

The Property/Casualty Insurance Industry Today

Critical Issues & Emerging Risks

September 3, 2003



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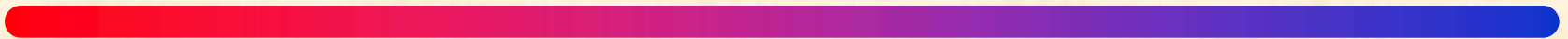


Presentation Outline

- Profitability Issues
 - What Does Wall Street Think of Us?
 - Economic Concerns
- Underwriting Performance
- (In)Solvency Concerns
- Investment Performance
- Capacity Crunch?
 - US, World, Bermuda, Captives
- Pricing
- Tort Environment
- Emerging Risks
- Q & A

P/C PROFITS:

NO LONGER AN OXYMORON





Highlights: Property/Casualty

First Quarter 2003 (\$ Millions)

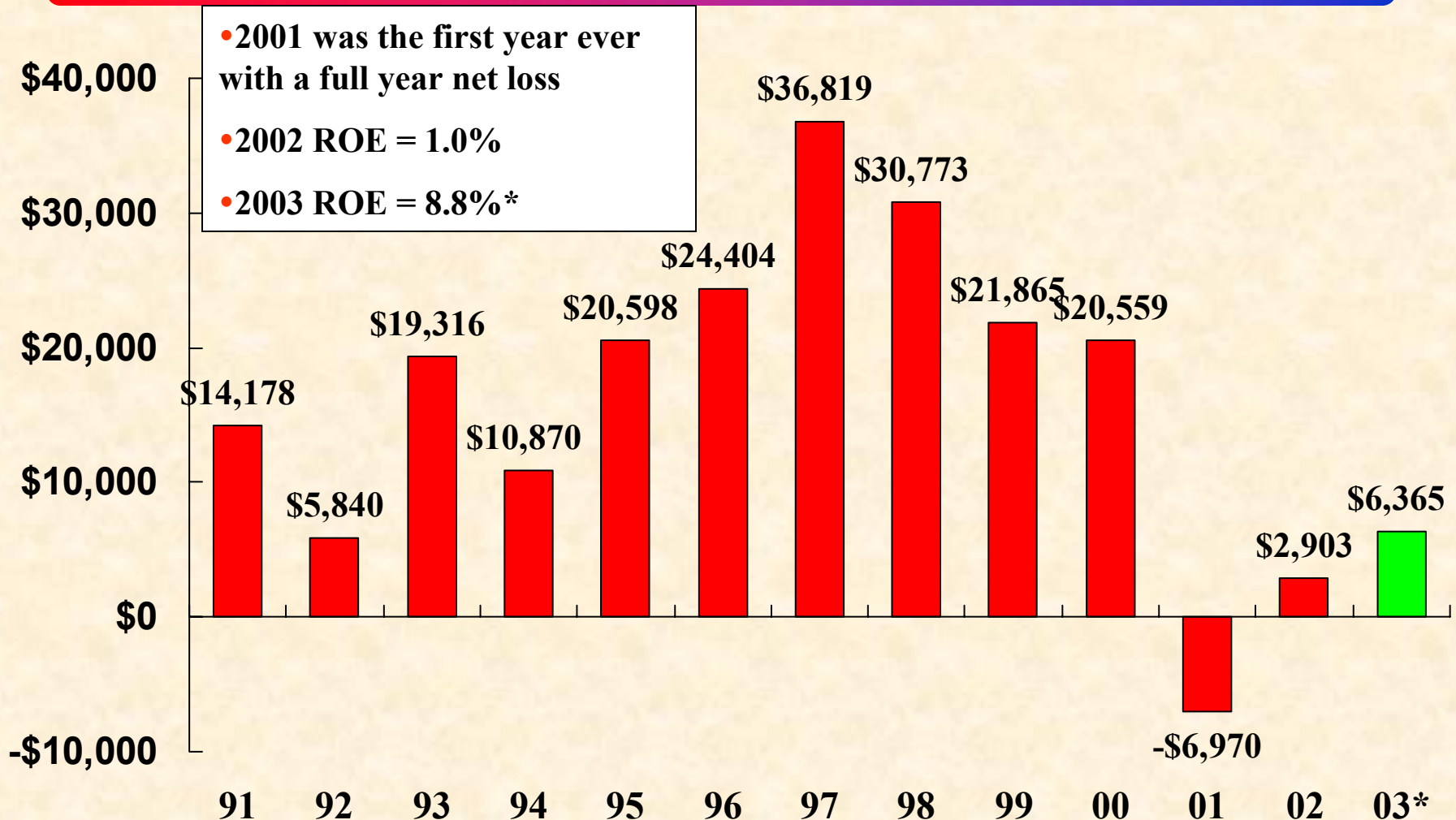
	2003	2002	Change
Net Written Prem.	\$101,329	\$89,874	+12.7%
Loss & LAE	69,956	63,185	+10.7%
Net UW Gain (Loss)	(1,461)	(3,644)	-59.9%
Net Inv. Income	8,984	9,007	-0.3%
Net Income (a.t.)	6,365	5,279	+20.6%
Surplus*	289,167	285,235	+1.4%
Combined Ratio**	99.5	107.2	-7.7 pts.

*Comparison with year-end 2002.

**Comparison is with full year 2002 combined ratio. Comparable 1st quarter 2002 figure is 102.2.



P/C Net Income After Taxes *1991-2003* (\$ Millions)*



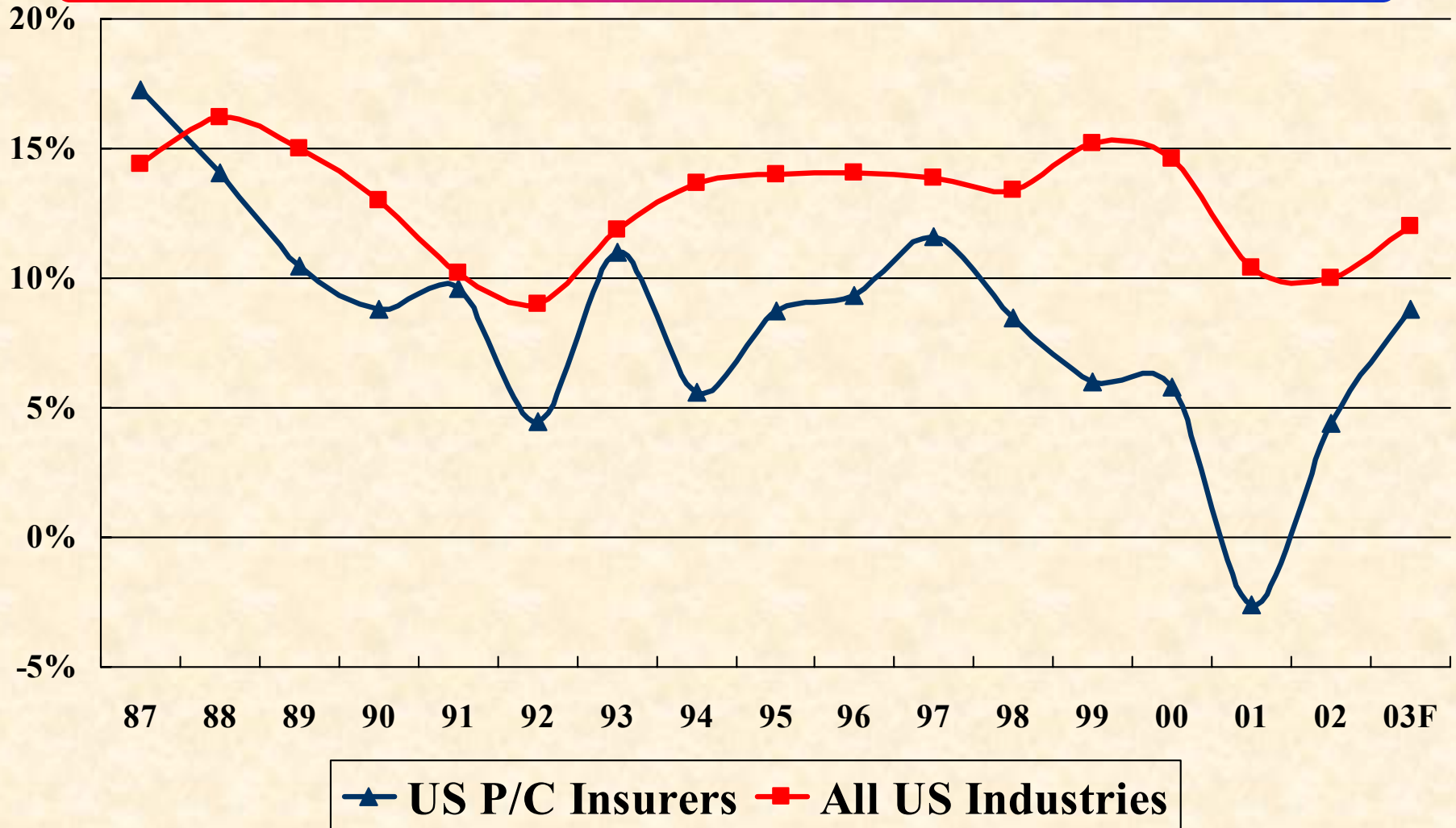
*First quarter

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



ROE: P/C vs. All Industries

1987–2003E*

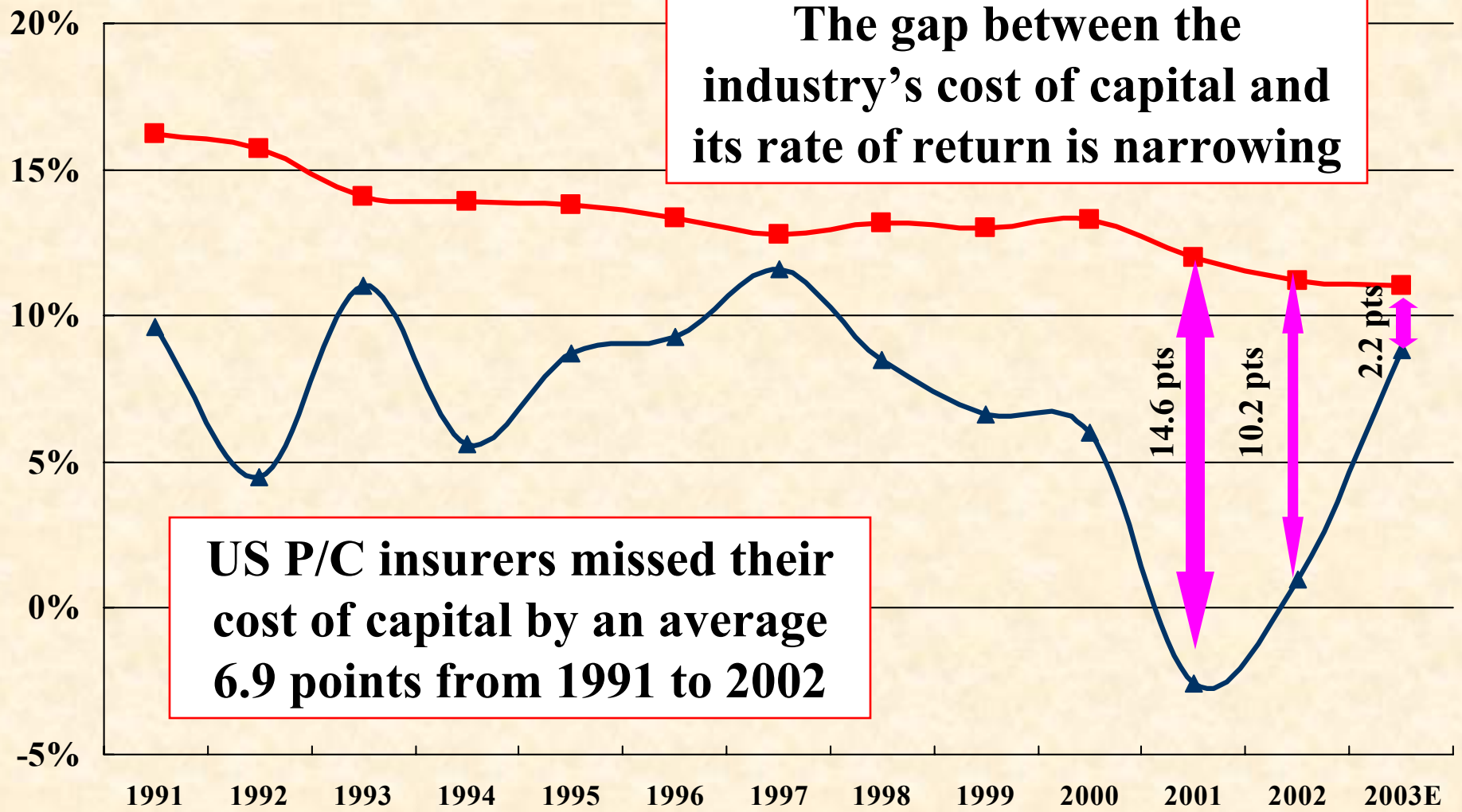


▲ US P/C Insurers ■ All US Industries

*2003 p/c estimate based on first quarter data.
Source: Insurance Information Institute; *Fortune*



ROE vs. Cost of Capital: US P/C Insurance: 1991 – 2003E

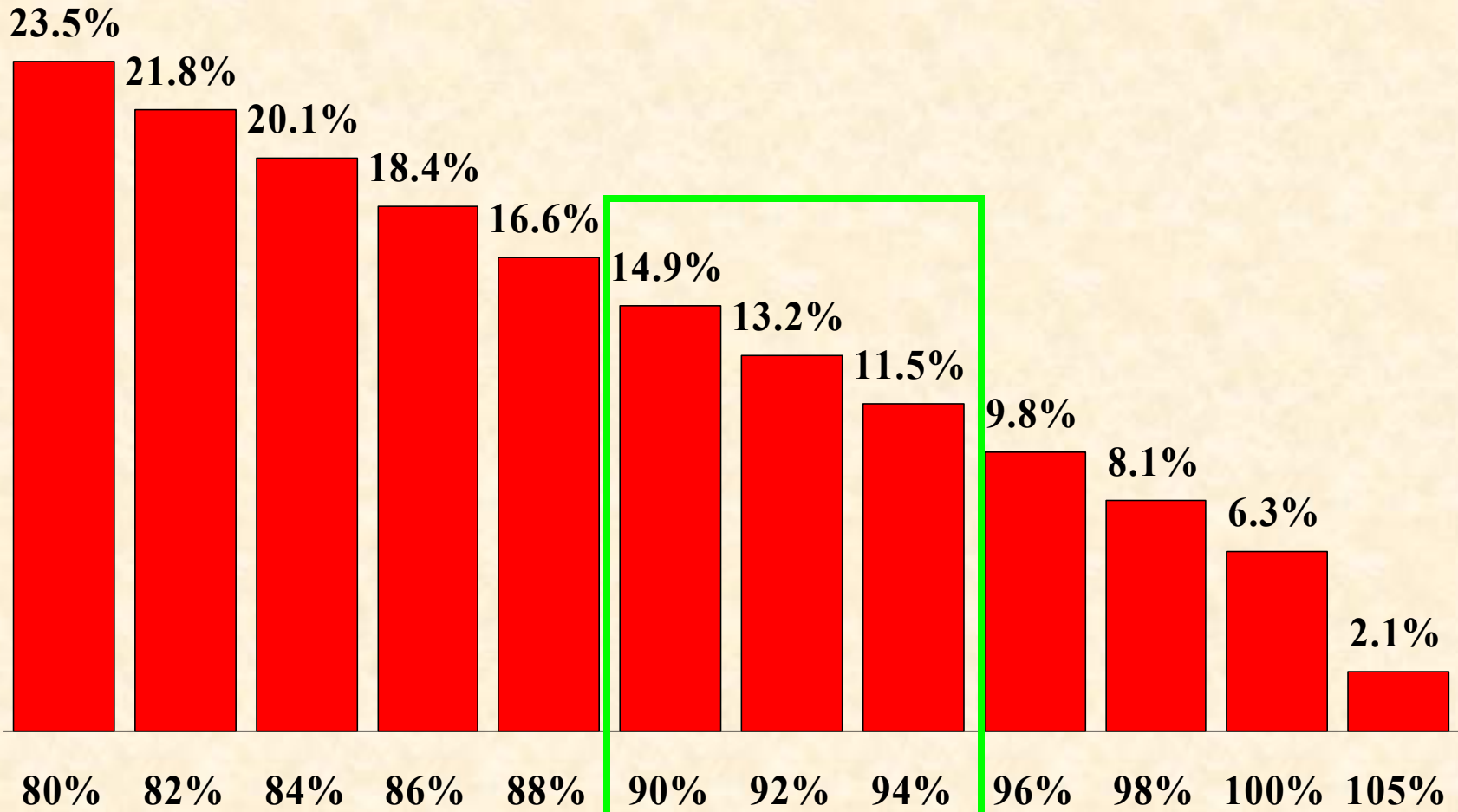


Source: The Geneva Association, Ins. Information Inst.

—▲— ROE —■— Cost of Capital



*After-Tax ROE for Selected AY Combined Ratios**

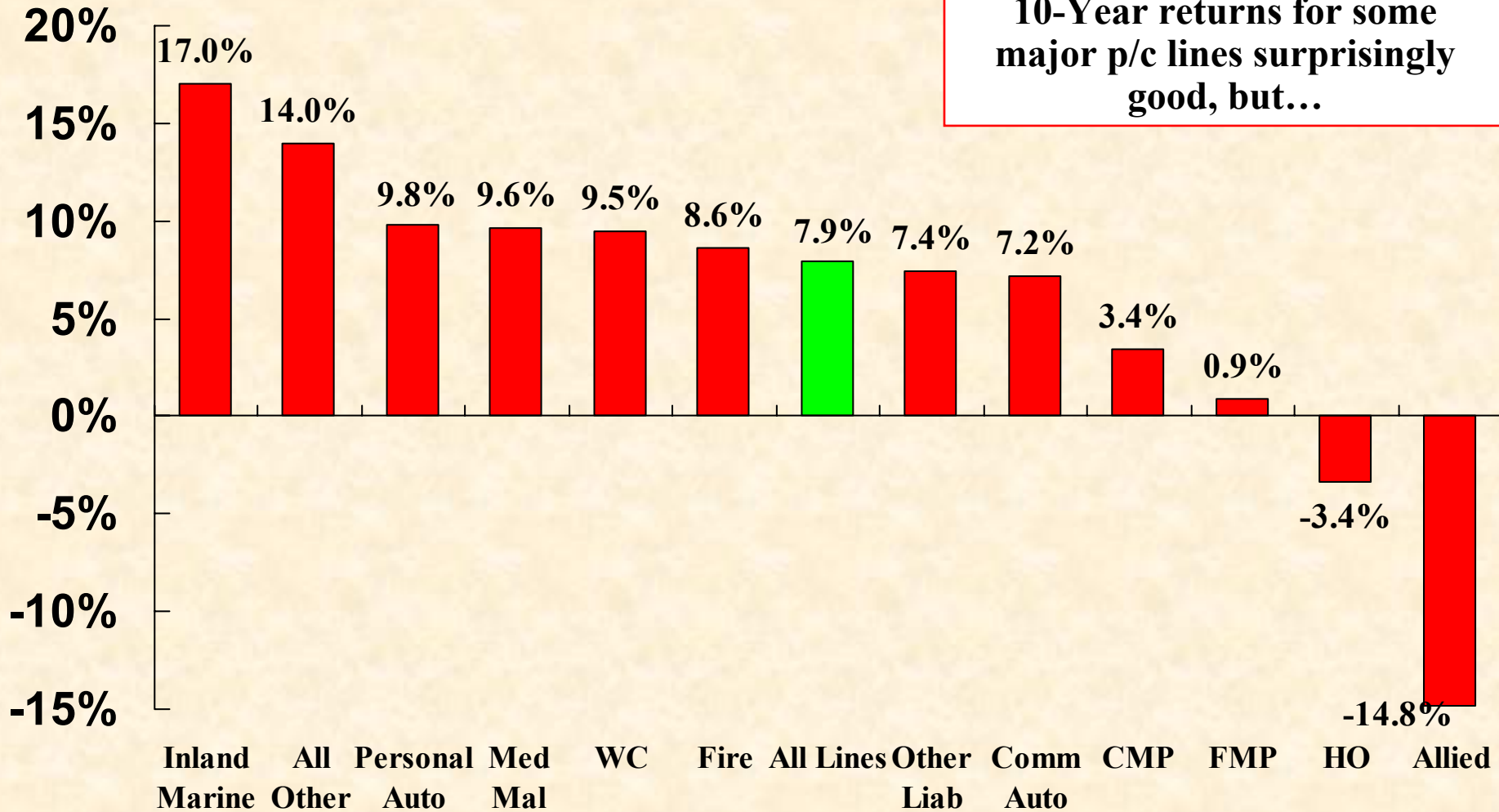


*Assumes 4% tax-equivalent yield, 28% expense ratio and 140% premium/surplus ratio

Source: Dowling & Partners Securities



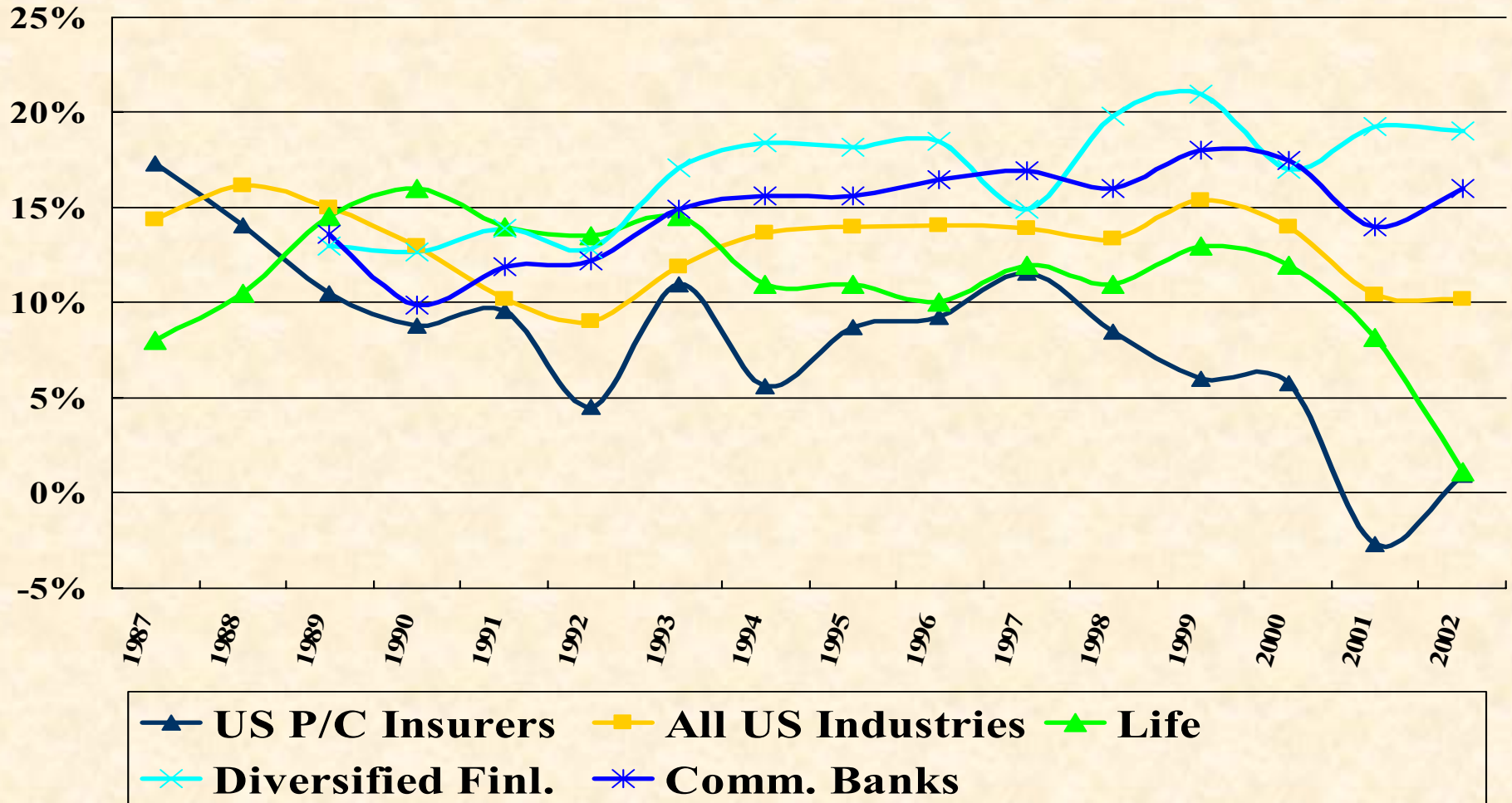
RNW for Major P/C Lines, 1992-2001 Average



Source: NAIC; Insurance Information Institute



ROE: Financial Services Industry Segments, 1987–2002



Source: Insurance Information Institute; *Fortune*



WALL STREET:

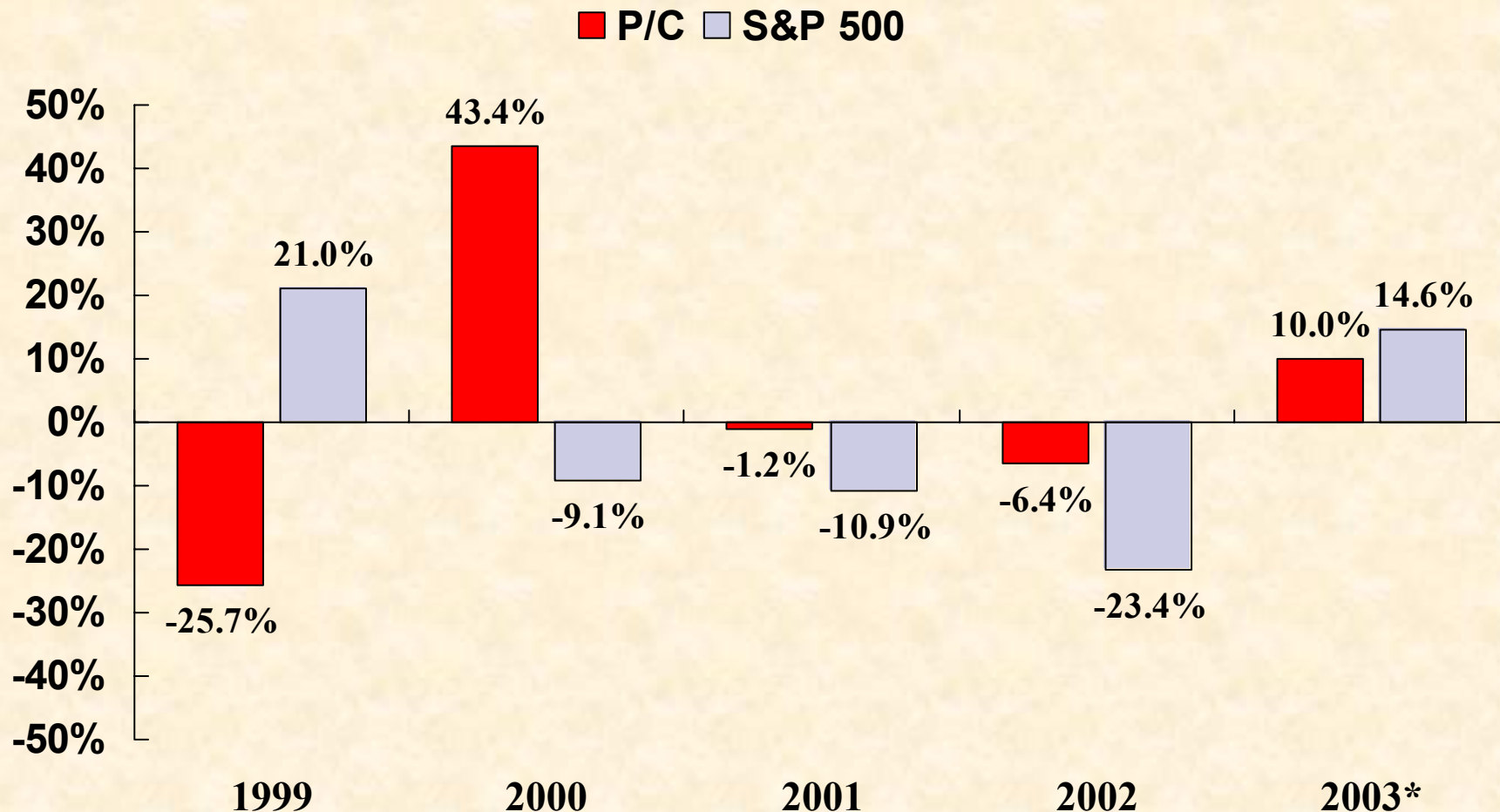
HIGH EXPECTATIONS





P/C Performance Volatile,

Underperforming S&P 500 Lately



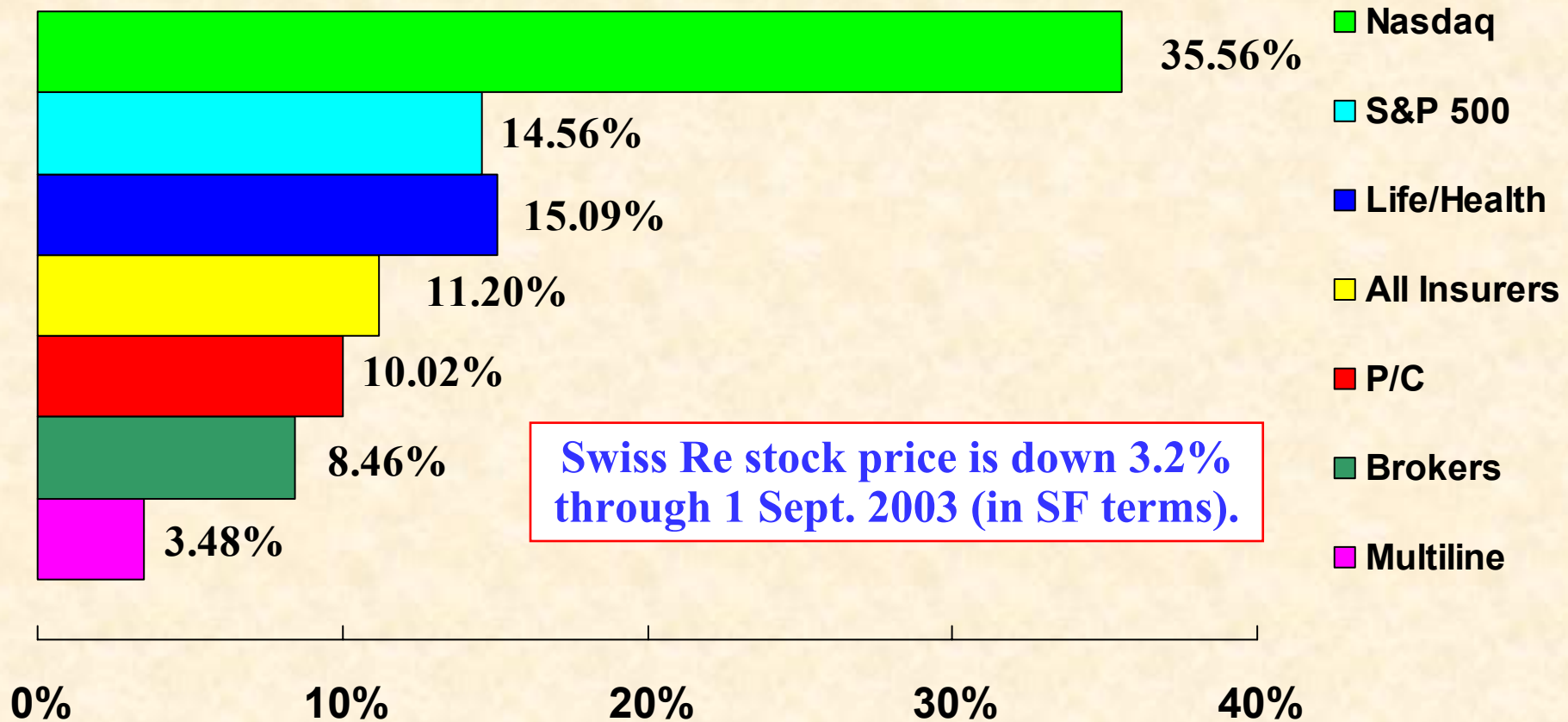
*Through August 29, 2003.

Source: SNL Securities, Insurance Information Institute



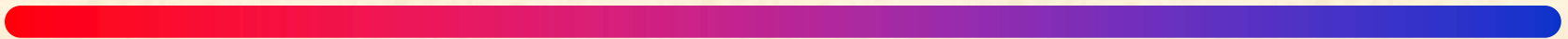
P/C Insurer Stocks: Lagging the S&P 500

Total Return 2003 YTD Through August 29, 2003



Source: SNL Securities, Insurance Information Institute

ECONOMIC CONCERNS





Economic Summary

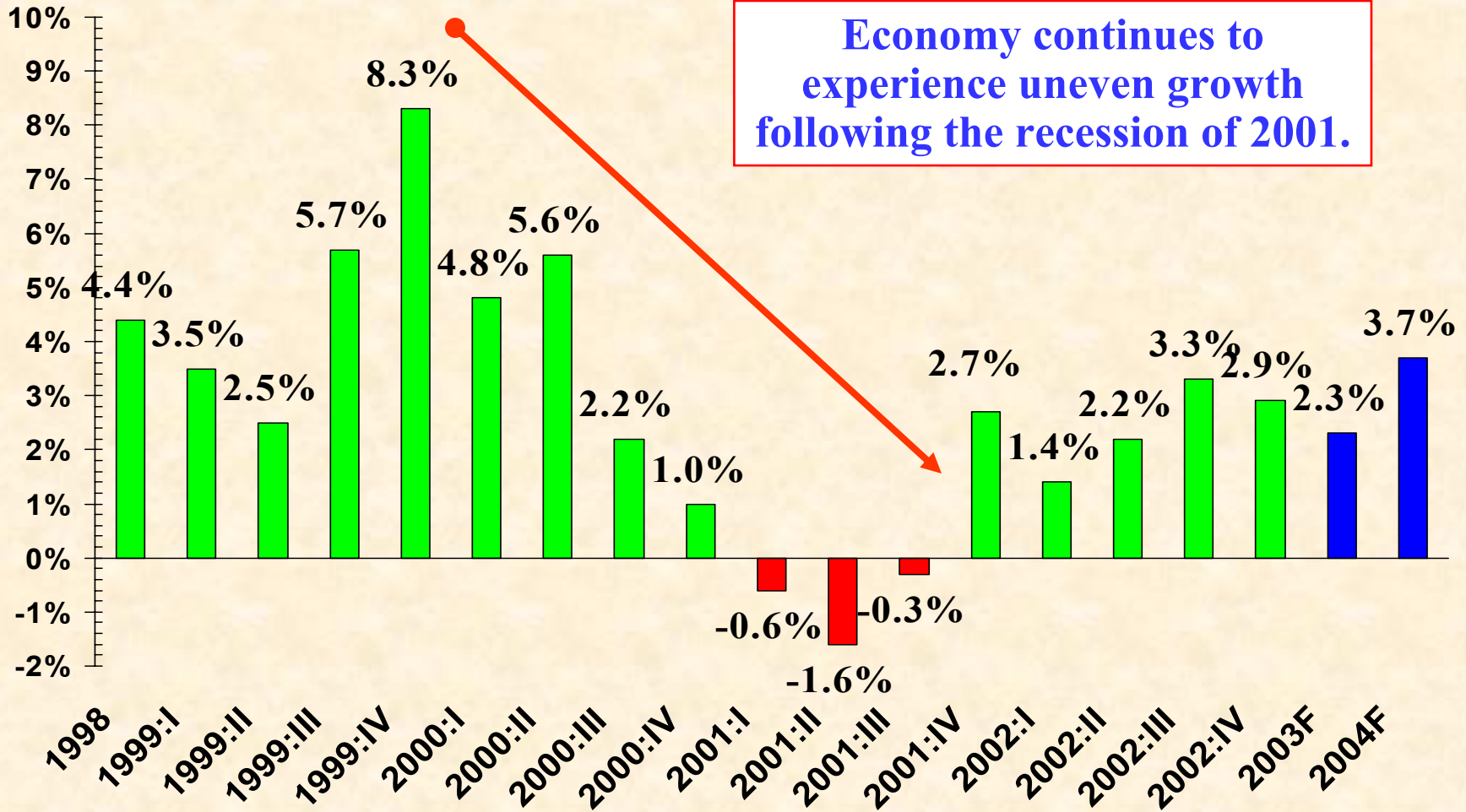
- **Weak Econ. Growth** GDP Growth: +1.9% 1st Half '03
- **Stubborn Unemployment** Unemp. Rate: 6.2% (July)
- **Low Inflation** CPI: +2.1% (July '03 over '02)
- **Interest Rates** 1-Yr T-bill =1.26%; 10-yr=4.45%
- **Cautious Consumers** Sentiment Up
- **Massive/Record Budget Deficit** \$480B+ Soon (FY 2004)
- **Uncertain Invest. Environment** Low Rates but Rising; Stocks??

Exposure growth picture for insurers mixed:

Personal lines better than commercial, but commercial is improving

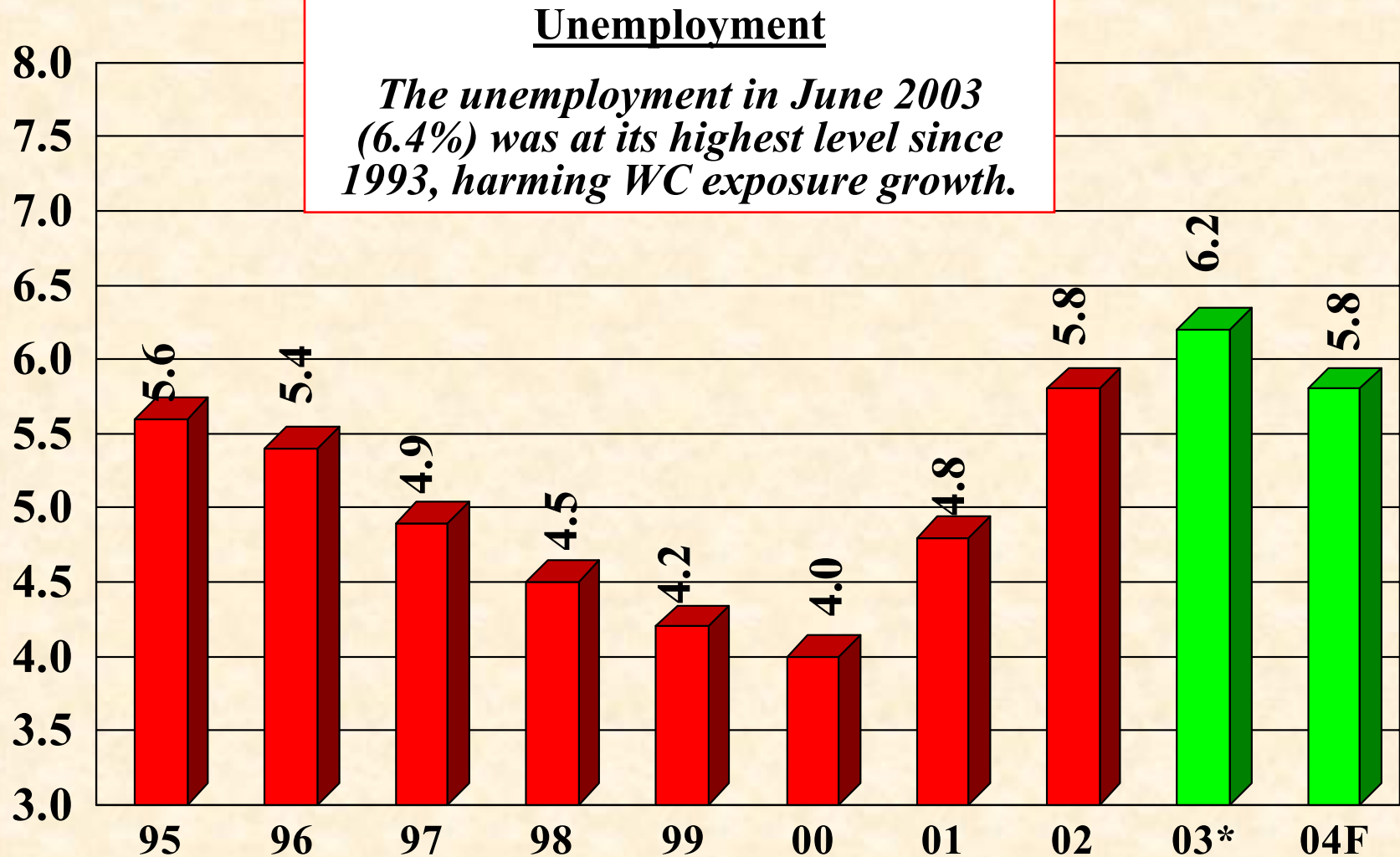


Real GDP Growth





Unemployment Rate (%)

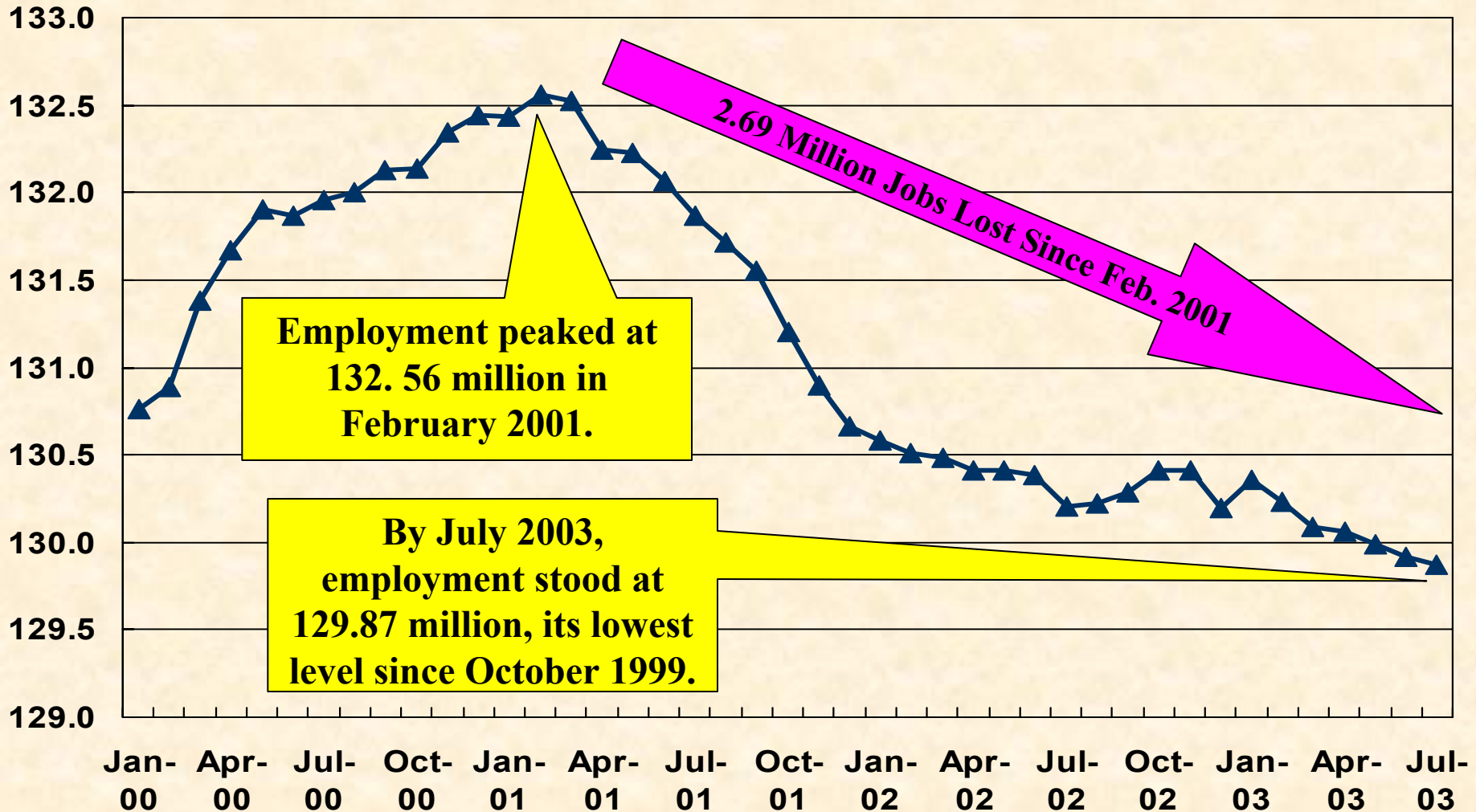


*July 2003.

Source: US Bureau of Labor Statistics; Blue Chip Economic Indicators (7/03), Insurance Info. Institute.



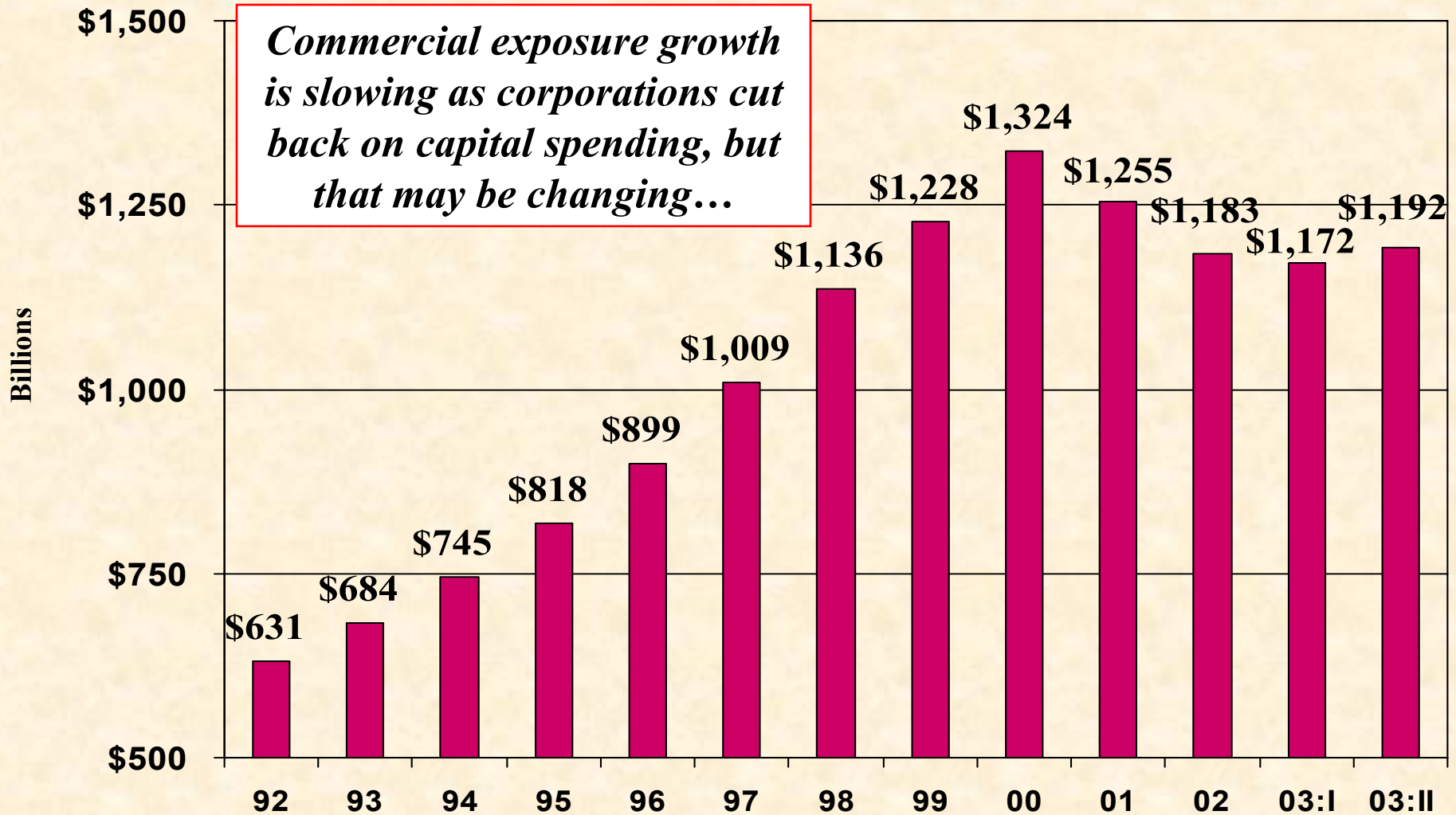
Number of Employed Workers (Millions)



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



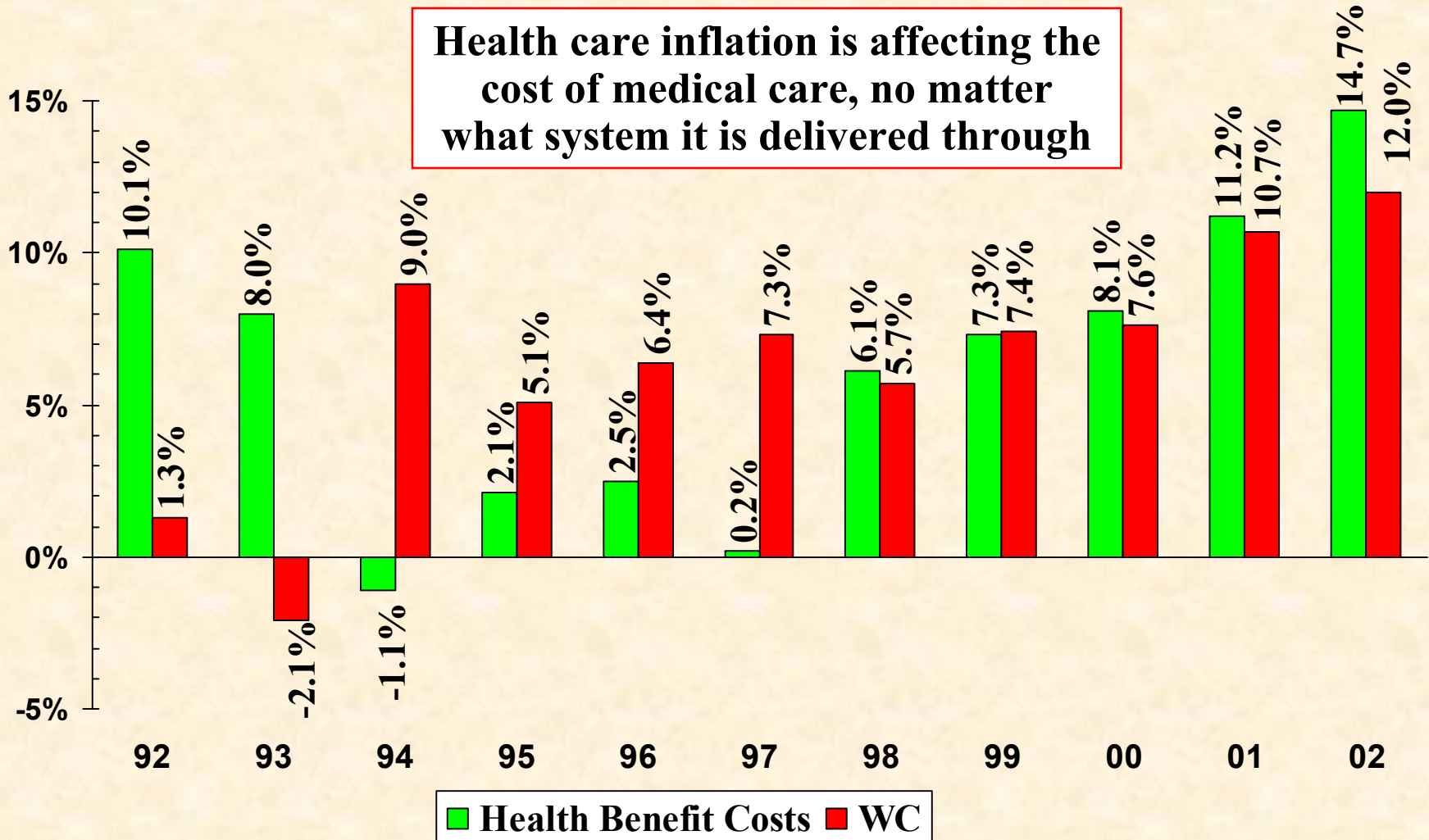
Private Non-Residential Investment (Real, \$1996)



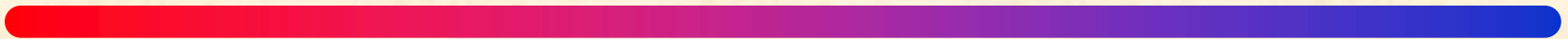


Med Claim Costs Rising Sharply

Health care inflation is affecting the cost of medical care, no matter what system it is delivered through

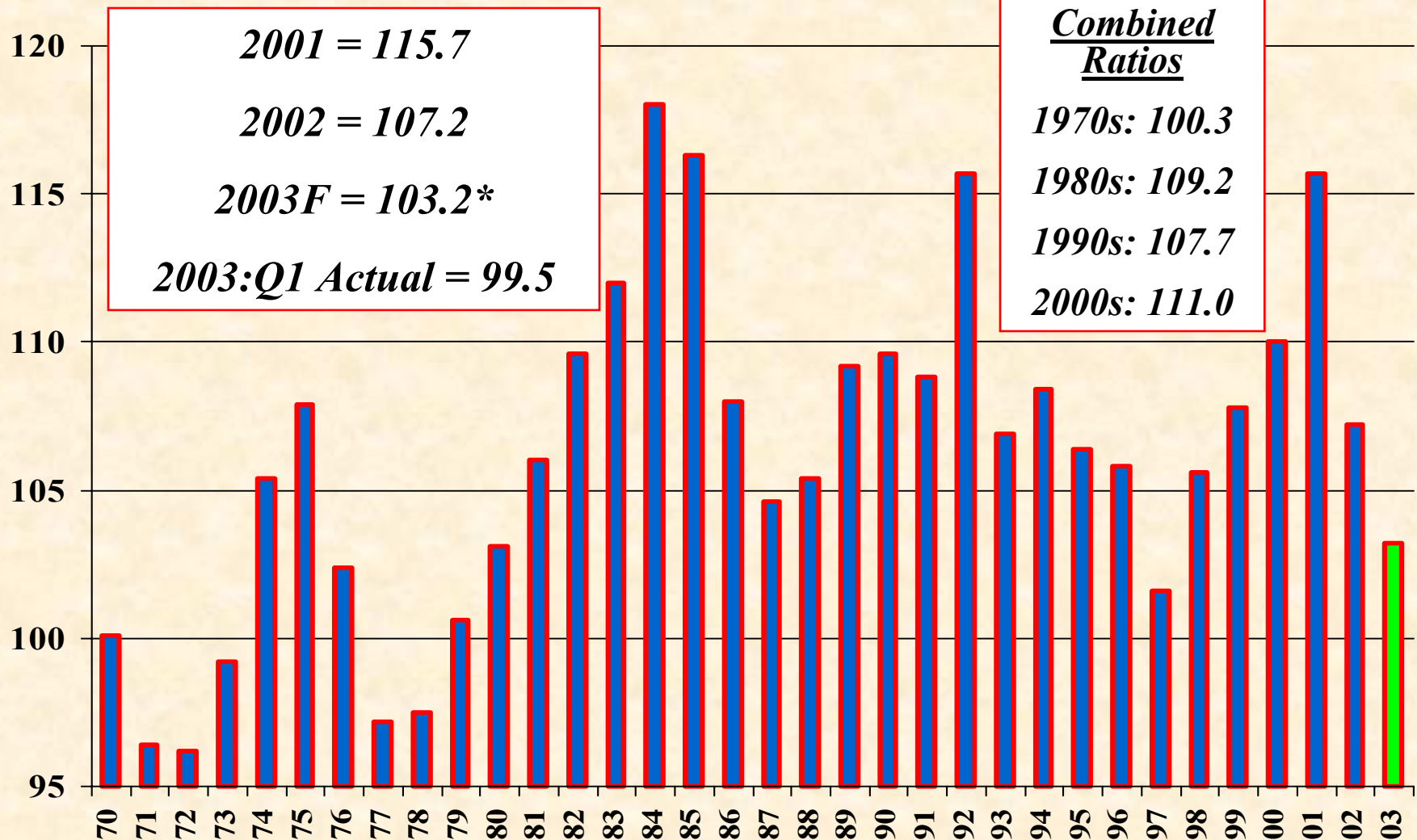


UNDERWRITING CONCERNS





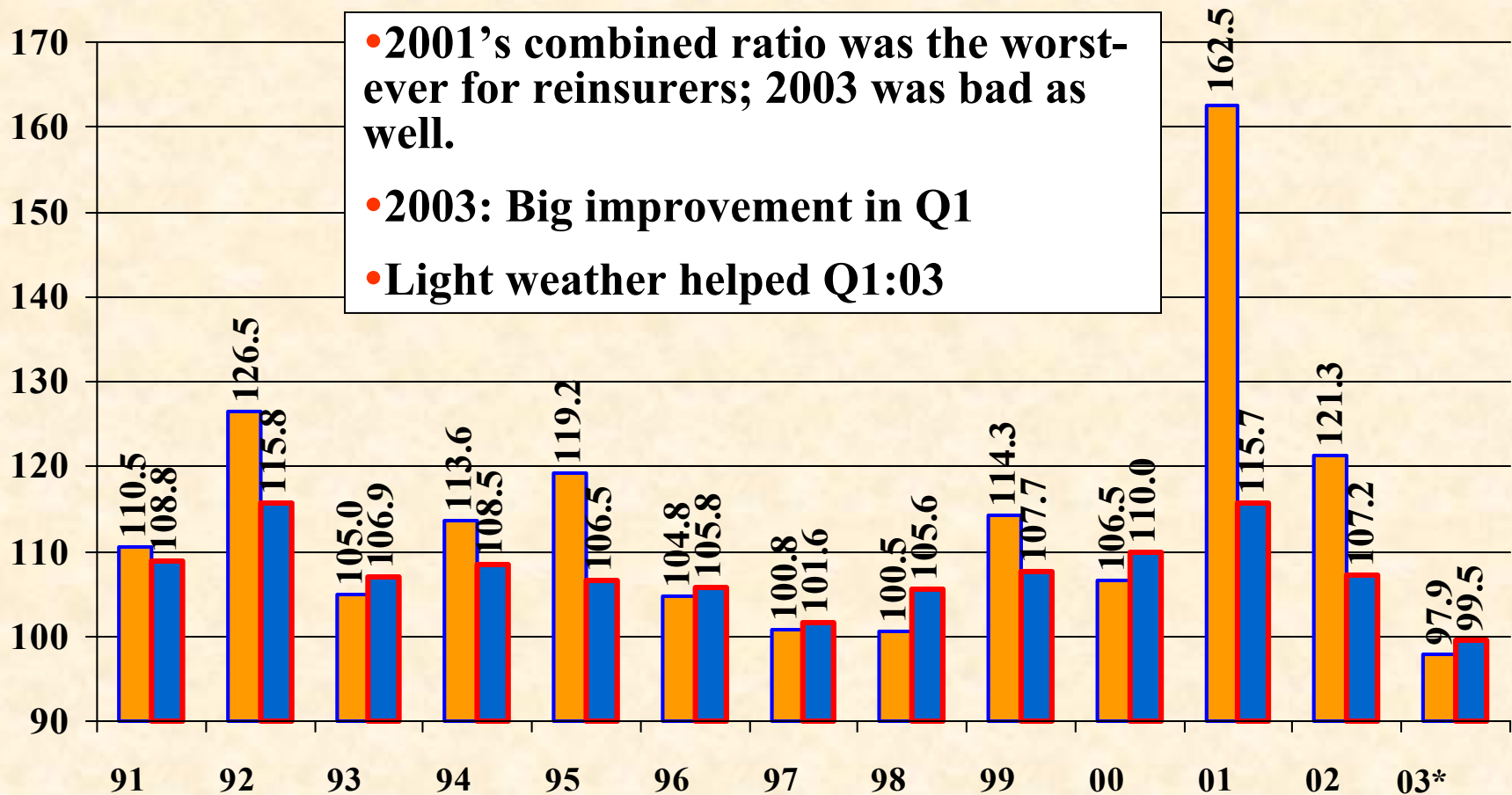
P/C Industry Combined Ratio





Combined Ratio: Reinsurance vs. P/C Industry

■ Reinsurance ■ All Lines Combined Ratio



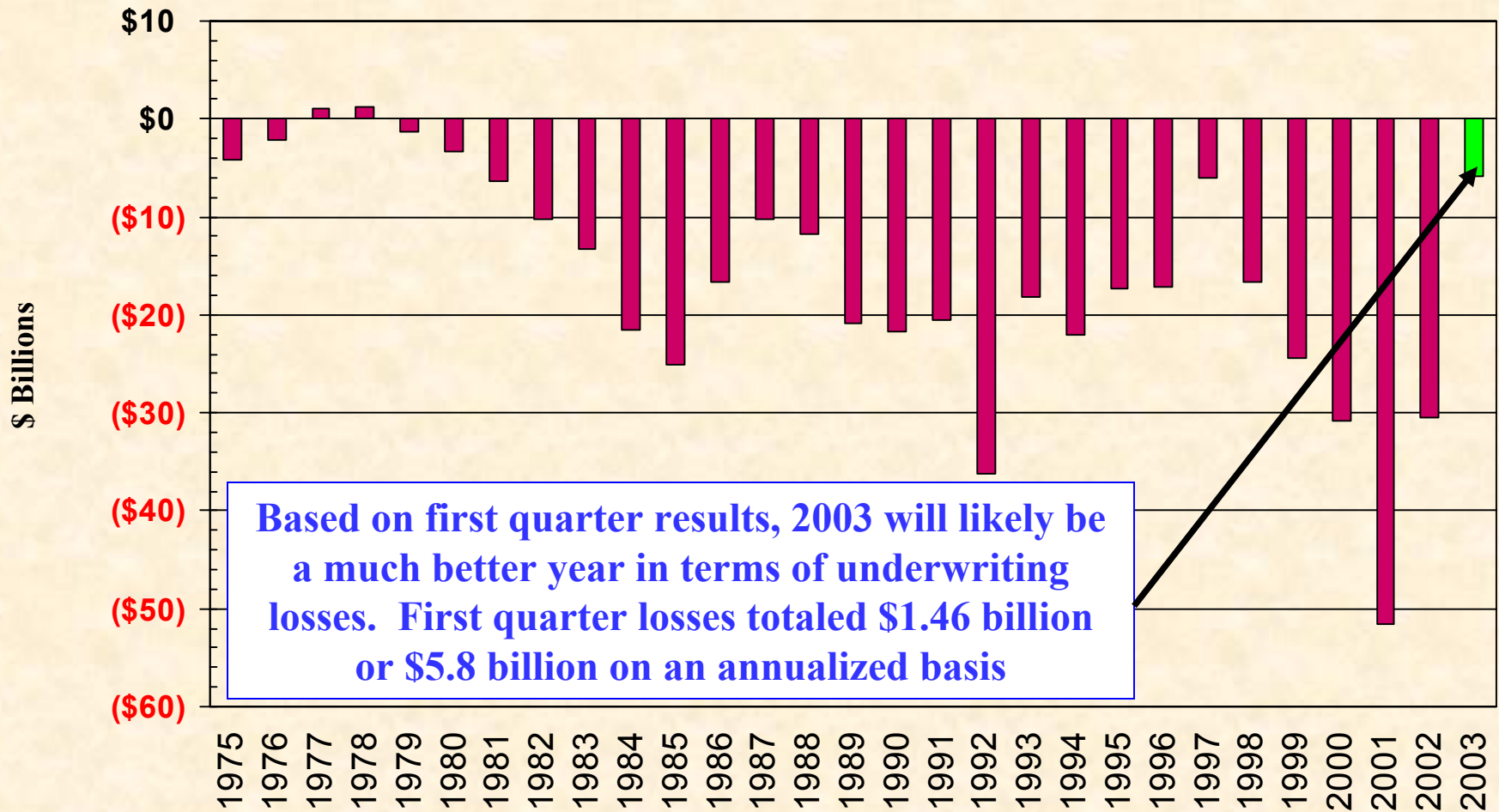
*First quarter 2003 figures for full industry from ISO; 1st half reinsurance figures from RAA.

Source: A.M. Best, ISO, Reinsurance Association of America, Insurance Information Institute



Underwriting Gain (Loss)

*1975-2003**

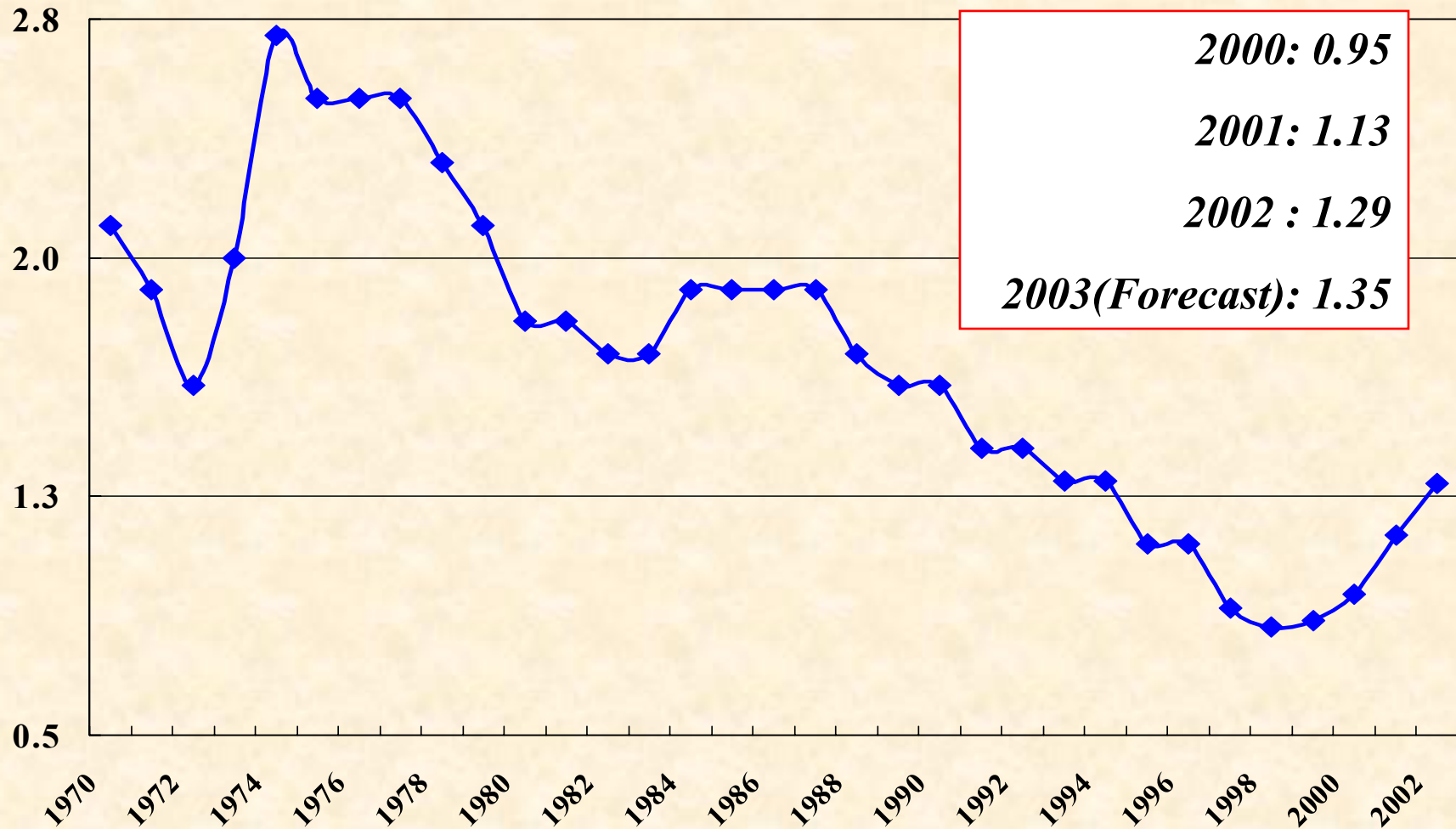


*2003 figure of \$5.84 billion is annualized based on first quarter underwriting loss of \$1.46 billion

Source: A.M. Best, Insurance Information Institute



Net Premiums Written to Policyholder Surplus Ratio



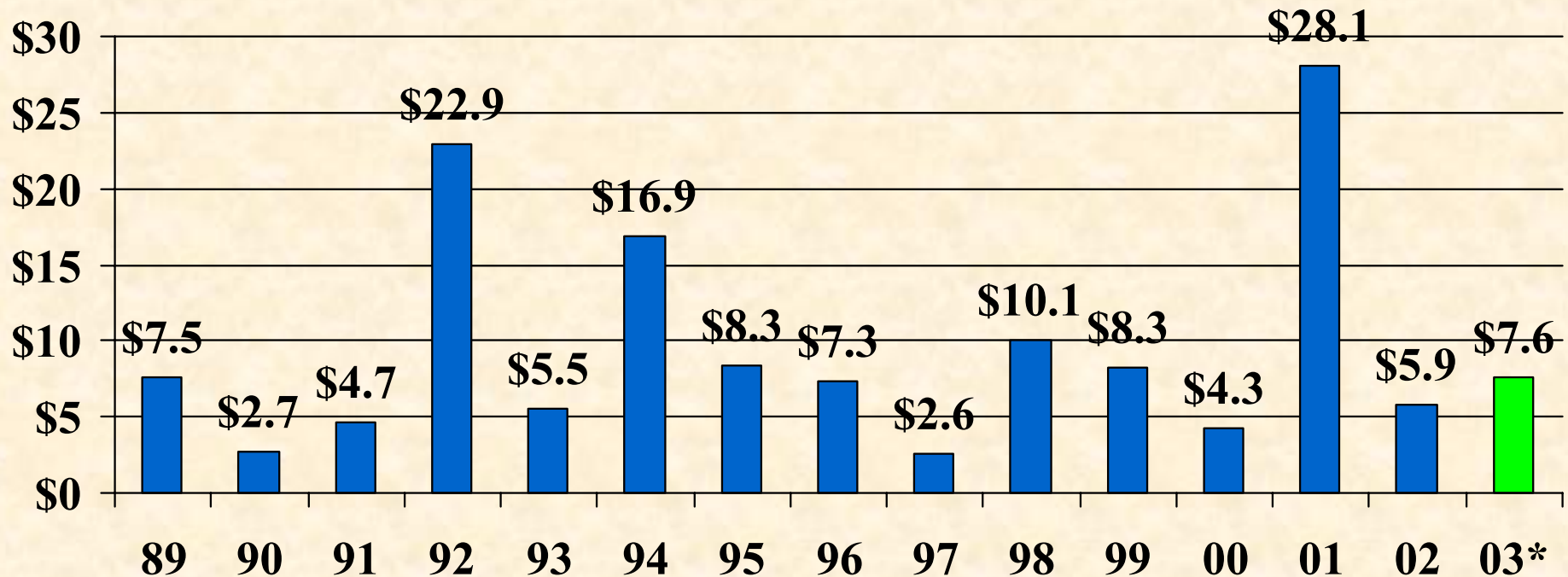
Source: A.M. Best, Insurance Information Institute





U.S. Insured Catastrophe Losses

\$ Billions



*Through August 2003.

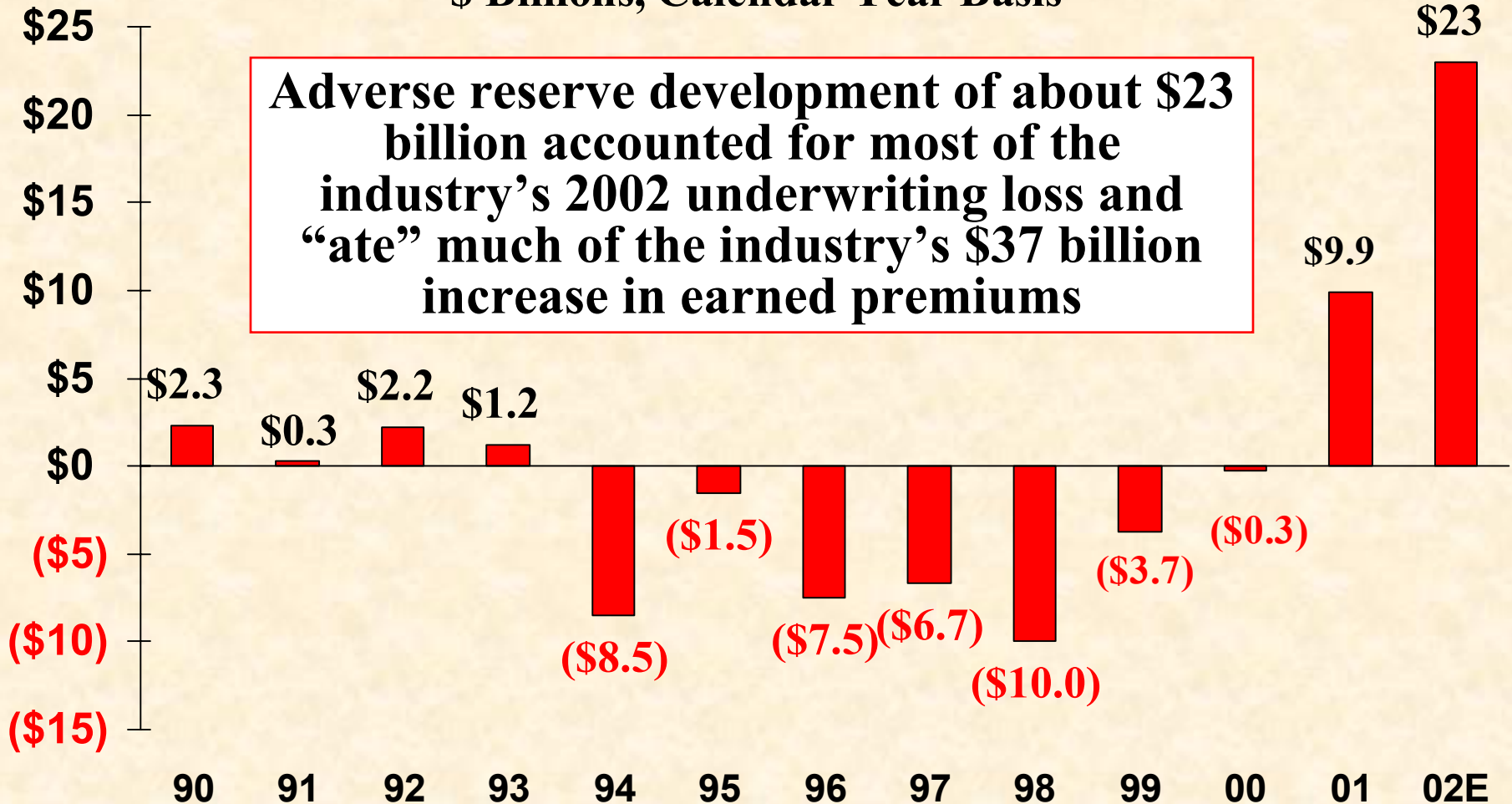
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims.

Source: Property Claims Service/ISO; Insurance Information Institute



*P/C Insurance Industry Prior Year Reserve Development**

\$ Billions, Calendar Year Basis



*Negative numbers indicate favorable development; positive figures represent adverse development.

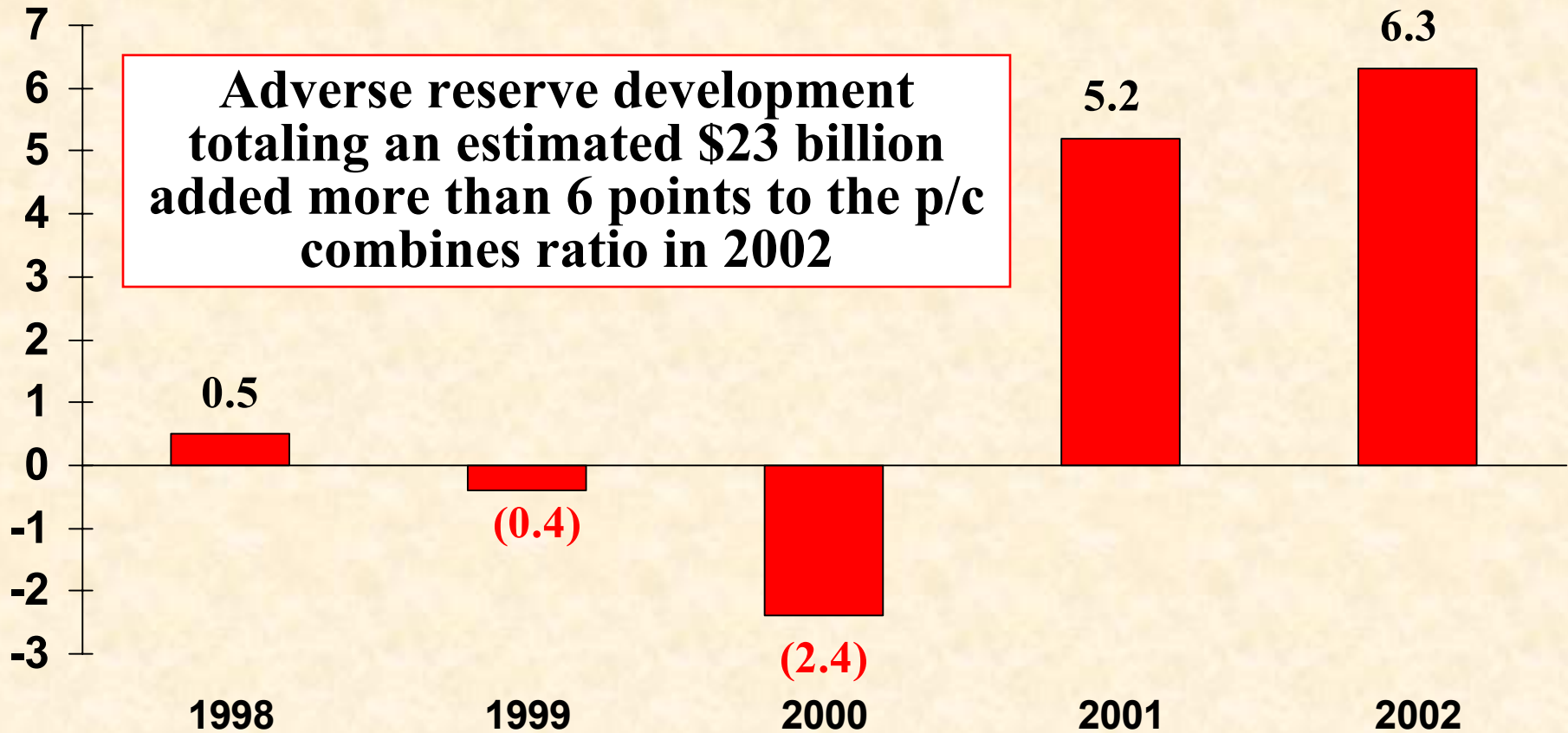
Source: A.M. Best, Morgan Stanley, Dowling & Partners Securities



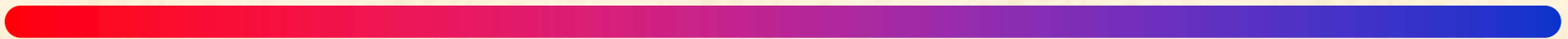
Combined Ratio:

Impact of Reserve Changes (Points)

Points (Reduced)/Increased

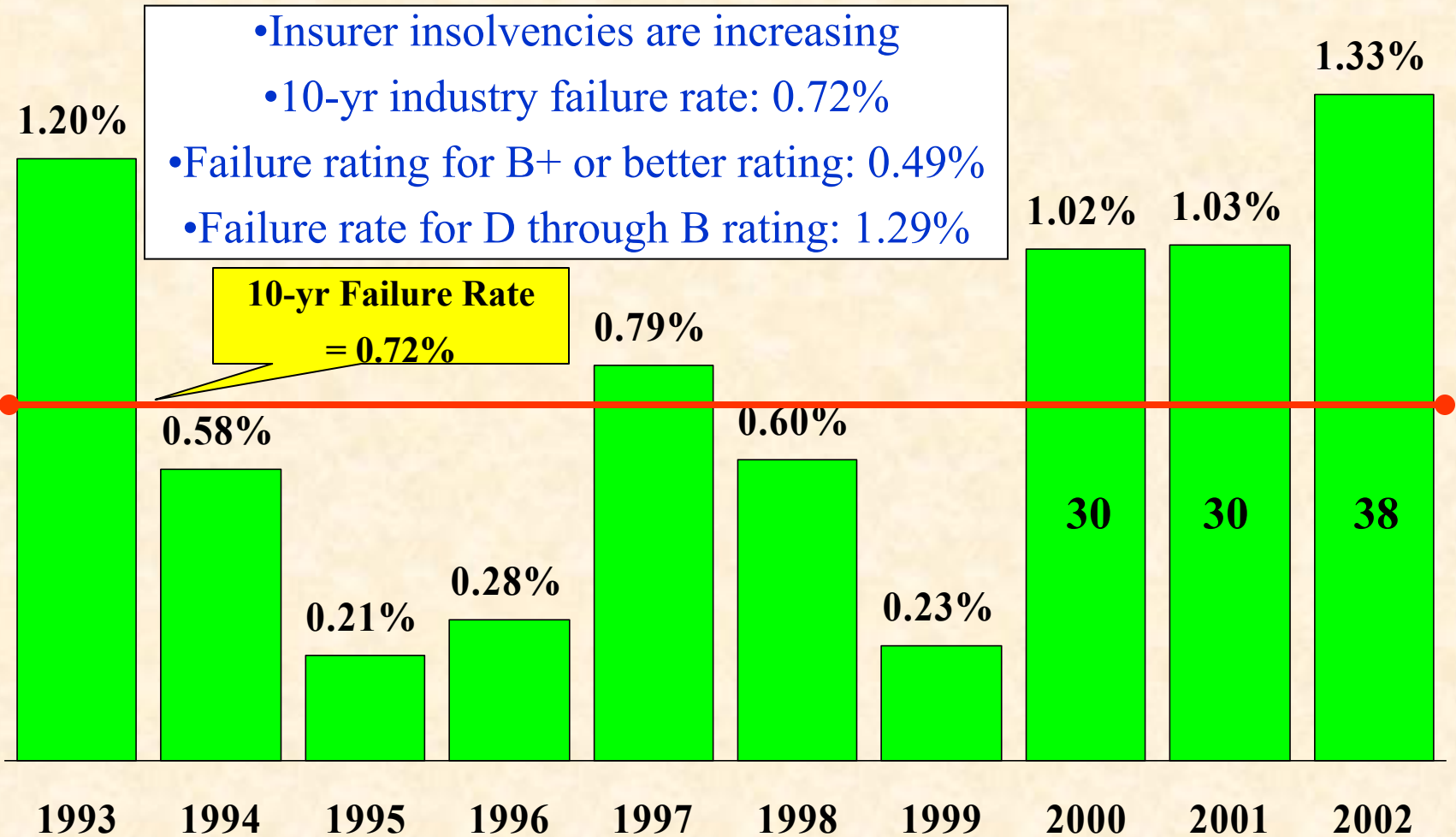


SOLVENCY ISSUES





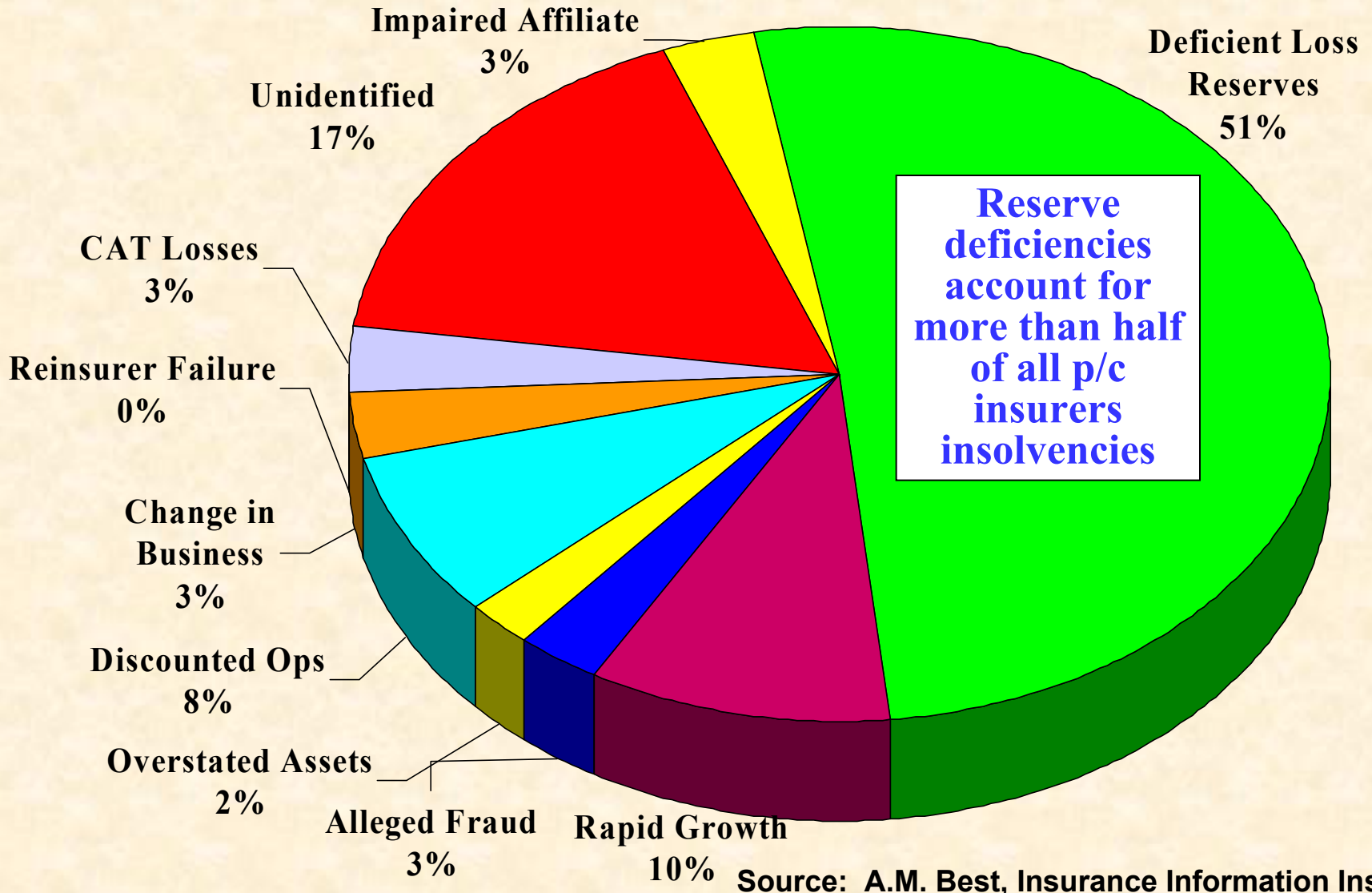
P/C Company Insolvency Rates, 1993 to 2002



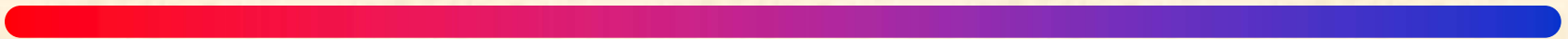


Reason for P/C Insolvencies

(218 Insolvencies, 1993-2002)

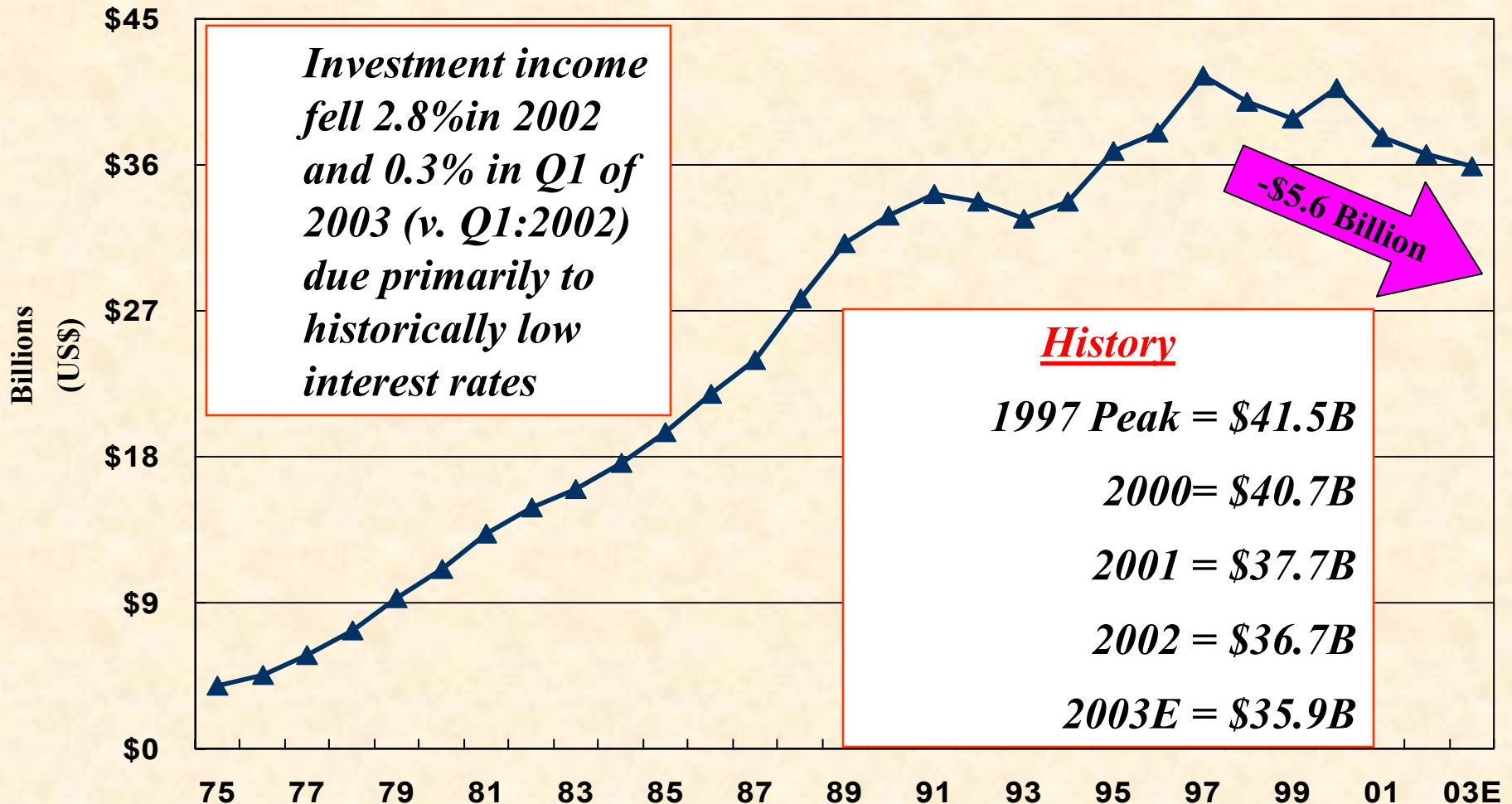


INVESTMENT PERFORMANCE:





Net Investment Income

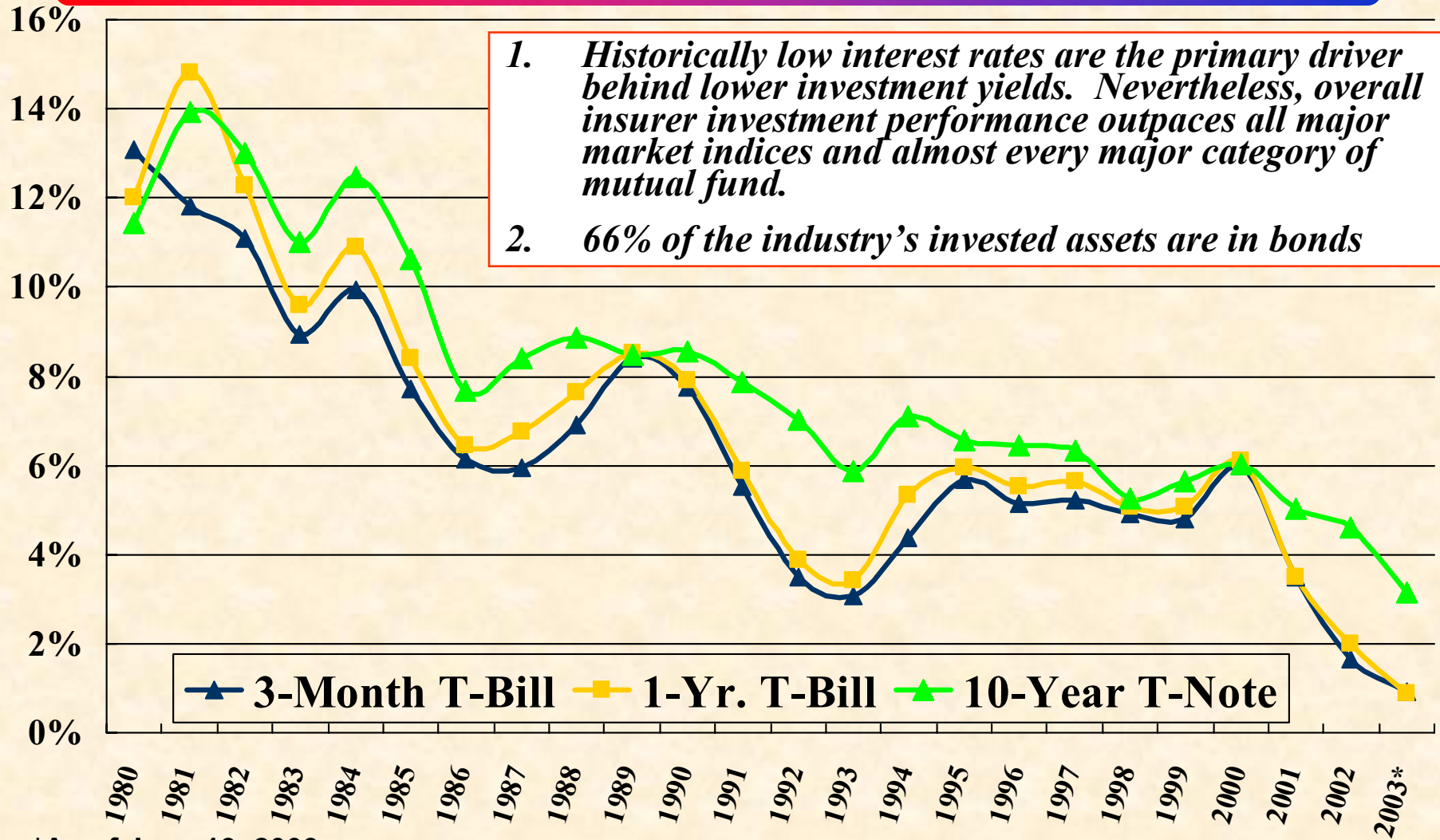


Note: 2003 estimate is based on annualized first quarter investment income of \$8.984 billion.

Source: A.M. Best, Insurance Information Institute



Interest Rates: Lower Than They've Been in Decades



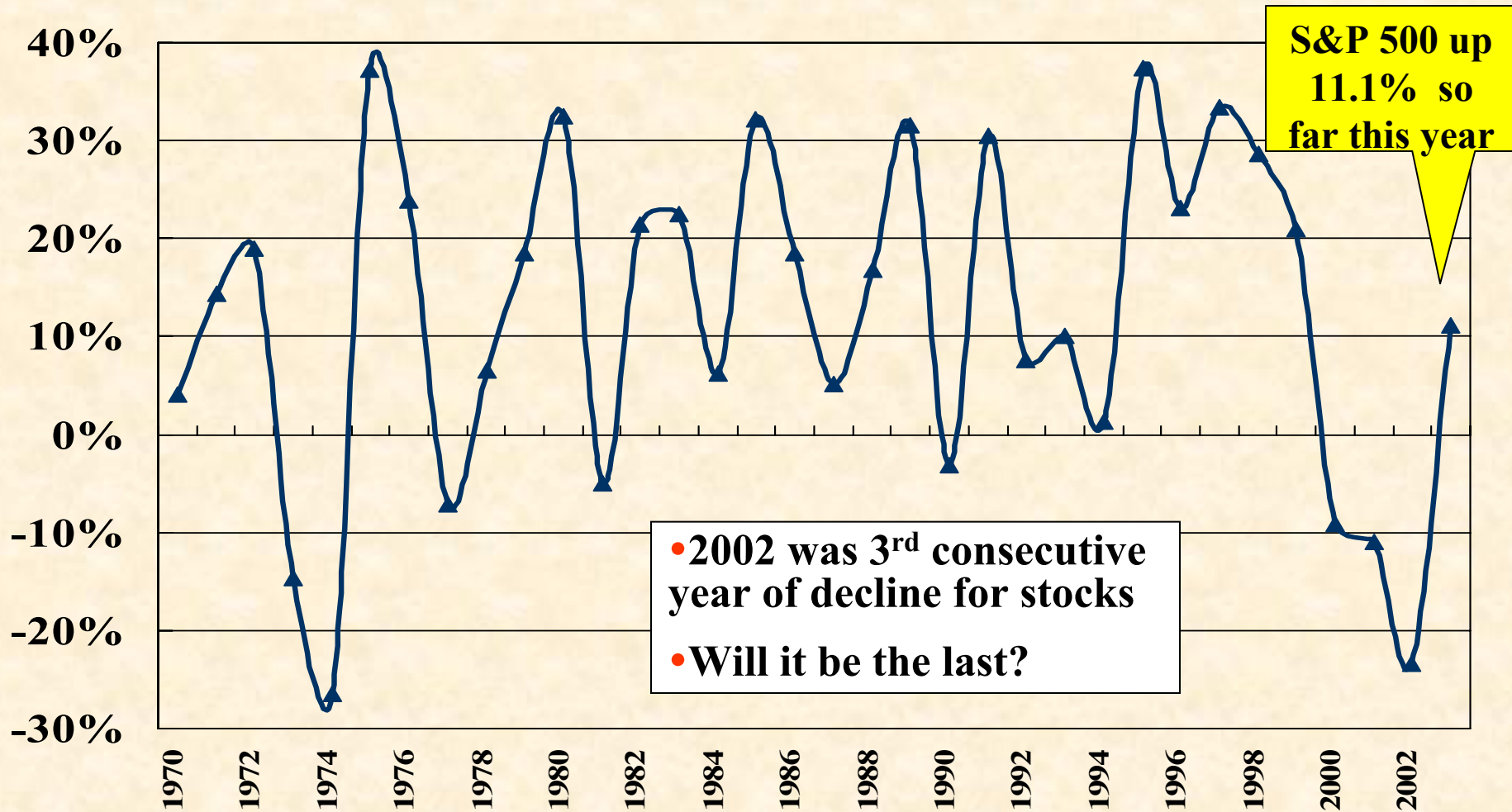
1. *Historically low interest rates are the primary driver behind lower investment yields. Nevertheless, overall insurer investment performance outpaces all major market indices and almost every major category of mutual fund.*
2. *66% of the industry's invested assets are in bonds*

*As of June 13, 2003.

Source: Board of Governors, Federal Reserve System; Insurance Information Institute



Total Returns for Large Company Stocks: 1970-2003*

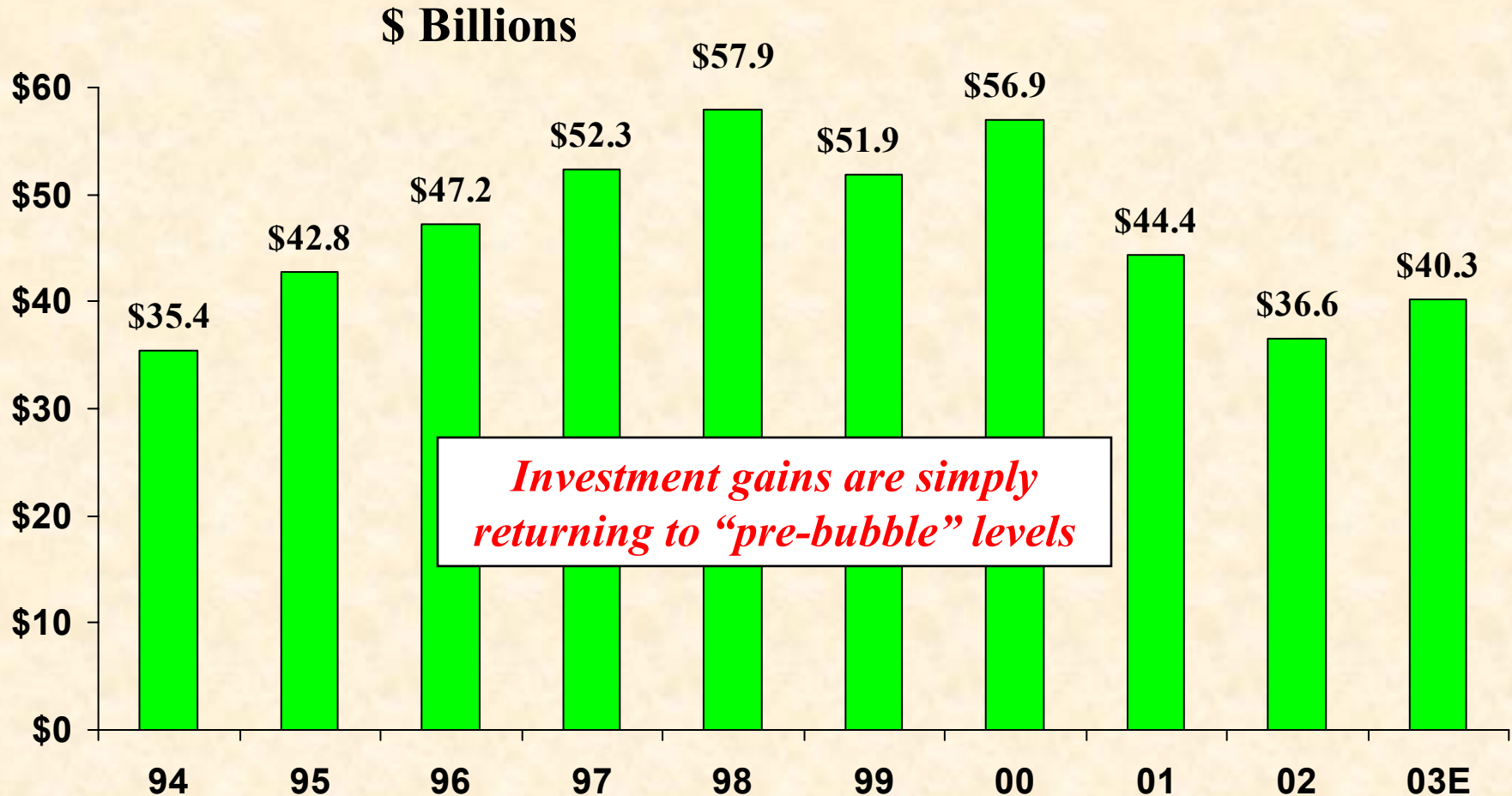


*As of August 8, 2003.

Source: Ibbotson Associates, Insurance Information Institute



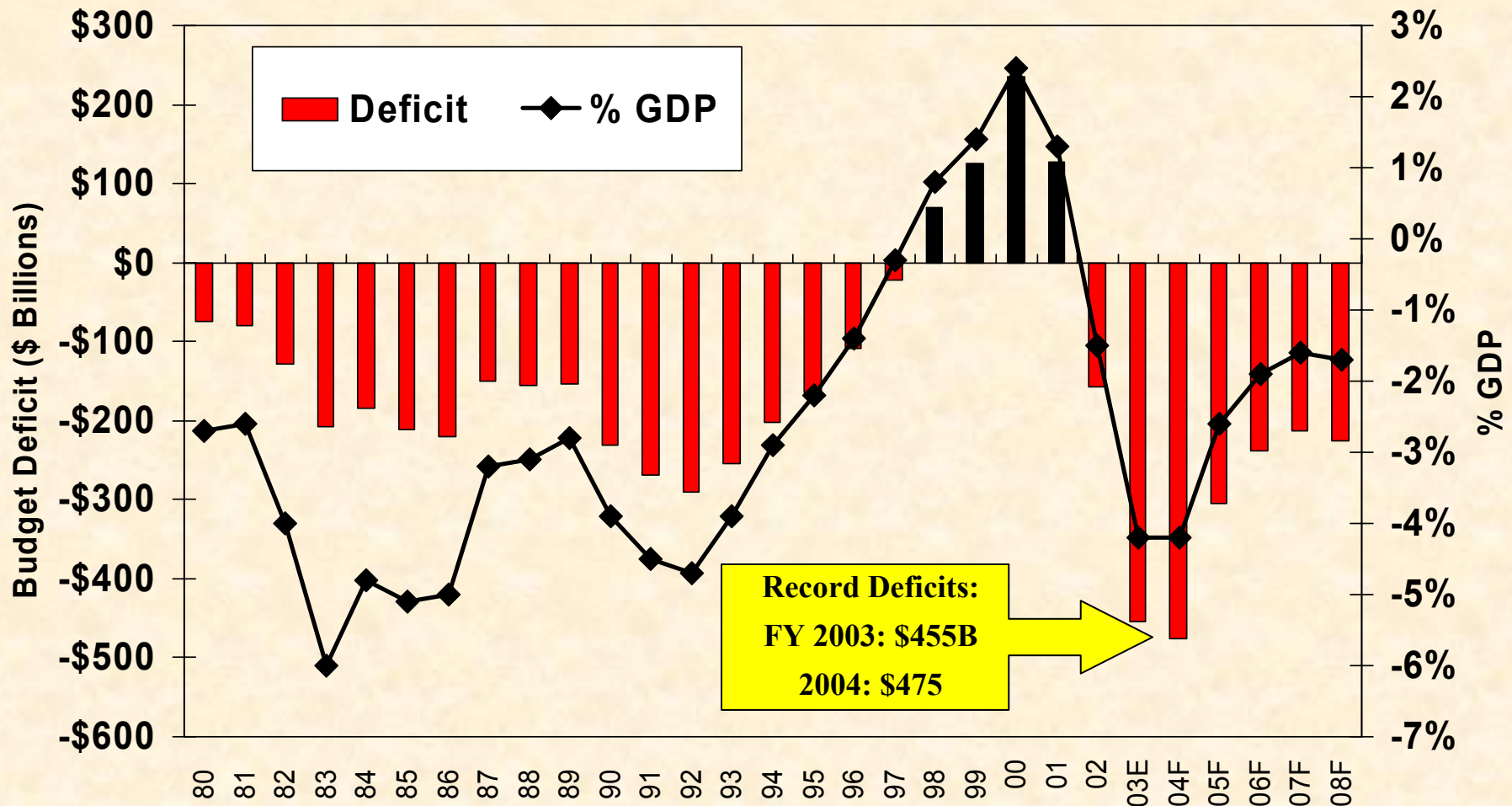
Property/Casualty Insurance Industry Investment Gain*



*Investment gains consists primarily of interest, stock dividends and realized capital gains and losses.
Source: Insurance Services Office; Insurance Information Institute estimate annualized as of 3/31/03.



Federal Budget Deficit: Is it Out of Control?

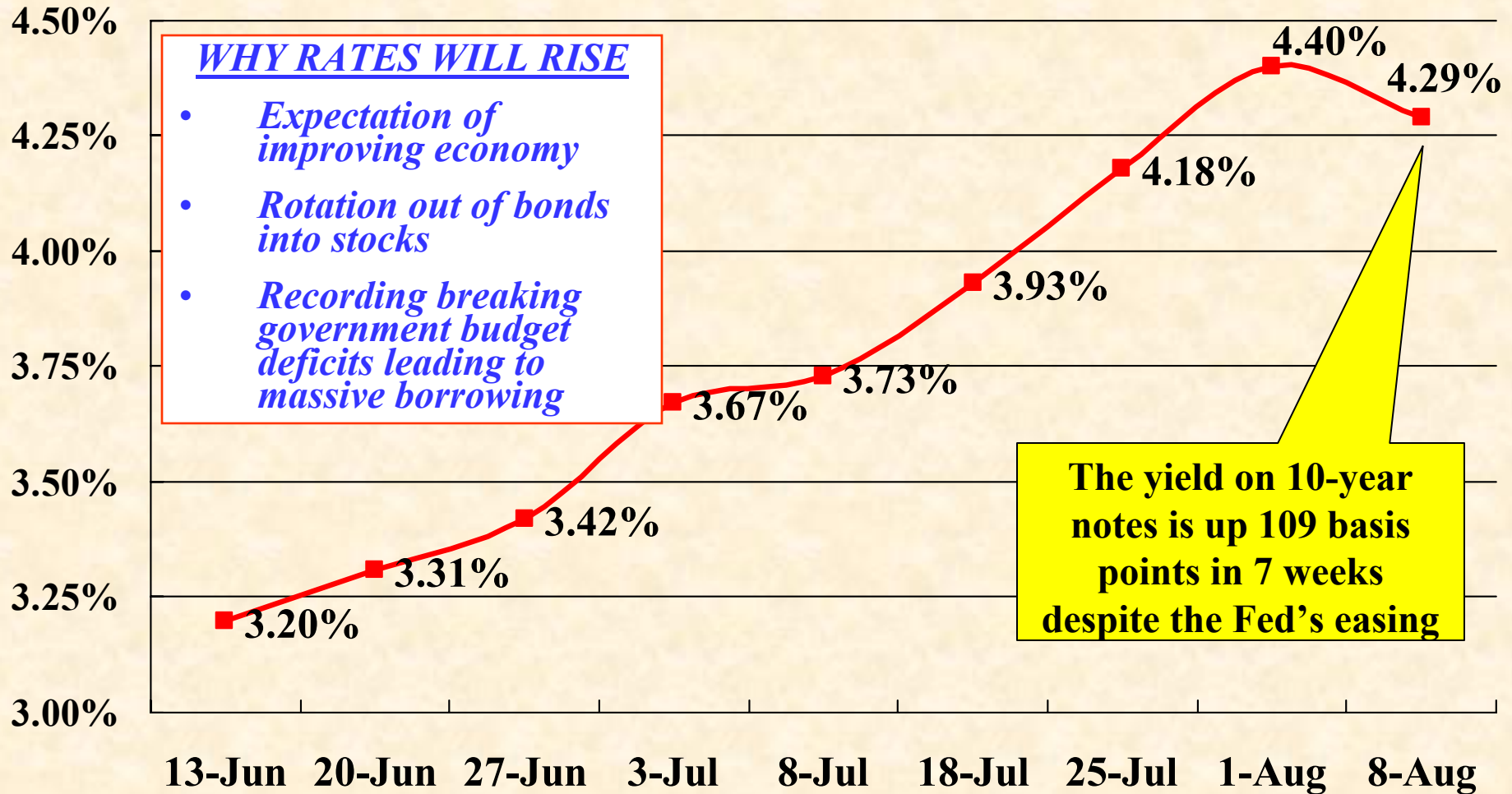




...But is the Bond Bubble

About to Burst? Rates Will Rise!

Yield on 10-Year US Treasury Notes



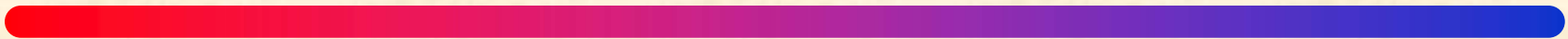
CAPACITY CRUNCH?

U.S. & Global Capacity

Bermuda

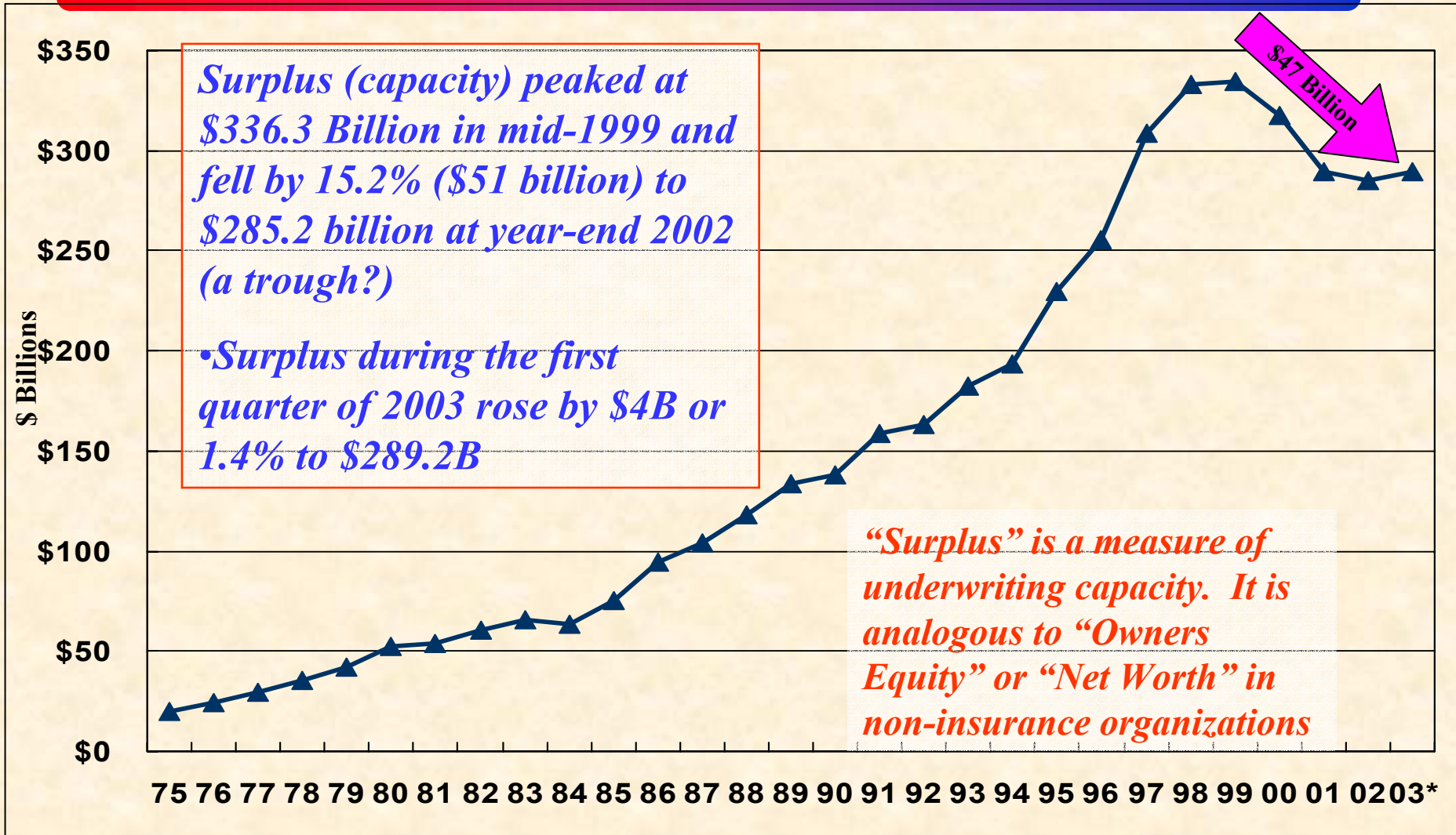
Lloyd's

Captives



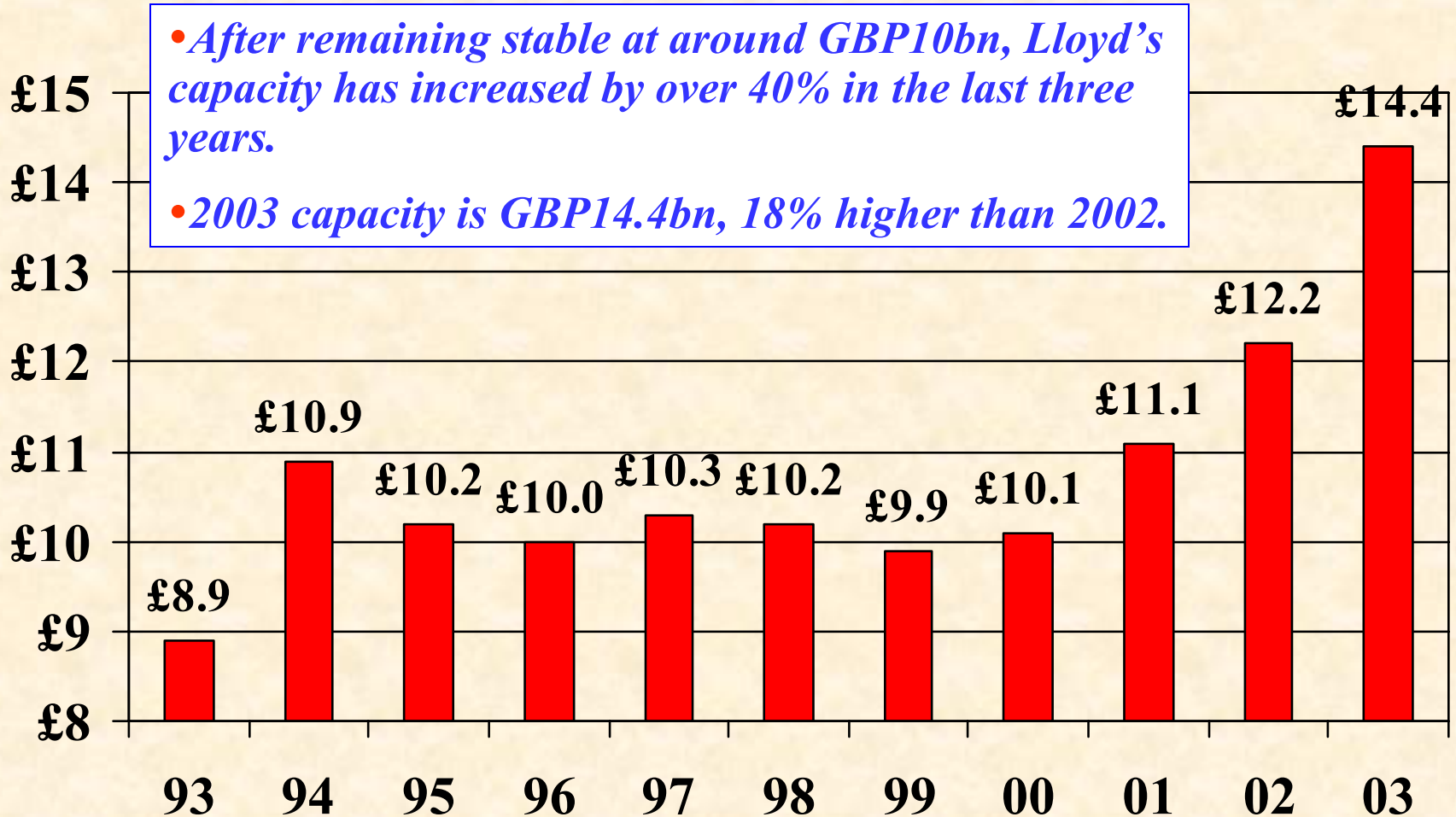


U.S. Policyholder Surplus: 1975-2003*



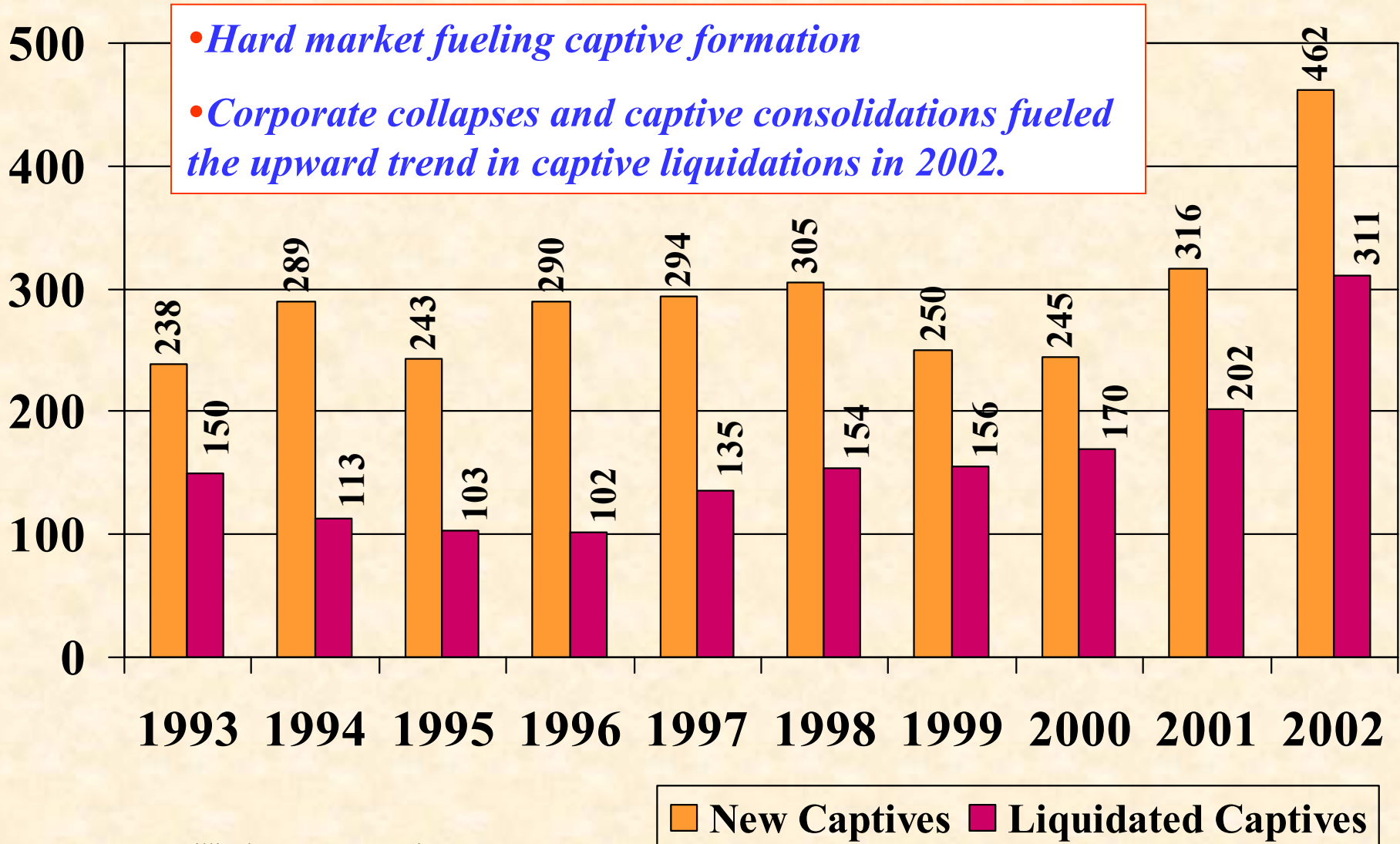


Capacity of Lloyd's Market





Number of Captive Formations & Liquidations 1993 to 2002

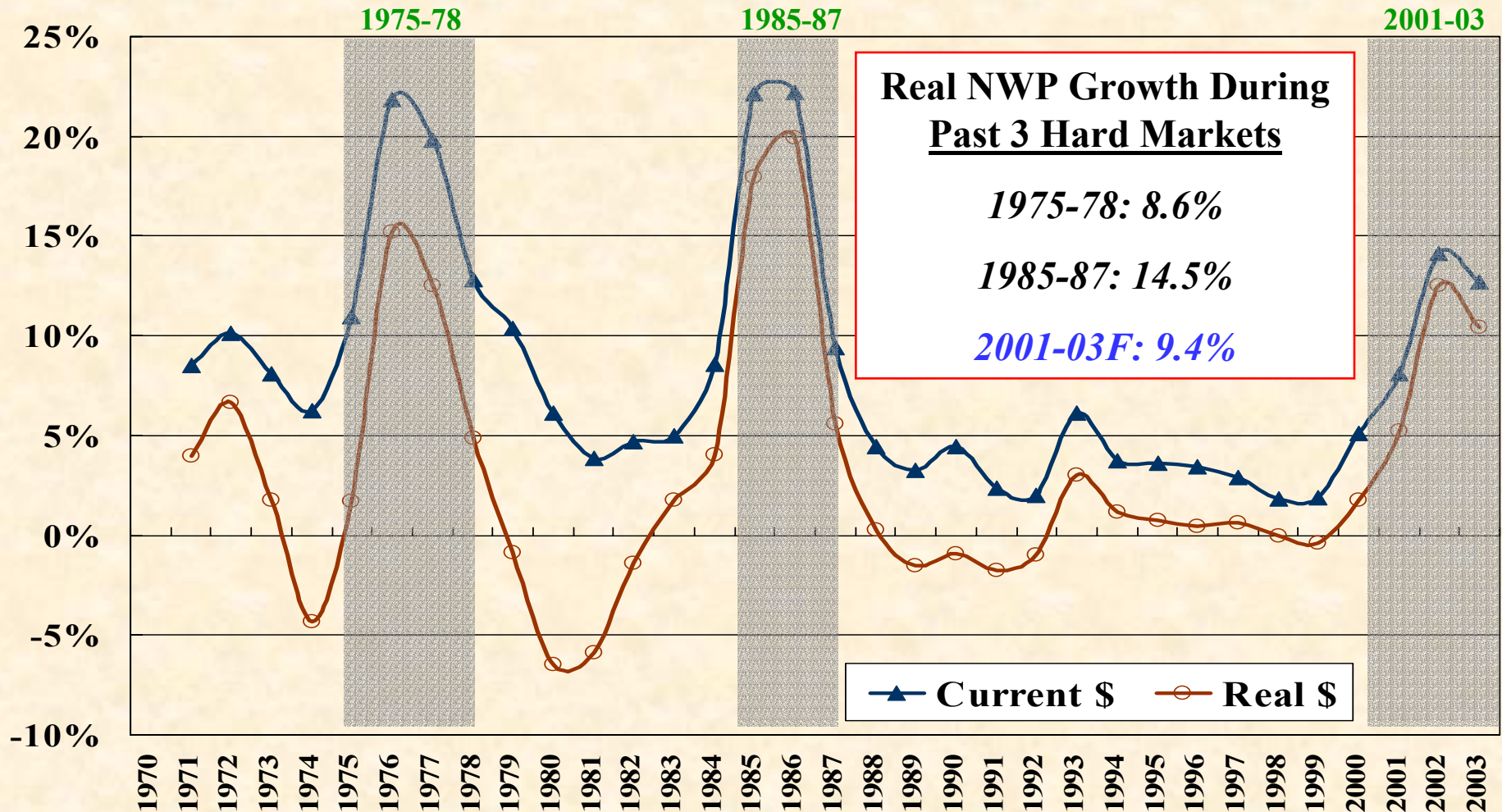


PRICING





Strength of Recent Hard Markets by Real NWP Growth

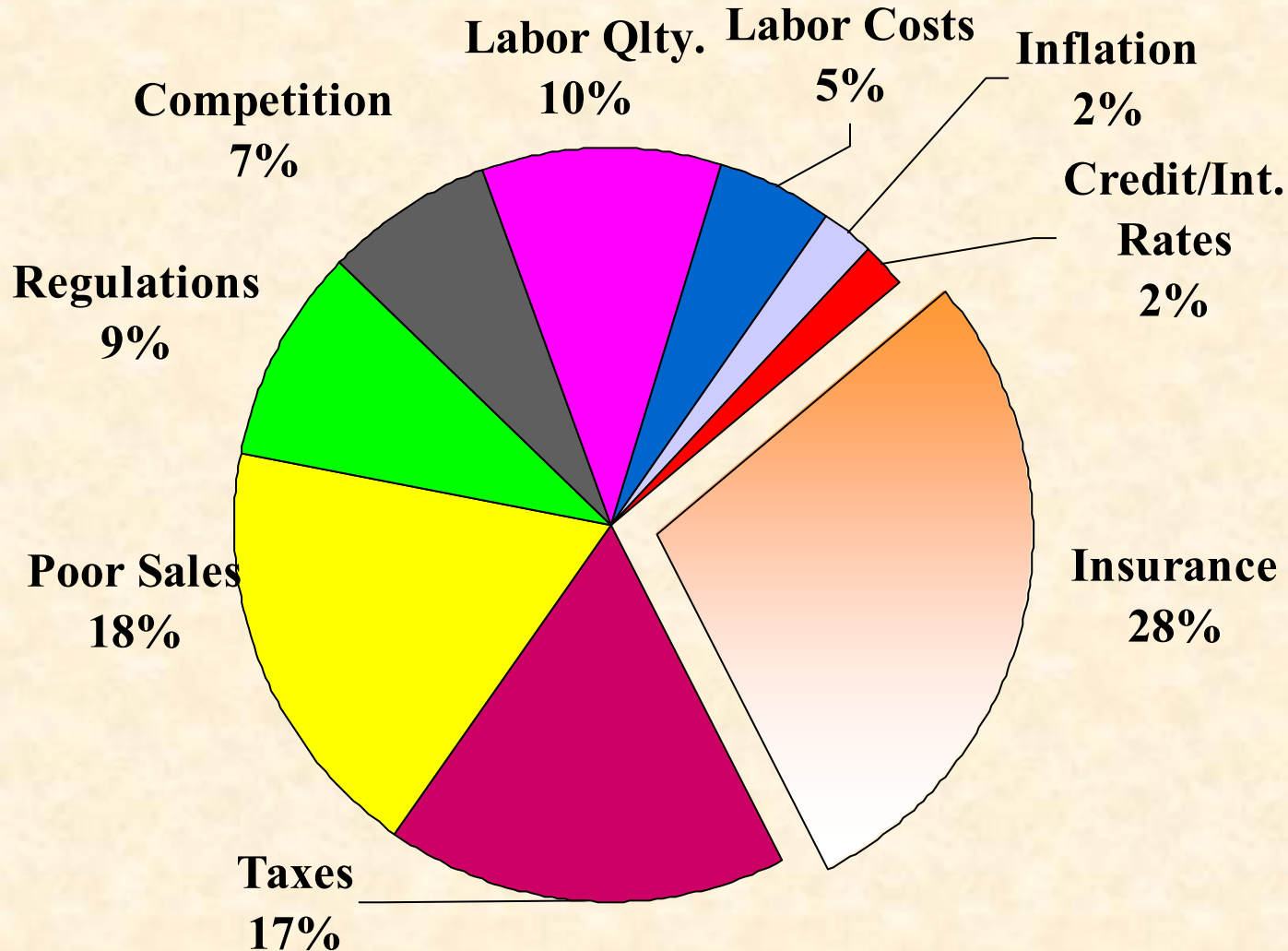


Note: Shaded areas denote hard market periods.
Source: A.M. Best, Insurance Information Institute

*2003 figure is estimate on first quarter result.



Insurance is the Biggest Concern of Small Business Owners





Council of Insurance Agents & Brokers Rate Survey

Second Quarter 2003

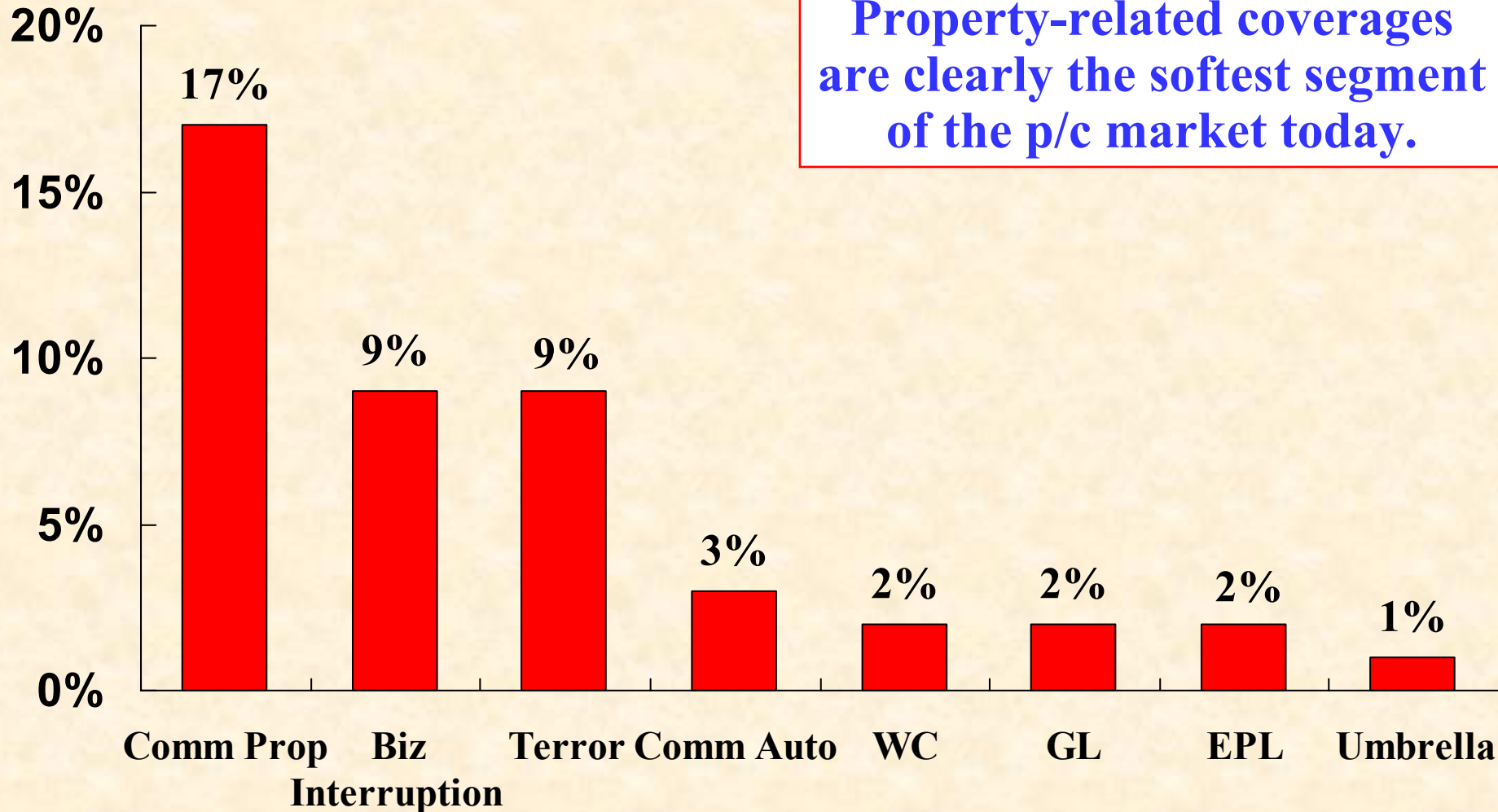
Rate Increases By Line of Business

	No Change	Up 1-10%	10-20%	20-30%	30-50%	50%-100%	>100%
Comm. Auto	8%	31%	43%	8%	2%	0%	0%
Workers Comp	11%	27%	28%	15%	3%	0%	2%
General Liability	10%	32%	41%	9%	1%	0%	0%
Comm. Umbrella	8%	21%	28%	27%	6%	3%	0%
D&O	3%	17%	30%	19%	13%	2%	1%
Comm. Property*	17%	32%	23%	5%	2%	0%	0%
Construction Risk	8%	18%	26%	17%	7%	1%	1%
Terrorism*	27%	18%	13%	4%	1%	0%	1%
Business Interr.	21%	38%	16%	3%	0%	0%	0%
Surety Bonds	12%	17%	13%	9%	2%	0%	1%
Med Mal	1%	2%	4%	20%	11%	12%	6%

Source: Council of Insurance Agents & Brokers.



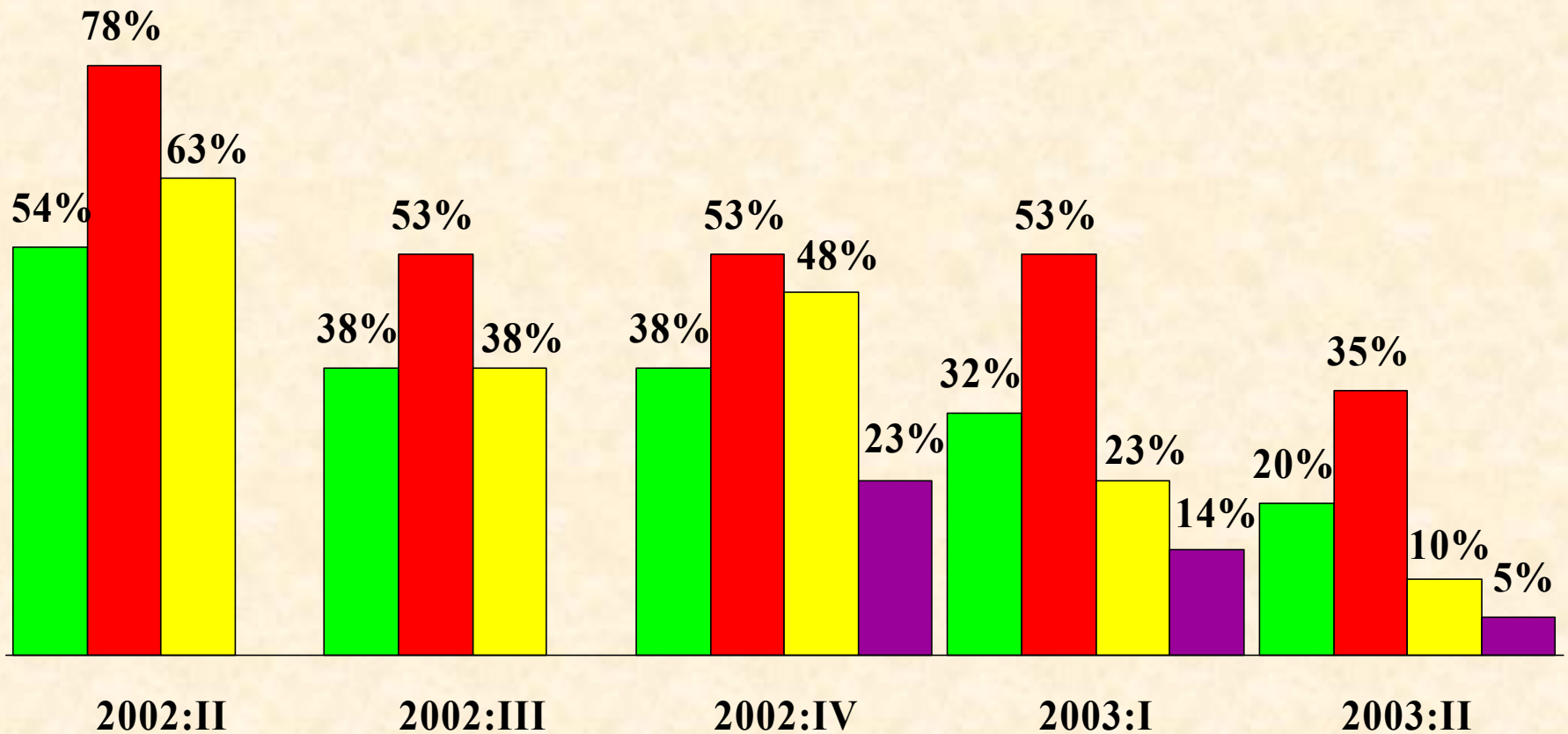
P/C Soft Spots: % Accounts With Negative Price Change (2nd Qtr 2003)





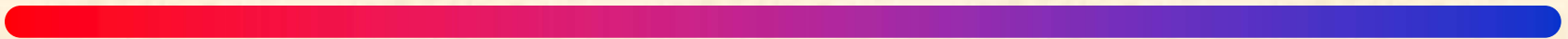
Proportion of Accounts Renewing With Increase of 20% or More, (Select Lines)

■ D&O ■ Construction Risk ■ GL ■ Terrorism



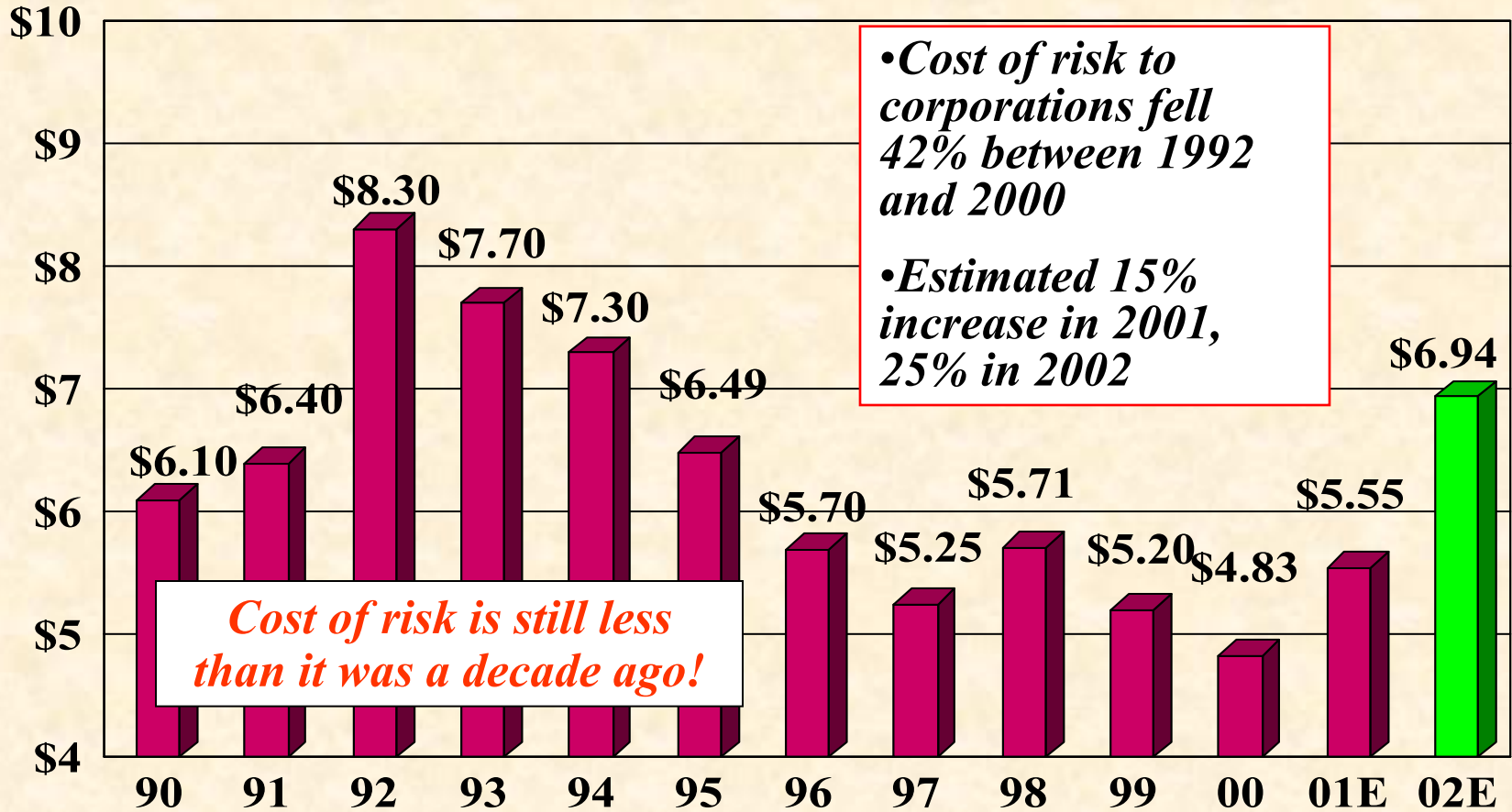
Urban Legend

Insurance is More Expensive
than Ever, Putting Businesses
Over the Edge





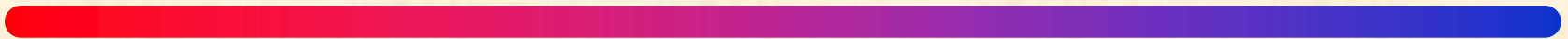
Cost of Risk per \$1,000 of Revenues: 1990-2002E



Source: 2001 RIMS Benchmark Survey; Insurance Information Institute estimates.

TORT-ure

***ABUSE OF THE U.S. CIVIL
JUSTICE SYSTEM***





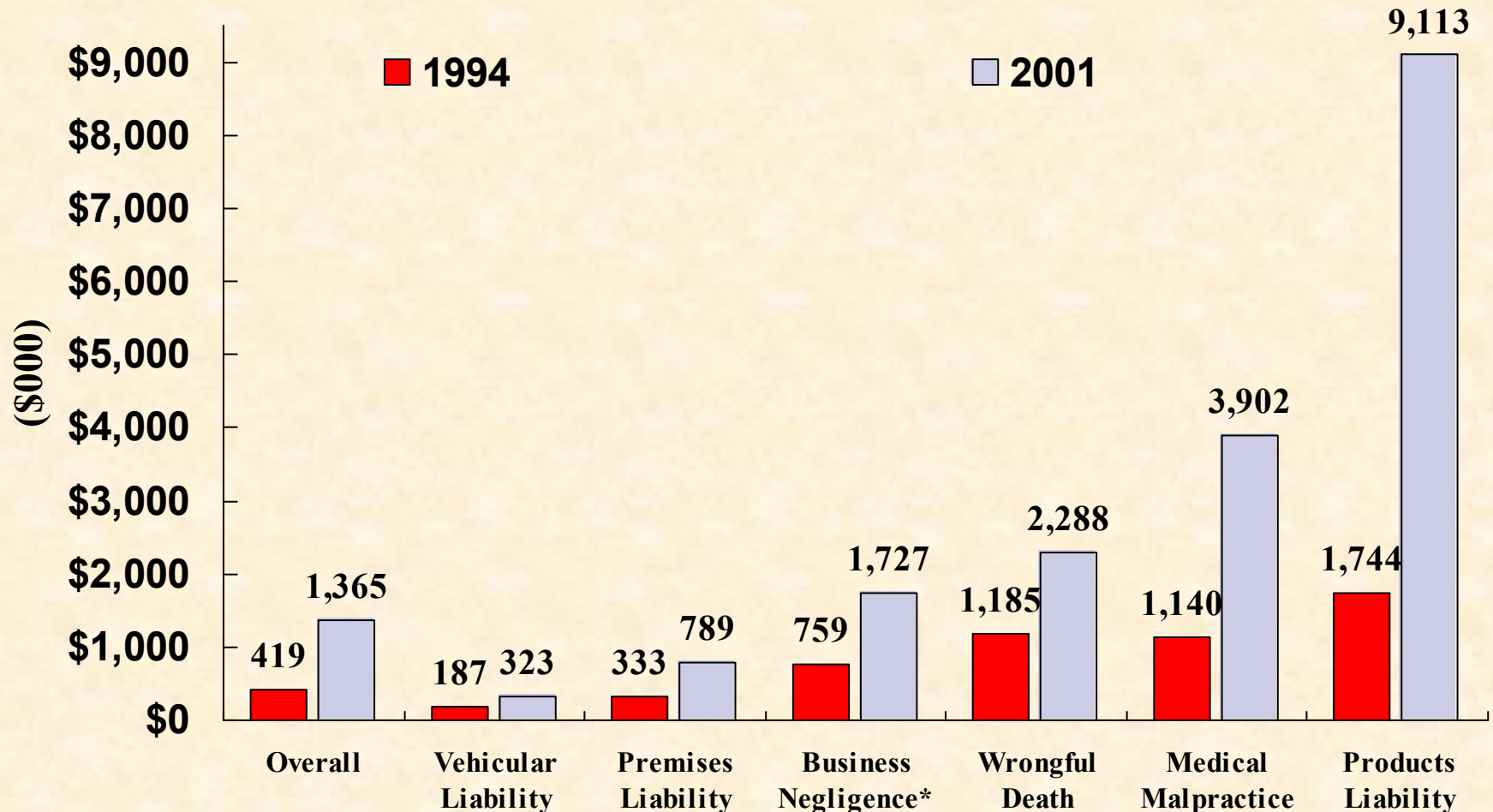
TORT-ure

- Asbestos
- “Toxic” Mold
- Medical Malpractice
- Construction Defects
- Lead
- Fast/Fattening Foods & Obesity *New*
- Reality TV *New*
- Arsenic Treated Lumber
- Guns
- Genetically Modified Foods (Corn)
- Pharmaceuticals & Medical Devices
- Security exposures (workplace violence, post-9/11 issues)
- Slavery
- What’s Next?





Average Jury Awards 1994 vs. 2001

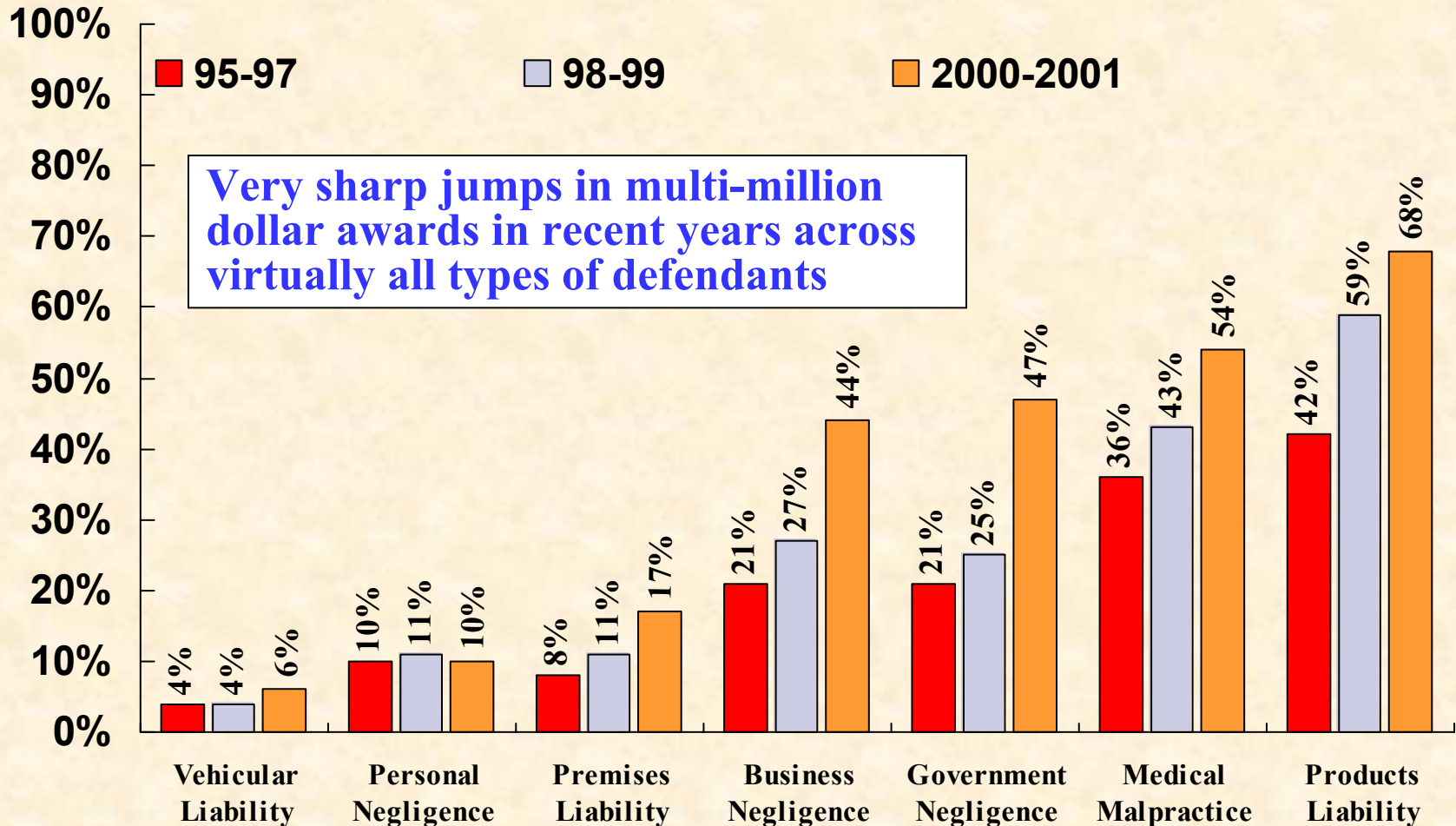


*Figure is for 2000 (latest available)

Source: Jury Verdict Research; Insurance Information Institute.



Trends in Million Dollar Verdicts*



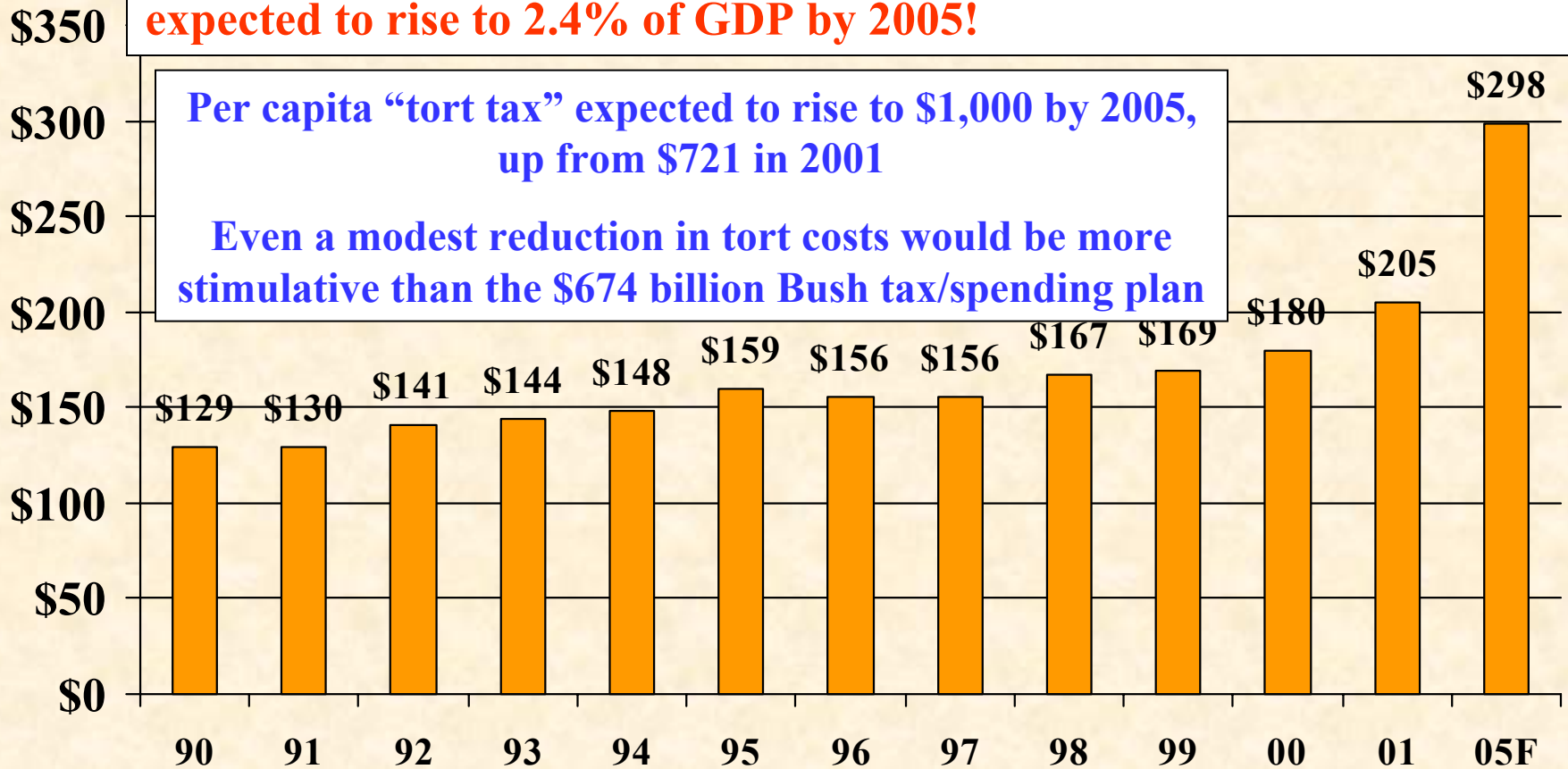
*Verdicts of \$1 million or more.

Source: Jury Verdict Research; Insurance Information Institute.



Cost of U.S. Tort System (*\$ Billions*)

Tort costs consumed 2.0% of GDP annually on average since 1990, expected to rise to 2.4% of GDP by 2005!



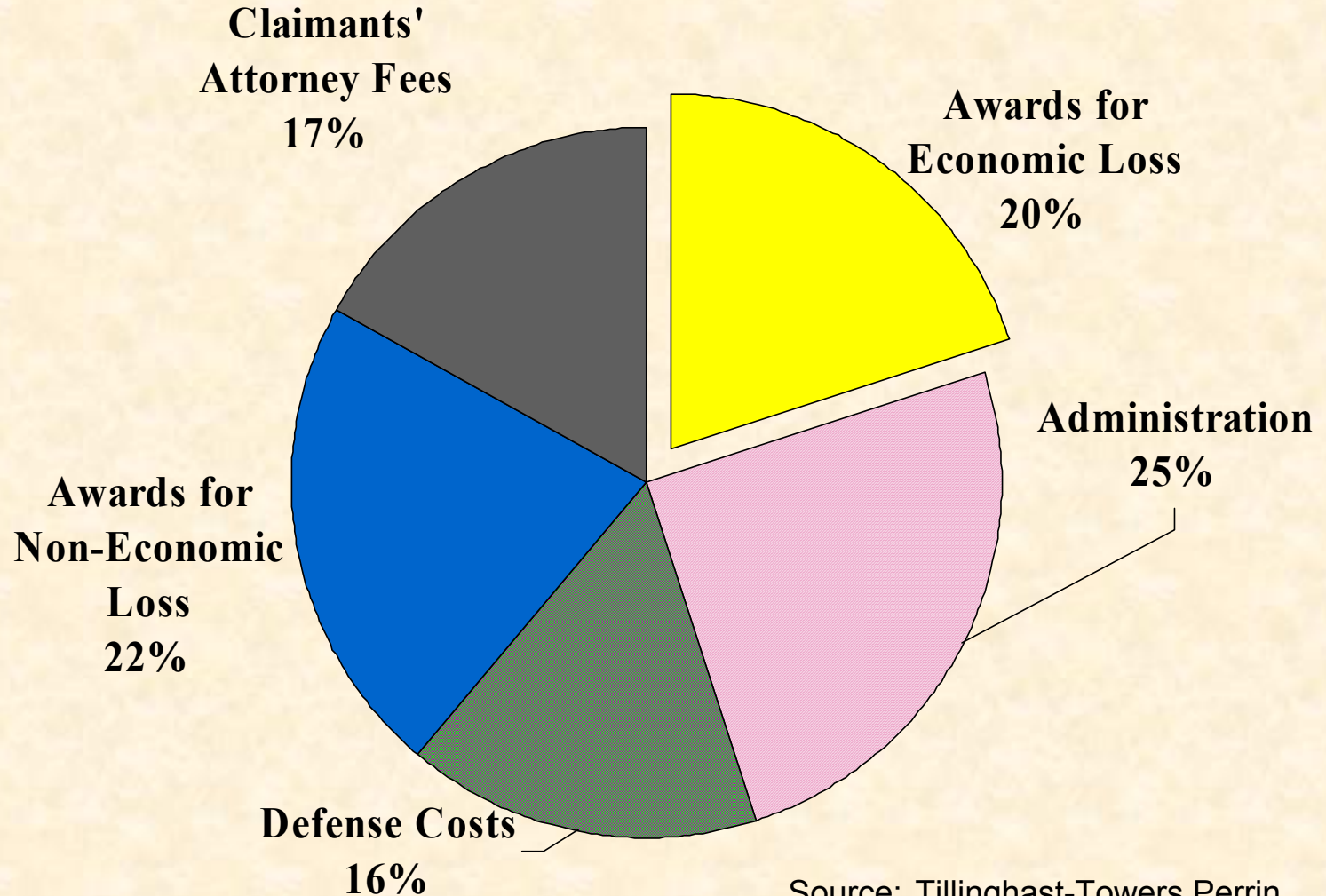
Source: Tillinghast-Towers Perrin. 2005 forecasts from Tillinghast.



Where the Tort Dollar Goes (2000)

Tort System is extremely inefficient:

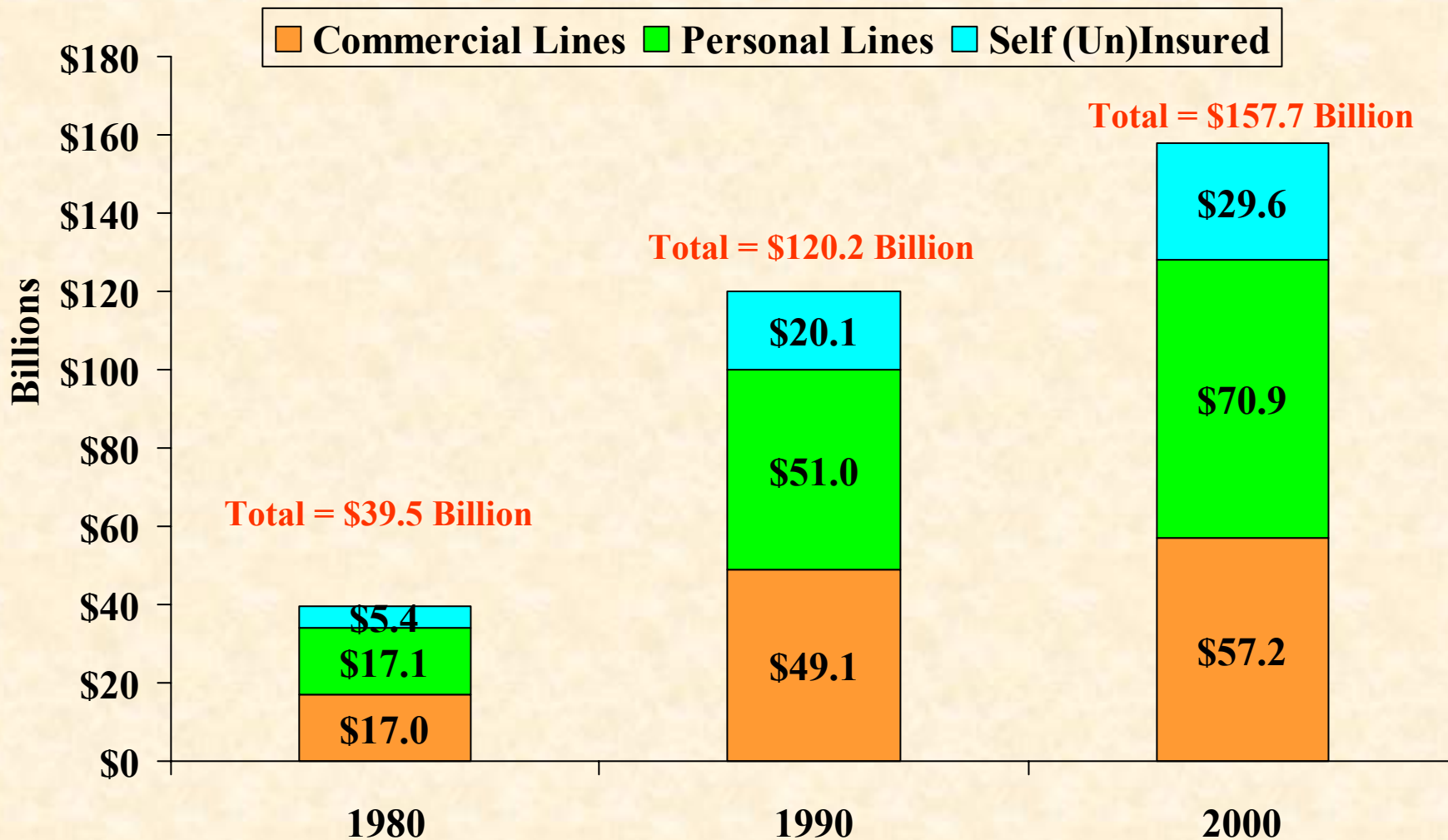
- Only 20% of the tort dollar compensates victims for economic losses
- At least 58% of every tort dollar never reaches the victim



Source: Tillinghast-Towers Perrin



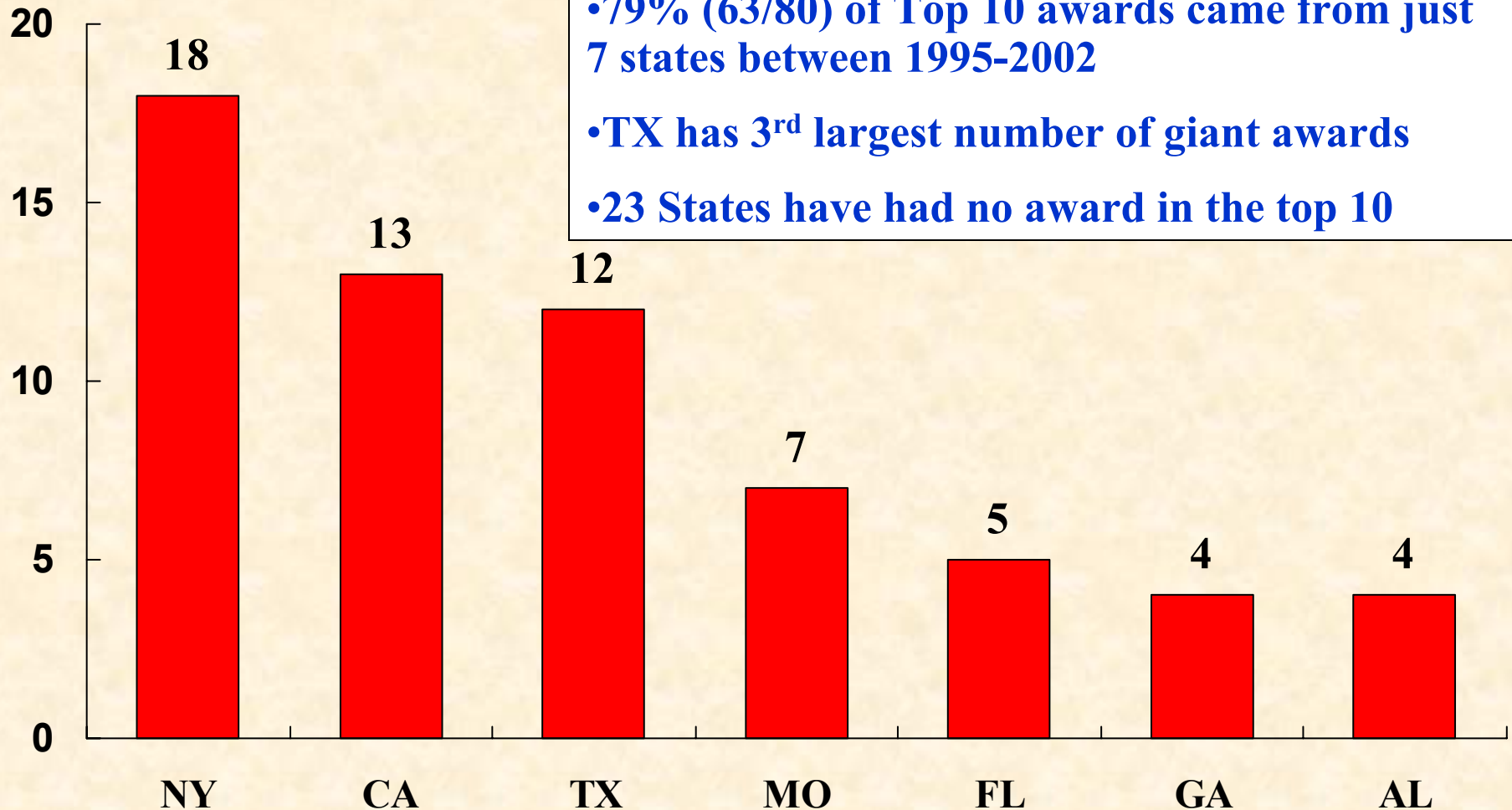
*Personal, Commercial & Self (Un) Insured Tort Costs**



*Excludes medical malpractice
Source: Tillinghast-Towers Perrin



States With the Most Top 10 Jury Awards 1995-2002



- 79% (63/80) of Top 10 awards came from just 7 states between 1995-2002
- TX has 3rd largest number of giant awards
- 23 States have had no award in the top 10



Business Leaders Ranking of Liability Systems for 2003

Best States

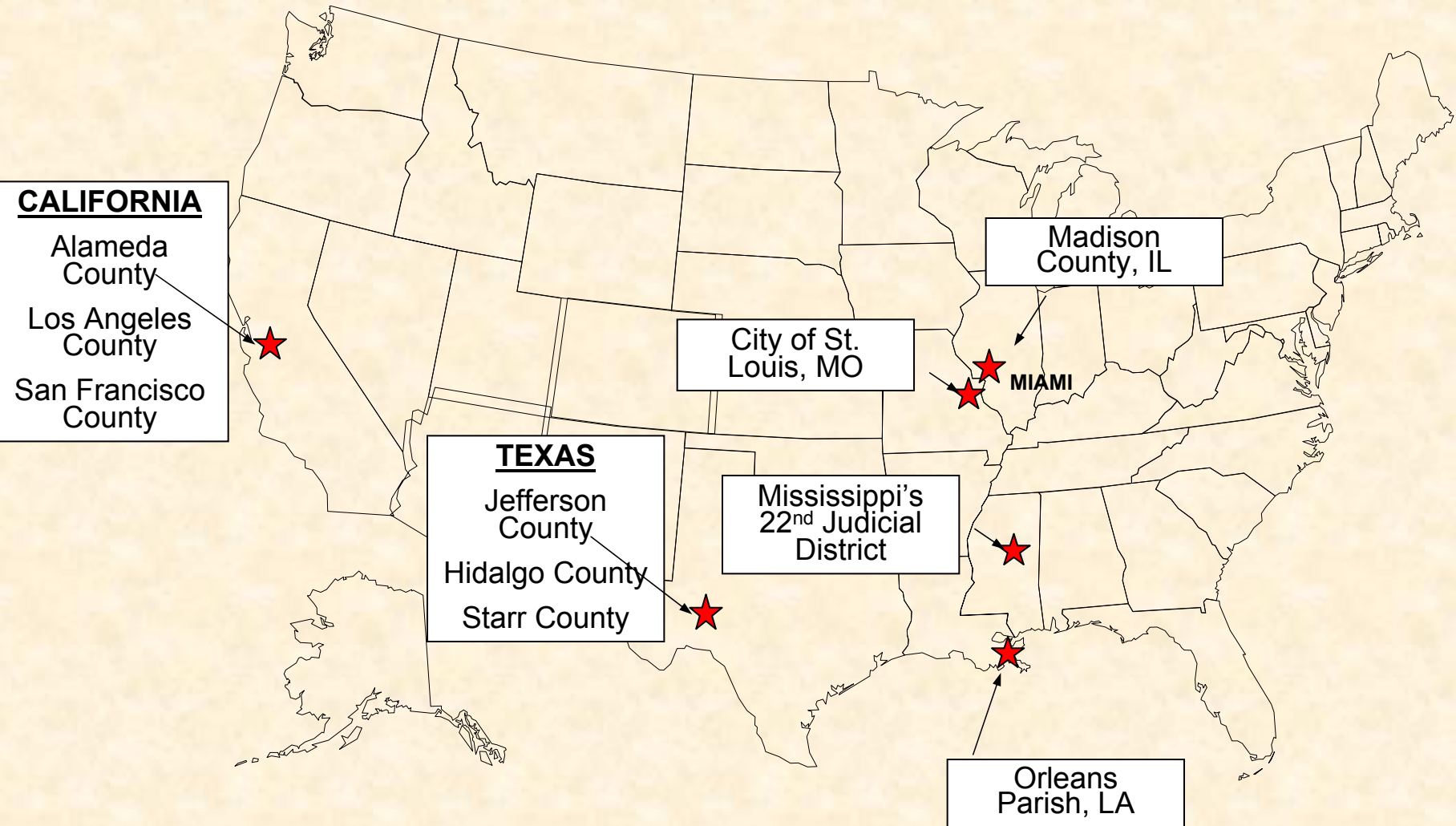
1. Delaware
2. Nebraska
3. Iowa
4. South Dakota
5. Indiana
6. North Dakota
7. Utah
8. Virginia
9. Minnesota
10. New Hampshire

Worst States

41. New Mexico
42. South Carolina
43. Hawaii
44. California
45. Arkansas
46. Texas
47. Louisiana
48. Alabama
49. West Virginia
50. Mississippi



The Nation's Judicial Hellholes: An International Embarrassment





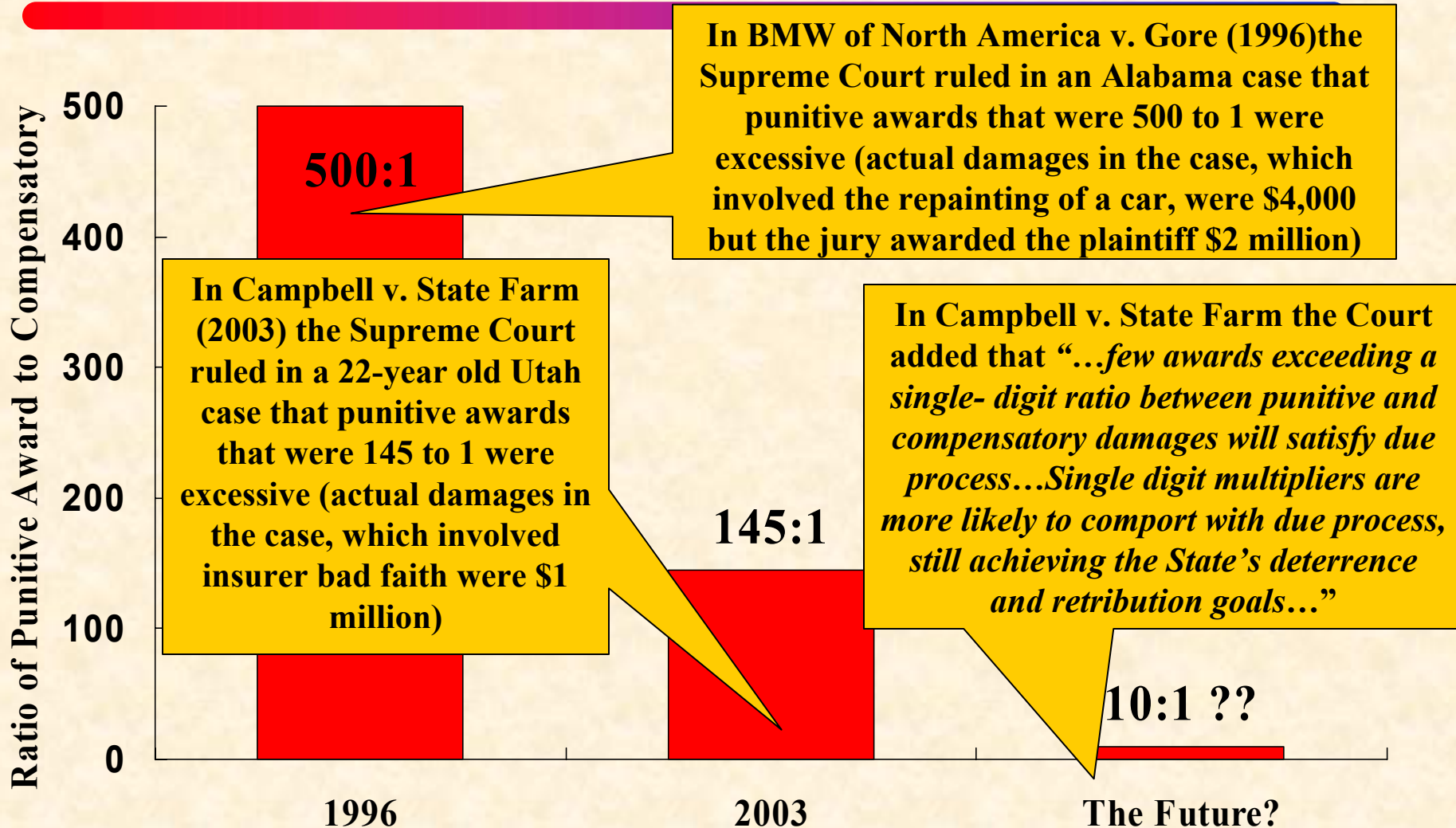
There is a Glimmer of Hope for Tort Reform

Best Chance for Tort Reform in Years

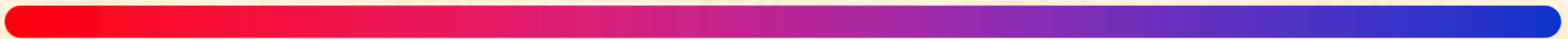
- Medical Malpractice
 - States—already happening: 20+ states have caps
 - Federal reform discussed in Congress but bill failed in Senate
- Class Action Reform
 - Class Action Fairness Act
 - Presently 2 or 3 votes short in the Senate. Vote in September
- Asbestos Reform
 - Fairness in Asbestos Injury Resolution of 2003; Sept. vote?
- Punitive Damages—What's Reasonable
 - Supreme Court ruled favorably in *Campbell v. State Farm*



Are We Finally Seeing Punitives Reigned In by the Supreme Court?

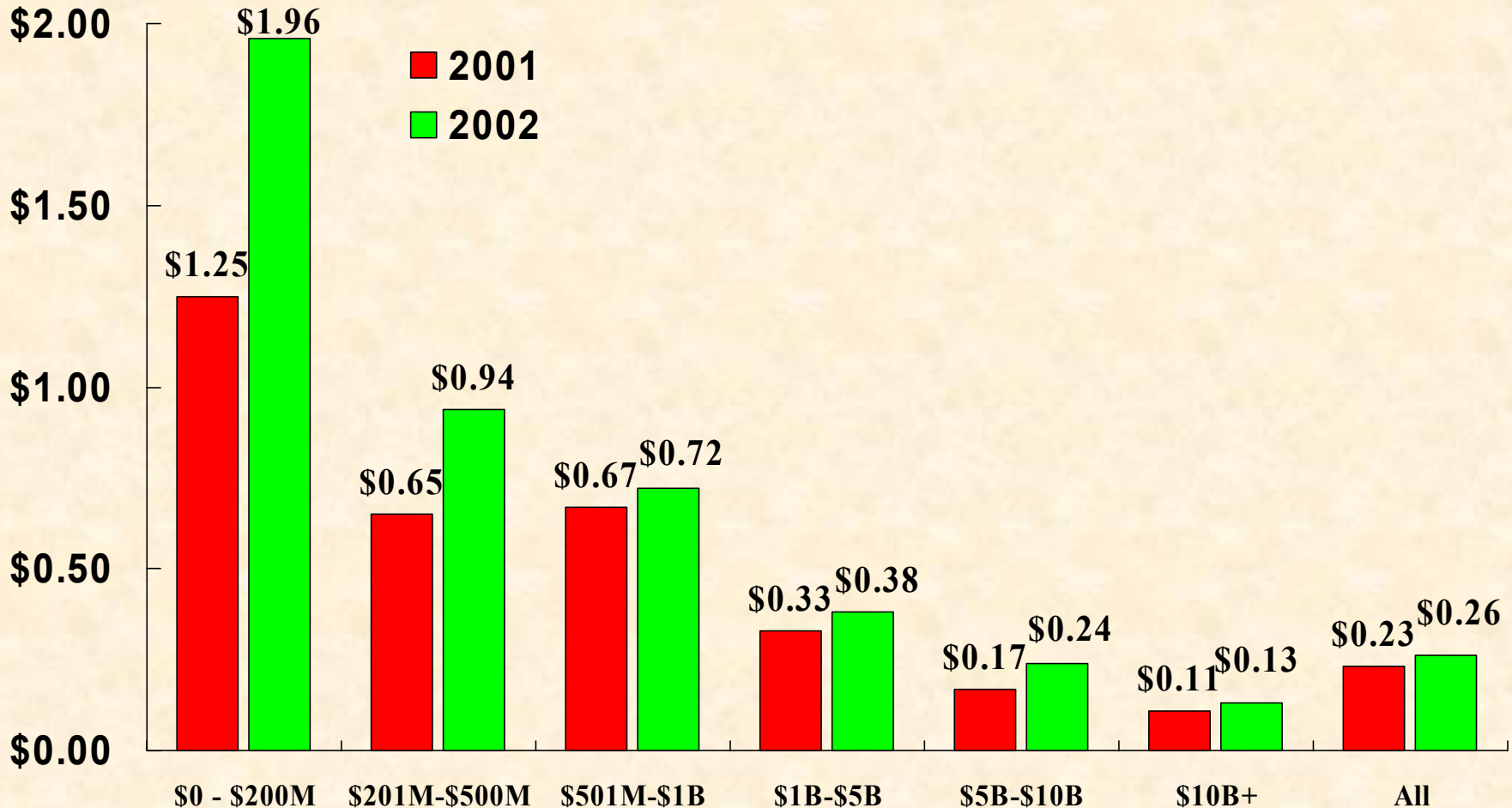


*INFLUENCE OF TORTS
ENVIRONMENT AND LEGAL
LIABILITY TRENDS ON PRICING*



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

2001 vs. 2002

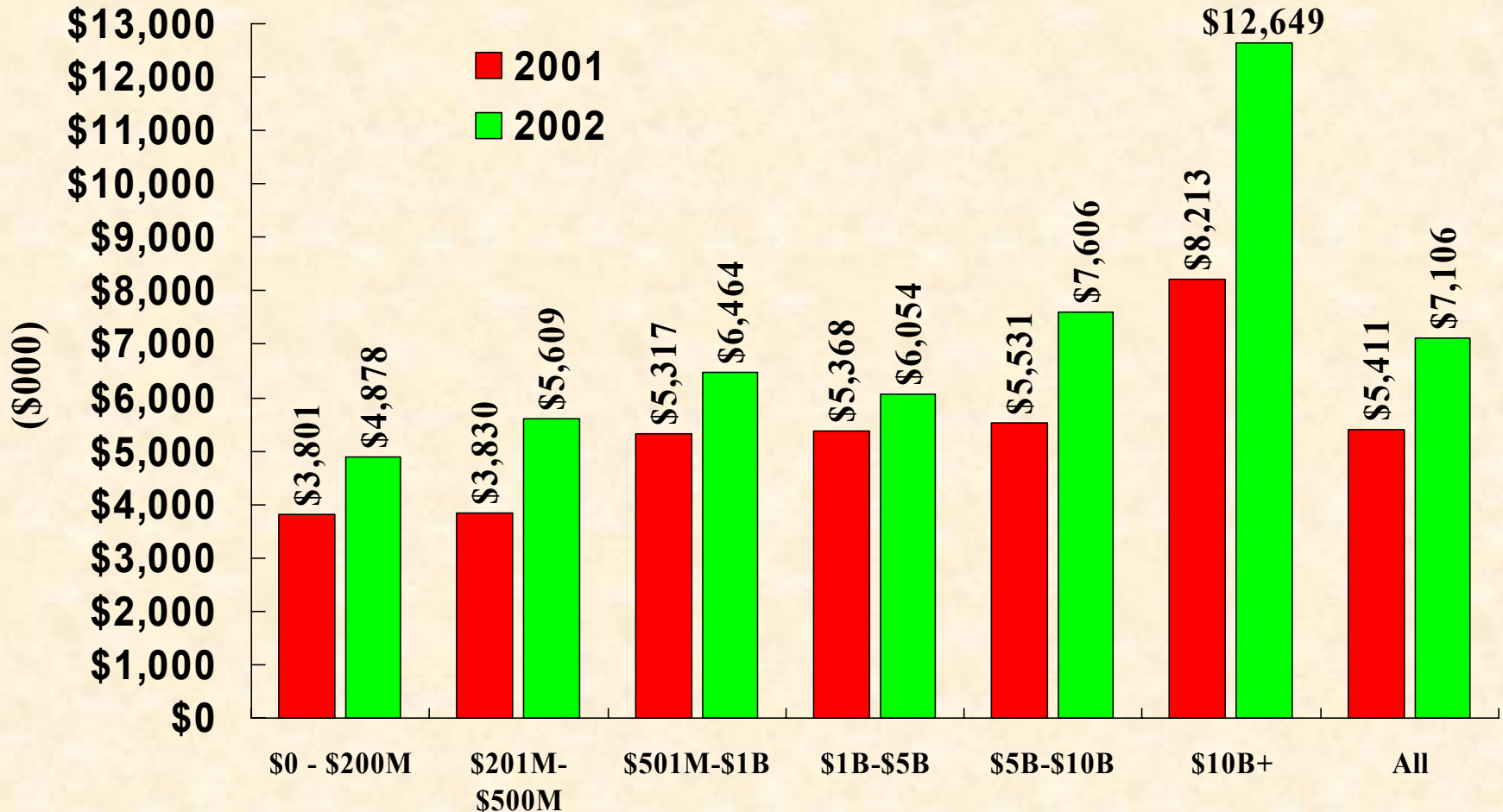


*Across entire liability program

Source: Marsh, 2002 Limits of Liability Report

Average Cost per \$1 Million Liability Coverage

2001 vs. 2002



Source: Marsh, 2002 Limits of Liability Report



Excess Layer Hit With Leveraged Impact of Increase in Trend

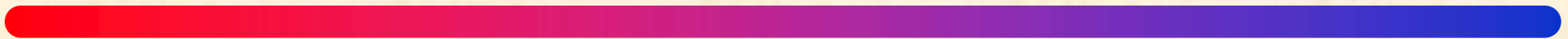
Assumptions: Primary Limit of \$1 M
Ground Up Trend of 7.0%

<u>Claim</u>	<u>Total Loss</u>	<u>Primary Loss</u>	<u>Excess Loss</u>	<u>% Loss Trend</u>	<u>Total Loss</u>	<u>Primary Loss</u>	<u>Excess Loss</u>
1	0.900	0.900	0	7.0	0.963	0.963	0
2	1.000	1.000	0	7.0	1.070	1.000	0.070
3	<u>2.000</u>	<u>1.000</u>	<u>1.00</u>	7.0	<u>2.140</u>	<u>1.000</u>	<u>1.140</u>
Total	3.900	2.900	1.00		4.173	2.963	1.210

Loss Trend: 7.0% 2.2% **21.0%**

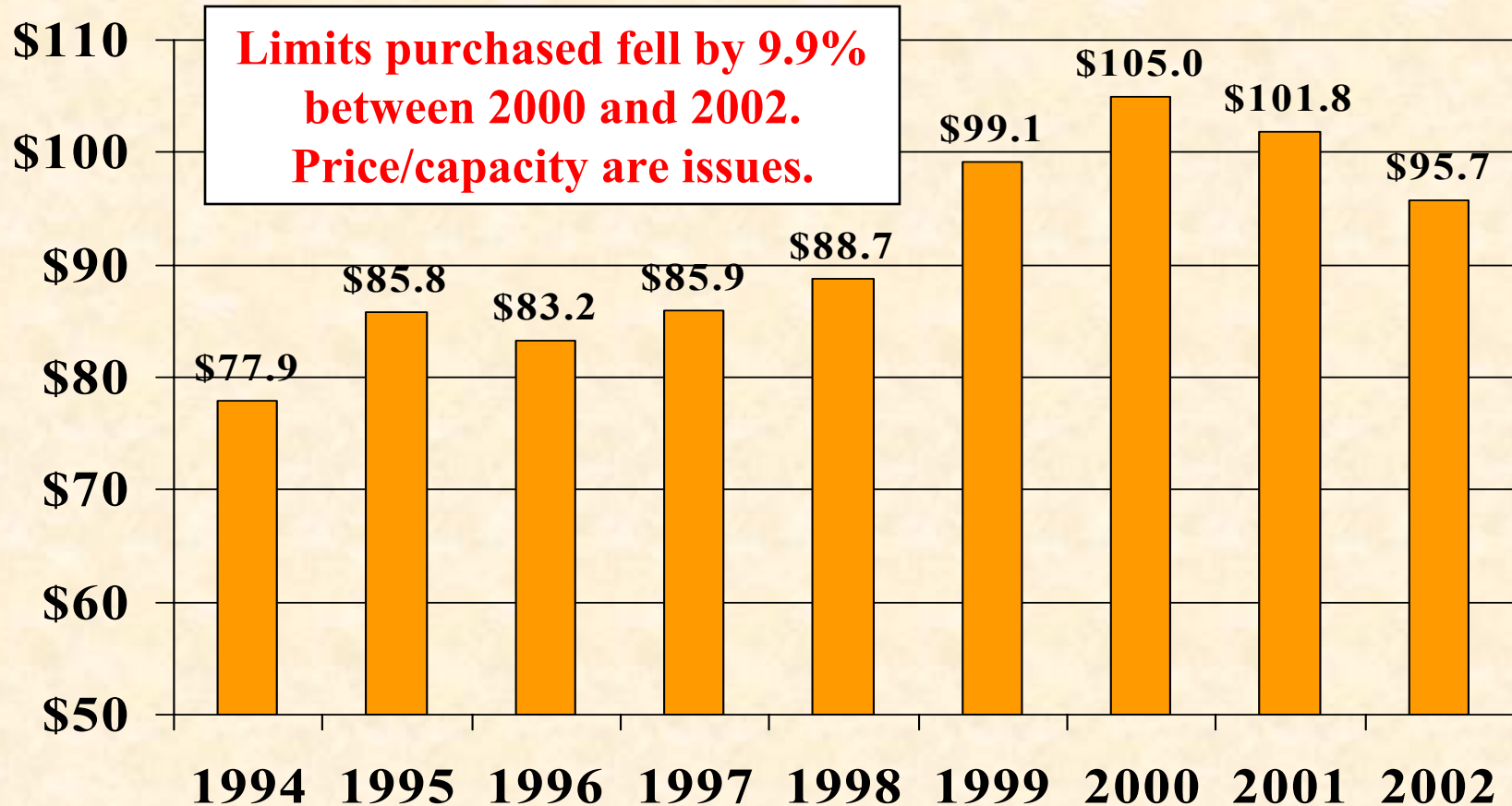
Trend in excess layers is 3 times the ground-up trend and nearly 10 times the primary trend

*INFLUENCE OF MASS TORTS AND
LEGAL LIABILITY TRENDS ON
AVAILABILITY*





Average Total Limits Purchased by All Firms* (\$ Millions)



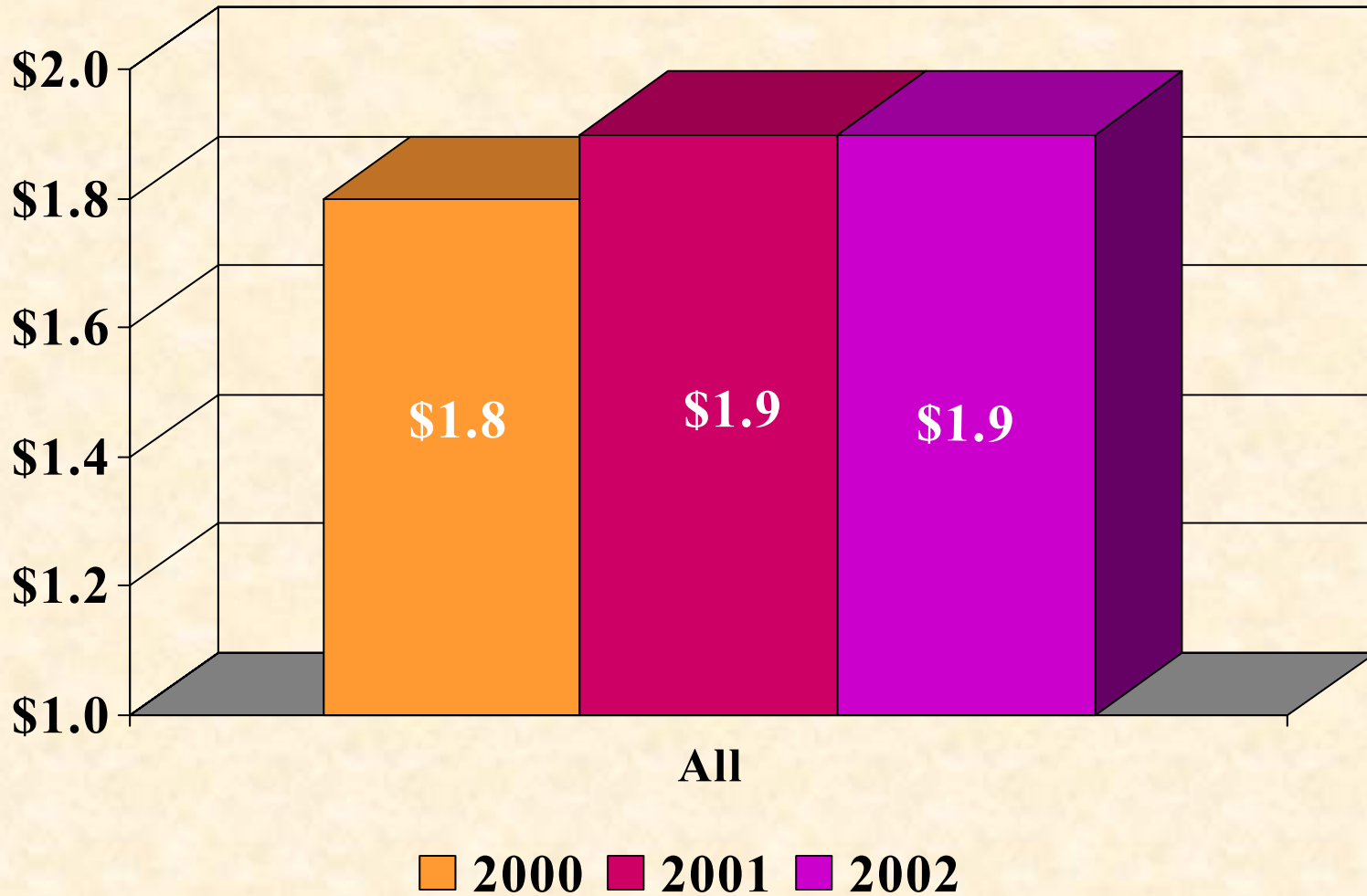
*Includes underlying primary limits

Source: *Limits of Liability 2002*, Marsh, Inc.



Average Underlying Limits (Attachment Points)

+0%*

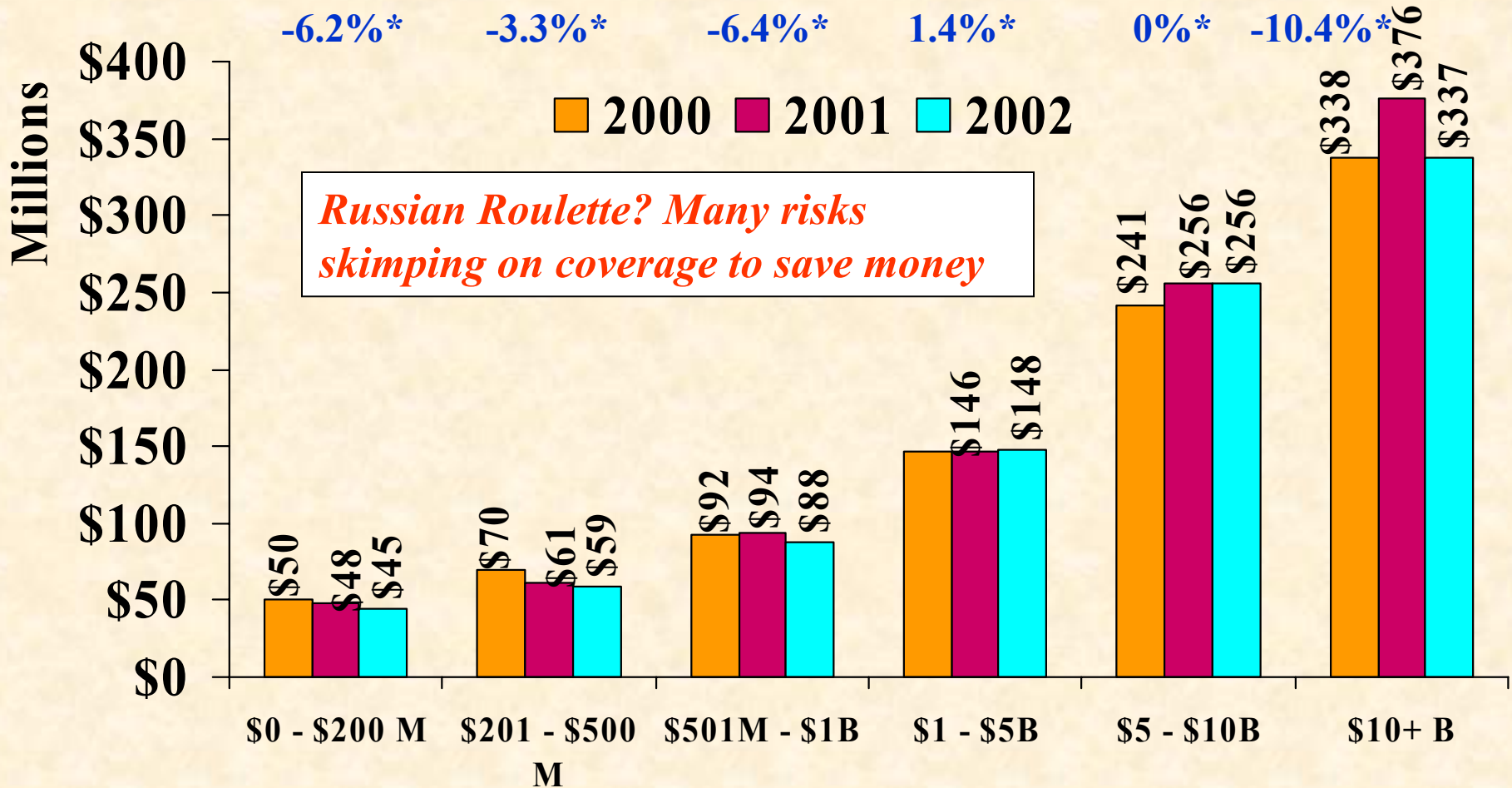


* Percent Change 2002 from 2001

Source: Marsh, 2002 Limits of Liability Report



Average Limits by Revenue Class 2000-2002 (\$ Millions)

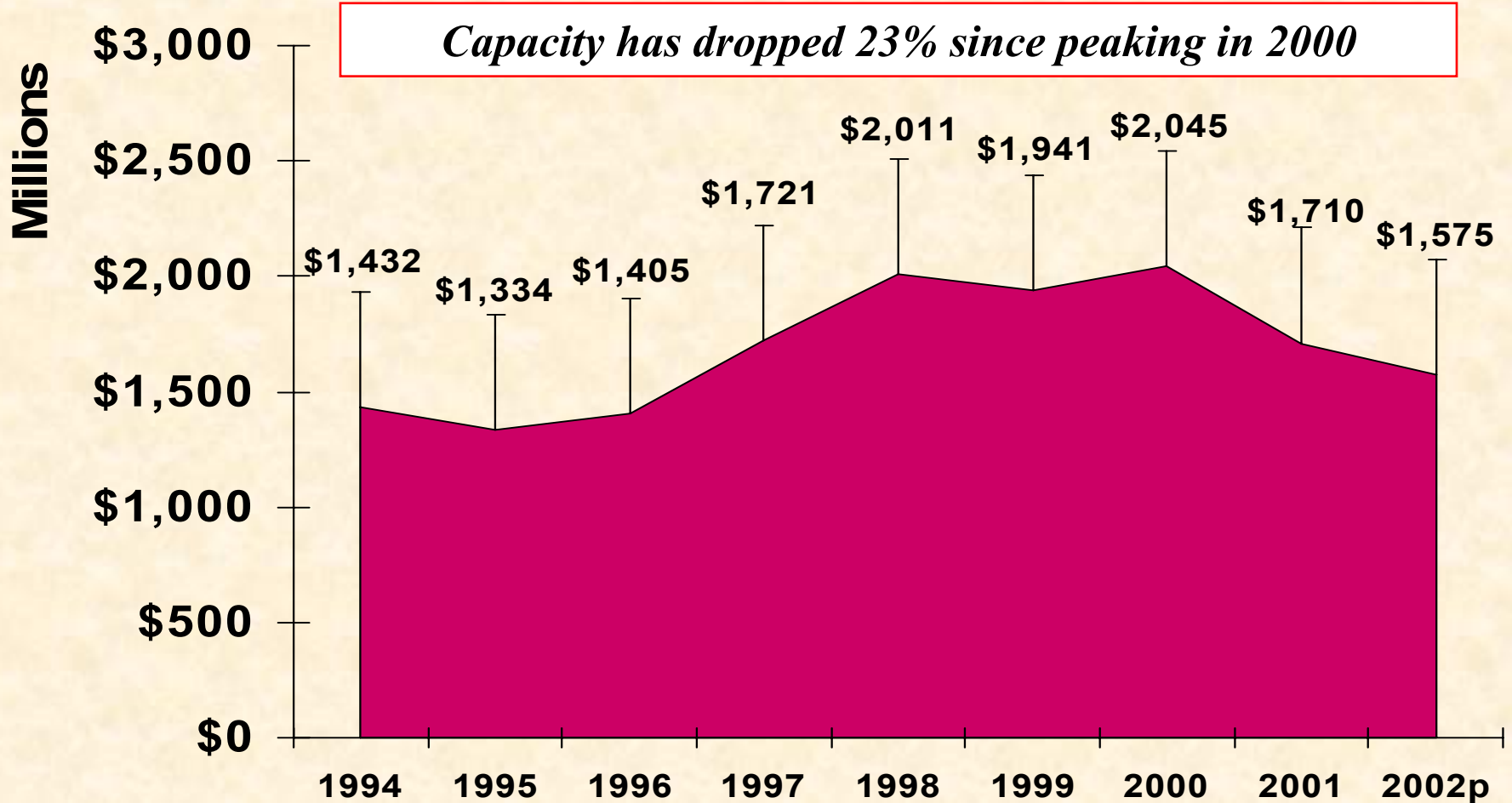


* Percent Change 2002 over 2001.

Source: Marsh, 2002 Limits of Liability Report

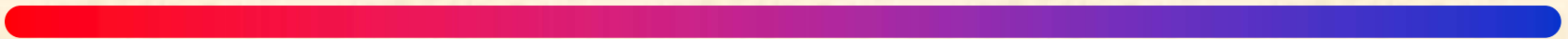


Excess Liability Market Capacity



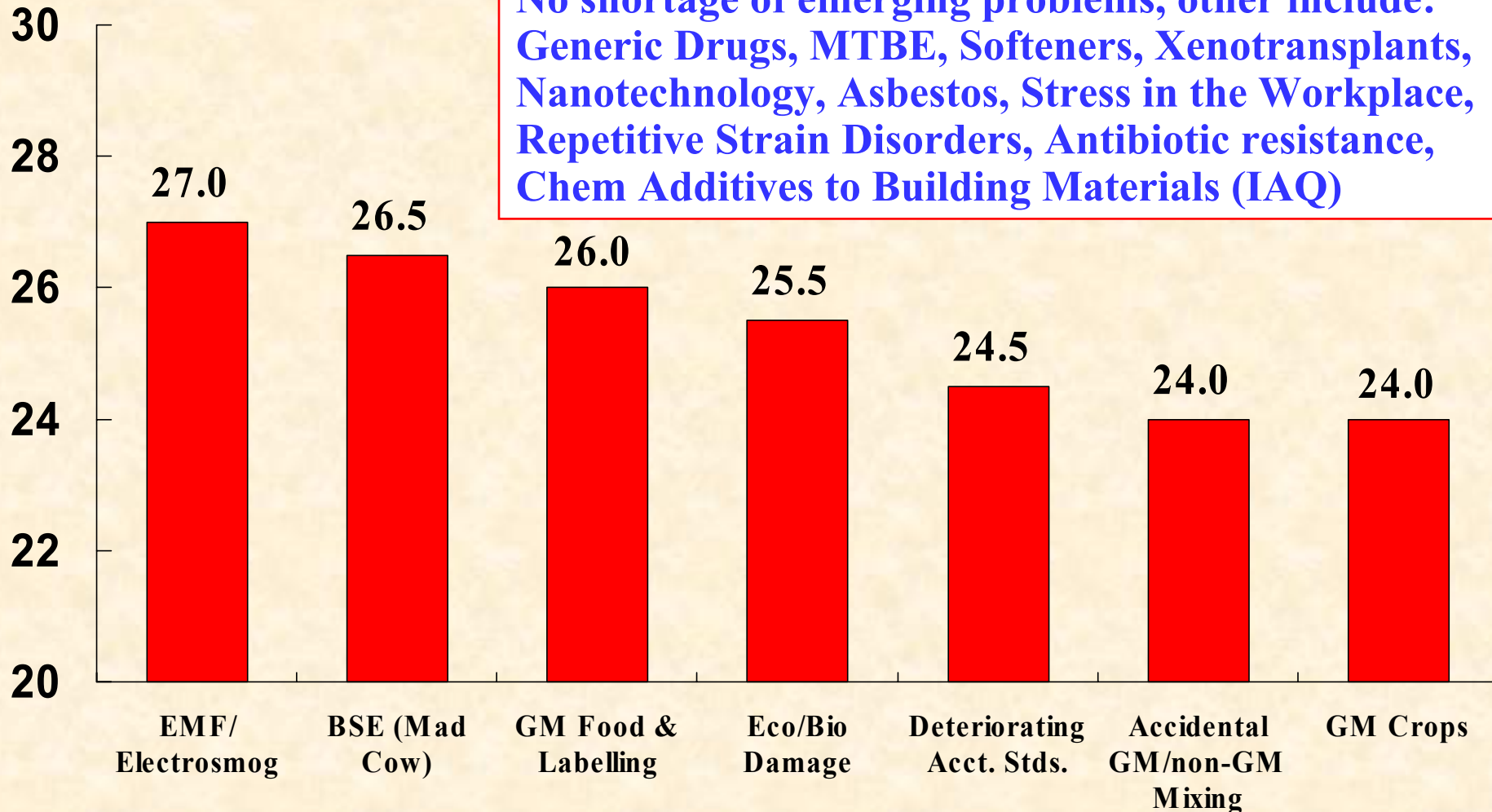
Source: Marsh, 2002 Limits of Liability Report

CASE STUDIES

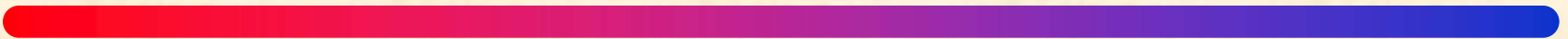




Possible Top Risks from Current Perspective



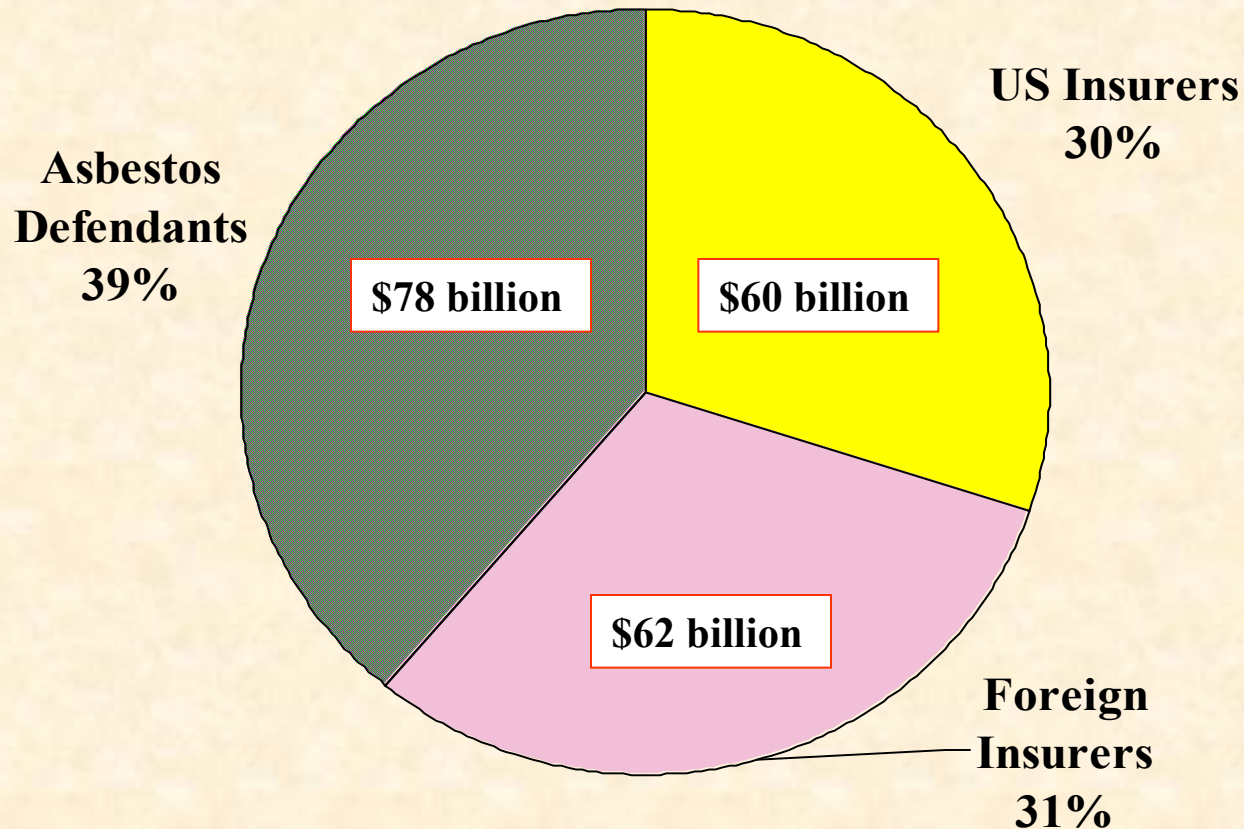
ASBESTOS



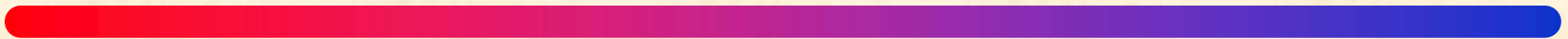


Who Will Pay for the US Asbestos Mess?

Estimated Total US Settlements & Expenses = \$200 billion



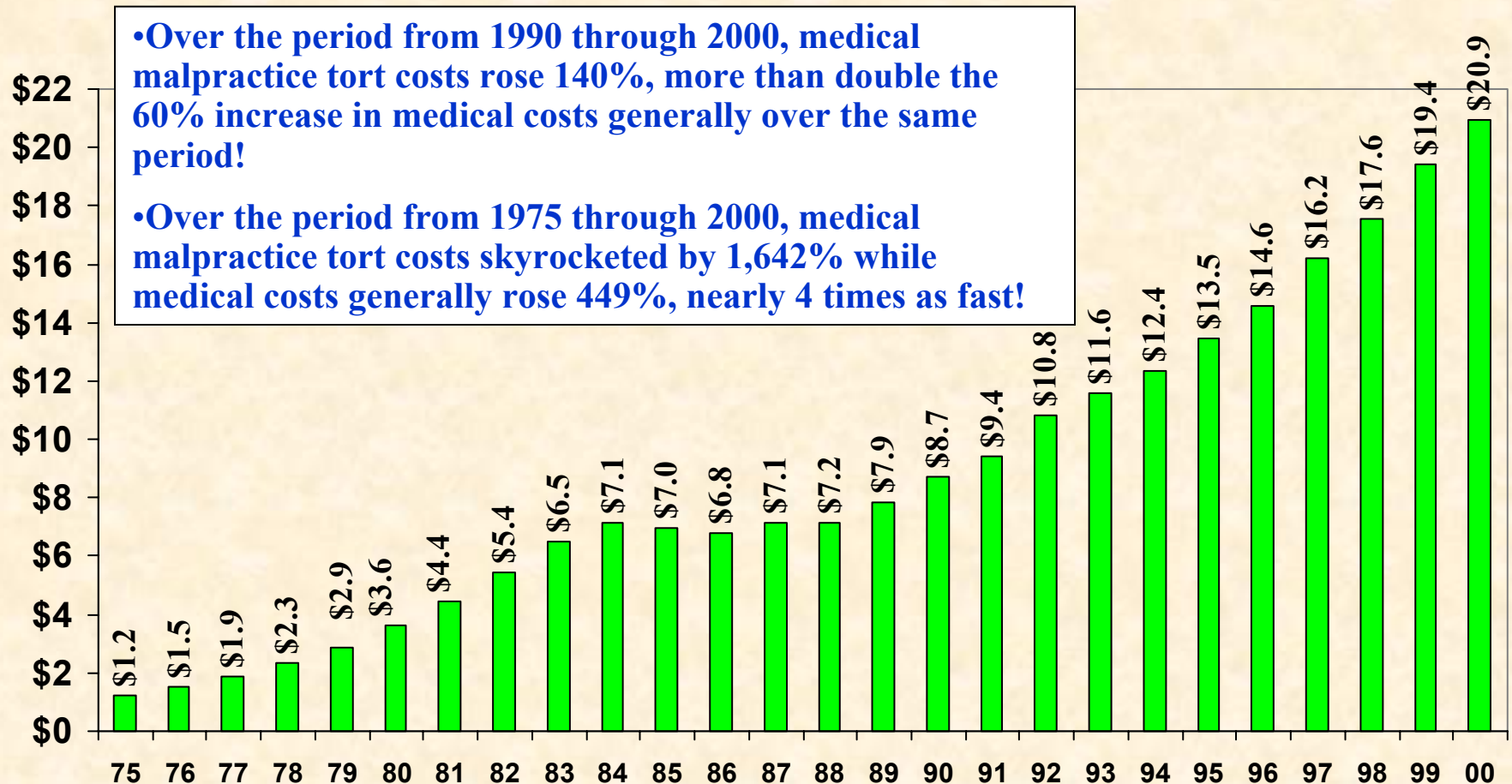
MEDICAL MALPRACTICE



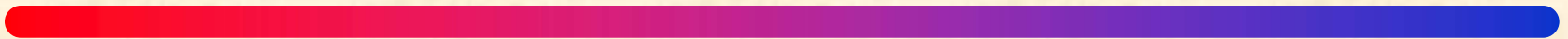


Medical Malpractice: Tort Cost Growth is Skyrocketing

\$ Billions

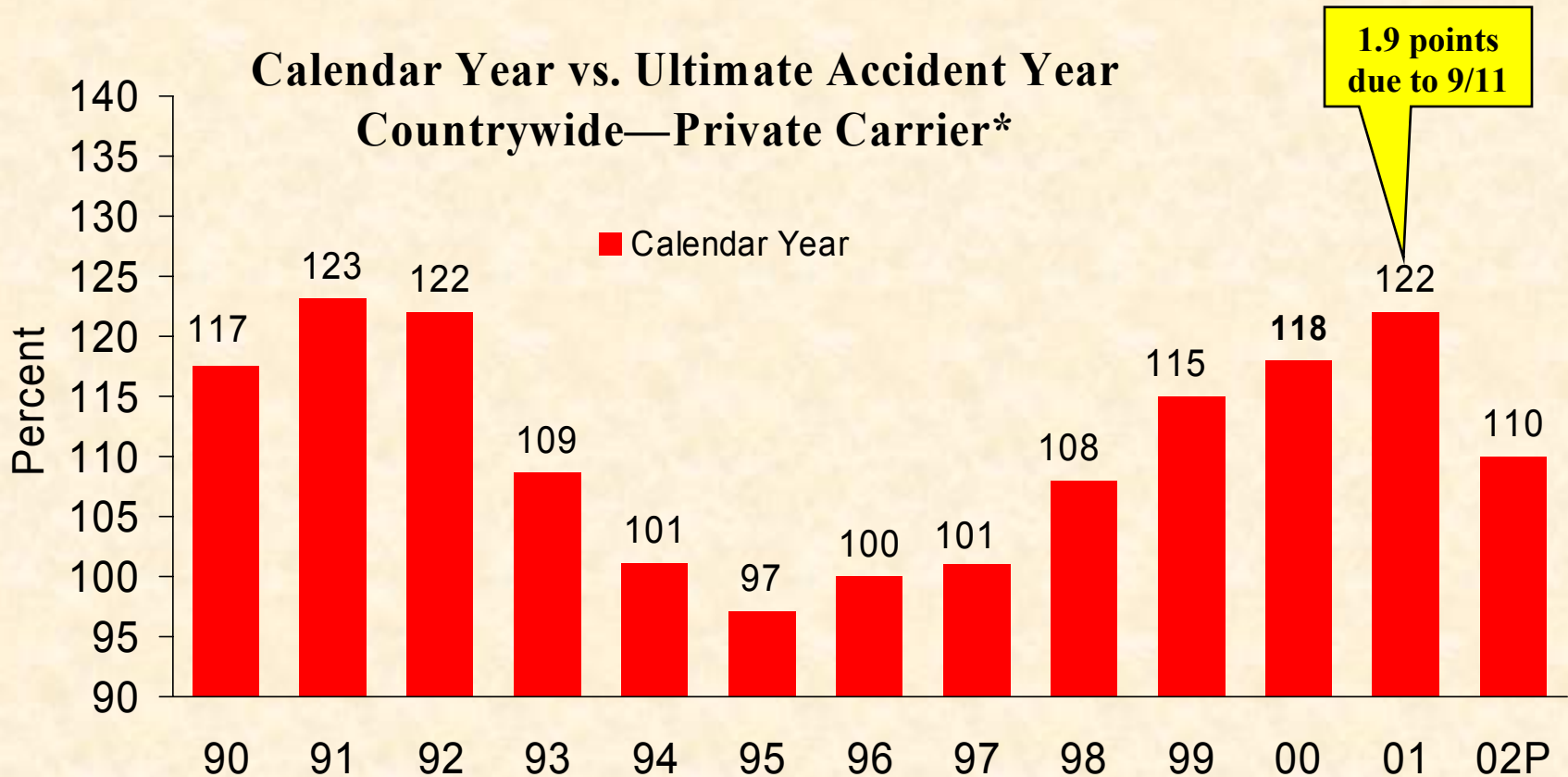


WORKERS COMP





WC Combined Ratios



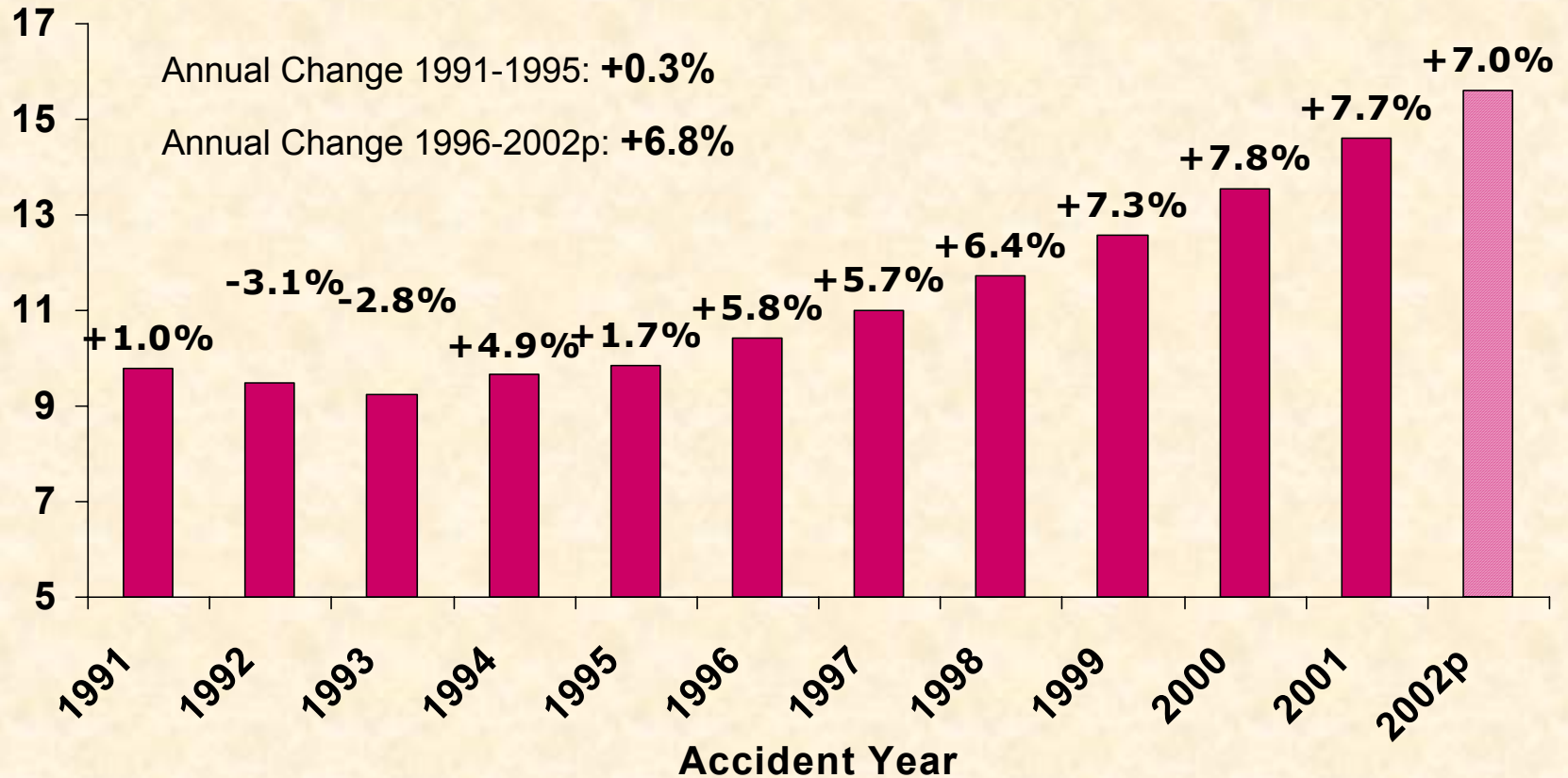
*Includes dividends to policyholders
Accident year is developed to ultimate;
2002 estimate from NCCI.

Source: A.M. Best, NCCI



WC Indemnity Claim Costs Has Accelerated Since 1995

Indemnity Claim Cost (000s)



Based on data through 12/31/2001, developed to ultimate, as of 12/2/2002; 2002 data are preliminary.

Based on the states where NCCI provides ratemaking services

Excludes the effects of deductible policies

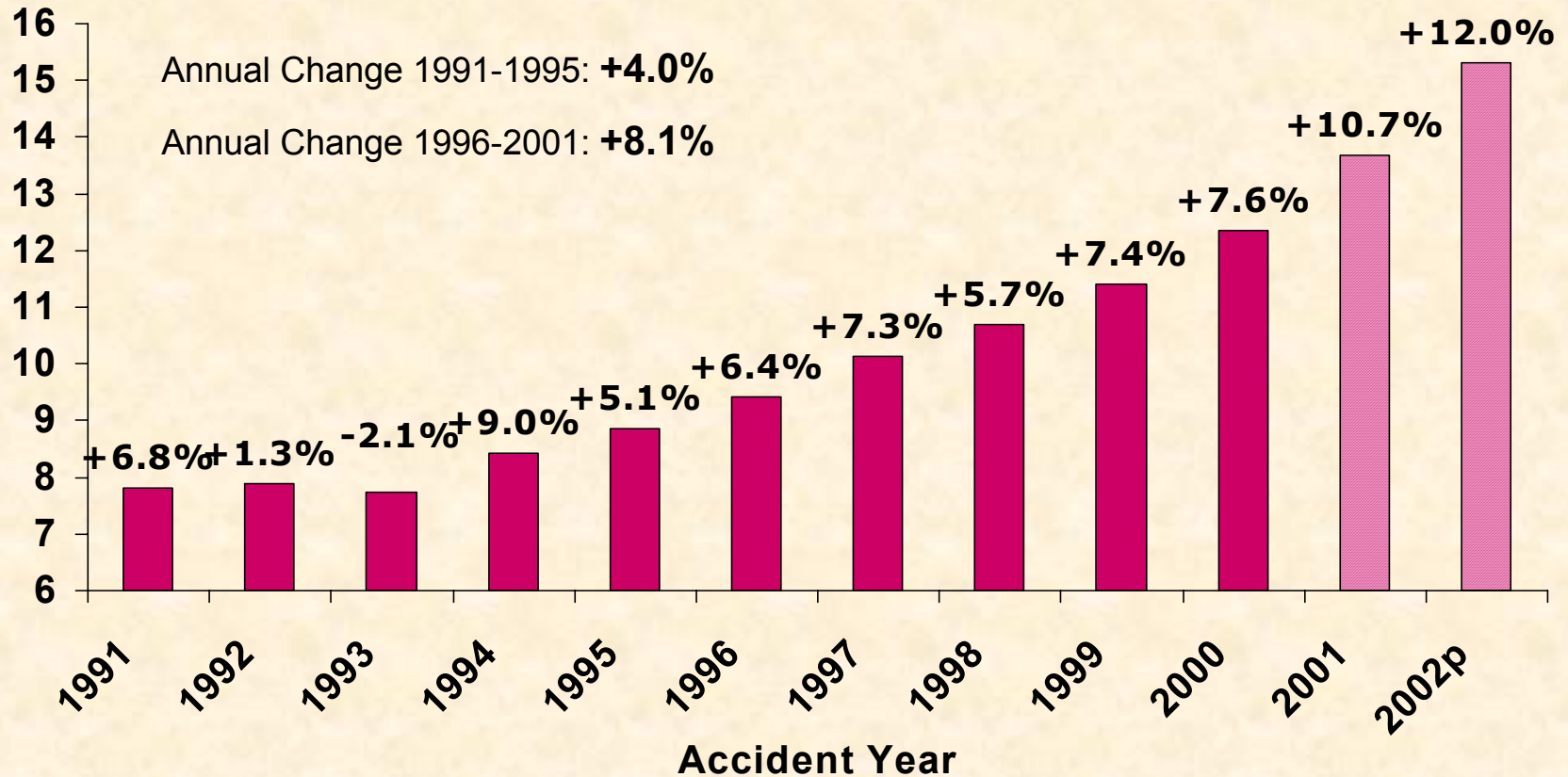
Source: NCCI



WC Medical Claim Costs

Accelerating Too

Medical Claim Cost (000s)



Based on data through 12/31/2001, developed to ultimate, as of 12/2/2002

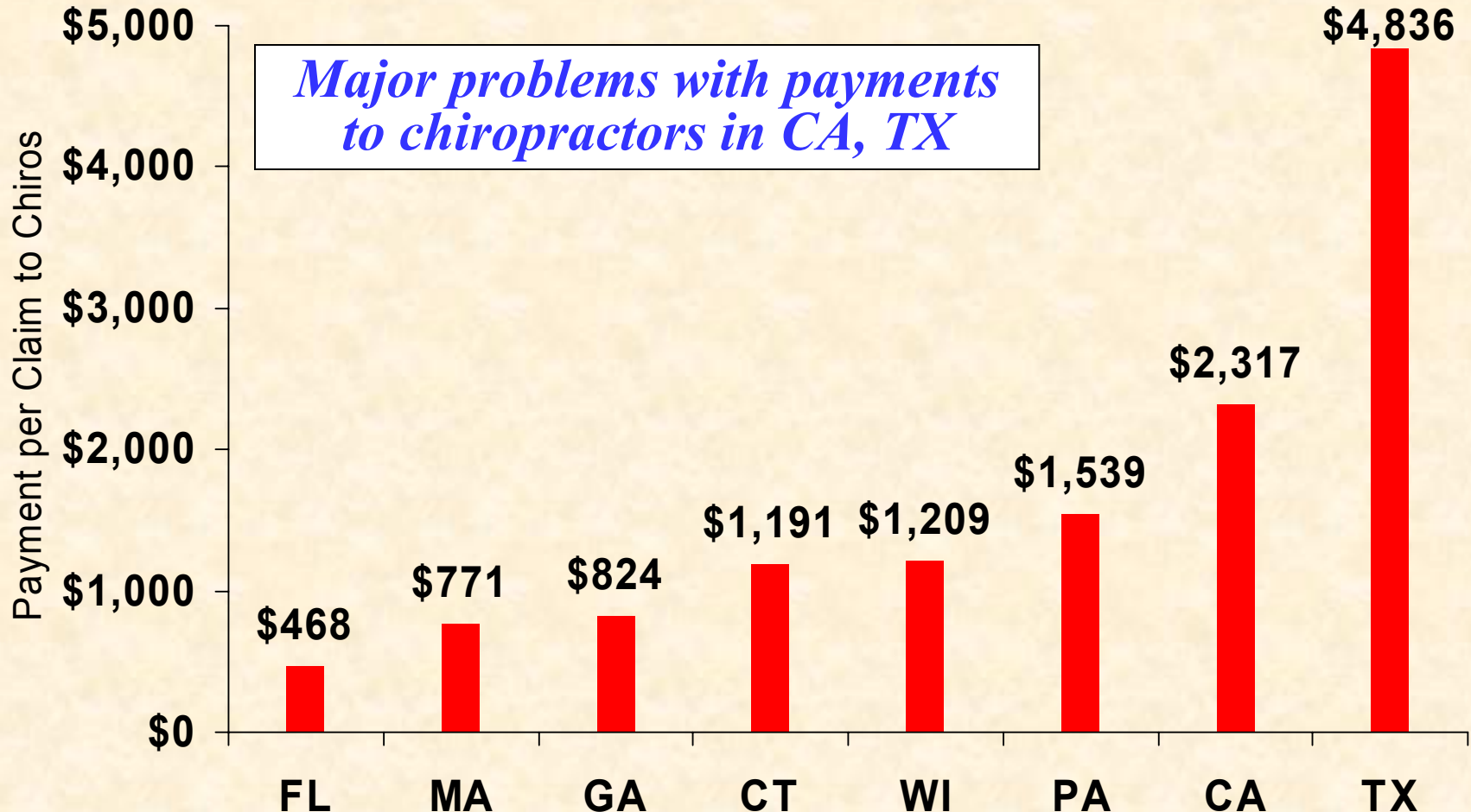
Based on the states where NCCI provides ratemaking services

Excludes the effects of deductible policies

Source: NCCI



Average Payment per Claim for Chiro. Visits



Source Eccleston, Wang, Watson and Zhao (2000) in *Targeting More Costly Care: Area Variation in Texas Medical Costs and Utilization*, Workers Compensation Research Institute (2002).



Schwartzenegger's Solution to California's Chiro Problem

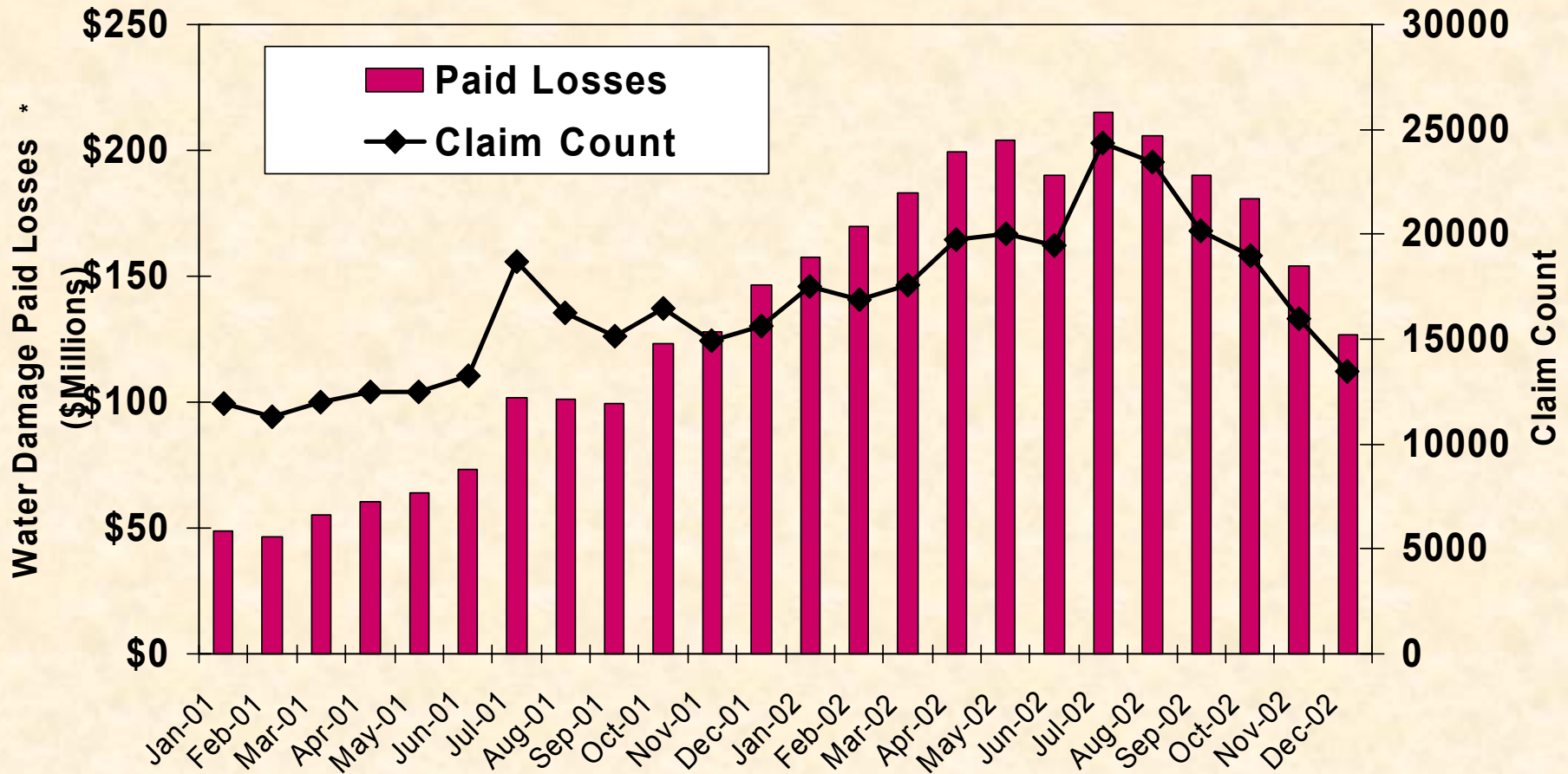


MOLD





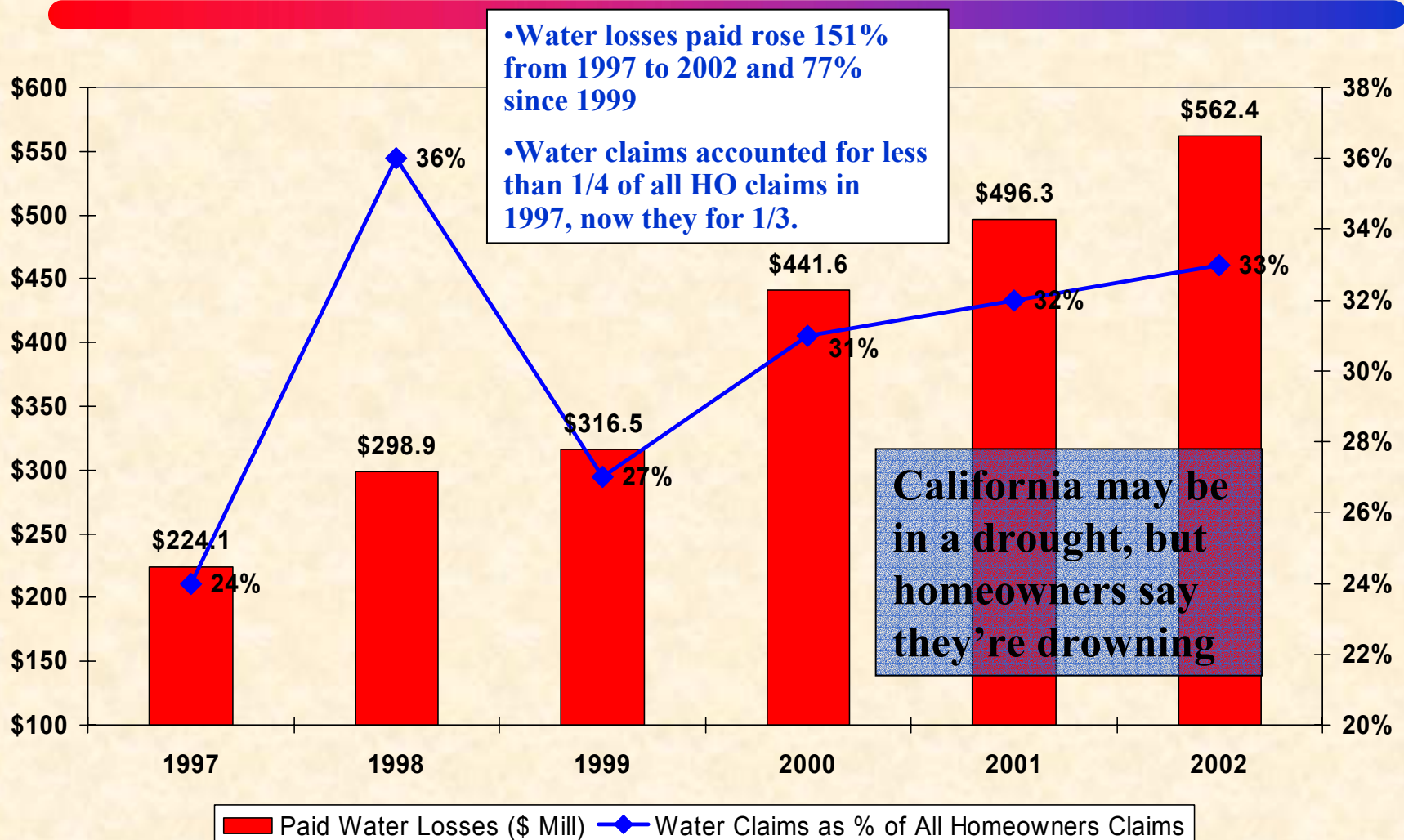
Texas: Mold Losses/Claims Are Finally Moderating*



* 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.



California: Surging Water Claim Frequency and Costs: Symptom of Growing Mold Problem





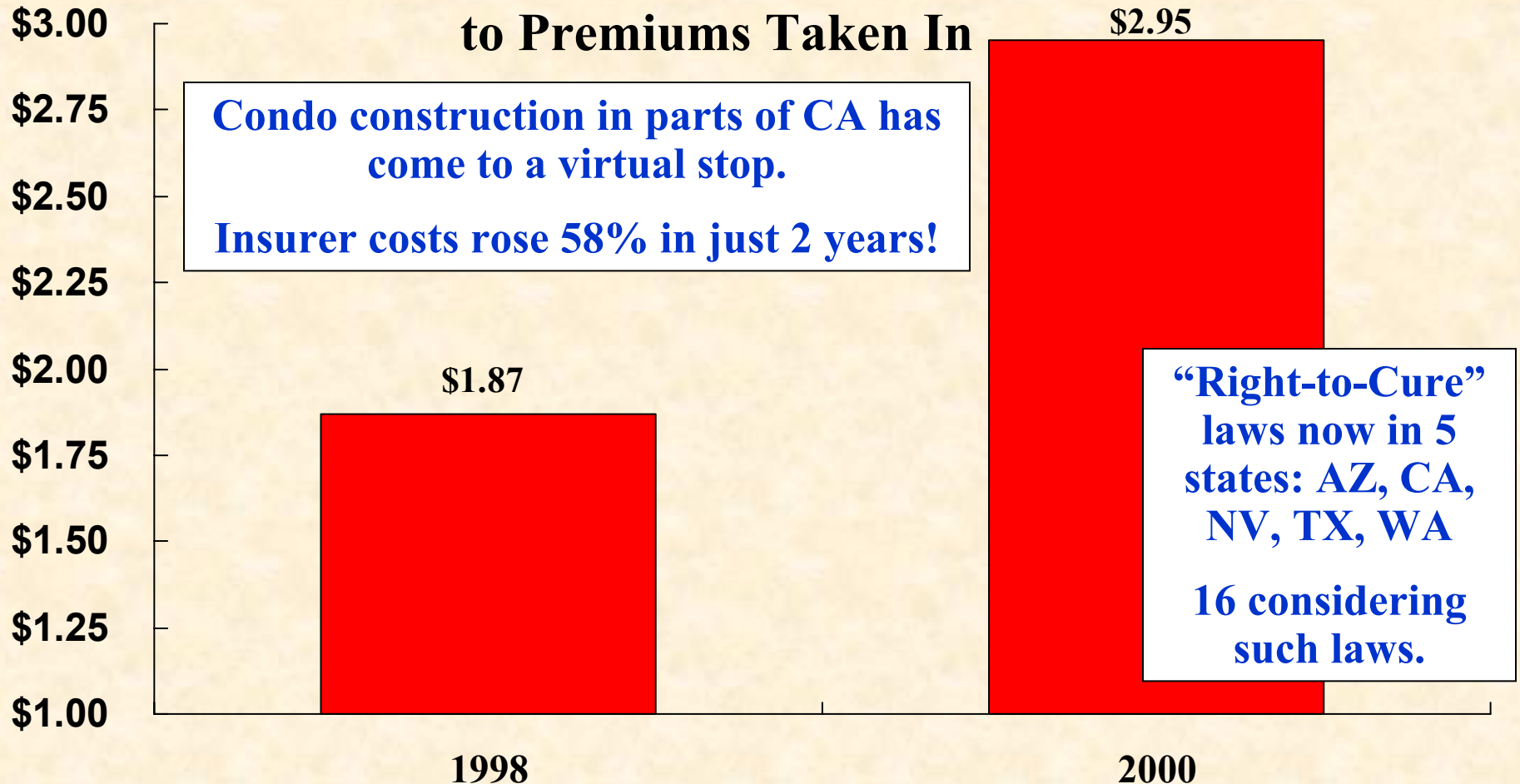
Where are the Next Battlefields for Mold?

- Homeowners issue probably crested in 2002
- Migration to commercial area affects many lines:
 - Commercial Property Commercial Liability
 - Products Liability Builders Risk/Construction Defects
 - Workers Comp...
- Hot Spots:
 - Apartments/Condos/Co-ops Office Structures (e.g., IBM)
 - Schools Municipal Buildings
 - Cars? (GM case in NC)
- Trend toward class actions since science doesn't support massive individual non-economic damages
 - Much more lucrative for trial lawyers to form class

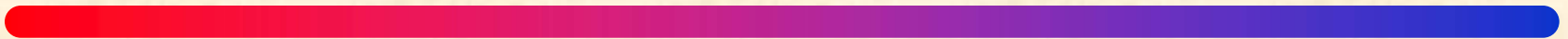


Construction Defect Litigation Destroying CA Condo Market

Ratio of Losses Paid Out to Premiums Taken In

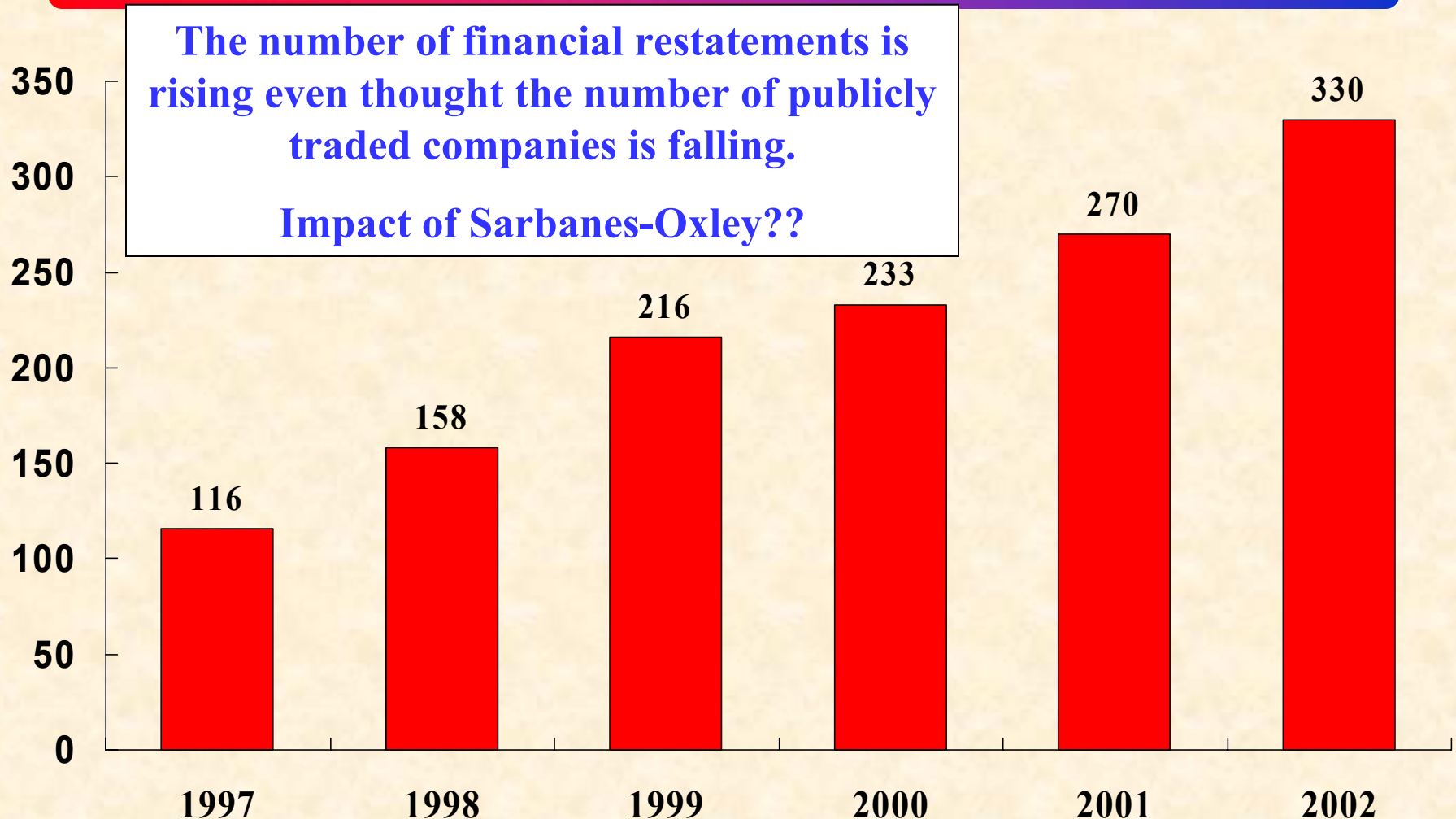


CORPORATE GOVERNANCE



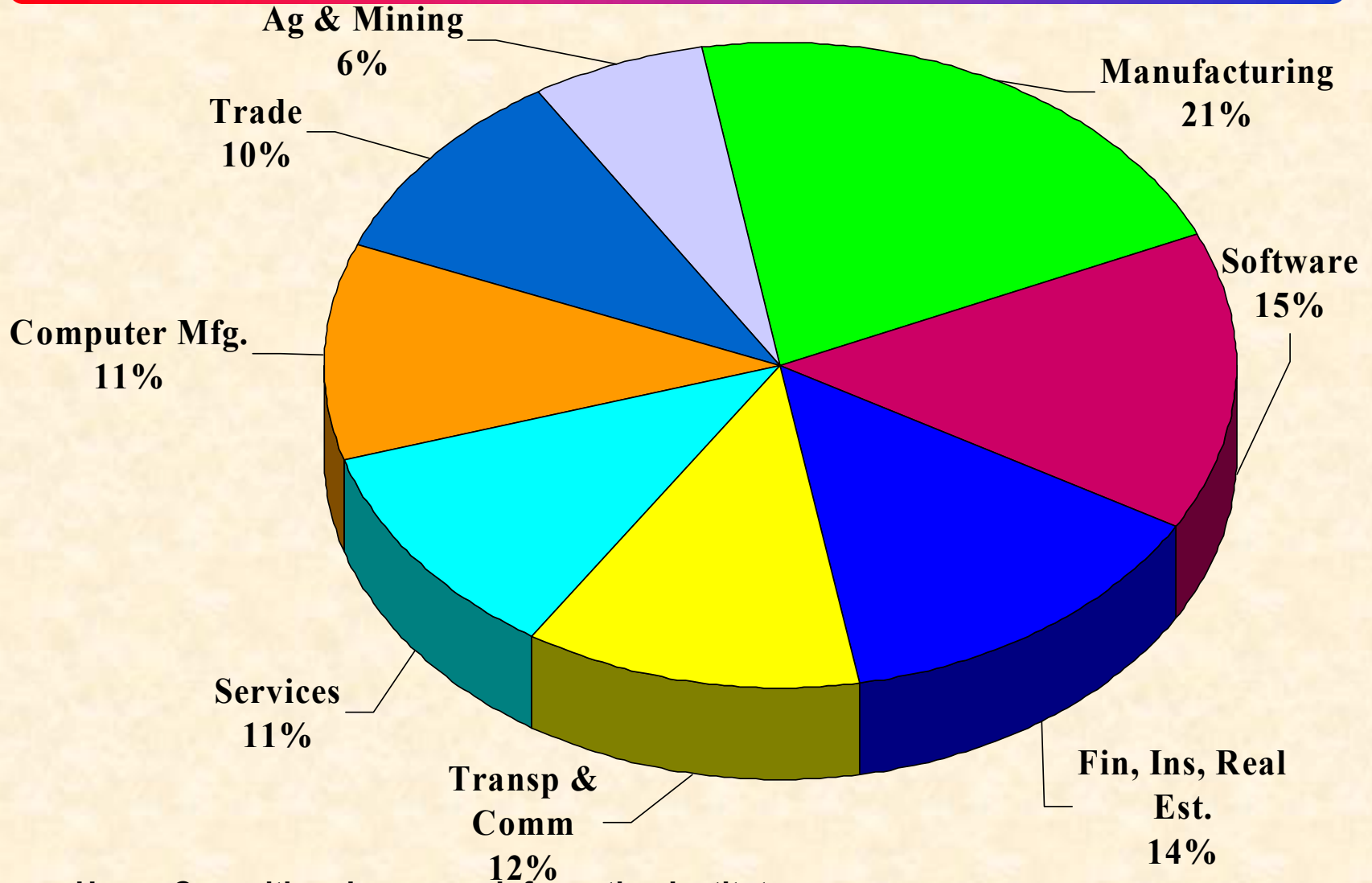


Financial Restatements Filed





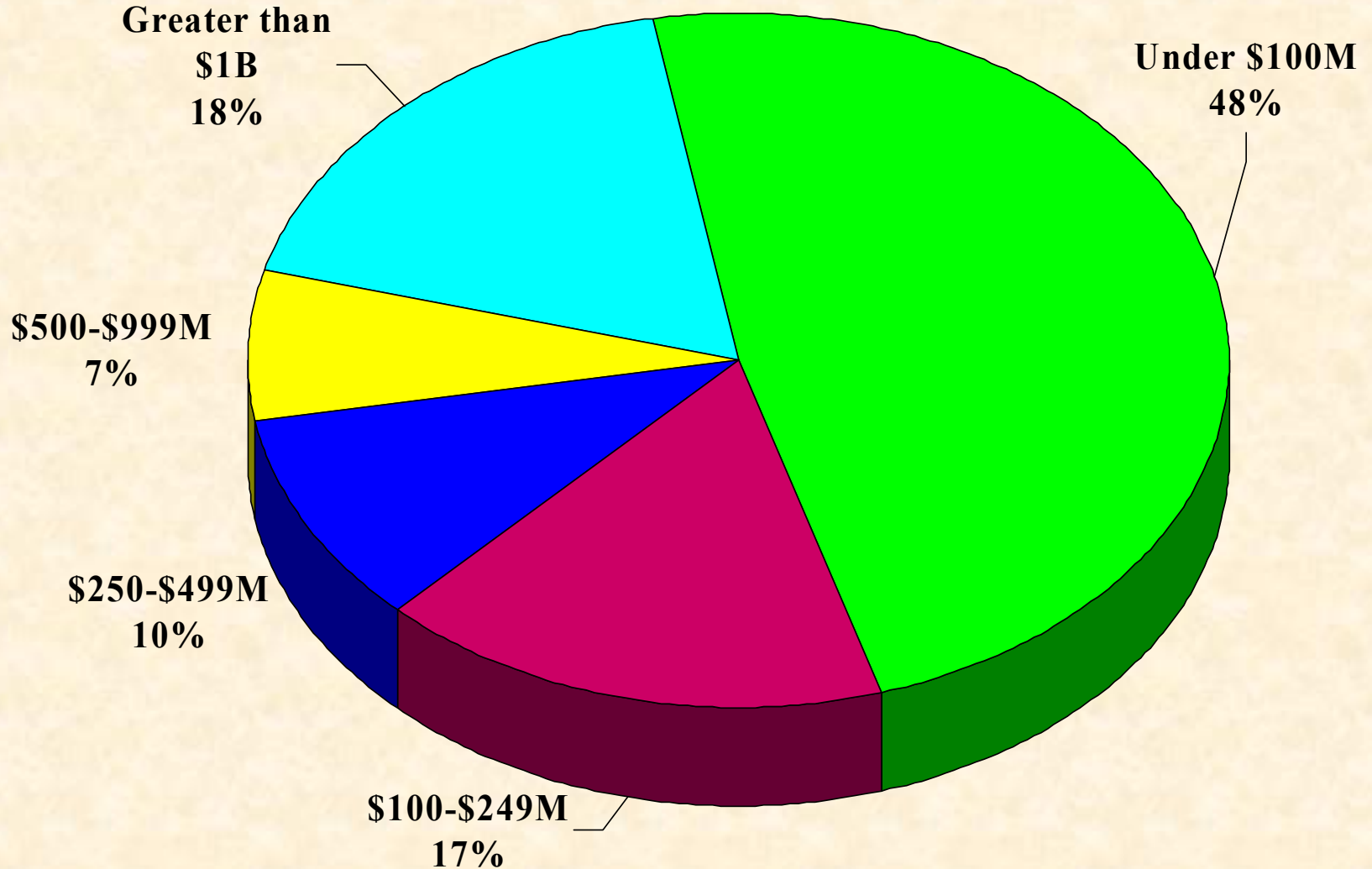
Financial Restatements by Industry (1987-2002)



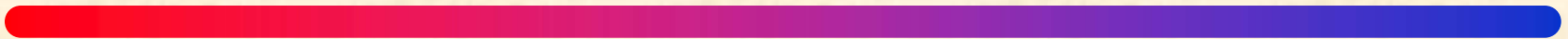
Source: Huron Consulting; Insurance Information Institute



Financial Restatements by Revenue Size (1998-2002)



OBESITY/ FAST FOOD





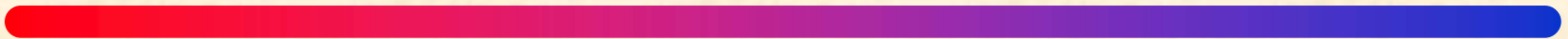
Fast Food/Junk Science: Edible Asbestos?

- Are the food service & manufacturing industry's vulnerable to suits over obesity?
- McDonald's sued in late 2002 over allegations that their food makes people fat
- Kraft sued earlier this year over trans fats in Oreo cookies



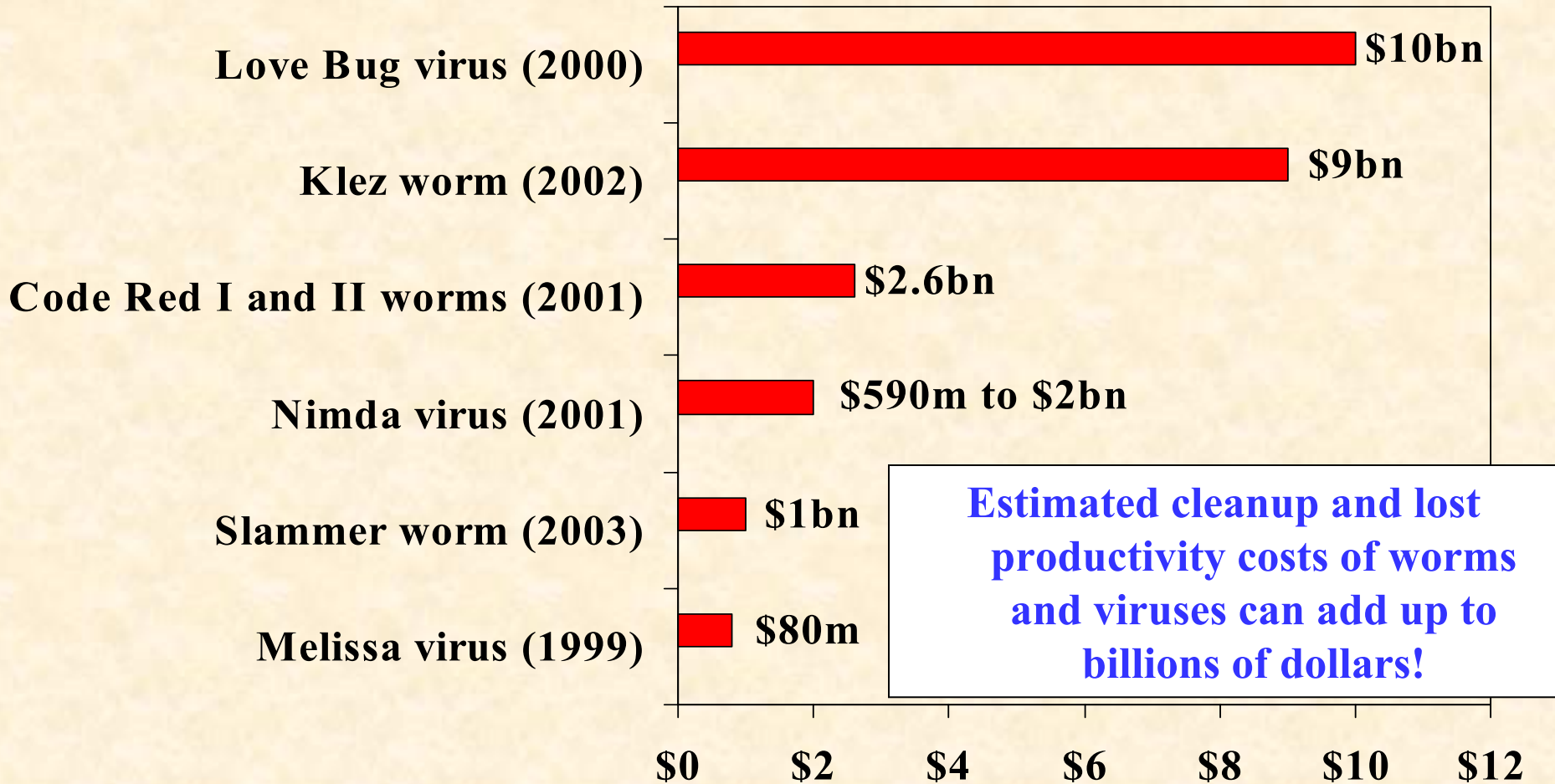
UPDATE: TRANS FAT AND OREO® COOKIES

CYBER RISK



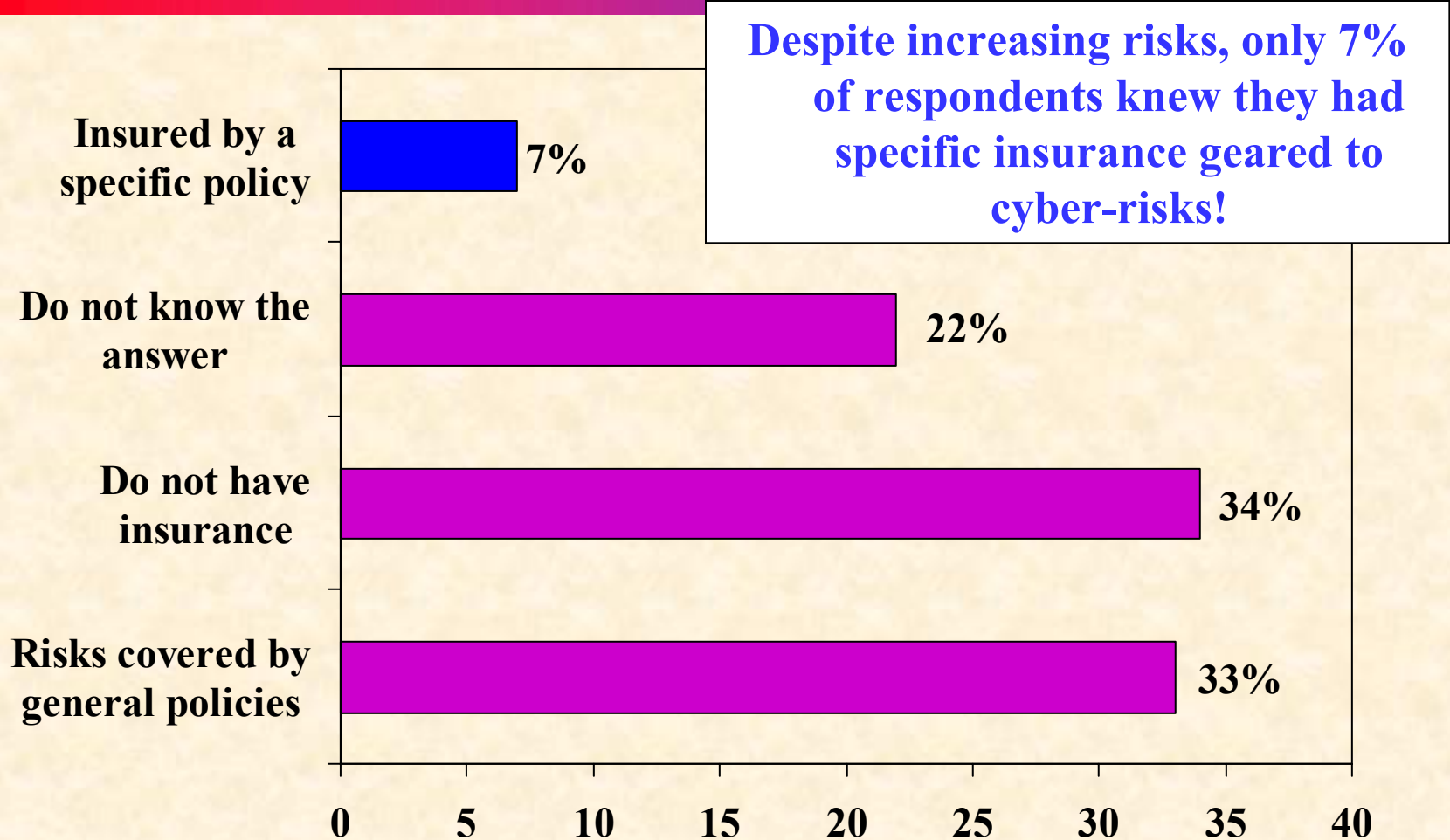


The Cost of Worms & Viruses *(\$ Billions)*



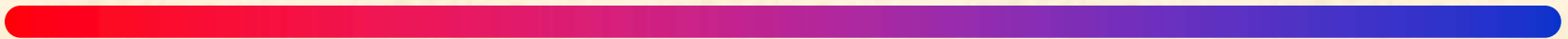


Cyber-Risk Gaps in Insurance Coverage



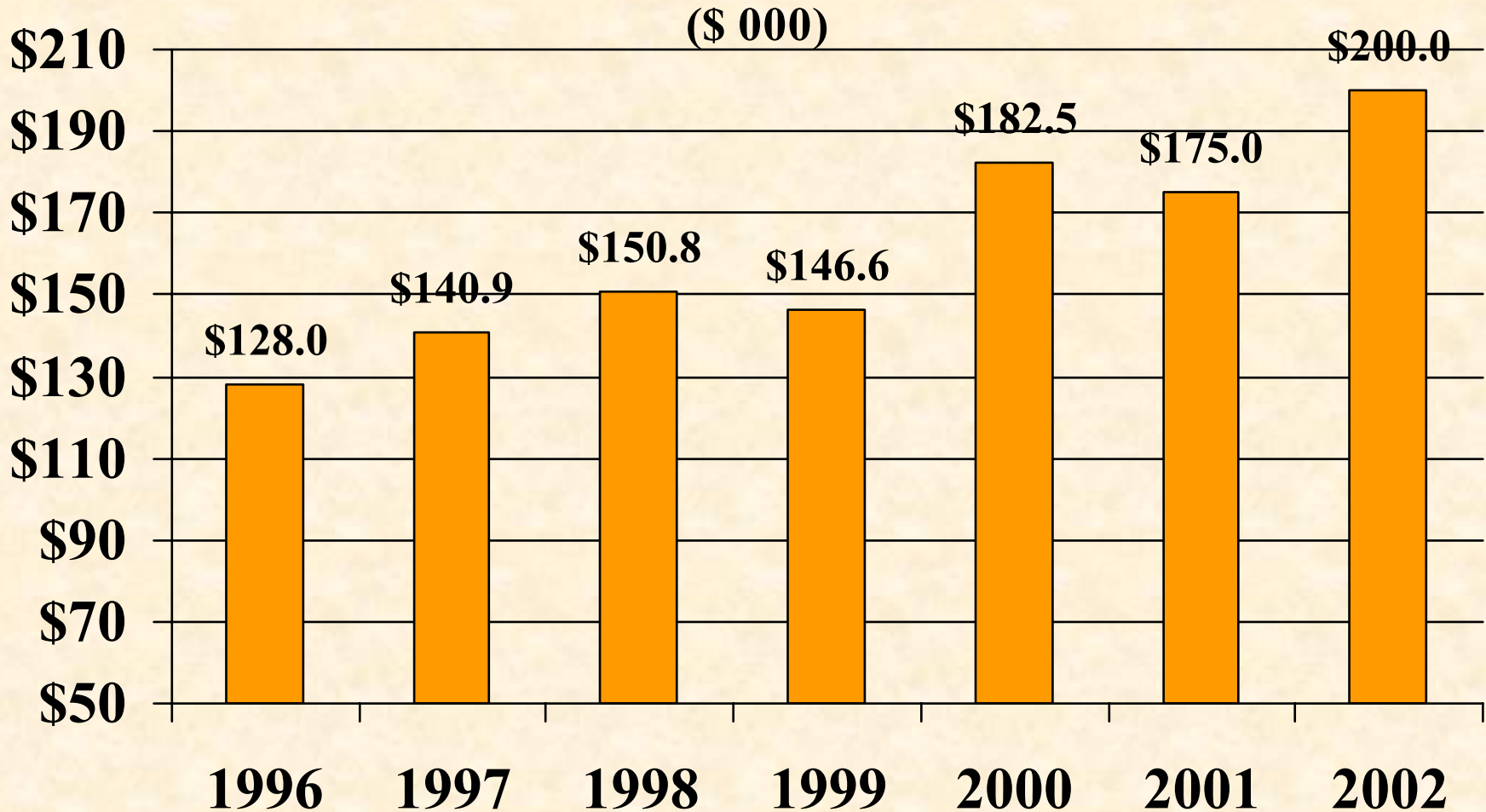
Source: Ernst & Young 2003 Global Information Security Survey of 1,400 organizations from 66 countries

EMPLOYMENT PRACTICES LIABILITY



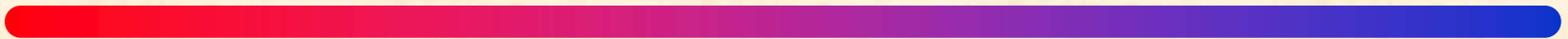


Employment Practices Liability: *Median Compensatory Award (\$000)*



Source: *Trends in Employment Practices Liability*, LRP Publications.

CONSTRUCTION DEFECTS





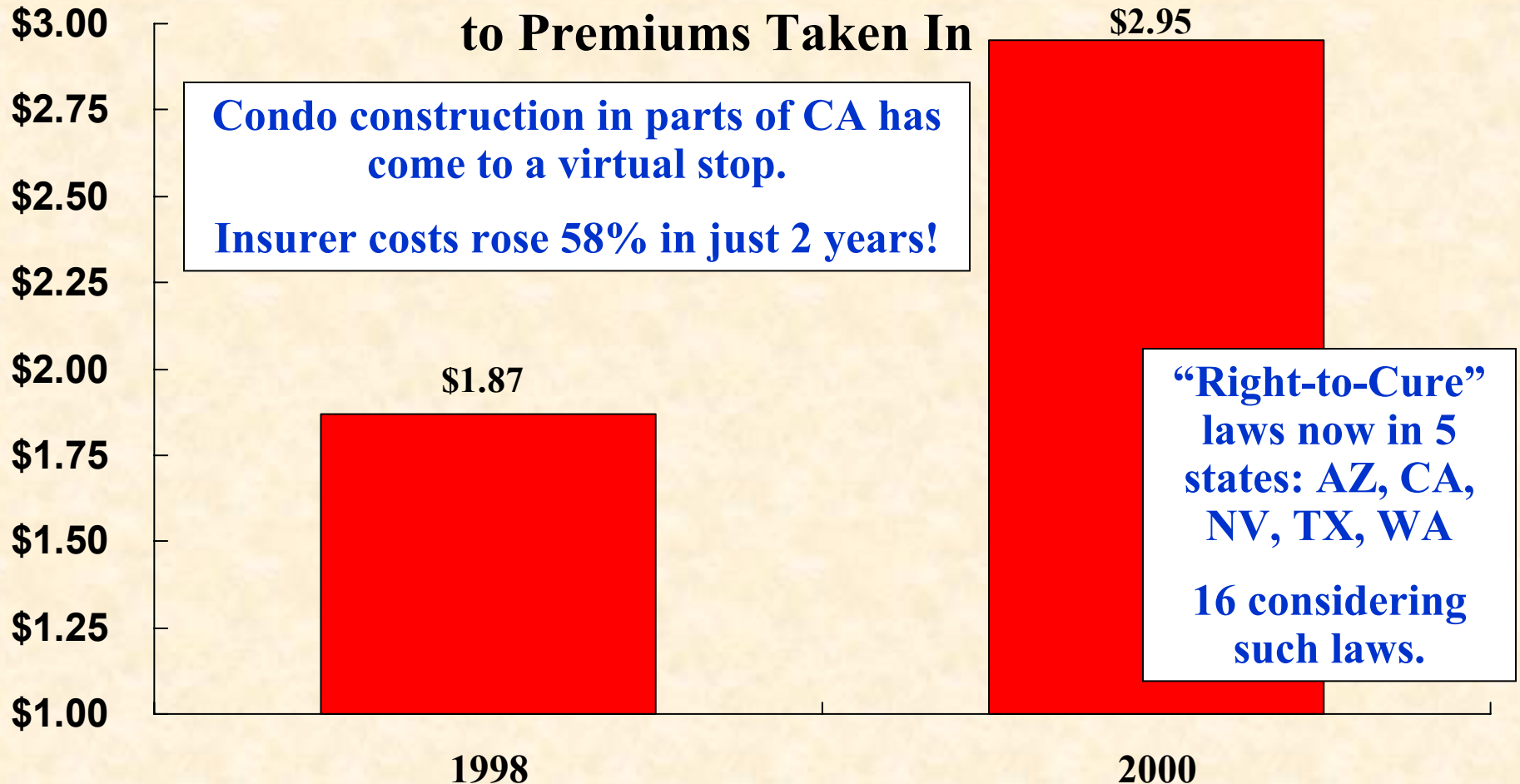
Construction Defect Problem

- **Growing number of lawsuits target:**
 - **Builders, Contractors, Developers, Sub-Contractors, Material Suppliers, Product Manufacturers, Architects & Engineers.**
- **Construction defect claims include:**
 - **Subsidence, collapse, cracks in walls & foundations.**
 - **Leaking roofs, windows, doors, foundations.**
 - **Dry rot of wood or other building materials, pest infestations.**
 - **Mold, code violations, improper specification of building materials.**
- **Hotspots:**
 - **California, Nevada, Colorado, Texas, the Carolinas, Florida, New York.**



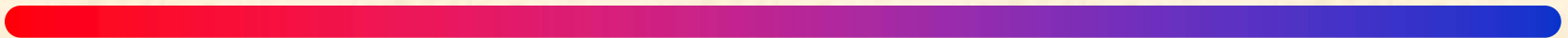
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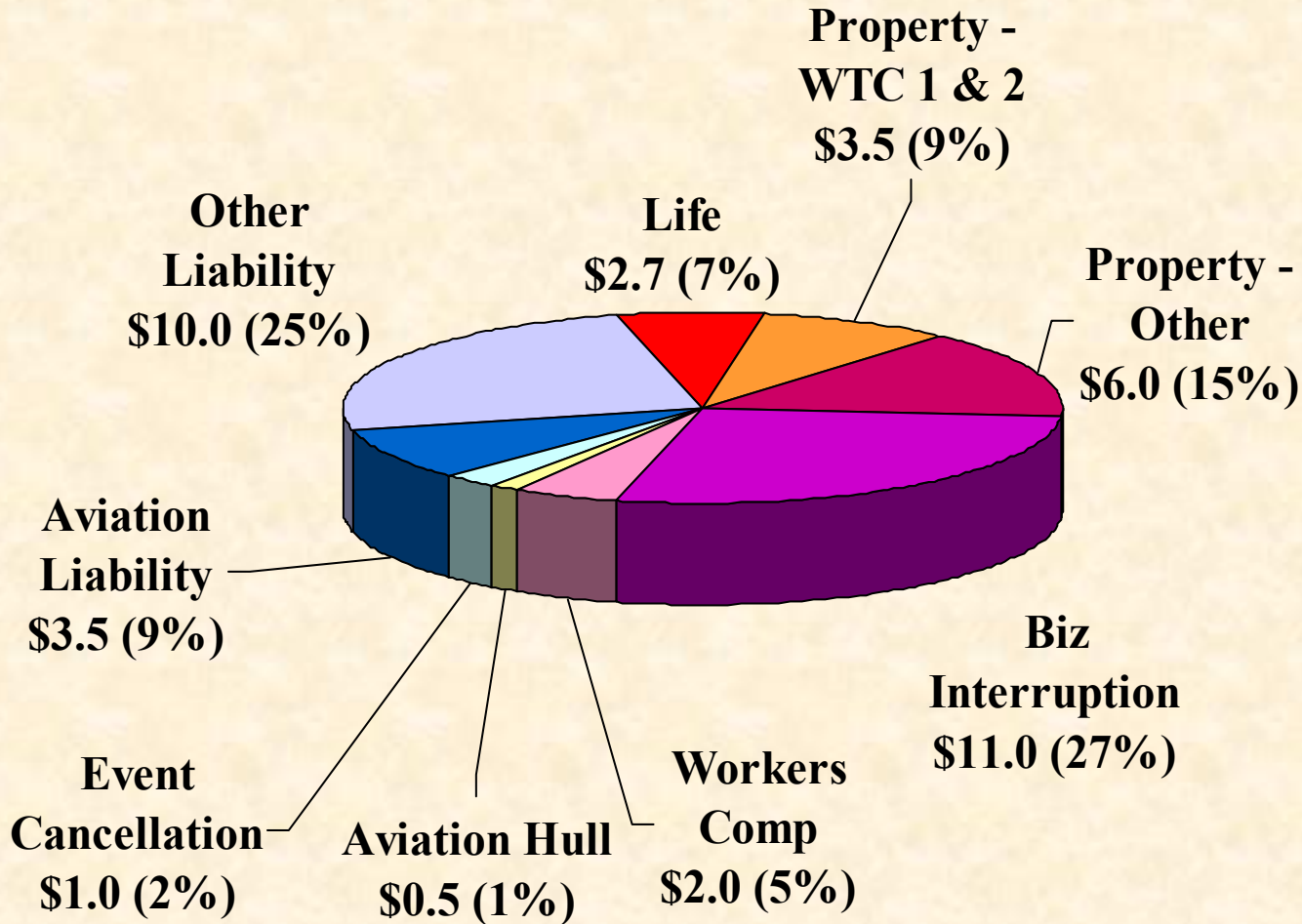
TERRORISM

▶	SEVERE
▶	HIGH
▶	ELEVATED
▶	GUARDED
▶	LOW





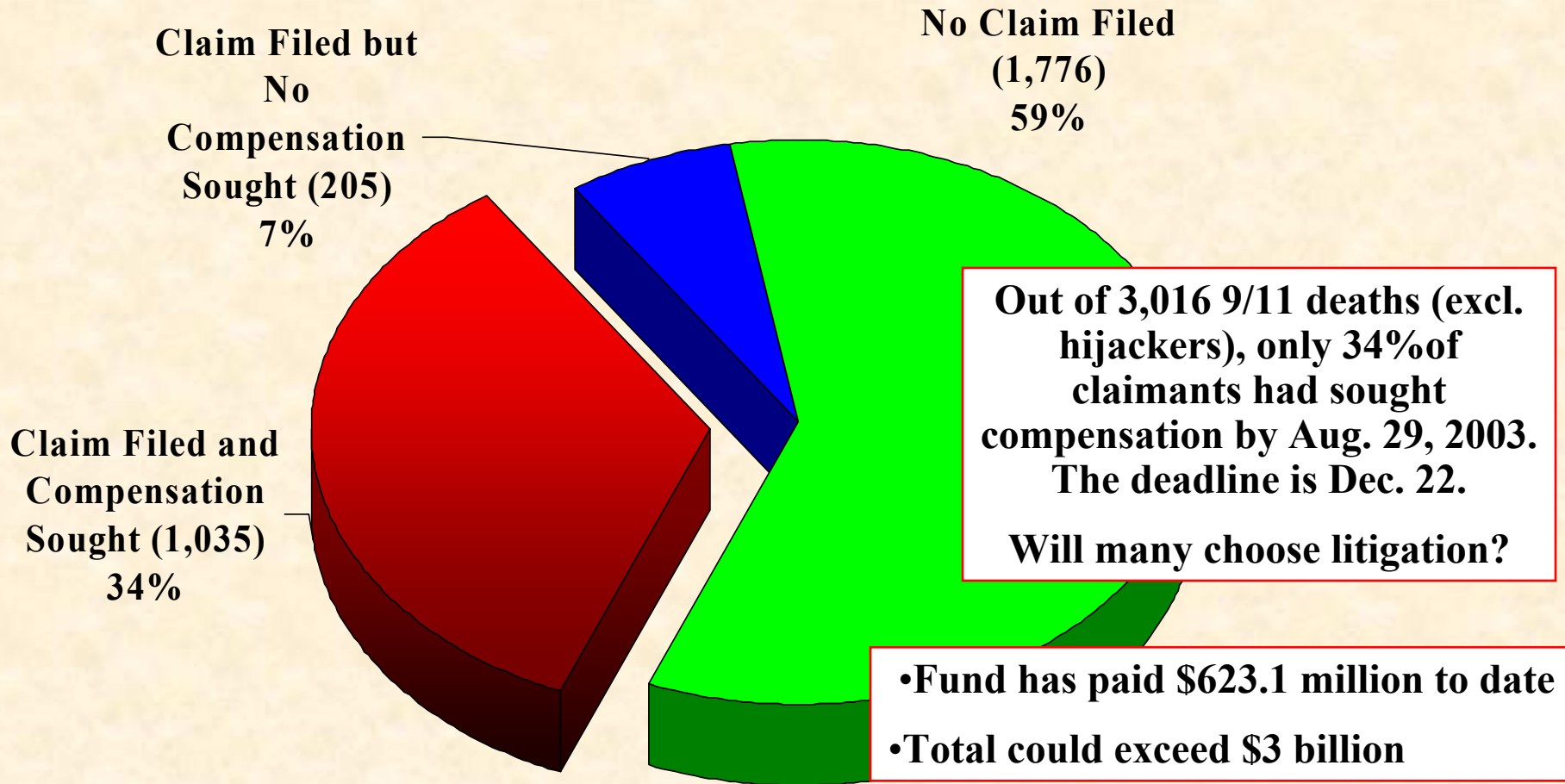
Terrorism: Sept. 11 Industry Loss Estimates (\$ Billions)



Consensus Insured Losses Estimate: \$40.2B



Status of 9/11 Death Claims (Through August 2003)

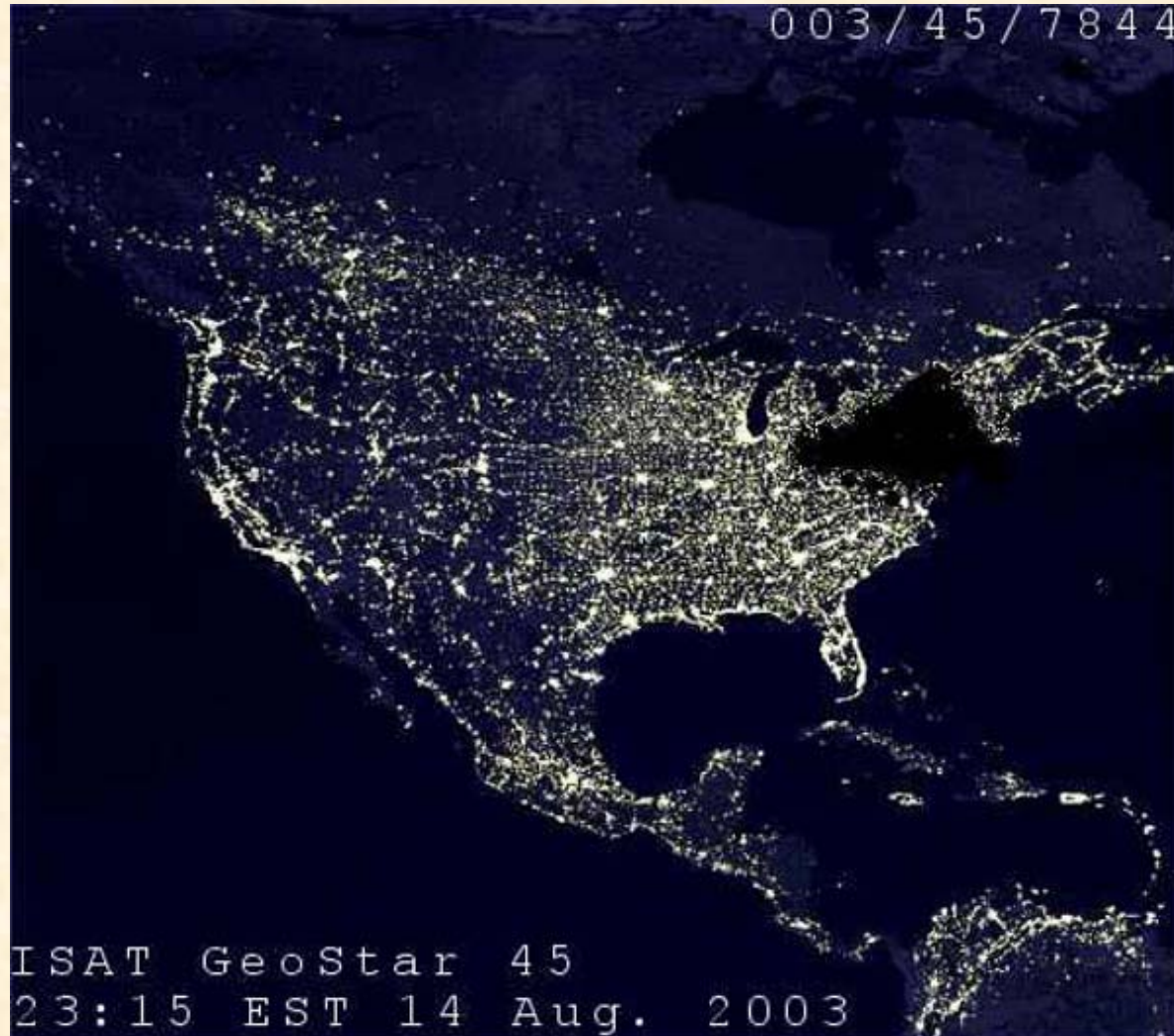


OTHER





Blackouts???

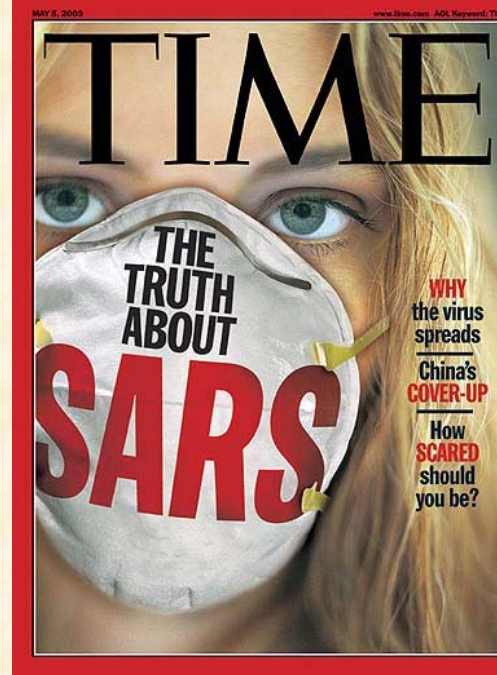




SARS: Limited P/C Insurance Industry Exposure

• Are there any potential SARS-related p/c insurance exposures?

- Workers comp? *Mostly health care workers*
- Event cancellation? *Fear of SARS insufficient, but legitimate claims possible*
- CGL? *Several courts have ruled that viruses/bacteria (e.g., E. Coli, Legionnaires' disease) not covered*
- EIL? *Court decisions + fact that at least half of EILs have "naturally occurring substance" exclusions preclude coverage.*





Summary

-
- **Profitability on the mend, but for how long?**
 - **Underwriting still needs improvement**
 - **Economic & Investment outlook uncertain**
 - **Tort system: A partial fix is in underway**
 - **Emerging Risks: No Shortage**
 - **Constant Challenge for Underwriters**



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