P/C Insurance Industry Trends: Challenges Amid the Economic Storm

Casualty Actuaries of New England
March 10, 2010, Sturbridge, MA

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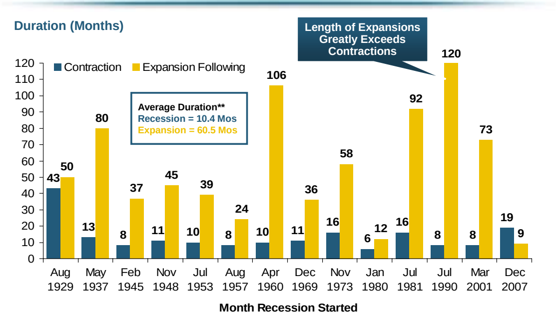
The Economic Situation

Its Effect on the Industry's Exposure Base, Growth, Investments, and Profitability

Length of US Business Cycles, 1929–Present*



*Through March 2010, assuming June 2009 is eventually determined to be the "official end" of recession. ** Post-WW II period through end of most recent expansion.
Sources: National Bureau of Economic Research; Insurance Information Institute.

A Weak Recovery is Forecast: Real GDP Growth, Yearly, 1970-2014F

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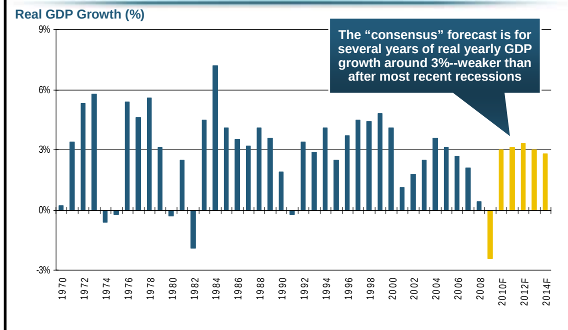

Estimates/Forecasts from Blue Chip Economic Indicators, 10/2009 and 2/2010 issues.
Sources: (GDP) U.S. Department of Commerce at http://www.bea.gov/national/xls/gdpchg.xls.

Percent of Noncurrent* Loans by FDIC-Insured Institutions, 2009 vs. 2008

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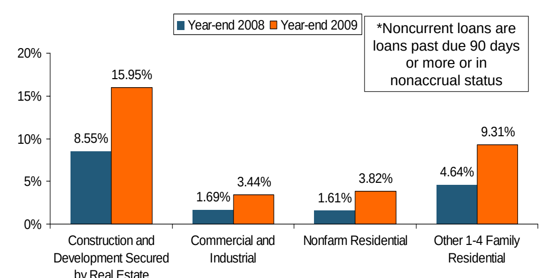

At Year-end 2009, an Additional 2.61% of Construction Loans, 0.95% of Commercial Loans, 1.24% of Nonfarm Residential Loans, and 3.18% of Other 1-4 Family Residential Loans were 30-89 Days Past Due

Source: FDIC Quarterly Banking Profile, Fourth Quarter 2008 and 2009, Table V-A

Amount of Outstanding Loans by FDIC-Insured Institutions, 2009 vs. 2008 vs. 2007

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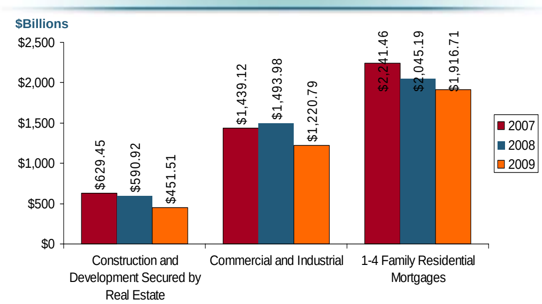
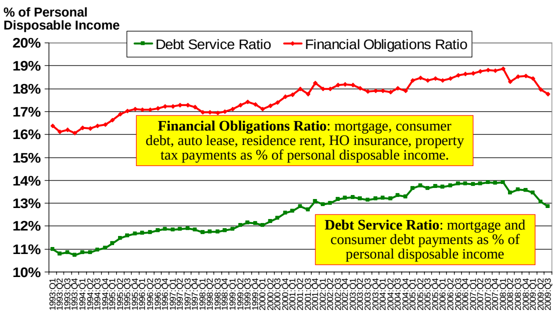


FDIC-Insured Institutions Had $541B Less in Outstanding Loans in These Three Categories at Year-end 2009 vs. 2008

Source: FDIC Quarterly Banking Profile, Fourth Quarter 2008 and 2009, Table I-A

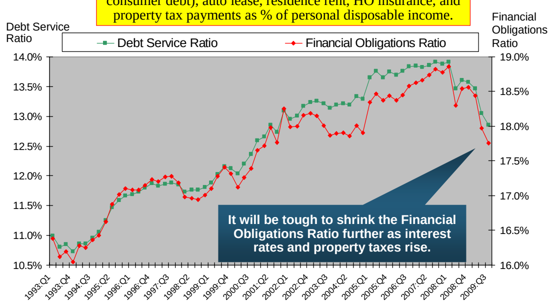
The Household Debt Load Rose From 1993 to 2008, Then Fell



Source: Federal Reserve Board, at http://www.federalreserve.gov/releases/housedebt

Households Are Now Reducing Their Financial Obligations

Financial Obligations Ratio: debt service (mortgage and consumer debt), auto lease, residence rent, HO insurance, and property tax payments as % of personal disposable income.



Source: Federal Reserve Board, at http://www.federalreserve.gov/releases/housedebt

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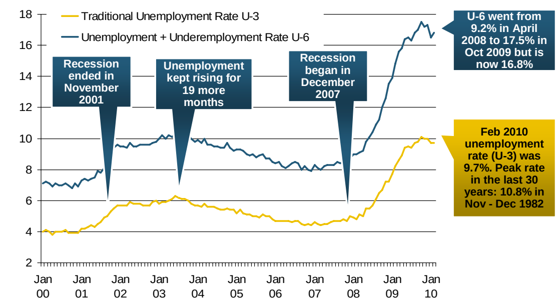
Labor Market Trends

Massive Job Losses Sap the Economy and the Commercial & Personal Lines Exposure Bases

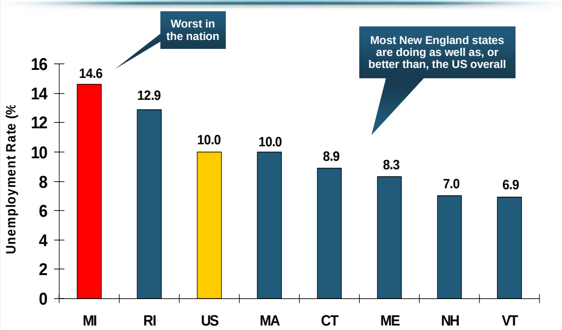
Unemployment and Underemployment Rates: Rocketing Up in 2008-09

January 2000 through February 2010, Seasonally Adjusted (%)



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

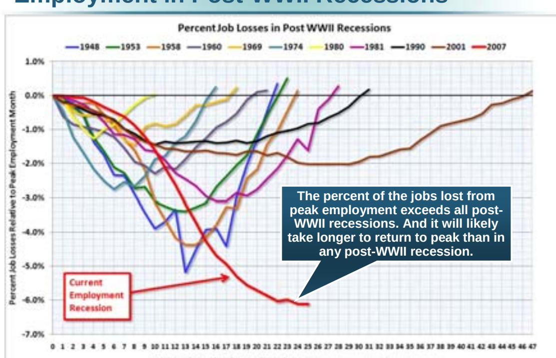
Unemployment Rates in New England states, December 2009



*Preliminary data for December 2009, seasonally adjusted.

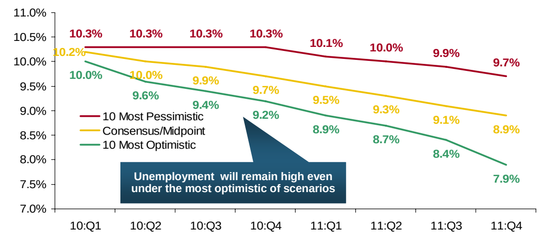
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

Percent Job Losses from Peak Employment in Post-WWII Recessions



US Quarterly Unemployment Rate Forecasts

Quarterly, 2010:Q1 to 2011:Q4



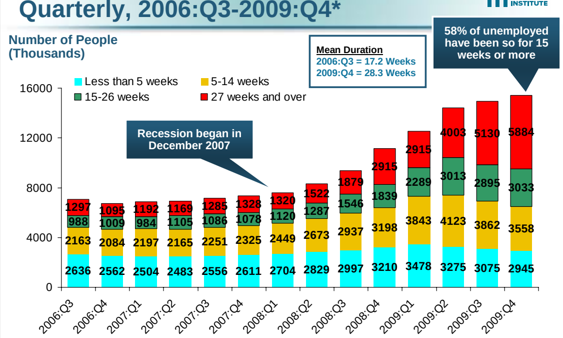
Stubbornly High Unemployment Will Hurt the Workers Comp's Exposure Base

Sources: Blue Chip Economic Indicators (2/10); Insurance Information Institute

Permanently Lost Jobs as a Percent of the Unemployed

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

Length of Unemployment, Quarterly, 2006:Q3-2009:Q4*



*Seasonally adjusted

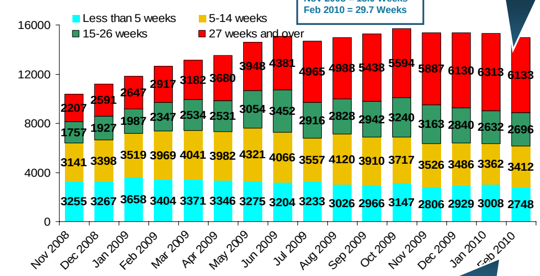
Sources: Bureau of Labor Statistics; Insurance Information Institute.

Length of Unemployment, Monthly, Nov 2008–Present*

59% of unemployed have been so for 15 weeks or more

Number of People (Thousands)

Mean Duration
Nov 2008 = 18.9 Weeks
Feb 2010 = 29.7 Weeks



Number of long-term (27+) unemployed dropped by 200,000 in February 2010

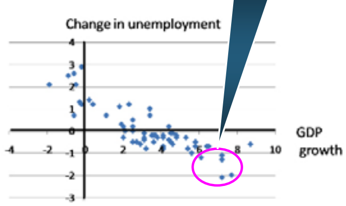
*Through Feb. 2010; Seasonally adjusted
Sources: Bureau of Labor Statistics; Insurance Information Institute.

It's Quite Unlikely Yearly Unemployment Will Drop Below 8 Percent Soon

- The graph plots yearly real GDP and changes in unemployment over the past 60 years.

Unemployment dropped more than 1 percentage point in a year only when real GDP grew at least 6%.

- More likely, real GDP will grow at a 3% rate and unemployment will drop by ½ of 1% per year



Source: http://krugman.blogs.nytimes.com/2009/10/29/growth-and-jobs/ using data from BEA and BLS

Job Growth Needed* to Return to "Pre-Recession" Employment Level

- Since the start of the recession in December 2007, an estimated 8.6 million jobs have been lost.
- To keep up with population growth, the economy needs to add roughly 130,000 jobs every month.
- This means the labor market is currently 12 million jobs below the level needed to restore the pre-recession employment rate.

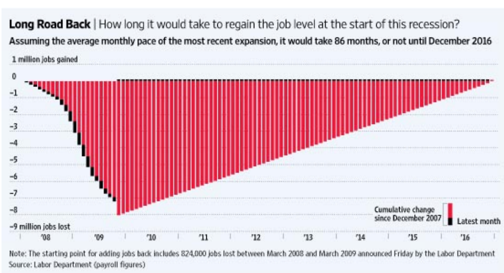
*as of February 2010
Source: Heidi Shierholz, "Signs of Healing in the Labor Market, Though Unemployment Remains in Double Digits," Economic Policy Institute, December 4, 2009, at http://www.epi.org/analysis_and_opinion/entry/signs_of_healing_in_the_labor_market_though_unemployment_remains_in_double_/

Job Growth Needed (cont'd)

- Even if no more jobs are lost, if we are to return to the equivalent of pre-recession employment levels in 5 years' time—by the start of 2015—we would have to average adding 300,000 jobs per month every month until then.
  - This is not likely. The Obama Administration's latest forecast for average monthly job growth is
    - 95,000 in 2010
    - 190,000 in 2011
    - 251,000 in 2012
    - 274,000 in 2013
    - 267,000 in 2014

Source: Economic Report of the President, at http://www.whitehouse.gov/sites/default/files/microsites/economic-report-president.pdf (Table 2-3, p. 75)

When Might All of the Lost Jobs Be Regained? 2016?



Source: *Wall Street Journal*, October 9, 2009, p. A3

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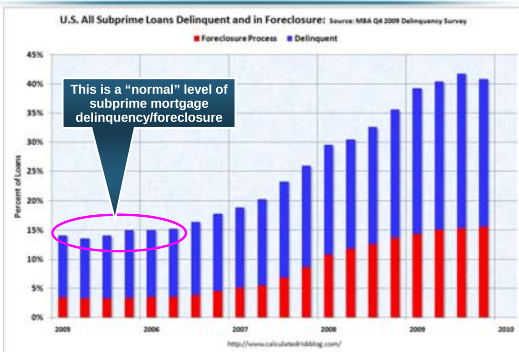
The Housing and Commercial Real Estate Markets

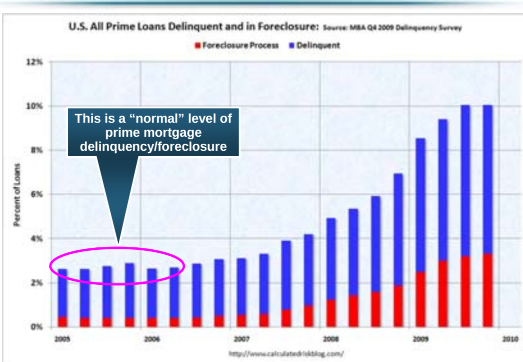
New Home Construction Will Likely Be Weak for Several Years; Limited HO and Commercial Lines Growth

At Year-end 2009, Over 40% of Subprime Loans Were Delinquent or in Foreclosure

(2005:Q1-2009:Q4)



Prime Loans: At Year-end 2009, the Percent Delinquent and in Foreclosure Leveled Off at 10% (2005:Q1-2009:Q4)

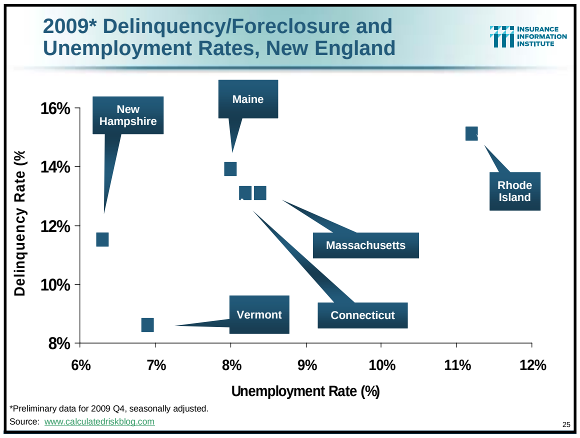


"Millions" More Foreclosures are Likely

- "**Even before the current crisis, when home prices were climbing, there were still many hundreds of thousands of foreclosures**. Therefore, even if HAMP is a total success, **we should still expect millions of foreclosures**, as President Obama noted when he launched the program in February.

  Some of these foreclosures will result from borrowers who, as investors, do not qualify for the program. Others will occur because borrowers do not respond to our outreach. Still others will be the product of borrowers who bought homes well beyond what they could afford and so would be unable to make the monthly payment even on a modified loan."

Source: Treasury Assistant Secretary for Financial Institutions Michael S. Barr, Written Testimony on Stabilizing the Housing Market before the House Financial Services Committee, Subcommittee on Housing and Community Opportunity (emphasis added)



2009* Delinquency/Foreclosure and Unemployment Rates, New England
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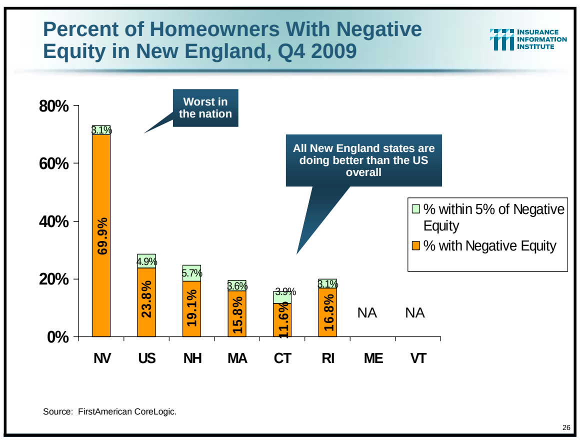
Delinquency Rate (%
16%
14%
12%
10%
8%
New Hampshire
Maine
Rhode Island
Massachusetts
Vermont
Connecticut
6%
7%
8%
9%
10%
11%
12%
Unemployment Rate (%)
*Preliminary data for 2009 Q4, seasonally adjusted.
Source: www.calculatedriskblog.com
25



Percent of Homeowners With Negative Equity in New England, Q4 2009
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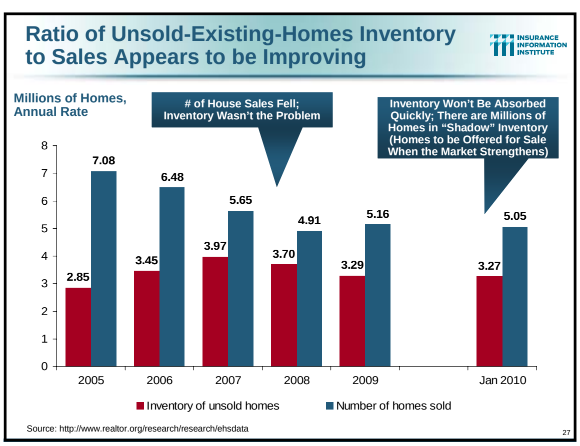
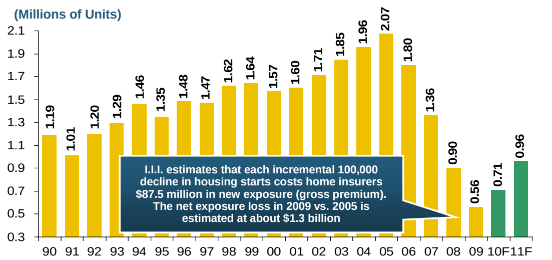
80%
60%
40%
20%
0%
Worst in the nation
All New England states are doing better than the US overall
% within 5% of Negative Equity
% with Negative Equity
3.1%
69.9%
4.9%
23.8%
5.7%
19.1%
3.6%
15.8%
3.9%
11.6%
3.1%
16.8%
NA
NA
NV
US
NH
MA
CT
RI
ME
VT
Source: FirstAmerican CoreLogic.
26



Ratio of Unsold-Existing-Homes Inventory to Sales Appears to be Improving
INSURANCE INFORMATION INSTITUTE
Millions of Homes, Annual Rate
# of House Sales Fell; Inventory Wasn't the Problem
Inventory Won't Be Absorbed Quickly; There are Millions of Homes in "Shadow" Inventory (Homes to be Offered for Sale When the Market Strengthens)
8
7
6
5
4
3
2
1
0
2.85
7.08
3.45
6.48
3.97
5.65
3.70
4.91
3.29
5.16
3.27
5.05
2005
2006
2007
2008
2009
Jan 2010
Inventory of unsold homes
Number of homes sold
Source: http://www.realtor.org/research/research/ehsdata
27

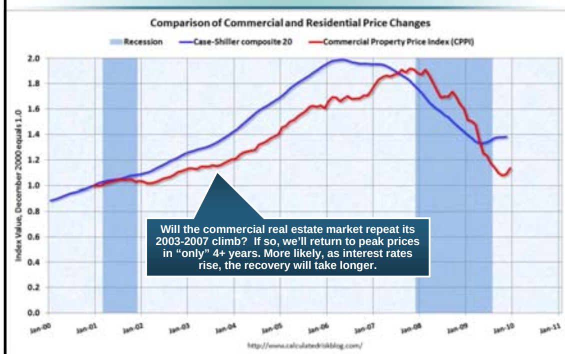
Private Housing Starts, 1990-2011F



Little Exposure Growth Likely for Homeowners Insurers
Due to Weak Home Construction Forecast for 2010-2011.
Also Affects Commercial Insurers with Construction Risk Exposure, Surety

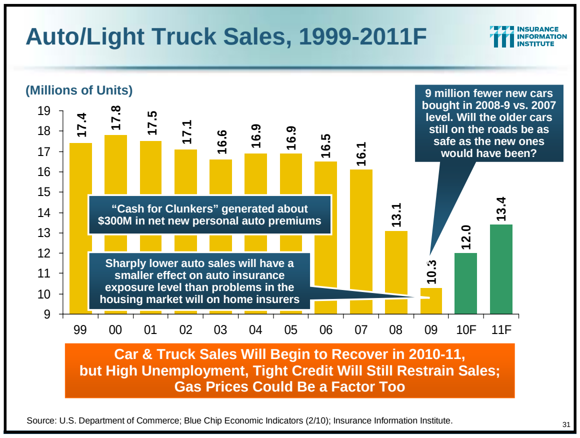
Sources: U.S. Department of Commerce (history) ; Blue Chip Economic Indicators (2/10), forecasts; Insurance Information Institute.

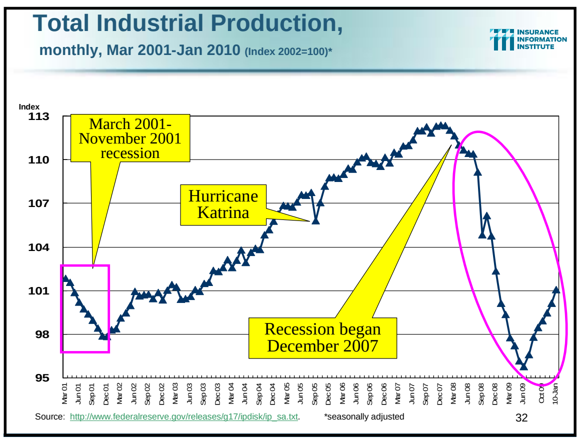
Commercial Real Estate Prices Fell Farther Than Residential Prices; Now Recovering?



The Recession's Effect on P-C Exposure Bases

Economic Obstacles to Growth in P/C Insurance


Auto/Light Truck Sales, 1999-2011F
INSURANCE INFORMATION INSTITUTE
(Millions of Units)
9 million fewer new cars bought in 2008-9 vs. 2007 level. Will the older cars still on the roads be as safe as the new ones would have been?
17.4
17.8
17.5
17.1
16.6
16.9
16.9
16.5
16.1
13.1
10.3
12.0
13.4
"Cash for Clunkers" generated about $300M in net new personal auto premiums
Sharply lower auto sales will have a smaller effect on auto insurance exposure level than problems in the housing market will on home insurers
99 00 01 02 03 04 05 06 07 08 09 10F 11F
Car & Truck Sales Will Begin to Recover in 2010-11, but High Unemployment, Tight Credit Will Still Restrain Sales; Gas Prices Could Be a Factor Too
Source: U.S. Department of Commerce; Blue Chip Economic Indicators (2/10); Insurance Information Institute.
31


Total Industrial Production,
monthly, Mar 2001-Jan 2010 (Index 2002=100)*
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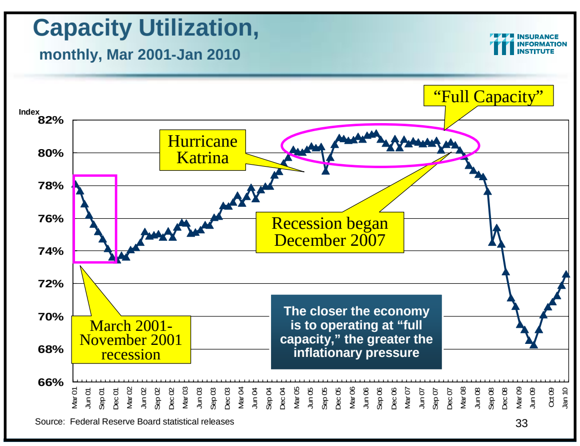
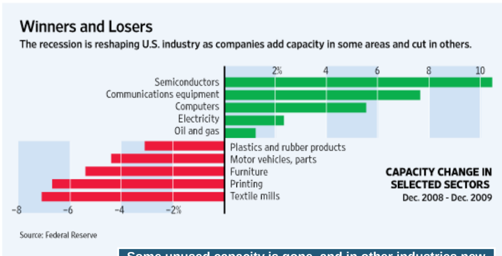
Index
113
110
107
104
101
98
95
March 2001-November 2001 recession
Hurricane Katrina
Recession began December 2007
Source: http://www.federalreserve.gov/releases/g17/ipdisk/ip_sa.txt. *seasonally adjusted
32


Capacity Utilization,
monthly, Mar 2001-Jan 2010
INSURANCE INFORMATION INSTITUTE
Index
82%
80%
78%
76%
74%
72%
70%
68%
66%
"Full Capacity"
Hurricane Katrina
Recession began December 2007
March 2001-November 2001 recession
The closer the economy is to operating at "full capacity," the greater the inflationary pressure
Source: Federal Reserve Board statistical releases
33

Some Industrial Production Capacity Has Vanished

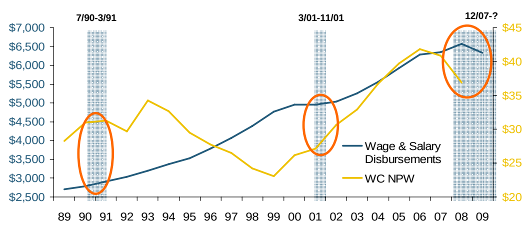


Some unused capacity is gone, and in other industries new capacity is needed, so the economy might be closer to full capacity than the industrial production numbers indicate. If so, this might spur inflation sooner than expected.

Source: Wall Street Journal, Feb. 3, 2009

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

Wage & Salary Disbursement (Private Employment) vs. WC NWP ($ Billions)

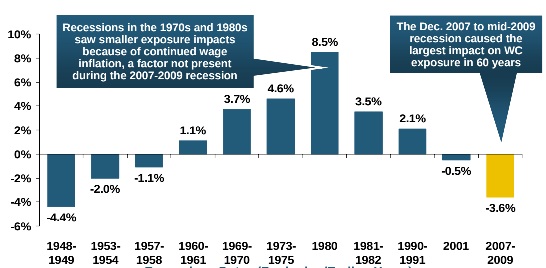


Weakening Payrolls Have Eroded $2B+ in Workers Comp Premiums

Shaded areas indicate recessions
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

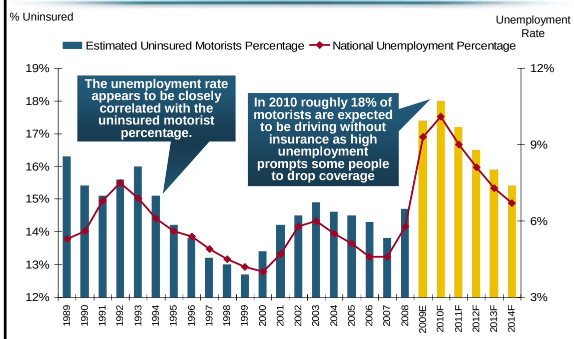
Estimated Effect of Recessions* on Payroll (Workers Comp Exposure)

(Percent Change) (All Post WW-II Recessions)



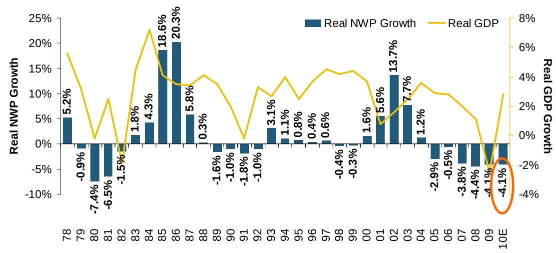
*Data represent maximum recorded decline over 12-month period using annualized quarterly wage and salary accrual data.
Source: Insurance Information Institute research; Federal Reserve Bank of St. Louis (wage and salary data); National Bureau of Economic Research (recession dates).

Unemployment's Effect on Percent of Uninsured Motorists, 1989-2014F



Source: *Uninsured Motorists, 2008* Edition, Insurance Research Council; Blue Chip Economic Indicators (Unemployment data, including forecasts); Insurance Information Institute.

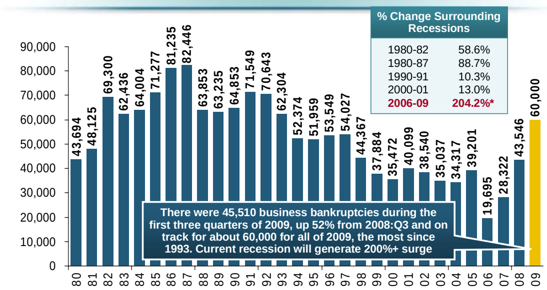
Real GDP Growth vs. Real P/C Premium Growth: Modest Association



P/C Insurance Industry's Growth is Influenced Modestly by Growth in the Overall Economy

Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 1/10; Insurance Information Institute

Business Bankruptcy Filings, 1980-2009*

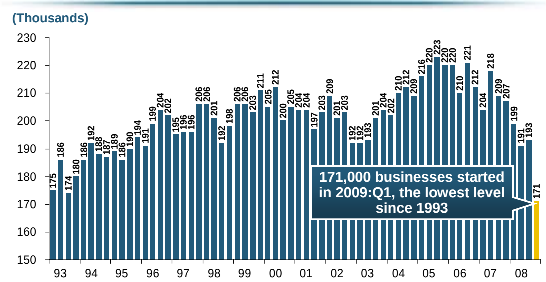


% Change Surrounding Recessions	
1980-82	58.6%
1980-87	88.7%
1990-91	10.3%
2000-01	13.0%
2006-09	204.2%*

Significant Implications for Bond & Surety Lines

*2009 is annualized estimate based on actual business bankruptcies in first three quarters of 2009
Source: American Bankruptcy Institute, http://www.abiworld.org/AM/Template.cfm?Section=Business_Bankruptcy_Filings1&Template=/TaggedPage/TaggedPageDisplay.cfm&TPLID=59&ContentID=36301.

Private Sector Business Starts, 1993:Q2 – 2009:Q1*



Business Starts Are Down 18% in the Current Downturn, Holding Back Most Types of Commercial Insurance Exposure

*Latest available as of Jan. 2010, seasonally adjusted
Source: Bureau of Labor Statistics, http://www.bls.gov/news.release/cewbd.t07.htm.

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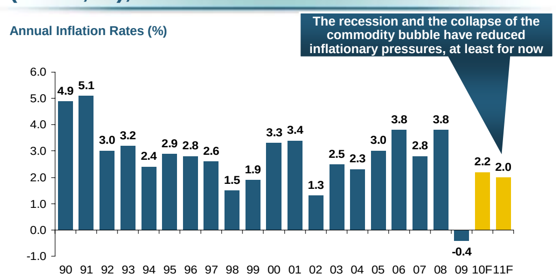
Inflation Trends: *Concerns Over Stimulus Spending and Monetary Policy*

Mounting Pressure on Claim Cost Severities?

Annual Inflation Rates (CPI-U, %), 1990–2011F

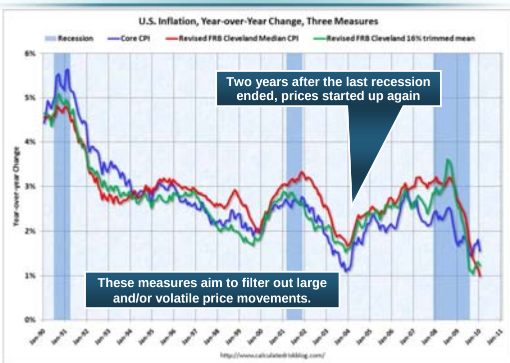


The Slack in the US Economy Implies that Inflation Should Not Be a Concern Through 2010/11, but Depreciation of Dollar is Concern Longer Run

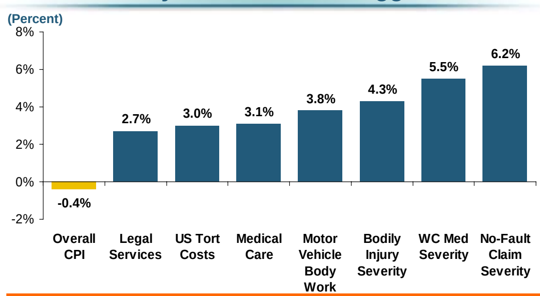
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, Feb. 10, 2010 (forecasts).

Three Alternate Inflation Measures

year-over-year changes, monthly, Jan 1990-Jan 2010



But P/C Insurers Experience Inflation More Intensely than 2009 CPI Suggests



Healthcare and Legal/Tort Costs Are a Major P/C Insurance Cost Driver. These Are Expected to Increase Above the Overall Inflation Rate (CPI) Indefinitely

Source: CPI is Blue Chip Economic Indicator 2009 estimate, 12/09; Legal services, medical care and motor vehicle body work are avg. monthly year-over-year change from BLS; BI and no-fault figures from ISO Fast Track data for 4 quarters ending 09:Q3. Tort costs is 2009 Towers-Perrin estimate. WC figure is I.I.I. estimate based on historical NCCI data.

Risks for Insurers if Inflation Is Reignited

- **Rising Claim Severities**
  - Cost of claims settlement rises across the board (property and liability)
- **Rate Inadequacy**
  - Rates inadequate due to low trend assumptions arising from use of historical data
- **Reserve Inadequacy**
  - Reserves may develop adversely and become inadequate (deficient)
- **Burn Through on Retentions**
  - Retentions, deductibles burned through more quickly
- **Reinsurance Penetration/Exhaustion**
  - Higher costs ➔ risks burn through their retentions more quickly, tapping into reinsurance more quickly and potentially exhausting their reinsurance more quickly

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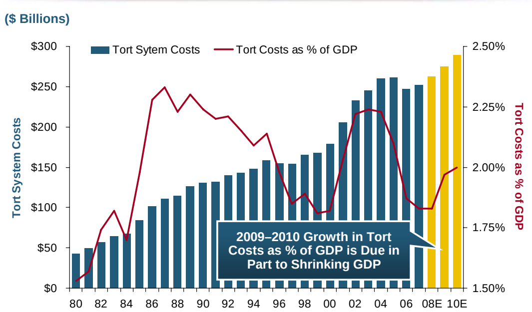
Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

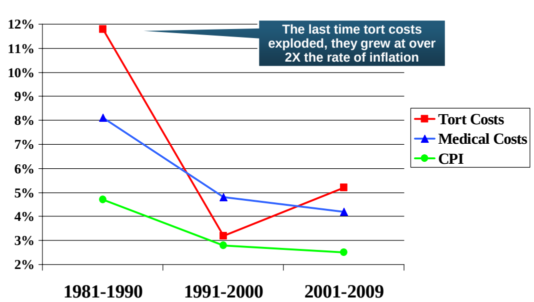
Over the Last Three Decades, Total Tort Costs* as a % of GDP Appear Somewhat Cyclical



* Excludes the tobacco settlement, medical malpractice

Sources: Tillinghast-Towers Perrin, *2008 Update on US Tort Cost Trends*, Appendix 1A; I.I.I. calculations/estimates for 2009 and 2010

Tort Cost & Medical Cost Growth vs. Overall Inflation (CPI-U), 1981-2009

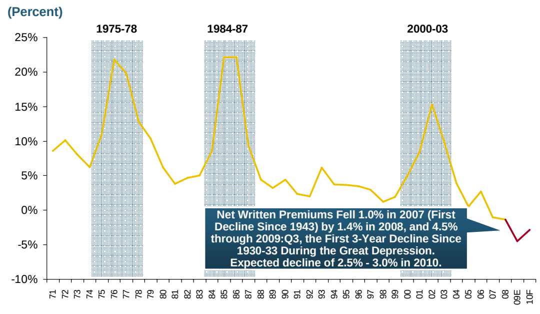


Sources: U.S. Bureau of Labor Statistics; Tillinghast-Towers Perrin, *2008 Update on U.S. Tort Costs*; I.I.I.

P/C Premium Growth

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

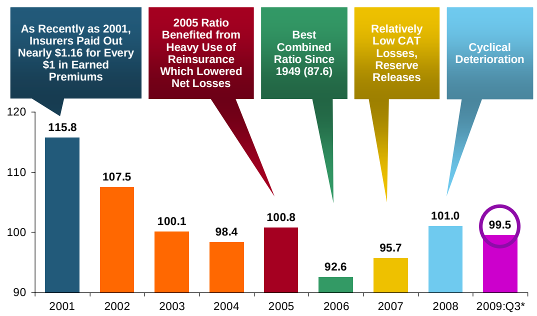
Annual NWP Growth, 1971-2010F



Shaded areas denote "hard market" periods
Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute

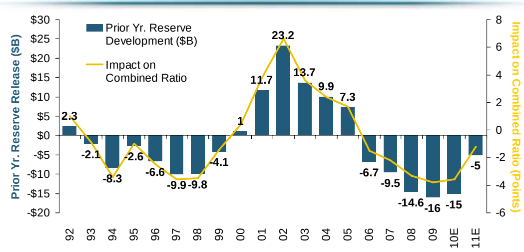
Underwriting Trends – Financial Crisis and Recession *Didn't* Directly Affect Underwriting Performance: Cycle, Catastrophes Were Main Drivers

P/C Insurance Industry Combined Ratio, 2001–2009:Q3*



* Excludes Mortgage & Financial Guaranty insurers in 2008. Including M&FG, 2008=105.1, 2009=100.7
Sources: A.M. Best, ISO.

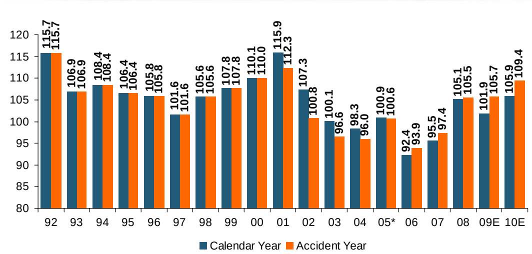
P/C Reserve Development, 1992–2011E



Reserve Releases Are Expected to Taper Off in 2010 and Drop Significantly in 2011

Note: 2005 reserve development excludes a $6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was $7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.
Sources: Barclay's Capital; A.M. Best.

Calendar Year vs. Accident Year P/C Combined Ratio: 1992–2010E[1]



Accident Year Results Show a More Significant Deterioration in Underwriting Performance. Calendar Year Results Are Helped by Reserve Releases

Note: 2005 reserve development excludes a $6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was $7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.
Sources: Barclay's Capital; A.M. Best.

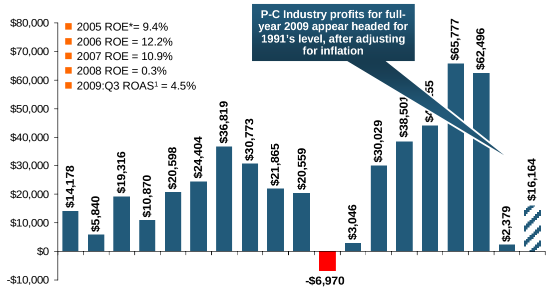
P/C Insurance Industry Financial Performance

A Resilient Industry in Challenging Times

Profitability

Historically Volatile

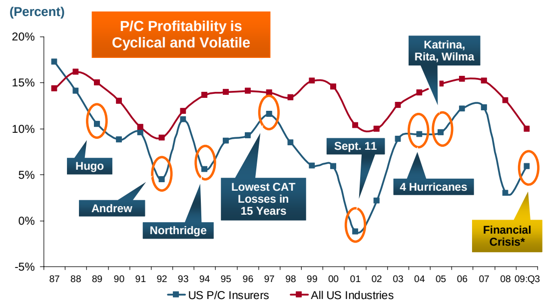
P/C Net Income After Taxes 1991–2009:Q3 ($ Millions)



* ROE figures are GAAP; [1]Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 4.5% ROAS for 2008 and 5.9% for the first 9 months of 2009. 2009:Q3 net income was $20.5 billion excluding M&FG.

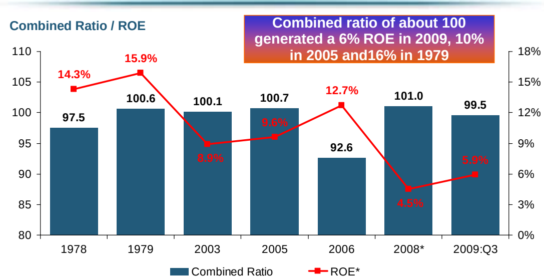
Sources: A.M. Best, ISO, Insurance Information Institute

ROE: P/C vs. All Industries1987–2009:Q3*



* Excludes Mortgage & Financial Guarantee in 2008 and 2009 through Q3.
Sources: ISO, *Fortune*; Insurance Information Institute.

A 100 Combined Ratio Isn't What It Once Was: 90-95 is Where It's At Now



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

* 2009 figure is return on average statutory surplus. 2008 and 2009 figures exclude mortgage and financial guarantee insurers
Source: Insurance Information Institute from A.M. Best and ISO data

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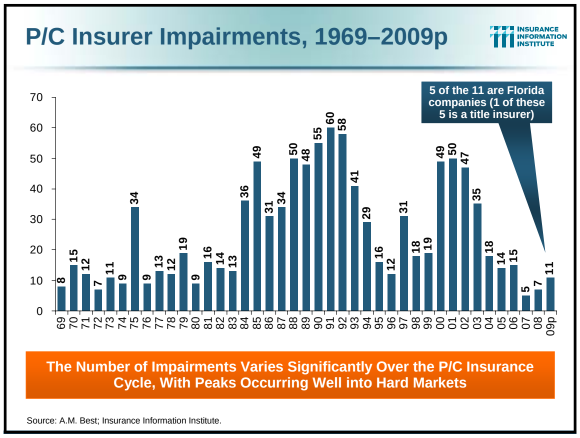
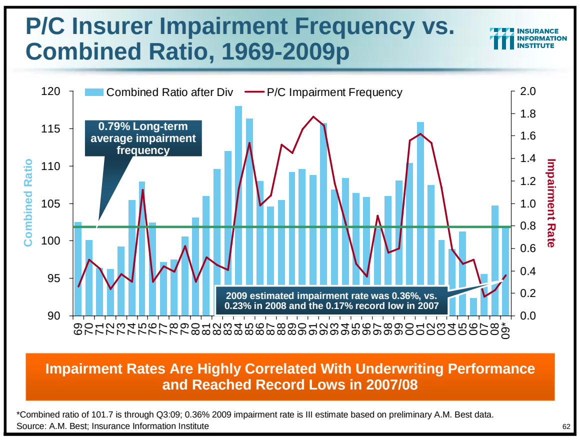
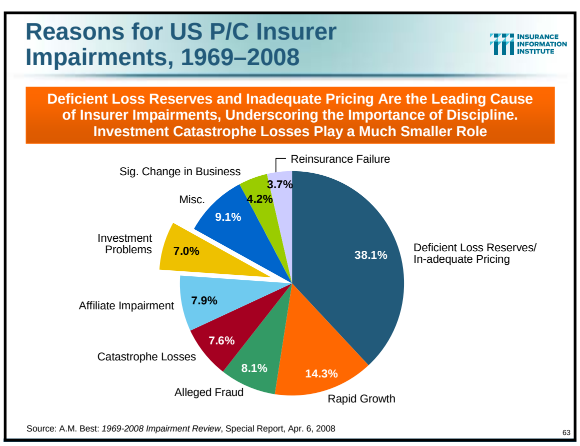
Financial Strength & Capacity

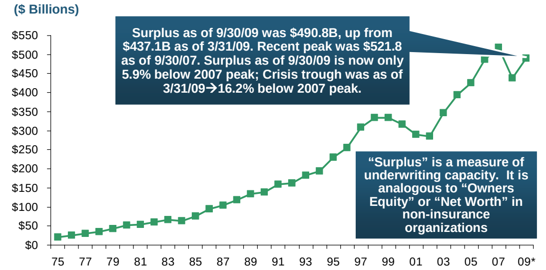
The P-C Industry Has Weathered the Storm Well


P/C Insurer Impairments, 1969–2009p
INSURANCE INFORMATION INSTITUTE
5 of the 11 are Florida companies (1 of these 5 is a title insurer)
8 15 12 7 11 9 34 9 13 12 19 9 16 14 13 36 49 31 34 50 48 55 60 58 41 29 16 12 31 18 19 49 50 47 35 18 14 15 5 7 11
69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09p
The Number of Impairments Varies Significantly Over the P/C Insurance Cycle, With Peaks Occurring Well into Hard Markets
Source: A.M. Best; Insurance Information Institute.


P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2009p
INSURANCE INFORMATION INSTITUTE
Combined Ratio after Div
P/C Impairment Frequency
Combined Ratio
Impairment Rate
0.79% Long-term average impairment frequency
2009 estimated impairment rate was 0.36%, vs. 0.23% in 2008 and the 0.17% record low in 2007
Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007/08
*Combined ratio of 101.7 is through Q3:09; 0.36% 2009 impairment rate is III estimate based on preliminary A.M. Best data.
Source: A.M. Best; Insurance Information Institute
62


Reasons for US P/C Insurer Impairments, 1969–2008
INSURANCE INFORMATION INSTITUTE
Deficient Loss Reserves and Inadequate Pricing Are the Leading Cause of Insurer Impairments, Underscoring the Importance of Discipline. Investment Catastrophe Losses Play a Much Smaller Role
Deficient Loss Reserves/ In-adequate Pricing 38.1%
Rapid Growth 14.3%
Alleged Fraud 8.1%
Catastrophe Losses 7.6%
Affiliate Impairment 7.9%
Investment Problems 7.0%
Misc. 9.1%
Sig. Change in Business 4.2%
Reinsurance Failure 3.7%
Source: A.M. Best: 1969-2008 Impairment Review, Special Report, Apr. 6, 2008
63

US Policyholder Surplus: 1975–2009:Q3*

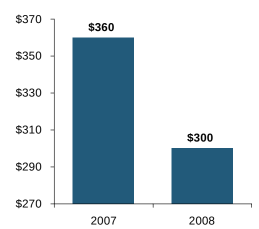


The Premium-to-Surplus Ratio Stood at $0.87:$1 as of 9/30/09, Up from Near Record Low of $0.85:$1 at Year-End 2007

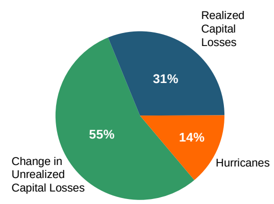
* As of 9/30/09
Source: A.M. Best, ISO, Insurance Information Institute.

Global Reinsurance Capacity Shrank in 2008, Mostly Due to Investments

Global Reinsurance Capacity



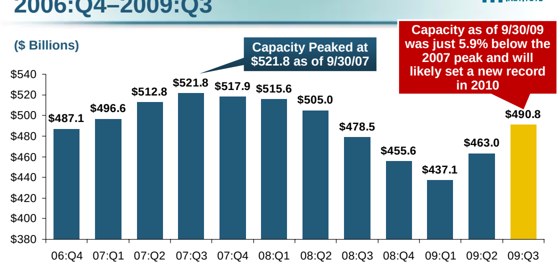
Source of Decline



Global Reinsurance Capacity Fell by an Estimated 17% in 2008

Source: AonBenfield Reinsurance Market Outlook 2009; Insurance Information Institute.

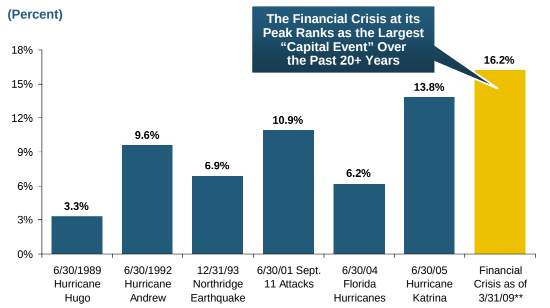
Policyholder Surplus, 2006:Q4–2009:Q3



Declines Since 2007:Q3 Peak	
08:Q2: -$16.6B (-3.2%)	*09:Q1: -$84.7B (-16.2%)*
08:Q3: -$43.3B (-8.3%)	09:Q2: -$58.8B (-11.2%)
08:Q4: -$66.2B (-12.9%)	09:Q3: -$31.8B (-5.9%)

Source: ISO, AM Best.

Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989*



* Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event
** Date of maximum capital erosion; As of 9/30/09 (latest available) ratio = 5.9%
Source: PCS; Insurance Information Institute

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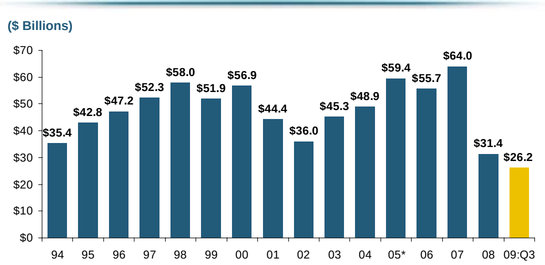
Investment Performance

Weak Investment Results Are a Main Cause of Low Profits

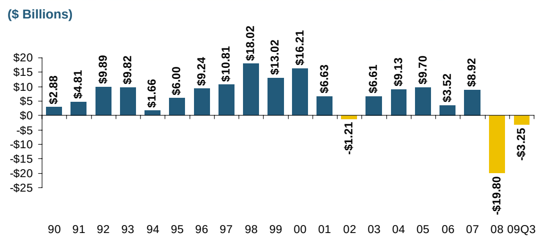
Property/Casualty Insurance Industry Investment Gain: 1994–2009:Q3[1]



Investment Gains Fell by 51% In 2008 Due to Lower Yields, Poor Equity Market Conditions. Through Three Quarters in 2009, Write-downs Were Offset by Unrealized Capital Gains

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

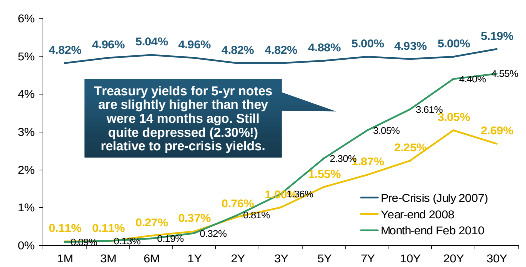
P/C Insurer Net Realized Capital Gains, 1990-2009:Q3



Realized Capital Losses Hit a Record $19.8 Billion in 2008 Due to Asset Price Turmoil, a $27.7 Billion Drop vs. 2007, and Down $3.25B More Through Q3:2009. This is a Main Cause of 2008/2009's Large Drop in Profits and ROE

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

Bond Yields Are Still Quite Low Compared to Pre-Crisis Levels



Stock Dividend Cuts Will Further Pressure Investment Income

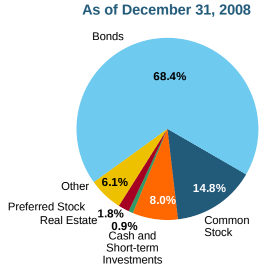
Sources: Board of Governors of the United States Federal Reserve Bank at http://ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield_historical_main.shtml ; Insurance Information Institute.

Distribution of P/C Insurance Industry's Investment Portfolio

Portfolio Facts

- Invested assets totaled $1.214 trillion as of 12/31/08
- Insurers are generally conservatively invested, with more than 2/3 of assets invested in bonds as of 12/31/08
- Only about 15% of assets were invested in common stock as of 12/31/08
- Even the most conservative of portfolios was hit hard in 2008

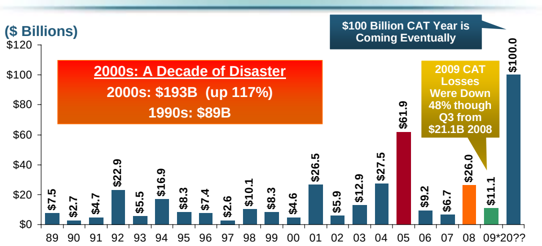
As of December 31, 2008



Sources: NAIC; Insurance Information Institute research.

Catastrophic Loss – Catastrophe Losses Trends Are Trending Adversely

US Insured Catastrophe Losses



2009 CAT Losses Were Less than Half of 2008. 2005 Was by Far the Worst Year Ever for Insured Catastrophe Losses in the Decade of the 2000s Were More than Double the 1990s, *But the Worst Has Yet to Come*

* 2009 figure is Munich Re estimate.
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. Non-prop/BI losses = $12.2B.
Sources: Property Claims Service/ISO; Insurance Information Institute.

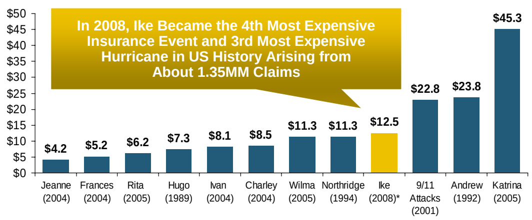
Natural Catastrophe Losses in the U.S. 2009

As of January 2010	Fatalities	Estimated Overall Losses (US $m)	Estimated Insured Losses (US $m)
Tropical Cyclones	8	Minor	Minor
Severe Thunderstorms	21	13,710	9,625†
Winter Storms	70	1,600	770†
Wildfires	6	280	185
Floods	22	1,600	232

Sources: (unmarked) - MR NatCat*SERVICE*,
† - Property Claims Services (PCS)

Top 12 Most Costly Disasters in US History

(Insured Losses, 2008, $ Billions)

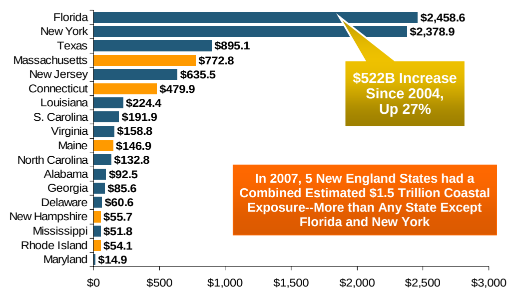


8 of the 12 Most Expensive Disasters in US History Have Occurred Since 2004

* PCS estimate as of August 1, 2009.
Sources: PCS; Insurance Information Institute inflation adjustments.

Total Value of Insured Coastal Exposure

(2007, $ Billions)



Source: AIR Worldwide

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Five Challenges Facing P-C Insurers in the Next 5-6 Years

1 Protecting Capital

- Black Swan: Surplus losses (mainly asset value losses) were larger and occurred more quickly than was believed possible
- In 6 calendar quarters surplus dropped over 16% ($85B) from 9/30/07 peak (a bigger capital hit than KRW in 2005)
  - Luckily for the industry, at the same time as the financial crisis/recession, it suffered only one major CAT event (Ike), unlike 2004-05 *but this could have happened*
- Most of the surplus loss has now been rebuilt, but now some equity analysts are again saying the P/C industry has "excess surplus"
  - They're calling for stock buy-backs, strategic acquisitions, etc.
- It Could Have Been Worse: During the Great Depression (1929–1933) PHS fell 37%, Assets fell 28% and Net Written Premiums fell by 35%. It took until 1939–40 before these key measures returned to their 1929 peaks

***Bottom Line:* We Should not Dismiss our Fresh Appreciation for the Vulnerability of the Capital We Have.**

2 Reloading Capital After "Capital Event"

- P/C insurers had come to believe that large amounts of capital can be raised quickly and cheaply after major events (9/11, Katrina)
  - *This assumption was incorrect during and immediately after the financial crisis*
- The cost of capital can rise sharply (relative to "risk-free" rates), reflecting both scarcity, increasing volatility, and heightened investor risk aversion
- Possible consequences of a failure to "reload": Insolvencies, forced mergers, calls for government aid, requests to relax capital requirements

***Implications:* P/C (re)insurers need to develop detailed contingency plans to raise fresh capital and/or generate it internally. Problems raising capital in a difficult environment were a reality for some life insurers.**

3 Years of Low Investment Earnings

- 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
- Fed actions in Treasury markets keep yields low
- Many insurers have not adjusted to this new investment paradigm of a sustained period of low investment gains
- ***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. Yet to manifest itself.
- Lessons from the period 1920–1975 need to be relearned

4 The Return of Terrorism Risk

- Rising perception that the U.S. is vulnerable to terrorism
- The thwarted Christmas Day attack by the "underwear bomber" reminded us that al Qaeda is still intent on bringing terror to the U.S.
  - Al Qaeda might step up its terrorist efforts in response to the surge in Afghanistan
  - Media reports on newly-discovered terrorist groups, such as "al Qaeda in the Arabian Peninsula"
- We will see increased anti-terror efforts
  - full-body scans at airports
  - Efforts by the government to appear more vigilant, prepared
    - Reports on new anti-terror coordination efforts
  - The trial of 9/11 suspects will focus media attention on terrorism and terrorists, possibly for several years

Bottom Line: Buyers and producers will likely have new discussions about terrorism coverage

5 The Re-Emerging 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
- Torts twice the overall rate of inflation
- Influence personal and commercial lines, esp. auto liability
- Historically ***extremely*** costly to p/c insurance industry
- Leads to reserve deficiency, rate pressure

Bottom Line: **Tort "crisis" is on the horizon and will be recognized as such by 2012–2014**

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Thank you for your time and your attention!