Financial Crisis, Economic Stimulus & the Future of the P/C Insurance Industry

Trends, Challenges & Opportunities

Independent Insurance Agents of Westchester County
Education Day
Tarrytown, NY
http://www.iii.org/media/presentations/westchester/
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Robert P. Hartwig, Ph.D., CPCU, President
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: (212) 346-5520 ♦ bobh@iii.org ♦ www.iii.org

Presentation Outline

- **Financial Crisis & The Weakening Economy: Insurance Impacts for the P/C Insurance Industry**
  - **Recession, Growth & Insurance**
- **Economic Stimulus Package**
  - **Impacts & Implications for P/C Insurers**
- **Financial Strength & Ratings**
- **P/C Insurance Industry Overview & Outlook**
  - **Profitability**
  - **Premium Growth**
  - **Underwriting Performance**
  - **Financial Market Impacts**
- **Capital & Capacity**
- **Regulatory Response to Crisis**
  - **Emerging Blueprint of Regulatory Overhaul**

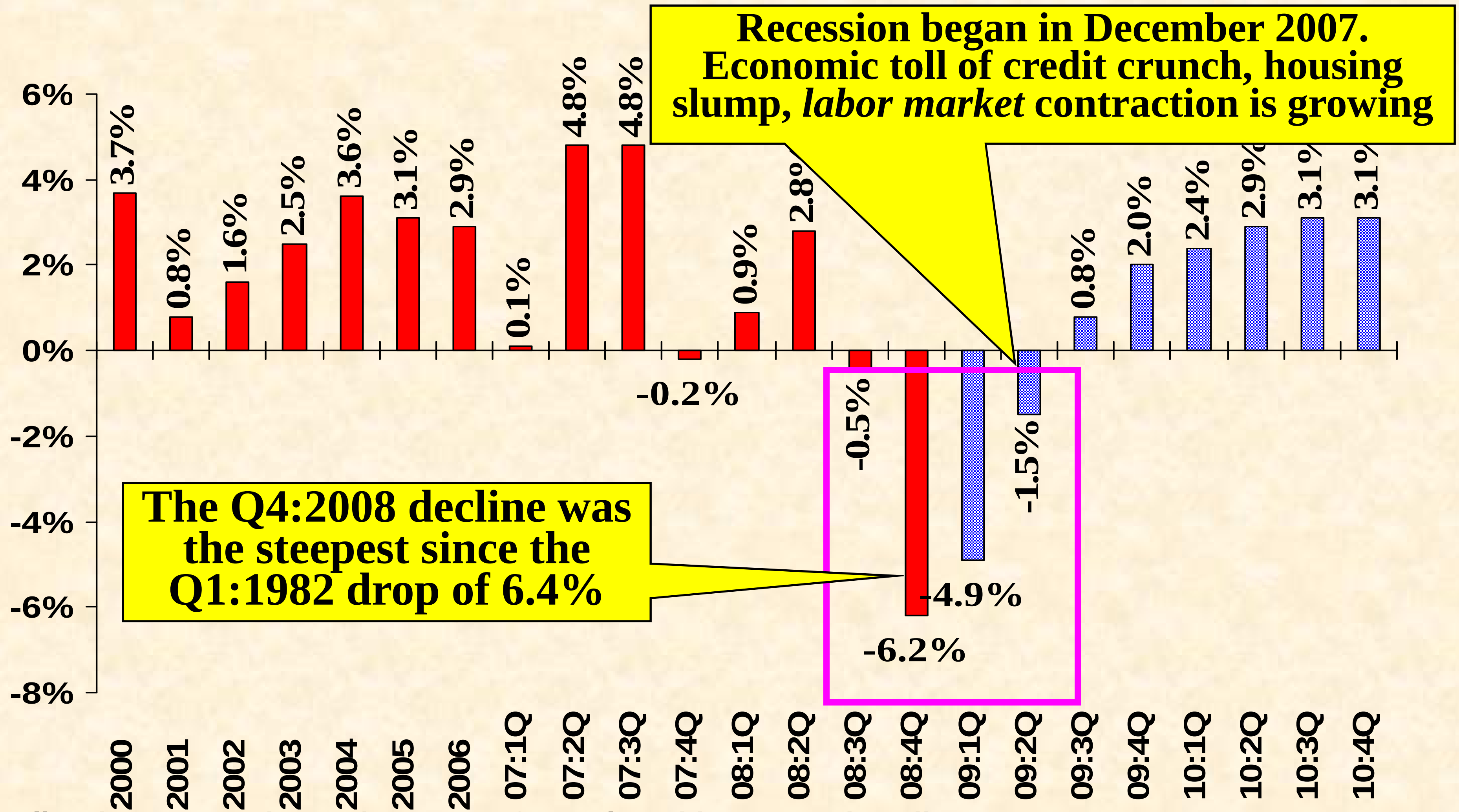
Q & A

THE ECONOMIC STORM

What a Weakening Economy and Financial Crisis Mean for the Insurance Industry

Exposure & Claim Cost Effects

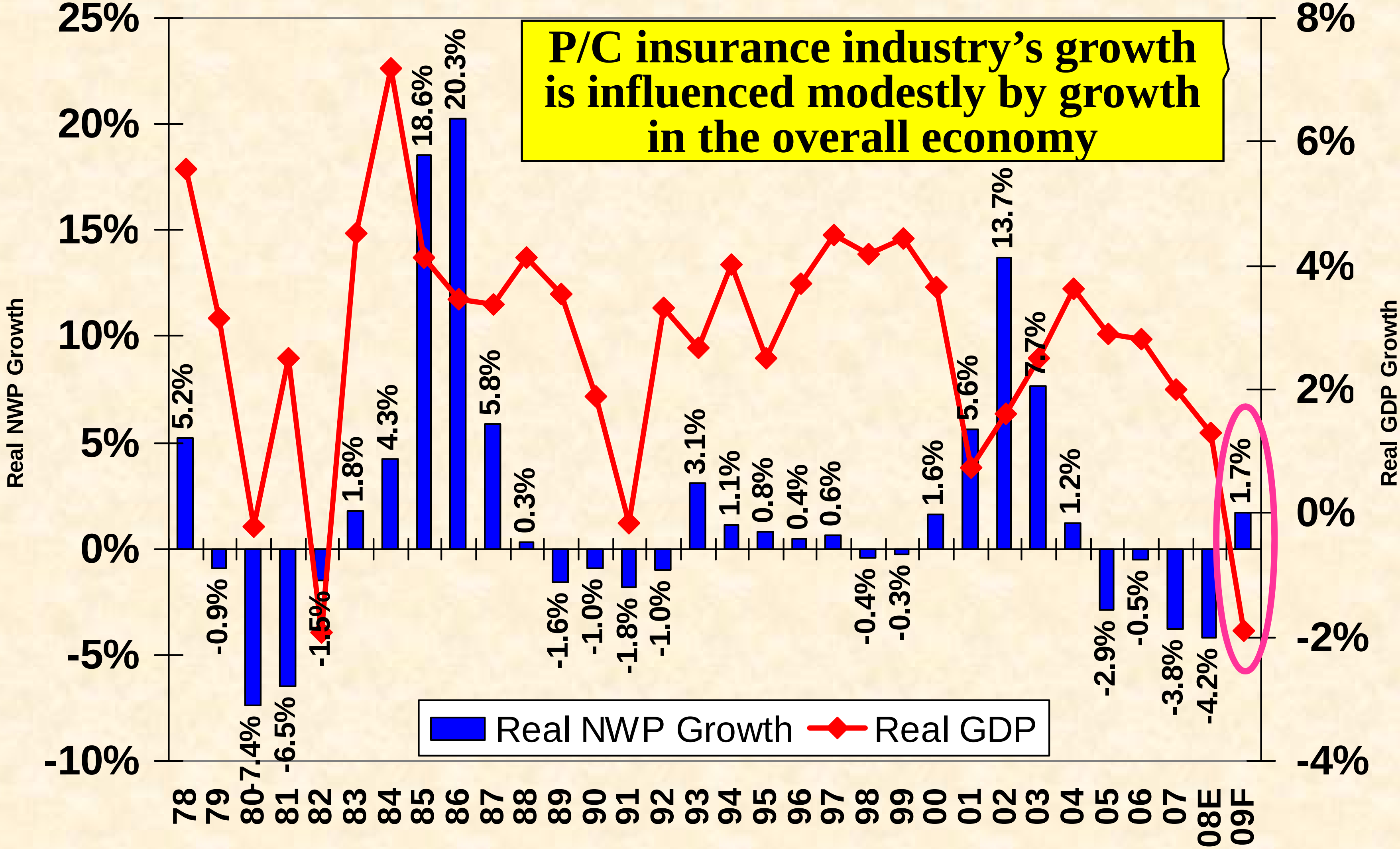
Real GDP Growth*



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

Source: US Department of Commerce, Blue Economic Indicators 2/09; Insurance Information Institute.

Real GDP Growth vs. Real P/C Premium Growth: Modest Association



Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 2/09; Insurance Information Inst.

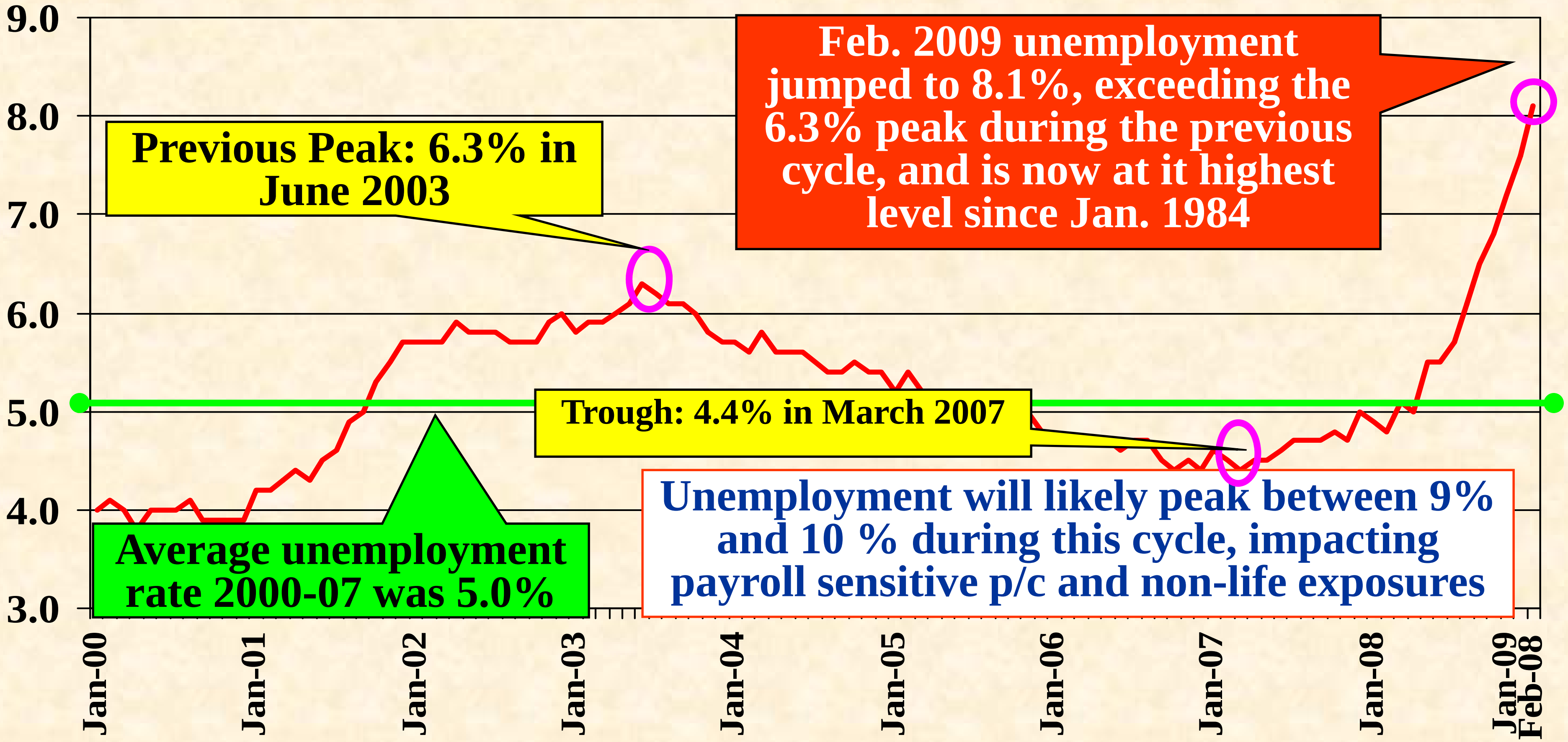
Length of US Recessions, 1929-Present*

* As of March 2009

Sources: National Bureau of Economic Research; Insurance Information Institute.

Unemployment Rate: On the Rise

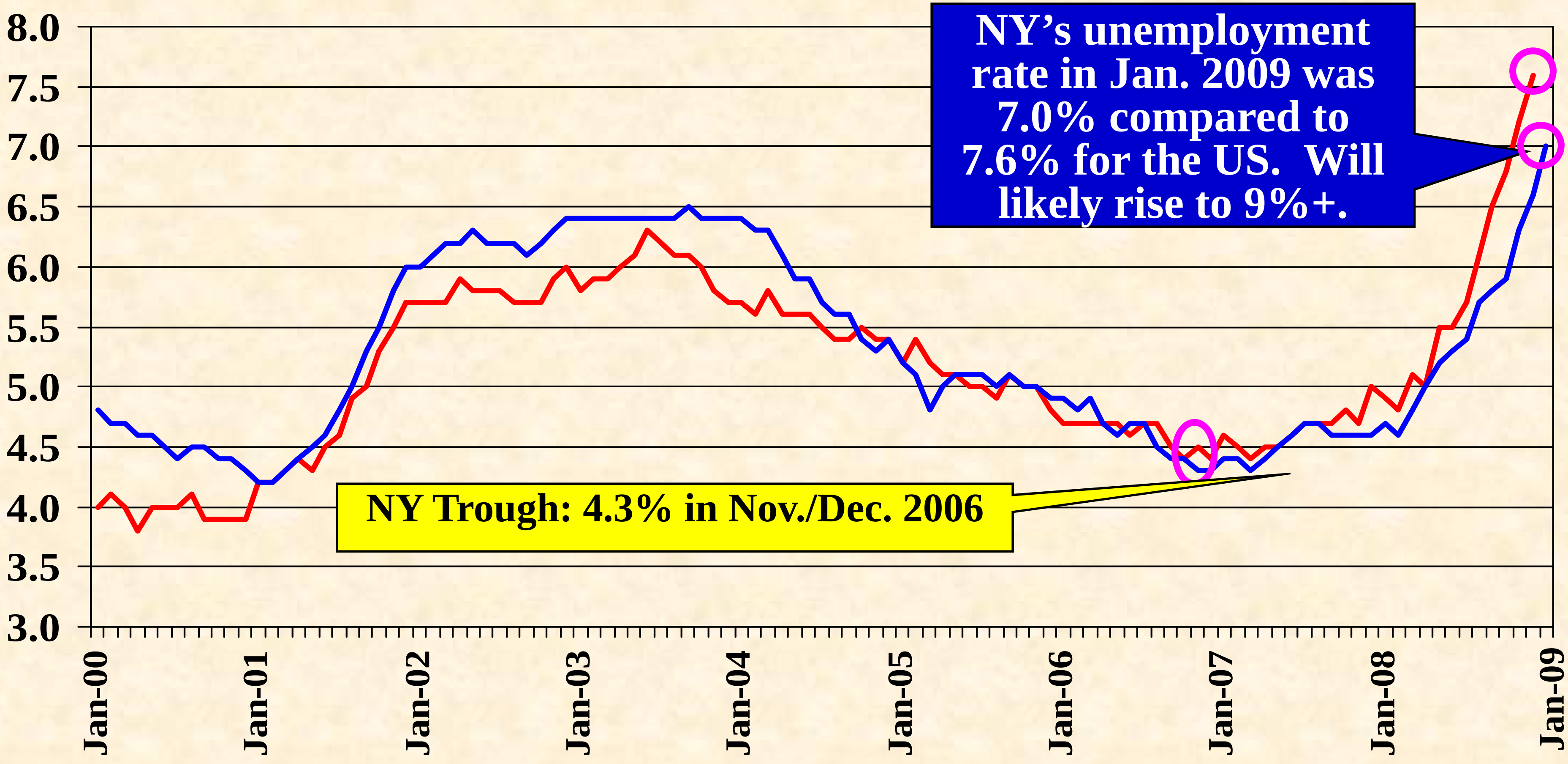
January 2000 through February 2009



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

Unemployment Rate: US vs. New York State

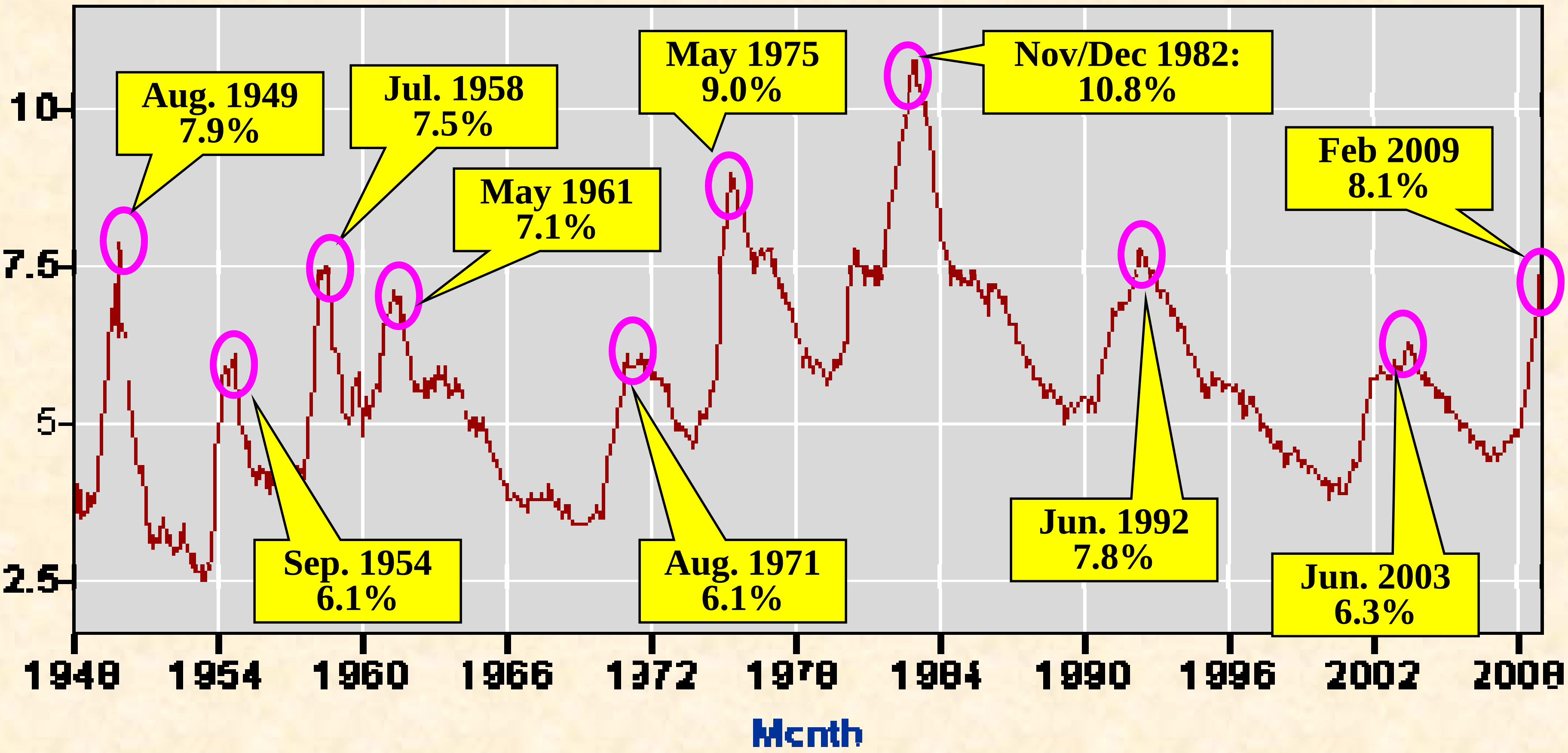
January 2000 through January 2009



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

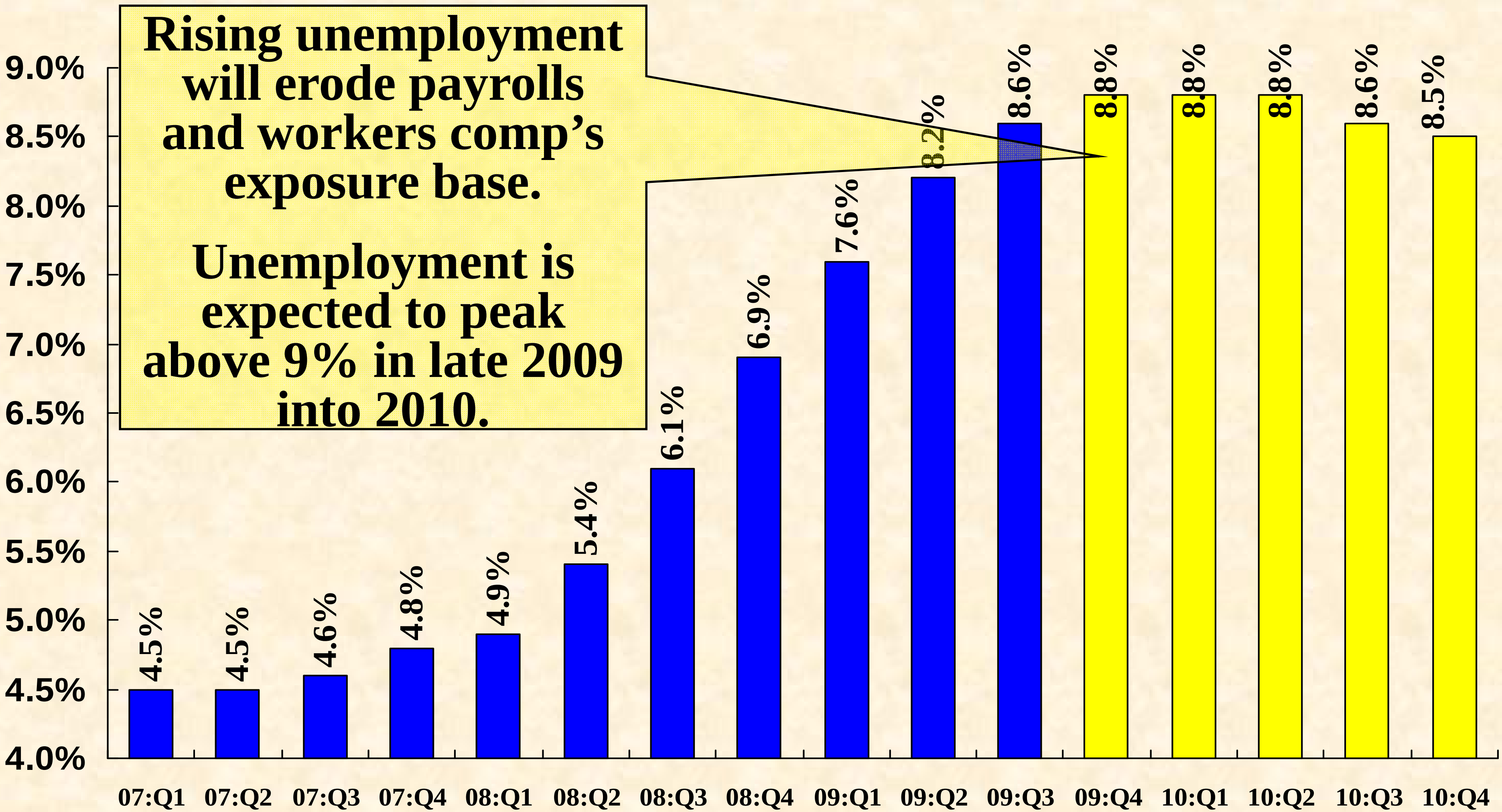
US Unemployment Rate: A Volatile History

January 1948 through February 2009



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

U.S. Unemployment Rate, (2007:Q1 to 2010:Q4F)*

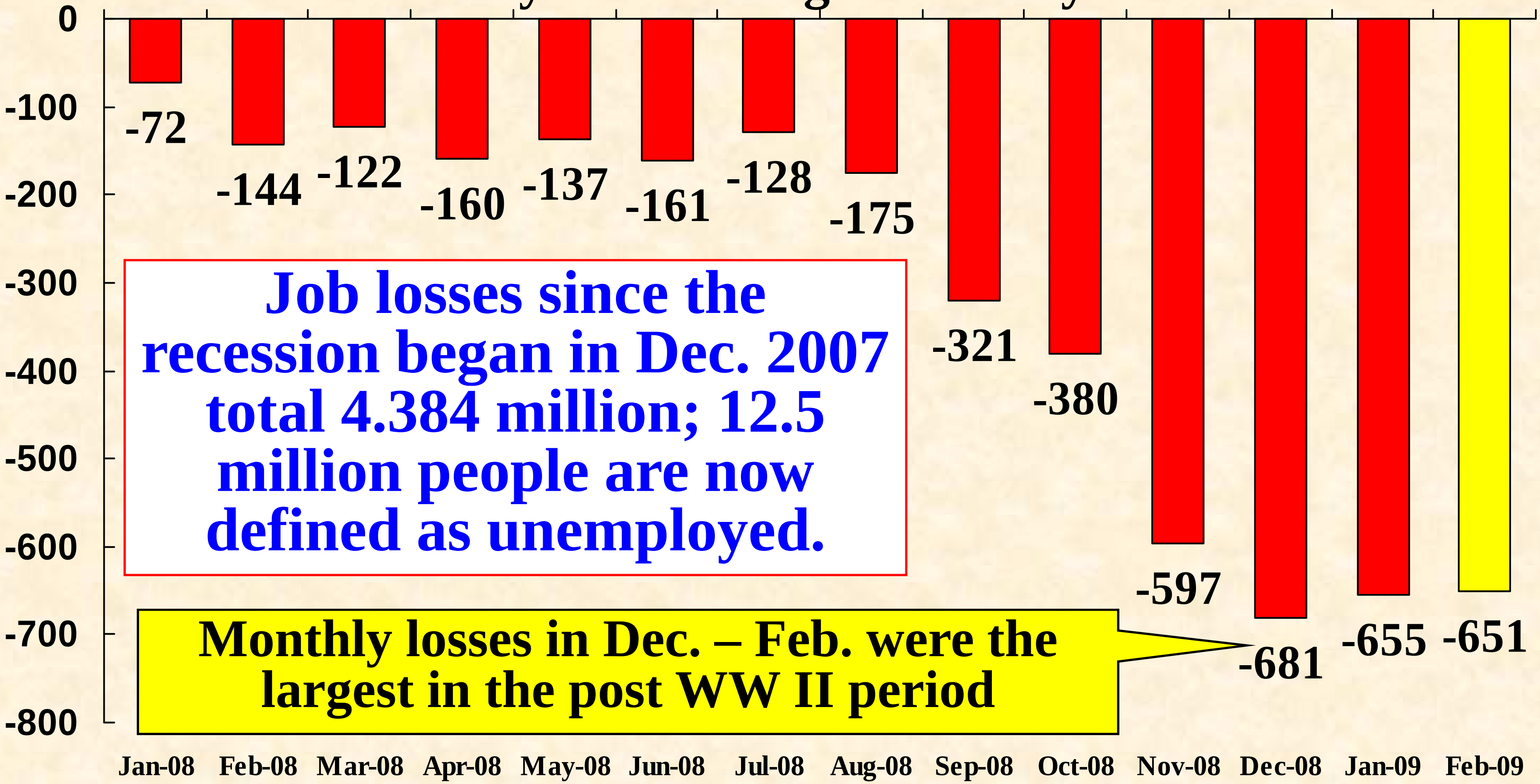


* Blue bars are actual; Yellow bars are forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (2/09); Insurance Info. Inst.

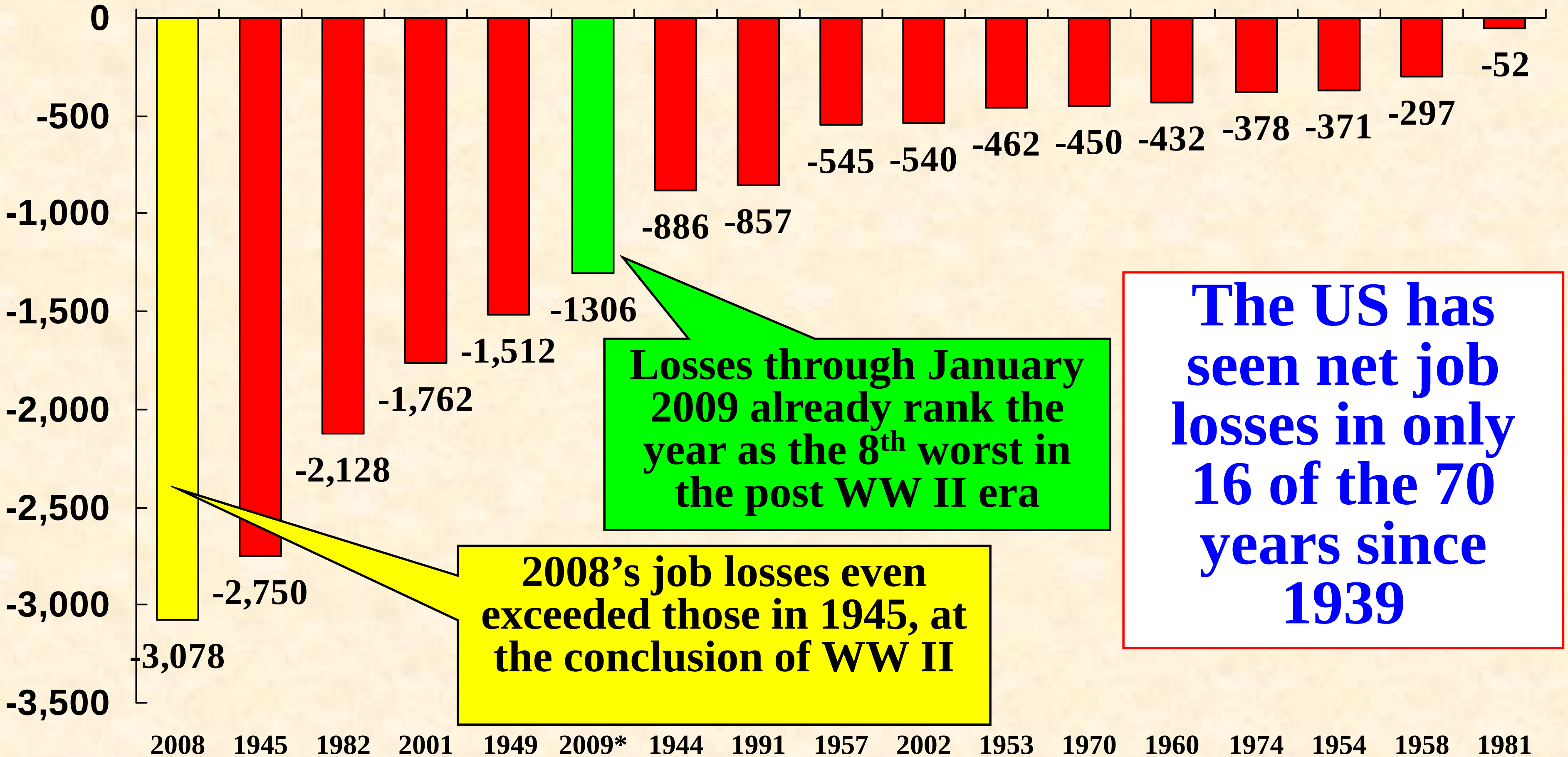
Monthly Change Employment (Thousands)*

January 2008 through February 2009



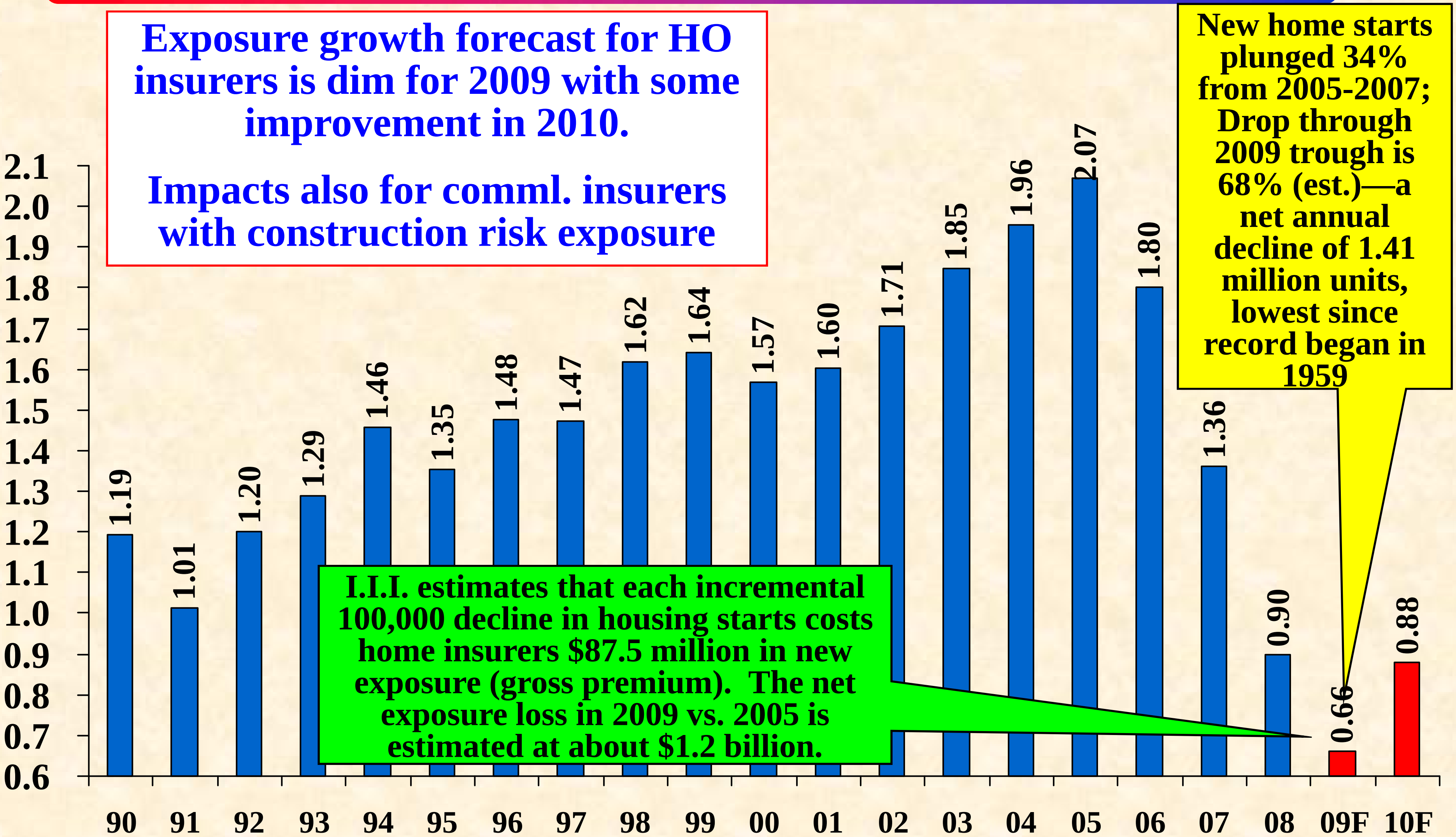
Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Info. Institute

Years With Job Losses: 1939-2009* (Thousands)



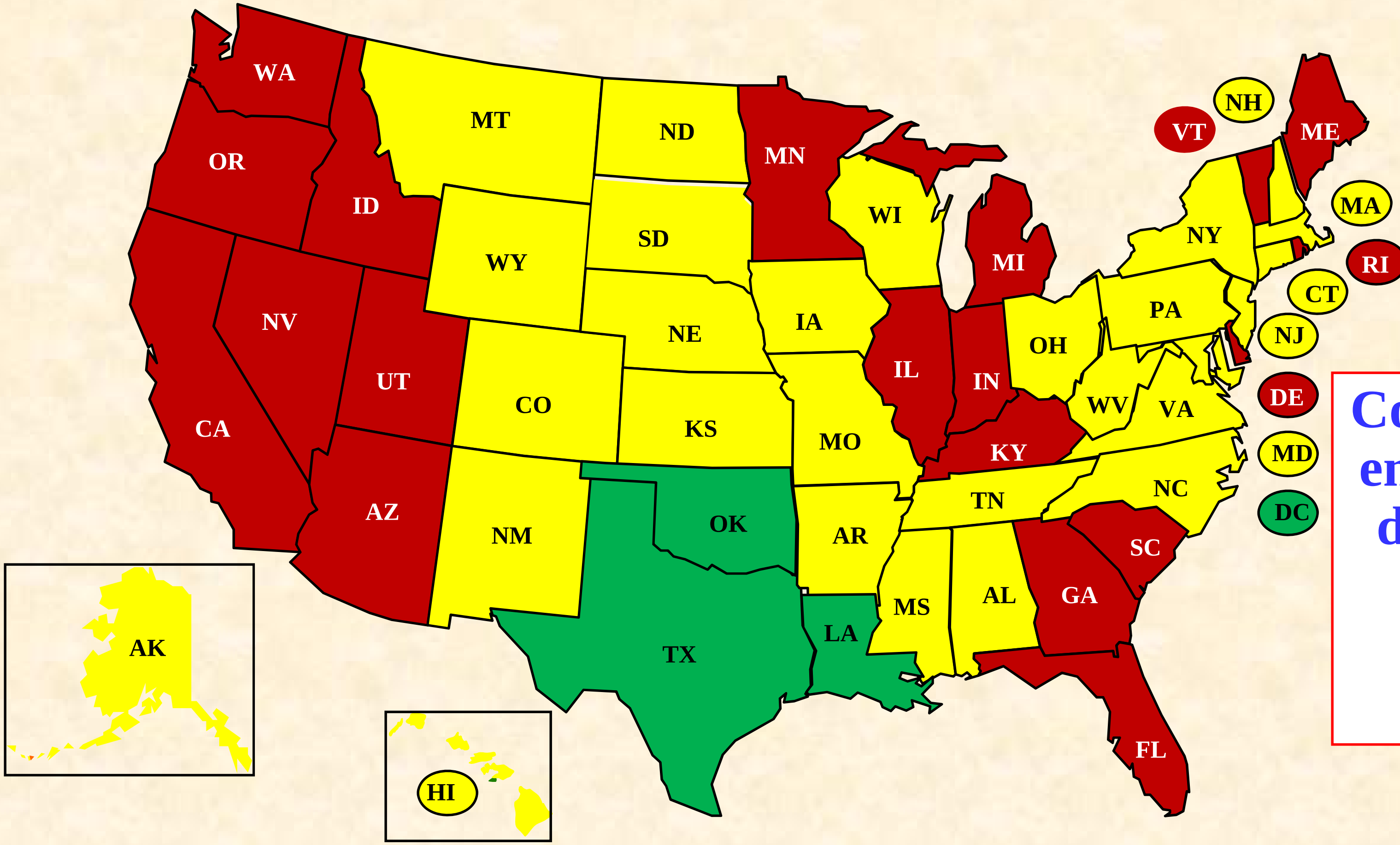
*Through February 2009.
Source: Insurance Information Institute research from
US Bureau of Labor Statistics data: http://www.bls.gov/ces/home.htm.

New Private Housing Starts, 1990-2010F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (2/09); Insurance Information Inst.

State Construction Employment, Dec. 2007 – Dec. 2008



Construction employment declined in 47 of 50 states in 2008

0% to 4%   -0.1% to -8.5%   -8.8% to -22%

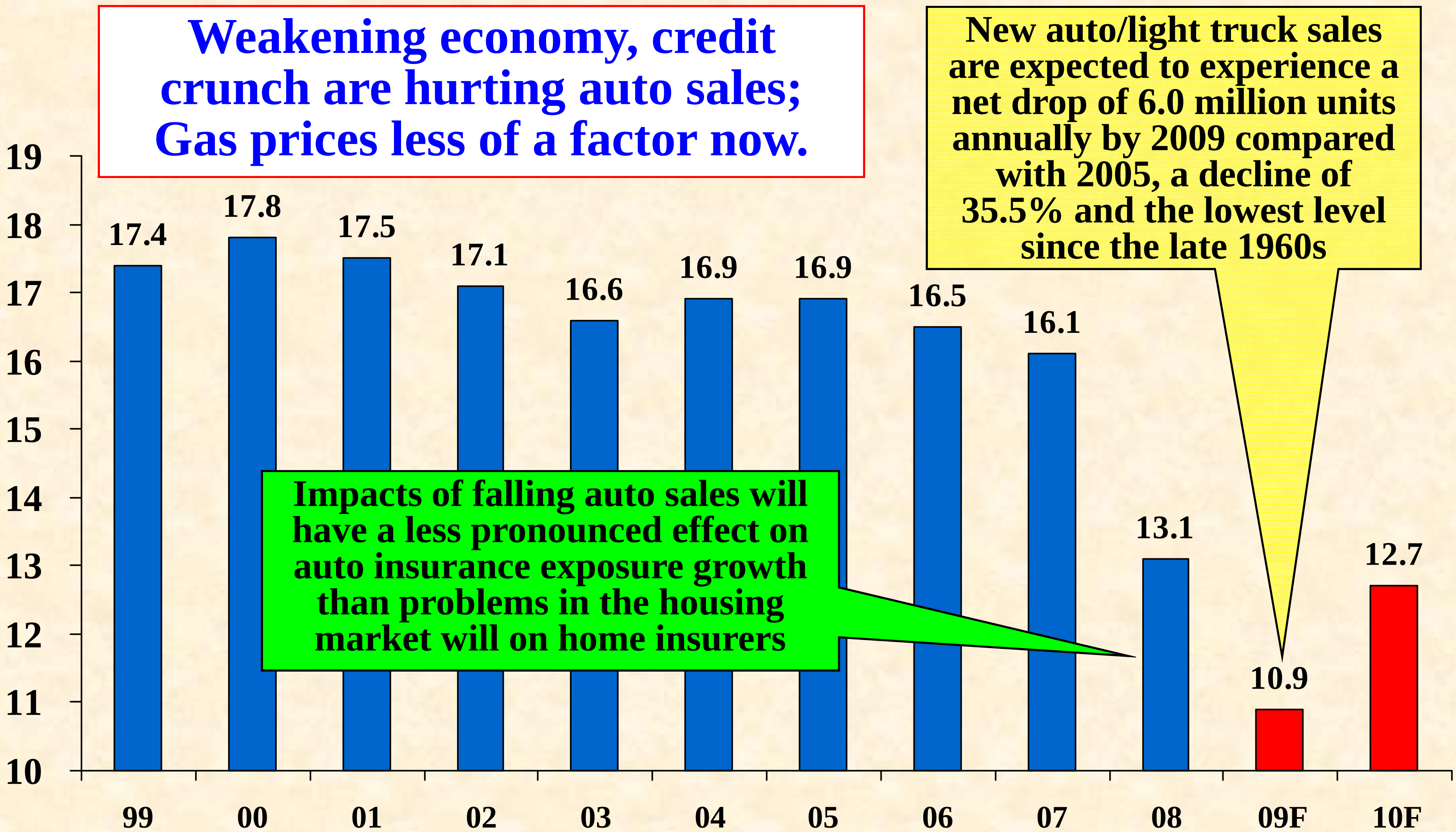
Sources: Associated General Contractors of America from Bureau of Labor Statistics; Insurance Information Institute.

State Construction Employment, Dec. 2007 – Dec. 2008

State	%		State	%		State	%		State	%	
Alabama	-4		Illinois	-13		Montana	-8		Rhode Island	-12	
Alaska	-1		Indiana	-13		Nebraska	-1		South Carolina	-17	
Arizona	-21		Iowa	-5		Nevada	-15		South Dakota	-5	
Arkansas	-3		Kansas	-3		New Hampshire	-8		Tennessee	-4	
California	-11		Kentucky	-12		New Jersey	-5		**Texas**	**+1**	
Colorado	-5		**Louisiana**	**+4**		New Mexico	-2		Utah	-22	
Connecticut	-8		Maine	-10		**New York**	**-5**		Vermont	-13	
Delaware	-11		Maryland	-6		North Carolina	-7		Virginia	-6	
District of Columbia	**+2**		Massachusetts	-9		North Dakota	-1		Washington	-10	
Florida	-16		Michigan	-16		Ohio	-9		West Virginia	-6	
Georgia	-10		Minnesota	-10		**Oklahoma**	**+4**		Wisconsin	-7	
Hawaii	-8		Mississippi	-1		Oregon	-13		Wyoming	-1	
Idaho	-15		Missouri	-1		Pennsylvania	-5				

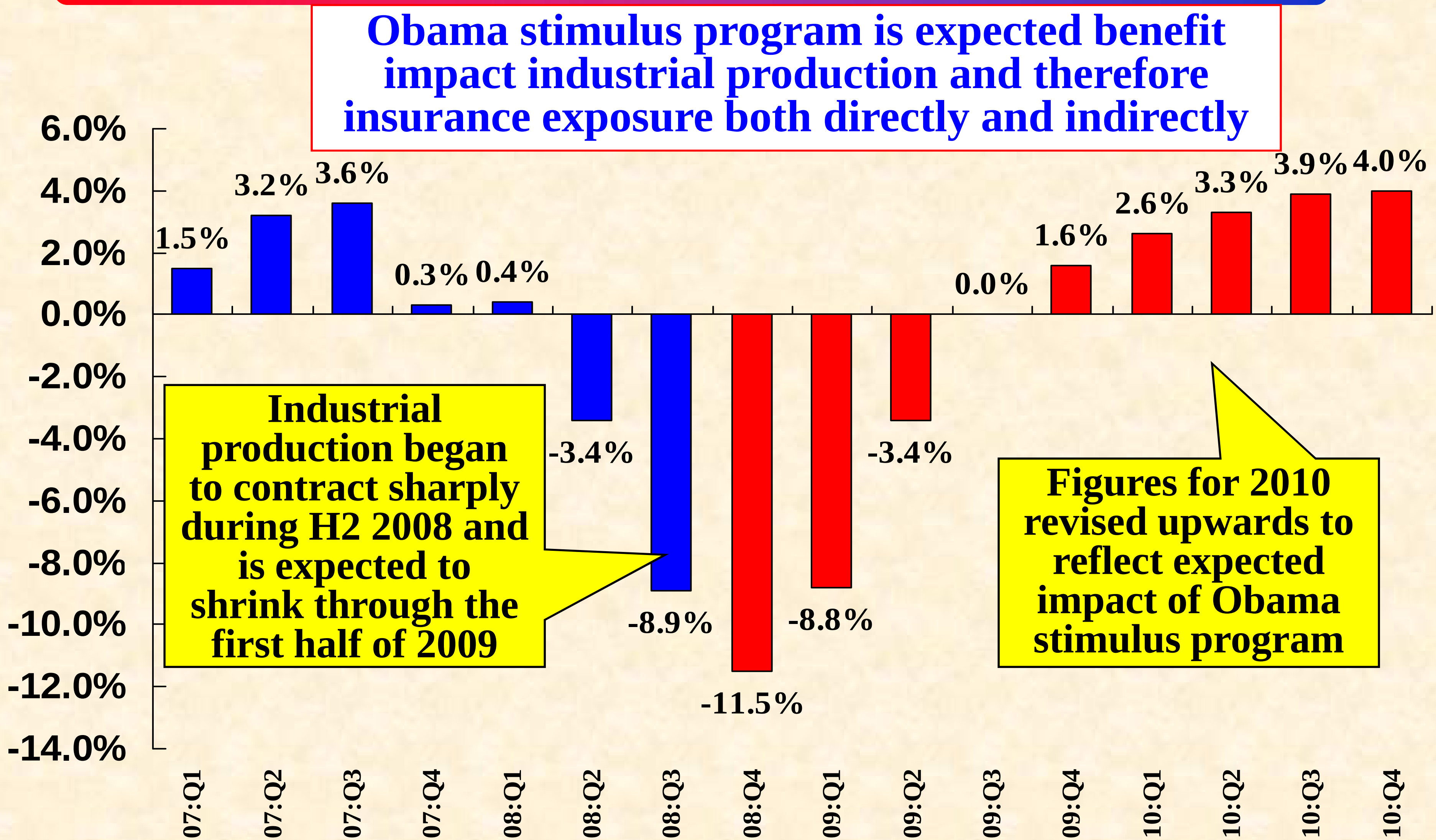
Sources: Associated General Contractors of America from Bureau of Labor Statistics; Insurance Info. Inst.

Auto/Light Truck Sales, 1999-2010F (Millions of Units)



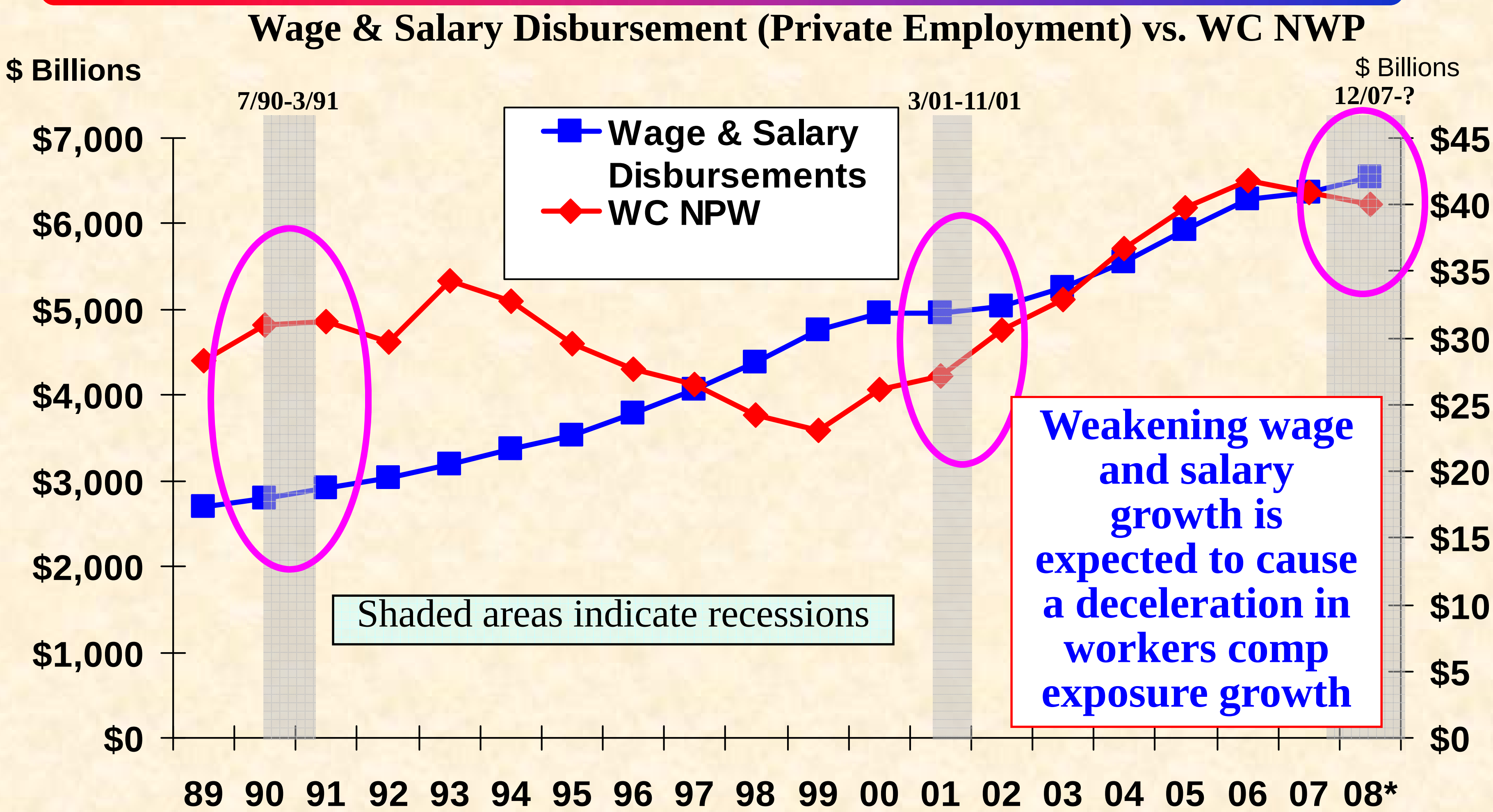
Source: US Department of Commerce; Blue Chip Economic Indicators (2/09); Insurance Information Inst.

Total Industrial Production, (2007:Q1 to 2010:Q4F)



Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (2/09); Insurance Info. Inst.

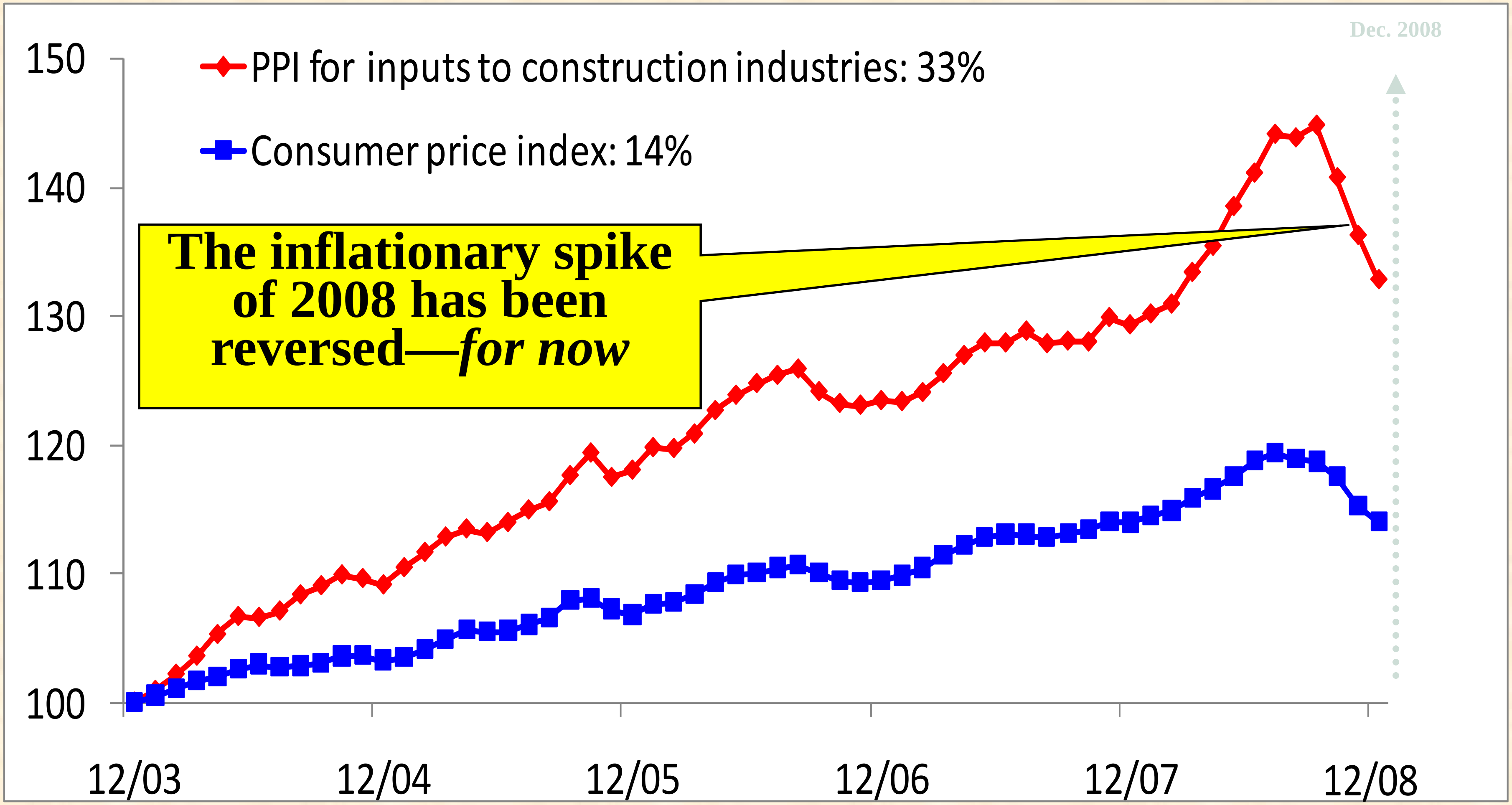
Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums



*9-month data for 2008

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

Change in Producer Prices for Construction vs. Consumer Prices, 2003 - 2008



Source: Associated General Contractors from BLS (CPI, PPI)

THE $787 BILLION ECONOMIC STIMULUS

Sectoral Impacts & Implications for P/C Insurance

Summary of Short-Run Impacts of Stimulus Package on P/C Insurance

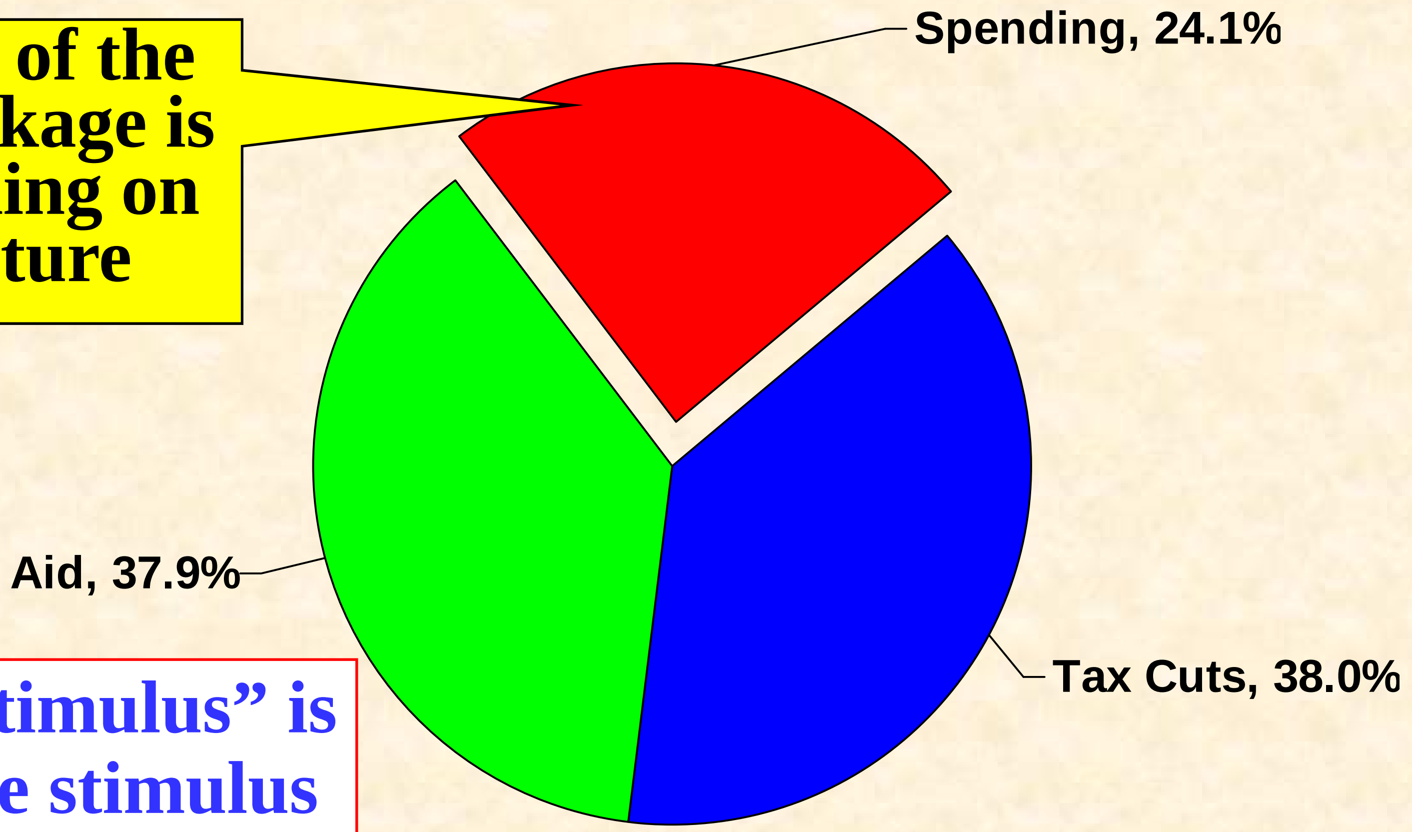
- **No Stimulus Provisions Specifically Address P/C Insurance**
  - **Spending, Aid and Tax Reductions benefit other industries, state and local governments, as well as individual and some corporate taxpayers**
- **Stimulus Package is Unlikely to Increase Net Premiums Written by Less Than 1% or Approximately $4.5 Bill. by Year-End 2010**
- **"Direct" Impact to P/C Insurers Results Primarily from Increased Demand for Commercial Insurance**
  - **Primarily the result of increased infrastructure spending and the resulting need to insure workers, property and protect against liability risks**
  - **Because the primary objective of the stimulus is employment related, workers compensation will be the p/c line that benefits the most**
  - **Assuming the target of 3.5 million jobs created or preserved is achieved, private workers comp NPW (new and preserved) could amount to as much as $1.1 billion**
  - **Other commercial lines to benefit: surety, commercial auto, inland marine**
- **Other "Direct" P/C Demand Benefits Will Be Minimal**
  - **Tax provisions providing incentives to buy cars and homes and accelerate the depreciation of equipment will have little net impact on exposure**
  - **Some additional premium may be generated as older cars and equipment are replaced with new and more valuable (and therefore more expensive to insure)**

Summary of Short-Run Impacts of Stimulus Package on P/C Insurance (cont'd)

- **"Indirect" Impacts: Limited Gains for P/C Insurers**
  - **If stimulus is successful at increasing disposable and corporate income via tax reductions and "multiplier" income and employment effects, then spending could rise and produce some additional insurable exposure growth for p/c insurers**
- **Investment Portfolio Impacts**
  - **It is impossible to discern what, if any, impact the stimulus will have on stock and bond performance**
  - **If successful, the stimulus package (along with other initiatives) should help stabilize and reinvigorate the economy, increasing stock prices and bolstering the value of corporate and asset-backed bonds**
  - **The stimulus could be viewed as inflationary. Combined with existing large deficits and other spending initiatives, an expectation of inflation could push interest rates upward**

Economic Stimulus Package: Where the $787B Goes

Less than ¼ of the stimulus package is direct spending on infrastructure

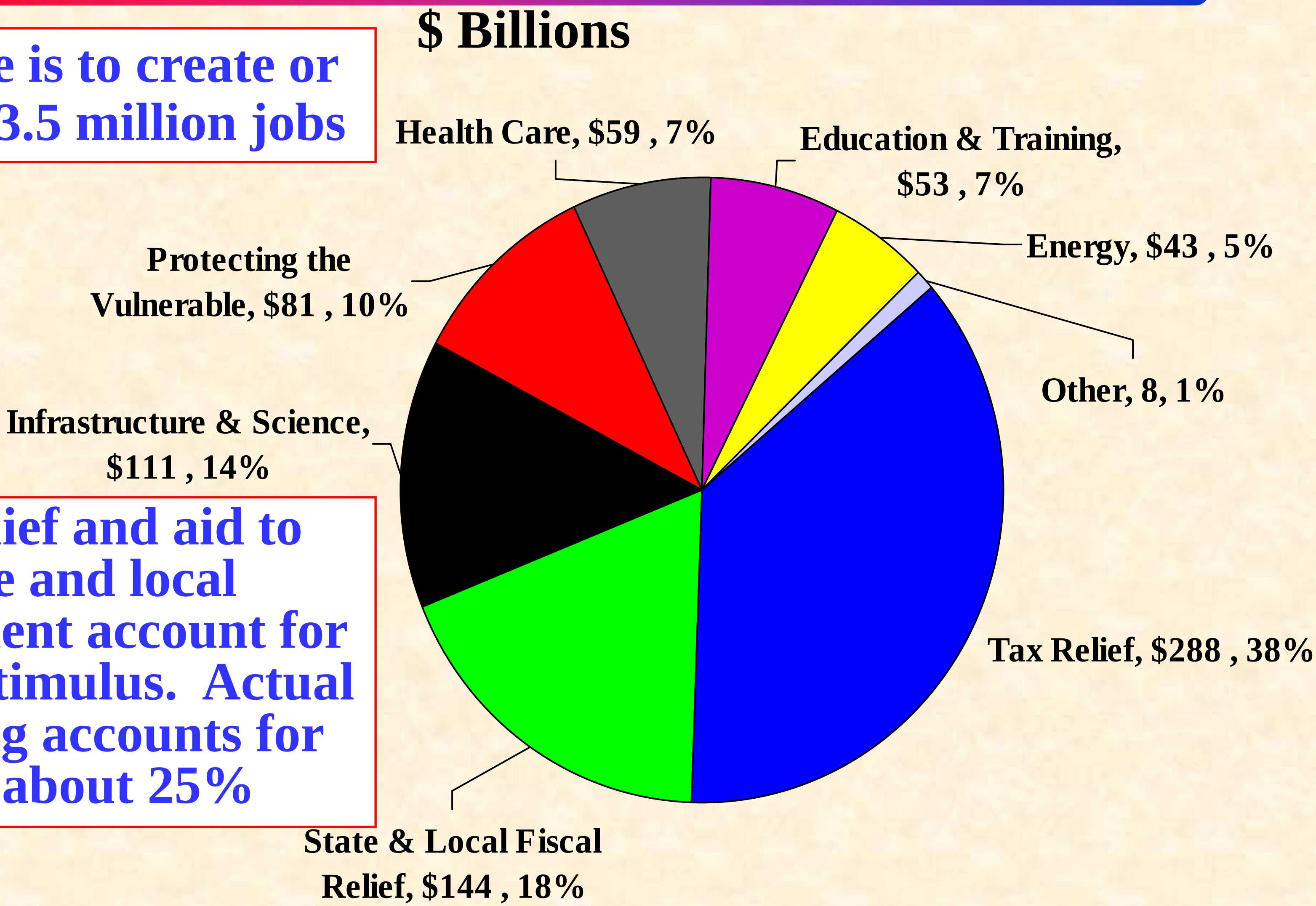


How much "stimulus" is actually in the stimulus package is open to debate and dispute

Sources: *Wall Street Journal* , 2/13/09; House Ways and Means Committee; Senate Finance Committee.

Economic Stimulus Package: Where the $787B Goes

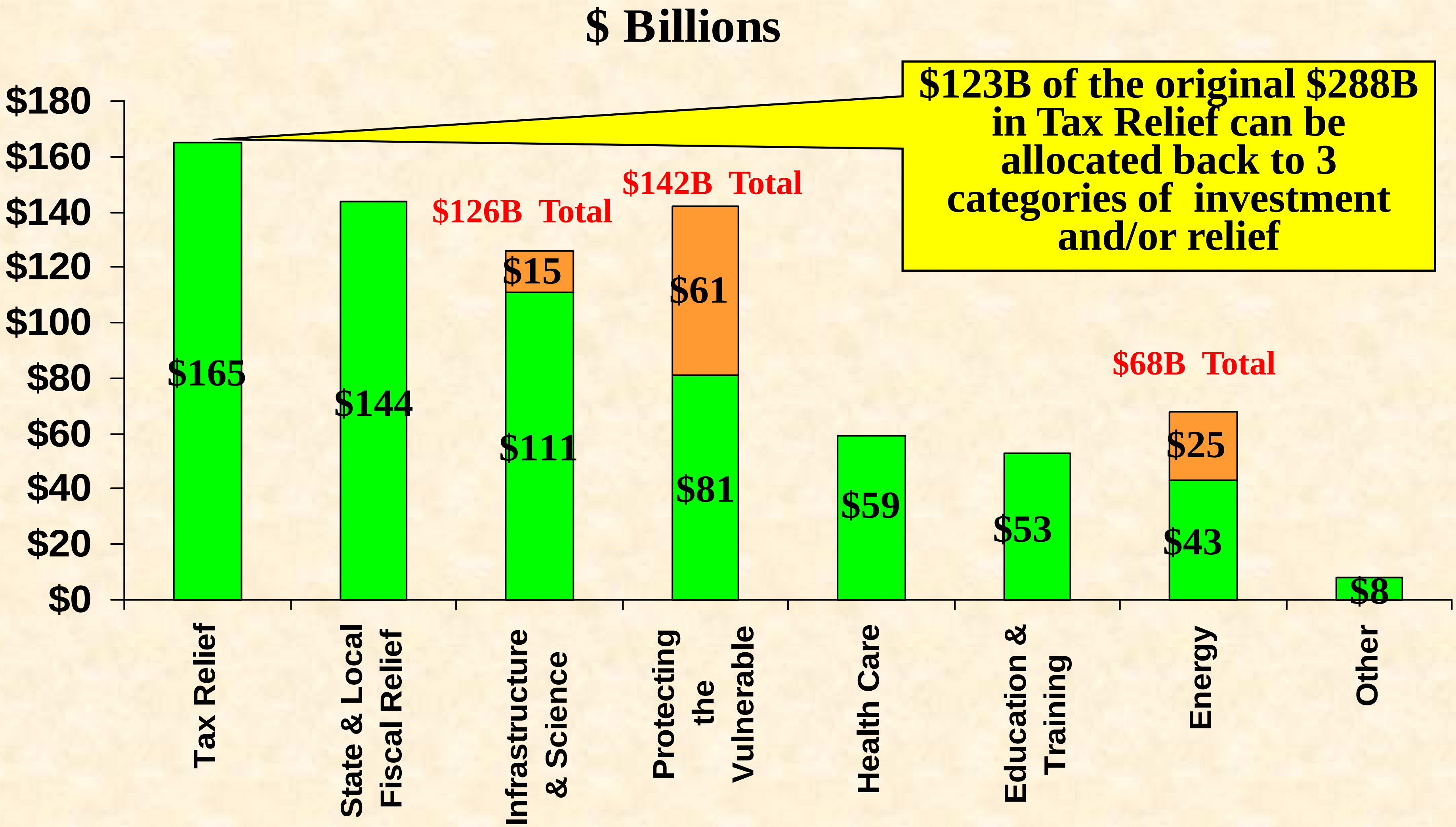
Objective is to create or preserve 3.5 million jobs



Tax relief and aid to state and local government account for 56% of stimulus. Actual spending accounts for only about 25%

Source: http://www.recovery.gov/ accessed 2/18/09; Insurance Information Institute.

Economic Stimulus Package: Where the $787B Goes After Tax Reallocations



Source: From http://www.recovery.gov/ accessed 2/18/09; Insurance Information Institute.

U.S. Economic $787B Stimulus Package: Major Spending Components

$ Billions

Objective is to create or preserve 3.5 million jobs

24.1% or $132.2B of the stimulus package is allocated toward direct spending. This is the component that will most directly benefit p/c insurers.

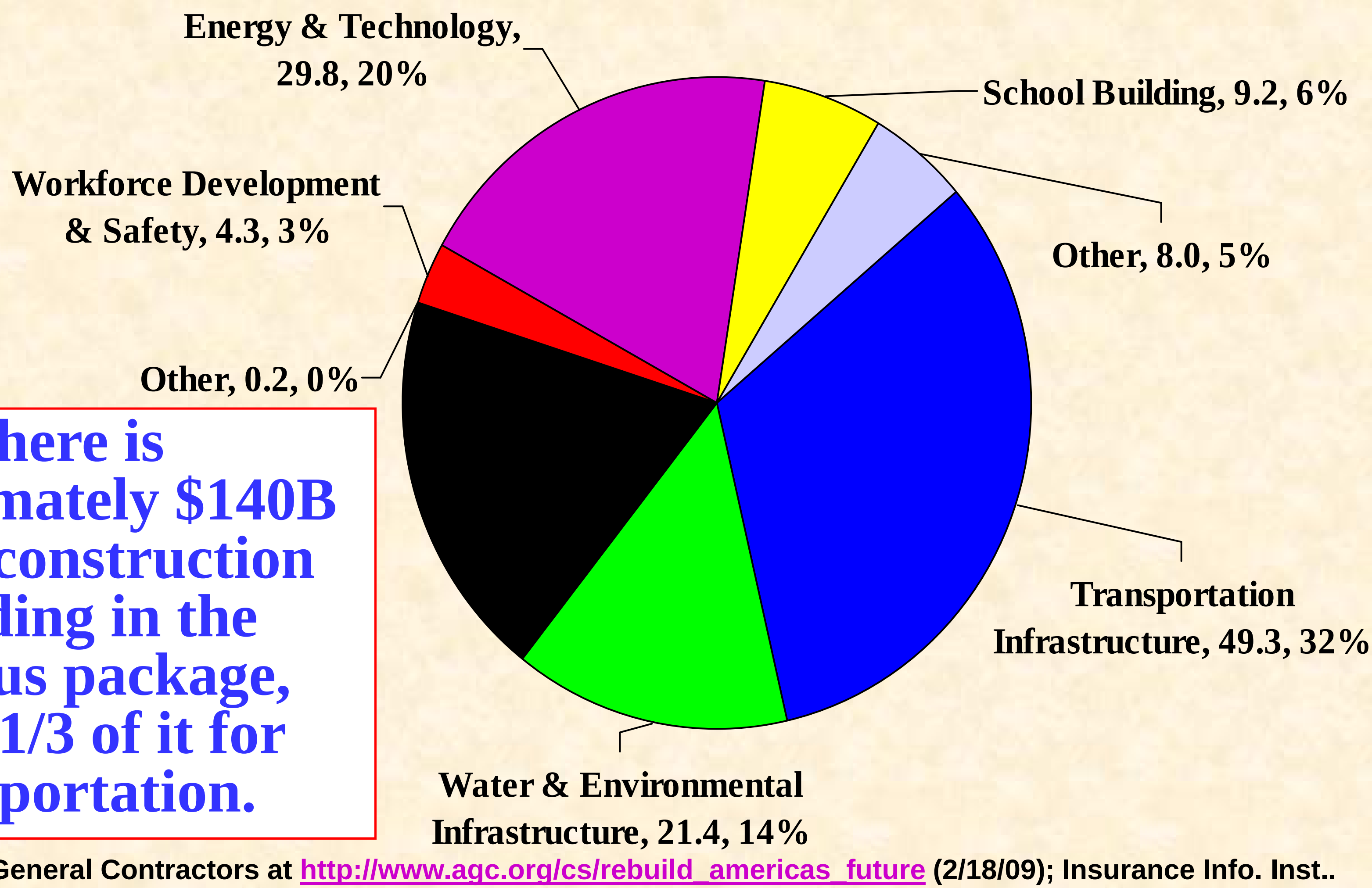
Lines Most Likely to Benefit:

Workers Comp
Commercial Auto
Inland Marine
Commercial Property & Liability
Surety

Sources: *Wall Street Journal* , 2/13/09; House Ways and Means Committee; Senate Finance Committee; Ins. Info. Inst.

Economic Stimulus Package: $143.4 in Construction Spending

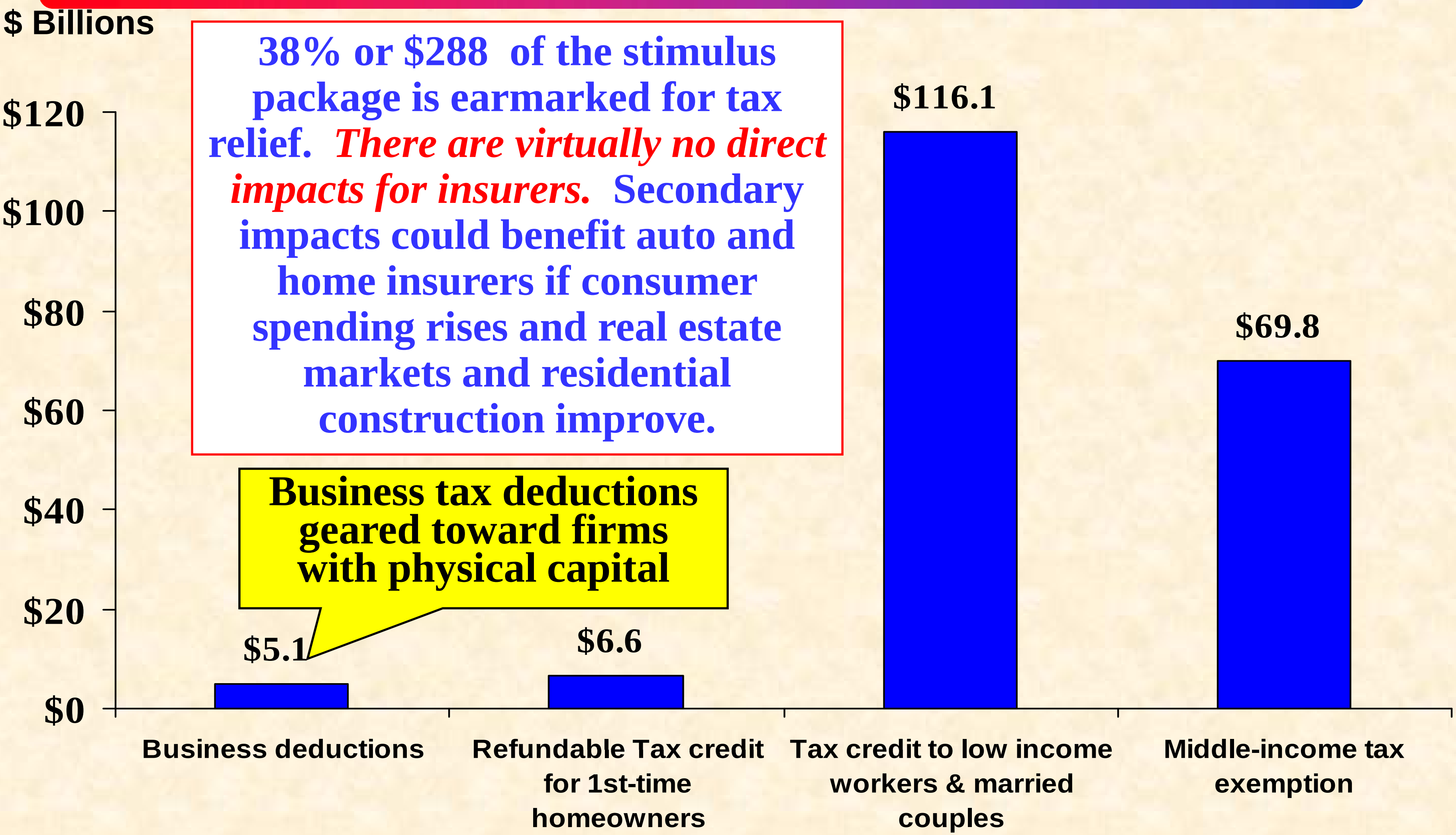
$ Billions



There is approximately $140B in new construction spending in the stimulus package, about 1/3 of it for transportation.

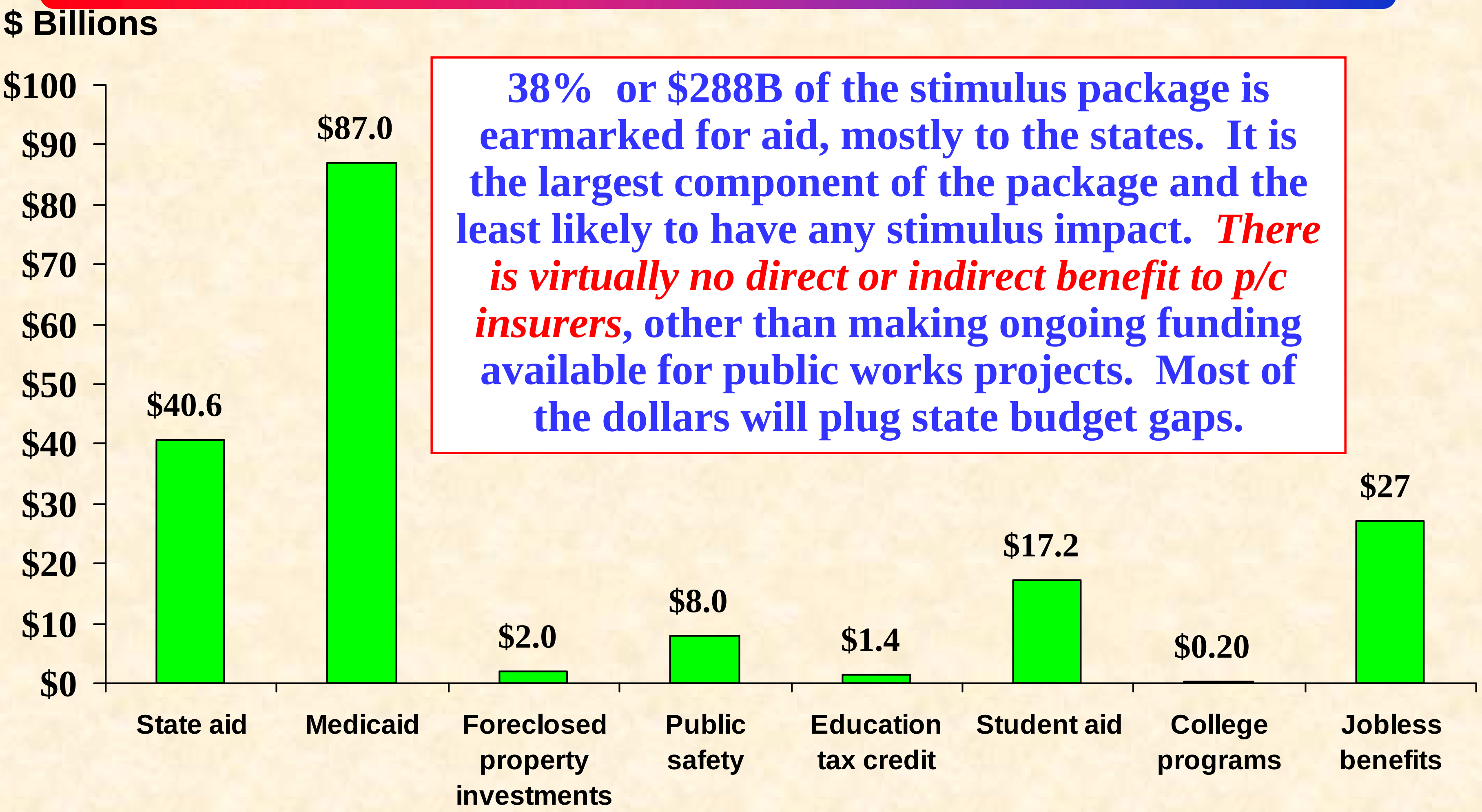
Source: Associated General Contractors at http://www.agc.org/cs/rebuild_americas_future (2/18/09); Insurance Info. Inst..

U.S. Economic $787B Stimulus Package: Major Tax Cut Components



Sources: The Wall Street Journal 2/13/09; Speaker of the House; House Ways and Means Committee; Senate Finance Committee; Insurance Information Institute.

U.S. Economic $787B Stimulus Package: Major Aid Components



Sources: The Wall Street Journal 2/13/09; Speaker of the House; House Ways and Means Committee; Senate Finance Committee; Insurance Information Institute.

State-by-State Infrastructure Spending

Bigger States Get More, Should Benefit Commercial Insurer Exposure

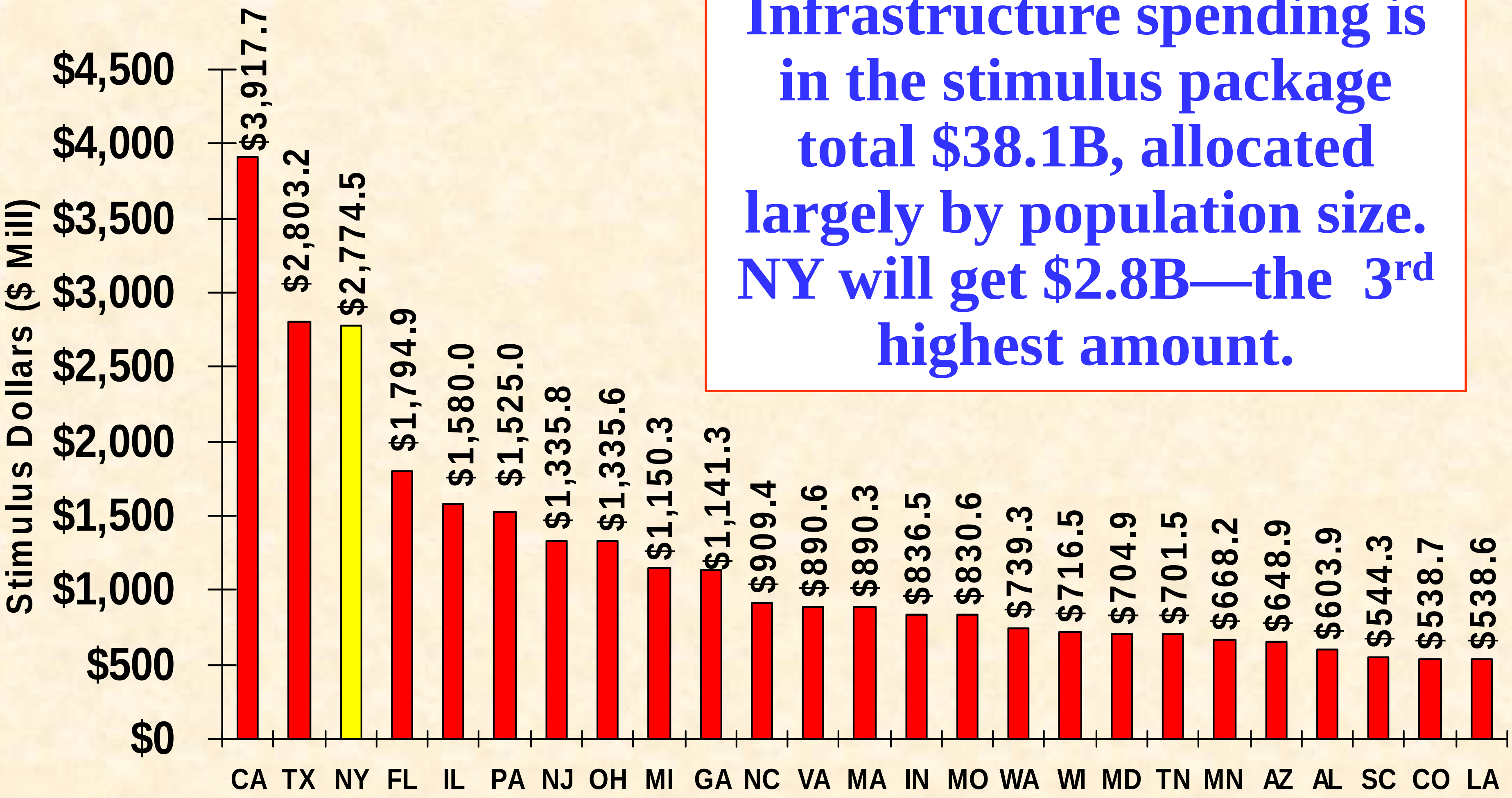
Infrastructure Stimulus Spending by State (Total = $38.1B)

State	Allocation	State	Allocation	State	Allocation
AL	$603,871,807	LA	$538,575,876	OK	$535,407,908
AK	$240,495,117	ME	$174,285,111	OR	$453,788,475
AZ	$648,928,995	MD	$704,863,248	PA	$1,525,011,979
AR	$405,531,459	MA	$890,333,825	RI	$192,902,023
CA	$3,917,656,769	MI	$1,150,282,308	SC	$544,291,398
CO	$538,669,174	MN	$668,242,481	SD	$213,511,174
CT	$487,480,166	MS	$415,257,720	TN	$701,516,776
DE	$158,666,838	MO	$830,647,063	TX	$2,803,249,599
DC	$267,617,455	MT	$246,599,815	UT	$292,231,904
FL	$1,794,913,566	NE	$278,897,762	VT	$150,666,577
GA	$1,141,255,941	NV	$270,010,945	VA	$890,584,959
HI	$199,866,172	NH	$181,678,856	WA	$739,283,923
ID	$219,528,313	NJ	$1,335,785,100	WV	$290,479,108
IL	$1,579,965,373	NM	$299,589,086	WI	$716,457,120
IN	$836,483,568	NY	$2,774,508,711	WY	$186,111,170
IA	$447,563,924	NC	$909,397,136	U.S. Territories	$238,045,760
KS	$413,837,382	ND	$200,318,301		
KY	$521,153,404	OH	$1,335,600,553	**Total**	**$38,101,898,173**

Sources: USA Today, 2/17/09; House Transportation and Infrastructure Committee; the Associated Press.

Infrastructure Stimulus Spending By State: Top 25 States ($ Millions)

Infrastructure spending is in the stimulus package total $38.1B, allocated largely by population size. NY will get $2.8B—the 3rd highest amount.



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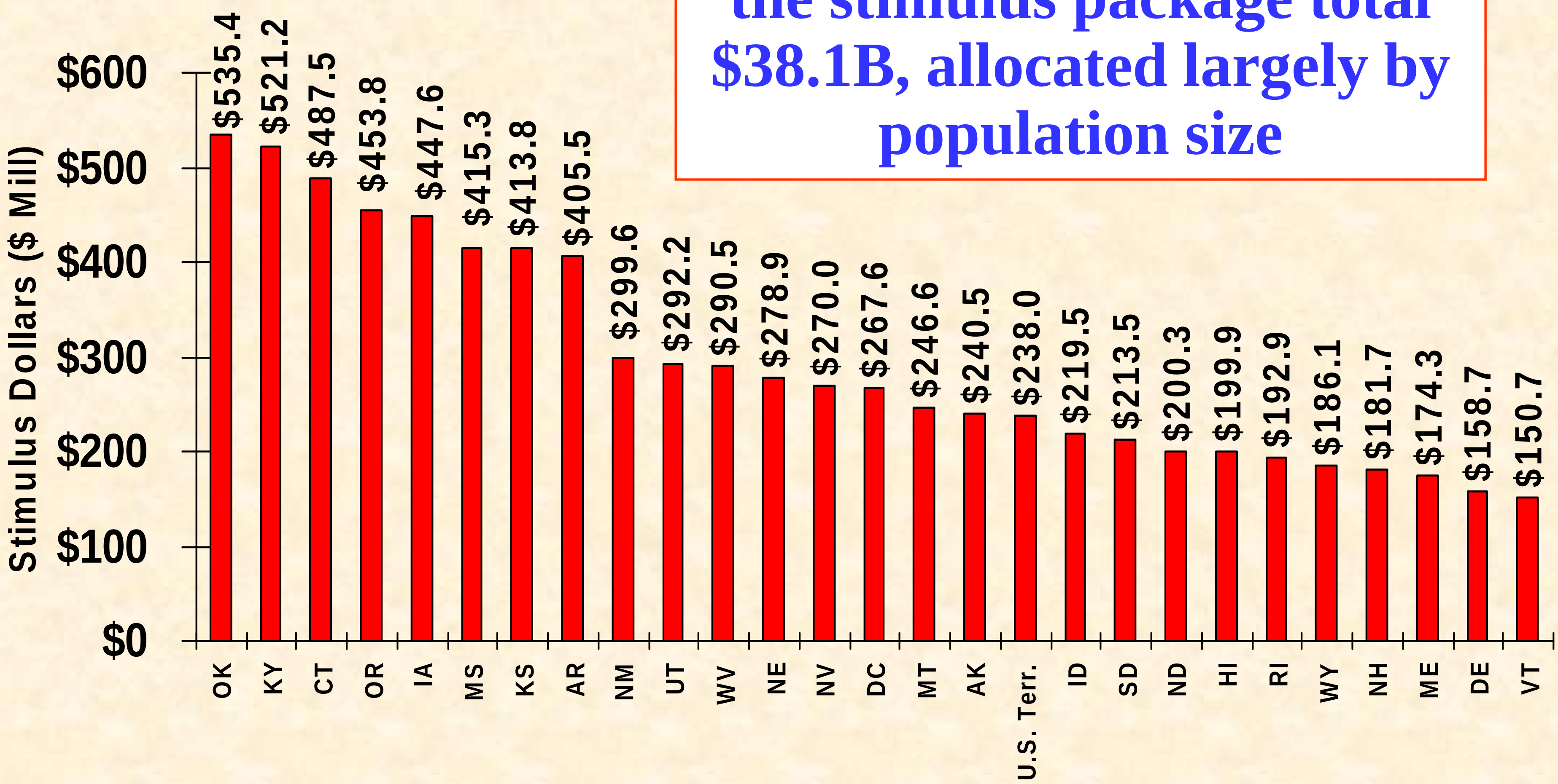


Sources: USA Today 2/19/09; House Transportation and Infrastructure Committee; the Associated Press.

Expected Number of Jobs Gained or Preserved by Stimulus Spending

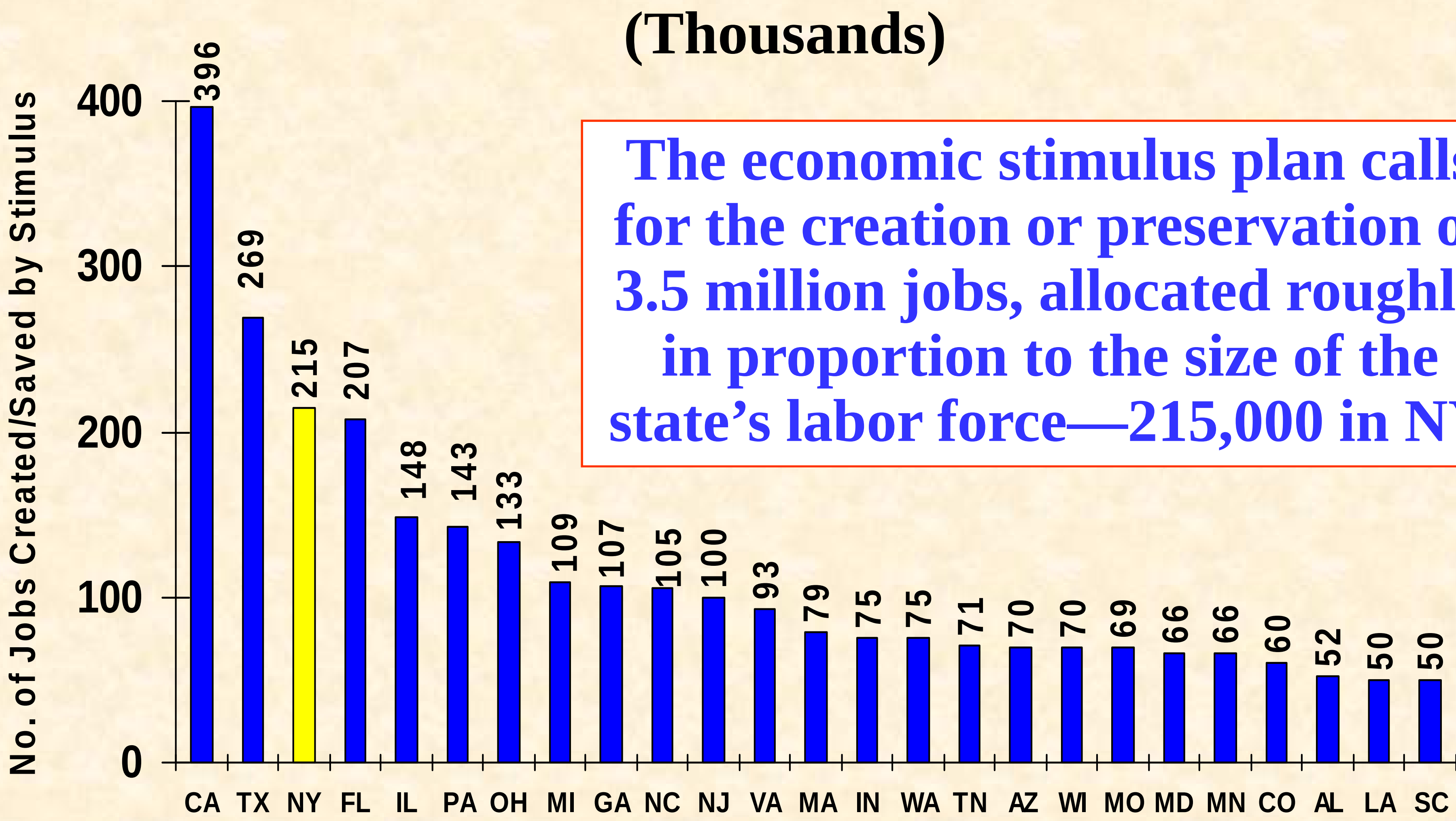
Larger States = More Jobs
Workers Comp Benefits

Estimated Job Effect of Stimulus: Jobs Created/Saved By State = 3.5 Mill Total

State	Jobs Created	State	Jobs Created	State	Jobs Created
AL	52,000	LA	50,000	OK	40,000
AK	8,000	ME	15,000	OR	44,000
AZ	70,000	MD	66,000	PA	143,000
AR	32,000	MA	79,000	RI	12,000
CA	396,000	MI	109,000	SC	50,000
CO	60,000	MN	66,000	SD	10,000
CT	41,000	MS	30,000	TN	71,000
DE	11,000	MO	69,000	TX	269,000
DC	12,000	MT	11,000	UT	32,000
FL	207,000	NE	23,000	VT	8,000
GA	107,000	NV	34,000	VA	93,000
HI	16,000	NH	16,000	WA	75,000
ID	17,000	NJ	100,000	WV	20,000
IL	148,000	NM	22,000	WI	70,000
IN	75,000	NY	215,000	WY	8,000
IA	37,000	NC	105,000		
KS	33,000	ND	9,000		
KY	48,000	OH	133,000	Total	3,467,000

Sources: http://www.recovery.gov/; Council of Economic Advisers; Insurance Information Institute.

Estimated Job Effect of Stimulus Spending By State: Top 25 States

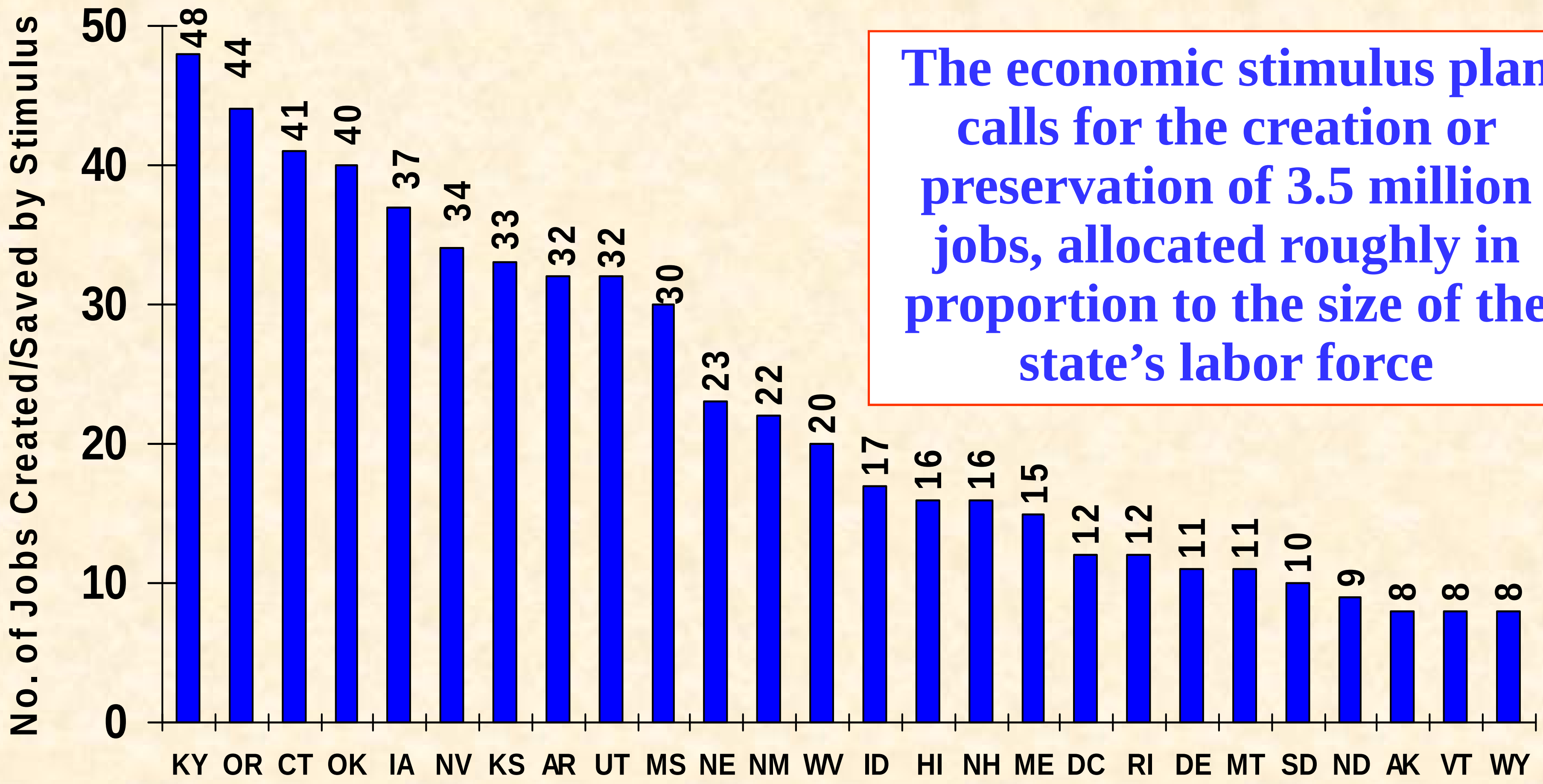


The economic stimulus plan calls for the creation or preservation of 3.5 million jobs, allocated roughly in proportion to the size of the state's labor force—215,000 in NY

Sources: http://www.recovery.gov/; Council of Economic Advisers Insurance Information Institute.

Estimated Job Effect of Stimulus Spending By State: Bottom 25 States

(Thousands)



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Sources: http://www.recovery.gov/; Council of Economic Advisers Insurance Information Institute.

Stimulus: Reading The Economic Tea Leaves for the Next 4 to 8 Years

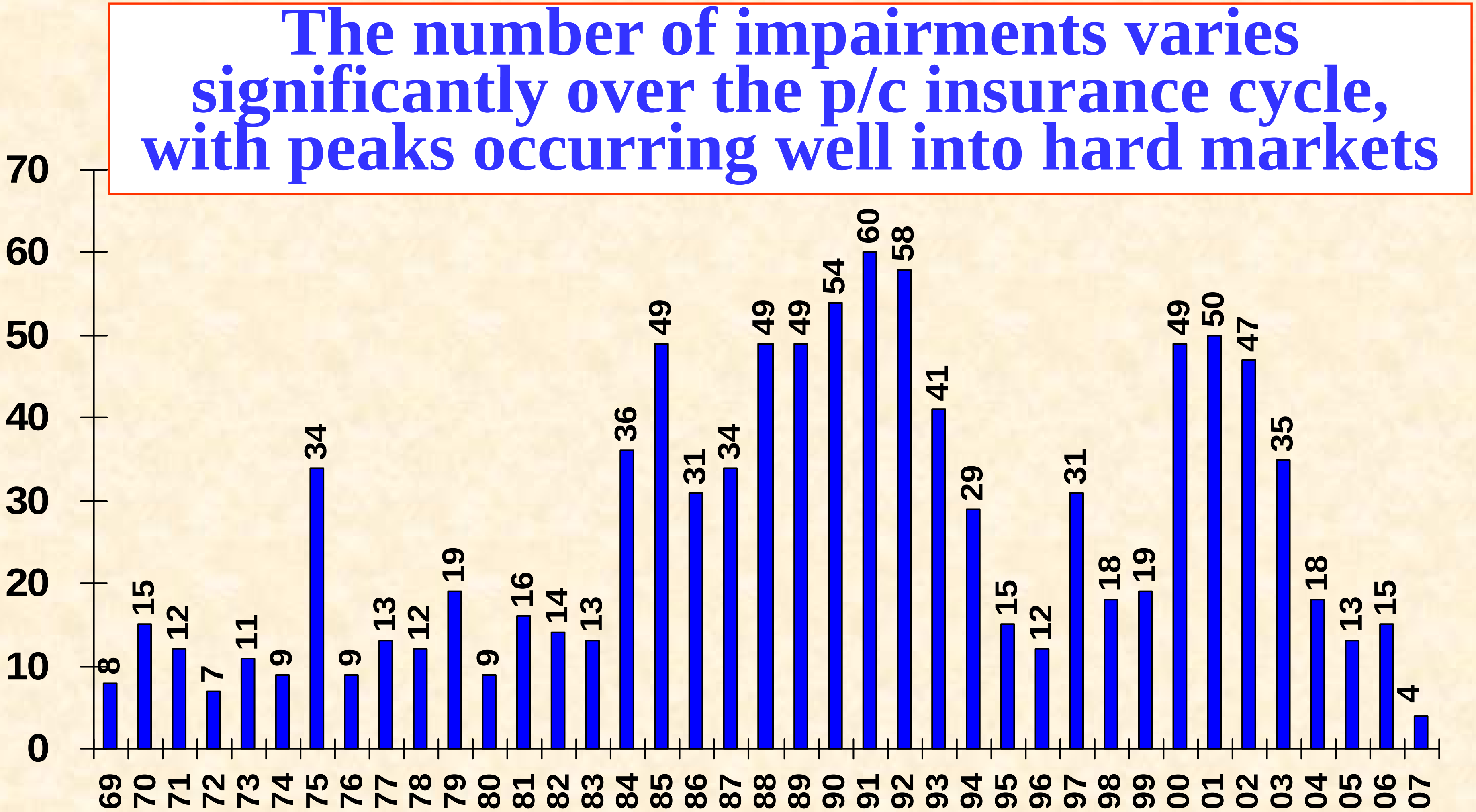
- **Growing Role of Government: 2009 Stimulus Package and Other Likely Spending Initiatives Guarantee that Government Will Play a Much Larger Role Than at Any Other Time in Recent History**
  - **Every industry, including insurance, will and must attempt to maximize direct and indirect benefits from this paradigm shift**
- **Obama Administration Priorities: Stimulus Package Acts as "Economic Tea Leaf" on the Administration's Fiscal Priorities for the Next Several Years**
- **These Include:**
  - **Alternative Energy**
  - **Health Care**
  - **Education**
  - **Aging/New Infrastructure**
  - **Aid to States**
- **Stimulus is Only One Leg of the Stool**
  - **(1) Stimulus; (2) Housing, and (3) Financial Services Reform**

Source: Insurance Information Institute

FINANCIAL STRENGTH & RATINGS

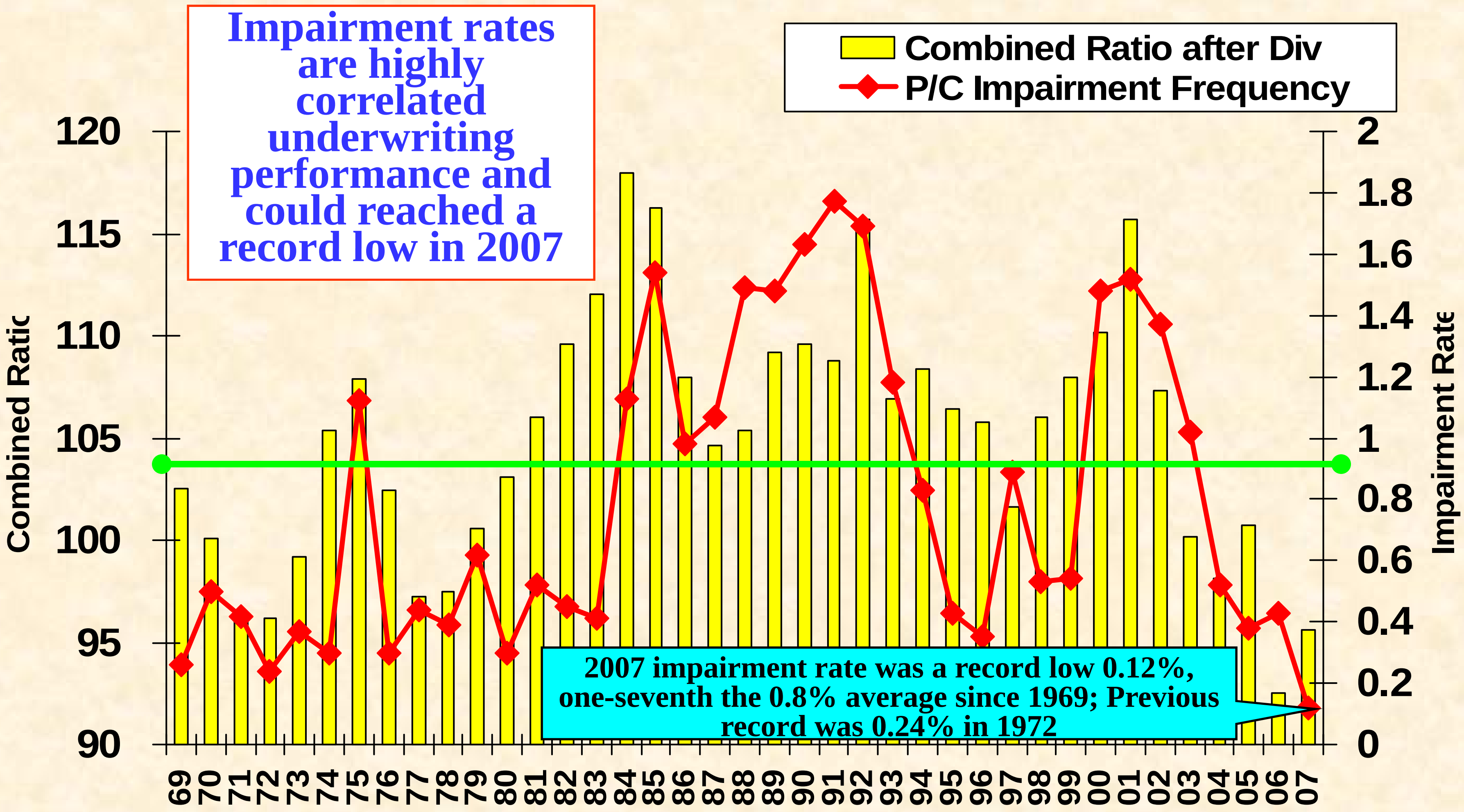
Industry Has Weathered the Storms Well

P/C Insurer Impairments, 1969-2007



Source: A.M. Best; Insurance Information Institute

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

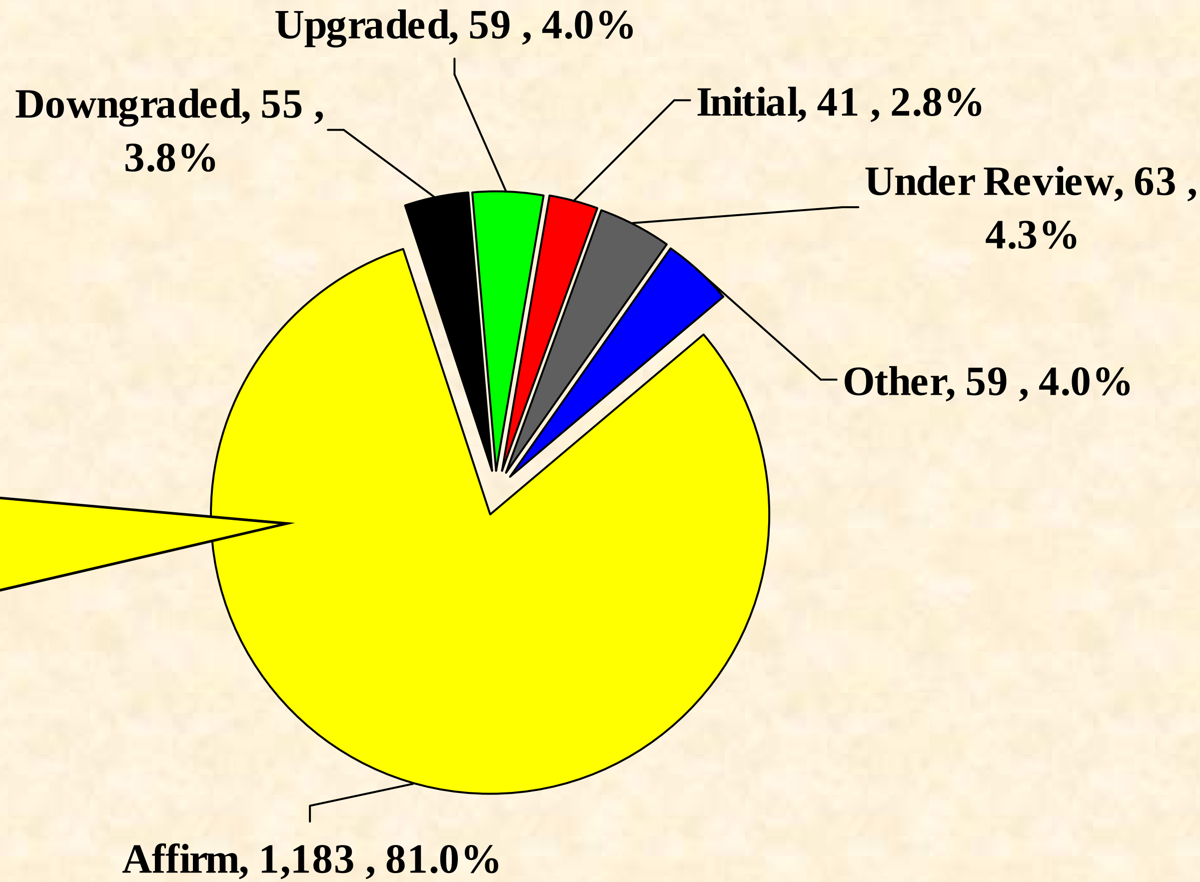


Source: A.M. Best; Insurance Information Institute

Summary of A.M. Best's P/C Insurer Ratings Actions in 2008*

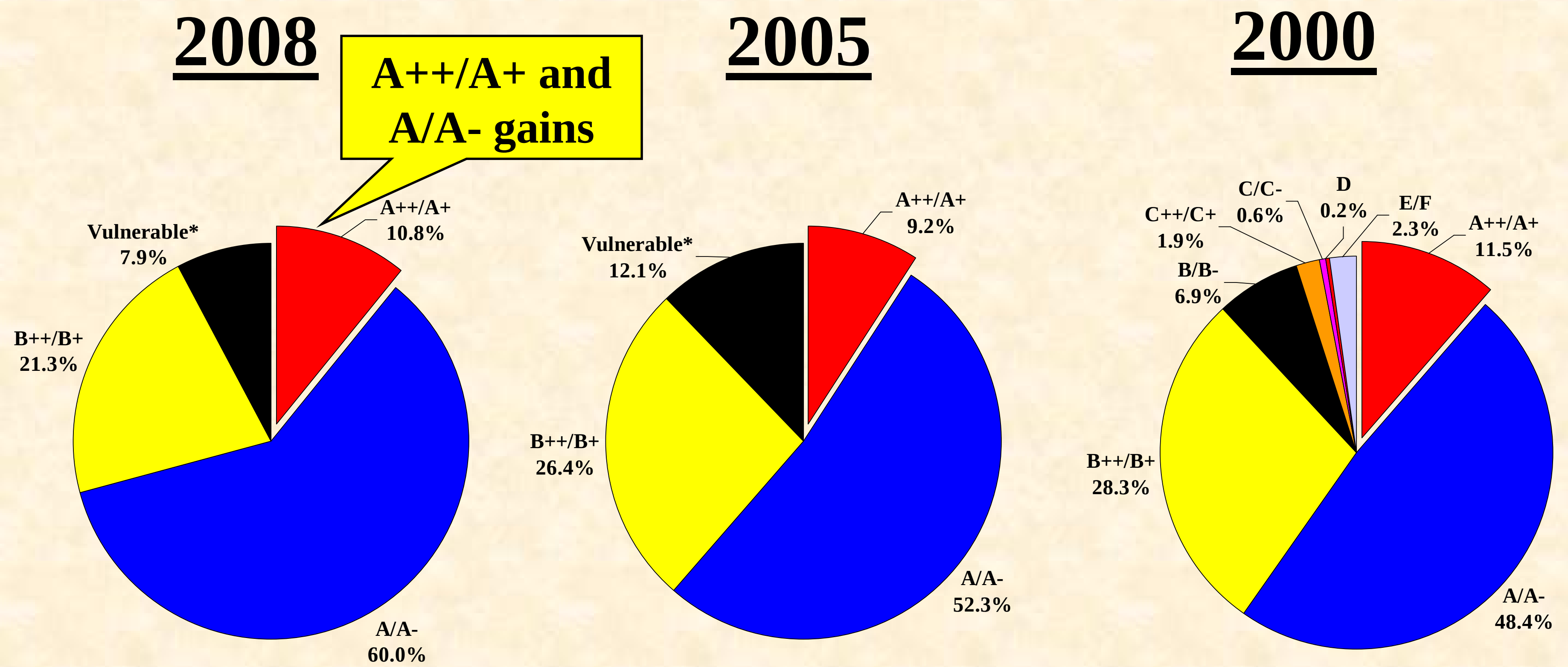
P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.

Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades



*Through December 19.
Source: A.M. Best.

Historical Ratings Distribution, US P/C Insurers, 2008 vs. 2005 and 2000

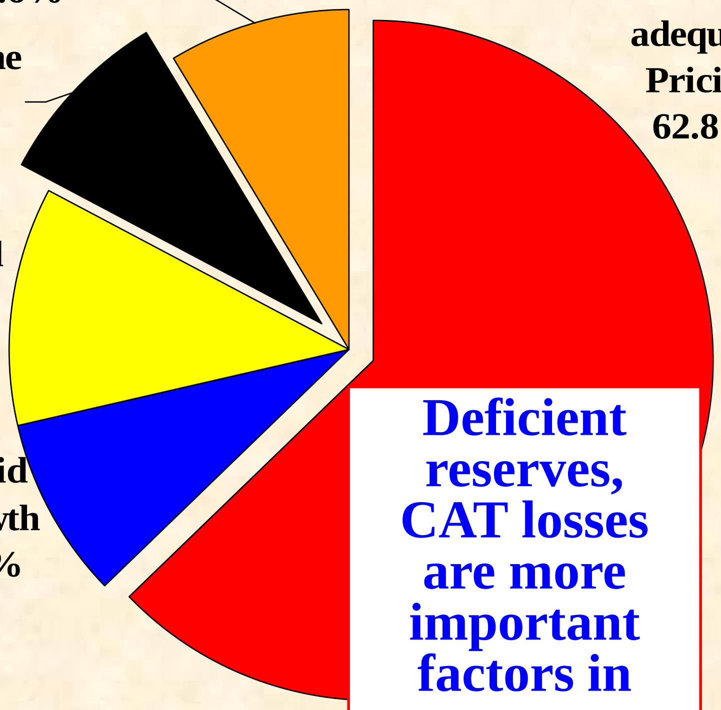


P/C insurer financial strength has improved since 2005 despite financial crisis

Source: A.M. Best: *Rating Downgrades Slowed but Outpaced Upgrades for Fourth Consecutive Year,* Special Report, November 8, 2004 for 2000; 2006 and 2009 *Review & Preview*. *Ratings 'B' and lower.

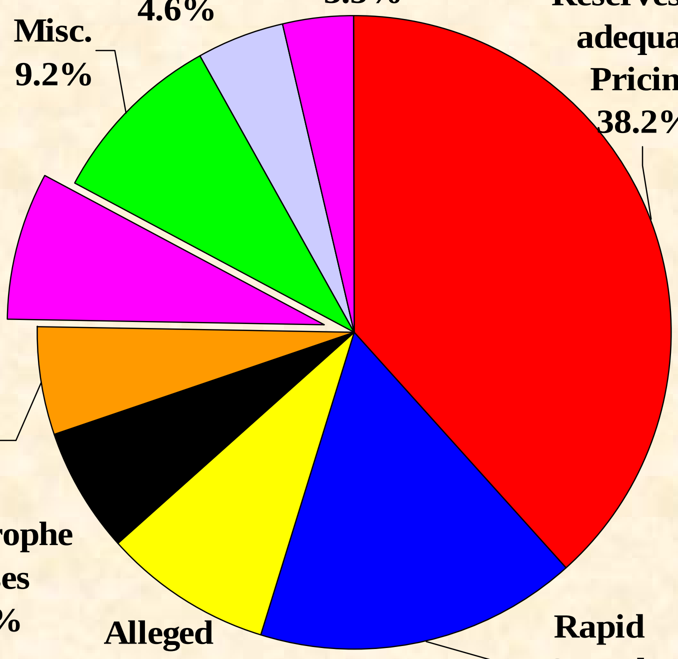
Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



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

1969-2005



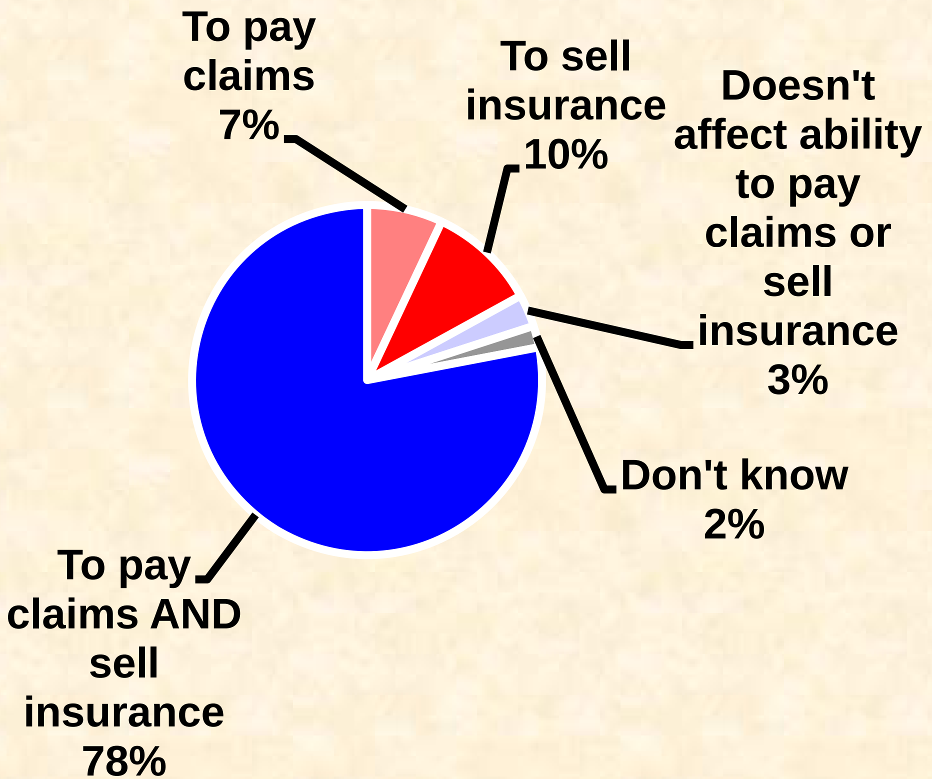
*Includes overstatement of assets.

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

CONSUMER POLL: 2008 I.I.I. PULSE SURVEY

Q. DO YOU THINK THAT THESE PROBLEMS (THE MORTGAGE PROBLEMS SOME AMERICANS FACE, THE DROP IN THE STOCK MARKET AND JOB LAYOFFS) AFFECT THE ABILITY OF INSURANCE COMPANIES TO PAY THEIR CLAIMS, TO SELL MORE INSURANCE, BOTH, NONE OF THESE (DOESN'T AFFECT ABILITY TO PAY CLAIMS OR SELL INSURANCE) OR DON'T KNOW?

95% Americans think that the downturn in the economy affects the basic business of the insurance industry: the ability to pay claims and/or sell insurance



Source: Insurance Information Institute, 2008 *Pulse* Survey, November 2008.

Critical Differences Between P/C Insurers and Banks

Superior Risk Management Model & Low Leverage Make a Big Difference

How Insurance Industry Stability Has Benefitted Consumers

BOTTOM LINE:

- **Insurance Markets—Unlike Banking—Are Operating *Normally***
- **The Basic Function of Insurance—the Orderly Transfer of Risk from Client to Insurer—Continues *Uninterrupted***
- **This Means that Insurers Continue to:**
  - **Pay claims (whereas 42 banks have gone under as of 3/6)**
    - ***The Promise is Being Fulfilled***
  - **Renew existing policies (banks are reducing and eliminating lines of credit)**
  - **Write new policies (banks are turning away people who want or need to borrow)**
  - **Develop new products (banks are scaling back the products they offer)**

Source: Insurance Information Institute

Reasons Why P/C Insurers Have Fewer Problems Than Banks: A Superior Risk Management Model

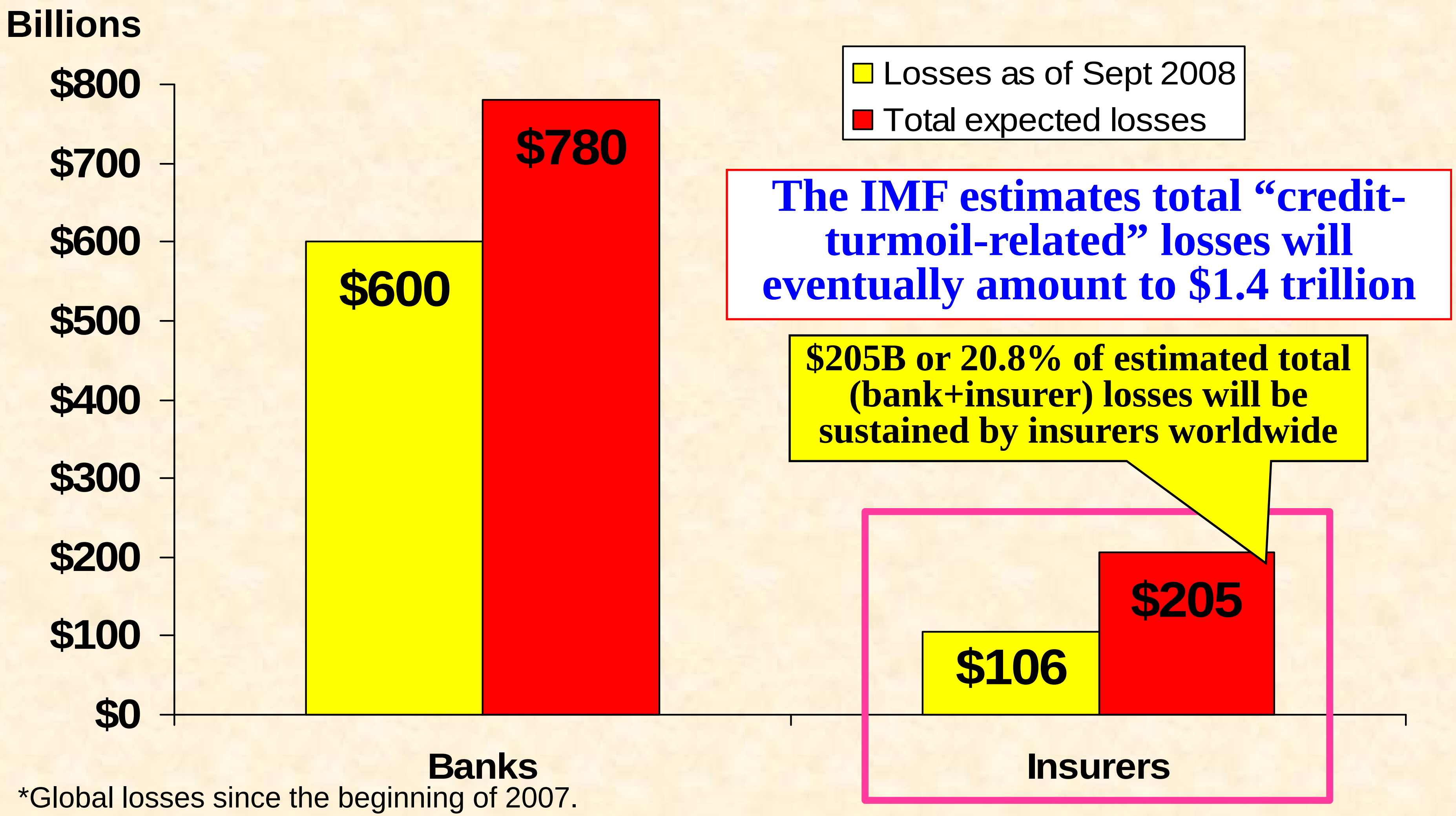
- ***Emphasis on Underwriting***
  - **Matching of risk to price (via experience and modeling)**
  - **Limiting of potential loss exposure**
  - ***Some banks sought to maximize volume and fees and disregarded risk***
- ***Strong Relationship Between Underwriting and Risk Bearing***
  - **Insurers always maintain a stake in the business they underwrite, keeping "skin in the game" at all times**
  - ***Banks and investment banks package up and securitize, severing the link between risk underwriting and risk bearing, with (predictably) disastrous consequences—straightforward moral hazard problem from Econ 101***
- ***Low Leverage***
  - **Insurers do not rely on borrowed money to underwrite insurance or pay claims →*There is no credit or liquidity crisis in the insurance industry***
- ***Conservative Investment Philosophy***
  - **High quality portfolio that is relatively less volatile and more liquid**
- ***Comprehensive Regulation of Insurance Operations***
  - **The business of insurance remained comprehensively regulated whereas a separate banking system had evolved largely outside the auspices and understanding of regulators (e.g., hedge funds, private equity, complex securitized instruments, credit derivatives—CDS's)**
- ***Greater Transparency***
  - **Insurance companies are an open book to regulators and the public**

Source: Insurance Information Institute

The Financial Crisis in Perspective

Bank vs. Insurer Impacts

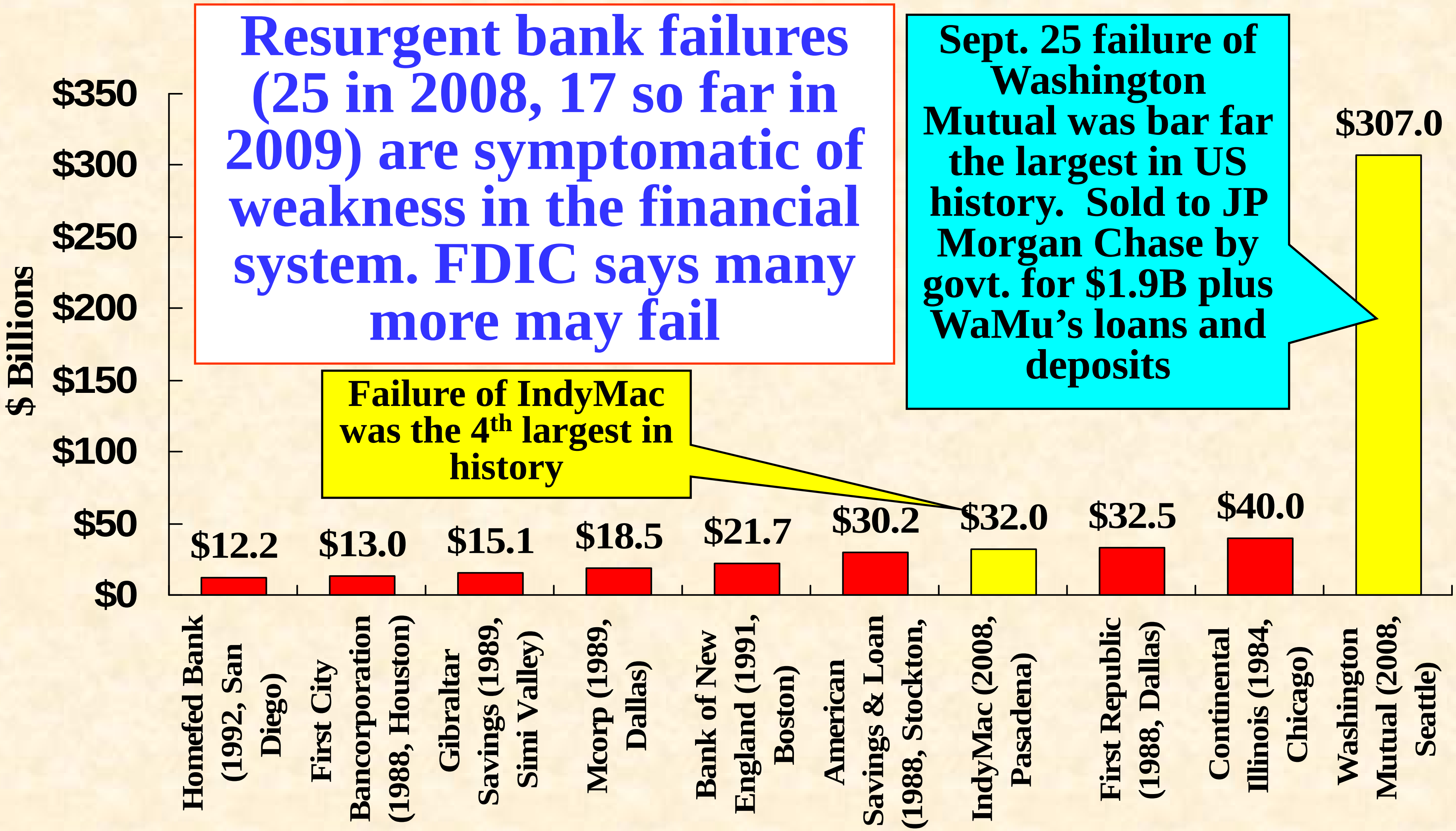
*Financial Institutions Globally Facing Huge Losses from the Credit Crunch**



*Global losses since the beginning of 2007.

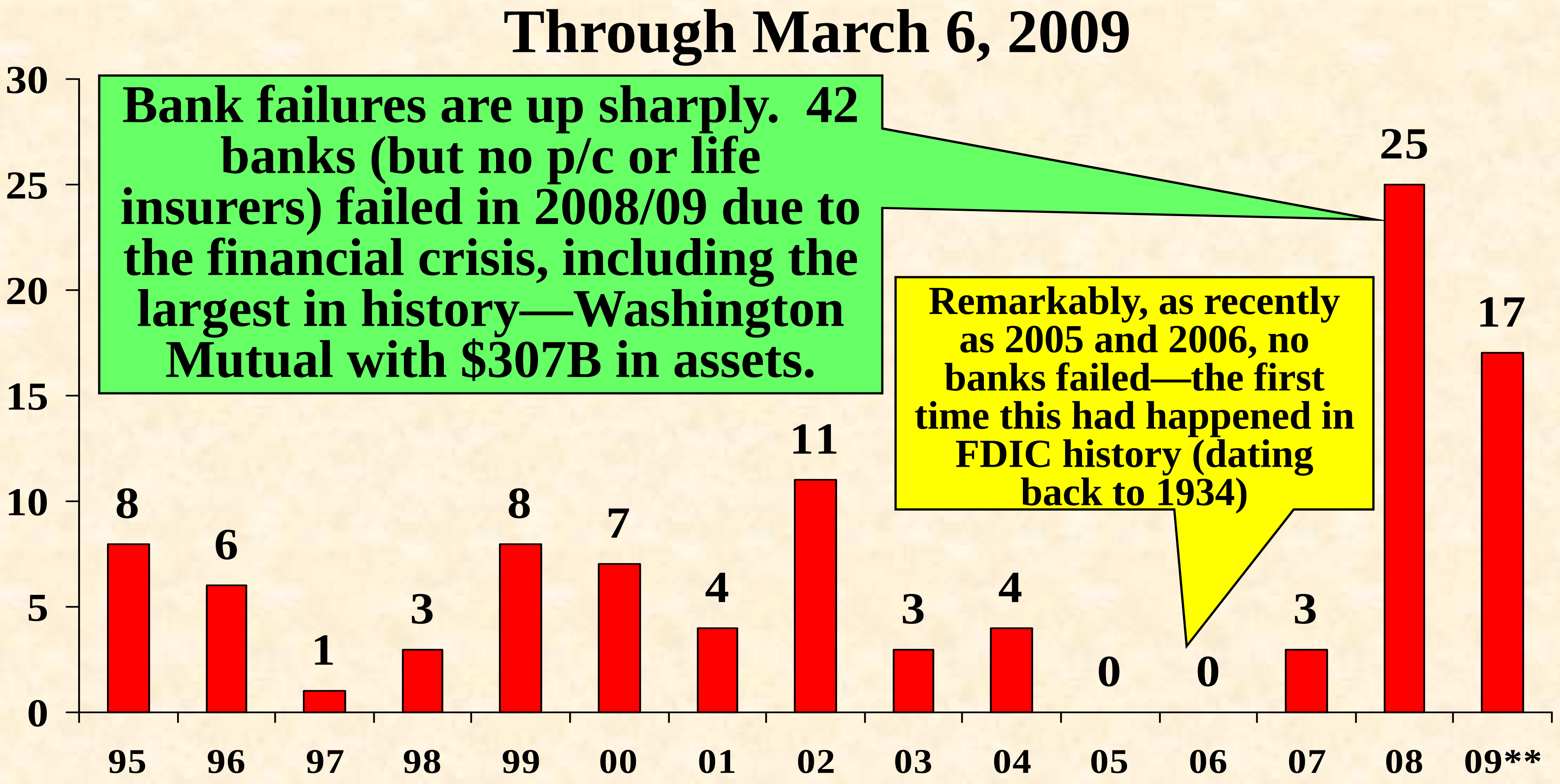
Source: IMF Global Financial Stability Report, October 2008, IIF, Bloomberg, cited in a presentation by Thomas Hess (Chief Economist, Swiss Re) October 23, 2008, accessed via Geneva Association web site.

Top 10 Largest Bank Failures



Source: FDIC; Insurance Information Institute research.

US Bank Failures:* 1995-2009**

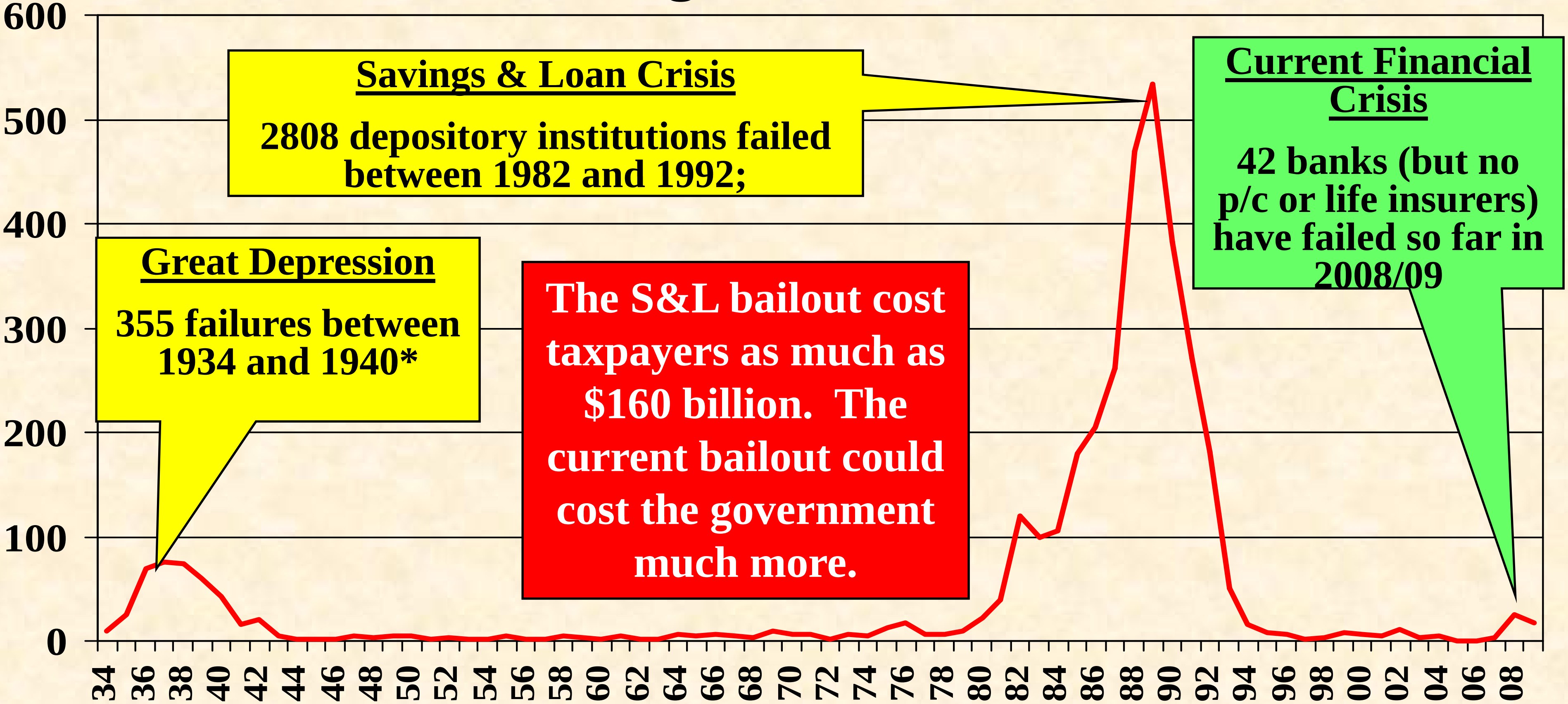


*Includes all commercial banking and savings institutions. **Through Mar. 6.

Source: FDIC: http://www.fdic.gov/bank/historical/bank/index.html; Insurance Info. Institute

US Bank Failures: 1934-2009***

Through March 6, 2009

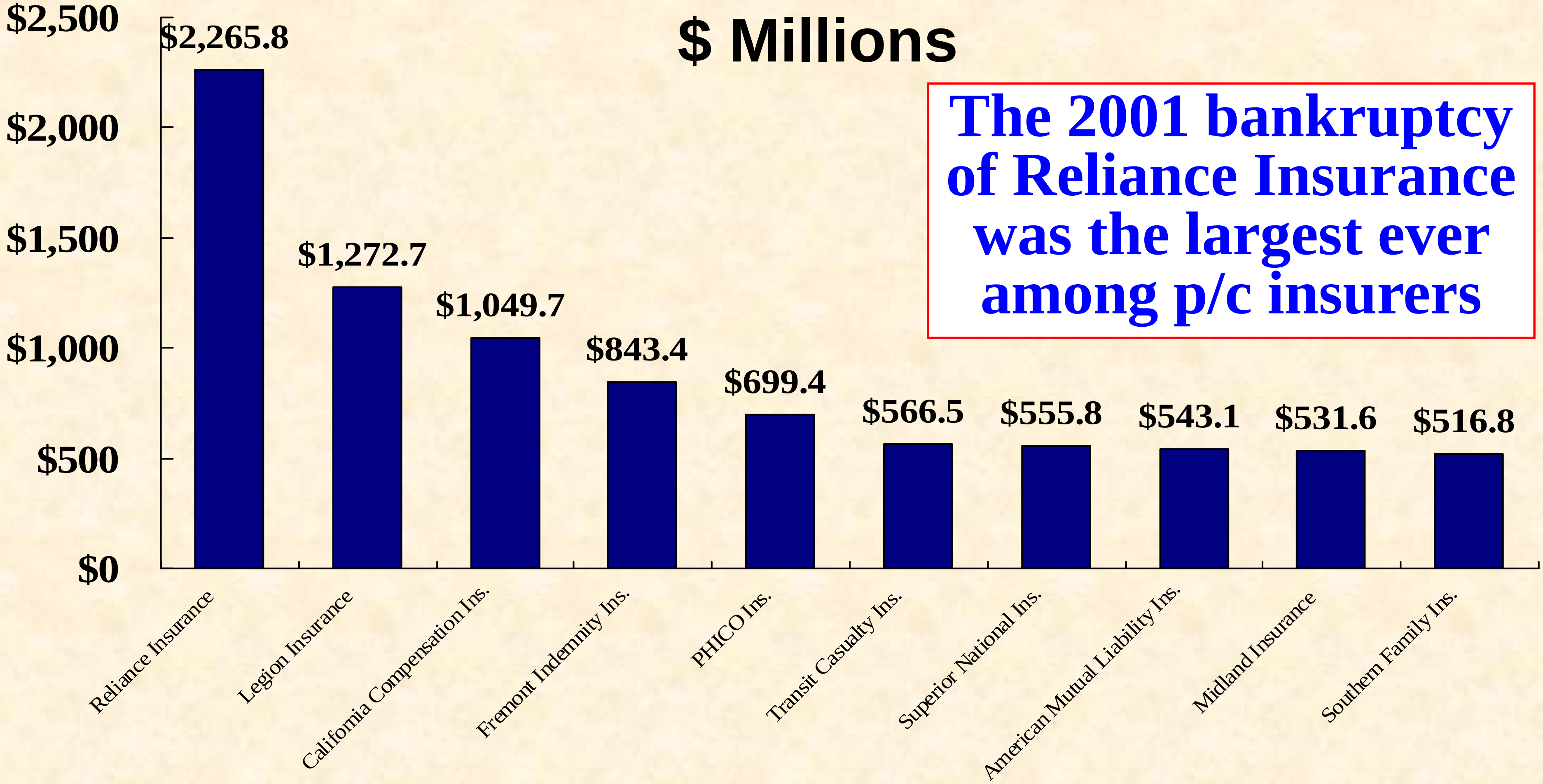


***Includes all commercial banking and savings institutions.**

****Data begin in 1934, the year the FDIC was established.**

Source: FDIC: http://www.fdic.gov/bank/historical/bank/index.html; Insurance Info. Institute

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



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

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

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

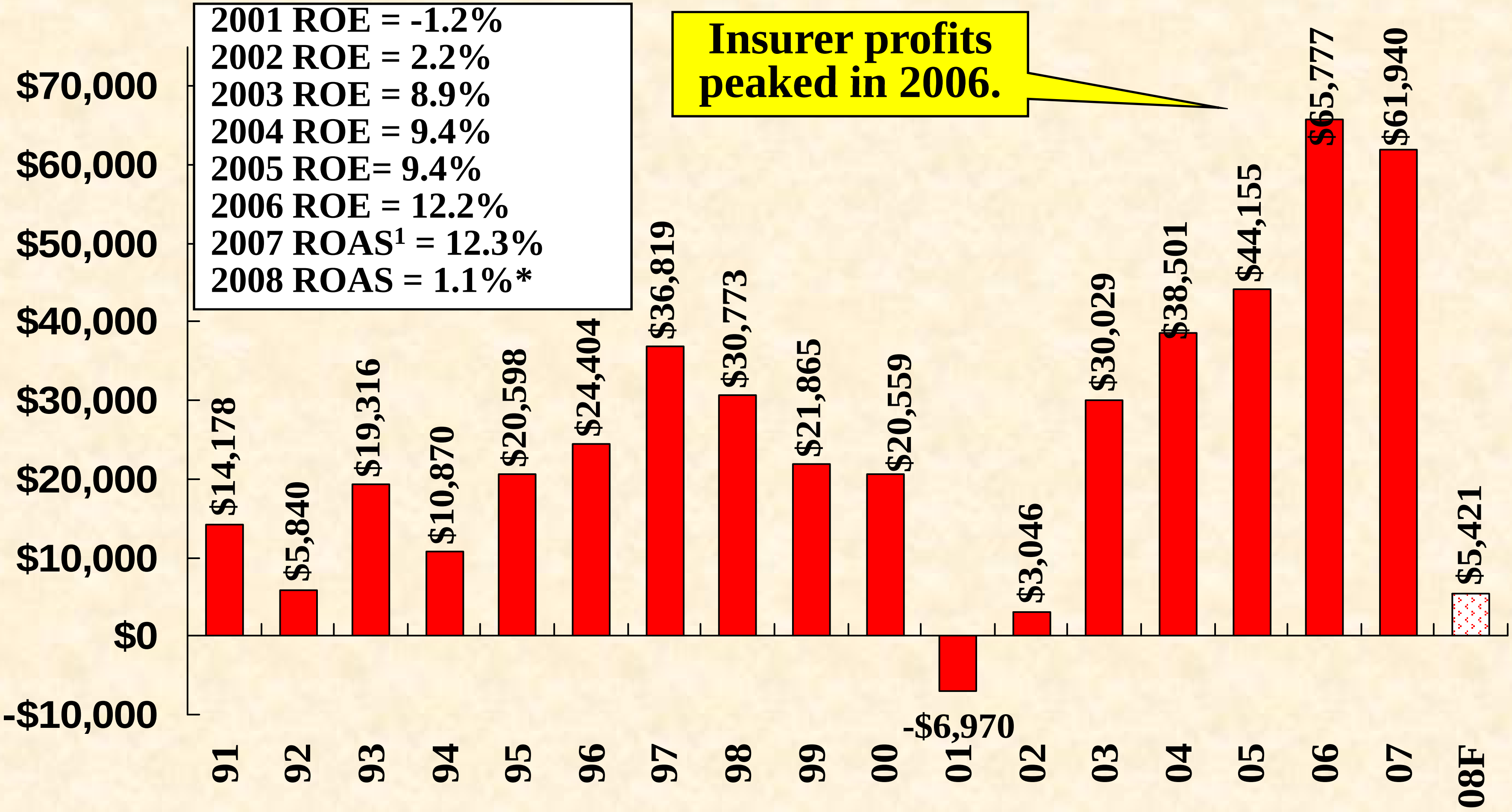
P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

Historically Volatile

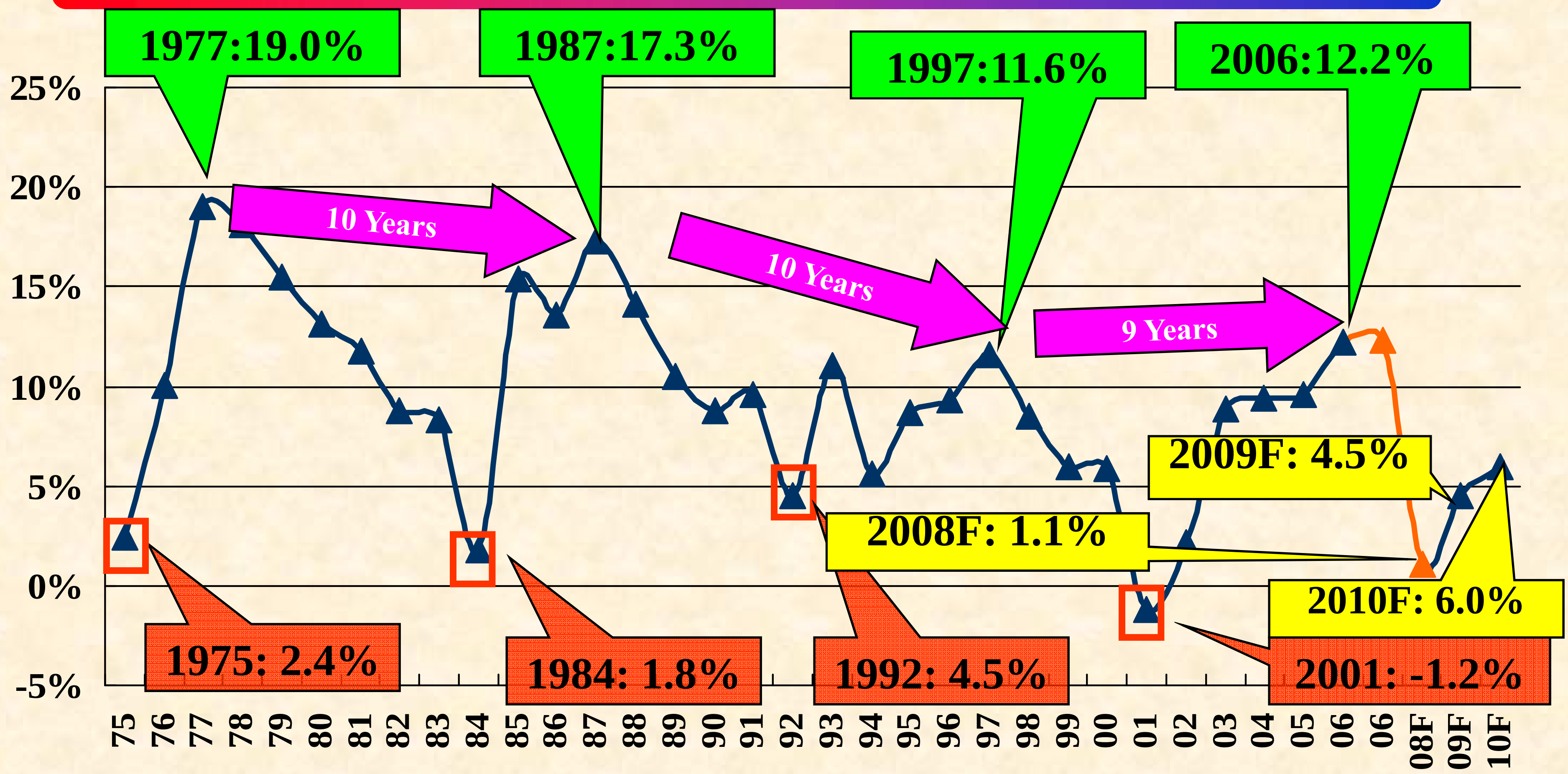
P/C Net Income After Taxes 1991-2009F ($ Millions)*



*ROE figures are GAAP; [1]Return on avg. surplus. 2008 numbers are annualized based on 9-mos. Actual of $4.066 billion.

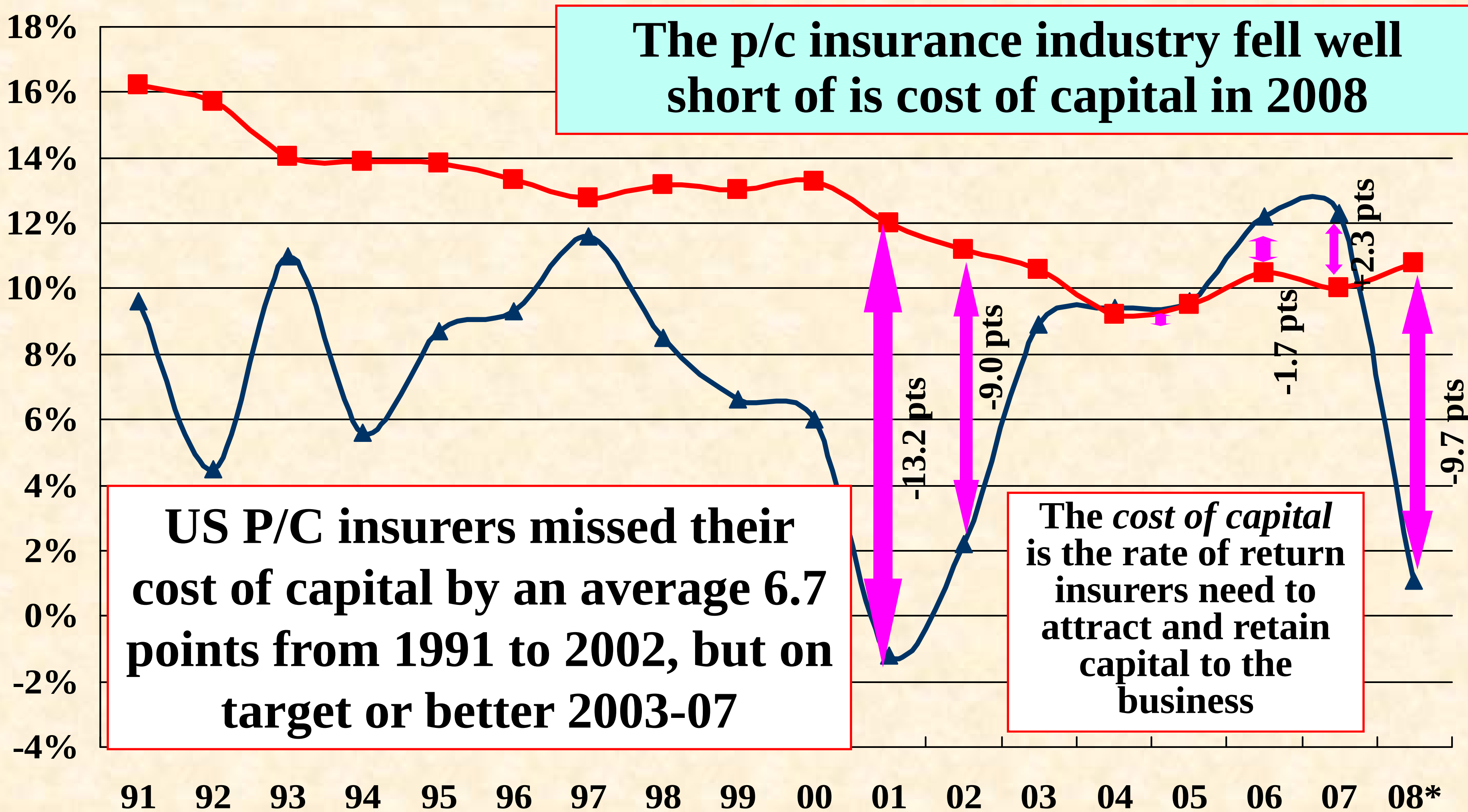
Sources: A.M. Best, ISO, Insurance Information Inst.

*P/C Insurance Industry ROEs, 1975 – 2010F**



Note: 2009 figure is actual 9-month result.
Sources: ISO; Insurance Information Institute.

ROE vs. Equity Cost of Capital: US P/C Insurance:1991-2008:Q3

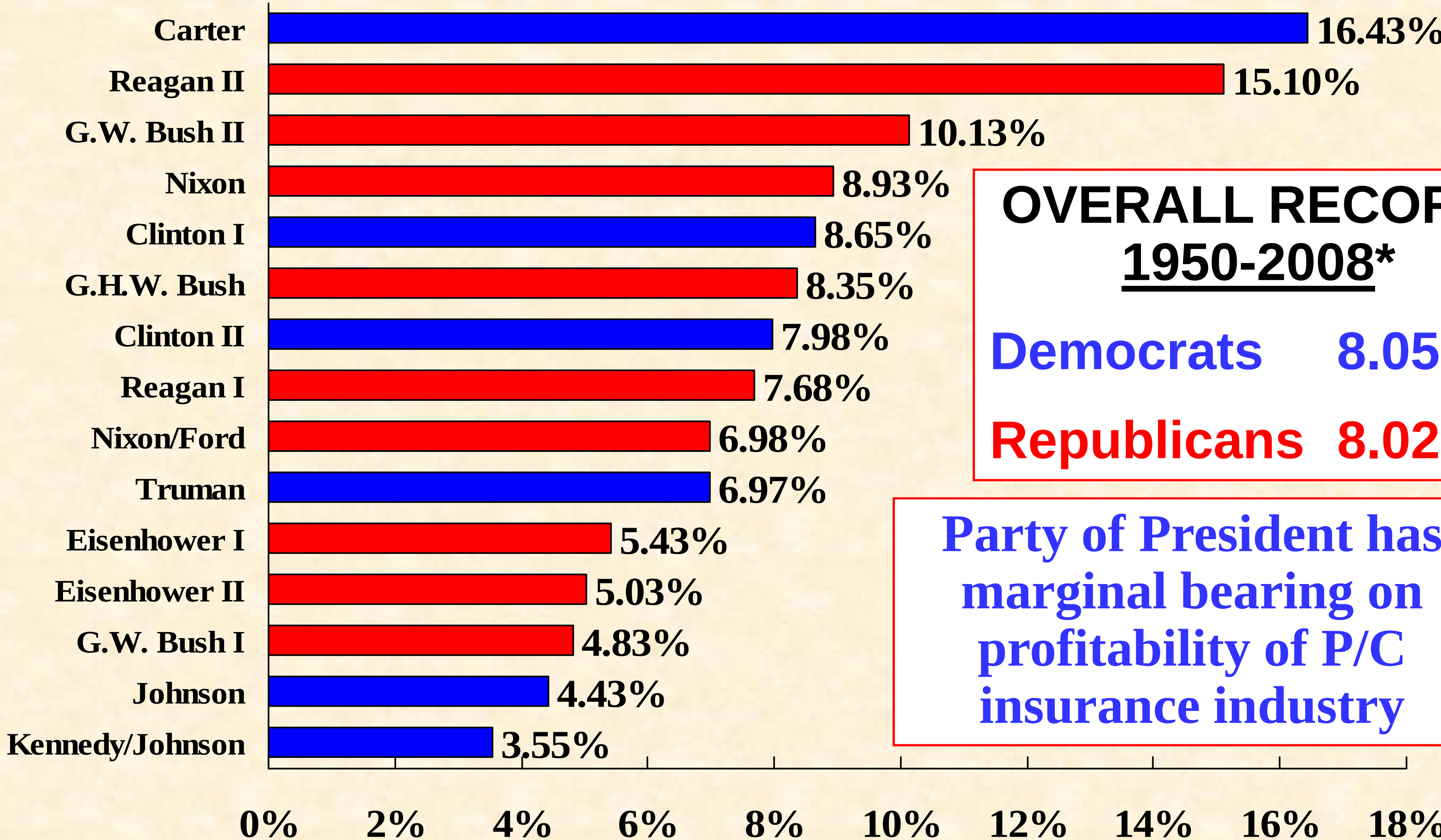


*Excludes mortgage and financial guarantee insurers.
Source: The Geneva Association, Ins. Information Inst.

Presidential Politics & P/C Insurance

How is Profitability Affected by the President's Political Party?

P/C Insurance Industry ROE by Presidential Administration,1950-2008*



OVERALL RECORD: 1950-2008*

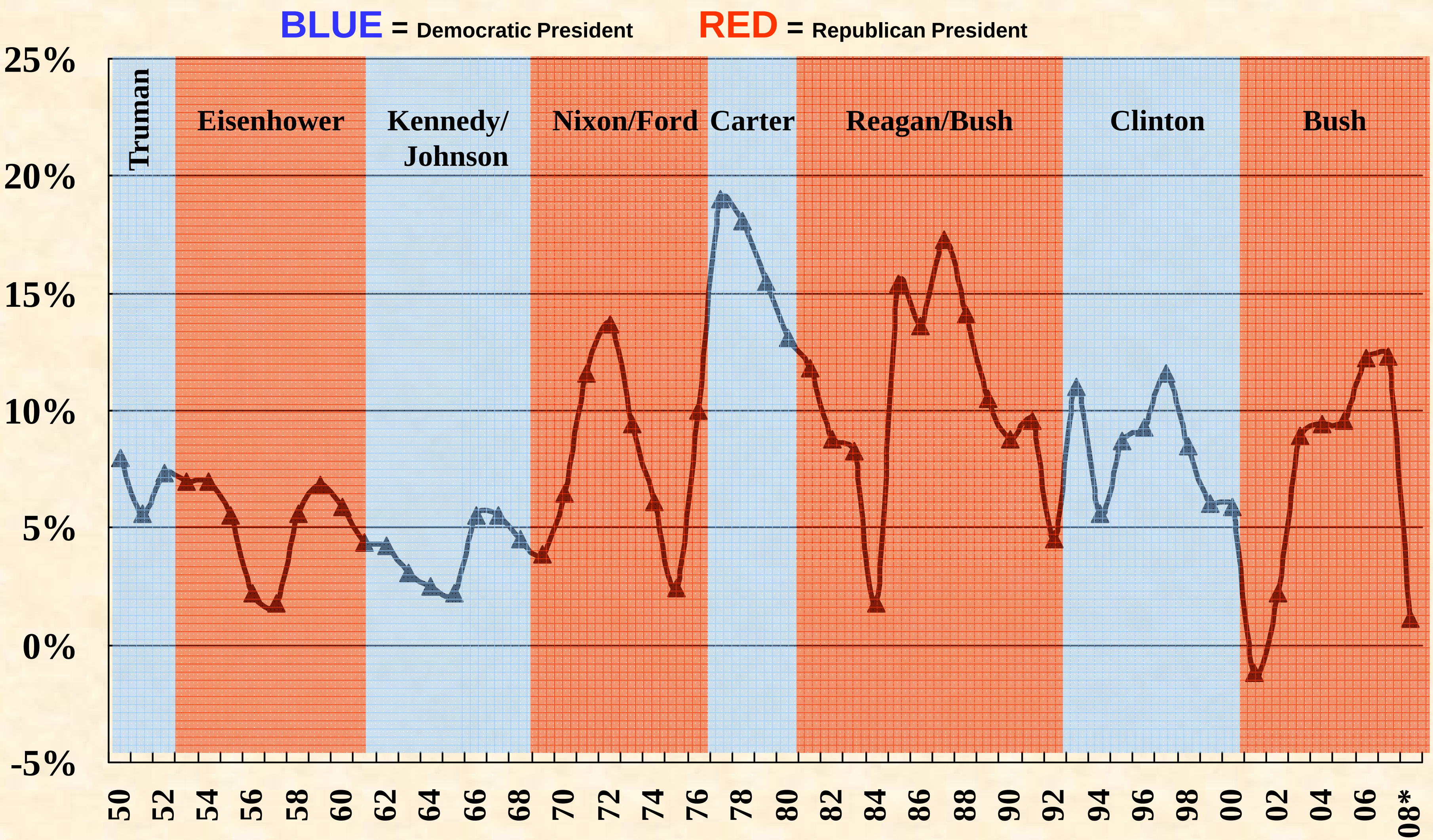
Democrats	8.05%
Republicans	8.02%

Party of President has marginal bearing on profitability of P/C insurance industry

*ROE for 2008 based on H1 data. Truman administration ROE of 6.97% based on 3 years only, 1950-52.

Source: Insurance Information Institute

P/C Insurance Industry ROE by Presidential Party Affiliation, 1950–2008*

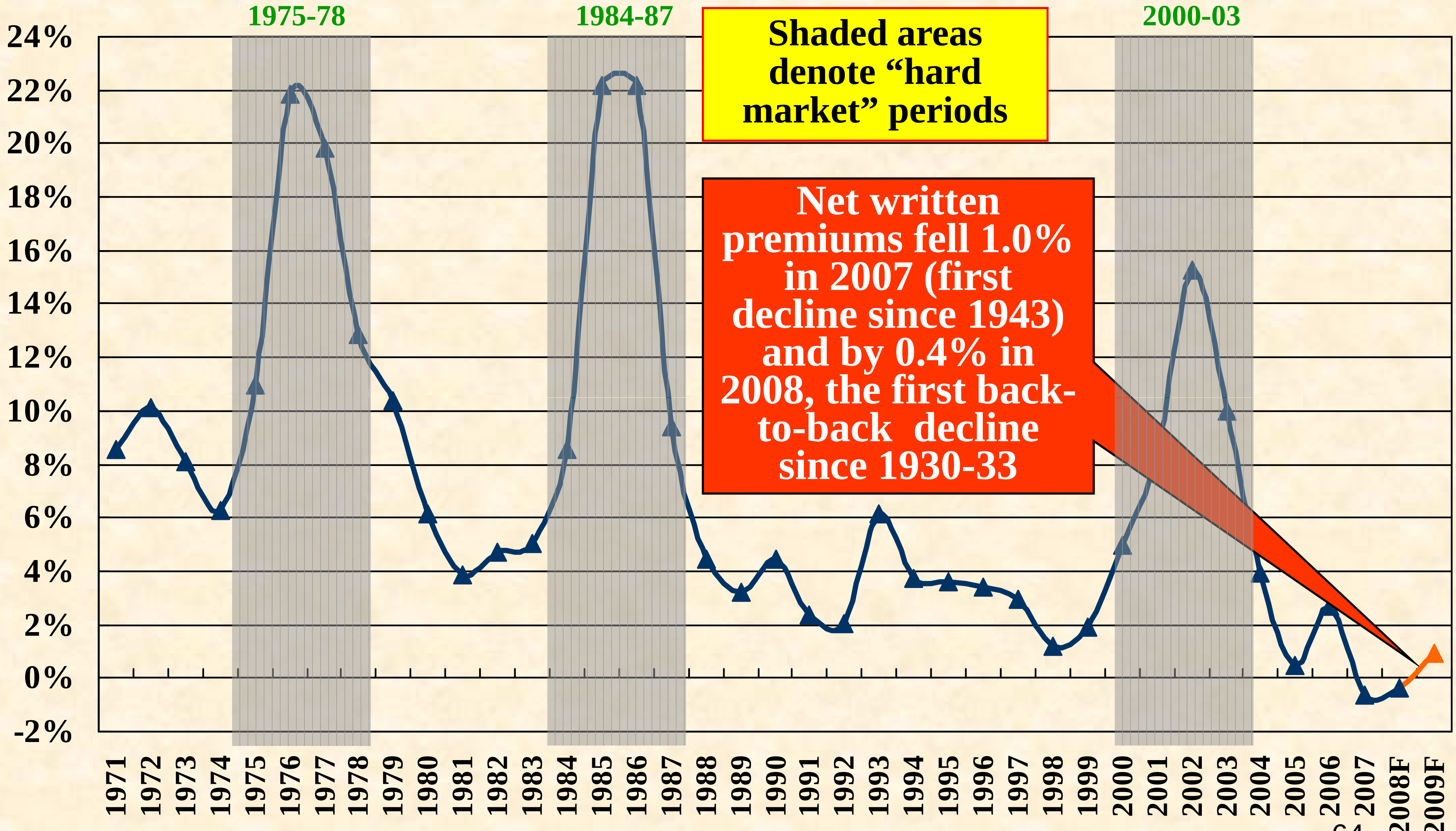


Source: Insurance Information Institute. *2008 based 9-month data.

P/C Premium Growth

Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Strength of Recent Hard Markets by NWP Growth



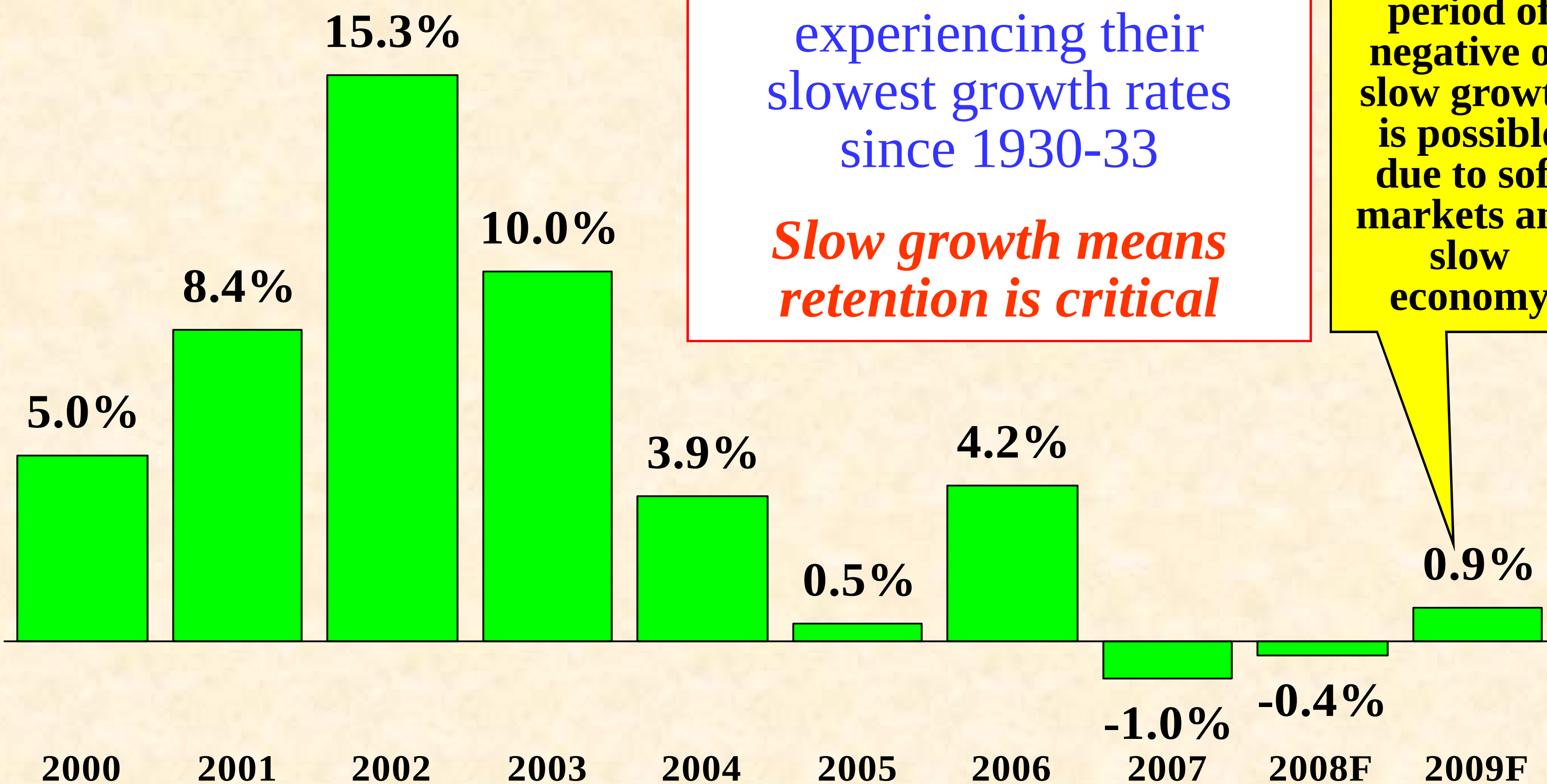
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute

Year-to-Year Change in Net Written Premium, 2000-2009F*

P/C insurers are experiencing their slowest growth rates since 1930-33

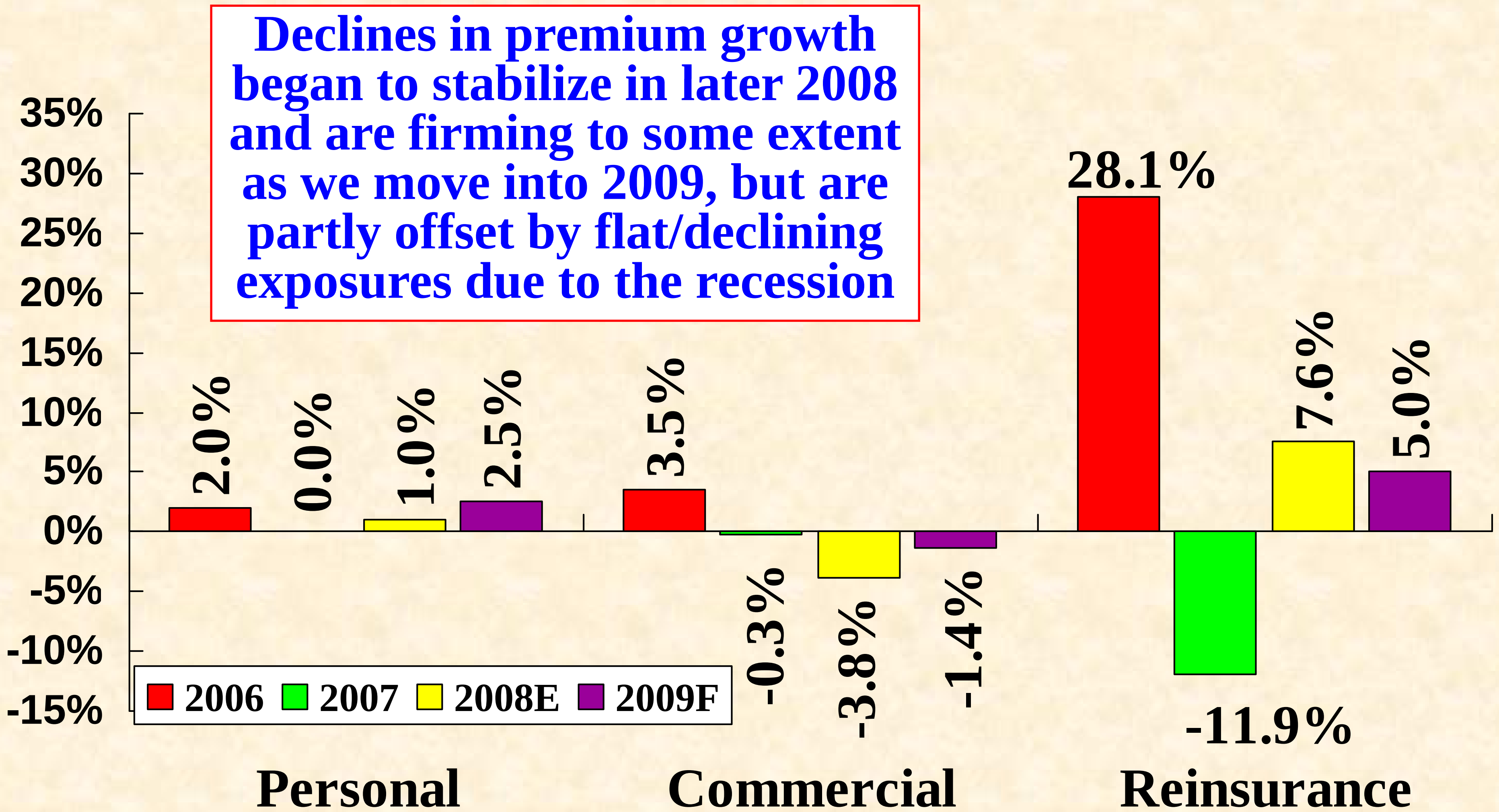
Slow growth means retention is critical

Protracted period of negative or slow growth is possible due to soft markets and slow economy



*2008 figure is 9-month actual result from ISO.
Source: A.M. Best (historical and forecast)

Personal/Commercial Lines & Reinsurance NPW Growth, 2006-2009F

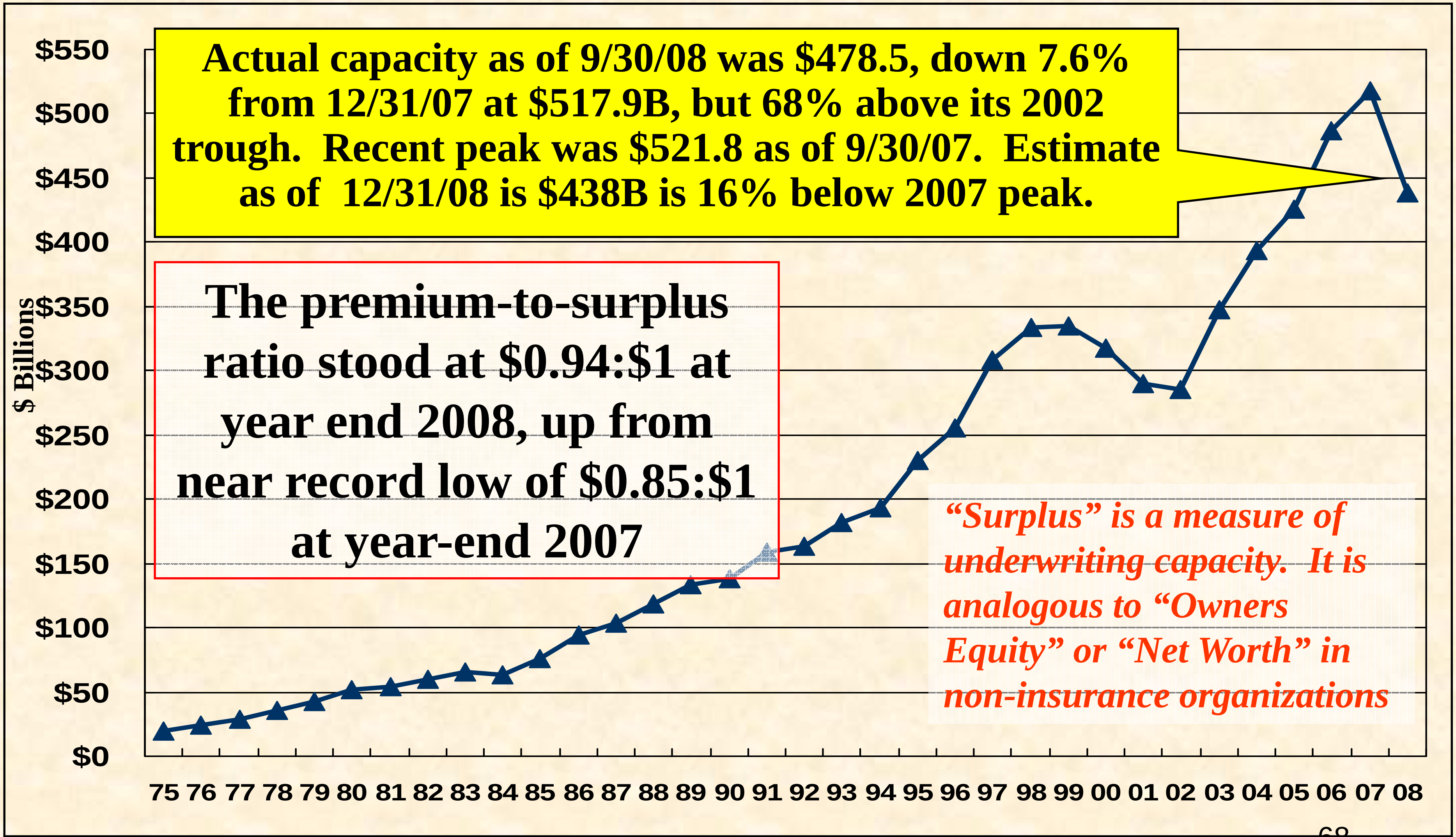


Sources: A.M. Best Review & Preview, Feb. 2009

Capital/ Policyholder Surplus

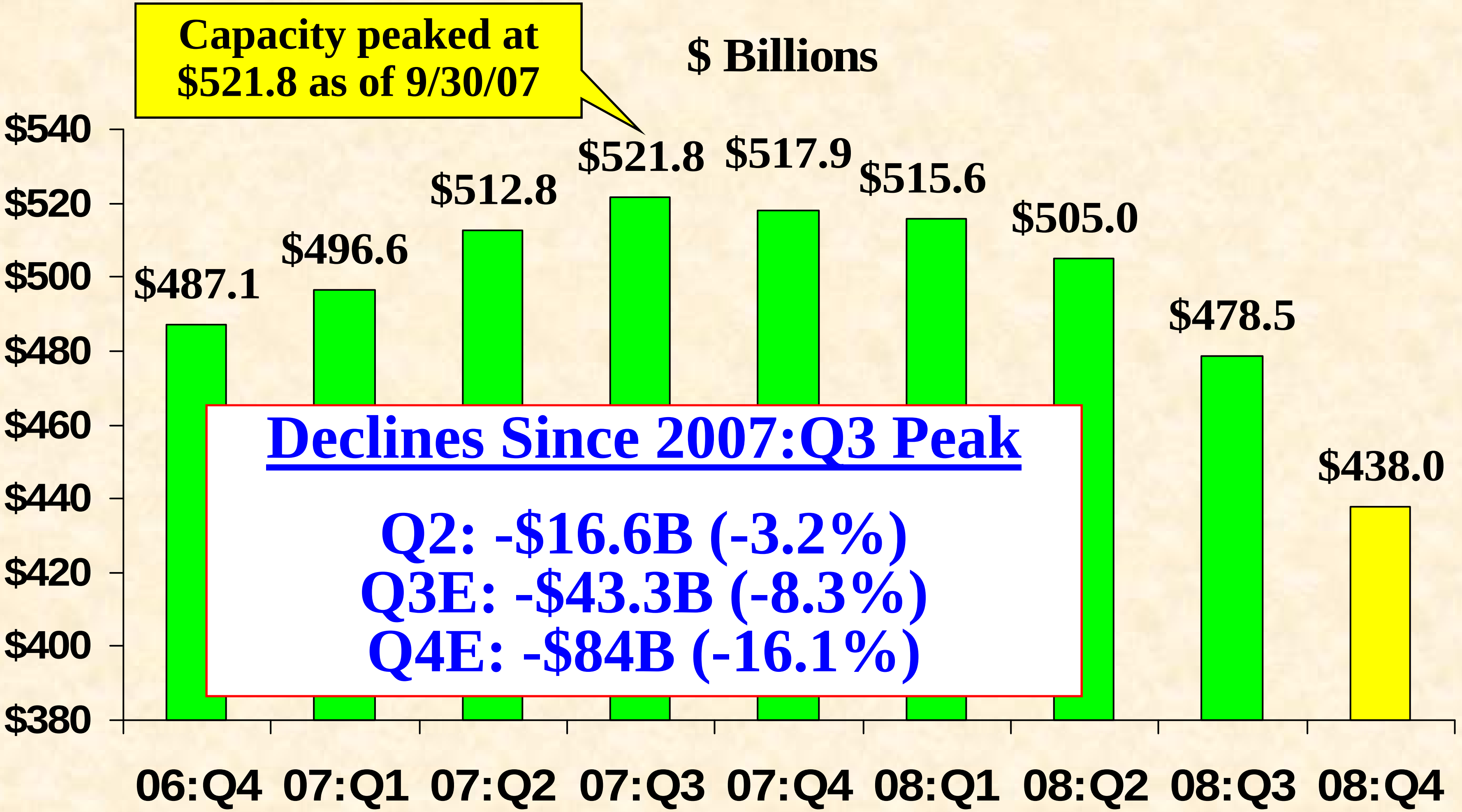
Shrinkage, but Capital is Within Historic Norms

U.S. Policyholder Surplus: 1975-2008*



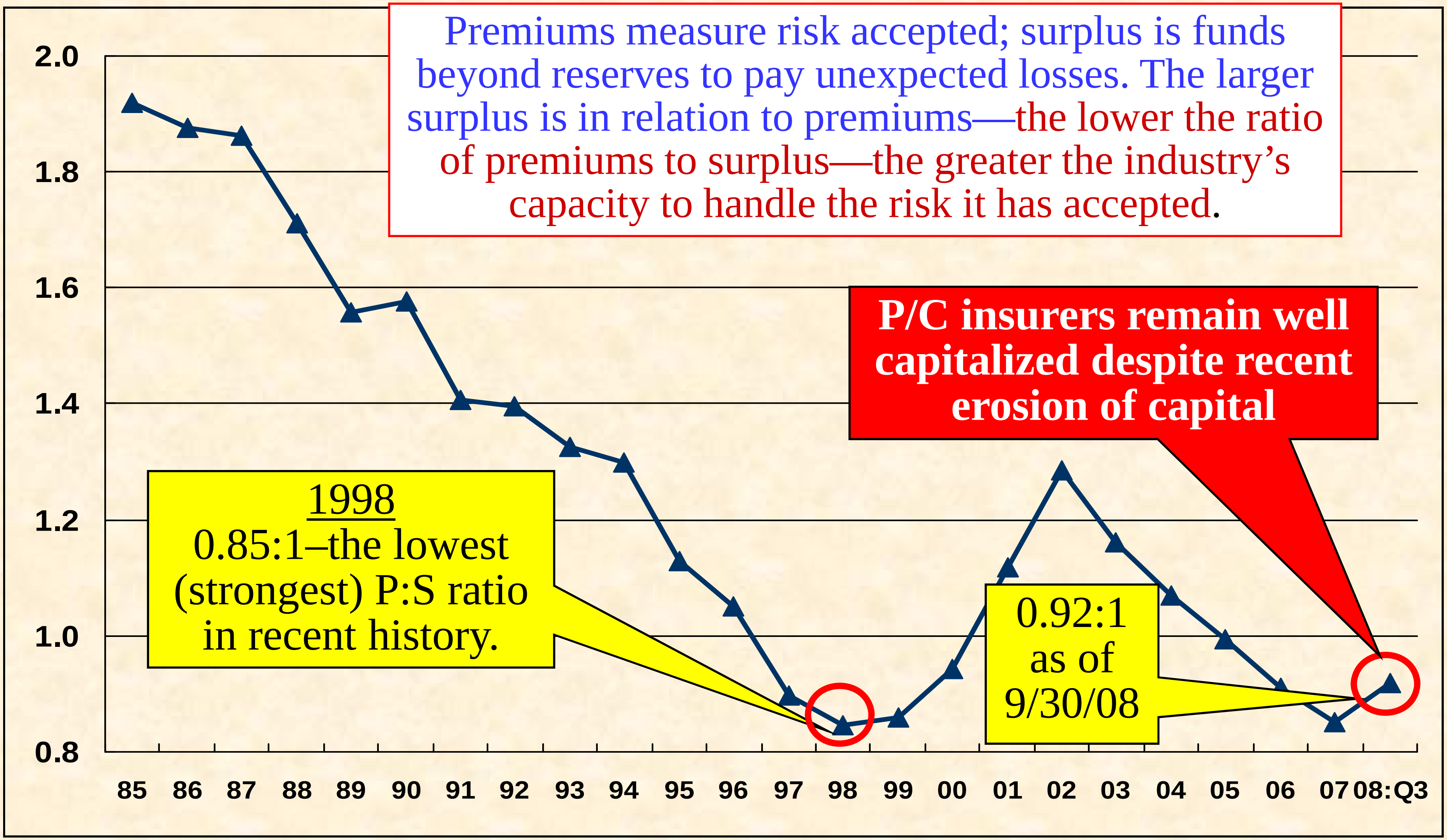
Source: A.M. Best, ISO, Insurance Information Institute. *Towers Perrin estimate as of 12/31/08

Policyholder Surplus,
2006:Q4 – 2008:Q4(Est.)



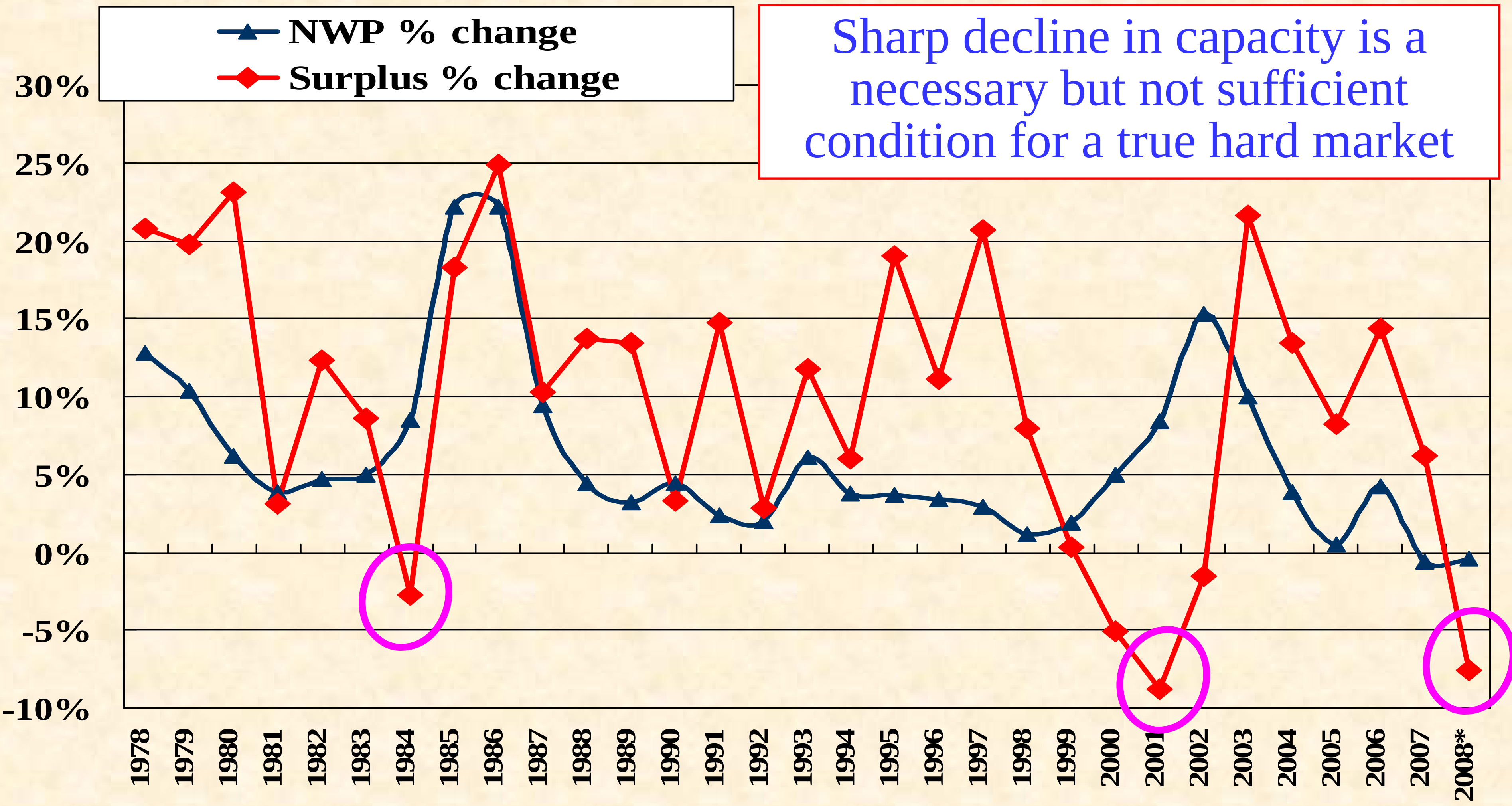
Source: ISO (historical); Towers Perrin (Oct. 21) estimates for Q4 2008. Q4 assumes no major Investment market recovery before year-end 2008.

U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2008:Q3



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

Historically, Hard Markets Follow When Surplus "Growth" is Negative



*Actual 9-month 2008 result.

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

Investment Performance

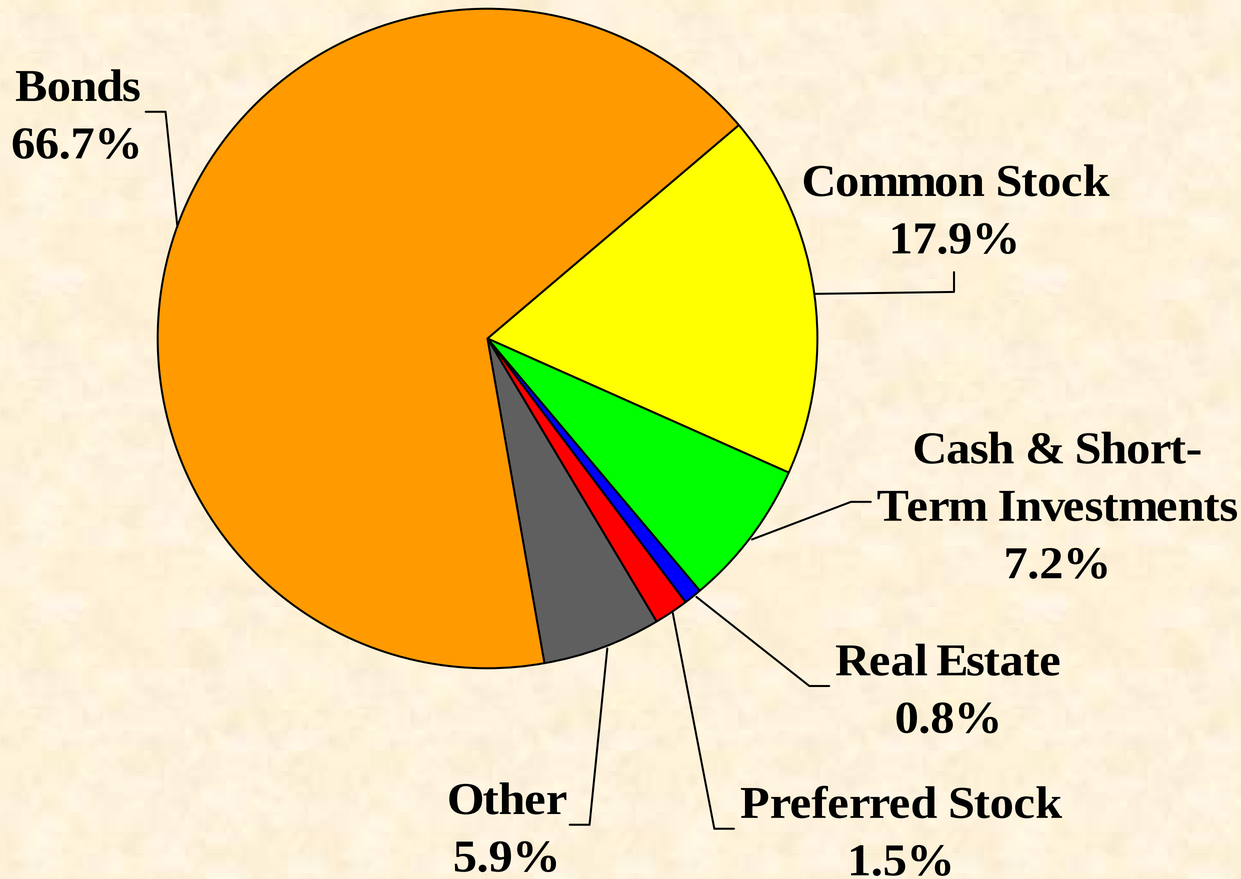
Investments are the Principle Source of Declining Profitability

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2007

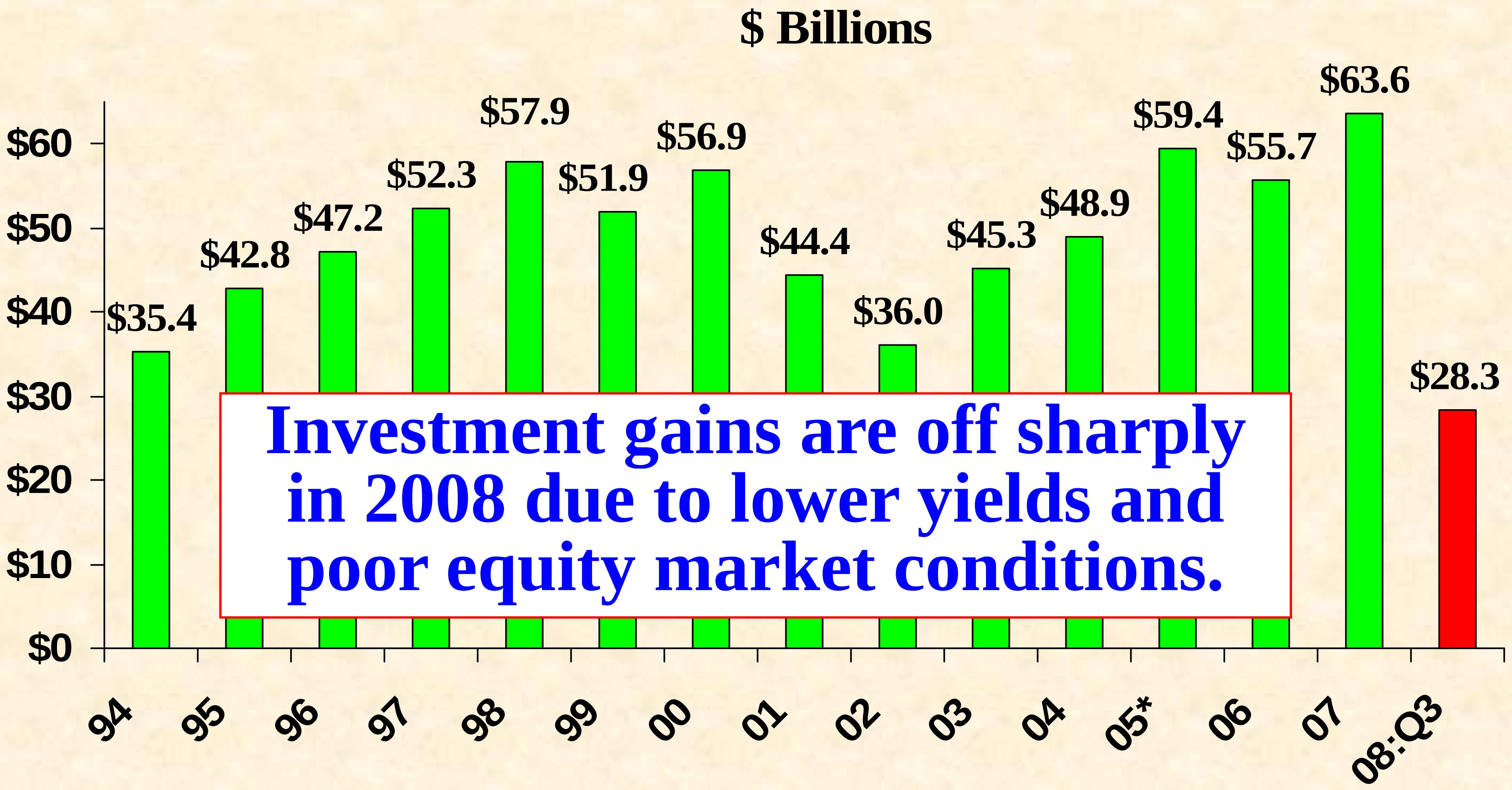
Portfolio Facts

- **Invested assets totaled $1.3 trillion as of 12/31/07**
- **Insurers are generally conservatively invested, with 2/3 of assets invested in bonds as of 12/31/07**
- **Only about 18% of assets were invested in common stock as of 12/31/07**
- **Even the most conservative of portfolios was hit hard in 2008**



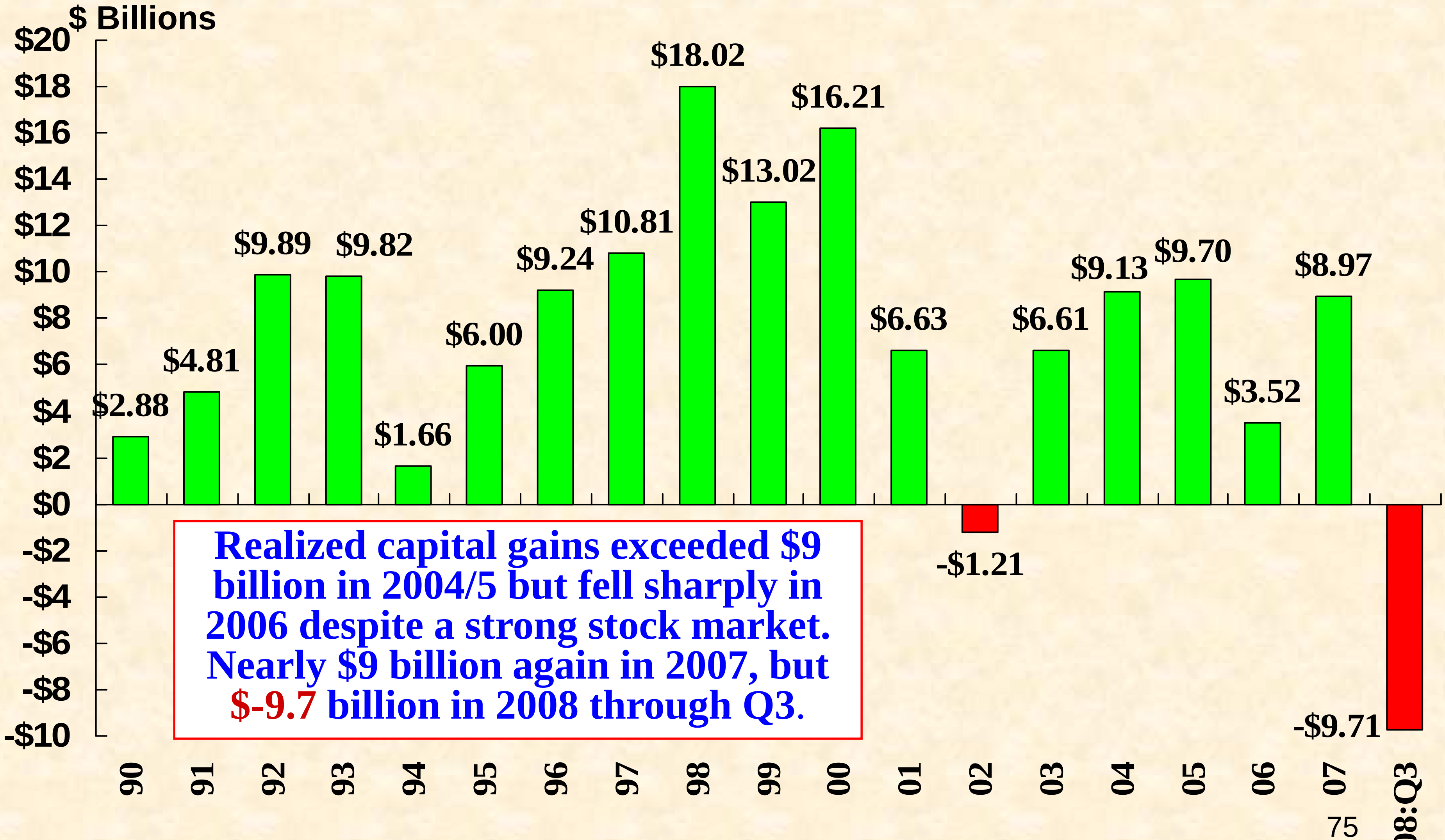
Source: NAIC; Insurance Information Institute research;.

Property/Casualty Insurance Industry Investment Gain:1994- 2008:Q3 [1]



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

P/C Insurer Net Realized Capital Gains, 1990-2008:Q3



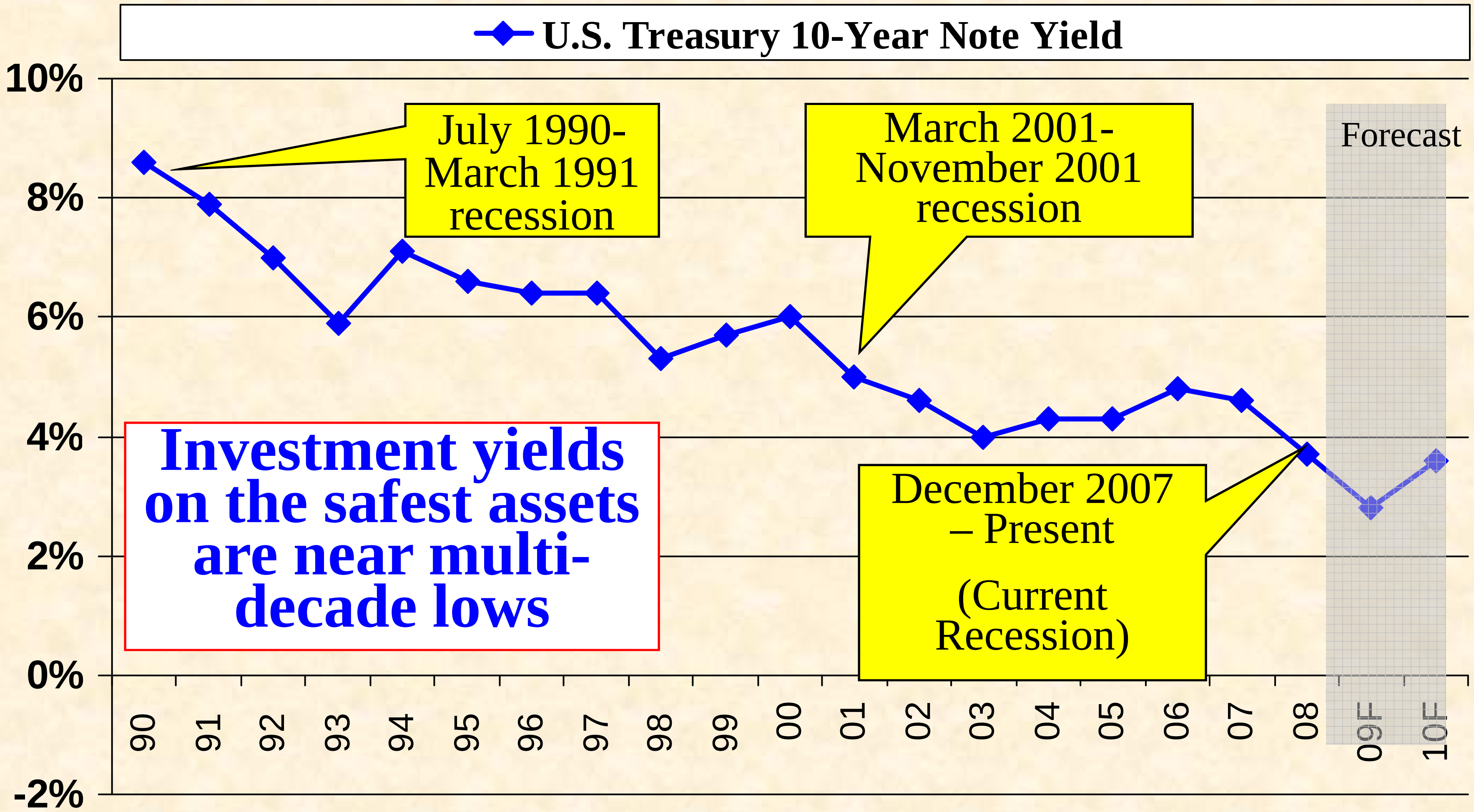
Sources: A.M. Best, ISO, Insurance Information Institute.

*Total Returns for Large Company Stocks: 1970-2009**

S&P 500 was down 20.3% in 2009*

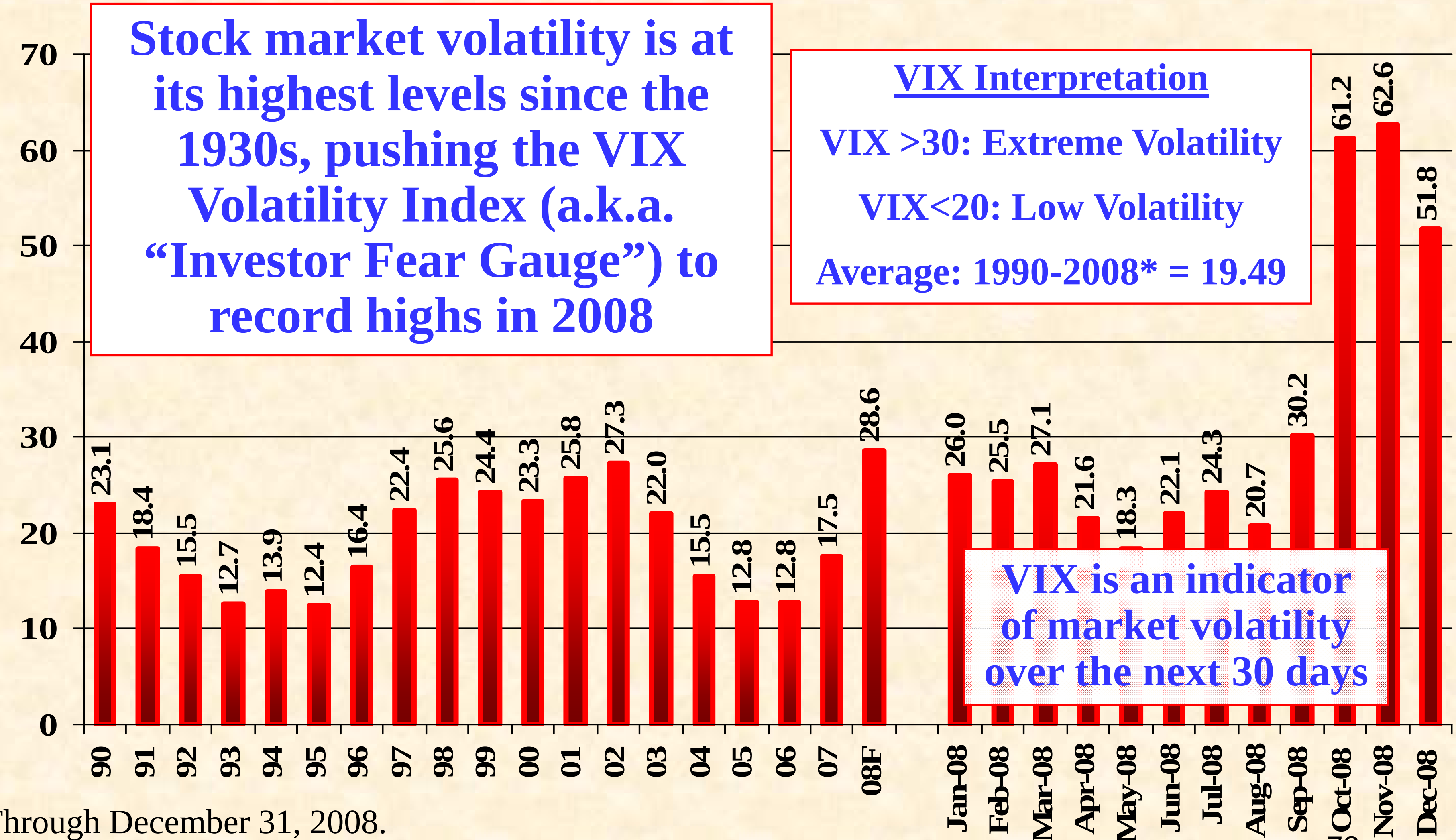
Source: Ibbotson Associates, Insurance Information Institute. *Through March 10, 2009.

Treasury Bond Yields Have Generally Been Falling



Sources: US Bureau of Labor Statistics (history); Blue Chip Economic Indicators, February 2009 issue (forecasts)

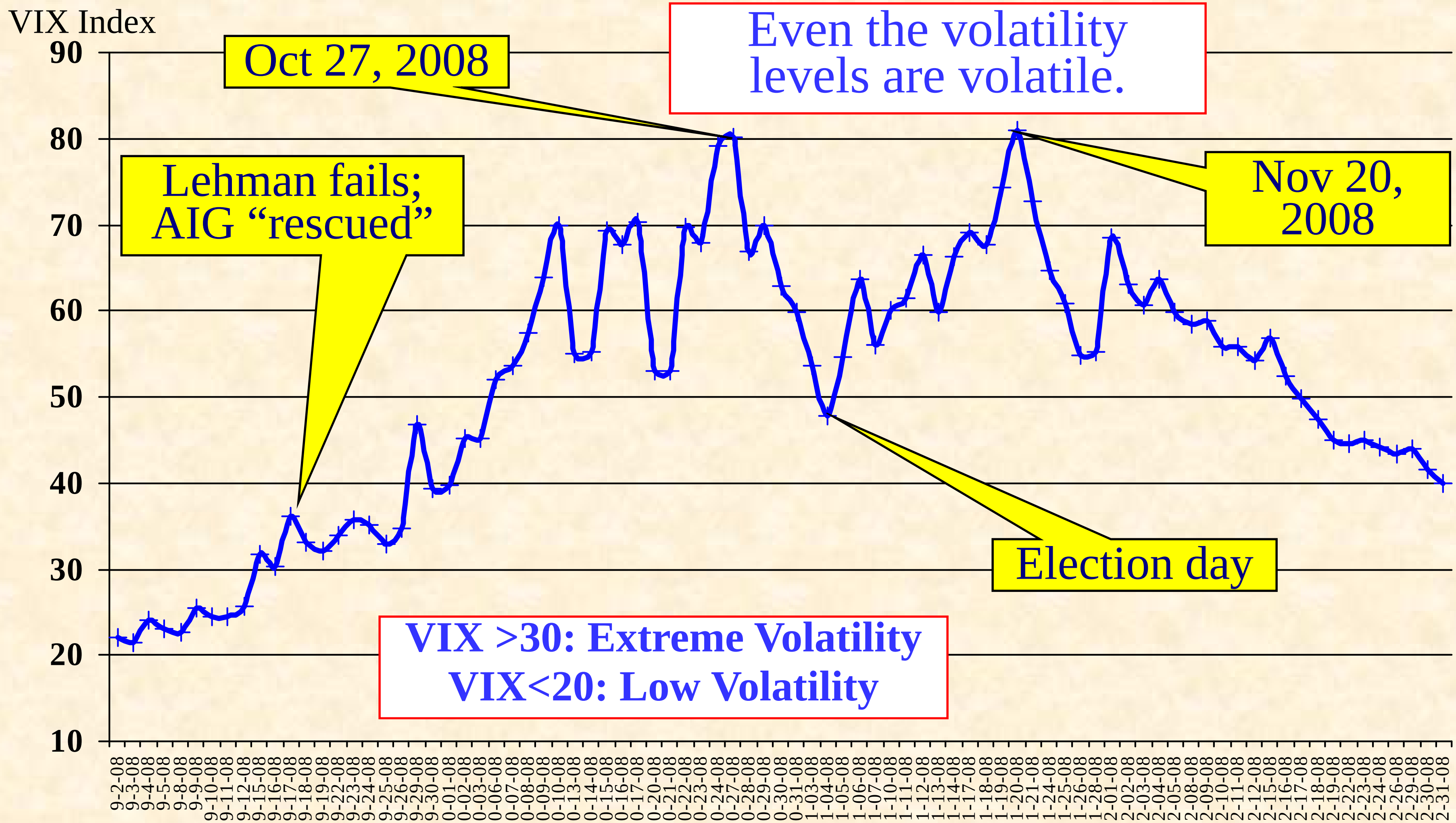
VIX Volatility Index: Stock Market Volatility at Record Highs in 2008*



*Through December 31, 2008.

Sources: Chicago Board Options Exchange: http://www.cboe.com/micro/vix/historical.aspx

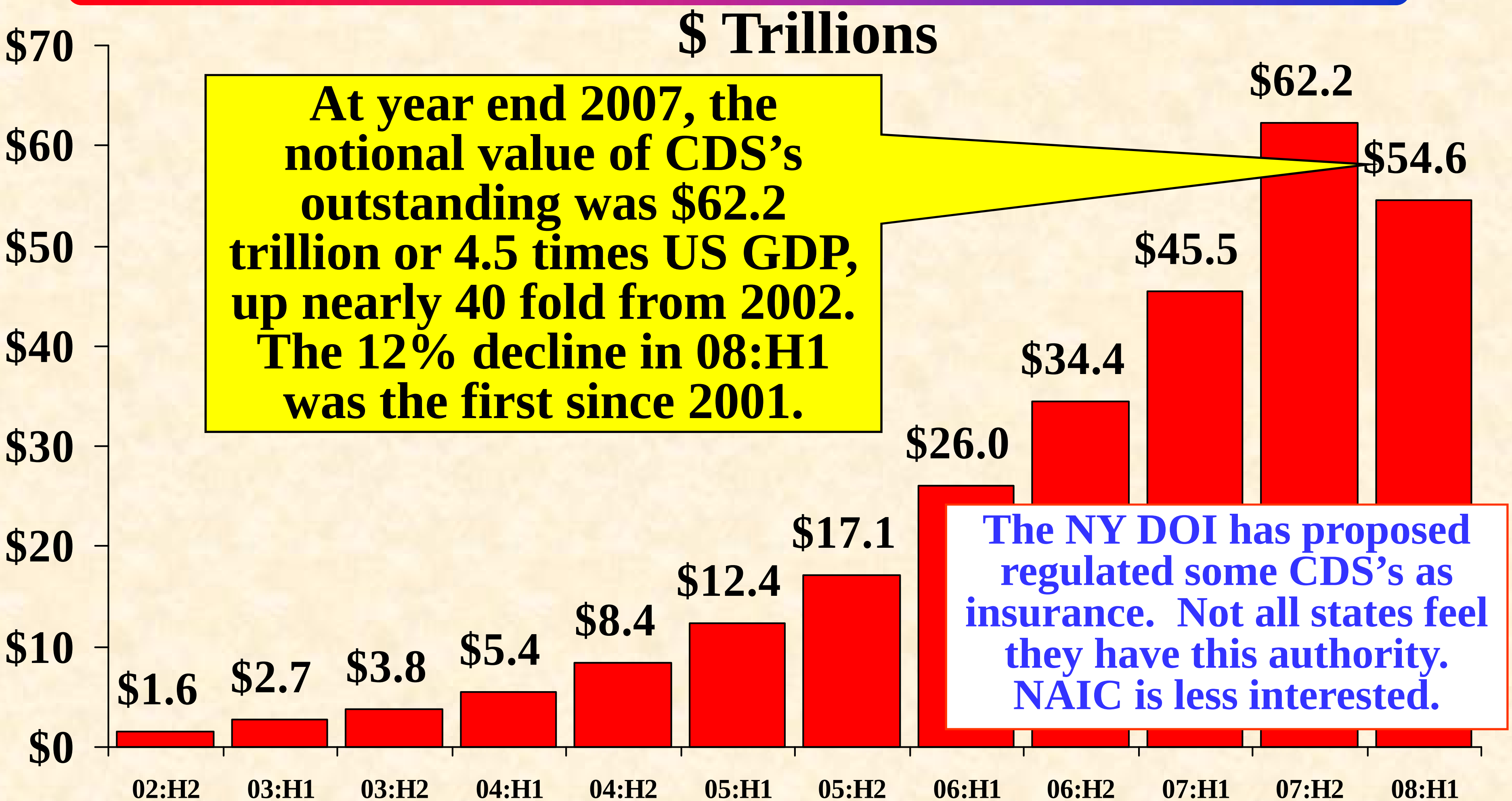
Stock Market Daily Volatility in 2008*: Heading to “Normal”?



*September 2 to December 31, 2008.

Source: Chicago Board Options Exchange: http://www.cboe.com/micro/vix/historical.aspx

Credit Default Swaps: Notional Value Outstanding, 2002:H2 – 2008:H1*



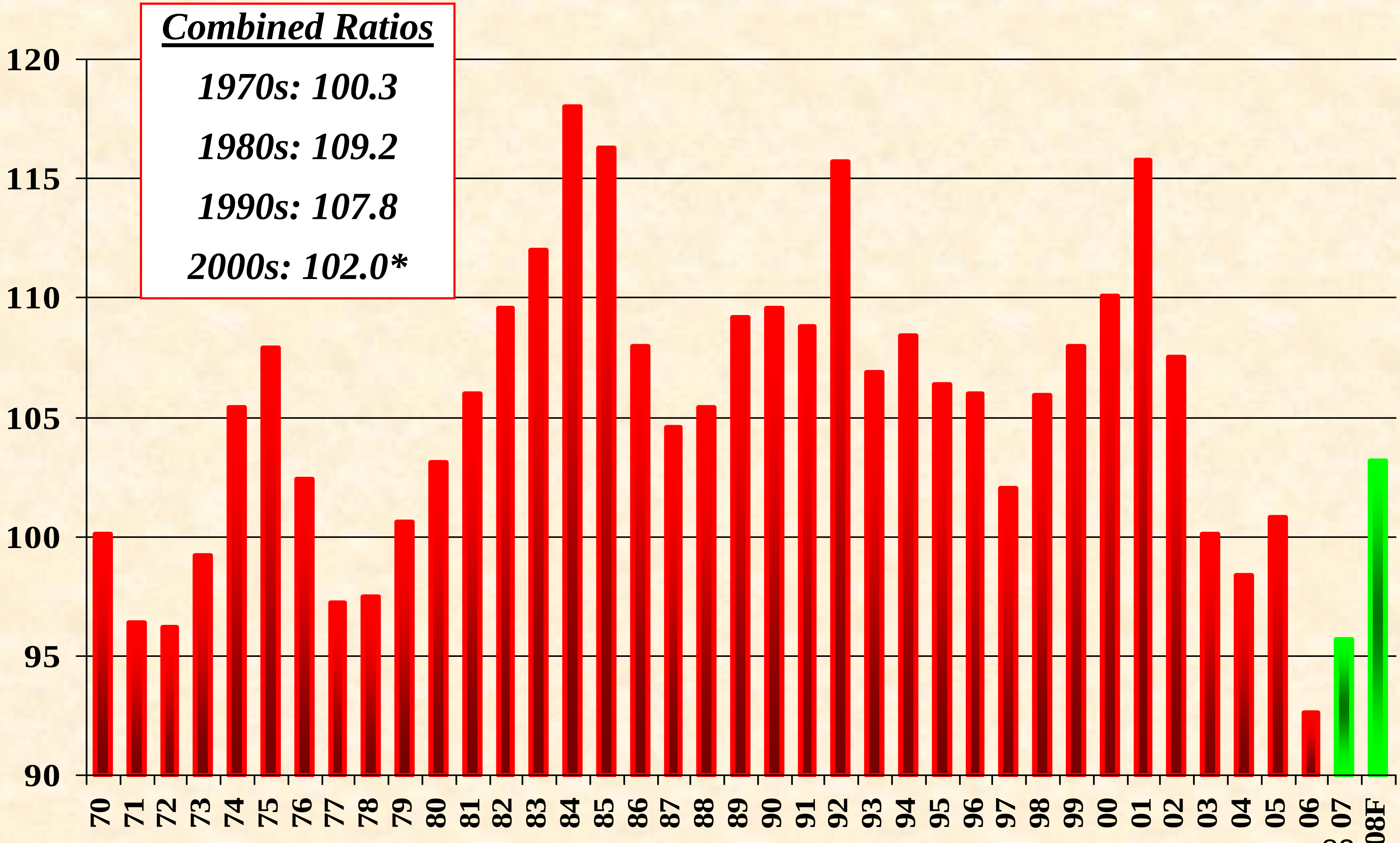
*End of calendar half (H1 = June 30, H2 = December 31).

Source: International Swaps and Derivatives Association: http://www.isda.org/statistics/recent.html

Underwriting Trends

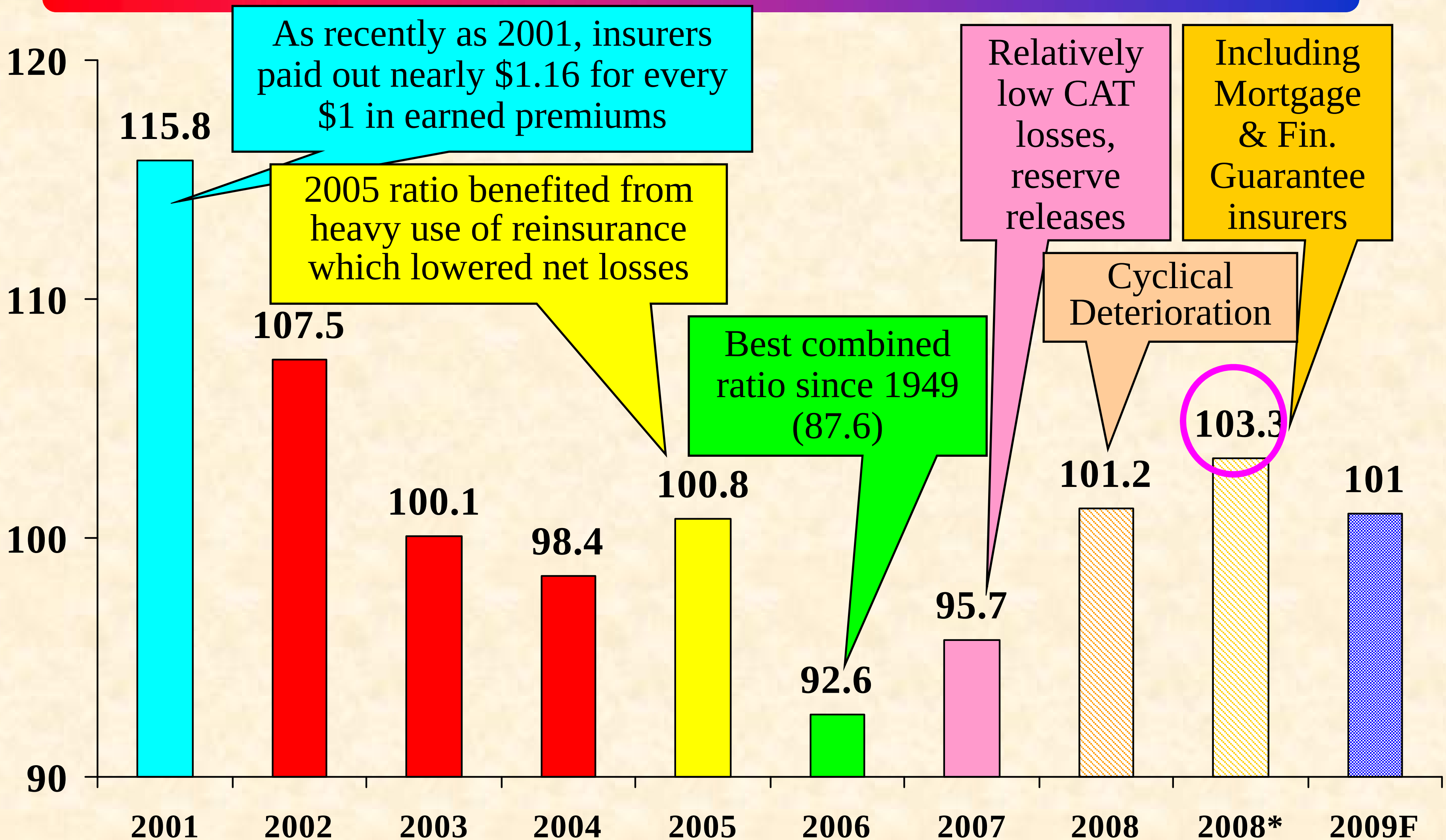
Financial Crisis Does *Not* Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

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



Sources: A.M. Best; ISO, III *A.M. Best year end estimate of 103.2; Actual 9-mos. result was 105.6.

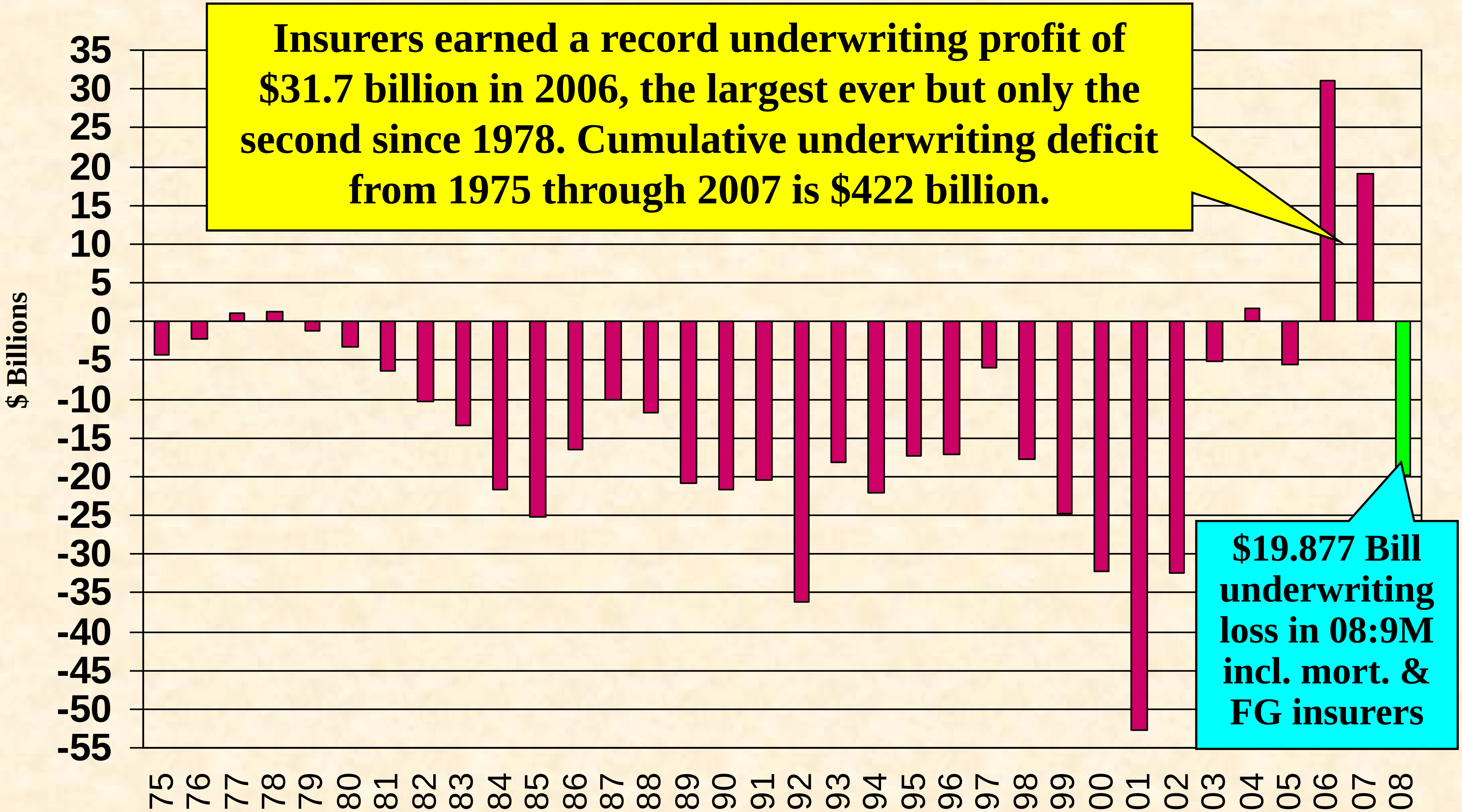
P/C Insurance Industry Combined Ratio, 2001-2009E



*Includes Mortgage & Financial Guarantee insurers.

Sources: A.M. Best.

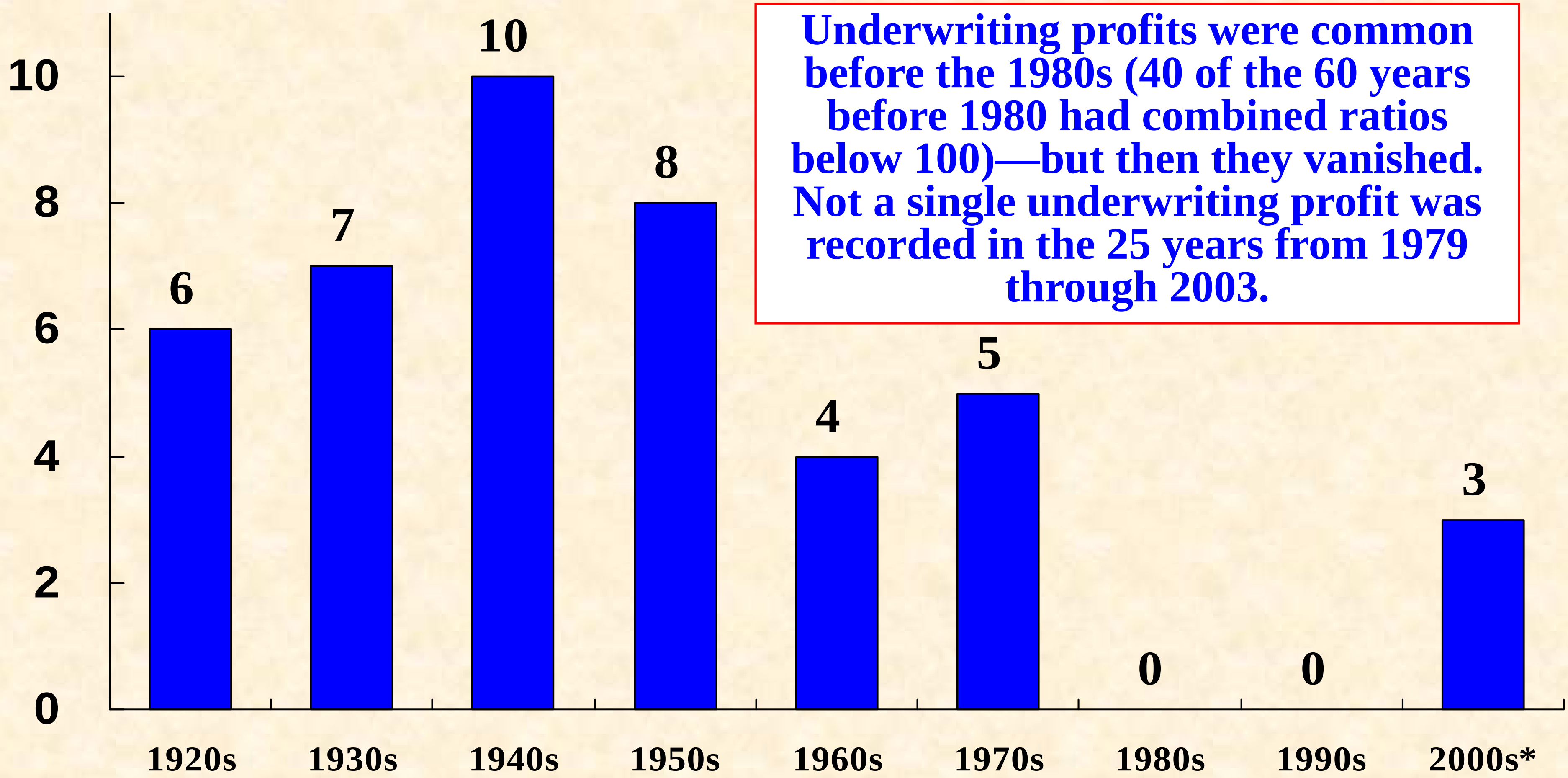
Underwriting Gain (Loss) 1975-2008:Q3*



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

Number of Years With Underwriting Profits by Decade, 1920s –2000s

Number of Years with Underwriting Profits



Note: Data for 1920 – 1934 based on stock companies only.

Sources: Insurance Information Institute research from A.M. Best Data.

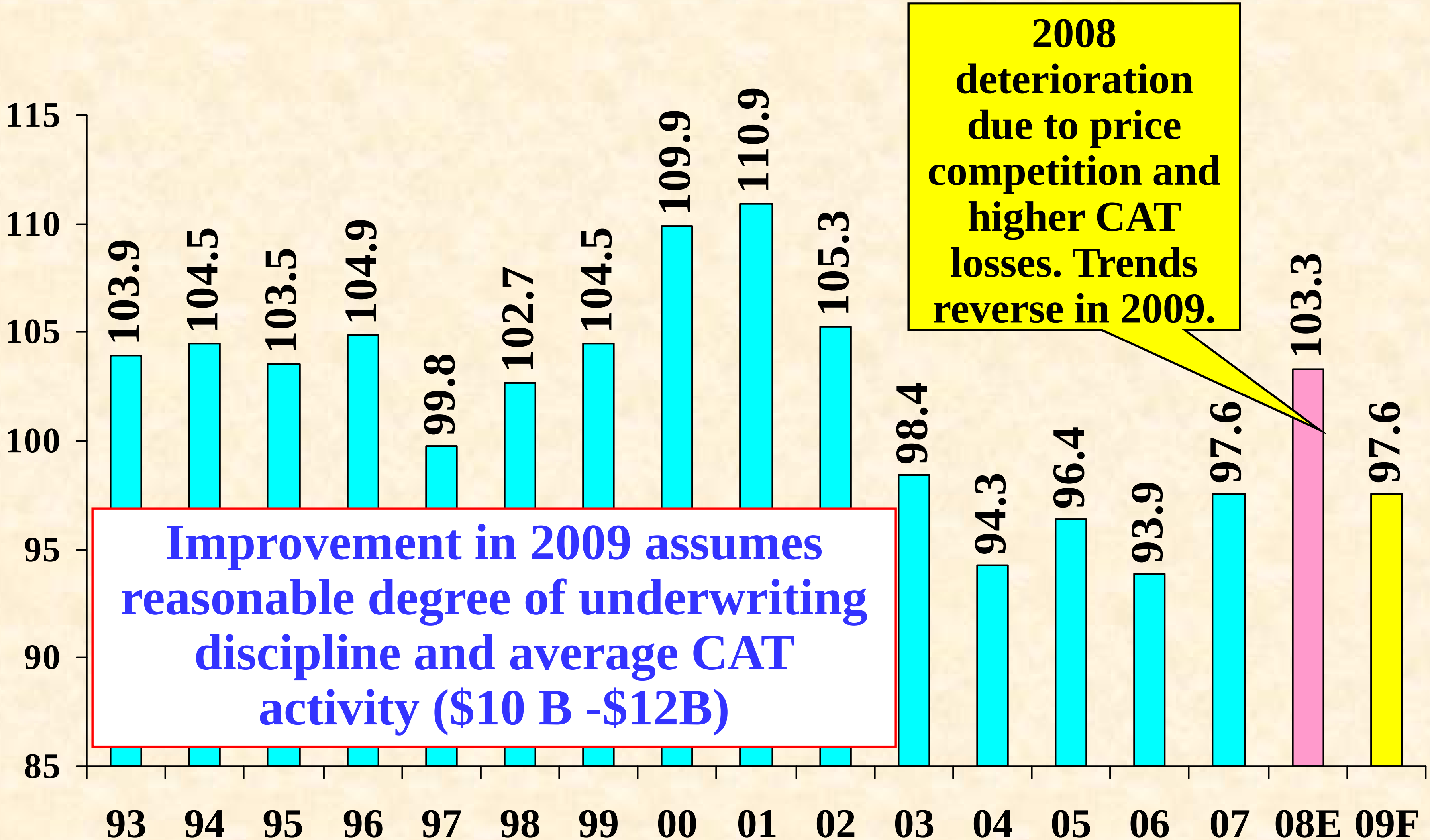
*2000 through 2008.

Personal Lines

Auto (~75% of Market)

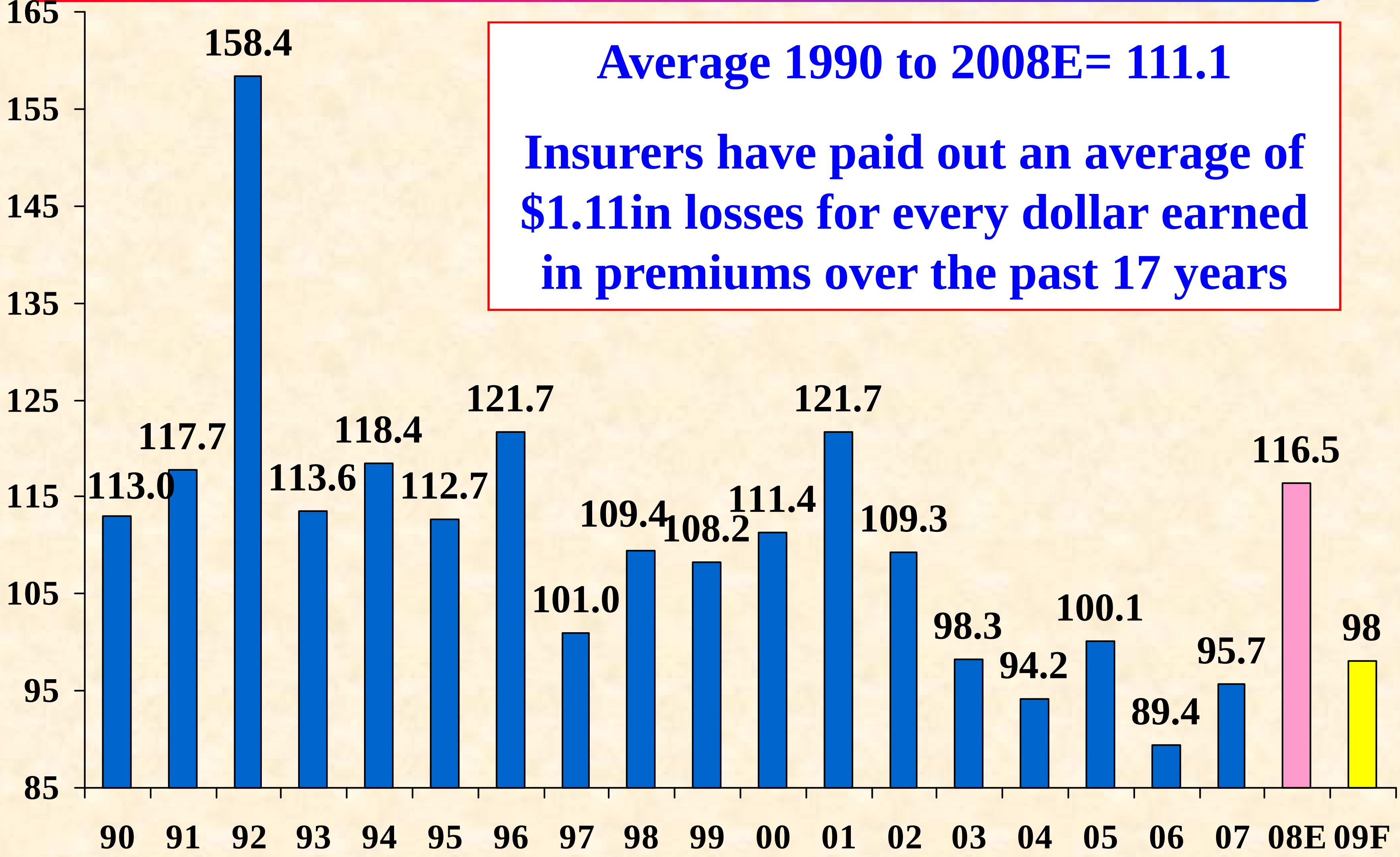
Home (~25%)

Personal Lines Combined Ratio, 1993-2009F



Source: A.M. Best (historical and forecast).

Homeowners Insurance Combined Ratio

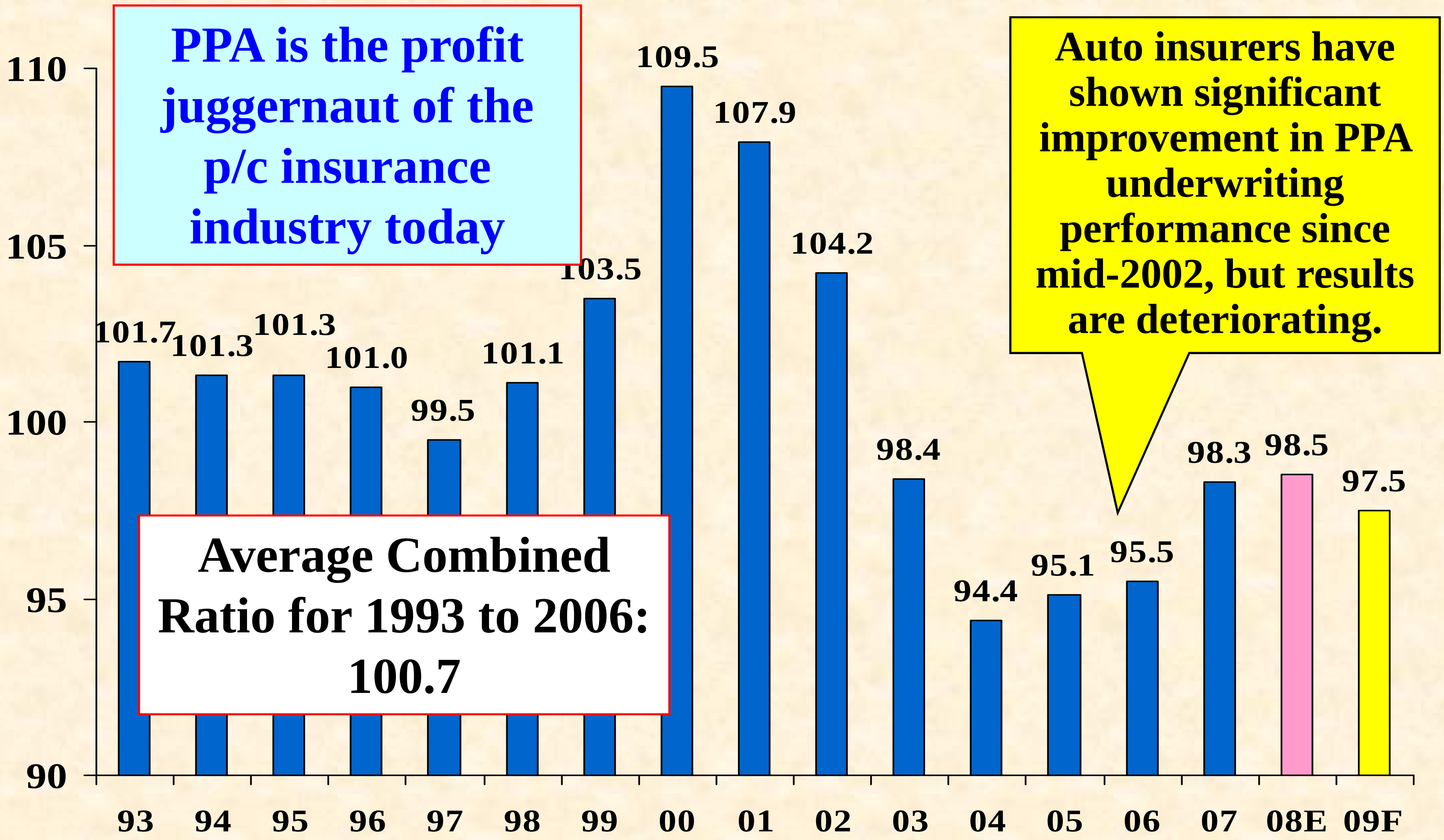


Average 1990 to 2008E= 111.1

Insurers have paid out an average of $1.11in losses for every dollar earned in premiums over the past 17 years

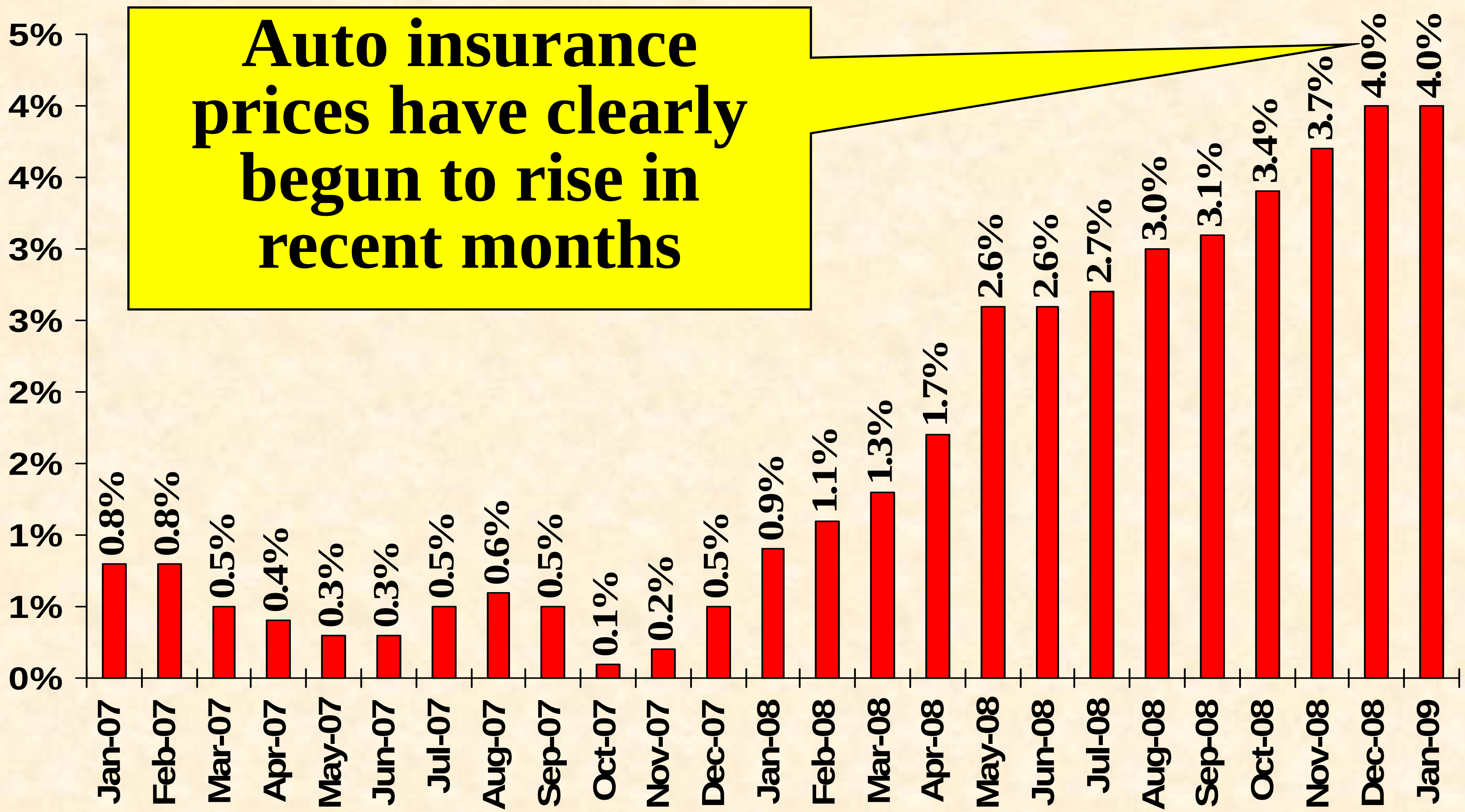
Sources: A.M. Best (historical and forecasts)

Private Passenger Auto (PPA) Combined Ratio



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

Monthly Change in Auto Insurance Prices*



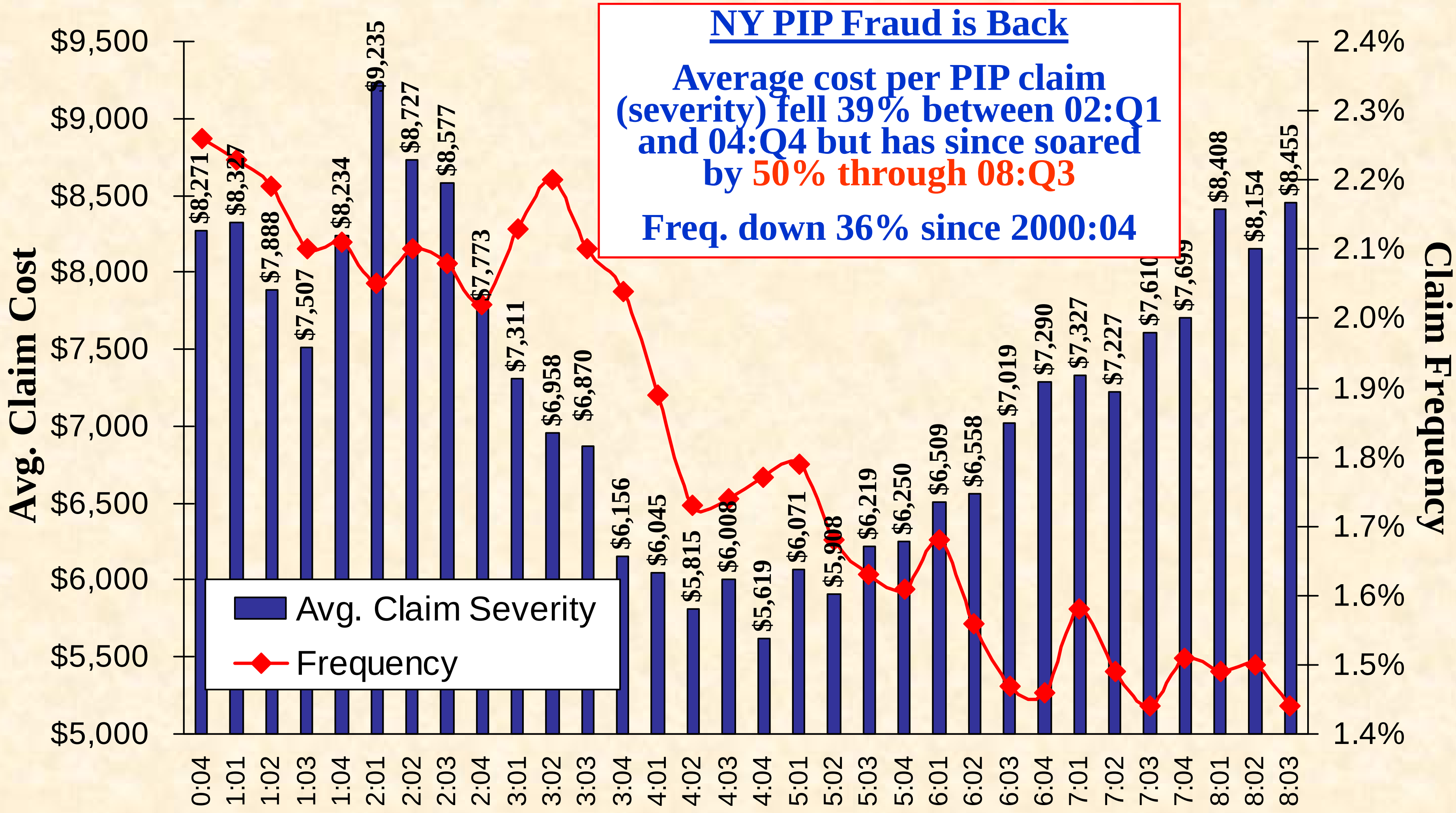
*Percentage change from same month in prior year.

Source: US Bureau of Labor Statistics

NY PIP UPDATE

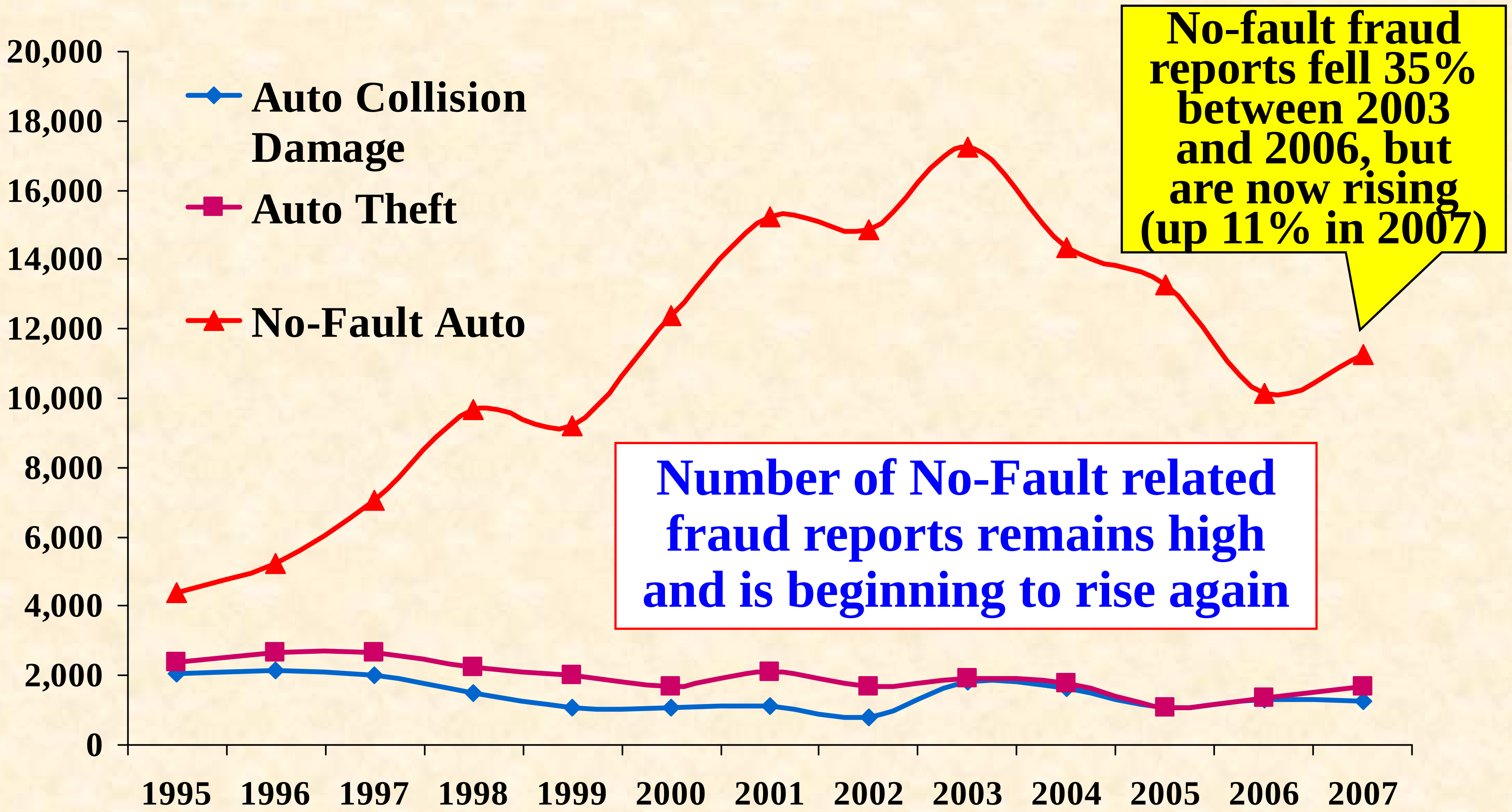
Is New York's No-Fault System Out of Control—Again?

NY PIP Claim Frequency & Severity, (2000:04 – 2008:03)



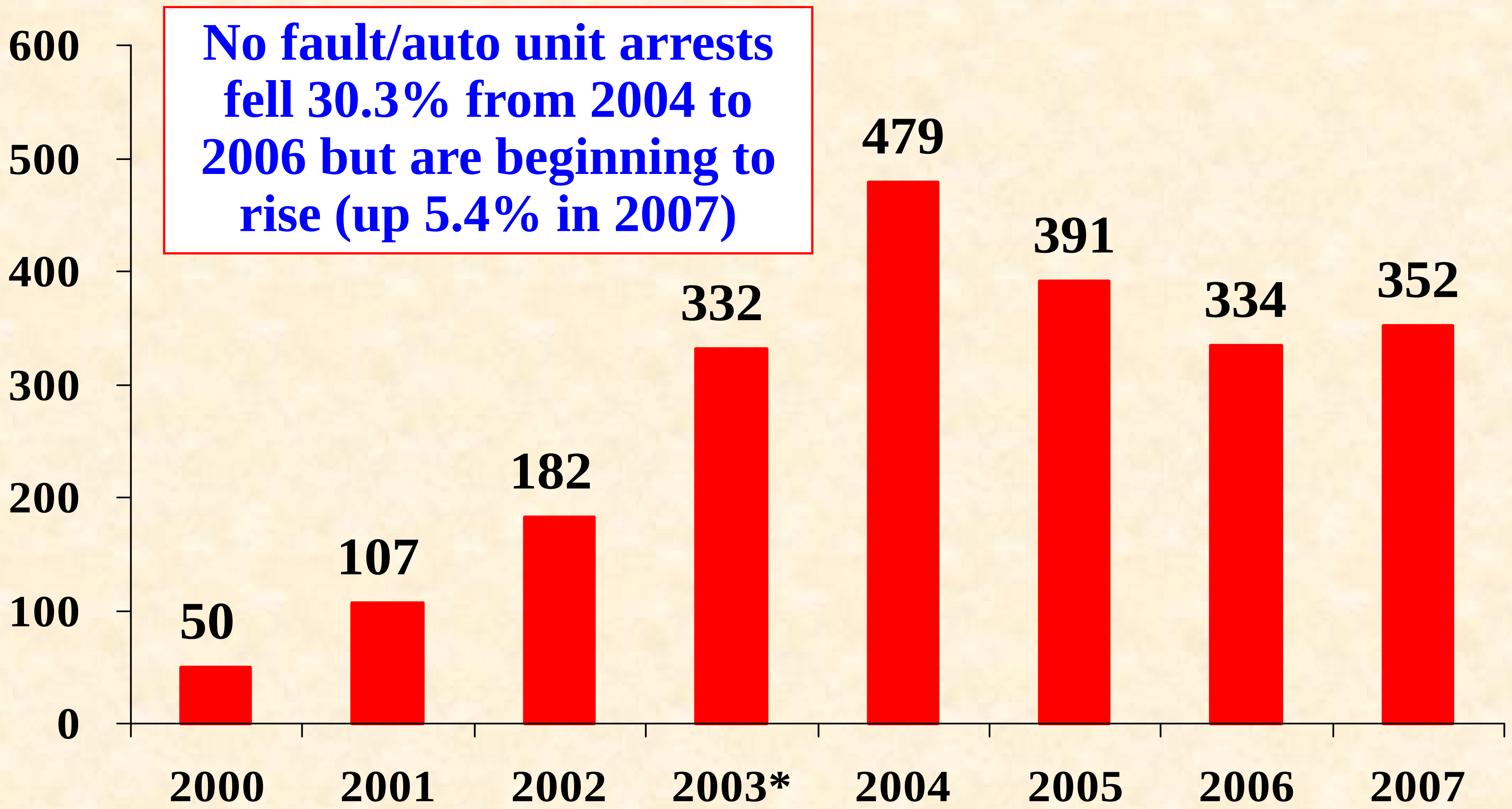
Sources: Insurance Information Institute based on ISO Fast Track data.

New York Insurance Fraud Reports, 1995 - 2007



Source: New York Department of Insurance, Insurance Frauds Bureau Annual Report; Insurance Info. Institute.

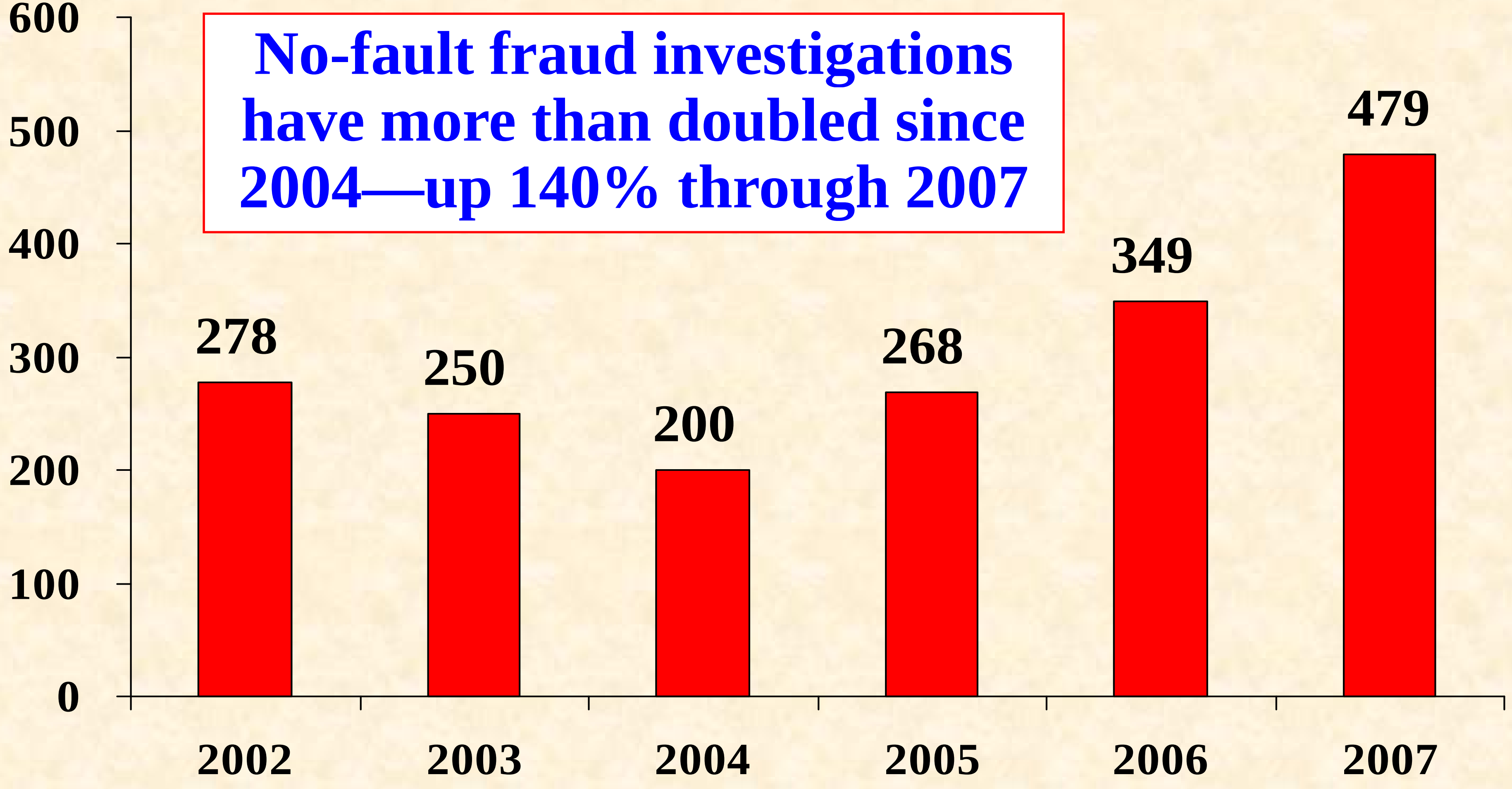
No-Fault/Auto Unit Arrests by NY Insurance Fraud Bureau



*In August 2003 the no-fault unit was merged with auto unit Data beginning in 2003 include no-fault auto unit arrests.

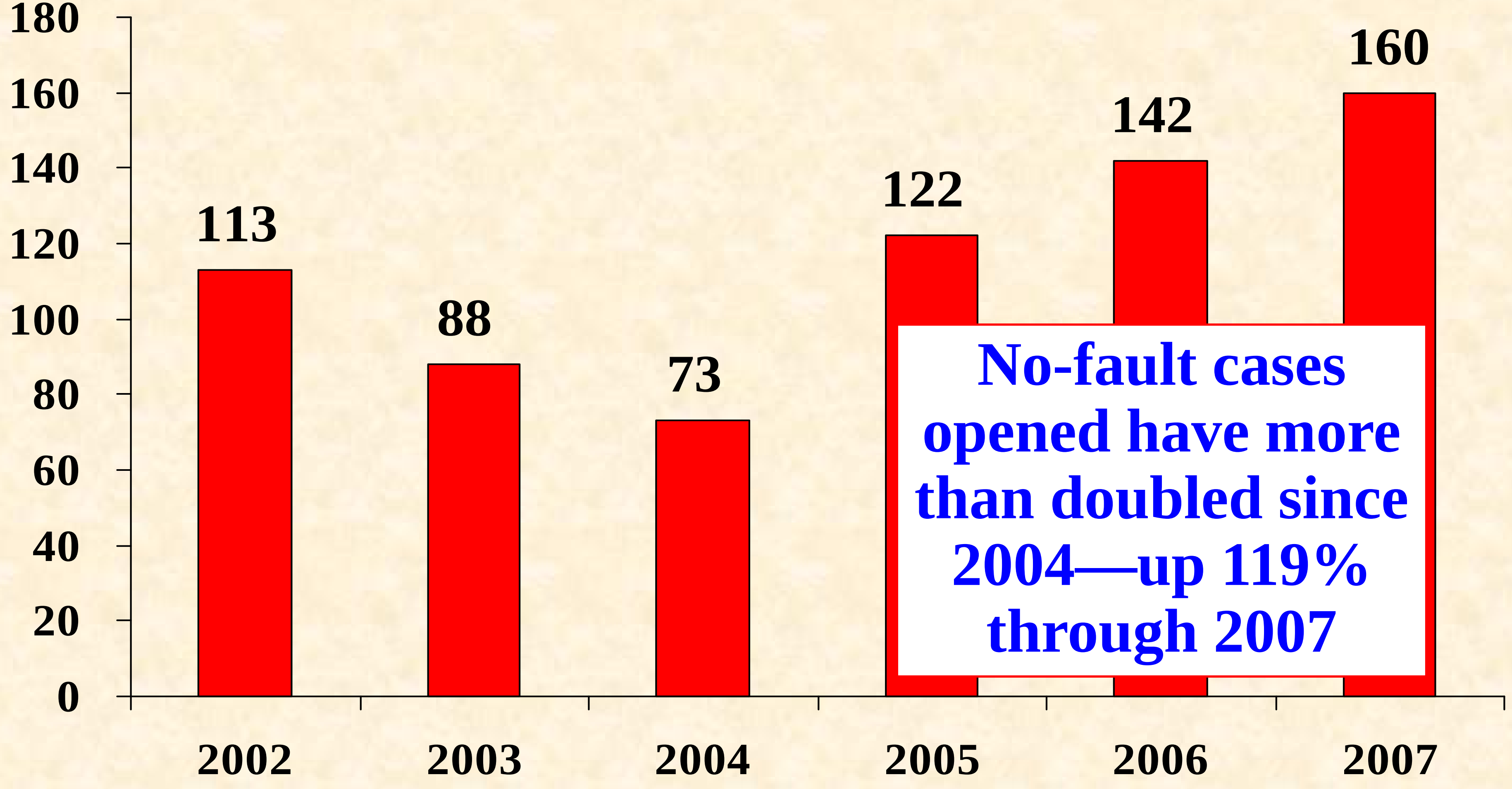
Source: New York Department of Insurance, Insurance Frauds Bureau Annual Report; Insurance Info. Institute.

No-Fault Auto Unit Investigations by NY Insurance Fraud Bureau



Source: New York Insurance Department http://www.ins.state.ny.us/acrobat/fd07ar2g.pdf; Ins. Info. Institute.

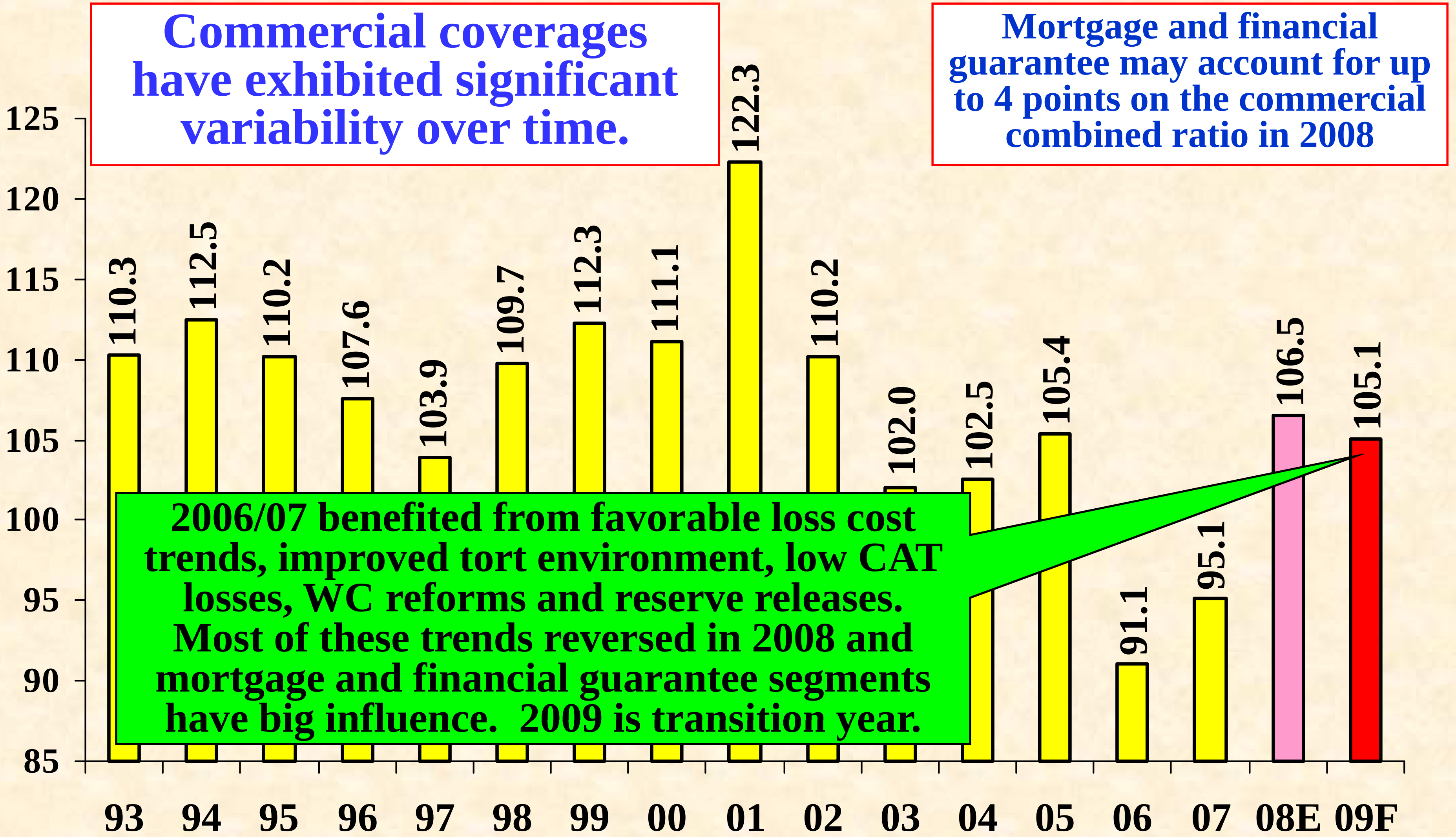
No-Fault Auto Unit Cases Opened by NY Insurance Fraud Bureau



Source: New York Insurance Department http://www.ins.state.ny.us/acrobat/fd07ar2g.pdf; Ins. Info. Institute.

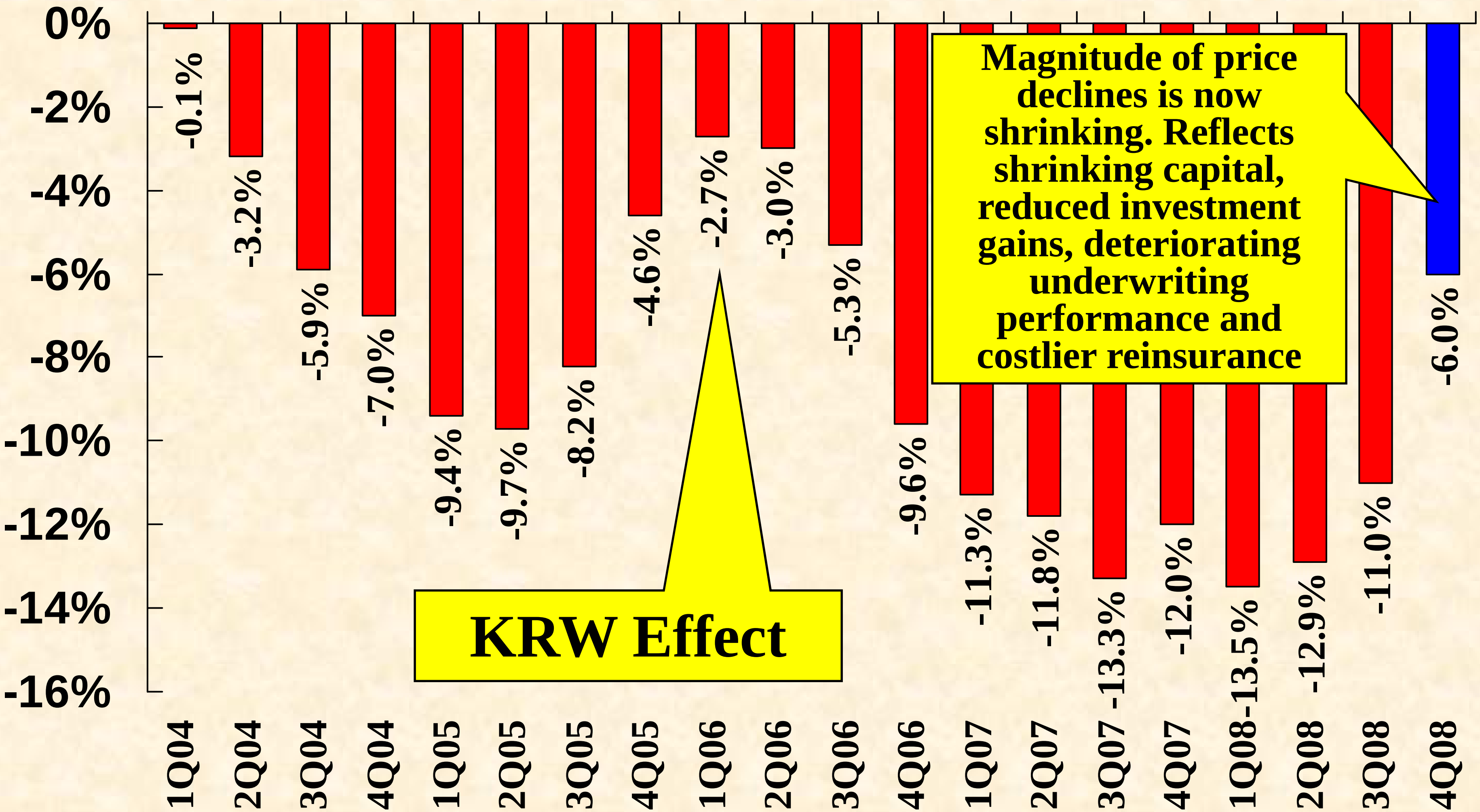
Commercial Lines

Commercial Lines Combined Ratio, 1993-2009F



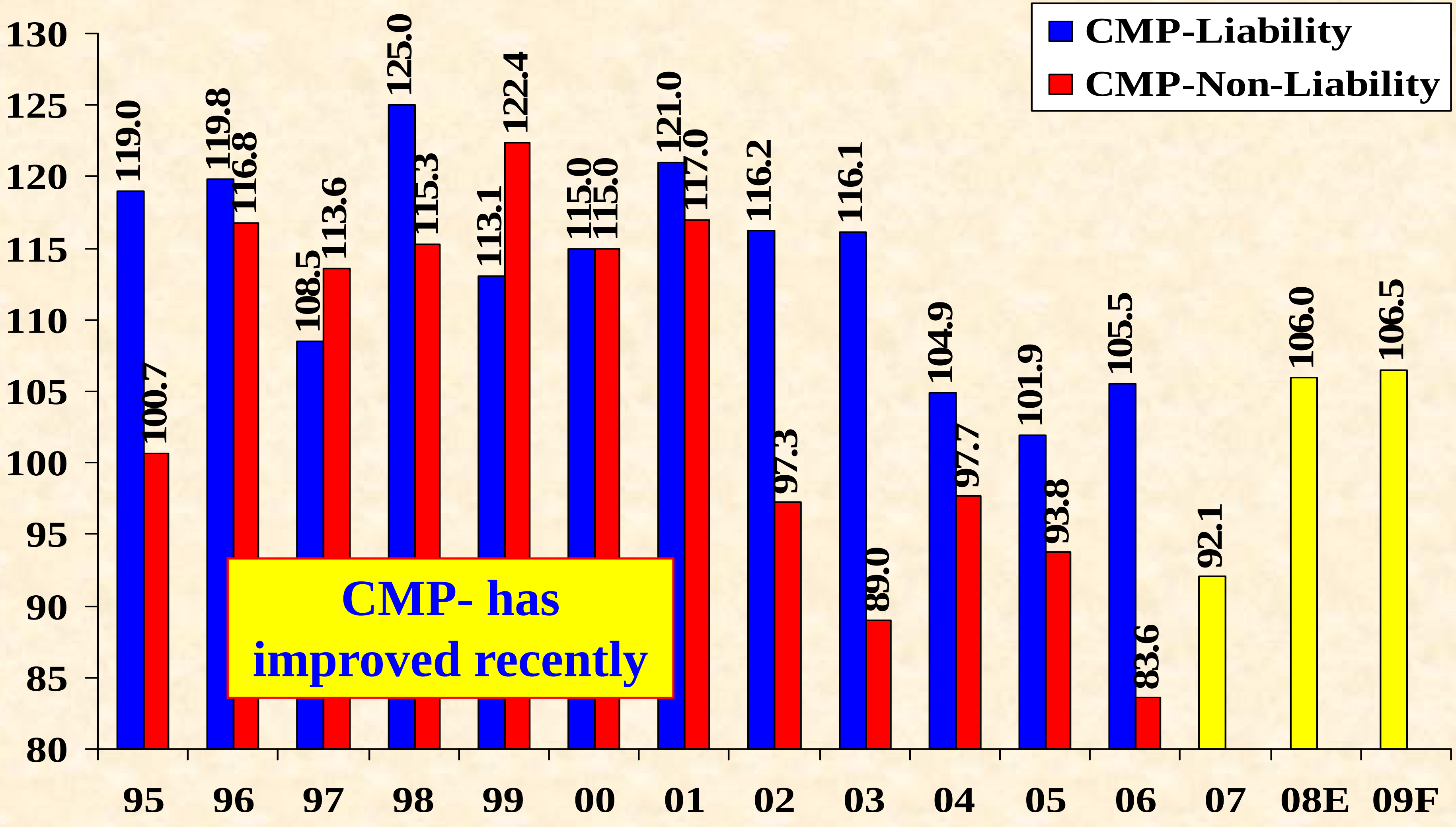
Sources: A.M. Best (historical and forecasts)

Average Commercial Rate Change, All Lines, (1Q:2004 – 4Q:2008)



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

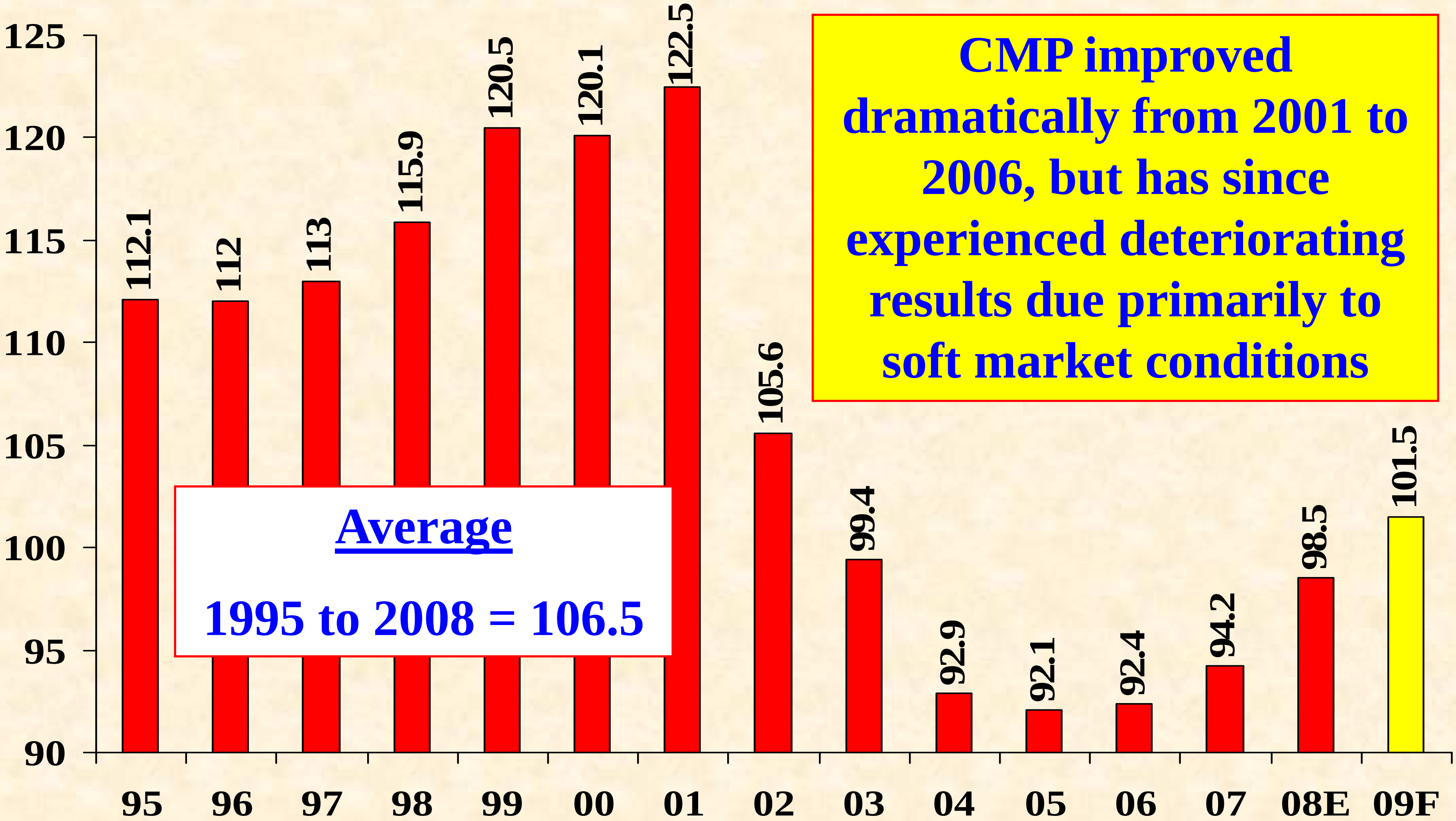
Commercial Multi-Peril Combined
(Liability vs. Non-Liability Portion)*



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

*Includes both liability and property damage for years 2007-2009F.

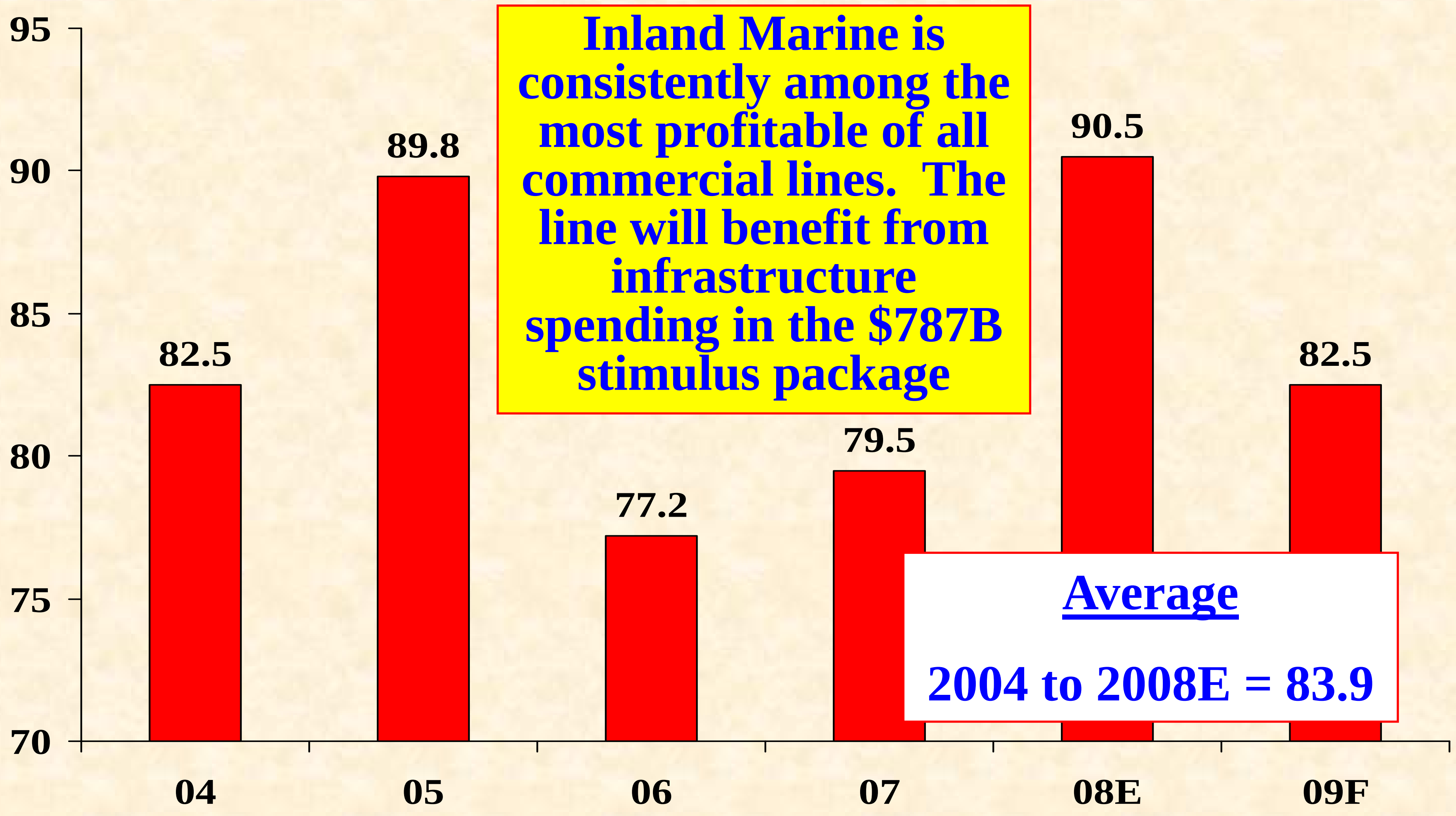
Commercial Auto Combined Ratio (1995-2009F)



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

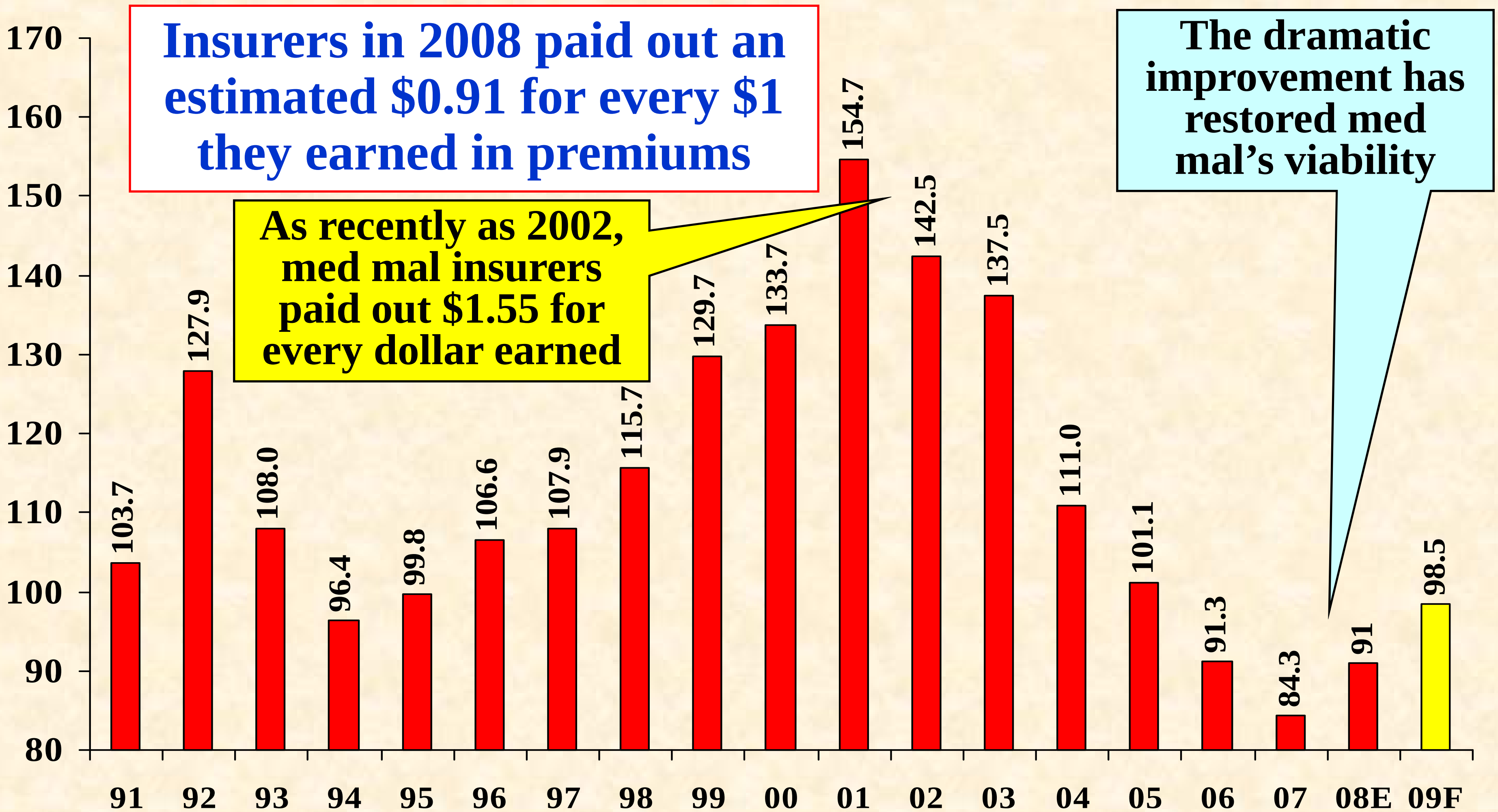
*Includes both liability and property damage.

Inland Marine Combined Ratio (2004-2009F)



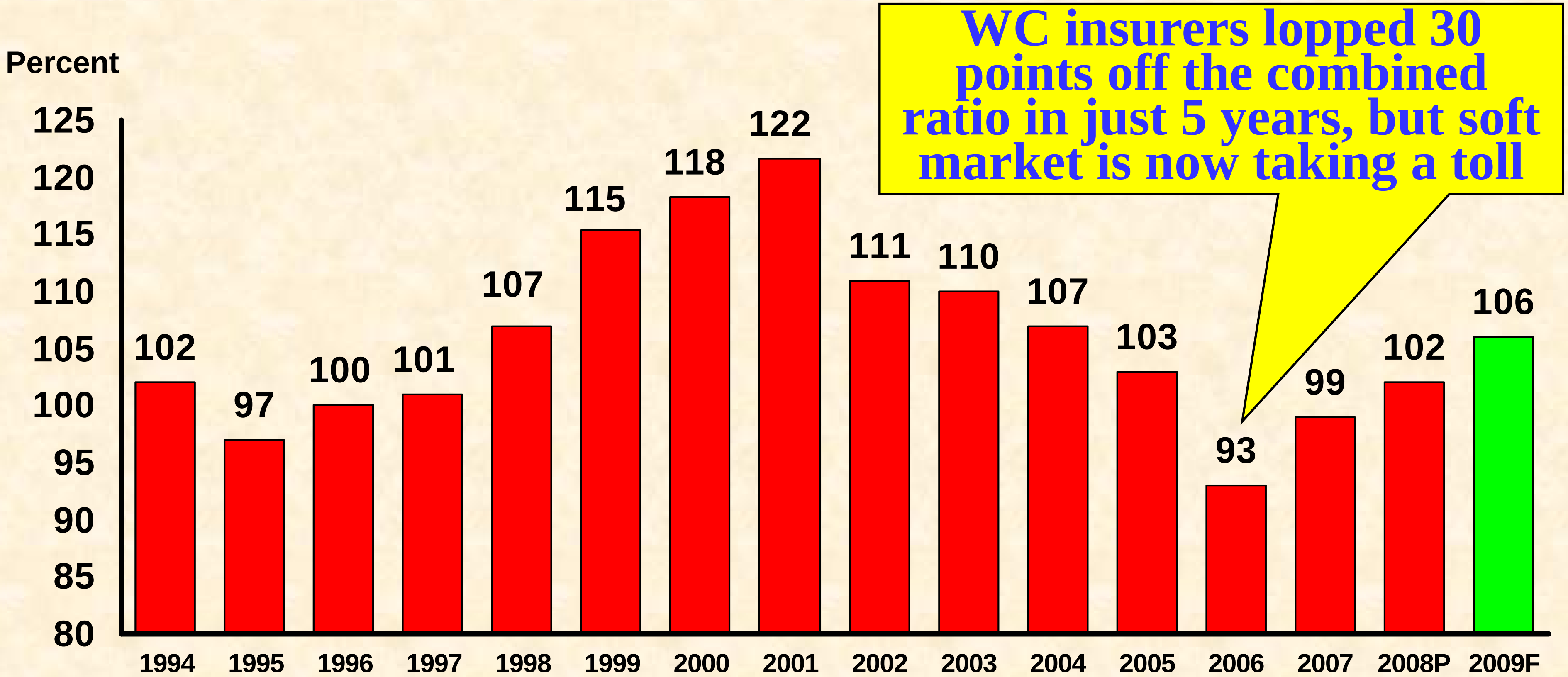
Sources: A.M. Best (historical and forecasts)

Medical Malpractice Combined Ratio



Source: AM Best, Insurance Information Institute

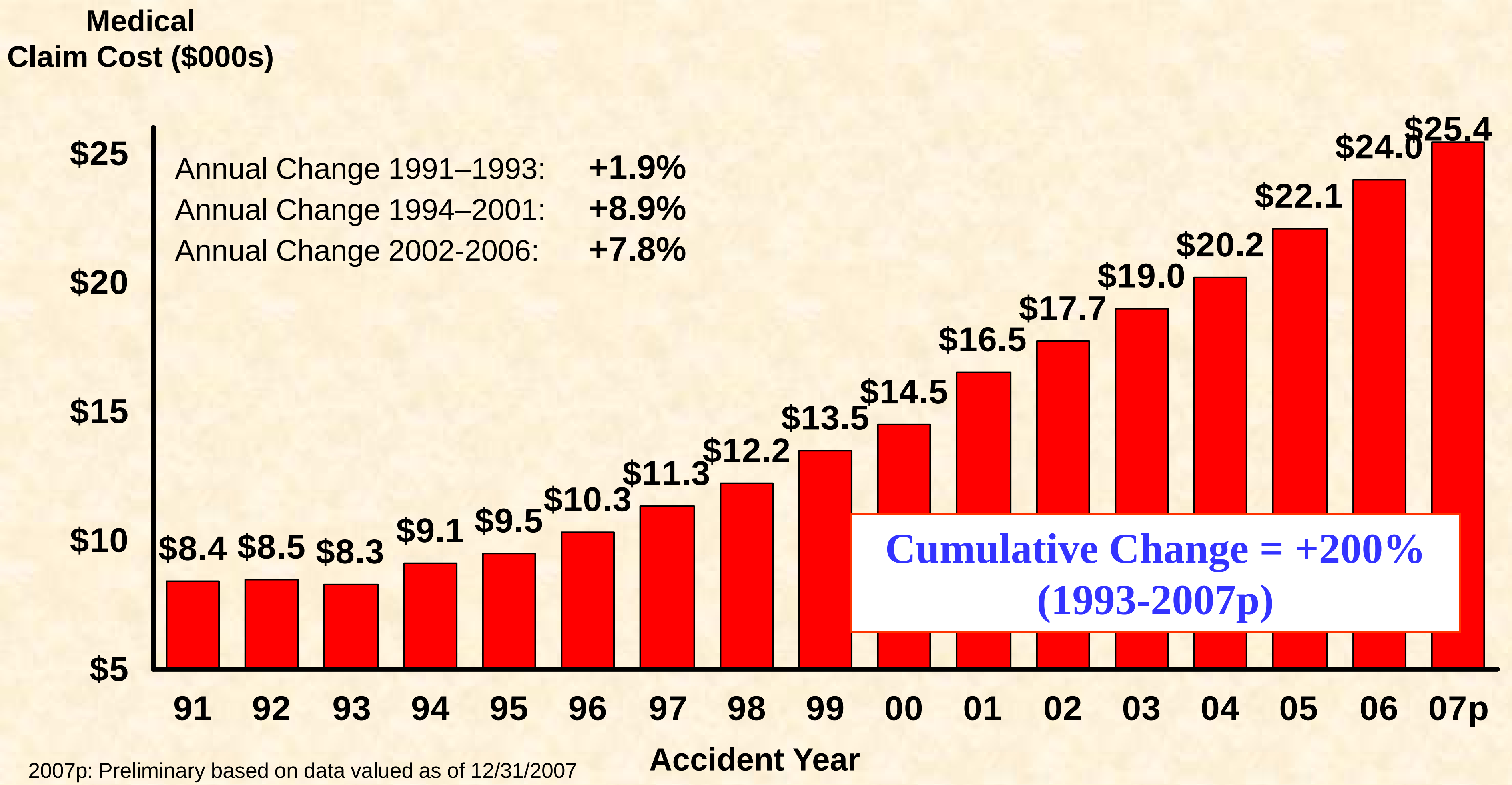
Workers Comp Combined Ratios,
(Calendar Year, Private Carriers) 1994-2009F



p Preliminary.
Sources: Calendar Years 1994-2007, A.M. Best Aggregates & Averages; Calendar Year 2008p and 2009F are I.I.I. estimates for private carriers based A.M. Best Review and Preview 2009; NCCI
Includes dividends to policyholders

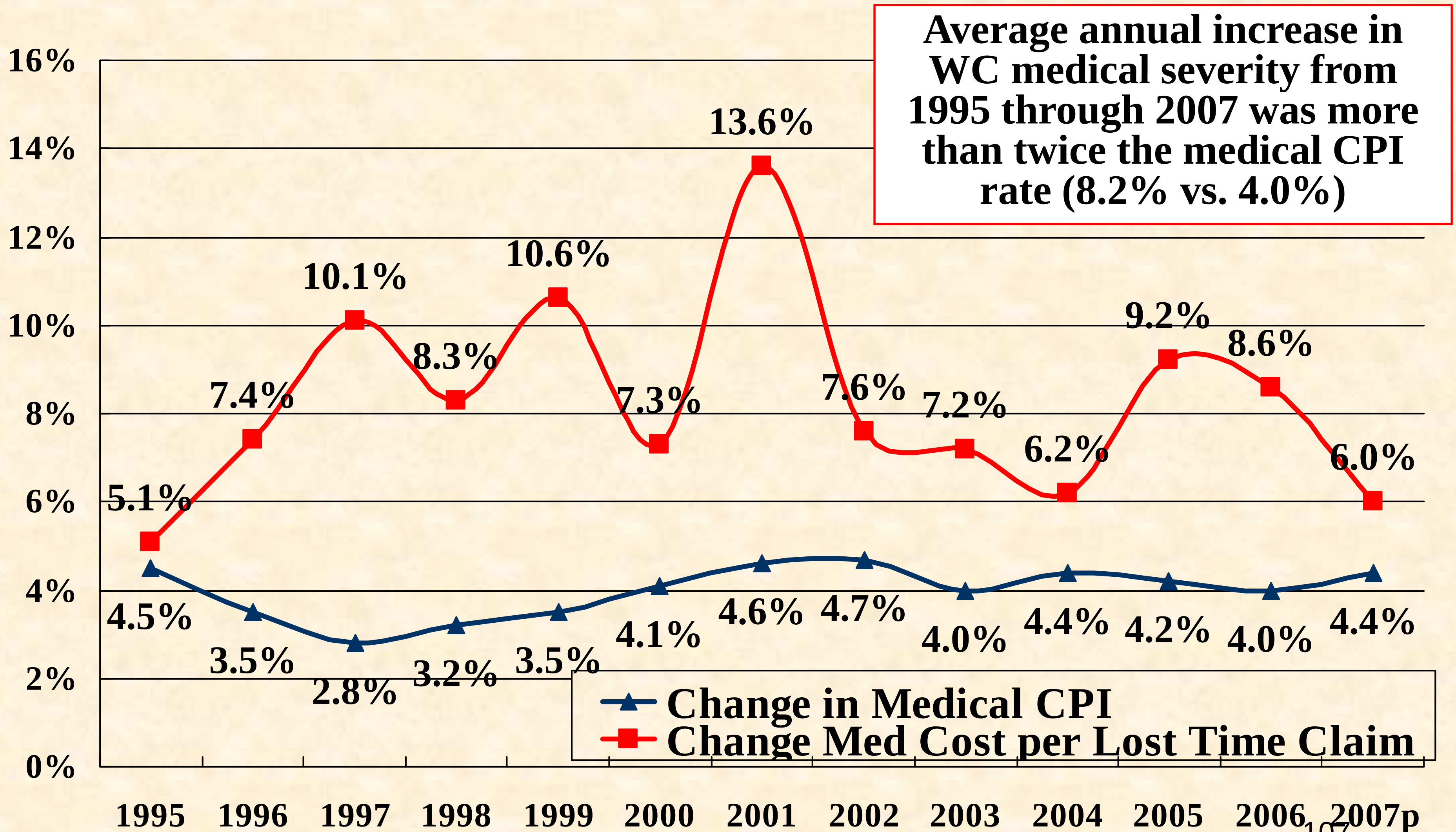
Workers Compensation Medical Claim Trends

Workers Comp Medical Claims Costs Continue to Climb



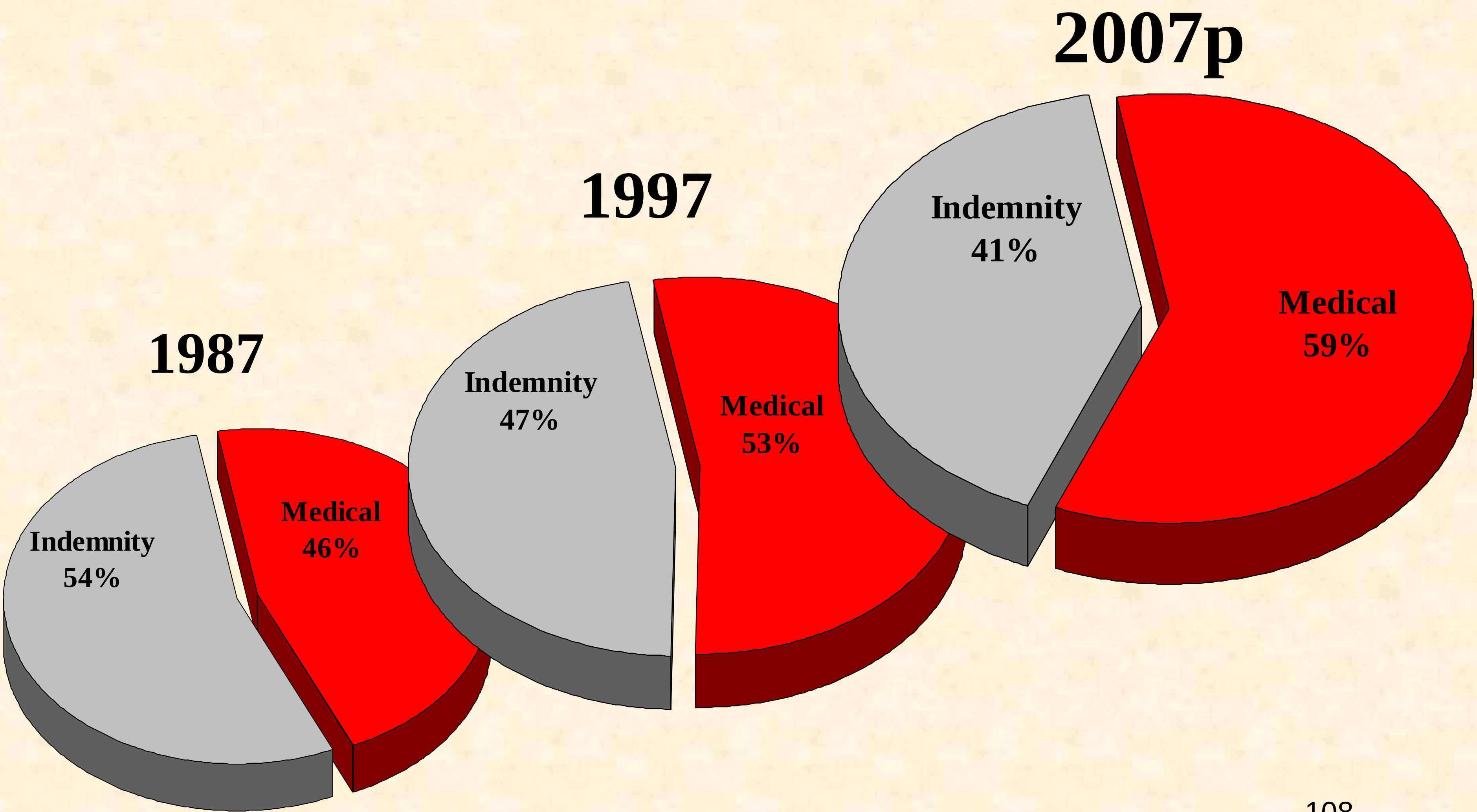
2007p: Preliminary based on data valued as of 12/31/2007
1991-2006: Based on data through 12/31/2006, developed to ultimate
Based on the states where NCCI provides ratemaking services; Excludes the effects of deductible policies

WC Medical Severity Rising at Double the Medical CPI Rate



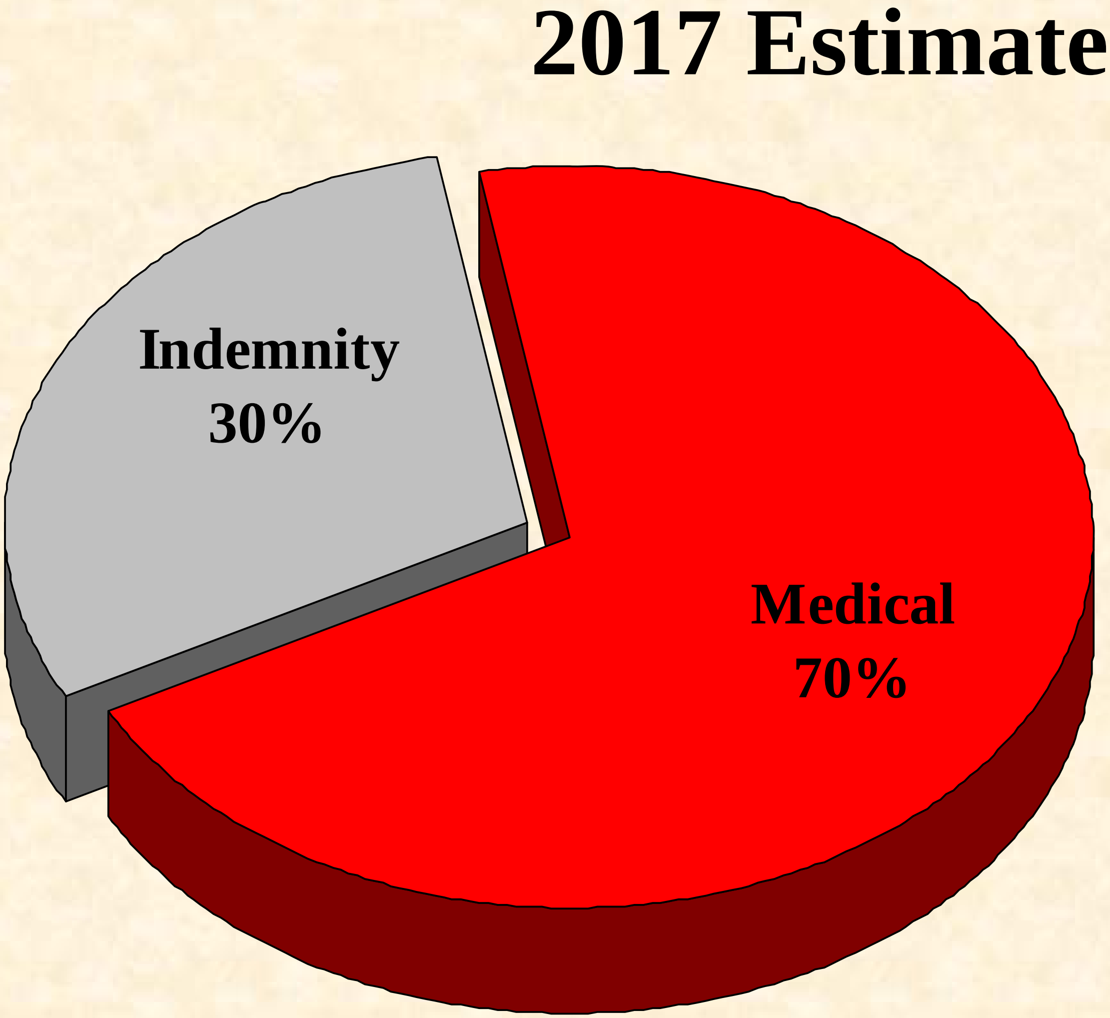
Sources: Med CPI from US Bureau of Labor Statistics, WC med severity from NCCI based on NCCI states.

Med Costs Share of Total Costs is Increasing Steadily



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

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



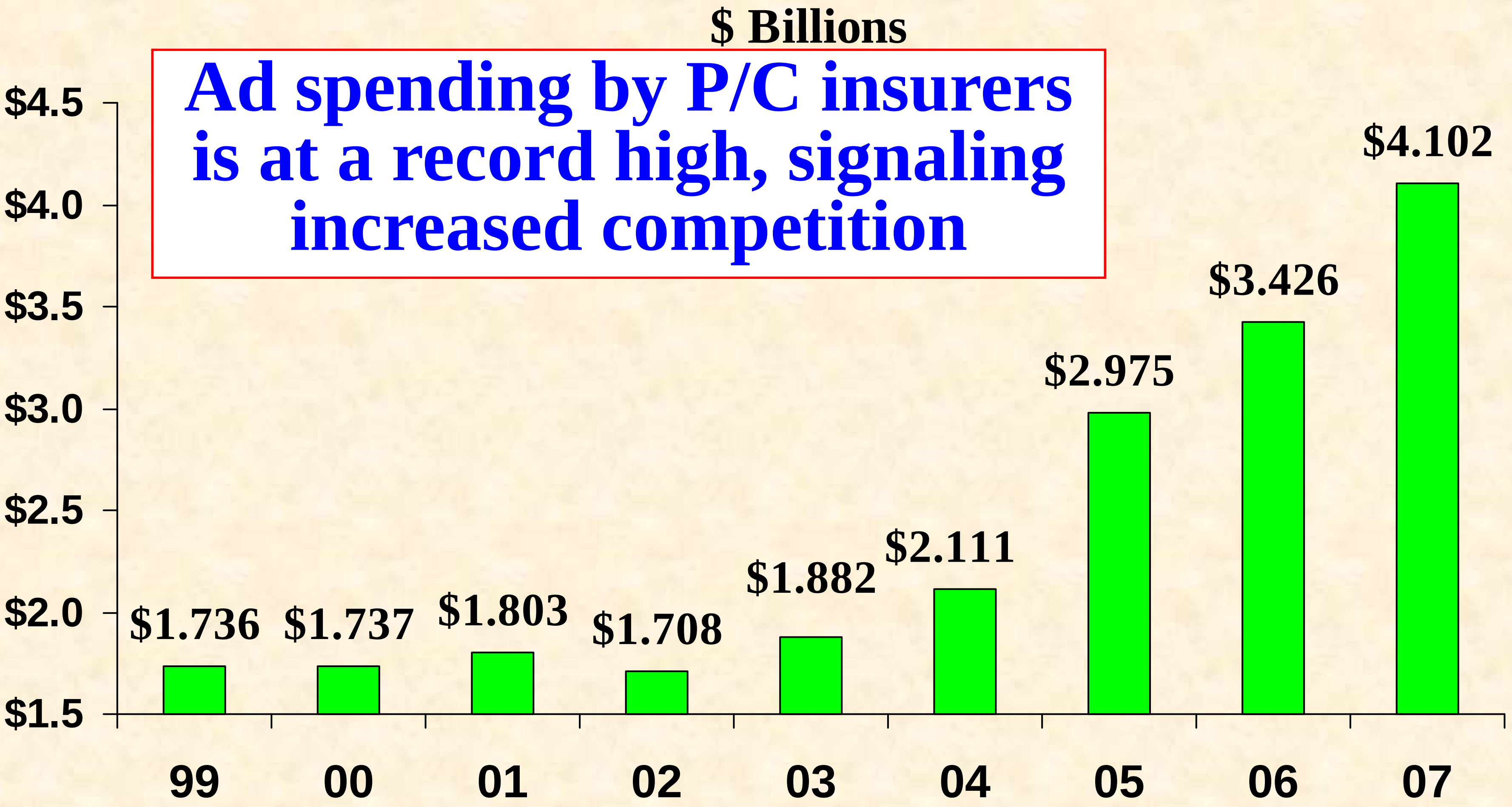
This trend will likely be supported by the increased labor force participation of workers age 55 and older.

Source: Insurance Information Institute.

Advertising

Unlike in Post 9/11 Period, Insurer Advertising Likely to Remain Strong

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



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

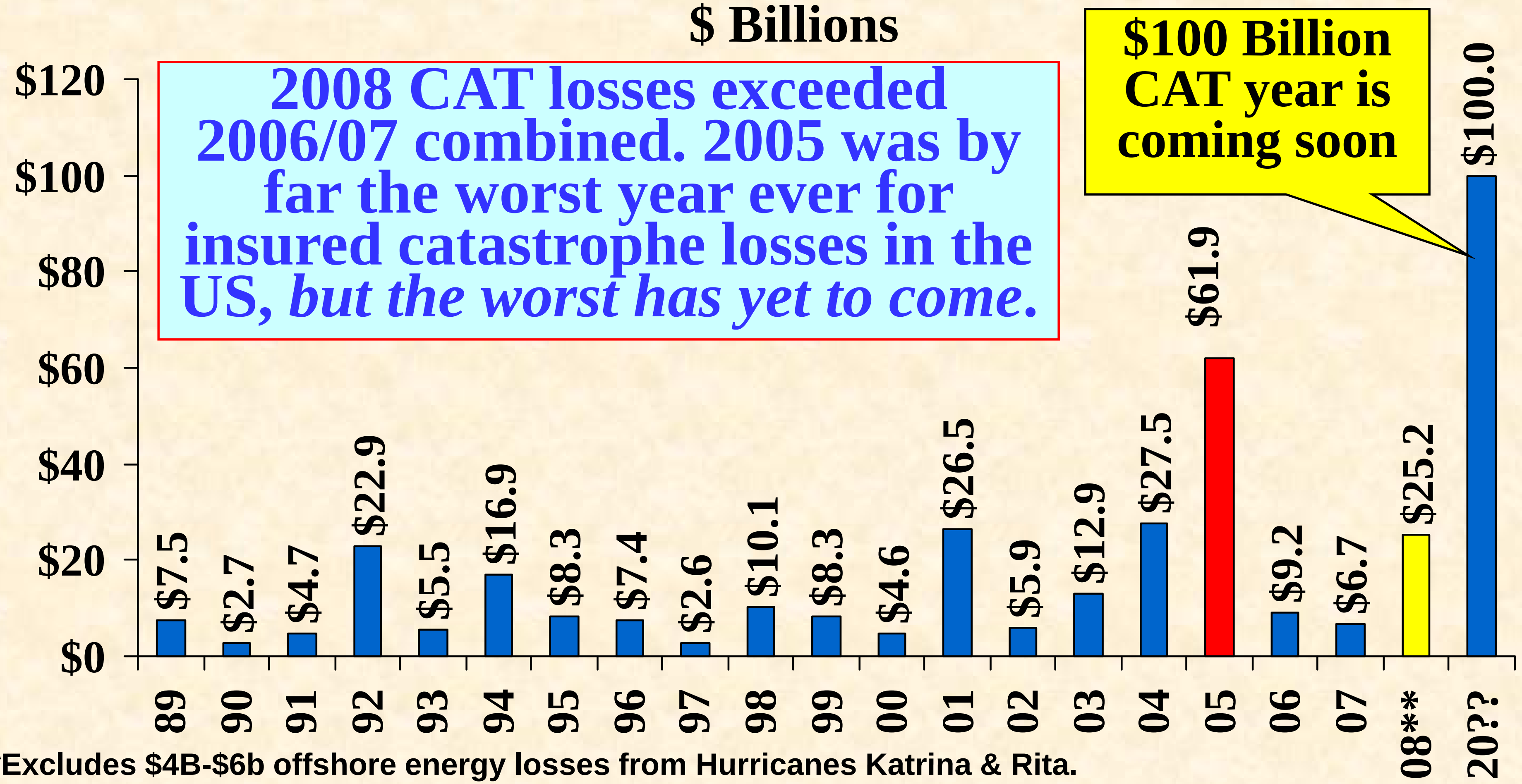
Why Advertising Will Likely Remain Strong?

- **DIRECT MARKETERS: No Agents = Advertising**
  - **Collectively, direct marketers have a larger market share**
  - **GEICO, 21st Century (formerly AIG Direct) and others are committed to the direct model**
  - **EA/IA companies sometimes have direct channels (some which bypass the agent, some which complement the agent)**
- **PERFORMANCE: U/W Results Not that Bad**
  - **Advertising is cut back when line is performing poorly from an underwriting perspective; Not generally the case today.**
- **SLOW GROWTH: Hope to Stimulate Demand**
- **INTERNET: Advertising Must Include New Media**
  - **Will appear more ubiquitous even if ad spend flat**
- **REBRANDING: Some Insurers Recasting Themselves**
  - **Want to emphasize affordability in down economy**

Catastrophe Losses

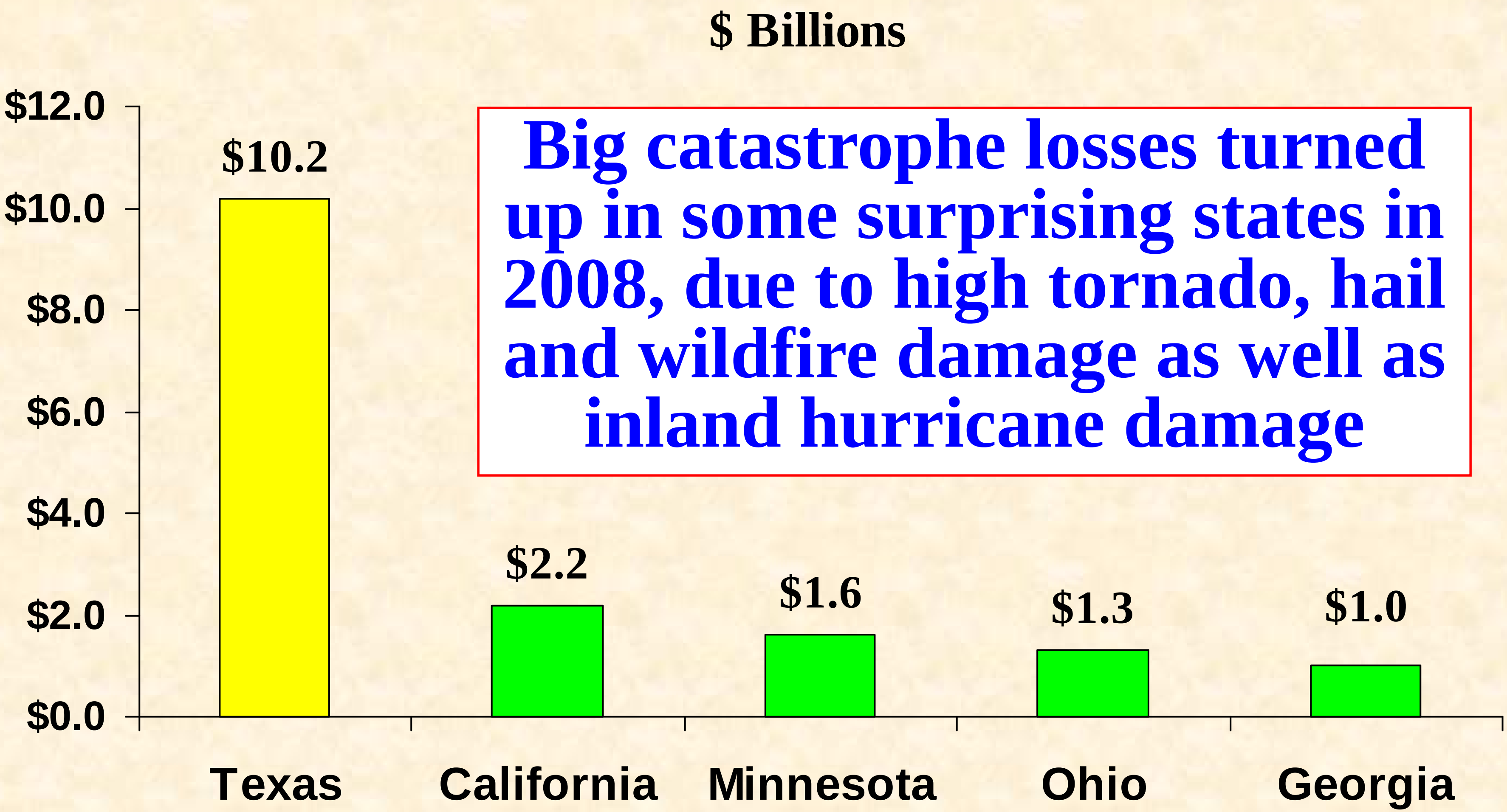
Impacting Underwriting Results and the Bottom Line

U.S. Insured Catastrophe Losses*



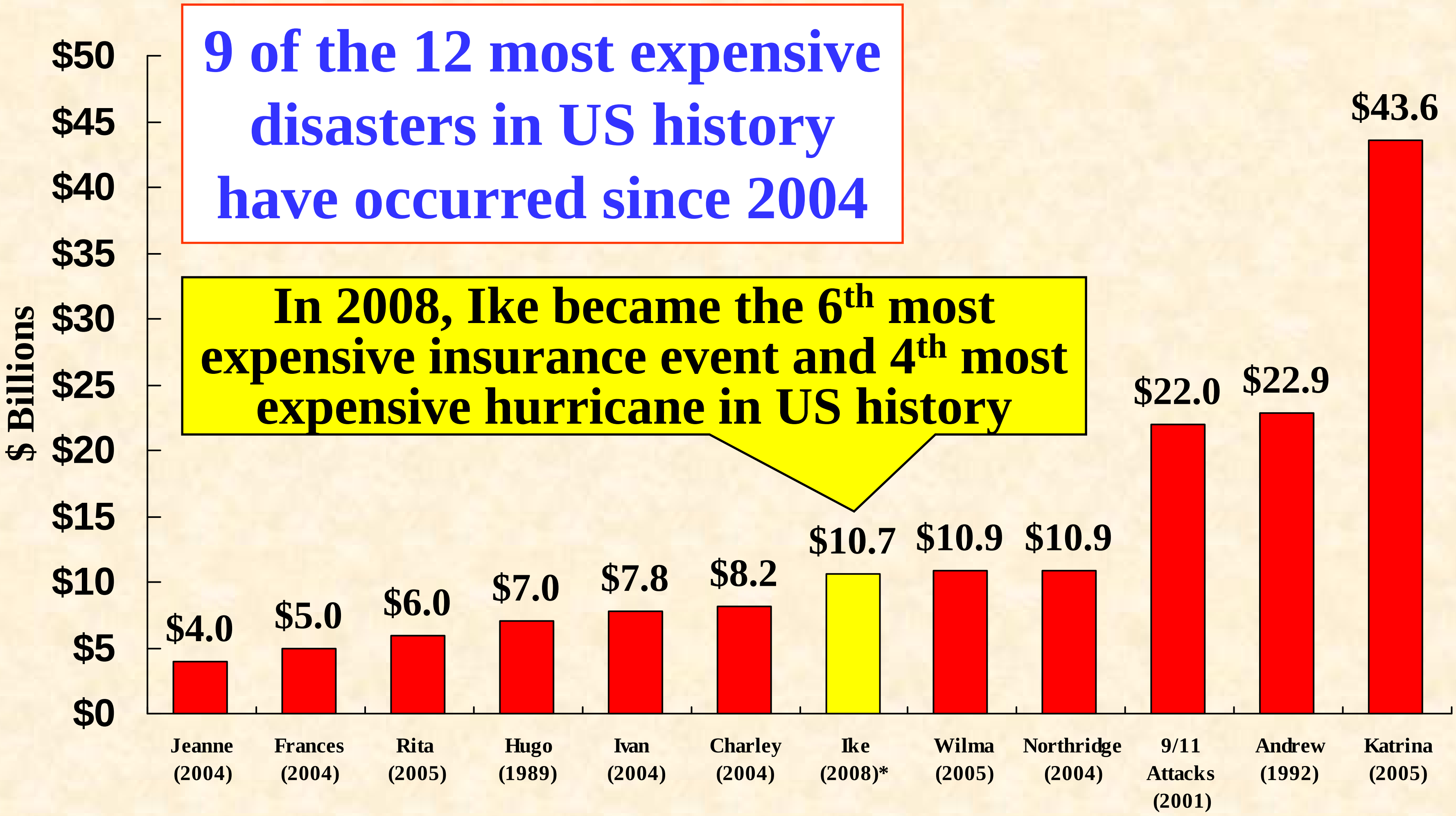
***Excludes $4B-$6b offshore energy losses from Hurricanes Katrina & Rita.**
****Based on PCS data through Dec. 31. PCS $2.1B loss of for Gustav. $10.655B for Ike of 12/05/08.**
<u>Note</u>: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = $12.2B.
Source: Property Claims Service/ISO; Insurance Information Institute

States With Highest Insured Catastrophe Losses in 2008



Source: PCS; Insurance Information Institute.

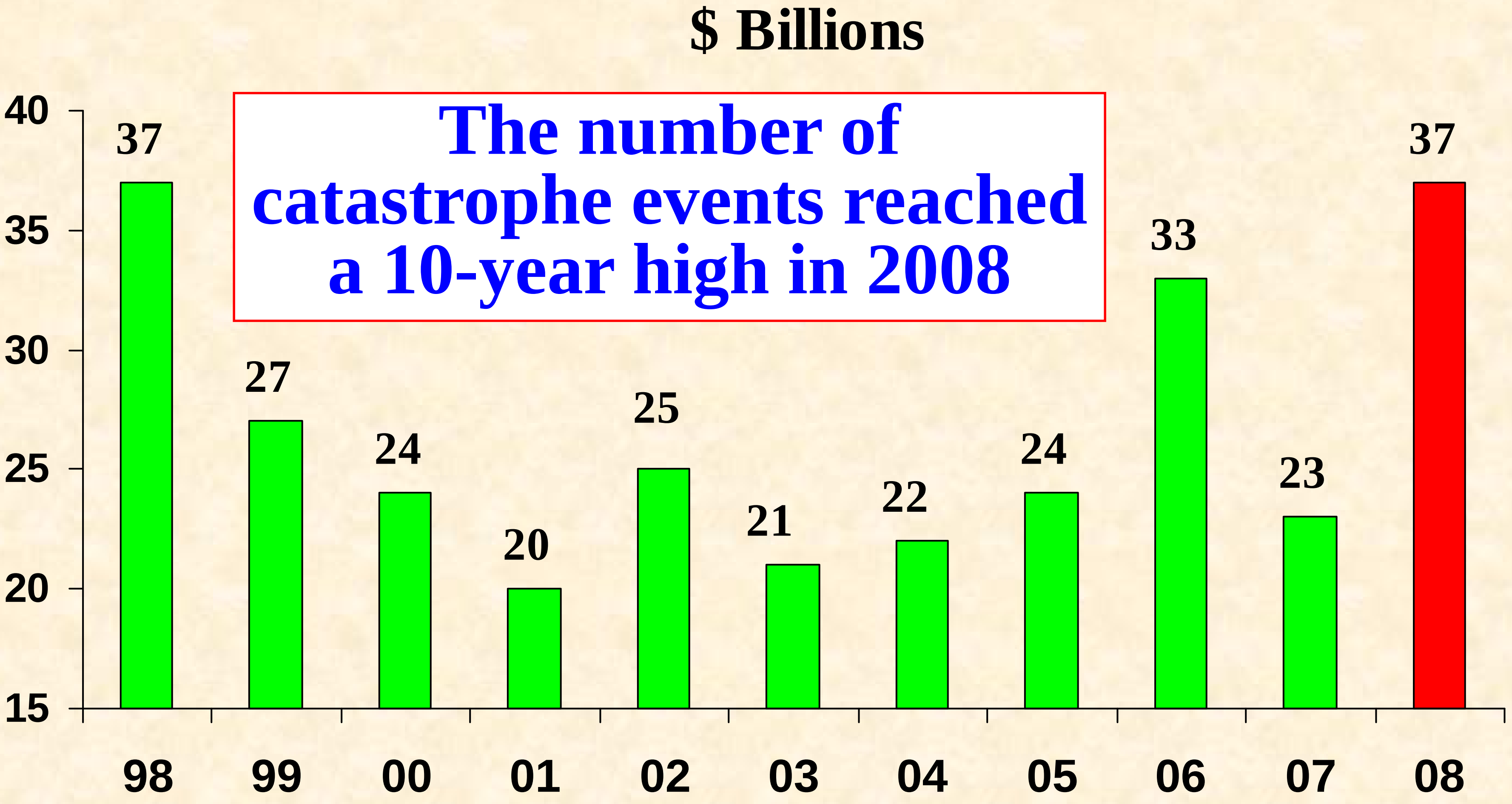
Top 12 Most Costly Disasters in US History, *(Insured Losses, $2007)*



*PCS estimate as of 12/15/08.

Sources: ISO/PCS; AIR Worldwide, RMS, Eqecat; Insurance Information Institute inflation adjustments.

Number of PCS Catastrophe Events, 1998-2008*



*PCS defines a catastrophe as an even that caused at least $25 million in insured property damage and affects and significant number of policyholders and insurers.

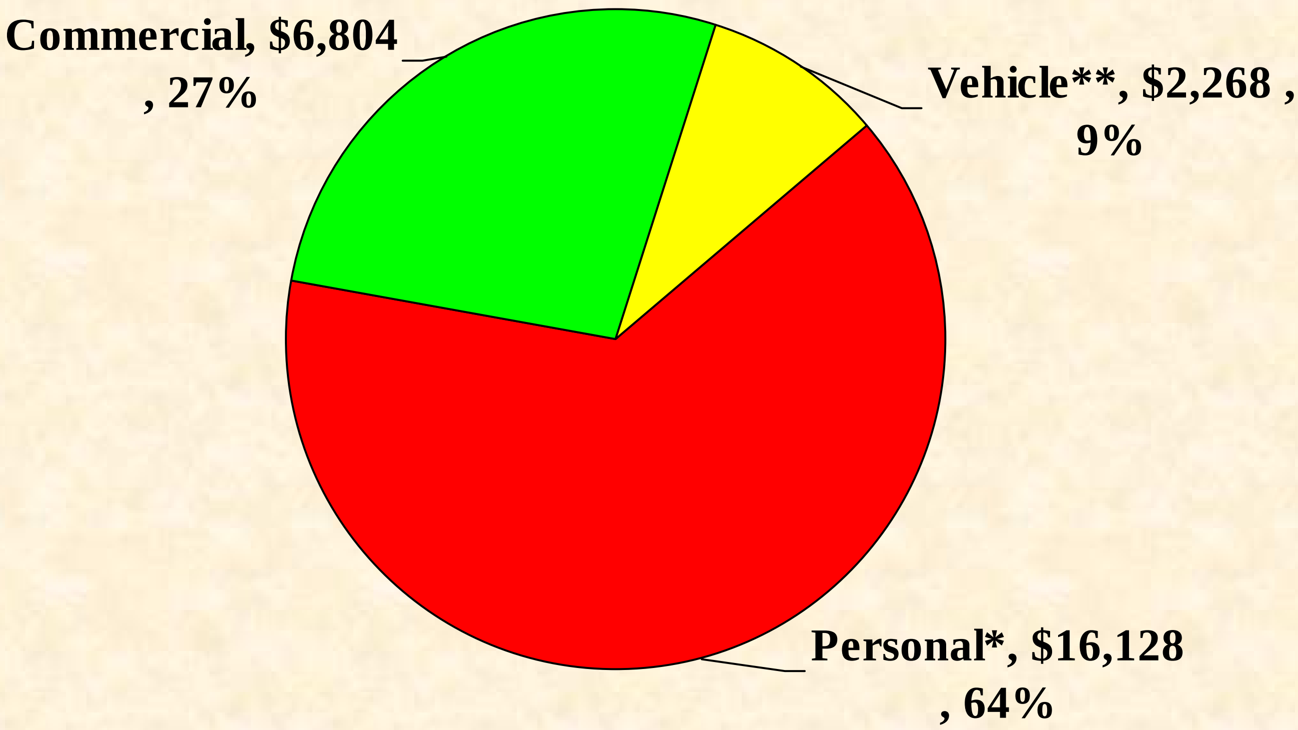
Source: PCS; Insurance Information Institute

2008 Insured Catastrophe Loss Distribution by Category

$ Millions

2008 CAT FACTS

- The $25.2 billion in insured losses was the 4th highest ever, behind only, 2005, 2004 and 2001
- There were 37 designated catastrophes in 2008, the highest since 1998 (also 37)
- Commercial losses accounted for 27% of insured losses but just 9% of claims



*Includes homeowers, condominium and rental policies.
**Includes commercial and private passenger vehicles
Source: PCS; Insurance Information Institute research.

2008 Insured Catastrophe Loss Distribution by Number of Claims

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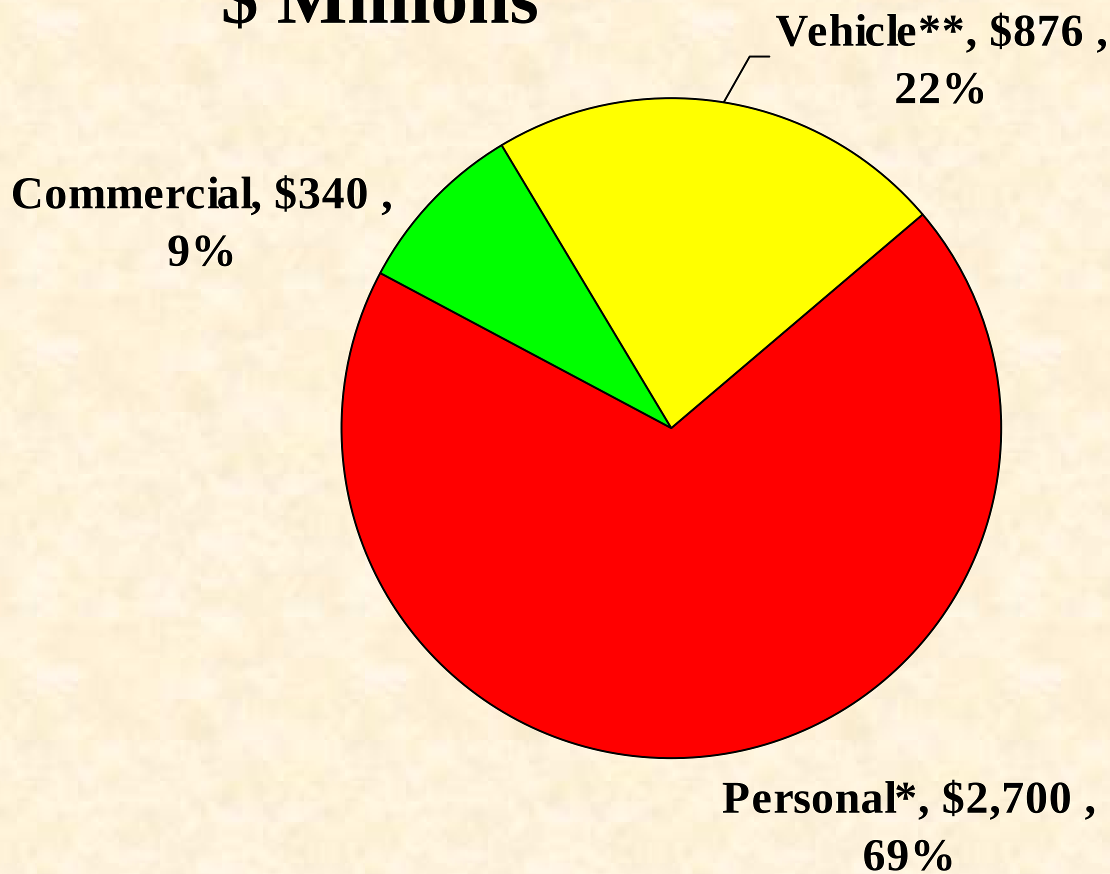


*Includes homeowers, condominium and rental policies.
**Includes commercial and private passenger vehicles
Source: PCS; Insurance Information Institute research.

Key Issues & Threats Facing P/C Insurers Amid Financial Crisis

Manageable Challenges

Important Issues & Threats Facing P/C Insurers in 2009

1. **Reloading Capital After "Capital Event"**
   - Continued asset price erosion coupled with major "capital event" could lead to shortage of capital among *some* companies
   - P/C insurers have come to assume that large amounts of capital can be raised quickly and cheaply after major events (post-9/11, Katrina). This assumption may be incorrect in the current environment.
   - Cost of capital is *much* higher today, reflecting both scarcity & risk
   - Implications: P/C insurers need to protect capital today and develop detailed contingency plans to raise fresh capital & generate internally
2. **Long-Term Loss of Investment Return**
   - Low interest rates, risk aversion toward equities and many categories of fixed income securities lock in a multi-year trajectory toward ever lower investment gains
   - Many insurers have not adjusted to this new investment paradigm
   - Regulators will not readily accept it; Many will reject it
   - Implication 1: Industry must be prepared to operate in environment with investment earnings accounting for a smaller fraction of profits
   - Implication 2: Implies underwriting discipline of a magnitude not witnessed in this industry in more than 30 years
   - Lessons from the period 1920-1975

Source: Insurance Information Inst.

Important Issues & Threats Facing P/C Insurers in 2009 *(cont'd)*

3. **Regulatory Overreach**
   - **P/C insurers get swept into vast federal regulatory overhaul and subjected to inappropriate , duplicative and costly regulation**

4. **Tort Threat**
   - **No tort reform (or protection of recent reforms) is forthcoming from the current Congress or Administration**
   - **Erosion of recent reforms is a certainty (already happening)**
   - **Innumerable legislative initiatives will create opportunities to undermine existing reforms and develop new theories and channels of liability**
   - **Historically extremely costly to p/c insurance industry**

5. **Disintermediation**
   - **Alternative forms of risk transfer are taking an ever-larger share of the (commercial) p/c insurance pie (e.g., 40%+ of workers comp)**
   - **Soft market did not bring it back**
   - **Trend toward state-sponsored insurance and reinsurance (e.g., FL) drains premium out of private insurance markets**

Source: Insurance Information Inst.

AFTERSHOCK: Regulatory Response Could Be Harsh

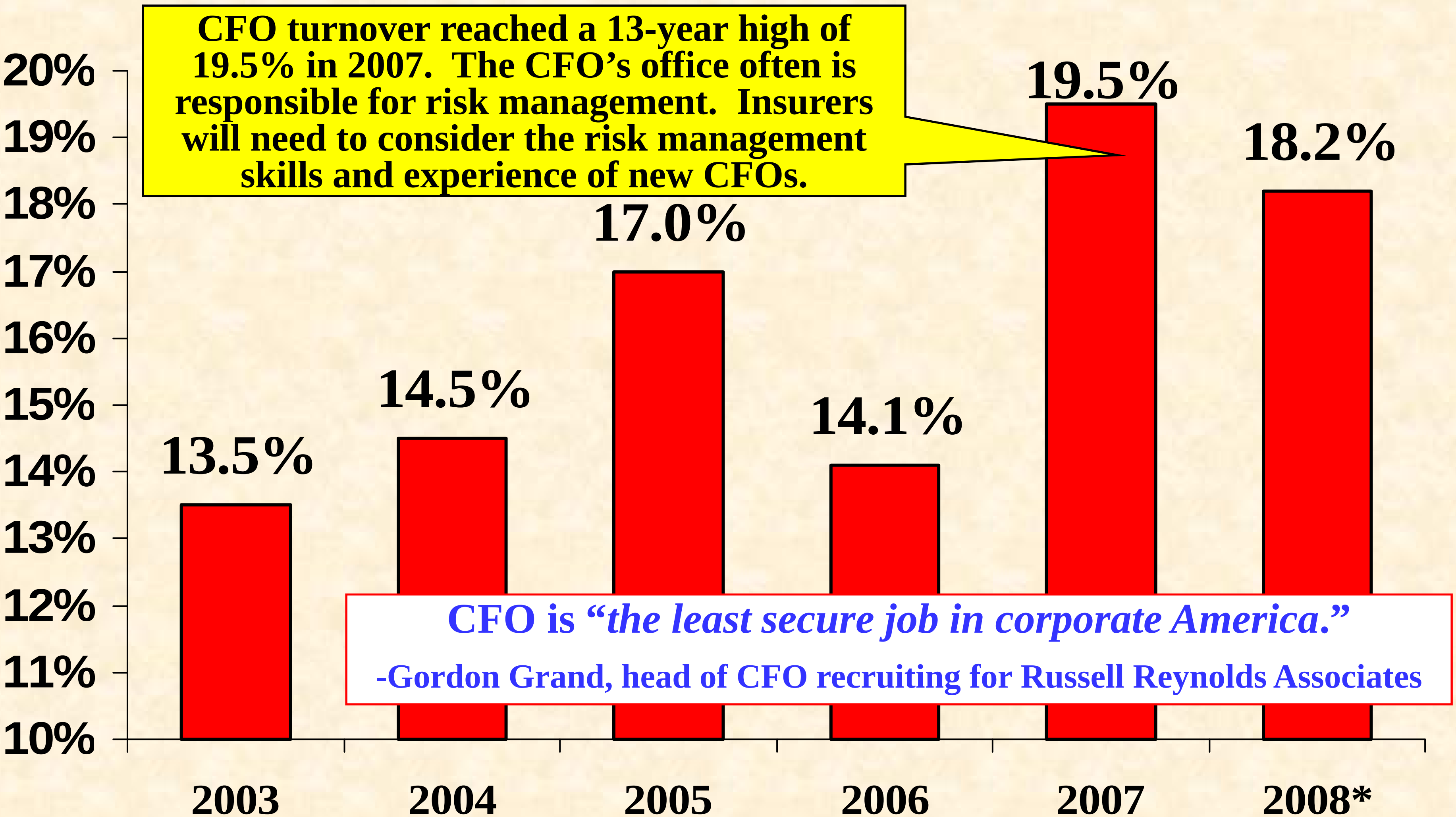
All Financial Segments Including Insurers Will Be Impacted

Post-Crunch: Fundamental Issues To Be Examined Globally

- **Failure of Risk Management, Control & Supervision at Financial Institutions Worldwide: Global Impact**
  - Colossal failure of risk management (and regulation)
  - Counterparty risk and collateral management were systemic failure points
  - Implications for Enterprise Risk Management (ERM)?
  - Misalignment of management financial incentives
- **Focus Will Be on Risk Controls: Implies More Stringent Capital & Liquidity Requirements; *Prevention of Systemic Risks***
  - Data reporting requirements also likely to be expanded
  - Non-Depository Financial Institutions in for major regulation
  - Changes likely under US and European regulatory regimes
  - Will new regulations be globally consistent?
  - Can overreactions be avoided?
- **Accounting Rule Changes??**
  - Problems arose under FAS, IAS
  - Asset Valuation, including Mark-to-Market
  - Structured Finance & Complex Derivatives
- **Ratings on Financial Instruments**
  - New approaches to reflect type of asset, nature of risk

Source: Ins. Info. Inst.

CFO Turnover Rate: The Fall Guy in Risk Management Failures



*2008 figure based on data for first 7 months of 2008.

Source: Crist|Kolder Associates from “Corporate Financial Chiefs Face New Pressures,” *WSJ*, 12/1/08, p. B5; I.I.I.

Emerging Blueprint for Financial Services Regulatory Overhaul

Phase I: Systemic Risk Regulation/Regulator

- Identification of systemic risk points in the financial system
- Design of appropriate regulation to prevent future collapses
- Will require international consultation (US can't manage systemic risk alone)

- **Oversight Responsibility: Likely With Federal Reserve**
  - Fed would have capacity and power to assess risk across financial markets regardless of corporate form and to intervene when appropriate*
  - Fed could oversee (according to House FS Committee Chairman Barney Frank:
    - Hedge funds (need to ensure "complete transparency")
    - Credit ratings agencies
    - Executive compensation (to curb "perverse risk incentives")
  - TIMELINE: Frank wants "general outline" by April 2 meeting of G20 industrialized and developing nations

*http://financialservices.house.gov/press110/press0320082.shtml

Source: *Wall Street Journal*, "Frank Backs Regulator for Systemic Risk," 2/4/09, p. C3; I.I.I. research.

Emerging Blueprint for Financial Services Regulatory Overhaul (cont'd)

Phase I: Systemic Risk Regulation/Regulator: OTHER (cont'd)

- **Unification of federal bank regulatory agencies**
- **Creation of a Financial Products Safety Commission to vet products before sold to investors**
- **Creation of federal insurance program for muni bonds paid via premiums**
- **Support for status quo on mark-to-market**

Phase II: Sectoral Reform/Overhaul

- **Each segment of the financial services industry will be examined and subject to regulation specific to its function, risks and other factors**
- **TIMELINE: August 2009 or later**

Source: *Wall Street Journal*, "Frank Backs Regulator for Systemic Risk," 2/4/09, p. C3; I.I.I. research.

Post-Crunch: Fundamental Regulatory Issues & Insurance

- **Federal Encroachment on Regulation of Insurance in Certain Amid a Regulatory Tsunami**
  - **$150 billion in aid to AIG makes increased federal involvement in insurance regulation a certainty**
  - **States will lose some of their regulatory authority**
  - **What Feds get/what states lose is unclear**
- **Removing the "O" from "OFC"?**
  - **Treasury in March proposed moving solvency and consumer protection authority to a federal "Office of National Insurance"**
  - **Moving toward more universal approach for regulation of financial services, perhaps under Fed/Treasury?**
  - **Is European (e.g., FSA) approach in store?**
  - **Treasury proposed assuming solvency and consumer protection roles while also eliminating rate regulation**
  - **Expect battle over federal regulatory role to continue to be a divisive issue within the industry**
  - **States will fight to maximize influence, arguing that segments of the financial services industry under their control had the least problems**

Source: Insurance Information Institute

Possible Regulatory Scenarios for P/C Insurers as of Year-End 2009

- **Status Quo: P/C Insurers Remain Entirely Under Regulatory Supervision of the States**
  - **Unlikely, but some segments of the industry might welcome this outcome above all others**
- **Federal Regulation: Everything is Regulated by Feds**
  - **Unlikely that states will be left totally in the cold**
- **Optional Federal Charter (OFC): Insurers Could Choose Between Federal and State Regulation**
  - **Unlikely to be implemented as envisioned for past several years by OFC supporters**
- **Dual Regulation: Federal Regulation Layer Above State**
  - **Feds assume solvency regulation, states retain rate/form regulation**
- **Hybrid Regulation: Feds Assume Regulation of Large Insurers at the Holding Company Level**
- **Systemic Risk Regulator: Feds Focus on Regulation of Systemic Risk Points in Financial Services Sector**
  - **What are these points for insurers? P/C vs. Life?**

Source: Insurance Information Inst.

Major Regulatory Considerations for Insurance Regulation in 2009

- **Power Sharing:** **Will Feds and States Divide Regulatory Authority & How?**
  - **Holding company (federal) and operating company/insurer (state)?**
- **Pre-Emption:** **Will Congress Pass Legislation Pre-Empting State Authority?**
- **Regulatory Consolidation:** **Will Regulatory Authority (now spread over 4+ agencies) be Consolidated Into One Entity? Will it Involve States?**
- **Life vs. P/C:** **Will Separate Regulatory Structures Emerge?**
- **Guaranty Fund System:** **FDIC has suggested federalization of system**
- **State Run Insurers:** **Who Would Regulate State-Run Insurers (Property, WC)?**
  - **Many coastal states have large state-run entities**
  - **About 25 states operate workers comp state funds or monopolistic insurers**
- **Regulation of Credit Default Swaps as Insurance:** **Will Feds take this up?**
- **Insurer Divisiveness:** **Industry is Not United on Many Key Issues**

Source: Insurance Information Institute research.

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Insurance Information Institute On-Line

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