

# Financial Crisis and the Future of P/C Insurance

## *Challenges Amid the Global Economic and Regulatory Storm*

Greater Milwaukee CPCU Society  
All Industry Day Luncheon  
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## *Presentation Outline*

- **Financial Crisis: Federal Government's Financial Rescue Package**
  - Emergency Economic Stabilization Act of 2008 (w/revisions)
  - Troubled Asset Relief Program (TARP)
  - AIG
  - Impacts for Financial Services and Insurers
- **The Weakening Economy: Insurance Impacts**
  - Exposure & Claim Impacts
  - What Accelerating Inflation Means for Insurers
  - Looming Financial Services Regulatory Reform
- **P/C Insurance Industry Overview & Outlook**

**Q & A**

# Federal Government's Financial Rescue Package\*

(a.k.a. “The Bailout”)

## Plan Details & Insurer Implications

\*Including additional provision of the Emergency  
Economic Stabilization Act of 2008



## *Federal Government Financial Services Rescue Package*

### THE SOLUTION: A 6-POINT PLAN

1. **Treasury Purchase of Equity Stakes in Banks**
  - Treasury will buy up to \$250B in senior preferred shares in wide variety of banks (out of \$700B in EESA)
  - 9 largest banks get \$125B
  - Stakes come in the form of non-voting shares and pay 5% for first 5 years and 9% thereafter
  - Feds get warrants to buy up to 15% more shares
  - Banks can buy back stake from government
  - Must agree to limits on CEO compensation
  - **GOAL: Bolster bank capital/liquidity**



## Federal Government Financial Services Rescue Package

### THE SOLUTION: A 6-POINT PLAN

#### 2. Treasury Purchase of Equity Stakes in Insurer(s)

- Treasury may purchase stakes in insurers beyond AIG
- Already being done in Europe (e.g., ING, Fortis, Aegon)
- Effort led by life insurers
- EESA language allows Treasury to take stakes in any financial institution, but in rules governing spending of first \$250B to recapitalize banks, program was limited to banks and bank holding companies
- Treasury must therefore redraft or create new rules
- Unclear how Treasury would take an “equity” stake in a mutual insurer
- Smaller, healthy insurers may be upset if infusion puts them at competitive disadvantage, funds are used to make acquisitions or decision to not take funds gives appearance of financial weakness
- **GOAL: Bolster insurers capital; Meet ratings agency/regulatory reqs.**

#### 3. Backing New Debt from Banks

- FDIC will guarantee new, senior unsecured debt issued by banks, thrifts and bank holding cos. Must mature within 3 years; Banks can opt in until 6/30/2009
- **GOAL: Restore confidence of buyers of bank debt that they will be paid back (no matter what happens to bank)**

Source: I.I.I. research; WSJ 10/25/08.



## Federal Government Financial Services Rescue Package

### THE SOLUTION: A 6-POINT PLAN (Cont'd)

#### 3. More Coverage for Bank Deposits

- FDIC will provide unlimited coverage for all non-interest bearing accounts through 12/31/09. (Such accounts are typically used by businesses to meet short-term expenses such as payrolls)
- Paid for by fees/premiums paid to FDIC
- **GOAL: Boost liquidity for otherwise healthy banks (esp. regional and local banks that might see nervous depositors withdraw money in favor of bigger banks)**

#### 4. Buy Short-Term Commercial Paper

- Federal Reserve will buy until 4/30/09 high-quality 3-month debt issued by businesses in commercial paper market
- Commercial paper is the prime source of funding to cover op. expenses at many large corps. and financial institutions
- **GOAL: Guarantees there will be a buyer of debt, so private sector buyers will be willing to buy too**

Source: US Treasury, CNN Money.com and I.I.I. research.



## Federal Government Financial Services Rescue Package

### THE SOLUTION: A 6-POINT PLAN (cont'd)

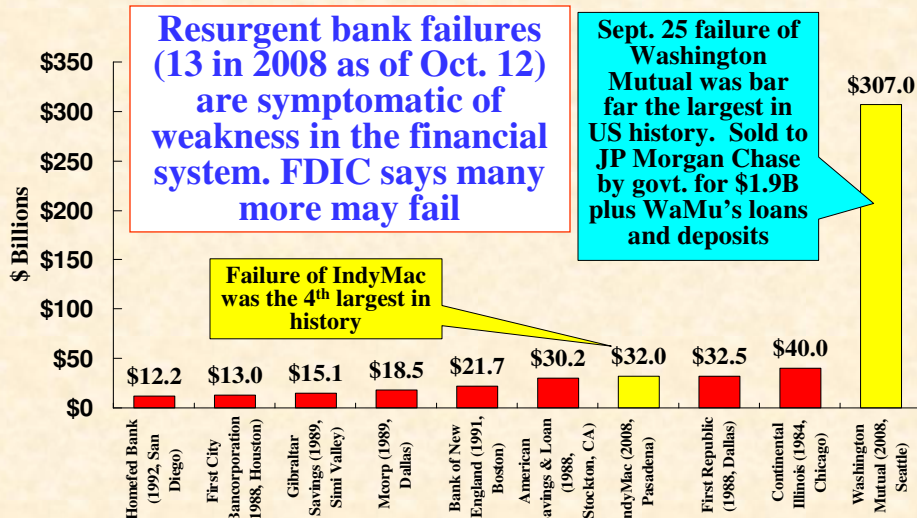
#### 5. Buy Troubled Assets: "Troubled Asset Relief Program" (TARP)

- Up to \$450B available (theoretically) available to purchase troubled assets from banks (and others?)
- Limits on CEO Compensation in Participating Firms
- Pricing: Debt Sold to Feds via Reverse Auction
  - Reverse auction is one in which sellers bid lowest price it will accept from the government (i.e., rather a traditional auction in which the highest bid from buyer wins). Helps ensure that the Feds (taxpayer) does not overpay for questionable debt
  - Will be sold in multi-billion dollar increments and run by outside asset managers in amounts ranging up to \$50 billion
  - Recoupment provision allows government to assess users of program to make taxpayers whole if program loses money
  - GOAL: By removing "toxic" assets with uncertain underlying value from bank balance sheets, banks should be better able to attract capital

Source: I.I.I. research.



## Top 10 Largest Bank Failures



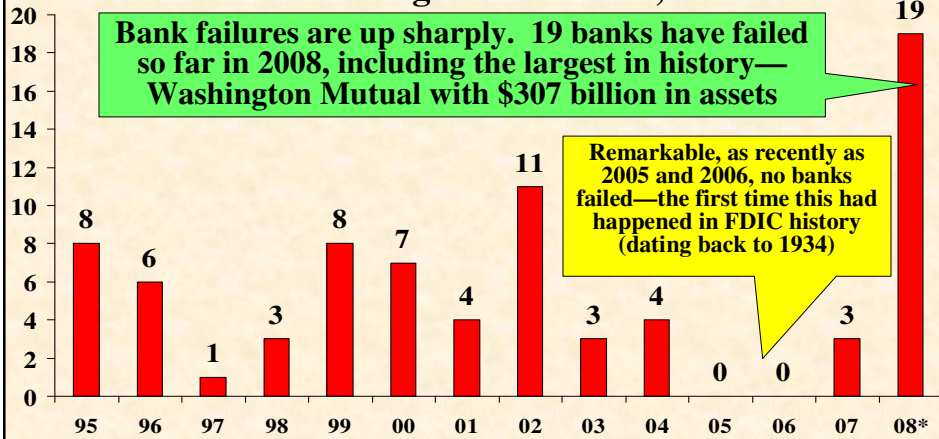
Source: FDIC; Insurance Information Institute research.



## US Bank Failures:\*

### 1995-2008

Through November 8, 2008

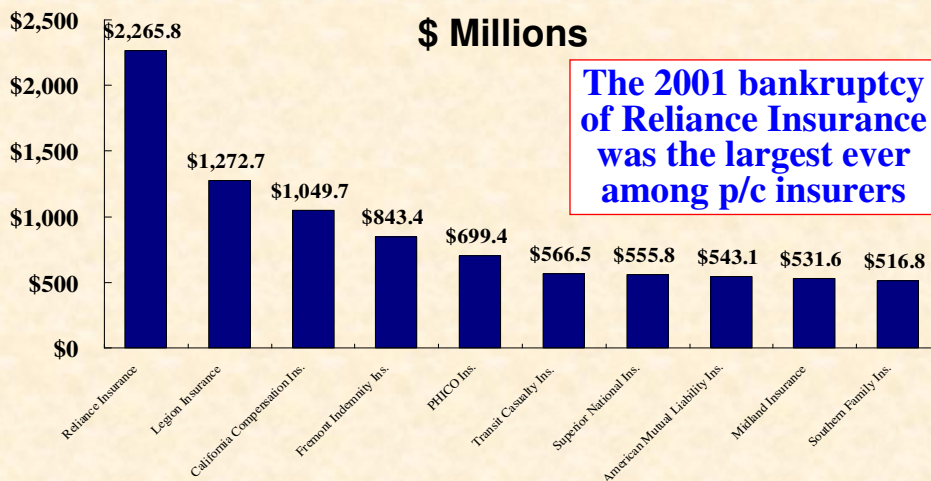


\*Includes all commercial banking and savings institutions.

Source: FDIC: <http://www.fdic.gov/bank/historical/bank/index.html>; Insurance Info. Institute



## Top 10 P/C Insolvencies, Based Upon Guaranty Fund Payments\*



\* Disclaimer: This is not a complete picture. If anything the numbers are understated as some states have not reported in certain years.

Source: National Conference of Insurance Guaranty Funds, as of September 17, 2008.



## Why Did Credit Markets Freeze & Why Are They So Hard to Thaw?

1. **CRISIS OF CONFIDENCE:** Banks are Fearful of Lending to Each Other as Well as Even Highly-Rated Corporate Risks
  - Lehman and bank bankruptcies have deeply damaged faith in the financial integrity of financial institutions
  - Fear has spread to European banks
  - Concern that US actions are insufficient and Europe's too uncoordinated
  - CONSEQUENCES: Lending is shriveling and LIBOR is rising
2. **DELEVERAGING:** Banks & Investors Want to Reduce Debt
  - Issuing new loans, even short term, slows purge of debt from balance sheets
3. **TANGLED WEB OF RISK:** Financial Innovations Designed to Spread and Hedge Against Risk Obscure Where Risk is Held and in What Amounts → Genesis of the Systemic Risk
  - The packaging, securitization and global sale of collateralized debt obligations (CDOs) such as mortgage backed securities (MBS) has made every financial institution in the world vulnerable
  - Explosive and widespread use of derivative hedges such as credit default swaps create large numbers of potentially vulnerable counterparties

Source: Wall Street Journal, 10/7/08, p. A2; Insurance Information Institute research.



## Positive Signs & Silver Linings in the Economy

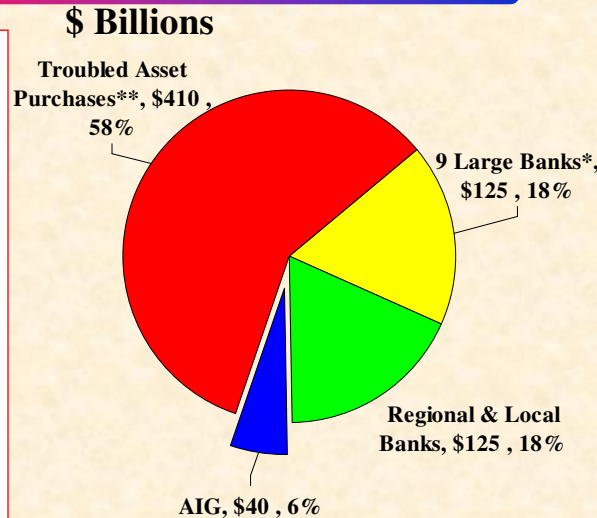
1. **CREDIT THAW:** Banks are beginning to lend to each other and to others in unsecured credit markets
  - Key interest rates falling (LIBOR)
2. **DELEVERAGING:** Banks, Businesses, Investors & Consumers reducing debt loads to more manageable levels
3. **ENERGY PRICES FALLING:** Oil prices are down more than 50% and gas prices down about 40%
  - Falling energy prices are potent economic stimulus and confidence builder
  - Helps all industries
4. **INFLATION THREAT WANING:** Falling energy, commodities prices will help consumers and cut off price spiral
  - Less erosion in real wages
5. **AFFORDABILITY IN HOUSING:** Rapidly falling home prices will attract more buyers, more quickly
  - Critical to clear away excess inventory, stem foreclosures
  - Some increases in home sales

Source: Insurance Information Institute

## Distribution of \$700 Billion in Funds Under Emergency Economic Stabilization Act of 2008\*

### Shifting Emphasis

- Original EESA allocated all \$700B to Troubled Asset Relief Program. None used for that purpose yet.
- View was that TARP would take too long and that liquidity/credit crisis required direct infusion of capital in banks, AIG by feds
- \$410B (58%) of original \$700B remains available



Source: US Treasury Department; Insurance Information Institute research; \*As of 11/11/08. \*\*Unused

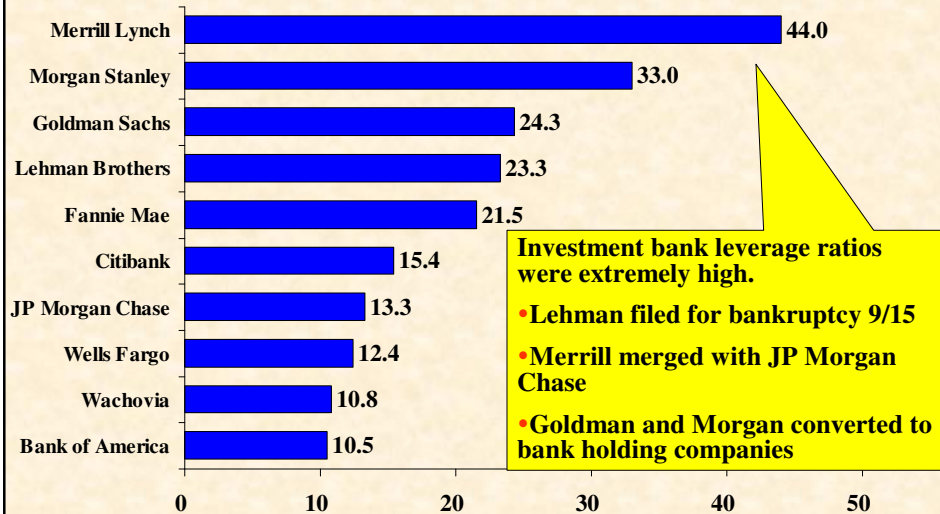
# The Deleveraging of America

## Economic Downtraft and Regulatory Questions





## Leverage Ratios for Investment Banks and Traditional Banks\*



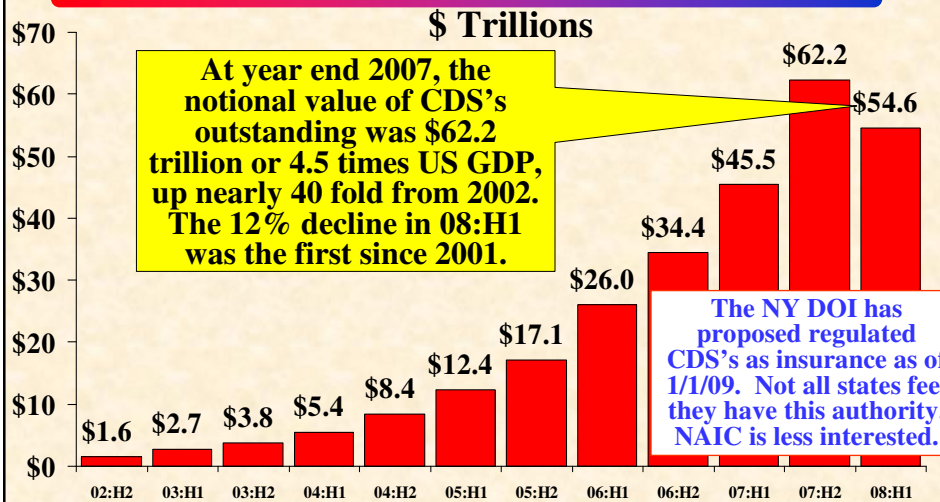
Investment bank leverage ratios were extremely high.

- Lehman filed for bankruptcy 9/15
- Merrill merged with JP Morgan Chase
- Goldman and Morgan converted to bank holding companies

\*Based on data for last quarter reported (May or June 2008).  
Source: "The Perils of Leverage," North Coast Investment Research, Sept. 15, 2008



## Credit Default Swaps: Notional Value Outstanding, 2002:H2 – 2008:H1\*



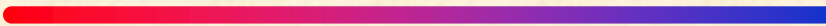
At year end 2007, the notional value of CDS's outstanding was \$62.2 trillion or 4.5 times US GDP, up nearly 40 fold from 2002. The 12% decline in 08:H1 was the first since 2001.

The NY DOI has proposed regulated CDS's as insurance as of 1/1/09. Not all states feel they have this authority. NAIC is less interested.

\*End of calendar half (H1 = June 30, H2 = December 31).  
Source: International Swaps and Derivatives Association: <http://www.isda.org/statistics/recent.html>

# Government Rescue Package for AIG

## Motivation & Structural Details



## *AIG's Revised "Rescue" Treatment in November 2008*

| Investor                          | AIG Gets   | Investor Gets  |
|-----------------------------------|--|--|
| U.S. Treasury investment          | <ul style="list-style-type: none"><li>•\$40 Billion Cash Infusion</li></ul>                  | <ul style="list-style-type: none"><li>•\$40 billion of preferred stock (comes from \$700 billion TARP "bailout" fund)</li><li>•Warrants to buy shares of common stock equal to 2% of the outstanding shares on day purchased; could result in ownership of 79.9% of common shares</li><li>•10% dividend on preferred stock</li></ul> |
| Federal Reserve Bank (of NY) Loan | <ul style="list-style-type: none"><li>•\$60 Billion Line of Credit; Term = 6 years</li></ul> | <ul style="list-style-type: none"><li>•Interest rate on borrowed money is 3%+3-month LIBOR (rate as of 11/11/2008 = 5.18%)</li><li>•Rate on unborrowed money is 0.75%</li></ul>  |

Source: "AIG Gets a Break in U.S. Loan Deal," NU Online New Service, Nov. 6, 2008.



## Revised “Rescue” Treatment of AIG’s Credit Default Swaps

| New Entity #1   | Source of New Entity’s Funds   | AIG Gets   | FRB-NY Gets   |
|---|--|--|---|
| <ul style="list-style-type: none"> <li>• Will buy AIG’s Multi-Sector CDOs from owners (e.g., banks) on which AIG has written credit default swap contracts</li> <li>• Former CDO owners get to keep about \$35B in collateral AIG posted and will get about 50 cents on the dollar for \$70B in face value of CDOs</li> </ul> | <ul style="list-style-type: none"> <li>• Up to \$30 billion senior loan from FRB-NY</li> <li>• \$5 billion subordinated loan from AIG (<i>i.e.</i>, AIG absorbs first \$5B in losses, if any)</li> </ul> | <ul style="list-style-type: none"> <li>• Losses on CDOs limited to decline in market value prior to sale of assets to new entity + \$5 billion (subordinated loan)</li> <li>• No new collateral needed even if credit default swaps values decline further</li> <li>• Interest on loan at 3-month LIBOR + 3%</li> <li>• Profits, if any, shared with FRB-NY</li> </ul> | <ul style="list-style-type: none"> <li>• Interest on loan at 3-month LIBOR + 1%; this interest is paid before AIG’s interest</li> <li>• Profits, if any, shared with AIG</li> </ul> |

Sources: “AIG Gets a Break in U.S. Loan Deal,” *NU Online News Service*, Nov. 6, 2008; Mary Williams Walsh, “A.I.G. Secures \$150 Billion Assistance Package,” *New York Times*, November 11,



## Revised “Rescue” Treatment of AIG’s Securities Lending Portfolio

| New Entity #2  | Source of New Entity’s Funds   | AIG Gets  | FRB-NY Gets  |
|--|--|---|--|
| Will buy residential mortgage-backed securities to resolve liquidity issue in AIG’s Securities Lending Portfolio (SLP) | <ul style="list-style-type: none"> <li>• Up to \$22.5 billion senior loan from FRB-NY</li> <li>• \$1 billion subordinated loan from AIG (<i>i.e.</i>, AIG absorbs first \$5B in losses, if any)</li> </ul> | <ul style="list-style-type: none"> <li>• Losses on CDOs limited to declines in market value prior to sale of assets to new entity + \$1 billion</li> <li>• Profits, if any, shared with FRB-NY</li> </ul> | <ul style="list-style-type: none"> <li>• Interest on loan</li> <li>• Profits, if any, shared with AIG</li> </ul> |

Sources: “AIG Gets a Break in U.S. Loan Deal,” *NU Online News Service*, Nov. 6, 2008; Mary Williams Walsh, “A.I.G. Secures \$150 Billion Assistance Package,” *New York Times*, November 11, 2008, p. C1



## *AIG's Revised "Rescue" Treatment (continued)*

|  | AIG   |
|--|---|
| Access U.S. Treasury's commercial paper program? | <ul style="list-style-type: none"><li>• Yes, up to \$20.9 billion; as of early November, AIG had issued about \$15.3 billion</li><li>• This is a cheaper source of funds than \$60b loan (under 3.9% since program started)</li></ul> |

Source: "AIG Gets a Break in U.S. Loan Deal," NU Online New Service, Nov. 6, 2008.



## *Rational for Federal Reserve's Rescue Package of AIG*

- **"Too Big to Fail" Doctrine Applied to Insurance for First Time**
- **AIG is the Largest Insurer in the US and One of the Top 5 Globally: Internationally Disruptive**
  - **Disorderly unwinding of CDS positions (which guarantee large amounts of debt) would have had large negative consequences on already fragile credit markets**
- **Fear Was that Generally Healthy Insurance Operations Affecting Millions of People and Businesses Would Have to Be Sold at Fire Sale Prices**
- **Original Loan and Subsequent Restructurings Allow Time for an Orderly Sale of Assets and a Minimal Disruption on Credit Markets while also Protecting Policyholders**

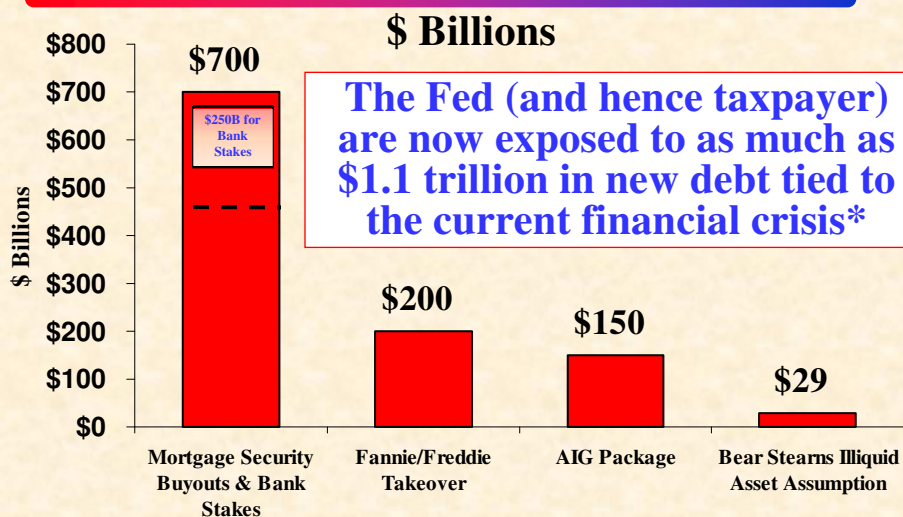
Source: Insurance Information Institute research.

# AFTERSHOCK: Regulatory Response Could Be Harsh

**All Financial Segments  
Including Insurers  
Will Be Impacted**



## *Incurring Liabilities of the Federal Government Due to Financial Crisis*



\*As of October 10, 2008. Amounts reflect maximum losses under terms at time of announcement. Source: Wall Street Journal, 11/10/08, p. A1; Insurance Information Institute research.



## Post-Crunch: Fundamental Issues To Be Examined Globally

- **Failure of Risk Management, Control & Supervision at Financial Institutions Worldwide: Global Impact**
  - Colossal failure of risk management (and regulation)
  - Implications for Enterprise Risk Management (ERM)?
  - Misalignment of management financial incentives
- **Focus Will Be on Risk Controls: Implies More Stringent Capital & Liquidity Requirements; *Prevention of Systemic Risks***
  - Data reporting requirements also likely to be expanded
  - Non-Depository Financial Institutions in for major regulation
  - Changes likely under US and European regulatory regimes
  - Will new regulations be globally consistent?
  - Can overreactions be avoided?
- **Accounting Rules**
  - Problems arose under FAS, IAS
  - Asset Valuation, including Mark-to-Market
  - Structured Finance & Complex Derivatives
- **Ratings on Financial Instruments**
  - New approaches to reflect type of asset, nature of risk

Source: Ins. Info. Inst.



## Post-Crunch: Fundamental Regulatory Issues & Insurance

- **Federal Encroachment on Regulation of Insurance in Certain Amid a Regulatory Tsunami**
  - \$123 billion in loans to AIG makes increased federal involvement in insurance regulation a certainty
  - States will lose some of their regulatory authority
  - What Feds get/what states lose is unclear
- **Removing the “O” from “OFC”?**
  - Treasury in March proposed moving solvency and consumer protection authority to a federal “Office of National Insurance”
  - Moving toward more universal approach for regulation of financial services, perhaps under Fed/Treasury?
  - Is European (e.g., FSA) approach in store?
  - Treasury proposed assuming solvency and consumer protection roles while also eliminating rate regulation
  - Expect battle over federal regulatory role to continue to be a divisive issue within the industry
  - States will fight to maximize influence, arguing that segments of the financial services industry under their control had the least problems

Source: Insurance Information Institute



## *Major Regulatory Considerations for Insurance Regulation in 2009*

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- **Power Sharing:** Will Feds and States Divide Regulatory Authority & How?
  - Holding company (federal) and operating company/insurer (state)?
- **Pre-Emption:** Will Congress Pass Legislation Pre-Empting State Authority?
- **Regulatory Consolidation:** Will Regulatory Authority (now spread over 4+ agencies) be Consolidated Into One Entity? Will it Involve States?
- **Life vs. P/C:** Will Separate Regulatory Structures Emerge?
- **Guarantee Fund System:** FDIC has suggested federalization of system
- **State Run Insurers:** Who Would Regulate State-Run Insurers (Property, WC)?
  - Many coastal states have large state-run entities
  - About 25 states operate workers comp state funds or monopolistic insurers
- **Regulation of Credit Default Swaps as Insurance:** Supported by NY State
- **Insurer Divisiveness:** Industry is Not United on Many Key Issues

Source: Insurance Information Institute research.

# Reasons Why Insurers Are Better Risk Managers Than Banks

*Insurers Will Emerge With Their Risk  
Management Model Largely Intact*





## *6 Reasons Why P/C Insurers Have Fewer Problems Than Banks*

- 1. Superior Risk Management Model**
  - Insurers overall approach to risk focuses on underwriting discipline, pricing accuracy and management of potential loss exposure
  - Banks eventually sought to maximize volume, disregarded risk
- 2. Low Leverage**
  - Insurers do not rely on borrowed money to underwrite insurance
- 3. Conservative Investment Philosophy**
  - High quality portfolio that is relatively less volatile and more liquid
- 4. Strong Relationship Between Underwriting and Risk Bearing**
  - Insurers always maintain a stake in the business they underwrite
  - Banks and investment banks package up and securitize, severing the link between risk underwriting and risk bearing, with disastrous consequences
- 5. Tighter Solvency Regulation**
  - Insurers are more stringently regulated than banks or investment banks
- 6. Greater Transparency**
  - Insurers are an open book to regulators and the public

Source: Insurance Information Institute

# **How Will an Obama Administration & New Congress Impact the Industry?**

## **Convention Wisdom & Agenda Items**





## *Views on Potential Impact of Obama Administration & New Congress on Insurance Industry*

- **Regulation:** Conventional Wisdom (CW) holds that Democrats are more inclined to support new and more onerous regulation
  - More regulation was in store for finl. services no matter who was elected
  - OFC, Flood & Wind, Nat Cat, Surplus Lines
  - Federalization of Guarantee Fund System?
- **Taxation:** CWs says that Democrats are more comfortable with higher taxes
  - Income, Capital Gains & Windfall Profit Taxes: Could rise or be implemented in the future
  - Offshore (Re)Insurers: Obama has criticized offshore tax havens
  - Private Equity: Taxing earnings of PE partners as ordinary income rather than 15% capital gains rate ; Source of some insurer capital recently
- **Tort:** CW suggests Democrats are more friendly to trial Lawyer Interests.
  - Erosion of recent tort reform
  - Creation of new liability channels/doctrines
  - Greatest impact on tort sensitive lines; Auto & WC also vulnerable

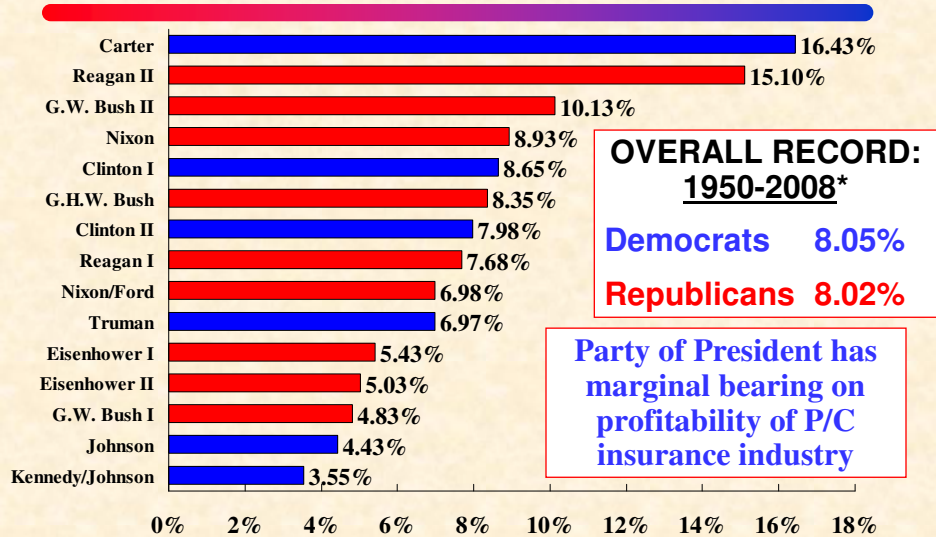
# Presidential Politics & P/C Insurance

*How is Profitability Affected by the President's Political Party?*





## *P/C Insurance Industry ROE by Presidential Administration, 1950-2008\**



\*ROE for 2008 based on H1 data. Truman administration ROE of 6.97% based on 3 years only, 1950-52.  
Source: Insurance Information Institute

# THE ECONOMIC STORM

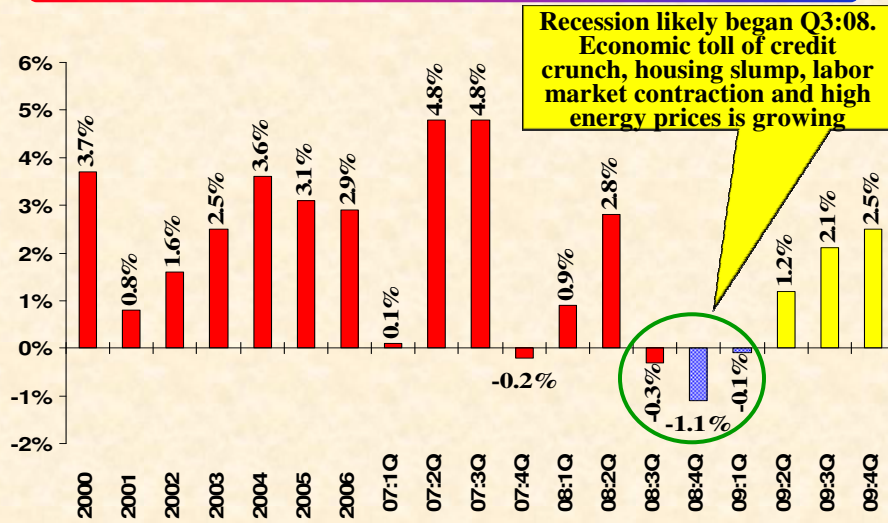
*What a Weakening Economy and  
The Threat of Inflation Mean for  
the Insurance Industry*



**Exposure & Claim  
Cost Effects**



## Real GDP Growth\*

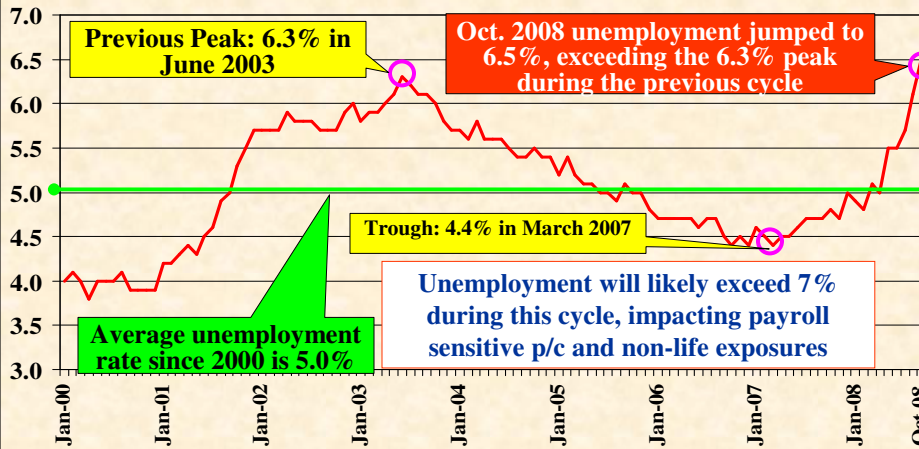


\*Yellow bars are Estimates/Forecasts from Blue Chip Economic Indicators.  
Source: US Department of Commerce, Blue Economic Indicators 10/08; Insurance Information Institute.



## Unemployment Rate: On the Rise

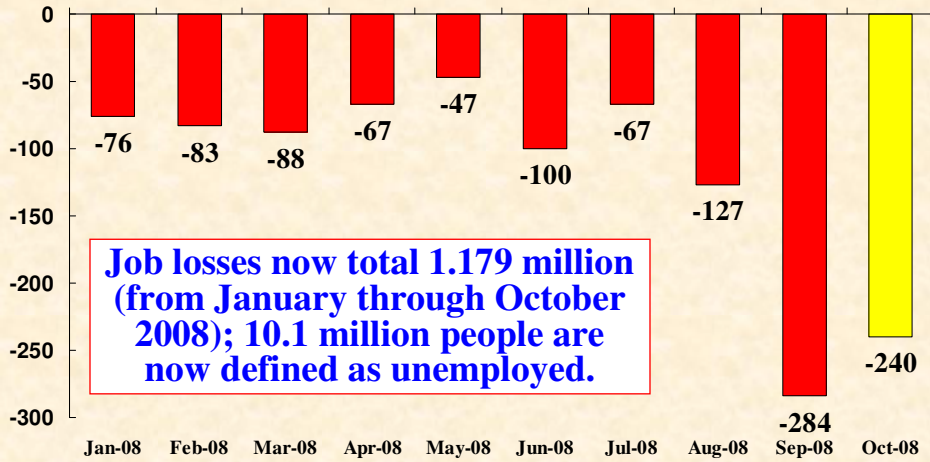
January 2000 through October 2008



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



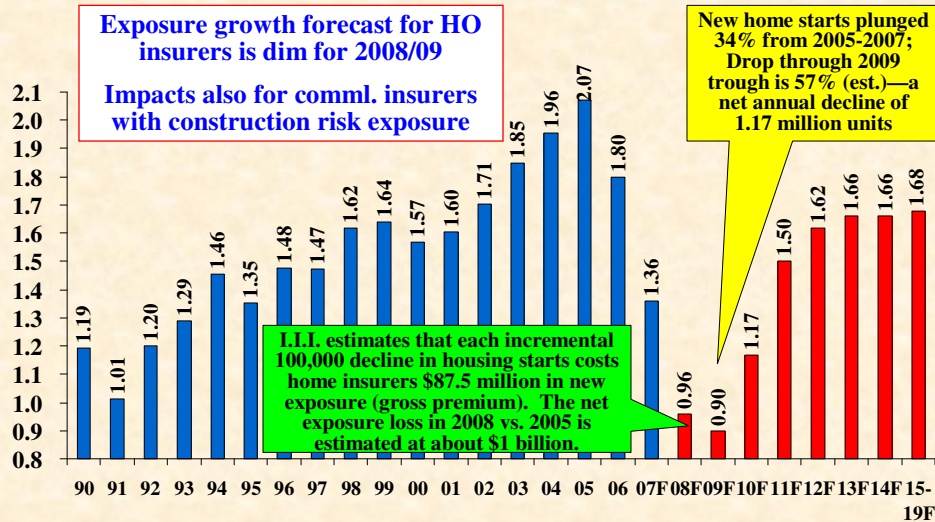
## Monthly Change Employment\* (Thousands)



Source: US Bureau of Labor Statistics: <http://www.bls.gov/ces/home.htm>; Insurance Info. Institute



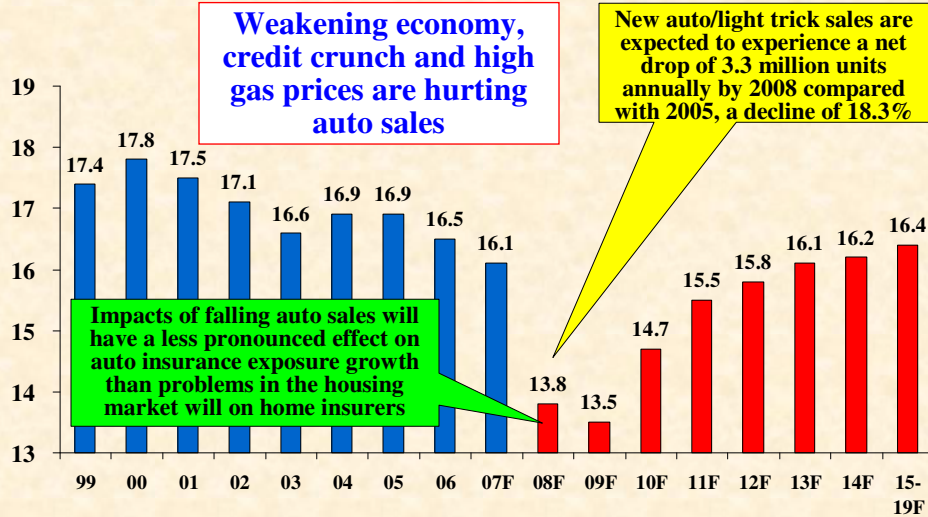
## New Private Housing Starts, 1990-2019F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (10/08); Insurance Information Inst.



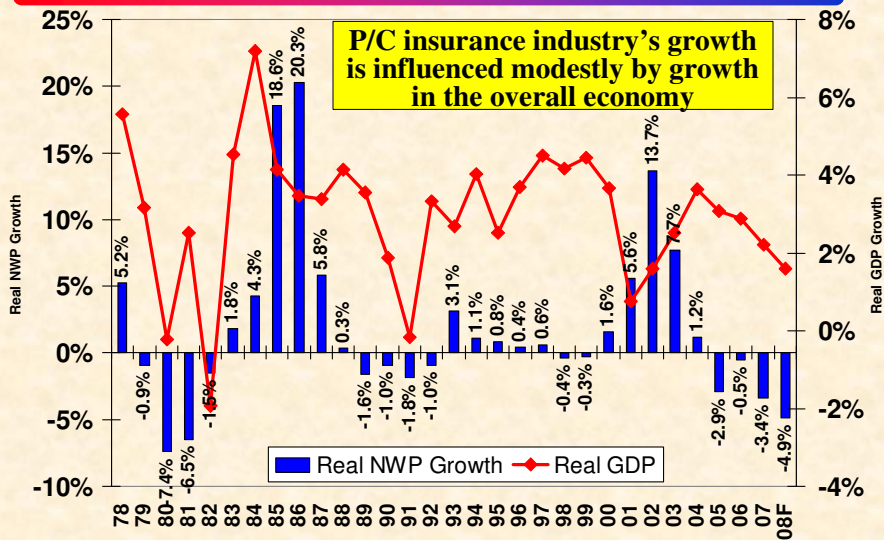
## Auto/Light Truck Sales, 1999-2019F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (10/08); Insurance Information Inst.



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

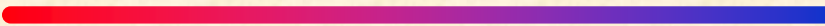


Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 8/08; Insurance Information Inst.

# The Housing Crash

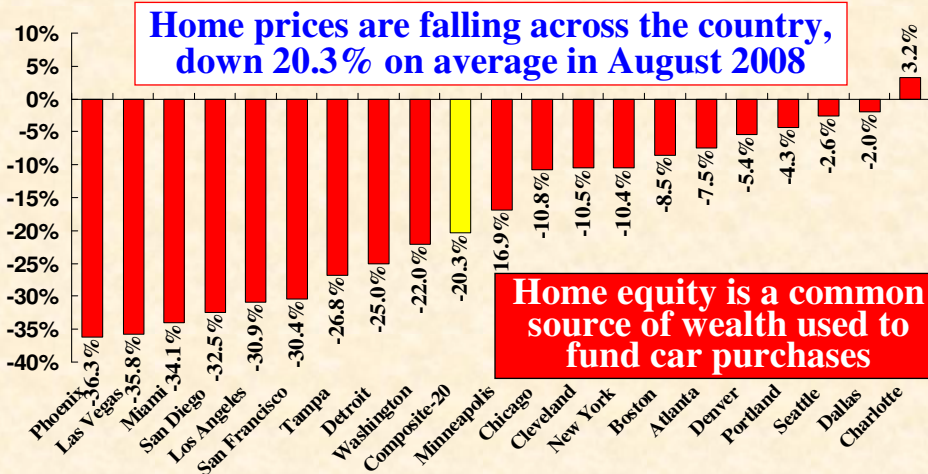
## *Collapse of Home Price Bubble*

### *Will Influence Auto & Home Purchases and Slow Insurer Exposure Growth*



## *Change in Home Values from July 2006*

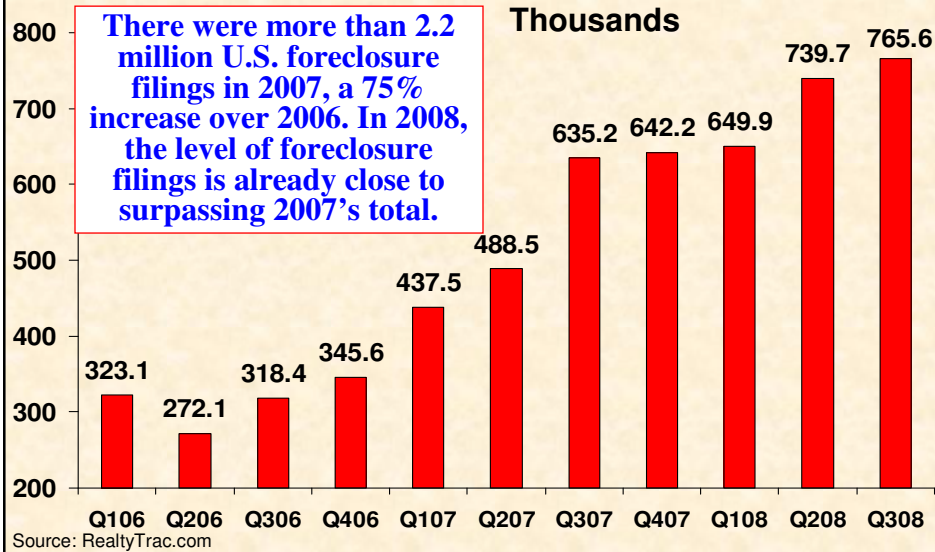
### *Housing Bubble Peak, by City\**



\*Calculated as of August 2008 (latest available) by III from monthly Case-Schiller price index data. Date of maximum price varies by city (July 2006 for 20-city composite: SPCS20R Index).  
 Source: Case-Schiller Home Price Index at [Standardandpoors.com](http://Standardandpoors.com); Insurance Info. Institute



## U.S. Quarterly Foreclosure Filings



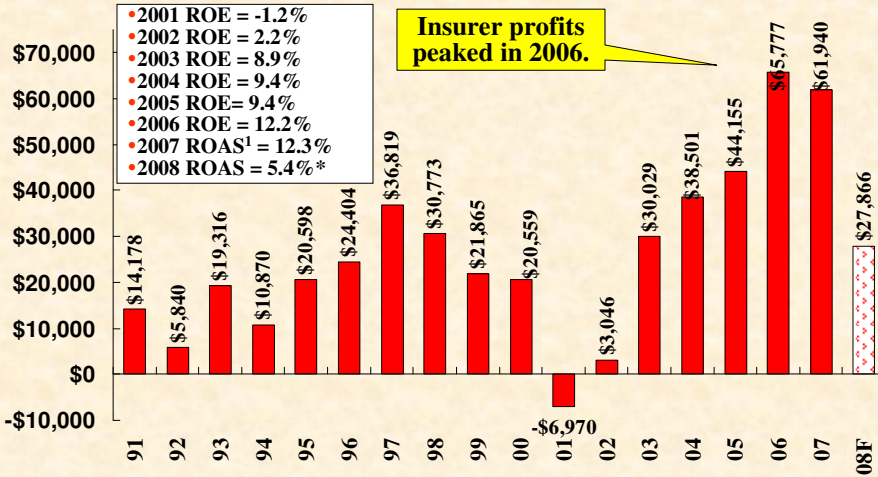
# P/C INSURANCE PROFITABILITY

In the Midst  
of a Cyclical Decline





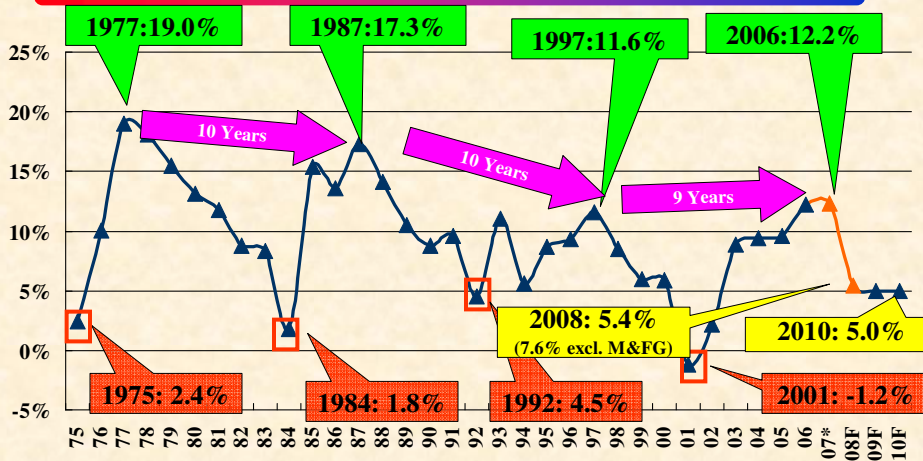
## P/C Net Income After Taxes 1991-2009F (\$ Millions)\*



\*ROE figures are GAAP; <sup>1</sup>Return on avg. surplus. 2008 numbers are annualized based on H1 actual.  
Sources: A.M. Best, ISO, Insurance Information Inst.



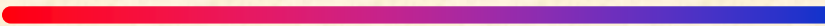
## P/C Insurance Industry ROEs, 1975 - 2010F\*



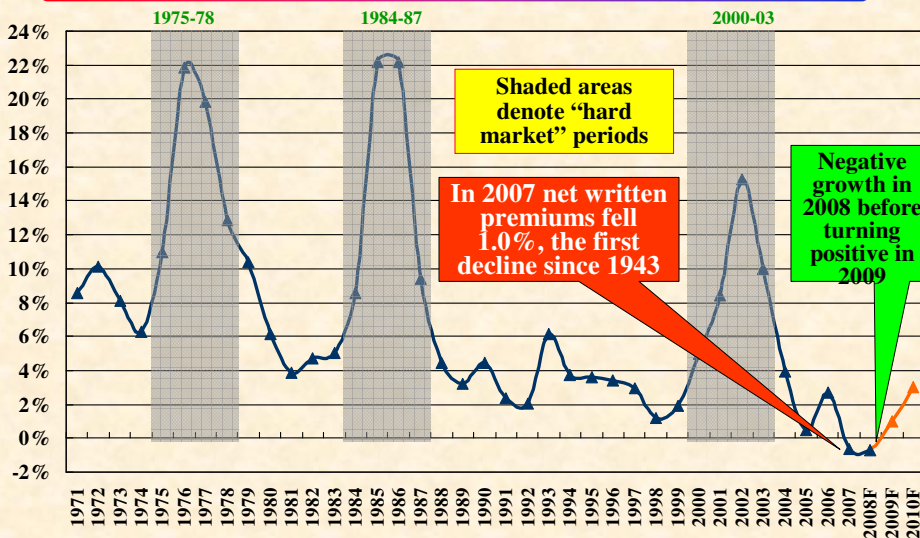
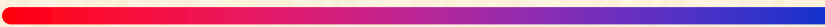
\*GAAP ROE for all years except 2007 and 2008 which are ROAS (statutory Return on Average Surplus).  
2008 ROAS is annualized based on H1 2008. Excluding mortgage and financial guarantee insurers = 7.6%.  
Sources: ISO, Insurance Information Institute.

# P/C PREMIUM GROWTH

Declines in 2007 and 2008,  
Small Gains Beginning  
in 2009?



## Strength of Recent Hard Markets by NWP Growth



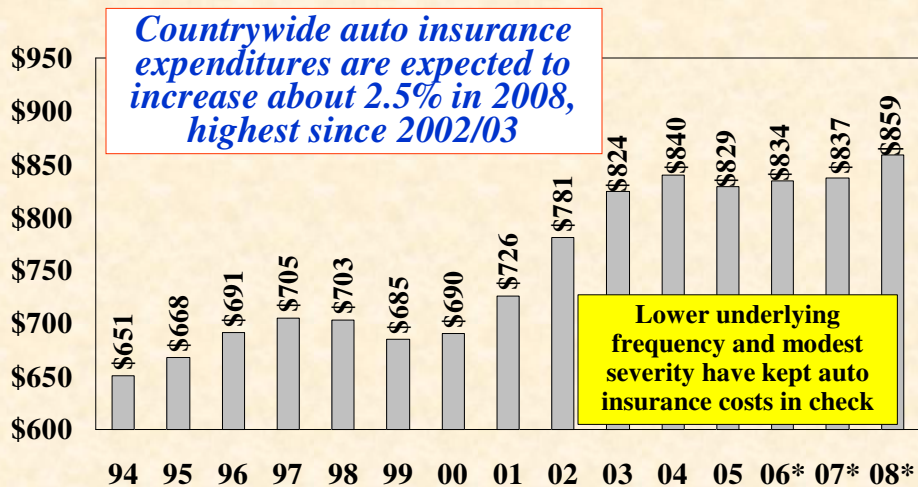
Sources: A.M. Best, ISO, Insurance Information Institute

# PRICING TRENDS

## Under Pressure, but Some Firming



### Average Expenditures on Auto Insurance

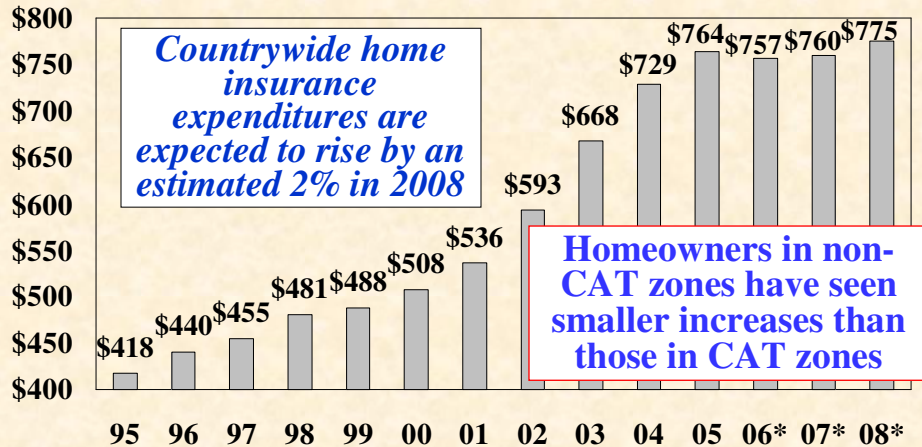


\*Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute estimates 2006-2008 based on CPI data.



## Average Expenditures on Homeowners Insurance\*\*



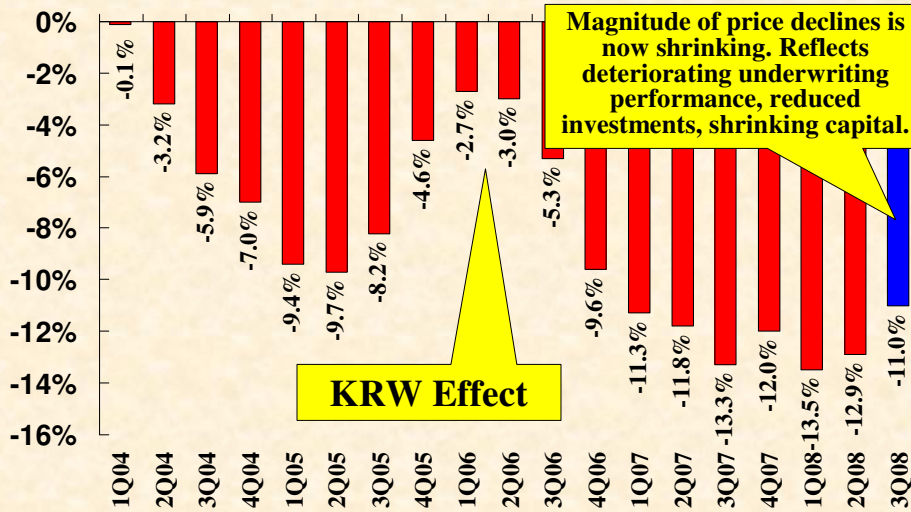
\*Insurance Information Institute Estimates/Forecasts

\*\*Excludes cost of flood and earthquake coverage.

Source: NAIC, Insurance Information Institute estimates 2006-2008 based on CPI data.



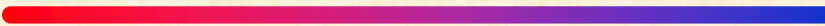
## Average Commercial Rate Change, All Lines, (1Q:2004 – 3Q:2008)



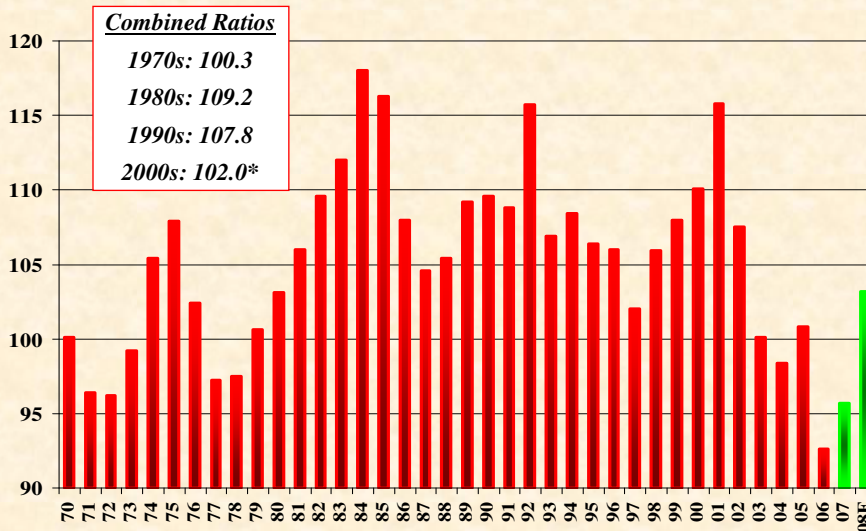
Source: Council of Insurance Agents & Brokers; Insurance Information Institute

# UNDERWRITING TRENDS

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



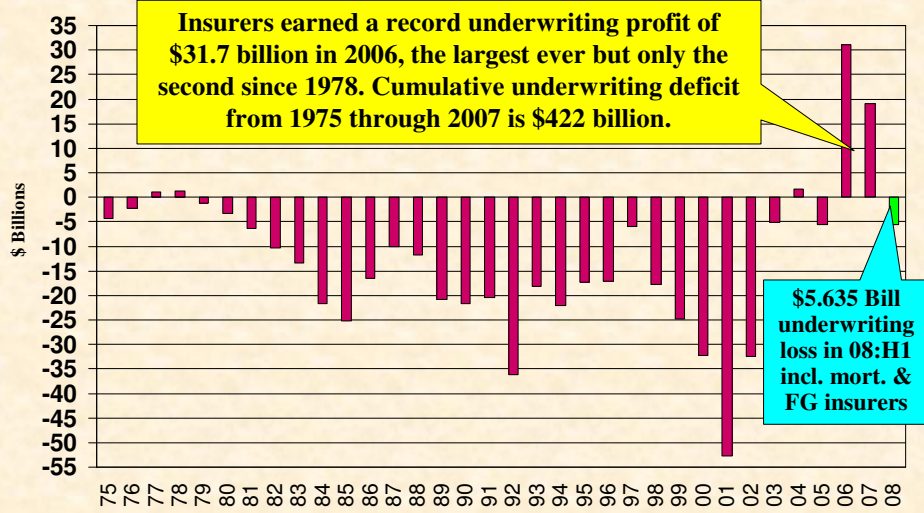
*P/C Insurance Combined Ratio,  
1970-2008F\**



Sources: A.M. Best; ISO, III \*A.M. Best year end estimate of 103.2; Actual H1 result was 102.1.



## Underwriting Gain (Loss) 1975-2008:H1\*



Source: A.M. Best, ISO; Insurance Information Institute \* Includes mortgage \* finl. guarantee insurers

# CAPACITY/ SURPLUS

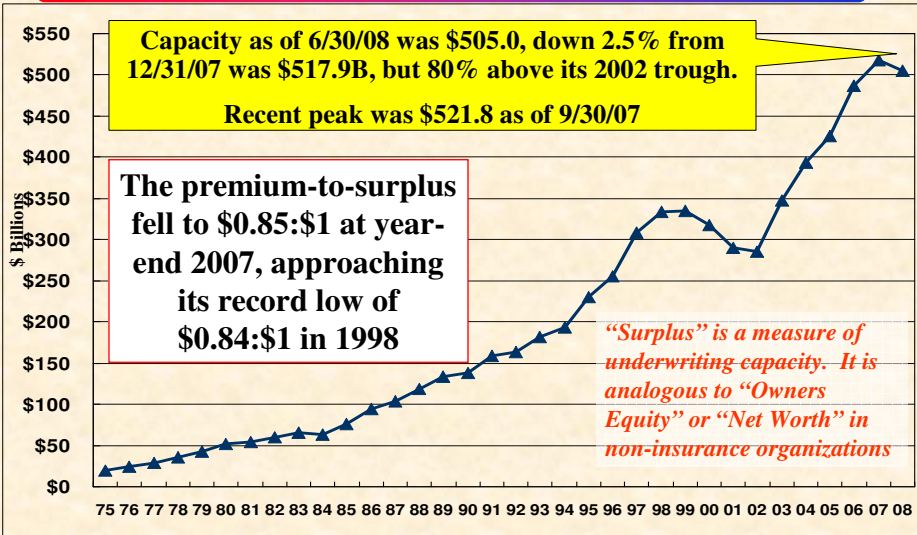
Capital/ Surplus is  
Shrinking at



Accelerating Pace



## U.S. Policyholder Surplus: 1975-2008:H1\*

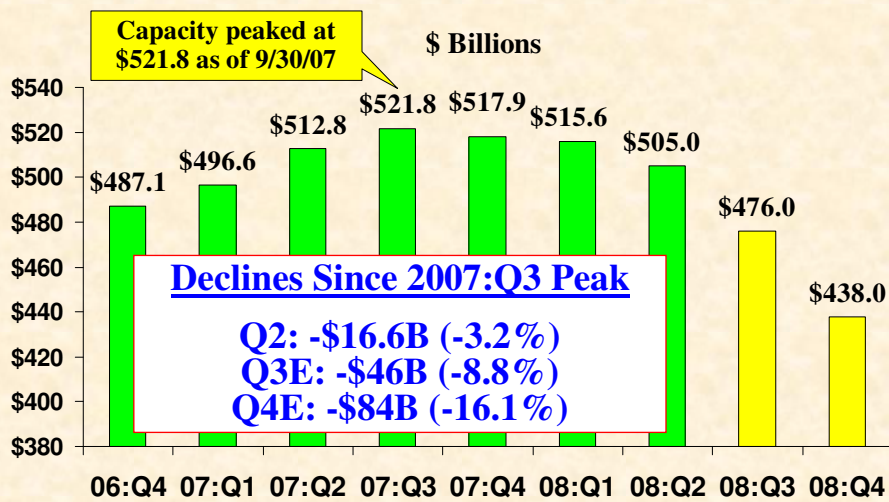


Source: A.M. Best, ISO, Insurance Information Institute.

\*As of June 30, 2008



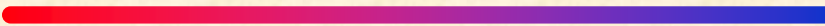
## Policyholder Surplus, 2006:Q4 – 2008:Q4(Est.)



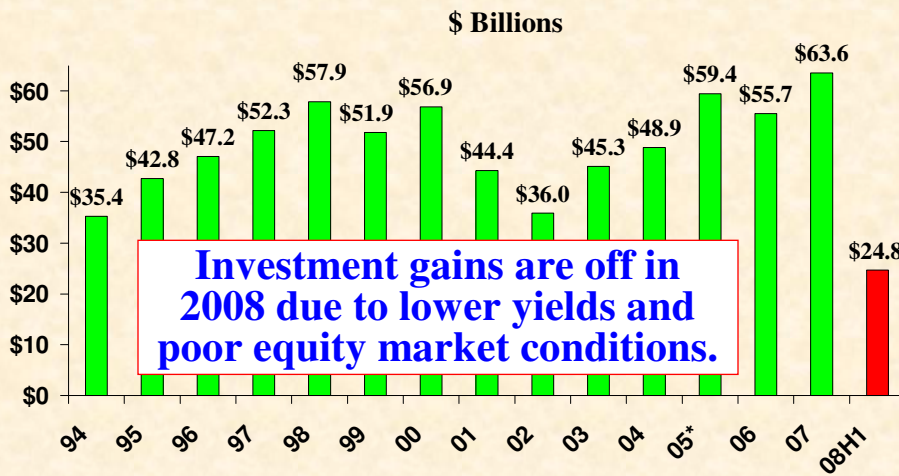
Source: ISO (historical); Towers Perrin (Oct. 21) estimates for Q3 and Q4 2008. Q4 assumes no major investment market recovery before year-end 2008.

# INVESTMENT OVERVIEW

*More Pain,  
Little Gain*



## *Property/Casualty Insurance Industry Investment Gain<sup>1</sup>*



<sup>1</sup>Investment 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.  
Sources: ISO; Insurance Information Institute.



## Total Returns for Large Company Stocks: 1970-2008\*

S&P 500 was up 3.53% in 2007, but down 34.0% so far in 2008\*



Source: Ibbotson Associates, Insurance Information Institute.

\*Through October 31, 2008.



## VIX Volatility Index: Stock Market Volatility at Record Highs in 2008\*

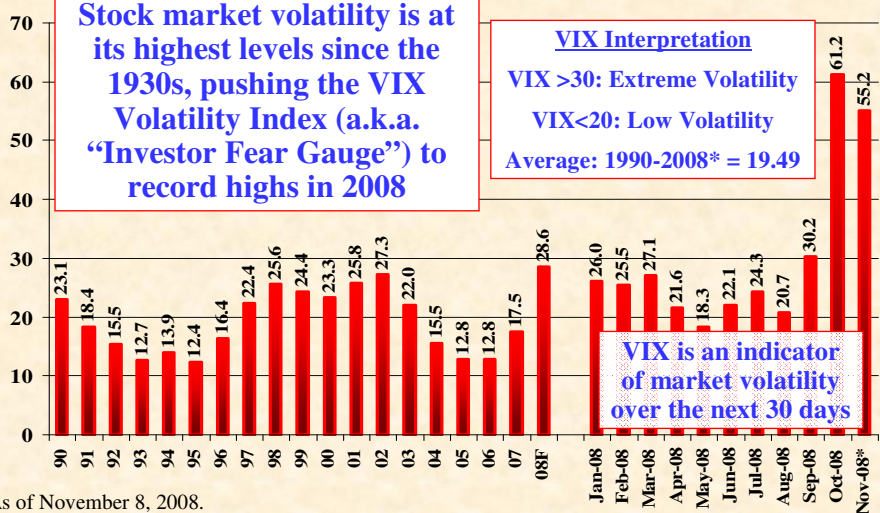
Stock market volatility is at its highest levels since the 1930s, pushing the VIX Volatility Index (a.k.a. "Investor Fear Gauge") to record highs in 2008

### VIX Interpretation

VIX >30: Extreme Volatility

VIX <20: Low Volatility

Average: 1990-2008\* = 19.49

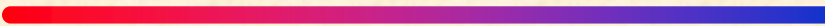


\*As of November 8, 2008.

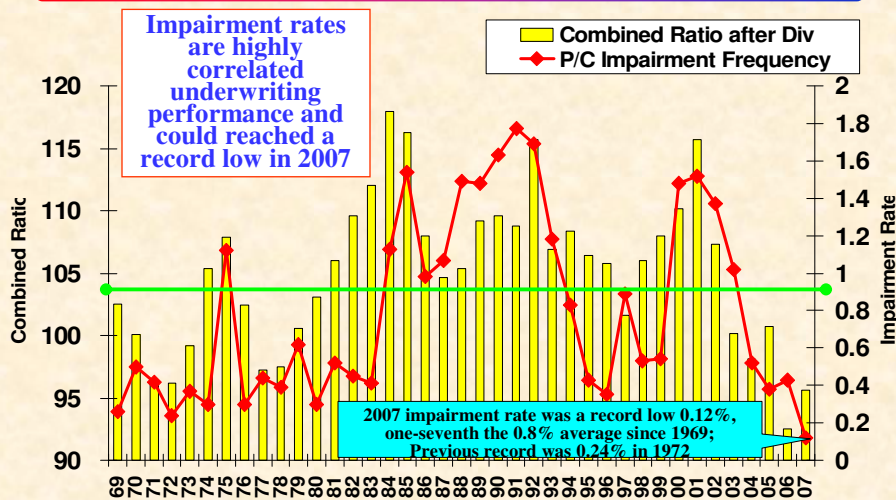
Sources: Chicago Board Options Exchange: <http://www.cboe.com/micro/vix/historical.aspx>

# FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well



## *P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2007*



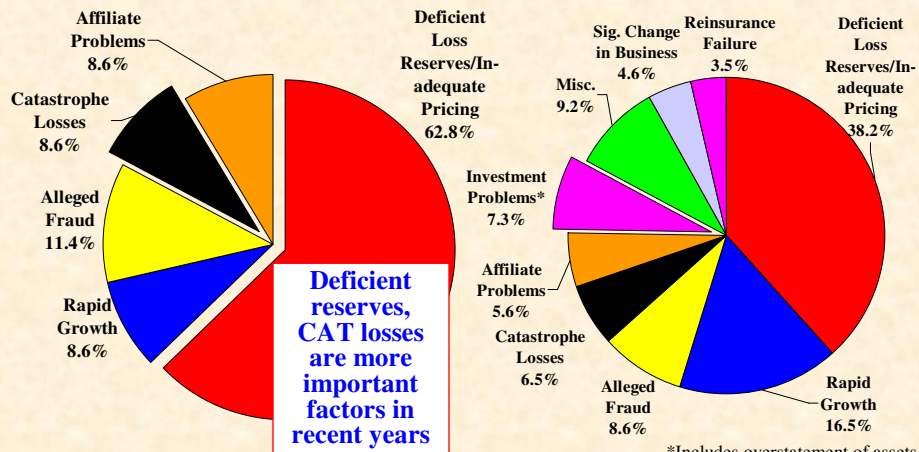
Source: A.M. Best; Insurance Information Institute



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

**2003-2005**

**1969-2005**



Source: A.M. Best: *P/C Impairments Hit Near-Term Lows Despite Surging Hurricane Activity*, Special Report, Nov. 2005;

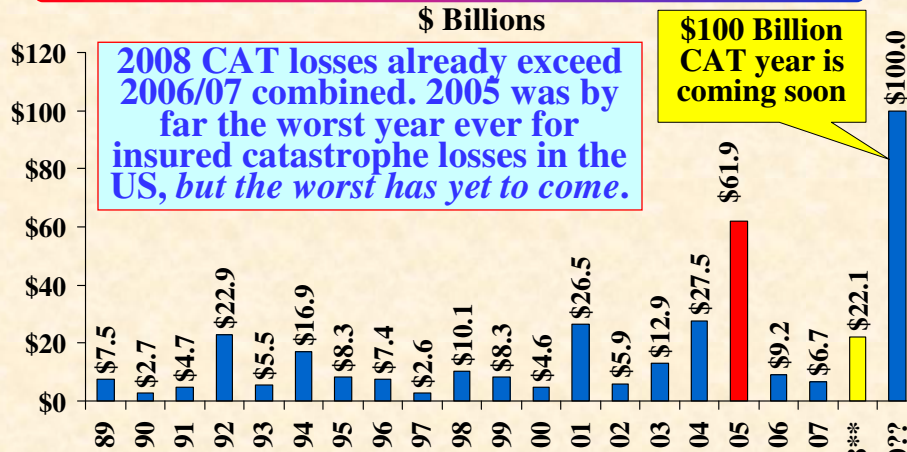
# CATASTROPHIC LOSS

## 2008 & Beyond





## U.S. Insured Catastrophe Losses\*



2008 CAT losses already exceed 2006/07 combined. 2005 was by far the worst year ever for insured catastrophe losses in the US, but the worst has yet to come.

\$100 Billion CAT year is coming soon

\*Excludes \$4B-\$6b offshore energy losses from Hurricanes Katrina & Rita.  
\*\*Based on preliminary PCS data through June 30. PCS \$1.8B loss of for Gustav. \$9.8B for Ike of 9/22.  
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



## Insurance Information Institute On-Line

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THANK YOU FOR YOUR TIME AND  
YOUR ATTENTION!