The Financial Crisis & the P/C Insurance Industry

Challenges Amid the Economic Storm

Excess Surplus Lines Claims Association
Scottsdale, AZ

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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

Federal Government Financial Services Rescue Package

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.

Federal Government Financial Services Rescue Package (cont'd)

3. **Money Market Fund Stabilization: Commercial Paper Market Froze After Mass Redemptions and Lending Fears ("Breaking the Buck")**
   - **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**

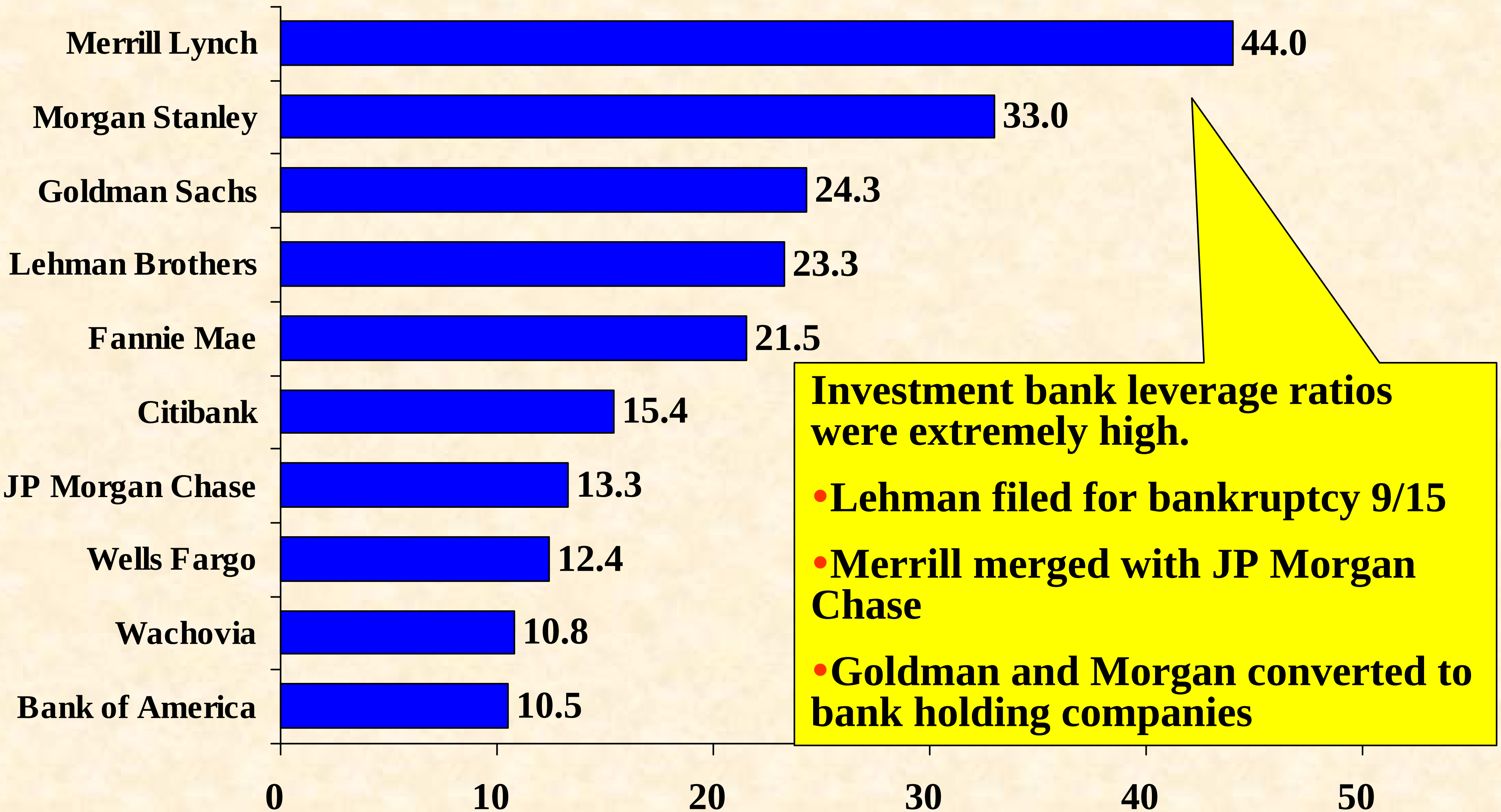
Source: Insurance Info. Inst. research.

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*



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

Source: "*The Perils of Leverage,*" North Coast Investment Research, Sept. 15, 2008

How Does Leverage Work?

- **Example of Non-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)**

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

- **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"**

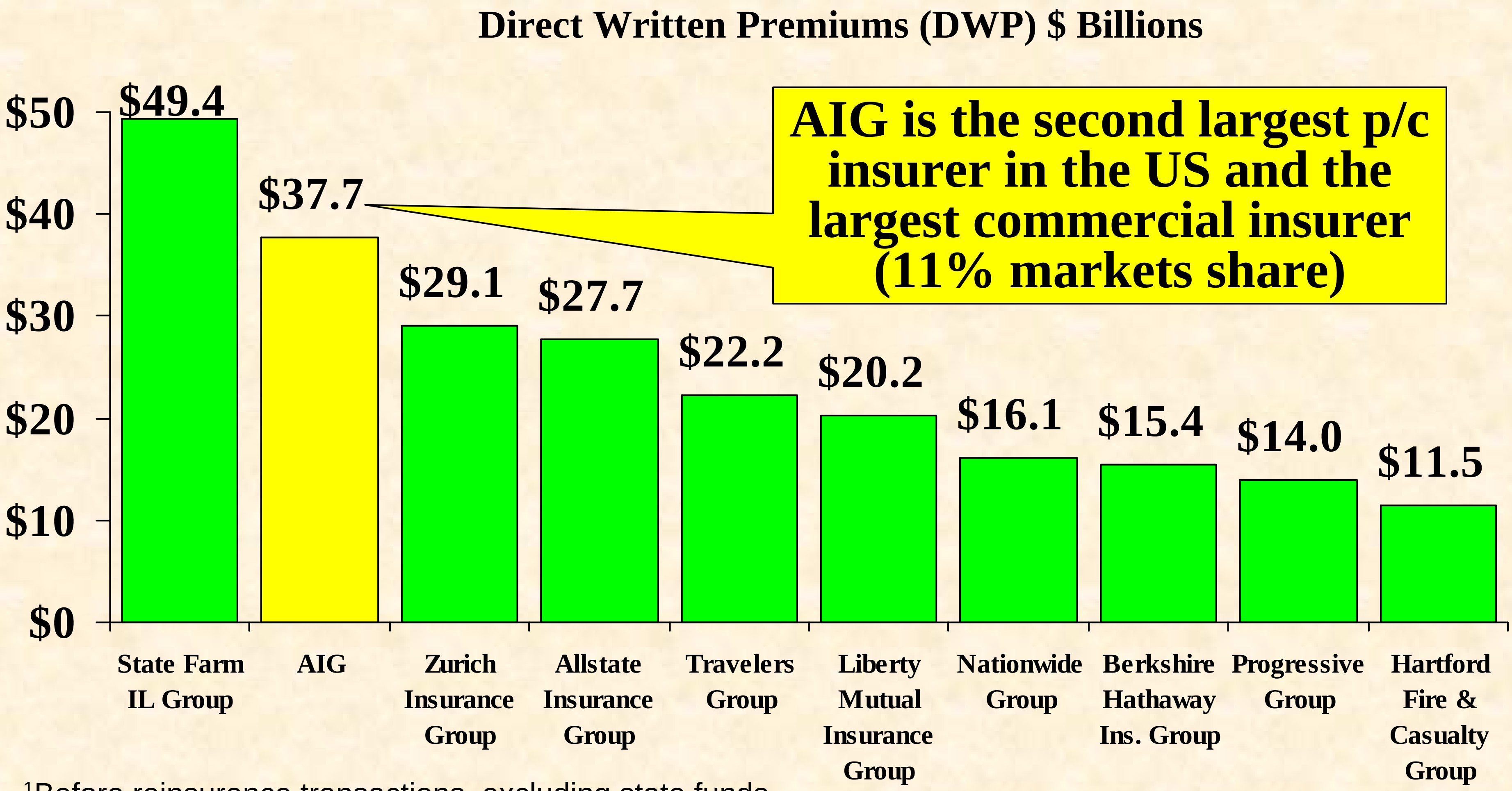
Source: AIG press releases and regulator statements.

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.

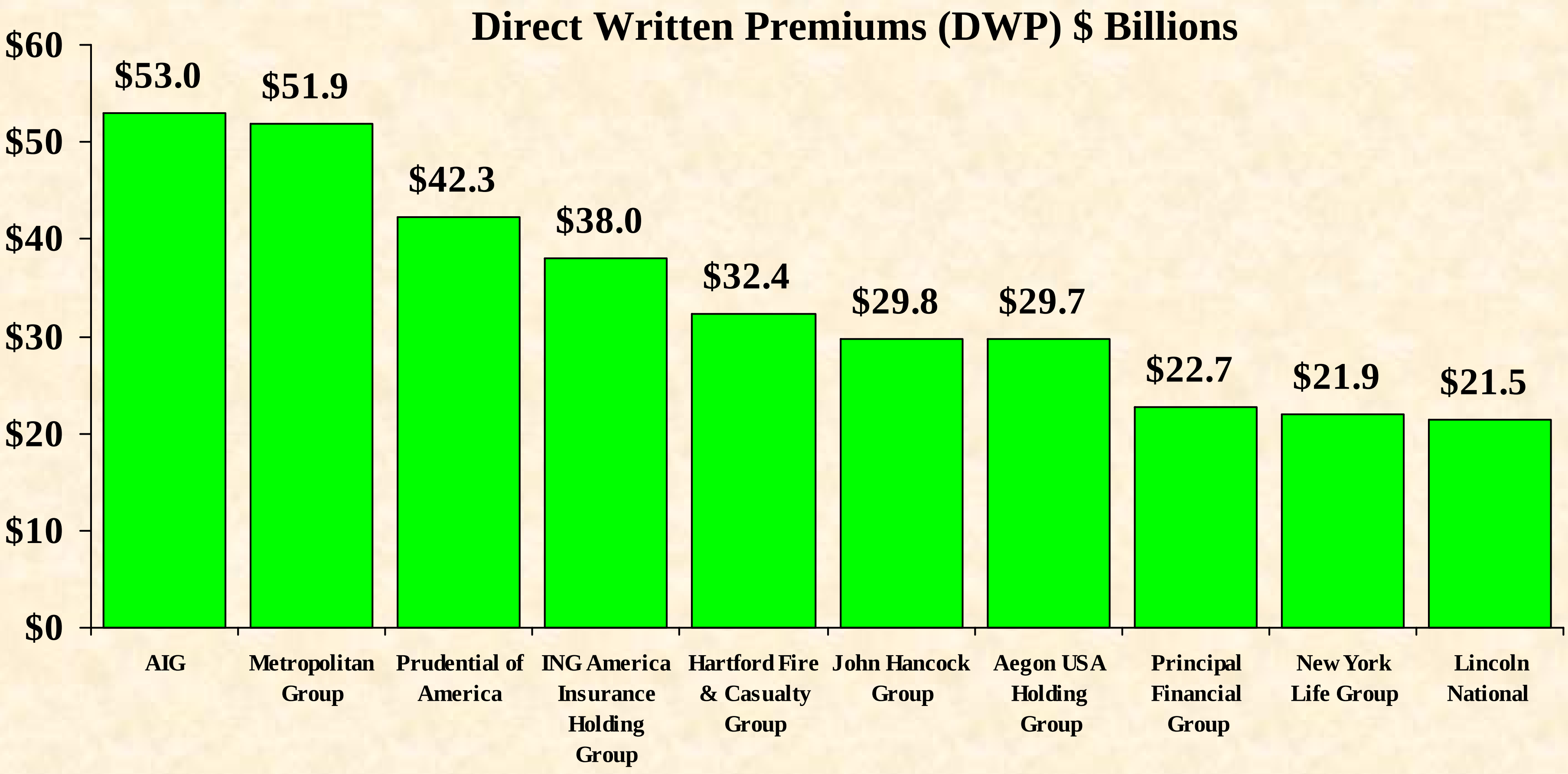
Leading U.S. Writers of P/C Insurance By DWP, 2007 ($ Billions)[1]



[1]Before 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]



[1]Premium and annuity totals, before reinsurance transactions, excluding state funds.

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

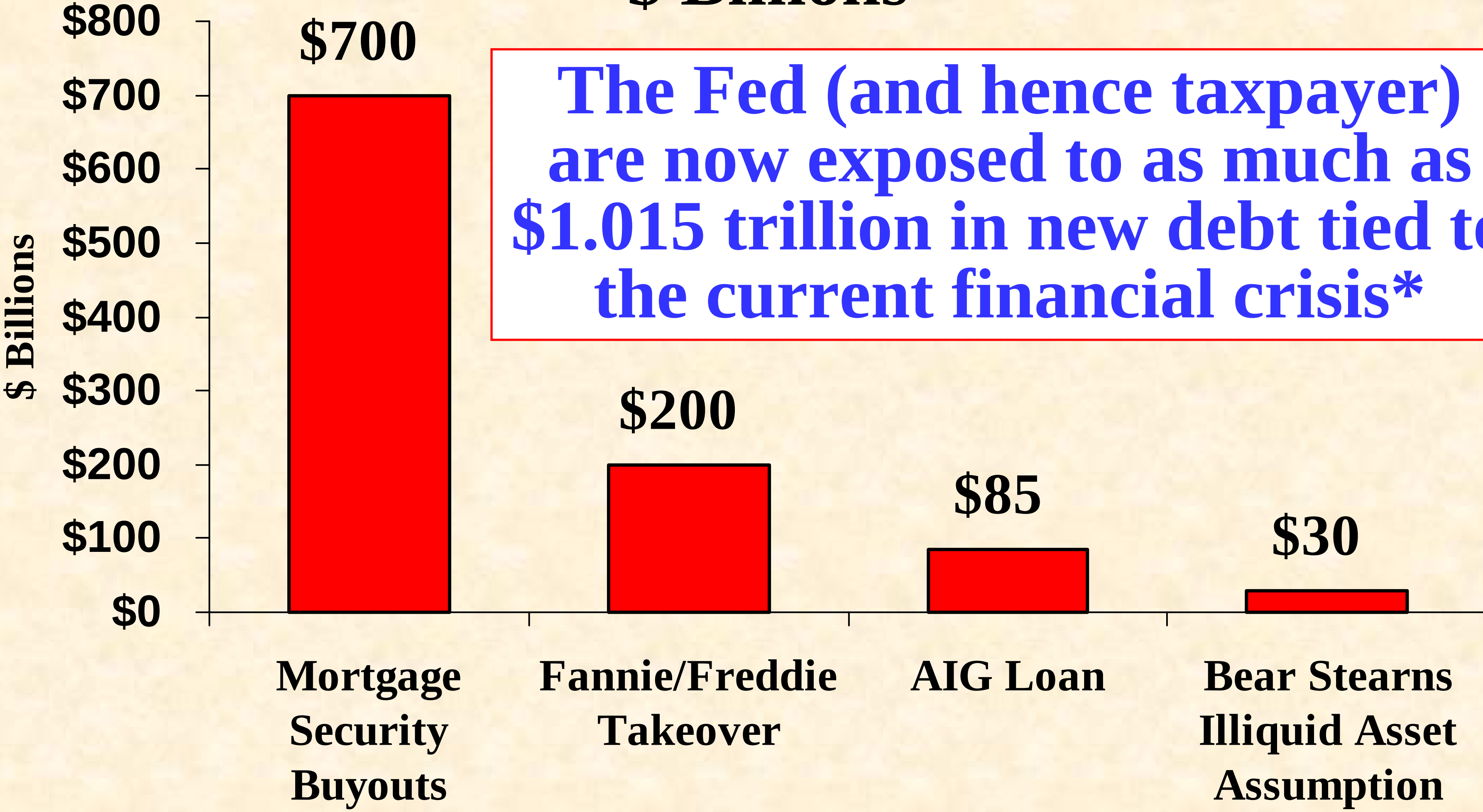
AFTERSHOCK: Regulatory Response Could Be Harsh

All Financial Segments Including Insurers Will Be Impacted

Incurred Liabilities of the Federal Government Due to Financial Crisis

$ Billions

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



*As of September 22, 2008. Amounts reflect maximum losses under terms at time of announcement.
Source: Wall Street Journal, 9/22/08, p. A8; Insurance Information Institute research.

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**

Source: Wall Street Journal, 9/22/08, p. A8; Insurance Information Institute research.

From Hubris to the Humbling of American Capitalism?

"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**

Source: Ins. Info. Inst.

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**

Source: Department of Treasury Blueprint for a Modernized Financial Regulatory System, March 2008.

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

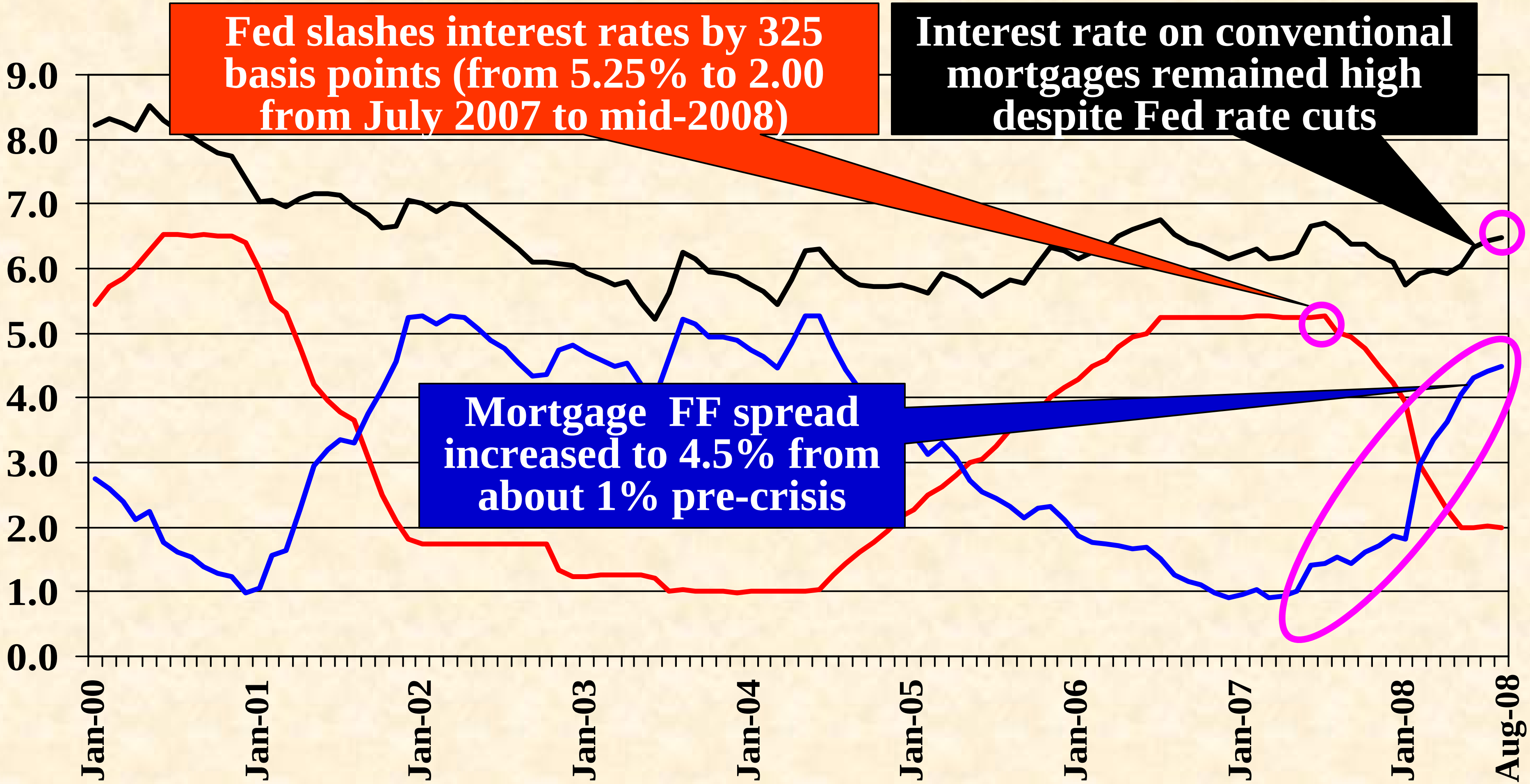
1. **Government seizes Fannie Mae/ Freddie Mac and places them in "conservatorship" under their regulator the Federal Housing Finance Agency (FHFA)**
   - **Current CEOs ousted. Fannie will be run by Herb Allison (CEO TIAA-CREF) and Freddie by David Moffet (CEO US Bancorp)**
2. **Treasury purchases senior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



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

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

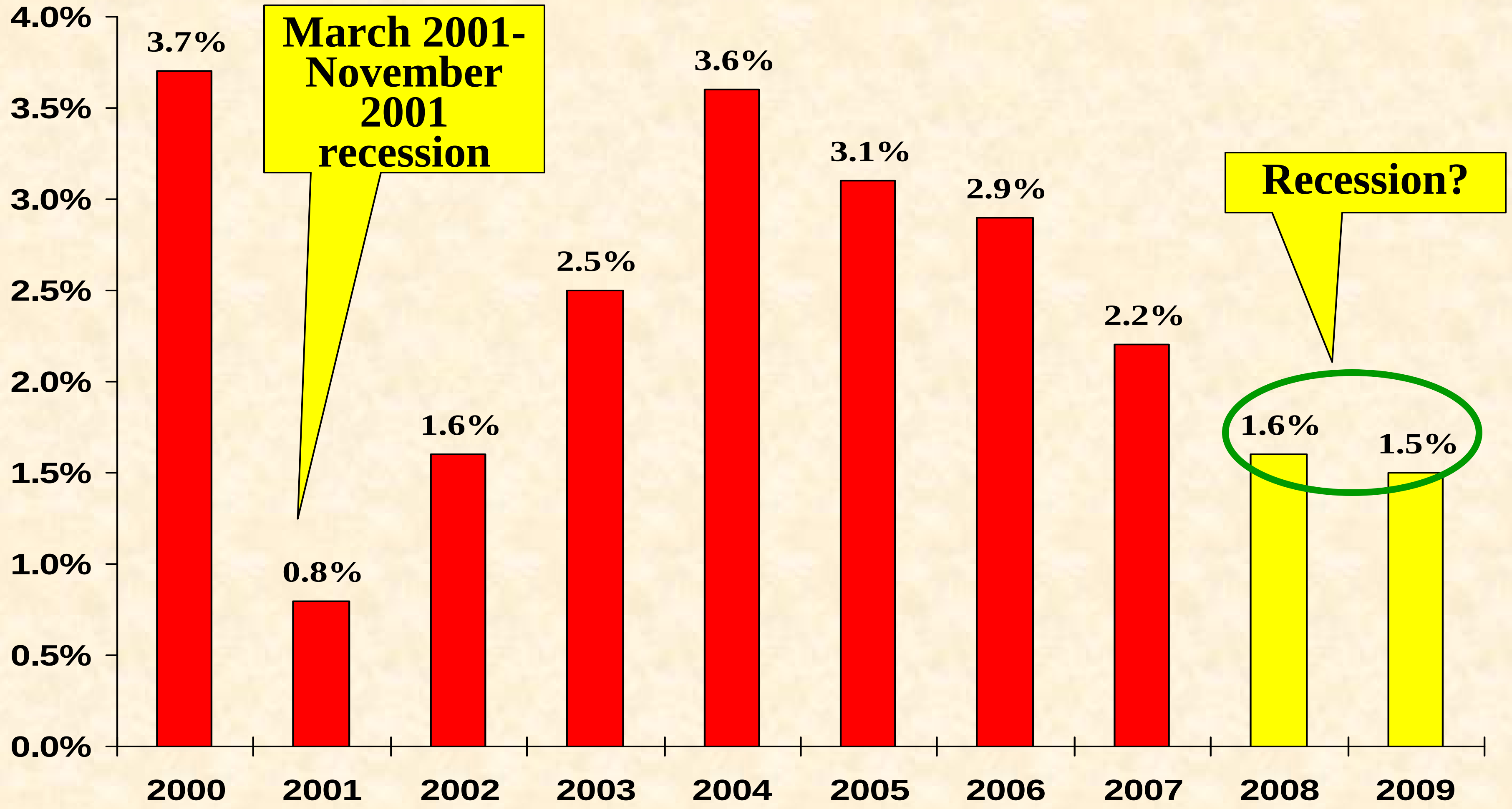
- **Crash in housing market is already costing home insurers alone about $1 billion annually in lost premium growth based on 50%+ decline in new home construction (about 1 million fewer homes per year)**
  - **Plan should lower interest rates, accelerate clearing away existing inventory and stimulate 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

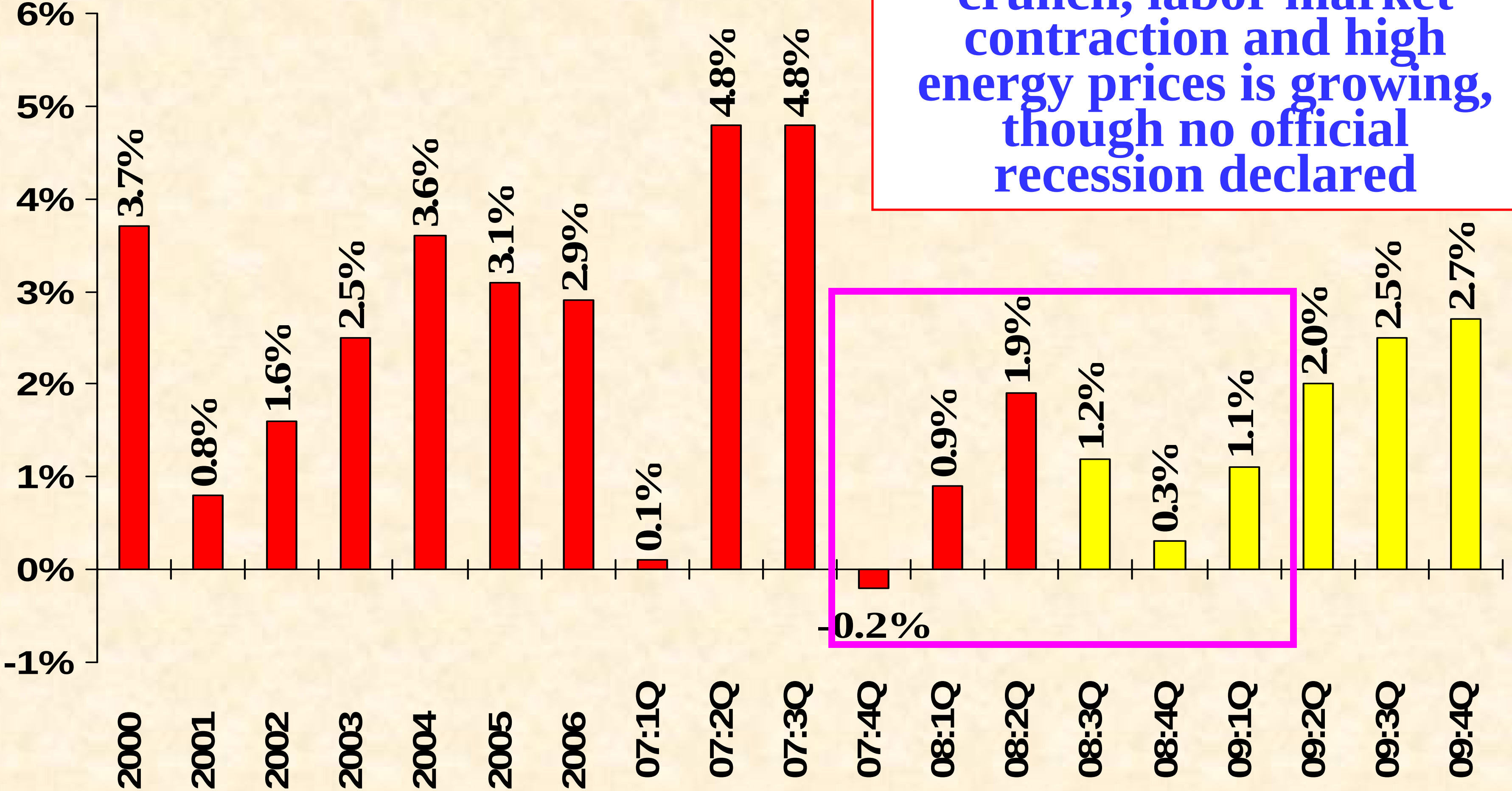
*Real **Annual** GDP Growth, 2000-2009F*



* Red bars are actual; Yellow bars are forecasts

Sources: US Department of Commerce (actual), Blue Economic Indicators 8/08 (forecasts).

*Real GDP Growth**

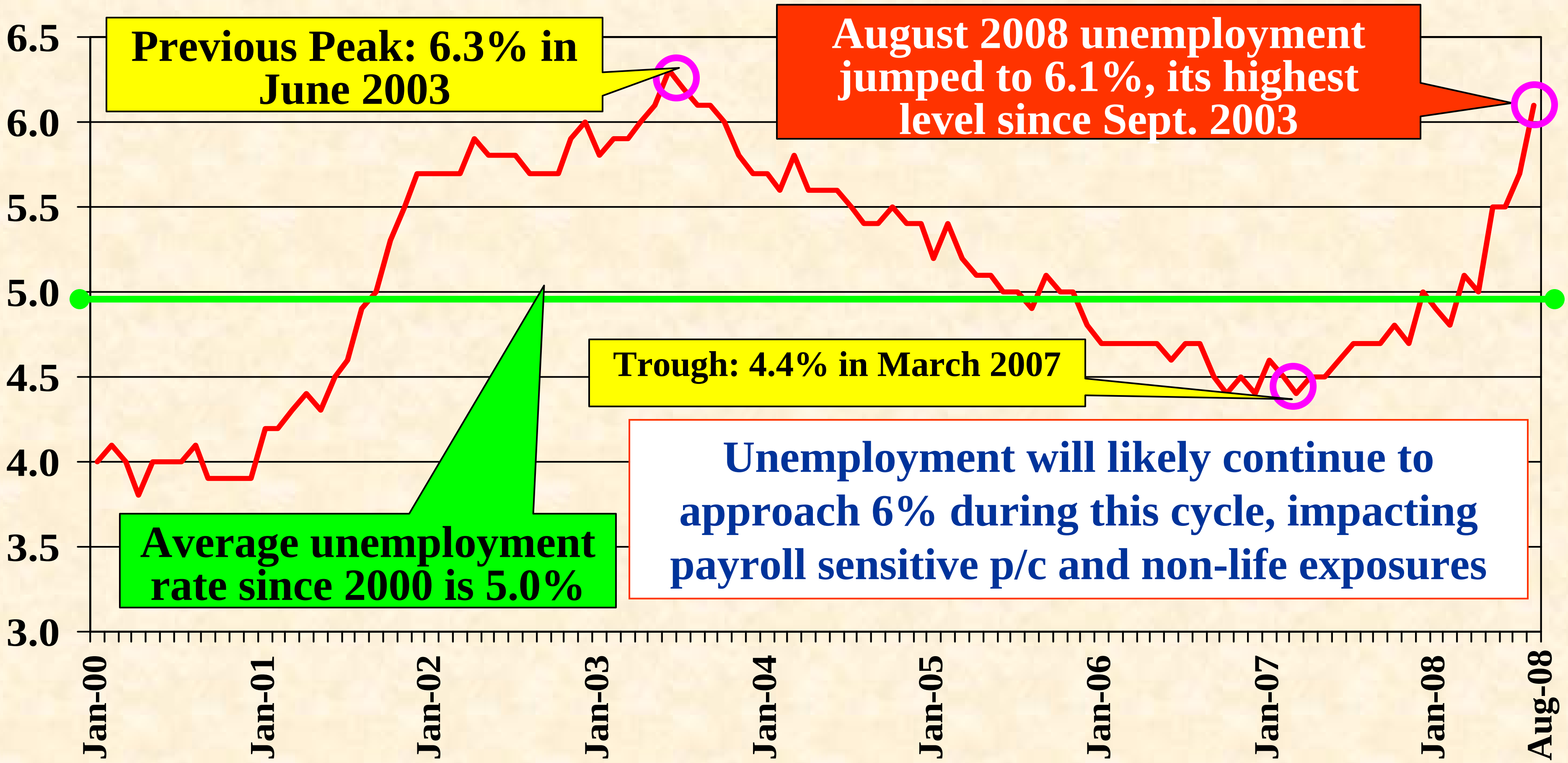


*Yellow bars are Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 8/08; Insurance Information Institute.

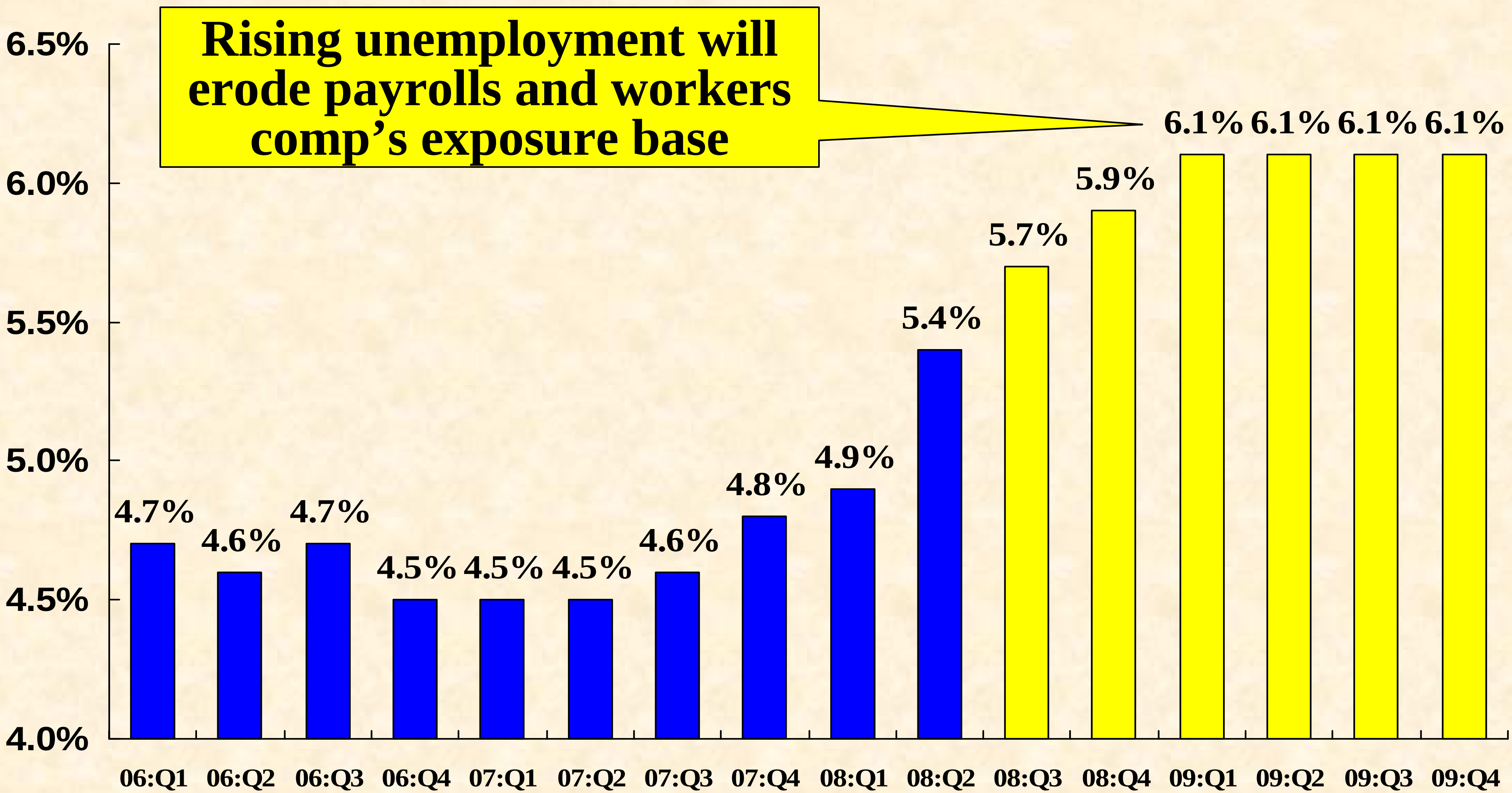
Unemployment Rate: On the Rise

January 2000 through August 2008



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

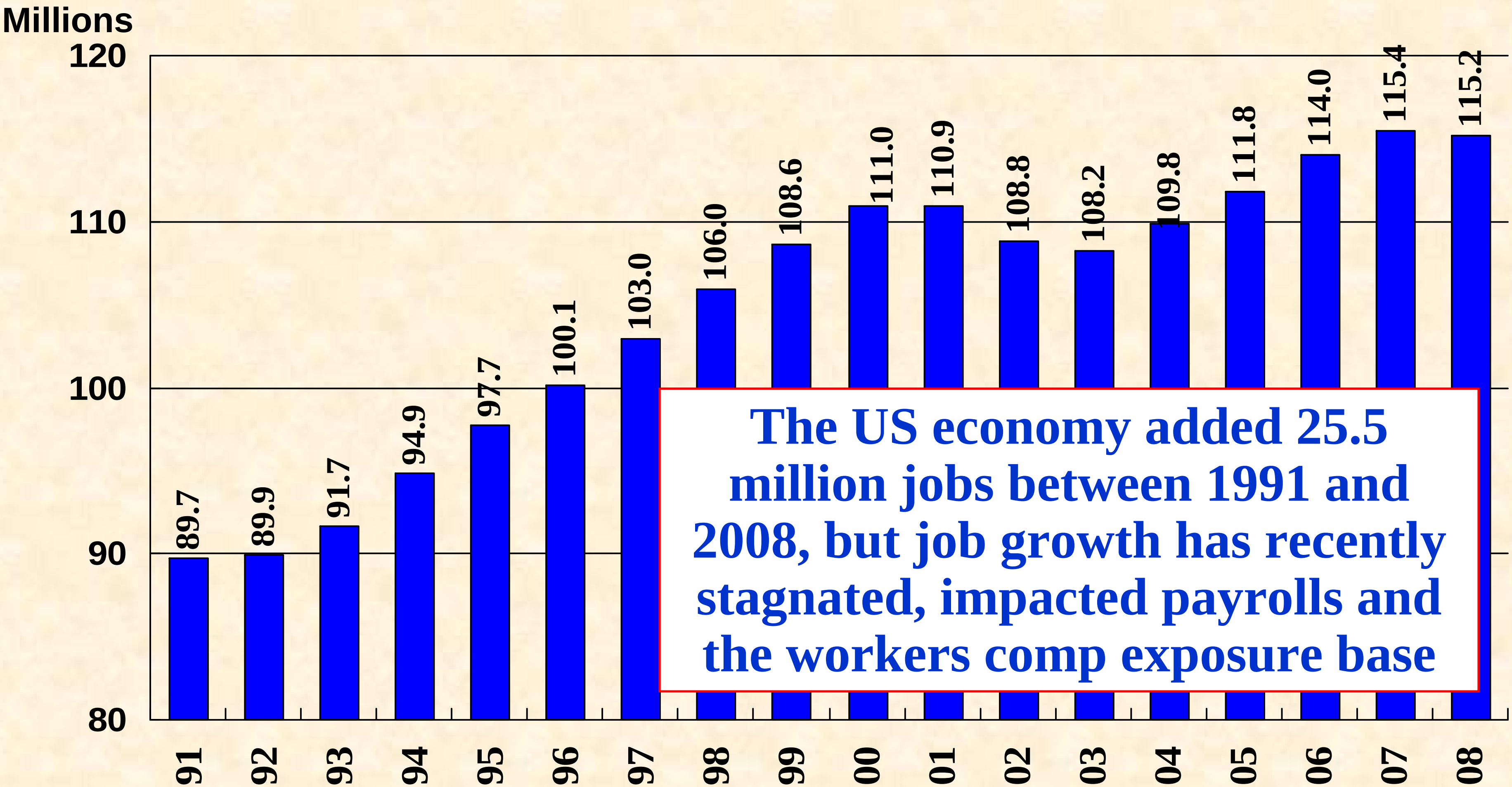
U.S. Unemployment Rate, (2007:Q1 to 2009:Q4F)*



* Blue bars are actual; Yellow bars are forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (8/08); Insurance Info. Inst.

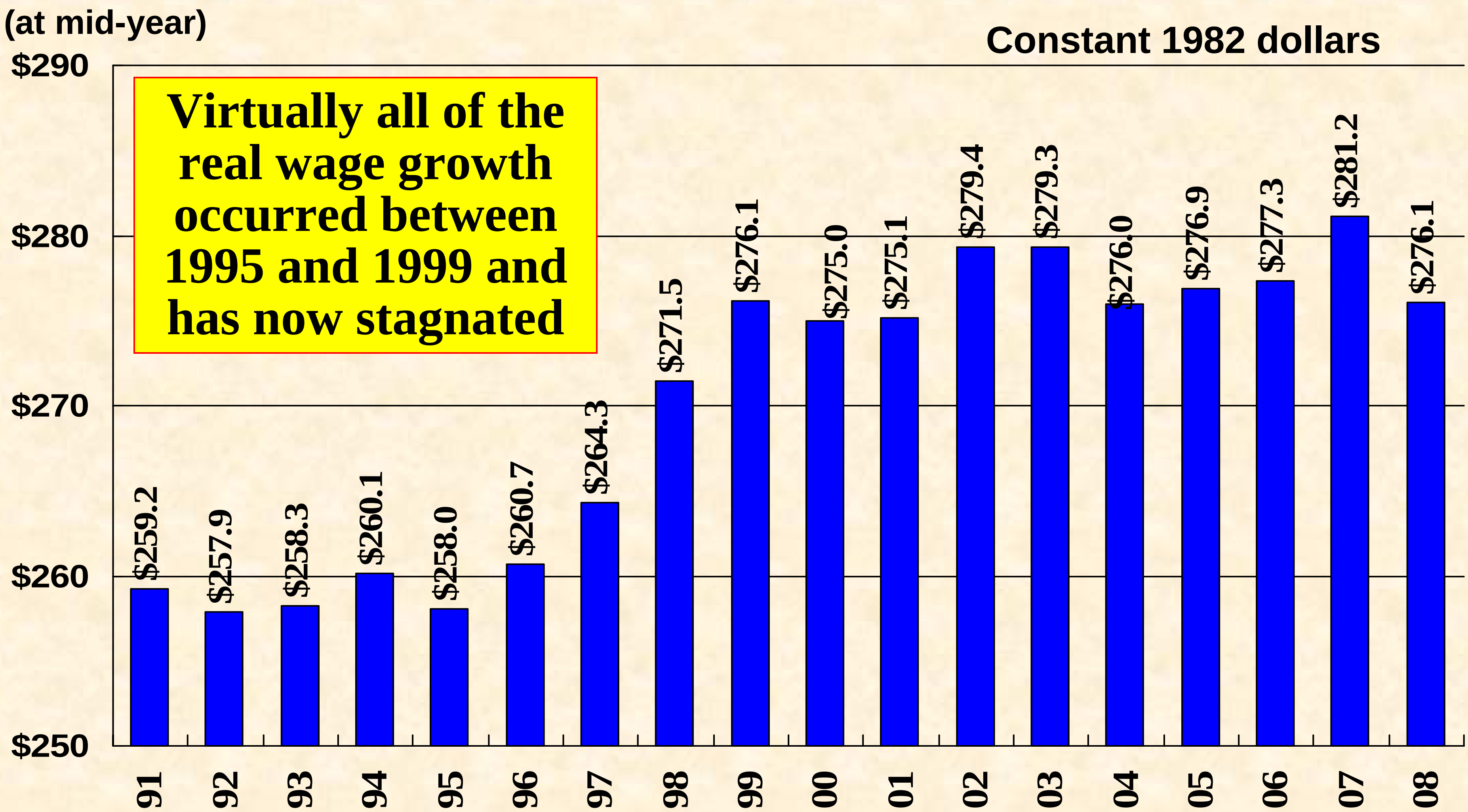
Total Private Employment* Grew by 25½ Million Workers from 1991 to 2008



*seasonally adjusted at mid-year

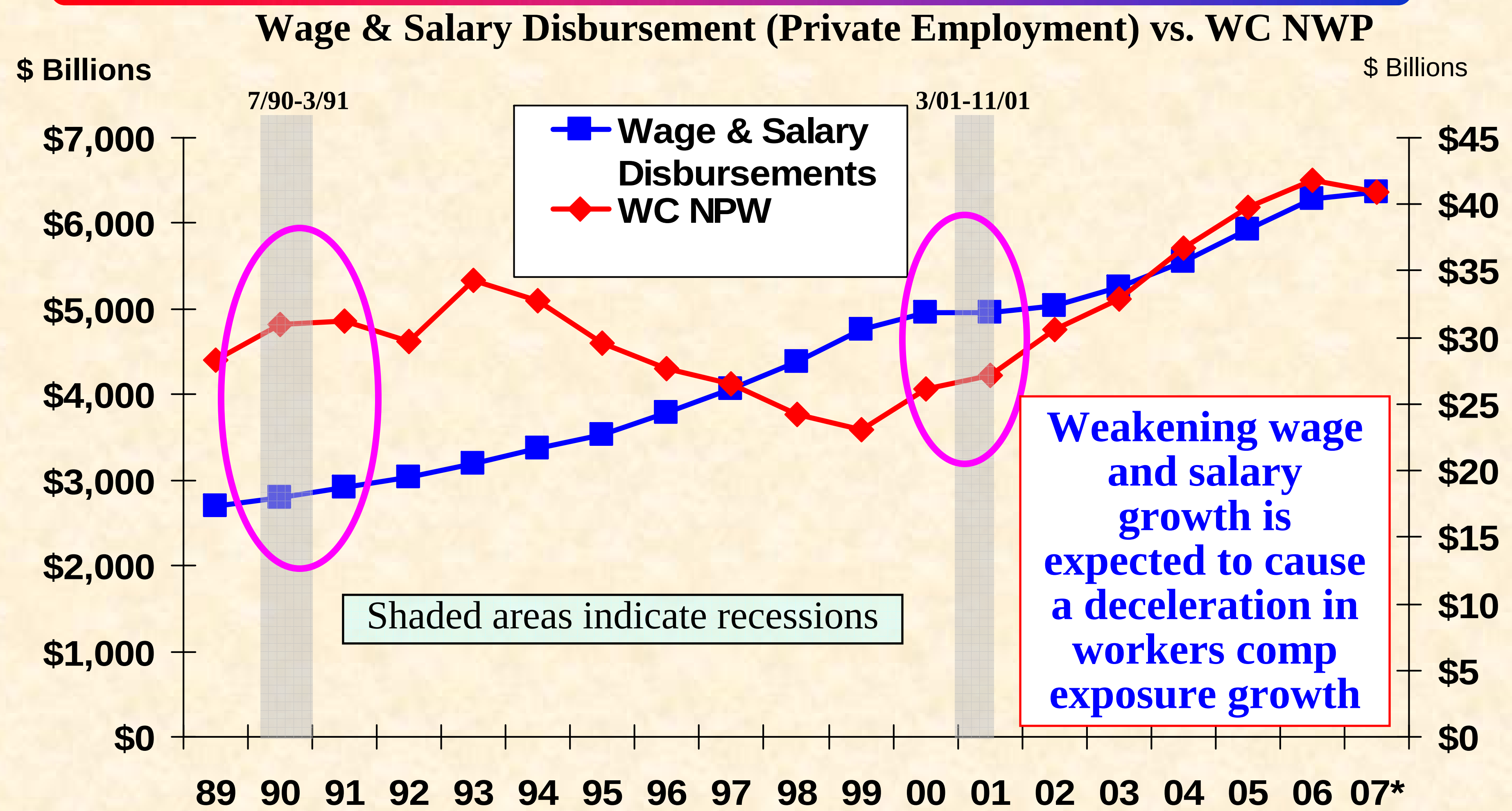
Source: U.S. Bureau of Labor Statistics, at http://data.bls.gov/cgi-bin/surveymost

Average Weekly Real Earnings in Private Employment Were Flat from 1999 to 2008



Sources: U.S. Bureau of Labor Statistics; I.I.I.

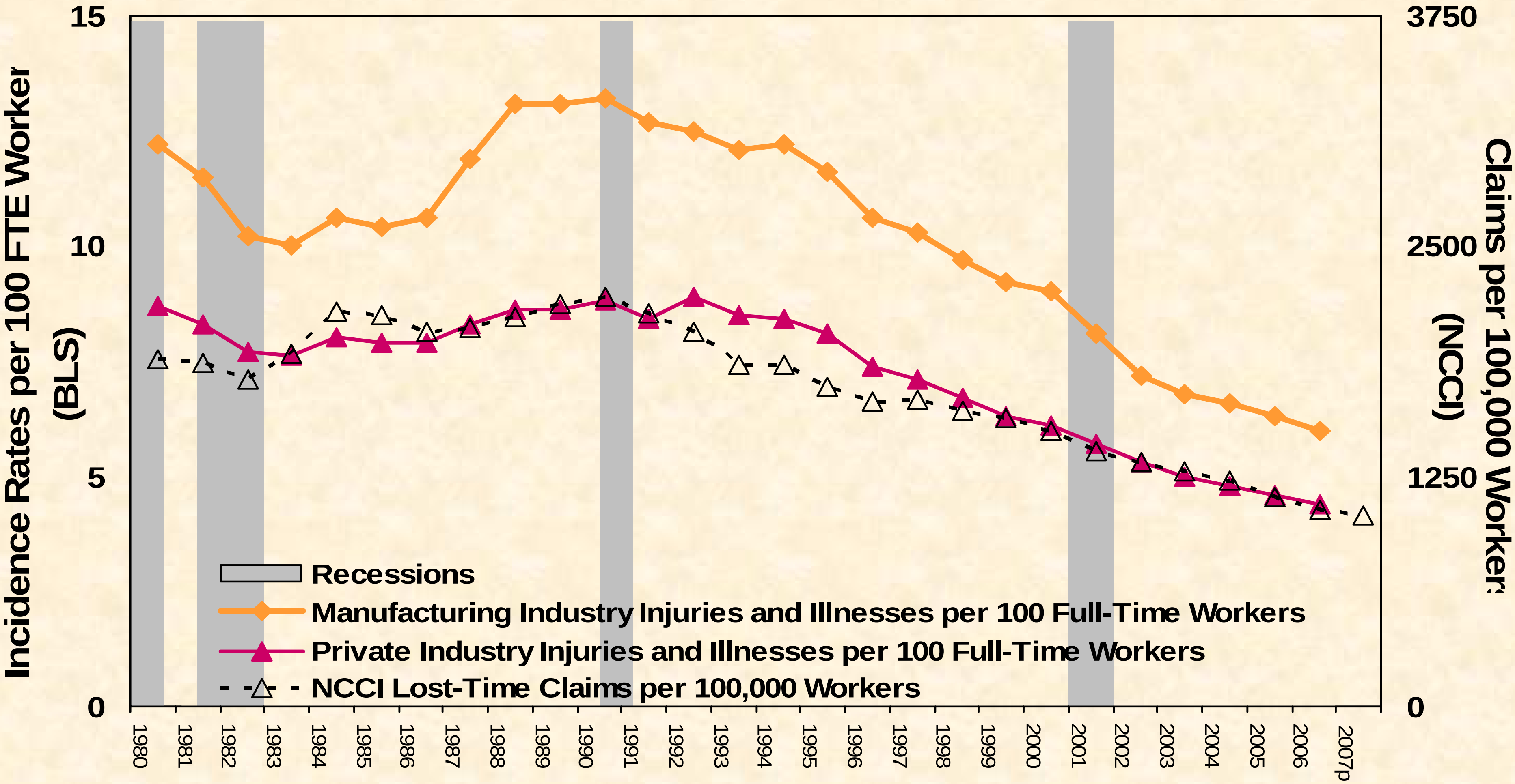
Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums



*Average of quarterly figures.

Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR; I.I.I. Fact Books

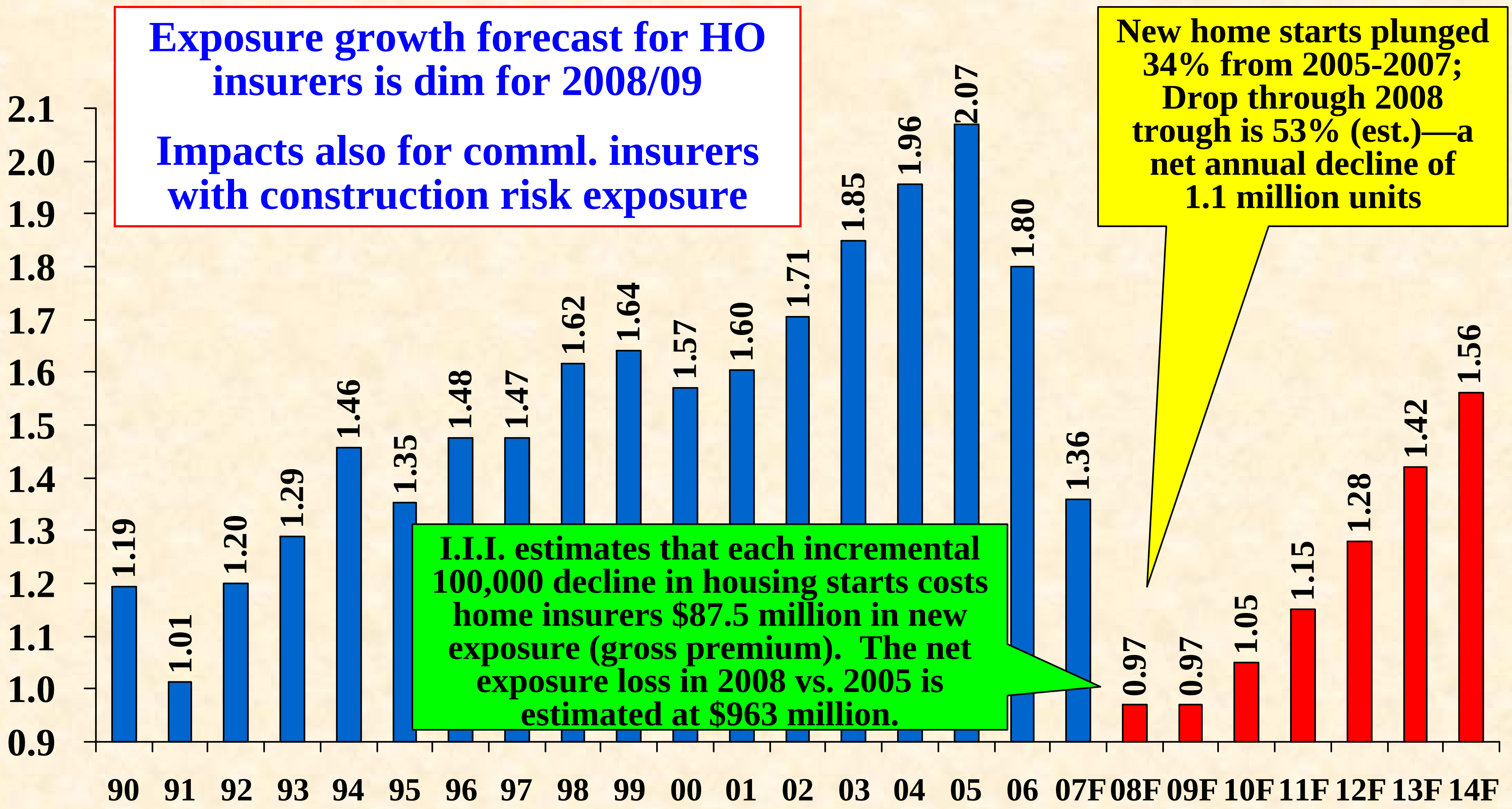
Workplace Injury Incidence Rates Declined in Last 4 Economic Downturns



p Preliminary

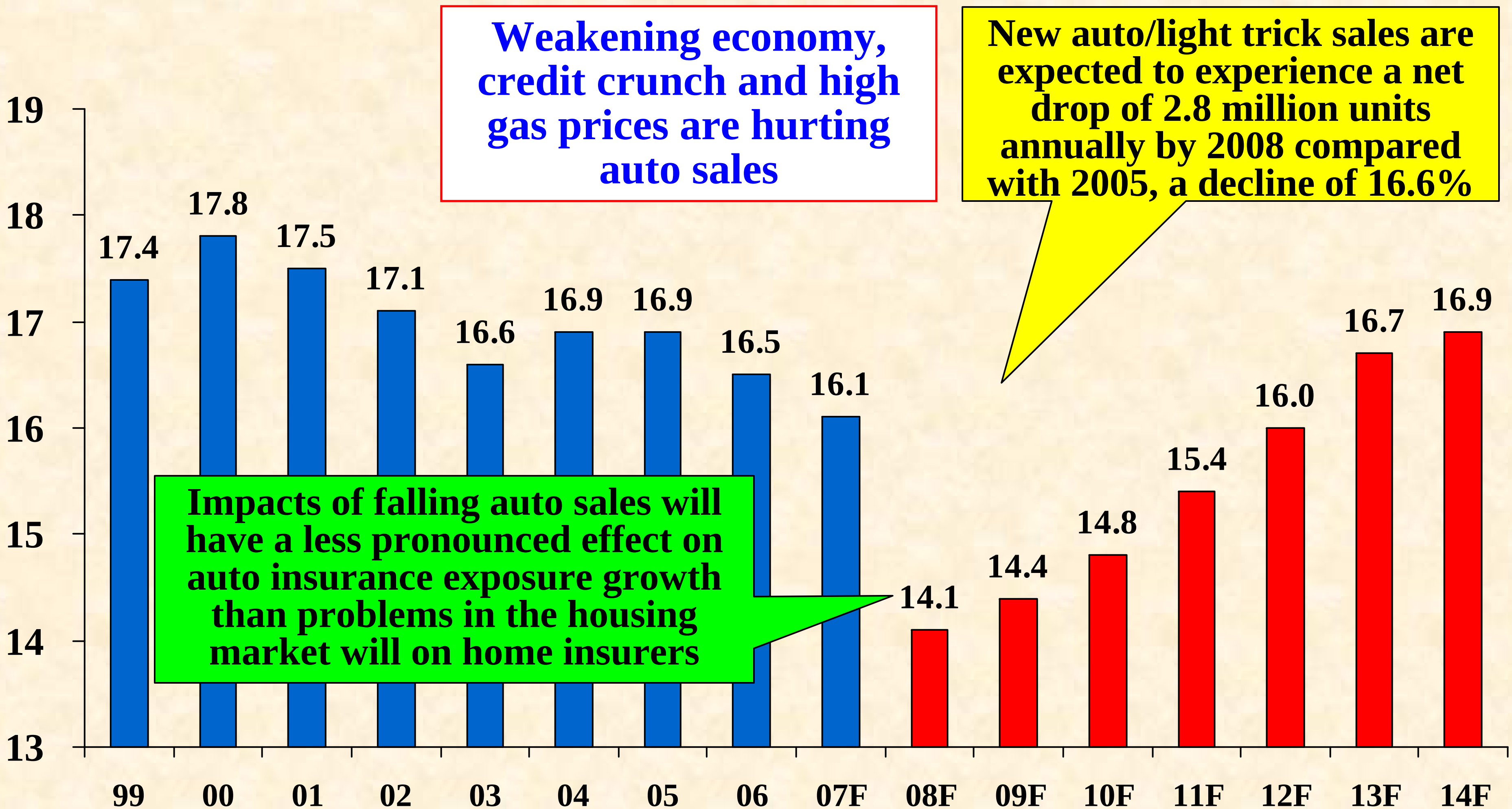
Source: US Department of Labor, Bureau of Labor Statistics (BLS), National Bureau of Economic Research; NCCI Frequency and Severity Analysis

New Private Housing Starts, 1990-2014F (Millions of Units)



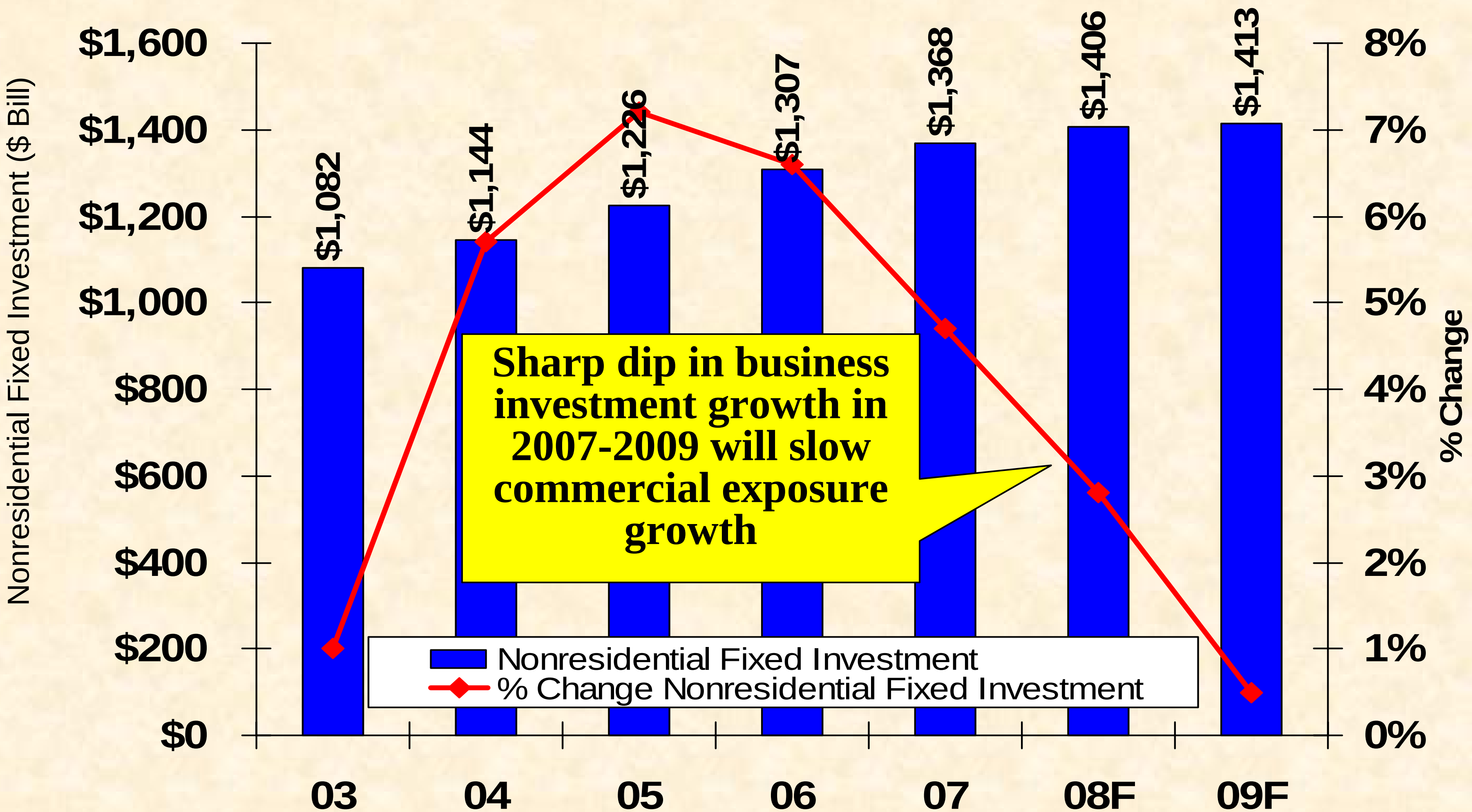
Source: US Department of Commerce; Blue Chip Economic Indicators for 2008/09, Aug. 2008. Insurance Information Institute for years 2010-2014.

Auto/Light Truck Sales, 1999-2014F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators for 2008/09, Aug. 2008. Insurance Information Institute for years 2010-2014.

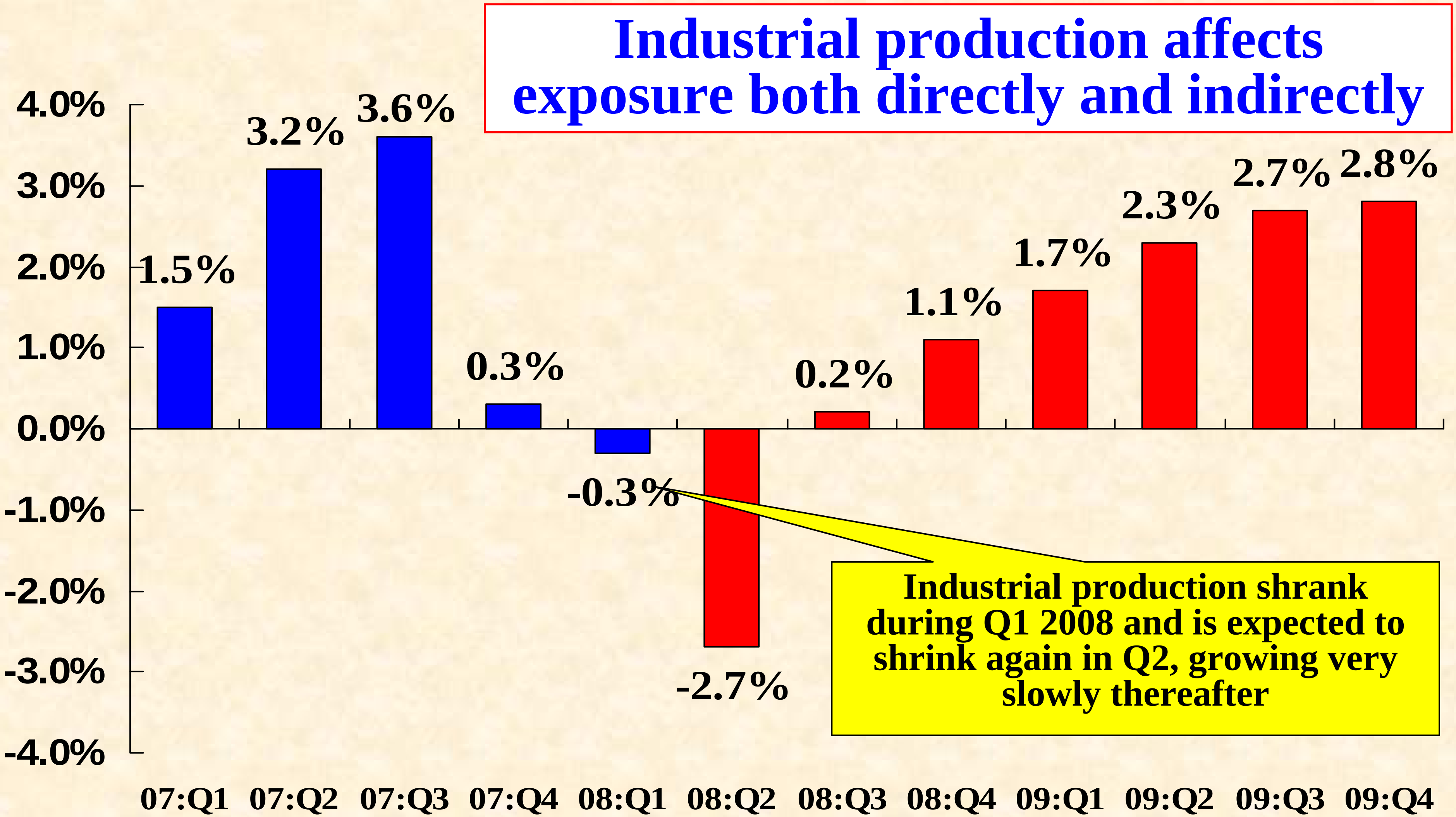
Nonresidential Fixed Investment,* 2003 – 2009F (Billions of 2000 $)



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

Sources: US Bureau of Economic Analysis (Historical), *Blue Chip Economic Indicators* (7/08) for forecasts.

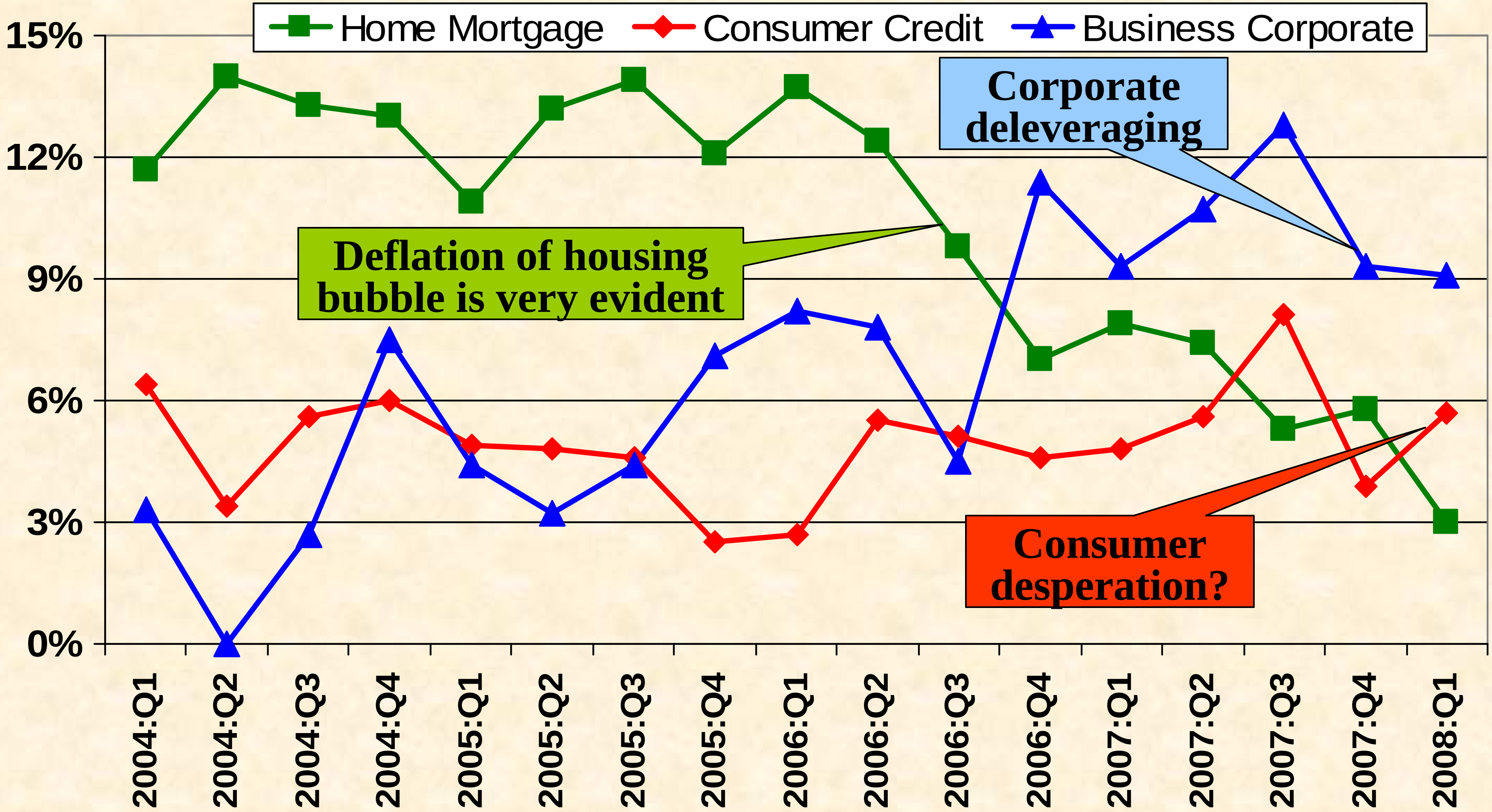
Total Industrial Production, (2007:Q1 to 2009:Q4F)



Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (7/08); Insurance Info. Inst.

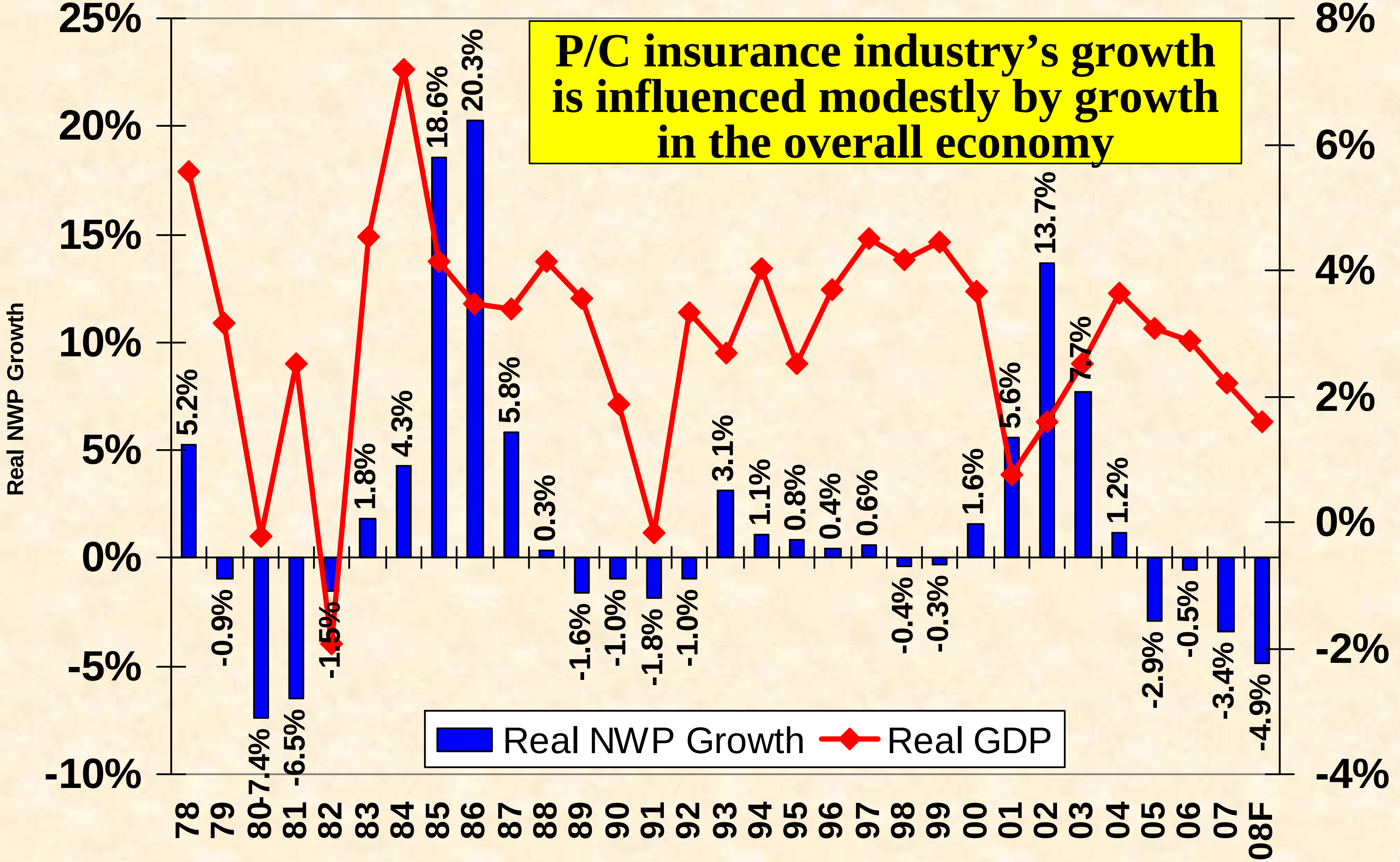
Percent Change in Debt Growth

(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



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

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

Sources: Insurance Information Institute

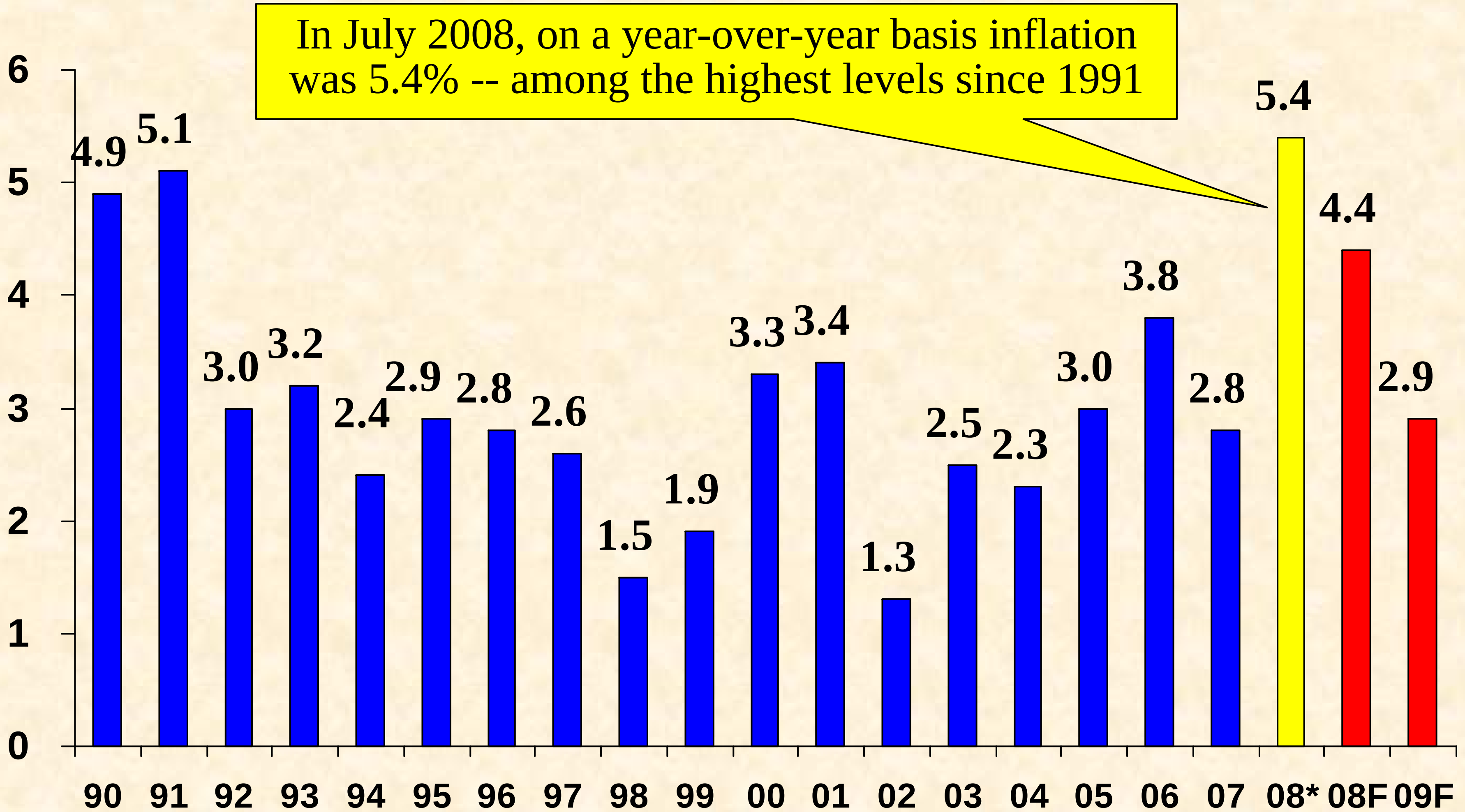
Summary of Economic Risks and Implications for (Re) Insurers

Economic Concern	Risks to Insurers
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

Annual Inflation Rates (CPI-U, %), 1990-2009F



***12-month change August 2008 vs. August 2007**

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, September 10, 2008. (forecasts)

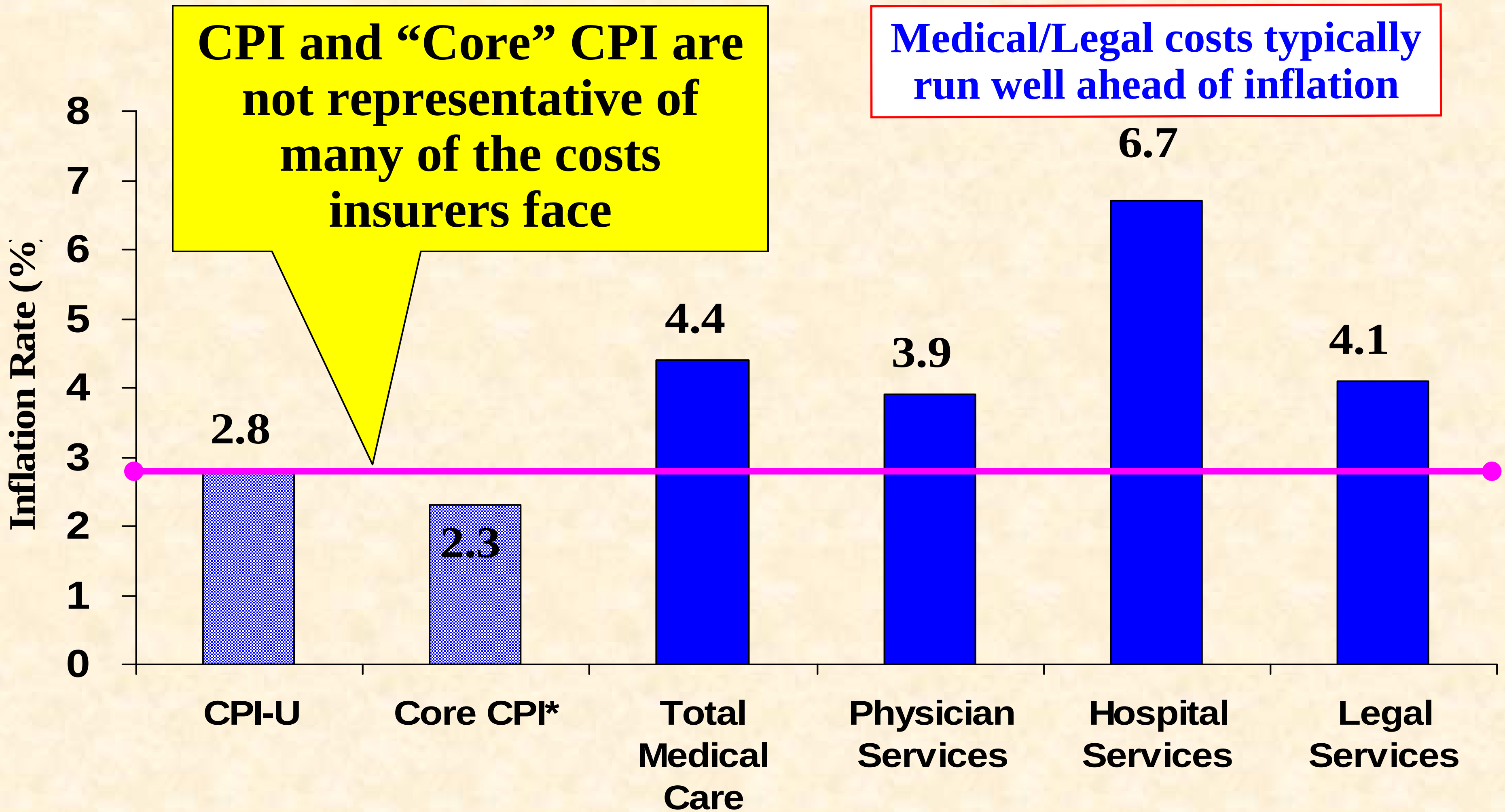
Inflation: Important Economic Risks and Implications for Insurers

Effects of Inflation	Risks to Insurers & Buyers
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

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

Effects of Inflation	Risks to Insurers
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 (%)

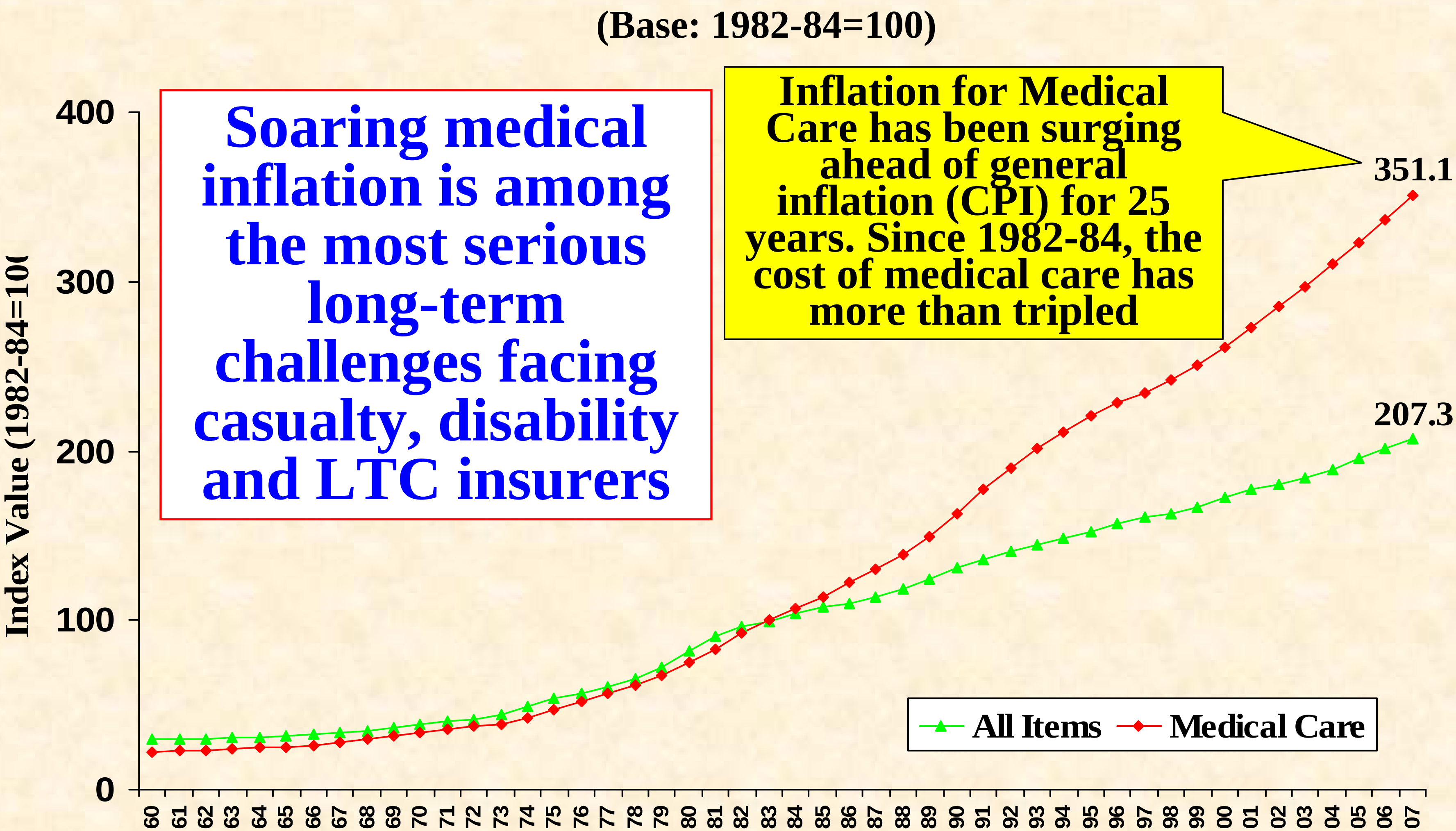


*Core CPI is the Consumer Price Index for all Urban Consumers (CPI-U) less food and energy costs.
Source: US Bureau of Labor Statistics; Insurance Information Institute.

Medical & Tort Cost Inflation

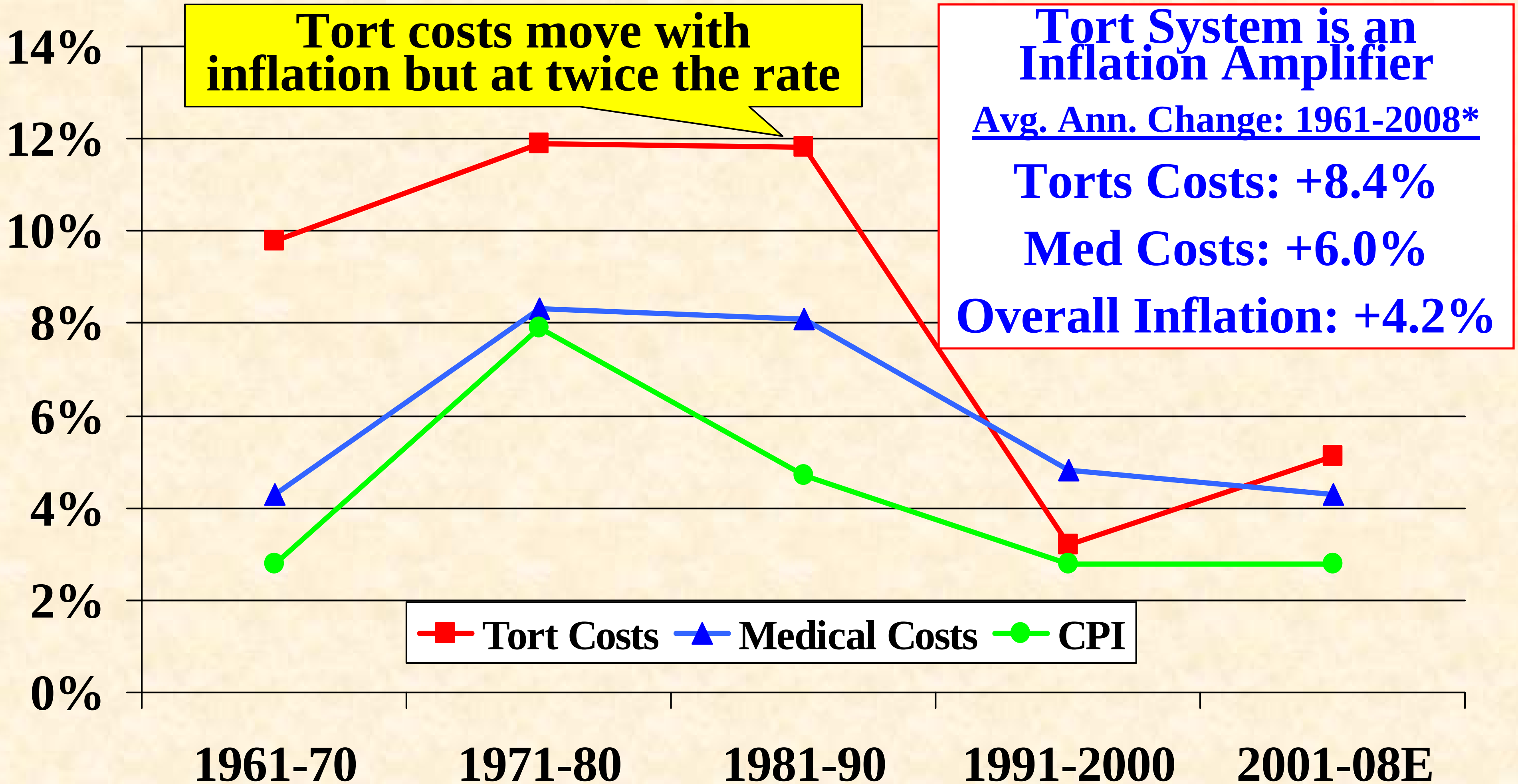
Amplifiers of Inflation, Major Insurance Cost Driver

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



Source: Department of Labor (Bureau of Labor Statistics; Insurance Information Institute.

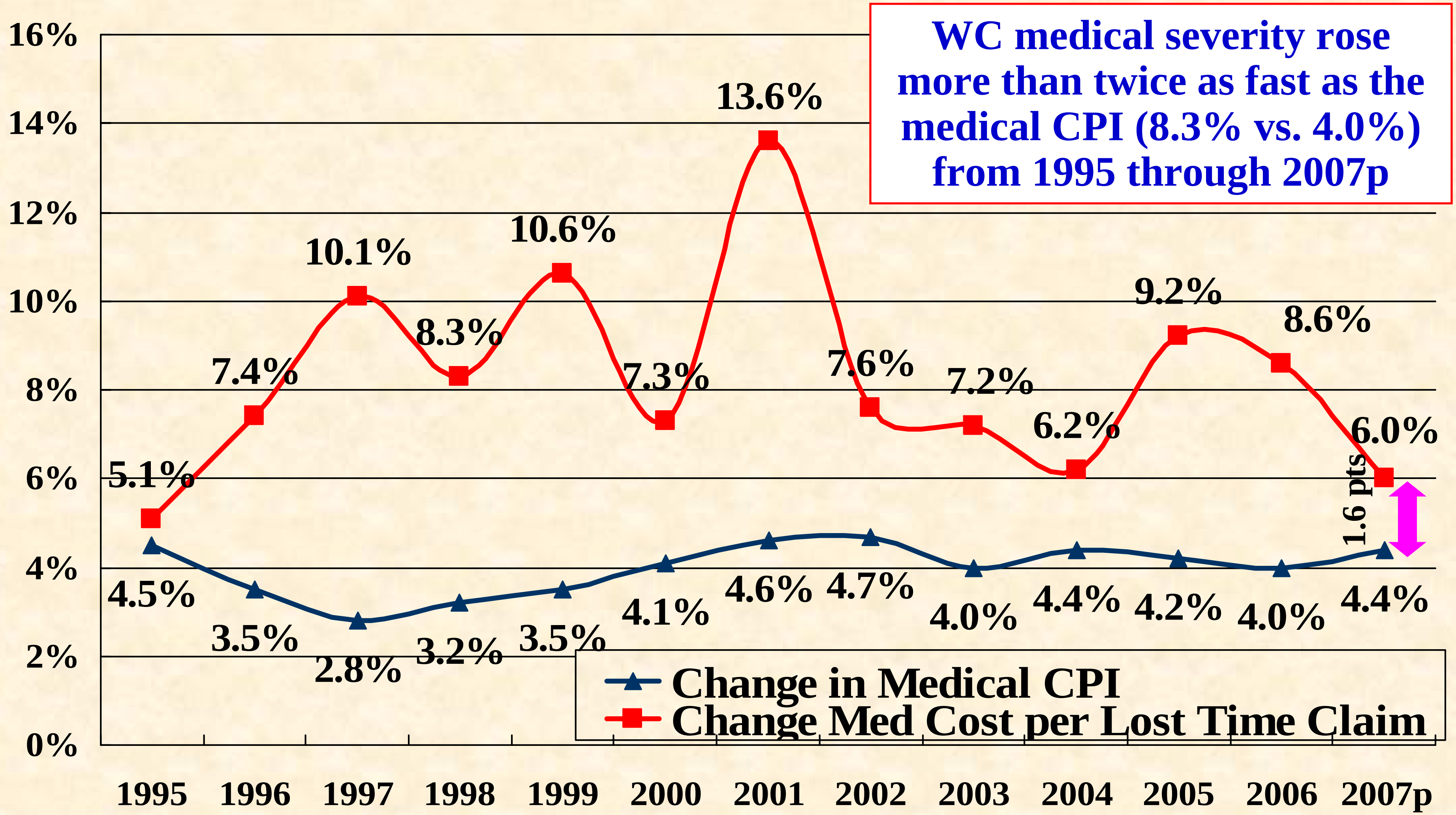
Tort Cost Growth & Medical Cost Inflation vs. Overall Inflation (CPI-U), 1961-2008*



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

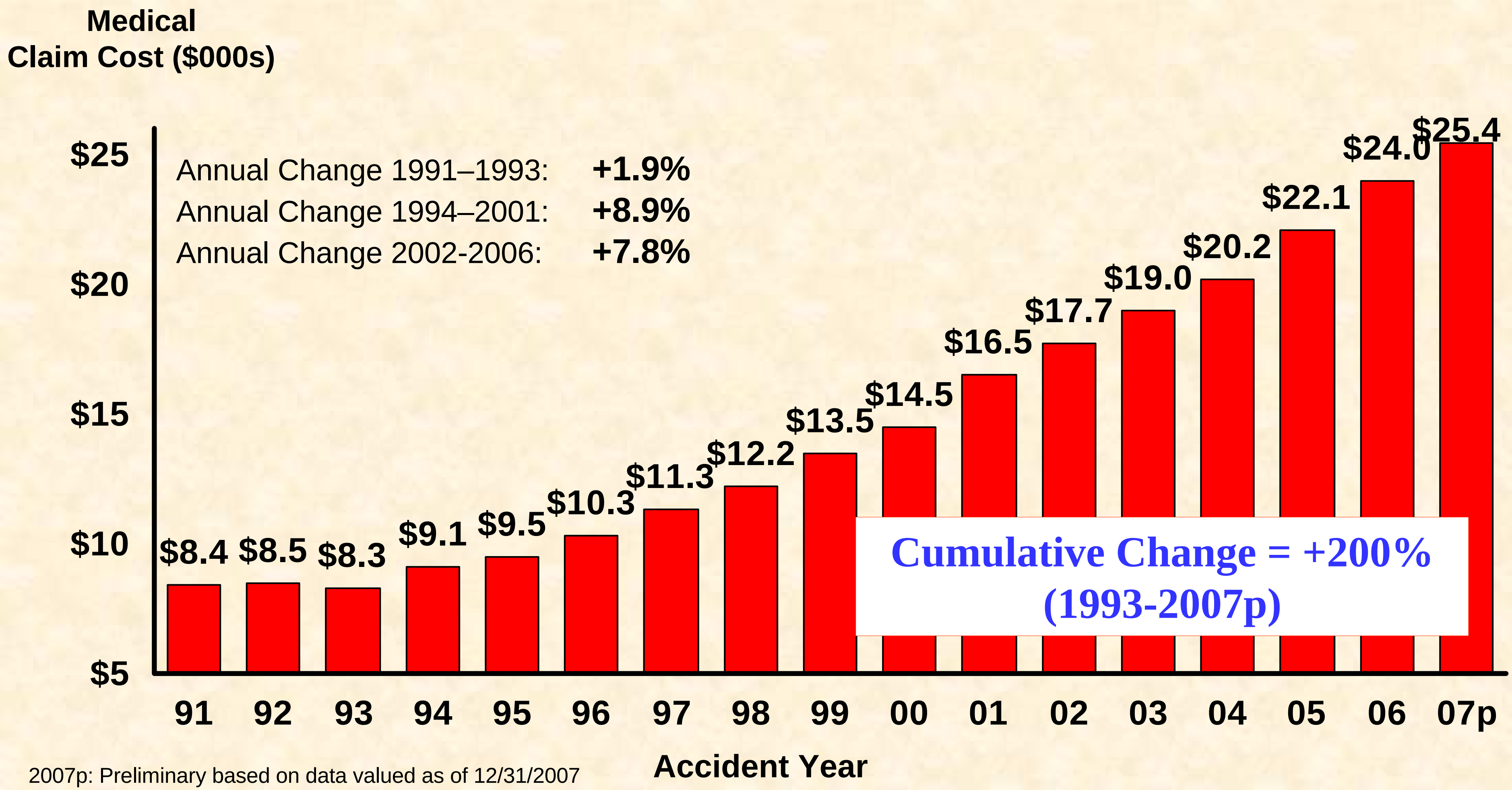
Sources: US Bureau of Labor Statistics, Tillinghast-Towers Perrin, *2007 Update on U.S. Tort Costs;* Insurance Info. Inst.

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.

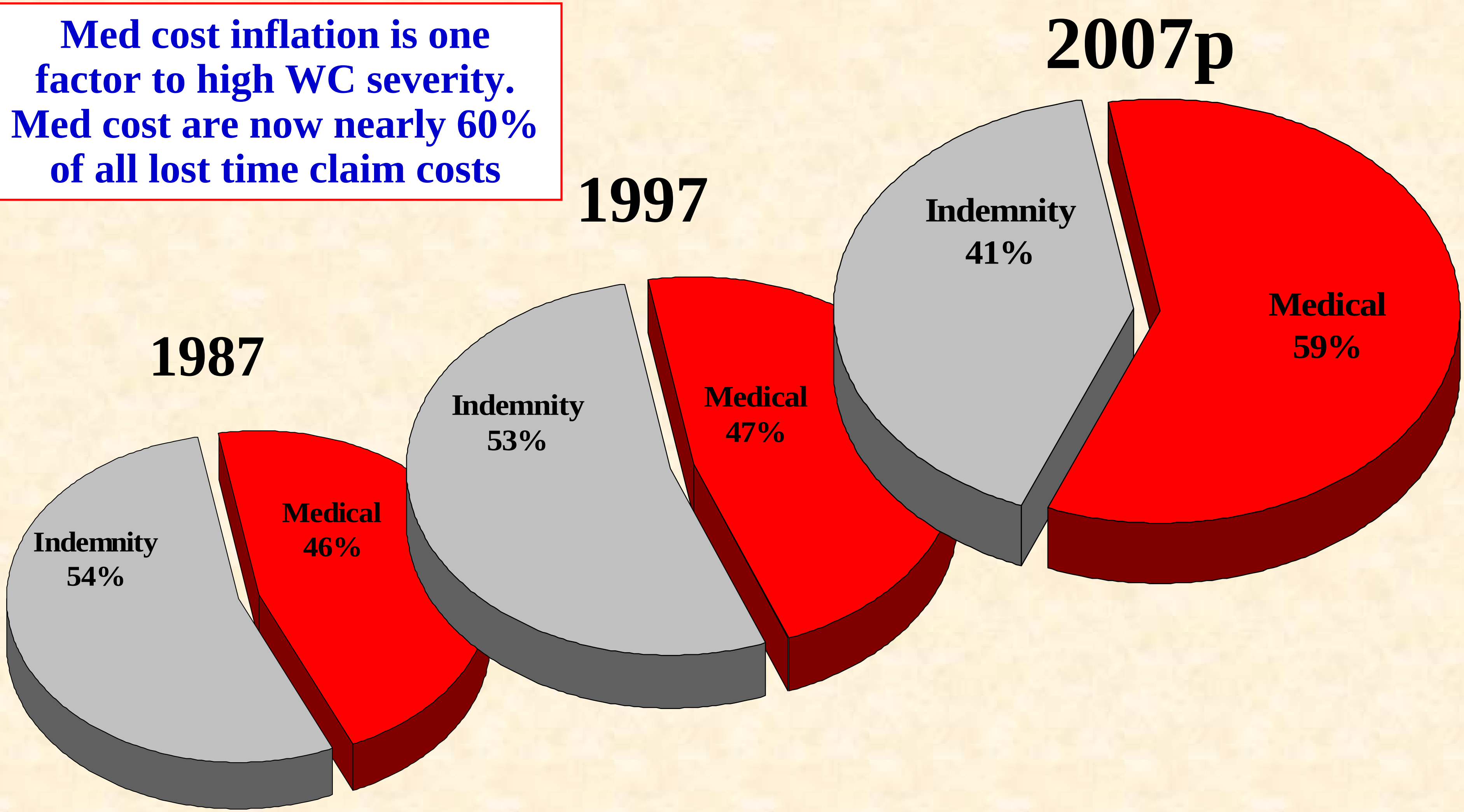
Workers Comp Medical Claims Costs Continue to Climb



2007p: Preliminary based on data valued as of 12/31/2007
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 Costs Share of Total Costs is Increasing Steadily

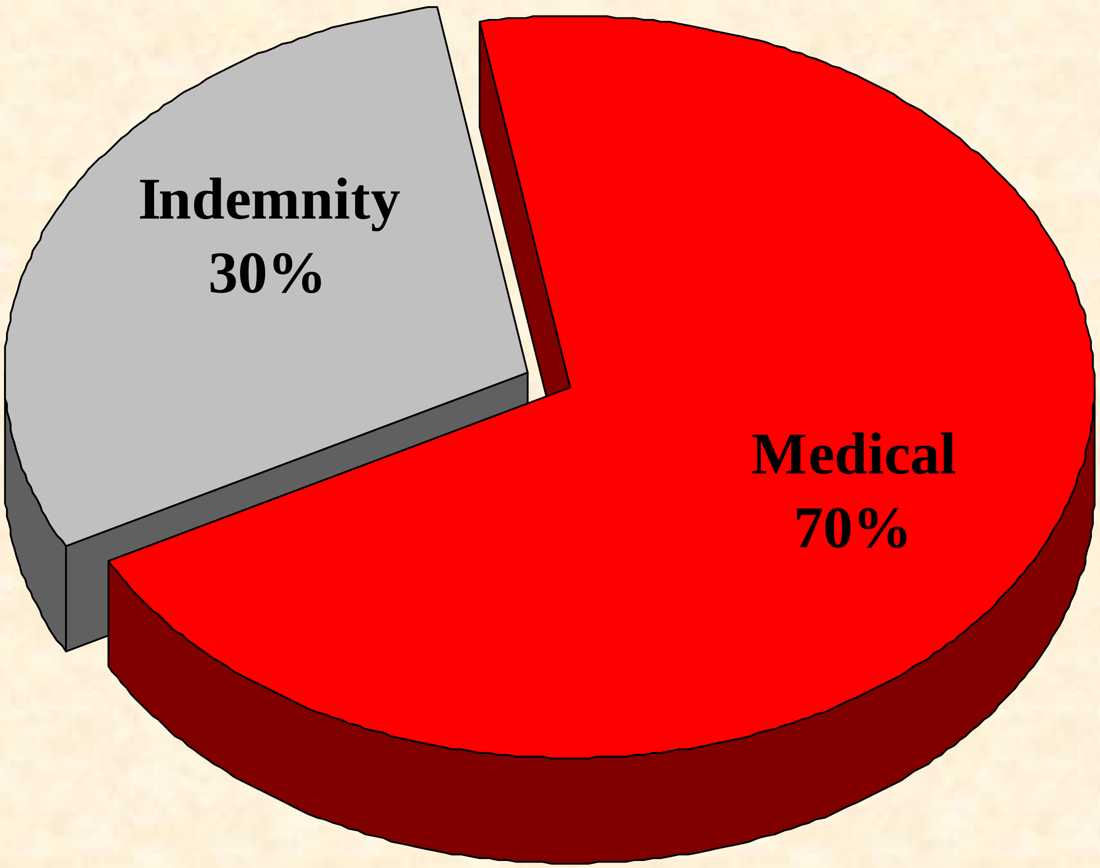
Med cost inflation is one factor to high WC severity. Med cost are now nearly 60% of all lost time claim costs



Source: NCCI (based on states where NCCI provides ratemaking services).

WC Med Cost Will Equal 70% of Total by 2017 if Trends Hold

2017 Estimate



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

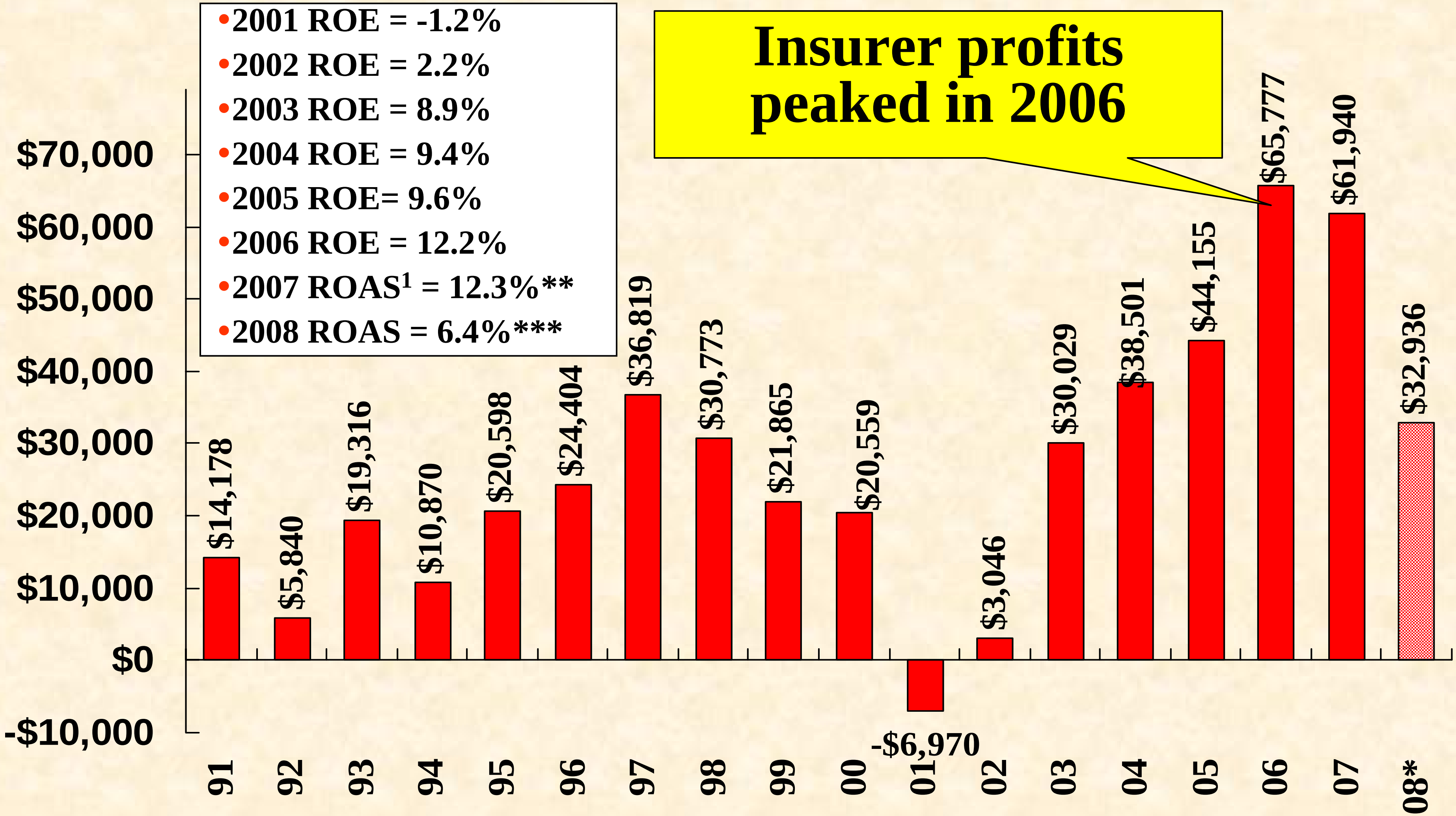
Source: Insurance Information Institute.

PROFITABILITY

Profits in 2006/07 Reached Their Cyclical Peak;

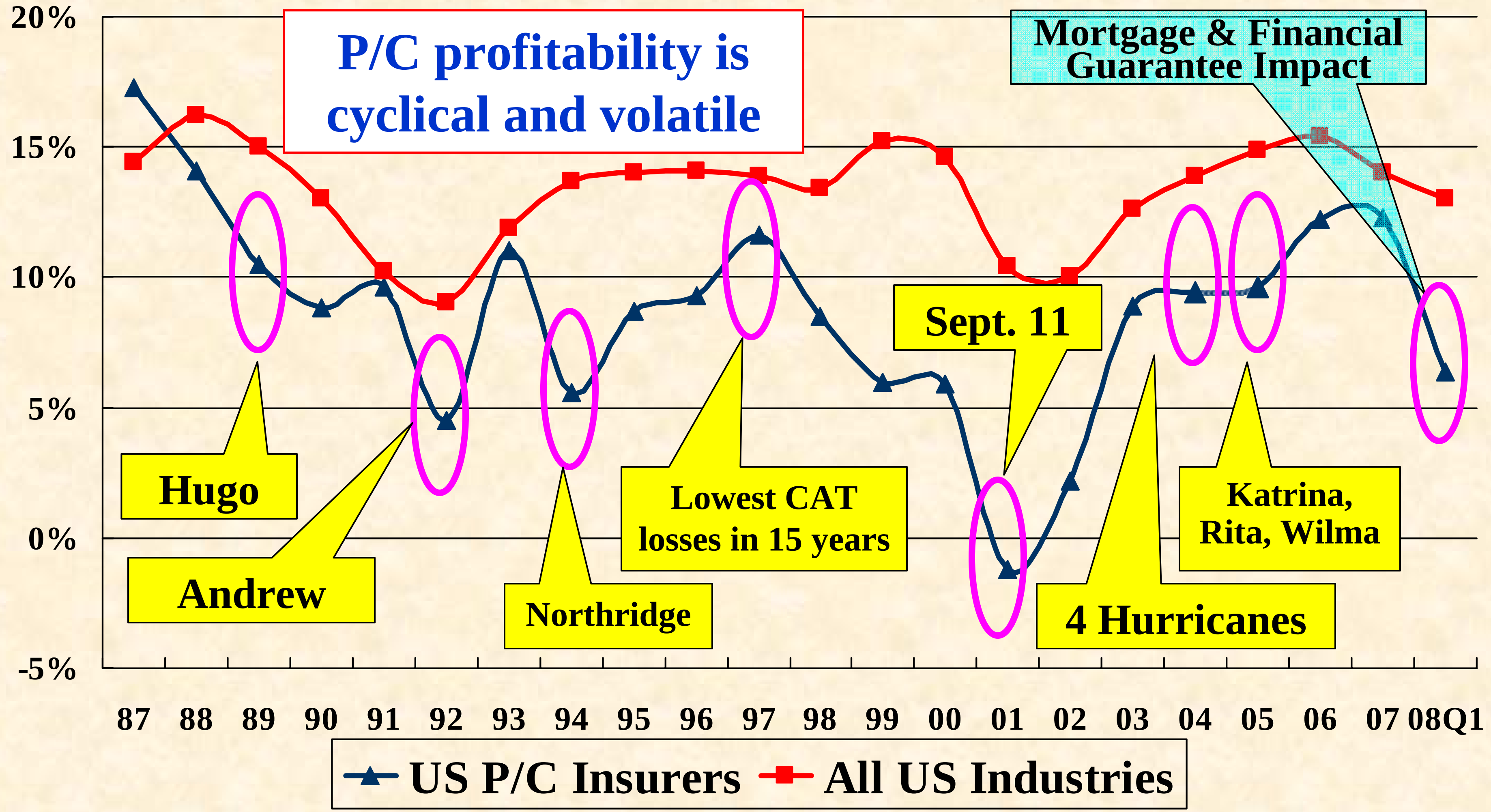
By No Reasonable Standard Can Profits Be Deemed Excessive

P/C Net Income After Taxes 1991-2008 ($ Millions)*



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

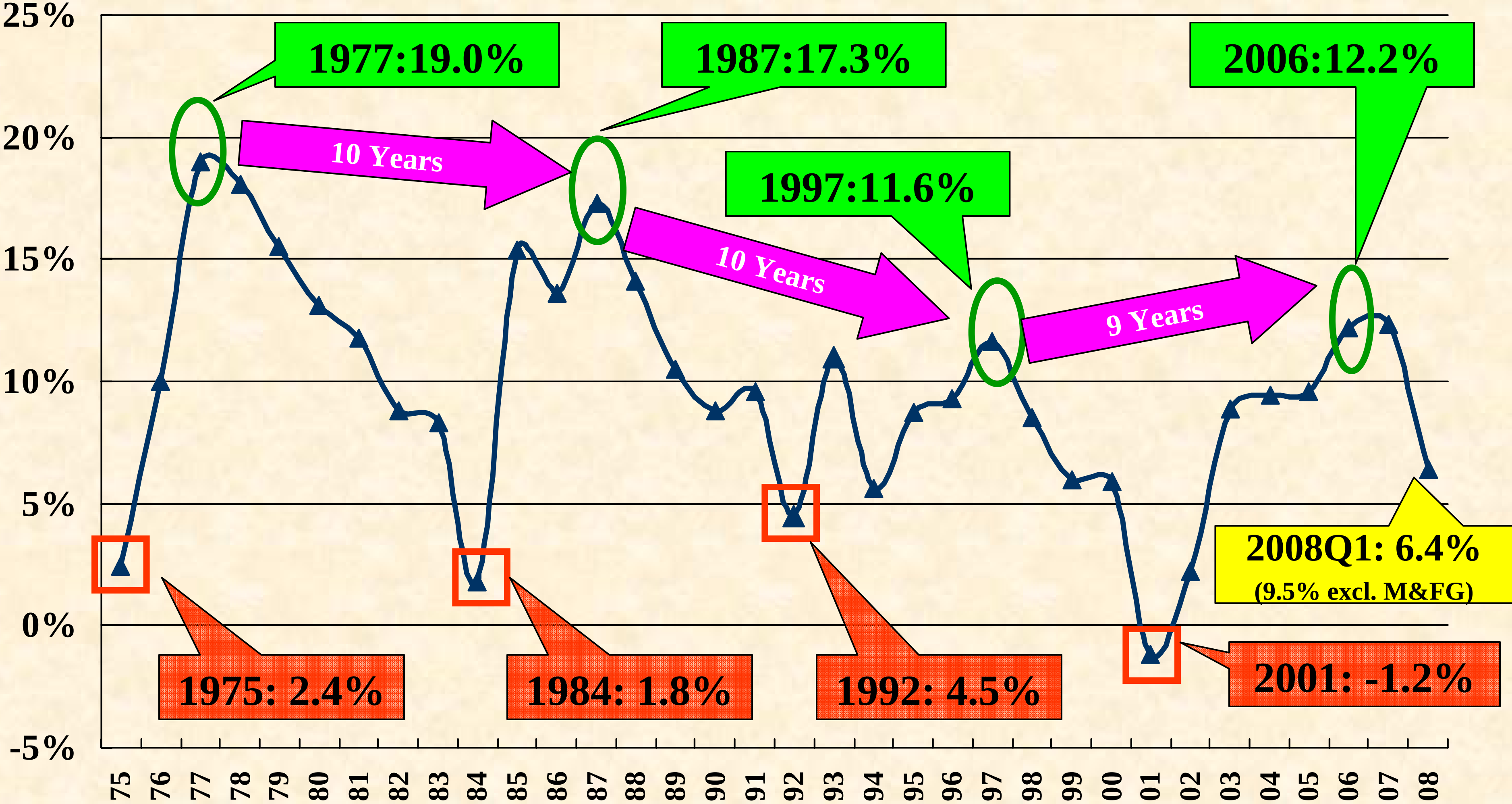
ROE: P/C vs. All Industries 1987–2008:Q1



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.

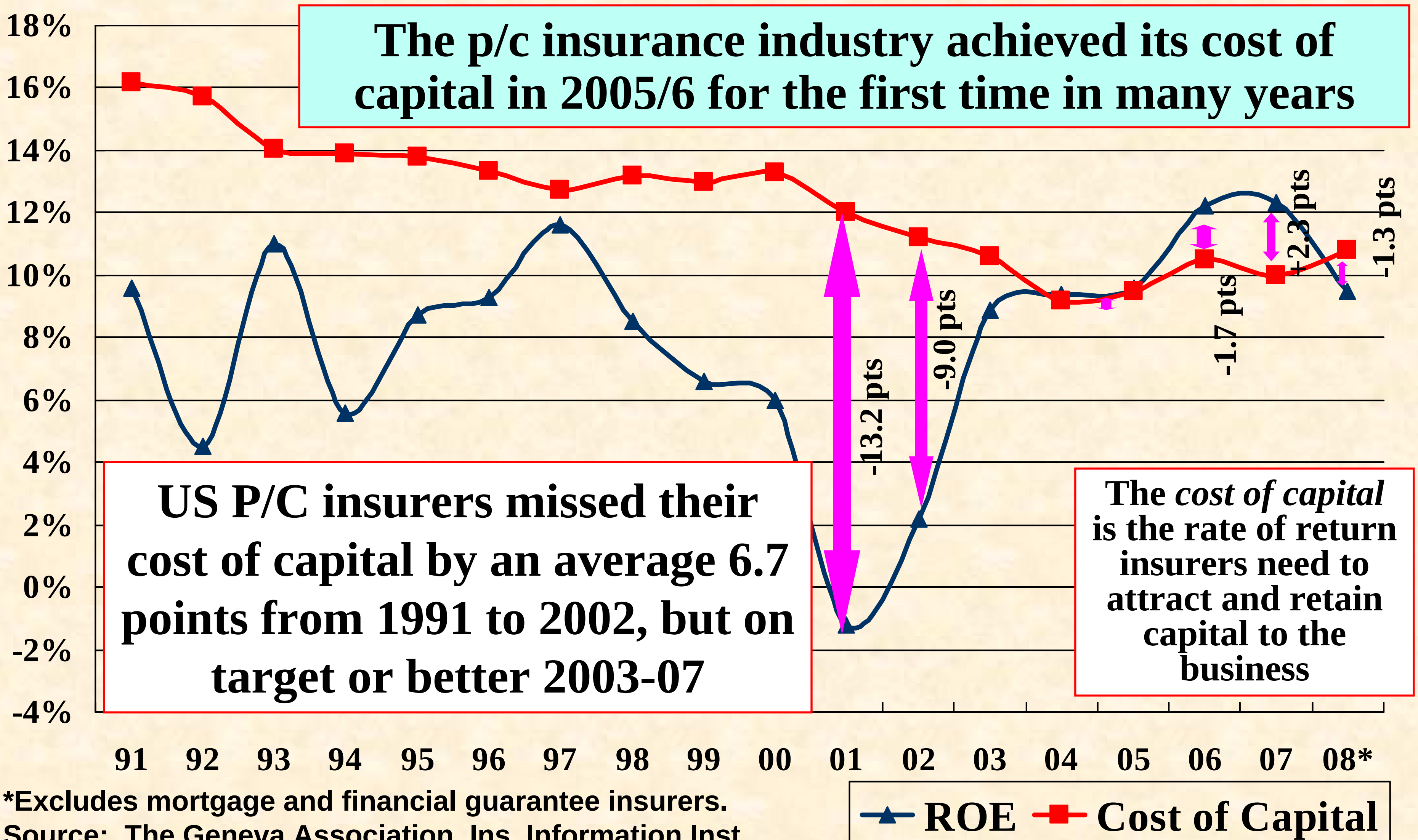
Profitability Peaks & Troughs in the P/C Insurance Industry,1975 – 2008:Q1



***GAAP ROE for all years except 2007 which is ROAS of 12.3%. All figures include mortgage an d 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: US P/C Insurance:1991-2008:Q1



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

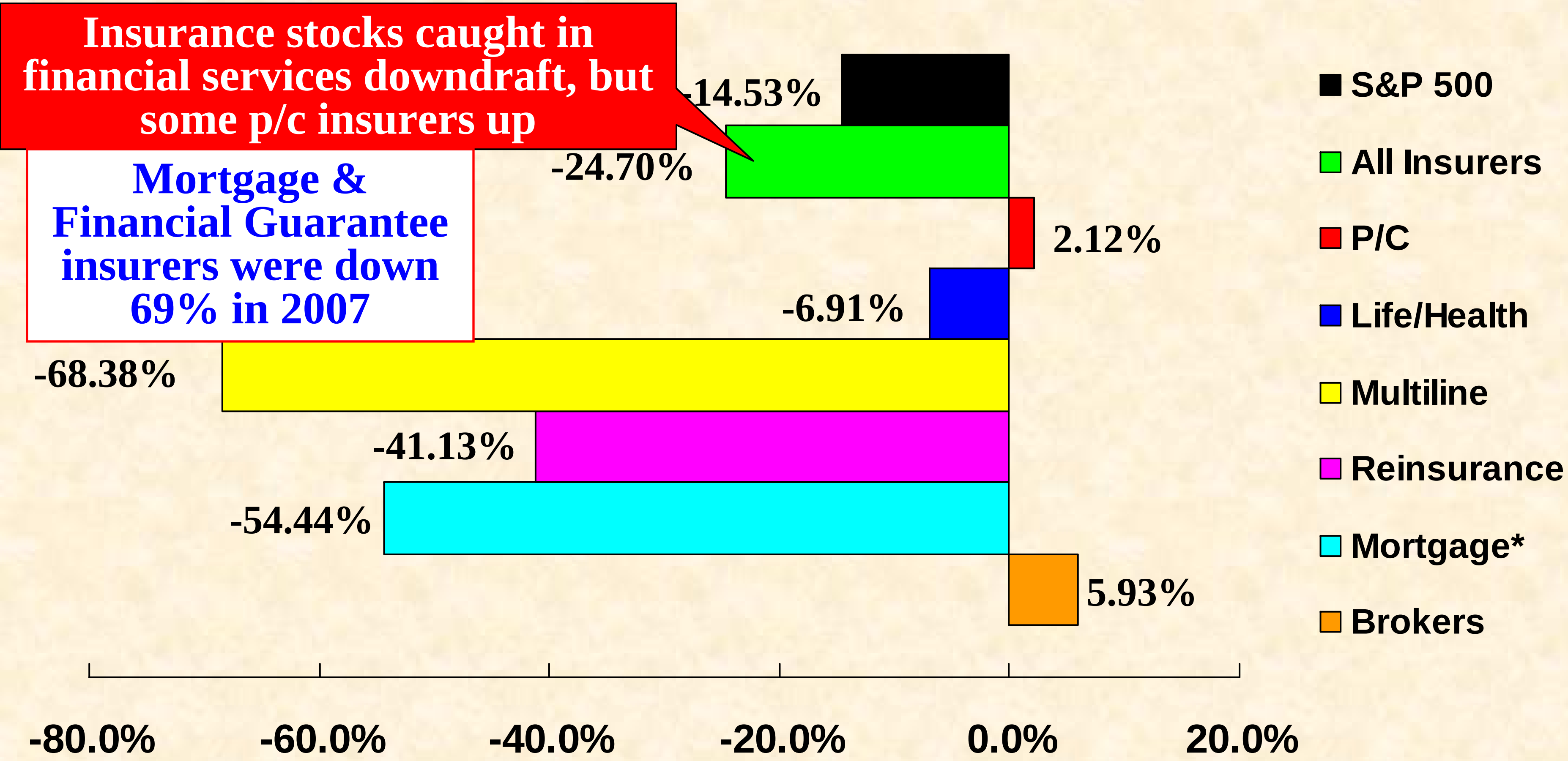
Factors that Will Influence the Length and Depth of the Cycle

- **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

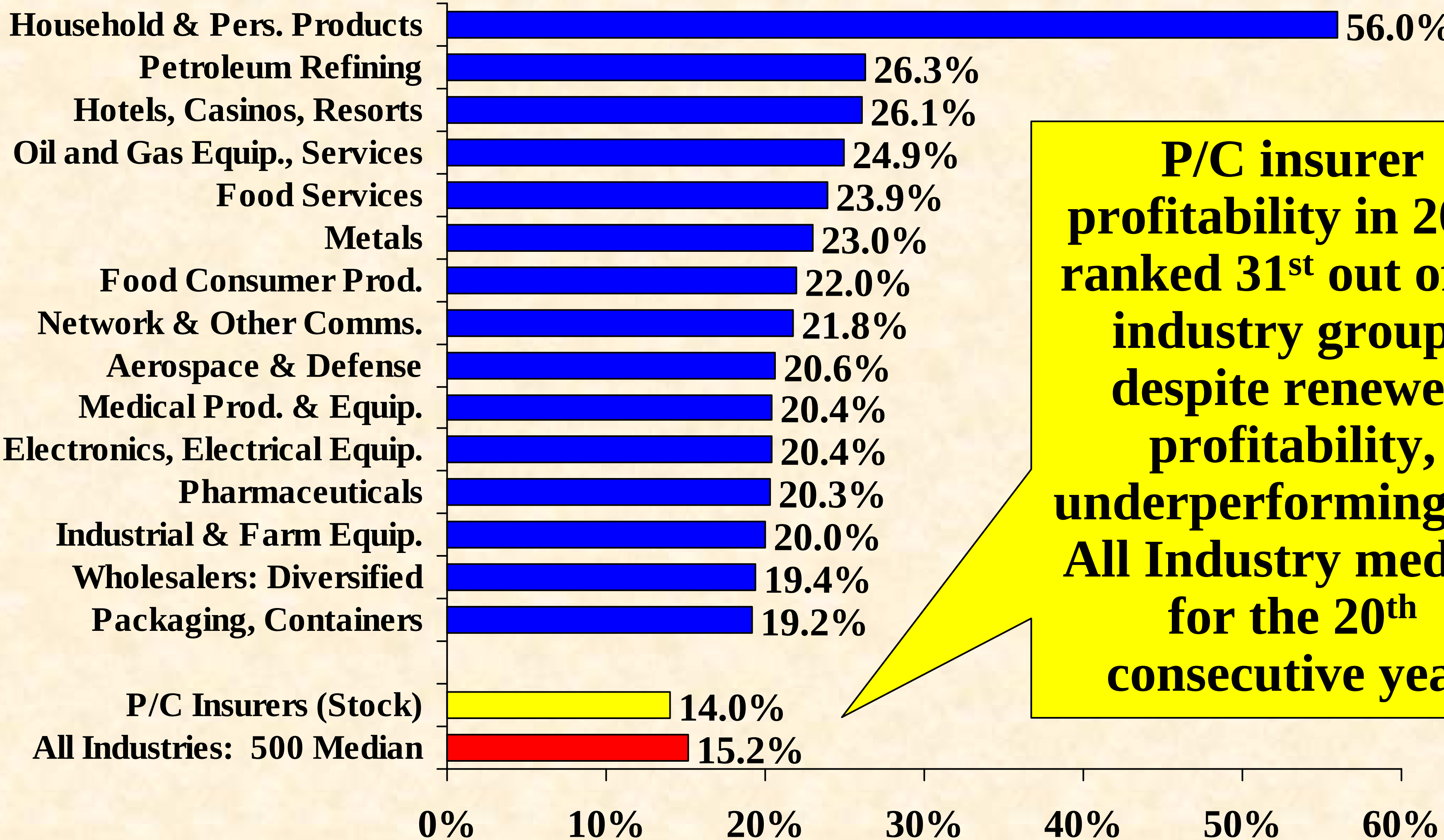
Total YTD Returns Through September 19 , 2008



*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

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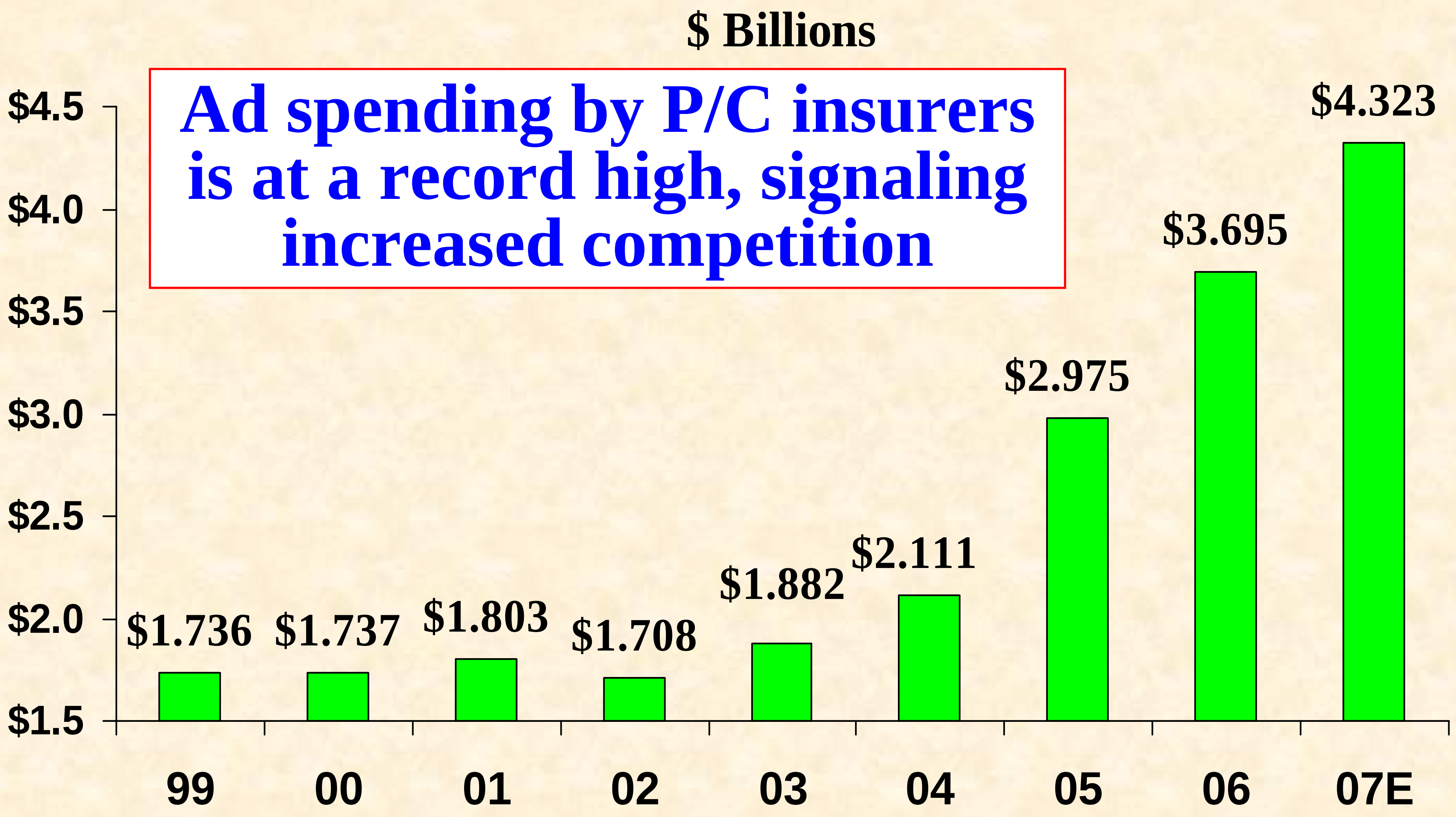
Source: Insurance Information Institute.

Advertising Expenditures by P/C Insurance Industry, 1999-2007E



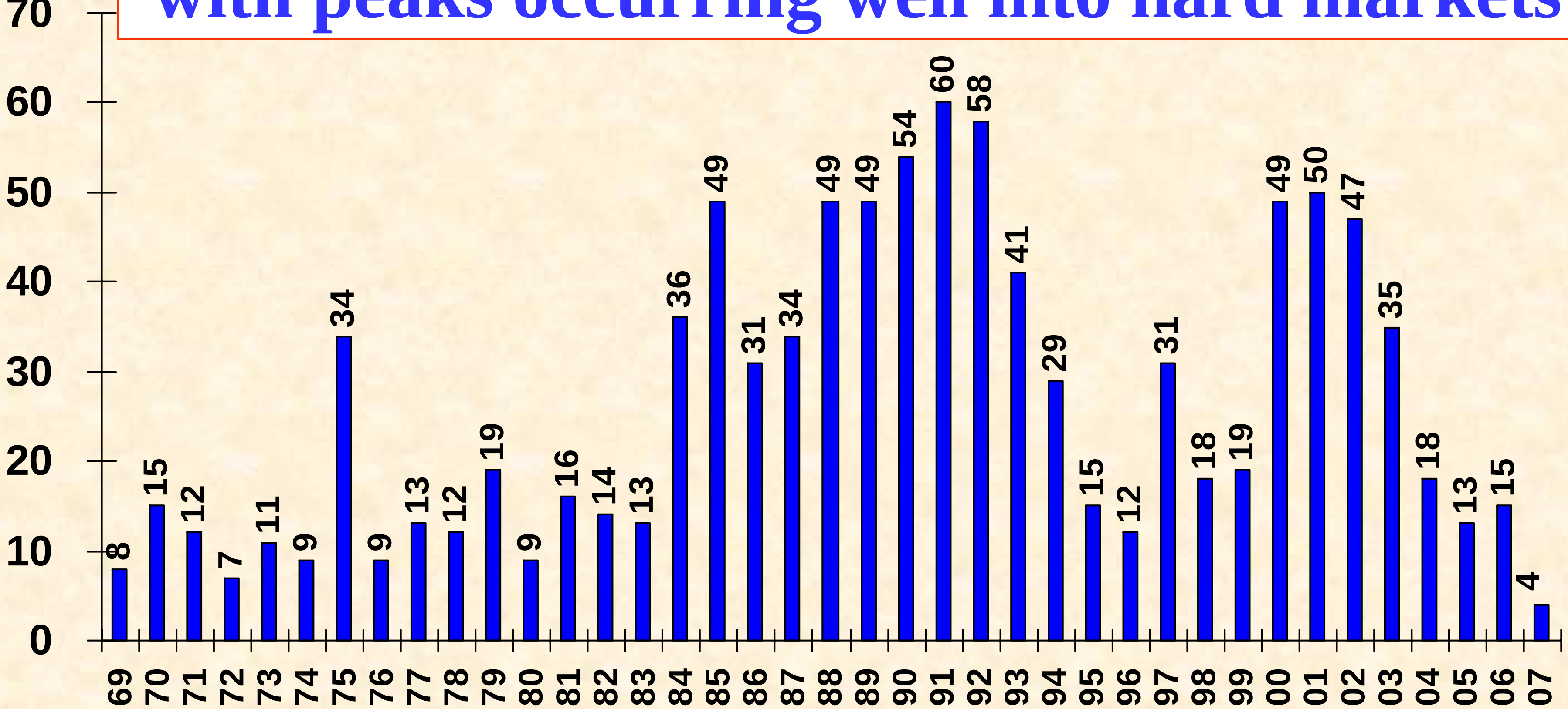
Source: Insurance Information Institute from consolidated P/C Annual Statement data.

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well, But Cycle May Takes Its Toll

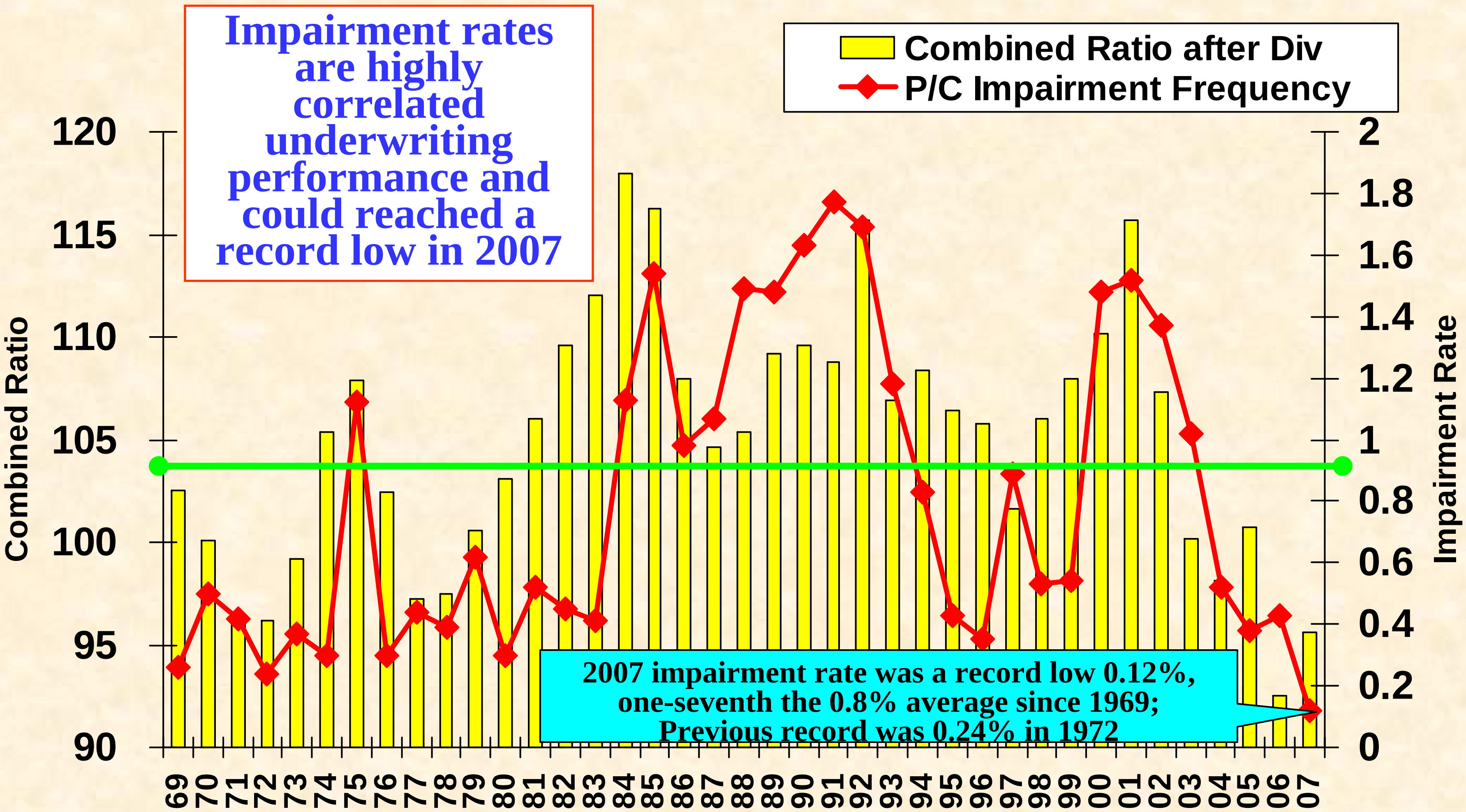
P/C Insurer Impairments, 1969-2007

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



Source: A.M. Best; Insurance Information Institute

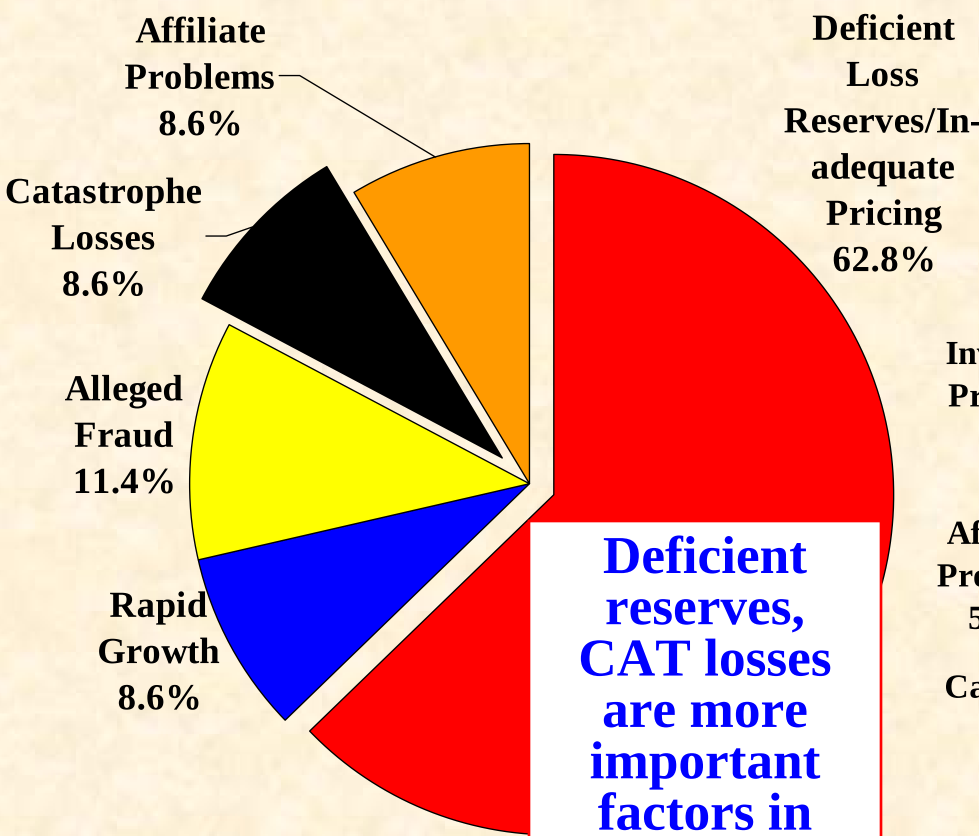
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2007E



Source: A.M. Best; Insurance Information Institute

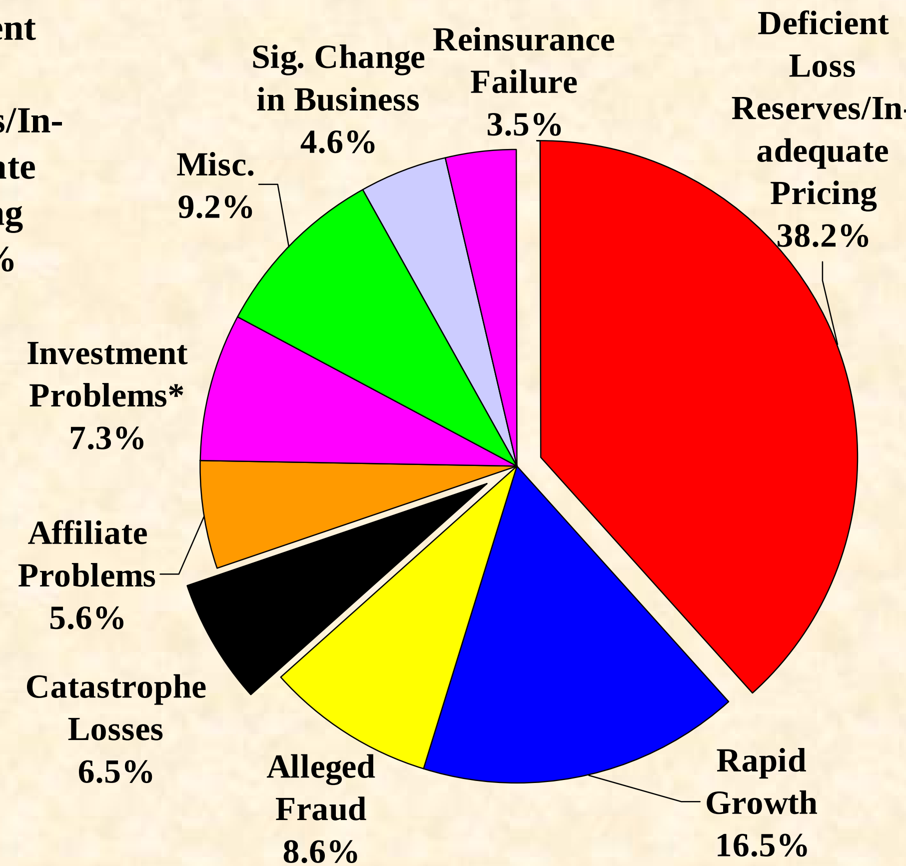
Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



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

1969-2005

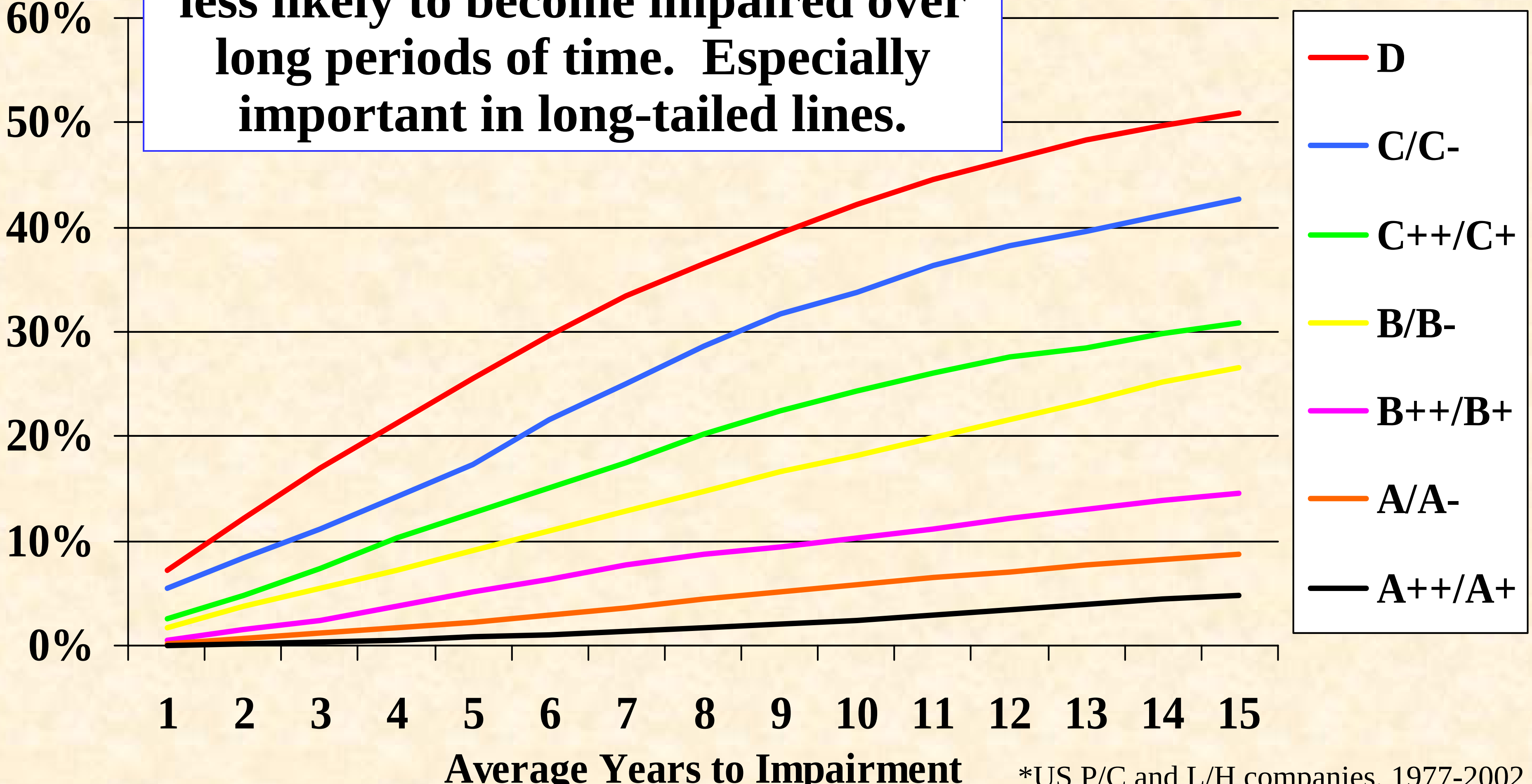


*Includes overstatement of assets.

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

Cumulative Average Impairment Rates by Best Financial Strength Rating*

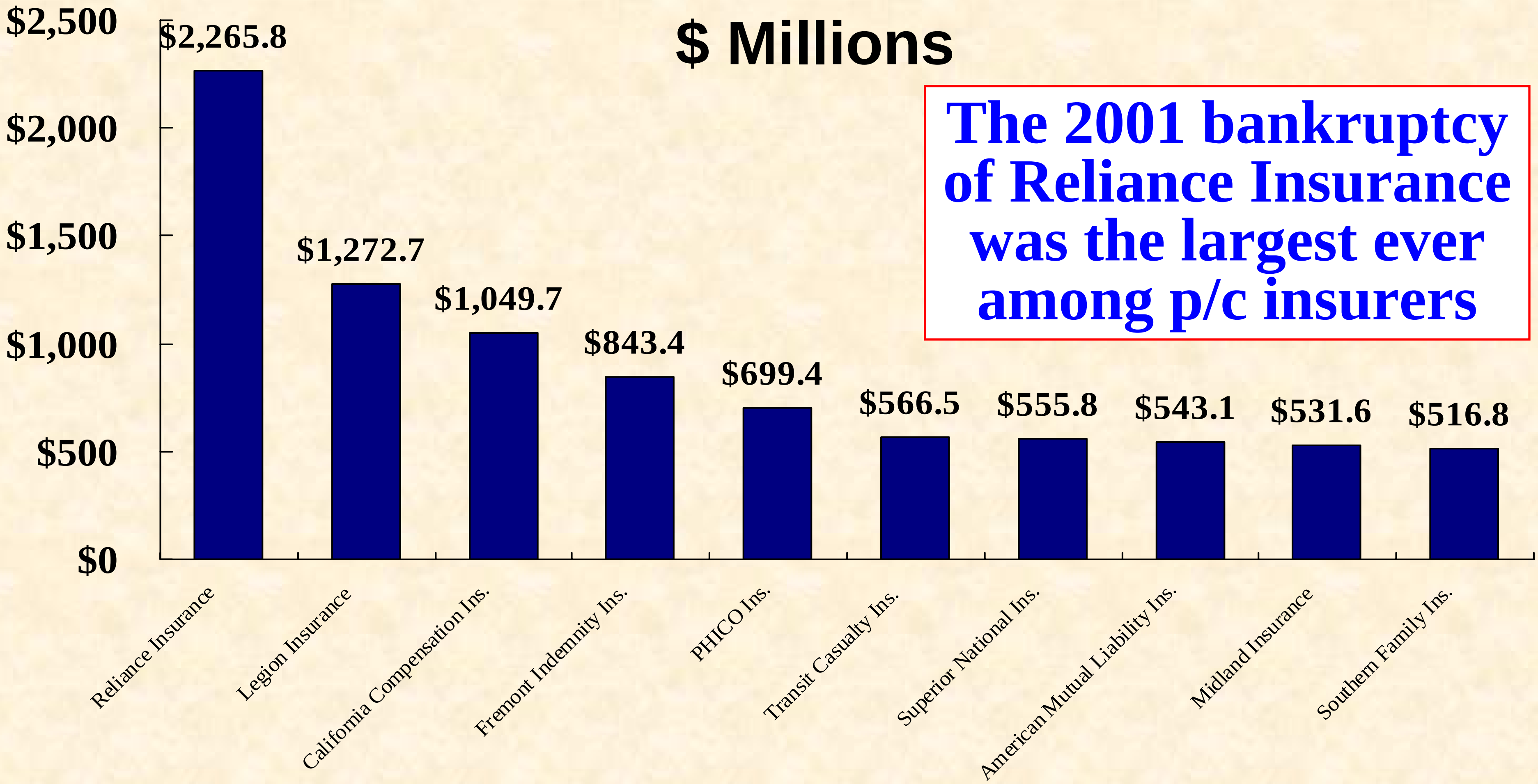
Insurers with strong ratings are far less likely to become impaired over long periods of time. Especially important in long-tailed lines.



*US P/C and L/H companies, 1977-2002

Sources: A.M. Best: *Best's Impairment Rate and Rating Transition Study—1977-2002*, March 1, 2004.

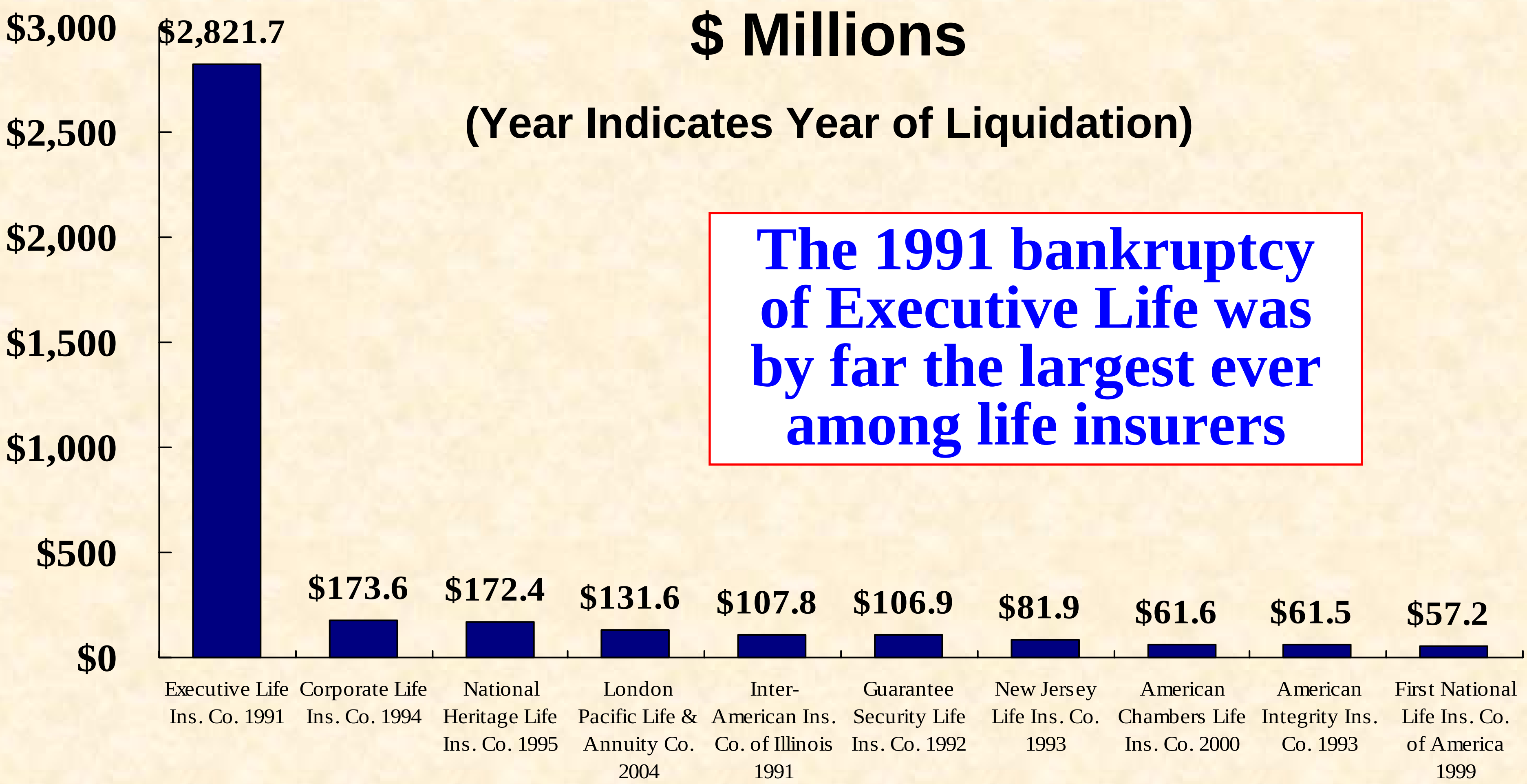
Top 10 P/C Insolvencies, Based Upon Guaranty Fund Payments*



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

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

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



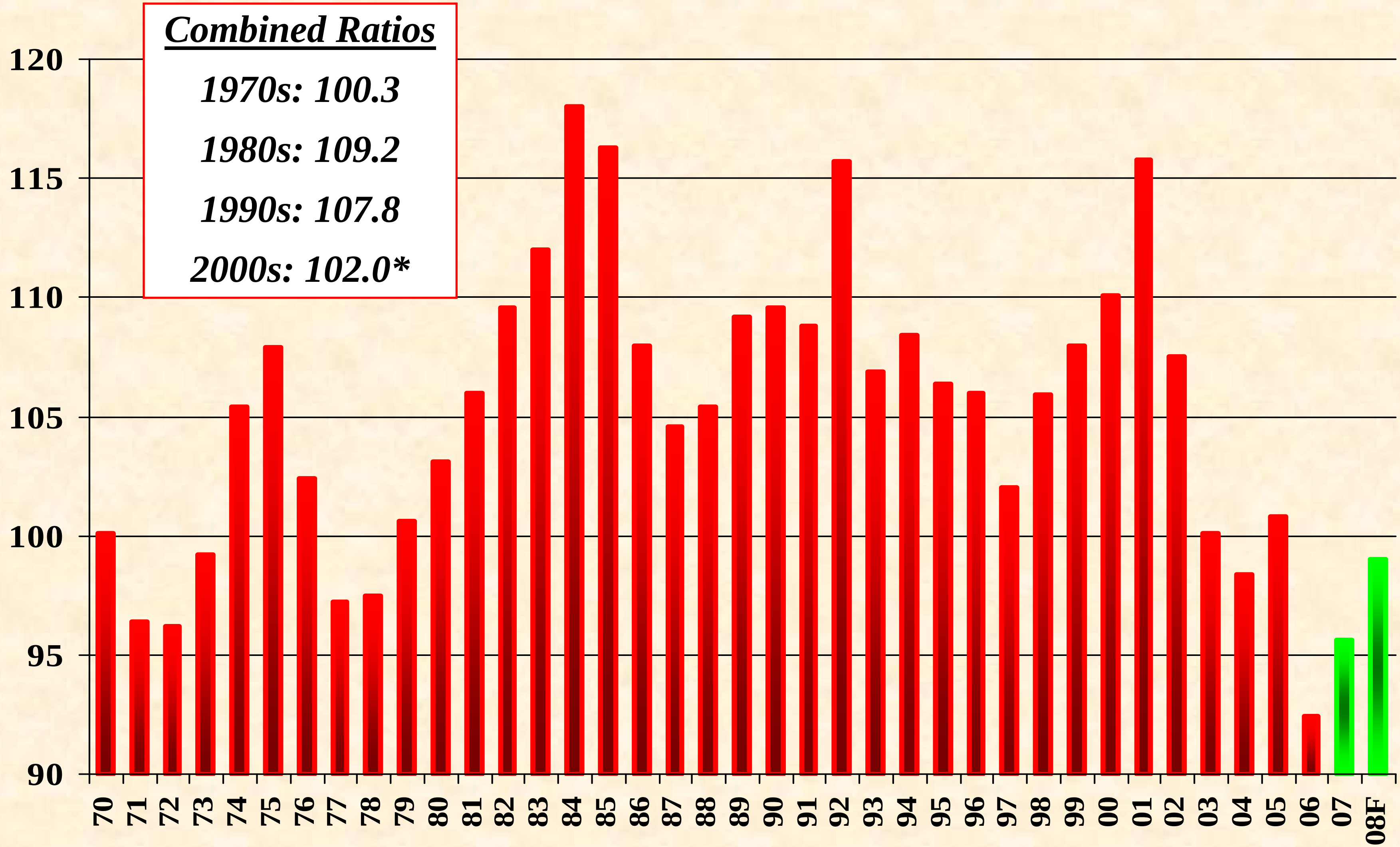
*As of 2007.

Source: National Organization of Life and Health Guaranty Funds

UNDERWRITING TRENDS

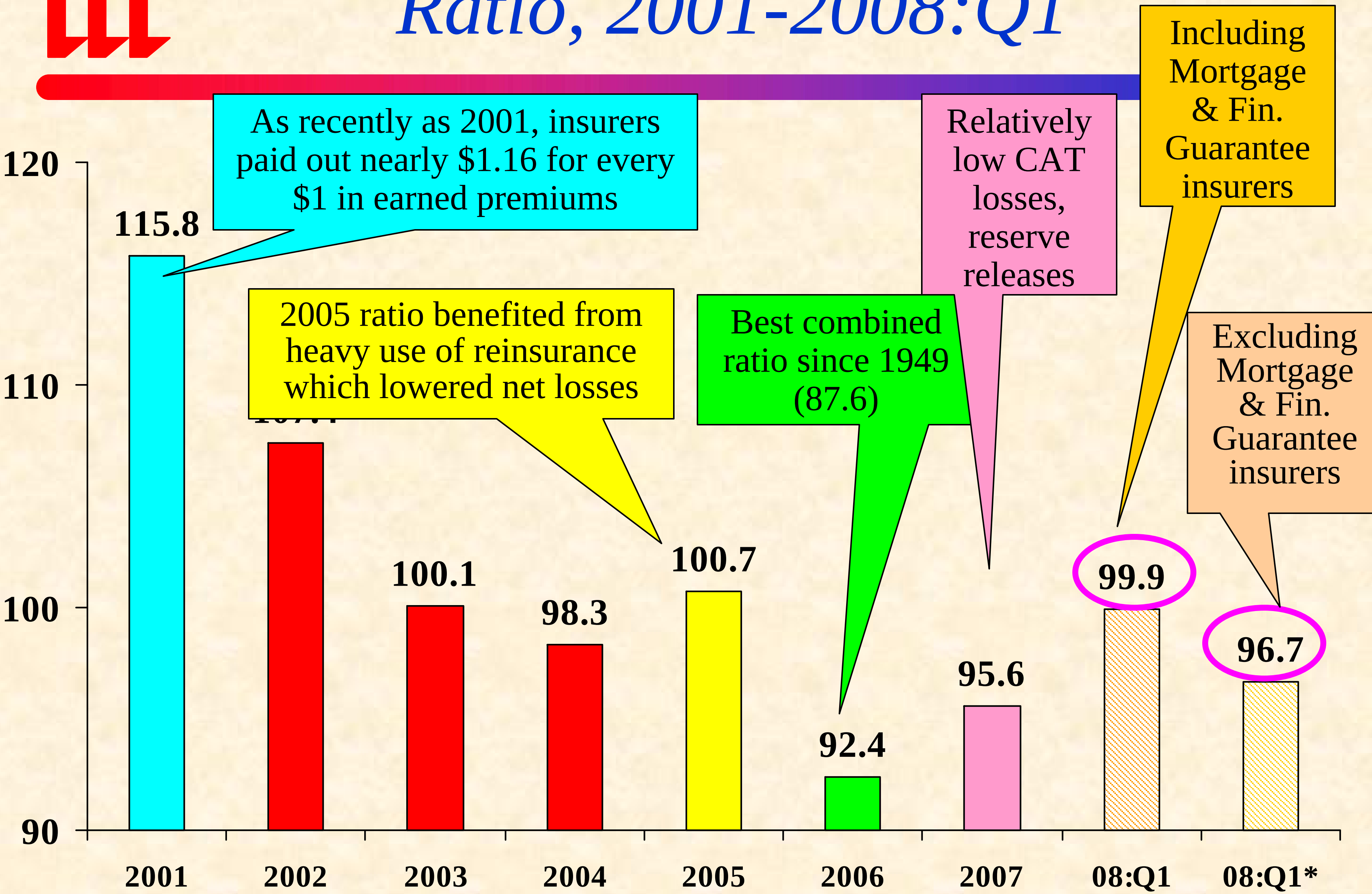
Extremely Strong 2006/07; Relying on Momentum & Discipline for 2008

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



Sources: A.M. Best; ISO, III *Full year 2008 estimates from III.

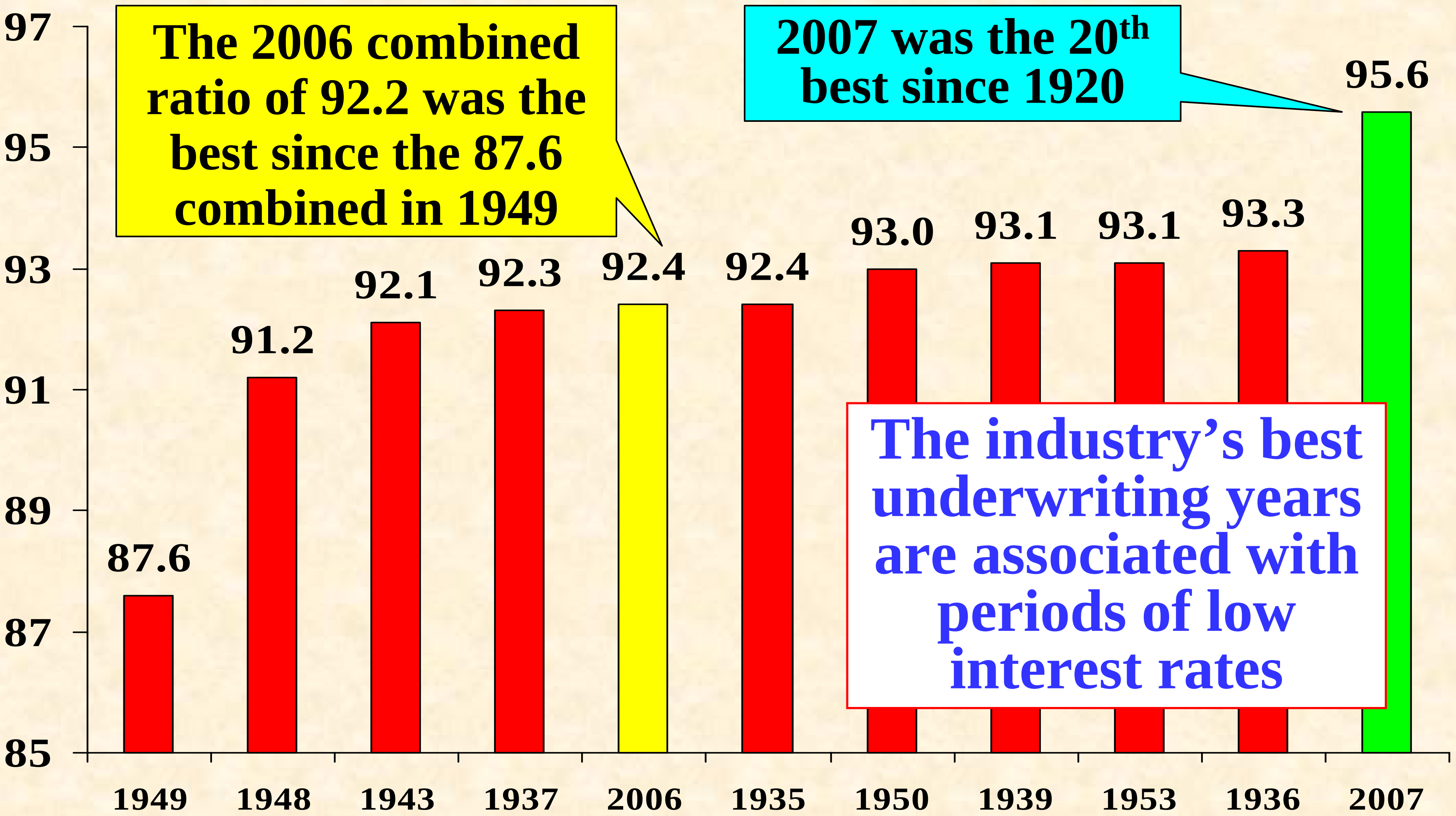
P/C Insurance Industry Combined Ratio, 2001-2008:Q1



*Excluding Mortgage & Financial Guarantee insurers.

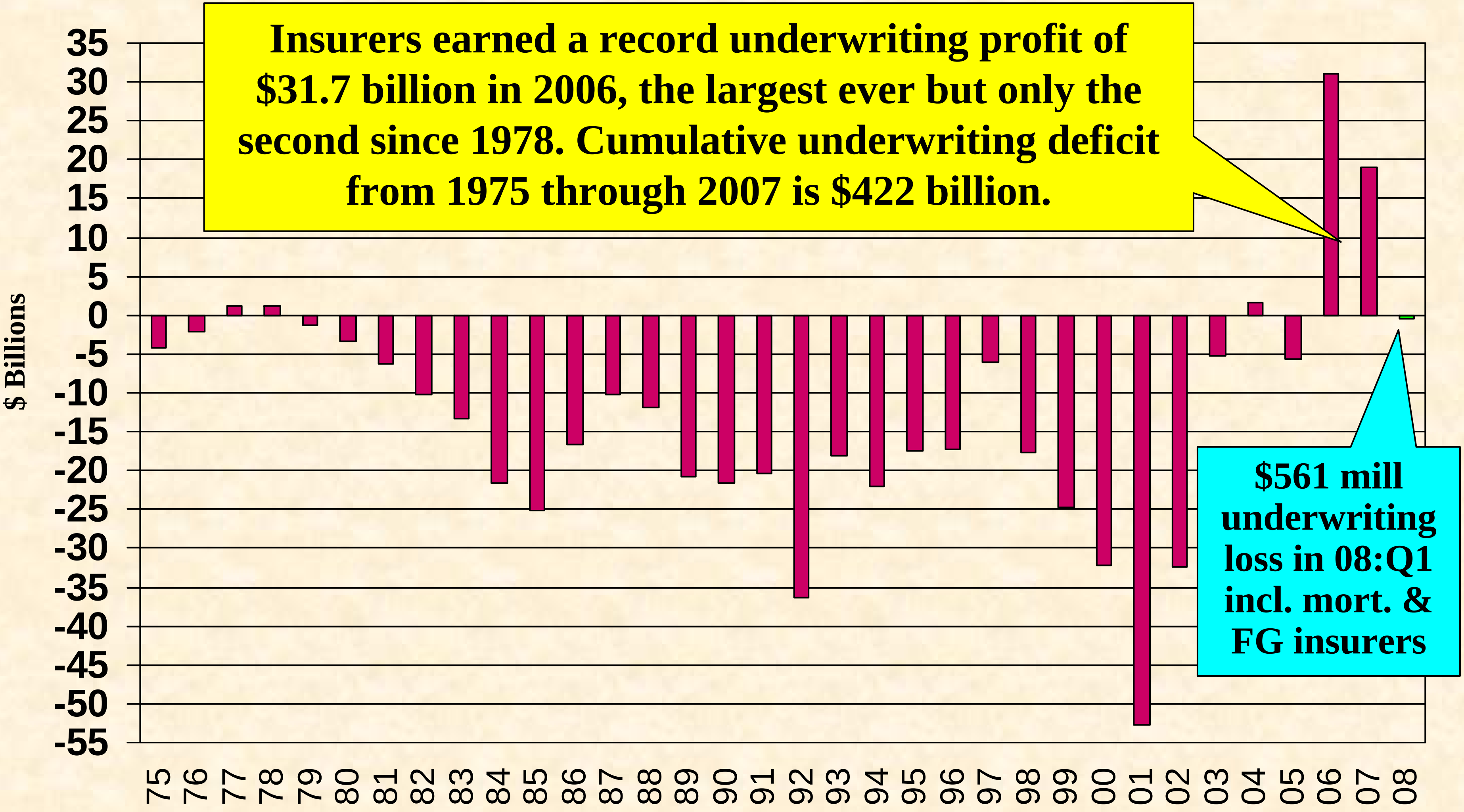
Sources: A.M. Best, ISO; III.

Ten Lowest P/C Insurance Combined Ratios Since 1920 vs. 2007



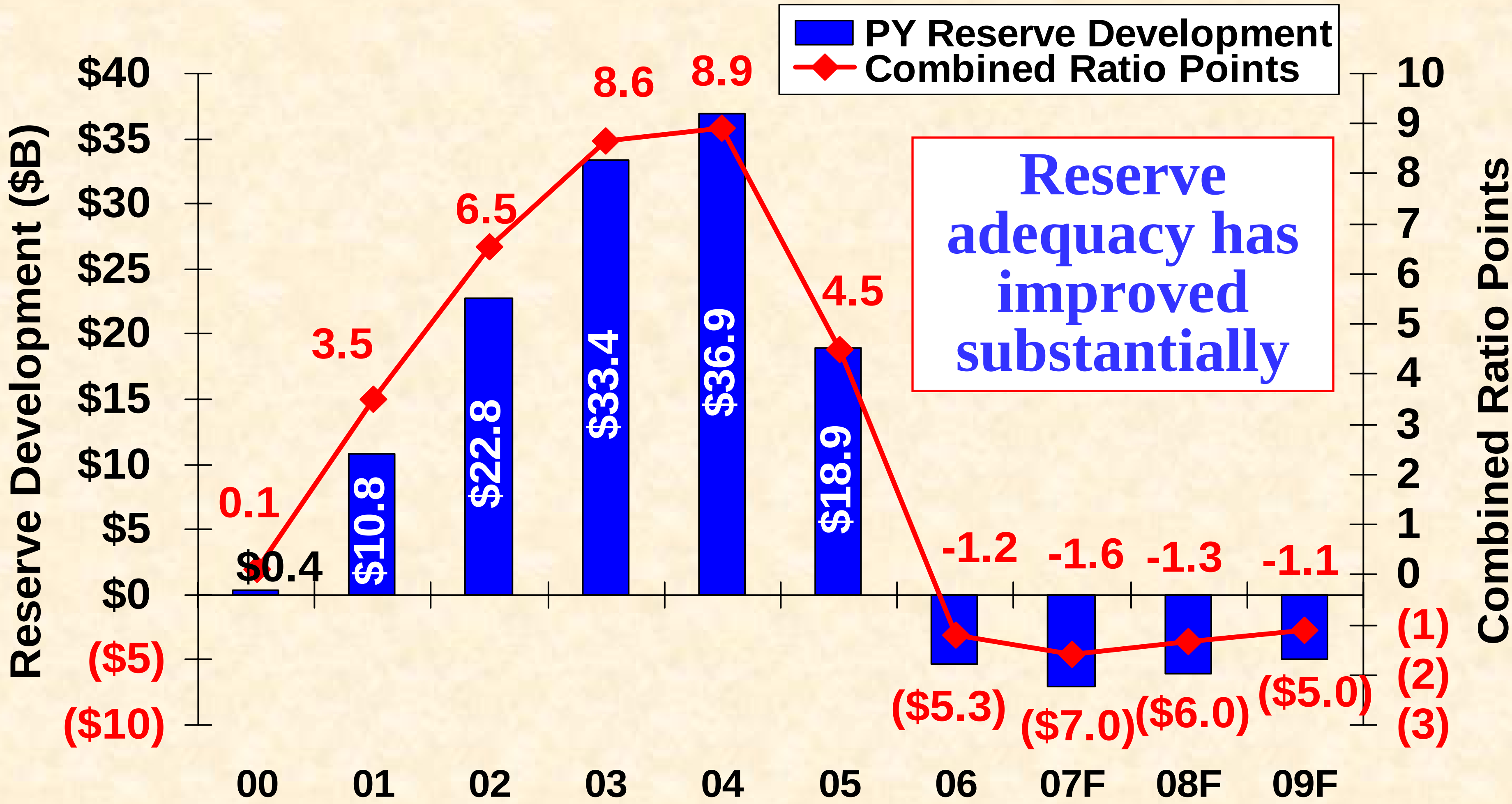
Sources: Insurance Information Institute research from A.M. Best data. *2007: III Earlybird survey.

*Underwriting Gain (Loss) 1975-2008:Q1**



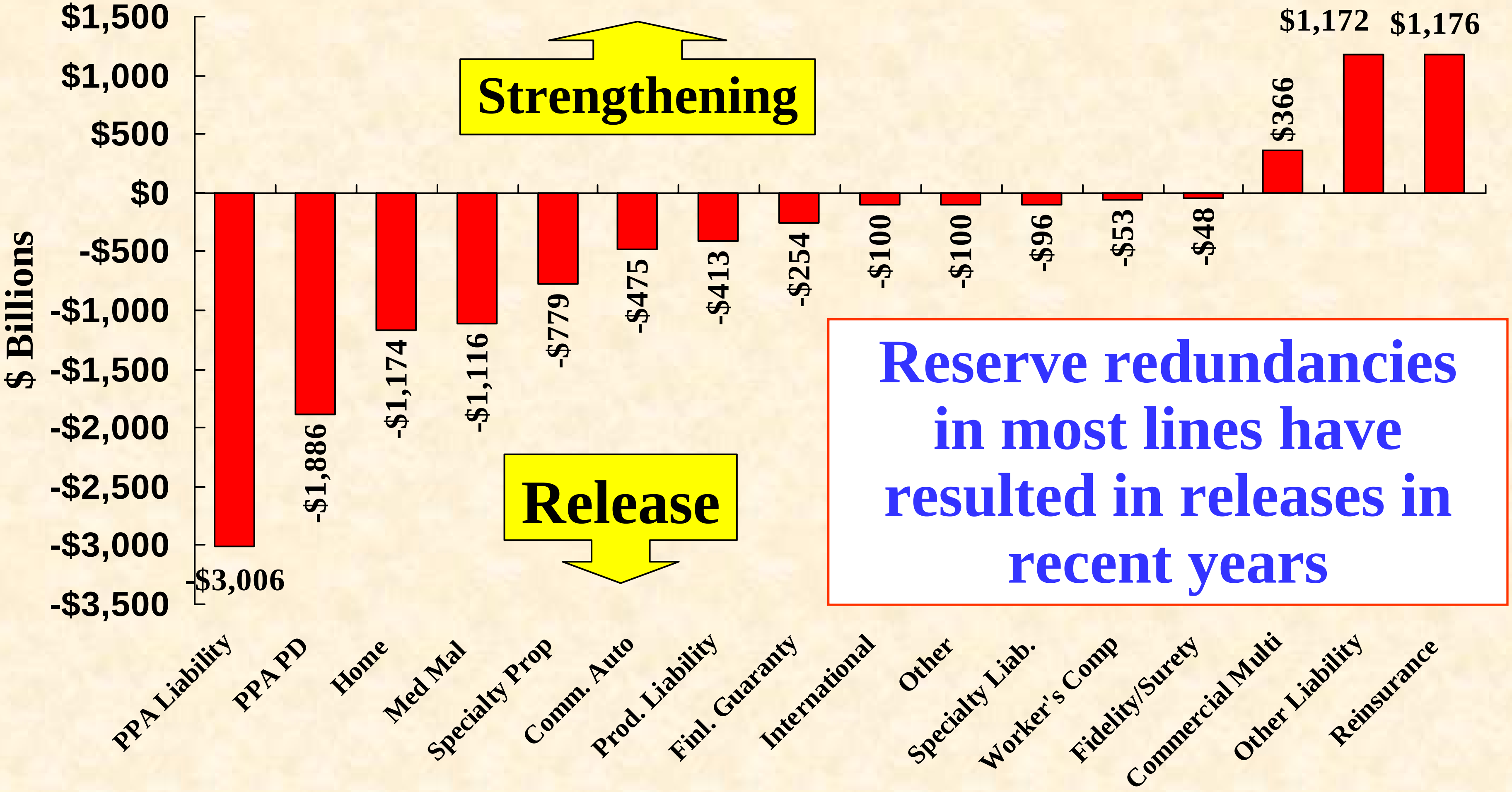
Source: A.M. Best, ISO; Insurance Information Institute * Includes mortgage * finl. guarantee insurers

Impact of Reserve Changes on Combined Ratio



Source: A.M. Best, Lehman Brothers estimates for years 2007-2009

Cumulative Prior Year Reserve Development by Line (As of 12/31/06)



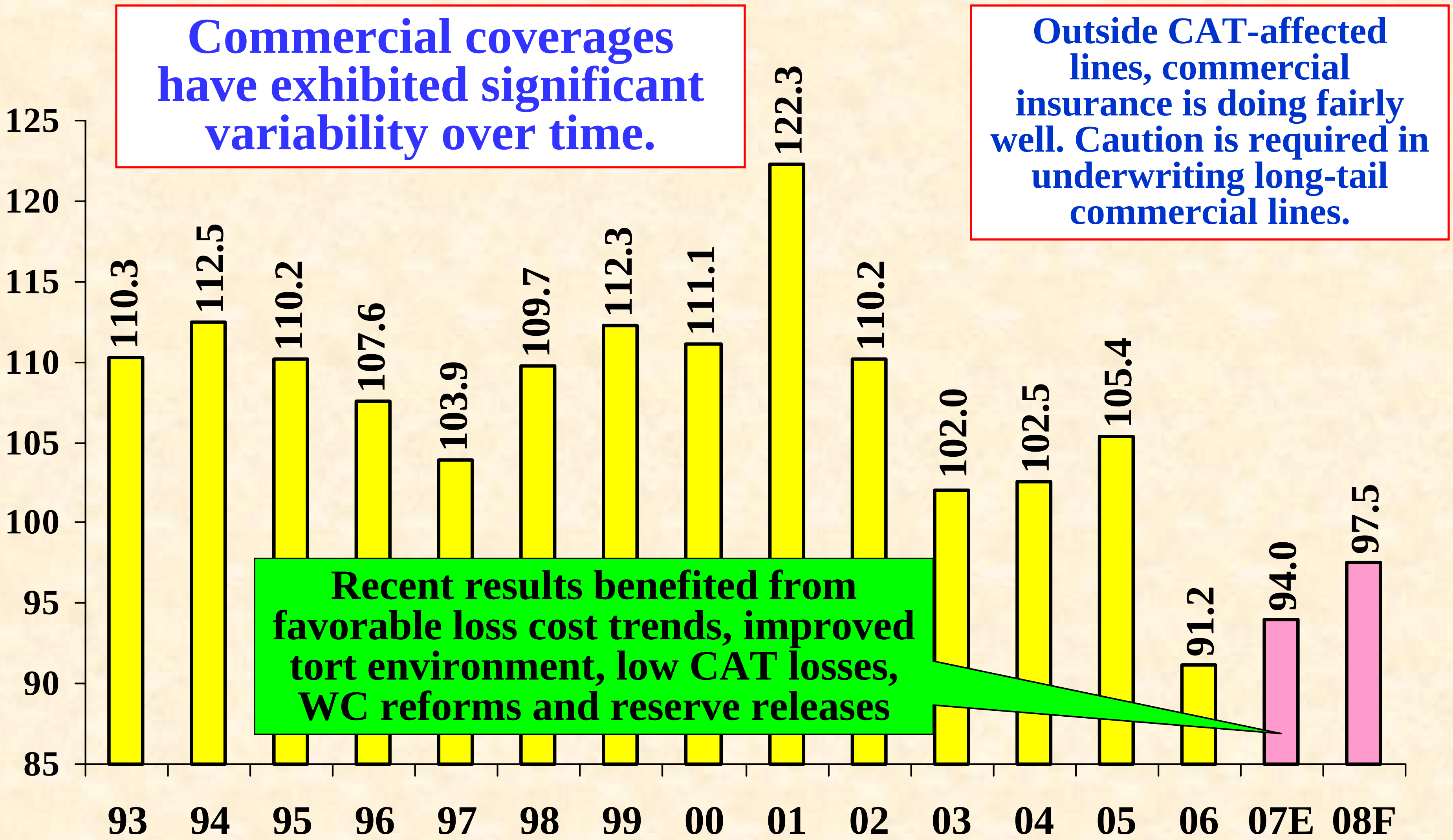
Reserve redundancies in most lines have resulted in releases in recent years

Sources: Lehman Brothers; A.M. Best's *Aggregates & Averages* Schedule P, Part 2.

COMMERCIAL LINES

Commercial Auto
Commercial Multi-Peril
Workers Comp

Commercial Lines Combined Ratio, 1993-2008F

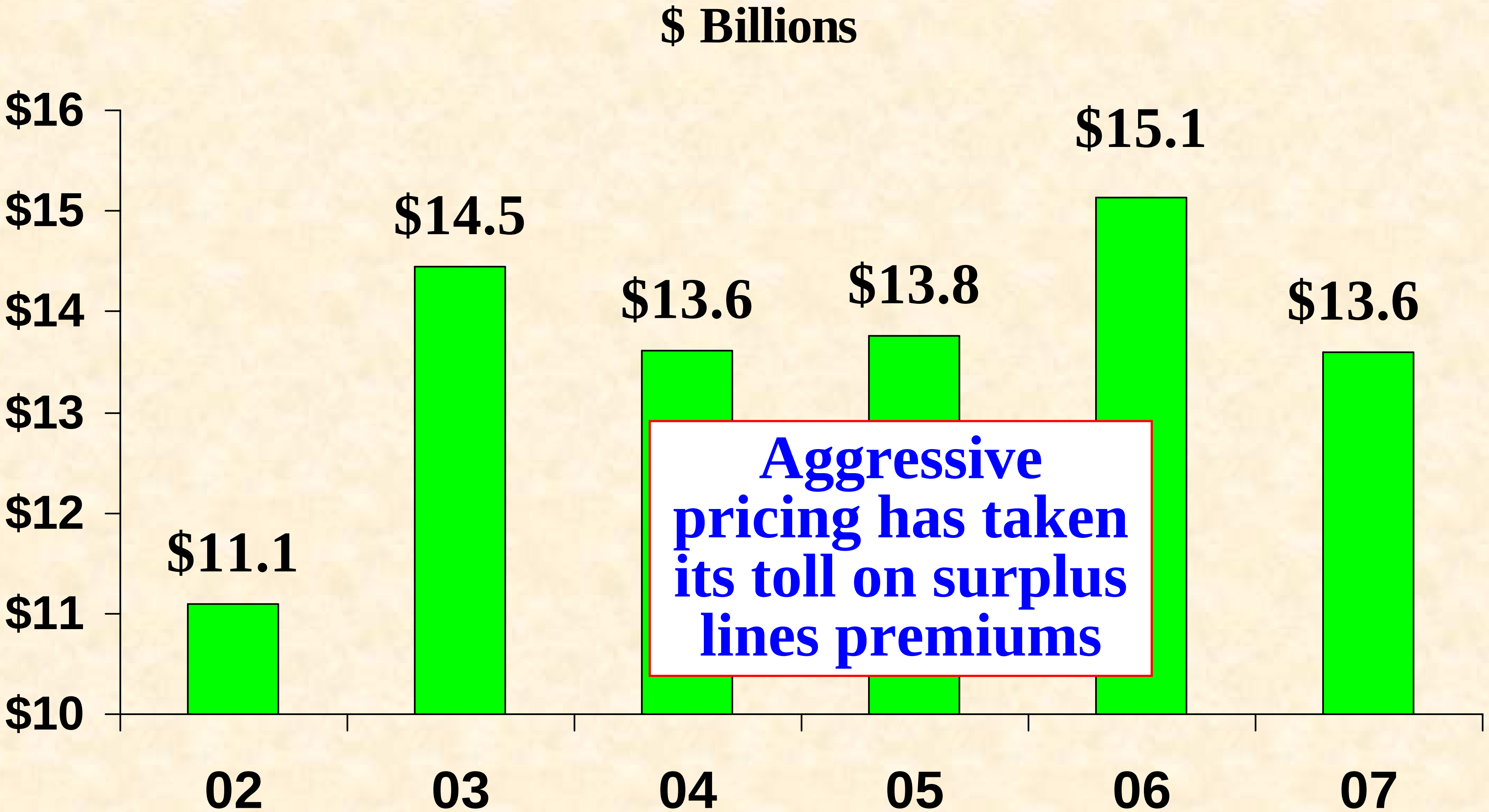


Sources: A.M. Best (historical and forecasts)

EXCESS & SURPLUS LINES

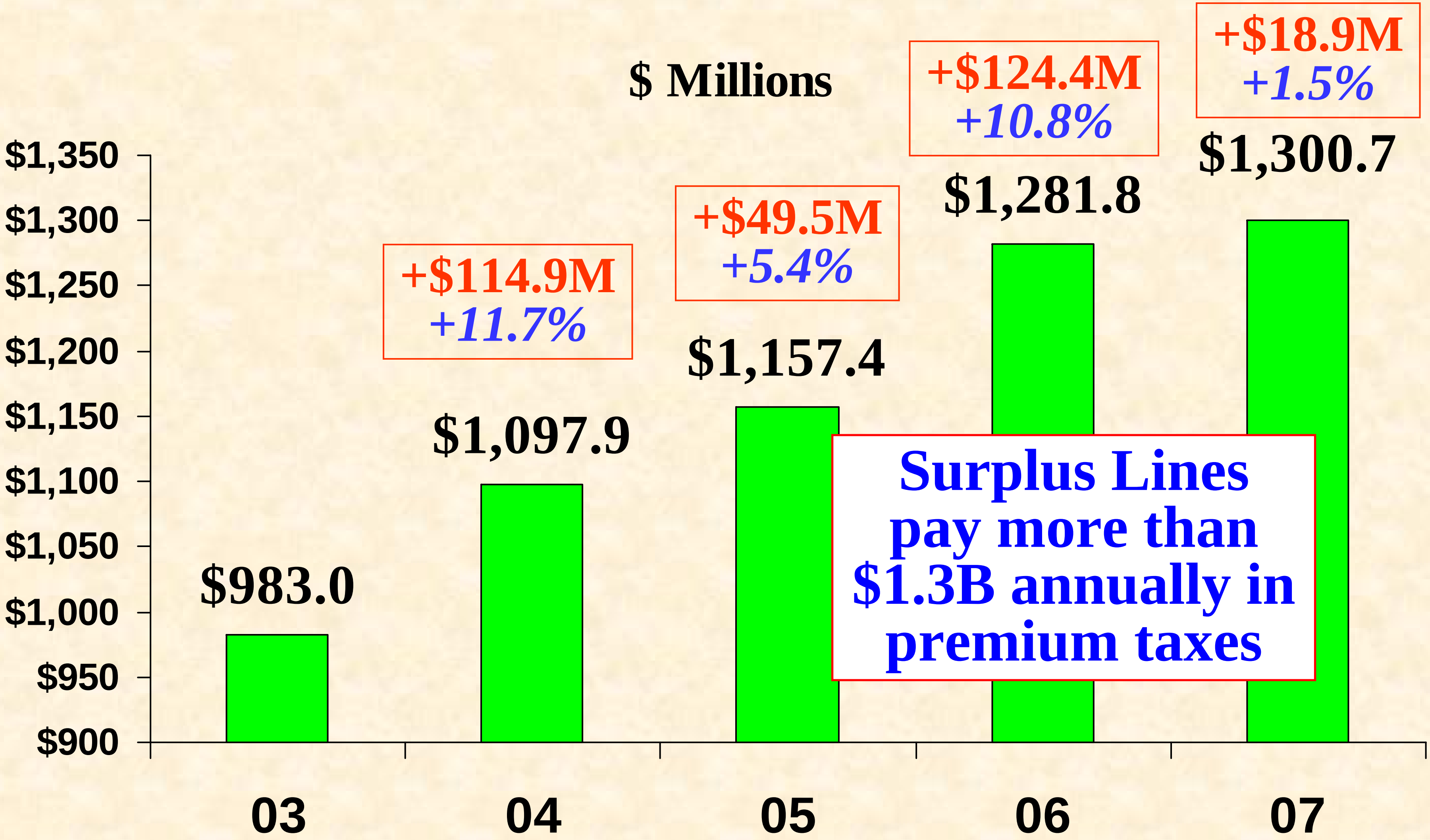
Growth, Performance & Markets

Direct Surplus Lines Premiums Written (Non-Admitted, Top 10 Writers)



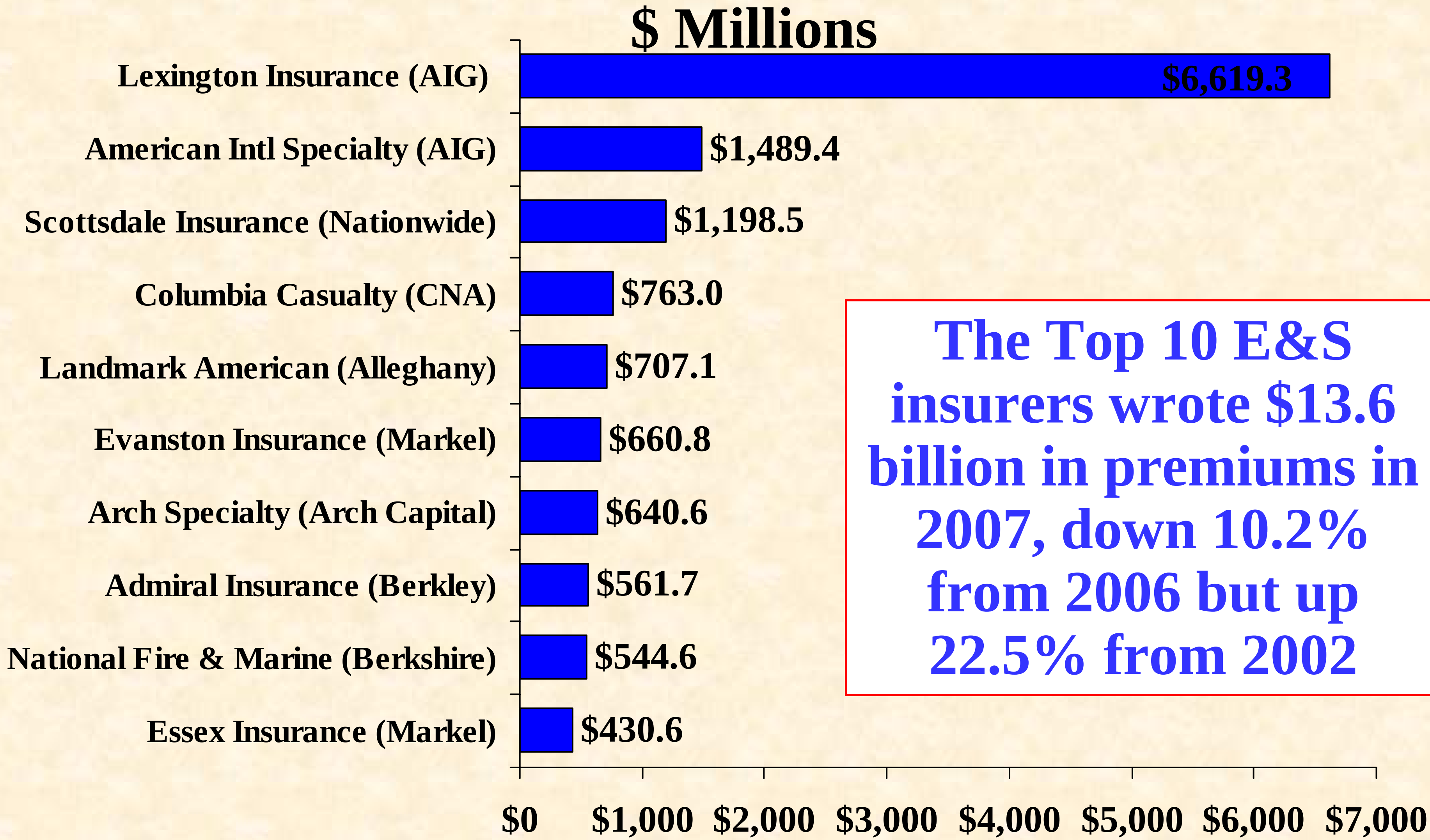
Source: *Business Insurance,* Sept. 8, 2008; Insurance Information Institute.

Surplus Lines Taxes Collected



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

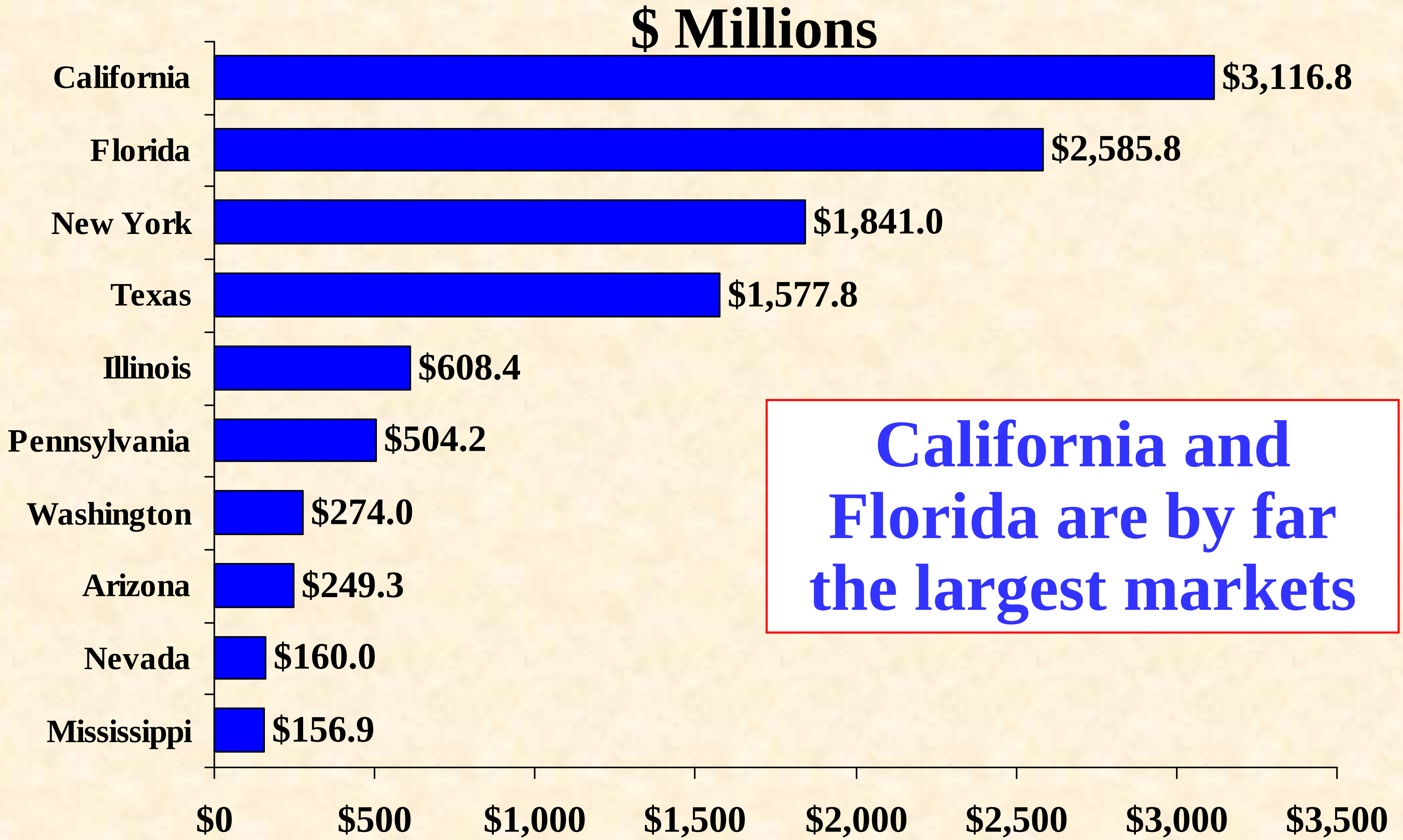
Top 10 E&S Insurers by Non-Admitted 2007 Direct Premiums Written



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

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

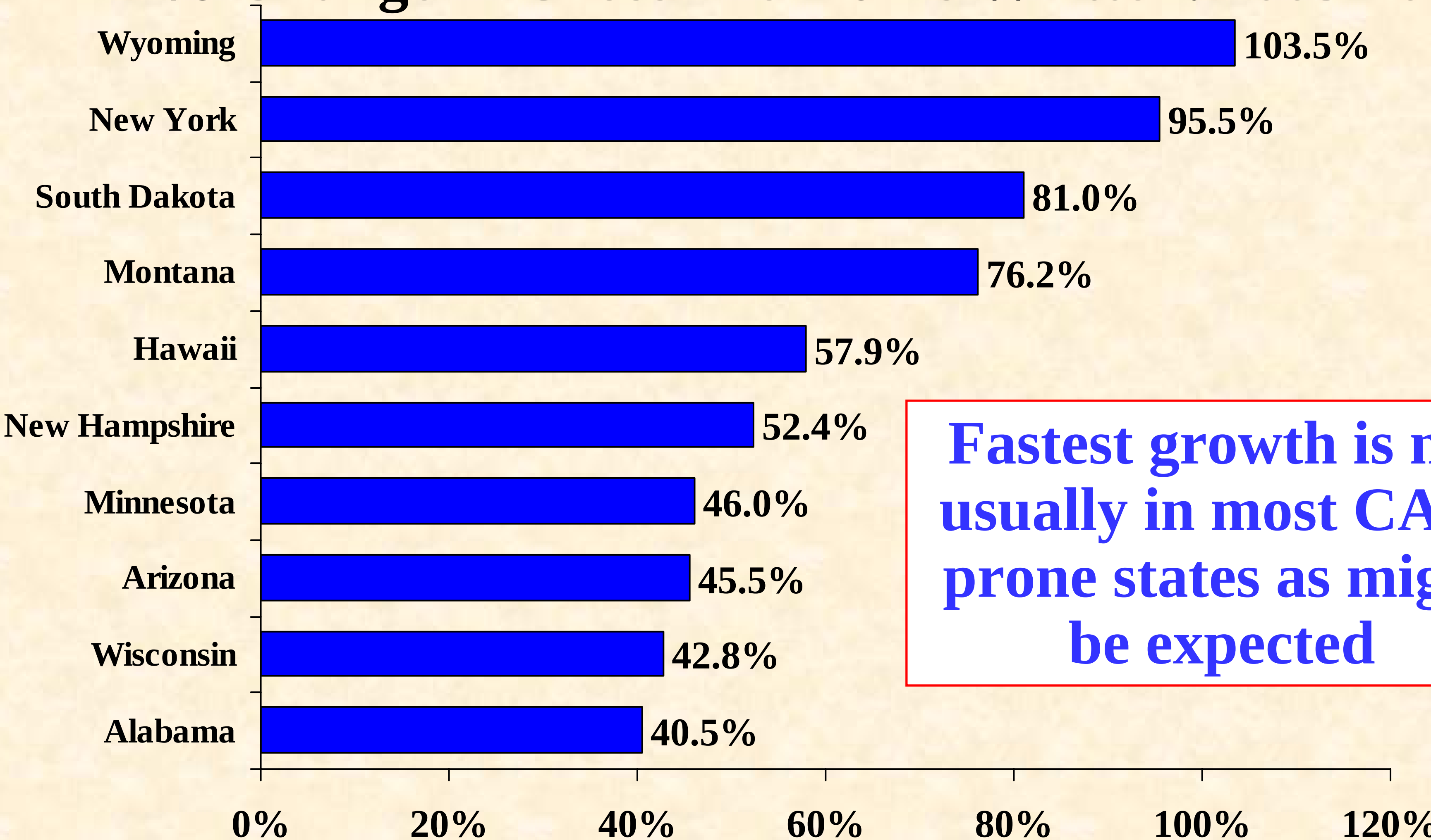
Top 10 E&S Markets, by First Half 2008 Gross Surplus Lines Premiums Written



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

Top 10 States With Fastest Growing E&S Markets, 2003-2005

% Change in Gross Premiums Written: 2003-2005

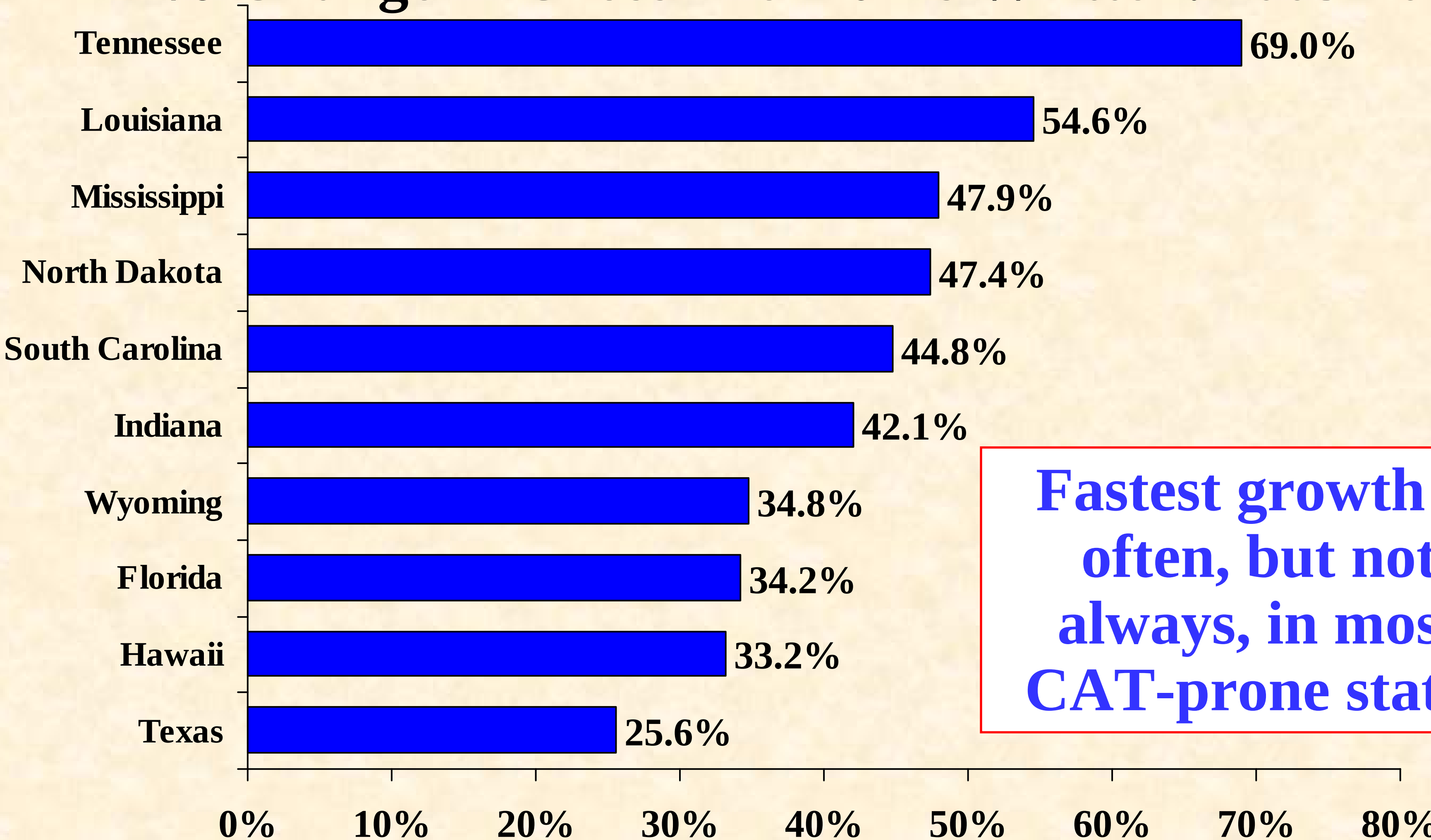


Fastest growth is not usually in most CAT-prone states as might be expected

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

Top 10 States With Fastest Growing E&S Markets, 2005-2007

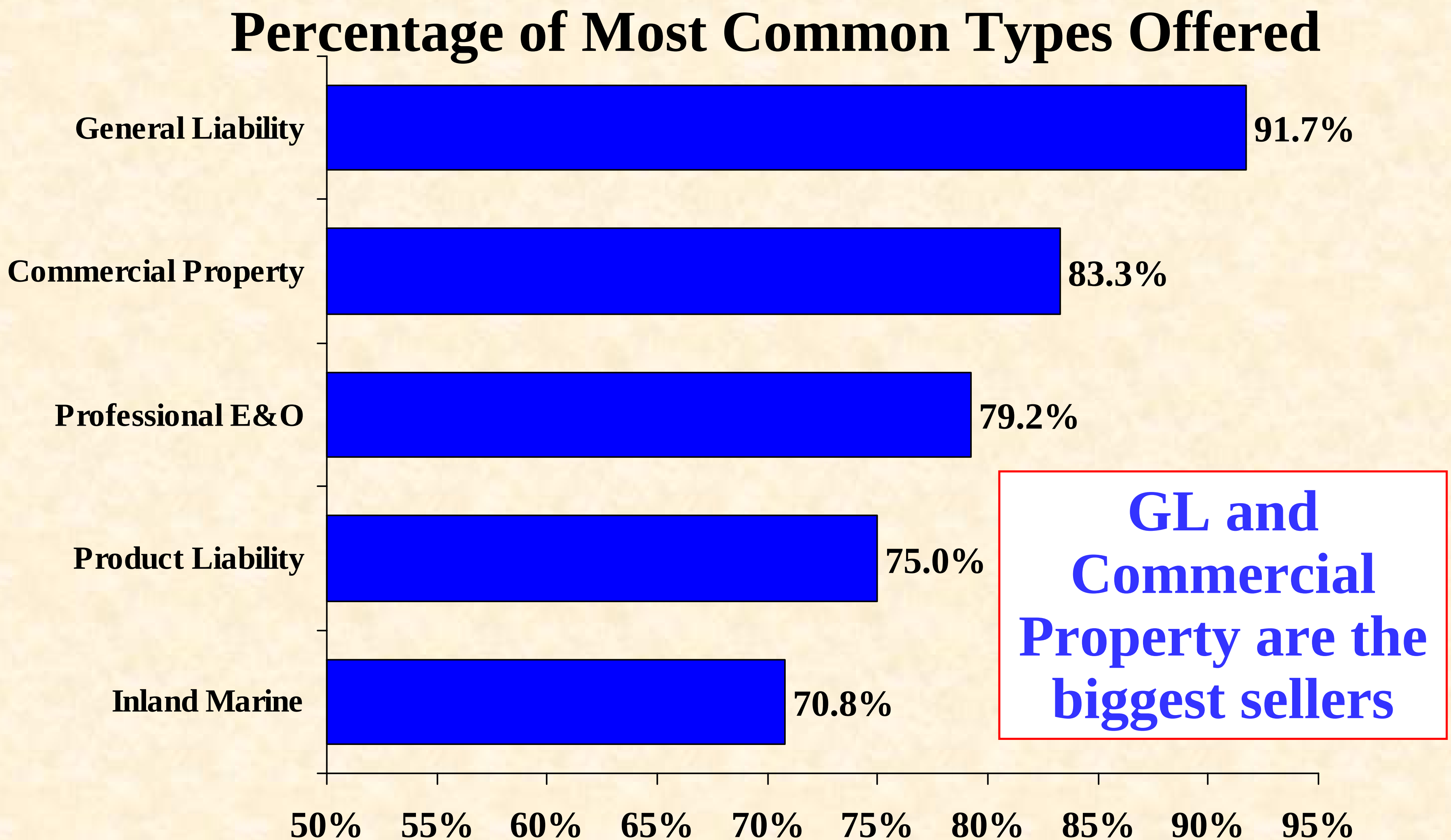
% Change in Gross Premiums Written: 2005-2007



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

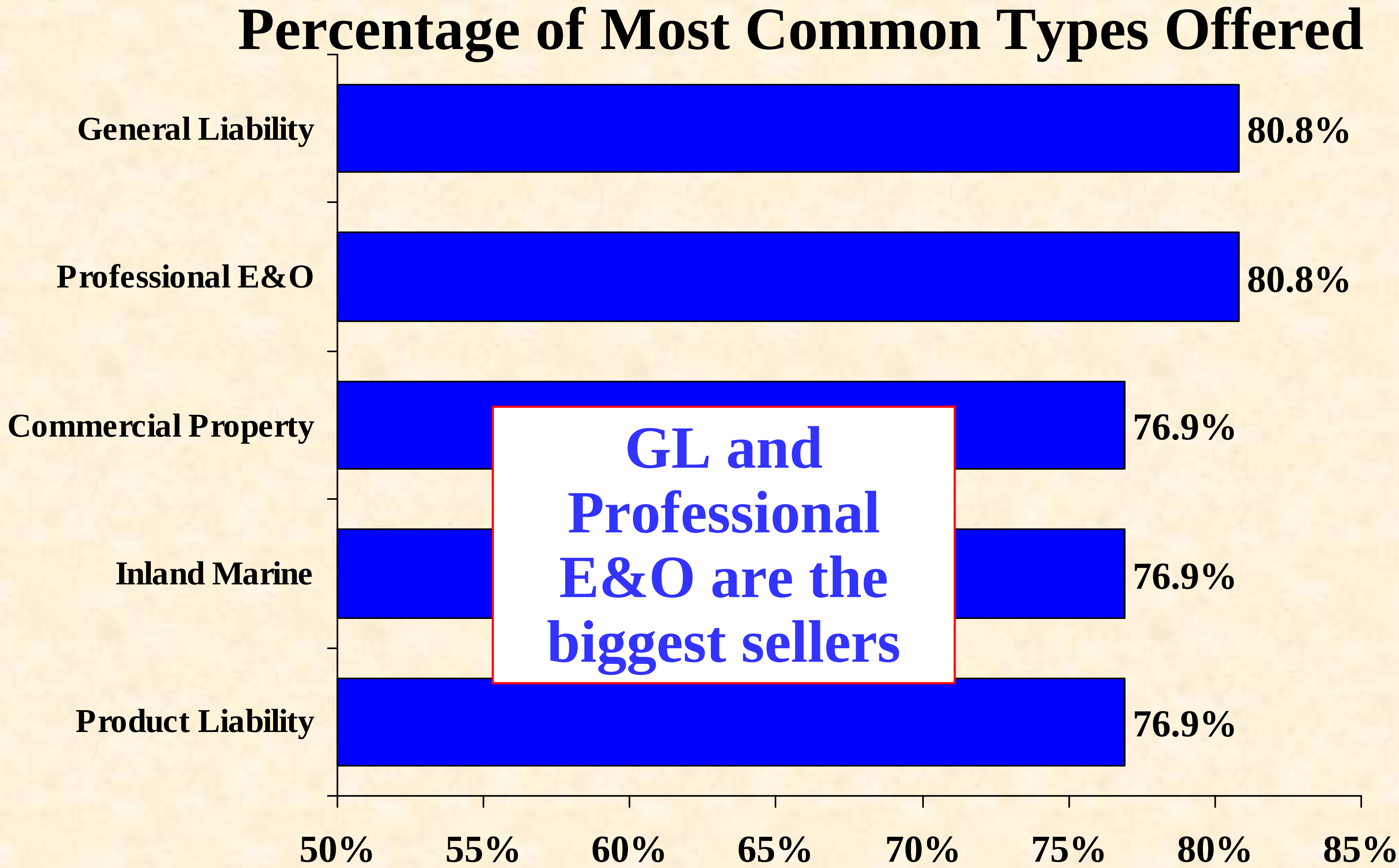
Source: *Business Insurance,* Sept. 8, 2008; Insurance Information Institute.

Most Common Classes of E&S Business Written, 2005



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

Most Common Classes of E&S Business Written, 2007



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

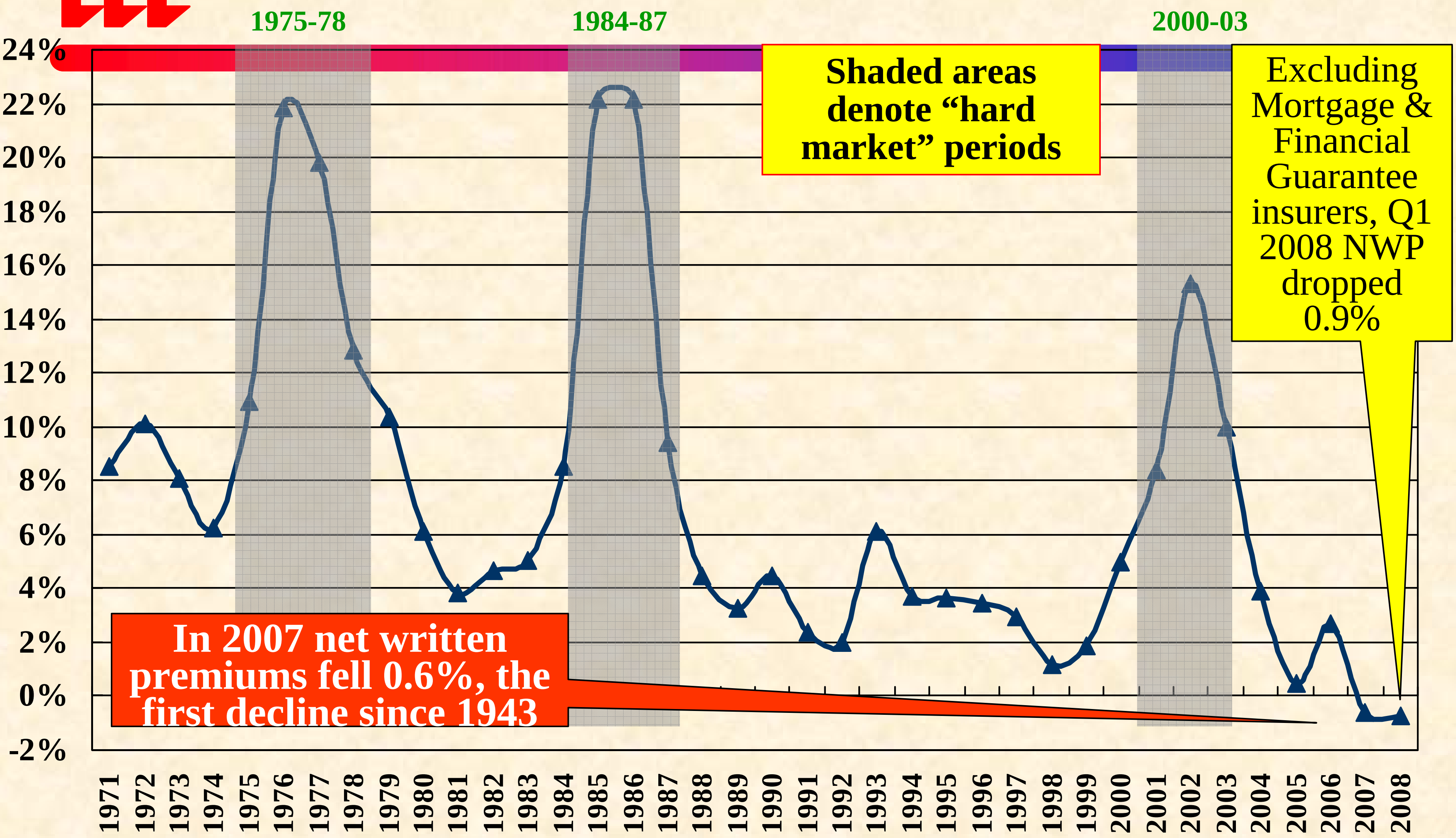
Issue	Issue
Erosion of Tort Reform	Inflation Risk
Bad Faith Litigation	Employment Practices Liability
Post-Catastrophe Litigation	Energy Sector
Climate Change (liability>property)	Nursing Home/Asst. Living
Products Liability (Imports, Food)	Currency Risk
Regulatory Risk	Economic Shock/Contagion Effects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

Source: Insurance Information Institute

PREMIUM GROWTH

At a Virtual Standstill in 2007/08

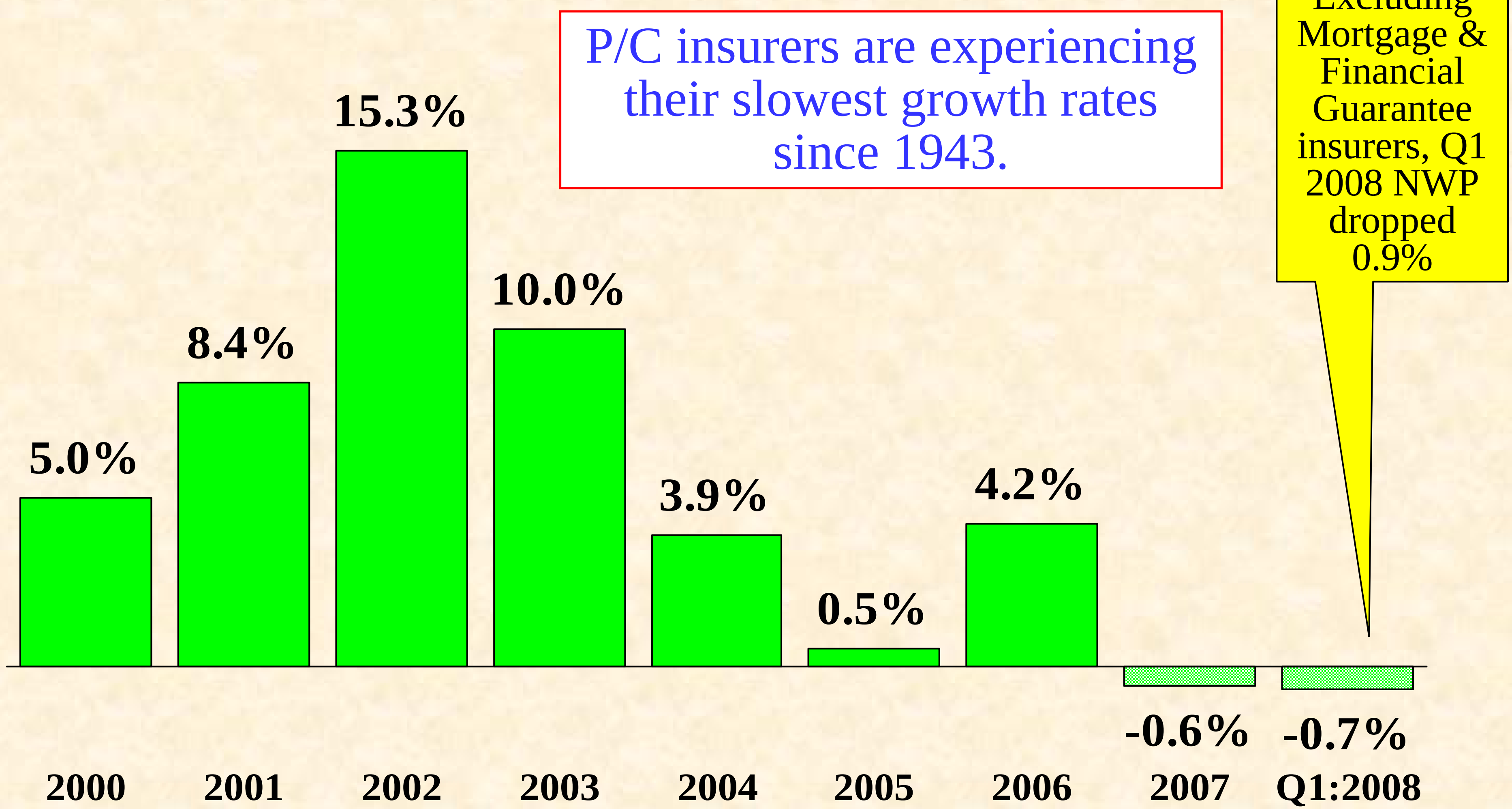
Strength of Recent Hard Markets by NWP Growth



2008 is Q1 actual (-0.7%), including Mortgage & Financial Guarantee insurers

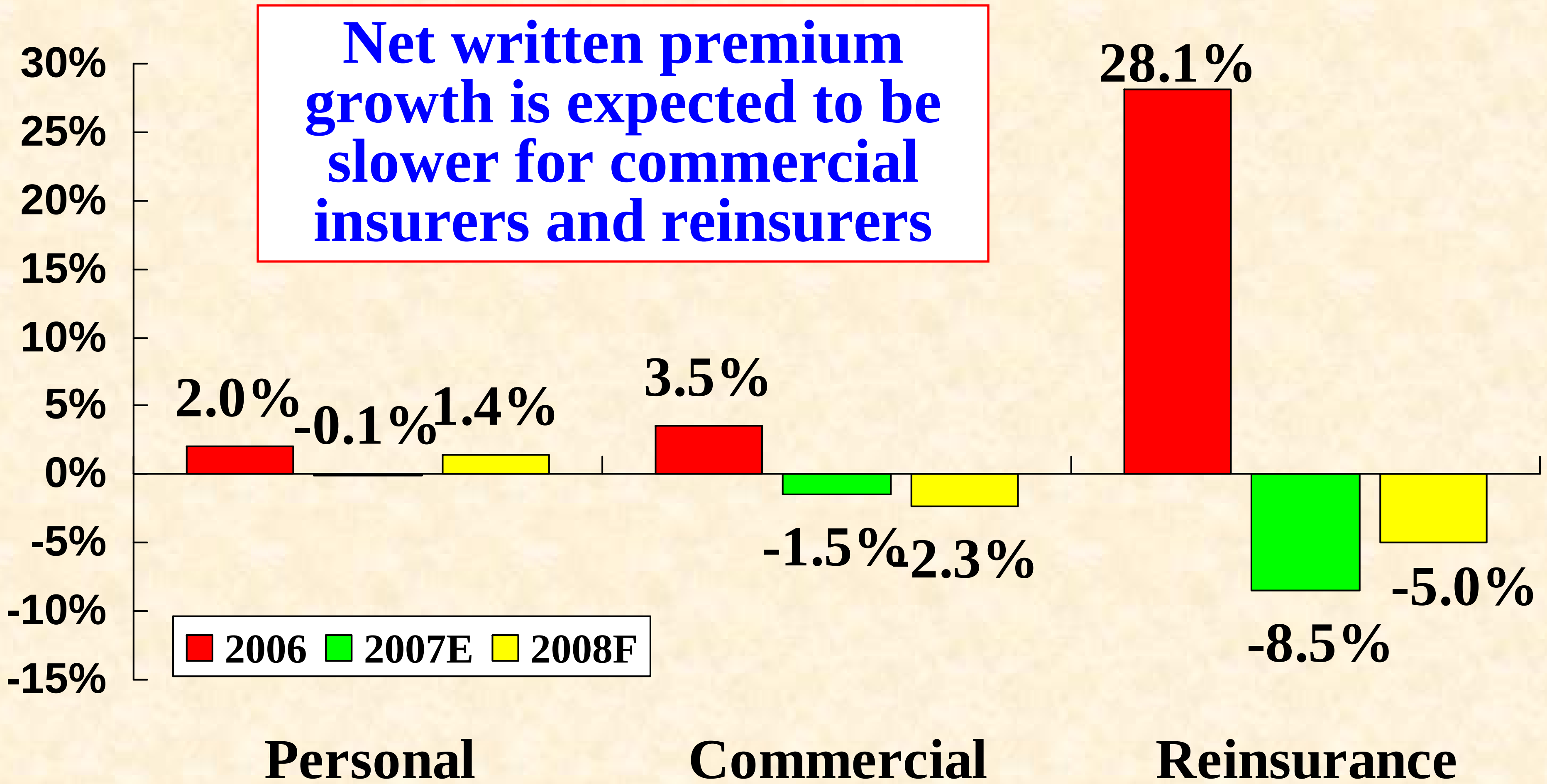
Sources: A.M. Best, ISO, Insurance Information Institute

Year-to-Year Change in Net Written Premium, 2000-Q1:2008



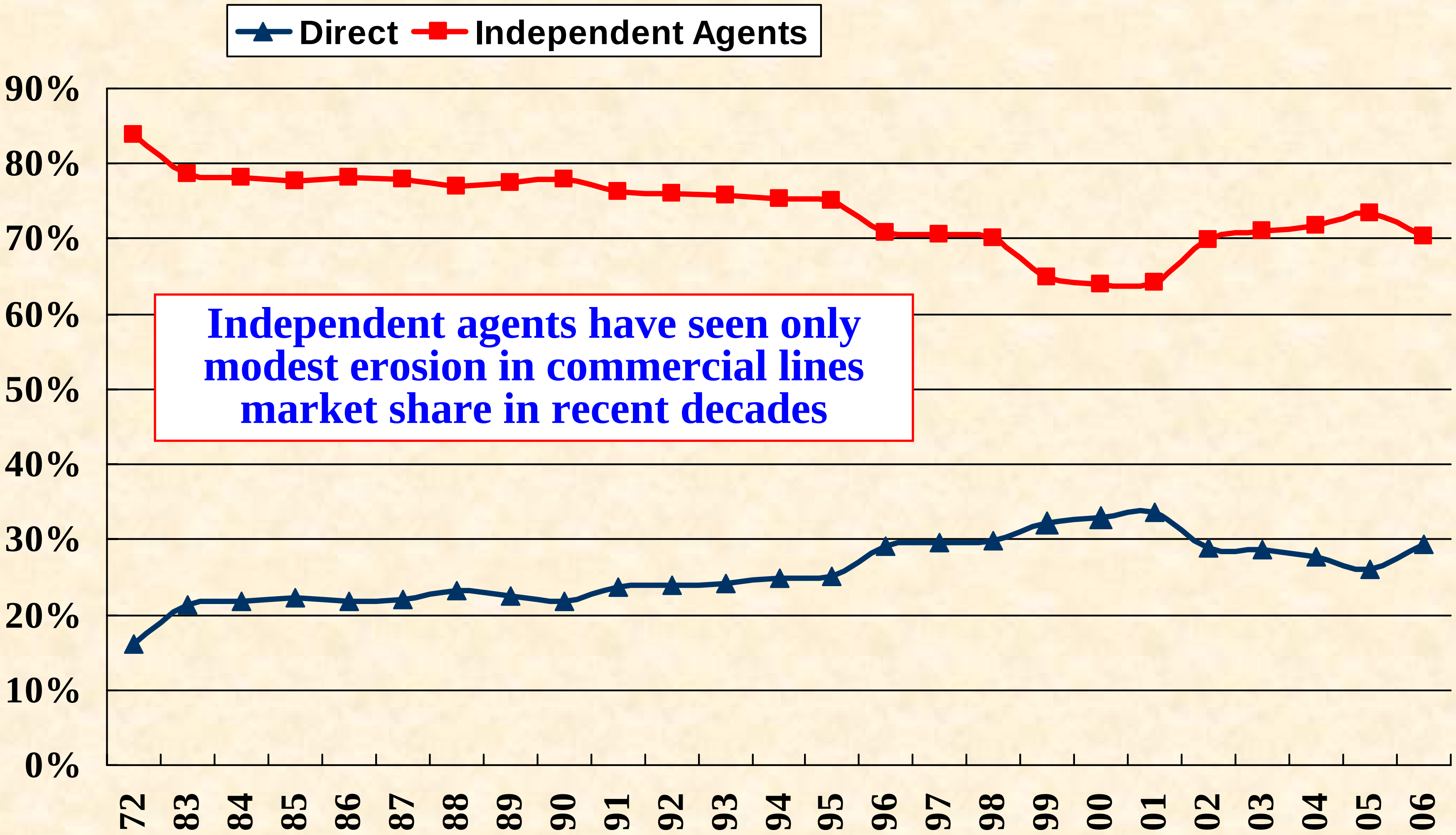
Source: A.M. Best; ISO.

Personal/Commercial Lines & Reinsurance NPW Growth, 2006-2008F



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

Commercial P/C Distribution Channels, Direct vs. Independent Agents

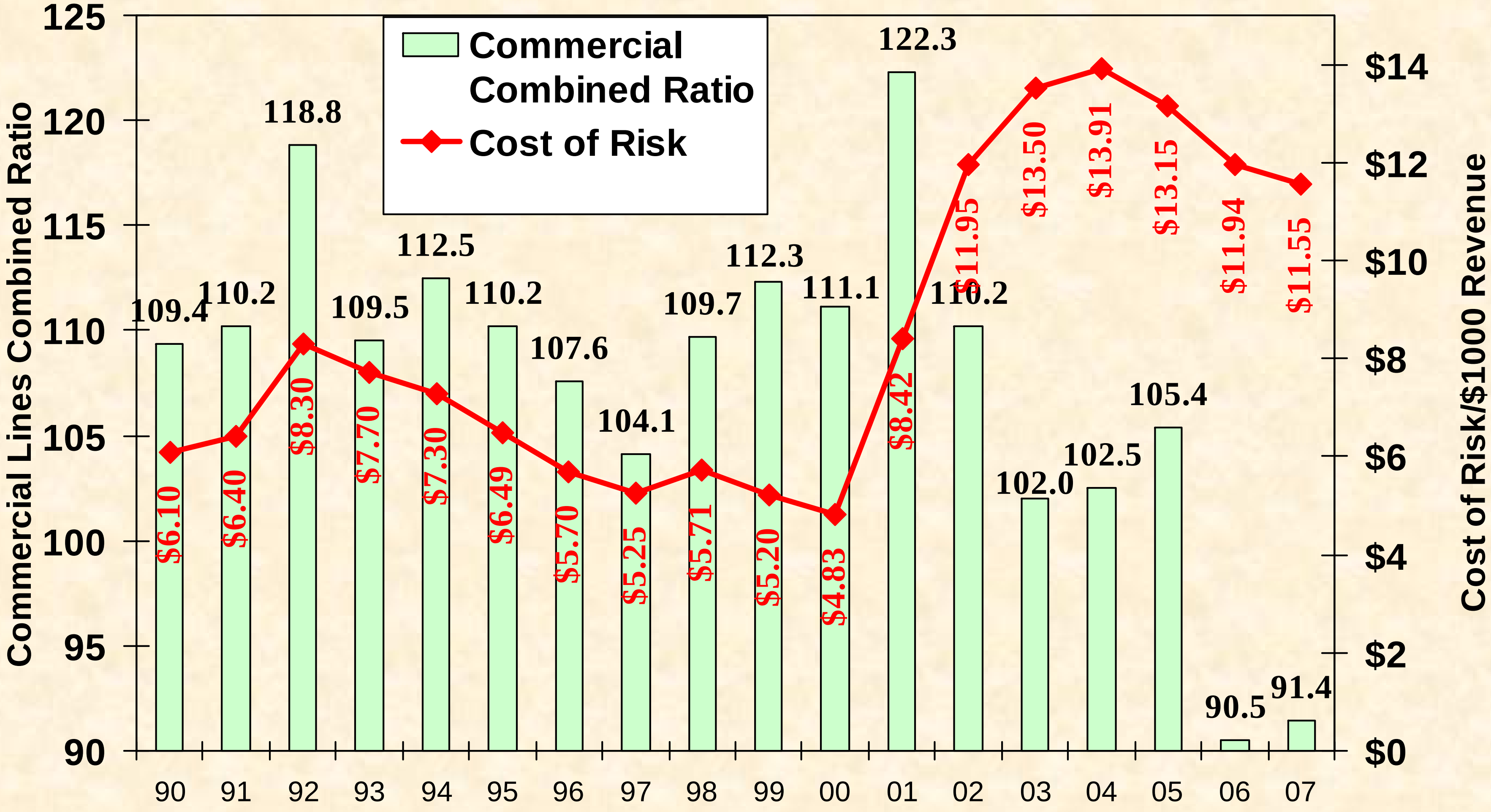


Source: Insurance Information Institute; based on data from Conning and A.M. Best.

PRICING TRENDS

Under Pressure

Cost of Risk vs. Commercial Lines Combined Ratio

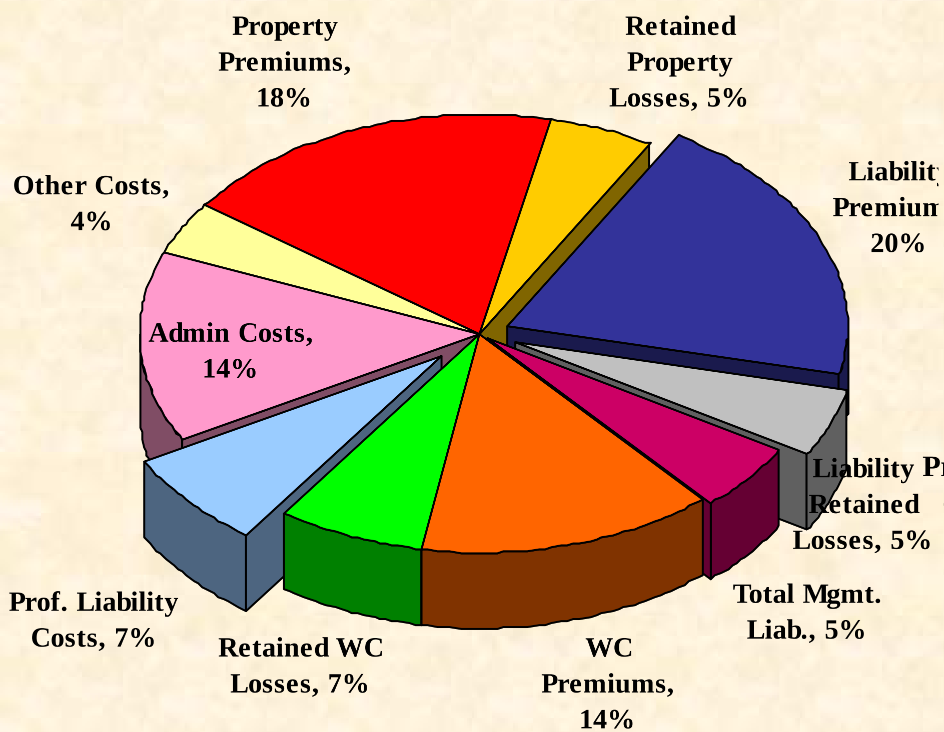


Source: RIMS Benchmark Survey, A.M. Best 2007 Aggregates & Averages; Insurance Information Institute

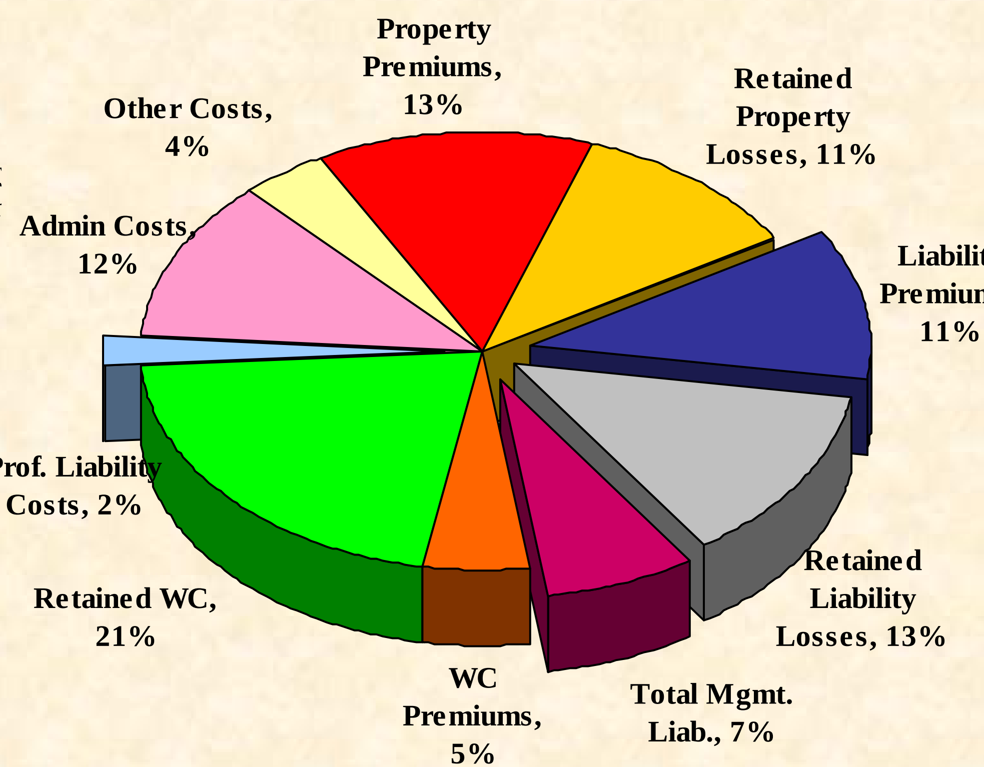
How the Risk Dollar is Spent (2006)

Total liability costs account for 35% - 40% of the risk dollar

Firms w/Revenues < $1 Billion

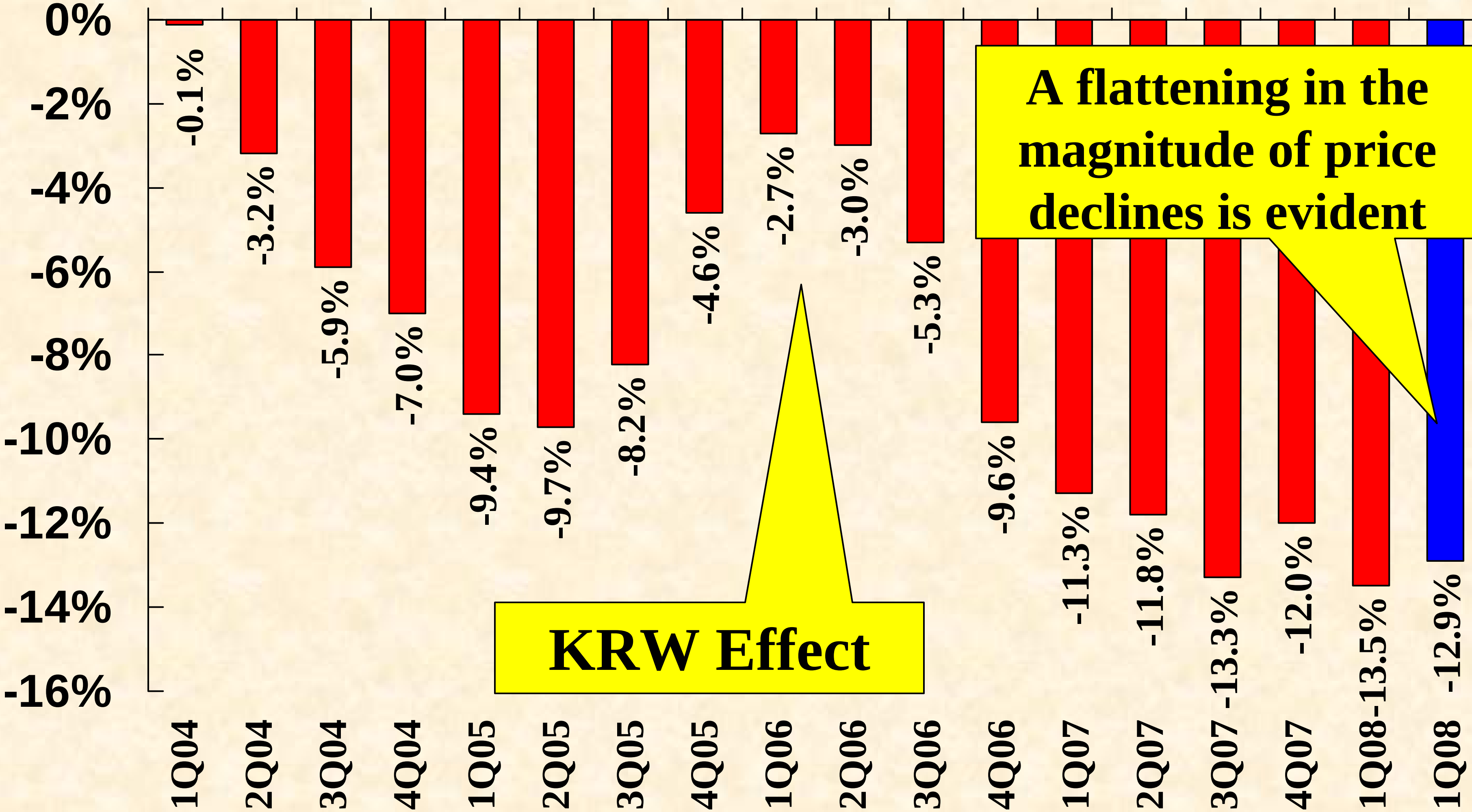


Firms w/Revenues > $1 Billion



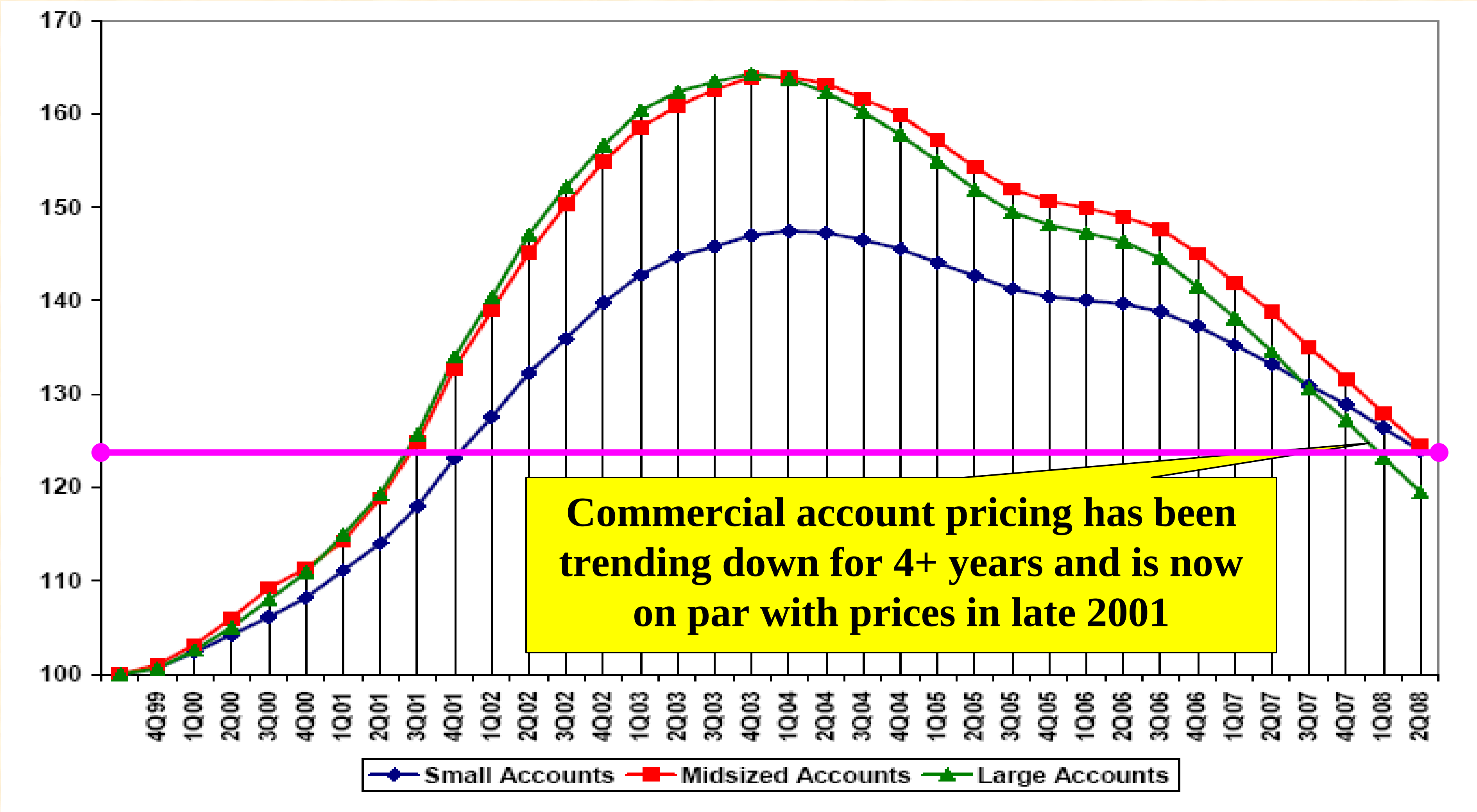
Source: RIMS (2007); Insurance Information Institute

Average Commercial Rate Change, All Lines, (1Q:2004 – 2Q:2008)



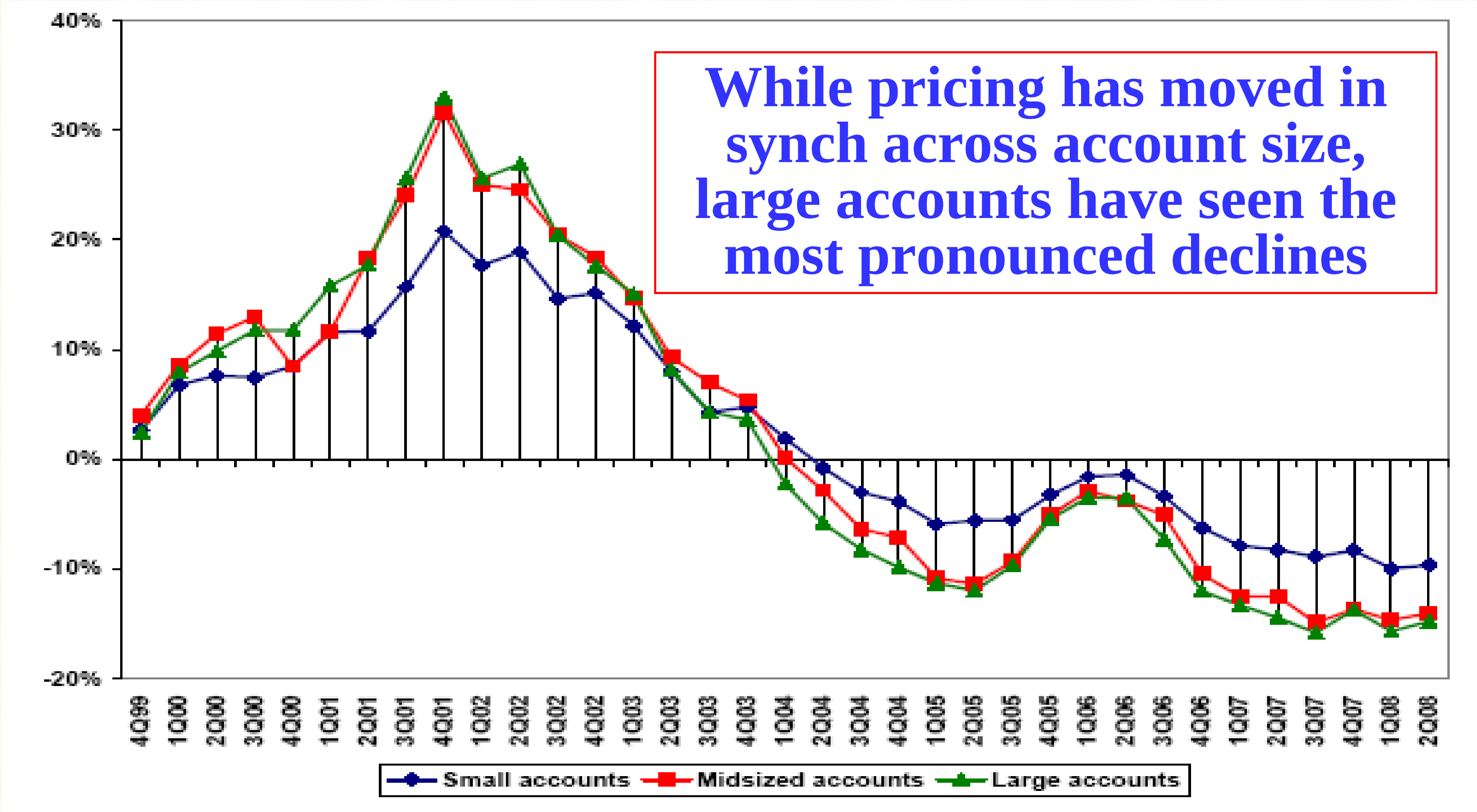
Source: Council of Insurance Agents & Brokers; Insurance Information Institute

Cumulative Commercial Rate Change by Line: 4Q99 – 2Q08



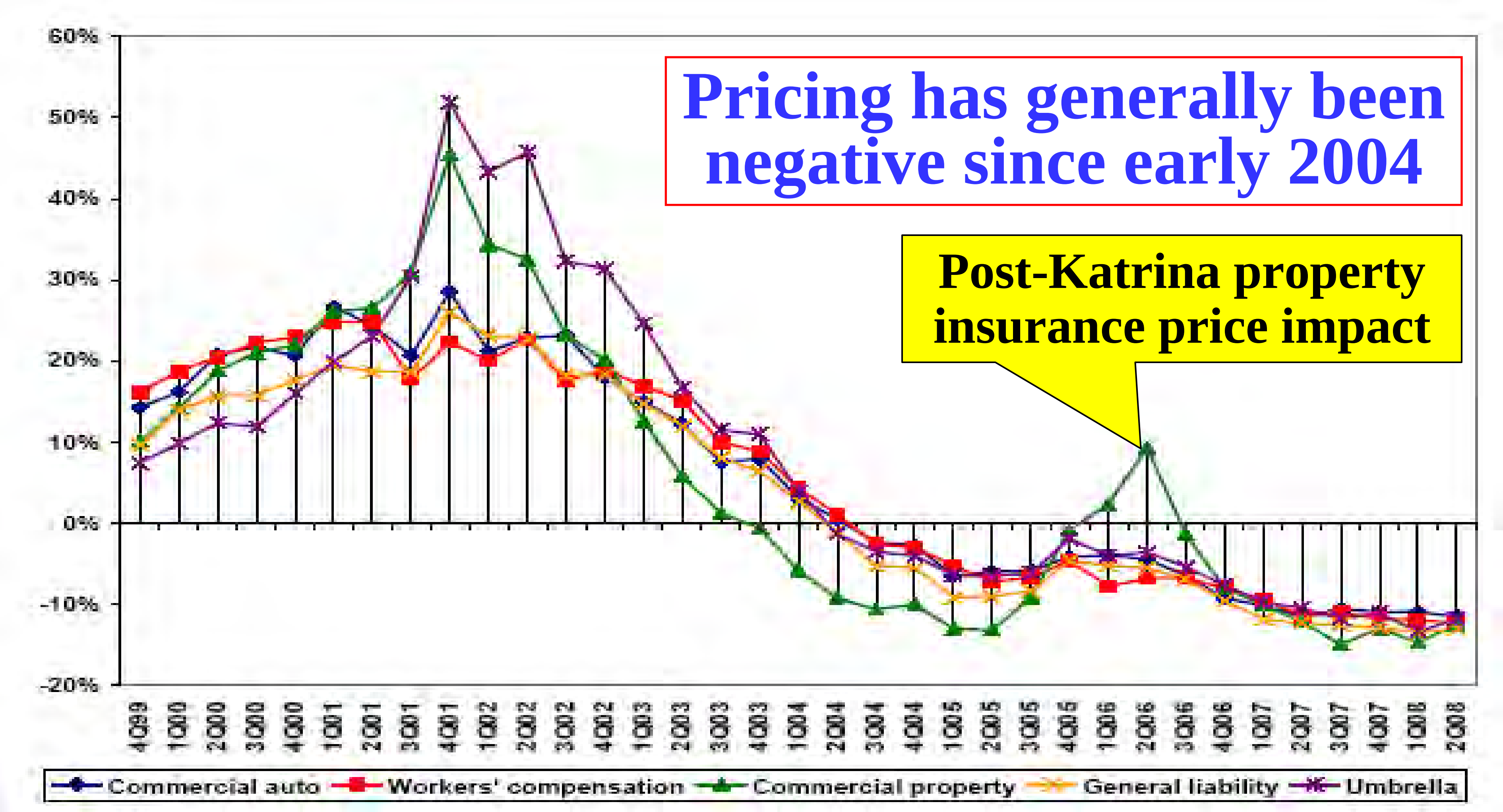
Source: Council of Insurance Agents & Brokers

Average Commercial Rate Change by Account Size: 4Q99 – 2Q08



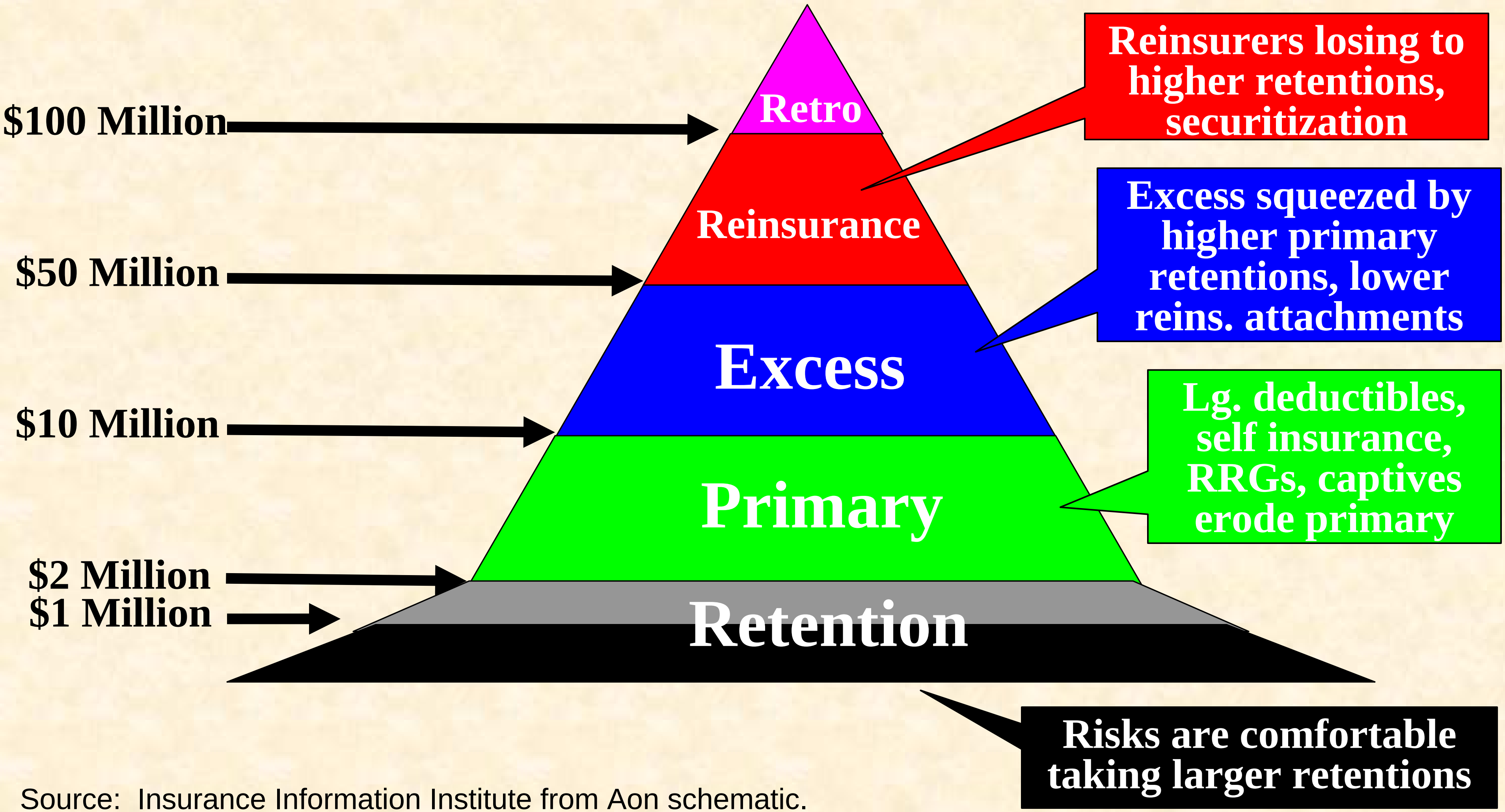
Source: Council of Insurance Agents & Brokers

Average Commercial Rate Change by Line: 4Q99 – 2Q08



Source: Council of Insurance Agents & Brokers

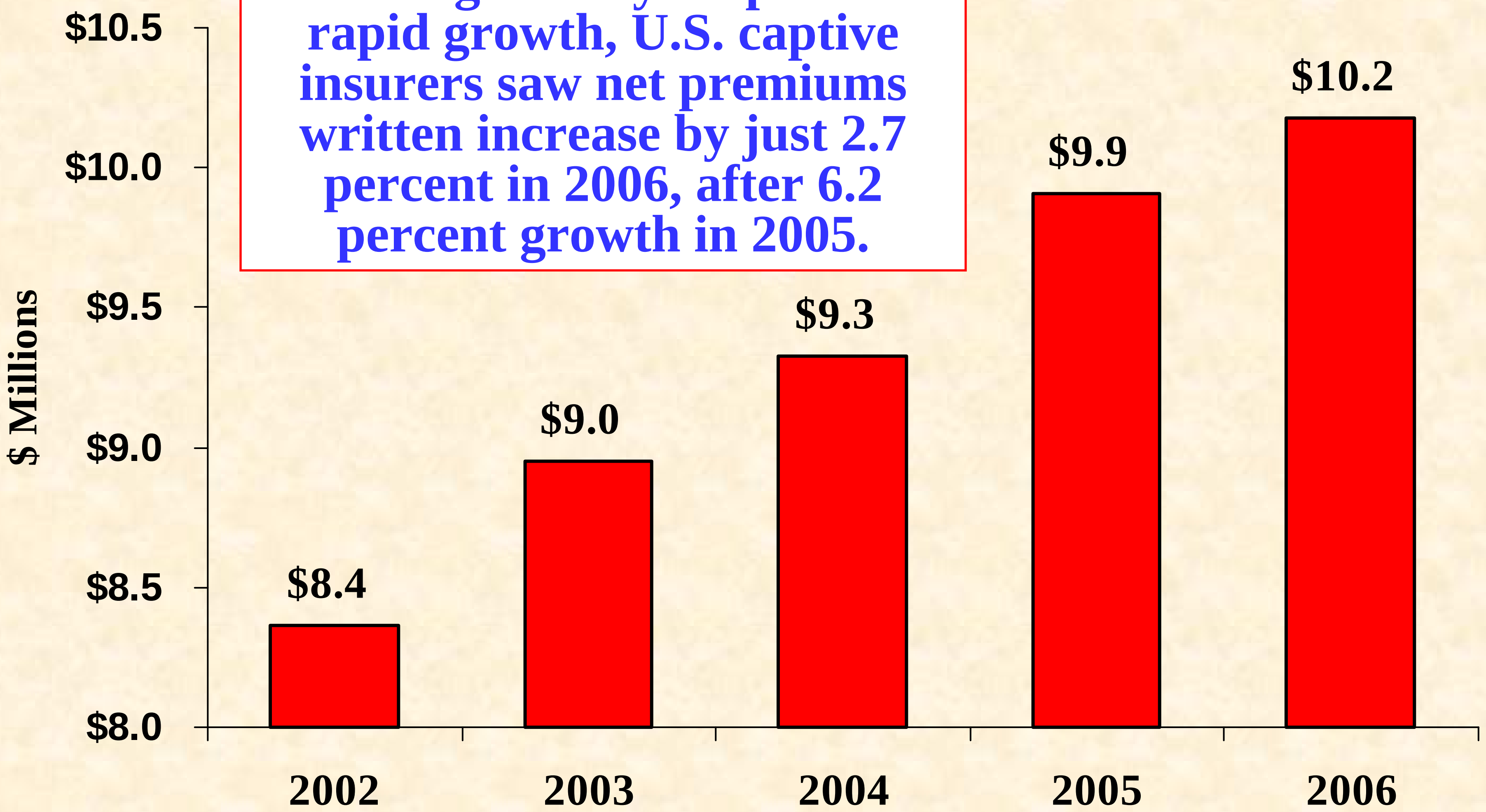
Most Layers of Coverage are Being Challenged/Leaking



Source: Insurance Information Institute from Aon schematic.

U.S. Domiciled Captives- Net Premiums Written ($ Millions)

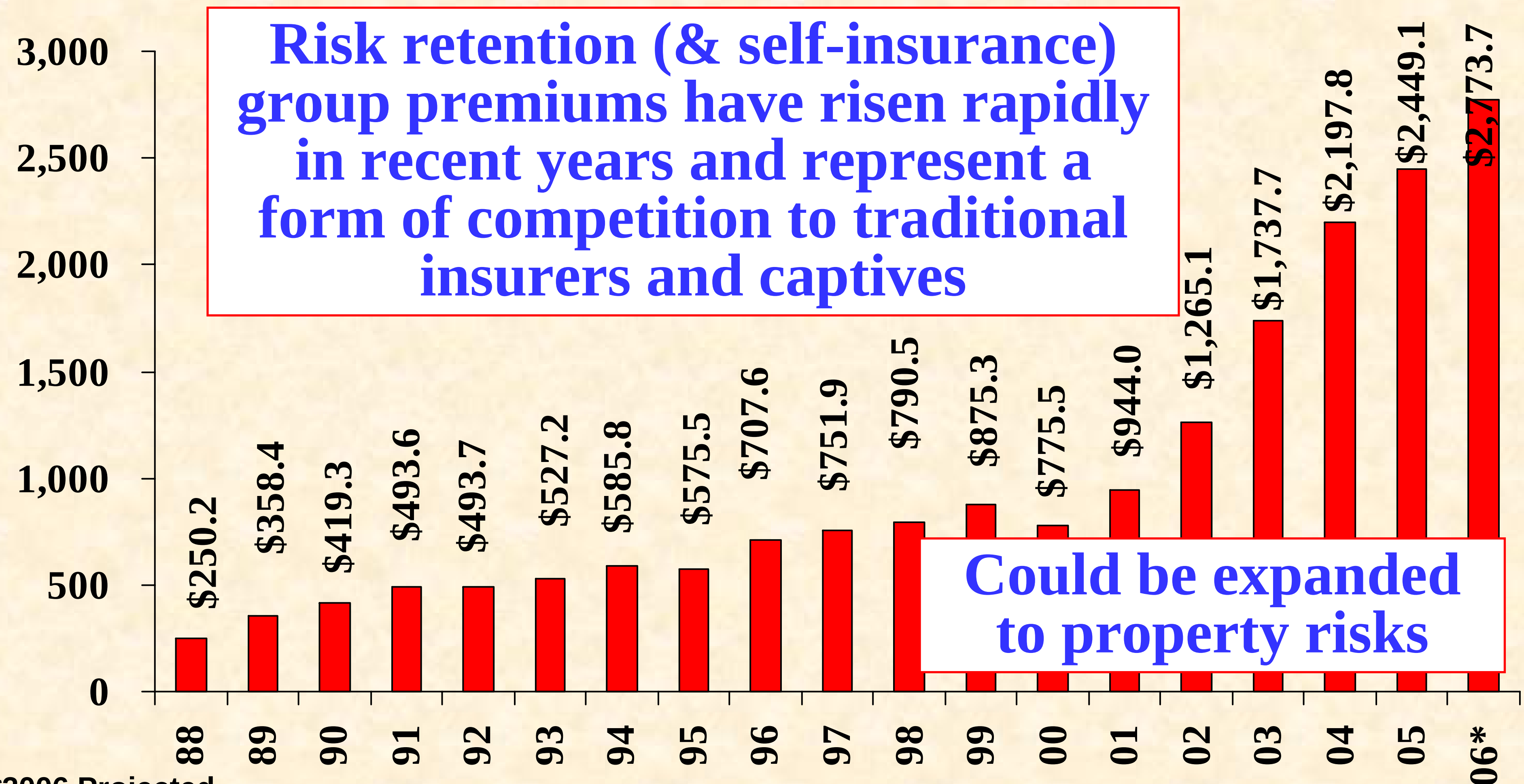
Following a five-year period of rapid growth, U.S. captive insurers saw net premiums written increase by just 2.7 percent in 2006, after 6.2 percent growth in 2005.



Source: A.M. Best, 2007 Special Report: U.S. Captive Insurers – 2006 Market Review

*Risk Retention Group Premiums, 1988 – 2006**

Millions of Dollars



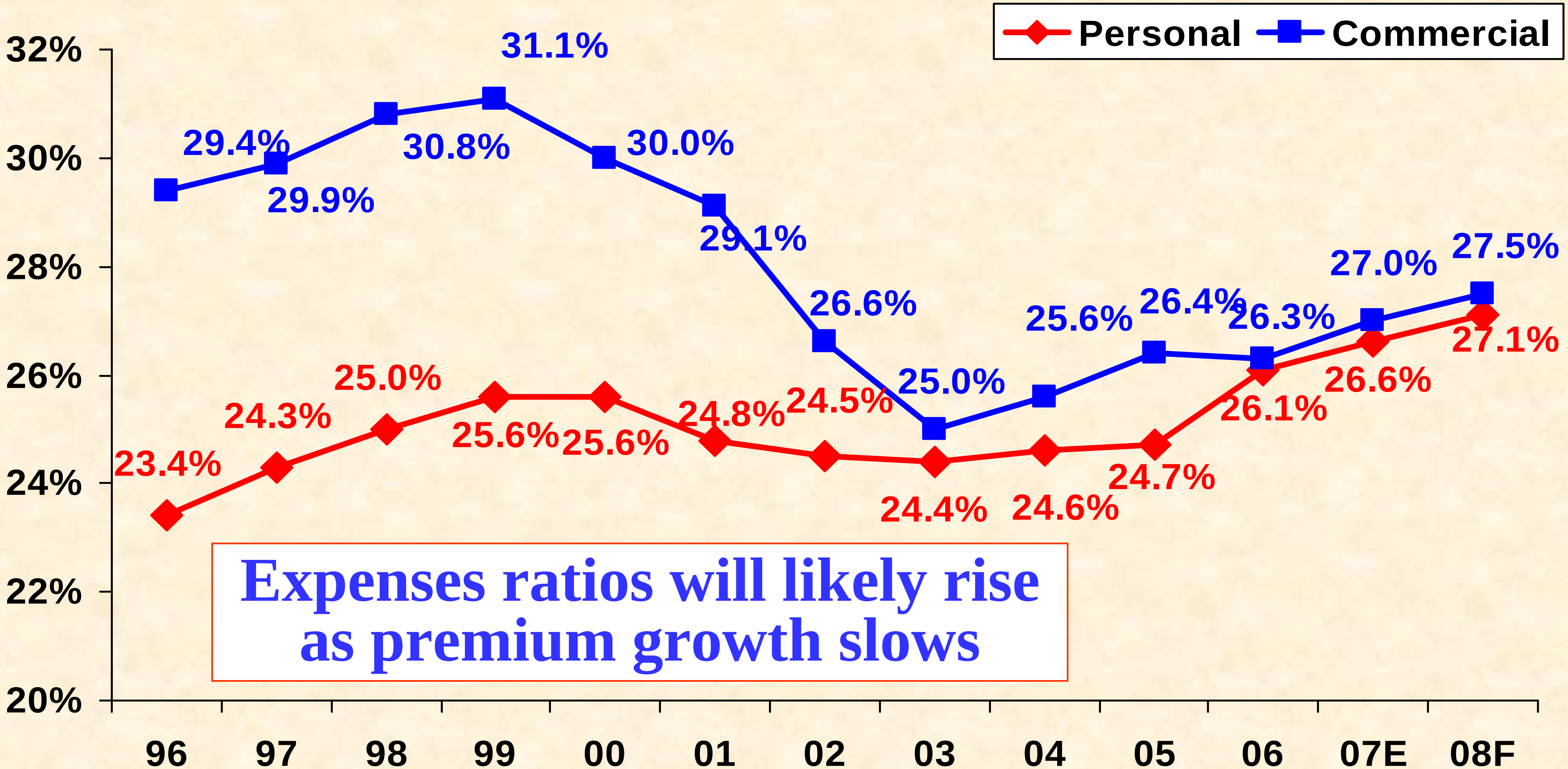
*2006 Projected

Source: Risk Retention Reporter, Insurance Info. Institute

RISING EXPENSES

Expense Ratios Will Rise as Premium Growth Slows

Personal vs. Commercial Lines Underwriting Expense Ratio*



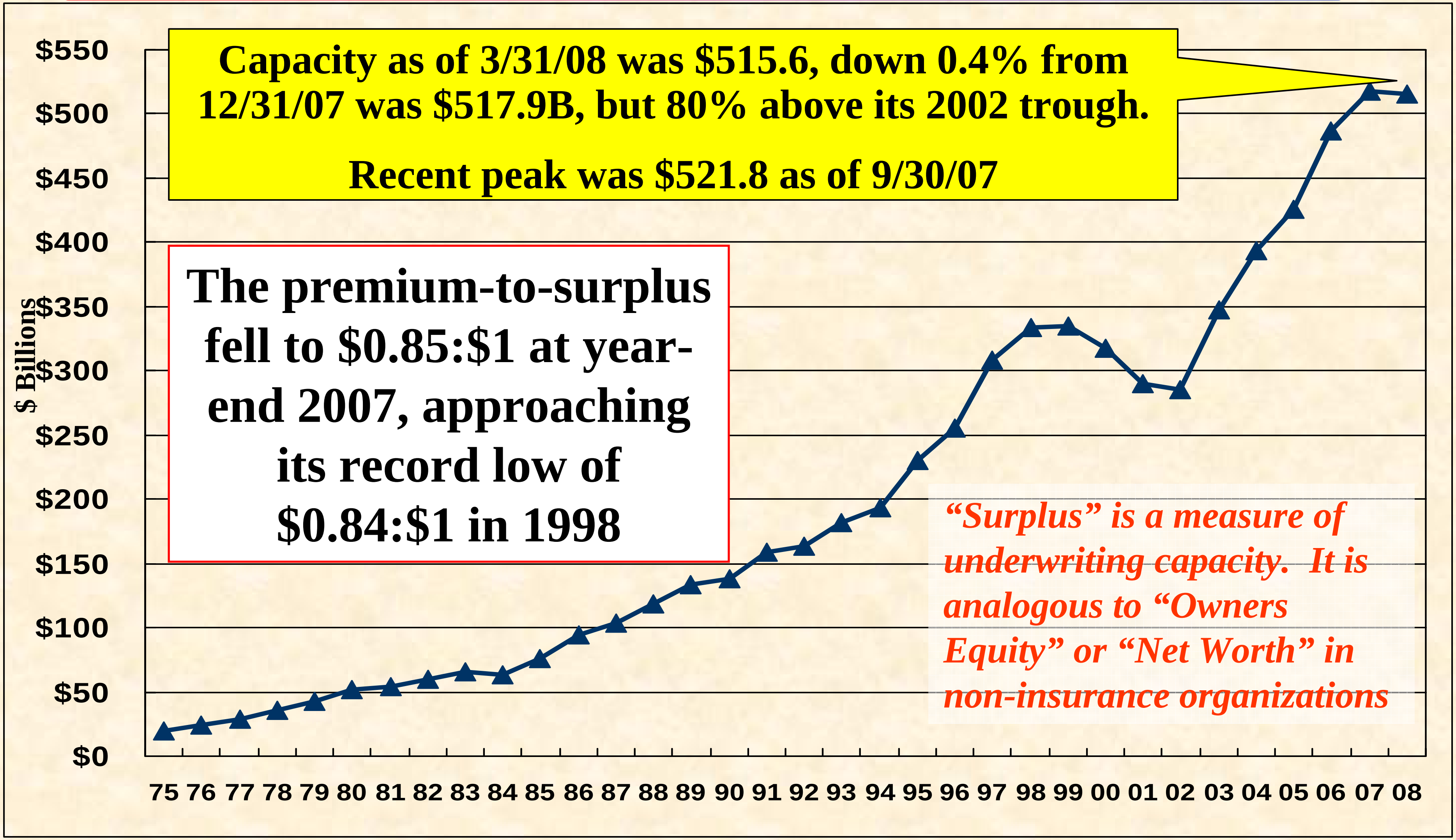
*Ratio of expenses incurred to net premiums written.

Source: A.M. Best; Insurance Information Institute

CAPACITY/ SURPLUS

Accumulation of Capital/ Surplus Depresses ROEs

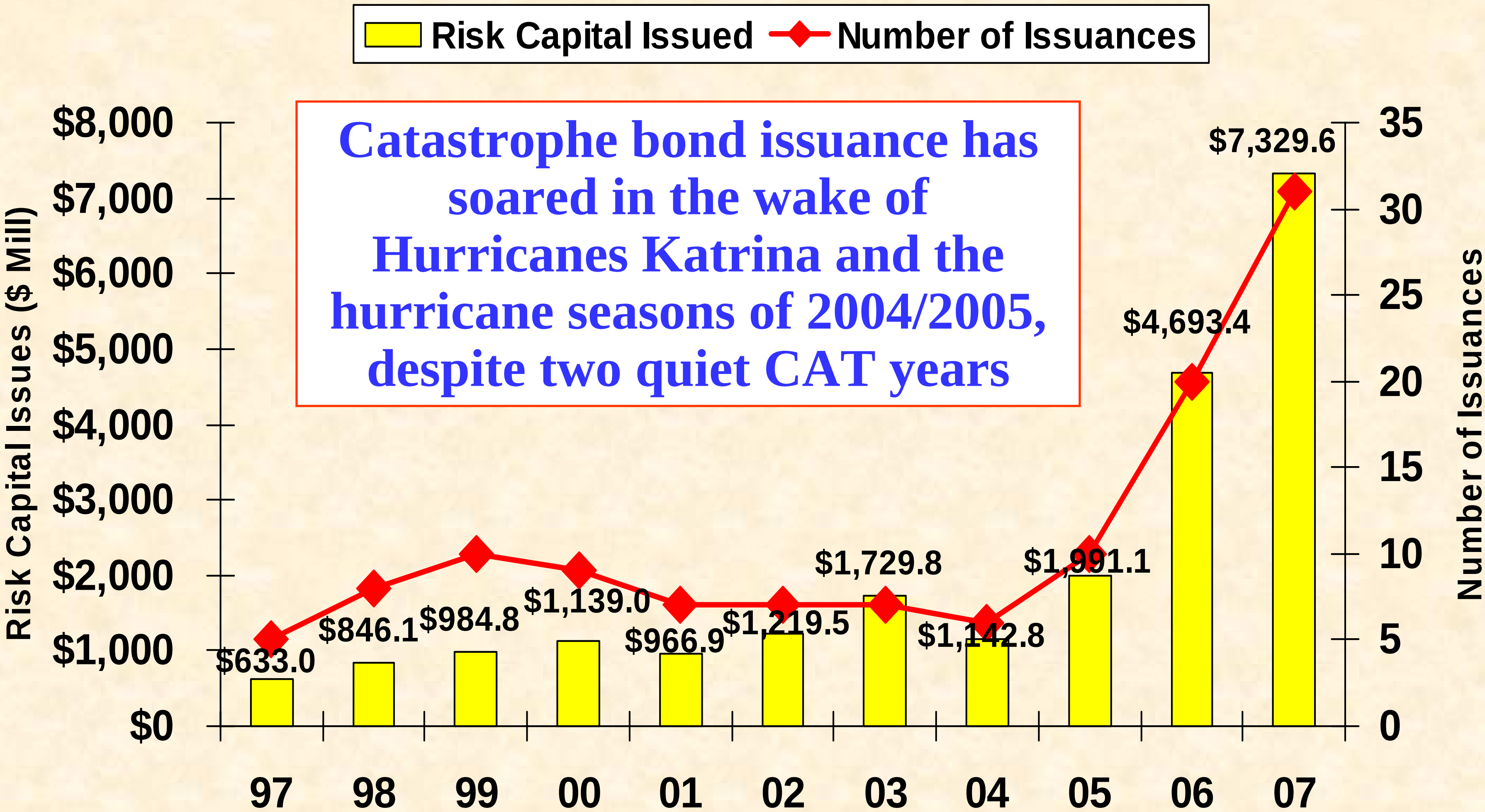
U.S. Policyholder Surplus: 1975-2008:Q1*



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

*As of March 31, 2008

Annual Catastrophe Bond Transactions Volume, 1997-2007



Source: MMC Securities Guy Carpenter, A.M. Best; Insurance Information Institute.

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%

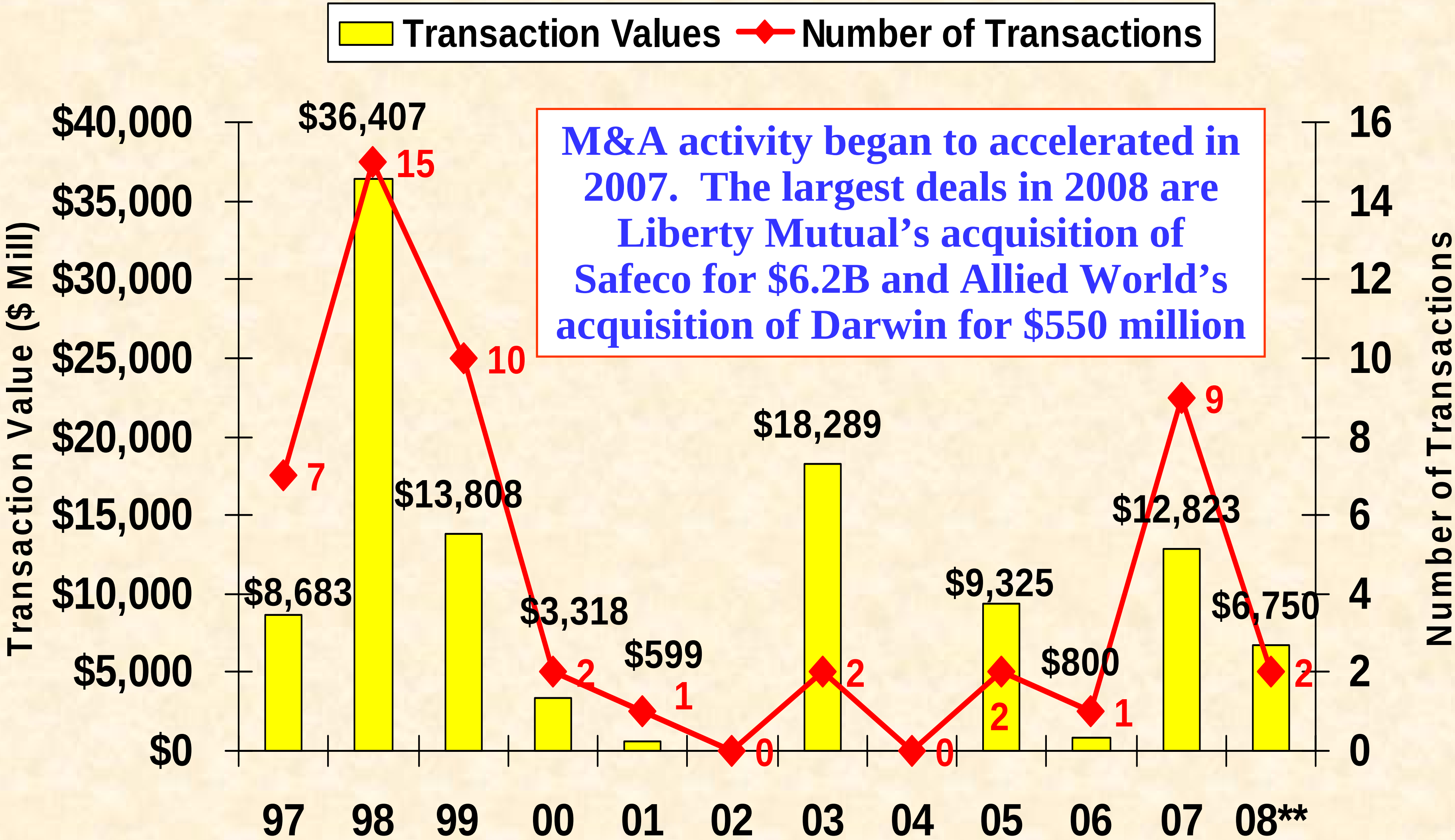
2007 repurchases to date equate to 3.9% of industry surplus, the highest in 20 years

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

MERGER & ACQUISITION

Are Catalysts for P/C Consolidation Growing in 2008?

P/C Insurer M&A Activity, 1997-2008***



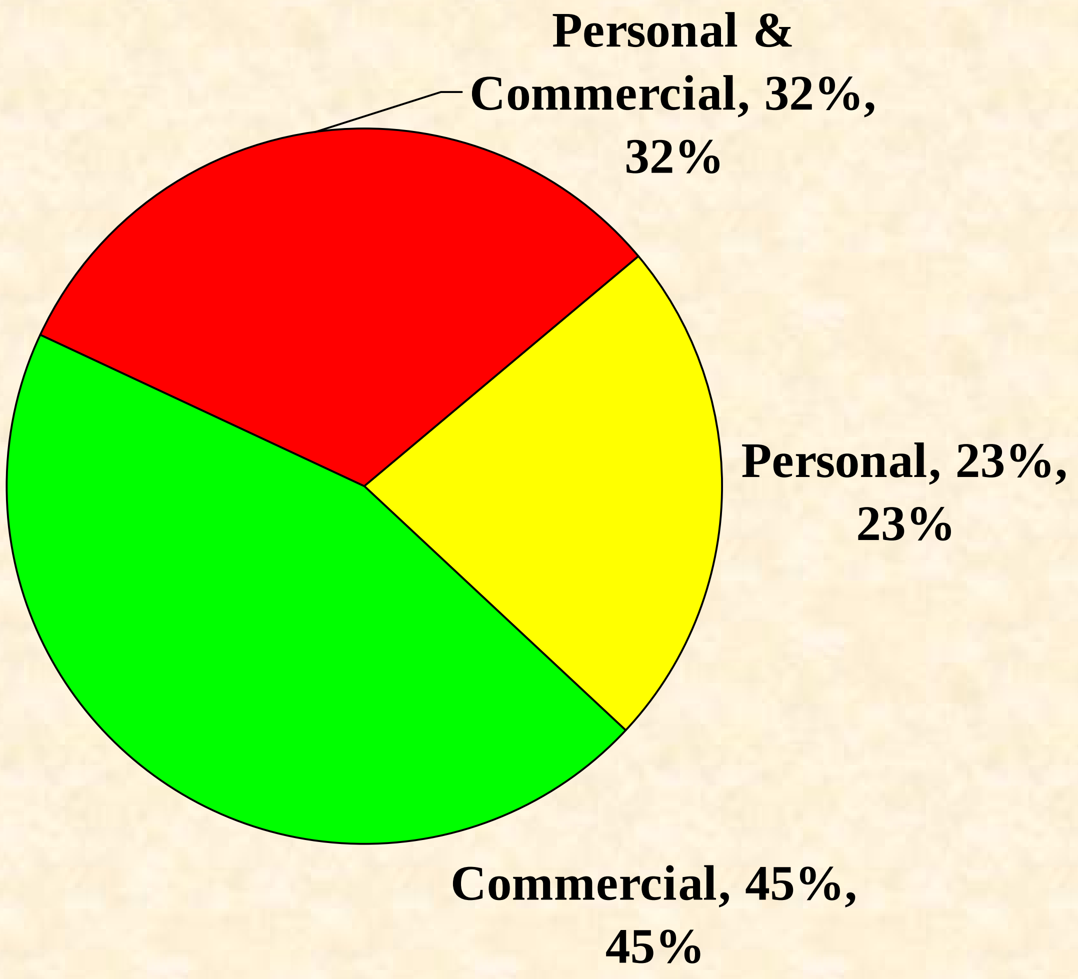
Source: Lehman Brothers. *Deals exceeding $500 million. *Through June 30, 2008.

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.

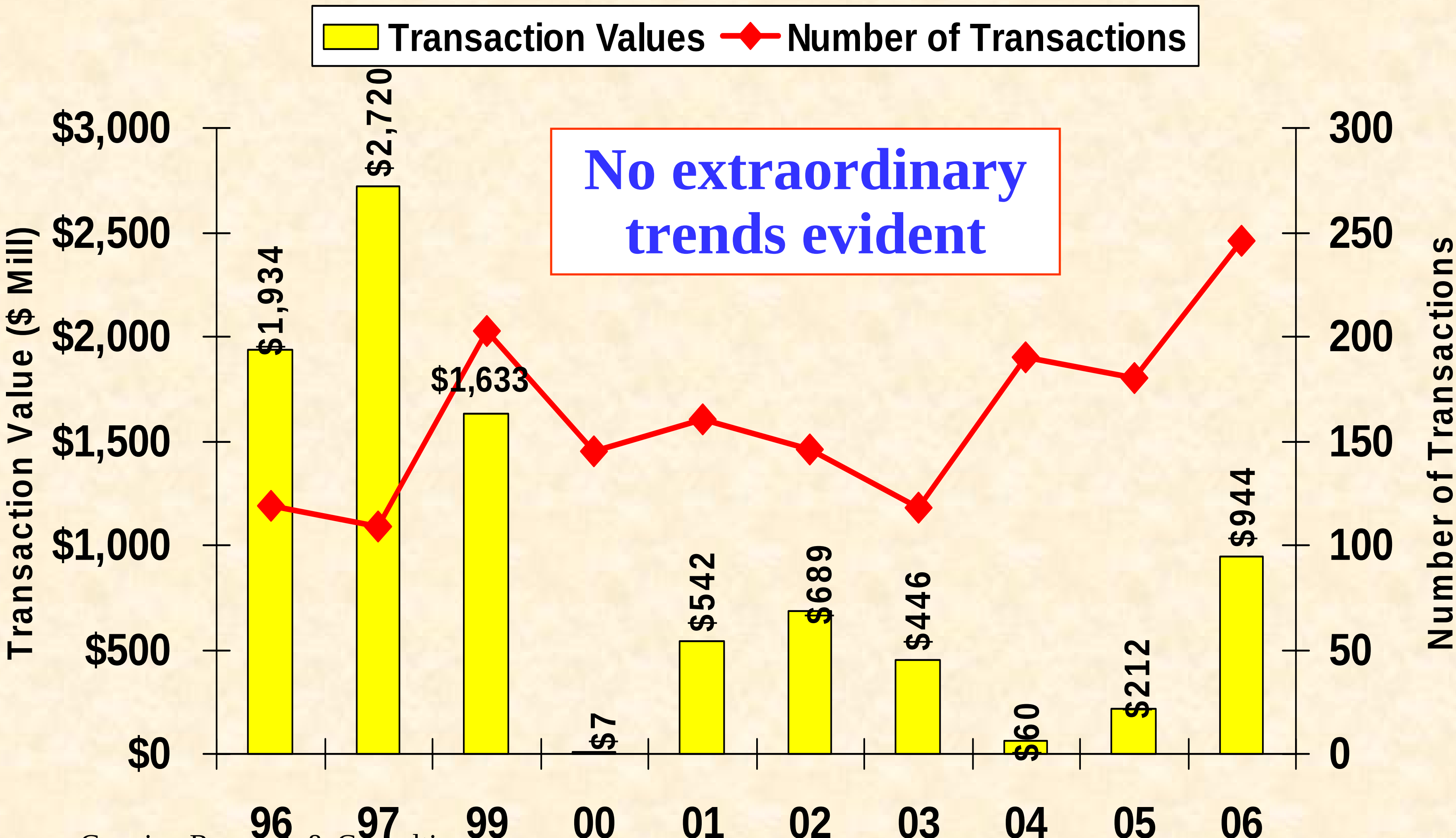
Motivating Factors for Increased P/C Insurer Consolidation

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**

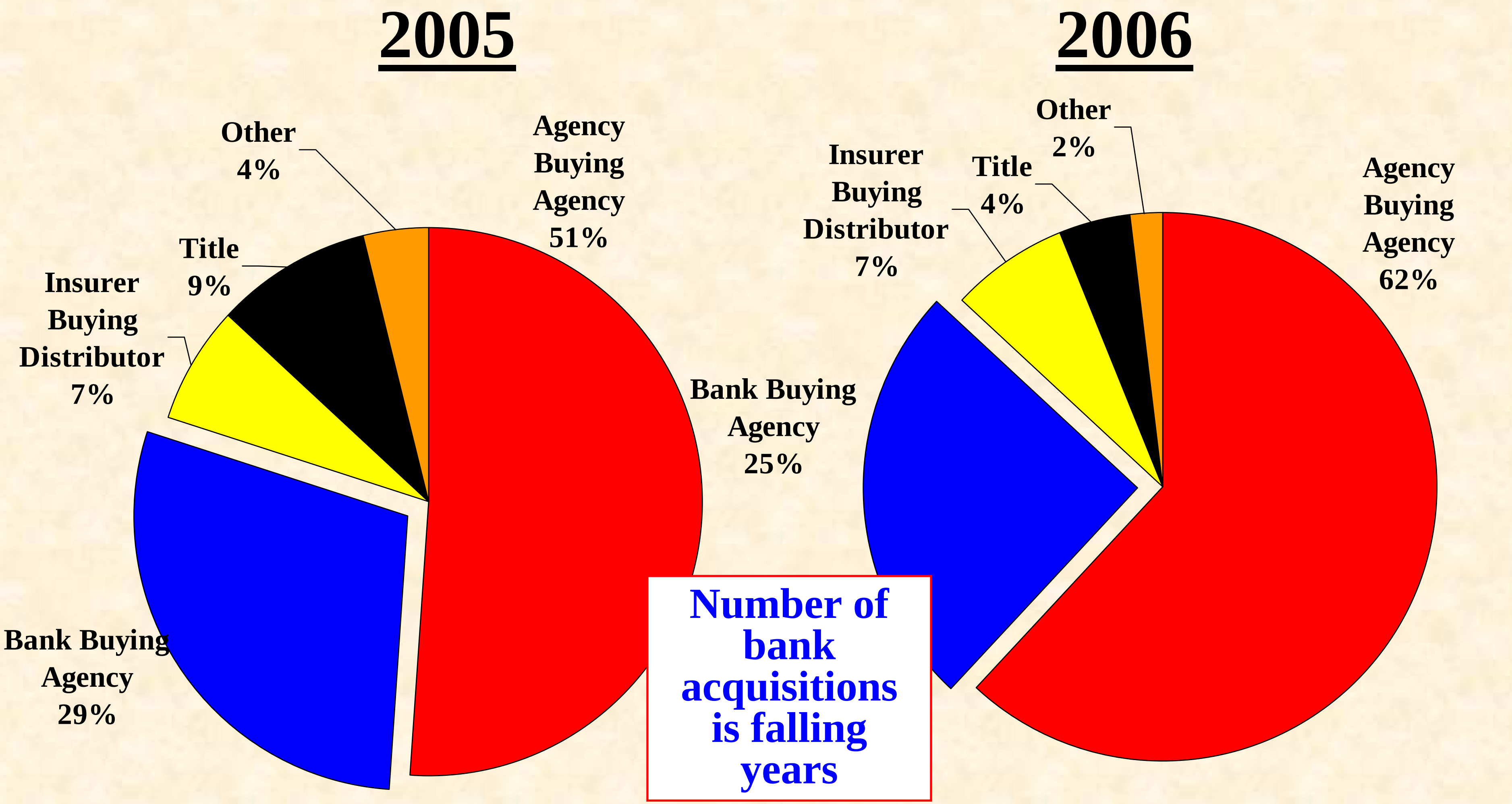
Source: Insurance Information Institute.

Distribution Sector: Insurance-Related M&A Activity, 1988-2006



Source: Conning Research & Consulting.

Distribution Sector M&A Activity, 2005 vs. 2006

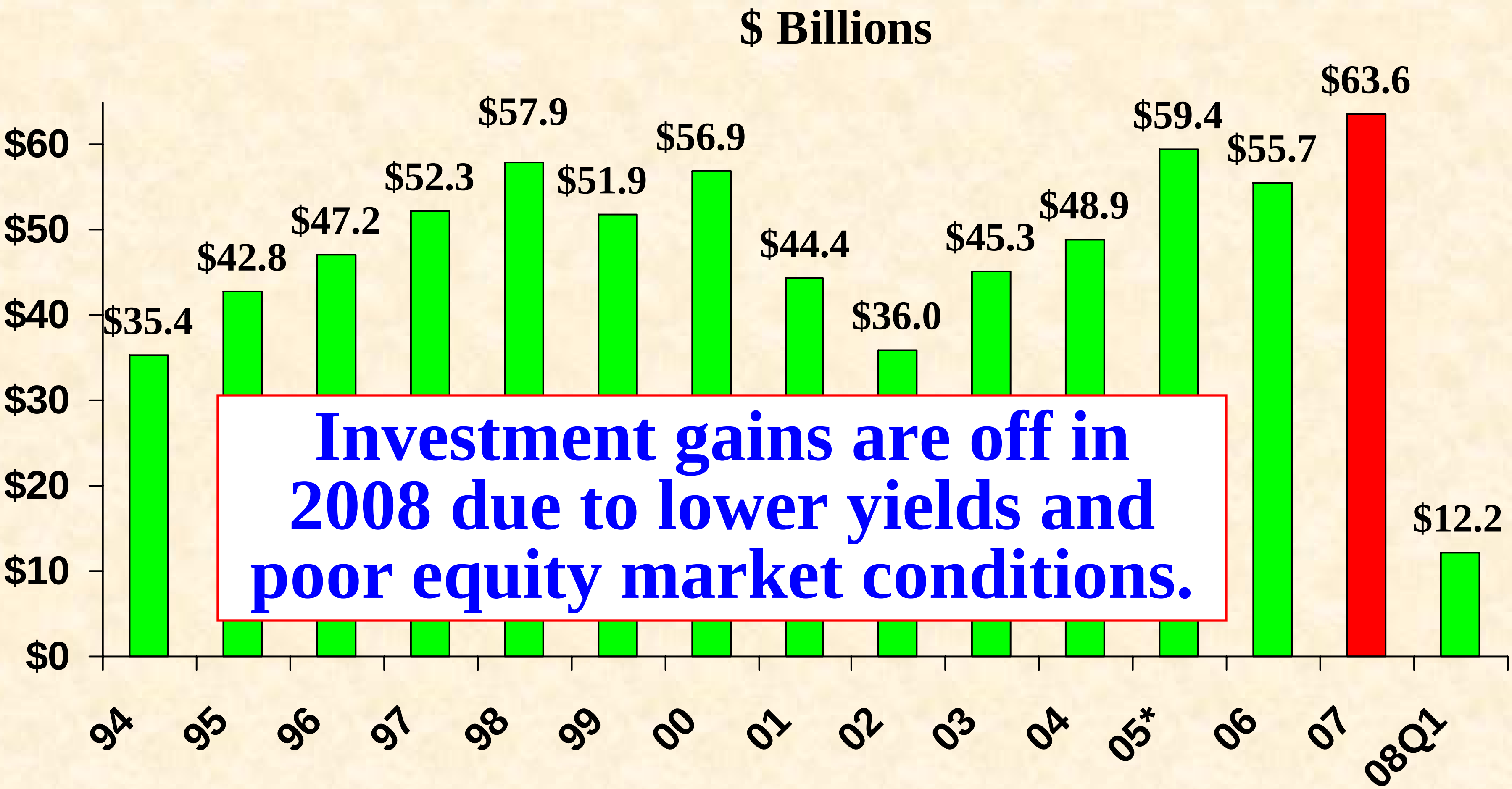


Source: Conning Research & Consulting

INVESTMENT OVERVIEW

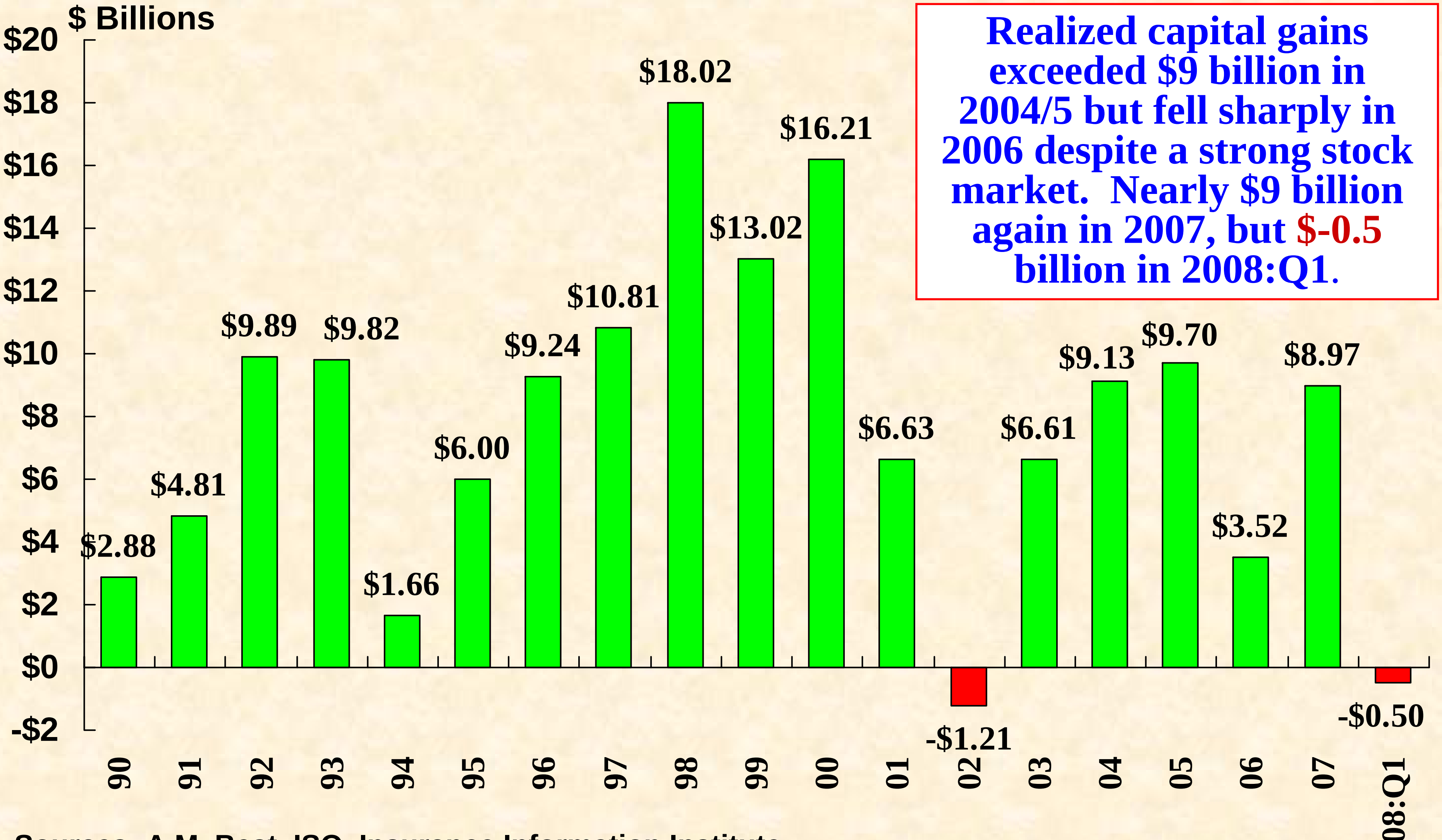
More Pain, Little Gain

Property/Casualty Insurance Industry Investment Gain[1]



[1]Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of $52.3B net investment income and $3.4B realized investment gain.
*2005 figure includes special one-time dividend of $3.2B.
Sources: ISO; Insurance Information Institute.

P/C Insurer Net Realized Capital Gains, 1990-2008:Q1



Realized capital gains exceeded $9 billion in 2004/5 but fell sharply in 2006 despite a strong stock market. Nearly $9 billion again in 2007, but $-0.5 billion in 2008:Q1.

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

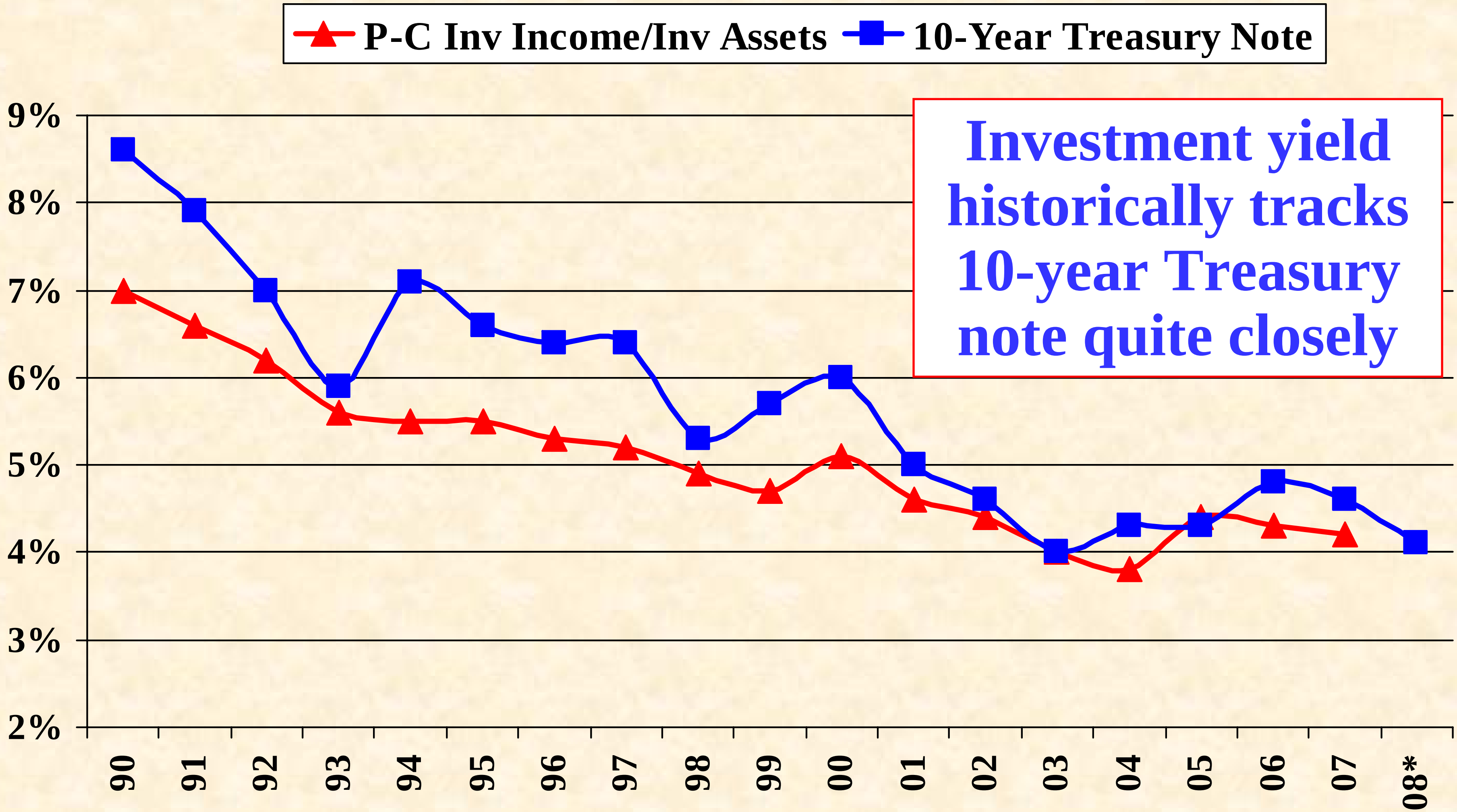
Total Returns for Large Company Stocks: 1970-2008*

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

Source: Ibbotson Associates, Insurance Information Institute.

*Through September 19, 2008.

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



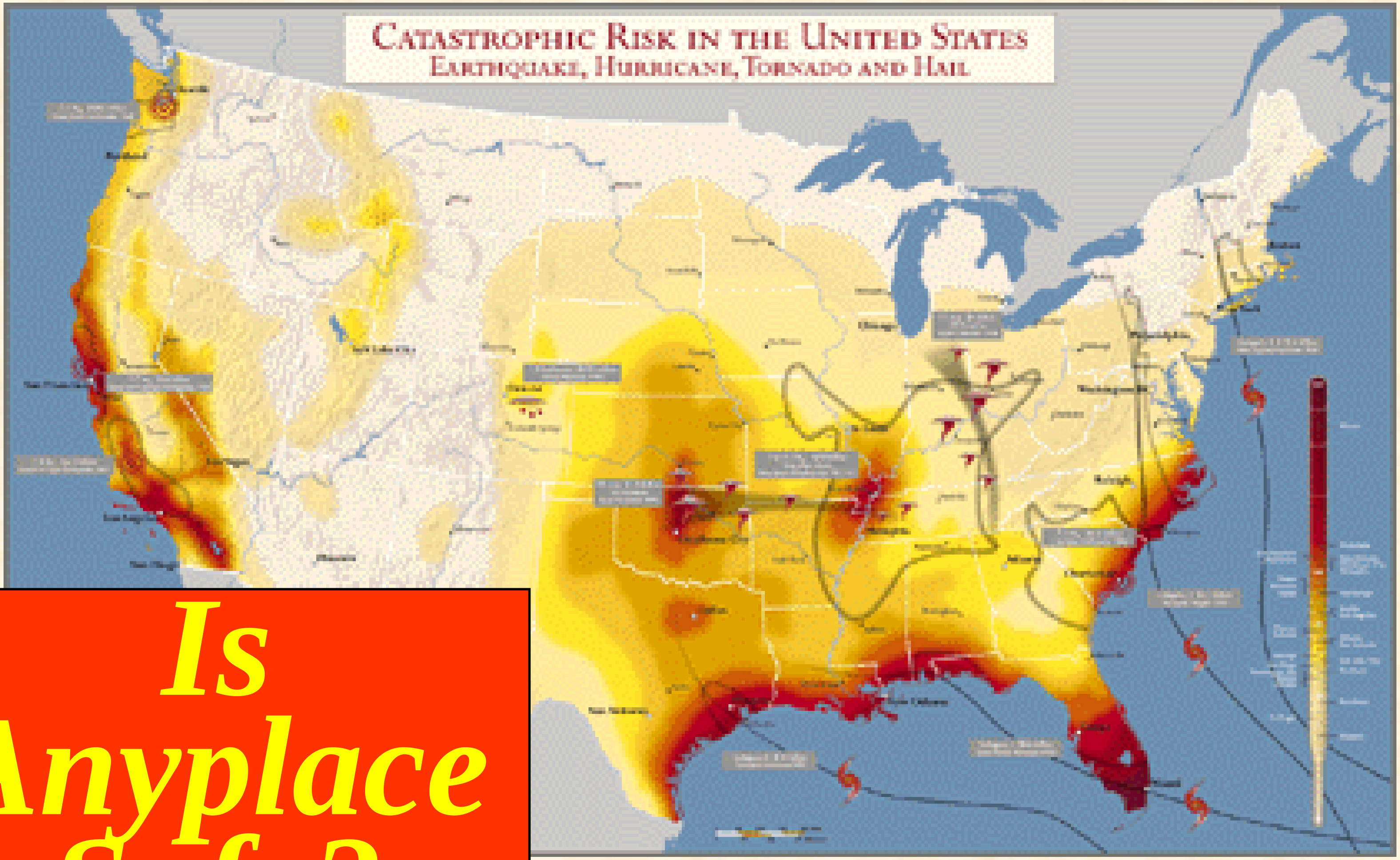
*As of July 2008.

Sources: Board of Governors, Federal Reserve System; A.M.Best; Insurance Information Institute.

CATASTROPHIC LOSS

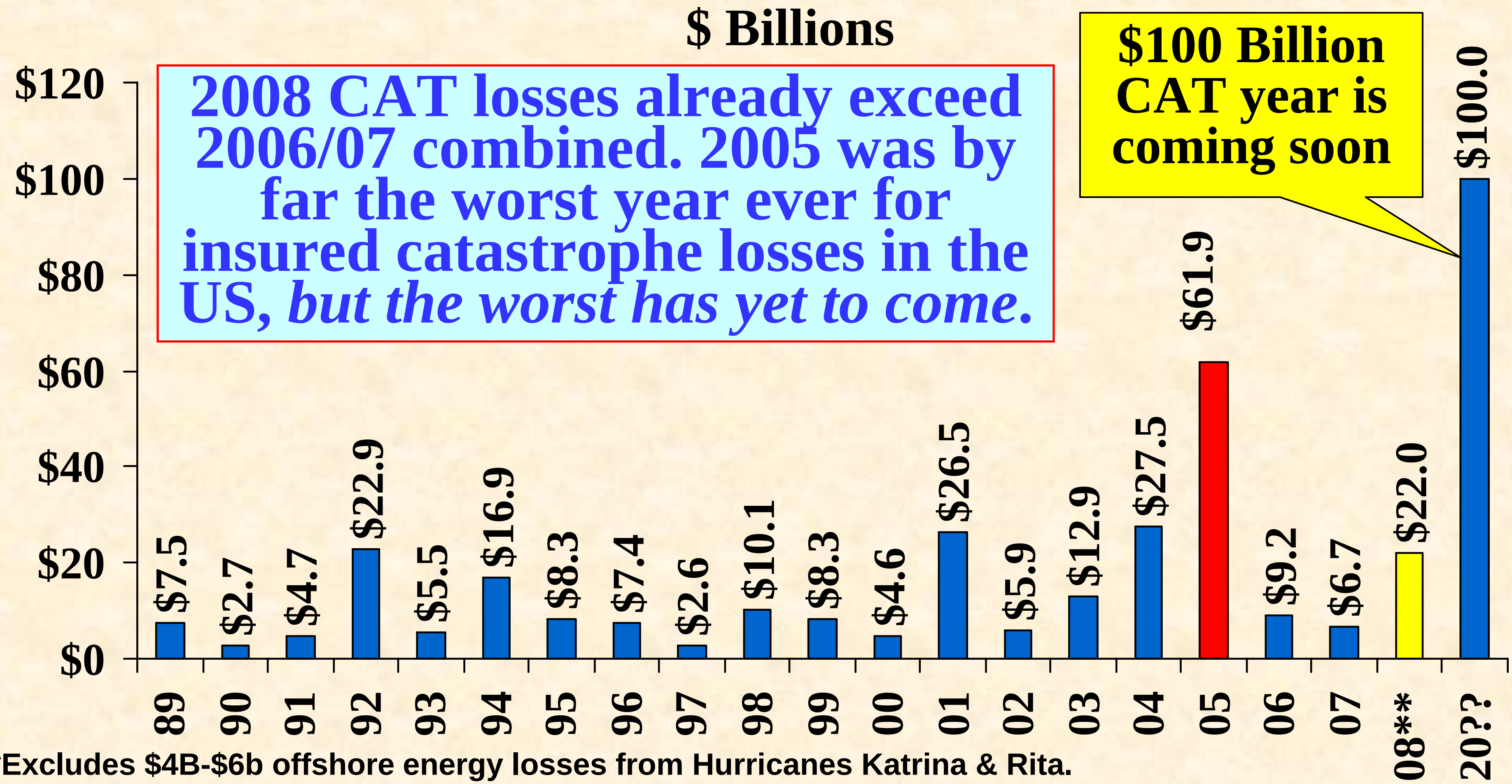
This is (One Reason) Why You Buy Reinsurance

Most of US Population & Property Has Major CAT Exposure



Is Anyplace Safe?

U.S. Insured Catastrophe Losses*



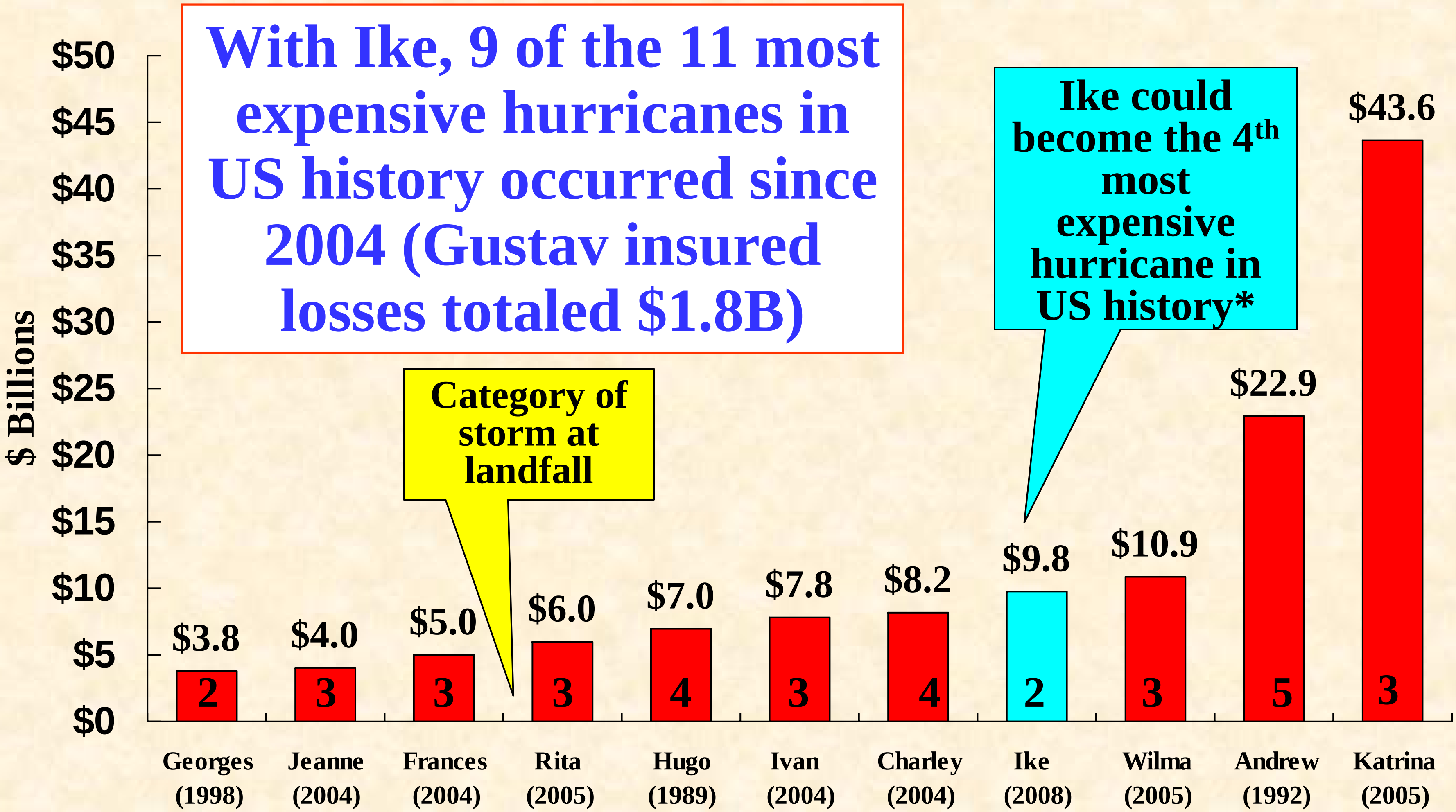
*Excludes $4B-$6b offshore energy losses from Hurricanes Katrina & Rita.

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

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

Source: Property Claims Service/ISO; Insurance Information Institute

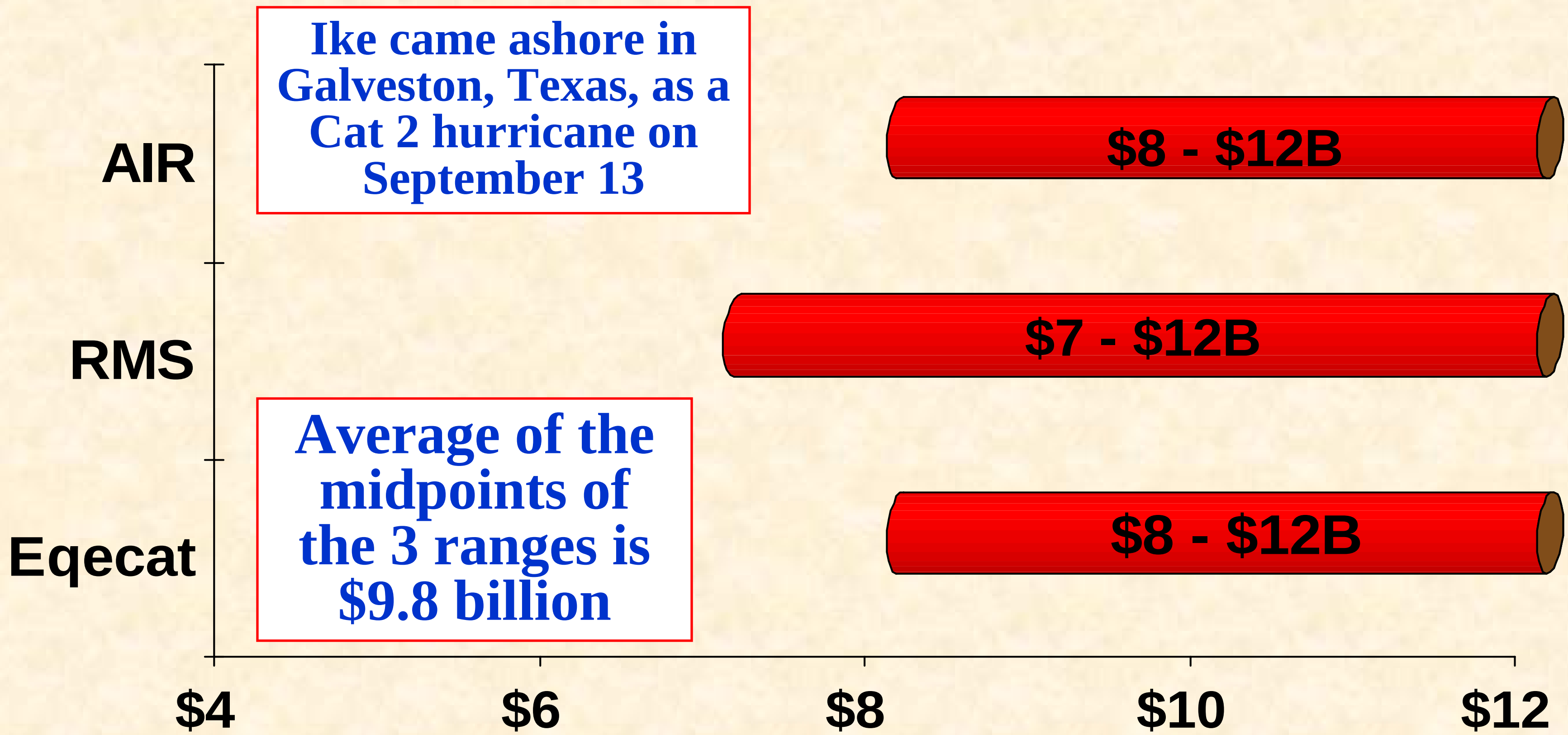
Top 12 Most Costly Hurricanes in US History, (Insured Losses, $2007)



*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.

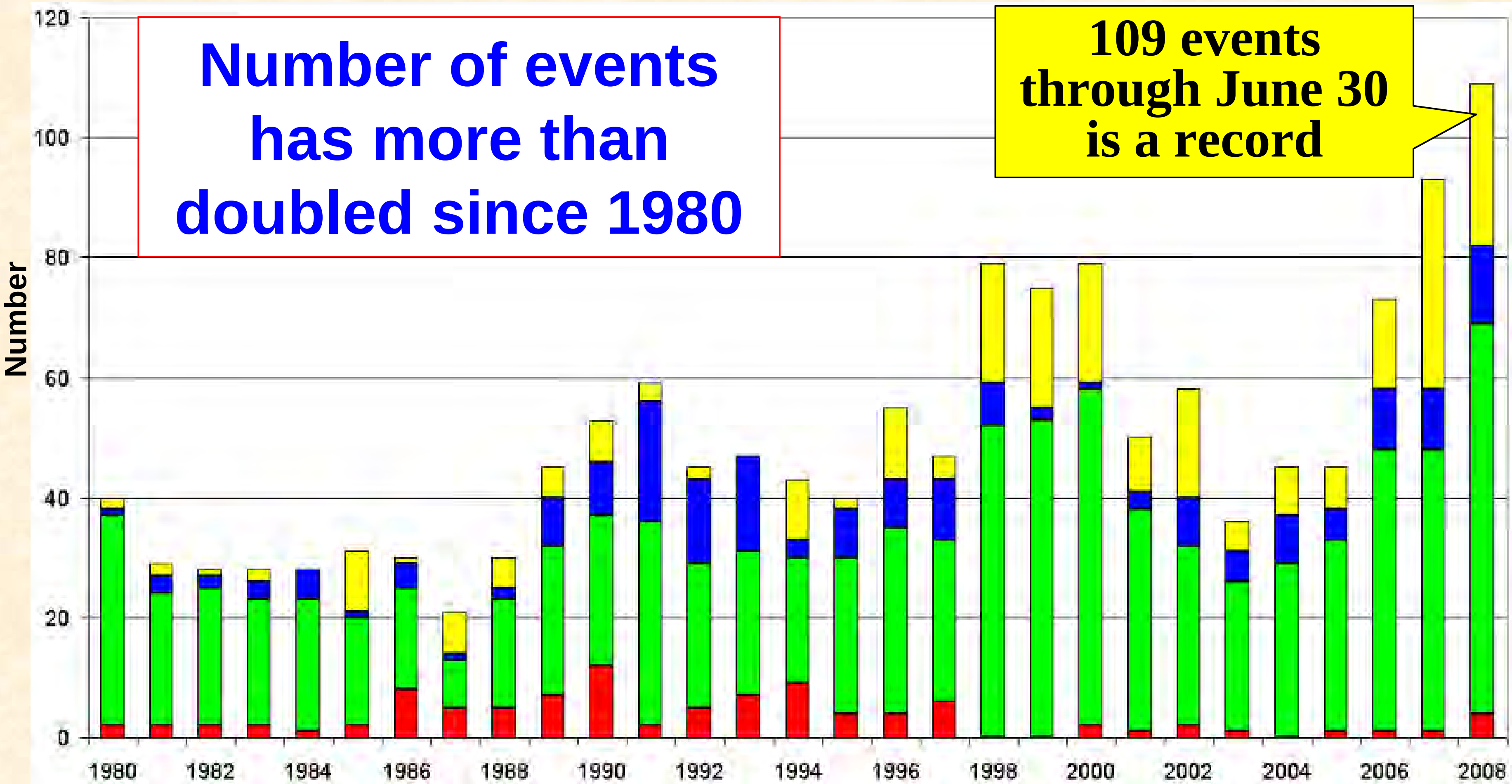
Hurricane Ike Initial Insured Loss Estimates

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



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)



Geophysical (earthquake, tsunami, volcanic activity)

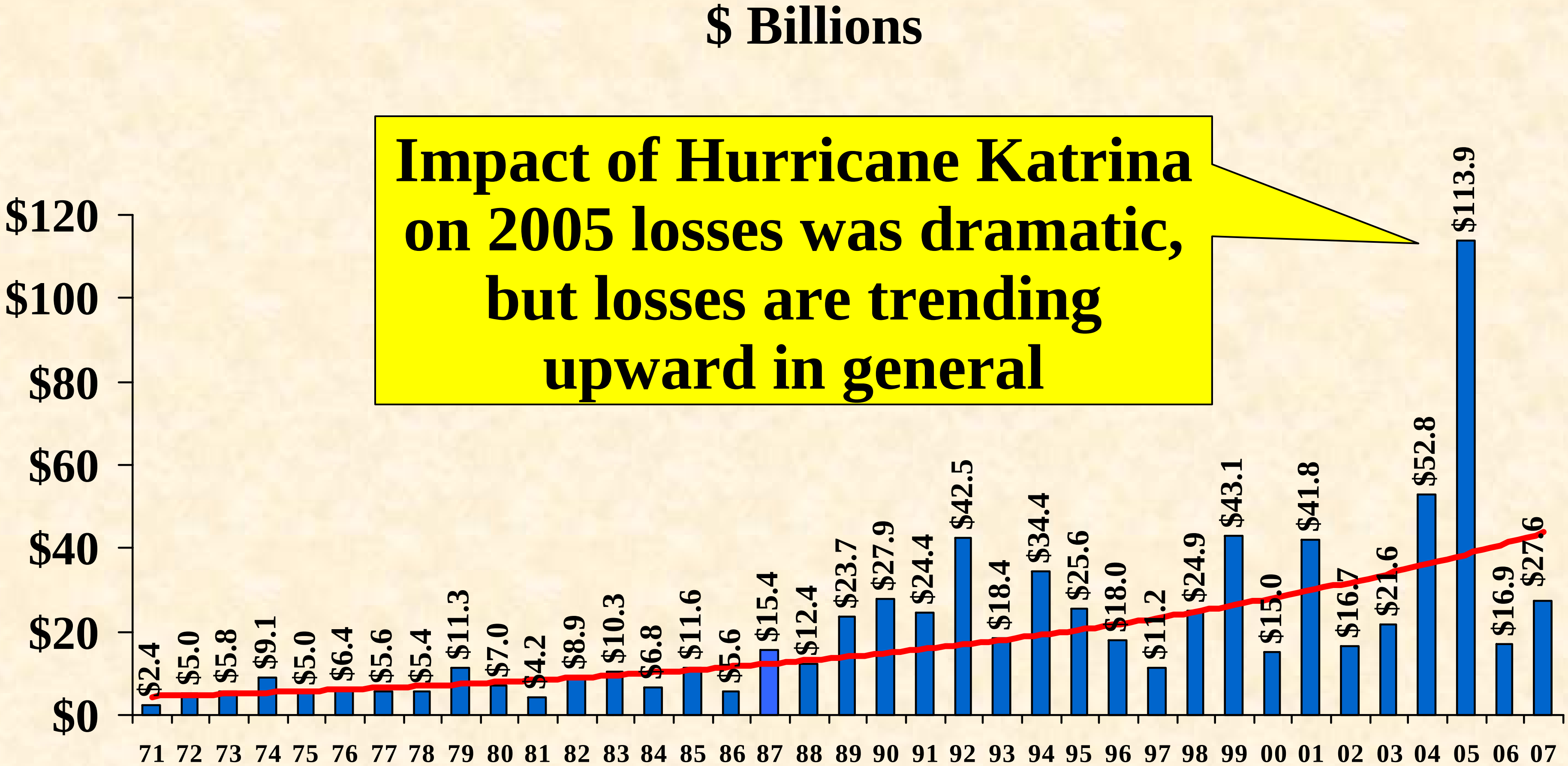
Meteorological (storm)

Hydrological (flood, mass movement)

Climatological (temperature extremes, drought, wildfire)

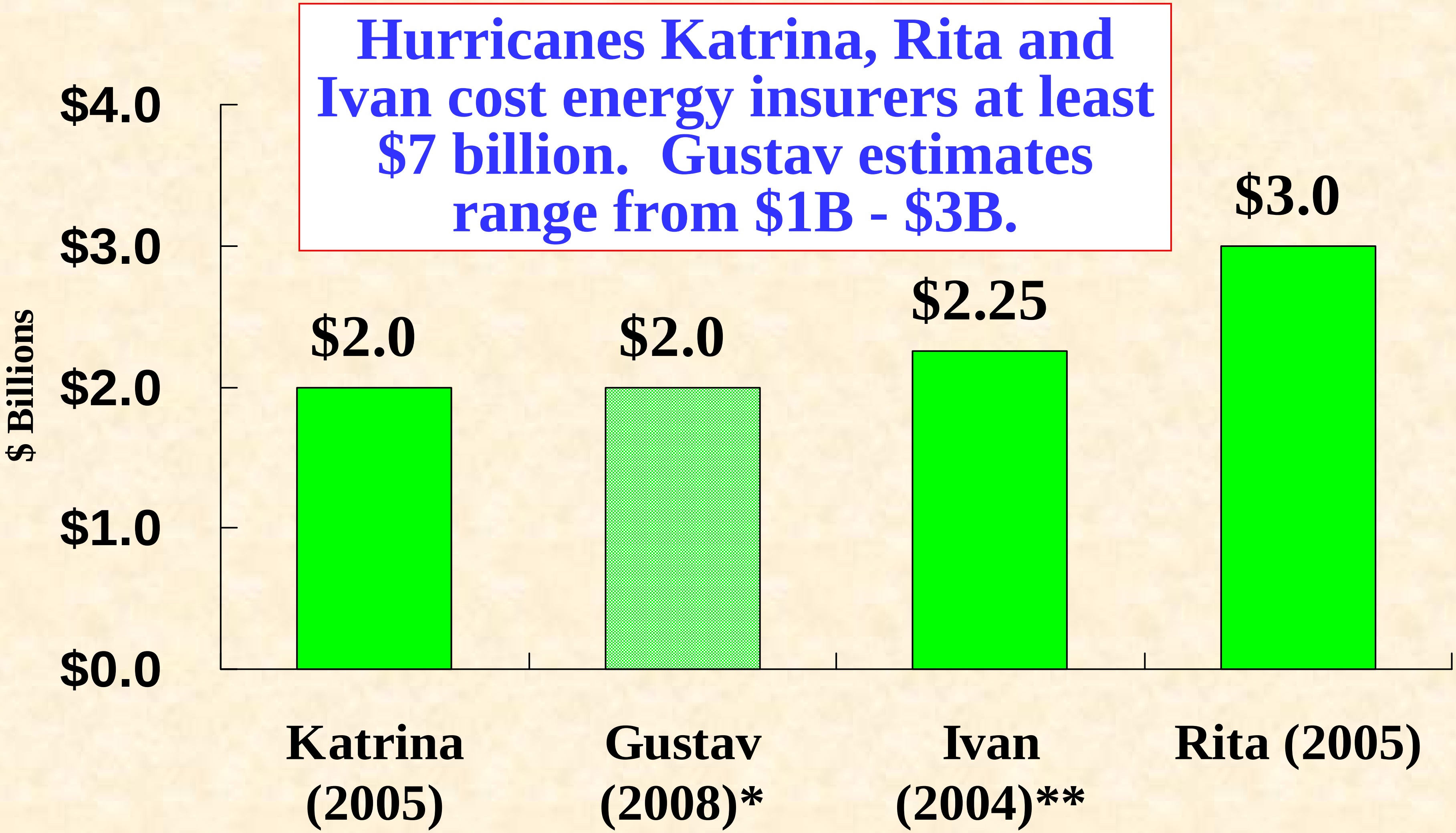
Source: MR NatCat*SERVICE*

Global Insured Catastrophe Losses 1970-2007 ($ 2007)



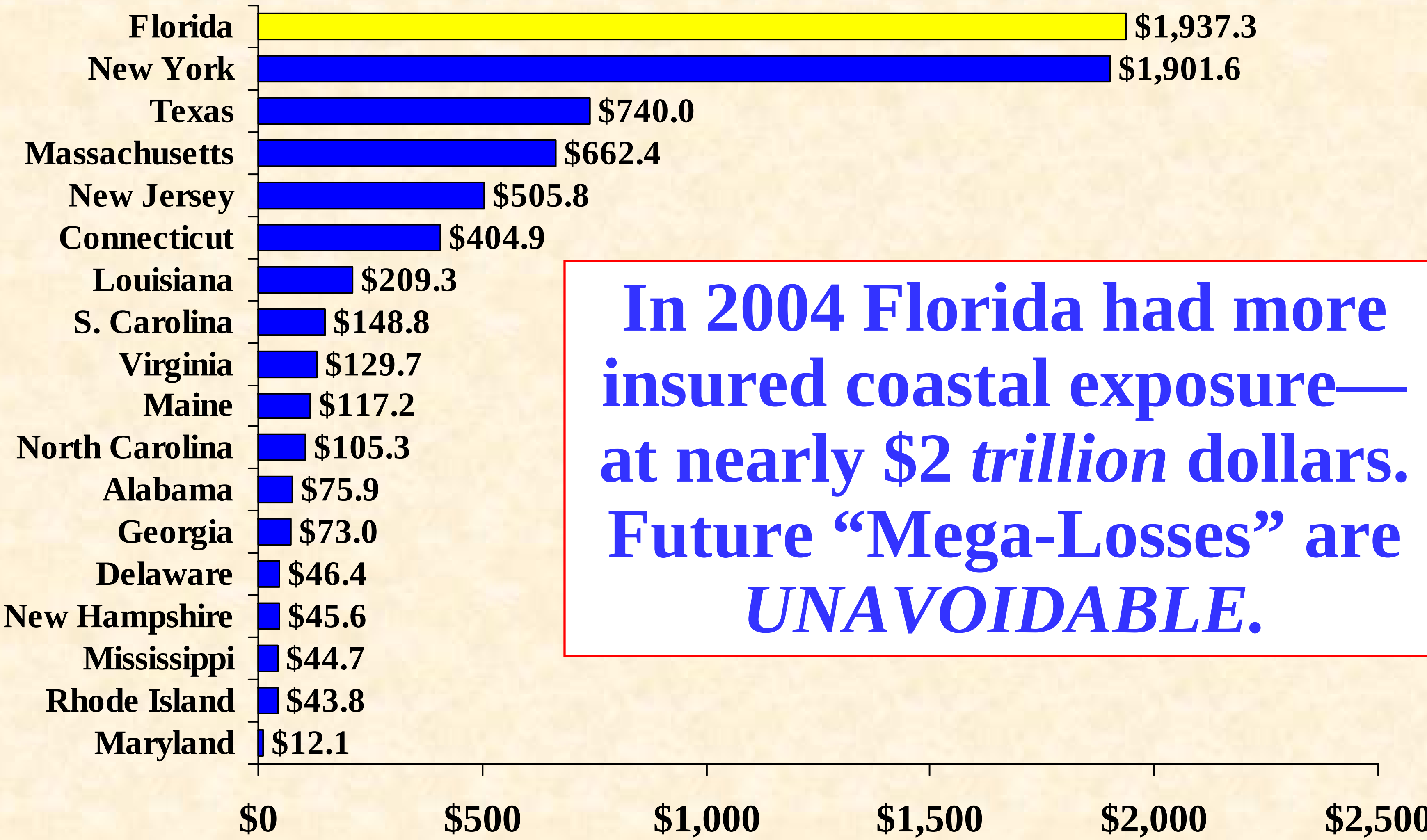
Source: Swiss Re Sigma No.1/08, ***Natural catastrophes and man-made disasters in 2007***

Insured Offshore Energy Losses for Recent Major Gulf Storms



*Midpoint of RMS estimated range of $1.0 to $3.0 billion as of 9/1/08; **Midpoint of range ofr $2.0 to $2.5 billion)
Sources: Insurance Information Institute research estimates.

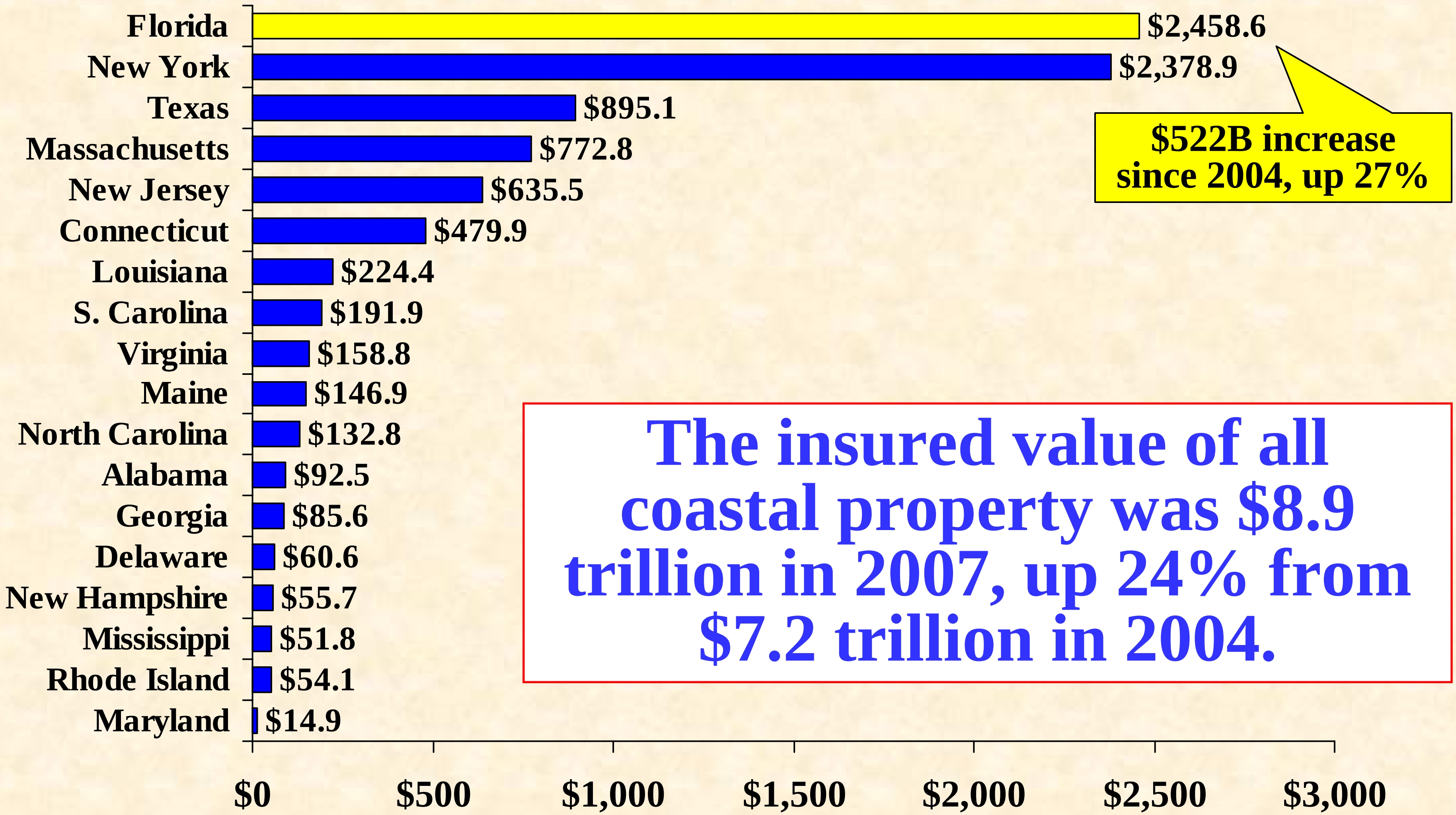
Total Value of Insured Coastal Exposure (2004, $ Billions)



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)



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

Source: AIR Worldwide

The 2008 Hurricane Season:

Preview to Disaster?

Outlook for 2008 Hurricane Season: 90% *Worse Than Average*

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

*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***

	Average*	2008F
Entire US East & Gulf Coasts	52%	67%
US East Coast Including Florida Peninsula	31%	43%
Gulf Coast from Florida Panhandle to Brownsville	30%	42%
Caribbean	NA	Above Average

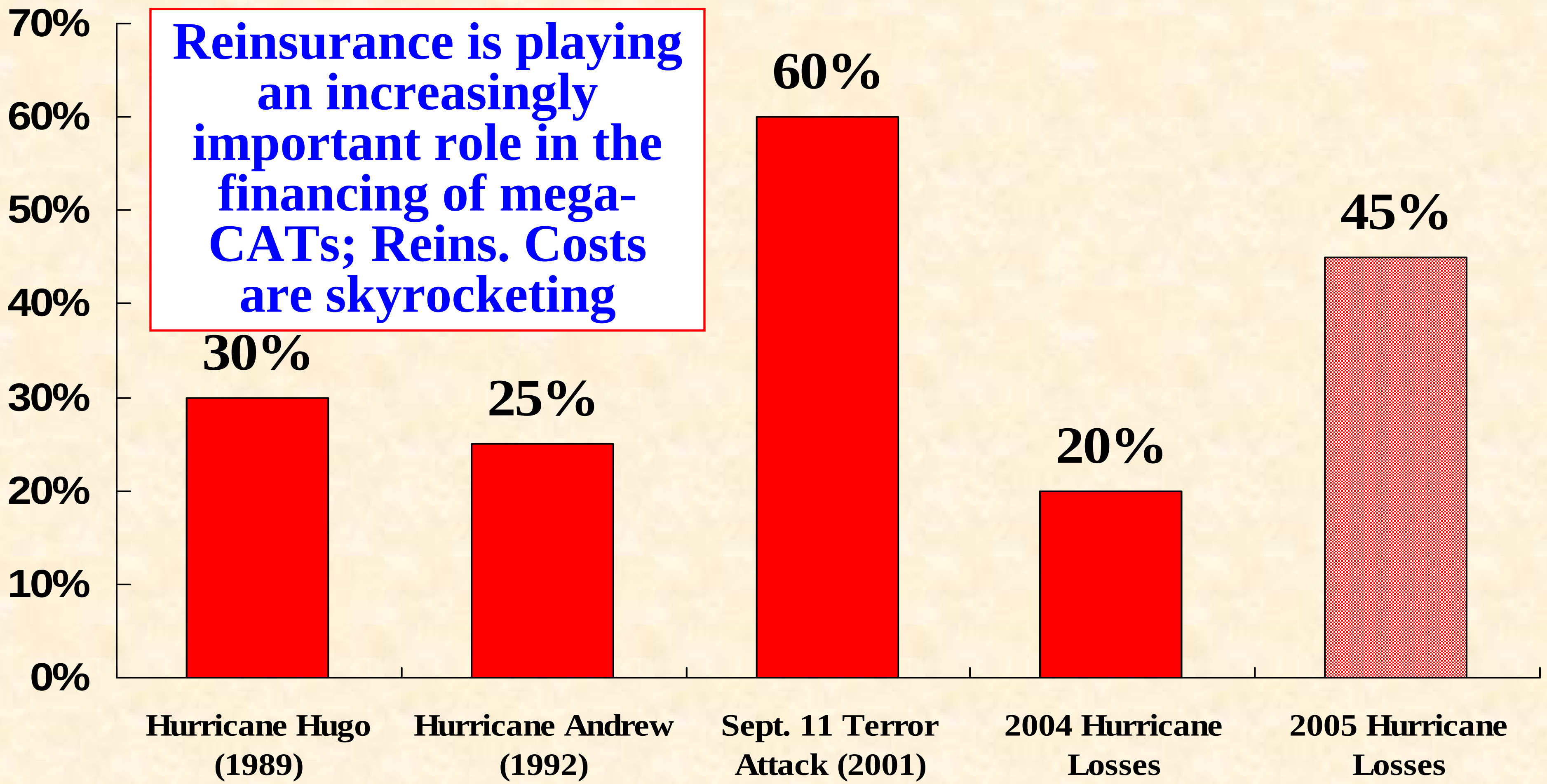
*Average over the past century.

Source: Dr. Philip Klotzbach and Dr. William Gray, Colorado State University, August 5, 2008.

REINSURANCE MARKETS

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

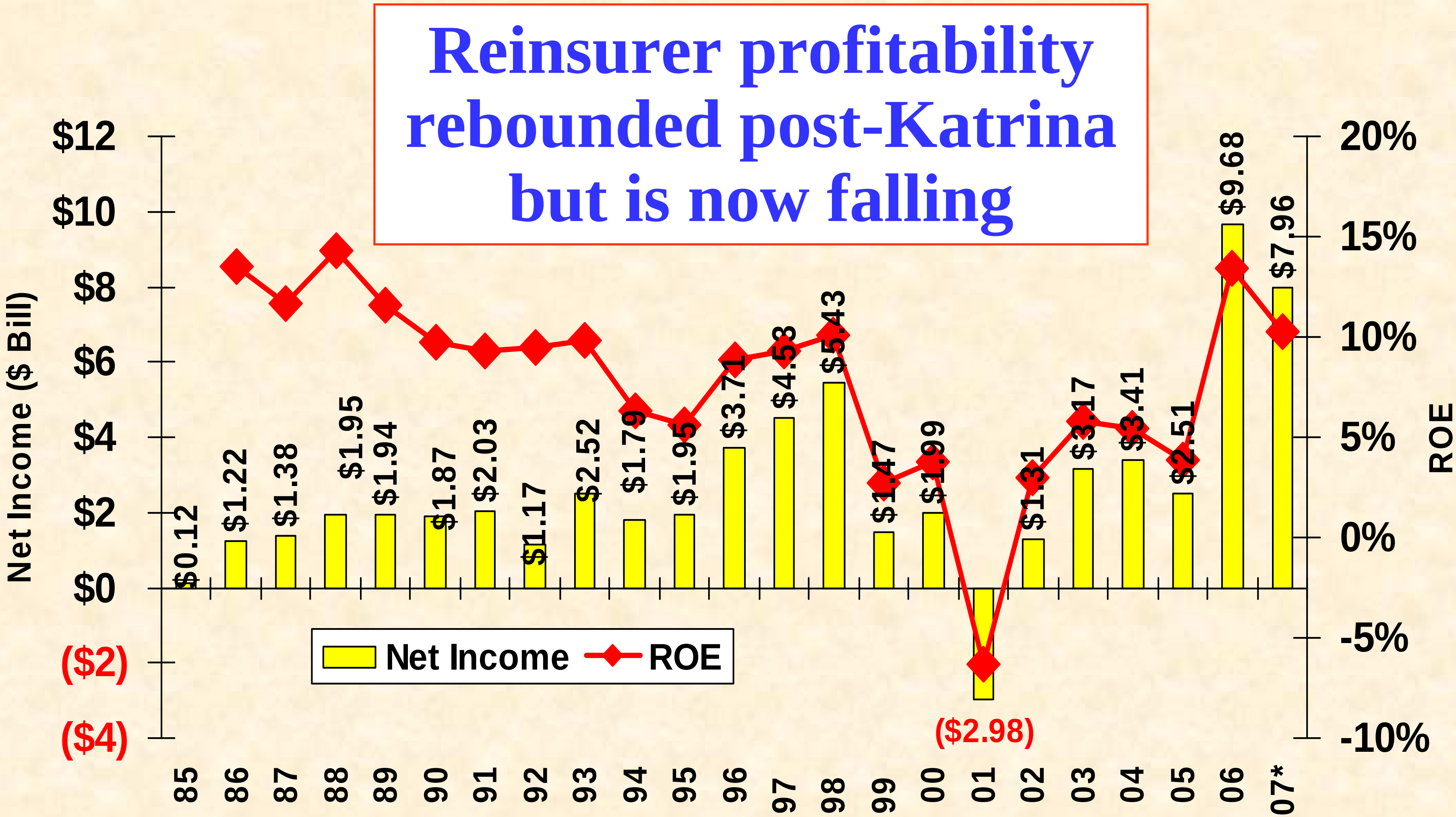
Share of Losses Paid by Reinsurers, by Disaster*



*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*

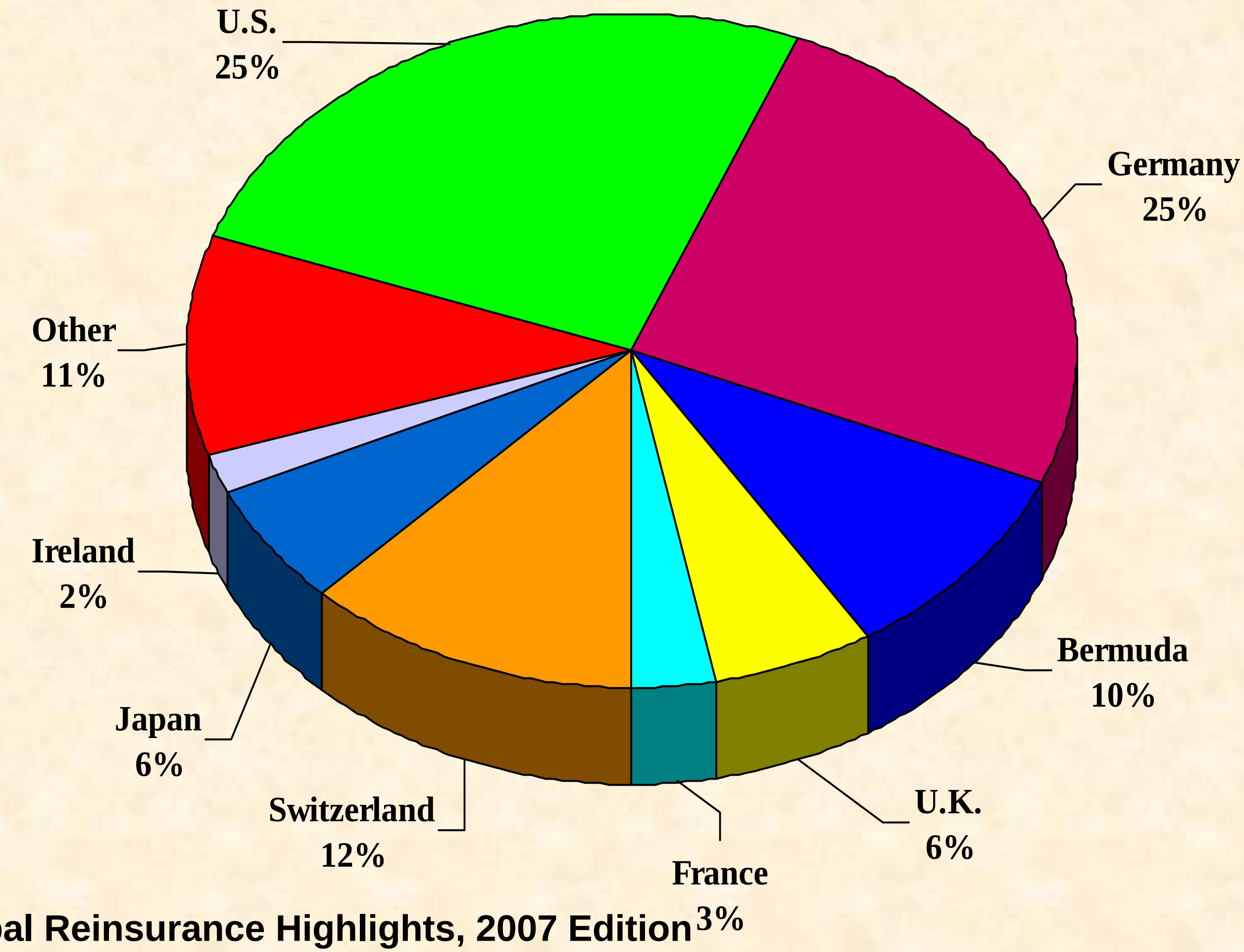


Source: Reinsurance Association of America. *2007 ROE figure is III estimate based return on average 2007 surplus.

Regional Distribution of Reinsurers by NWP, 2006

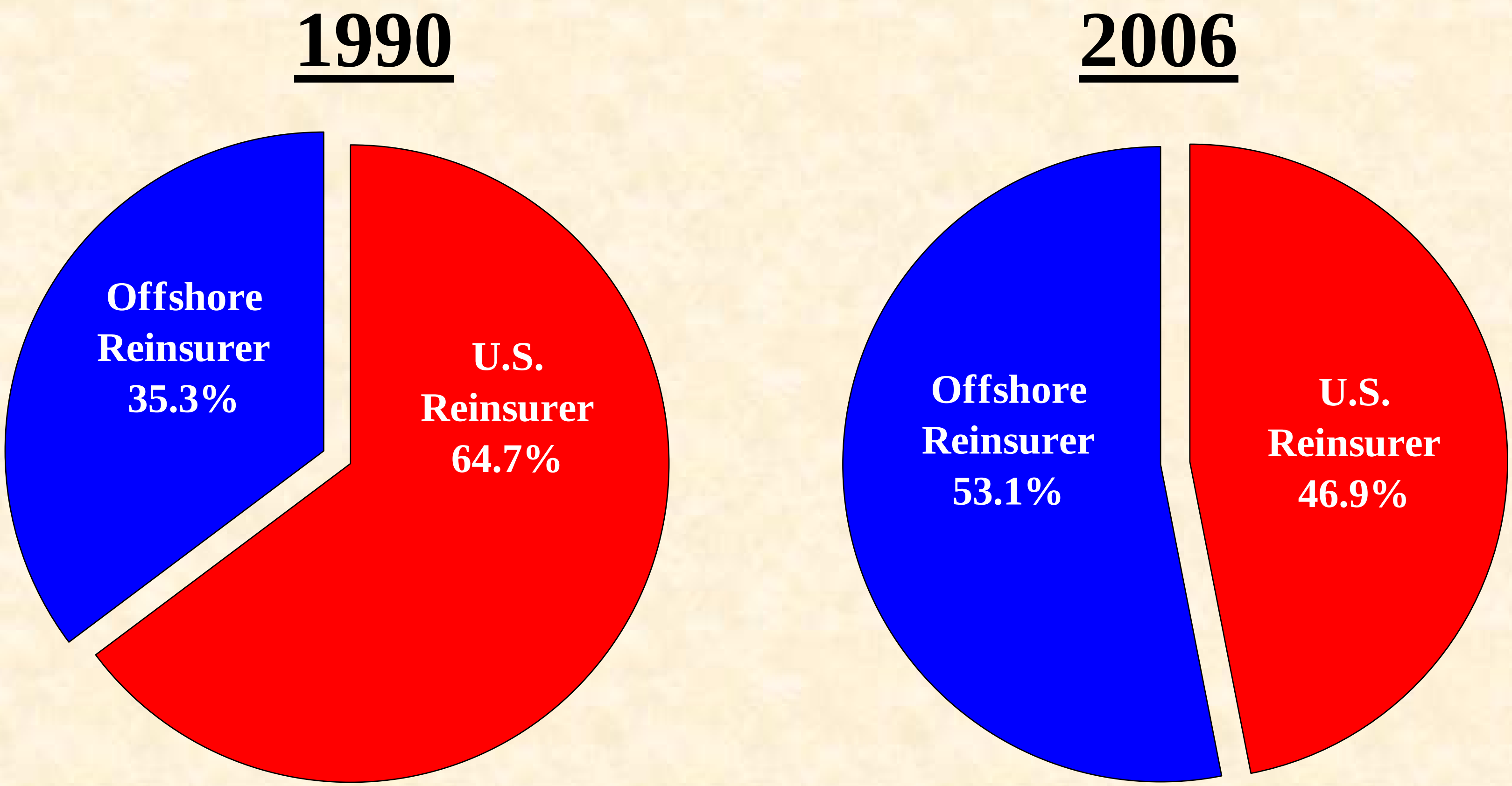
Eight countries account for 89 percent of global reinsurance volume.

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



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

Sources: Reinsurance Association of America; Insurance Information Institute.

Shifting Legal Liability & Tort Environment

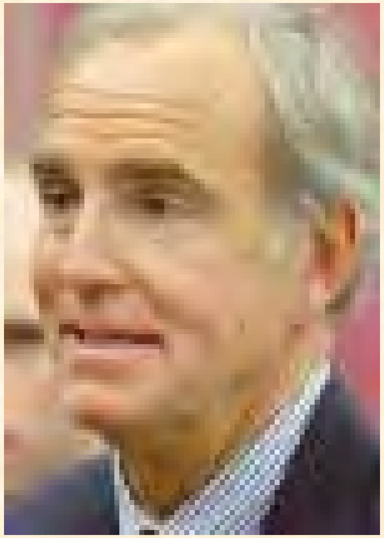
Is the Tort Pendulum Swinging Against Insurers?

*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 serves 1-2 years in prison and forfeit $7.75 million; $250,000 fine**

Source: San Diego Union Tribune, 9/19/07

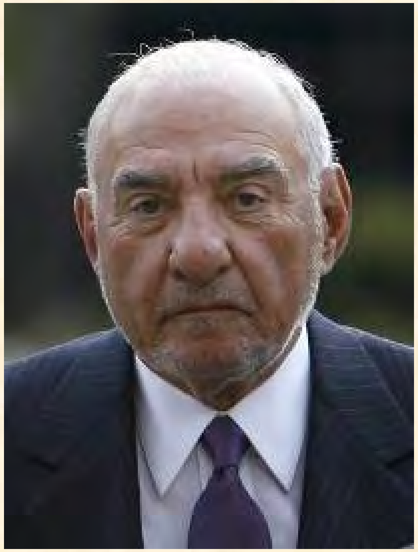


"King of Torts" Dickie Scruggs

- **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**

Source: Wall Street Journal, 3/15/07

Bad Year for Tort Kingpins (Continued)*

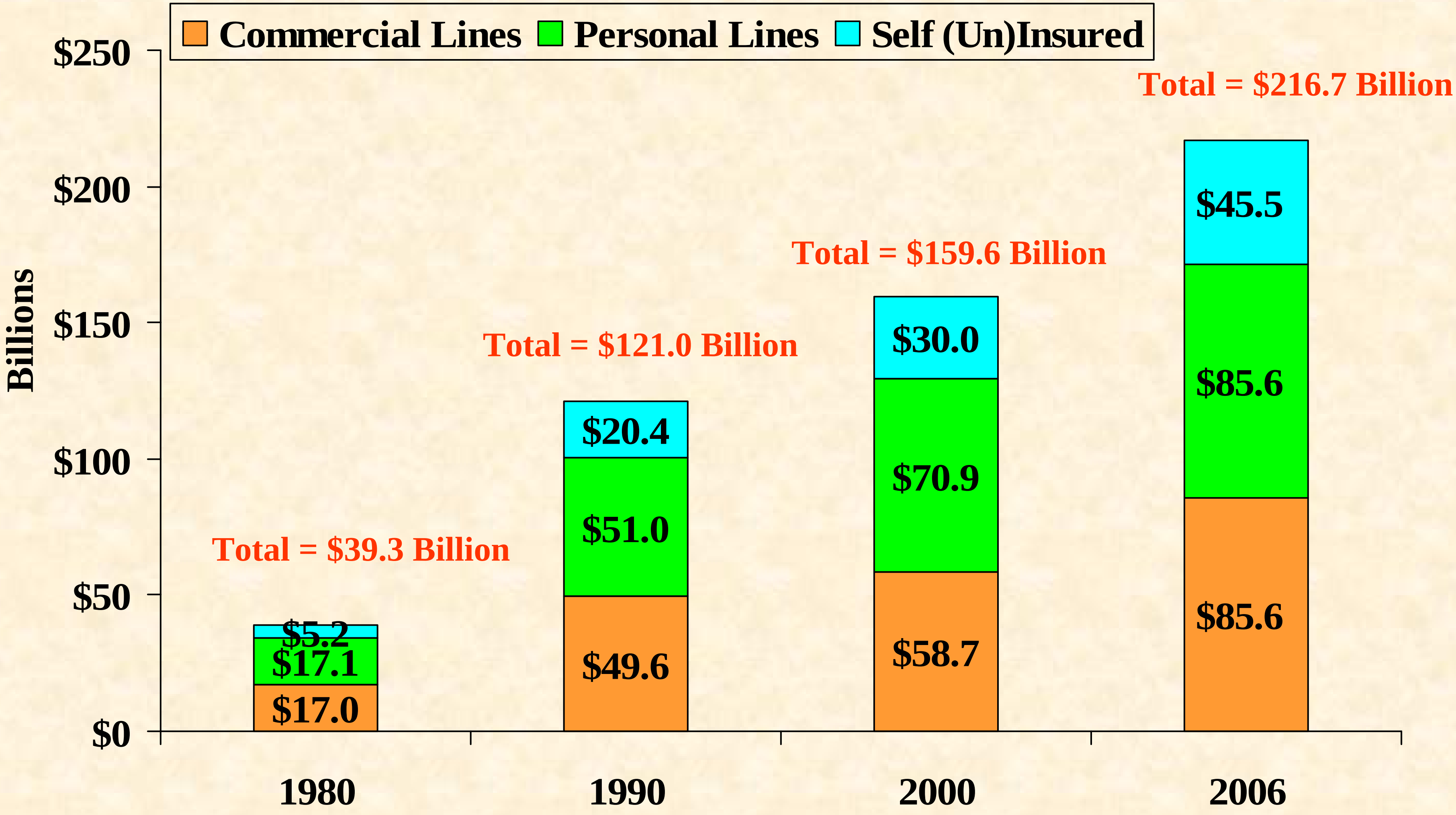


“King of Class Actions” Melvyn Weiss

- **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**

Source: Wall Street Journal, various issues.

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

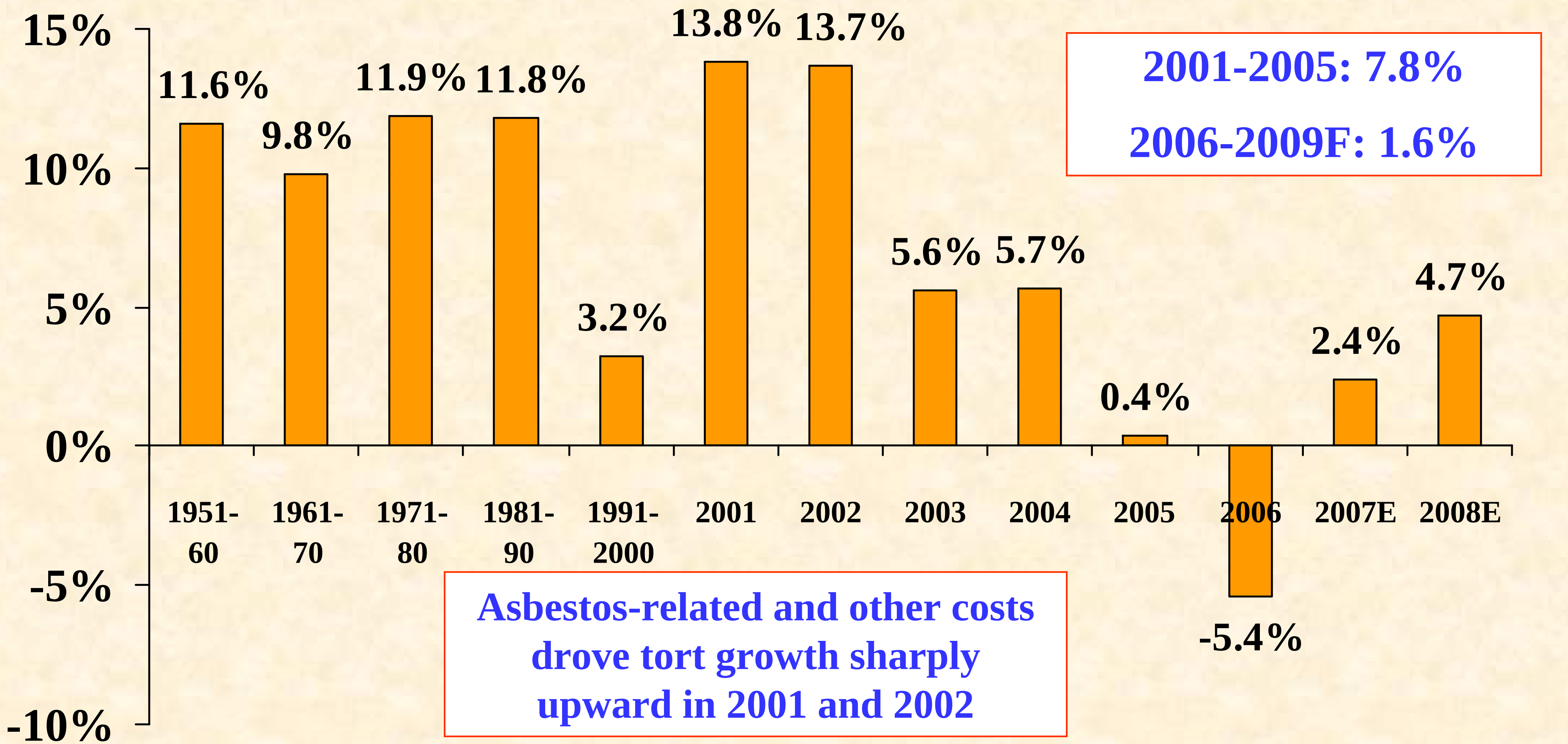


*Excludes medical malpractice

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

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

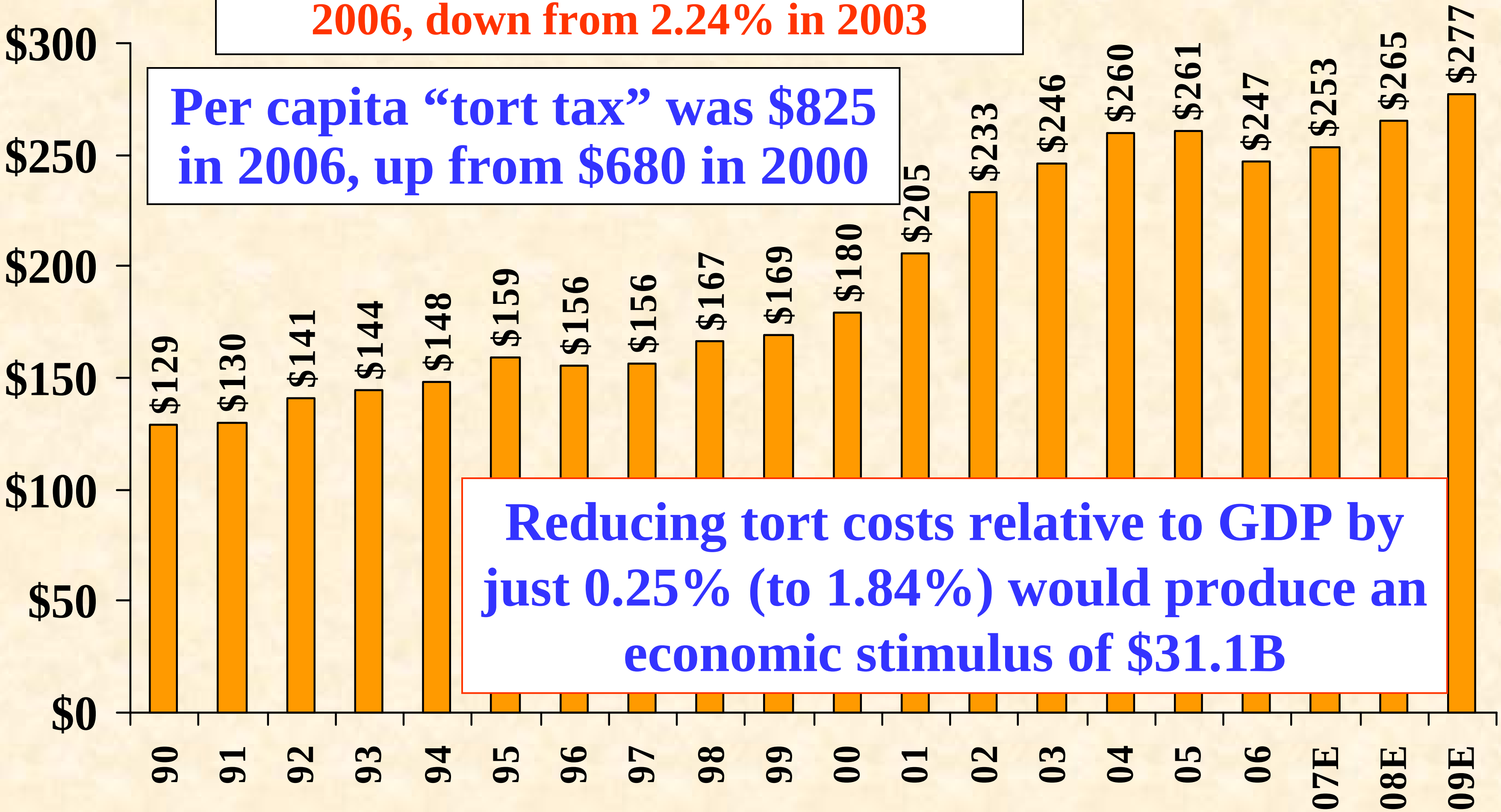


Source: Tillinghast-Towers Perrin.

Cost of US Tort System
($ Billions)

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

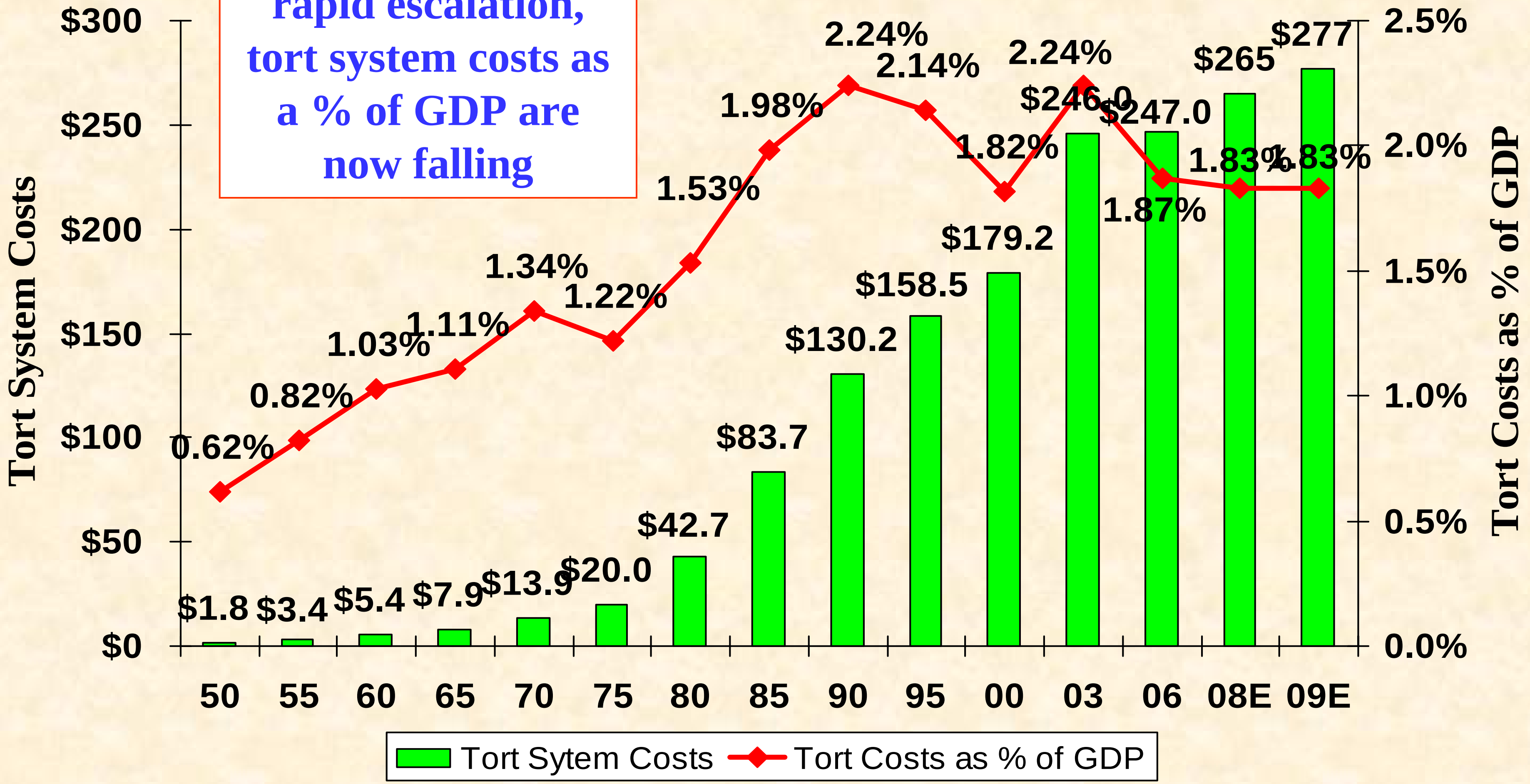


Reducing tort costs relative to GDP by just 0.25% (to 1.84%) would produce an economic stimulus of $31.1B

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

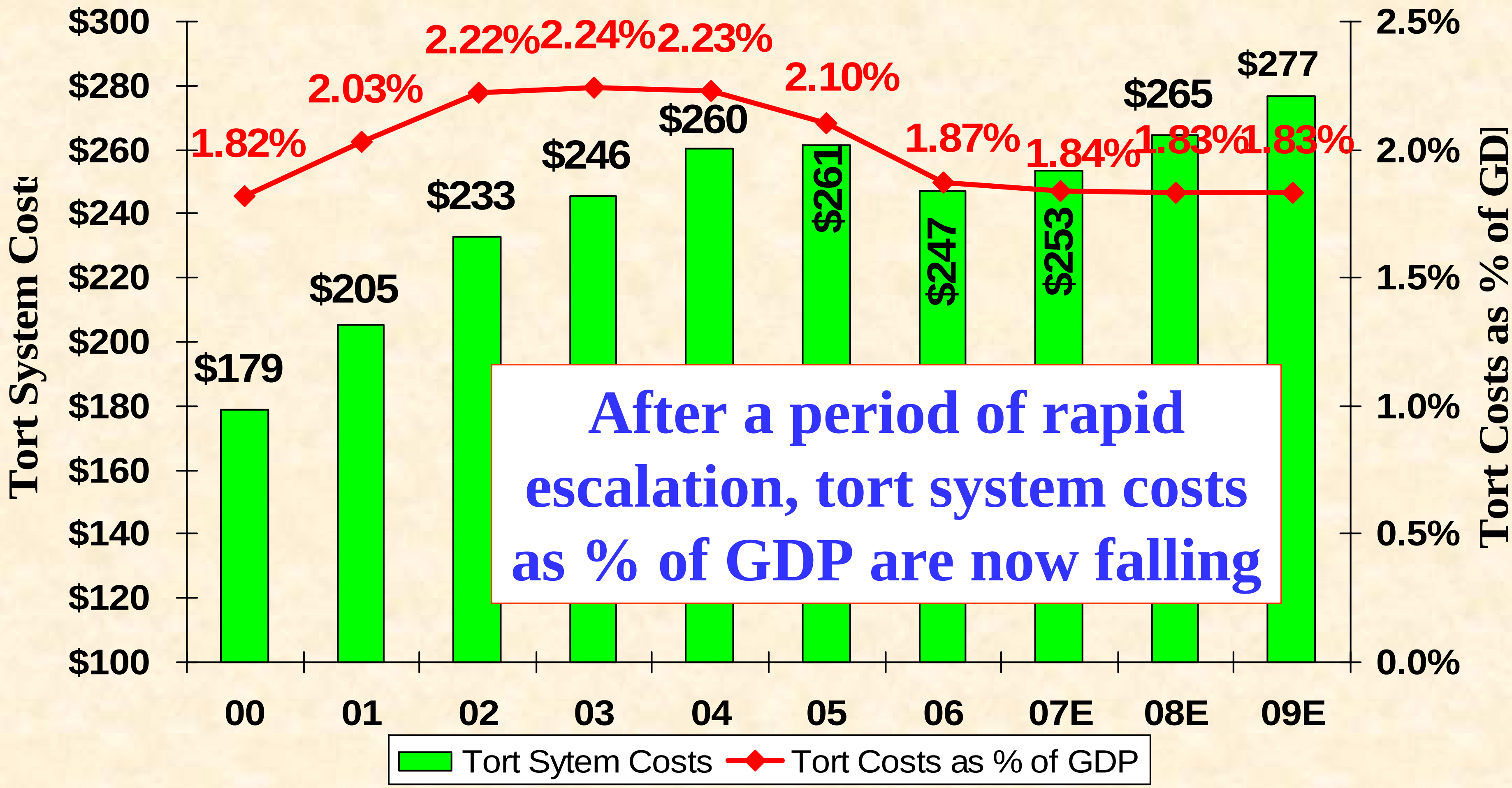
Tort System Costs, 1950-2009E

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



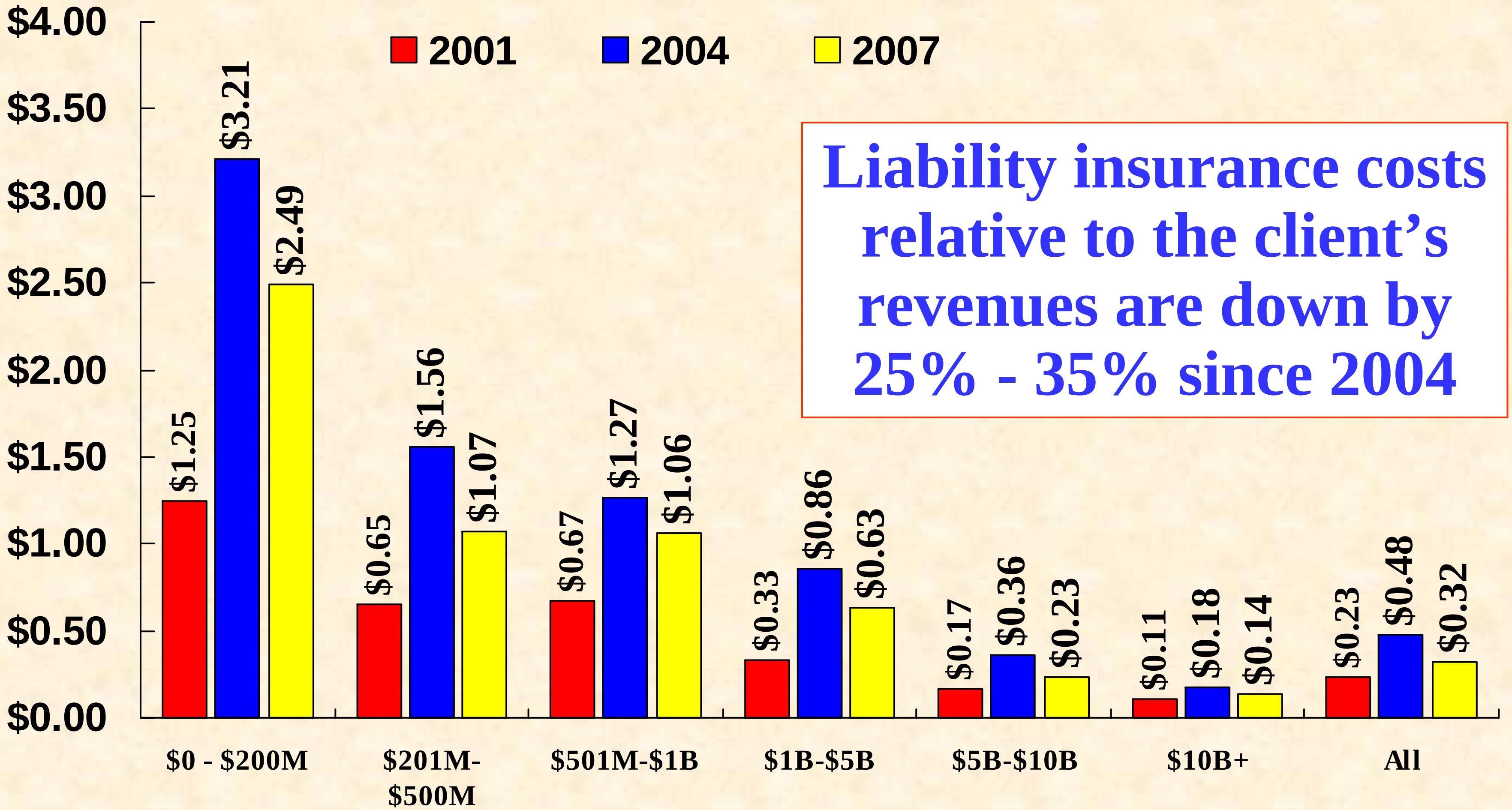
Source: Tillinghast-Towers Perrin, *2007 Update on U.S. Tort Costs as % of GDP*

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



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

*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

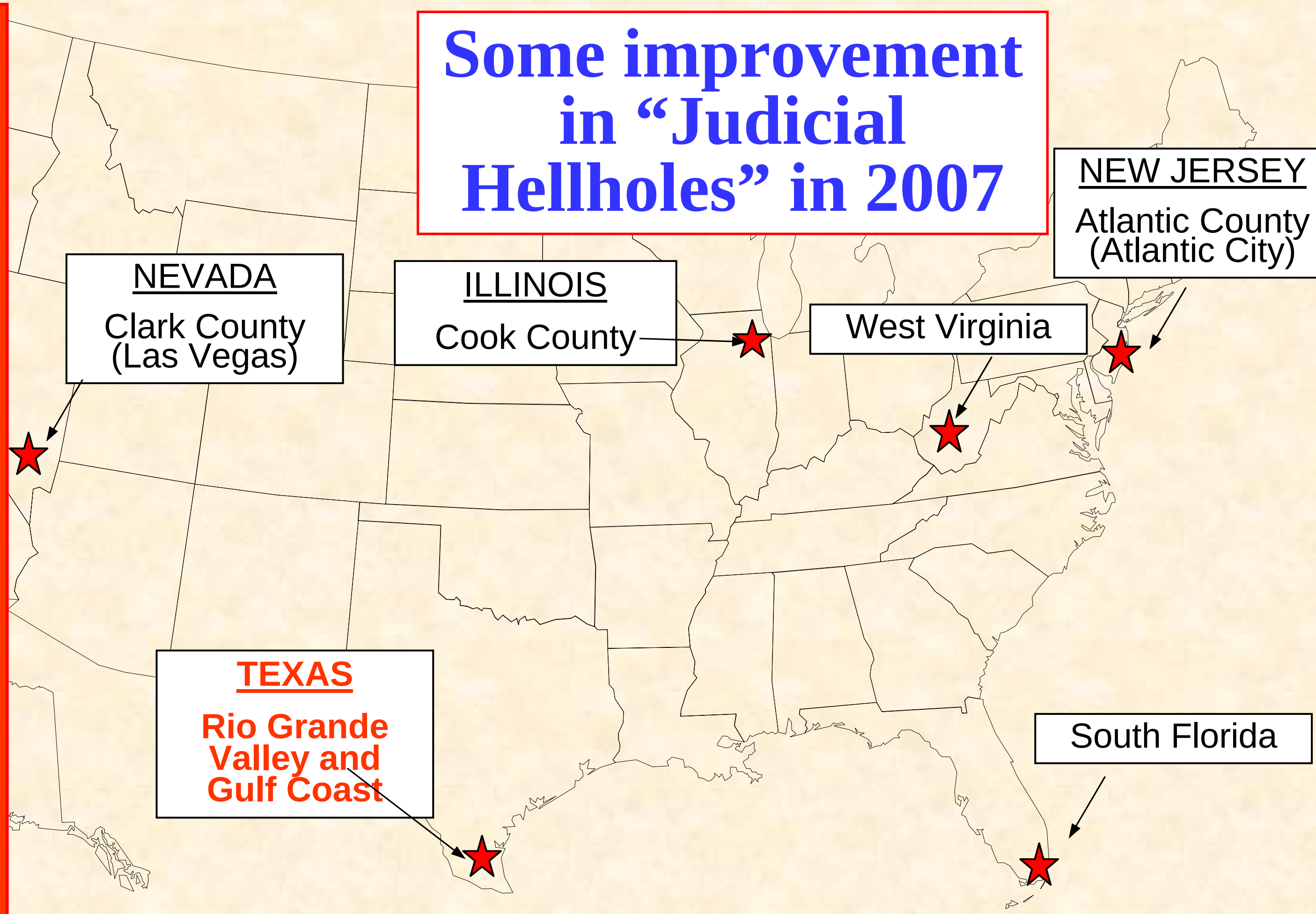
District of Columbia

MO Supreme Court

MI Legislature

GA Supreme Court

Oklahoma



Source: American Tort Reform Association; Insurance Information Institute

Business Leaders Ranking of Liability Systems for 2007

Best States

1. Delaware
2. Minnesota
3. Nebraska
4. Iowa
5. Maine
6. New Hampshire
7. Tennessee
8. Indiana
9. Utah
10. Wisconsin

New in 2007

ME, NH, TN, UT, WI

Drop-Offs

ND, VA, SD, WY, ID

Midwest/West has mix of good and bad states

Worst States

41. Arkansas
42. Hawaii
43. Alaska
44. Texas
45. California
46. Illinois
47. Alabama
48. Louisiana
49. Mississippi
50. West Virginia

Newly Notorious

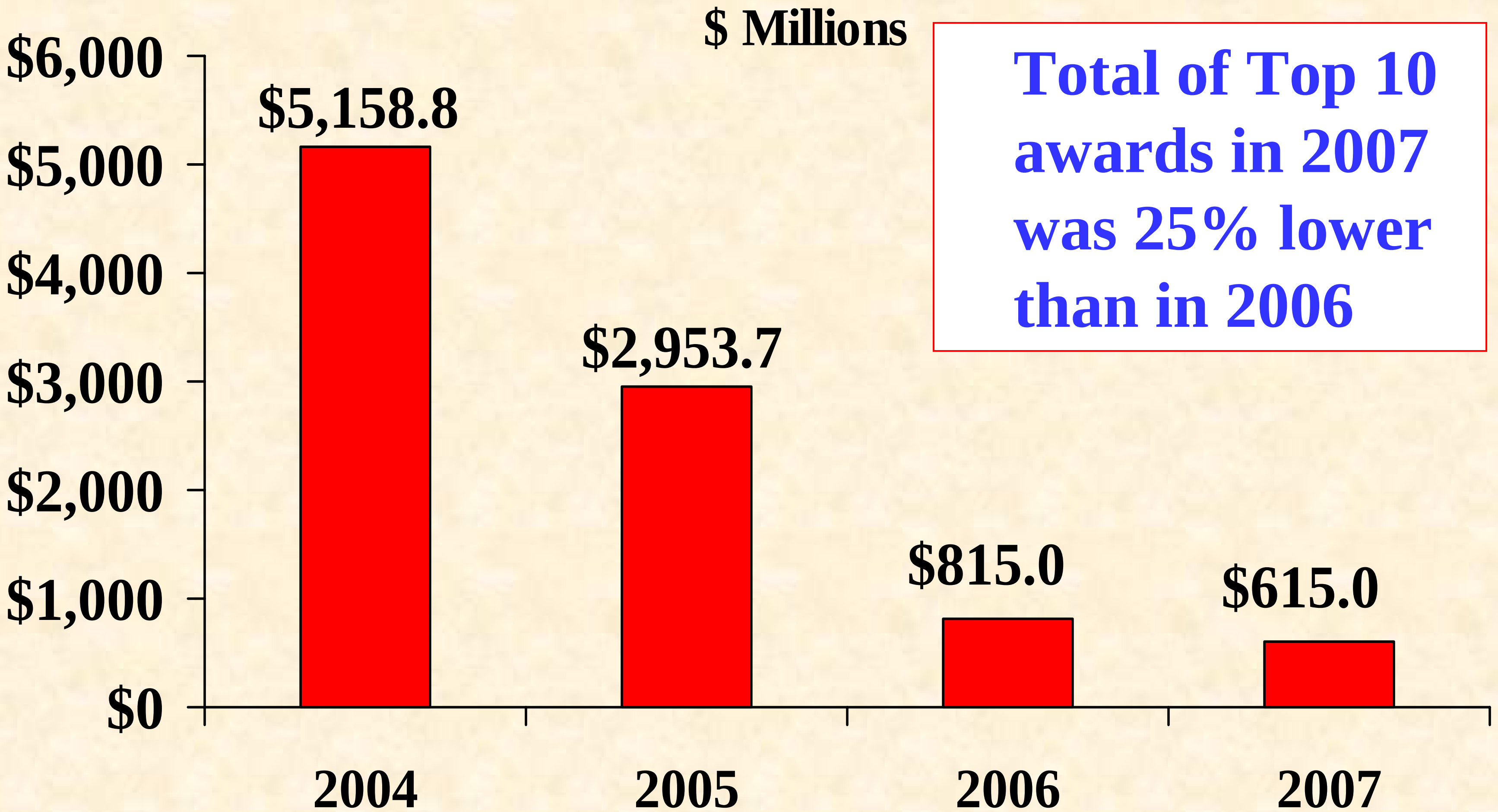
AK

Rising Above

FL

Source: US Chamber of Commerce 2007 State Liability Systems Ranking Study; Insurance Info. Institute.

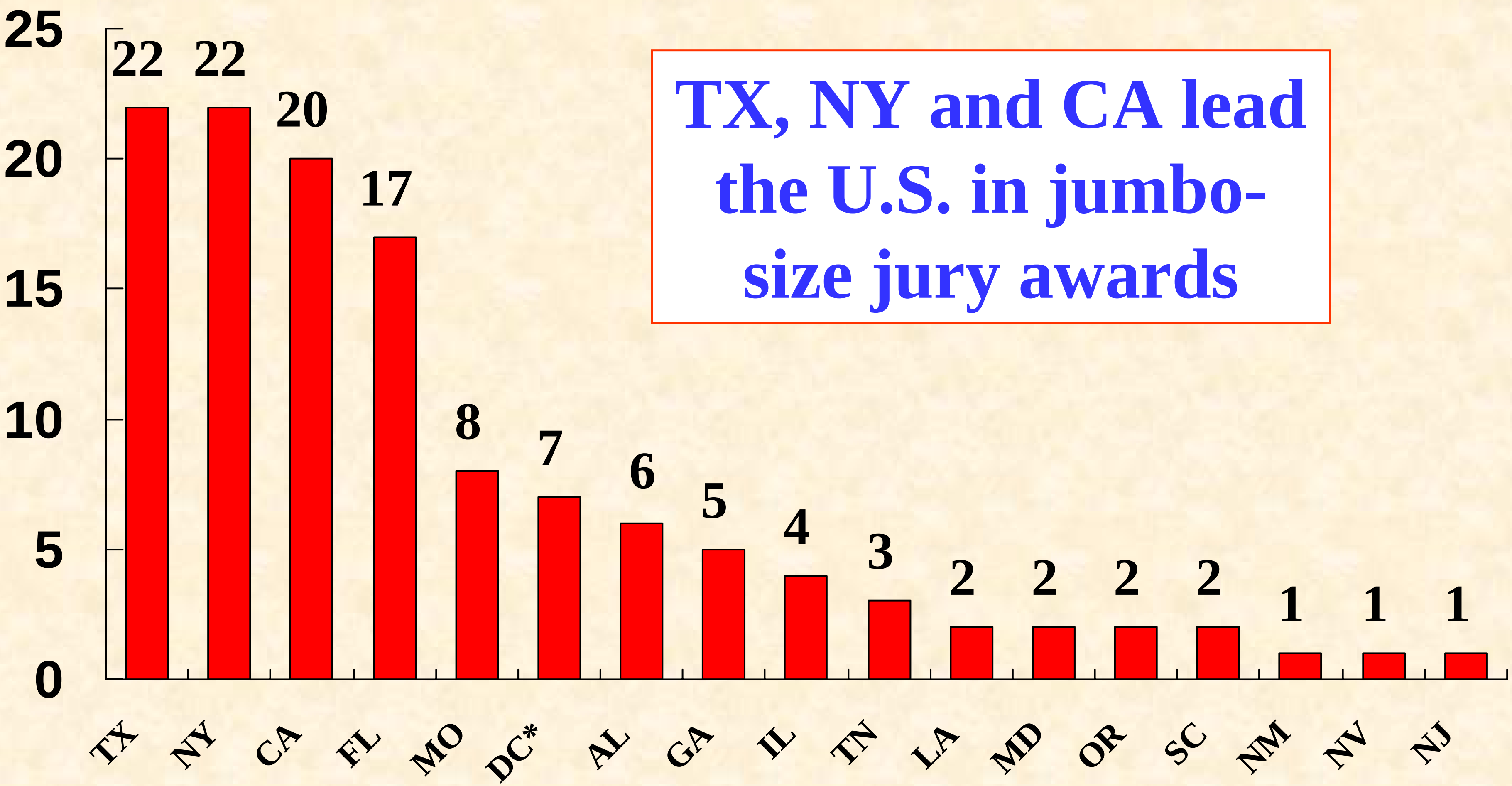
Sum of Top 10 Jury Awards, 2004-2007



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

Source: Insurance Information Institute from LawyersWeekly USA, January 2005, 2006, 2007 and 2008.

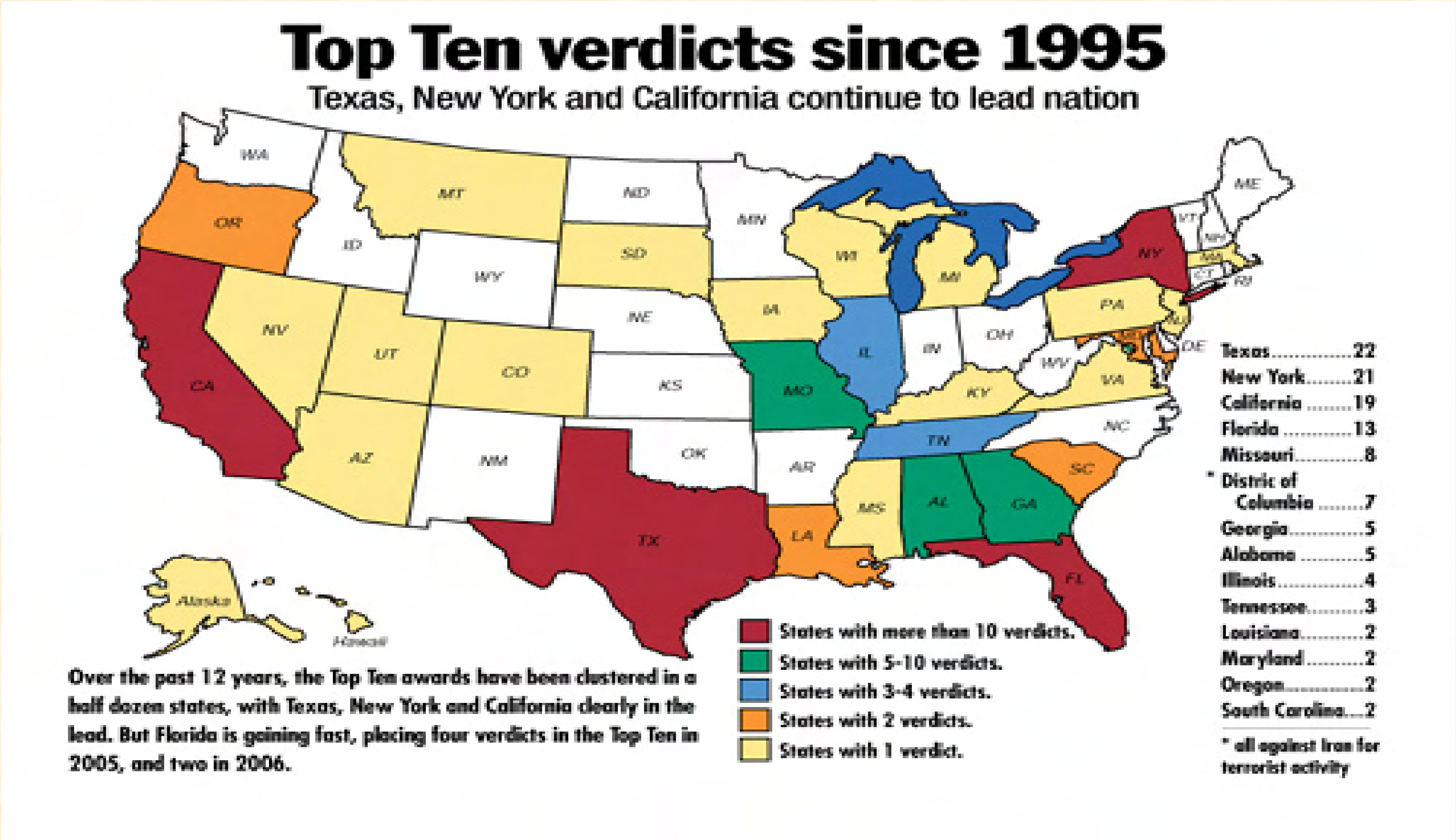
Number of Top 10 Jury Awards, 1995 - 2007



Source: LawyersWeekly USA,, January 22, 2008.

*All against Iran for terrorist activity

Total Top 10 Verdicts, 1995 through 2006



Source: Lawyers USA, 2007

2007 Top Ten Verdicts

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

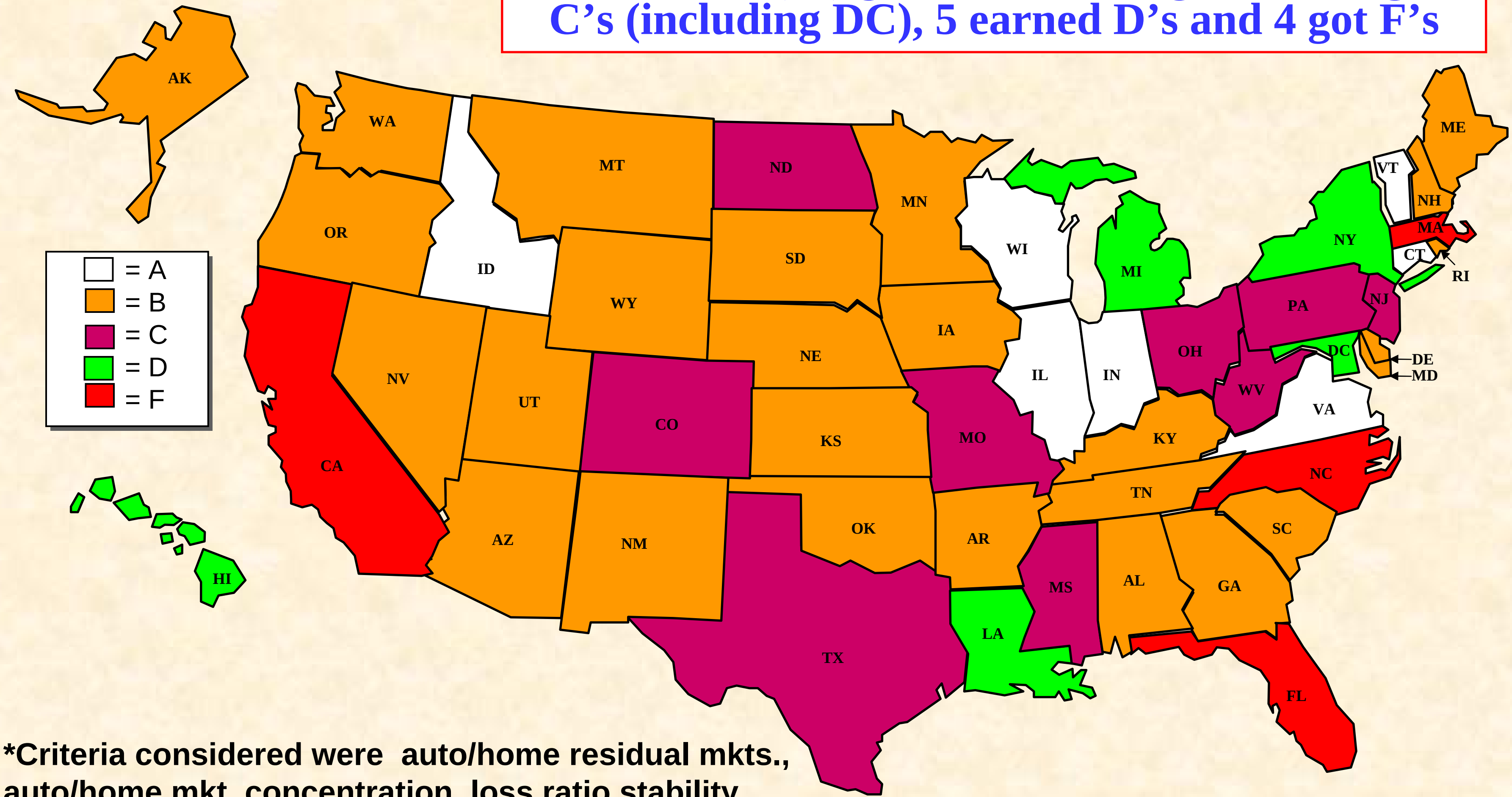
Source: LawyersWeekly USA, January 22, 2008.

REGULATORY & LEGISLATIVE ENVIRONMENT

Isolated Improvements, Mounting Zealoutry

Rating of Auto/Home Insurance Regulatory & Operating Environment*

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

Insurance Information Institute On-Line

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