

P/C Insurance Overview & Outlook

Focus on California Markets



Insurance Information Institute

Sacramento, CA

March 15, 2005



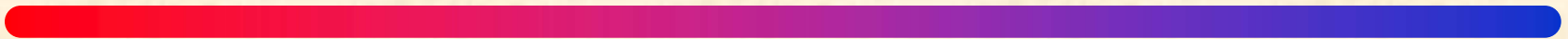
**Robert P. Hartwig, Ph.D., CPCU, Senior Vice President & Chief Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
Tel: (212) 346-5520 ♦ Fax: (212) 732-1916 ♦ bobh@iii.org ♦ www.iii.org**



Presentation Outline

- **Impact of Insurance Industry on California Economy**
- **The Truth About Profitability in P/C Insurance**
- **CALIFORNIA: The History of P/C Profitability**
- **Underwriting Performance: US & TX**
- **Ratings, Solvency & Financial Strength**
- **Investment Overview**
- **Capacity**
- **Pricing Trends**
- **IMPORTANT STATE & FEDERAL ISSUES**
 - **Spitzer/State/SEC Investigations**
 - **Insurance Scoring (Credit)**
 - **Federal vs. State Regulation**
 - **The Debate Over a Federal Natural Disaster Insurance Facility**

INSURERS' IMPACT ON THE CALIFORNIA ECONOMY

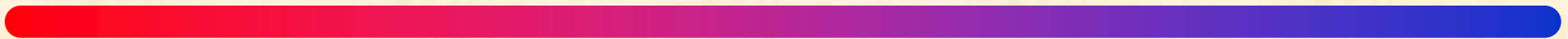




California's Insurance Industry is an Important Economic Force

- **1,279 insurers in CA providing benefits to over 30 million Californians**
- **P/C insurers pay \$50B+ CA homeowners drivers and businesses annually for their losses**
- **Insurers have invested \$23B in municipal bonds in CA**
- **Insurers paid about \$2.1B in premium taxes in 2003/04**
 - **4th largest source of general revenue funds in CA**
- **Insurers provided jobs for 308,422 Californians in 2004 (228,460 directly & 79,961 indirectly)**
- **Helped record numbers of Californians realize the American dream of homeownership (59.7% HO rate)**

MARKET CONDITIONS



Highlights: Property/Casualty, 9-Months 2004 vs. 9-Months 2003

	Growth rate less than half that of a year earlier		Change
Net Written Prem.	321,225	307,472	+4.5%
Loss & LAE	223,687	216,796	+3.2%
Net UW Gain (Loss)	2,848	(5,854)	N/A
Record Surplus!	28,748	An underwriting profit? What's that?	
Net Income (a.t.)	26,707	20,819	+20.5%
Surplus*	369,018	346,987	+6.3%
Combined Ratio	97.9	100.3**	-2.4 pts.

*2003 surplus figure is as of 12/31/03

**The combined ratio for full-year 2003 was 100.1

Combined < 100

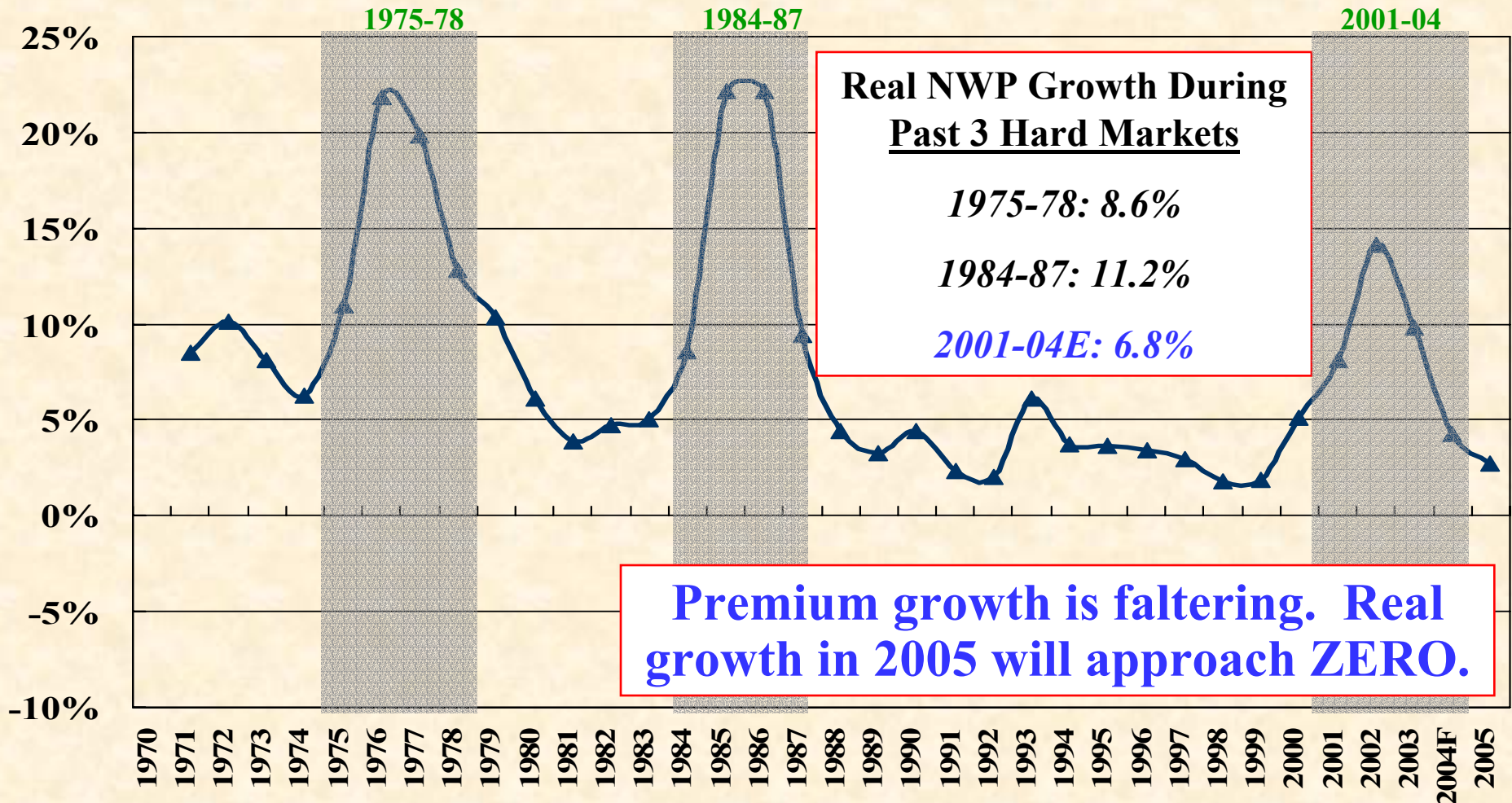
TOP & BOTTOM LINES

Premiums &
Profits





Strength of Recent Hard Markets by NWP Growth*

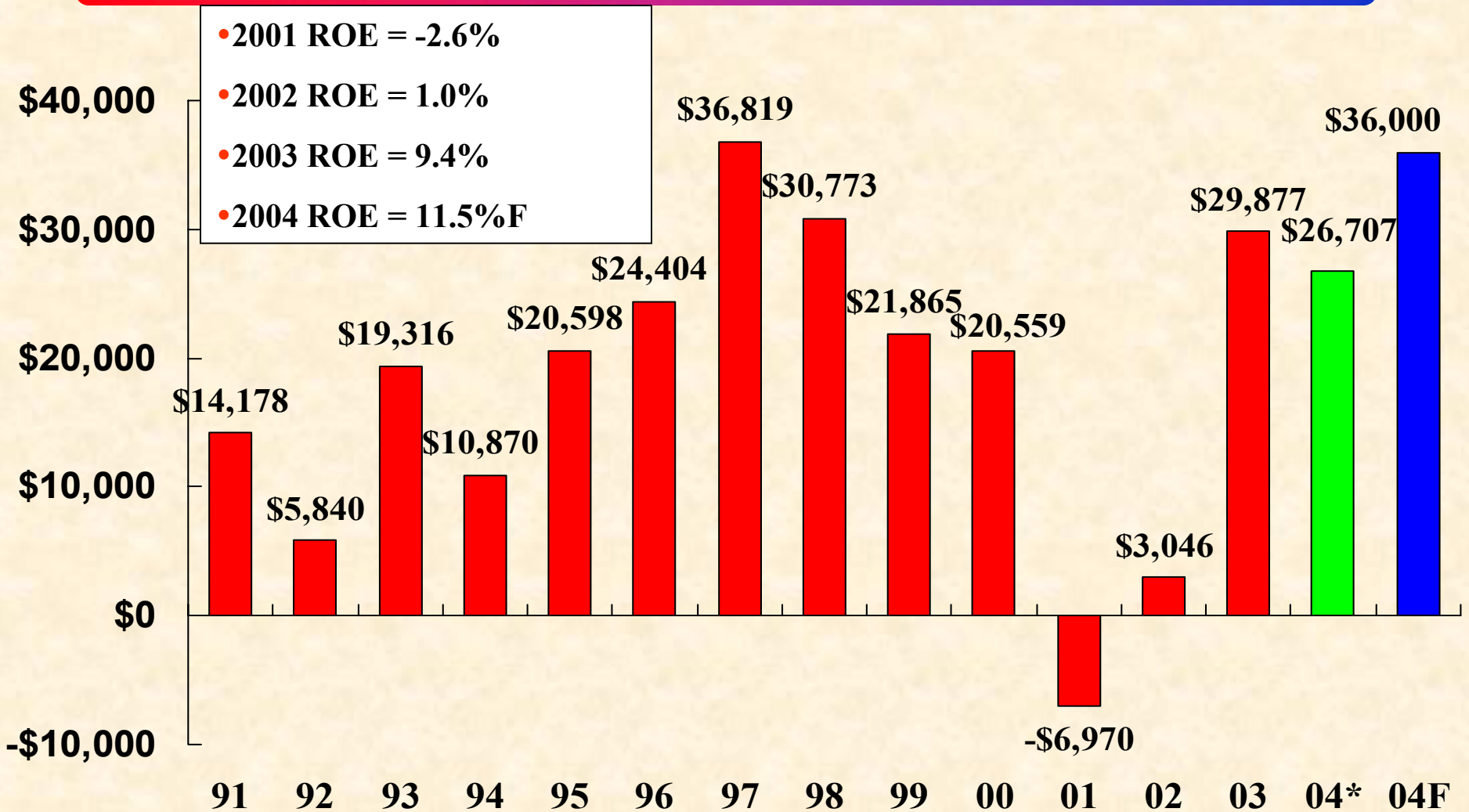


Note: Shaded areas denote hard market periods.
Source: A.M. Best, Insurance Information Institute

*2004/5 based on III forecast.



P/C Net Income After Taxes *1991-2004E* (\$ Millions)*



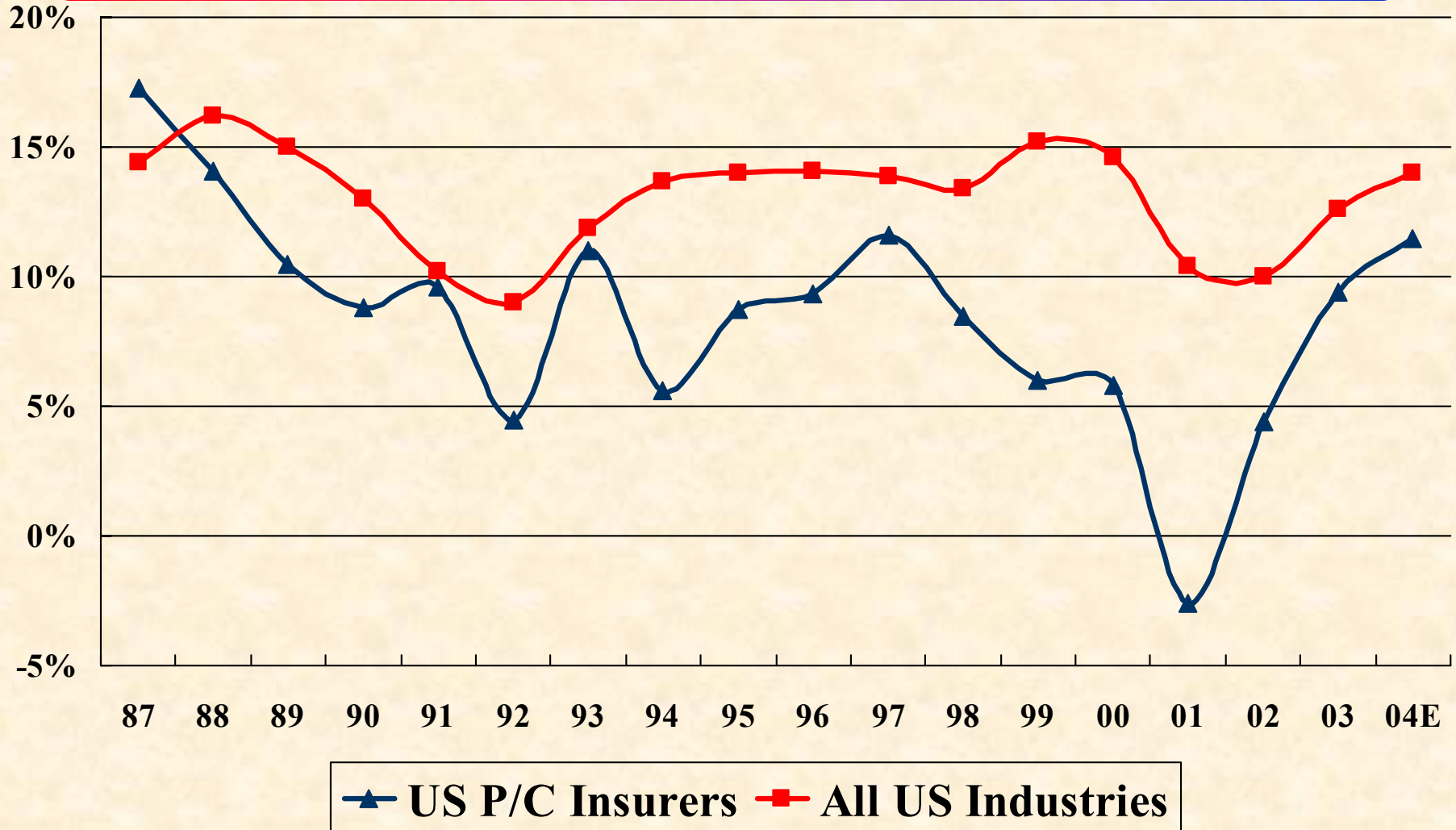
*9-Month results; F = Full Year forecast/estimate.

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



ROE: P/C vs. All Industries

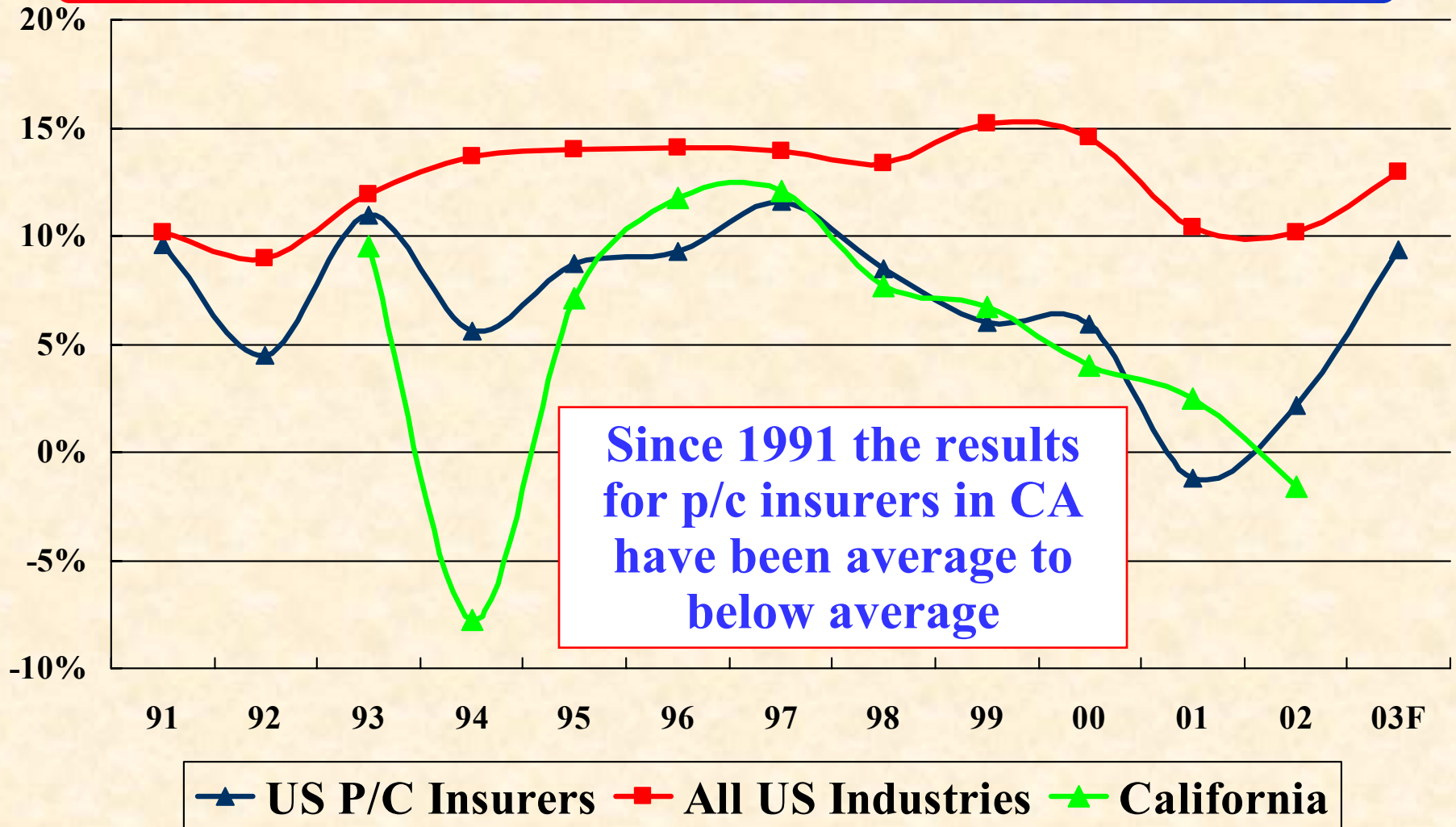
1987–2004E



▲ US P/C Insurers ■ All US Industries



ROE: US & CA P/C vs. All Industries, 1991–2003*

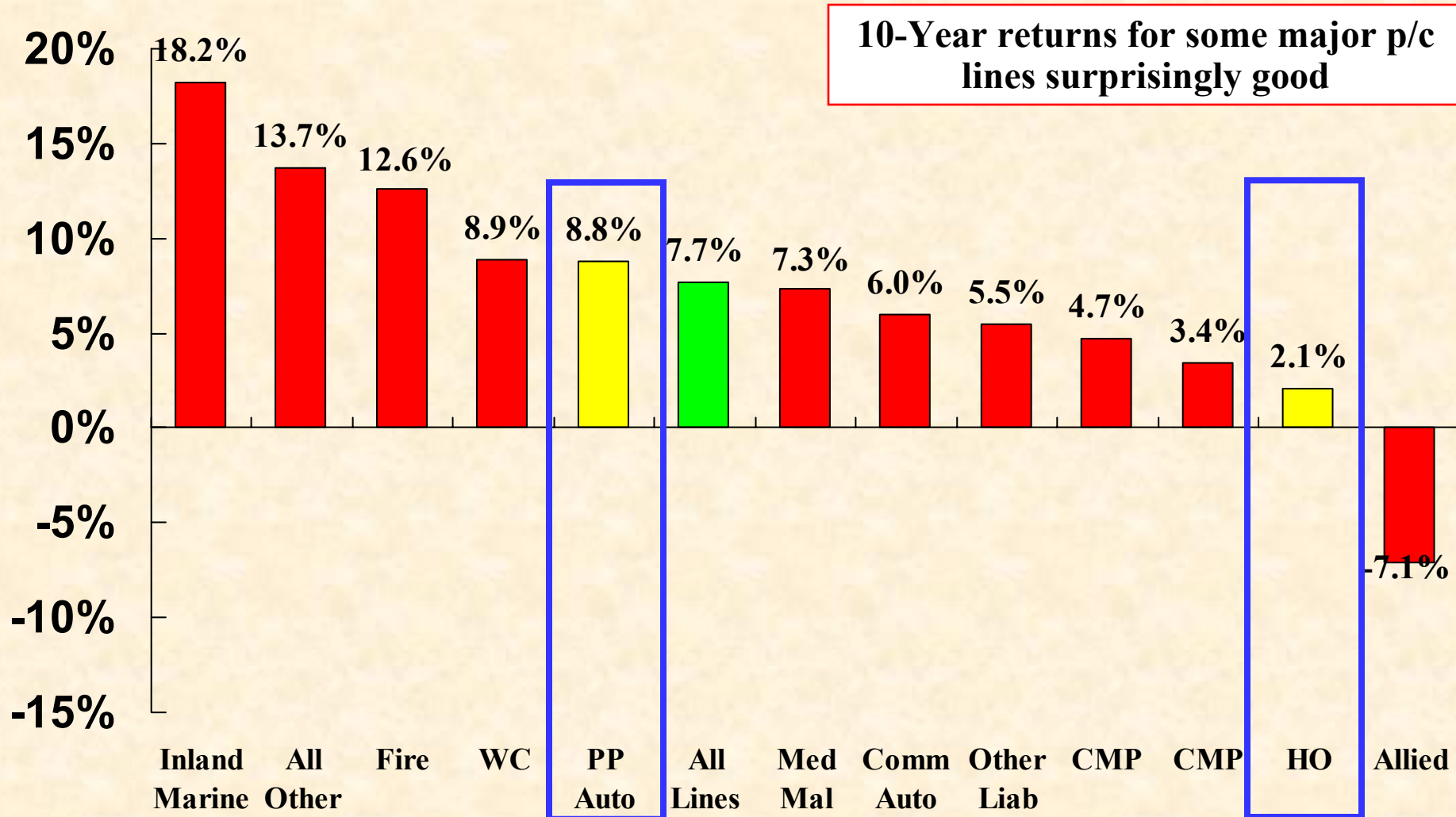


*2003 CA ROE is Ill estimate.

Source: Insurance Information Institute; NAIC, *Fortune*



RNW for Major P/C Lines, 1993-2002 Average

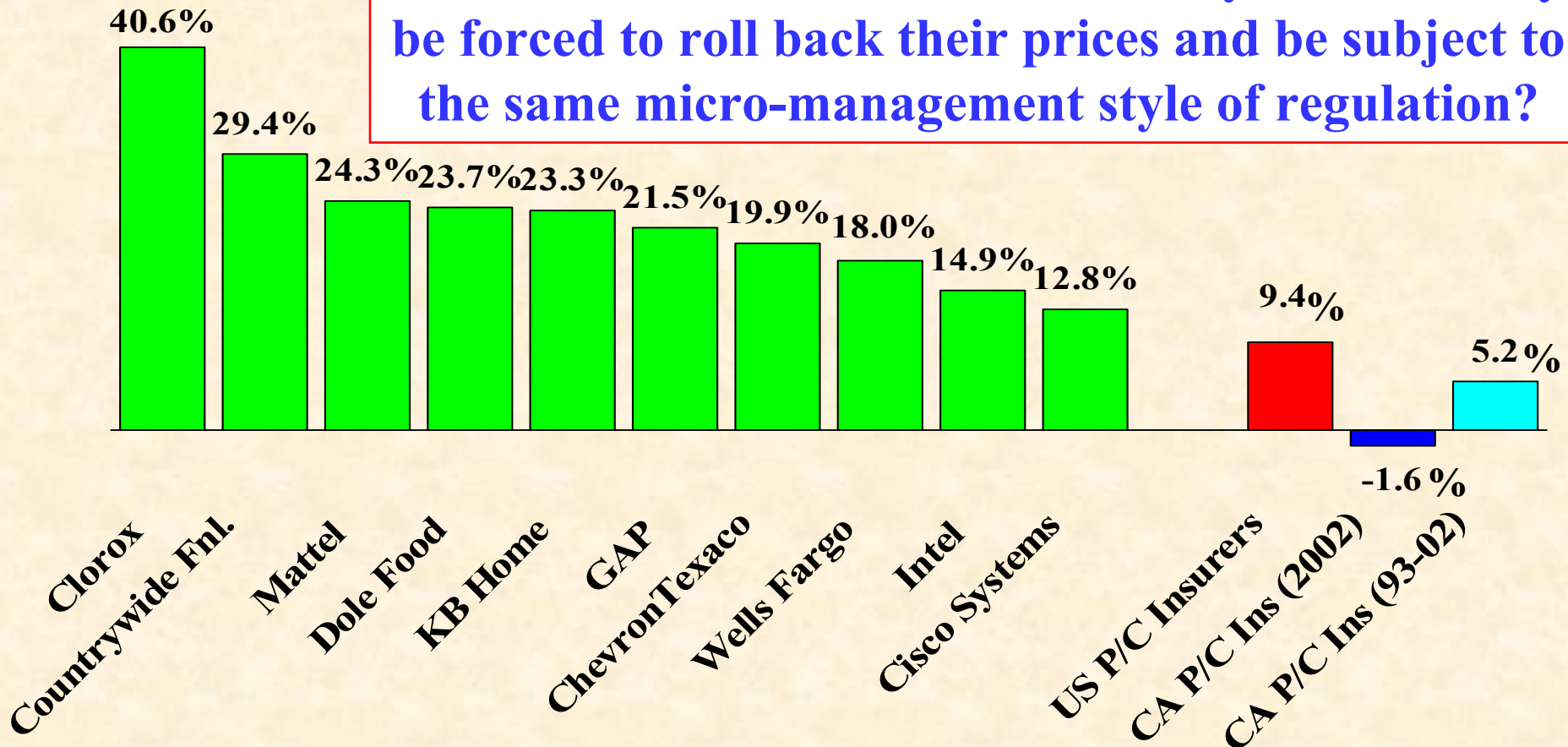


Source: NAIC; Insurance Information Institute



Top 10 California Companies by ROE vs. P/C Insurance, 2003

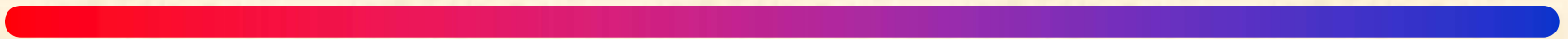
Profitability of many leading CA-based companies dwarfs that of the insurance industry. Should they be forced to roll back their prices and be subject to the same micro-management style of regulation?



FINANCIAL STRENGTH

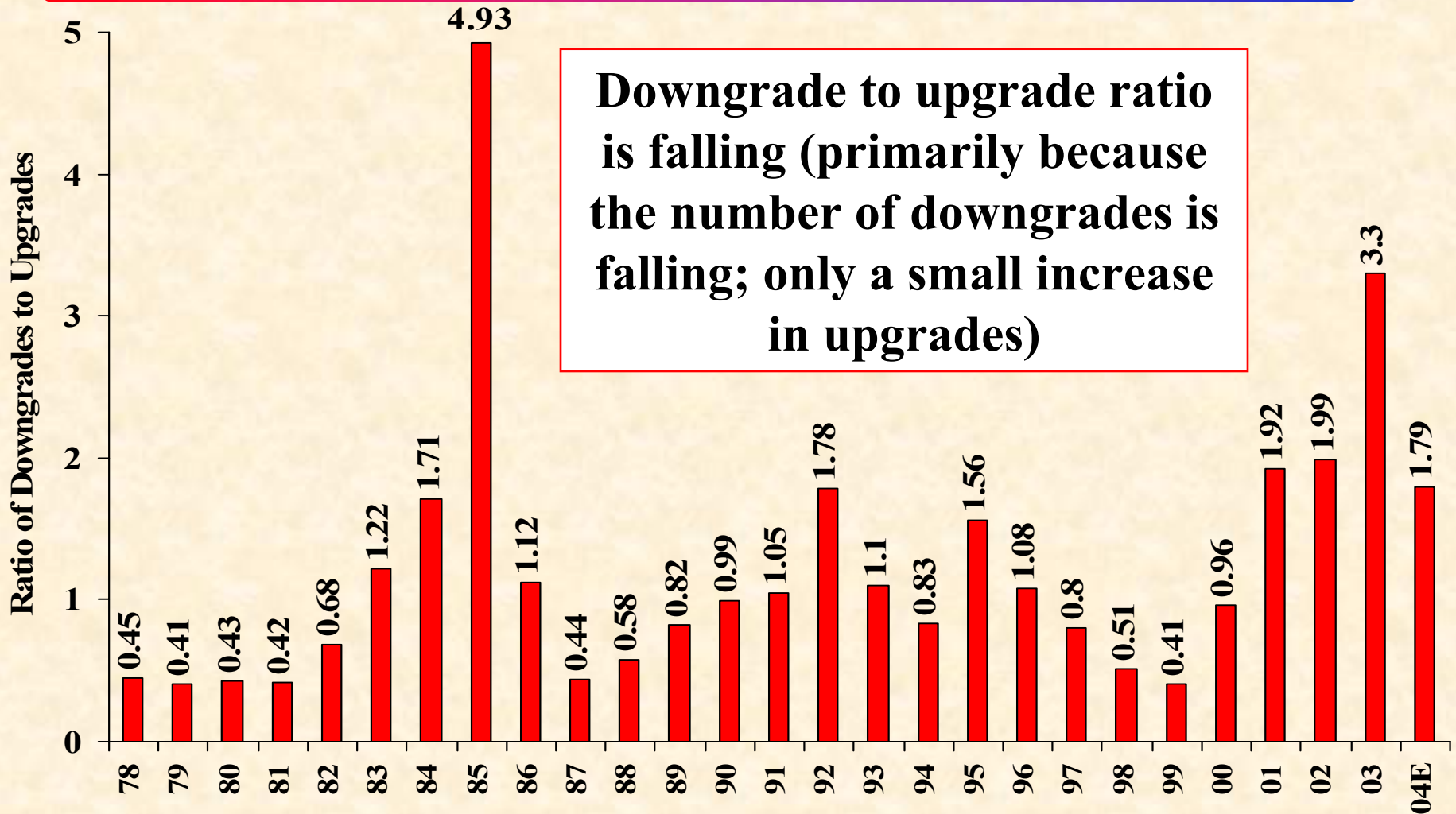
*Is There Cause for
iii Concern?*

iii





Downgrade/Upgrade Ratio*

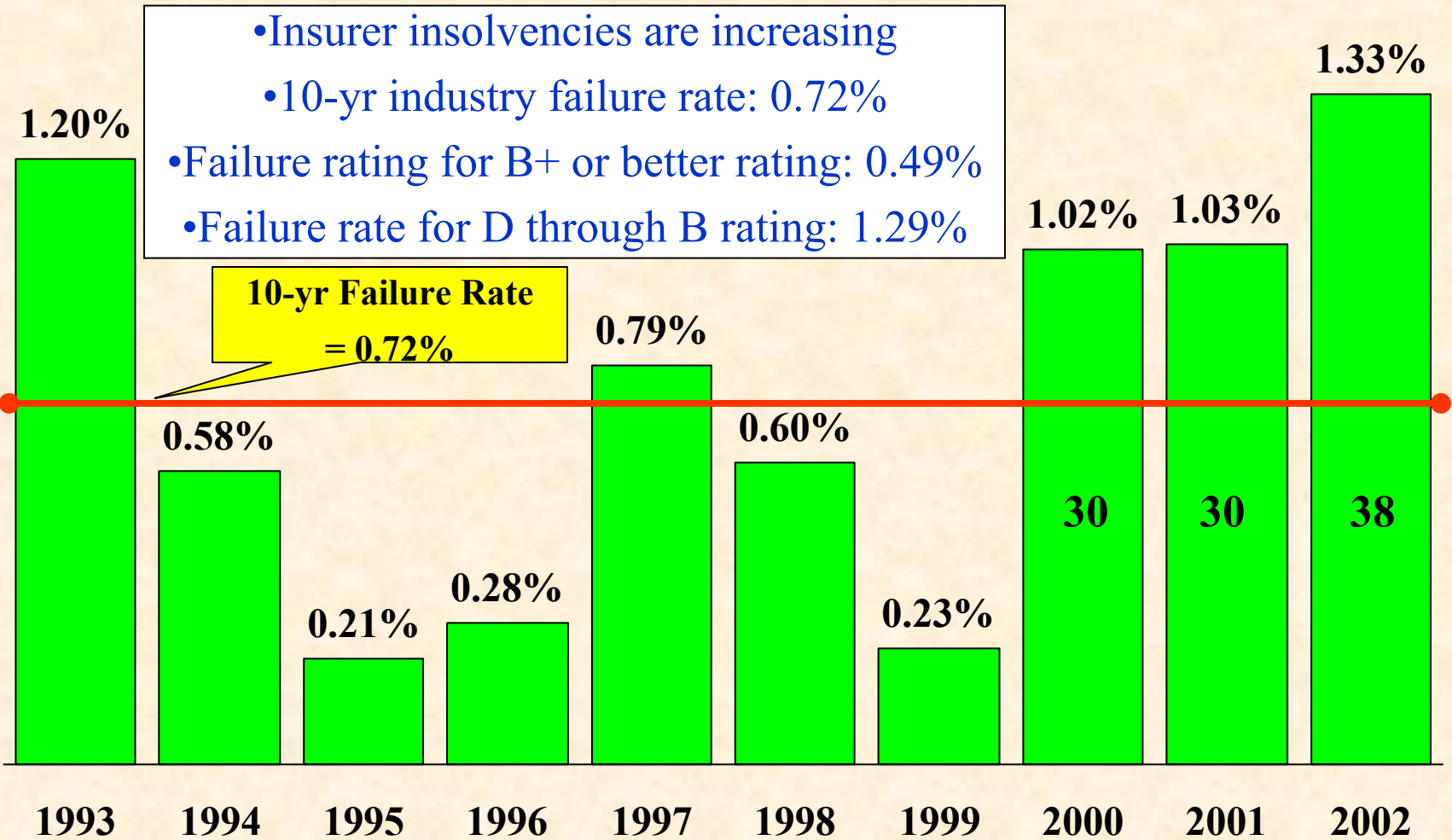


Sources: *Impairment Rate and Rating Transition Study—1977 to 2002*, A.M. Best & Co.

*U.S. property/casualty and life/health insurers before 2000; P/C only 2000-2004.

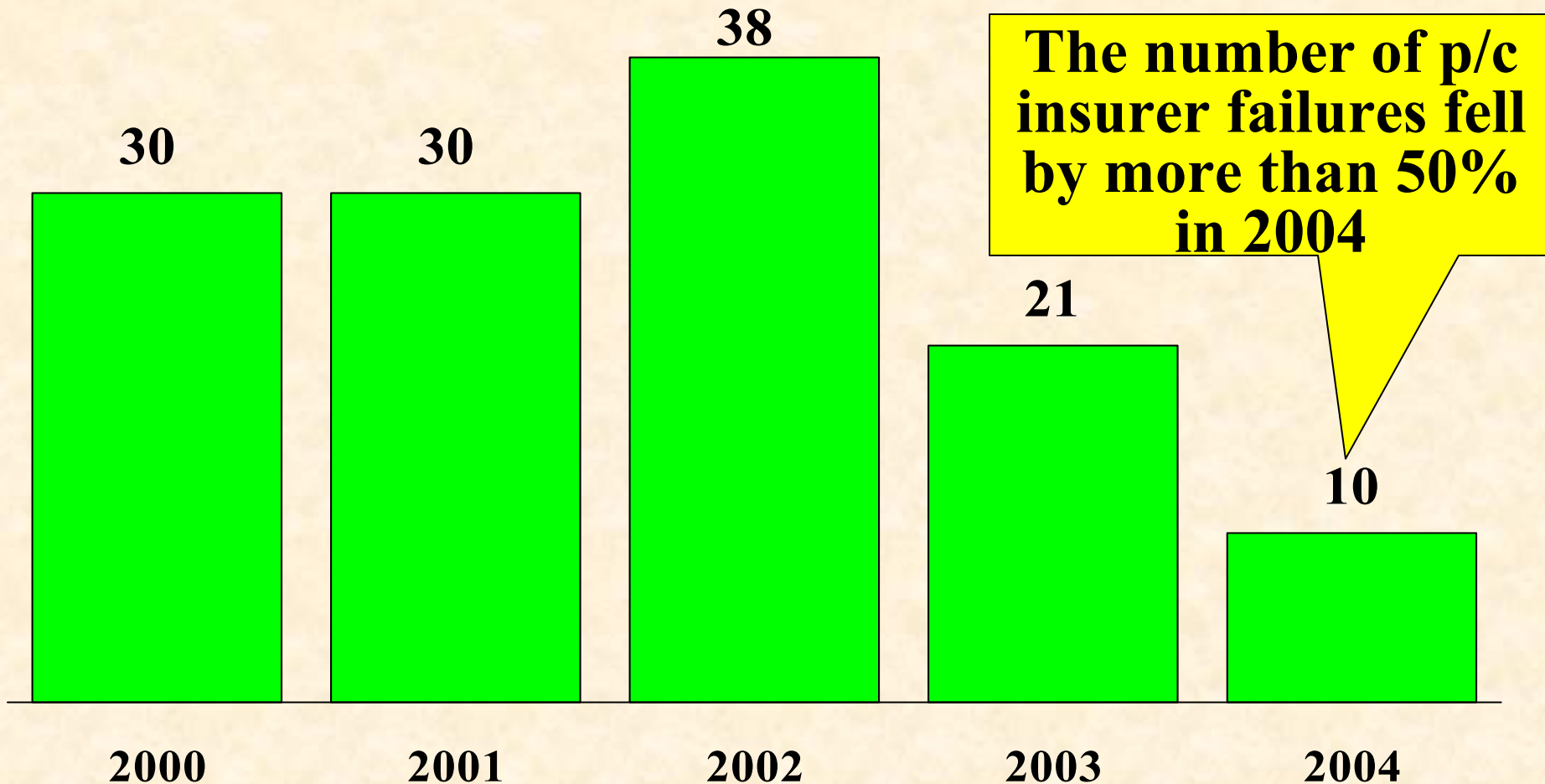


P/C Company Insolvency Rates, 1993 to 2002





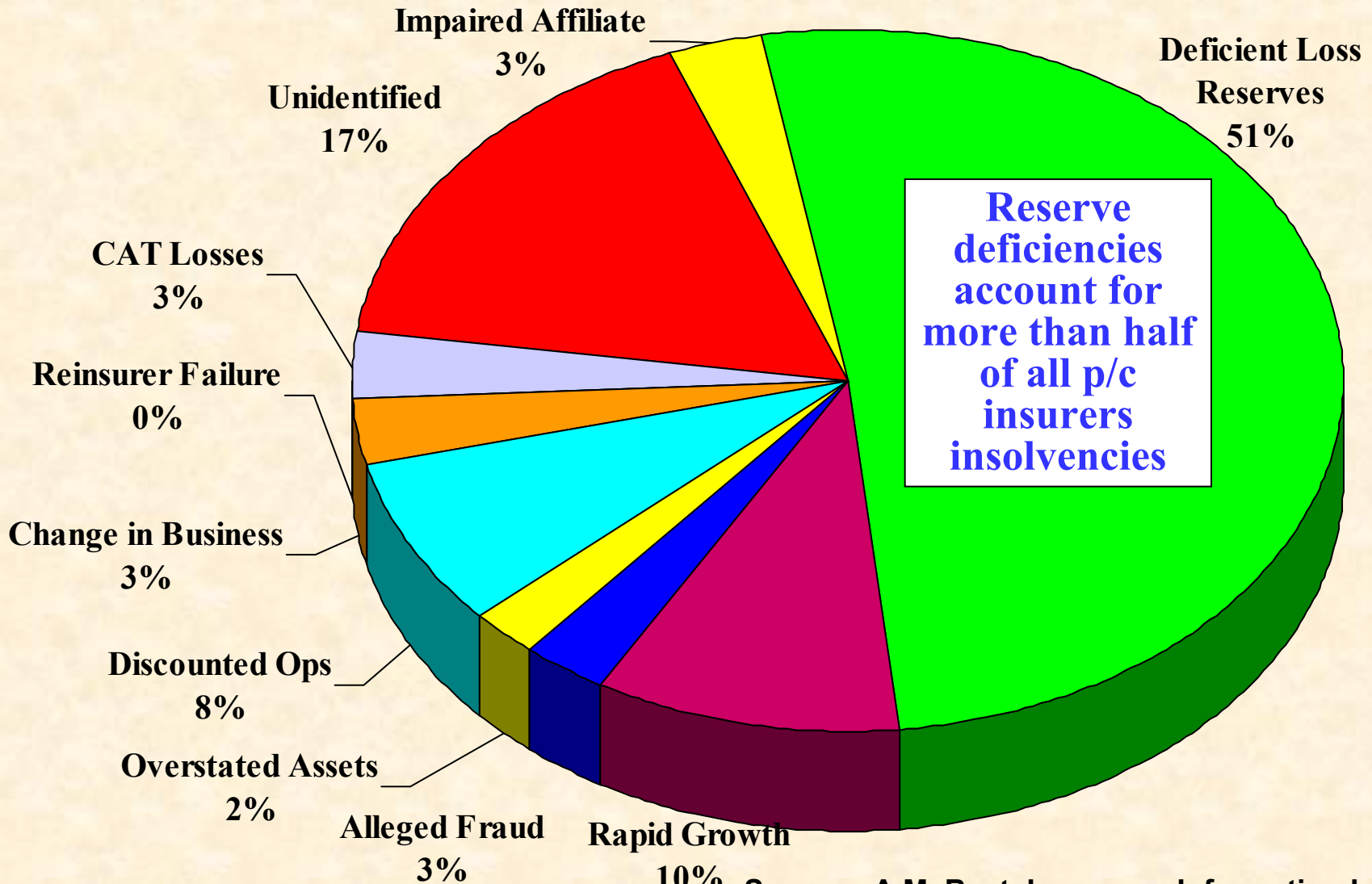
Number of P/C Insurer Insolvencies, 2000 to 2004





Reason for P/C Insolvencies

(218 Insolvencies, 1993-2002)

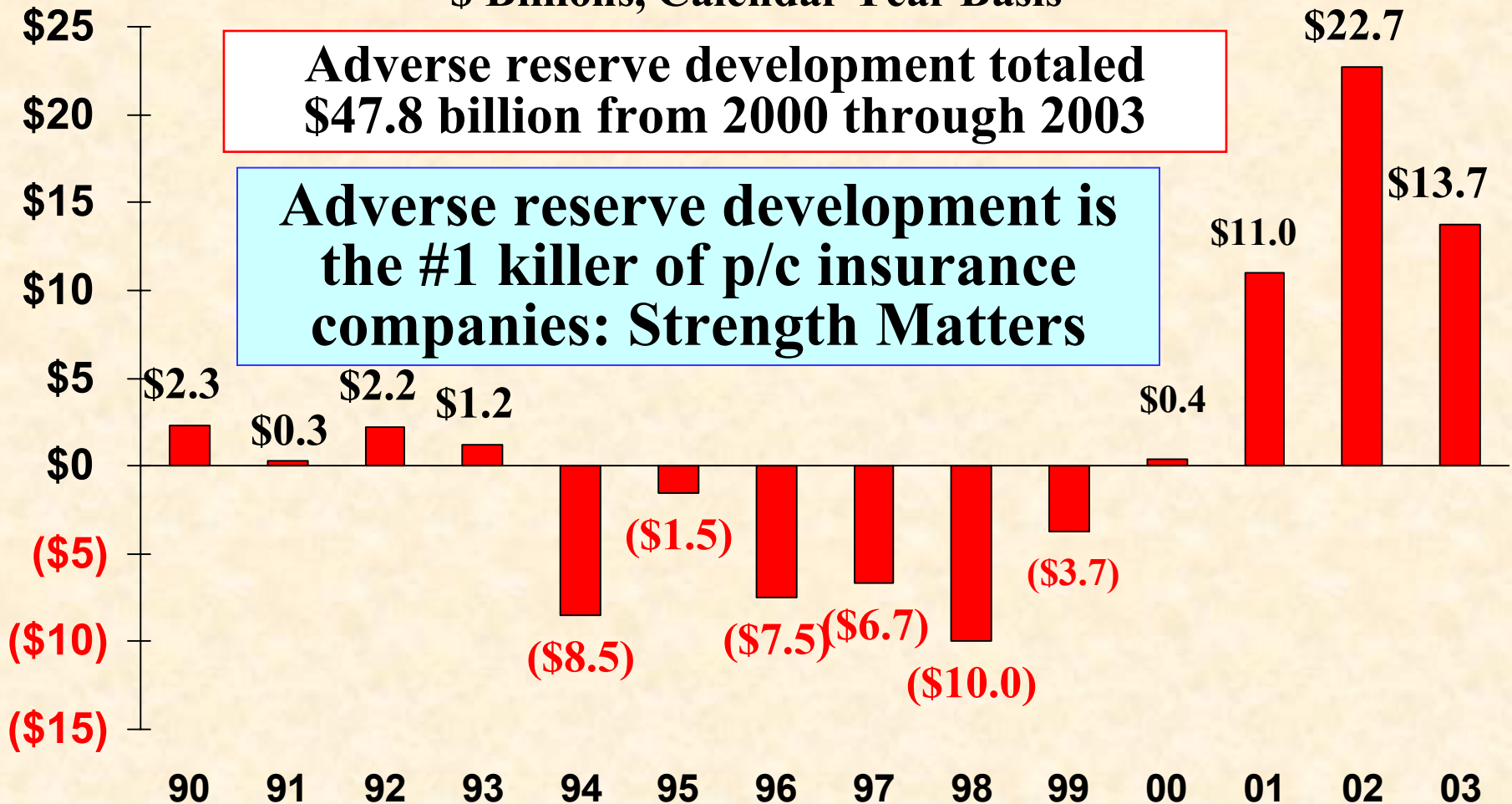


Source: A.M. Best, Insurance Information Institute



*P/C Insurance Industry Prior Year Reserve Development**

\$ Billions, Calendar Year Basis



Adverse reserve development totaled \$47.8 billion from 2000 through 2003

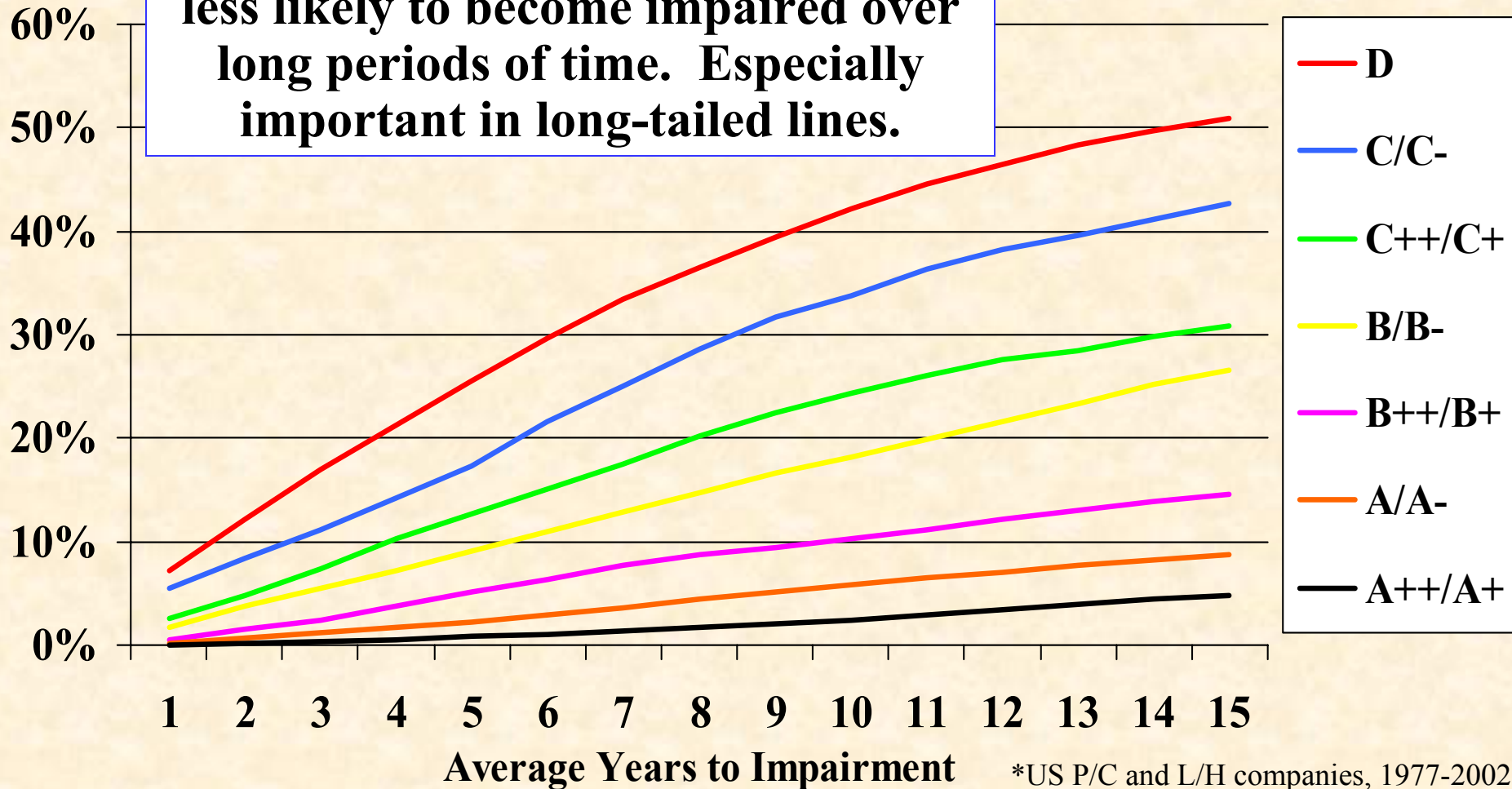
Adverse reserve development is the #1 killer of p/c insurance companies: Strength Matters

*Negative numbers indicate favorable development; positive figures represent adverse development.
Source: A.M. Best, Morgan Stanley, Dowling & Partners Securities, Prudential Securities, Ins. Info. Inst.



Cumulative Average Impairment Rates by Best Financial Strength Rating*

Insurers with strong ratings are far less likely to become impaired over long periods of time. Especially important in long-tailed lines.



*US P/C and L/H companies, 1977-2002

Sources: A.M. Best: *Best's Impairment Rate and Rating Transition Study—1977-2002*, March 1, 2004.



Guarantee Fund Net Assessments* (1979-2003P)



*Excludes NY and workers comp security funds in NJ and PA.

Source: National Conference of Insurance Guarantee Funds; Insurance Information Institute

WALL STREET:

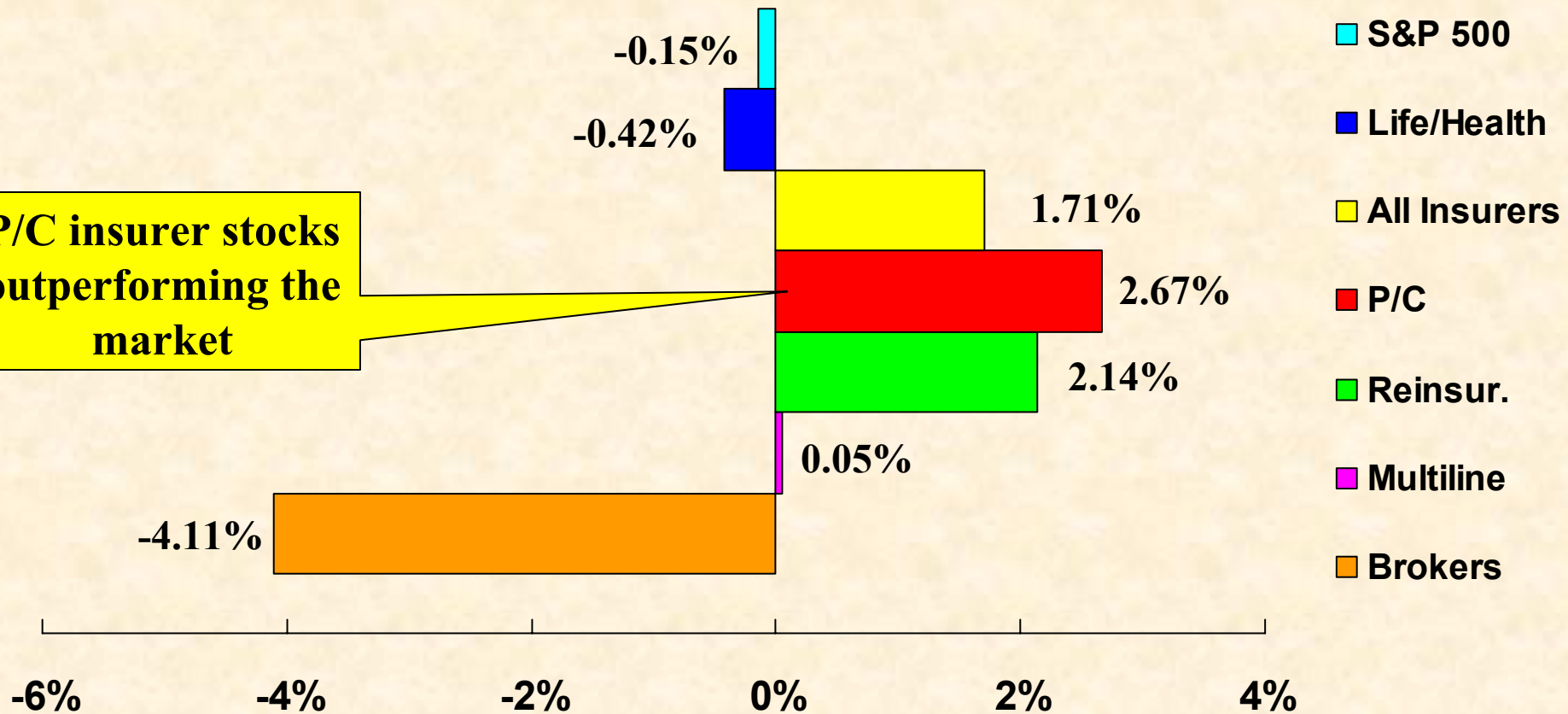
HIGH EXPECTATIONS





Most Insurers Up, Brokers Down So Far in 2005

Total Return 2004 YTD Through March 11, 2005

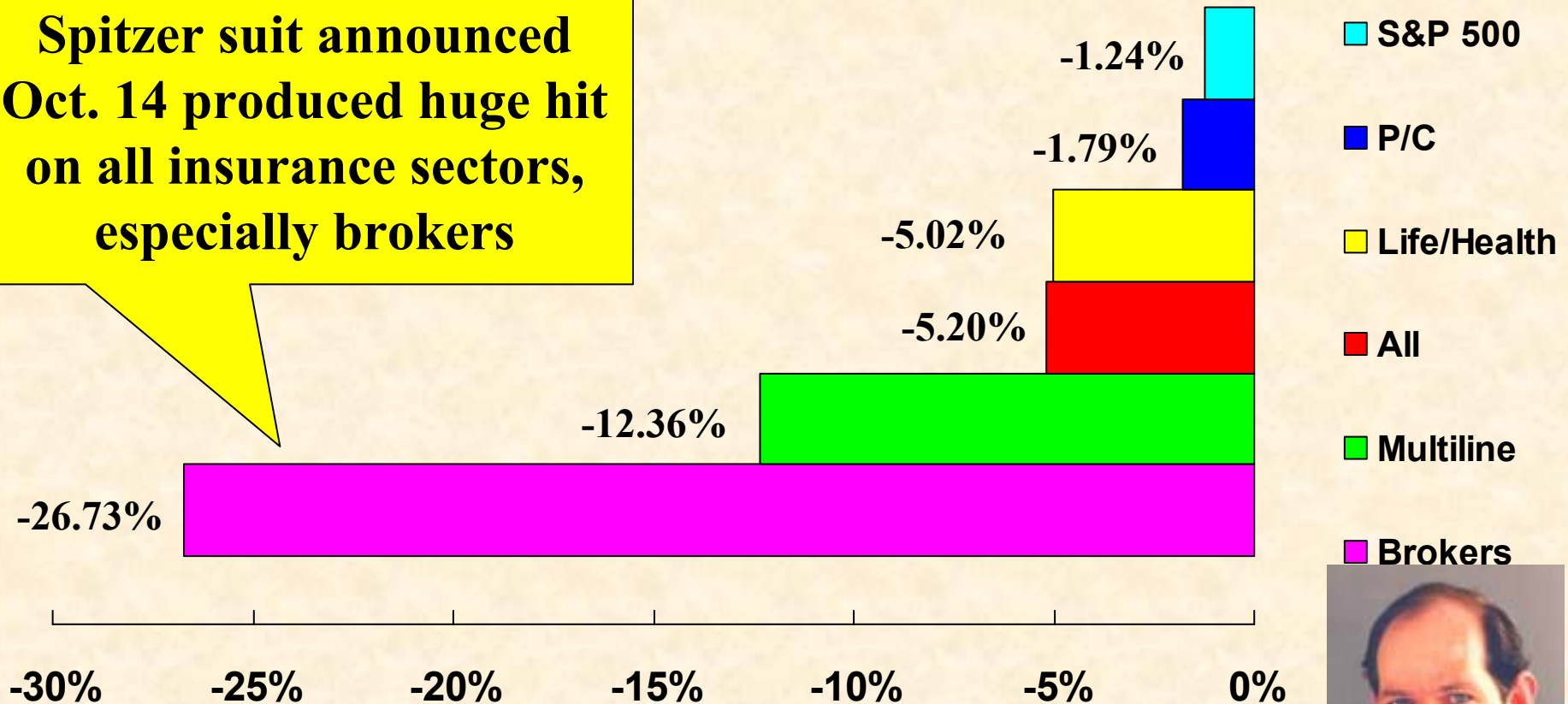




*Insurer/Broker Stocks: Hammered by the Spitzer Suit**

Change in YTD Total Return from October 8 to October 15, 2004

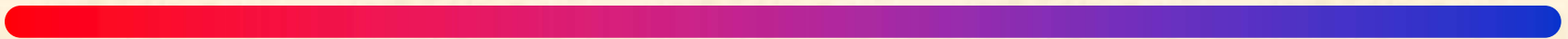
**Spitzer suit announced
Oct. 14 produced huge hit
on all insurance sectors,
especially brokers**



*Percentage point change.

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

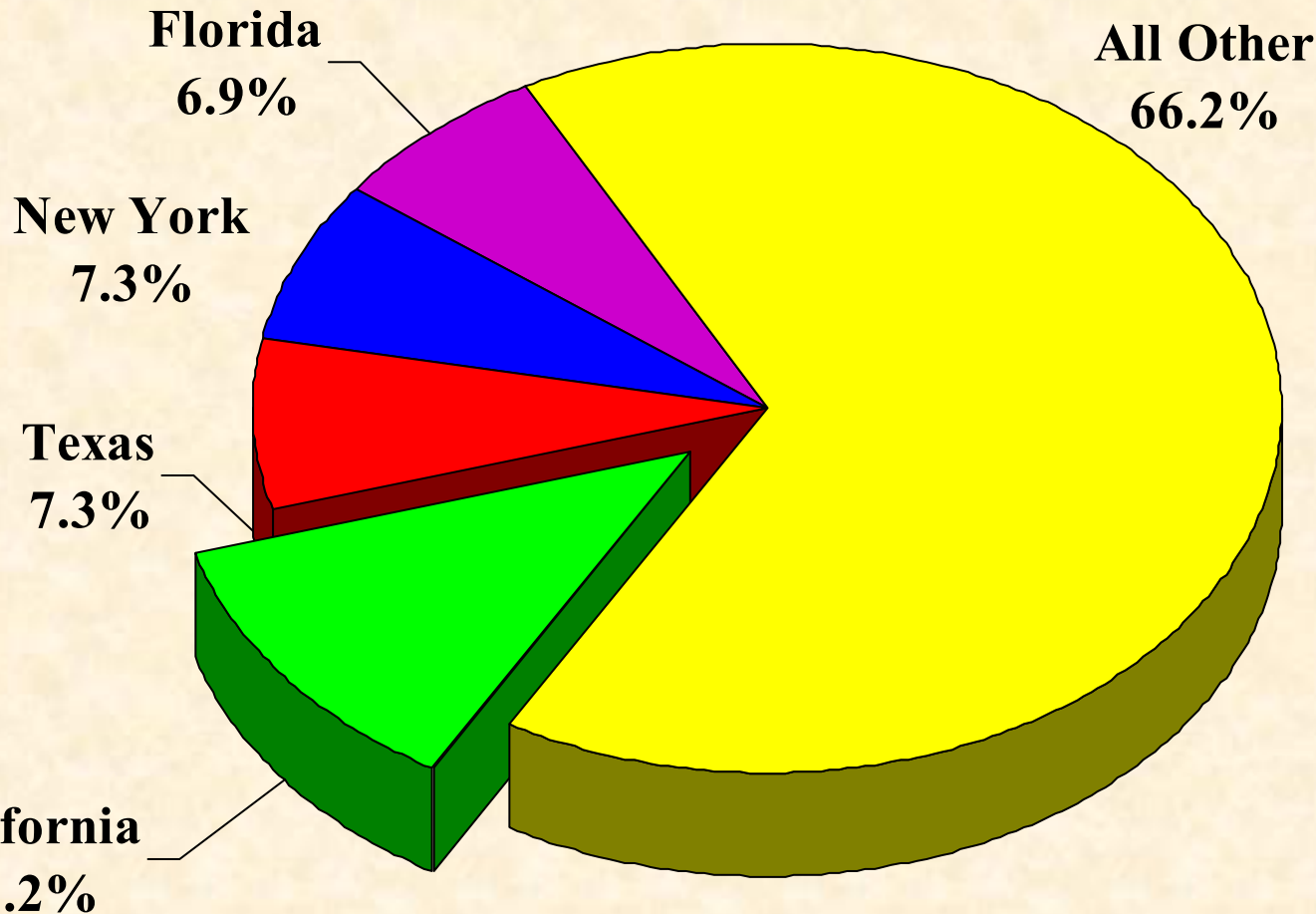
***THE TRUTH ABOUT
PROFITS IN
CALIFORNIA***





California is the Largest US Insurance Market by Far

Market Share by State



DPW: 2003

US: \$438.1B

CA: \$53.6B

TX: \$32.2B

NY: \$32.0B

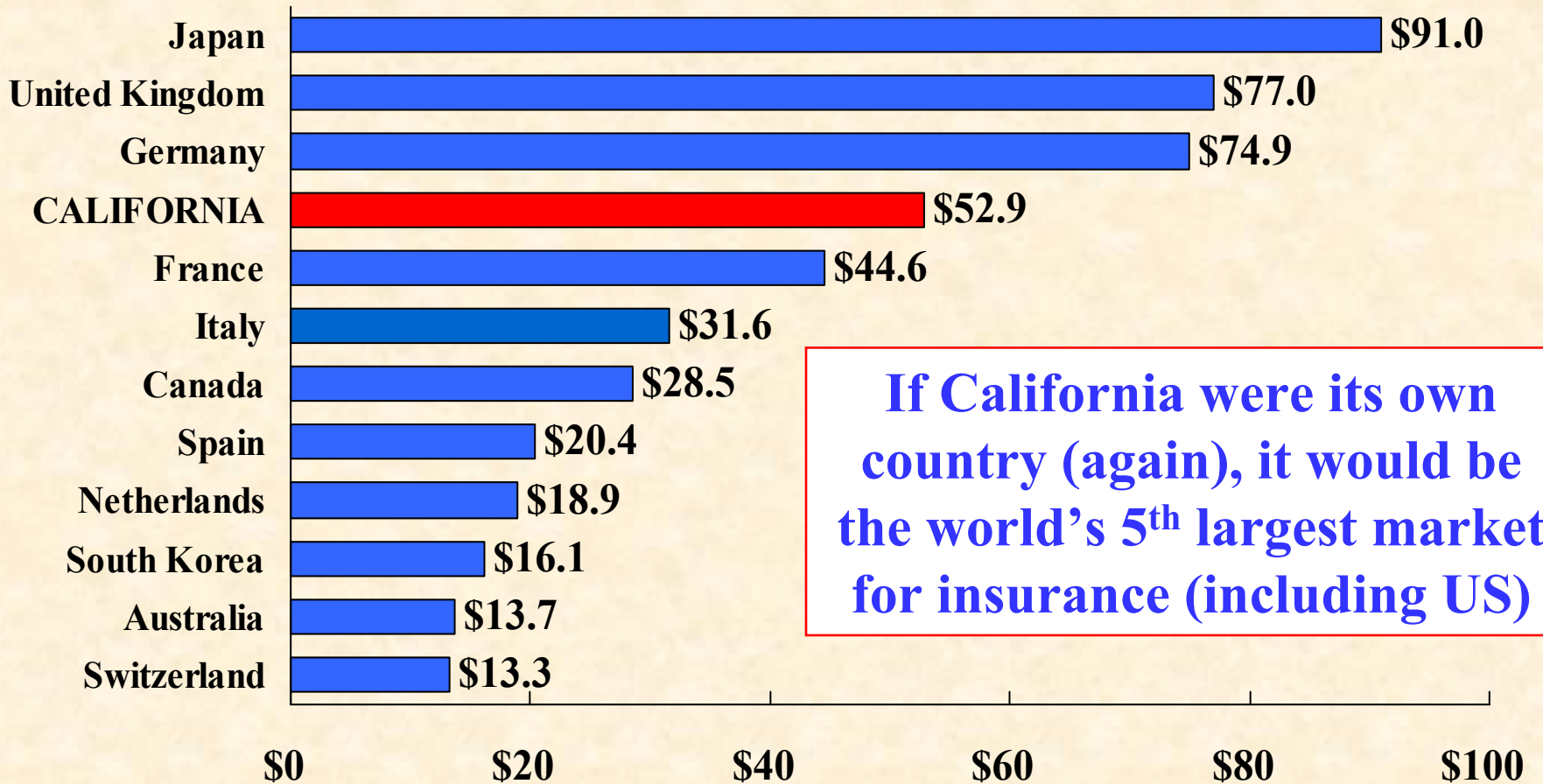
FL: \$30.2B

Source: Insurance Information Institute; Based on 2003 Direct Premiums Written from A.M. Best.



California is One of the World's Largest P/C Insurance Markets

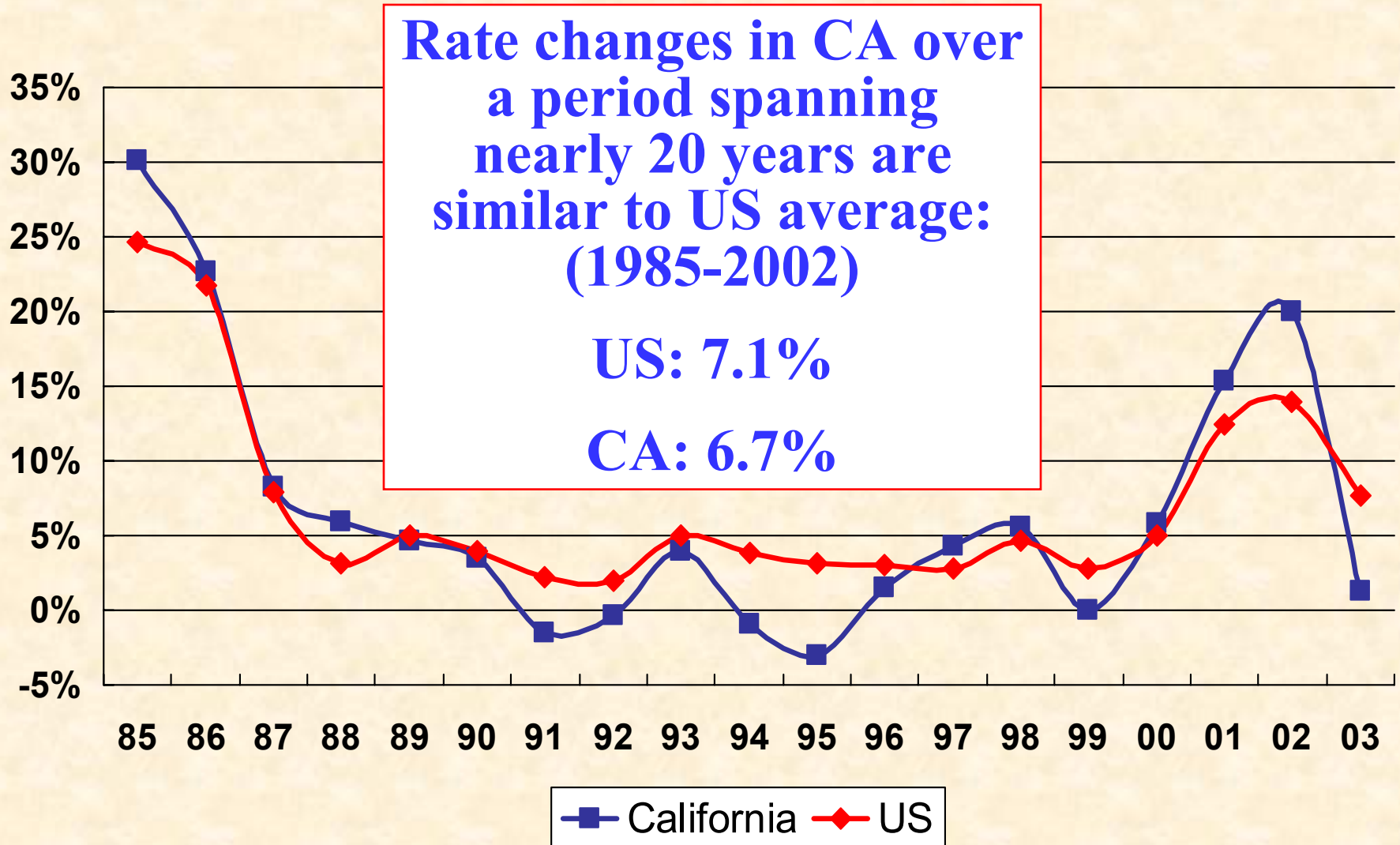
World's Largest P/C Insurance Markets (\$ Bill., ex. US)



Source: Swiss Re, Economic Research & Consulting, "World Insurance in 2002," *sigma* No.8/2003.

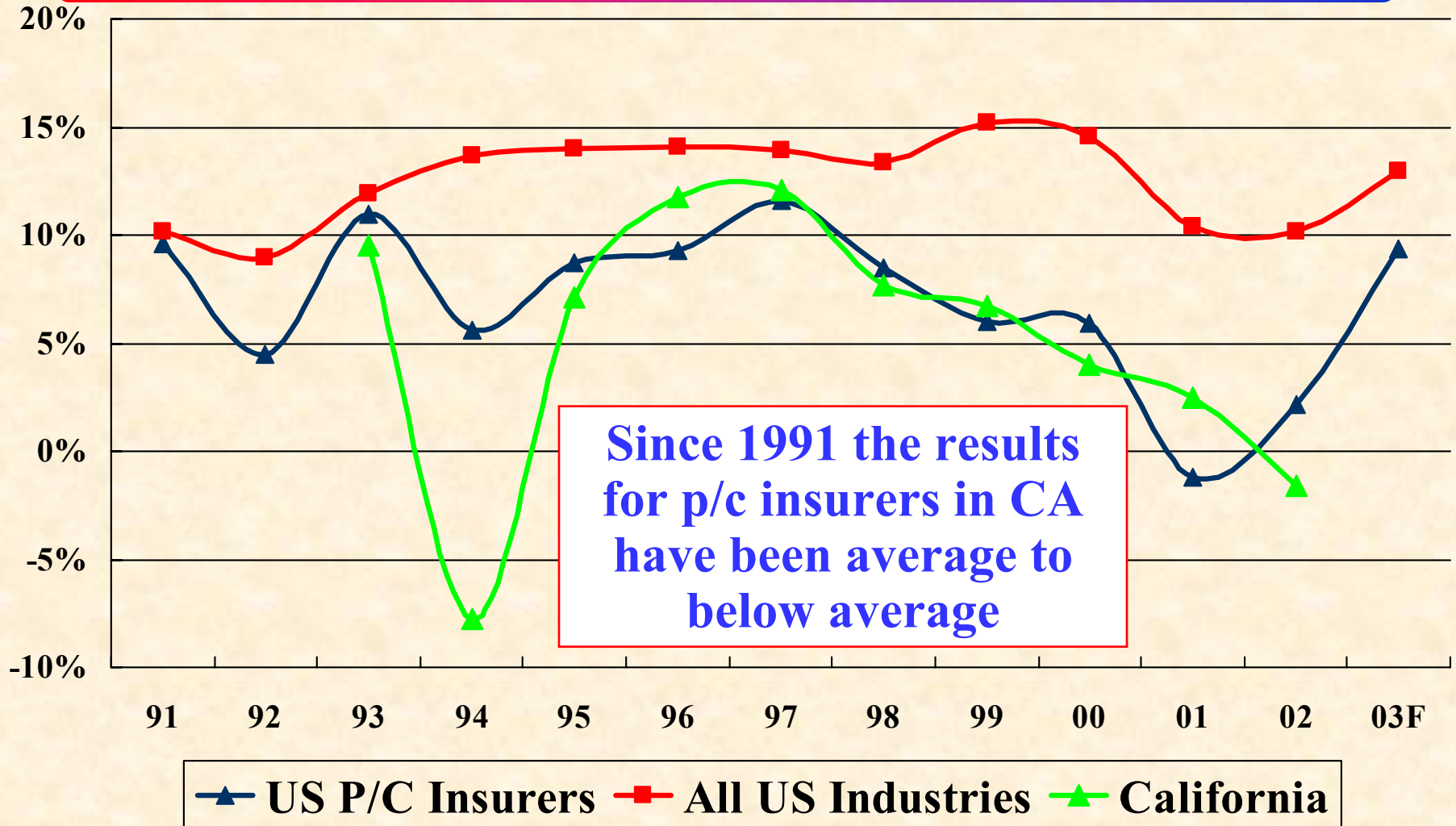


Growth in Direct Written Premiums: CA vs. US



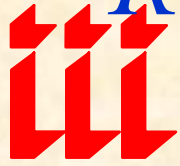


ROE: US & CA P/C vs. All Industries, 1991–2003*

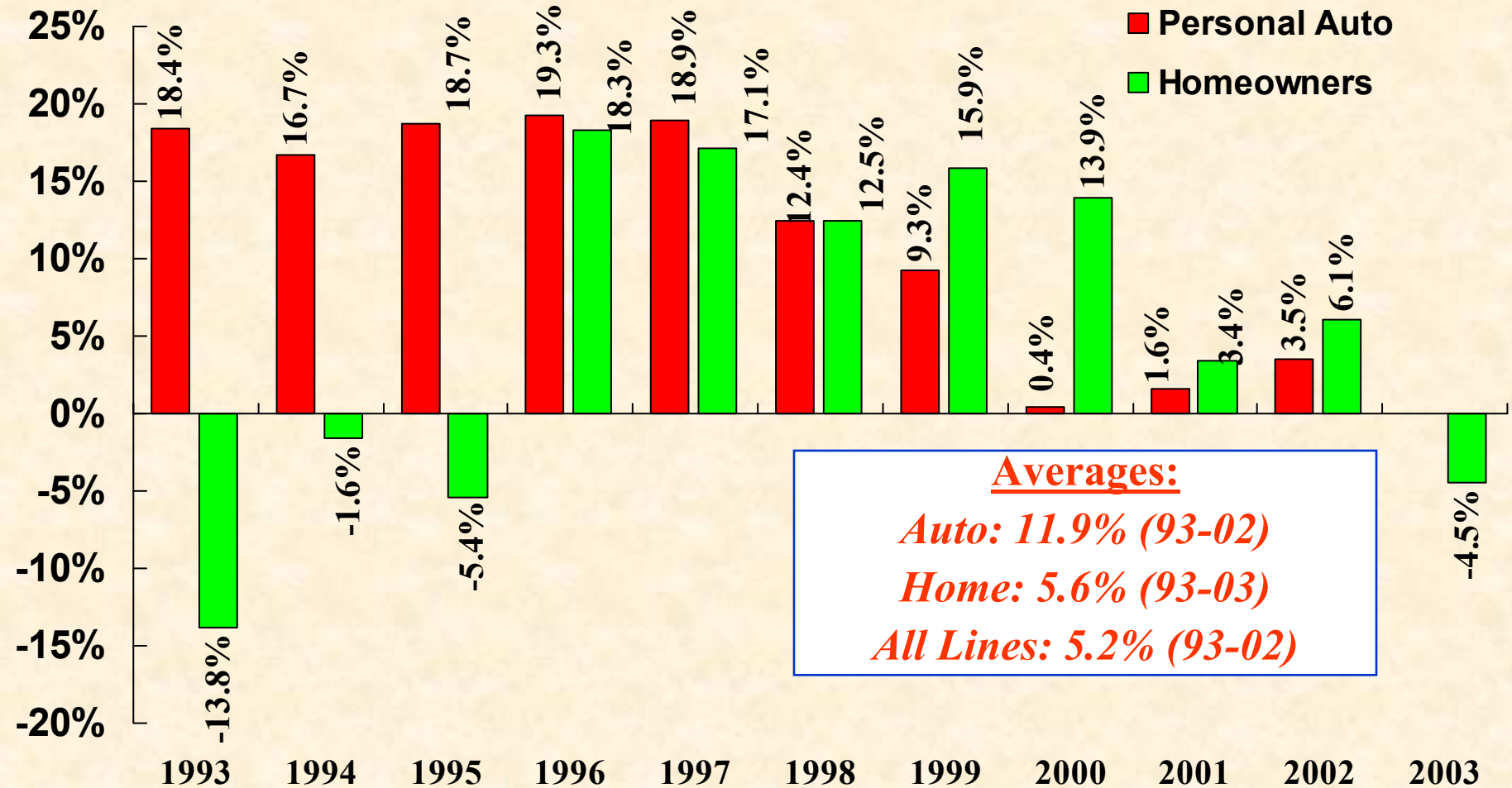


*2003 CA ROE is Ill estimate.

Source: Insurance Information Institute; NAIC, *Fortune*



ROE for Personal Lines in California 1993 – 2003*

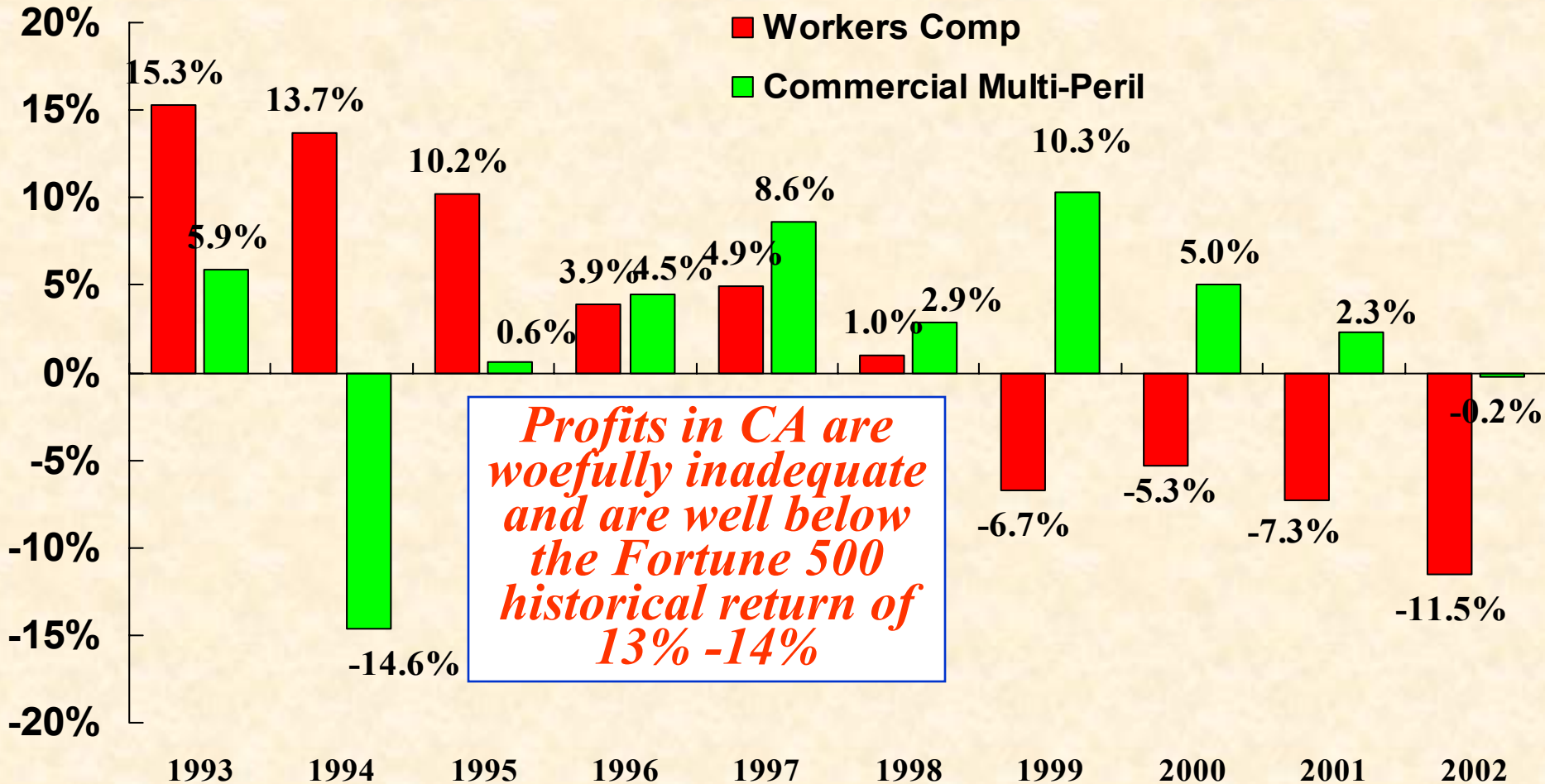


*2003 Auto date not yet available. HO figure is profit a % of direct premiums earned.

Source: NAIC



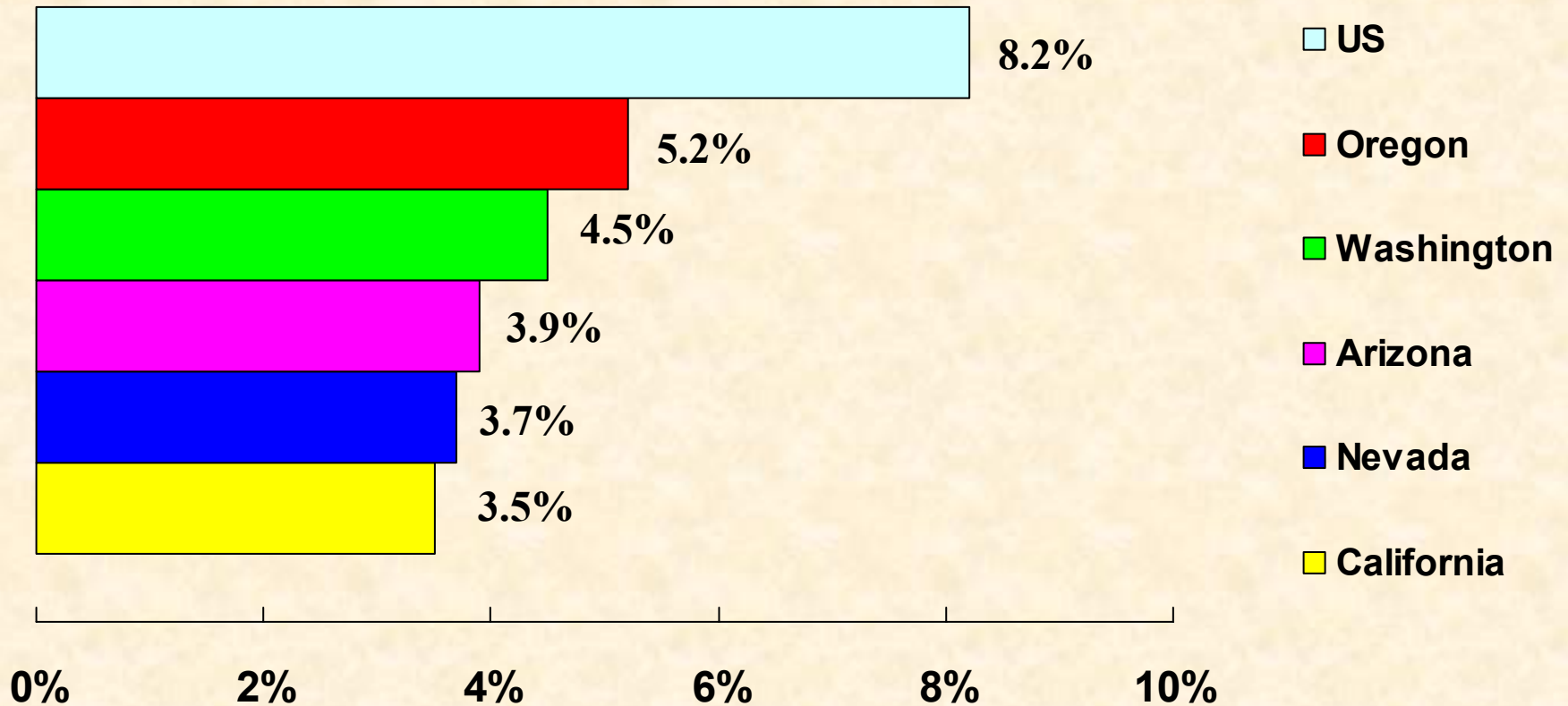
ROE for Major Commercial Lines in CA, 1993 - 2002





2002 Return on Equity: CA & Nearby States PP Auto

2002



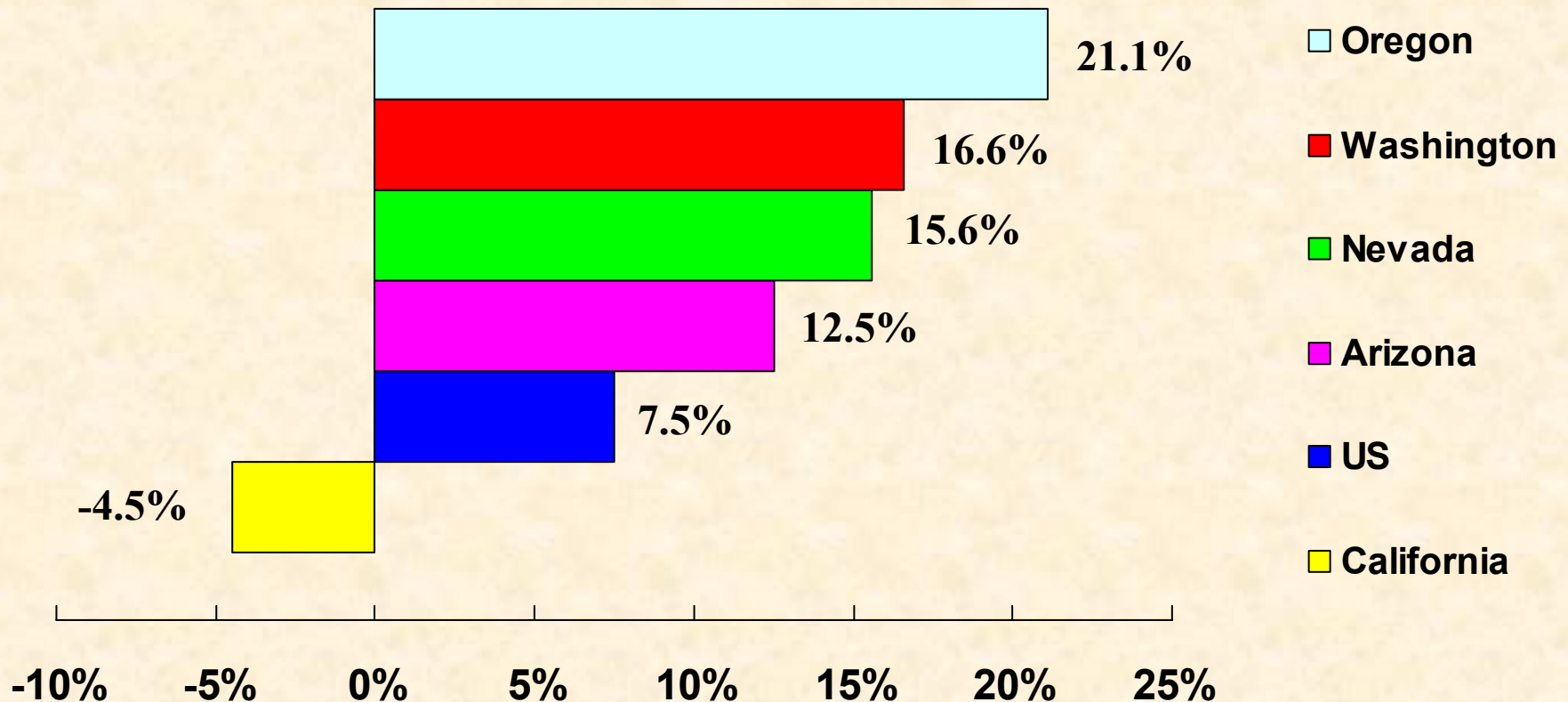
Source: NAIC, Insurance Information Institute



2003 Profit as % of DPE:*

CA & Nearby States HO

2003

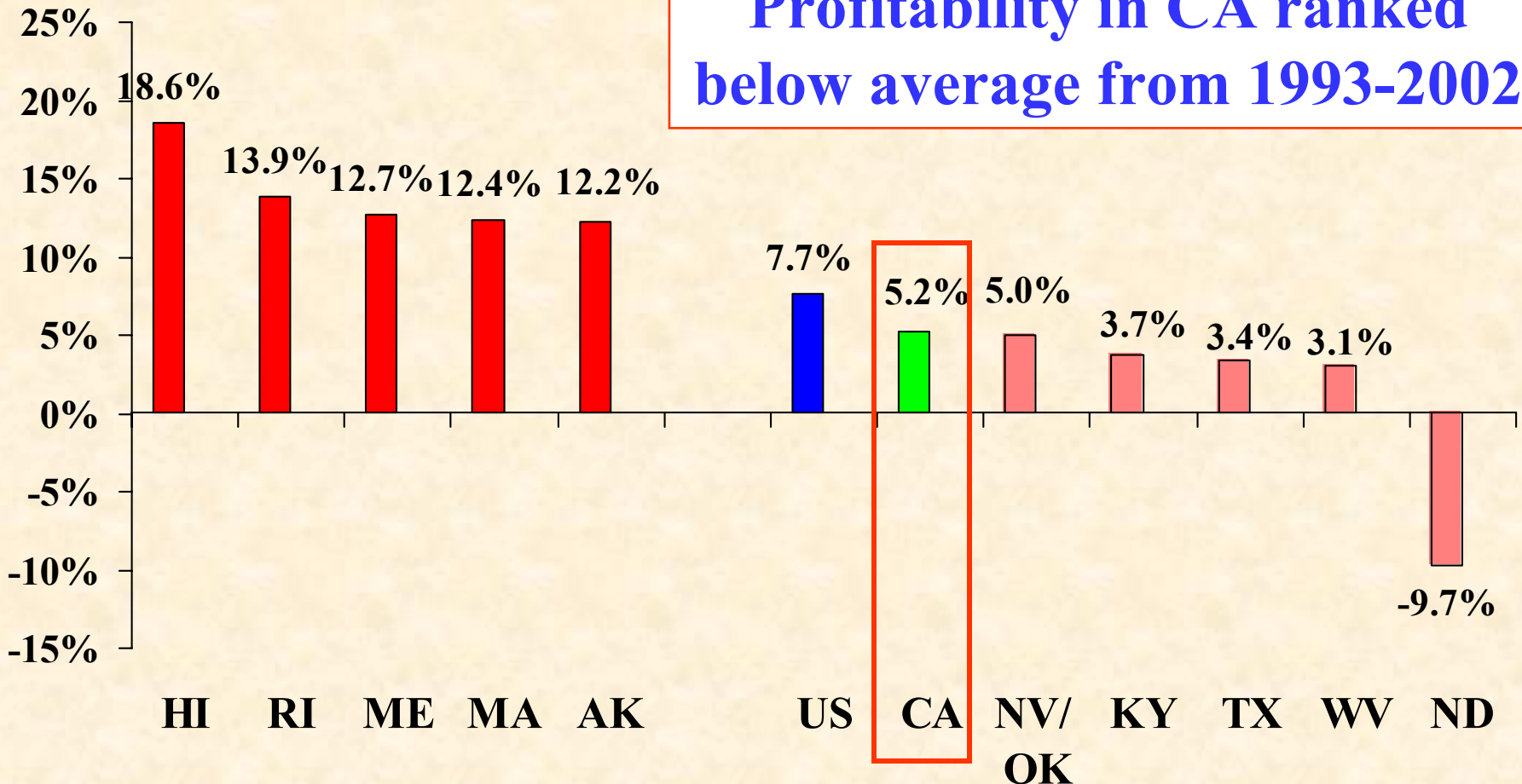


*DPE = Direct Premium Earned

Source: NAIC, Insurance Information Institute

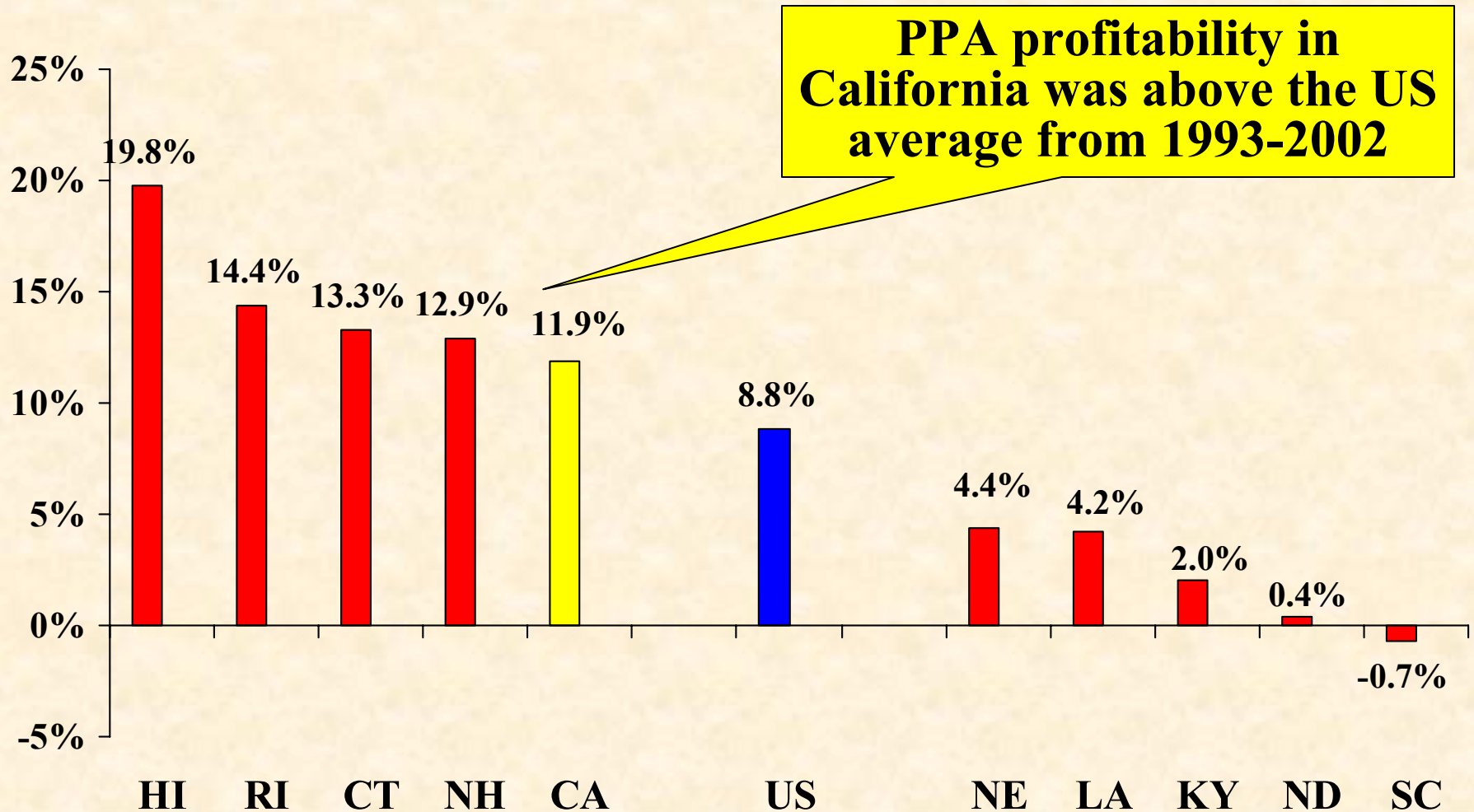


Top/Bottom 5 Markets for ALL P/C LINES By Average RNW*, 1993-2002



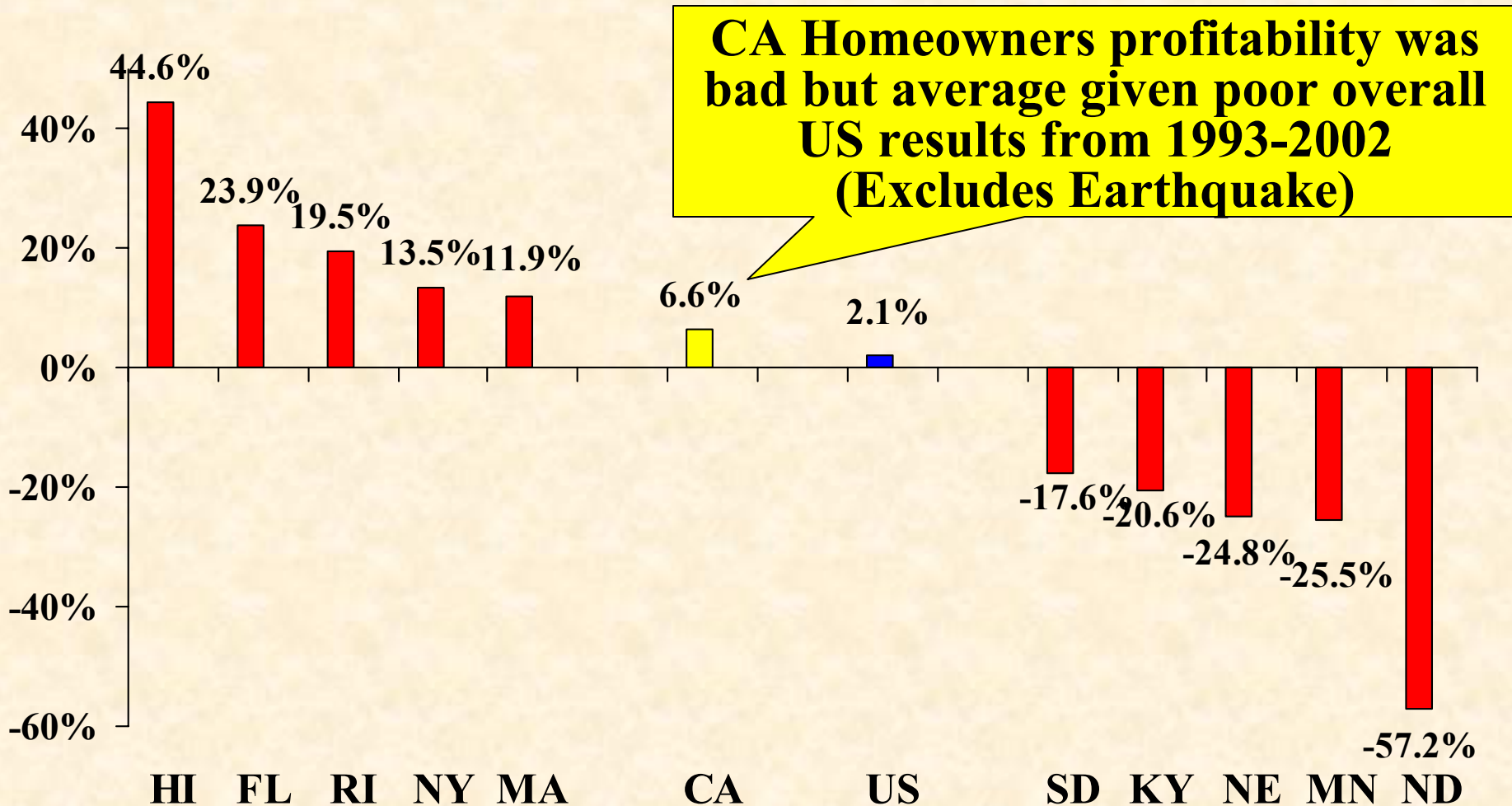


Top/Bottom 5 Markets for PVT. PASS. AUTO By Avg. RNW, 1993-2002





Top/Bottom 5 Markets for HOME-OWNERS By Avg. RNW, 1993-2002

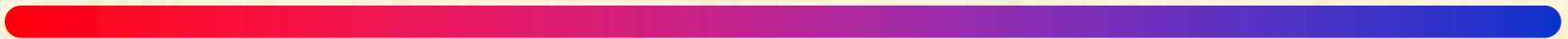


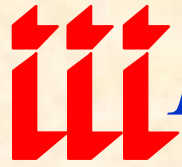
THE BLAME

GAME:

Insurance-to-Value

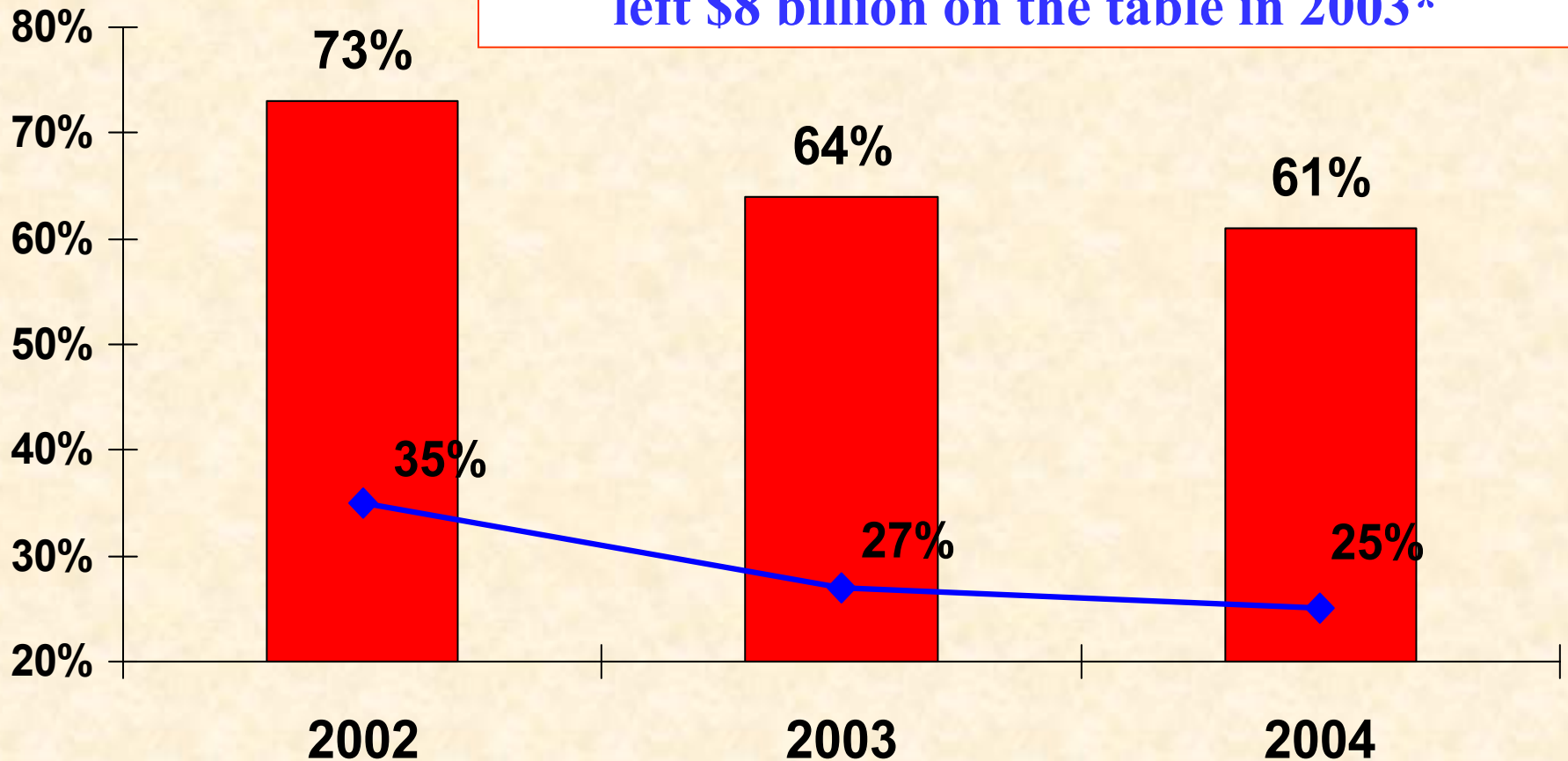
***Only in California is Underinsuring
Your Home the Insurer's Fault***





Insurance-to-Value in HO is a National Problem, Improved Recently

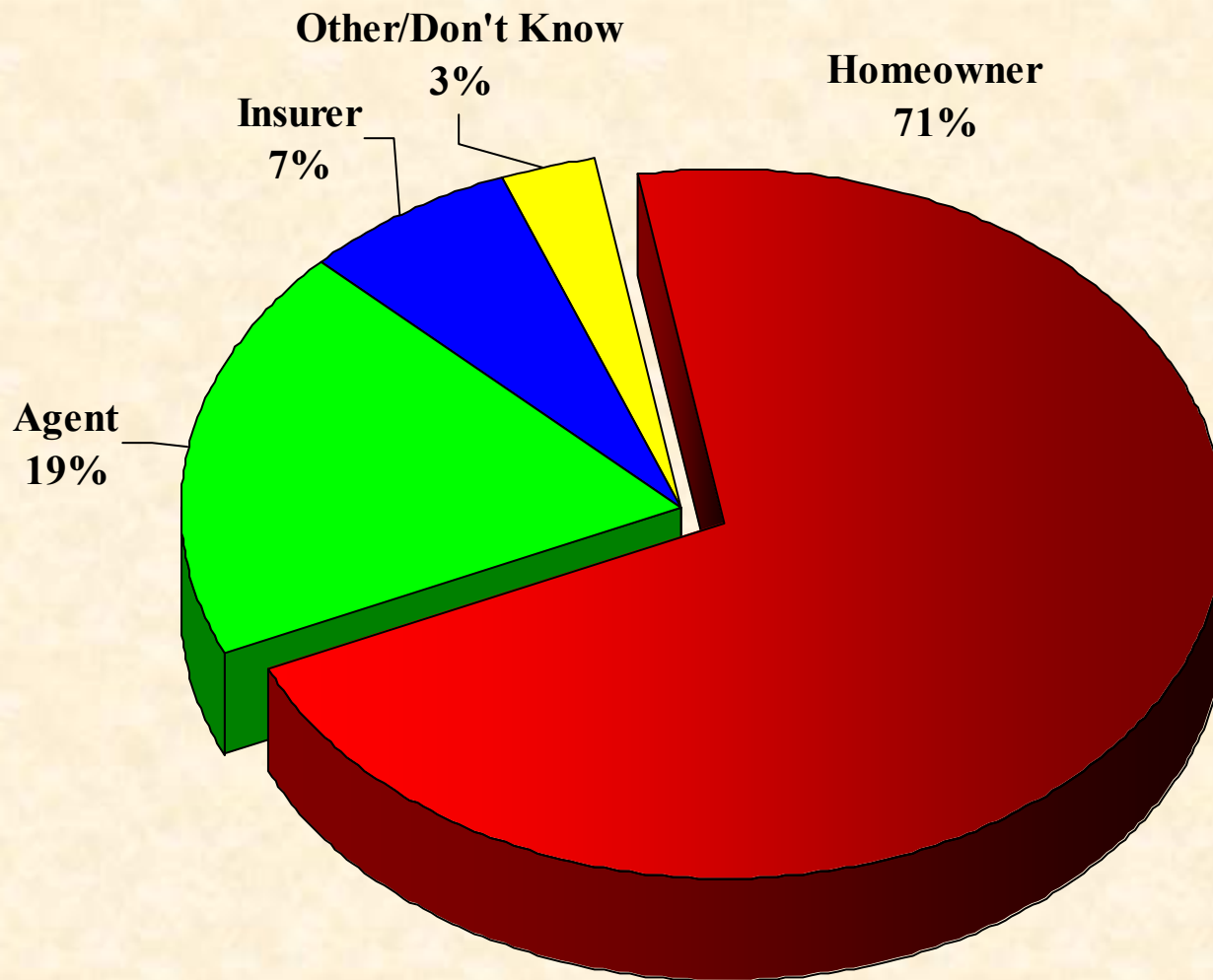
Less than ITV means homeowners insurers left \$8 billion on the table in 2003*



*According MS/B.
Source: Marshall & Swift/Boeckh

■ Proportion of Home Undervalued ◆ Average Undervaluation

Who's Responsibility Is It to Keep Homeowners Policy Up-to-Date?

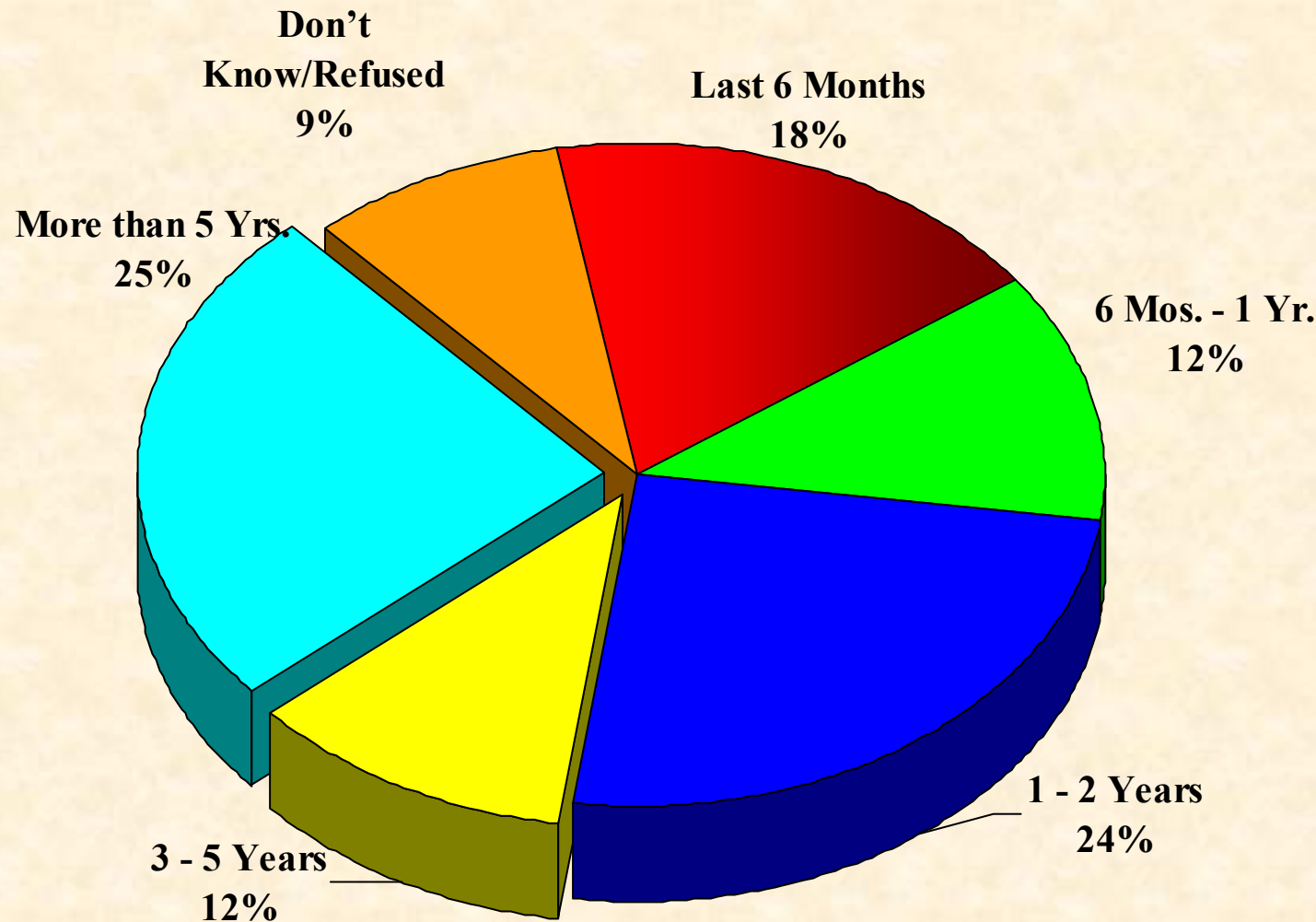


- Nearly 3 out of 4 people, even fire-weary Californians, believe it is the homeowner's responsibility to keep insurance up-to-date
- BUT 26% believe it's the agent's or insurer's responsibility
- This substantial minority is wrong, but gets heard (CA, FL) and comments reflect badly on insurers
- Media, regulators and legislators join fray

Source: September 2004 poll of 800 Californians conducted for the Insurance Information Network of California by Public Opinion Strategies. Margin of error = +/- 3.46%.

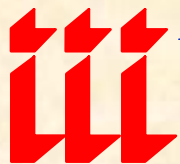


Time Since Homeowner Last Updated HO Policy

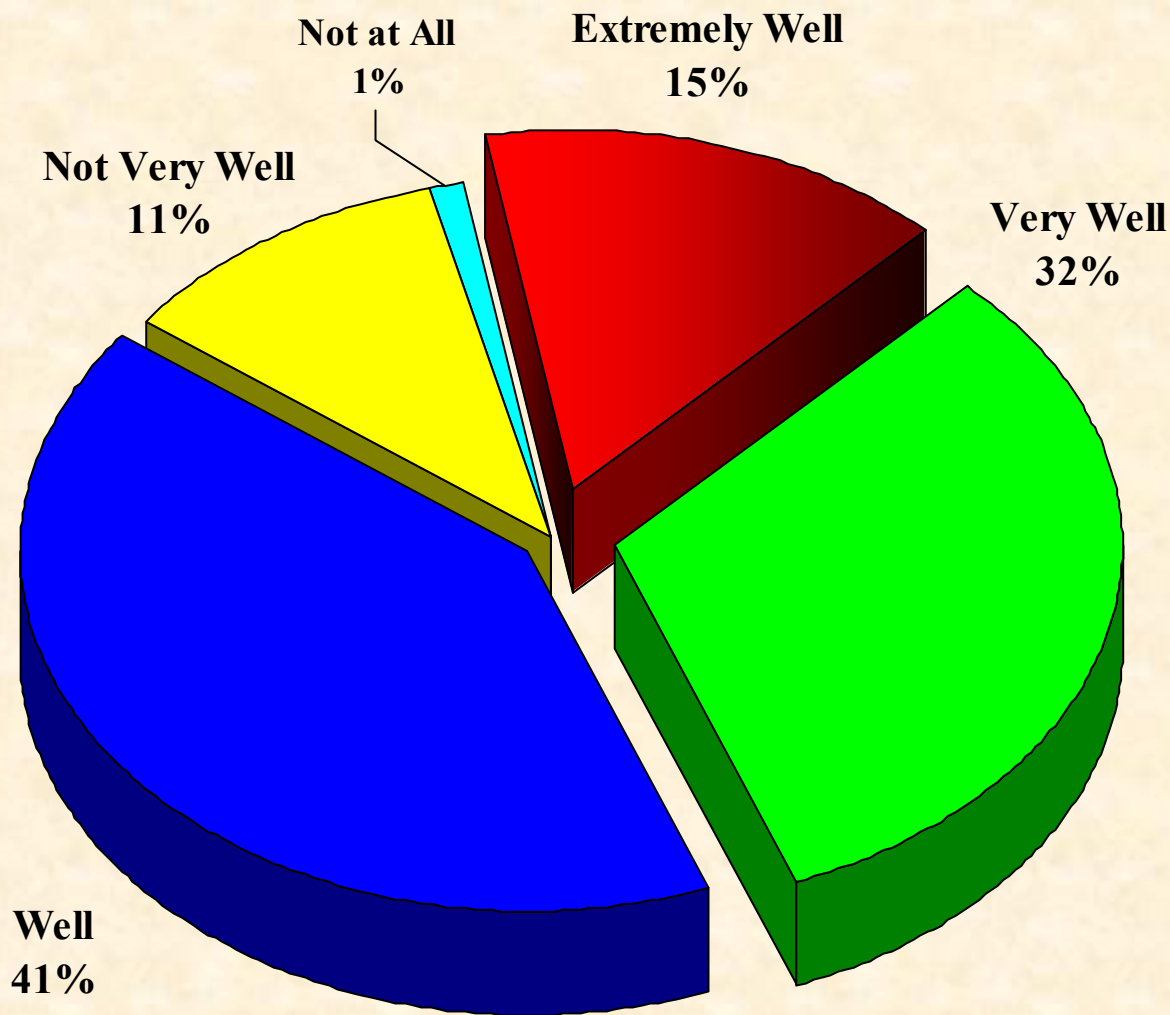


- Nearly 40% of people haven't updated their homeowner's policy within the last 3 years
- Huge potential for problems, especially in disaster-prone states
- Leads automatically to large under-insurance problems

Source: September 2004 poll of 800 Californians conducted for the Insurance Information Network of California by Public Opinion Strategies. Margin of error = +/- 3.46%.



Most Homeowners Believe They Have a Good Understanding of Their HO Policy...BUT



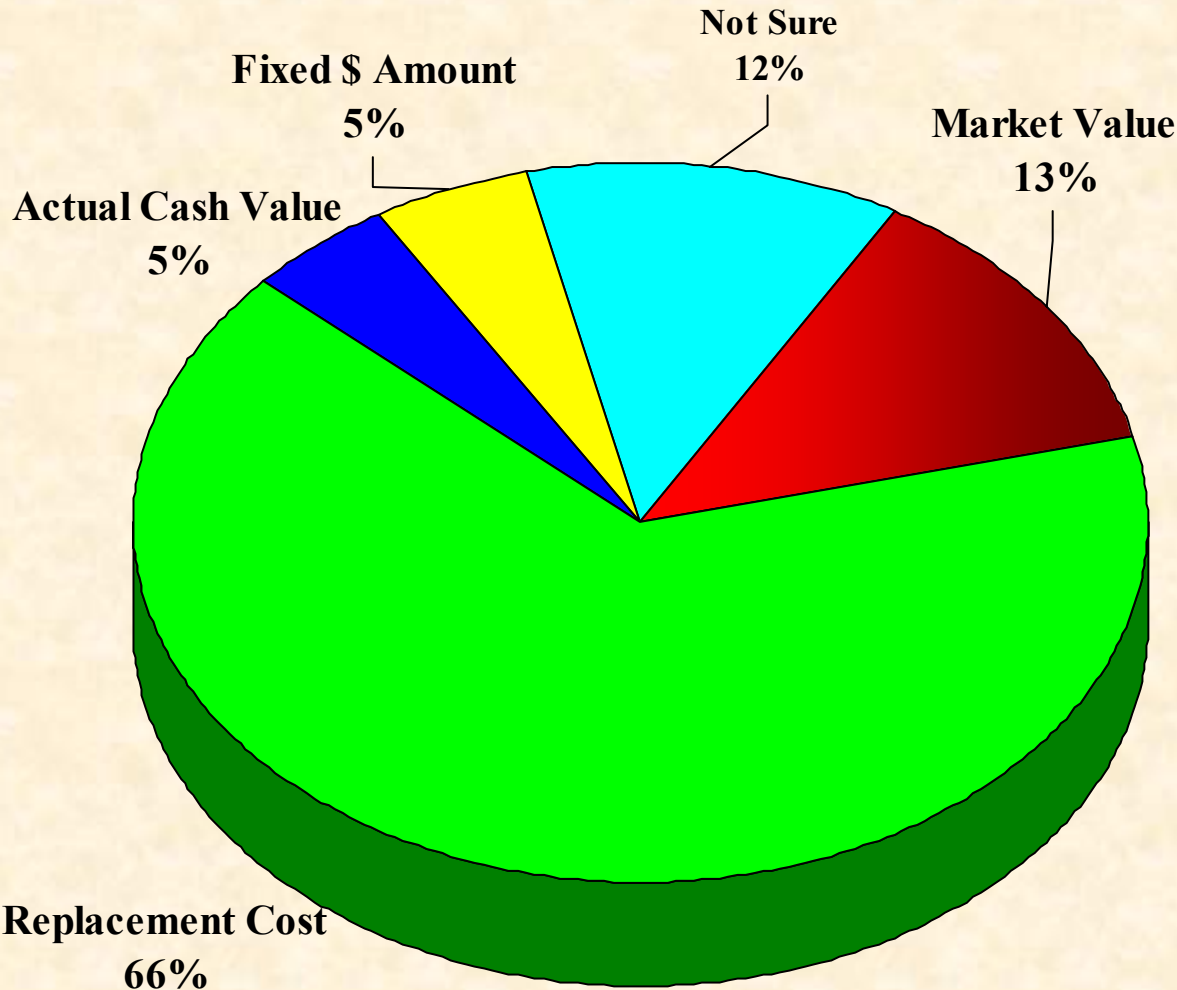
- **88%** of homeowners think they understand their HO policies Well, Very Well or Extremely Well
- **BUT 66%** believe they have replacement cost coverage **AND 13%** believe their insurance will pay *market value!*
- **Hardly surprising** coverage disputes erupt after major disasters, esp. in areas with rapid home price appreciation

Source: Harris interactive poll conducted for Fireman's Fund, July 2004.

See: <http://www.firemansfund.com/dcmssites/about/pdf/firemansfundtoplinerev2.pdf>



Most Homeowners Believe They Have Replacement or Mkt. Value HO Coverage



- 66% of homeowners (mostly mistakenly) think they have replacement cost coverage
- 13% (all mistakenly) believe their insurance pays *market* value!
- 12% admit they don't know how much their HO policy would pay

Source: Harris interactive poll conducted for Fireman's Fund, July 2004.

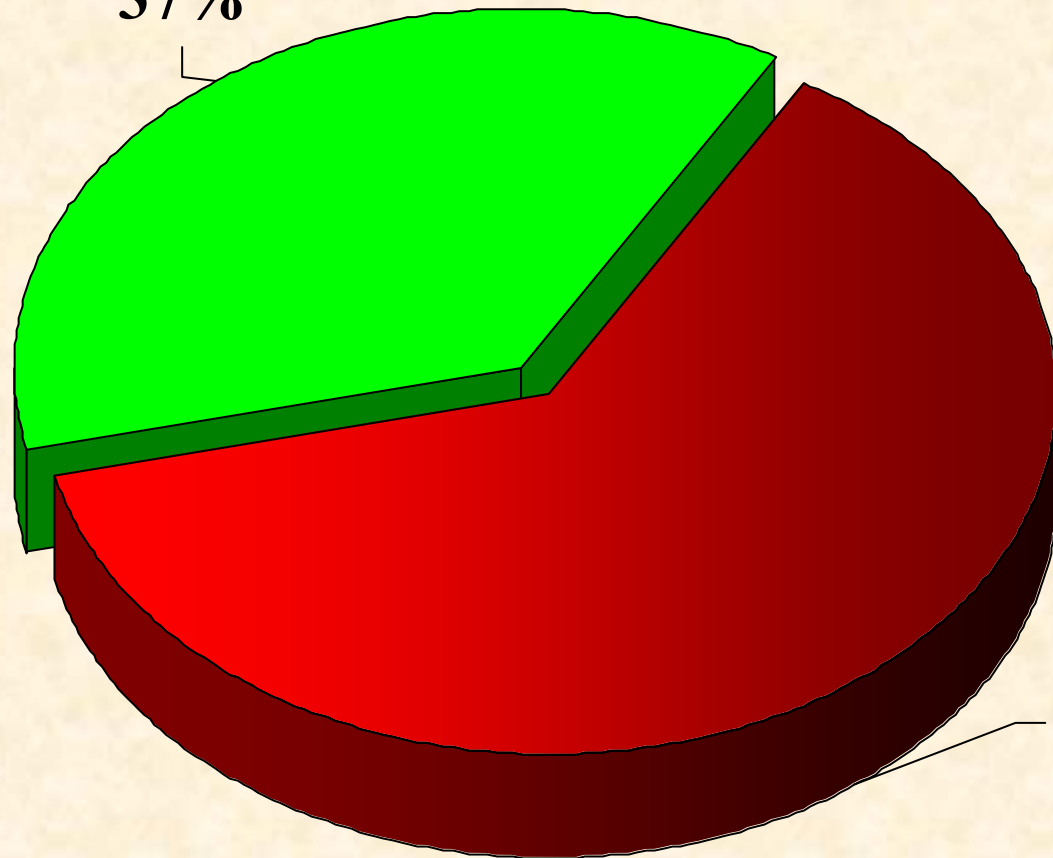
See: <http://www.firemansfund.com/dcmssites/about/pdf/firemansfundtoplinerev2.pdf>



Many Homeowners Don't Know What it Would Cost to Rebuild Home if Destroyed

Don't Know

37%



• Only 63% of homeowners believe they know what it would cost to replacement their home if destroyed

Know
63%



Why People Don't Increase Homeowners Coverage



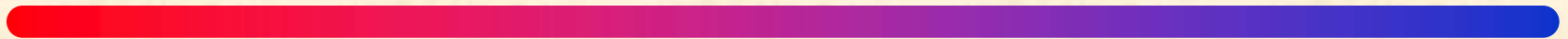
- 22% cite expense as reason they don't adjust they're HO coverage
- 25% don't realize they need to
- 30% say they're too busy (to think about protecting their most valuable asset)
- 25% say their agent said there's nothing to worry about

Source: Harris interactive poll conducted for Fireman's Fund, July 2004.

See: <http://www.firemansfund.com/dcmssites/about/pdf/firemansfundtoplinerev2.pdf>

WORKERS COMP: A National Problem

**Is California Out of
the Woods?**



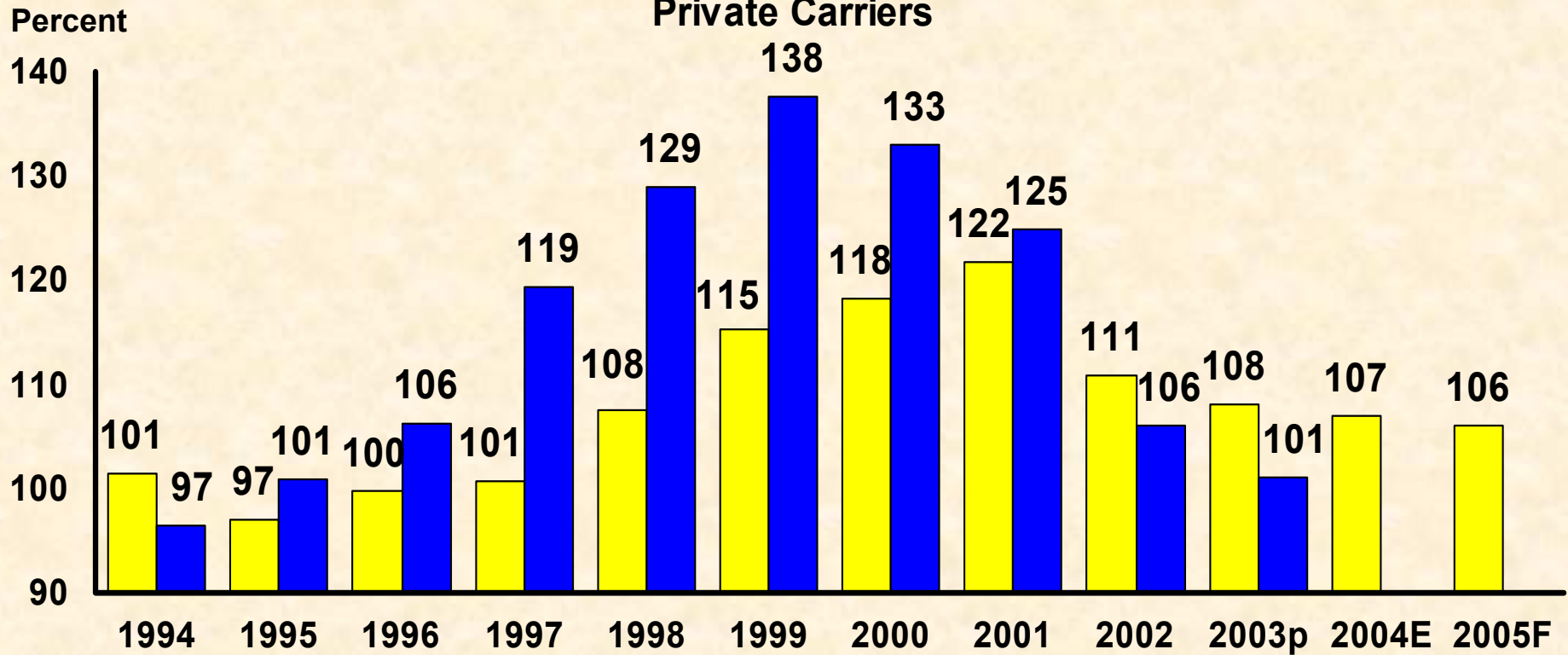
National Perspective





Workers Comp Combined Ratios, 1994-2005F

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



p Preliminary AY figure.

Accident Year data is evaluated as of 12/31/2003 and developed to ultimate

Source: Calendar Years 1994-2002, A.M. Best Aggregates & Averages; Calendar Year 2003p and Accident Years 1994-2003p and 2004/5 estimate and forecast, NCCI

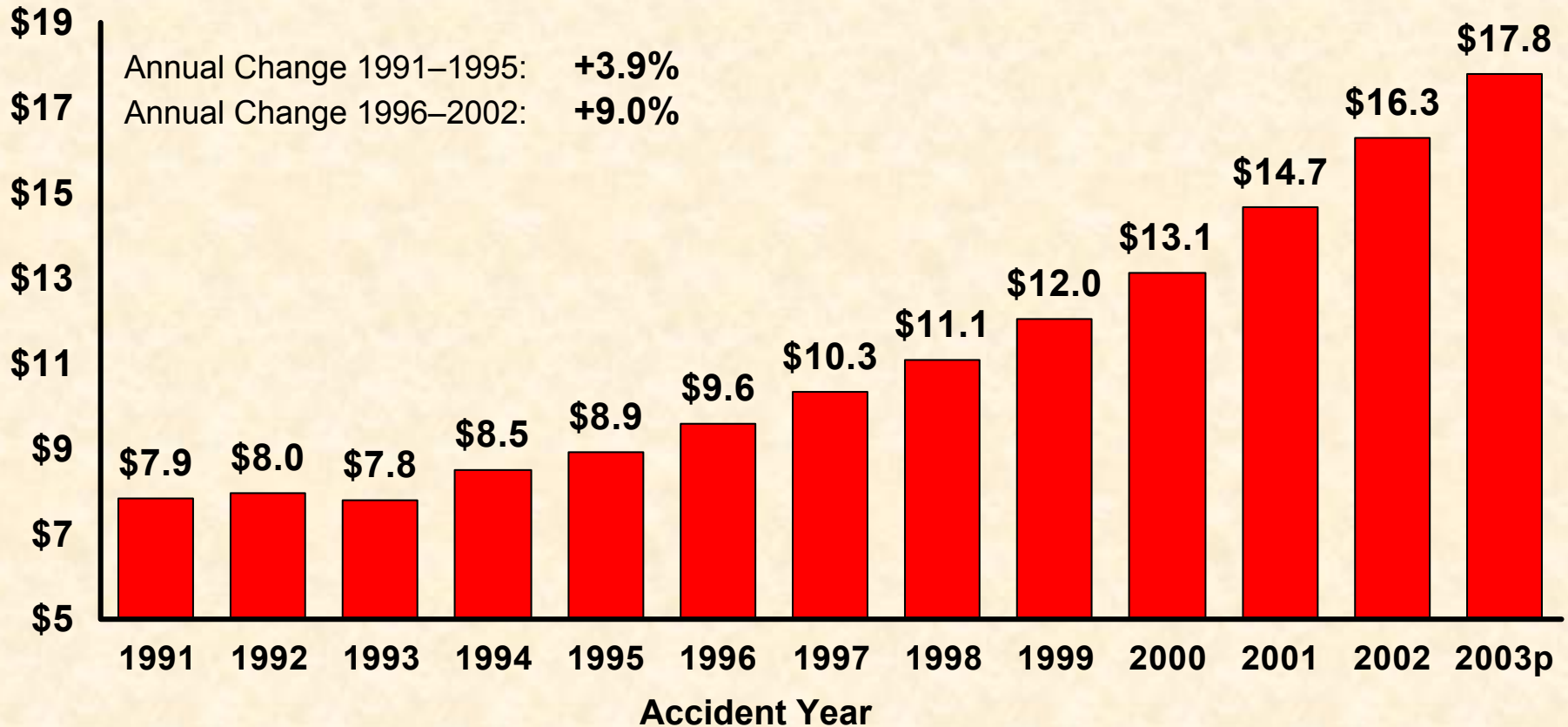
Includes dividends to policyholders



Workers Comp Medical Claims Continue to Climb



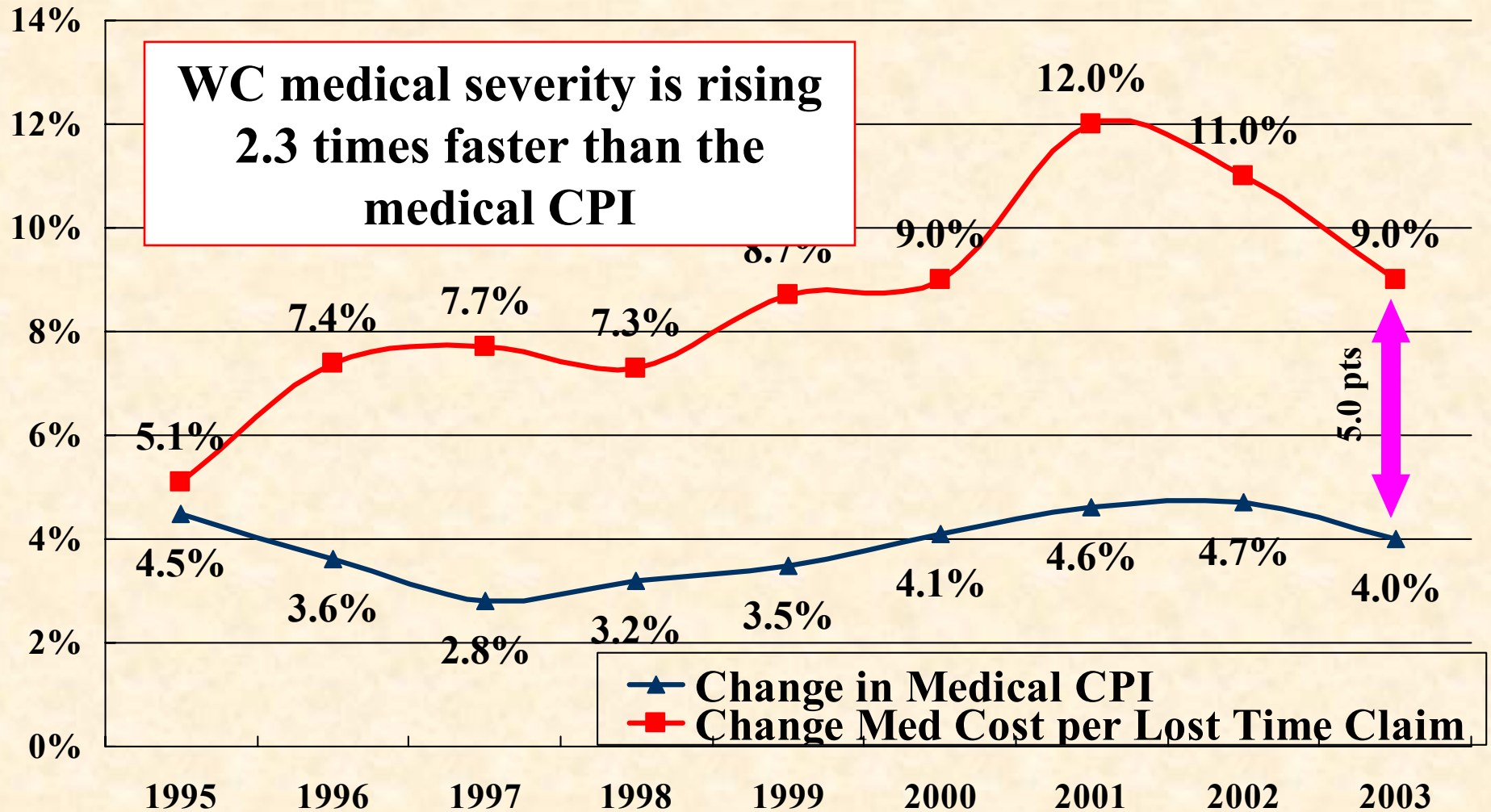
**Medical
Claim Cost (\$000s)**



2003p: Preliminary based on data valued as of 12/31/2003
1991-2002: Based on data through 12/31/2002, developed to ultimate
Based on the states where NCCI provides ratemaking services
Excludes the effects of deductible policies

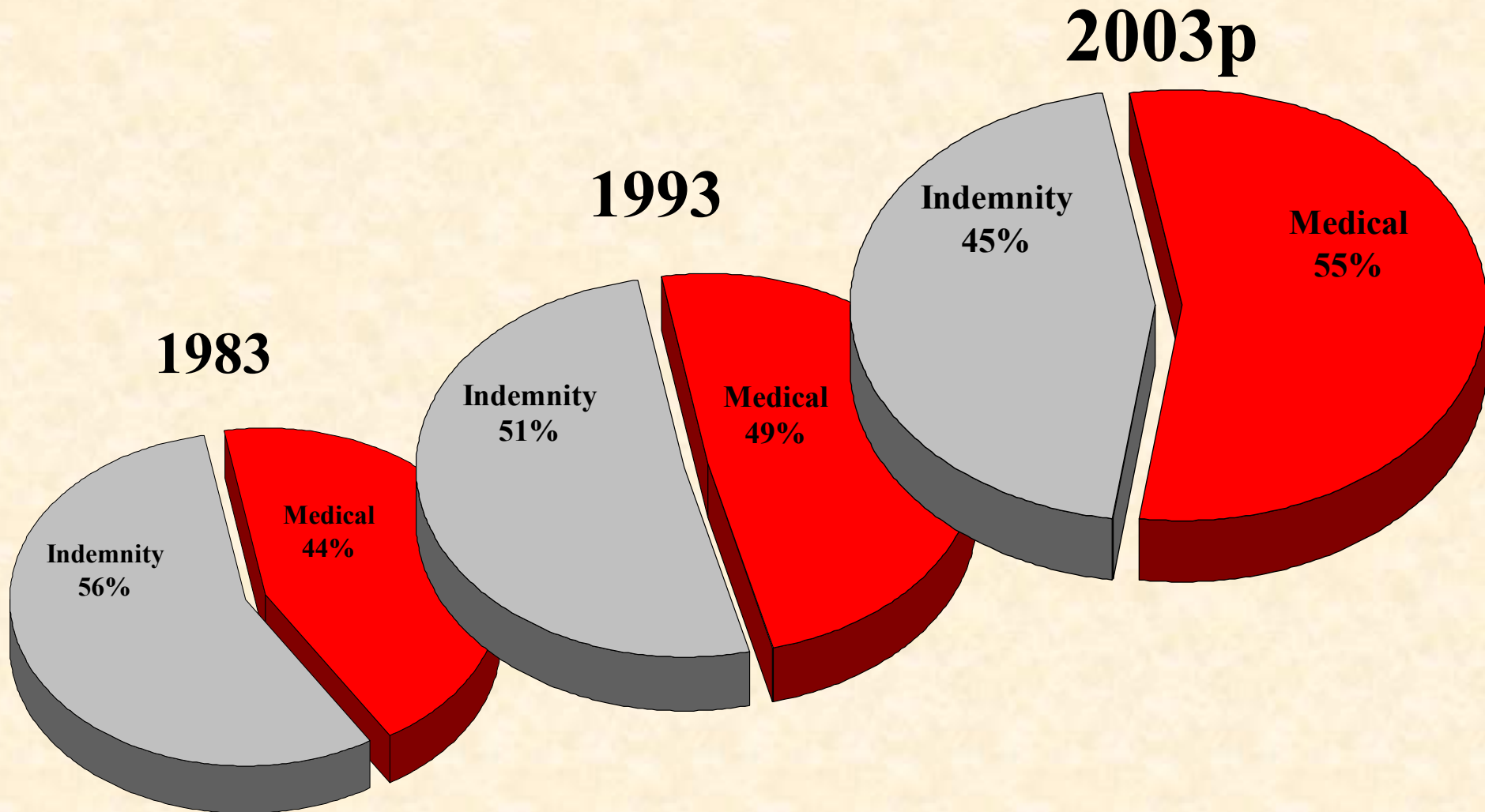


WC Medical Severity Rising Far Faster than Medical CPI





Med Costs Share of Total Costs is Increasing Steadily

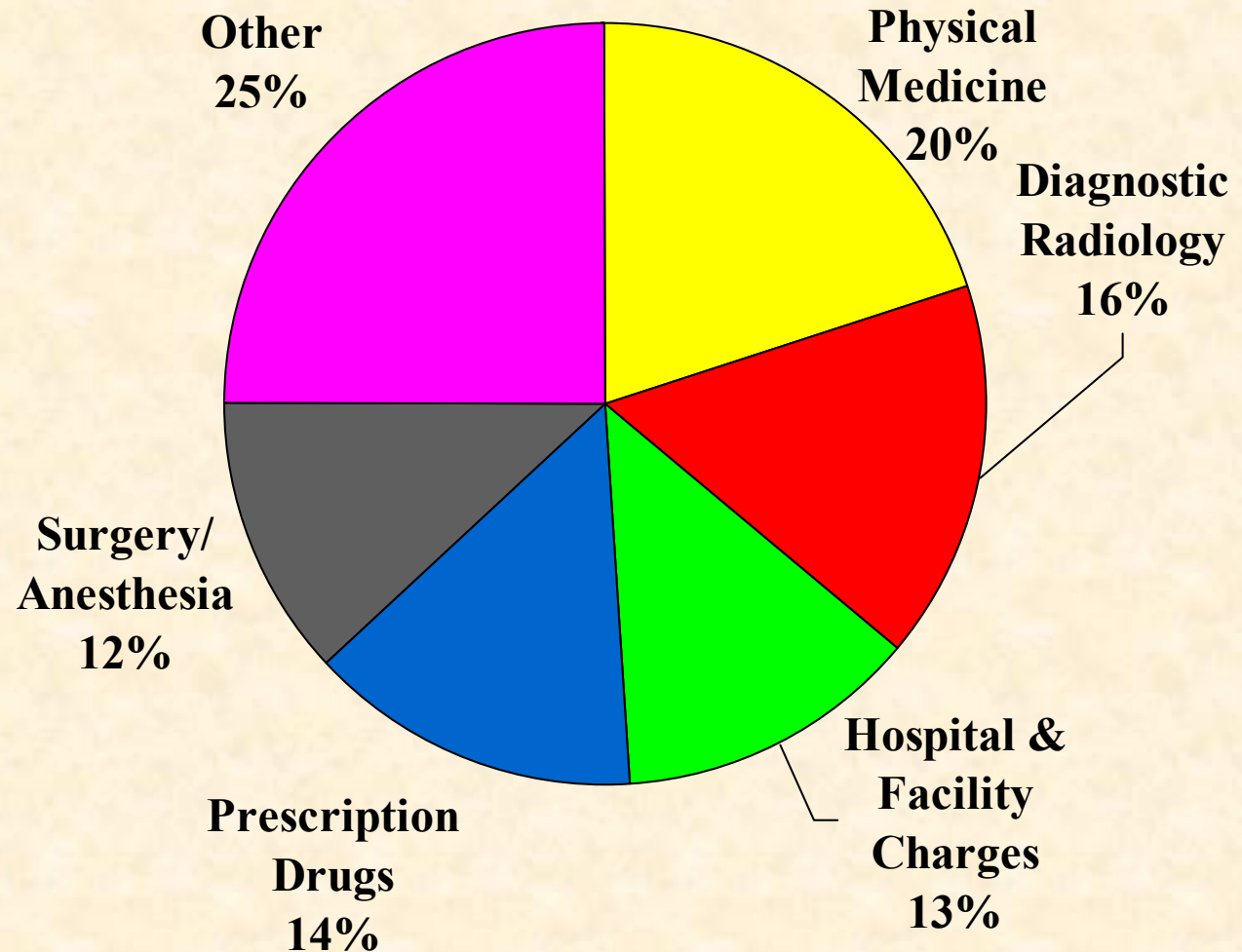


Source: NCCI (based on states where NCCI provides ratemaking services).



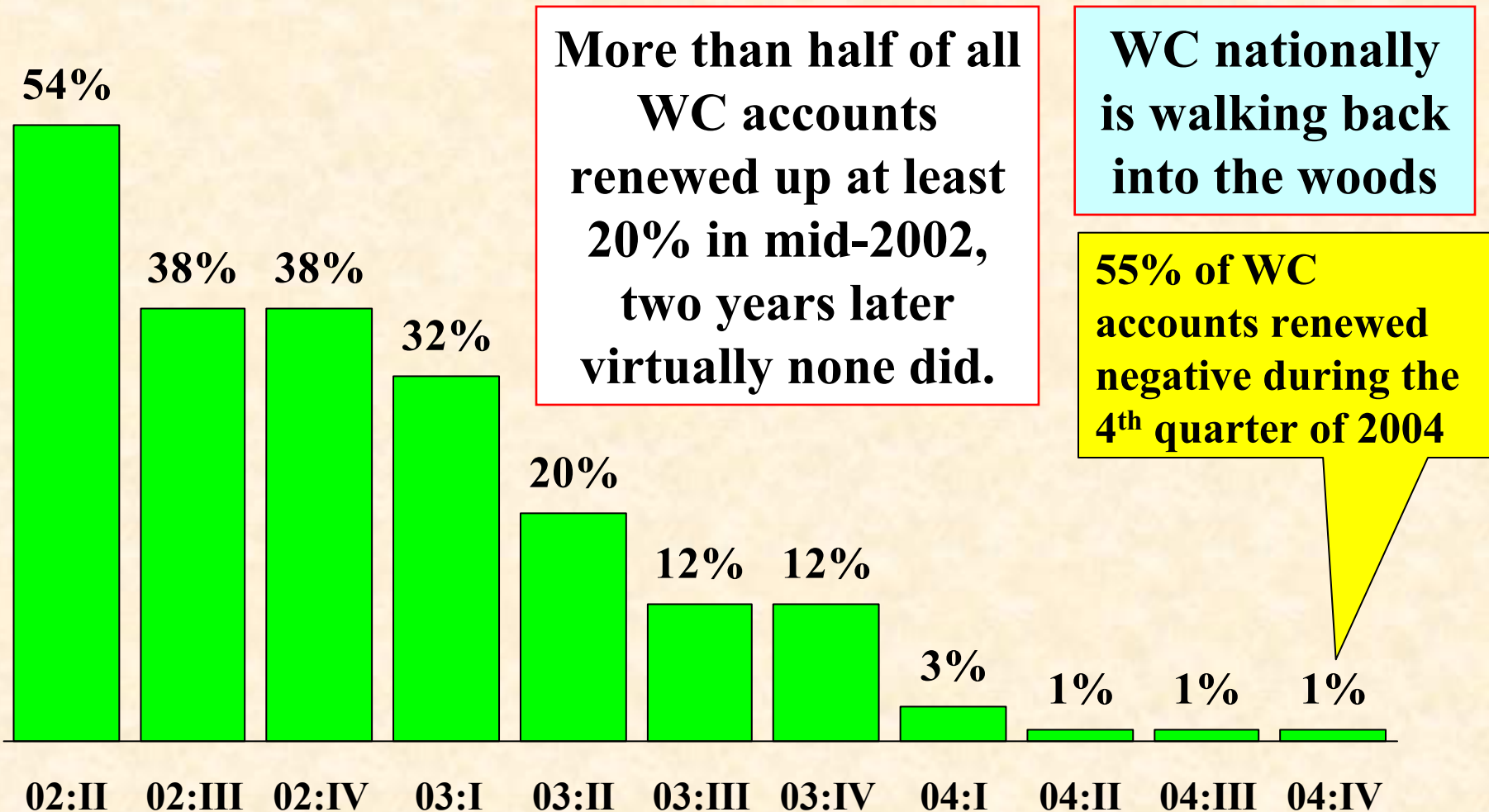
Cost Drivers in Workers Comp

Average rate of inflation in the 5 specific areas is likely to continue at 5%-6% for the indefinite future, which bodes ill given current WC rate environment





Proportion of Workers Comp Accounts Renewing With Increase of 20% or More



California Focus on Workers Compensation



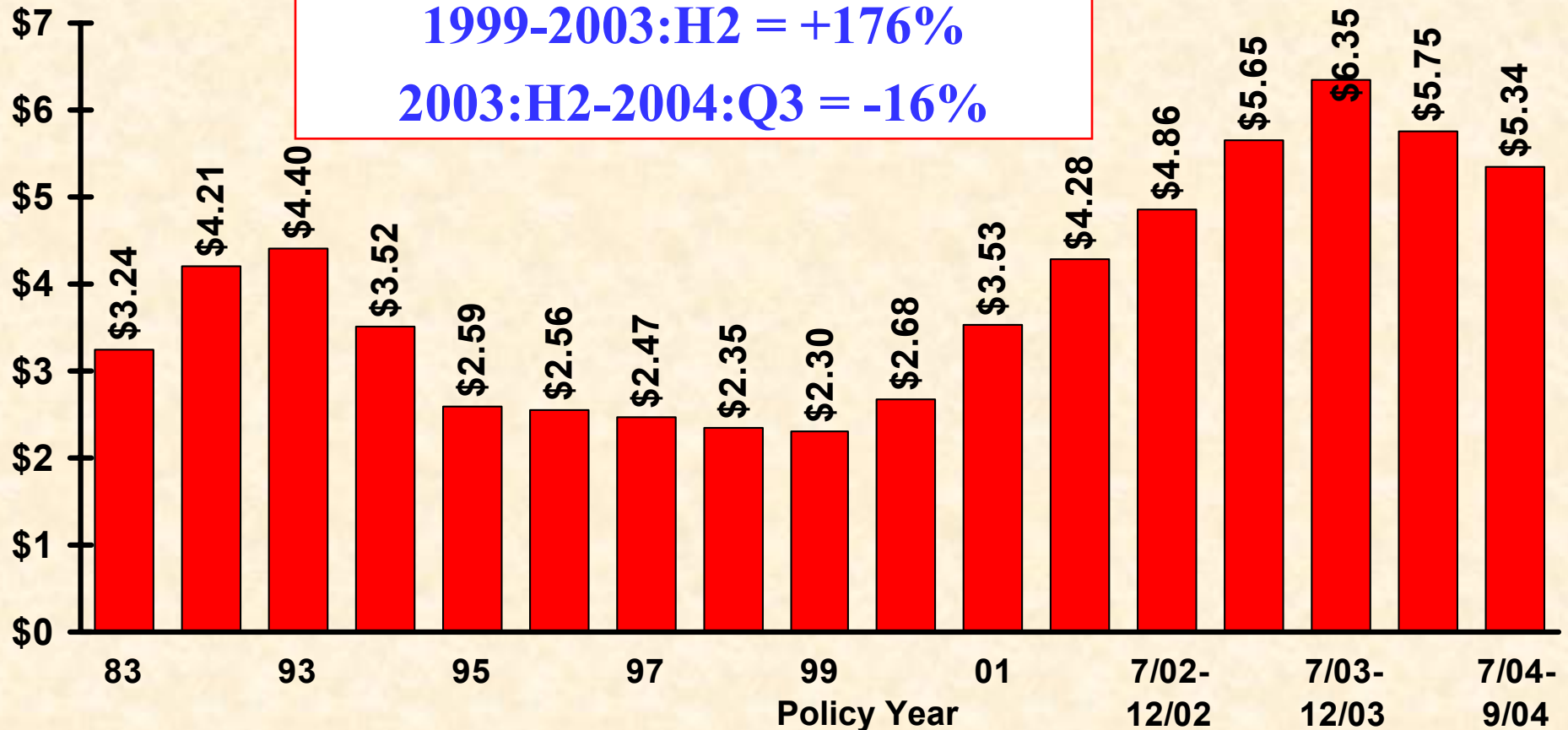


CA: Average Insurer Rate Per \$100 Payroll, 1983-2004:Q3

CA Employer costs for WC are finally falling

1999-2003:H2 = +176%

2003:H2-2004:Q3 = -16%



Source: Workers Compensation Insurance Rating Bureau of California, WCIRB Summary of September 30, 2004 (release date Jan. 12, 2005).

*As of 9/30/04

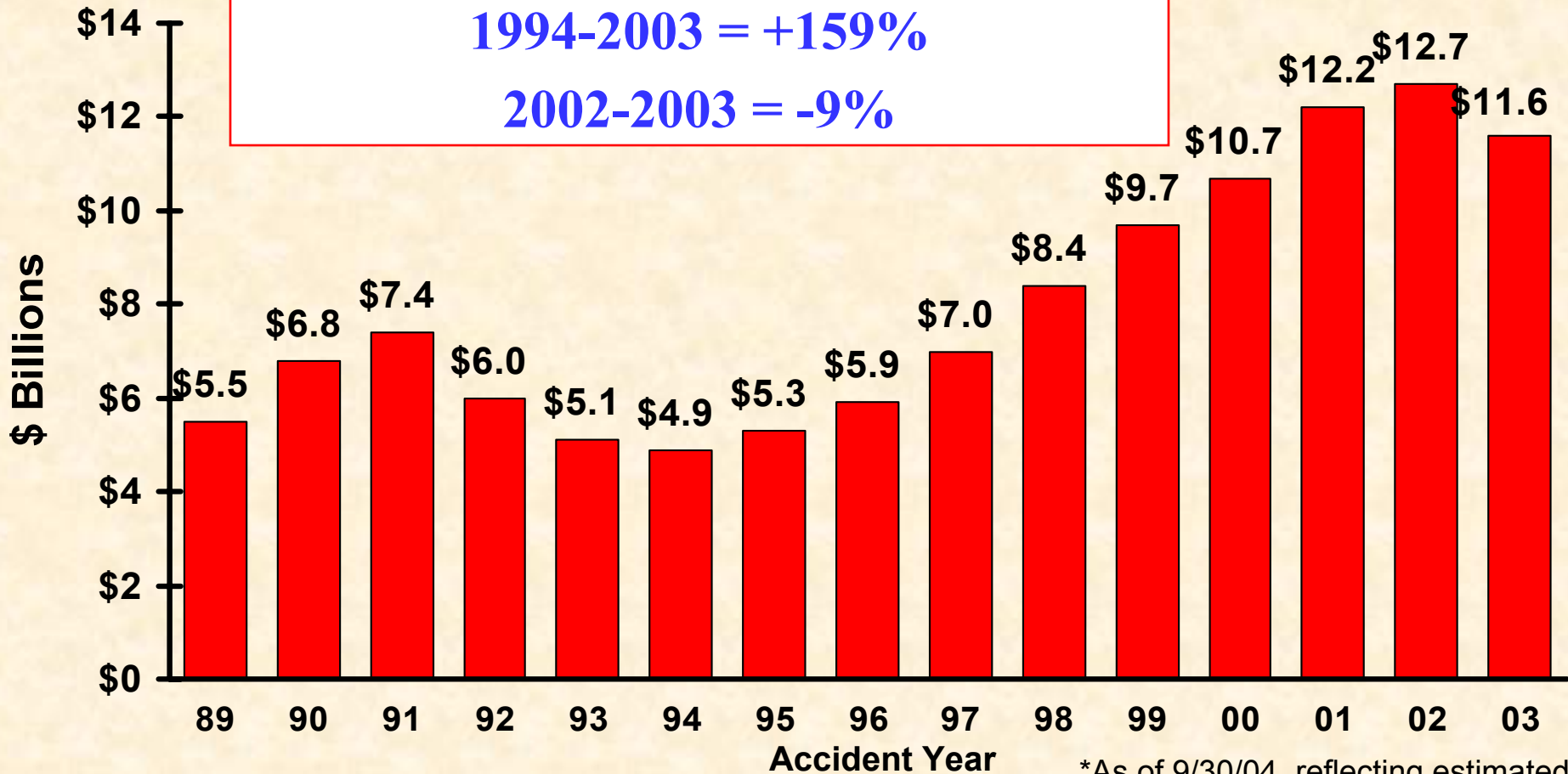


CA: Estimated Ultimate Losses by Accident Year, 1989-2003*

CA Ultimate Losses are Finally Falling

1994-2003 = +159%

2002-2003 = -9%

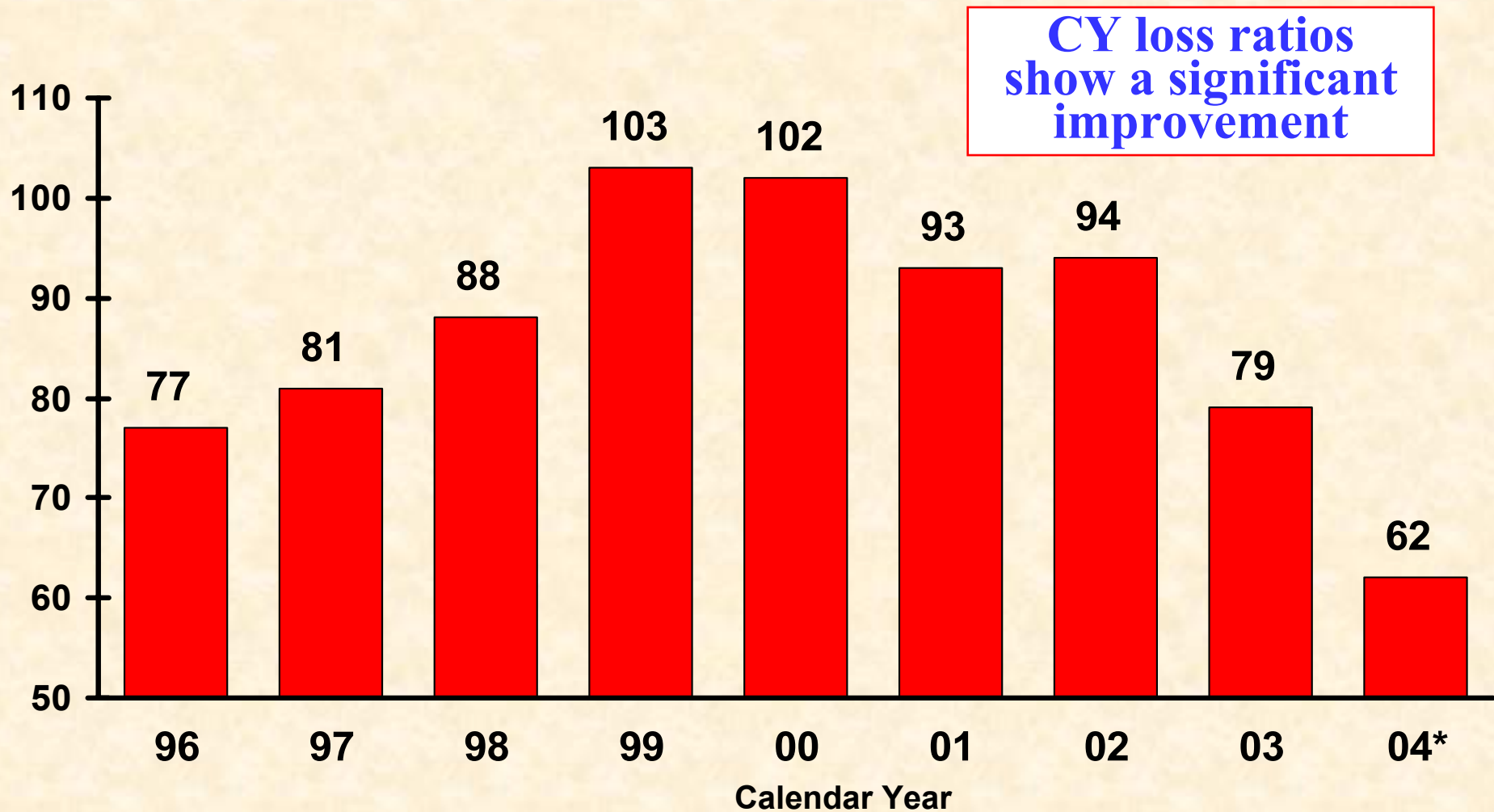


*As of 9/30/04, reflecting estimated impact of AB 227, SB 228 & SB 899 on unpaid losses.

Source: Workers Compensation Insurance Rating Bureau of California, WCIRB Summary of September 30, 2004, (release date Jan. 12, 2005).



CA: Loss Ratios by Calendar Year, 1996-2004*

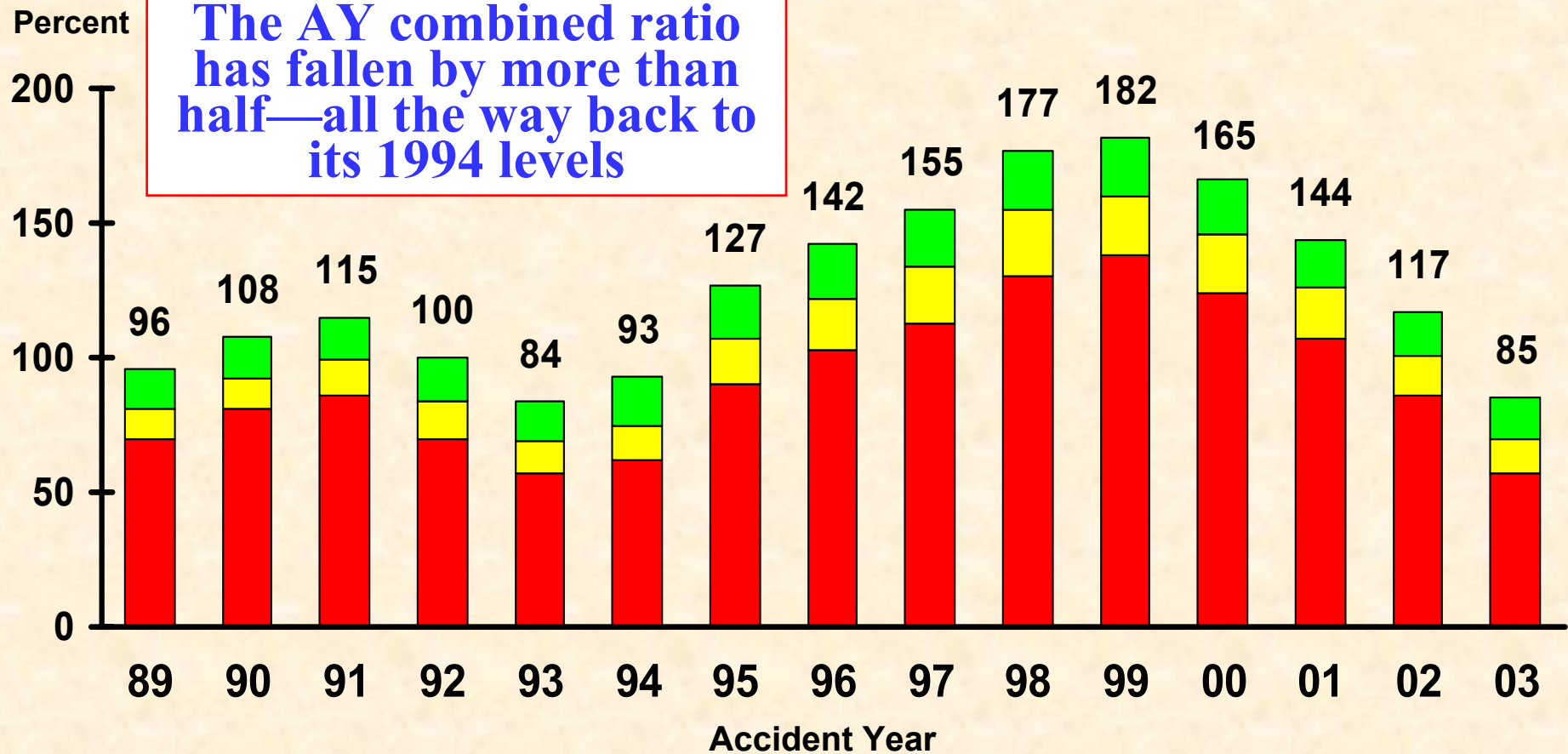


Source: Workers Compensation Insurance Rating Bureau of California,
WCIRB Summary of September 30, 2004, (release date Jan. 12, 2005).

*As of 9/30/04



CA: AY Combined and Loss Ratios, 1989-2003*

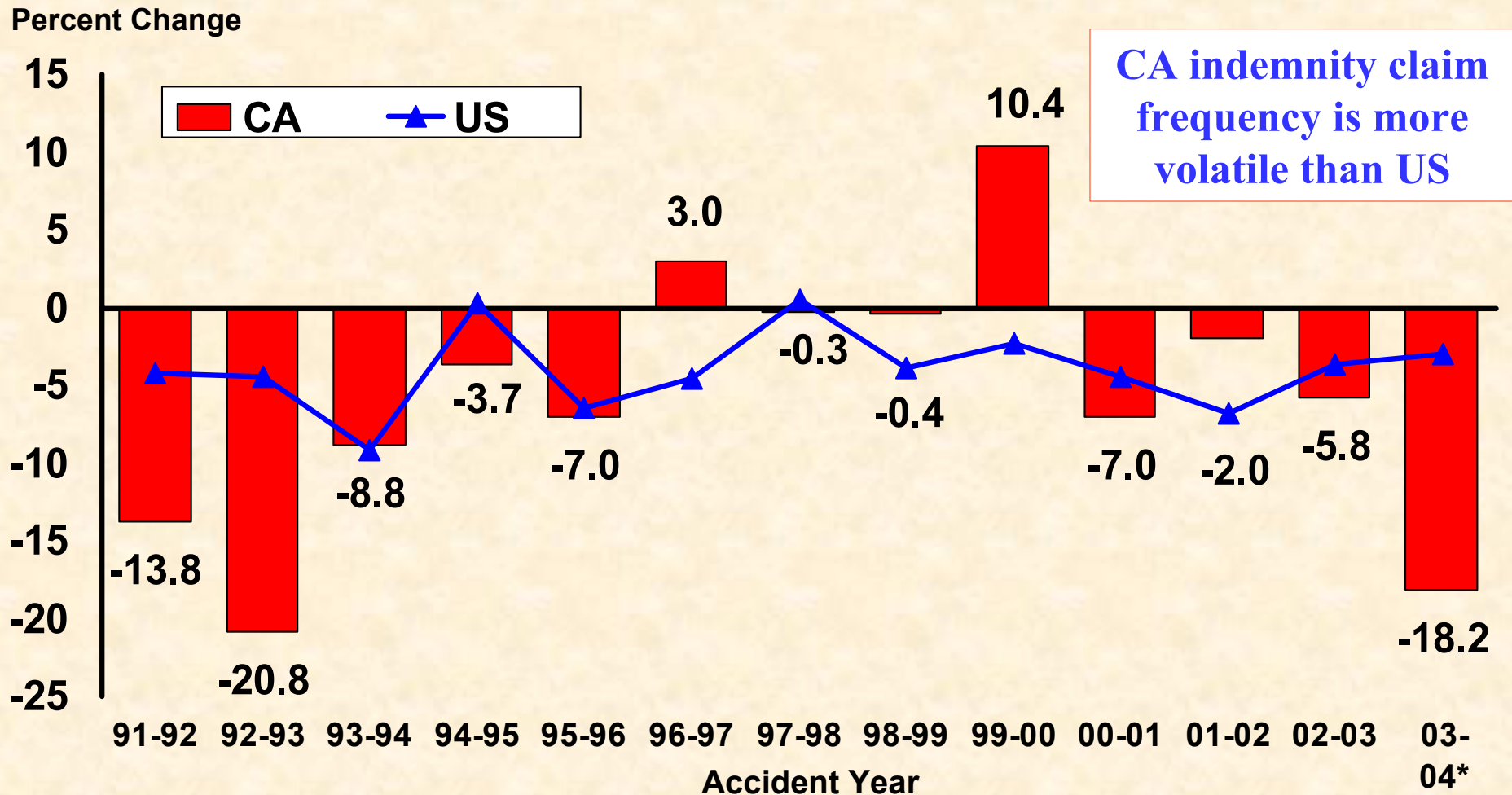


■ Losses ■ LAE ■ Other Expenses

Source: Workers Compensation Insurance Rating Bureau of California, WCIRB Summary of September 30, 2004, (release date Jan. 12, 2005).

*As of 9/30/04, reflecting estimated impact of AB 227, SB 228 & SB 899 on unpaid losses.

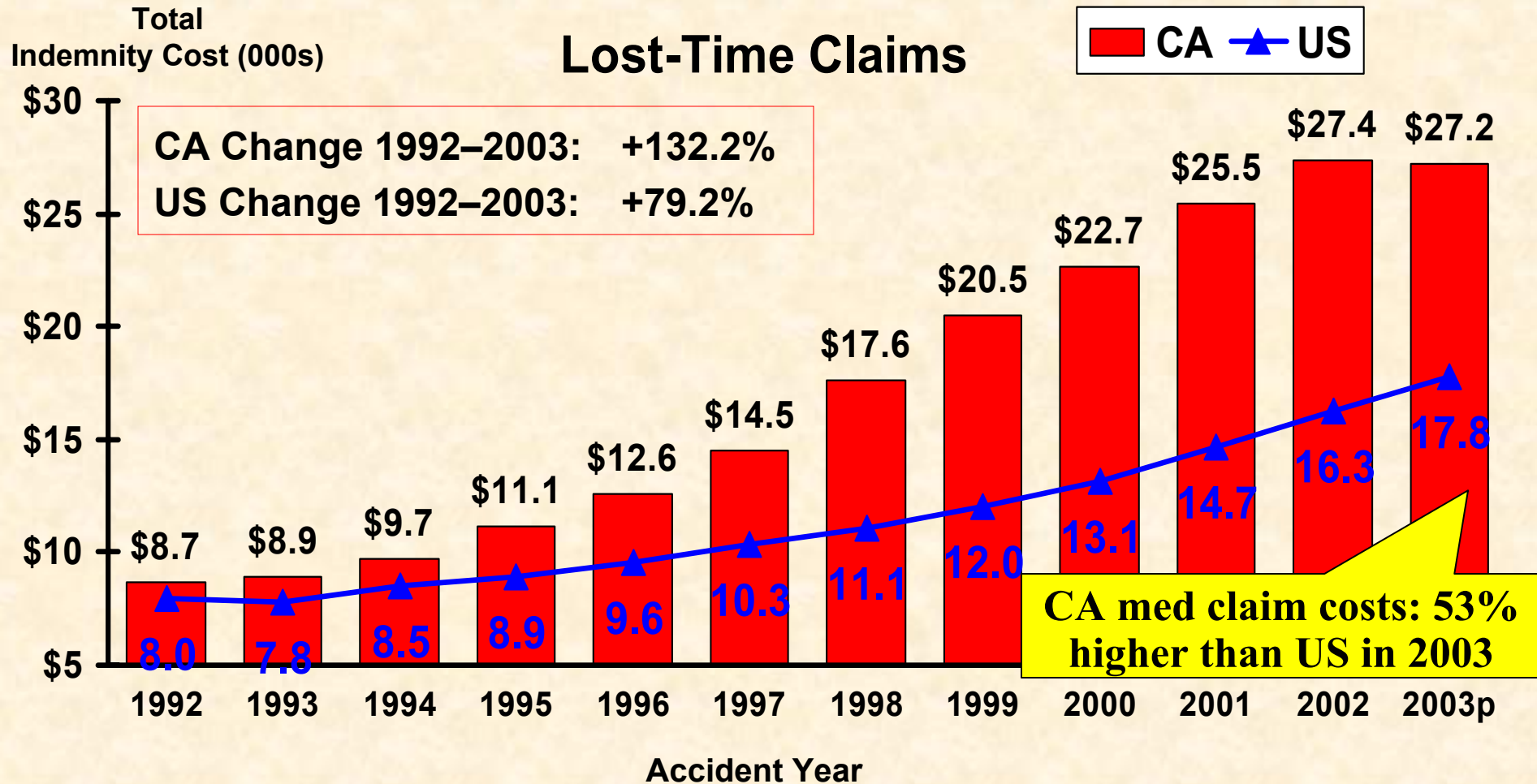
Estimated % Change in Indemnity Claim Frequency, AY 1991-2004*



Source: Workers Compensation Insurance Rating Bureau of California, *WCIRB Summary of September 30, 2004*, (release date Jan. 12, 2005). NCCI for US figures.

*As of 9/30/04 for CA; 12/31/03 for US.

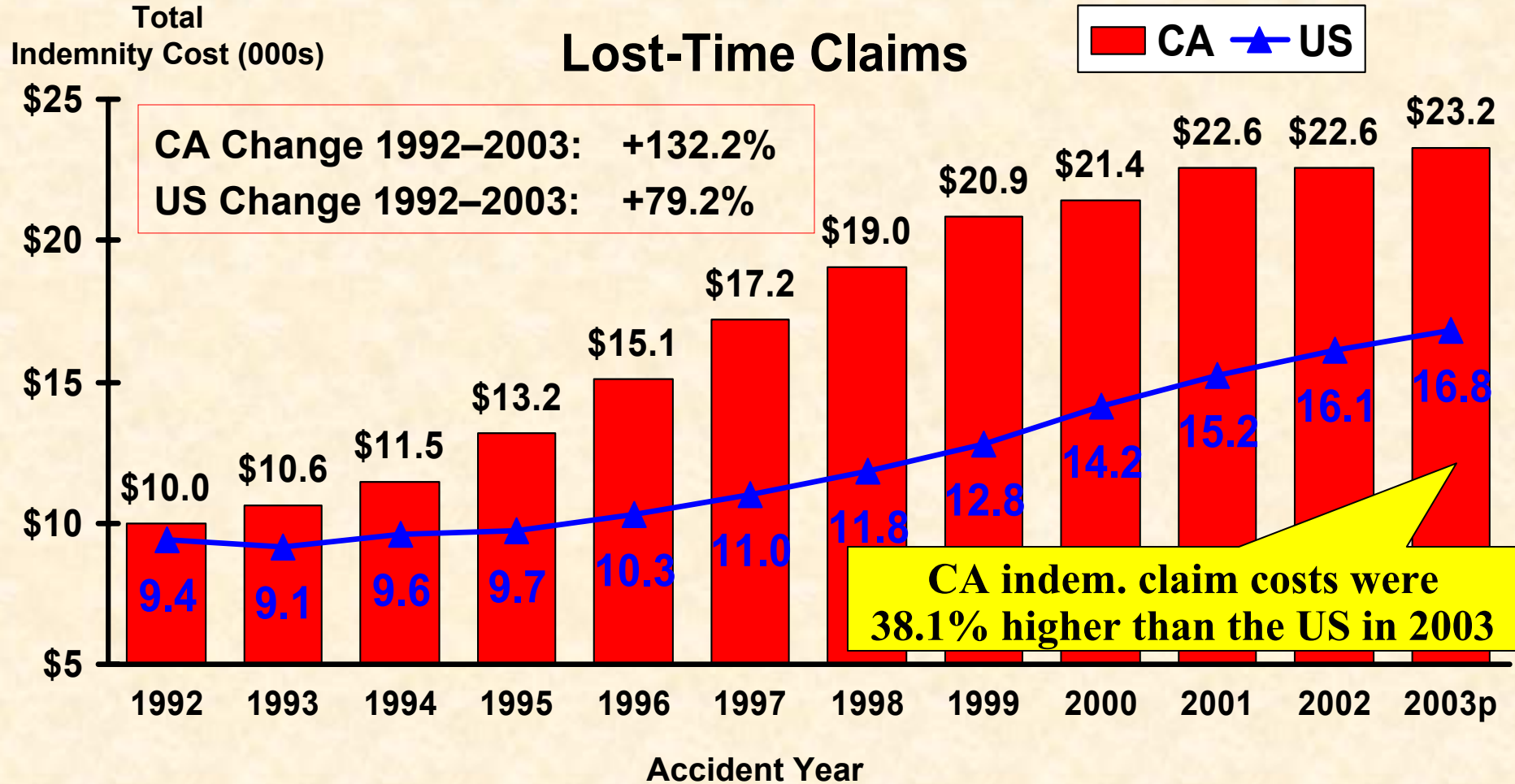
CA vs. US: Est. Ultimate Medical Loss per Indemnity Claim, 1992-2003*



Source: Workers Compensation Insurance Rating Bureau of California, *WCIRB Summary of September 30, 2004*, (release date Jan. 12, 2005). US data from NCCI: 2003 preliminary

*As of 9/30/04, reflecting estimated impact of AB 227, SB 228 & SB 899 on unpaid losses. Excludes med only.

CA vs. US: Est. Ultimate Indemnity Loss per Indemnity Claim, 1992-2003*

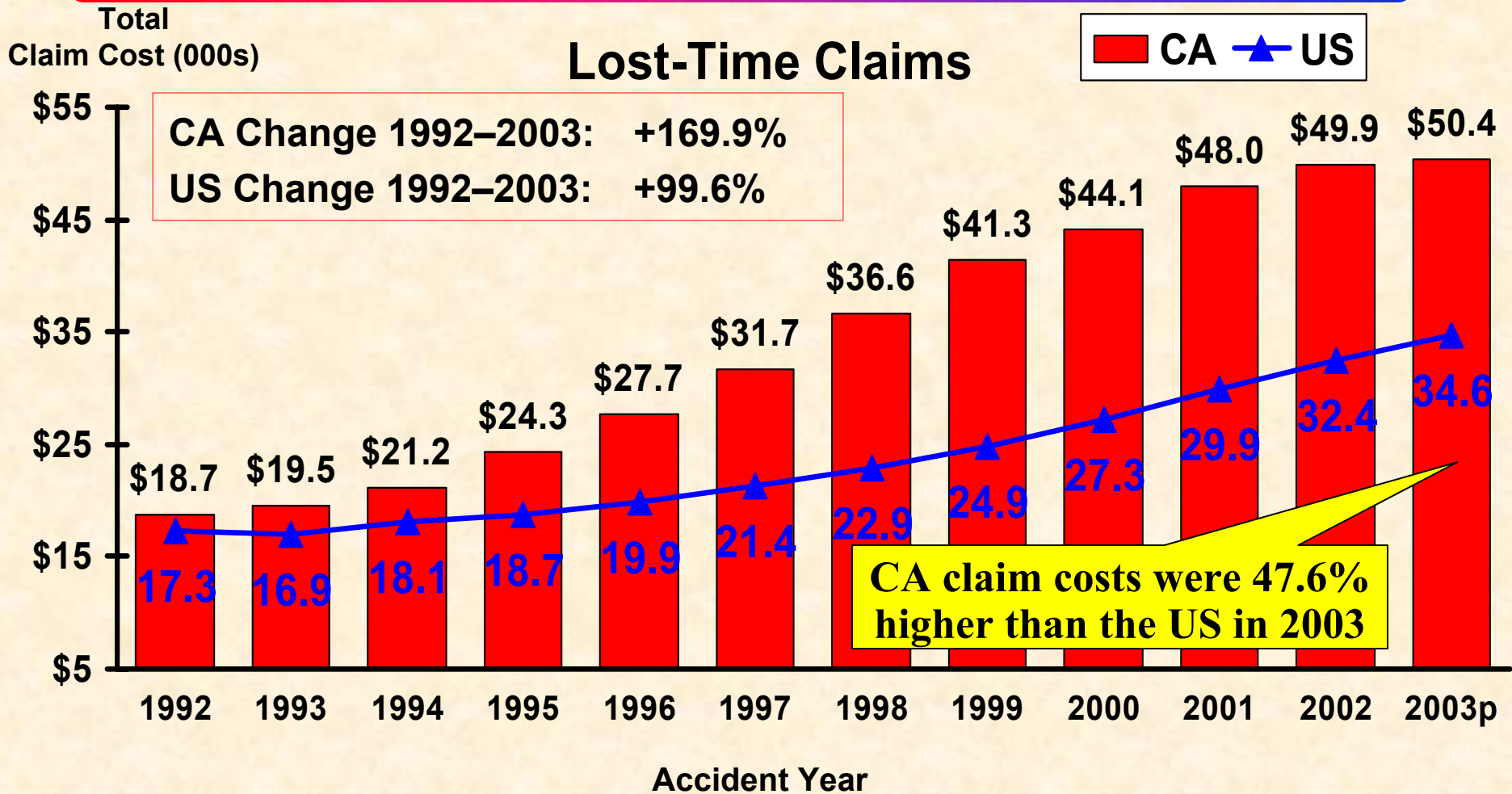


Source: Workers Compensation Insurance Rating Bureau of California, *WCIRB Summary of September 30, 2004*, (release date Jan. 12, 2005).
 US data from NCCI: 2003 preliminary

*As of 9/30/04, reflecting estimated impact of AB 227, SB 228 & SB 899 on unpaid losses.



CA vs. US: Est. Ultimate Total Loss per Indemnity Claim, 1992-2003*

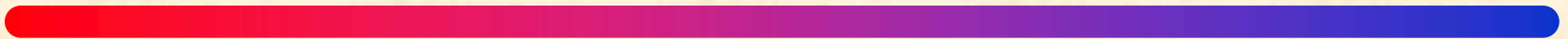


Source: Workers Compensation Insurance Rating Bureau of California, *WCIRB Summary of September 30, 2004*, (release date Jan. 12, 2005). US data from NCCI: 2003 preliminary.

*As of 9/30/04, reflecting estimated impact of AB 227, SB 228 & SB 899 on unpaid losses. Excludes med only.

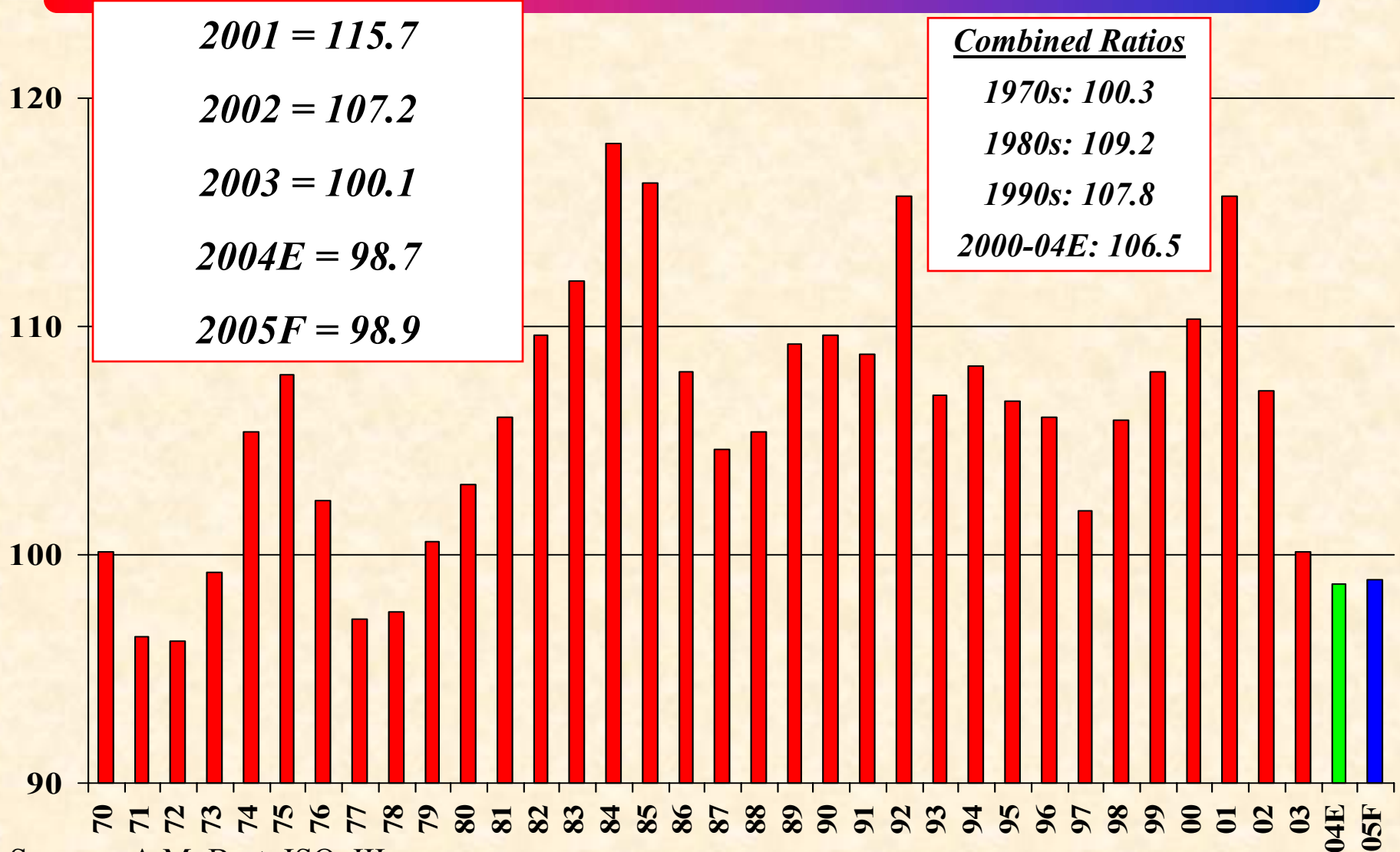
UNDERWRITING PERFORMANCE:

US & California





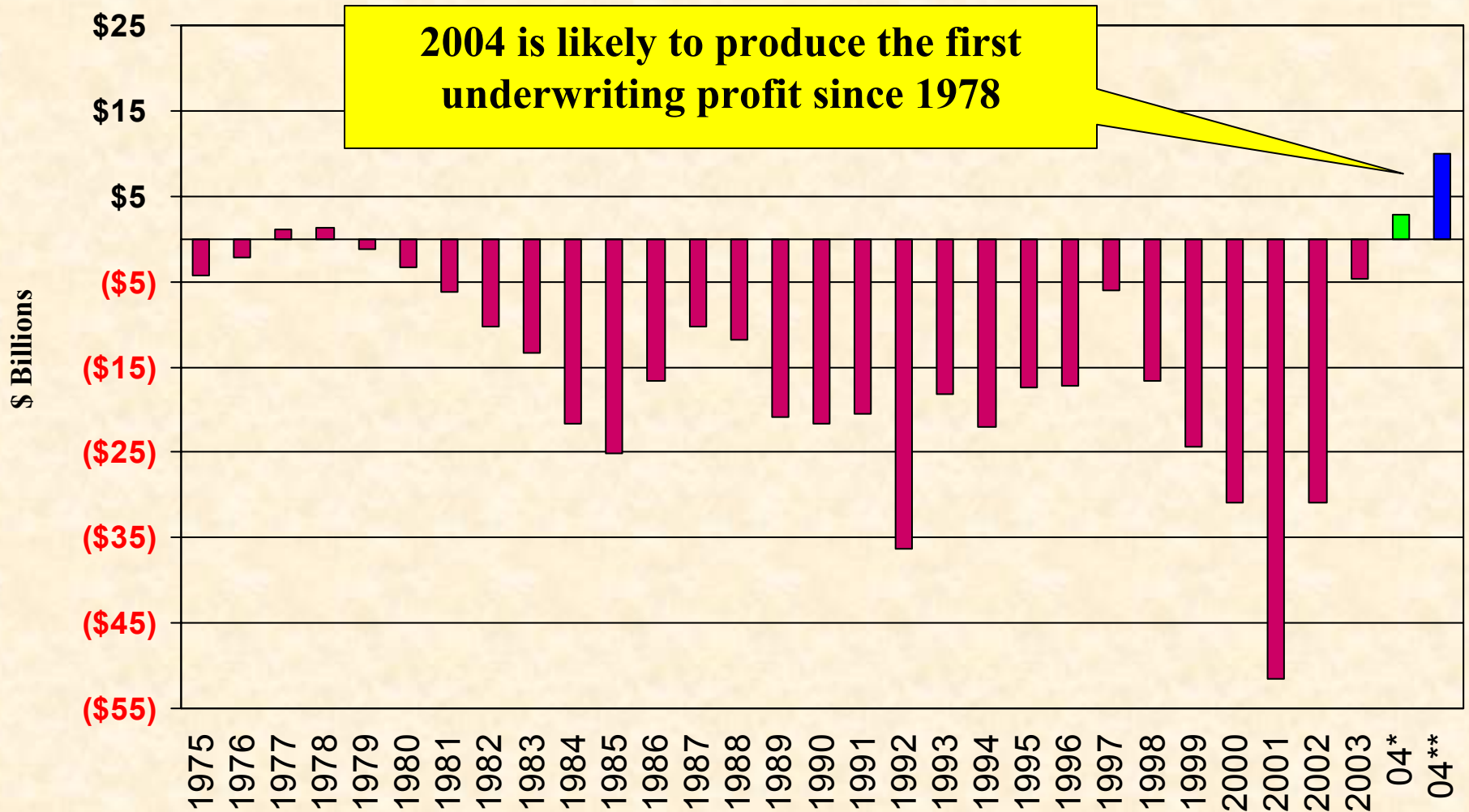
P/C Industry Combined Ratio





Underwriting Gain (Loss)

1975-2004F



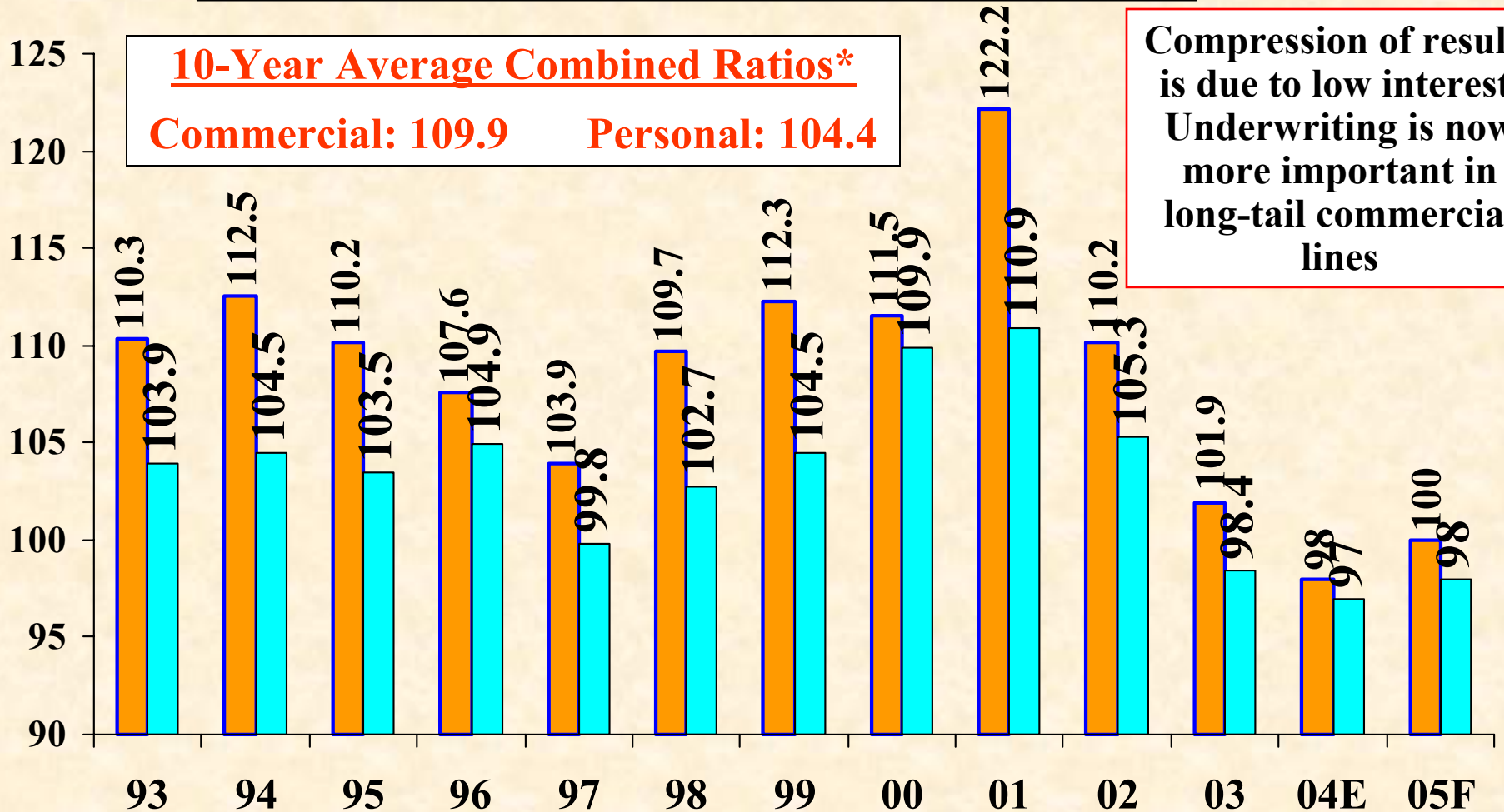
*Based on 9-month result.

Source: A.M. Best, Insurance Information Institute



Commercial vs. Personal Lines Combined Ratios

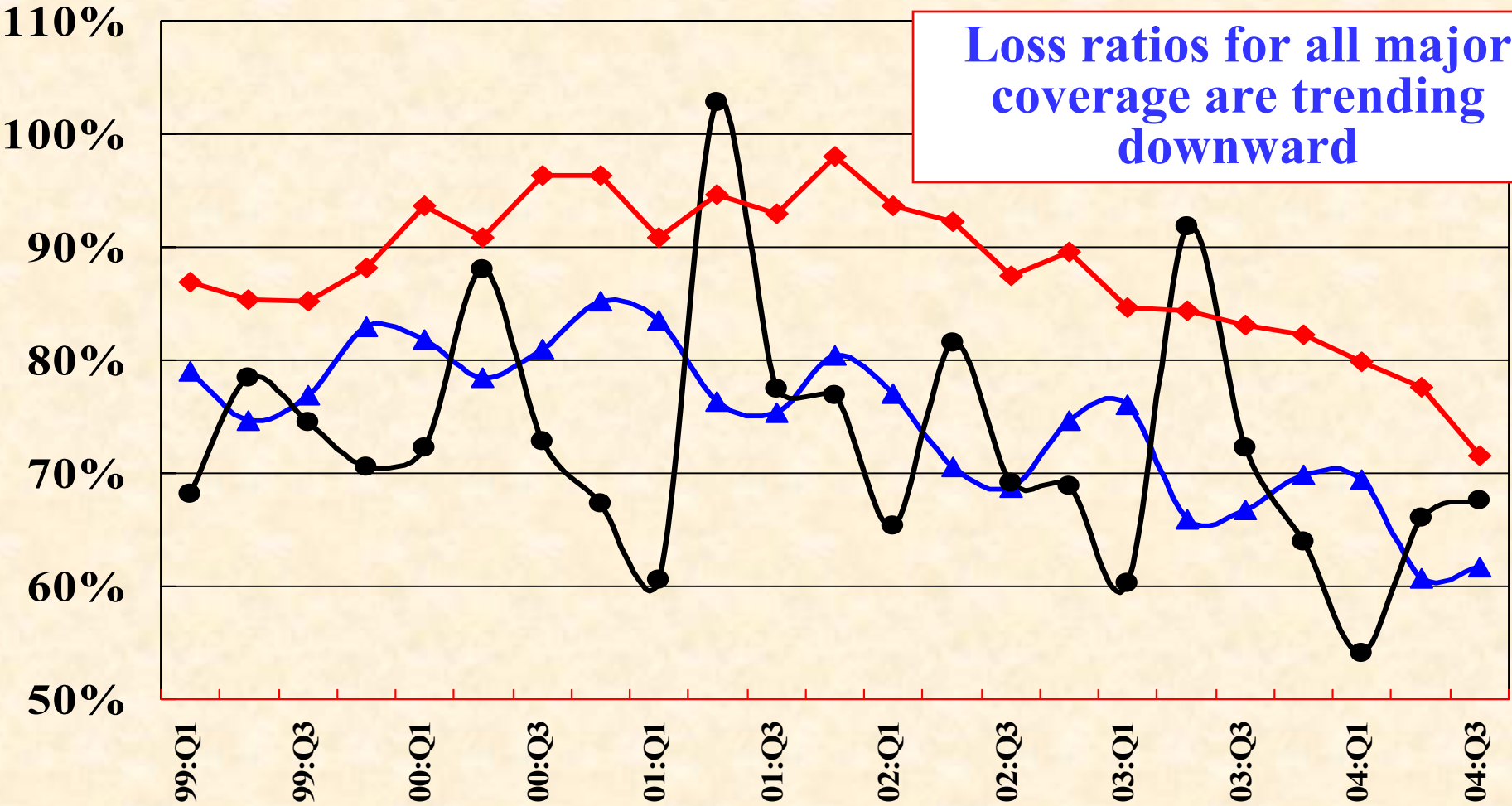
Commercial--Net Basis Personal--Net Basis





Private Passenger Auto: Incurred Loss Ratios, 1999-2004:Q3

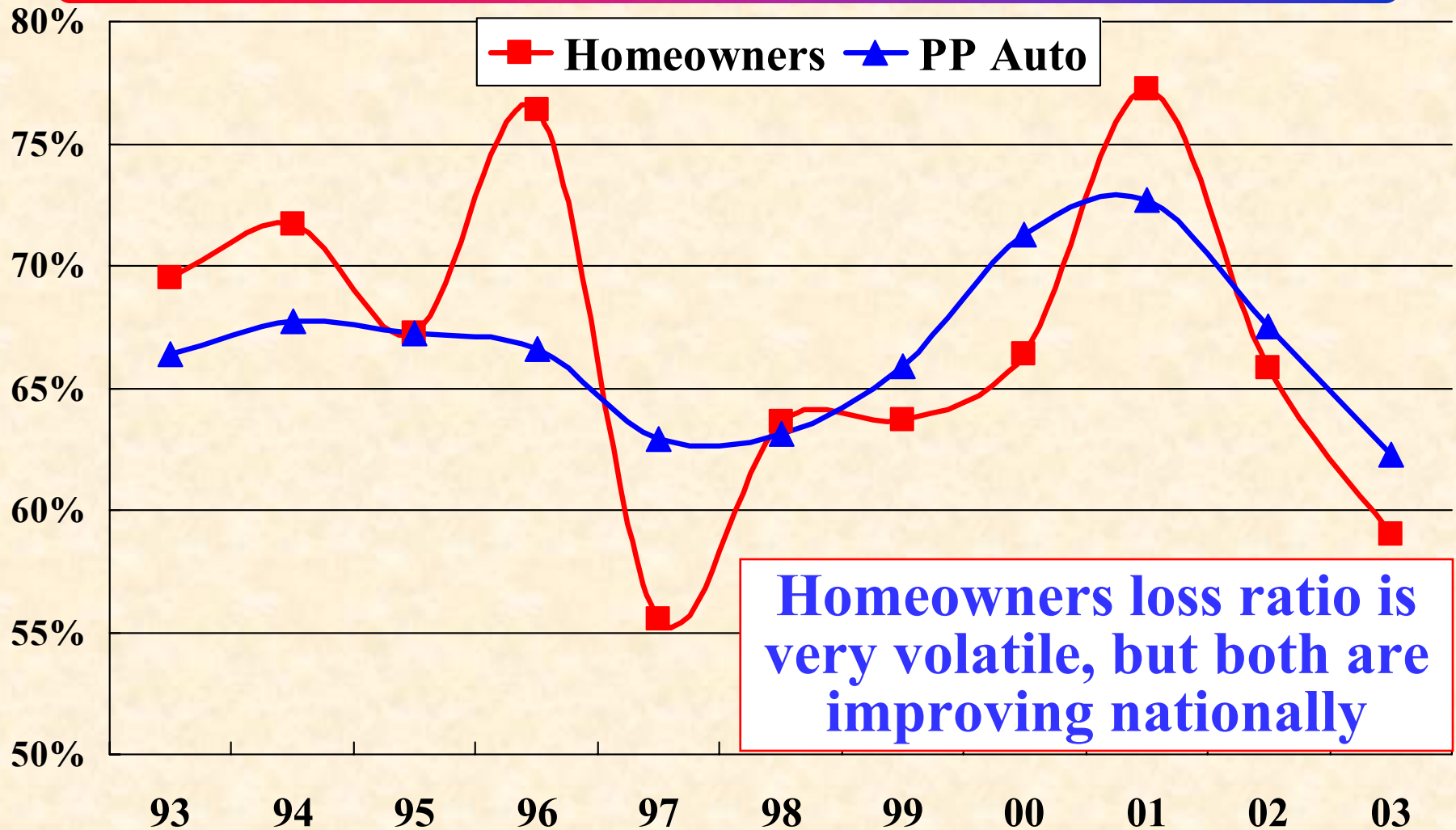
▲ Collision ● Comprehensive ◆ Liability (BI & PD)



Source: ISO Fast Track; Insurance Information Institute.



Loss Ratios: Private Passenger Auto & Homeowners

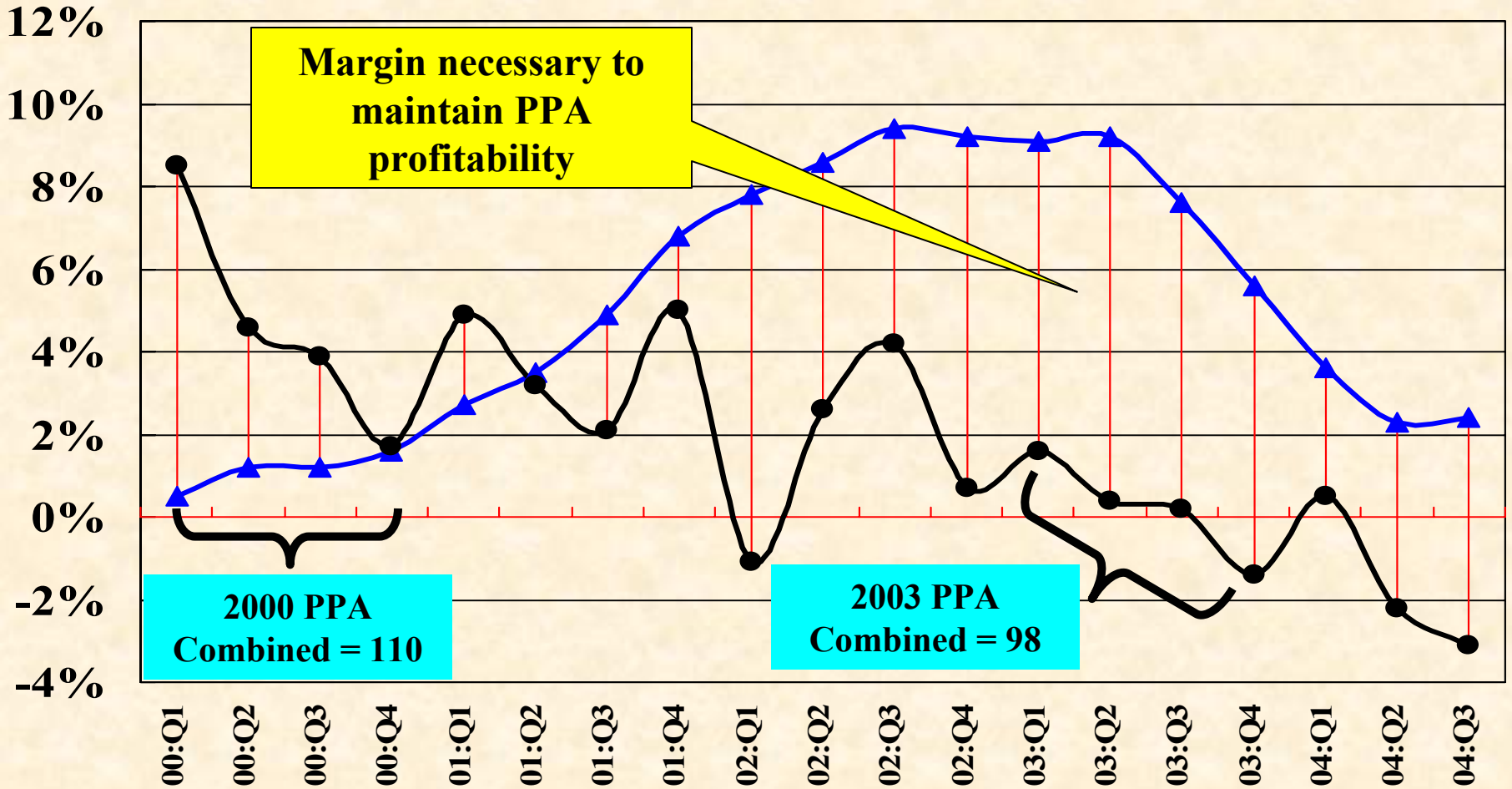


Source: NAIC; 2003 figure from A.M. Best; Insurance Information Institute



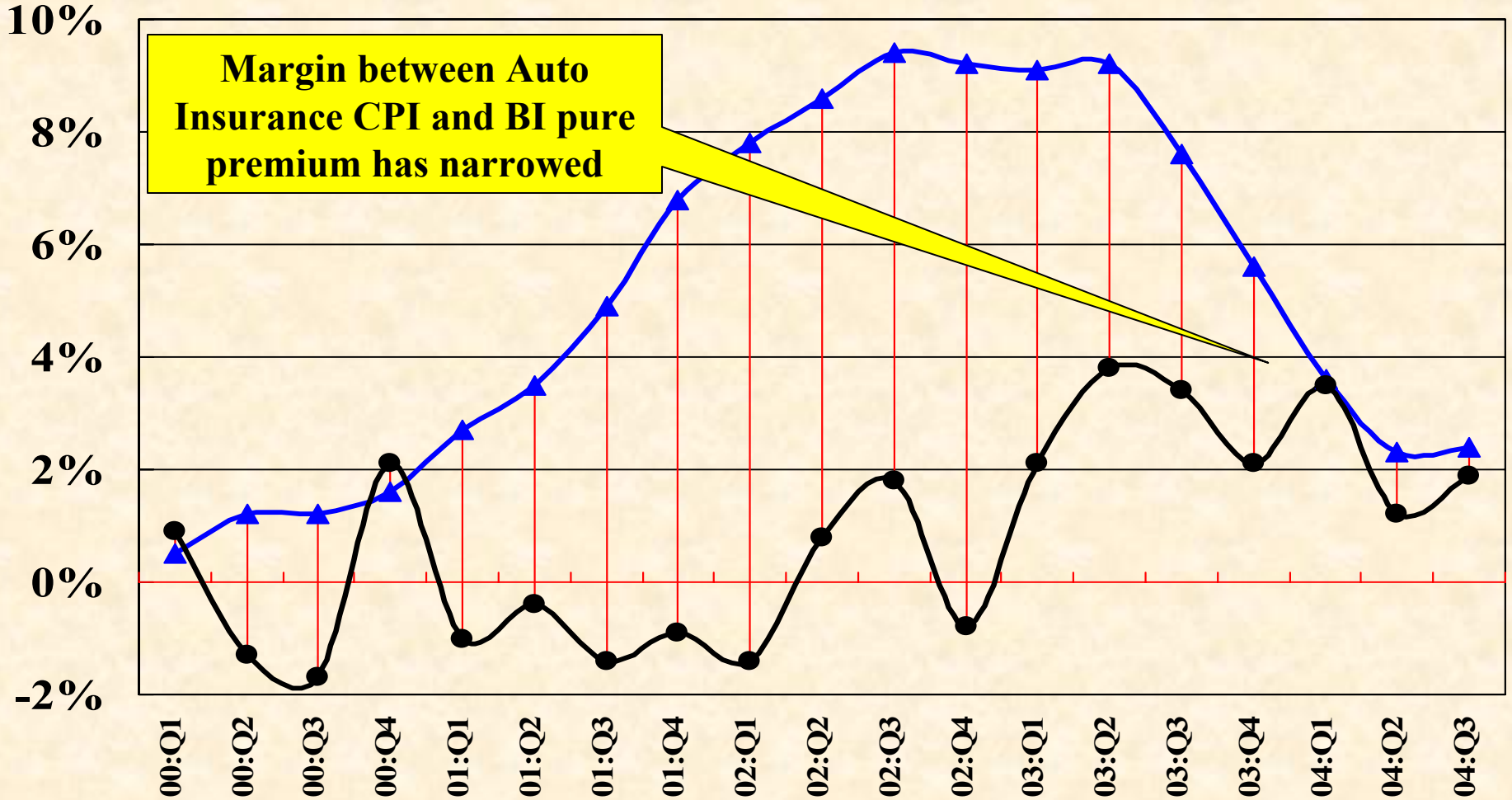
Pure Premium Spread: Personal Auto PD Liability, 2000-2004:Q3

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



Pure Premium Spread: Personal Auto BI Liability, 1999-2004:Q3

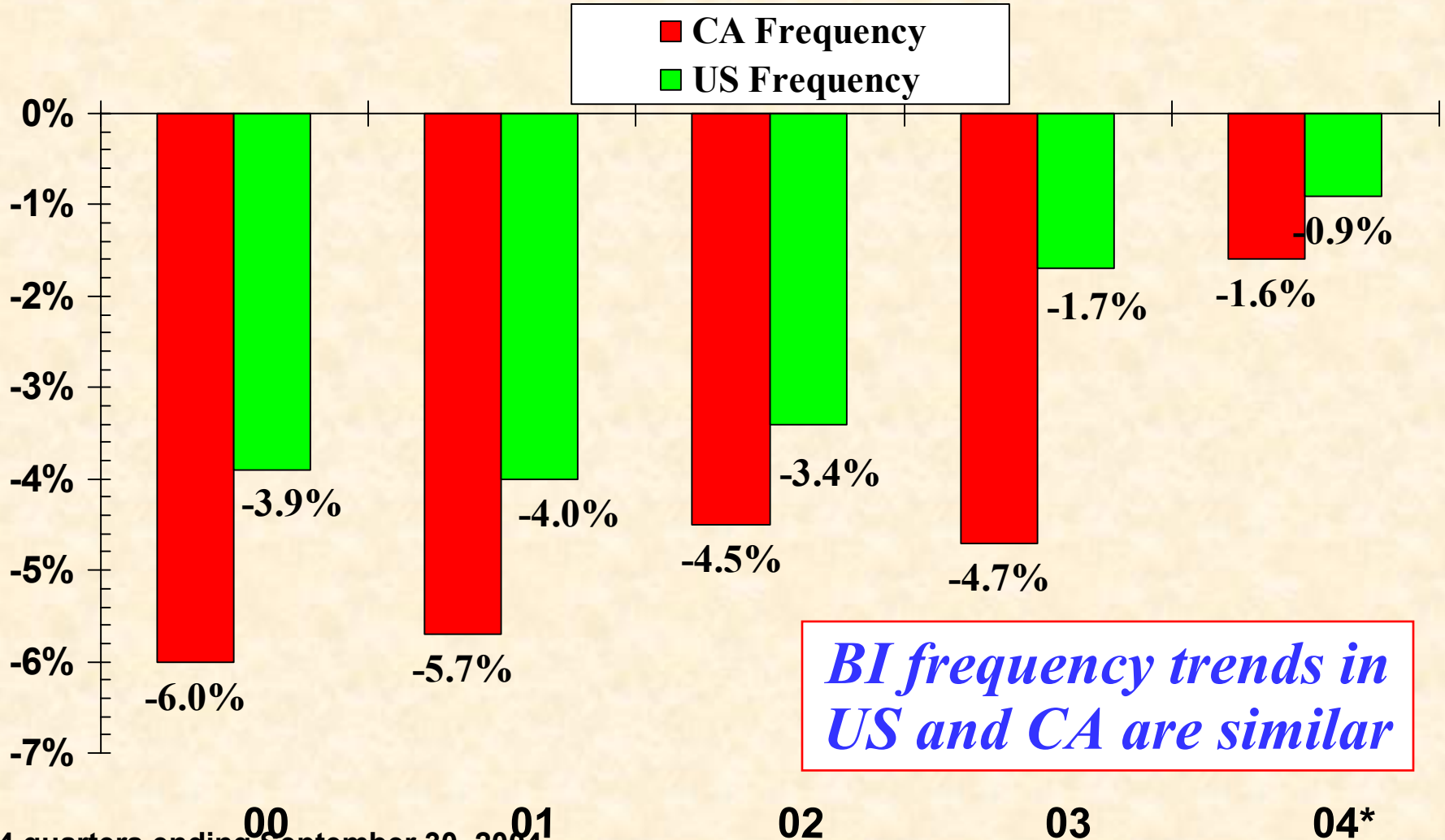
▲ Auto Insurance Component of CPI
 ● Personal Auto-BI Pure Premium



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



PPA Bodily Injury Frequency: US vs. CA

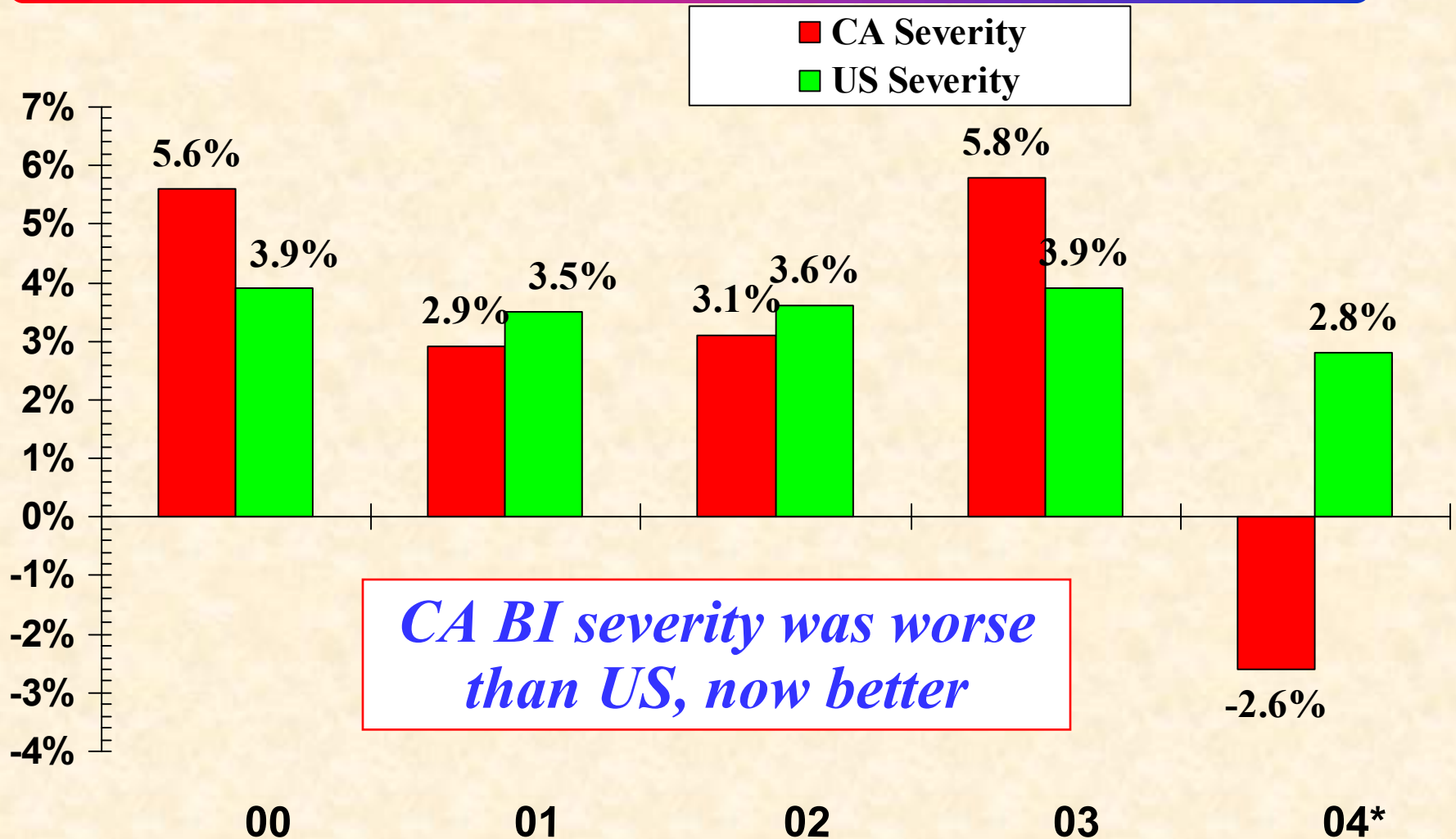


BI frequency trends in US and CA are similar

*4 quarters ending September 30, 2004.
Source: ISO Fast Track data.



PPA Bodily Injury Severity: US vs. CA



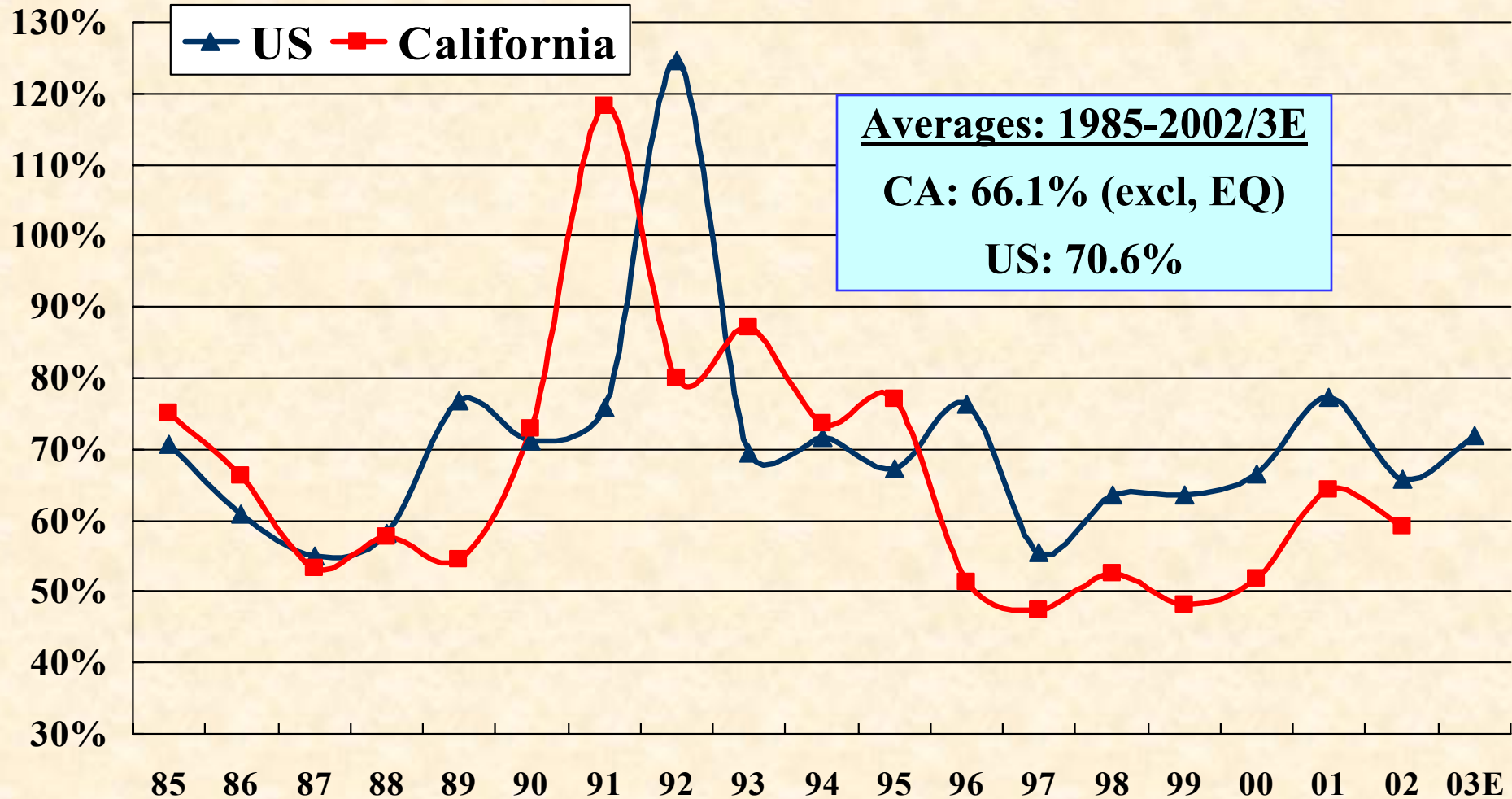
*4 quarters ending September 30, 2004.
Source: ISO Fast Track data.



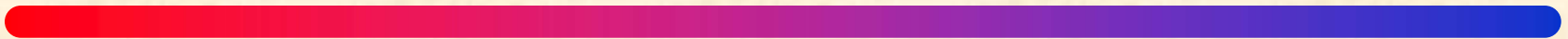
Homeowners Direct Loss

Ratios: CA vs. US

1985-2003E

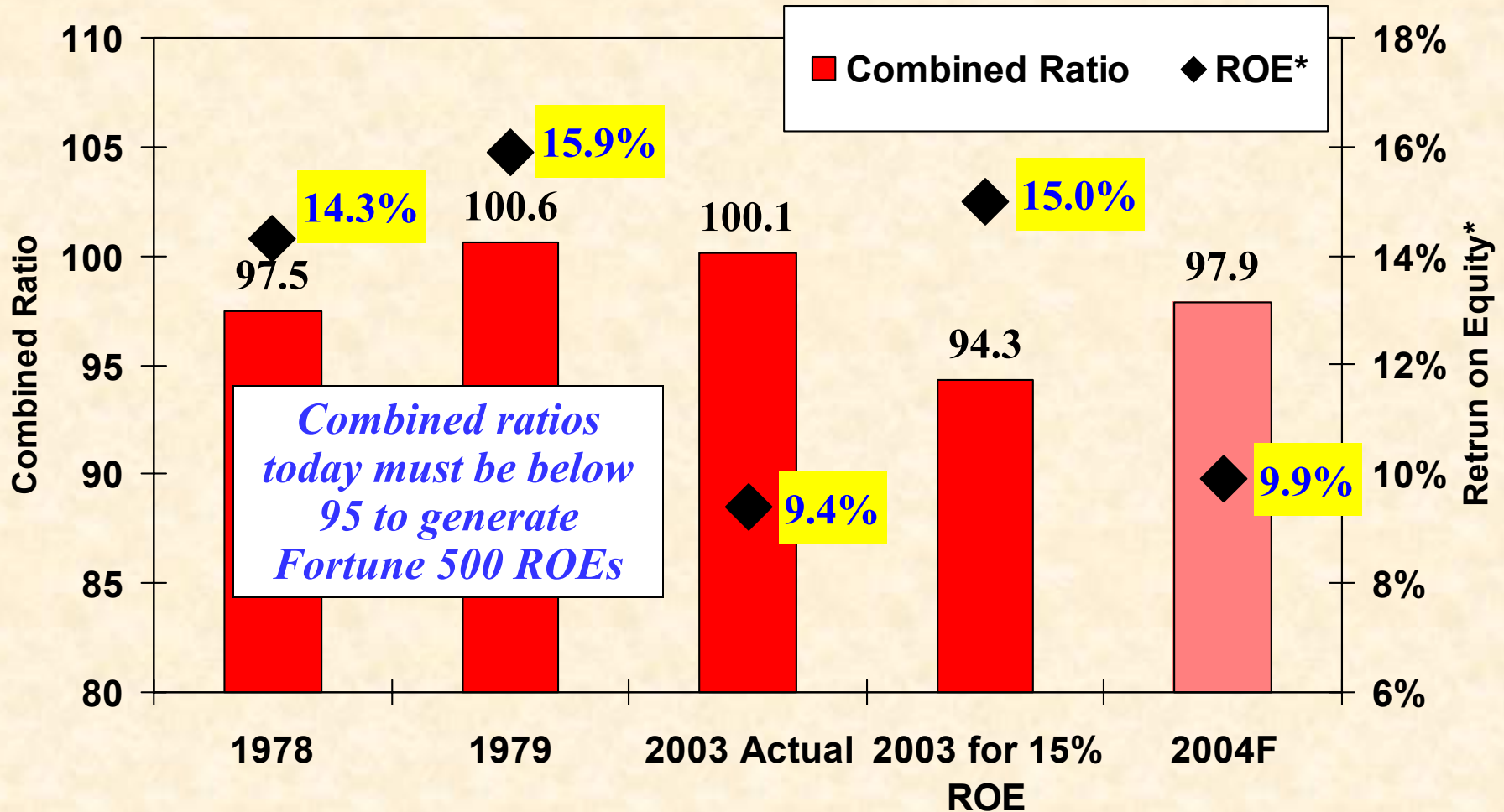


WHY UNDERWRITING DISCIPLINE MATTERS





A 100 Combined Ratio Isn't What it Used to Be: 95 is Where It's At

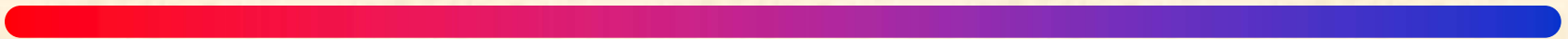


* 2004 figure is return on average statutory surplus based in first 9 months data

Source: Insurance Information Institute from A.M. Best and ISO data.

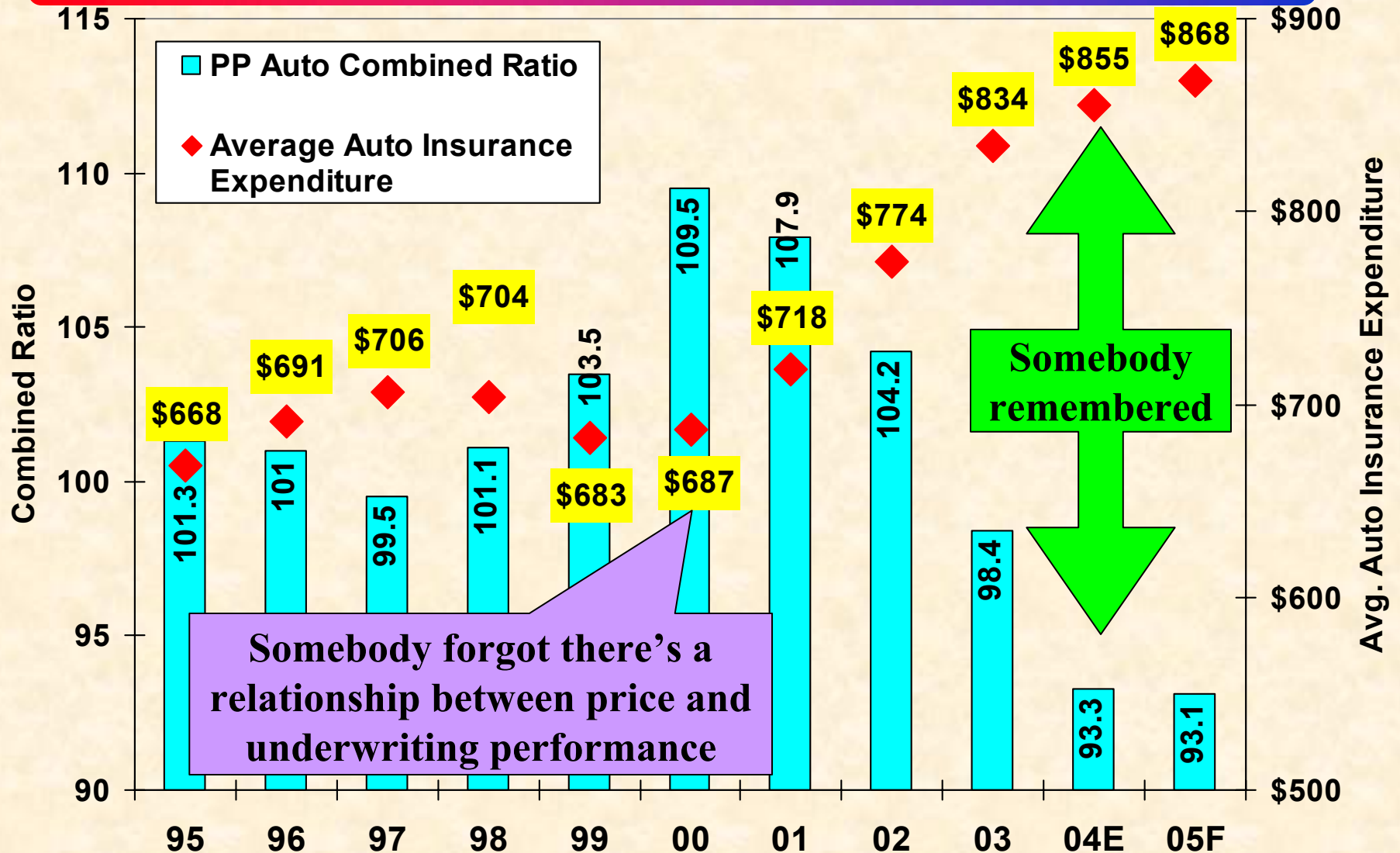
FATAL ATTRACTION?

**A LOSS OF PRICING &
UNDERWRITING
DISCIPLINE**



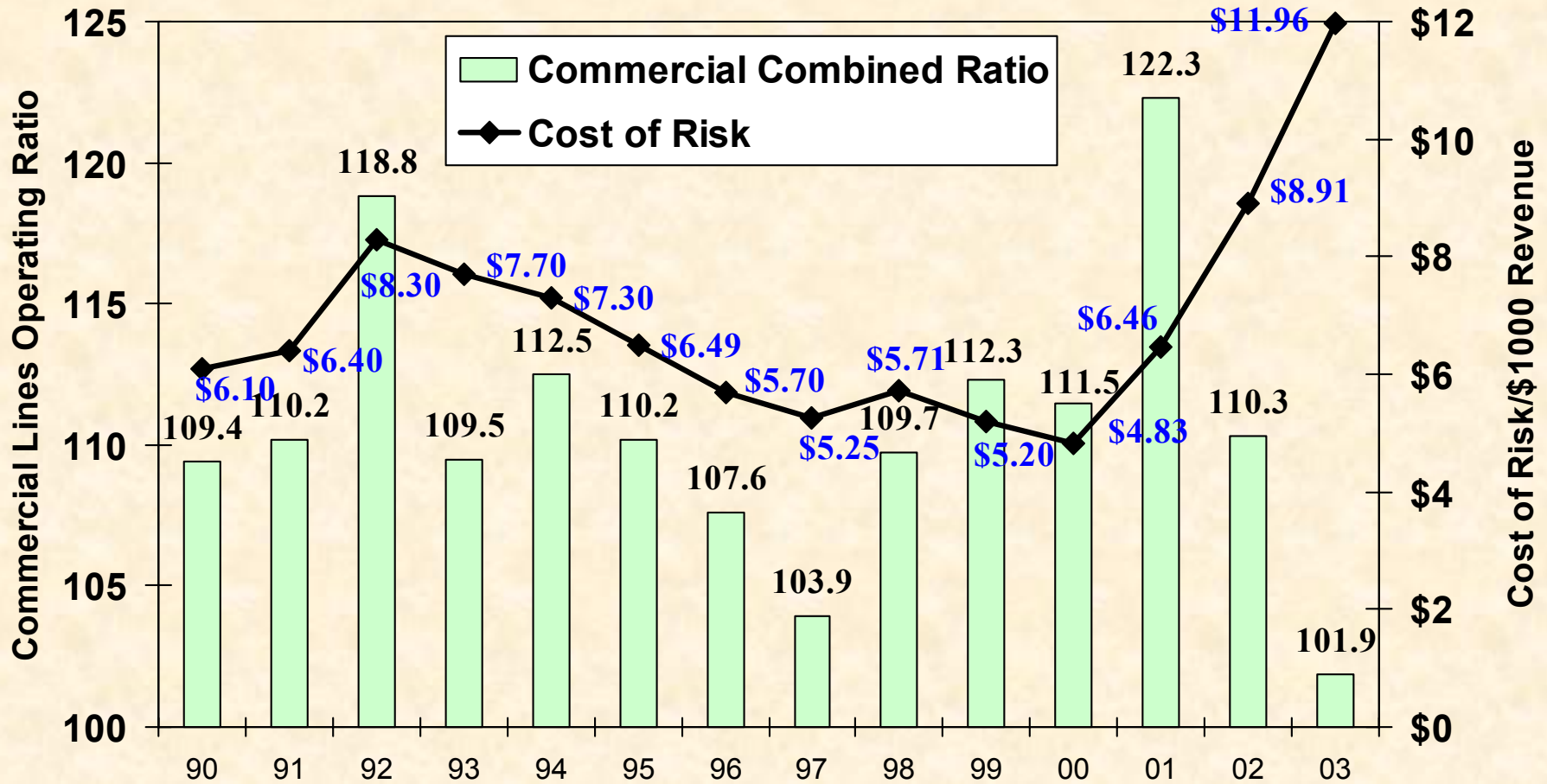


Private Passenger Auto Combined Ratios, 1993-2005F



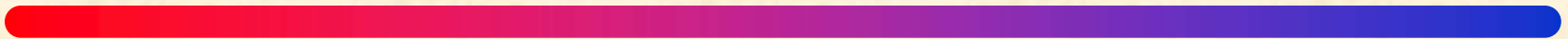


Cost of Risk vs. Commercial Lines Combined Ratio



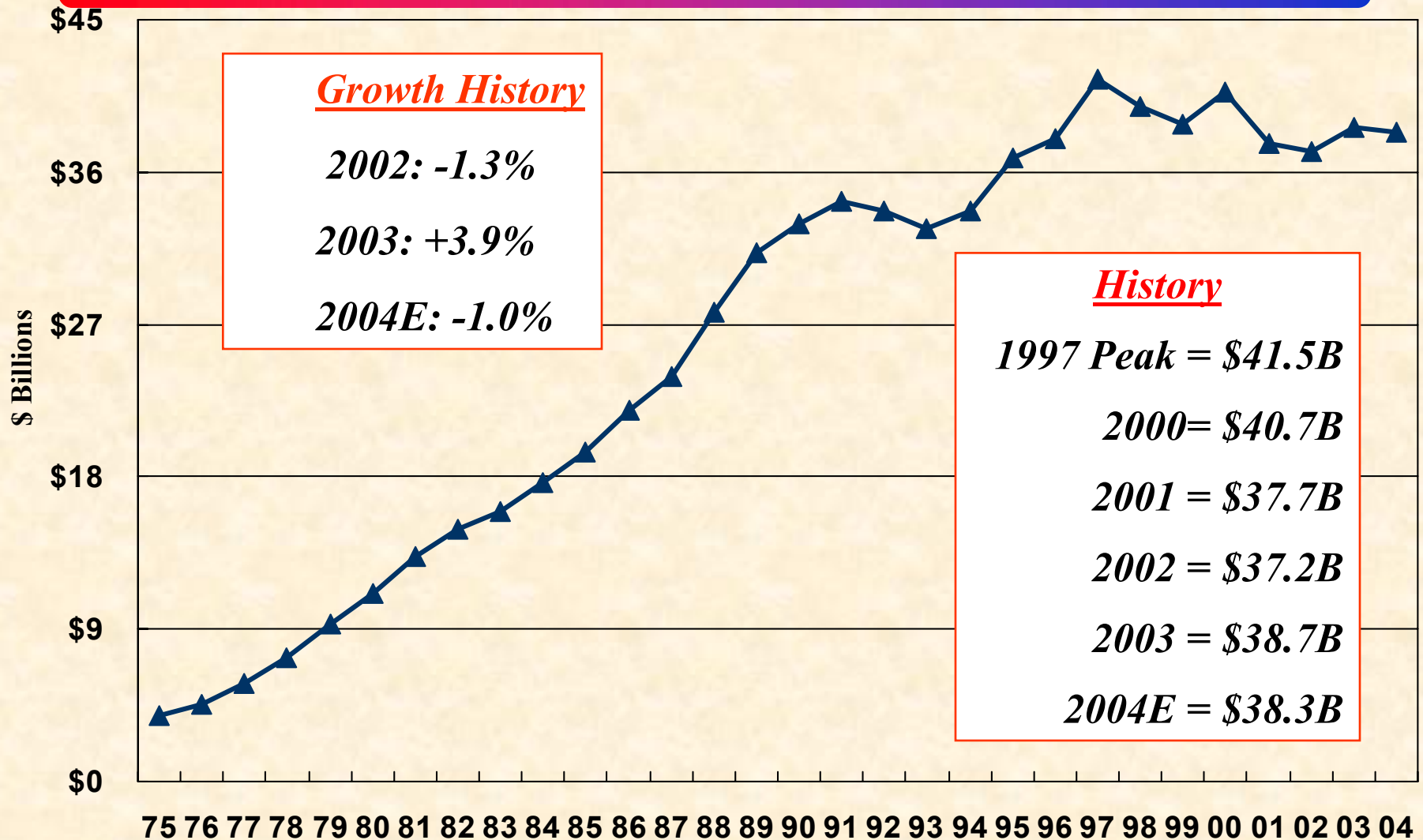
INVESTMENTS:

*NO SUBSTITUTE FOR
SOUND UNDERWRITING*





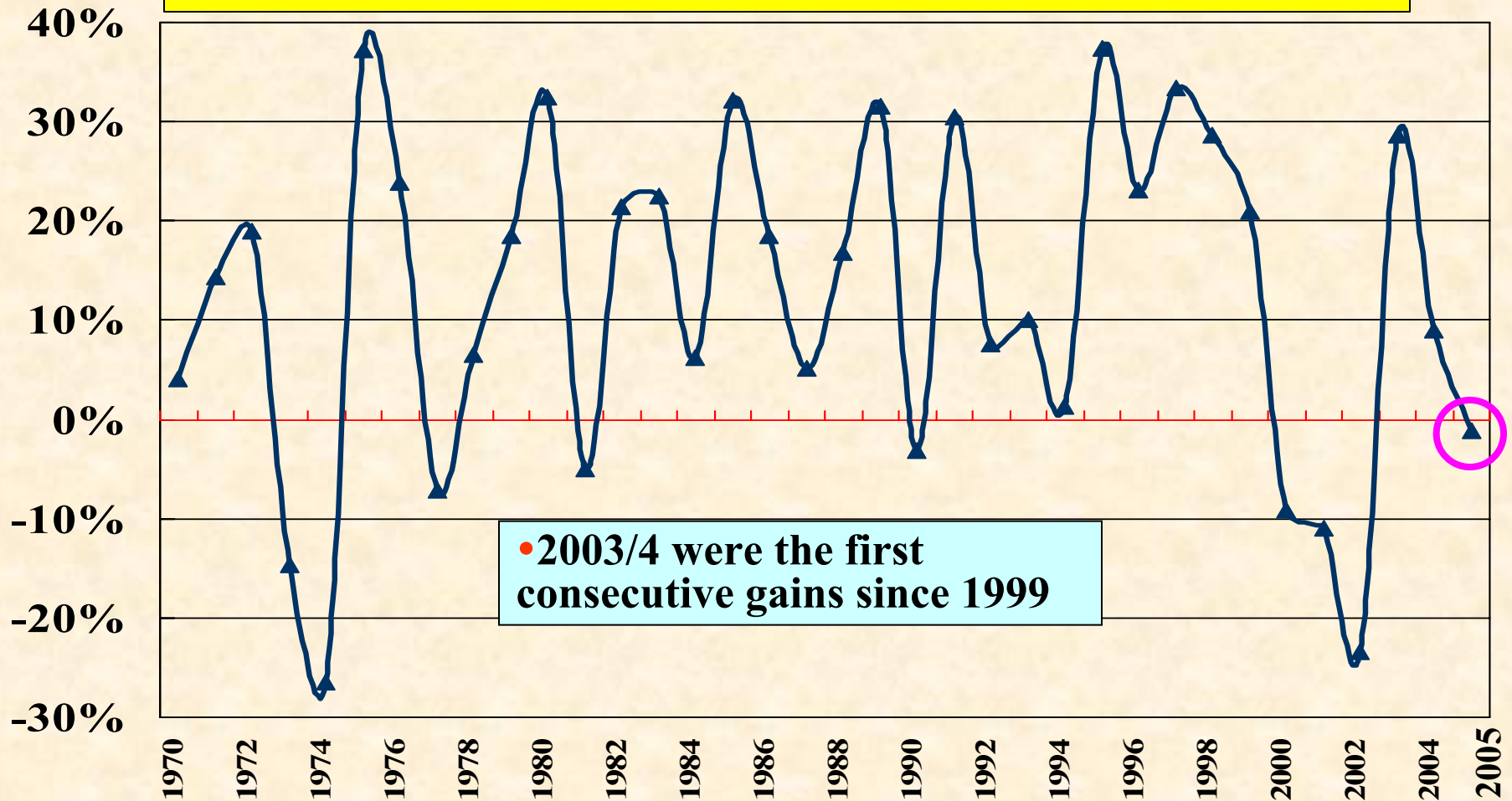
Net Investment Income





Total Returns for Large Company Stocks: 1970-2005*

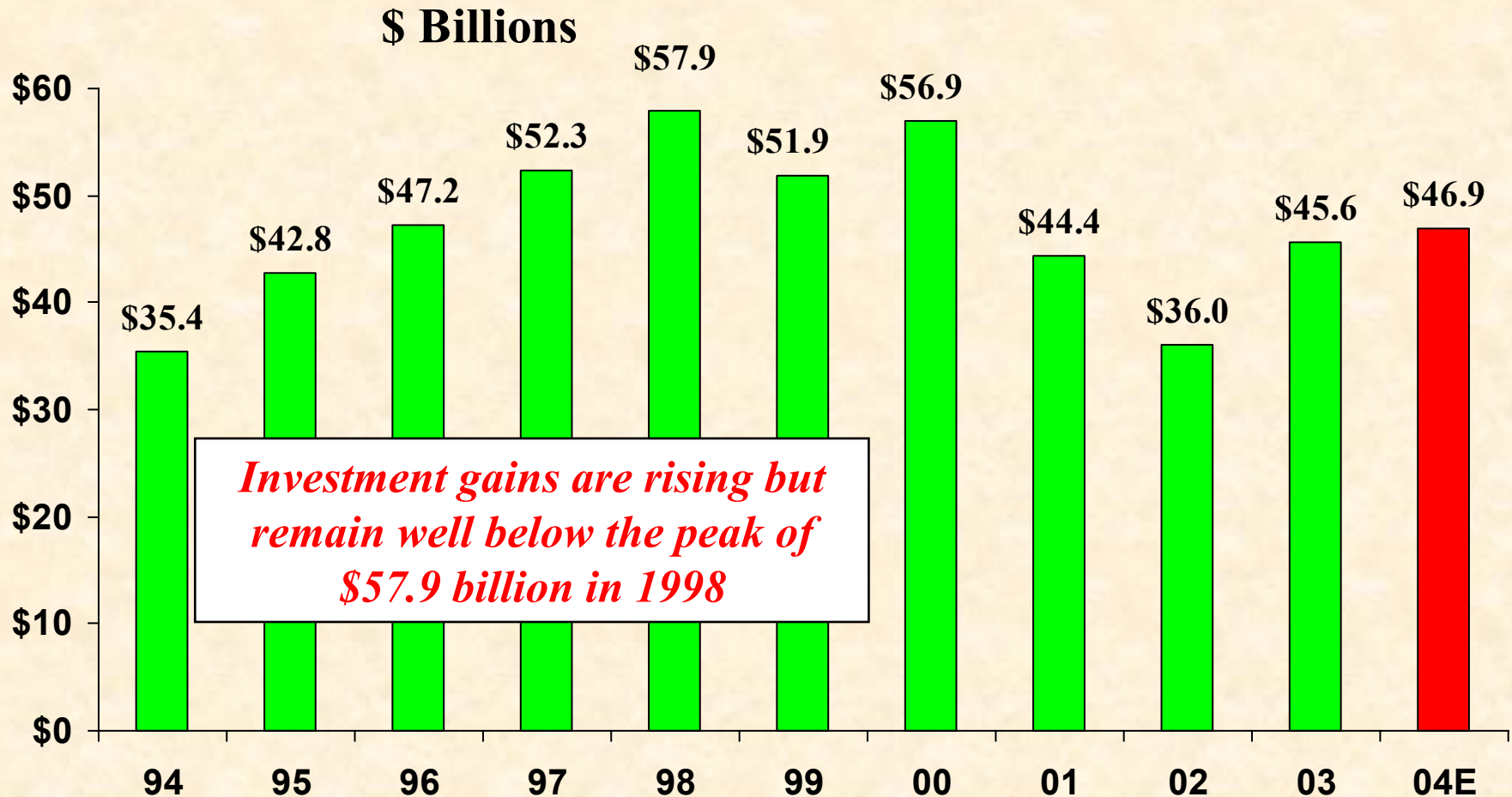
S&P 500 was up 9% in 2004. Fears of higher interest rates, inflation, the falling dollar, big deficits, resurgent oil prices are concerns in 2005



• 2003/4 were the first consecutive gains since 1999



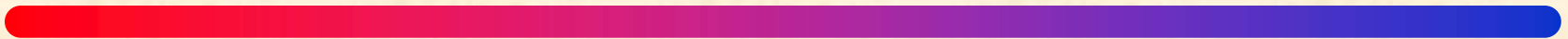
Property/Casualty Insurance Industry Investment Gain*



*Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2004 estimate is annualized figure based on first 9-months results.

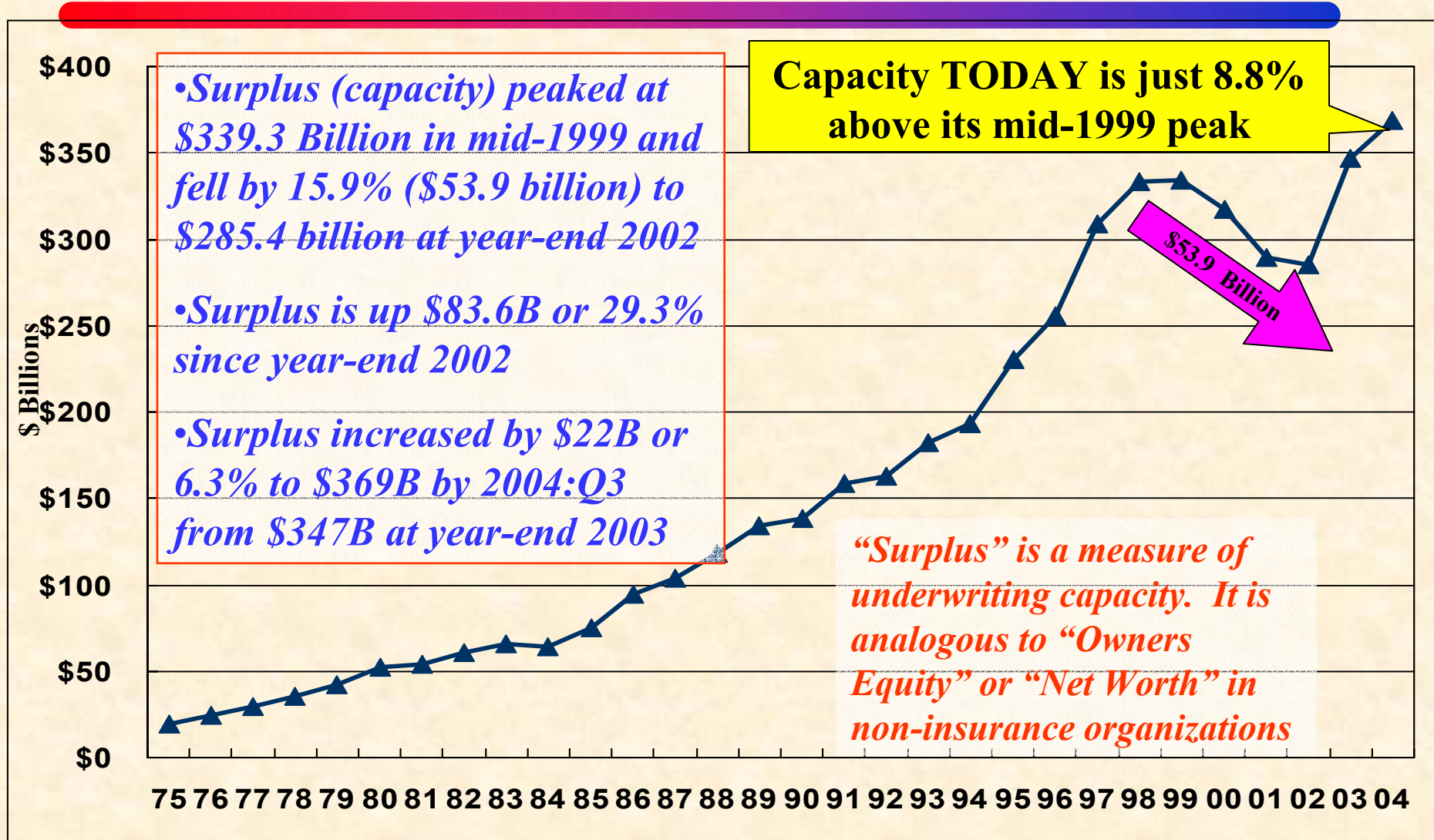
Source: Insurance Services Office; Insurance Information Institute.

CAPACITY CRUNCH?



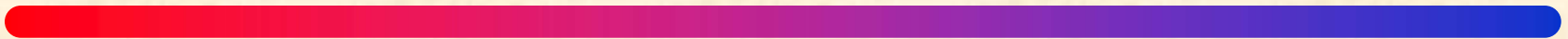


U.S. Policyholder Surplus: 1975-2004*



PRICING:

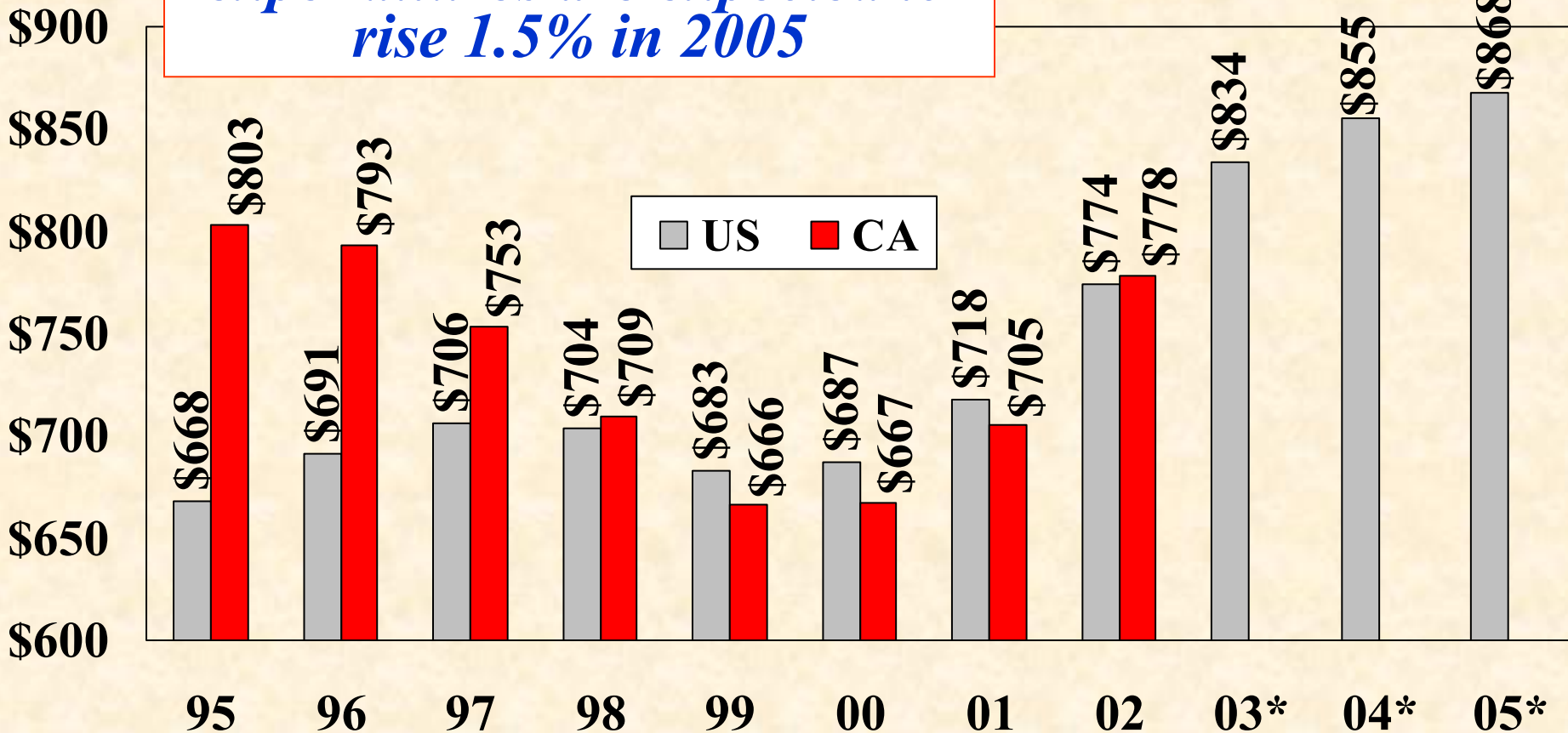
**DOWNWARD
PRESSURE?**





Average Expenditures on Auto Insurance: US vs. CA

Countrywide auto insurance expenditures are expected to rise 1.5% in 2005



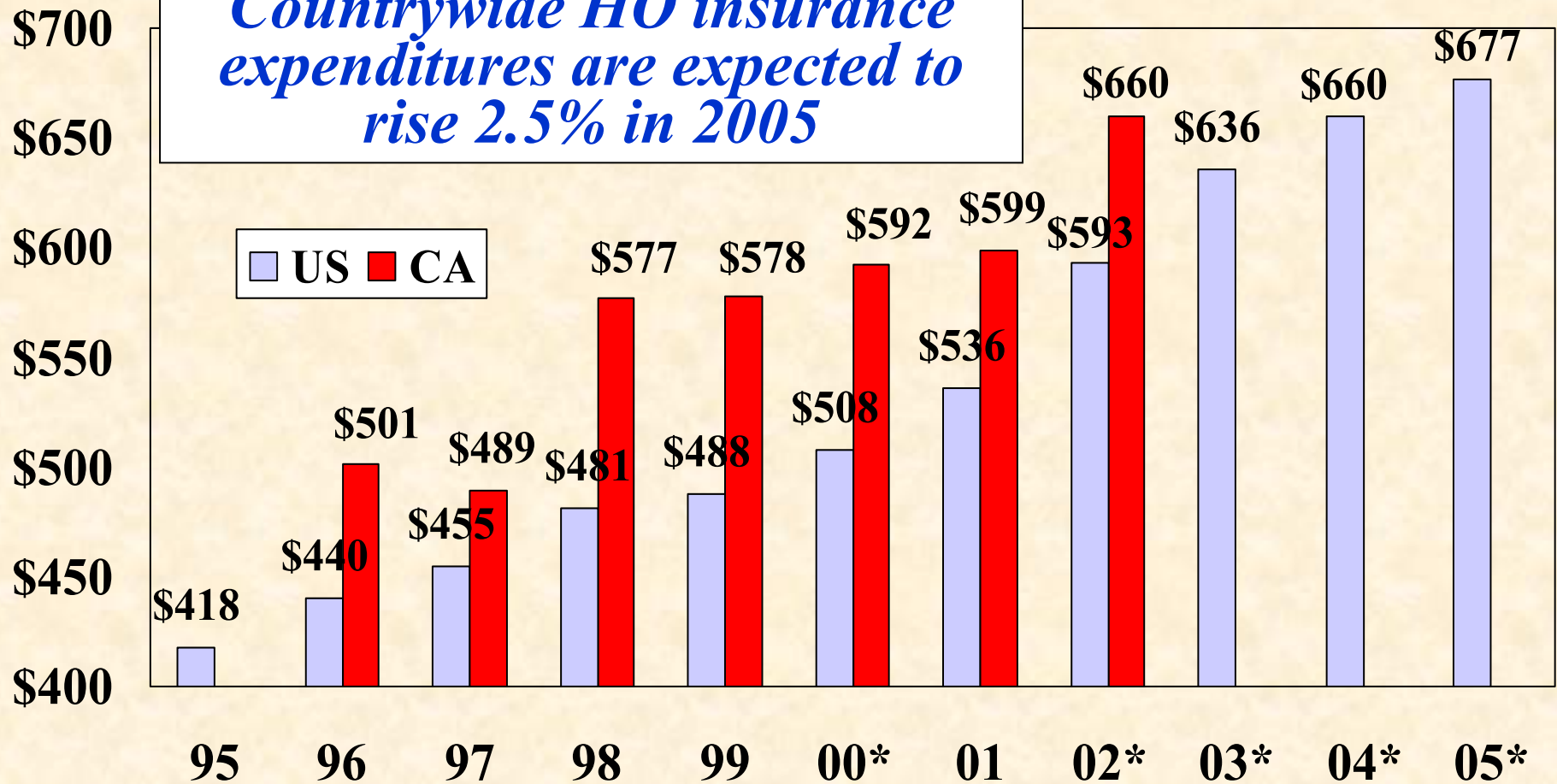
*III Estimates; Estimates for 2003-2004 based on BLS CPI data for motor vehicle insurance.

Source: NAIC, Insurance Information Institute



Average Expenditures on Homeowners Ins.: US vs. CA

Countrywide HO insurance expenditures are expected to rise 2.5% in 2005



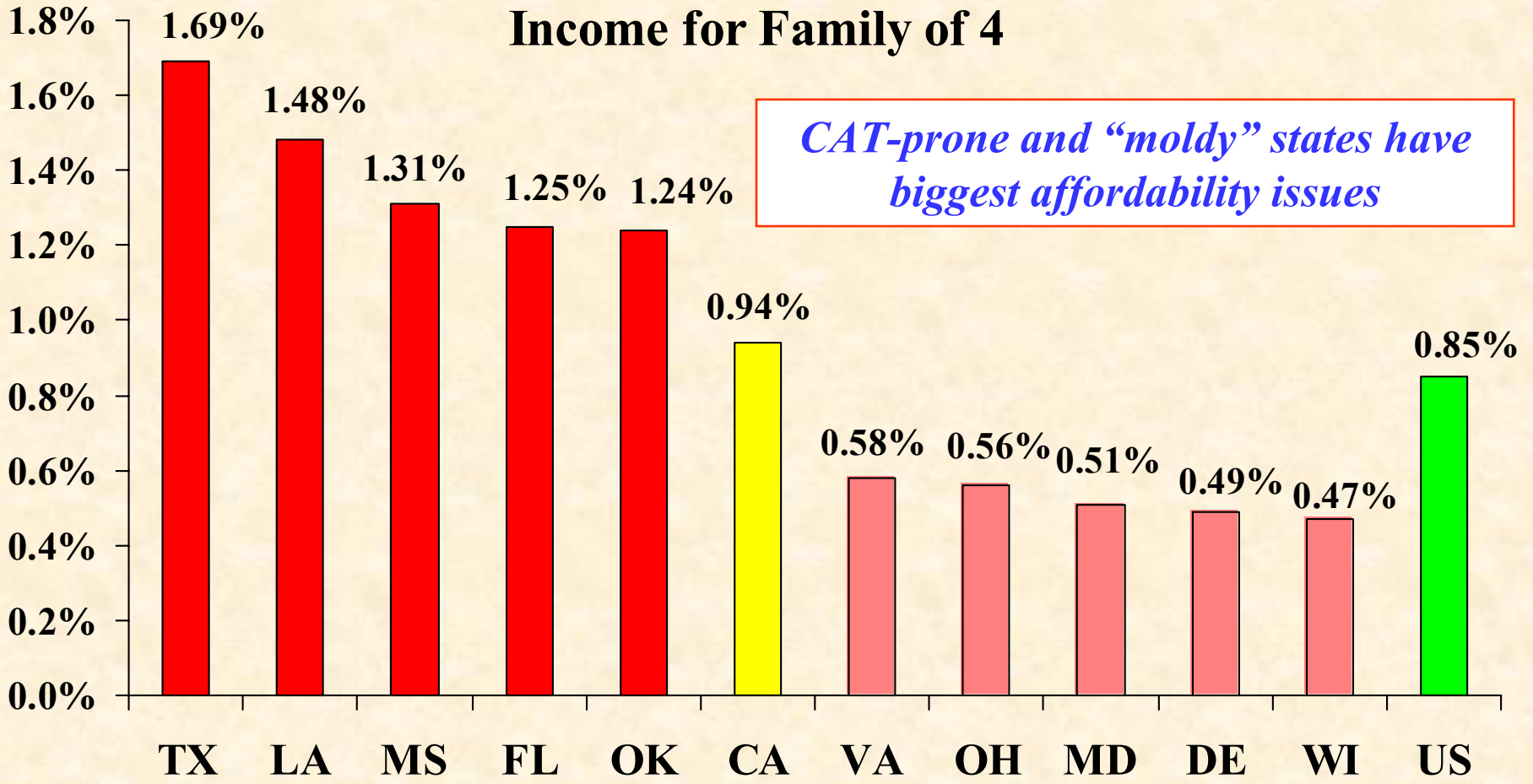
*III Estimates

Source: NAIC, Insurance Information Institute.



Homeowners Affordability “HURT Index”* (Top/Bottom 5 States)

Ratio of Avg. Homeowners Ins Expenditure to Median Income for Family of 4



CAT-prone and “moldy” states have biggest affordability issues

*Ratio of 2001 state average auto expenditure to states median income for family of 4.

Sources: *Property Insurance Report*, Oct 4, 2004



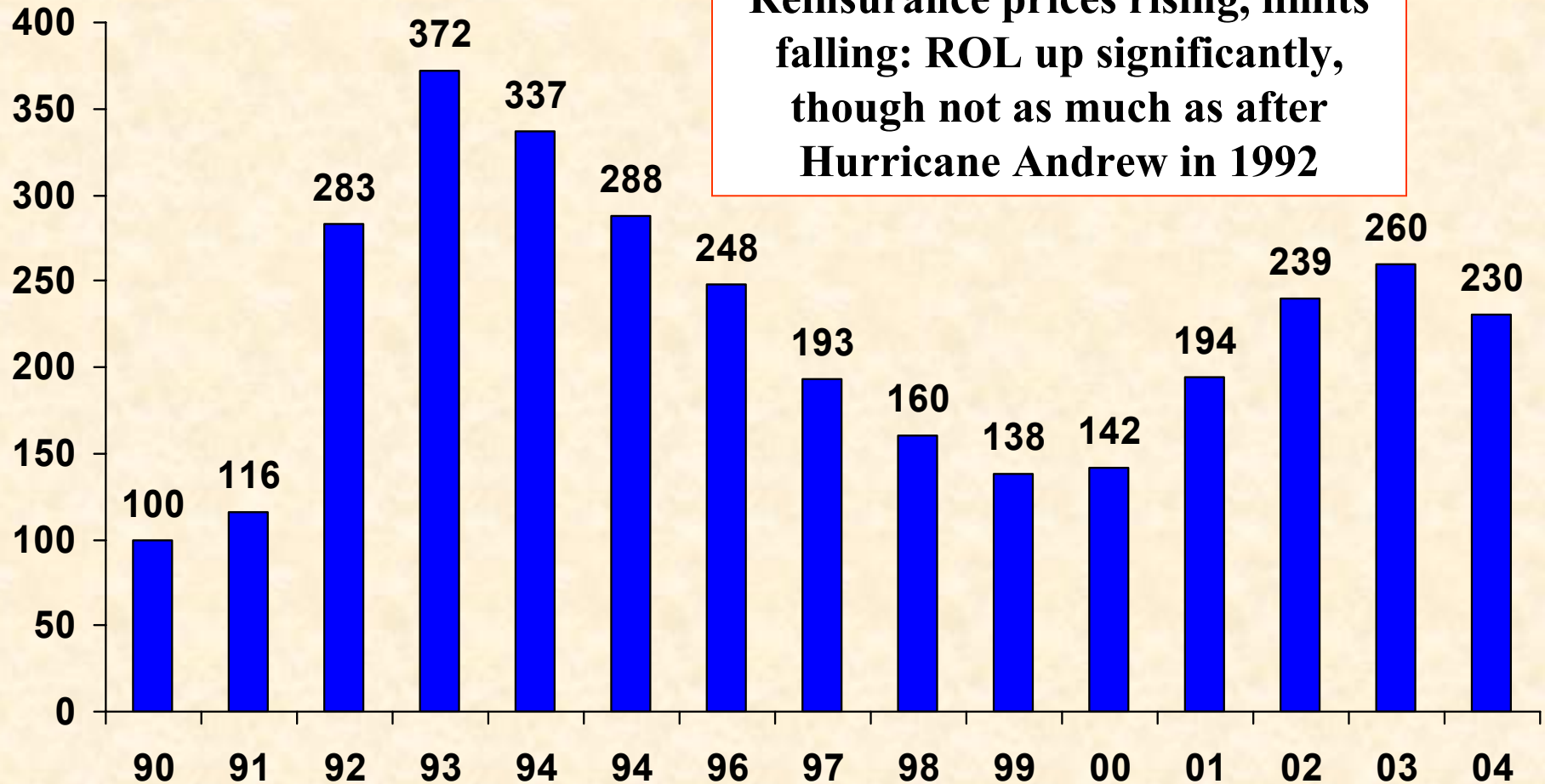
Commercial Premium Rate Changes Are Sharply Lower



Source: MarketScout.com

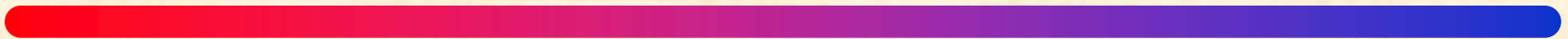


World Rate-On-Line Index (1990 = 100)



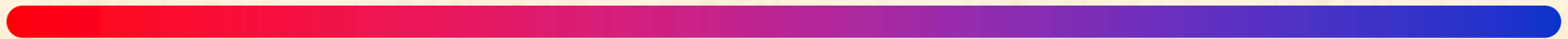
Source: Guy Carpenter

REPORT ON IMPORTANT ISSUES IN WASHINGTON & THE STATES



SPITZER INVESTIGATION

*Has the Industry's
Reputation Been
Shattered?*





Headlines from Hell

- **HOW INVESTIGATIONS OF AIG LED TO RETIREMENT OF LONGTIME CEO**
-Wall Street Journal, March 15, 2005, Page A1
- **AON SETTLES CASE ON COMMISSIONS FOR \$190 MILLION**
-Wall Street Journal, March 5, 2005, Page C3
- **INQUIRY MAY PUT HEAT ON INSURERS**
-Wall Street Journal, February 16, 2005, Page C3
- **MORE PLEAD GUILTY IN MARSH CASE**
-Wall Street Journal, February 16, 2005, Page C3
- **MARSH, SPITZER SETTLE WITH \$850 MILLION, AN APOLOGY TO CLIENTS**
-Wall Street Journal, February 1, 2005, Page C1
- **INSURERS REEL FROM SPITZER'S STRIKE**
-Wall Street Journal, October 18, 2004, Page A1
- **BROKER ACCUSED OF RIGGING BIDS FOR INSURANCE**
-New York Times, October 15, 2004, Page A1
- **CLASS ACTION THREAT ADDED TO CHALLENGES FACING INSURERS**
-Wall Street Journal, October 20, 2004, Page C1
- **INSURERS POST STEEP LOSSES IN DAY OF WIDESPREAD DECLINES**
-New York Times, October 15, 2004, Page C4





5 Main Areas of Investigation

- **PROBE 1: Anti-Competitive Acts**
 - Big-rigging, fraud is the only actual illegal act
 - *Contingent commissions not illegal but painted as root of problem*
 - **Accusation: Broker contractual responsibility to buyer breached**
 - **Likely Outcome: Fines, penalties, disclosure; E&O/D&O, sharehldr. suits**
 - **New Economic Model Needed to replace lost broker (agent?) income**
 - **Independent Agents: Distinction that agent works for insurer not as helpful as commonly believed**
- **PROBE 2: Tying**
 - **Alleges brokers steered business to certain insurers who would then utilize their reinsurance broker affiliate**
 - **Likely Outcome: Fines, penalties, disclosure; divestiture (worse case)**
- **PROBE 3: Finite (Re) Insurance/"Non-Traditional" Products**
 - **Issue 1: Was there "significant" transfer of risk or merely a loan disguised as insurance?**
 - **Issue 2: Was there proper accounting treatment**
 - **Issue 3: Misrepresentation of policy details**
 - **Likely Outcome: Fines, Penalties, revamped accounting definitions; stds.**



5 Main Areas of Investigation

- **PROBE 4: Legal Malpractice**

- Allegations by trial lawyers that their firms' premiums have risen and coverage is more difficult to get
- Response (& the Truth): All professional liability markets have tightened due to litigation explosion against providers of professional services
- E.g., Doctors, accountants, brokers, lawyers, directors
 - Med mal
 - D&O
 - E&O

- **PROBE 5: Outsourced Claims Handling**

- Subpoenas issued to several firms that handle outsourced claims functions
- Nature of allegations unclear, but could be performance-based incentives

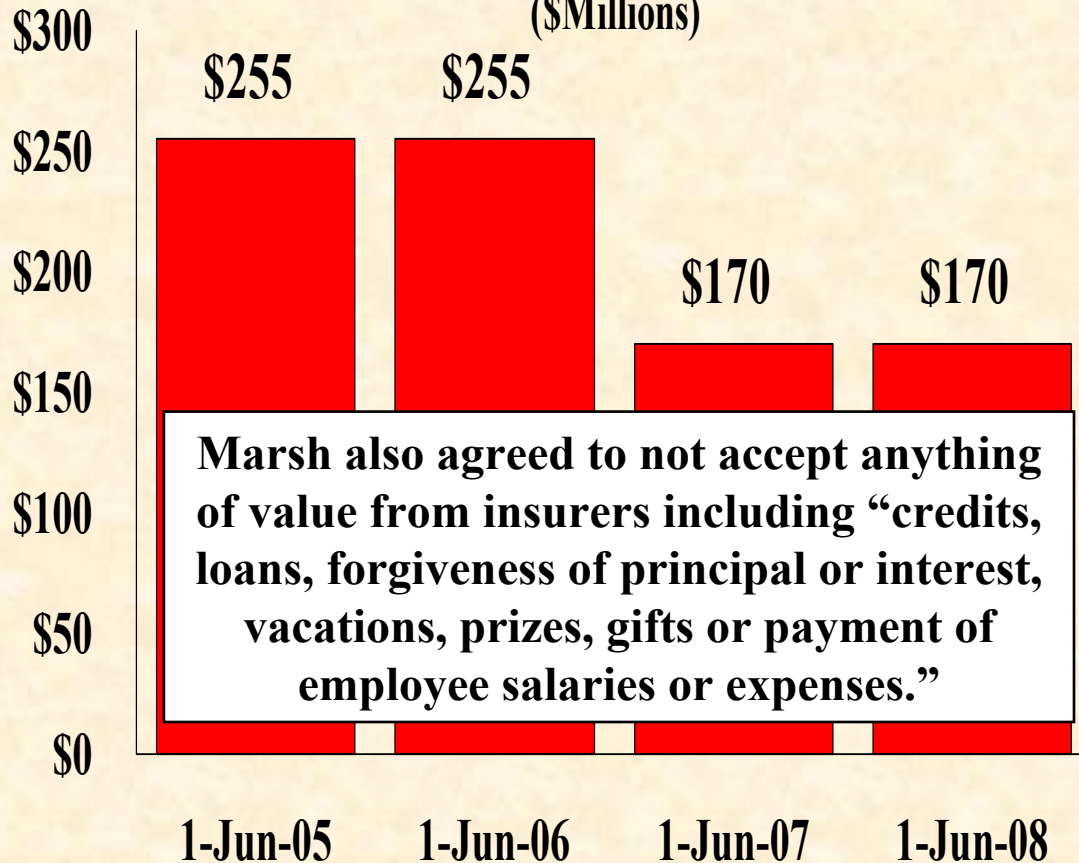
Approximately 42 states have different investigations and inquires underway by Attorneys General and Insurance Departments as of mid-January 2005



Details of Spitzer's \$850 Million Settlement with Marsh*

Restitution Payment Timetable

(\$Millions)



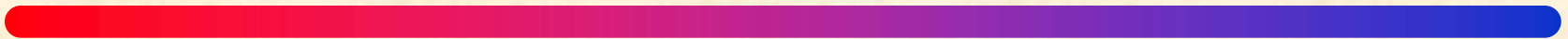
Marsh also agreed to not accept anything of value from insurers including “credits, loans, forgiveness of principal or interest, vacations, prizes, gifts or payment of employee salaries or expenses.”

Details of Settlement:

- Pay \$850 million into restitution fund over 4 years
- Apologize to clients acknowledging certain employees “unlawfully deceived their customers.”
- Marsh to codify ban on contingent commissions
- Prohibits tying (steering business to insurers who promise to pay for services of other Marsh units)
- Marsh pays no “fine”
- Marsh neither admits nor denies wrongdoing
- Participation in restitution fund requires forgoing other litigation

*Agreement announced January 31, 2005.
Source: Insurance Information Institute

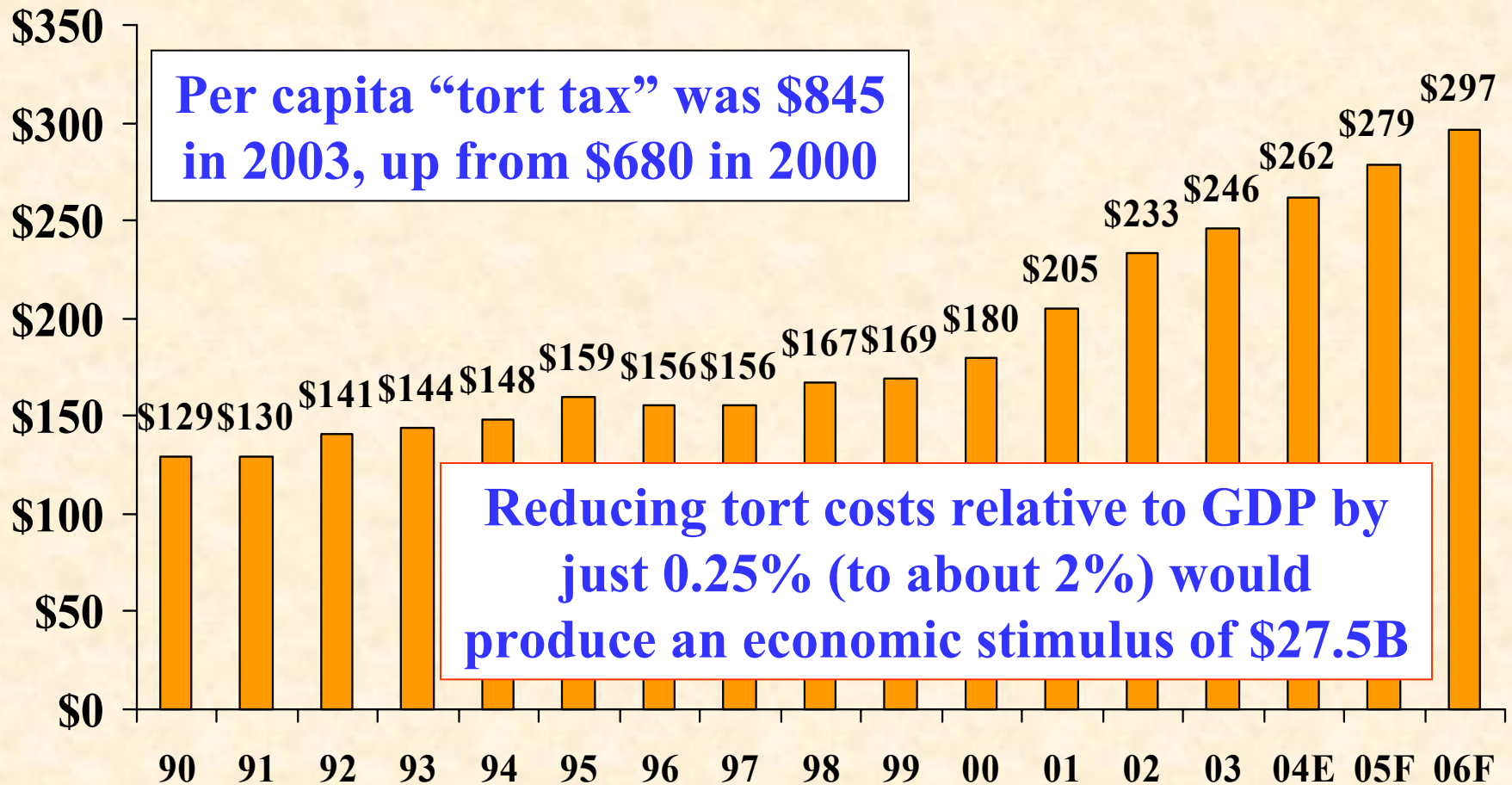
***LEGAL LIABILITY
& TORT
ENVIRONMENT***



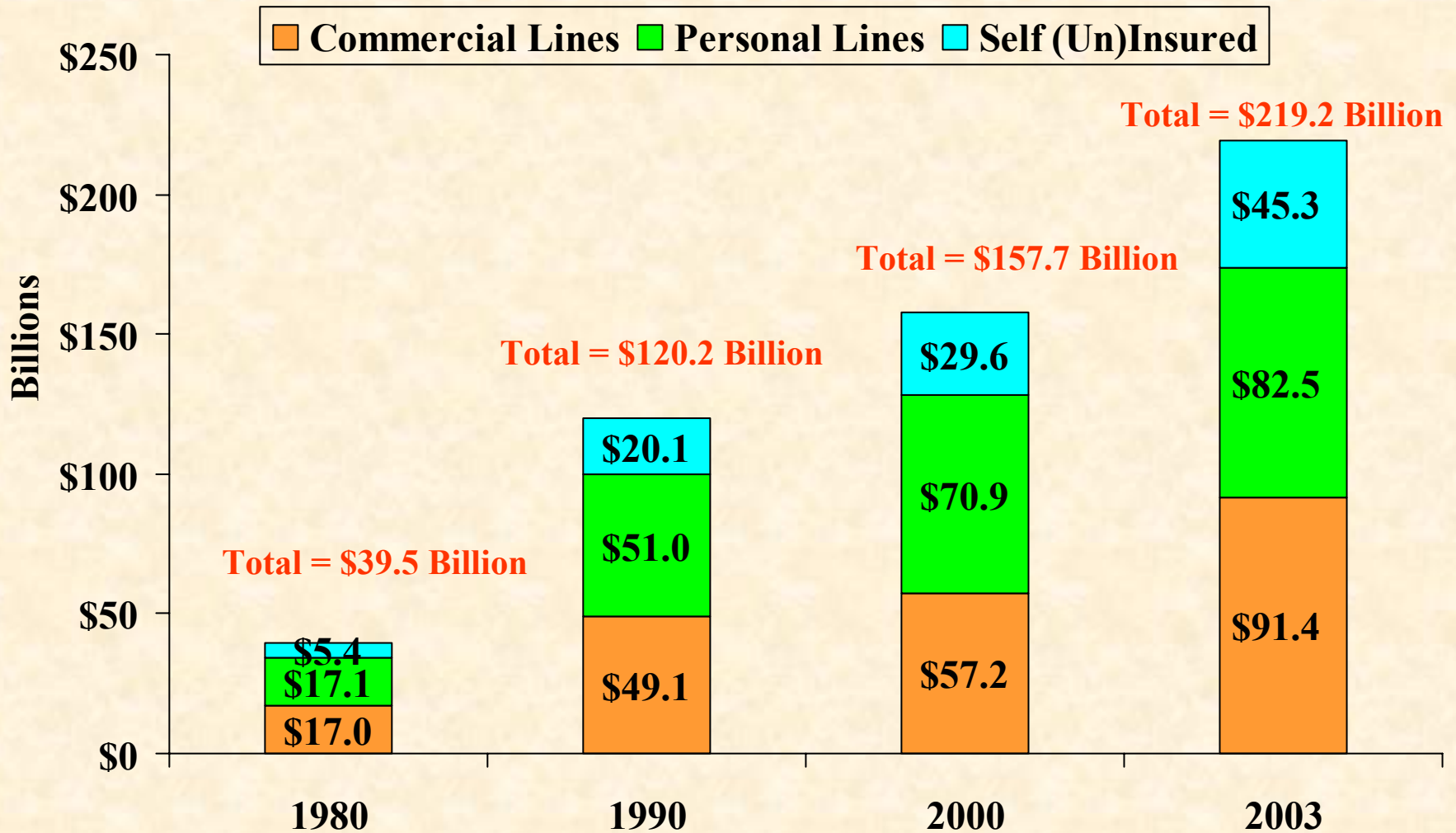


Cost of U.S. Tort System (\$ Billions)

Tort costs will consume an estimated 2.24% of GDP in 2005



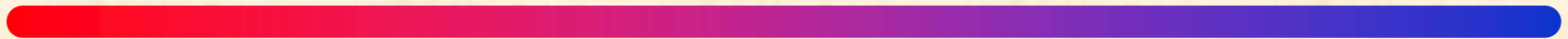
Personal, Commercial & Self (Un) Insured Tort Costs*



*Excludes medical malpractice
 Source: Tillinghast-Towers Perrin

***LEGAL LIABILITY
& TORT
ENVIRONMENT***

Good News for a Change?





There is ~~Was~~ is ~~Was~~ Is a Glimmer of Hope for Tort Reform

Best Chance for Tort Reform in Years is *BACK*

- Medical Malpractice
 - States—already happening: 20+ states have caps
 - Federal reform discussed in Congress but bill *failed* in Senate
 - Attempt to get caps for specialties failed February 2004
- Class Action Reform
 - Class Action Fairness Act
 - *Failed* by 1 Vote 10/22/03; *Failed* again in 2004
 - *Passed by Senate 2/10/05 with 72-26 vote; Signed by Pres. Bush 2/18.*
- Asbestos Reform
 - Fairness in Asbestos Injury Resolution of 2003; *Failed Apr. 2004*
- Punitive Damages—What's Reasonable
 - Supreme Court ruled favorably in *Campbell v. State Farm*



Summary of Class Action Fairness Act *(S. 5, approved Feb. 10, 2005)*

- 1. Allows most state court suits seeking \$5 million or more to be removed to federal courts**
- 2. Lets federal judges decline to hear cases involving many out-of-state class members**
- 3. Requires greater scrutiny of settlements offering goods/services or coupons (in lieu of cash)**
- 4. Bans settlements resulting in a net loss to class members**
- 5. Bans settlements giving plaintiffs larger awards on basis of proximity to court**



Likely Impacts of Class Action Fairness Act on P/C Insurance Industry

1. **Effect will be modestly positive, benefiting primarily commercial casualty lines, though some benefit to PPA**
 1. **Likely to reduce both freq. & severity (incl. defense costs)**
2. **Does *NOT* create a windfall for insurers**
 - **Most savings will be quickly passed along to policyholders**
3. **Improves underwriting and rating environment, creates incentives to expand capacity, esp. commercial casualty coverages (excl. WC) & creates some new opportunities; insurers can return to some markets**
4. **Does NOT limit legal fees, non-economic damages or provide appeal bond limits**
5. **Does NOT solve asbestos or med mal crises**

Summary of Class Action Fairness Act **Details on Removal to Federal Courts**

- **Aggregate amount in dispute must exceed \$5 million**
- **At 100 class members**
- **At least one member of the plaintiff class is citizen of a different state than that of the defendant.**
- **Any member of class or defendant is citizen or subject of a foreign state**
- **Home State Exception (Feinstein Amendment):**
 - **If more than 2/3 of class members are from defendant's home state then case is not subject to removal to fed. court**

Summary of Class Action Fairness Act **Details on Removal to Federal Courts**

- **Home State Exception (Feinstein Amendment)**: If more than 2/3 of class members are from defendant's home state then case is **not** subject to removal to federal court
 - If 1/3 to 2/3 of class have shared citizenship with defendant, fed court could decline to exercise jurisdiction depending on:
 - Whether claims are of significant national or interstate interest
 - Whether claims would be governed by laws other than forum state
 - Whether case pleaded in manner that seeks to avoid federal jurisdiction
 - Whether action brought in forum with distinct nexus to class members, defendants or the alleged harm
 - Whether number of citizens of forum state in class substantially larger from other states and whether class members from other states substantially dispersed
 - Whether similar claims filed by 1+ class members over past 3 years



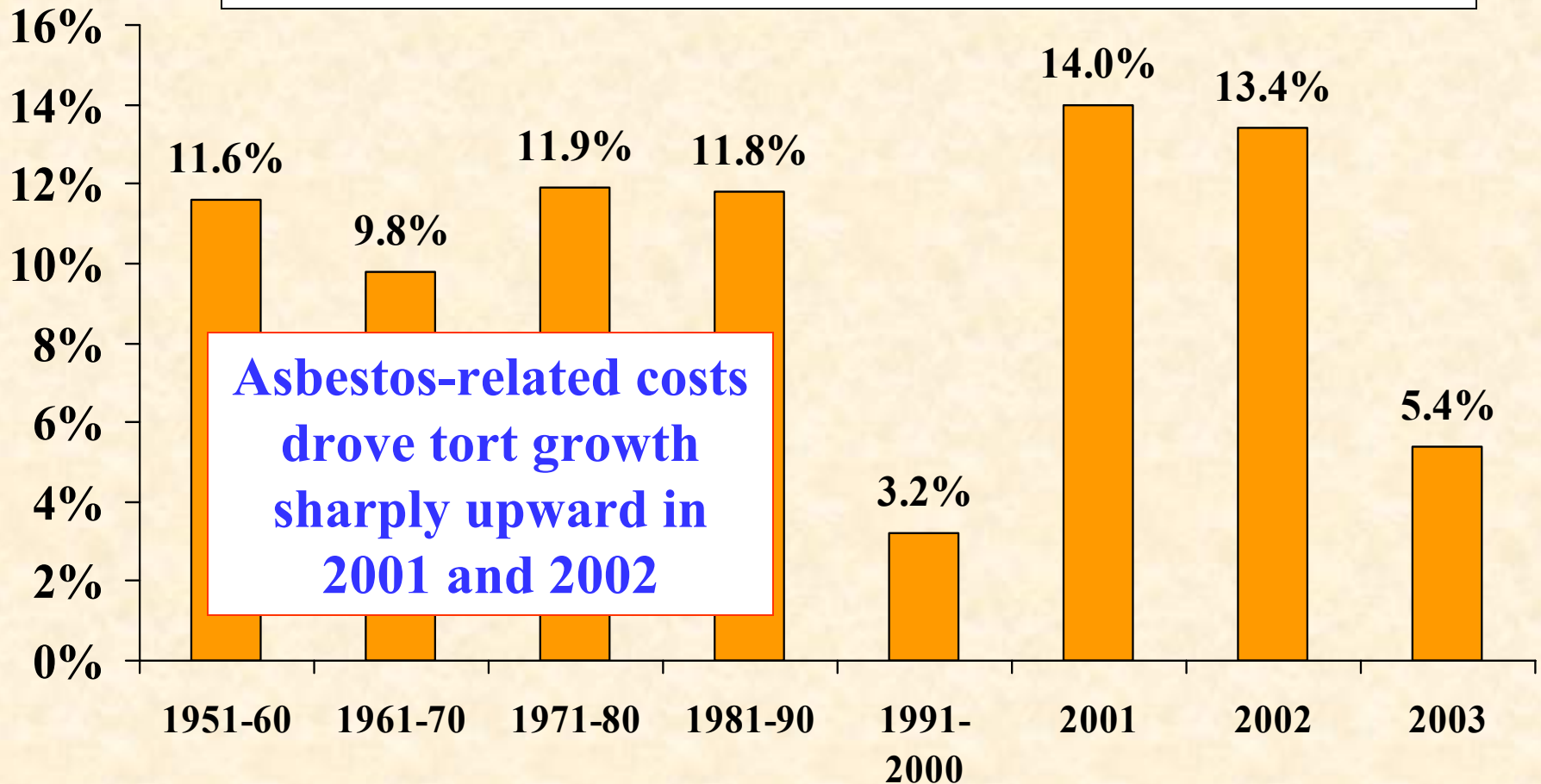
Potential Hazards in the Post-CAFA Era for Insurers

- 1. Insurers overestimate CAFA's impact**
 - 1. Reduce rates too much**
 - 2. Reduce rates too quickly**
 - 3. Assume reserves are redundant when they're not**
 - 4. Reserve inadequately**
- 2. Rapid expansion into lines with little or no experience to seize post-CAFA territory**
- 3. Unwarranted broadening of terms and conditions**
- 4. Commit too much capital to some casualty lines**
- 5. Entry of new capital = accelerated casualty market softening**
- 6. Succumb to regulatory pressure to reduce rates when reductions can't be justified actuarially**



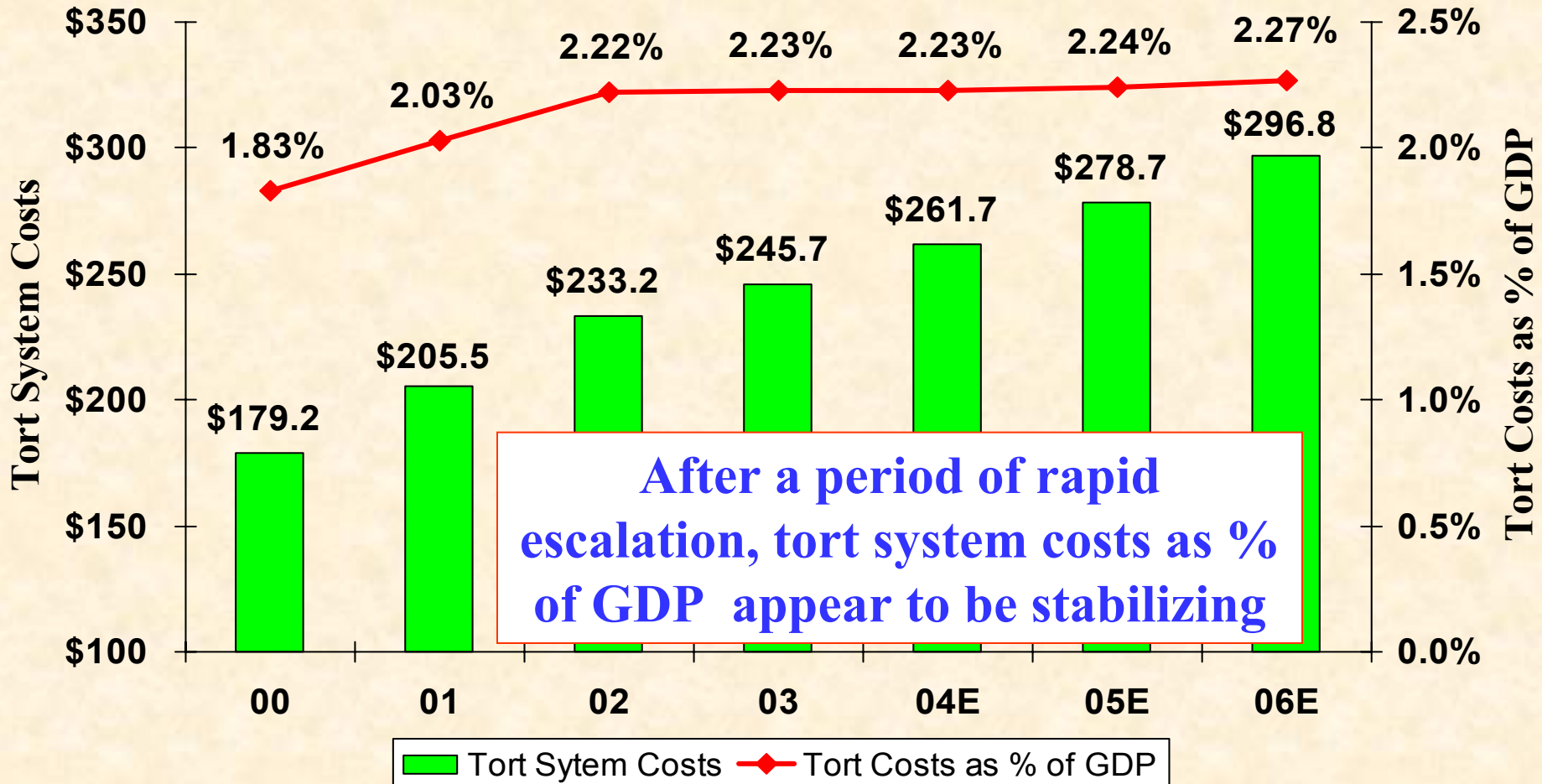
Growth in Cost of U.S. Tort System, 1951-2003

Tort costs moderated in 2003 as some of the asbestos-related costs that drove growth up in 2001 and 2002 abated.



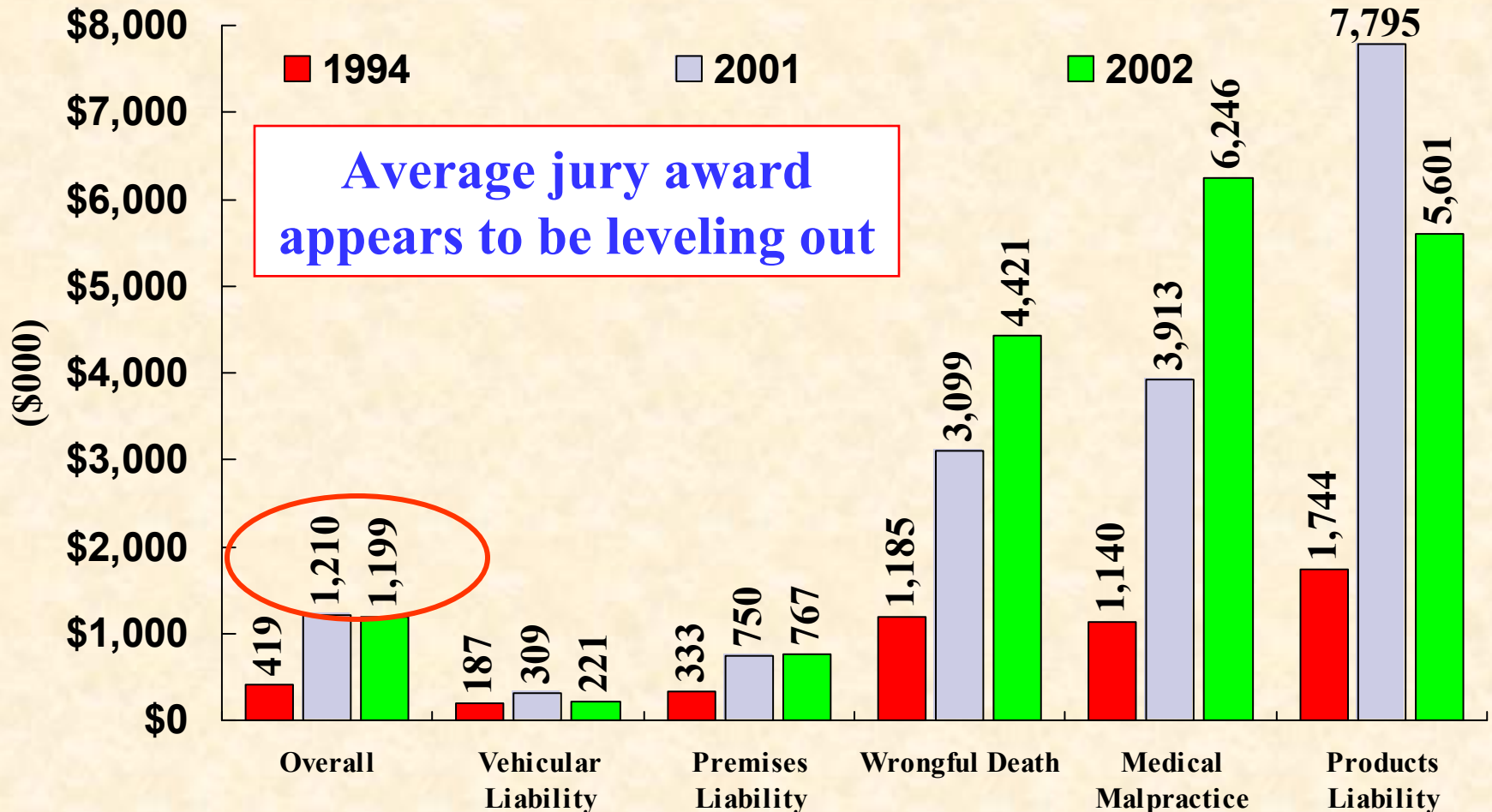


Tort System Costs, 2000-2006E



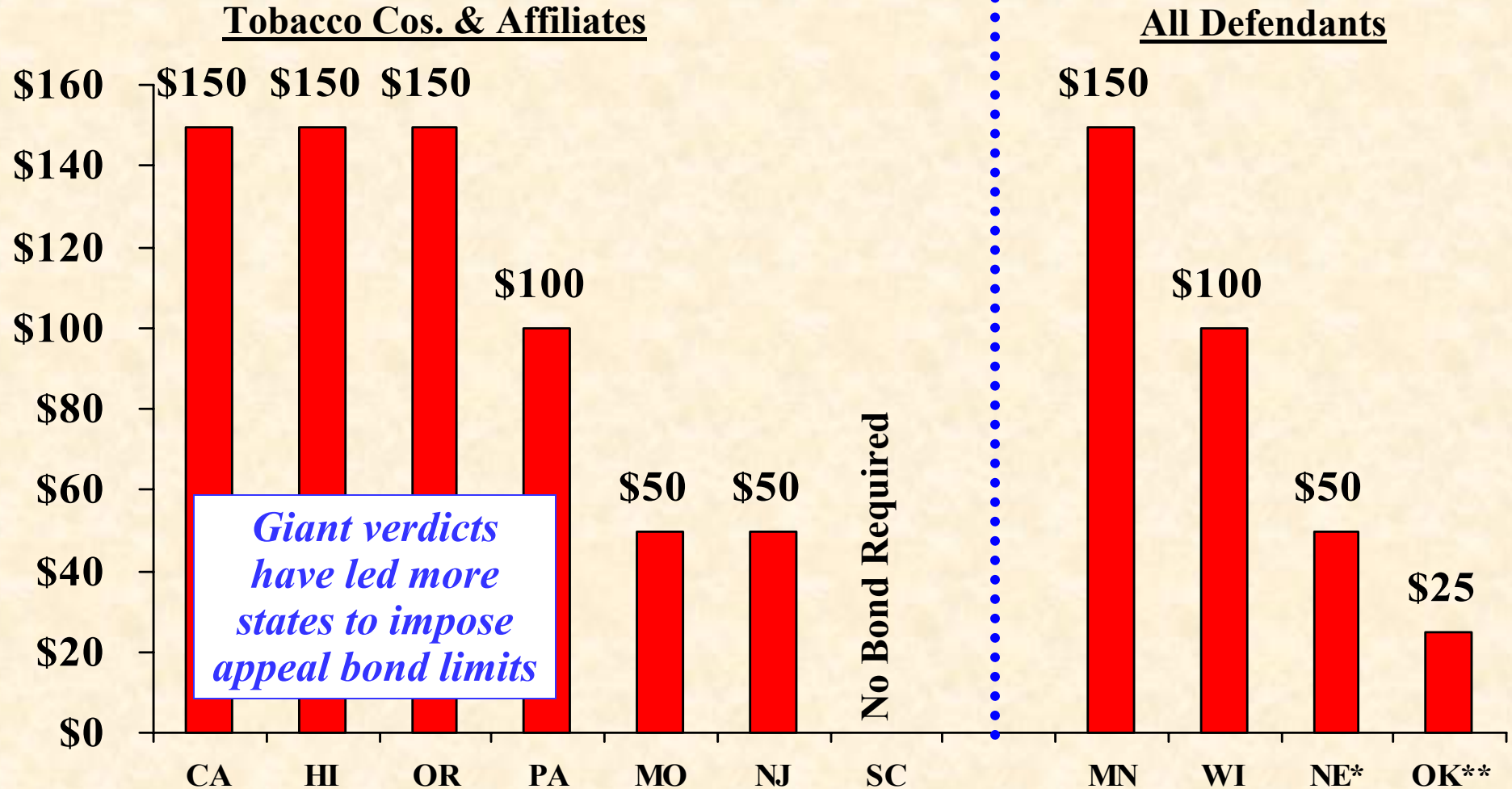


Average Jury Awards 1994 vs. 2001 and 2002





Appeal Bond Limit Laws Enacted Since July 2003 (\$ Millions)



*Giant verdicts
have led more
states to impose
appeal bond limits*

No Bond Required

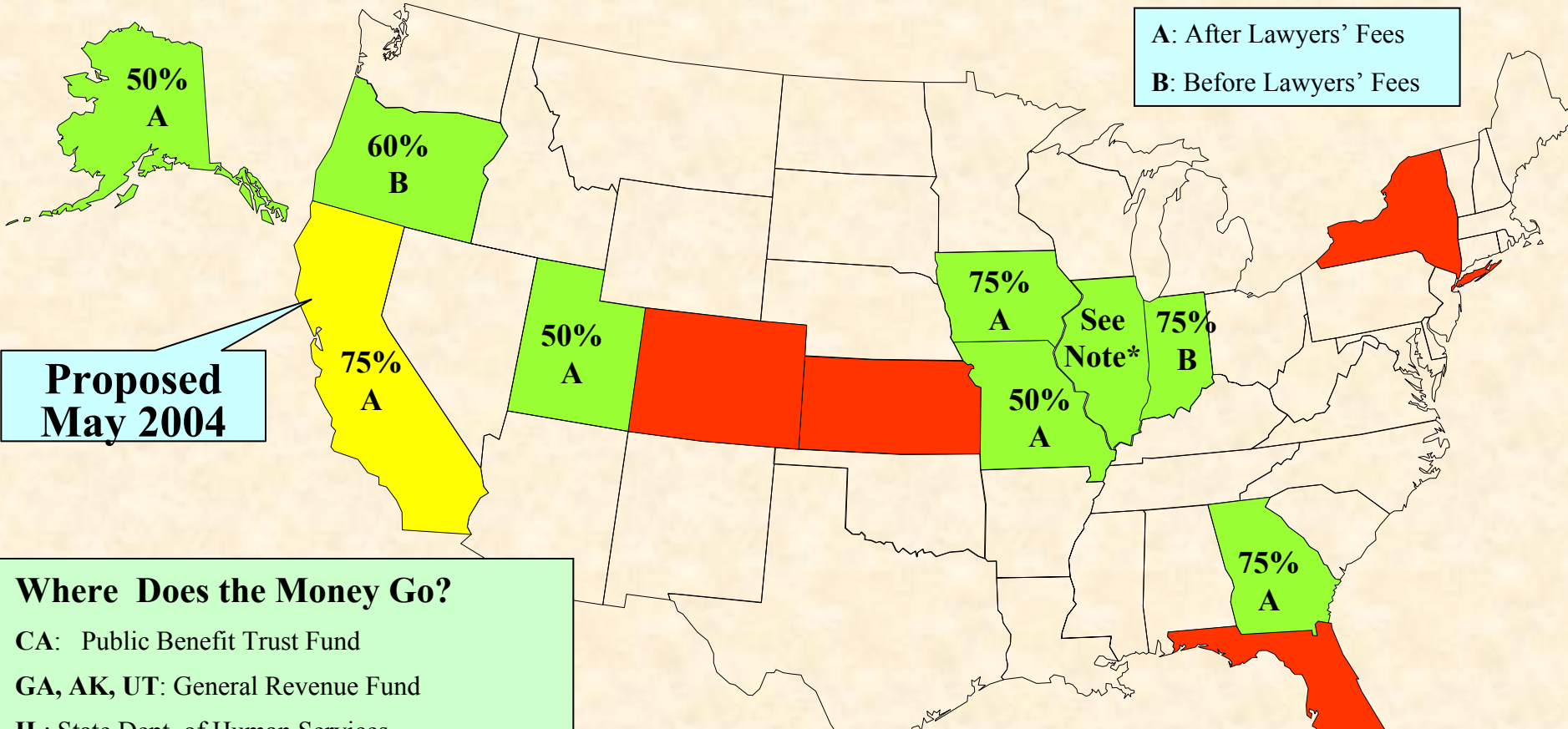
*Lesser amounts may apply.

**\$25 million figure applies to tobacco companies; other defendants have different limits.

Source: Covington & Burling; *NY Times* June 2004; Insurance Info Institute.



States With Split Recovery Laws & Share of Punitives Taken by State



**Proposed
May 2004**

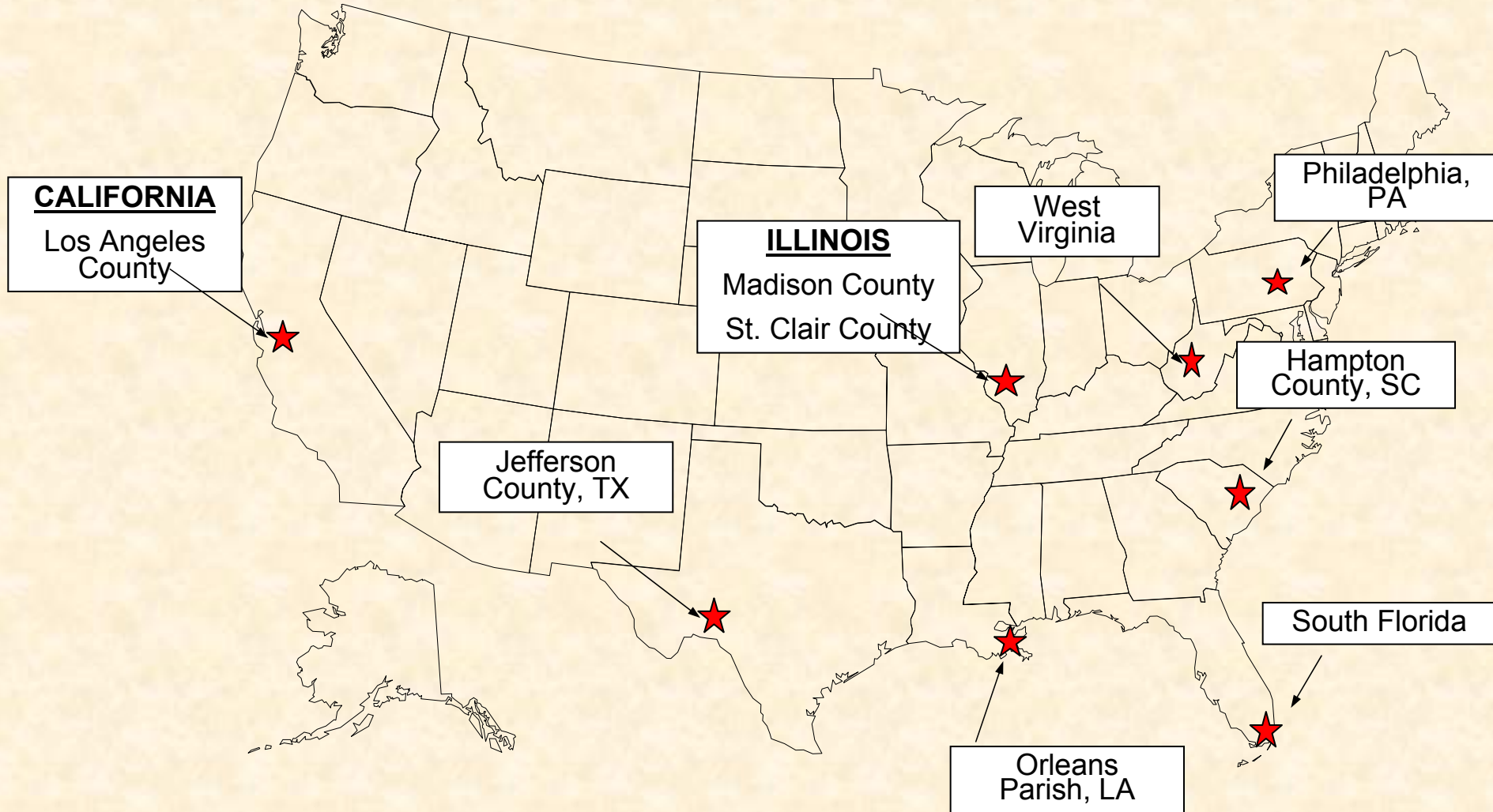
Where Does the Money Go?

- CA: Public Benefit Trust Fund
- GA, AK, UT: General Revenue Fund
- IL: State Dept. of Human Services
- IN: Violent Crimes Reparation Fund
- IA: Civil Reparations Fund
- OR: Criminal Injuries Compensation Account
- MO: Tort Plaintiffs' Compensation Fund

***IL trial judge determines share and when taken.**
Note: FL, KS, NY have repealed/allowed law allowing spit recoveries to expire; CO struck down law as unconstitutional.
Sources: Yale Law Journal, California Legislative Analyst's Office; NY Times, May 30, 2004, A16; Insurance Info. Institute



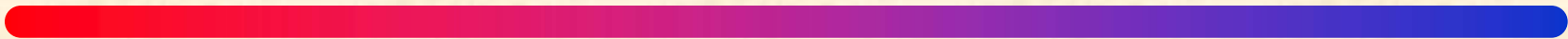
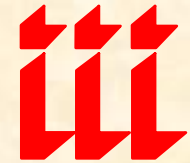
The Nation's Judicial Hellholes



INSURANCE SCORING

*Biggest Losers from
California's Ban on*

iii Credit are Consumers





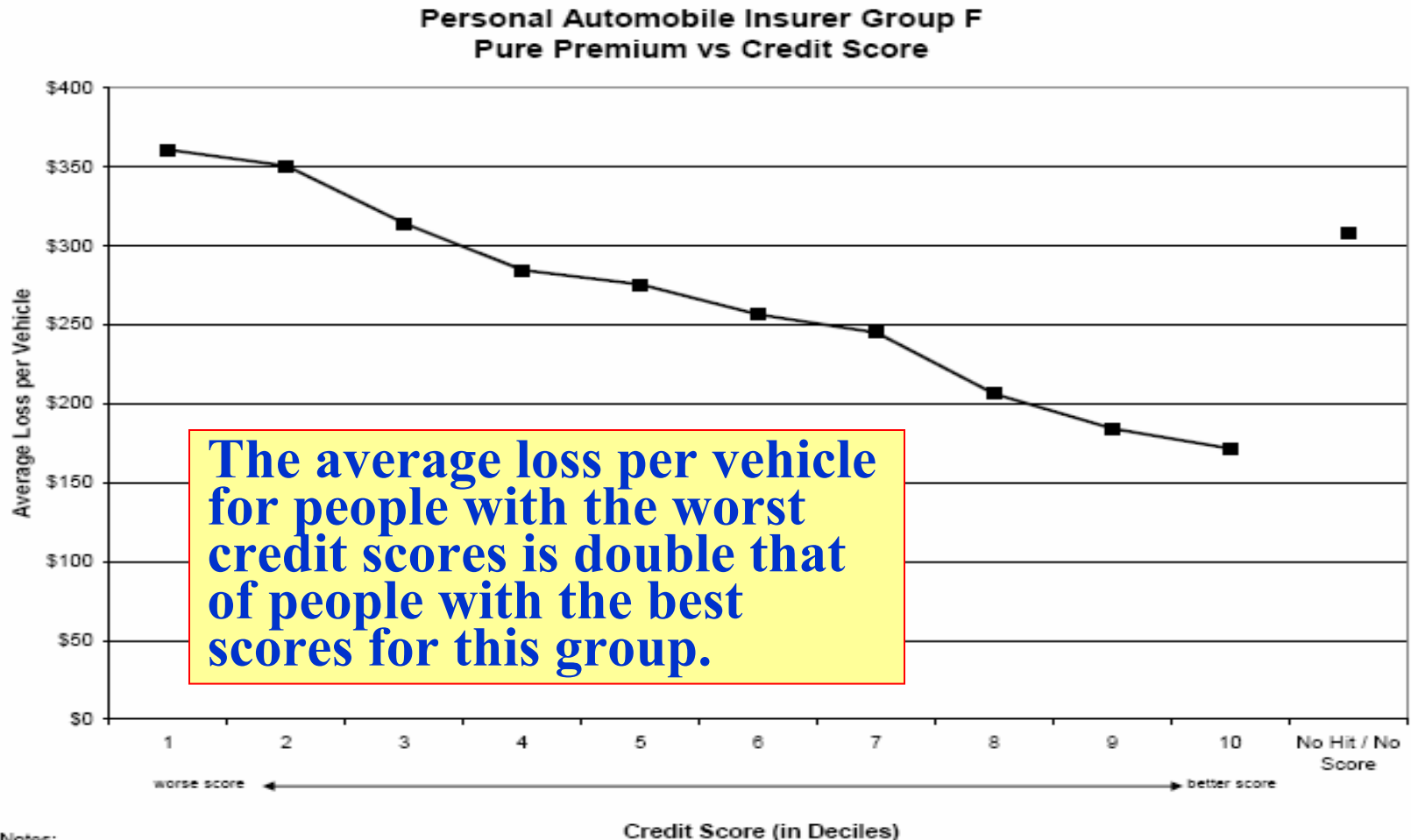
Importance of Rating Factors by Coverage Type

Coverage	Factor 1	Factor 2	Factor 3
BI Liability	Age/Gender	Ins. Score	Geography
PD Liability	Age/Gender	Ins. Score	Geography
PIP	Ins. Score	Geography	Yrs. Insured
Med Pay	Ins. Score	Limit	Age/Gender
Comprehensive	Model Year	Age/Gender	Ins. Score
Collision	Model Year	Age/Gender	Ins. Score

Source: *The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity* Michael Miller, FCAS and Richard Smith, FCAS (EPIC Actuaries), June 2003 (Presented at June 2003 NAIC meeting).



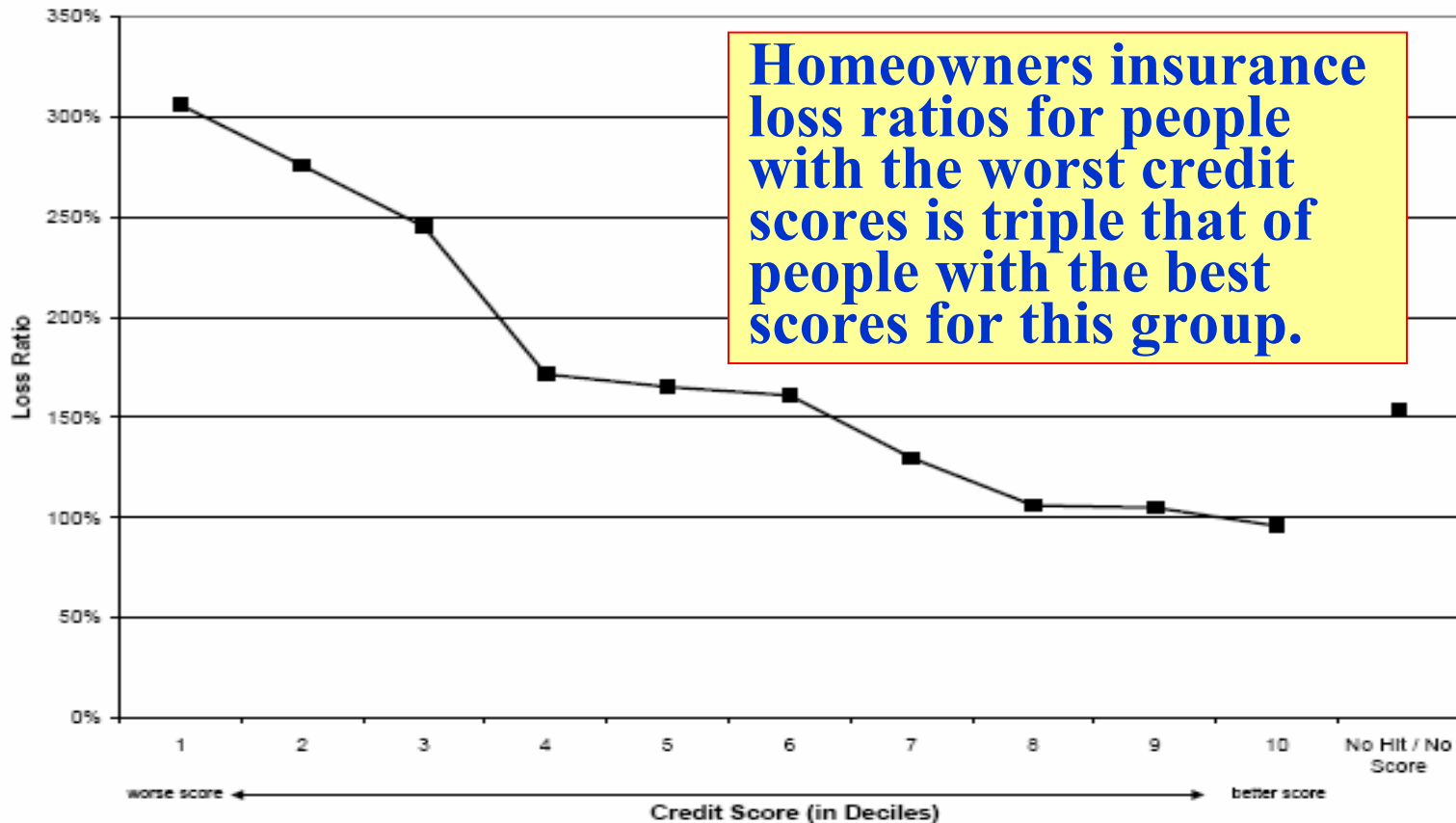
AUTO: New TX Study Confirms Strong Correlation Between Credit Score & Loss Performance





HOMEOWNERS: New TX Study Confirms Strong Correlation Between Credit Score & Loss Performance

Homeowners Insurer Group E
Loss Ratio vs Credit Score



Homeowners insurance loss ratios for people with the worst credit scores is triple that of people with the best scores for this group.

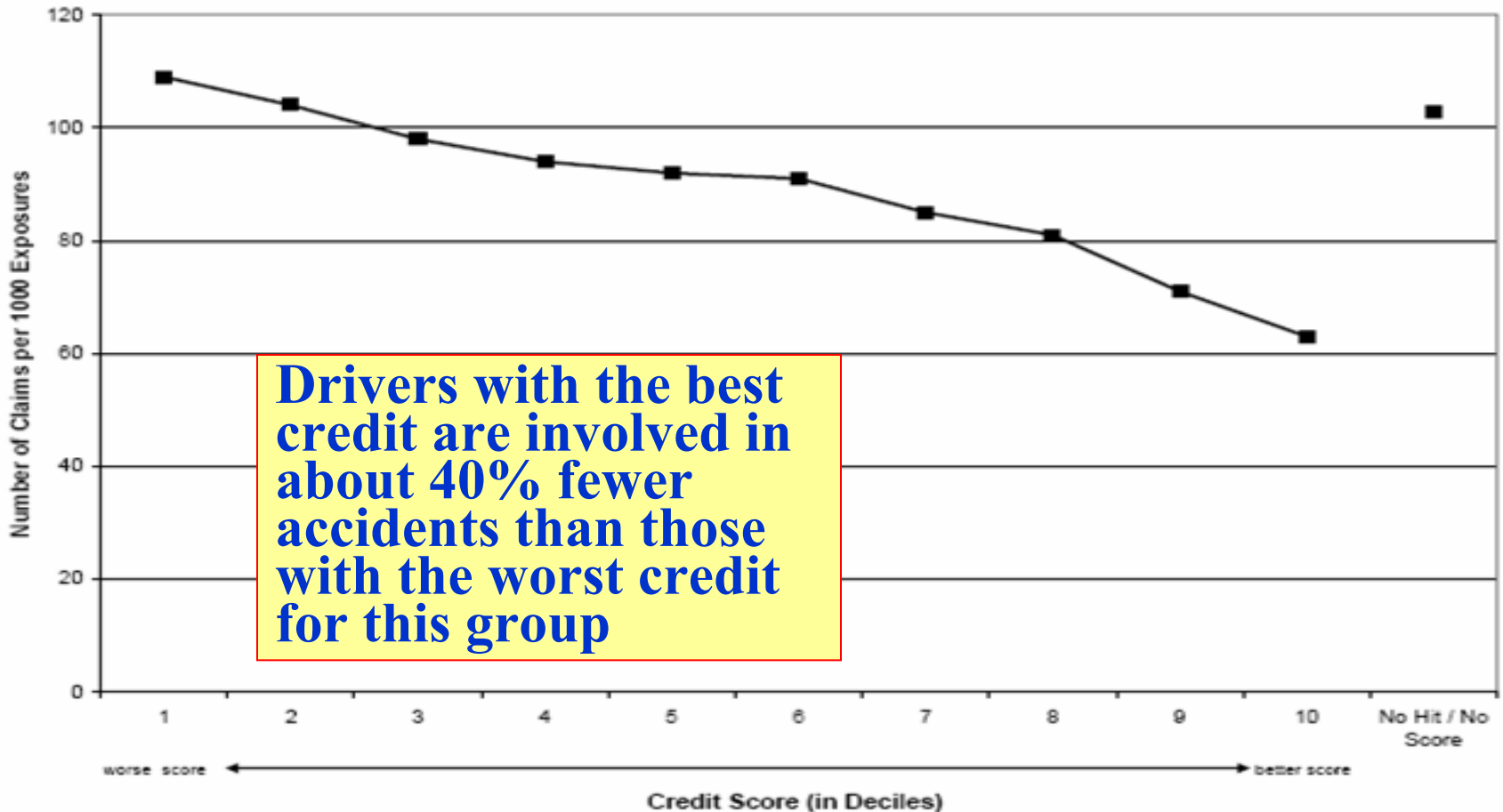
Notes:

1. Incorporates losses from all perils, including water damage, wind and hail



AUTO: New TX Study Shows People With Good Credit Involved in Far Fewer Accidents

Personal Automobile Insurer Group B
Claim Frequency vs Credit Score

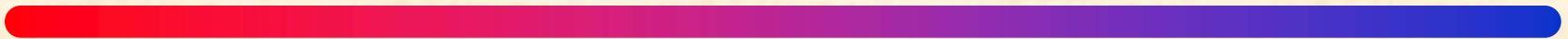


Drivers with the best credit are involved in about 40% fewer accidents than those with the worst credit for this group

Notes:

1. Includes BI (bodily injury) and PD (property damage)

***THE DEBATE OVER
FEDERAL vs. STATE
REGULATION OF
INSURANCE***





Is a Federal Regulatory Mechanism for Insurance Just a Matter of Time?

- **Agreement that current regulatory system is broken**
- **2 Main Problems:**
 - **Speed-to-Market:**
 - Too slow
 - **Duplicative regulatory process:**
 - Slow, inefficient, expensive & byzantine patchwork system
- **Solutions/Outcomes**
 - **Status Quo (unsupported but could be short/intermediate-term outcome)**
 - **Federal Standards Approach**
 - **Optional Federal Charter (OFC)**



What Do Proponents of Optional Federal Chartering Want?

- **MAJOR PROPONENTS: AIA, ACLI, FSR...**
- **Market Based System**
 - **Competition, not regulatory approval, should determine products sold by insurers and prices charged**
 - **Enhances speed- to-market, efficiency**
- **National Treatment**
 - **OFC allows insurer to operate in all 50 states w/ 1 license**
 - **Federal RBC and capital requirements**
- **Uniform Regulatory Requirements**
 - **Fed regulator would promulgate and enforce federal requirements governing market conduct, claims practices, solvency, liquidation...**



What Do Proponents of Optional Federal Chartering Want? (cont'd)

- **Timely & Impartial Implementation**
 - **Enforcement of regulatory requirements will be timely, impartial and professional;**
 - **Fines and other penalties proportional to violation**
- **Level Playing Field**
 - **Level regulatory playing vis a vis other financial services industries**
 - **New federal regulatory to be located within Treasury Dept.**
- **Technology for the 21st Century**
 - **Fed regulator would embrace use of new technologies by federally chartered insurers and pre-empts inconsistent state requirements**



What Do Proponents of State Insurance Regulation Want?

- **MAJOR PROPONENTS: NAMIC, PCIAA, IIABA, NAIC**
- **Federal Standards/Tools Approach**
 - **“Targeted and limited” national standards with state enforcement, national/multi-state reciprocity, incentives and pre-emption of certain state laws provides a superior regulatory mechanism**
- **CLAIM: Not obvious you get better regulation from Washington**
 - **Note previous failures in banking system, mutual fund & securities scandals**
- **CLAIM: State regulators more responsive to local needs and market idiosyncrasies**



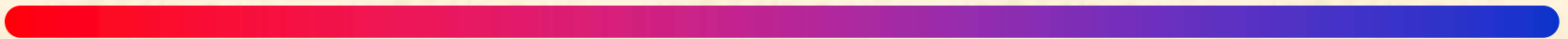
Key Elements of SMART Act

- **Affirms 1945 McCarran-Ferguson Act, which preserves state authority to regulate insurance unless specific federal pre-emption exists**
- **SMART would (for the first time) pre-empt state personal & commercial lines rating laws to create “nationwide competitive insurance pricing”**
 - **2 years after enactment—rate deregulation for virtually all commercial lines except med mal**
 - **Flex band rating in personal lines: +/-7% yr. 1; +/-12% yr. 2**
- **Speeds up approval process for new products**
- **Licensing: Creates “single point-of-entry” system**
 - **Allows a company licensed and in good standing in 1 state to submit uniform application to conduct business in other states**

Key Elements of SMART Act (cont'd)

- **Limits market conduct exams to “for cause” situations**
- **Creates 7-member “state-national insurance coordination partnership” to assess if uniformity requirements met. Has no regulatory/supervisory authority but must make a report to Congress**
- **In wake of Spitzer probes, future drafts of SMART Act will likely contain language on disclosure of producer compensation.**
- **SUMMARY: Likely more hearings in Congress, but no bill in 2005**

***SHOULD THERE BE A
NATIONAL DISASTER
(RE)INSURANCE
FACILITY?***



California is No Stranger to Disaster



Earthquake



Wildfire

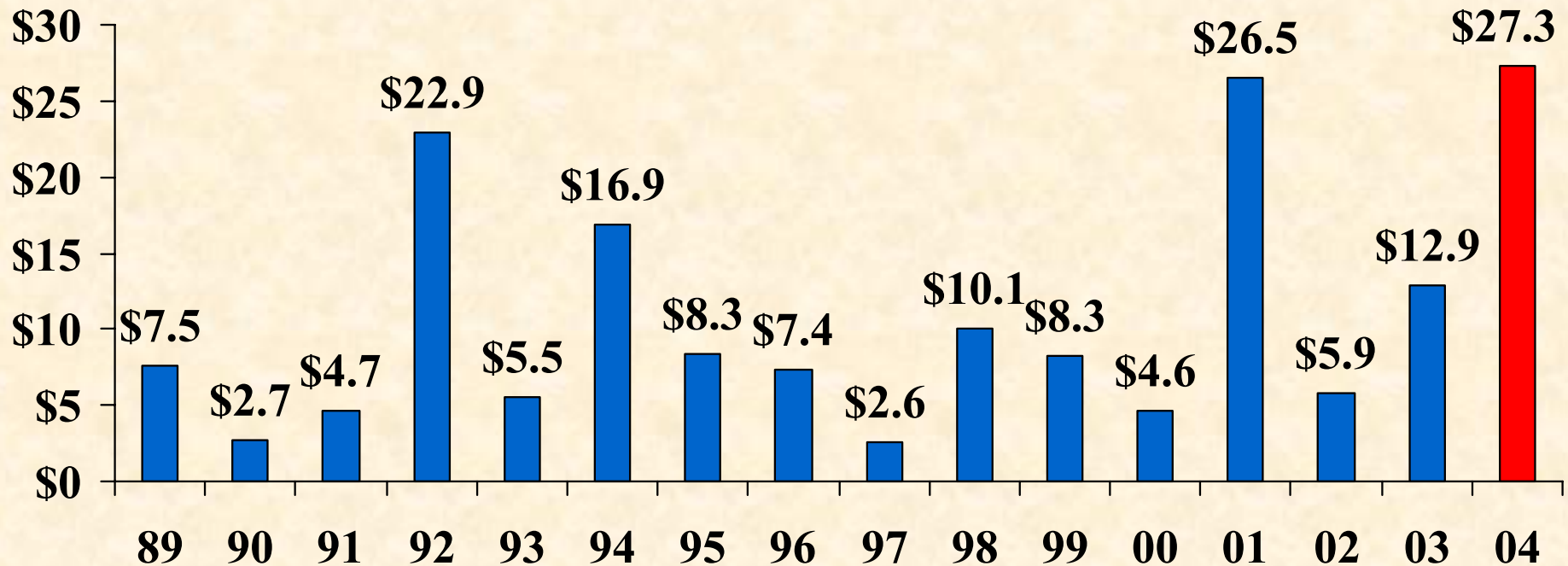


Flood & Mud



U.S. Insured Catastrophe Losses (\$ Billions)

2004 was the second worst year ever for natural disaster losses in the US after adjusting for inflation. About 79% of those losses originated in Florida.



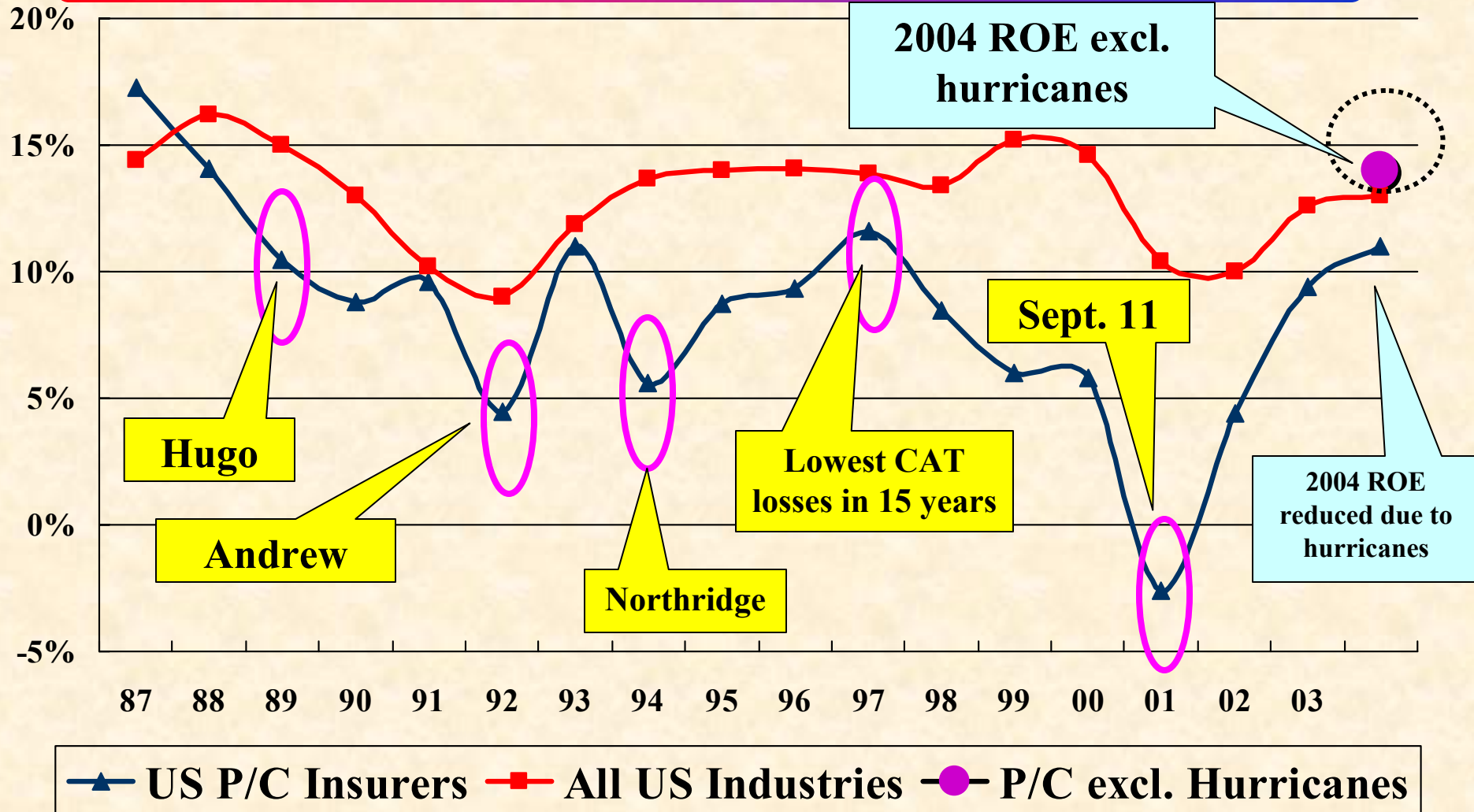
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims.

Source: Property Claims Service/ISO; Insurance Information Institute



ROE: P/C vs. All Industries

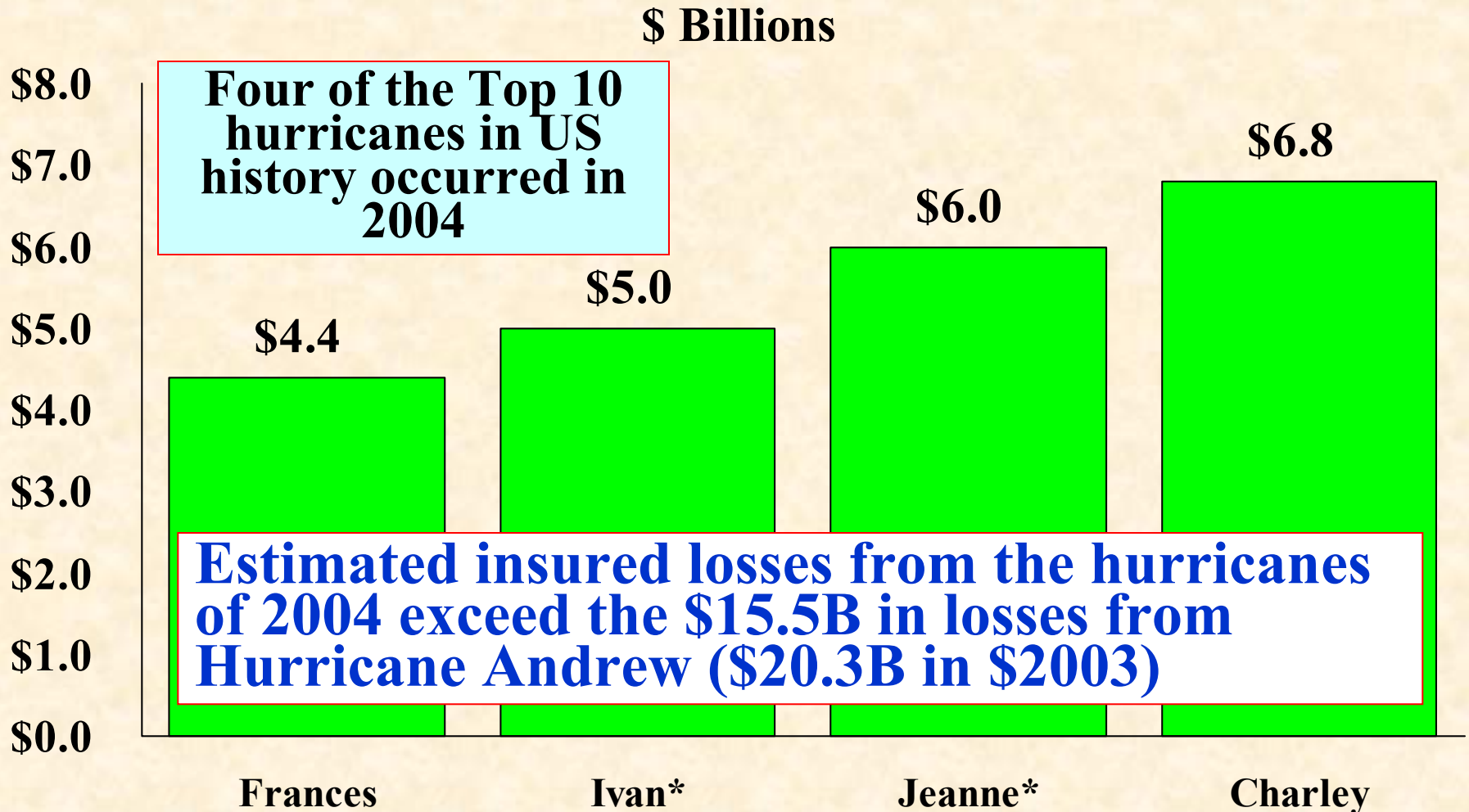
1987-2004E*



*2004 p/c estimate based on first 9 months data.
Source: Insurance Information Institute; Fortune



Losses from Hurricanes of 2004



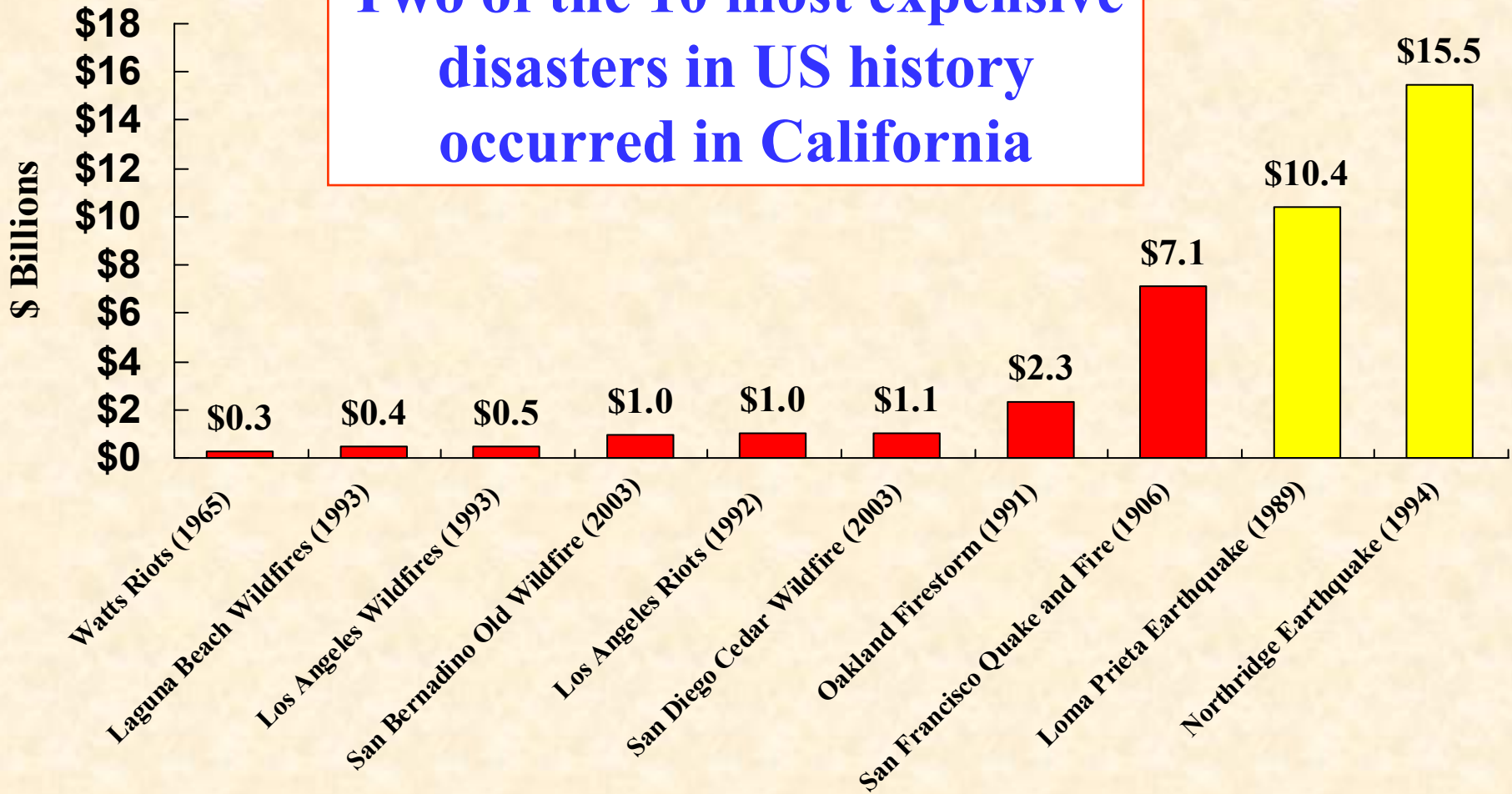
*III estimates as of 9/29/04

Source: ISO/PCS; Insurance Information Institute



Top 10 Insured Losses In California History (\$2003)

Two of the 10 most expensive disasters in US history occurred in California





Top 10 Insured Losses Worldwide, 1970-2004 (\$2003)



*Insurance Information Institute estimate; Hurricane Charley figure is from ISO/PCS. Both in 2004 \$.
Sources: Swiss Re, "Natural Catastrophes and Man-Made Disasters in 2003," *Sigma*, no. 1, 2004;
except Sept. 11 estimate from Hartwig, Robert P., *2004 Mid-Year Property/Casualty Insurance Update*, Insurance Information Institute. Figure is stated in 2001 dollars.

Top 10 Insured Losses in U.S. History, 1980-2004 (\$2003)

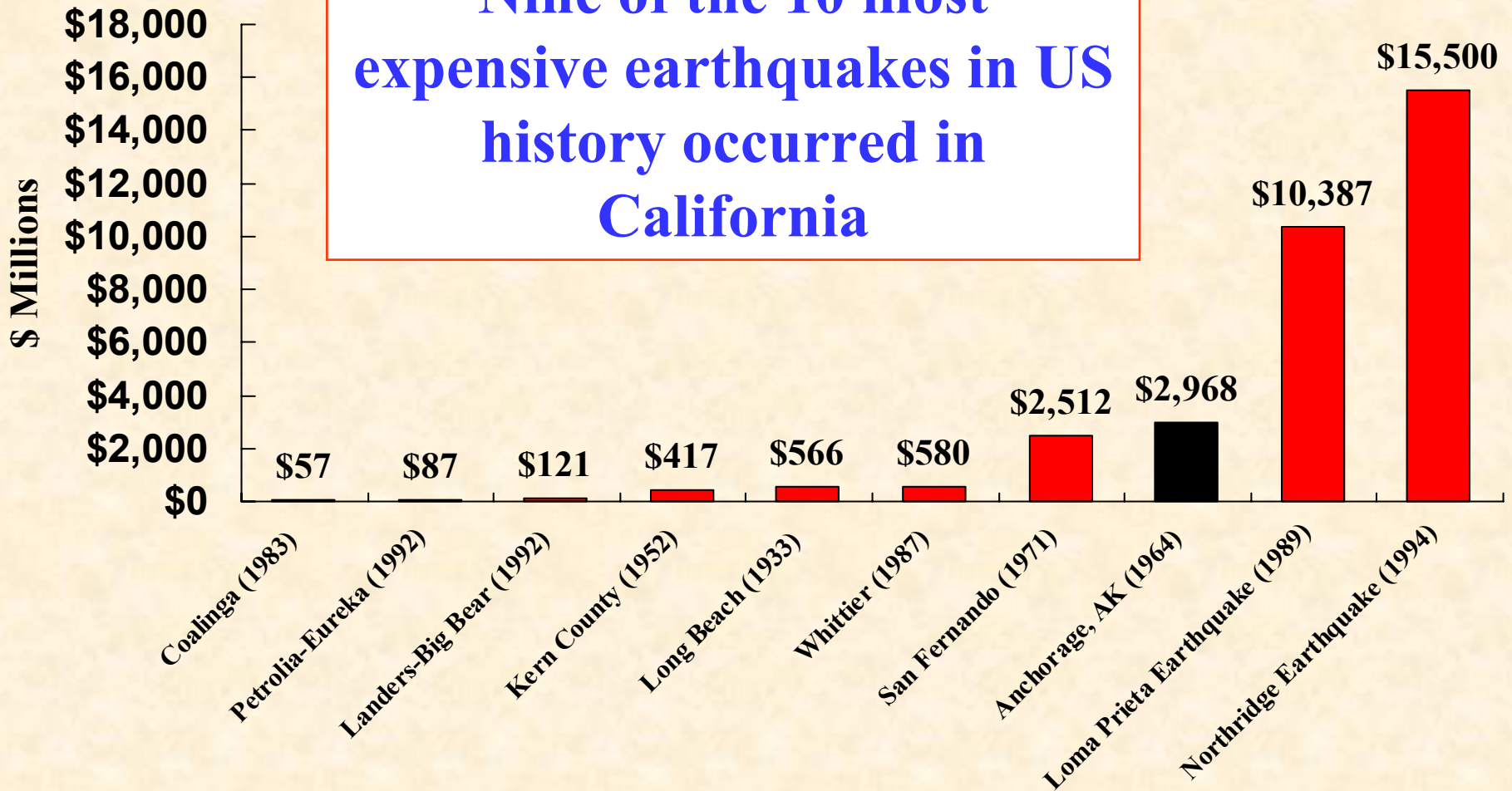


*Insurance Information Institute estimate; Hurricane Charley figure is from ISO/PCS. Both in 2004 \$. Sources: Swiss Re, "Natural Catastrophes and Man-Made Disasters in 2003," *Sigma*, no. 1, 2004; except Sept. 11 estimate from Hartwig, Robert P., *2004 Mid-Year Property/Casualty Insurance Update*, Insurance Information Institute. Figure is stated in 2001 dollars.



Top 10 Most Costly Earthquakes in U.S. History Since 1930 (\$2003)

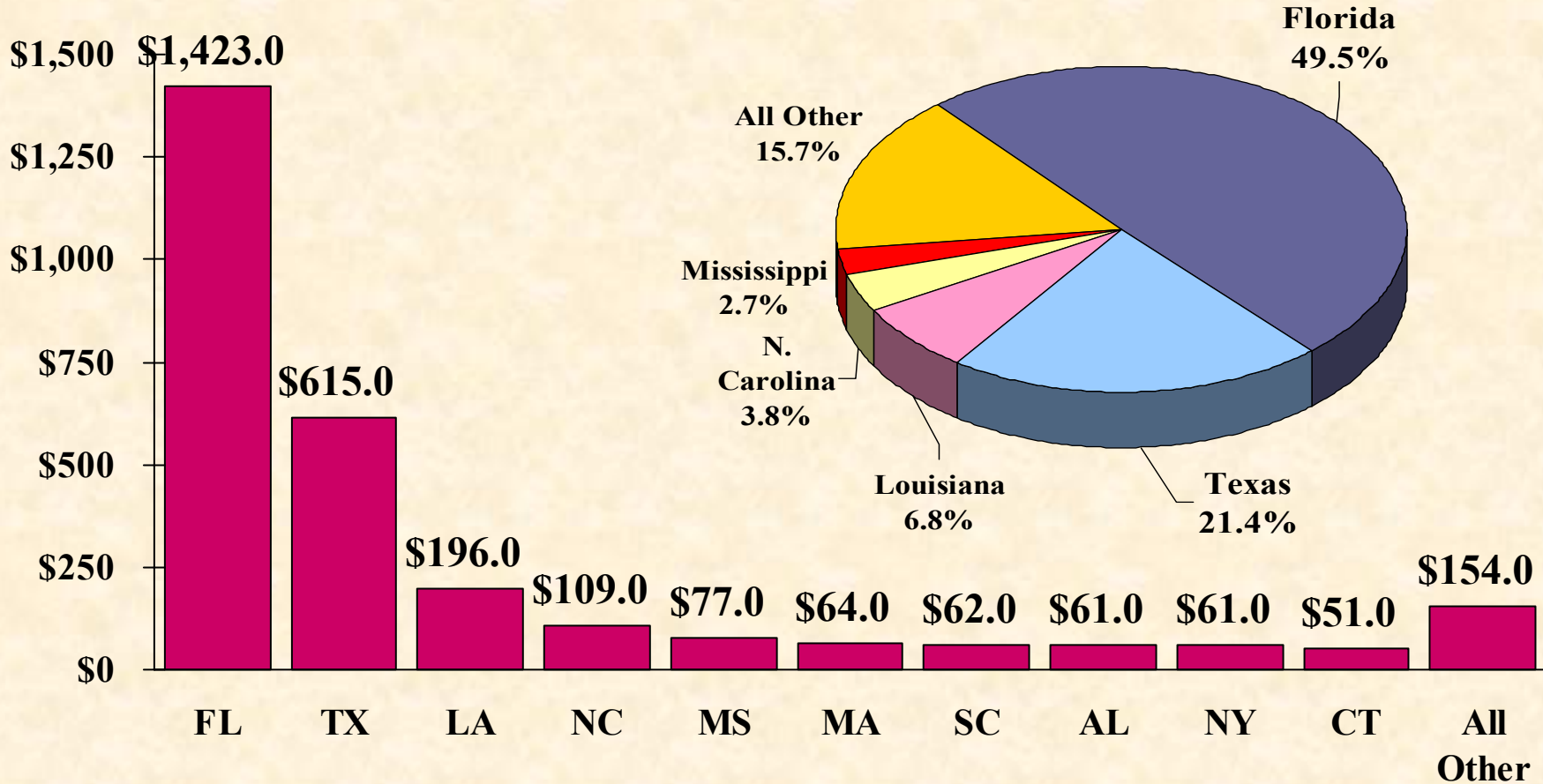
Nine of the 10 most expensive earthquakes in US history occurred in California





Average Annual Insured Losses* (Top 10 States, \$ Millions)

Distribution of Annual Losses



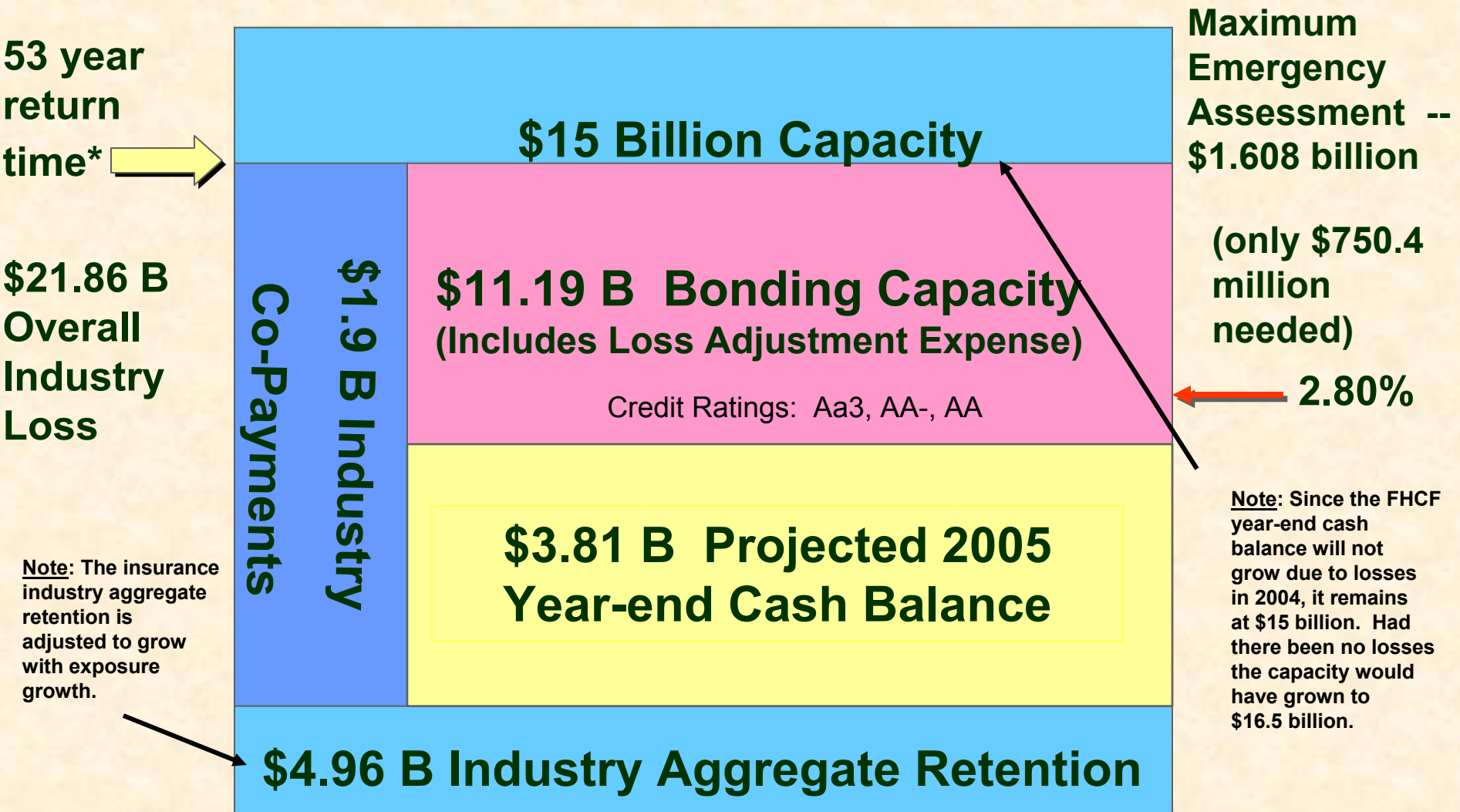
*Normalized losses adjusted for inflation, housing density, wealth and wind insurance coverage, based on historical data for 100-year period 1900-1999.

Source: Tillinghast-Towers Perrin

Initial Season Capacity For the 2005 Hurricane Season

(Projection for 2005 Estimate)

Assumes Cash Balance is Reduced \$3 billion



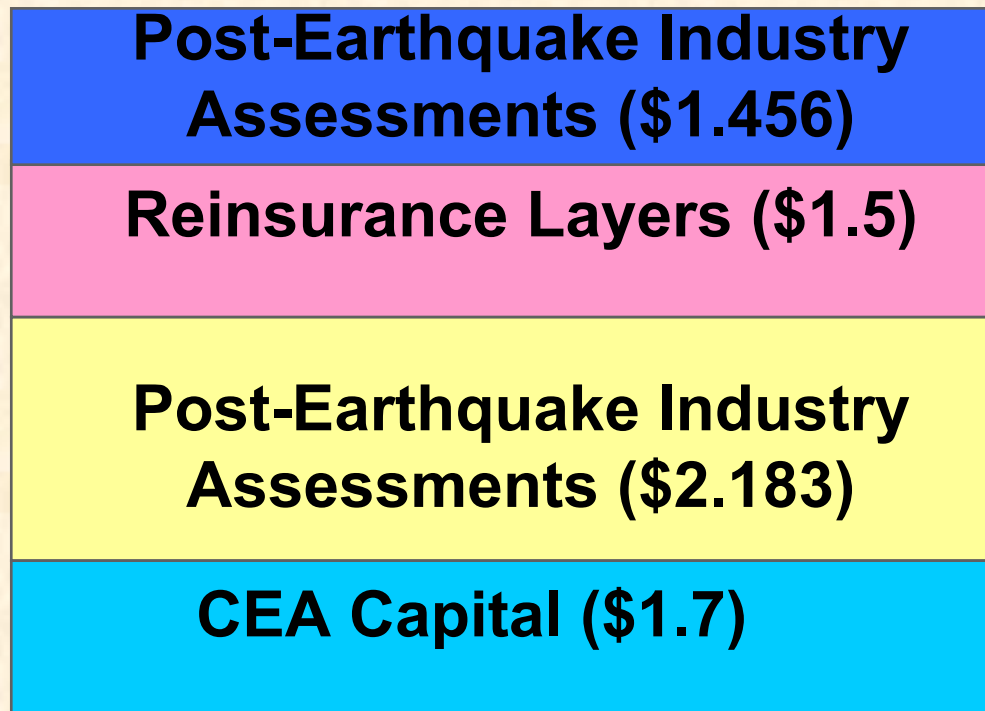
Not Drawn to scale.

*Return time not adjusted for premium/exposure growth.



California Earthquake Authority 2004 Capacity Schematic

A privately-financed, publicly managed entity, the CEA is the world's largest provider of residential earthquake insurance, with current funding capacity of over \$7.2 billion.



CEA \$7.2 Billion

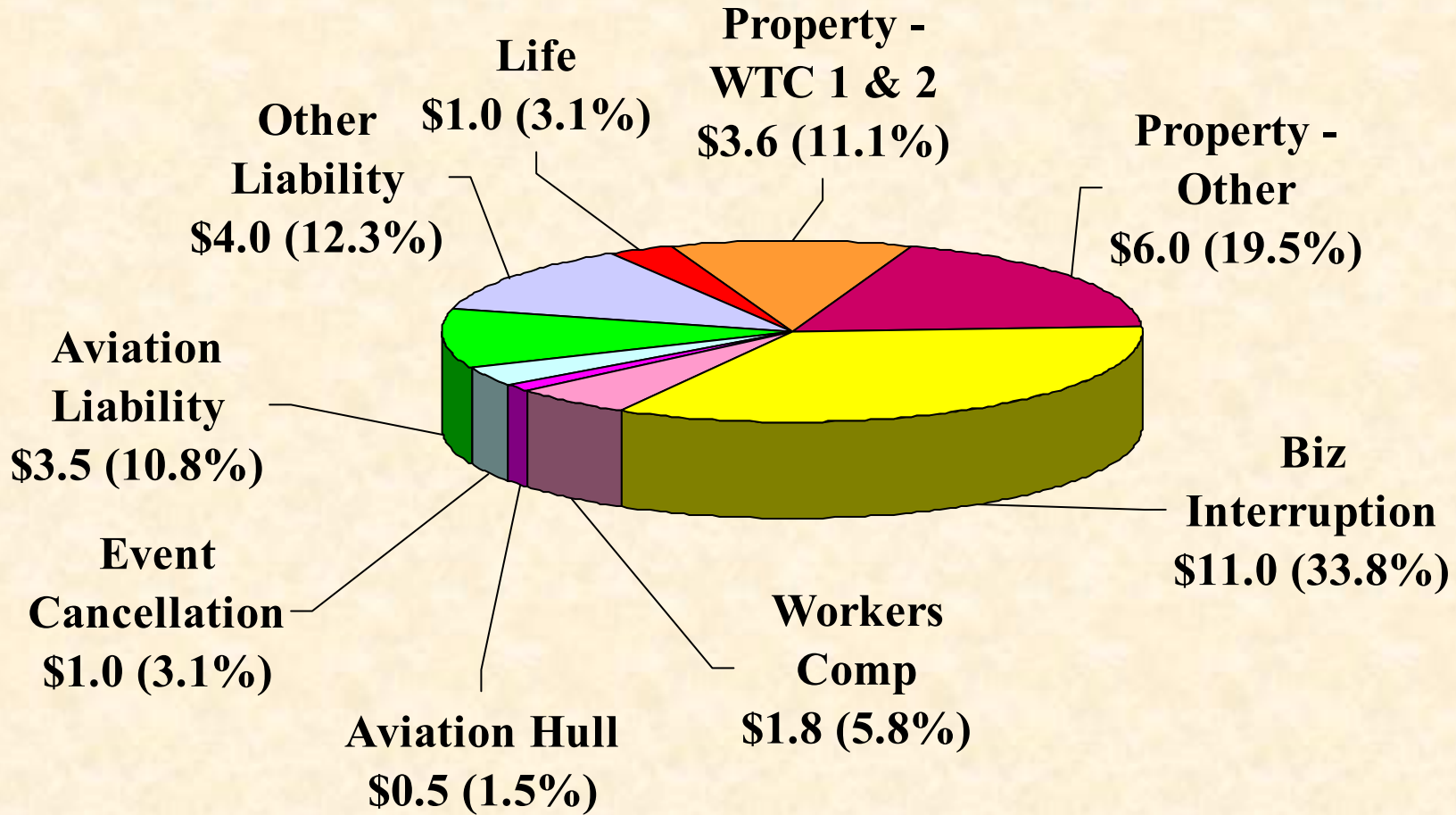
THE CHALLENGE OF TERRORISM





Sept. 11 Industry Loss Estimates

(\$ Billions)

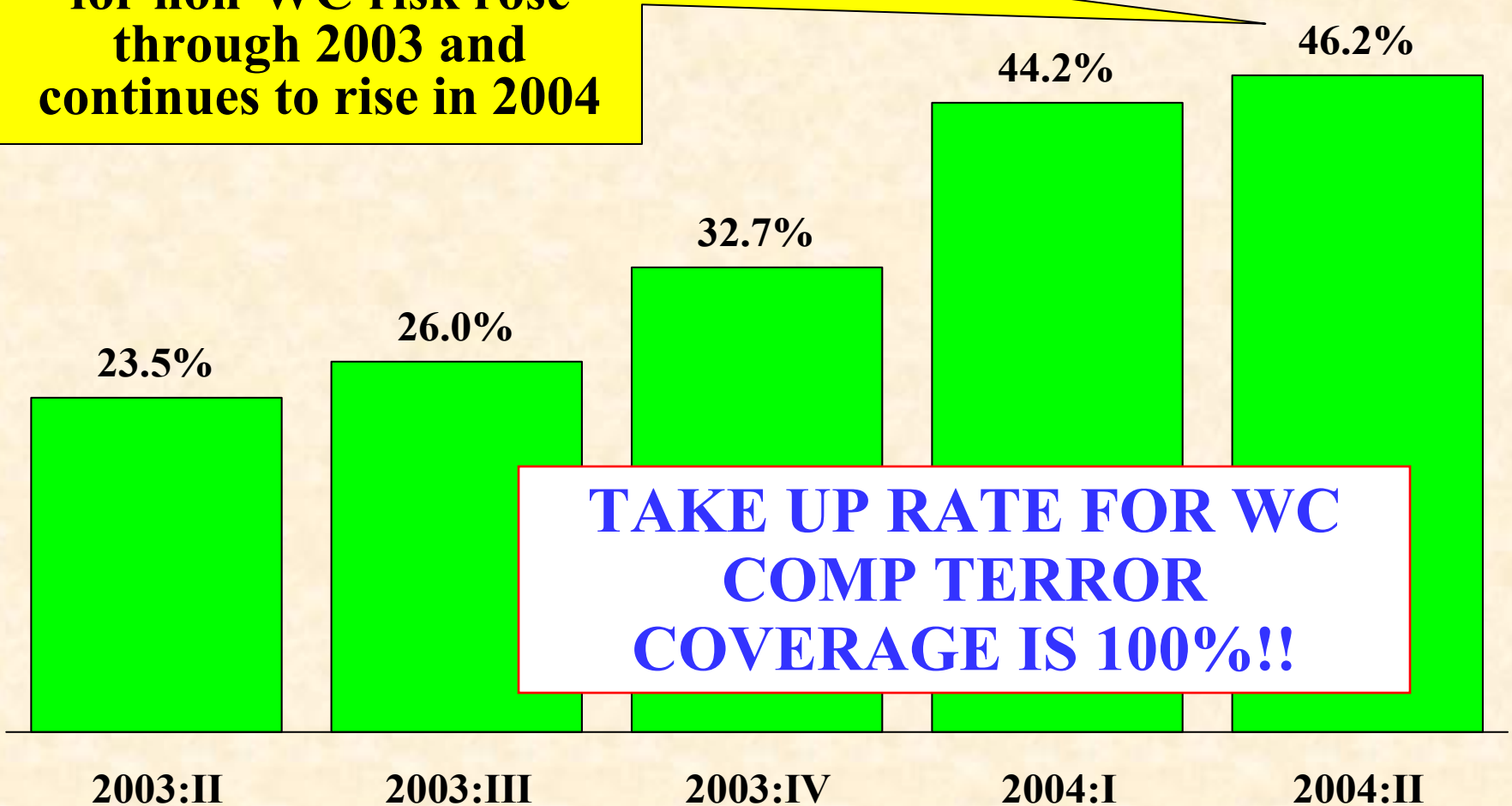


Current Insured Losses Estimate: \$32.5B



Terrorism Coverage Take-Up Rate Rising

**Terrorism take-up rate
for non-WC risk rose
through 2003 and
continues to rise in 2004**

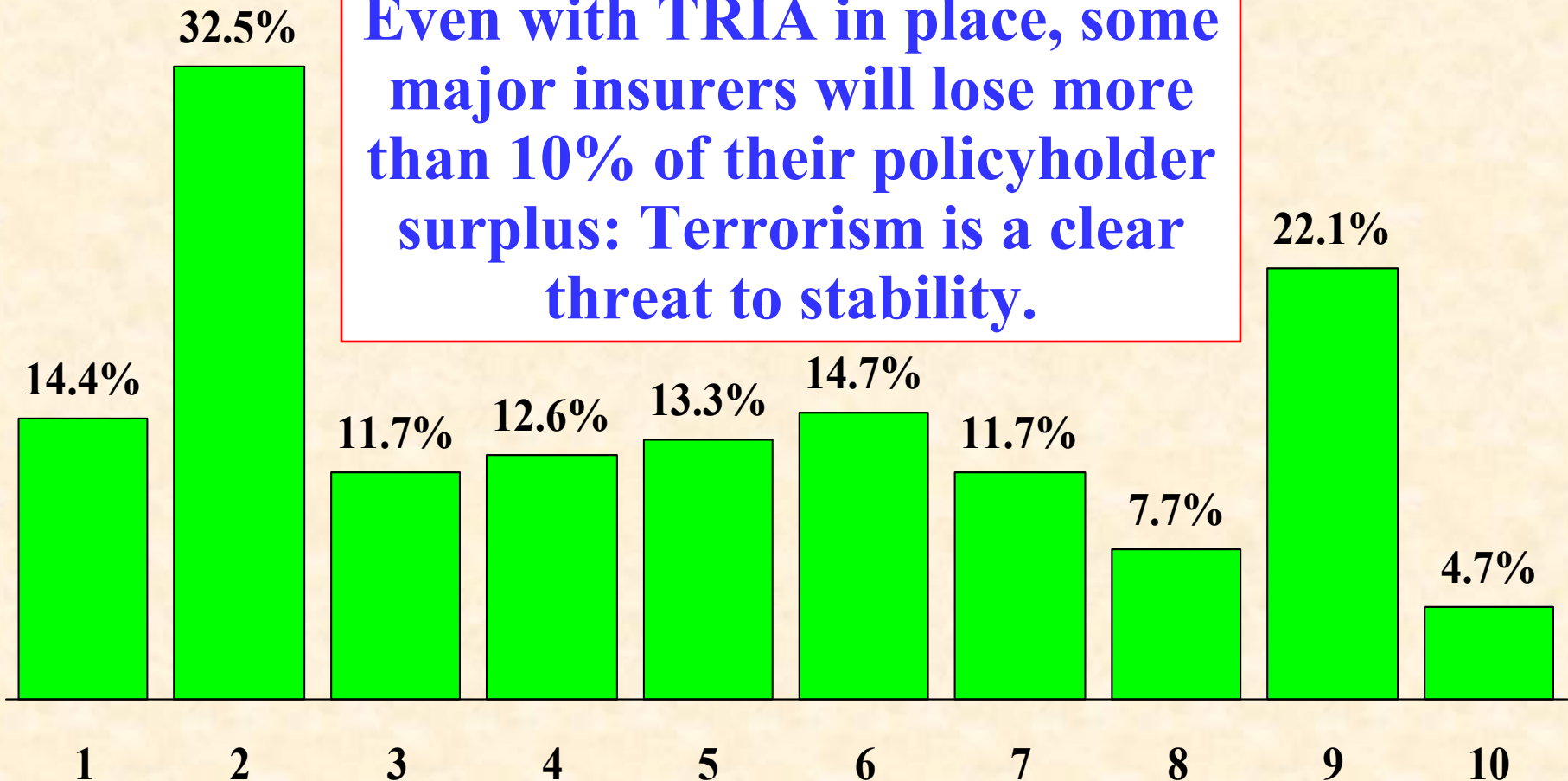




Percent of 2003 Surplus Lost Due to a \$25 Billion Terrorism Attack in 2004 With TRIA in Place

Top 10 US P/C Insurers by Market Share

Even with TRIA in place, some major insurers will lose more than 10% of their policyholder surplus: Terrorism is a clear threat to stability.





Capital Myth: US P/C Insurers Have \$350 Billion to Pay Terrorism Claims

Total PHS = \$298.2 B as of 6/30/01
= \$291.1 B as of 12/31/02
= \$347.0 B as of 12/31/03

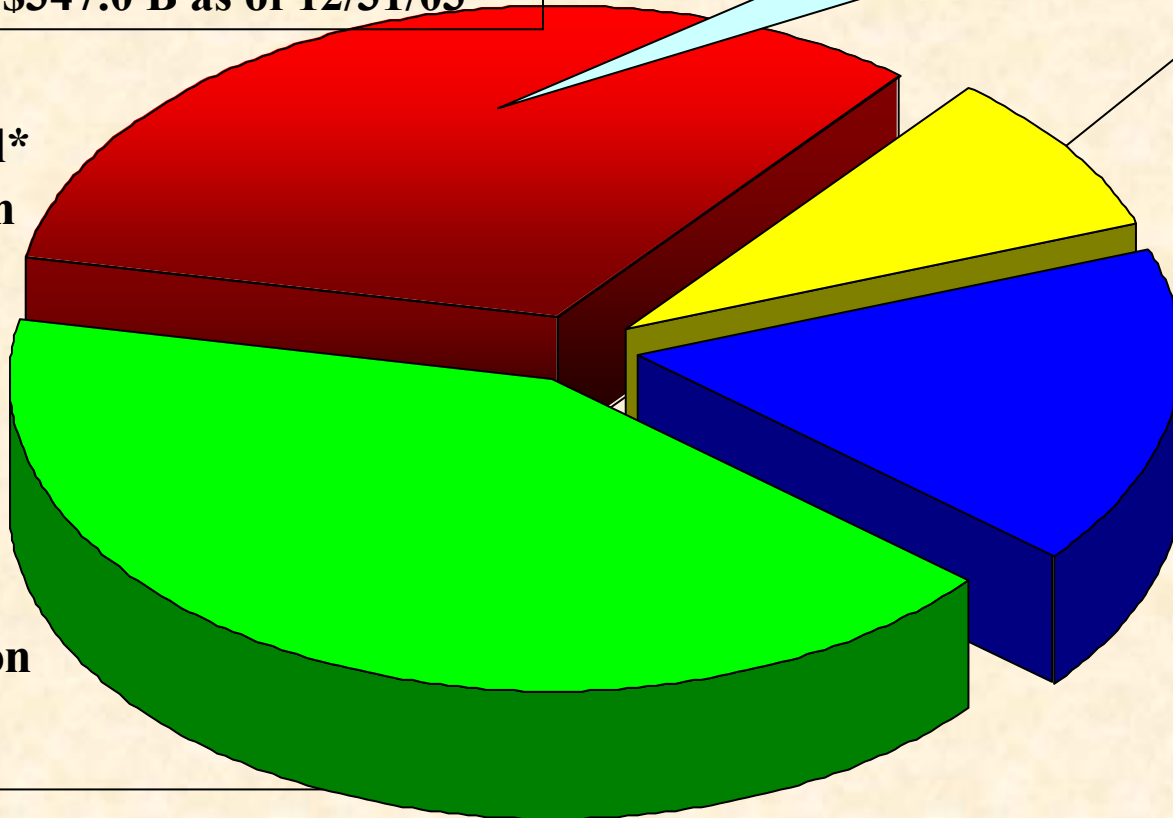
Only 33% of surplus backs "target" lines net of reserve deficiency

"Target" Commercial*
\$114 billion
33%

Commercial Reserve Deficiency
\$30 billion (est.)
9%

Other Commercial
\$58 billion
17%

Personal
\$146 billion
42%



*"Target" Commercial includes: Comm property, liability and workers comp; Surplus must also back-up on non-terrorist related property/liability and WC claims

Source: Insurance Information Institute estimates based on A.M. Best Q.A.R Data.



Summary

- **US: 2004/5 sweet spots in the current cycle in terms of earnings and underwriting performance**
- **CA market getting better though historically the state has historically been difficult**
- **Despite recent progress, nothing has changed that suggests we are on the threshold of a prolonged period of stability and prosperity in CA**
- **Factors that guarantee long-term problems**
 - **CAT exposure**
 - **Tort environment**
 - **Occasionally hostile legislative & regulatory environment**
 - **Uninformed critics get big play**
- **OUTLOOK: Short-term improvement**



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