



The State of the P/C Insurance Industry

2010 PAAS Annual Forum
Savannah, GA
June 9, 2010

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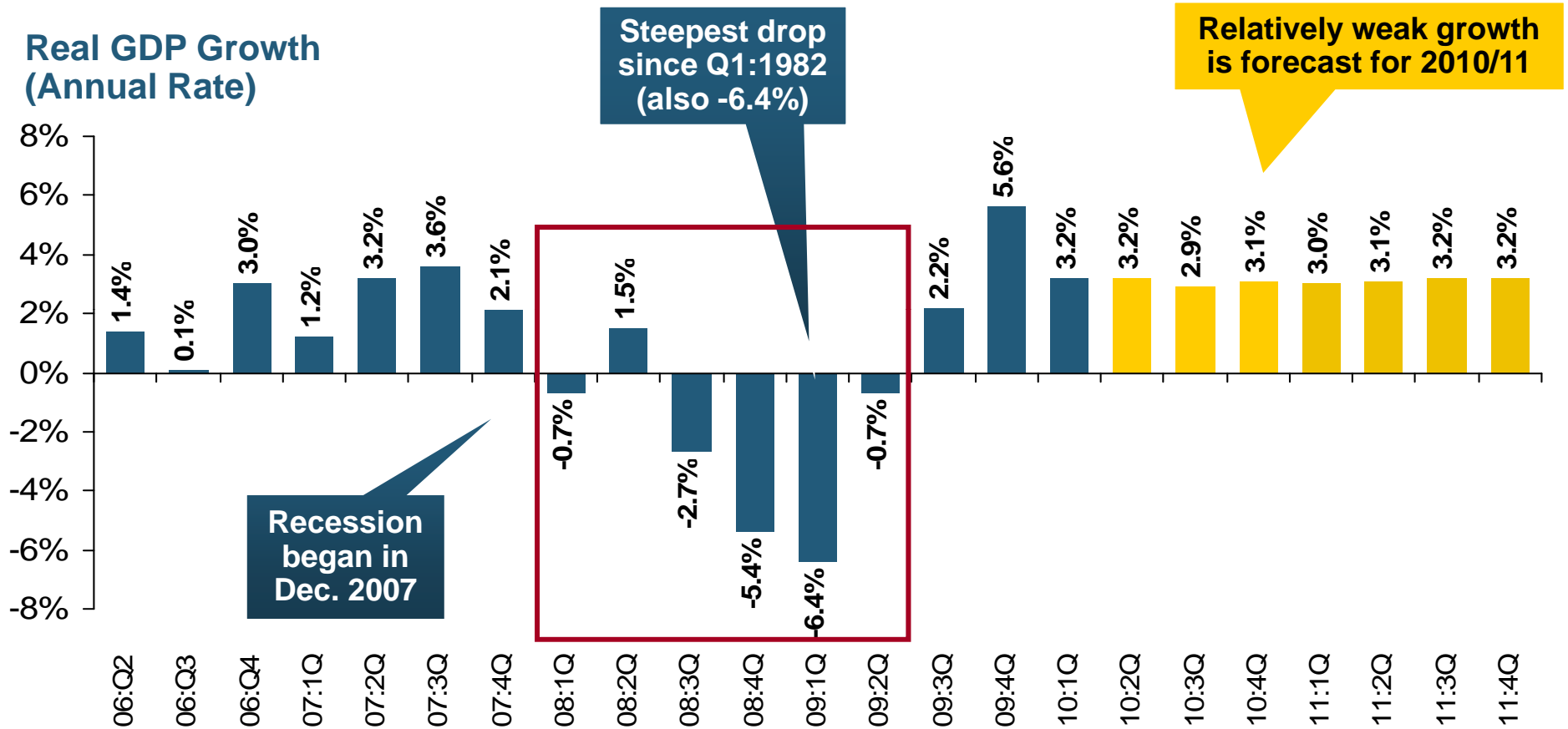
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The Economic Backdrop

Real Quarterly GDP Growth: A Slow Recovery is Forecast



Personal and Commercial Lines Exposure Bases Have Been Hit Hard and Will Be Slow to Come Back

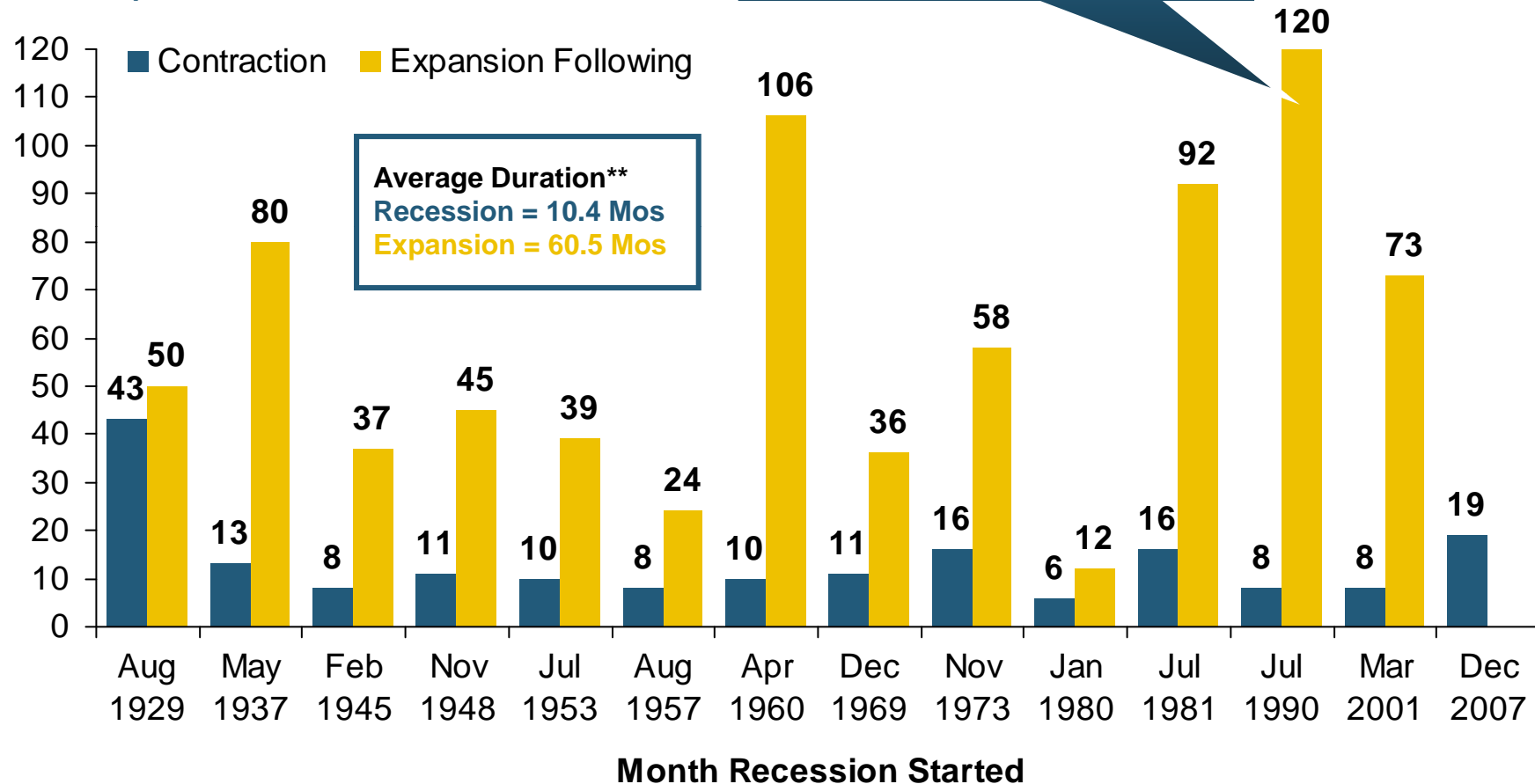
*  Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 5/10; Insurance Information Institute.

It Seems We Have a Recession Every 5-8 Years or So

Duration
(Months)

Length of Expansions
Greatly Exceeds Contractions



* Through June 2009 (likely the "official end" of recession) ** Post-WW II period through end of most recent expansion.
 Sources: National Bureau of Economic Research; Insurance Information Institute.



Labor Market Trends

**Massive Job Losses Affect the
Commercial and Personal Lines
Exposure Bases**

Unemployment and Underemployment Rates: Rocketing Up in 2008-09

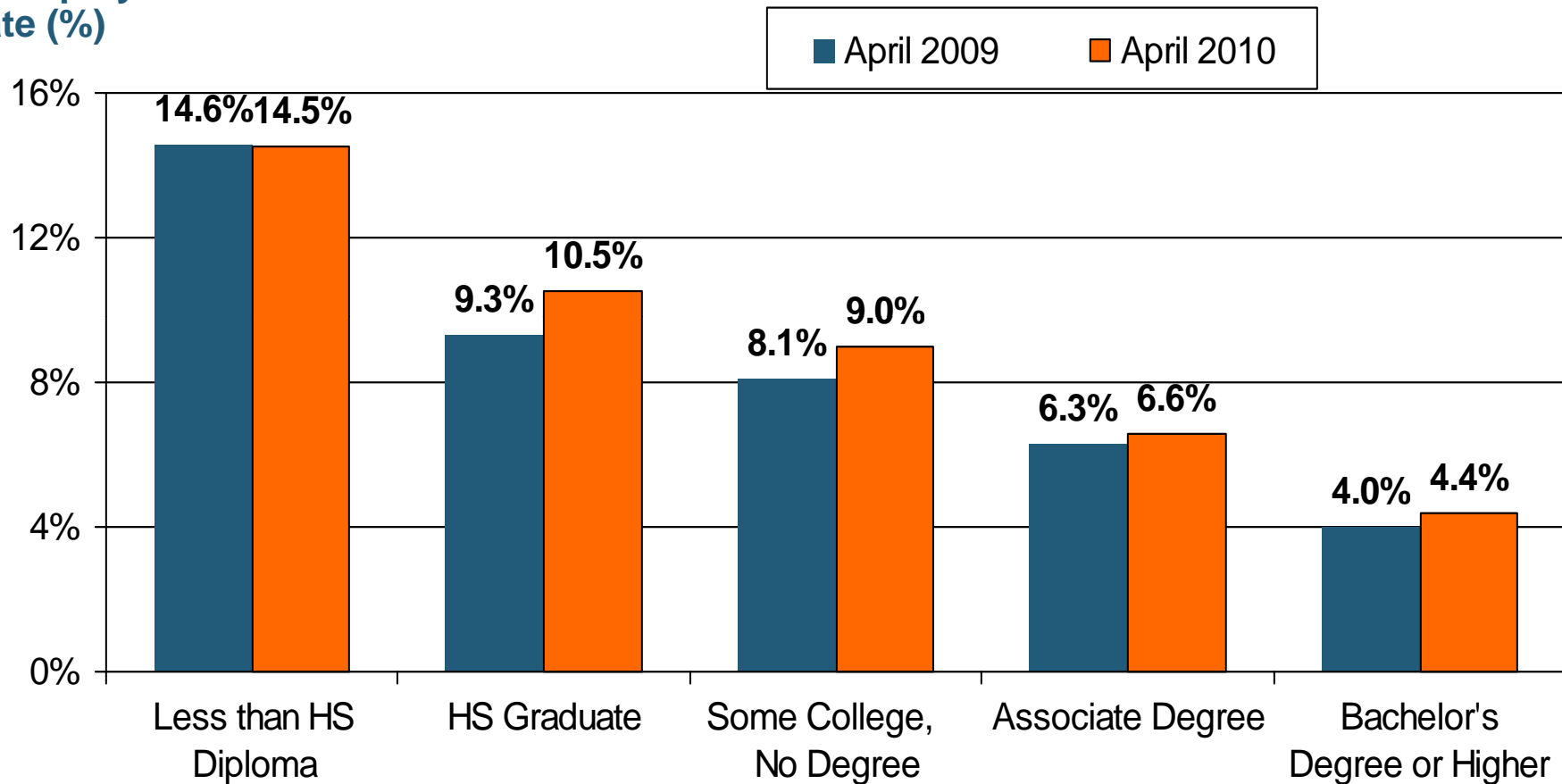
January 2000 through April 2010, Seasonally Adjusted (%)



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

An Uneven Recession: Less Education => Higher Unemployment

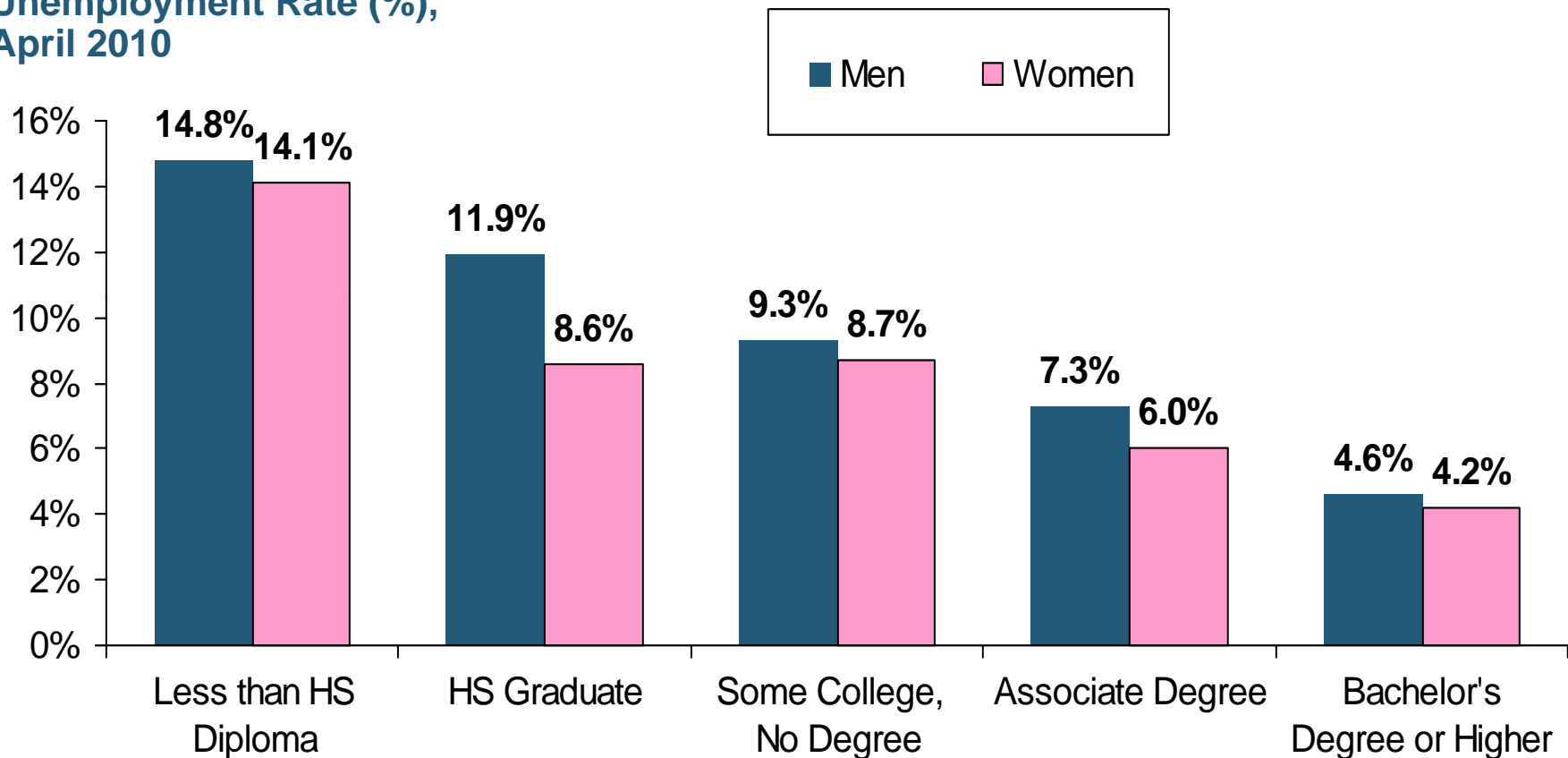
Unemployment Rate (%)



Personal Lines Exposures Should Remain More Stable in Populations with Higher Educational Attainment

Unemployment Rate by Gender: The “Mancession” Can Affect Exposure Too

Unemployment Rate (%),
April 2010



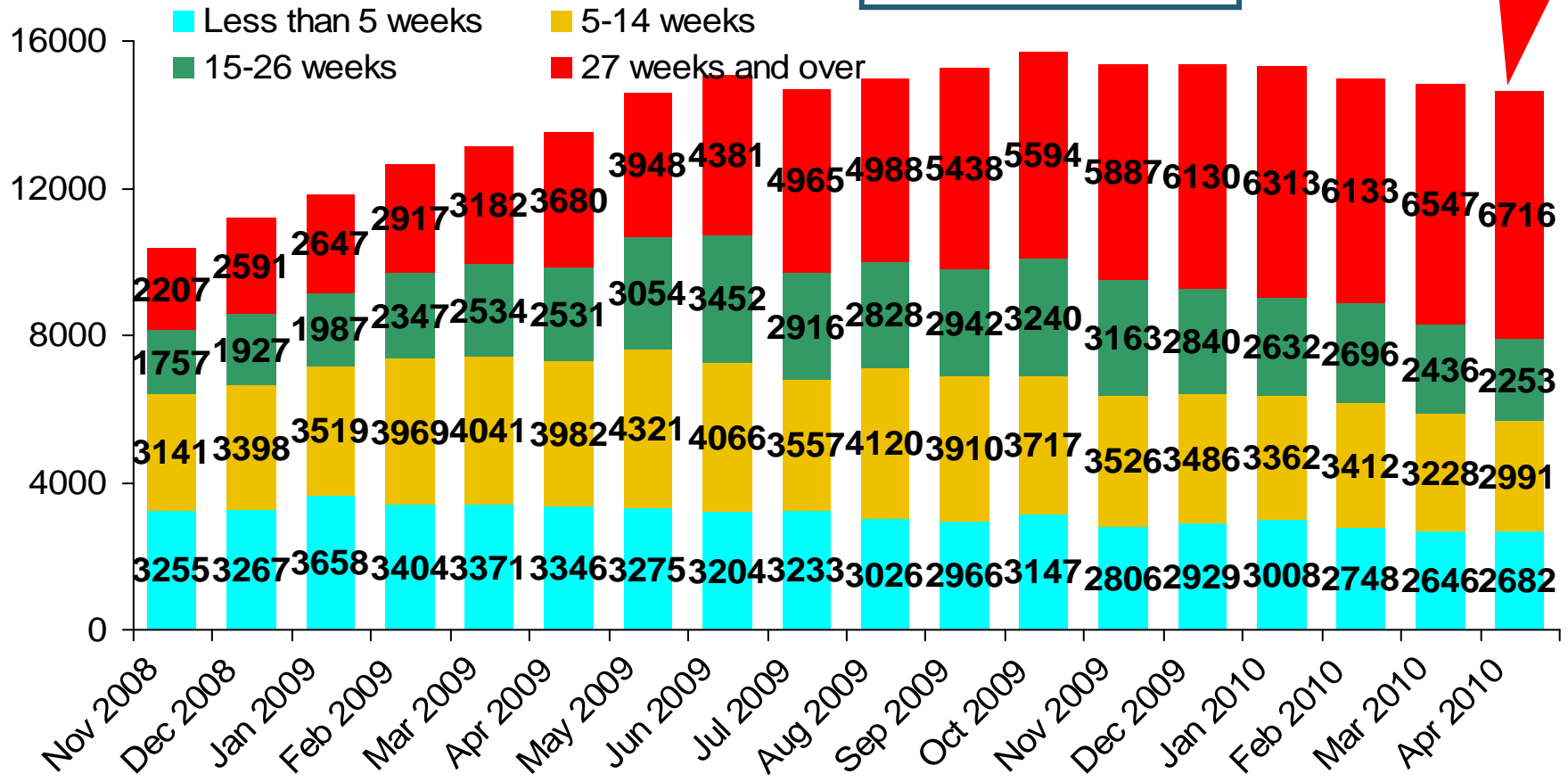
Higher Male Unemployment Rate Has Had a Significant Impact on Specialty Personal Lines (e.g., watercraft, RVs, campers, motorcycles, snowmobiles, etc.)

Length of Unemployment, Monthly, Nov 2008–Present*

Number of People (Thousands)

Mean Duration
 Nov 2008 = 18.9 Weeks
 Apr 2010 = 33.0 Weeks

Highest number on record (since 1948)



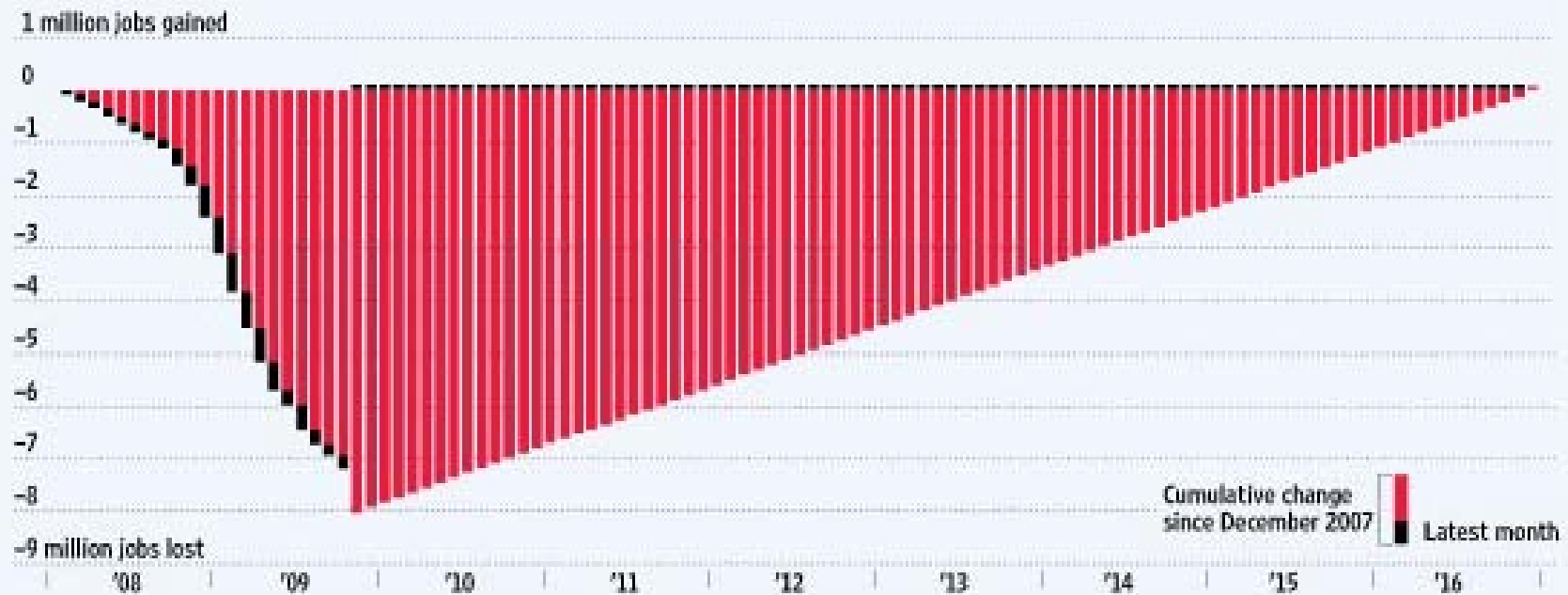
*Through April 2010; Seasonally adjusted

Sources: Bureau of Labor Statistics; Insurance Information Institute.

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

Long Road Back | How long it would take to regain the job level at the start of this recession?

Assuming the average monthly pace of the most recent expansion, it would take 86 months, or not until December 2016



Note: The starting point for adding jobs back includes 824,000 jobs lost between March 2008 and March 2009 announced Friday by the Labor Department
Source: Labor Department (payroll figures)

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



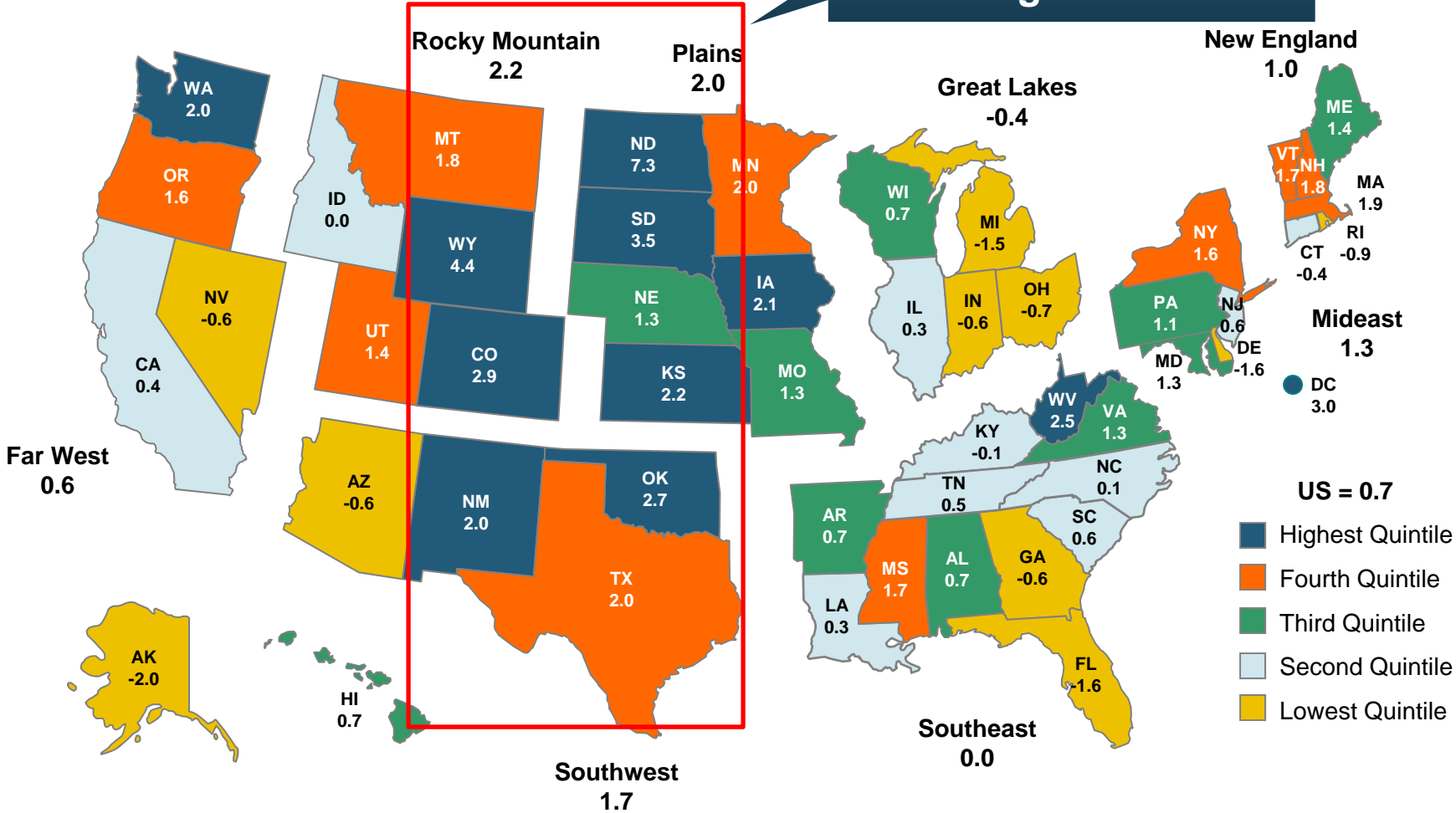
Regional Differences Will Significantly Affect P/C Markets

**Recovery in Some Areas Will
Begin Years Ahead of Others;
Speed of Recovery Will Differ by
Orders of Magnitude**

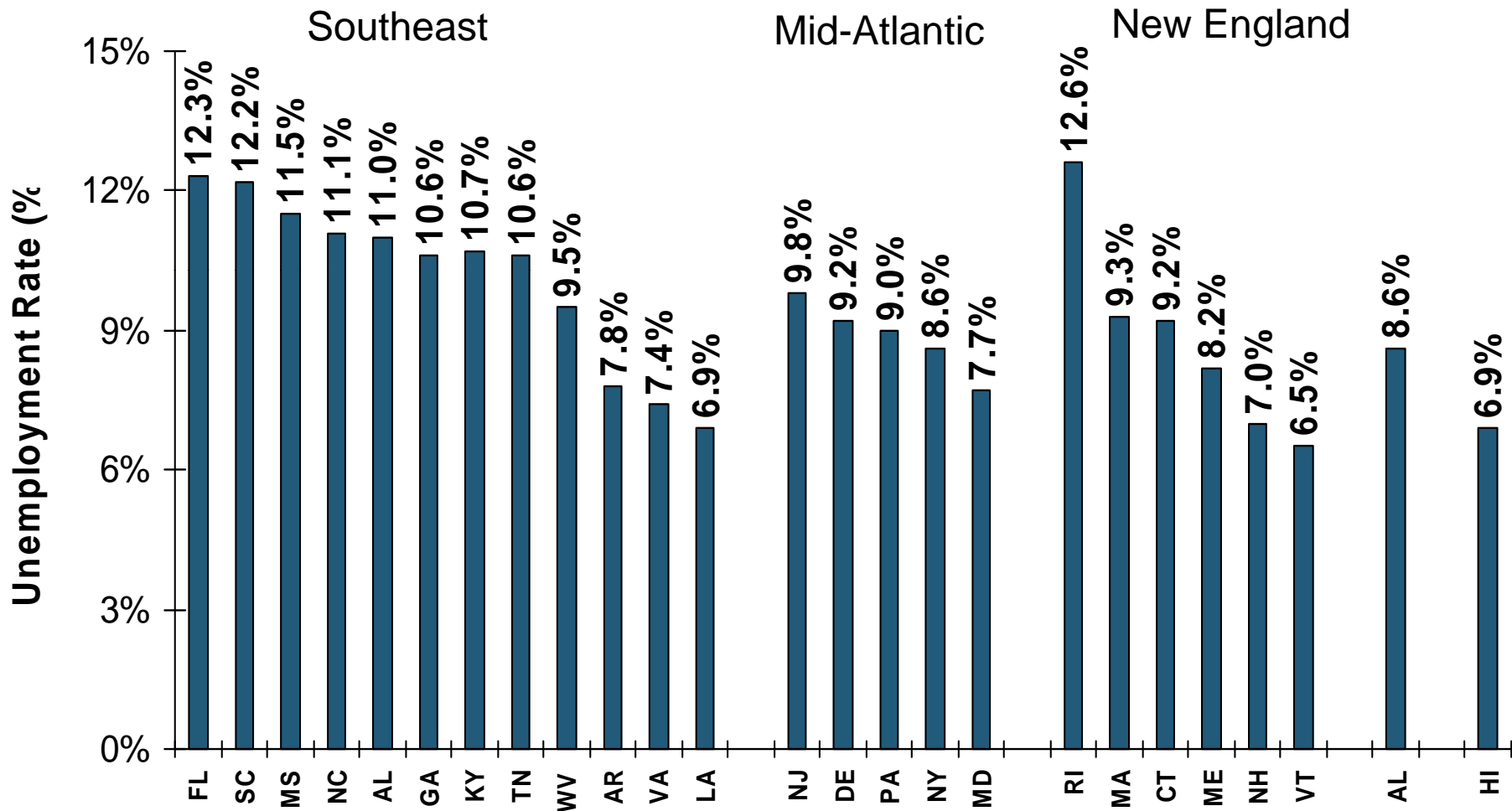
State Economic Growth Varied Tremendously in 2008

Percent Change in Real GDP by State, 2007–2008

Mountain, Plains States Growing the Fastest



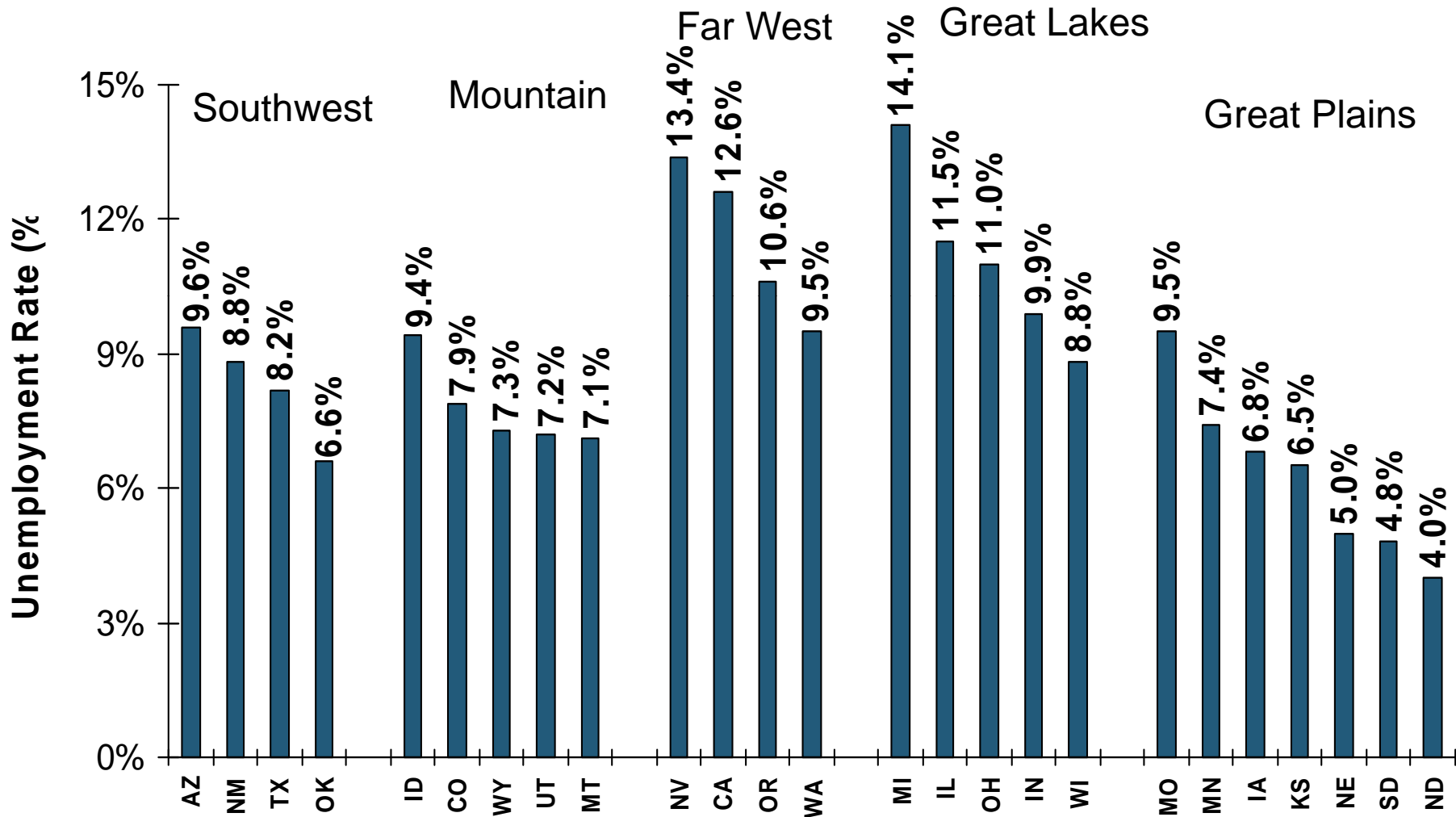
Unemployment Rates Vary Widely by State and Region*



*Provisional figures for March 2010, seasonally adjusted.

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

Unemployment Rates Vary Widely by State and Region* (cont'd)



*Provisional figures for March 2010, seasonally adjusted.

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

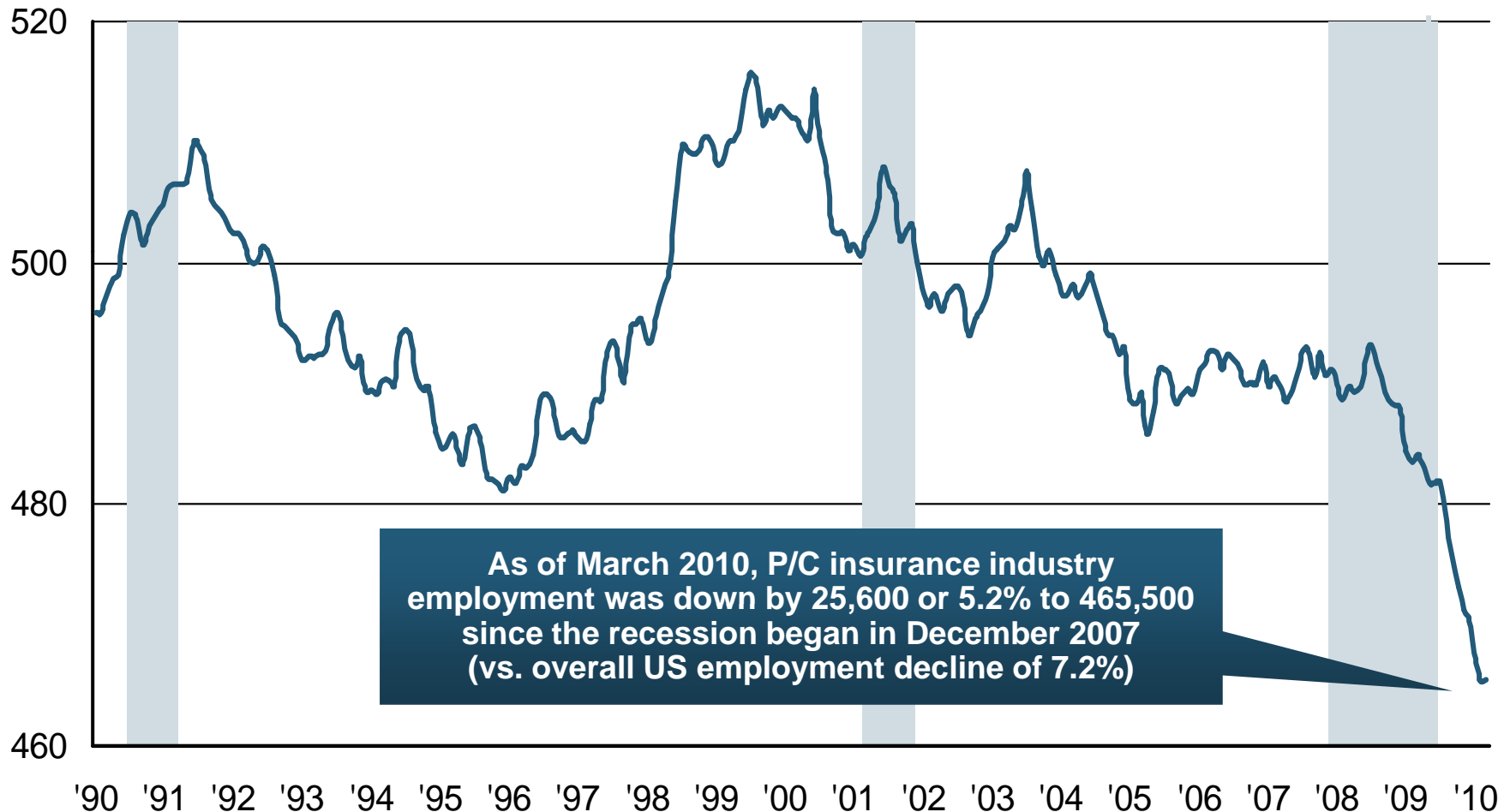


Insurance Industry Employment Trends

**Soft Market, Difficult Economy,
Outsourcing Have Contributed to
Industry's Job Losses**

U.S. Employment in the Direct P/C Insurance Industry: 1990–2010*

Thousands



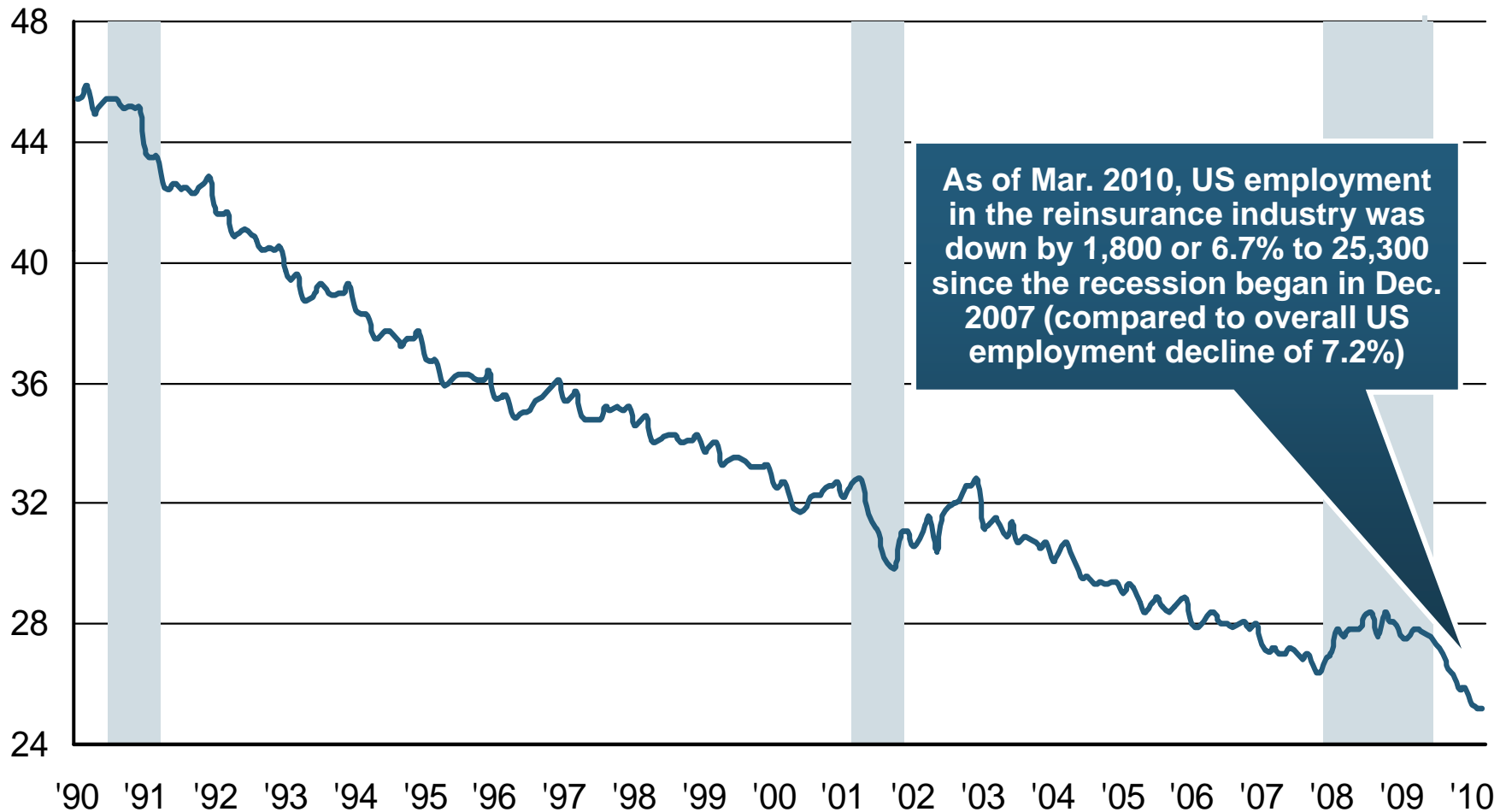
*As of March 2010; Not seasonally adjusted; Does not including agents & brokers

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

U.S. Employment in the Reinsurance Industry: 1990–2010*

Thousands



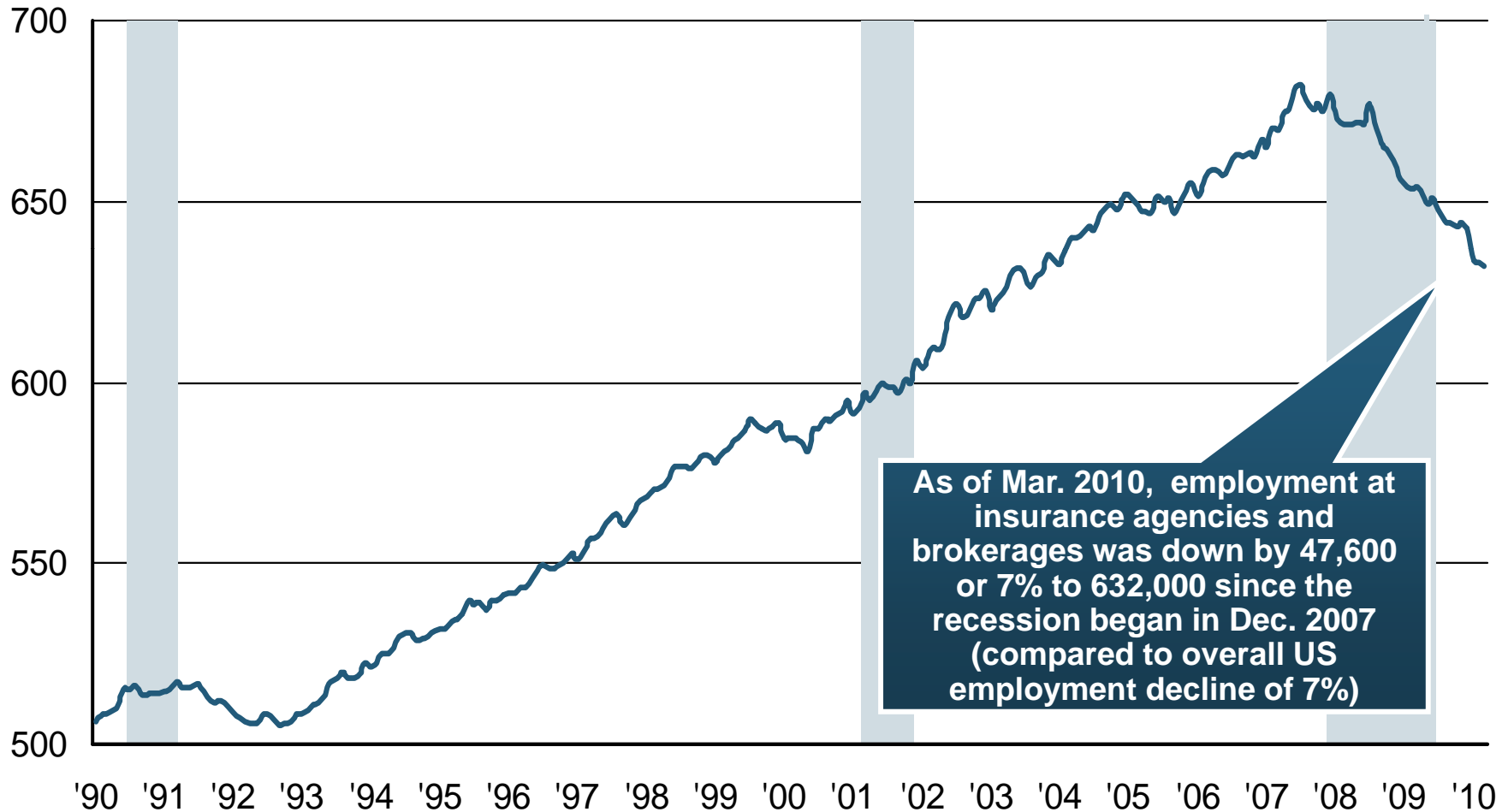
*As of March 2010; Not seasonally adjusted; Does not including agents & brokers

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

U.S. Employment in Insurance Agencies & Brokerages: 1990–2010*

Thousands



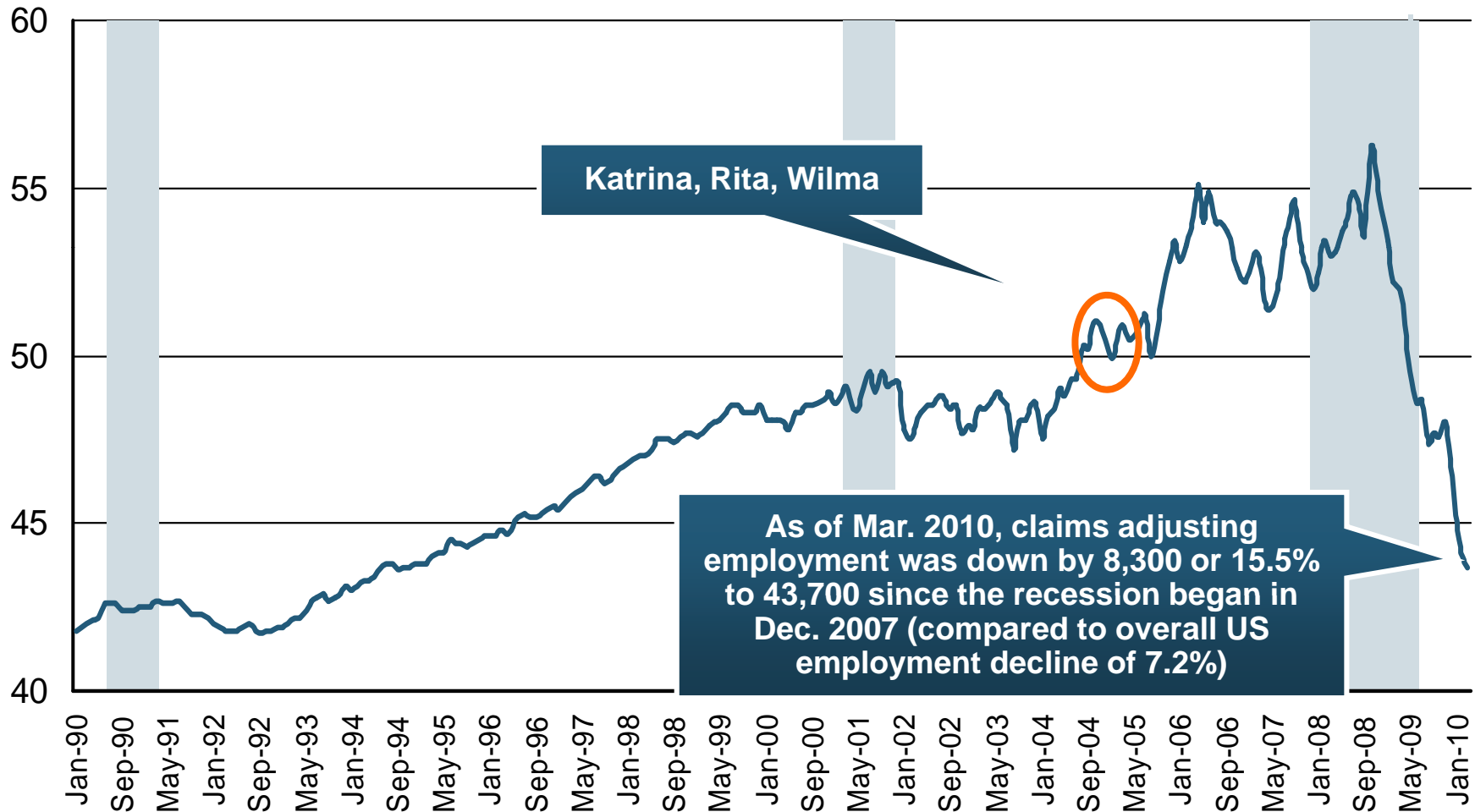
*As of March 2010; Not seasonally adjusted. Includes all types of insurance.

Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

U.S. Employment in Insurance Claims Adjusting: 1990–2010*

Thousands



*As of March 2010; Not seasonally adjusted.

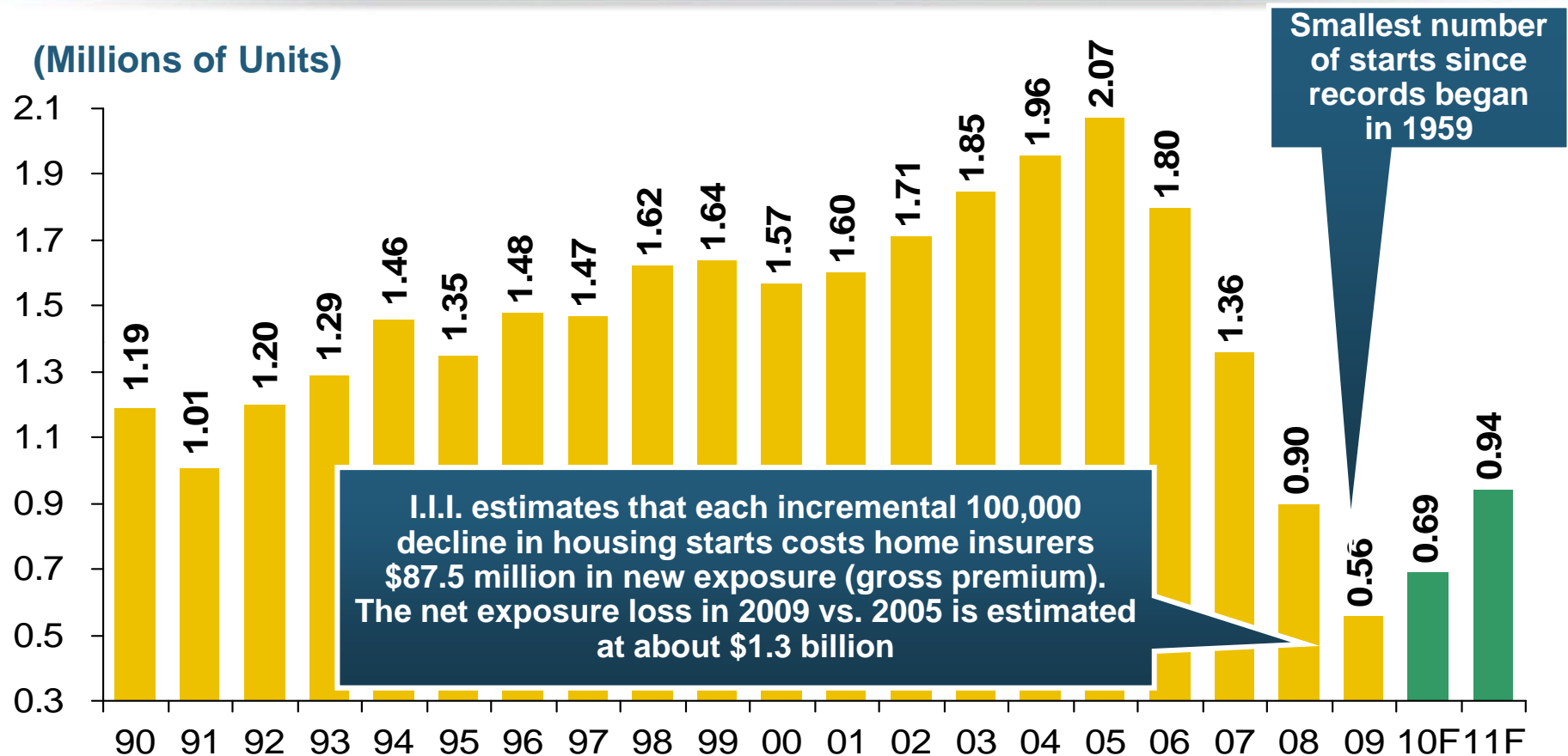
Note: Recessions indicated by gray shaded columns.

Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institutes.

Exposure Drivers

**Economic Obstacles or Pathways
to Growth in the P/C Insurance
Exposure Base**

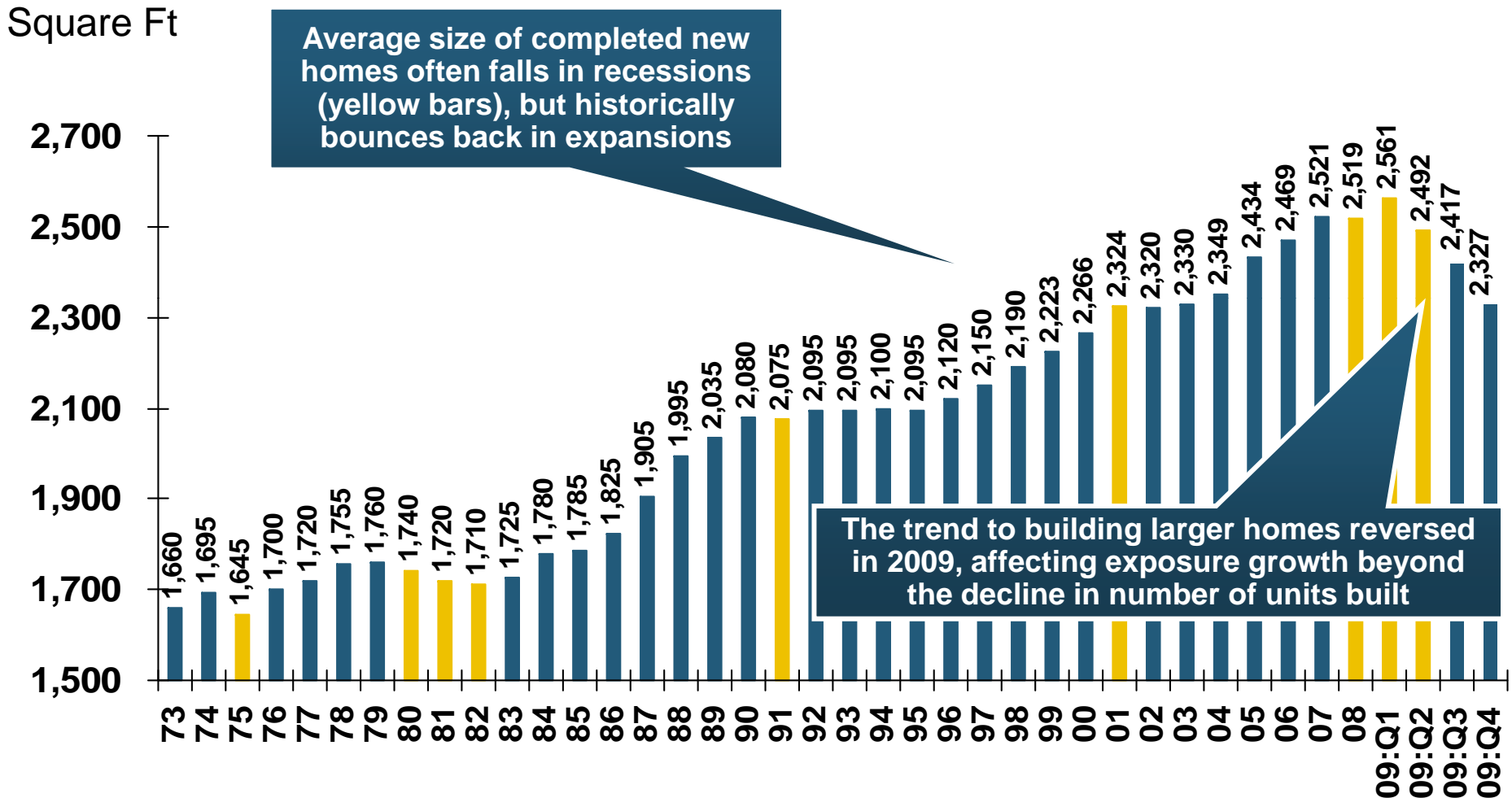
Private Housing Unit Starts, 1990-2011F



**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**

Source: U.S. Department of Commerce; Blue Chip Economic Indicators (5/10); Insurance Information Institute.

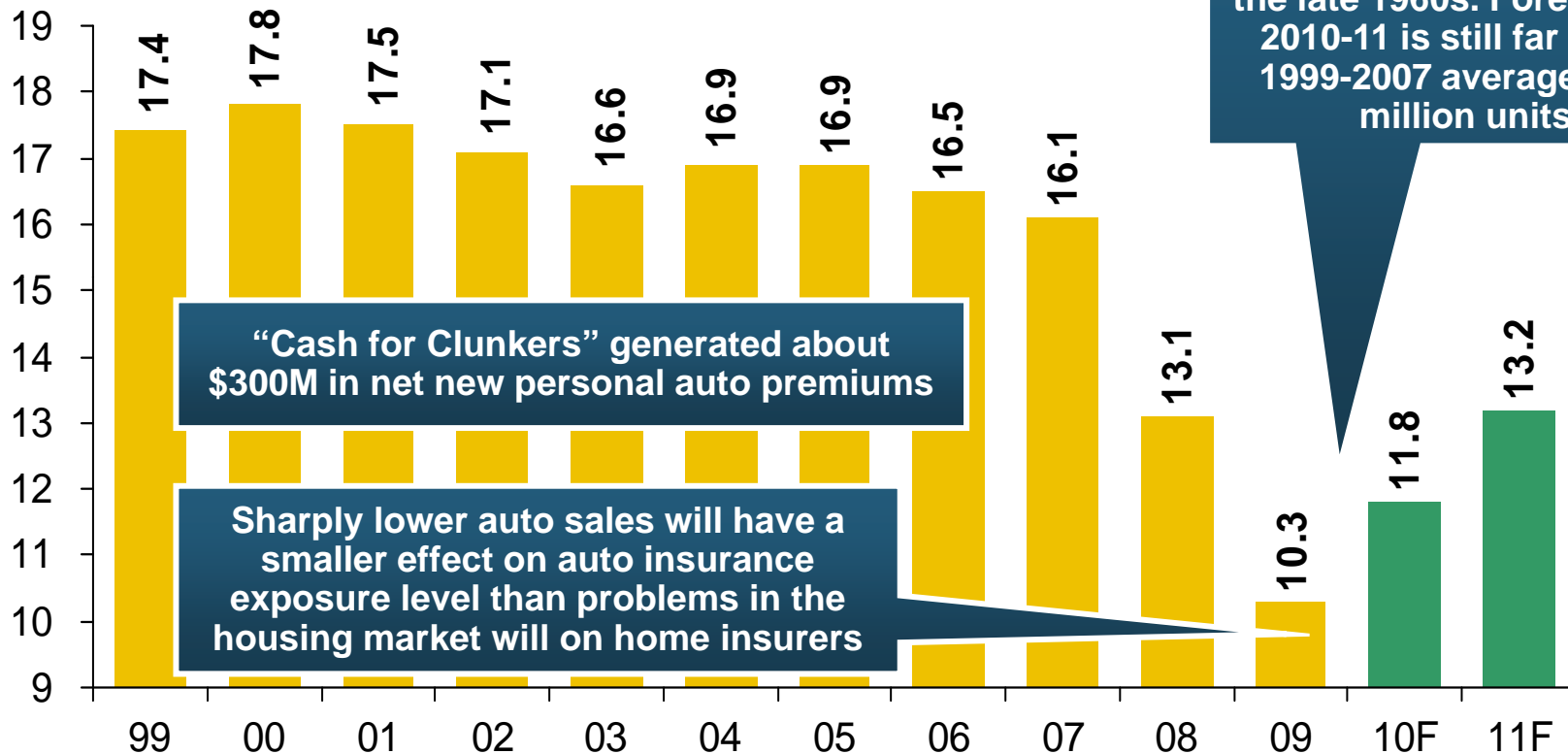
Average Square Footage of Completed New Homes in U.S., 1973-2009:Q4



Source: U.S. Census Bureau: http://www.census.gov/const/www/quarterly_starts_completions.pdf; Insurance Information Institute.

Auto/Light Truck Sales, 1999-2011F

(Millions of Units)



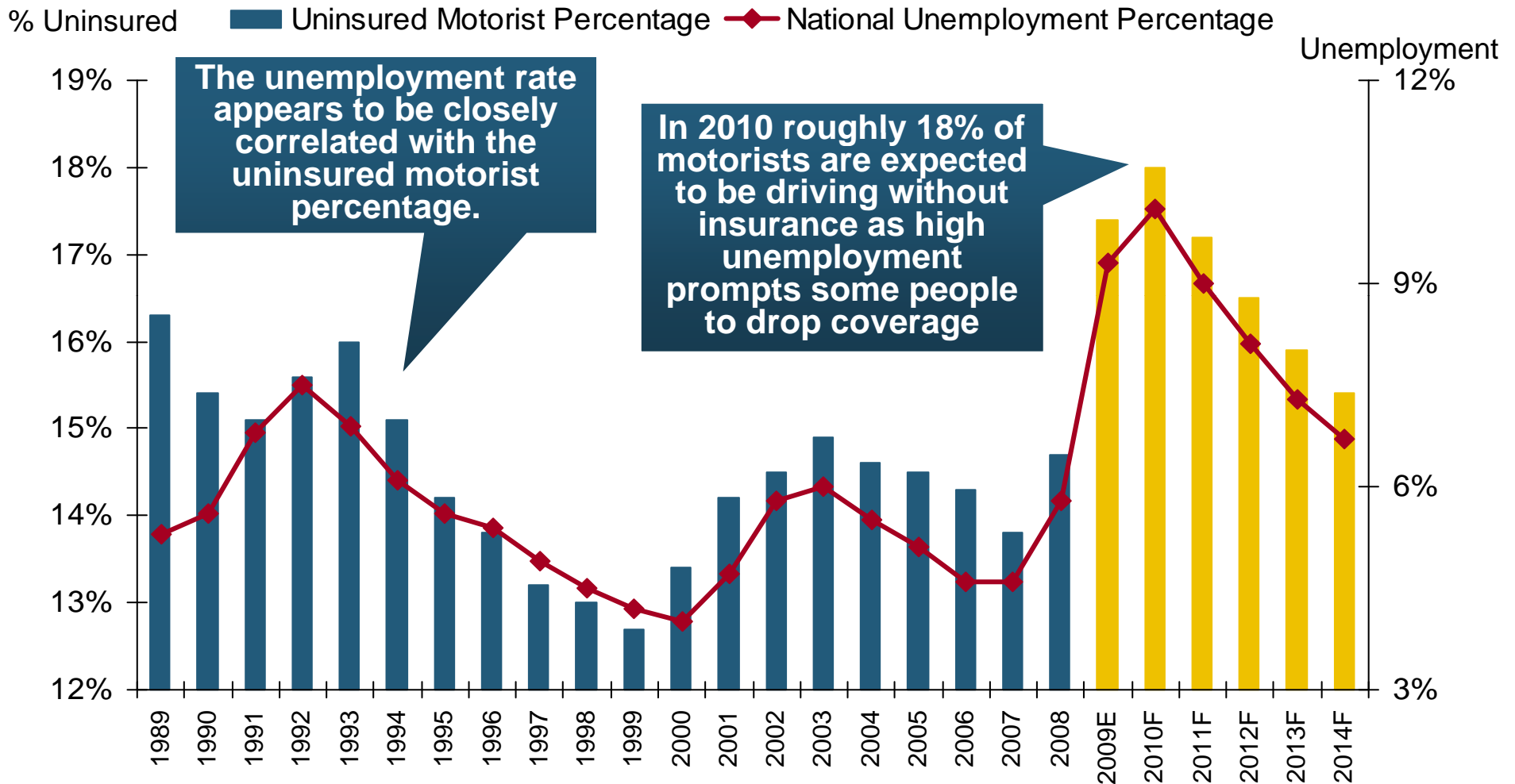
New auto/light truck sales fell to the lowest level since the late 1960s. Forecast for 2010-11 is still far below 1999-2007 average of 17 million units

“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

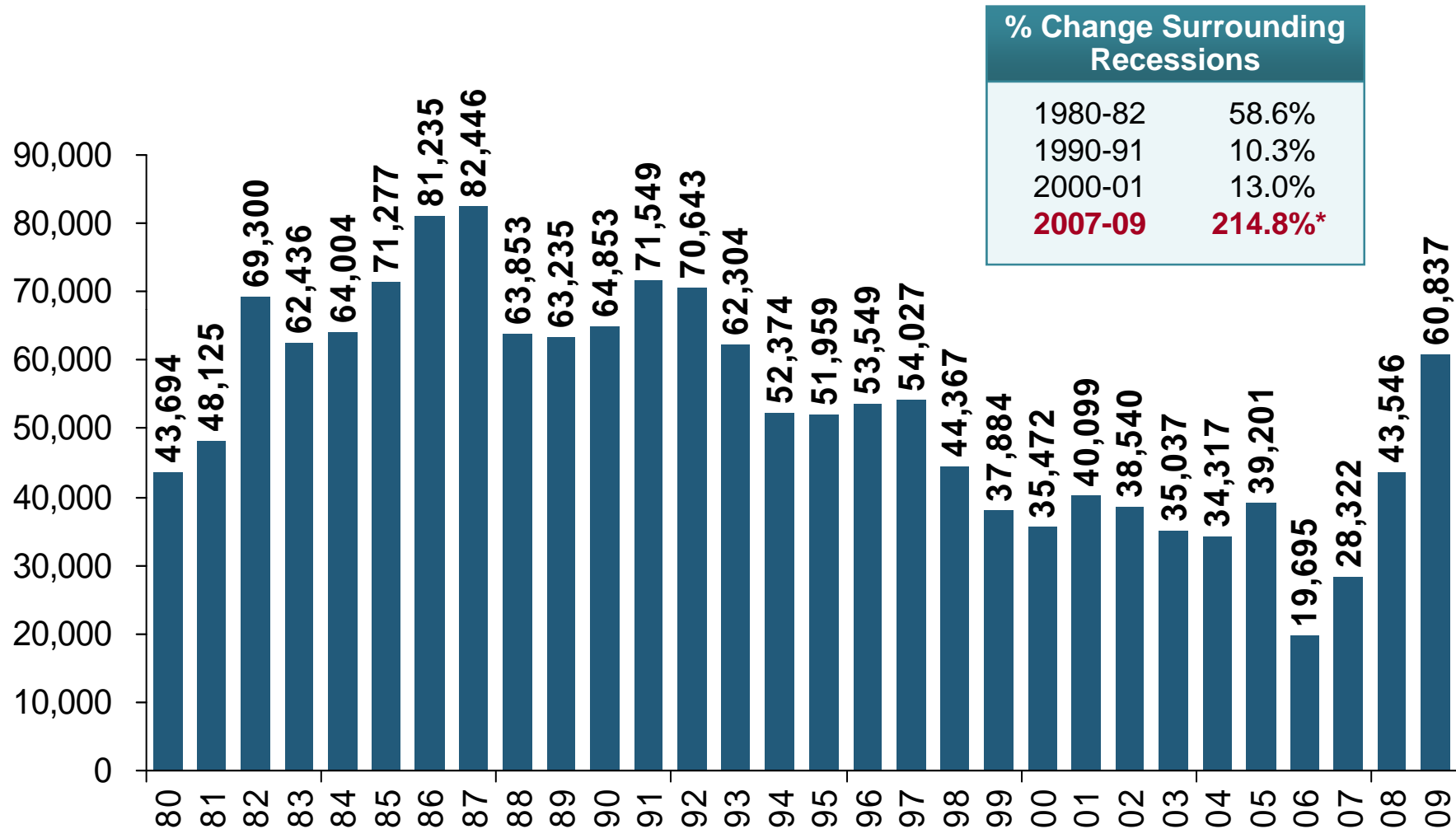
Car/Light Truck Sales Will Recover from the 2009 Low Point, but High Unemployment, Tight Credit Are Still Restraining Sales; Gas Prices Could Once Again Become a Factor Too

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.

Business Bankruptcy Filings 1980–2009

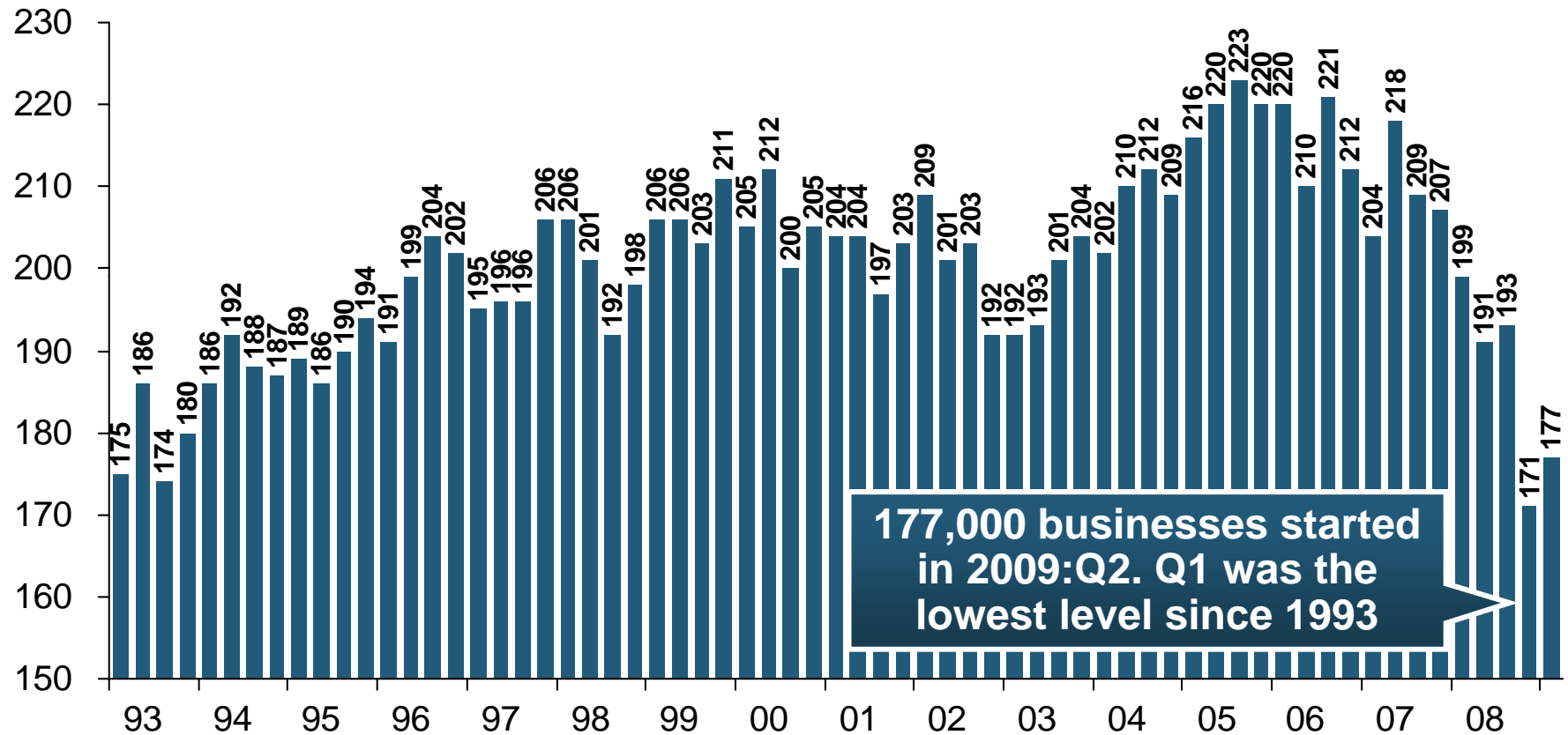


Source: American Bankruptcy Institute at [http://www.abiworld.org/AM/AMTemplate.cfm?Section=Business Bankruptcy Filings1&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=60240](http://www.abiworld.org/AM/AMTemplate.cfm?Section=Business%20Bankruptcy%20Filings1&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=60240)

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



(Thousands)



177,000 businesses started in 2009:Q2. Q1 was the lowest level since 1993

Business Starts Are Down Nearly 20% in the Current Downturn, Holding Back Most Types of Commercial Insurance Exposure

*Latest available as of May 2010, seasonally adjusted

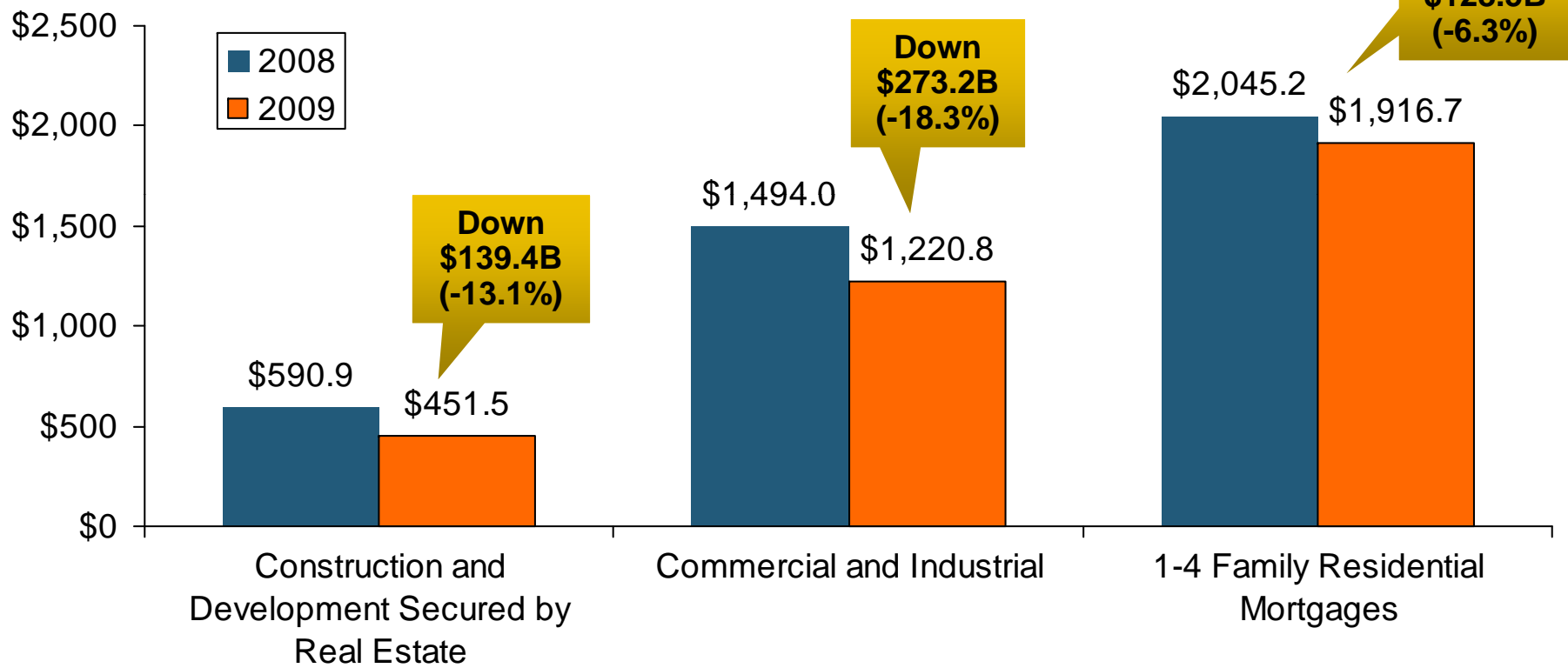
Source: Bureau of Labor Statistics, <http://www.bls.gov/news.release/cewbd.t07.htm>.

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



\$Billions

April 2010: Many banks are maintaining tight loan standards; some are tightening further; virtually no one loosening

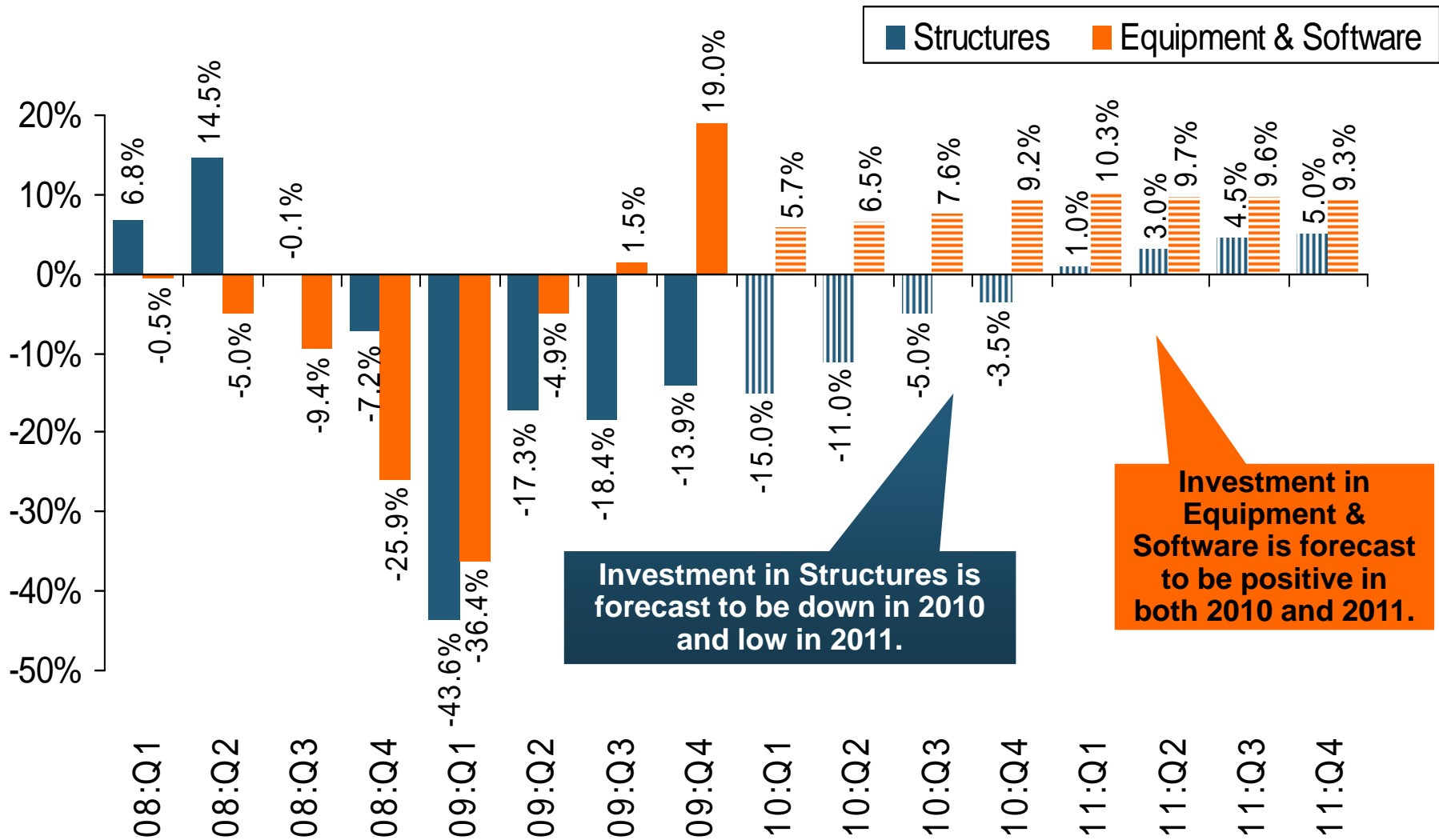


FDIC-Insured Institutions Had \$541.1B (-13.1%) Less in Outstanding Loans in These Three Categories at Year-end 2009 vs. 2008

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

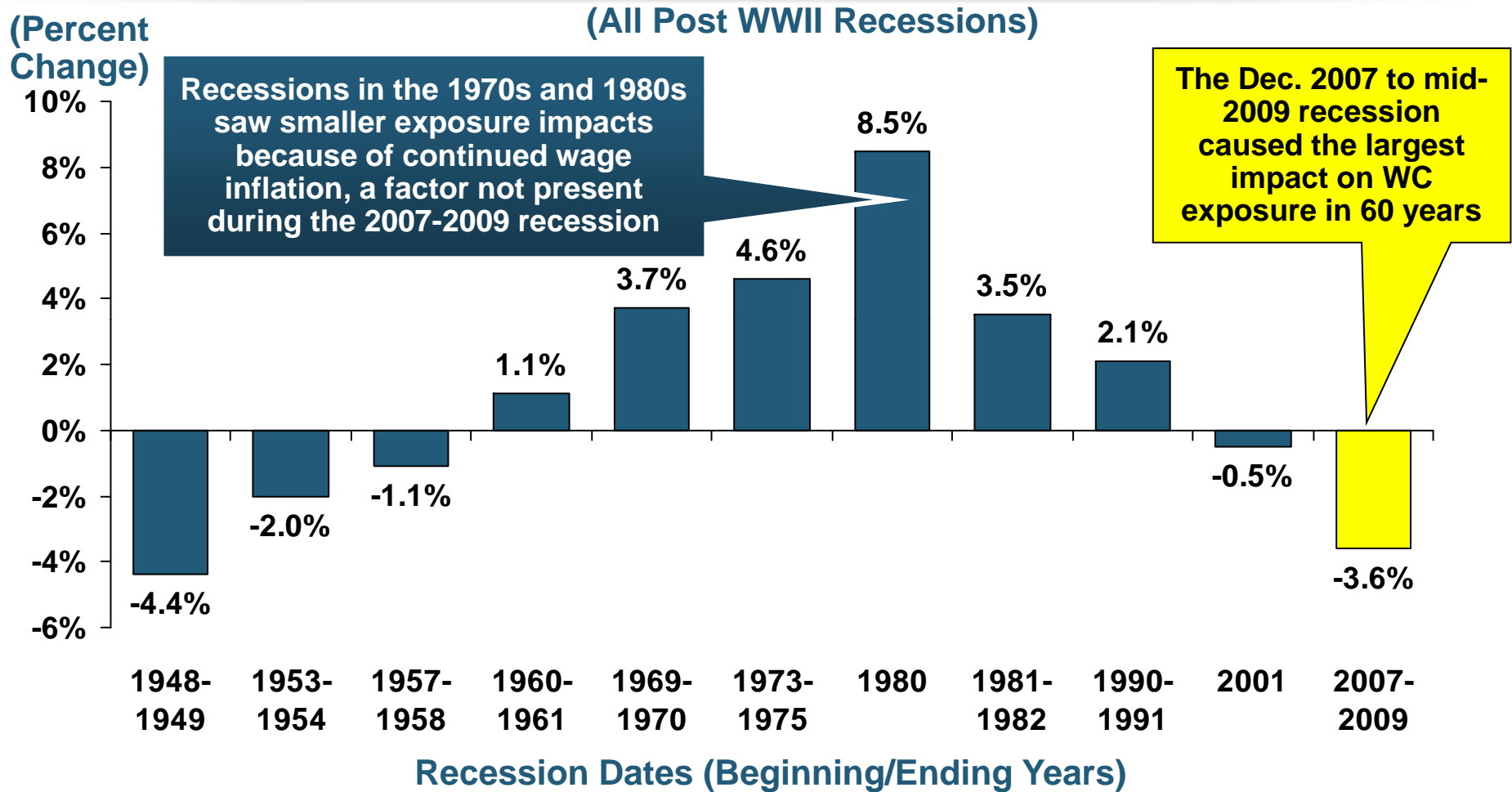
Business Fixed Investment

2008:Q1 to 2011:Q4F



Source: Wells Fargo Securities Economics Group, Monthly Outlook, April 7, 2010

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



*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).

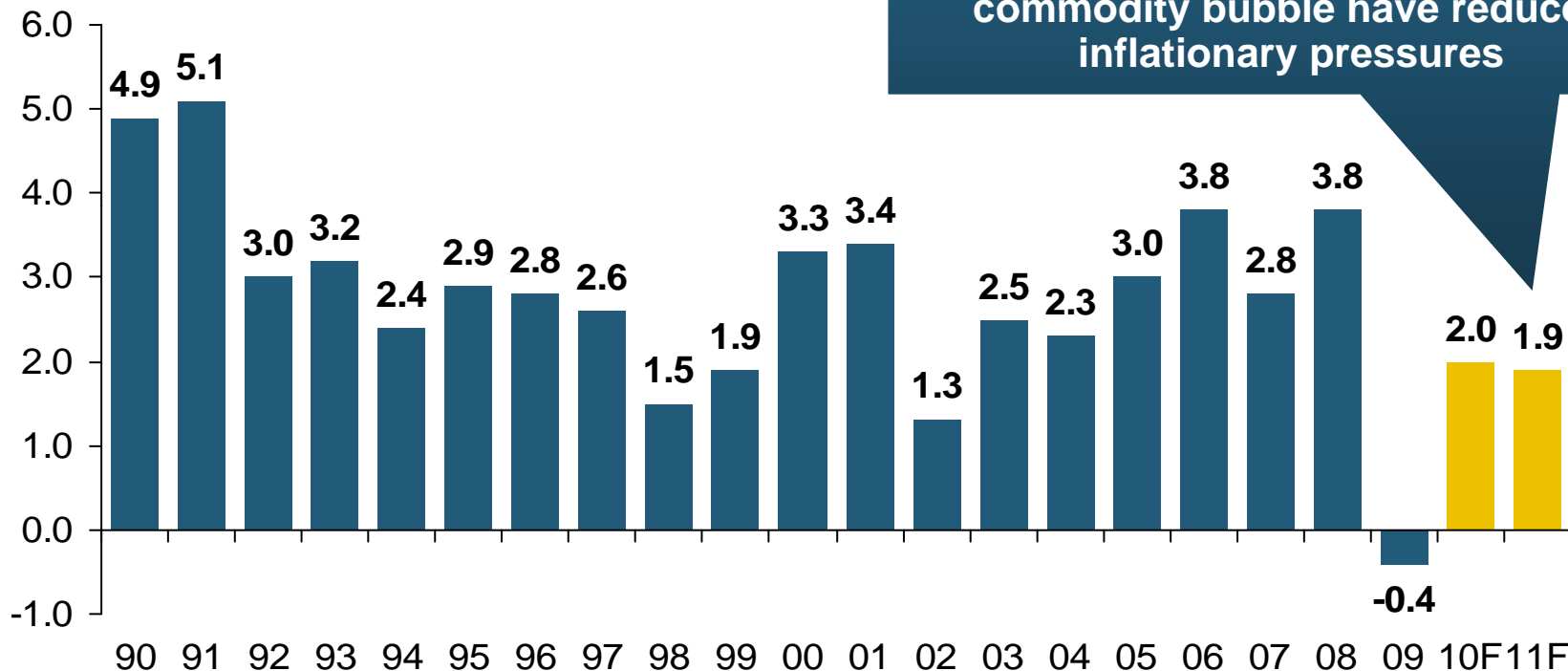


**Inflation Trends:
*Concerns Over Stimulus Spending
and Monetary Policy***

**Mounting Pressure on Claim
Cost Severities?**

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

Annual Inflation Rates (%)

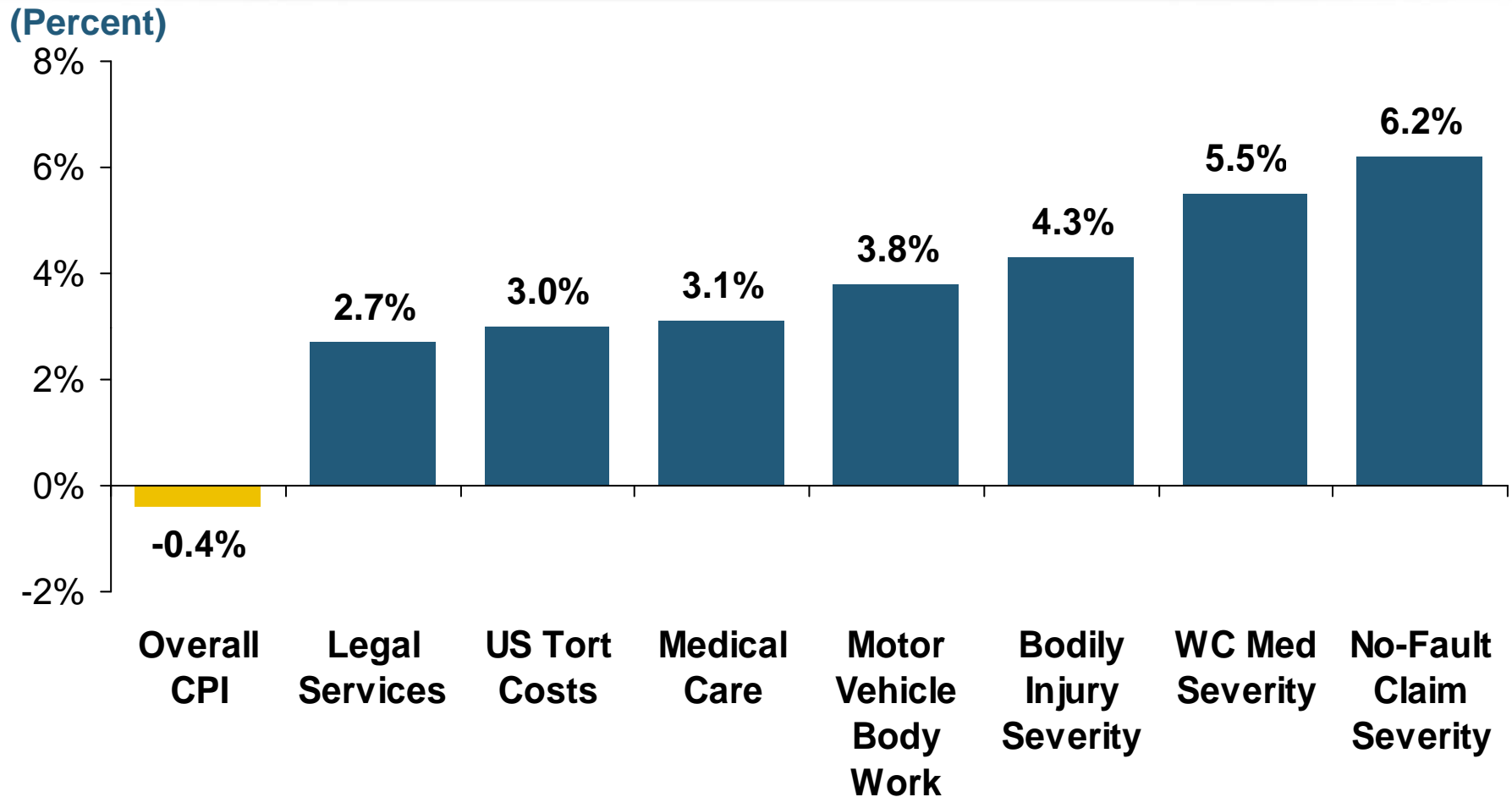


Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble have reduced inflationary pressures

There is So Much Slack in the US Economy 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, May 10, 2010 (forecasts).

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



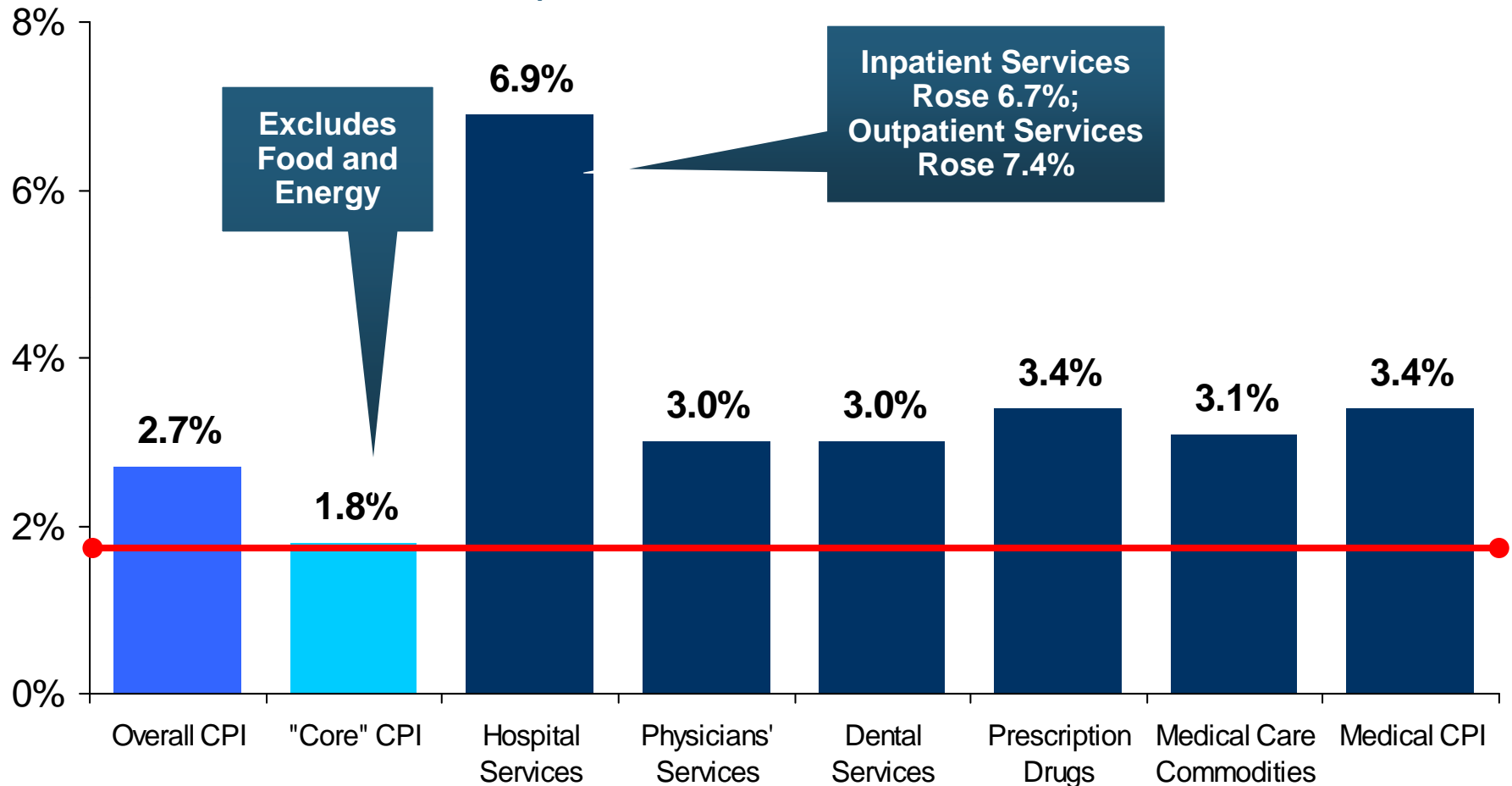
Healthcare and Legal/Tort Costs, Major P/C Insurance Cost Drivers, Are Expected to Grow Above the Overall Inflation Rate (CPI) Indefinitely

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.

WC Insurers Experience Inflation More Intensely than 2009 CPI Suggests



(Percent increase Dec 08 to Dec 09)



Healthcare Costs Are a Major WC Insurance Cost Driver. They Are Likely to Increase Faster than the CPI for the Next Few Years, at Least

Source: Bureau of Labor Statistics; Insurance Information Institute.

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

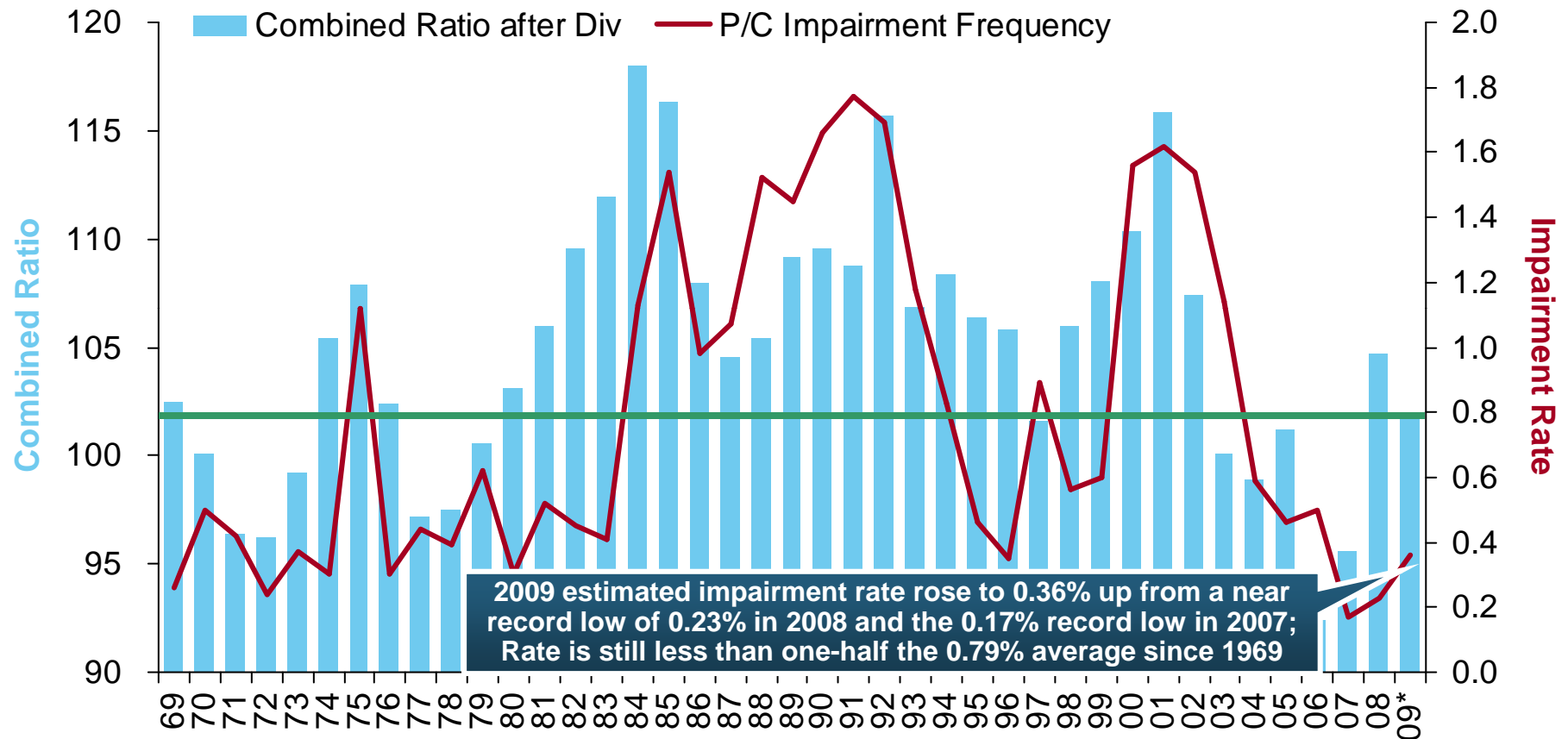
- ◆ Higher costs → risks burn through their retentions more quickly, tapping into reinsurance more quickly and potentially exhausting their reinsurance more quickly



Financial Strength & Ratings

**Industry Has Weathered
the Storms Well**

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2009p

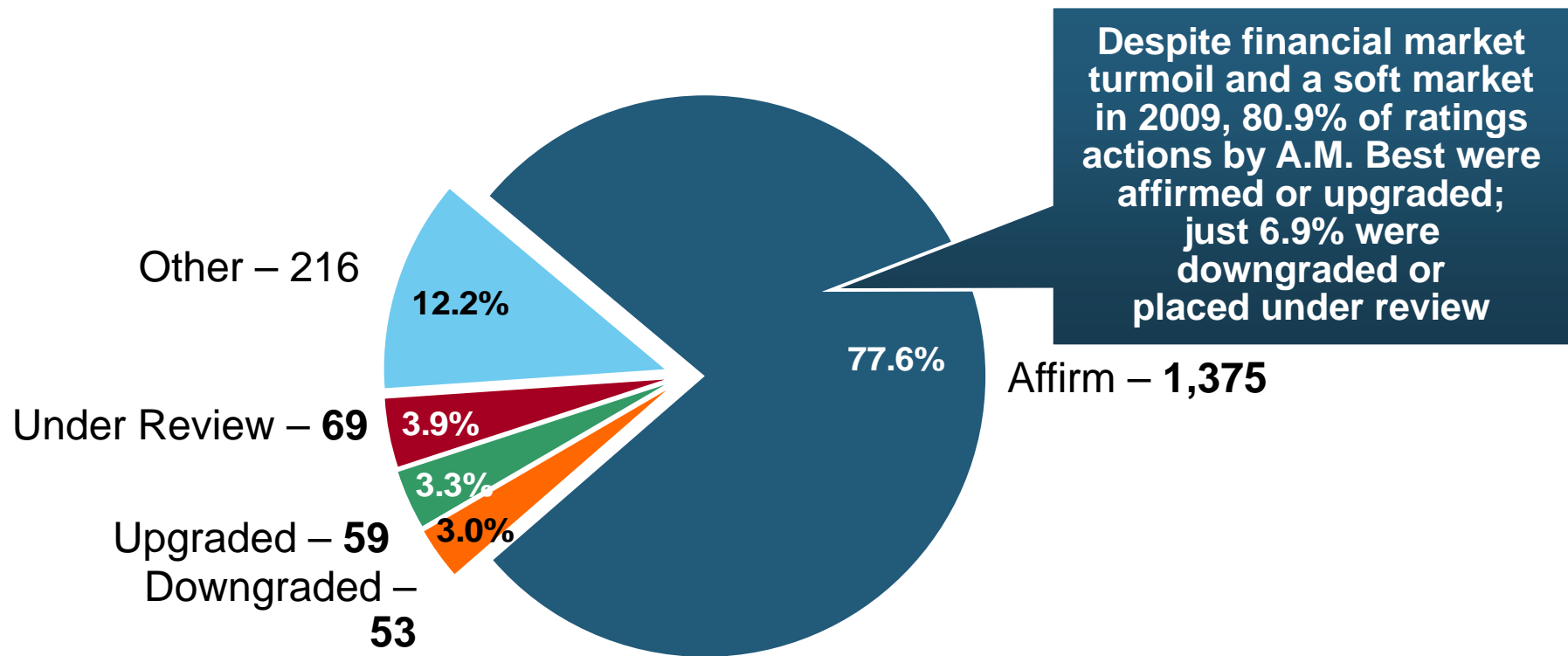


Impairment Rates Are Highly Correlated With Underwriting Performance and Reached Record Lows in 2007/08

*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

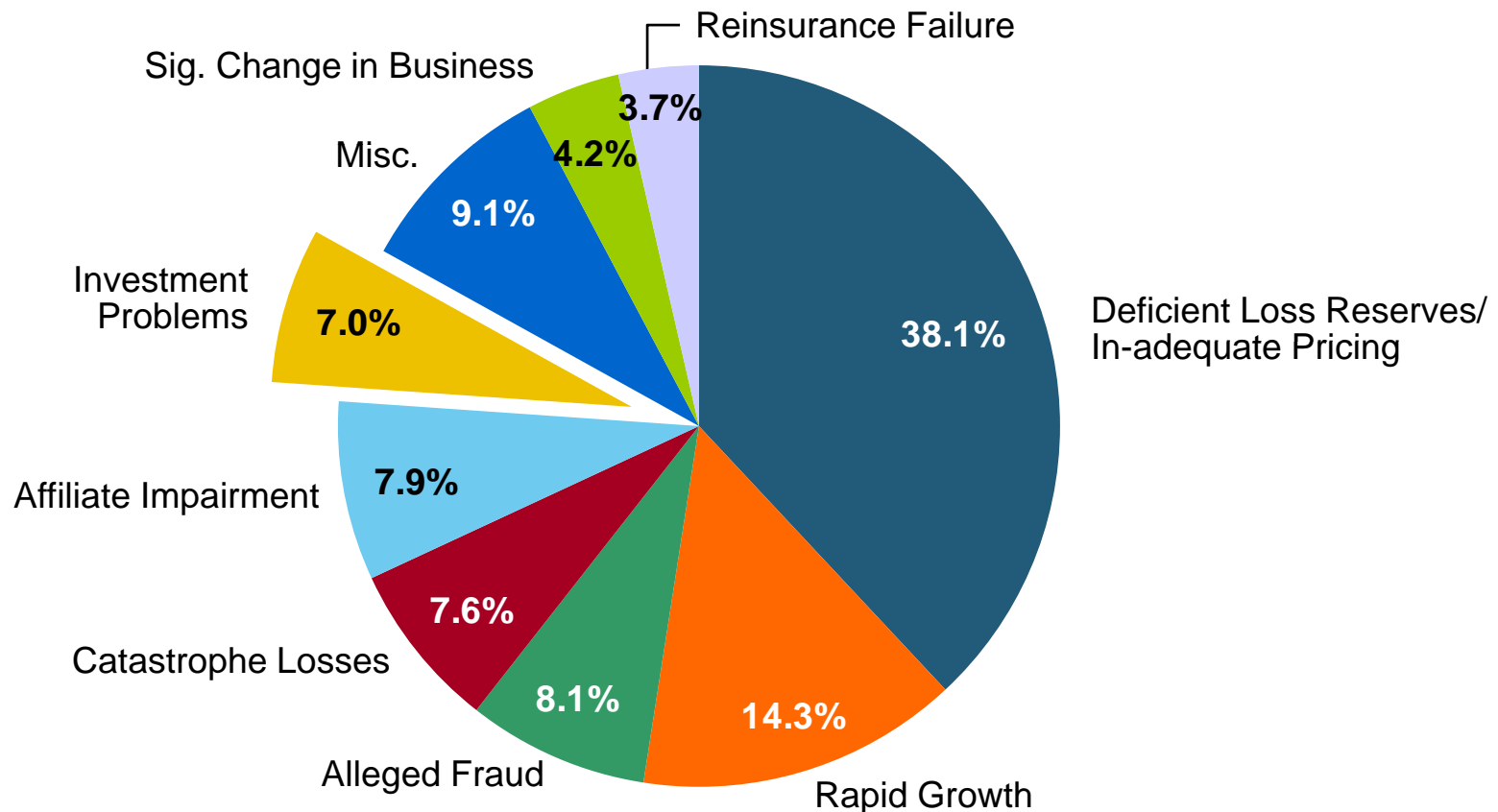
Summary of A.M. Best's P/C Insurer Ratings Actions in 2009



**P/C Insurance is by Design a Resilient Business.
The Dual Threat of Financial Disasters and Catastrophic Losses
Are Anticipated in the Industry's Risk Management Strategy**

Reasons for US P/C Insurer Impairments, 1969–2008

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





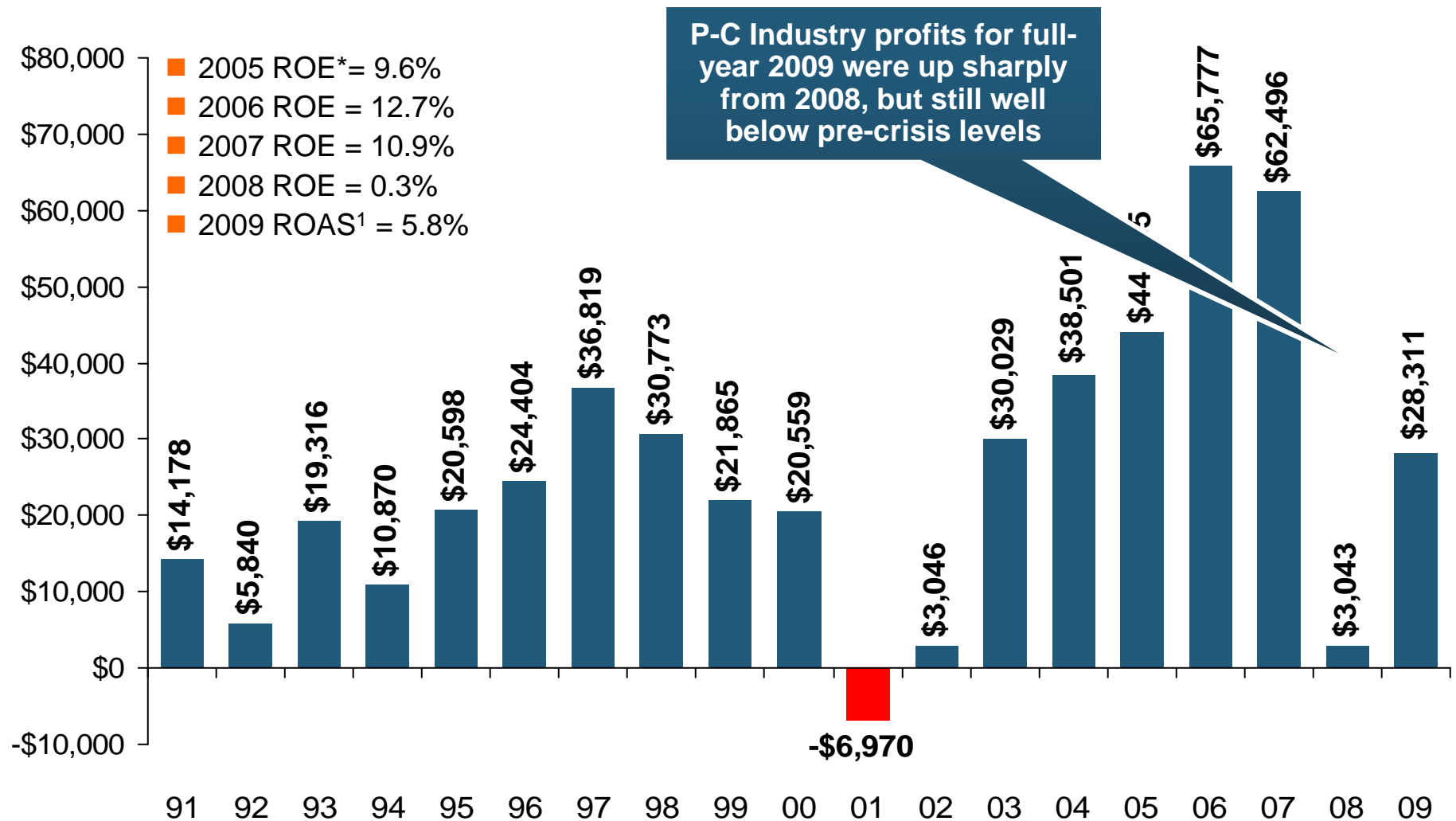
P/C Insurance Financial Performance

A Resilient Industry in Challenging Times

Profitability

Historically Volatile

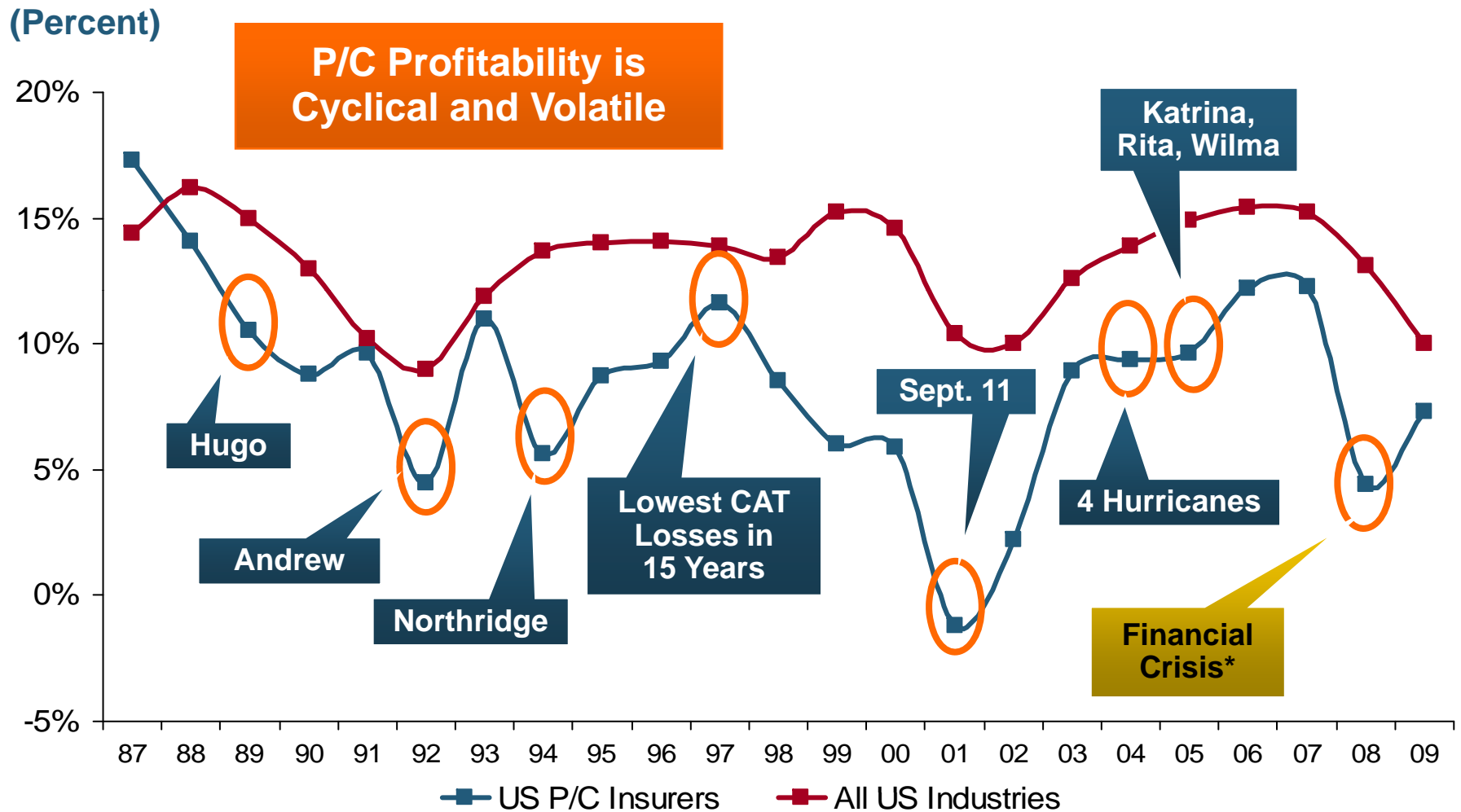
P/C Net Income After Taxes 1991–2009 (\$ Millions)



* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 7.3% ROAS for 2009 and 4.4% for 2008. 2009 net income was \$34.5 billion and \$20.8 billion in 2008 excluding M&FG.

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

ROE: P/C vs. All Industries 1987–2009*

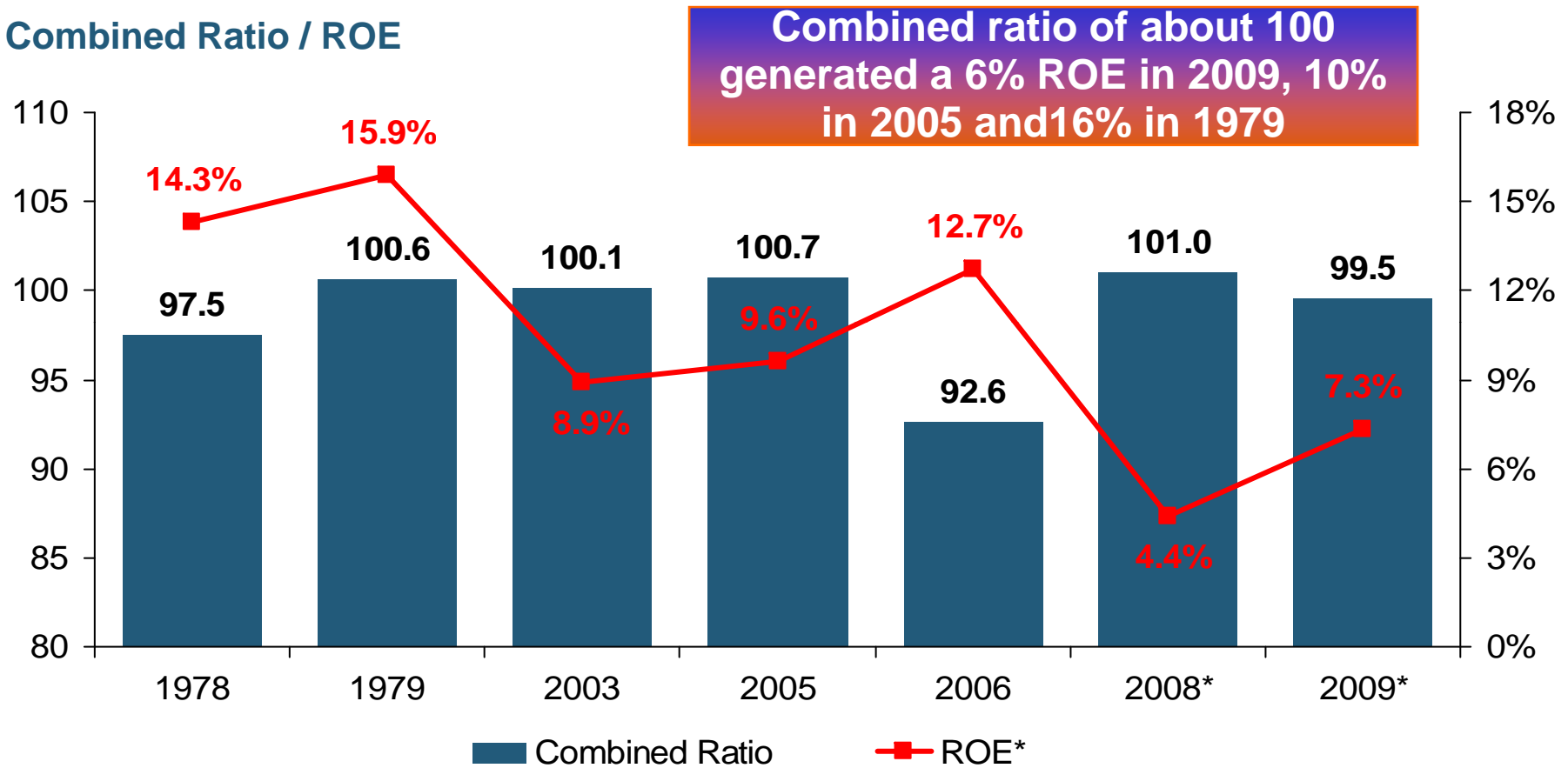


* Excludes Mortgage & Financial Guarantee in 2008 and 2009.
Sources: ISO, *Fortune*; Insurance Information Institute.

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



Combined Ratio / ROE



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

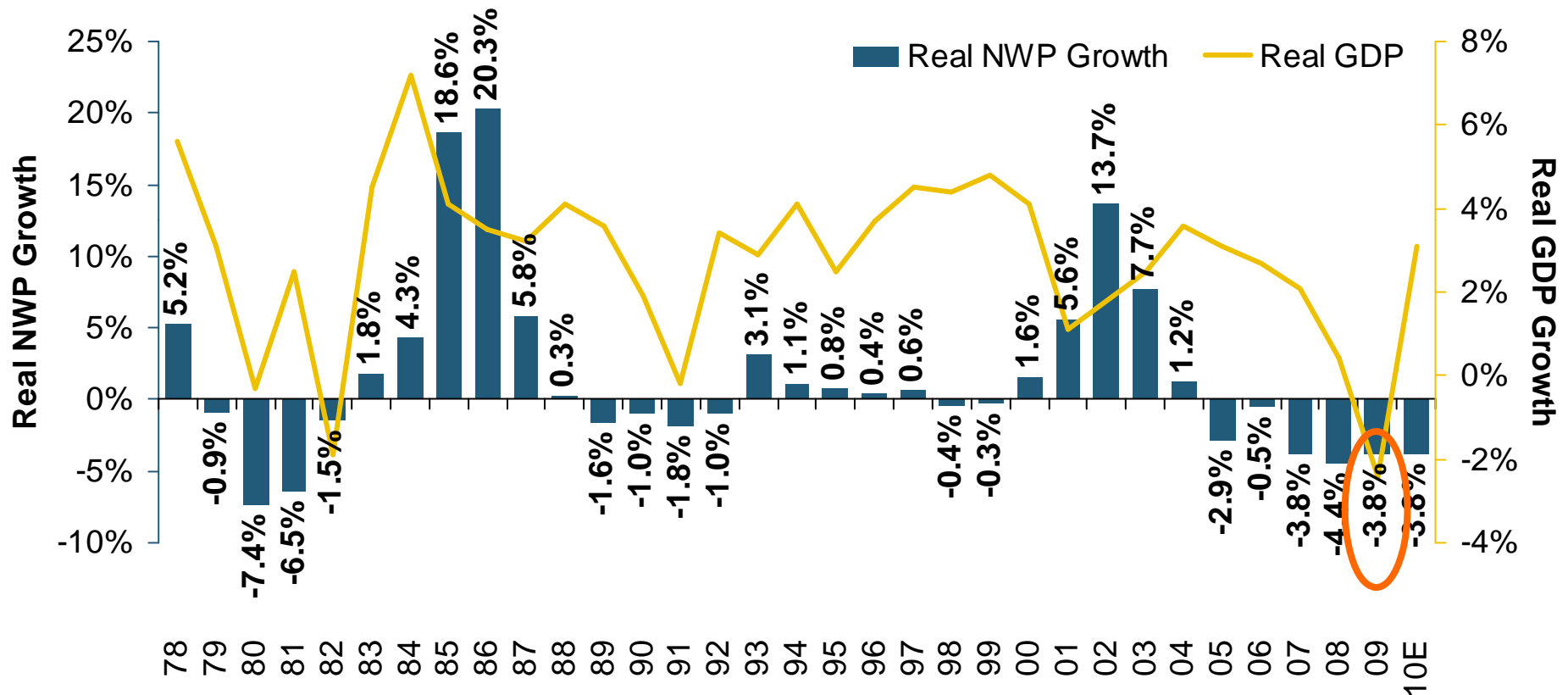
* 2009 figure is return on average statutory surplus. 2008 and 2009 figures exclude mortgage and financial guarantee insurers
Source: Insurance Information Institute from A.M. Best and ISO data



**P/C Premium Growth(?)
Driven Mainly by the
Industry's Underwriting Cycle,
Not the Economy**

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

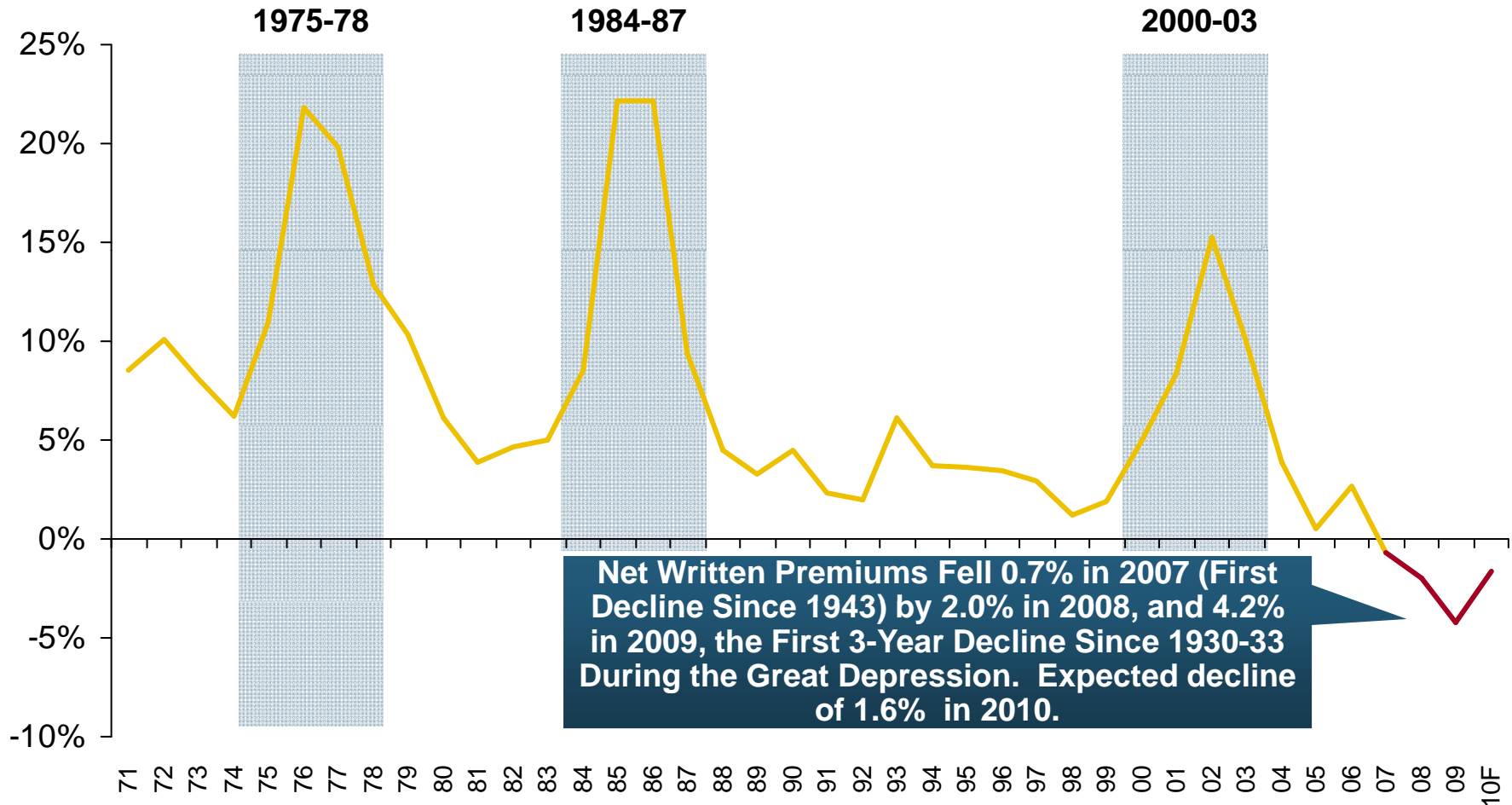
Real GDP Growth vs. Real P/C (%)



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

Strength of Recent Hard Markets by NWP Growth

(Percent)



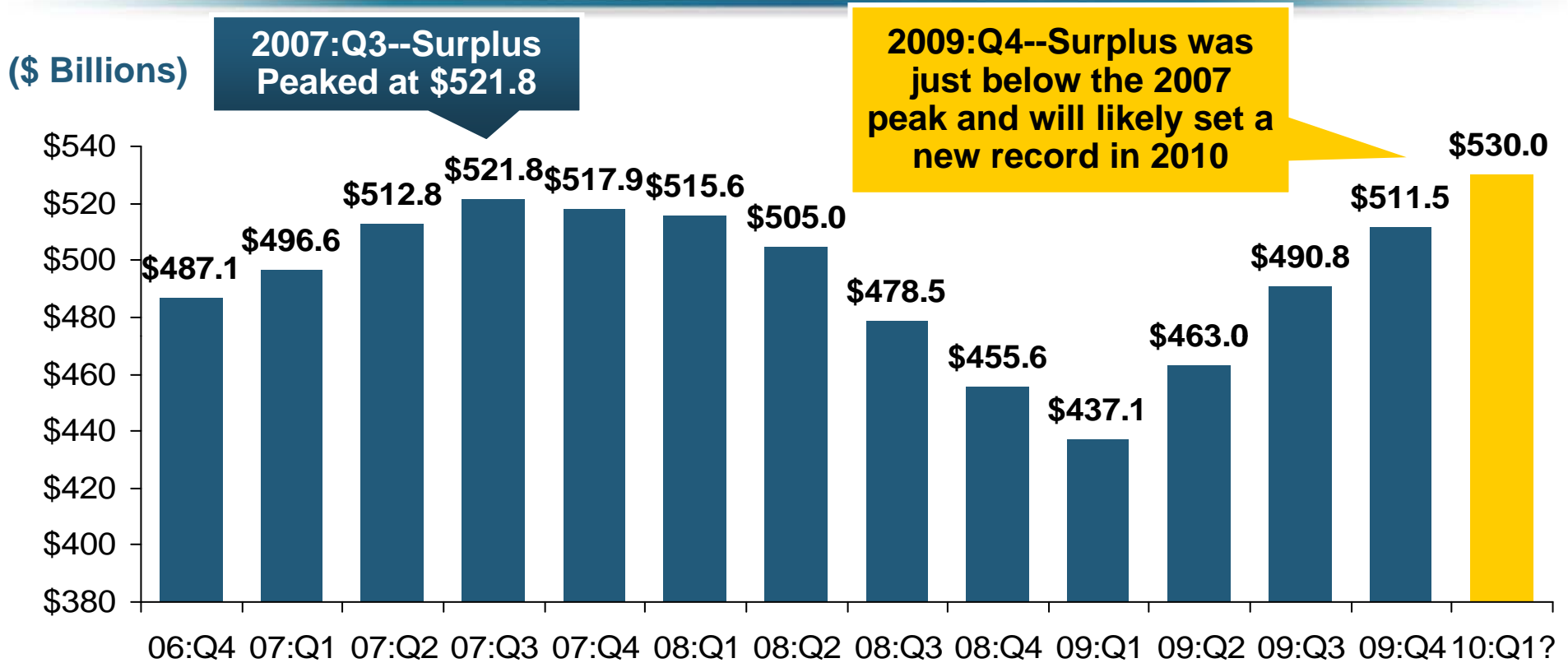
Shaded areas denote "hard market" periods

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



Capital/Policyholder Surplus (US)

Policyholder Surplus, 2006:Q4–2010:Q1E



Declines Since 2007:Q3 Peak

08:Q2: **-\$16.6B (-3.2%)**

09:Q2: **-\$58.8B (-11.2%)**

08:Q3: **-\$43.3B (-8.3%)**

09:Q3: **-\$31.8B (-5.9%)**

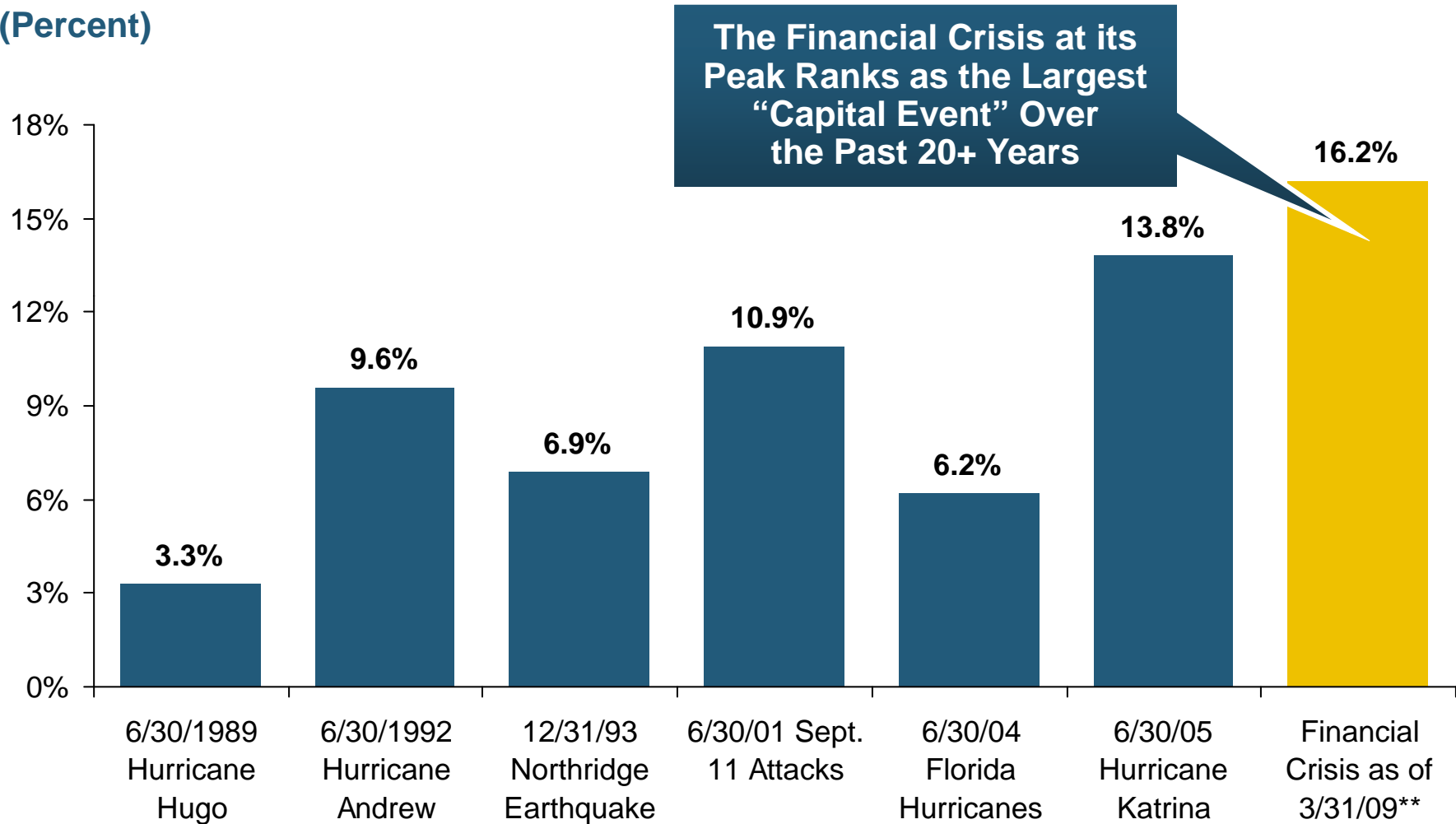
08:Q4: **-\$66.2B (-12.9%)**

09:Q4: **-\$10.3B (-2.0%)**

09:Q1: *-\$84.7B (-16.2%)*

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

(Percent)



* 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



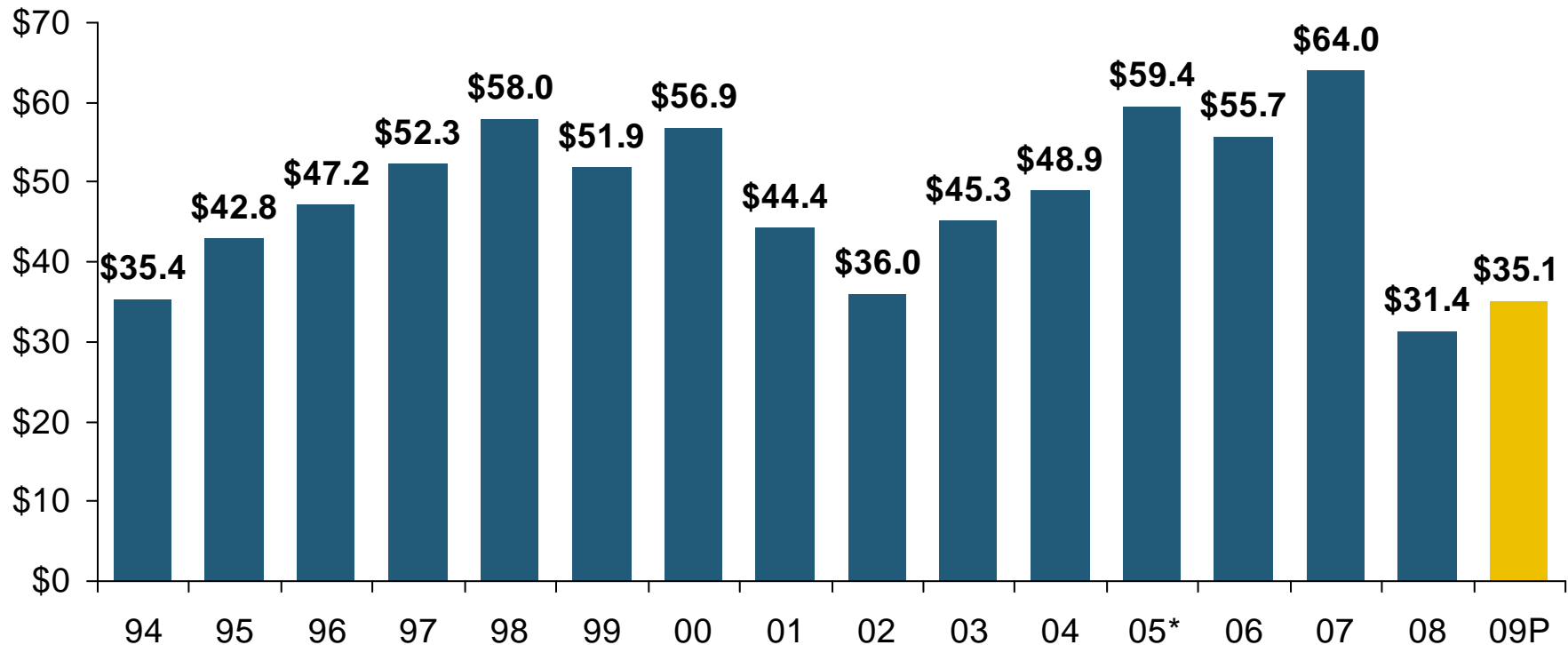
Investment Performance

**Investments Are a Principle
Source of Declining Profitability**

Property/Casualty Insurance Industry Investment Gain: 1994–2009P¹



(\$ Billions)



Investment Gains Fell by 51% In 2008 Due to Lower Yields, Poor Equity Market Conditions. In 2009, the Return of Realized Capital Losses Helped Offset Lower Investment Income

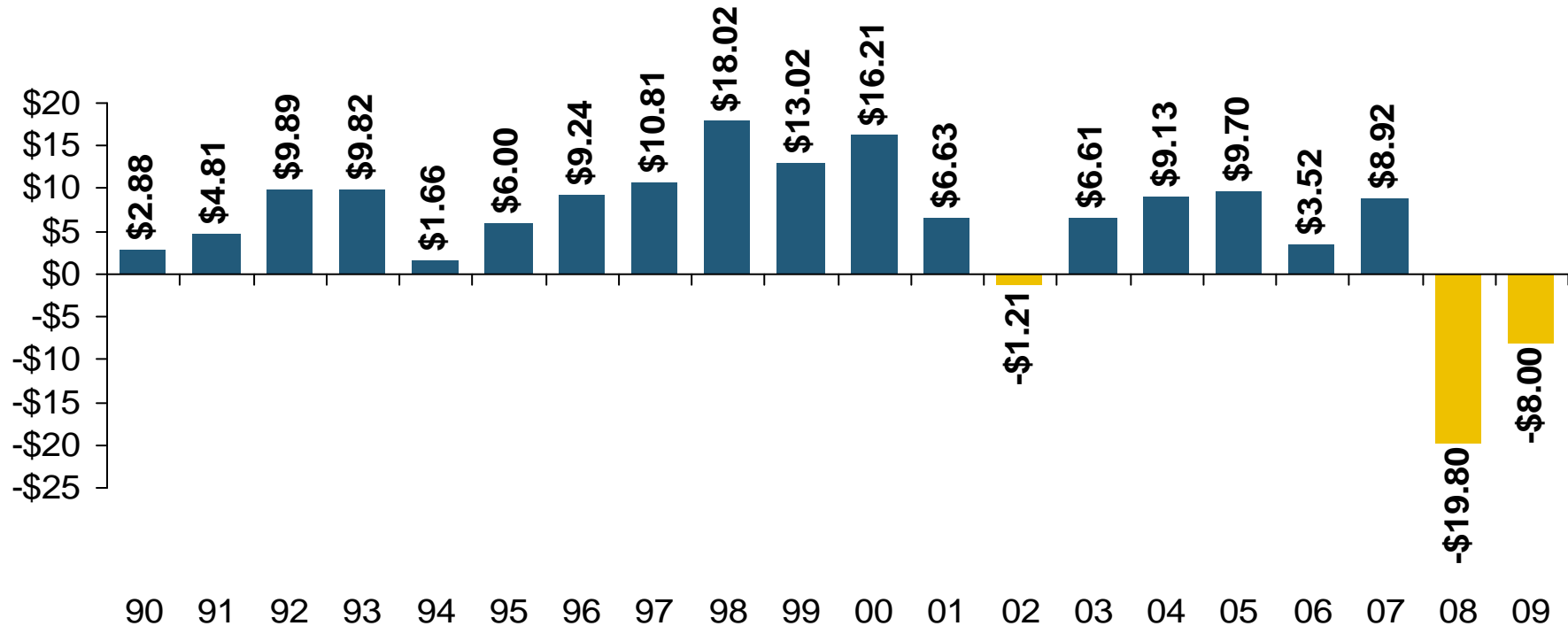
¹ Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

* 2005 figure includes special one-time dividend of \$3.2B.

Sources: ISO; Insurance Information Institute.

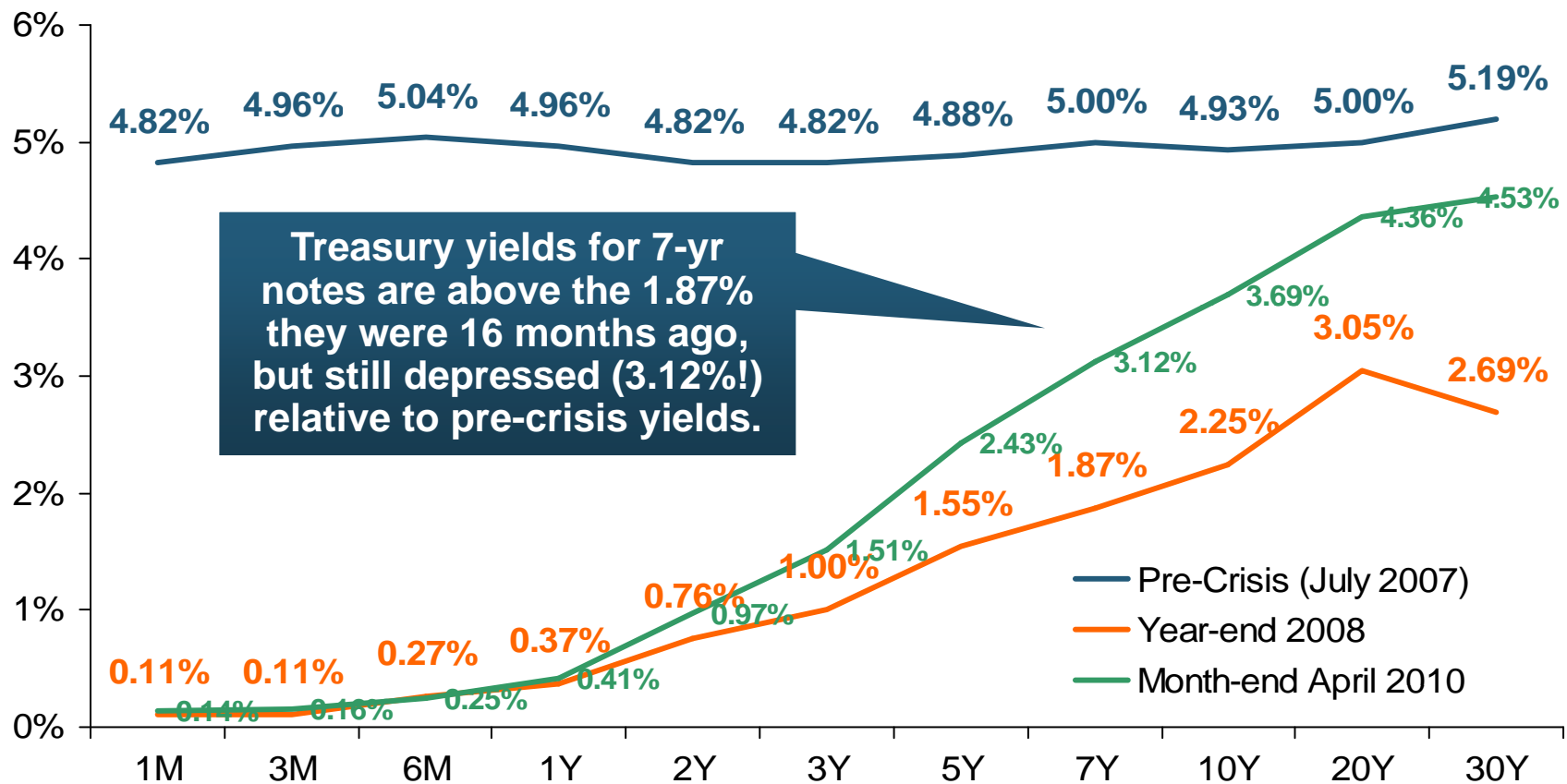
P/C Insurer Net Realized Capital Gains, 1990-2009

(\$ Billions)



**Realized Capital Losses Hit a Record \$19.8 Billion in 2008
Due to Financial Market Turmoil, Followed by an \$8.0B Drop in 2009.
This is a Primary Cause of 2008/2009's Large Drop in Profits and ROE**

U.S. Treasury Yields Are Still Quite Low Compared to Pre-Crisis Levels



The Average Maturity on Bonds in P-C Insurers' Portfolios Has Remained Steady at About 7.5 Years Through the Last Decade

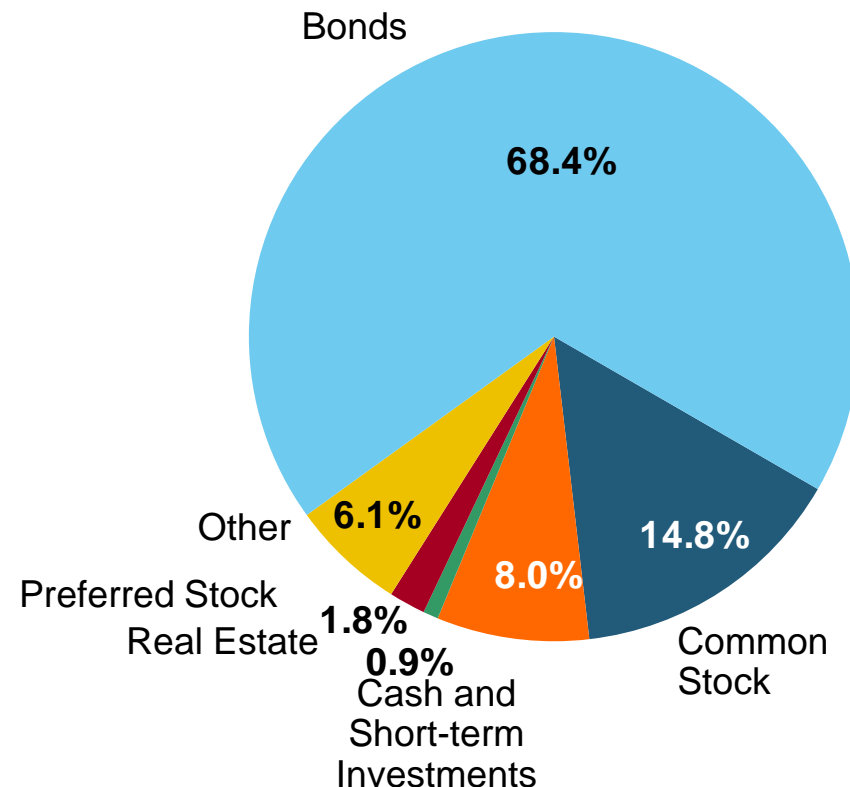
Sources: Board of Governors of the United States Federal Reserve Bank at http://ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield_historical_main.shtml ; Insurance Information Institute.

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

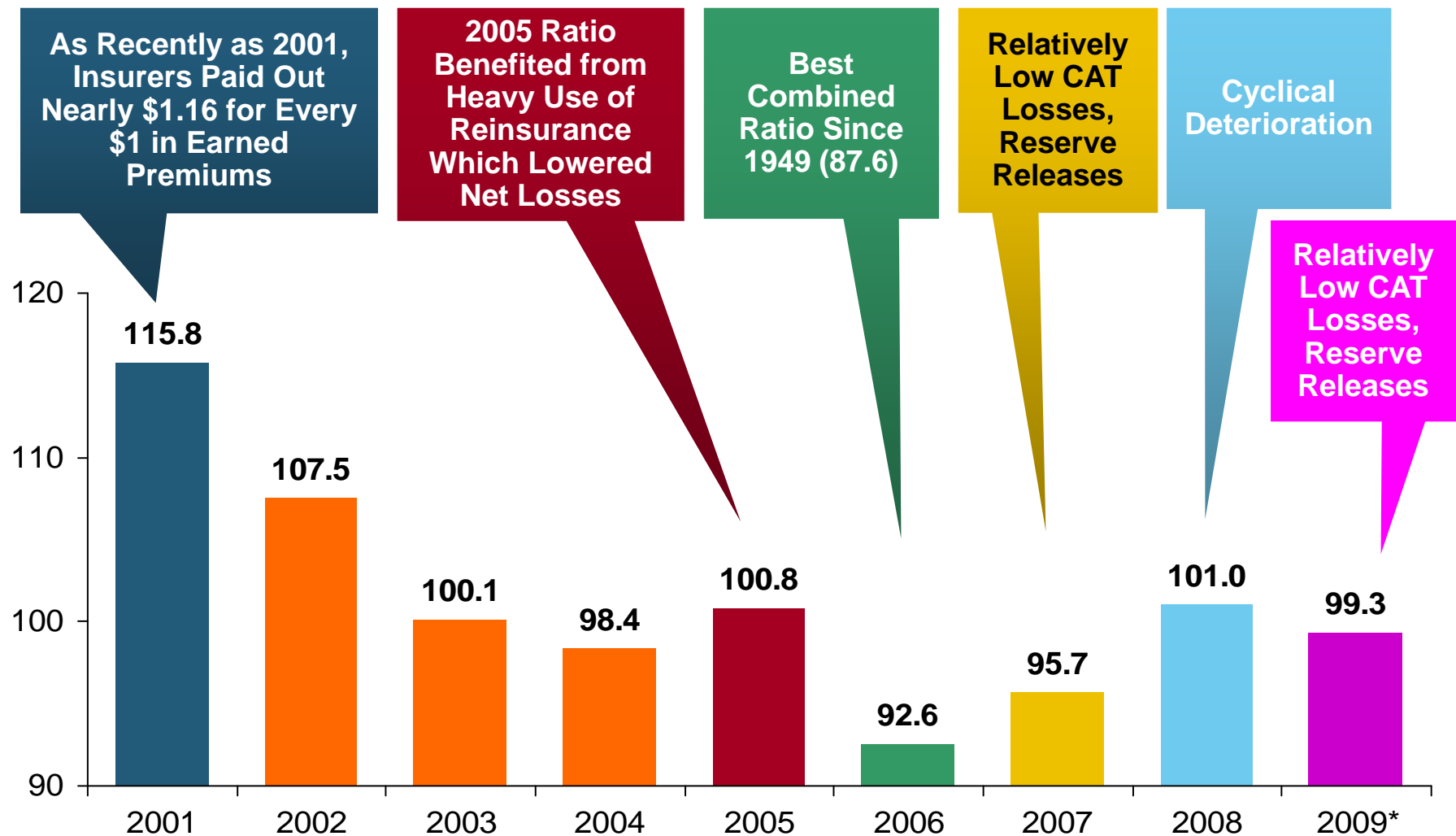
As of December 31, 2008



Underwriting: It Wasn't the Economy, ...

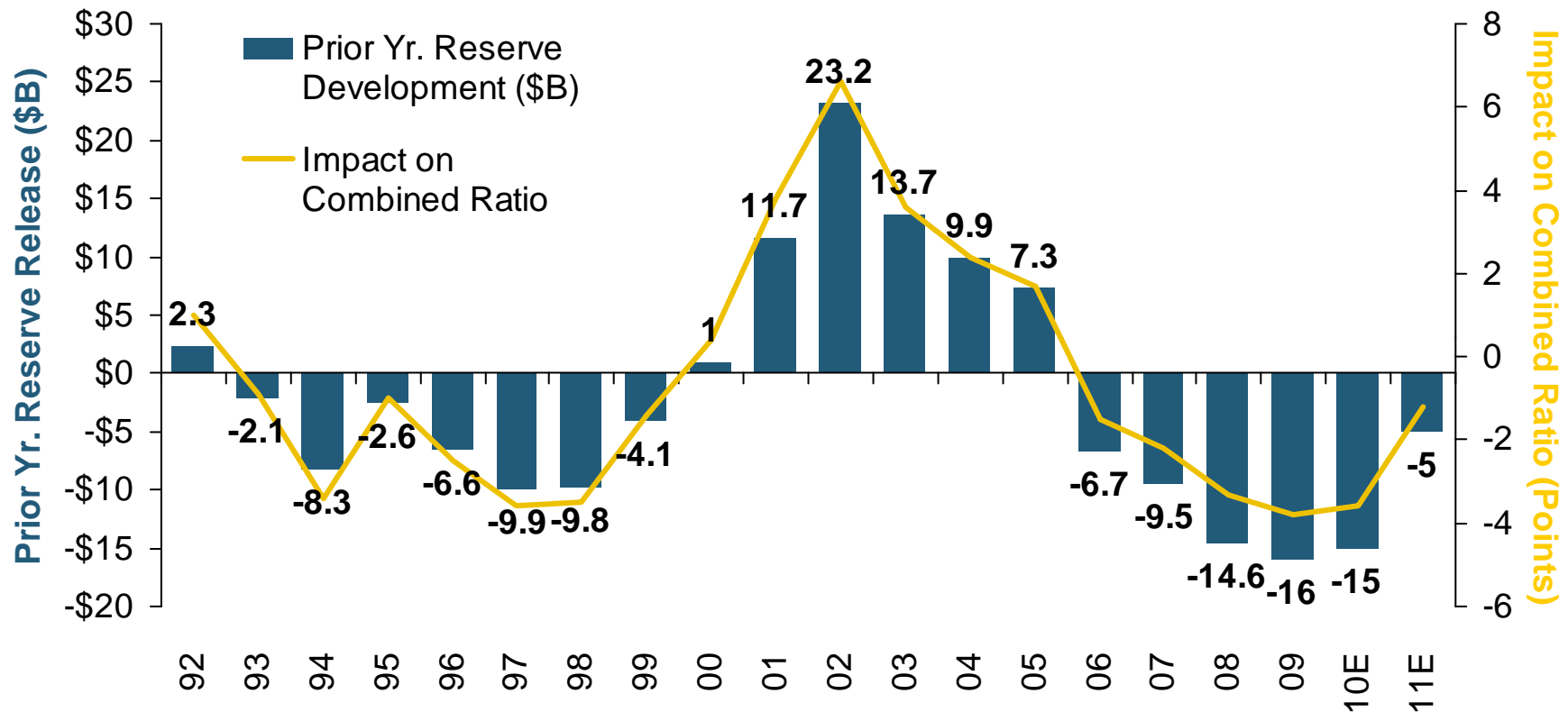
**The Underwriting Cycle,
Catastrophe Losses
Were the Main Drivers**

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



* 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



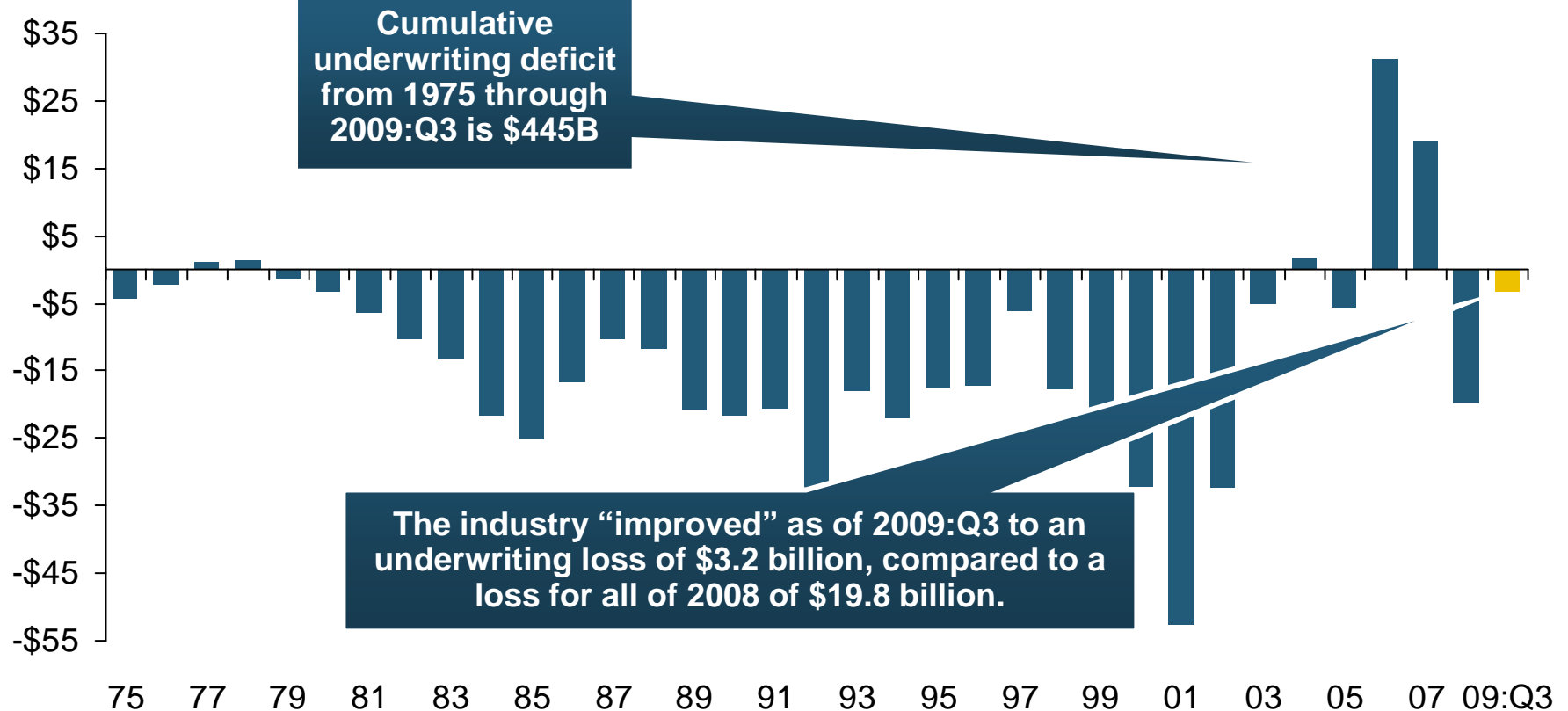
Reserve Releases Will Expected to Taper Off in 2010 and Drop Significantly in 2011

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.

Underwriting Gain (Loss) 1975–2009:Q3*

(\$ Billions)



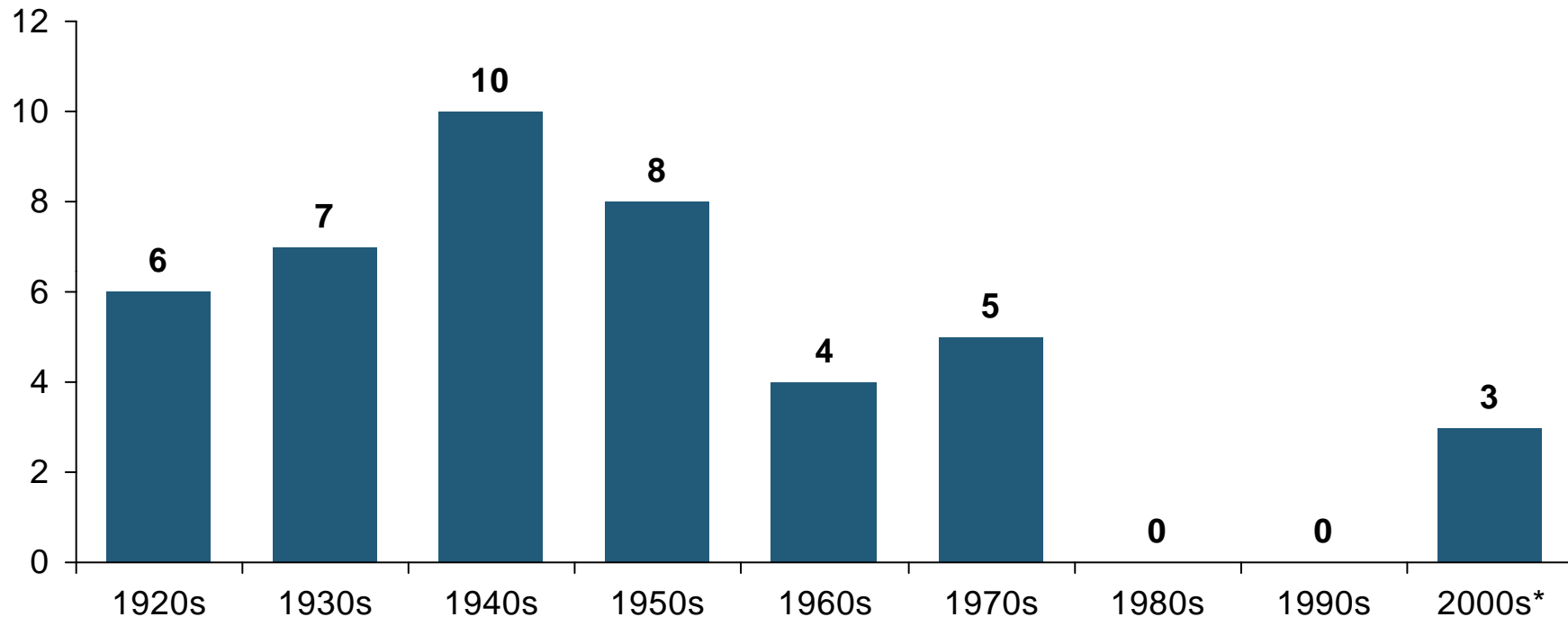
**Large Underwriting Losses Are *NOT* Sustainable
in Current Investment Environment**

* Includes mortgage and financial guarantee insurers.

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

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

Number of Years with Underwriting Profits



Underwriting Profits Were Common Before the 1980s (40 of the 60 Years Before 1980 Had Combined Ratios Below 100) – But Then They Vanished. Not a Single Underwriting Profit Was Recorded in the 25 Years from 1979 Through 2003

* 2000 through 2009. 2009 combined ratio was 100.7 through Q3.

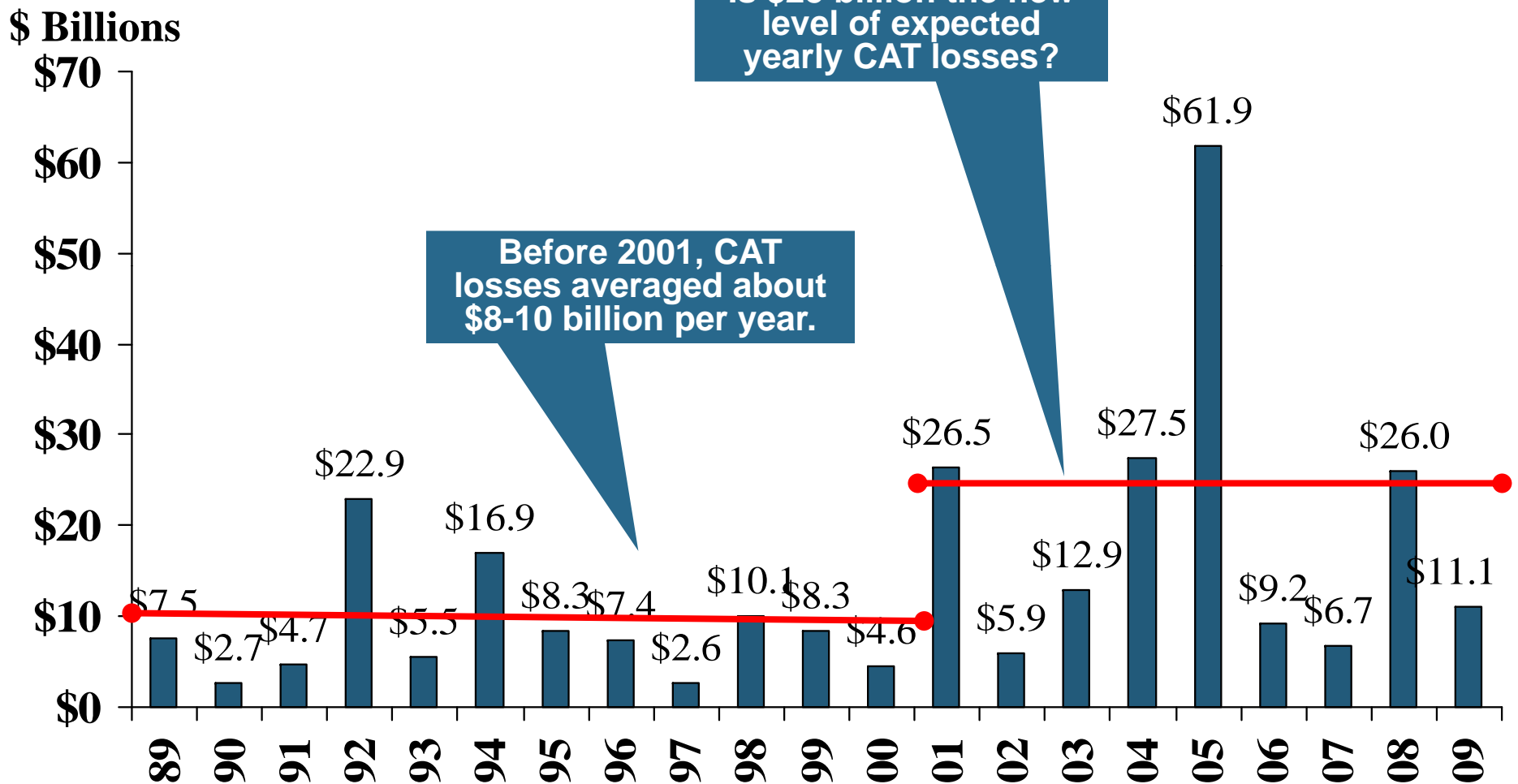
Note: Data for 1920–1934 based on stock companies only.

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



Catastrophic Loss – Claims Are Trending Adversely

Catastrophic Losses*: Was 2005 an Outlier or a Harbinger?



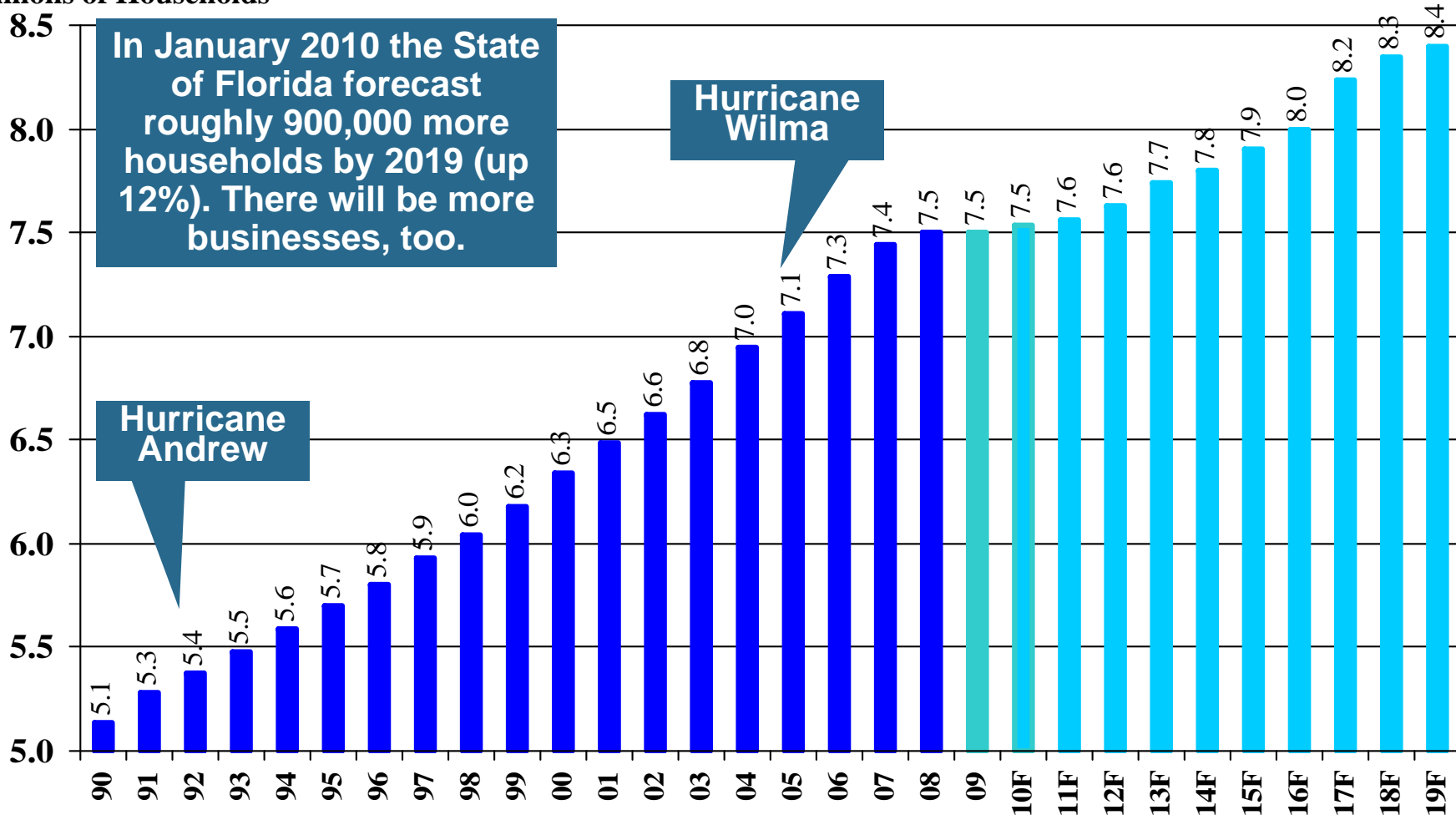
*Excludes \$4B-\$6b offshore energy losses from Hurricanes Katrina & Rita.

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

A Million More Florida Resident Households in the Next Decade?

Millions of Households

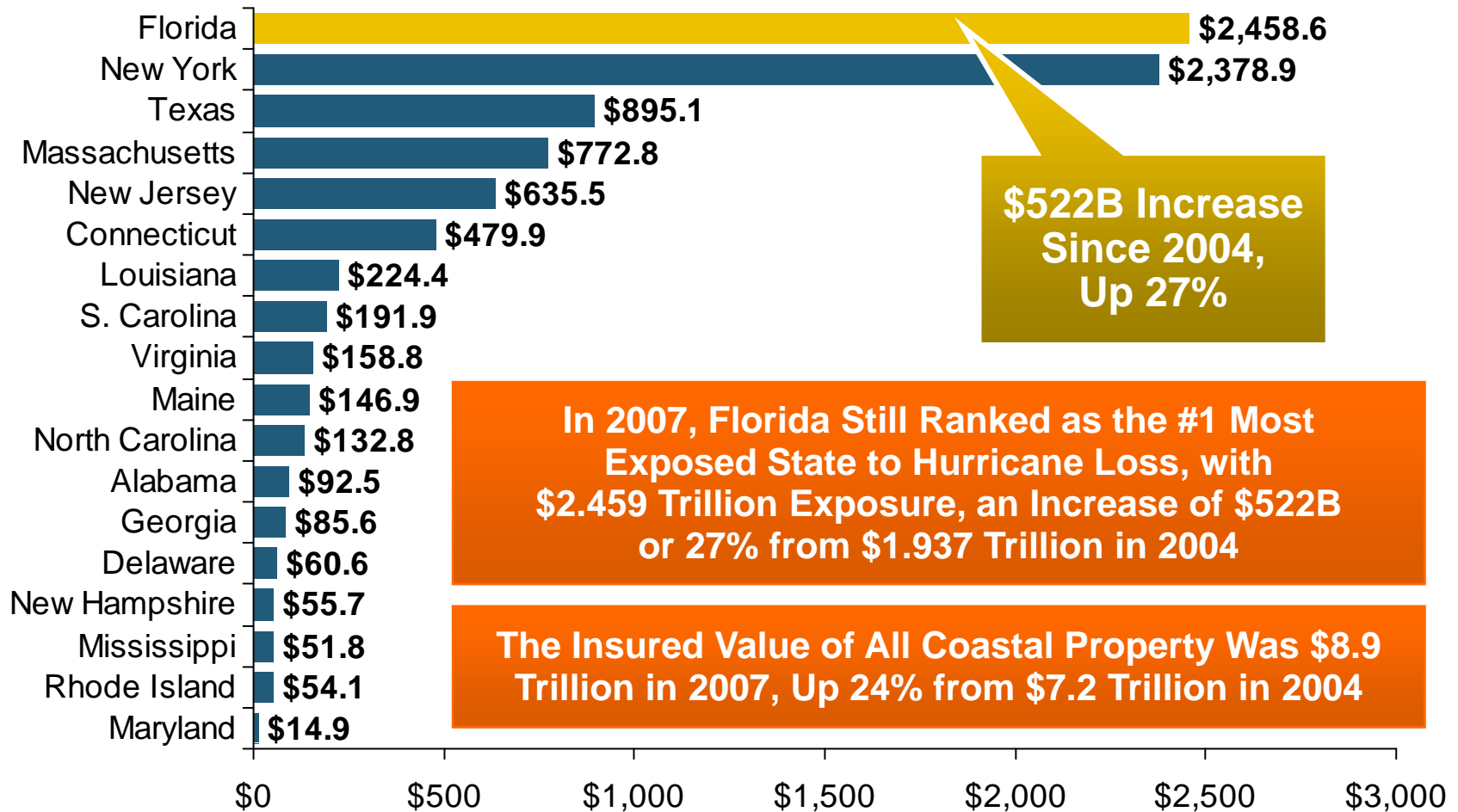


Source: <http://edr.state.fl.us/conferences/population/demographic.htm>

Data are from Jan. 26, 2010 Florida Demographic Estimating conference

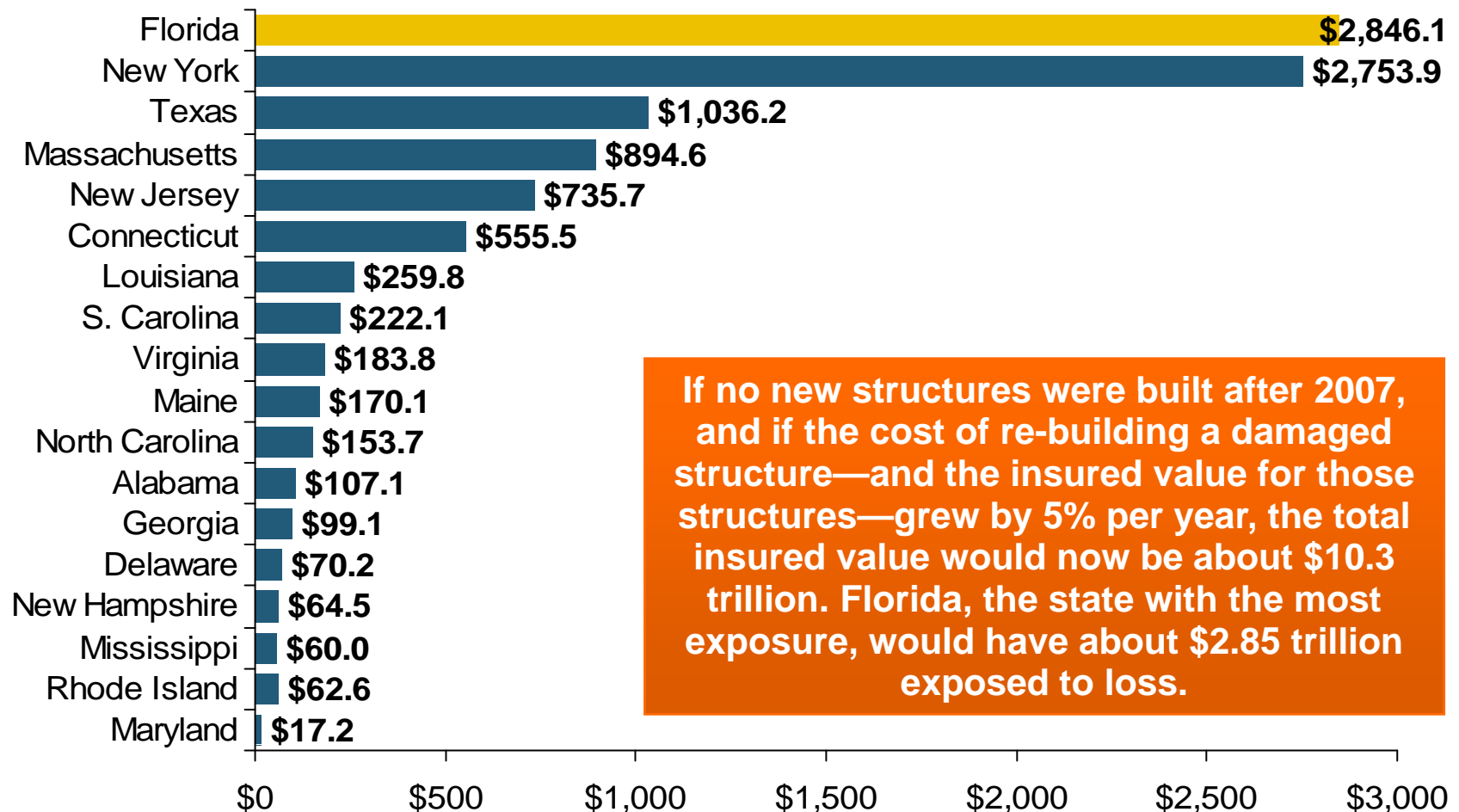
Estimated Value, in 2007, of Insured Coastal Exposure, by State

(2007, \$ Billions)

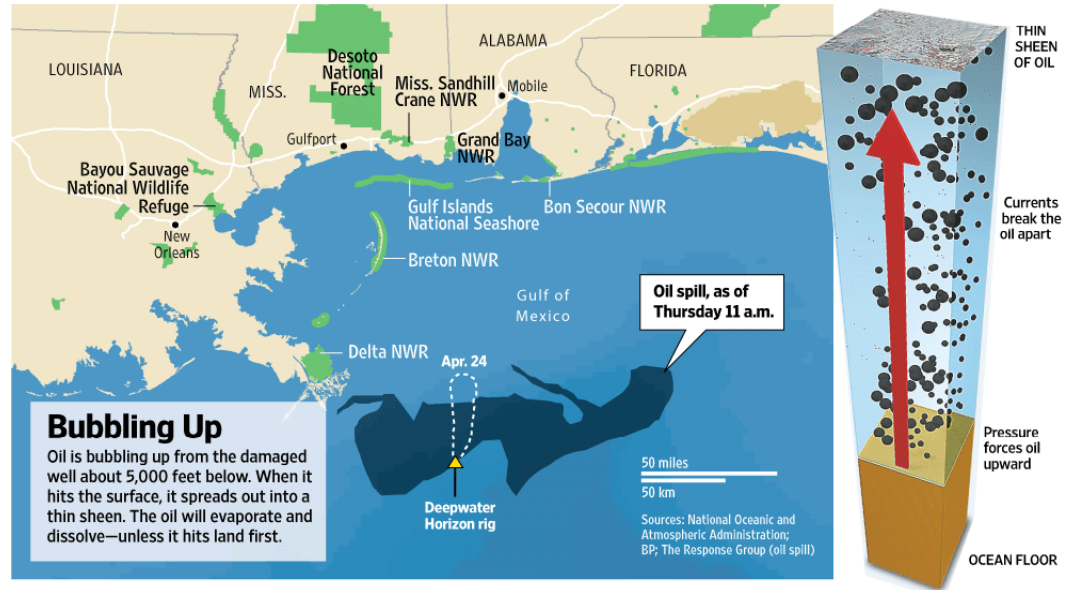


Estimated Value, in 2010, of Insured Coastal Exposure

\$ Billions



Source: AIR Worldwide's 2007 estimates, assumed to grow by 5% per year increased rebuilding cost; assumes no new structures built in 2008-2010



Sinking of Deepwater Horizon Platform and Gulf of Mexico Oil Spill

Insurance Implications of Sinking of *Deepwater Horizon* Platform and Oil Spill

- Insurance losses from the explosion and sinking of the *Deepwater Horizon* offshore oil platform will be significant
 - ◆ One of the Largest Losses Ever for Global Offshore Energy Insurance and Reinsurance Markets
 - ◆ Early Loss Estimates Put the Insured Loss in Excess of \$1B to \$1.25B*
 - ◆ Includes \$560 million as replacement cost of sunken oil platform
 - ◆ Loss Appears to Be Well Syndicated With a Global Spectrum of Insurers and Reinsurers Sharing in the Losses
 - ◆ Significant retentions/self-insurance may be in play

Deepwater Horizon Oil Rig/Spill Loss: 6 Types of Coverage That Might Apply

- **Physical Damage:** covers physical damage or loss to a company's offshore property and equipment, including offshore fixed platforms, pipelines and production and accommodation facilities.
- **Business Interruption/Loss of Production Income:** covers energy businesses against loss due to temporary interruption in oil/gas supply from an offshore facility as a result of physical loss or damage to an offshore facility.
- **Operators' Extra Expense (Control of Well):** covers costs incurred by energy businesses when regaining control of a well after a "blowout". Might include expenses incurred in restoring or re-drilling well after blowout; seepage and pollution liability coverage to pay third party bodily injury, damage to and loss of third party property.

Deepwater Horizon Oil Rig/Spill Loss: 6 Types of Coverage That Might Apply (cont'd)



- **Offshore Construction:** covers the many different risks energy businesses face during construction projects, from project inception through completion and beyond.
- **Liability:** *Comprehensive general liability:* covers claims an energy business is legally obligated to pay as a result of bodily injury or property damage to a third party. *Workers compensation/employers liability:* covers energy businesses for losses from injury or death of employees.
- **Environmental/Pollution Liability:** covers bodily injury, property damage, and clean up costs as a result of a pollution incident from a designated site.

Insurance Information Institute Online:

www.iii.org

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and your attention!***

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