Financial Crisis and the State of the P/C Insurance Industry

Challenges Amid the Global Economic Storm

Informational Hearing of the Connecticut Insurance and Real Estate Committee

Hartford, CT

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Insurance: One of Connecticut's Most Critical Industries

Industry's Economic Contributions at a Glance

- **Insurers Contribute $15 Billion to the CT Economy**
- **Insurers Employee 74,000 people directly and support twice as many indirectly**
- **Payroll Expenditures Total $8.6 Billion Annually**

Source: Insurance Information Institute.

Critical Differences Between P/C Insurers and Banks

Superior Risk Management Model & Low Leverage Make a Big Difference

Reasons Why P/C Insurers Have Fewer Problems Than Banks

- **Superior Risk Management Model**
  - **Insurers overall approach to risk focuses on underwriting discipline: implies pricing accuracy and management of potential loss exposure**
  - **Banks eventually sought to maximize volume, disregarded risk**
- **Low Leverage**
  - **Insurers do not rely on borrowed money to underwrite insurance or pay claims**
- **Conservative Investment Philosophy**
  - **High quality portfolio that is relatively less volatile and more liquid**
- **Strong Relationship Between Underwriting and Risk Bearing**
  - **Insurers always maintain a stake in the business they underwrite, keeping "skin in the game" at all times**
  - **Banks and investment banks package up and securitize, severing the link between risk underwriting and risk bearing, with (predictably) disastrous consequences**
- **Tighter Regulation**
  - **Insurers are more stringently regulated than banks, investment banks & hedge funds**
- **Greater Transparency**
  - **Insurer companies are an open book to regulators and the public**

Source: Insurance Information Institute

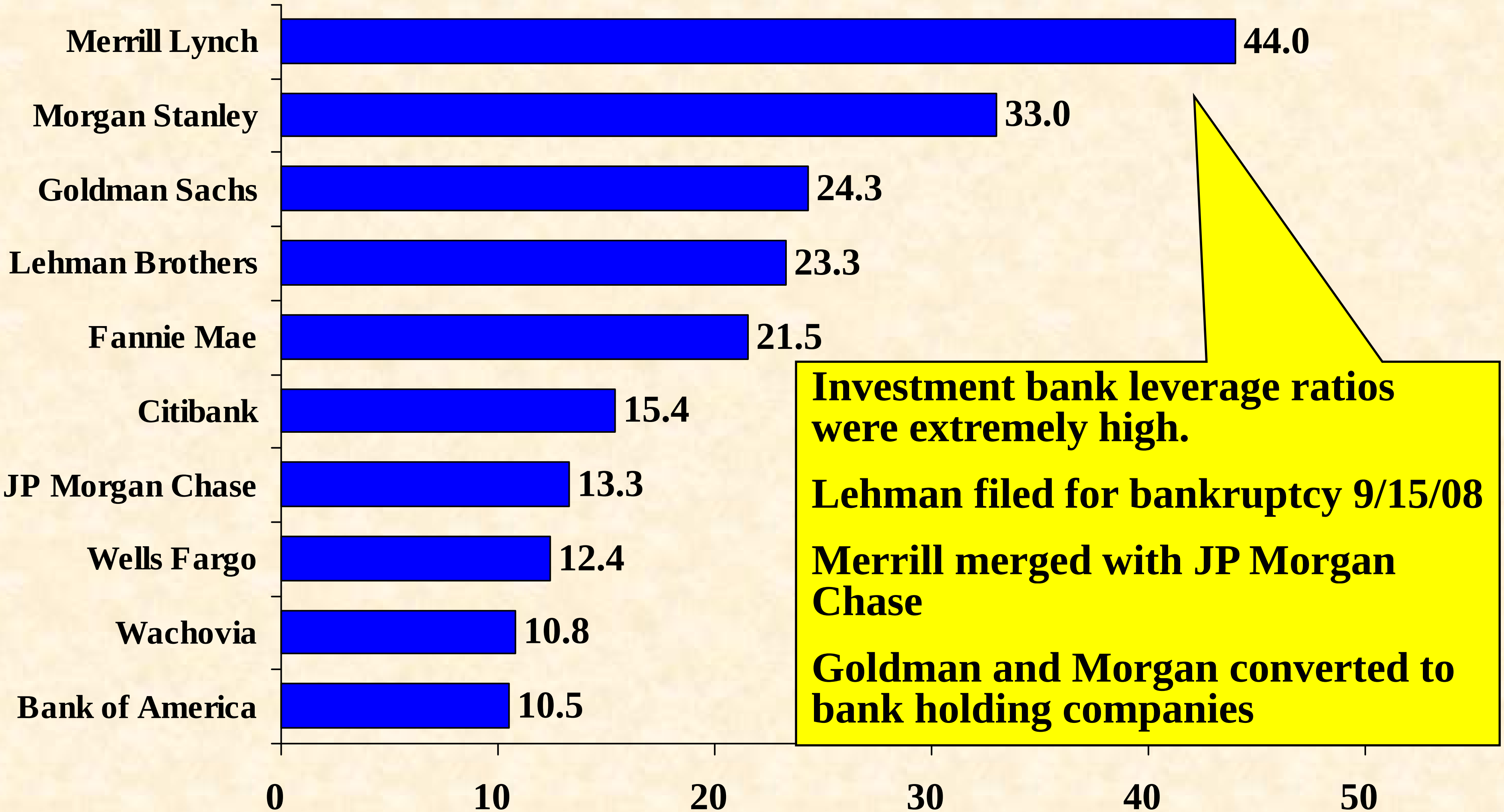
How Insurance Industry Stability Has Benefitted Consumers

BOTTOM LINE:

- **Insurance Markets—Unlike Banking—Are Operating *Normally***
- **The Basic Function of Insurance—the Orderly Transfer of Risk from Client to Insurer—C ontinues *Uninterrupted***
- **This Means that Insurers Continue to:**
  - **Pay claims (whereas 25 banks have gone under)**
  - **Renew existing policies (banks are reducing and eliminating lines of credit)**
  - **Write new policies (banks are turning away people who want or need to borrow)**
  - **Develop new products (banks are scaling back the products they offer)**

Source: Insurance Information Institute

Leverage Ratios for Investment Banks and Traditional Banks*



*Based on data for last quarter reported (May or June 2008).
Source: "*The Perils of Leverage,*" North Coast Investment Research, Sept. 15, 2008

How Does Leverage Work?

- **Example of Non-Leveraged Transaction**
  - **Buy 1 share of stock for $100**
  - **Price of share rises to $110**
  - **RETURN = $10 or 10%**
- **Leveraged Transaction**
  - **Invest $10 and borrow $90**
  - **Stock rises to $110**
  - **RETURN = $10 *or 100%* (less borrowing costs)**
- **This Pleasant Arithmetic Works Equally Unpleasantly in the Opposite Direction**
- **Declining asset values, seizing of credit markets made such borrowing impossible and the operating model of investment banks nonviable**

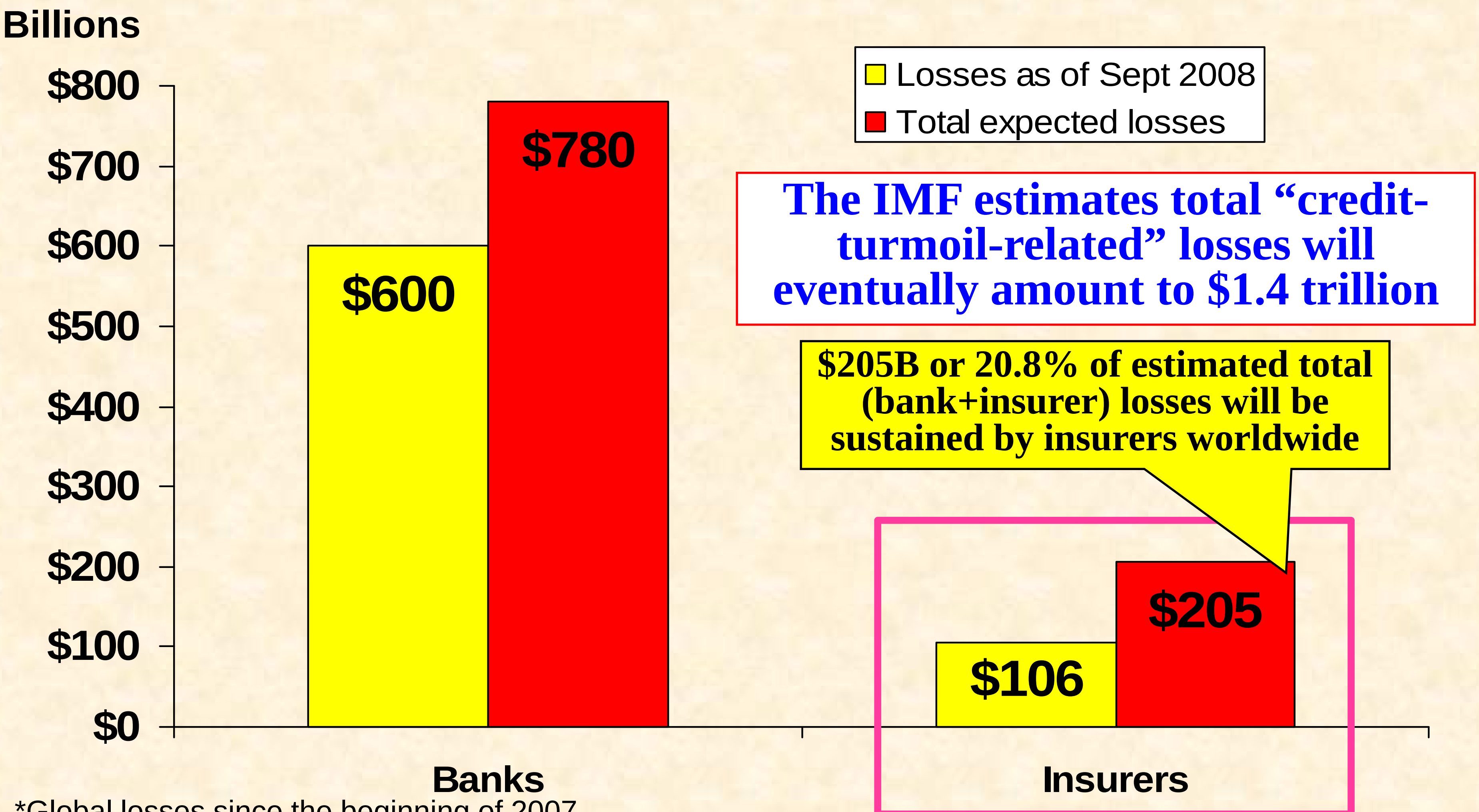
Investment banks and others juiced their returns by making big, bad bets with (mostly) borrowed money on mortgage securities

Source: Insurance Information Institute.

The Financial Crisis in Perspective

Bank vs. Insurer Impacts

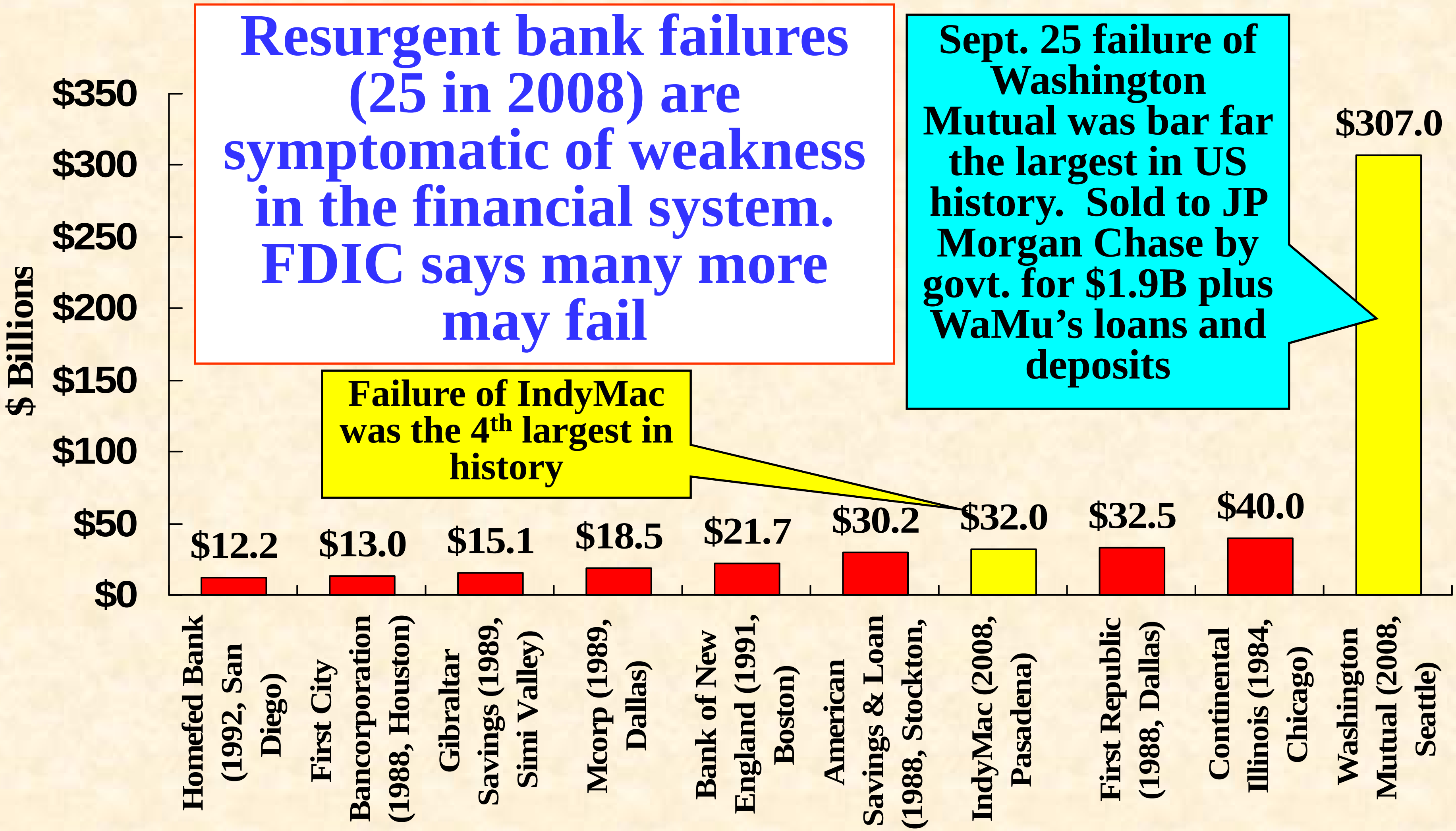
*Financial Institutions Globally Facing Huge Losses from the Credit Crunch**



*Global losses since the beginning of 2007.

Source: IMF Global Financial Stability Report, October 2008, IIF, Bloomberg, cited in a presentation by Thomas Hess (Chief Economist, Swiss Re) October 23, 2008, accessed via Geneva Association web site.

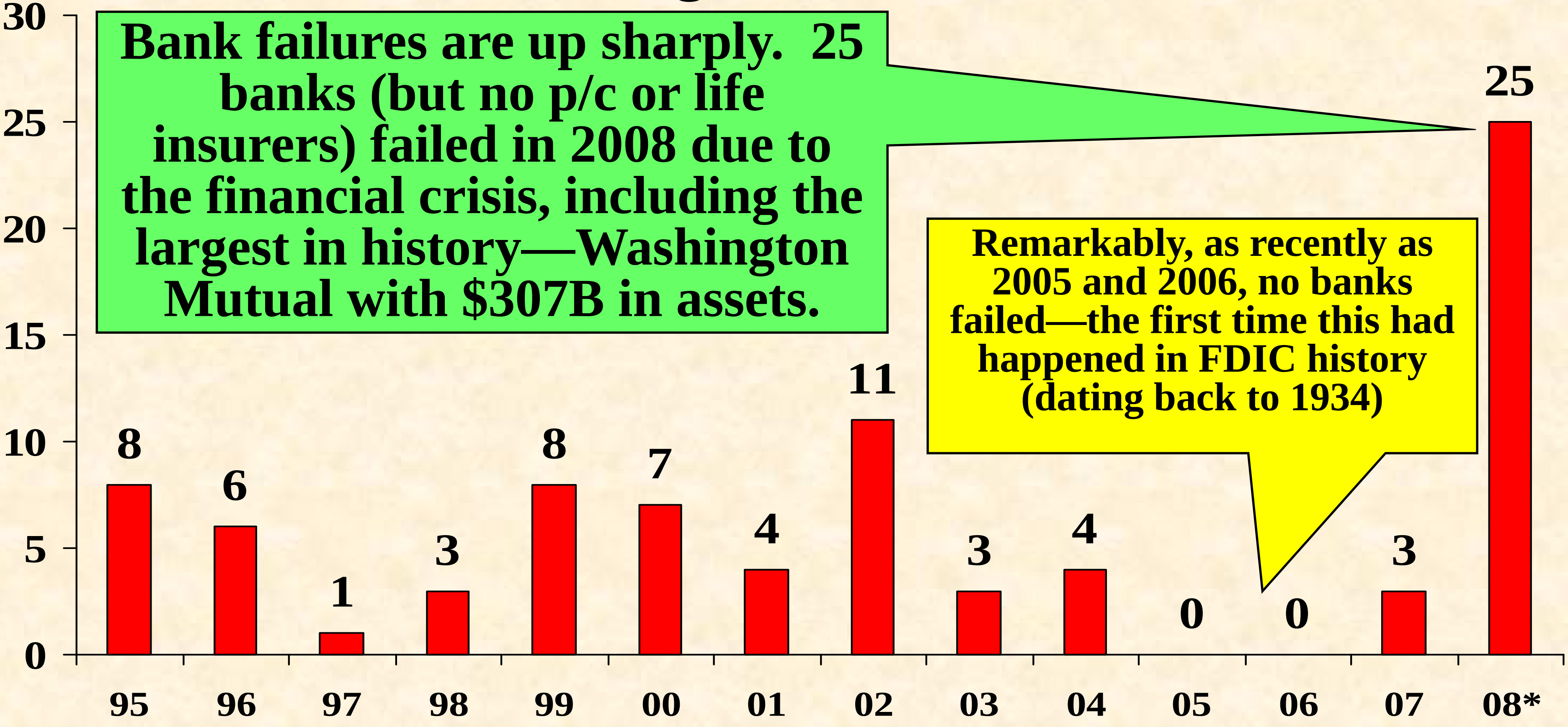
Top 10 Largest Bank Failures



Source: FDIC; Insurance Information Institute research.

US Bank Failures: 1995-2008*

Through December 31, 2008

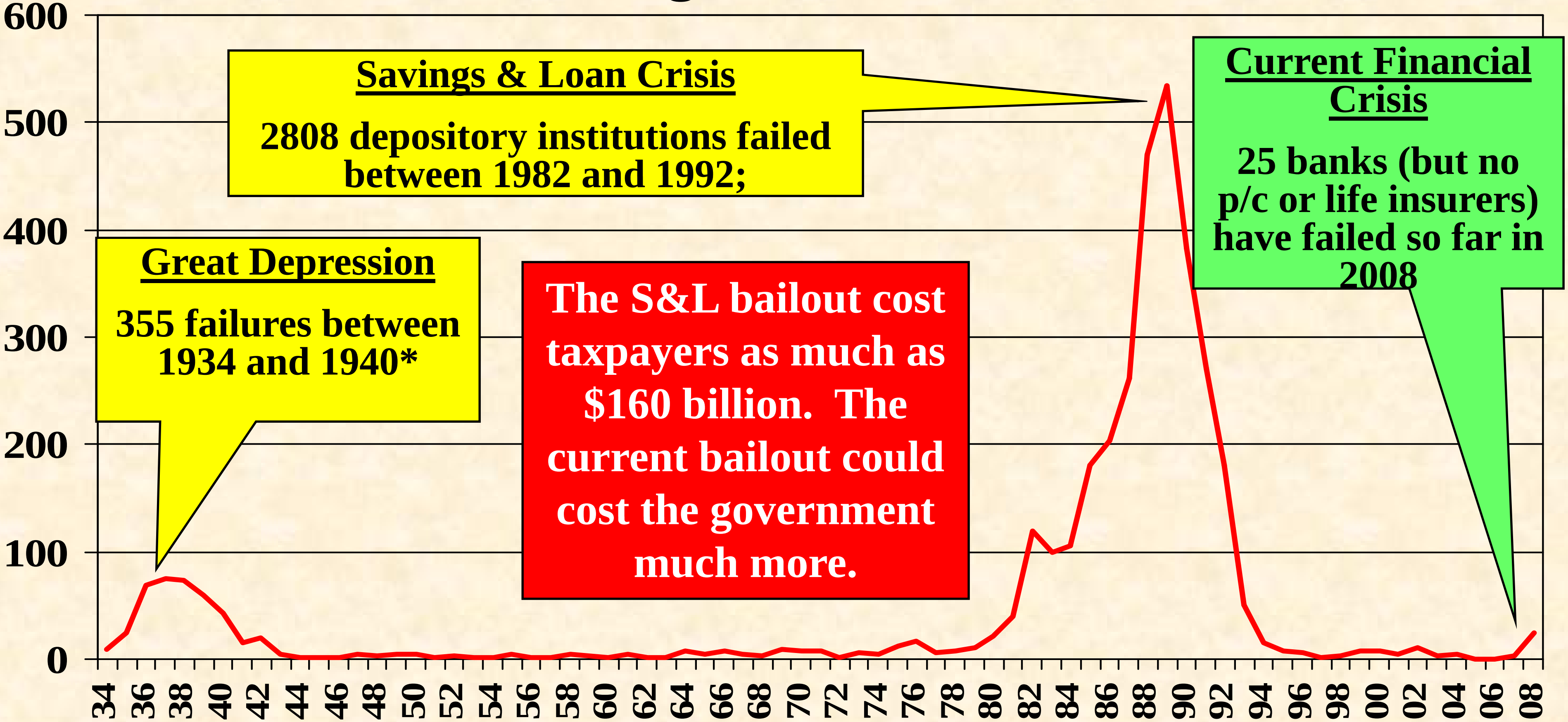


*Includes all commercial banking and savings institutions.

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

US Bank Failures: 1934-2008***

Through December 31, 2008

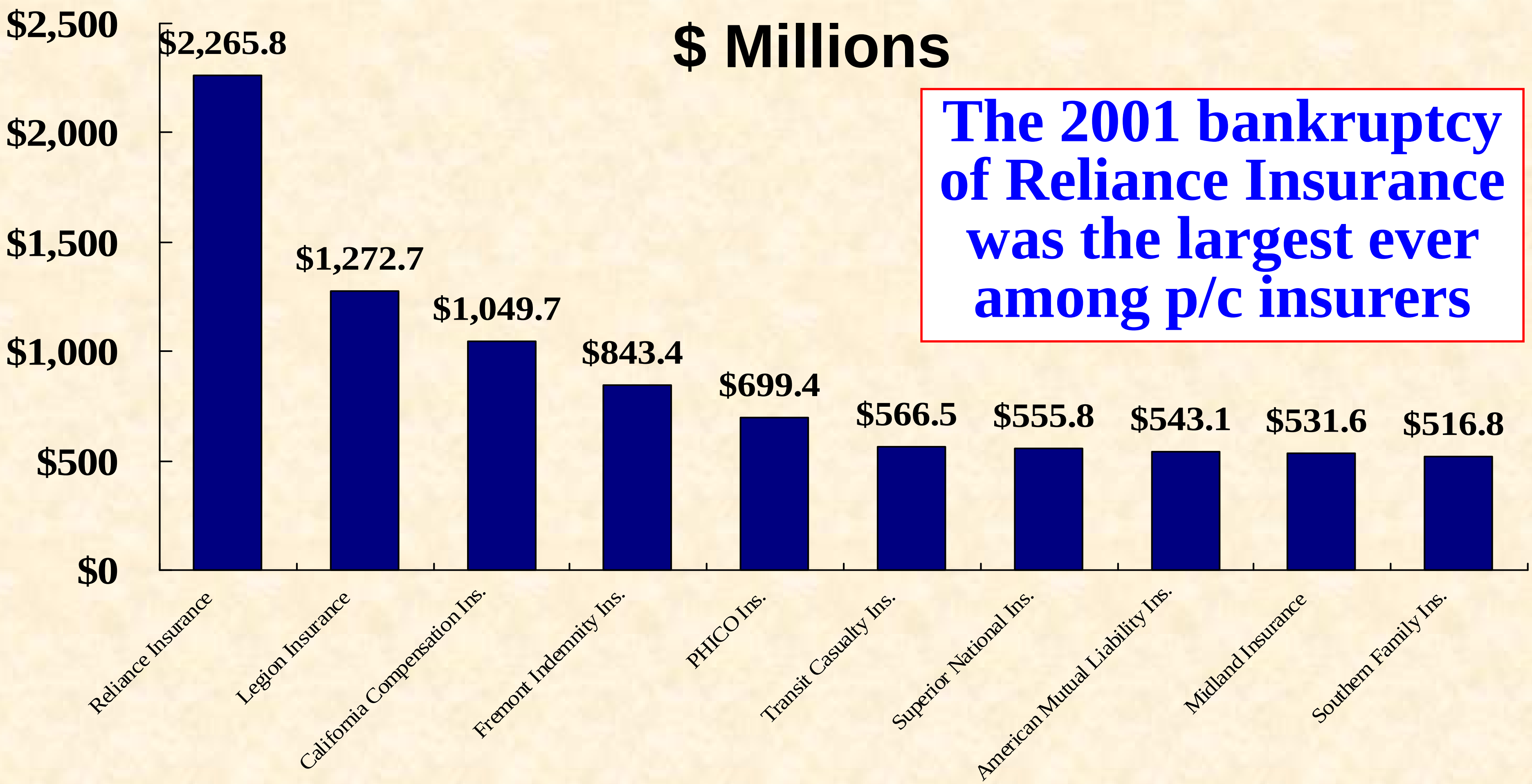


*Includes all commercial banking and savings institutions.

**Data begin in 1934, the year the FDIC was established.

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

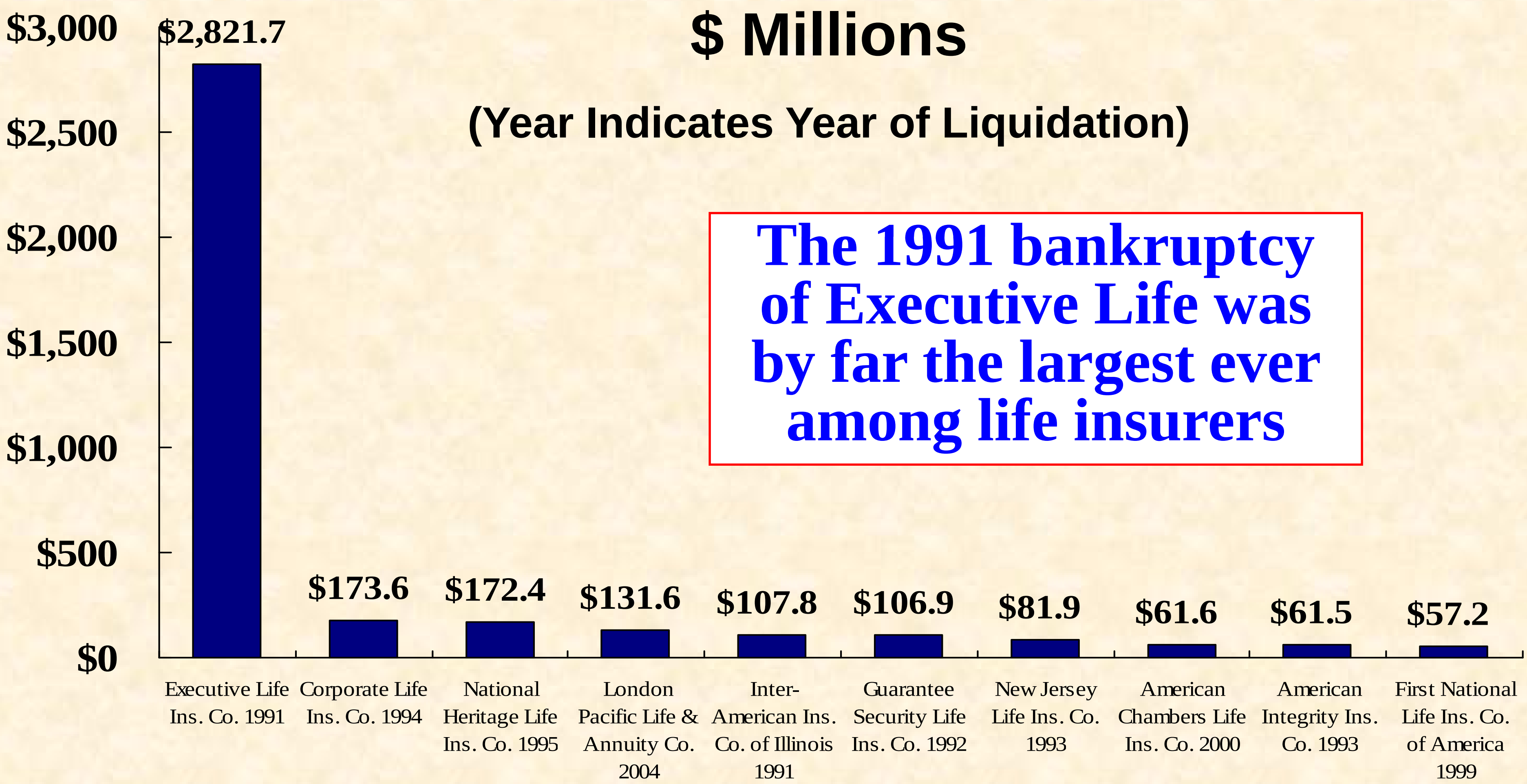
Top 10 P/C Insolvencies, Based Upon Guaranty Fund Payments*



* Disclaimer: This is not a complete picture. If anything the numbers are understated as some states have not reported in certain years.

Source: National Conference of Insurance Guaranty Funds, as of September 17, 2008.

Top 10 Life Insolvencies, Based On Guaranty Fund Payments and Net Estimated Costs*



*As of 2007.

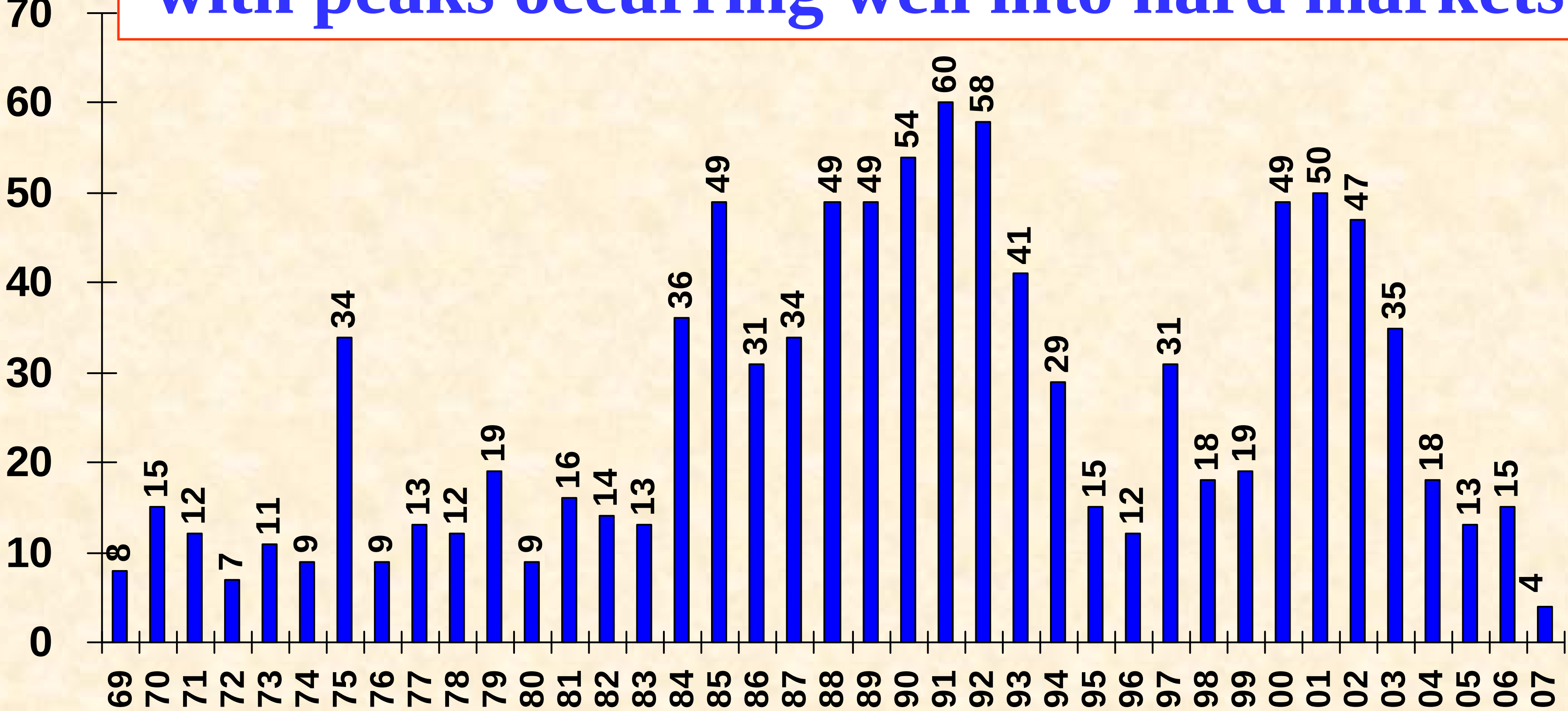
Source: National Organization of Life and Health Guaranty Funds

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well

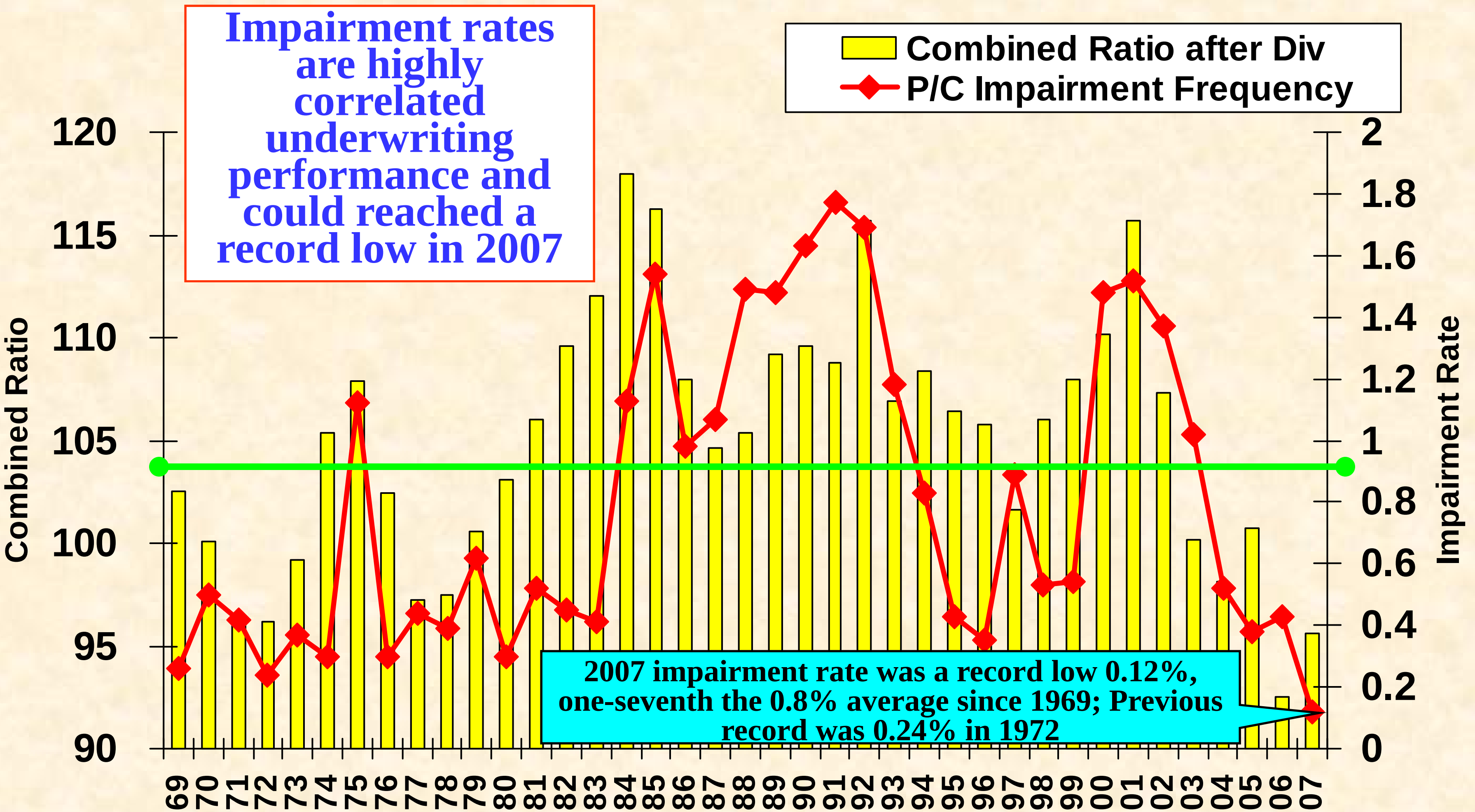
P/C Insurer Impairments, 1969-2007

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



Source: A.M. Best; Insurance Information Institute

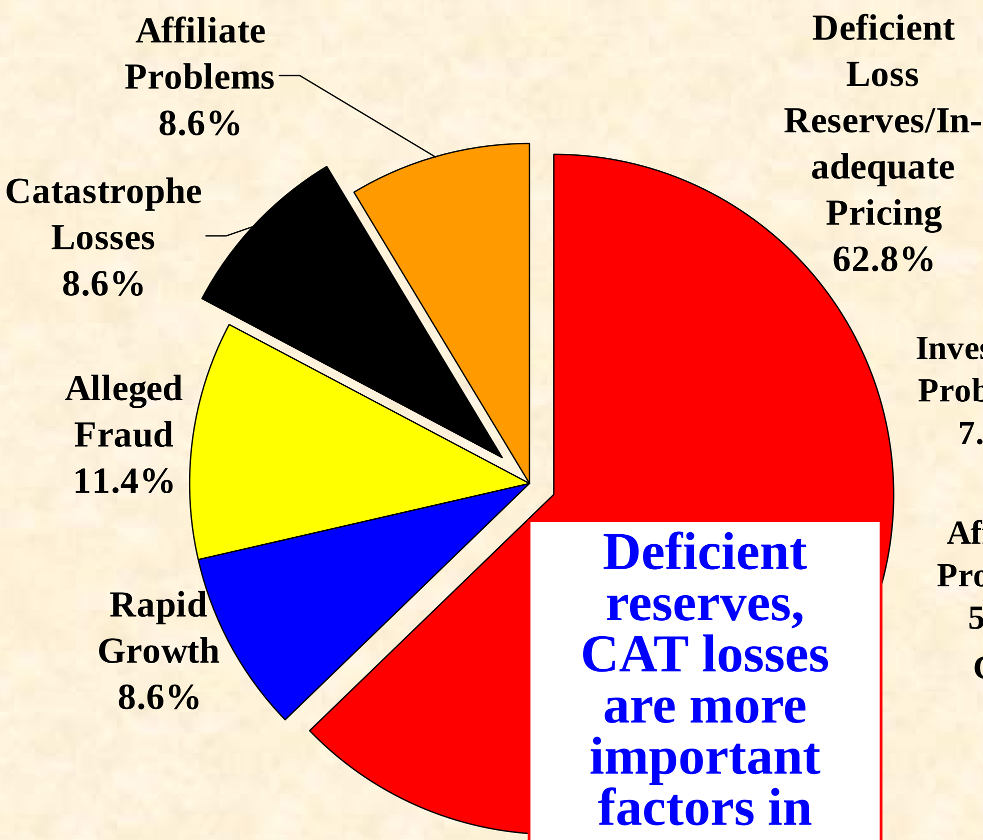
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2007



Source: A.M. Best; Insurance Information Institute

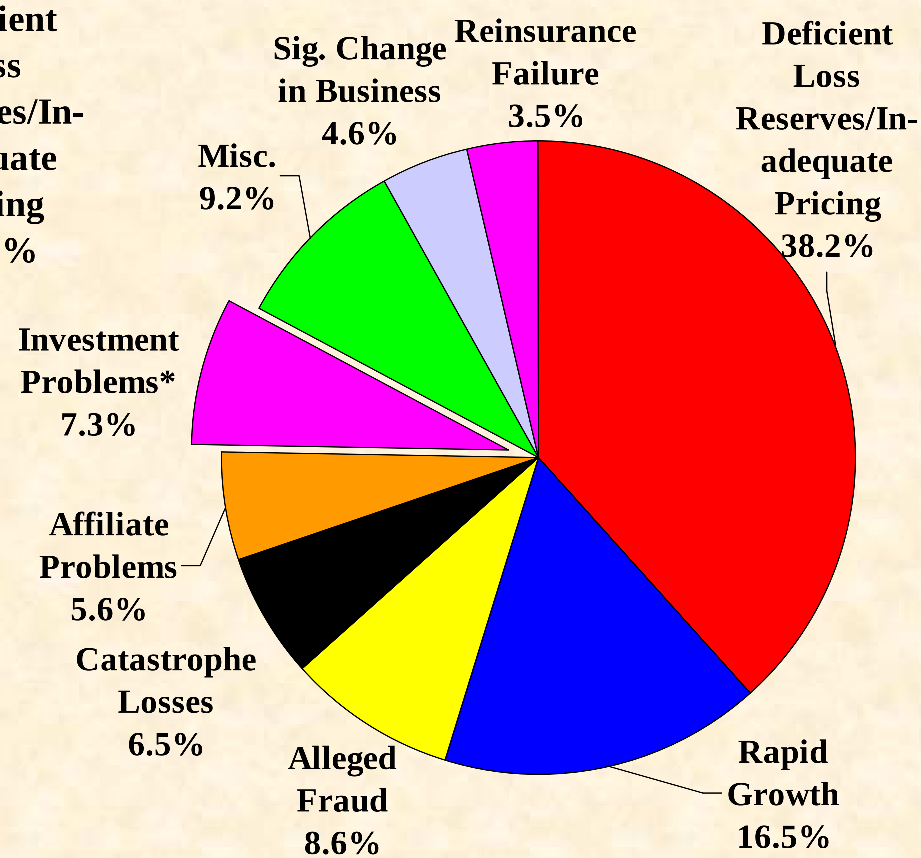
Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



Deficient reserves, CAT losses are more important factors in recent years

1969-2005



*Includes overstatement of assets.

Source: A.M. Best: *P/C Impairments Hit Near-Term Lows Despite Surging Hurricane Activity*, Special Report, Nov. 2005;

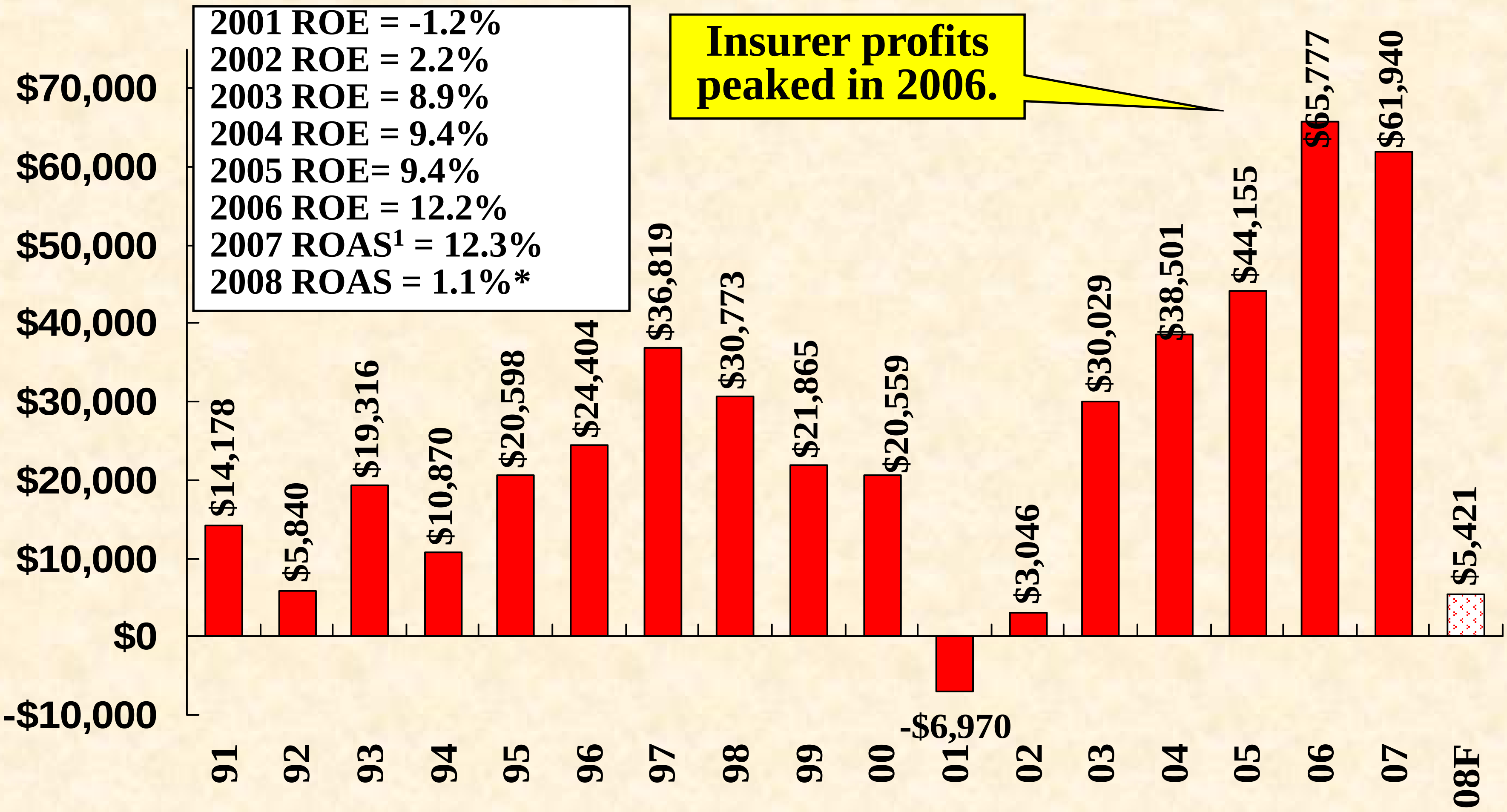
P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

Historically Volatile

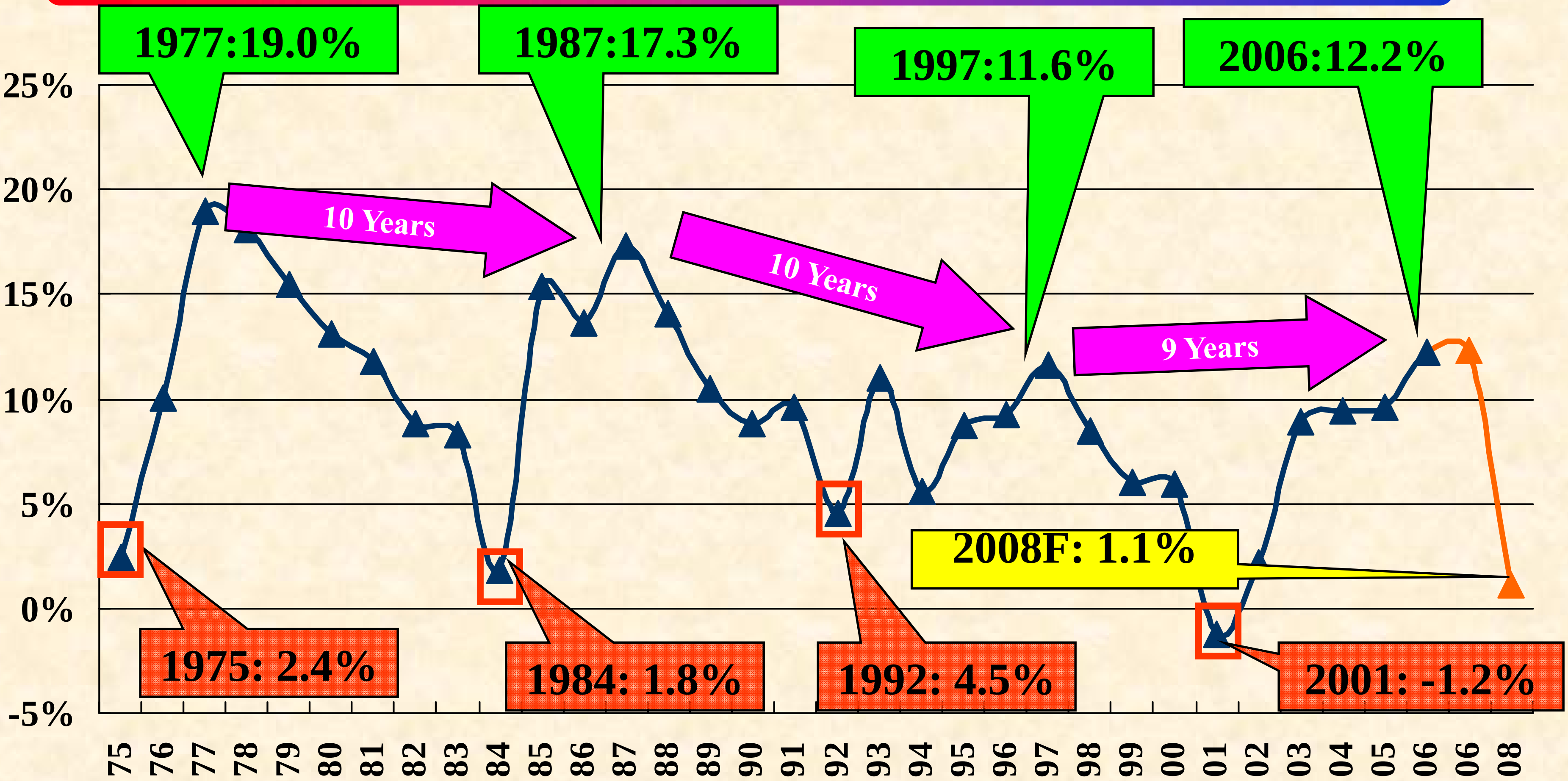
P/C Net Income After Taxes 1991-2009F ($ Millions)*



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

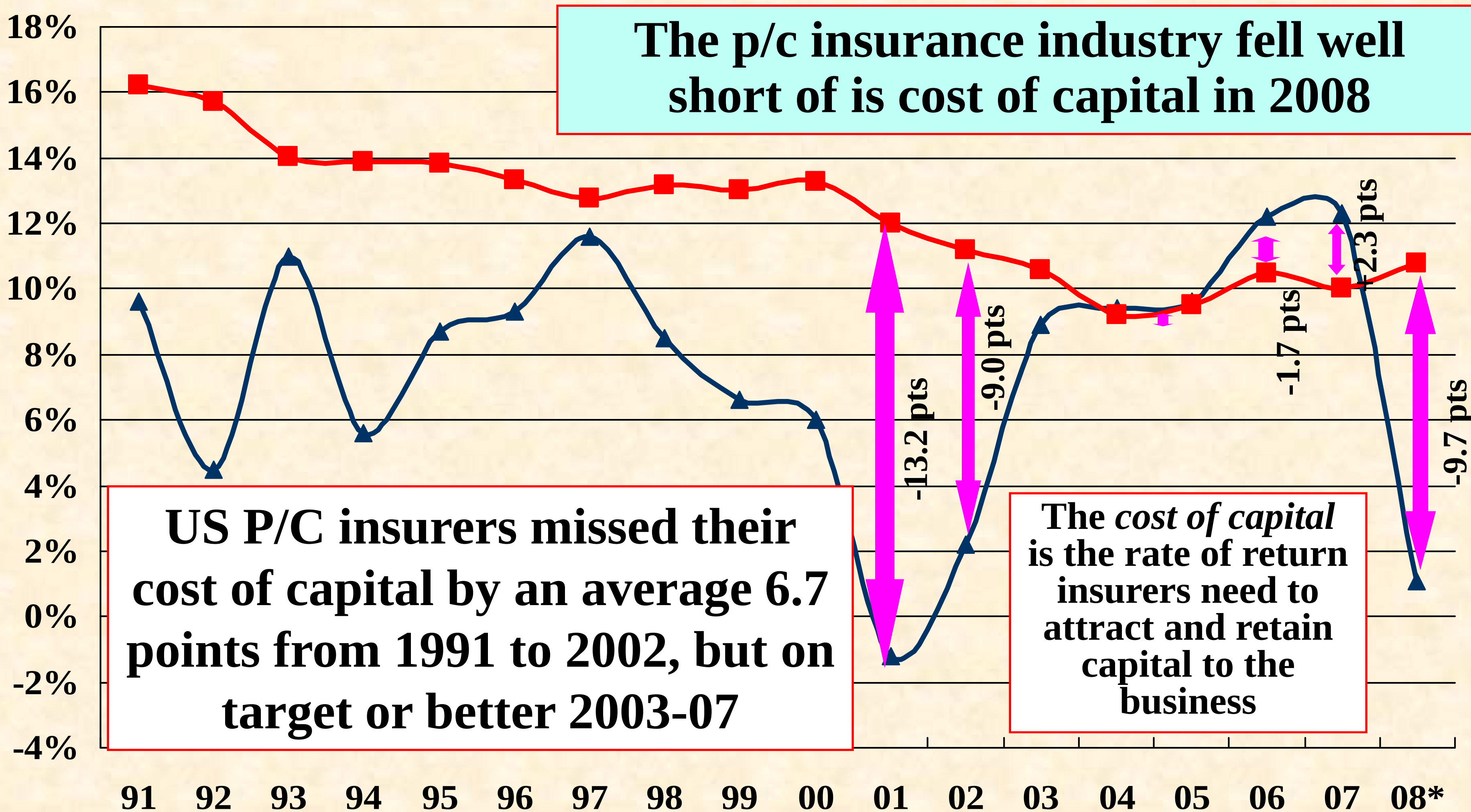
Sources: A.M. Best, ISO, Insurance Information Inst.

*P/C Insurance Industry ROEs, 1975 – 2008E**



Note: 2008 figure is actual 9-month result.
Sources: ISO; Insurance Information Institute.

ROE vs. Equity Cost of Capital: US P/C Insurance:1991-2008:Q3



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

Investment Performance

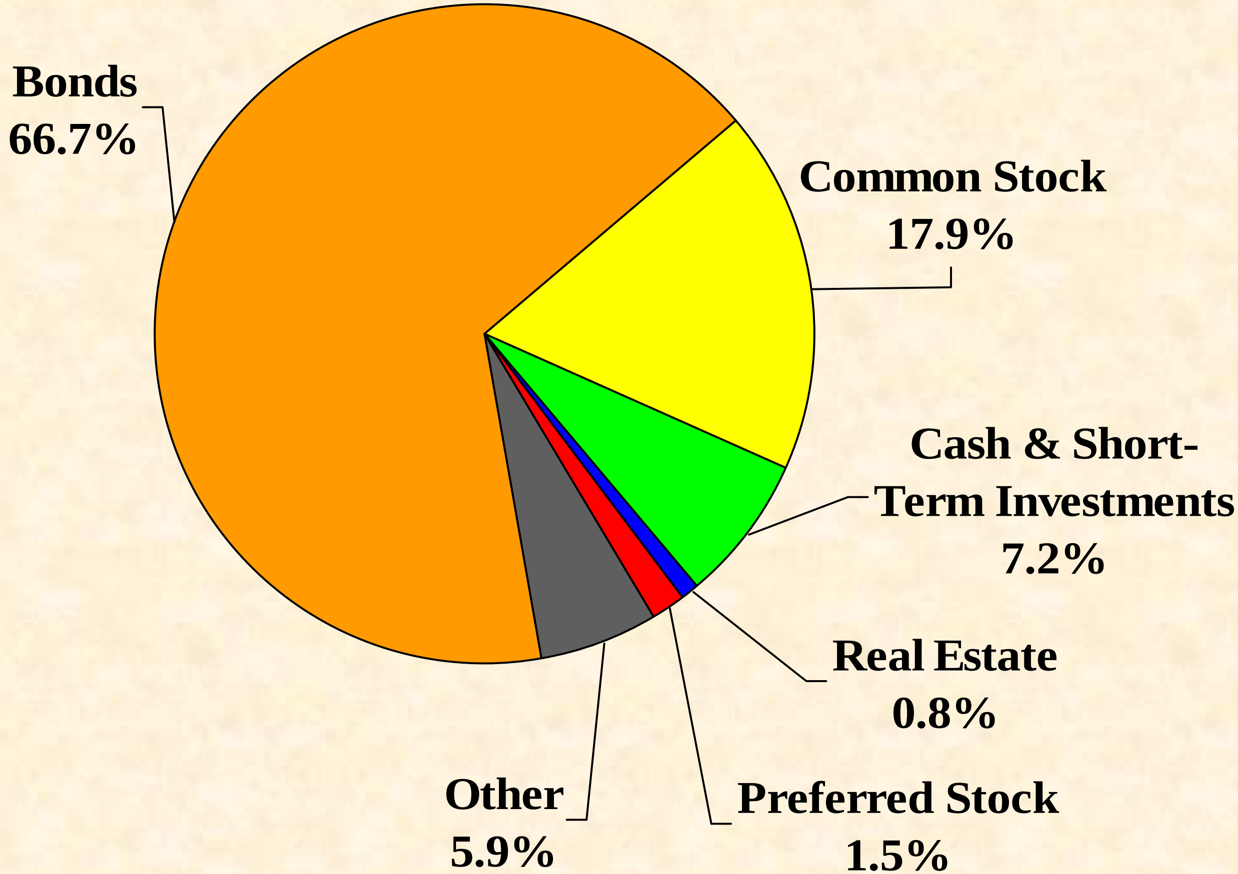
Investments are the Principle Source of Declining Profitability

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2007

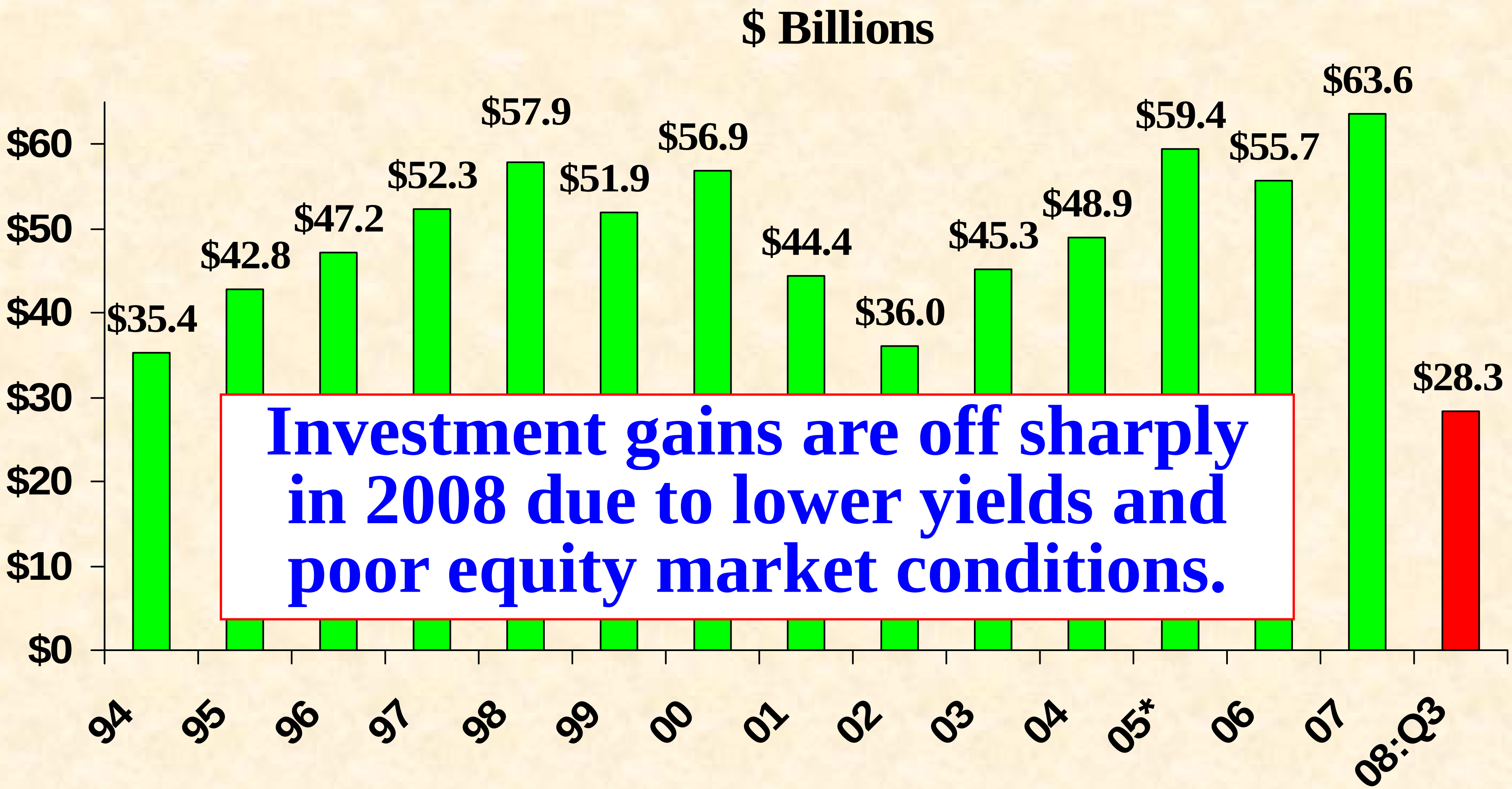
Portfolio Facts

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



Source: NAIC; Insurance Information Institute research;.

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

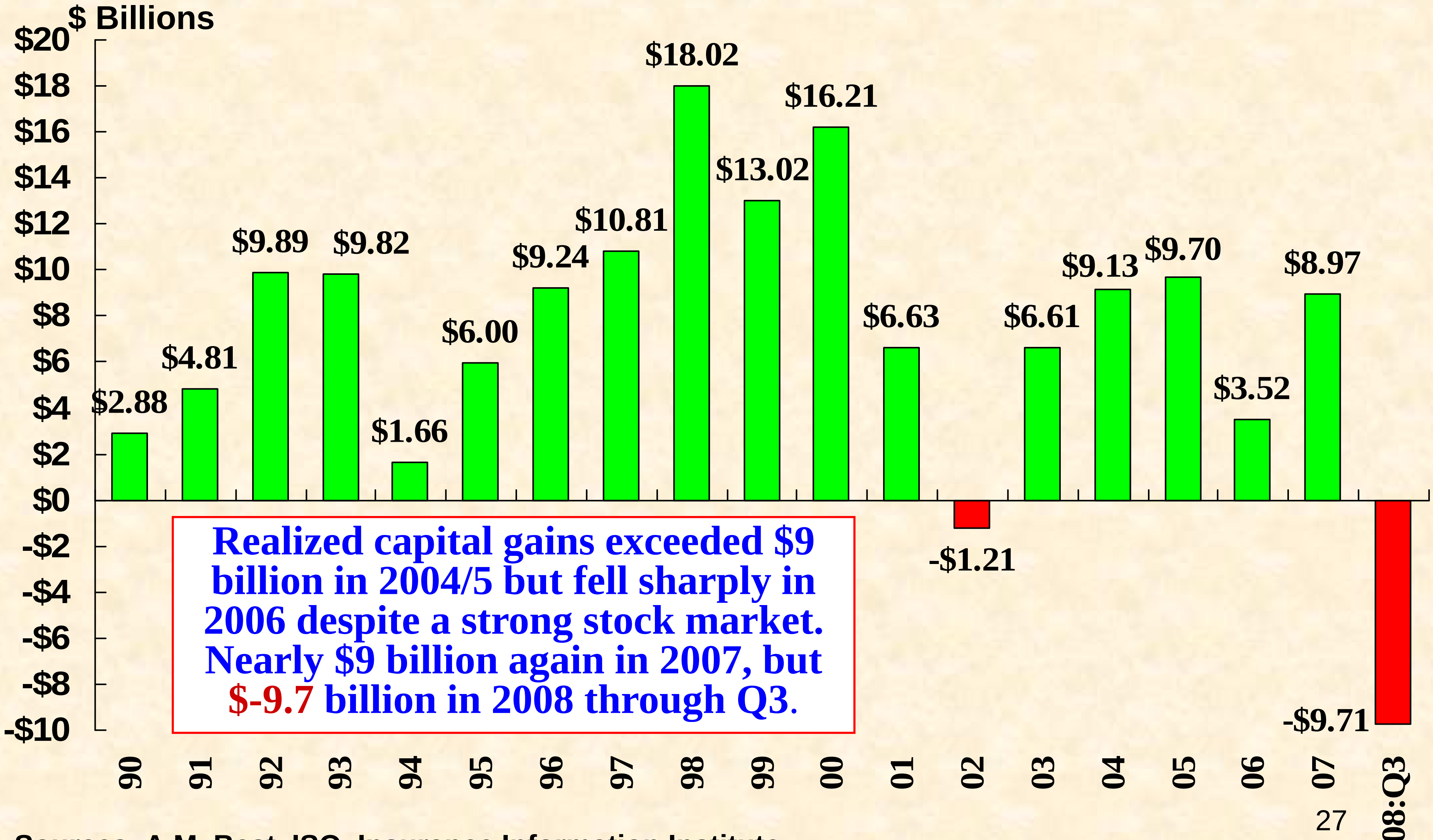


[1]Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of $52.3B net investment income and $3.4B realized investment gain.

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

Sources: ISO; Insurance Information Institute.

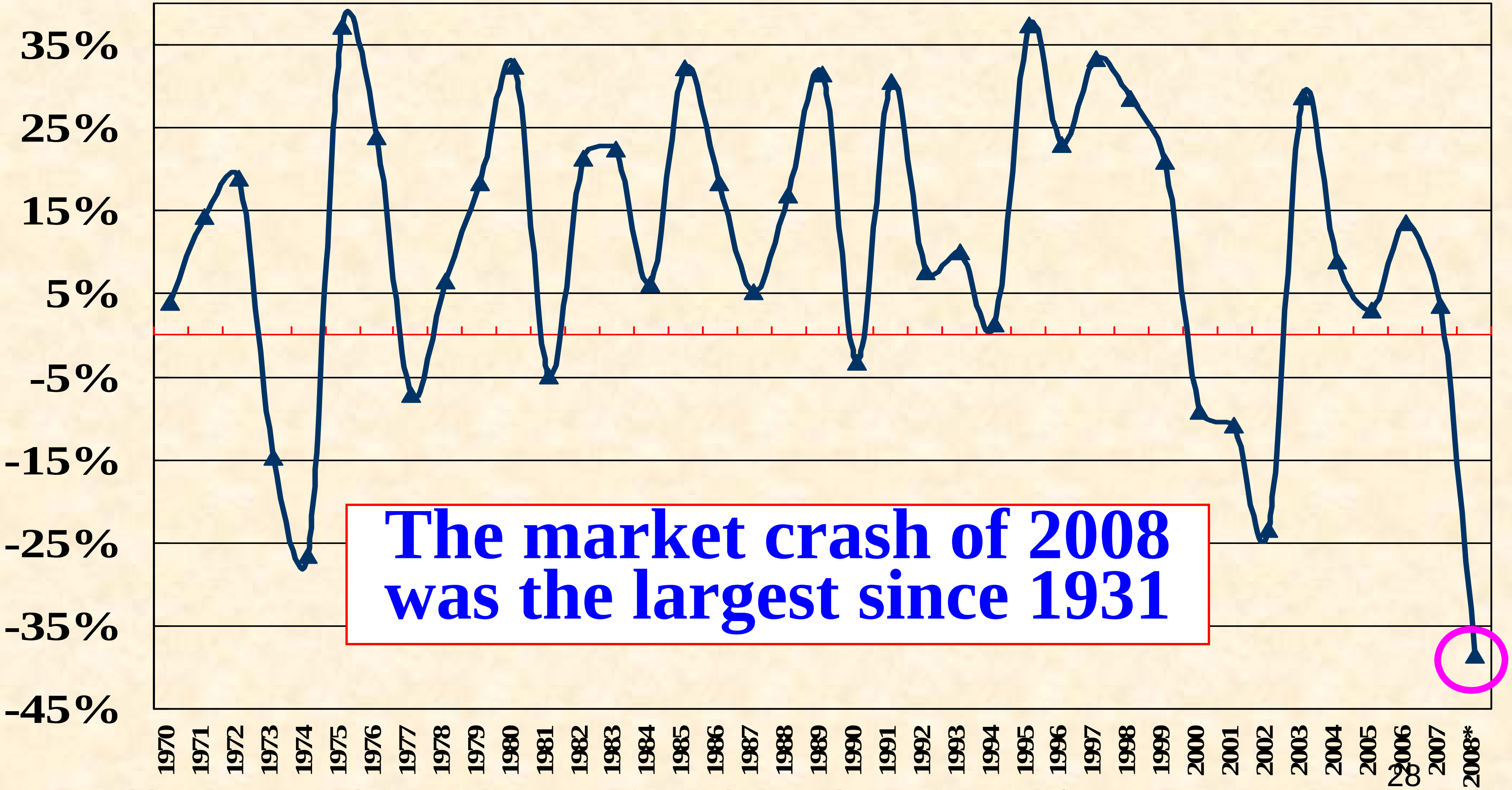
P/C Insurer Net Realized Capital Gains, 1990-2008:Q3



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

Total Returns for Large Company Stocks: 1970-2008*

S&P 500 was down 38.5% in 2008*



Source: Ibbotson Associates, Insurance Information Institute.

*Through December 31, 2008.

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

Stock market volatility is at its highest levels since the 1930s, pushing the VIX Volatility Index (a.k.a. "Investor Fear Gauge") to record highs in 2008

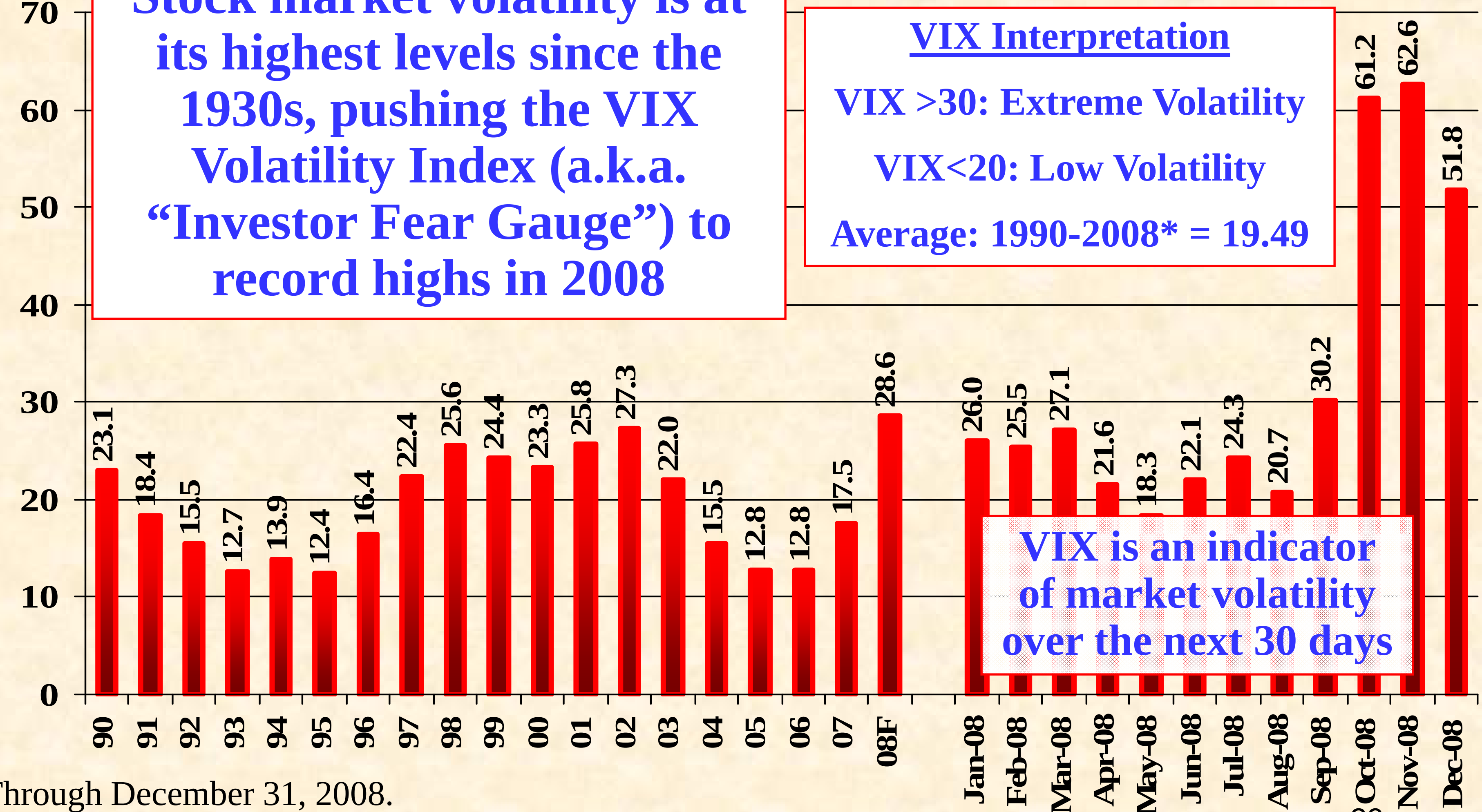
<u>VIX Interpretation</u>

VIX >30: Extreme Volatility

VIX<20: Low Volatility

Average: 1990-2008* = 19.49

VIX is an indicator of market volatility over the next 30 days



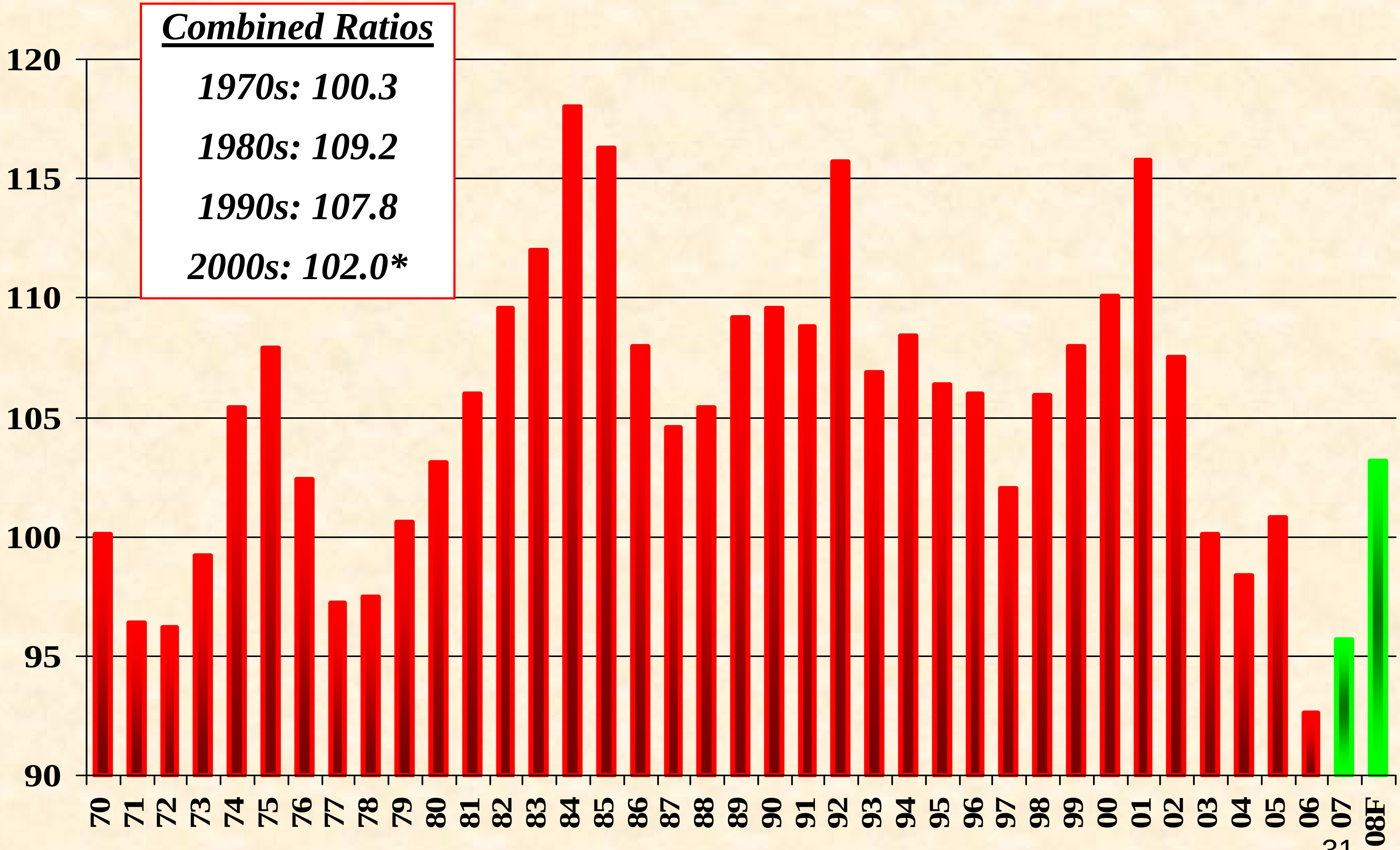
*Through December 31, 2008.

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

Underwriting Trends

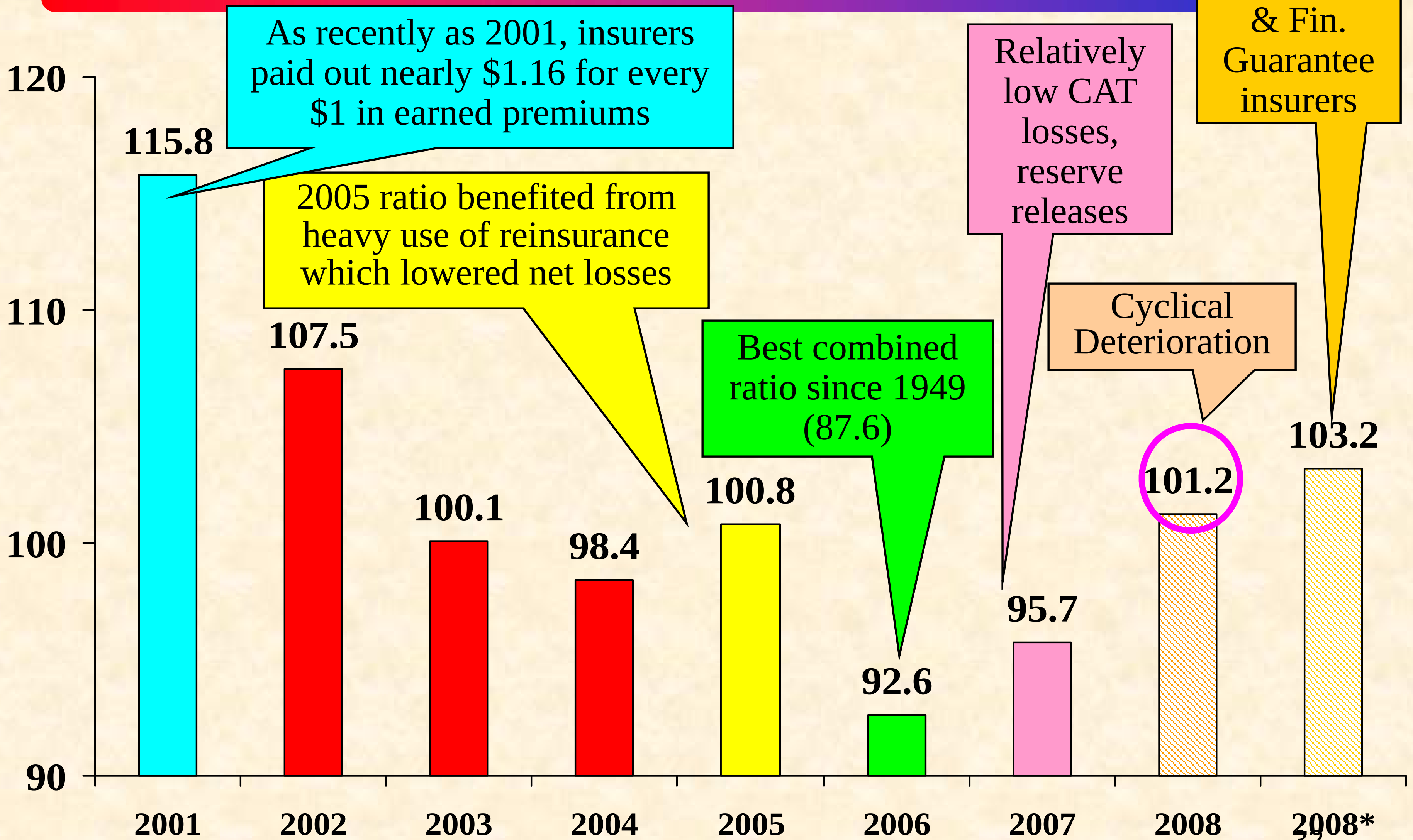
Financial Crisis Does *Not* Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

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



Sources: A.M. Best; ISO, III *A.M. Best year end estimate of 103.2; Actual 9-mos. result was 105.6.

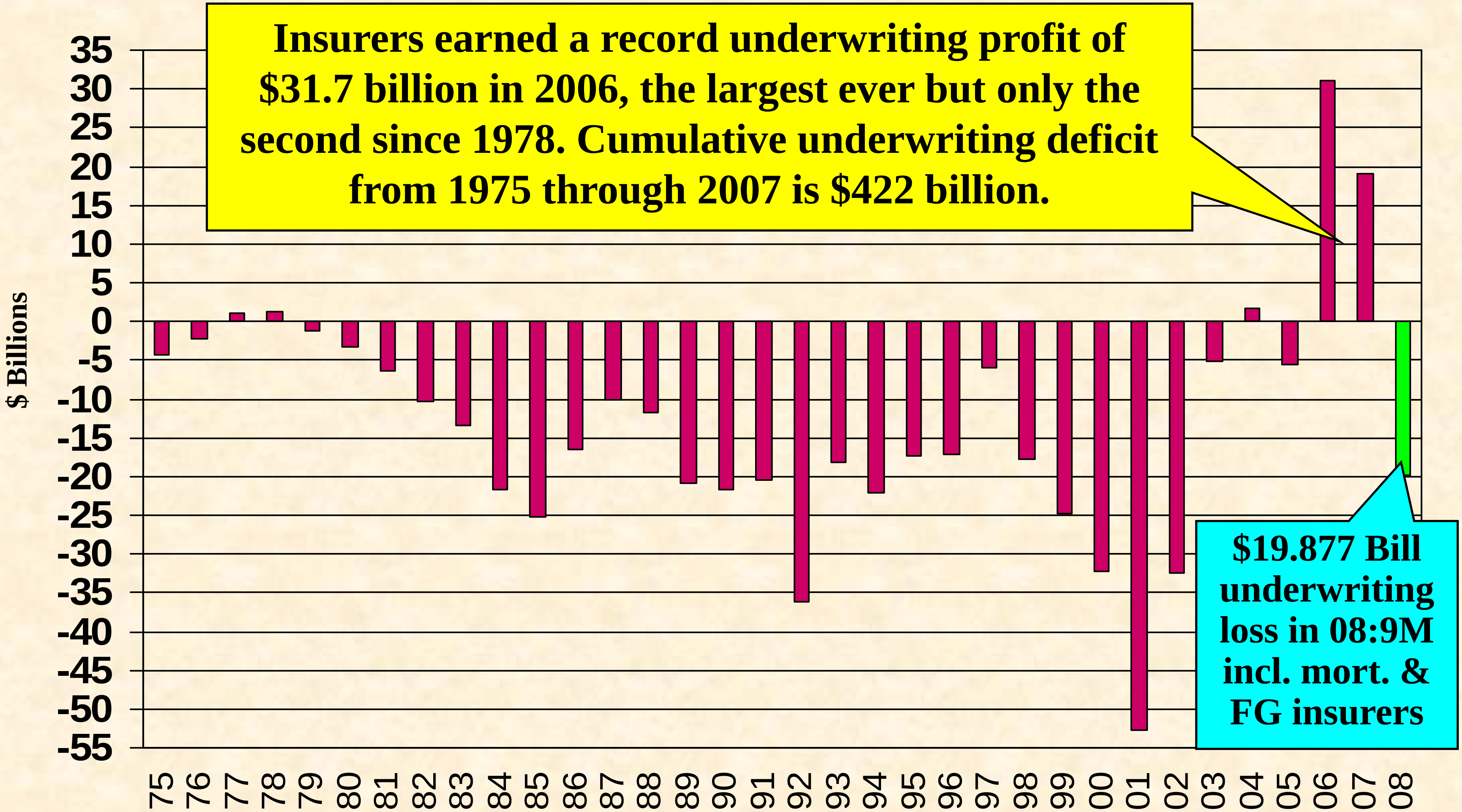
P/C Insurance Industry Combined Ratio, 2001-2008E



*Includes Mortgage & Financial Guarantee insurers.

Sources: A.M. Best, ISO; III.

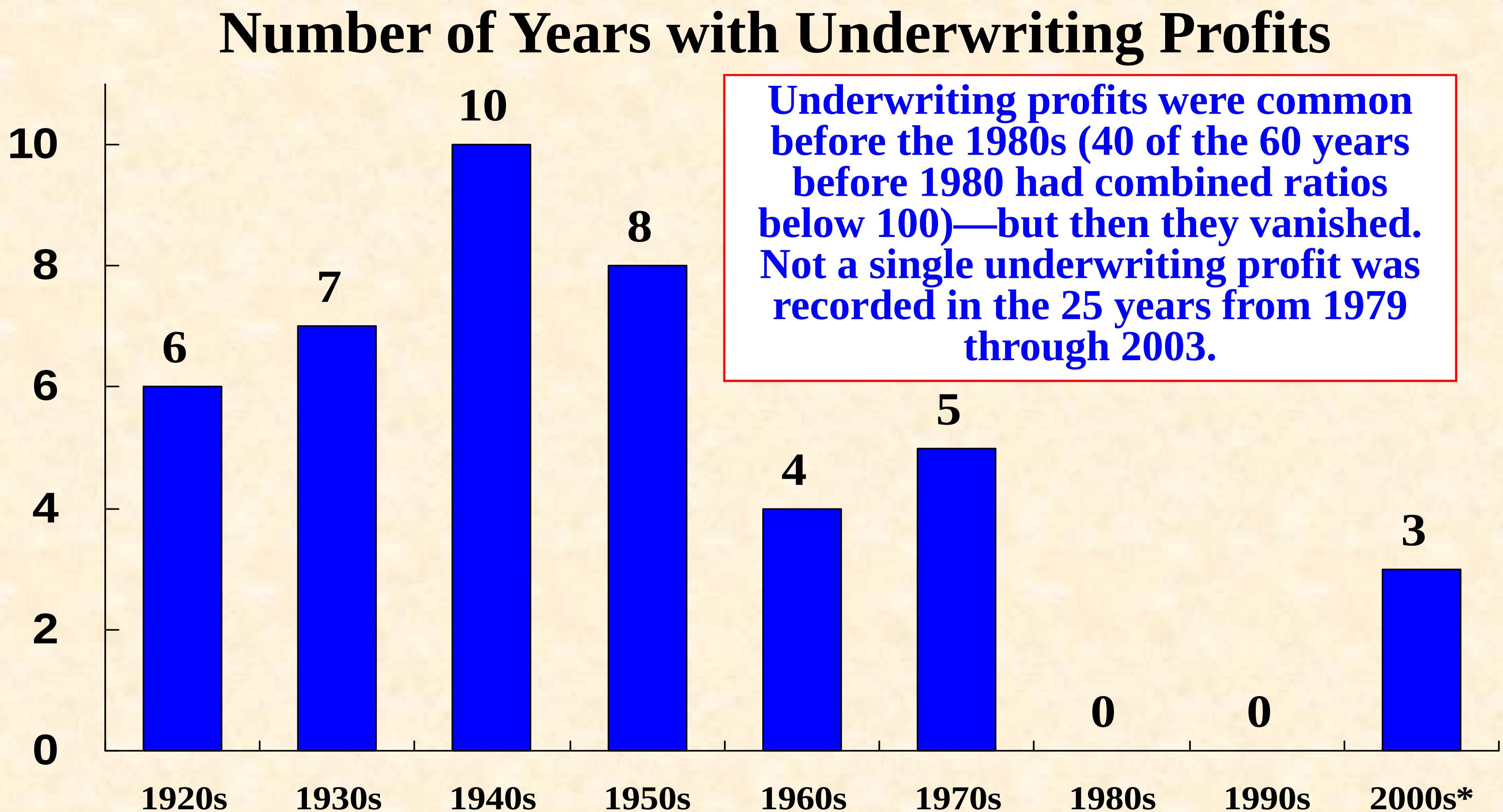
*Underwriting Gain (Loss) 1975-2008:Q3**



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

* Includes mortgage & finl. guarantee insurers

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



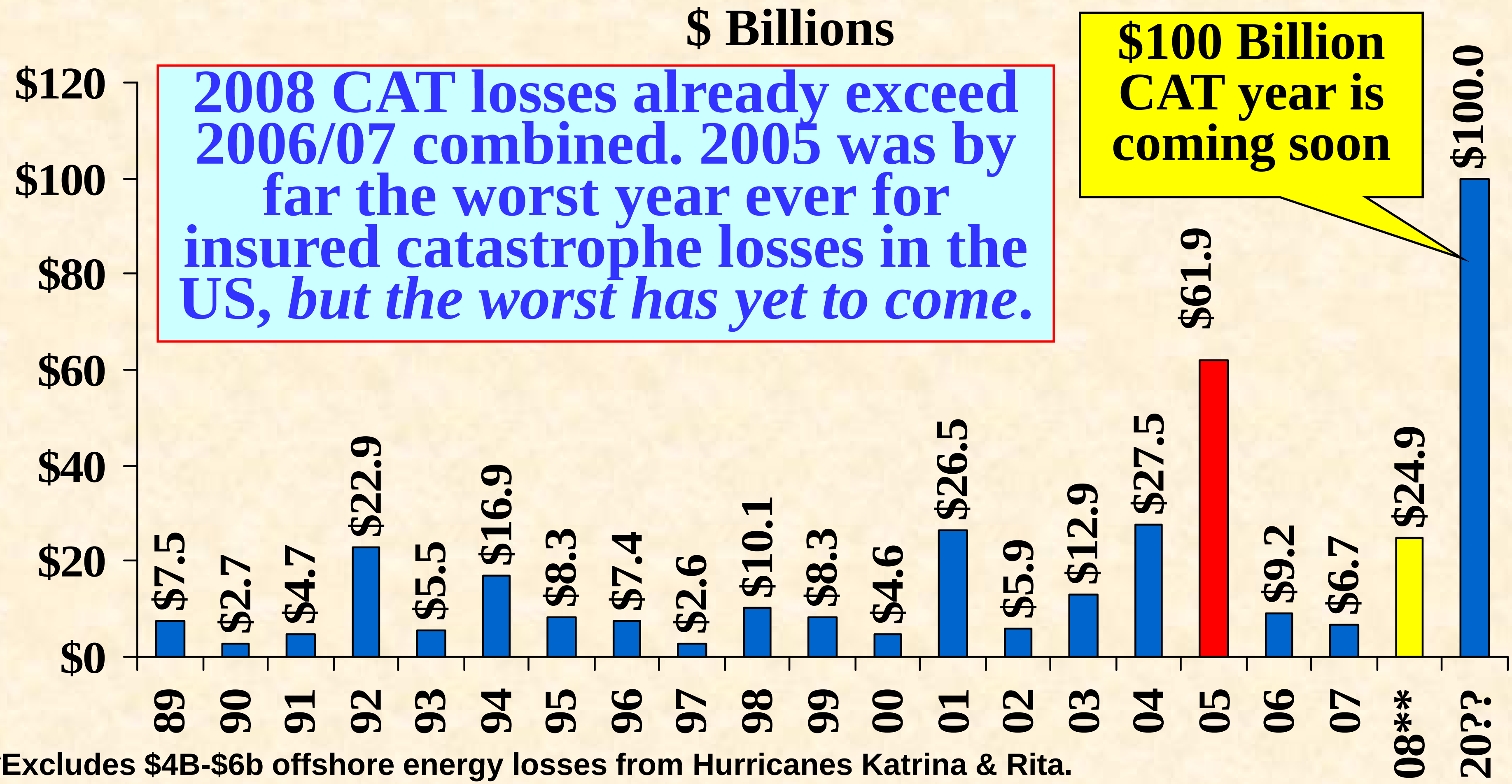
Underwriting profits were common before the 1980s (40 of the 60 years before 1980 had combined ratios below 100)—but then they vanished. Not a single underwriting profit was recorded in the 25 years from 1979 through 2003.

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

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

*2000 through 2008.

U.S. Insured Catastrophe Losses*



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

**Based on PCS data through Sept. 30. PCS $2.1B loss of for Gustav. $10.655B for Ike of 12/05/08.

<u>Note</u>: 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.

Source: Property Claims Service/ISO; Insurance Information Institute

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

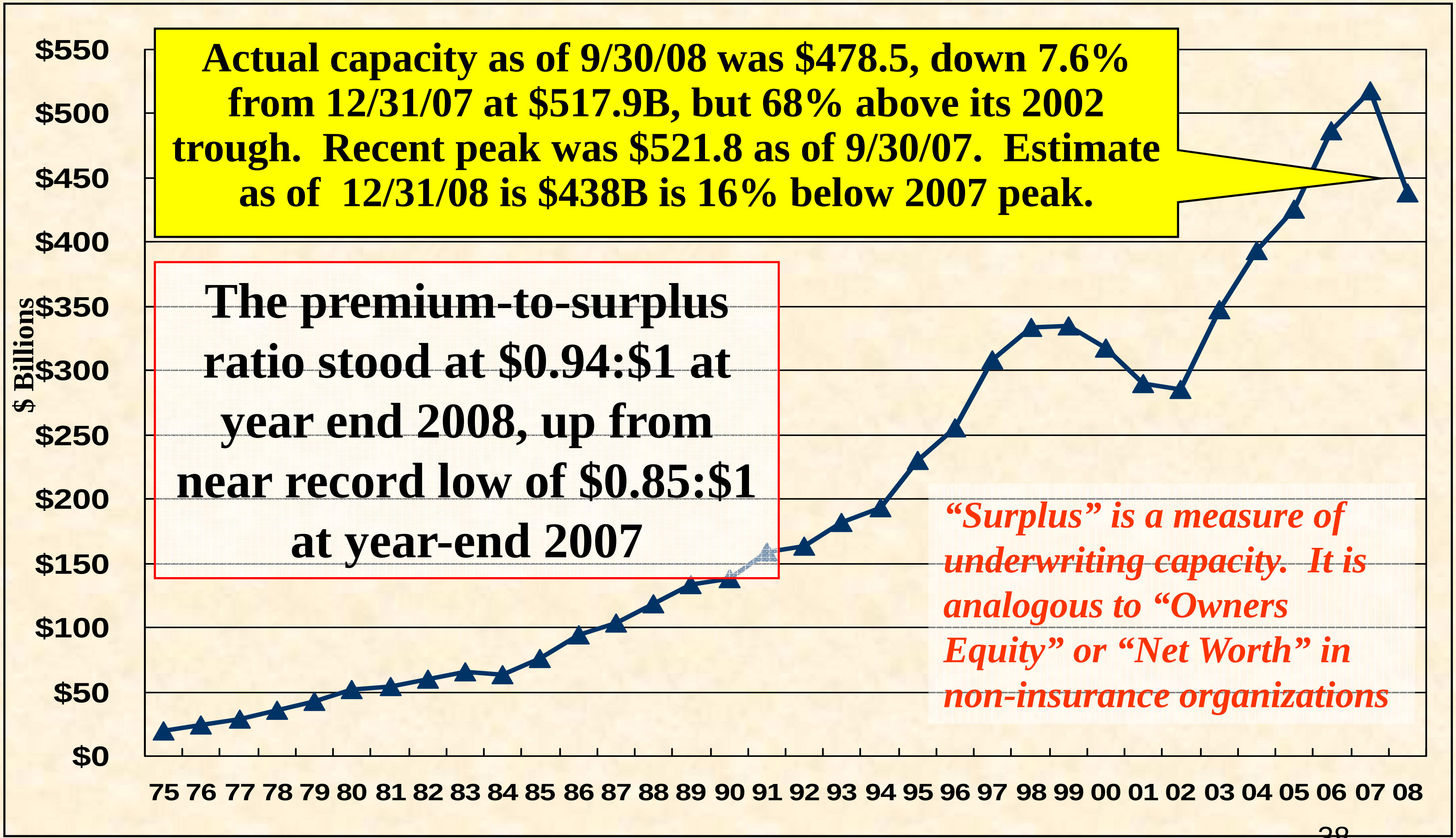
*PCS estimate as of 12/15/08.

Sources: ISO/PCS; AIR Worldwide, RMS, Eqecat; Insurance Information Institute inflation adjustments.

Capital/ Policyholder Surplus

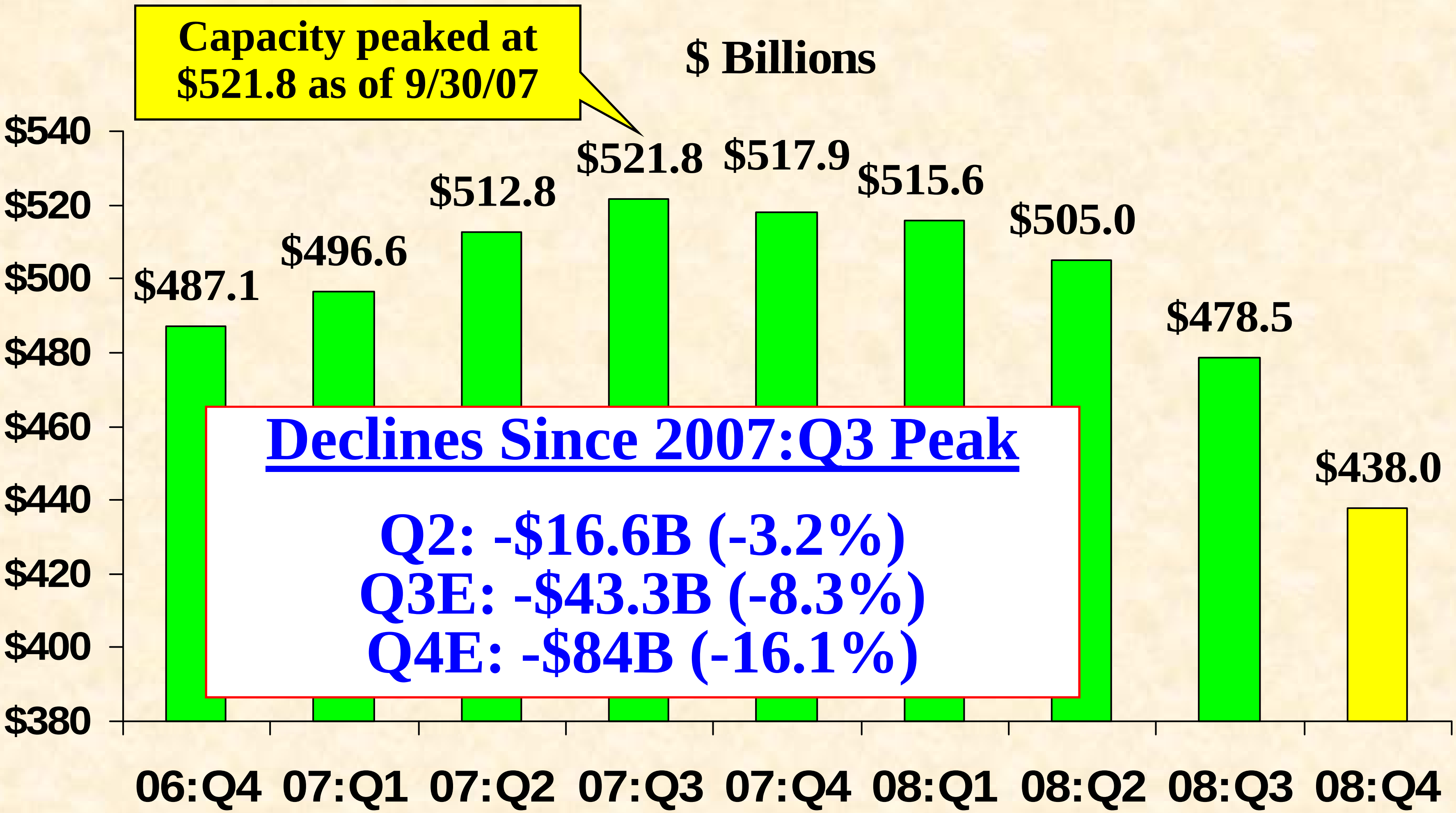
Shrinkage, but Capital is Within Historic Norms

U.S. Policyholder Surplus: 1975-2008*



Source: A.M. Best, ISO, Insurance Information Institute. *Towers Perrin estimate as of 12/31/08

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

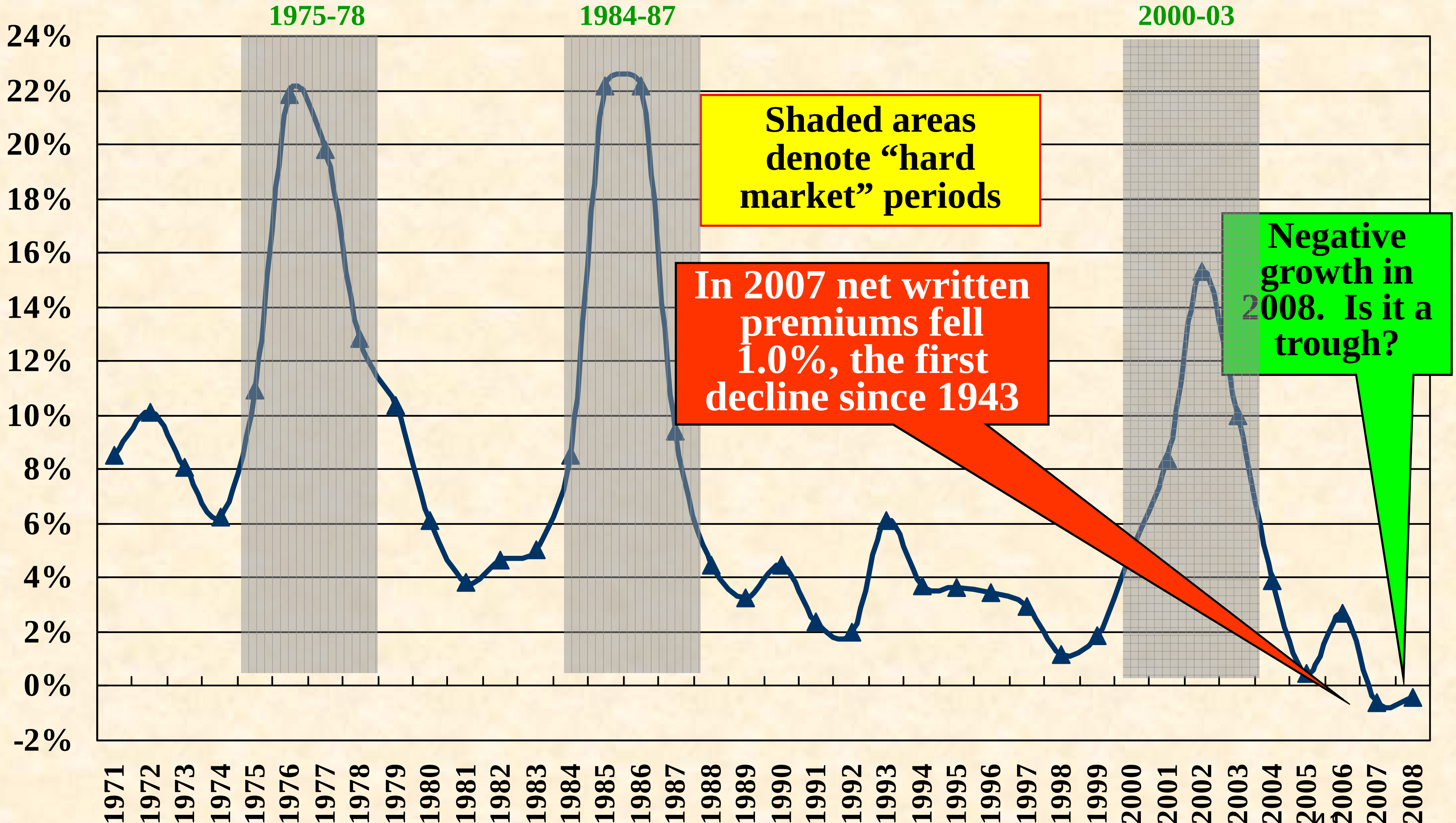


Source: ISO (historical); Towers Perrin (Oct. 21) estimates for Q4 2008. Q4 assumes no major Investment market recovery before year-end 2008.

P/C Premium Growth

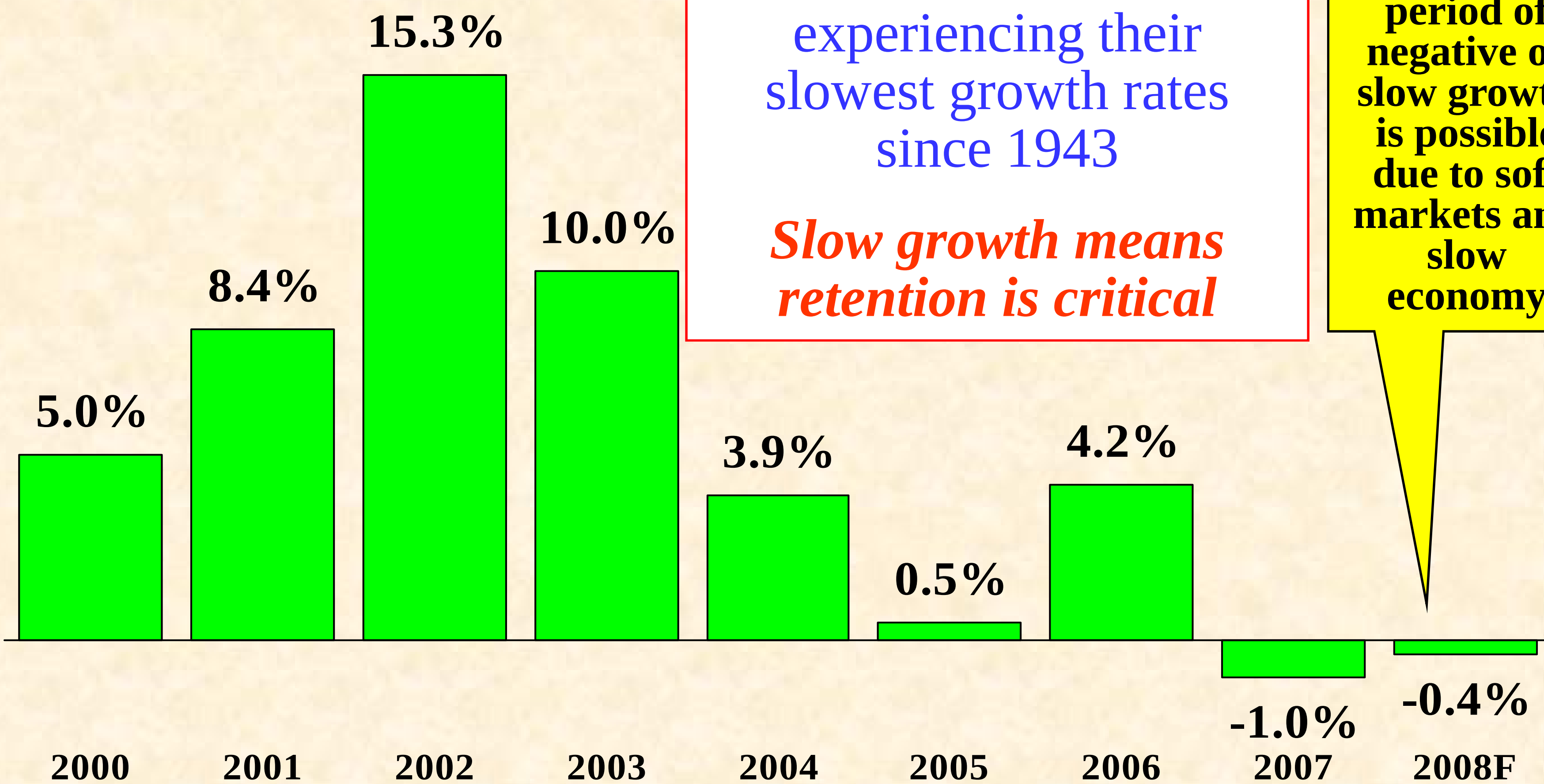
Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Strength of Recent Hard Markets by NWP Growth



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

Year-to-Year Change in Net Written Premium, 2000-2008E*



P/C insurers are experiencing their slowest growth rates since 1943

Slow growth means retention is critical

Protracted period of negative or slow growth is possible due to soft markets and slow economy

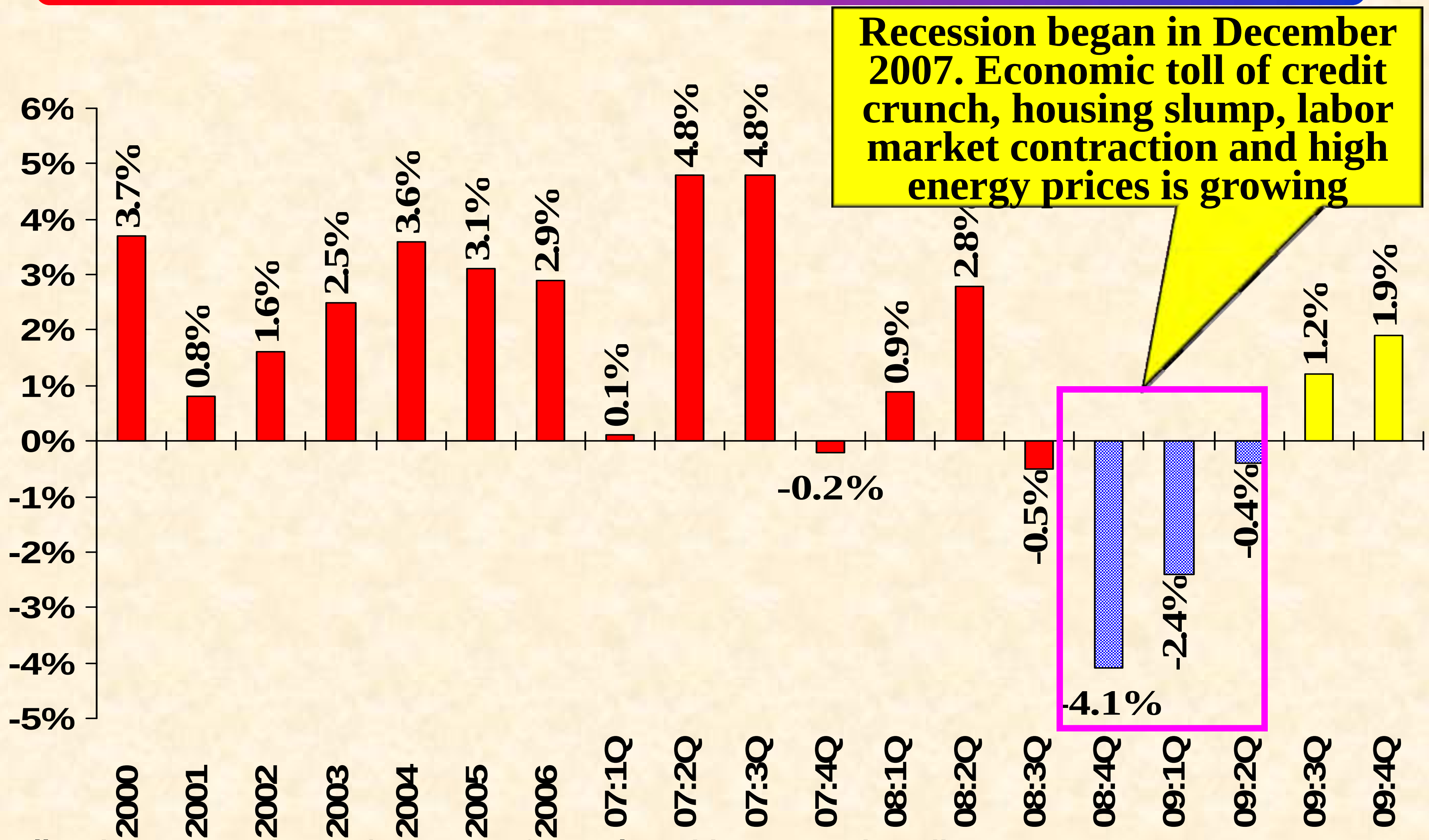
*2008 figure is 9-month actual result from ISO.
Source: A.M. Best (historical).

THE ECONOMIC STORM

What a Weakening Economy Means for the P/C Insurance Industry

Exposure Effects

Real GDP Growth*

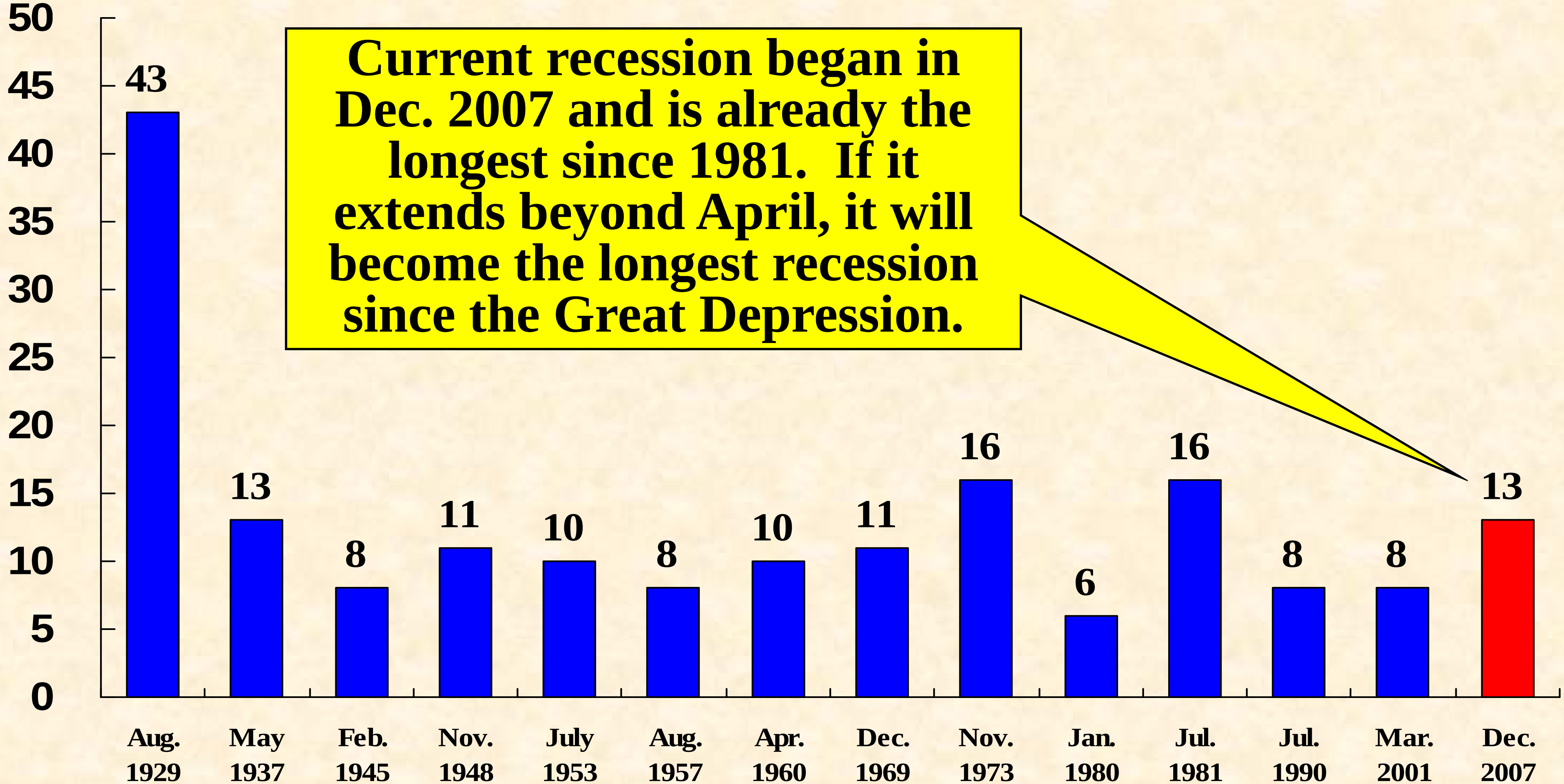


*Yellow bars are Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 12/08; Insurance Information Institute.

*Length of US Recessions, 1929-Present**

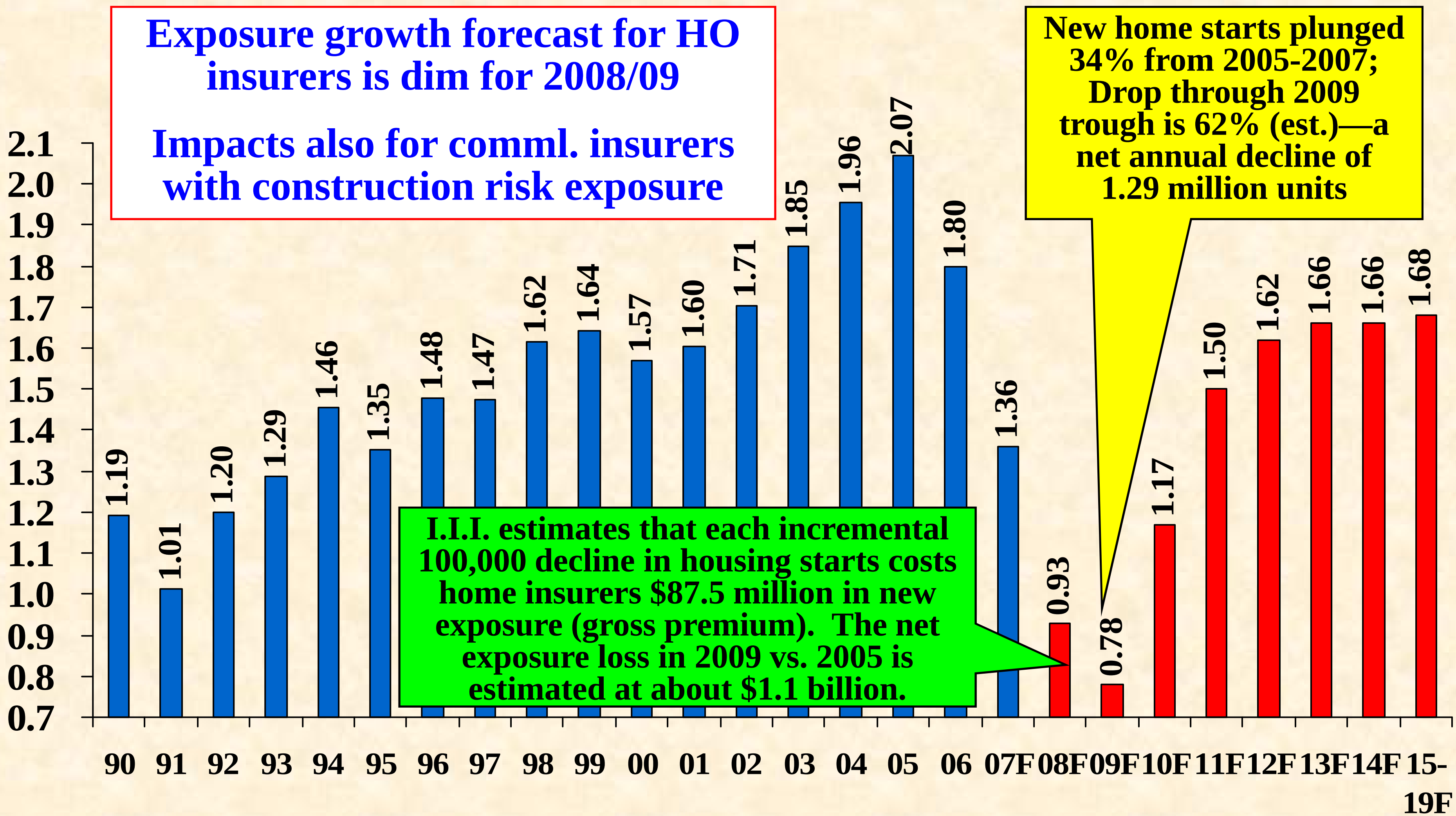
Months in Duration



* As of January 2009

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

New Private Housing Starts, 1990-2019F (Millions of Units)

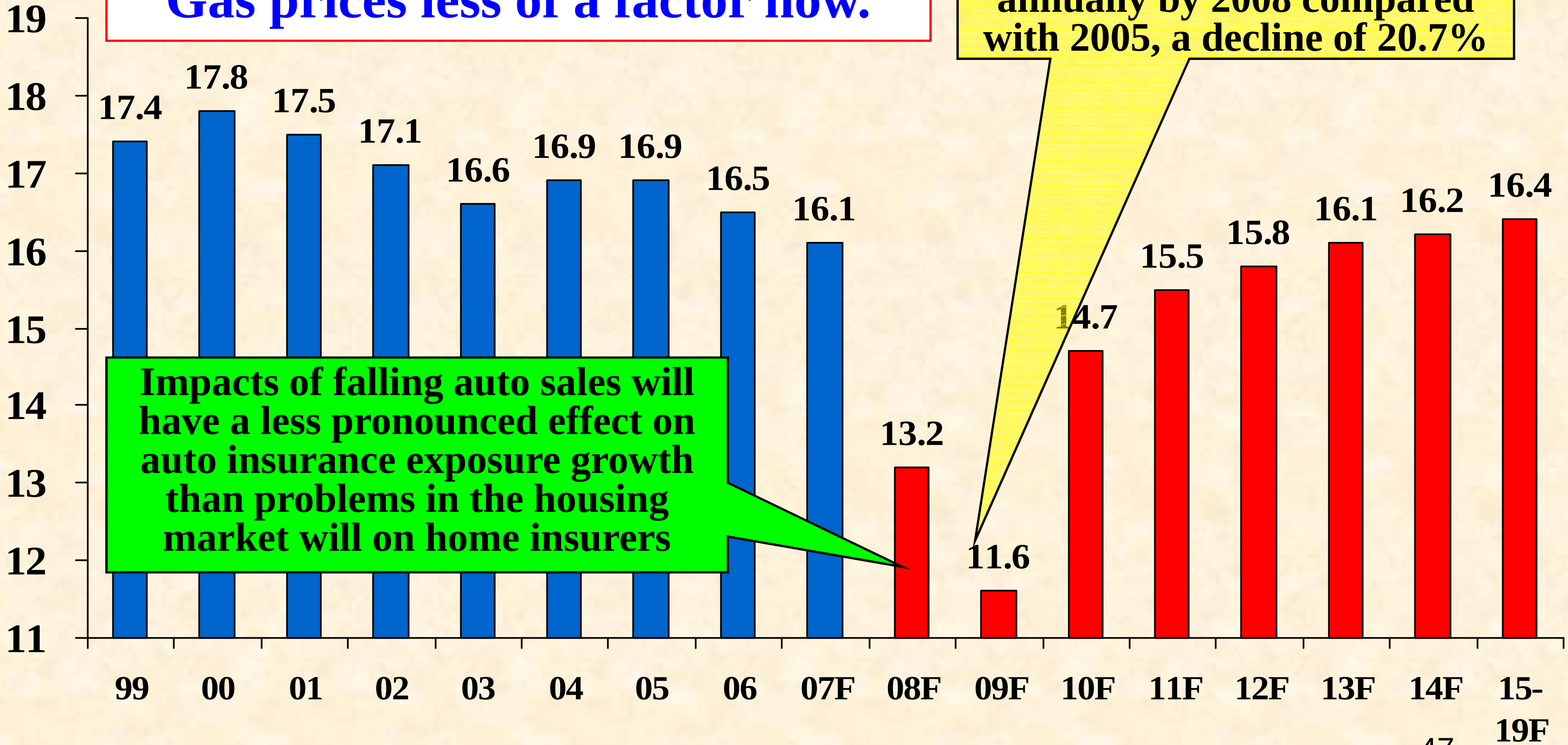


Source: US Department of Commerce; Blue Chip Economic Indicators (12/08); Insurance Information Inst.

Auto/Light Truck Sales, 1999-2019F (Millions of Units)

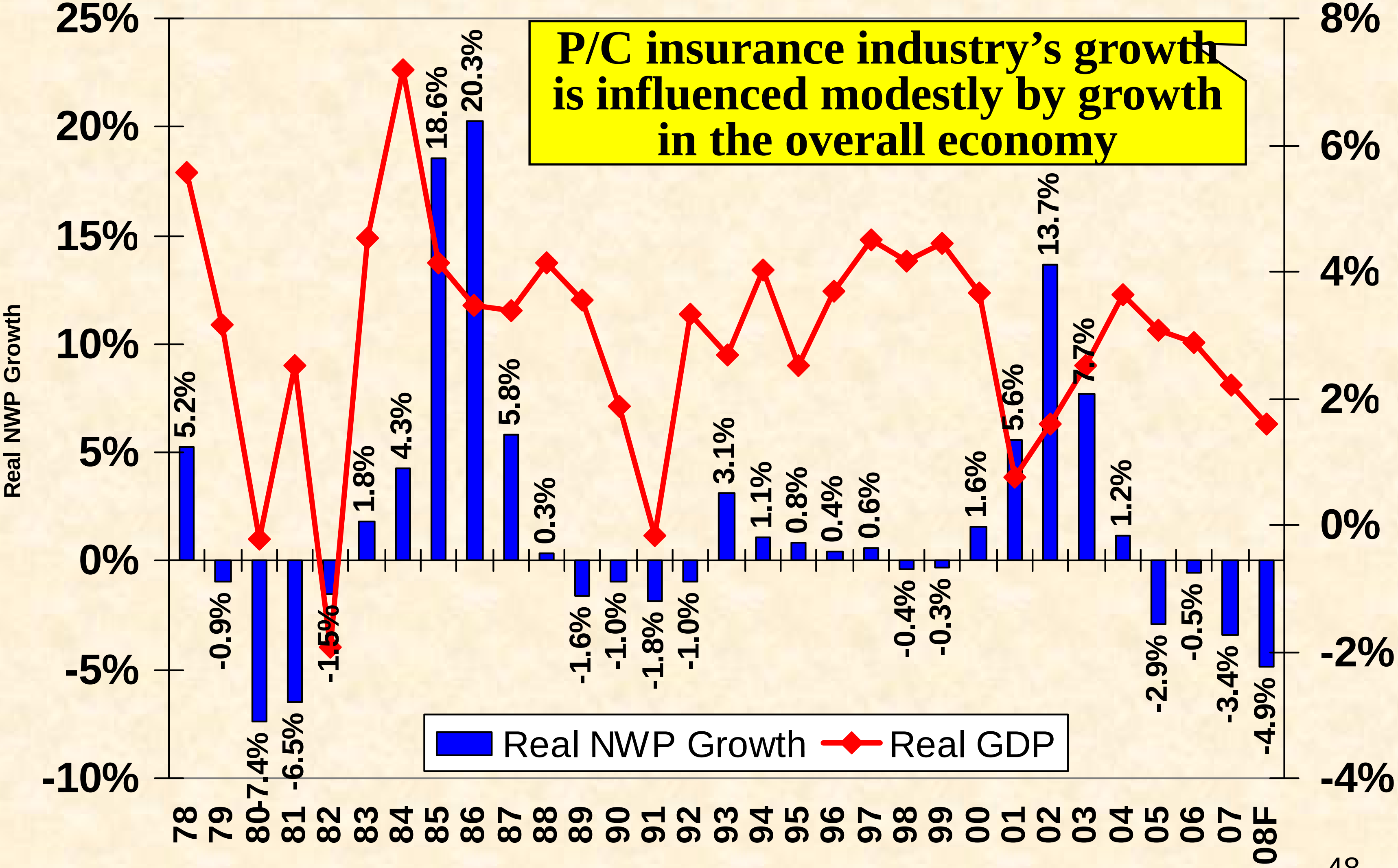
Weakening economy, credit crunch are hurting auto sales; Gas prices less of a factor now.

New auto/light trick sales are expected to experience a net drop of 3.5 million units annually by 2008 compared with 2005, a decline of 20.7%



Source: US Department of Commerce; Blue Chip Economic Indicators (12/08); Insurance Information Inst.

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



Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 8/08; Insurance Information Inst.

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THANK YOU FOR YOUR TIME AND

YOUR ATTENTION!