Trends & Challenges in P/C Insurance Business Today

Focus on Oregon & Idaho Markets

Professional Insurance Agents of Oregon & Idaho
Insurance Institute of Oregon & Idaho

June 7/8, 2004

Robert P. Hartwig, Ph.D., CPCU, Senior Vice President & Chief Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: (212) 346-5520 ♦ Fax: (212) 732-1916 ♦ bobh@iii.org ♦ www.iii.org
The mission of the Insurance Information Institute (I.I.I.) is to improve public understanding of insurance -- what it does and how it works. The I.I.I. enjoys broad membership throughout the insurance industry, including most of the major p/c insurers and reinsurers operating in the United States, as well as companies operating on a regional basis and internationally.

For more than 40 years, the I.I.I. has provided definitive insurance information. Today, the I.I.I. is recognized throughout the insurance industry as well as by the media, governments, regulatory organizations, universities and the public as a primary source of information, analysis and referral concerning insurance.

Each year, the I.I.I. works on more than 3,700 news stories, handles more than 6,000 requests for information from its members, the media, and other parties and answers nearly 50,000 questions from consumers.

In addition to direct contact with the media, individuals and organizations, the I.I.I. publishes a host of helpful brochures and books on a wide variety of insurance topics, ranging in subjects from 12 Ways to Lower Your Auto Insurance Costs to the I.I.I. Fact Book series. I.I.I.’s members benefit from direct access to all information, I.I.I. staff and its members-only web site. The Institute does not lobby. Its central function is to provide accurate and timely information on insurance subjects. Questions concerning I.I.I. membership should be directed to Cary Schneider at (212) 346-5566 or by email at carys@iii.org.
Presentation Outline

- Profitability
- Underwriting
- Ratings, Solvency & Financial Strength
- Investment Overview
- Pricing
- Auto & Homeowners Overview
- Workers Comp: The Insurance Industry’s Quiet Crisis?
- Tort Environment
- Insurance Scoring
- The Challenge of Terrorism
- Q & A
P/C FINANCIAL UPDATE:

Profitability: Good but Not Good Enough
Underwriting: Need to Stay Disciplined
Investments: Keep Expectations Low
P/C FINANCIAL OVERVIEW:

PROFIT PRESSURE
## Highlights: Property/Casualty
### Full-Year 2003 vs. 2002

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2002</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Written Prem.</td>
<td>405,855</td>
<td>369,673</td>
<td>+9.8%</td>
</tr>
<tr>
<td>Loss &amp; LAE</td>
<td>289,800</td>
<td>283,640</td>
<td>+2.2%</td>
</tr>
<tr>
<td>Net UW Gain (Loss)</td>
<td>(4,635)</td>
<td>(30,840)</td>
<td>-85.0%</td>
</tr>
<tr>
<td>Net Inv. Income</td>
<td>38,686</td>
<td>37,225</td>
<td>+3.9%</td>
</tr>
<tr>
<td><strong>Net Income (a.t.)</strong></td>
<td><strong>29,877</strong></td>
<td><strong>3,046</strong></td>
<td><strong>+880.9%</strong></td>
</tr>
<tr>
<td>Surplus*</td>
<td>346,987</td>
<td>285,386</td>
<td>+21.6%</td>
</tr>
<tr>
<td>Combined Ratio</td>
<td>100.1</td>
<td>107.3</td>
<td>-7.2 pts.</td>
</tr>
</tbody>
</table>
Strength of Recent Hard Markets by Real NWP Growth*

Real NWP Growth During Past 3 Hard Markets

- 1975-78: 8.6%
- 1985-87: 14.5%
- 2001-04F: 7.6%

Note: Shaded areas denote hard market periods.
Source: A.M. Best, Insurance Information Institute

Commercial Insurance Share of P/C Market is Rising

Direct Premiums Written ($ Billions)

Commercial Market Share:
1993: 52.7%
1998: 48.0%
2002: 52.9%
2003E: 53.5%

Source: A.M. Best; Insurance Information Institute
**P/C Net Income After Taxes**

*1991-2003 ($ Millions)*

- 1991: $14,178
- 1992: $5,840
- 1993: $19,316
- 1994: $10,870
- 1995: $20,598
- 1996: $24,404
- 1997: $36,819
- 1998: $30,773
- 1999: $21,865
- 2000: $20,559
- 2001: $3,046
- 2002: -$6,970
- 2003: $29,877

- **2001 was the first year ever with a full year net loss**
- **2002 ROE = 1.0%**
- **2003 ROE = 9.4%**

Sources: A.M. Best, ISO, Insurance Information Institute.
IMMEDIATE LESSON:
Results are better but the industry remains a laggard.
U/W, Pricing Discipline are Key!

Source: Insurance Information Institute; Fortune
The gap between the industry’s cost of capital and its rate of return is narrowing.

US P/C insurers missed their cost of capital by an average 6.5 points from 1991 to 2003.

10-Year returns for some major p/c lines surprisingly good, but…
**P/C Return on Equity: 2002**

**Select Northwest States & CA**

2002: ALL P/C LINES

- Washington: 8.0%
- US: 3.3%
- Oregon: 3.0%
- Idaho: 2.0%
- California: -1.6%

Source: NAIC, Insurance Information Institute
P/C ROE: 1993-2002
Select Northwest States & CA

1993-2002: ALL P/C LINES

- Oregon: 9.6%
- Idaho: 9.4%
- Washington: 8.0%
- US: 7.7%
- California: 5.2%

Source: NAIC, Insurance Information Institute
Profitability in OR and ID has generally followed national trends & lags the *Fortune 500*.

Source: Insurance Information Institute; NAIC, *Fortune*
Homeowners and auto experience has deteriorated in recent years, but likely improved picked up in 2003/4
Commercial lines had a mixed performance in recent years.
ROE for Major Commercial Lines in IDAHO, 1993 - 2002

Commercial lines had a mixed performance in recent years.

Source: NAIC
Rates of Return on Net Worth for Workers Comp: OR vs. ID

Averages: 1993 to 2002

US WC Insurance = +8.9%*
OR WC Insurance = +7.1%
ID WC Insurance = +5.4%

Source: NAIC, Insurance Information Institute
WALL STREET:

HIGH EXPECTATIONS
Insurer Stocks: Outperforming the S&P 500

Total Return 2004 YTD Through June 4, 2004

Source: SNL Securities, Insurance Information Institute
Private Passenger Auto: Top 25 Writers Market Share

Substantial consolidation evident over the past 25 years, suggesting:
- M&As more successful
- Scale economies
- Barriers to entry exist
- Capital (esp. foreign capital) cannot enter easily

Sources: A.M. Best, Morgan Stanley, Insurance Information Institute.
Commercial Lines: Top 25 Writers Market Share*

Virtually no consolidation in commercial p/c sector over the past 25 years, suggesting:

- M&As not generally successful
  - Scale?
  - Execution?
  - Legacy
  - Distribution?

- Deconsolidation (asset sales, spin-offs, failures)
- Low barriers to entry

* By direct premiums written.
Sources: A.M. Best, Morgan Stanley, Insurance Information Institute.
P/C FINANCIAL OVERVIEW:

UNDERWRITING PRESSURE
P/C Industry Combined Ratio

Combined Ratios

1970s: 100.3
1980s: 109.2
1990s: 107.8
2000-04: 106.7

2001 = 115.7
2002 = 107.2
2003 = 100.1
2004E = 100.0*

Sources: A.M. Best; ISO, III

*2004 figures based on III Groundhog Survey, 2/04.
Underwriting Gain (Loss) 1975-2004F*

2003 was the best year since 1997, with underwriting losses of just $4.6 billion. The forecast underwriting loss for 2004 is $0, given the expectation of a 100.0 combined ratio.

*2004 underwriting loss is forecast at $0 (based on forecast combined ration of 100.0 from III Groundhog forecast, 2/04.

Source: A.M. Best, Insurance Information Institute
Commercial vs. Personal Lines
Combined Ratios

10-Year Average Combined Ratios
Commercial: 111.1   Personal: 105.2

Source: A.M. Best; Insurance Information Institute
Combined Ratios:
Selected Major Lines, 2003E—2004F

U/W performance improving, but variation in results is enormous.

Source: A.M. Best; Insurance Information Institute
2001’s combined ratio was the worst-ever for reinsurers; 2002 was bad as well.

2003: Big improvement in primary and reinsurer segments

Source: A.M. Best, ISO, Reinsurance Association of America, Insurance Information Institute
After-Tax ROE for Selected AY Combined Ratios

<table>
<thead>
<tr>
<th>Rate of Return (%)</th>
<th>80%</th>
<th>82%</th>
<th>84%</th>
<th>86%</th>
<th>88%</th>
<th>90%</th>
<th>92%</th>
<th>94%</th>
<th>96%</th>
<th>98%</th>
<th>100%</th>
<th>105%</th>
</tr>
</thead>
<tbody>
<tr>
<td>23.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21.8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18.4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16.6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14.9%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13.2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Assumes 4% tax-equivalent yield, 28% expense ratio and 140% premium/surplus ratio

Source: Dowling & Partners Securities
Private Passenger Auto Direct

Loss Ratios: US vs. OR & ID

1993-2002

Loss Ratios in OR and ID have generally been better than the US as a whole

Source: NAIC; Insurance Information Institute
2003 was the 4th worst year ever for insured catastrophe losses in the US. There were 4 events with losses exceeding $1 billion.

*2004 figure is for 1st quarter only ($963 million).
Note: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims.
Source: Property Claims Service/ISO; Insurance Information Institute
Texas: Mold Losses/Claims
Continuing to Moderate*

* Data are for TDI Cause 61: Discharge – Other Damage. Not all claims in cause 61 are mold and mold claims may also arise from other (non-water) causes of loss.

Source: Texas Department of Insurance; Insurance Information Institute
FATAL ATTRACTION?

A LOSS OF PRICING & UNDERWRITING DISCIPLINE

RATINGS, SOLVENCY, FINANCIAL STRENGTH
Private Passenger Auto Combined & Operating Ratios, 1993-2004F

Rating actions contributed to dramatic improvement in PP Auto U/W performance

Sources: Insurance Information Institute from A.M. Best and NAIC data; 2003/4 expenditure estimates from III.
Cost of Risk vs. Commercial Lines Operating Ratio

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

* 2003 operating ratio is III estimate.
Number of P/C Failures vs. Combined Ratio, 1991-2003

2003 failures fell to a 5-year low

Source: Standard & Poor's; Insurance Information Institute
Downgrade/Upgrade Ratio*


*U.S. property/casualty and life/health insurers
### P/C Insurers Maintaining Rating of A+ or Better Rating for 50+ Years

<table>
<thead>
<tr>
<th>P/C Company</th>
<th>Group Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. AIU Insurance Co.</td>
<td>1. American International Group</td>
</tr>
<tr>
<td>2. Alfa Mutual Ins. Co.</td>
<td>2. Alfa Insurance Group</td>
</tr>
<tr>
<td>3. Amica Mutual Ins. Co.</td>
<td>3. Amica Mutual Group</td>
</tr>
<tr>
<td>4. Church Mutual Ins. Co.</td>
<td>4. None</td>
</tr>
<tr>
<td>5. Federal Insurance Co.</td>
<td>5. Chubb Group of Ins Cos.</td>
</tr>
<tr>
<td>10. Otsego Mutual Fire</td>
<td>10. None</td>
</tr>
<tr>
<td>11. Pharmacists Mutual Ins. Co.</td>
<td>11. None</td>
</tr>
<tr>
<td>15. Vigilant Insurance Co.</td>
<td>15. Chubb Group of Ins Cos.</td>
</tr>
</tbody>
</table>

*Source: Best’s Review, January 1, 2004.*
P/C Company Insolvency Rates, 1993 to 2002

- Insurer insolvencies are increasing
- 10-yr industry failure rate: 0.72%
- Failure rating for B+ or better rating: 0.49%
- Failure rate for D through B rating: 1.29%

Source: A.M. Best; Insurance Information Institute
Reason for P/C Insolvencies
(218 Insolvencies, 1993-2002)

- Deficient Loss Reserves: 51%
- Reserve deficiencies account for more than half of all p/c insurers insolvencies
- Unidentified: 17%
- Impaired Affiliate: 3%
- CAT Losses: 3%
- Reinsurer Failure: 0%
- Change in Business: 3%
- Discounted Ops: 8%
- Overstated Assets: 2%
- Alleged Fraud: 3%
- Rapid Growth: 10%

Source: A.M. Best, Insurance Information Institute
Insolvencies Generating Largest Guarantee Fund (Net) Payouts*

*Net expenses form inception to date (November 13, 2003).
Source: National Conference of Insurance Guarantee Funds; Insurance Information Institute.

*Excludes NY and workers comp security funds in NJ and PA.
Source: National Conference of Insurance Guarantee Funds; Insurance Information Institute

Assessments rose dramatically during the last hard market, setting a new record now.
$ Billions, Calendar Year Basis

Adverse reserve development of about $23 billion accounted for most of the industry’s 2002 and $17 billion in 2003.

*Negative numbers indicate favorable development; positive figures represent adverse development.
Combined Ratio: Impact of Reserve Changes (Points)

Adverse reserve development totaling an estimated $23 billion added more than 6 points to the p/c combines ratio in 2002.

<table>
<thead>
<tr>
<th>Category</th>
<th>Reserve Shortfalls</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other Liability**</td>
<td>$15.1</td>
</tr>
<tr>
<td>Workers Comp</td>
<td>$9.3</td>
</tr>
<tr>
<td>Commercial Multiperil</td>
<td>$8.0</td>
</tr>
<tr>
<td>Med Mal**</td>
<td>$4.7</td>
</tr>
<tr>
<td>Commercial Auto</td>
<td>$3.8</td>
</tr>
<tr>
<td>Products Liability**</td>
<td>$1.8</td>
</tr>
<tr>
<td>Specialty Liab</td>
<td>($0.1)</td>
</tr>
</tbody>
</table>

Market Conditions & Commercial lines issues dominated the media in 2002 and 2003

The I.I.I. conducted nearly 4,000 media interviews in 2003

Source: Insurance Information Institute from Lexis/Nexis search.
The fastest growing areas of media interest were CLUE, Credit & Med Mal. Media interest in mold and terrorism waned substantially.
THE INSURANCE INFORMATION INSTITUTE:  

*THE PLACE FOR INSURANCE INFORMATION*
I.I.I. ranks 3rd on Google out of 105 million hits on “insurance.”
Visits to I.I.I.’s public web site increased by 50% in 2003.
With 60 million visitors annually, I.I.I. drives customers to your site.
Information you need is only a mouse click away.
I.I.I. Members: Searches by Issue/Topic

- Arson
- Asbestos
- Cell Phones & Driving
- Credit Scoring
- Corporate Governance
- Dog Bite Liability
- Drunk Driving
- Generic Auto Crash Parts
- Hurricane and Windstorm Deductibles
- Insurance Scoring
- Loss History Reports (CLUE)
- Medical Malpractice
- Mold
- No-Fault Auto Insurance (PIF)
- Older Drivers
- Optional Federal Charter
- Privacy
- Teen Drivers
- Terrorism

- Auto Insurance
- Auto Safety / Crashworthiness
- Auto Theft
- Captives and Other Risk Financing Options
- Catastrophe
- Compulsory Auto Insurance
- Corporate Social Responsibility
- Crime
- Crop Insurance
- Cyber Risks
- Directors & Officers Liability (D&O)
- Earthquakes
- Environmental Pollution
- Financial and Market Conditions
- Financial Services
- Fire
- Fraud
- Health
- Homeowners Insurance
- Identity Theft
- International Insurance
- Insolvencies / Guaranty Funds
- Kidnap/Ransom
- Liability / Litigation
I.I.I. Members: Searches by Issue/Topic

Studies, presentations and message points for all major p/c industry issues

INSURANCE SCORING

- Message Points: INSURANCE SCORING
- III White Paper
- Insurance Issues Update: CREDIT BASED INSURANCE SCORING
- III Presentation: "The Use of Credit Information as an Underwriting Tool in Personal Lines Insurance: Analysis of Evidence and Benefits"
- III Response to Missouri DOI Study (Feb., 2004)

2004 Reports
- EPIC RESPONSE TO MISSOURI DOI REPORT

2003 Reports
- Agents Guide
- Epic Actuarial Study (June, 2003) + Appendix
- Insurance Monitor
- NCOIL Model Law
- Texas University Study
- Washington State Report

INTERNATIONAL INSURANCE

- Asia Insurance Market (Sigma 2003)
- Institutional Investors Statistical Yearbook
- Insurance Regulation and Supervision in the OECD Countries
I.I.I. Members: Regional Info

Regional News

Massachusetts Insurance Industry Association May Seek Its Own Insurance

Cape Cod Times, Hyannis, Mass. — April 17, 2004, Saturday
HYANNIS, Mass. — The insurance industry association that provides stopgap coverage for Massachusetts homeowners may take out insurance itself. Officials of the FAIR plan are looking at a contract for reinsurance, which would give the plan protection if too many homeowners file claims, president.

Diagnosis Of The Numbers Shows Doctors Not Leaving State In Droves; A 3-Year Campaign Has Demanded Caps On Malpractice Suits And Claimed That Physicians Are Going Elsewhere, Yet Statistics Show Their Ranks Here Are Probably Growing.

Morning Call (Allentown, PA) — April 18, 2004 Sunday
Pennsylvania doctors are not leaving in droves because of rising malpractice premiums, contrary to their relentless three-year campaign to convince state lawmakers and the public otherwise. New state government statistics, the first to shed definitive light on askuously murky crisis that has...

Pleased Governor To Sign Workers’ Comp Reform

March Independent Journal (Los Angeles, CA) — April 17, 2004 Saturday
SACRAMENTO - A workers’ compensation system that seemed to please no one is bound for an overhaul following passage yesterday of reforms that businesses greeted with applause and critics continued to call a selective insurance companies. It is a blow to Gov. Arnold Schwarzenegger, the Legislature...

Ethics Panel Will Honor Subpoena In Fisher Probe

Tulsa World (Oklahoma) — April 17, 2004 Saturday Final News Edition
OKLAHOMA CITY — The state Ethics Commission voted Friday to honor a subpoena that was issued this week by a special House panel that’s investigating state insurance Commissioner Carroll Fisher. The legislative committee, led by Rep. John Torre, D-Oklahoma City, is investigating several allegations...

PROGRESSIVE TO EXPAND CLAIMS CENTER, ADD STAFF

Buffalo News (New York) — April 10, 2004 Friday, PHAILED
Auto insurer Progressive Corp. is tripling the size of its local claims center and preparing to double its staff to accommodate continued strong growth in its New York state insurance business. The nation’s third-largest auto insurer confirmed Thursday that it has leased 21,300 square feet of...
INVESTMENTS:

NO SUBSTITUTE FOR SOUND UNDERWRITING
Investment income fell 1.3% in 2002 but rose 3.9% in 2003.

**History**
- 1997 Peak = $41.5B
- 2000 = $40.7B
- 2001 = $37.7B
- 2002 = $37.2B
- 2003 = $38.7B

Source: A.M. Best, ISO, Insurance Information Institute
Interest Rates: Lower Than They’ve Been in Decades, But…

- Lower bond yields were the primary driver behind declining investment income in recent years, with the 10-year note reaching a 45-year low in 2003.
- Higher rates are now a certainty as inflationary expectations build.

About 2/3 of invested assets are in the form of bonds.

*As of April 29, 2004.
Source: Board of Governors, Federal Reserve System; Insurance Information Institute
Total Returns for Large Company Stocks: 1970-2004*

S&P 500 was up 28.7% in 2003 but up just 1% through early June as fears of higher interest rates, Iraq, terror & high oil prices paralyze the market

- 2003 ended a streak of 3 consecutive years of declines for stocks
- Will the bull market run out of steam in 2004?

Source: Ibbotson Associates, Insurance Information Institute
Realized capital gains rebounded strongly in 2003

Sources: A.M. Best, ISO, Insurance Information Institute.
Property/Casualty Insurance Industry Investment Gain*

*Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.
Source: Insurance Services Office; Insurance Information Institute.

Investment gains are simply returning to “pre-bubble” levels.
CAPACITY CRUNCH?
Surplus (capacity) peaked at $339.3 Billion in mid-1999 and fell by 15.9% ($53.9 billion) to $285.4 billion at year-end 2002 (a trough?)

- Surplus increased by $61.6B or 21.6% to $347.0B

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

Source: A.M. Best, Insurance Information Institute
*As of 9/30/03.
After remaining stable at around GBP10bn, Lloyd’s capacity has increased by over 40% in the last three years.

2004 capacity is GBP14.9bn, unchanged from 2003.

Source: Lloyd’s
Number of Captive Formations & Liquidations 1993 to 2003E

- Hard market fueling captive formation
- Corporate collapses and captive consolidations fueled the upward trend in captive liquidations in 2002.

Source: AM Best, Advisen
PRICING:

DOWNWARD PRESSURE?
How the Risk Dollar is Spent (2003)

Firms w/Revenues < $1 Billion

- Property Premiums: 16%
- WC Premiums: 8%
- Retained Liability: 11%
- Liability Premiums: 14%
- Admin Costs: 5%
- Total Prof. Liab.: 10%
- Retained WC: 21%
- Other: 2%

Firms w/Revenues > $1 Billion

- Property Premiums: 20%
- WC Premiums: 14%
- Retained Liability: 4%
- Liability Premiums: 18%
- Admin Costs: 9%
- Total Prof. Liab.: 13%
- Retained WC: 10%
- Other: 4%

Source: RIMS (2003); Insurance Information Institute
Insurance is the Biggest Concern of Small Business Owners

- Insurance: 28%
- Poor Sales: 16%
- Taxes: 17%
- Credit/Int. Rates: 1%
- Inflation: 1%
- Labor Costs: 5%
- Labor Qlty.: 8%
- Competition: 9%
- Regulations: 11%
- Poor Sales: 16%

Source: National Federation of Independent Business (November 2003); Insurance Information Institute
Cost of Risk: 1990-2003*

* Cost of risk includes insurance premiums, retained losses and administrative expenses

Source: 2003 RIMS Benchmark Survey; Insurance Information Institute
Cost of Risk vs. Commercial Lines Operating Ratio

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

* 2003 operating ratio is III estimate.
PRICING
Commercial Premium Rate Changes Highly Cyclical

- Pricing power is ebbing
- Is moderation due to realization of performance and profit goals, increasing capacity/capital, or market-share strategies?

Source: MarketScout.com
Components of Cost of Risk Per $1,000 of Revenue*

* Cost of risk includes insurance premiums, retained losses and administrative expenses
Source: 2003 RIMS Benchmark Survey; Insurance Information Institute
P/C Soft Spots: % Accounts With Negative Price Change (1st Qtr. 2004)

More moderation is evident in the commercial casualty segments.
Proportion of Accounts Renewing With Increase of 20% or More, (Select Lines)

Source: Council of Insurance Agents and Brokers; Insurance Information Institute
Proportion of Workers Comp Accounts Renewing With Increase of 20% or More

Source: Council of Insurance Agents and Brokers; Insurance Information Institute
Average Expenditures on Auto Insurance: US

Countrywide auto insurance expenditures are expected to rise 3.5% in 2004

*III Estimates; Estimates for 2002-2004 based on BLS CPI data for motor vehicle insurance.
Source: NAIC, Insurance Information Institute
Average Expenditures on Homeowners Ins.: US

Average US HO expenditures are expected to rise by 2.8% in 2004

*III Estimates; Estimates for 2001-2003 based on BLS CPI data for tenants and household insurance
Source: NAIC, Insurance Information Institute.
World Rate-On-Line Index
(1990 = 100)

Reinsurance prices rising, limits falling: ROL up significantly, though not as much as after Hurricane Andrew in 1992

Source: Guy Carpenter
### Average Expenditures on Auto Insurance: ID, OR vs. Ohio

<table>
<thead>
<tr>
<th>Year</th>
<th>US Average</th>
<th>ID</th>
<th>OR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>$651</td>
<td>$445</td>
<td>$565</td>
</tr>
<tr>
<td>1995</td>
<td>$668</td>
<td>$447</td>
<td>$565</td>
</tr>
<tr>
<td>1996</td>
<td>$691</td>
<td>$465</td>
<td>$585</td>
</tr>
<tr>
<td>1997</td>
<td>$706</td>
<td>$479</td>
<td>$620</td>
</tr>
<tr>
<td>1998</td>
<td>$704</td>
<td>$494</td>
<td>$630</td>
</tr>
<tr>
<td>1999</td>
<td>$683</td>
<td>$494</td>
<td>$621</td>
</tr>
<tr>
<td>2000</td>
<td>$687</td>
<td>$505</td>
<td>$625</td>
</tr>
<tr>
<td>2001</td>
<td>$718</td>
<td>$523</td>
<td>$643</td>
</tr>
</tbody>
</table>

Average Auto expenditures in OR and ID are well below the US average.

Source: NAIC, Insurance Information Institute
Average Expenditures on Homeowners Ins.: ID, OR vs. US

Average HO expenditures in OR and ID are well below the US average.

Source: NAIC, Insurance Information Institute.
AUTO INSURANCE OVERVIEW
Private Passenger Auto is Enormous Part of P/C Industry

Total 2002 Direct Personal + Commercial Premiums Written = $399.7 Billion

Private passenger auto accounted for 36% or $145.1B in DPW in 2002

Source: A.M. Best; Insurance Information Institute
Auto Insurance:
Direct Premiums Written

Source: A.M. Best; Insurance Information Institute
Many auto insurers have shown significant improvements in underwriting performance since mid-2002.
Key Auto Insurance Stats:
OR, ID vs. US, 2002 vs. 2003*

*Average for 4 quarters ending with the 4th quarter of 2003 vs. full year 2002.
Source: Insurance Services Office, Insurance Information Institute
Private passenger auto profitability deteriorated throughout the 1990s.
Average Expenditures on Auto Insurance: US

Countrywide auto insurance expenditures are expected to rise 3.5% in 2004

*III Estimates; Estimates for 2002-2004 based on BLS CPI data for motor vehicle insurance.
Source: NAIC, Insurance Information Institute
Average Auto Insurance Expenditure: Top/Bottom 5 vs. US (2001)

Most expensive states are in Northeast, least in upper Midwest.

Source: NAIC; Insurance Information Institute.
Auto insurance costs in the NW vary widely. Most expensive states are in NE, least in upper midwest.
PPA Affordability “Pain Index:”
Not an Issue in Select States*

*Ratio of 2001 state average auto expenditure to states median income for family of 4.
Sources: Auto Insurance Report, August 18, 2003
1993-2002 Return on Equity: Western States PP Auto*

1993-2002 10-year average

- Washington: 8.7%
- Oregon: 10.0%
- Idaho: 10.3%
- Hawaii: 19.8%
- Alaska: 7.2%
- California: 11.9%
- US: 8.8%

Source: NAIC, Insurance Information Institute
PPA Affordability “Pain Index”:
Not an Issue in Select States*

While the highest premiums are concentrated in the NE, measures of affordability have considerable geographic spread.

*Ratio of 2001 state average auto expenditure to states median income for family of 4.

Sources: Auto Insurance Report, August 18, 2003
### Motor Vehicle Retail Sales
(Millions of Units)

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales (Millions of Units)</th>
</tr>
</thead>
<tbody>
<tr>
<td>96</td>
<td>15.5</td>
</tr>
<tr>
<td>97</td>
<td>15.5</td>
</tr>
<tr>
<td>98</td>
<td>16.0</td>
</tr>
<tr>
<td>99</td>
<td>17.4</td>
</tr>
<tr>
<td>00</td>
<td>17.8</td>
</tr>
<tr>
<td>01</td>
<td>17.2</td>
</tr>
<tr>
<td>02</td>
<td>17.1</td>
</tr>
<tr>
<td>03</td>
<td>16.7</td>
</tr>
<tr>
<td>04F</td>
<td>16.8</td>
</tr>
<tr>
<td>05F</td>
<td>16.7</td>
</tr>
<tr>
<td>06F</td>
<td>16.8</td>
</tr>
<tr>
<td>07F</td>
<td>16.9</td>
</tr>
<tr>
<td>08F</td>
<td>17.1</td>
</tr>
<tr>
<td>09F</td>
<td>17.2</td>
</tr>
</tbody>
</table>

**New Motor Vehicle Sales**

Sales of automobiles remained relatively strong despite the weak economy in recent years. Economic recovery, incentives, low rates & demographics will keep exposure picture bright for auto insurers.

*Source: US Department of Commerce; Insurance Information Institute; Blue Chip Economic Indicators as of December 2003.*
Private Passenger Auto: Investment Gain*

Average Inv. Gain 1993 to 2002 = 5.5%

PPA investment gain (as a % of earned premium fell by more than 50% from 1993-2002), due primarily to historically low interest rates.

*Ratio to earned premiums

Sources: A.M. Best; III estimate/forecast for 2003/4.
Profitability of PPA line varies enormously by state. Unlike homeowners, the variation is not significantly the result of CAT activity.

Sources: NAIC; Insurance Information Institute
US Bodily Injury: Severity Trends
Now Offset Declining Claim Freq.

Medical inflation a powerful driving force

Source: ISO Fast Track data.
US PD Liability: Severity Trend
Now Offset Declining Claim Freq.

Fewer accidents, but more damage when they occur: SUV Effect?

Source: ISO Fast Track data.
US PIP Liability: Claim Frequency & Severity Falling

Crackdown on fraud and abuse evident in severity statistics.

Source: ISO Fast Track data.
US Collision: Severity Trends

Trail Declining Claim Freq.

Fewer accidents, but more damage when they occur: SUV Effect?

Source: ISO Fast Track data.
US Comprehensive: Severity Now Offsets Falling Claim Freq.

Source: ISO Fast Track data.
Auto Theft Rates: On the Rise

Reasons for Rising Auto Theft rates:

- Economy
- “Do not chase” restrictions
- Fraud
- Export/Chop Shop Demand

*Through first half of 2003
The Nation’s Worst Major Metropolitan Areas for Vehicle Theft in 2002

Number of Vehicle Thefts Reported per 100,000 Population
(*Based on 2000 Census)

Source: National Insurance Crime Bureau (NICB)
Fraud Costs Insurers Billions

Total Fraud = $96.4 Billion

- Health: 64%
- Auto (PP): 11%
- Life: 12%
- Disability: 1%
- P/C (excl. PPA): 12%

Source: Conning & Co., Insurance Information Institute

Private passenger auto fraud costs insurers at least $10 billion annually.
Countries with Lowest Traffic Death Rates: 1970 vs. 2001 (deaths per 100 million miles driven)

America’s ranking has fallen from first to ninth in the course of 30 years. Reasons for this include the rise in speeding and drunk driving, lower seat-belt use, and the proliferation of SUVs and pickup trucks.

*Australian rate is from 1971

Source: New York Times 11/27/03, Organization for Economic Cooperation and Development, as well as data compiled by traffic agencies in Australia, France and the US, and by Dr. Leonard Evans.
UNINSURED MOTORISTS
Enforcement of compulsory insurance laws varies significantly by state.

CO has/had the highest UM rate in US. ME has the lowest.
PERSISTENCY IN AUTO INSURANCE
Why Persistency Makes Sense for Insurers & Policyholders

• **Claims Costs:** Loss ratios for new customers 5-10 pts. higher than for those who have persisted for 1+ yrs.
• **Acquisition Costs:** USAA has 99% persistency rate, one of the lowest acquisition costs in the industry.
• **Volume:** Hartford has 96% retention rate with AARP.
• **Customer Service:** Amica: Has 95% retention rate, rated #1 by J.D. Power & Associates for 4 years in a row.
• **Guaranteed Insurability:** Safeco: “Pledge of Lifetime Insurability” eligible if:
  - Age 50+, insured 3 consecutive years, or
  - 9 years accident free (regardless of age)
• **Deductible Reduction:** MetLife Auto & Home: Reduces deductible for each year of persistency.
HOMEOWNERS INSURANCE OVERVIEW
Homeowners as a Percentage of the P/C Industry

Total 2002 Direct Personal + Commercial Premiums Written = $399.7 Billion

- All Commercial Lines 53%
- PPA Liability 21%
- PPA Phys Dam 15%
- Homeowners 11%
- $211.6B (All Commercial Lines)
- $61.2B (PPA Liability)
- $83.9B (PPA Phys Dam)
- $43.0B (Homeowners)

Homeowners insurance accounted for 11% or $43.0B in DPW in 2002

Source: A.M. Best; Insurance Information Institute
Homeowners Insurance: Direct Premiums Written

Source: A.M. Best; Insurance Information Institute
Homeowners Insurance
Combined Ratio

Average 1990 to 2002 = 117

Insurers have paid out an average of $1.17 in losses for every dollar earned in premiums over the past 13 years

2002 Loss: $3.4 Billion
2001 Loss: $7.4 Billion

Sources: A.M. Best; III
Rates of Return on Net Worth for Homeowners Ins: US vs. OR & ID

Source: NAIC, Insurance Information Institute

* US Average is 1.35% if excluding 1992 (year of Hurricanes Andrew and Iniki.)
Average Expenditures on Homeowners Ins.: US

Average US HO expenditures are expected to rise by 2.8% in 2004

*III Estimates; Estimates for 2001-2003 based on BLS CPI data for tenants and household insurance
Source: NAIC, Insurance Information Institute, TX Department of Insurance.
Homeowners Insurance Expenditure as a % of Median Home Price

![Graph showing the relationship between median home sales price and homeowners insurance expenditure as a % of sales price. The graph indicates that the cost of homeowners insurance relative to the price of a typical home has fallen over time.](image)

Source: Insurance Information Institute calculations based on data from National Association of Realtors, NAIC.
Recent increases in the cost of homeowners insurance are miniscule in comparison to the soaring cost of homes.

Source: Insurance Information Institute calculations based on data from Natl. Association of Realtors, NAIC. 2001-2003 HO figures are III estimates.
Homeowners Affordability “HURT Index”* (Top/Bottom 5 States)

Ratio of Avg. Homeowners Ins Expenditure to Median Income for Family of 4

CAT-prone and “moldy” states have biggest affordability issues

*Ratio of 2000 state average auto expenditure to states median income for family of 4.
Sources: Property Insurance Report, Sept 8, 2003
**Estimated Insured Mold Losses: 2000-2002**

Insured mold losses rose by 500% from 2000 to 2002.

Source: Insurance Information Institute
Texas: Mold Losses/Claims
Continuing to Moderate*

Source: Texas Department of Insurance; Insurance Information Institute

* Data are for TDI Cause 61: Discharge – Other Damage. Not all claims in cause 61 are mold and mold claims may also arise from other (non-water) causes of loss.
Profitability of HOMEOWNERS line varies enormously by state.

Sources: NAIC; Insurance Information Institute
Causes of Homeowners Insurance Losses, 1998-2002*

Percent of Losses Incurred

*Data exclude tenants and condominium owners insurance. All other property damage includes vandalism and malicious mischief. Liability includes bodily injury and property damage, medical payments and credit card and other.

Source: Insurance Services Office, Inc (ISO)
Average Annual Insured Losses*
(Top 10 States, $ Millions)

*Normalized losses adjusted for inflation, housing density, wealth and wind insurance coverage, based on historical data for 100-year period 1900-1999.
Source: Tillinghast-Towers Perrin
New Private Housing Starts
(Millions of Units)

- Housing market remain strong.
- Virtually no exposure impact for insurers

Source: US Department of Commerce; Blue Chip Economic Indicators (4/04), Insurance Info. Institute
Workers Compensation
Residual Market
Workers Comp Residual Market
Premium Volume

NCCI-Serviced Workers Compensation Residual Market Pools
as of December 31, 2003

Size of residual market nearly quadrupled from 1999 to 2003

* Excludes Maine Residual Market Pool
** Incomplete Policy Year Projected to Ultimate
Source: NCCI
Workers Compensation Residual Market Shares Continue to Rise

Workers Compensation Insurance Plan States*
Premium as a Percent of Direct Written Premium

Residual market share quadrupled from 3% to 12% from 1999 to 2003

p Preliminary
• NCCI Plan states plus DE, IN, MA, MI, NJ, NC
• Source: NCCI
Workers Compensation Residual Market Combined Ratios

NCCI-Serviced Workers Compensation Residual Market Pools
As of December 31, 2003

Percent

* Excludes Maine Residual Market Pool
** Incomplete Policy Year Projected to Ultimate
Source: NCCI
WC Residual Market Underwriting Results Continue to Decline

NCCI-Serviced Workers Compensation Residual Market Pools
As of December 31, 2003

$ Millions

<table>
<thead>
<tr>
<th>Policy Year</th>
<th>$ Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>($937)</td>
</tr>
<tr>
<td>1986</td>
<td>($1,359)</td>
</tr>
<tr>
<td>1987</td>
<td>($1,793)</td>
</tr>
<tr>
<td>1988*</td>
<td>($1,876)</td>
</tr>
<tr>
<td>1989*</td>
<td>($2,059)</td>
</tr>
<tr>
<td>1990*</td>
<td>($1,674)</td>
</tr>
<tr>
<td>1991*</td>
<td>($1,176)</td>
</tr>
<tr>
<td>1992*</td>
<td>($537)</td>
</tr>
<tr>
<td>1993</td>
<td>($126)</td>
</tr>
<tr>
<td>1994</td>
<td>$88</td>
</tr>
<tr>
<td>1995</td>
<td>$116</td>
</tr>
<tr>
<td>1996</td>
<td>$24</td>
</tr>
<tr>
<td>1997</td>
<td>($13)</td>
</tr>
<tr>
<td>1998</td>
<td>($46)</td>
</tr>
<tr>
<td>1999</td>
<td>($49)</td>
</tr>
<tr>
<td>2000</td>
<td>($64)</td>
</tr>
<tr>
<td>2001</td>
<td>($95)</td>
</tr>
<tr>
<td>2002</td>
<td>($171)</td>
</tr>
<tr>
<td>2003**</td>
<td>($180)</td>
</tr>
</tbody>
</table>

* Excludes Maine Residual Market Pool
** Incomplete Policy Year Projected to Ultimate

Source: NCCI
WORKERS COMPENSATION
MEDICAL COSTS:

CRITICAL CONDITION
Workers Comp Medical Claims Continue to Climb

Medical Claim Cost ($000s)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$7.9</td>
<td>$8.0</td>
<td>$7.8</td>
<td>$8.5</td>
<td>$8.9</td>
<td>$9.6</td>
<td>$10.3</td>
<td>$11.1</td>
<td>$12.0</td>
<td>$13.1</td>
<td>$14.7</td>
<td>$16.3</td>
<td>$17.8</td>
</tr>
</tbody>
</table>

Annual Change 1991–1995: +3.9%
Annual Change 1996–2002: +9.0%

2003p: Preliminary based on data valued as of 12/31/2003
1991-2002: Based on data through 12/31/2002, 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

Source: NCCI (based on states where NCCI provides ratemaking services).
WC Drug Costs as % of Total WC Medical Costs*

WC drug costs account for an increasingly large share of WC medical costs. They are a major driver behind the accelerating cost of providing medical care to injured workers.

*Analysis is on an accident year (AY) basis, developed through 8th report.
Utilization has greater impact on WC drug costs than price. Reflects trend toward new/more powerful drugs and more prescriptions.

Generic Prescriptions Written When Generics Available in WC

- 79% of times generic available but not prescribed
- 21% of times generic available but not prescribed
- 8% Additional cost savings if generic used 100% of time when available
- 92% All other brand and prescription drug costs

Prescription Drug Cost Breakdown: WC vs. General Health

Workers Comp % Total Paid
- Painkillers: 55%
- Muscle Relaxants: 20%
- Antidepressants: 14%
- All Other: 11%

## Top 10 Prescription Drugs by Total Paid in Workers Comp

<table>
<thead>
<tr>
<th>DRUG NAME</th>
<th>Brand vs. Generic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Celebrex (anti-inflammatory)</td>
<td>Brand (generic not available)</td>
</tr>
<tr>
<td>Oxycontin (painkiller)</td>
<td>Brand (generic not available)</td>
</tr>
<tr>
<td>Vioxx (anti-inflammatory)</td>
<td>Brand (generic not available)</td>
</tr>
<tr>
<td>Hydrocodone (painkiller)</td>
<td>Generic</td>
</tr>
<tr>
<td>Neurontin (painkiller)</td>
<td>Brand (generic not available)</td>
</tr>
<tr>
<td>Ultram (painkiller)</td>
<td>Brand (generic available)</td>
</tr>
<tr>
<td>Carisoprodol (muscle relaxant)</td>
<td>Generic (same as Soma)</td>
</tr>
<tr>
<td>Cyclobenzaprine (muscle relaxant)</td>
<td>Generic</td>
</tr>
<tr>
<td>Soma (muscle relaxant)</td>
<td>Brand (Same as carisoprodol)</td>
</tr>
<tr>
<td>Ambien (sedative)</td>
<td>Brand (generic not available)</td>
</tr>
</tbody>
</table>

Reasons for Increased Prescription Drug Utilization in Workers Comp

Aggressive Marketing
- Major pharmaceuticals spend twice as much on advertising as on R&D

Greater Availability & Dependence on Medications for Treatments

Aging Workforce: requires more assistance from prescription drugs

Unhealthy Workforce
- E.g.,: About 2/3 of adults are overweight or obese, increasing the frequency of some types of injuries and making recovery more difficult relative to a healthy weight individual.

Addiction? (e.g., Oxycontin)

Source: National Council on Compensation Insurance, Insurance Information Institute
LEGAL LIABILITY & TORT ENVIRONMENT

(full presentation available upon request to III members)
Cost of U.S. Tort System
($ Billions)

Tort costs consumed 2.23% of GDP in 2002

Per capita “tort tax” expected to rise to $1,003 by 2005, up from $809 in 2002

Source: Tillinghast-Towers Perrin.
Personal, Commercial & Self (Un) Insured Tort Costs*

*Excludes medical malpractice
Source: Tillinghast-Towers Perrin
Where the Tort Dollar Goes (2002)

Tort System is *extremely* inefficient:

- Only 22% of the tort dollar compensates victims for economic losses
- At least 54% of every tort dollar never reaches the victim

Claimants' Attorney Fees 19%
Awards for Economic Loss 22%
Awards for Non-Economic Loss 24%
Defense Costs 14%
Administration 21%

Source: Tillinghast-Towers Perrin
THE U.S. LEGAL SYSTEM: IS IT OUT OF CONTROL?

TRENDS, CONDITIONS & OUTLOOK
TORT-ure

- Asbestos
- Silicosis
- “Toxic” Mold
- Medical Malpractice
- Construction Defects
- Lead
- Fast/Fattening Foods & Obesity
- Reality TV
- Arsenic Treated Lumber
- Guns
- Genetically Modified Foods & Labeling
- Generic Drugs, Pharmaceuticals & Medical Devices
- Security exposures (workplace violence, post-9/11 issues)
- Slavery
# Business Leaders Ranking of Liability Systems for 2004

## Best States
1. Delaware
2. Nebraska
3. Virginia
4. Iowa
5. Idaho
6. Utah
7. New Hampshire
8. Minnesota
9. Kansas
10. Wisconsin

## Worst States
41. Missouri
42. Arkansas
43. Montana
44. Illinois
45. Texas
46. California
47. Louisiana
48. Alabama
49. West Virginia
50. Mississippi

The Nation’s Judicial Hellholes

Source: American Tort Reform Association; Insurance Information Institute
Average Jury Awards
1994 vs. 2001 and 2002

<table>
<thead>
<tr>
<th>Category</th>
<th>1994</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>419</td>
<td>1,199</td>
<td>1,744</td>
</tr>
<tr>
<td>Vehicular Liability</td>
<td>187</td>
<td>309</td>
<td>221</td>
</tr>
<tr>
<td>Premises Liability</td>
<td>333</td>
<td>750</td>
<td>767</td>
</tr>
<tr>
<td>Wrongful Death</td>
<td>1,185</td>
<td>3,099</td>
<td>4,421</td>
</tr>
<tr>
<td>Medical Malpractice</td>
<td>1,140</td>
<td>3,913</td>
<td>6,246</td>
</tr>
<tr>
<td>Products Liability</td>
<td>1,744</td>
<td></td>
<td>7,795</td>
</tr>
</tbody>
</table>

Source: Jury Verdict Research; Insurance Information Institute.
The median award fell by 1/3 between 2000 to 2002, but average awards rose because of a large number of jumbo awards.
# Probability of Plaintiff Verdict is Rising

<table>
<thead>
<tr>
<th></th>
<th>1994</th>
<th>1997</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premises Liability</td>
<td>43%</td>
<td>45%</td>
<td>49%</td>
</tr>
<tr>
<td>Business Negligence</td>
<td>NA</td>
<td>57%</td>
<td>62%</td>
</tr>
<tr>
<td>Vehicular Liability</td>
<td>58%</td>
<td>59%</td>
<td>63%</td>
</tr>
<tr>
<td>Products Liability</td>
<td>39%</td>
<td>39%</td>
<td>61%</td>
</tr>
</tbody>
</table>

Source: Jury Verdict Research, *2003 Current Award Trends*
There is a Glimmer of Hope for Tort Reform

Best Chance for Tort Reform in Years

- Medical Malpractice
  - States—already happening: 20+ states have caps
  - Federal reform discussed in Congress but bill failed in Senate
  - Attempt to get caps for specialties failed February 2004

- Class Action Reform
  - Class Action Fairness Act
  - Failed by 1 Vote 10/22/03; Likely back up 2004???

- Asbestos Reform
  - Fairness in Asbestos Injury Resolution of 2003; Failed Apr. 2004

- Punitive Damages—What’s Reasonable
  - Supreme Court ruled favorably in *Campbell v. State Farm*
Medical Malpractice: Tort Cost Growth is Skyrocketing

$ Billions

- Over the period from 1990 through 2000, medical malpractice tort costs rose 140%, more than double the 60% increase in medical costs generally over the same period!
- Over the period from 1975 through 2000, medical malpractice tort costs skyrocketed by 1,642% while medical costs generally rose 449%, nearly 4 times as fast!

Who Will Pay for the US Asbestos Mess?

Estimated Total US Settlements & Expenses = $200 billion

- Asbestos Defendants: $78 billion (39%)
- US Insurers: $60 billion (30%)
- Foreign Insurers: $62 billion (31%)

Source: Tillinghast-Towers Perrin; Insurance Information Institute
INSURANCE SCORING (CREDIT)
Texas Auto: Relative Loss Ratio
(by Credit Score Decile, Total Market)*

Interpretation:
Those with poorest credit scores generated losses more than double that of those with the best scores

Extremely strong statistical evidence linking credit score with loss/claim outcomes:
• Credit score & likelihood of positive claim (p<.0001)
• Size of loss related to credit score (p<.0001)
• Correlation between relative loss ratio and credit score (r = .95)

1st Decile = Lowest Credit Scores
10th Decile = Highest Credit Scores.

Score Range
Source: University of Texas, Bureau of Business Research, March 2003.

*Each decile contains approximately 15,300 policies. Includes standard and non-standard policyholders.
Texas Auto: Average Loss per Policy
(by Credit Score Decile, Total Market)

Interpretation:
Those with poorest credit scores generated incurred losses 65% higher than those with the best scores.

Source: University of Texas, Bureau of Business Research, March 2003.
Indicated Relative Pure Premium by Insurance Score (PD Liability)*

**Interpretation:**
Those with poorest credit scores had loss experience 33% above average while those with the best scores had loss experience that was 19% below average.

Source: EPIC Actuaries, June 2003
# Importance of Rating Factors by Coverage Type

<table>
<thead>
<tr>
<th>Coverage</th>
<th>Factor 1</th>
<th>Factor 2</th>
<th>Factor 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>BI Liability</td>
<td>Age/Gender</td>
<td>Ins. Score</td>
<td>Geography</td>
</tr>
<tr>
<td>PD Liability</td>
<td>Age/Gender</td>
<td>Ins. Score</td>
<td>Geography</td>
</tr>
<tr>
<td>PIP</td>
<td>Ins. Score</td>
<td>Geography</td>
<td>Yrs. Insured</td>
</tr>
<tr>
<td>Med Pay</td>
<td>Ins. Score</td>
<td>Limit</td>
<td>Age/Gender</td>
</tr>
<tr>
<td>Comprehensive</td>
<td>Model Year</td>
<td>Age/Gender</td>
<td>Ins. Score</td>
</tr>
<tr>
<td>Collision</td>
<td>Model Year</td>
<td>Age/Gender</td>
<td>Ins. Score</td>
</tr>
</tbody>
</table>

Adverse Impact: No Evidence
New Private Housing Starts
(Millions of Units)

New Private Housing Starts
• Housing market remains strong.

Source: US Department of Commerce; National Association of Realtors; Insurance Info. Institute
*Annualized January 2004 figure
Homeownership is at a record high. Because you can’t buy a home without insurance, insurance is clearly available and affordable, including to millions of Americans of modest means and all ethnic groups.
Homeownership rates in central cities is at an all-time record high. Because you can’t buy a home without insurance, insurance is clearly available and affordable, including to millions of Americans of modest means and all ethnic groups.
Homeownership Rates Among Minorities is Rising, 1994 to 2003

- Homeownership rates for minorities are at or near record highs
- Minorities are using their good credit to buy homes and get insurance

Source: U.S. Census Bureau
Homeownership rates in Oregon, 1990 to 2003

Homeownership rates in Oregon are at an all-time record high.

Source: U.S. Census Bureau
Homeownership rates in Idaho are at an all-time record high.

Source: U.S. Census Bureau
Percent Change in Homeownership, 1995-2001

- Homeownership rates have increased much faster for minority groups than for whites.
- Minorities are using their good credit to buy homes and get insurance.
- 4.3 million minority net new homeowners were created between 1995 and 2001.

Percent Change:

- White: 10.7%
- Black: 23.2%
- Hispanic: 45.9%
- Other*: 83.5%

*Includes American Indian, Eskimo, Aleut, Asian and Pacific Islander.
Source: U.S. Census Bureau
Credit Contrast: Western States vs. US

NW states generally have above-average credit scores, but income varies widely.

Note: Range of possible scores is 300 to 900.
Source: Experian; Insurance Information Institute.
THE CHALLENGE OF TERRORISM
TRIA UPDATE

- TRIA expires 12/31/05
- House subcommittee hearings held April 28—went well
- Senate hearings May 18—many committee members amenable
- Industry coalescing around a 2-year extension
  - Some life insurers trying to push for inclusion of group life
- Treasury required to complete a study of the program by 6/05
- Broad support from non-insurance industry groups/coalitions
- Reauthorization opposed by:
  - Consumer Federation of America
  - Some conservative think tanks (e.g., American Enterprise Institute)
  - Laissez-faire academics
- “Make Available” requirement expires this year
  - Treasury must make ruling on extension of this provision by 9/1/04.
  - Industry, non-insurers and regulators support extension
Terrorism: Is it Insurable Three Years After 9/11?

- Traditional arguments against insurability still apply
  - No solid sense of frequency or severity of future events despite modeling efforts
- Most major modern industrialized democracies have determined that terrorism risk is appropriately borne or at least shared by the state
  - UK, Spain, France, Germany, Australia, Israel, South Africa...
- No appreciable reinsurance market has developed
- Very little securitization of terrorism risk
- Very limited standalone market
- Workers comp terror exposure problem seems insoluble
- Terrorism is the face of warfare in the 21st century
- NEW: Increasing politicization of terrorism is compromising the integrity of the threat assessment process
- NEW: Budget and turf battles in Washington could harm funding for anti-terror programs & initiatives (e.g., Homeland Security, esp. TSA funding)
Sept. 11 Industry Loss Estimates
($ Billions)

- Life: $1.0 (3.1%)
- Aviation Liability: $3.5 (10.8%)
- Other Liabilities: $4.0 (12.3%)
- Biz Interruption: $11.0 (33.8%)
- Event Cancellation: $1.0 (3.1%)
- Aviation Hull: $0.5 (1.5%)
- Workers Comp: $1.8 (5.8%)
- Property - WTC 1 & 2: $3.6 (11.1%)
- Property - Other: $6.0 (19.5%)

Current Insured Losses Estimate: $32.5B

Source: Insurance Information Institute
Capital Myth: US P/C Insurers Have $300 Billion to Pay Terrorism Claims

Total PHS = $298.2 B as of 6/30/01
= $291.1 B as of 12/31/02

"Target" Commercial*
$116 billion
40%

Personal
$123 billion
42%

Other Commercial
$53 billion
18%

Only 40% of industry surplus backs up “target” lines

"Target" Commercial includes: Comm property, liability and workers comp; Surplus must also back-up on non-terrorist related property/liability and WC claims

Source: Insurance Information Institute based on A.M. Best Q.A.R Data.
Terrorism Take-Up Rates, Coverage Types & Pricing
Terrorism Coverage
Take-Up Rate Rising

Terrorism take-up rate rose through 2003 as commercial property premiums level-off or fall

FACTS on Take-Up Rates
Highest = Energy Industry = 40.5%
Lowest = Construction = 12.2%
Northeast = Highest = 30.3%
West = Lowest = 18.6%

Source: Marsh, Inc.; Insurance Information Institute
Terrorism Coverage: Take-Up Rates by Industry

- Energy: 40.5%
- Media: 35.3%
- Food & Beverage: 34.7%
- Habitational/Hospitality: 31.5%
- Healthcare: 31.0%
- Real Estate: 30.2%
- Transportation: 29.5%
- Utility: 27.1%
- Financial Institution: 26.8%
- Public Entity: 25.9%
- Tech/Telecom: 22.1%
- Education: 21.6%
- Retail: 20.0%
- Manufacturing: 18.2%
- Construction: 12.2%

Source: Marsh, Inc.
Terrorism Coverage: Take-Up Rates by Region

Terrorism take-up rate is highest in the Northeast

Northeast 30.3%
Midwest 26.2%
South 21.8%
West 18.6%

Source: Marsh, Inc.; Insurance Information Institute
Terrorism Coverage Take-Up Rates by Total Insured Value (TIV)*

- <$100: 18.2%
- $100-$500: 26.3%
- $500-$1,000: 39.7%
- >$1,000: 27.1%
- Average: 27.3%

Nearly 40% of firms with TIV between $500 million and $1 billion buy terror coverage.

Take-Up Rates for Small Firms
- TIV: Between $5 million and $50 million take-up rate estimated at 30%
- TIV below $5 million: Terror coverage “regularly purchased” via package policies

*Does not include firms that buy coverage through package policies.
Source: Marsh, Inc.; Insurance Information Institute
Terrorism Premium as a Percentage of Property Premium

FACTs on Terror Premium Relative to Property Premium

Highest = Energy Industry = 8.03%
Lowest = Construction = 2.36%

Increase reflects fall in price of property coverage rather than increase in price of terror coverage.

Source: Marsh, Inc.; Insurance Information Institute
The price of terrorism coverage fell during 2003—helps explain increase in take-up rate.

FACTS on Price Relative to TIV
Highest = Energy Industry = 0.0128%
Lowest = Education = 0.0030%

0.0078%
0.0055%
0.0045%
0.0056%


*Excludes risks with nominal $1 premium or built into all risks policy
Source: Marsh, Inc.; Insurance Information Institute
Terrorism Premium as Percentage of Property Premium, by Industry

- Energy: 8.03%
- Habitational/Hospitality: 7.65%
- Media: 6.07%
- Real Estate: 5.09%
- Utility: 4.94%
- Education: 4.76%
- Transportation: 4.76%
- Food & Beverage: 4.69%
- Public Entity: 4.20%
- Technology/Telecom: 4.02%
- Retail: 3.75%
- Financial Institutions: 3.56%
- Healthcare: 3.31%
- Manufacturing: 3.10%
- Construction: 2.36%

Source: Marsh, Inc.
Terrorism Pricing: Median Rates as Percentage of Total Insured Value

- Energy: 0.0128%
- Habitational/Hospitality: 0.0115%
- Real Estate: 0.0101%
- Construction: 0.0061%
- Financial Institutions: 0.0059%
- Transportation: 0.0058%
- Food & Beverage: 0.0058%
- Media: 0.0055%
- Utility: 0.0055%
- Technology/Telecom: 0.0052%
- Manufacturing: 0.0049%
- Public Entity: 0.0041%
- Retail: 0.0041%
- Healthcare: 0.0037%
- Education: 0.0030%

Source: Marsh, Inc.
Reinsurers didn’t exclude windstorm after Andrew in 1992, but generally excluded terror post 9/11, so ROL not up as much

After unprecedented disasters, reinsurance prices rise, limits fall so ROL rises:

1991-93: +221%
2000-2003: +75%

Source: Guy Carpenter

*Rate-on-Line is the ratio of premium to loss limit.
Types of Terrorism Coverage Being Purchased

<table>
<thead>
<tr>
<th>Year</th>
<th>TRIA Only</th>
<th>TRIA &amp; Non-Certified</th>
<th>TRIA Only</th>
<th>TRIA &amp; Non-Certified</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003:II</td>
<td>1.9</td>
<td>58.3</td>
<td>39.8</td>
<td>38.7</td>
</tr>
<tr>
<td>2003:III</td>
<td>4.2</td>
<td>57.1</td>
<td>38.7</td>
<td>32.2</td>
</tr>
<tr>
<td>2003:IV</td>
<td>2.6</td>
<td>65.2</td>
<td>32.2</td>
<td>36.4</td>
</tr>
<tr>
<td>Average</td>
<td>2.9</td>
<td>60.7</td>
<td>36.4</td>
<td></td>
</tr>
</tbody>
</table>

Source: Marsh, Inc.
Types of Terrorism Coverage Being Purchased

Source: Marsh, Inc.
THE POLITICIZATION OF TERRORISM
If They Don’t Know, Insurers Can’t Presume to Know Either
They’re Here and Plans are “90% Complete” to Attack

- Most major government officials believe another attack is imminent
- Terrorists’ plans are 90% complete for next attack
- Government has no idea of how, when, where, who or what kind of attack is next.
Summary

• 2004/5 represent “sweet spot” in the current cycle for p/c insurance (underwriting/earnings);
  ➢ Yet expect more downgrades 1H04
• OH remains has historically been a better-than-average state for the industry, but…
• Rising investment returns could be a distraction
• Reserve deficiency remains industry’s principal boogieman
  ➢ Concern exacerbated in Sarbanes-Oxley world
• Major Challenges:
  ➢ Maintaining price/underwriting discipline
  ➢ Managing variability/volatility of results
  ➢ New/emerging/re-emerging risks
If you would like a copy of this presentation, please give me your business card with e-mail address.