

Presentation to CAS

Reserve Pendulum Has Swung Too Far

November 13, 2007

MORGAN STANLEY EQUITY RESEARCH

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Reserves are Meaningfully Redundant

- Analysis of commercial insurers points to redundancies of ~10-25% of Book Value
- Skeptical?
 - YE 2001 deficiency estimated at \$65 billion
 - Through YE 2006 ~\$50 bil. of adverse development
 - Position at 12/06: ~\$18 bil. redundancy
- Direction and Order of Magnitude

Reserves are Meaningfully Redundant

- MAD: Mutually Assured Destruction
 - Insurers are stockpiling reserves

- Seeds of soft cycle being sewn...

- Three Outcomes:
 - Status Quo
 - Self Destruction
 - Macro Shock

Reserves are Meaningfully Redundant

- What is an investor to do?
 - 2 of 3 scenarios: choose company with largest stockpile

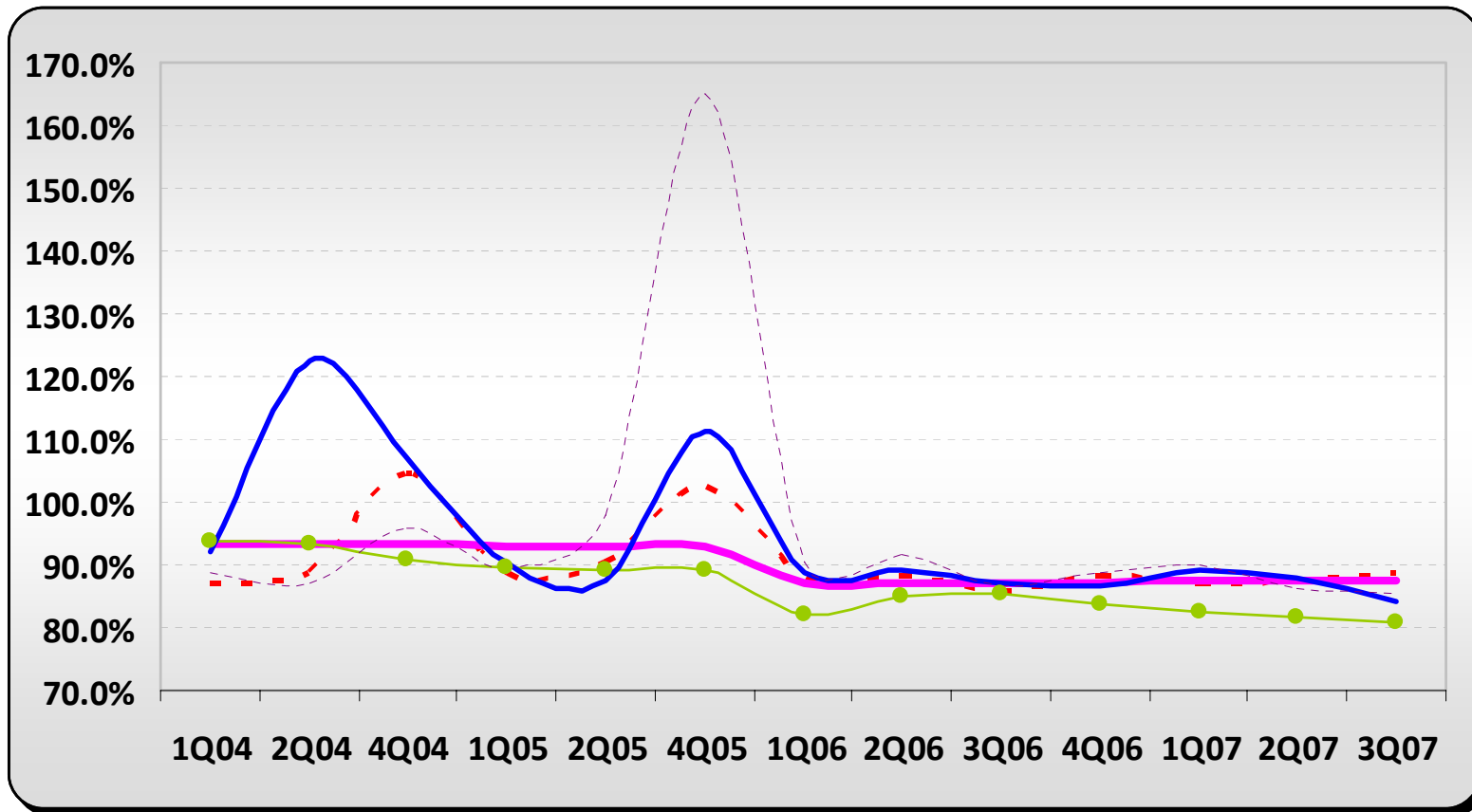
- BUT
 - Declining earnings quality \neq multiple expansion
 - Reserve releases = 3.1% of 2006 earnings*
 - Reserve releases = 10.6% of 2007 earnings*
 - Reserve releases = 8.7% of 2008 earnings*

- Bottom line: Transfer of Shareholder Wealth

*Select commercial insurance companies
Source: Company Data, Morgan Stanley Research

Do Insurers manage earnings? You Decide

Reported combined ratios have remained stable...

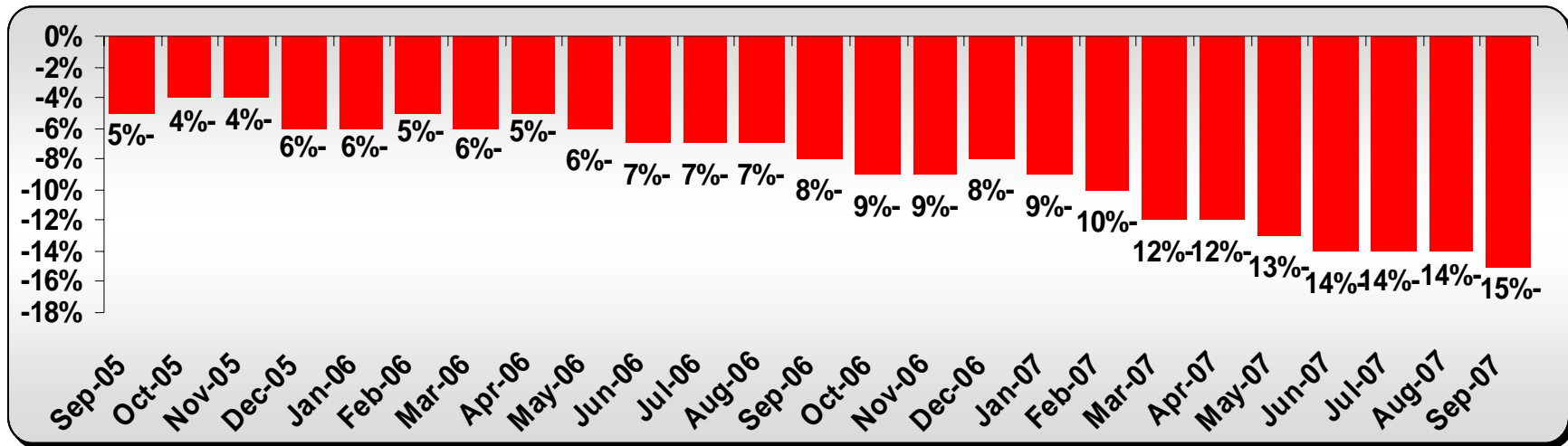


Source: Company Data, Morgan Stanley Research

Do Insurers manage earnings? You Decide

While premium rates have fallen...

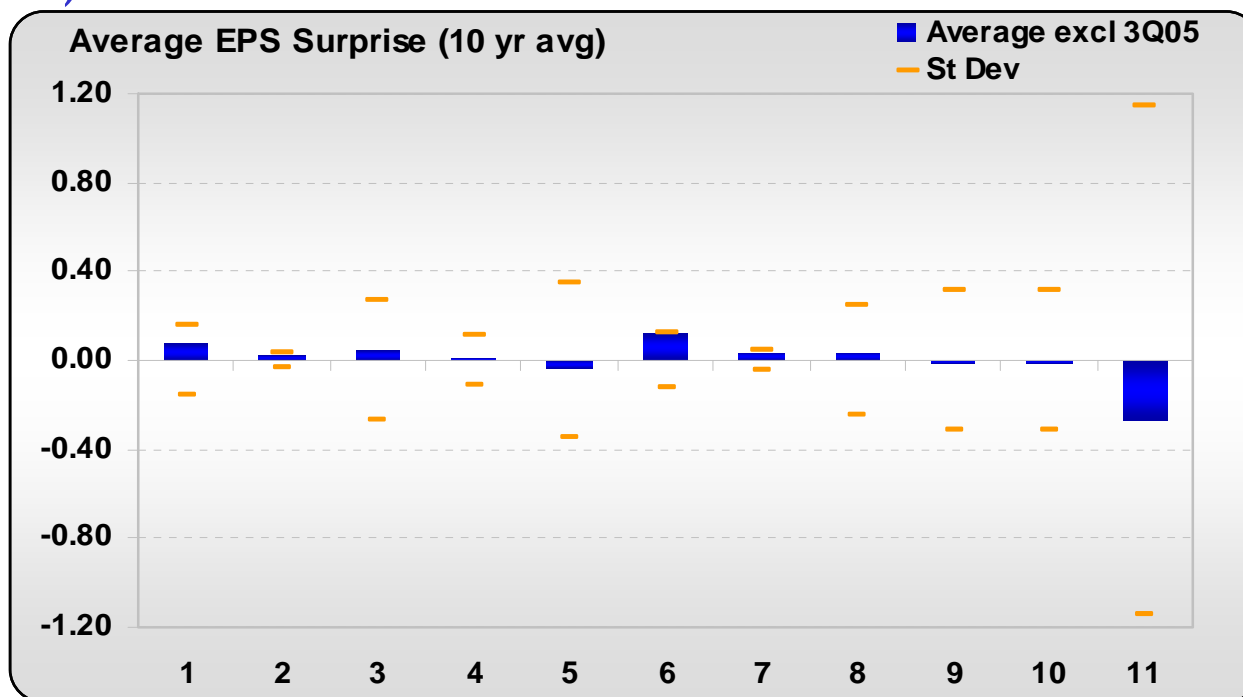
Monthly Commercial Rate Changes



Source: MarketScout, Morgan Stanley Research

Do Insurers manage earnings? You Decide

- Question: The companies below are in which sub sector of S&P 500
 - A) Consumer Discretionary
 - B) Consumer Staples
 - C) Financial Institutions/Insurance



Source: FactSet,
Morgan Stanley Research

IASB: Fair Value is Coming

- IASB : Fair value of liabilities is coming

- Discussion Paper issued Spring, 2007
- Comments....NOW!
- Exposure Draft in 2008
- Implementation in 2009

- Are we all on the same page?

- From the Fair Value of Liabilities, CAS 2004*

"The implementation of fair value may not actually move reported results materially closer to economic reality." ... "This is because claim reserves are subject to considerable uncertainty, with significant potential for estimation error, and this phenomenon does not disappear with the adoption of fair value principles."

"Of course, the use of fair values will move financial reporting closer to underlying economic reality."

*Fair Value of P&C Liabilities: Practical Implications (CAS, 2004)

IASB: Fair Value is Coming

- Are we all on the same page?

- From Deloitte, Preliminary Views on Insurance Contracts (August, 2007)*

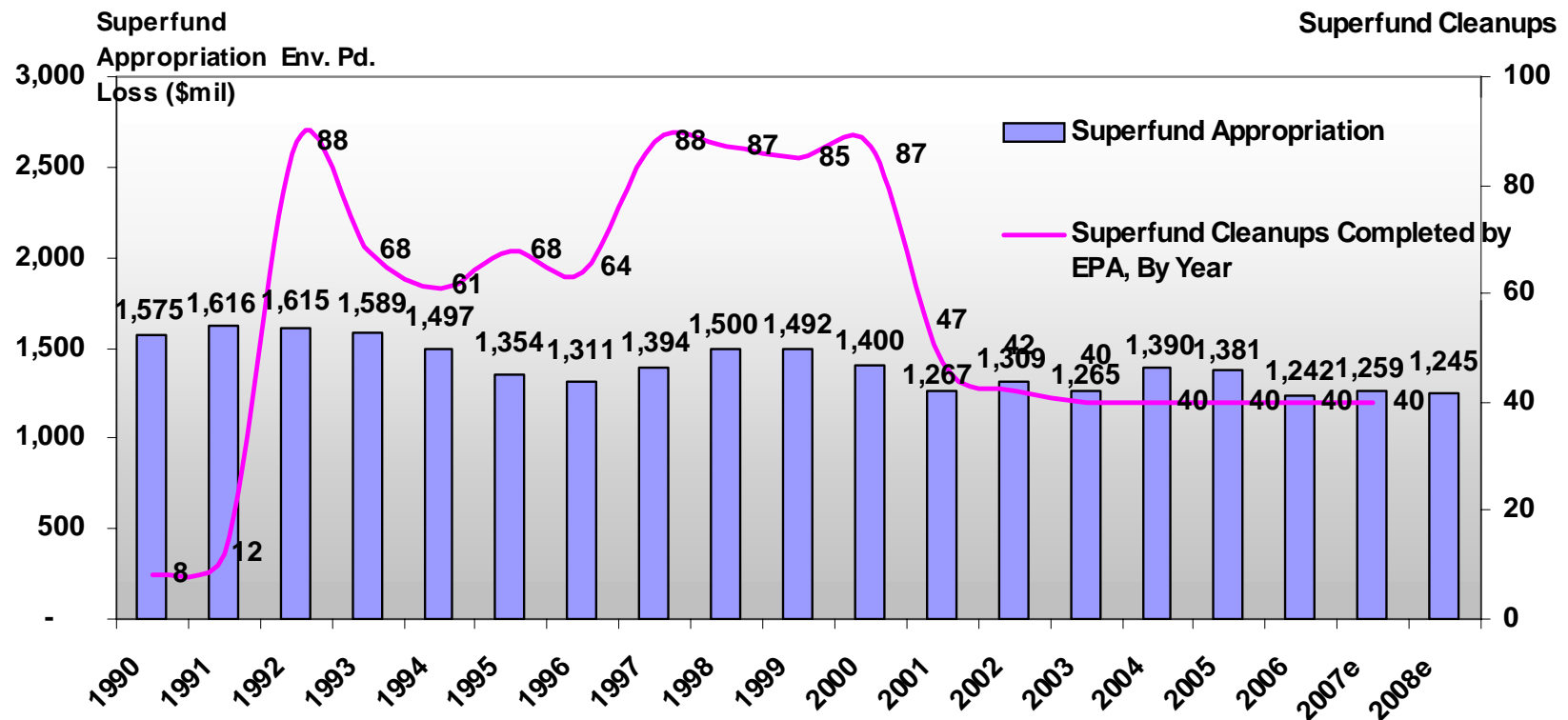
- “The approach proposed by the Board when valuing insurance liabilities is a market-consistent discounted best estimate of explicit liabilities plus explicit risk and service margins.”*

- Recommendation: Press for release of reserve ranges

*Preliminary Views on Insurance Contracts (Deloitte, August 2007)

Predictions

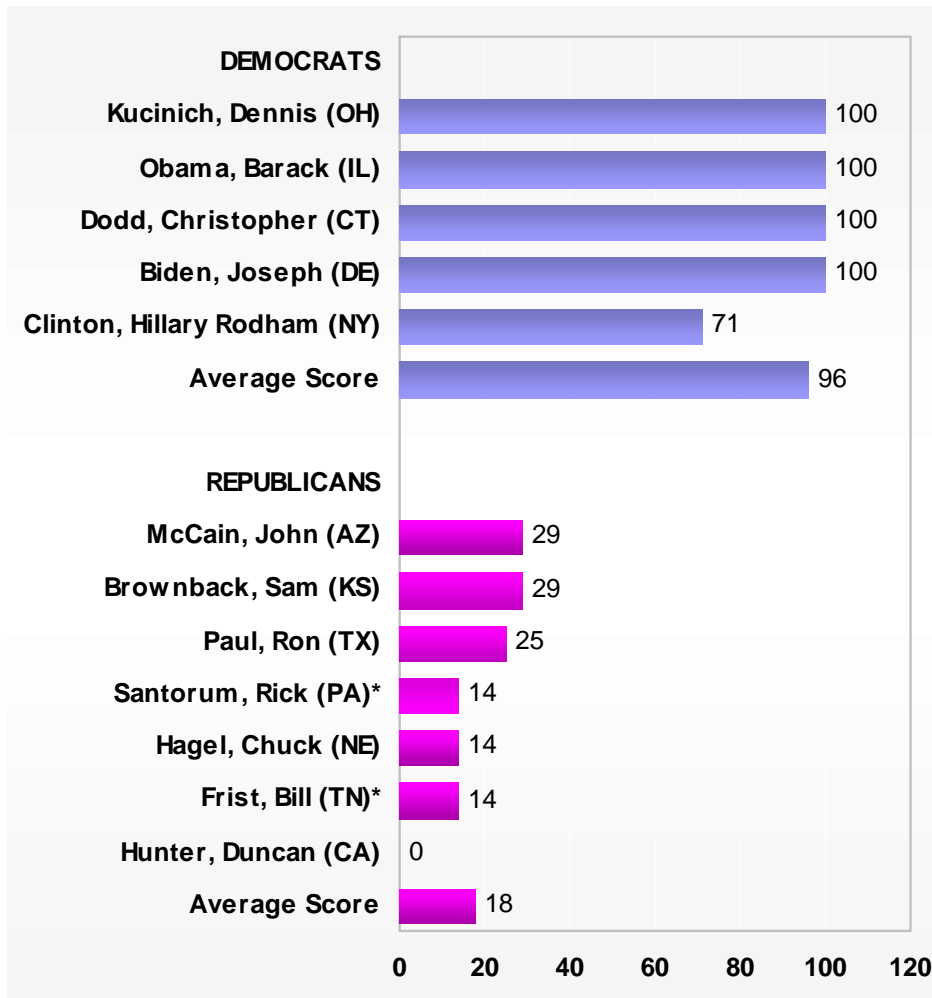
- Asbestos: More Topping Off
- Environmental: Forget-E-Not



Source: Environmental Protection Agency, Morgan Stanley Research

Predictions

- Environmental: Al Gore won the Nobel Peace Prize



➤ An environmentalist has a good shot at the White House.

➤ Do those seem like early warning signs?

Source: 2006 National Environmental Scorecard - League of Conservation Voters (LCV), Morgan Stanley Research

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(as of October 31, 2007)

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	Count	% of Total	Count	% of Total IBC	% of Rating Category
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Total	2,275		710		

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