Financial Crisis: Private & Public Sector Impacts

Challenges Amid Economic and Regulatory Uncertainty

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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)**
  - ➢ **Impacts for Financial Services and Insurers**
- **Regulatory Aftershocks**
- **The Weakening Economy: Impact Analysis**
- **P/C Insurance Industry Overview**
- **Southeast US Catastrophe Exposure**
- **Tort & Regulatory Environment**

Q & A

Federal Government's Financial Rescue Package*

(a.k.a. "The Bailout")

Plan Details & Implications

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

Federal Government Financial Services Rescue Package

THE SOLUTION: A 5-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**
2. **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: US Treasury, CNN Money.com and I.I.I. research.

Federal Government Financial Services Rescue Package

THE SOLUTION: A 5-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 5-POINT PLAN (cont'd)

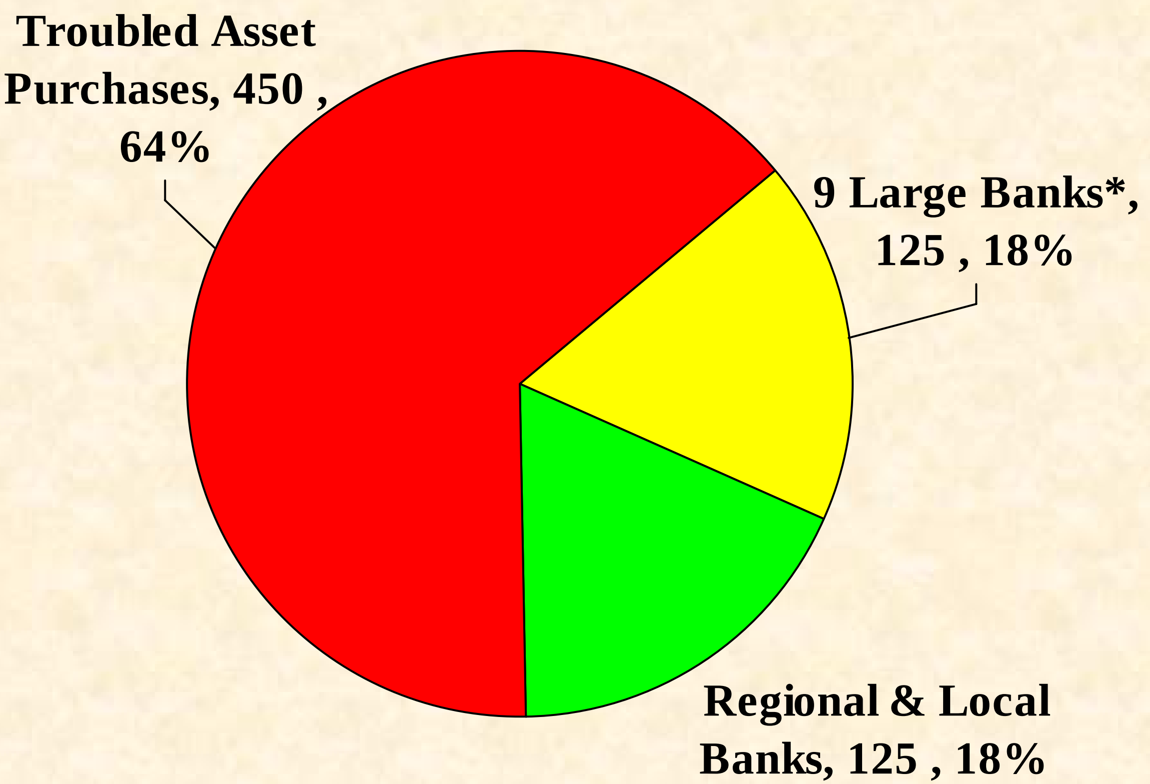
5. **Buy Troubled Assets: "Troubled Asset Relief Program" (TARP)**
   - ➢ **Up to $450B available (theoretically) available to purchase troubled assets from banks (and others?)**
   - ➢ **Limits on CEO Compensation in Participating Firms**
   - ➢ **Pricing: Debt Sold to Feds via Reverse Auction**
   - **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.

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

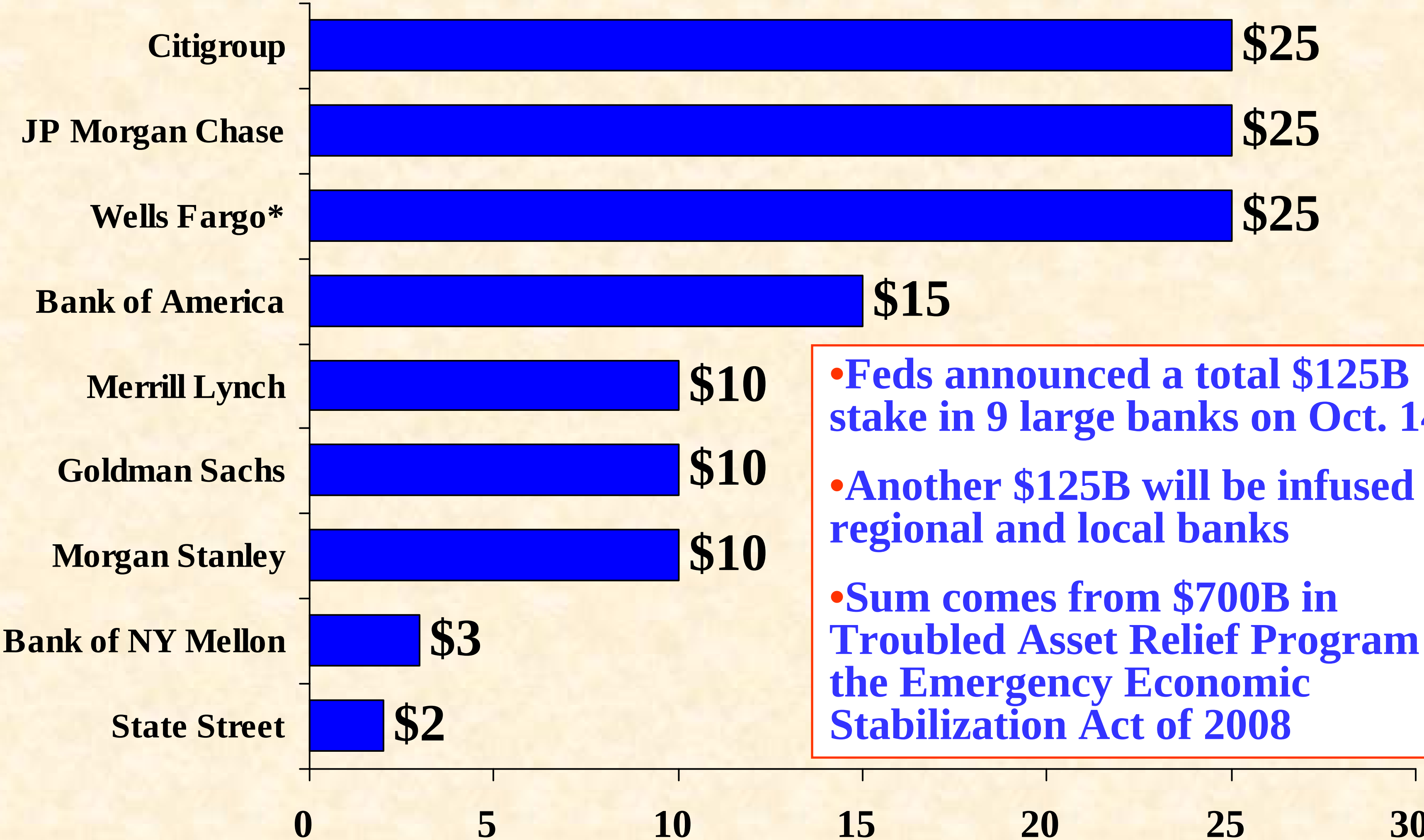
Shifting Emphasis

- Original EESA allocated all $700B to Troubled Asset Relief Program
- View was that TARP would take too long and that liquidity/credit crisis required direct infusion of capital in banks by feds



Source: US Treasury Department; Insurance Information Institute research.

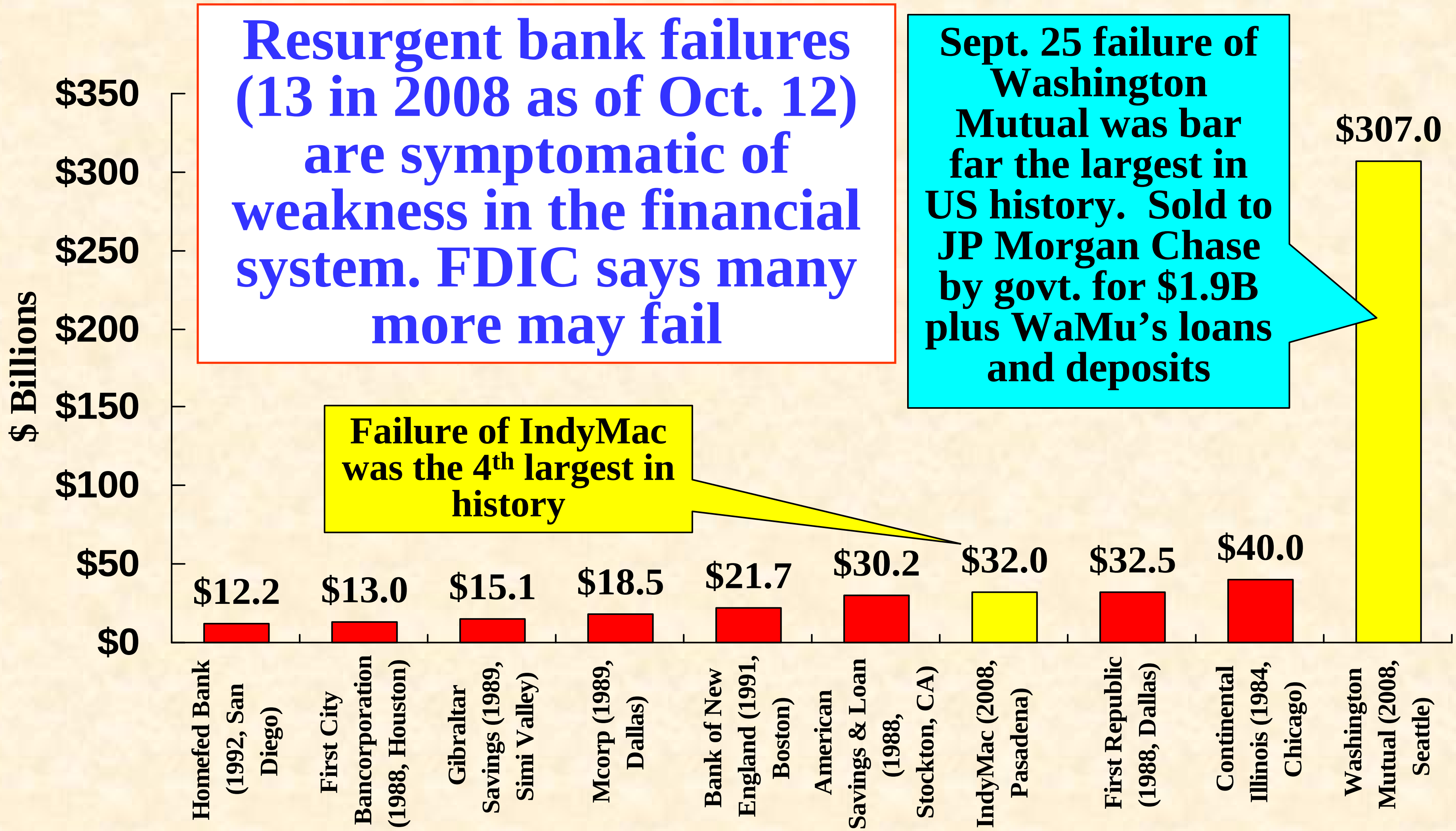
Stakes Taken by Federal Government in 9 Large US Banks



- Feds announced a total $125B stake in 9 large banks on Oct. 14.
- Another $125B will be infused in regional and local banks
- Sum comes from $700B in Troubled Asset Relief Program in the Emergency Economic Stabilization Act of 2008

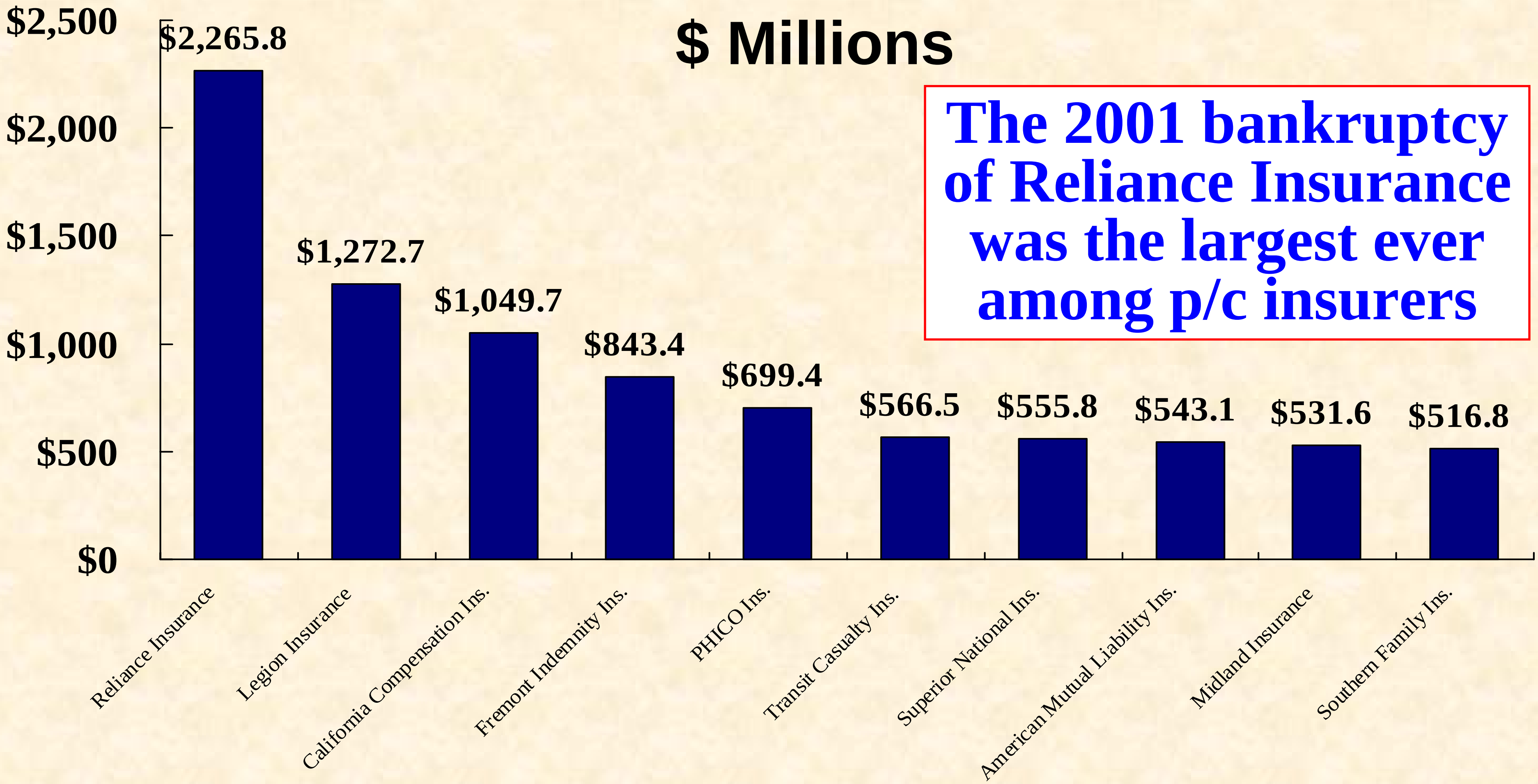
*Includes $5 billion for purchase of Wachovia.
Source: USA Today, Oct. 15, 2008, p. 1B.

Top 10 Largest Bank Failures



Source: FDIC; Insurance Information Institute research.

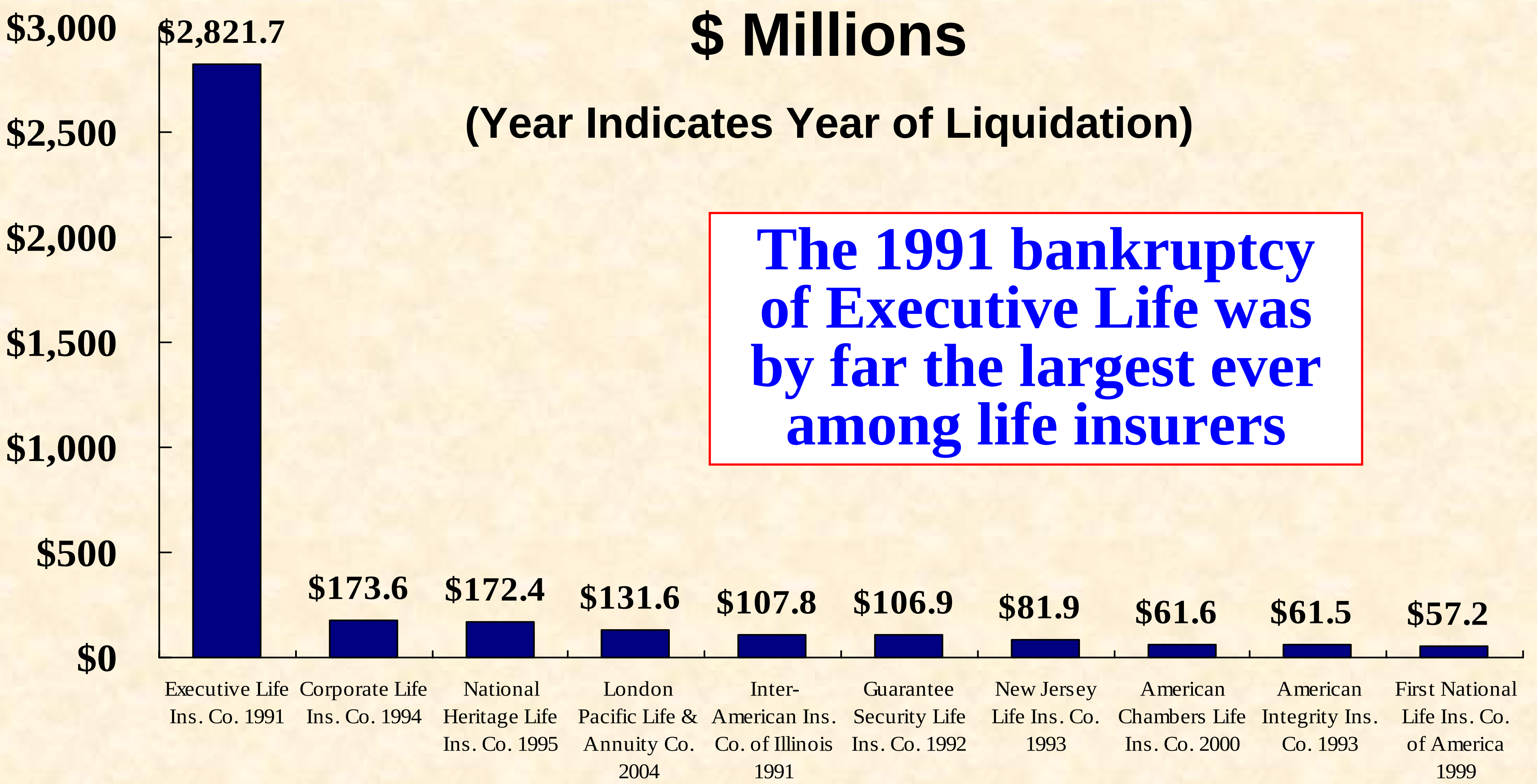
Top 10 P/C Insolvencies, Based Upon Guaranty Fund Payments*



* 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.

Top 10 Life Insolvencies, Based On Guaranty Fund Payments and Net Estimated Costs*



*As of 2007.

Source: National Organization of Life and Health Guaranty Funds

Federal Government Financial Services Rescue Package

Other Recent Provisions

1. **Fannie/Freddie Will Increase Mortgage Buying**
   - **Feds step-up buying MBS in open market**
2. **10-Day Ban on Short-Selling 829 Financial Stocks**
   - **Most major public insurers on list**
   - **Expired Oct. 7**
3. **Increase FDIC Insurance Limits on Deposits to $250,000 from $100,000**
4. **Establish Financial Oversight Board**
   - **Includes Treasury Secretary, Fed Chairman and others TBD**

Source: Insurance Info. Inst. research.

Federal Government Financial Services Rescue Package

Other Recent Provisions (cont'd)

5. **Conversion of Last 2 Remaining Investment Banks (Goldman Sachs and Morgan Stanley) to Bank Holding Companies**
   - **Recognition that Wall Street as it existed for decades is dead**
   - **High leverage investment bank model no longer viable in current market environment**
   - **New entities will be subject to stringent federal regulation in exchange for more access to federal dollars/liquidity facilities**
   - **Capital and liquidity requirements will be greatly enhanced**
   - **Reduced leverage means new entities will be less profitable**

Source: Insurance Info. Inst. research.

Liquidity Enhancements Implemented by Fed Due to Crisis

- **Lowered Interest Rates for Direct Loans to Banks**
  - **Federal funds rate cut from 5.5% in mid-2007 to 1.5% now**
  - **Most recent cut from 2.0% to 1.5% globally coordinated on Oct. 7**
- **Injected Funds Into Money Markets**
- **Increased FDIC Insurance Limits to $250,000 from $100,000**
- **Coordinated Exchange Transactions w/Foreign Central Banks**
- **Injected Cash Directly Into Banks; Will Take Ownership Stake**
- **Created New and Expanded Auction & Lending Programs for Banks**
  - **e.g., Term Auction Facility expanded to $900B**
- **Started Direct Lending to Investment Banks for the First Time Ever**
- **Authorized Short-Term Lending to Fannie/Freddie, Backstopping a Treasury Credit Line**

Source: Wall Street Journal, 9/22/08, p. A8; Insurance Information Institute research as of Oct. , 2008.

Why Have Credit Markets Frozen & 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 an 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

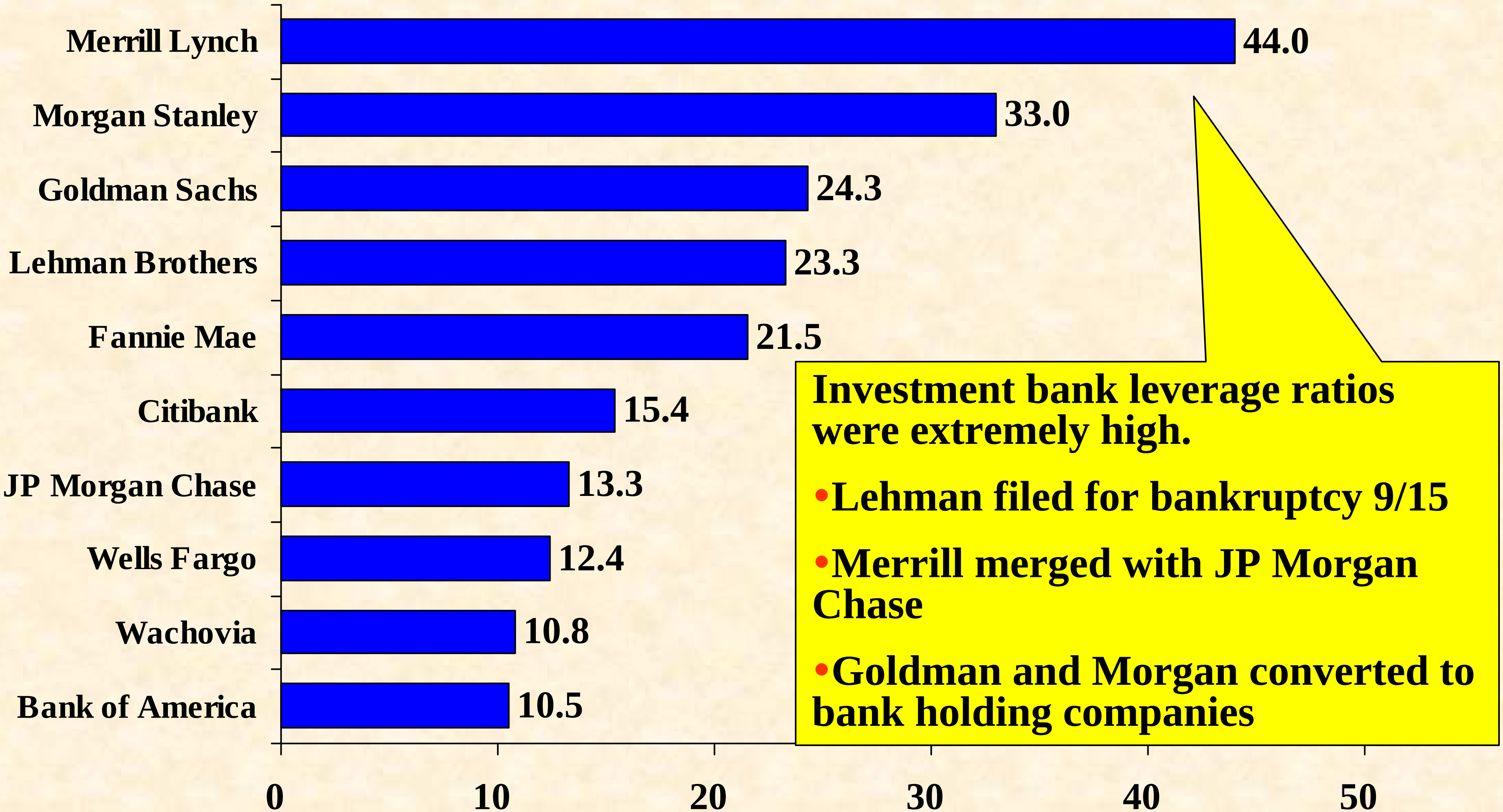
1. **CREDIT THAW: Banks are beginning to lend to each other and to others in unsecured credit markets**
   - **Key interest rates falling (LIBOR)**
2. **DELEVERAGING: Banks, Businesses & Consumers reducing debt loads to more manageable levels**
3. **ENERGY PRICES FALLING: Oil prices are down more than 50% and gas prices down about 33%**
   - **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**

Source: Insurance Information Institute

The Deleveraging of America

Economic Downdraft and Regulatory Questions

Leverage Ratios for Investment Banks and Traditional Banks*



*Based on data for last quarter reported (May or June 2008).

Source: "*The Perils of Leverage,*" North Coast Investment Research, Sept. 15, 2008

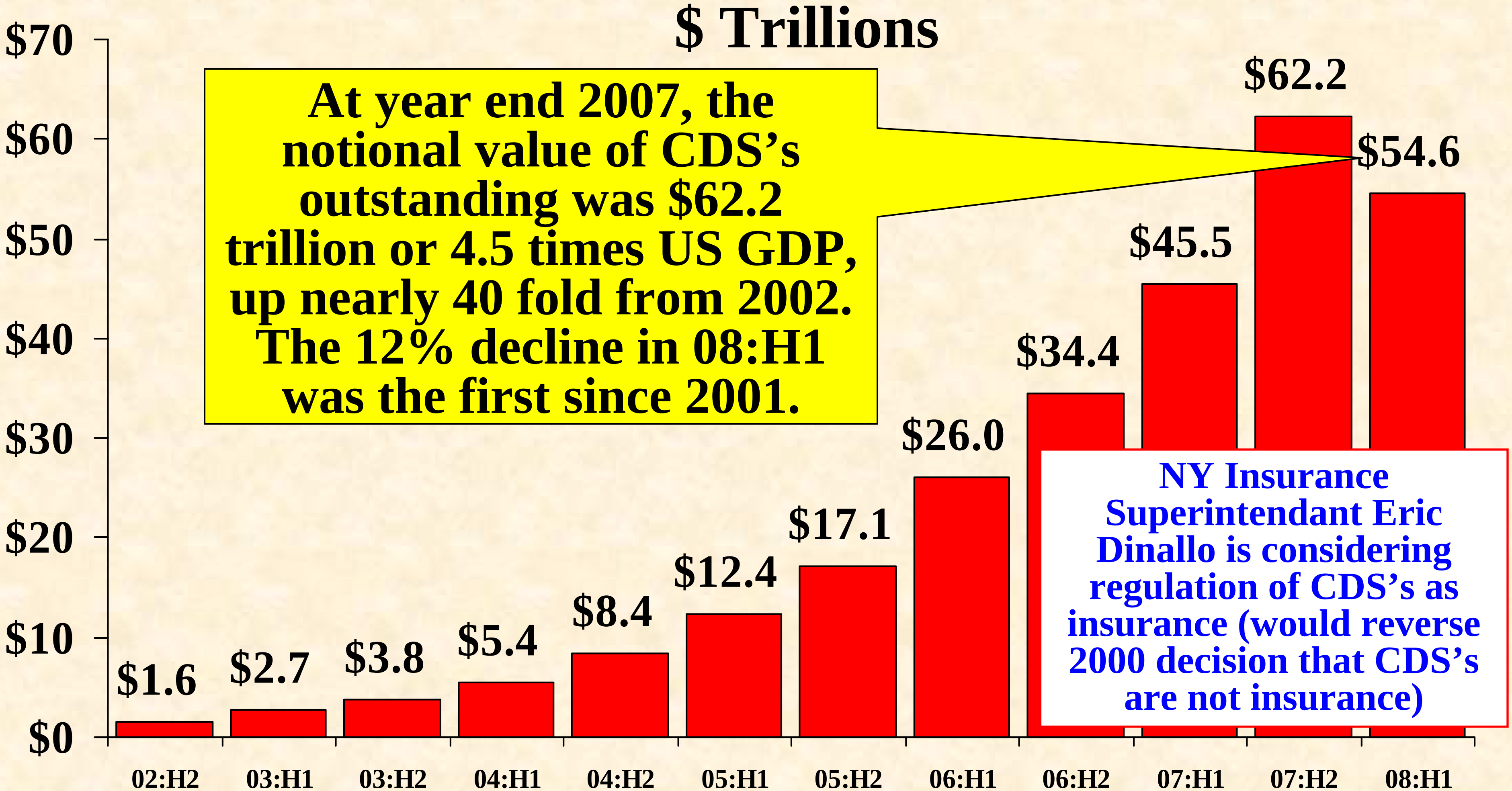
How Does Leverage Work?

- **Example of Non-Leverage Transaction**
  - **Buy 1 share of stock for $100**
  - **Price of share rises to $110**
  - **RETURN = $10 or 10%**
- **Leveraged Transaction**
  - **Invest $10 and borrow $90**
  - **Stock rises to $110**
  - **RETURN = $10 *or 100%* (less borrowing costs)**
- **This Pleasant Arithmetic Works Equally Unpleasantly in the Opposite Direction**
- **Declining asset values, seizing of credit markets made such borrowing impossible and the operating model of investment banks nonviable**

Investment banks and others juiced their returns by making big, bad bets with (mostly) borrowed money on mortgage securities

Source: Insurance Information Institute.

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

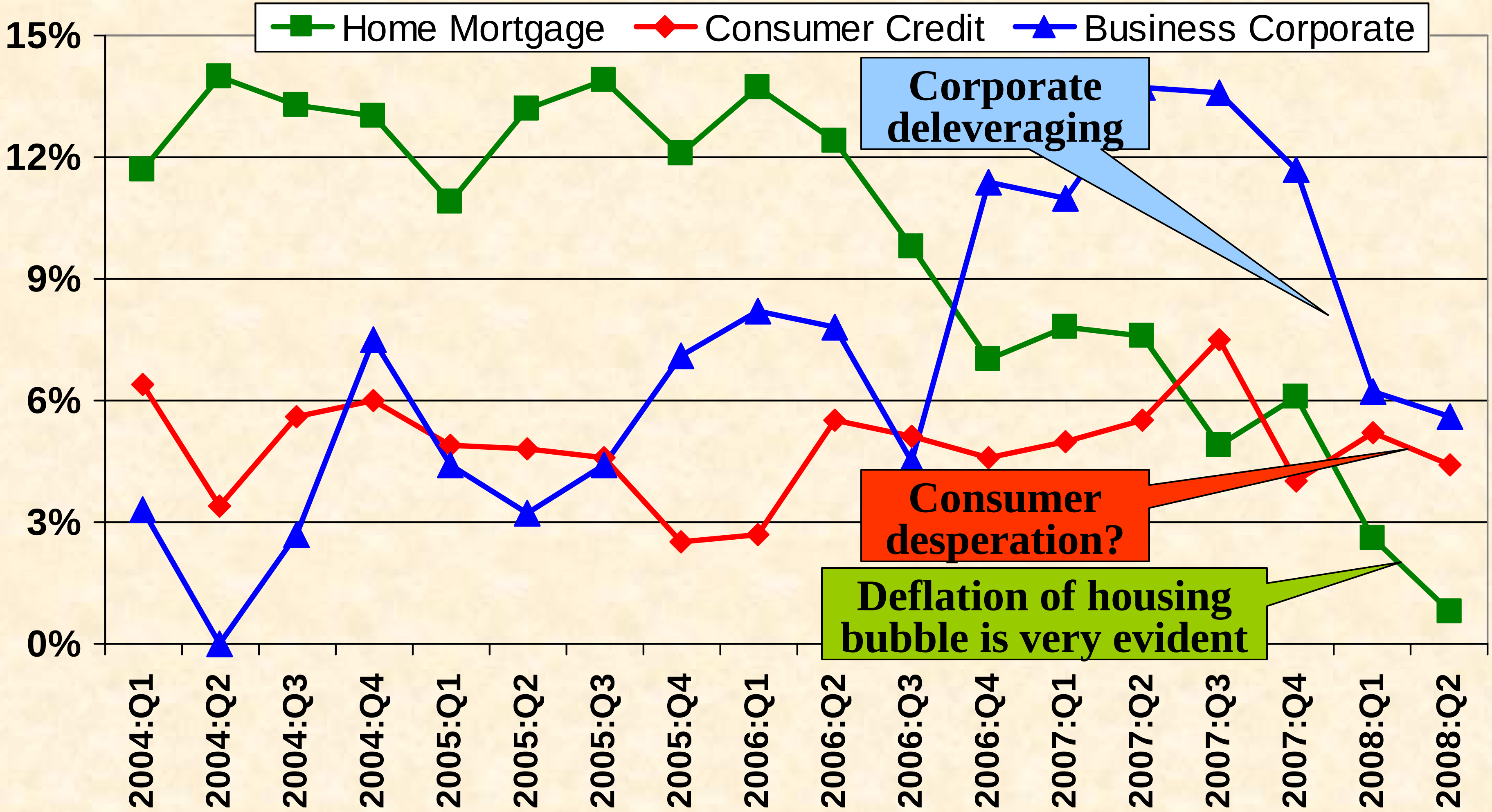


*End of calendar half (H1 = June 30, H2 = December 31).

Source: International Swaps and Derivatives Association: http://www.isda.org/statistics/recent.html

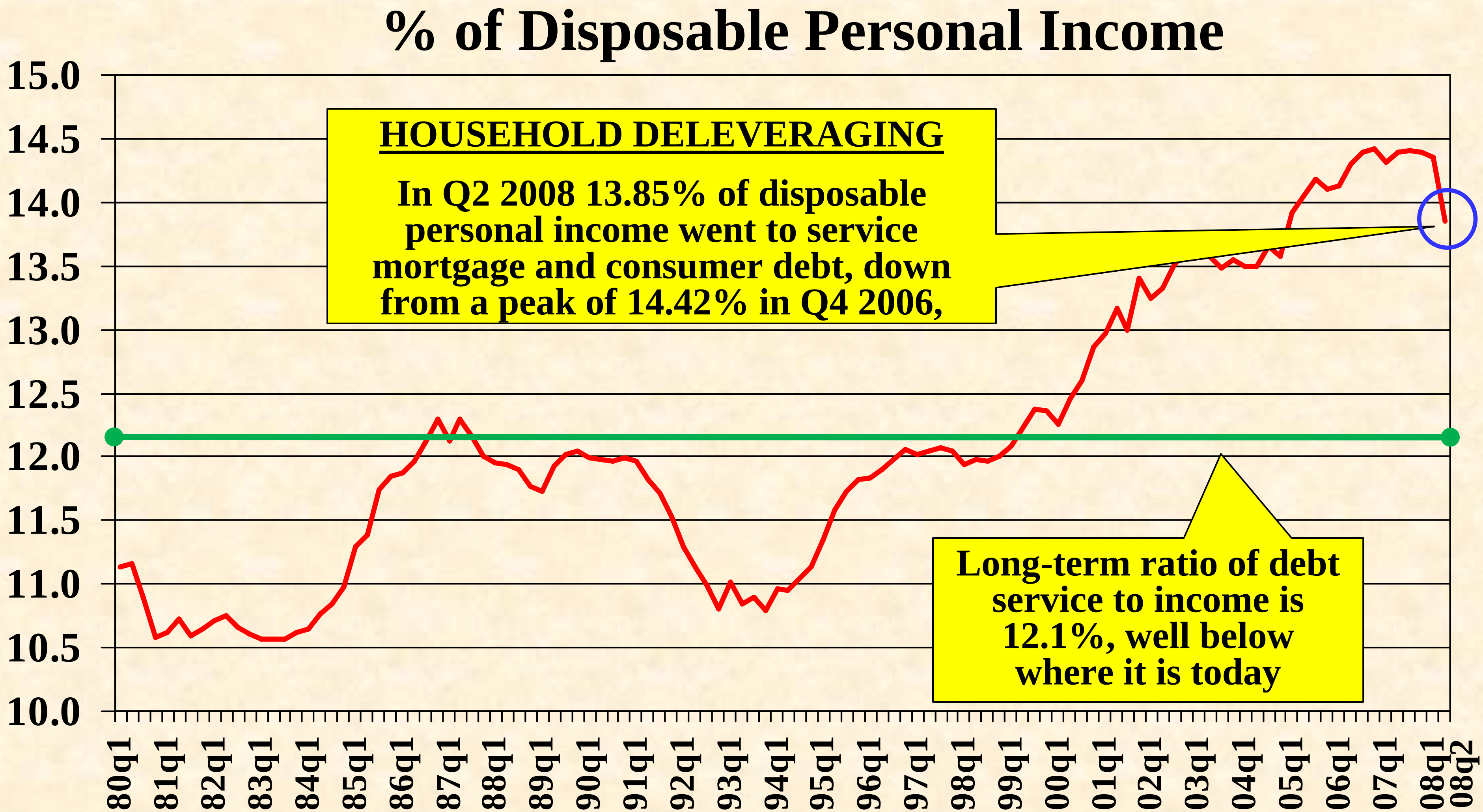
Percent Change in Debt Growth

(Quarterly since 2004:Q1, at Annualized Rate)



Source: Federal Reserve Board, at http://www.federalreserve.gov/releases/z1/Current/z1r-2.pdf

Ratio of Debt Service Payments to Disposable Income, 1980 – 2008:Q2



Source: Board of Governors of the Federal Reserve: http://www.federalreserve.gov/releases/housedebt/default.htm;

Government Rescue Package of AIG

Motivation & Structural Details

AIG Rescue Package by the Fed

- **AIG suffered a liquidity crisis due to large positions, mostly associated with Credit Default Swaps, related to mortgage debt through its AIG Financial Products division**
- **The losses at AIGFP brought AIG's holding company to the brink of bankruptcy by Sept. 16 (AIG has 245 divisions, 71 are US domiciled insurers)**
  - **Efforts to create large credit pool via private banks failed**
- **AIG's separately regulated insurance subsidiaries were solvent at all times and met local capital requirements in all jurisdictions***
- **Federal Reserve Agreed to Lend AIG $85 Billion to Prevent Bankruptcy, of which $70B has been borrowed (as of 10/10)**
  - **2-year term @ 850 bps over LIBOR (about 11 to 11.5%); 8% unborrowed**
  - **Fed gets 79.9% stake in AIG (temporary nationalization)**
  - **CEO Robert Willumstad replaced by former Allstate CEO Edward Liddy**
- **Proceeds from sale of non-core assets will be used to repay loan**
- **New CEO says most insurance divisions are "core"**

*Sources: AIG press releases and regulator statements.

Expansion of AIG Rescue Package by the Fed on Oct. 8, 2008

- **On Oct. 8 the Federal Reserve Bank of NY agreed to provide liquidity to AIG's Securities Lending Program**
  - **Fed will borrow investment grade fixed income securities from AIG's domestic <u>life</u> insurance companies, on commercial terms and conditions, in exchange for cash**
  - **Puts Fed into traditional lender of last resort position**
- **Problem in the Securities Lending Program (SLP)**
  - **AIG lent securities to 3rd parties, receiving collateral in return**
  - **Invested some of collateral in other assets whose value declined**
  - **When borrowers of securities returned them, AIG had to make up difference and sometimes couldn't lend out securities for fresh collateral**
- **NY Fed Authorized to Borrow $37.8B**
  - **AIG's total securities lending obligations = $37.2B as of Oct. 6**
- **Objective is to Provide Liquidity to SLP while Providing Enhanced Credit Protection to NY Fed by Giving them Possession of Third Party Investment Grade Securities***

*Sources: AIG press releases; Wall Street Jounal and regulator statements.

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**
- **Loan Allowed Time for an Orderly Sale of Assets and a Minimal Disruption on Credit Markets while also Protecting Policyholders**
- **New CEO says most insurance divisions are "core"**

Source: Insurance Information Institute research.

AIG Actions to Date*

- On October 3, New CEO Ed Liddy Announced Plan to Sell Assets and Focus on Core Commercial P/C Operations
  - Worldwide P/C premiums totaled approximately $40B in 2007
- Overall Impact May Be More Transformational for Global Life Industry
- Will Sell:
  - All of Its US Life Insurance Operations
    - Valued at as much as $24B**
  - Sell some foreign life operations, which collectively generated $64.5B in premiums, deposits and other considerations in 2007 (24.5% in Japan and 37.5% in Europe)
    - Involves sale of American Life Ins. Co. (operates in Japan, Europe and Middle East & elsewhere) as well as other life units operating in Japan and Taiwan
    - Will retain majority stake in another life insurer operating in China and other Asian countries
  - May sell personal lines business (excluding Private Client Group)
    - Accounts for $4.8 billion in premiums ($4.1 billion excluding Private Client Group) and 3% market share in personal auto.
    - AIG's personal lines business (excluding its PCG is 73% direct and 27% agency***
  - Wind down AIG Financial Products (root of AIG's problems), try to extract value
  - Will sell aircraft leasing and asset management businesses
  - Other, small insurance units and minor assets to be sold as well

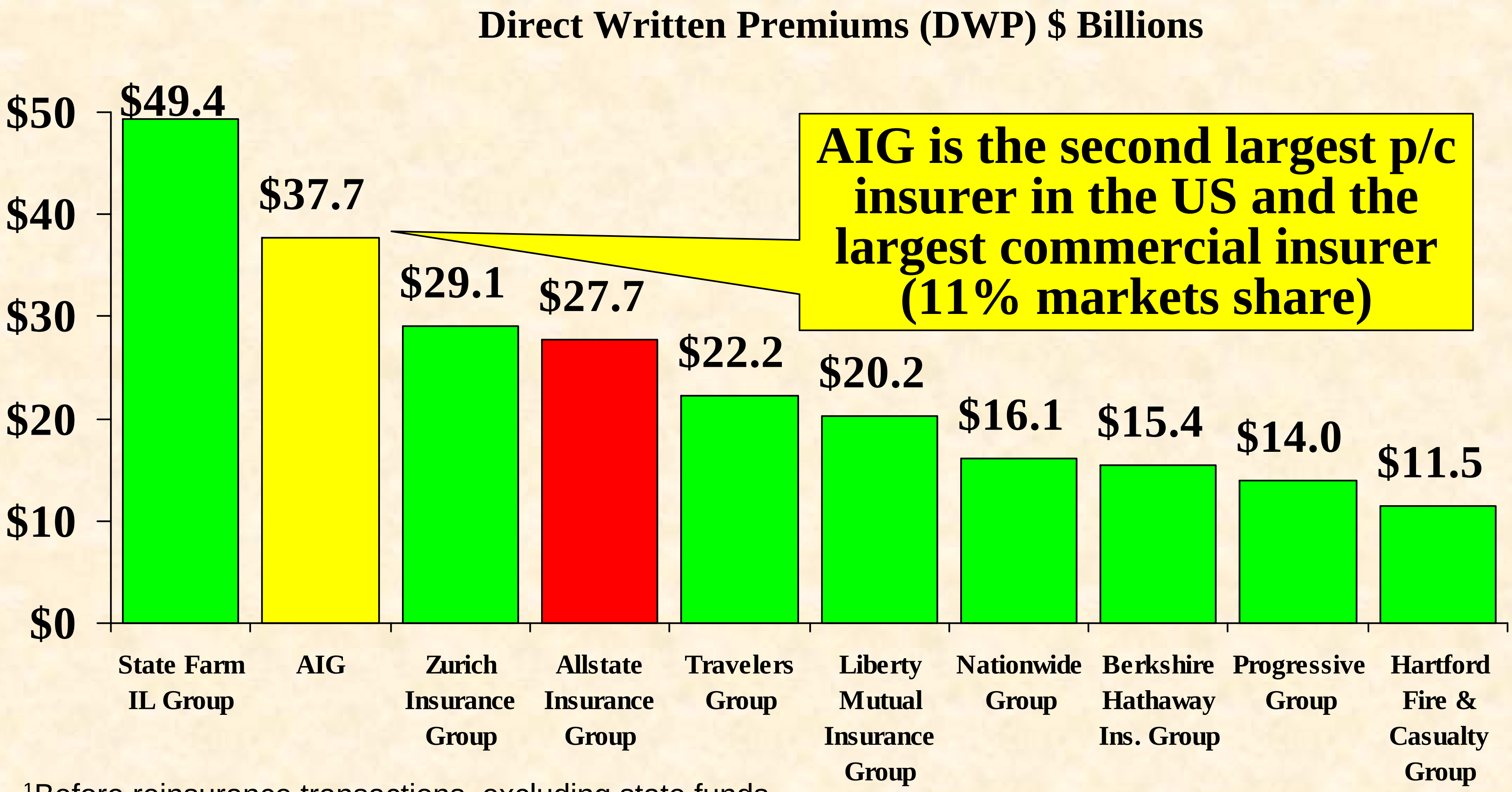
*As of Oct. 5, 2008; **UBS analyst Andrew Klingerman (WSJ, Oct. 4, 2008) * **Barclay's Capital, Oct. 3, 2008
Sources: AIG, Wall Street Journal (Oct. 4, 2008), Insurance Information Institute research.

"Rescue" Treatment of AIG vs. Eight Large Banks

	AIG	8 Large Banks*
U.S. Treasury's ownership	79.9% of common stock	Non-voting preferred stock; no dilution of common stock ownership
Interest/ Dividends Payable to Treasury	•8.5% on unused line of credit up to $85 billion •8.5%+3-month LIBOR on borrowed money (total recently = 12.92%) •2% one-time fee on credit line	•5% on preferred stock**, rising to 9% after 5 years •Can borrow from the Fed's discount "window" for as little as 1.75%
Time limit to pay off credit line	2 years	Indefinite
"Toxic" assets	Unclear whether can sell to Treasury	Can sell to Treasury

*Citigroup, Bank of America (includes Merrill Lynch), JPMorganChase, Wells Fargo, Goldman, MorganStanley, State Street, Bank of New York Mellon. **$25 billion for Citi, BoA, JPMorgan, and Wells; $10 billion for Goldman and Morgan Stanley; $3 billion for BONY; $2 billion for State Street.

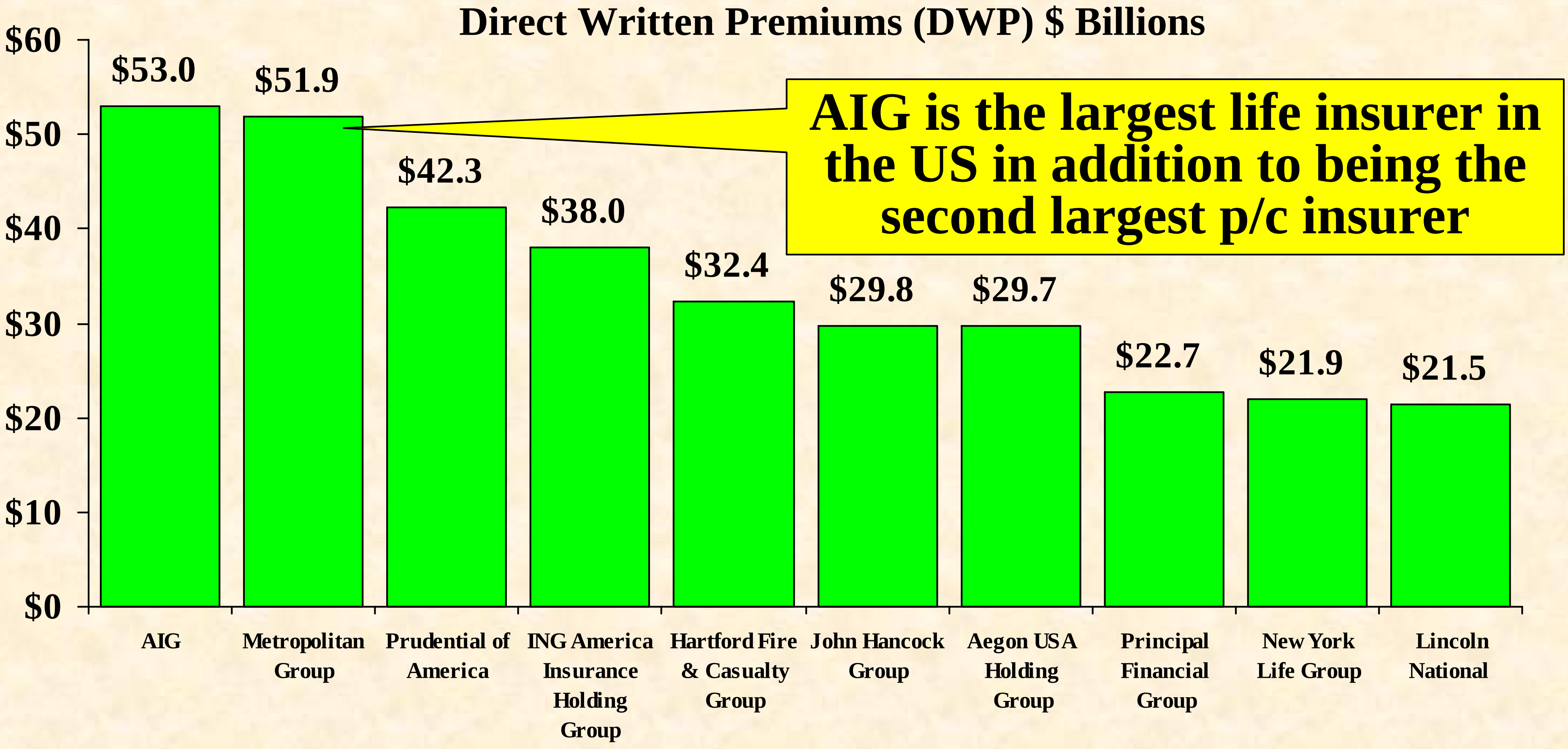
Leading U.S. Writers of P/C Insurance by DWP, 2007 ($ Billions)[1]



[1]Before reinsurance transactions, excluding state funds.

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

Leading U.S. Writers of Life Insurance By DWP, 2007 ($ Billions)[1]



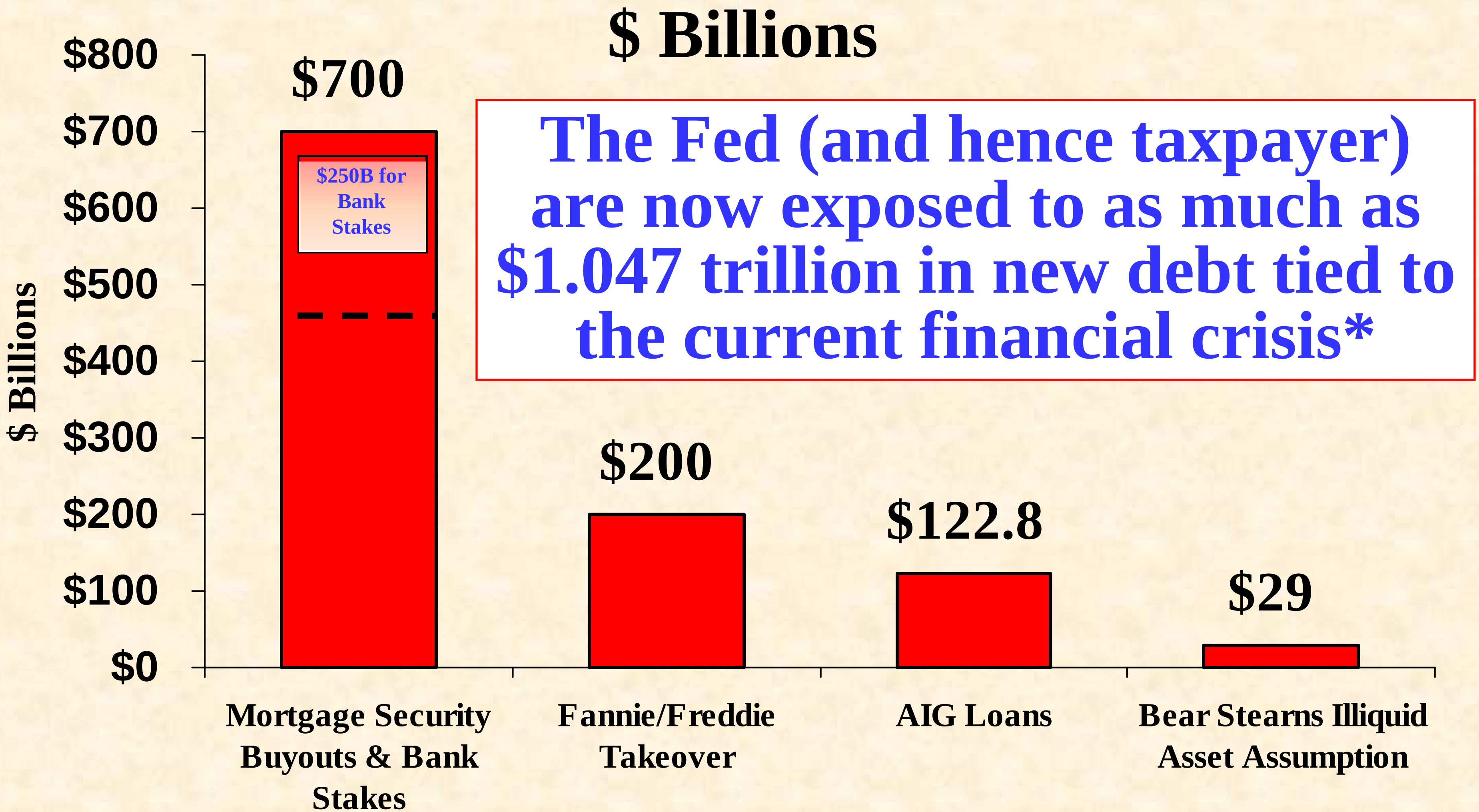
[1]Premium and annuity totals, before reinsurance transactions, excluding state funds.

Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data LLC.

AFTERSHOCK: Regulatory Response Could Be Harsh

All Financial Segments Including Insurers Will Be Impacted

Incurred 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, 9/22/08, p. A8; Insurance Information Institute research. AIG amount consistent of $85B loan on Sept. 16 and additional $37.8B on Oct. 8.

From Hubris to the Humbling of American Capitalism?

"Government is not the solution to our problem, government is the problem."

--Ronald Reagan, from his first inaugural address, January 20, 1981

From Hubris to the Humbling of American Capitalism?

"Given the precarious state of today's financial markets, and their vital importance to the daily lives of the American people, Government intervention is not Only warranted, it is essential."

--President George W. Bush, Sept. 19, 2008, on the $700 billion financial institution bailout

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**
  - **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

Post-Crunch: Fundamental Regulatory Issues & Insurance

- **Unclear How Feds Will Approach and Implement New Regulations on Financial Services Industry**
  - **Option A: Could take "Big Bang" Approach and pass massive, sweeping reform measure that draws little distinction between various segments of the financial services industry**
  - **Option B: Limited legislation pertaining to all segments with detailed treatment of each segment**
- **Removing the "O" from "OFC"?**
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Source: Insurance Information Institute

Reasons Why Insurers Are Better Risk Managers Than Banks

Risk Management Matters

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

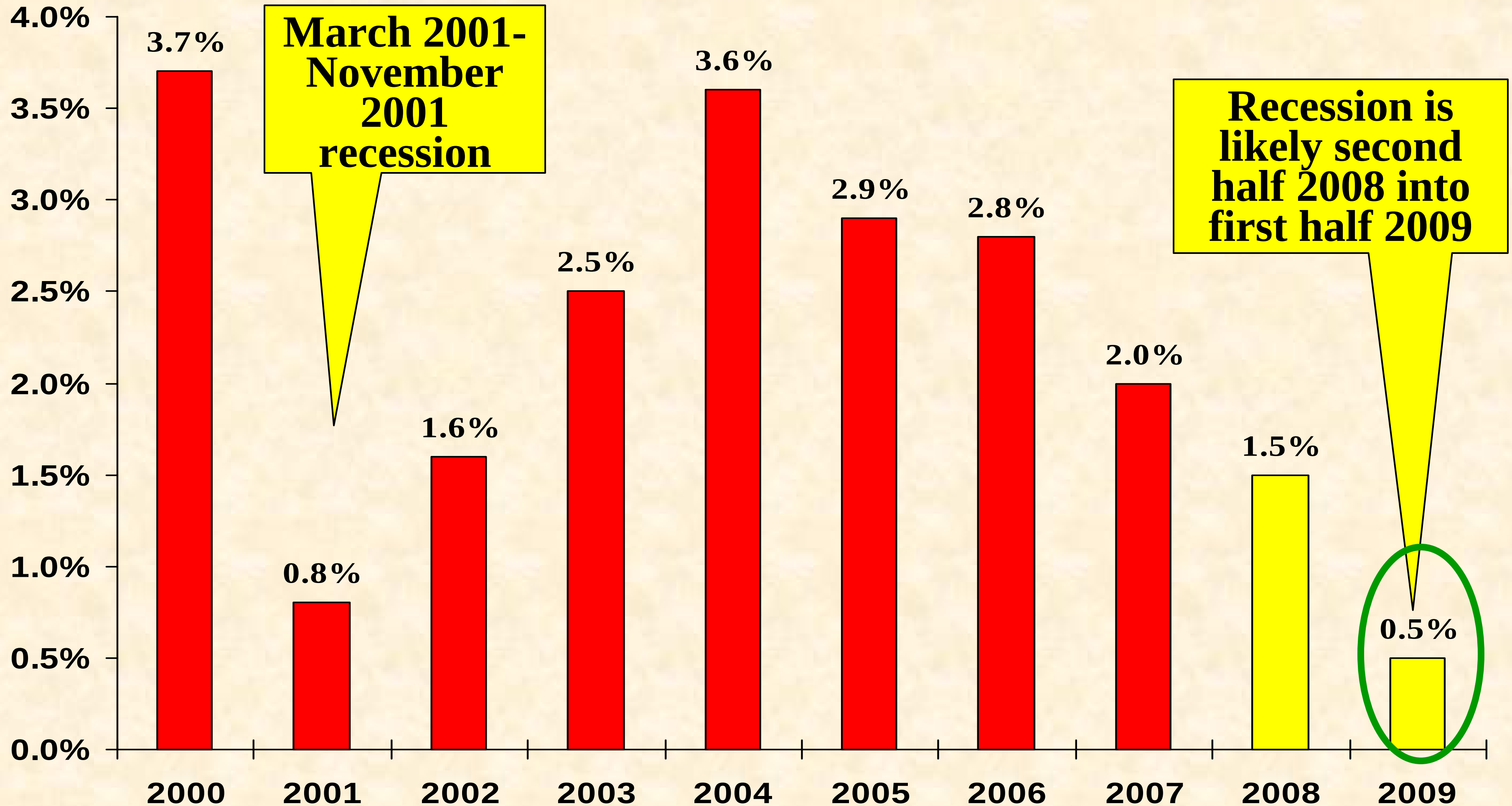
1. **Superior Risk Management Model**
   - Insurers overall approach to risk focuses on underwriting discipline, pricing accuracy and management of potential loss exposure
   - Banks eventually sought to maximize volume, disregarded risk
2. **Low Leverage**
   - Insurers do not rely on borrowed money 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

THE ECONOMIC STORM

Weakening Economy, Threat of Inflation

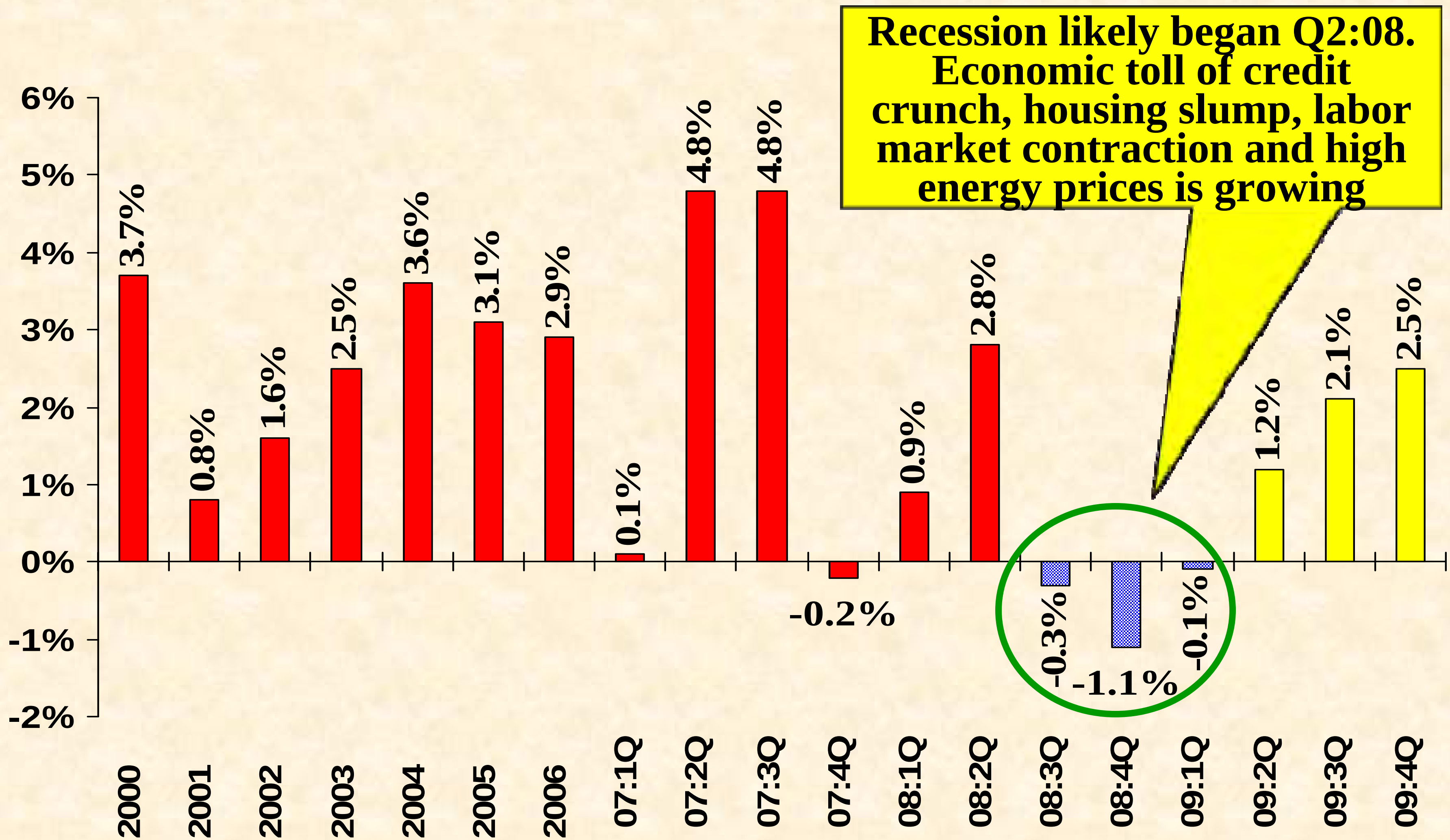
*Real **Annual** GDP Growth, 2000-2009F*



* Red bars are actual; Yellow bars are forecasts

Sources: US Department of Commerce (actual), Blue Economic Indicators 10/08 (forecasts).

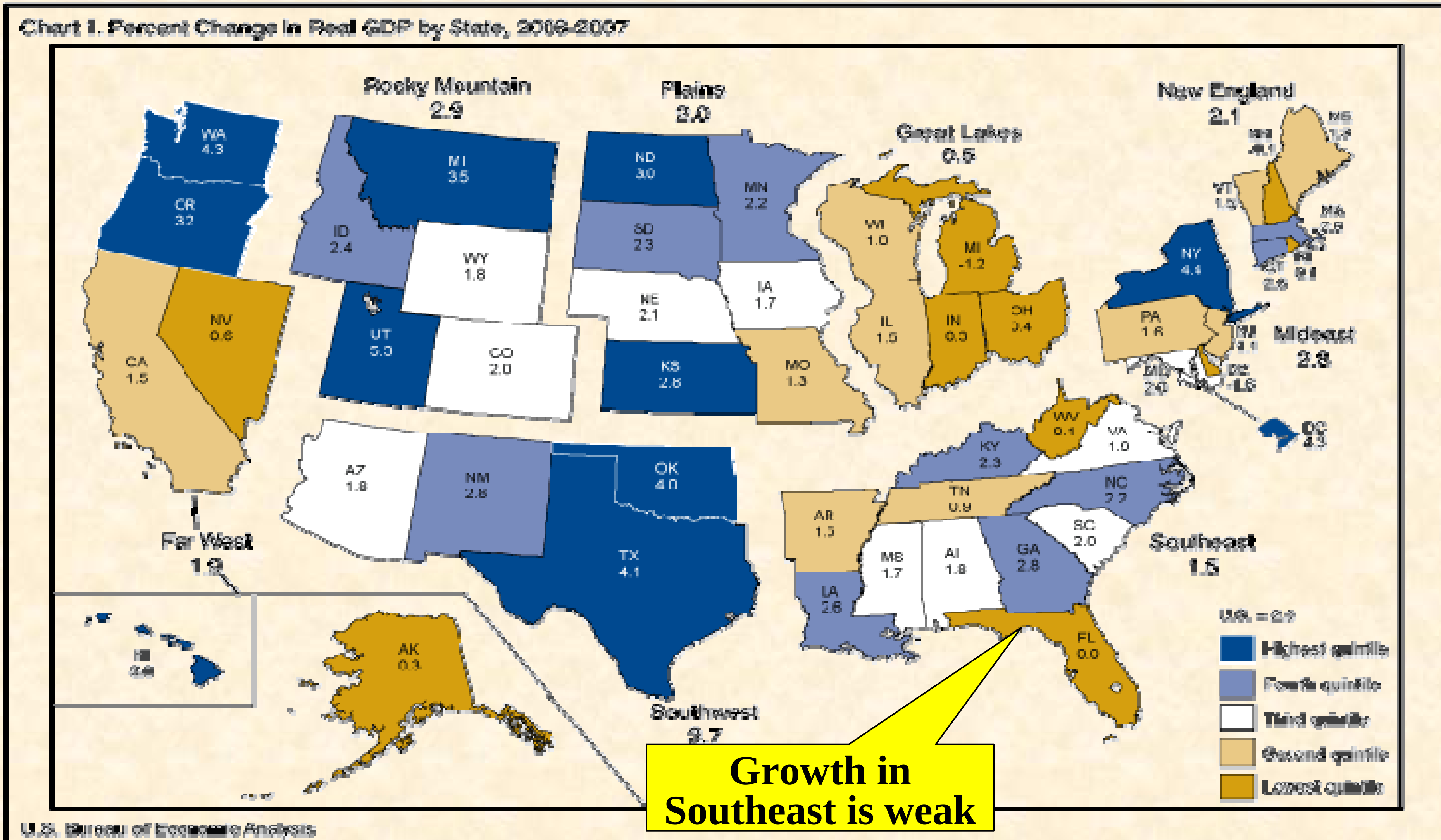
Real GDP Growth*



*Yellow bars are Estimates/Forecasts from Blue Chip Economic Indicators.

Source: US Department of Commerce, Blue Economic Indicators 10/08; Insurance Information Institute.

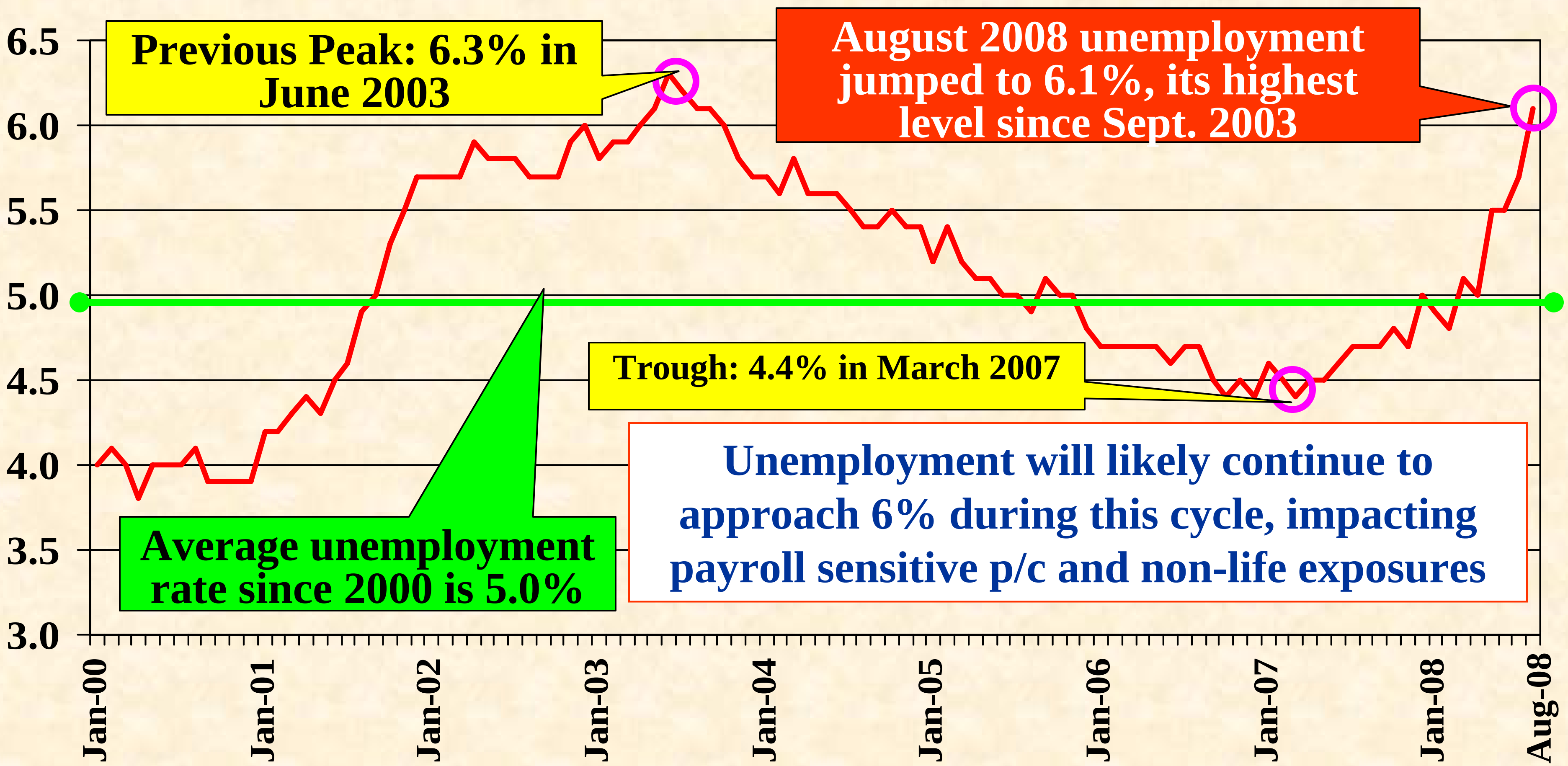
Real GDP Growth by State, 2006-2007



Growth in Southeast is weak

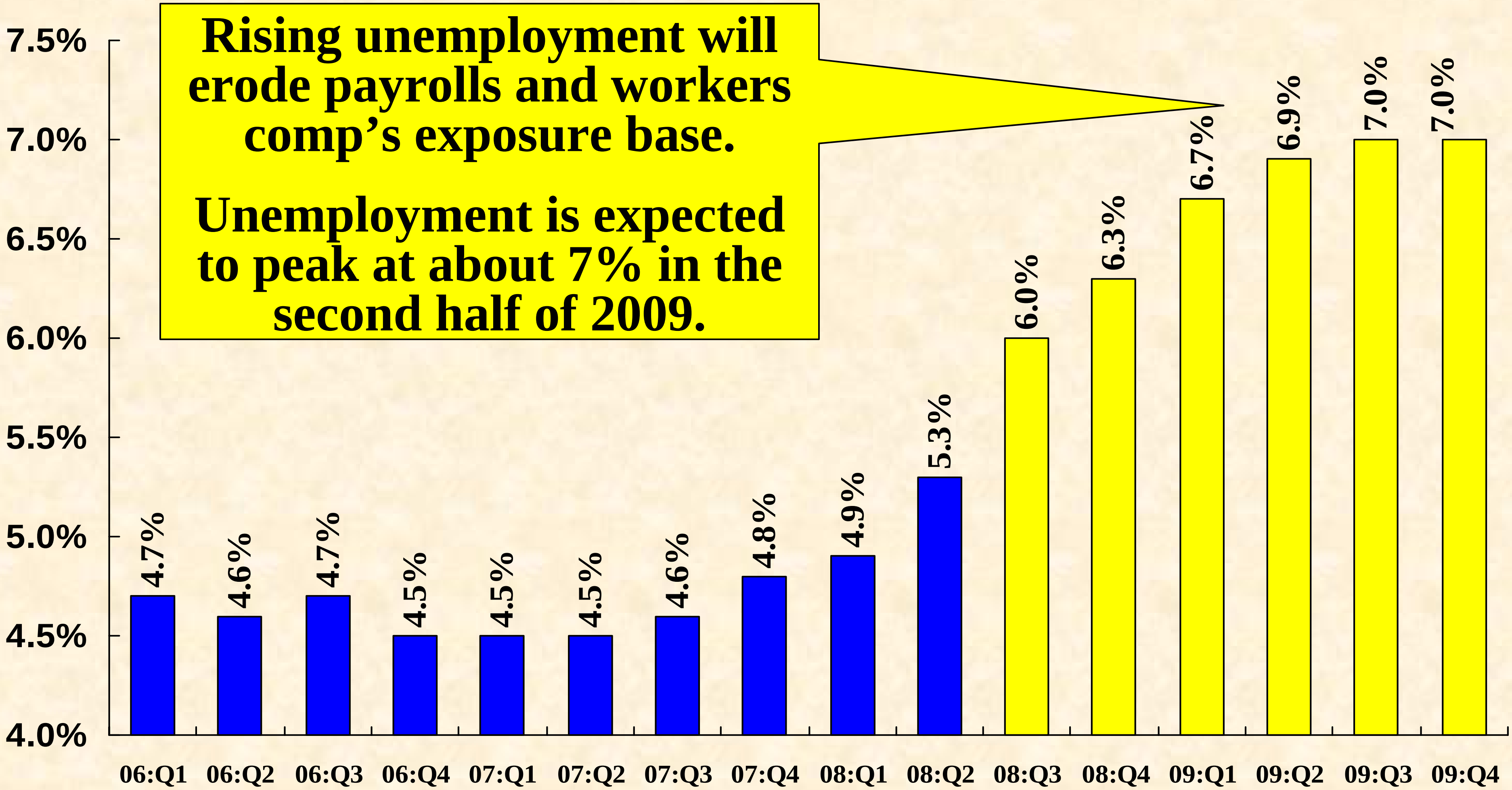
Unemployment Rate: On the Rise

January 2000 through August 2008



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

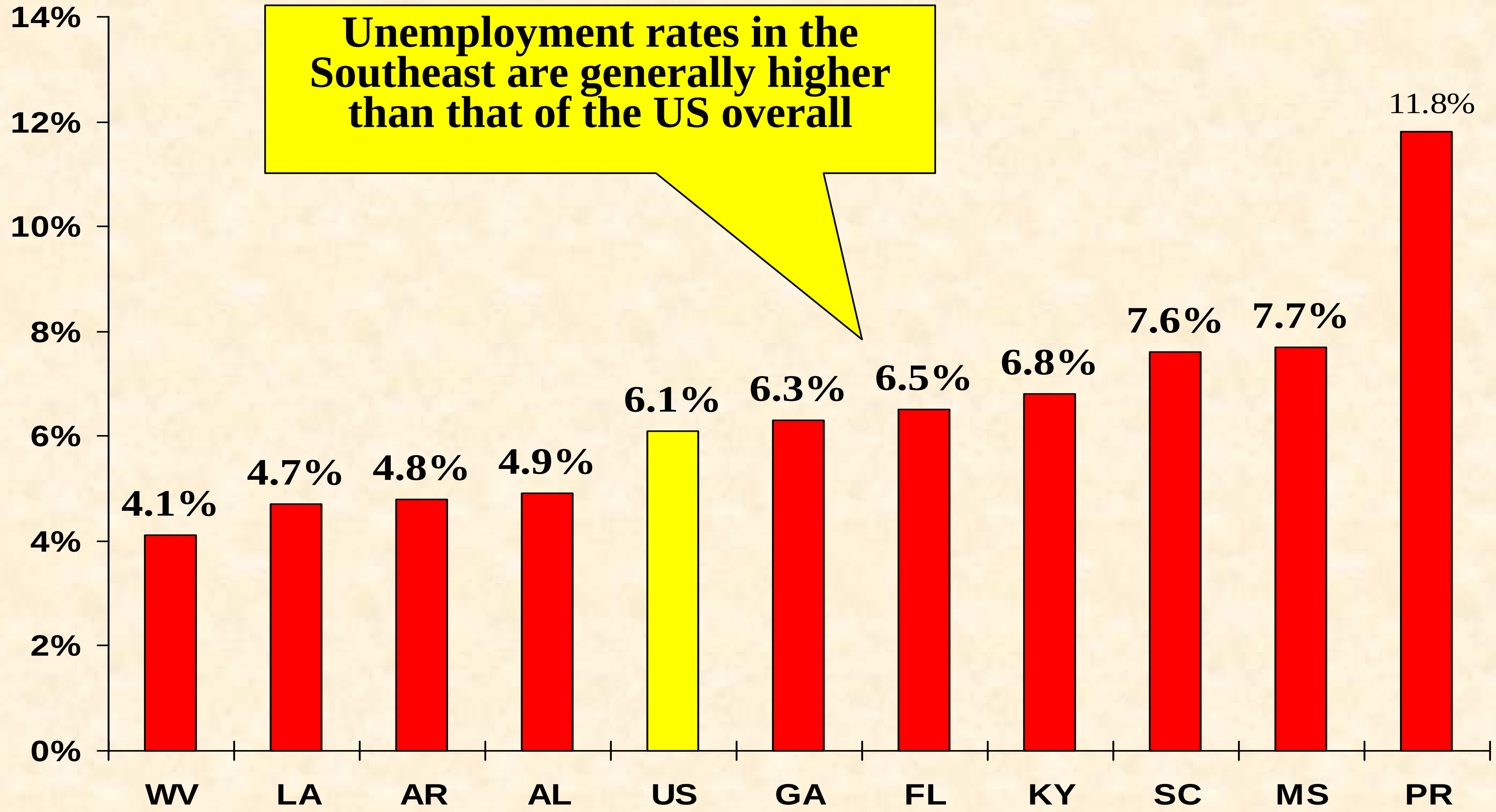
U.S. Unemployment Rate, (2007:Q1 to 2009:Q4F)*



* Blue bars are actual; Yellow bars are forecasts

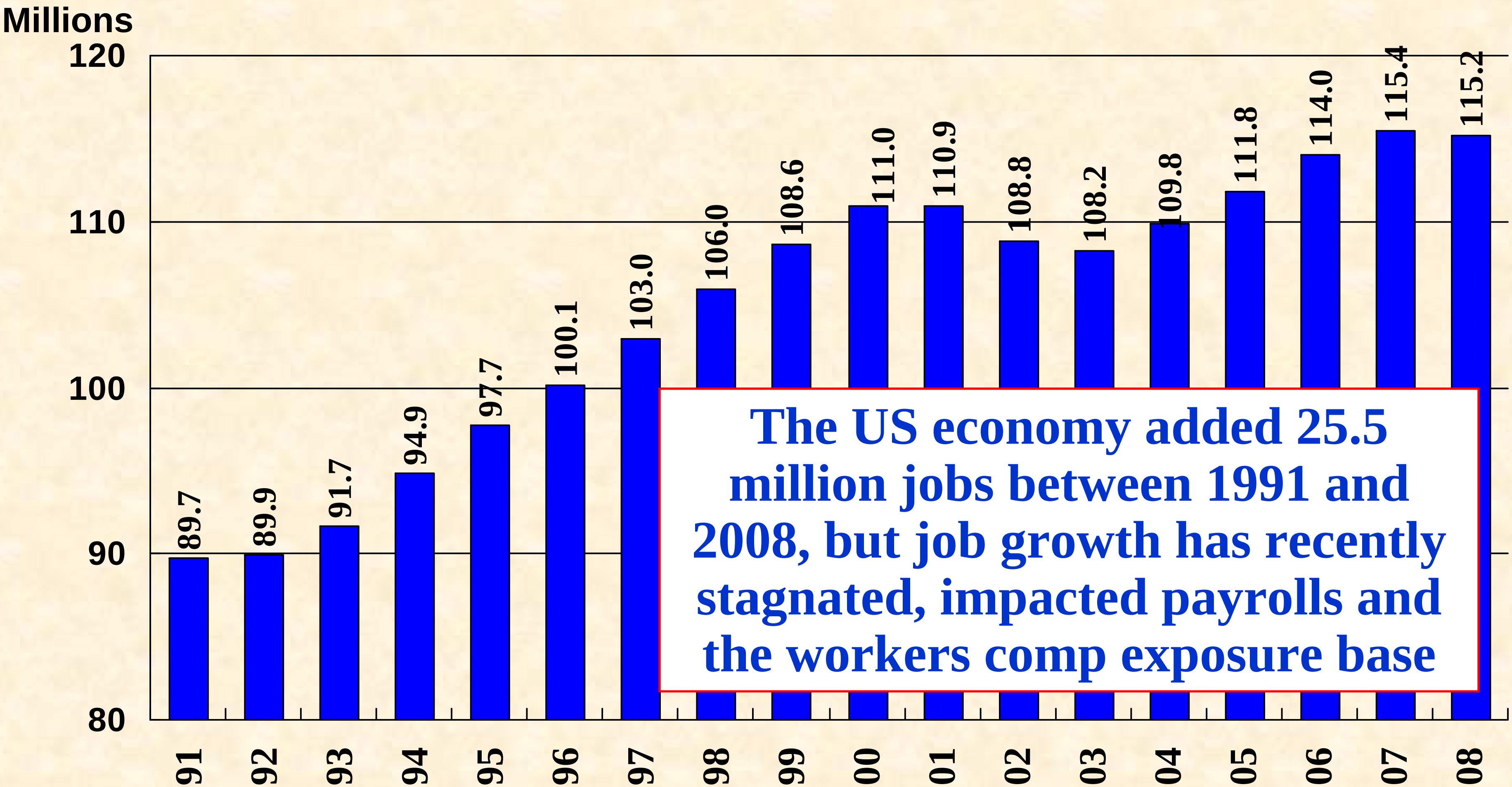
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (10/08); Insurance Info. Inst.

Unemployment Rates in the Southeast, August 2008



Source: US Bureau of Labor Statistics.

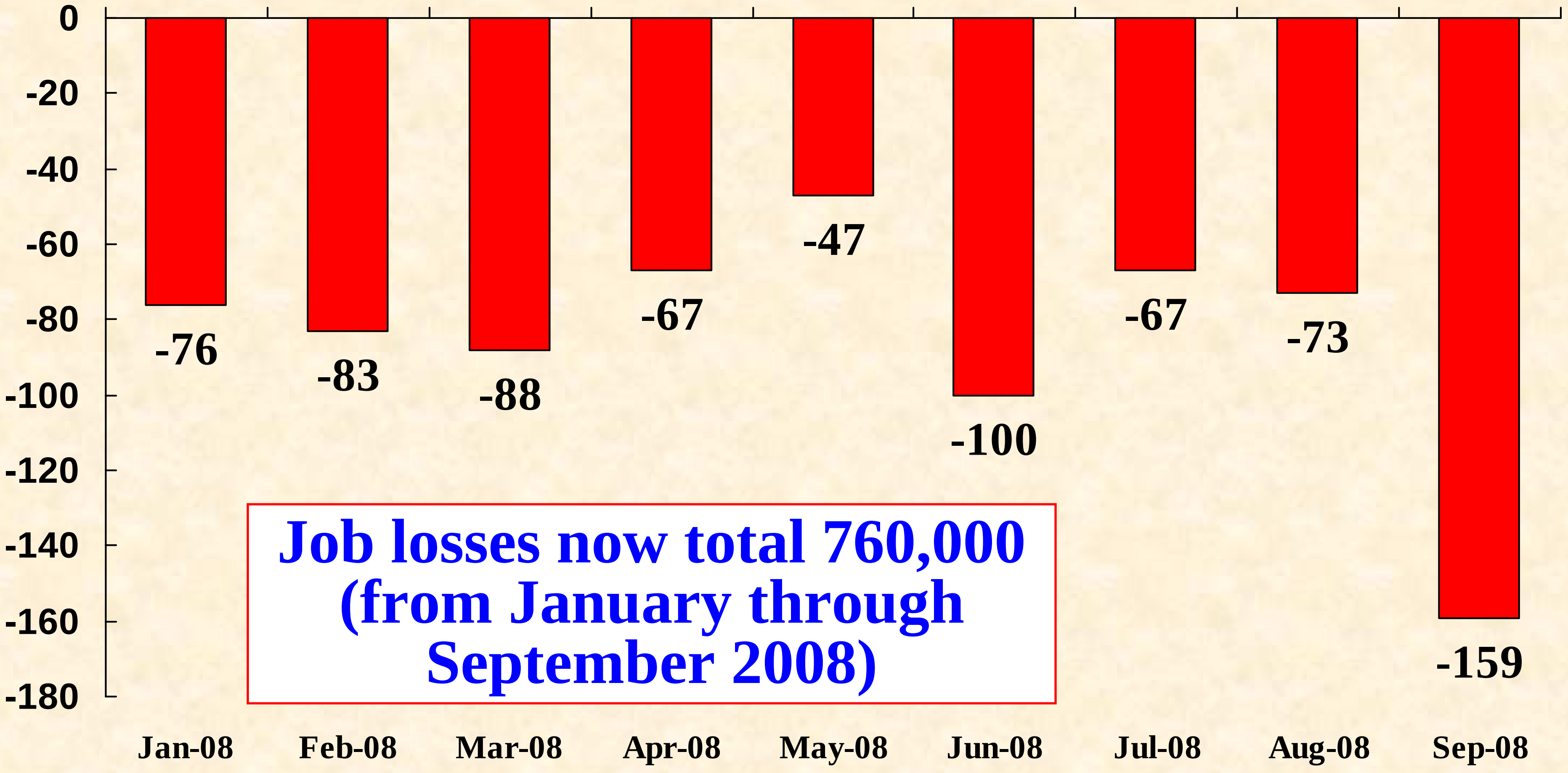
Total Private Employment Grew by 25½ Million Workers from 1991 to 2008*



***seasonally adjusted at mid-year**

Source: U.S. Bureau of Labor Statistics, at http://data.bls.gov/cgi-bin/surveymost

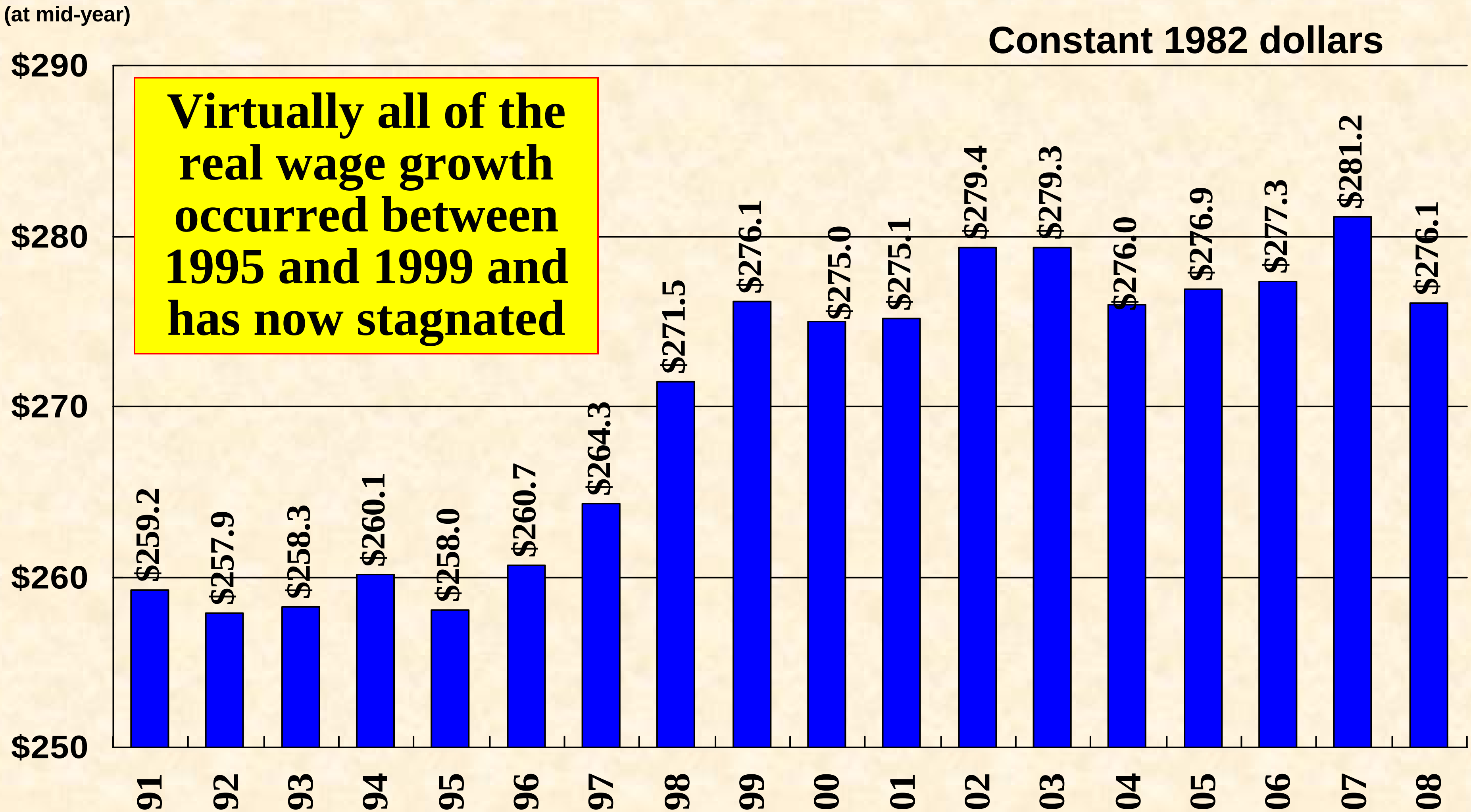
Monthly Change Employment (Thousands)*



Job losses now total 760,000 (from January through September 2008)

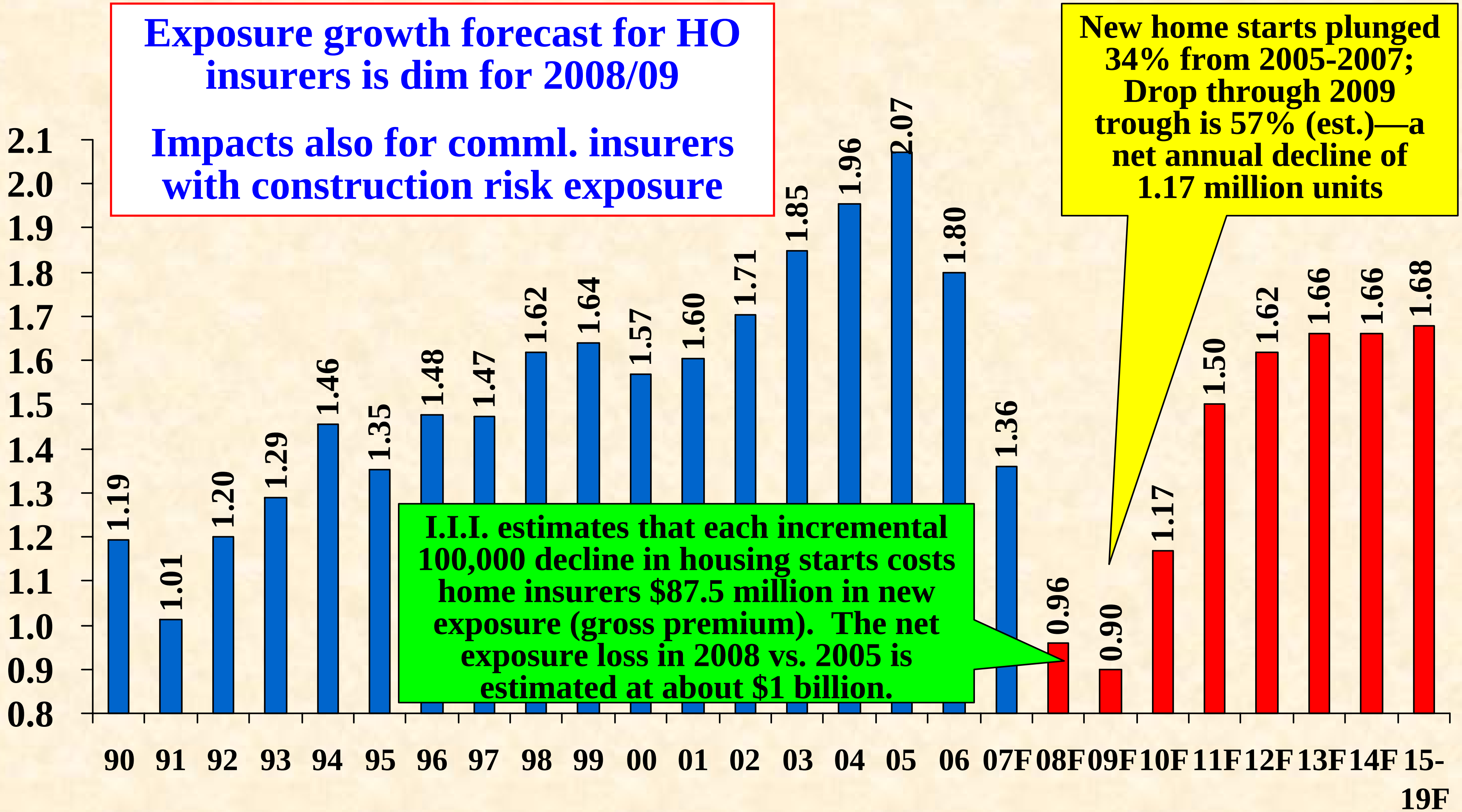
Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Info. Institute

Average Weekly Real Earnings in Private Employment Were Flat from 1999 to 2008



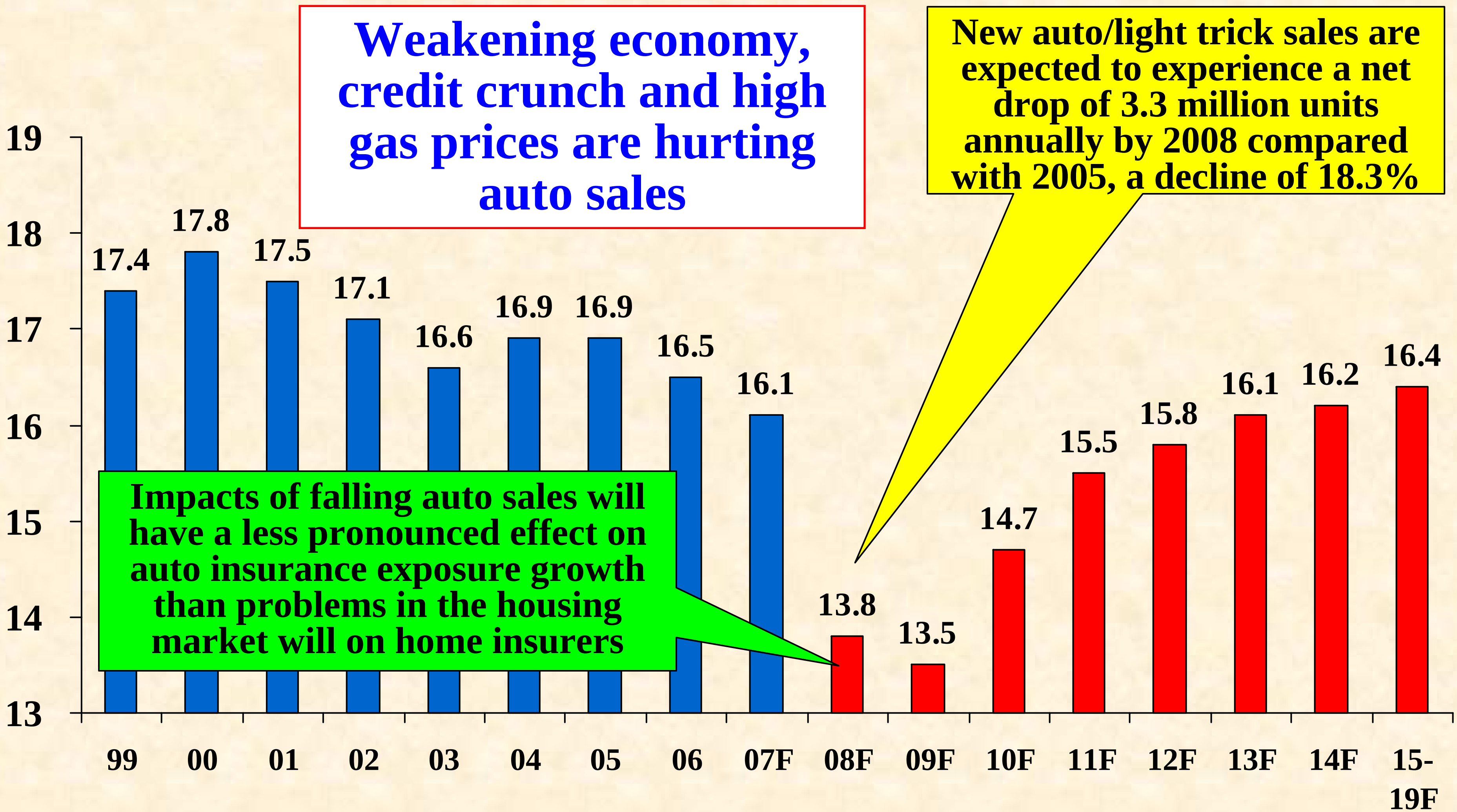
Sources: U.S. Bureau of Labor Statistics; I.I.I.

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



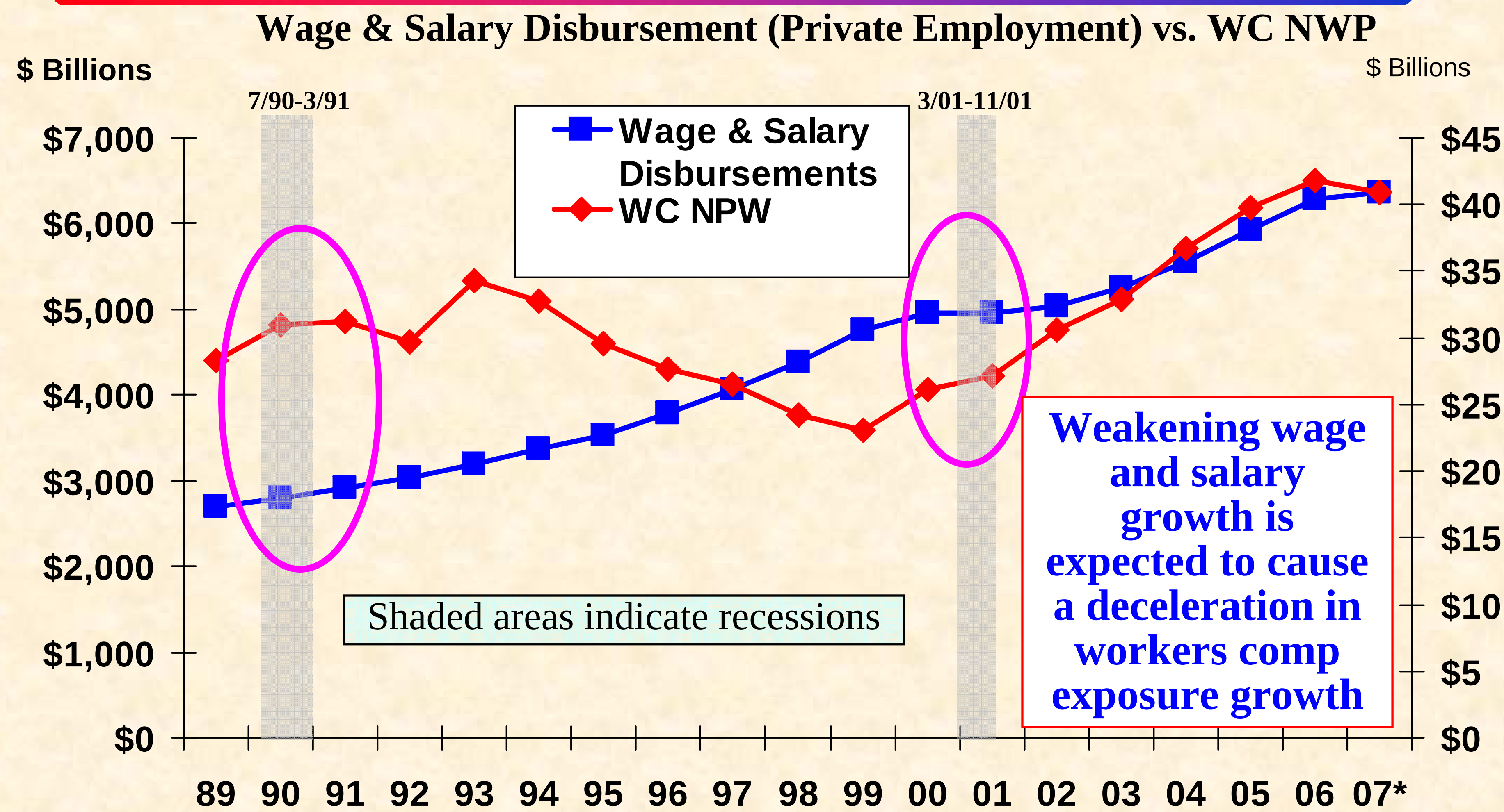
Source: US Department of Commerce; Blue Chip Economic Indicators (10/08); Insurance Information Inst.

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



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

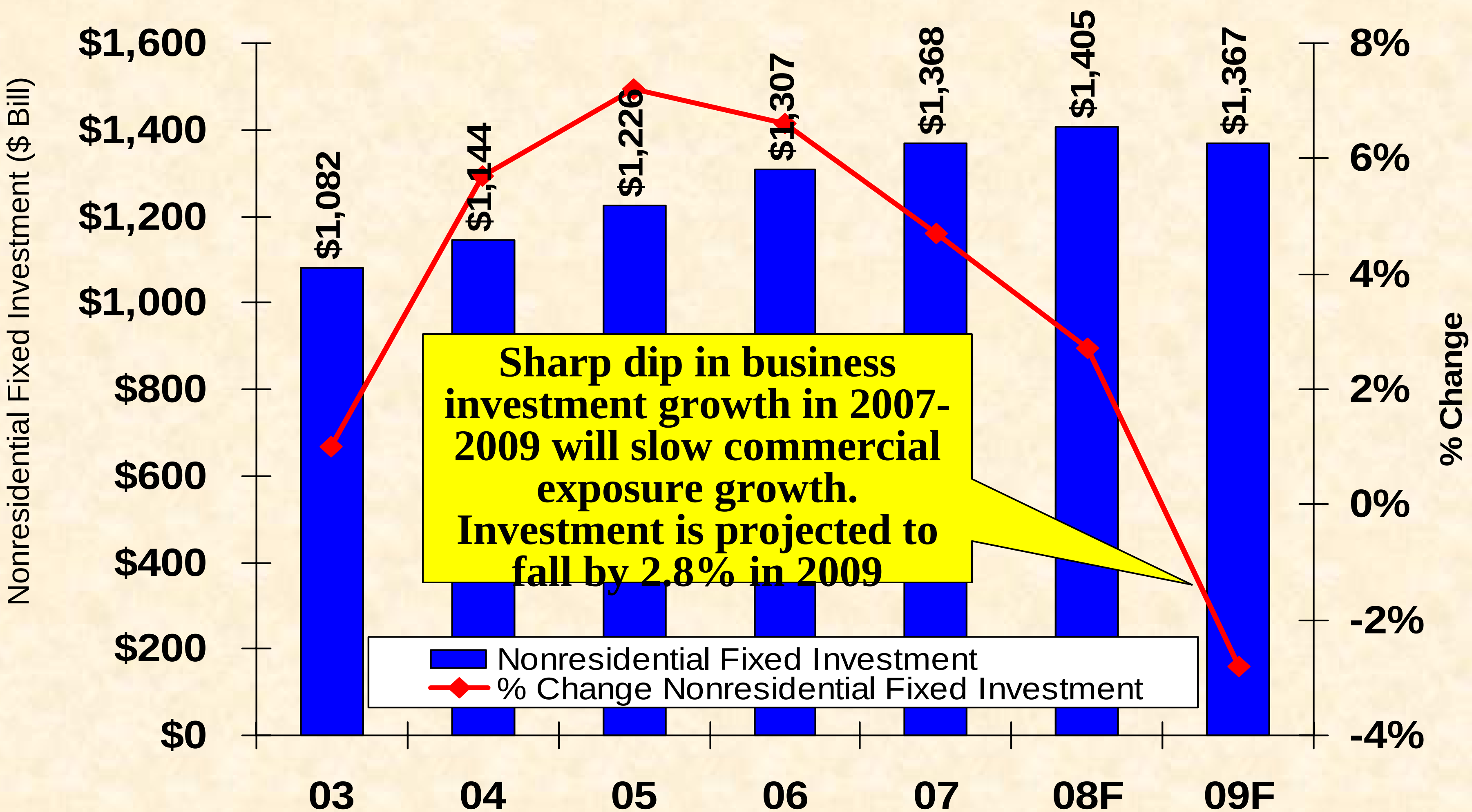
Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums



*Average of quarterly figures.

Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR; I.I.I. Fact Books

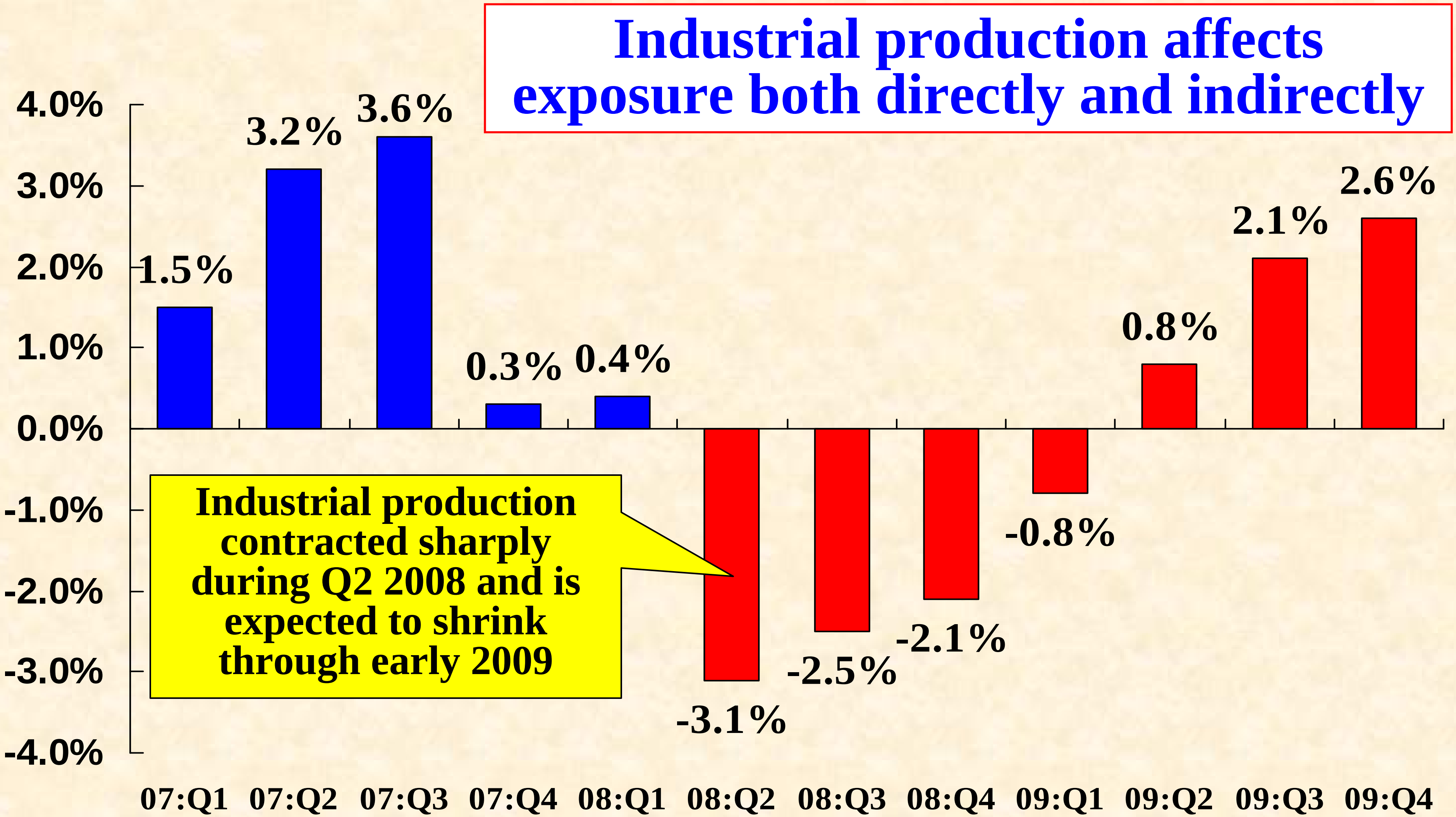
Nonresidential Fixed Investment, 2003 – 2009F (Billions of 2000 $)*



*Nonresidential fixed investment consists of structures, equipment and software.

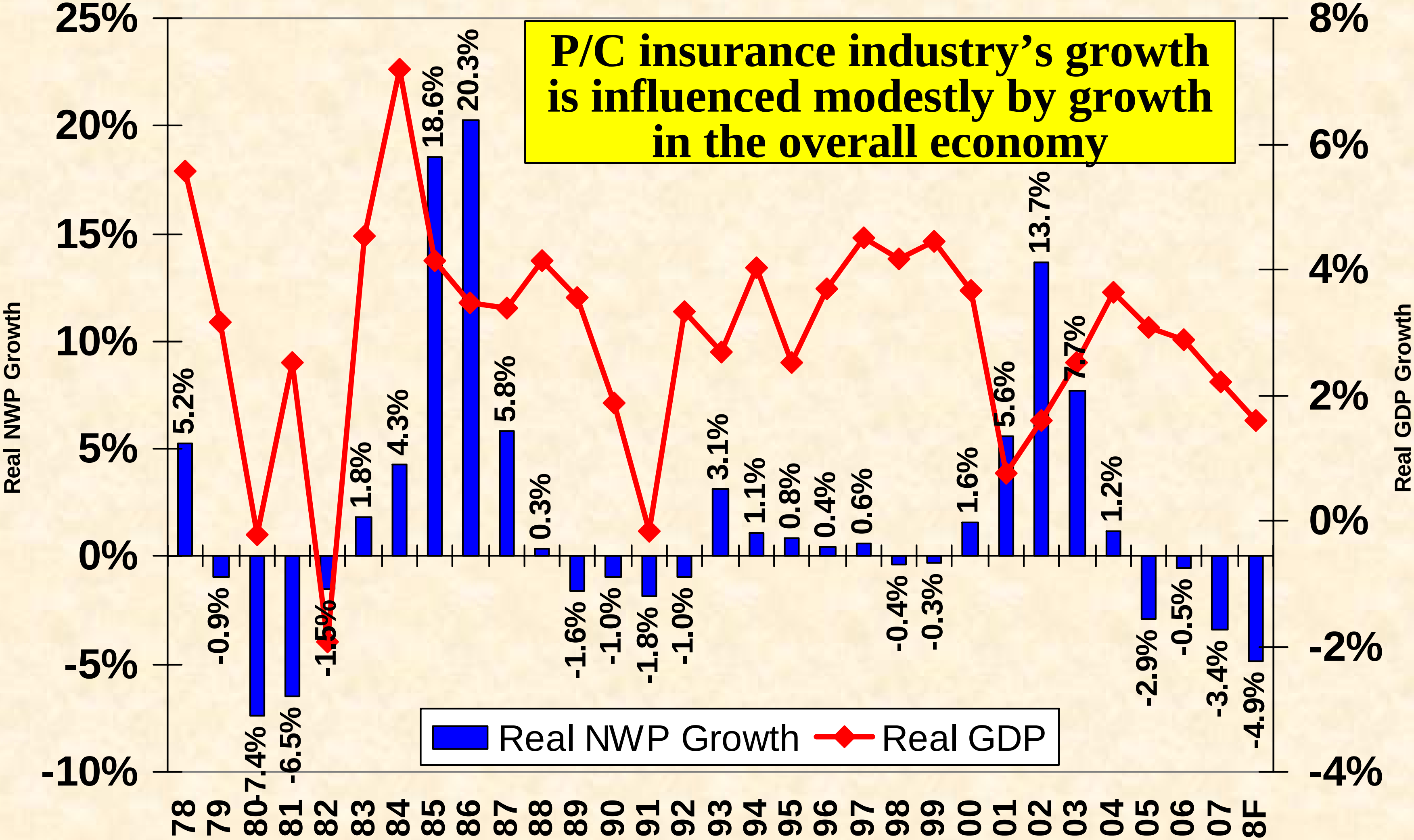
Sources: US Bureau of Economic Analysis (Historical), *Blue Chip Economic Indicators* (10/08) for forecasts.

Total Industrial Production, (2007:Q1 to 2009:Q4F)



Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (10/08); Insurance Info. Inst.

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



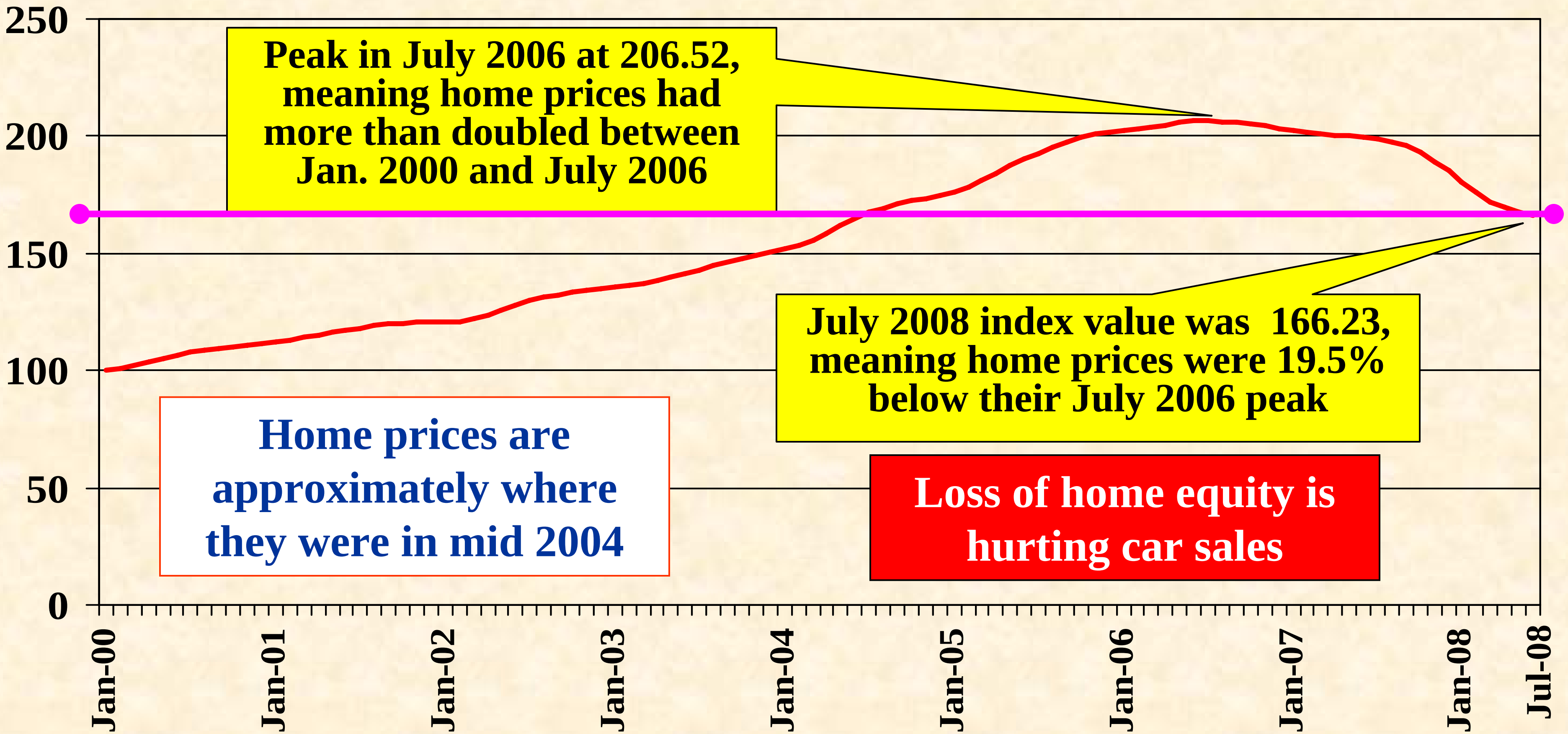
Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 8/08; Insurance Information Inst.

The Housing Crash

Collapse of Home Price Bubble Will Influence Auto & Home Purchases

Case-Schiller Home Price Index: 20 City Composite

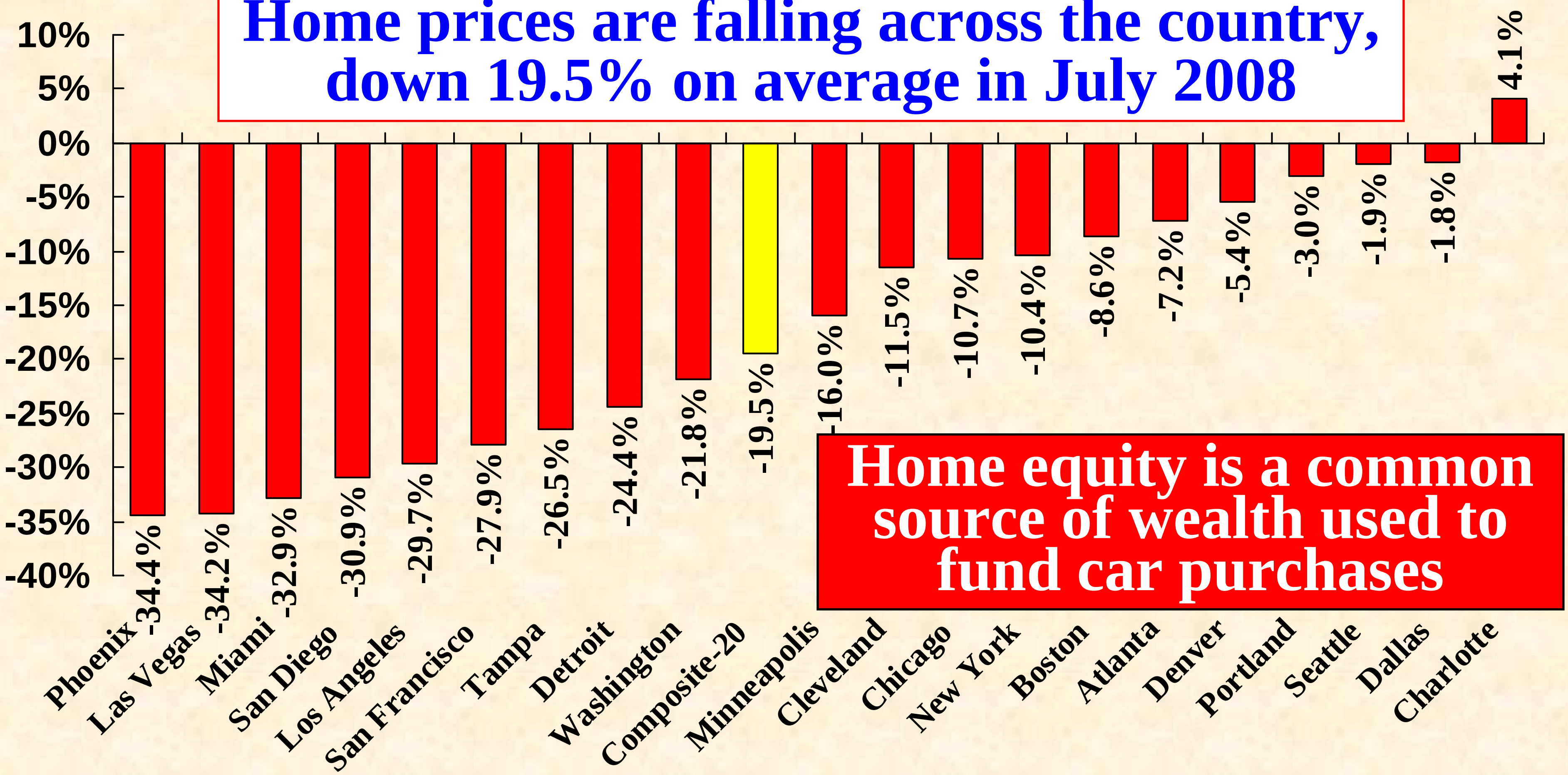
January 2000 = 100



Source: Standardandpoors.com (SPCS20R Index); Insurance Info. Institute

Change in Home Values from July 2006 Housing Bubble Peak, by City*

Home prices are falling across the country, down 19.5% on average in July 2008



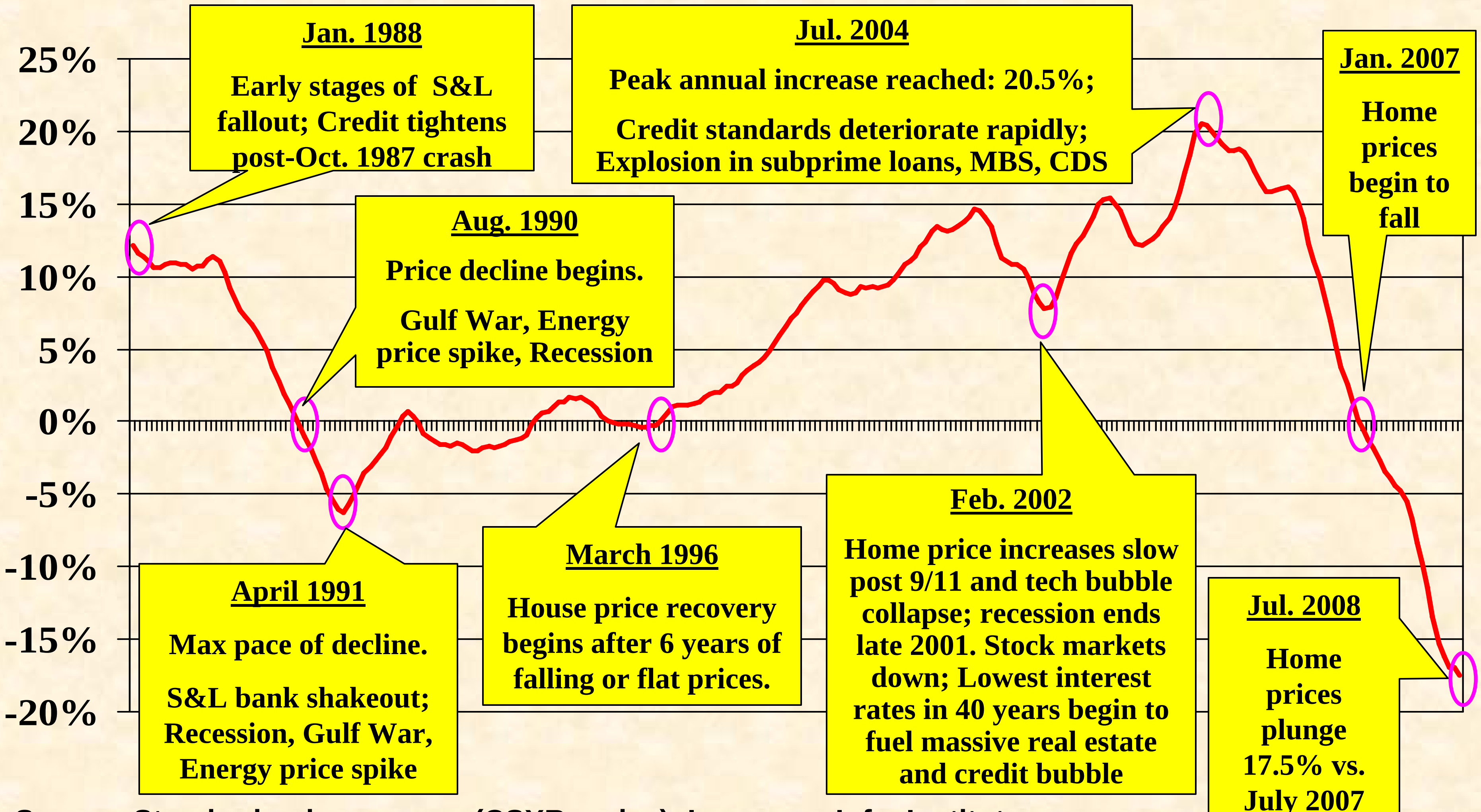
Home equity is a common source of wealth used to fund car purchases

*Calculated as of July 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; Insurance Info. Institute

Home Price History: Anatomy of a Bubble

Annual Change on a Monthly Basis: Jan. 1988 – Jul. 2008

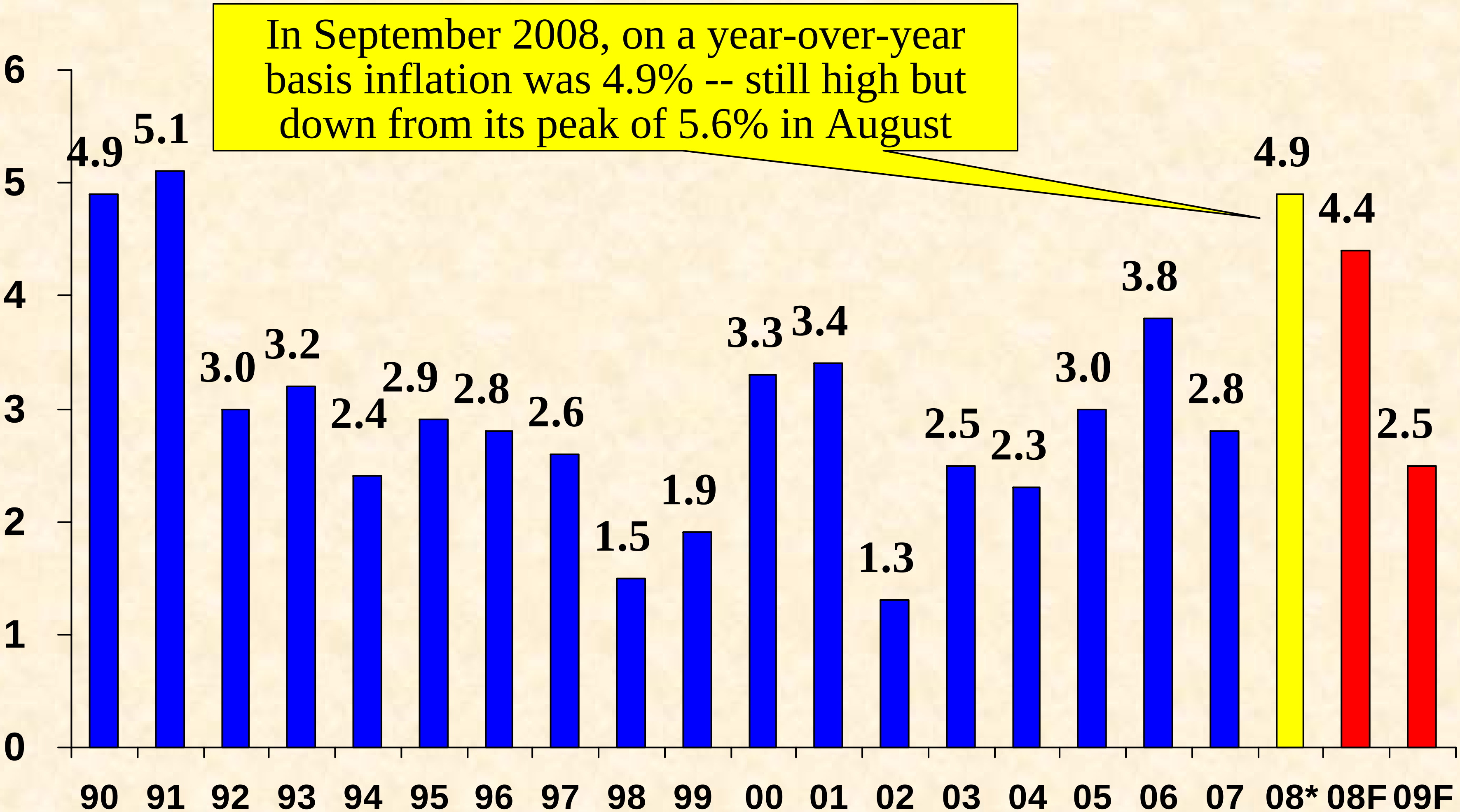


Source: Standardandpoors.com (CSXR series); Insurance Info. Institute

Inflation Overview

Pressures Claim Costs, Expands Probable & Possible Max Losses

Annual Inflation Rates (CPI-U, %), 1990-2009F

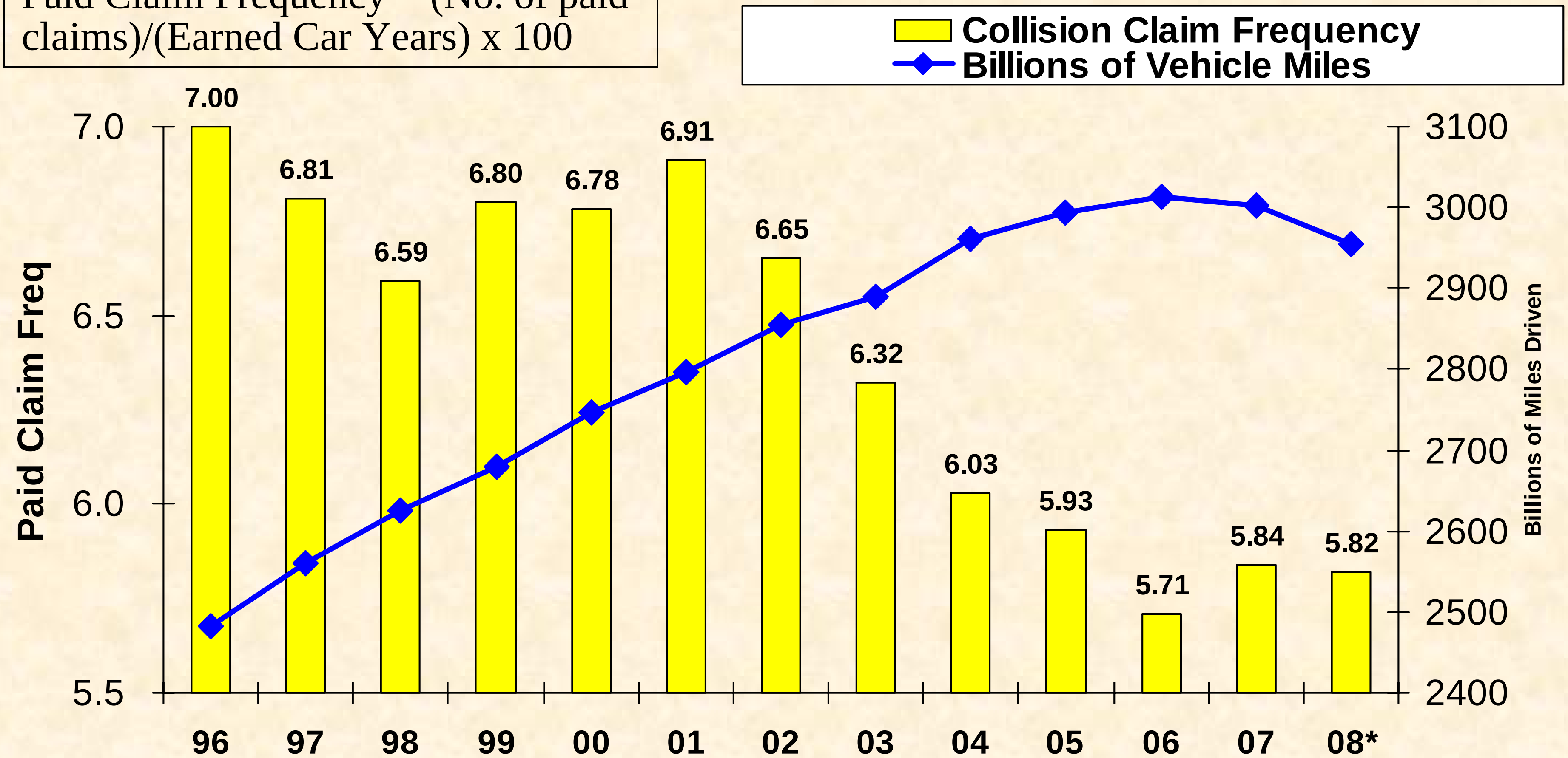


***12-month change September 2008 vs. September 2007**

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, October 10, 2008. (forecasts)

Do Changes in **Miles Driven** Affect Auto Collision Claim Frequency?

Paid Claim Frequency = (No. of paid claims)/(Earned Car Years) x 100



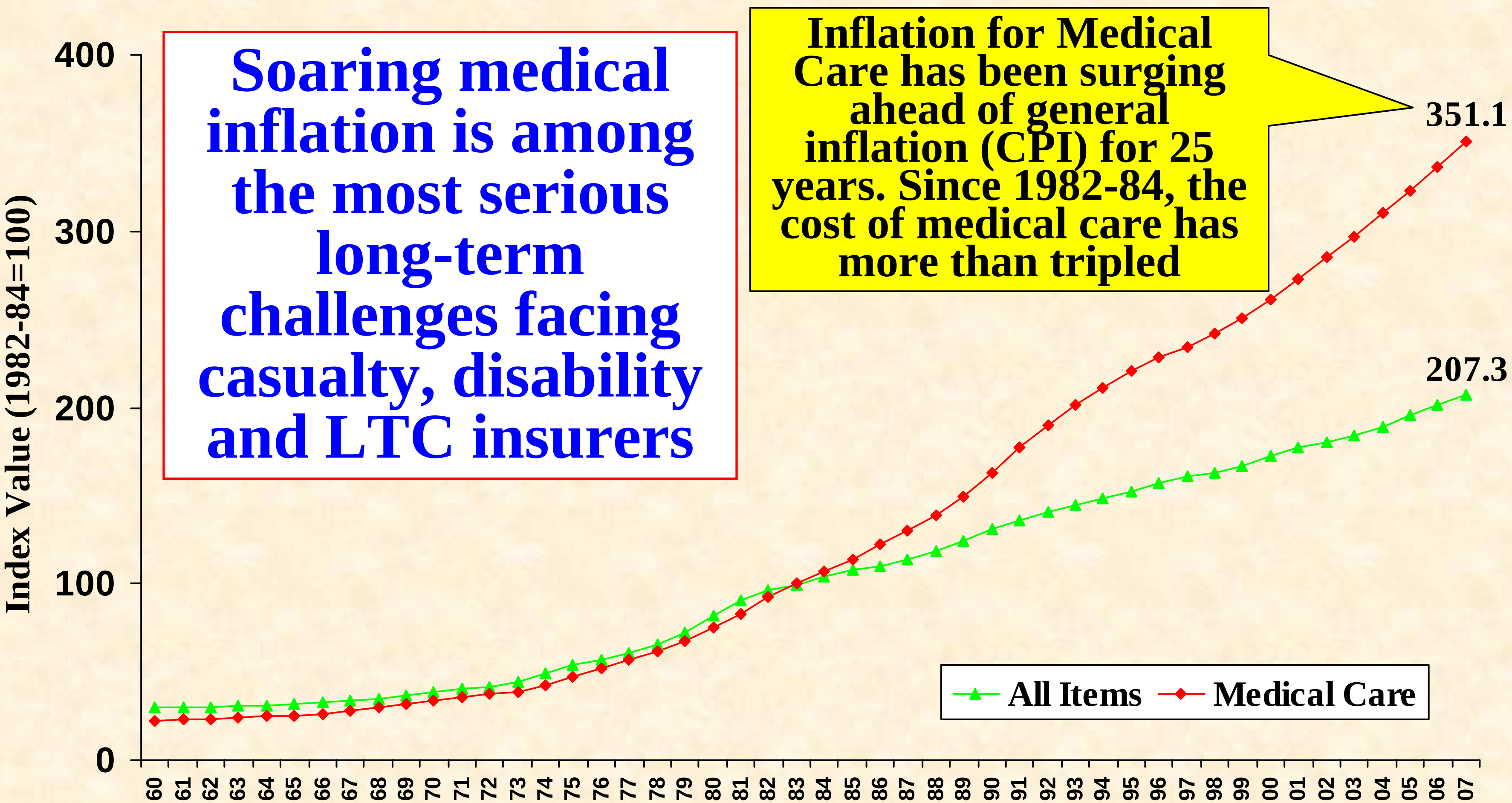
Sources: Federal Highway Administration (http://www.fhwa.dot.gov/ohim/tvtw/08juntvt/08juntvt.pdf; ISO Fast Track Monitoring System, *Private Passenger Automobile Fast Track Data*: First Half 2008, published October 1, 2008 and earlier reports. 2008 figure is for 4 quarters ending Q2 2008.

Medical & Tort Cost Inflation

Amplifiers of Inflation, Major Insurance Cost Driver

Consumer Price Index for Medical Care vs. All Items, 1960-2007

(Base: 1982-84=100)

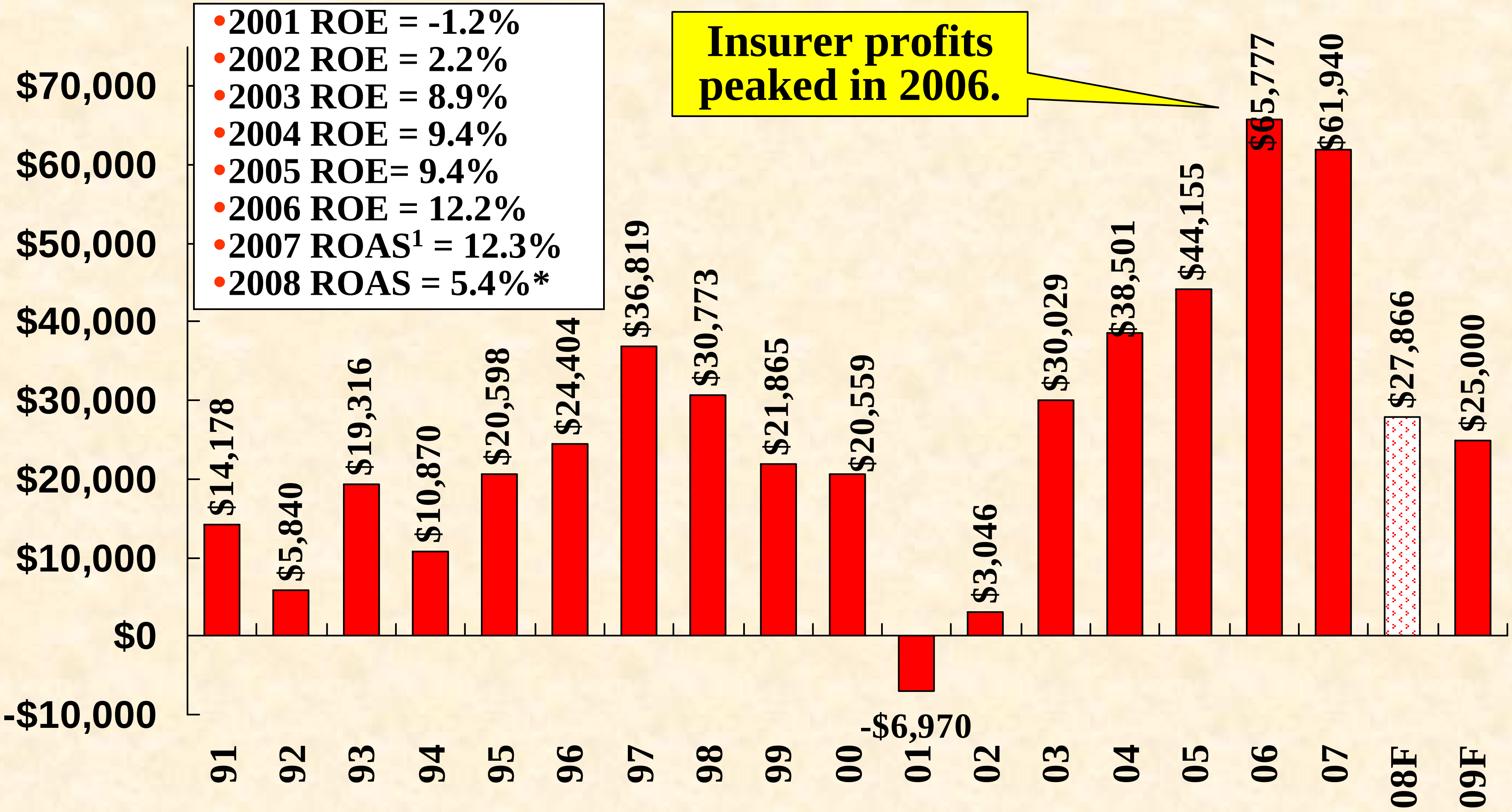


Source: Department of Labor (Bureau of Labor Statistics; Insurance Information Institute.

P/C INSURANCE PROFITABILITY

In the Midst of a Cyclical Decline

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

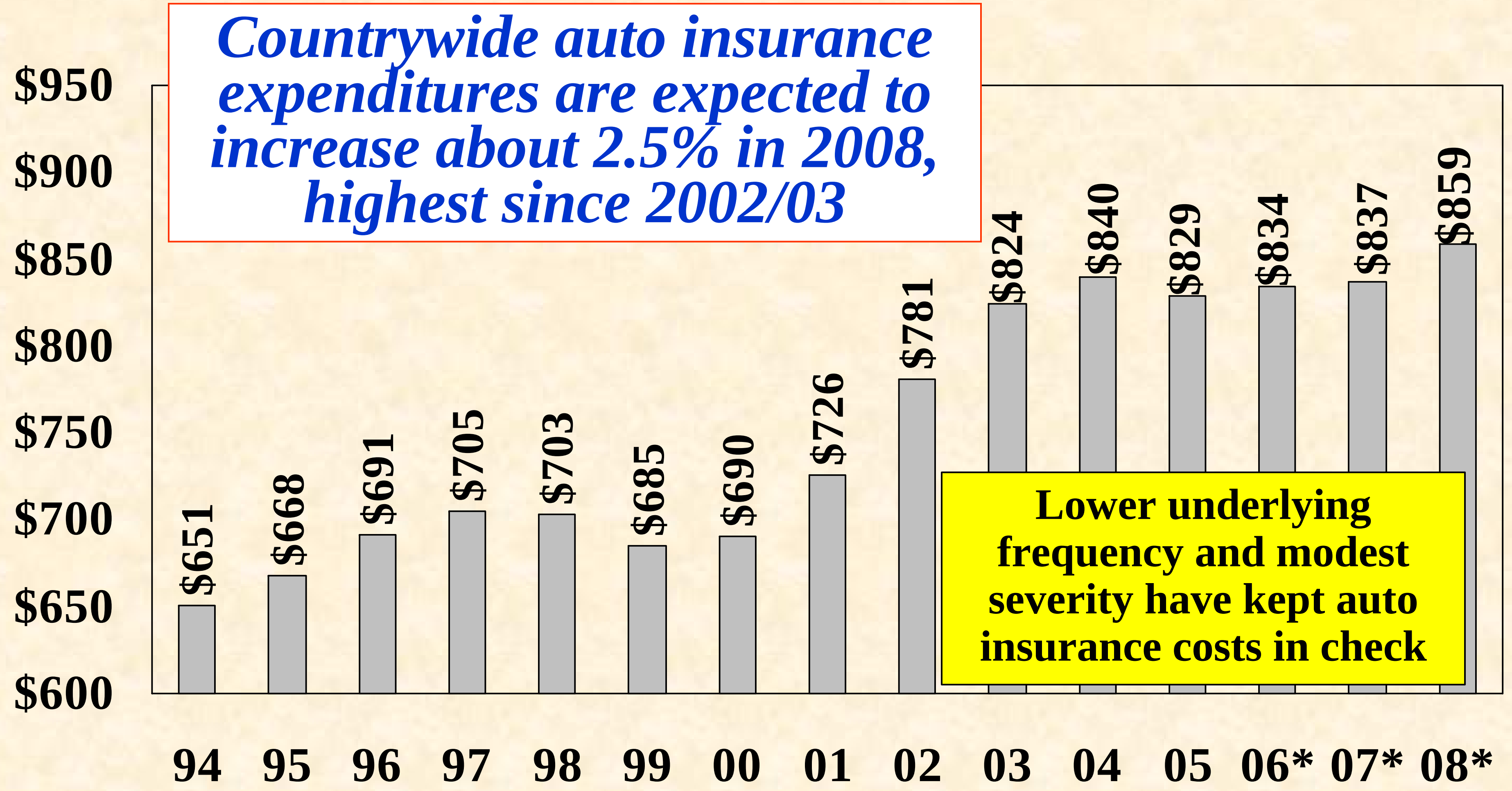


*ROE figures are GAAP; [1]Return on avg. surplus. 2008 numbers are annualized based on H1 actual.
Sources: A.M. Best, ISO, Insurance Information Inst.

PRICING TRENDS

Under Pressure

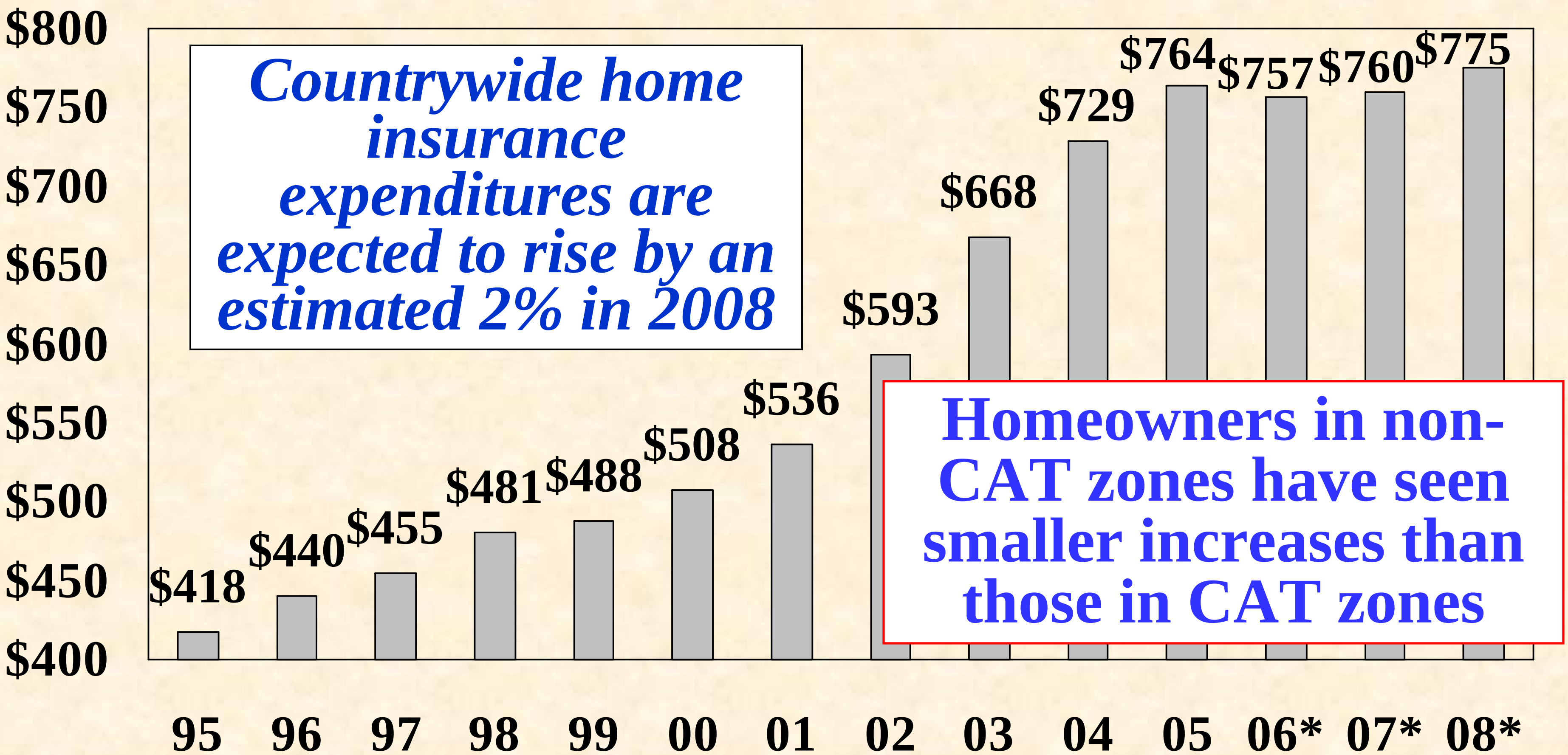
Average Expenditures on Auto Insurance



*Insurance Information Institute Estimates/Forecasts

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

*Average Expenditures on Homeowners Insurance***

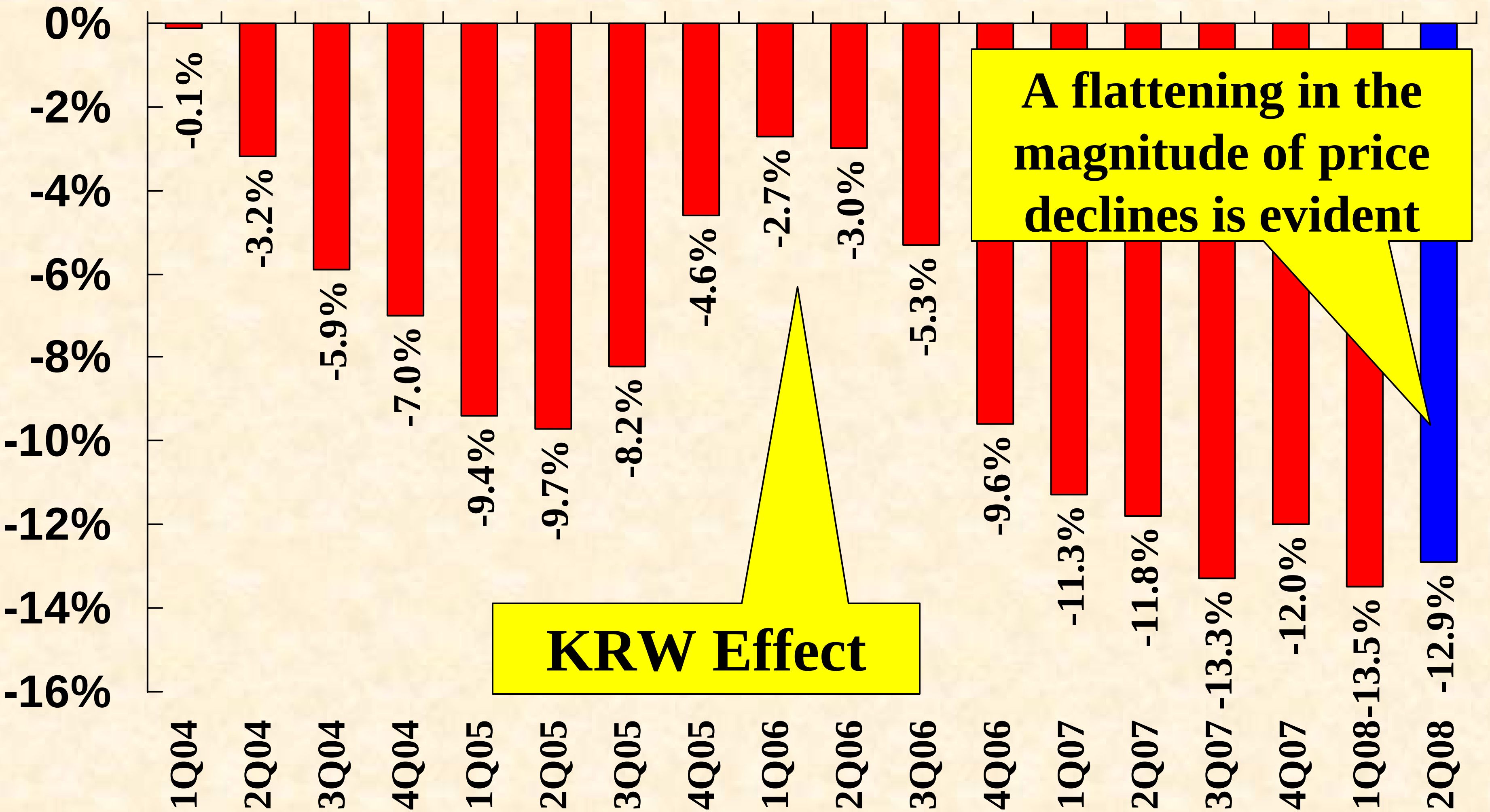


*Insurance Information Institute Estimates/Forecasts

**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 – 2Q:2008)

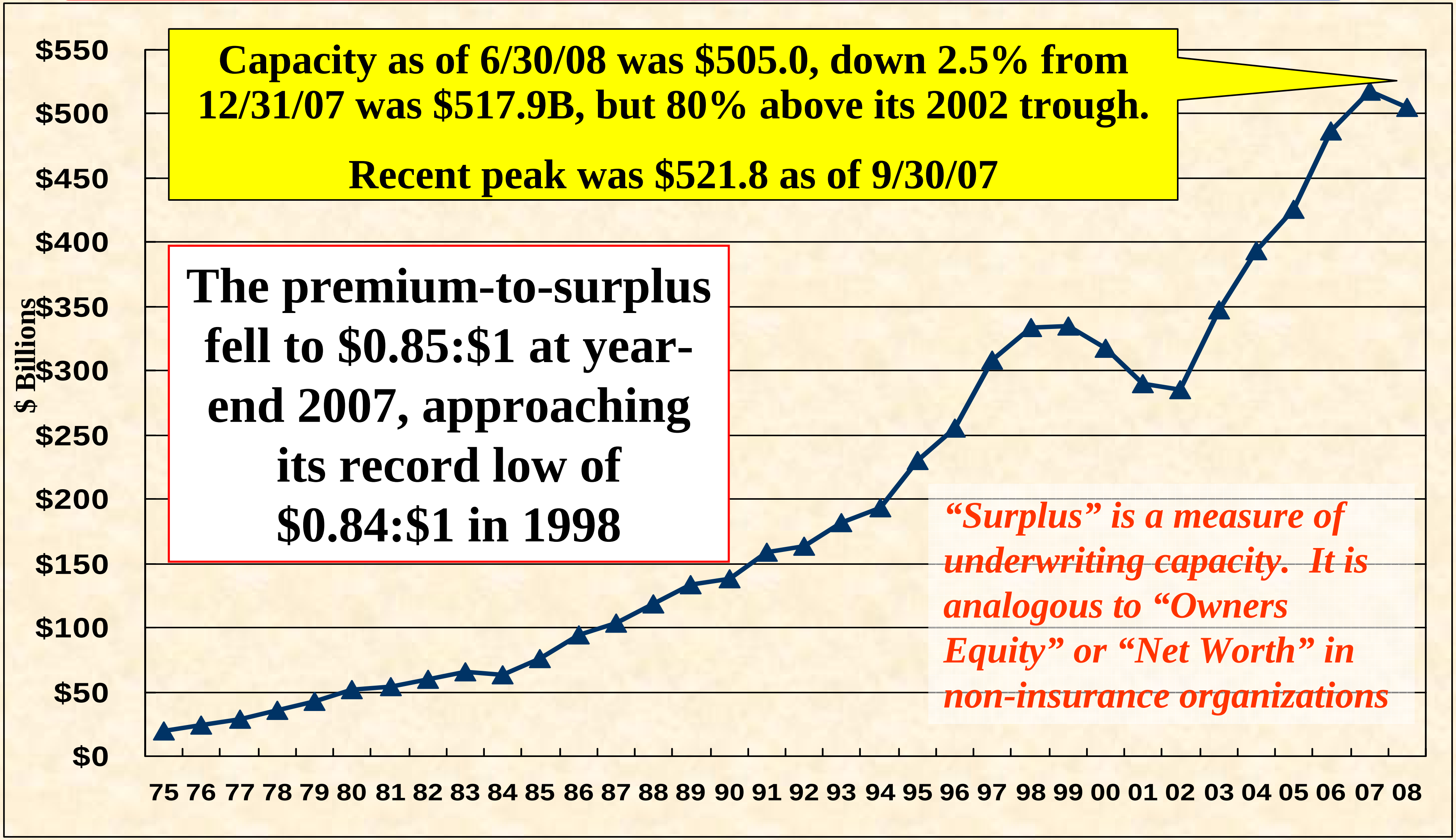


Source: Council of Insurance Agents & Brokers; Insurance Information Institute

CAPACITY/ SURPLUS

Capital/ Surplus Falling from 2007 Peak

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



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

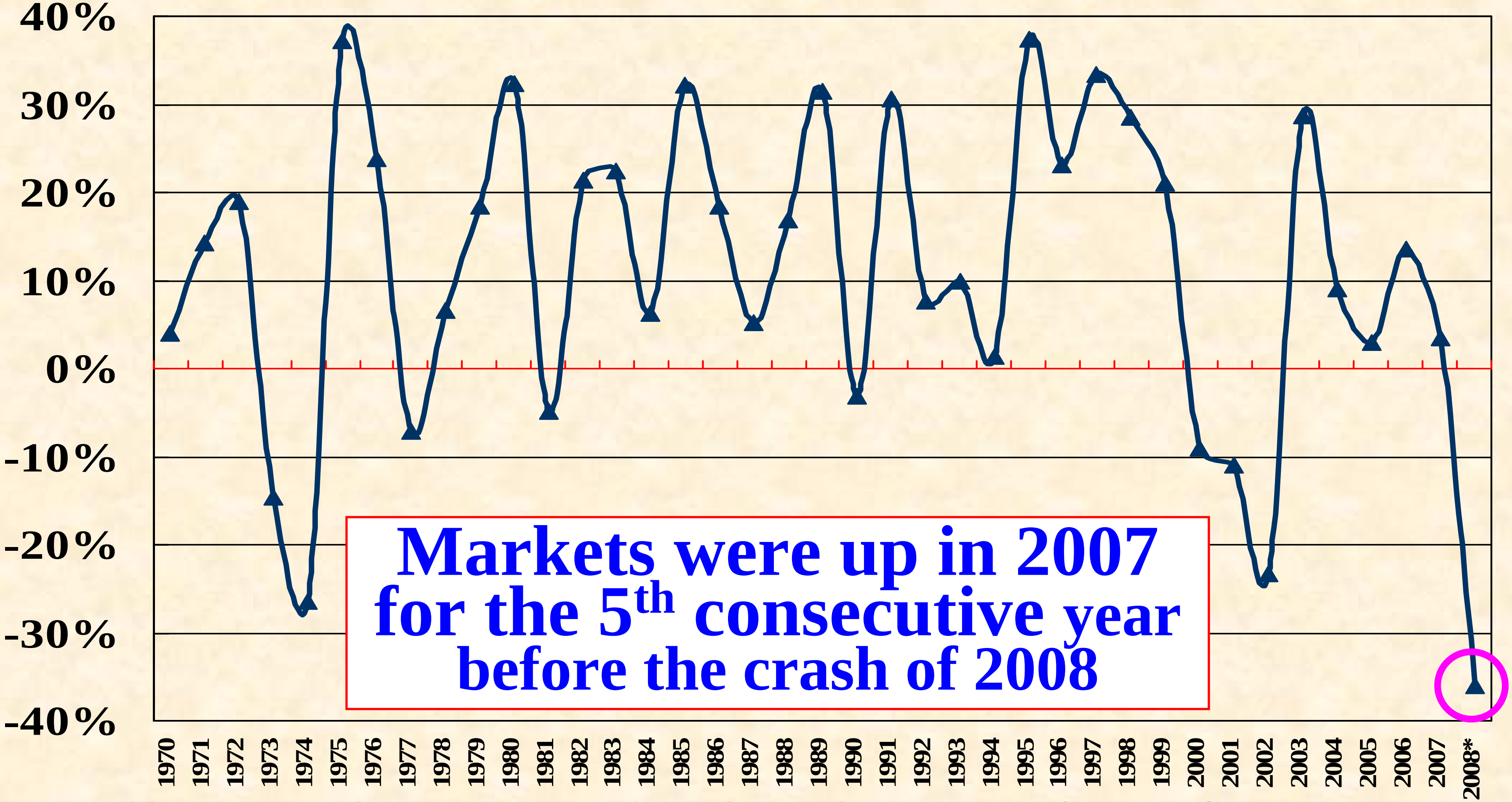
*As of June 30, 2008

INVESTMENT OVERVIEW

More Pain, Little Gain

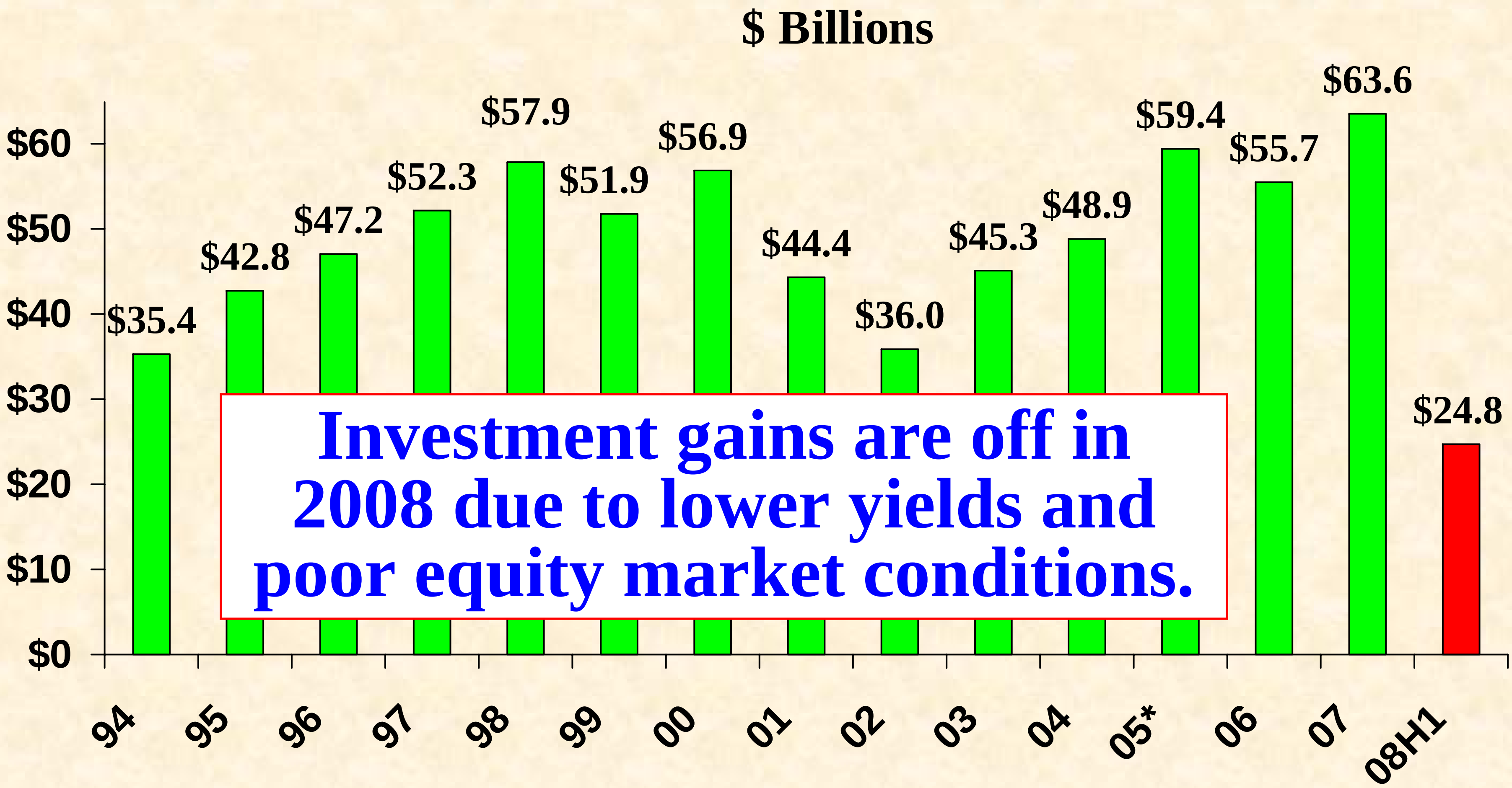
Total Returns for Large Company Stocks: 1970-2008*

S&P 500 was up 3.53% in 2007, but down 36.0% so far in 2008*



Source: Ibbotson Associates, Insurance Information Institute. *Through October 17, 2008.

Property/Casualty Insurance Industry Investment Gain[1]

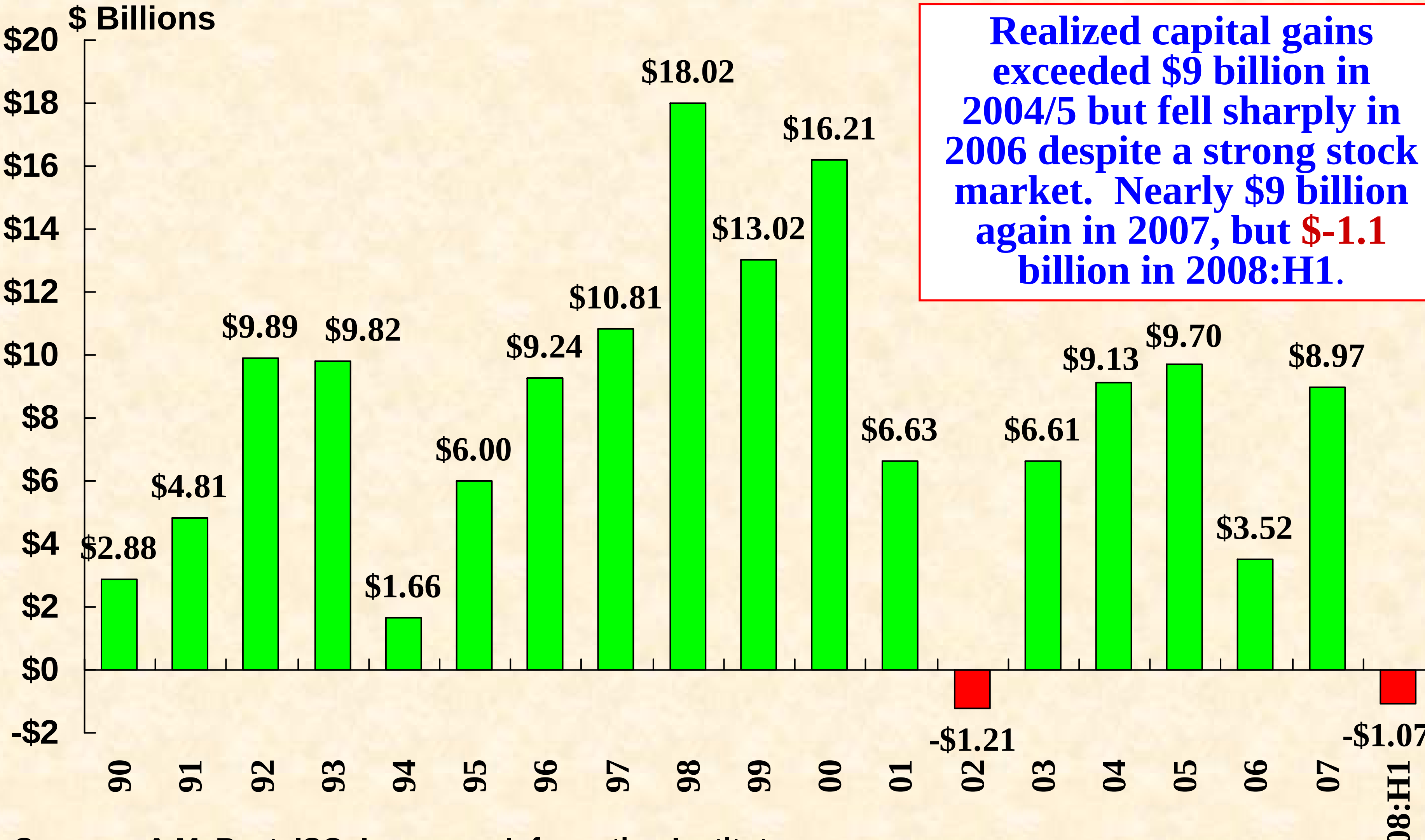


[1]Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of $52.3B net investment income and $3.4B realized investment gain.

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

Sources: ISO; Insurance Information Institute.

P/C Insurer Net Realized Capital Gains, 1990-2008:H1



Realized capital gains exceeded $9 billion in 2004/5 but fell sharply in 2006 despite a strong stock market. Nearly $9 billion again in 2007, but $-1.1 billion in 2008:H1.

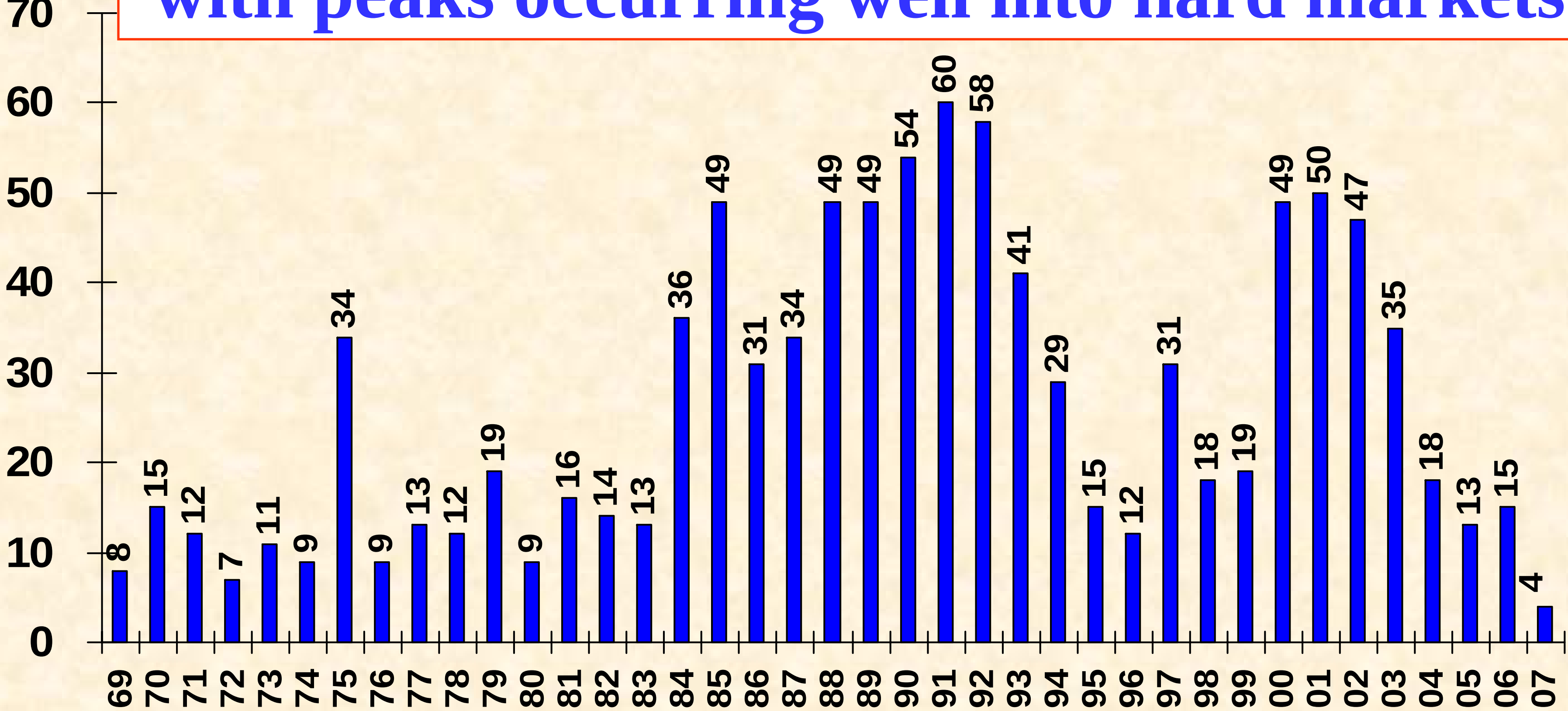
Sources: A.M. Best, ISO, Insurance Information Institute.

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well

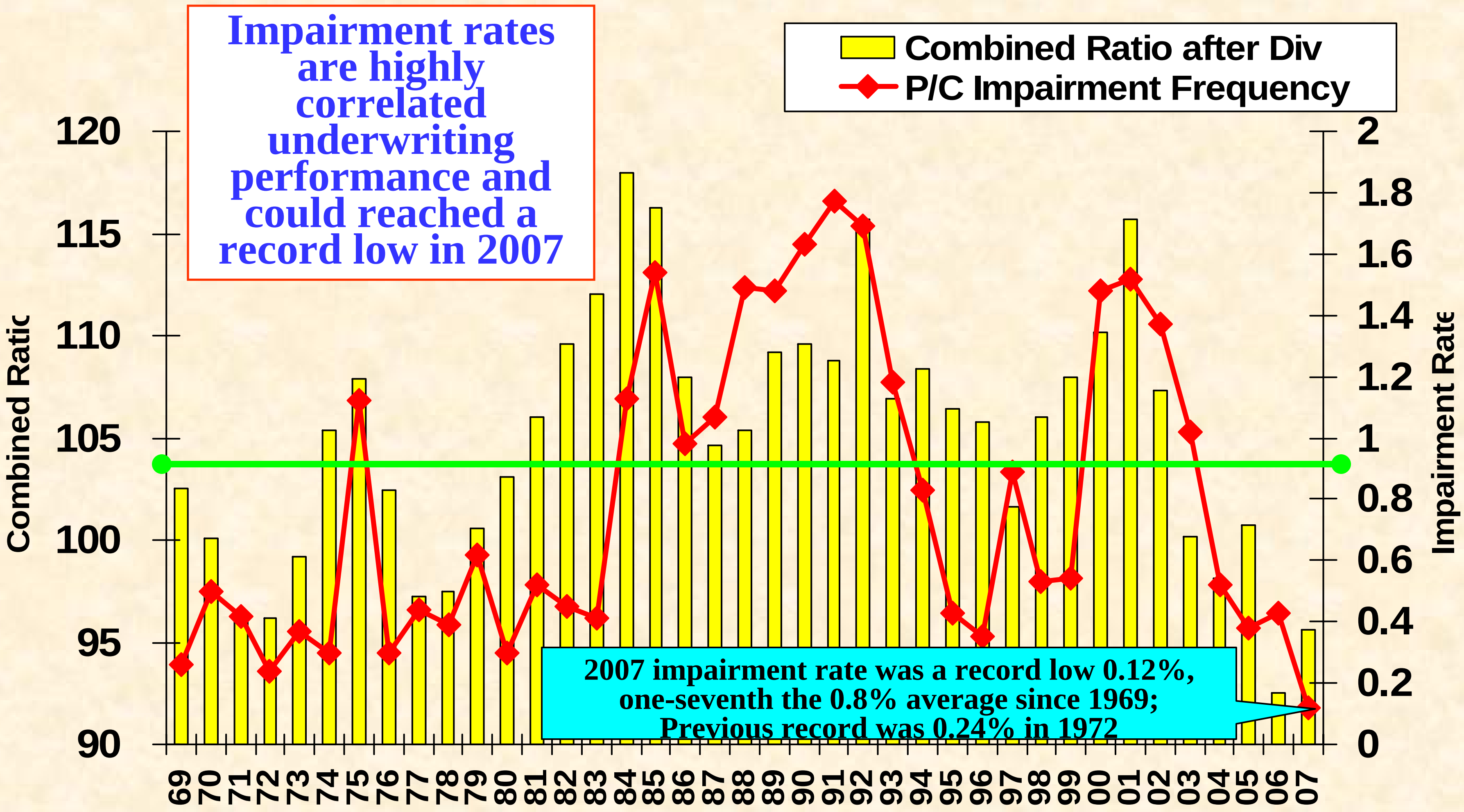
P/C Insurer Impairments, 1969-2007

The number of impairments varies significantly over the p/c insurance cycle, with peaks occurring well into hard markets



Source: A.M. Best; Insurance Information Institute

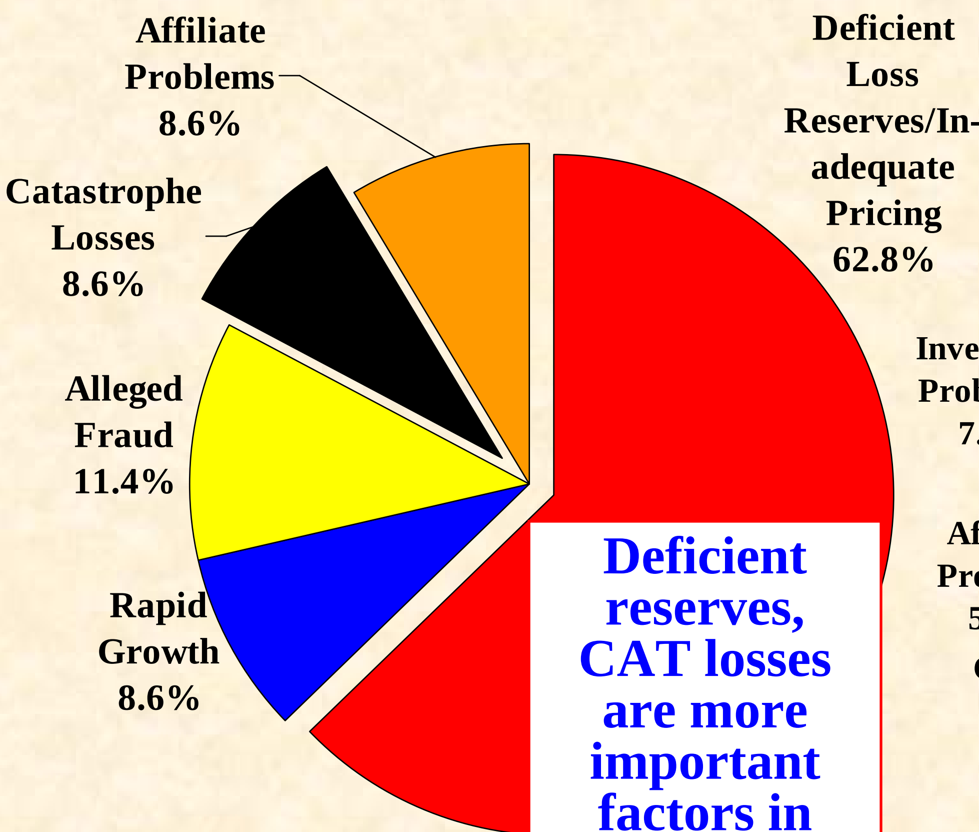
P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2007



Source: A.M. Best; Insurance Information Institute

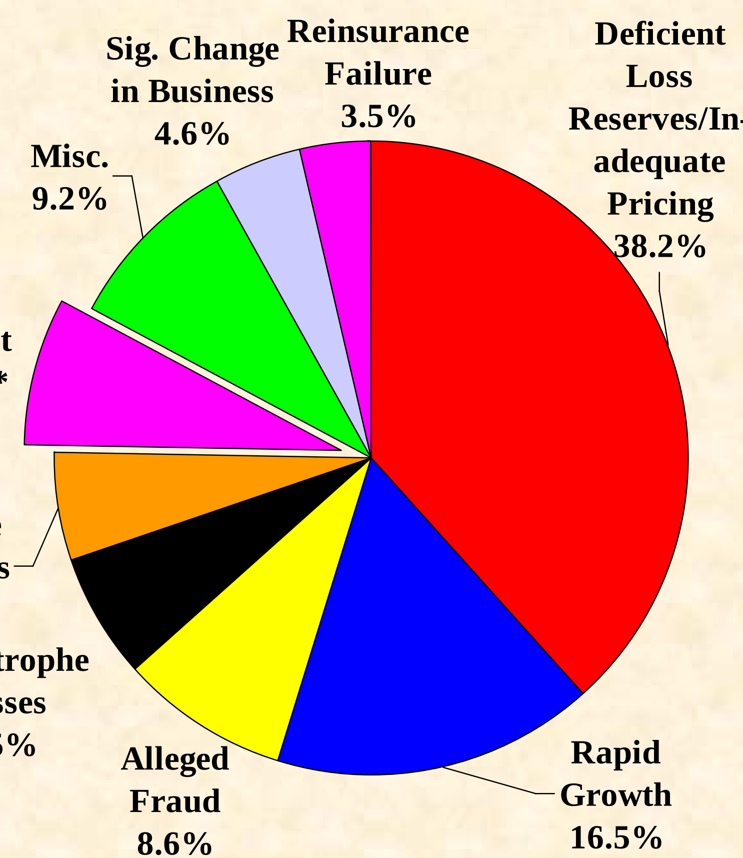
Reasons for US P/C Insurer Impairments, 1969-2005

2003-2005



Deficient reserves, CAT losses are more important factors in recent years

1969-2005



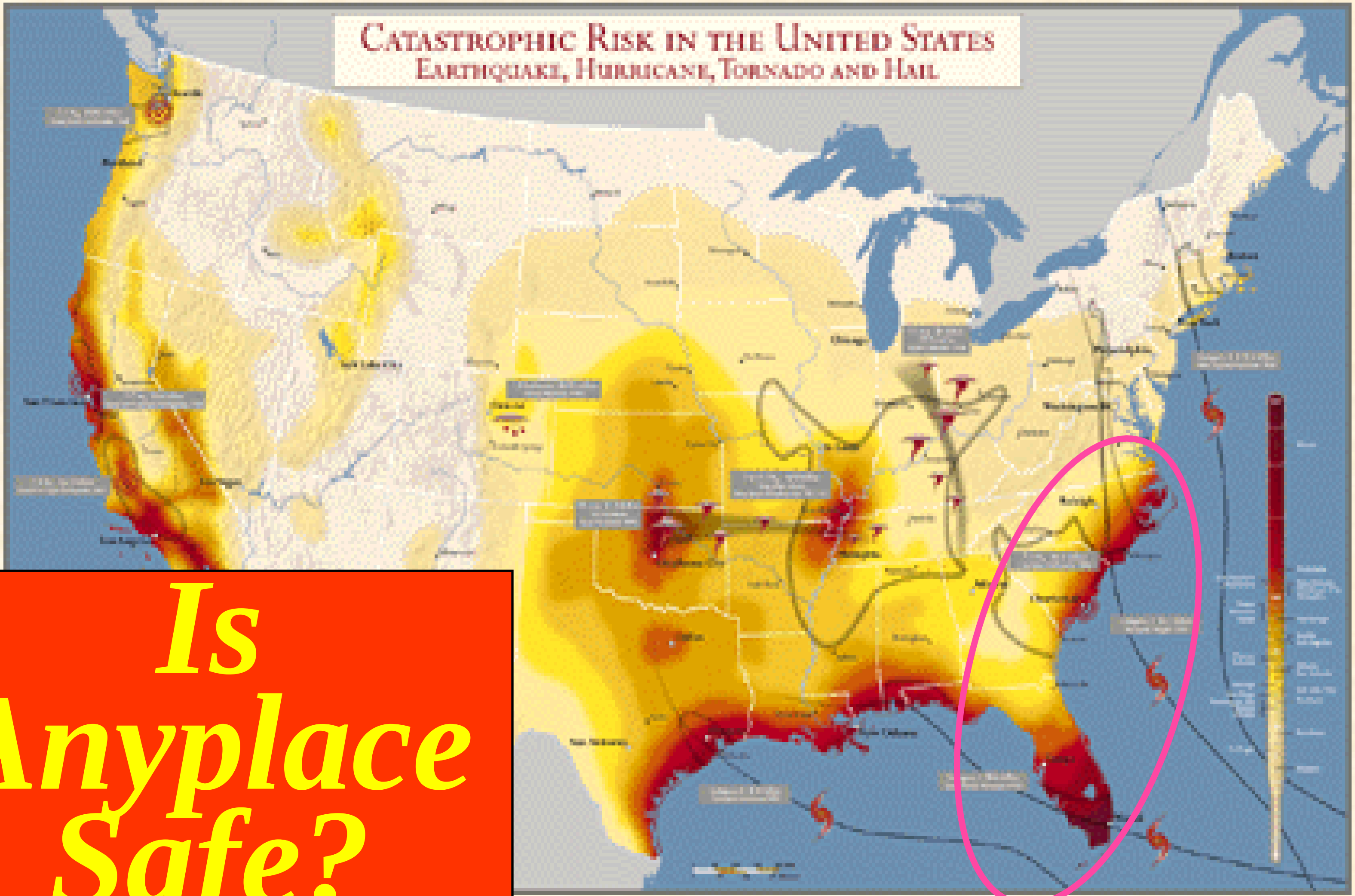
*Includes overstatement of assets.

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

CATASTROPHIC LOSS

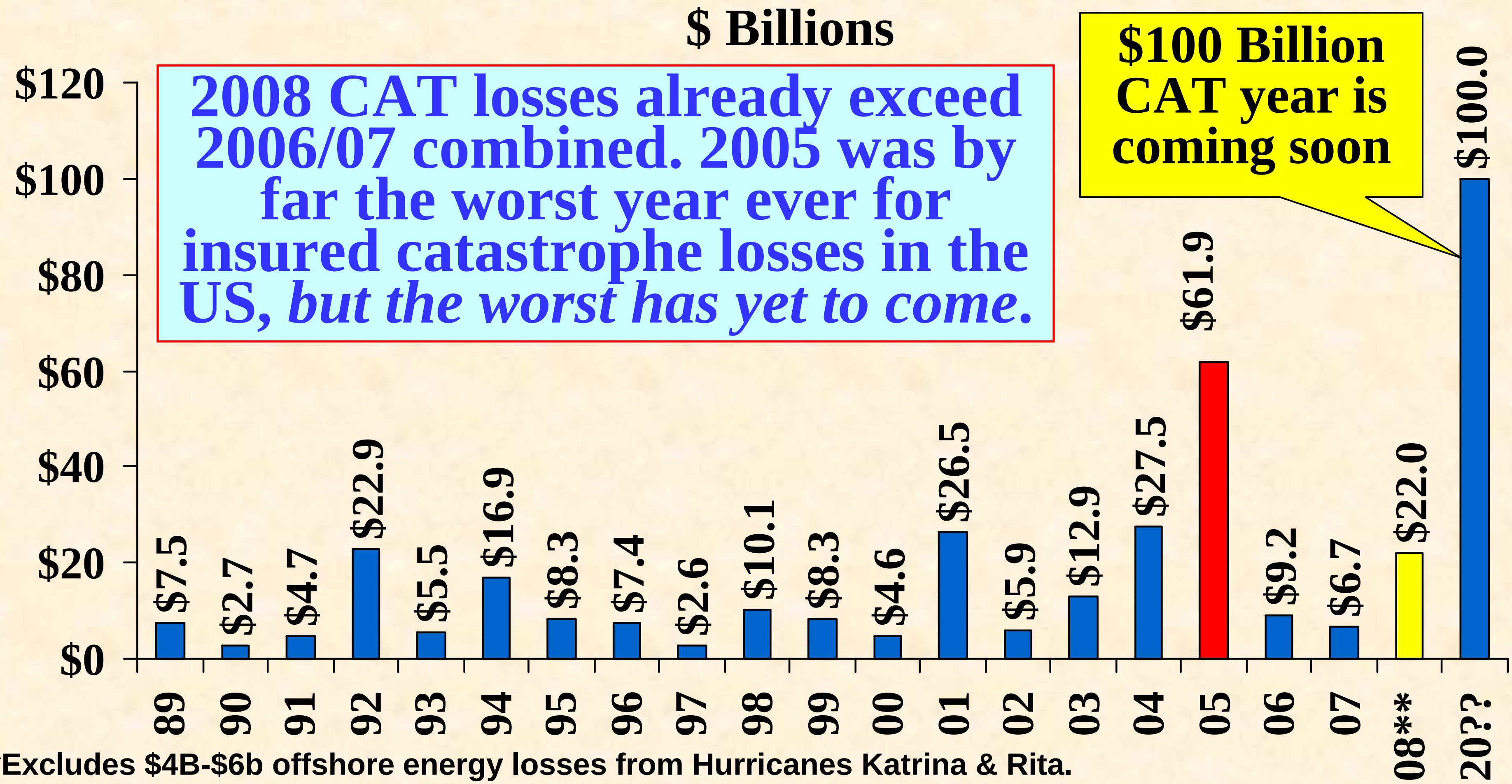
Southeast is Very Vulnerable

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.

**Based on preliminary PCS data through June 30. PCS $1.8B loss of for Gustav. $9.8B for Ike of 9/22.

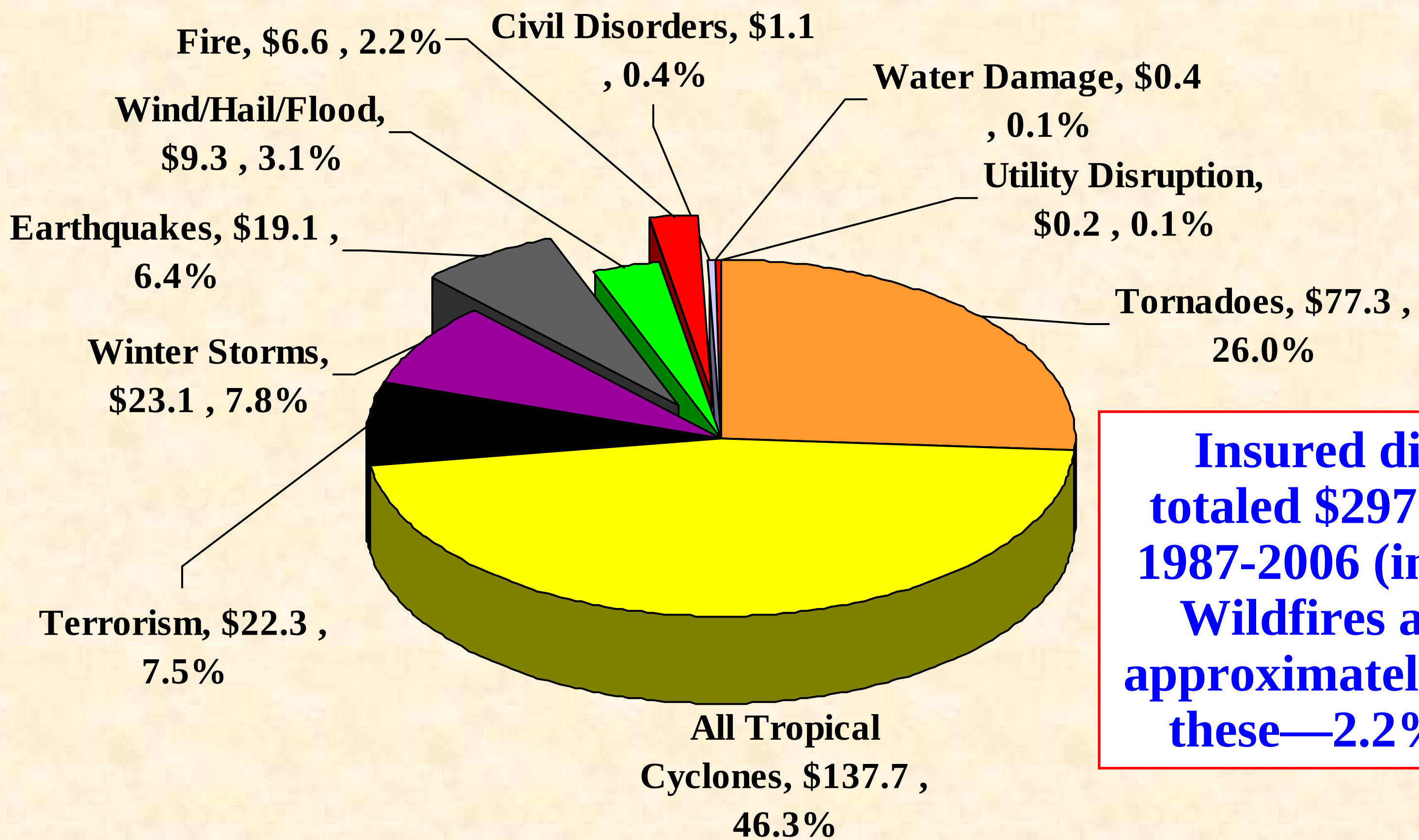
Note: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = $12.2B.

Source: Property Claims Service/ISO; Insurance Information Institute

Top 12 Most Costly Disasters in US History, (Insured Losses, $2007)

*Based on average of midpoints of range estimates from risk modelers AIR, RMS and Eqecat as of 9/15/08.
Sources: ISO/PCS; AIR Worldwide, RMS, Eqecat; Insurance Information Institute inflation adjustments.

Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1987-2006[1]

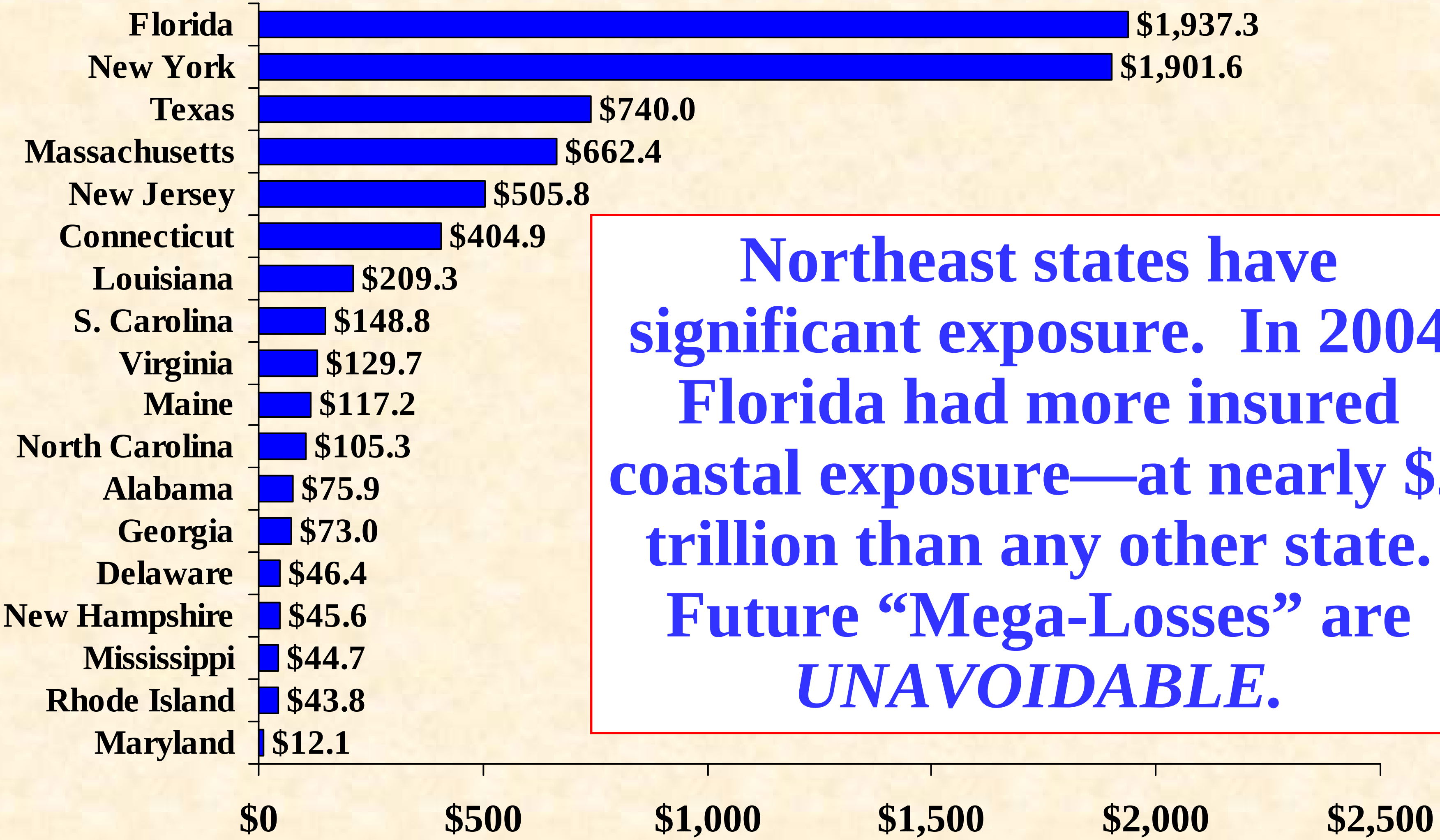


Insured disaster losses totaled $297.3 billion from 1987-2006 (in 2006 dollars). Wildfires accounted for approximately $6.6 billion of these—2.2% of the total.

[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.

Source: Insurance Services Office (ISO)..

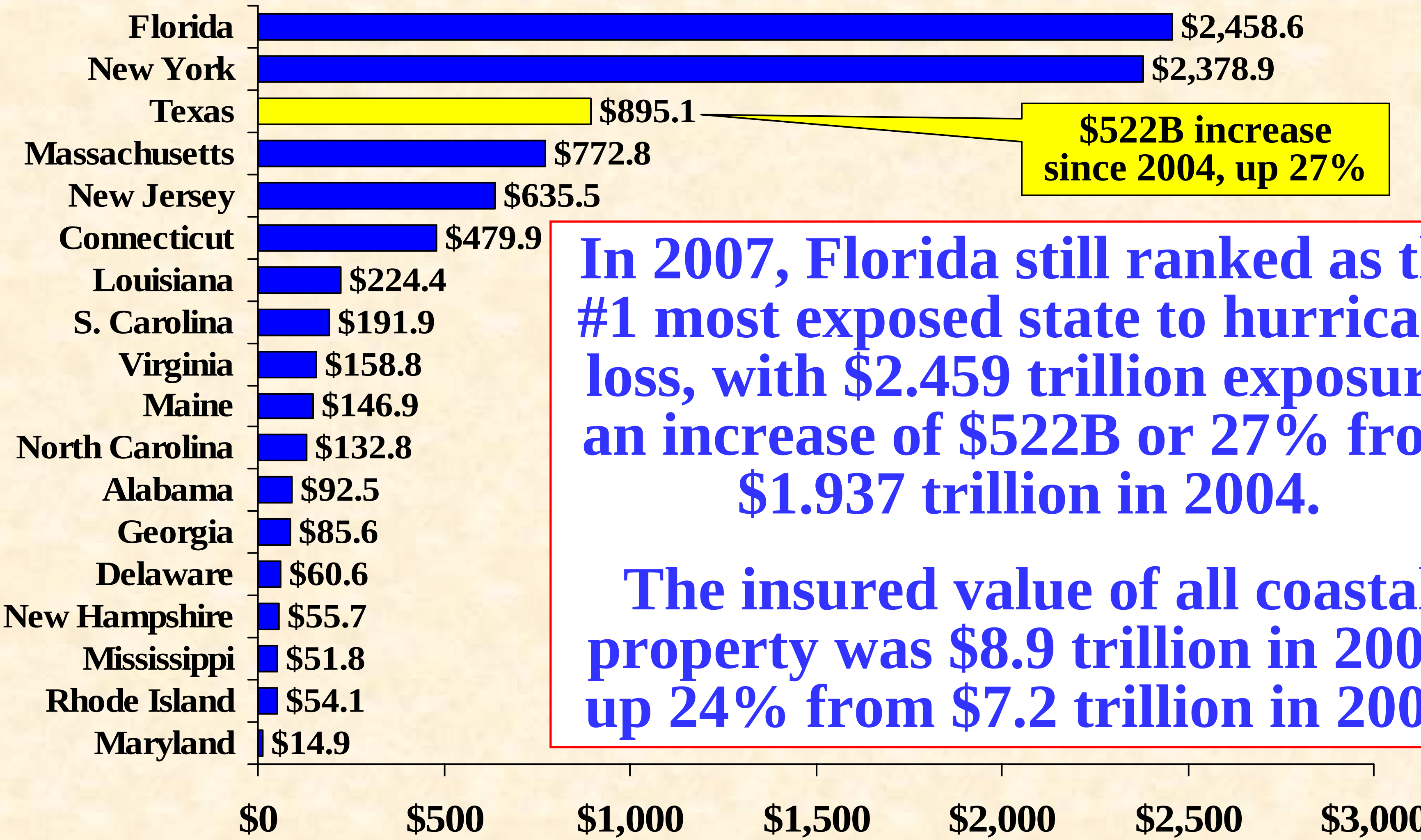
Total Value of Insured Coastal Exposure *(2004, $ Billions)*



Northeast states have significant exposure. In 2004 Florida had more insured coastal exposure—at nearly $2 trillion than any other state. Future "Mega-Losses" are *UNAVOIDABLE*.

Source: AIR Worldwide

Total Value of Insured Coastal Exposure (2007, $ Billions)

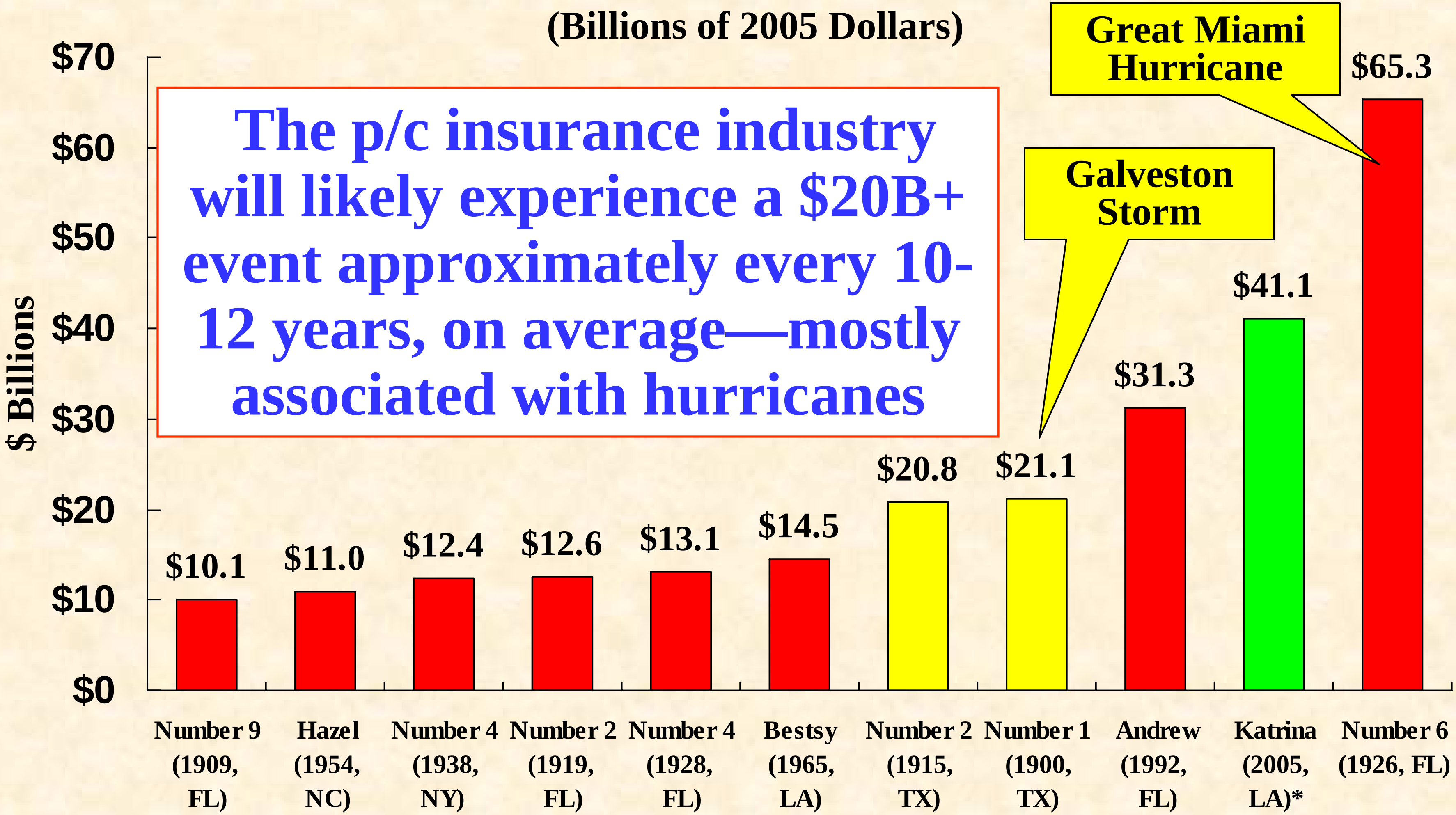


In 2007, Florida still ranked as the #1 most exposed state to hurricane loss, with $2.459 trillion exposure, an increase of $522B or 27% from $1.937 trillion in 2004.

The insured value of all coastal property was $8.9 trillion in 2007, up 24% from $7.2 trillion in 2004.

Source: AIR Worldwide

Insured Losses from Top 10 Hurricanes Since 1900 & Katrina Adjusted for Inflation, Growth in Coastal Properties, Real Growth in Property Values & Increased Property Insurance Coverage



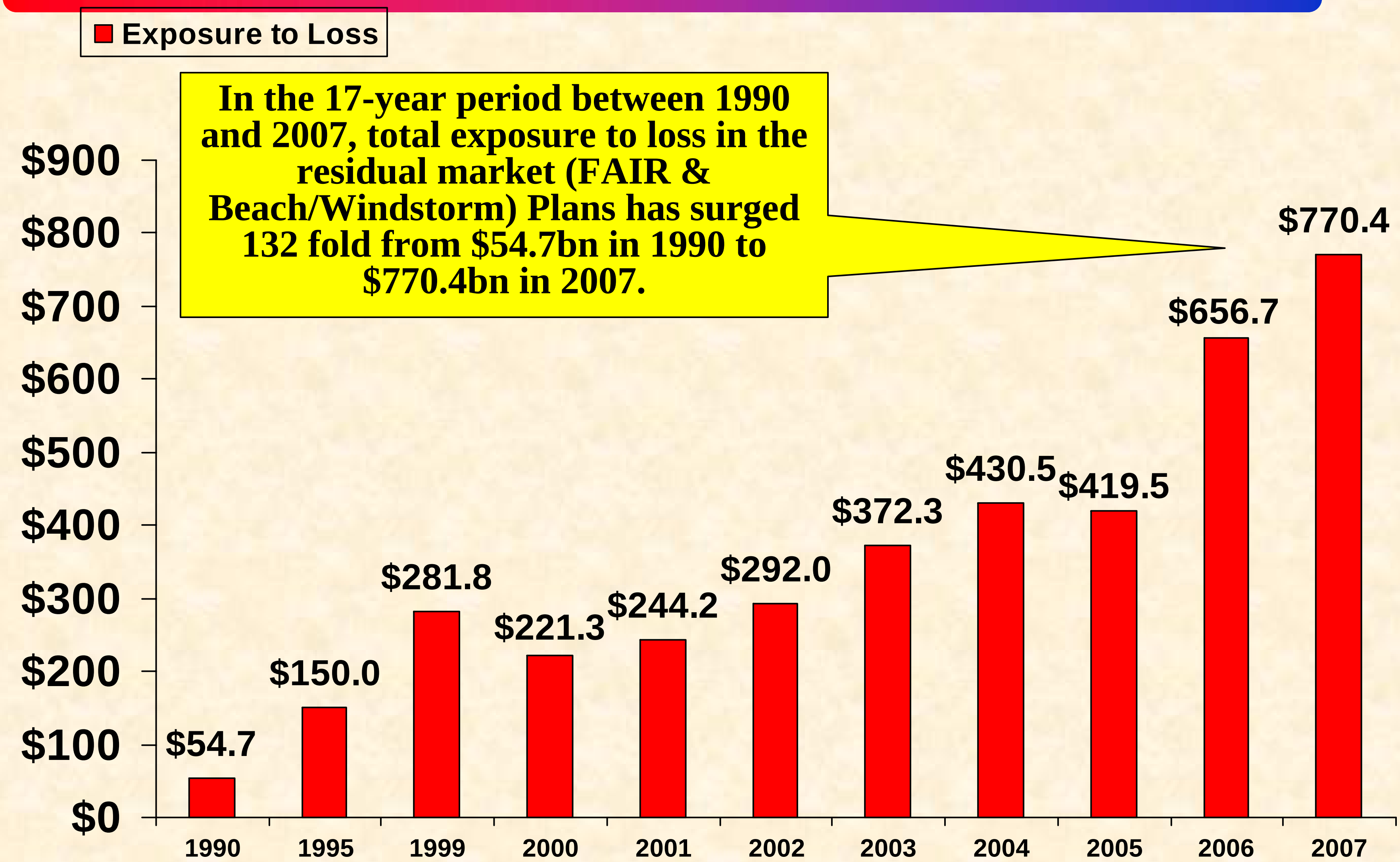
*ISO/PCS estimate as of June 8, 2006.

Source: *Hurricane Katrina: Analysis of the Impact on the Insurance Industry,* Tillinghast, October 2005; Insurance Info. Institute.

Government as Property Insurer of Last Resort

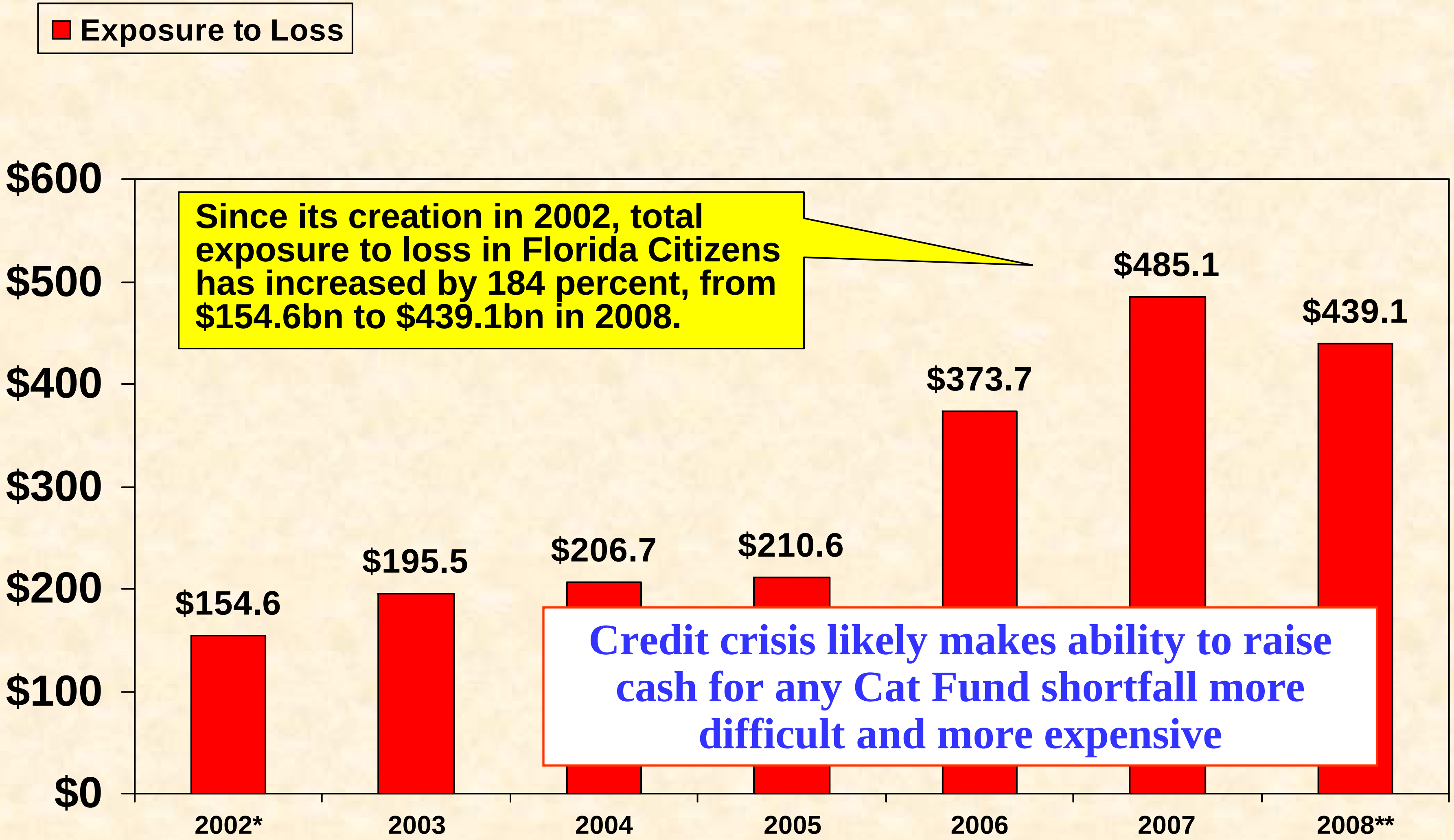
Credit and Economic Crisis Increases Vulnerability

U.S. Residual Market Exposure to Loss (Billions of Dollars)



Source: PIPSO; Insurance Information Institute

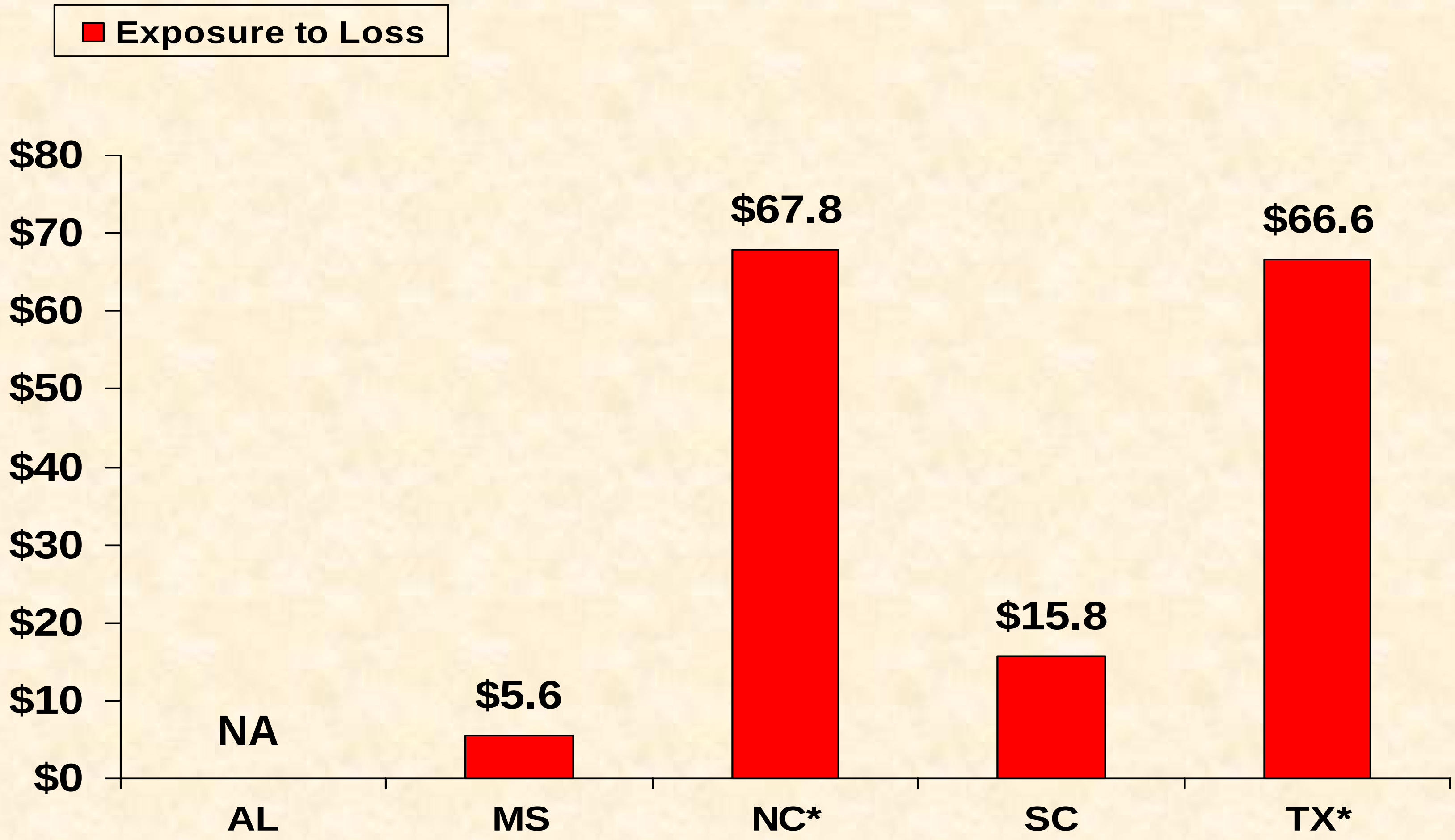
Florida Citizens Annual Exposure to Loss (Billions of Dollars)



*PIPSO Data. **Florida Citizens as of July 2008.

Source: PIPSO; Florida Citizens; Zurich American Insurance Co; Insurance Information Institute

Beach and Windstorm Plans Exposure to Loss ($ Billion), 2007



***As of Aug. 31, 2008**

Source: PIPSO; NCIUA; TWIA.

FHCF: Capacity Shortfall, But Strong Liquidity

- FHCF total reimbursement capacity est. at $13.3 billion for 12mth period and $11.8 billion if bonding limited to 6mth period
- Ests. reflect a shortfall from FHCF's theoretical capacity of $10 billion to $15 billion
- Shortfall in FHCF capacity estimate is the result of:
  - Current conditions in the financial markets due to liquidity crisis
  - Increases in interest rates
  - Slight reduction in FHCF's assessment base
  - Expenses paid out of the fund for $4 billion put option agreement with Berkshire Hathaway
  - Investment losses
- But – the FHCF has a strong liquidity position:
  - $2.8 billion in year-end cash for payment of claims
  - Plus $3.5 billion in five-year floating rate notes totaling $6.5 billion
  - Additional $4 billion from Berkshire Hathaway put option

Source: SBAFLA; FHCF

Natural Catastrophe Plans (1)

- **Homeowners' Defense Act of 2007 (H.R. 3355) (Co-authors Rep. Tim Mahoney (D-FL) and Rep. Ron Klein (D-FL)):**
  - **Would create a national catastrophe fund**
  - **Allow states to pool catastrophe risk and transfer risk to private market via cat bonds or reinsurance**
  - **Also create a federal loan program to provide funds to state reinsurance plans both prior and after a disaster**
  - **Bill passed House Nov. 2007, but is currently stalled in the Senate (S. 2310)**

- **Allstate -- ProtectingAmerica.org:**
  - **Created in 2005 by coalition of emergency management officials, first responders, disaster relief experts, insurers and others**
  - **Propose establishing a national catastrophe fund to serve as financial backstop for state catastrophe funds**
  - **Backs H.R. 3355**

Source: Insurance Information Institute

Natural Catastrophe Plans (2)

- **The Hartford – Coastal Catastrophe Partnership:**
  - **Seek to put risk back on private insurers**
  - **Mandate flood insurance for all coastal homeowners**
  - **Create a Federal and state-level reinsurance funds to backstop losses by private insurers**
  - **Establish untaxed savings accounts ("supplemental catastrophic security accounts") to pay for property insurance**

- **The Travelers, Nationwide and broker groups:**
  - **Create Federally regulated "Coastal Hurricane Zone" from Texas to Maine.**
  - **Fed. Govt would not have a financial role, but would oversee wind underwriting by private insurers, including pricing**
  - **Federal reinsurance sold at cost for extreme events such as $100 billion+ hurricane**
  - **Risk-based, actuarially sound rates using approved standards and wind risk models**
  - **Incentives for state and local governments to adopt federal guidelines for appropriate building codes and land use planning.**

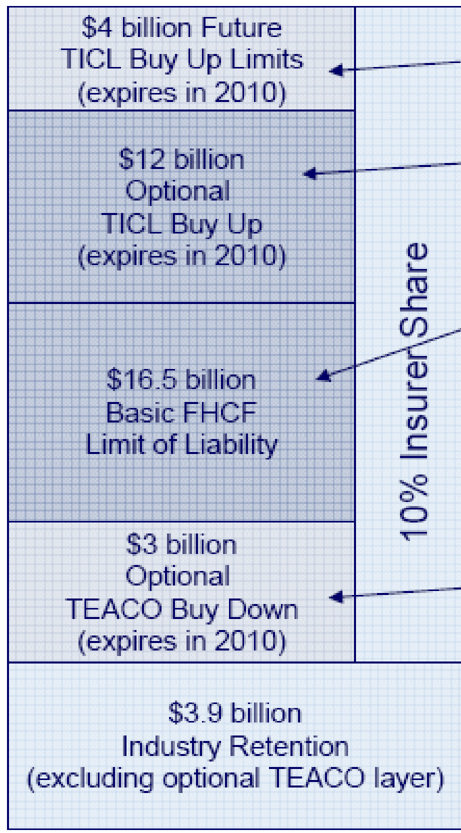
Source: Insurance Information Institute

Florida Hurricane Catastrophe Fund

Assets:	$3.4 billion
Annual Premium:	$1.3 billion
Annual Exposure:	$28.5 billion
Multi-Year Exposure:	$50.0 billion

FHCF estimates that there is a 1.7% chance in 2008 that it would need to levy a $1,902,000,000 assessment on all Florida homeowners, auto owners and businesses for <u>each</u> of the next <u>30 years</u>

FHCF requires insurers to retain a share of $6.9 billion for the first two events in a year. The retention for additional events during the year are reduced to 1/3.



1:70 probability

FHCF has the authority to offer this additional coverage but has not done so

1:60 probability (1.7%)

Annual premium ~242 million from 134 insurers at about $.02-$.03 per $1 of coverage

1:30 probability (3.3%)

Annual premium ~1.09 billion from 207 insurers

1:7 probability

No company has purchased TEACO Buy Down coverage which is offered at market rates

<u>Top FHCF mandatory coverage recipients</u>

Florida Citizens	40.4%
State Farm	11.2%
Allstate	3.5%
QBE	2.4%
USAA	2.4%
Chubb	2.4%
Nationwide	2.2%

Source: Preliminary Official Statement Series 2008 A Bonds (7/9/08)

Florida Hurricane Catastrophe Fund

Loss History:
1995 $13 million
2004 $5.2 billion
2005 $3.95 billion ($1.975 billion financed through long term debt)

Total Premium Collected: $8.6 billion (1995-2008)

Berkshire Put: FHCF has entered into an agreement by which Berkshire would agree to purchase up to $4 billion of FHCF post-event debt at pre-negotiated terms in exchange for a $224 million premium payment

Reported Investment Impairment:
$141 million in illiquid commercial paper
$110.35 million in securities downgraded since purchase

Source: Preliminary Official Statement Series 2008 A Bonds (7/9/08) and 2007 Annual Statement

Shifting Legal Liability & Tort Environment

Is the Tort Pendulum About to Swing?

The Nation's Judicial Hellholes (2007)

Watch List

Madison County, IL

St. Clair County, IL

Northern New Mexico

Hillsborough County, FL

Delaware

California

Dishonorable Mentions

District of Columbia

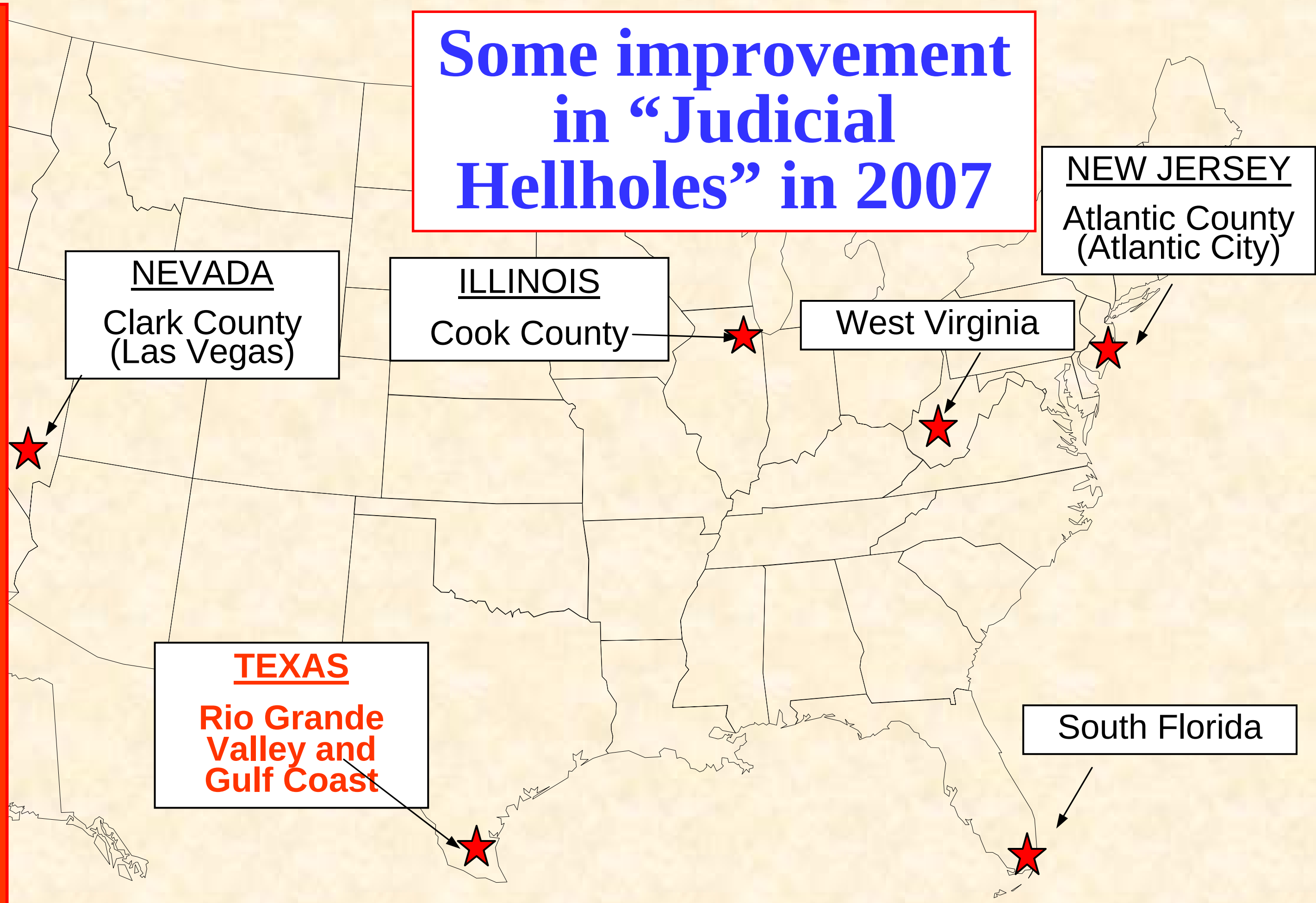
MO Supreme Court

MI Legislature

GA Supreme Court

Oklahoma

Some improvement in "Judicial Hellholes" in 2007



Source: American Tort Reform Association; Insurance Information Institute

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

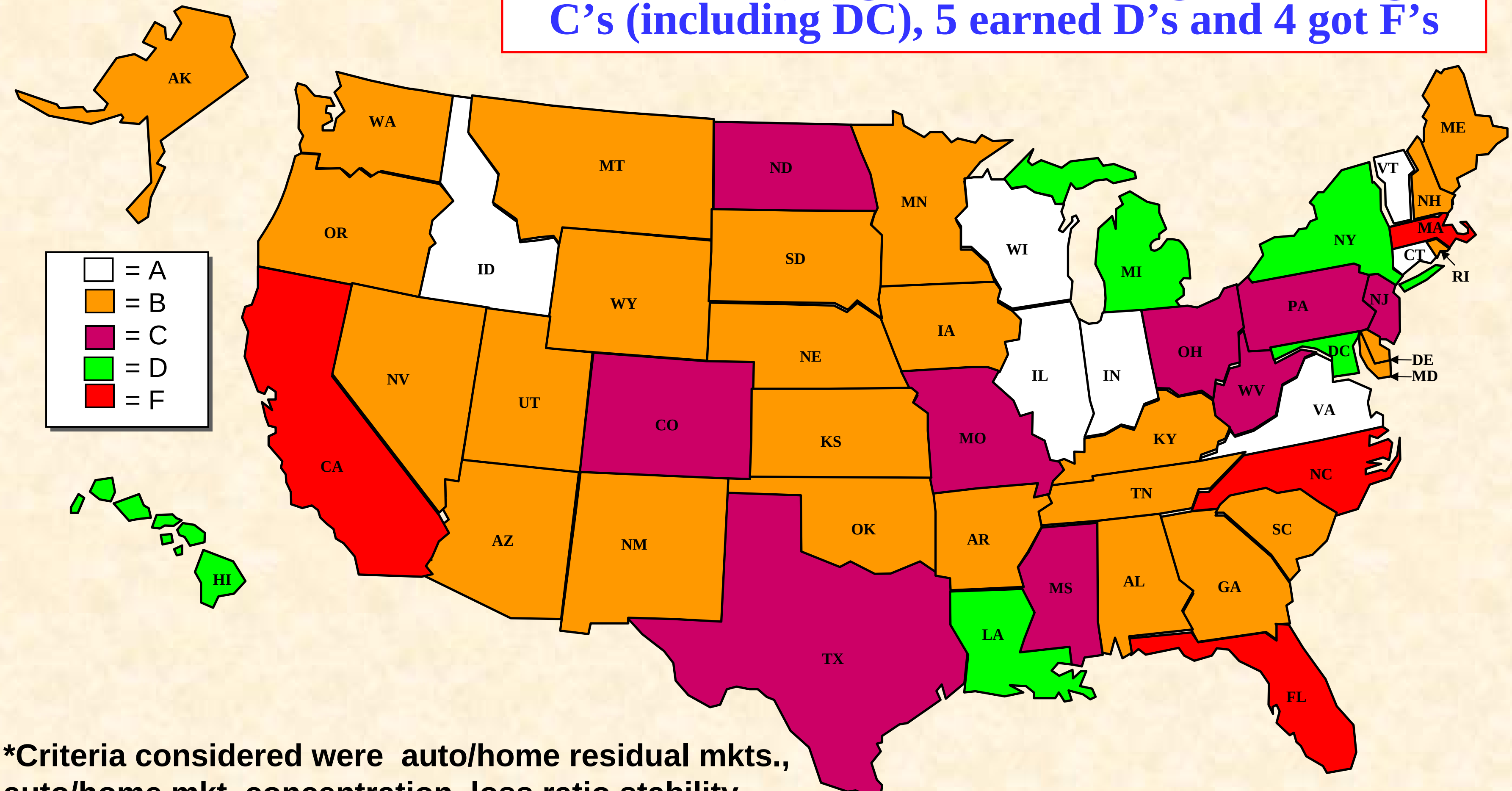
Source: US Chamber of Commerce 2007 State Liability Systems Ranking Study; Insurance Info. Institute.

REGULATORY & LEGISLATIVE ENVIRONMENT

Significant Diversity Across States

Rating of Auto/Home Insurance Regulatory & Operating Environment*

Most states (25) get a "B", but 7 got A's, 10 got C's (including DC), 5 earned D's and 4 got F's



***Criteria considered were auto/home residual mkts., auto/home mkt. concentration, loss ratio stability, reg. env.,form regulation, credit scores, territorial restrictions**

Source: James Madison Institute, Feb. 2008

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THANK YOU FOR YOUR TIME AND

YOUR ATTENTION!