

Why 2008 is Shaping Up To Be a Make or Break Year for the P/C Insurance Industry

**Casualty Actuaries of Greater New York
New York, NY**



December 6, 2007

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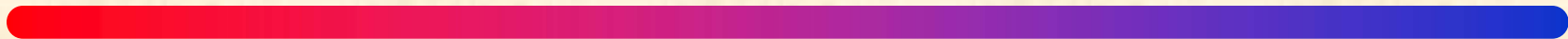
Presentation Outline

1. **Declining Profitability—*Past the Cyclical Peak***
 - Ratings & Financial Strength
2. **Deteriorating Underwriting Trends: *Still Strong, for How Long?***
 - Key Personal & Commercial Lines Review
3. **Vanishing Premium Growth: *Approaching a Standstill***
4. **Weak Pricing: *Competitive Pressures Mounting***
5. **Rising Expenses: *Creeping Upward***
6. **Overcapacity: *Rapid Capital/Surplus Growth → ROE Pressure***
7. **Investment Volatility: *More Pain, Less Gain***
8. **Catastrophic Loss: *The Worst Has Yet to Come***
9. **Shifting Legal Liability & Tort Environment: *Will the Pendulum Swing Against Insurers?***
10. **Regulatory & Legislative Zealotry: *Scrutiny is Mounting***

Q&A

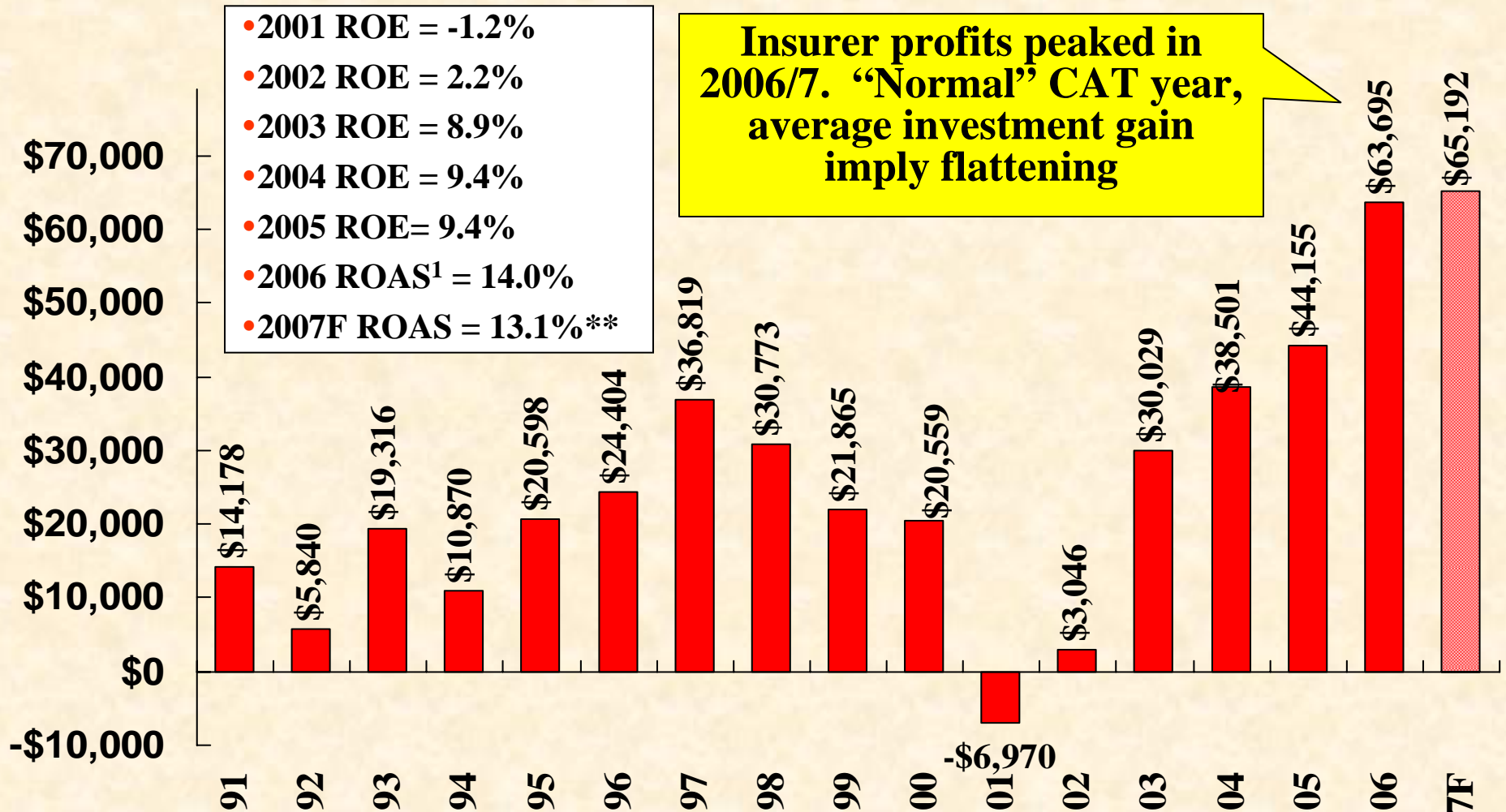
#1 DECLINING PROFITABILITY

**Profits in 2006/7 Reached
Their Cyclical Peak;
ROEs Already Falling**





*P/C Net Income After Taxes 1991-2007F (\$ Millions)**

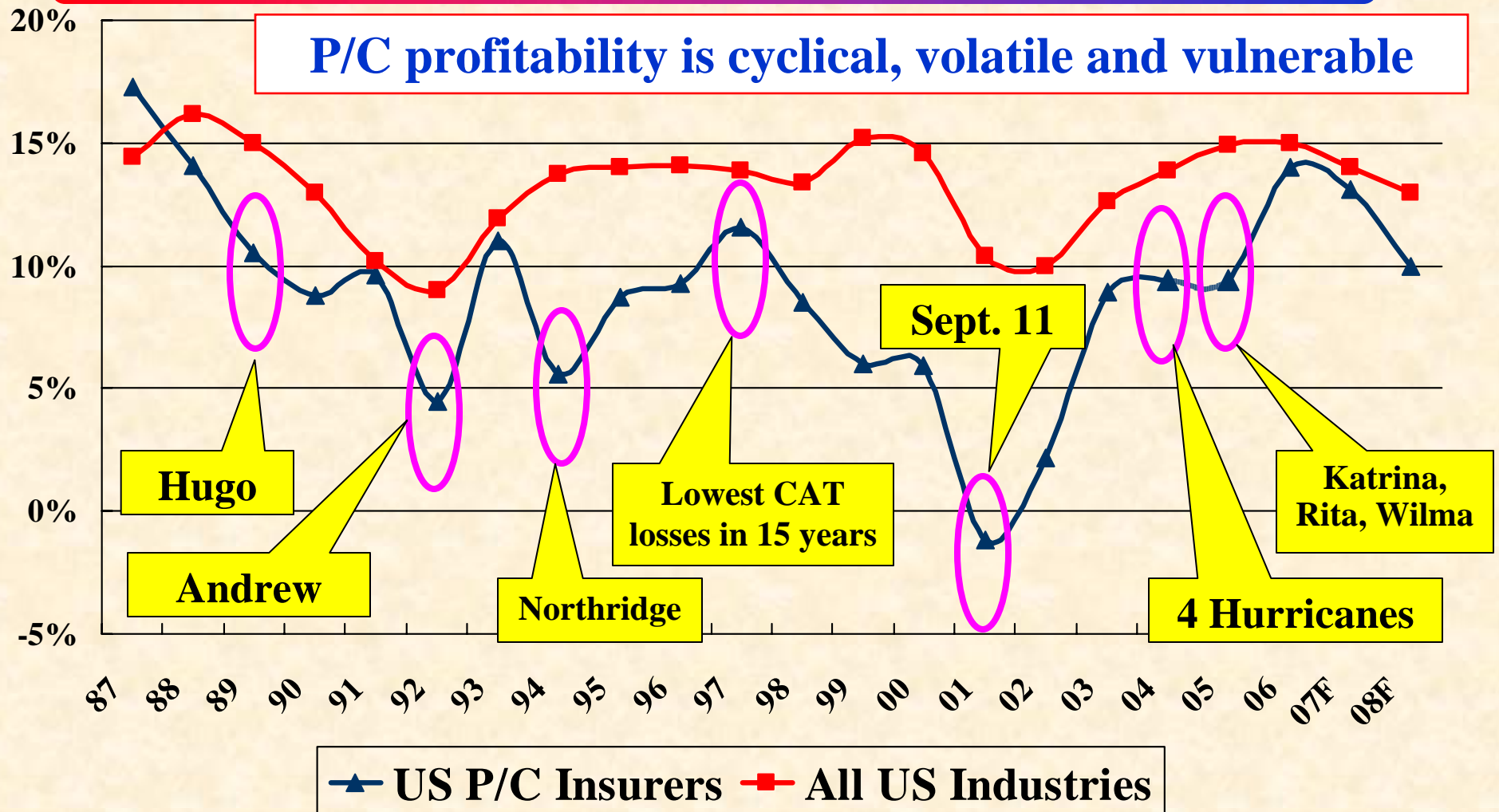


*ROE figures are GAAP; ¹Return on avg. surplus. 2007F figure is annualized actual first half net income of \$32.596B ** Actual first half 2007 result.

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



ROE: P/C vs. All Industries 1987–2008E

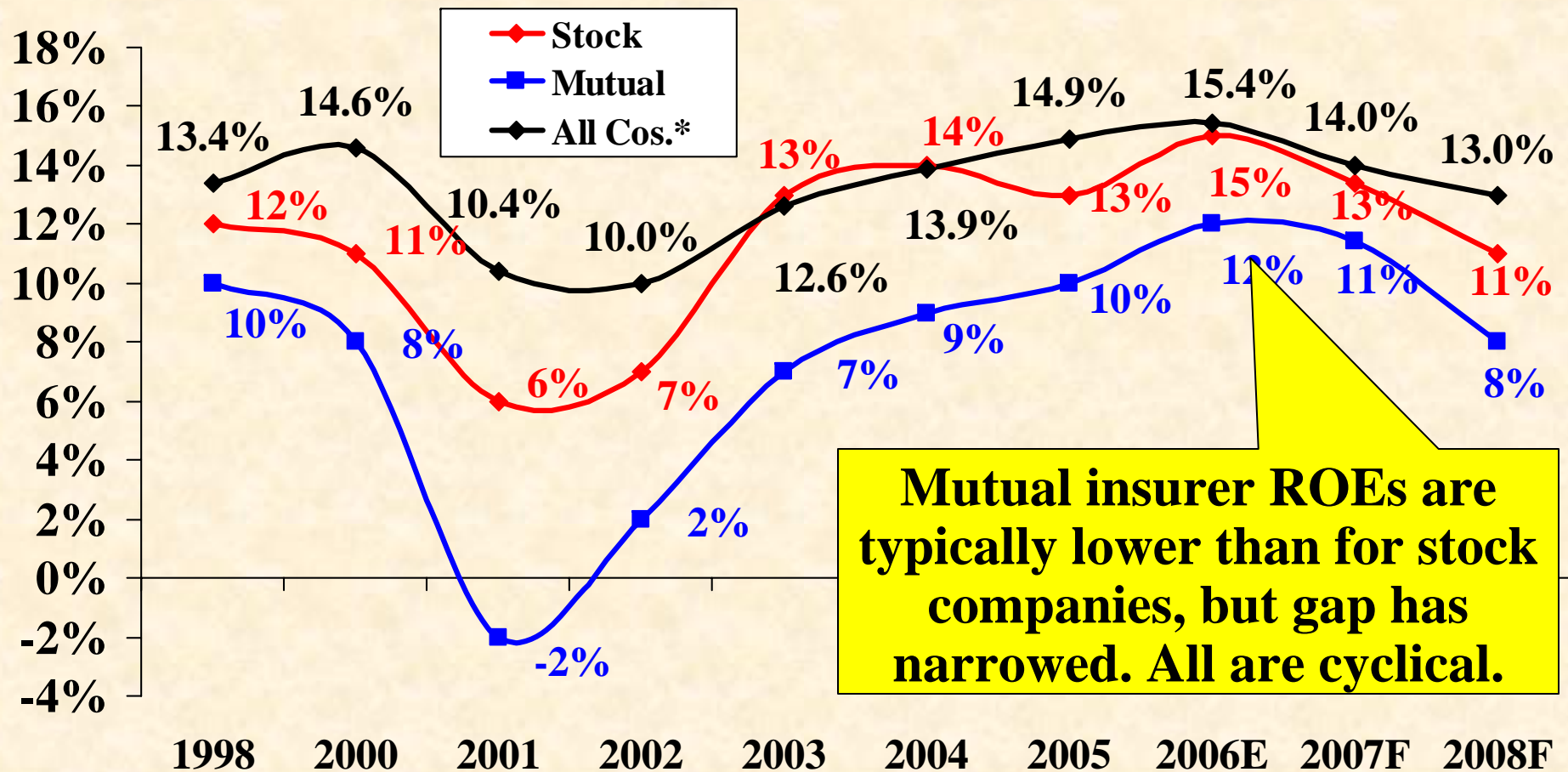


*2007 is actual first half ROAS of 13.1%. 2008 P/C insurer ROE is I.I.I. estimate.

Source: Insurance Information Institute; *Fortune*



RETURN ON EQUITY (Fortune): Stock & Mutual vs. All Companies*



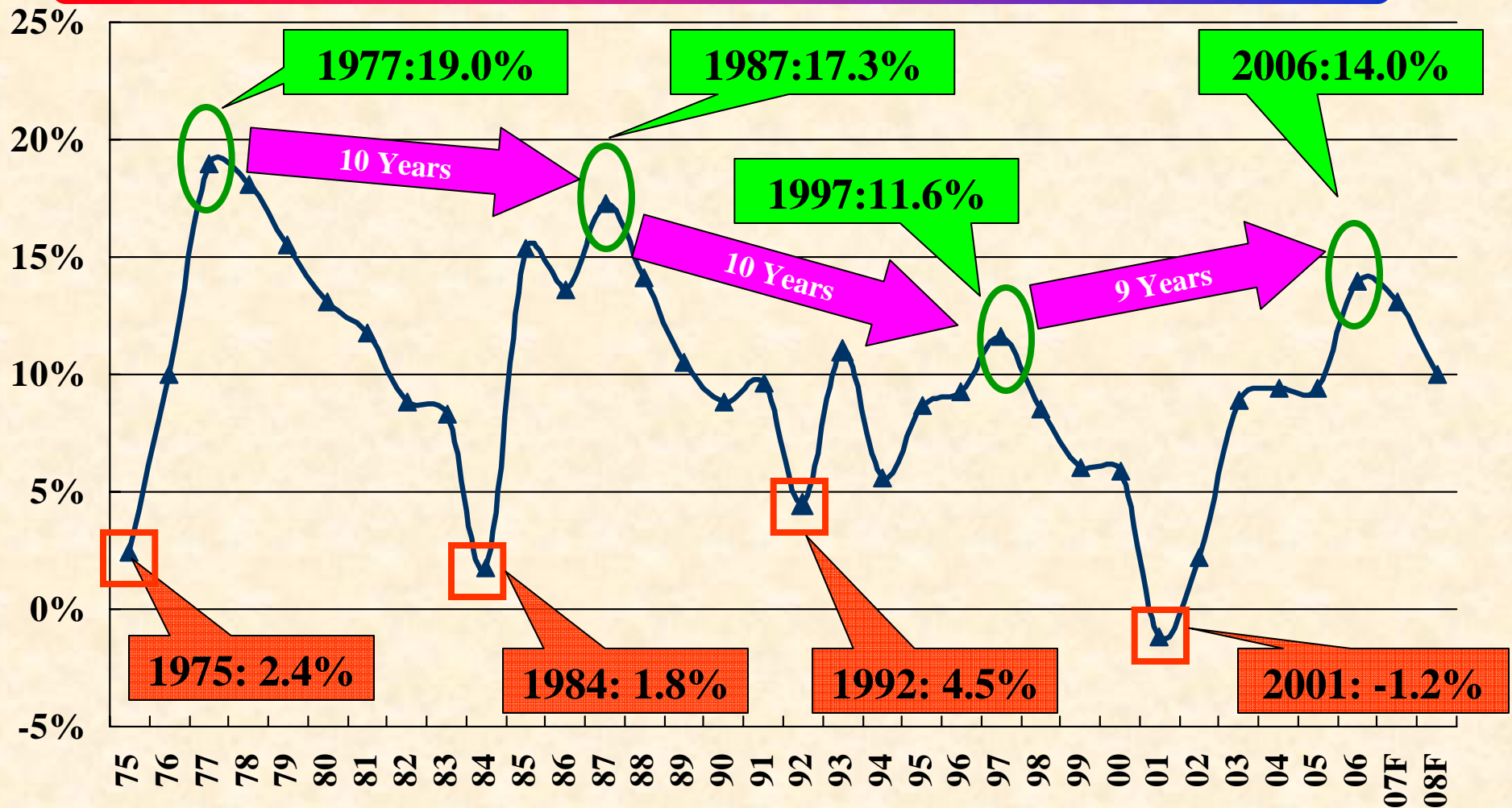
Mutual insurer ROEs are typically lower than for stock companies, but gap has narrowed. All are cyclical.

*Fortune 1,000 group.

Source: *Fortune Magazine*, Insurance Information Institute.



Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2008F

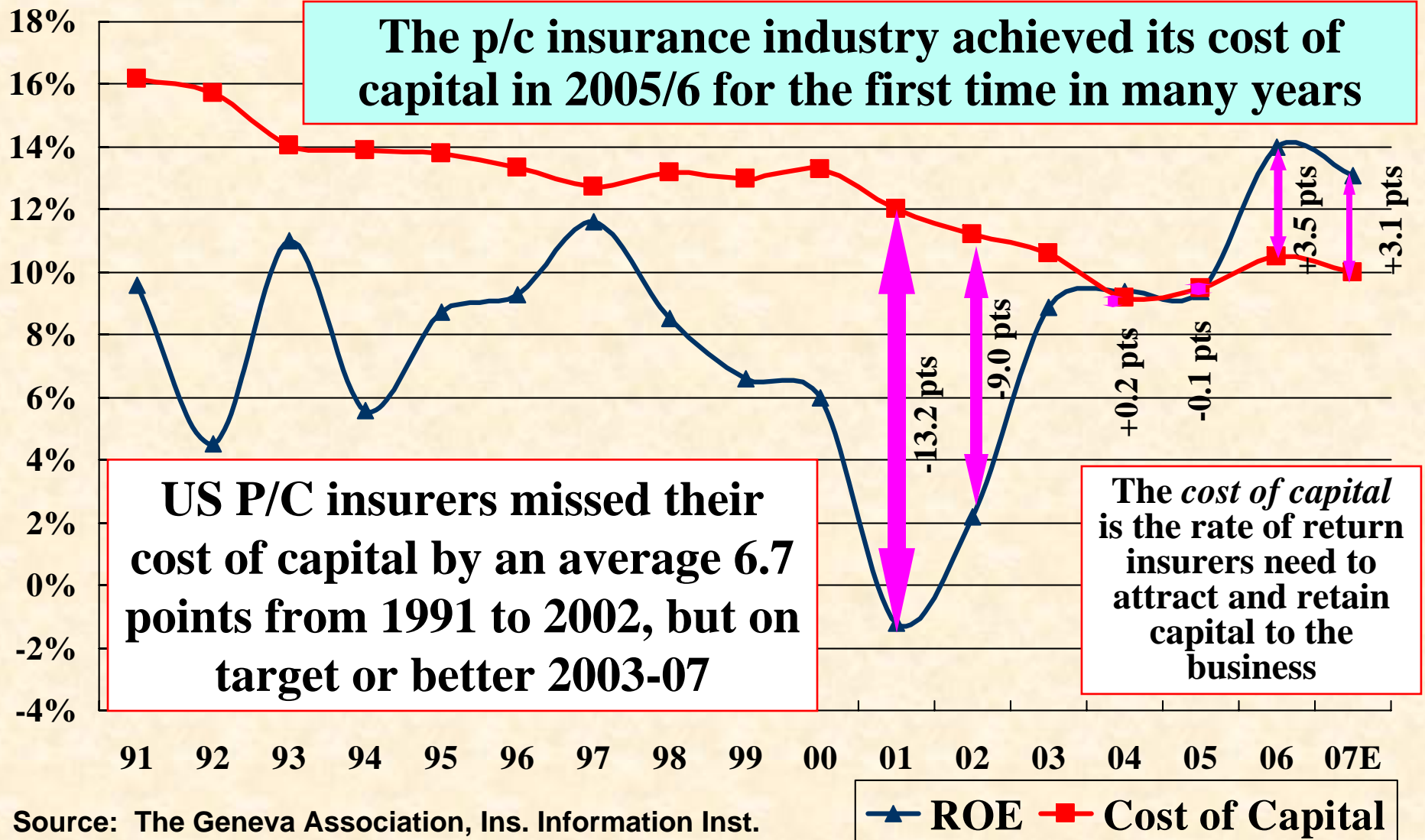


*2007 is actual first half ROAS of 13.1%. 2008 P/C insurer ROE is I.I.I. estimate.

Source: Insurance Information Institute; *Fortune*



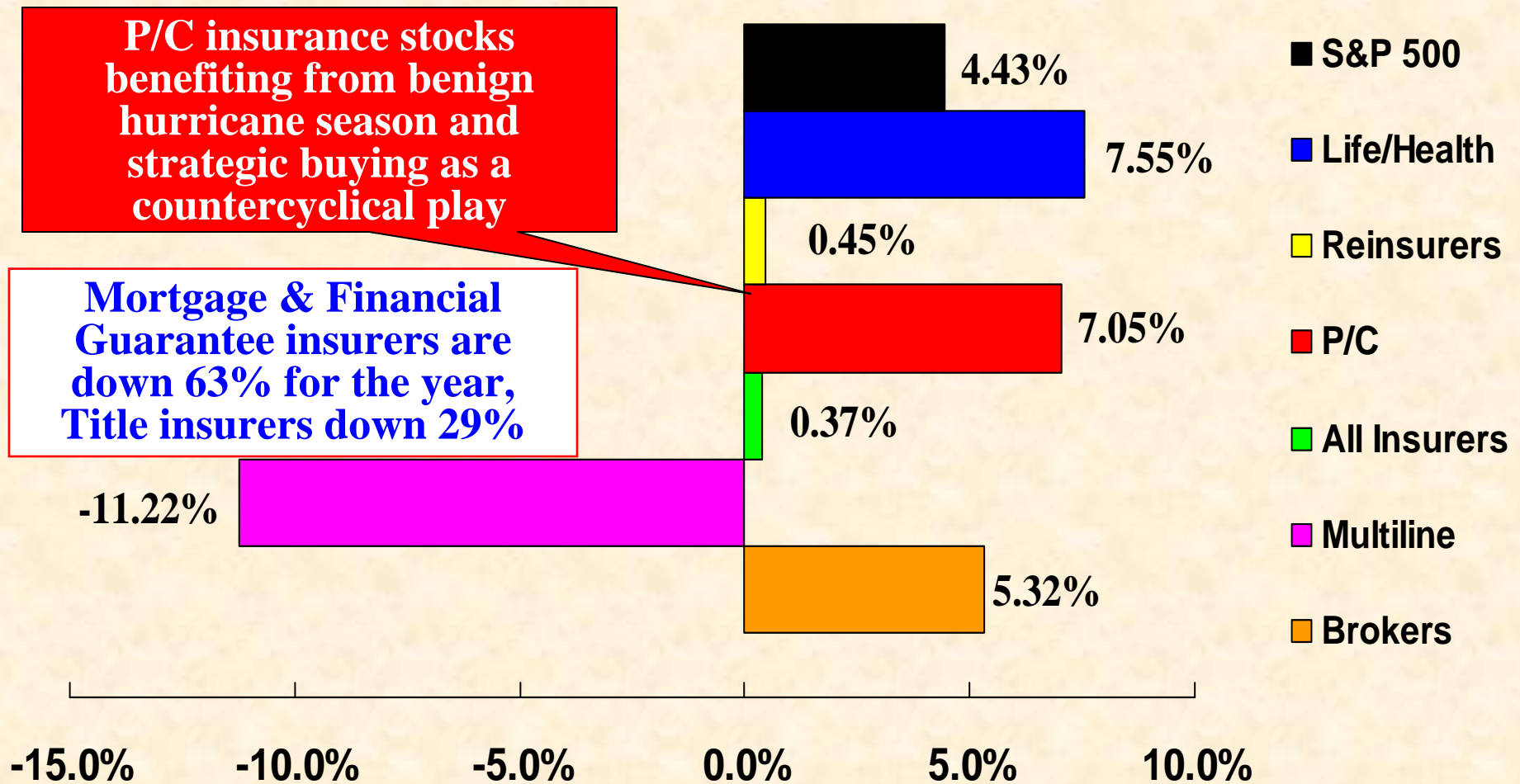
ROE vs. Equity Cost of Capital: US P/C Insurance: 1991-2007E





Insurance & Reinsurance Stocks: Finally Gaining in 2007

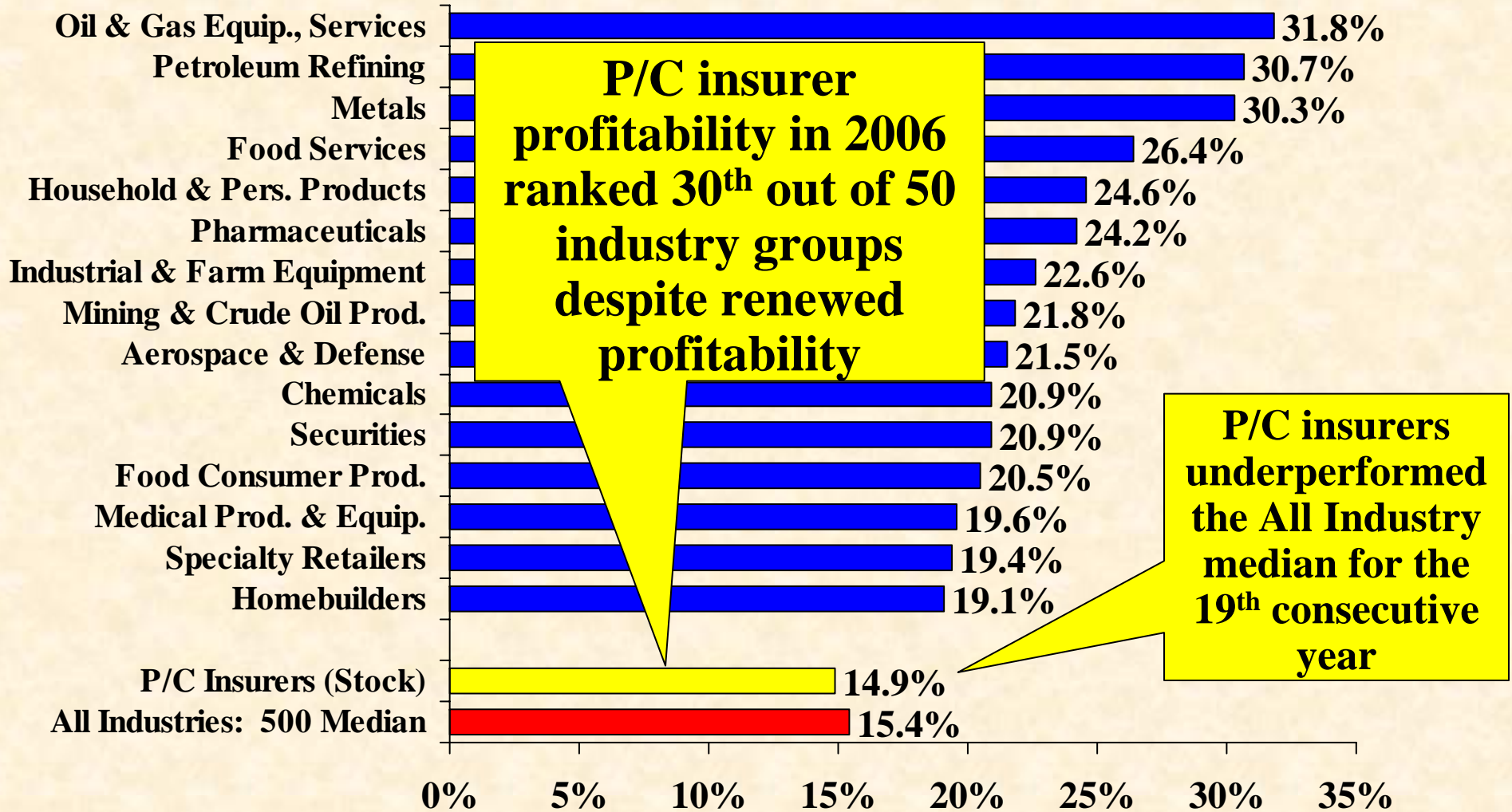
Total YTD Returns Through November 30, 2007



Source: SNL Securities, Standard & Poor's, Insurance Information Inst.



Top Industries by ROE: P/C Insurers Still Underperformed in 2006*

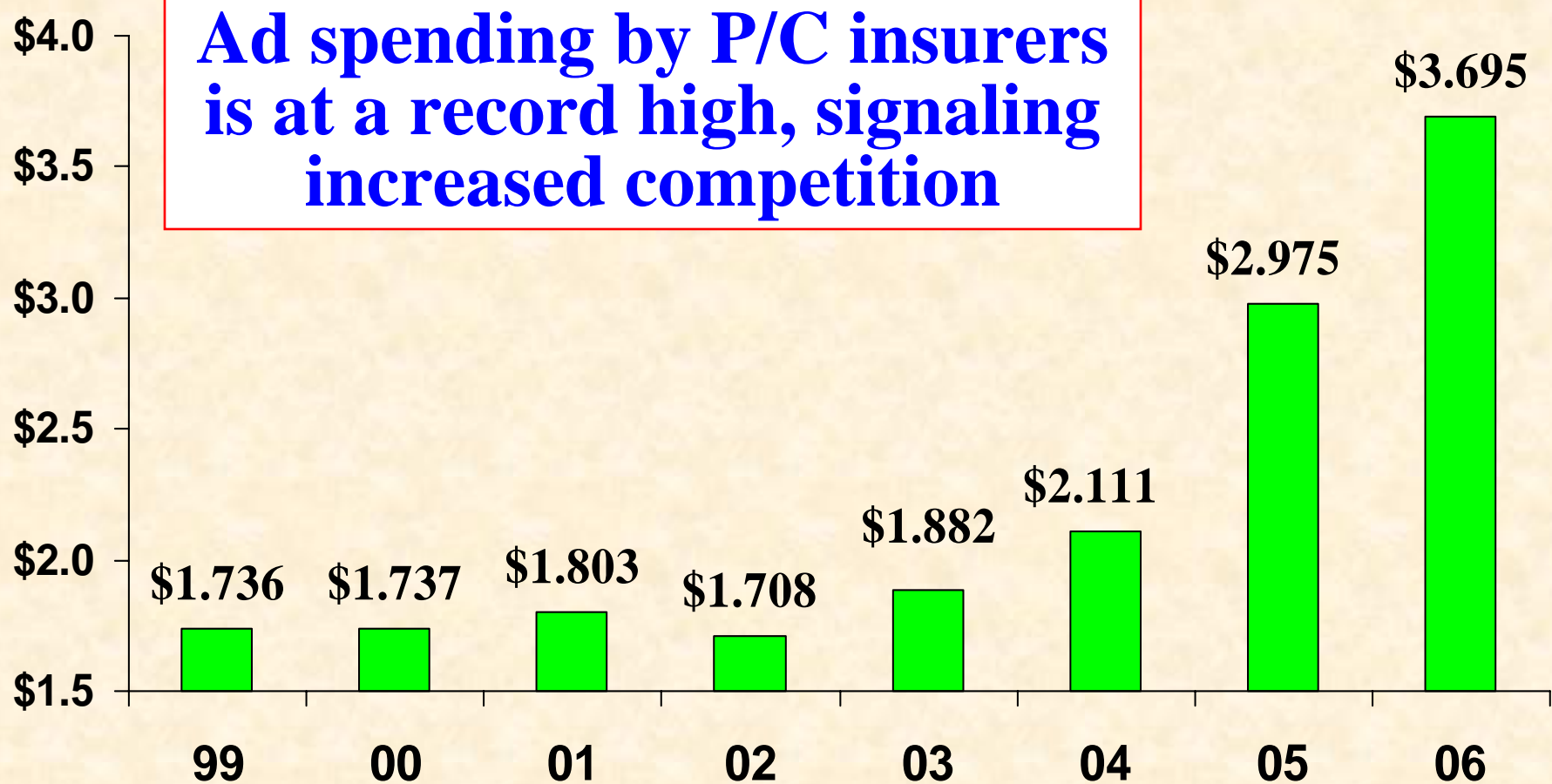


*Excludes #1 ranked Airline category at 65.1% due to special one-time bankruptcy-related factors.
Source: Fortune, April 30, 2007 edition; Insurance Information Institute



Advertising Expenditures by P/C Insurance Industry, 1999-2006

\$ Billions



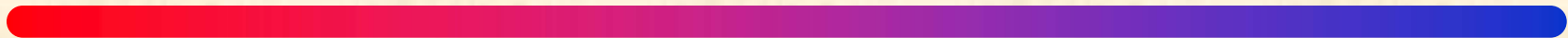
Source: Insurance Information Institute from consolidated P/C Annual Statement data.

FINANCIAL STRENGTH & RATINGS

**Industry Has Weathered
the Storms Well, But Cycle**



May Takes Its Toll

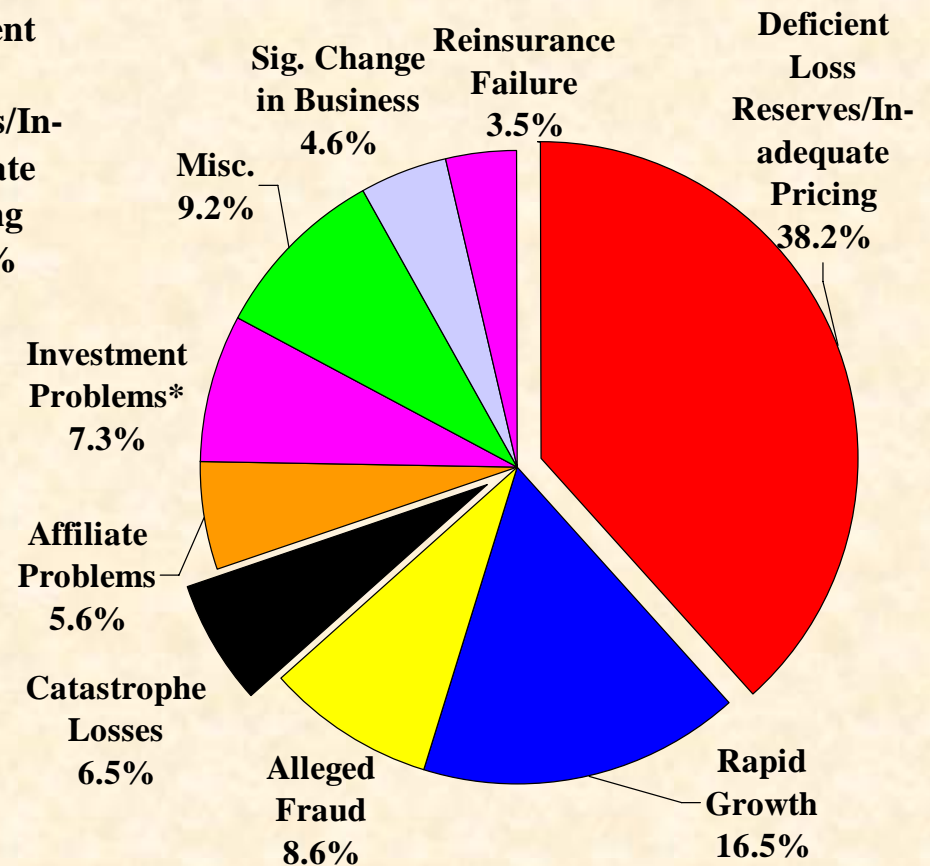
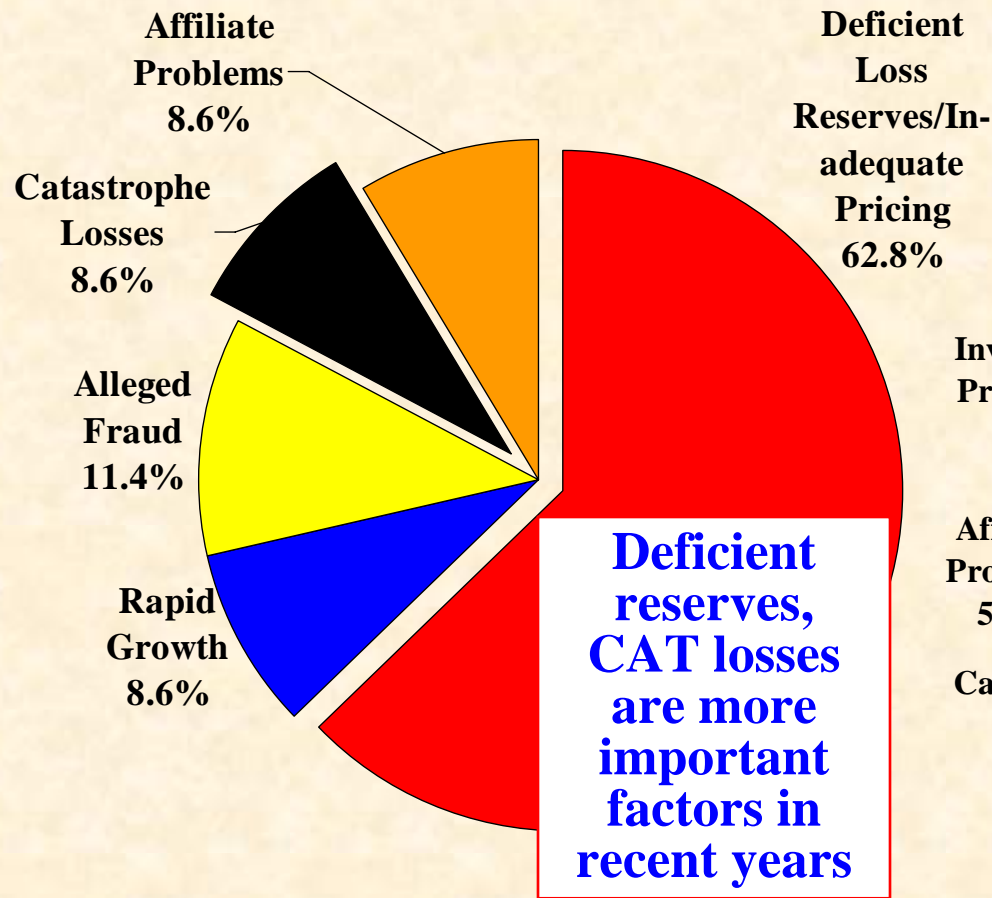




Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005

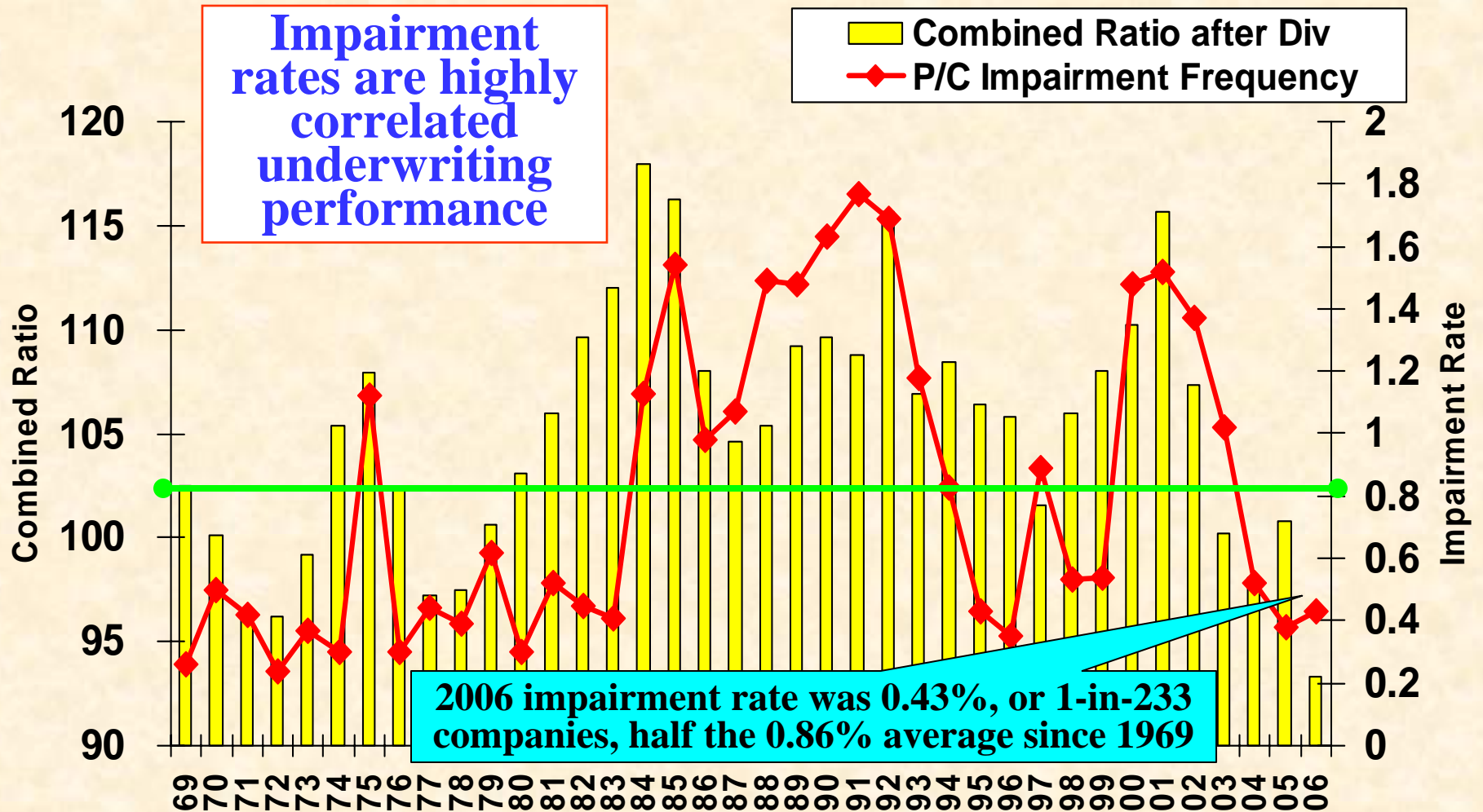
1969-2005



*Includes overstatement of assets.



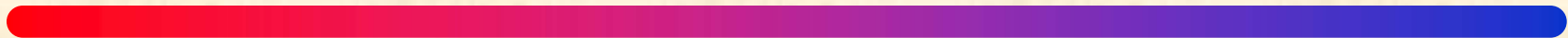
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2006



#2

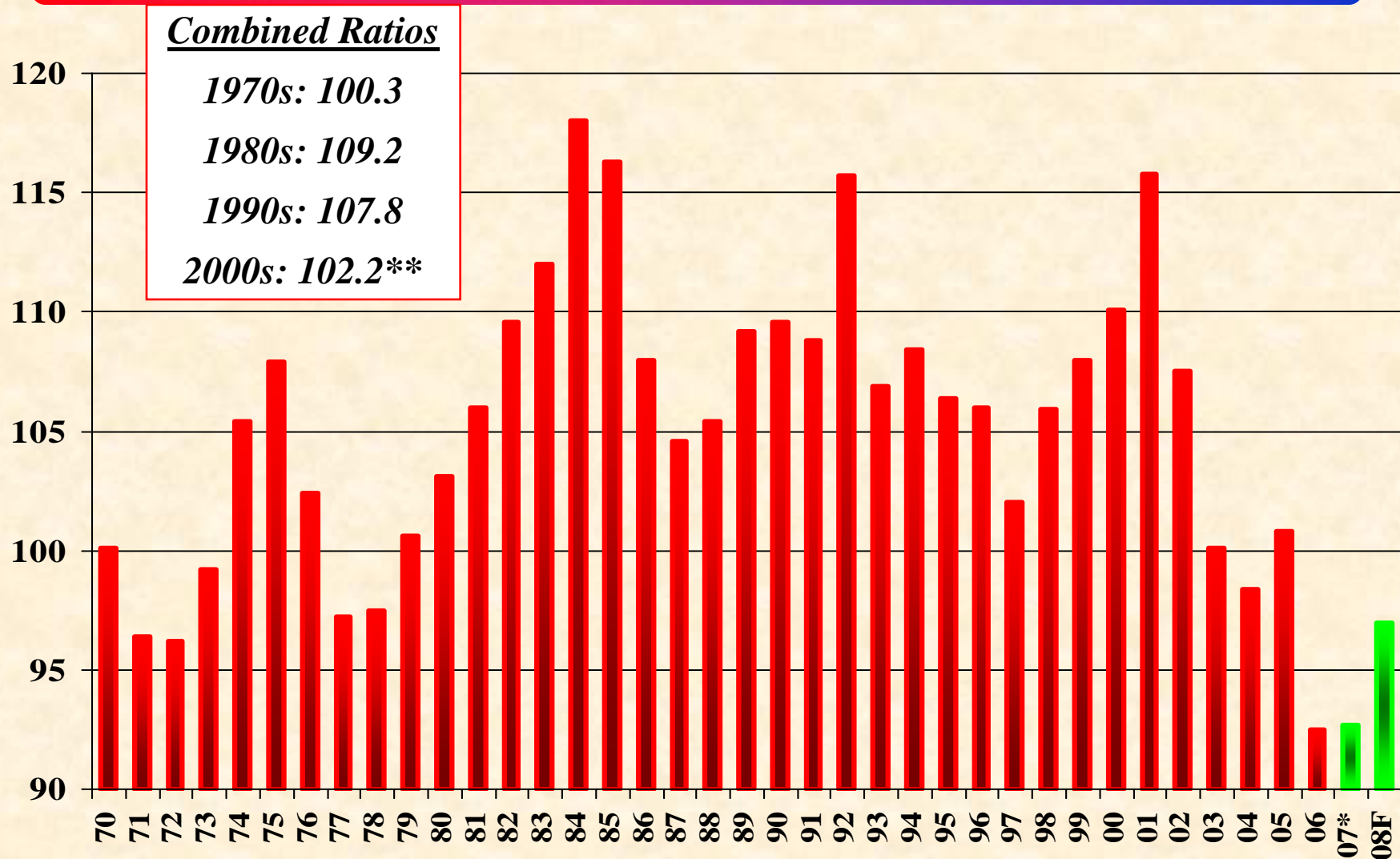
DETERIORATING UNDERWRITING

**Extremely Strong 2006/07;
Relying on Momentum &
Discipline for 2008**





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

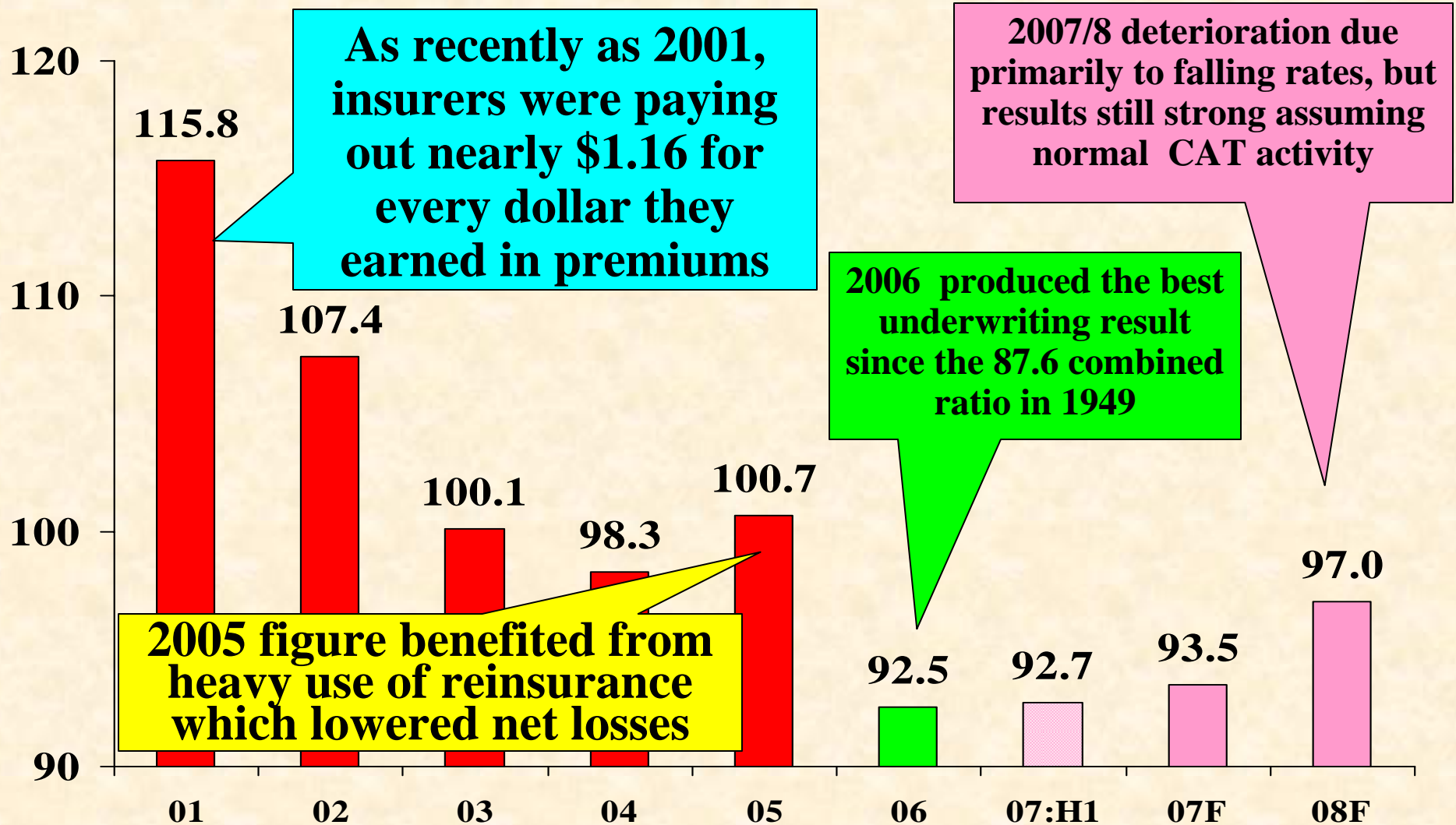


Sources: A.M. Best; ISO, III

*Actual figure of 92.7 through first half 2007. **Through 2007:H1.



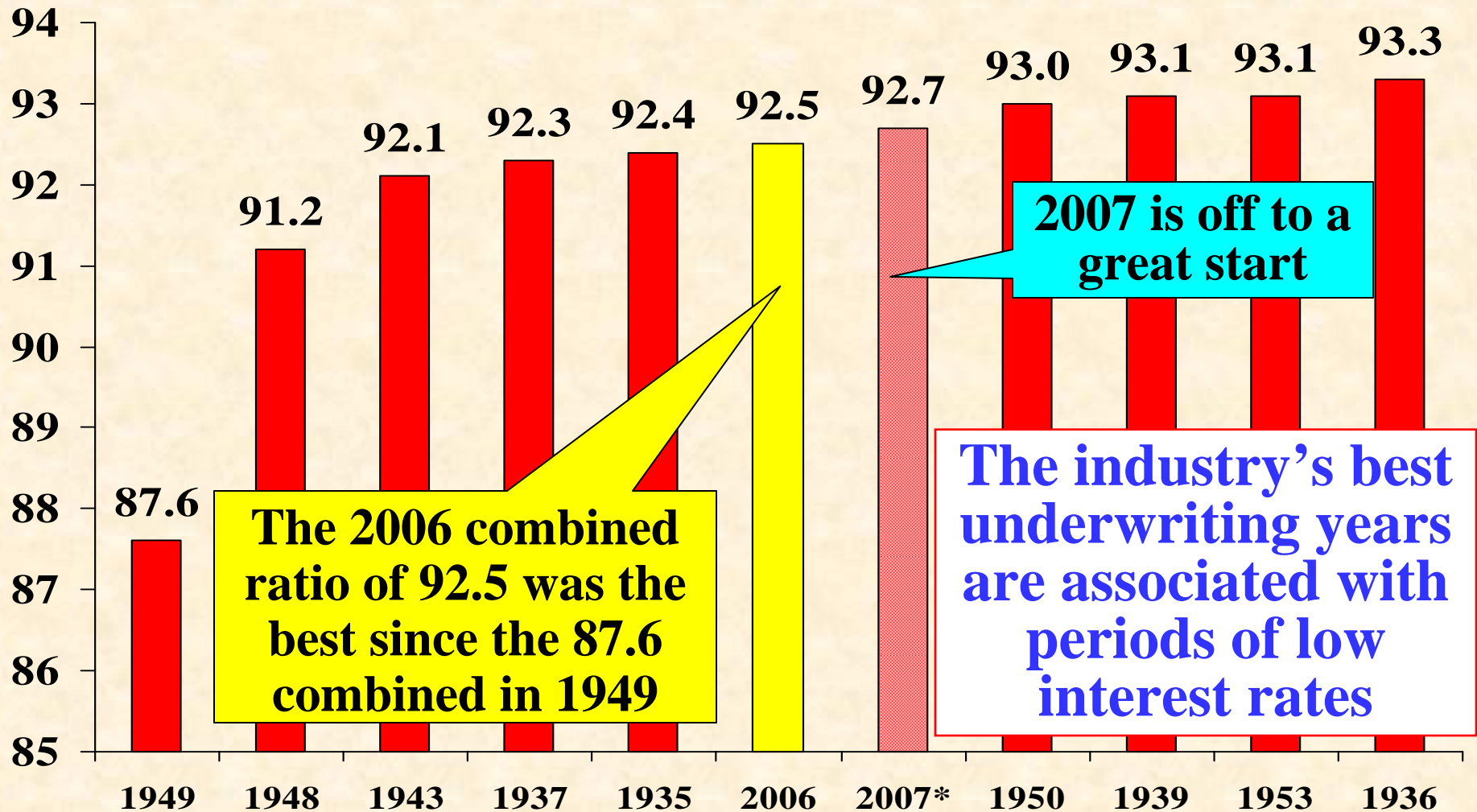
P/C Insurance Combined Ratio, 2001-2008F



Sources: A.M. Best; ISO, III. *III estimates for 2007/8.



Ten Lowest P/C Insurance Combined Ratios Since 1920 (& 2007:H1)

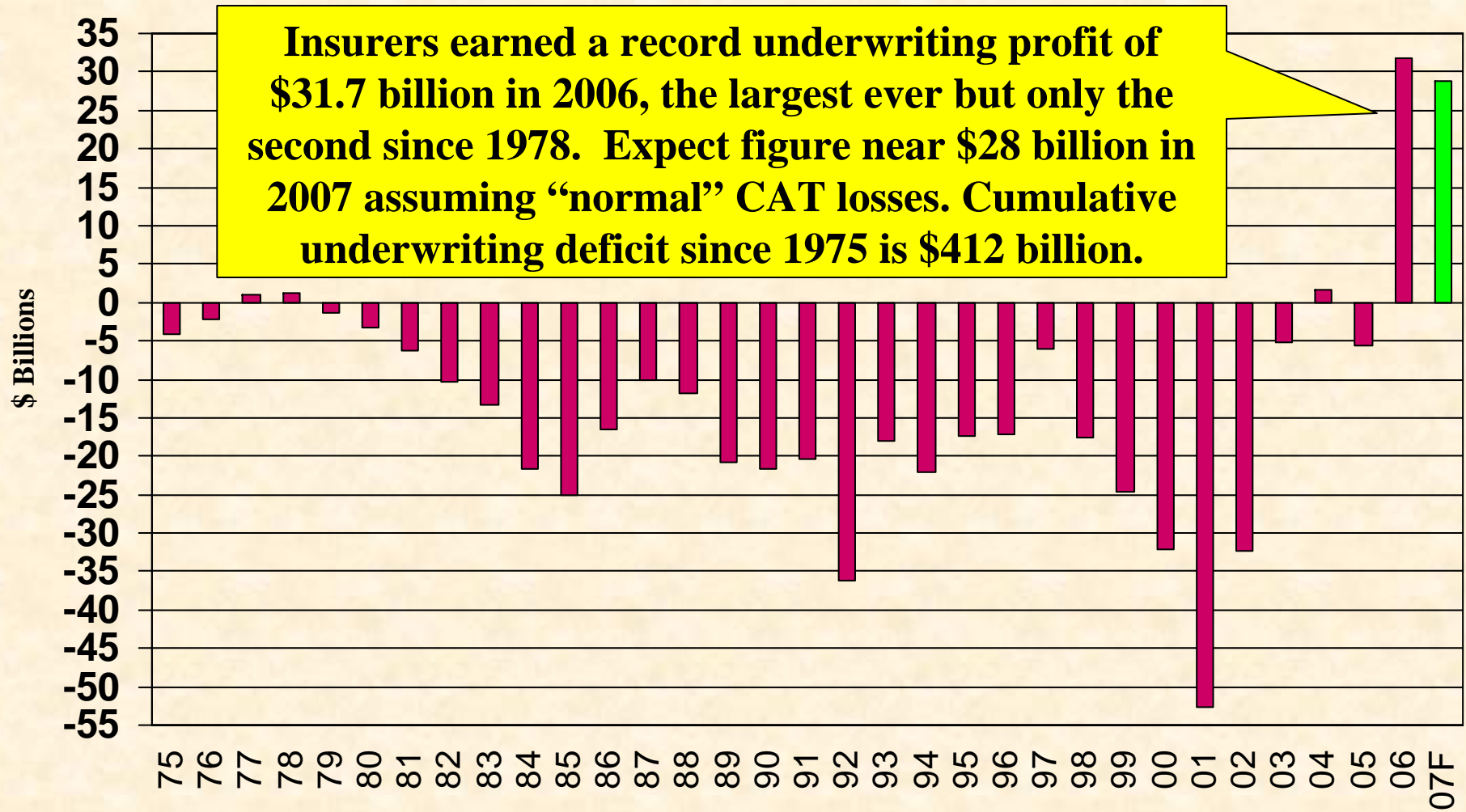


Sources: Insurance Information Institute research from A.M. Best data. *2007 first half actual.



Underwriting Gain (Loss)

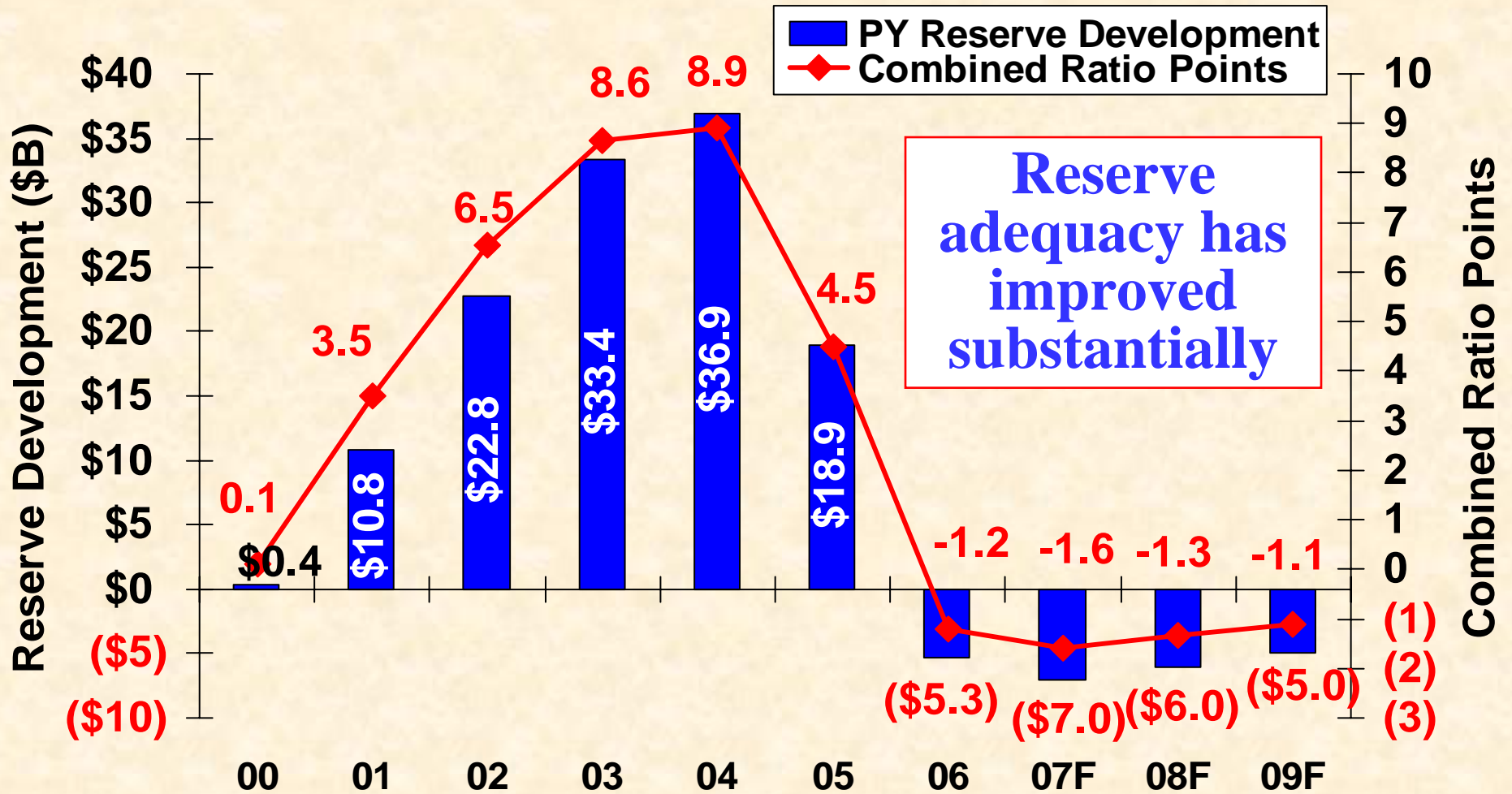
*1975-2007F**



Source: A.M. Best, Insurance Information Institute *Actual 2007:H1 underwriting profit = \$14.402B annualized to \$28.8B.



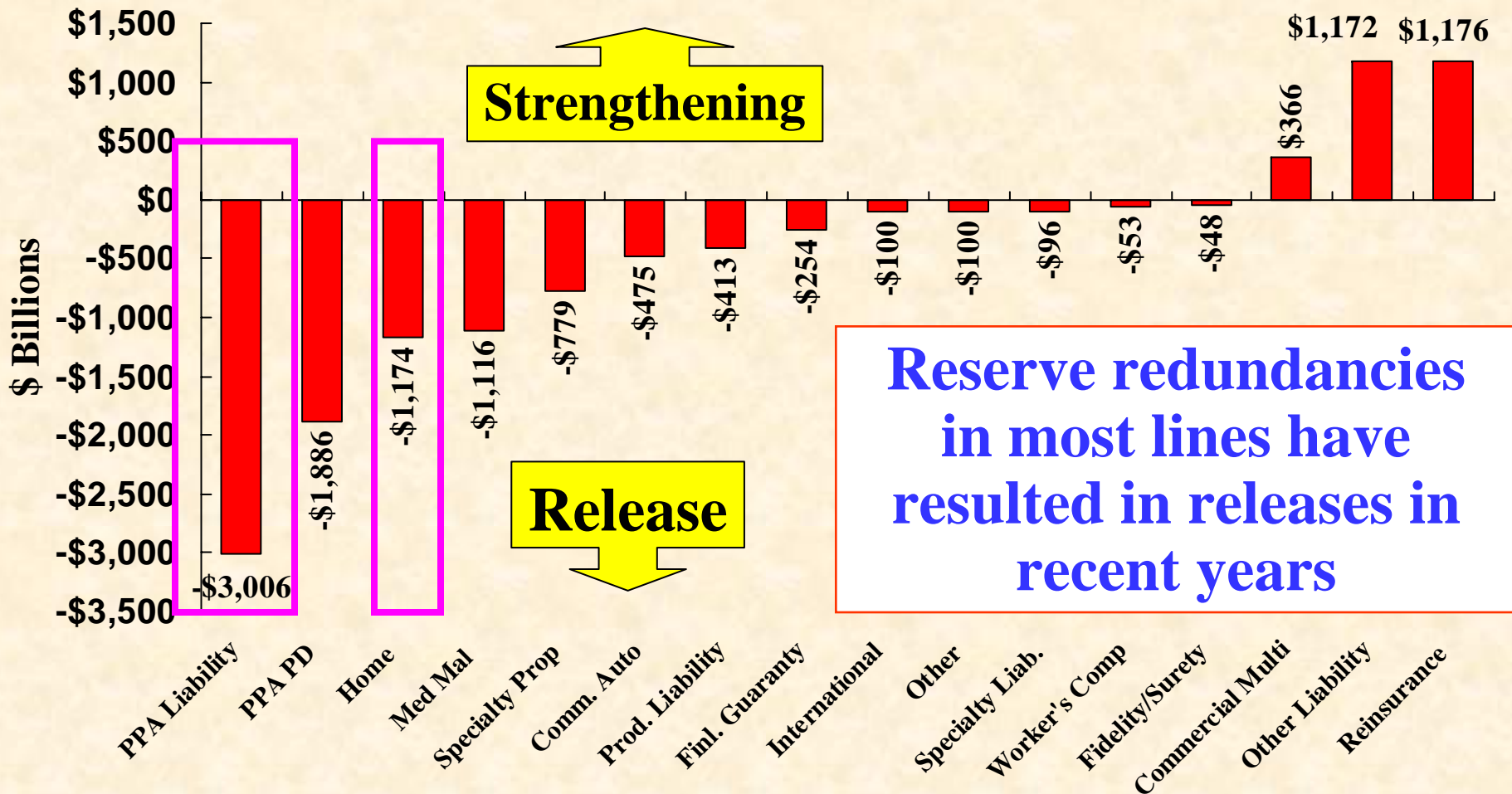
Impact of Reserve Changes on Combined Ratio



Source: A.M. Best, Lehman Brothers estimates for years 2007-2009

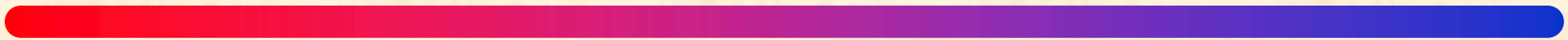


Cumulative Prior Year Reserve Development by Line (As of 12/31/06)



Sources: Lehman Brothers; A.M. Best's *Aggregates & Averages* Schedule P, Part 2.

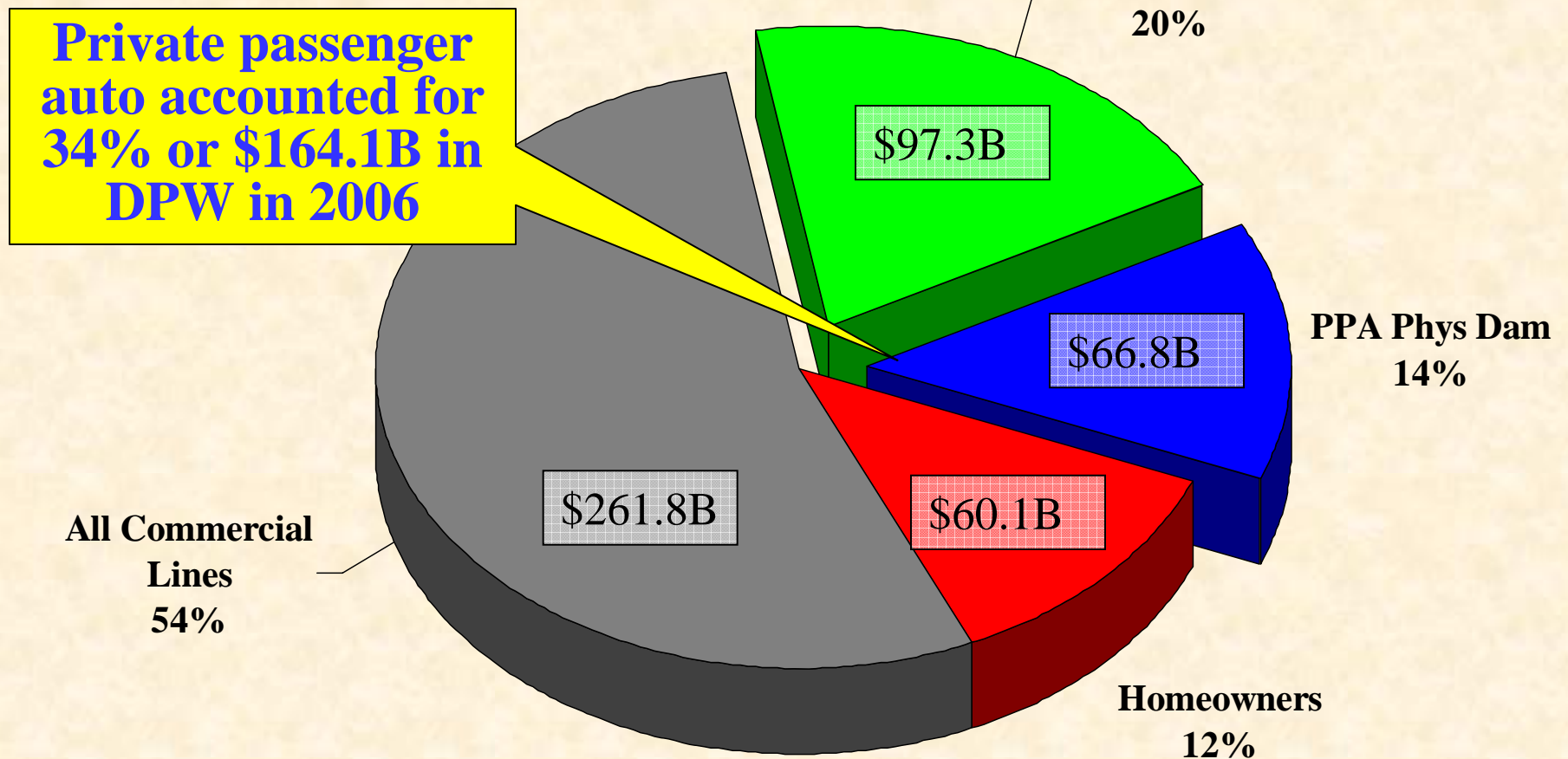
PERSONAL LINES





Private Passenger Auto is Enormous Part of P/C Industry

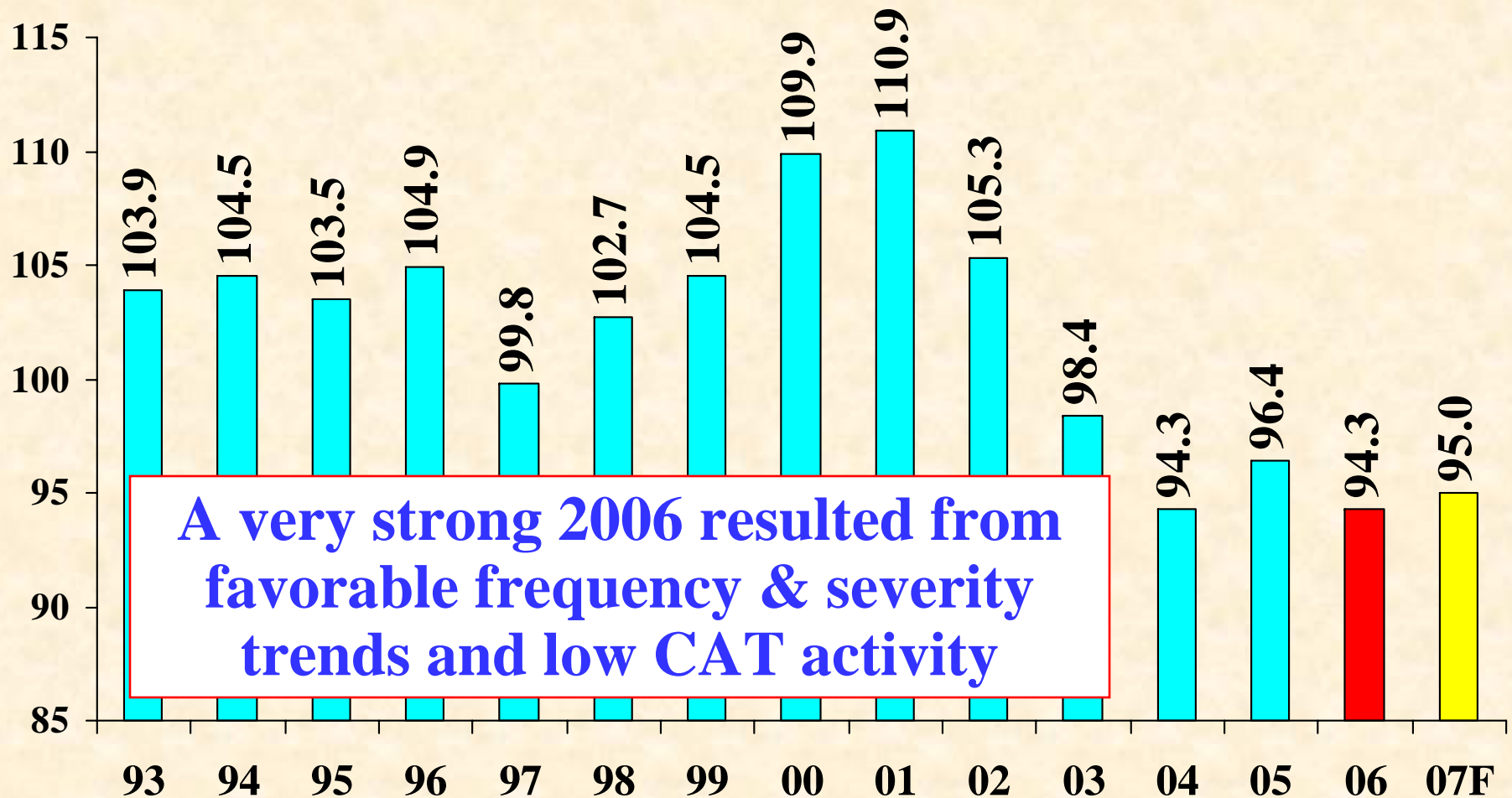
**Total 2006 Direct Personal + Commercial Premiums Written
= \$486.1 Billion**



Source: A.M. Best; Insurance Information Institute



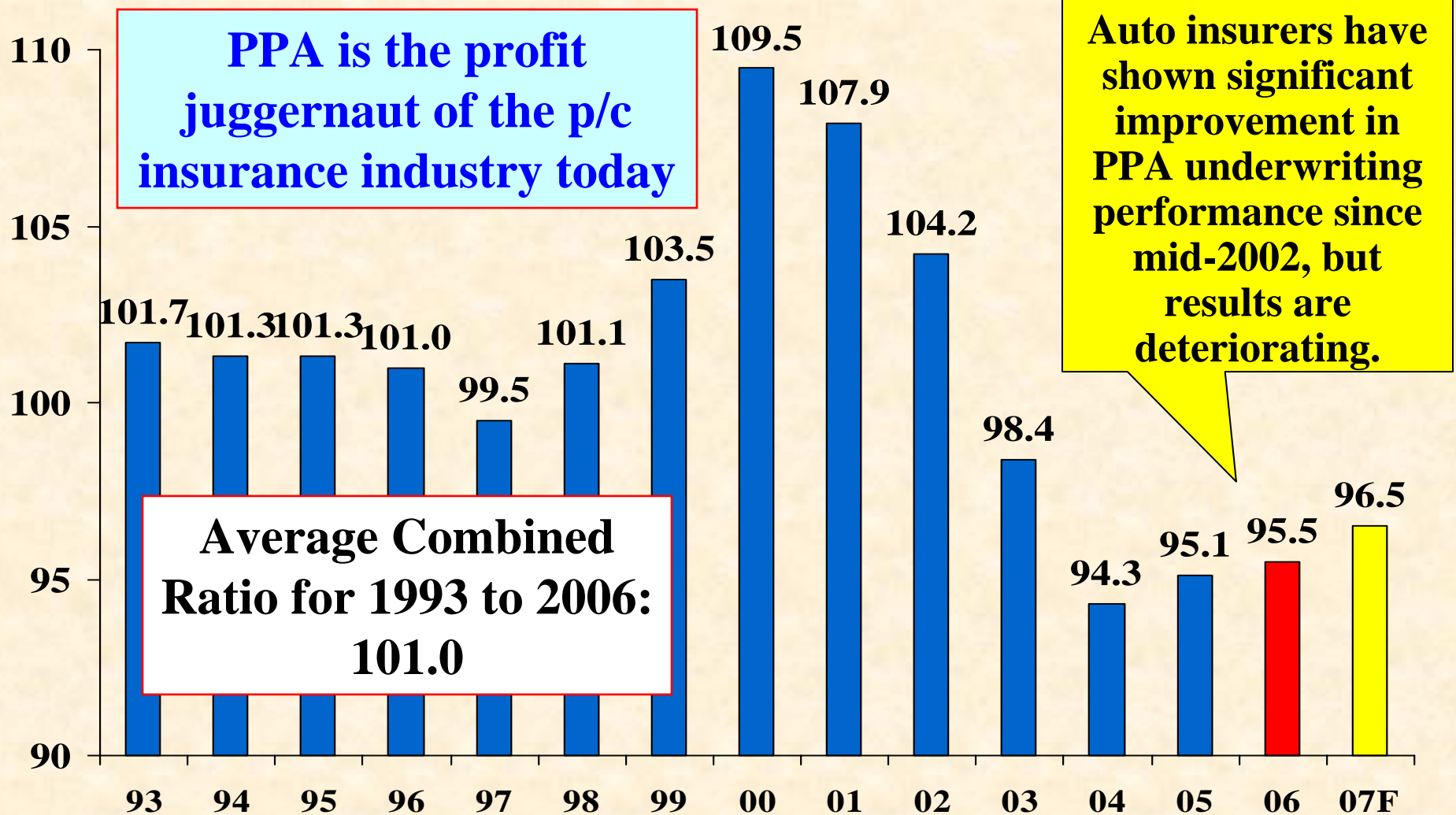
Personal Lines Combined Ratio, 1993-2006



Source: A.M. Best; Insurance Information Institute.



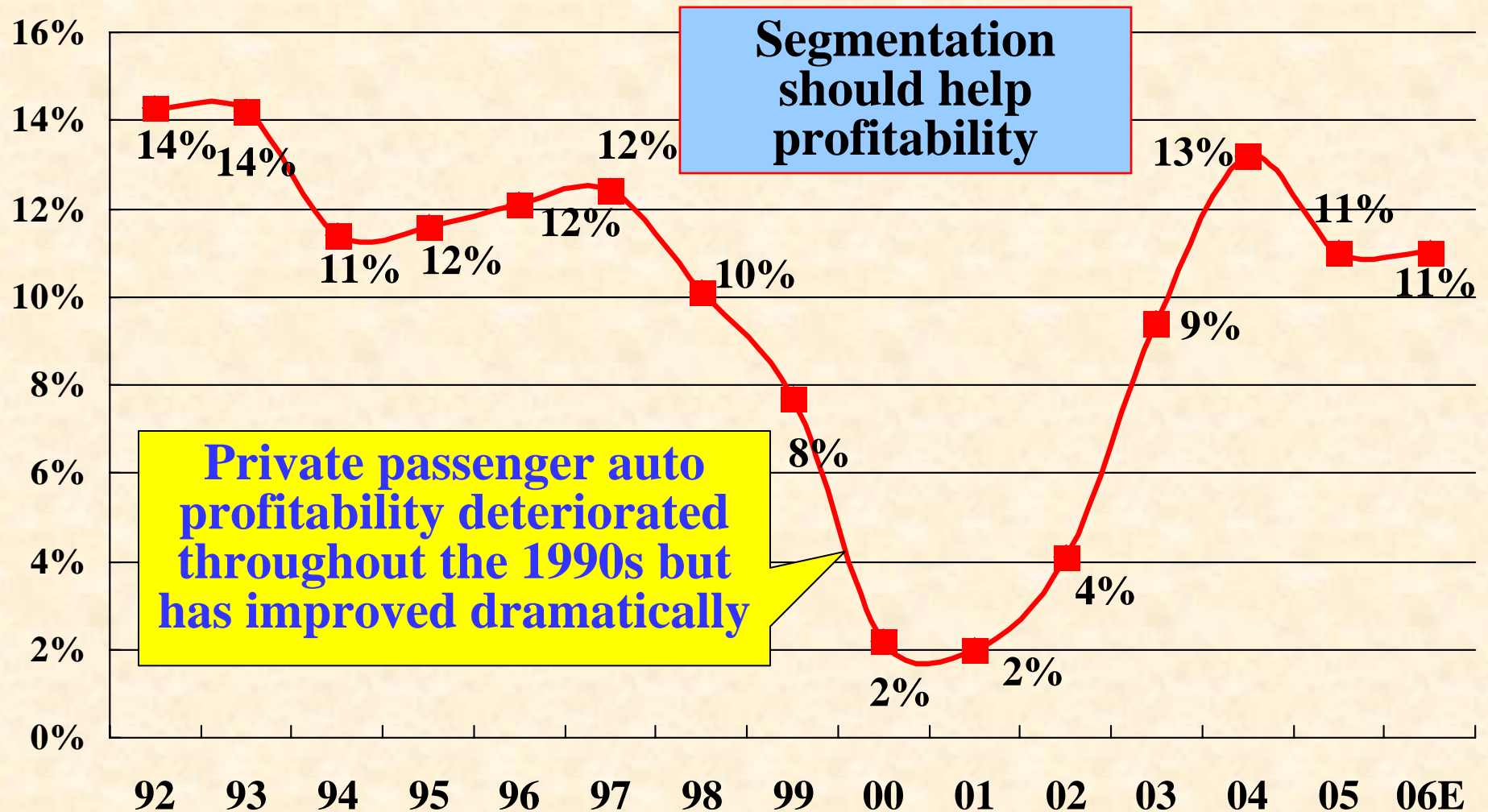
Private Passenger Auto (PPA) Combined Ratio



Sources: A.M. Best; III



RNW: Private Passenger Auto, United States, 1992-2006E

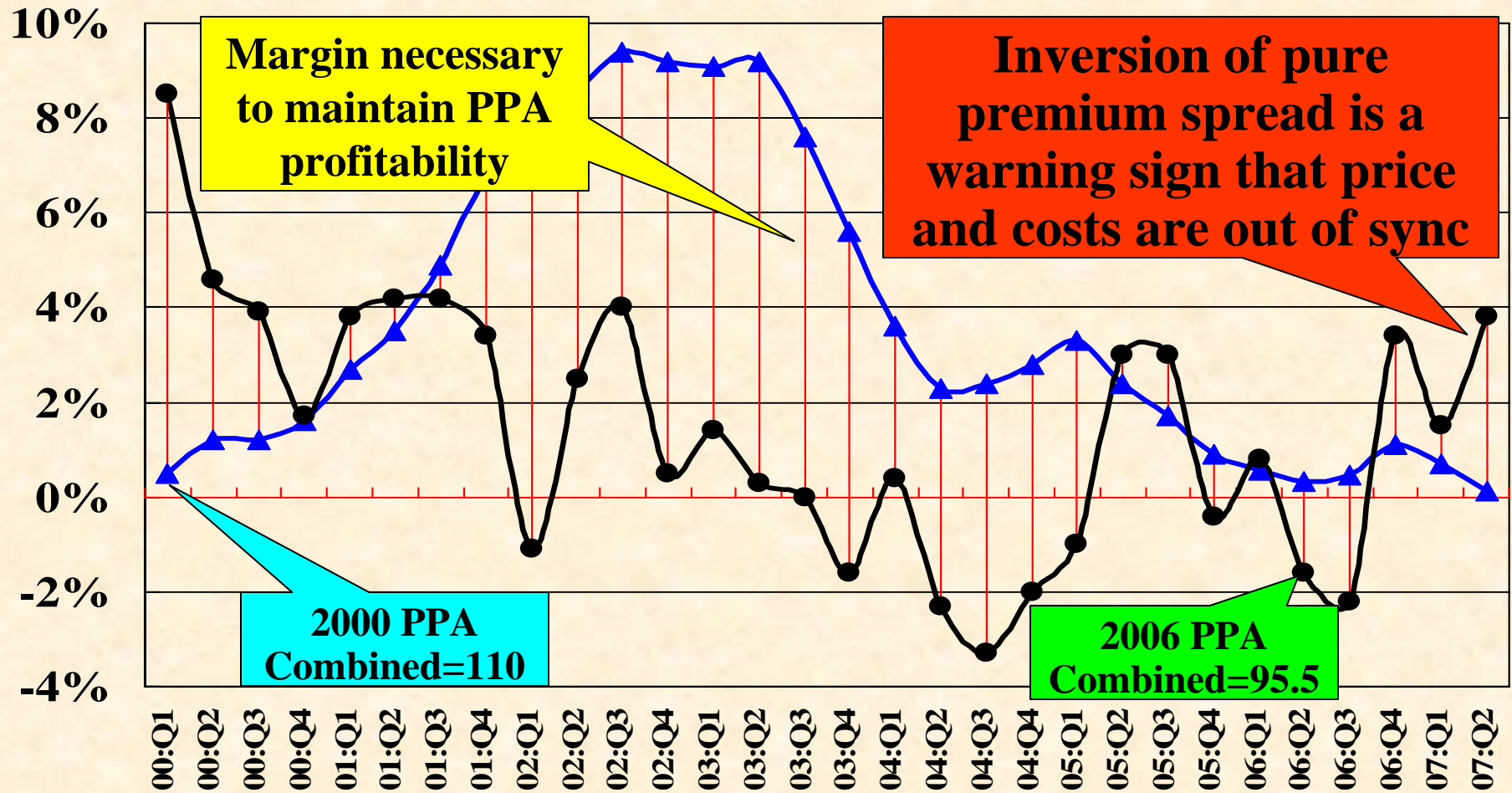


Source: NAIC; Insurance Information Institute



Pure Premium Spread: Personal Auto PD Liability, 2000-2007:Q2

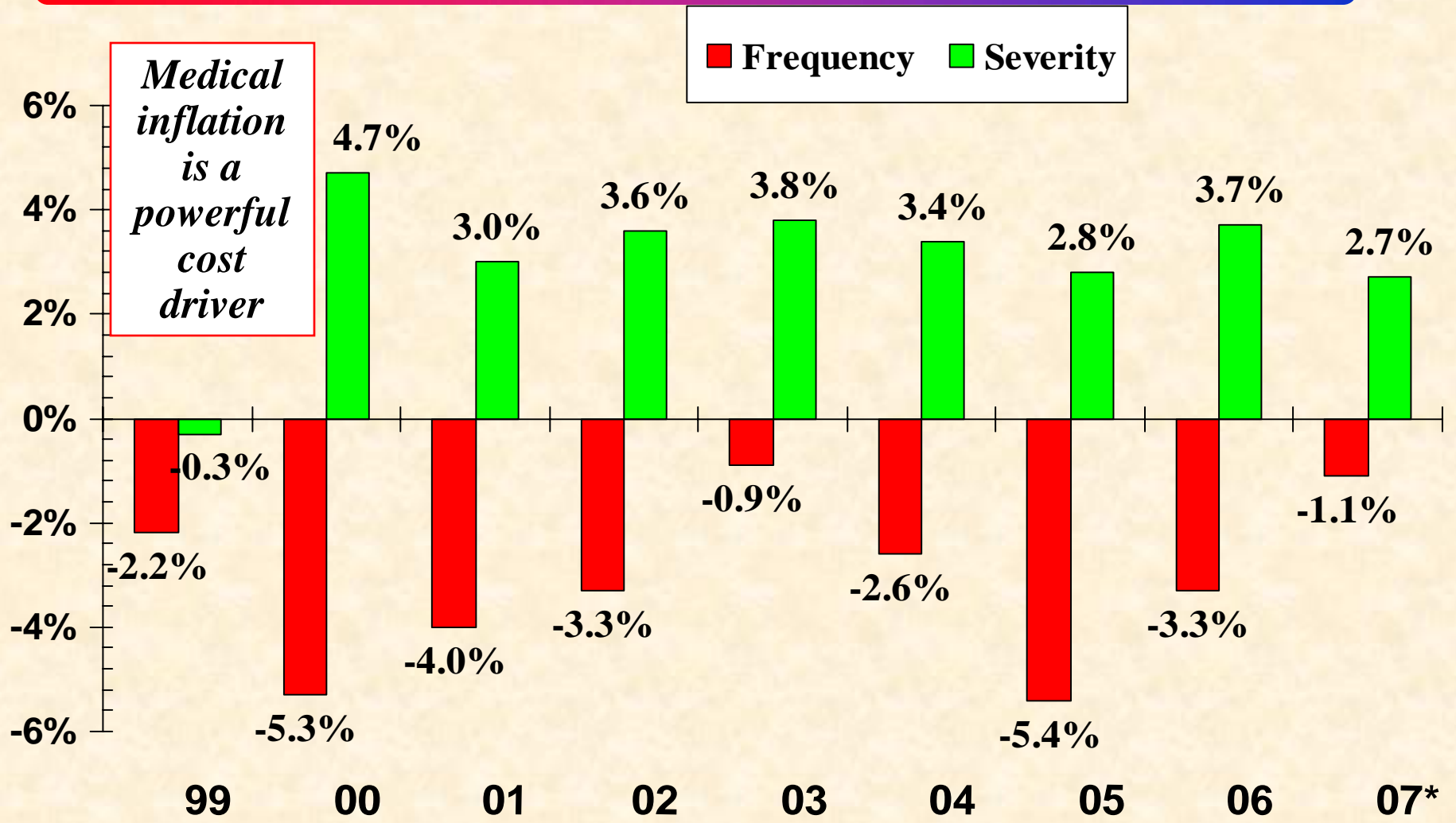
▲ Auto Insurance Component of CPI ● Personal Auto-PD Pure Premium



Source: Insurance Information Institute calculations based ISO Fast Track and US BLS data.



Bodily Injury: Severity Trend Running Ahead of Frequency



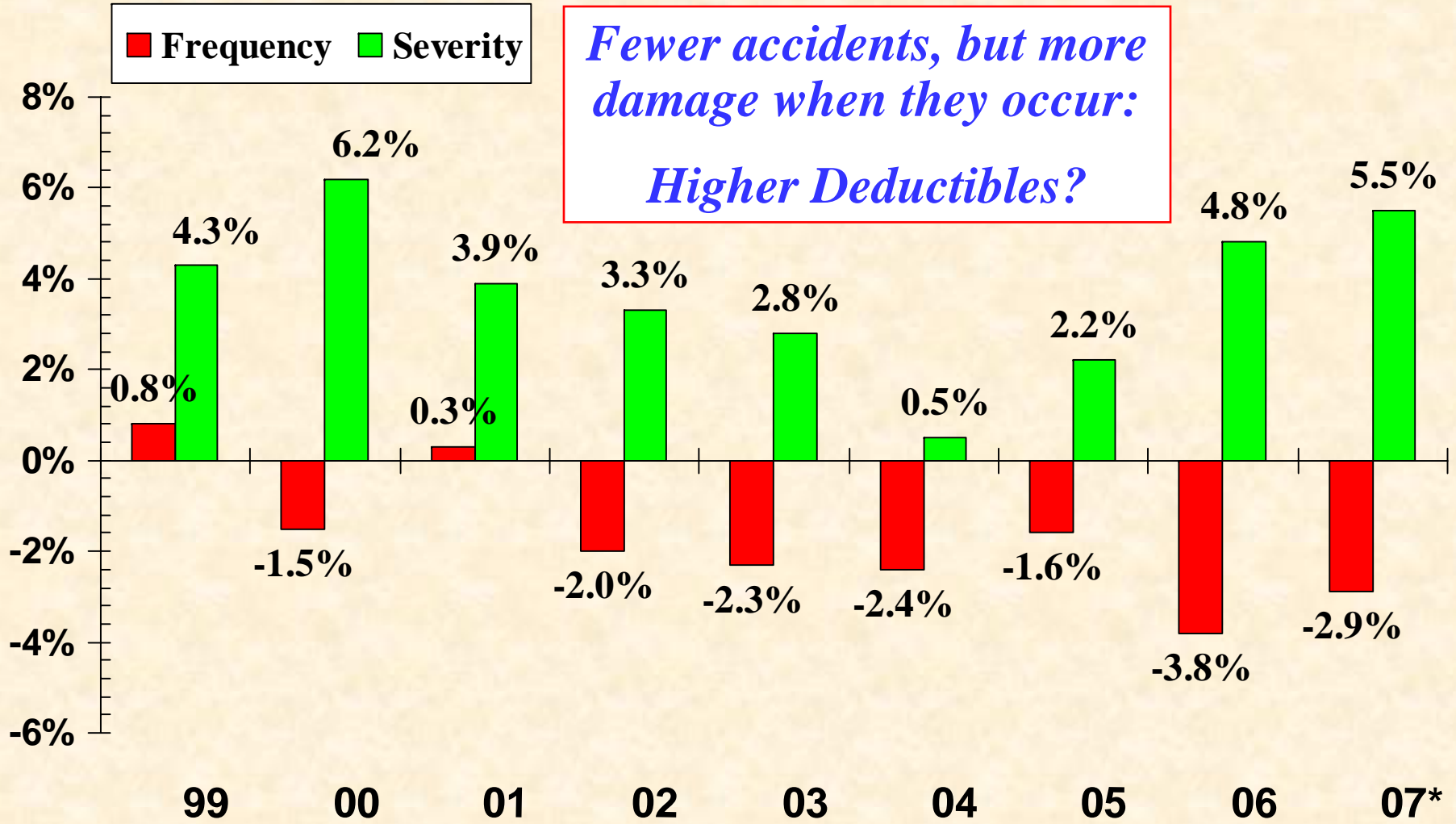
*Average of 4 quarters ending with 2nd quarter 2007.

Source: ISO Fast Track data.



PD Liability: Frequency Trend

No Longer Offsets Severity

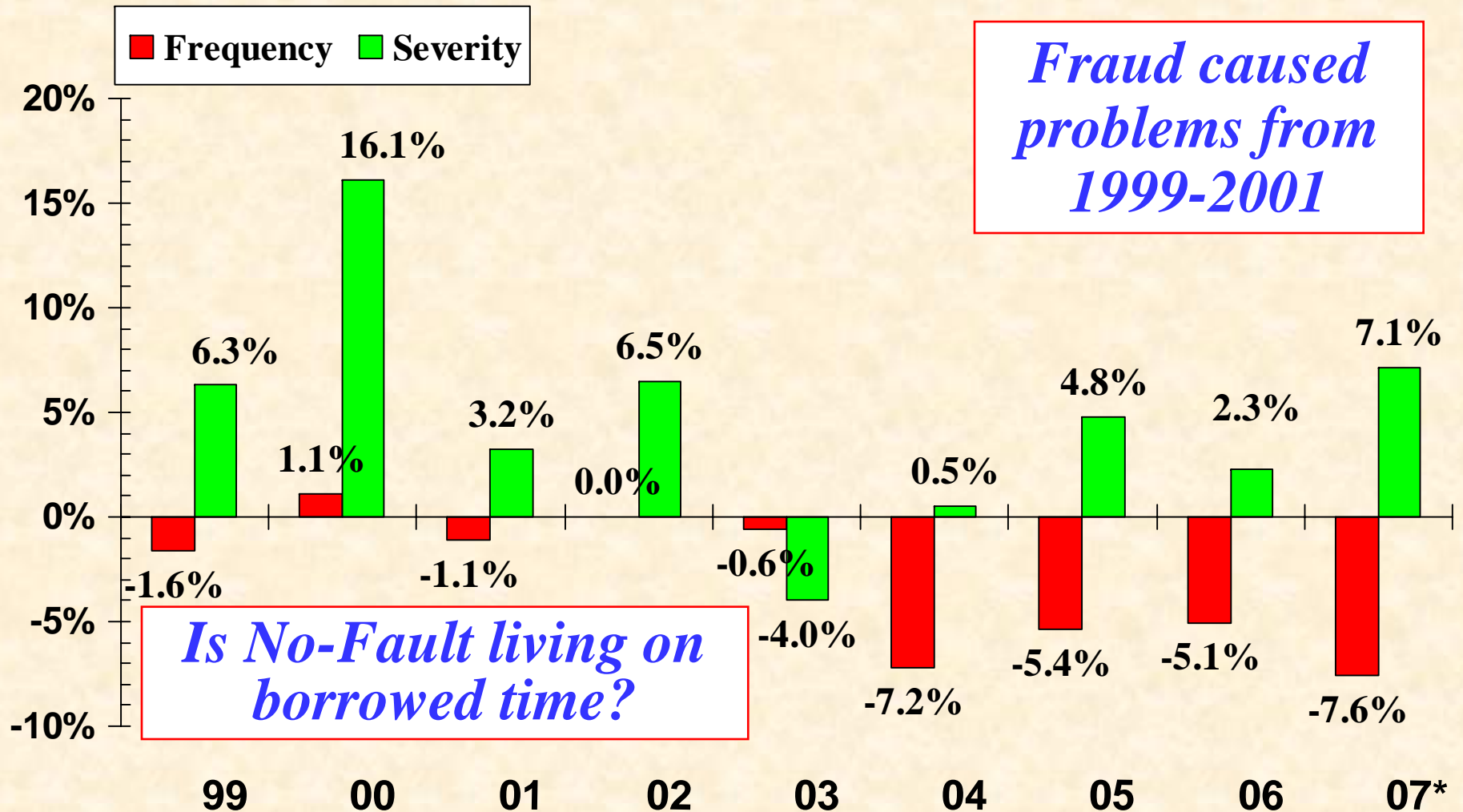


*Average of 4 quarters ending with 2nd quarter 2007.

Source: ISO Fast Track data.



PIP: Frequency Trend Now Offsets Rising Claim Severity

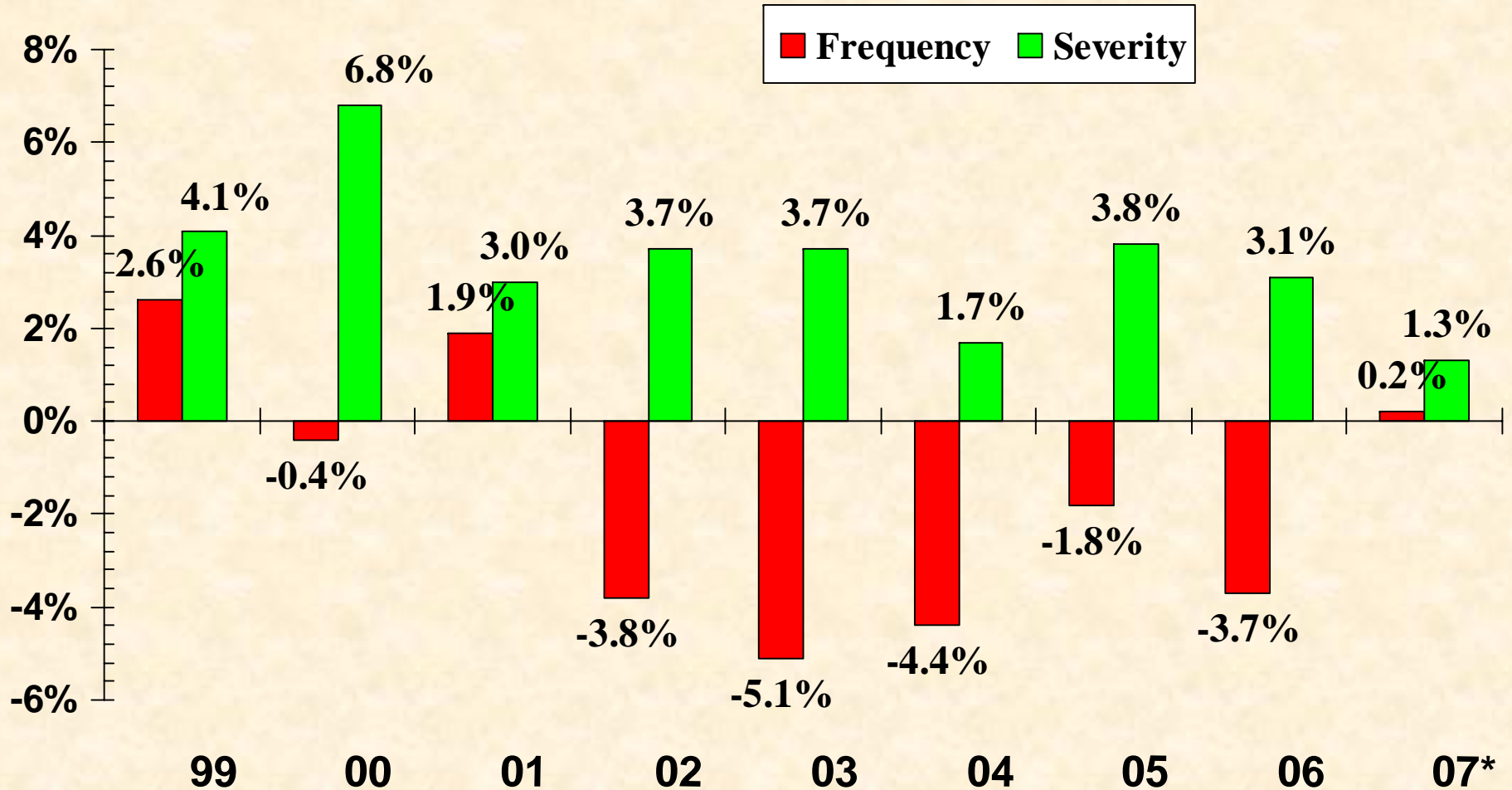


*Average of 4 quarters ending with 2nd quarter 2007.

Source: ISO Fast Track data.



Collision: Frequency and Severity Claim Trend Adverse

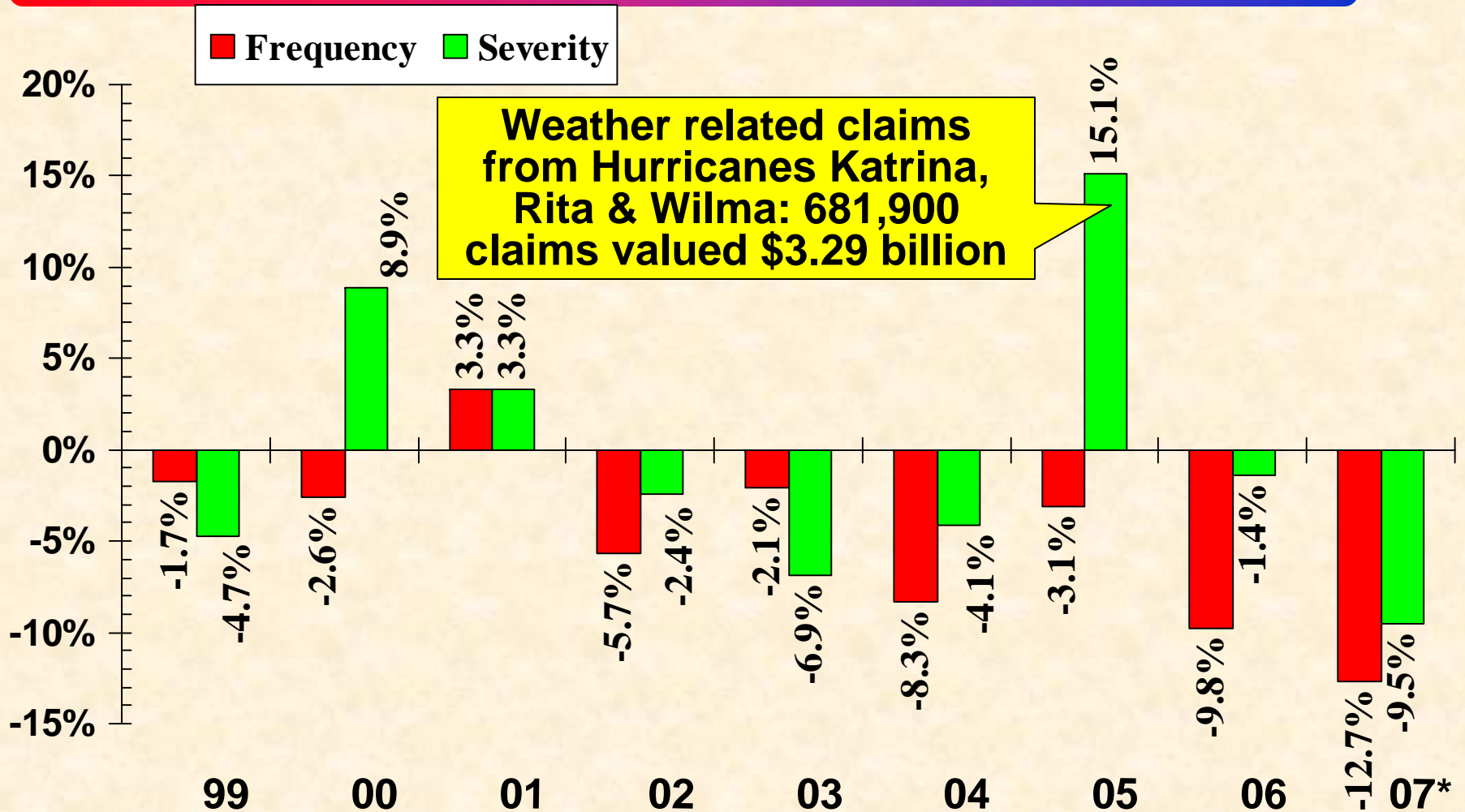


*Average of 4 quarters ending with 2nd quarter 2007.

Source: ISO Fast Track data.



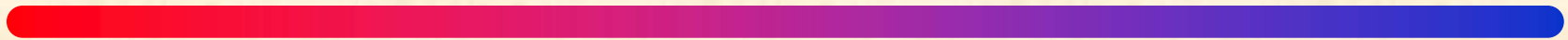
Comprehensive: Favorable Frequency and Severity Trends



*Average of 4 quarters ending with 2nd quarter 2007.

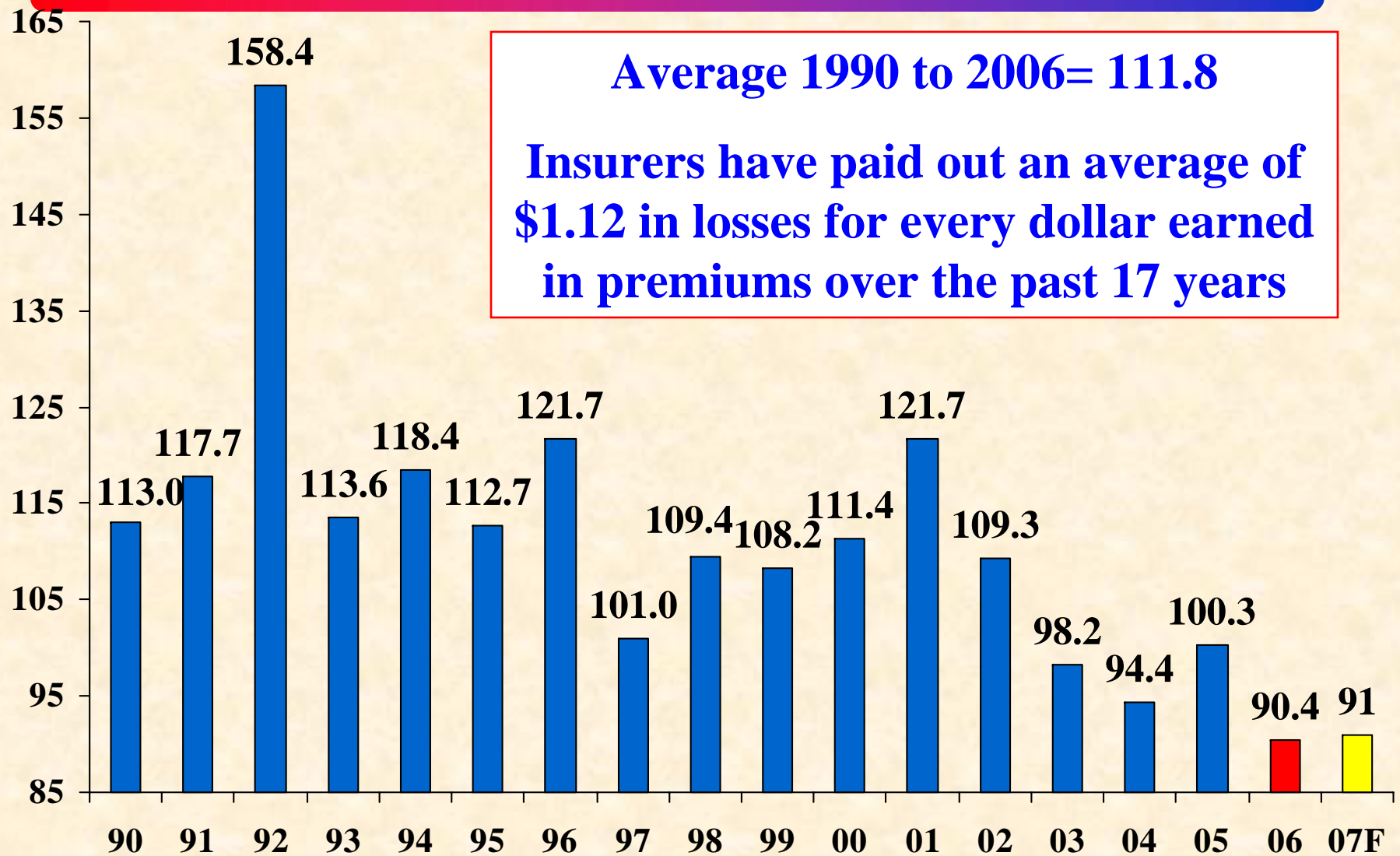
Source: ISO Fast Track data.

Homeowners Insurance





Homeowners Insurance Combined Ratio



Sources: A.M. Best; III

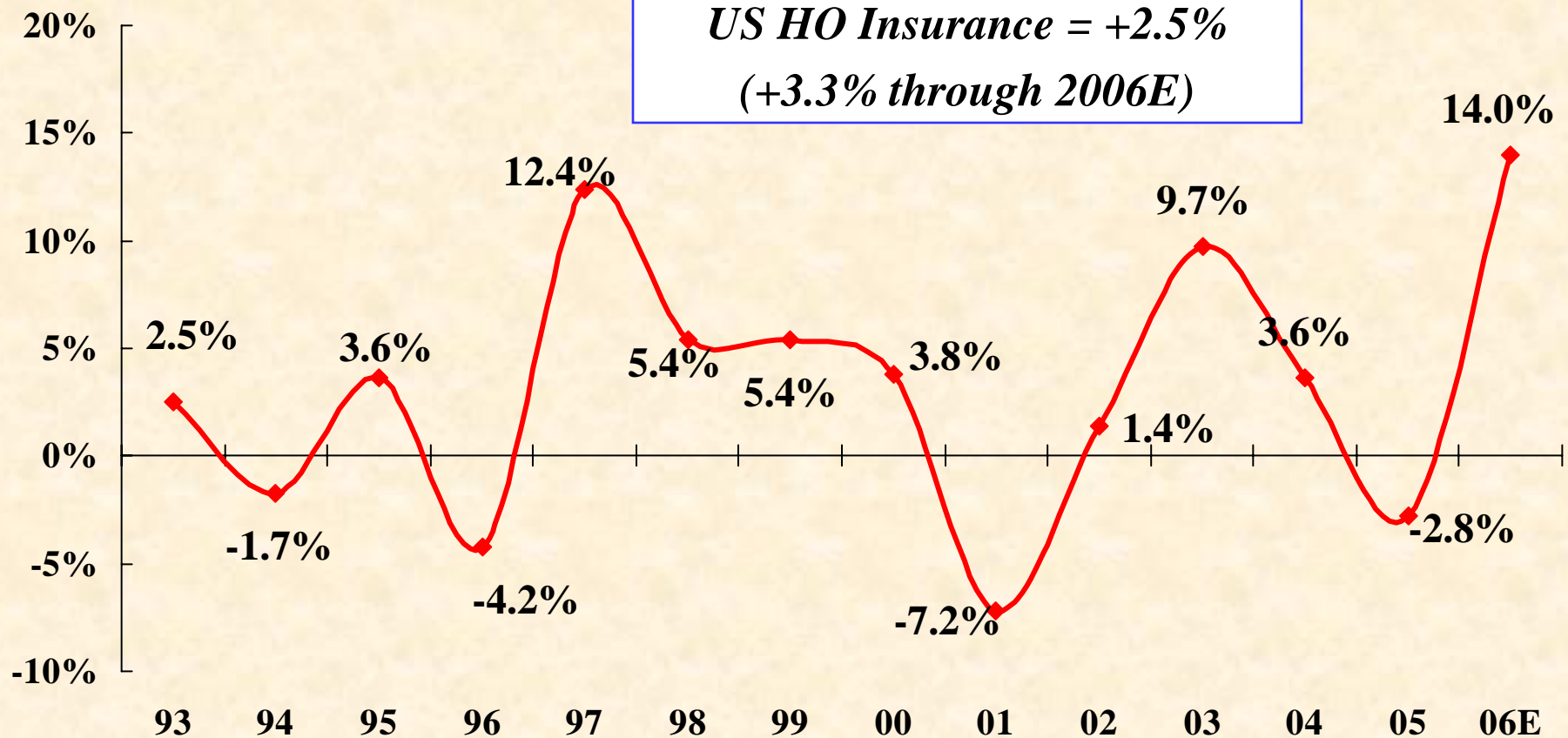


Rates of Return on Net Worth for Homeowners Ins: US

Averages: 1993 to 2005

US HO Insurance = +2.5%

(+3.3% through 2006E)



Source: NAIC; 2006 figure is Insurance Information Institute estimate.

COMMERCIAL LINES

Commercial Auto

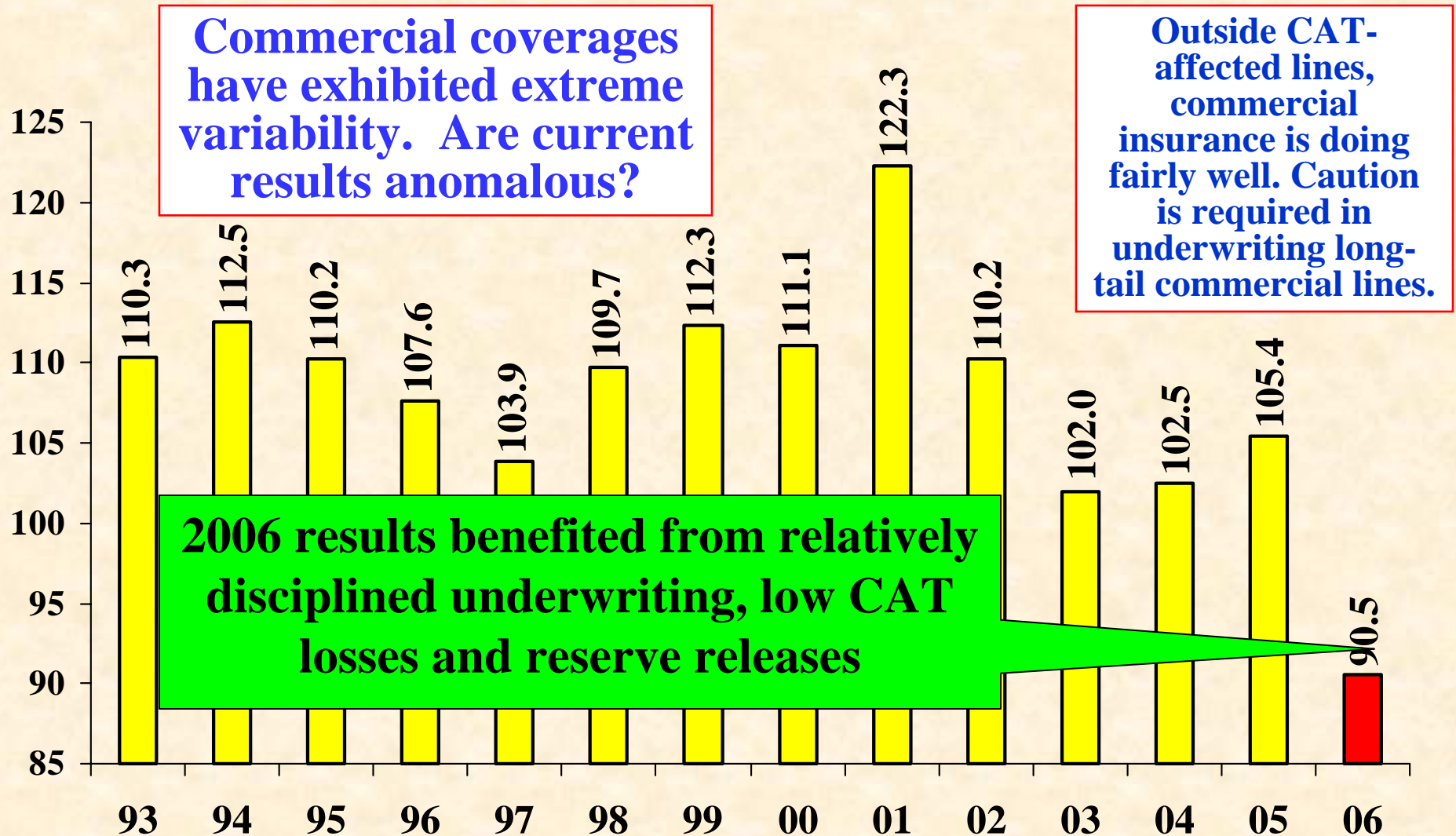
Commercial Multi-Peril



Workers Comp



Commercial Lines Combined Ratio, 1993-2006

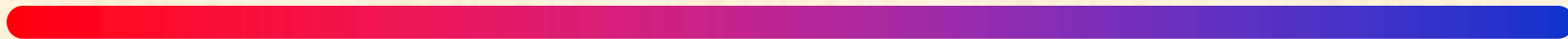




The Big Question: Is the Industry More Disciplined Today?

- **Signs suggest that the answer is *yes***
- **Current period of sustained underwriting profitability is the first since the 1950s**
- **While prices are falling, underlying lost cost trends (frequency and severity trends) are generally favorable to benign**
 - Suggest impact of falling prices will be less pronounced than late 1990s
- **Reserve situation appears much improved and under control**
- **Management Information Systems: Much More Sophisticated**
 - Insurers can monitor and make adjustments much more quickly
 - Adjustments made quickly by line, geographic area, producer, etc.
- **Investment Income**
 - Relative to late 1990s, interest rates and stock markets returns are lower
 - Has effect of imposing (some) discipline
- **Ratings Agencies**
 - More stringent capital requirements
 - Quicker to downgrade

COMMERCIAL MULTI-PERIL & COMMERCIAL AUTO

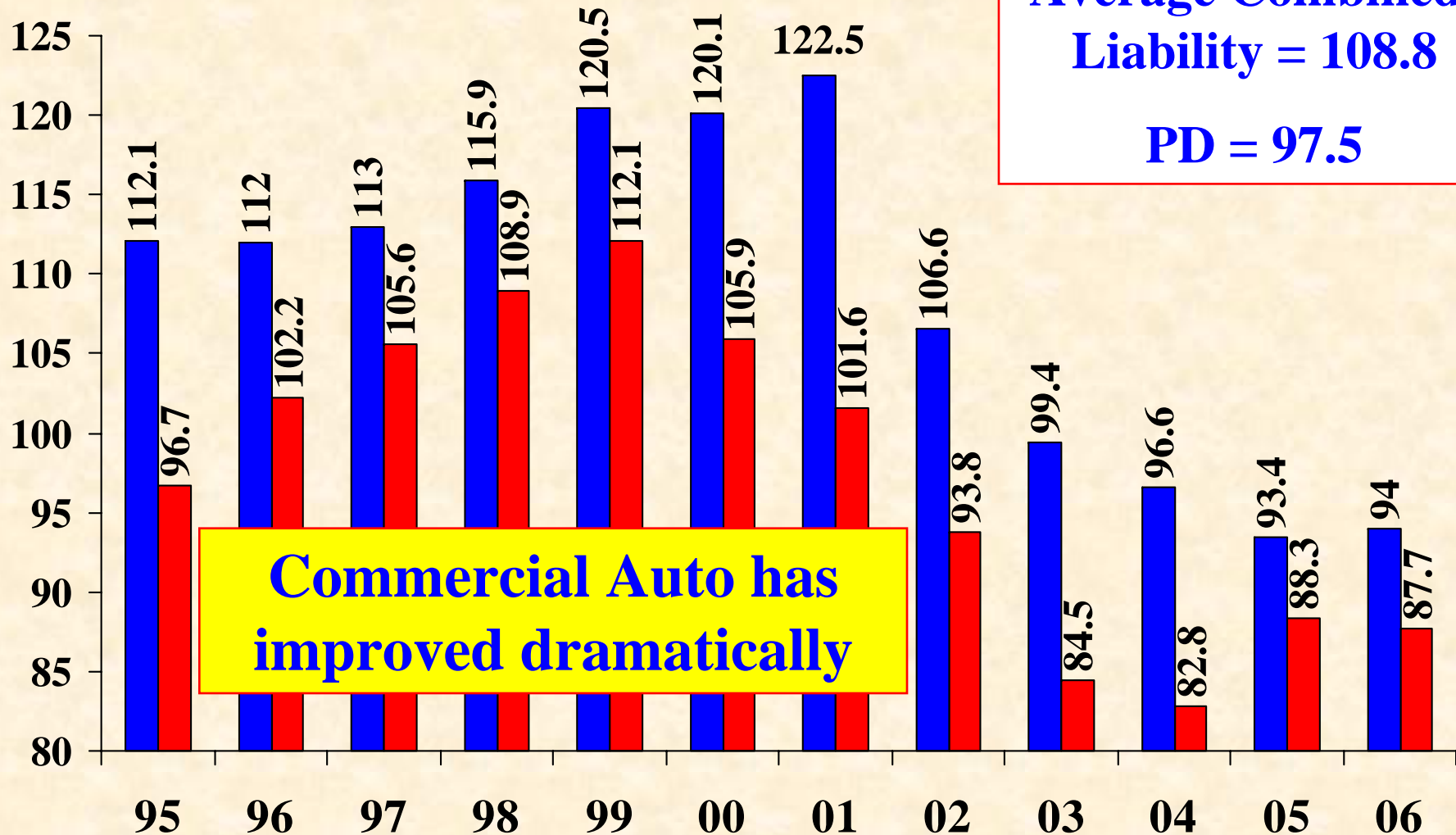




Commercial Auto Liability & PD Combined Ratios

■ Comm Auto Liab ■ Comm Auto PD

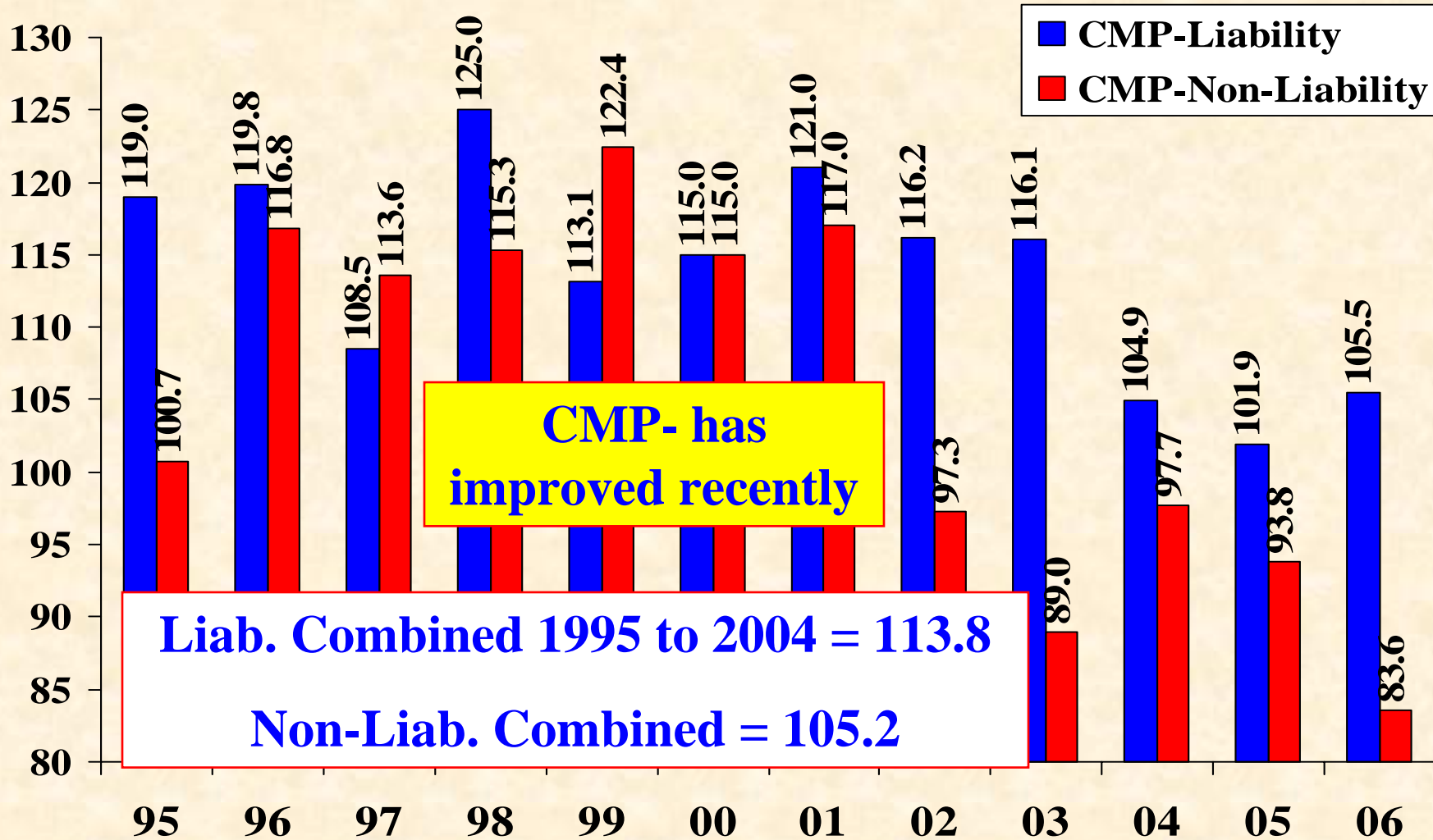
**Average Combined:
Liability = 108.8
PD = 97.5**



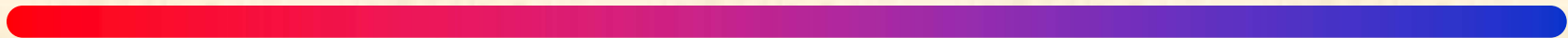
**Commercial Auto has
improved dramatically**

Sources: A.M. Best; III

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



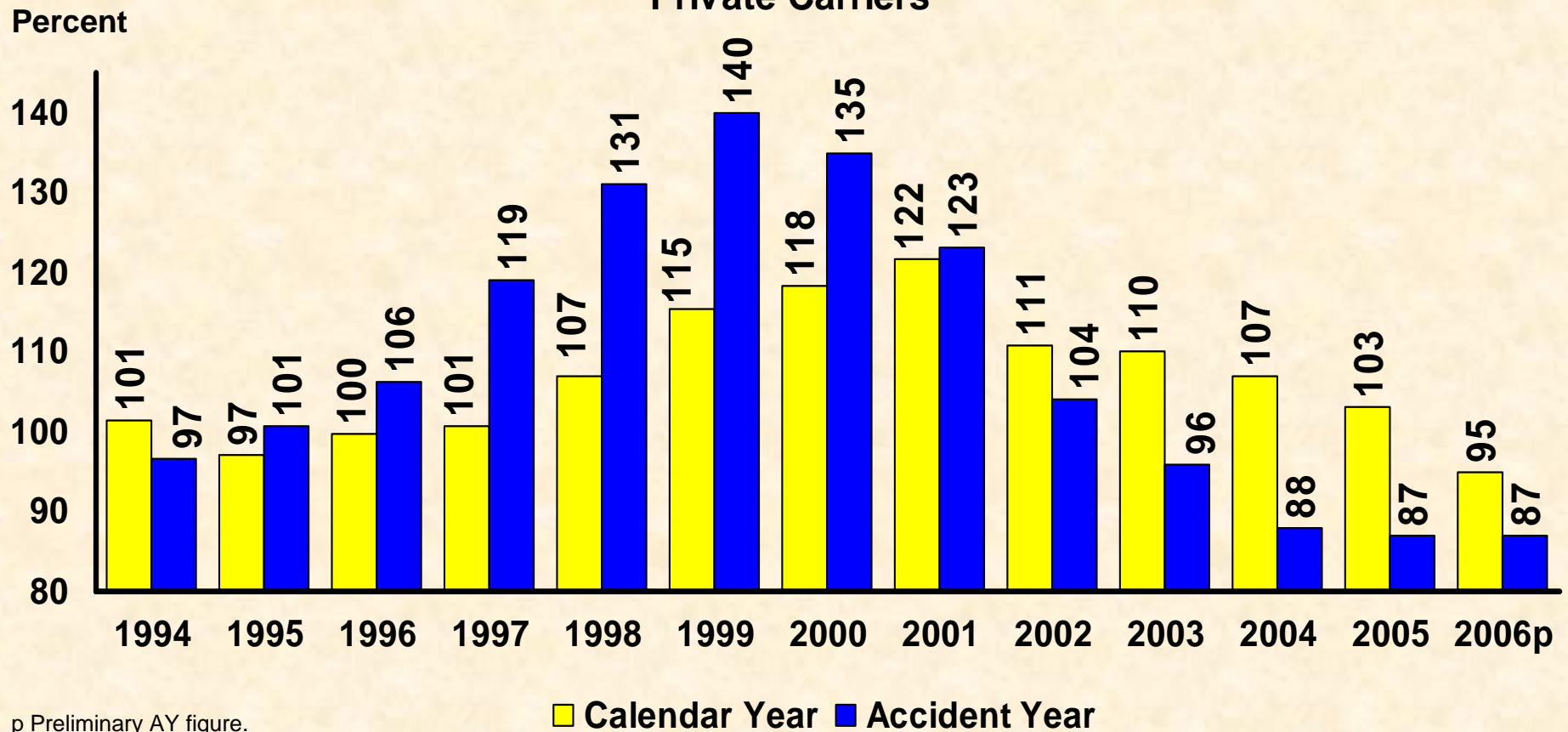
WORKERS COMPENSATION OPERATING ENVIRONMENT





Workers Comp Combined Ratios, 1994-2006P

Workers Comp Calendar Year vs. Ultimate Accident Year – Private Carriers



p Preliminary AY figure.

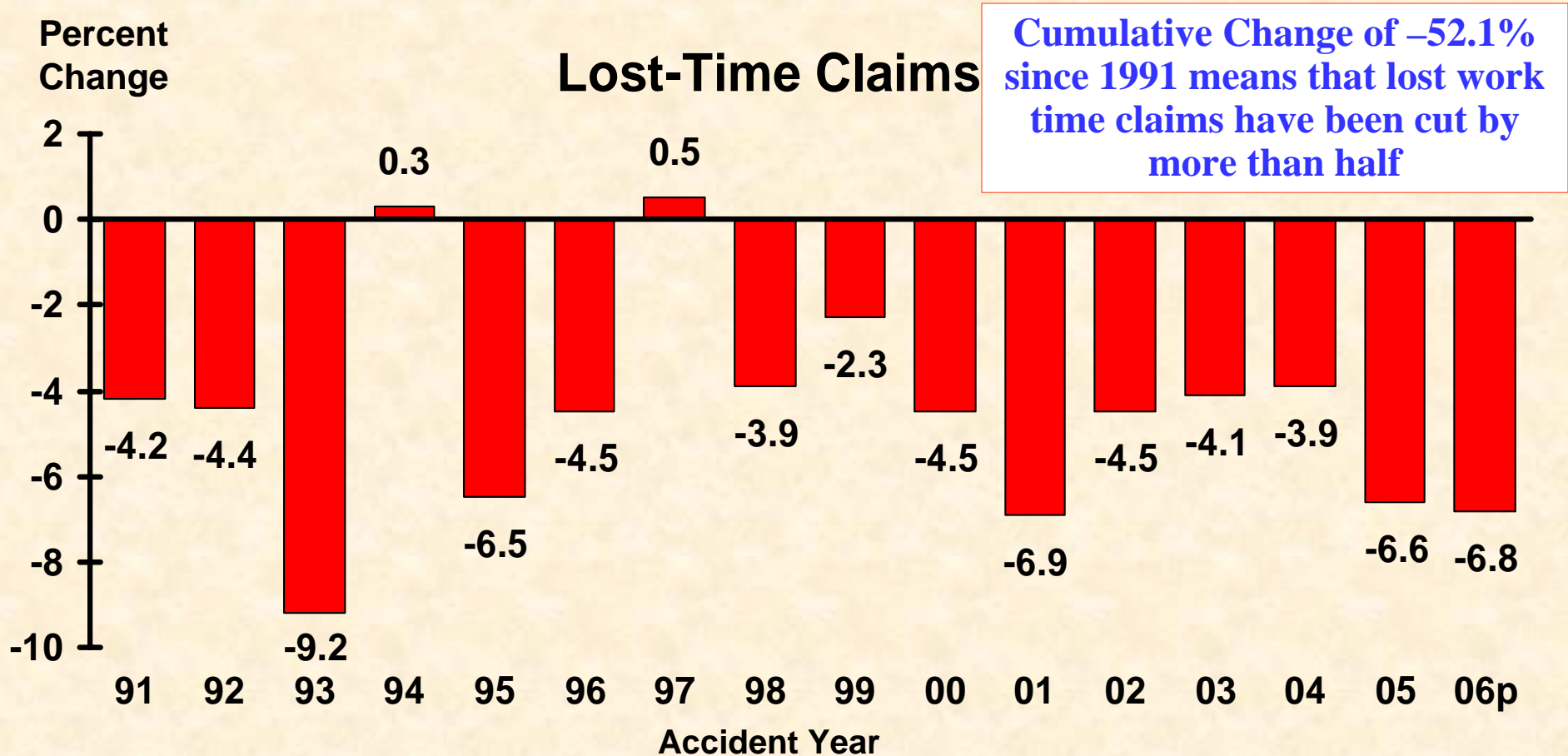
Accident Year data is evaluated as of 12/31/2006 and developed to ultimate

Source: Calendar Years 1994-2005, A.M. Best Aggregates & Averages; Calendar Year 2006p and Accident Years 1994-2006pbased on NCCI Annual Statement Analysis.

Includes dividends to policyholders



Workers Comp Lost-Time Claim Frequency (% Change)



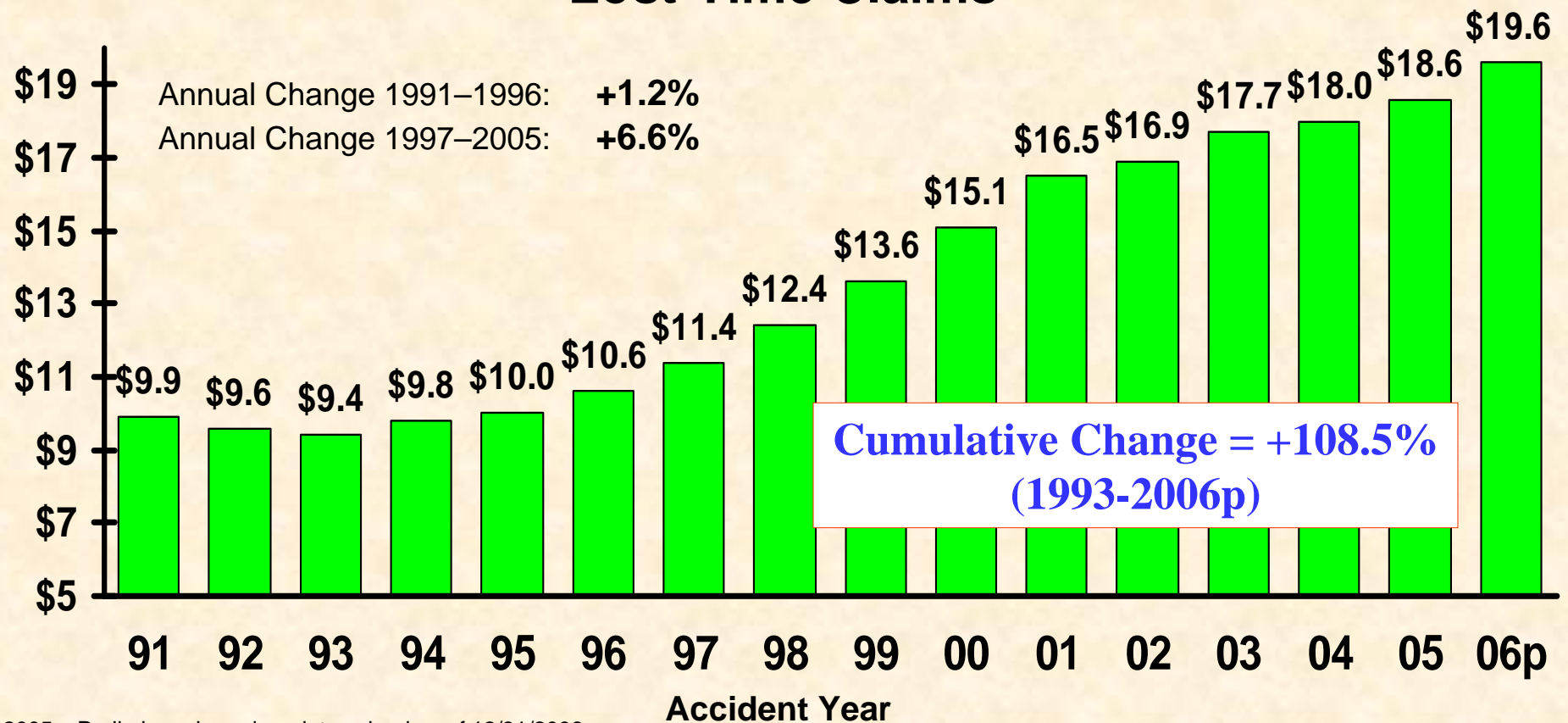
2003p: Preliminary based on data valued as of 12/31/2006
1991-2005: Based on data through 12/31/2005, developed to ultimate
Based on the states where NCCI provides ratemaking services
Excludes the effects of deductible policies
Source: NCCI

Workers Comp Indemnity Claims

Costs Have Accelerated, 1993-2006p

Indemnity
Claim Cost (000s)

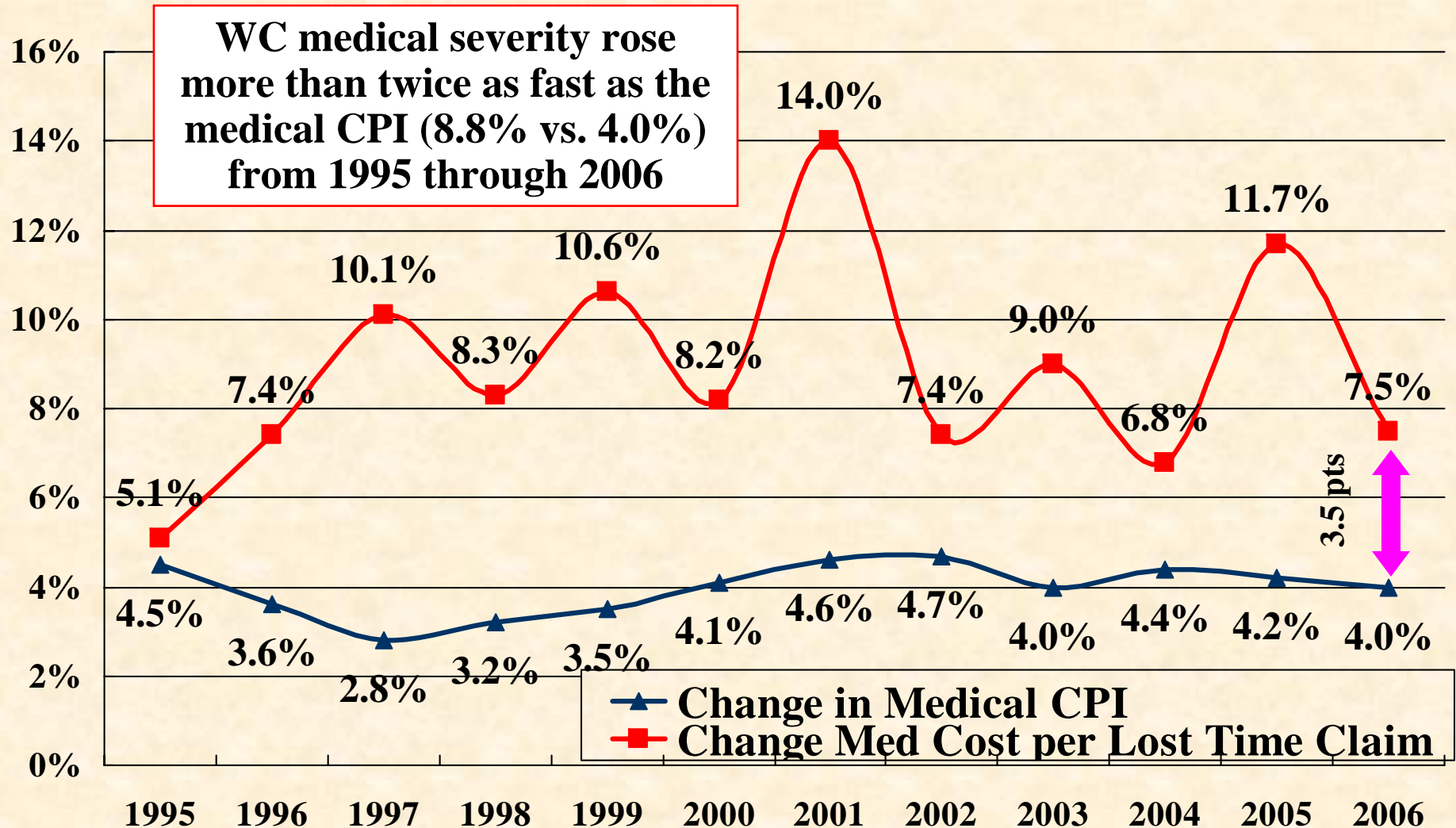
Lost-Time Claims



2005p: Preliminary based on data valued as of 12/31/2006
 1991-2005: Based on data through 12/31/2005, developed to ultimate
 Based on the states where NCCI provides ratemaking services
 Excludes the effects of deductible policies
 Source: NCCI



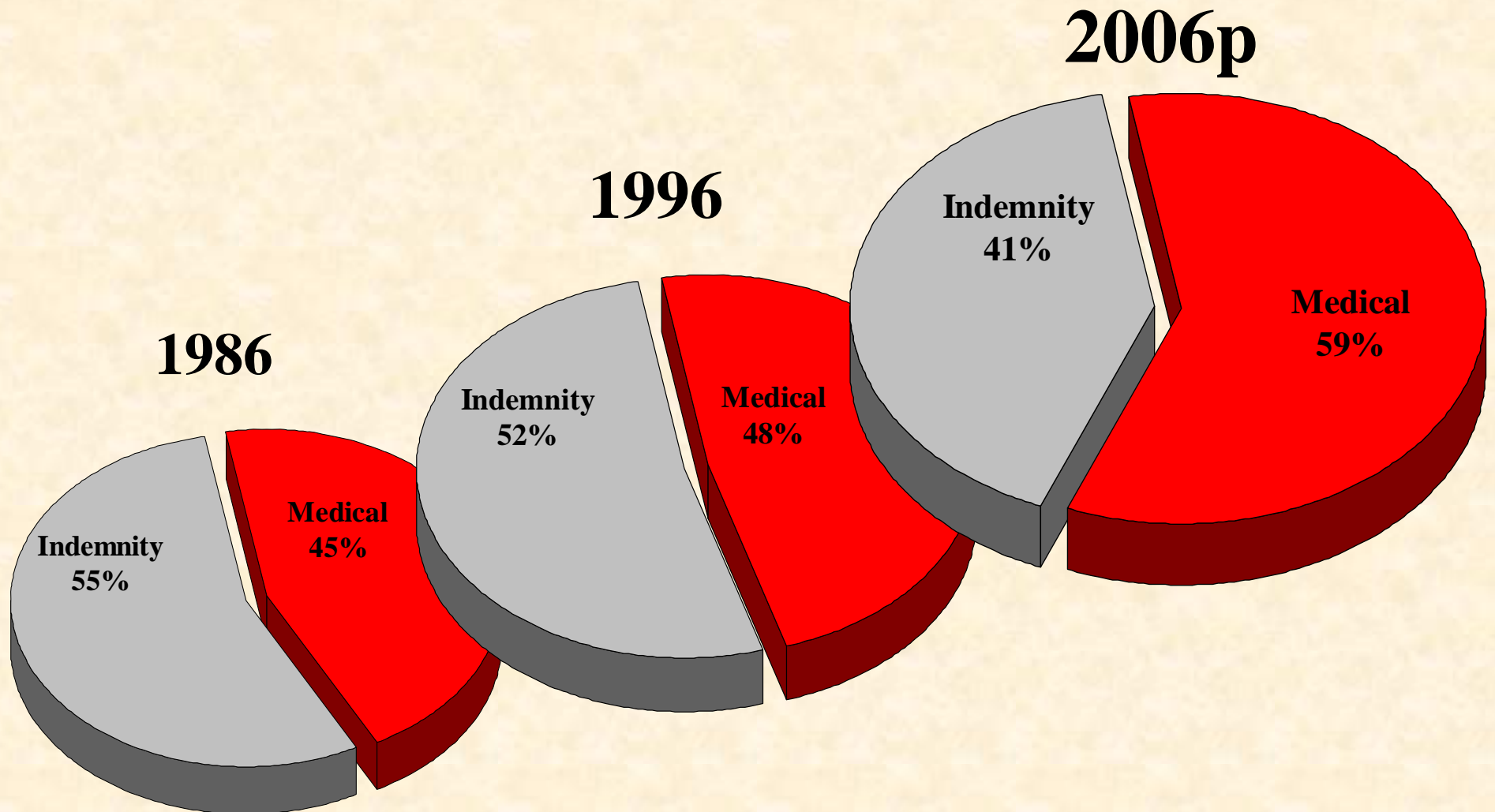
WC Medical Severity Rising Far Faster than Medical CPI



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



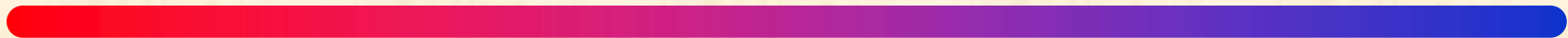
Source: NCCI (based on states where NCCI provides ratemaking services).

#3

**VANISHING
PREMIUM
GROWTH**

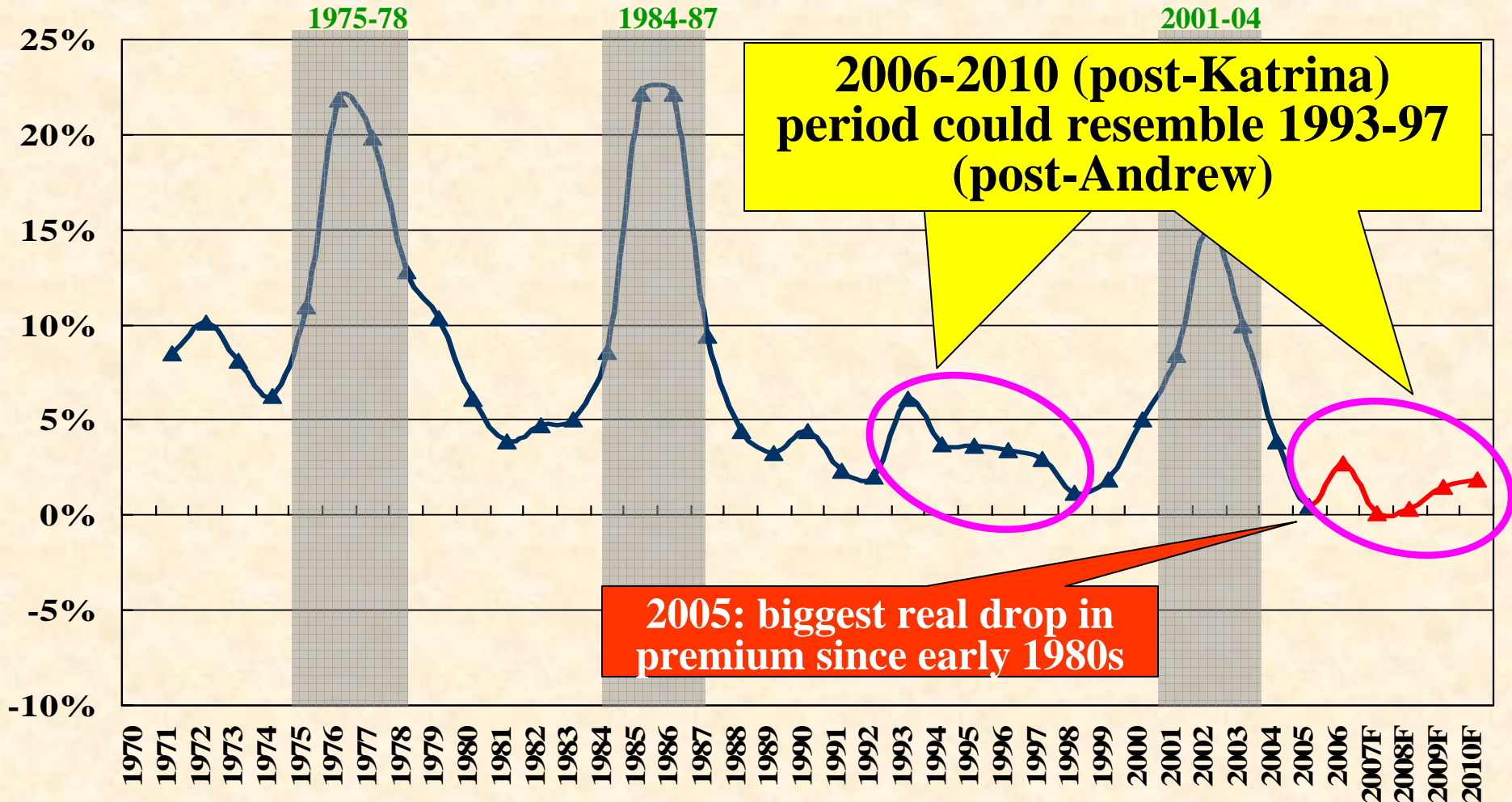


**At a Virtual Standstill
in 2007/08**





Strength of Recent Hard Markets by NWP Growth*

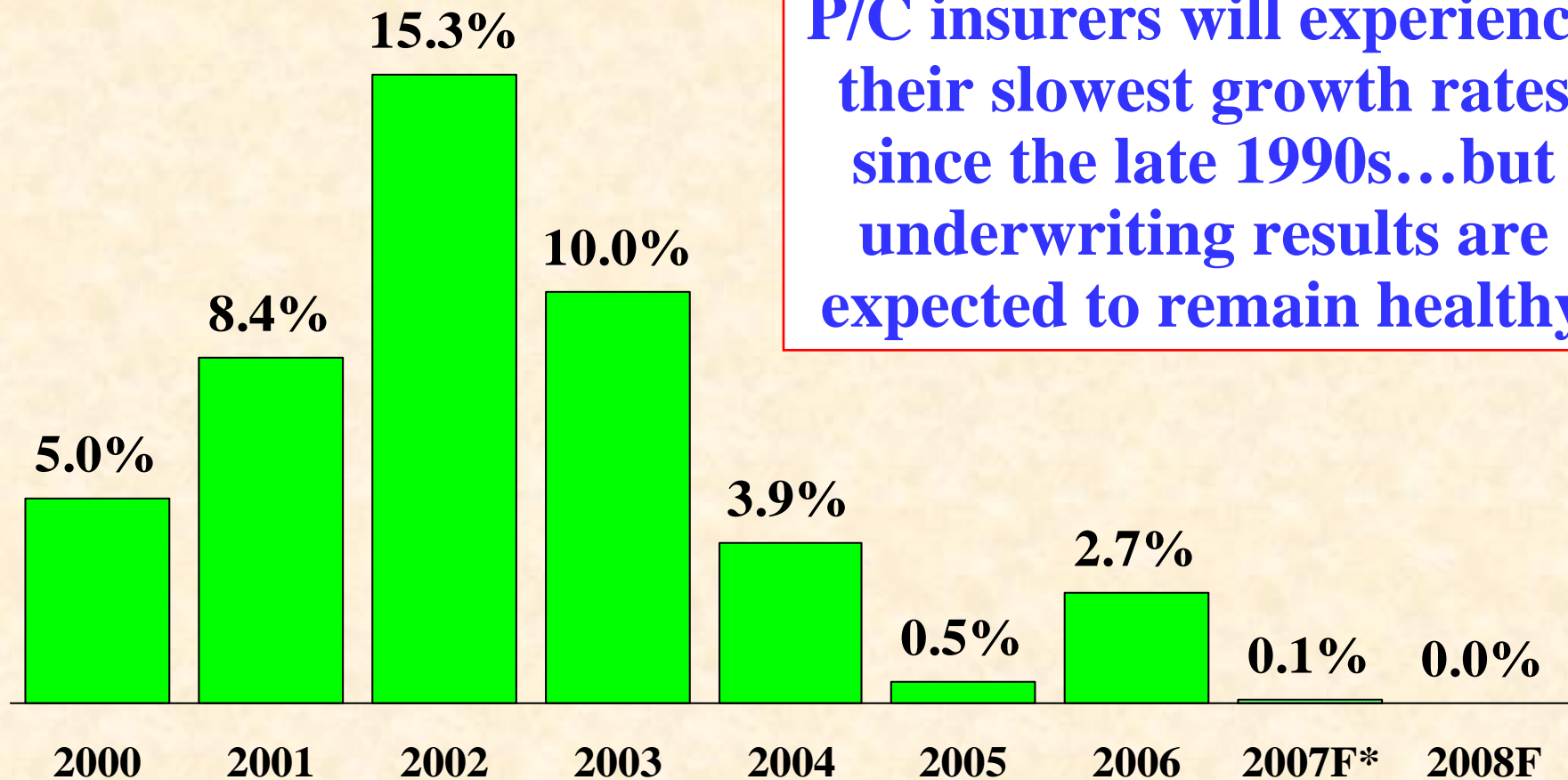


Note: Shaded areas denote hard market periods.
Source: A.M. Best, Insurance Information Institute

*2007-10 figures are III forecasts/estimates.



Growth in Net Written Premium, 2000-2008F



P/C insurers will experience their slowest growth rates since the late 1990s...but underwriting results are expected to remain healthy

*2007 figure base on 2007 actual first half result of 0.1%.
Source: A.M. Best; Forecasts from the Insurance Information Institute.

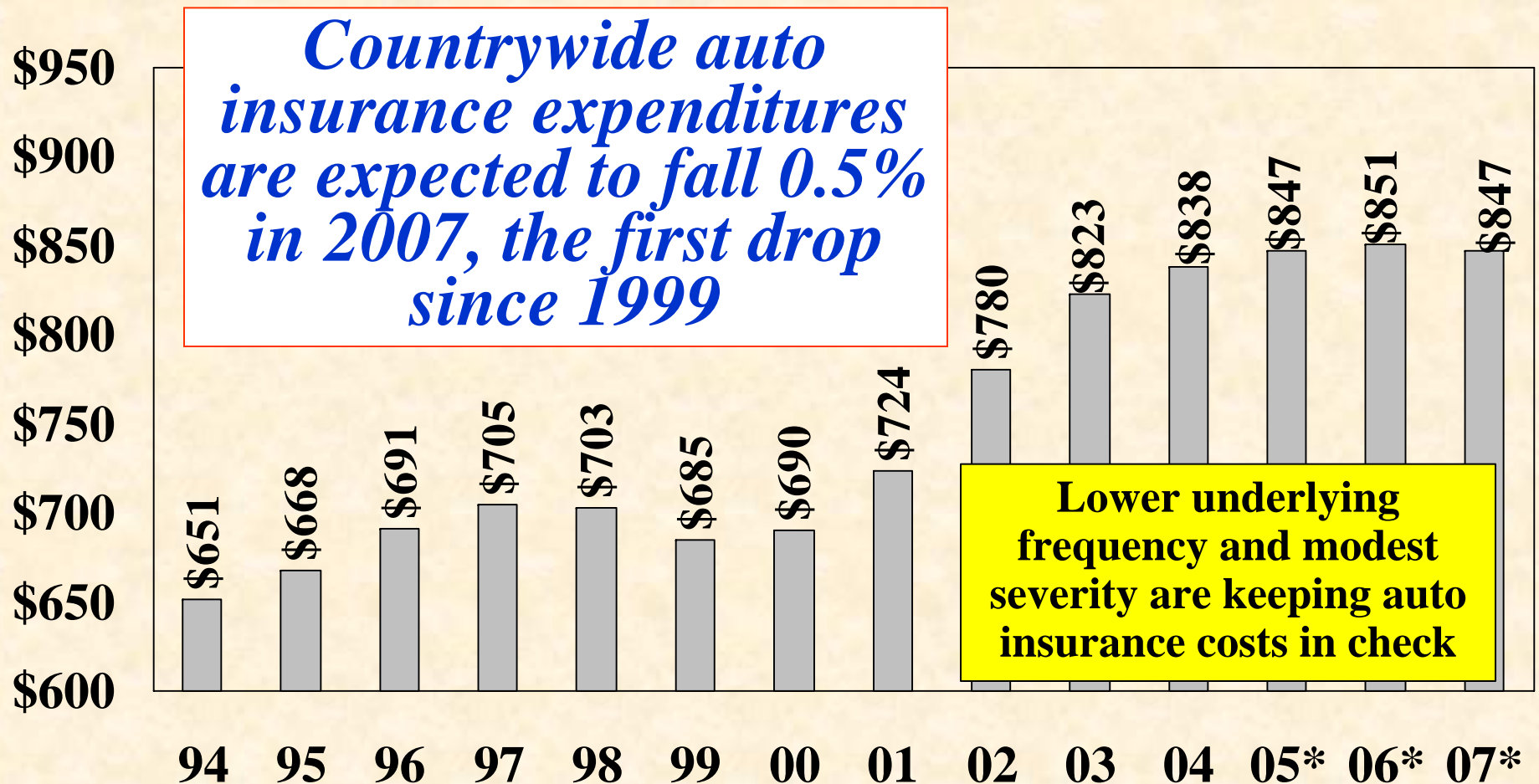
#4

WEAK PRICING

**Under Intense Pressure
in 2007/08, Especially
iii Commercial Lines**



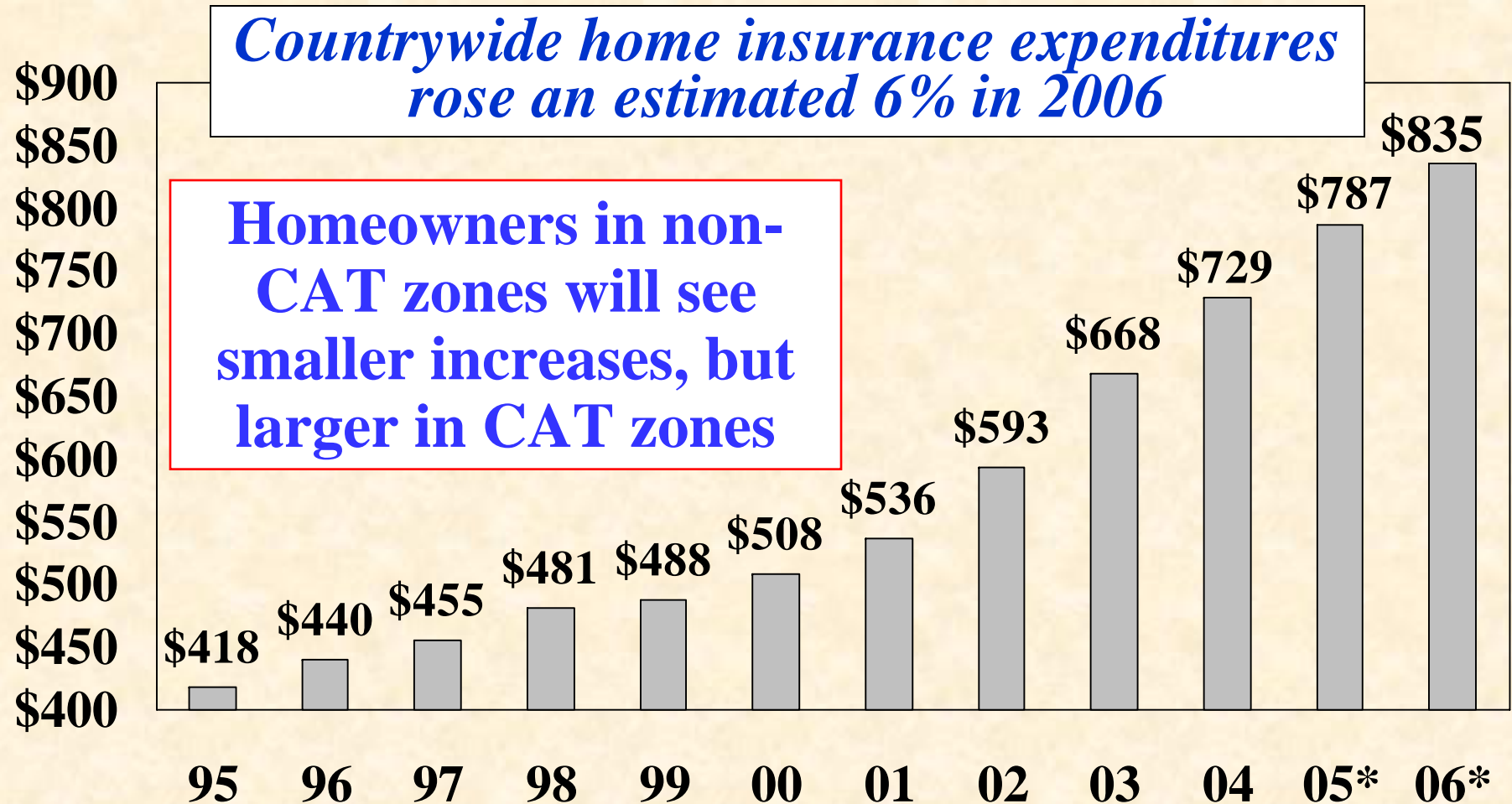
Average Expenditures on Auto Insurance



*Insurance Information Institute Estimates/Forecasts
Source: NAIC, Insurance Information Institute



Average Expenditures on Homeowners Insurance**



*Insurance Information Institute Estimates/Forecasts

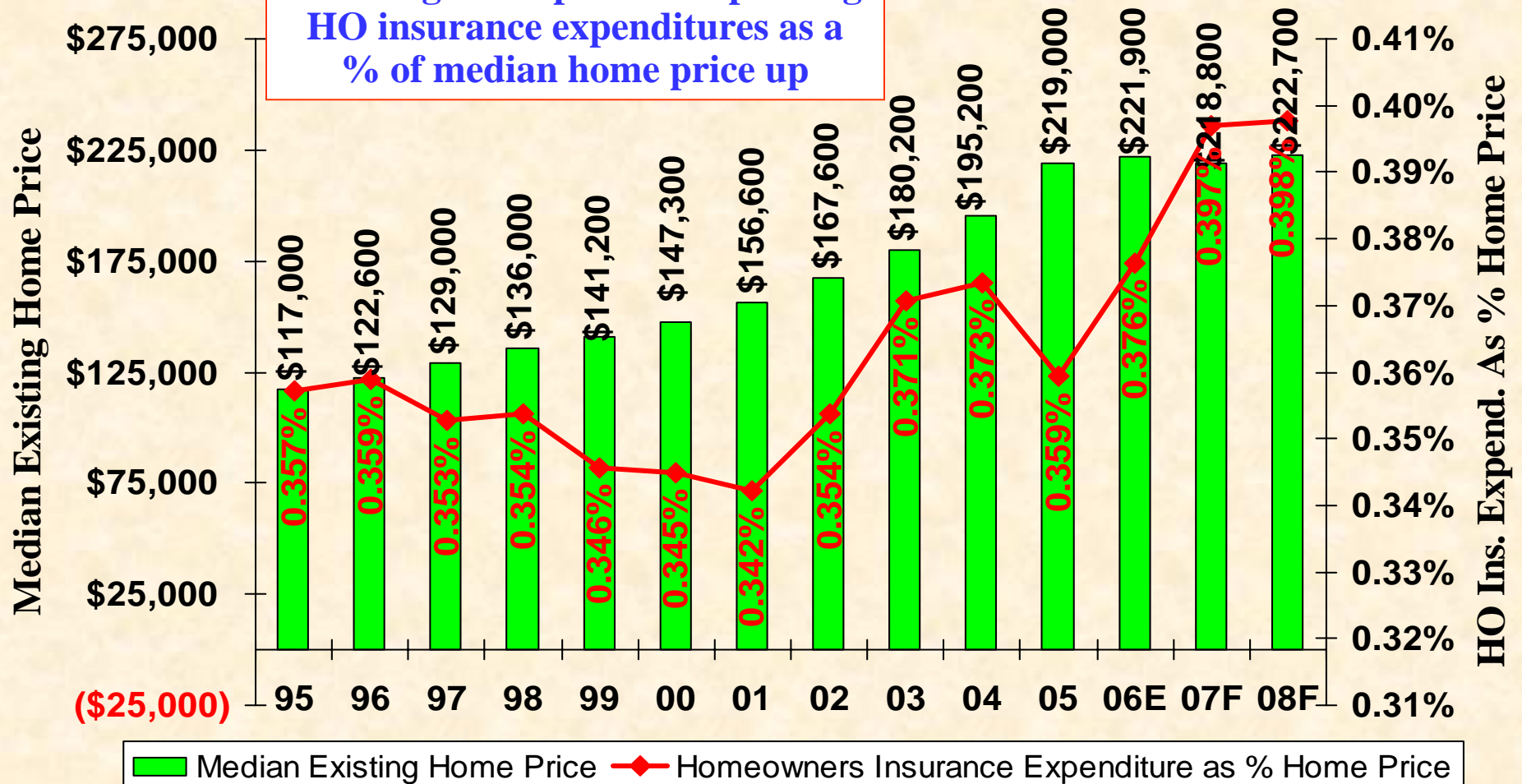
**Excludes cost of flood and earthquake coverage.

Source: NAIC, Insurance Information Institute

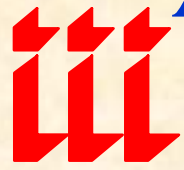


Homeowners Insurance Expenditures as a % of Median Existing Home Prices, 1995-2008F

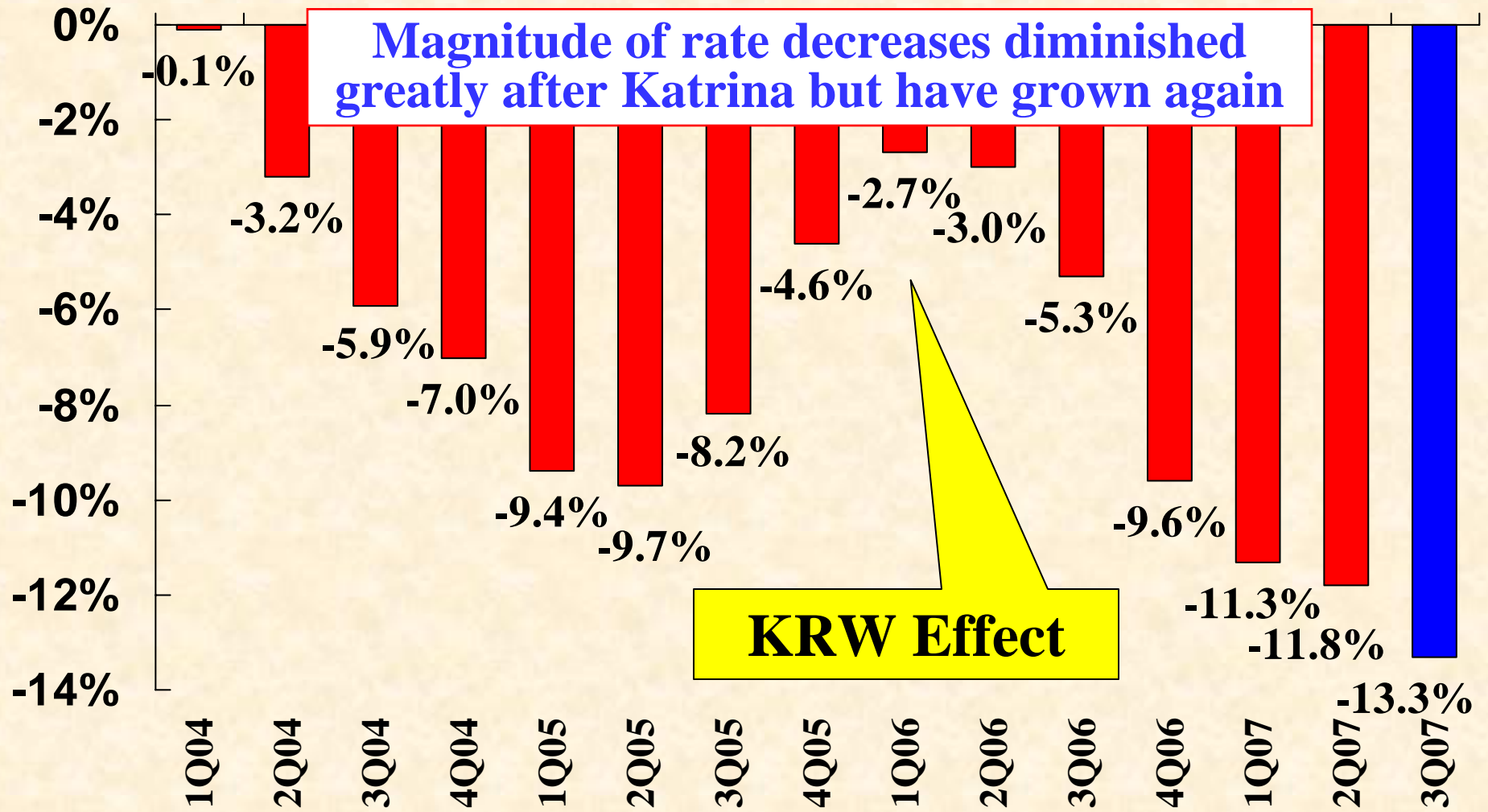
Record catastrophe losses and declining home prices are pushing HO insurance expenditures as a % of median home price up



Source: National Association of Realtors, NAIC; Insurance Info. Institute calculations and HO expenditure estimates/forecasts for years 2005-2008.



Average Commercial Rate Change, All Lines, (1Q:2004 – 3Q:2007)

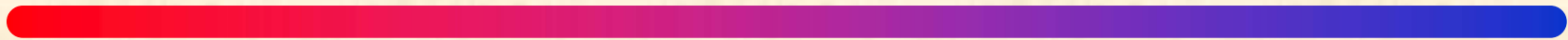


Source: Council of Insurance Agents & Brokers; Insurance Information Institute

#5

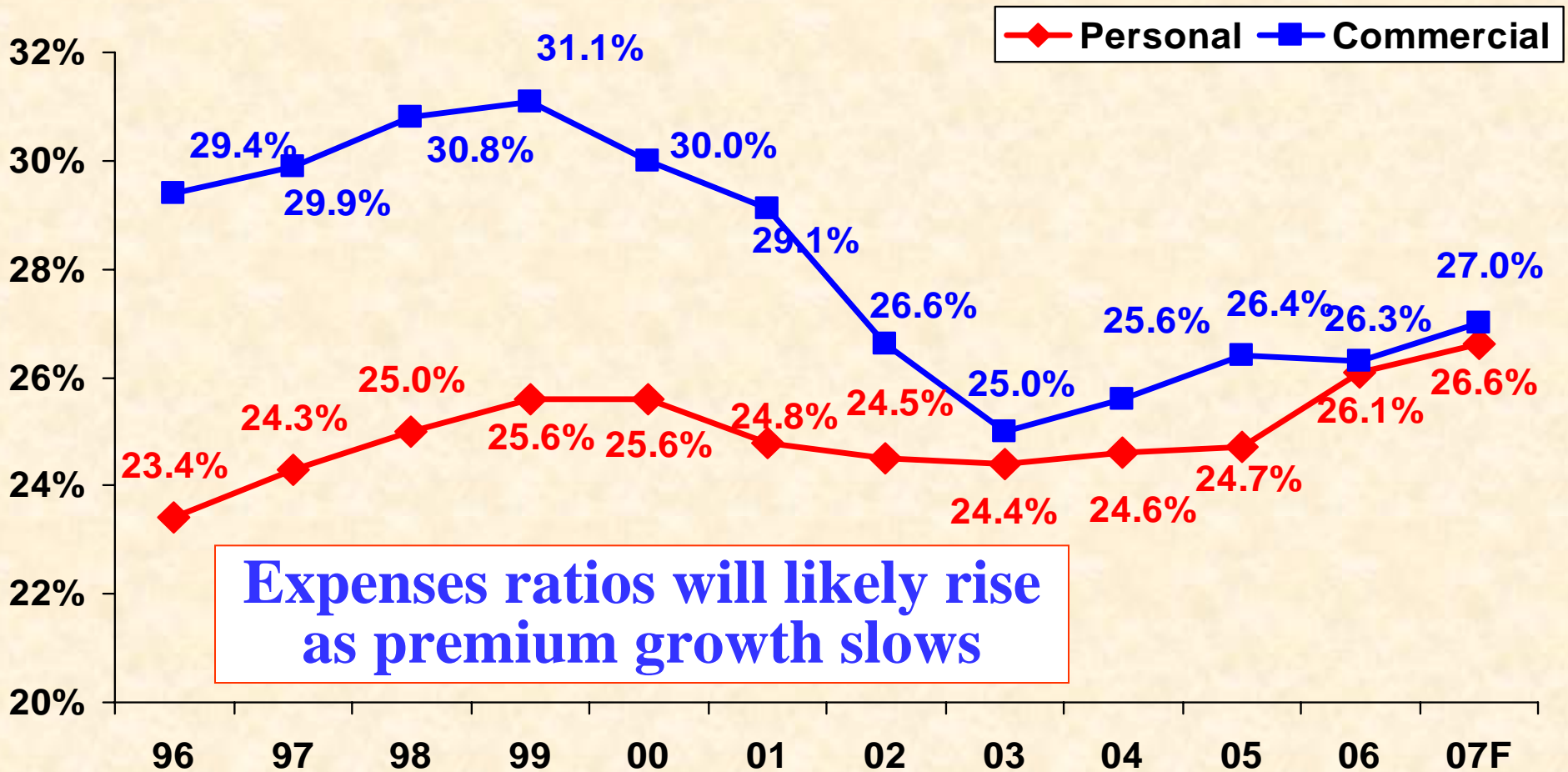
RISING EXPENSES

*Expense Ratios Will Rise as
Premium Growth Slows*





Personal vs. Commercial Lines Underwriting Expense Ratio*



Expenses ratios will likely rise
as premium growth slows

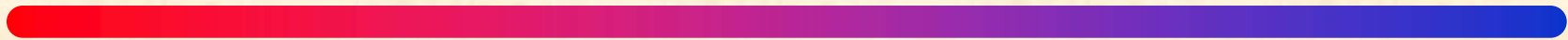
*Ratio of expenses incurred to net premiums written.

Source: A.M. Best; Insurance Information Institute

#6

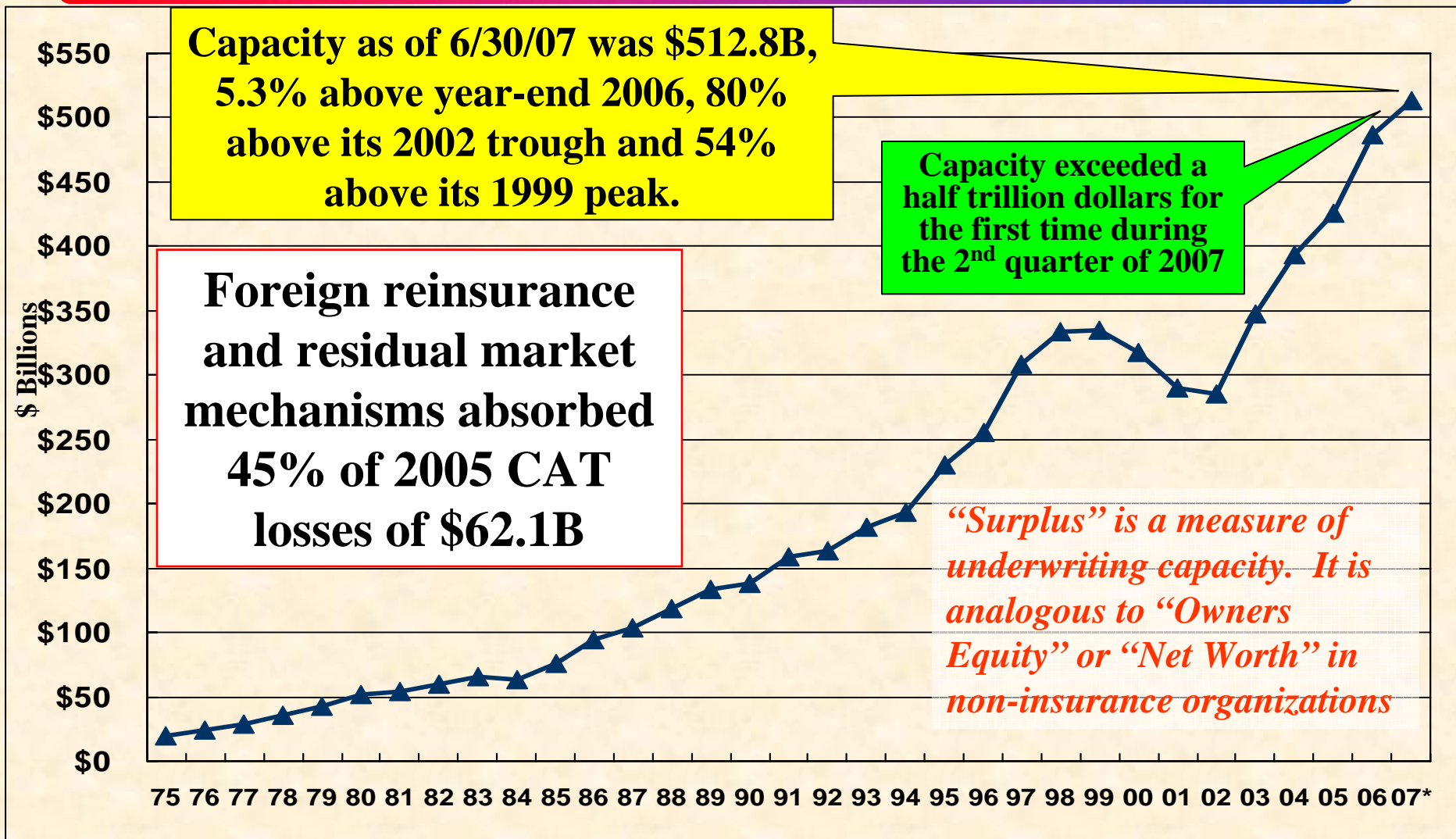
OVERCAPACITY

**Accumulation of Capital/
Surplus Depresses ROEs**





U.S. Policyholder Surplus: 1975-2007*



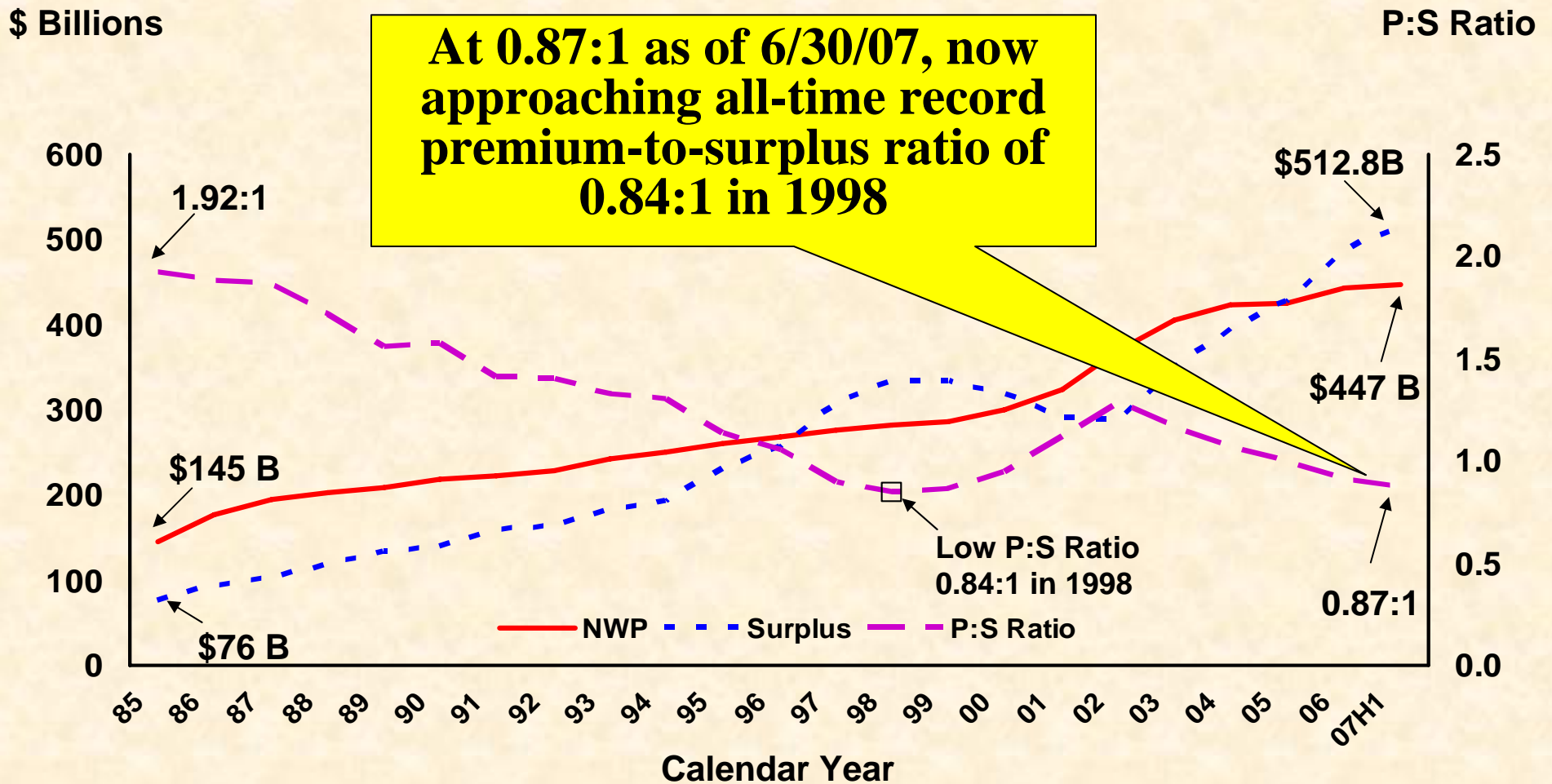
Source: A.M. Best, ISO, Insurance Information Institute.

*As of June 30, 2007



P/C Industry Premium-to-Surplus Ratio, 1985-2007:H1

Private Carriers

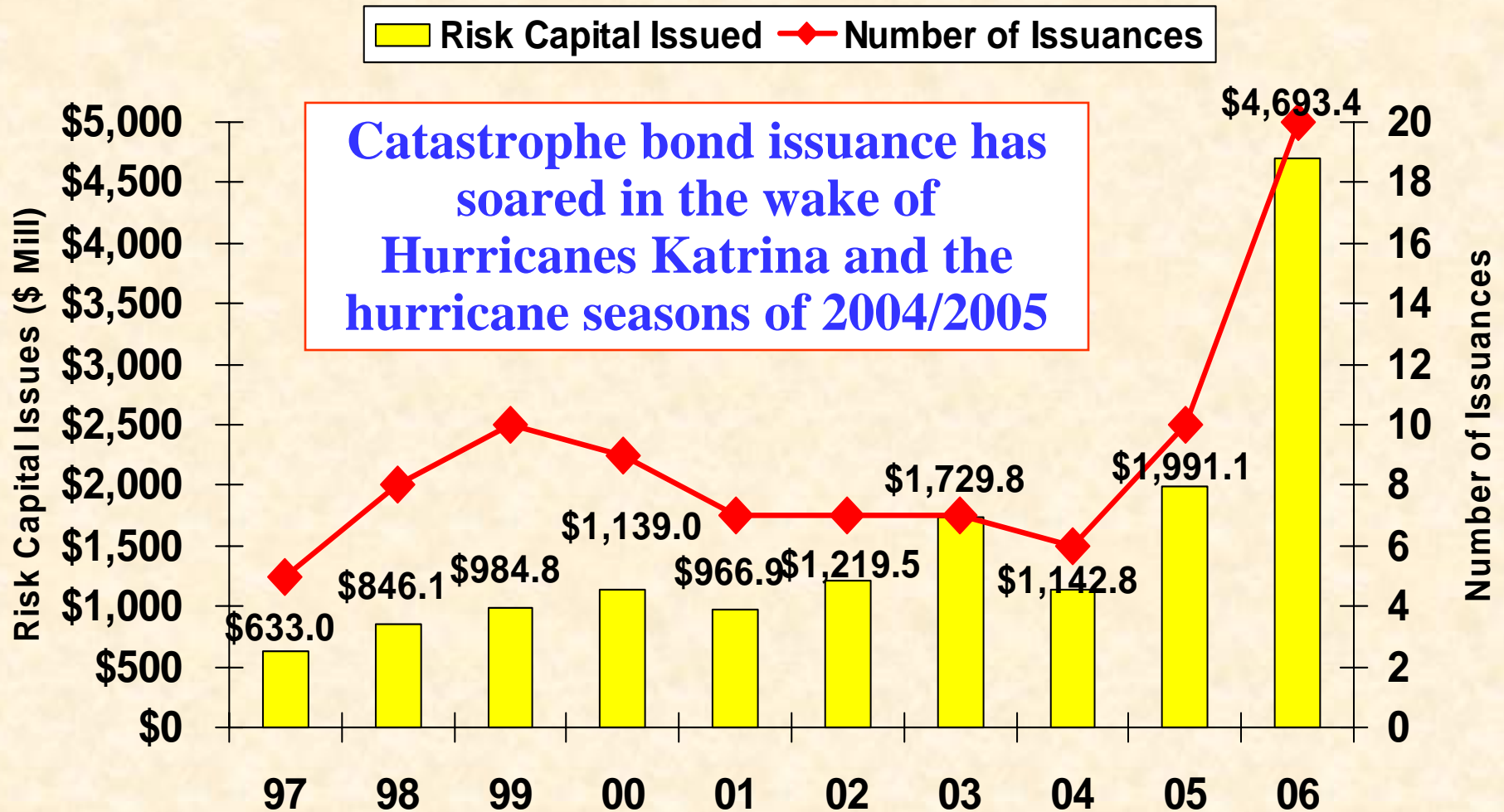


H1 = First Half

Source: 1985-2006, A.M. Best Aggregates & Averages;; 2007 ISO

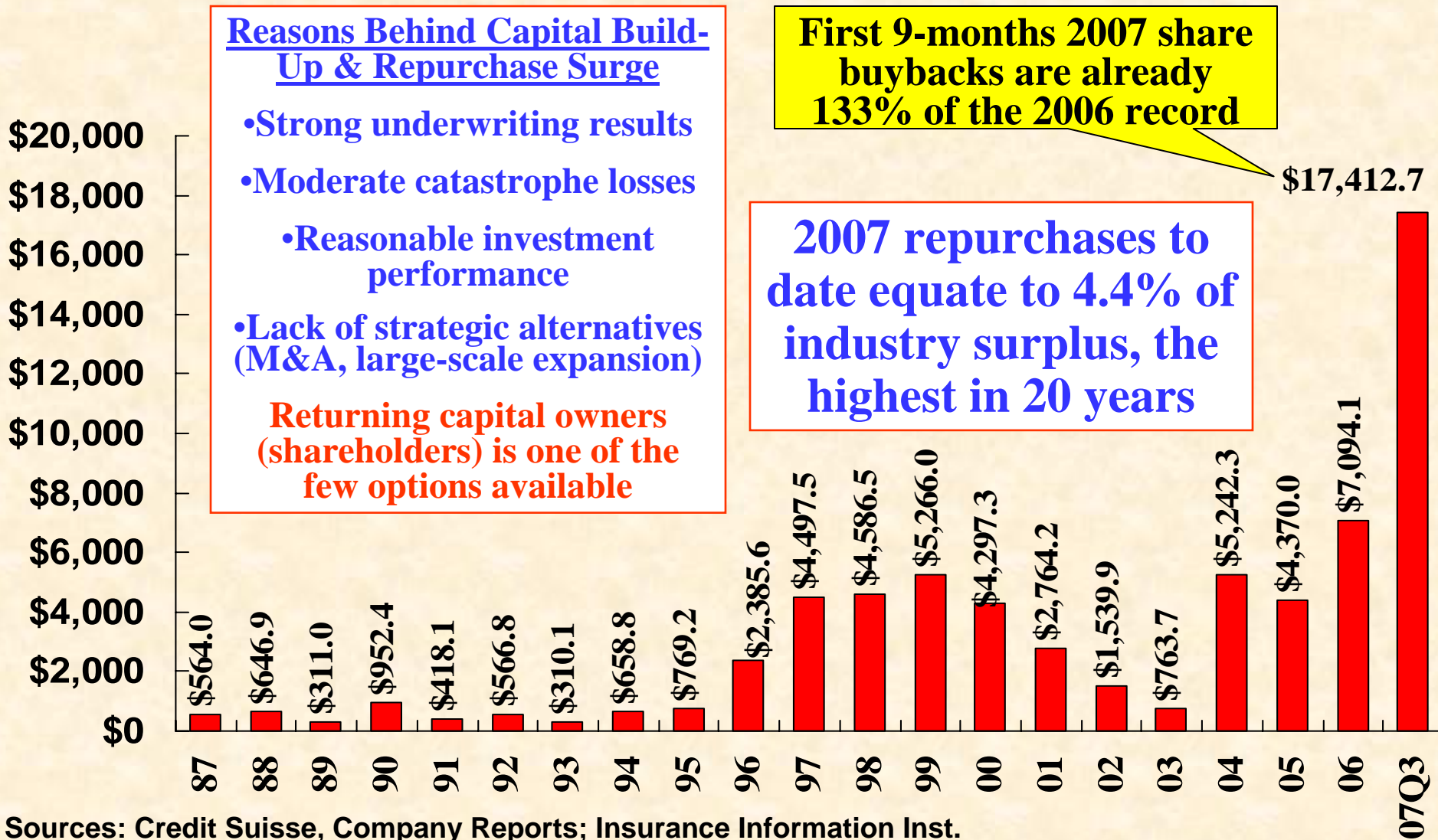


Annual Catastrophe Bond Transactions Volume, 1997-2006



Source: MMC Securities and Guy Carpenter; Insurance Information Institute.

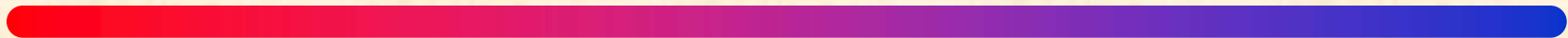
P/C Insurer Share Repurchases, 1987- Through Q3 2007 (\$ Millions)



Sources: Credit Suisse, Company Reports; Insurance Information Inst.

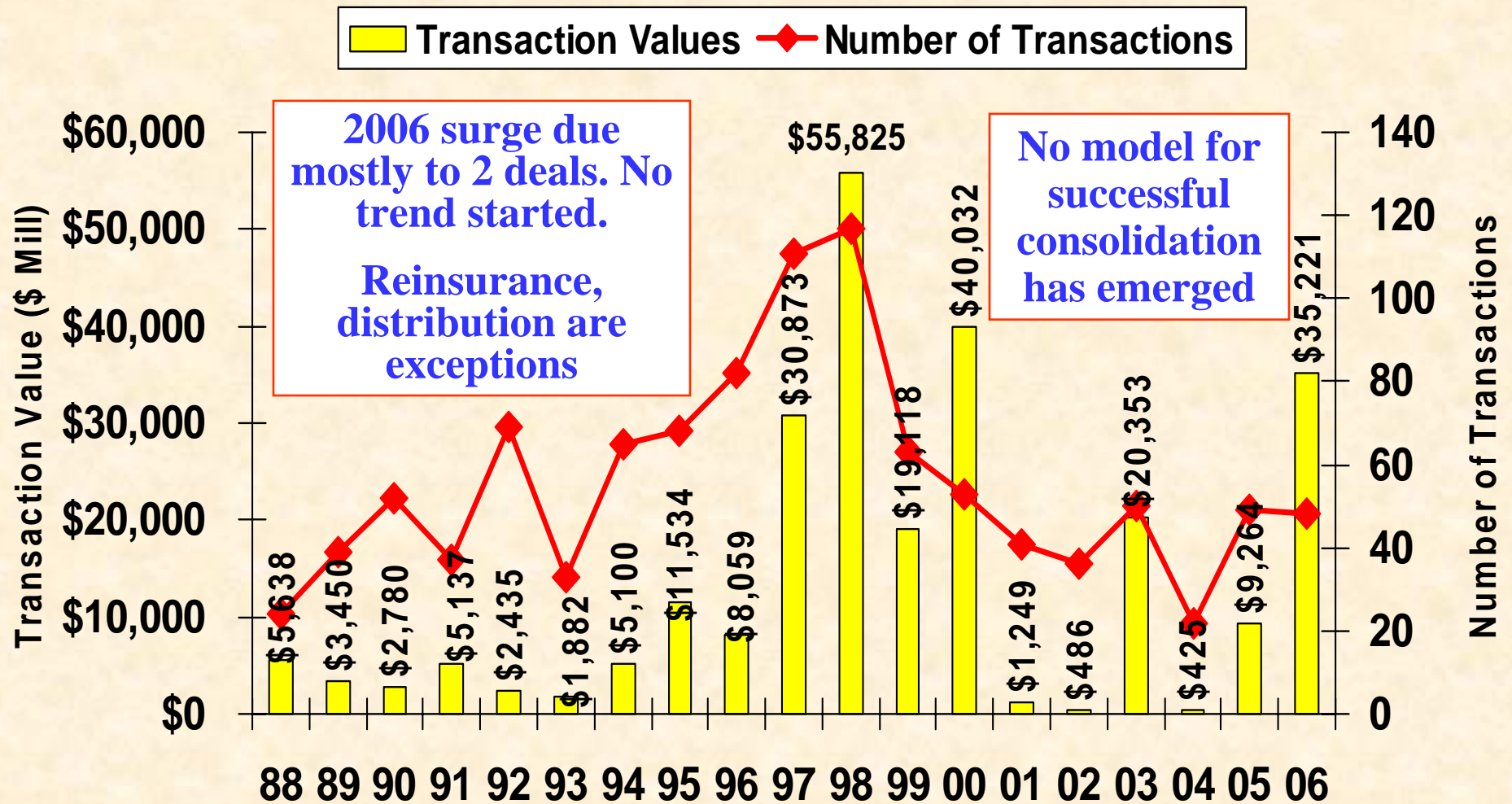
MERGER & ACQUISITION

**Few Catalysts for Major
P/C Consolidation in '08**



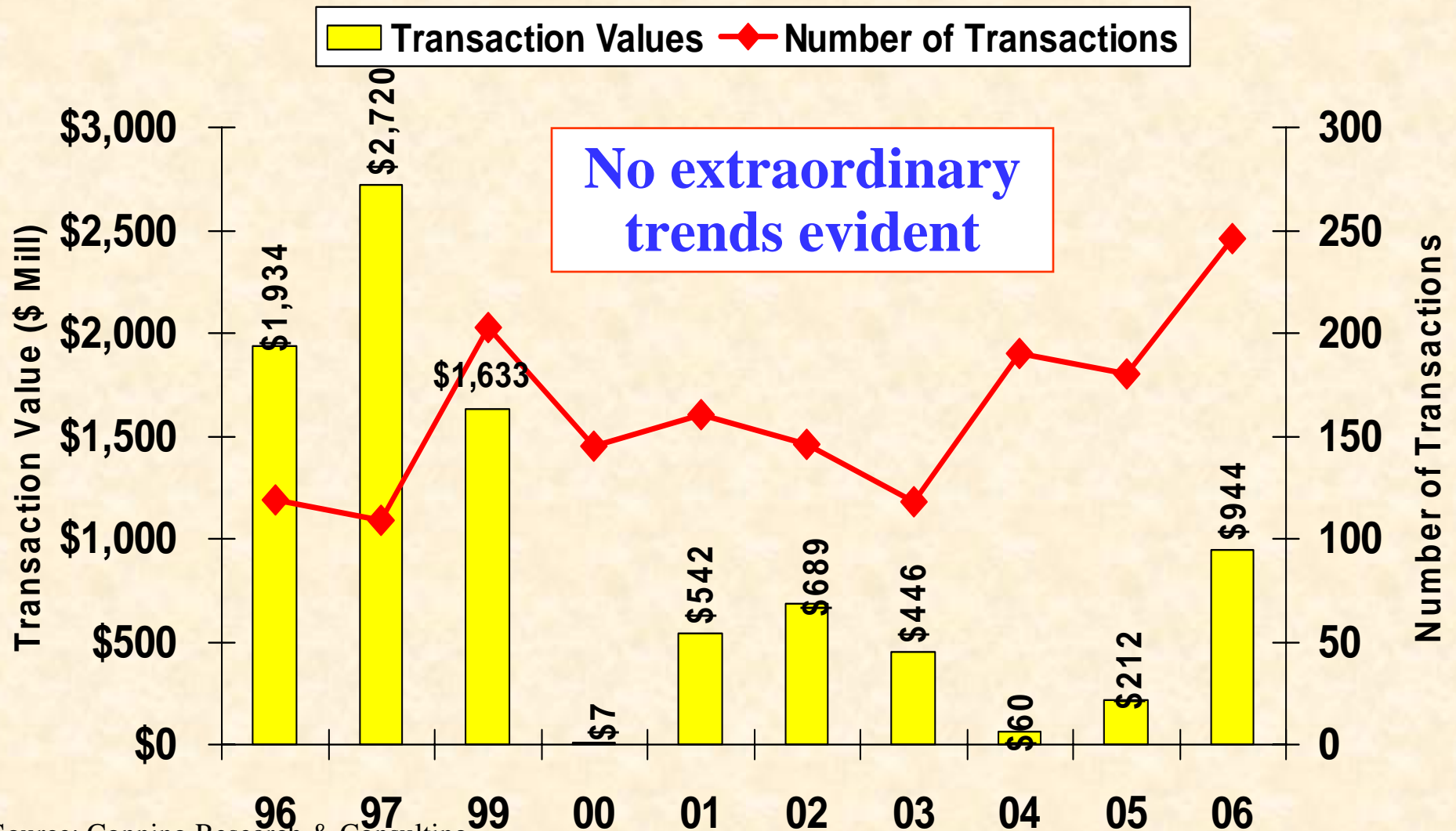


P/C Insurance-Related M&A Activity, 1988-2006





Distribution Sector: Insurance-Related M&A Activity, 1988-2006



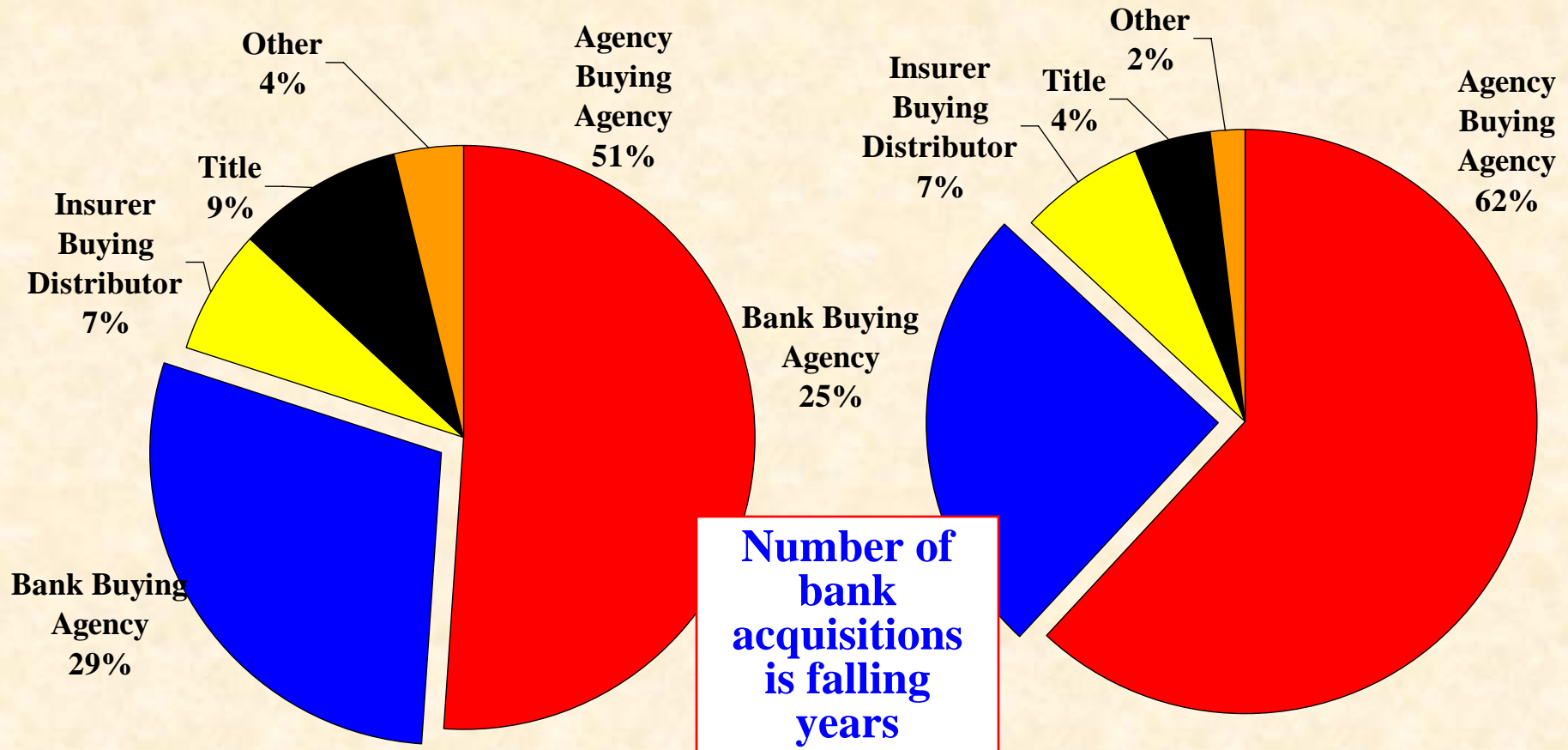
Source: Conning Research & Consulting.



Distribution Sector M&A Activity, 2005 vs. 2006

2005

2006



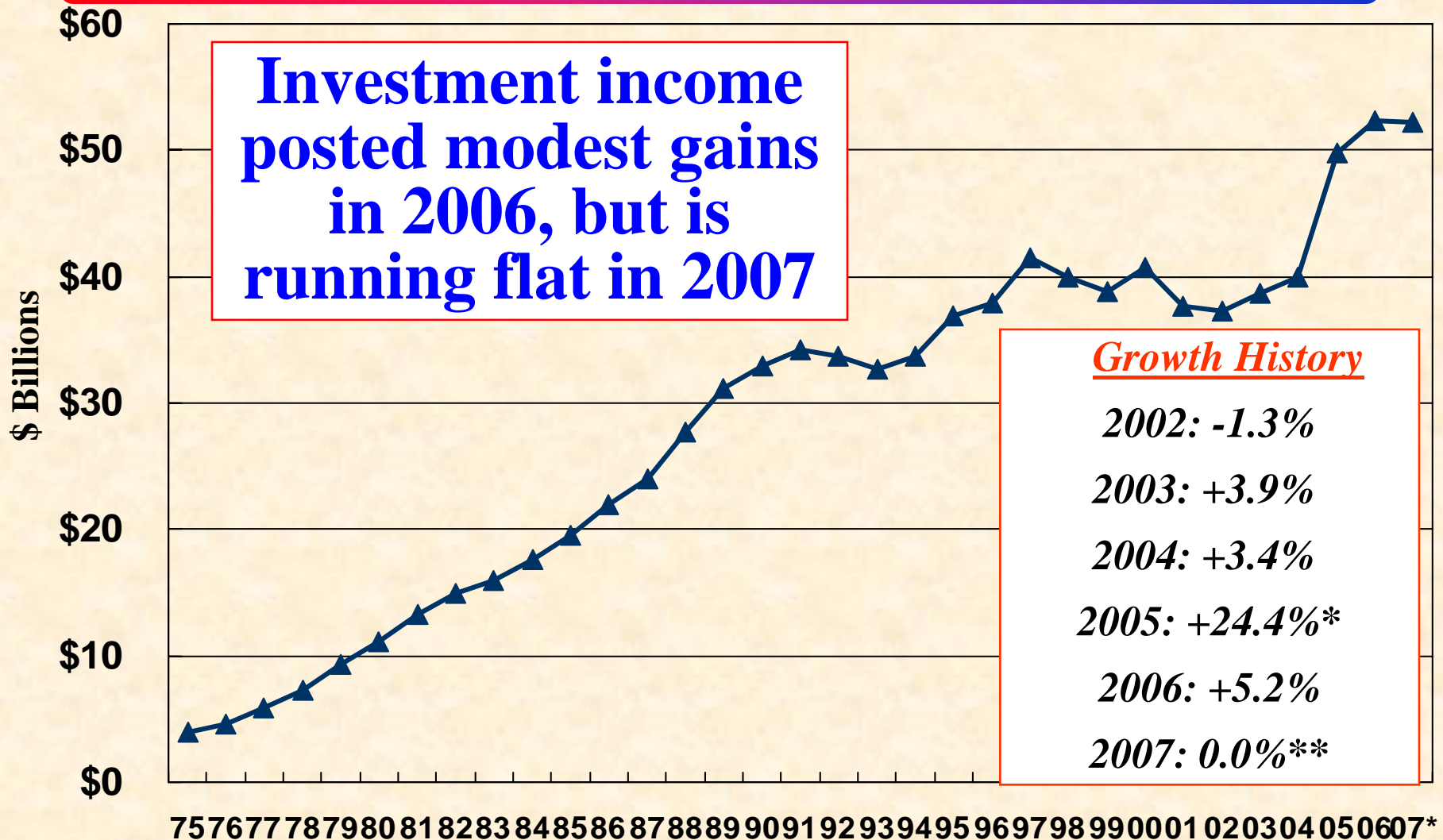
#7 FLAT & VOLATILE INVESTMENTS



*More Pain,
Little Gain*



Net Investment Income



Source: A.M. Best, ISO, Insurance Information Institute;

*Includes special dividend of \$3.2B. Increase is 15.7% excluding dividend. **Based on annualized H1 result of \$26.128B.



Total Returns for Large Company Stocks: 1970-2007*

S&P 500 was up 13.62% in 2006, Up 4.43% YTD 2007*

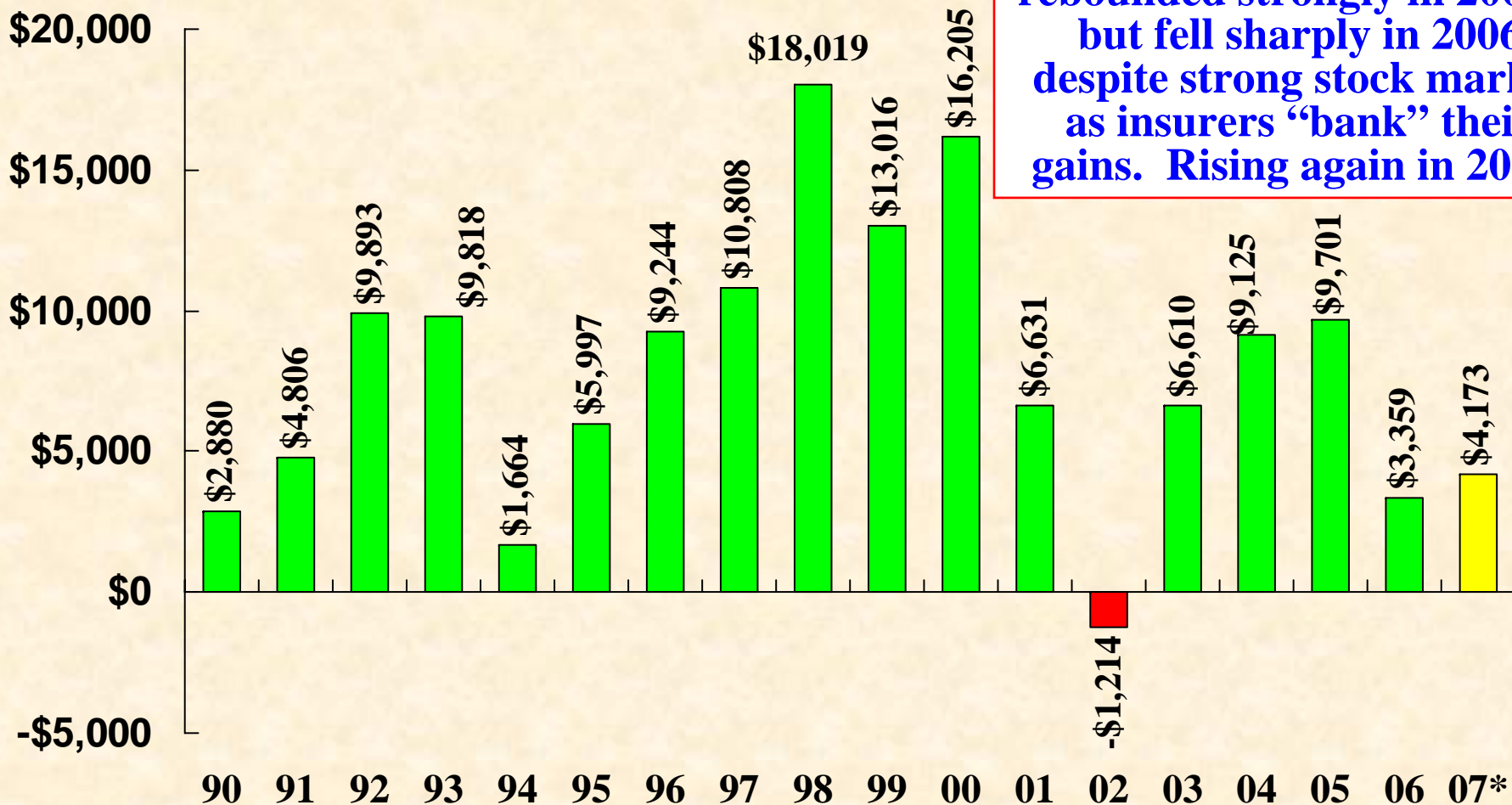


Source: Ibbotson Associates, Insurance Information Institute.

*Through November 30, 2007.



US P/C Net Realized Capital Gains, 1990-2007:H1 (\$ Millions)



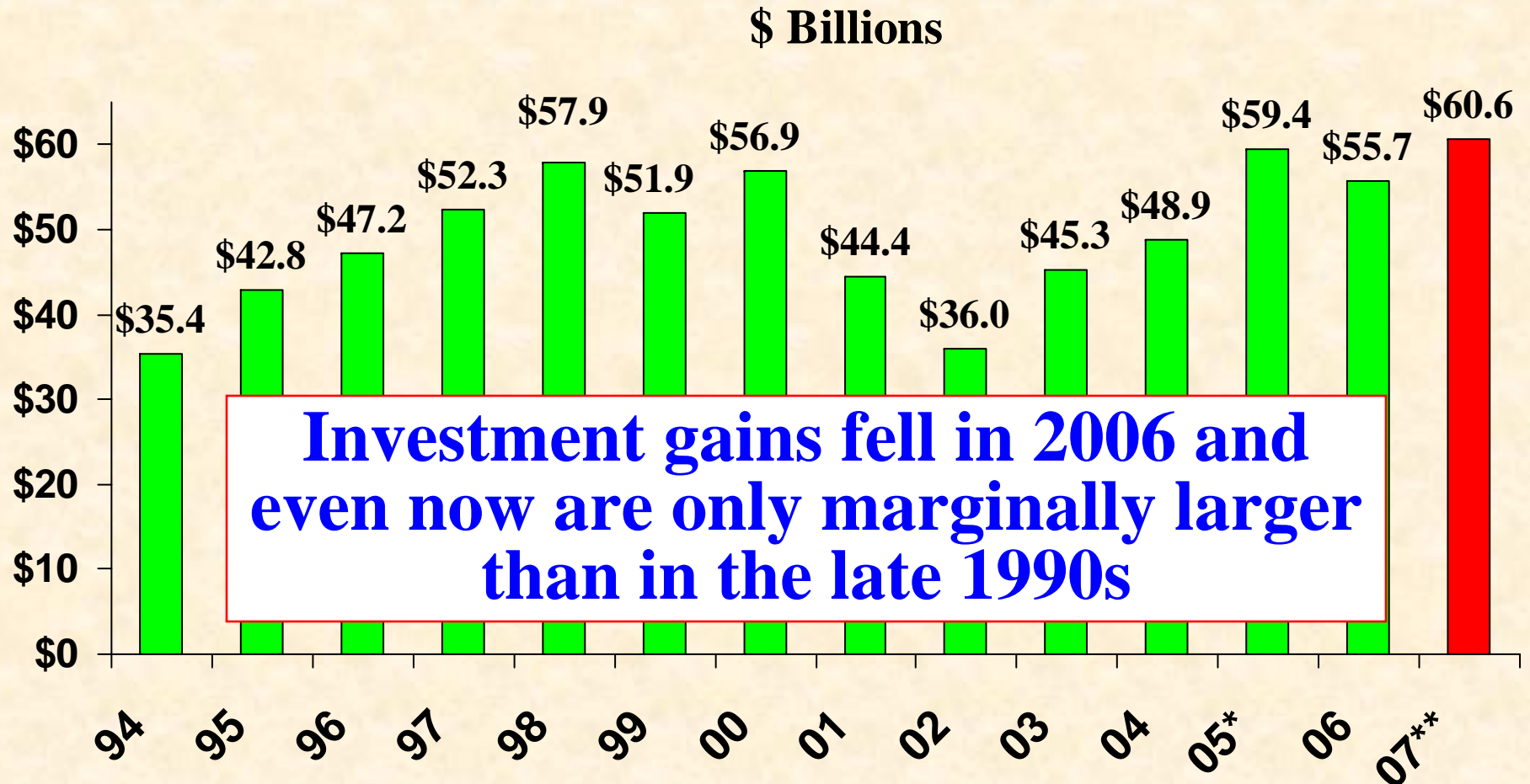
Realized capital gains rebounded strongly in 2004/5 but fell sharply in 2006 despite strong stock market as insurers “bank” their gains. Rising again in 2007.

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

*As of June 30, 2007.



Property/Casualty Insurance Industry Investment Gain¹



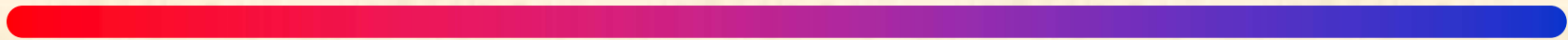
¹Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of \$52.3B net investment income and \$3.4B realized investment gain.

*2005 figure includes special one-time dividend of \$3.2B. **Annualized H1 result of \$30.301B.

Sources: ISO; Insurance Information Institute.

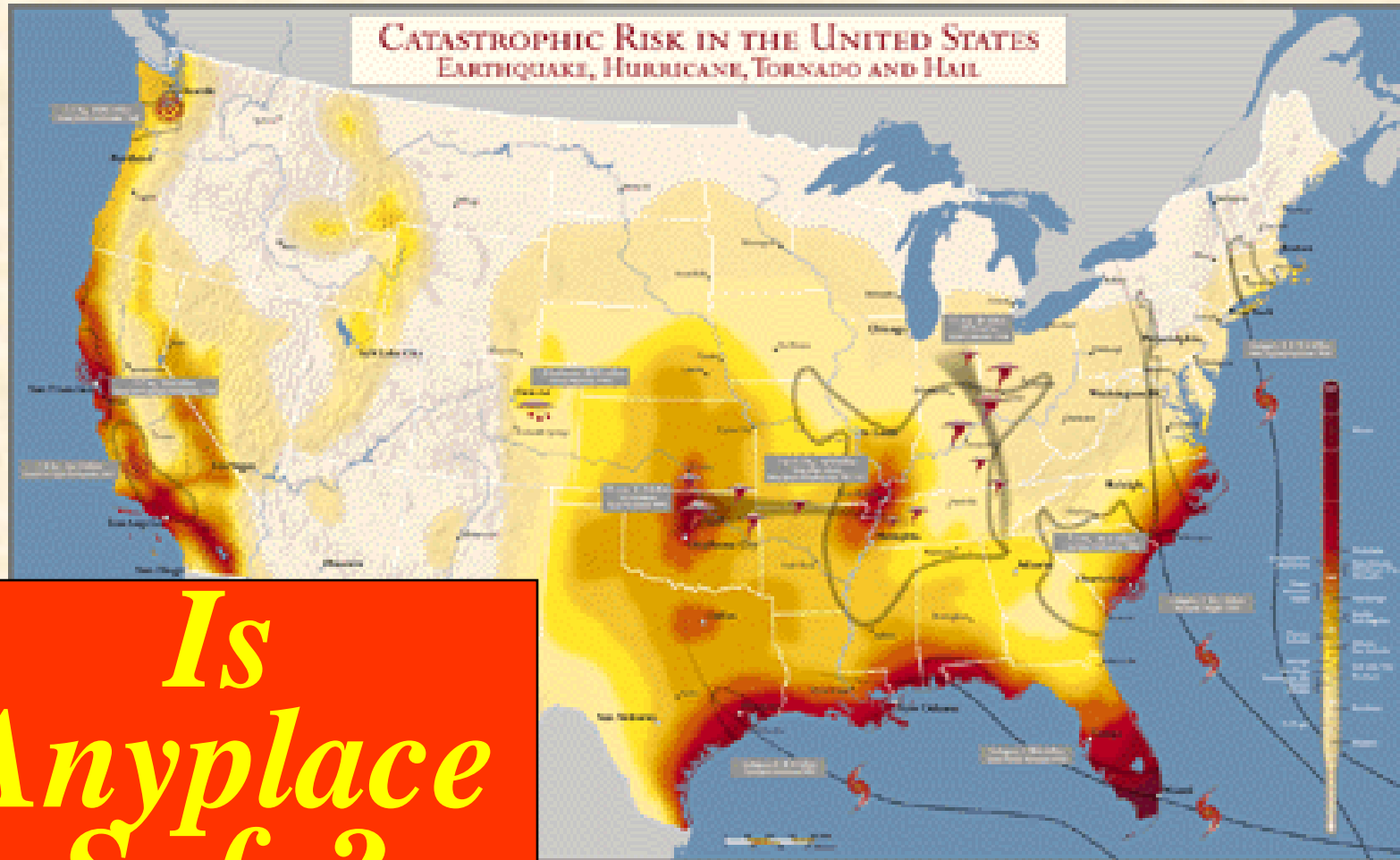
#8 CATASTROPHIC LOSS

 **What Will 2008 Bring?**





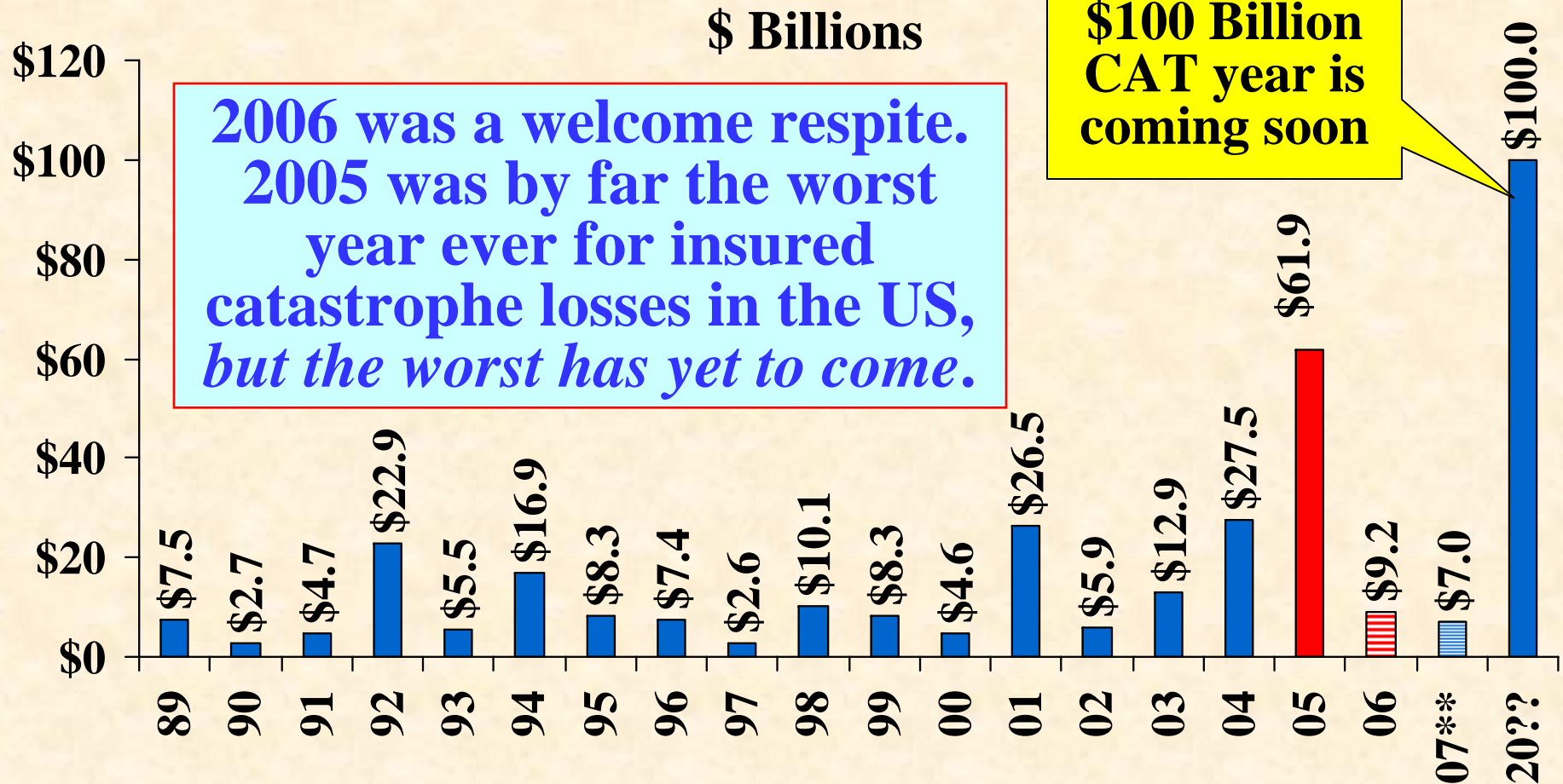
Most of US Population & Property Has Major CAT Exposure



*Is
Anyplace
Safe?*



U.S. Insured Catastrophe Losses*



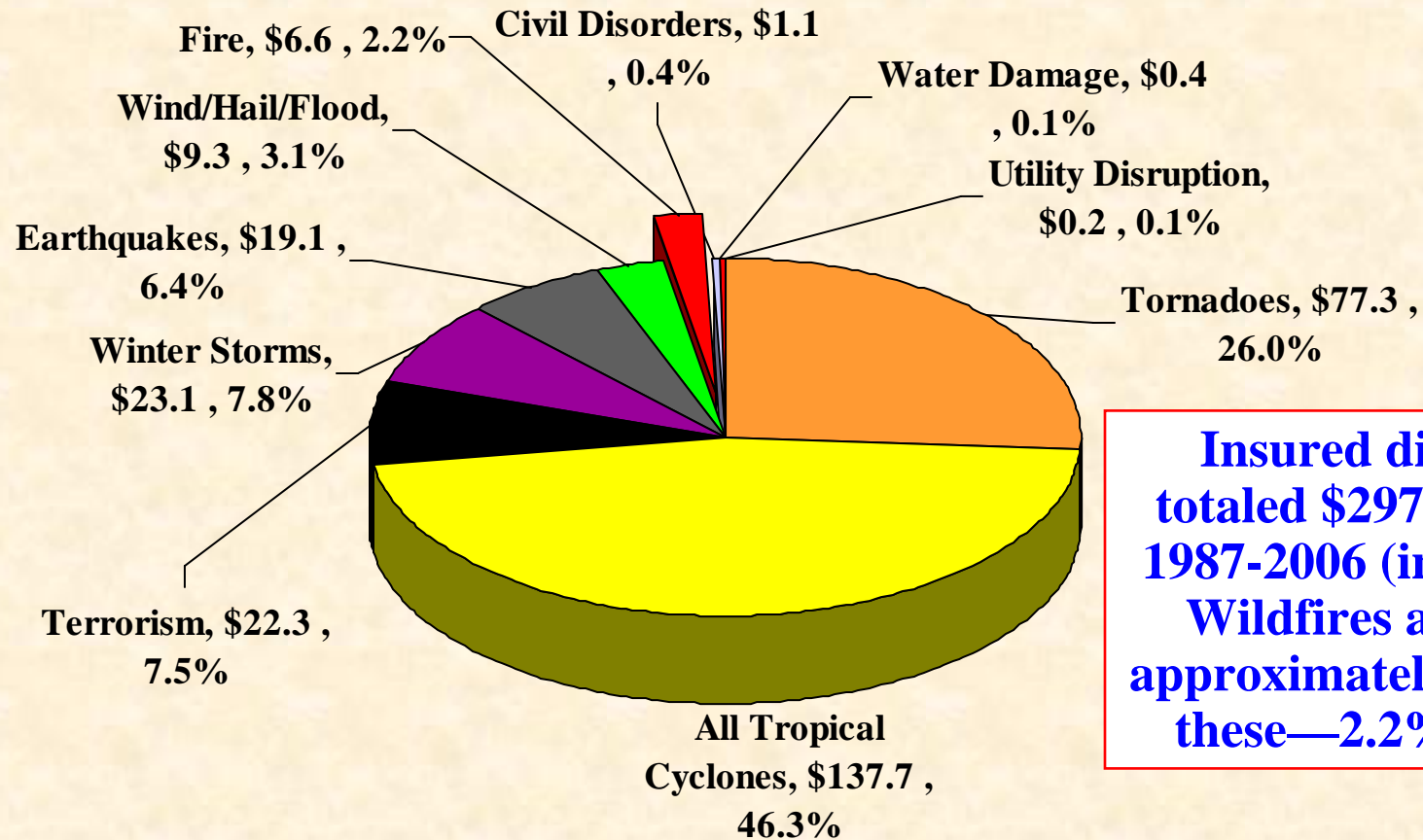
*Excludes \$4B-\$6b offshore energy losses from Hurricanes Katrina & Rita. **Estimate.

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.

Source: Property Claims Service/ISO; Insurance Information Institute



Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1987-2006¹



Insured disaster losses totaled \$297.3 billion from 1987-2006 (in 2006 dollars). Wildfires accounted for approximately \$6.6 billion of these—2.2% of the total.

¹ Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2006 dollars.

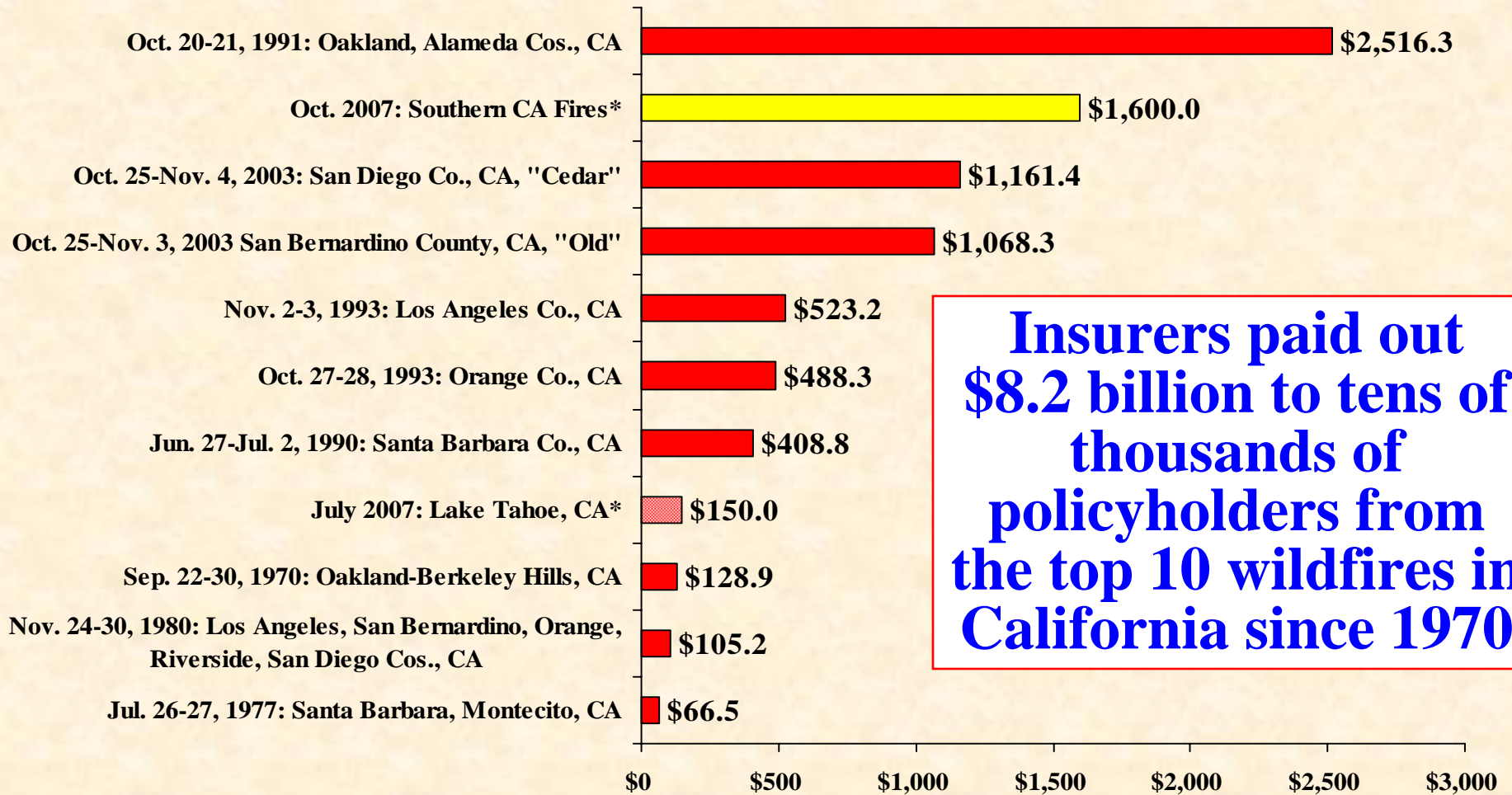
Catastrophe threshold changed from \$5 million to \$25 million beginning in 1997. Adjusted for inflation by the III.

² Excludes snow. ³ Includes hurricanes and tropical storms. ⁴ Includes other geologic events such as volcanic eruptions and other earth movement. ⁵ Does not include flood damage covered by the federally administered National Flood Insurance Program. ⁶ Includes wildland fires.



Top Ten Catastrophic Wildland Fires In California, 1970-2007*

Insured Losses (Millions 2006 \$)



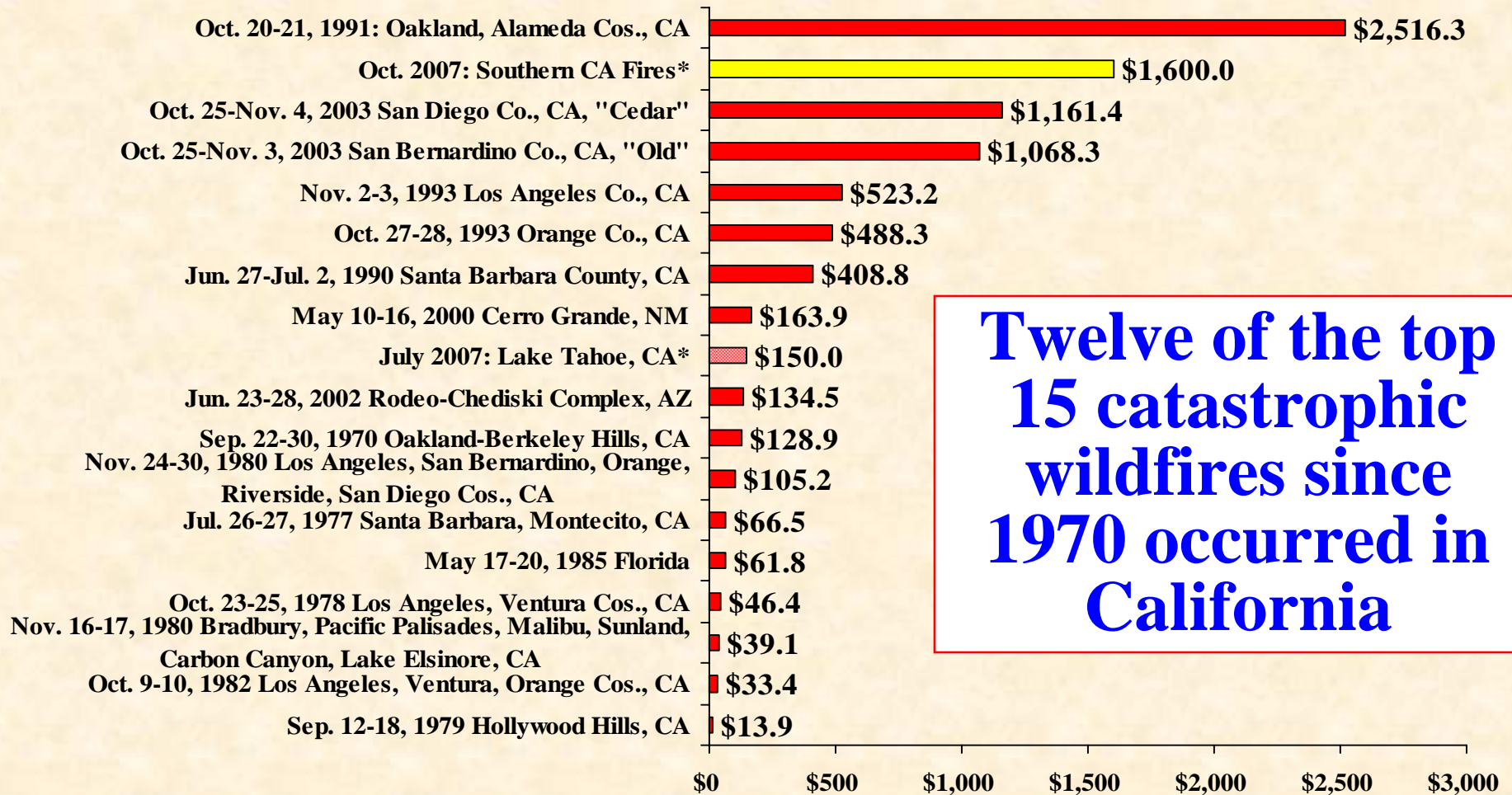
**Insurers paid out
\$8.2 billion to tens of
thousands of
policyholders from
the top 10 wildfires in
California since 1970**

*Estimated insured losses. Adjusted to 2006 dollars by the Insurance Information Institute. 2007 fire losses are stated in 2007 dollars.
Source: ISO's Property Claim Services Unit; Insurance Information Institute.



Top Catastrophic Wildland Fires In The United States, 1970-2007*

Insured Losses (Millions 2006 \$)

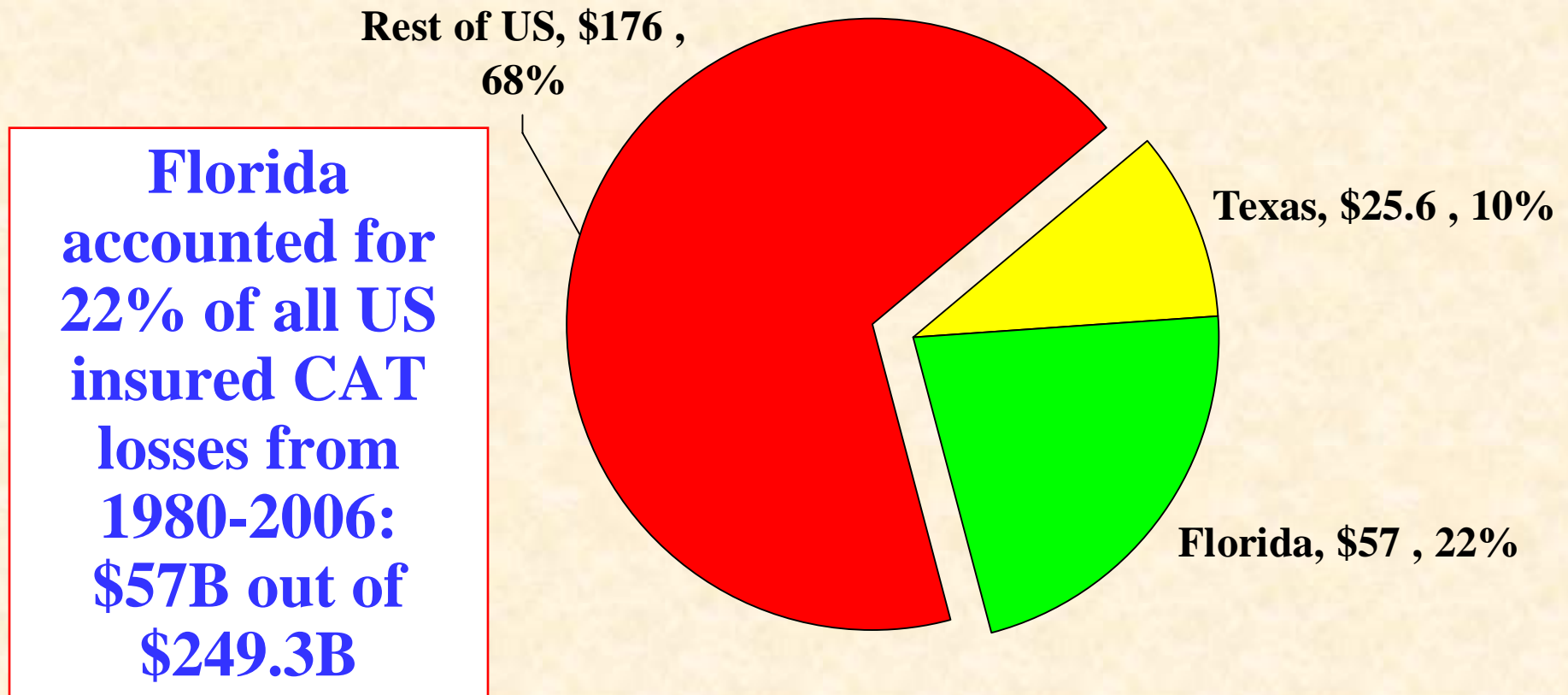


**Twelve of the top
15 catastrophic
wildfires since
1970 occurred in
California**

*Estimated insured losses. Adjusted to 2006 dollars by the Insurance Information Institute. 2007 fire losses are stated in 2007 dollars.
Source: ISO's Property Claim Services Unit; Insurance Information Institute.

*Distribution of US Insured CAT Losses: TX, FL vs US, 1980-2006**

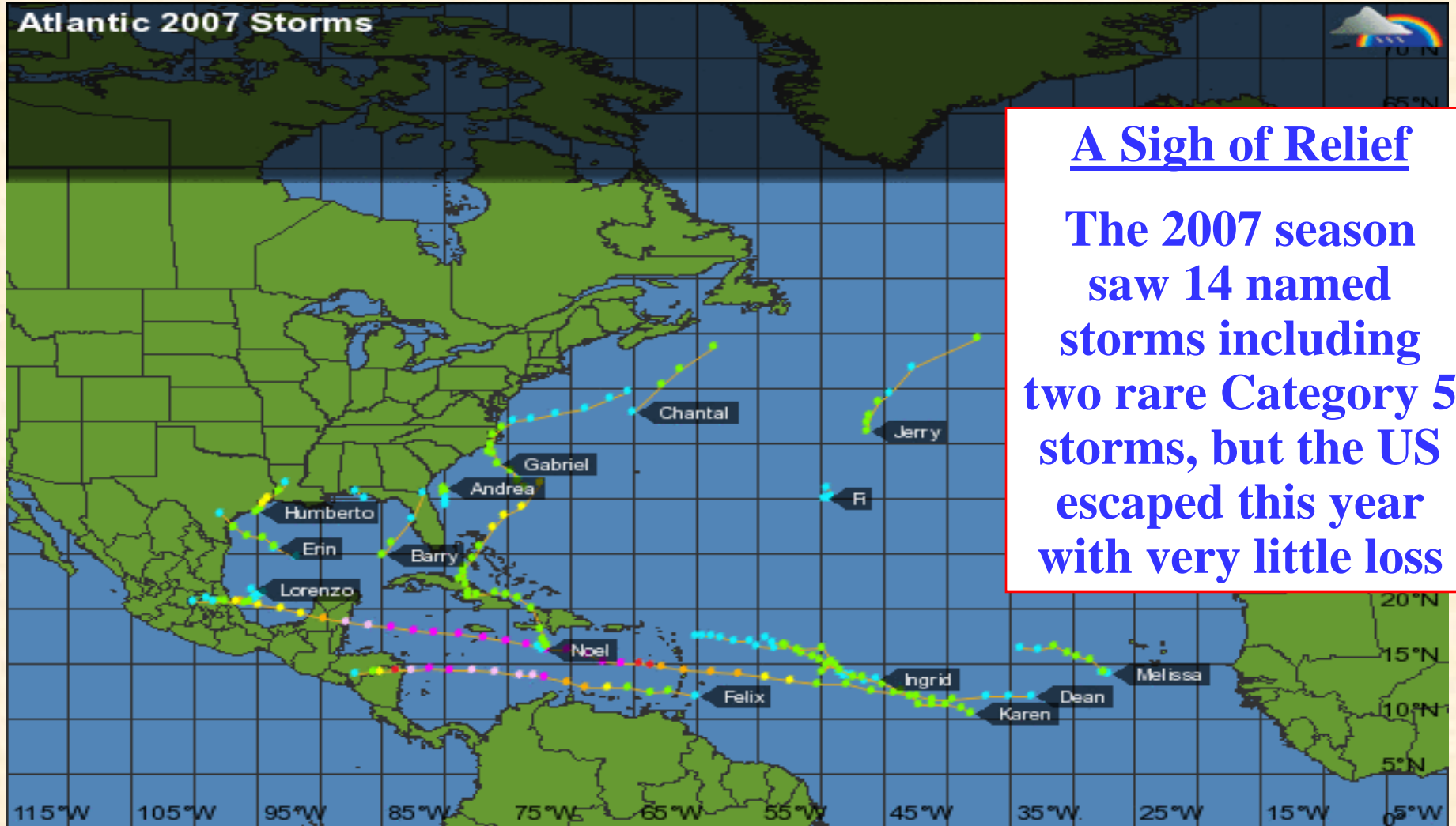
\$ Billions of 2005 Dollars



*All figures (except 2006 loss) have been adjusted to 2005 dollars.
Source: PCS division of ISO.



2007 Hurricane Season: No Big Hits...So Far

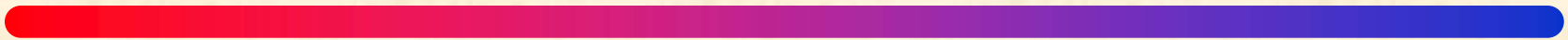


A Sigh of Relief

The 2007 season saw 14 named storms including two rare Category 5 storms, but the US escaped this year with very little loss

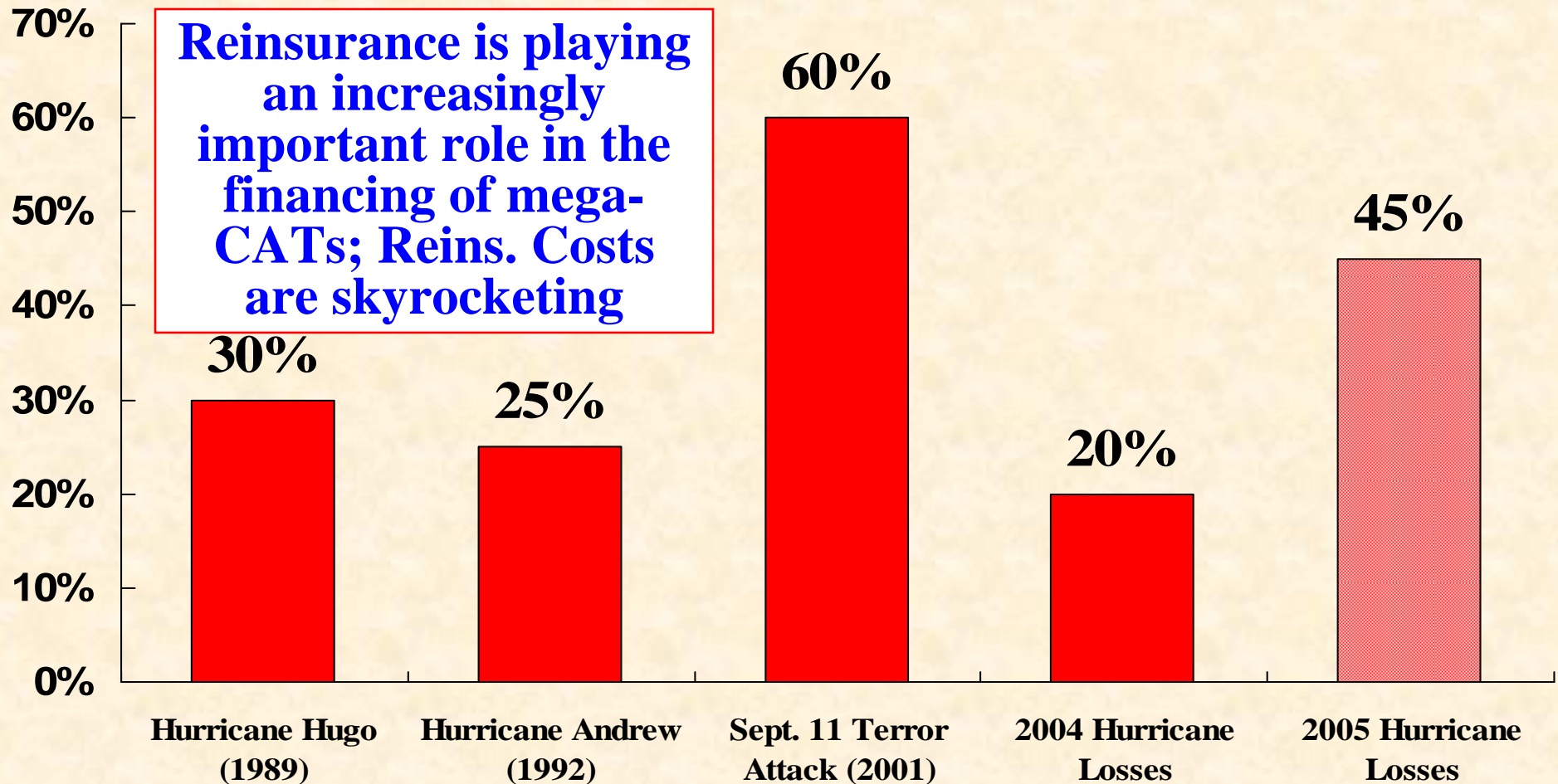
REINSURANCE MARKETS

*Reinsurance Prices are
Stabilizing; Falling in Some
Areas*





Share of Losses Paid by Reinsurers, by Disaster*



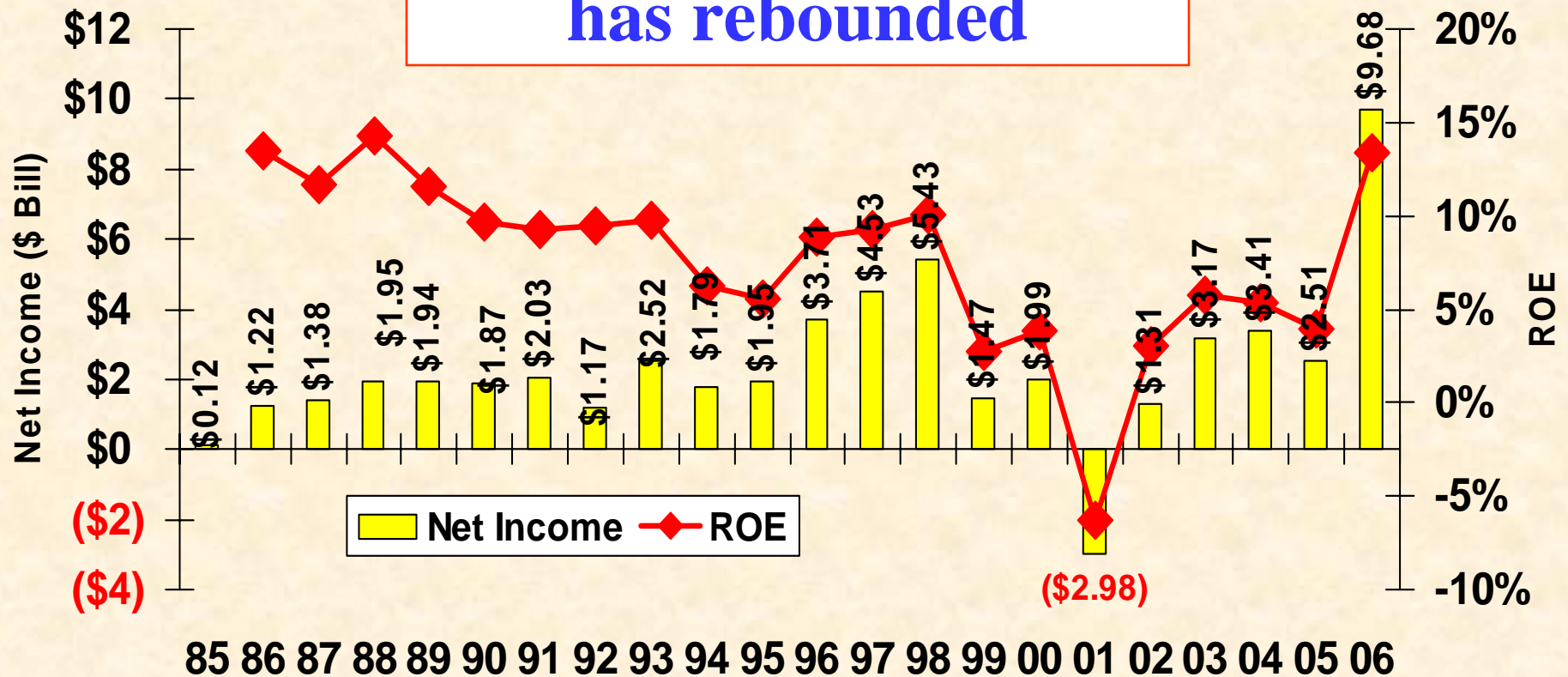
*Excludes losses paid by the Florida Hurricane Catastrophe Fund, a FL-only windstorm reinsurer, which was established in 1994 *after* Hurricane Andrew. FHCF payments to insurers are estimated at \$3.85 billion for 2004 and \$4.5 billion for 2005.

Sources: Wharton Risk Center, Disaster Insurance Project; Insurance Information Institute.



US Reinsurer Net Income & ROE, 1985-2006

Reinsurer profitability
has rebounded



#9

Shifting Legal Liability & Tort Environment

 *Is the Pendulum Swinging
Against Insurers?*

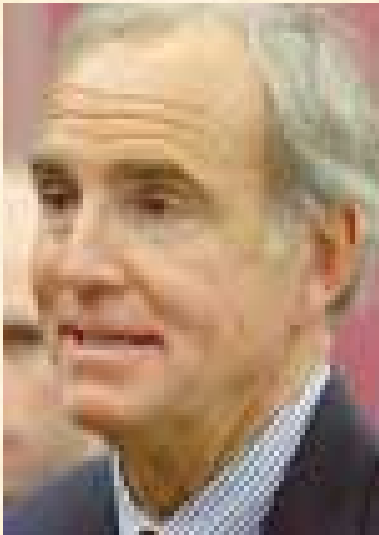


*Bad Year for Tort Kingpins**



“King of Class Actions” Bill Lerach

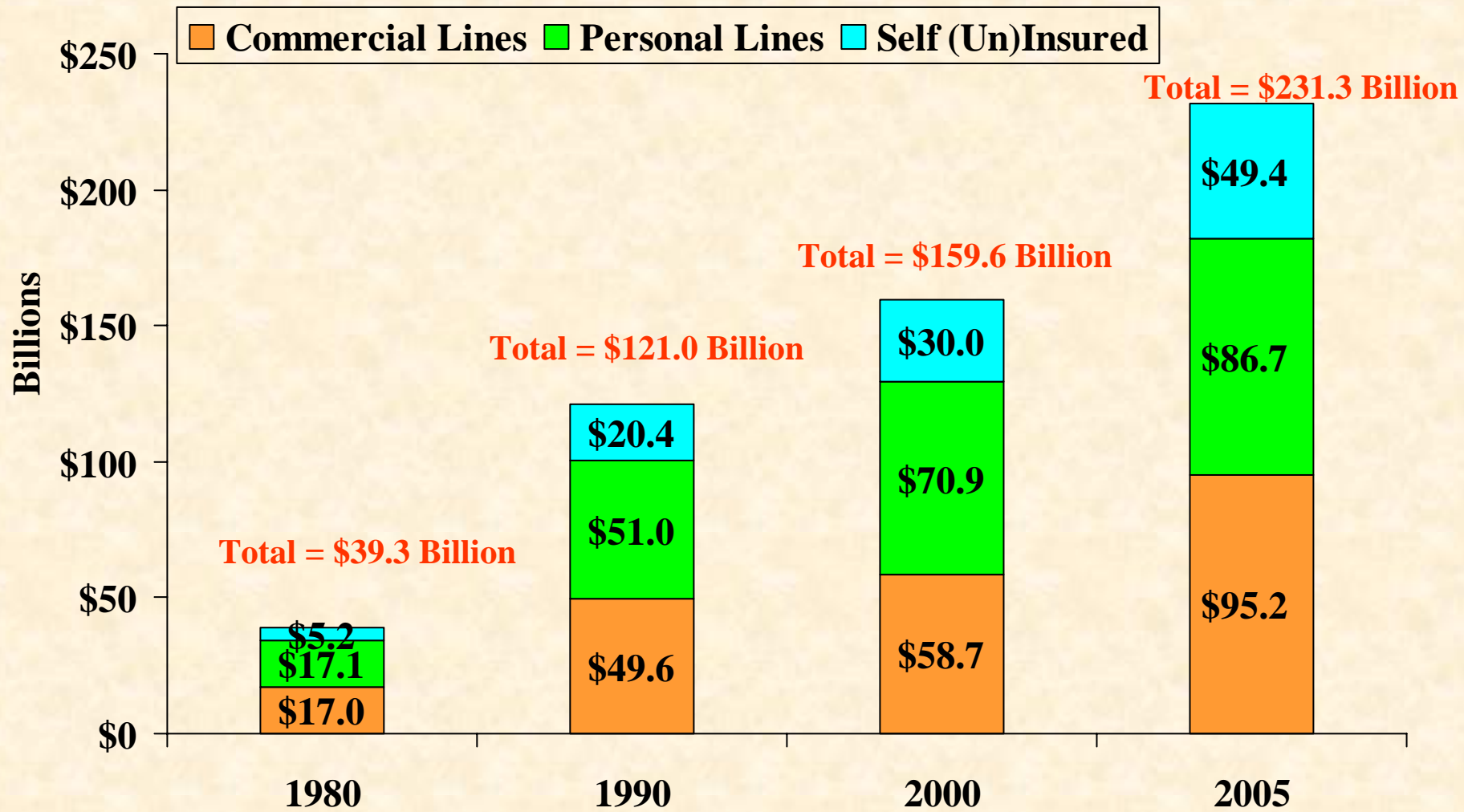
- Former partner in class action firm Milberg Weiss
- Admitted felon. Guilty of paying 3 plaintiffs \$11.4 million in 150+ cases over 25 years & lying about it repeatedly to courts
- Will serves 1-2 years in prison and forfeit \$7.75 million; \$250,000 fine



“King of Torts” Dickie Scruggs

- Won billions in tobacco, asbestos and Katrina litigation
- Indicted for attempting to offer a judge \$50,000 bribe to resolve attorney fee allocation from Katrina litigation in his firm’s favor. His son and others indicted too.
- Could get 75 years in prison, \$1.5 million fine

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

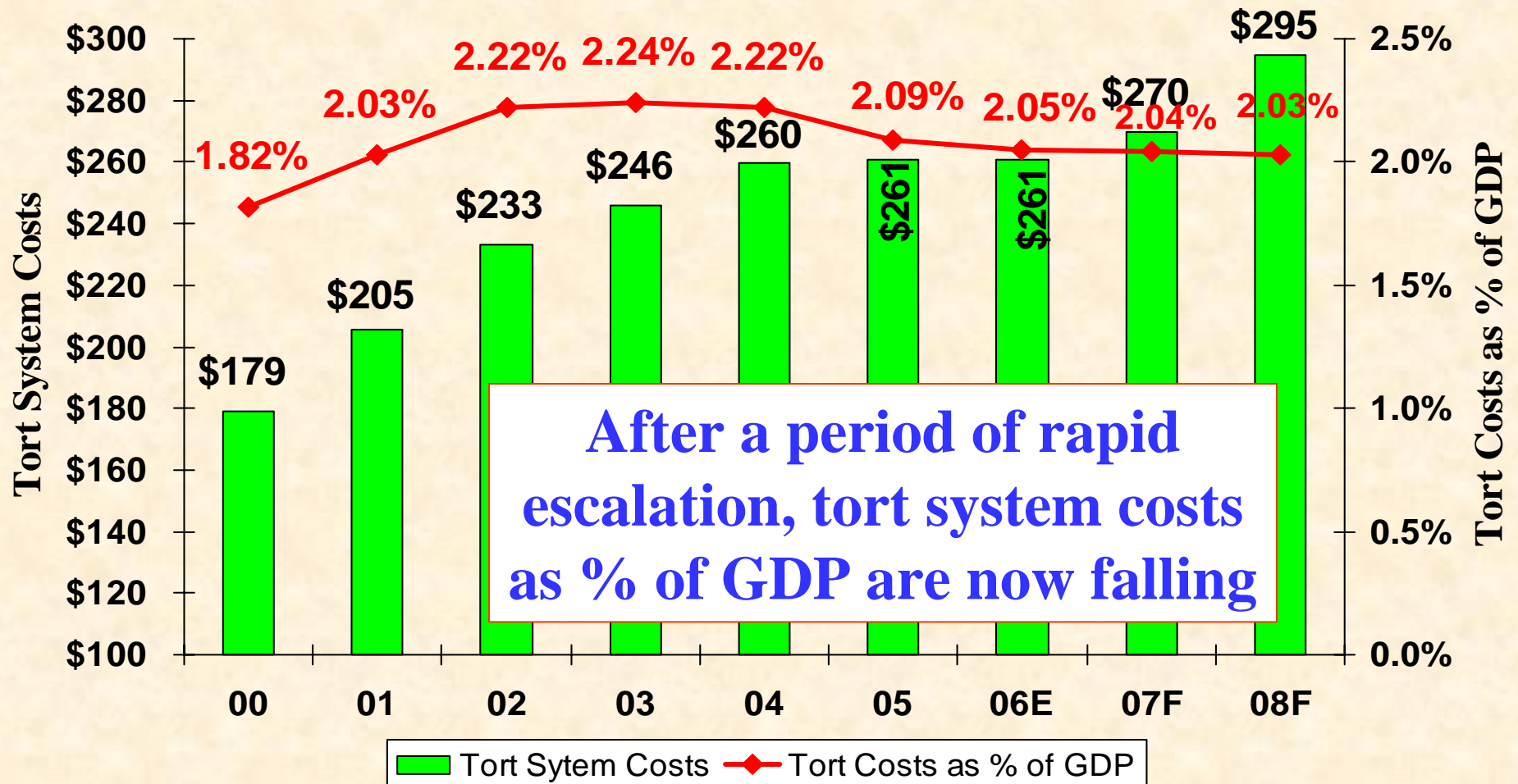


*Excludes medical malpractice

Source: Tillinghast-Towers Perrin, 2006 Update on US Tort Cost Trends.



Tort System Costs, 2000-2008F



Source: Tillinghast-Towers Perrin, 2006 Update on US Tort Cost Trends; 2006 is III estimate.



Business Leaders Ranking of Liability Systems for 2007

Best States

1. Delaware
2. Minnesota
3. Nebraska
4. Iowa
5. Maine
6. New Hampshire
7. Tennessee
8. Indiana
9. Utah
10. Wisconsin

New in 2007

*ME, NH, TN,
UT, WI*

Drop-Offs

*ND, VA, SD,
WY, ID*

*Midwest/West
has mix of good
and bad states*

Worst States

41. Arkansas
42. Hawaii
43. Alaska
44. Texas
45. California
46. Illinois
47. Alabama
48. Louisiana
49. Mississippi
50. West Virginia

Newly Notorious

AK

Rising Above

FL



The Nation's Judicial Hellholes (2006)

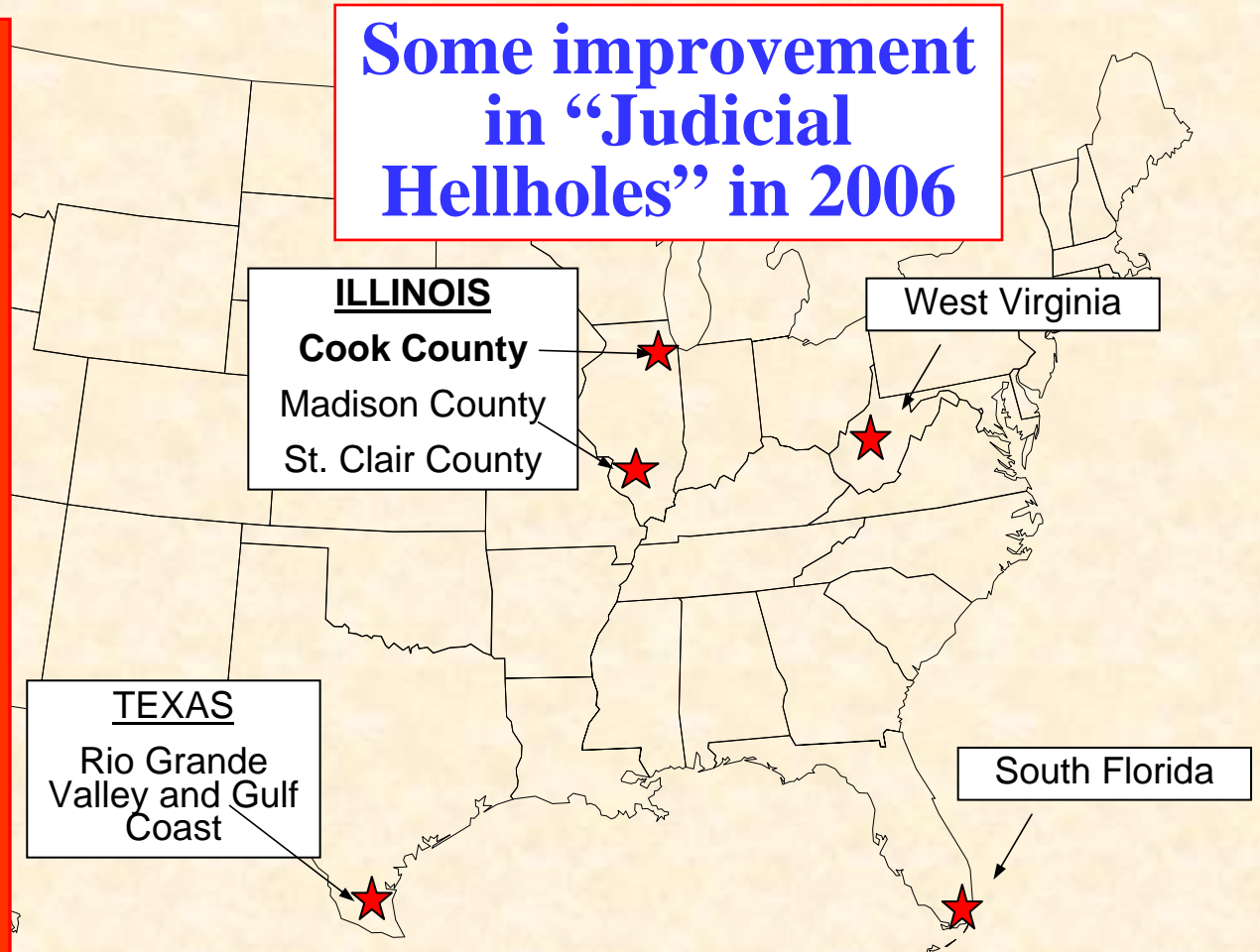
Watch List

Miller County, AR
Los Angeles County, CA
San Francisco, CA
Philadelphia, PA
Orleans Parish, LA
Delaware

Dishonorable Mentions

Providence, RI
MA Supreme Court
LA Supreme Court
New Jersey
NE Supreme Court
California

**Some improvement
in “Judicial
Hellholes” in 2006**





Catastrophe Litigation

- **Insurers have won virtually every major case in post-Katrina litigation environment**
 - **Most cases centered on validity of flood exclusion and various wind vs. water theories**
- **This came at a high PR cost as post-Katrina litigation was dragged out over a 2-year period accounting for the vast majority of negative press in the first 16 months after the storm**
 - **FL significantly added to negative press in 2007**
- **While the industry was successful at explaining the rationale for pursuing most cases, it struggled with the classic David vs. Goliath story**
- **Championed by personally affected politicians**
- **Feeds “Insurance Hoax” genre of stories**
 - **View that insurers systematically deny, delay and lowball**
 - **Bad Faith litigation is wave of future (e.g., LA AG suit)**



Preventing/Limiting Erosion of Recent Tort Reform

- **Tort Pendulum Likely to Swing Against Insurers as Political Environment Changes (WA referendum, FL No-Fault?)**
- **Insurers Must Remain Active Members of Tort Reform Coalitions at State and Federal Level**
 - May have more success at the state level
- **Pursuing Good Cases Can Set Precedent & Bring About Quantum Shifts in Judicial Philosophy**
 - *Campbell v. State Farm* (limited punitives)
 - *Safeco v. Burr*, *Geico v. Edo* (FCRA reporting violations)
 - **Asbestos: Class actions limited; no pre-pack bankruptcies**
 - **Products Liability: Merck's successful Vioxx defense**
- **Educate Policyholders About Link Between Tort Environment and Cost/Availability of Insurance**
 - **Businesses understand; Need facts to support local efforts**
 - **Personal lines customers understand relationship, agents do**
- **Tighten Contract Language**
 - **From 9/11 to Katrina, alleged "ambiguities" cost big bucks**

#10 REGULATORY/ LEGISLATIVE ZEALOTRY

iii Scrutiny is Mounting

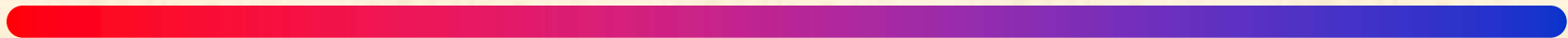


Legal, Legislative & Regulatory Threats are Multiplying (cont'd)

- **Attacks on Underwriting**: Perennial issue, with challenges to even long-established underwriting criteria popping up; Will be a bigger problem with evolution of Predictive Modeling
 - **Credit-Based Insurance Scores**: Remain the largest issue & became the subject of a US House O&I hearing Oct. 2
 - **Education/Occupation Attacked** (e.g., FL)
 - **CAT Models**: Black box allegation, short vs. long-term model
 - **Any type of individual risk rating factor is subject to allegations of discrimination**
- **Allegations of Collusion via Ratings Agencies, Trades & Modelers**: Novel theory espoused by Gov. Crist and OIR in FL that insurers collude indirectly via ratings agencies, trade associations and modeling firms
 - **Some insurers subpoenaed for documents**
 - **Some discussion at recent NAIC meeting**
- **Proliferation of Insurance Regulators**: Insurance Commissioner's influence and power is waning in many states. There are 632 insurance regulators in the US (50 Commissioners, 50 AGs, 50 Governors, 50 Senators and 432 US)
 - **Attorneys General**: Spitzer (and copycats) did serious damage to commissioner authority; Followed by AG Hood in MS; Foti in LA.
 - **Congress is exerting itself over a wide range of issues**
 - **Governors like Crist not shy on insurance matters** Source: Insurance Information Institute.

REGULATORY UPDATE

*Busy Year for Insurers
in Washington*





Federal Legislative Update

Federal Terrorism Reinsurance (TRIA)

- **TRIA expires 12/31/07. The current federal program offers \$100 billion of coverage subject to a \$27.5B industry aggregate retention.**
- **Under S. 2761: “Terrorism Risk Insurance Program Reauthorization Act of 2007”**
 - **7-Yr. Extension, expiring 12/31/14**
 - **Maintains 20% Direct Earned Premium Deductible for duration of Extension (about \$35B)**
 - **NBCR risks remain excluded (in contrast to House bill)**
 - **Eliminates distinction between foreign and domestic acts of terrorism**
 - **Deletes requirement that terrorist act be on behalf of foreign person or foreign interest**
 - ***Changes in definition of terrorist act require substantial rate and form filings in states***
 - **Federal government’s cap remains at \$100 billion through 2014**
 - **Requires Comptroller General to issue report within 1 year on feasibility of NBCR insurance market; CG must also issue report within 180 days on obstacles in development of private sector market for terror insurance**
- **Administration has said it will not oppose Senate bill (issued veto threat for House)**



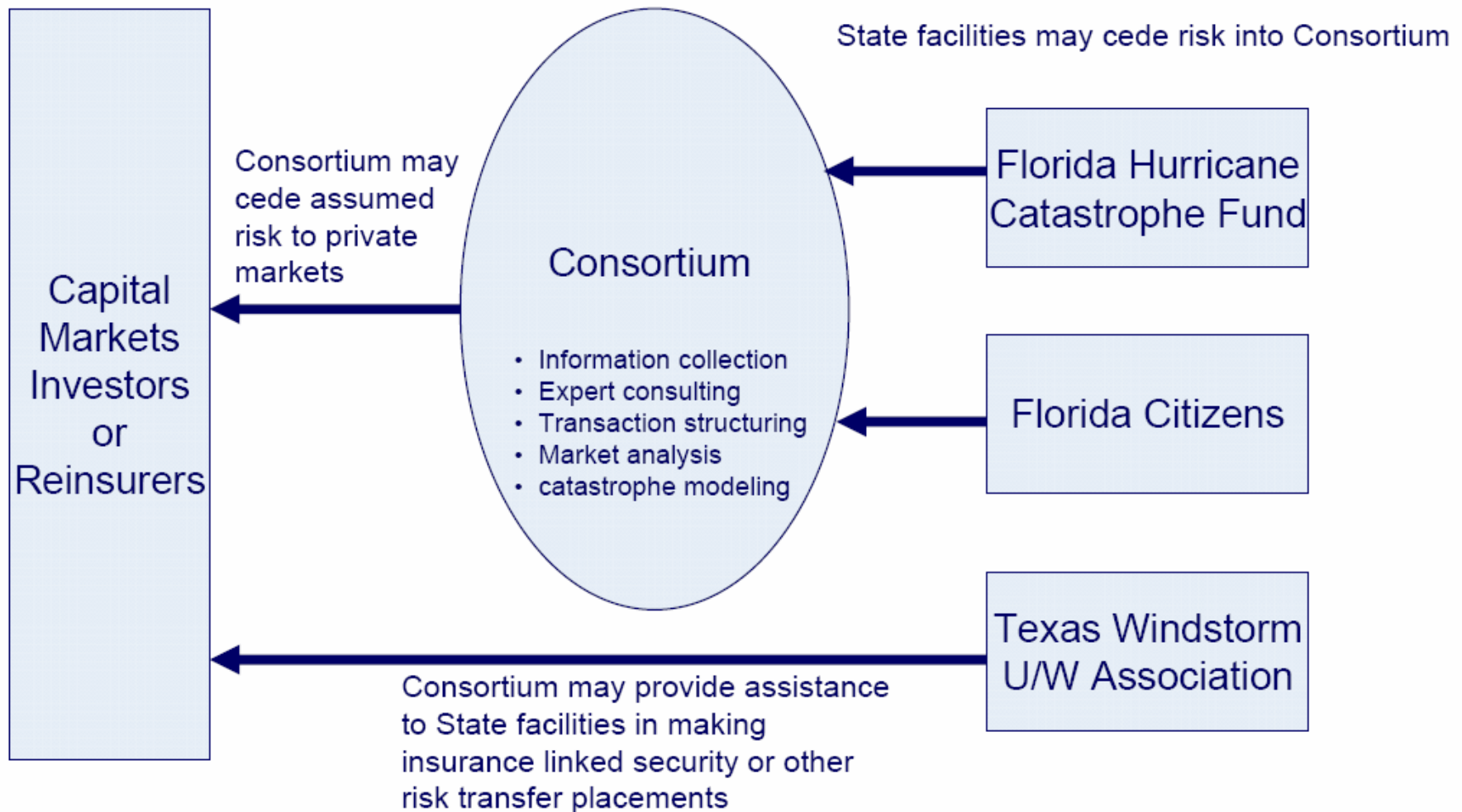
Federal Legislative Update

Natural Disaster Coverage

- **Some insurers are pushing for federal catastrophic risk fund coverage in the wake of billions of dollars of losses suffered by insurers from the 2004-2005 hurricane seasons.**
- **Legislative relief addressing property/casualty insurers' exposure to natural catastrophes, such as the creation of state and federal catastrophe funds, has been advocated by insurers include Allstate and State Farm recently. However, there is active opposition many other insurers and all reinsurers.**
- **There are supporters in Congress, mostly from CAT-prone states. Skeptics in Congress believe such a plan would be a burden on taxpayers like the NFIP and that the private sector can do a better job. Unlike TRIA, the industry is not unified on this issue.**
- **Allowing insurers to establish tax free reserves for future catastrophe losses has also been proposed, but Congress has not yet indicated much support.**



How the Homeowners Defense Act of 2007 Would Operate





Homeowners Defense Act of 2007: How it Works & Rationale

The Act has Three Main Components:

- 1. Establishment of Consortium to encourage state facilities to cede risk into the private markets, particularly the catastrophe bond markets**
- 2. Creation of a Federal loan program to provide pre-event liquidity and post-event long term financing for state residual markets and catastrophe funds**
- 3. Creation of a Federal catastrophe fund to back-stop state catastrophe funds**



Homeowners Defense Act of 2007: How it Works & Rationale

- **With the back-drop of frequently poor financial conditions within State property residual markets in certain states, the objectives of the Bill appear to be:**
 - 1. Transfer of catastrophic risk from under-capitalized state facilities into the global reinsurance network and capital markets**
 - 2. Ensuring the ability of these State facilities to make good on their commitments in the weeks after a storm and to spread over-time the potentially massive state taxpayer burden caused by under-capitalization and unsound pricing**
 - 3. Transfer high layer cat risk to the Federal taxpayer**



Homeowners Defense Act of 2007: How it Works & Rationale

The Main Questions Appear to be Whether:

- 1. The Bill would lead to the structural changes necessary to bring these facilities into financial health over time or simply enable further fiscal deterioration**
- 2. The State facilities could be otherwise motivated to purchase reinsurance and explore capital market solutions without the need for Federal involvement**
- 3. Adequate private capital can be mustered to meet the borrowing needs of the State catastrophe funds and residual markets**



Federal Legislative Update

Optional Federal Charter (OFC)

- **Large P&C and life insurers are the major supporters of OFC. Supporters argue that the current patchwork of 50 state regulators reduces competition, redundant, slows new product introductions and adds cost to the system.**
- **In general, global P/C insurers , reinsurers and large brokers mostly support the concept, while regulators (state insurance commissioners), small single-state and regional insurers, and independent agency groups largely oppose the idea. An optional federal charter is more favorable for global P&C insurers, because an insurer that operates in multiple states could opt to be regulated under federal rules rather than multiple state regulations. As a result, this could increase innovation in the industry.**
- **Currently appears to be more momentum for OFC for life than for P&C insurers based on the homogeneous nature of many life products. The debate should intensify and although passage may not occur in the current session of Congress, it may lay the groundwork for passage in the 2009-2010 session.**



Summary

- Results were *unsustainably* good 2006; Overall profitability reached its highest level (est. 14%) since 1988
 - Strong first half in 2007 but ROEs slipping
- Underwriting results were aided by lack of CATs & favorable underlying loss trends, including tort system improvements
- Property cat reinsurance markets past peak & more competitive
- Premium growth rates are slowing to their levels since the late 1990s; Commercial leads decreases.
- Rising investment returns insufficient to support deep soft market in terms of price, terms & conditions
- Clear need to remain underwriting focused
- How/where to deploy/redeploy capital??
- Major Challenges:
 - Slow Growth Environment Ahead
 - Maintaining price/underwriting discipline
 - Managing variability/volatility of results
 - Managing regulatory/legislative activism



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