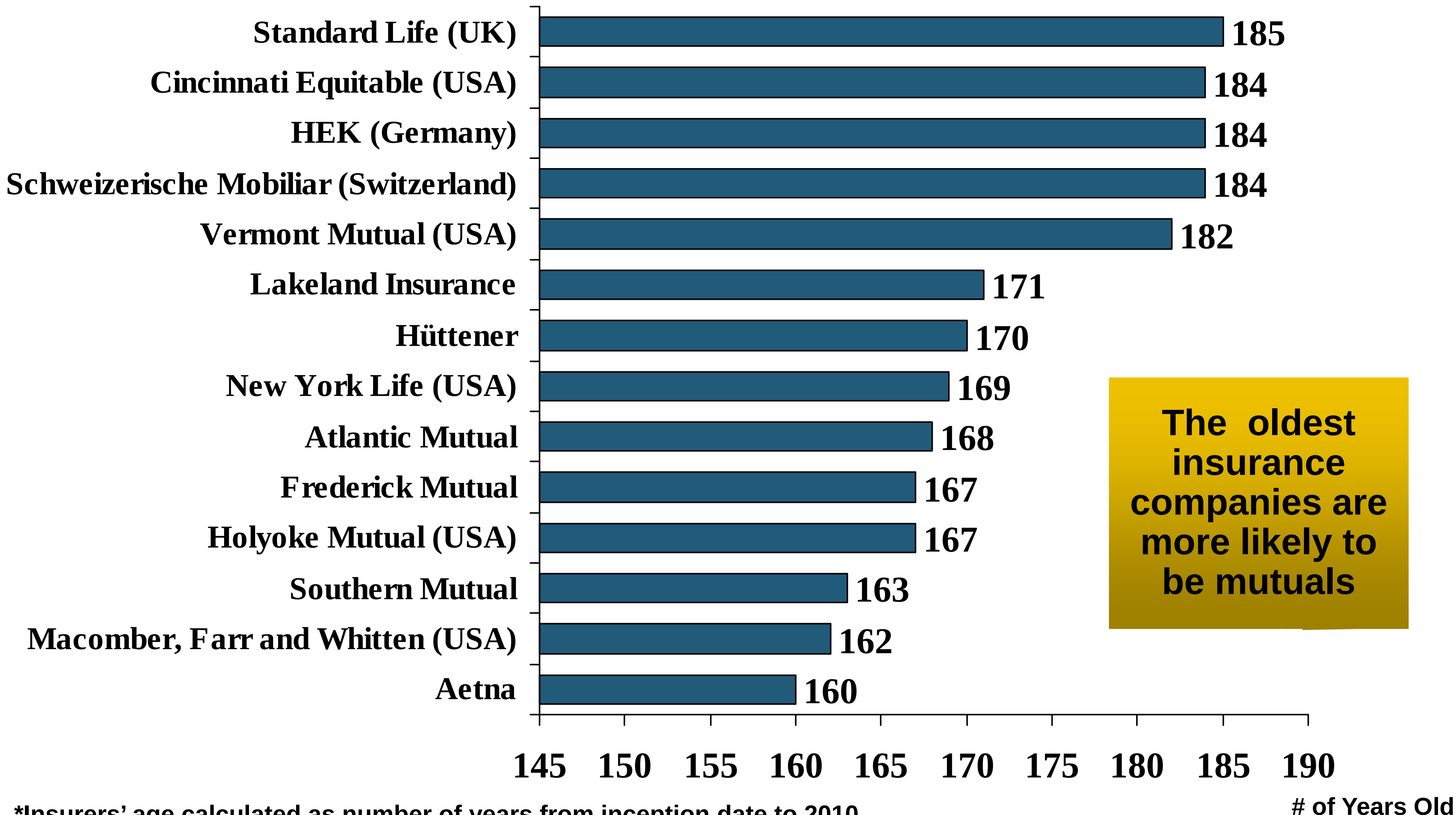

The oldest insurance companies are more likely to be mutuals

*Insurers' age calculated as number of years from inception date to 2010.
Source: http://en.wikipedia.org/wiki/List_of_oldest_companies

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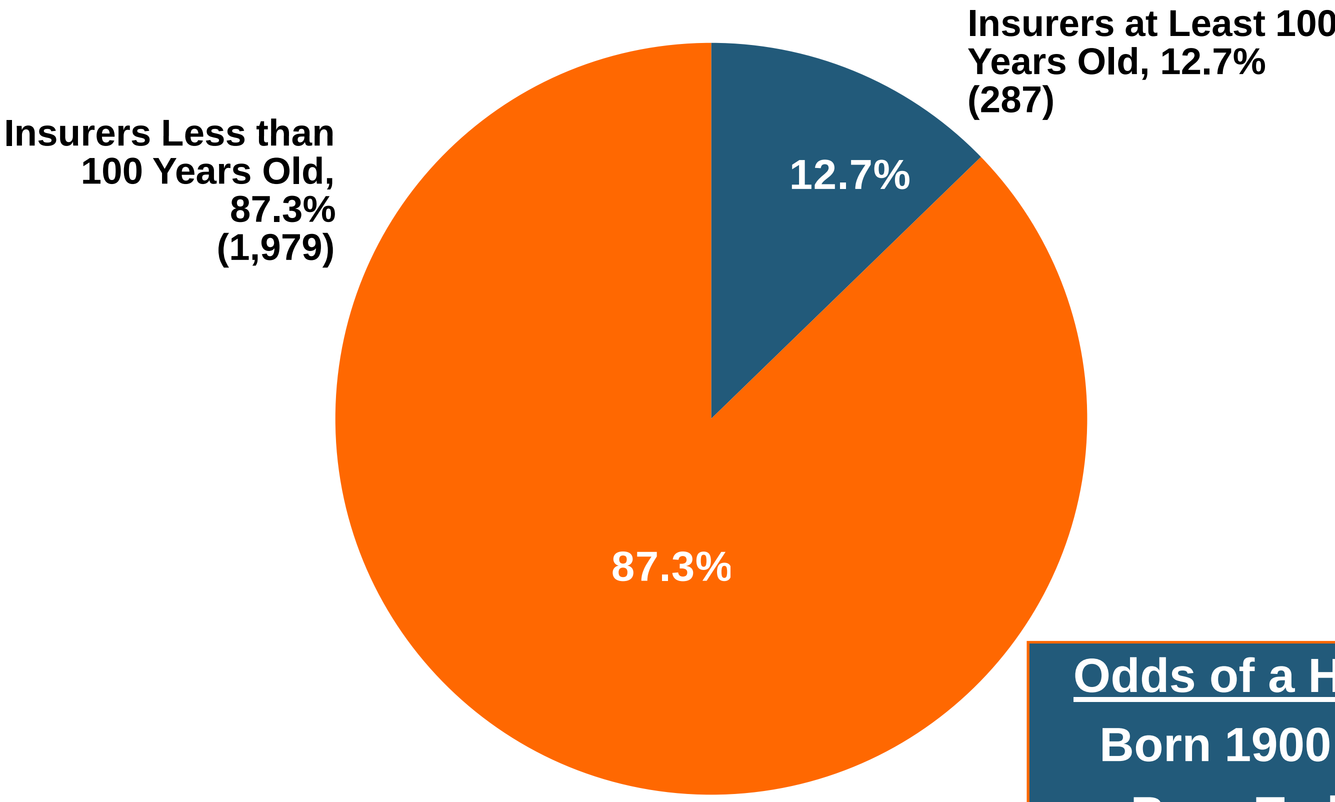
The Centenarians: Who Lives to Be 100+ in the P/C Insurance World?

Characteristics of An Exclusive Club of Insurers

100+ Year Old Insurers as a Share of All P/C Insurers

Nearly 13% of P/C insurance companies (1-in-8) today is 100+ years old. This is a surprisingly high percentage.



<u>Odds of a Human Living to 100</u>

Born 1900: ~0.25% (1-in-400)

Born Today: ~2% (1-in-50)

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC; CDC

Decade of Formation for P/C Insurers at Least 100 Years Old in 2010

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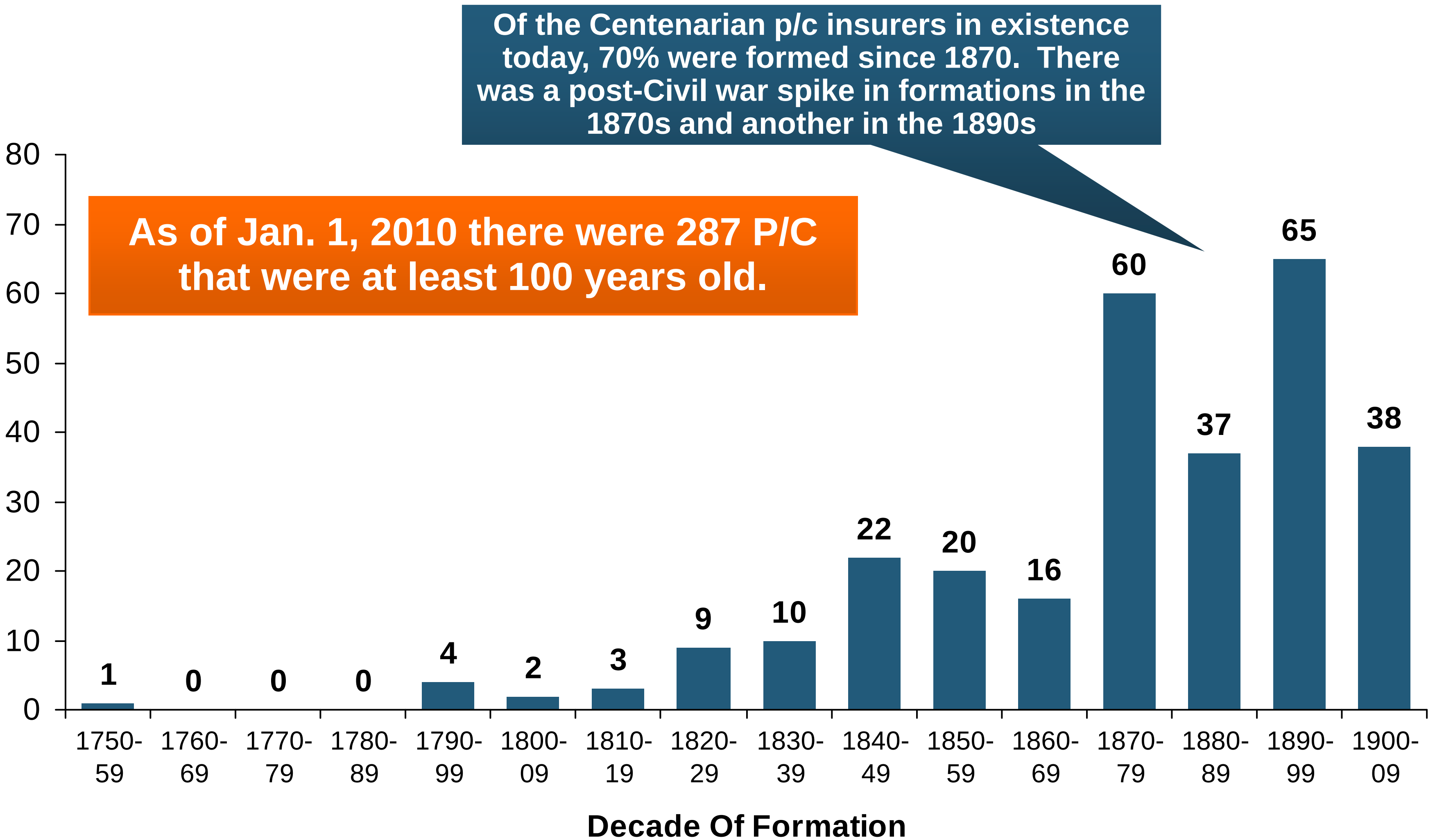

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

100-Year-Old Insurers: Independent vs. Part of Group/Holding Company

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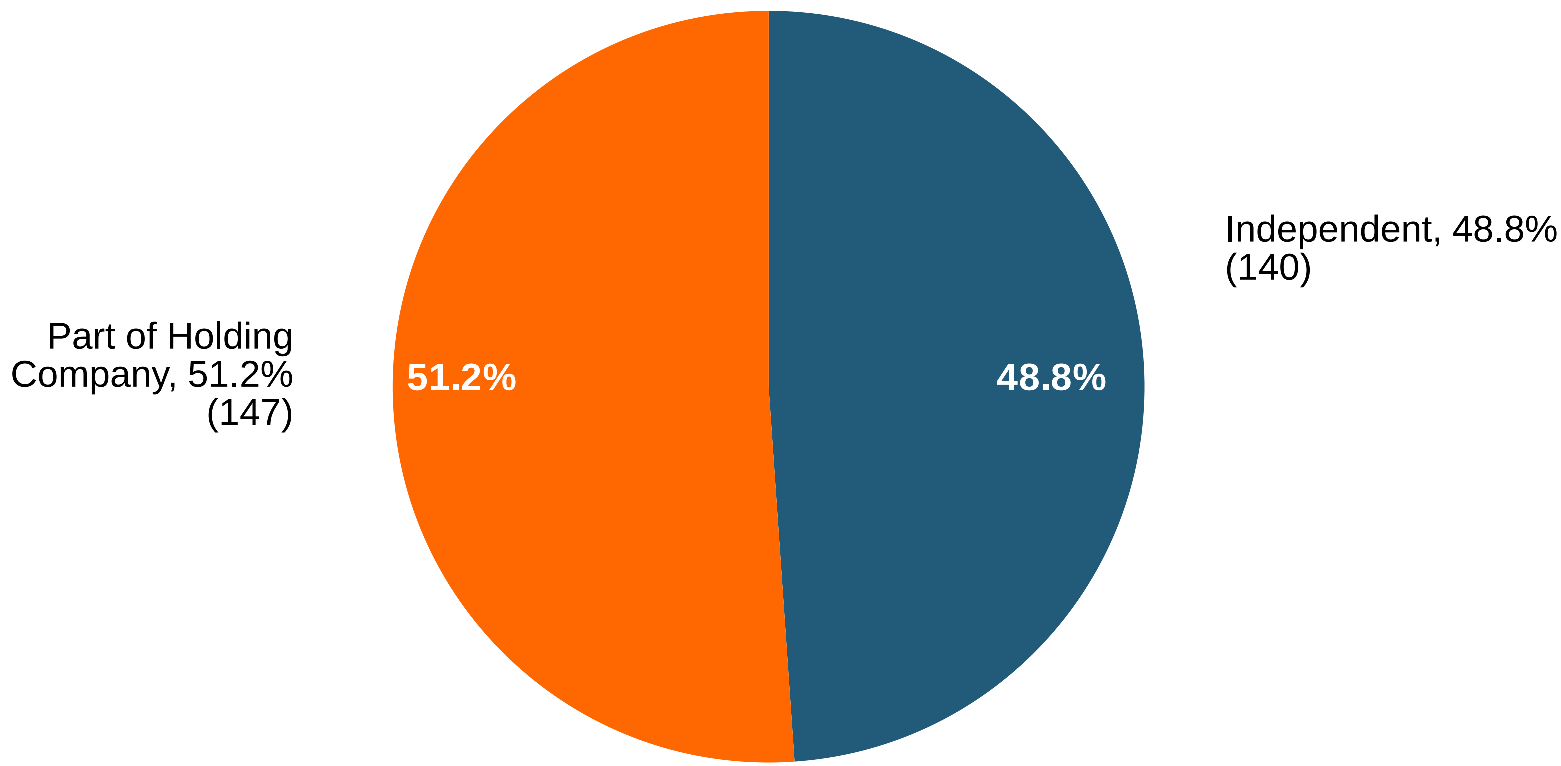
The number of 100-year-old insurers that are independent vs. part of a more diversified group structure is split almost evenly.



Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

100-Year-Old Insurers: Some Are Shell Companies or Are in Runoff

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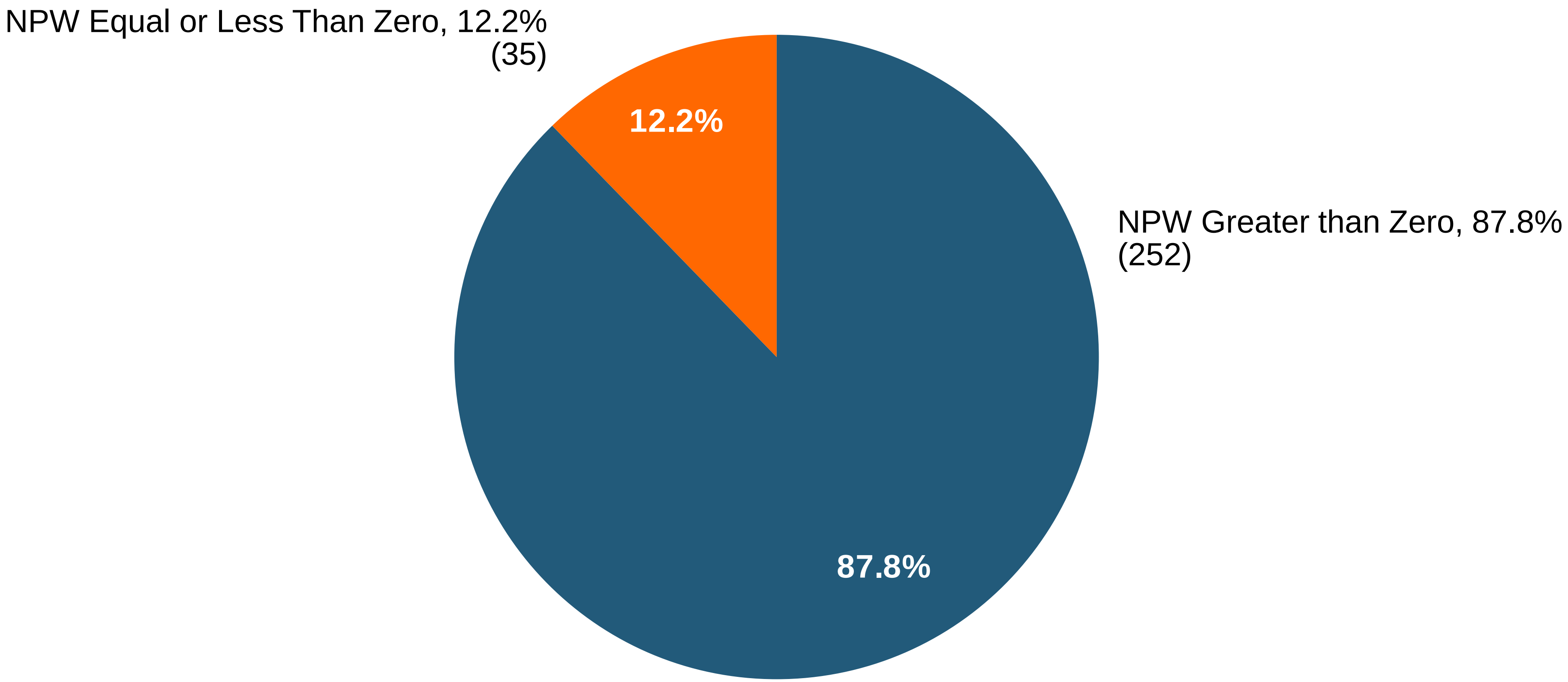
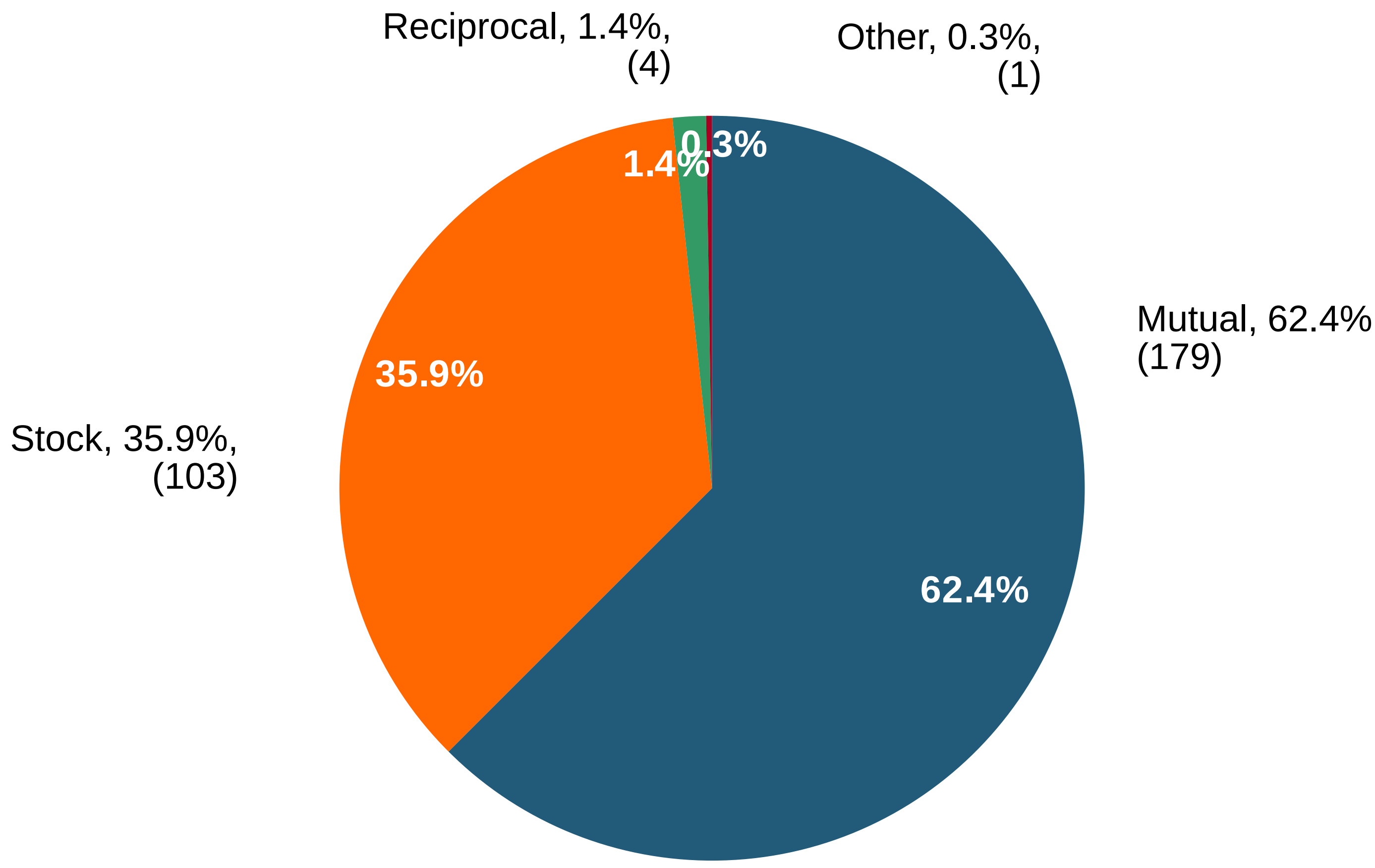
Approximately 12% of "existing" 100-year old insurers had net written premiums greater than zero, suggesting they were either unused shell companies or in runoff and not actively writing new business.



Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

100-year-old Insurers: Mutual vs. Stock vs. Reciprocal

The vast majority (62.4%) of 100-year-old insurers are mutual insurers, while stock insurers account for 35.9% of the total.



Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

100-Year Old Insurers: Share of Total Industry NWP 1998 vs. 2008

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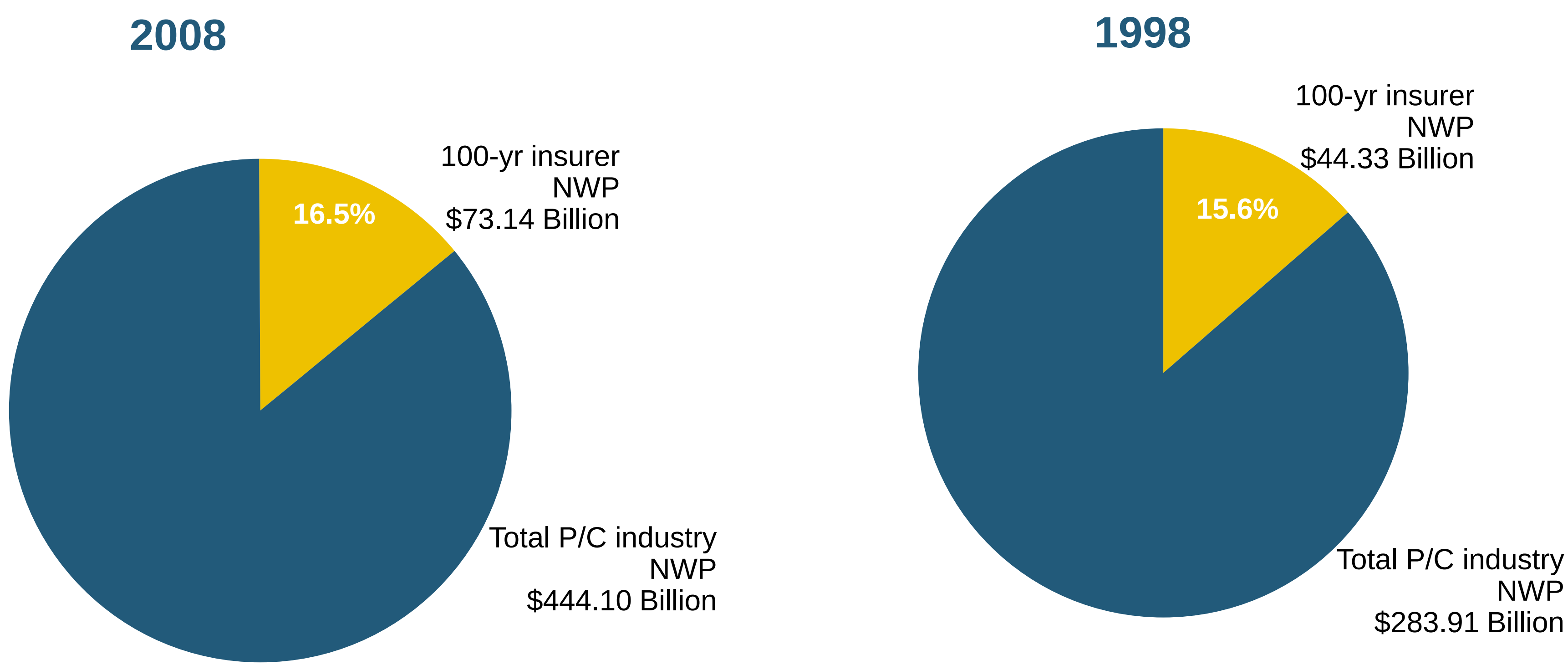

The market share of 100-year-old insurers as a % of total P/C industry NWP remained stable over the decade ending in 2008 (latest available)

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC; A.M. Best

100-year-old Insurers: Share of Total Industry Admitted Assets 1998 vs. 2008

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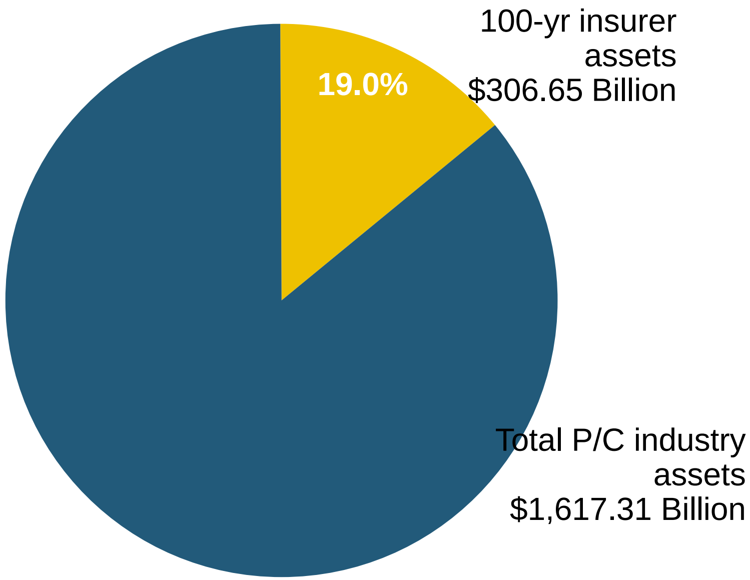
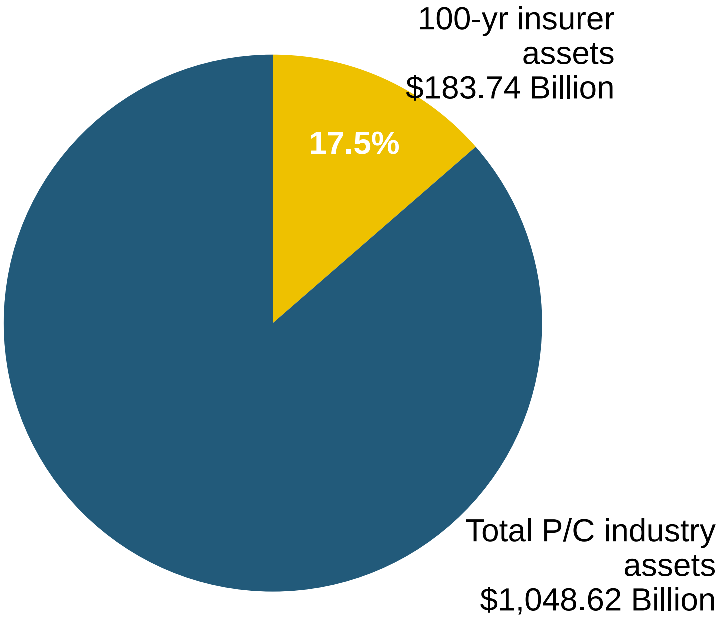
2008



1998

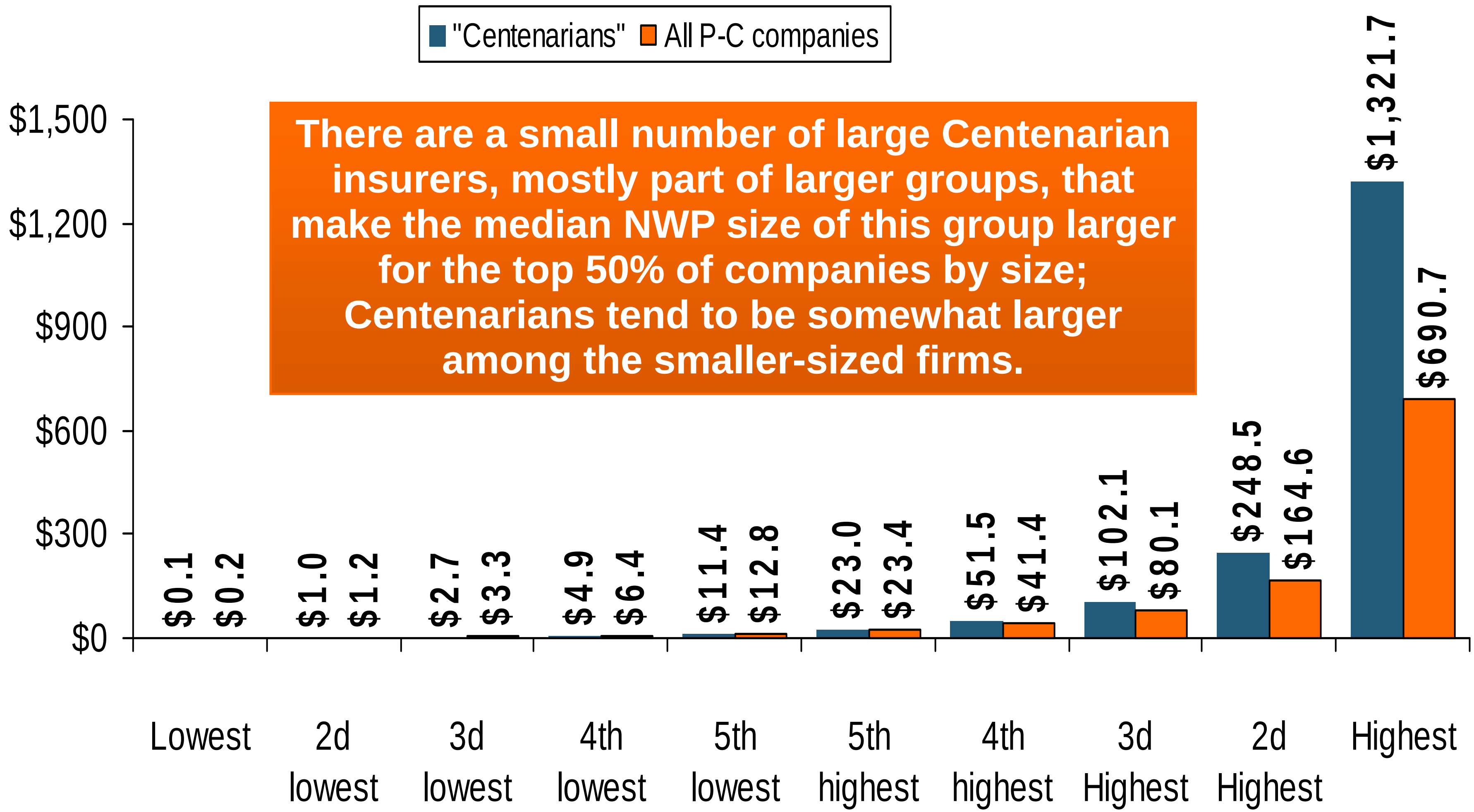


The market share of 100-year-old insurers as a % of total P/C industry assets has increased slightly over the years.

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC; A.M. Best

Distribution of 2008 NWP by Decile

Median NWP ($Million)



Note: 25 companies per decile for centenarians; 227 per decile for all p/c industry

Source: NAIC Annual Statement data, via Highline

Distribution of 2008 Surplus by Decile

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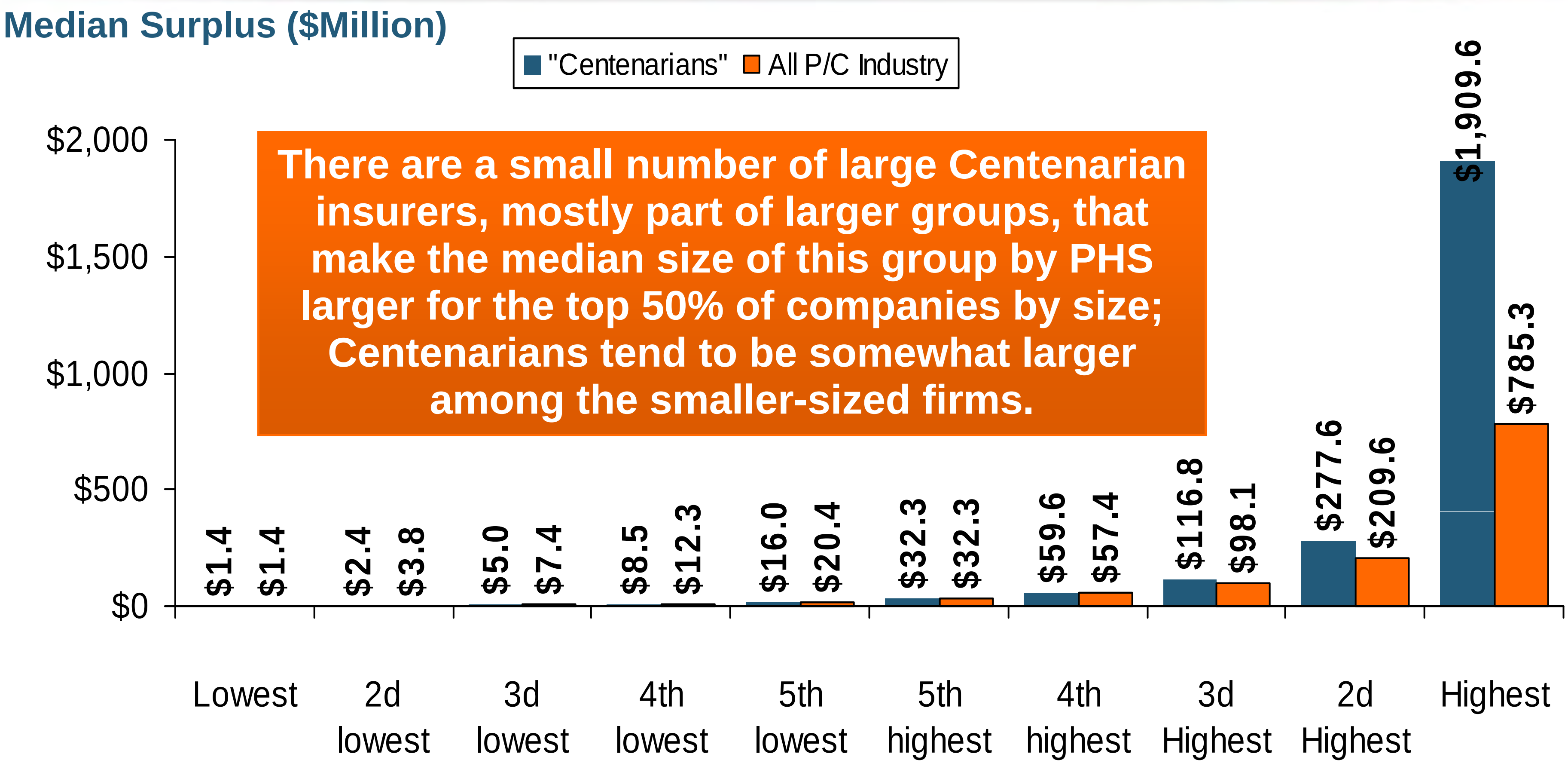

Note: 25 companies per decile for centenarians; 225 per decile for all P-C

Source: NAIC Annual Statement data, via Highline

Distribution of 1998-2008 NWP Change, by Decile

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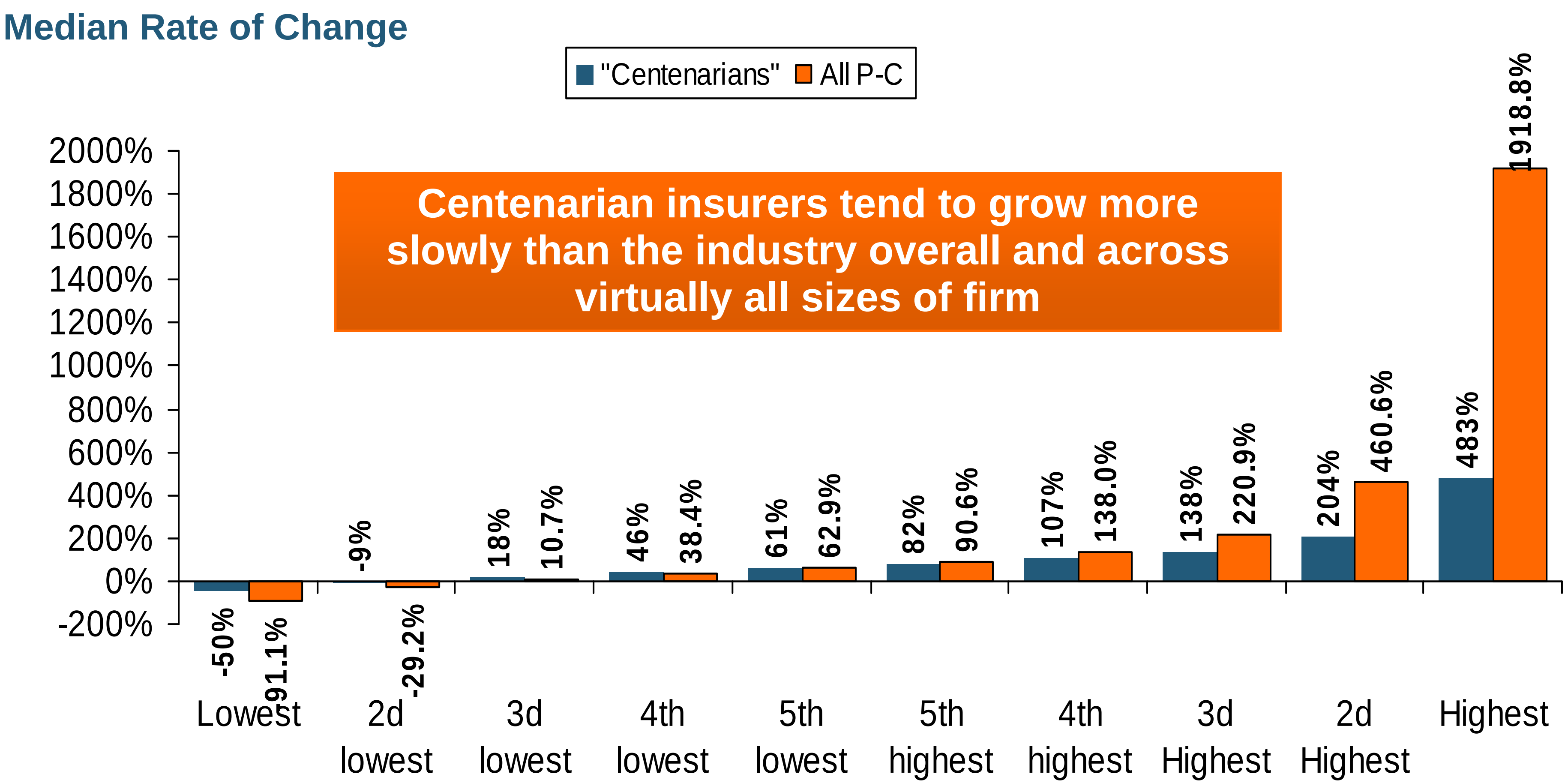

Note: 24 companies per decile for centenarians' 163 per decile for all P-C industry 1998-2008

Source: NAIC Annual Statement data, via Highline

Distribution of 1998-2008 Surplus Change, by Decile

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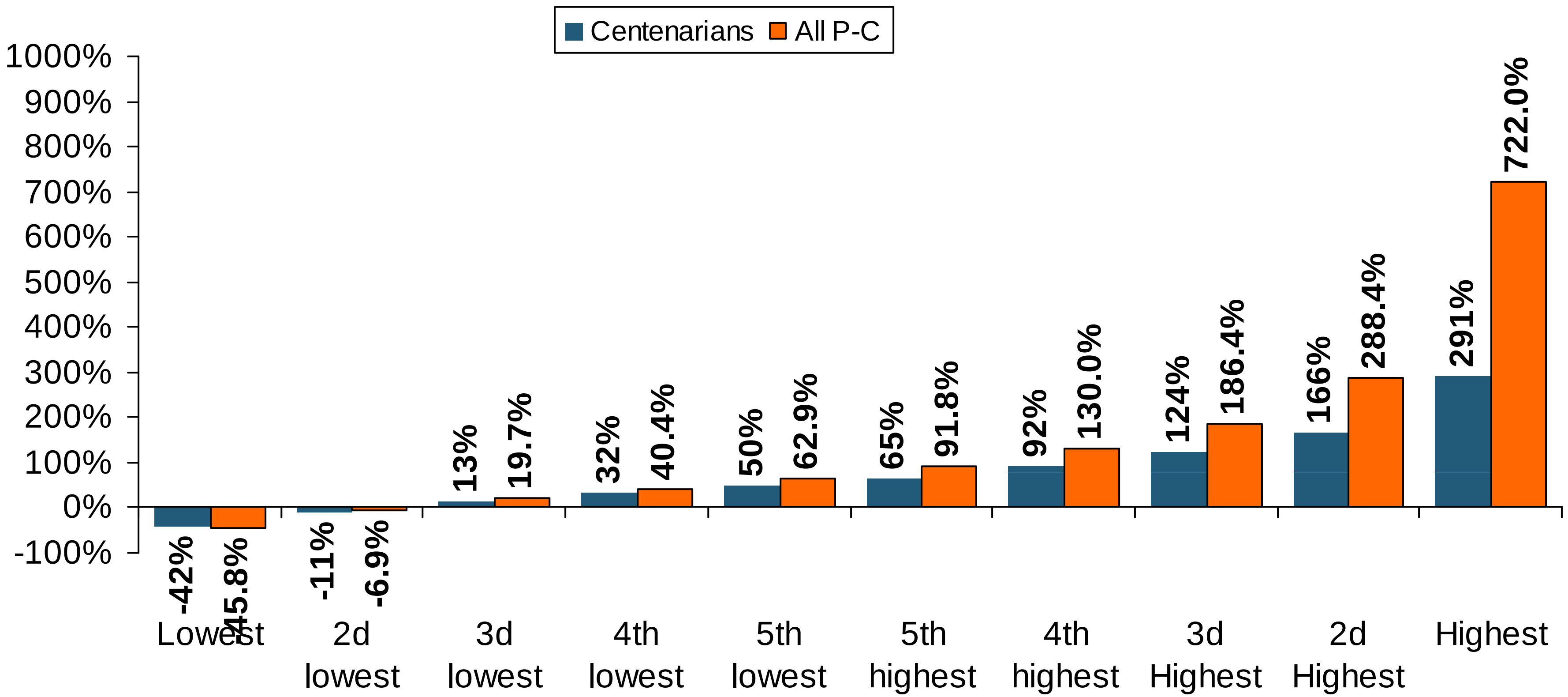
Median Rate of Change



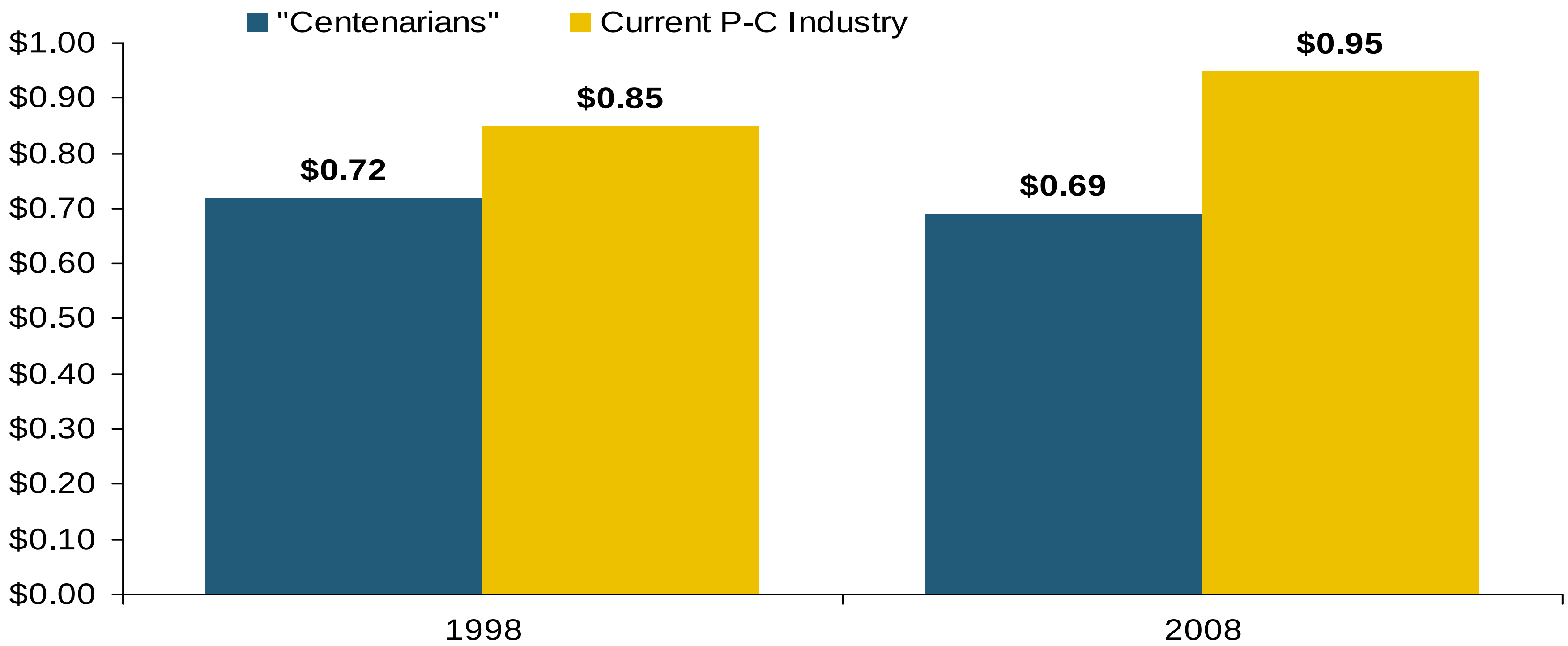
Centenarian Insurers Surplus Expanded Less Quickly Relative to Other Insurers

Note: 24 companies per decile for centenarians; 163 per decile for all p-c 1998-2008

Source: NAIC Annual Statement data, via Highline

Premium to Surplus Ratios, "Centenarians" vs. Current P-C Industry, 1998 and 2008

NWP/Surplus

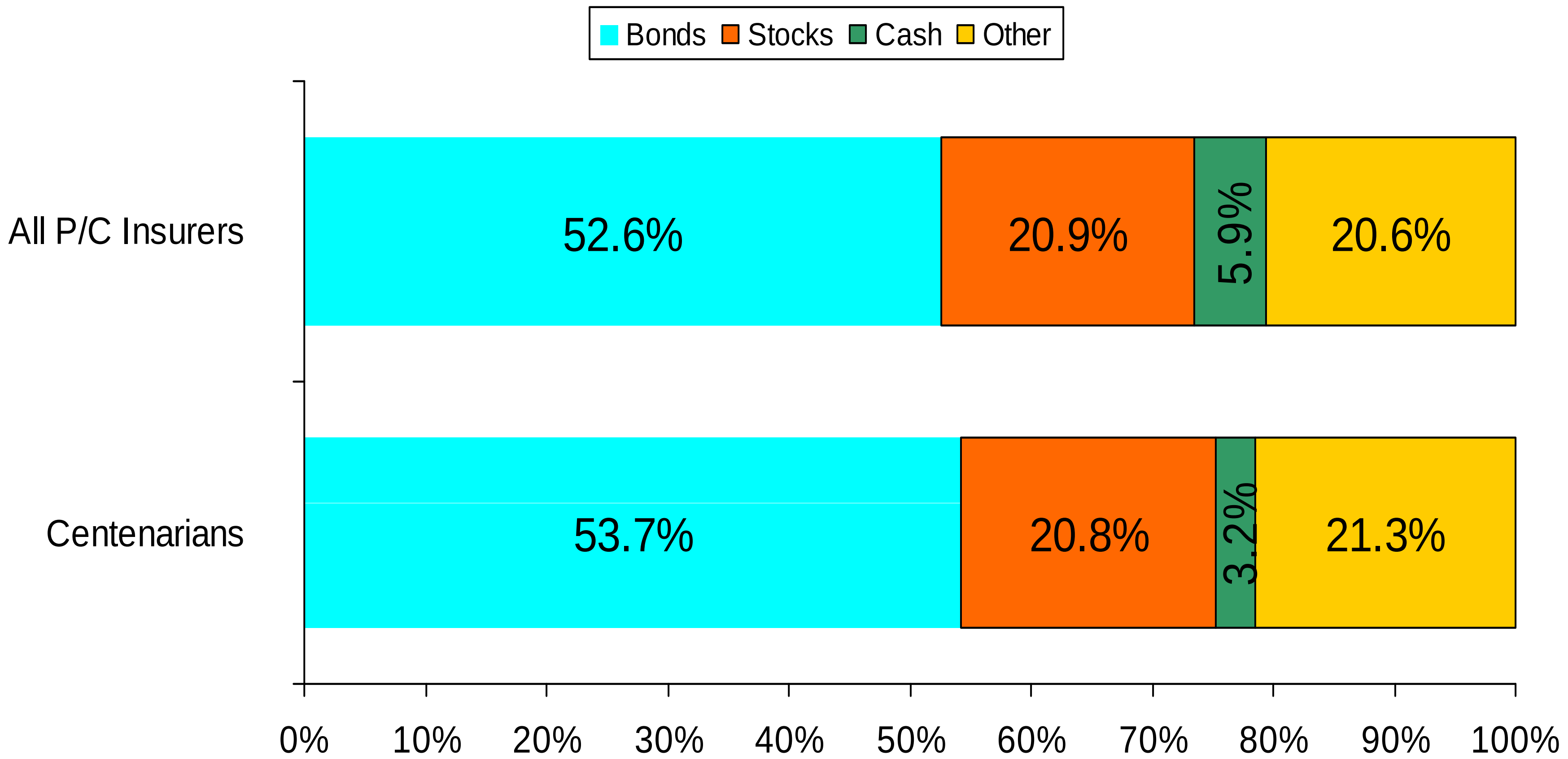


Premiums are a rough measure of risk accepted; surplus is funds beyond reserves to pay unexpected losses. The larger surplus is in relation to premiums—the lower the ratio of premiums to surplus—the greater the capacity to handle the risk it has accepted.

"Centurians" are companies at least 100 years old with positive NWP in 2008

Sources: National Association of Insurance Commissioners' Annual Statements, via Highline; I.I.I. calculations

Asset Class Distribution of Admitted Assets, "Centenarians" vs. All P/C Insurers, 2008



Note: 25 companies per decile
Source: NAIC Annual Statement data, via Highline

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Why Do Insurers Fail?

Leading Reasons Why Most Insurers Don’t Make it to 100

P/C Insurer Impairments, 1969–2009

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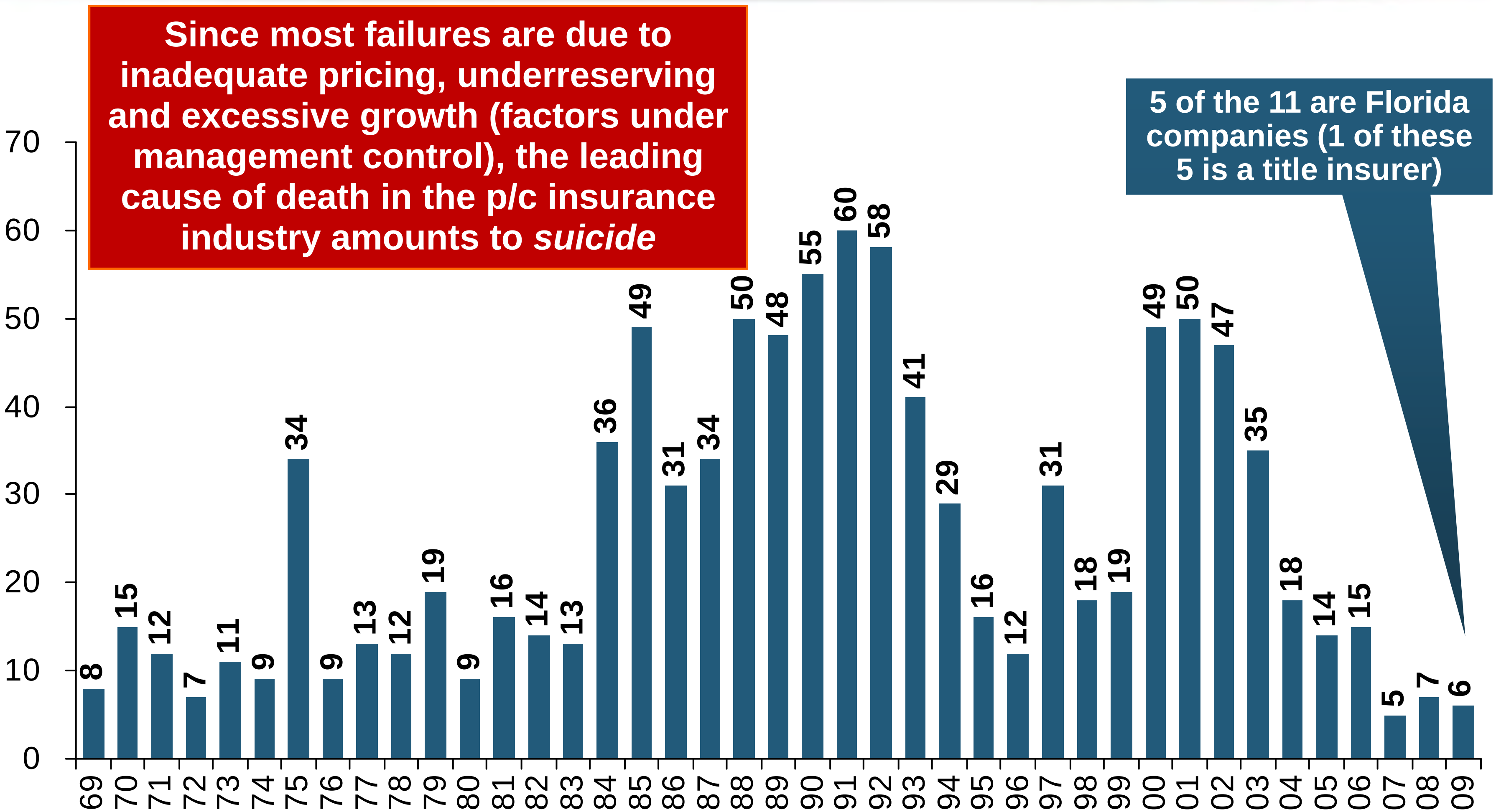

The Number of Impairments Varies Significantly Over the P/C Insurance Cycle, With Peaks Occurring Well into Hard Markets

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

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2009

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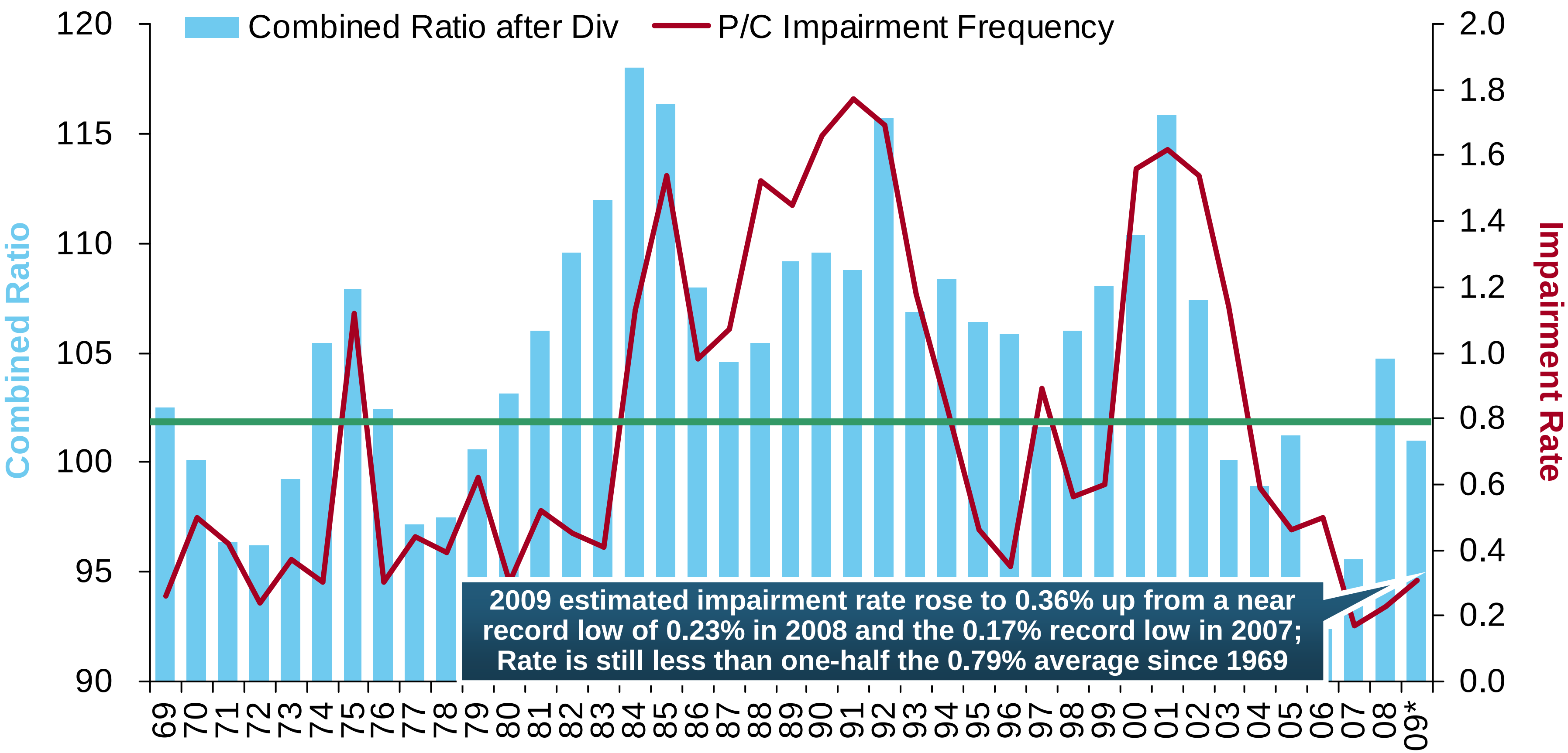
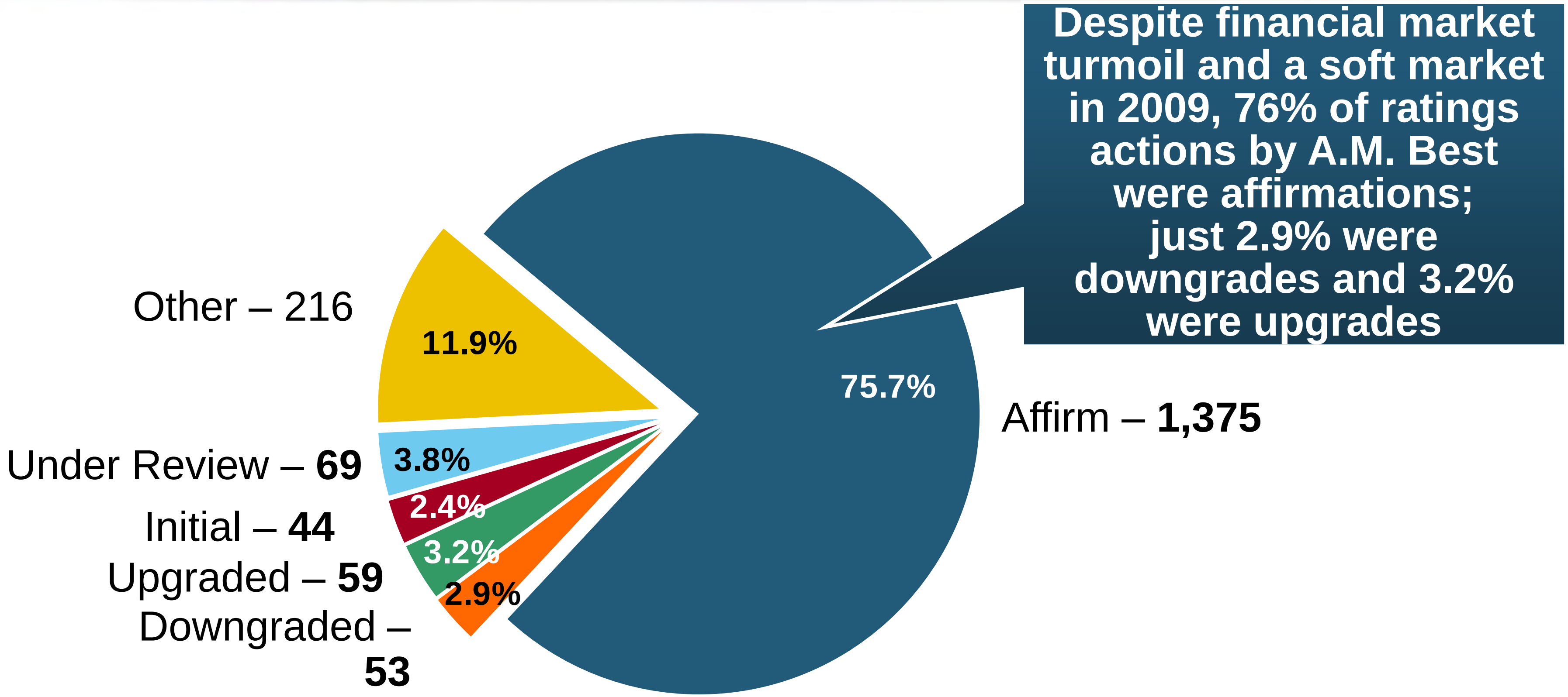


Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007/08

Source: A.M. Best; Insurance Information Institute

Summary of A.M. Best's P/C Insurer Ratings Actions in 2009



P/C Insurance is by Design a Resilient Business.
The Dual Threat of Financial Disasters and Catastrophic Losses Are Anticipated in the Industry's Risk Management Strategy

Source: A.M. Best.

Five Deadliest Sins for P/C Insurance Companies

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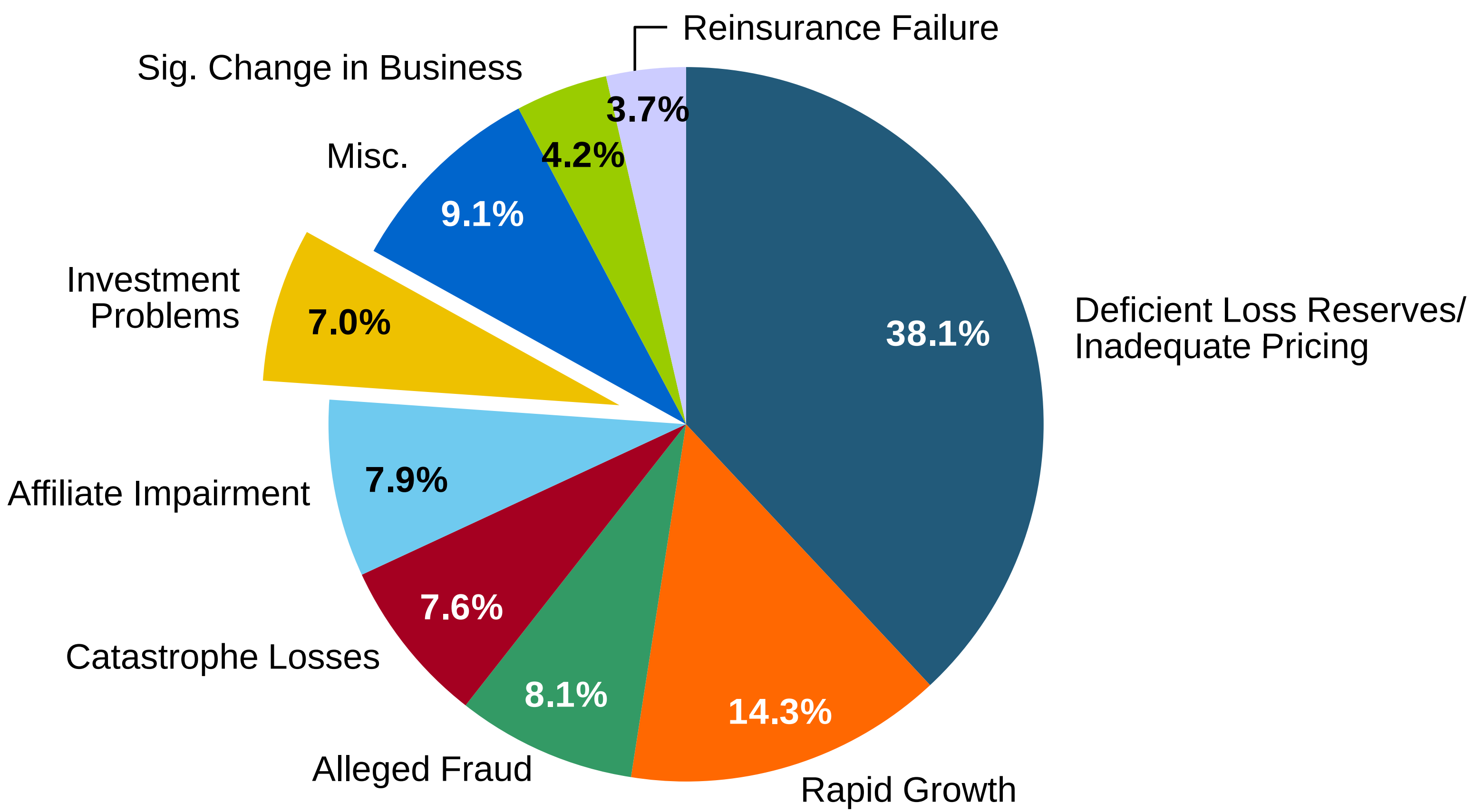
■ OPERATIONAL ISSUES

1. **Underpricing/Underreserving (~38% of failures)**
   - Leading cause of p/c insurer death according to A.M. Best
2. **Excessive Growth (~14%)**
   - Too much growth too fast (organically or via M&A) can be fatal
3. **Excessive Catastrophe Exposure (~8%)**
   - Too much underpriced exposure, too little reinsurance, insufficient diversification
4. **Investment Problems (~7%)**
   - Investments are too risky, too illiquid or insufficiently understood
5. **Affiliate Problems (~8%)**
   - Non-core operations can cause problems for parent (e.g., AIG)

Source: I.I.I. research.

Reasons for US P/C Insurer Impairments, 1969–2008

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



Source: A.M. Best: *1969-2008 Impairment Review*, Special Report, Apr. 6, 2008

U.S. P/C Insurance-Related M&A Activity, 1988–2009

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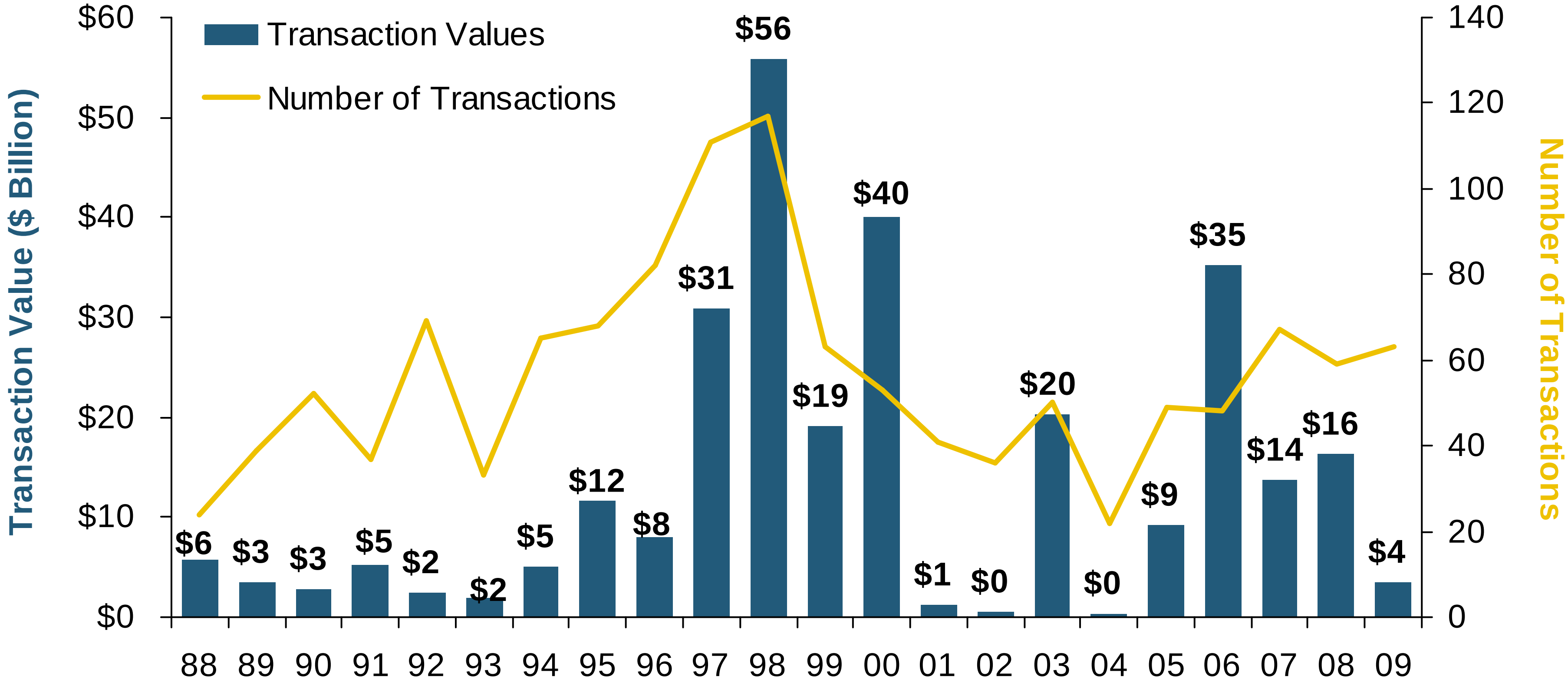

$ Value of Deals Down 78% in 2009, Volume Up 7%

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.

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Leadership Attributes Found in Insurers that Reach 100+ Years

Secrets of the Ancients

Leadership Attributes Inherent in Long-Lived Insurance Companies

1. **Management Acts as a Steward of the Enterprise**
   - Objective is to pass a healthy firm safely and securely to the next generation of management and policyholders
2. **Management Financial Incentives**
   - In line with the goal of providing the protection purchased
   - There is typically no 3rd party (shareholders) to compensate
     - Objective if public company is to maximize profits
   - CEO (total) comp is a smaller multiple relative to average employee
3. **Nimble: Environment for Small Insurers Can & Does Change**
   - Not likely first to change, but adaptation occurs within reasonable timeframe
4. **Customer Focus & Relationship Driven**
   - Customer is the #1 priority
   - Committed to agency form of distribution, with 21st century enhancement
5. **Regulation**
   - In favor of comprehensive but local regulation (contrast with banks)

What Do I Admire in an Insurer and Its Management?

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1. **A Firm Whose Management's Incentives are Strictly Aligned With the Insurer's Principal Stakeholders**
   - Customers, agents, employees, community
   - These include financial and operational objectives

2. **Management Is Knowledgeable**
   - Management of small, long-lived insurer is no less knowledgeable about industry trends, opportunities and threats than larger competitors

3. **Intuitive and Comprehensive Understanding of Enterprise Risk Management**
   - Much is made of ERM today, but long-lived insurers practiced it well before it had a name

What Do I Admire in an Insurer and Its Management?

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4. **CEO is Willing to Seek Advice and Counsel**
   - No imperial CEOs; Self-aggrandizement is rare
   - CEO is a listener and consensus builder

5. **Commitment to Core Constituencies**
   - Customer is the #1 priority
   - Committed to agency form of distribution, with 21st century enhancement

6. **Lack of a "Wandering Eye"**
   - Disciplined enough to stick with the business you know, but also adapting to changing business conditions and seizing opportunities as necessary

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Lessons from the Financial Crisis

What Have the Past Two Years Taught the P/C Insurance Industry?

Lessons All Financial Industries Must Learn from the Recent Financial Crisis

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1. **Risk Management Matters**
2. **Getting Involved in Businesses You Don't Understand Can Be Fatal**
3. **Too Rapid Growth Can Kill Quickly**
4. **Management Financial Incentives Can Pervert Risk Management Controls**
5. **Support of Comprehensive and Appropriate Regulation is Vital to Longevity of Financial Services Enterprises**
6. **Keeping "Skin in the Game" is Critical**
7. **Never Lose Sight of What is in the Best Interest of the Customer**

What Some Troubled Insurers Learned From the Financial Crisis

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Bottom Line:

- Adherence to Sound Risk Management Makes a Big Difference
- Keeping Skin in the Game Matters
- Taking Inordinate Risk on the Investment Portfolio to Earn a Few More Basis Points in Yield is Dangerous
- Involvement in Non-Core Business Can Cause Serious Problems
- Tail Probabilities Matter and May Often Be Underestimated
- Can't Substitute Liquidity for Capital
- Regulatory Vacuums and Regulatory Arbitrage are Dangerous
- Taking Government Money Can Be Like Making a Deal With the Devil

Source: Insurance Information Institute

How P/C Insurance Industry Stability Has Benefitted Consumers

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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 287 banks have gone under as of 9/10/10)
    - ***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

5 Challenges for the Next 10 Years

Staying Alive: The Decade Ahead

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#1.

Maintaining Adequate Reserves and Pricing

Historically Failure to Adequately Reserve and Price is the #1 Killer of Insurance Companies

P/C Reserve Development, 1992–2011E

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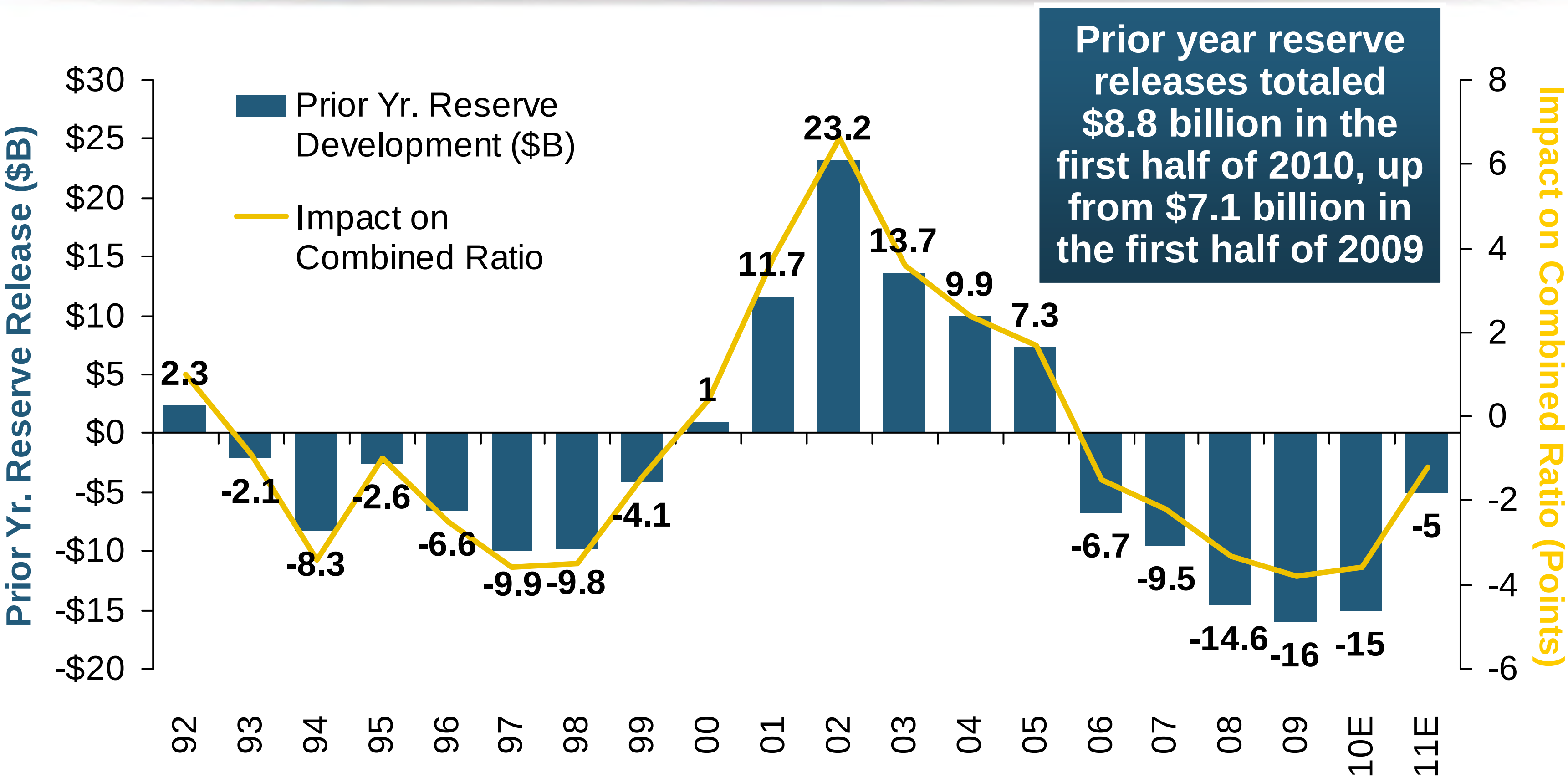
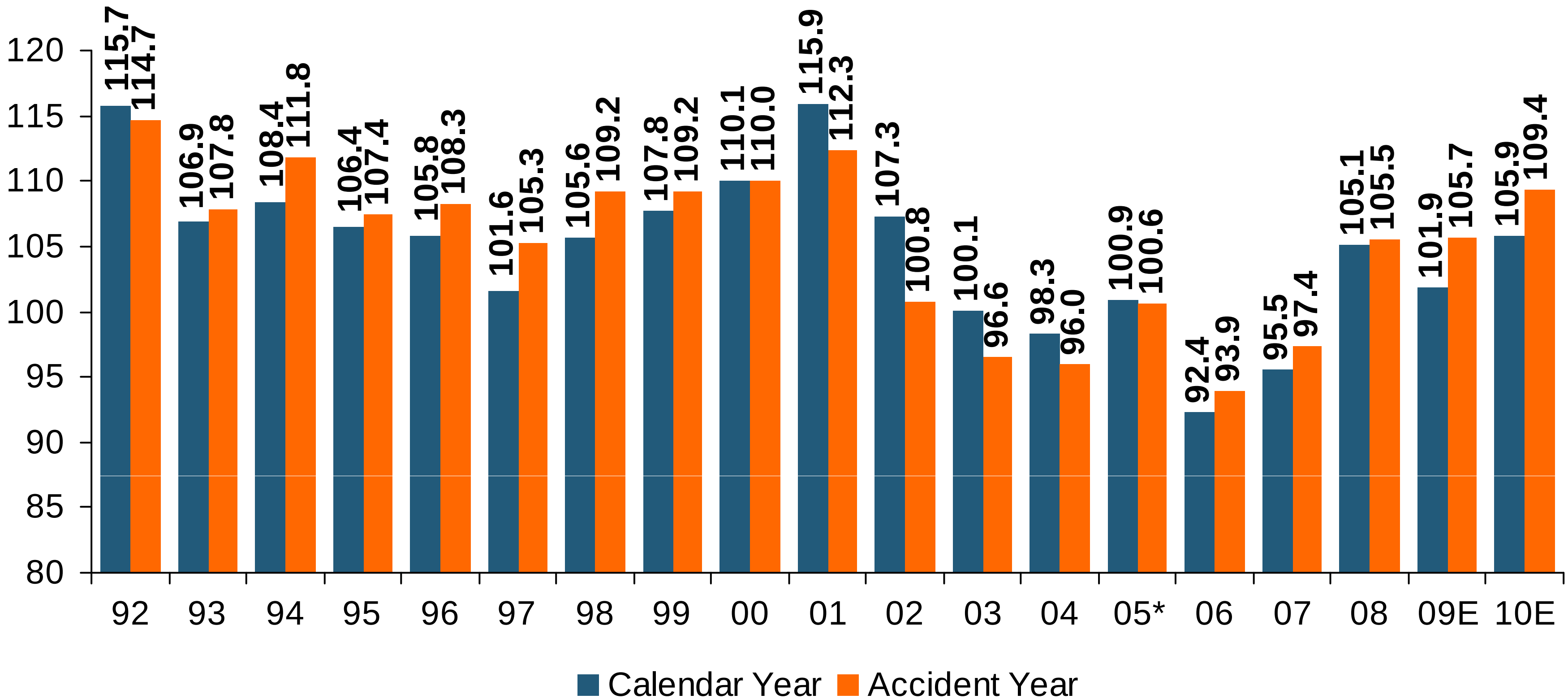


Reserve Releases Are Continuing Strong in 2010 But Should Begin to Taper Off in 2011

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 P/C Combined Ratio: 1992–2010E[1]

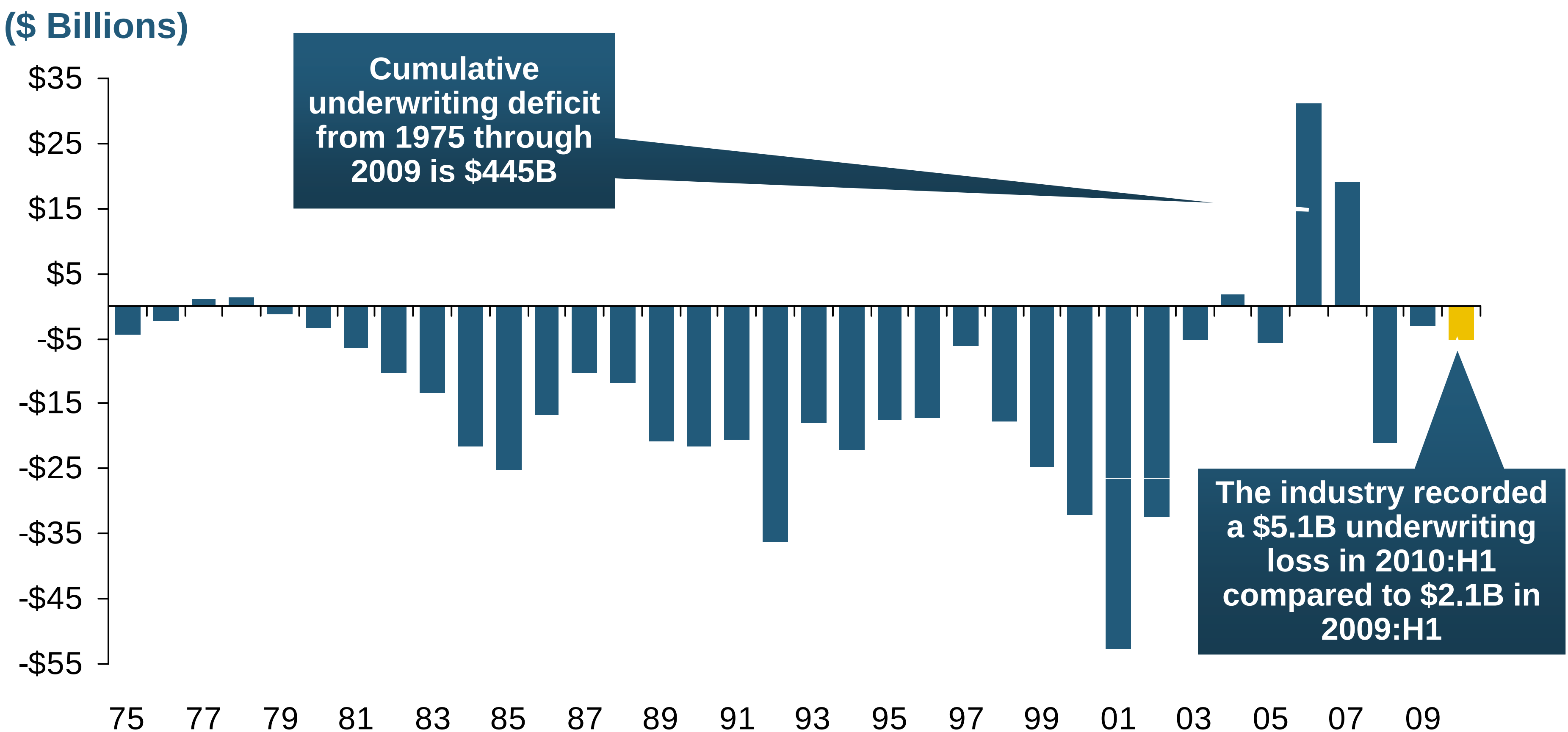


Accident Year Results Show a More Significant Deterioration in Underwriting Performance. Calendar Year Results Are Helped by Reserve Releases

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 Gain (Loss) 1975–2010:H1*

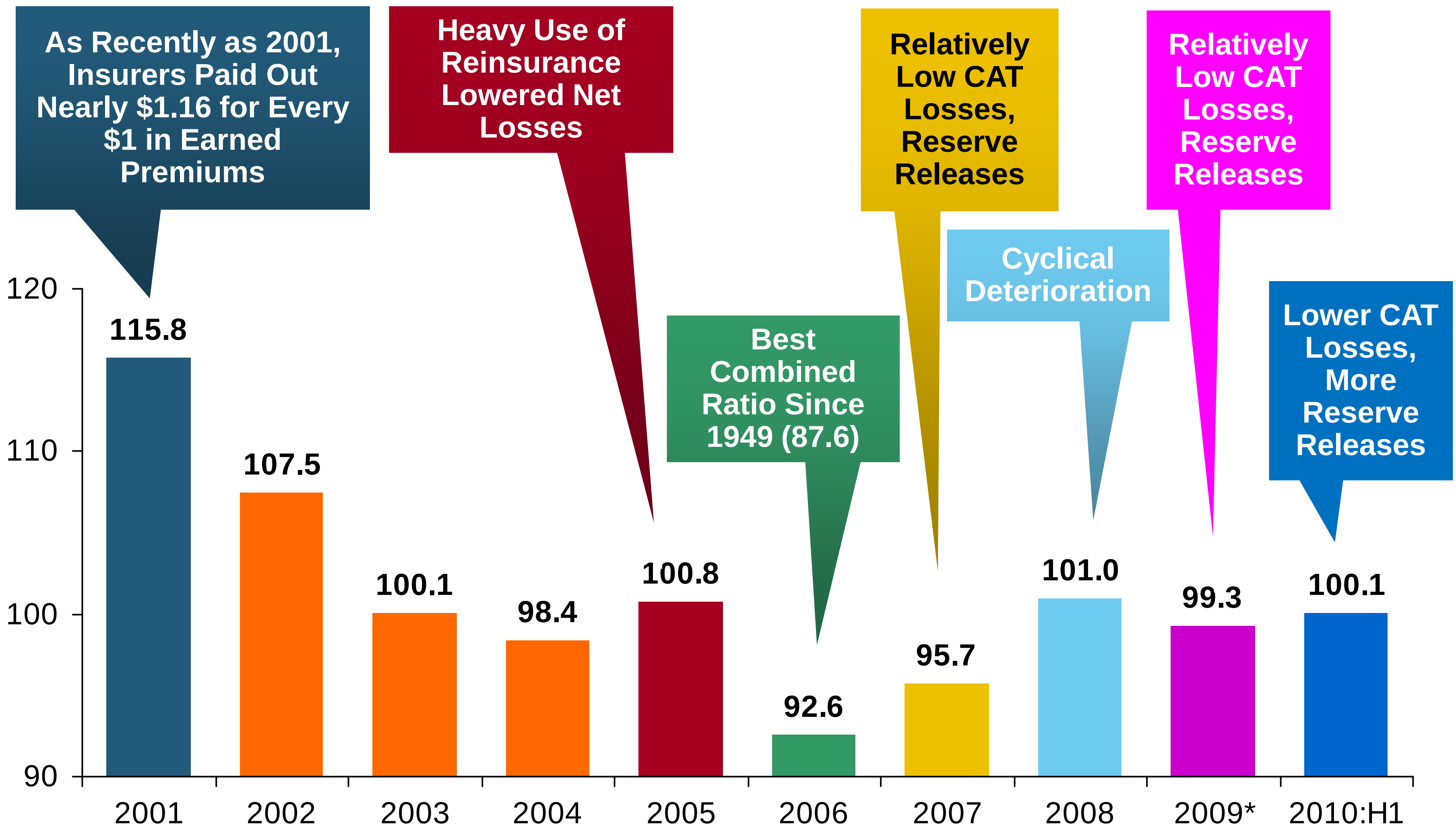


Large Underwriting Losses Are *NOT* Sustainable in Current Investment Environment

* Includes mortgage and financial guarantee insurers.

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

P/C Insurance Industry Combined Ratio, 2001–2010:H1*



* Excludes Mortgage & Financial Guaranty insurers in 2008, 2009 and 2010. Including M&FG, 2008=105.1, 2009=100.7, 2010:H1=101.7

Sources: A.M. Best, ISO.

Number of Years with Underwriting Profits by Decade, 1920s–2010s

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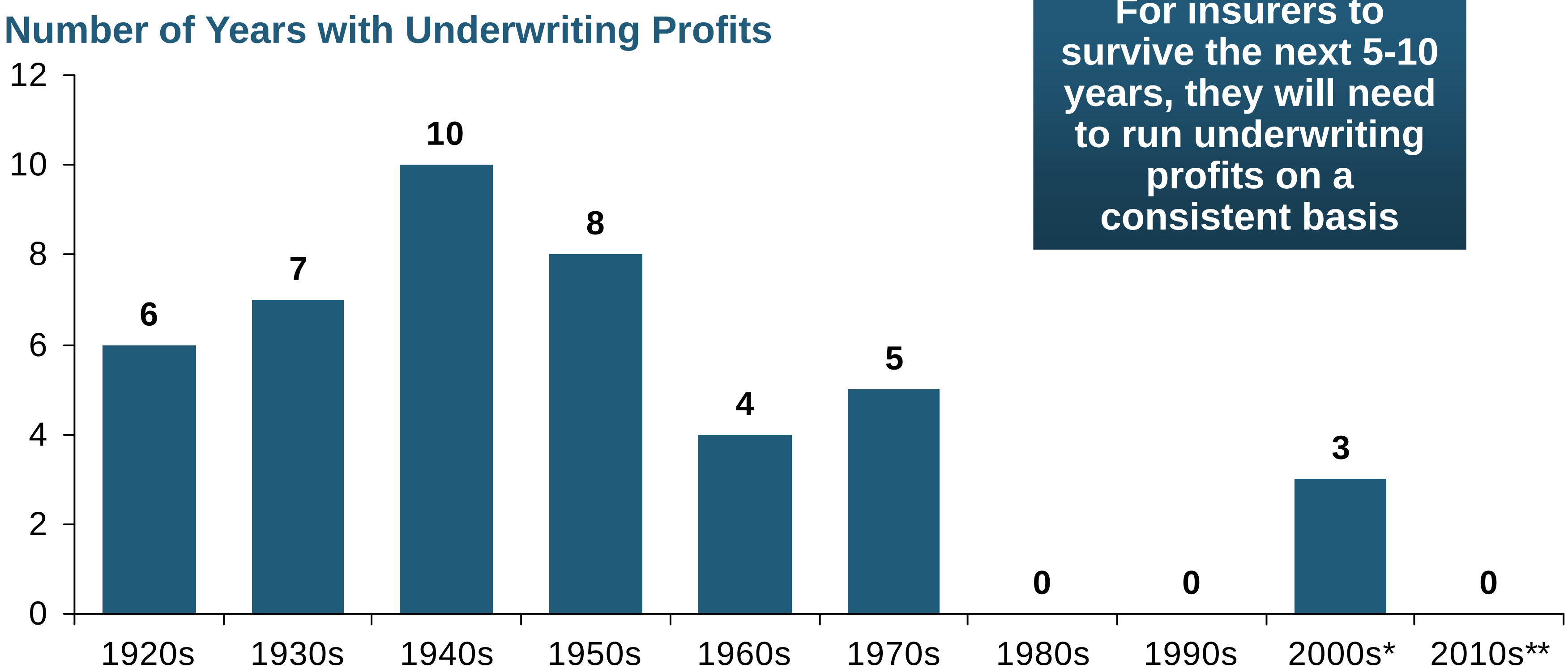


For insurers to survive the next 5-10 years, they will need to run underwriting profits on a consistent basis

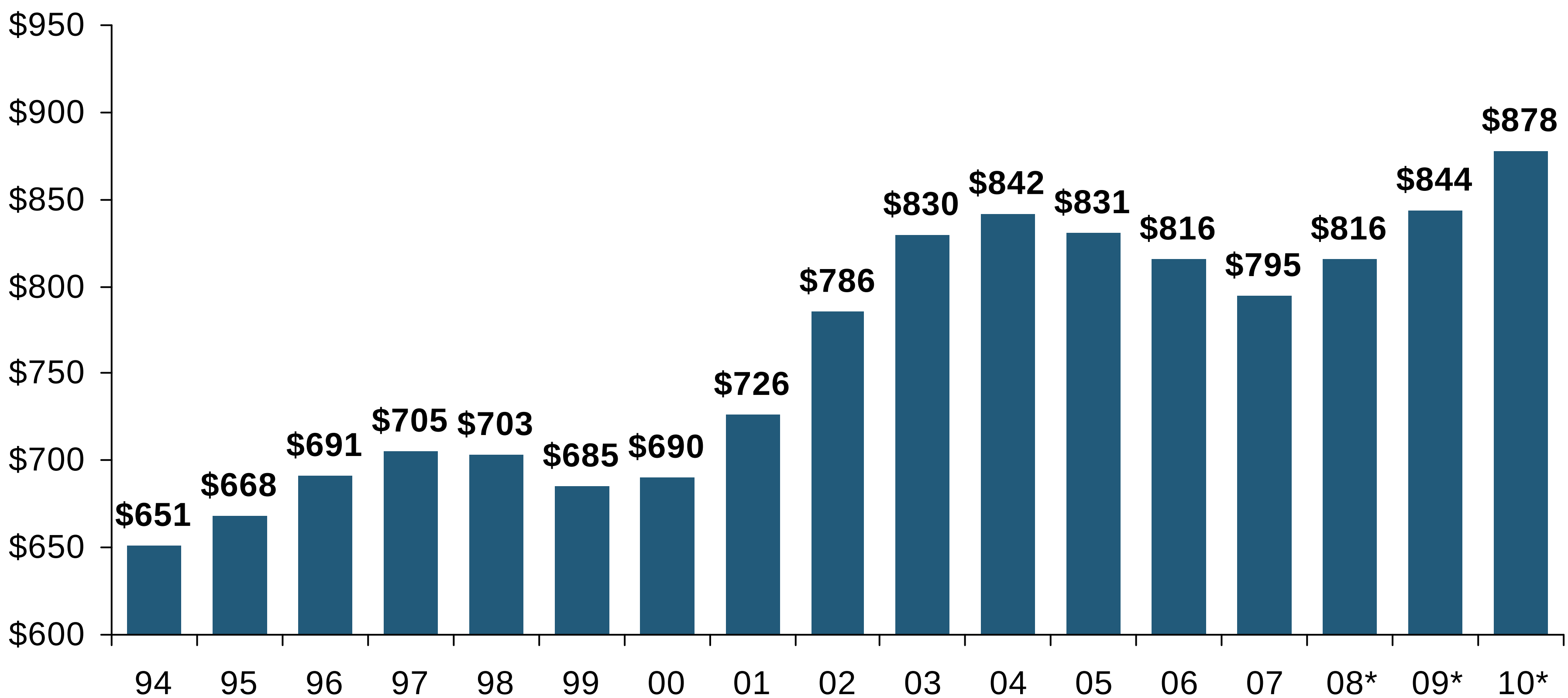
Underwriting Profits Were Common Before the 1980s (40 of the 60 Years Before 1980 Had Combined Ratios Below 100) – But Then They Vanished. Not a Single Underwriting Profit Was Recorded in the 25 Years from 1979 Through 2003

*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.

**Based on estimated combined ration of 101.7 for 2010.

Note: Data for 1920–1934 based on stock companies only. Sources: Insurance Information Institute research from A.M. Best Data.

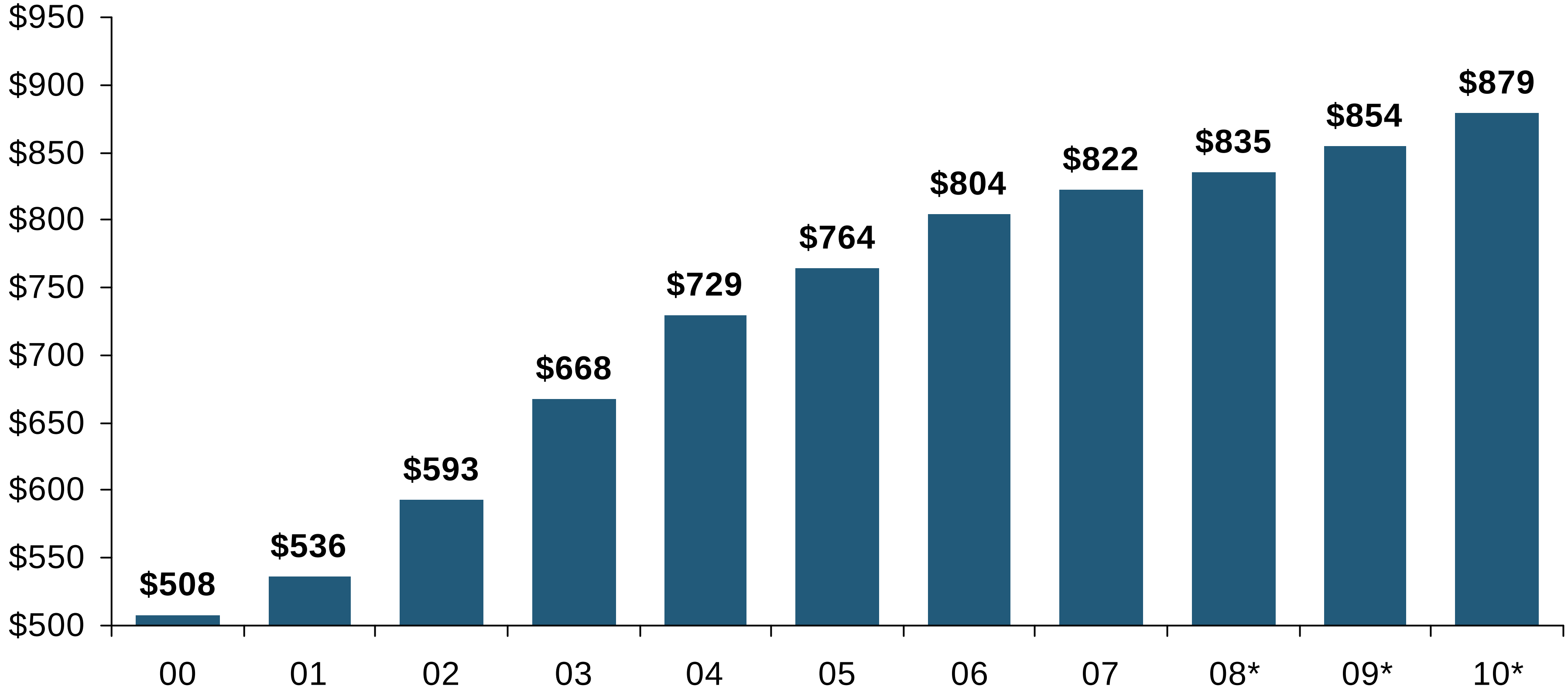
Average Expenditures on Auto Insurance



Countrywide Auto Insurance Expenditures Increased 2.6% in 2008 and 3.5% Pace in 2009 (est.) and 4% in 2010 (est.)

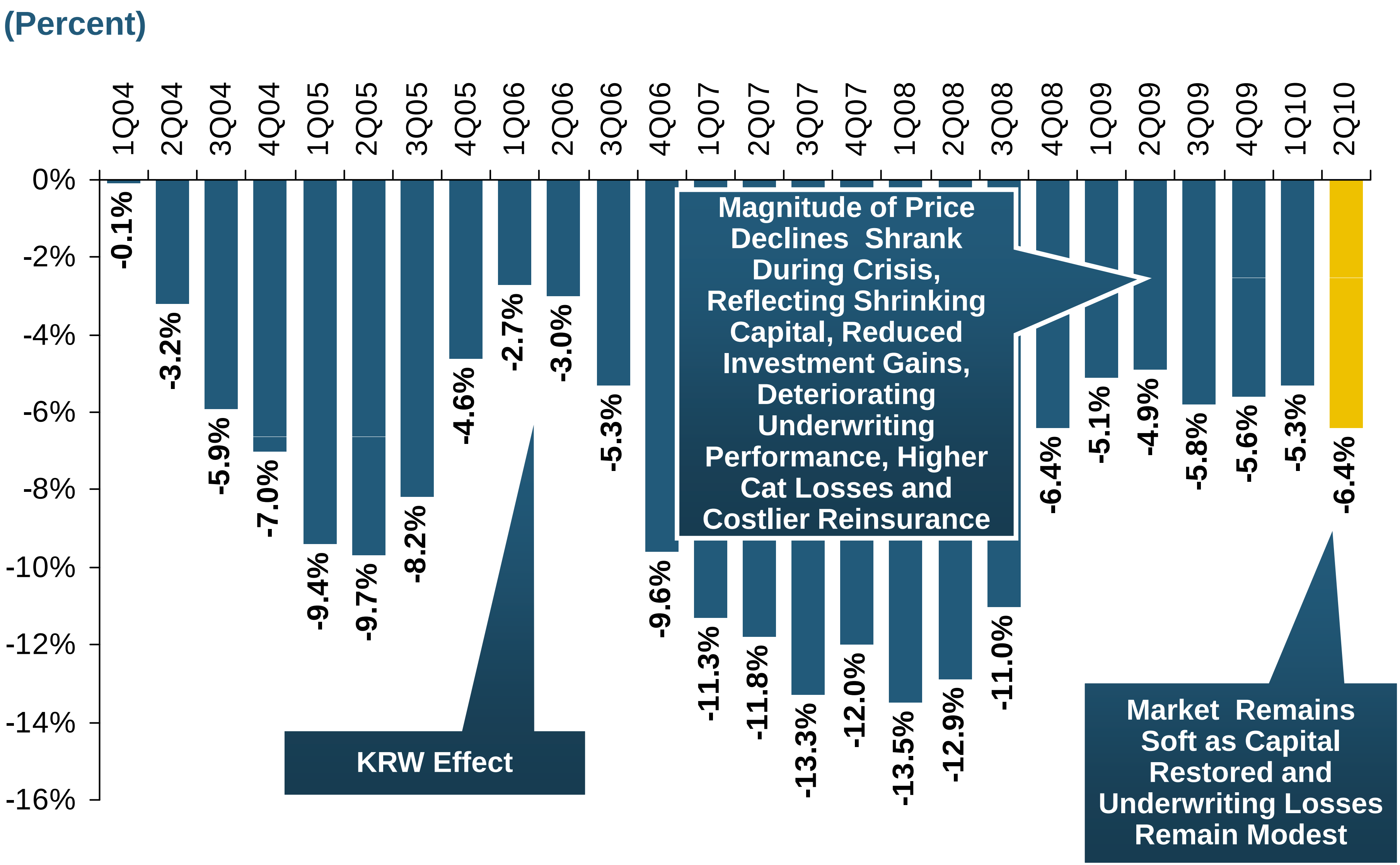
* Insurance Information Institute Estimates/Forecasts
Source: NAIC, Insurance Information Institute estimates 2008-2010 based on CPI data.

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:2004–2Q:2010)



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

Change in Commercial Rate Renewals, by Line: 2010:Q2

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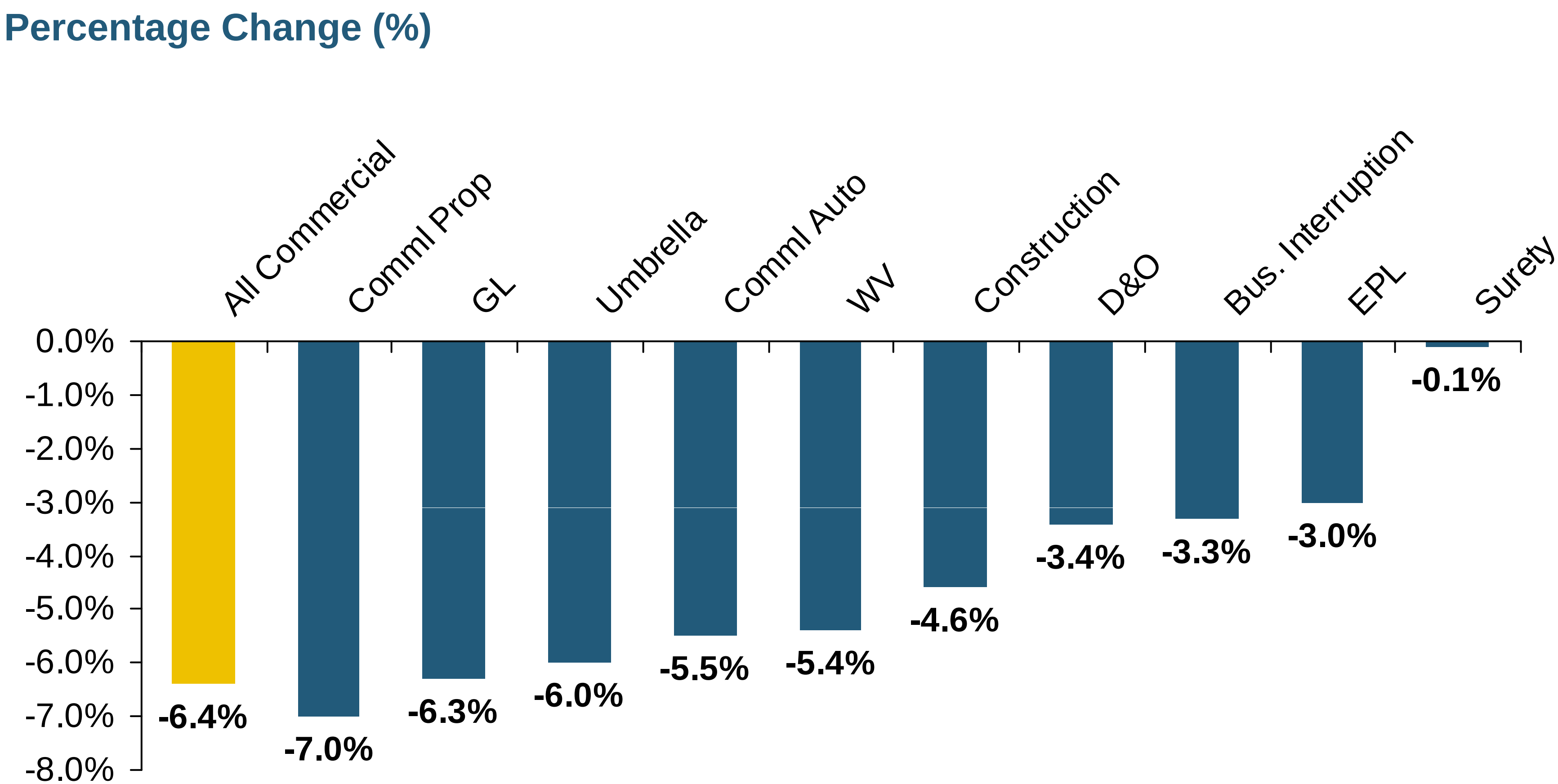

Most Major Commercial Lines Renewed Down in Q2:2010 at a Faster Pace than a year Earlier

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

Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2010:Q2

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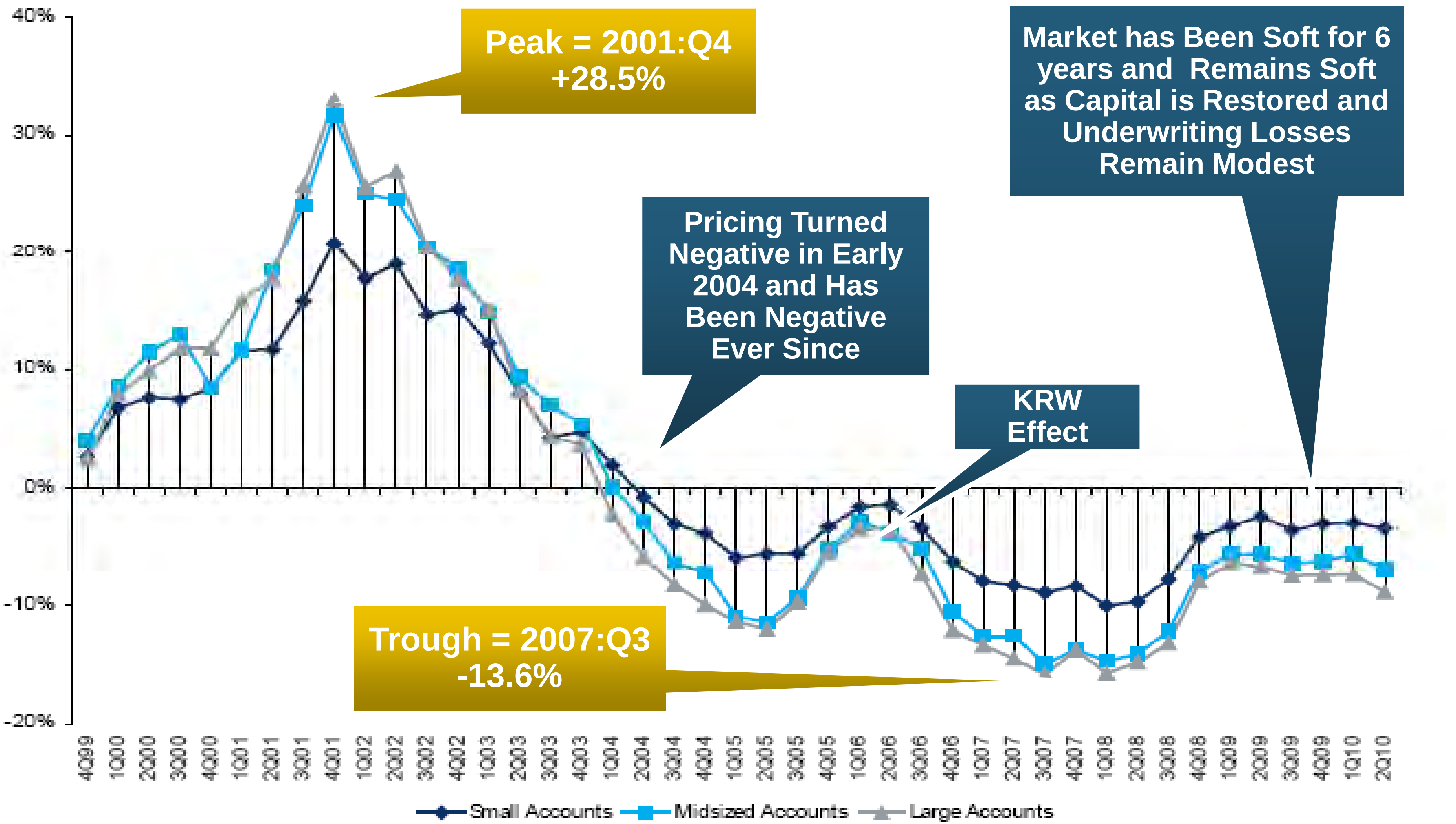
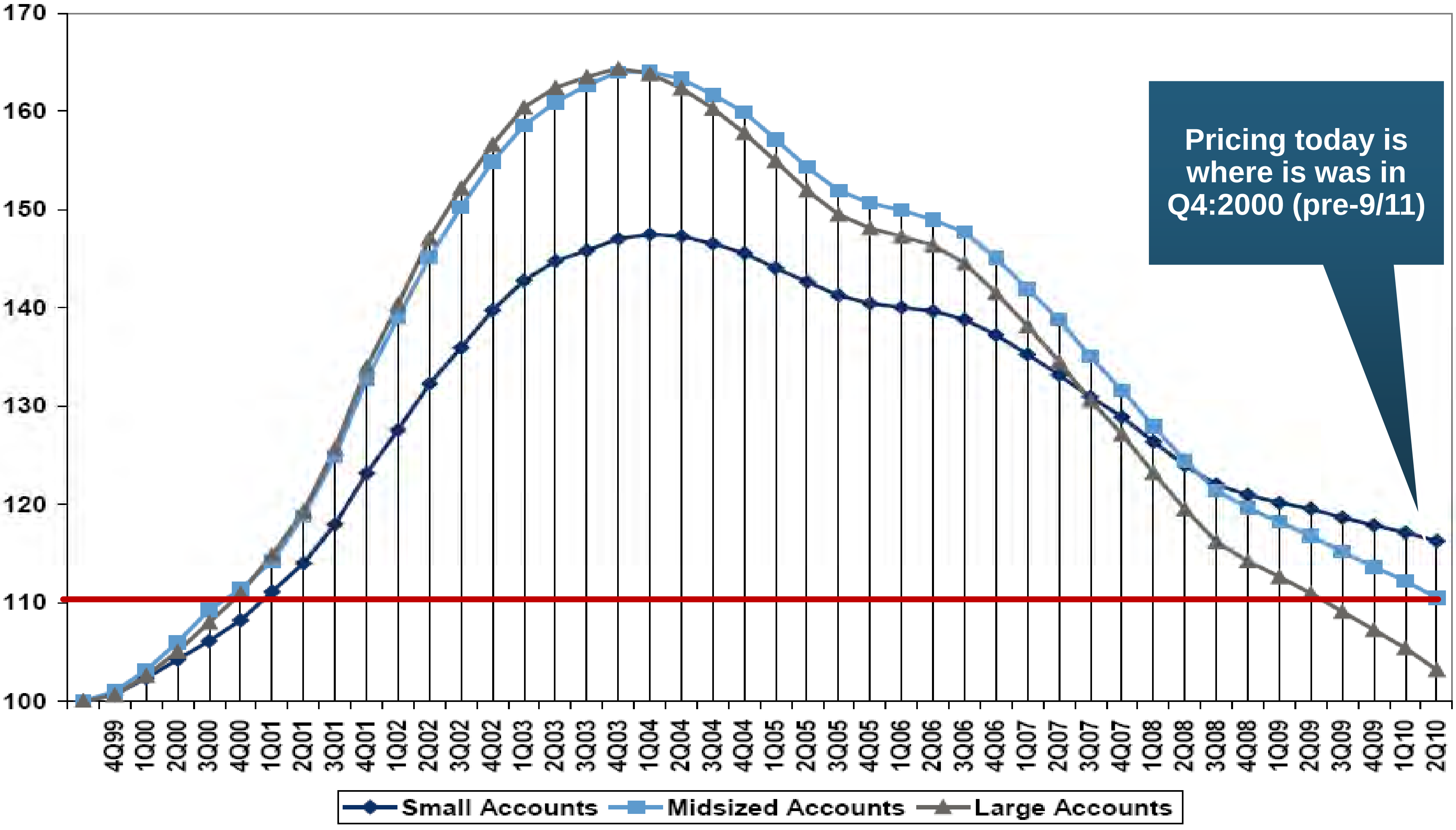
Percentage Change (%)



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

Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2010:Q2

1999:Q4 = 100



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

#2

Falling Behind in Underwriting Technology: The Competitive Leading Edge

Underwriting Acumen Will Determine Long-Run Success

A Technological Arms Race?

Competition: Success Defined More by Underwriting Acumen than by Price

- Consumers see competition mostly in terms of price and service
- While insurance is generally very price competitive, long-run success for insurers is not solely correlated with the lowest price
- Underwriting is the key to accurate risk assessment and pricing
- An insurer that systematically prices business more accurately will turn in a better financial performance and lead competitors misprice
- There are theoretically no boundaries when it comes to underwriting
- The past 15 years launched a technological revolution in underwriting
  - Now we're in the midst of a *Technological Arms Race*
- From Credit, to Predictive Modeling to Telematics to….???
- Next Wave of Innovations Will Include Integration of Real-Time Information About the Vehicle and Driver
- Interactive Technologies
  - Allows drivers to "log on" to view how driving behaviors influence risk and price
- Ability for Consumer to Adjust Behaviors
  - Tremendous public policy, public safety implications

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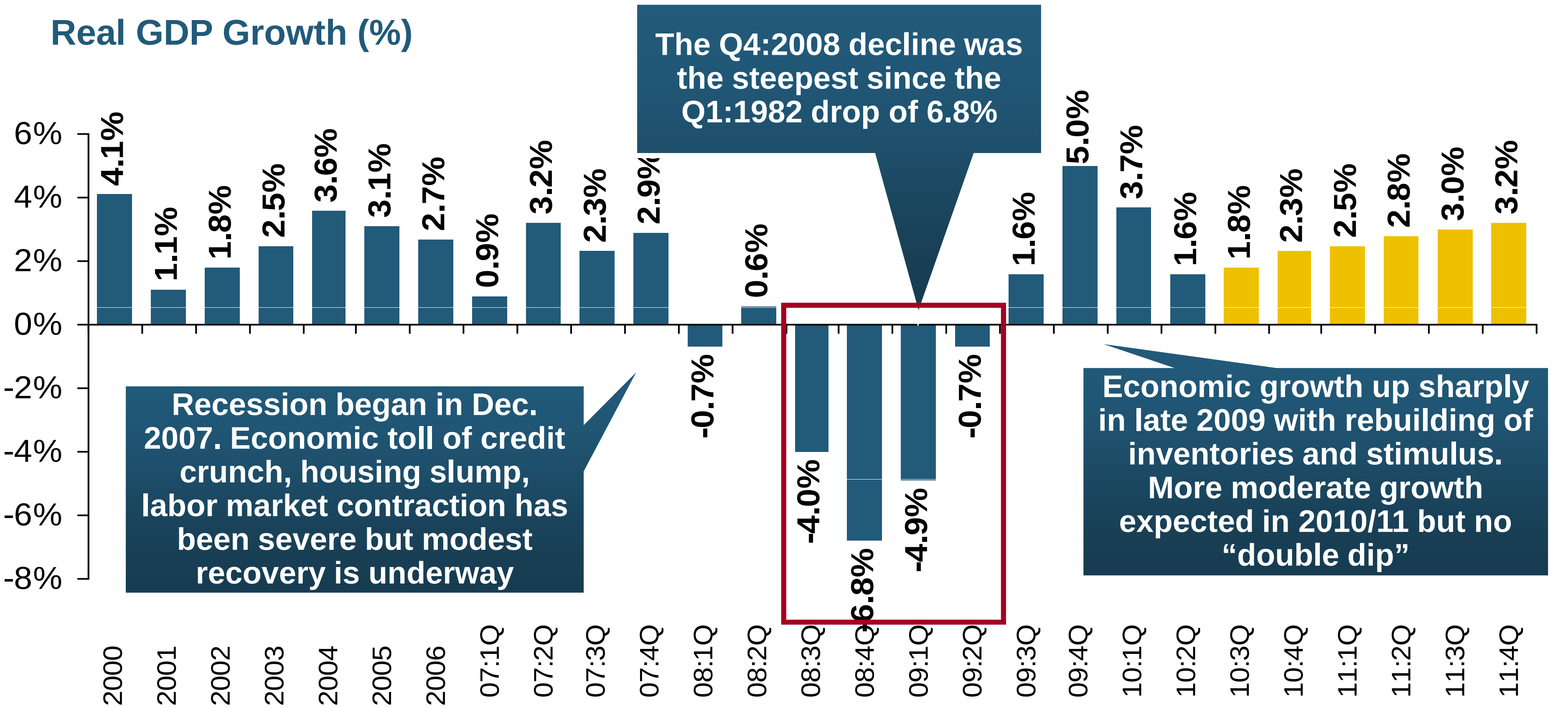
#3

The Economic Storm

Continued Economic Weakness and Financial Market Volatility Will Challenge Industry's Exposure Base, Growth and Profitability

US Real GDP Growth*



Demand Commercial Insurance Continues To Be 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.

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

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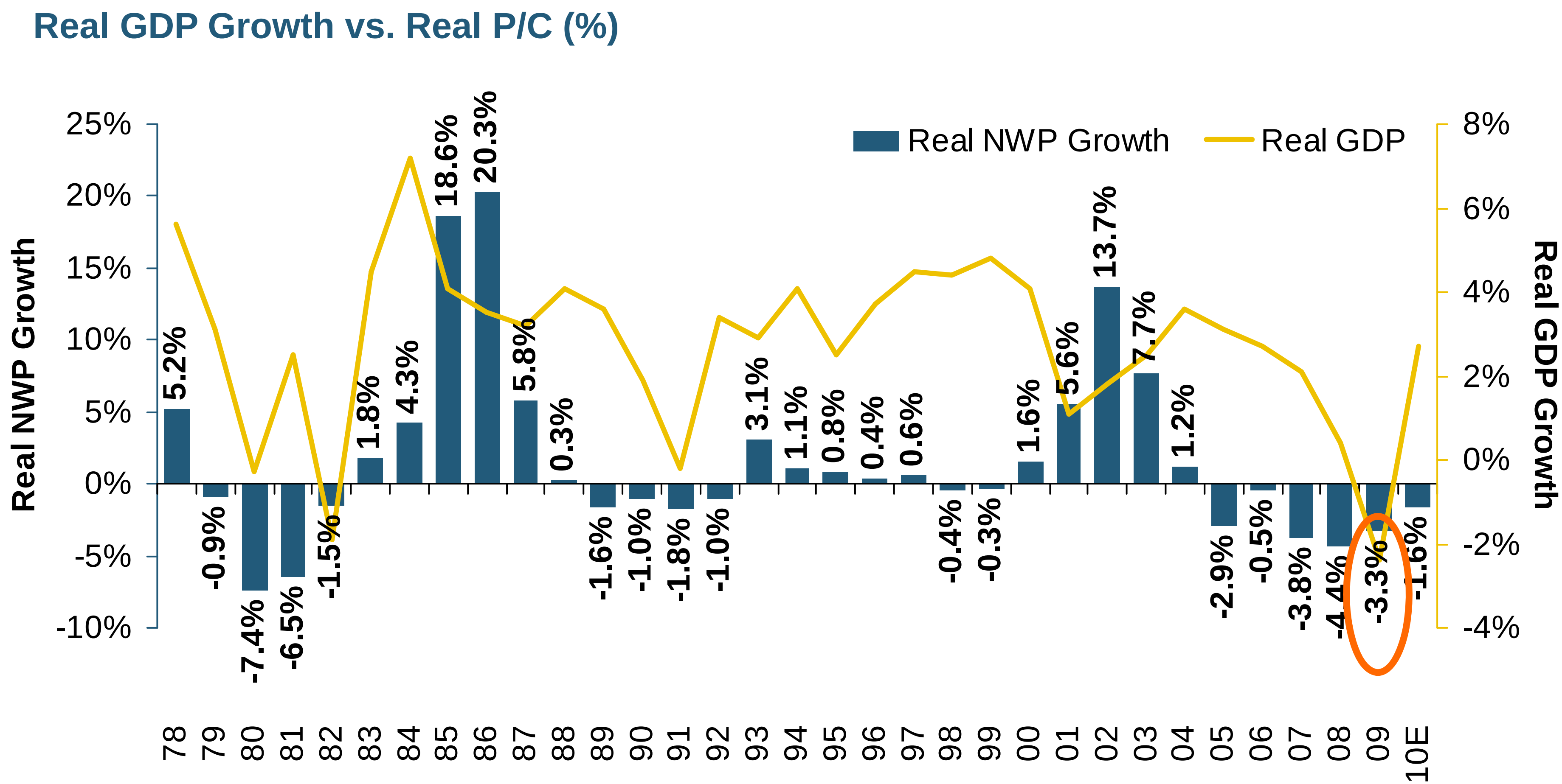

P/C Insurance Industry's Growth is Influenced Modestly by Growth in the Overall Economy

Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 9/10; Insurance Information Institute

Soft Market Appears to Persist in 2010 but May Be Easing: Relief in 2011?

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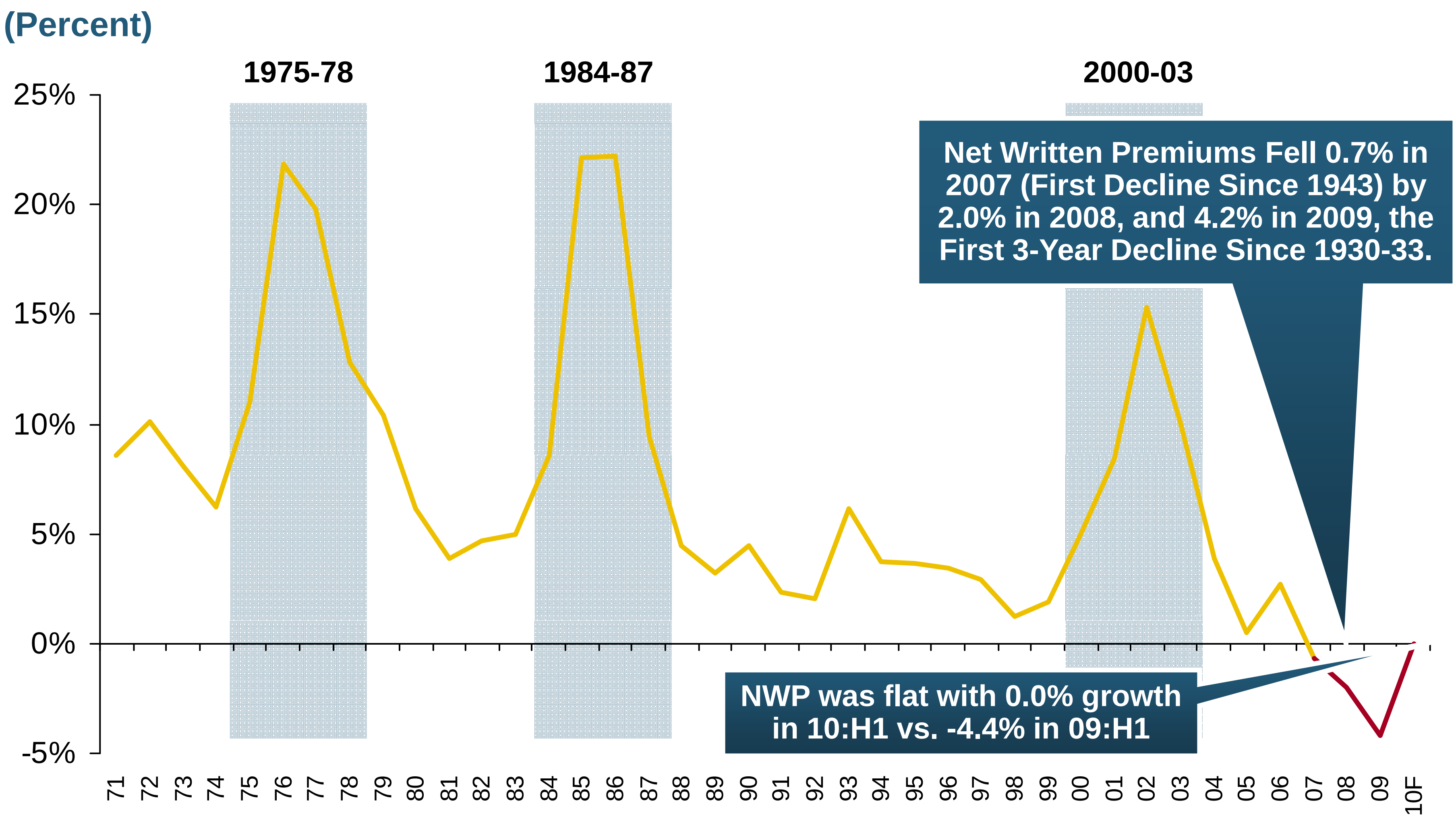

Shaded areas denote "hard market" periods

Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

Auto/Light Truck Sales, 1999-2011F

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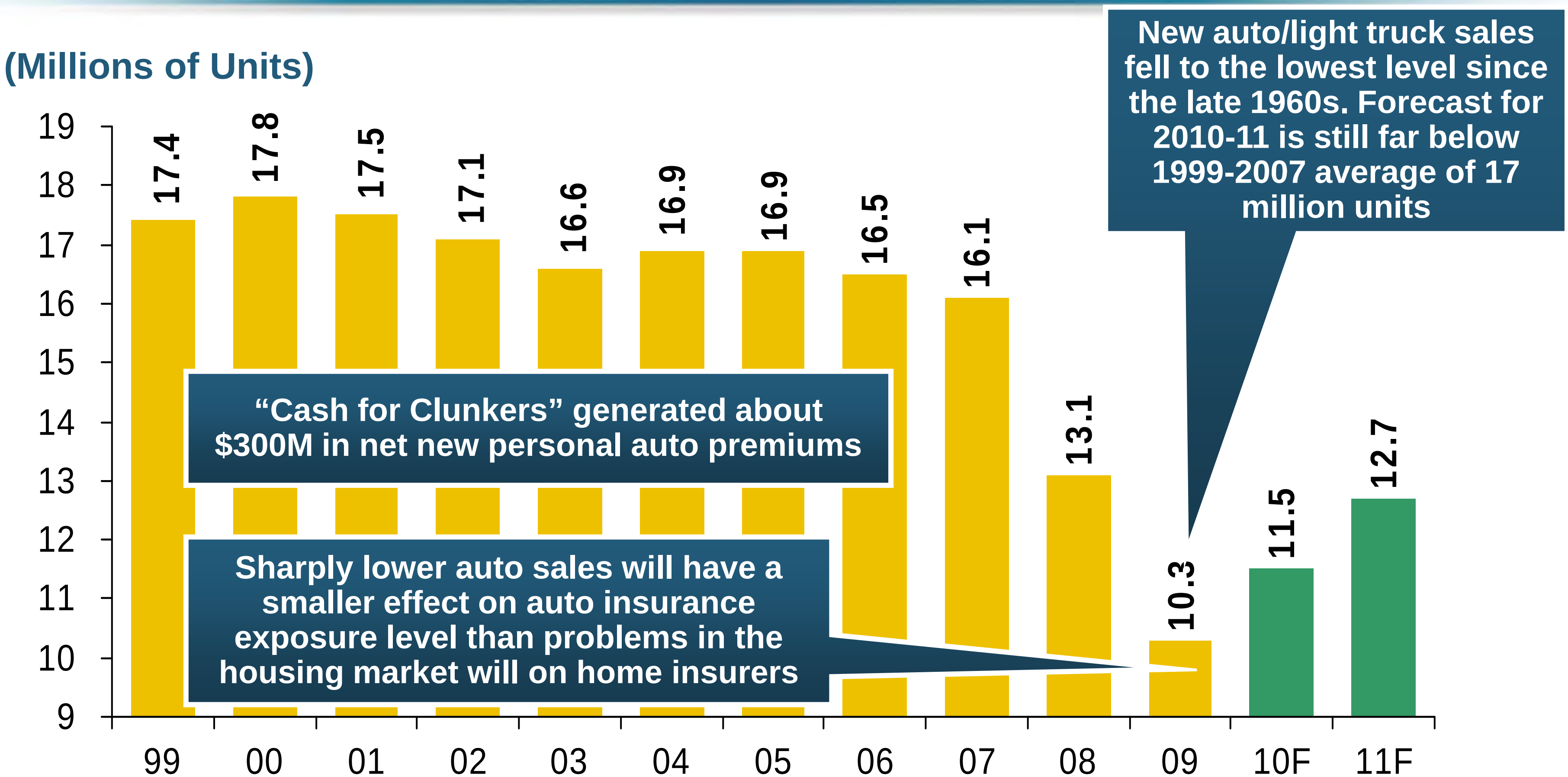

Car/Light Truck Sales Will Recover from the 2009 Low Point, but High Unemployment, Tight Credit Are Still Restraining Sales

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (9/10); Insurance Information Institute.

New Private Housing Starts, 1990-2011F

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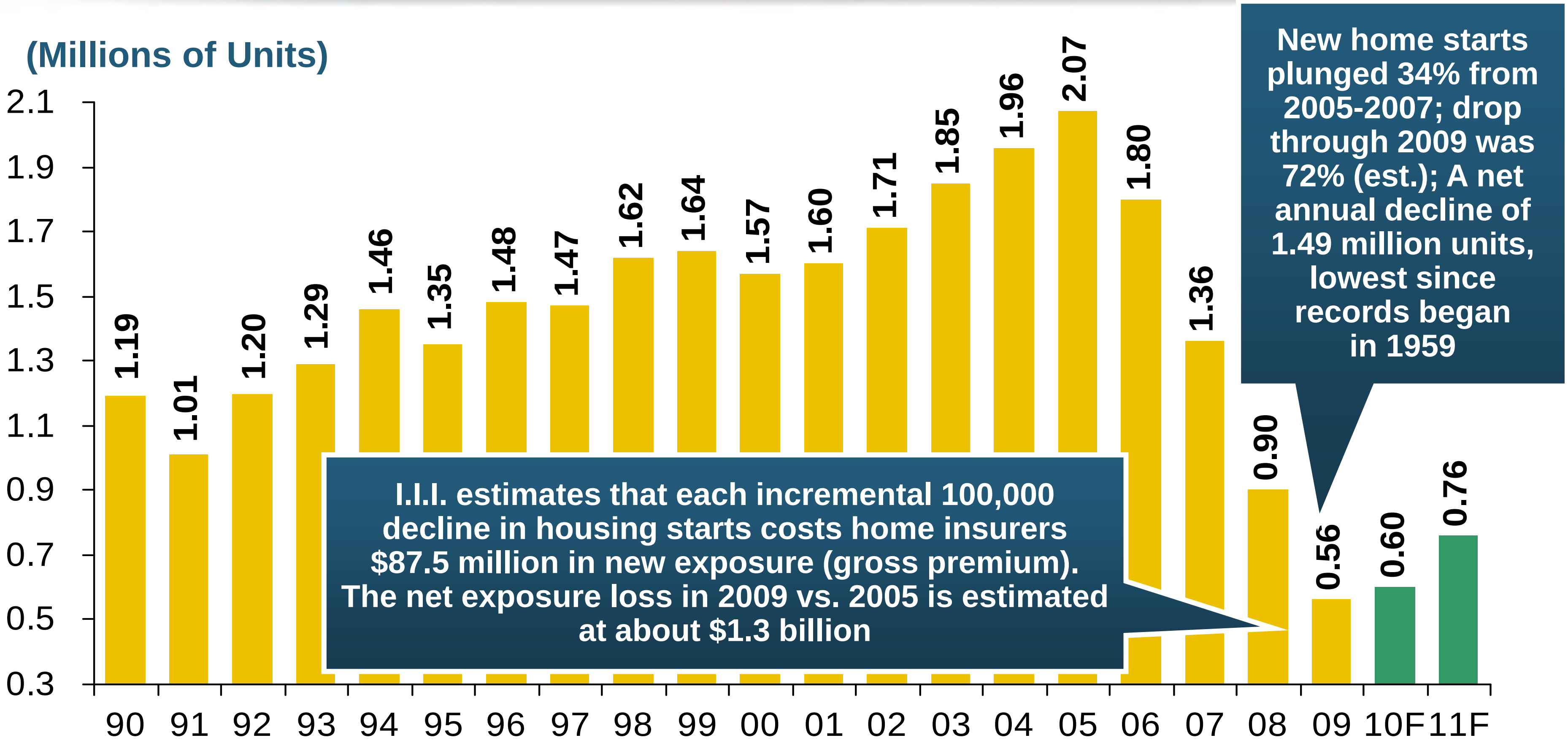

Little Exposure Growth Likely for Homeowners Insurers Due to Weak Home Construction Forecast for 2010-2011. Also Affects Commercial Insurers with Construction Risk Exposure, Surety

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (9/10); Insurance Information Institute.

Recovery in Capacity Utilization is a Positive Sign for Insurance Exposure

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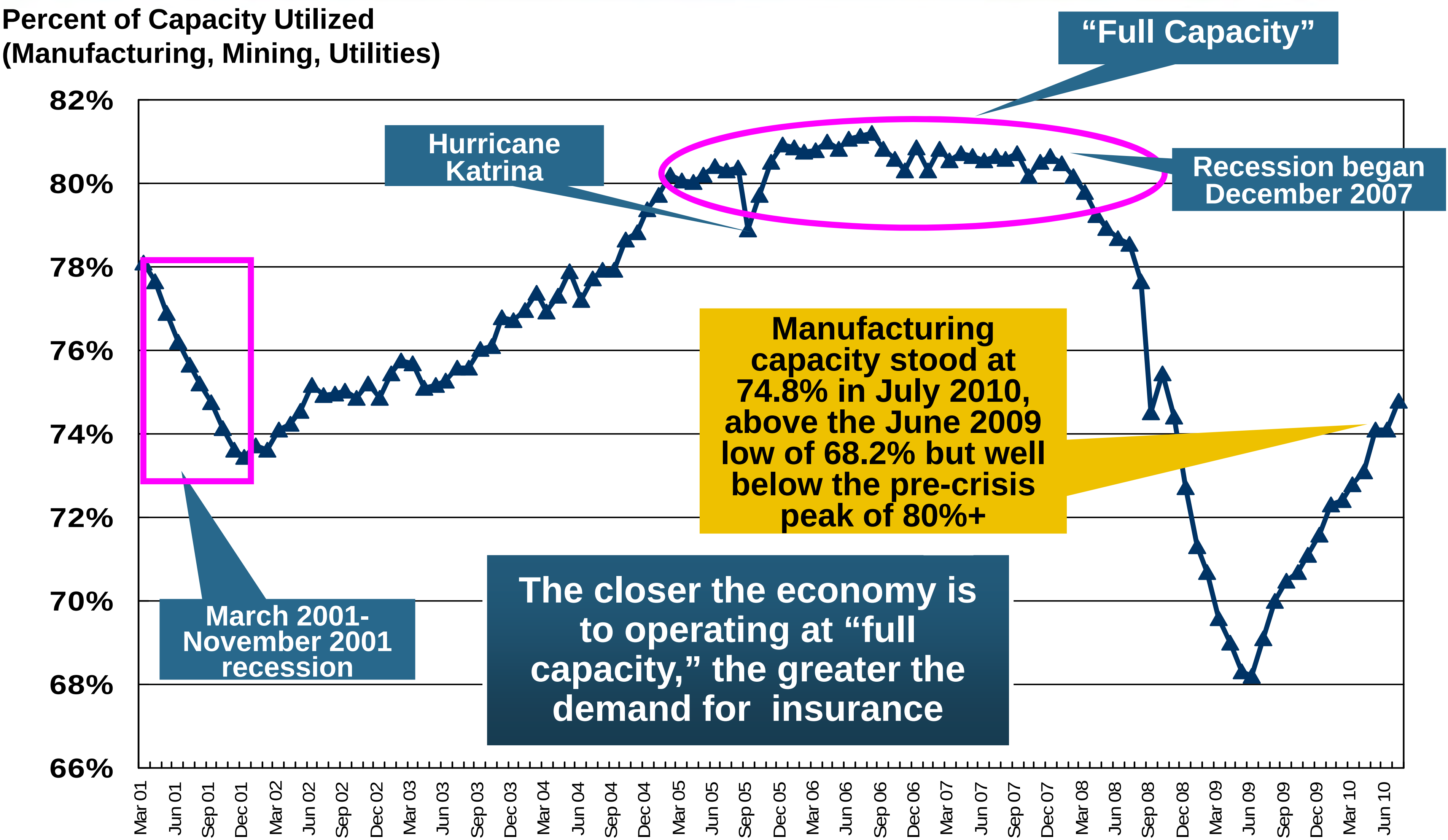

Source: Federal Reserve Board statistical releases at http://www.federalreserve.gov/releases/g17/Current/default.htm.

Unemployment and Underemployment Rates: Rocketed Up in 2008-09; Stabilizing in 2010?

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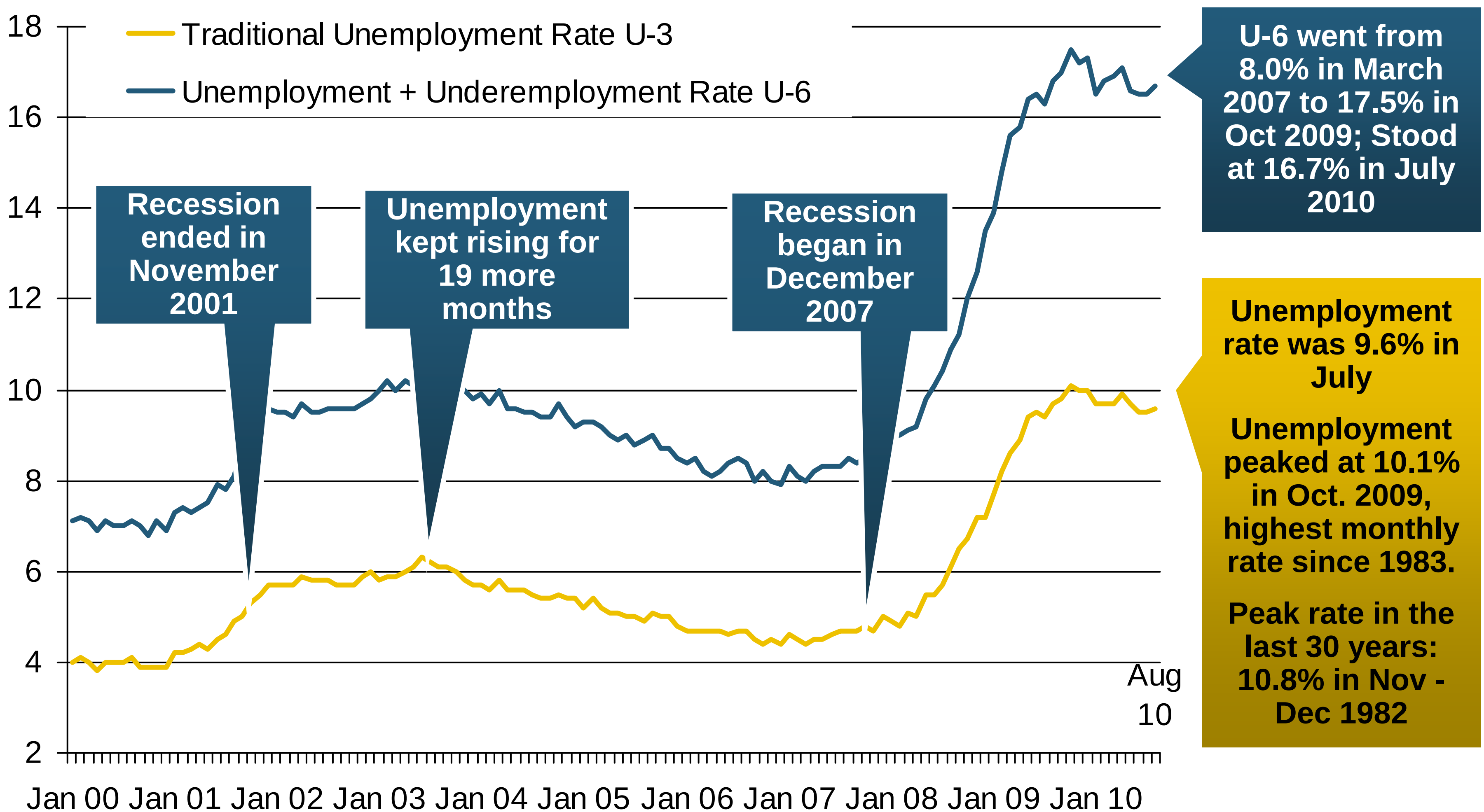
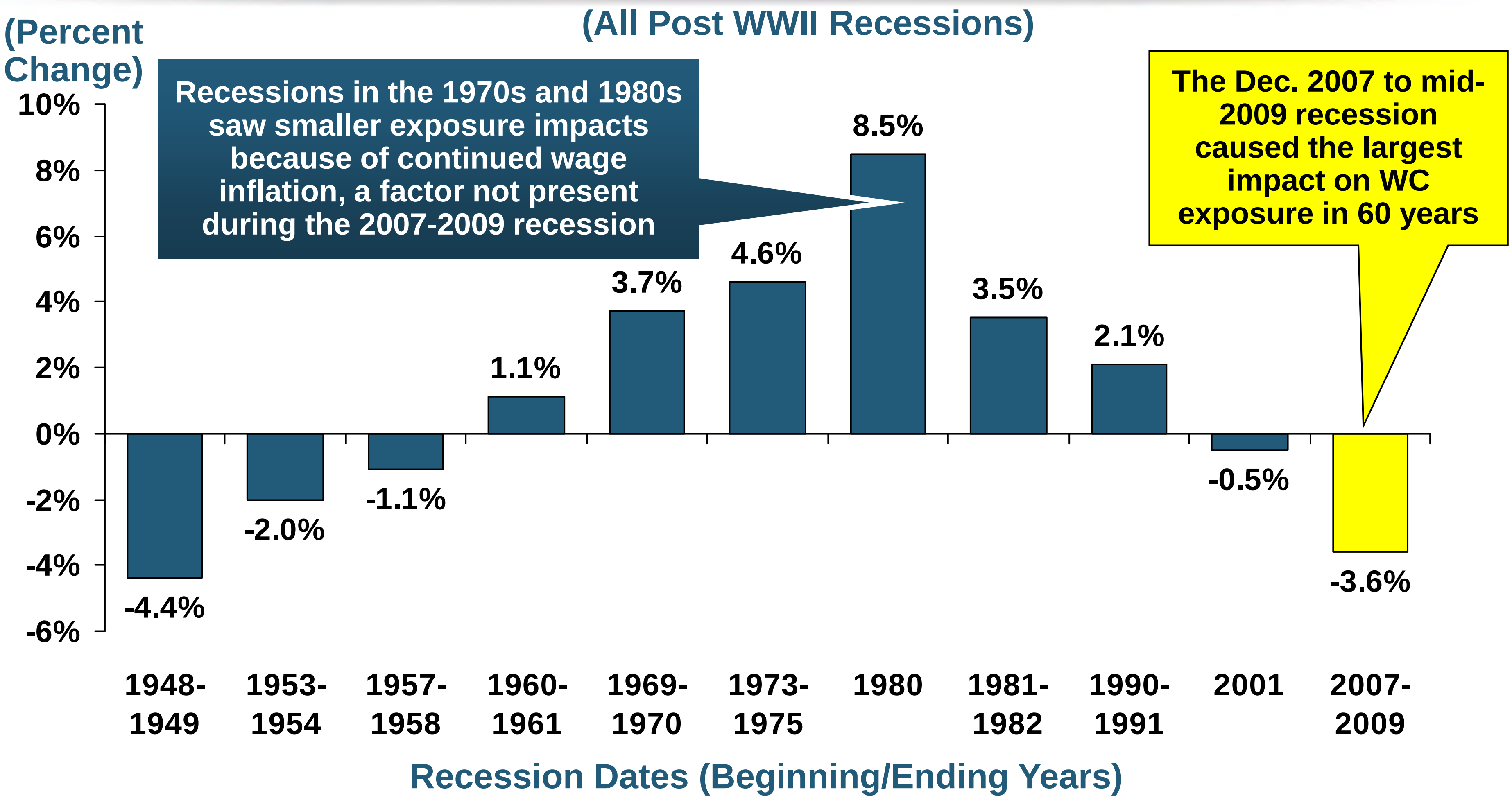
January 2000 through August 2010, Seasonally Adjusted (%)



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

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



*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).

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Deflation: An Old Adversary

What History Teaches Us About Deflation and the P-C Industry

All Insurers that Are 100+ Year Old Today Survived Bouts of Inflation in the Past, but Not in the Most Recent 75 or So Years

Primary Causes and Major Bouts of Deflation

Deflation is:

- A falling general price level
  - Note: this is different from
    - A fall in *the rate of increase* of the general price level;
      - This is called **disinflation**
    - A fall in the prices of some items or category of items
- For a prolonged period
- That is expected to continue indefinitely

Deflation results from some or all of:

- A surge in productivity, generally from technological innovation
- A steep and prolonged drop in the money supply
- A steep and prolonged recession
  - Note: this is different from a fall in *the rate of increase* of the price level

Major US Bouts of Deflation

- 1920-22
- 1930-33

Sources: http://www-personal.umich.edu/~alandear/glossary/d.html; http://en.wikipedia.org/wiki/Deflation; I.I.I.

Broad Impact of Deflation

Deflation causes…

- Consumers to delay buying things
  - They expect to buy those things later at lower prices
- A drop in the level of aggregate demand, from the delay in consumption
- A transfer of wealth
  - From borrowers and holders of illiquid assets
  - To savers/lenders and holders of liquid assets and currency
- A drop in the level of business investment
  - Following the drop in aggregate demand
  - Slack in capacity if the economy is in recession
  - Increased likelihood of lower profits or losses as selling prices drop below costs

Sources: http://en.wikipedia.org/wiki/Deflation; I.I.I.

1920-1950: Inflation, Deflation and the P-C Industry's Combined Ratio*

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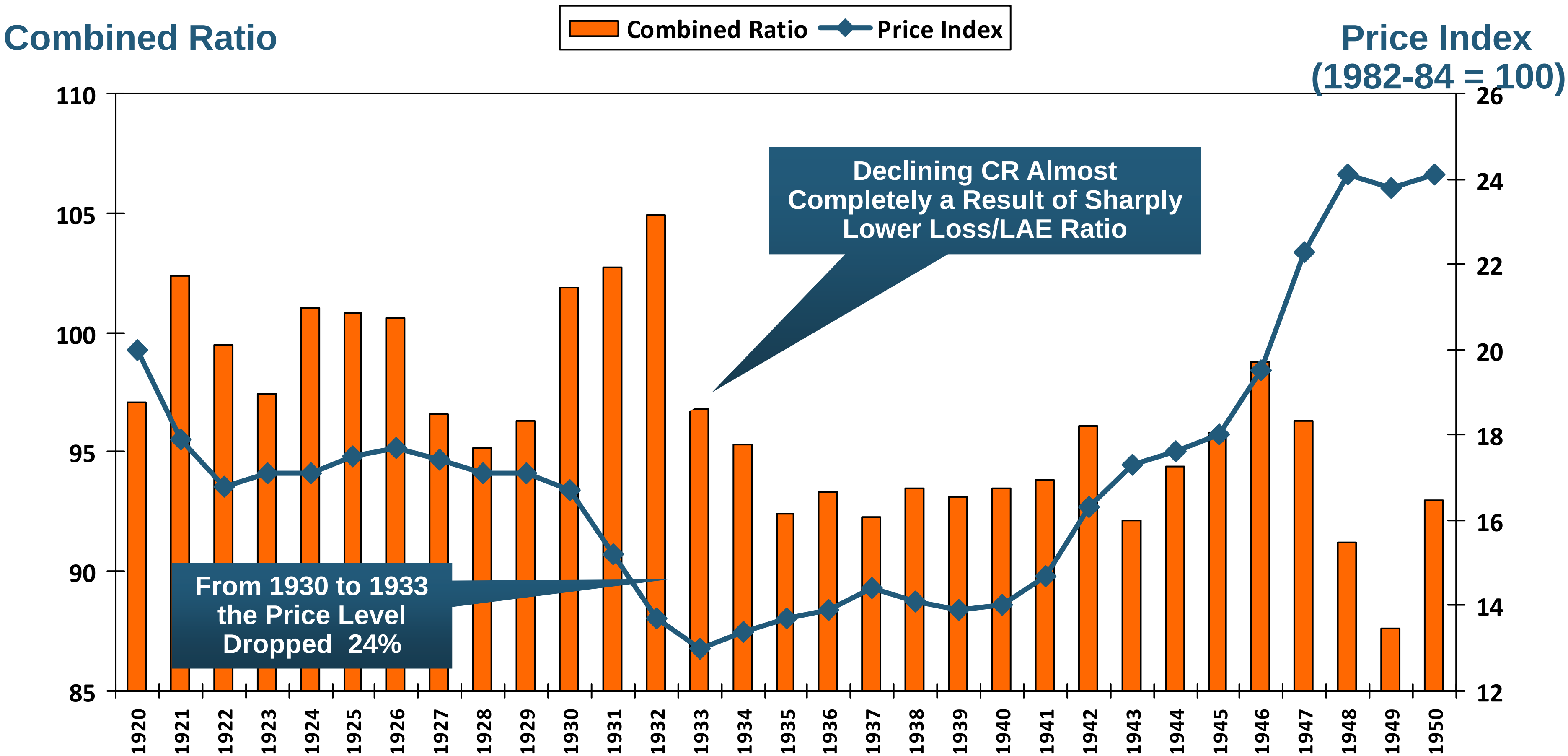
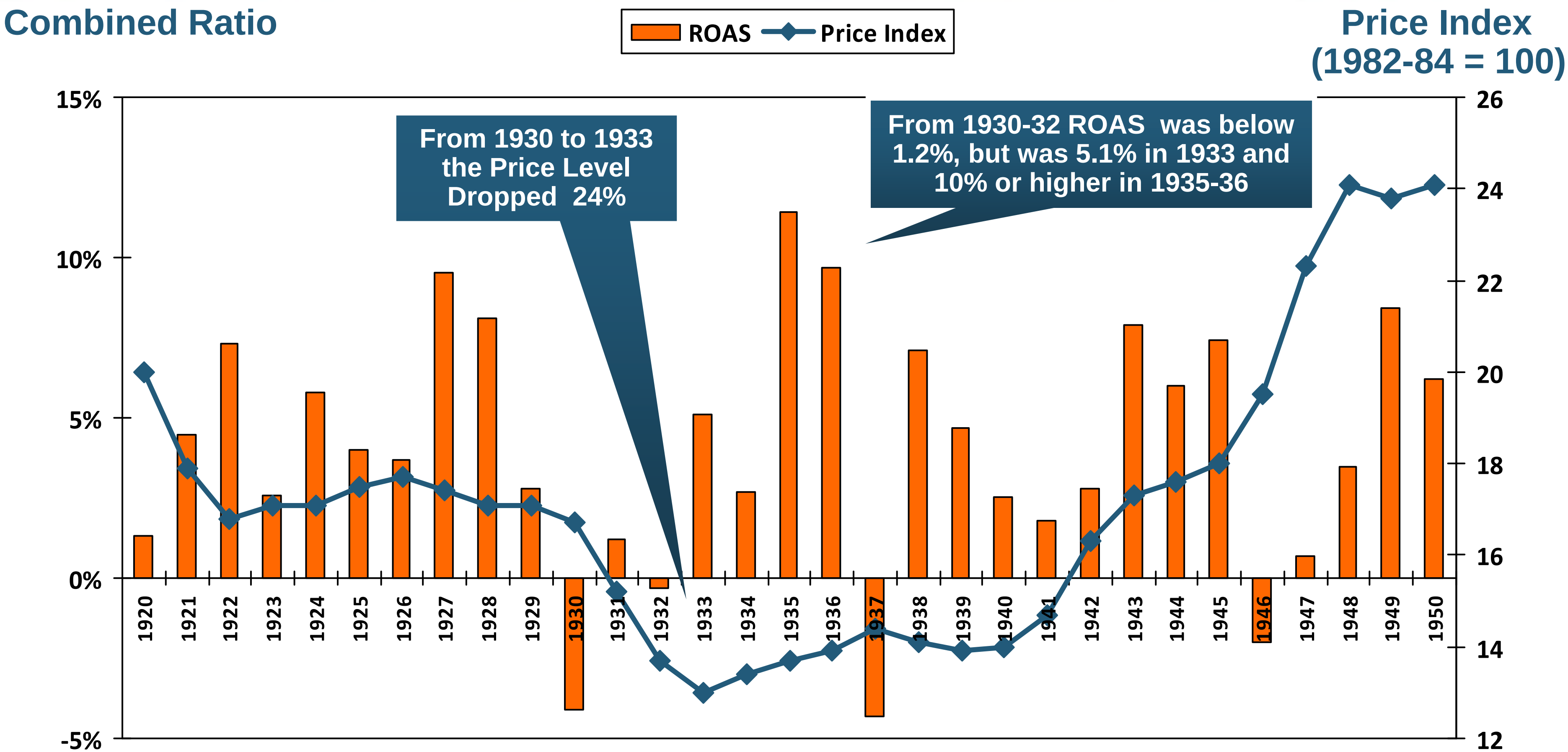


From Year-end 1929 Through 1932, the Industry's Combined Ratio Rose from 96.3 to 104.9 as the CPI Dropped. But from 1933 into the 1950s, the Combined Ratio Remained Below 100 Even as Prices Slowly Rose, Then Shot Up after WWII.

*From 1920-1934, stock companies only
Sources: Best's Aggregates & Averages; http://www.rateinflation.com/consumer-price-index/usa-historical-cpi.php?form=usacpi

1920-1950: Inflation, Deflation and P-C Industry Profitability*



The Significant Deflation from 1930-32 Punished the Industry's ROAS, But an Improving Economy (and Slight Inflation) Helped Achieve ROAS in Double Digits in 1935-36.

*stock companies only
Sources: Best's Aggregates & Averages; I.I.I.; ; http://www.rateinflation.com/consumer-price-index/usa-historical-cpi.php?form=usacpi

Deflation's Effects on the P-C Insurance Industry

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- **Lower Claim Severities**
  - Particularly for property claims, severity drops for many items that insurers pay for
- **Rate contingency margins increase**
  - At least until rate construction reflects persistently declining claims severity, margins will be higher than otherwise due to high trend assumptions arising from use of historical data
- **Reserve Releases?**
  - Reserves may develop beneficially to become "redundant"
- **Lower Claim Frequency as Fewer Claims Reach Deductible, Retention Levels**
- **Less Use of Reinsurance**
  - Lower costs ➔ risks burn through their retentions less quickly, reaching policy limits less quickly

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#4
Investment Performance Will Remain a Drag on Results

Investments Are a Principle Source of Subpar Profitability and Will Force Insurers' Hand on Generating Underwriting Profits

Property/Casualty Insurance Industry Investment Gain: 1994–2010:H1[1]

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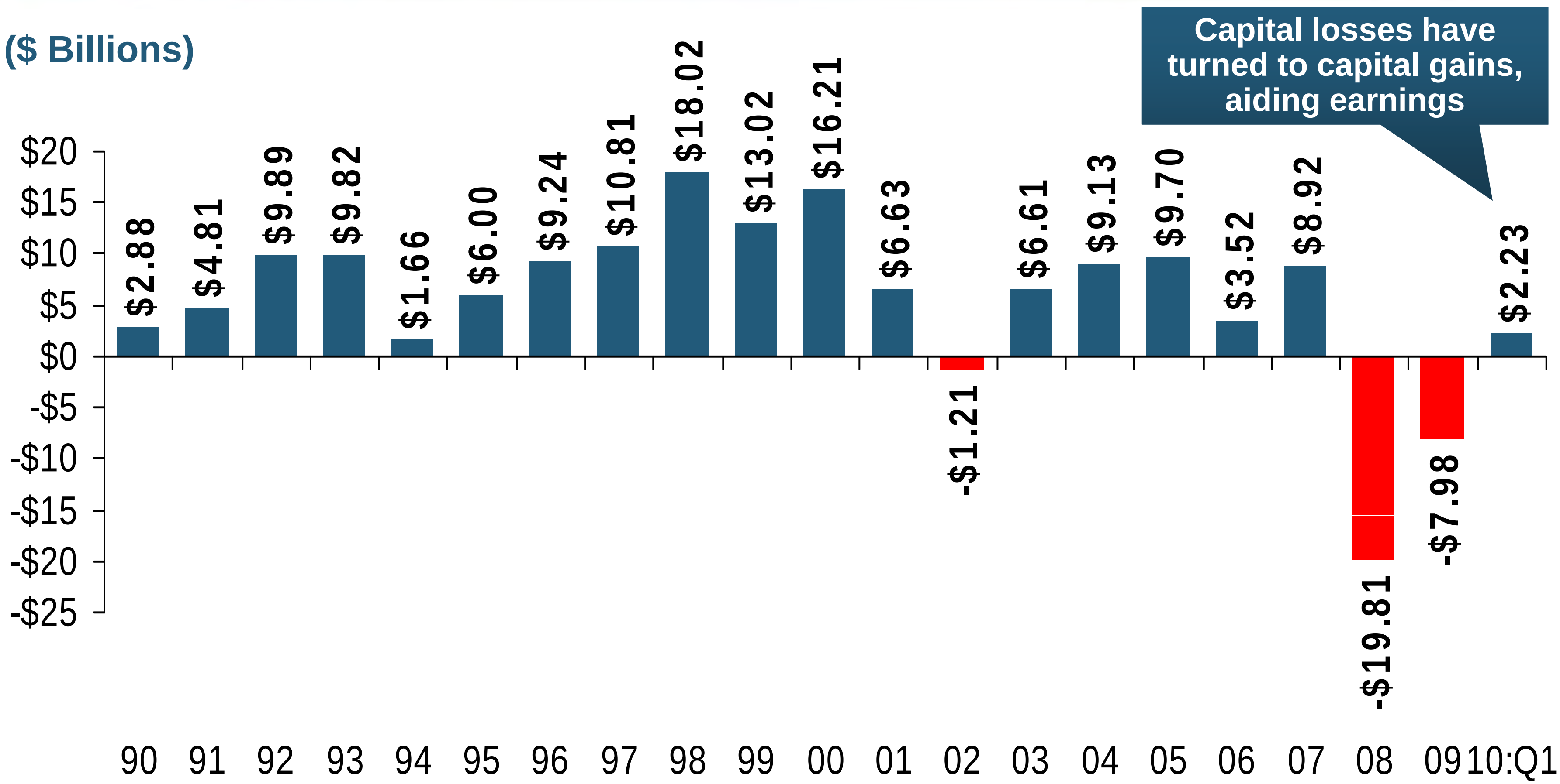
In 2008, Investment Gains Fell by 50% Due to Lower Yields and Nearly $20B of Realized Capital Losses
2009 Saw Smaller Realized Capital Losses But Declining Investment Income
Investment Gains Are Recovering So Far in 2010

[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.

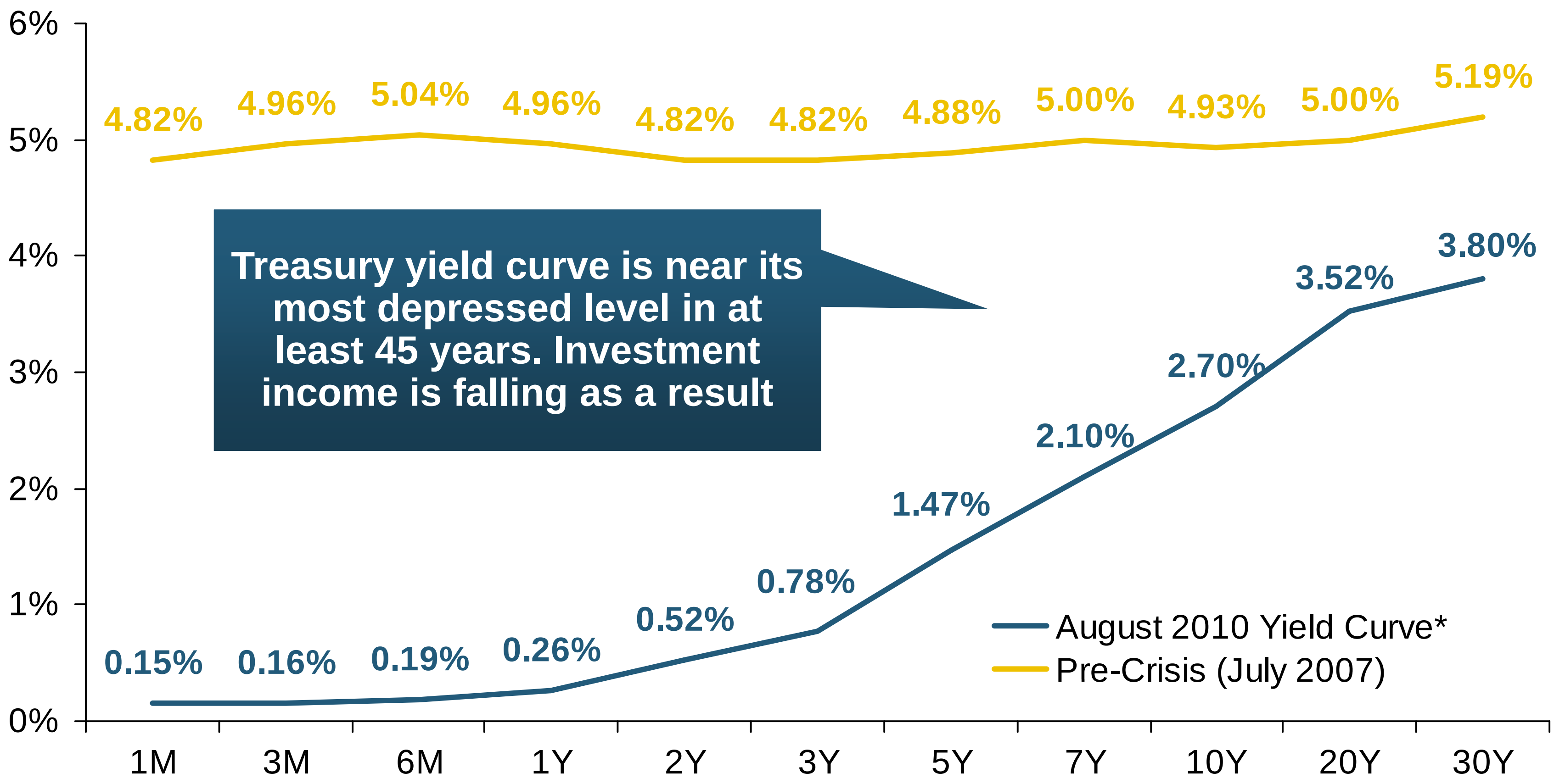
P/C Insurer Net Realized Capital Gains, 1990-2010:H1



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 Curves: Pre-Crisis (July 2007) vs. August 2010



Stock Dividend Cuts Have Further Pressured Investment Income

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*

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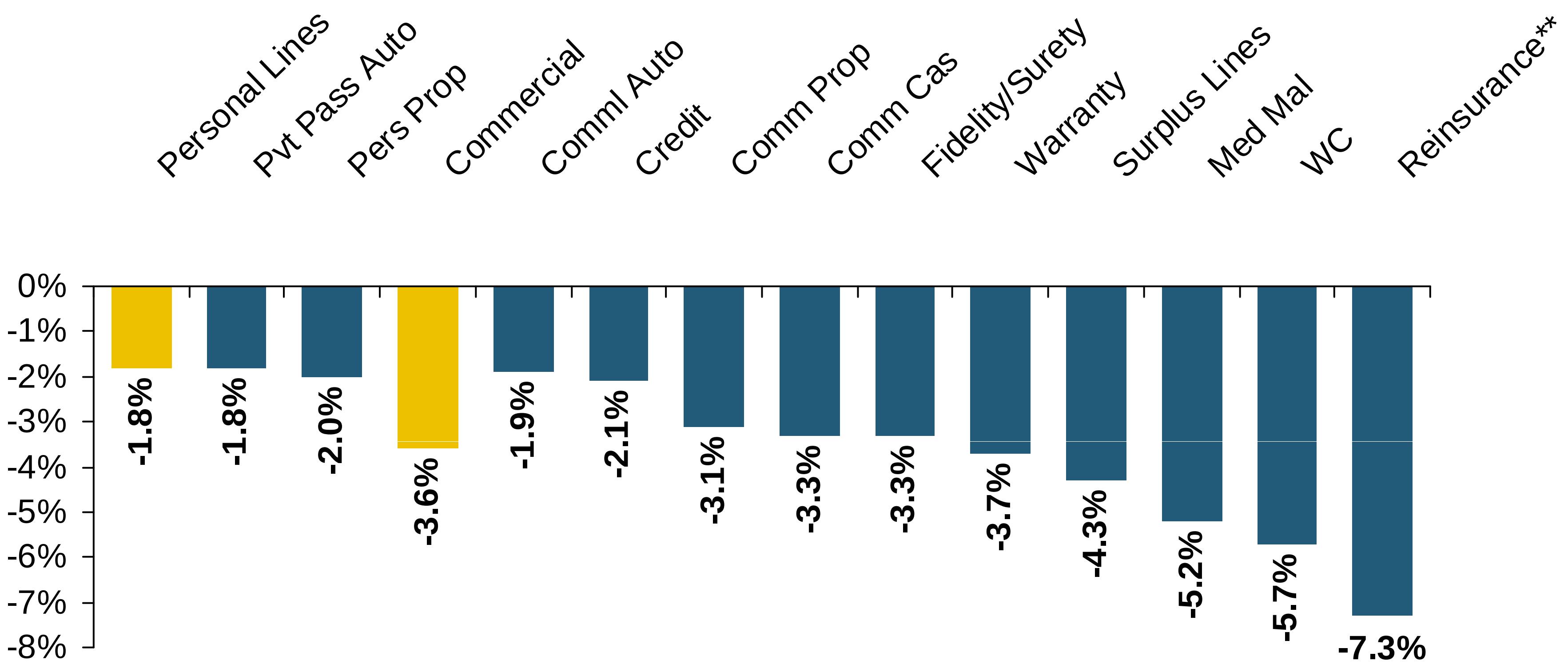

Lower Investment Earnings Place a Greater Burden on Underwriting and Pricing Discipline

*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

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

#5
Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

Important Issues & Threats Facing Insurers: 2010–2015

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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

AMERICAN ASSOCIATION for JUSTICE

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

Source: Institute for Legal Reform.

Trial Lawyer Poll: Which Areas Offer the Greatest Potential Benefit?

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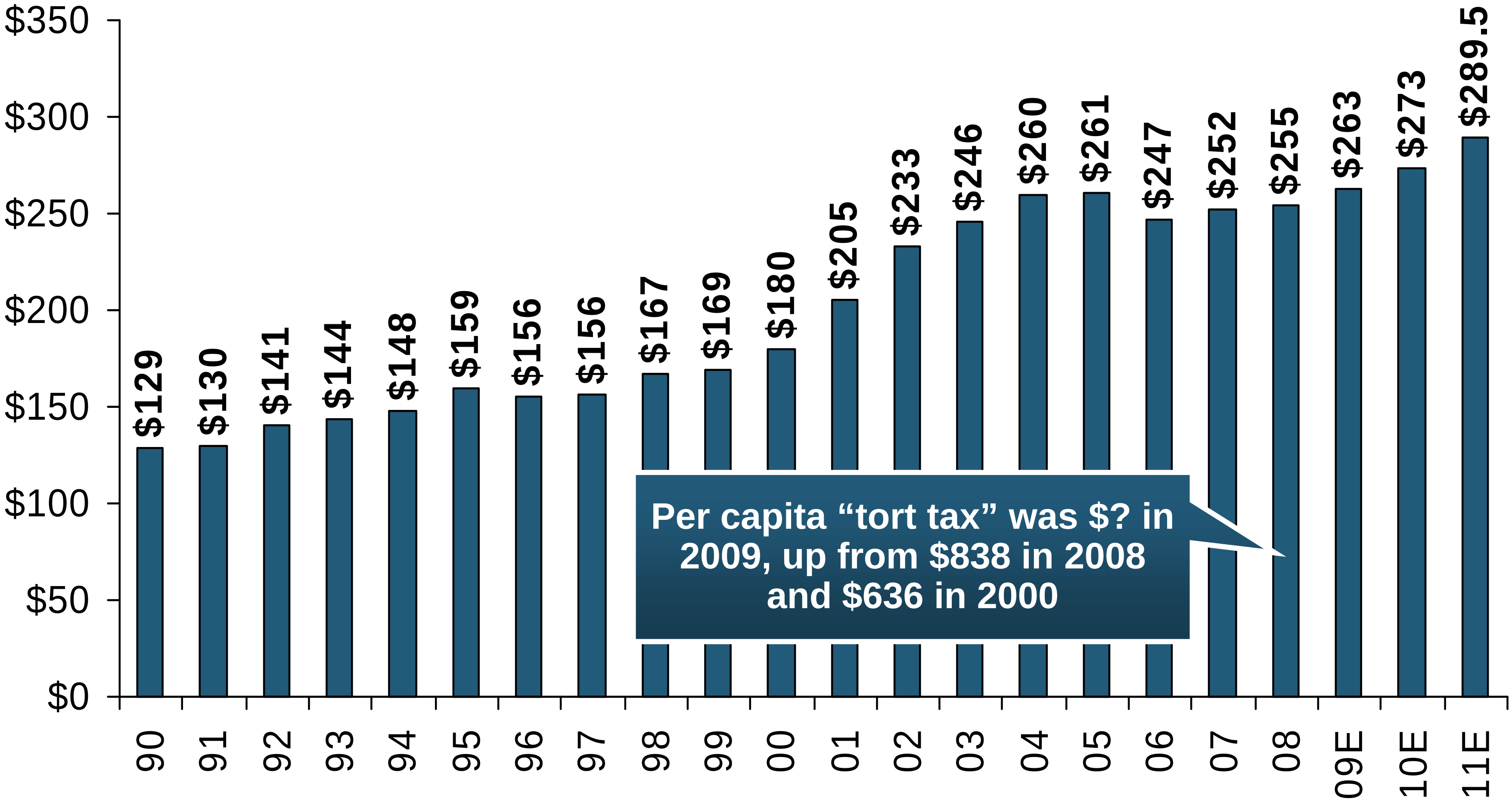
Top Categories	Percentage
Environmental	14%
Insurance coverage	13%
Mortgage fraud	12%
Nursing home/seniors issues	11%
Bad-faith against insurance companies	10%

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



Source: Tillinghast-Towers Perrin, *2009 Update on US Tort Cost Trends.*

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

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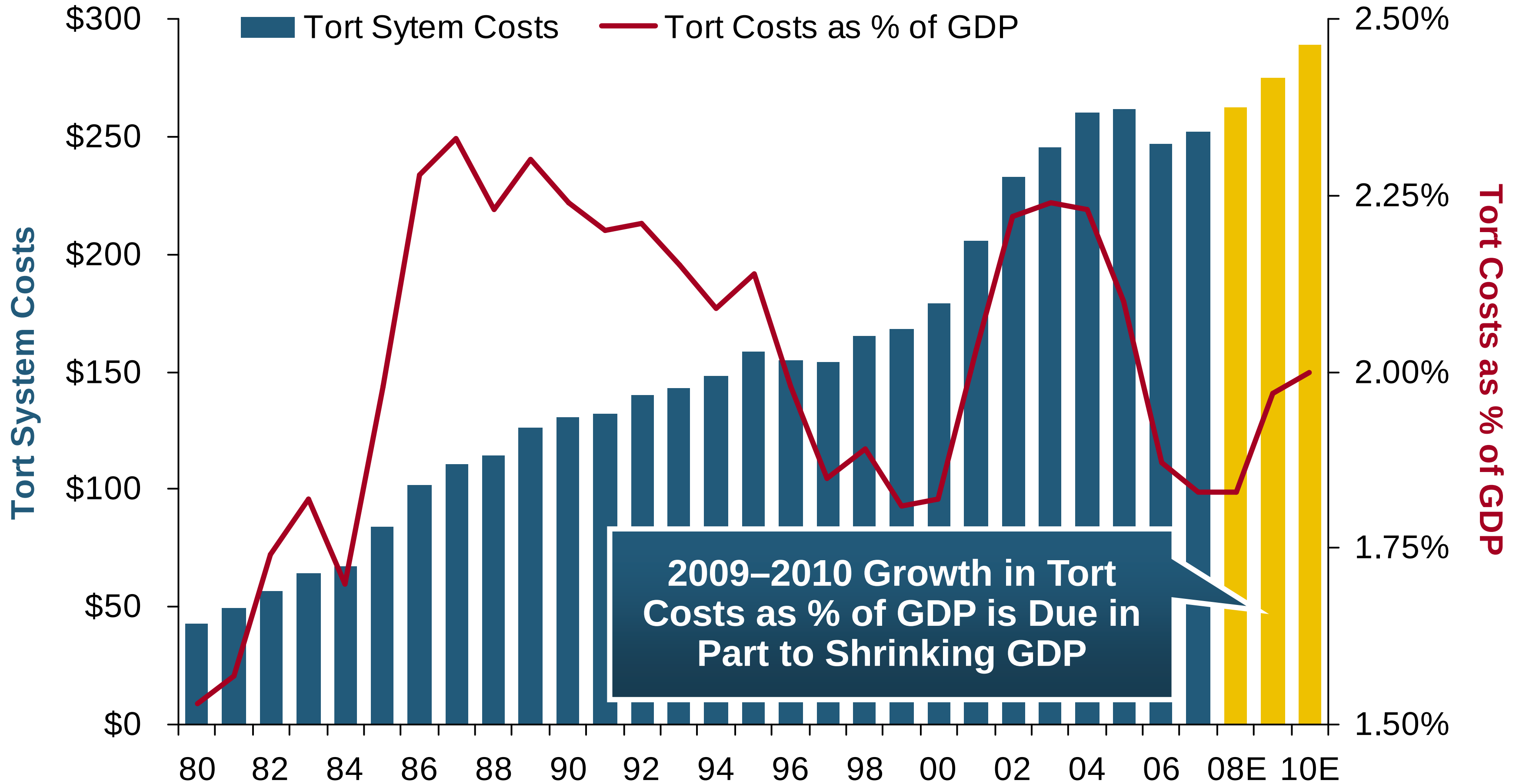
($ Billions)



* 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*

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Best States

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

New in 2009

- North Dakota
- Massachusetts
- South Dakota

Drop-offs

- Maine
- Vermont
- Kansas

Midwest/West has mix of good and bad states.

Worst States

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

Newly Notorious

- New Mexico
- Montana
- Arkansas

Rising Above

- Texas
- South Carolina
- Hawaii

Source: US Chamber of Commerce 2009 State Liability Systems Ranking Study; Insurance Info. Institute.

The Nation's Judicial Hellholes: 2010

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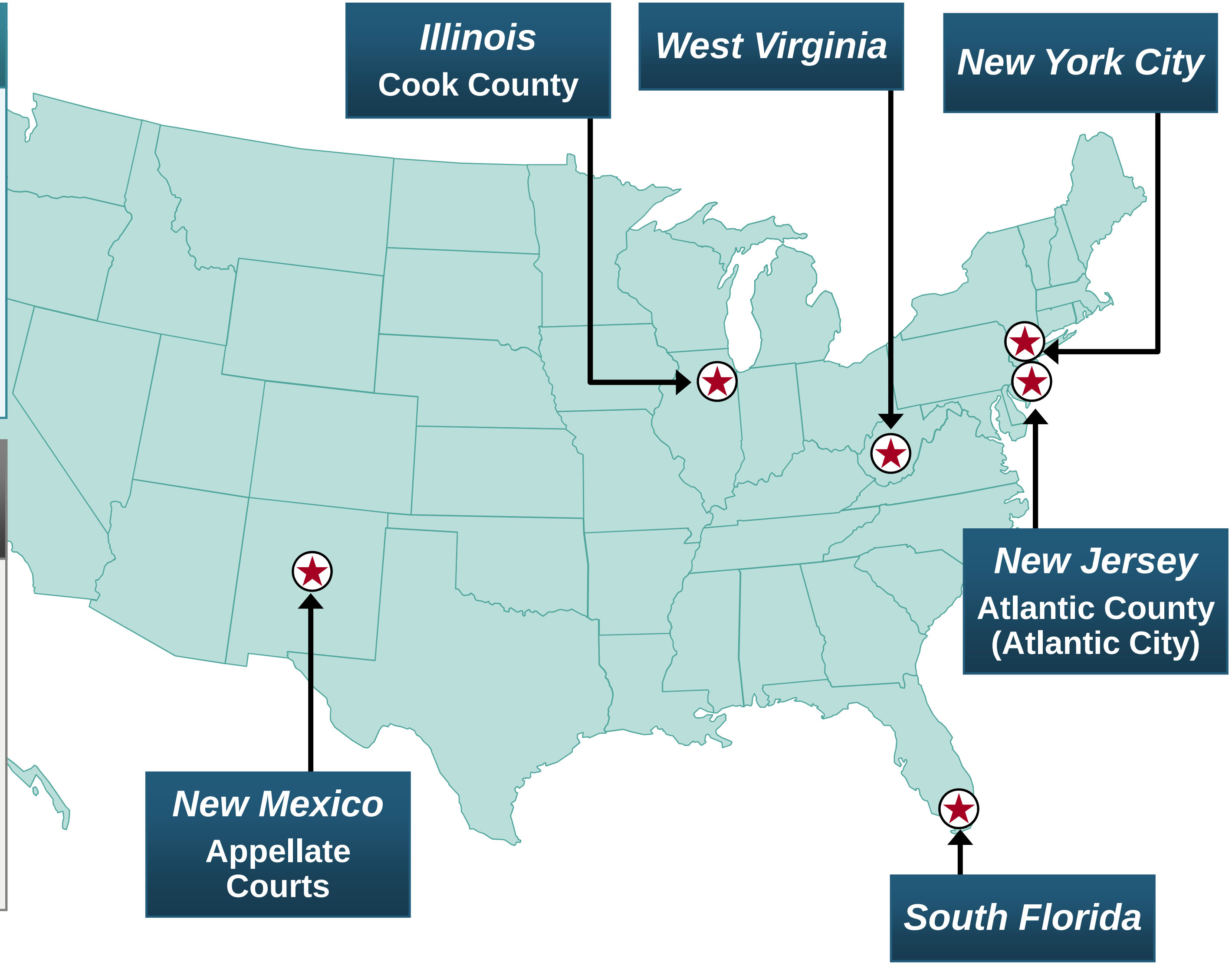
Watch List

- 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

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#6
Regulatory and Fiscal Threats

Bad Regulation is Still the Norm in Some States

New Taxes Can Help/Hurt P-C Insurers

Financial Services Reform: *What does it mean for insurers?*

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The Dodd Frank Wall Street Reform and Consumer Protection Act

- **Systemic Risk and Resolution Authority**
  - Creates the Financial Stability Oversight Council and the Office of Financial Research
  - Imposes heightened federal regulation on large bank holding companies and "systemically risky" nonbank financial companies, including insurers
- **Federal Insurance Office (FIO)**
  - Establishes the FIO (while maintaining state regulation of insurance) within the Department of Treasury, headed by a Director appointed by the Secretary of Treasury
  - FIO will have authority to monitor the insurance industry, identify regulatory gaps that could contribute to systemic crisis
  - ***CONCERN: FIO morphs into quasi/shadow or actual regulator***
- **Surplus Lines/Reinsurance**
  - Title V of the Dodd-Frank bill includes, as a separate subtitle, the Nonadmitted and Reinsurance Reform Act (NRRA), which eliminates regulatory inefficiencies associated with surplus lines insurance and reinsurance

Source: Insurance Information Institute (I.I.I.) updates and research; The Financial Services Roundtable; Adapted from summary by Dewey & LeBoeuf LLP

2010 Property and Casualty Insurance Report Card

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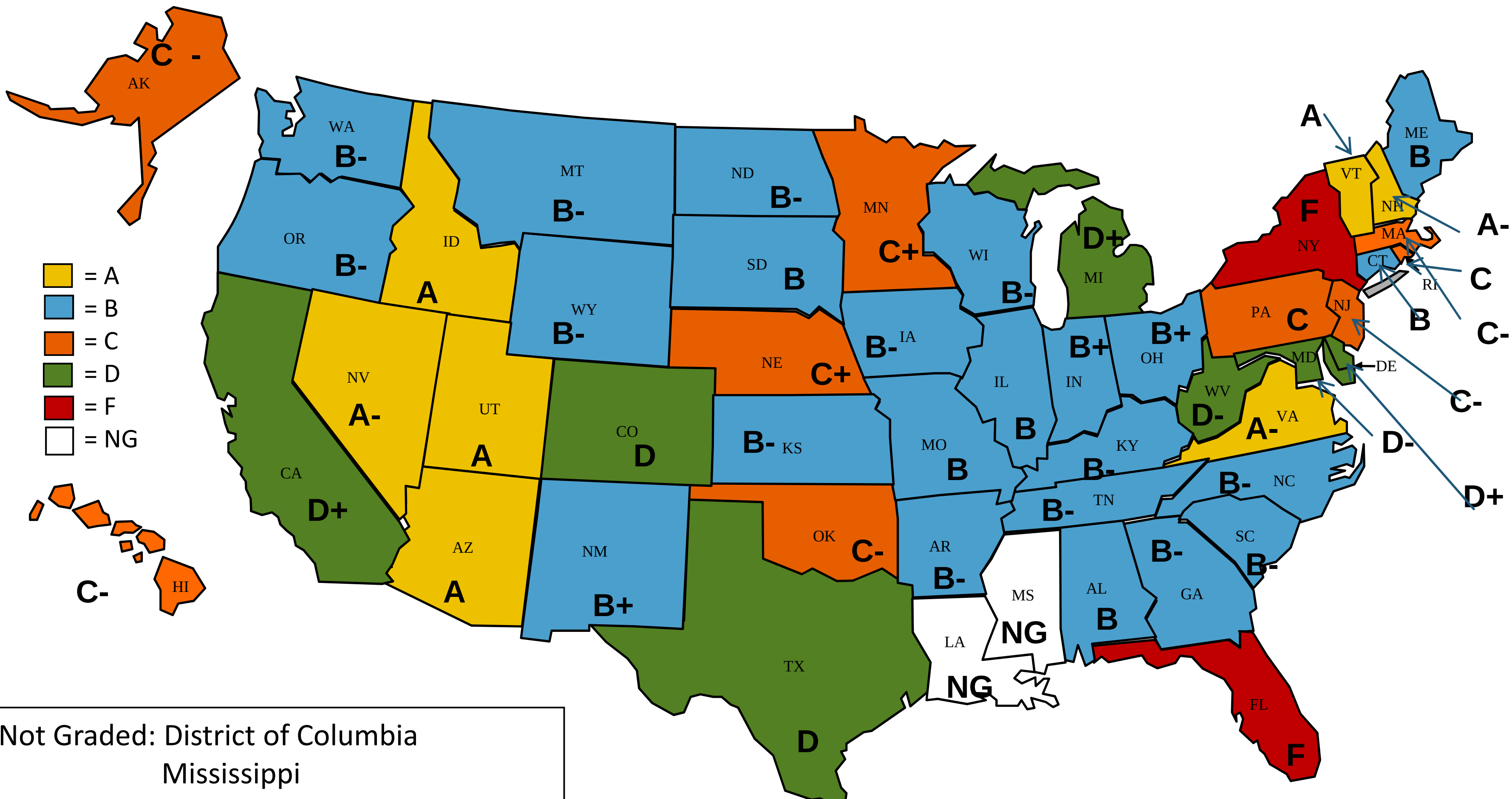

Not Graded: District of Columbia
Mississippi
Louisiana

Source: Heartland Institute, May 2010

Potential Impacts of Current Federal Tax Proposals on P/C Insurance Industry

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Proposal	Potential P/C Insurance Industry Impact	P/C Lines that Benefit
100% Expensing of New Investment in Plant & Equipment in 2011 and Continuation of Bonus Depreciation	Could produce a 5-10% surge in investment in physical plant and equipment in 2011 which will need to be insured immediately. Although the proposal only "steals" investment from the future, this provides a permanent benefit to commercial insurers since insurance coverage must be purchased sooner and be maintained. New construction activity boosts WC and surety.	•Commercial Property •Construction •Commercial Liability •Commercial Auto •Specialty Lines •Excess & Surplus •Workers Comp •Surety •Reinsurance
Reinstate 36% and 39.6% Rates for High Income Taxpayers >$250K	Potential damage to new/small business formation and growth. Weakness in these areas has hurt p/c insurance exposure and tax hikes could depress insurance exposure in this segment	•None
Continue 2001 and 2003 Tax Cuts for All Taxpayers	Should produce an environment that more beneficial to recovery in small business segment & associate insurance exposures	•Small Business Commercial Lines •Personal Lines

Sources: Proposals from Tax Policy Center; P/C discussion is Insurance Information Institute research.

Potential Impacts of Current Federal Tax Proposals on P/C Insurance Industry (cont'd)

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Proposal	Potential P/C Insurance Industry Impact	P/C Lines that Benefit
Impose 20% Tax Rate for Capital Gains and Dividends for High Income Taxpayers	The increase in dividends and capital gains taxes makes private investment less attractive. Under current law the rate is 15%. Additional taxes on investment would presumably result in a marginal but negative impact on p/c insurance exposure.	•None
Payroll Tax Holiday	Reducing the cost of hiring workers would theoretically reduce the cost of employment and should spark hiring, increasing overall employment and payrolls	•Workers comp
Limit Value of Itemized Deductions to 28% for High Income Taxpayers	Will have an unambiguously negative impact on charitable giving. Nonprofit sector will be negatively impacted.	•None (Commercial lines products Designed for NPOs would be negatively impacted; This is a large p/c market.)

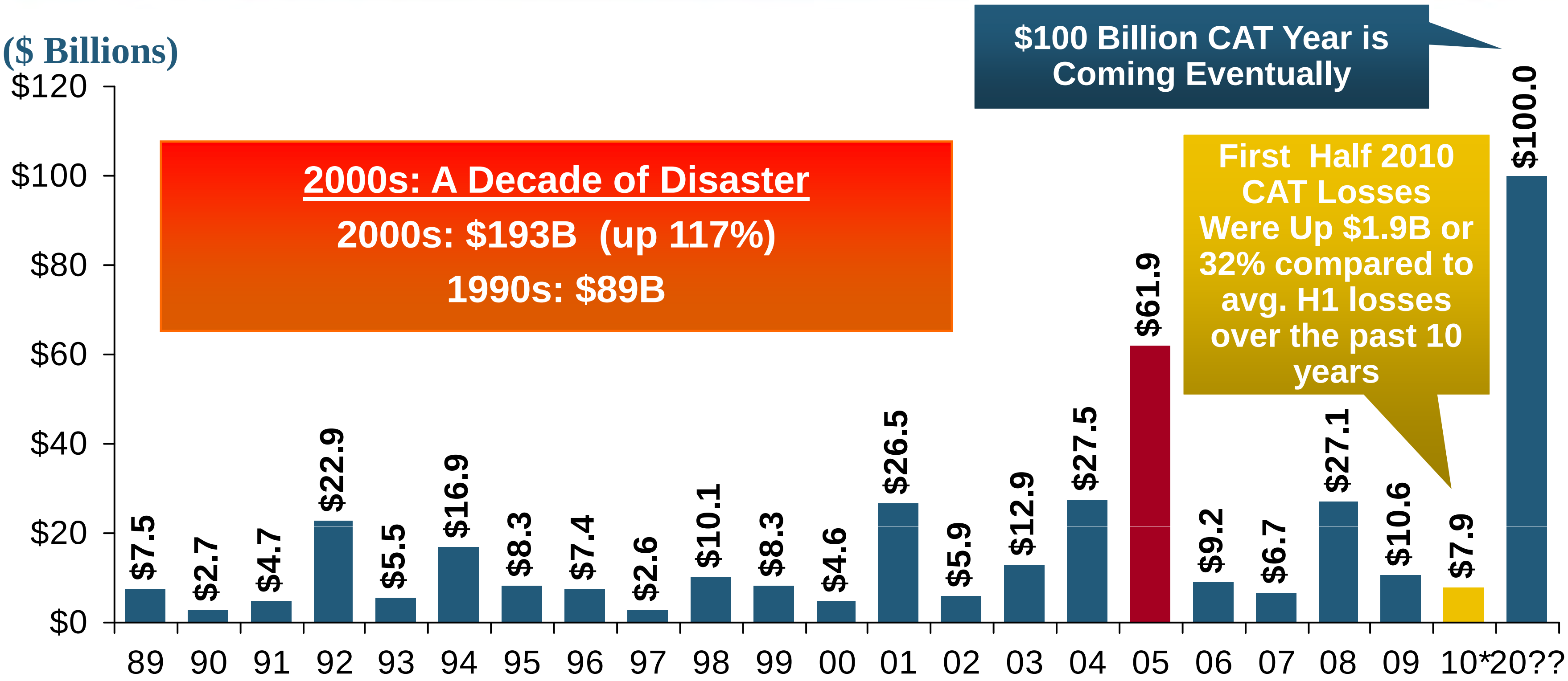
Sources: Proposals (except Payroll Tax Holiday) from Tax Policy Center; P/C discussion is Insurance Information Institute research.

#7

Catastrophic Loss – An Omnipresent Challenge

While Rare, Major CATs Can Kill Insurance Companies

US Insured Catastrophe Losses



2010 CAT Losses Are Running Below 2009, *So Far*
Figures Do Not Include an Estimate of Deepwater Horizon Loss

*Through June 30, 2010.

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 – 2009

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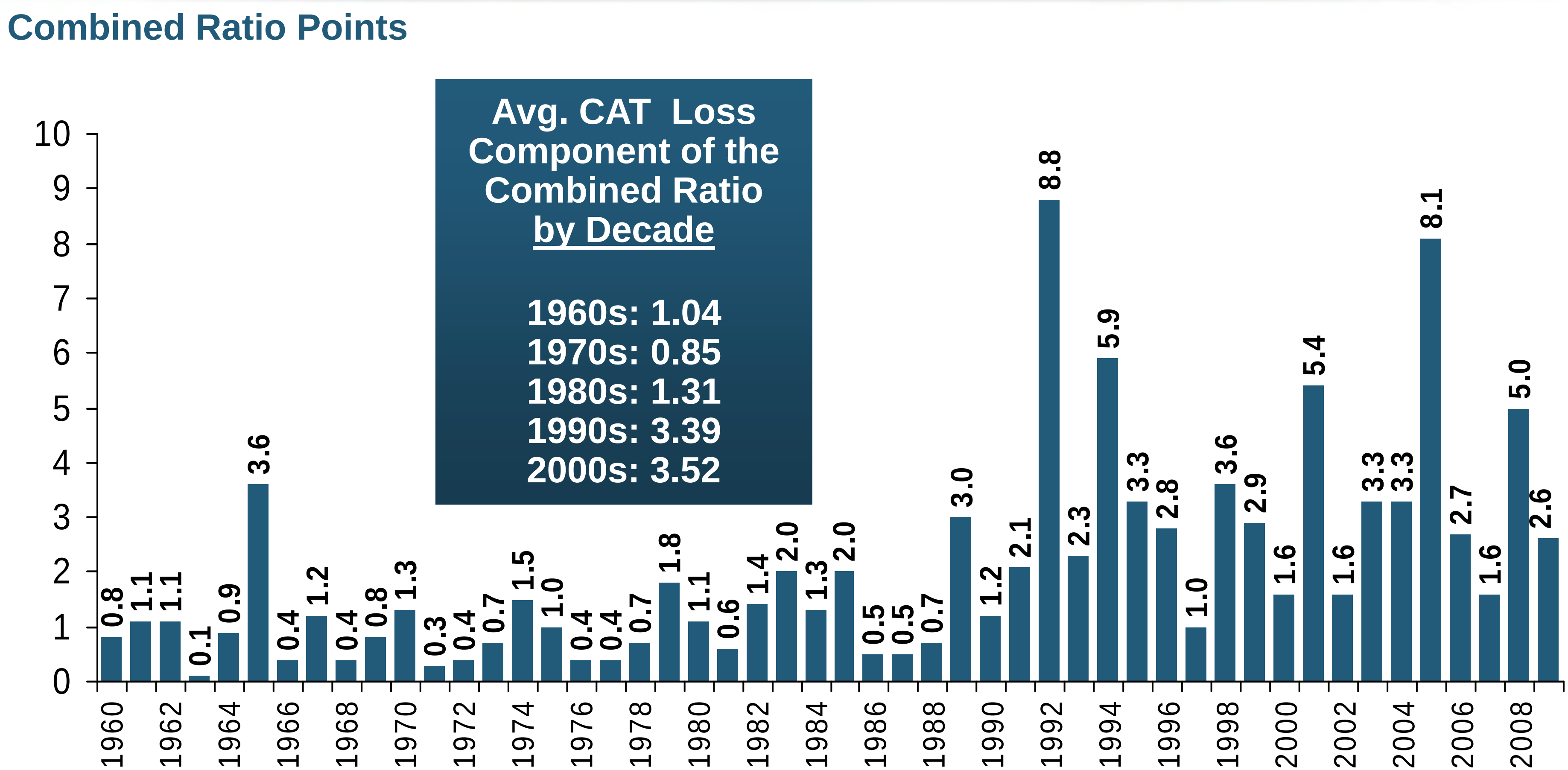

The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

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.

Source: ISO; Insurance Information Institute.

Global Natural Catastrophes: January – June 2010

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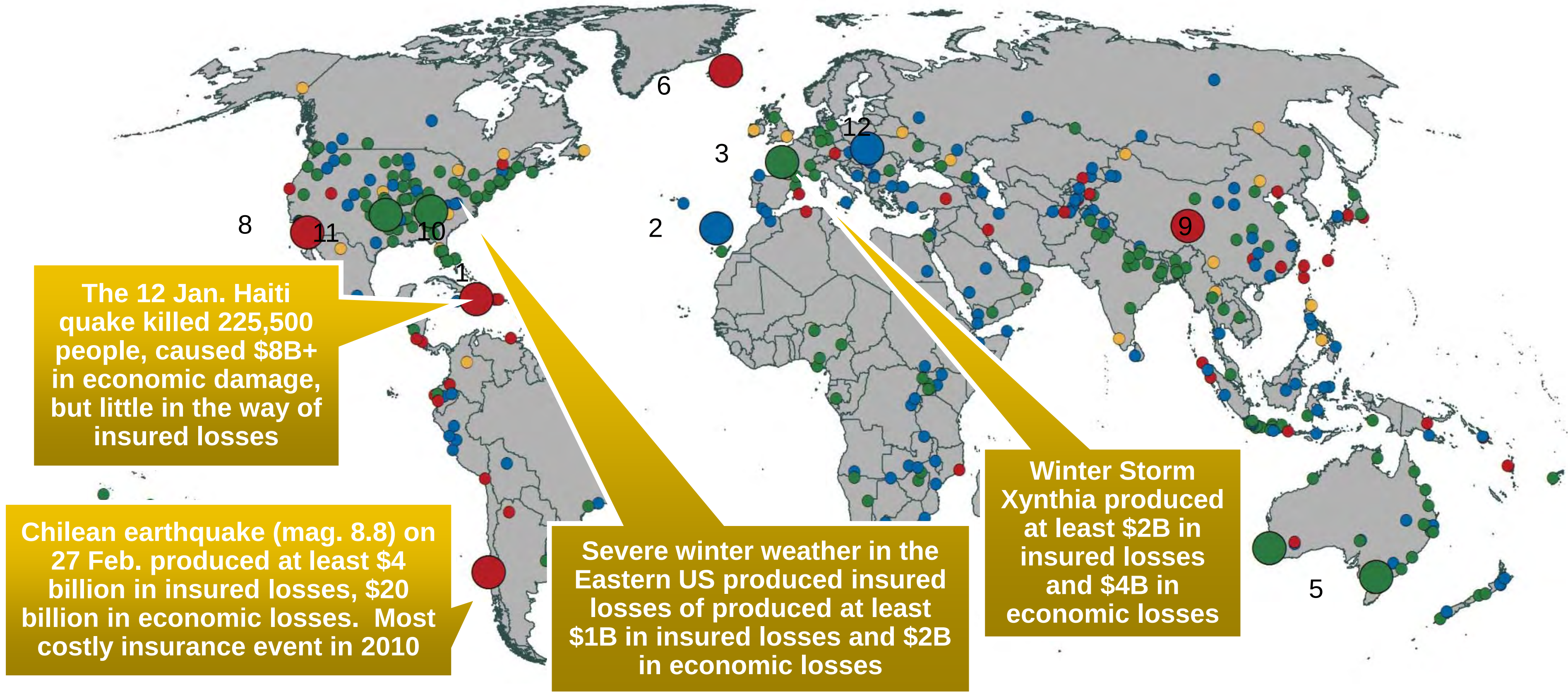

○ **Global natural catastrophes**

◯ **Selection of significant natural catastrophes (see table)**

● **Geophysical events** (earthquake, tsunami, volcanic activity)

● **Meteorological events** (storm)

● **Hydrological events** (flood, mass movement)

● **Climatological events** (extreme temperature, drought, wildfire)

Largest International Oil Well Blowouts by Volume, as of July 12, 2010*

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Date	Well	Location	Bbl Spilled
April 20 2010-July 12, 2010	**Deepwater Horizon**	**Gulf of Mexico, USA**	**est. 4,900,000**
June 1979-April 1980	Ixtoc I	Bahia del Campeche, Mexico	3,300,000
October 1986	Abkatun 91	Bahia del Campeche, Mexico	247,000
April 1977	Ekofisk Bravo	North Sea, Norway	202,381
January 1980	Funiwa 5	Forcados, Nigeria	200,000
October 1980	Hasbah 6	Gulf, Saudi Arabia	105,000
December 1971	Iran Marine International	Gulf, Iran	100,000
January 1969	Alpha Well 21 Platform A	Pacific, CA, USA	100,000
March 1970	Main Pass Block 41 Platform C	Gulf of Mexico	65,000
October 1987	Yum II/Zapoteca	Bahia del Campeche, Mexico	58,643
December 1970	South Timbalier B-26	Gulf of Mexico, USA	53,095

*Date well was capped. Federal government estimate as of August 2, 2010. Does not include offset for any amounts recovered.

Source: American Petroleum Institute (API), 09/18/2009; http://www.api.org/ehs/water/spills/upload/356-Final.pdf and updates from the Insurance Information Institute.

Natural Disasters in the United States, 1980 – 2010

Number of Events (Annual Totals 1980 – 2009 vs. First Half 2010)

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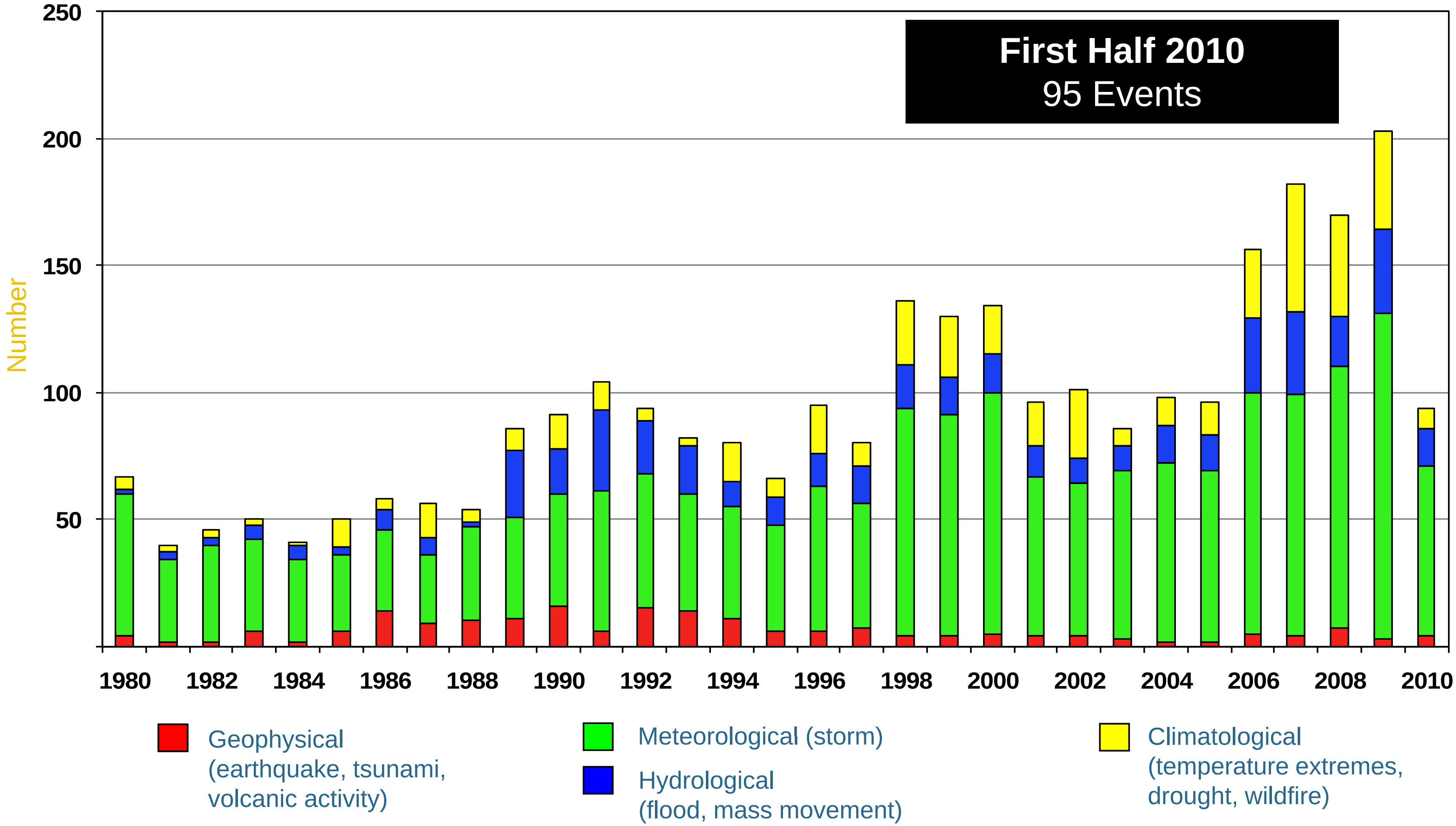
Number of events in first half of 2010 is close to the annual totals from five of past ten years.

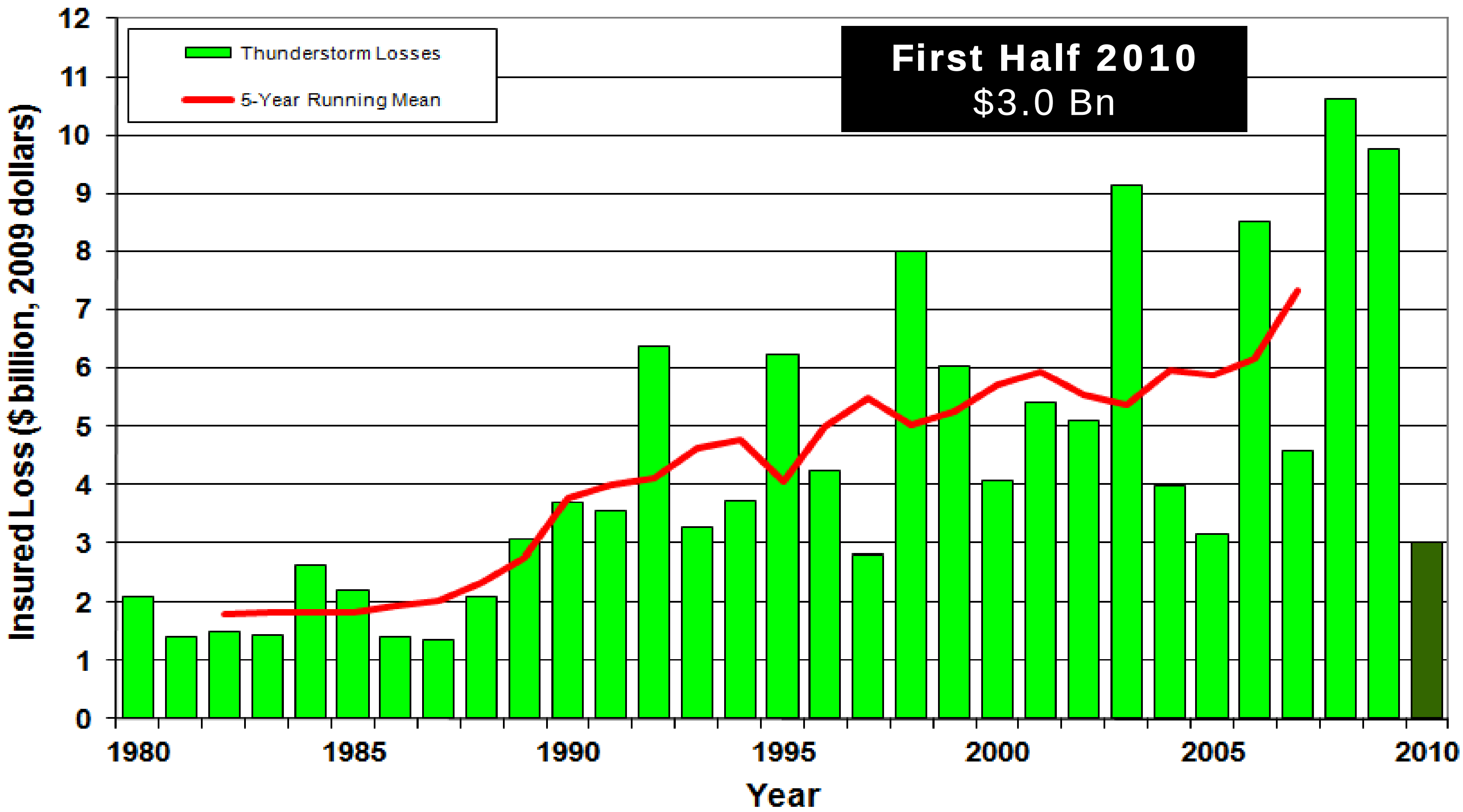


Source: MR NatCat*SERVICE*

U.S. Thunderstorm Loss Trends

Annual Totals 1980 – 2009 vs. First Half 2010

Thunderstorm losses have quadrupled since 1980.



U.S. Winter Storm Loss Trends

Annual totals 1980 – 2009 vs. First Half 2010

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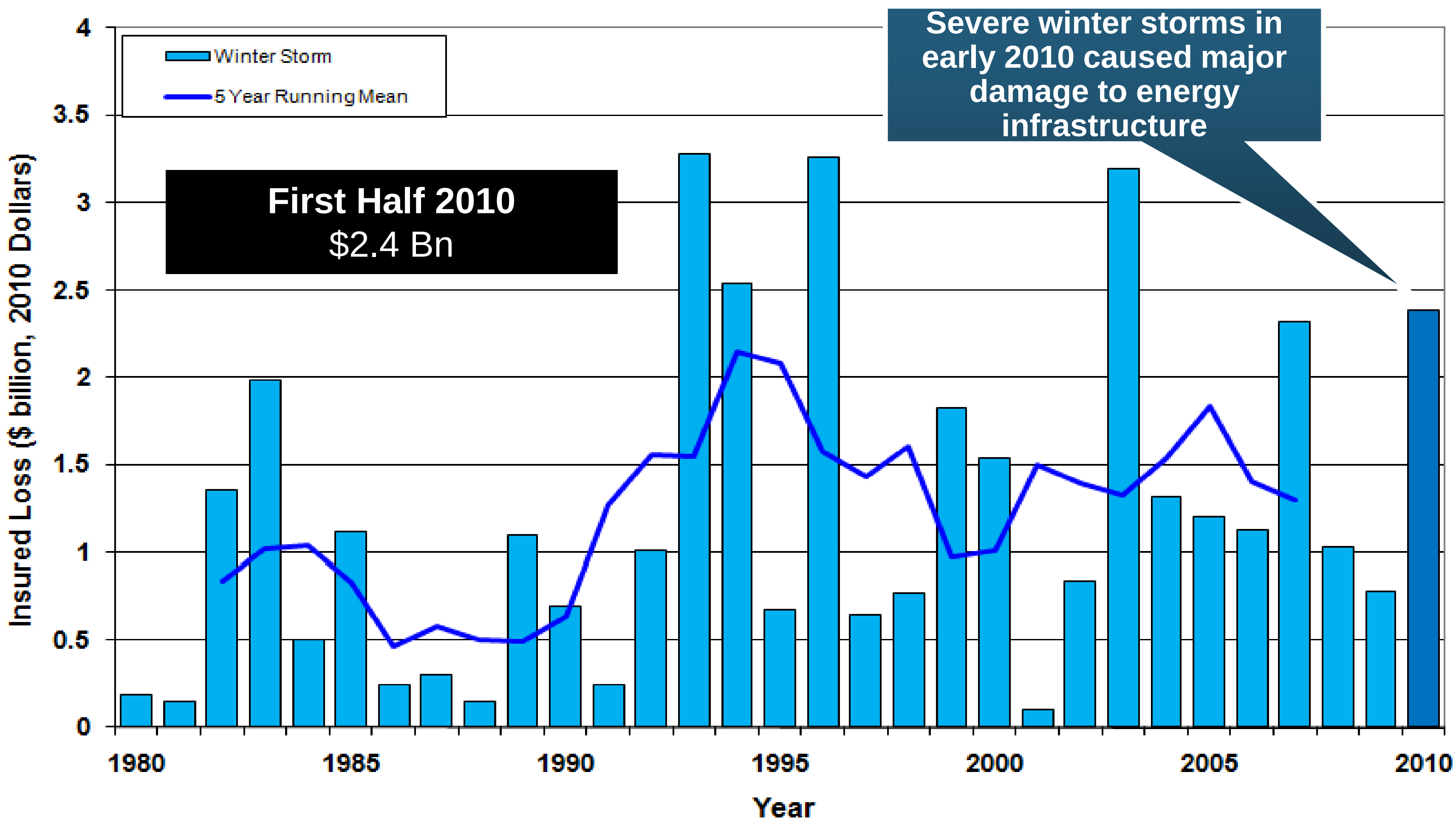
Average annual winter storm losses have increased over 50% since 1980.



Source: Property Claims Service, MR NatCat*SERVICE*

U.S. Significant Natural Catastrophes, 1950 – 2009

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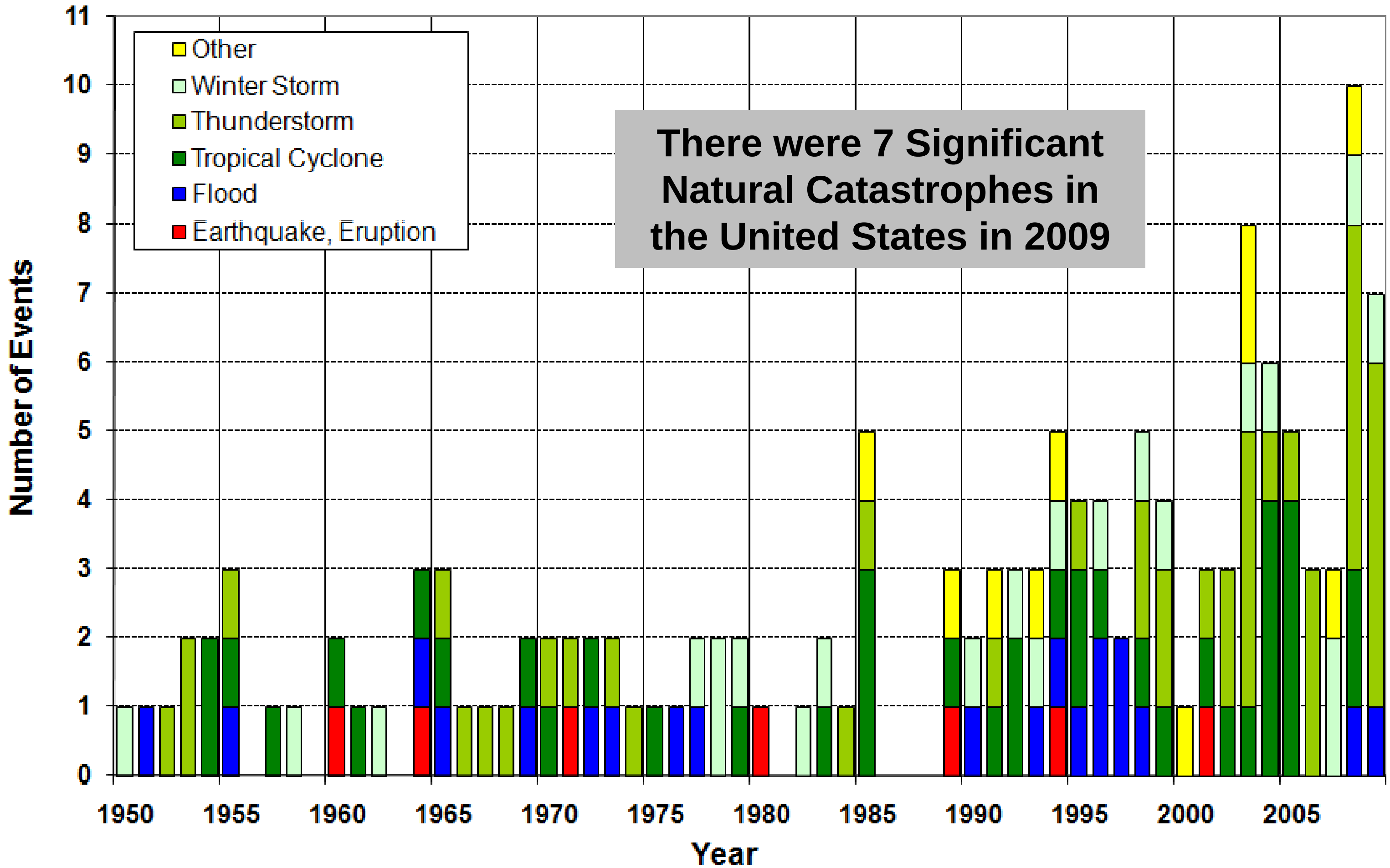
Number of Events ($1+ Bill economic loss and/or 50+ fatalities)



Sources: MR NatCat*SERVICE*

Distribution of US Insured CAT Losses: TX, FL, LA vs. US, 1980-2008*

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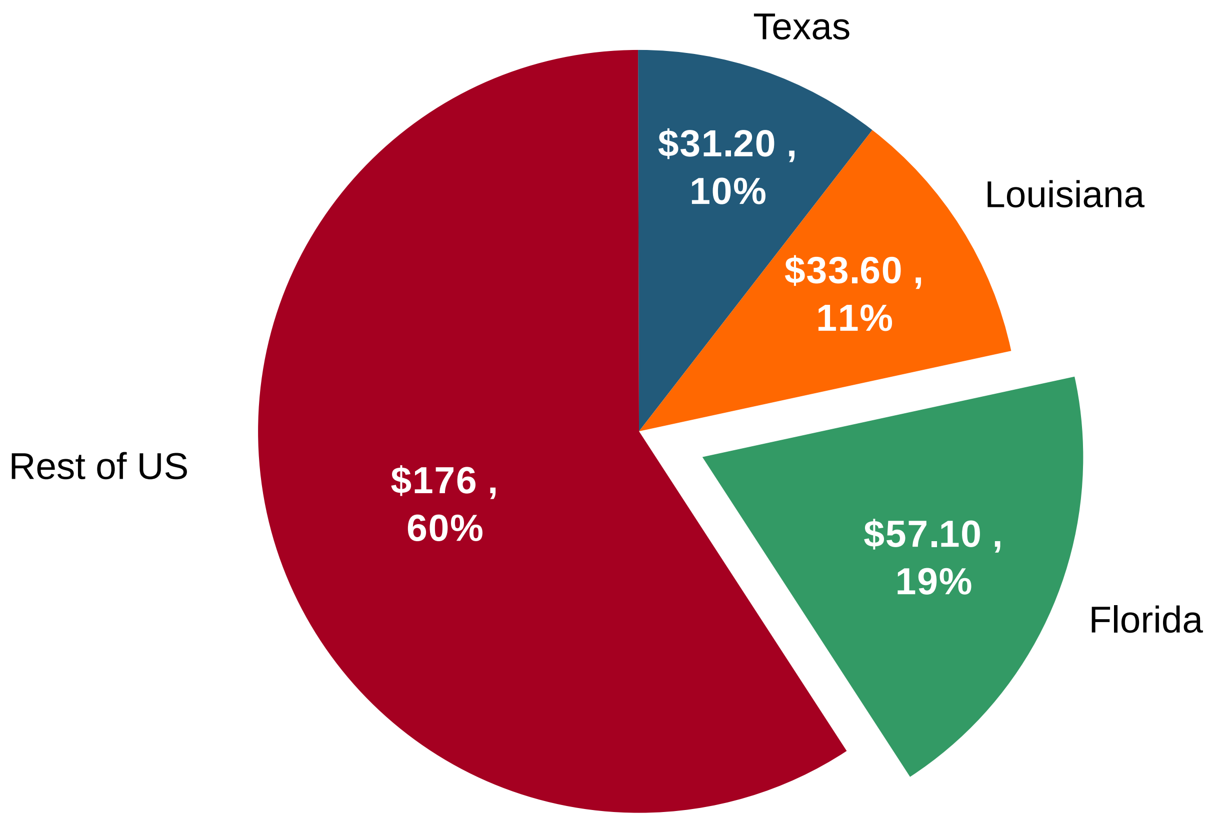
($ Billions)

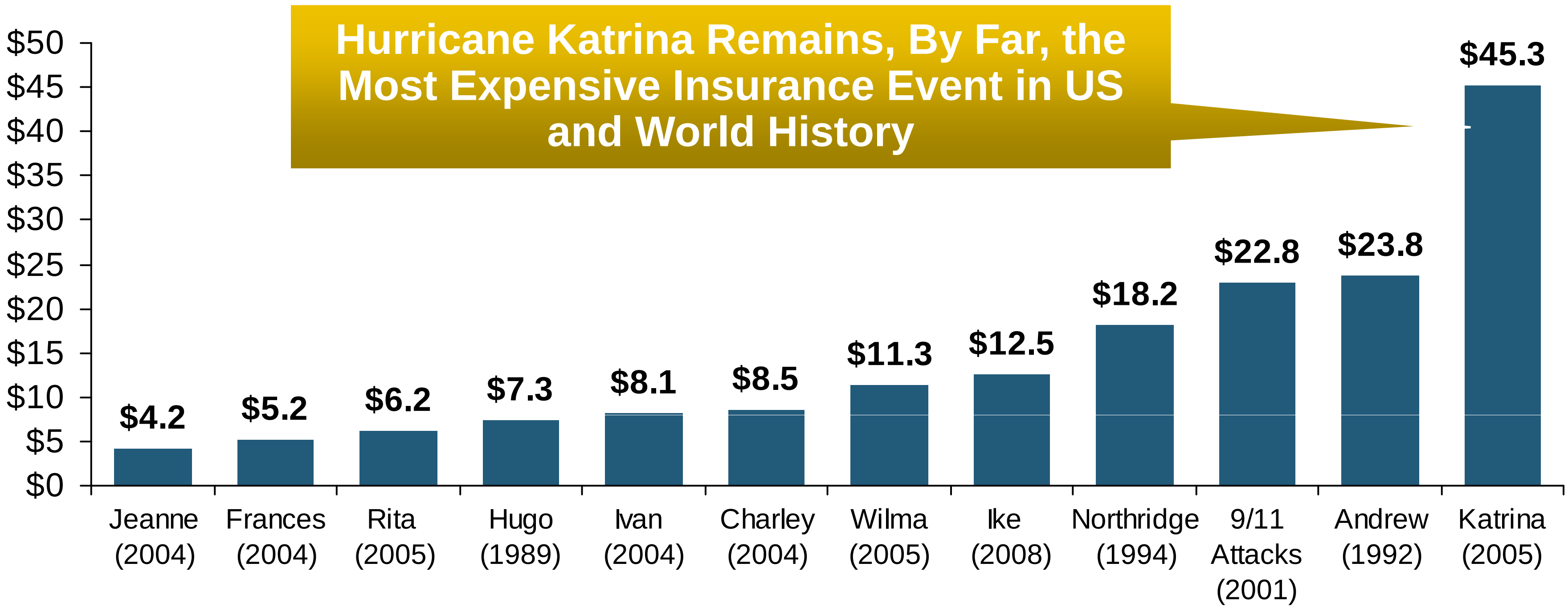


Florida Accounted for 19% of All US Insured CAT Losses from 1980-2008: $57.1B out of $297.9B

* 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)



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

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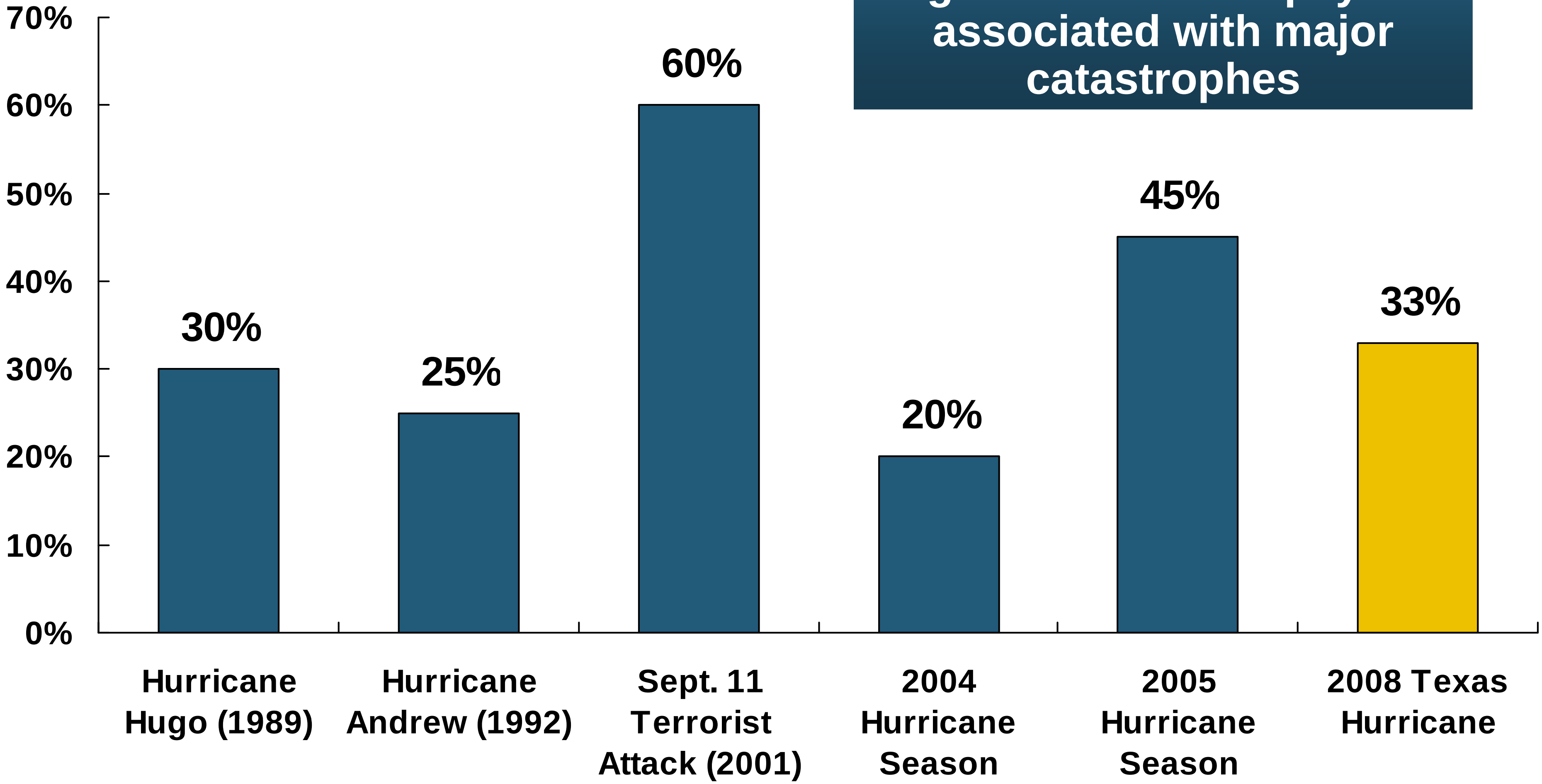
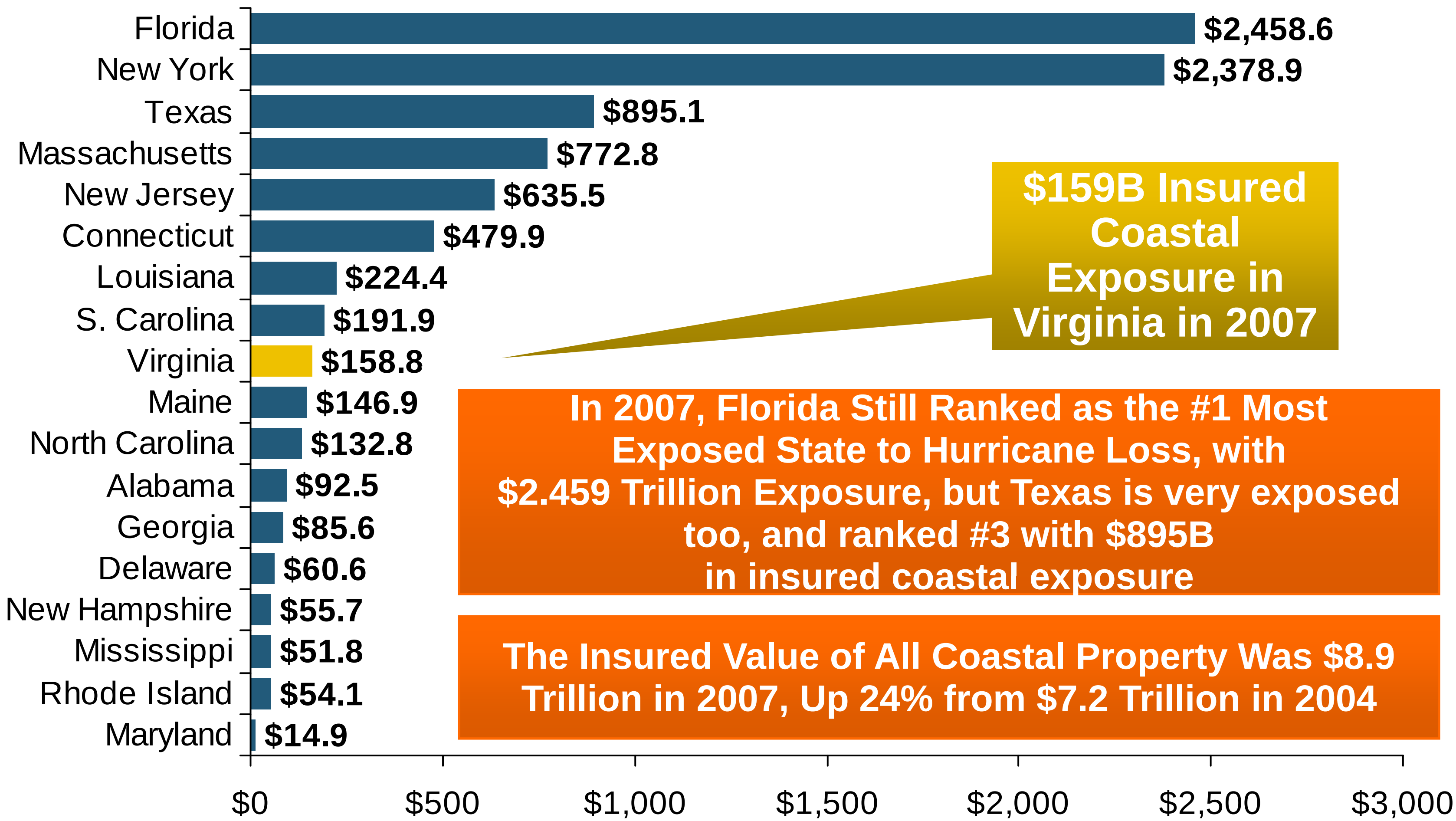
Reinsurance plays a very large role in claims payouts associated with major catastrophes



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

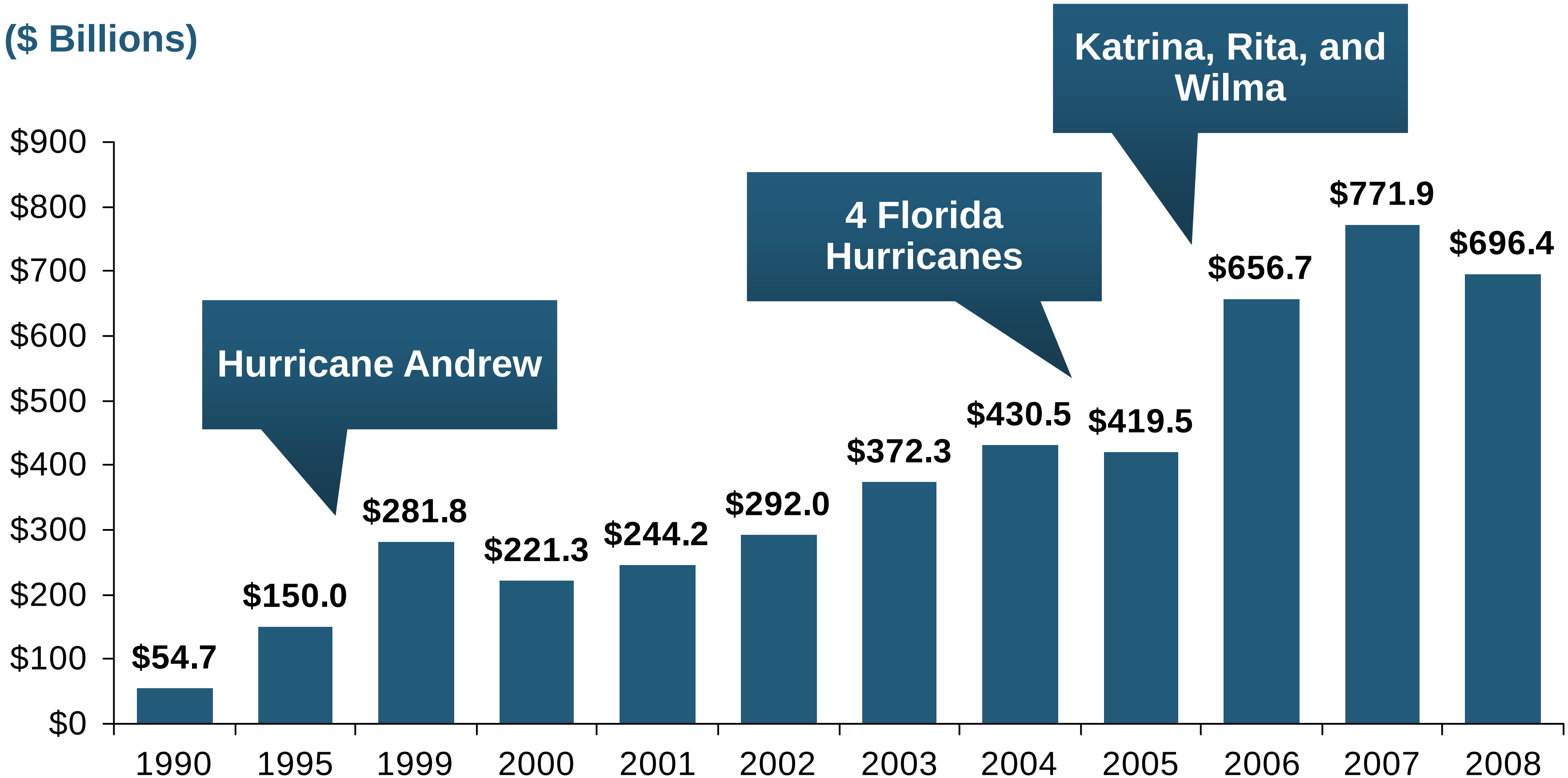
Total Value of Insured Coastal Exposure

(2007, $ Billions)



Source: AIR Worldwide

US Residual Market Exposure to Loss



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

Insurance Information Institute Online:

www.iii.org

Thank you for your time and your attention!

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