



U.S. Insurance Industry Outlook

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U.S. Insurance Industry Outlook

- **S&P's industry outlook reflects our expectation of the prospective relationship of rating upgrades and downgrades.**
- **Our outlooks on the largest S&P rated insurance sectors remain unchanged since mid-year.**
 - Health insurance, personal line P/C insurance, and life insurance retain their stable outlook, despite macroeconomic headwinds.
 - Commercial P/C insurance outlook remains negative.
- **We expect few upgrades or downgrades on our stable sectors going into 2012, unless the U.S. sovereign rating is lowered, which likely would affect eight rated groups.**
- **The industry's capital is adequate to weather all but the most extreme adverse developments.**
- **The probability that interest rates will remain at historically low levels for a prolonged period remains a concern for the industry as a whole, with heightened risk for life insurers in particular. Conversely, if inflation picks up, P/C loss reserves and current pricing might prove to be inadequate to support future claims leading to potential adverse reserve development.**
- **Pricing weakness remains an ongoing concern for P/C insurers, particularly commercial lines writers, and mounting catastrophe losses throughout 2011 will likely have a significant impact on earnings and we believe present a medium to high risk going forward.**
- **Health insurers continue to face legal and regulatory uncertainties concerning the implementation of various aspects of health care reform, but ratings will be driven predominantly by the economy.**

S&P Economic Outlook

- We expect real GDP to rise 1.6% in 2011, which is almost half the 3% rate in 2010. For 2012 and 2013 we expect just 1.9% and 2.2% growth.
- None of this seems enough to make a dent in the unemployment rate, which will likely remain above 8% through 2013.
- Higher unemployment rates are keeping a lid on consumer activity. Due to weak wage growth, people are scared to spend, and we expect them to remain cautious.
- We expect CPI to be 3.2% in 2011, double from 1.6% in 2010.
- Interest rates at historical lows. 10-year treasury yielding 2.06% at Nov. 15, 2011, down 124 bps from Dec. 31, 2010.
- We do not expect these macro risk factors to impact each insurance sector the same; we will focus on each sectors' sensitivity to these factors in the context of our ratings.

Insurance Industry Macro Risk Matrix

Sensitivity / Rating Bias Analysis - Q4 2011

Risk factors/sectors	--Life--		--Life - asset accumulation--		--Health--		--PC--					
	Protection	General account	Separate account	Private sector	Government programs	Mortgage	Title	Personal	Commercial	Reins	Bond	Broker
Economic development (real GDP)	L	L	L	H	H	H	L	L	M	H	M	M
Market risk												
- interest rate	M	H	M	L	L	M	M	M	M	M	M	H
- equity	L	L	H	M	L	M	M	M	L	M	L	L
- credit	H	H	L	L	L	M	M	L	L	L	H	L
Employment conditions	L	L	L	H	H	H	L	L	M	M	M	M
Inflation trend (CPI / PPI / other)	L	L	L	M	M	L	L	M	H	H	L	L
Legislative / regulatory / judicial	M	M	M	H	H	M	M	M	M	M	L	M
Catastrophic event	L	L	L	M	M	L	L	H	M	H	L	H
Housing market conditions												
- prices	-	-	-	-	-	H	L	-	-	-	-	-
- originations / starts	-	-	-	-	-	M	M	-	-	-	-	-

Letters: forward-looking sensitivity. H - high. M - medium. L - low.

- **The insurance industry's sensitivity to macro risk factors varies by sector and in many cases down to the product level.**
- **Life Insurers:** Market risk including interest rate, equity and credit represents "high" risk sensitivities, though the degree of such varies by subsector.
- **Health insurers:** Economic development (real GDP), employment conditions, and legislative/regulatory/judicial factors represent "high" risk.
- **P/C insurers:** Inflation trend (CPI/PPI/other) and catastrophe events represent "high" risk.

U.S. Life Insurance Sector

U.S. Life Insurance Sector Outlook: Stable

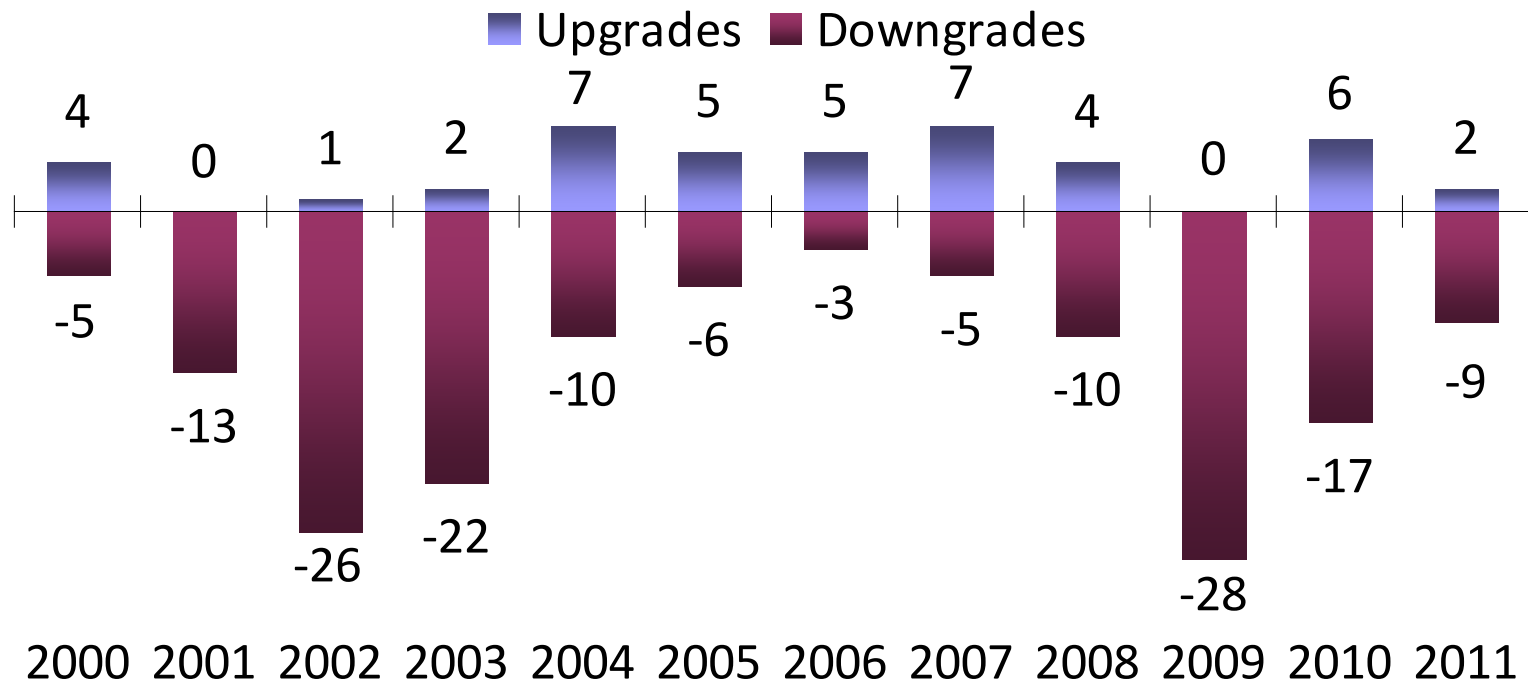
- **Key supporting factors:**

- Strong capitalization
- Improving holding company liquidity
- Recovered operating earnings
- Resiliency of new life and annuity sales

- **Key assumptions:**

- Continued, albeit slow, economic recovery
- Limited earnings impact of low interest rates in the near term
- Moderate credit losses
- Prudent balance sheet management

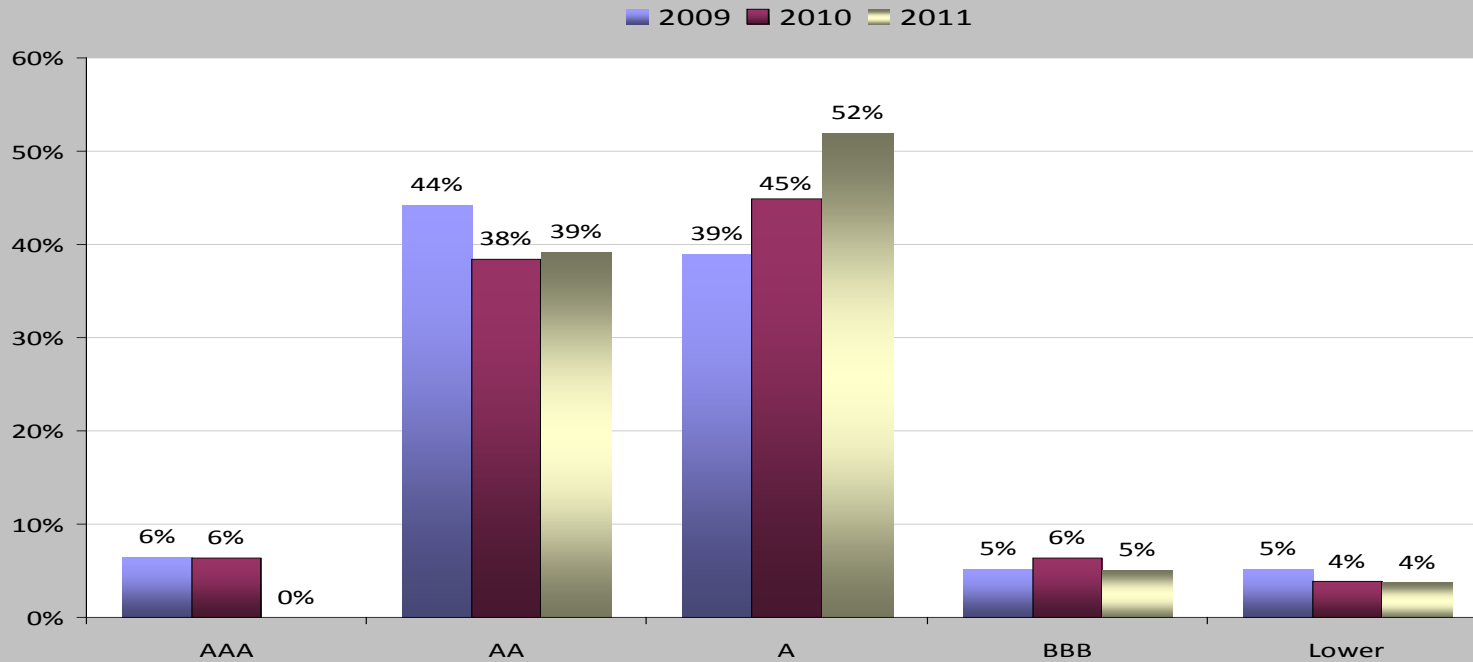
Rating Trends: U.S. Life Insurance



2011 totals are through Nov. 11

- **2011 includes five downgrades related to S&P's downgrade of the U.S.A. sovereign rating.**

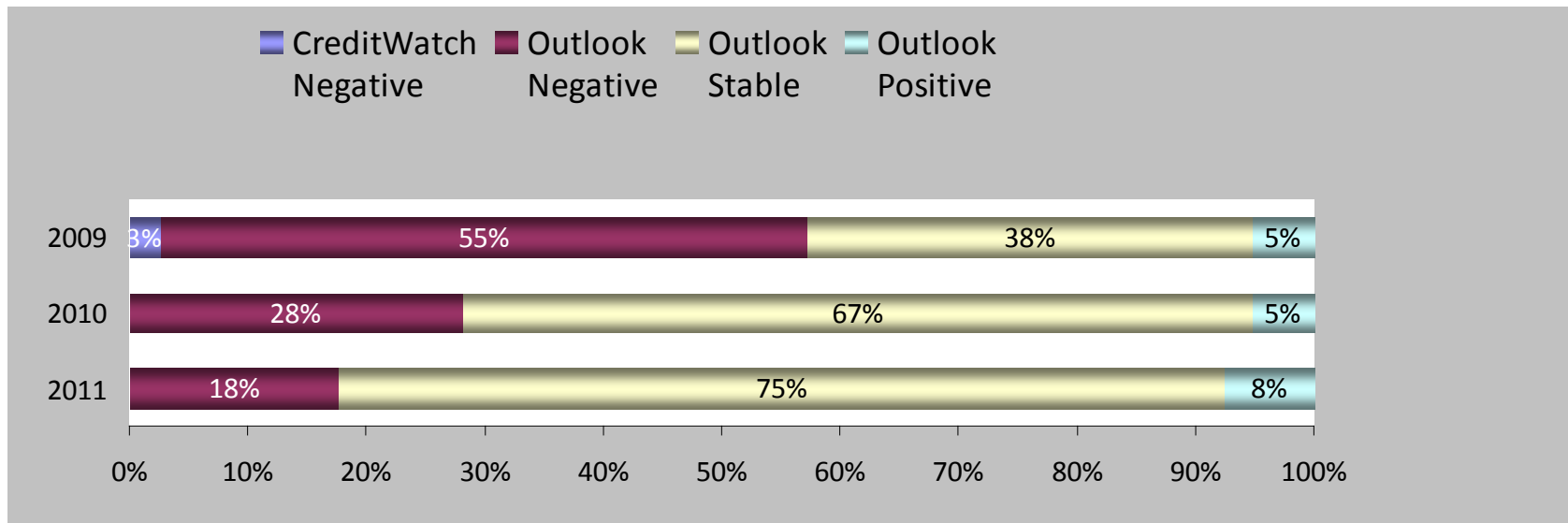
Rating Distribution: U.S. Life Insurance



Ratings of 79 interactively-rated groups as of Nov. 11 each year.

- The life insurance industry remains among the highest rated industries by S&P.

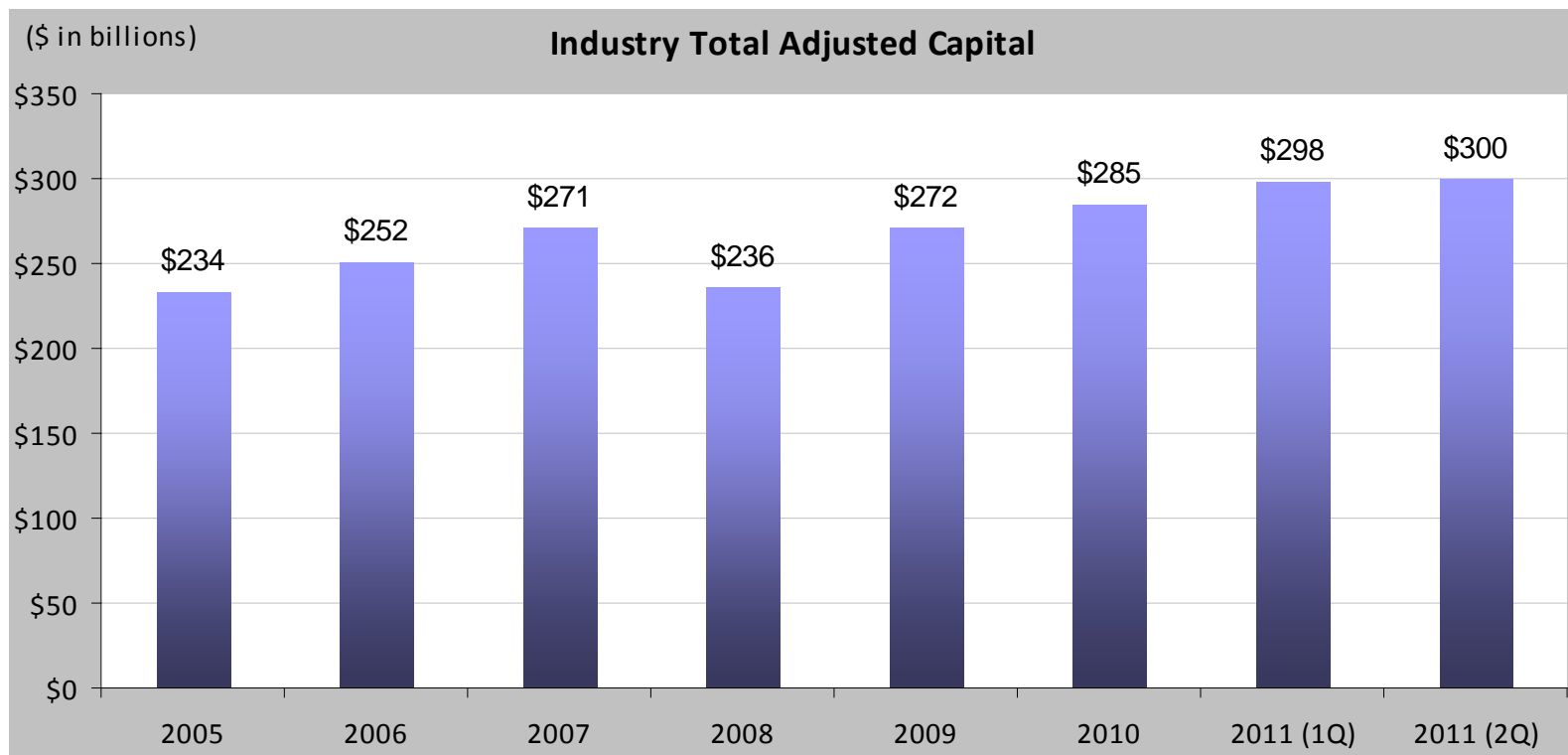
Rating Outlooks: U.S. Life Insurance



As of Nov. 11 of each year; 79 interactive ratings.

- Life insurer outlooks have trended towards stable in 2011, inclusive of eight 'AA+' rated entities placed on negative outlook as a result of the negative outlook on the U.S.A. sovereign rating.

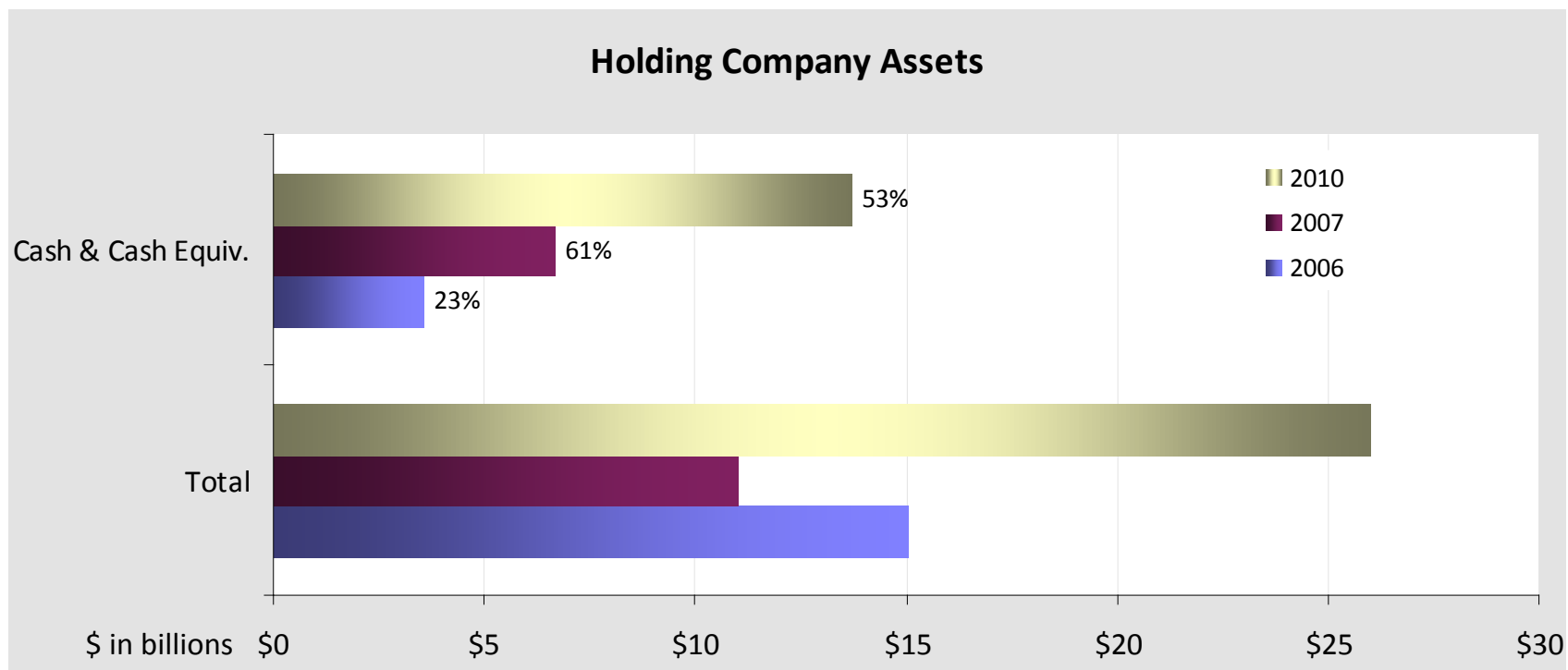
Total Adjusted Capital – Life Sector



Source: Standard & Poor's Ratings Services.

- **Organic capital generation from positive operating results continues to add to the life industry capital base.**

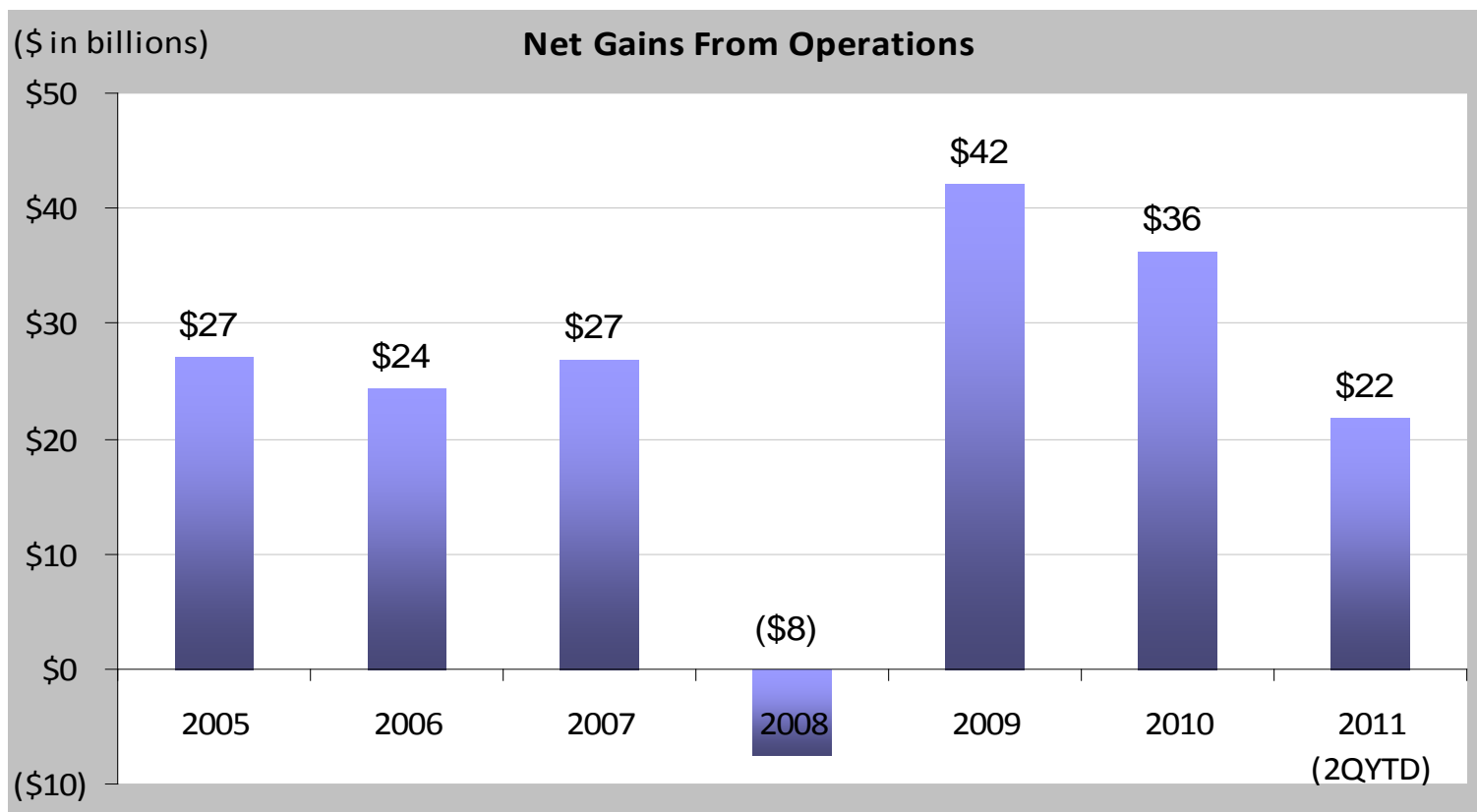
Holding Company Balance Sheets – Life Sector



Source: Standard and Poor's Ratings Services. Values represent estimates based on a sampling of the 10 largest U.S. life insurance holding companies.

- In general, life insurance holding company assets have increased and remain sound, including higher absolute levels of available cash and liquid assets.

Net Gain From Operations (Statutory) – Life Sector



Source: Standard & Poor's Insurance Ratings Services.

- **Net gains from operations (after tax and excluding realized gains and losses) have recovered from 2008 lows, and were strong through second quarter 2011.**

Macroeconomic Headwinds

- **Low interest rates**

- 10-year treasury yielding 2.06% at Nov. 15, 2011, down 124 bps from Dec. 31, 2010
- S&P base case scenario calls for a much slower increase in rates, with 10-Year Treasury yields remaining below 3% through most of 2013

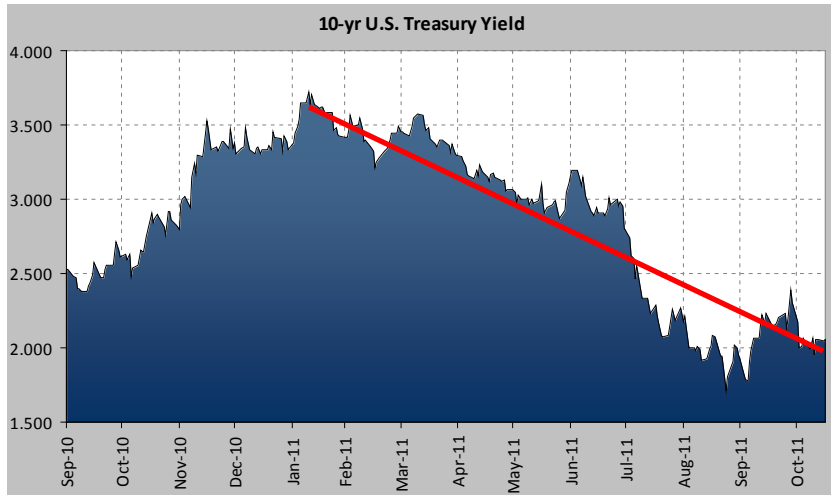
- **Equity market declines and volatility**

- S&P 500 declined 10% through the first nine-months of 2011
- VIX readings regularly 30% or higher

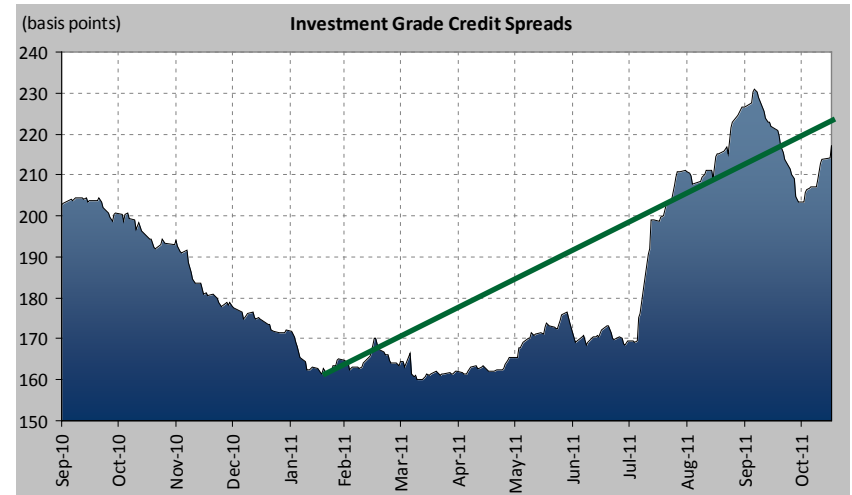
- **Slow economic growth**

- S&P real GDP forecast of 1.8% in 2011 and 1.7% in 2012
- S&P economists place the odds of a double-dip recession at 35%

Financial Markets – Implied Corporate Bond Yields



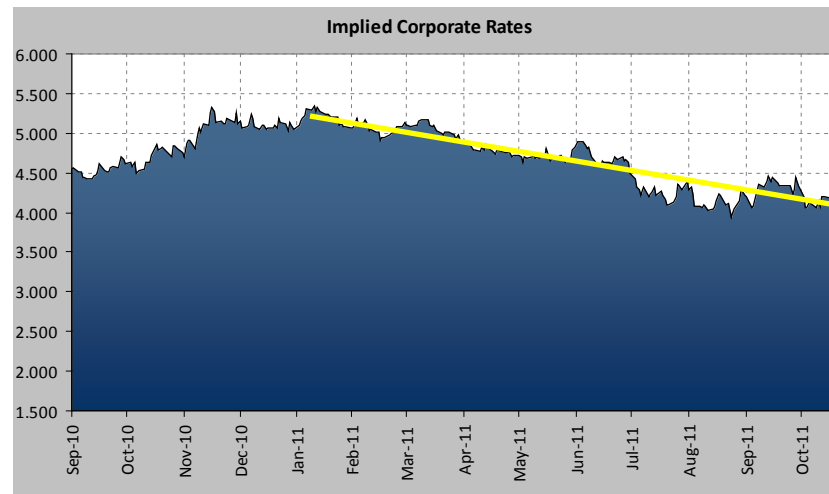
Source: Bloomberg Financial L.P.



Source: Standard & Poor's Global Fixed Income Research

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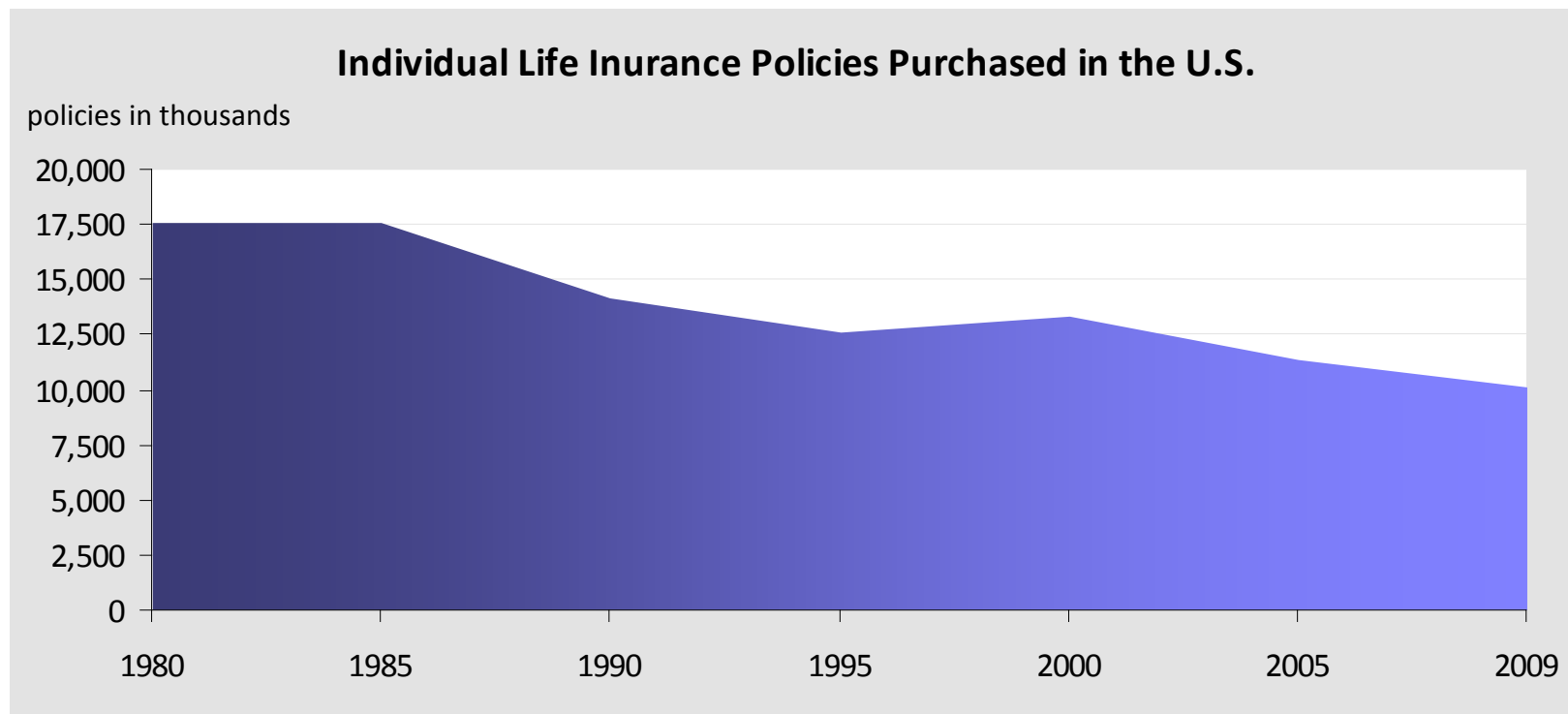


Source: Bloomberg Financial L.P. and Standard & Poor's Rating Services

Longer Term Challenges

- **Competitive rivalry and soft demand for protection products**
 - Product commoditization and pricing competition, particularly in third-party distribution, pressure profit margins
 - Only 44% of U.S. households have individual life insurance, a 50-year low (Source: LIMRA Facts About Life 2010)
- **Trend towards complex products with exposures to market risk, requires sophisticated risk management capabilities**

Changes in Individual Life Insurance Purchases



Source: ACLI tabulations of National Association of Insurance Commissioners (NAIC) data.

- **The number of individual life insurance policies purchased annually in the U.S. has declined about 42% in the past 20 years, reflecting the declining penetration rates into the growing number of U.S. middle-income households.**

Opportunities

- **Retirement Savings and Income**

- Seniors are growing at a faster rate than the rest of the population and will drive future demand for retirement products
- The first of the baby boomers reached retirement age in 2011
- Declining confidence in the future of Social Security Benefits for future generations and trend towards defined contribution retirement plans
- Life insurance industry uniquely positioned to provide guaranteed income solutions

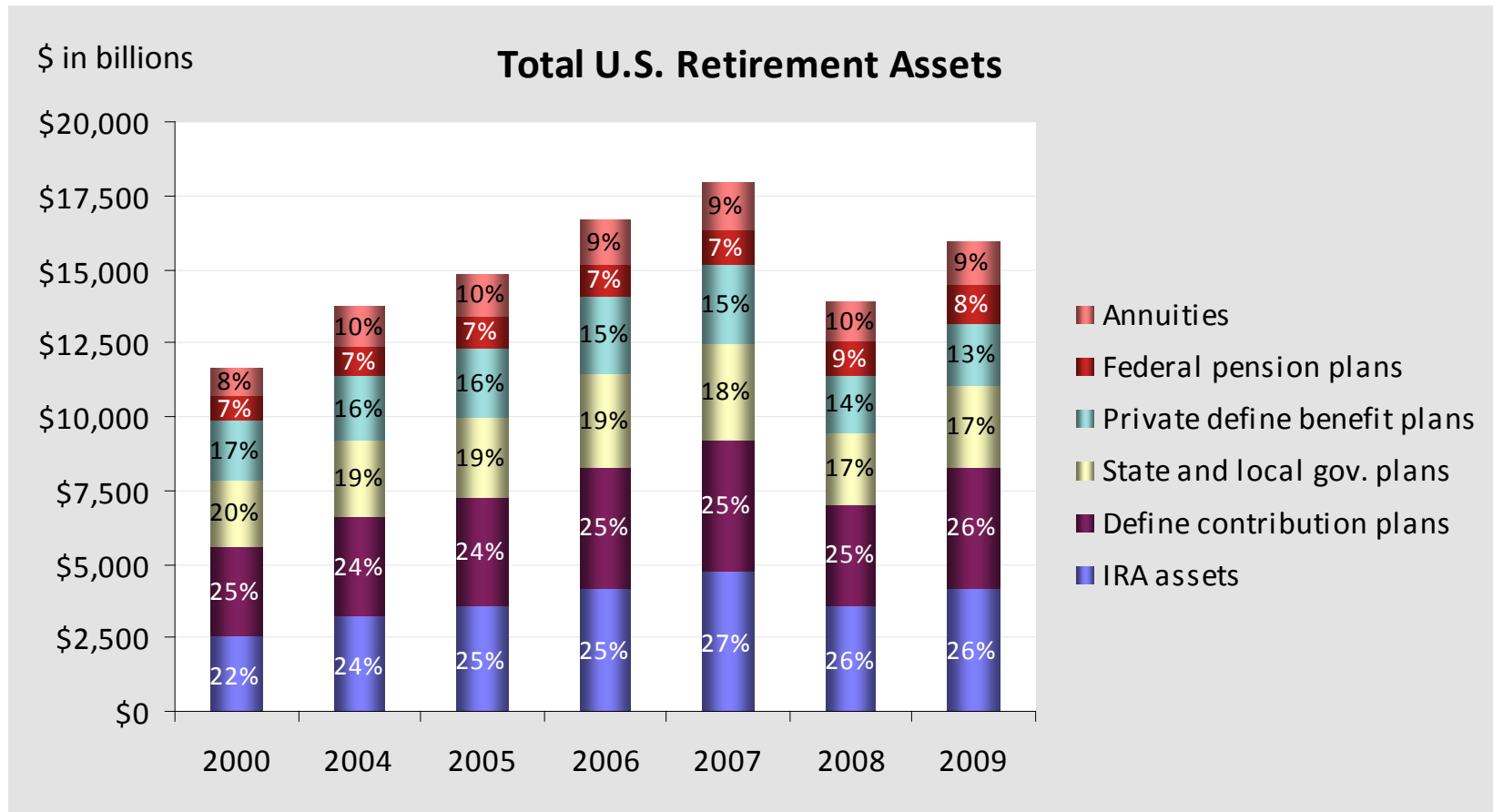
- **Middle-market life insurance**

- Underinsured middle-market represents an opportunity to grow sales of protection products
- Recurring revenue and steady mortality margins supportive of high investment grade ratings

- **Ratings Implications**

- Increased business risk could exert negative pressure on ratings

Distribution of U.S. Retirement Assets



Source: Investment Company Institute, Washington, DC, Research Fundamentals, "The U.S. Retirement Market, 2009", Vol. 19, No. 3, May 2010.

- The rollover opportunity**

Legislative and Regulatory Activity: Moderate Impact

- **“The Dodd-Frank Act”**: authorizes the Financial Stability Oversight Council (FSOC) to designate certain non-bank financial companies as systematically important financial institutions (SIFIs) and require supervision and prudential standards.
 - SIFI criteria was announced in October, 2011
 - Potential insurers to be designated as SIFIs include, AIG, MetLife, Prudential, and Allianz North America
 - Approaching end of 60 day public comment period on the FSOC’s second notice of proposed rulemaking and proposed interpretive guidance
- A federal insurance office was created within the U.S. Treasury, but its functions are mostly advisory in nature
 - An exception is its authorization to negotiate international insurance agreements and preempt conflicting state laws
- Discussions around federal chartering are ongoing, but was not part of this legislation
- **The overall impact on the life insurance sector has been moderate relative to the banking sector with no direct impact on insurer ratings expected.**

Life Outlook Remains Stable

- **Key supporting factors for maintaining stable outlook on the Life sector.**
 - The Life Industry's capital base is expected to remain strong
 - Holding company liquidity is expected to remain sound
 - Earnings impact from low interest rates is expected to be gradual
 - In our rated universe of life insurers, 62% of bond holdings have 5 or more years to maturity and 34% have 10 or more years to maturity
 - Ability to lower crediting rates to guaranteed minimums
 - Disciplined ALM means that a portion of liabilities will roll-off as bonds mature

U.S. P/C Insurance Sector

U.S. Personal Lines Insurance Sector Outlook: Stable

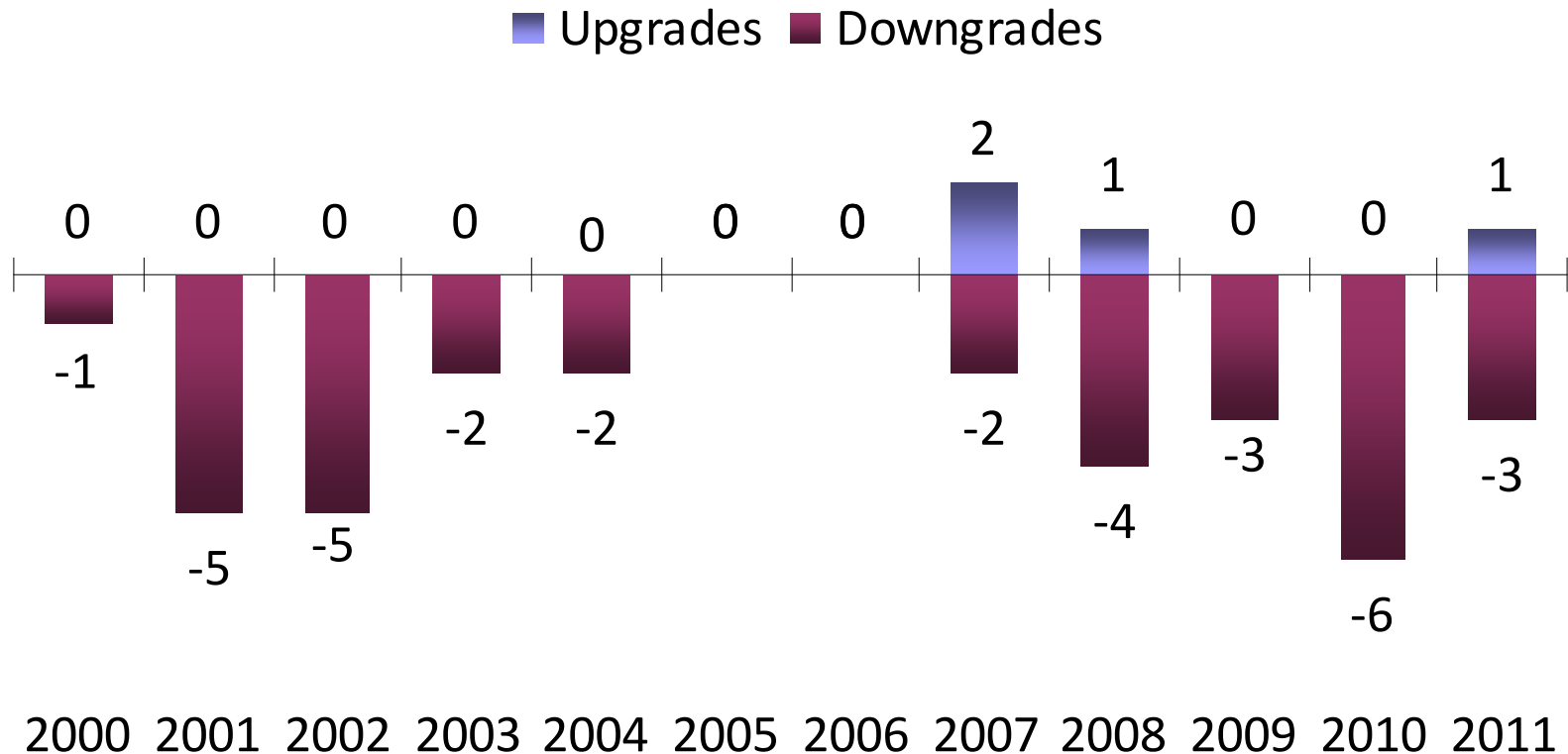
- **Key Supporting Factors**

- Rates have been moderately improving since early 2008
- Extremely strong capital adequacy.
- Conservative investment portfolio.
- Shorter tail business lines may lead to lower reserve adequacy uncertainty.

- **Key assumptions**

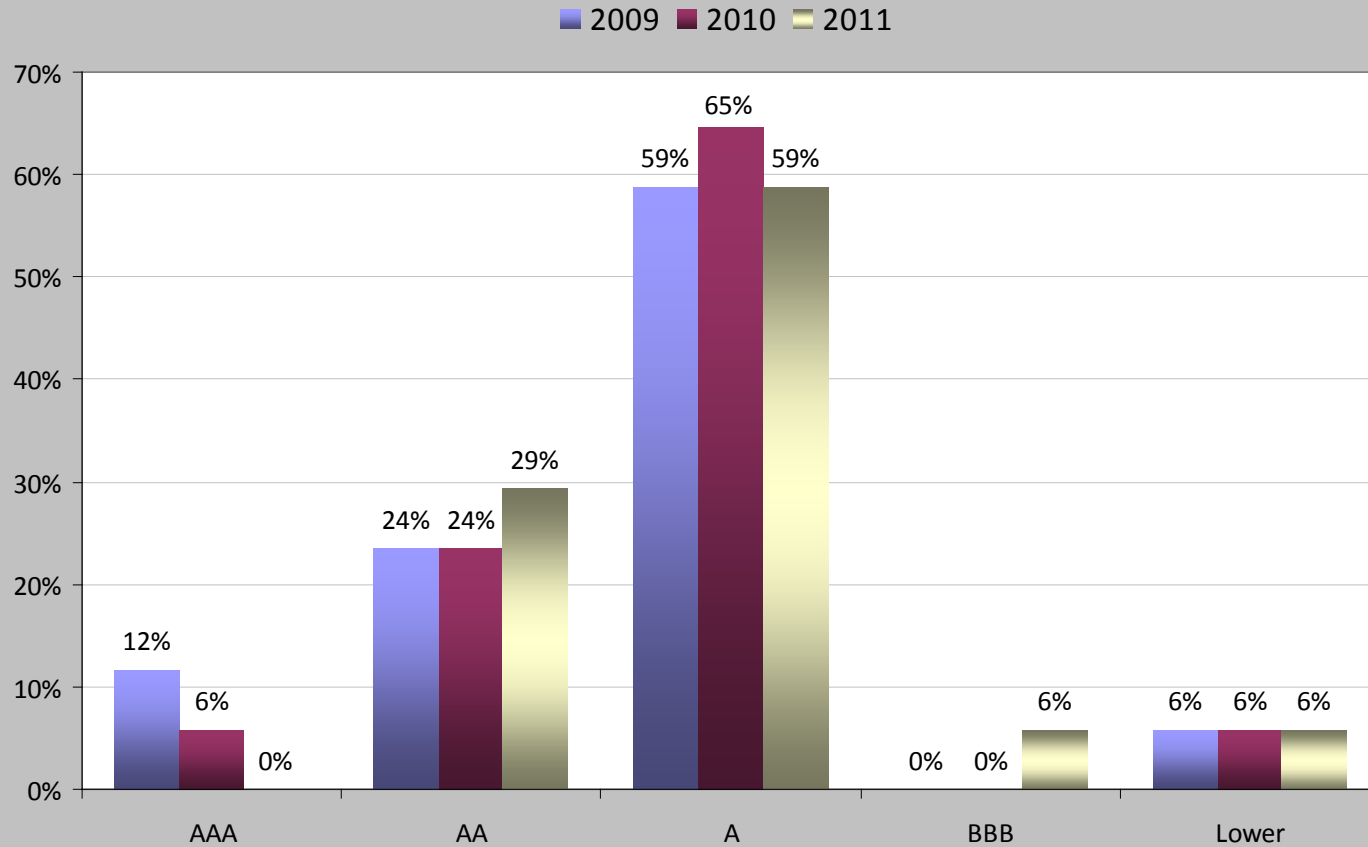
- While the rate of economic recovery will likely dictate the pace of insurable exposures, rates are on the rise and premium volume should remain stable.
- Above average frequency of catastrophe events and lower reinvestment rates should translate to a weaker earnings profile.

Rating Trends: U.S. Personal Lines



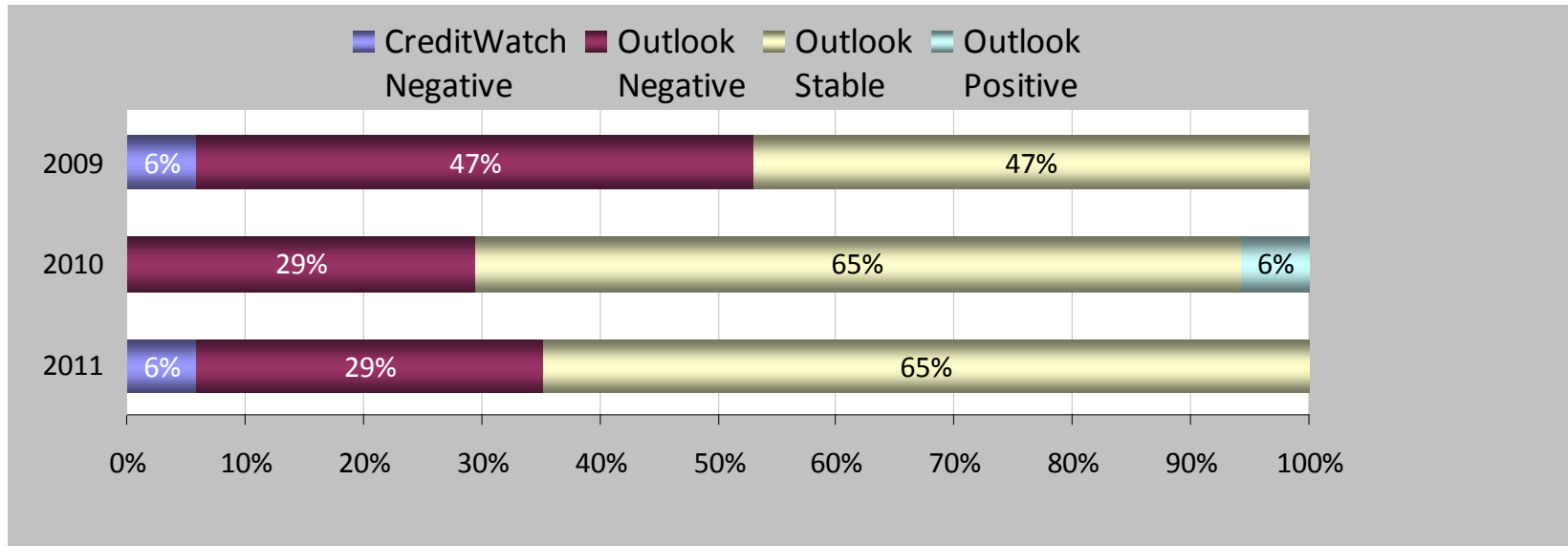
- Multiple rating actions within a given year are included, 2011 totals are through November 2011.

Rating Distribution: U.S. Personal Lines



Ratings of 16 interactively-rated companies and groups as of November 11, 2011 looking backward to 2009 & 2010.

Rating Outlooks: U.S. Personal Lines



- As of 11/11 of each year; includes 17 interactive ratings.

U.S. Commercial Lines Insurance Sector Outlook: Negative

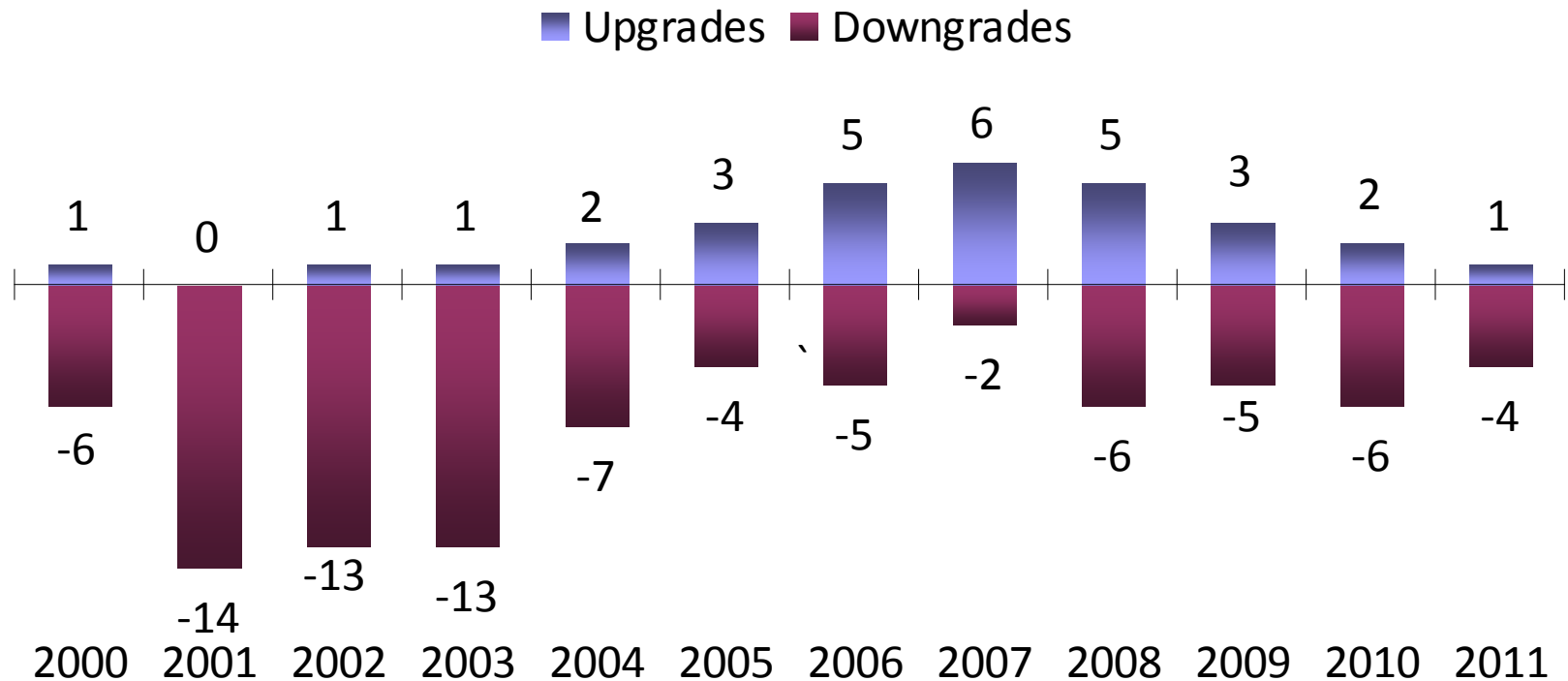
- **Key supporting factors:**

- While there are recent signs of rate improvements, multi-year price reductions compress underwriting margins.
- Reduced re-investment yields
- Relatively longer tail of business as compared to the personal lines
 - Heightens reserve risk and inflation risk
 - Longer ability to realize price adequacy

- **Key assumptions:**

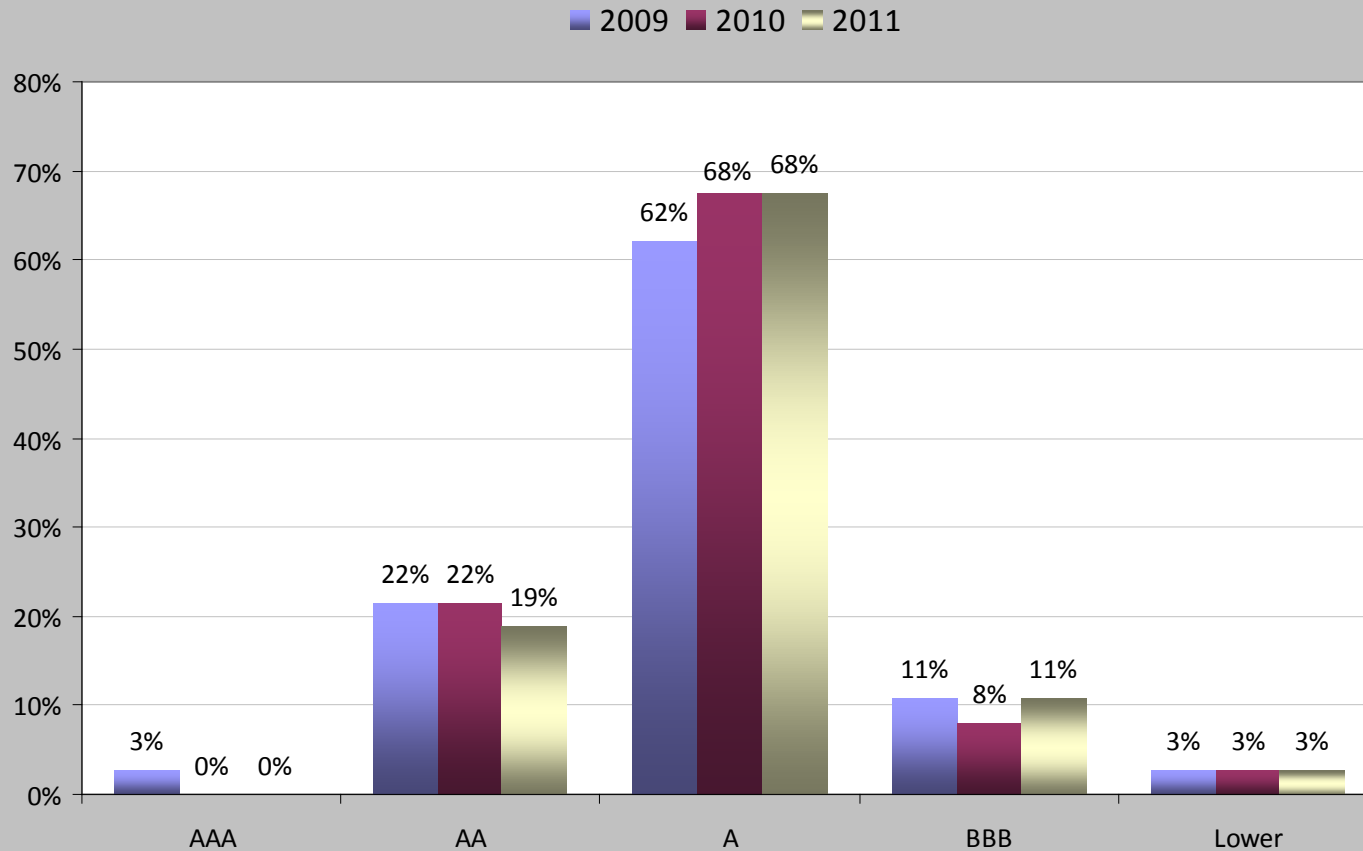
- Capital adequacy strong for most insurers
- Conservative investment portfolio

Rating Trends: U.S. Commercial Lines



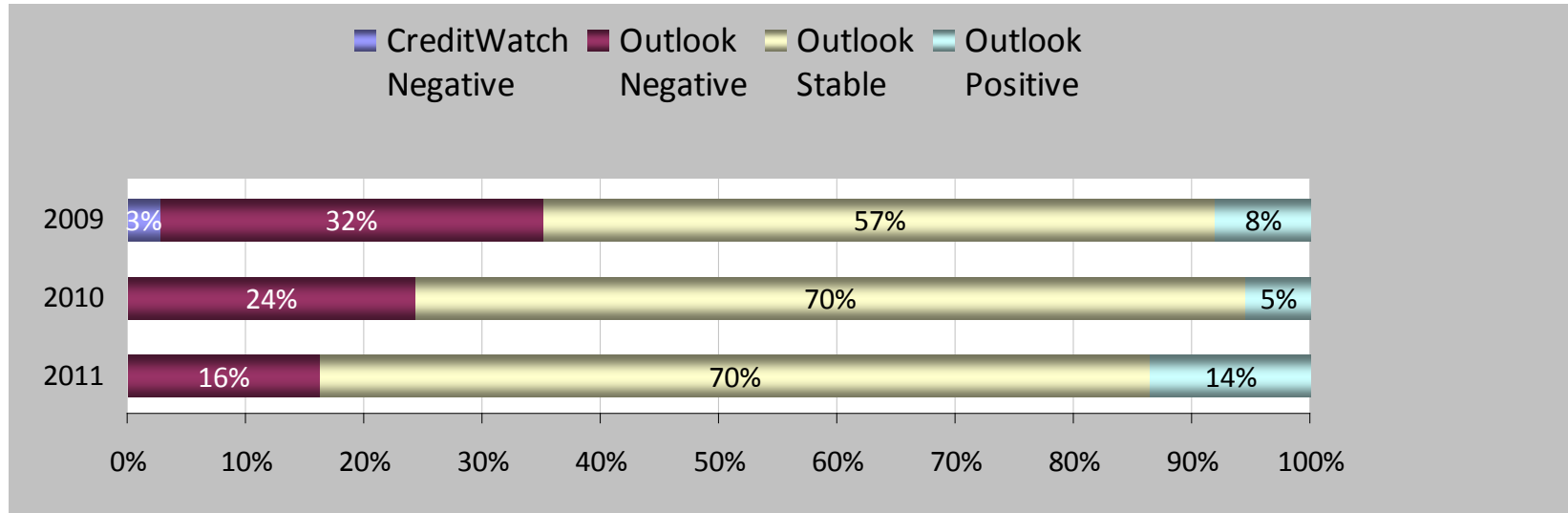
- Multiple rating actions within a given year are included, 2011 totals are through November 2011.

Rating Distribution: U.S. Commercial Lines



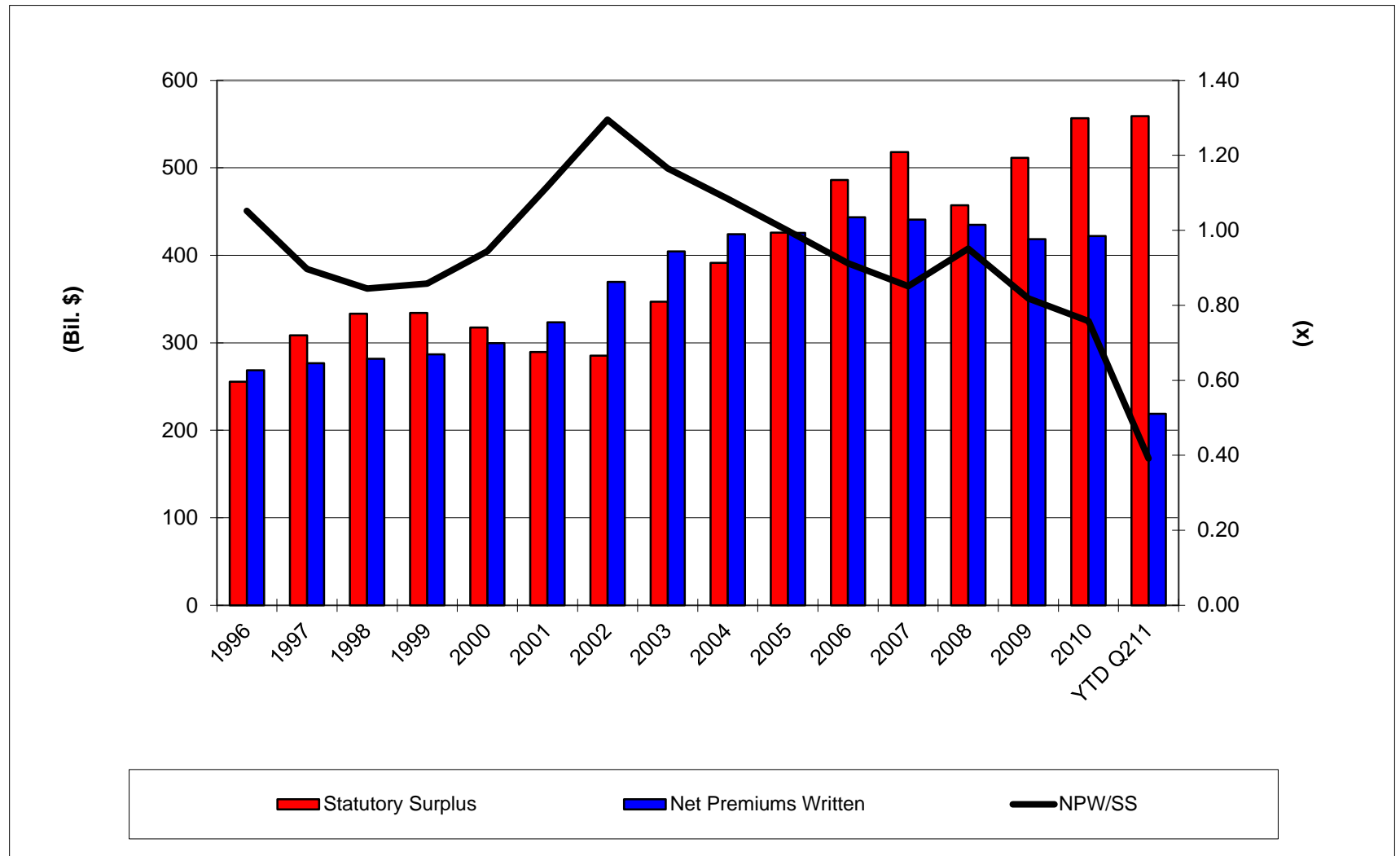
Ratings of 37 interactively-rated companies and groups as of November 11, 2011 looking backward to 2009 & 2010.

Rating Outlooks: U.S. Commercial Lines



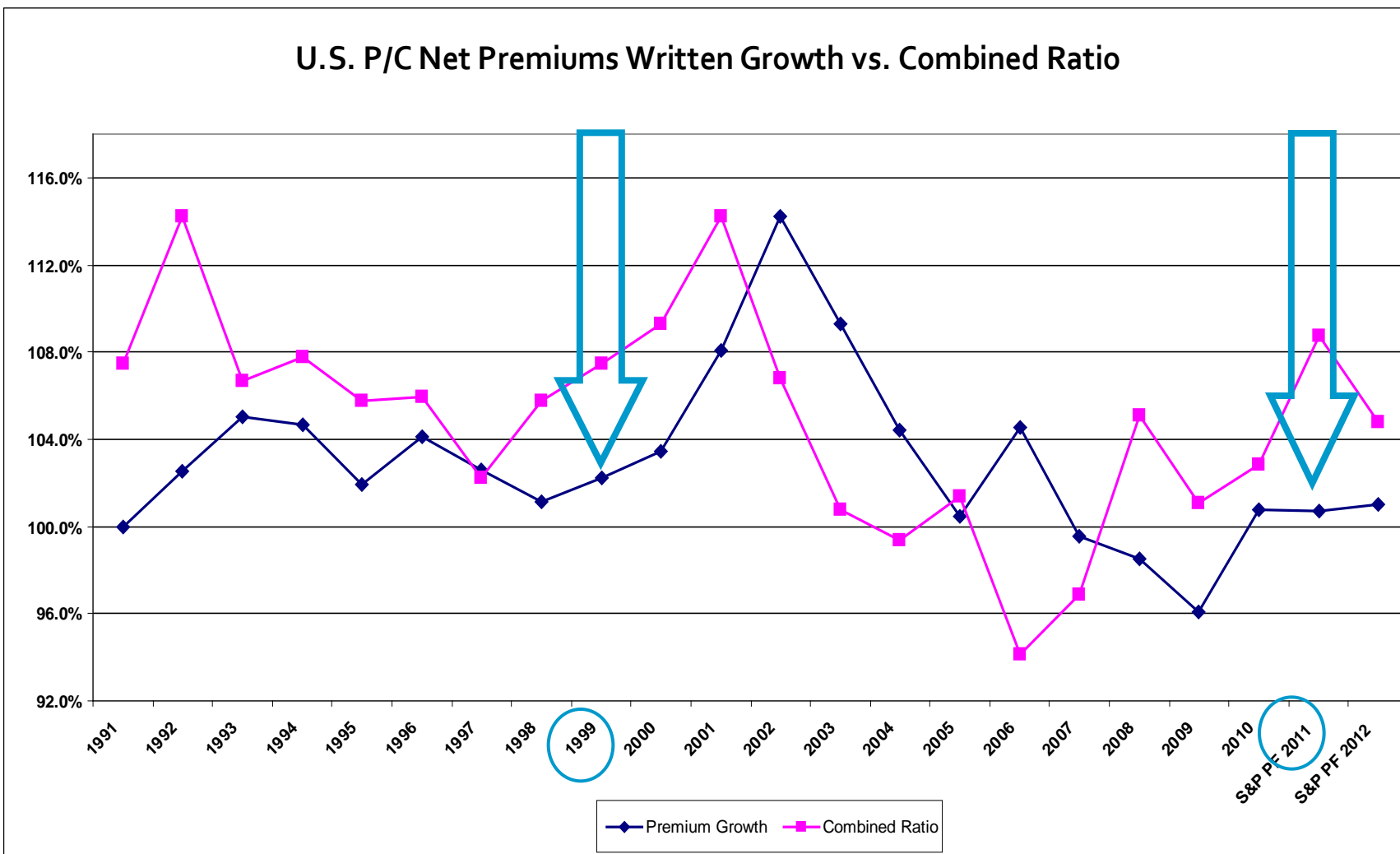
- As of 11/11 of each year; includes 37 interactive ratings.

P/C Insurer Capitalization: Significant Rebound In 2009



Source: ISO

P/C Industry (U.S Only) Underwriting Cycle: 20+ years

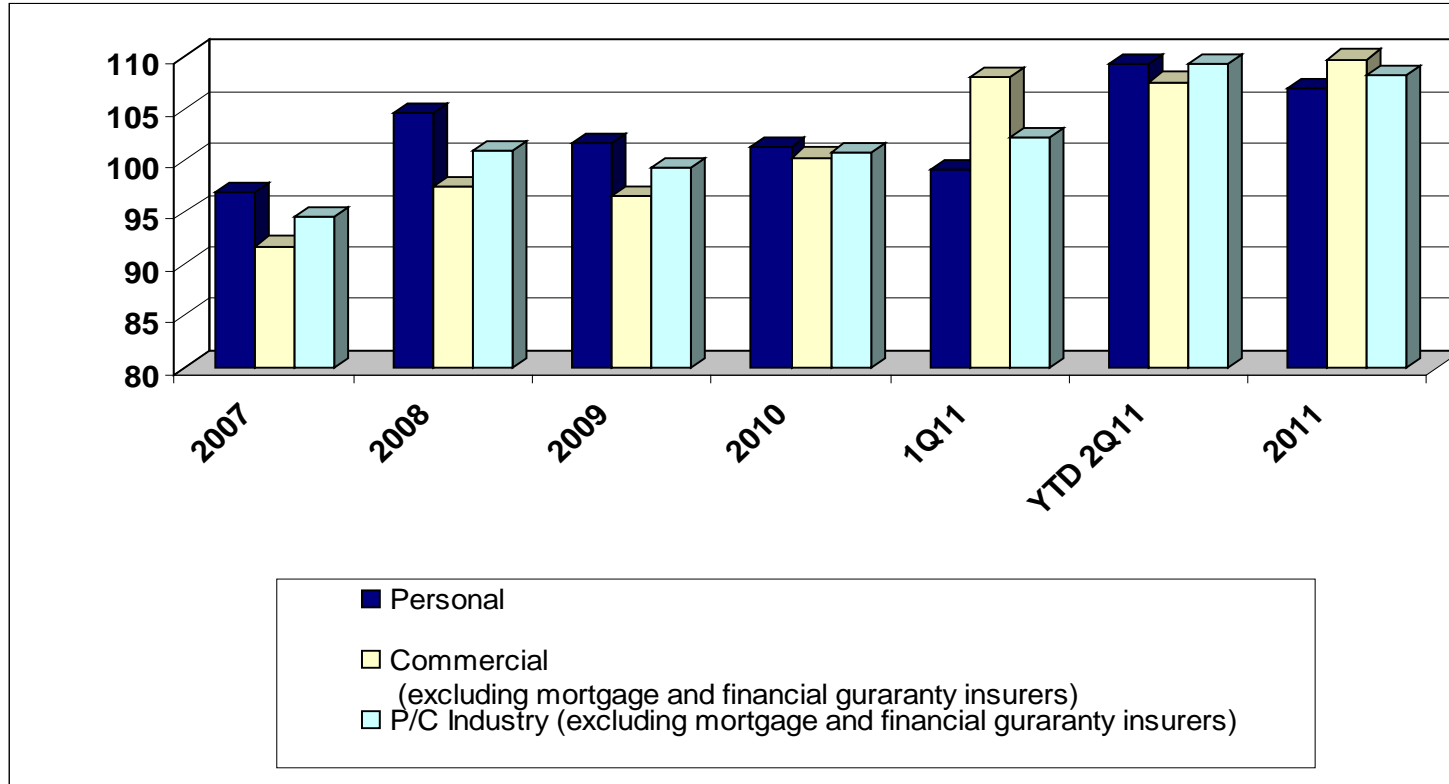


S&P Findings; U.S. P/C Industry including mortgage and financial guaranty insurers



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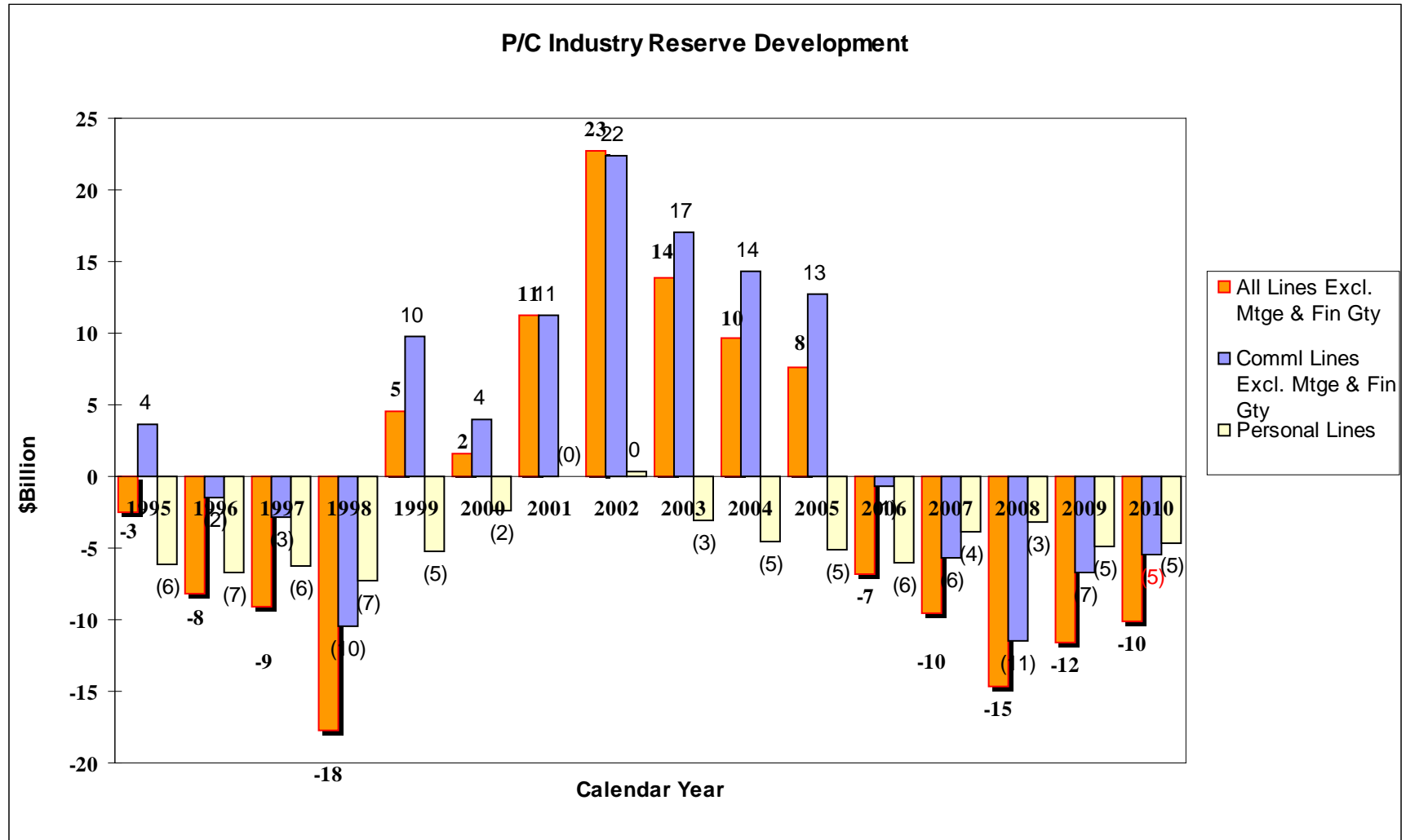
Underwriting Performance



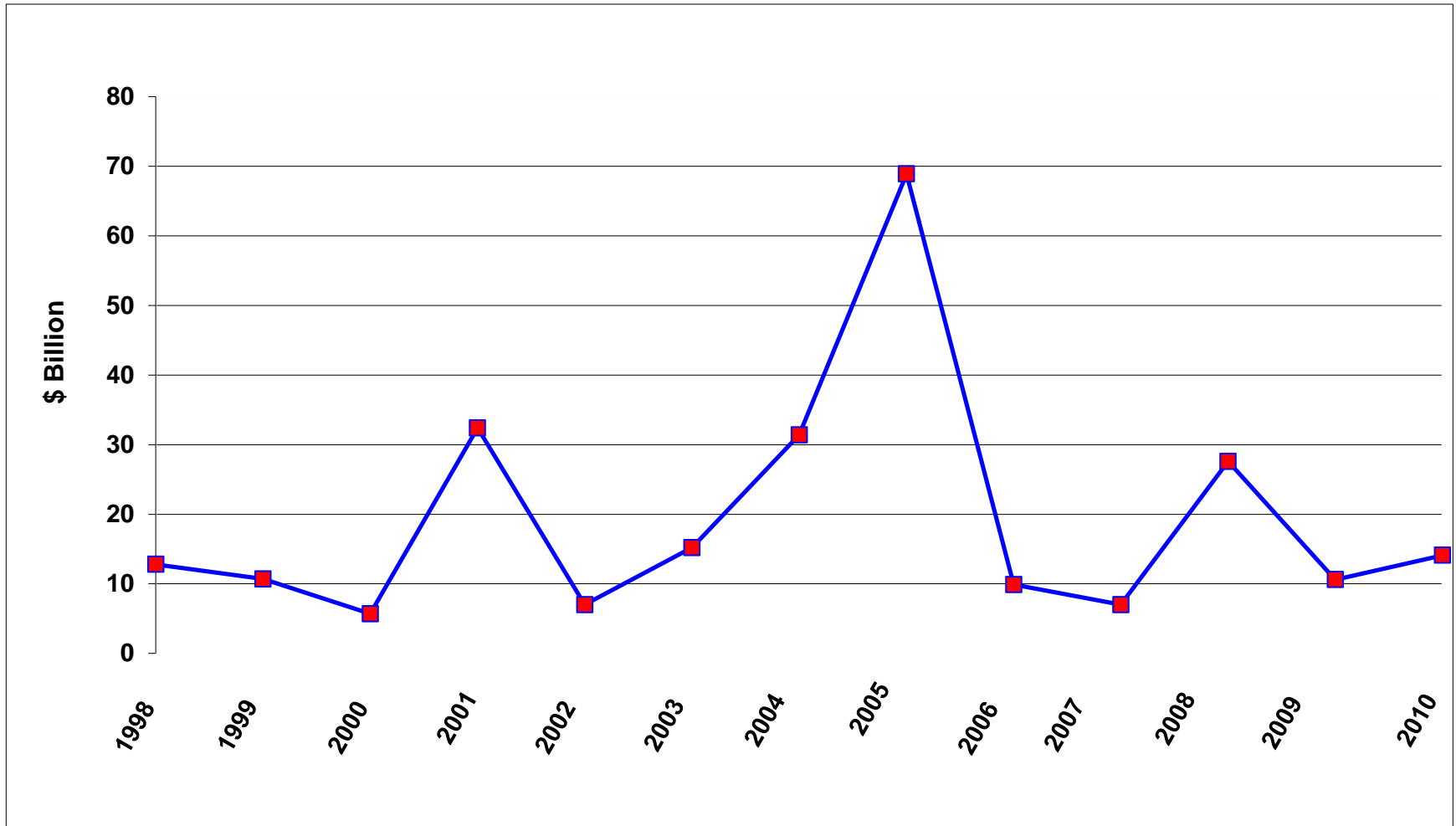
Source: ISO (Personal Lines and Commercial Lines defined by ISO); 2011 data S&P expectations.

- **Reported Combined Ratio (%): Personal Lines vs. Commercial Lines vs. P/C Industry (excluding mortgage and financial guaranty insurers)**

P/C Industry (U.S. Only), S&P Findings



Insured Losses, U.S. Catastrophes, 1998-2010



Source: Insurance Information Institute

YTD 2011 Above Average Catastrophe Events

S&P estimates U.S. primary catastrophe losses for full year 2011
(assuming catastrophe events for the remainder of the year remain quiet):
\$35 billion - \$40 billion



1Q11 International Cats (Japan EQ, N.Z. EQ, Australian Floods)

\$2B-\$5B of losses to U.S. Insurers, according to ISO



April & May Cumulative Storms and Tornadoes

\$15B Industry Losses. Losses mostly contained by primary writers.



Hurricane/Tropical Storm Irene

\$5B as reported by S&P. Of which we view \$4B to be above “normal”.

Legislative and Regulatory Activity: Relatively Quiet

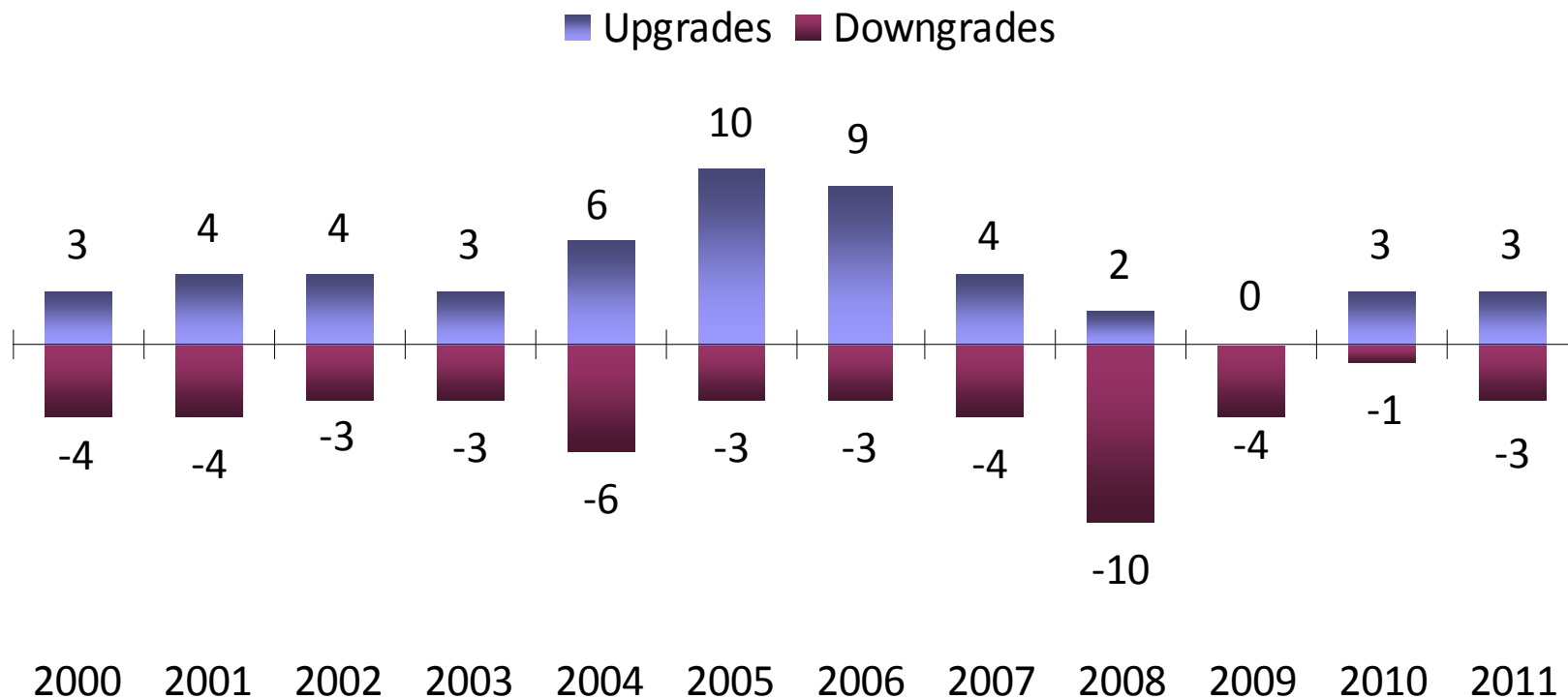
- **Sweeping federal overhaul of financial services regulation generally bypassed p/c insurers**
 - P/C insurers did not need government assistance following the recent financial markets turmoil (AIG's problems were not in its p/c nor life operations)
 - The long discussed proposal to give insurers the option of a federal charter and regulation was not included in this legislation
 - A federal insurance office was created within the U.S. Treasury, but its functions are mostly advisory in nature
 - An exception is its authorization to negotiate international insurance agreements and preempt conflicting state laws

U.S. Health Insurance Sector

U.S. Health Insurance Sector Outlook: Stable

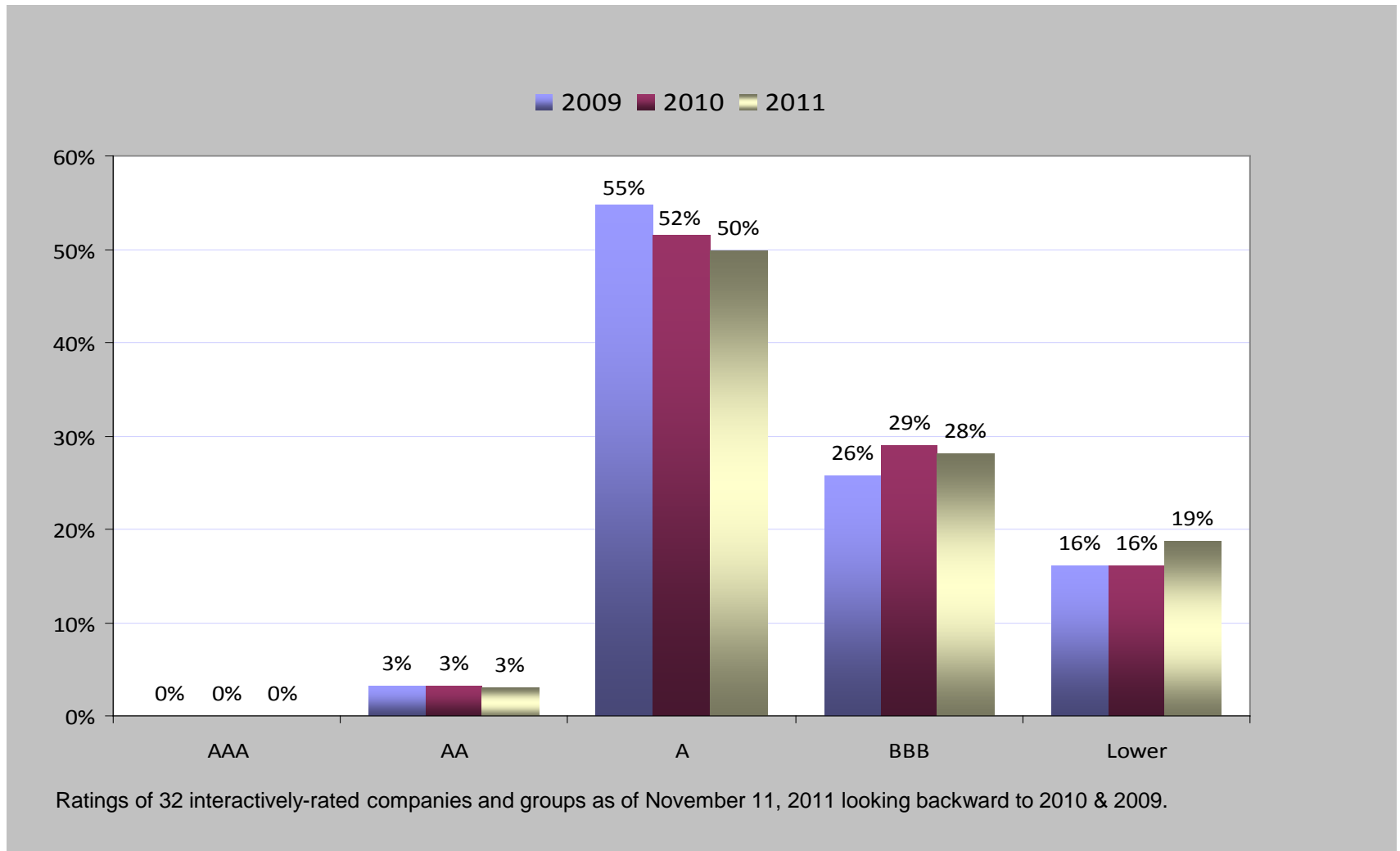
- **Key supporting factors:**
 - Moderating industry risk
 - Improving business conditions
 - Strengthened financial fundamentals
- **Risk considerations:**
 - Pace of economic improvement
 - Governmental fiscal pressures
 - Health care reform

Rating Trends: Recent Activity Has Been Modestly Favorable

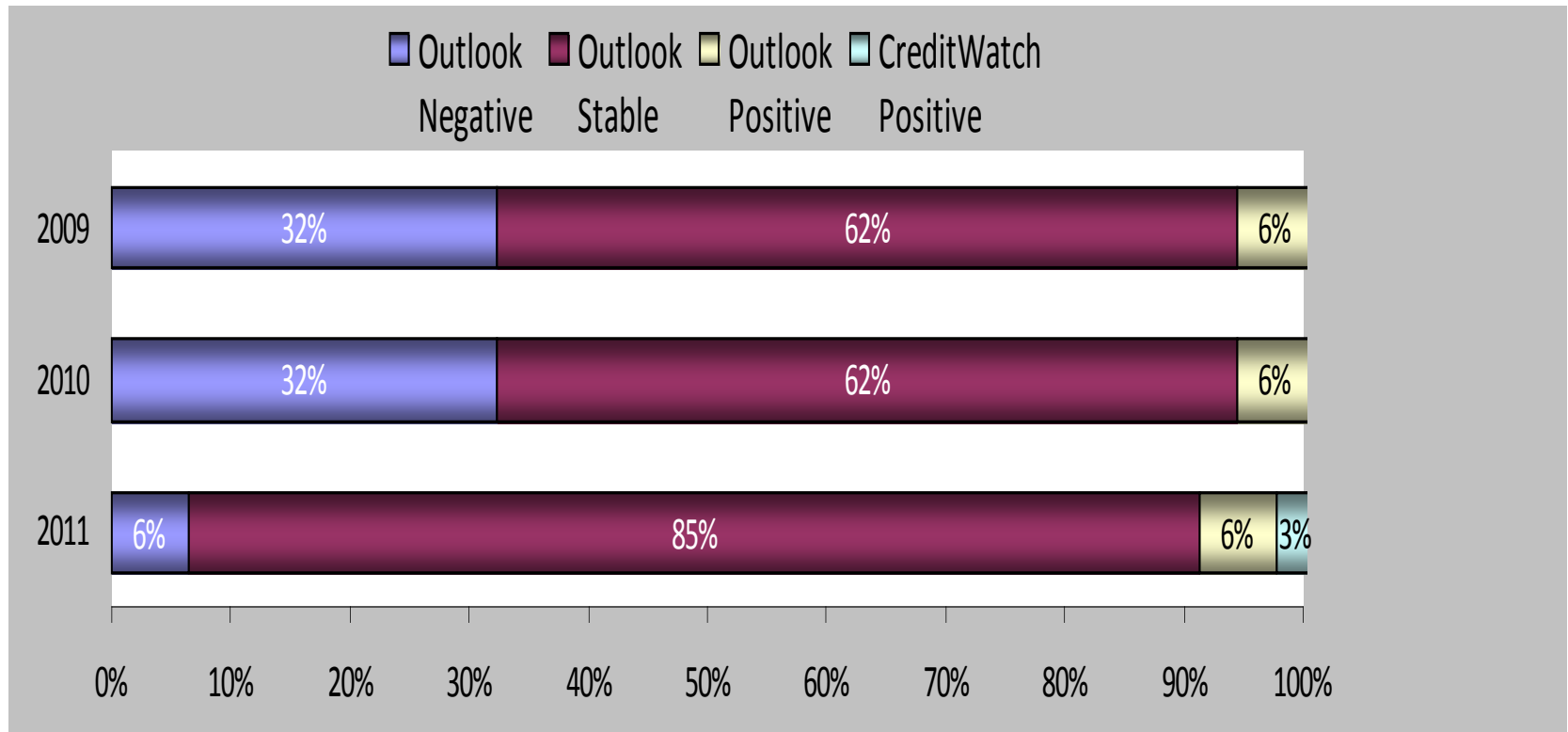


- **Multiple rating actions within a given year are included; 2011 totals are through November 2011.**

Rating Distribution: Generally Strong With Some Erosion In Quality



Rating Outlooks: Improved Balance With Some Potential For Action



- **As of November 2011 of each year; includes 32 interactively rated companies.**

Regulatory Developments - Health Insurance

- **Reform - Minimum Medical Loss Ratio (Rebates payable Q3 2012)**
 - Individual / Small Group (80%), Large group (85%)
 - Formula calculation / waivers dilute impact
 - Moderate downside impact to profitability
- **Reform - Health and Human Service (HHS) Rate Review**
 - Federal Gov't is encouraging / funding intensified rate review
 - States retain exclusive jurisdiction over rate setting process
 - Greater risk of pricing / trend mismatch - a potential driver of margin compression
- **Reform - U.S. Supreme Court**
 - The key challenge relates to legality of the individual mandate
 - Arguments (early Spring 2012), expected Ruling (June 2012)
 - Market based reforms will move forward regardless

Things To Consider

- **Sector consideration:**
 - Market structure and growth potential
 - Cyclicalities
 - Barriers to entry
 - Regulatory and legislative environment
- **Company consideration:**
 - Geographic and market segment diversity
 - Earnings and cash flow quality
 - Balance sheet management

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