An Industry and Economy in Transition:
Overview and Outlook for P/C Insurance Markets

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Presentation Outline

- U.S. Economic Overview and Outlook
  - Economy as a Growth Engine for P/C Insurers
  - Labor Market Review
- Summary of P/C Financial Performance
- Catastrophe Loss Developments & Trends
  - Global, US
- Will the Market Turn? Four Necessary Criteria:
  - Underwriting Loss Trends
  - Capital/Capacity
  - Reinsurance Markets
  - Pricing Discipline
- Analysis by Key Line
- Other Contributing Factors to the Underwriting Cycle
  - Investment Environment
  - Tort/Casualty Environment
  - Inflation
- Q&A
Economics 2012:
The World Is Changing

2012 Is the First Year Since 2005 Where Economic Perceptions and Reality in the US Will Be Positive

Potentially Enormous Benefits for P/C Insurers
Economic Outlook for 2012

- Economic Growth Will Continue 2012/13, Albeit Modestly and Unevenly
  - No Double Dip Recession
  - Economy remains more resilient than most pundits presume
- Consumer Confidence Could Ebb, But Won’t Collapse
- Consumer Spending/Investment Will Continue to Expand Modestly
- Consumer and Business Lending Continue to Expand Modestly
- Business Bankruptcies Fall, New Business Formations Grow
- Housing Market Remains Weak, but Some Improvement Expected by 2013
- Inflation Remains Tame
  - Runaway inflation highly unlikely but energy spike possible; Fed has things under control
- Private Sector Hiring Remains Consistently Positive But Anemic
  - Unemployment is about 8% by year’s end
- Sovereign Debt, Euro Currency/Economy, Muni Bond “Crises” Overblown
- European Recession in Milder than Commonly Presumed
- Soft Landing in China
- Threat from Oil Price Shock, Middle East Turmoil Has Subsided
- Interest Rates Remain Low by Historical Standards; Fear & Fed Factors
- Stock and Bond Market Stability Has Given Way to Fear Trading
- Congress & President Agree on Tax Cut Extensions Before Year-End
Insurance Industry Predictions for 2012

- P/C Insurance Exposures Grow Robustly
  - Personal and commercial exposure growth is certain in 2012; Strongest since 2004
  - But restoration of destroyed exposure will take until mid-decade

- P/C Industry Growth in 2012 Will Be Strongest Since 2004
  - Growth likely to exceed A.M. Best projection of +3.8% for 2012
  - No traditional “hard market” emerges in 2012

- Underwriting Fundamentals Deteriorate Modestly
  - Some pressure from claim frequency, in some severity in key lines

- Increasing Private Sector Hiring Will Drive Payrolls/WC Exposures
  - Wage growth is also positive and could modestly accelerate
  - WC will prove to be tough to fix from an underwriting perspective

- Increase in Demand for Commercial Insurance Will Accelerate in 2012
  - Includes workers comp, property, marine, many liability coverages
  - Laggards: inland marine, aviation, commercial auto, surety
  - Personal Lines: Auto leads, homeowners lags *(though HO leads in NPW growth due to rates)*

- Investment Environment Is/Remains More Favorable
  - Return of realized capital gains as a profit driver
  - Interest rates remain low; Some upward pressure if economic strength surprises

- Industry Capacity Hits a New Record by Year-End 2012 (Barring Mega-CAT)
The Strength of the Economy Will Influence P/C Insurer Growth Opportunities

Growth Will Expand Workers Comp Payroll Exposure Base

America’s Manufacturing Renaissance? Construction Activity Still Depressed?
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

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 5/12; Insurance Information Institute.
Growth varied considerably across states but in total was weak in 2011 with US overall growth at just 1.7%.
Consumer confidence has been low for years amid high unemployment, falling home prices and other factors adversely impact consumers, but improved substantially in late 2011 and early 2012.

Optimism among consumers is recovering, in part due to an improving jobs outlook, after plunging amid the debt debate debacle and S&P downgrade.
Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, Bolstering the Auto Insurer Growth and the Manufacturing Sector.

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (10/11 and 5/12); Insurance Information Institute.
Monthly Change* in Auto Insurance Prices, 1991–2012*

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

“Hard” markets tend to occur during recessionary periods

Pricing peak occurred in 2010 at 5.1%, falling to 2.8% by Mar. 2012

The Apr. 2012 reading of 2.9% was the 3rd lowest since July 2008

*Percentage change from same month in prior year; through April 2012; 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.
New Private Housing Starts, 1990-2022F

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

The plunge and lack of recovery in homebuilding and in construction in general is holding back payroll exposure growth.

Job growth, improved credit market conditions and demographics will eventually boost home construction.

Little Exposure Growth Likely for Homeowners Insurers Until at least 2014. Also Affects Commercial Insurers with Construction Risk Exposure, Surety

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (10/11 and 5/12); Insurance Information Institute.
Construction Employment, Jan. 2010—May 2012*

Construction employment is still below where it was in Jan. 2010. In a normal recovery, construction employment would be growing robustly.

*Seasonally adjusted
Value of Construction Put in Place, Mar. 2012 vs. Mar. 2011*

Overall Construction Activity is Up, But Growth Is Entirely in the Private Sector as State/Local Government Budget Woes Continue

*seasonally adjusted
Source: U.S. Census Bureau, [http://www.census.gov/construction/c30/c30index.html](http://www.census.gov/construction/c30/c30index.html); Insurance Information Institute.
Value of Private Construction Put in Place, by Segment, Mar. 2012 vs. Mar. 2011*

Private sector construction activity is up by double digits in many segments after plunging during the “Great Recession”

Private Construction Activity is Up in Most Segments, Including Residential Construction

*seasonally adjusted
Source: U.S. Census Bureau, [http://www.census.gov/construction/c30/c30index.html](http://www.census.gov/construction/c30/c30index.html) ; Insurance Information Institute.

Public sector construction activity is down by substantially in many segments.

Growth (%)

-3.2%  -17.0%  -8.9%  -11.1%  8.4%  0.0%  1.3%  -0.5%  -9.6%  -16.2%


Public Construction Activity is Up Down in Many Segments as State, City and County Budgets Remain Under Stress

*seasonally adjusted
The manufacturing sector has been expanding for 34 consecutive months and adding jobs. The question is whether this will continue.

Monthly shipments are nearly back to peak (in July 2008, 8 months into the recession). Trough in May 2009. Growth from trough to March 2012 was 31%. This growth leads to gains in many commercial exposures: WC, Commercial Auto, Marine, Property and Various Liability Coverages.

*seasonally adjusted

Manufacturing Growth for Selected Sectors, 2012 vs. 2011*

Manufacturing of durable goods has been especially strong.

Durables: +11.4%

Non-Durables: +8.5%

Manufacturing Is Expanding Across a Wide Range of Sectors that Will Contribute to Growth in Insurable Exposures Including: WC, Commercial Property, Commercial Auto and Many Liability Coverages

*Seasonally adjusted; Date are YTD comparing data through March 2012 to the same period in 2011.
Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

March 2001 through April 2012

Percent of Industrial Capacity

82%
80%
78%
76%
74%
72%
70%
68%
66%

The US operated at 79.2% of industrial capacity in Apr. 2012, above the June 2009 low of 68.3% and the highest level since April 2008.

Recession in Capacity Utilization is a Positive Sign for Commercial Exposures

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

Source: Federal Reserve Board statistical releases at [http://www.federalreserve.gov/releases/g17/Current/default.htm](http://www.federalreserve.gov/releases/g17/Current/default.htm).
Manufacturing Employment, Jan. 2010—Apr. 2012*

Manufacturing employment is up by nearly 500,000 or 4.3% since Jan. 2010—a surprising source of strength in the economy

*Seasonally adjusted

Non-manufacturing industries have been expanding and adding jobs. The question is whether this will continue.

Optimism among non-manufacturers was stable in late 2011 and increased in early 2012.

Business Bankruptcy Filings, 1980-2012: Q1

% Change Surrounding Recessions

<table>
<thead>
<tr>
<th>Recessions</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980-82</td>
<td>58.6%</td>
</tr>
<tr>
<td>1980-87</td>
<td>88.7%</td>
</tr>
<tr>
<td>1990-91</td>
<td>10.3%</td>
</tr>
<tr>
<td>2000-01</td>
<td>13.0%</td>
</tr>
<tr>
<td><strong>2006-09</strong></td>
<td><strong>208.9%</strong></td>
</tr>
</tbody>
</table>

2011 bankruptcies totaled 47,806, down 15.1% from 56,282 in 2010—the second consecutive year of decline. Business bankruptcies more than tripled during the financial crisis. Through Q1:2012, filings are down 11.1% vs. Q1:2011

Significant Exposure Implications for All Commercial Lines as Business Bankruptcies Begin to Decline

Sources: American Bankruptcy Institute at http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=61633; Insurance Information Institute
Business starts were up 3.5% to 561,000 in the first 9 months of 2011 vs. first 9 months of 2011. 722,000 new business starts were recorded in 2010, up 3.6% from 697,000 in 2009, which was the slowest year for new business starts since 1993.

Small business optimism has increased but is still only at the level it was when the Financial Crisis began.
12 Industries for the Next 10 Years: Insurance Solutions Needed

<table>
<thead>
<tr>
<th>Industry</th>
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<tbody>
<tr>
<td>Health Care</td>
</tr>
<tr>
<td>Health Sciences</td>
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<tr>
<td>Energy (Traditional)</td>
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<tr>
<td>Alternative Energy</td>
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<tr>
<td>Petrochemical</td>
</tr>
<tr>
<td>Agriculture</td>
</tr>
<tr>
<td>Natural Resources</td>
</tr>
<tr>
<td>Technology (incl. Biotechnology)</td>
</tr>
<tr>
<td>Light Manufacturing</td>
</tr>
<tr>
<td>Insourced Manufacturing</td>
</tr>
<tr>
<td>Export-Oriented Industries</td>
</tr>
<tr>
<td>Shipping (Rail, Marine, Trucking)</td>
</tr>
</tbody>
</table>

Many industries are poised for growth, though insurers’ ability to capitalize on these industries varies widely.
Presidential Politics & the P/C Insurance Industry

How Is Profitability Affected by the President’s Political Party?
P/C Insurance Industry ROE by Presidential Administration, 1950-2012*

OVERALL RECORD: 1950-2012*
Democrats 7.67%
Republicans 7.97%

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

*Truman administration ROE of 6.97% based on 3 years only, 1950-52; ROEs for the years 2008 forward exclude mortgage and financial guaranty segments. Estimated ROE for 2012 = 7.0%.
Source: Insurance Information Institute
P/C insurance Industry ROE by Presidential Party Affiliation, 1950-2012*

*ROEs for the years 2008 forward exclude mortgage and financial guaranty segments; Estimated 2012 ROE = 7.0%
Source: Insurance Information Institute
Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend is Improving
Unemployment and Underemployment Rates: Stubbornly High in 2012, But Falling

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

Unemployment stood at 8.2% in May 2012
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 constrain overall economic growth, but the job market is now clearly improving

Monthly Change in Private Employment

January 2008 through May 2012 (Thousands)


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

82,000 private sector jobs were created in May


December 2007 through May 2012 (Millions)

Cumulative job losses peaked at 8.444 million in December 2009

Cumulative job losses as of May 2012 totaled 4.069 million

All of the jobs “lost” since President Obama took office in Jan. 2009 have been recouped


Cumulative Change in Private Sector Employment: Jan. 2010—May 2012

January 2010 through May 2012* (Millions)

Job gains and pay increases have added more than $600 billion to payrolls since Jan. 2010

Cumulative job gains through May 2012 totaled 4.355 million


January 2010 through May 2012* (Millions)

Government at all levels has shed more than a half million jobs since Jan. 2010 even as private employers created 4.38 million jobs.

Cumulative job losses through May 2012 totaled 510,000

Governments at All Levels are Under Severe Fiscal Strain As Tax Receipts Plunged and Pension Obligations Soared During the Financial Crisis, Causing Them to Reduce Staff

State government employment fell by 15% since the end of 2009 while Federal employment is down just 2%.

Local government employment shrank by 424,000 from Jan. 2010 through May 2012, accounting for 83% of all government job losses, negatively impacting WC exposures for those cities and counties that insure privately.

*Cumulative change from prior month; Base employment date is Dec. 2009.
In April, 37 states and the District of Columbia reported over-the-month unemployment rate decreases, 5 had increases, and 8 had no change.

*Provisional figures for April 2012, seasonally adjusted.

In April, 37 states and the District of Columbia reported over-the-month unemployment rate decreases, 5 had increases, and 8 had no change.

*Provisional figures for April 2012, seasonally adjusted.
US Unemployment Rate Forecast

2007:Q1 to 2013:Q4F*

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

Jobless figures have been revised downwards for 2012

Unemployment forecasts have been revised downwards for 2012 and 2013. Optimistic scenarios put the unemployment as low as 7.8% by Q4 of this year.

* = actual; ** = forecasts
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (5/12 edition); Insurance Information Institute.
Unemployment will remain high even under the most optimistic of scenarios, but forecasts are being revised downwards.

Steadily Decreasing Unemployment Should Benefit the Workers Comp Exposure Base at Least Through 2013

Sources: Blue Chip Economic Indicators (5/12); Insurance Information Institute
Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2012:Q1

Peak was 2008:Q1 at $6.60 trillion

Recent trough (2009:Q3) was $6.25 trillion, down 5.3% from prior peak

Latest (2011:Q4) was $6.88 trillion, a new peak

Growth rates in 2011/12
- Q2 over Q1: 0.6%
- Q3 over Q2: 0.4%
- Q4 over Q3: 1.3%
- Q1 over Q4: 1.0%

Pace of payroll growth is accelerating

Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.
Sources: [http://research.stlouisfed.org/fred2/series/WASCUR](http://research.stlouisfed.org/fred2/series/WASCUR); National Bureau of Economic Research (recession dates); Insurance Information Institute.
Payroll vs. Workers Comp Net Written Premiums, 1990-2011

Payroll Base* $Billions

$2,000
$3,000
$4,000
$5,000
$6,000
$7,000

WC NWP $Billions

$25
$30
$35
$40
$45
$50

Wage & Salary Disbursements
WC NPW

WC premium volume dropped two years before the recession began

WC net premiums written were down $14B or 29.3% to $33.8B in 2010 after peaking at $47.8B in 2005

+7.9% in 2011

7/90-3/91
3/01-11/01
12/07-6/09

90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11*

Continued Payroll Growth and Rate Increases Suggest WC NWP Will Grow Again in 2012; +7.9% Growth in 2011 Was the First Gain Since 2005

*Private employment; Shaded areas indicate recessions. Payroll and WC premiums for 2011 is I.I.I. estimate
Sources: NBER (recessions); Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR ; NCCI; I.I.I.
POSITIVE LABOR MARKET DEVELOPMENTS

Key Factors Driving Workers Compensation Exposure
Mass Layoff Announcements, Jan. 2002—Apr. 2012*

*Percentage change from same month in prior year; seasonally adjusted

Note: Recessions indicated by gray shaded columns.

Average Weekly Hours of All Private Workers, Mar. 2006—May 2012

(Hours Worked)

Hours worked plummeted during the recession, impacting payroll exposures.

Hours worked totaled 34.4 per week in May, still shy of the 34.6 hours typically worked before the “Great Recession.”

*Seasonally adjusted
Note: Recessions indicated by gray shaded columns.
The average hourly wage was $23.41, up 10.2% from $21.25 when the recession began in Dec. 2007

Wage gains continued during the recession, despite massive job losses

*Seasonally adjusted
Note: Recessions indicated by gray shaded columns.
Manufacturing employment is up by nearly 500,000 or 4.3% since Jan. 2010—a surprising source of strength in the economy.

*Seasonally adjusted

Construction employment is still below where it was in Jan. 2010. In a normal recovery, construction employment would be growing robustly.
ADVERSE LONG-TERM LABOR MARKET DEVELOPMENTS

Key Factors Harming Workers Compensation Exposure and the Overall Economy
Duration of Unemployment, May 2011 vs. May 2012

<table>
<thead>
<tr>
<th>Duration</th>
<th>May 2011</th>
<th>May 2012</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less Than 5 Weeks</td>
<td>2,687</td>
<td>2,580</td>
<td>-4.0%</td>
</tr>
<tr>
<td>5-14 Weeks</td>
<td>2,912</td>
<td>3,002</td>
<td>+3.1%</td>
</tr>
<tr>
<td>15-26 Weeks</td>
<td>1,994</td>
<td>1,662</td>
<td>-16.6%</td>
</tr>
<tr>
<td>27 Weeks +</td>
<td>6,204</td>
<td>5,411</td>
<td>-12.8%</td>
</tr>
</tbody>
</table>

The plight of the long-term unemployed remains a serious issue for the US. Skills atrophy over time—impact on WC claim frequency/severity?

Labor Force Participation Rate, Jan. 2002—May 2012*

Labor Force Participation as a % of Population

Large numbers of people are exiting (or not returning to the labor force)

*Defined as the percentage of working age persons in the population who are employed or actively seeking work.

Note: Recessions indicated by gray shaded columns.

In recent good times, the number of discouraged workers ranged from 200,000-400,000 (1995-2000) or from 300,000-500,000 (2002-2007).

Notes: Recessions indicated by gray shaded columns. Data are seasonally adjusted.
P/C Insurance Industry
Financial Overview

Profit Recovery Was Set Back in 2011 by High Catastrophe Loss & Other Factors
P/C Net Income After Taxes
1991–2011 ($ Millions)

P-C Industry 2011 profits were down 46% to $19.2B vs. 2010, due primarily to high catastrophe losses and as non-cat underwriting results deteriorated.

* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 4.6% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

Sources: A.M. Best, ISO, Insurance Information Institute
A 100 Combined Ratio Isn’t What It Once Was: Investment Impact on ROEs

Combined Ratio / ROE

A combined ratio of about 100 generated ~5.5% 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

* 2008-2011 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2011 combined ratio including M&FG insurers is 108.2, ROAS = 3.5%.
Source: Insurance Information Institute from A.M. Best and ISO data.
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2011*

*Profitability = P/C insurer ROEs are I.I.I. estimates. 2011 figure is an estimate based on ROAS data. Note: Data for 2008-2011 exclude mortgage and financial guaranty insurers. For 2011:Q3 ROAS = 3.5% including M&FG.

Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

History suggests next ROE peak will be in 2016-2017

1977: 19.0%
1987: 17.3%
1997: 11.6%
2006: 12.7%
2011: 4.6%*

1975: 2.4%
1984: 1.8%
1992: 4.5%
2001: -1.2%
ROE: Property/Casualty Insurance vs. Fortune 500, 1987–2011*

Sources: ISO, Fortune; Insurance Information Institute.
The P/C Insurance Industry Fell Well Short of Its Cost of Capital Every Year Since 2008

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

For 2011:H1 ROAS.
Source: Insurance Information Institute; NAIC, ISO.
Profitability and Growth in California, Washington, Oregon, Texas, Louisiana, Mississippi, Colorado, New Mexico, and Arizona P/C Insurance Markets

Analysis by Line and Nearby State Comparisons
All Lines: 10-Year Average RNW CA, WA, OR, TX, LA, MS, CO, NM, AZ vs. U.S.

2001-2010

- Washington: 10.6%
- New Mexico: 10.5%
- Oregon: 10.2%
- Colorado: 9.3%
- California: 9.2%
- Arizona: 7.2%
- Texas: 7.1%
- U.S.: 4.9%
- Louisiana: -9.2%
- Mississippi: -11.5%

Source: NAIC, Insurance Information Institute
Comm. Auto: 10-Year Average RNW CA, WA, OR, TX, LA, MS, CO, NM, AZ vs. U.S.

2001-2010

-3.1% 4.0% 6.8% 9.2% 9.2% 10.6% 11.0% 11.7% 13.6% 16.2%

-5% 0% 5% 10% 15% 20%

Oregon Colorado New Mexico Washington California U.S. Arizona Texas Mississippi Louisiana

Source: NAIC, Insurance Information Institute
Comm. M-P: 10-Year Average RNW CA, WA, OR, TX, LA, MS, CO, NM, AZ vs. U.S.

2001-2010

-18.1%
-8.7%
-2.2%
5.6%
6.7%
8.3%
8.6%
9.6%
11.9%
13.6%

New Mexico
California
Oregon
Colorado
U.S.
Washington
Arizona
Texas
Mississippi
Louisiana

Source: NAIC, Insurance Information Institute
Workers Comp: 10-Year Average RNW CA, WA, OR, TX, LA, MS, CO, NM, AZ vs. U.S.

2001-2010

- Washington: 21.1%
- Louisiana: 9.6%
- Texas: 9.5%
- Mississippi: 7.7%
- New Mexico: 6.4%
- Arizona: 6.1%
- California: 5.6%
- Colorado: 5.4%
- Oregon: 5.0%
- U.S.: 4.0%

Source: NAIC, Insurance Information Institute.
Global Catastrophe Loss Developments and Trends

2011 Rewrote Catastrophe Loss and Insurance History

But Will Losses Turn the Market?
Global Catastrophe Loss Summary: 2011

- **2011 Was the *Highest* Loss Year on Record for Economic Losses Globally**
  - Extraordinary accumulation of severe natural catastrophe: Earthquakes, tsunami, floods and tornadoes are the primary causes of loss

- **$380 Billion in *Economic* Losses Globally (New Record)**
  - New record, exceeding the previous record of $270B in 2005

- **$105 Billion in *Insured* Losses Globally**
  - 2011 losses were 2.5 times 2010 insured losses of $42B
  - Second only to 2005 on an inflation adjusted basis (new record on an unadjusted basis)
  - Over 5 times the 30-year average of $19B

- **$72.8 Billion in *Economic* Losses in the US**
  - Represents a 129% increase over the $11.8 billion amount through the first half of 2010

- **$35.9 Billion in *Insured* Losses in the US Arising from 171 CAT Events**
  - Fifth highest year on record
  - Represents 51% increase over the $23.8 billion total in 2010

Source: Munich Re; Insurance Information Institute.
Natural Loss Events, 2011

World Map

Number of Events: 820

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

Source: MR NatCatSERVICE
**Natural Catastrophes Worldwide, 2011**

**Overview and Comparison with Previous Years**

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
<th>Average of the last 10 years 2001-2010</th>
<th>Average of the last 30 years 1981-2010</th>
<th>Top Year 1981-2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of events</td>
<td>820</td>
<td>970</td>
<td>790</td>
<td>630</td>
<td>2007 (1,025)</td>
</tr>
<tr>
<td>Overall losses in US$ m</td>
<td>380,000</td>
<td>152,000</td>
<td>113,000</td>
<td>75,000</td>
<td>2005 (227,000)</td>
</tr>
<tr>
<td>(original values)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insured losses in US$ m</td>
<td>105,000</td>
<td>42,000</td>
<td>35,000</td>
<td>19,000</td>
<td>2005 (101,000)</td>
</tr>
<tr>
<td>(original values)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fatalities</td>
<td>27,000</td>
<td>296,000</td>
<td>106,000</td>
<td>69,000</td>
<td>2010 (296,000)</td>
</tr>
</tbody>
</table>

Source: MR NatCatSERVICE © 2011 Munich Re
### 5 Costliest Natural Catastrophes Worldwide in Terms of Insured Losses, 2011 ($Mill)

<table>
<thead>
<tr>
<th>Date</th>
<th>Region</th>
<th>Event</th>
<th>Fatalities</th>
<th>Overall losses US$ m</th>
<th>Insured losses US$ m</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 11</td>
<td>Japan</td>
<td>Earthquake, tsunami</td>
<td>15,840</td>
<td>210,000</td>
<td>35,000-40,000</td>
</tr>
<tr>
<td>Feb. 22</td>
<td>New Zealand</td>
<td>Earthquake</td>
<td>181</td>
<td>16,000</td>
<td>13,000</td>
</tr>
<tr>
<td>Aug. 1 – Nov. 15</td>
<td>Thailand</td>
<td>Floods, landslides</td>
<td>813</td>
<td>40,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Apr. 22-28</td>
<td>USA</td>
<td>Severe storms/tornadoes</td>
<td>350</td>
<td>15,000</td>
<td>7,300</td>
</tr>
<tr>
<td>Aug. 22 - Sep. 2</td>
<td>USA, Caribbean</td>
<td>Hurricane Irene</td>
<td>55</td>
<td>15,000</td>
<td>7,000</td>
</tr>
</tbody>
</table>

Source: MR NatCatSERVICE
### Natural Catastrophes Worldwide 2011

**Insured losses US$ 105bn - Percentage distribution per continent**

<table>
<thead>
<tr>
<th>Continent</th>
<th>Insured losses US$ m</th>
</tr>
</thead>
<tbody>
<tr>
<td>America (North and South America)</td>
<td>40,000</td>
</tr>
<tr>
<td>Europe</td>
<td>2,000</td>
</tr>
<tr>
<td>Africa</td>
<td>Minor damages</td>
</tr>
<tr>
<td>Asia</td>
<td>45,000</td>
</tr>
<tr>
<td>Australia/Oceania</td>
<td>18,000</td>
</tr>
</tbody>
</table>

In 2011, 61% of insured natural catastrophe losses were in the Asia/Pacific region, nearly 3.5 times the average of 13% over the prior 30 years (1981-2010).

In 2011, just 37% of insured natural catastrophe losses were in the Americas, barely half the average of 66% over the prior 30 years (1981-2010).

Source: MR NatCatSERVICE
In 2011, 61% of natural catastrophe losses were in the Asia/Pacific region, nearly 3.5 times the average of 13% over the prior 30 years (1981-2010).

<table>
<thead>
<tr>
<th>Continent</th>
<th>Insured losses US$ m</th>
</tr>
</thead>
<tbody>
<tr>
<td>America (North and South America)</td>
<td>566,000</td>
</tr>
<tr>
<td>Europe</td>
<td>146,000</td>
</tr>
<tr>
<td>Africa</td>
<td>2,000</td>
</tr>
<tr>
<td>Asia</td>
<td>115,000</td>
</tr>
<tr>
<td>Australia/Oceania</td>
<td>41,000</td>
</tr>
</tbody>
</table>

Source: MR NatCatSERVICE
2011 set a record for both overall economic losses in Asia ($266B) and insured losses ($45B). The rapid economic development of Asia and increased insurance penetration guarantee that losses will trend higher in the future.
Top 16 Most Costly World Insurance Losses, 1970-2011**

(Insured Losses, 2011 Dollars, $ Billions)

5 of the top 14 most expensive catastrophes in world history have occurred within the past 2 years

**Average of range estimates of $35B - $40B as of 1/4/12; Privately insured losses only.

**Figures do not include federally insured flood losses.

Sources: Swiss Re sigma 1/2011; Munich Re; Insurance Information Institute research.
Worldwide Natural Disasters, 1980 – 2011

Number of Events

There were 820 events in 2011

- **Geophysical events** (Earthquake, tsunami, volcanic eruption)
- **Meteorological events** (Storm)
- **Hydrological events** (Flood, mass movement)
- **Climatological events** (Extreme temperature, drought, forest fire)

Source: MR NatCatSERVICE
Worldwide Natural Disasters 1980–2011, Overall and Insured Losses

(In insured losses, 2011 dollars, $ billions)

Overall losses (in 2011 values)

Insured losses (in 2011 values)

Source: MR NatCatSERVICE

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U.S. Insured Catastrophe Loss Update

2011 Was One of the Most Expensive Years on Record
Top 14 Most Costly Disasters in U.S. History

(Insured Losses, 2011 Dollars, $ Billions)

Taken as a single event, the Spring 2011 tornado and storm season are is the 4th costliest event in US insurance history

Hurricane Irene became the 11th most expense hurricane in US history

*Losses will actually be broken down into several “events” as determined by PCS. Includes losses for the period April 1 – June 30. Sources: PCS; Insurance Information Institute inflation adjustments.
There were 117 natural disaster events in 2011.
Losses Due to Natural Disasters in the US, 1980–2011 (Overall & Insured Losses)

**2011 was the 5th most expensive year on record for insured catastrophe losses in the US.**

Approximately 50% of the overall cost of catastrophes in the US was covered by insurance in 2011.

- Overall Losses: $72.8 Bill
- Insured Losses: $35.9 Bill

Source: MR NatCatSERVICE © 2011 Munich Re
US CAT Losses in 2011 Were the 5th Highest in US History on An Inflation Adjusted Basis

*PCS figure as of April 6, 2012.

Note: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01 ($25.9B 2011 dollars). Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = $12.2B ($15.6B in 2011 dollars.)

Sources: Property Claims Service/ISO; Insurance Information Institute.
## Natural Disaster Losses in the United States: 2011

<table>
<thead>
<tr>
<th>As of Jan. 1, 2012</th>
<th>Number of Events</th>
<th>Fatalities</th>
<th>Estimated Overall Losses (US $m)</th>
<th>Estimated Insured Losses (US $m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severe Thunderstorm</td>
<td>69</td>
<td>617</td>
<td>46,548</td>
<td>25,813</td>
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<tr>
<td>Winter Storm</td>
<td>9</td>
<td>67</td>
<td>2,708</td>
<td>2,017</td>
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<tr>
<td>Flood</td>
<td>14</td>
<td>20</td>
<td>2,705</td>
<td>535</td>
</tr>
<tr>
<td>Earthquake</td>
<td>5</td>
<td>1</td>
<td>257</td>
<td>50</td>
</tr>
<tr>
<td>Tropical Cyclone</td>
<td>3</td>
<td>0</td>
<td>10,700</td>
<td>5,510</td>
</tr>
<tr>
<td>Wildfire</td>
<td>58</td>
<td>15</td>
<td>1,922</td>
<td>855</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>33</td>
<td>8,000</td>
<td>1,000</td>
</tr>
</tbody>
</table>

Source: MR NatCatSERVICE
2011’s Most Expensive Catastrophes, Insured Losses

Thunderstorms, Apr. 22-26: $7,300
Thunderstorms, May 20-27: $6,900
Hurricane Irene, Aug. 26-28**: $5,000
Thunderstorms, Apr. 3-5: $2,000
Thunderstorms, Apr. 8-11: $1,510
Thunderstorms, Apr. 14-16: $1,400
Thunderstorms, Jun. 16-22: $1,200
Texas Drought, 2011*: $1,000
Thunderstorms, Jul. 10-14: $980
Winter Storm, Jan. 31-Feb. 3: $975
Thunderstorms, Aug. 18-19: $840
Thunderstorms, Apr. 19-20: $830
Wildfire, Sep. 4-19: $530
Flooding, April*: $500

**Includes $700 million in flood losses insured through the National Flood Insurance Program.

Source: PCS except as noted by “*” which are sourced to Munich Re; Insurance Information Institute.
Claim Payments to Policyholders, by State, for the May 20-27 Storms (Joplin)

At $2.16 billion, MO suffered, by far, the largest losses from the May 20-27 storms

TOTAL = $6.9 BILLION

Missouri Claim Payout Accounted for 32% of the $6.9 Billion US Total for the May 20-27 Tornado and Storm Event, Which Affected 19 States

Sources: Catastrophe loss data is for Catastrophe Serial No. 48 (May 22 – 27, 2011) from PCS as of May 10, 2012; Insurance Information Institute.
Distribution of Number of Claims Paid to MO Policyholders for May 20-27 Storms

TOTAL = 61,000 CLAIMS PAID

Vehicle, 28,000, 46%
Commercial, 7,000, 11%
Home, 26,000, 43%

Commercial (business) claims accounted for 64% of the claim dollars paid by insurers but just 11% of the actual number of claims.

Sources: Catastrophe loss data is for Catastrophe Serial No. 48 (May 20 – 27, 2011) from PCS as of May 10, 2012; Insurance Information Institute.
Distribution of Claim Dollars Paid to MO Policyholders for May 20-27 Storms ($ Mill)

TOTAL = $2.160 BILLION

Vehicle, $100, 5%

Commercial, $1,385, 64%

Home, $675, 31%

Commercial (business) claims accounted for 64% of the claim dollars paid by insurers but just 11% of the actual number of claims.

Sources: Catastrophe loss data is for Catastrophe Serial No. 48 (May 20 – 27, 2011) from PCS as of May 10, 2012; Insurance Information Institute.
Claim Payments to Policyholders, by State, for the April 22-28 Storms (Tuscaloosa)

TOTAL = $7.3 BILLION

At $2.925 billion, AL suffered, by far, the largest losses from the Apr. 22-28 storms

Alabama Claim Payout Accounted for 40% of the $7.3 Billion US Total for the April 22-28 Tornado and Storm Event, Which Affected 13 States

Sources: Catastrophe loss data is for Catastrophe Serial No. 46 (April 22 – 28, 2011) from PCS as of April 13, 2012; Insurance Information Institute.
# Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2011

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

*Insurance Information Institute estimates for 2010 and 2011 based on A.M. Best data.

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.
Average thunderstorm losses are up more than 5 fold since the early 1980s.

Hurricanes get all the headlines, but thunderstorms are consistent producers of large scale loss. 2008-2011 are the most expensive years on record.

Thunderstorm losses in 2011 totaled a record $25.8 billion.

Source: Property Claims Service, MR NatCatSERVICE
Insured winter storm losses in 2011 totaled $2.0 billion. Average winter storm losses have nearly doubled since the early 1980s.
8.3 millions acres were burned by wildfires in 2011, one of the worst years on record, causing $855 in insured losses.
Notable Wildfires in 2011

- Worst wildfire year on record in Texas due to persistent drought.

- **Spring**: Over 3 million acres burned in west Texas from 12 major seats of fire. Over 200 homes and businesses destroyed, $50 million insured loss.

- **September**: Bastrop County Complex Fire near San Antonio destroys over 1,600 homes, insured loss of $530 million.

Source: FEMA

© 2011 Munich Re
U.S. Insured Catastrophe Losses by Cause of Loss, 2011 ($ Millions)

- Hurricanes & Tropical Storms, $5,510
- Thunderstorms (Incl. Tornadoes), $25,813
- Wildfires, $855
- Winter Storms, $2,017
- Flood, $535
- Geological Events, $50
- Other, $1,000

Thunderstorm/Tornado losses were 2.5 times above the 30-year average.

2011’s insured loss distribution was unusual with tornado and thunderstorm accounting for the vast majority of loss.

Source: ISO’s Property Claim Services Unit, Munich Re; Insurance Information Institute.
Inflation Adjusted U.S. Catastrophe Losses by Cause of Loss, 1990–2011:H1

1. Catastrophes are defined as events causing direct insured losses to property of $25 million or more in 2009 dollars.
2. Excludes snow.
3. Does not include NFIP flood losses
4. Includes wildland fires
5. Includes civil disorders, water damage, utility disruptions and non-property losses such as those covered by workers compensation.

Source: ISO’s Property Claim Services Unit.

Wind losses are by far cause the most catastrophe losses, even if hurricanes/TS are excluded.

Tornado share of CAT losses is rising

Wind/Hail/Flood (3), $12.7
Geological Events, $18.5
Terrorism, $24.9
Winter Storms, $30.0
Tornadoes (2), $119.5
Fires (4), $9.0
Other (5), $0.6

Hurricanes & Tropical Storms, $160.5

42.7%
31.8%
6.6%
8.0%
4.9%
3.4%
0.2%
Federal Disaster Declarations Patterns: 1953-2012

Records Were Set for Federal Disaster Declarations in 2010 and 2011—Most Declarations Were Unrelated to Tropical Activity
There have been 2,058 federal disaster declarations since 1953. The average number of declarations per year is 34 from 1953-2010, though that few haven’t been recorded since 1995.

The number of federal disaster declarations set a new record in 2011, with 99, shattering 2010’s record 81 declarations.

13 federal disasters were declared through June 3, 2012

The Number of Federal Disaster Declarations Is Rising and Set New Records in 2010 and 2011


Federal Disasters Declarations by State, 1953 – 2012: Highest 25 States*

Over the past nearly 60 years, Texas has had the highest number of Federal Disaster Declarations.


Federal Disasters Declarations by State, 1953 – 2012: Lowest 25 States*

Over the past nearly 60 years, Utah and Rhode Island had the fewest number of Federal Disaster Declarations.


2012 Got Off to a Worrisome Start, But Is No Repeat of 2011
Number of Tornadoes and Related Deaths, 1990 – 2012*

Tornadoes claimed 553 lives in 2011, the most since 1925

740 tornadoes have been recorded so far this year*

2012 Tornado Losses Got Off to an Ominous Beginning, but Slowed. First Half 2011 Insured Losses from Tornadoes and Thunderstorms Topped $21B.

*Through May 26, 2012.
There were 1,897 tornadoes in the US in 2011 far above average, but well below 2008’s record.

2012 count is running well behind 2011.

Source: http://www.spc.noaa.gov/wcm/
Location of Tornadoes in the US, 2012*

Through May 26, 2012.

Source: NOAA Storm Prediction Center; http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html#
Location of Tornadoes in the US, 2011

1,894 tornadoes killed 553 people in 2011, including at least 340 on April 26 mostly in the Tuscaloosa area, and 130 in Joplin on May 22.
There were 3,639 “Large Hail” reports through May 26, 2012, causing extensive damage to homes, businesses and vehicles.
There were 9,417 “Large Hail” reports in 2011, causing extensive damage to homes, businesses and vehicles.

There were 2,901 “Wind Damage” reports through May 26, causing extensive damage to homes and businesses.
Location of Wind Damage Reports in the US, 2011

There were 18,685 “Wind Damage” reports through Dec. 27, causing extensive damage to homes and businesses.

Severe Weather Reports, 2012*

There were already 7,281 severe weather reports through May 26; including 740 tornadoes; 3,639 “Large Hail” reports and 2,901 high wind events.

*Through May 26, 2012.
Source: NOAA Storm Prediction Center; [http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html](http://www.spc.noaa.gov/climo/online/monthly/2012_annual_summary.html)
Severe Weather Reports, 2011

There were 29,996 severe weather reports in 2011; including 1,894 tornadoes; 9,417 “Large Hail” reports and 18,685 high wind events.

Large Hail, 9,417, 31%
Wind Damage, 18,685, 63%
Tornadoes, 1,894, 6%

Tornadoes accounted for just 6% of all Severe Weather Reports but more than 550 deaths in 2011, the most in 75 years

The BIG Question: When Will the Market Turn?

Are Catastrophes and Other Factors Pressuring Insurance Markets?
### Criteria Necessary for a “Market Turn”: All Four Criteria Must Be Met

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
</table>
| Sustained Period of Large Underwriting Losses | *Early Stage, Inevitable*       | • Apart from 2011 CAT losses, overall p/c underwriting losses remain modest  
• Combined ratios (ex-CATs) still in low 100s (vs. 110+ at onset of last hard market)  
• Prior-year reserve releases continue to reduce u/w losses, boost ROEs, though more modestly |
| Material Decline in Surplus/Capacity    | *Entered 2011 at Record High; Only Small Decline* | • Surplus hit a record $565B as of 3/31/11  
• Fell just 1.6% through 12/31/11 from 12/31/10  
• Will likely see new record in 2012  
• Little excess capacity remains in reinsurance markets  
• Modest growth in demand for insurance is insufficient to absorb much excess capacity |
| Tight Reinsurance Market                | *Somewhat in Place*             | • Much of the global “excess capacity” was eroded by cats  
• Higher prices in Asia/Pacific  
• Modestly higher pricing for US risks |
| Renewed Underwriting & Pricing Discipline | *Some Firming esp. in Property, WC* | • Commercial lines pricing trends have turned from negative to flat and now positive, esp. Property & WC;  
• Competition remains intense as many seek to maintain market share |

Sources: Barclays Capital; Insurance Information Institute.
1. UNDERWRITING

Have Underwriting Losses Been Large Enough for Long Enough to Turn the Market?
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

Avg. CAT Losses, More Reserve Releases

Higher CAT Losses, Shrinking Reserve Releases, Toll of Soft Market

Underwriting Gain (Loss)
1975–2011E*

Cumulative underwriting deficit from 1975 through 2011 is $479B

Underwriting losses in 2011 totaled $36.5B, the largest since 2001

Large Underwriting Losses Are NOT Sustainable in Current Investment Environment

* Includes mortgage and financial guaranty insurers in all years
Sources: A.M. Best, ISO; Insurance Information Institute.
The combined ratios for both personal and commercial lines insurers jumped by similar amounts 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: Barclays Capital; A.M. Best.
Underwriting Profits Were Common Before the 1980s (40 of the 60 Years Before 1980 Had Combined Ratios Below 100) – But Then They Vanished. Not a Single Underwriting Profit Was Recorded in the 25 Years from 1979 Through 2003

* 2009 combined ratio excl. mort. and finl. guaranty insurers was 99.3, which would bring the 2000s total to 4 years with an u/w profit.

**Data for the 2010s includes 2010 and 2011.

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

Sources: Insurance Information Institute research from A.M. Best Data.
## P/C Estimated Loss Reserve Deficiency/ (Redundancy), Excl. Statutory Discount

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Auto Liability</td>
<td>-$1.8B</td>
</tr>
<tr>
<td>Homeowners</td>
<td>-$0.2</td>
</tr>
<tr>
<td>Other Liab (incl. Prod Liab)</td>
<td>$4.0</td>
</tr>
<tr>
<td>Workers Compensation</td>
<td>$8.2</td>
</tr>
<tr>
<td>Commercial Multi Peril</td>
<td>$1.5</td>
</tr>
<tr>
<td>Commercial Auto Liability</td>
<td>$0.0</td>
</tr>
<tr>
<td>Medical Malpractice</td>
<td>-$4.0</td>
</tr>
<tr>
<td>Reinsurance—Nonprop Assumed</td>
<td>$3.4</td>
</tr>
<tr>
<td>All Other Lines*</td>
<td>-$2.2</td>
</tr>
<tr>
<td><strong>Total Core Reserves</strong></td>
<td><strong>$8.9</strong></td>
</tr>
<tr>
<td>Asbestos &amp; Environmental</td>
<td>$7.4</td>
</tr>
<tr>
<td><strong>Total P/C Industry</strong></td>
<td><strong>$16.3B</strong></td>
</tr>
</tbody>
</table>

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

3 small insurers in Missouri did encounter problems in 2011 following the May tornado in Joplin. They were absorbed by a larger insurer and all claims were paid.

Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007; Recent Increase Was Associated Primarily With Mortgage and Financial Guaranty Insurers and Not Representative of the Industry Overall.

2011 impairment rate was 0.91%, up from 0.67% in 2010; the rate is slightly higher than the 0.82% average since 1969.

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

Workers Comp and Pvt. Passenger Auto Account for Nearly Half of the Premium Volume of Impaired Insurers Over the Past Decade

Number of Recessions Endured by P/C Insurers, by Number of Years in Operation

Number of Recessions Since 1860

Insurers are true survivors—not just of natural catastrophes but also economic ones.

Many US Insurers Are Close to a Century Old or Older

Sources: Insurance Information Institute research from National Bureau of Economic Research data.
Performance by Segment
A.M. Best Commercial Lines Outlook: Negative (as of January 2012)

- Underwriting Margins Pressured
  - Will recent rate increases hold?
- Loss Reserve Redundancies Fade
- Historically Low Investment Yields

OFFSETTING FACTORS

- Capitalization Still Solid
- Emergence of Sophisticated Price Monitoring and Underwriting Tools

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

Sources: A.M. Best (1990-2012F); Insurance Information Institute.
Homeowners Performance Deteriorated in 2011 Due to Large Cat Losses. Extreme Regional Variation Can Be Expected Due to Local Catastrophe Loss Activity.

Sources: A.M. Best (1990-2012E); Insurance Information Institute.
Homeowners Multi-Peril Loss & LAE Ratio, 2011: Highest 25 States

Tennessee (TN) and Alabama (AL) had the worst underwriting performance of all states in 2011 due to high tornado and storm losses.

Sources: SNL Financial; Insurance Information Institute.
Homeowners Multi-Peril Loss & LAE Ratio, 2011: Lowest 25 States

HI and FL had the best performance in 2011 due to the absence of hurricanes/tropical storms impacts in either state last year.

Sources: SNL Financial; Insurance Information Institute.
Commercial Lines Combined Ratio, 1990-2012F*

*2007-2012 figures exclude mortgage and financial guaranty segments.
Source: A.M. Best; Insurance Information Institute
Commercial Auto is Expected to Deteriorate as Loss Frequency and Severity Trends Deteriorate 2011-2012

Sources: A.M. Best Insurance Information Institute.
Commercial Multi-Peril Underwriting Performance is Expected to Improve in 2012 Assuming Normal Catastrophe Loss Activity

*2012 figures are A.M. Best estimate/forecast for the combined liability and non-liability components. Sources: A.M. Best; Insurance Information Institute.
Commercial General Liability Underwriting Performance Has Deteriorated in Recent Years

Source: Conning Research and Consulting.
Inland Marine Combined Ratio: 1999–2012F

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

Sources: A.M. Best (historical and forecast); Insurance Information Institute.
 Liability Lines Have Performed Better in the Post-Tort Reform Era (~2005), but There Has Been Some Deterioration in Recent Years

Sources: A.M. Best; Insurance Information Institute.
Med Mal Insurers in 2011 paid out $0.87 in loss and expense for every $1 they earned in premiums.

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

The dramatic improvement over the past decade has restored med mal’s viability.

Source: AM Best, Insurance Information Institute
Workers Compensation Combined Ratio: 1994–2012F

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio</th>
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</thead>
<tbody>
<tr>
<td>1994</td>
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<tr>
<td>1995</td>
<td>97.0</td>
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<td>1998</td>
<td>107.0</td>
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<tr>
<td>1999</td>
<td>115.3</td>
</tr>
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<td>2002</td>
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<td>2007</td>
<td>103.6</td>
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<td>2008</td>
<td>104.4</td>
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<td>2009</td>
<td>110.6</td>
</tr>
<tr>
<td>2010</td>
<td>116.8</td>
</tr>
<tr>
<td>2011</td>
<td>115.0</td>
</tr>
<tr>
<td>2012</td>
<td>116.0</td>
</tr>
</tbody>
</table>

Workers Comp Underwriting Results Are Deteriorating Markedly and the Worst They Have Been in a Decade

Sources: A.M. Best (1994-2010 all carriers); NCCI for 2011 (Private carriers only); 2012 (All Carriers) Insurance Information Institute.
The Weak Economy and Soft Market Have Made the Workers Comp Operating Environment Increasingly Challenging
Workers Comp Medical Claim Costs Continue to Rise

Average Medical Cost per Lost-Time Claim

Cumulative Change = 238% (1991-2010p)

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

Does smaller pace of increase suggest that small med-only claims are becoming lost-time claims?

2010p: Preliminary based on data valued as of 12/31/2010
1991-2008: Based on data through 12/31/2008, developed to ultimate
Based on the states where NCCI provides ratemaking services; Excludes the effects of deductible policies
Workers Comp Indemnity Claim Costs Decline in 2010

Indemnity Claim Cost ($ 000s)

Average Indemnity Cost per Lost-Time Claim

Claiming behavior has changed significantly. Large numbers of lost time, low severity claims have entered the system—claims that previously were medical only, driving down average indemnity costs per claim.

Annual Change 1991–1993: -1.7%
Annual Change 1994–2001: +7.3%
Annual Change 2002–2009: +4.1%

2010p: Preliminary based on data valued as of 12/31/2010
1991–2008: Based on data through 12/31/2008, developed to ultimate
Based on the states where NCCI provides ratemaking services
Excludes the effects of deductible policies
Workers Compensation Premium Continues Its Sharp Decline

Net Written Premium

$ Billions

<table>
<thead>
<tr>
<th>Year</th>
<th>State Funds ($ B)</th>
<th>Private Carriers ($ B)</th>
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<td>25.9</td>
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<td>2007</td>
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<tr>
<td>2010</td>
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<td>33.8</td>
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</table>

Source: 1990–2009 Private Carriers, Best's Aggregates & Averages; 2010p, NCCI
1996–2010p State Funds: AZ, CA, CO, HI, ID, KY, LA, MD, MO, MT, NM, OK, OR, RI, TX, UT Annual Statements
State Funds available for 1996 and subsequent
Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2011:Q4

Billions

Peak was 2008:Q1 at $6.60 trillion

Latest (2011:Q4) was $6.71 trillion, a new peak

Pace of payroll growth is accelerating

Recent trough (2009:Q3) was $6.25 trillion, down 5.3% from prior peak

Growth rates in 2011:
Q2 over Q1: 0.6%
Q3 over Q2: 0.4%
Q4 over Q3: 1.0%

Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.
Sources: http://research.stlouisfed.org/fred2/series/WASCUR; National Bureau of Economic Research (recession dates); Insurance Information Institute.
Payroll vs. Workers Comp Net Written Premiums, 1990-2011

Payroll Base*

$Billions

WC NWP

$Billions

Wage & Salary Disbursements

WC NPW

WC premium volume dropped two years before the recession began

WC net premiums written were down $14B or 29.3% to $33.8B in 2010 after peaking at $47.8B in 2005

Resumption of payroll growth and rate increases suggests WC NWP will grow again in 2012

*Private employment; Shaded areas indicate recessions. Payroll and WC premiums for 2011 is I.I.I. estimate

Sources: NBER (recessions); Federal Reserve Bank of St. Louis at [http://research.stlouisfed.org/fred2/series/WASCUR](http://research.stlouisfed.org/fred2/series/WASCUR); NCCI; I.I.I.
Average Approved Bureau Rates/Loss Costs

History of Average WC Bureau Rate/Loss Cost Level Changes

Cumulative 1990–1993
+36.3%

Cumulative 1994–1999
-27.8%

Cumulative 2000–2003
+17.1%

Cumulative 2004–2011
-26.2%

*States approved through 4/8/11.

Note: Countrywide approved changes in advisory rates, loss costs and assigned risk rates as filed by applicable rating organization.

Source: NCCI.
The Q4 2011 WC rate change was the largest among all major commercial lines.
Direct Premiums Written: Worker’s Comp Percent Change by State, 2005-2010*

Top 25 States

Only 7 (small) states showed growth in workers comp premium volume between 2005 and 2010

Workers Comp DPW in MD dropped 14.7% from between 2005 and 2010

*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Sources: SNL Financial LC.; Insurance Information Institute.
Direct Premiums Written: Worker’s Comp Percent Change by State, 2005-2010*

<table>
<thead>
<tr>
<th>State</th>
<th>Percent Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AZ</td>
<td>-22.6</td>
</tr>
<tr>
<td>ME</td>
<td>-23.7</td>
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<tr>
<td>GA</td>
<td>-24.2</td>
</tr>
<tr>
<td>KY</td>
<td>-25.0</td>
</tr>
<tr>
<td>IN</td>
<td>-25.2</td>
</tr>
<tr>
<td>NH</td>
<td>-25.2</td>
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<tr>
<td>OR</td>
<td>-25.3</td>
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<tr>
<td>DC</td>
<td>-26.8</td>
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<tr>
<td>MA</td>
<td>-26.9</td>
</tr>
<tr>
<td>TN</td>
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<td>US</td>
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<td>TX</td>
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<td>CA</td>
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<td>FL</td>
<td>-57.7</td>
</tr>
</tbody>
</table>

*Excludes monopolistic fund states: ND, OH, WA, WY as well as WV, which transitioned to a competitive structure during this period.

Source: SNL Financial LC.; Insurance Information Institute.
2. SURPLUS/CAPITAL/CAPACITY

Have Large Global Losses Reduced Capacity in the Industry, Setting the Stage for a Market Turn?
US Policyholder Surplus: 1975–2011*

The Premium-to-Surplus Ratio Stood at $0.80:$1 as of 12/31/11, A Near Record Low (at Least in Recent History)*

* As of 12/31/11.


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

Surplus as of 12/31/11 was $550.3 down 2.5% from the record $564.7B as of 3/31/11, but still up 25.9% ($113.2B) from the crisis trough of $437.1B at 3/31/09. Pre-crisis peak was $521.8 as of 9/30/07. Surplus as of 12/31/11 was 5.5% above 2007 peak.
Policyholder Surplus, 2006:Q4–2011:Q4

The Industry now has $1 of surplus for every $0.80 of NPW, close to the strongest claims-paying status in its history.

Surplus as of 12/31/11 was down 2.5% below its all time record high of $564.7B set as of 3/31/11. A new record high in 2012 is possible.

*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.

Quarterly Surplus Changes Since 2011:Q1 Peak

11:Q2: -$5.6B (-1.0%)
11:Q3: -$26.1B (-4.6%)
11:Q4: -$14.3B (-2.5%)
Excess/(Deficit) Capital (Policyholder Surplus)

2006/07: Low CAT losses, strong underwriting results since 1940s increase capital
2009-10: End of financial crisis, rising asset prices, modest u/w losses push capital to record levels
2005: Katrina, Rita, Wilma produce record CAT losses
2008: Financial crisis causes sharp drop in capital
High cats, u/w losses push capital down


Note: The assumption of a 0.9:1 P/S ratio is derived from a Feb. 2011 announcement by Advisen, Ltd., that the US P/C insurance industry has $74 billion in excess capital. The implied P/S ratio (calculated by III) is 0.88:1, which was rounded to 0.9:1. Source: Insurance Information Institute calculations from A.M. Best and ISO data.
M&A Activity in the US P/C Insurance Industry, 1997-2011*

P/C M&A activity in 2011 is up 60% since 2008, its highest level (in $ terms) since 2008

M&A Activity in the P/C Insurance Industry Remains Well Below its 1990s Peak

*2011 data are through December 1.
Source: SNL Securities; Insurance Information Institute.
Paid-in capital for insurance operations rose by $27.4B in 2010, the largest on record dating back to 1959.

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

Source: ISO; Insurance Information Institute.
Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989*

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

* Ratio is for end-of-quarter surplus immediately after the 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*

*2011 NWP and Surplus figures are % changes as of Q4:11 vs. Q4:10.
Sources: A.M. Best, ISO, Insurance Information Institute

Sharp Decline in Capacity is a Necessary but Not Sufficient Condition for a True Hard Market
The premium-to-surplus ratio (a measure of leverage) hit a record low at just 0.76:1 in 2010. It has decreased as PHS grows more quickly than NPW, with the effect of holding down profitability.

Record High P-S Ratio was 2.7:1 in 1974.

Record Low P-S Ratio was 0.76:1 as of 12/31/10, rising slightly to 0.80:1 as of 12/31/11.

The Premium-to-Surplus Ratio in 2011:Q4 Implies that P/C Insurers Held $1 in Surplus Against Each $0.80 Written in Premiums. In 1974, Each $1 of Surplus Backed $2.70 in Premium.

*2011 data are as of 12/31/11.

Sources: Insurance Information Institute calculations from A.M. Best data.
3. REINSURANCE MARKET CONDITIONS

Record Global Catastrophes Activity is Pressuring Pricing
Reinsurer Share of Recent Significant Market Losses

Reinsurers Paid a High Proportion of Insured Losses Arising from Major Catastrophic Events Around the World in Recent Years

Source: Insurance Information Institute from reinsurance share percentages provided in RAA, ABIR and CEA press release, Jan. 13, 2011.
Global Property Catastrophe Rate on Line Index, 1990—2012 (as of Jan. 1)

Property-Cat reinsurance pricing is up about 8% as of 1/1/12—modest relative to the level CAT losses.

Sources: Guy Carpenter; Insurance Information Institute.
Most excess reinsurance capacity was removed from the market in 2011, but there does not appear to be a shortage, leading to modest increases in 2012 reinsurance renewals except in areas hit hard by CATs.
4. RENEWED PRICING DISCIPLINE

Is There Evidence of a Broad and Sustained Shift in Pricing?
### Distribution Facts

- **Personal/Commercial lines split has been about 50/50 for many years; Personal Lines overtook Commercial Lines in 2010**

- **Pvt. Passenger Auto is by far the largest line of insurance and is currently the most important source of industry profits**

- **Billions of additional dollars in homeowners insurance premiums are written by state-run residual market plans**

### 2010

- **Commercial Lines**: $226.8B (49%)
- **Homeowners**: $68.2B (15%)
- **Pvt. Pass Auto**: $165.0B (36%)

Sources: A.M. Best; Insurance Information Institute research.
Premium Growth Is Up Modestly: More in 2012?

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.

2011 growth was +3.3%

NWP was up 0.9% in 2010

Shaded areas denote “hard market” periods
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.
Direct Premiums Written: All P/C Lines Percent Change by State, 2005-2010

Top 25 States

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

LA, OK and TX were among the fastest growing states in the US in recent years…

Sources: SNL Financial LC.; Insurance Information Institute.
States with the poorest performing economies also produced the most negative net change in premiums of the past 5 years.

US Direct Premiums Written declined by 1.6% between 2005 and 2010.
Finally! Back-to-back quarters of net written premium growth (vs. the same quarter, prior year)

In 2011, growth in personal lines predominating cos. (+2.9%) and commercial lines predominating cos. (+4.3%), diversified (+2.4%)

Sources: ISO, Insurance Information Institute.
Growth in Net Written Premium by Segment, 2011 vs. 2010

Personal lines insurer growth decelerated as auto pricing moderated even has homeowners insurance rates rose.

Commercial lines growth improved dramatically as a 7-year long soft market came to an end and an improving economy bolstered demand.

Source: ISO/PCI; Insurance Information Institute
Monthly Change* in Auto Insurance Prices, 1991–2012*

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

Pricing peak occurred in 2010 at 5.1%, falling to 2.8% by Mar. 2012

"Hard" markets tend to occur during recessionary periods

The Feb. 2012 reading of 2.7% was the lowest since July 2008

*Percentage change from same month in prior year; through March 2012; 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 Commercial Rate Change, All Lines, (1Q:2004–1Q:2012)

(Percent)

Pricing as of Q1:2012 was positive for only the third time since 2003. Slightly stronger gains in Q4.

Q2 2011 marked the 30th consecutive quarter of price declines.

Source: Council of Insurance Agents & Brokers (1Q04-4Q11); Insurance Information Institute
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2012:Q1

Percentage Change (%)

Peak = 2001:Q4 +28.5%

Pricing Turned Negative in Early 2004 and Remained that way for 7 ½ years

KRW: No Lasting Impact

Trough = 2007:Q3 -13.6%

Pricing turned positive in Q3:2011, the first increase in nearly 8 years; Q1:2012 renewals were up 4.4%

Source: Council of Insurance Agents and Brokers; Barclay’s Capital; Insurance Information Institute.
Cumulative Qtrly. Commercial Rate Changes, by Account Size: 1999:Q4 to 2012:Q1

1999:Q4 = 100

Despite 3 consecutive quarters of gains (Q1:2012 = 4.4%), pricing today is where it was in early 2001 (pre-9/11)

Upward pricing pressure is small for large accounts, 4.1% in Q1:2012, vs. 4.2% for small accounts and 4.9% for medium accounts

Source: Council of Insurance Agents and Brokers; Barclay’s Capital; Insurance Information Institute.
Change in Commercial Rate Renewals, by Line: 2012:Q1

<table>
<thead>
<tr>
<th>Line</th>
<th>Percentage Change (%)</th>
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<tbody>
<tr>
<td>Surety</td>
<td>0.8%</td>
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<tr>
<td>EPL</td>
<td>2.0%</td>
</tr>
<tr>
<td>Comm Auto</td>
<td>3.1%</td>
</tr>
<tr>
<td>General Liability</td>
<td>3.1%</td>
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<tr>
<td>Umbrella</td>
<td>3.3%</td>
</tr>
<tr>
<td>D&amp;O</td>
<td>3.6%</td>
</tr>
<tr>
<td>Construction</td>
<td>3.8%</td>
</tr>
<tr>
<td>EPL</td>
<td>4.0%</td>
</tr>
<tr>
<td>Bus. Interruption</td>
<td>4.0%</td>
</tr>
<tr>
<td>Commercial Property</td>
<td>6.5%</td>
</tr>
<tr>
<td>Workers Comp</td>
<td>7.4%</td>
</tr>
</tbody>
</table>

Workers Comp rate increases are large than any other line, followed by Property lines.

Major Commercial Lines Renewed Uniformly Upward in Q1:2012 for Only the Third Time Since 2003; Property Lines & Workers Comp Leading the Way.

Source: Council of Insurance Agents and Brokers; Insurance Information Institute.
Workers Comp Rate Changes, 2008:Q4 – 2012:Q1

WC rate changes have been positive for 4 consecutive quarters, longer than any other commercial line

Source: Council of Insurance Agents and Brokers; Information Institute.
High Global Catastrophe Losses Have Had a Modest Adverse Impact on Global Reinsurance Market Capacity

Source: Aon Reinsurance Market Outlook, September 2011 from Individual Company and AonBenfield Analytics; Insurance Information Institute.
Cost of Risk vs. Commercial Lines Combined Ratio

The cost of risk cannot continue to fall as actual results deteriorate.

*Insurance Information Institute estimates for 2011.
Source: 2011 RIMS Benchmark Survey; A.M. Best; Insurance Information Institute
How the Risk Dollar is Spent (2011)

Management & Professional Liability Costs Account for 9% - 13% of the Risk Dollar

Firms w/Revenues < $1 Billion
- Property Premiums, 21%
- WC Premiums, 8%
- Total Prof. Liability Costs, 8%
- WC Retained Losses, 9%
- Retained Property Losses, 3%
- Liability Premiums, 21%
- Liability Retained Losses, 13%

Firms w/Revenues > $1 Billion
- Property Premiums, 13%
- WC Premiums, 6%
- Total Prof. Liability Costs, 3%
- WC Retained Losses, 21%
- Liability Premiums, 10%
- Liability Retained Losses, 12%
- Total Mgmt. Liab., 6%
- Retained Property Losses, 8%

Source: 2011 RIMS Benchmark Survey, Advisen; Insurance Information Institute
Direct Premiums Written: All P/C Lines
Percent Change by State, 2005-2010

Top 25 States

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

West Virginia premium growth was among the fastest in the US in recent years…

Sources: SNL Financial LC.; Insurance Information Institute.
States with the poorest performing economies also produced the most negative net change in premiums of the past 5 years.
Claim Trends in Auto Insurance

Frequency and Severity Trends Are Mixed But On Net Have Deteriorated
US Bodily Injury: Severity Trend Rising, Frequency Decline Has Ended

Annual Change, 2005 through 2011

Cost Pressures Will Increase if BI Severity Frequency Increases Continue

Source: ISO/PCI Fast Track data; Insurance Information Institute
Severity/Frequency Trends Were Stable Through 2010, But Rising Severity in 2011 Is a Concern

Source: ISO/PCI Fast Track data; Insurance Information Institute
US No-Fault (PIP) Liability: Severity Trend Remains Adverse*

Annual Change, 2005 through 2011

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

*No-fault states included are: FL, HI, KS, KY, MA, MI, MN, NY, ND and UT.

Source: ISO/PCI Fast Track data; Insurance Information Institute
US Collision Coverage: Frequency and Severity Trends Are Up in 2011

Annual Change, 2005 through 2011

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

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

Annual Change, 2005 through 2011

Severe weather is a principal cause of the spike in both frequency and severity in 2011

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

Source: ISO/PCI Fast Track data; Insurance Information Institute
Increase in No-Fault Claim Severity: Selected States, 2004-2011

The no-fault systems in MI, NJ, NY, FL, and MN are under stress due to rising fraud and abuse, which leads to higher premiums for honest drivers.

Sources: Insurance Information Institute research from ISO/PCI Fast Track data.
Distribution Trends

Distribution by Channel Type Continues to Evolve
Independent agents steadily lost market share from the early 1980s through the early 2000s across all P/C lines, but have gained or held generally steady in recent years. Direct channels include exclusive agency companies, direct marketers and direct sales (e.g., internet).
Independent agents have lost significant personal lines market share since the early 1970s. Although the trend has slowed, it may be accelerating again.

Source: Insurance Information Institute; based on data from Conning and A.M. Best.
Independent agents have seen only modest erosion in commercial lines market share in recent decades.

Source: Insurance Information Institute; based on data from Conning and A.M. Best.
Other Cycle-Influencing Factors

Could Other Factors Act as a Catalyst to Turn the Market?
INVESTMENTS: THE NEW REALITY

Investment Performance is a Key Driver of Profitability

*Does It Influence Underwriting or Cyclicality?*
Insurers Have Not Yet Fully Adapted to a Persistently Low Interest Rate Environment

No Expectation that Rates Would Be:

- Pushed to Such Low Levels
- Pushed Down so Rapidly
- Held to Such Low Levels for So Long
- Suppressed via Unprecedented Aggressiveness of the Federal Reserve
  - Use of traditional and unconventional tools (QE)
  - Unconventional ’s policies couldn’t be anticipated, esp. QE1, 2 (3?)

Competitive Pressure→Protracted Soft Market

Ability to Release Prior Reserves Eases Urgency

Realization of Capital Gains
Investment Income in 2011 Was Surprisingly Strong, Though Investment Income Is Likely to Weaken in 2012 Due to Persistently Low Interest Rates

Investment gains consist primarily of interest and stock dividends.

*2012F-201F based on Conning projections.
Sources: ISO; Conning Research & Consulting; Insurance Information Institute.
Investment Gains in 2011 Were Surprisingly Robust. Investment Gains Recovered Significantly in 2011 Due to Realized Investment Gains; The Financial Crisis Caused Investment Gains to Fall by 50% in 2008

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.
Insurers Posted Net Realized Capital Gains in 2010 and 2011 After Following Two Years of Realized Losses During the Financial Crisis. Realized Capital Losses Were the Primary Cause of 2008/2009’s Large Drop in Profits and ROE.
Yields on 10-Year U.S. Treasury Notes have been essentially below 5% for nearly a decade.

Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

Treasury yield curve remains near its most depressed level in at least 45 years. Investment income is falling as a result. Fed is unlikely to hike rates until well into 2014.

The Fed Is Actively Signaling that it Is Determined to Keep Rates Low Through Late 2014

Source: Federal Reserve Board of Governors; Insurance Information Institute.
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.
Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?
Over the Last Three Decades, Total Tort Costs as a % of GDP Appear Somewhat Cyclical, 1980-2013E

Tort costs in dollar terms have remained high but relatively stable since the mid-2000s, but are down substantially as a share of GDP.

Sources: Towers Watson, 2011 Update on US Tort Cost Trends, Appendix 1A
Commercial Lines Tort Costs: Insured vs. Self-(Un)Insured Shares, 1973-2010

Tort Costs and the Share Retained by Risks Both Grew Rapidly from the mid-1970s to mid-2000s, When Tort Costs Began to Fall But Self-Insurance Shares Continued to Rise

The Share of Tort Costs Retained by Risks Has Been Steadily Increasing for Nearly 40 Years. This Trend Contributes Has Left Insurers With Less Control Over Pricing.

## 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

**New in 2010**

- North Dakota
- Massachusetts
- South Dakota

**Drop-offs**

- Maine
- Vermont
- Kansas

### 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

---

Midwest/West has mix of good and bad states.

The Nation’s Judicial Hellholes: 2011

**Watch List**
- Eastern District of Texas
- Cook County, IL
- Southern NJ
- Franklin County, AL
- Smith County, MS
- Louisiana

**Dishonorable Mention**
- MI Supreme Court
- AK Supreme Court
- MO Supreme Court

Source: American Tort Reform Association; Insurance Information Institute
Inflation

Is it a Threat to Claim Cost Severities
The slack in the U.S. economy suggests that inflationary pressures should remain subdued for an extended period of times. Energy, health care and commodity prices, plus U.S. debt burden, remain longer-run concerns.

Annual Inflation Rates, (CPI-U, %), 1990–2017F

Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble reduced inflationary pressures in 2009/10.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 10/11 and 5/12 (forecasts).
P/C Personal Insurance Claim Cost Drivers Grow Faster Than the Core CPI Suggests

Price Level Change: 2011 vs. 2010

Overall CPI: 3.2%
"Core" CPI: 1.7%
Inpatient Hospital Services: 6.8%
Outpatient Hospital Services: 5.1%
Prescription Drugs: 4.2%
Medical Care Commodities: 3.0%
Legal Services: 3.2%
Motor Vehicle Parts & Equipment: 5.0%
Residential Maint. & Repair: 7.1%

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

Drivers Grow Faster than the Overall CPI Suggests

Price Level Change: 2011 vs. 2010

Copper prices spiked and retreated in 2011. In July its price was 33% higher than a year earlier; by November it cost 8% less than in November 2010.

Medical Cost Inflation Has Outpaced Overall Inflation For Over 50 Years

A claim that cost $1,000 in 1961 would cost nearly $17,500 based on medical cost inflation trends over the past 51 years.

Source: Department of Labor (Bureau of Labor Statistics)
Thank you for your time and your attention!

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