

Trends & Challenges in the P/C Insurance Industry *Energy Markets at the Eye of the Economic Storm*

Insurance Information Institute



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Presentation Outline

- **Profitability**
- **Underwriting Trends**
- **Investment Overview**
- **Premium Growth & Pricing**
- **Capacity & Policyholder Surplus**
- **Directors & Officers Market**
- **Energy Market Review**
- **Implications of the Weak Economy & Rising Inflation**
- **Proposed Changes in the Insurance/Financial Sector Regulation**
- **Catastrophic Loss Review & Energy's Respite**
- **Reinsurance Markets**
- **Shifting Legal Liability & Tort Environment**

PROFITABILITY

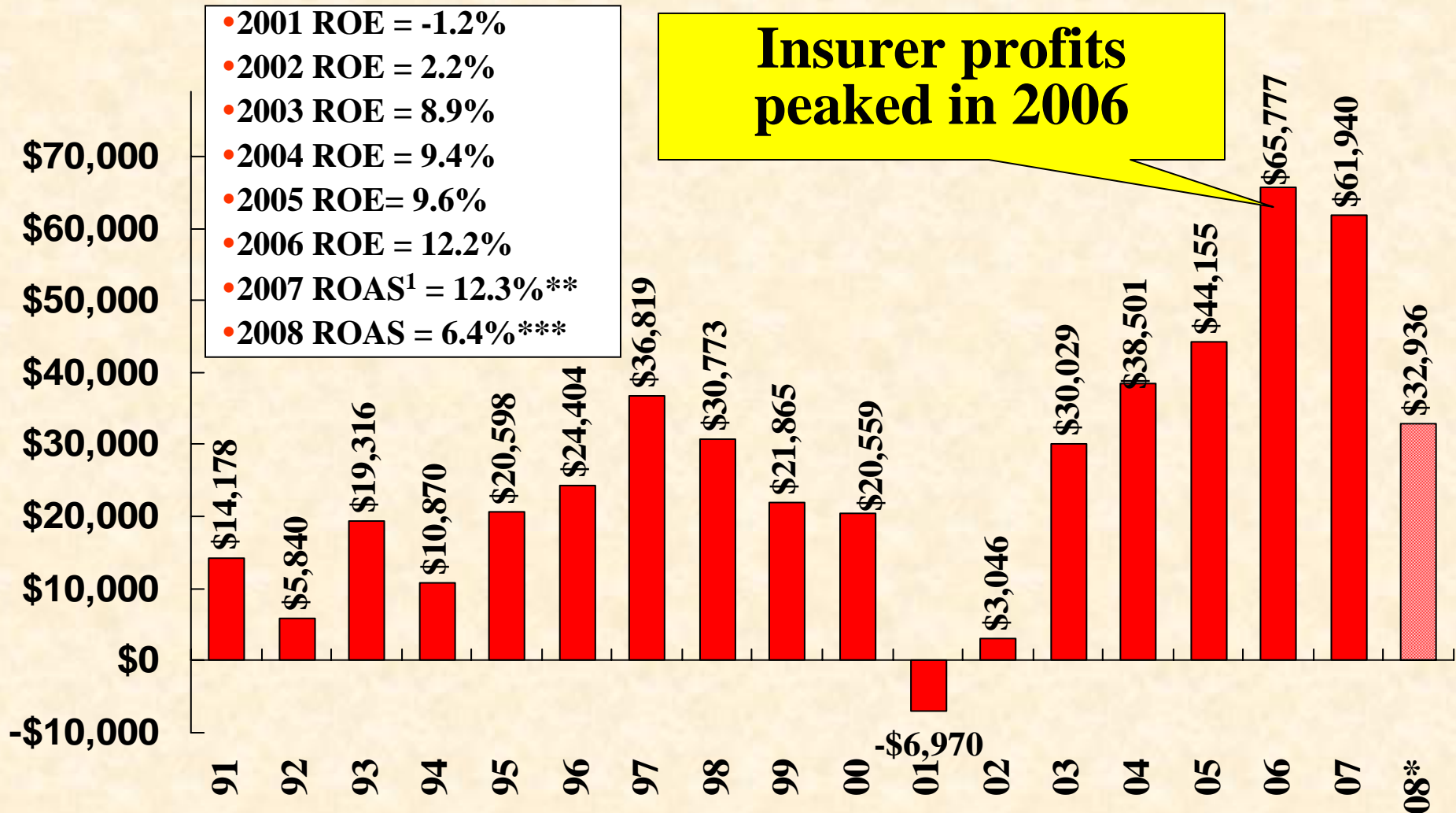
**In the Midst
of a Cyclical Decline**





P/C Net Income After Taxes

*1991-2008 (\$ Millions)**

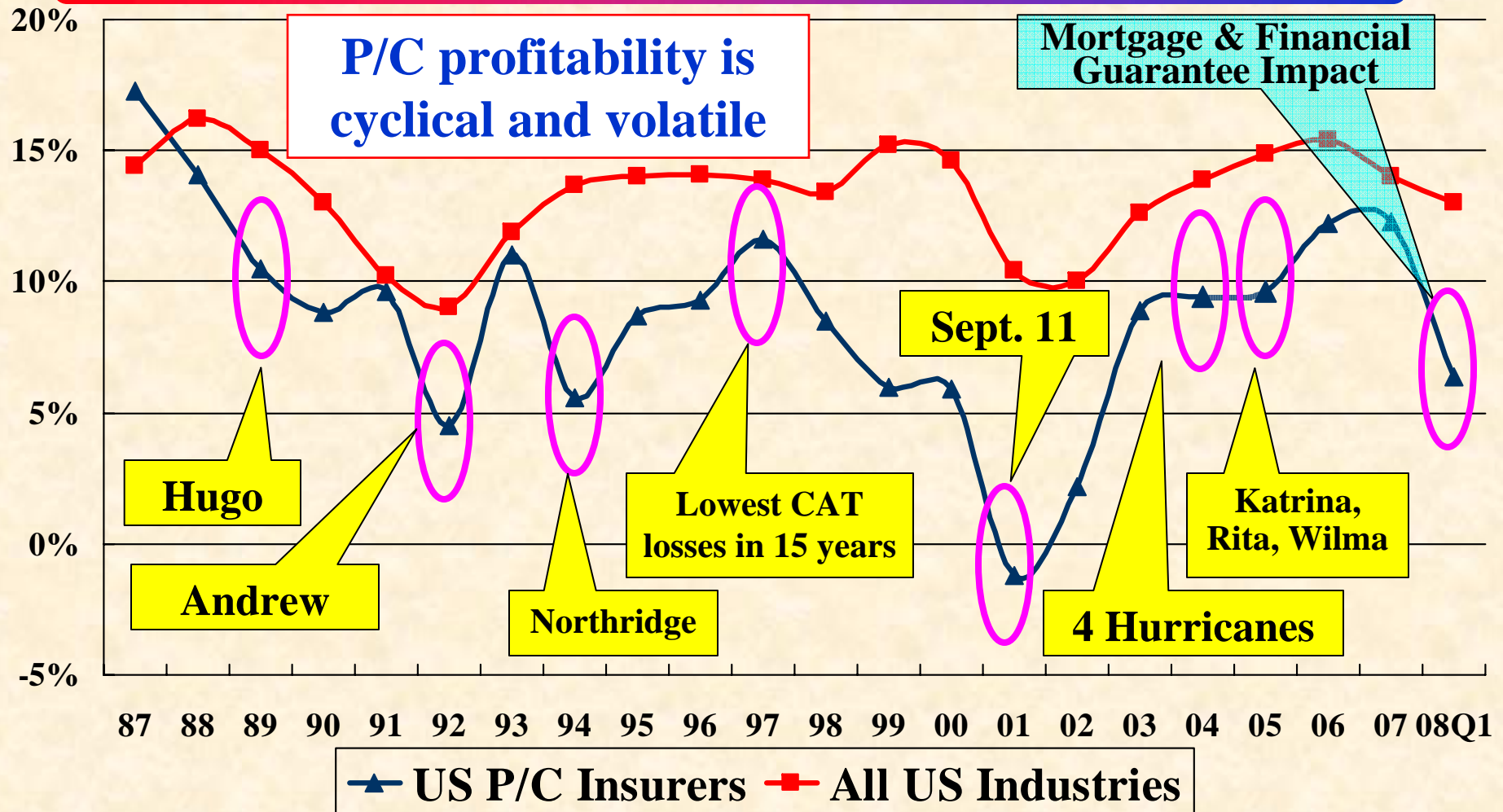


*ROE figures are GAAP; 2008 figure is annualized Q1 net income of \$8.234B; ¹Return on avg. surplus.
Sources: A.M. Best, ISO, Insurance Information Inst. ***9.5% excl. mortgage and finl. guarantee insurers.



ROE: P/C vs. All Industries

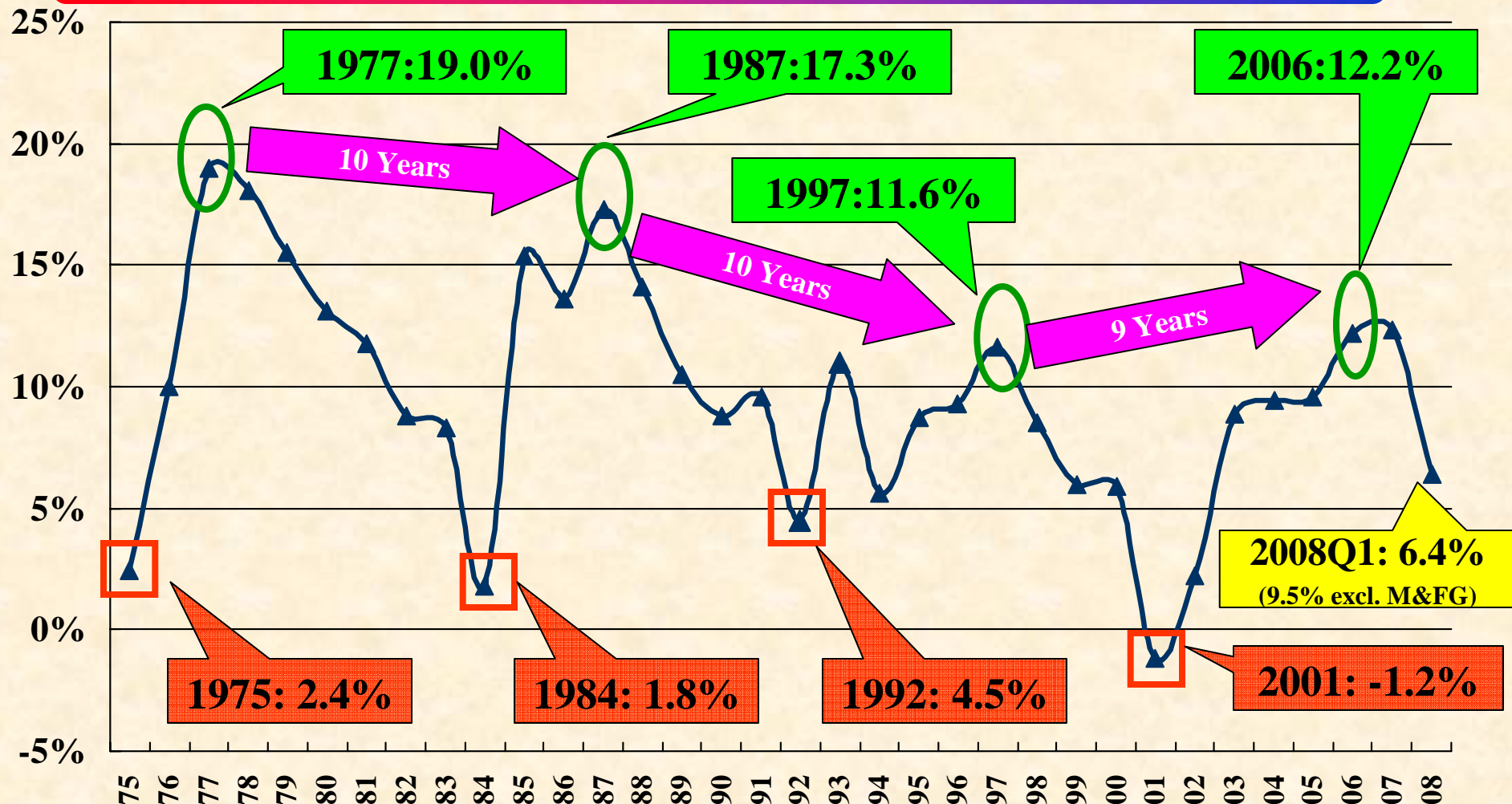
1987–2008:Q1



2008 P/C insurer figure is annualized Q1 return on average surplus. Excluding mortgage and financial guarantee insurers = 9.5%.

Source: ISO, *Fortune*; Insurance Information Institute.

Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2008:Q1



*GAAP ROE for all years except 2007 which is ROAS of 12.3%. All figures include mortgage and financial guarantee insurers. Excluding M&FG insurers 2008:Q1 ROAS is 9.5%..

Source: Insurance Information Institute, ISO; *Fortune*

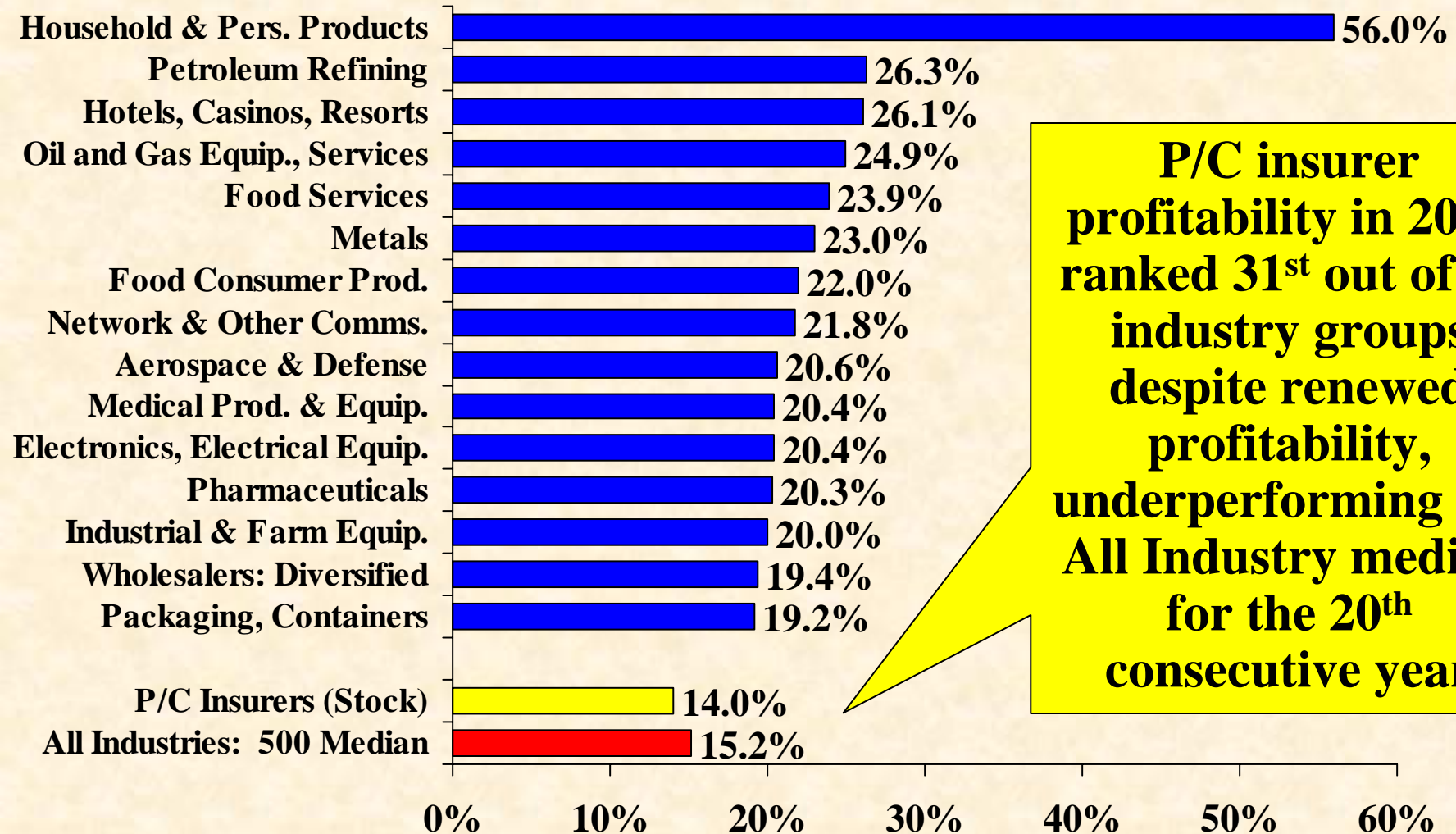


Factors that Will Influence the Length and Depth of the Cycle

- **Capacity**: Rapid surplus growth in recent years has left the industry with between \$85 billion and \$100 billion in excess capital, according to analysts, at end of 2007
 - All else equal, rising capital leads to greater price competition and a liberalization of terms and conditions
- **Reserves**: Reserves are in the best shape (in terms of adequacy) in decades, which could extend the depth and length of the cycle
- **Investment Gains**: With sharp declines in stock prices and falling interest rates, portfolio yields are certain to fall → Contributes to discipline and shallower cycle
- **Sarbanes-Oxley**: Presumably SOX will lead to better and more conservative management of company finances, including rapid recognition of deficient or redundant reserves
 - With more “eyes” on the industry, the theory is that cyclical swings should shrink
- **Ratings Agencies**: Focus on Cycle Management; Quicker to downgrade
- **Information Systems**: Management has more and better tools that allow faster adjustments to price, underwriting and changing market conditions than it had during previous soft markets
- **Analysts/Investors**: Less fixated on growth, more on ROE through soft mkt.
 - Management has backing of investors of Wall Street to remain disciplined
- **M&A Activity**: More consolidation would imply greater discipline



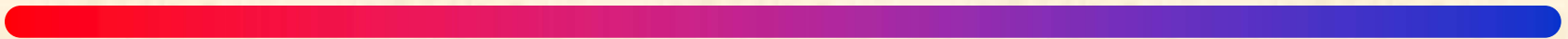
*Top Industries by ROE: P/C Insurers Still Underperformed in 2007**



Source: Fortune, May 5, 2008 edition; Insurance Information Institute

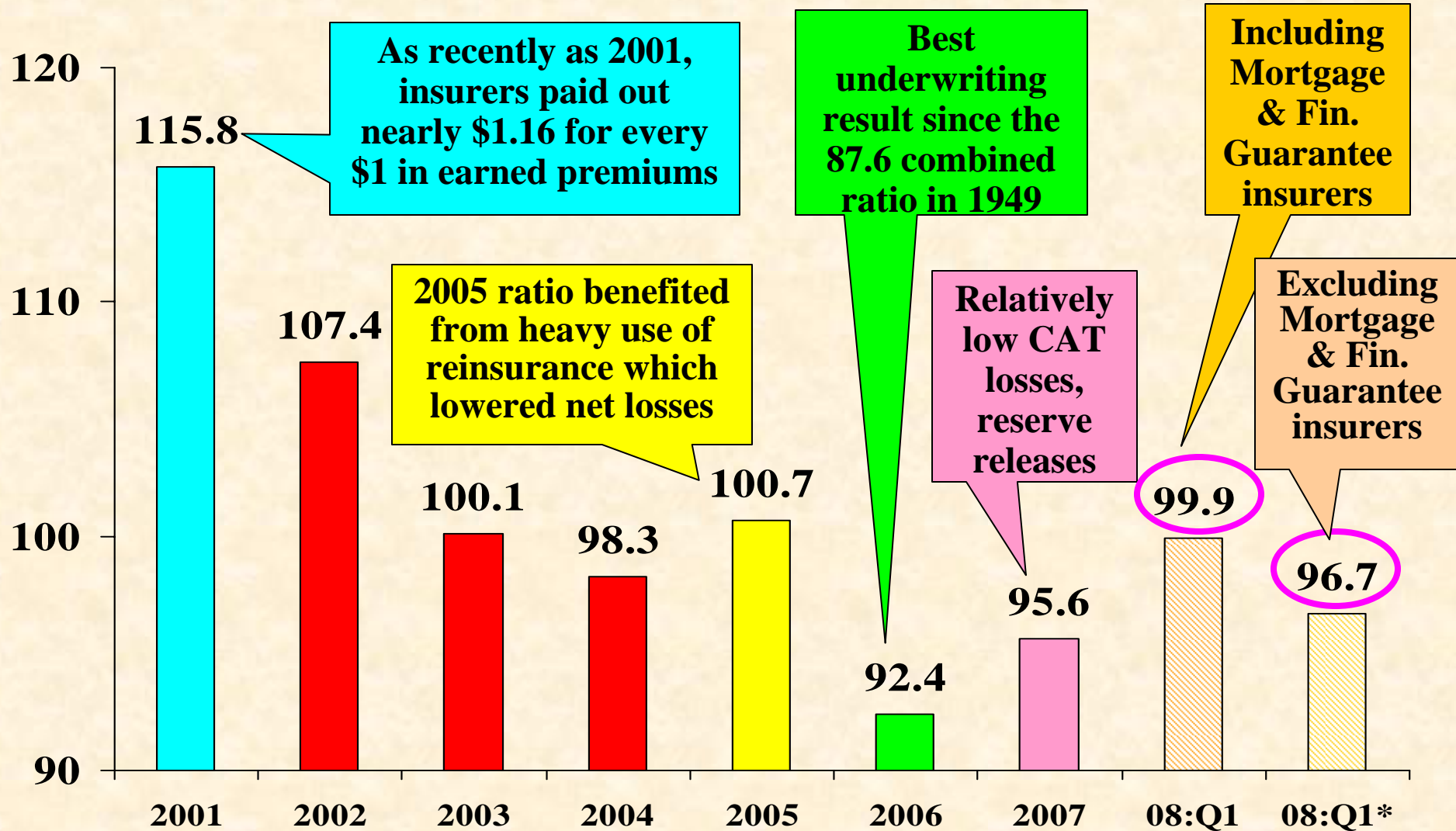
UNDERWRITING TRENDS

**Extremely Strong 2006/07;
Relying on Momentum &
Discipline for 2008**





P/C Insurance Combined Ratio, 2001-2008:Q1



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

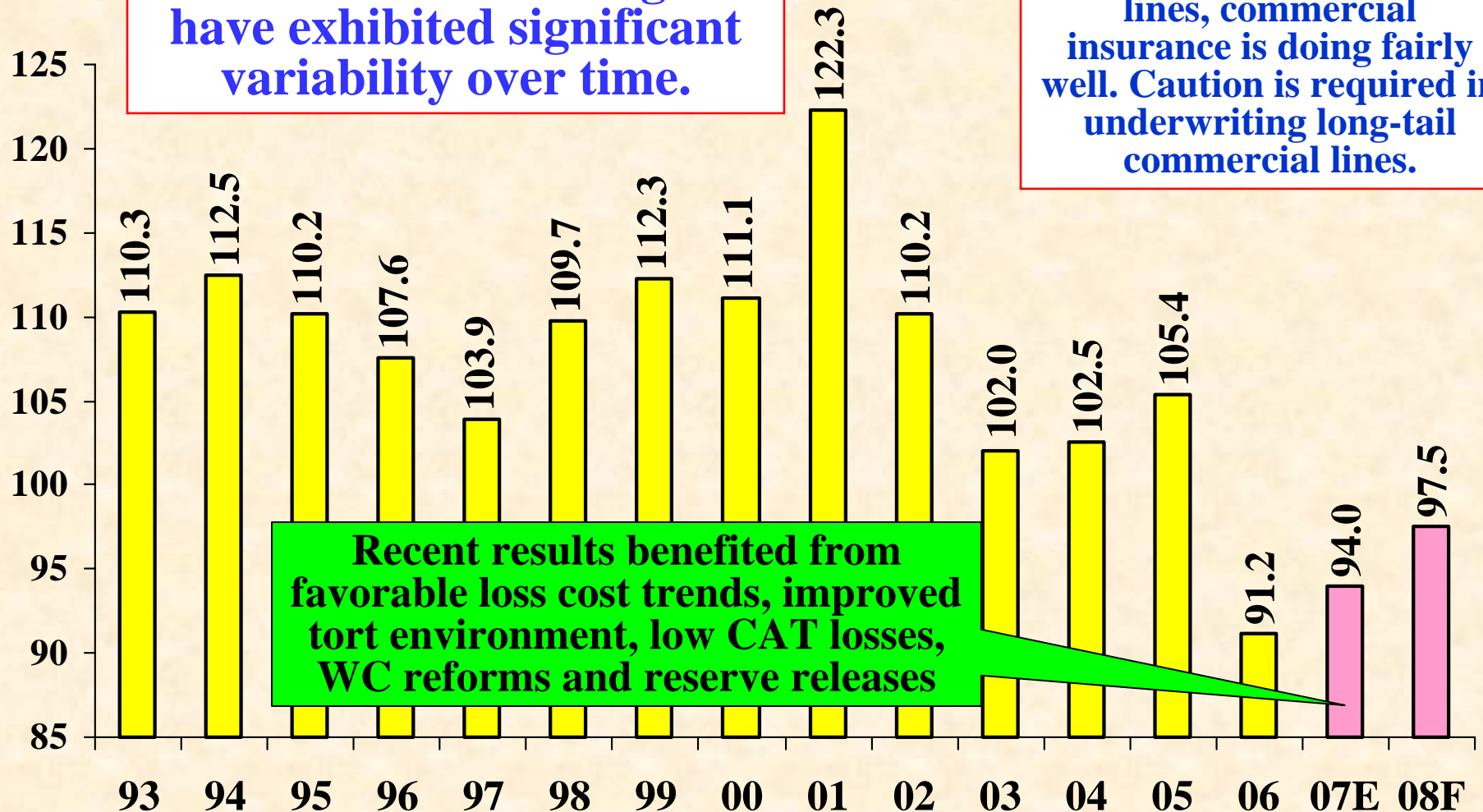
*Excluding Mortgage & Financial Guarantee insurers.



Commercial Lines Combined Ratio, 1993-2008F

**Commercial coverages
have exhibited significant
variability over time.**

**Outside CAT-affected
lines, commercial
insurance is doing fairly
well. Caution is required in
underwriting long-tail
commercial lines.**

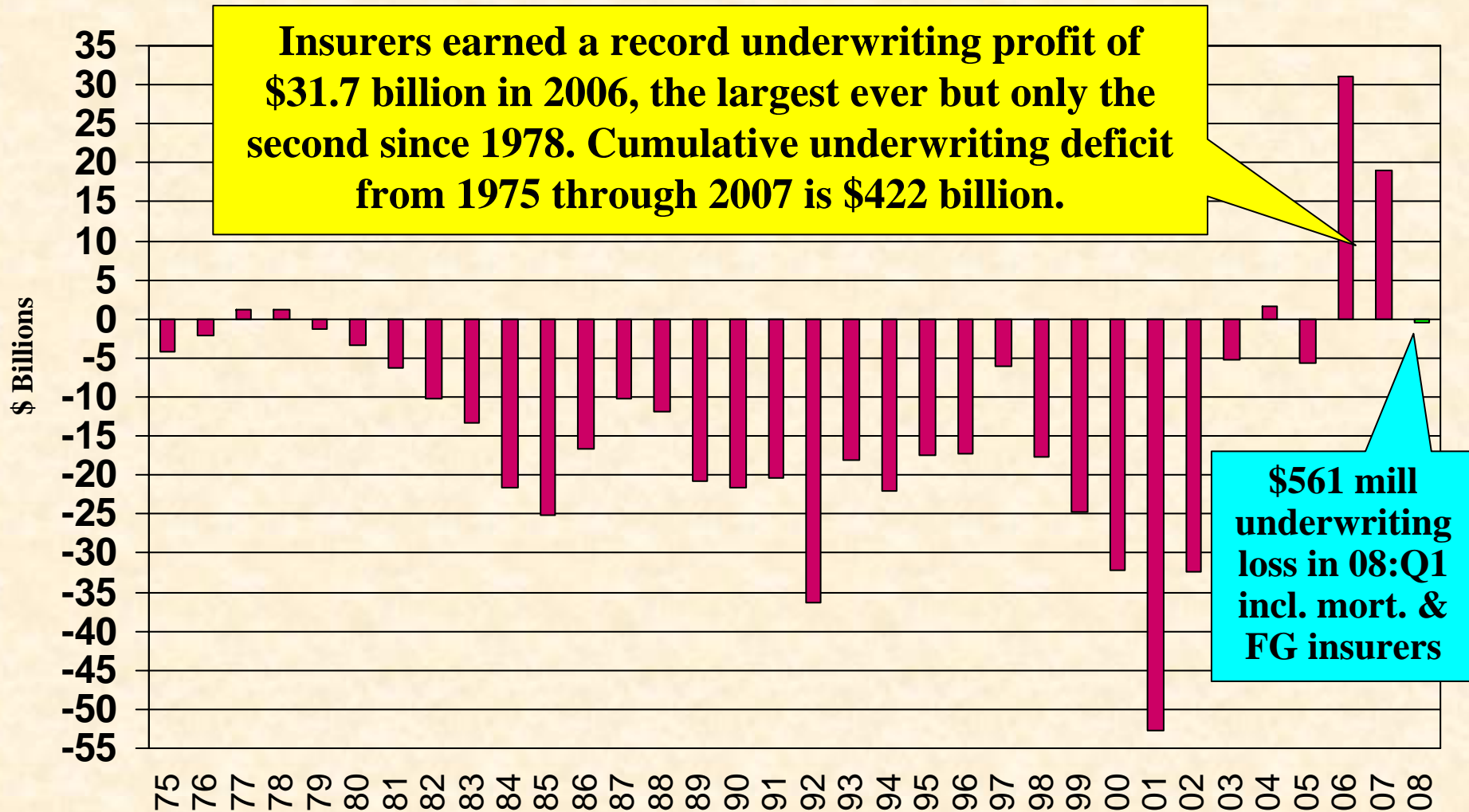




Underwriting Gain (Loss)

*1975-2008:Q1**

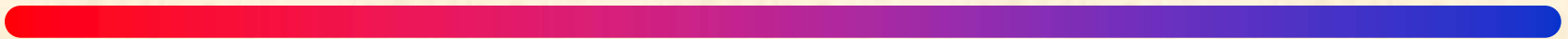
Insurers earned a record underwriting profit of \$31.7 billion in 2006, the largest ever but only the second since 1978. Cumulative underwriting deficit from 1975 through 2007 is \$422 billion.



**\$561 mill
underwriting
loss in 08:Q1
incl. mort. &
FG insurers**

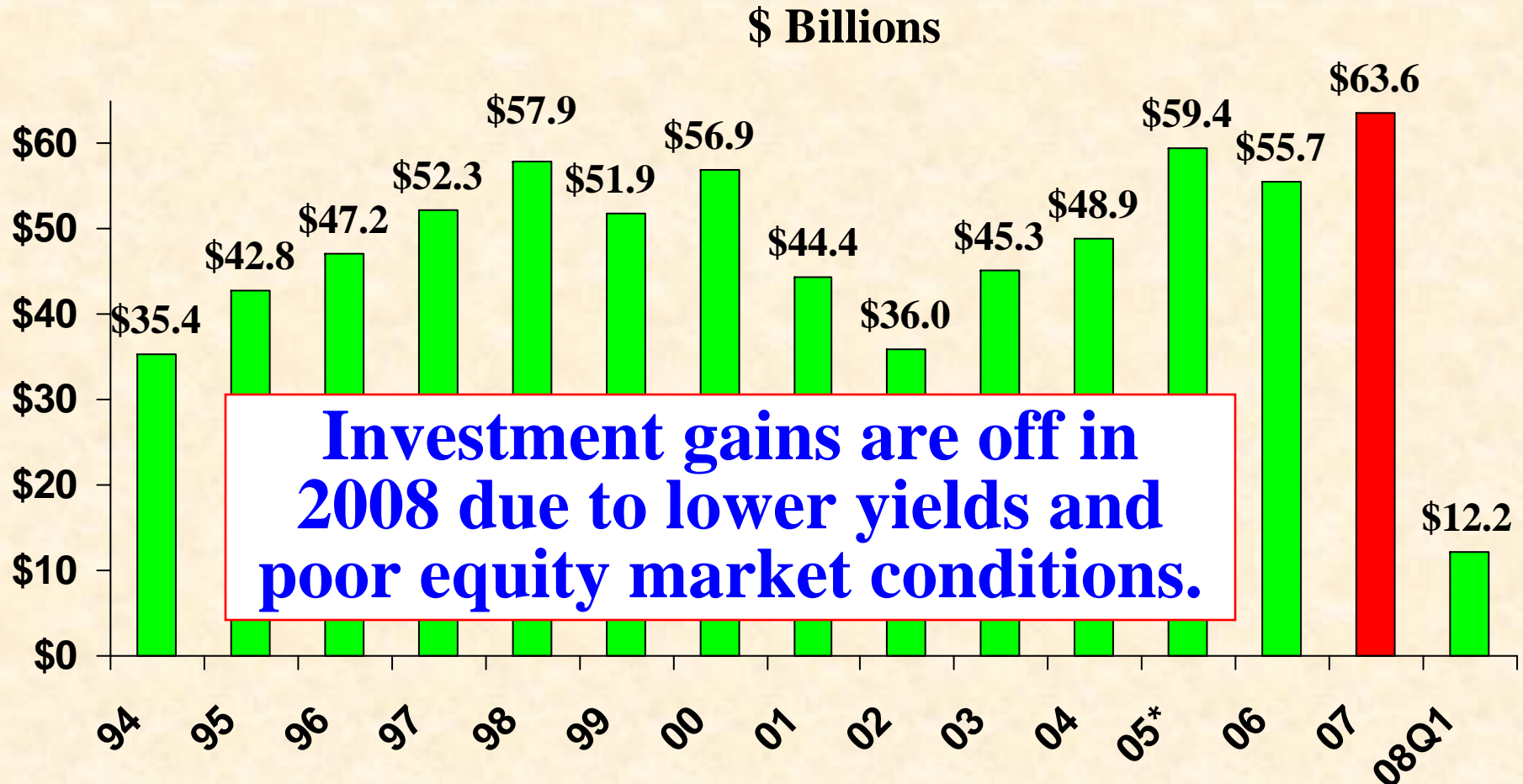
INVESTMENT OVERVIEW

*More Pain,
Little Gain*





Property/Casualty Insurance Industry Investment Gain¹



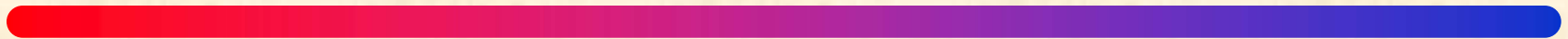
¹Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain.

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

Sources: ISO; Insurance Information Institute.

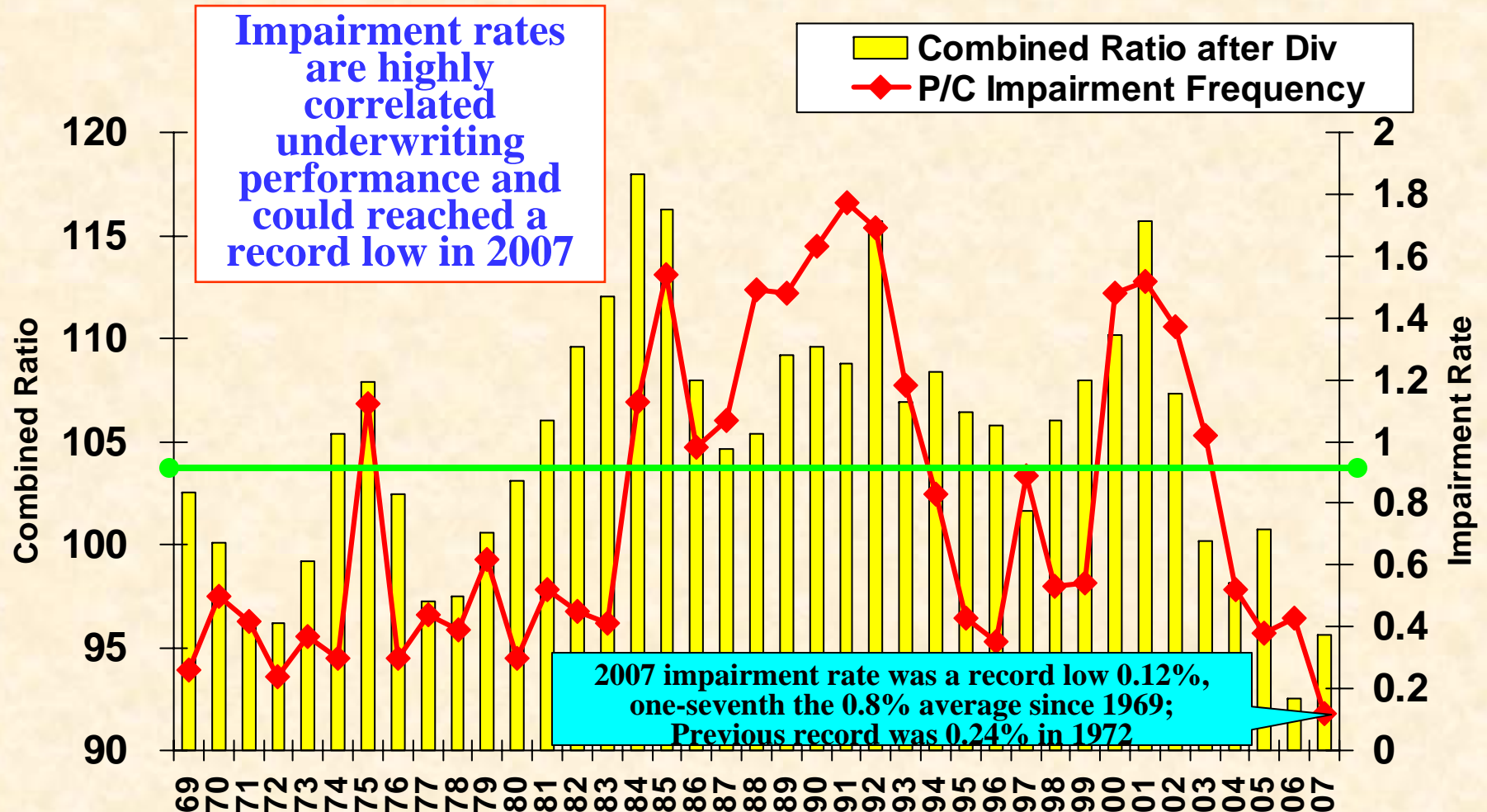
FINANCIAL STRENGTH & RATINGS

Industry Has Weathered
Storms and Economy Well,
But Cycle May
Take Its Toll





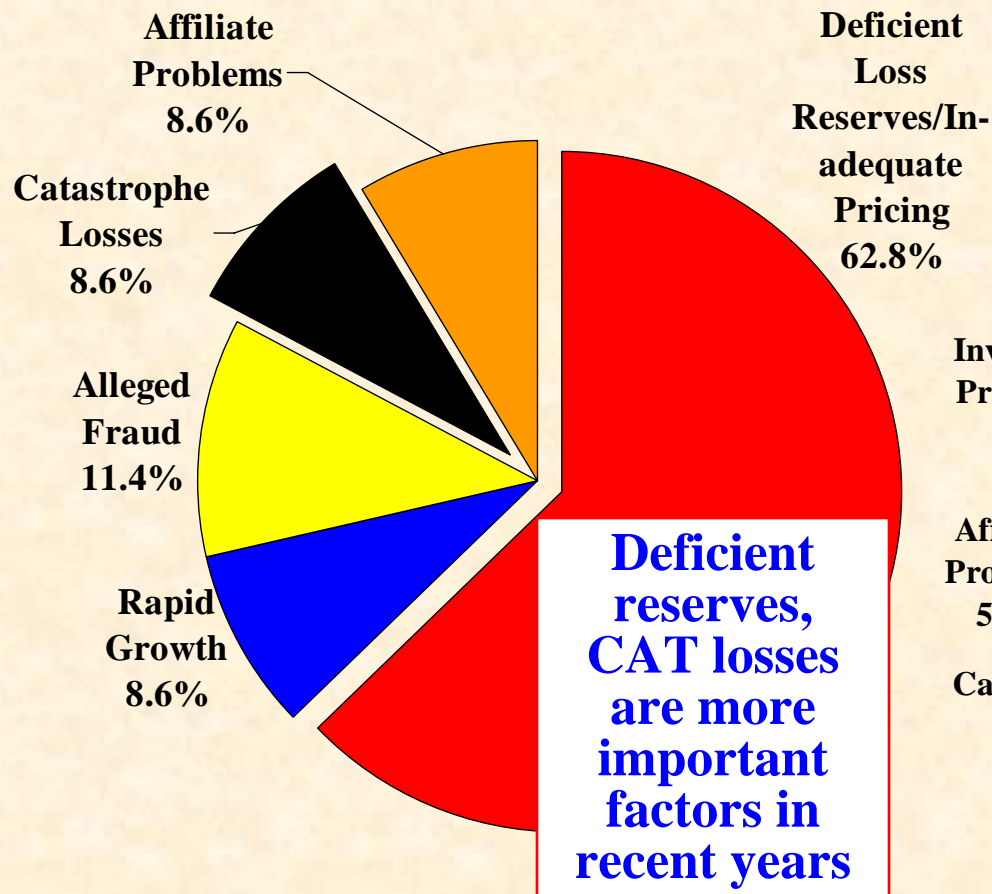
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2007E



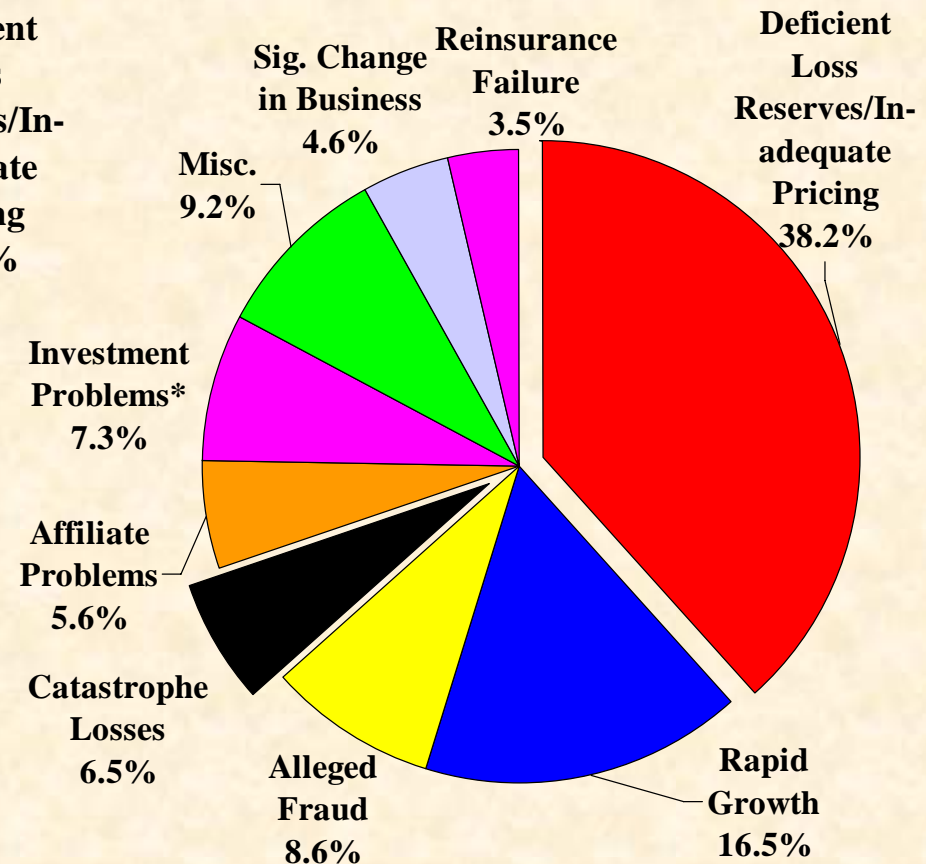


Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



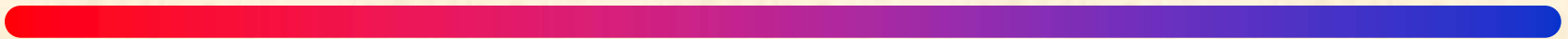
1969-2005



*Includes overstatement of assets.

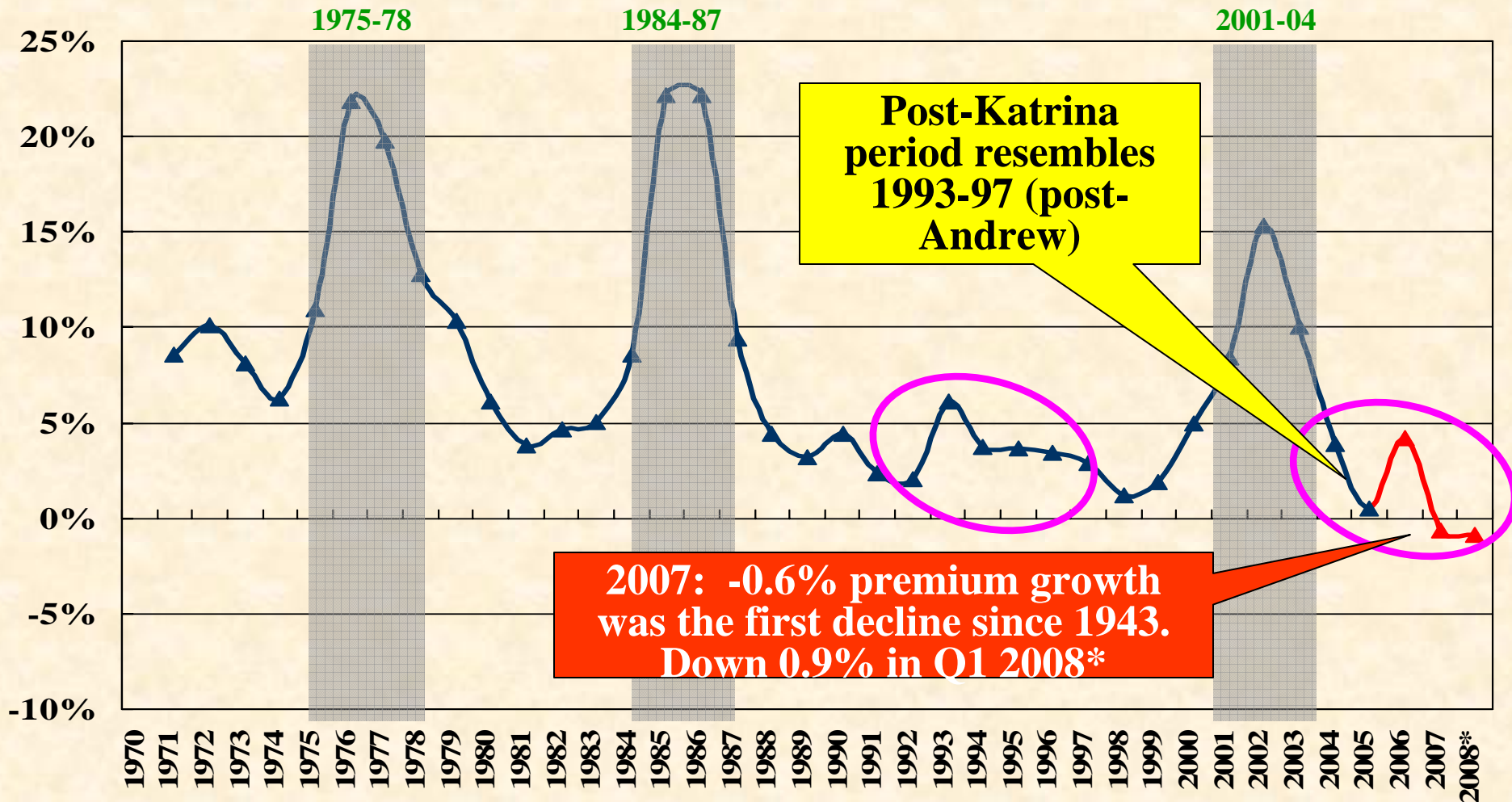
PREMIUM GROWTH

**Negative Growth
in 2007/08**





Strength of Recent Hard Markets by NWP Growth*

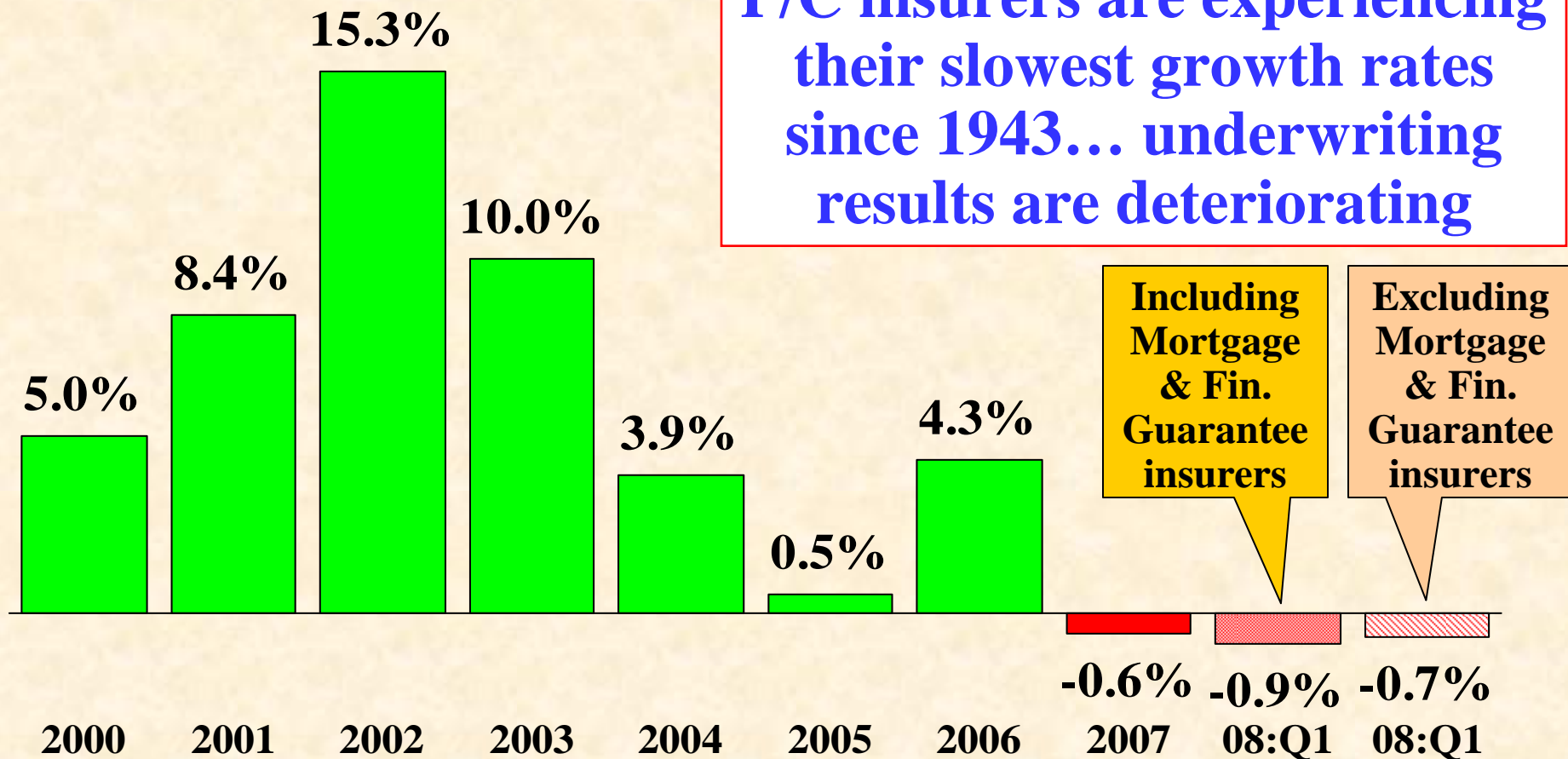


Note: Shaded areas denote hard market periods. *2008 is Q1 figure = -0.9%. Ex. M&FG insurers = -0.7%

Source: A.M. Best, Insurance Information Institute



*Growth in Net Written Premium, 2000-2008:Q1**



*2008:Q1 results shown including and excluding mortgage and financial guarantee insurers.

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

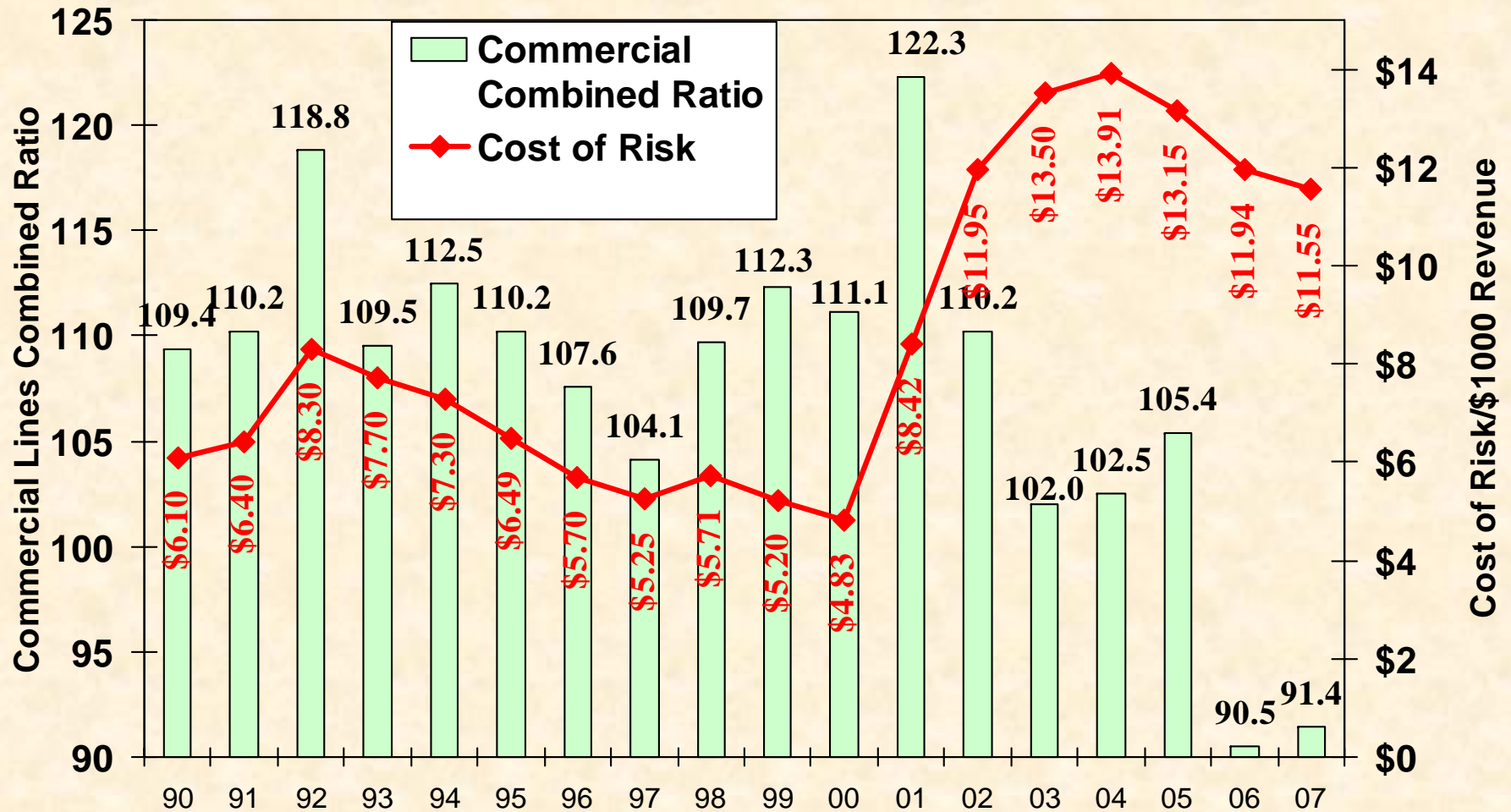
WEAK PRICING

Under Pressure in 2008





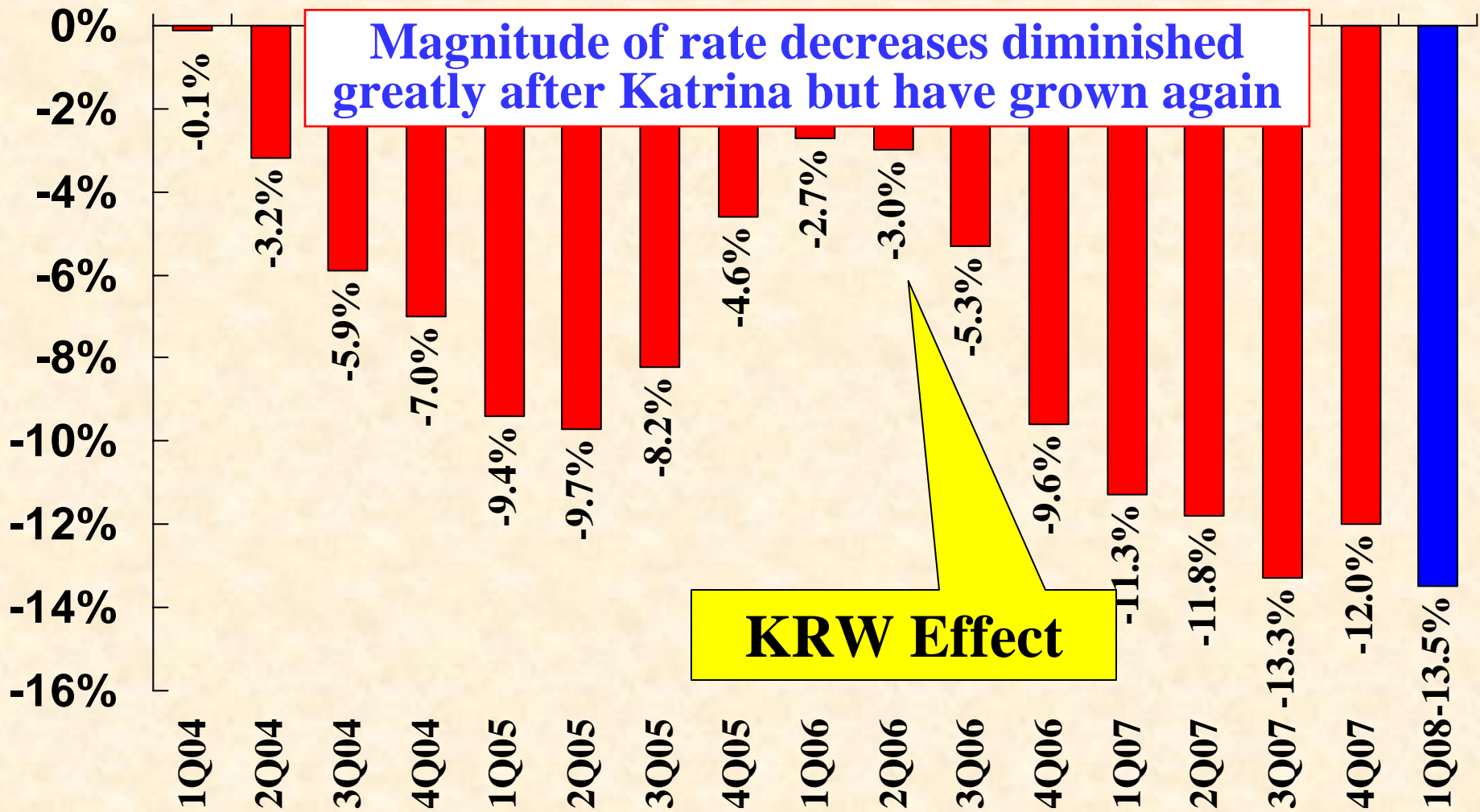
Cost of Risk vs. Commercial Lines Combined Ratio



Source: RIMS Benchmark Survey, A.M. Best 2007 Aggregates & Averages; Insurance Information Institute

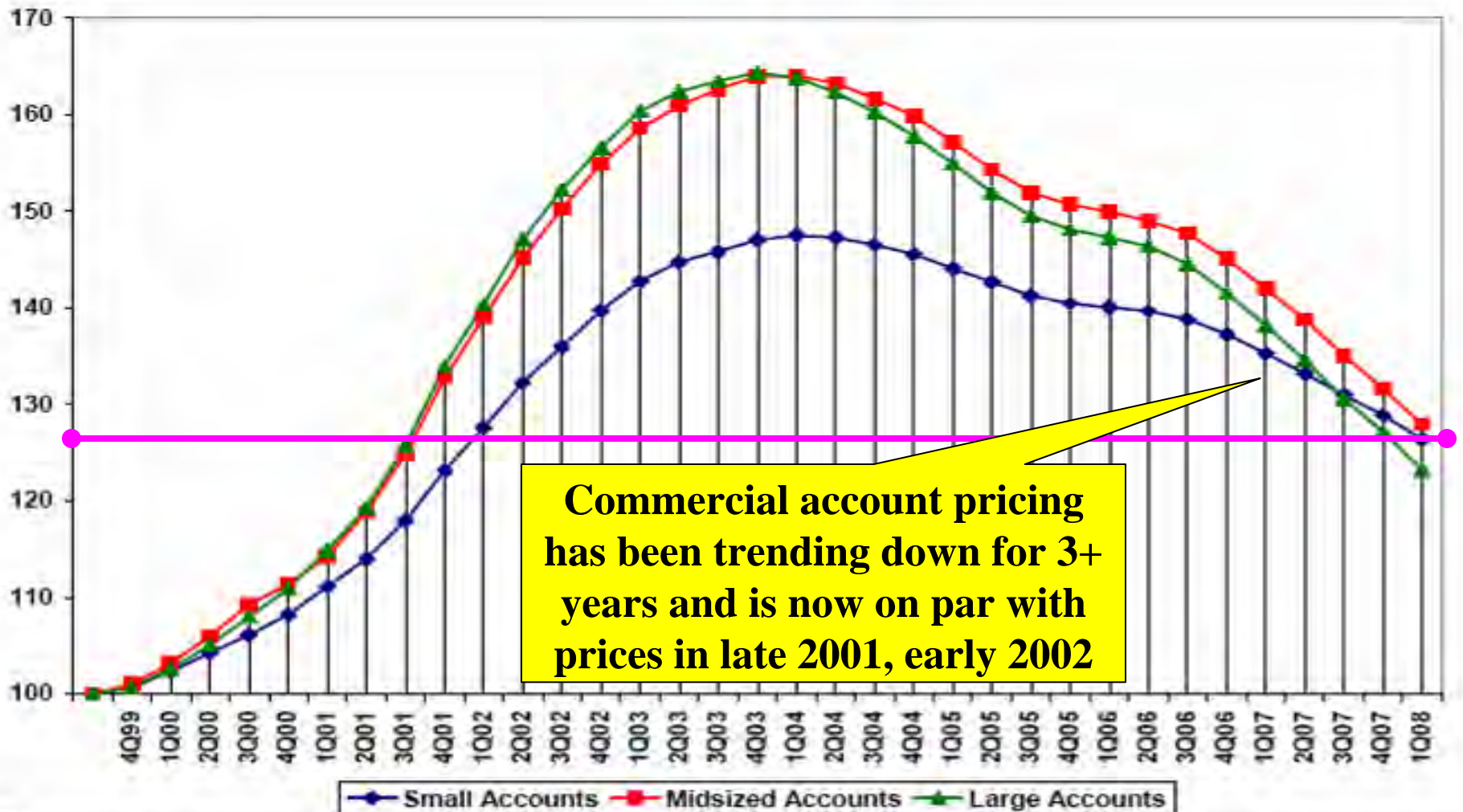


Average Commercial Rate Change, All Lines, (1Q:2004 – 1Q:2008)





Cumulative Commercial Rate Change by Line: 4Q99 – 1Q08



CAPACITY/ SURPLUS

**Accumulation of Capital/
Surplus Depresses ROEs**





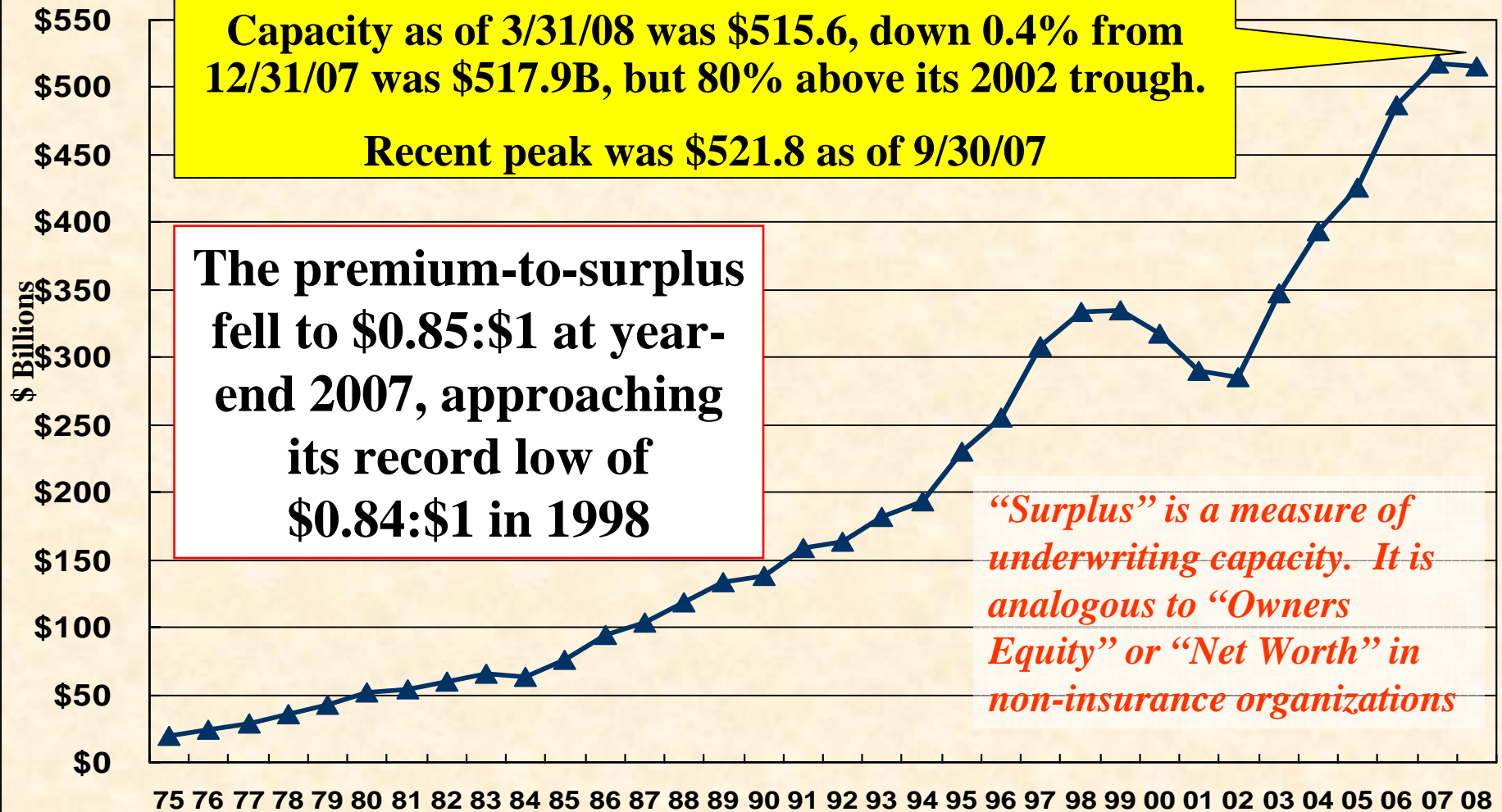
*U.S. Policyholder Surplus: 1975-2008:Q1**

Capacity as of 3/31/08 was \$515.6, down 0.4% from 12/31/07 was \$517.9B, but 80% above its 2002 trough.

Recent peak was \$521.8 as of 9/30/07

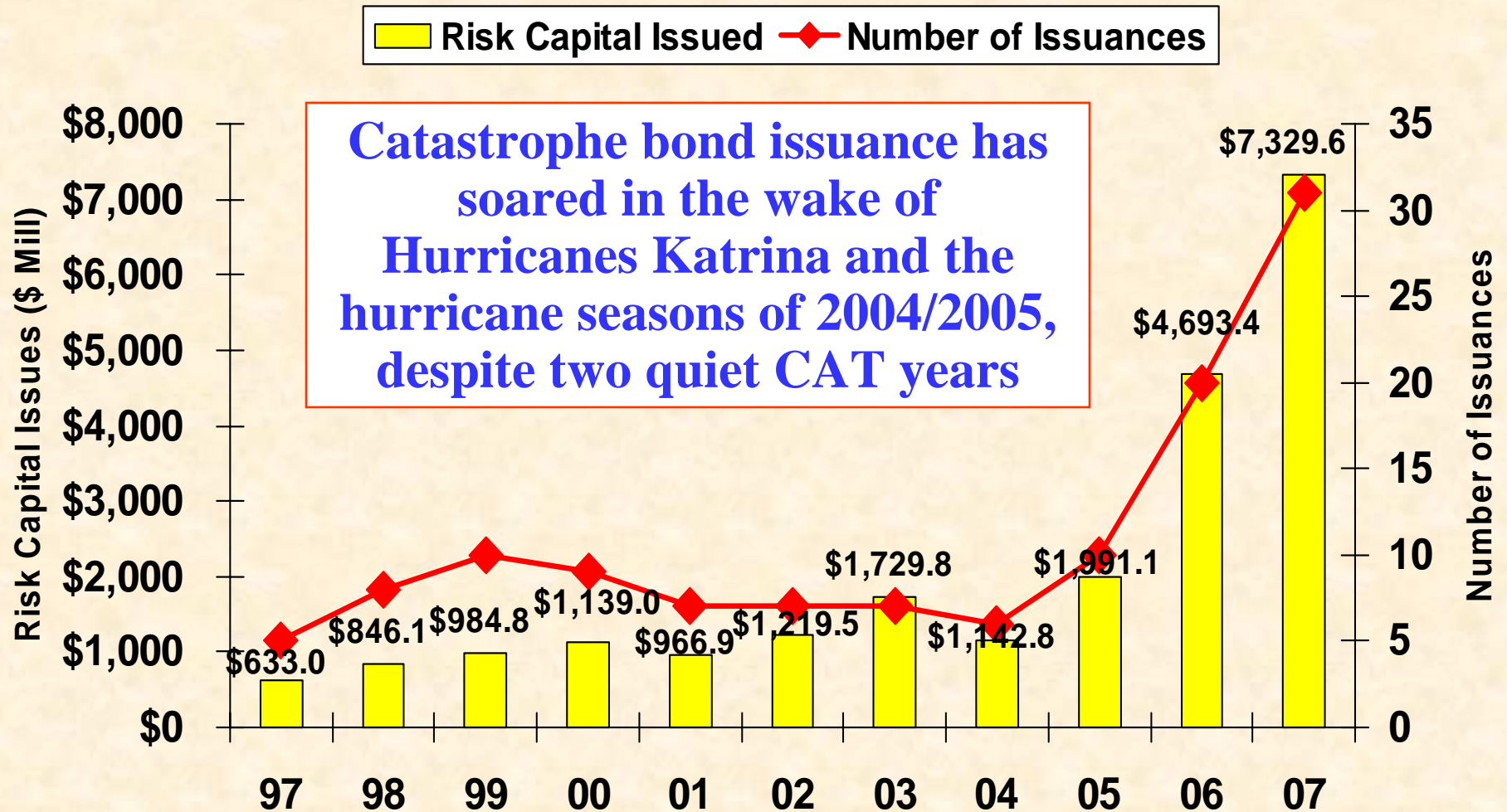
**The premium-to-surplus
fell to \$0.85:\$1 at year-
end 2007, approaching
its record low of
\$0.84:\$1 in 1998**

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





Annual Catastrophe Bond Transactions Volume, 1997-2007





P/C Insurer Share Repurchases, 1987- Through Q4 2007 (\$ Millions)

Reasons Behind Capital Build-Up & Repurchase Surge

- Strong underwriting results
- Moderate catastrophe losses
- Reasonable investment performance
- Lack of strategic alternatives (M&A, large-scale expansion)

Returning capital owners (shareholders) is one of the few options available

2007 share buybacks shattered the 2006 record, up 214%

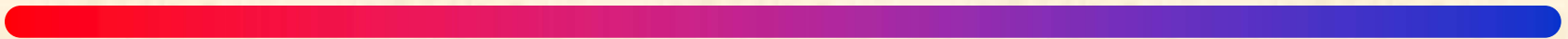
2007 repurchases to date equate to 3.9% of industry surplus, the highest in 20 years

\$22,322.6



COST OF RISK

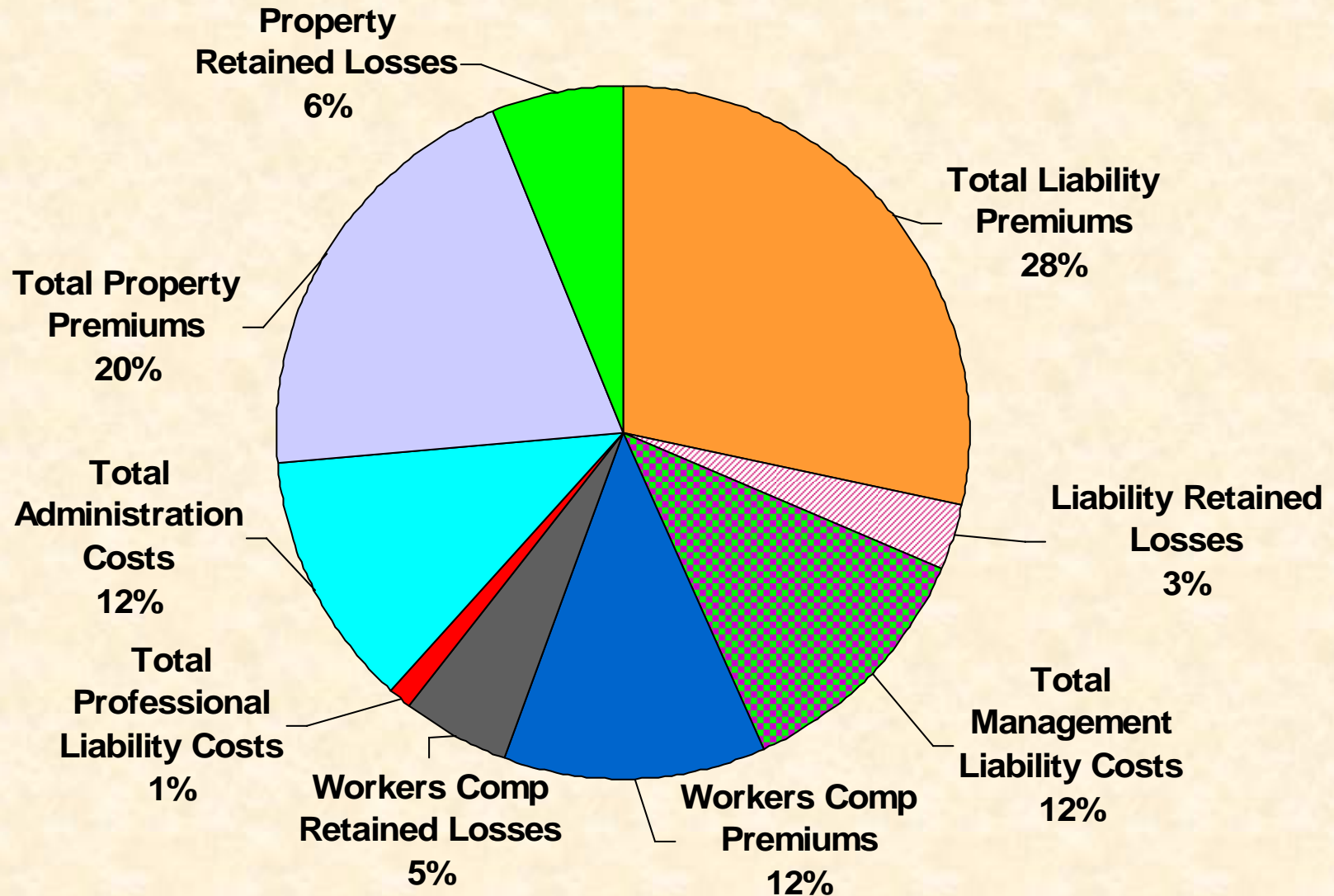
Utility Sector Focus





Utilities: How the Risk Dollar is Spent

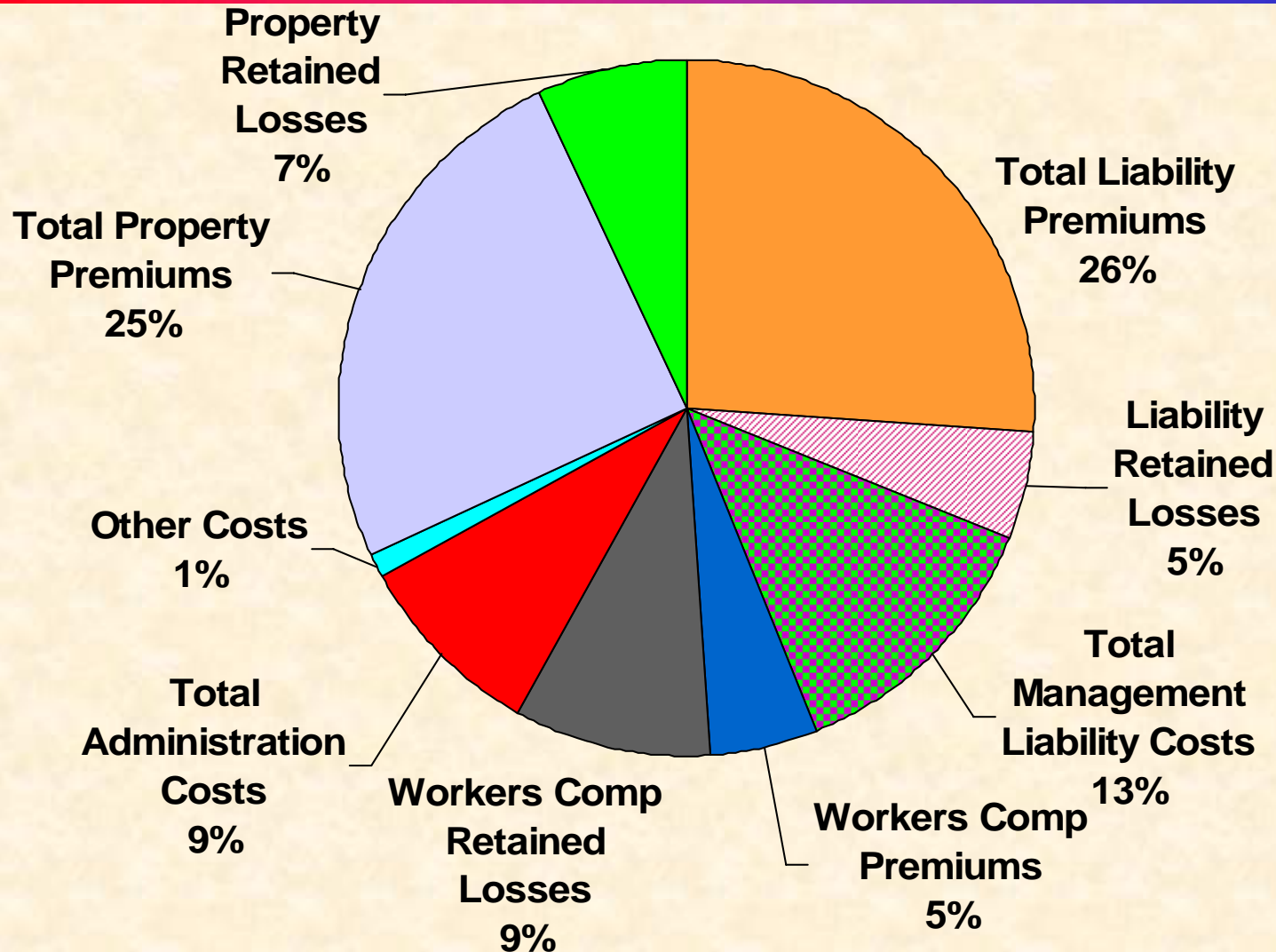
(Respondent Revenues < \$1B)





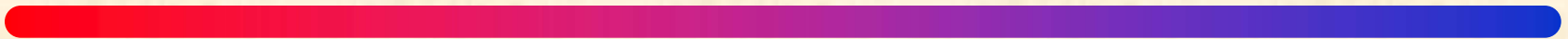
Utilities: How the Risk Dollar is Spent

(Respondent Revenues > \$1B)



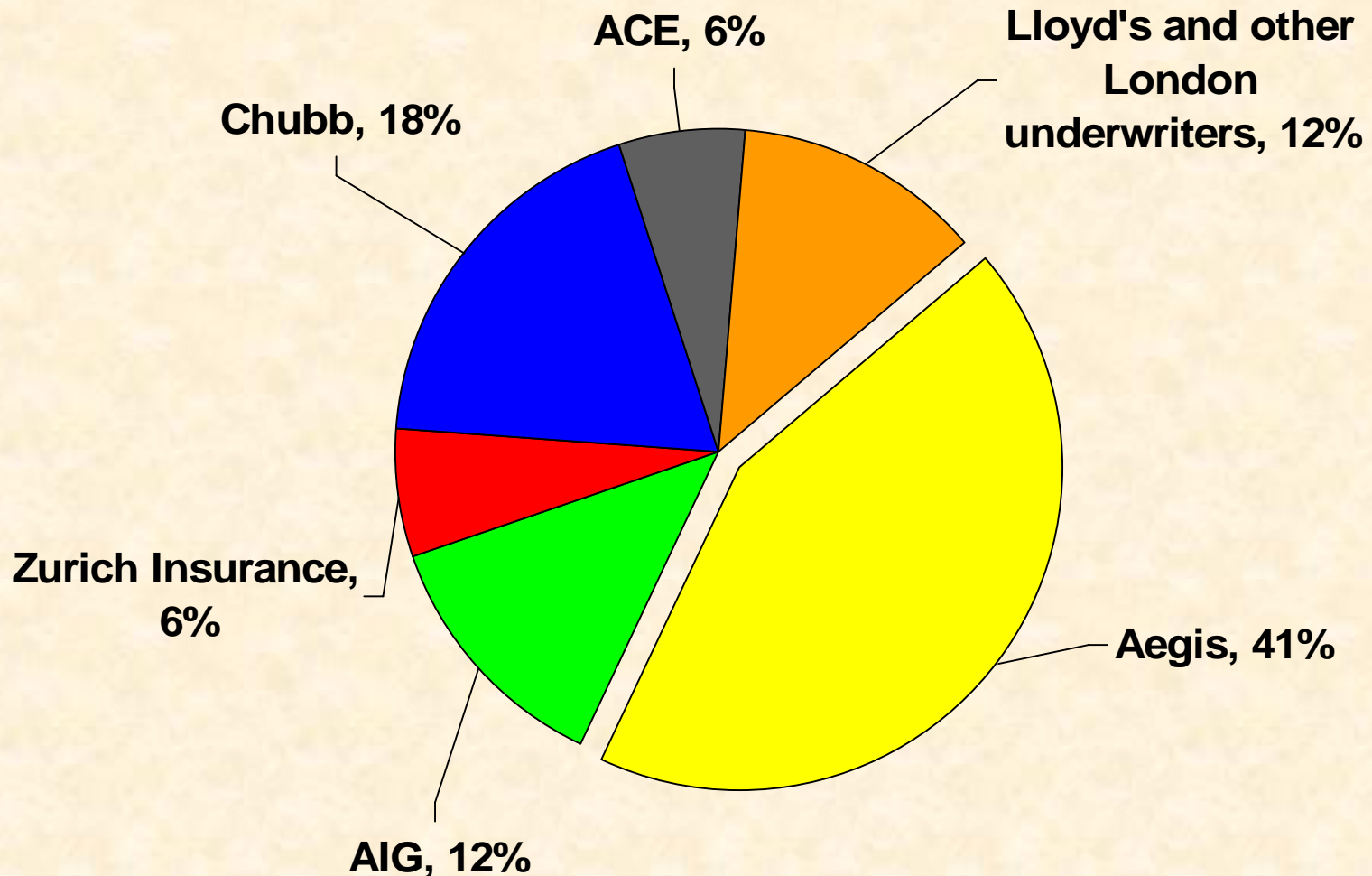
Directors & Officers Coverage

Energy Issues Not Today's
Driver of D&O Litigation





Leading Utility D&O Insurers by Premium Volume



Source: Tillinghast Towers-Perrin, 2007 *Directors and Officers Liability Survey*



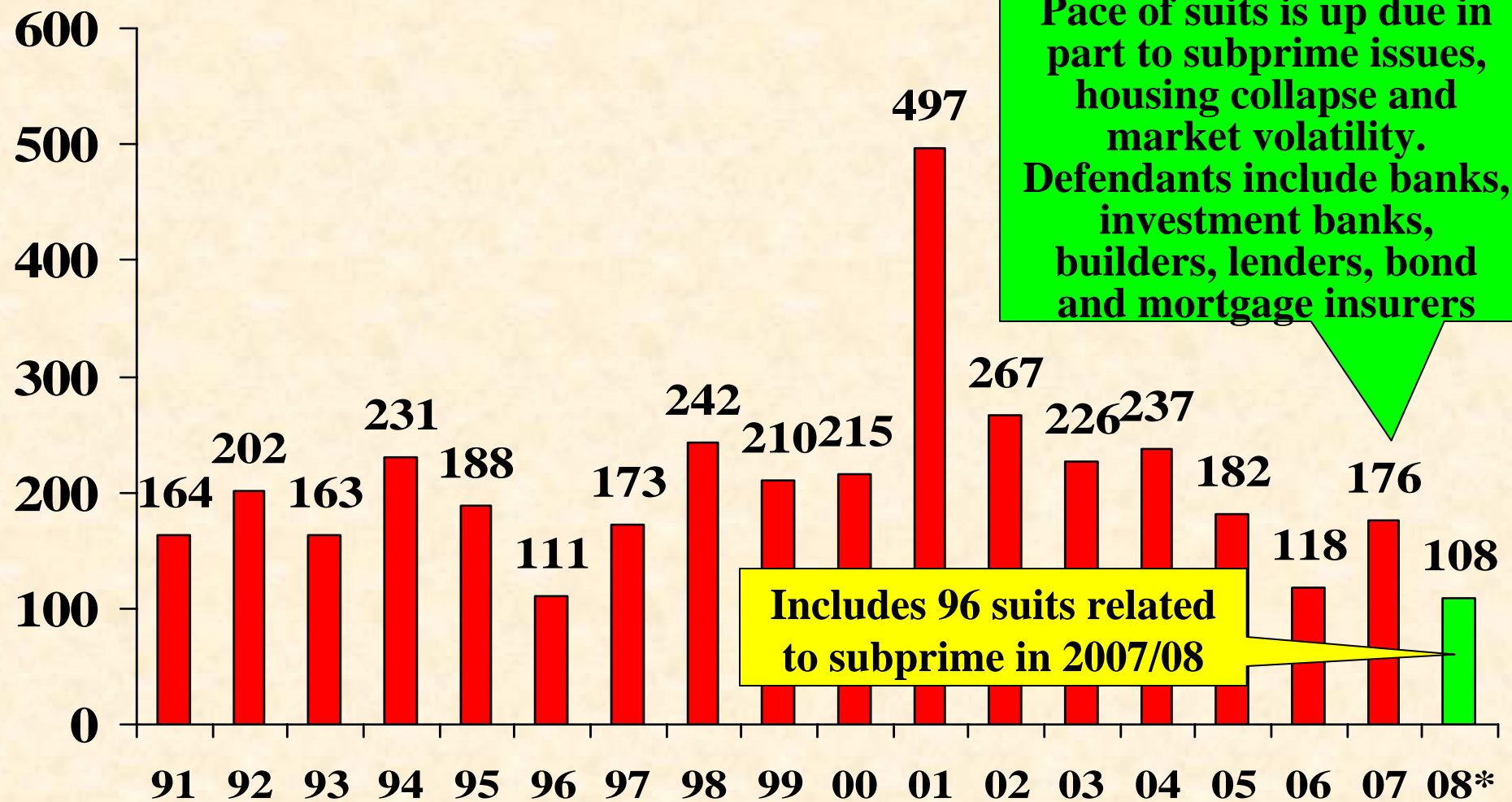
Corporate Governance & Directors & Officers Coverage

- **D&O Litigation**

- **Subprime & credit crisis is driving much of the (threatened) litigation today**
- **Energy sector is not at center of today's D&O concerns**
 - **Focus is on financial institutions and other entities affected by subprime/credit problems**
 - **Outside of financial institutions, prices falling**



Shareholder Class Action Lawsuits*

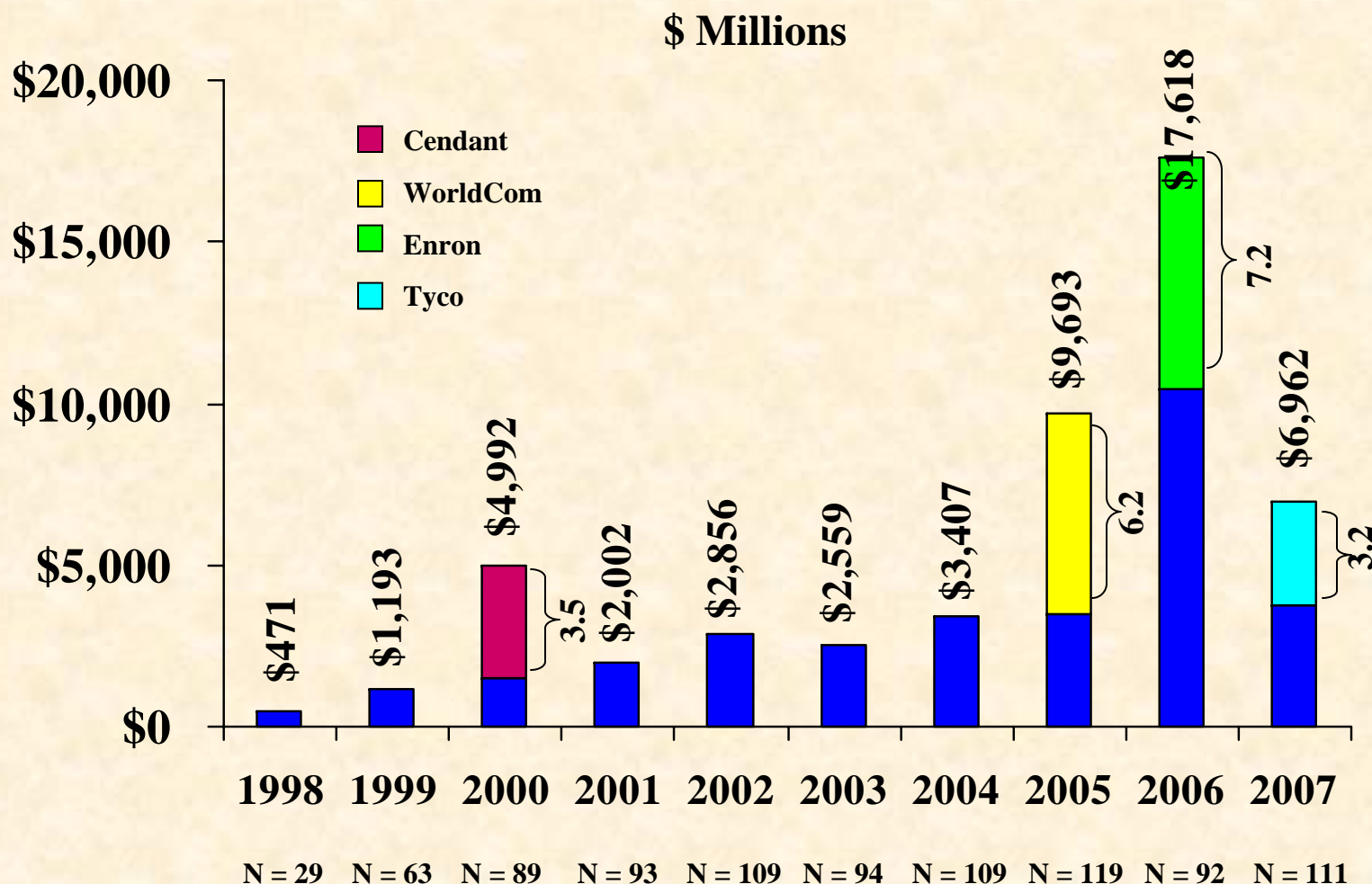


*Securities fraud suits filed in U.S. federal courts; 2008 figure is current through July 2.

Source: Stanford University School of Law (securities.stanford.edu); Insurance Information Institute



Securities Class Action Claims: Total Settlement Dollars, 1998-2007

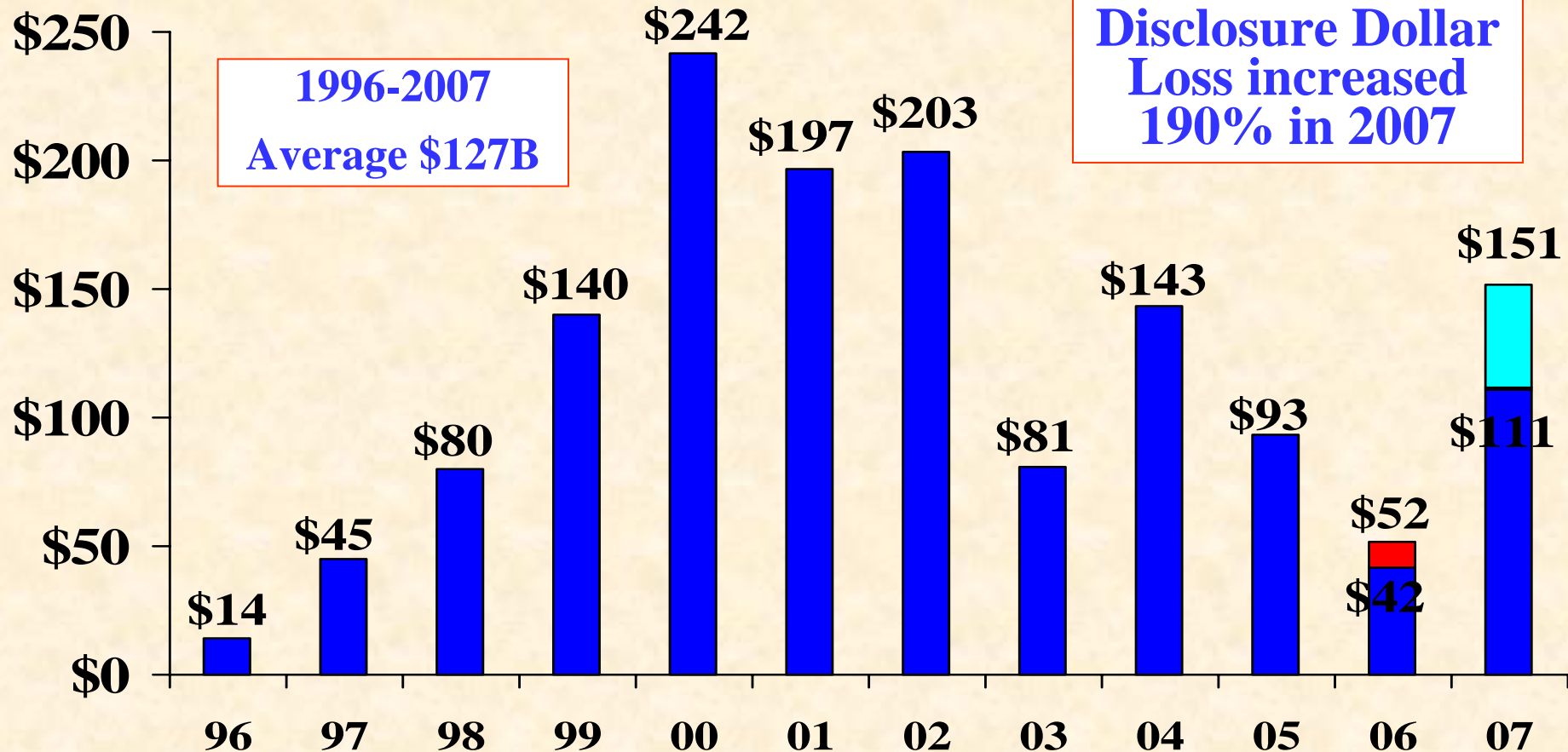




Disclosure Dollar Loss, 1996-2007 (\$ Billions)*

\$ Billions

■ All Other Filings ■ Options Backdating ■ Subprime Filings

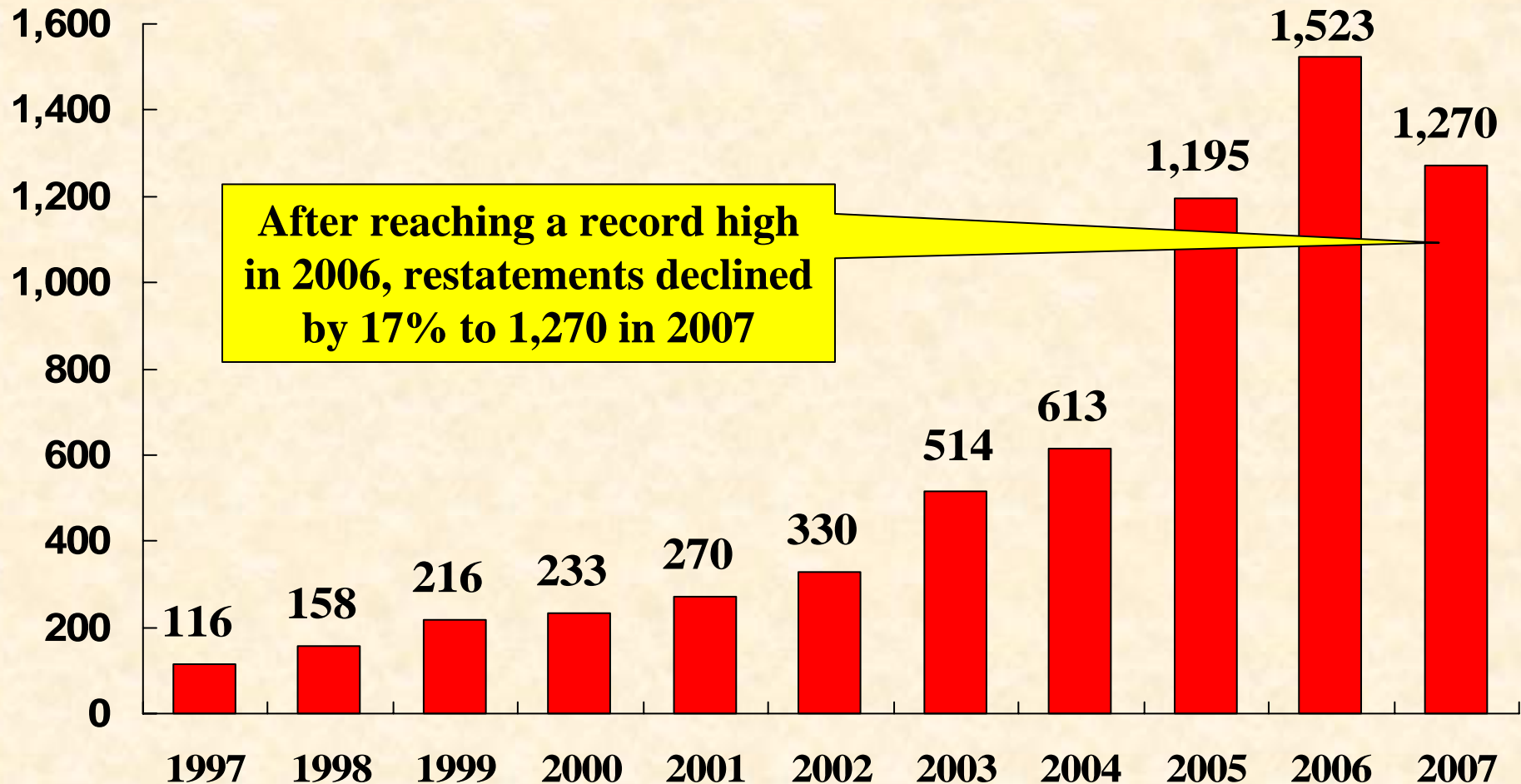


* Dollar Disclosure Loss is the decline of market capitalization from the trading day immediately preceding the end of class period to the trading day immediately following the end of the class period.

Source: Stanford University School of Law (securities.stanford.edu); Cornerstone Research.



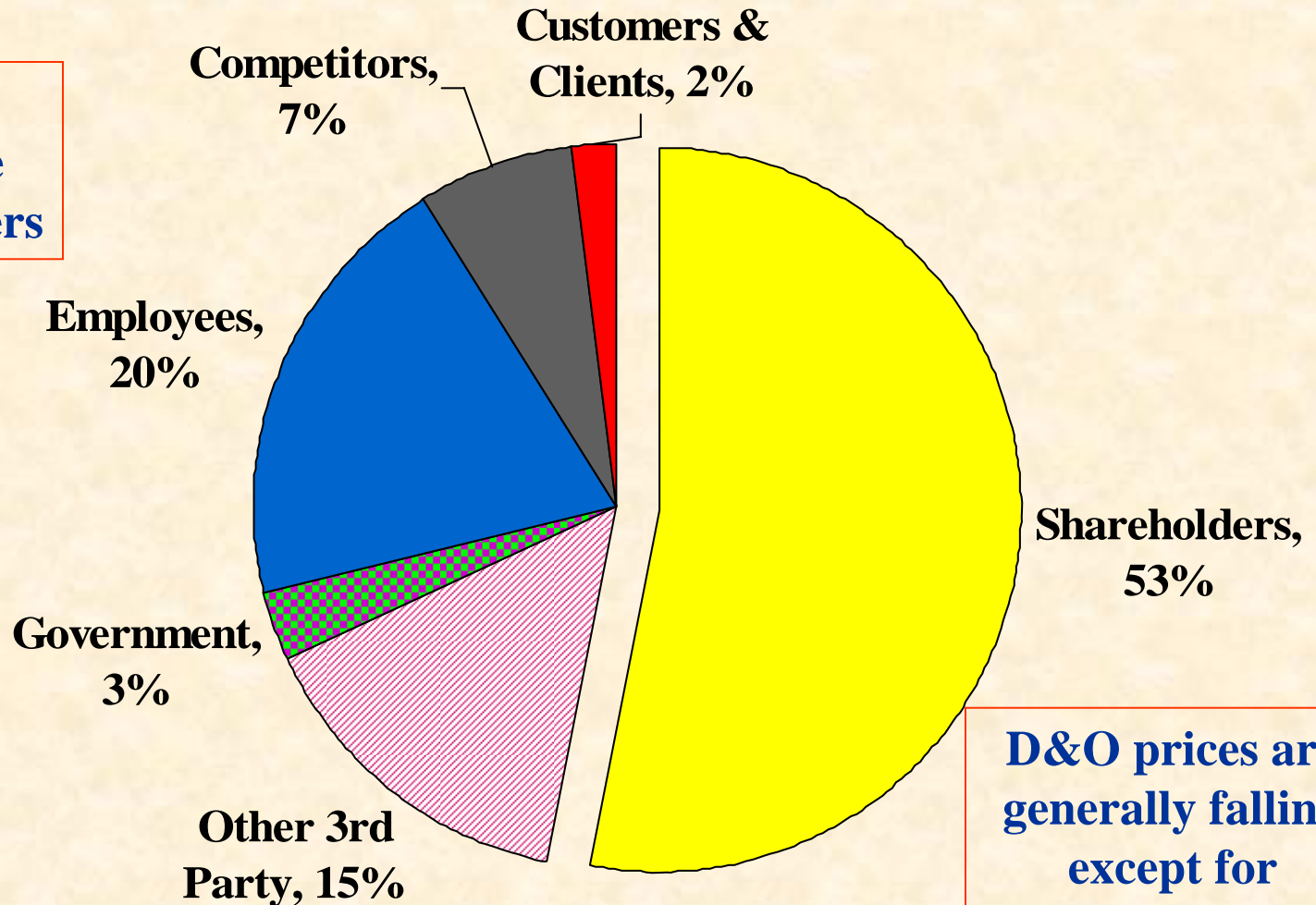
Financial Restatements Filed Continue to Grow





Origin of D&O Claims for Public Companies, 2007

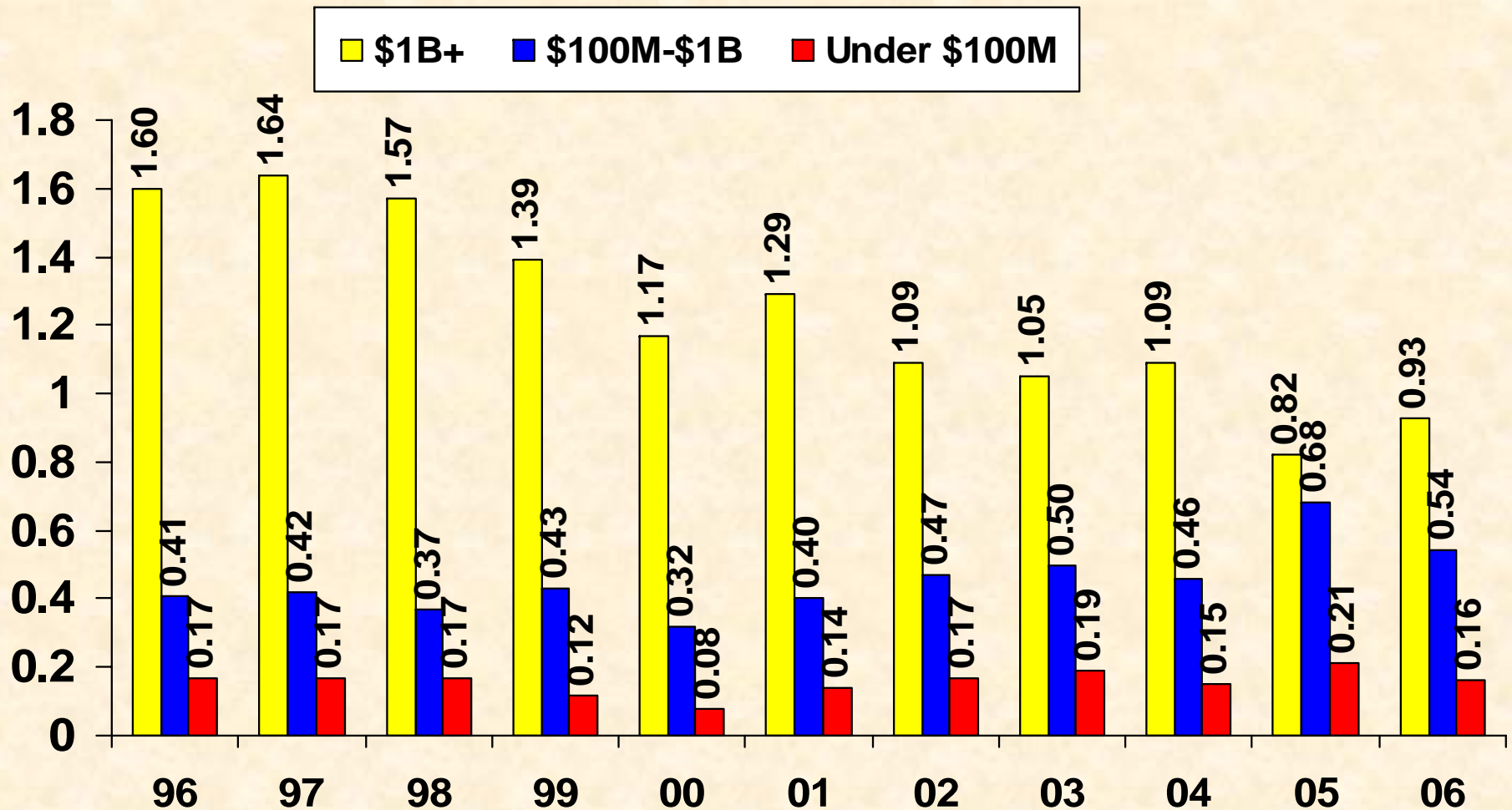
53% of D&O suits originate with shareholders



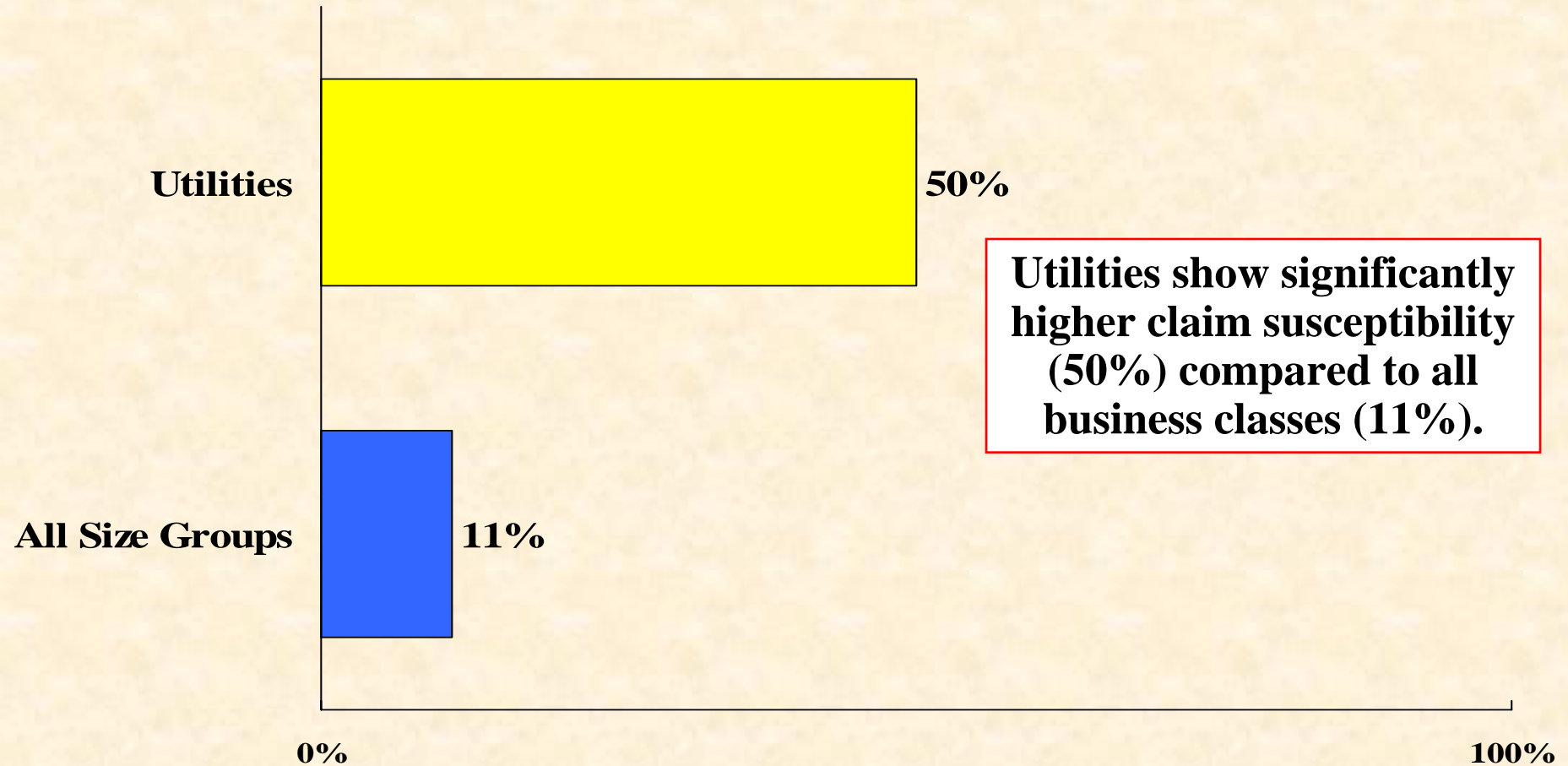
D&O prices are generally falling except for Financial Institutions



*D&O Frequency Trends by Asset Size**



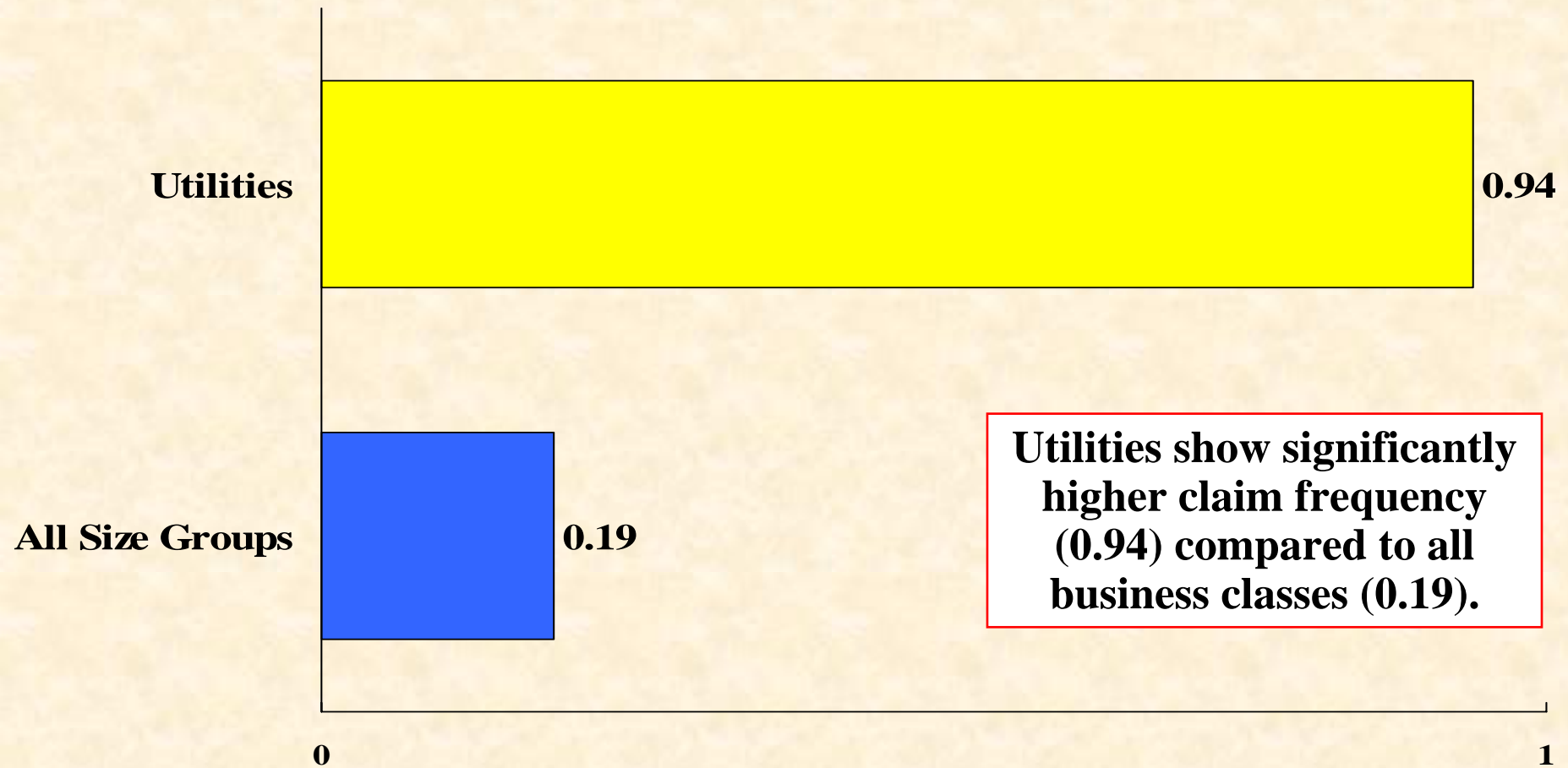
*Claim Incidence (Susceptibility): Utilities vs. All Businesses, 2007**



*Claim susceptibility is defined as the percentage of participants that reported one or more claims over the 10-year experience period. A claim susceptibility of 10% would indicate that one-tenth of all survey participants had at least one claim during the 10-year experience period.

Source: Tillinghast Towers-Perrin, *2007 Directors and Officers Liability Survey*

*Claim Incidence (Frequency): Utilities vs. All Businesses, 2007**



*Claim frequency is the average number of claims per participant over the 10-year experience period. A claim frequency of 0.25 would indicate that 100 entities reported a total of 25 claims over the 10-year experience period.

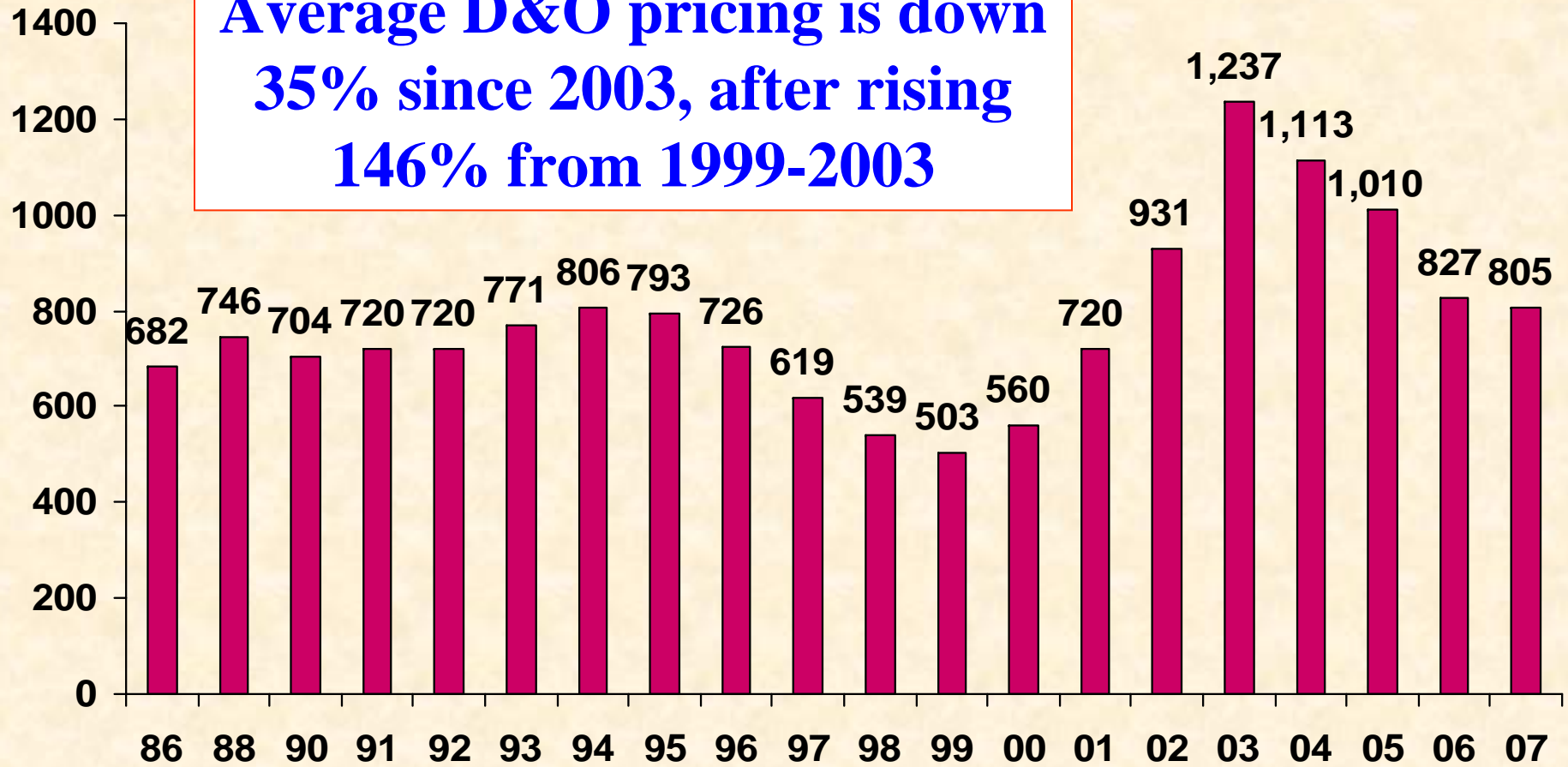
Source: Tillinghast Towers-Perrin, *2007 Directors and Officers Liability Survey*



D&O Premium Index

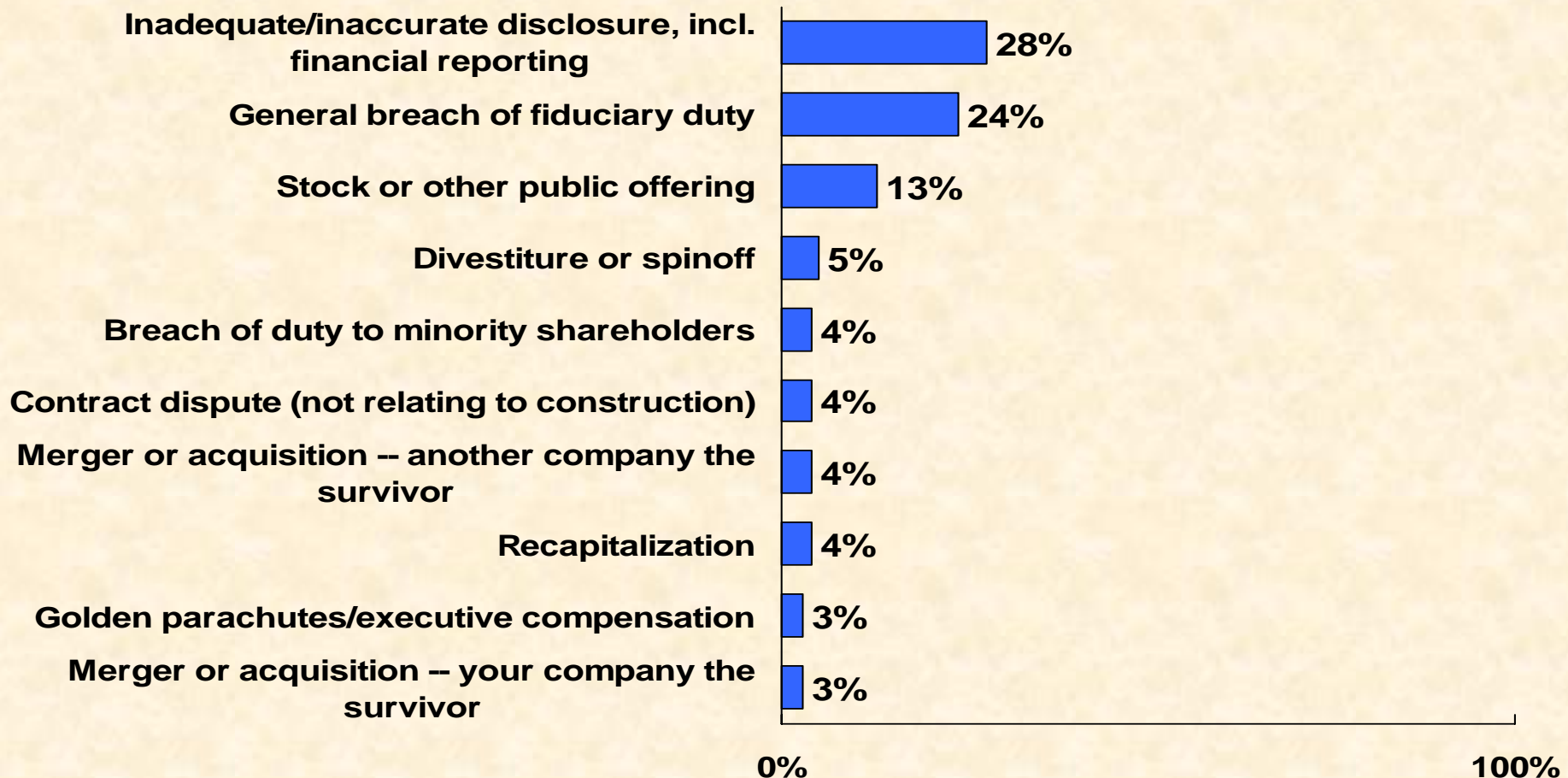
(1974 Average = 100)

**Average D&O pricing is down
35% since 2003, after rising
146% from 1999-2003**



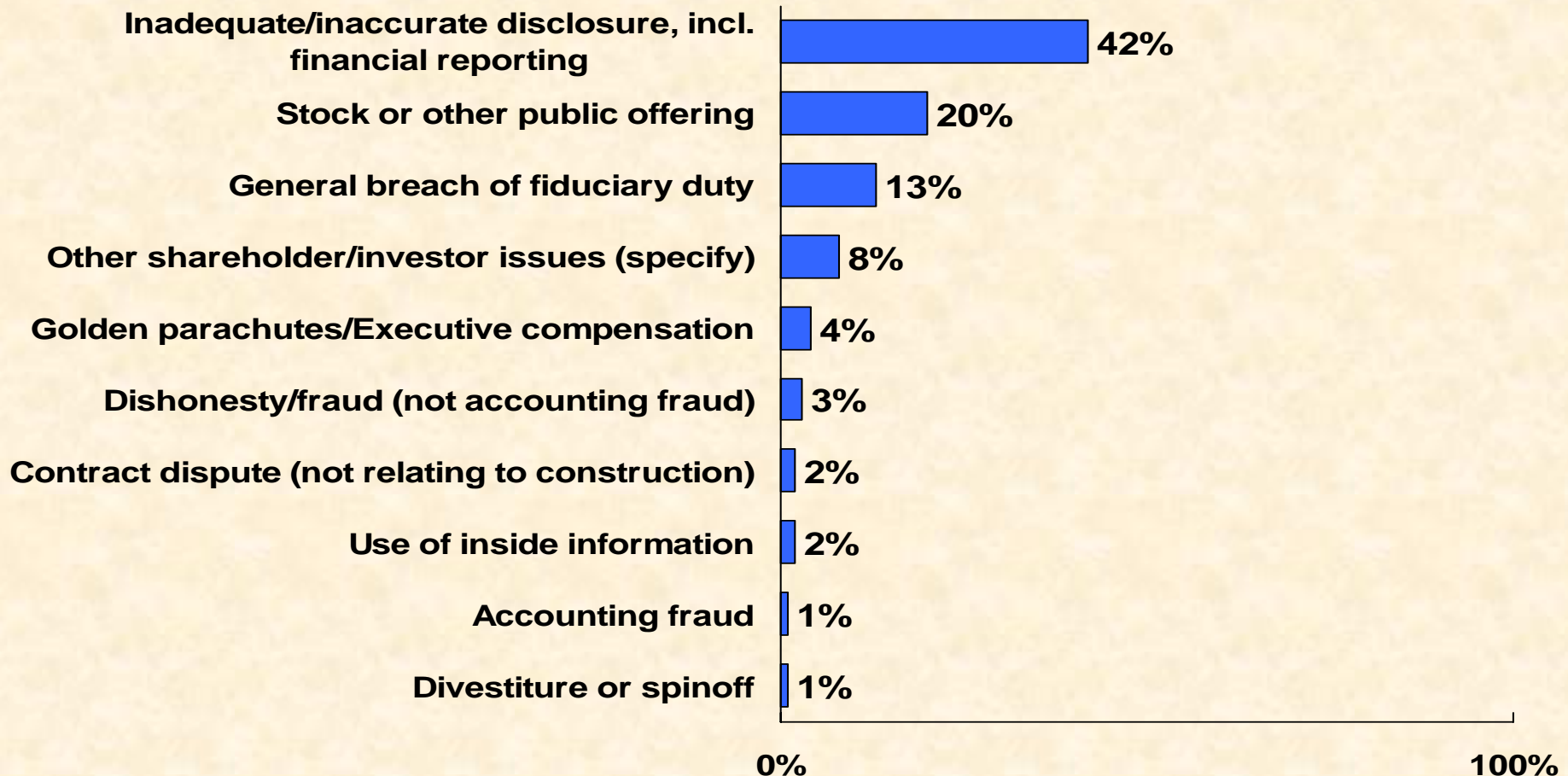
Top 10 D&O Claim Allegations From Shareholder Claimants by Ownership

Private Companies



Top 10 D&O Claim Allegations From Shareholder Claimants by Ownership

Public Companies



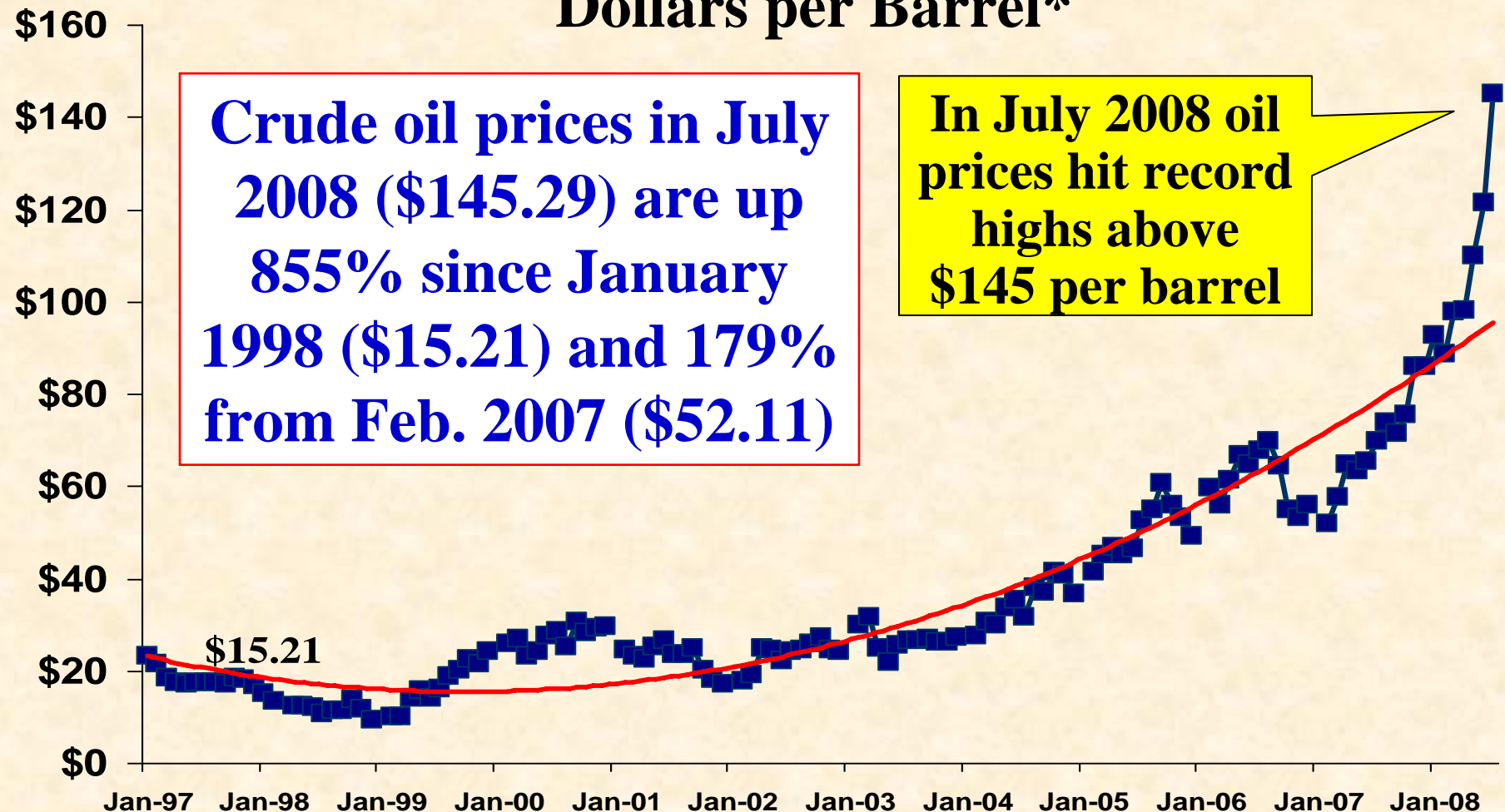
ENERGY MARKET REVIEW





World Crude Oil Prices: 1997- July 2008

Dollars per Barrel*

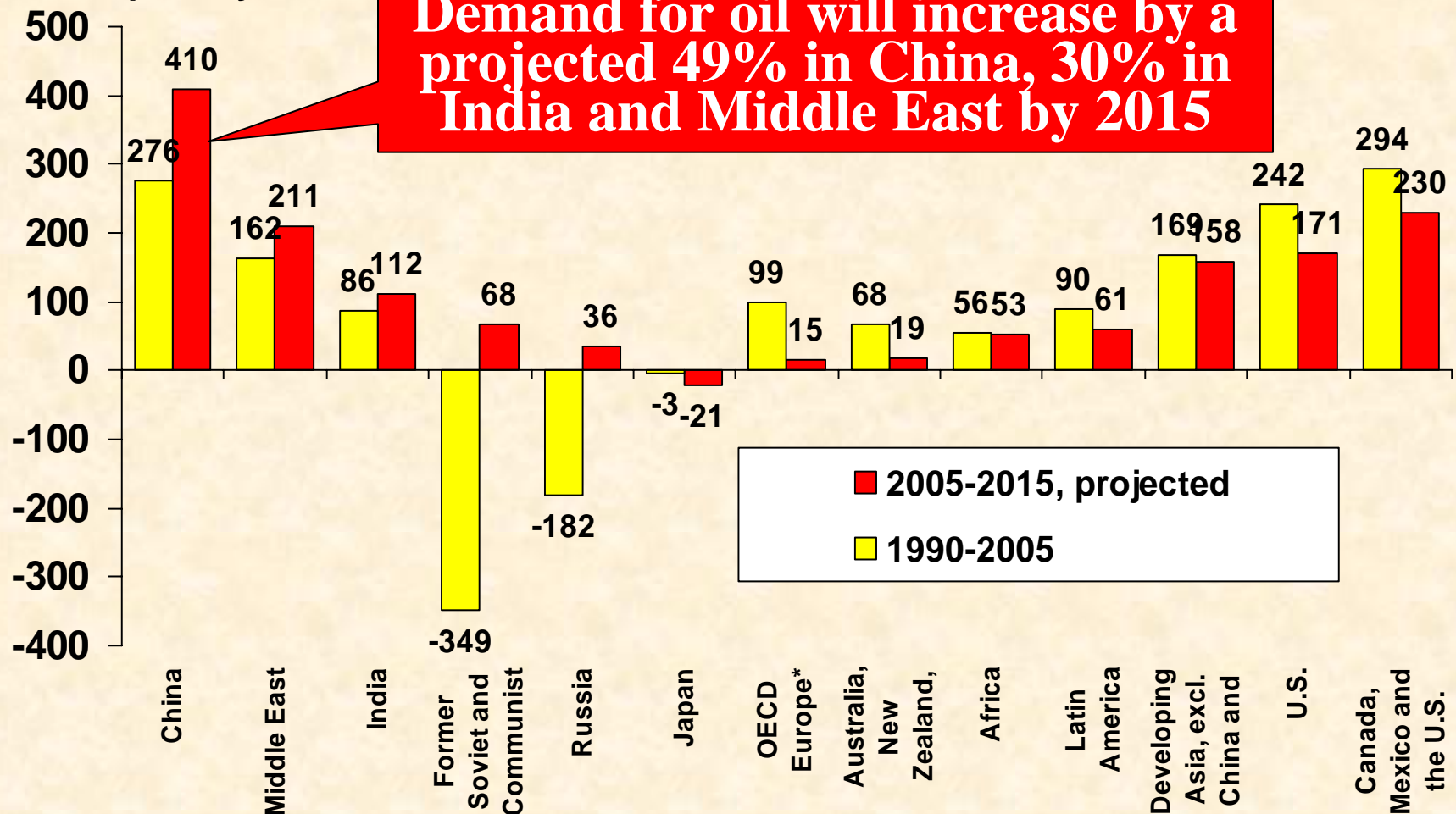


*All countries spot market price weighted by estimated export volume. July 2008 figure is NYMEX crude.
Source: Energy Information Administration; <http://tonto.eia.doe.gov/dnav/pet/hist/wtotworldw.htm>



Avg. Annual Change in Consumption of Crude Oil in Major World Regions

000 barrels per day



*Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey and UK.
Source: Wall Street Journal, January 3, 2008 edition; International Energy Agency



Energy Market: Key Trends

- **Energy loss record continues to improve after second consecutive quiet year (2006/07)**
- **Profitable energy sector has led to increased market capacity (highest since 9/11)**
- **Greater capacity has led to continued price pressure in 2008 (mirrors most of commercial mkt.)**
- **Energy sector not at center of emerging D&O issue arising from subprime issue (no similarities to Enron era)**



Energy Market: Primary Threats

- **Major CATs, esp. in Gulf of Mexico**
- **Facilities running at full capacity: strained?**
- **Pushing limits of existing/new technology?**
- **Increased political risk abroad in some areas**
- **Inflation: Higher labor, contractor & building materials costs: Rebuild/repair costs rising**
- **Oil is at center of global commodities boom; Could go bust, esp. as economies weaken?**
- **Climate change, CO2 regs, environmental regs**
- **Ocean Marine, Transport Risk**
- **Terrorism Threats/Vulnerability**
- **US political & tort shifts?**



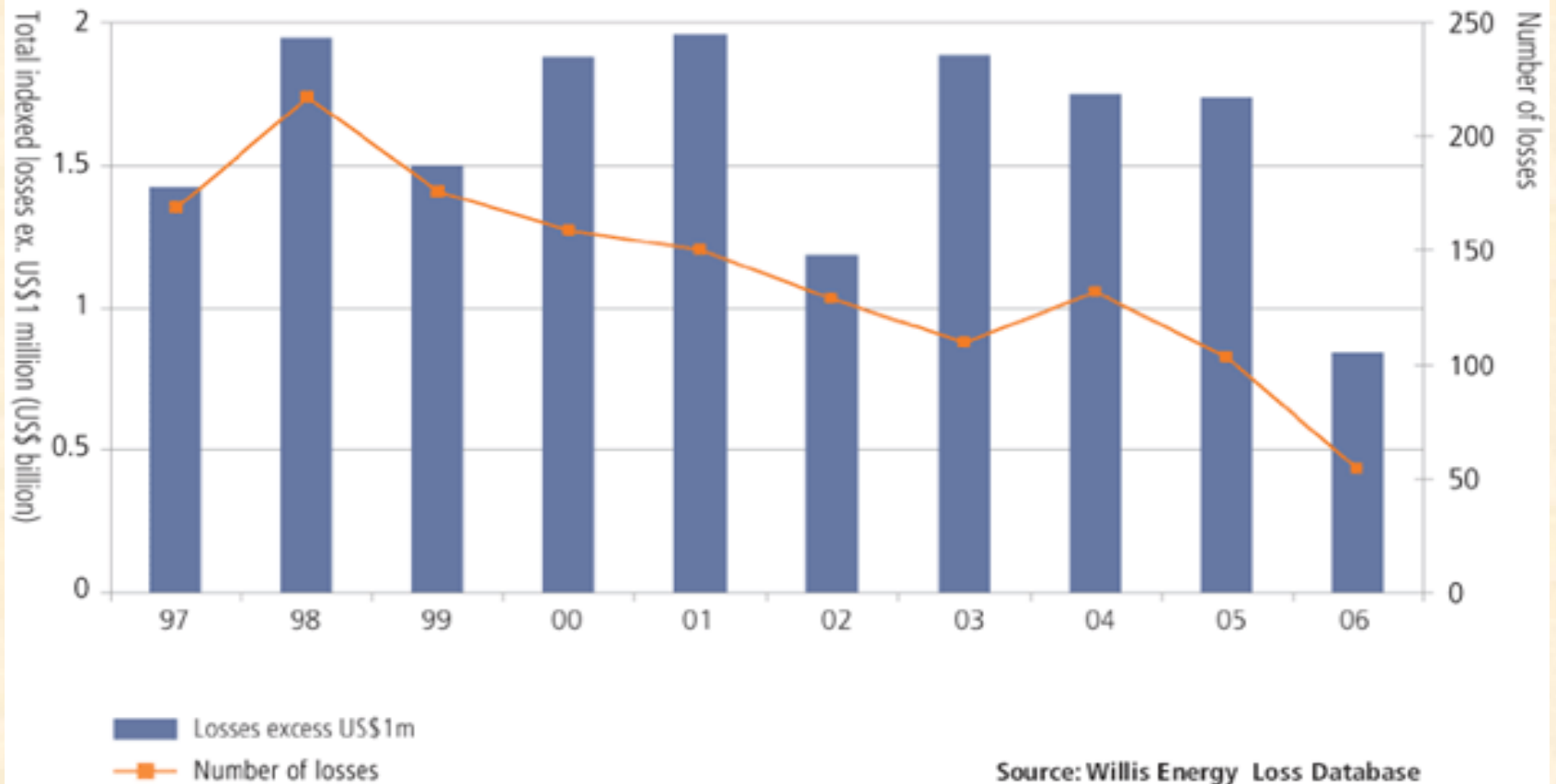
Oil/Energy is Replacing Credit as Chief Source of Economic Instability

- **Rising oil/energy prices leading to severe economic dislocation and hardship on a global scale**
- **Reduced economic growth globally (except energy exporting countries)**
- **Fueling inflation**
 - **Forcing central banks to raise interest rates**
- **Encouraging collateral boom in other commodities**
- **Increasing the cost of food production**
- **Disastrous for transport sector (e.g., airlines)**
- **Food, energy costs are acute problems in poorest parts of the world (rioting in some areas)**
- **Increasing the power and wealth of states opposed to US policy interests (e.g., Iran, Venezuela)**
- **Influence on US biofuels policy**



Offshore Losses Excl. Windstorm, 1997-2006

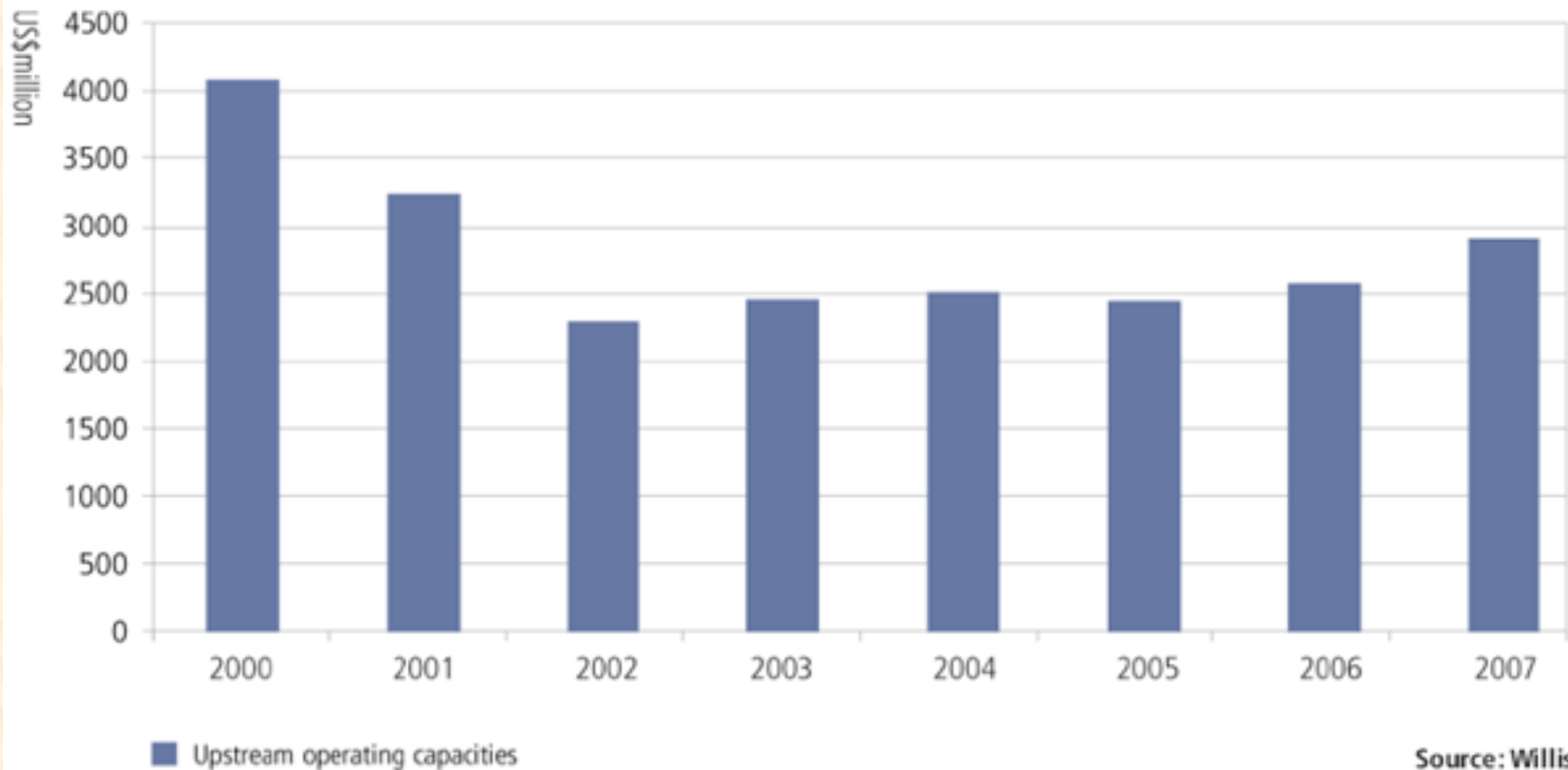
A volatile sector? – offshore losses excluding windstorm, 1997-2006





Upstream Operating Underwriting Capacities, 2000-07

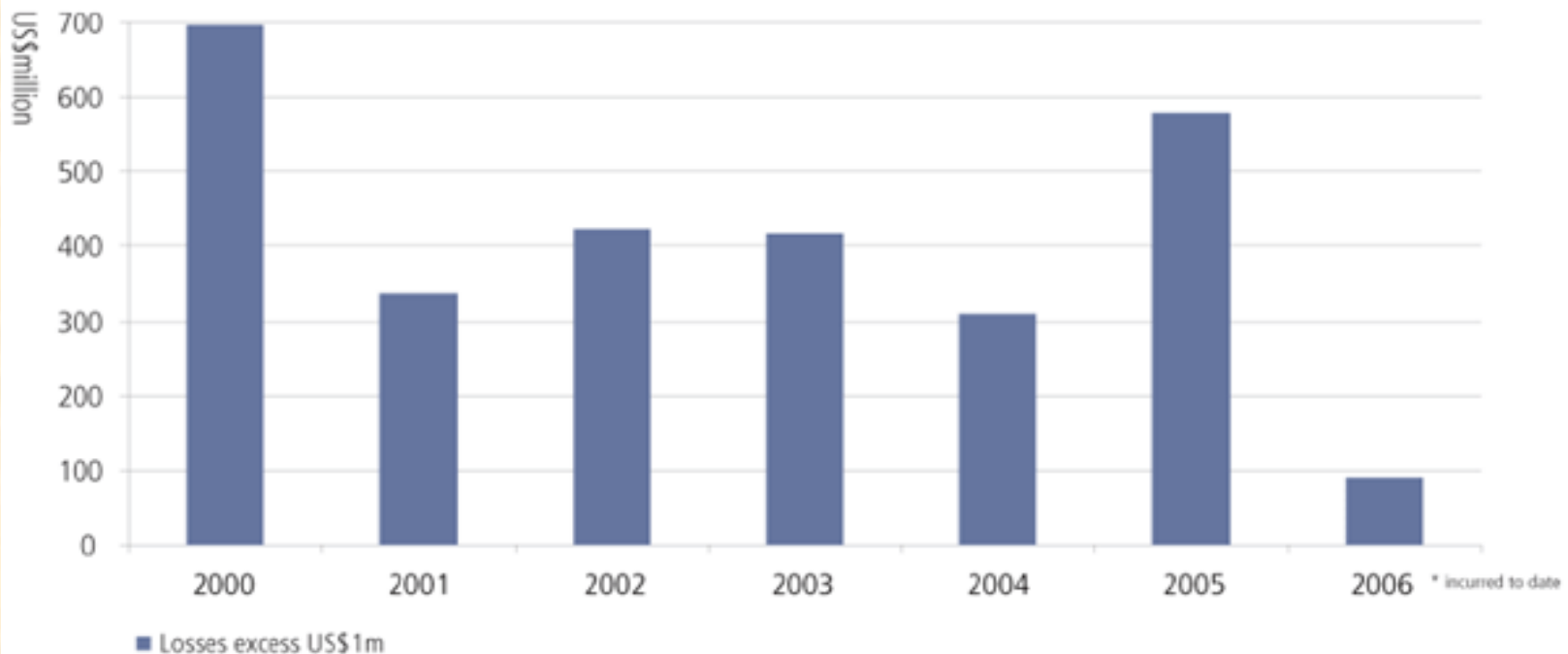
Upstream operating underwriting capacities, 2000-07 (excluding Gulf of Mexico Windstorm)





Worldwide Offshore Construction Losses, 2000-2006 (> \$1M)

Worldwide offshore construction losses 2000-2006 above US\$ 1 million

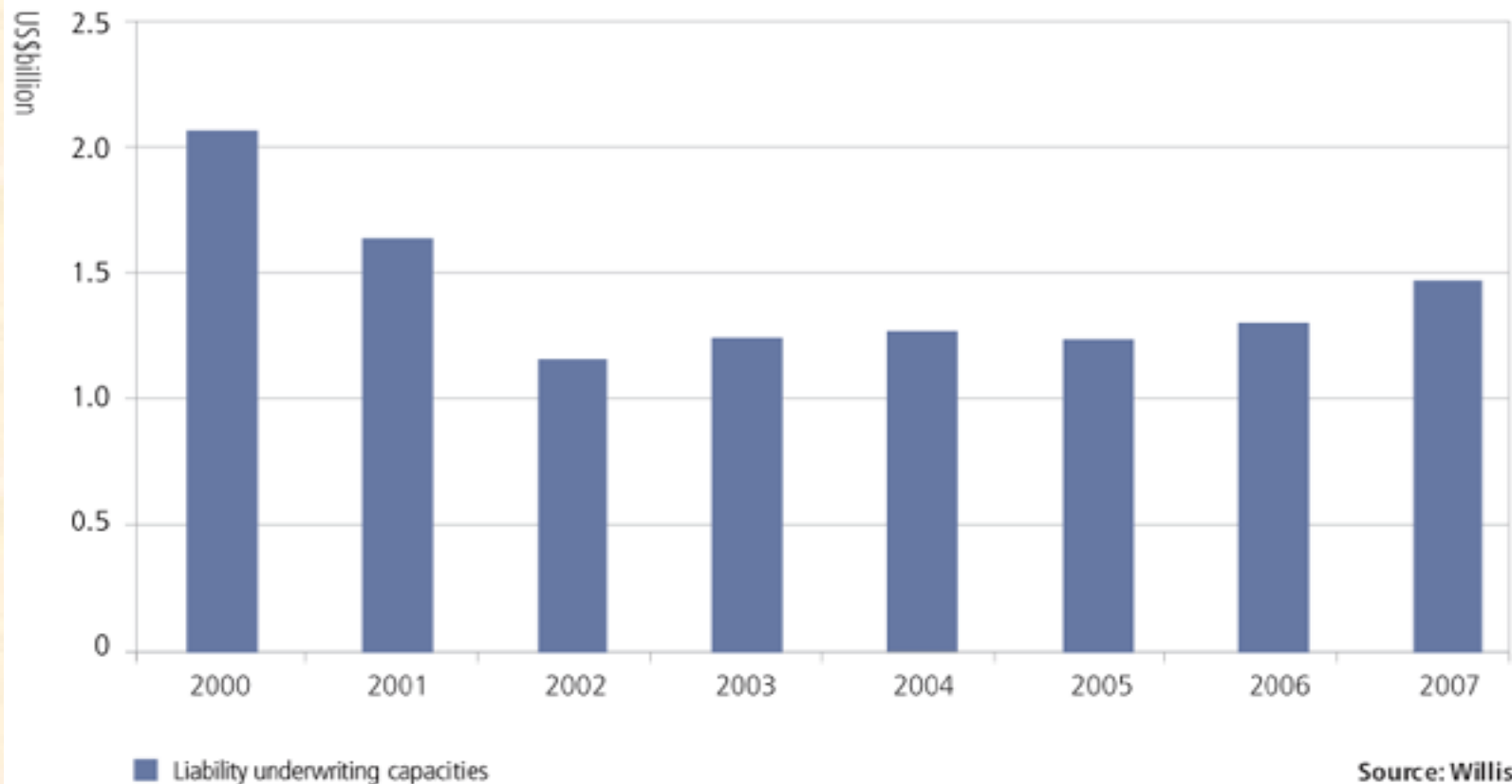


Source: Willis Energy Loss Database



Liability Market Capacity 2000-2007

Liability market capacity, 2000-2007





Global Political Risk is Always an Issue in Energy Markets

- **IRAN:** Leader unpopular at home; Constant saber-rattling with US; Domestic energy shortages
- **IRAQ:** Situation improving but unclear if Iraqi regime can protect oil infrastructure
- **RUSSIA:** Politically and economically resurgent country; nationalism rising
- **NIGERIA:** Domestic political instability, energy infrastructure vulnerable
- **VENEZUELA:** Chavez is US antagonist

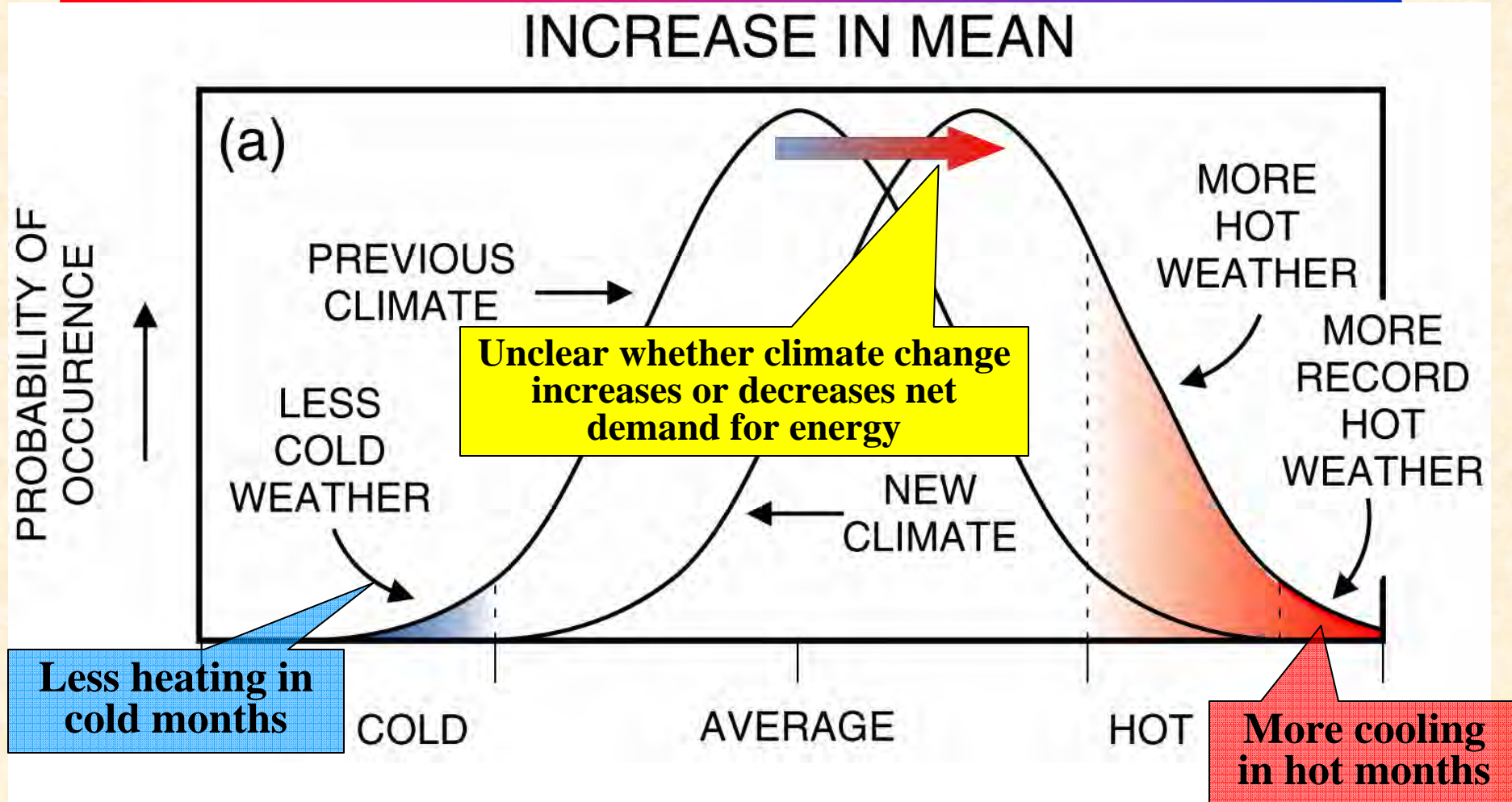
UTILITIES, CLIMATE CHANGE & INSURANCE RISK

*Property, Casualty,
Operational and
Political Effects*





Mean Temperature Rise Implies Increase in Extreme Heat Events

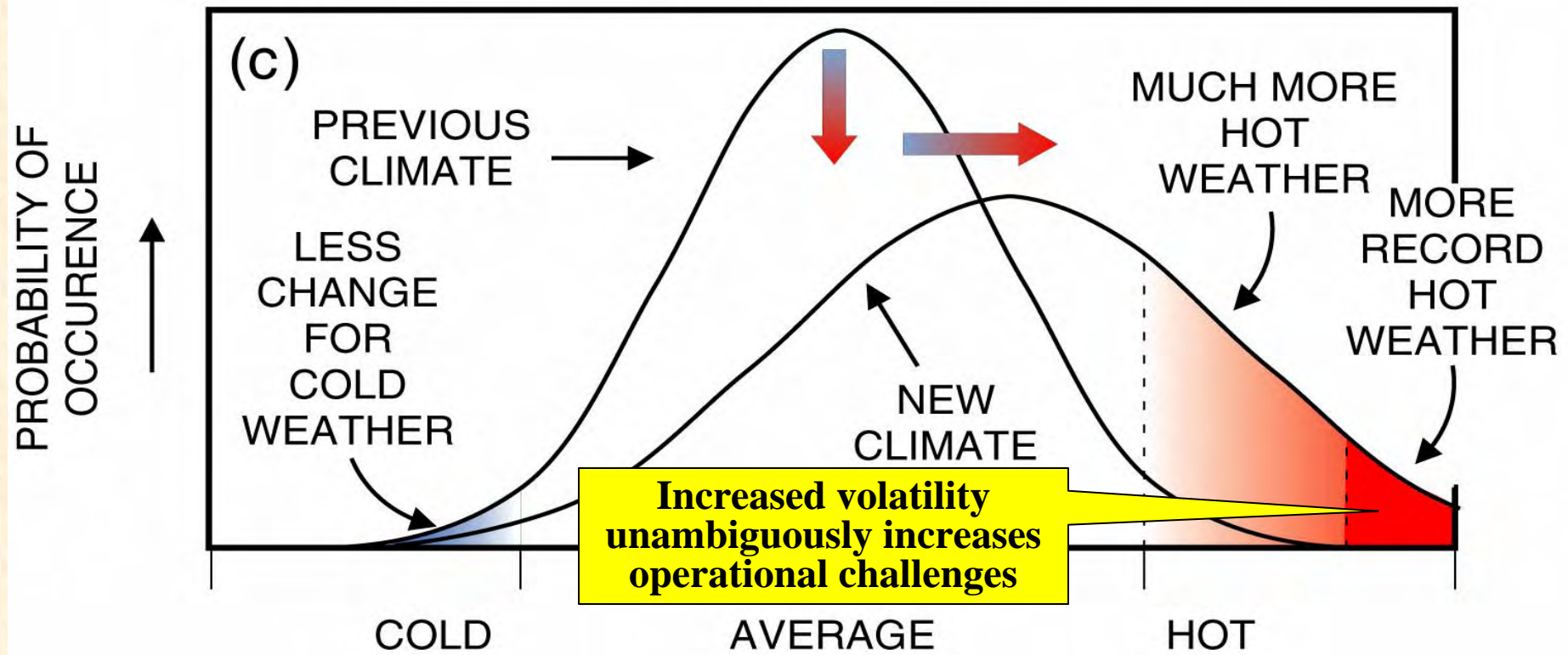


Much bigger percentage changes in extremes



Mean Temperature Rise Implies Increase in Extreme Heat Events

INCREASE IN MEAN AND VARIANCE



Much bigger percentage changes in extremes



Elements of Climate Change Risk Affecting Utilities

Risk	Potential Issues
Property Risk	<ul style="list-style-type: none">• Assumption is that climate will generally be more volatile• Extreme events more frequent• Implies utility disruptions (local/regional power outages) more frequent, more extensive• Hurricanes more intense (facility/infrastructure damage, fuel costs)
Liability Risk	<ul style="list-style-type: none">• Utilities will be blamed for less stable electrical service, surge losses and interruption to business• CO2 emission• Carbon capture & sequestration• Liability associated with alternative energy
Operational Risk	<ul style="list-style-type: none">• Rising and volatile fuel costs• Increased need for hedging, substitute adds risk
Political & Reputation Risk	<ul style="list-style-type: none">• Utilities caught in between• Consumers, consumer advocates, politicians will blame power generators (in part) for high prices• Regulators/legislators could slow ability to pass along increases in cost to consumers

CO₂ REGULATION

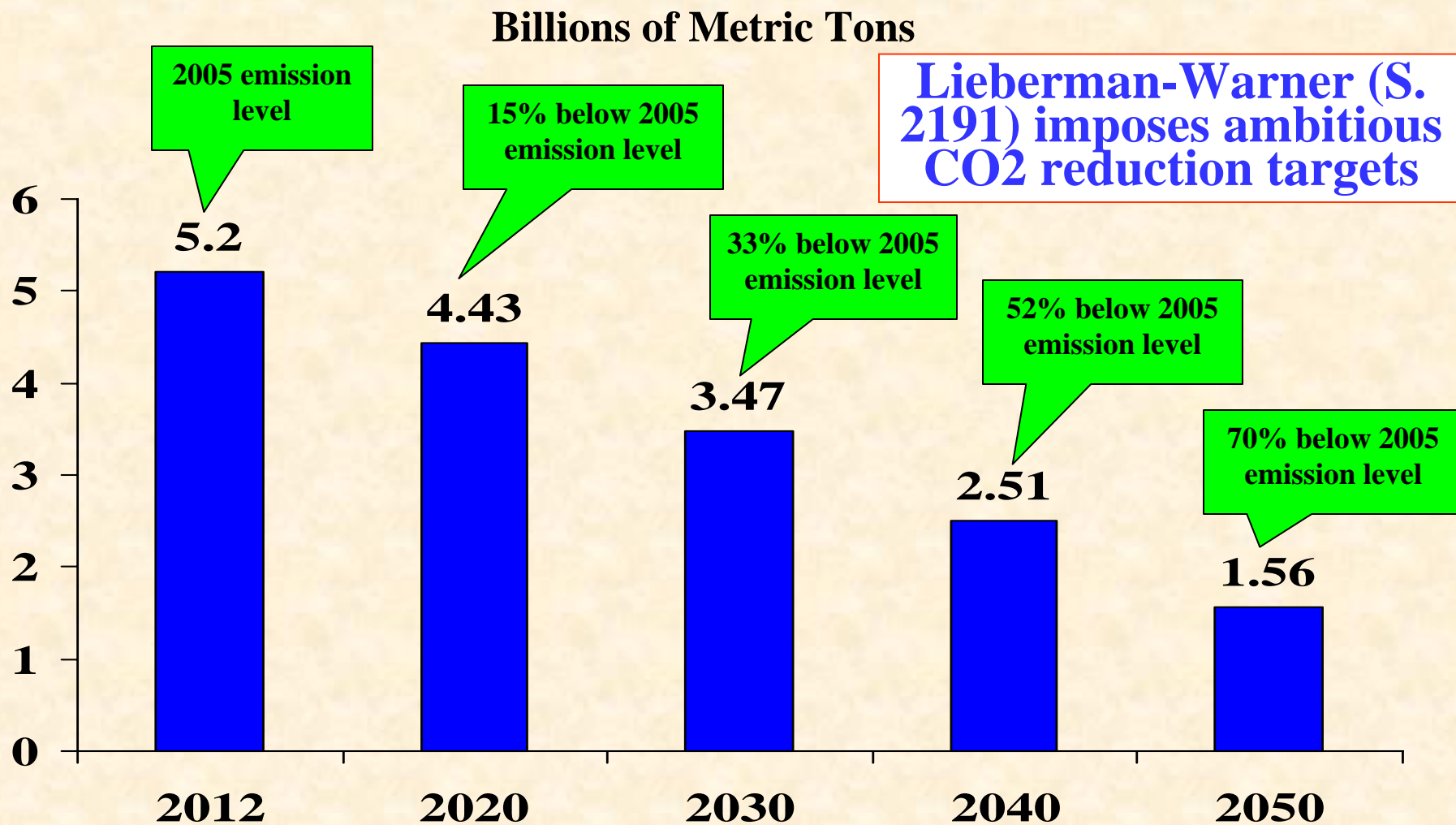
*Greenhouse Gases Can Be
Reduced, But at What Cost?*





CO₂ Caps Set by S. 2191

Through 2050 (Billions of Metric Tons)



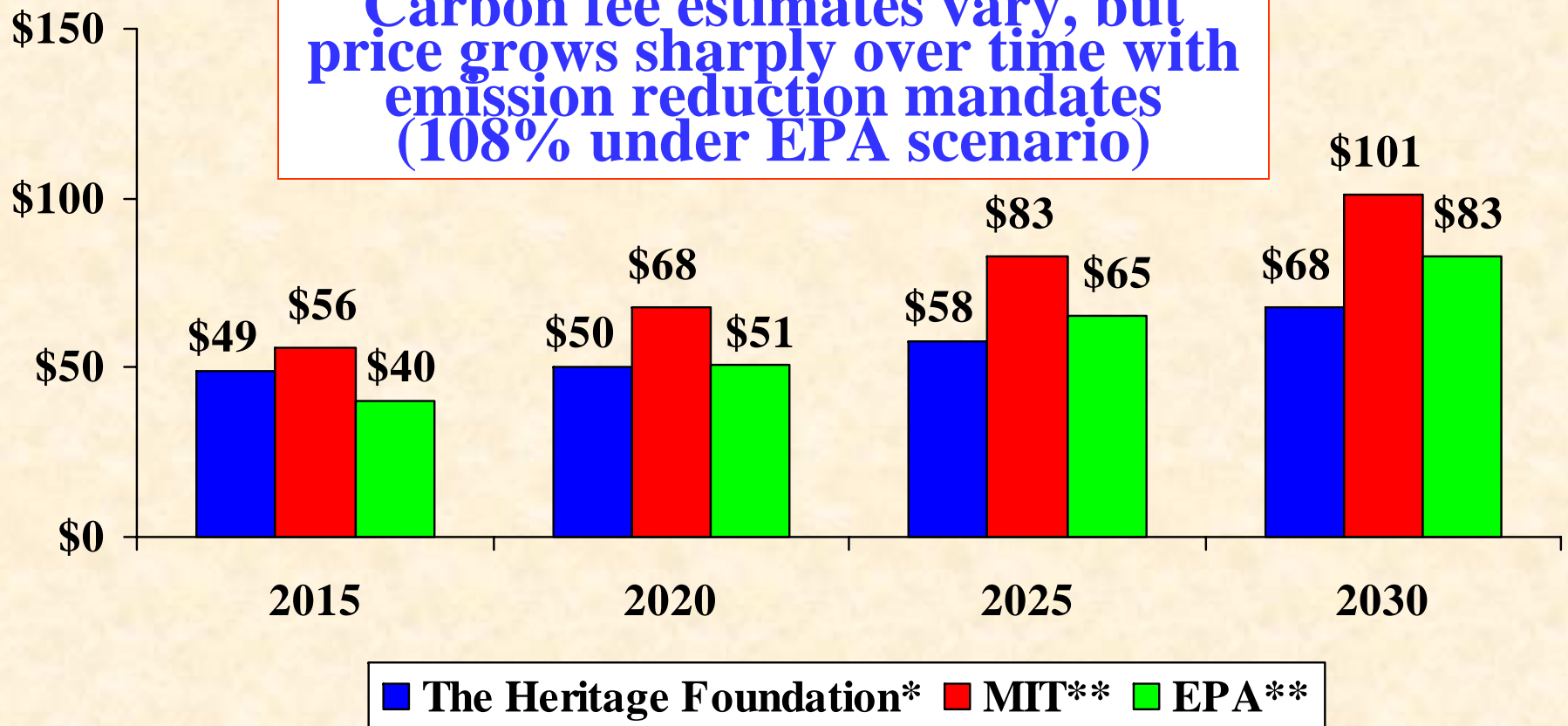
Source: Heritage Foundation; America's Climate Security Act of 2007, S. 2191, 110th Congress, 1st Sess. (2007), Sec. 1201 (d).



Comparing Simulations of Carbon Dioxide Fees

Carbon Fees Per Ton, Adjusted for Inflation

Carbon fee estimates vary, but price grows sharply over time with emission reduction mandates (108% under EPA scenario)



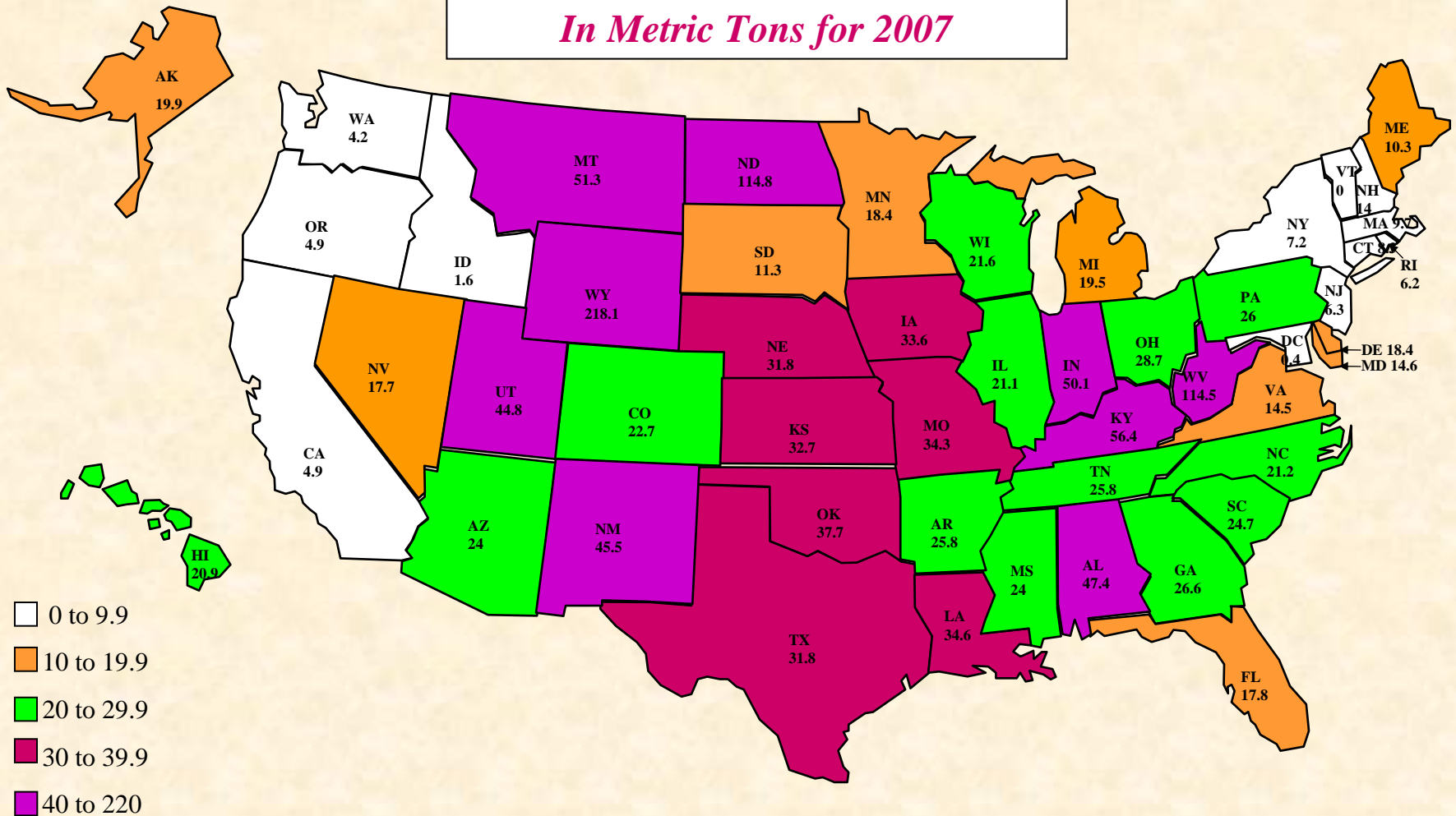
*In 2006 dollars; **In 2005 Dollars.

Source: Heritage Foundation, *The Economic Costs of the Lieberman-Warner Climate Change Legislation*, May 2008.




Per-Household Carbon Dioxide Emissions

In Metric Tons for 2007






Carbon Sequestration: An Alien Concept to Most Americans



**LEECHES. ALIENS.
CARBON SEQUESTRATION.**


(Perfect topics for your next barbecue.)





Hungry for science? This summer, Neil deGrasse Tyson serves up the freshest news from the front lines of scientific research.

 **NOVA**
science**NOW**

pbs.org/novasciencenow

WEDNESDAYS STARTING
JUNE 25 9PM ET/PT

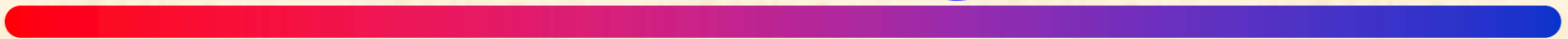
Be more  **PBS**

Funding provided by:    

Source: Back cover of *Discover Magazine*, July 2008.

Domestic Political Risk Rising for Energy Sector

**Profits, Economic Dislocation
Could Lead to Taxation
& More Regulation**





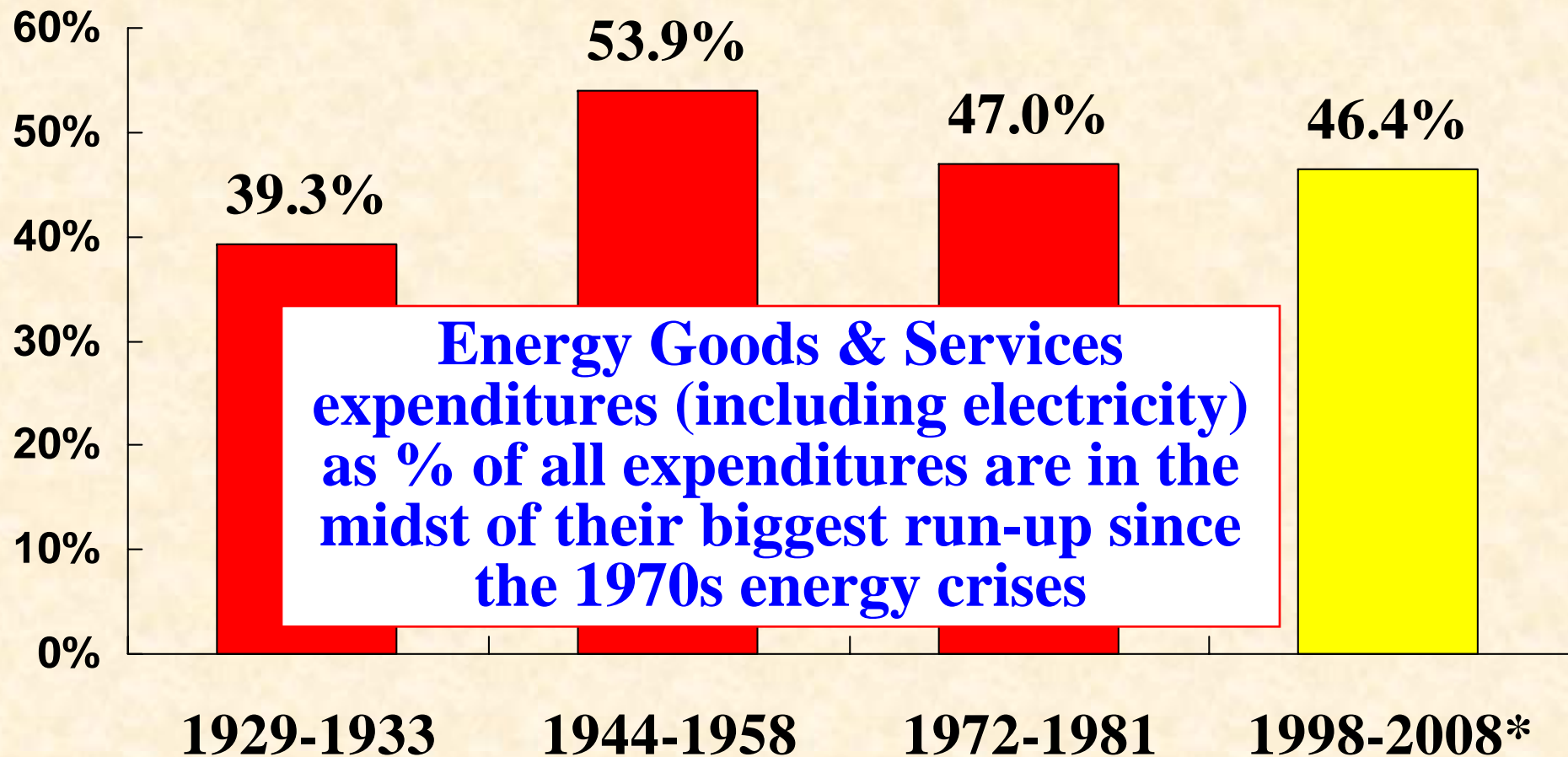
*Energy Goods & Services as % of All Personal Consumption Expenditures***



*First quarter 2008. **Includes electricity and fuel oils.

Source: US Bureau of Economic Analysis (Insurance Information Institute calculations).

*Increases in Energy Goods & Services as a % of All Personal Cons. Expenditures***



*As of 2008:Q1

**Includes energy and food costs.

Sources: Insurance Information Institute calculations from Bureau of Economic Analysis data.



Domestic Political Problems

on the Rise for Energy Concerns

- **Windfall profits tax is a major risk to energy firms**
 - **Top 5 publicly traded energy firms earned \$120 billion in 2007 (roughly twice entire p/c industry)**
- **Announced share buybacks increased from \$10B in 2003 to \$60B in 2006 (500%), while spending on:**
 - **Existing oil field develop. rose just 43% (\$35B to \$50B)**
 - **New oil field development rose 67% (\$6B to \$10B)**
- **Reality is that “incidence” of a tax will largely fall on the consumer**
- **Watch for additional focus on “bottlenecks” such as refineries which exert control over supply**



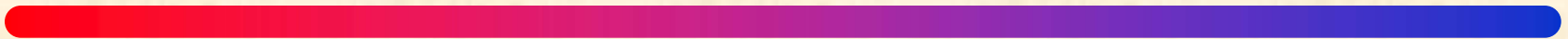
Domestic Political Problems

on the Rise for Energy Concerns

- **Continued Local Opposition to Building New Energy Generation Facilities of Any Sort (“NIMBY”)**
 - But energy firms will still be blamed for high prices
- **States Requiring Plant Designs that Conform to Their Own CO₂ Reduction Goals (Patchwork)**
 - Recent Georgia Case
- **High Construction Costs; Immense Red Tape**
- **Miscomprehension over Short and Intermediate-Term Potential of Alternative Energy**
- **No Understanding of Carbon Capture & Sequestration Technology, Risk or Cost**

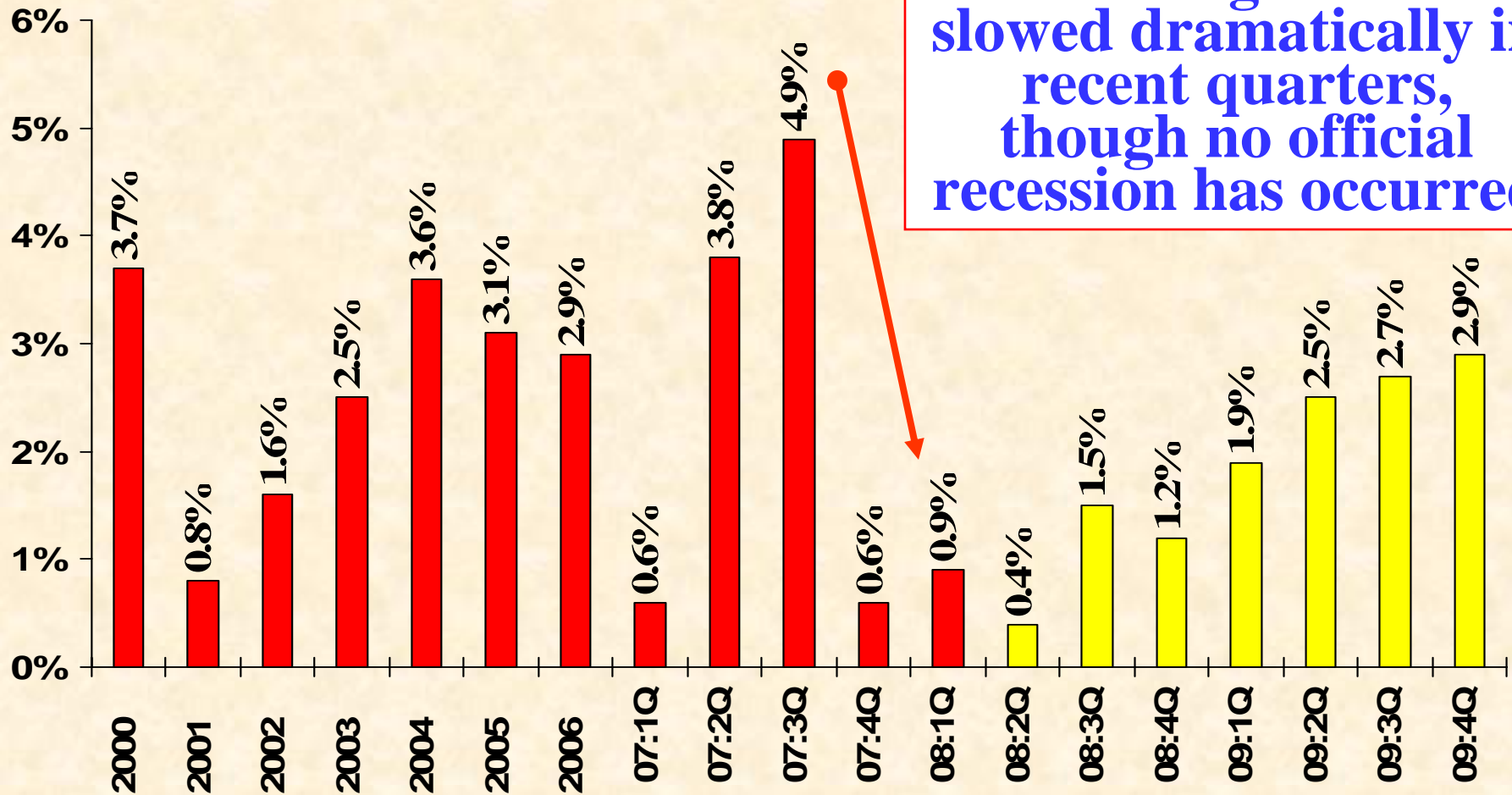
A STORMY ECONOMIC FORECAST

*What a Weakening Economy &
The Threat of Inflation Mean
 for the Insurance Industry*





*Real GDP Growth**

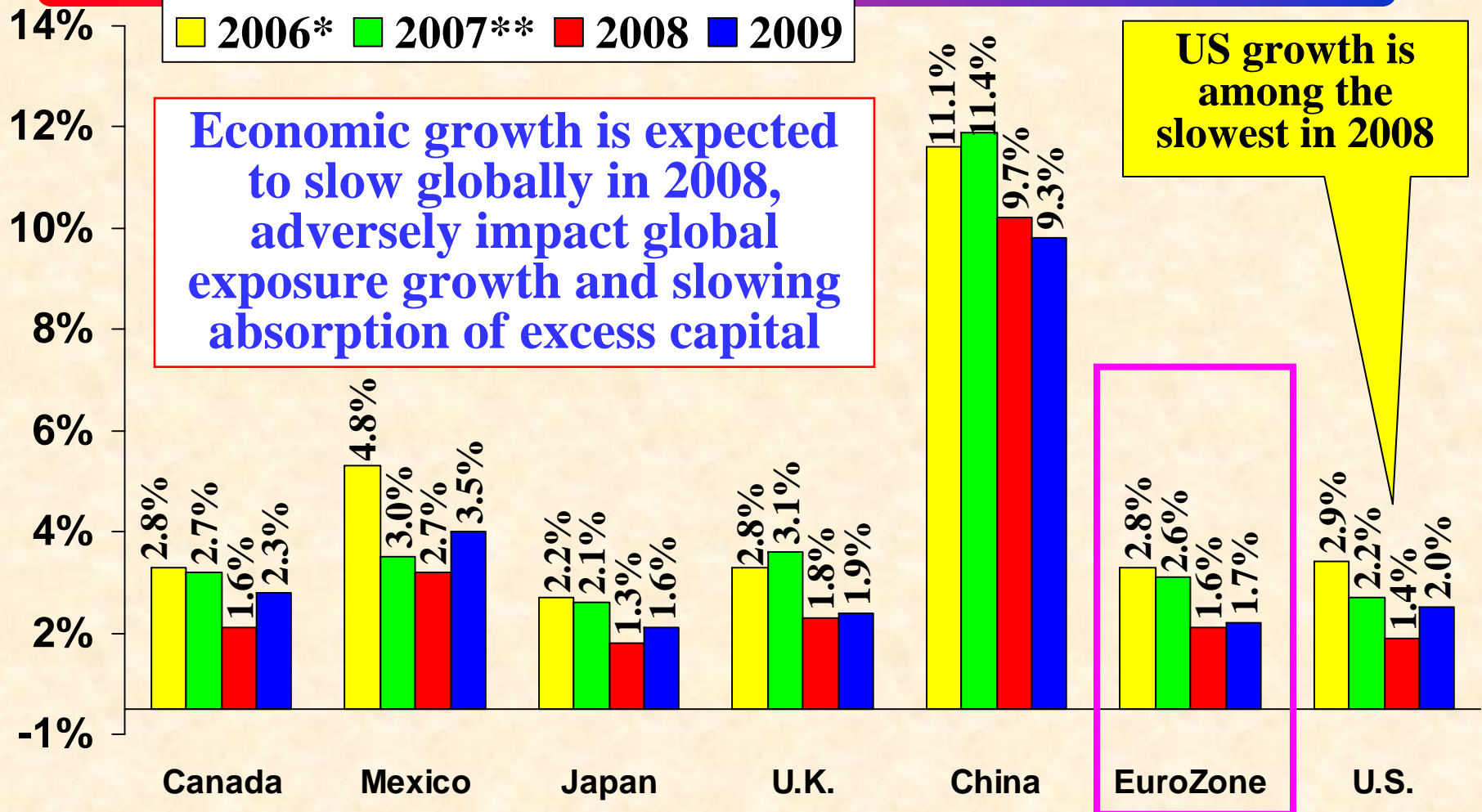


*Yellow bars are Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 6/08; Insurance Information Institute.

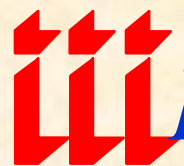


Percent Change in GDP By Country, 2006-2009



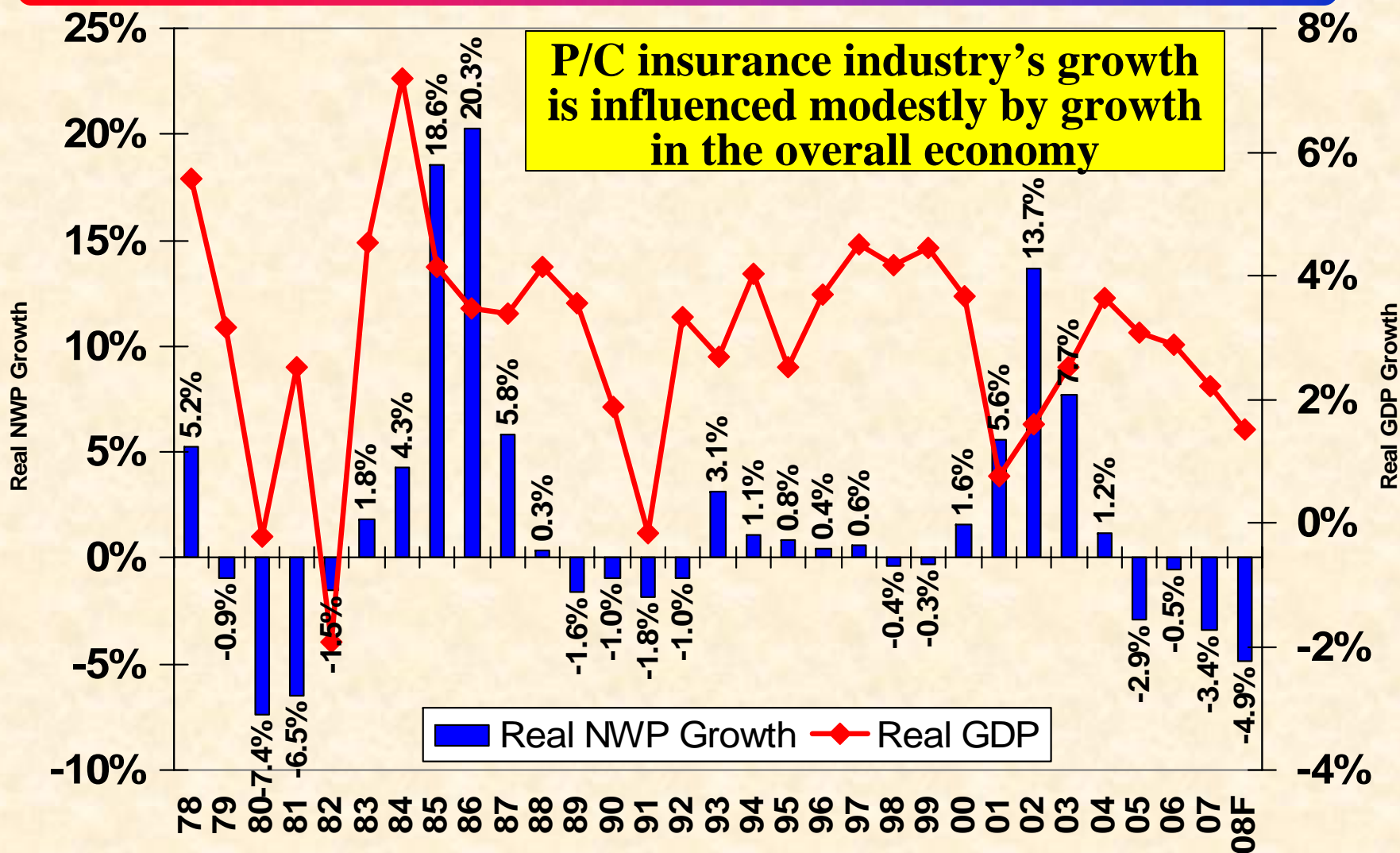
* Best estimates available. **In most cases, actual data for 2007. Where actual data not available, figures are consensus forecasts from Dec. 10., 2007 issue of Blue Chip Economic Indicators.

Source: Blue Chip Economic Indicators, May 10, 2008.



Real GDP Growth vs. Real P/C

Premium Growth: Modest Association





Summary of Economic Risks and Implications for (Re) Insurers

Economic Concern	Risks to Insurers
Subprime Meltdown/ Credit Crunch	<ul style="list-style-type: none">• <i>Some</i> insurers have <i>some</i> asset risk• D&O/E&O exposure for <i>some</i> insurers• Client asset management liability for <i>some</i>• Bond insurer problems; Muni credit quality
Lower Interest Rates	<ul style="list-style-type: none">• Lower investment income
Stock Market Slump	<ul style="list-style-type: none">• Decreased capital gains (which are usually relied upon more heavily as a source of earnings as underwriting results deteriorate)
General Economic Slowdown/Recession	<ul style="list-style-type: none">• Reduced commercial lines exposure growth• Surety slump• Decreased workers comp frequency due to drop in high hazard class employment



Toward a New World Economic Order


- 1. Credit Crunch (incl. Subprime) Issue Will Ultimately Cost Hundreds of Billions Globally (est. up to \$600B)**
 - Problem exacerbated by leveraged bets taken by some financial institutions therefore its reach extends beyond simple defaults
- 2. Heavy Toll on Capital Base of Some Large Financial Institutions Worldwide (e.g., Bear Stearns)**
 - Cash infusions necessary; Sovereign Wealth Funds important source
 - Federal Reserve forced into playing a larger role; must improvise
- 3. Most Significant Economic Event in a Generation**
 - US economy will recover, but will take 18-24 months
- 4. Shuffling of Global Economic Deck; Economic Pecking Order Shifting**
 - China, oil producing countries hold the upper hand
- 5. IOUs are Being Redeemed**
 - Stakes in hard assets/institutions demanded
- 6. Good News: No Shortage of Available Capital**
 - Central banks are (generally) making right decisions; Dollar sinks



Post-Crunch: Fundamental Issues To Be Examined Globally

- **Adequacy of Risk Management, Control & Supervision at Financial Institutions Worldwide**
 - Failure of risk management (and regulation)
 - Implications for ERM?
 - Includes review of incentives
- **Effectiveness and Nature of Regulation**
 - What sort of oversight is optimal given recent experience?
 - Credit problems arose under US and European (Basel II) regulatory regimes
 - Will new regulations be globally consistent?
 - Can overreactions be avoided?
 - Capital adequacy & liquidity
- **Accounting Rules**
 - Problems arose under FAS, IAS
 - Asset Valuation, including Mark-to-Market
 - Structured Finance & Complex Derivatives
- **Ratings on Financial Instruments**
 - New approaches to reflect type of asset, nature of risk

Summary of Treasury “Blueprint” for Financial Services Modernization

 Impacts on Insurers



Treasury Regulatory

Recommendations Affecting Insurers

- **Establishment of an Optional Federal Charter (OFC)**
 - Would provide system for federal chartering, licensing, regulation and supervision of insurers, reinsurer and producers (agents & brokers)
- **OFC Would Incorporate Several Regulatory Concepts**
 - Ensure safety and soundness
 - Enhance competition in national and international markets
 - Increase efficiency through elimination of price controls, promote more rapid technological change, encourage product innovation, reduce regulatory costs and provide consumer protection
- **Establishment of Office of National Insurance (ONI)**
 - Department within Treasury to regulate insurance pursuant to OFC
 - Headed by Commissioner of National Insurance
 - Commissioner has regulatory, supervisory, enforcement and rehabilitative powers to oversee organization, incorporation, operation, regulation of national insurers and national agencies
- **UPDATE: HR 5840 Introduced April 17 Would Establish Office of Insurance Information (OII)**
 - Would create industry “voice” within Treasury

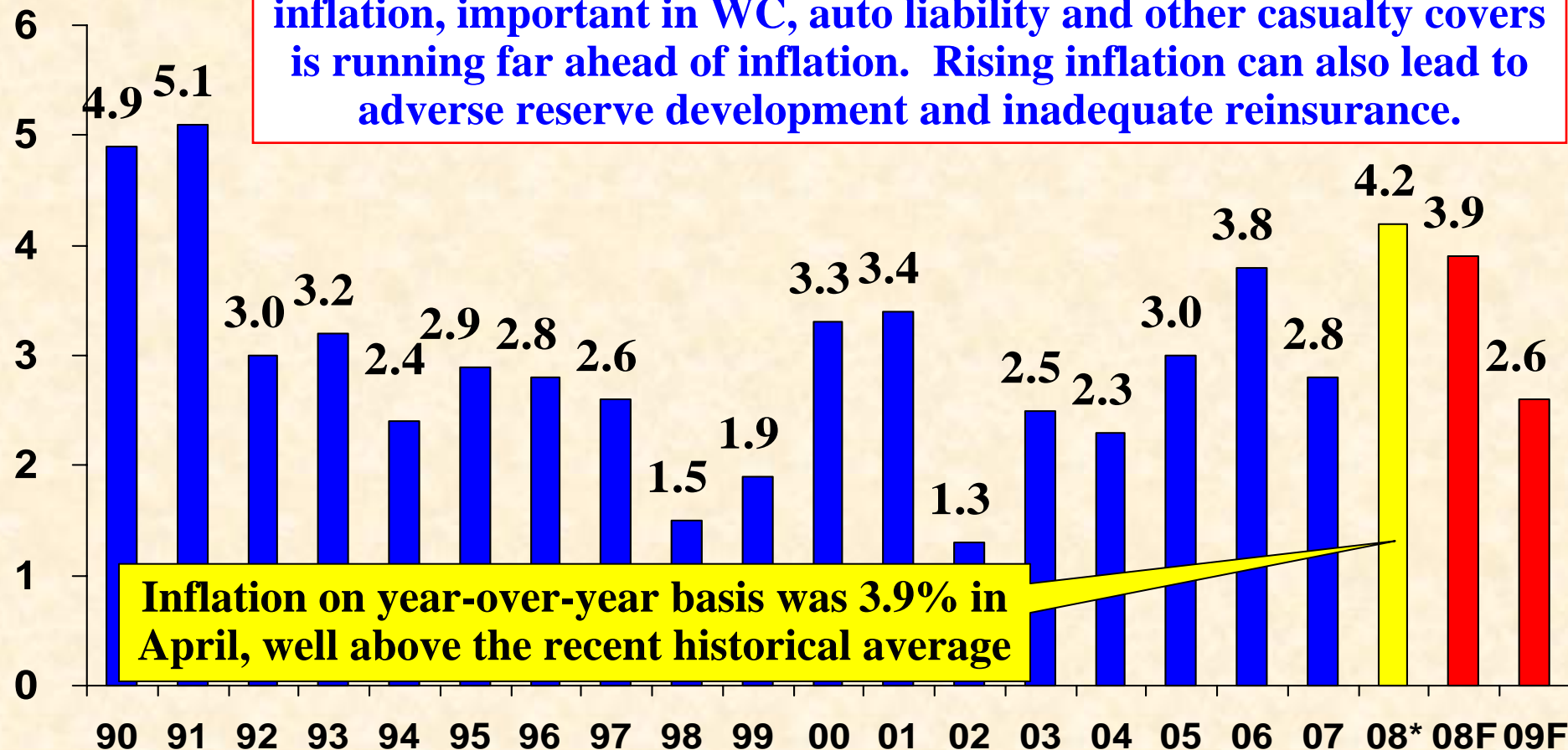
Inflation Overview

**Pressures Claim Costs,
Expands Probable &
Possible Max Losses**



Inflation Rate (CPI-U, %), 1990 – 2009F

Inflation was just 2.8% in 2007 but is accelerating. Medical cost inflation, important in WC, auto liability and other casualty covers is running far ahead of inflation. Rising inflation can also lead to adverse reserve development and inadequate reinsurance.

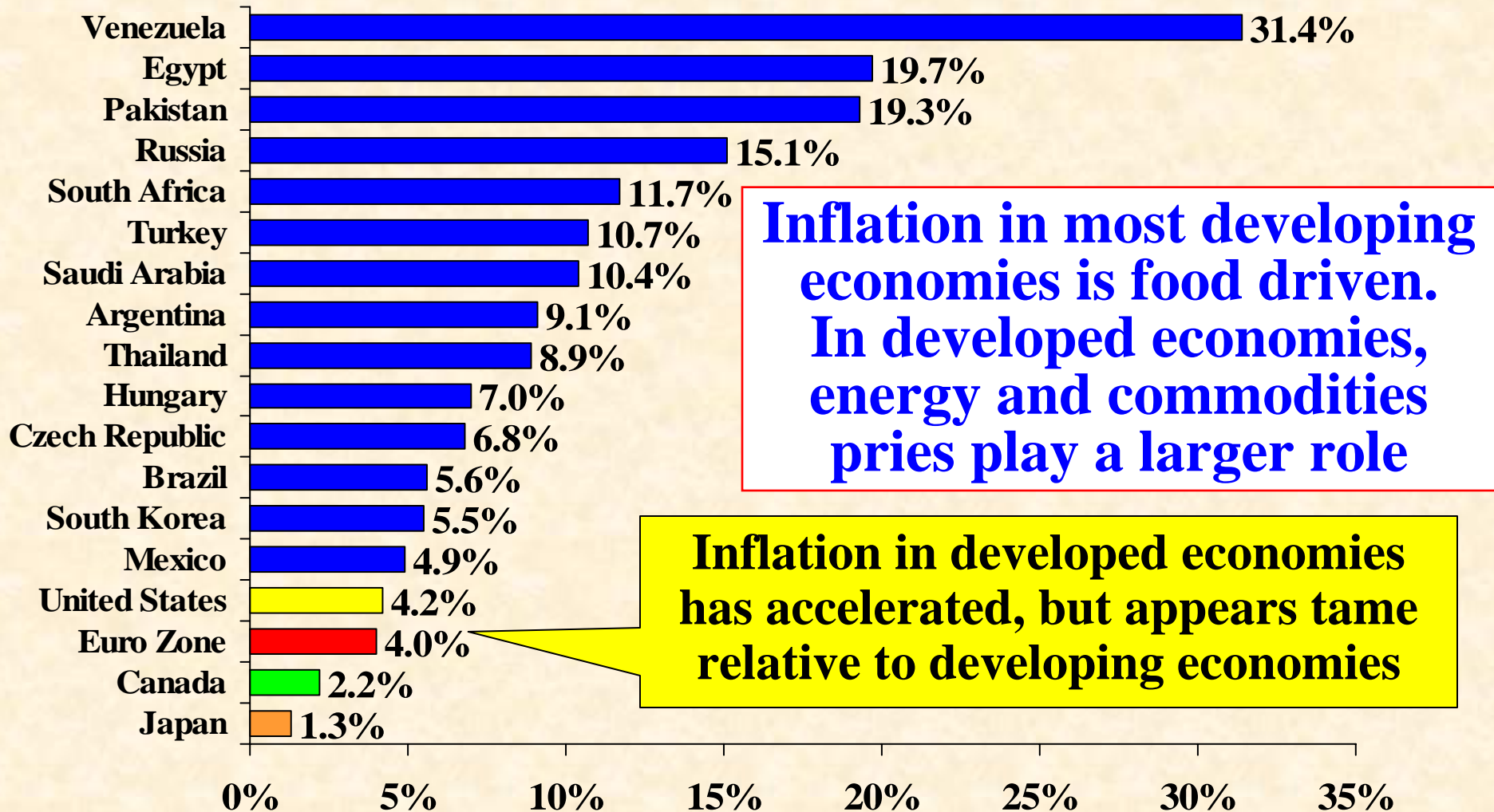


*12-month change May 2008 vs. May 2007;

Source: US Bureau of Labor Statistics; Blue Chip Economic Indicators, June 10, 2008; Ins. Info. Institute.



*Inflation: A Growing Problem Around the World**



*Data are for the year ending in the most recent month available, typically May 2008.

Source: *The Economist*, July 5 - 11, 2008 edition; Insurance Information Institute.



Inflation: Important Economic Risks and Implications for Insurers (cont'd)

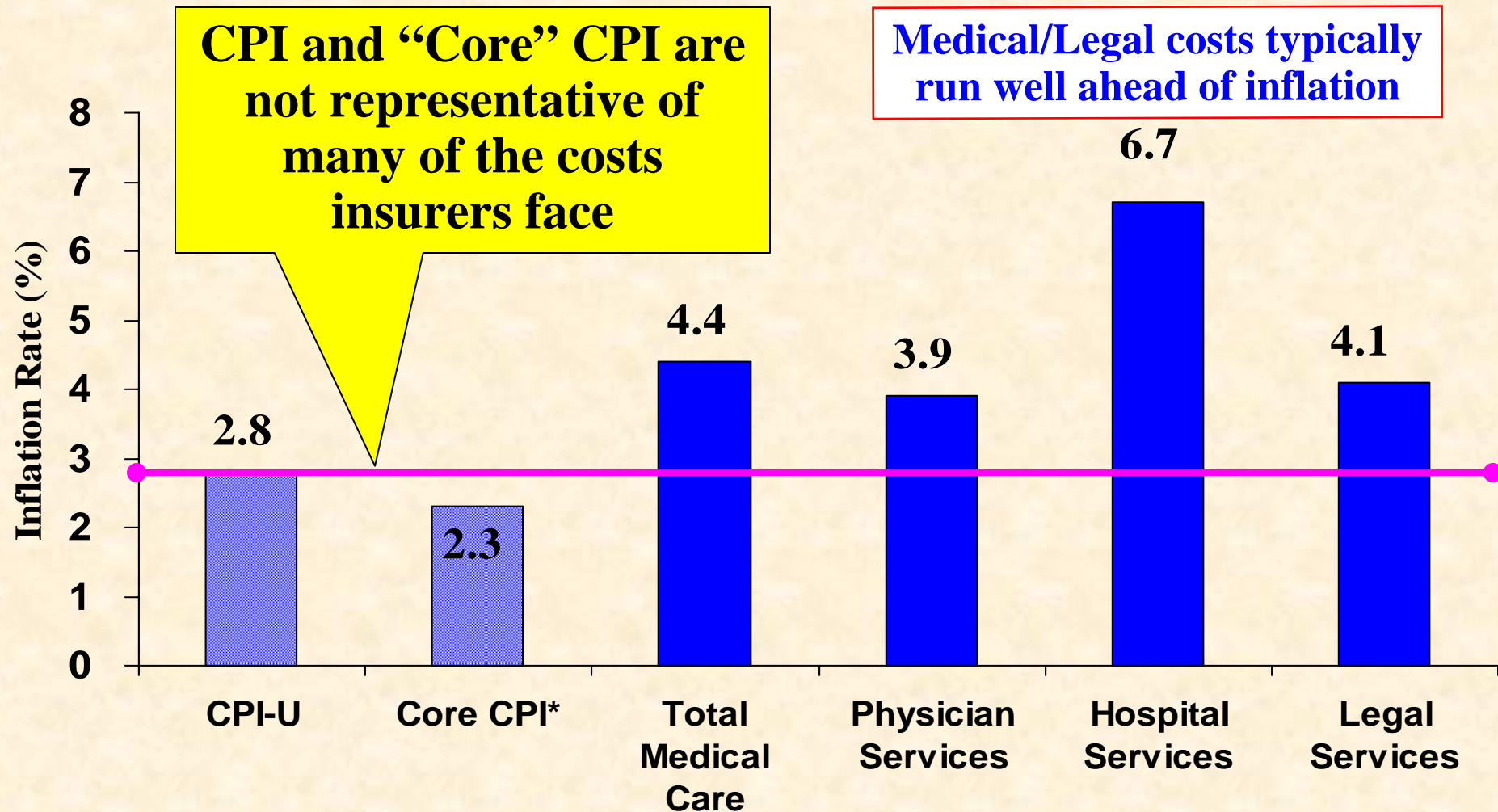
Effects of Inflation	Risks to Insurers & Buyers
Claim Severity Increase	<ul style="list-style-type: none">• Claims (property and liability) costs may rise as the price of goods and services increase• PMLs could be (much) higher
Rate Inadequacy	<ul style="list-style-type: none">• Accelerating inflation can contribute to rate inadequacy because ratemaking is largely a retrospective process• Many types of loss trends are sensitive to the pace of inflation: medical cost, tort, etc.• Historical loss cost trends could be biased predictors of future loss if inflation accelerates
Business Interruption & Contingent BI Cost Escalation	<ul style="list-style-type: none">• Business interruption and contingent business interruption claim costs will rise because the nominal value of interrupted business and expense costs will grow more rapidly• Especially pronounced in energy, commodity and natural resource intensive industries



Inflation: Important Economic Risks and Implications for Insurers (cont'd)

Effects of Inflation	Risks to Insurers
Reserve Deficiency	<ul style="list-style-type: none">• Reserves are established using certain assumptions about future development and discounting factors• If inflation accelerates, development could be more rapid and/or be more substantial (in dollar terms) than assumed and discount factors may be too low
Inadequate Insurance Limits	<ul style="list-style-type: none">• Policyholders could find themselves inadequately insured as claims costs escalate
Inadequate Reinsurance	<ul style="list-style-type: none">• Inflation can lead to a more rapid and unexpected exhaustion of reinsurance because losses are higher than expected

Comparative 2007 Inflation Statistics Important to Insurers (%)



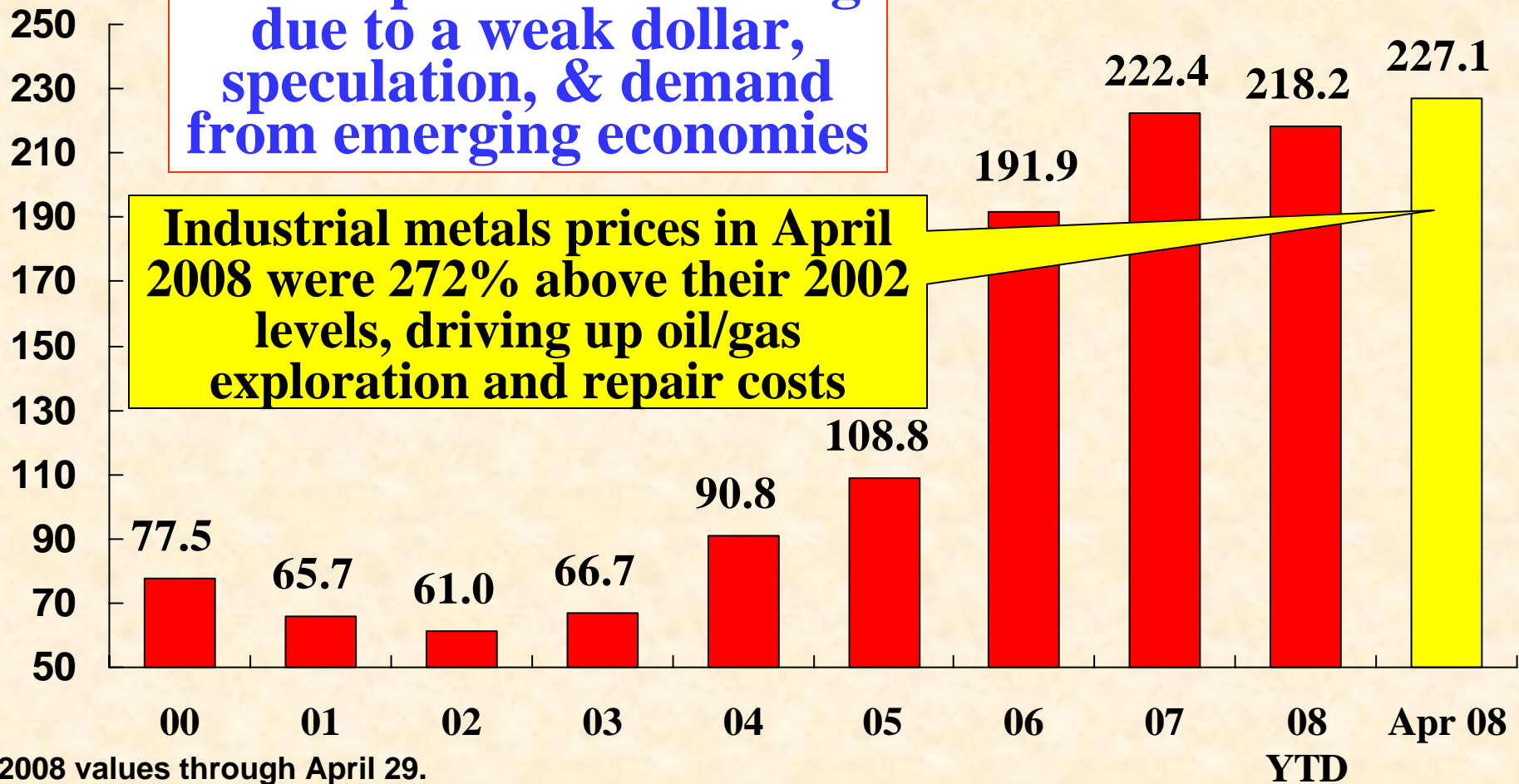
*Core CPI is the Consumer Price Index for all Urban Consumers (CPI-U) less food and energy costs.
Source: US Bureau of Labor Statistics; Insurance Information Institute.



*Industrial Metals Index, 2000-2008**

**Metals prices are soaring
due to a weak dollar,
speculation, & demand
from emerging economies**

**Industrial metals prices in April
2008 were 272% above their 2002
levels, driving up oil/gas
exploration and repair costs**

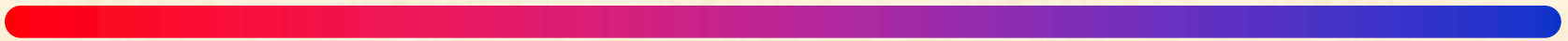


*2008 values through April 29.

Sources: Dow Jones-AIG: http://www.djindexes.com/mdsidx/downloads/xlspages/aigci/djaig_full_hist.xls accessed 1/30/08; I.I.I.
calculations based on daily index values.

Medical & Tort Cost Inflation

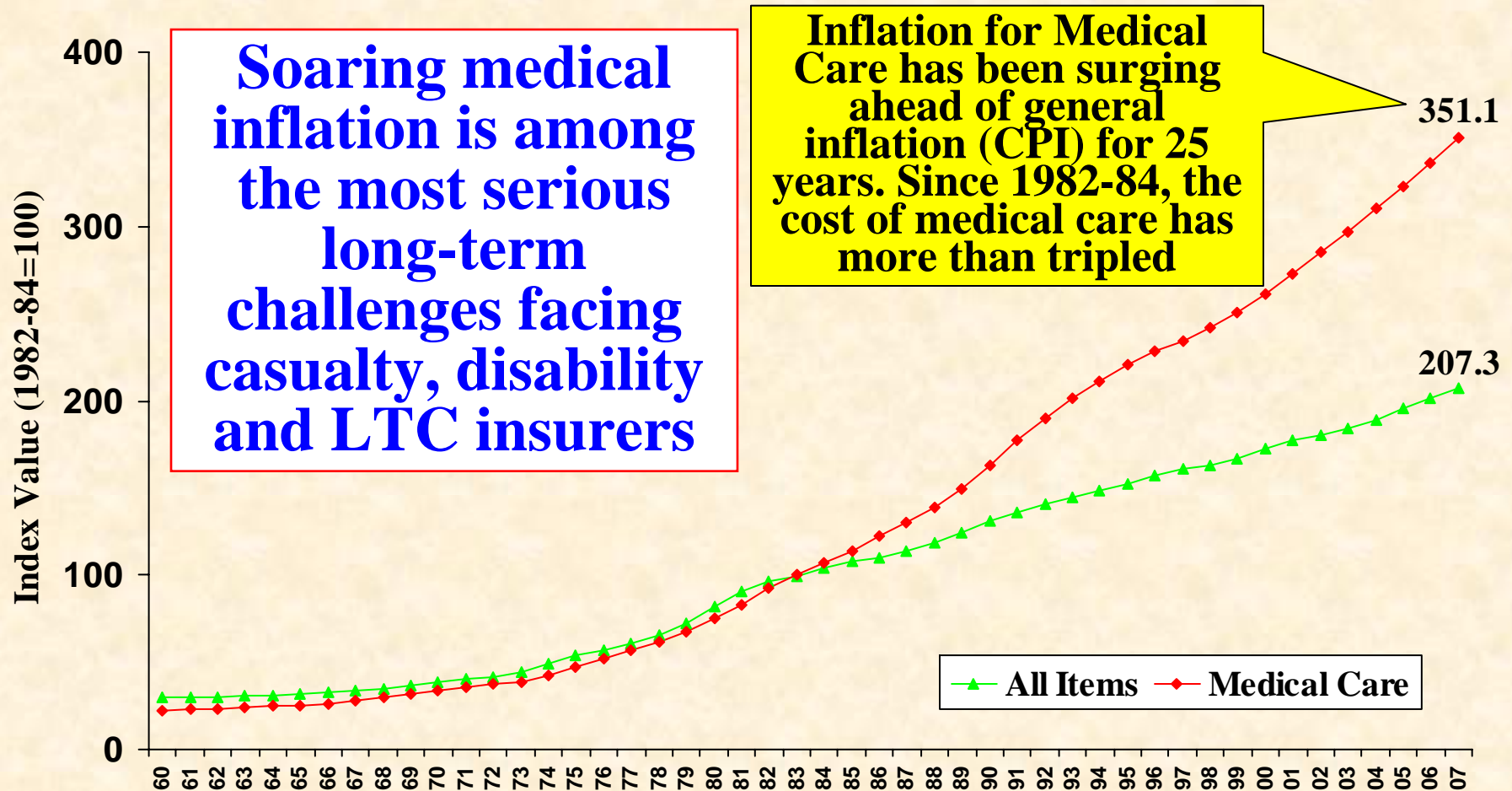
**Amplifiers of Inflation, Major
Insurance Cost Driver**



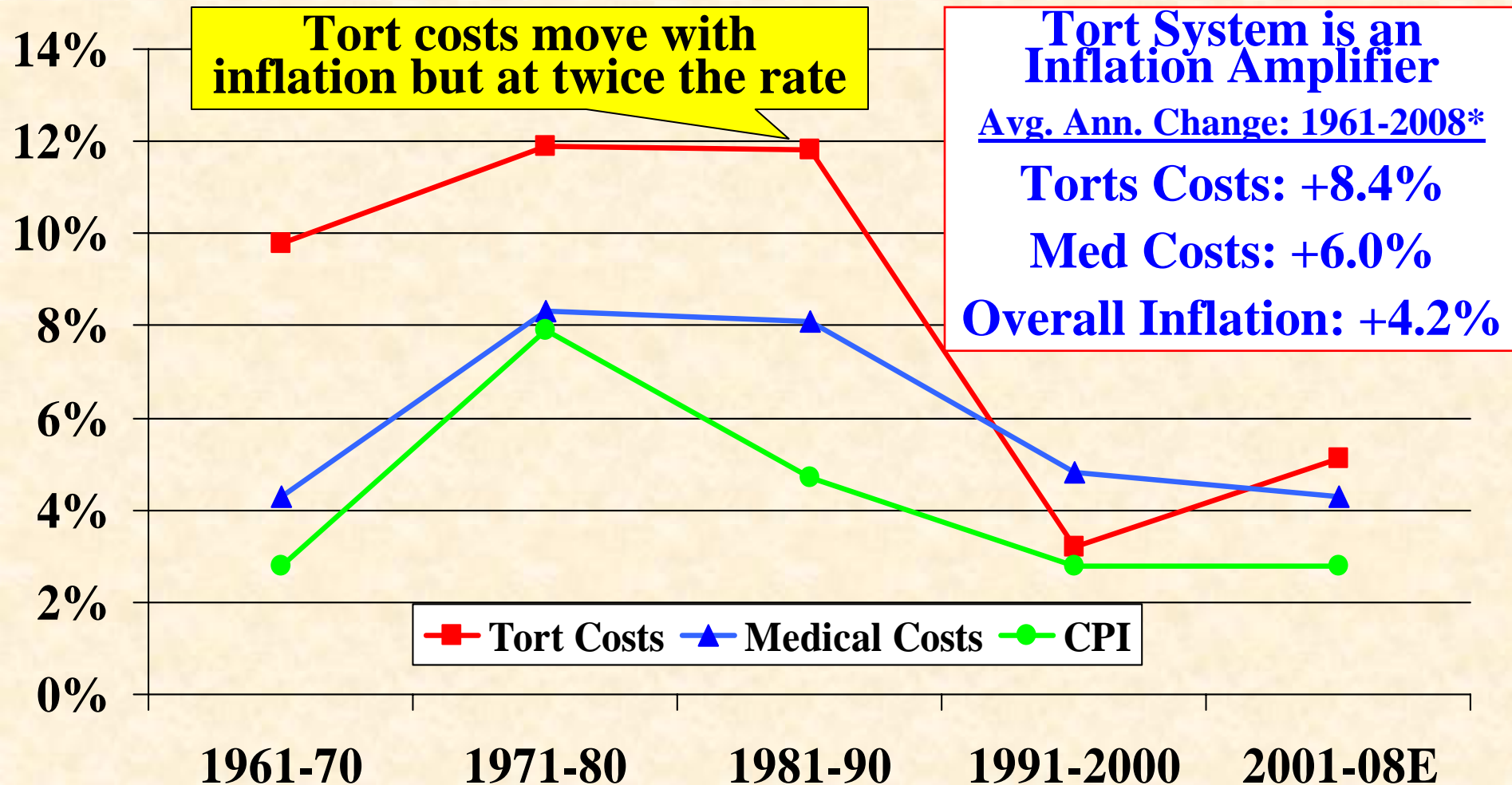


Consumer Price Index for Medical Care vs. All Items, 1960-2007

(Base: 1982-84=100)



Tort Cost Growth & Medical Cost Inflation vs. Overall Inflation (CPI-U), 1961-2008*

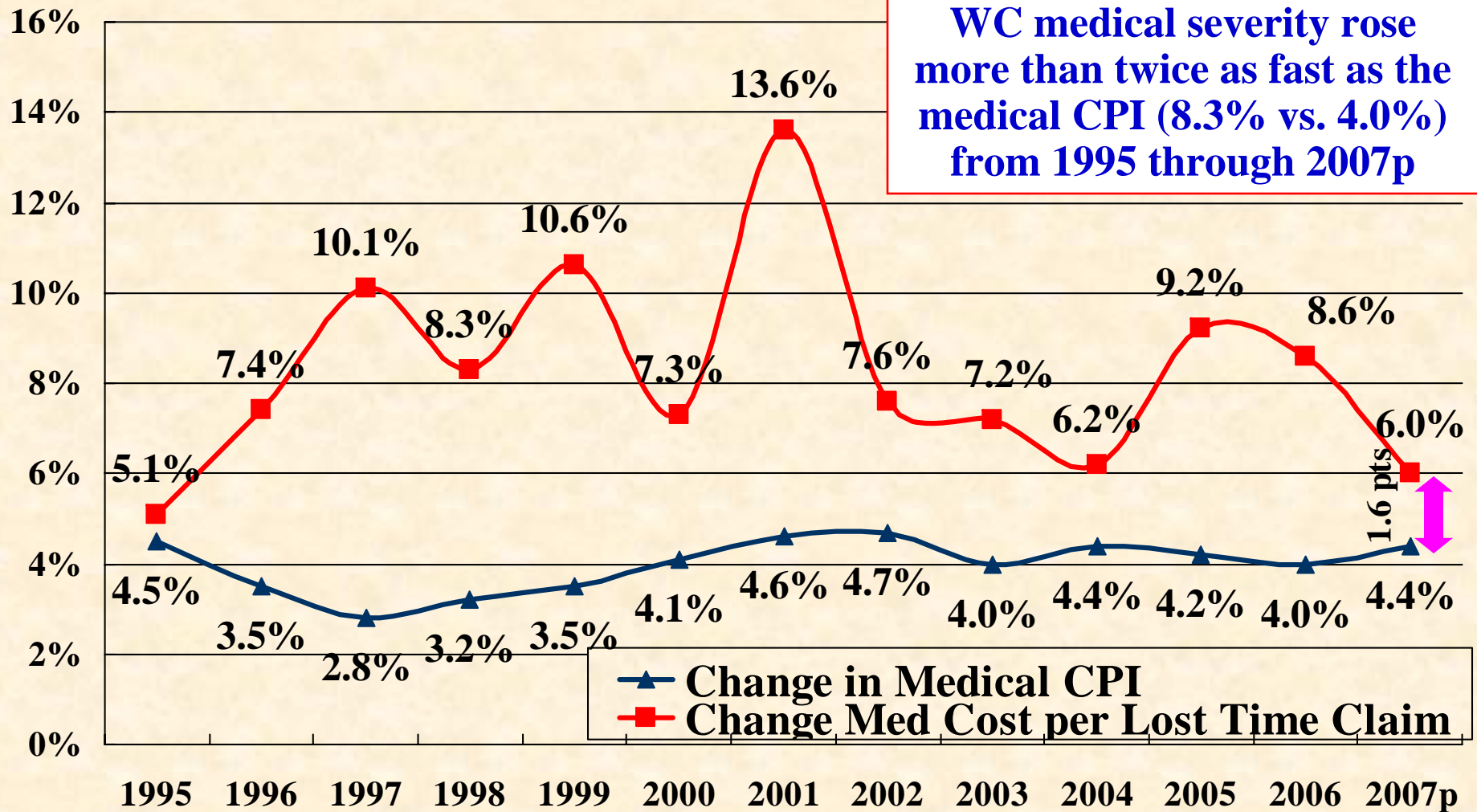


*Medical cost and CPI-U through April 2008 from BLS. Tort figure is for full-year 2008 from Tillinghast.

Sources: US Bureau of Labor Statistics, Tillinghast-Towers Perrin, 2007 *Update on U.S. Tort Costs*; Insurance Info. Inst.



WC Medical Severity Rising Far Faster than Medical CPI



Sources: NCCI; Med CPI from Economy.com; WC med severity from NCCI based on NCCI states.

Dollar Depreciation

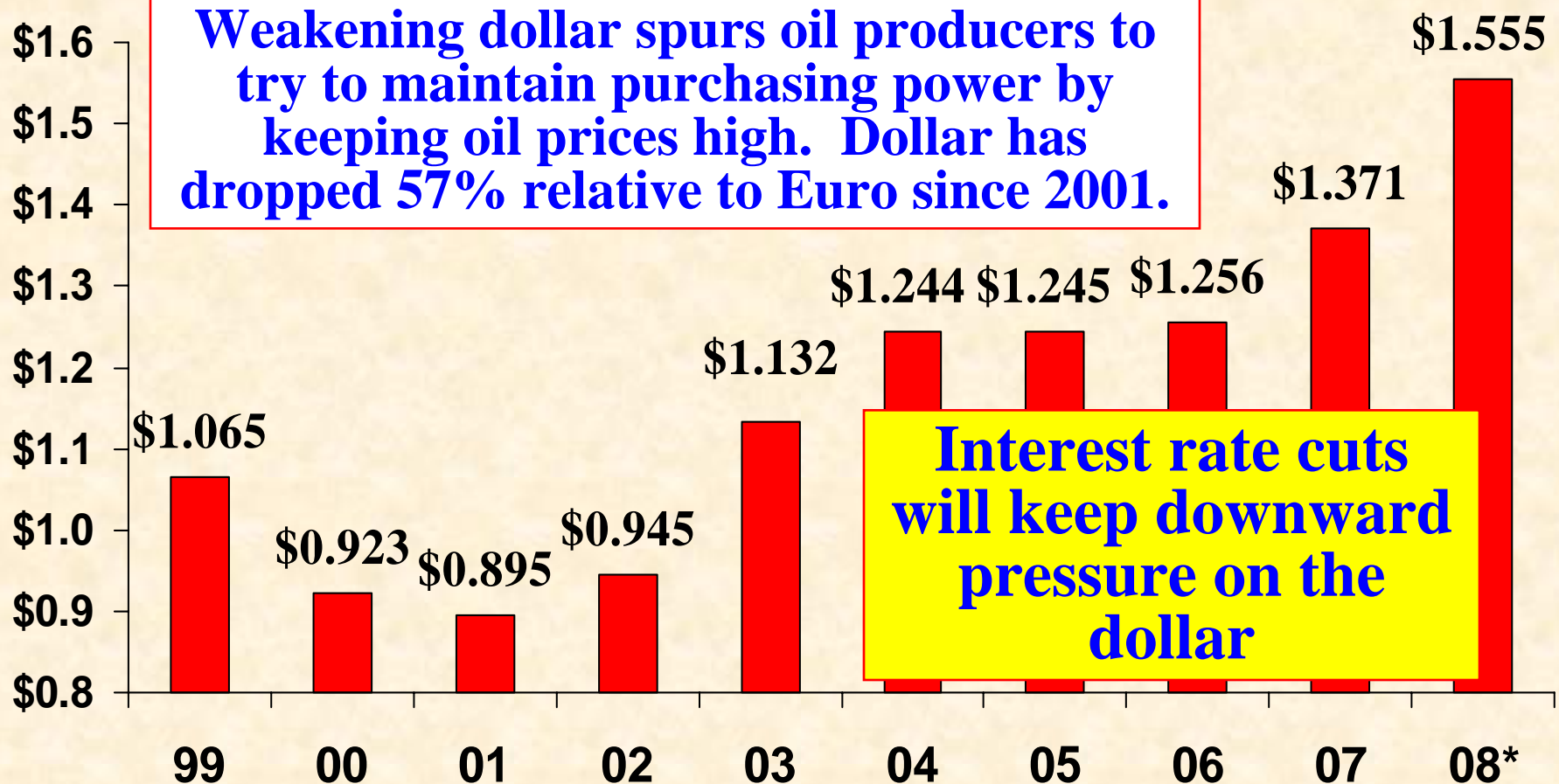
**Driver of Higher Energy,
Commodities Prices and
Overall Inflation**





Depreciation of Dollar is Partly Responsible for Rising Energy Prices

US Dollars per Euro

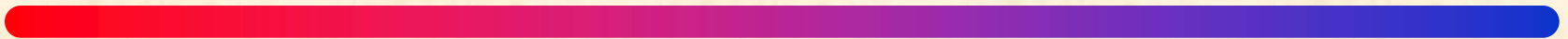


*As of May 2008.

Source: Board of Governors of the Federal Reserve Bank; Insurance Information Institute.

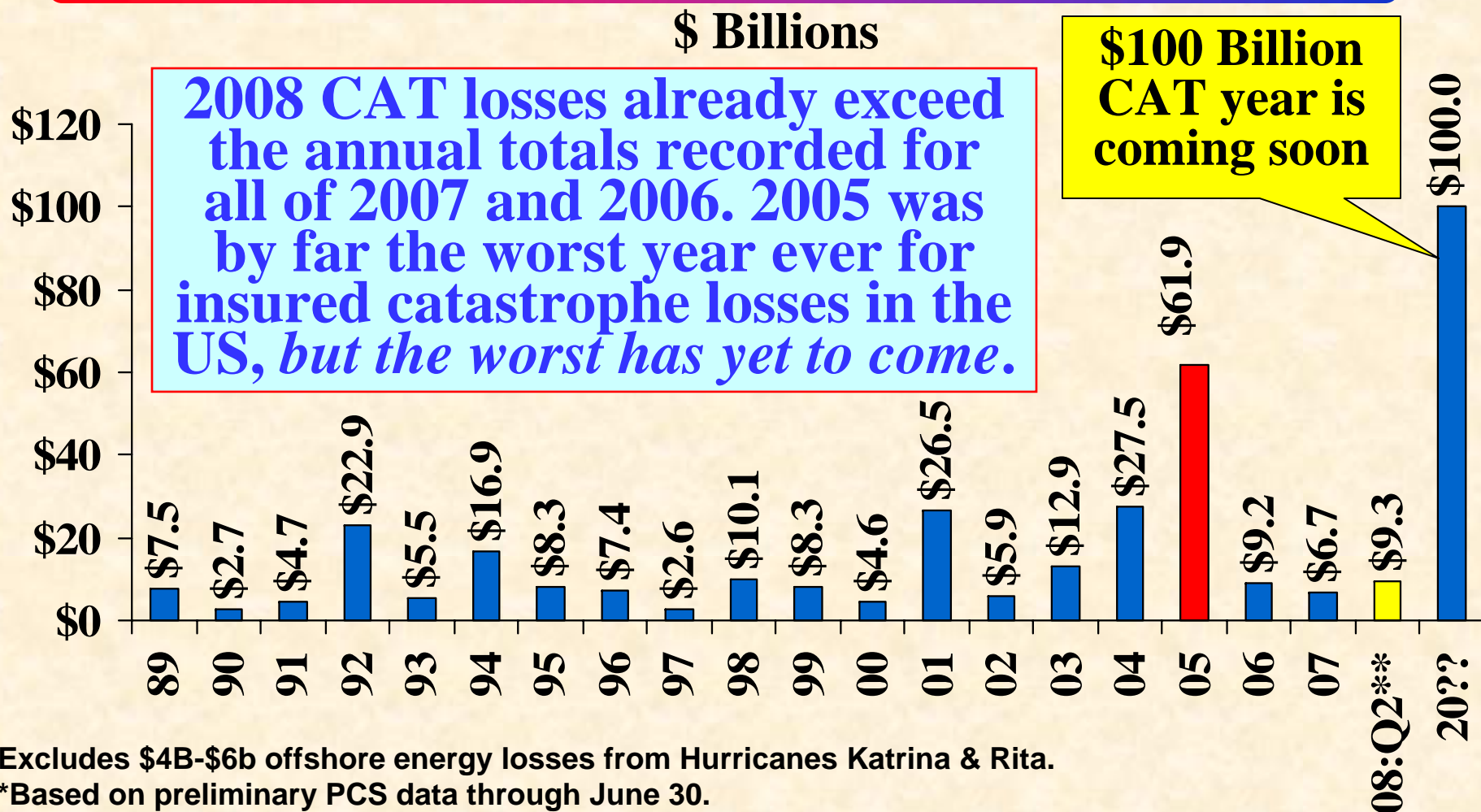
CATASTROPHIC LOSS

What Will 2008 Bring?





U.S. Insured Catastrophe Losses*

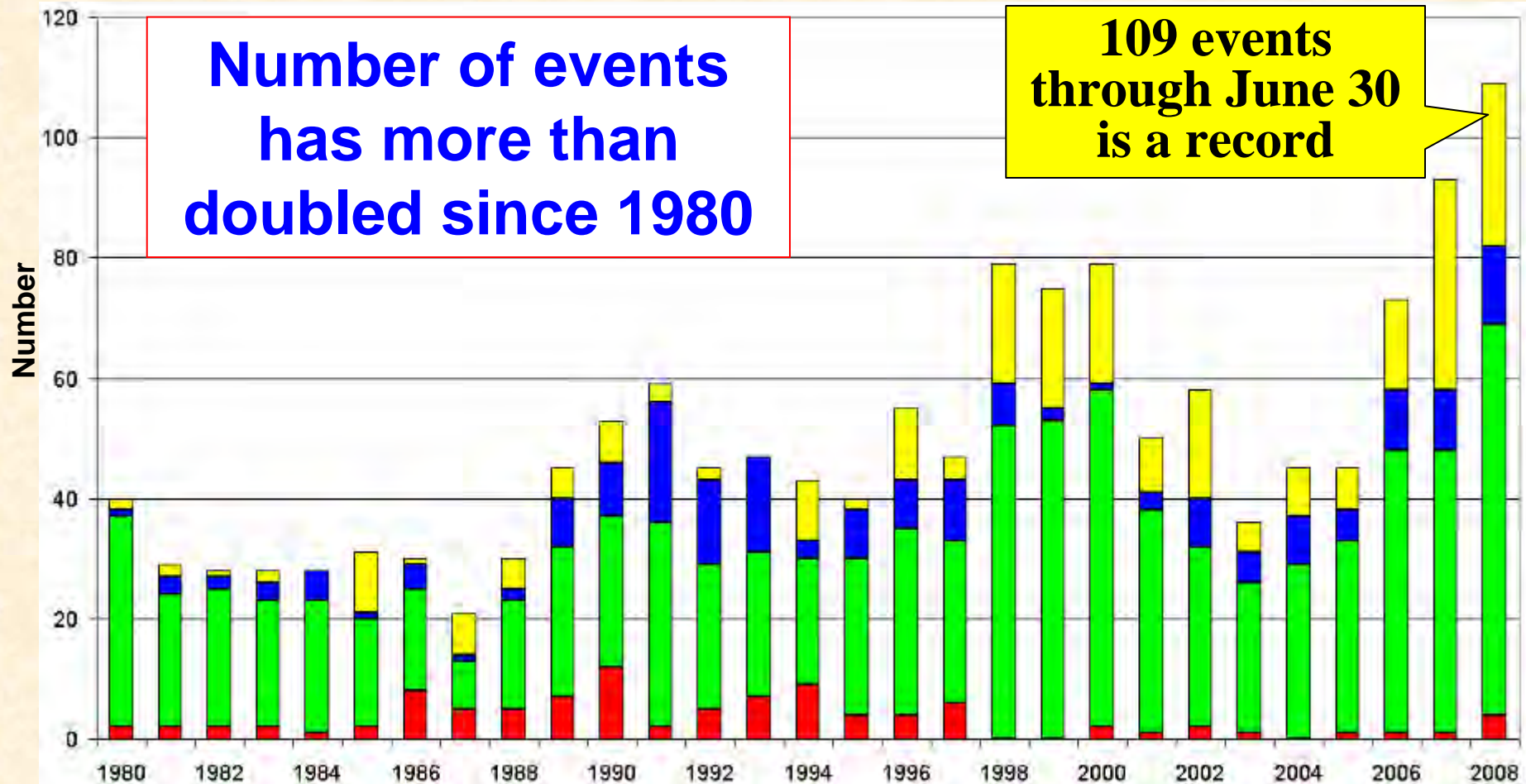


Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B.

Source: Property Claims Service/ISO; Insurance Information Institute



Natural Disasters in the United States, 1980-2008 (Jan – June Only)



Geophysical
(earthquake, tsunami,
volcanic activity)

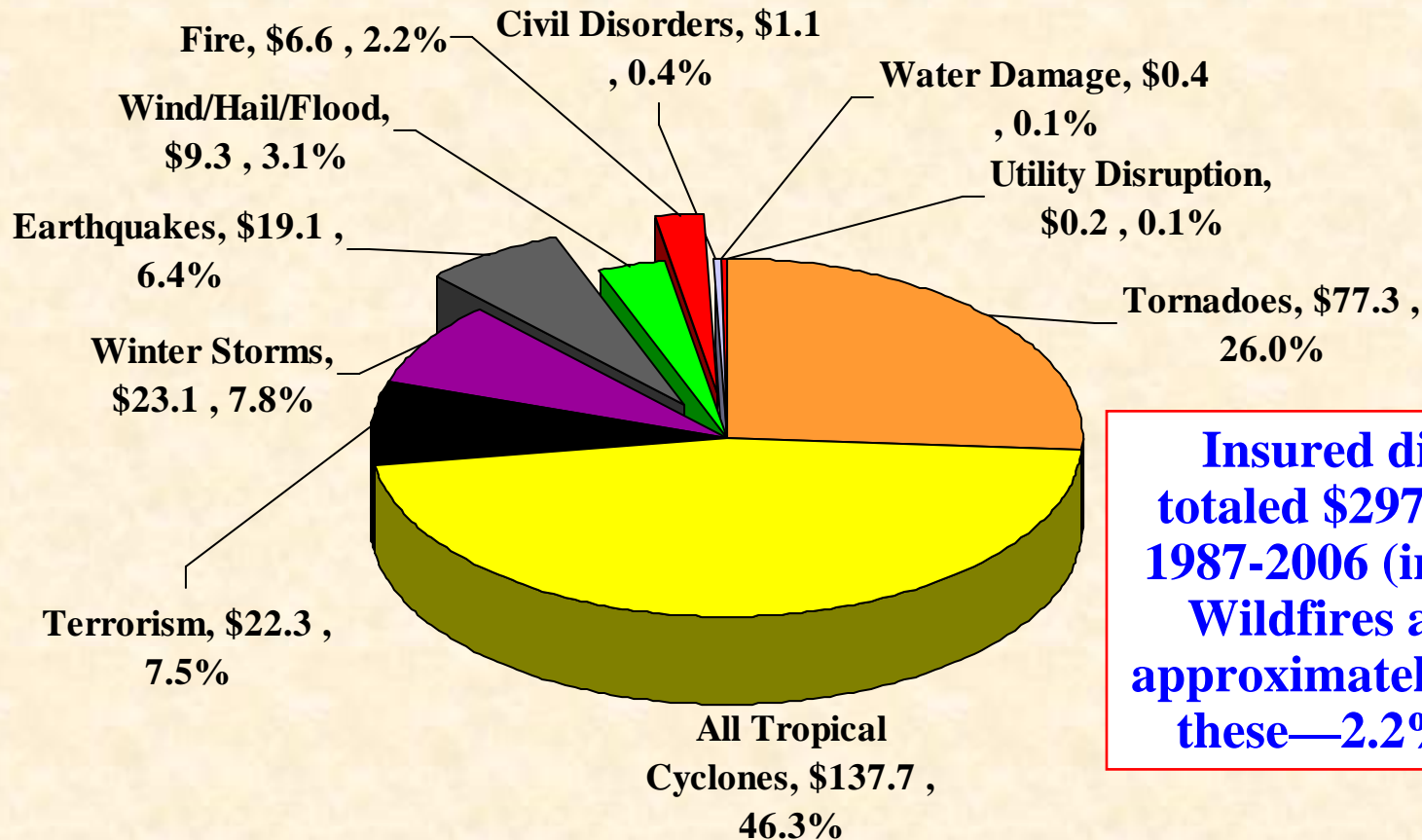
Meteorological (storm)

Hydrological
(flood, mass movement)

Climatological
(temperature extremes,
drought, wildfire)



Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1987-2006¹



Insured disaster losses totaled \$297.3 billion from 1987-2006 (in 2006 dollars). Wildfires accounted for approximately \$6.6 billion of these—2.2% of the total.

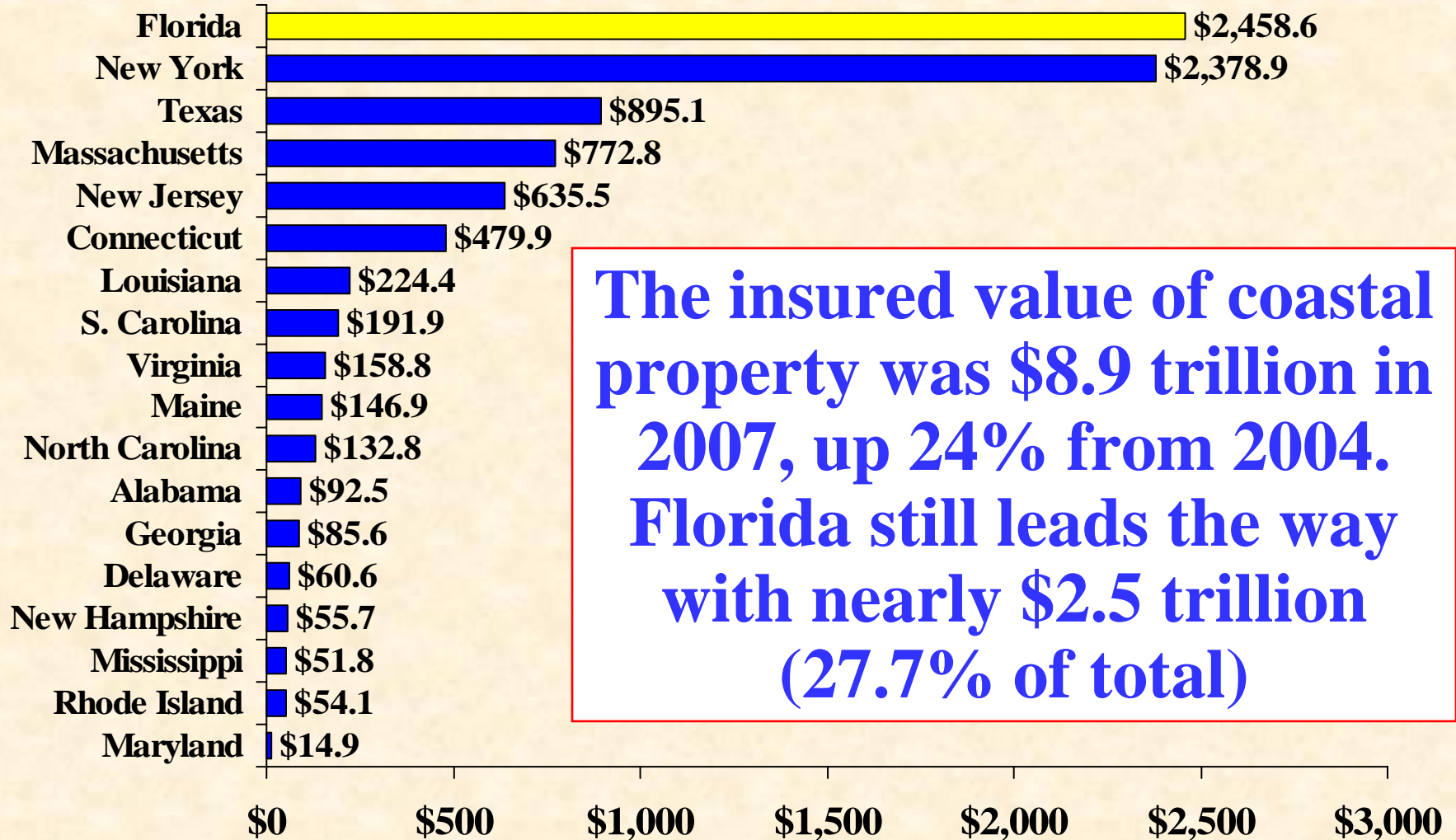
¹ Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2006 dollars.

Catastrophe threshold changed from \$5 million to \$25 million beginning in 1997. Adjusted for inflation by the III.

² Excludes snow. ³ Includes hurricanes and tropical storms. ⁴ Includes other geologic events such as volcanic eruptions and other earth movement. ⁵ Does not include flood damage covered by the federally administered National Flood Insurance Program. ⁶ Includes wildland fires.



Total Value of Insured Coastal Exposure (2007, \$ Billions)

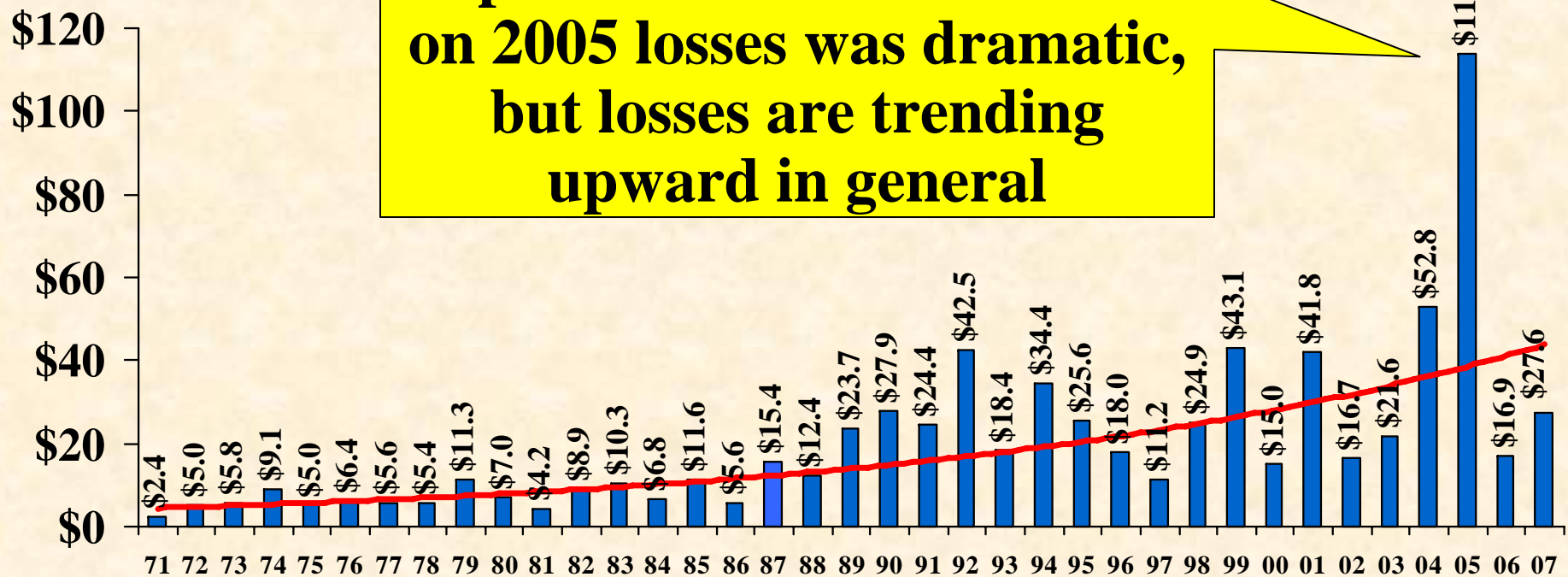




Global Insured Catastrophe Losses 1970-2007 (\$ 2007)

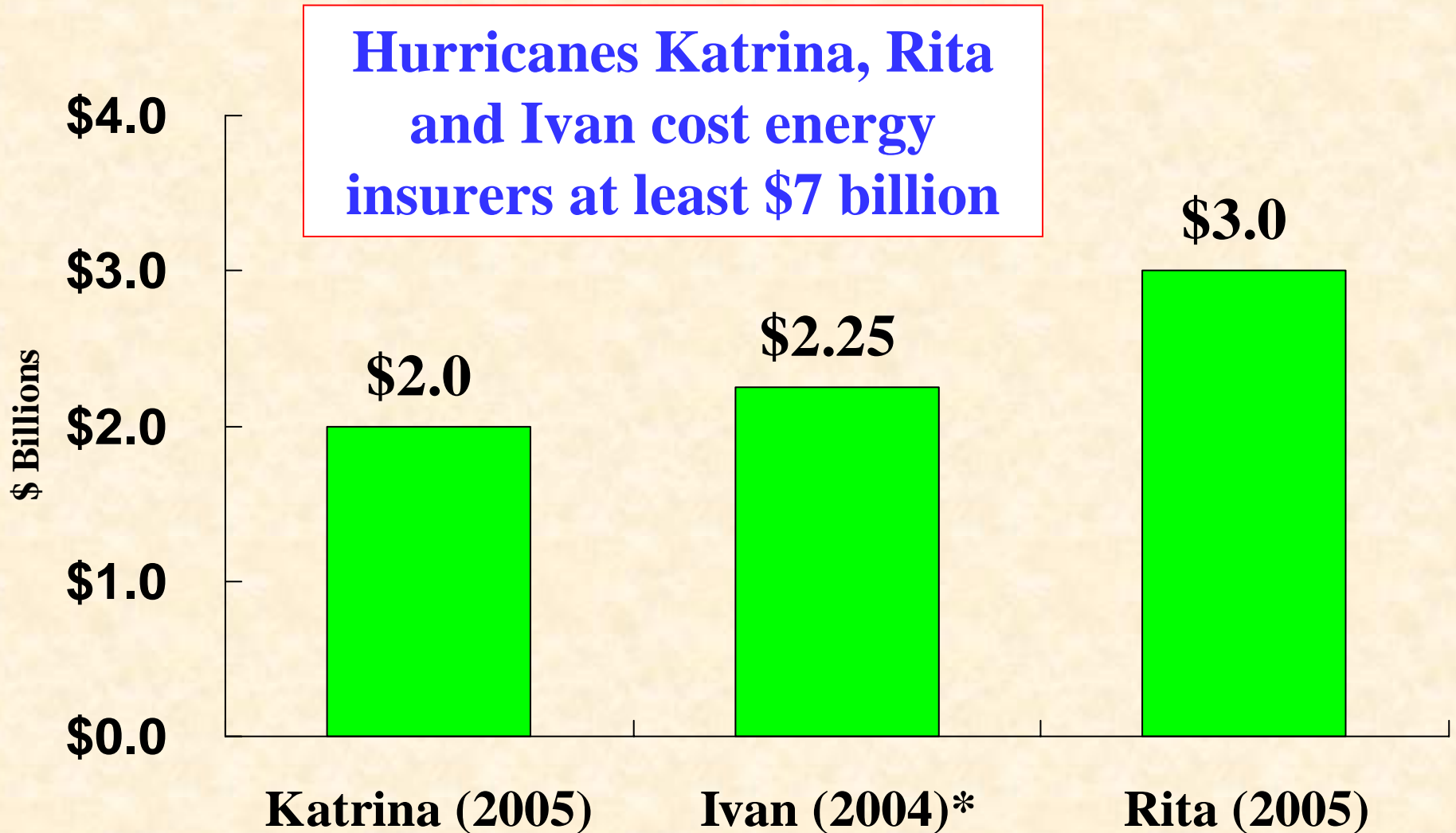
\$ Billions

**Impact of Hurricane Katrina
on 2005 losses was dramatic,
but losses are trending
upward in general**





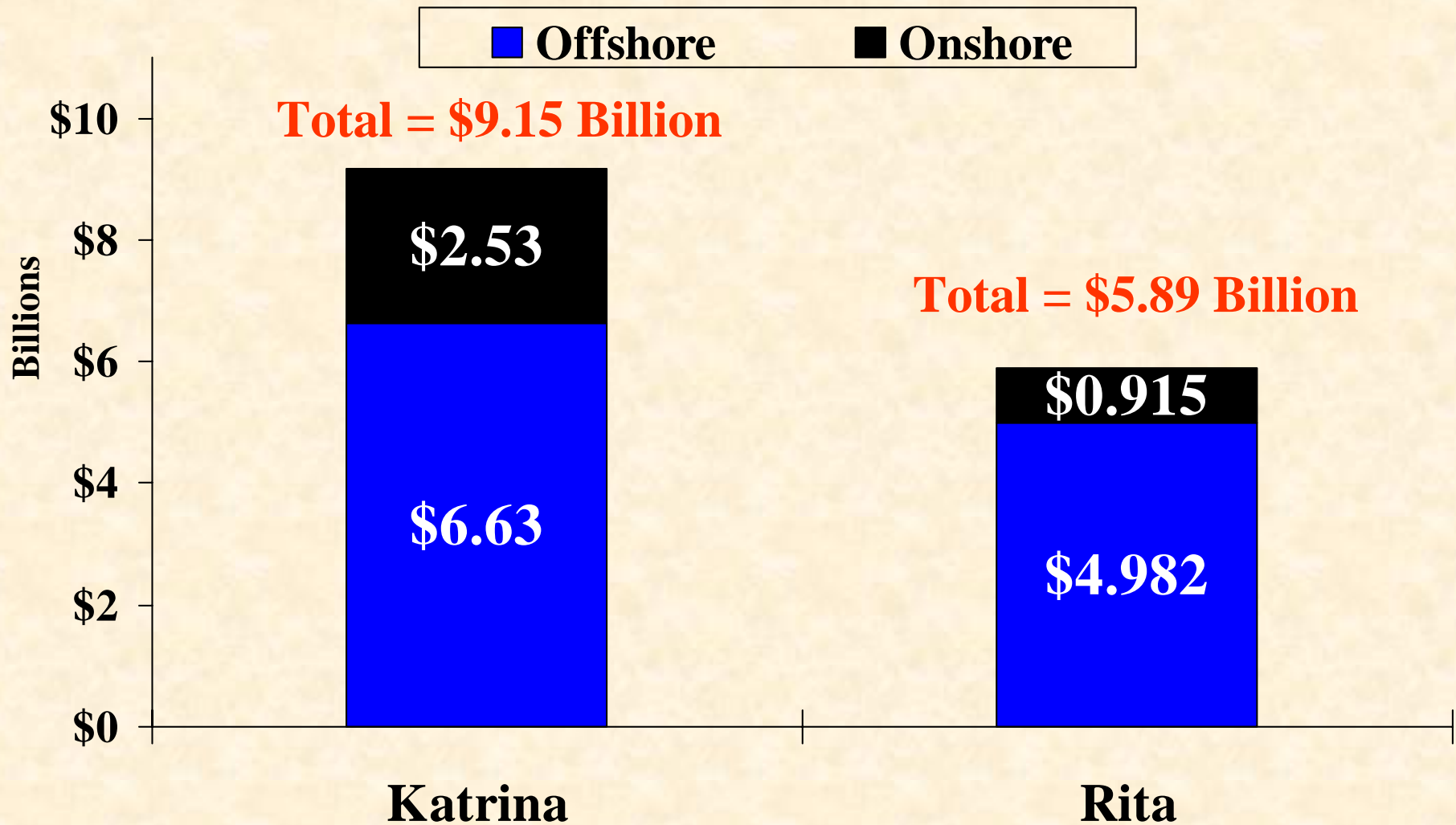
Insured Offshore Energy Losses for Recent Major Gulf Storms



Sources: Insurance Information Institute research estimates. *Midpoint of estimated range for \$2.0 to \$2.5 billion)



*Katrina & Rita: Total Energy Losses, Onshore vs. Offshore**



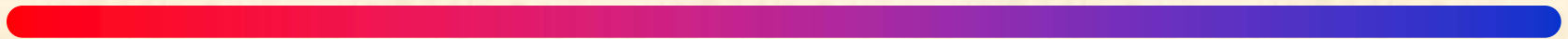
Source: Willis

*Loss estimates are total losses, not just insured losses.

FIRST HALF 2008 CATASTROPHE LOSSES

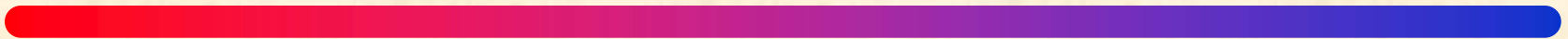


Many Record Set



The 2008 Hurricane Season:

Preview to Disaster?





Outlook for 2008 Hurricane

Season: 60% Worse Than Average

	Average*	2005	2008F
Named Storms	9.6	28	15
Named Storm Days	49.1	115.5	80
Hurricanes	5.9	14	8
Hurricane Days	24.5	47.5	40
Intense Hurricanes	2.3	7	4
Intense Hurricane Days	5	7	9
Accumulated Cyclone Energy	96.2	NA	150
Net Tropical Cyclone Activity	100%	275%	160%

*Average over the period 1950-2000.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, June 3, 2008.



Landfall Probabilities for 2008 Hurricane Season: Above Average

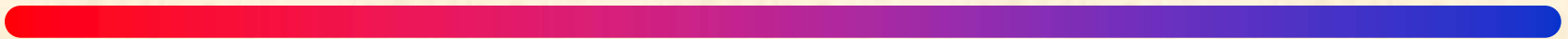
	Average*	2008F
Entire US East & Gulf Coasts	52%	69%
US East Coast Including Florida Peninsula	31%	45%
Gulf Coast from Florida Panhandle to Brownsville	30%	44%
Caribbean	NA	Above Average

*Average over the past century.

Source: Philip Klotzbach and Dr. William Gray, Colorado State University, June 3, 2008.

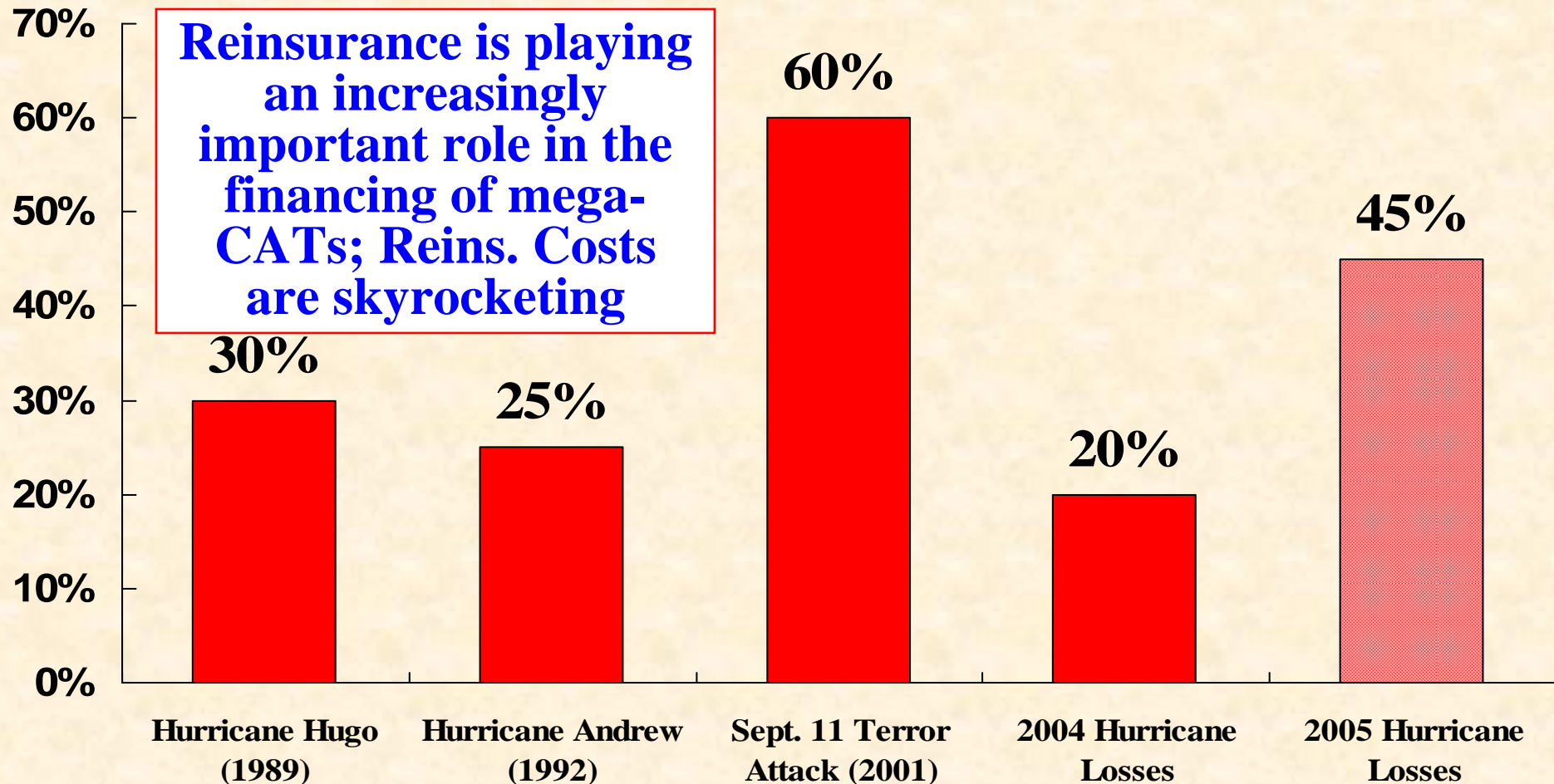
REINSURANCE MARKETS

*Reinsurance Prices are
Falling in Non-Coastal
Zones, Casualty Lines*





*Share of Losses Paid by Reinsurers, by Disaster**



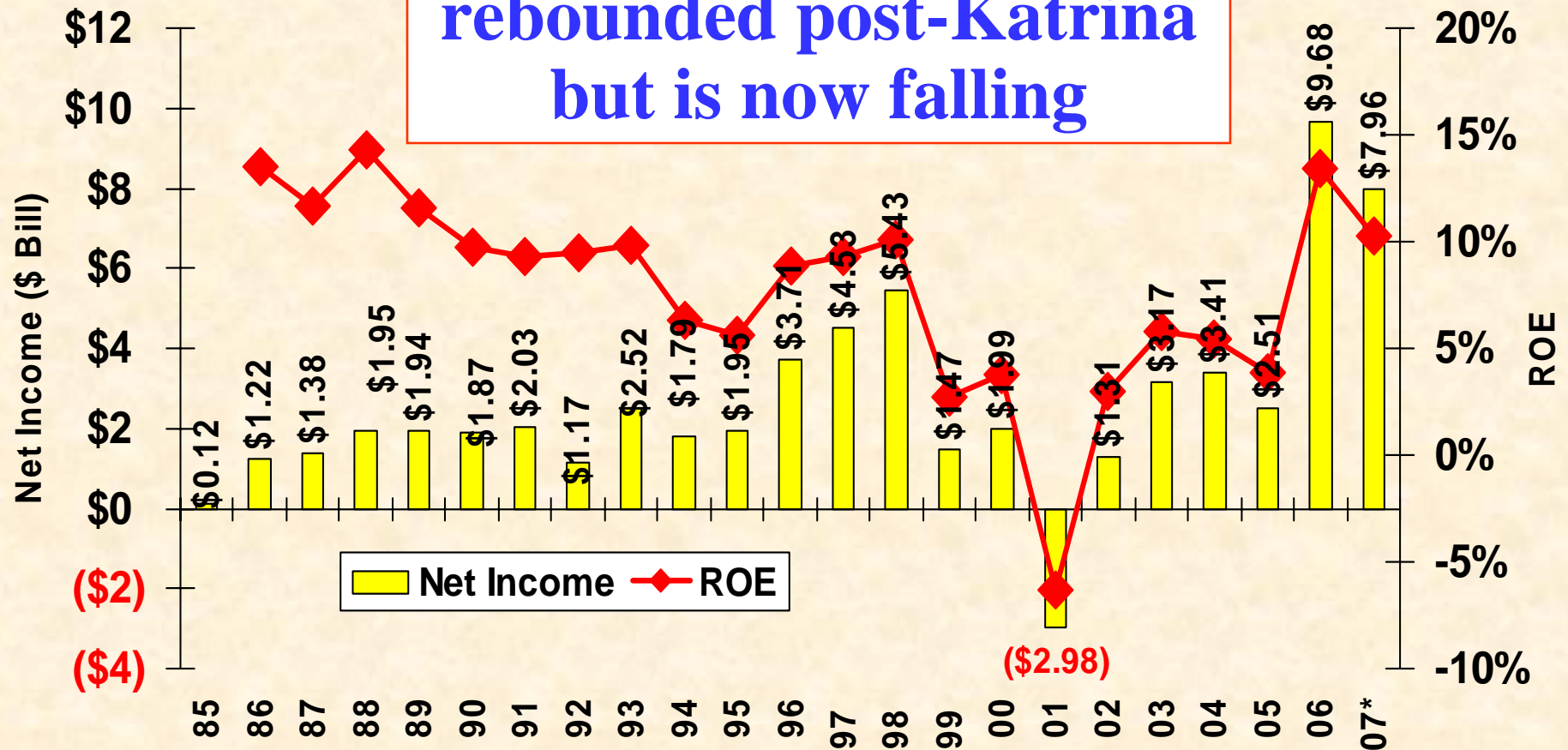
*Excludes losses paid by the Florida Hurricane Catastrophe Fund, a FL-only windstorm reinsurer, which was established in 1994 *after* Hurricane Andrew. FHCF payments to insurers are estimated at \$3.85 billion for 2004 and \$4.5 billion for 2005.

Sources: Wharton Risk Center, Disaster Insurance Project; Insurance Information Institute.



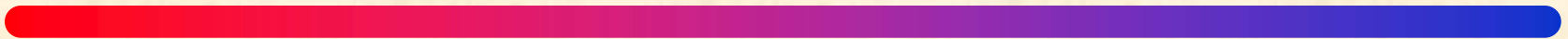
*US Reinsurer Net Income & ROE, 1985-2007**

**Reinsurer profitability
rebounded post-Katrina
but is now falling**



Shifting Legal Liability & Tort Environment

*Is the Tort Pendulum
Swinging Against Insurers?*





*Bad Year for Tort Kingpins**



“King of Class Actions” Bill Lerach

- **Former partner in class action firm Milberg Weiss**
- **Admitted felon. Guilty of paying 3 plaintiffs \$11.4 million in 150+ cases over 25 years & lying about it repeatedly to courts**
- **Will serves 1-2 years in prison and forfeit \$7.75 million; \$250,000 fine**

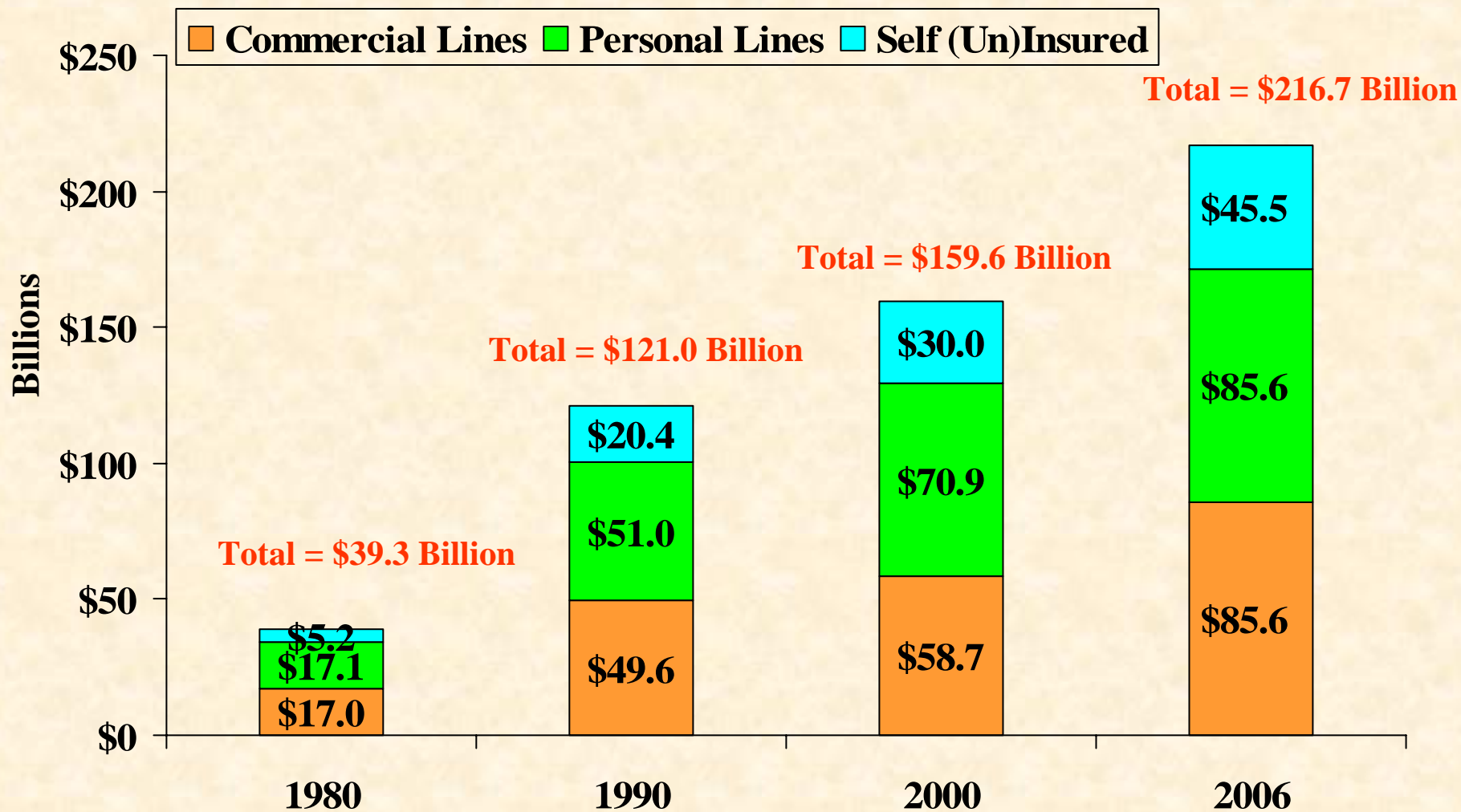


“King of Torts” Dickie Scruggs

- **Won billions in tobacco, asbestos and Katrina litigation**
- **Pleaded guilty for attempting to offer a judge \$40,000 bribe to resolve attorney fee allocation from Katrina litigation in his firm's favor. His son/others → guilty on related charges**
- **Could get 5 years in prison, \$250,000 fine**



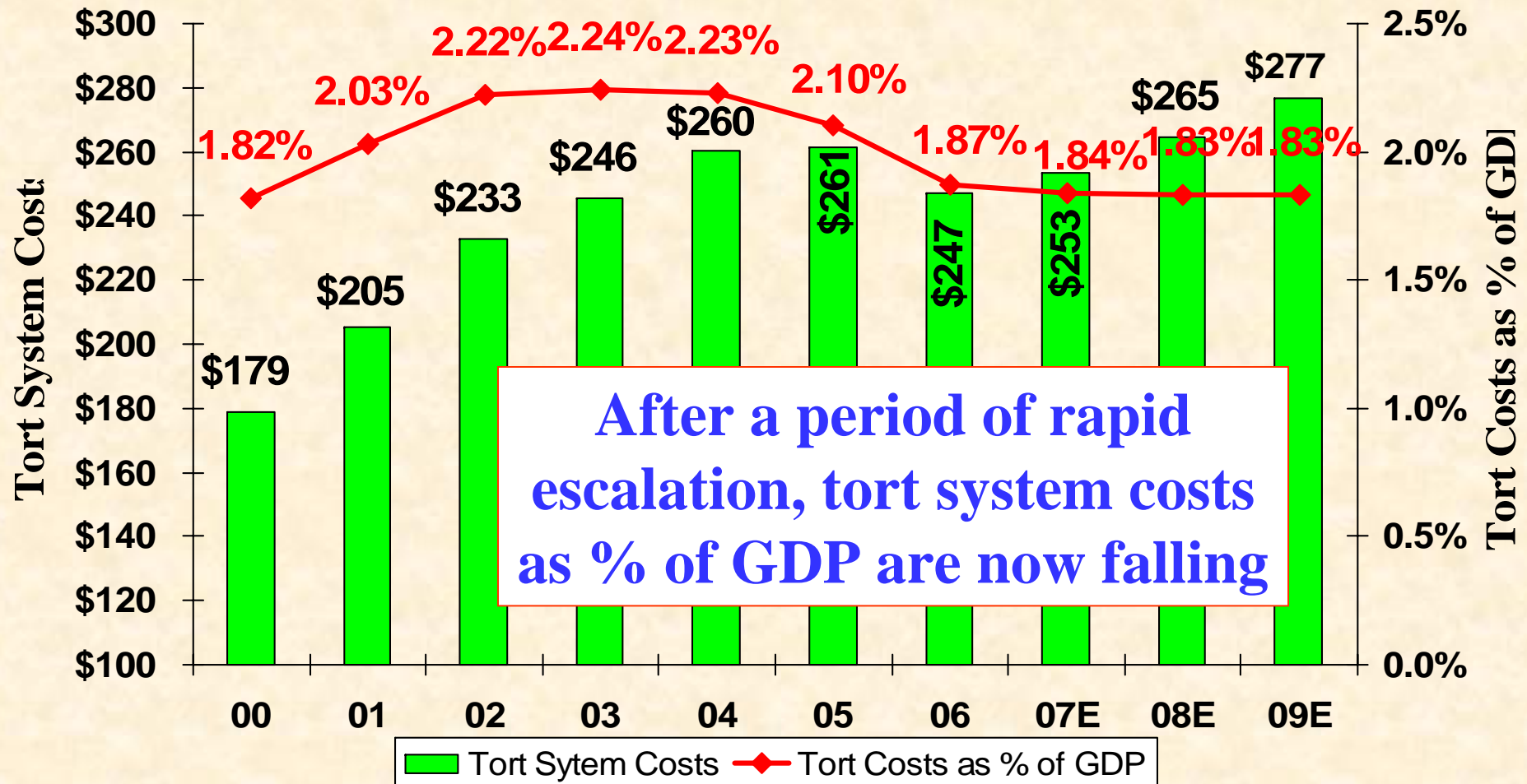
*Personal, Commercial & Self (Un) Insured Tort Costs**



*Excludes medical malpractice

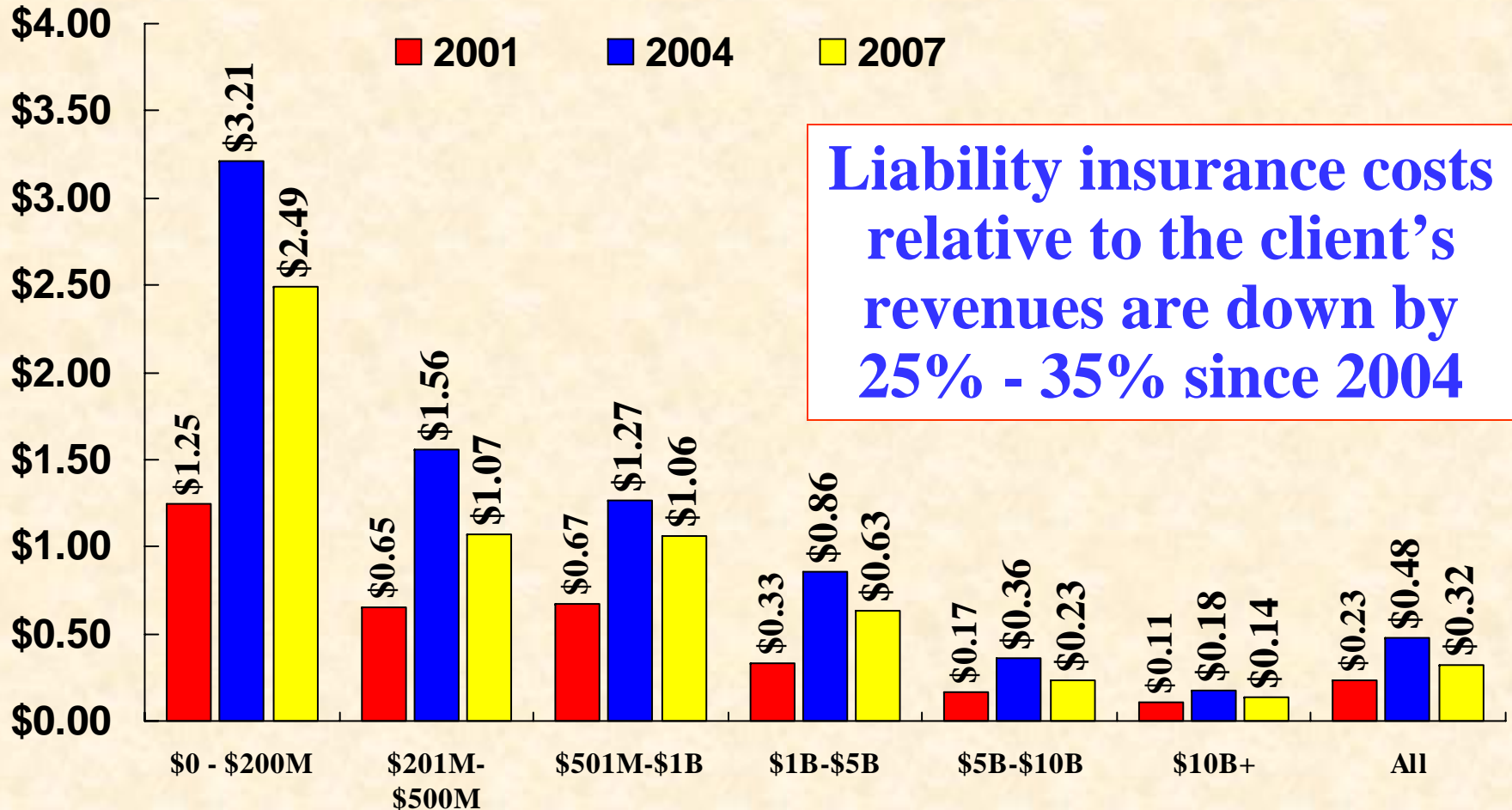
Source: Tillinghast-Towers Perrin, 2007 Update on US Tort Cost Trends.

Tort System Costs and Tort Costs as a Share of GDP, 2000-2009F



*Liability: Average Cost per \$1,000 of Revenue**

United States, 2001 to 2007



*Across entire liability program (full population)

Source: Marsh, 2007 Limits of Liability Report



The Nation's Judicial Hellholes (2007)

Watch List

Madison County, IL

St. Clair County, IL

Northern New Mexico

Hillsborough County, FL

Delaware

California

Dishonorable Mentions

District of Columbia

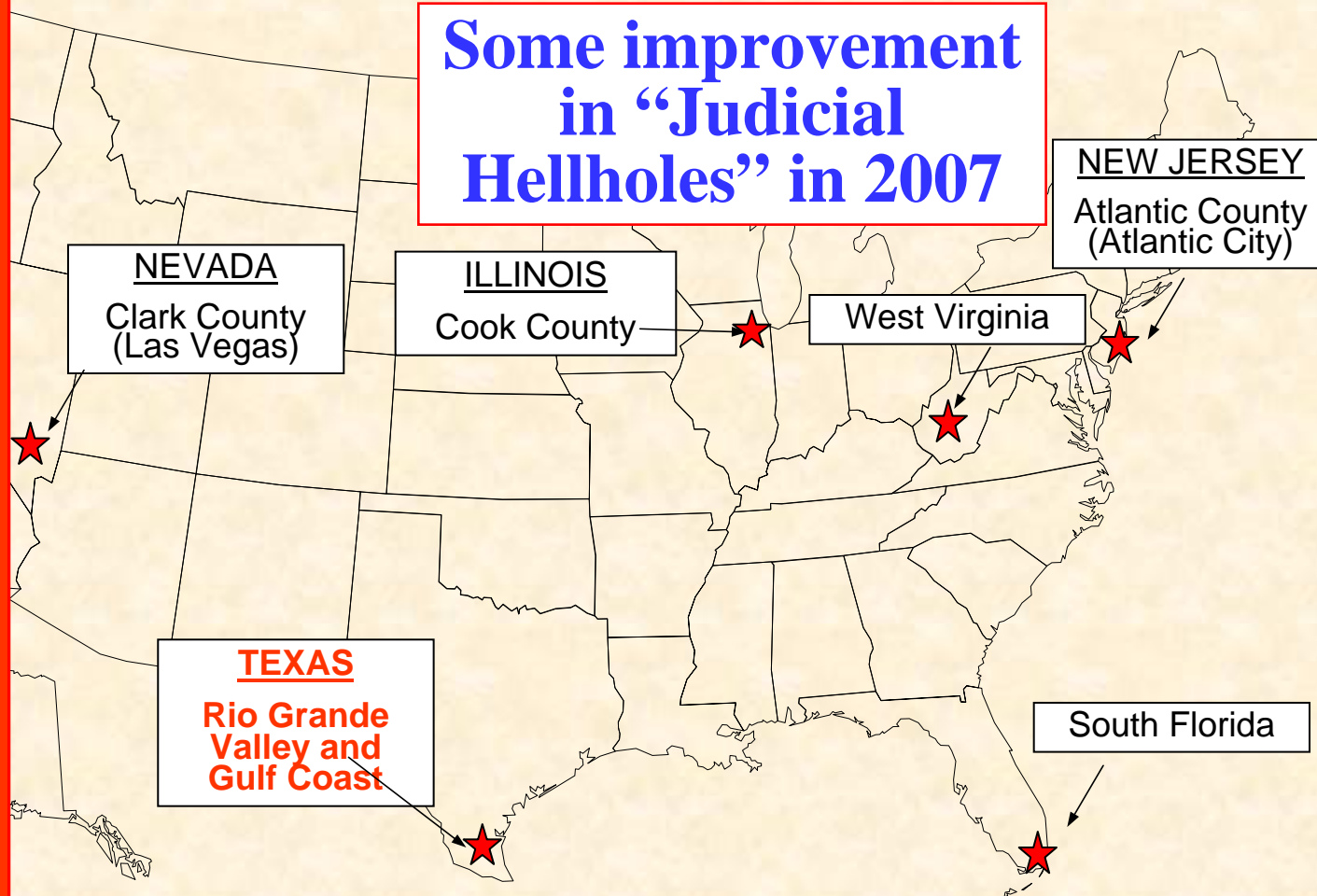
MO Supreme Court

MI Legislature

GA Supreme Court

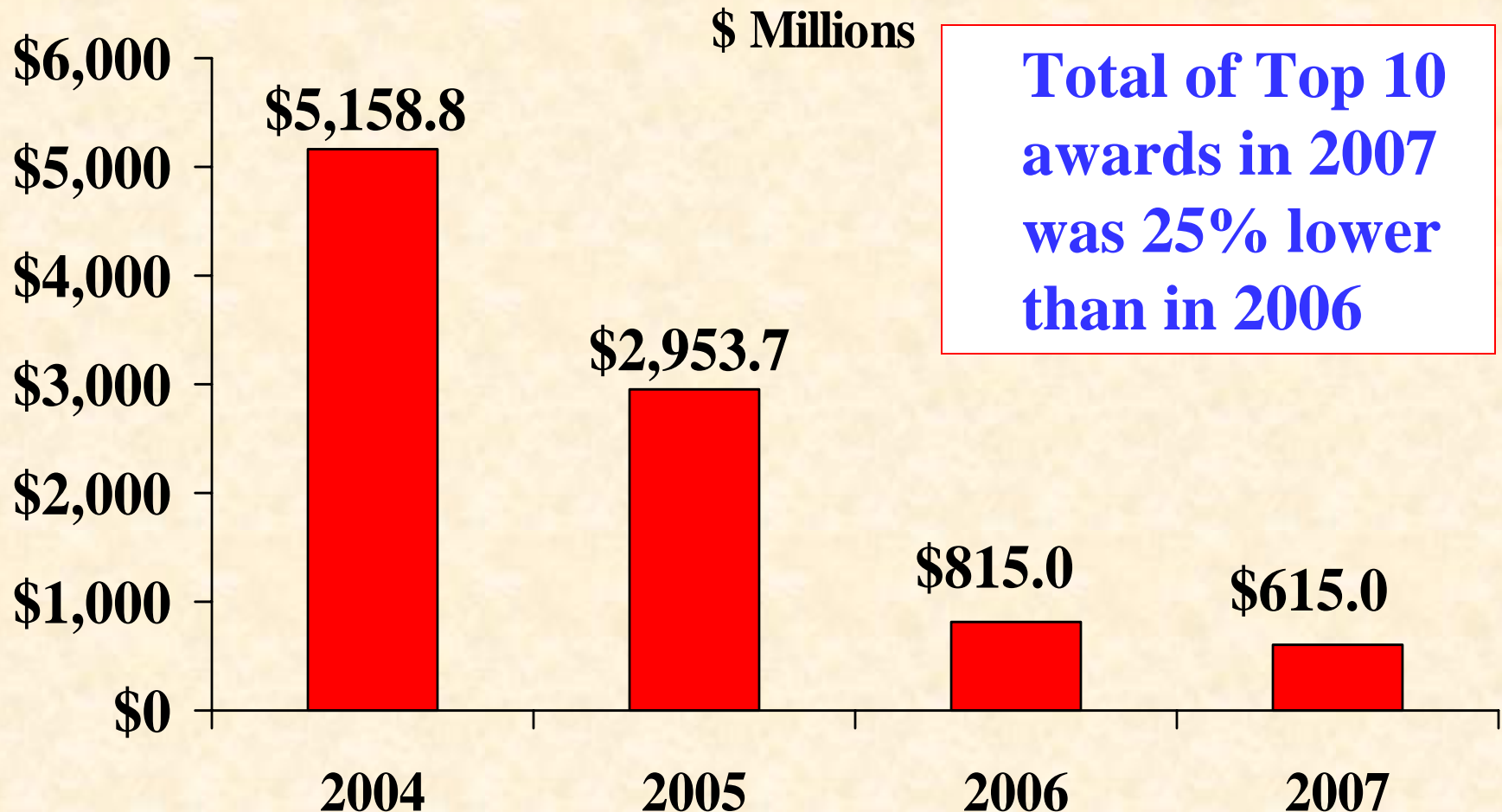
Oklahoma

**Some improvement
in “Judicial
Hellholes” in 2007**





Sum of Top 10 Jury Awards, 2004-2007



2008 ELECTIONS

*Major Implications for
Energy Industry &
Its Insurers*





Political Implications for Energy Insurers & Policyholders

- **All 435 House Seats and 35 of 50 Senate Seats Up for Grabs**
 - State legislatures and key committees will also see significant turnover
- **Election Impacts Will Be Felt by All Industries, Energy and Insurance Included**
- **Areas to Watch Include:**
 - Climate Change Regulation (CO2)
 - Energy Policy (drilling, refineries, permitting & licensing, nuclear)
 - Political response to energy “crisis”
 - Restrictions on “speculators” in energy markets (CFTC)
 - Environmental Policy
 - Shifts in Tort Environment
 - Tax Policy (Energy firms, international (re)insurance)
 - Insurance Regulation (OFC?)
 - Congressional/Presidential response to rising inflation
 - Dollar Strategy (strong vs. weak)
 - Federal Reserve monetary policy (interest rates)



Insurance Information Institute On-Line

WWW.III.ORG

*If you would like a copy of this presentation, please
give me your business card with e-mail address*