The Financial Crisis & the P/C Insurance Industry
Challenges Amid the Economic Storm

Excess Surplus Lines Claims Association
Scottsdale, AZ

September 23, 2008

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Presentation Outline

• Federal Government Economic Bailout: Plan Summary, Insurer Implications
• AIG’s Loan from the Fed: Structure of Agreement
• Regulatory Aftershock: The Coming Regulatory Tsunami in Financial Services
• Weakening Economy: Insurance Impacts & Implications
  ➢ Exposure Impacts: Commercial Insurance
  ➢ Inflation Threat Looming for Insurers?
• Treasury “Blueprint” for Insurance Regulatory Modernization
• Profitability
• Underwriting Trends
• Excess & Surplus Market Trends
• Premium Growth
• Capacity/Capital
• Investment Overview
• Catastrophic Loss
• Shifting Legal Liability, Tort & Political Environment

Q&A
Troubled Asset Relief Program (a.k.a. “The Bailout”) 

Plan Details & Insurer Implications
THE SOLUTION: A 5-POINT PLAN

1. Mortgage Debt Purchases: Up to $700 billion in mortgage debt to purchased by Feds
   - Pricing: Debt Sold to Feds via Reverse Auction
     - Reverse auction is one in which sellers bid lowest price it will accept from the government (i.e., rather a traditional auction in which the highest bid from buyer wins). Helps ensure that the Feds (taxpayer) does not overpay for questionable debt
     - Will be sold in $10 billion increments
     - Amassed portfolios will be run by 5-10 outside asset managers in amounts ranging up to $50 billion

2. Fannie/Freddie Will Increase Mortgage Buying
   - Feds step-up buying MBS in open market

Source: Insurance Information Institute research.

- Treasury will establish a 1-year temporary guaranty program for the money-fund industry for deposits held as of Sept. 19.
- Will insure retail and institutional funds (but not those investing exclusively in municipal and government debt)
- Funds must pay a fee to participate in the program
- Program financed with as much as $50 billion from the Treasury's Exchange Stabilization Fund, which was created in 1934 for exchange rate stabilization
- The Federal Reserve will also essentially lend as much as $230 billion to the industry, via banks, to be used against their illiquid asset-backed holdings

4. 10-Day Ban on Short-Selling 829 Financial Stocks

Source: Insurance Info. Inst. research.
Federal Government Financial Services Rescue Package (cont’d)

5. Conversion of Last 2 Remaining Investment Banks (Goldman Sachs and Morgan Stanley) to Bank Holding Companies
   - Recognition that Wall Street as we have known it for decades is dead
   - High leverage investment bank model no longer viable in current market environment
   - New entities will be subject to stringent federal regulation in exchange for more access to federal dollars/liquidity facilities
   - Capital and liquidity requirements will be greatly enhanced
   - Reduced leverage means new entities will be less profitable

Source: Insurance Info. Inst. research.
Leverage Ratios for Investment Banks and Traditional Banks

- Merrill Lynch: 44.0
- Morgan Stanley: 33.0
- Goldman Sachs: 24.3
- Lehman Brothers: 23.3
- Fannie Mae: 21.5
- Citibank: 15.4
- JP Morgan Chase: 13.3
- Wells Fargo: 12.4
- Wachovia: 10.8
- Bank of America: 10.5

*Based on data for last quarter reported (May or June 2008).

Investment bank leverage ratios were extremely high.
- Lehman filed for bankruptcy 9/15
- Merrill merged with JP Morgan Chase
- Goldman and Morgan converted to bank holding companies
How Does Leverage Work?

• Example of Non-Leverage 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

Source: Insurance Information Institute.
Government Rescue Package of AIG

Motivation & Structural Details
AIG Rescue Package by the Fed

- AIG suffered a liquidity crisis due to large positions, mostly associated with Credit Default Swaps, related to mortgage debt through its AIG Financial Products division
- The losses at AIGFP brought AIG’s holding company to the brink of bankruptcy by Sept. 16 (AIG has 71 divisions)
  - Efforts to create large credit pool via private banks failed
- AIG’s separately regulated insurance subsidiaries were solvent at all times and met local capital requirements in all jurisdictions*
- Federal Reserve Agreed to Lend AIG $85 Billion to Prevent Bankruptcy
  - 2-year term @ 850 bps over LIBOR (about 11 to 11.5%)
  - Fed gets 79.9% stake in AIG (temporary nationalization)
  - CEO Robert Willumstad replaced by former Allstate CEO Edward Liddy
- Proceeds from sale of non-core assets will be used to repay loan
- New CEO says most insurance divisions are “core”

Source: AIG press releases and regulator statements.
Rational for Federal Reserve’s Rescue Package of AIG

- “Too Big to Fail” Doctrine Applied to Insurance for First Time
- AIG is the Largest Insurer in the US and One of the Top 5 Globally: Internationally Disruptive
  - Disorderly unwinding of CDS positions (which guarantee large amounts of debt) would have had large negative consequences on already fragile credit markets
- Fear Was that Generally Healthy Insurance Operations Affecting Millions of People and Businesses Would Have to Be Sold at Fire Sale Prices
- Loan Allowed Time for an Orderly Sale of Assets and a Minimal Disruption on Credit Markets while also Protecting Policyholders
- New CEO says most insurance divisions are “core”

Source: Insurance Information Institute research.
### Leading U.S. Writers of P/C Insurance By DWP, 2007 ($ Billions)¹

<table>
<thead>
<tr>
<th>Company</th>
<th>Direct Written Premiums (DWP) $ Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Farm IL Group</td>
<td>$49.4</td>
</tr>
<tr>
<td>AIG</td>
<td>$37.7</td>
</tr>
<tr>
<td>Zurich Insurance Group</td>
<td>$29.1</td>
</tr>
<tr>
<td>Allstate Insurance Group</td>
<td>$27.7</td>
</tr>
<tr>
<td>Travelers Group</td>
<td>$22.2</td>
</tr>
<tr>
<td>Liberty Mutual Insurance Group</td>
<td>$20.2</td>
</tr>
<tr>
<td>Nationwide Group</td>
<td>$16.1</td>
</tr>
<tr>
<td>Berkshire Hathaway Ins. Group</td>
<td>$15.4</td>
</tr>
<tr>
<td>Progressive Group</td>
<td>$14.0</td>
</tr>
<tr>
<td>Hartford Fire &amp; Casualty Group</td>
<td>$11.5</td>
</tr>
</tbody>
</table>

¹Before reinsurance transactions, excluding state funds.

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.
Leading U.S. Writers of Life Insurance
By DWP, 2007 ($ Billions)\(^1\)

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<thead>
<tr>
<th>Company</th>
<th>Direct Written Premiums (DWP) $ Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>AIG</td>
<td>$53.0</td>
</tr>
<tr>
<td>Metropolitan Group</td>
<td>$51.9</td>
</tr>
<tr>
<td>Prudential of America</td>
<td>$42.3</td>
</tr>
<tr>
<td>ING America Insurance Holding Group</td>
<td>$38.0</td>
</tr>
<tr>
<td>Hartford Fire &amp; Casualty Group</td>
<td>$32.4</td>
</tr>
<tr>
<td>John Hancock Group</td>
<td>$29.8</td>
</tr>
<tr>
<td>Aegon USA Holding Group</td>
<td>$29.7</td>
</tr>
<tr>
<td>Principal Financial Group</td>
<td>$22.7</td>
</tr>
<tr>
<td>New York Life Group</td>
<td>$21.9</td>
</tr>
<tr>
<td>Lincoln National</td>
<td>$21.5</td>
</tr>
</tbody>
</table>

\(^1\text{Premium and annuity totals, before reinsurance transactions, excluding state funds.}\

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.
AFTERSHOCK: Regulatory Response Could Be Harsh

All Financial Segments Including Insurers Will Be Impacted
Incurred Liabilities of the Federal Government Due to Financial Crisis

The Fed (and hence taxpayer) are now exposed to as much as $1.015 trillion in new debt tied to the current financial crisis*

Liquidity Enhancements
Implemented by Fed Due to Crisis

• Lowered Interest Rates for Direct Loans to Banks
  ➢ Federal funds rate cut from 5.5% in mid-2007 to 2.0% now
• Injected Funds Into Money Markets
• Coordinated Exchange Transactions w/Foreign Central Banks
• Created New Auction and Other Lending Programs for Banks
• Started Direct Lending to Investment Banks for the First Time Ever
• Authorized Short-Term Lending to Fannie/Freddie, Backstopping a Treasury Credit Line

“Government is not the solution to our problem, government is the problem.”

--Ronald Reagan, from his first inaugural address, January 20, 1981
From Hubris to the Humbling of American Capitalism?

“Given the precarious state of today’s financial markets, and their vital importance to the daily lives of the American people, Government intervention is not only warranted, it is essential.”

--President George W. Bush, Sept. 19, 2008, on the $700 billion financial institution bailout
Post-Crunch: Fundamental Issues To Be Examined Globally

- **Failure of Risk Management, Control & Supervision at Financial Institutions Worldwide: Global Impact**
  - Colossal failure of risk management (and regulation)
  - Implications for Enterprise Risk Management (ERM)?
  - Misalignment of management financial incentives

- **Focus Will Be on Risk Controls: Implies More Stringent Capital & Liquidity Requirements**
  - Data reporting requirements also likely to be expanded
  - Non-Depository Financial Institutions in for major regulation
  - Changes likely under US and European regulatory regimes
  - Will new regulations be globally consistent?
  - Can overreactions be avoided?

- **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

Post-Crunch: Fundamental Regulatory Issues & Insurance

• Federal Encroachment on Regulation of Insurance
  - $85 billion AIG loan makes increased federal involvement in insurance regulation a certainty
  - States will lose some of their regulatory authority
  - What Feds get/what states lose is unclear

• Removing the “O” from “OFC”?
  - Treasury in March proposed moving solvency and consumer protection authority to a federal “Office of National Insurance”
  - Moving toward more universal approach for regulation of financial services, perhaps under Fed/Treasury
  - Is European (e.g., FSA) approach in store?
  - Treasury proposed assuming solvency and consumer protection roles while also eliminating rate regulation
  - Expect battle over federal regulatory role to continue to be a divisive issue within the industry
  - States will fight to maximize influence, arguing that segments of the financial services industry under their control had the least problems

Source: Insurance Information Institute
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

Government Takeover of Fannie Mae & Freddie Mac

Beneficial for Insurers
Treasury’s Fannie/Freddie Rescue Package Should Help Residential Property Insurers

THE PROBLEM

• Fannie Mae/ Freddie Mac borrow huge sums to buy mortgages from mortgage lenders and do so with an implicit government guarantee that should these mortgage sour the government will come to the rescue

• Together the entities own or guarantee $5.4 trillion in mortgages (about 50% of US total)

• Collectively Fan/Fred have lost about $14 billion over the past 4 quarters and their capital is nearly depleted

• Loss of confidence in Fannie/Freddie is primary reason why Fed’s slashing of rates since has not lowered interest rates (esp. on mortgages)

Source: Wall Street Journal Online, 9/7/08; Insurance Information Institute.
Treasury’s Fannie/Freddie Rescue Package Should Help Residential Property Insurers

THE SOLUTION: A 4-POINT PLAN

1. Government seizes Fannie Mae/ Freddie Mac and places them in “conservatorship” under their regulator the Federal Housing Finance Agency (FHFA)
   ➢ Current CEOs ousted. Fannie will be run by Herb Allison (CEO TIAA-CREF) and Freddie by David Moffet (CEO US Bancorp)

2. Treasury purchases senior preferred stock; Govt. gains 79.9% ownership. Could buy up to $100 billion per firm.

3. Treasury will buy mortgage backed securities (MBS) in the open market issued by Fan/Fred in attempt to lower borrowing costs ($ unspecified)

4. Treasury establishing new lending facilities for Fan/Fred

Total federal involvement could amount to $200 billion

Source: Federal Housing Finance Agency; Wall Street Journal Online, 9/7/08; Insurance Information Institute.
Credit Crisis: Fed Interest Rate Cuts Failed to Reduce Mortgage Rates

January 2000 through August 2008

Fed slashes interest rates by 325 basis points (from 5.25% to 2.00 from July 2007 to mid-2008)

Interest rate on conventional mortgages remained high despite Fed rate cuts

Mortgage FF spread increased to 4.5% from about 1% pre-crisis

Why Treasury’s Fannie/Freddie Rescue Package Should Help Residential Property Insurers

• Crash in housing market is already costing home insurers alone about $1 billion annually in lost premium growth based on 50%+ decline in new home construction (about 1 million fewer homes per year)
  ➢ Plan should lower interest rates, accelerate clearing away existing inventory and stimulate new construction (don’t expect big gains until 2010 at earliest)
  ➢ Mortgage rates fell ½ point day after announcement

• Home in or headed for foreclosure are likely to suffer worse than average loss experience (neglect, abuse, abandonment, vandalism, theft…). Plan may bring interest rate relief to people who’s mortgages will reset over the next several years, averting some foreclosures.

• Insurers hold tens of billion in Fan/Fred MBS debt as well as shares in both companies. Both survive.

Source: Insurance Information Institute.
THE ECONOMIC STORM

What a Weakening Economy & The Threat of Inflation Mean for the Insurance Industry
Real Annual GDP Growth, 2000-2009F

March 2001-November 2001 recession

Recession?

* Red bars are actual; Yellow bars are forecasts
Sources: US Department of Commerce (actual), Blue Economic Indicators 8/08 (forecasts.)
Economic toll of credit crunch, labor market contraction and high energy prices is growing, though no official recession declared.

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

Source: US Department of Commerce, Blue Economic Indicators 8/08; Insurance Information Institute.
Unemployment will likely continue to approach 6% during this cycle, impacting payroll sensitive p/c and non-life exposures.

Rising unemployment will erode payrolls and workers comp’s exposure base.

### U.S. Unemployment Rate, (2007:Q1 to 2009:Q4F) *

<table>
<thead>
<tr>
<th>Quarter</th>
<th>06:Q1</th>
<th>06:Q2</th>
<th>06:Q3</th>
<th>06:Q4</th>
<th>07:Q1</th>
<th>07:Q2</th>
<th>07:Q3</th>
<th>07:Q4</th>
<th>08:Q1</th>
<th>08:Q2</th>
<th>08:Q3</th>
<th>08:Q4</th>
<th>09:Q1</th>
<th>09:Q2</th>
<th>09:Q3</th>
<th>09:Q4</th>
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<tbody>
<tr>
<td>Rate</td>
<td>4.7%</td>
<td>4.6%</td>
<td>4.7%</td>
<td>4.7%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.6%</td>
<td>4.9%</td>
<td>5.4%</td>
<td>5.7%</td>
<td>5.9%</td>
<td>6.1%</td>
<td>6.1%</td>
<td>6.1%</td>
</tr>
</tbody>
</table>

* Blue bars are actual; Yellow bars are forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (8/08); Insurance Info. Inst.
Total Private Employment* Grew by 25½ Million Workers from 1991 to 2008

The US economy added 25.5 million jobs between 1991 and 2008, but job growth has recently stagnated, impacted payrolls and the workers comp exposure base.

*seasonally adjusted at mid-year
Average Weekly Real Earnings in Private Employment Were Flat from 1999 to 2008

Virtually all of the real wage growth occurred between 1995 and 1999 and has now stagnated

Weakening wage and salary growth is expected to cause a deceleration in workers comp exposure growth.

Shaded areas indicate recessions.
Workplace Injury Incidence Rates Declined in Last 4 Economic Downturns

Incidence Rates per 100 FTE Workers

Claims per 100,000 Workers

- Recessions
- Manufacturing Industry Injuries and Illnesses per 100 Full-Time Workers
- Private Industry Injuries and Illnesses per 100 Full-Time Workers
- NCCI Lost-Time Claims per 100,000 Workers

p Preliminary
Source: US Department of Labor, Bureau of Labor Statistics (BLS), National Bureau of Economic Research; NCCI Frequency and Severity Analysis
New home starts plunged 34% from 2005-2007; drop through 2008 trough is 53% (est.)—a net annual decline of 1.1 million units. 

Exposure growth forecast for HO insurers is dim for 2008/09. Impacts also for comml. insurers with construction risk exposure.

I.I.I. estimates that each incremental 100,000 decline in housing starts costs home insurers $87.5 million in new exposure (gross premium). The net exposure loss in 2008 vs. 2005 is estimated at $963 million.

Weakening economy, credit crunch and high gas prices are hurting auto sales. New auto/light truck sales are expected to experience a net drop of 2.8 million units annually by 2008 compared with 2005, a decline of 16.6%.

Impacts of falling auto sales will have a less pronounced effect on auto insurance exposure growth than problems in the housing market will on home insurers.

Nonresidential Fixed Investment, *
2003 – 2009F (Billions of 2000 $)

Sharp dip in business investment growth in 2007-2009 will slow commercial exposure growth

*Nonresidential fixed investment consists of structures, equipment and software.

Sources: US Bureau of Economic Analysis (Historical), Blue Chip Economic Indicators (7/08) for forecasts.
Industrial production affects exposure both directly and indirectly.

Industrial production shrank during Q1 2008 and is expected to shrink again in Q2, growing very slowly thereafter.

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (7/08); Insurance Info. Inst.
Percent Change in Debt Growth
(Quarterly since 2004:Q1, at Annualized Rate)

Source: Federal Reserve Board, at http://www.federalreserve.gov/releases/z1/Current/z1r-2.pdf
Real GDP Growth vs. Real P/C

Premium Growth: Modest Association

P/C insurance industry’s growth is influenced modestly by growth in the overall economy.

Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 8/08; Insurance Information Inst.
## Favored Industry Groups for Insurer Exposure Growth

<table>
<thead>
<tr>
<th>Industry</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health Care</td>
<td>• Economic Necessity → Recession Resistant</td>
</tr>
<tr>
<td></td>
<td>• Demographics: aging/immigration → Growth</td>
</tr>
<tr>
<td>Energy (incl. Alt.)</td>
<td>• Fossil, Solar, Wind, Bio-Fuels, Hydro &amp; Other</td>
</tr>
<tr>
<td>Agriculture &amp; Food Processing &amp; Manufacturing</td>
<td>• Consumer Staple → Recession Resistant</td>
</tr>
<tr>
<td></td>
<td>• Grain and land prices high due to global demand, weak dollar (exports)</td>
</tr>
<tr>
<td></td>
<td>• Acreage Growing → Farm Equipment, Transport</td>
</tr>
<tr>
<td></td>
<td>• Benefits many other industries</td>
</tr>
<tr>
<td>Export Driven</td>
<td>• Weak dollar, globalization persist</td>
</tr>
<tr>
<td>Natural Resources &amp; Commodities</td>
<td>• Strong global demand,</td>
</tr>
<tr>
<td></td>
<td>• Supplies remain tight… <em>but beware of bubbles</em></td>
</tr>
<tr>
<td></td>
<td>• Significant investments in R&amp;D, plant &amp; equip required</td>
</tr>
</tbody>
</table>

Sources: Insurance Information Institute
# Summary of Economic Risks and Implications for (Re) Insurers

<table>
<thead>
<tr>
<th>Economic Concern</th>
<th>Risks to Insurers</th>
</tr>
</thead>
</table>
| **Subprime Meltdown/ Credit Crunch**           | • *Some* insurers have *some* asset risk  
|                                                | • D&O/E&O exposure for *some* insurers  
|                                                | • Client asset management liability for *some*  
|                                                | • Bond insurer problems; Muni credit quality  
|                                                | • Mortgage insurers face losses; Also tightening standards and slowing real estate market  
|                                                | • Banks less able to lend, slowing construction  
| **Lower Interest Rates**                       | • Lower investment income  
| **Stock Market Slump**                         | • Decreased capital gains (which are usually relied upon more heavily as a source of earnings as underwriting results deteriorate)  
| **General Economic Slowdown/Recession**       | • Reduced commercial lines exposure growth  
|                                                | • Surety slump  
|                                                | • Decreased workers comp frequency due to drop in high hazard class employment |
Inflation Overview

Pressures Claim Costs, Expands Probable & Possible Max Losses
In July 2008, on a year-over-year basis inflation was 5.4% -- among the highest levels since 1991.

*12-month change August 2008 vs. August 2007
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, September 10, 2008. (forecasts)
Inflation: Important Economic Risks and Implications for Insurers

<table>
<thead>
<tr>
<th>Effects of Inflation</th>
<th>Risks to Insurers &amp; Buyers</th>
</tr>
</thead>
</table>
| Claim Severity Increase | • Claims (property and liability) costs may rise as the price of goods and services increase  
  • PMLs could be (much) higher |
| Rate Inadequacy      | • Accelerating inflation historically contributed 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 |
### Effects of Inflation

<table>
<thead>
<tr>
<th>Effects of Inflation</th>
<th>Risks to Insurers</th>
</tr>
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</table>
| Reserve Deficiency           | - 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   | - Policyholders could find themselves inadequately insured as claims costs escalate                                                                                                                                 |
| Inadequate Reinsurance       | - 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 (%)

CPI and “Core” CPI are not representative of many of the costs insurers face.

Medical/Legal costs typically run well ahead of inflation.

*Core CPI is the Consumer Price Index for all Urban Consumers (CPI-U) less food and energy costs.

Medical & Tort Cost Inflation

Amplifiers of Inflation, Major Insurance Cost Driver
Soaring medical inflation is among the most serious long-term challenges facing casualty, disability and LTC insurers.

Inflation for Medical Care has been surging ahead of general inflation (CPI) for 25 years. Since 1982-84, the cost of medical care has more than tripled.

Source: Department of Labor (Bureau of Labor Statistics; Insurance Information Institute.)
Tort Cost Growth & Medical Cost Inflation vs. Overall Inflation (CPI-U), 1961-2008*

Tort System is an Inflation Amplifier
Torts Costs: +8.4%
Med Costs: +6.0%
Overall Inflation: +4.2%

Tort costs move with inflation but at twice the rate

*Medical cost and CPI-U through April 2008 from BLS. Tort figure is for full-year 2008 from Tillinghast.
WC Medical Severity Rising Far Faster than Medical CPI

WC medical severity rose more than twice as fast as the medical CPI (8.3% vs. 4.0%) from 1995 through 2007p

Sources: NCCI; Med CPI from Economy.com; WC med severity from NCCI based on NCCI states.
Workers Comp Medical Claims Costs Continue to Climb

Medical Claim Cost ($000s)

Annual Change 1991–1993: +1.9%
Annual Change 1994–2001: +8.9%
Annual Change 2002-2006: +7.8%

Cumulative Change = +200%
(1993-2007p)

1991-2006: Based on data through 12/31/2006, developed to ultimate
Based on the states where NCCI provides ratemaking services; Excludes the effects of deductible policies
Med cost inflation is one factor to high WC severity. Med cost are now nearly 60% of all lost time claim costs.
WC Med Cost Will Equal 70% of Total by 2017 if Trends Hold

2017 Estimate

Indemnity 30%
Medical 70%

This trend will likely be supported by the increased labor force participation of workers age 55 and older.

Source: Insurance Information Institute.
PROFITABILITY

Profits in 2006/07 Reached Their Cyclical Peak;

By No Reasonable Standard Can Profits Be Deemed Excessive
P/C Net Income After Taxes
1991-2008 ($ Millions)*

- 2001 ROE = -1.2%
- 2002 ROE = 2.2%
- 2003 ROE = 8.9%
- 2004 ROE = 9.4%
- 2005 ROE = 9.6%
- 2006 ROE = 12.2%
- 2007 ROAS1 = 12.3%**
- 2008 ROAS = 6.4%***

Insurer profits peaked in 2006

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

*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
**ROE vs. Equity Cost of Capital:**


The p/c insurance industry achieved its cost of capital in 2005/6 for the first time in many years.

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.

*Excludes mortgage and financial guarantee insurers.

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 consolidatio would imply greater discipline

Source: Insurance Information Institute.
**P/C Stocks: Mirroring the S&P 500 Index in 2008**

Total YTD Returns Through September 19, 2008

- **S&P 500**: 14.53%
- **All Insurers**: -6.91%
- **P/C**: 2.12%
- **Life/Health**: -24.70%
- **Multiline**: 5.93%
- **Reinsurance**: -41.13%
- **Mortgage**: -54.44%
- **Mortgage & Financial Guarantee insurers were down 69% in 2007**: -68.38%

*Includes Financial Guarantee.
Source: SNL Securities, Standard & Poor’s, Insurance Information Institute.*
Top Industries by ROE: P/C Insurers Still Underperformed in 2007*

P/C insurer profitability in 2007 ranked 31st out of 51 industry groups despite renewed profitability, underperforming the All Industry median for the 20th consecutive year.

Source: Fortune, May 5, 2008 edition; Insurance Information Institute
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 consolidatio would imply greater discipline

Source: Insurance Information Institute.
Ad spending by P/C insurers is at a record high, signaling increased competition.

Source: Insurance Information Institute from consolidated P/C Annual Statement data.
FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well, But Cycle May Takes Its Toll
The number of impairments varies significantly over the p/c insurance cycle, with peaks occurring well into hard markets.
Impairment rates are highly correlated underwriting performance and could reach a record low in 2007.

2007 impairment rate was a record low 0.12%, one-seventh the 0.8% average since 1969; previous record was 0.24% in 1972.

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;
Insurers with strong ratings are far less likely to become impaired over long periods of time. Especially important in long-tailed lines.

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

<table>
<thead>
<tr>
<th>Company</th>
<th>Guaranty Fund Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reliance Insurance</td>
<td>$2,265.8</td>
</tr>
<tr>
<td>Legion Insurance</td>
<td>$1,272.7</td>
</tr>
<tr>
<td>California Compensation Ins.</td>
<td>$1,049.7</td>
</tr>
<tr>
<td>Fremont Indemnity Ins.</td>
<td>$843.4</td>
</tr>
<tr>
<td>PHICO Ins.</td>
<td>$699.4</td>
</tr>
<tr>
<td>Transit Casualty Ins.</td>
<td>$566.5</td>
</tr>
<tr>
<td>Superior National Ins.</td>
<td>$555.8</td>
</tr>
<tr>
<td>American Mutual Liability Ins.</td>
<td>$543.1</td>
</tr>
<tr>
<td>Midland Insurance</td>
<td>$531.6</td>
</tr>
<tr>
<td>Southern Family Ins.</td>
<td>$516.8</td>
</tr>
</tbody>
</table>

The 2001 bankruptcy of Reliance Insurance was the largest ever among p/c insurers.

* 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*

$ Millions
(Year Indicates Year of Liquidation)

The 1991 bankruptcy of Executive Life was by far the largest ever among life insurers

*As of 2007.

Source: National Organization of Life and Health Guaranty Funds
UNDERWRITING TRENDS

Extremely Strong 2006/07; Relying on Momentum & Discipline for 2008
P/C Insurance Combined Ratio, 1970-2008F*

| Combined Ratios | 1970s: 100.3 | 1980s: 109.2 | 1990s: 107.8 | 2000s: 102.0* |

Sources: A.M. Best; ISO, III  *Full year 2008 estimates from III.
As recently as 2001, insurers paid out nearly $1.16 for every $1 in earned premiums.

2005 ratio benefited from heavy use of reinsurance which lowered net losses.

Best combined ratio since 1949 (87.6)

Relatively low CAT losses, reserve releases

Including Mortgage & Fin. Guarantee insurers

Excluding Mortgage & Fin. Guarantee insurers

*Excluding Mortgage & Financial Guarantee insurers.
Ten Lowest P/C Insurance Combined Ratios Since 1920 vs. 2007

The 2006 combined ratio of 92.2 was the best since the 87.6 combined in 1949.

2007 was the 20th best since 1920.

The industry’s best underwriting years are associated with periods of low interest rates.

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

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

* Includes mortgage * finl. guarantee insurers
Impact of Reserve Changes on Combined Ratio

Reserve adequacy has improved substantially

Source: A.M. Best, Lehman Brothers estimates for years 2007-2009
## Cumulative Prior Year Reserve Development by Line (As of 12/31/06)

<table>
<thead>
<tr>
<th>Line</th>
<th>Reserve Development (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPA Liability</td>
<td>$3,006</td>
</tr>
<tr>
<td>PPA PD</td>
<td></td>
</tr>
<tr>
<td>Home</td>
<td>$1,174</td>
</tr>
<tr>
<td>Med Mal</td>
<td>$1,116</td>
</tr>
<tr>
<td>Specialty Prop</td>
<td>$779</td>
</tr>
<tr>
<td>Comm. Auto</td>
<td>$-475</td>
</tr>
<tr>
<td>Prod. Liability</td>
<td>$-413</td>
</tr>
<tr>
<td>Finl. Guaranty</td>
<td>$-254</td>
</tr>
<tr>
<td>International</td>
<td>$-100</td>
</tr>
<tr>
<td>Other</td>
<td>$-100</td>
</tr>
<tr>
<td>Specialty Liab.</td>
<td>$-86</td>
</tr>
<tr>
<td>Worker’s Comp</td>
<td>$-53</td>
</tr>
<tr>
<td>Fidelity/Surety</td>
<td>$-48</td>
</tr>
<tr>
<td>Commercial Multi</td>
<td>$366</td>
</tr>
<tr>
<td>Other Liability</td>
<td>$1,172</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>$1,176</td>
</tr>
</tbody>
</table>

Reserve redundancies in most lines have resulted in releases in recent years.

Sources: Lehman Brothers; A.M. Best’s Aggregates & Averages Schedule P, Part 2.
COMMERCIAL LINES

Commercial Auto
Commercial Multi-Peril
Workers Comp
Recent results benefited from favorable loss cost trends, improved tort environment, low CAT losses, WC reforms and reserve releases.

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.

Sources: A.M. Best (historical and forecasts)
EXCESS & SURPLUS LINES

Growth, Performance & Markets
Direct Surplus Lines Premiums Written (Non-Admitted, Top 10 Writers)

$ Billions

Source: Business Insurance, Sept. 8, 2008; Insurance Information Institute.

Aggressive pricing has taken its toll on surplus lines premiums.
Surplus Lines pay more than $1.3B annually in premium taxes.
The Top 10 E&S insurers wrote $13.6 billion in premiums in 2007, down 10.2% from 2006 but up 22.5% from 2002.

<table>
<thead>
<tr>
<th>Insurer</th>
<th>Direct Premiums Written</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lexington Insurance (AIG)</td>
<td>$6,619.3 (Millions)</td>
</tr>
<tr>
<td>American Intl Specialty (AIG)</td>
<td>$1,489.4</td>
</tr>
<tr>
<td>Scottsdale Insurance (Nationwide)</td>
<td>$1,198.5</td>
</tr>
<tr>
<td>Columbia Casualty (CNA)</td>
<td>$763.0</td>
</tr>
<tr>
<td>Landmark American (Alleghany)</td>
<td>$707.1</td>
</tr>
<tr>
<td>Evanston Insurance (Markel)</td>
<td>$660.8</td>
</tr>
<tr>
<td>Arch Specialty (Arch Capital)</td>
<td>$640.6</td>
</tr>
<tr>
<td>Admiral Insurance (Berkley)</td>
<td>$561.7</td>
</tr>
<tr>
<td>National Fire &amp; Marine (Berkshire)</td>
<td>$544.6</td>
</tr>
<tr>
<td>Essex Insurance (Markel)</td>
<td>$430.6</td>
</tr>
</tbody>
</table>

Source: Business Insurance, Sept. 8, 2008; Insurance Information Institute.
Top 10 E&S Markets, by First Half 2008
Gross Surplus Lines Premiums Written

<table>
<thead>
<tr>
<th>Market</th>
<th>Premiums Written ($ Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>3,116.8</td>
</tr>
<tr>
<td>Florida</td>
<td>2,585.8</td>
</tr>
<tr>
<td>New York</td>
<td>1,841.0</td>
</tr>
<tr>
<td>Texas</td>
<td>1,577.8</td>
</tr>
<tr>
<td>Illinois</td>
<td>608.4</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>504.2</td>
</tr>
<tr>
<td>Washington</td>
<td>274.0</td>
</tr>
<tr>
<td>Arizona</td>
<td>249.3</td>
</tr>
<tr>
<td>Nevada</td>
<td>160.0</td>
</tr>
<tr>
<td>Mississippi</td>
<td>156.9</td>
</tr>
</tbody>
</table>

California and Florida are by far the largest markets.


% Change in Gross Premiums Written: 2003-2005

- Wyoming: 103.5%
- New York: 95.5%
- South Dakota: 81.0%
- Montana: 76.2%
- Hawaii: 57.9%
- New Hampshire: 52.4%
- Minnesota: 46.0%
- Arizona: 45.5%
- Wisconsin: 42.8%
- Alabama: 40.5%

Fastest growth is not usually in most CAT-prone states as might be expected.

Source: Business Insurance, Sept. 11, 2006; Insurance Information Institute.

% Change in Gross Premiums Written: 2005-2007

- Tennessee: 69.0%
- Louisiana: 54.6%
- Mississippi: 47.9%
- North Dakota: 47.4%
- South Carolina: 44.8%
- Indiana: 42.1%
- Wyoming: 34.8%
- Florida: 34.2%
- Hawaii: 33.2%
- Texas: 25.6%

Fastest growth is often, but not always, in most CAT-prone states

Source: Business Insurance, Sept. 8, 2008; Insurance Information Institute.
Most Common Classes of E&S Business Written, 2005

Percentage of Most Common Types Offered

- General Liability: 91.7%
- Commercial Property: 83.3%
- Professional E&O: 79.2%
- Product Liability: 75.0%
- Inland Marine: 70.8%

GL and Commercial Property are the biggest sellers

Source: Business Insurance, Sept. 11, 2006; Insurance Information Institute.
Most Common Classes of E&S Business Written, 2007

Percentage of Most Common Types Offered

- General Liability: 80.8%
- Professional E&O: 80.8%
- Commercial Property: 76.9%
- Inland Marine: 76.9%
- Product Liability: 76.9%

GL and Professional E&O are the biggest sellers

Source: Business Insurance, Sept. 8 2008; Insurance Information Institute.
EMERGING RISKS

Common Mistake is to Assume all Emerging Risks are About Underwriting
# Emerging Risks Impacting the Global (Re)Insurance Industry

<table>
<thead>
<tr>
<th>Issue</th>
<th>Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Erosion of Tort Reform</td>
<td>Inflation Risk</td>
</tr>
<tr>
<td>Bad Faith Litigation</td>
<td>Employment Practices Liability</td>
</tr>
<tr>
<td>Post-Catastrophe Litigation</td>
<td>Energy Sector</td>
</tr>
<tr>
<td>Climate Change (liability&gt;property)</td>
<td>Nursing Home/Asst. Living</td>
</tr>
<tr>
<td>Products Liability (Imports, Food)</td>
<td>Currency Risk</td>
</tr>
<tr>
<td>Regulatory Risk</td>
<td>Economic Shock/Contagion Effects</td>
</tr>
<tr>
<td>Securities Litigation</td>
<td>Terrorism</td>
</tr>
<tr>
<td>Asset Valuation Risk (Mark-to-Market)</td>
<td>Nanotechnology</td>
</tr>
<tr>
<td>Environmental Liability</td>
<td>Pharmaceuticals</td>
</tr>
<tr>
<td>Latent Occupational Disease</td>
<td>Disintermediation</td>
</tr>
<tr>
<td>Socialization of Insurance Markets</td>
<td>US Tax Policy</td>
</tr>
</tbody>
</table>

Source: Insurance Information Institute
PREMIUM GROWTH
At a Virtual Standstill in 2007/08
2007 is Q1 actual (-0.6%), the first decline since 1943

2008 is Q1 actual (-0.7%), including Mortgage & Financial Guarantee insurers
Sources: A.M. Best, ISO, Insurance Information Institute
Year-to-Year Change in Net Written Premium, 2000-Q1:2008

Excluding Mortgage & Financial Guarantee insurers, Q1 2008 NWP dropped 0.9%

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

Source: A.M. Best; ISO.
Net written premium growth is expected to be slower for commercial insurers and reinsurers.

Sources: A.M. Best Review & Preview (historical and forecast).
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.
PRICING TRENDS

Under Pressure
Cost of Risk vs. Commercial Lines Combined Ratio

Source: RIMS Benchmark Survey, A.M. Best 2007 Aggregates & Averages; Insurance Information Institute
Total liability costs account for 35% - 40% of the risk dollar.

Firms w/Revenues < $1 Billion
- Property Premiums, 18%
- Admin Costs, 14%
- Retained Property Losses, 5%
- WC Premiums, 14%
- Retained WC Losses, 7%
- Prof. Liability Costs, 7%
- Other Costs, 4%

Firms w/Revenues > $1 Billion
- Property Premiums, 13%
- Admin Costs, 12%
- Liability Prof. Liability Retained Losses, 2%
- WC Premiums, 5%
- Retained WC, 21%
- Total Mgmt. Liab., 7%
- Retained Property Losses, 11%
- Liabilt Premium 11%

Source: RIMS (2007); Insurance Information Institute
### Average Commercial Rate Change, All Lines, (1Q:2004 – 2Q:2008)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Rate Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1Q04</td>
<td>-0.1%</td>
</tr>
<tr>
<td>2Q04</td>
<td>-3.2%</td>
</tr>
<tr>
<td>3Q04</td>
<td>-5.9%</td>
</tr>
<tr>
<td>4Q04</td>
<td>-7.0%</td>
</tr>
<tr>
<td>1Q05</td>
<td>-9.4%</td>
</tr>
<tr>
<td>2Q05</td>
<td>-9.7%</td>
</tr>
<tr>
<td>3Q05</td>
<td>-8.2%</td>
</tr>
<tr>
<td>4Q05</td>
<td>-4.6%</td>
</tr>
<tr>
<td>1Q06</td>
<td>-2.7%</td>
</tr>
<tr>
<td>2Q06</td>
<td>-3.0%</td>
</tr>
<tr>
<td>3Q06</td>
<td>-5.3%</td>
</tr>
<tr>
<td>4Q06</td>
<td>-9.6%</td>
</tr>
<tr>
<td>1Q07</td>
<td>-9.6%</td>
</tr>
<tr>
<td>2Q07</td>
<td>-11.3%</td>
</tr>
<tr>
<td>3Q07</td>
<td>-11.8%</td>
</tr>
<tr>
<td>4Q07</td>
<td>-12.0%</td>
</tr>
<tr>
<td>1Q08</td>
<td>-12.9%</td>
</tr>
</tbody>
</table>

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

A flattening in the magnitude of price declines is evident.

**KRW Effect**
Commercial account pricing has been trending down for 4+ years and is now on par with prices in late 2001.

Source: Council of Insurance Agents & Brokers
While pricing has moved in sync across account size, large accounts have seen the most pronounced declines.
Average Commercial Rate Change by Line: 4Q99 – 2Q08

Pricing has generally been negative since early 2004

Post-Katrina property insurance price impact

Source: Council of Insurance Agents & Brokers
Most Layers of Coverage are Being Challenged/Leaking

- Risks are comfortable taking larger retentions
  - Lg. deductibles, self insurance, RRGs, captives erode primary
  - Reinsurers losing to higher retentions, securitization
  - Excess squeezed by higher primary retentions, lower reins. attachments

Source: Insurance Information Institute from Aon schematic.
Following a five-year period of rapid growth, U.S. captive insurers saw net premiums written increase by just 2.7 percent in 2006, after 6.2 percent growth in 2005.

Risk Retention Group Premiums, 1988 – 2006*

Risk retention (& self-insurance) group premiums have risen rapidly in recent years and represent a form of competition to traditional insurers and captives.

*2006 Projected
Source: Risk Retention Reporter, Insurance Info. Institute
RISING EXPENSES

Expense Ratios Will Rise as Premium Growth Slows
Personal vs. Commercial Lines

Underwriting Expense Ratio *

Expenses ratios will likely rise as premium growth slows

*Ratio of expenses incurred to net premiums written.
Source: A.M. Best; Insurance Information Institute
CAPACITY/SURPLUS

Accumulation of Capital/Surplus Depresses ROEs
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.
Catastrophe bond issuance has soared in the wake of Hurricanes Katrina and the hurricane seasons of 2004/2005, despite two quiet CAT years.

Source: MMC Securities Guy Carpenter, A.M. Best; Insurance Information Institute.
### P/C Insurer Share Repurchases, 1987- Through Q4 2007 ($ Millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Repurchases ($ Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>87</td>
<td>$564.0</td>
</tr>
<tr>
<td>88</td>
<td>$646.9</td>
</tr>
<tr>
<td>89</td>
<td>$311.0</td>
</tr>
<tr>
<td>90</td>
<td>$952.4</td>
</tr>
<tr>
<td>91</td>
<td>$566.8</td>
</tr>
<tr>
<td>92</td>
<td>$310.1</td>
</tr>
<tr>
<td>93</td>
<td>$658.8</td>
</tr>
<tr>
<td>94</td>
<td>$769.2</td>
</tr>
<tr>
<td>95</td>
<td>$2,385.6</td>
</tr>
<tr>
<td>96</td>
<td>$4,497.5</td>
</tr>
<tr>
<td>97</td>
<td>$4,986.5</td>
</tr>
<tr>
<td>98</td>
<td>$5,266.0</td>
</tr>
<tr>
<td>99</td>
<td>$4,297.3</td>
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<tr>
<td>00</td>
<td>$2,764.2</td>
</tr>
<tr>
<td>01</td>
<td>$1,539.9</td>
</tr>
<tr>
<td>02</td>
<td>$763.7</td>
</tr>
<tr>
<td>03</td>
<td>$5,242.3</td>
</tr>
<tr>
<td>04</td>
<td>$4,370.0</td>
</tr>
<tr>
<td>05</td>
<td>$7,094.1</td>
</tr>
<tr>
<td>06</td>
<td>$22,322.6</td>
</tr>
<tr>
<td>07</td>
<td></td>
</tr>
</tbody>
</table>

### 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.

Sources: Credit Suisse, Company Reports; Insurance Information Inst.
MERGER & ACQUISITION

Are Catalysts for P/C Consolidation Growing in 2008?
Distribution of P/C Insurer Acquisitions, Jan. 2007 – June 2008

Deals Exceeding $100 Million

SUMMARY STATS

- 22 deals
- $23 billion total transaction value
- $475 million median deal value
- Acquirers mostly p/c insurers and limited number of private equity deals

Source: SNL, Lehman Brothers.
Motivating Factors for Increased P/C Insurer Consolidation

Motivating Factors for P/C M&As

- **Slow Growth:** Growth is at its lowest levels since the late 1990s
  - NWP growth was 0% in 2007; Appears similarly flat in 2008
  - Prices are falling or flat in most non-coastal markets

- **Accumulation of Capital:** Excess capital depresses ROEs
  - Policyholder Surplus up 6-7% in 2007 and up 80% since 2002
  - Insurers hard pressed to maintain earnings momentum
  - Options: Share Buybacks, Boost Dividends, Invest in Operation, Acquire
  - Option B: Engage in destructive price war and destroy capital

- **Reserve Adequacy:** No longer a drag on earnings
  - Favorable development in recent years offsets pre-2002 adverse develop.

- **Favorable Fundamentals/Drop-Off in CAT Activity**
  - Underlying claims inflation (frequency and severity trends) are benign
  - Lower CAT activity took some pressure of capital base

Source: Insurance Information Institute.

No extraordinary trends evident

Source: Conning Research & Consulting.
Distribution Sector M&A Activity, 2005 vs. 2006

Source: Conning Research & Consulting

Number of bank acquisitions is falling years
INVESTMENT OVERVIEW

More Pain, Little Gain
Property/Casualty Insurance Industry Investment Gain

Investment gains are off in 2008 due to lower yields and poor equity market conditions.

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.
Total Returns for Large Company Stocks: 1970-2008*

S&P 500 was up 3.53% in 2007, but down 14.5% so far in 2008*

Markets were up in 2007 for the 5th consecutive year; 2008 off to a rough start


P/C Investment Income as a % of Invested Assets Follows 10-Year US T-Note

Investment yield historically tracks 10-year Treasury note quite closely

*As of July 2008.
Sources: Board of Governors, Federal Reserve System; A.M.Best; Insurance Information Institute.
CATASTROPHIC LOSS

This is (One Reason) Why You Buy Reinsurance
Most of US Population & Property Has Major CAT Exposure

Is Anyplace Safe?
U.S. Insured Catastrophe Losses*

$ Billions

2008 CAT losses already exceed 2006/07 combined. 2005 was by far the worst year ever for insured catastrophe losses in the US, but the worst has yet to come.

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

**Based on preliminary PCS data through June 30. PCS $1.8B loss of for Gustav. $9.8B for Ike of 9/22.

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

With Ike, 9 of the 11 most expensive hurricanes in US history occurred since 2004 (Gustav insured losses totaled $1.8B)

Category of storm at landfall

Ike could become the 4th most expensive hurricane in US history*

*Based on average of midpoints of range estimates from risk modelers AIR, RMS and Eqecat as of 9/15/08. Sources: ISO/PCS; AIR Worldwide, RMS, Eqecat; Insurance Information Institute inflation adjustments.
Hurricane Ike Initial Insured Loss Estimates

(Billions of $, as of September 19, 2008)

Ike came ashore in Galveston, Texas, as a Cat 2 hurricane on September 13.

- AIR: $8 - $12B
- RMS: $7 - $12B
- Eqecat: $8 - $12B

Average of the midpoints of the 3 ranges is $9.8 billion.

Sources: RMS, AIR Worldwide, Eqecat; Compiled by the Insurance Information Institute as of 9/19/08.
Natural Disasters in the United States, 1980-2008 (Jan – June Totals)

Number of events has more than doubled since 1980

109 events through June 30 is a record

Number of events has more than doubled since 1980

Source: MR NatCatSERVICE

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109 events through June 30 is a record

© 2008 Munich Re Group

Geophysical (earthquake, tsunami, volcanic activity)

Meteorological (storm)

Hydrological (flood, mass movement)

Climatological (temperature extremes, drought, wildfire)

Source: MR NatCatSERVICE

<table>
<thead>
<tr>
<th>Year</th>
<th>Losses ($B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td>$2.4</td>
</tr>
<tr>
<td>71</td>
<td>$7.0</td>
</tr>
<tr>
<td>72</td>
<td>$8.9</td>
</tr>
<tr>
<td>73</td>
<td>$8.6</td>
</tr>
<tr>
<td>74</td>
<td>$6.8</td>
</tr>
<tr>
<td>75</td>
<td>$5.6</td>
</tr>
<tr>
<td>76</td>
<td>$11.1</td>
</tr>
<tr>
<td>77</td>
<td>$12.4</td>
</tr>
<tr>
<td>78</td>
<td>$23.7</td>
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<tr>
<td>79</td>
<td>$42.5</td>
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<tr>
<td>80</td>
<td>$184.4</td>
</tr>
<tr>
<td>81</td>
<td>$279.4</td>
</tr>
<tr>
<td>82</td>
<td>$34.4</td>
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<tr>
<td>83</td>
<td>$25.6</td>
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<tr>
<td>84</td>
<td>$18.0</td>
</tr>
<tr>
<td>85</td>
<td>$12.2</td>
</tr>
<tr>
<td>86</td>
<td>$24.9</td>
</tr>
<tr>
<td>87</td>
<td>$43.1</td>
</tr>
<tr>
<td>88</td>
<td>$41.8</td>
</tr>
<tr>
<td>89</td>
<td>$21.6</td>
</tr>
<tr>
<td>90</td>
<td>$52.8</td>
</tr>
<tr>
<td>91</td>
<td>$113.9</td>
</tr>
</tbody>
</table>

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

Source: Swiss Re Sigma No.1/08, *Natural catastrophes and man-made disasters in 2007*
Insured Offshore Energy Losses for Recent Major Gulf Storms

Hurricanes Katrina, Rita and Ivan cost energy insurers at least $7 billion. Gustav estimates range from $1B - $3B.

- Katrina (2005): $2.0 billion
- Gustav (2008)*: $2.0 billion
- Ivan (2004)**: $2.25 billion
- Rita (2005): $3.0 billion

*Midpoint of RMS estimated range of $1.0 to $3.0 billion as of 9/1/08;  **Midpoint of range of $2.0 to $2.5 billion)
Sources: Insurance Information Institute research estimates.
<table>
<thead>
<tr>
<th>State</th>
<th>Total Value of Insured Coastal Exposure (2004, $ Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Florida</td>
<td>$1,937.3</td>
</tr>
<tr>
<td>New York</td>
<td>$1,901.6</td>
</tr>
<tr>
<td>Texas</td>
<td>$740.0</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$662.4</td>
</tr>
<tr>
<td>New Jersey</td>
<td>$505.8</td>
</tr>
<tr>
<td>Connecticut</td>
<td>$404.9</td>
</tr>
<tr>
<td>Louisiana</td>
<td>$209.3</td>
</tr>
<tr>
<td>S. Carolina</td>
<td>$148.8</td>
</tr>
<tr>
<td>Virginia</td>
<td>$129.7</td>
</tr>
<tr>
<td>Maine</td>
<td>$117.2</td>
</tr>
<tr>
<td>North Carolina</td>
<td>$105.3</td>
</tr>
<tr>
<td>Alabama</td>
<td>$75.9</td>
</tr>
<tr>
<td>Georgia</td>
<td>$73.0</td>
</tr>
<tr>
<td>Delaware</td>
<td>$46.4</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>$45.6</td>
</tr>
<tr>
<td>Mississippi</td>
<td>$44.7</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>$43.8</td>
</tr>
<tr>
<td>Maryland</td>
<td>$12.1</td>
</tr>
</tbody>
</table>

In 2004 Florida had more insured coastal exposure—at nearly $2 trillion dollars. Future “Mega-Losses” are UNAVOIDABLE.

Source: AIR Worldwide
Total Value of Insured Coastal Exposure (2007, $ Billions)

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

Source: AIR Worldwide

The insured value of all coastal property was $8.9 trillion in 2007, up 24% from $7.2 trillion in 2004.
The 2008 Hurricane Season:

*Preview to Disaster?*
Outlook for 2008 Hurricane Season: 90% Worse Than Average

<table>
<thead>
<tr>
<th>Category</th>
<th>Average*</th>
<th>2005</th>
<th>2008F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Named Storms</td>
<td>9.6</td>
<td>28</td>
<td>17</td>
</tr>
<tr>
<td>Named Storm Days</td>
<td>49.1</td>
<td>115.5</td>
<td>90</td>
</tr>
<tr>
<td>Hurricanes</td>
<td>5.9</td>
<td>14</td>
<td>9</td>
</tr>
<tr>
<td>Hurricane Days</td>
<td>24.5</td>
<td>47.5</td>
<td>45</td>
</tr>
<tr>
<td>Intense Hurricanes</td>
<td>2.3</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Intense Hurricane Days</td>
<td>5</td>
<td>7</td>
<td>11</td>
</tr>
<tr>
<td>Accumulated Cyclone Energy</td>
<td>96.2</td>
<td>NA</td>
<td>175</td>
</tr>
<tr>
<td>Net Tropical Cyclone Activity</td>
<td>100%</td>
<td>275%</td>
<td>190%</td>
</tr>
</tbody>
</table>

*Average over the period 1950-2000.
Source: Dr. Philip Klotzbach and Dr. William Gray, Colorado State University, August 5, 2008.
## Landfall Probabilities for 2008 Hurricane Season: Above Average

<table>
<thead>
<tr>
<th>Region</th>
<th>Average*</th>
<th>2008F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entire US East &amp; Gulf Coasts</td>
<td>52%</td>
<td>67%</td>
</tr>
<tr>
<td>US East Coast Including Florida Peninsula</td>
<td>31%</td>
<td>43%</td>
</tr>
<tr>
<td>Gulf Coast from Florida Panhandle to Brownsville</td>
<td>30%</td>
<td>42%</td>
</tr>
<tr>
<td>Caribbean</td>
<td>NA</td>
<td>Above Average</td>
</tr>
</tbody>
</table>

*Average over the past century.

Source: Dr. Philip Klotzbach and Dr. William Gray, Colorado State University, August 5, 2008.
Reinsurance Prices are Falling in Non-Coastal Zones, Casualty Lines
Share of Losses Paid by Reinsurers, by Disaster*

- Hurricane Hugo (1989) - 30%
- Hurricane Andrew (1992) - 25%
- Sept. 11 Terror Attack (2001) - 60%
- 2004 Hurricane Losses - 20%
- 2005 Hurricane Losses - 45%

*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.

Reinsurance is playing an increasingly important role in the financing of mega-CATs; Reins. Costs are skyrocketing.
US Reinsurer Net Income & ROE, 1985-2007*

Reinsurer profitability rebounded post-Katrina but is now falling

Source: Reinsurance Association of America. *2007 ROE figure is III estimate based return on average 2007 surplus.
Regional Distribution of Reinsurers by NWP, 2006

Eight countries account for 89 percent of global reinsurance volume.

International reinsurers from Germany, Switzerland and France account for 40 percent of global reinsurance volume. Bermuda is a growing market, with a 10 percent share. Lloyd’s and London-based reinsurers account for 6 percent of the world market.

Source: Standard & Poor’s, Global Reinsurance Highlights, 2007 Edition
Reinsurer Market Share Comparison: 1990 vs. 2006

**1990**
- Offshore Reinsurer: 35.3%
- U.S. Reinsurer: 64.7%

**2006**
- Offshore Reinsurer: 53.1%
- U.S. Reinsurer: 46.9%

**U.S. Reinsurer market share fell precipitously between 1990 and 2006**

Sources: Reinsurance Association of America; Insurance Information Institute.
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 serve 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
• Plead 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

Source: San Diego Union Tribune, 9/19/07
Source: Wall Street Journal, 3/15/07
Bad Year for Tort Kingpins*
(Continued)

“King of Class Actions” Melvyn Weiss
• Former partner in class action firm Milberg Weiss; Earned $251 million in legal fees
• Pled guilty to federal charges of racketeering and conspiracy for paying kickbacks to professional plaintiffs
• Sentenced to 30 months in prison, pay $9.75 million in restitution; $250,000 fine

Total = $216.7 Billion

Total = $159.6 Billion

Total = $121.0 Billion

Total = $39.3 Billion

Commercial Lines
Personal Lines
Self (Un)Insured


Commercial Lines
Personal Lines
Self (Un)Insured

$5.2
$17.1
$17.0
$5.2
$17.1
$17.0

$49.6
$51.0
$20.4

$58.7
$70.9
$30.0

$85.6
$85.6
$45.5

*Excludes medical malpractice
Growth in Cost of U.S. Tort System, 1951-2009F

Tort costs moderated beginning in 2003 as many improvements in the tort system began to bear fruit.

Asbestos-related and other costs drove tort growth sharply upward in 2001 and 2002.

Source: Tillinghast-Towers Perrin.
Cost of US Tort System
($ Billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>90</td>
<td>$129</td>
</tr>
<tr>
<td>91</td>
<td>$130</td>
</tr>
<tr>
<td>92</td>
<td>$141</td>
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<td>$247</td>
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<tr>
<td>07</td>
<td>$253</td>
</tr>
<tr>
<td>08</td>
<td>$265</td>
</tr>
<tr>
<td>09E</td>
<td>$277</td>
</tr>
</tbody>
</table>

Tort costs consumed 1.87% of GDP in 2006, down from 2.24% in 2003.

Per capita “tort tax” was $825 in 2006, up from $680 in 2000.

Reducing tort costs relative to GDP by just 0.25% (to 1.84%) would produce an economic stimulus of $31.1B.

Tort System Costs, 1950-2009E

After a period of rapid escalation, tort system costs as a % of GDP are now falling.

Source: Tillinghast-Towers Perrin, 2007 Update on U.S. Tort Costs as % of GDP
After a period of rapid escalation, tort system costs as % of GDP are now falling.

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

*United States, 2001 to 2007*

Liability insurance costs relative to the client’s revenues are down by 25% - 35% since 2004

*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

NEVADA
Clark County (Las Vegas)

I LLINOIS
Cook County

TEXAS
Rio Grande Valley and Gulf Coast

West Virginia

NEW JERSEY
Atlantic County (Atlantic City)

South Florida

Source: American Tort Reform Association; Insurance Information Institute
## Business Leaders Ranking of Liability Systems for 2007

<table>
<thead>
<tr>
<th>Best States</th>
<th>New in 2007</th>
<th>Worst States</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Delaware</td>
<td>ME, NH, TN, UT, WI</td>
<td>41. Arkansas</td>
</tr>
<tr>
<td>2. Minnesota</td>
<td></td>
<td>42. Hawaii</td>
</tr>
<tr>
<td>3. Nebraska</td>
<td><strong>Drop-Offs</strong></td>
<td>43. Alaska</td>
</tr>
<tr>
<td>4. Iowa</td>
<td>ND, VA, SD, WY, ID</td>
<td>44. Texas</td>
</tr>
<tr>
<td>5. Maine</td>
<td></td>
<td>45. California</td>
</tr>
<tr>
<td>7. Tennessee</td>
<td></td>
<td>47. Alabama</td>
</tr>
<tr>
<td>8. Indiana</td>
<td></td>
<td>48. Louisiana</td>
</tr>
<tr>
<td>9. Utah</td>
<td></td>
<td>49. Mississippi</td>
</tr>
<tr>
<td>10. Wisconsin</td>
<td></td>
<td>50. West Virginia</td>
</tr>
</tbody>
</table>

Sum of Top 10 Jury Awards, 2004-2007

Total of Top 10 awards in 2007 was 25% lower than in 2006

TX, NY and CA lead the U.S. in jumbo-size jury awards.
Total Top 10 Verdicts, 1995 through 2006

Top Ten verdicts since 1995
Texas, New York and California continue to lead nation

Over the past 12 years, the Top Ten awards have been clustered in a half dozen states, with Texas, New York and California clearly in the lead. But Florida is gaining fast, placing four verdicts in the Top Ten in 2005, and two in 2006.

Source: Lawyers USA, 2007
## 2007 Top Ten Verdicts

<table>
<thead>
<tr>
<th>Value</th>
<th>Issue</th>
<th>State</th>
</tr>
</thead>
<tbody>
<tr>
<td>$109 Million</td>
<td>Medical Malpractice</td>
<td>New York</td>
</tr>
<tr>
<td>$102.7 Million</td>
<td>Premises Liability, Death</td>
<td>Florida</td>
</tr>
<tr>
<td>$55.2 Million</td>
<td>Product Liability, Death</td>
<td>California</td>
</tr>
<tr>
<td>$54 Million</td>
<td>Private Air Crash</td>
<td>Florida</td>
</tr>
<tr>
<td>$54 Million</td>
<td>Nursing Home, Death</td>
<td>New Mexico</td>
</tr>
<tr>
<td>$50 Million</td>
<td>DUI Crash</td>
<td>Florida</td>
</tr>
<tr>
<td>$50 Million</td>
<td>Product Liability, Death</td>
<td>Alabama</td>
</tr>
<tr>
<td>$47.6 Million</td>
<td>Prempro</td>
<td>Nevada</td>
</tr>
<tr>
<td>$47.5 Million</td>
<td>Vioxx</td>
<td>New Jersey</td>
</tr>
<tr>
<td>$45 Million</td>
<td>Auto Crash, Death</td>
<td>Florida</td>
</tr>
</tbody>
</table>

Source: LawyersWeekly USA, January 22, 2008.
REGULATORY & LEGISLATIVE ENVIRONMENT

Isolated Improvements, Mounting Zealoutry
Most states (25) get a “B”, but 7 got A’s, 10 got C’s (including DC), 5 earned D’s and 4 got F’s

*Criteria considered were auto/home residual mkts., auto/home mkt. concentration, loss ratio stability, reg. env., form regulation, credit scores, territorial restrictions

Source: James Madison Institute, Feb. 2008
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