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# Subprime Impact on D&O and E&O Profitability

Nick Durant, Guy Carpenter & Company



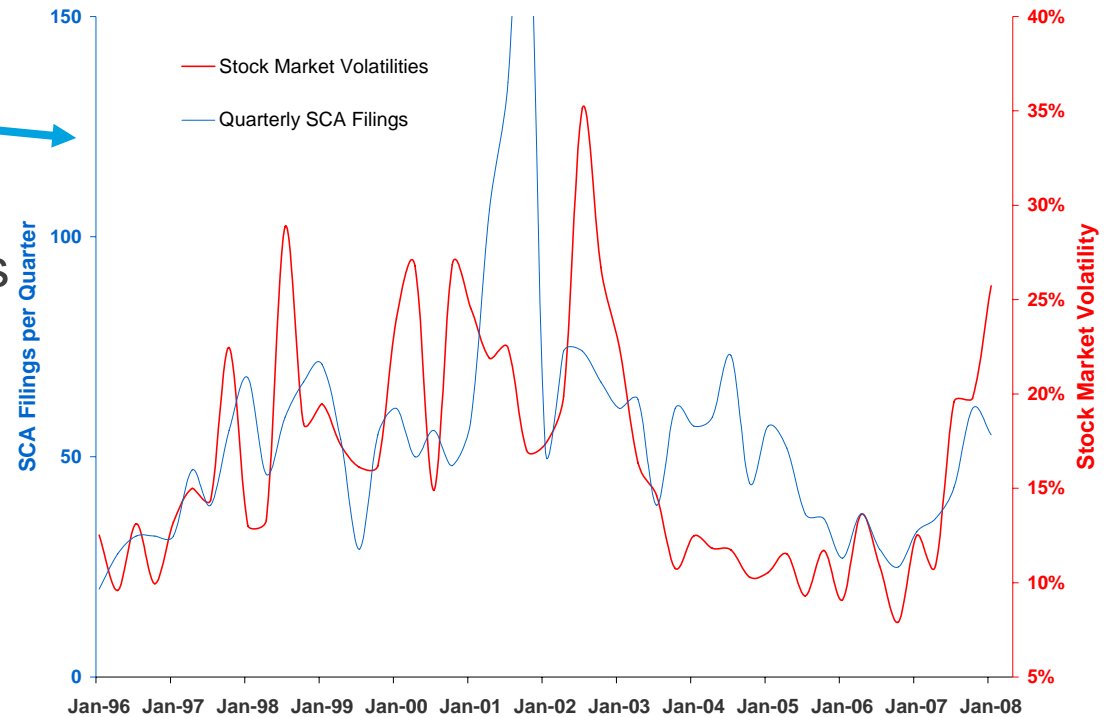
## Overview of D&O/E&O Market

- \$15b GWP in U.S.
  - D&O - \$8b
  - Non-Medical E&O - \$7b
- Approximately 10% of GWP is reinsurance premium
- Historic profits earned from 2003 to 2007
  - Those without soft market “drag” booking ULR’s from 20% to 60%
  - Reinsurers’ results have mirrored or been better than insurers
- 5<sup>th</sup> year of softening pricing
  - Profitability has attracted new entrants
  - Insured firms and companies are merging or going private
- Litigation environment has improved
  - Dura, Tellabs, Stoneridge



## Ominous Clouds Forming Over Industry

- Rates, loss trends and the economy indicate that profitability has peaked
- Securities Class Actions filings up
  - 80+ subprime related
  - 4Q07 and 1Q08 experienced largest numbers in a quarter since 1Q05
- Volatile equity market precedes increased claim frequency
- Democratic president + Congress = Lawyers' Payday
- Subprime will be a “net” event for D&O/E&O insurers

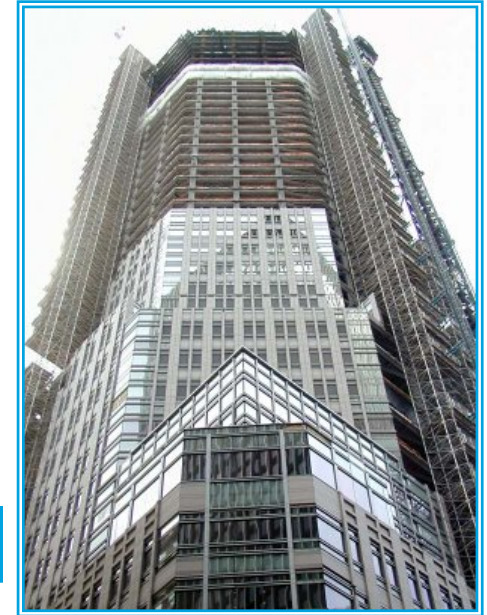




## This Year's Annual Non-Recurring Event.....

- Magnitude of market cap drops and high profile nature of problem suggest large settlements
  - Large banks only carry A-side or small amount of A/B D&O, up to \$600m in total limits
  - Limits up to \$300m for large non-FI companies
- Coverage provided is key

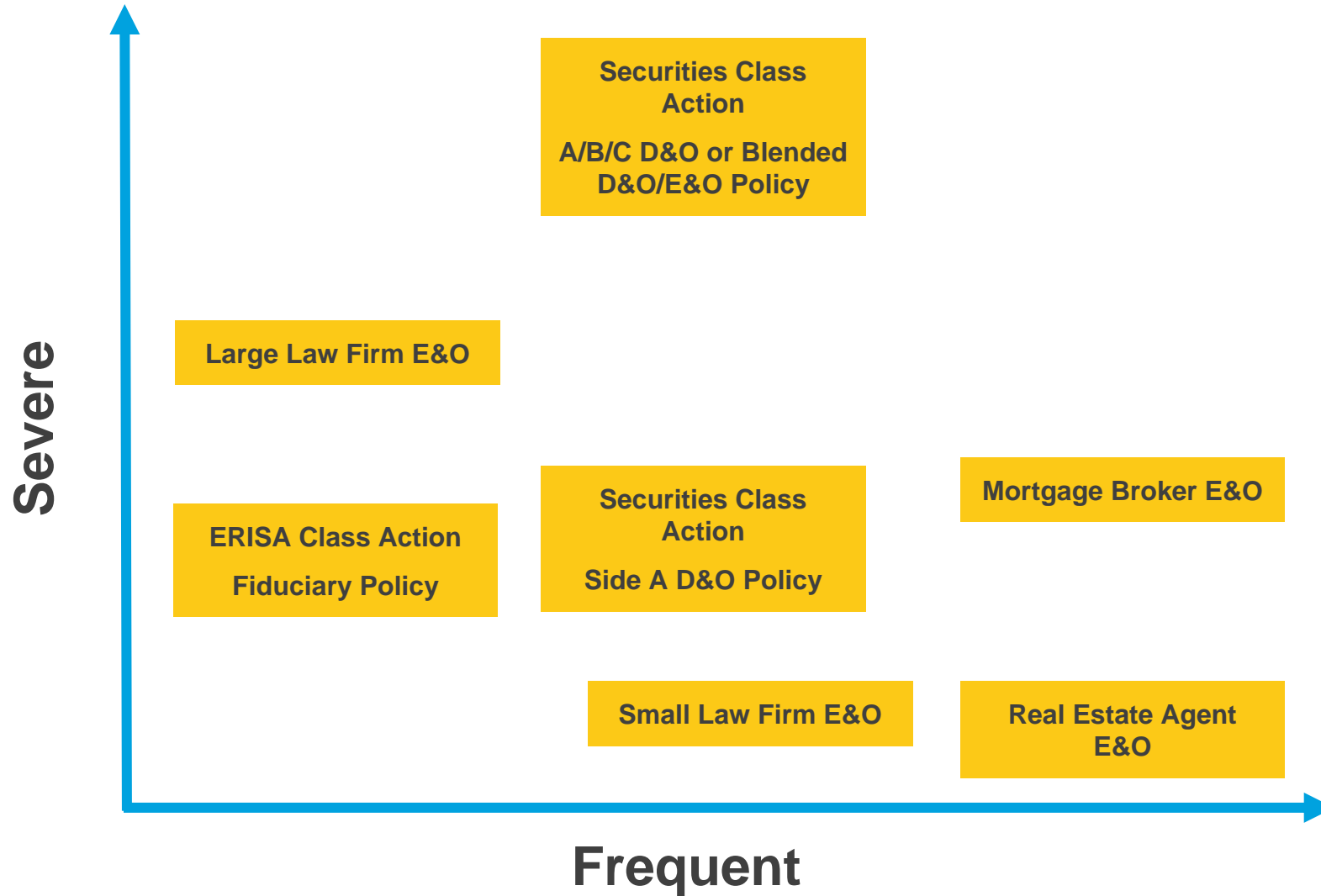
**Bear Stearns' building \$1.2b > \$240m sale price**



- How this event compares to S&L crisis and other Contagion events
  - Severity: various sources put event b-tax \$5b - \$10b (60 – 120% loss ratio pts)
  - More recent events appear to pale in comparison (options backdating, mutual funds, insurance companies, ...)



## All Subprime Claims Are Not Created Equal





## How Are Carriers' 2008 Results Better Than 2007?

- Industry Schedule P Other Liability Claims Made can be used as a proxy for D&O and E&O
  - Part 2 Development

Accident Year	Industry Aggregate Other Liability Claims-Made						
	Earned Premiums	Current Ultimate Loss	% EP	Initial Ultimate Loss	% EP	Reserve Changes	% EP
1998	5,843,884	5,063,546	87%	3,864,265	66%	1,199,281	20.5%
1999	5,537,799	5,954,554	108%	3,778,958	68%	2,175,596	39.3%
2000	6,688,968	7,247,611	108%	4,749,150	71%	2,498,461	37.4%
2001	7,120,424	7,460,464	105%	5,248,688	74%	2,211,776	31.1%
2002	9,592,964	9,093,521	95%	6,607,179	69%	2,486,342	25.9%
2003	12,137,507	7,712,631	64%	7,961,907	66%	(249,276)	-2.1%
2004	14,536,453	7,738,025	53%	9,498,328	65%	(1,760,303)	-12.1%
2005	15,507,084	8,658,563	56%	9,811,684	63%	(1,153,121)	-7.4%
2006	15,340,200	9,746,857	64%	9,875,296	64%	(128,439)	-0.8%
2007	14,853,556	9,932,415	67%				

**Reserve charges**  
**AY's 1998-2002**  
 vs.  
**Reserve releases**  
**AY's 2003 - 2006**

- Recent quarters' reserve releases from AY's 2003 to 2006 in professional liability business accounted for up to 23 CR pts.
- Is Subprime within reserve pick?
- Reinsurers have been more conservative than cedents



## Crystal Ball

- D&O/E&O market will turn faster than previous cycle
  - Single year policies
  - Claims made
  - Public data
- Consolidation will have greater impact on D&O/E&O than other areas
  - Limited existing players
- U.S. political changes will reverse some recent legal gains
- Equity analysts and rating agencies will become as familiar with D&O metrics as property cat models
  - 1 in 100 RMS loss = Open AY SCA's x limits loss
- Next systemic event
  - Oil, Gas, Coal