The Commercial P/C Insurance Industry: Overview & Outlook

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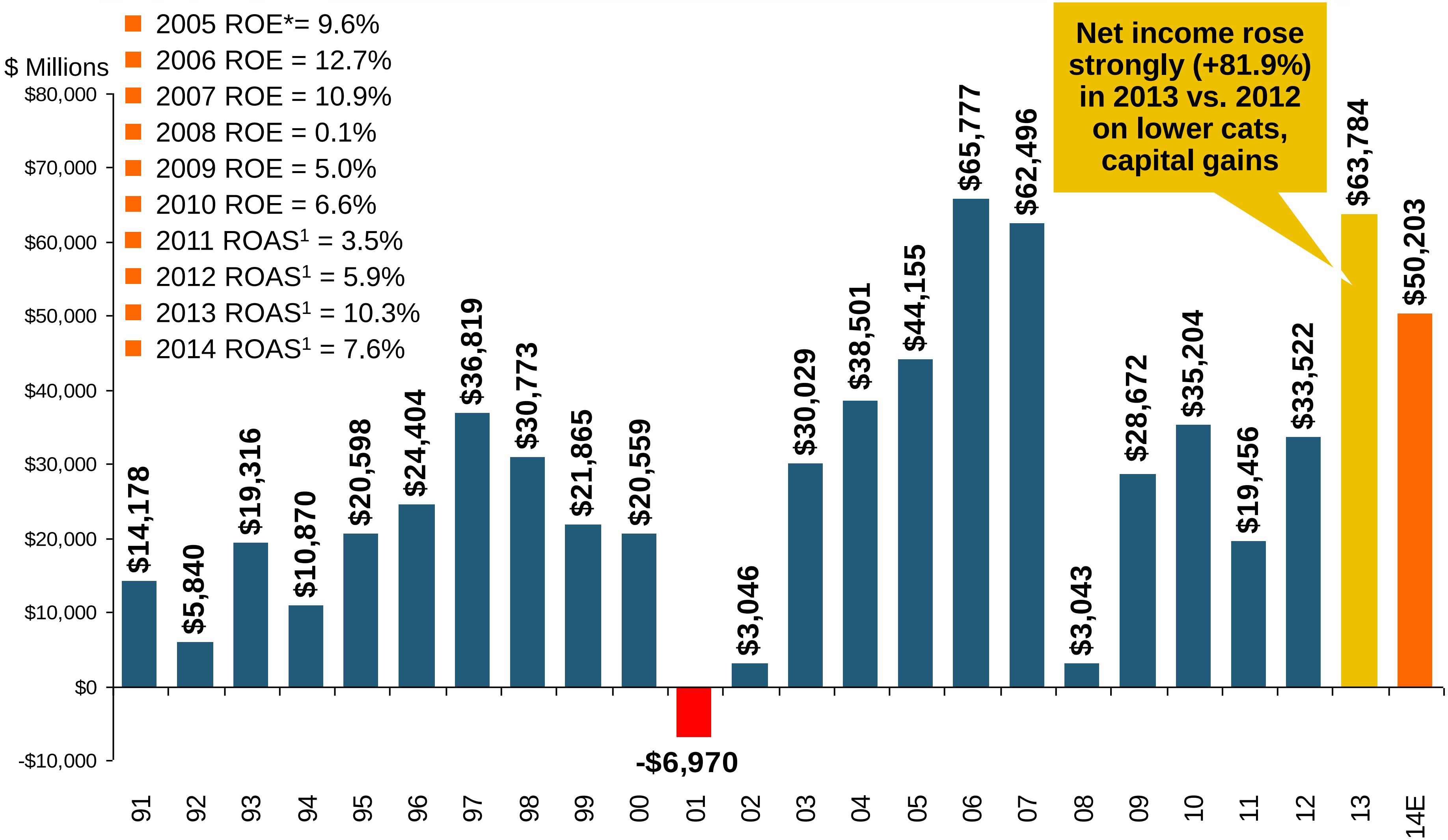
Insurance Industry: *Financial Update & Outlook*

2014 Was a Reasonably Good Year

2013 Was the Industry's Best Year in the Post-Crisis Era

P/C Industry Net Income After Taxes 1991–2014E



•ROE figures are GAAP; [1]Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.7% ROAS through 2014:Q2, 9.8% ROAS in 2013, 6.2% ROAS in 2012, 4.7% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009.

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

Back to '60s? P/C Insurance Industry Profitability, 1950 – 2014*

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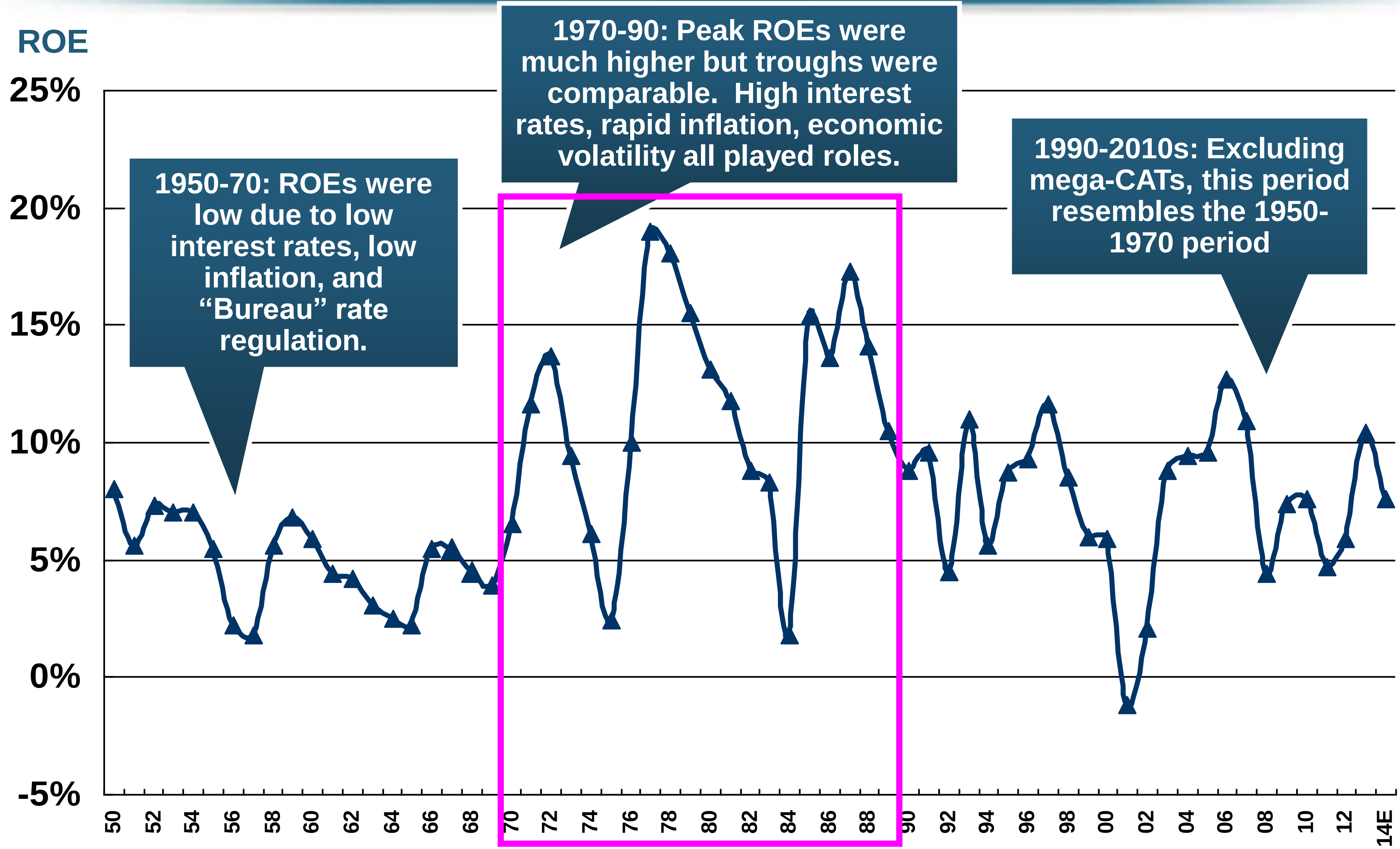
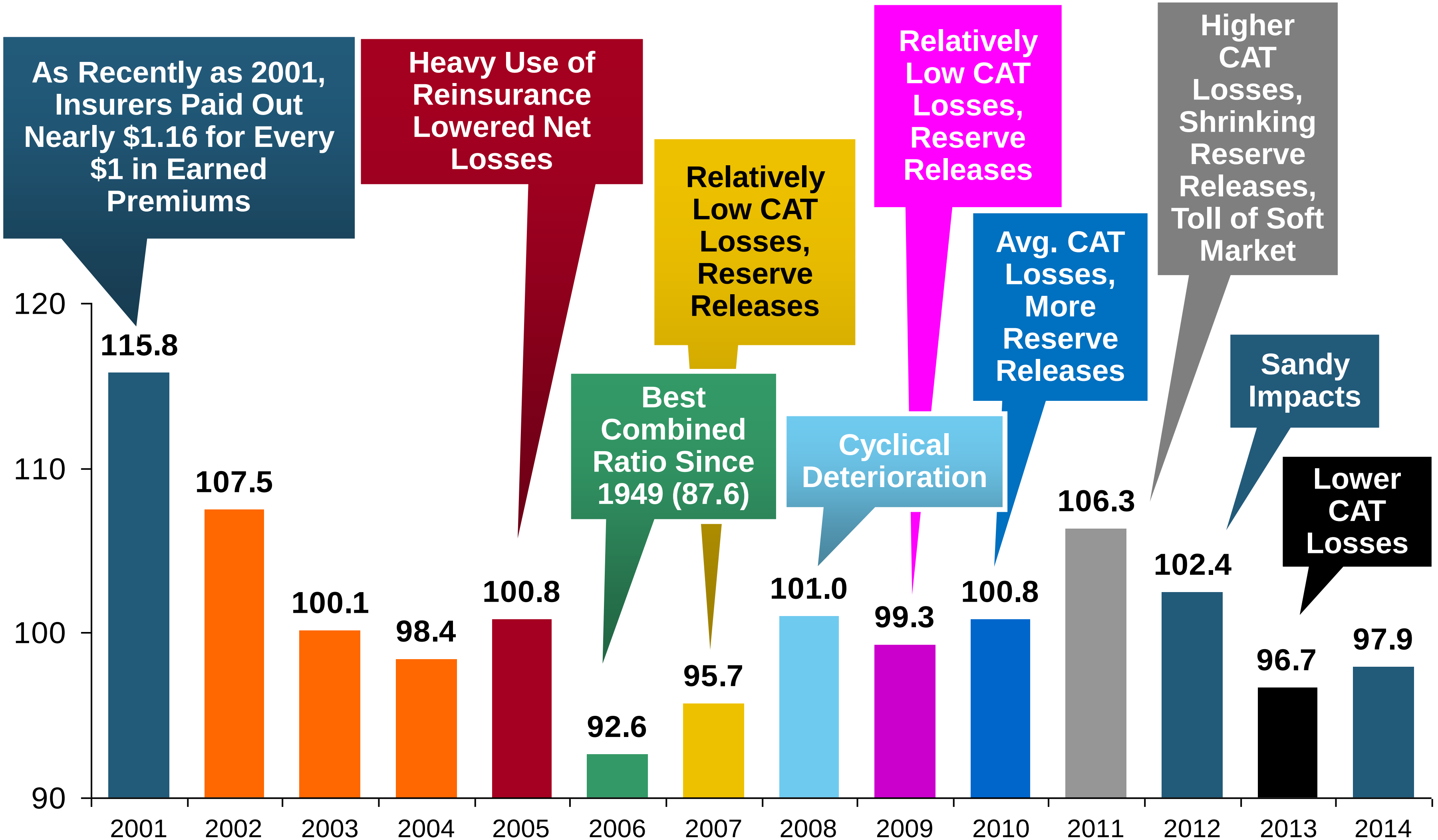


*Profitability = P/C insurer ROEs. 2011-14 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers. 2014 figure is through Q3.

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

P/C Insurance Industry Combined Ratio, 2001–2014:Q3*



* Excludes Mortgage & Financial Guaranty insurers 2008--2014. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.1; 2012:=103.2; 2013: = 96.1; 2014:9M = 97.7.

Sources: A.M. Best, ISO.

A 100 Combined Ratio Isn't What It Once Was: Investment Impact on ROEs

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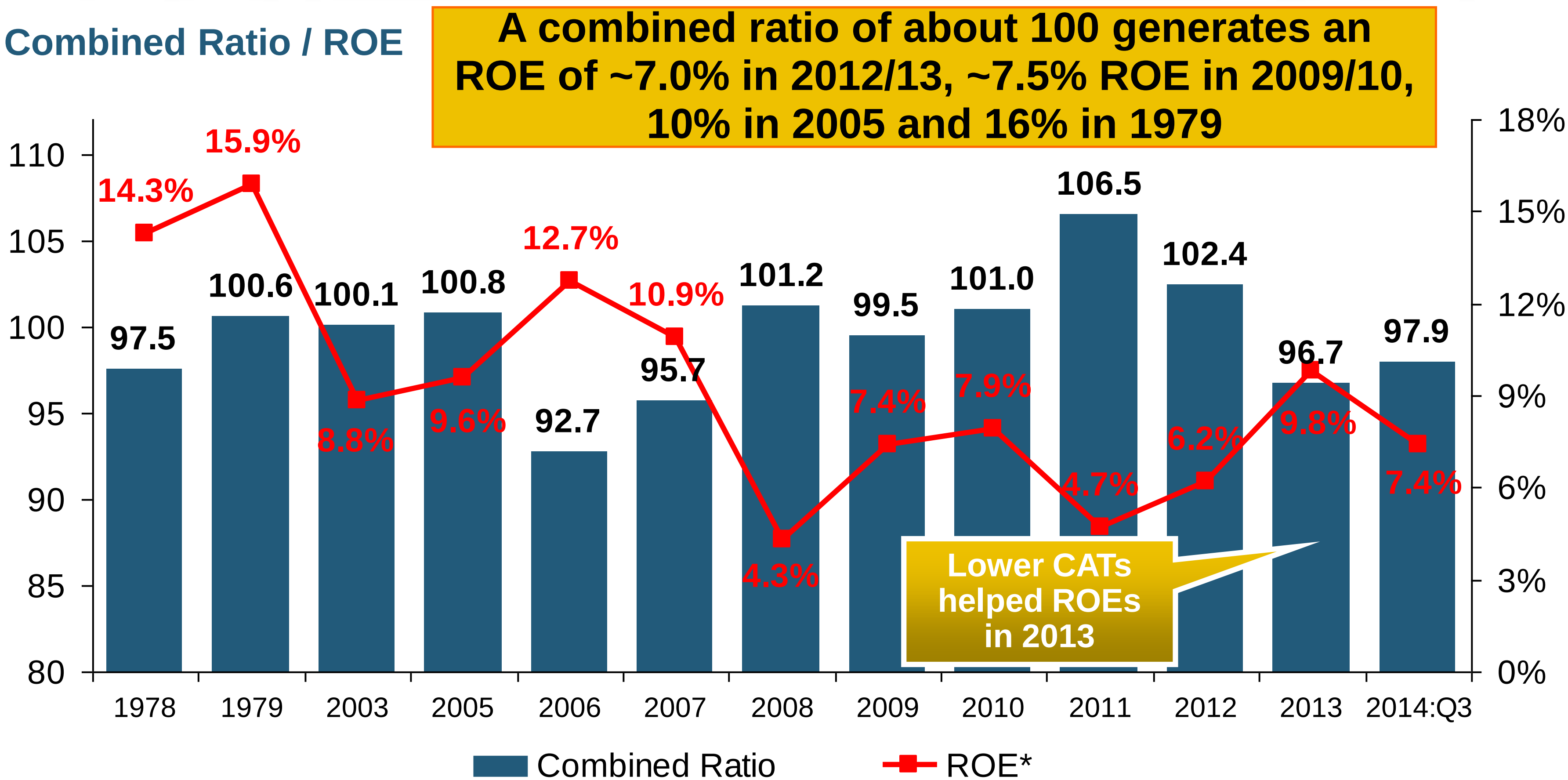
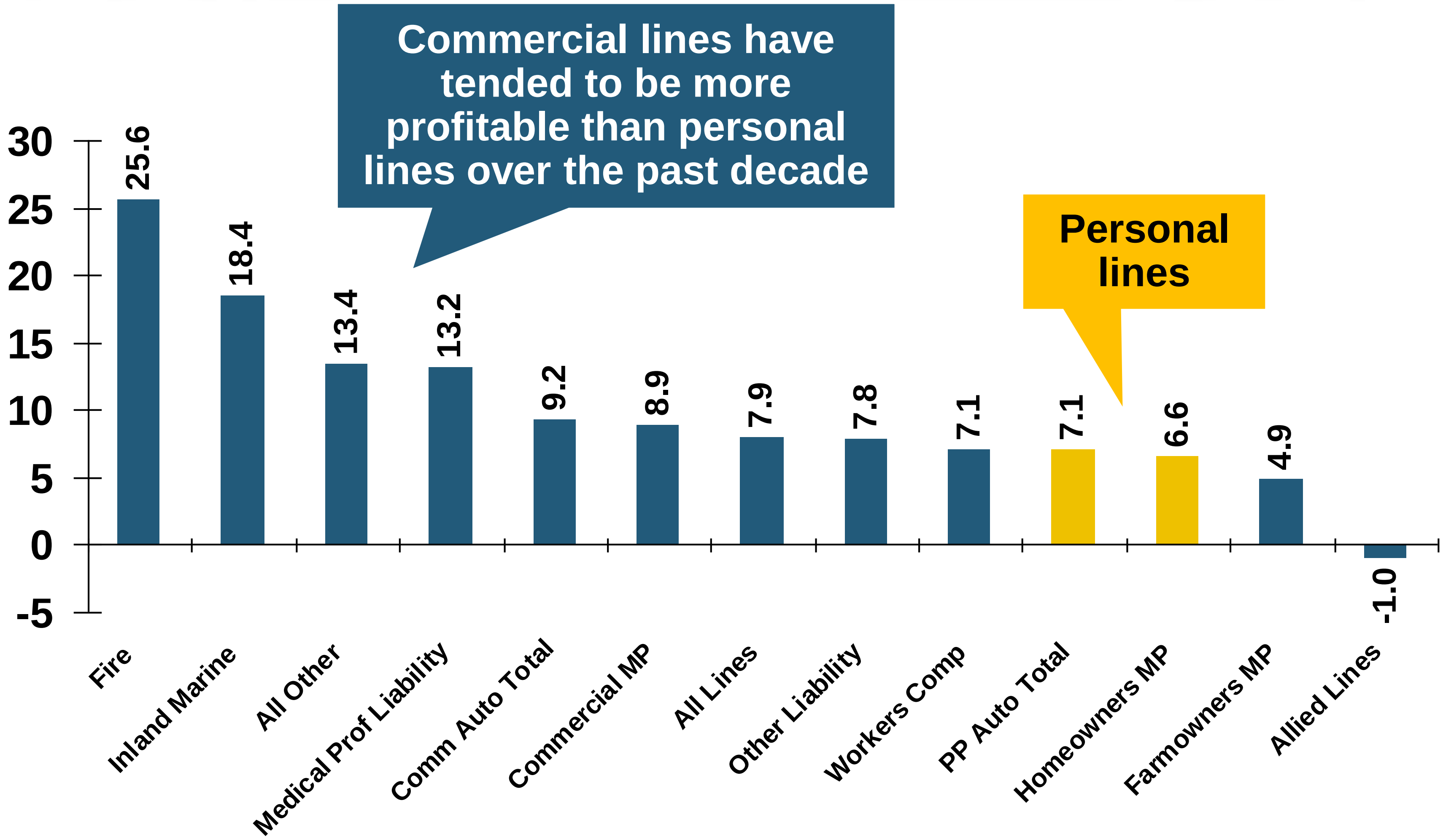


Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs

* 2008 -2014 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2014:9M combined ratio including M&FG insurers is 97.7; 2013 = 96.1; 2012 =103.2, 2011 = 108.1, ROAS = 3.5%.

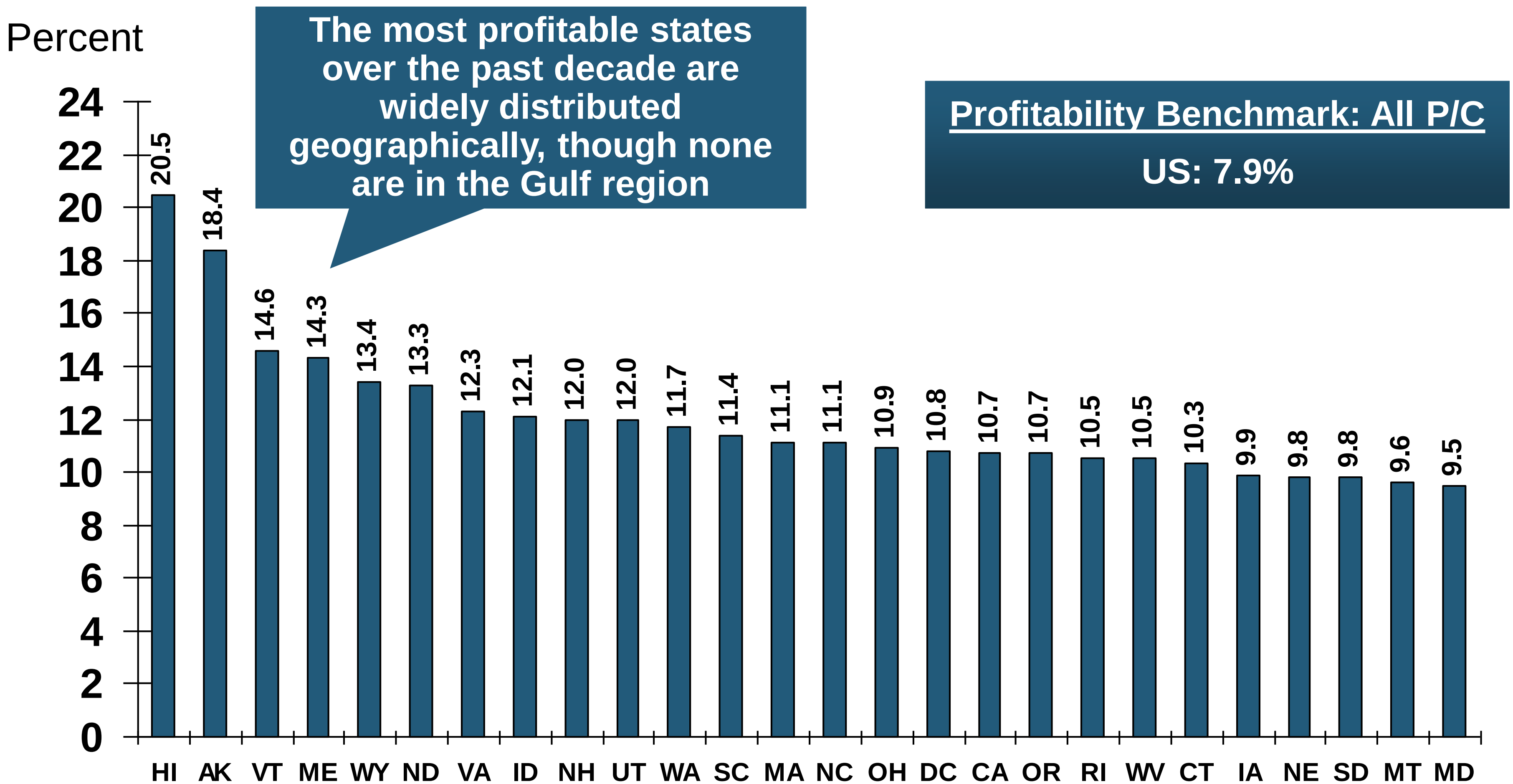
Source: Insurance Information Institute from A.M. Best and ISO Verisk Analytics data.

Return on Net Worth (RNW) All Lines: 2004-2013 Average



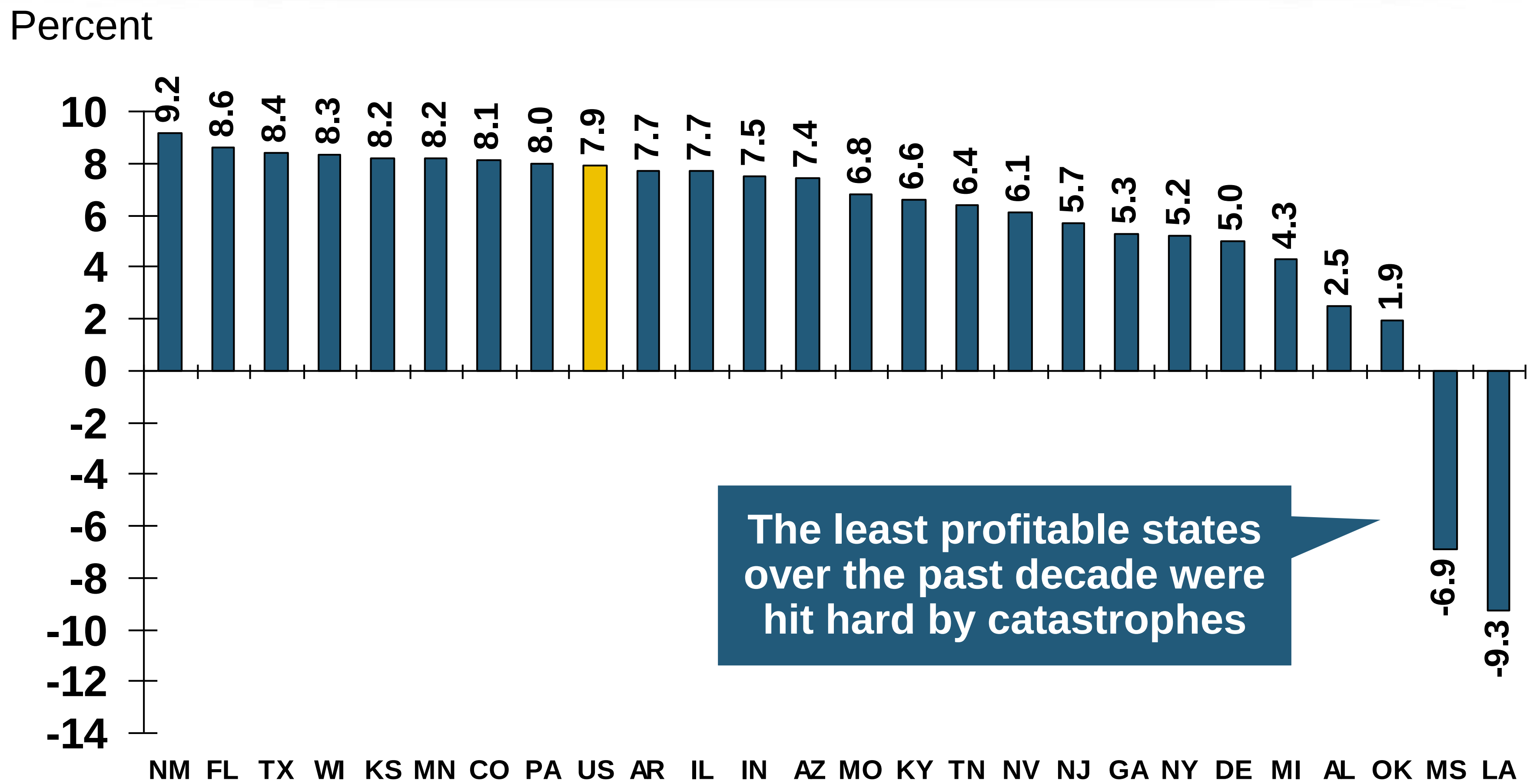
Source: NAIC; Insurance Information Institute.

RNW All Lines by State, 2004-2013 Average: Highest 25 States



Source: NAIC; Insurance Information Institute.

RNW All Lines by State, 2004-2013 Average: Lowest 25 States



Source: NAIC; Insurance Information Institute.

U.S. Insured Catastrophe Loss Update

2013/14 Had Below-Average CAT Activity Following Very High CAT Losses in 2011/12

U.S. Insured Catastrophe Losses

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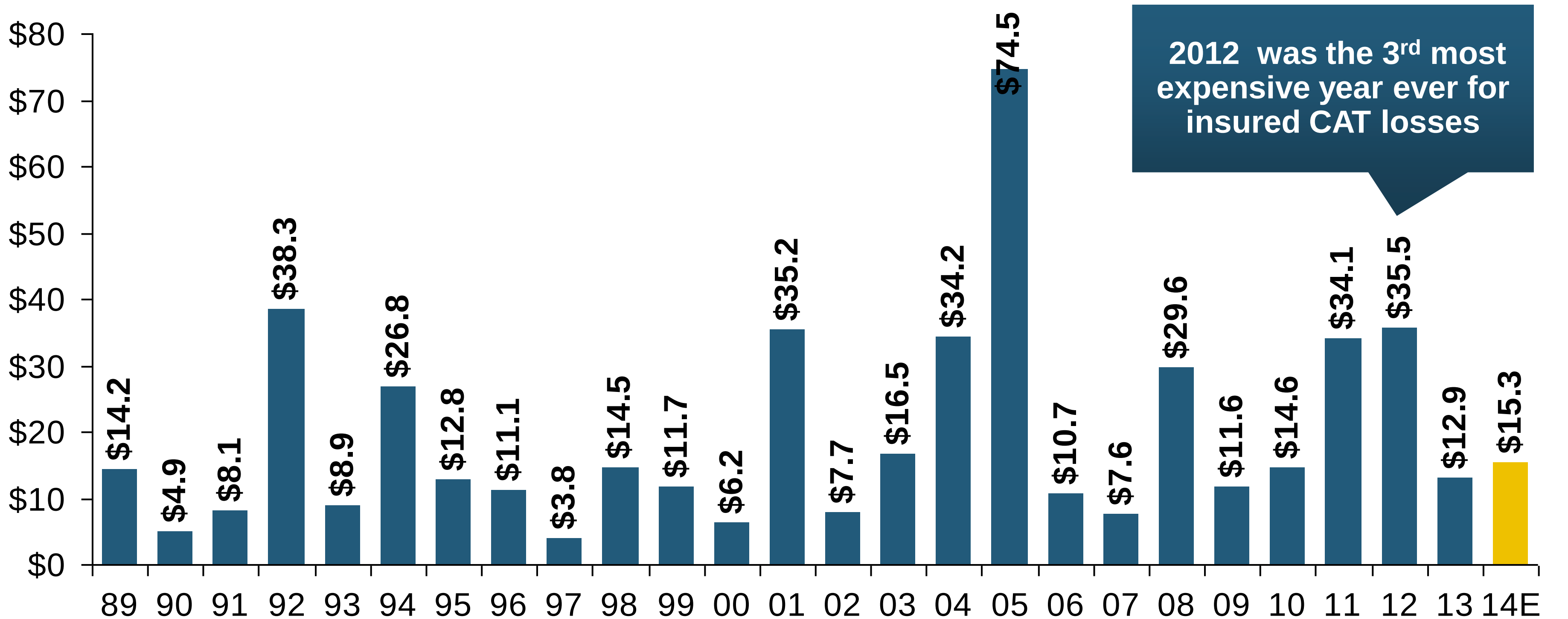
($ Billions, $ 2013)



2013 Was a Welcome Respite from 2012, the 3rd Costliest Year for Insured Disaster Losses in US History. Longer-term Trend is for more—not fewer—Costly Events

*Through 12/31/14.

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

Sources: Property Claims Service/ISO; Insurance Information Institute.

Inflation Adjusted U.S. Catastrophe Losses by Cause of Loss, 1994–2013[1]

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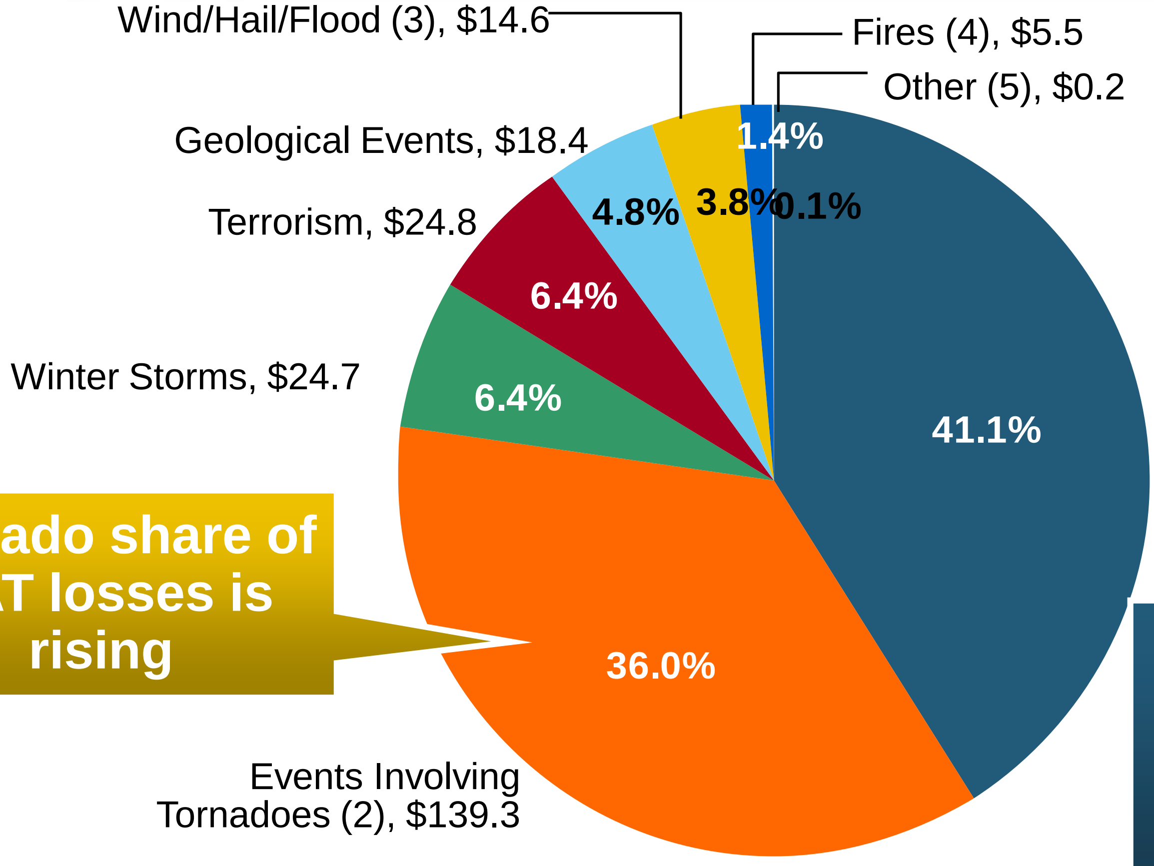


Insured cat losses from 1993-2012 totaled $386.7B, an average of $19.3B per year or $1.6B per month

Tornado share of CAT losses is rising

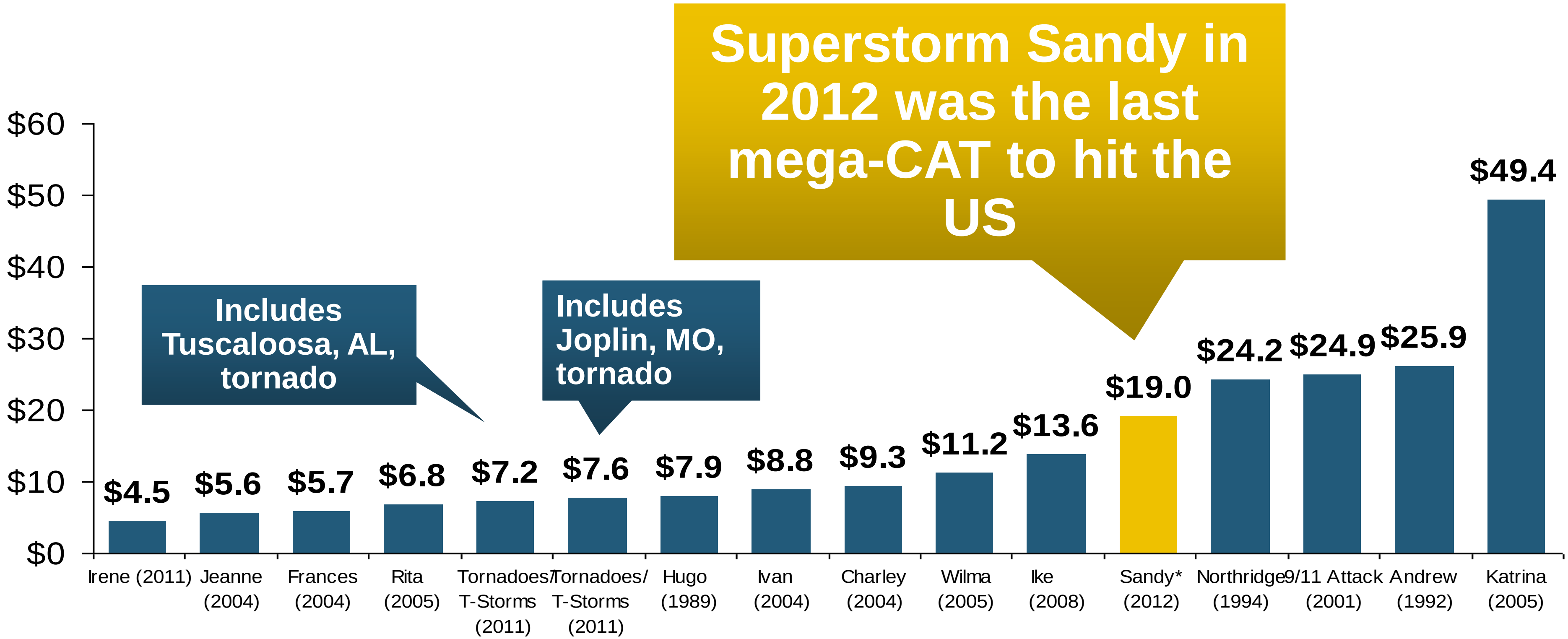
Wind losses are by far cause the most catastrophe losses, even if hurricanes/TS are excluded.

1. Catastrophes are defined as events causing direct insured losses to property of $25 million or more in 2013 dollars.
2. Excludes snow.
3. Does not include NFIP flood losses
4. Includes wildland fires
5. Includes civil disorders, water damage, utility disruptions and non-property losses such as those covered by workers compensation.

Source: ISO's Property Claim Services Unit.

Top 16 Most Costly Disasters in U.S. History

(Insured Losses, 2013 Dollars, $ Billions)



12 of the 16 Most Expensive Events in US History Have Occurred Over the Past Decade

Sources: PCS; Insurance Information Institute inflation adjustments to 2013 dollars using the CPI.

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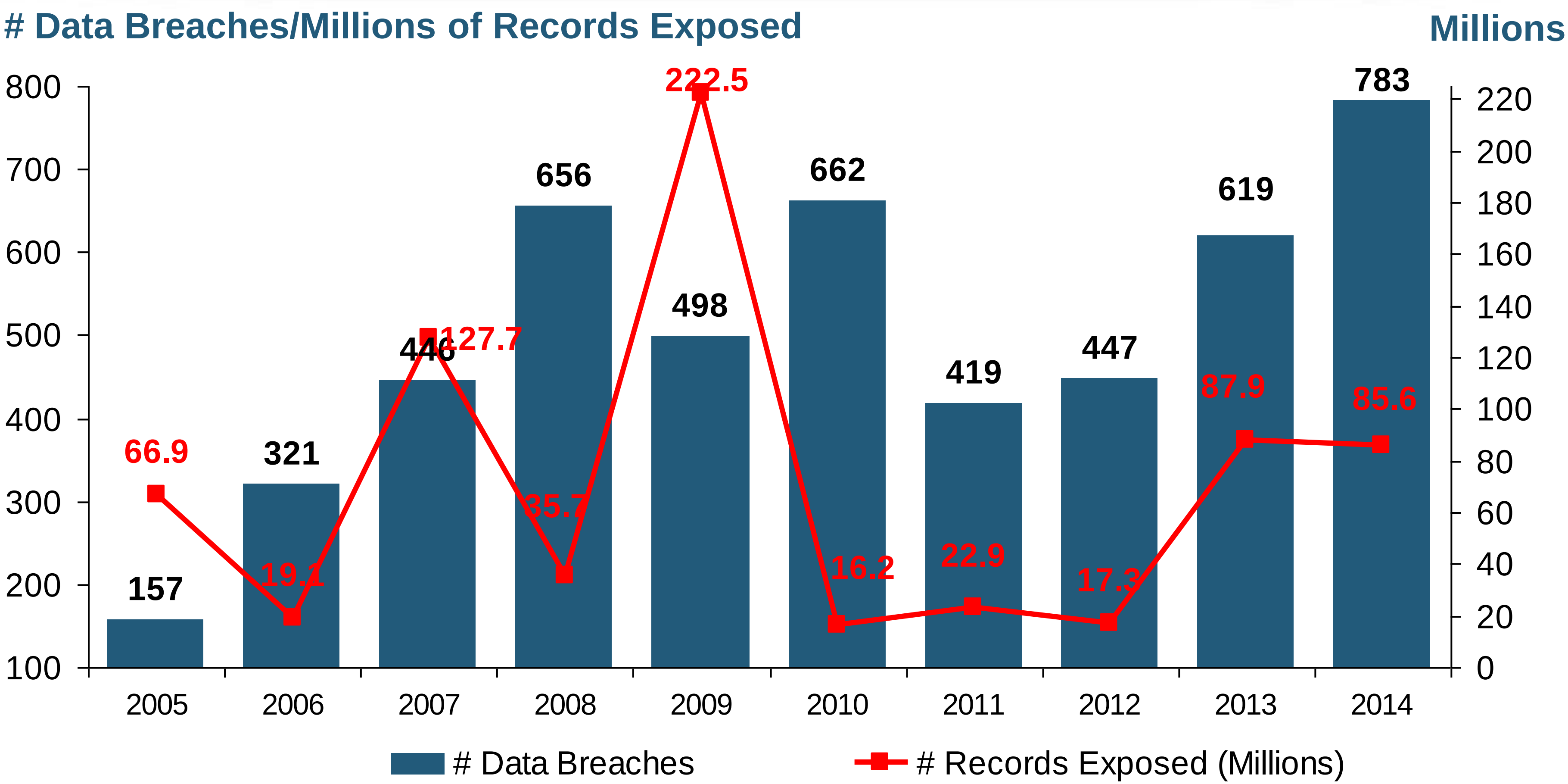
CYBER RISK: A Rapidly Emerging Exposure for Businesses Large and Small in Every Industry

Rapidly Increasing Interest from Businesses, Media, & Public Policymakers

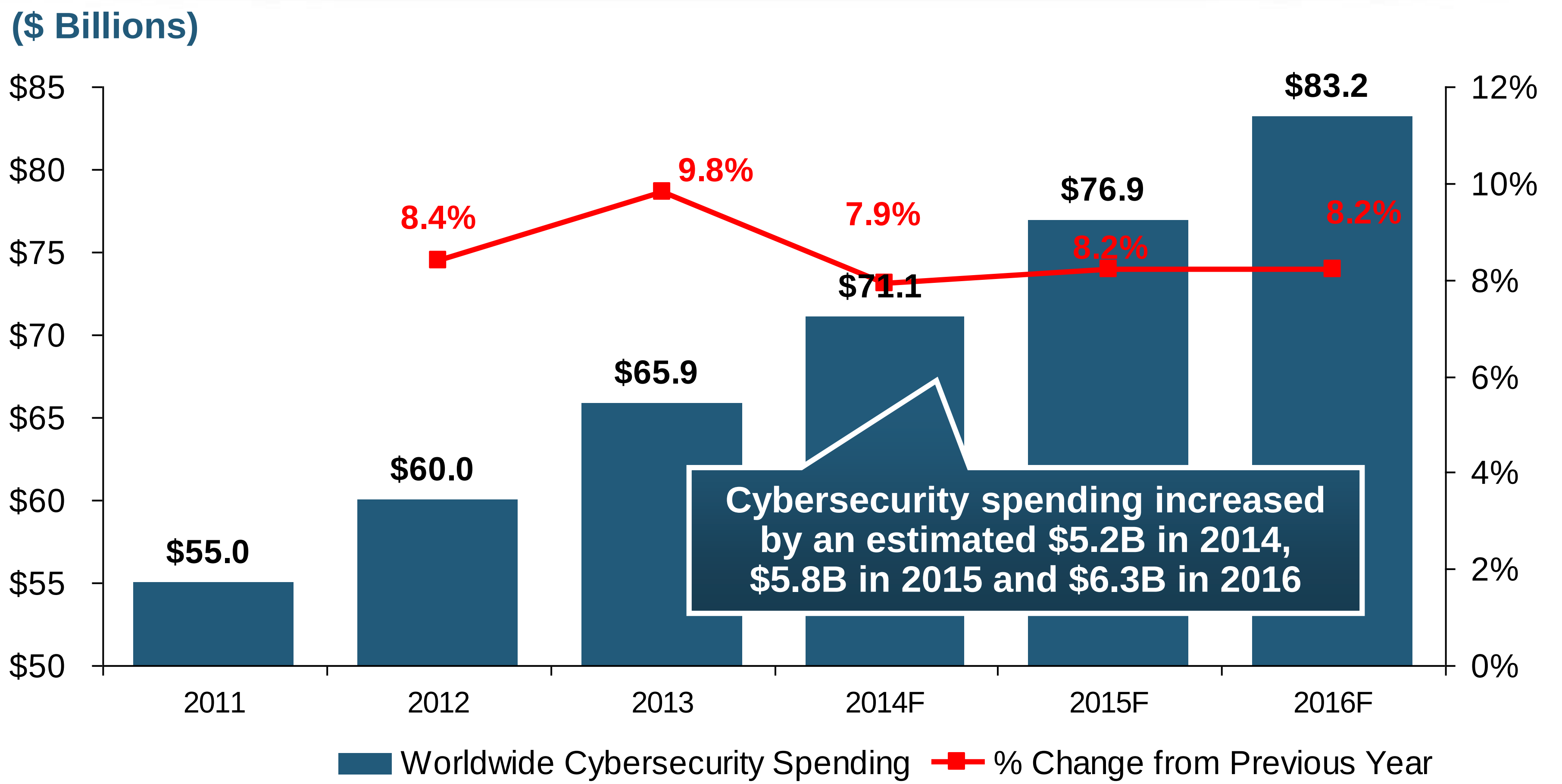
Data Breaches 2005-2014, by Number of Breaches and Records Exposed



The Total Number of Data Breaches Rose 28% While the Number of Records Exposed Was Relatively Flat (-2.6%)

* 2014 figures as of Jan. 12, 2014 from the ITRC.
Source: Identity Theft Resource Center.

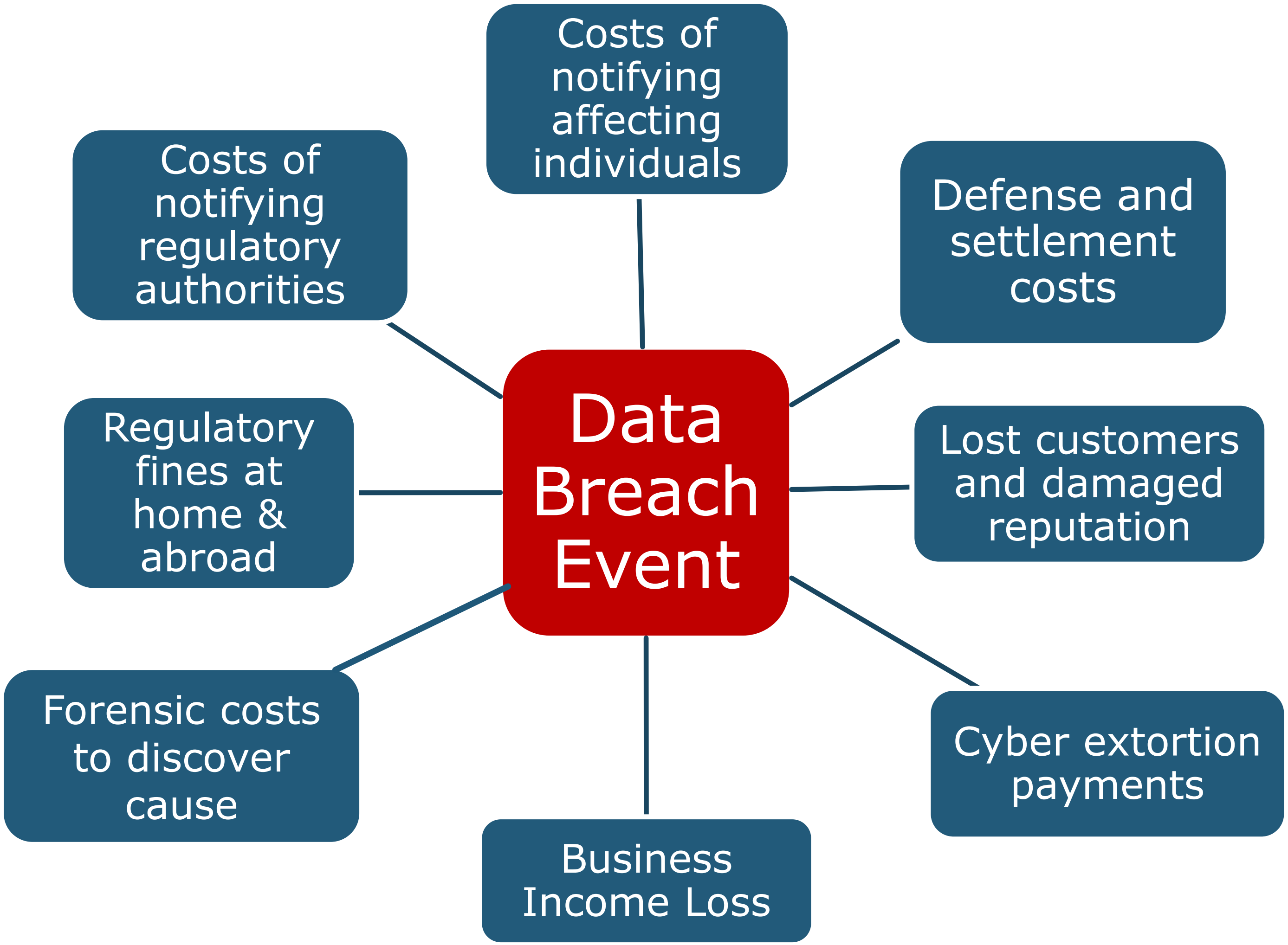
Worldwide Cybersecurity Spending, 2011- 2016F



Cybersecurity Spending Is Rising Sharply, Up by About 8%+ Annually through 2016—a Projected Increase of $12.1 Billion from 2014 to 2016

Source: Gartner Group; Insurance Information Institute; Adapted from *Wall Street Journal*: "Financial Firms Boost Cybersecurity Funds," Nov. 17, 2014.

Data/Privacy Breach: Many Potential Costs Can Be Insured



Source: Zurich Insurance; Insurance Information Institute

The Three Basic Elements of Cyber Coverage: Prevention, Transfer, Response

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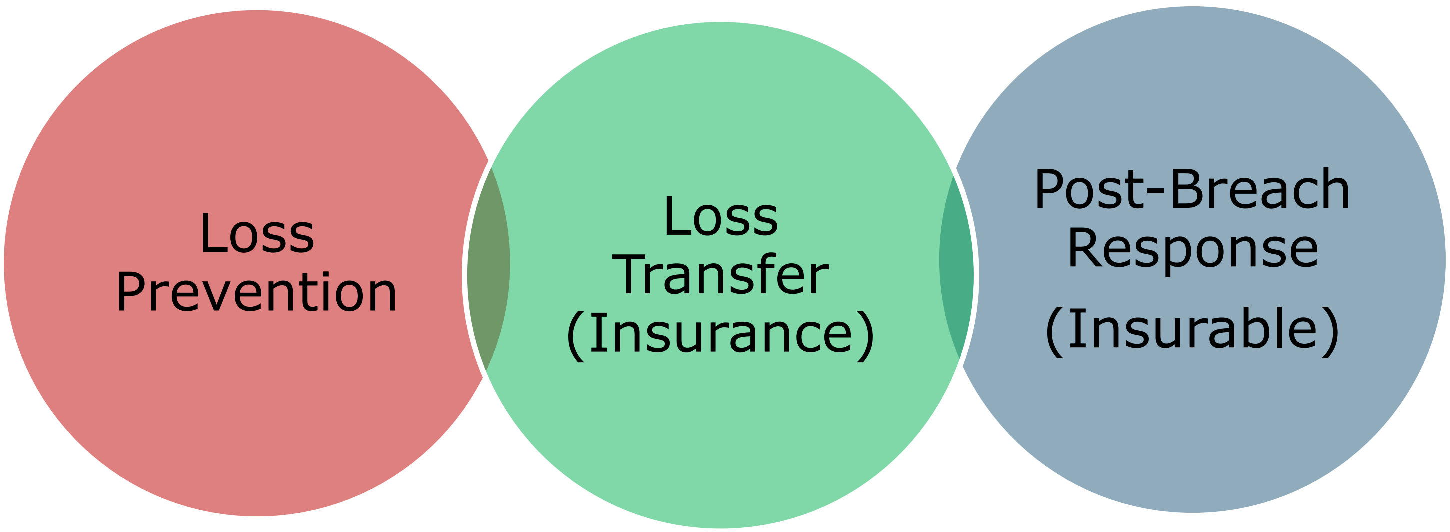
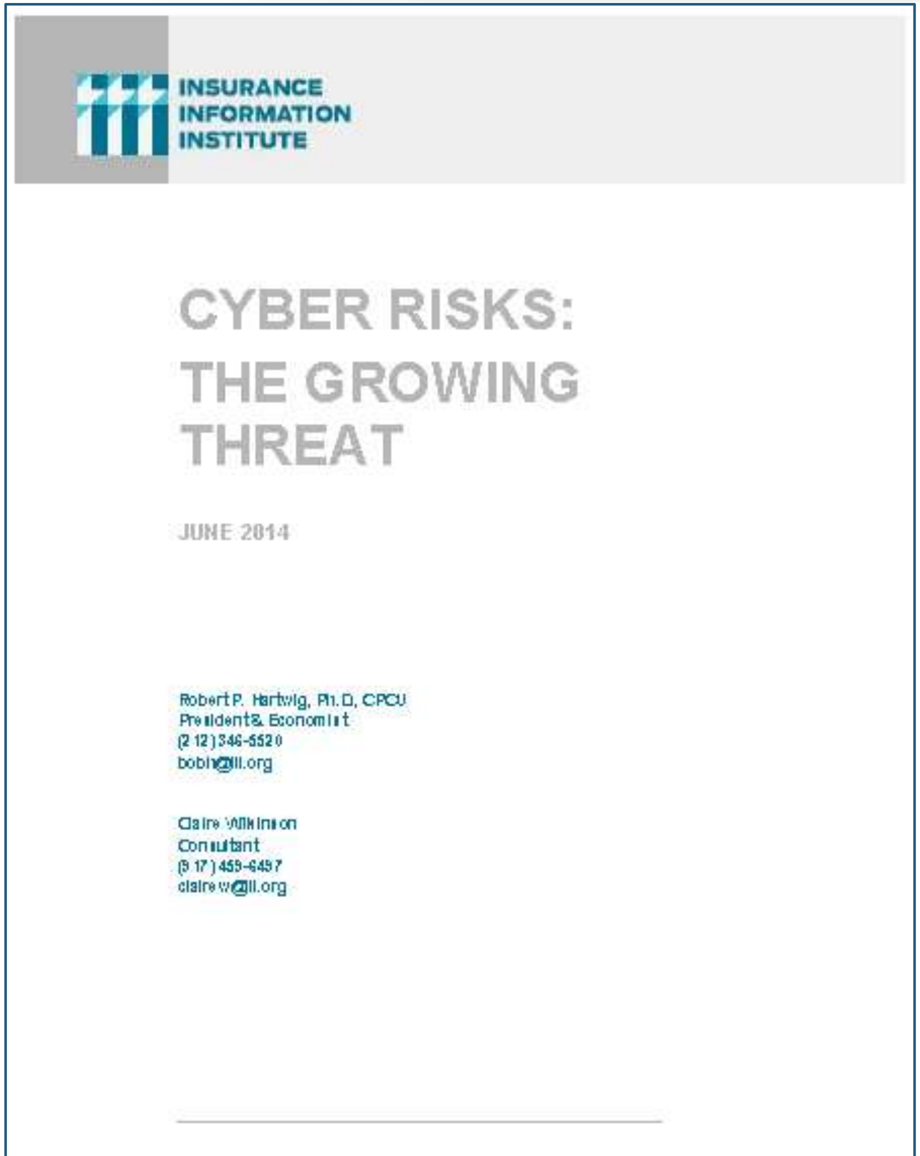


Cyber risk management today involves three essential components, each designed to reduce, mitigate or avoid loss. An increasing number of cyber risk products offered by insurers today provide all three.

Source: Insurance Information Institute research.

I.I.I. Released its Second Cyber Report in 2014: *Cyber Risk: The Growing Threat*



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CYBER RISKS:
THE GROWING
THREAT

JUNE 2014

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- **I.I.I.'s 2nd report on cyber risk released June 2014**
- **Provides information on cyber threats and insurance market solutions**
- **Global cyber risk overview**
  - **Quantification of threats by type and industry**
- **Cyber security and cost of attacks**
- **Cyber terrorism**
- **Cyber liability**
- **Insurance market for cyber risk**
- ***3rd Report in Q2 2015***

INVESTMENTS:
A Key Driver of Profitability

Depressed Yields Will Continue to Affect Underwriting & Pricing

Distribution of Invested Assets: P/C Insurance Industry, 2013

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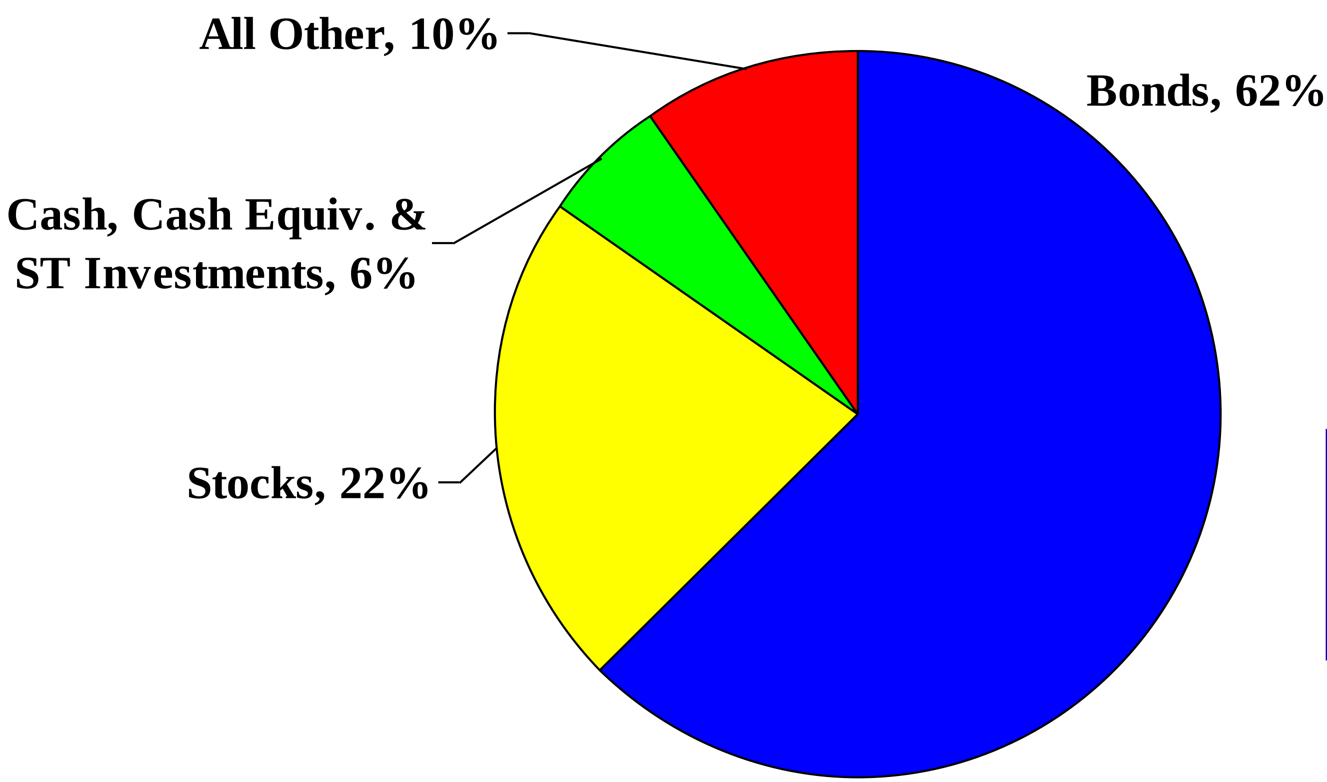
$ Billions



Total Invested Assets = $1.5 Trillion

Source: Insurance Information Institute *Fact Book 2015,* A.M. Best.

Distribution of Bond Maturities, P/C Insurance Industry, 2004-2013

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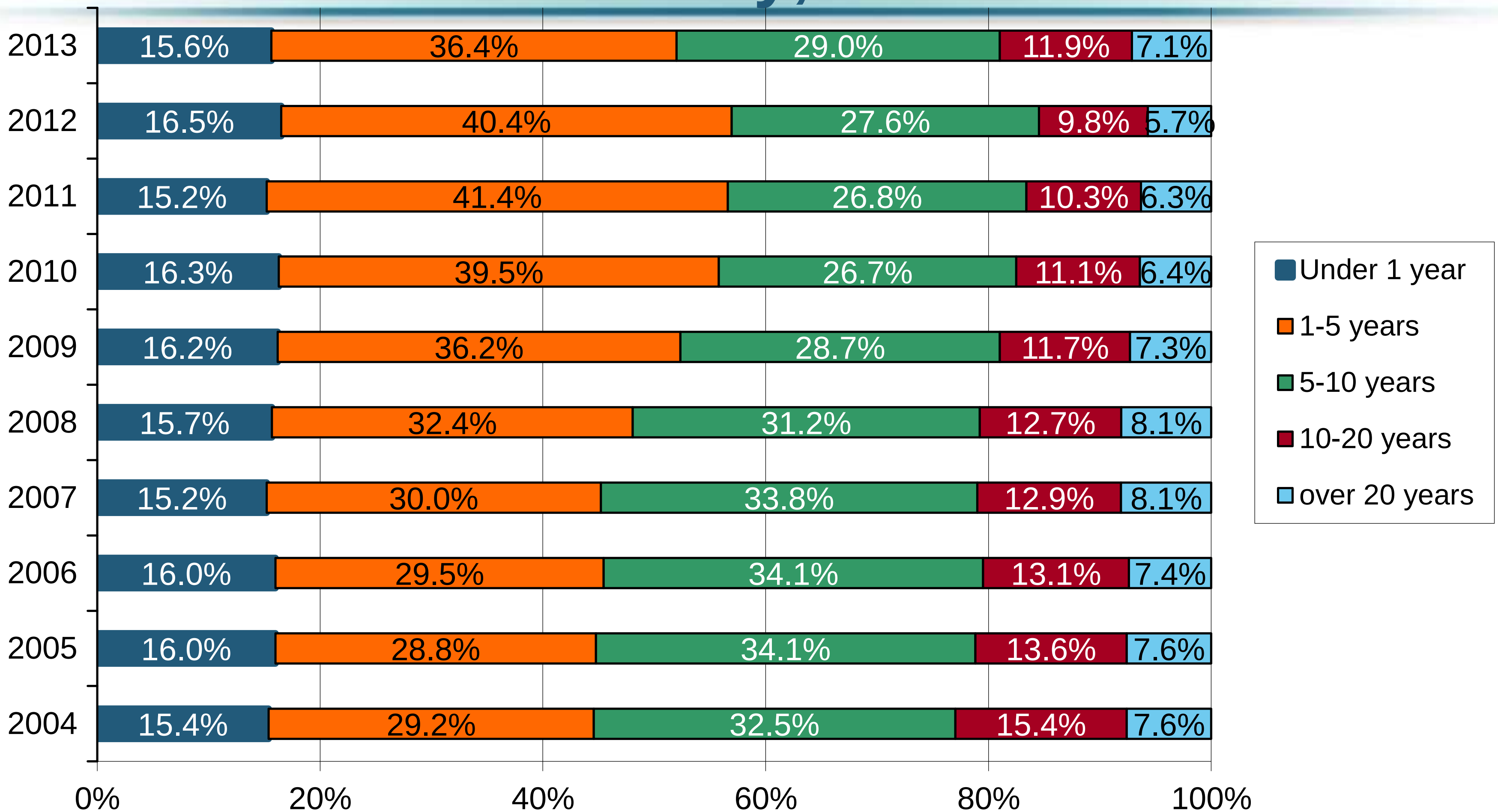
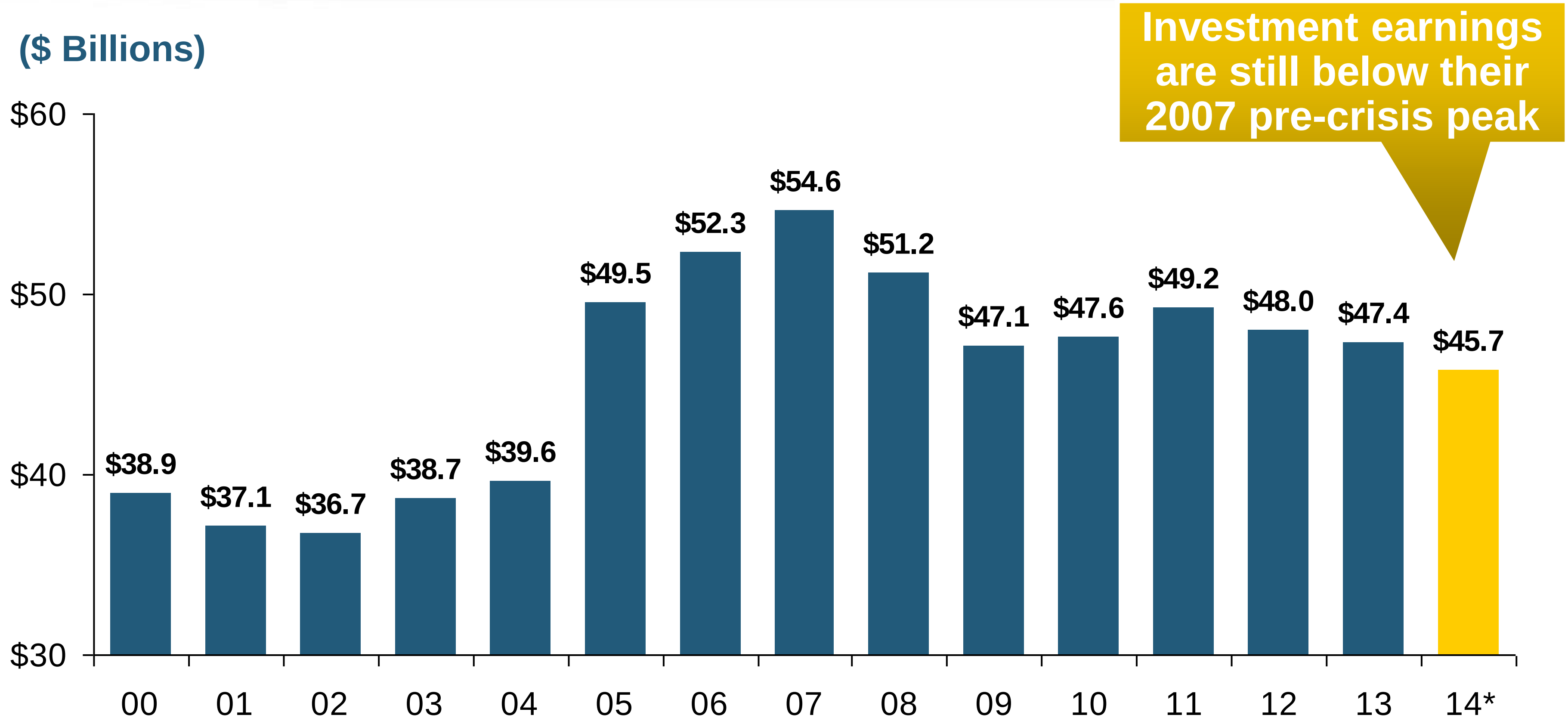


The main shift over these years has been from longer maturities to shorter maturities, but the 2013 data suggest a shift back has begun. The 2013 distribution resembles that at year-end 2009.

Sources: SNL Financial; Insurance Information Institute.

Property/Casualty Insurance Industry Investment Income: 2000–2014[1]



Due to persistently low interest rates, investment income fell in 2012, 2013 and 2014.

[1] Investment gains consist primarily of interest and stock dividends. *2014 figure is estimated based on annualized data through Q3.
Sources: ISO; Insurance Information Institute.

U.S. Treasury 2- and 10-Year Note Yields*: Monthly, 1990–2015

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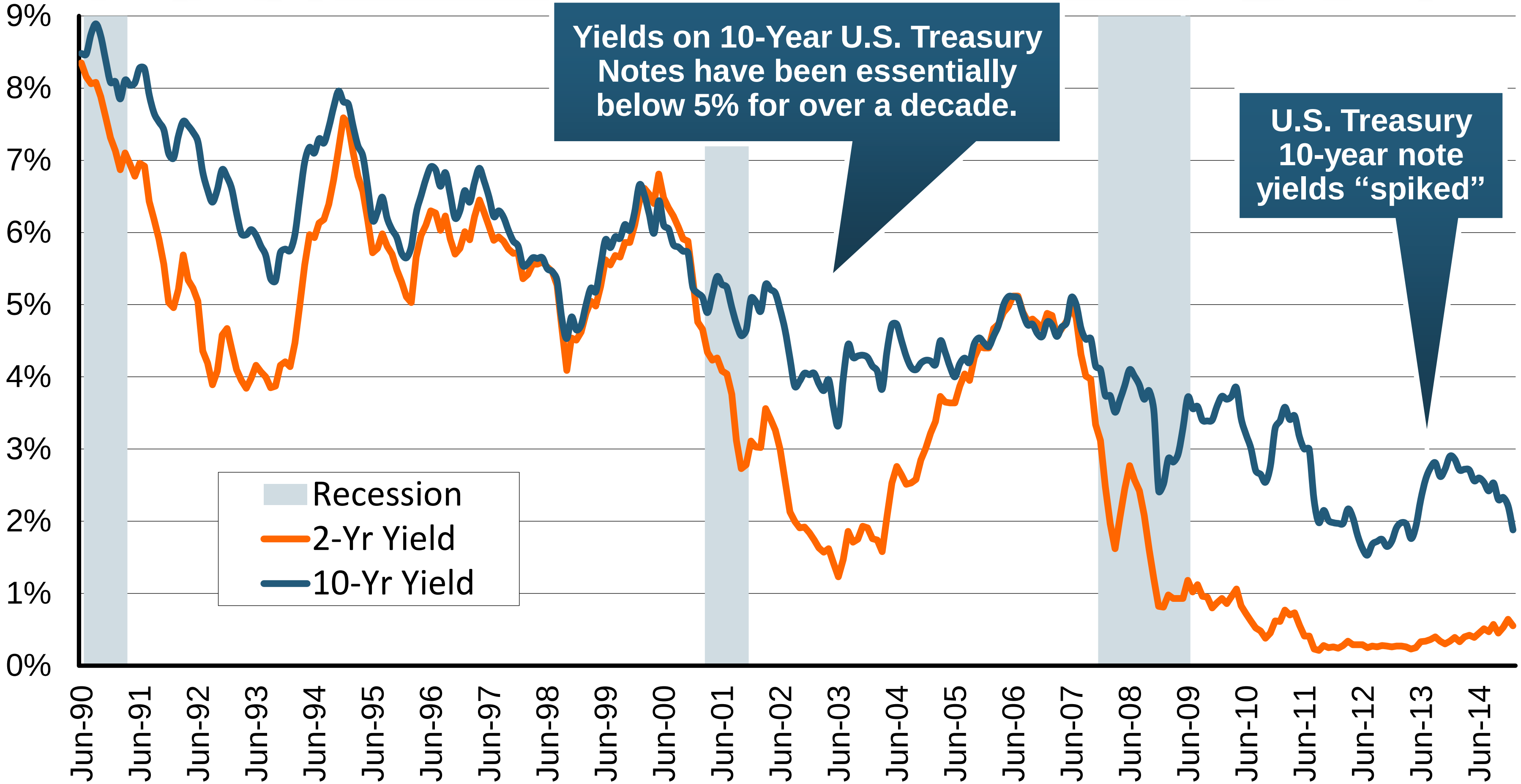


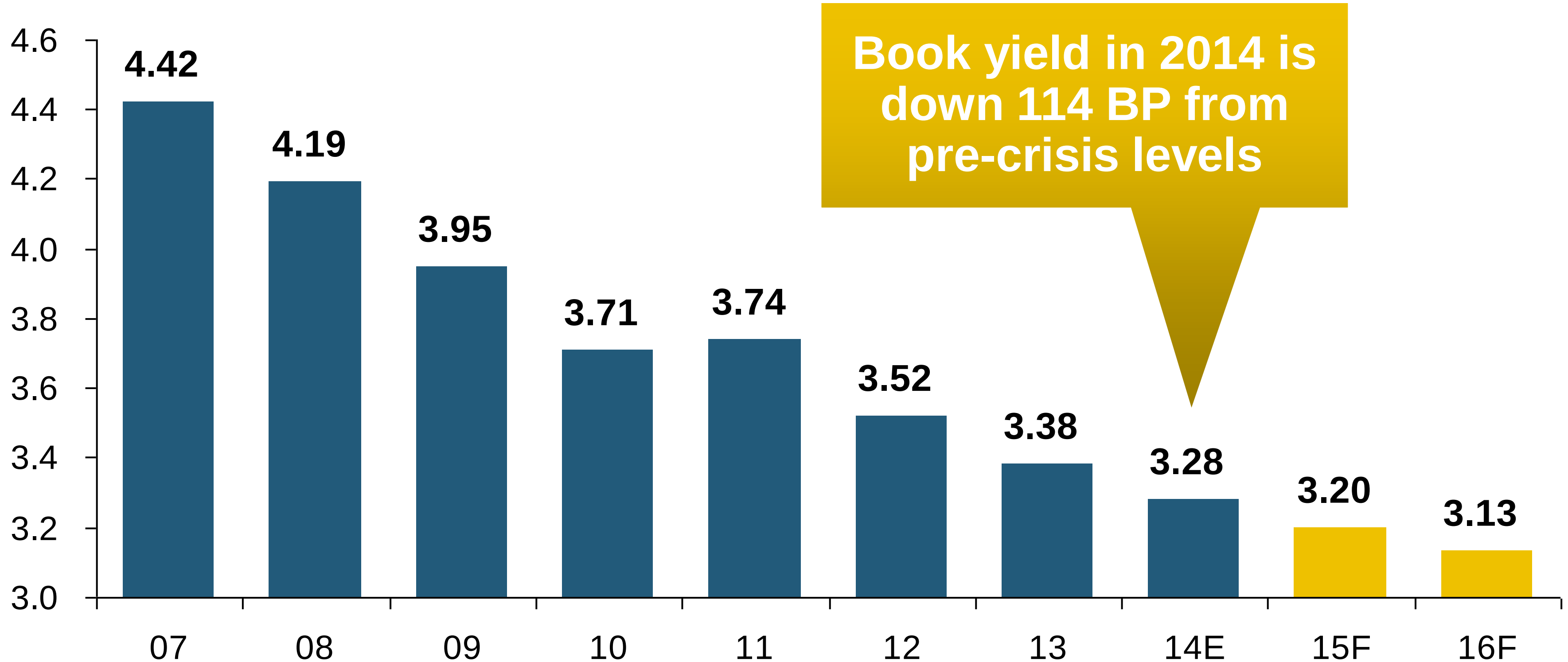
Since roughly 80% of P/C bond/cash investments are in 10-year or shorter durations, most P/C insurer portfolios will have low-yielding bonds for years to come.

*Monthly, constant maturity, nominal rates, through January 2015.

Sources: Federal Reserve Bank at http://www.federalreserve.gov/releases/h15/data.htm.
National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Book Yield on Property/Casualty Insurance Invested Assets, 2007–2016F

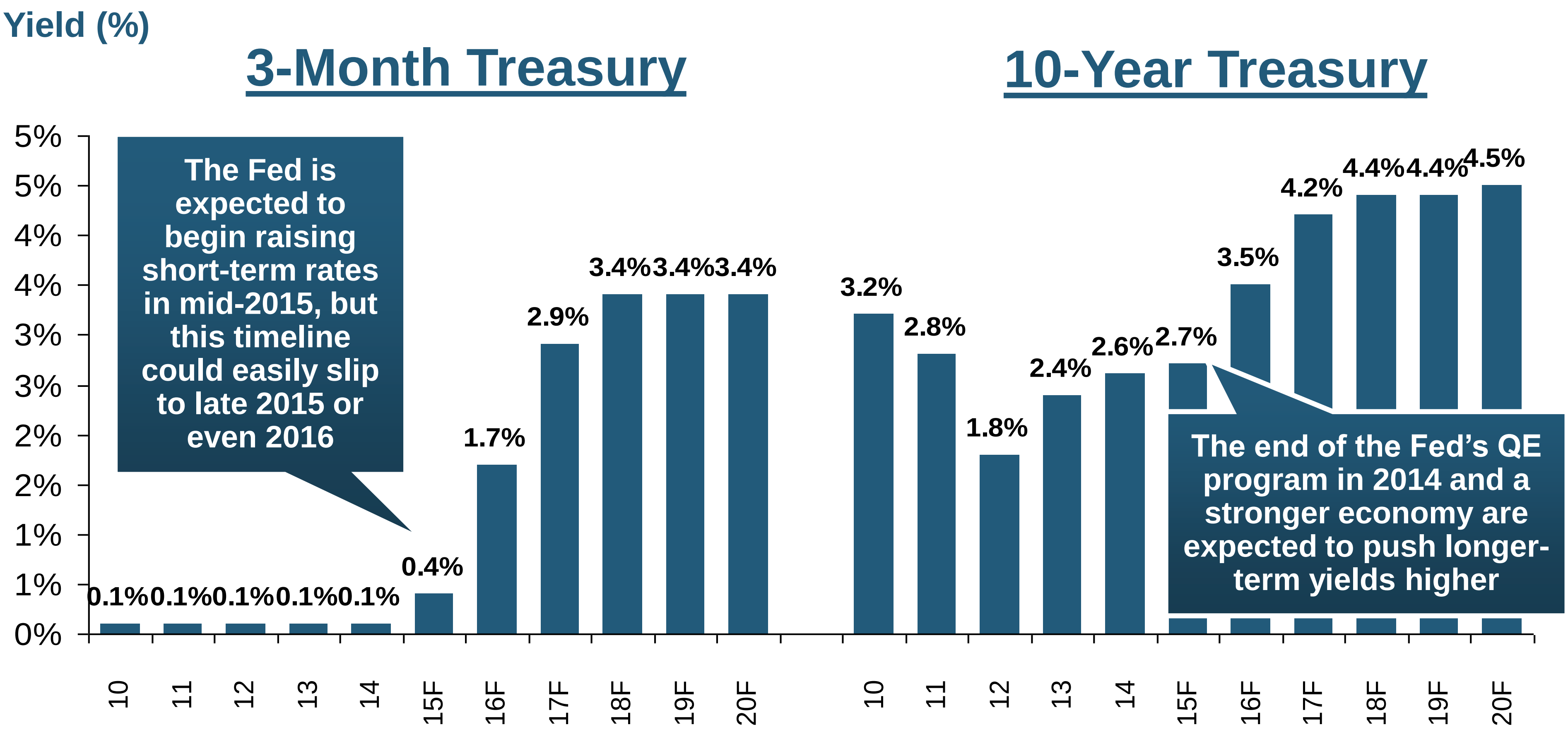
(Percent)



The yield on invested assets continues to decline as returns on maturing bonds generally still exceed new money yields. Even short term interest rate increases are unlikely until mid-to-late 2015

Sources: Conning.

Interest Rate Forecasts: 2015 – 2020



A Full Normalization of Interest Rates Is Unlikely Until 2018, More than a Decade After the Onset of the Financial Crisis

Sources: Federal Reserve Board of Governors (historical); Blue Chip Economic Indicators (1/15 for 2015 and 2016; for 2017-2020 10/14 issue); Insurance Info. Institute.

Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line*

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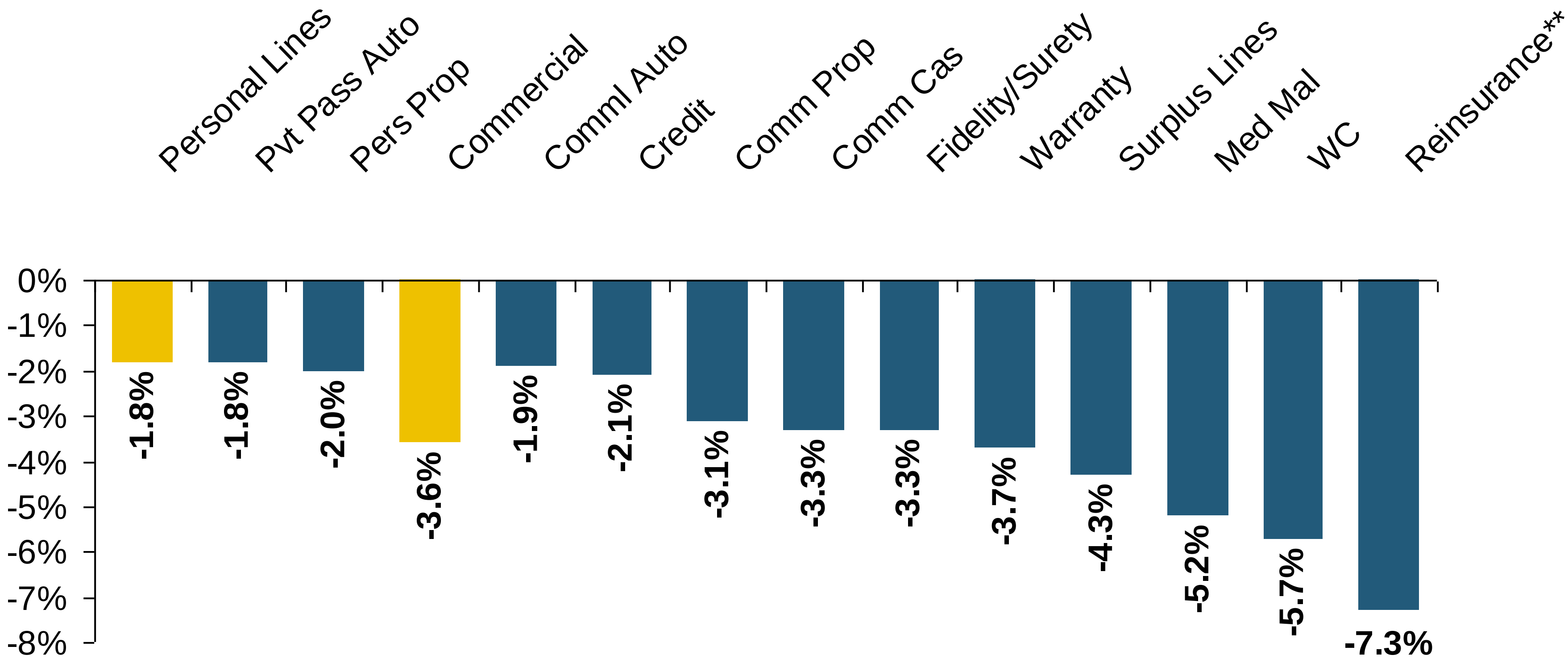

Lower Investment Earnings Place a Greater Burden on Underwriting and Pricing Discipline

*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

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

P/C Insurer Net Realized Capital Gains/Losses, 1990-2014:Q3

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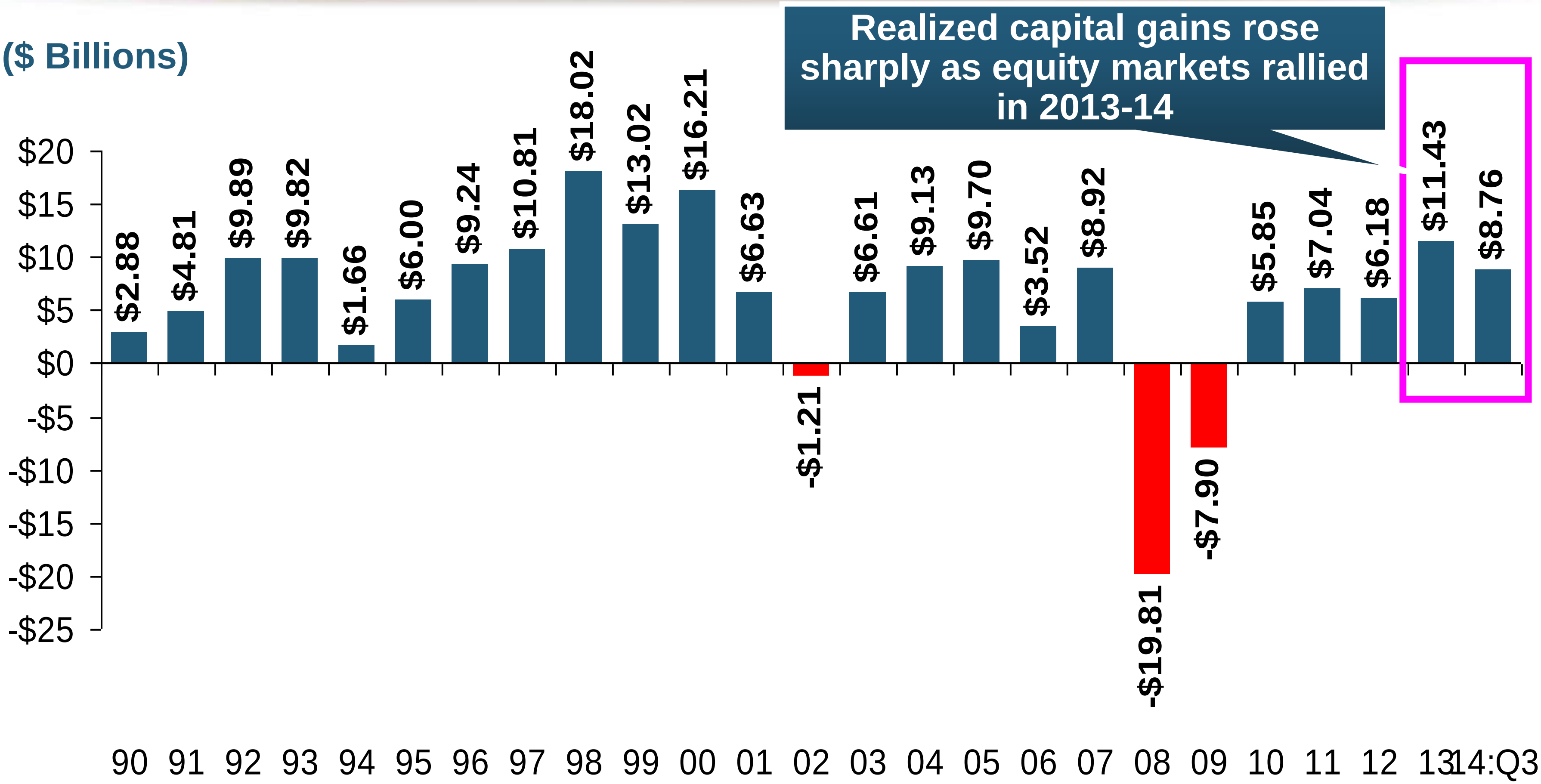

Insurers Posted Net Realized Capital Gains in 2010 - 2014 Following Two Years of Realized Losses During the Financial Crisis. Realized Capital Losses Were a Primary Cause of 2008/2009's Large Drop in Profits and ROE

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

Property/Casualty Insurance Industry Investment Gain: 1994–2014E[1]

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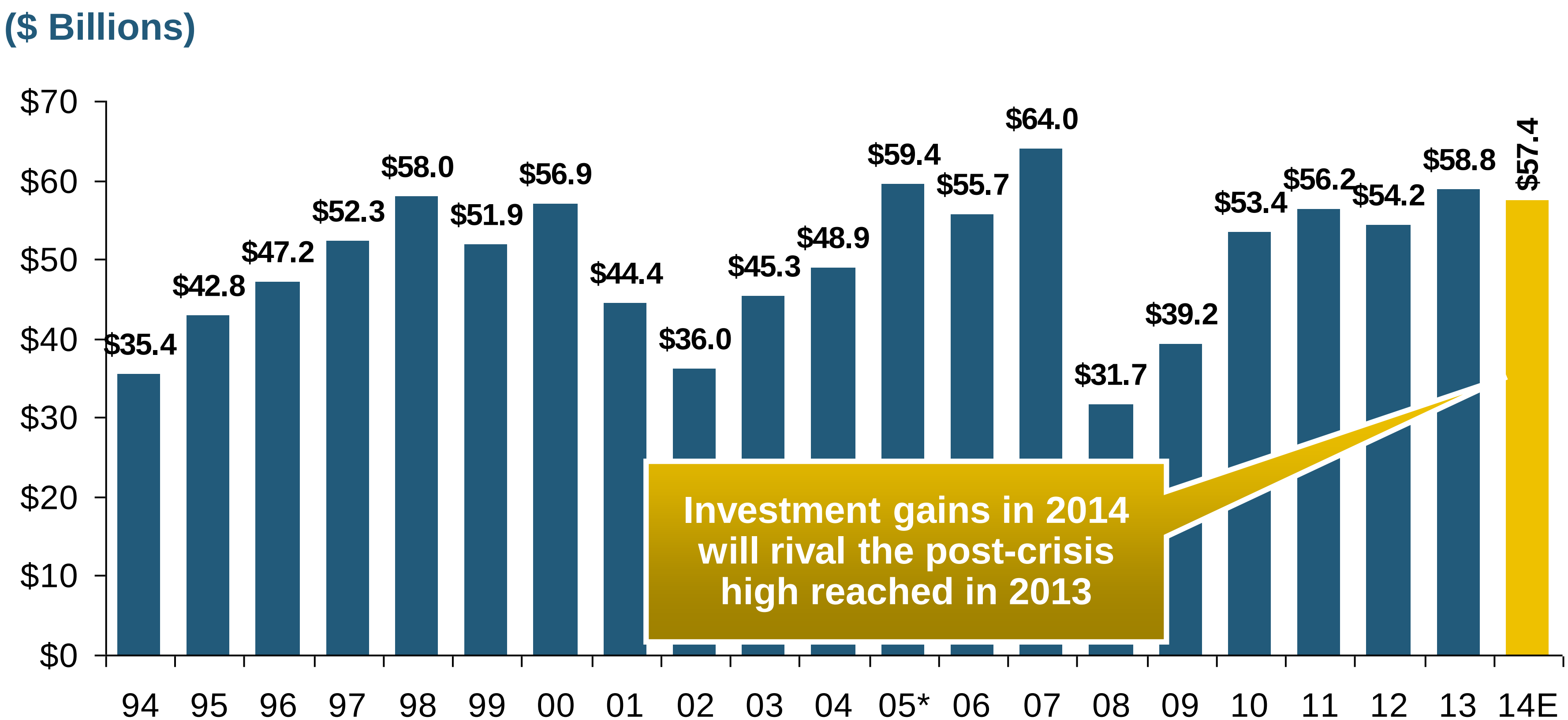

Total Investment Gains Were Flat in 2014 as Low Interest Rates Pressured Investment Income but Realized Capital Gains Remained Robust

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

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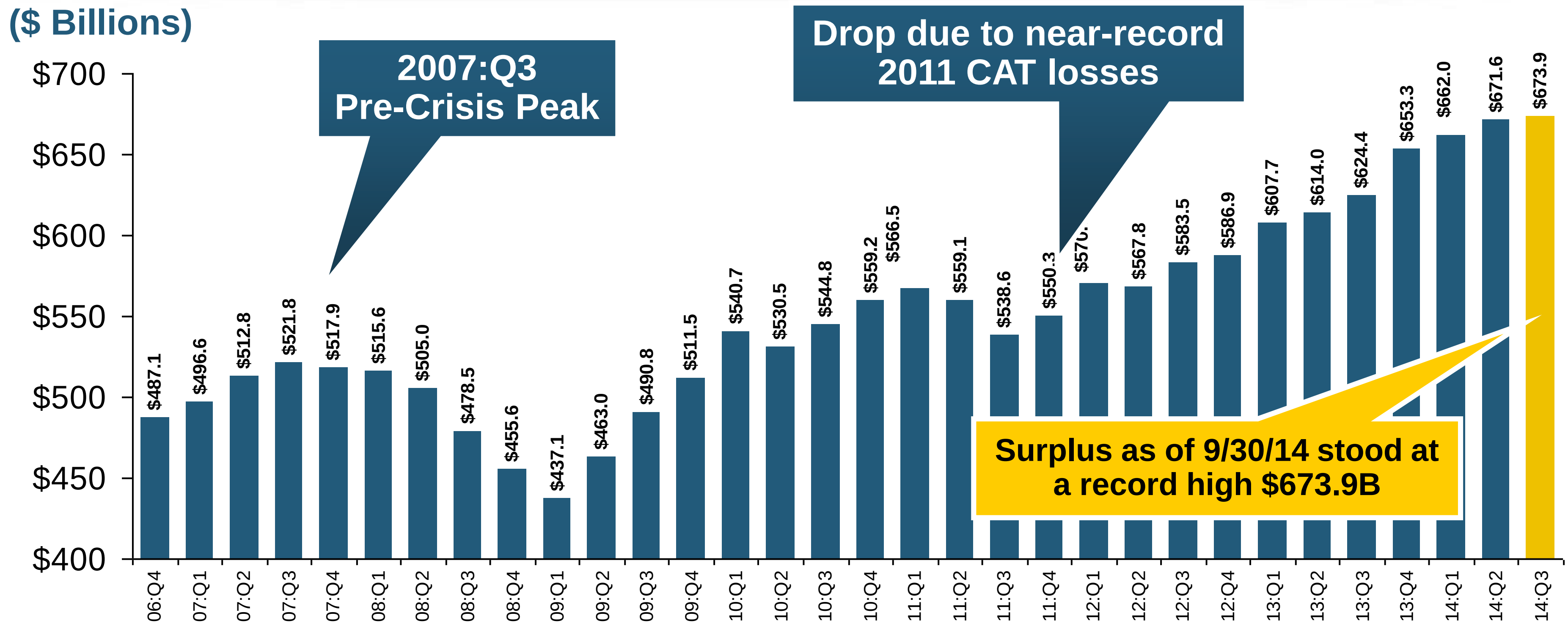
CAPITAL/CAPACITY

Capital Accumulation Has Multiple Impacts

Policyholder Surplus, 2006:Q4–2014:Q3



The industry now has $1 of surplus for every $0.73 of NPW, close to the strongest claims-paying status in its history.

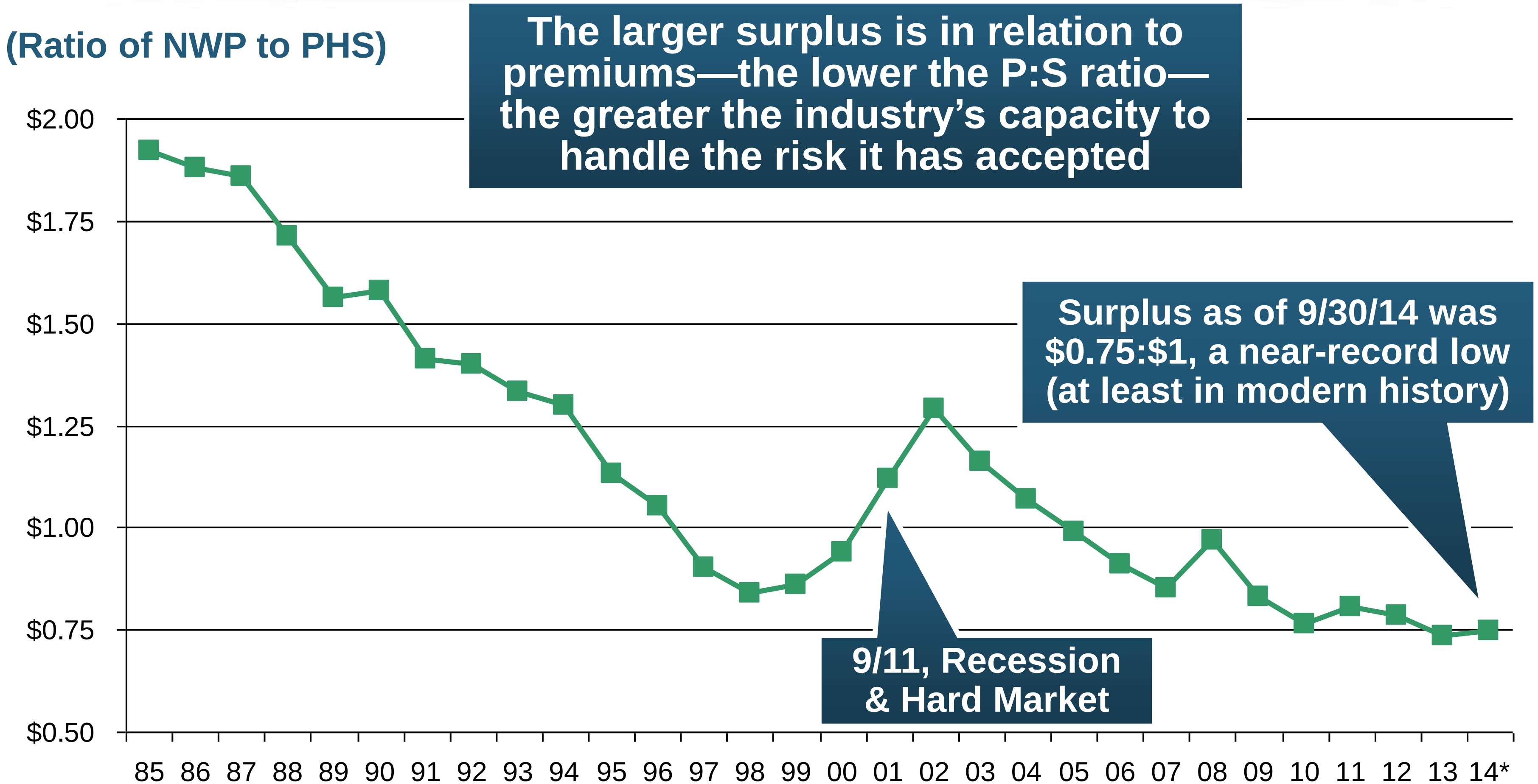
2010:Q1 data includes $22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business .

The P/C insurance industry entered 2015 in very strong financial condition.

Sources: ISO, A.M .Best.

Premium-to-Surplus Ratio: 1985–2014*

(Ratio of NWP to PHS)



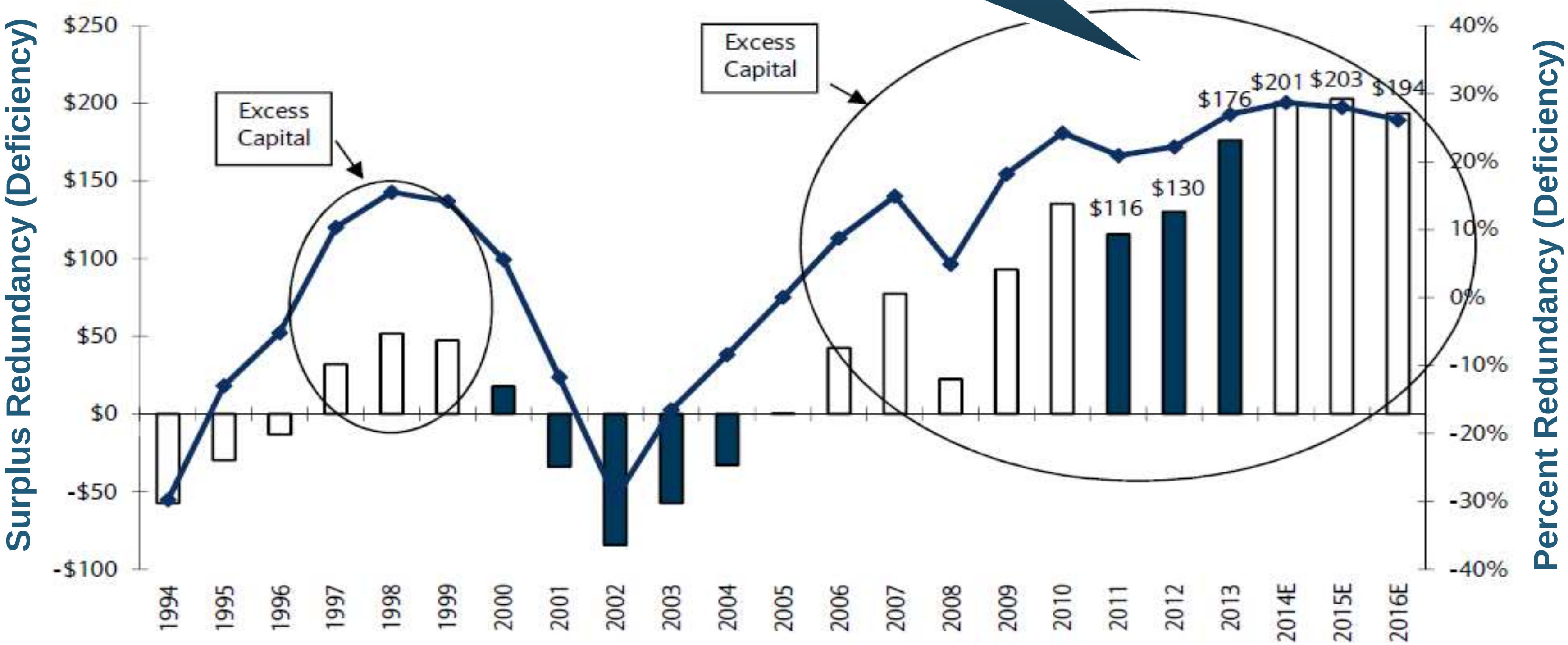
The Premium-to-Surplus Ratio Stood at $0.75:$1 as of 9/30/14, a Record Low (at Least in Recent History)

* As of 9/30/14.

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

US P/C Insurance Industry Excess Capital Position: 1994–2016E

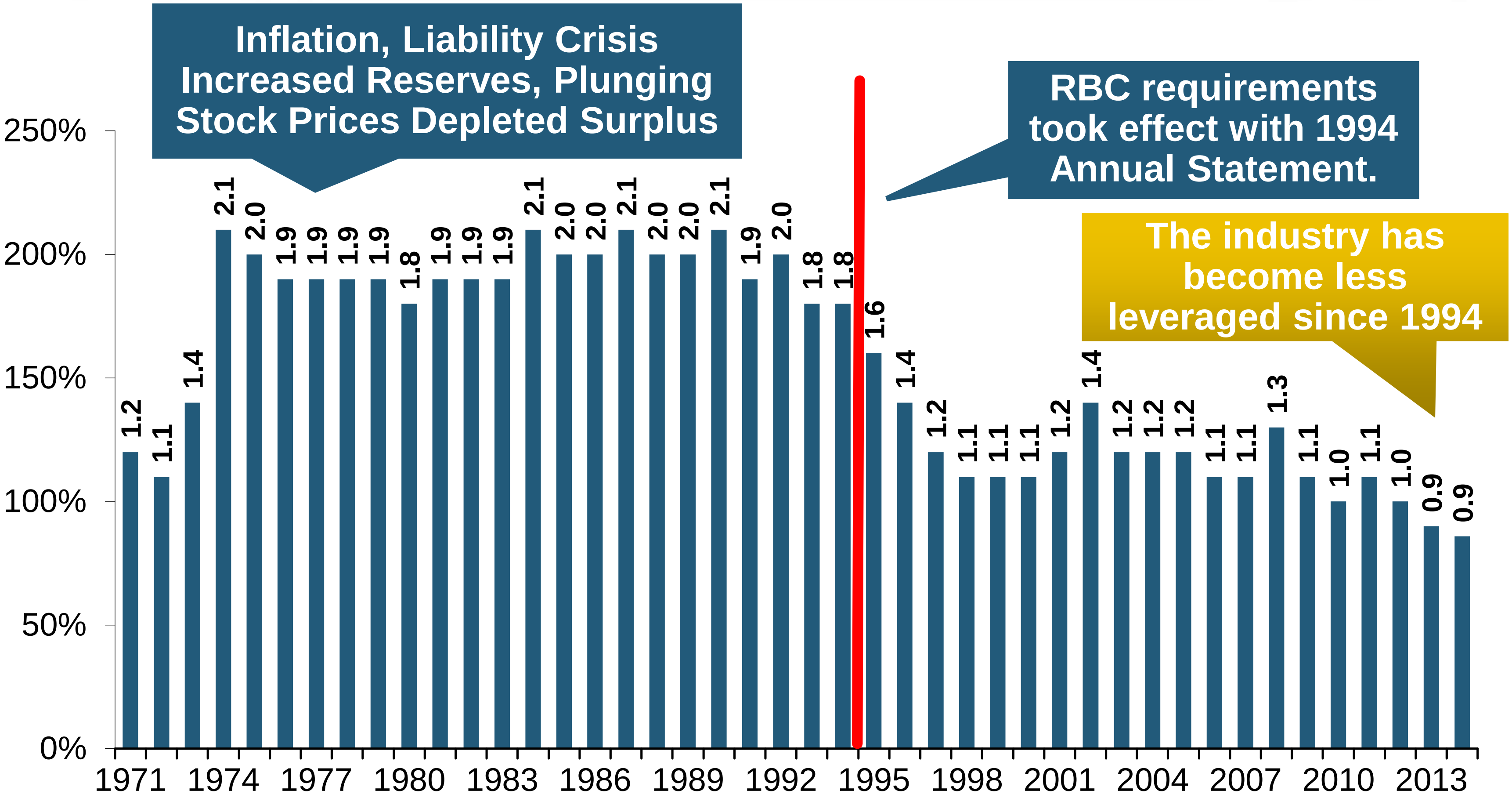
Barclay's suggests that excess is about $200B (~30%)



The Industry's Strong Capital Position Suggests Insurers Are in a Good Position to Increase Risk Appetite, Repurchase Shares and Pursue Acqusitions

Source: Barclays Research estimates.

P/C Industry: Loss Reserve-to-Surplus Ratio, 1971-2014:Q3



The Property/Casualty Industry Adjusted Its Risk Portfolio in Response to Risk-Based Capital Requirements Implemented in 1994.

Source: Calculations from A.M. Best data by Insurance Information Institute.

Alternative Capital

New Investors are Changing the Reinsurance Landscape

The First I.I.I. White Paper on This Issue Will Be Released Q1 2015

Global Reinsurance Capital (Traditional and Alternative), 2006 - 2014

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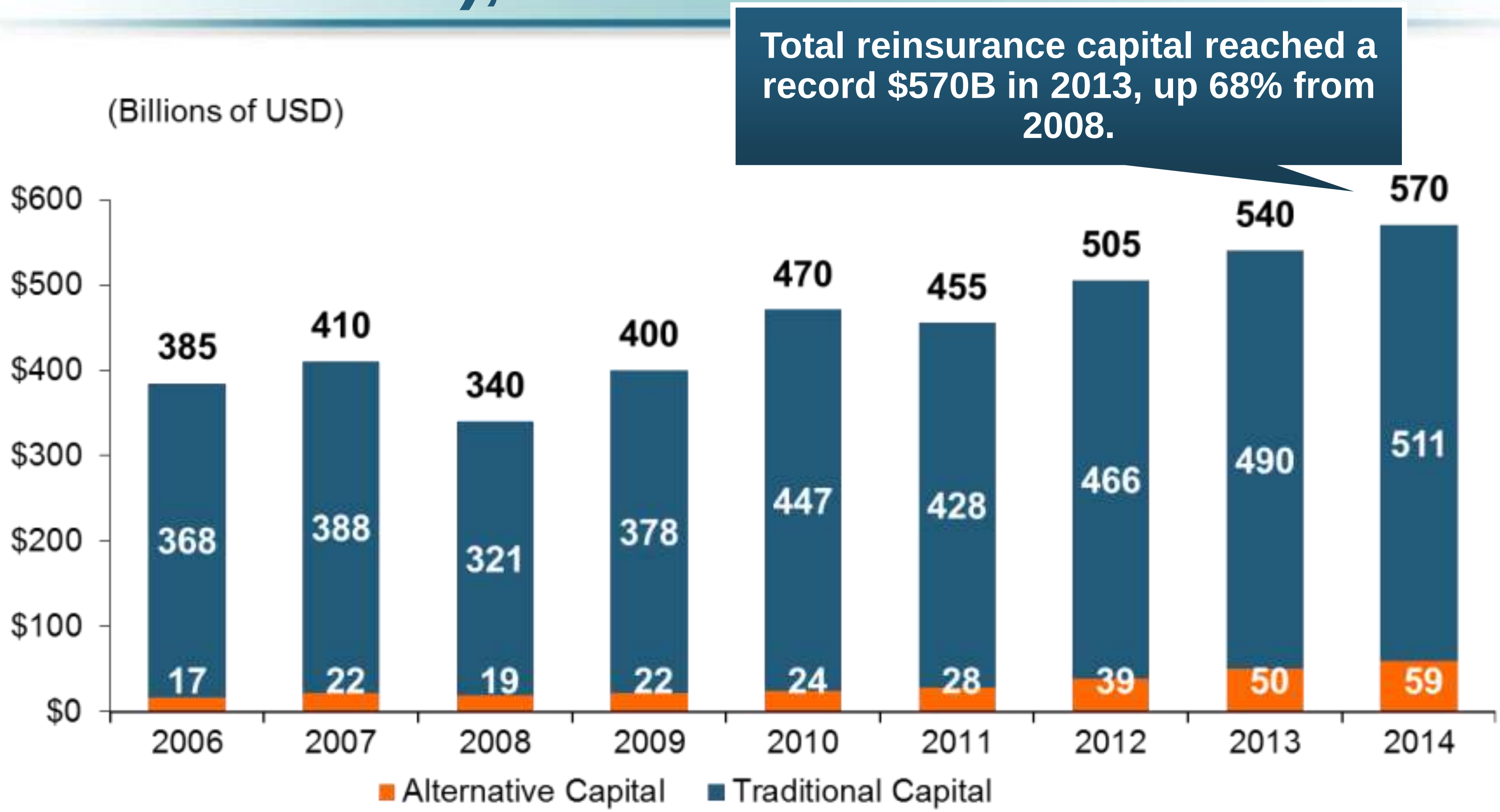

But alternative capacity has grown 210% since 2008, to $50B. It has more than doubled in the past three years.

2014 data is as of June 30, 2014.

Source: Aon Benfield Analytics; Insurance Information Institute.

Growth of Alternative Capital Structures, 2002 - 2014

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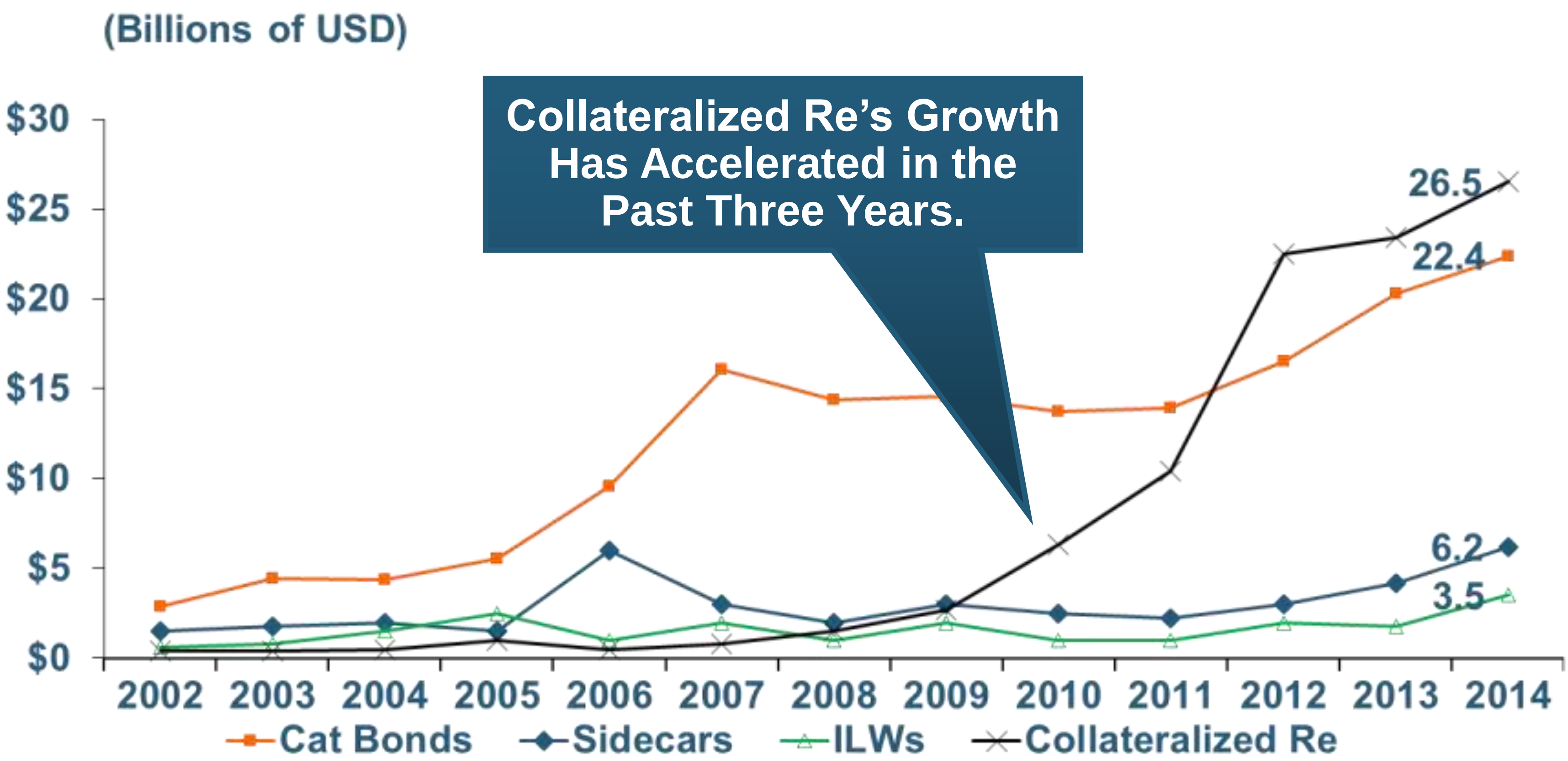

Collateralized Reinsurance and Catastrophe Bonds Currently Dominate the Alternative Capital Market.

2014 data is as of June 30, 2014.

Source: Aon Benfield Analytics; Insurance Information Institute.

I.I.I. Will Release its First Report on Alternative Capital During Q1 2015

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ALTERNATIVE CAPITAL: PASSING FANCY OR PERMANENT FIXTURE?

Forthcoming: Q1 2015

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- Issue of alternative capital in (re)insurance has received increased attention in recent years
- Significant structural changes in property catastrophe reinsurance space
- Questions addressed include:
  - Sources of new capital
  - Reasons/Drivers of growth
  - New structures
  - Impact of major triggering event(s)
  - Impacts of higher interest rates
  - Cat bond yield compression

Questions Arising from Influence of Alternative Capital

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- What Will Happen When Investors Face Large-Scale Losses?
- What Happens When Interest Rates Rise?
- Does ILS Have a Higher Propensity to Litigate?
- How Much Lower Will Risk Premiums Shrink/ROLs Fall?
- Will There Be Spillover Into Casualty Reinsurance?
- Will Alternative Capital Drive Consolidation?

The Strength of the Economy Will Influence P/C Insurer Growth Opportunities

Growth Will Expand Insurer Exposure Base Across Most Lines

Real U.S. Quarterly GDP Growth Since the “Great Recession

Since the Great Recession ended, even 3% real growth (at an annual rate) in a quarter has been unusual. It happened only 7 times in 22 quarters, but 4 of those 7 were in the most recent 6 quarters.

Data are quarterly changes at annualized rates. 2014:Q4 is revised estimate
Sources: US Department of Commerce, at http://www.bea.gov/national/index.htm#gdp ; Insurance Information Institute.

Index of Total Industrial Production:* A Near Peak as of December 2014

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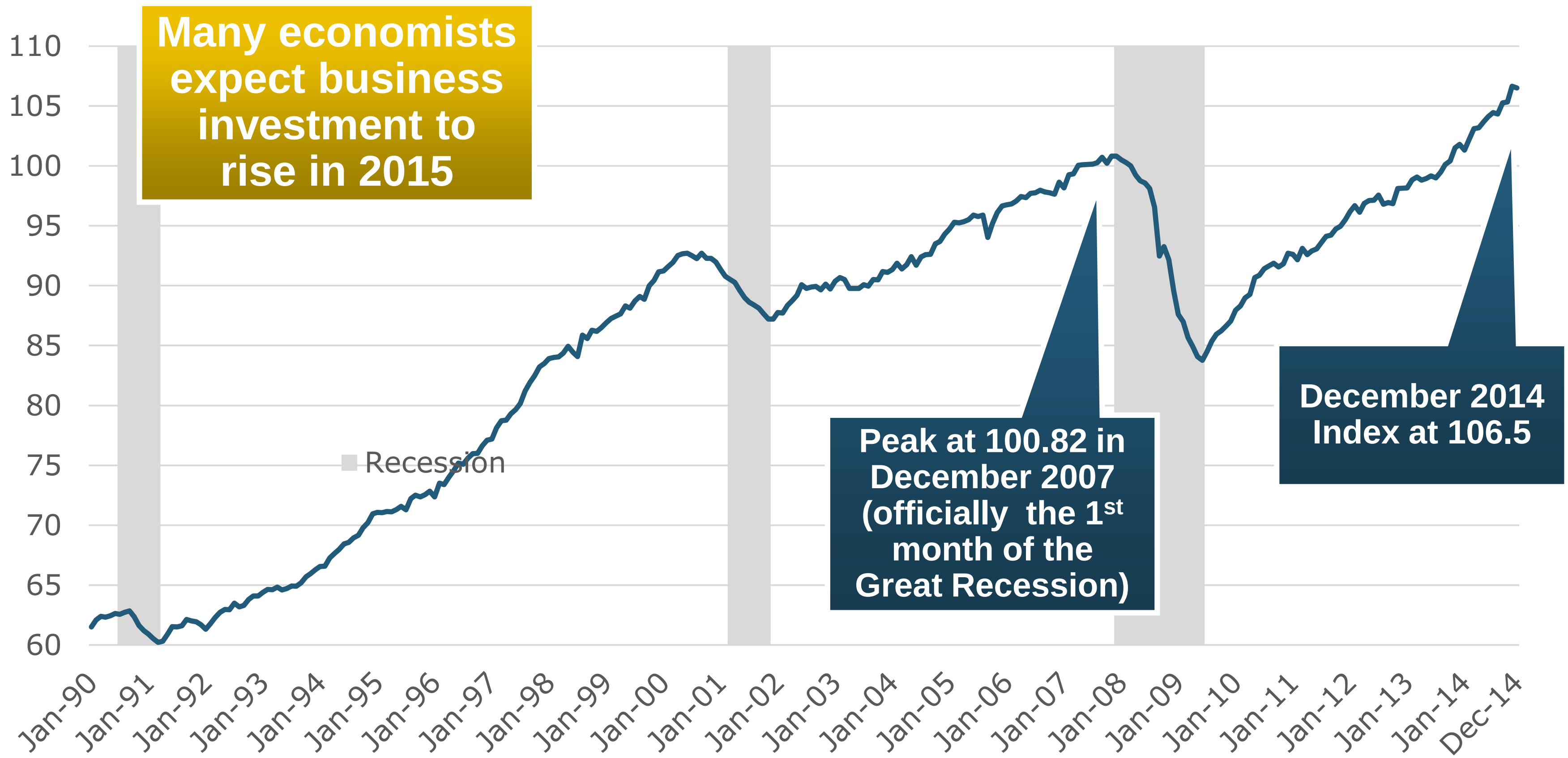


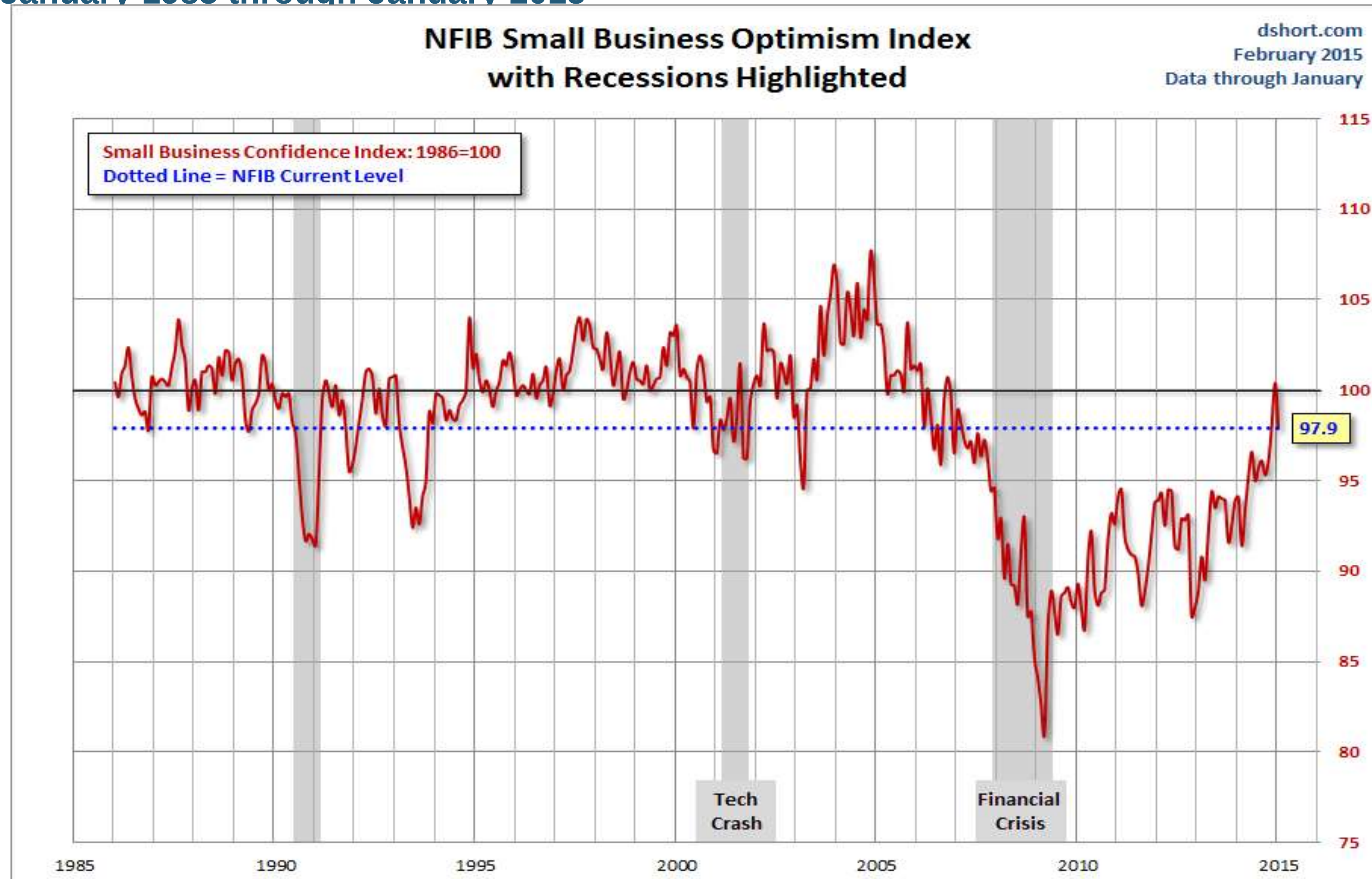
Insurance exposures for industrial production will continue growing in 2015, and commercial insurance premium volume with them. Y-o-Y growth to December 2014 was 4.6%. Both production and premium volume growth for 2015 should exceed this.

*Monthly, seasonally adjusted, through December 2014 (which is preliminary). Index based on year 2007 = 100

Sources: Federal Reserve Board at http://www.federalreserve.gov/releases/g17/ipdisk/ip_sa.txt .
National Bureau of Economic Research (recession dates); Insurance Information Institute.

NFIB Small Business Optimism Index

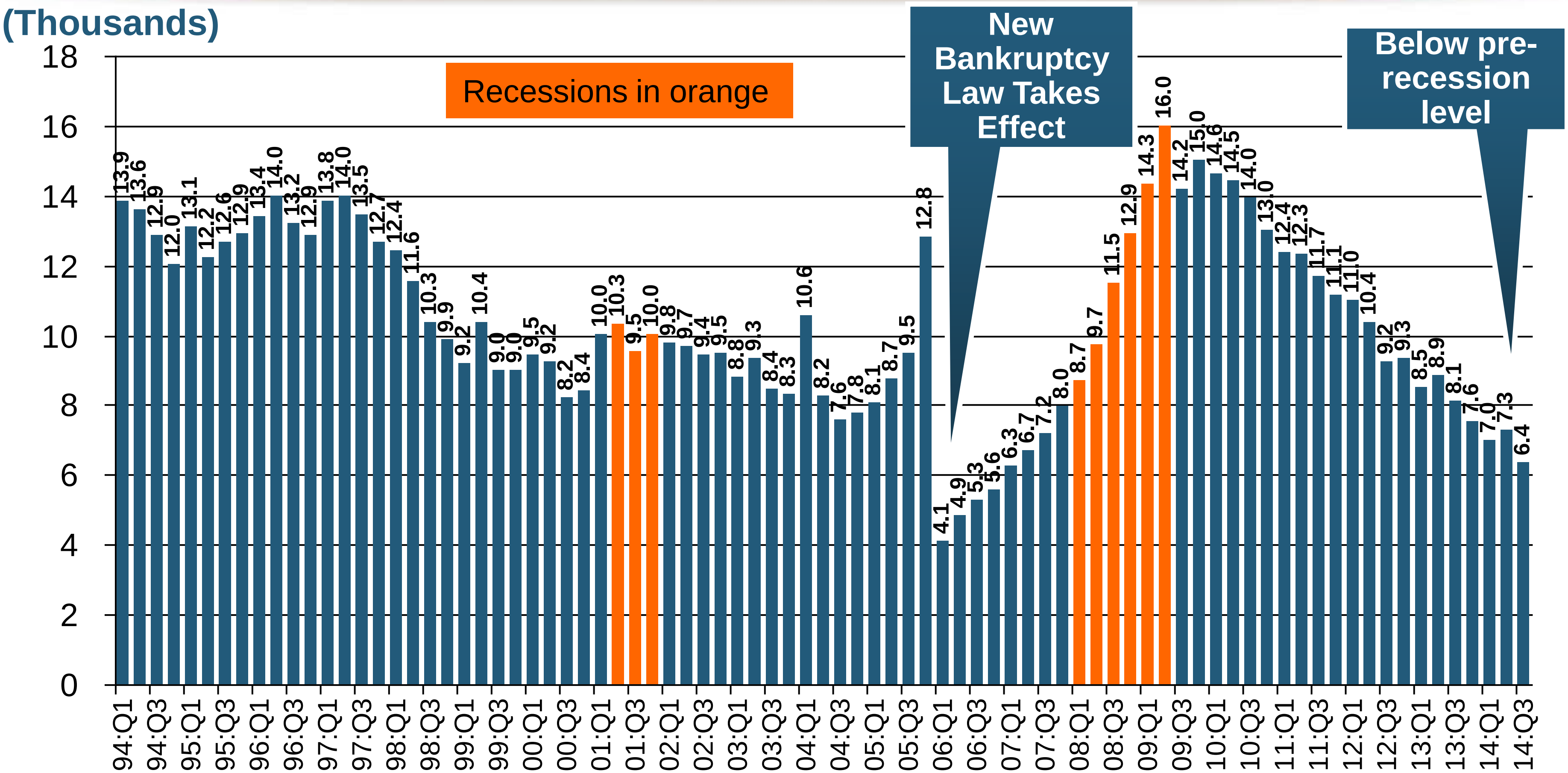
January 1985 through January 2015



Source: National Federation of Independent Business at http://www.advisorperspectives.com/dshort/charts/indicators/Sentiment.html?NFIB-optimism-index.gif ; Insurance Information Institute.

Business Bankruptcy Filings: Still Falling

(1994:Q1 – 2014:Q3)



Business bankruptcies in 2014 were below both the Great Recession levels and the 2003:Q3-2005:Q1 period (the best five-quarter stretch in the last 20 years). Bankruptcies restrict exposure growth in all commercial lines.

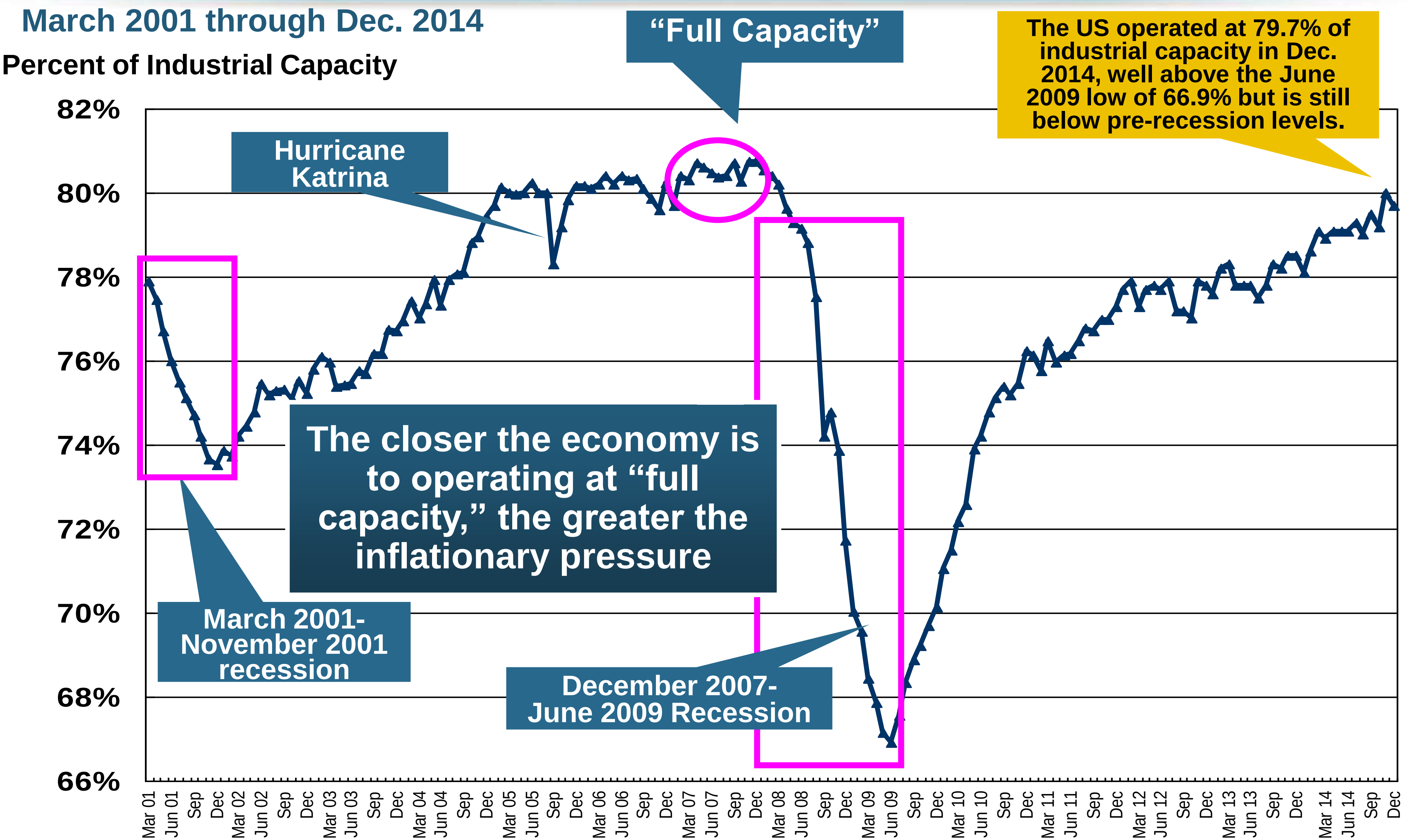
Sources: U.S. Courts at http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2013/0913_f2q.pdf ; Insurance Information Institute

Insurance Information Institute Online:

www.iii.org

Thank you for your time and your attention!

Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures



Source: Federal Reserve Board statistical releases at http://www.federalreserve.gov/releases/g17/Current/default.htm.

Business Fixed Investment is Forecast to Grow Steadily in 2015-16, Fueling Commercial Exposure Growth

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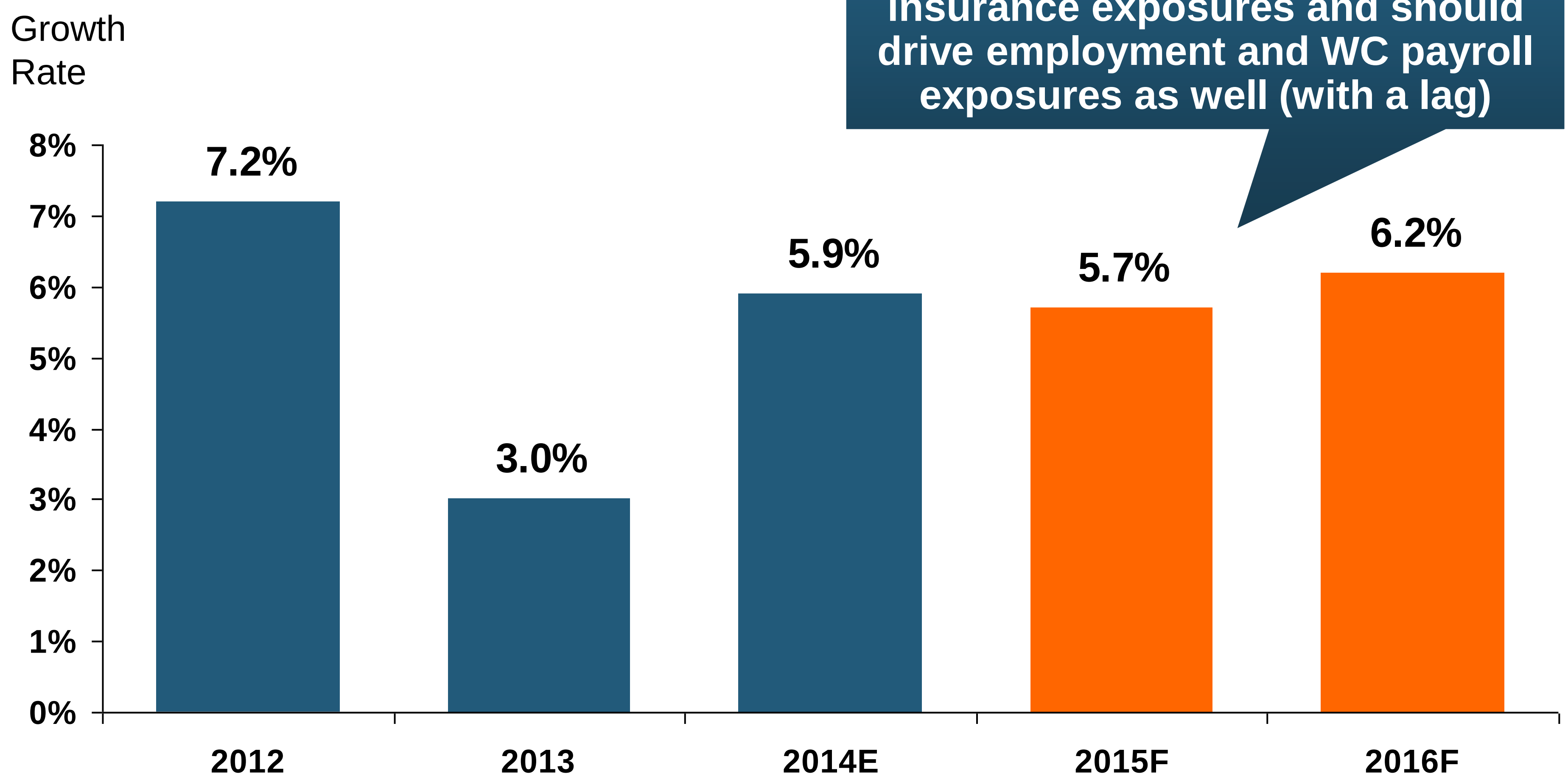
Business investment will drive commercial property and liability insurance exposures and should drive employment and WC payroll exposures as well (with a lag)



Sources: Wells Fargo Economic Group; Insurance Information Institute.

Labor Market Trends

Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend Has Greatly Improved

Unemployment and Underemployment Rates: Still Too High, But Falling

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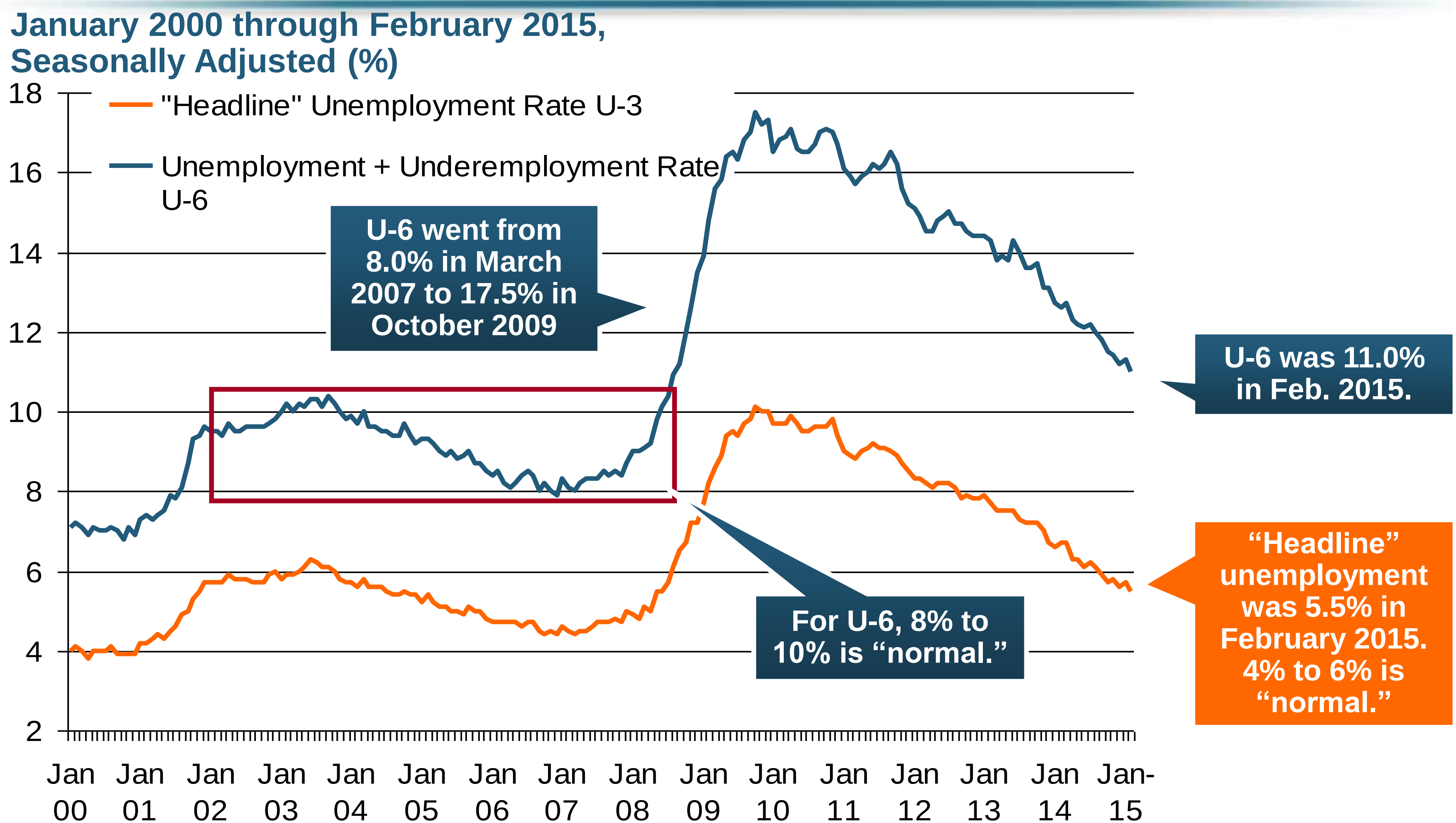

High unemployment and underemployment still constrain overall economic growth, but the job market is now clearly improving.

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

Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2014:Q3

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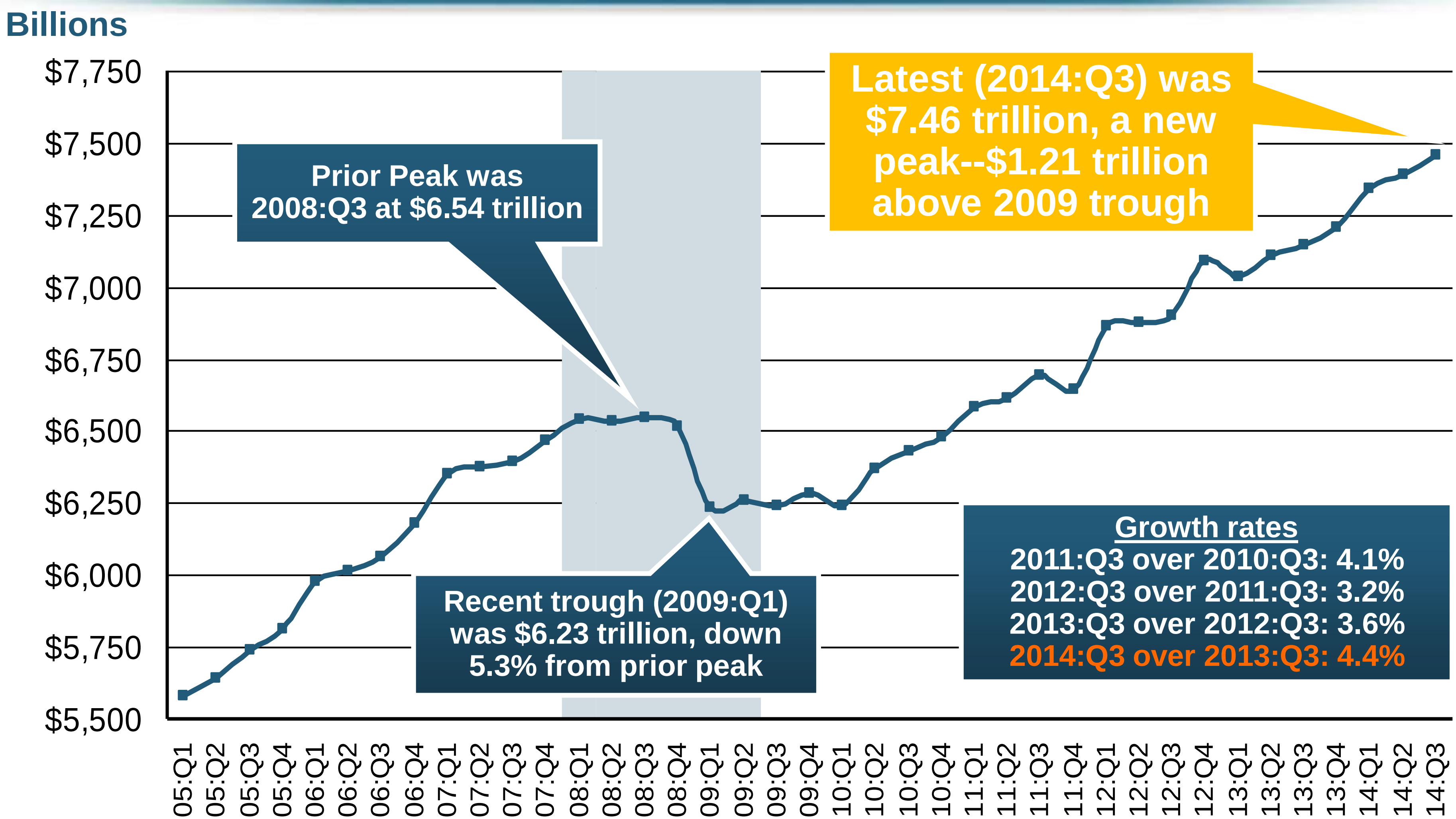

Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

Sources: http://research.stlouisfed.org/fred2/series/WASCUR; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Payroll vs. Workers Comp Net Written Premiums, 1990-2014P

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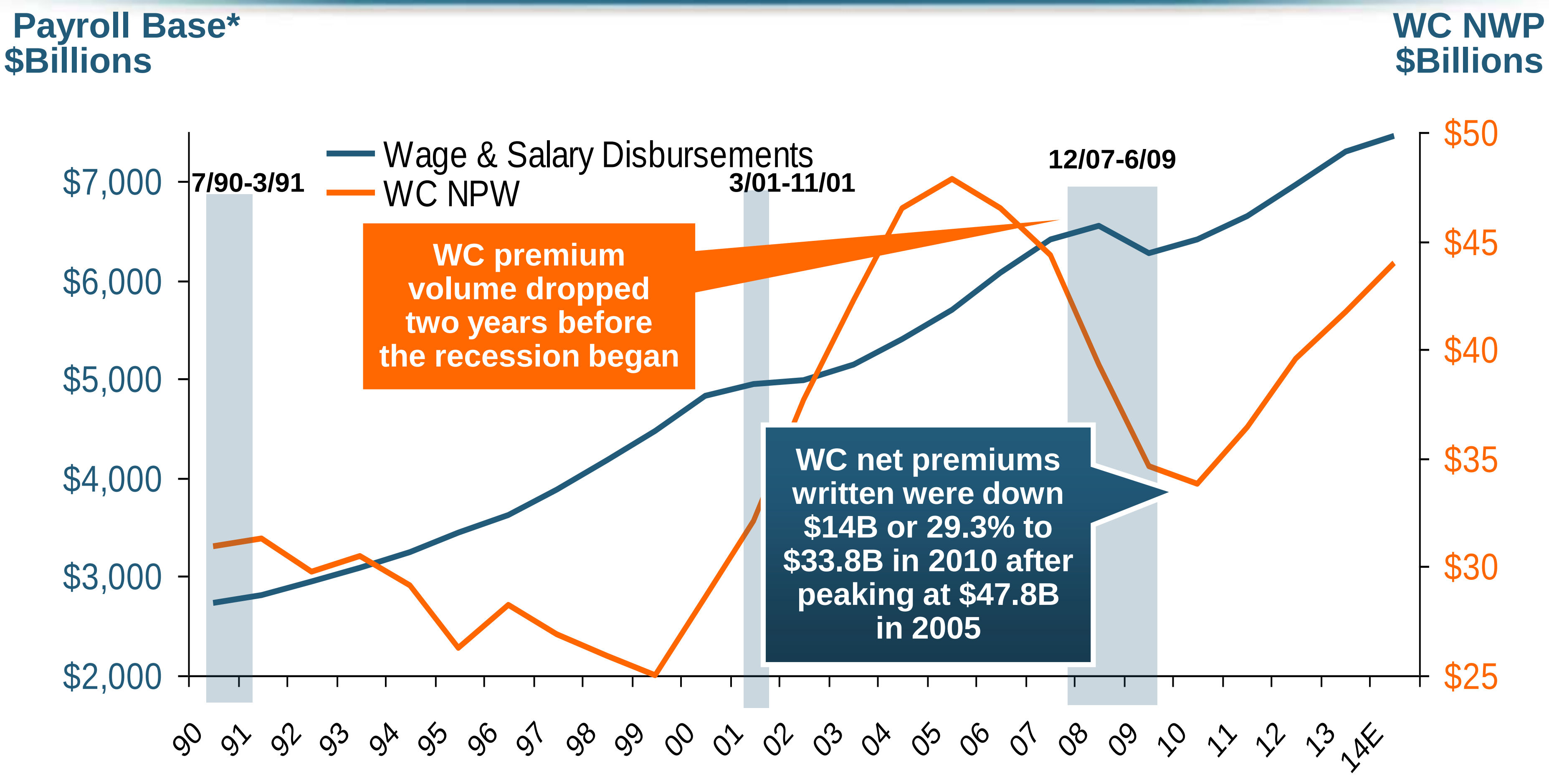
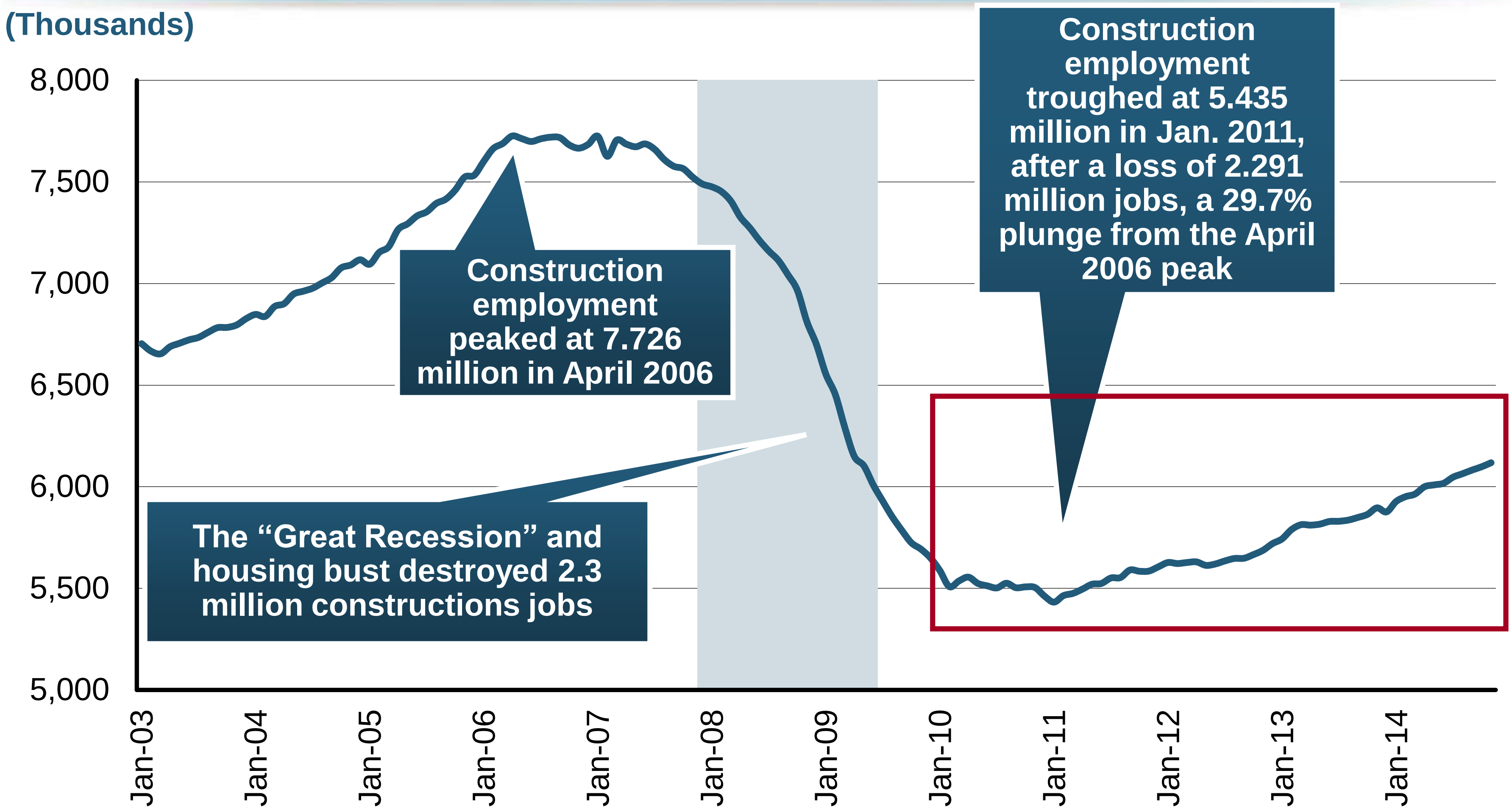


Continued Payroll Growth and Rate Gains Suggest WC NWP Will Grow Again in 2015

*Private employment; Shaded areas indicate recessions. WC premiums for 2014 are I.I.I. estimates..
Sources: NBER (recessions); Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR ; NCCI; I.I.I.

Construction Employment, Jan. 2003–December 2014

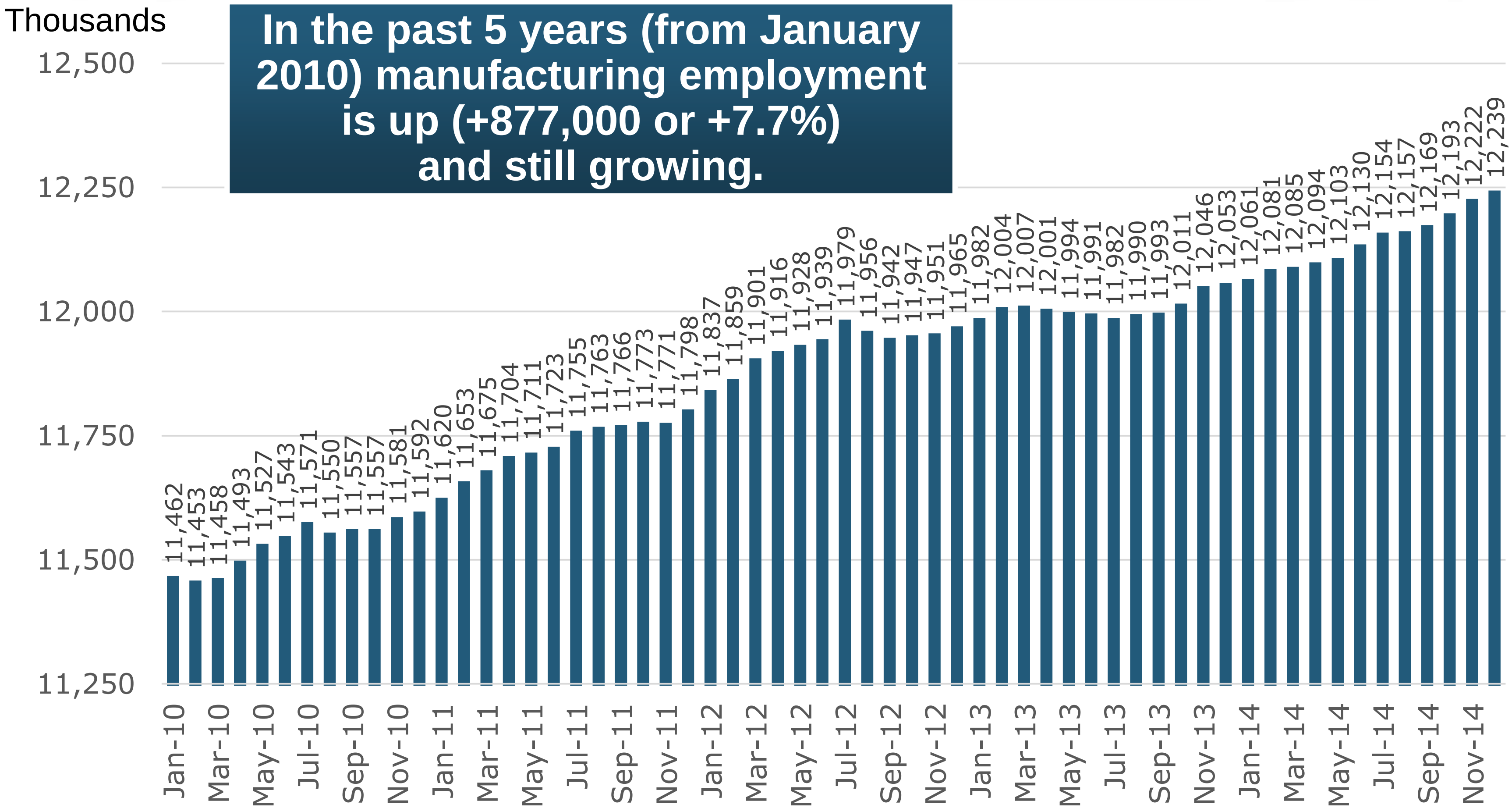


The Construction Sector Could Be a Growth Leader in 2015 as the Housing Market, Private Investment and Govt. Spending Recover.

Note: Recession indicated by gray shaded column.

Sources: U.S. Bureau of Labor Statistics; Insurance Information Institute.

Manufacturing Employment, January 2010—December 2014*

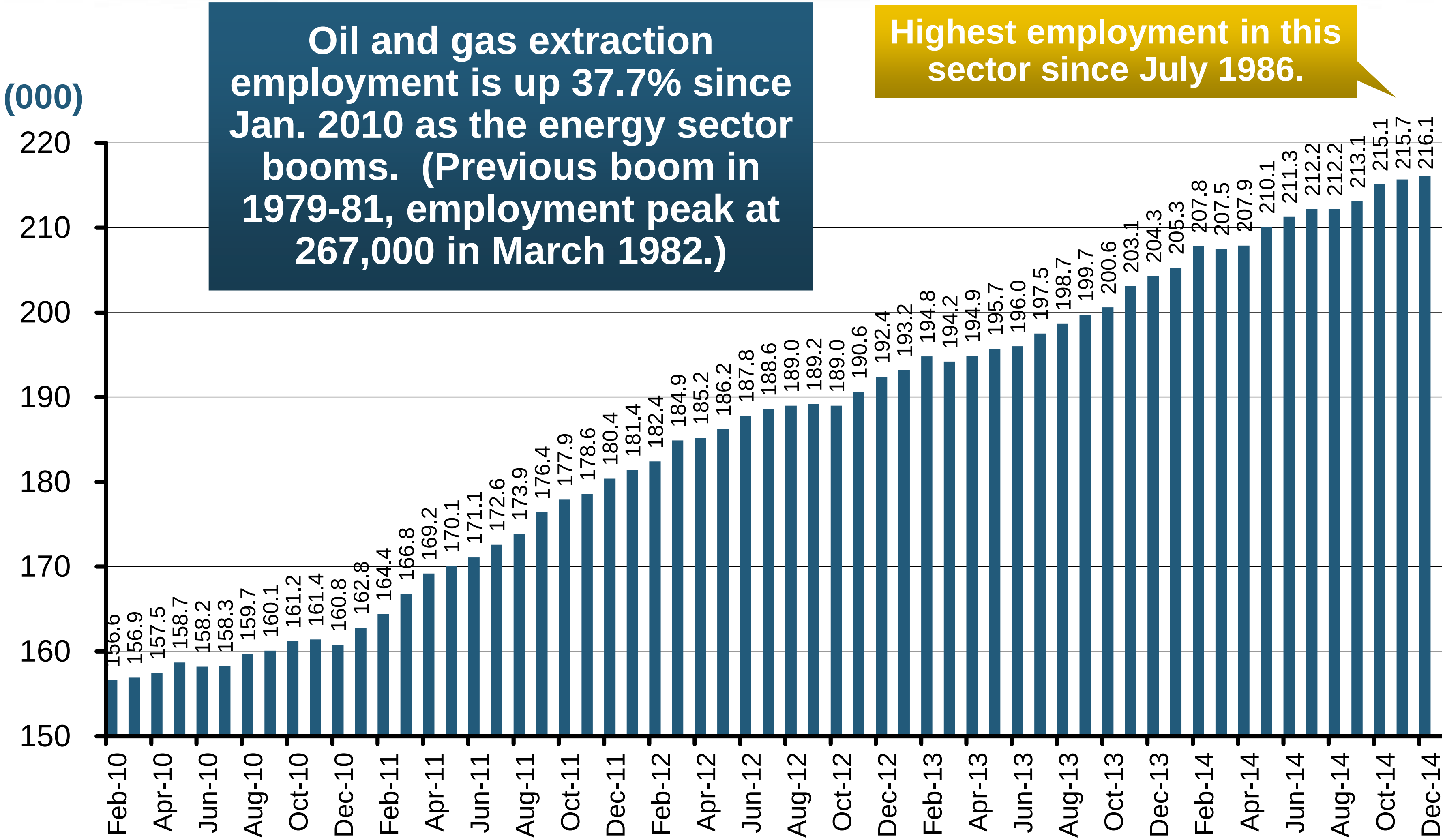


Manufacturing employment is a surprising source of strength in the economy. Employment in the sector is at a multi-year high.

*Seasonally adjusted; Dec and Nov 2013 are preliminary

Sources: US Bureau of Labor Statistics at http://data.bls.gov; Insurance Information Institute.

Employment in Oil & Gas Extraction, Jan. 2010—Dec. 2014*

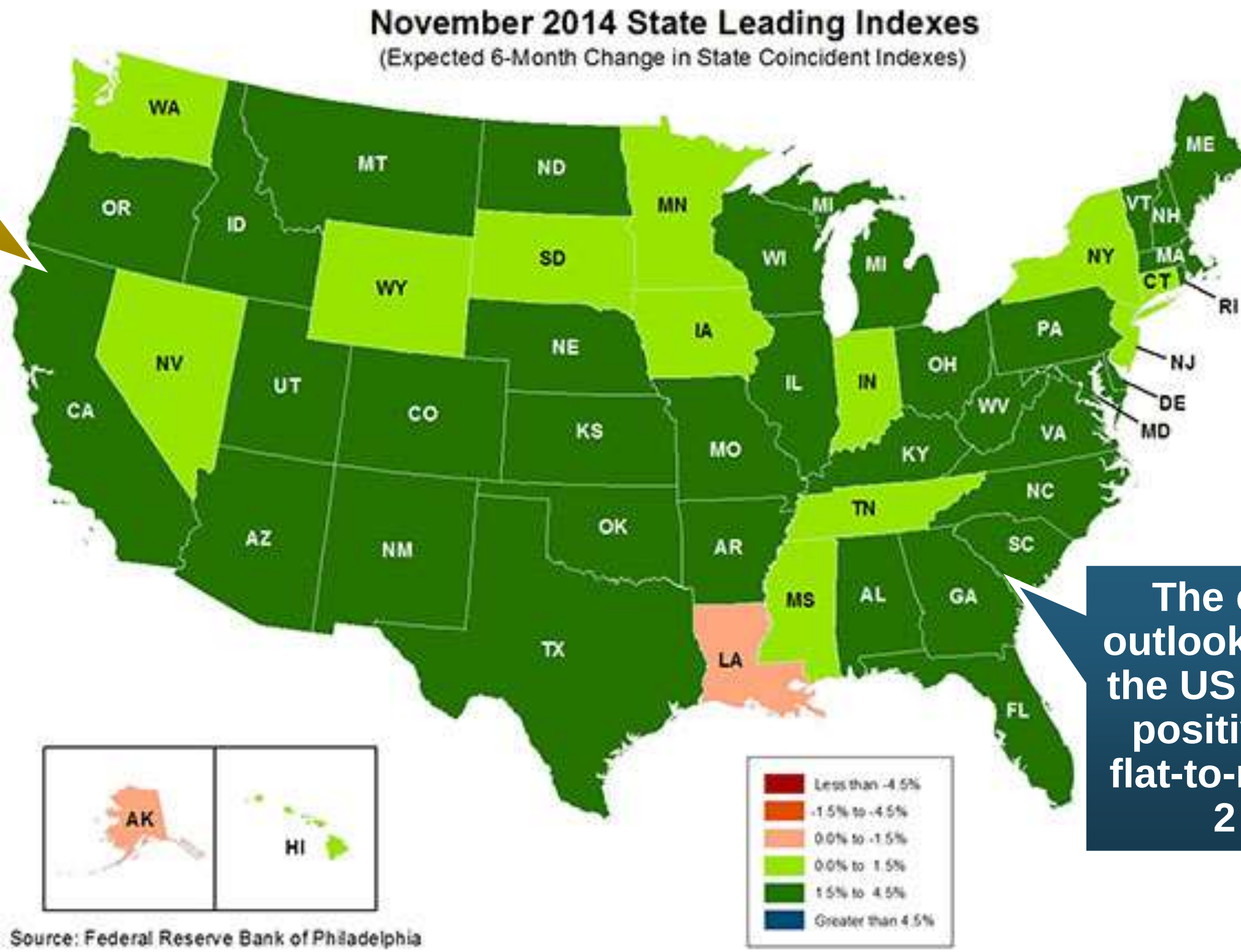


*Seasonally adjusted

Sources: US Bureau of Labor Statistics at http://data.bls.gov; Insurance Information Institute.

State-by-State Leading Indicators through 2015:Q2

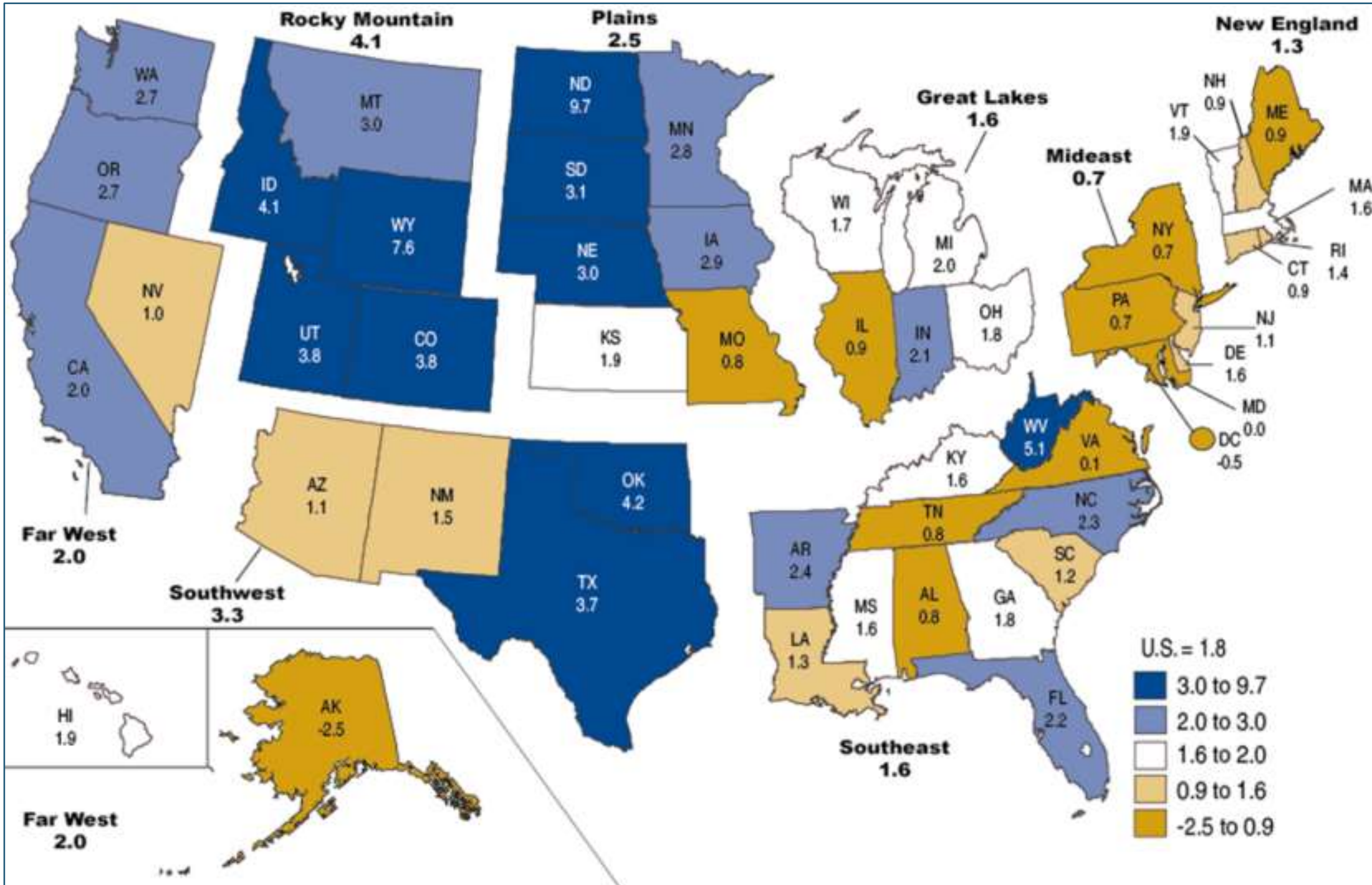
Growth in the West is finally beginning to pick up



The economic outlook for most of the US is generally positive, though flat-to-negative for 2 states

Sources: Federal Reserve Bank of Philadelphia at http://www.philadelphiafed.org/index.cfm ;Insurance Information Institute.

Percent Change in Real GDP by State, 2013



Sources: US Bureau of Economic Analysis; Insurance Information Institute.

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Performance by Segment and by State

Net Premium Growth: Annual Change, 1971—2016F

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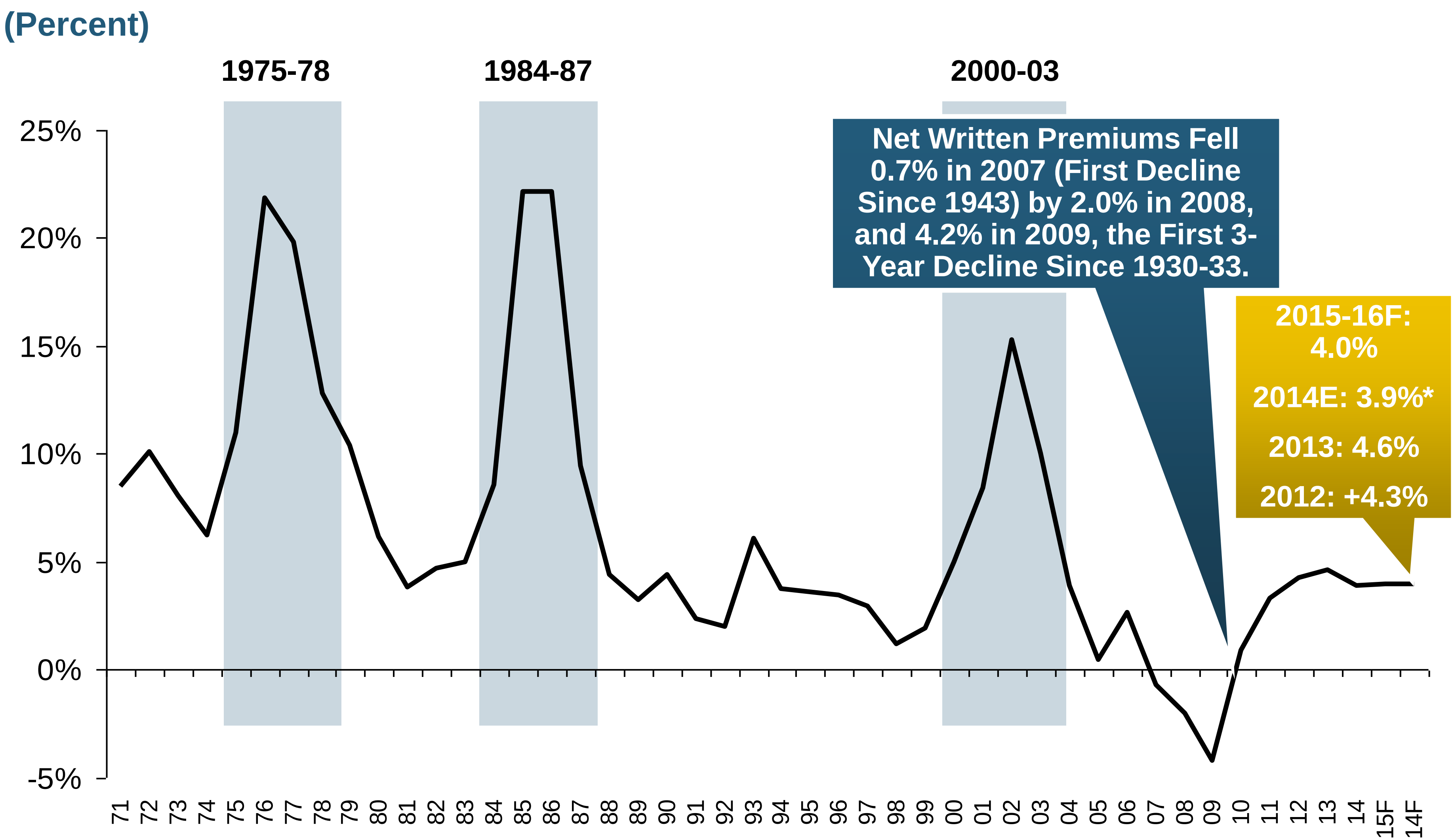
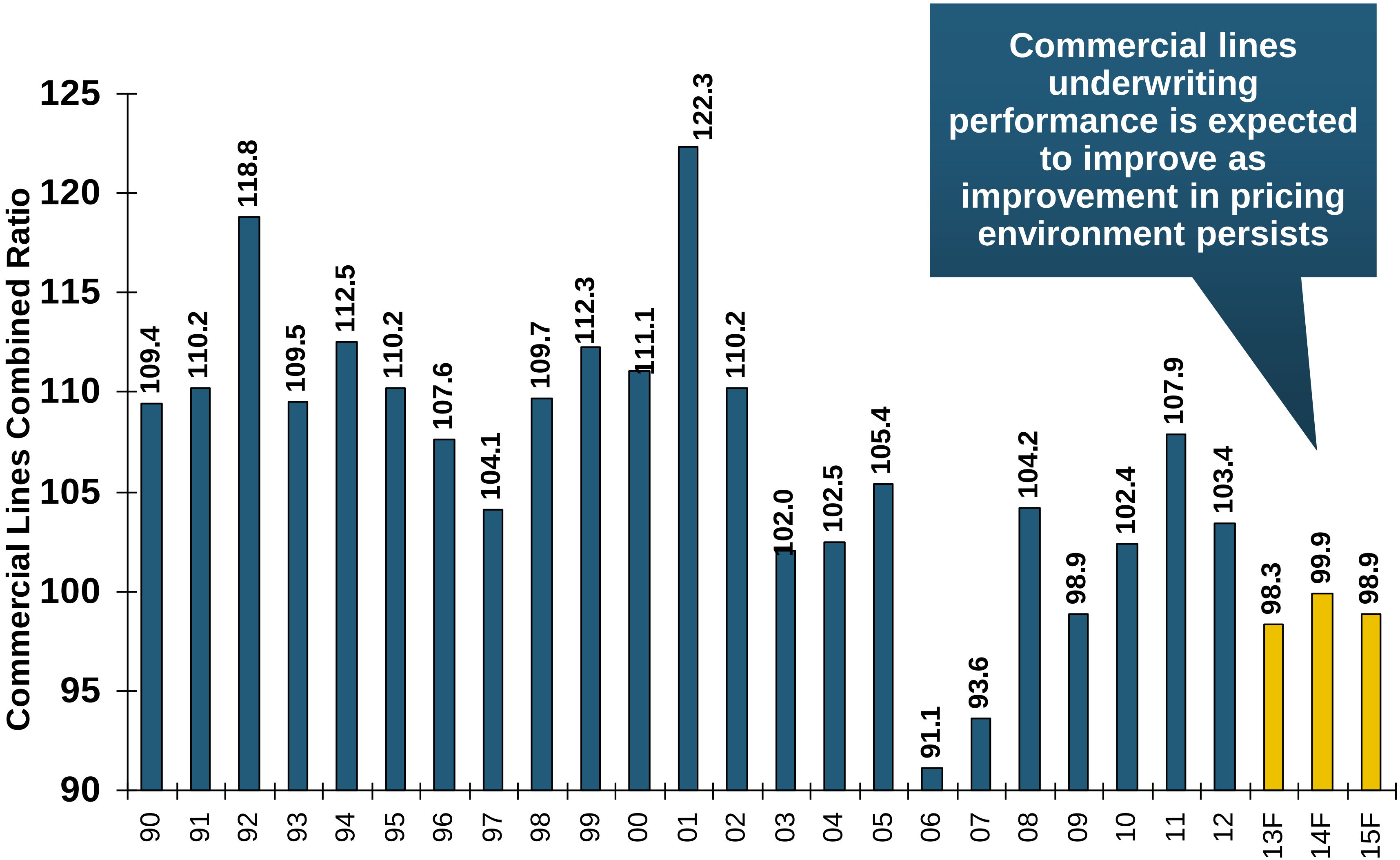


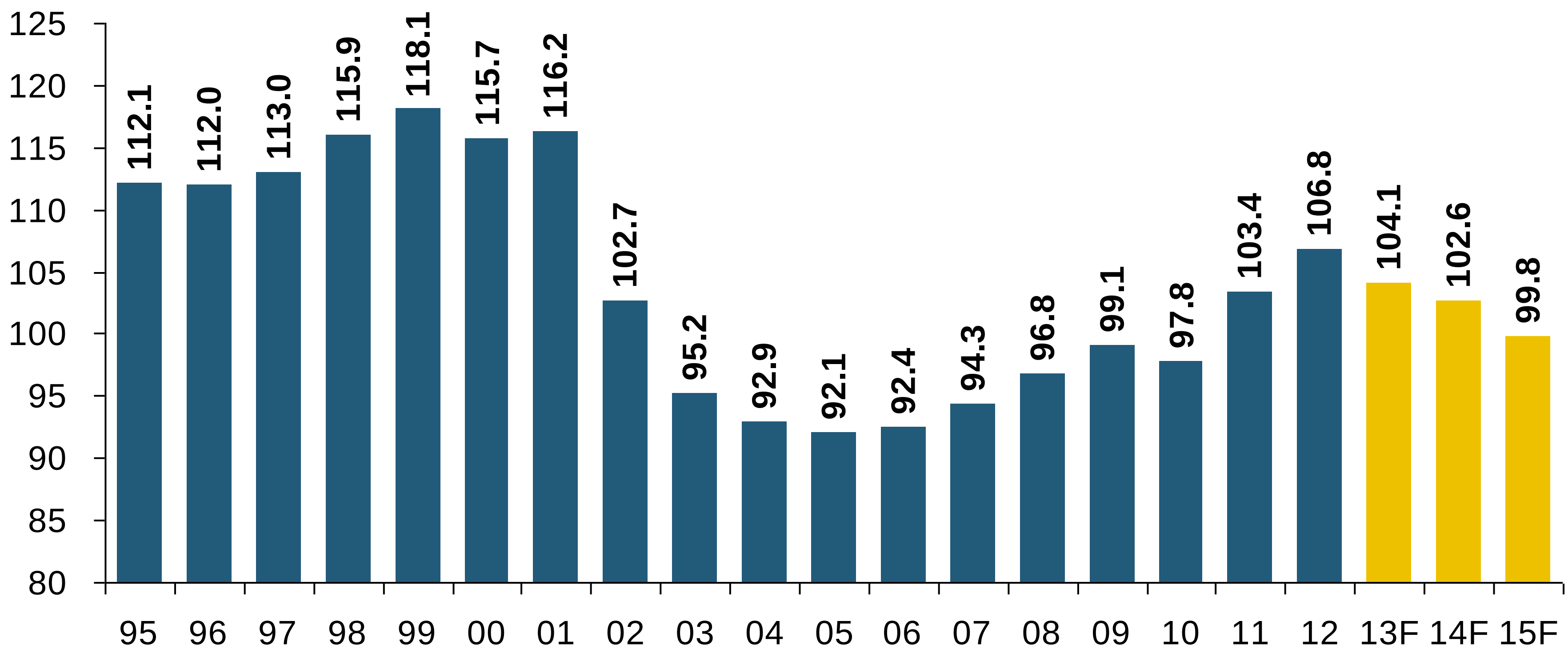
*Actual figure based on data through Q3 2014.
Shaded areas denote "hard market" periods
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute.

Commercial Lines Combined Ratio, 1990-2015F*



*2007-2012 figures exclude mortgage and financial guaranty segments.
Source: A.M. Best (1990-2014F); Conning (2015F) Insurance Information Institute.

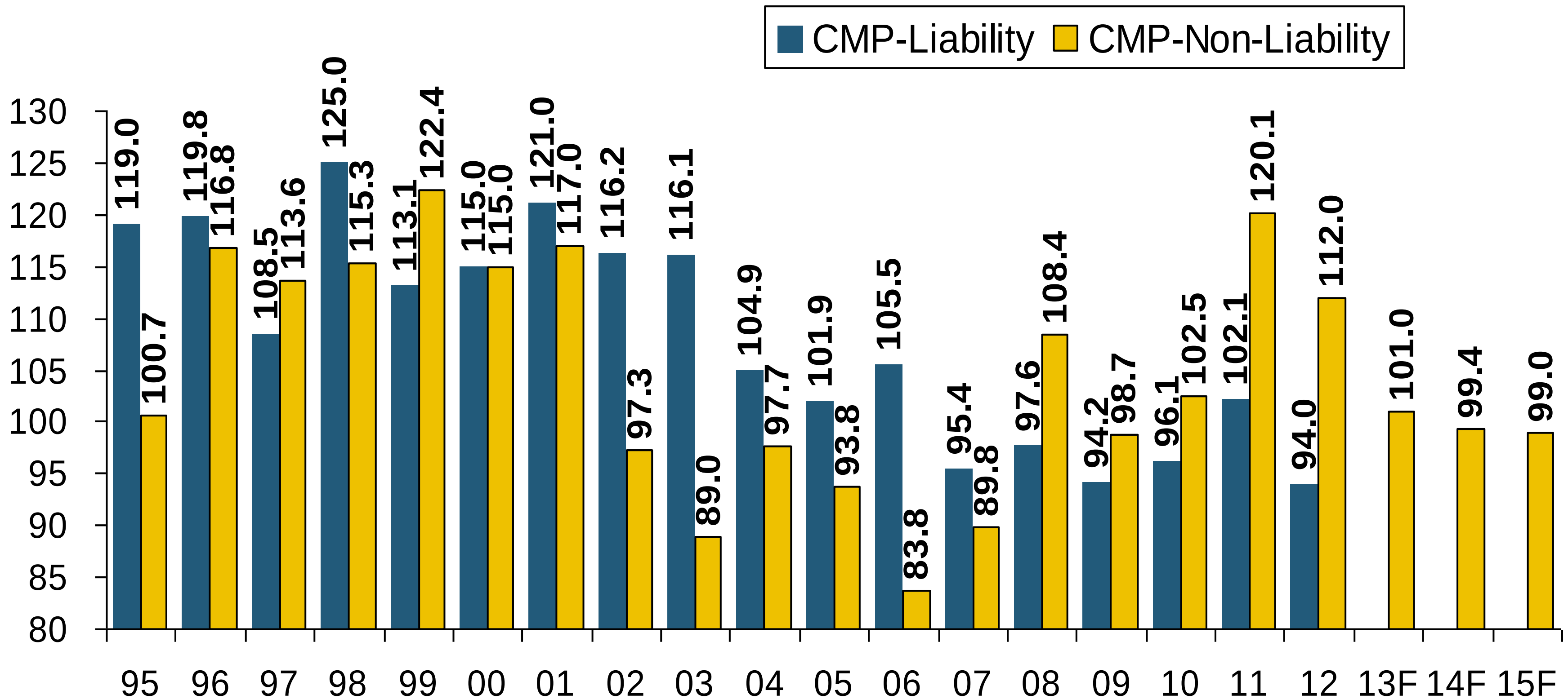
Commercial Auto Combined Ratio: 1993–2015F



Commercial Auto is Expected to Improve as Rate Gains Outpace Any Adverse Frequency and Severity Trends

Sources: A.M. Best (1990-2014F);Conning (2015F); Insurance Information Institute.

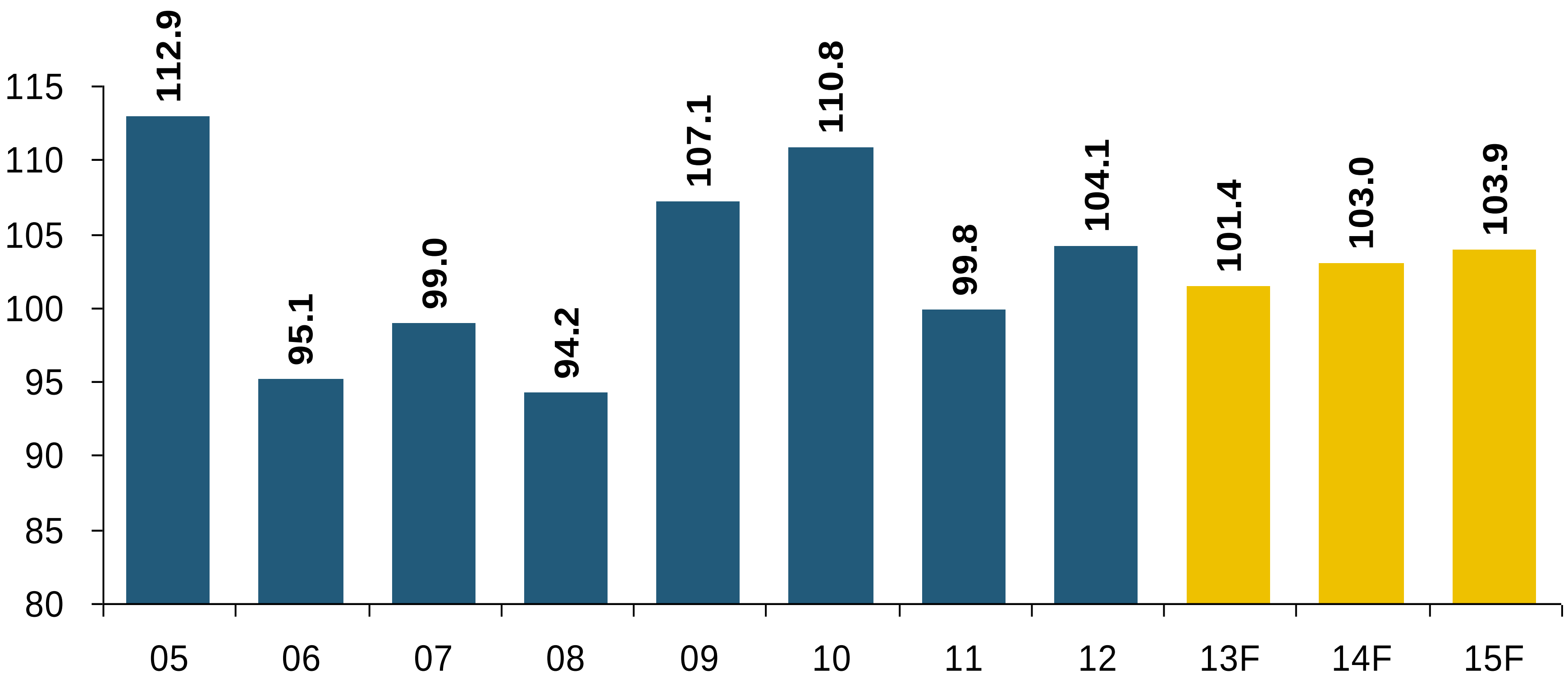
Commercial Multi-Peril Combined Ratio: 1995–2015F



Commercial Multi-Peril Underwriting Performance is Expected to Improve in 2013 Assuming Normal Catastrophe Loss Activity

*2013F-2012F figures are Conning figures for the combined liability and non-liability components..
Sources: A.M. Best; Conning; Insurance Information Institute.

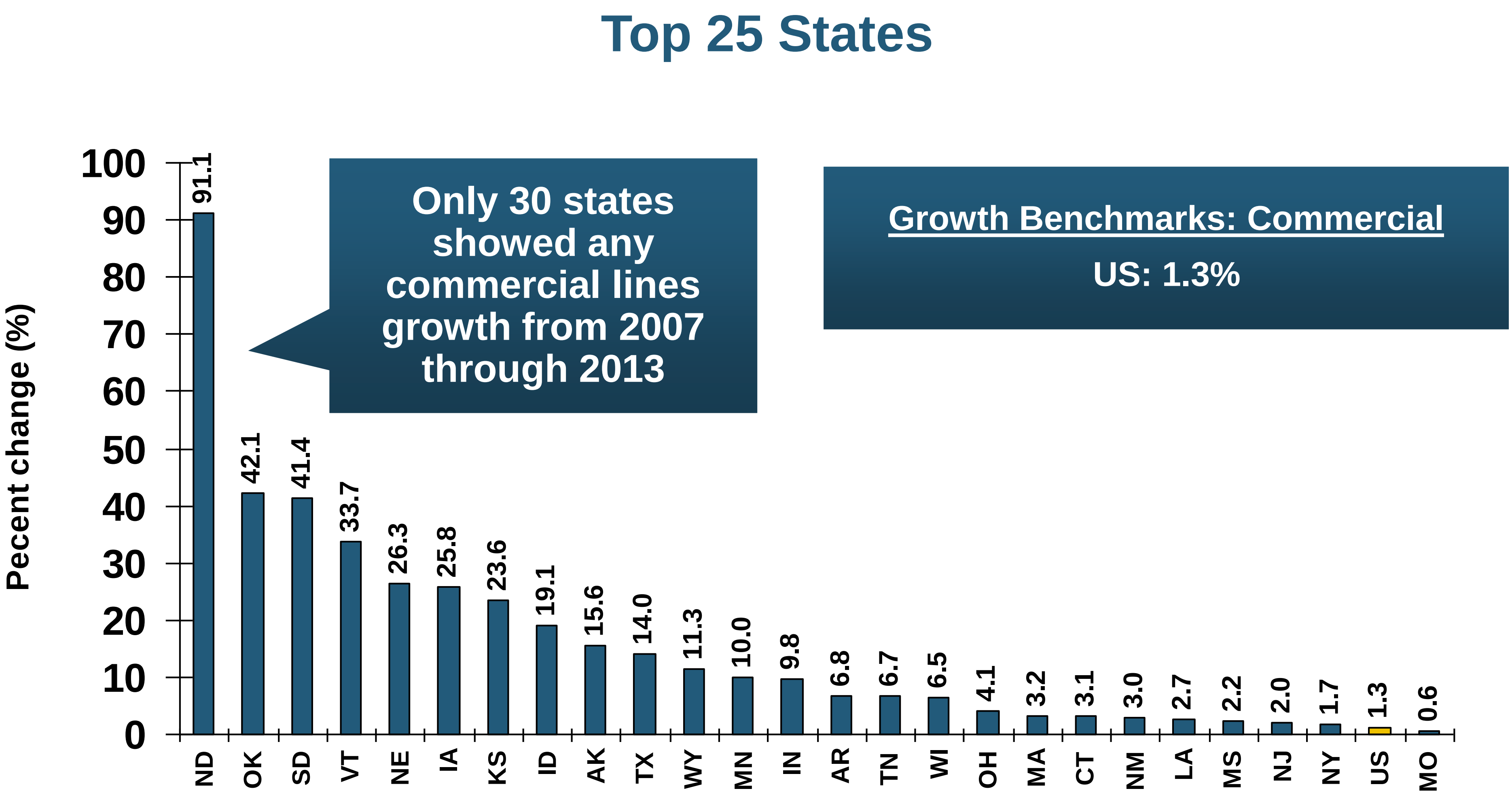
General Liability Combined Ratio: 2005–2015F



Commercial General Liability Underwriting Performance Has Been Volatile in Recent Years

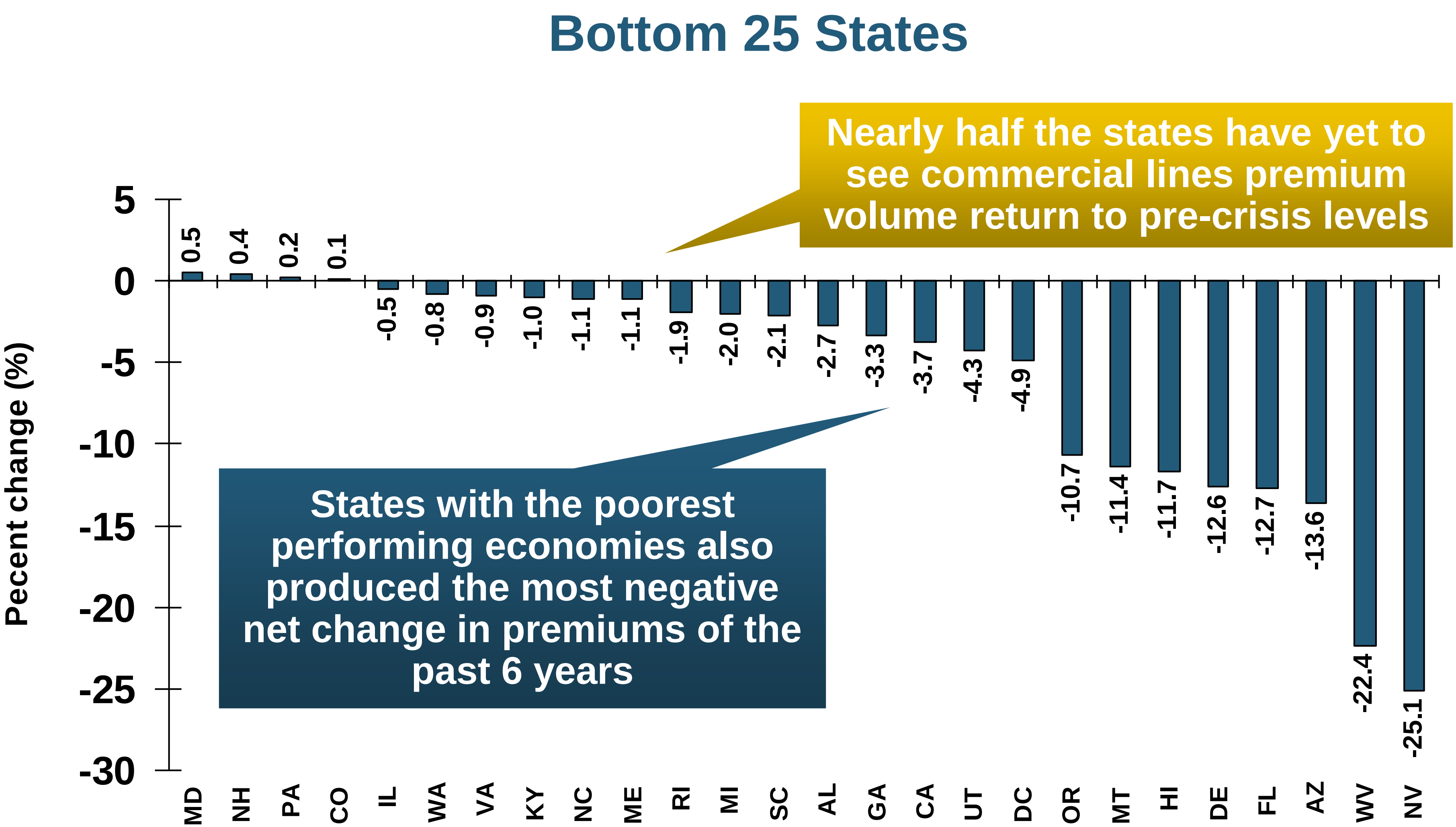
Source: Conning Research and Consulting.

Direct Premiums Written: Comm. Lines Percent Change by State, 2007-2013



Sources: SNL Financial LLC.; Insurance Information Institute.

Direct Premiums Written: Comm. Lines Percent Change by State, 2007-2013



Sources: SNL Financial LLC.; Insurance Information Institute.

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Top Insurance Issues: *What's Hot, What's Not*

No Dominant Event in 2014, but Some Key Commercial Lines Issues Spiked

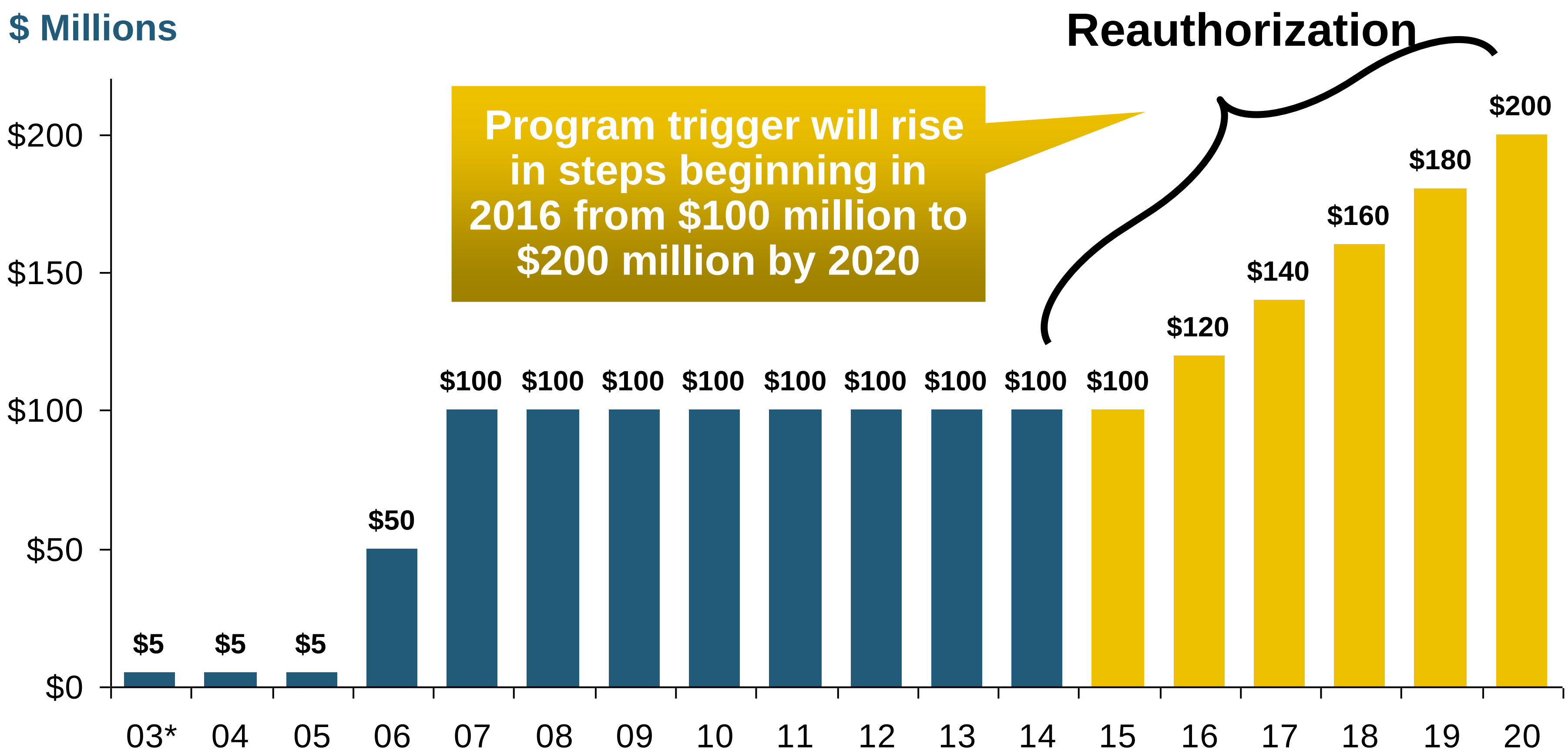
Terrorism, TRIA, & Cyber

TERRORISM

TRIA Reauthorization Was a Major Industry Effort Over the Past Few Years

Outline of New TRIA Structure

TRIA Program Trigger, from Inception (2003) through Extension (2020)



The TRIA program trigger is the amount of claims insurers will incur before any Federal participation starts

*First full year of program; TRIA was signed in to law on Nov. 26, 2002, with provisions identical to those in 2003.
Source: Insurance Information Institute research.

Industry Co-Pay Share in Excess of Individual Retention

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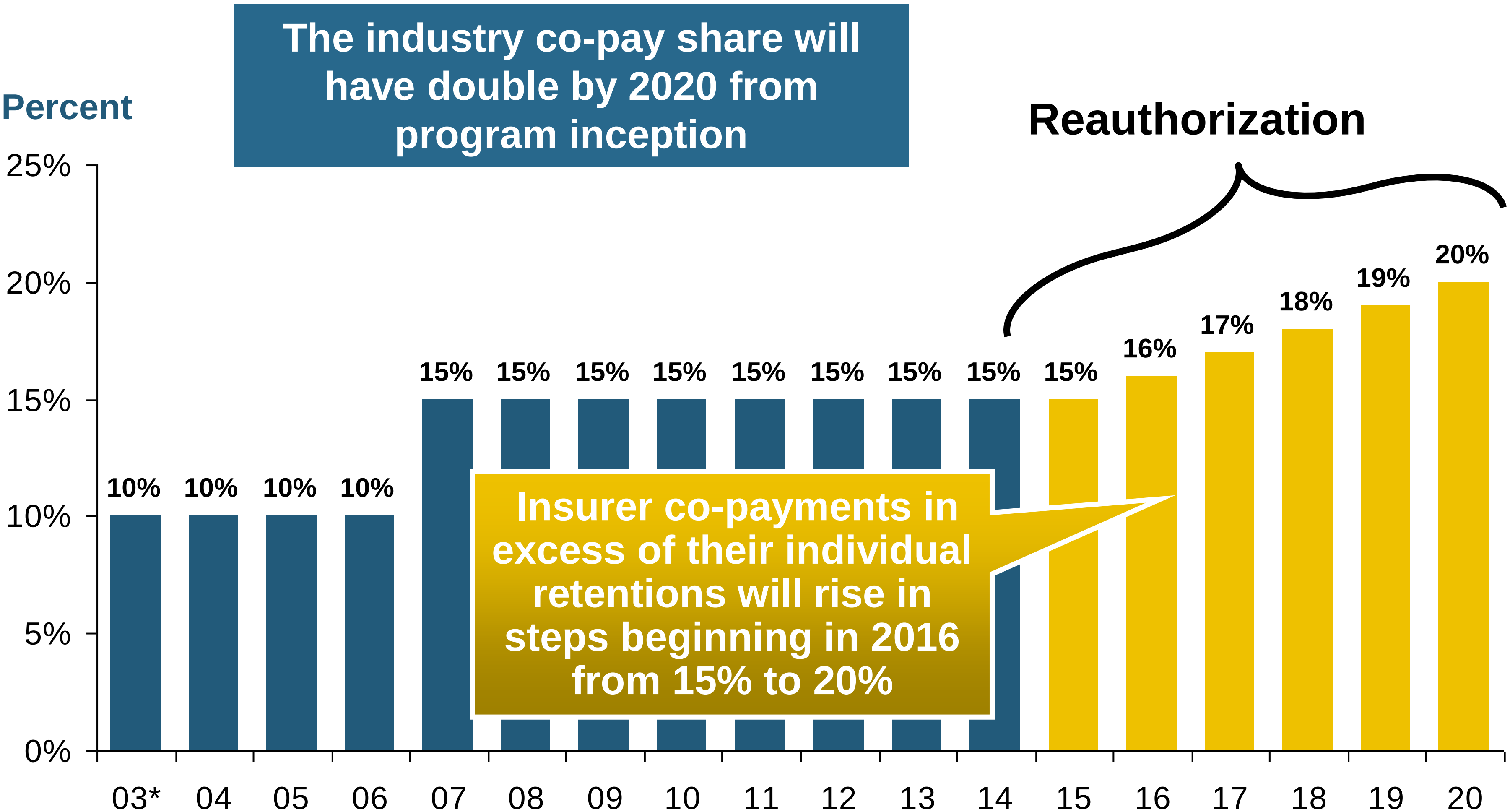
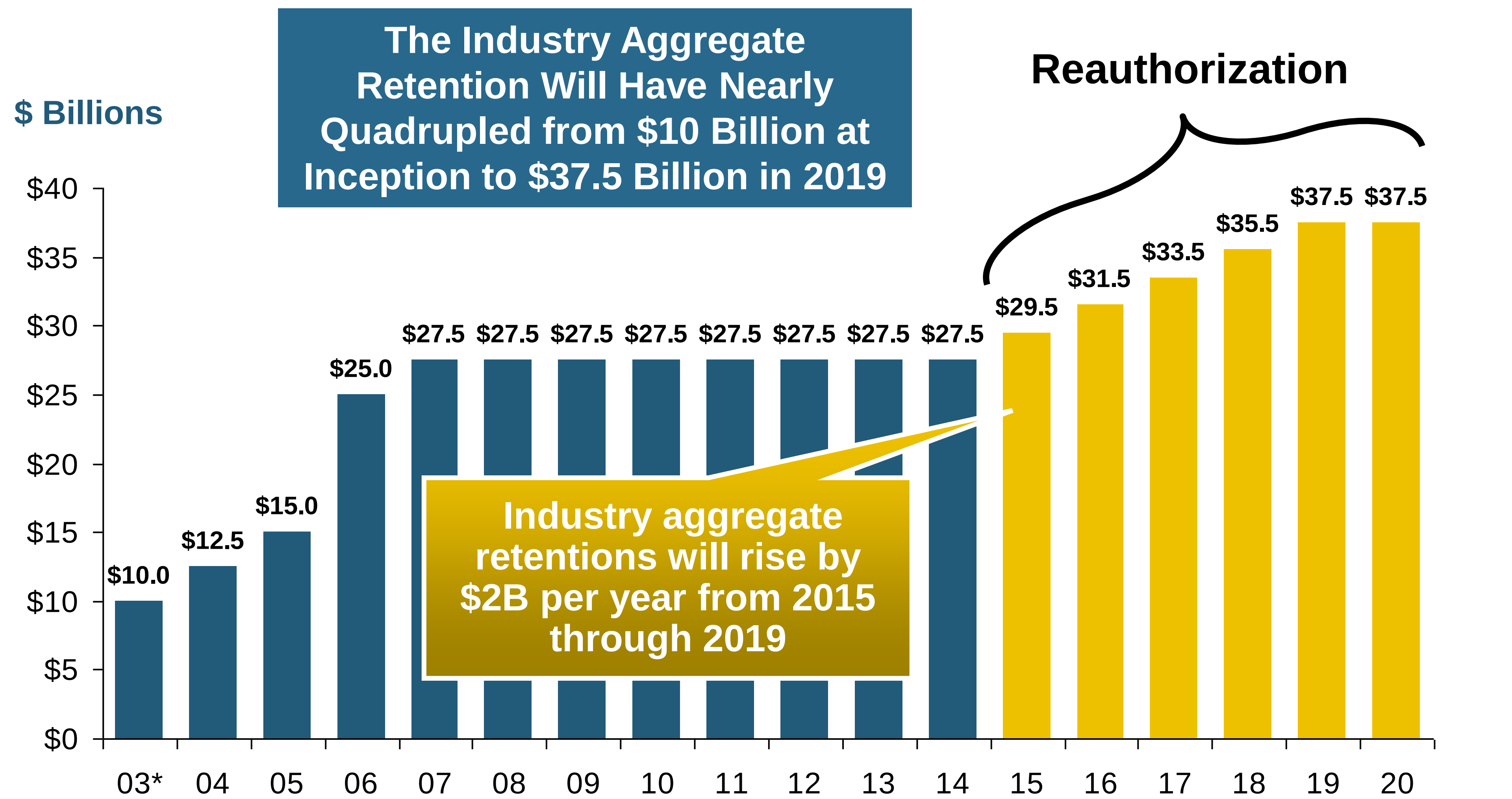


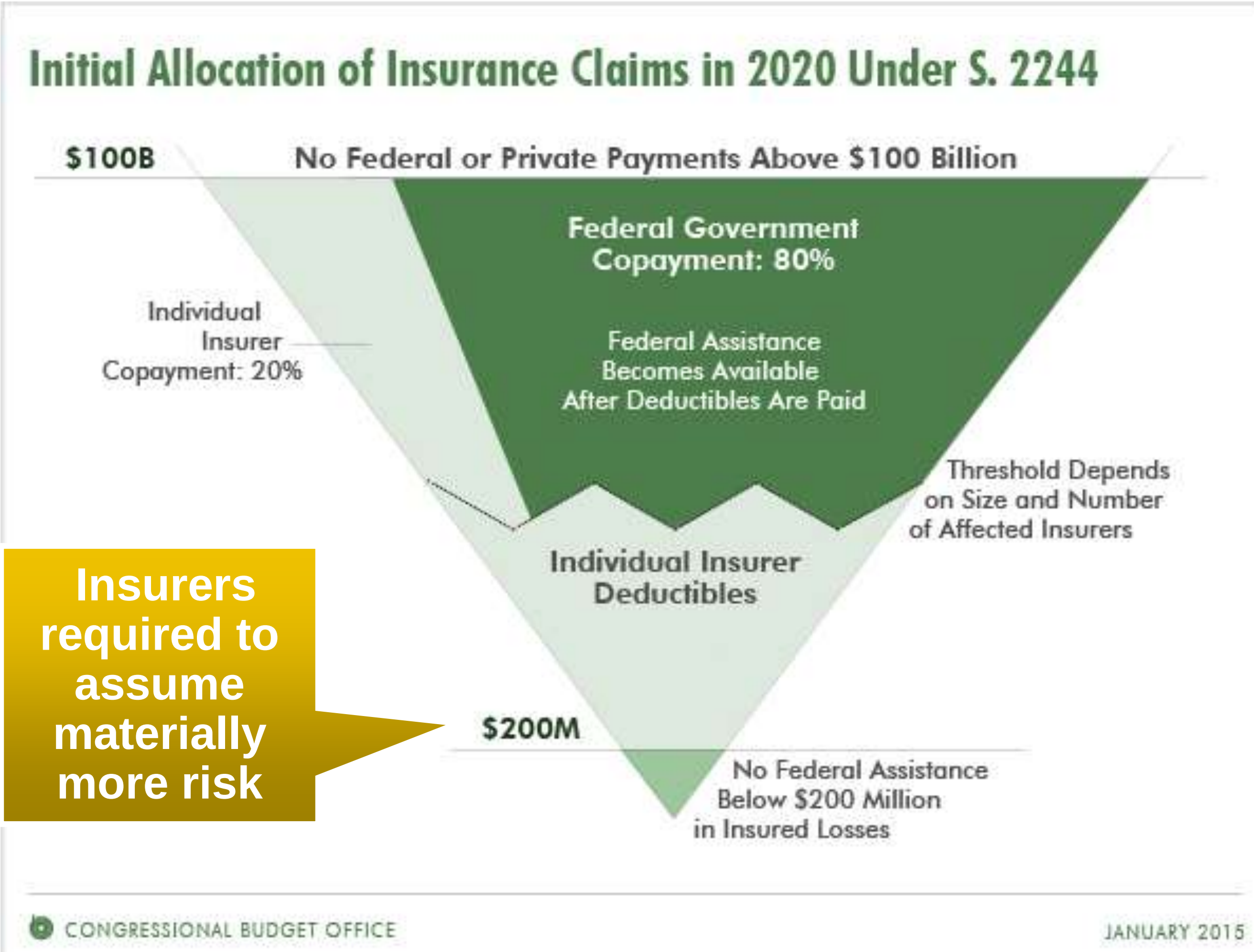
*First full year of program; TRIA was signed in to law on Nov. 26, 2002, with provisions identical to those in 2003.
Source: Insurance Information Institute research.

Industry Aggregate Retention Under TRIA, from Inception through Extension



*First full year of program; TRIA was signed in to law on Nov. 26, 2002, with provisions identical to those in 2003.
Source: Insurance Information Institute research.

Structure of Reauthorized TRIA Program (as of 2020)



Insurers required to assume materially more risk

Major Changes

- **6-Year reauthorization**
- **Trigger rises in steps from $100MM to $200MM**
- **Industry aggregate retention rises in steps from $27.5B to $37.5B**
- **Industry co-share above retained losses rises in steps from 15% to 20%**

Source: Congressional Budget Office: http://www.cbo.gov/publication/49866; Insurance Information Institute research.