



Is the World Becoming a Riskier Place?

Economic Overview and Commercial Lines Outlook for 2012 & Beyond

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What in the World Is Going On?

**Is the World Becoming a
Riskier Place?**

***What Are the Implications for
Insurance and Risk Management?***

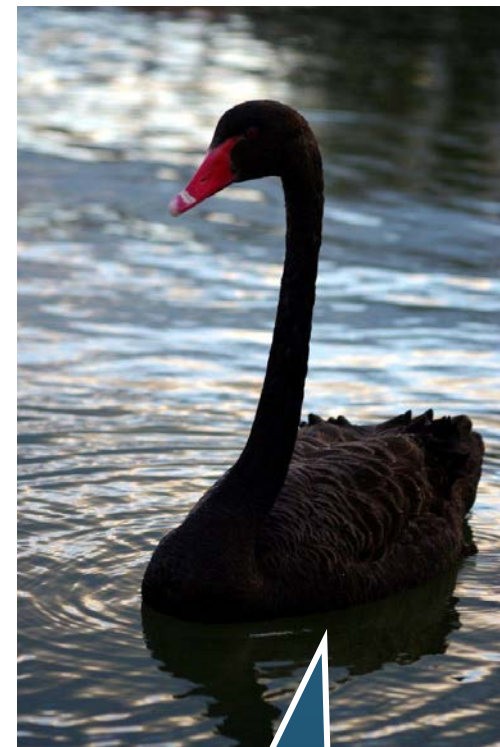
Uncertainty, Risk and Fear Abound

ECONOMIC & POLITICAL CONCERNS

- Global Economic Slowdown
- Echoes of the Financial Crisis
- European Sovereign Debt, Bank & Currency Crises
- Collapse of Major Financial Institutions
- US Debt and Budget Crisis, S&P Downgrade & Austerity
- Housing Crisis
- Persistently High Unemployment
- Inflation/Deflation
- Runaway Energy & Commodity Prices
- Political Upheaval in the Middle East
- Regulation
- China→Now the #2 Economy in the World
- 2012 Elections

CATASTROPHIC LOSS

- Japan, New Zealand, Turkey, Haiti, Chile Earthquakes
- Nuclear Fears
- US: Tornadoes, Flooding, Wildfires, Hurricanes, Winter Storms
- Manmade Disasters (e.g., Deepwater Horizon)
- Cyber Attacks
- Resurgent Terrorism Risk (e.g., Bin Laden, Gadhafi Killings)



Are “Black Swans” everywhere or does it just seem that way?

What is Going On in the US and Global Financial Markets?

- 1. Need for a Binding, Comprehensive Solution to Europe's Debt Problems**
 - ◆ 15 of 17 Eurozone countries put on negative credit watch by S&P on Dec. 5
 - ◆ Current requires construction of a "fiscal union" to save Euro monetary union
 - ◆ Requires rewriting EU treaties to mandate strict Debt/GDP ratios (3%) with sanctions to be imposed on violators
 - ◆ Short-term Europe needs to build a financial "Firewall" (larger bailout fund) around Italy, Spain, Ireland, Portugal to avoid another "Big, Fat Greek Debt Disaster"
 - ◆ Solution: Unified strategy similar to TARP; Monetary easing; Binding fiscal pact
 - ◆ **OUTCOME:** Europeans will eventually stumble into a resolution
- 2. Realization that US Economic Growth Will Remain Lackluster**
 - ◆ Q1 GDP just 0.4%; Q2 only 1.3%; Q3 still a subpar 2.0%; Acceleration unlikely
 - ◆ Job growth has been anemic for months and unemployment remains high at 8.6%
 - ◆ Markets remain extremely volatile and jittery; Housing/Debt hangover
 - ◆ **OUTCOME:** Tepid growth in the 2% - 2.5% range in 2012; Unemployment 8.5% - 9%
- 3. View that Washington is Dysfunctional and "Rudderless"**
 - ◆ Lack of coherent, consistent medium and long term plan to deal with basic structural issues in the US economy (debt, taxes, employment, regulation, etc.)
 - ◆ No confidence that 2012 political cycle will resolve these problems
- 4. Economic Slowdown in Emerging Markets**
 - ◆ China, other economies less able to stimulate global economy than in 2008

Déjà Vu? Lehman II?

Is This 2008 All Over Again?

Why Today is Not 2008 All Over Again

- The Situation Today is Very, Very Different from 2008
- Credit Markets Are Not Seizing; Some Contraction in Europe
- Bank Balance Sheets Are in Much Stronger Shape
 - ◆ Capital up, charge offs falling
- We Will Not Experience the Mega-Collapses/Near Collapses Like in 2008
 - ◆ No repeat of Lehman, AIG, Washington Mutual, Wachovia...
 - ◆ MF Global is not a “Systemically Important Financial Institution”
- Some Additional Regulatory Controls Are Now Place

What Would Be Helpful Now?

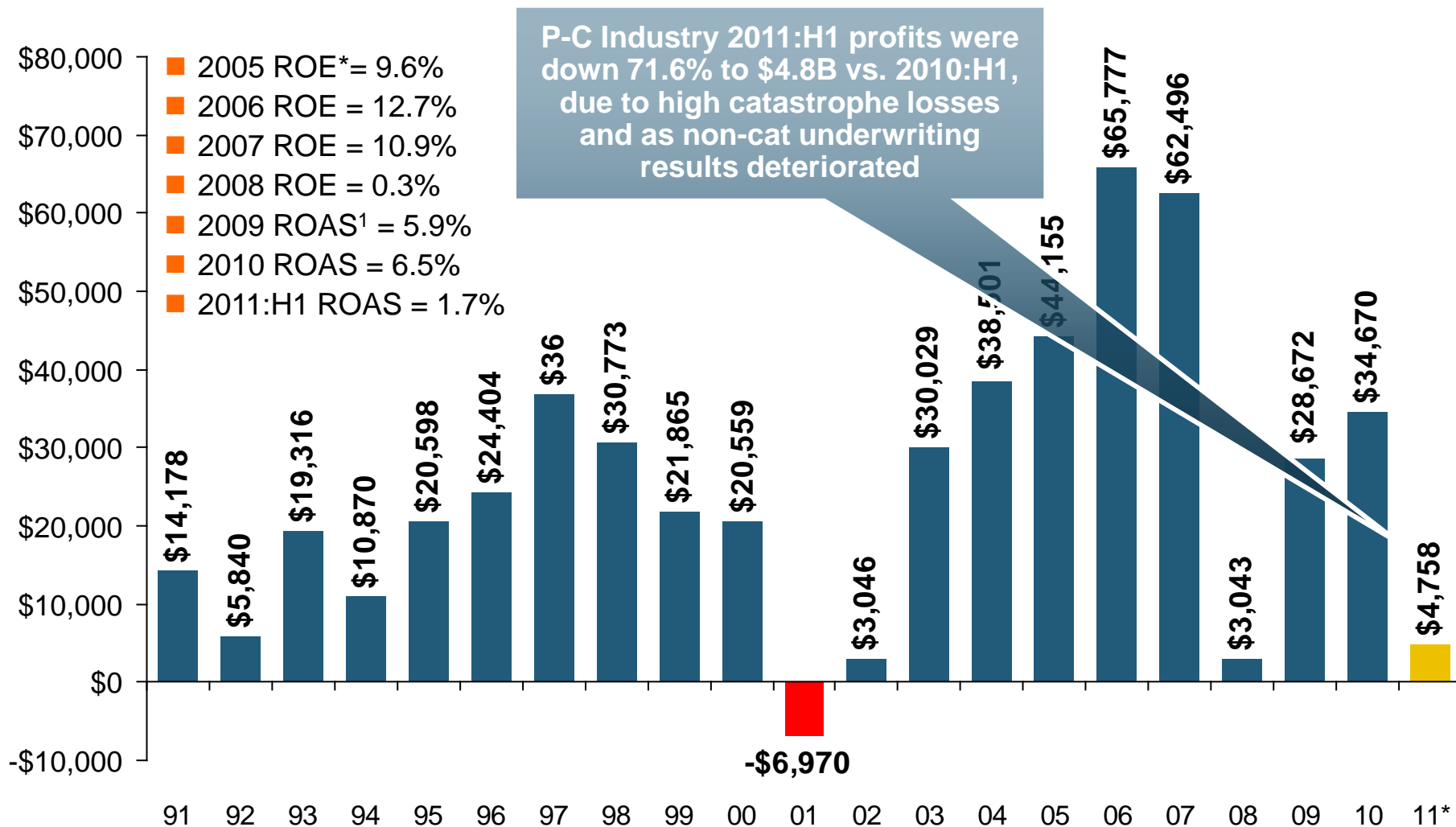
- Solution to European Bank/Sovereign Debt Problem (Thought We Had One!)
- Long-Term Fiscal and Monetary Policy Direction
- Fed on Aug. 9 stated rates would remain low “*at least through mid-2013*”
 - ◆ This is not only a signal that borrowing costs will remain low over an extended period of time and that inflation will remain muted; Also tells investors that they’ll need to take on risk in order to earn returns in the market.
 - ◆ Congress and the Administration need to remove regulatory and tax uncertainty ASAP and drive a pro-growth agenda



P/C Insurance Industry Financial Overview

**Profit Recovery Will Be Set
Back by High CATs, Low
Interest Rates, Diminishing
Reserve Releases**

P/C Net Income After Taxes 1991–2011:H1 (\$ Millions)



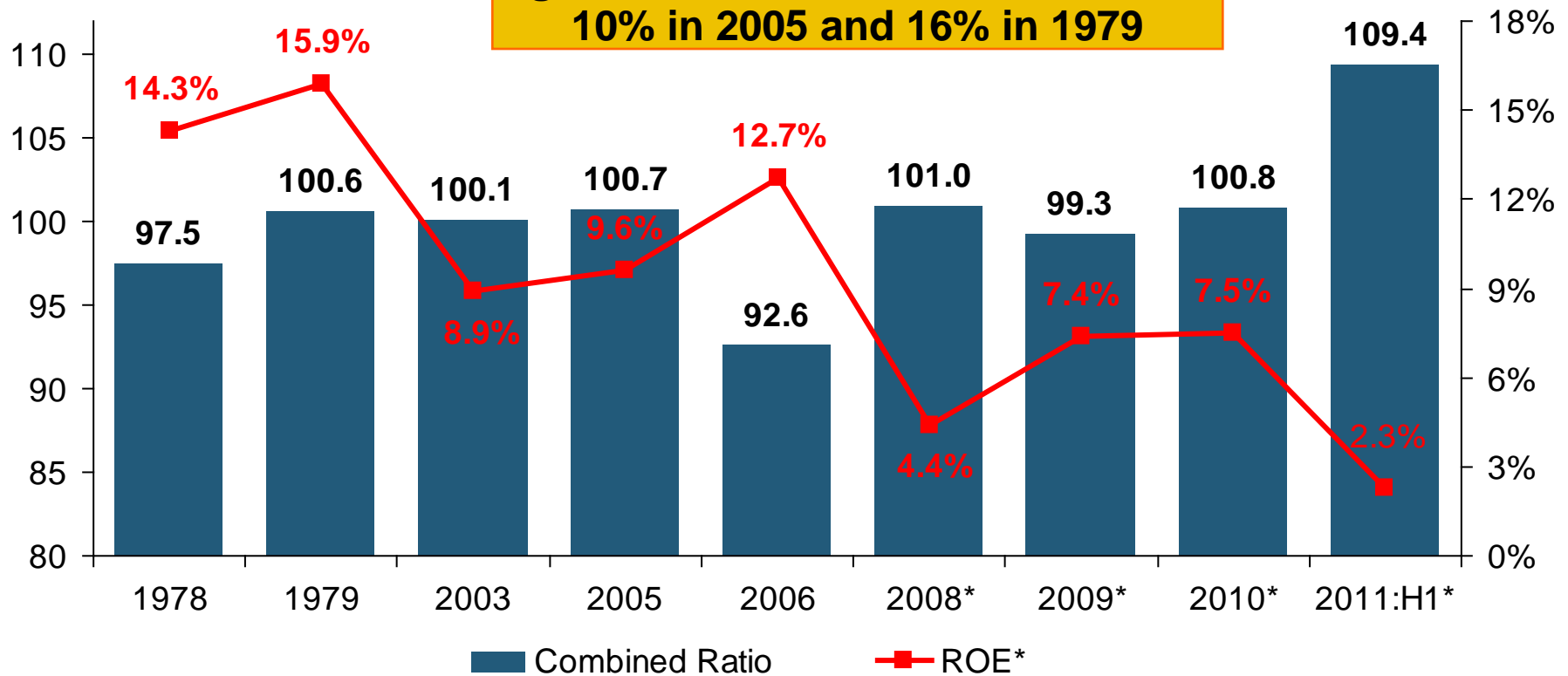
* ROE figures are GAAP; ¹Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 2.3% ROAS for 2011:H1, 7.5% for 2010 and 7.4% for 2009.

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

A 100 Combined Ratio Isn't What It Once Was: Investment Impact on ROEs

Combined Ratio / ROE

A combined ratio of about 100 generated ~7.5% ROE in 2009/10, 10% in 2005 and 16% in 1979

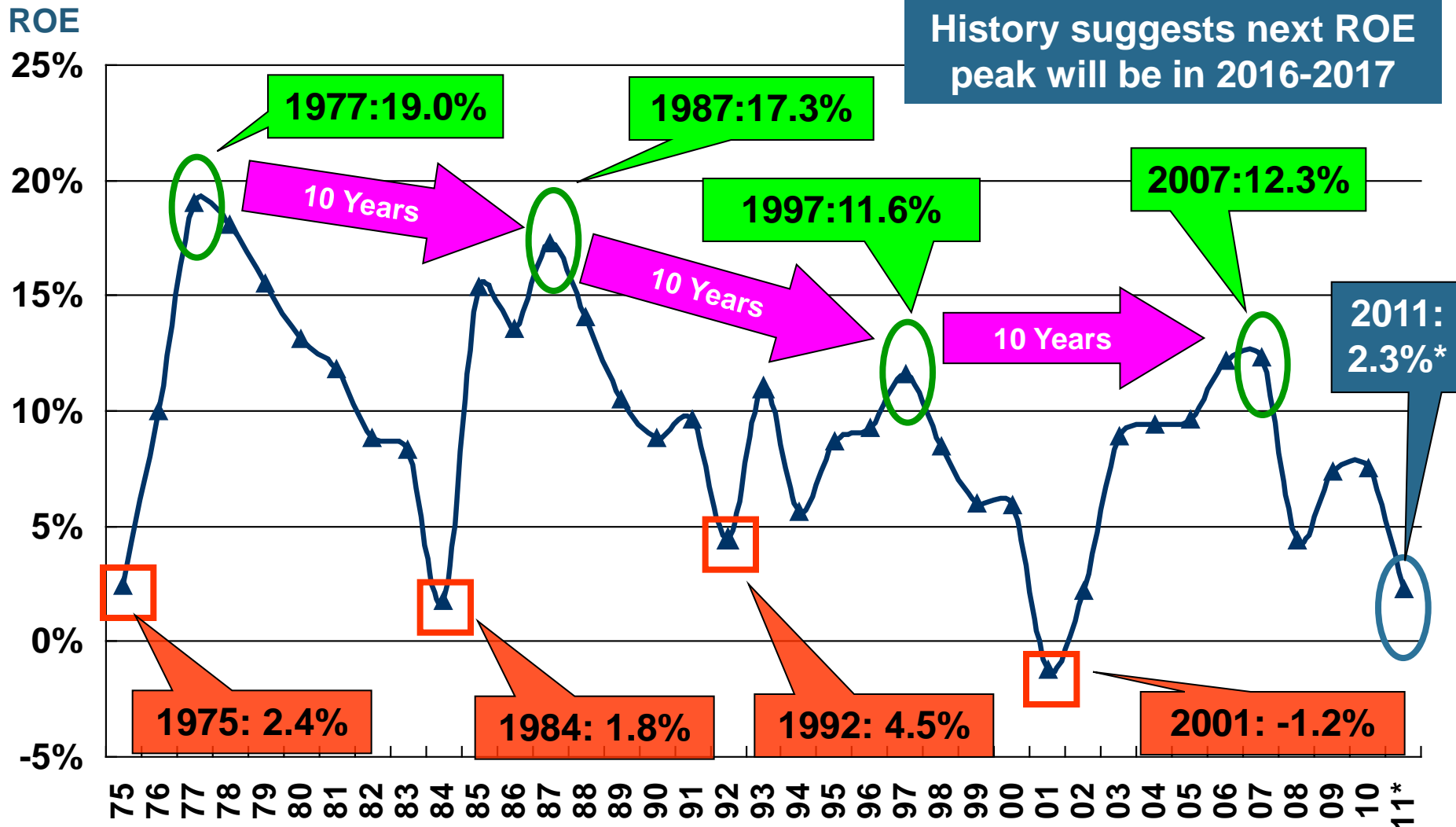


Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs

* 2009 and 2010 figures are return on average statutory surplus. 2008 -2011 figures exclude mortgage and financial guaranty insurers. 2011H1 combined ratio including M&FG insurers is 110.5 , ROAS = 2.3%.

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

Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2011*



*Profitability = P/C insurer ROEs are I.I.I. estimates. 2011 figure is an estimate based on annualized ROAS for H1 data.
 Note: Data for 2008-2011 exclude mortgage and financial guaranty insurers. For 2011:H1 ROAS = 1.7% including M&FG.
 Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

Global Catastrophe Loss Developments and Trends

**2011 Will Rewrite Catastrophe Loss
and Insurance History**

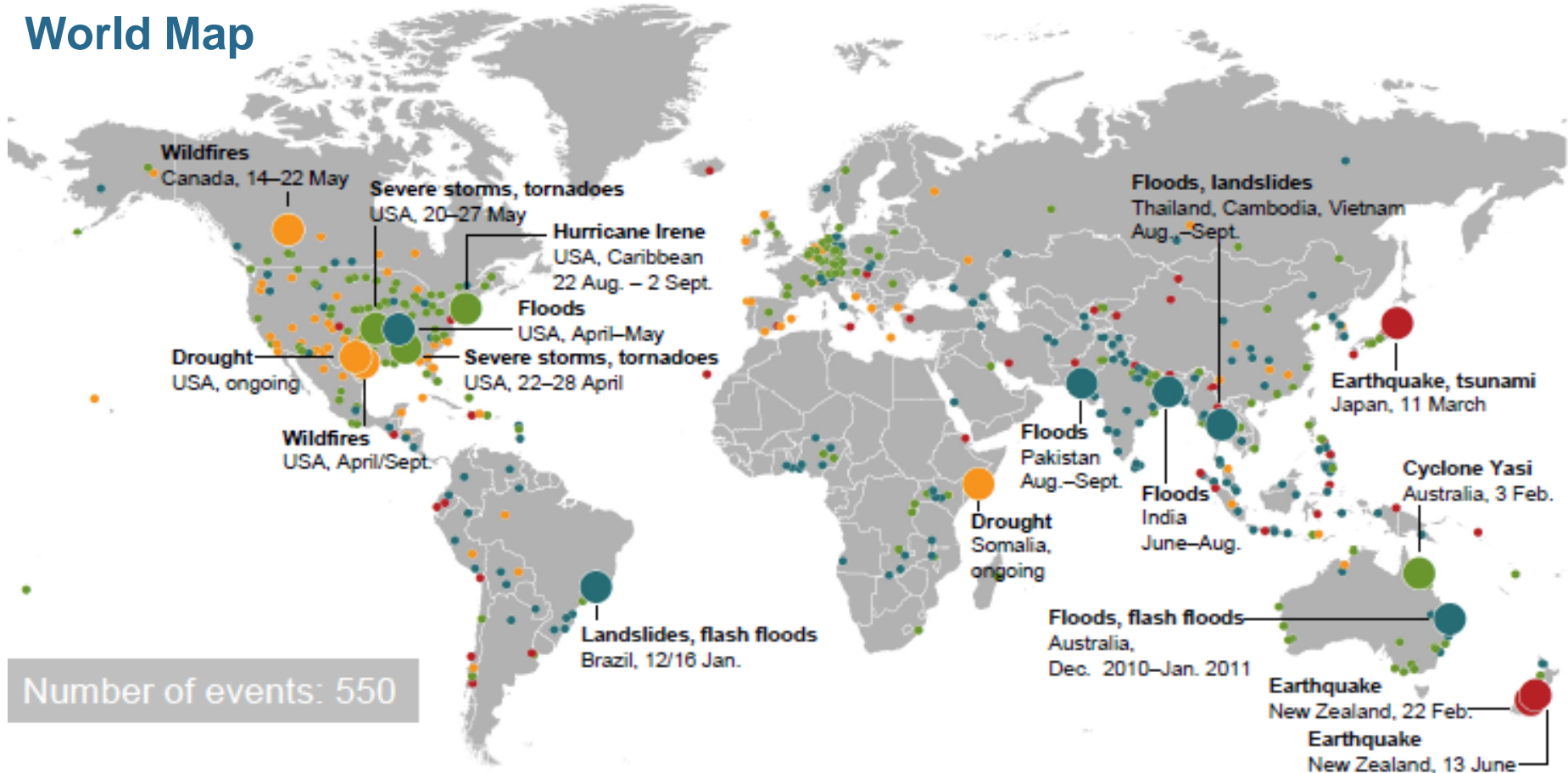
But Will Losses Turn the Market?

Global Catastrophe Loss Summary: First Half 2011

- **2011 Is Already (as of June 30) the *Highest* Loss Year on Record Globally**
 - ◆ Extraordinary accumulation of severe natural catastrophe: Earthquakes, tsunami, floods and tornadoes are the primary causes of loss
- **\$260 Billion in *Economic* Losses Globally**
 - ◆ New record for the first six months, exceeding the previous record of \$220B in 2005
 - ◆ Economy is more resilient than most pundits presume
- **\$55 Billion in *Insured* Losses Globally**
 - ◆ More than double the first half 2010 amount
 - ◆ Over 4 times the 10-year average
- **\$27 Billion in *Economic* Losses in the US**
 - ◆ Represents a 129% increase over the \$11.8 billion amount through the first half of 2010
- **\$17.3 Billion in *Insured* Losses in the US Arising from 100 CAT Events**
 - ◆ Represents a 162% increase over the \$6.6 billion amount through the first half of 2010

Natural Loss Events, January – September 2011

World Map



○ Natural catastrophes

● Geophysical events
(earthquake, tsunami, volcanic activity)

● Hydrological events
(flood, mass movement)

○ Selection of significant
loss events (see table)

● Meteorological events
(storm)

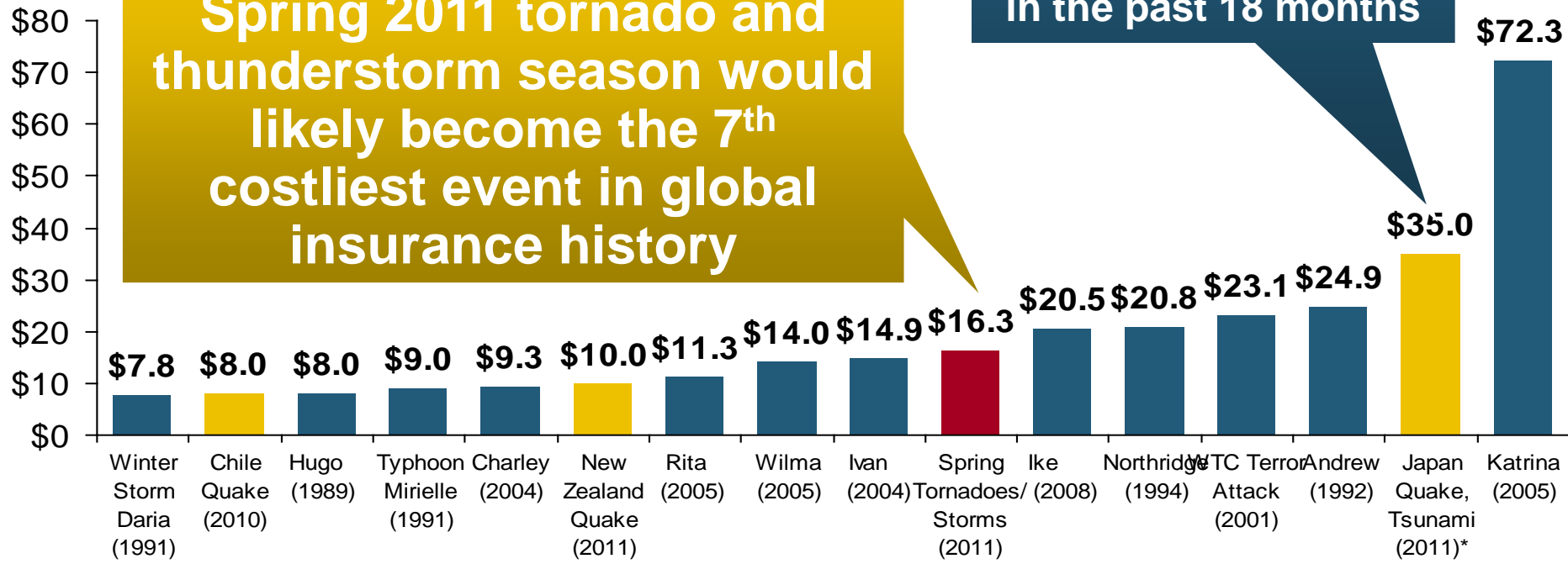
● Climatological events
(extreme temperature, drought, wildfire)

Top 16 Most Costly World Insurance Losses, 1970-2011*

(Insured Losses, 2010 Dollars, \$ Billions)

Taken as a single event, the Spring 2011 tornado and thunderstorm season would likely become the 7th costliest event in global insurance history

3 of the top 15 most expensive catastrophes in world history have occurred in the past 18 months

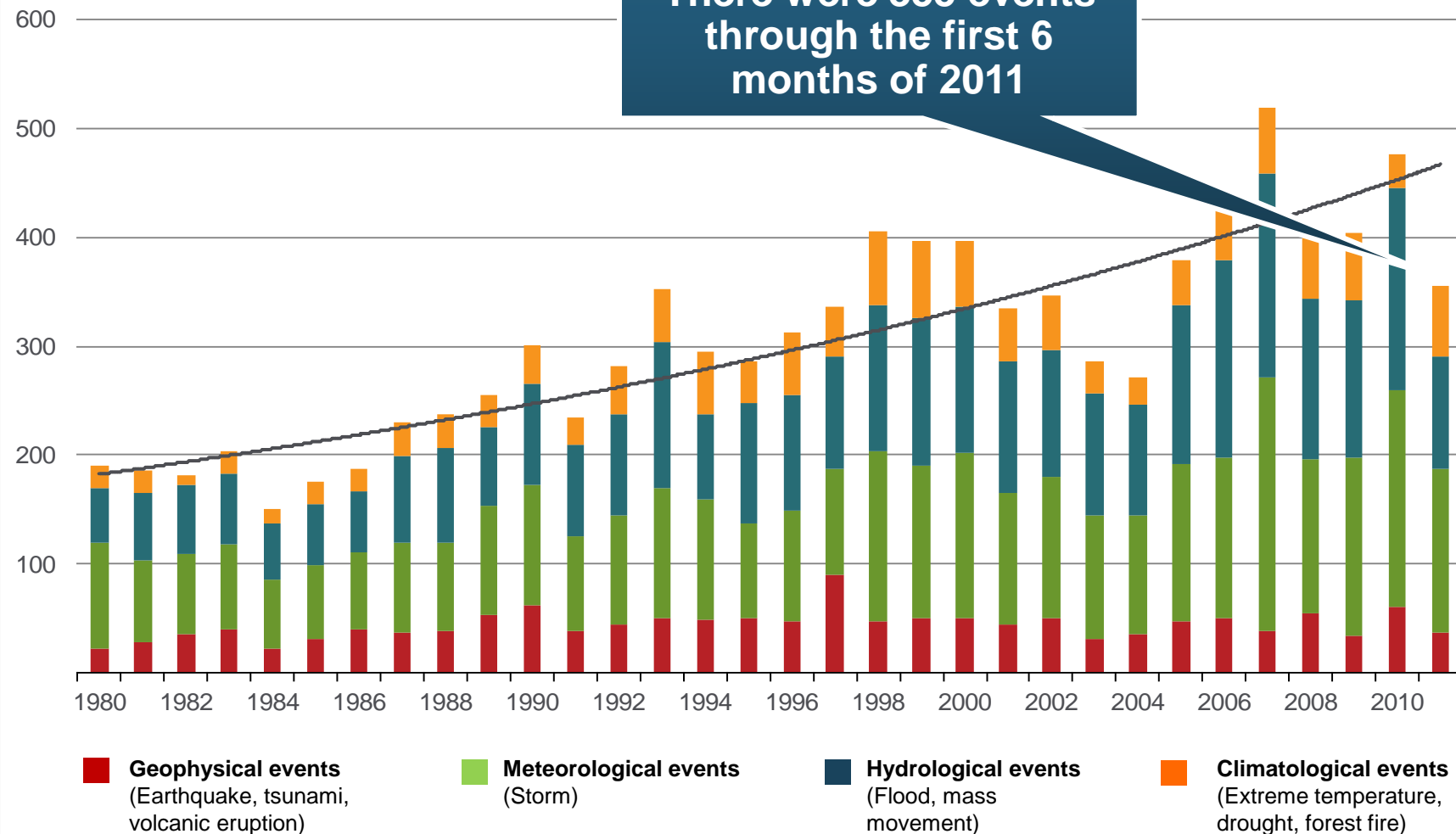


*Through June 20, 2011. 2011 disaster figures are estimates; Figures include federally insured flood losses, where applicable.

Sources: Swiss Re *sigma* 1/2011; AIR Worldwide, RMS, Eqecat; Insurance Information Institute.

Worldwide Natural Disasters, 1980 – 2011*

Number of Events

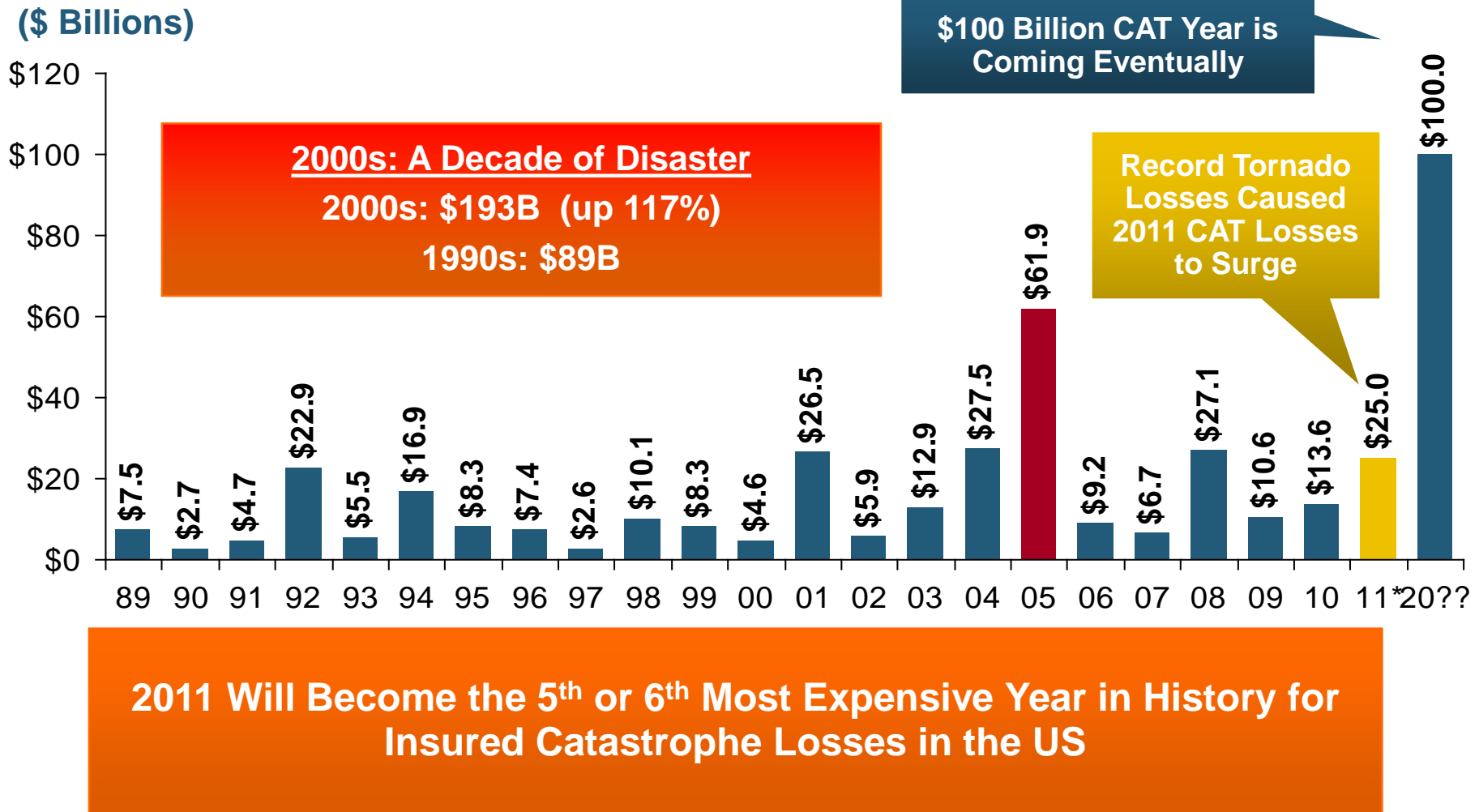


*2011 figure is through June 30.
 Source: MR NatCatSERVICE

U.S. Insured Catastrophe Loss Update

**2011 CAT Losses Already Greatly
Exceed All of 2010 and Will Become One
of the Most Expensive Years on Record**

US Insured Catastrophe Losses



*Estimate through Oct. 31, 2011.

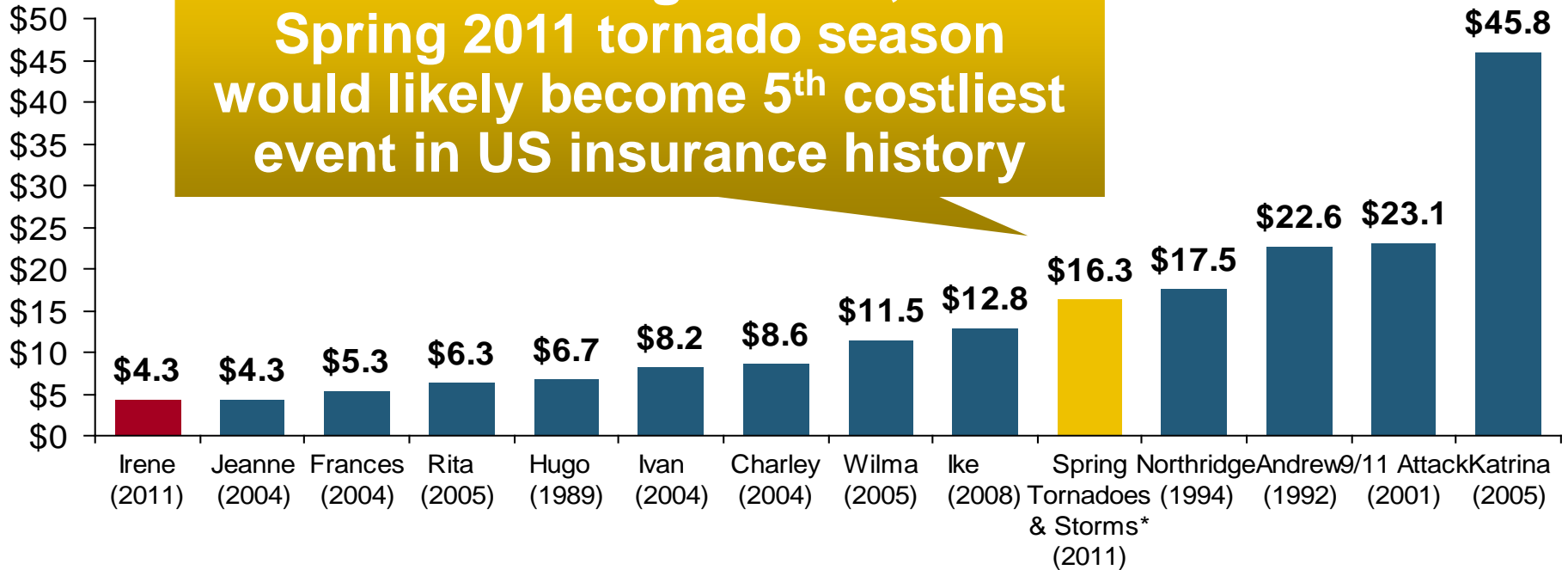
Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B.

Sources: Property Claims Service/ISO; Insurance Information Institute.

Top 13 (14?) Most Costly Disasters in U.S. History

(Insured Losses, 2010 Dollars, \$ Billions)**

Taken as a single event, the Spring 2011 tornado season would likely become 5th costliest event in US insurance history



*Losses will actually be broken down into several "events" as determined by PCS.

**Hurricane Irene losses stated in 2011 dollars.

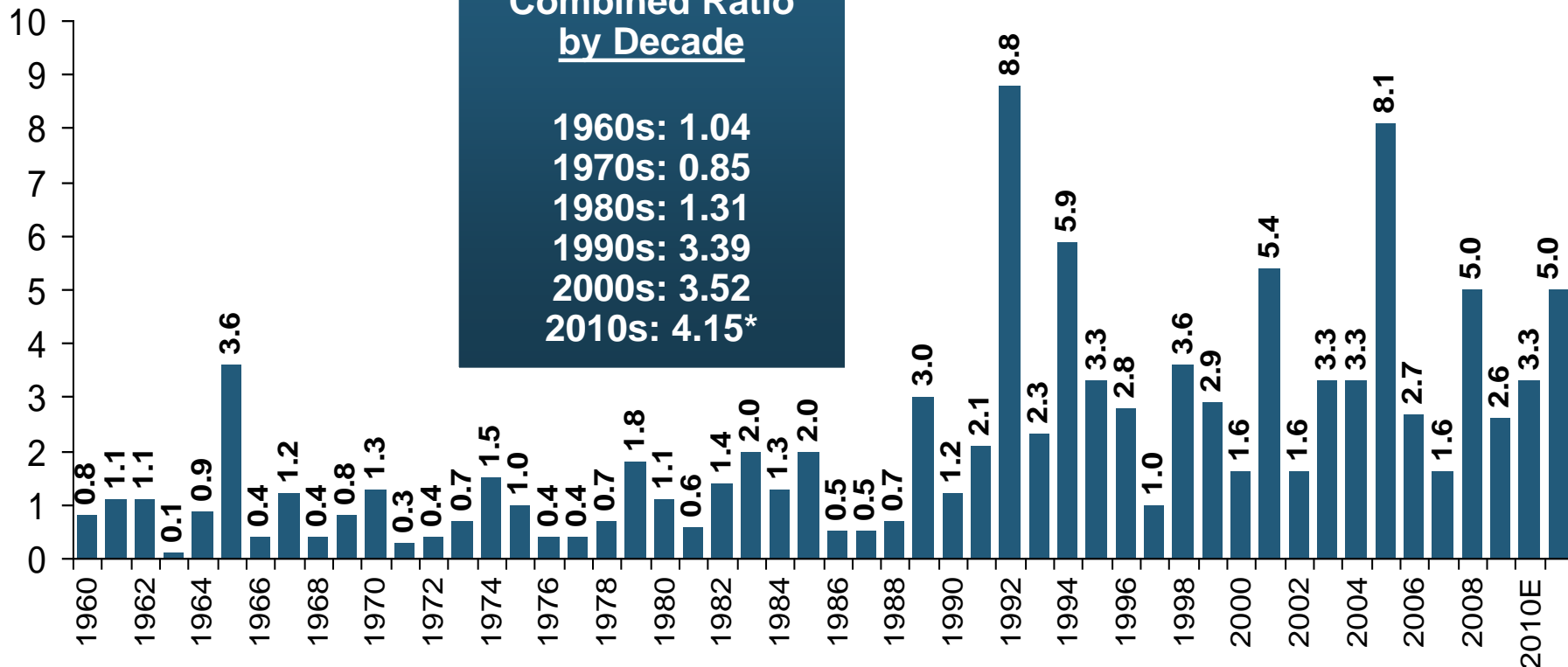
Sources: PCS; Insurance Information Institute inflation adjustments.

Combined Ratio Points Associated with Catastrophe Losses: 1960 – 2011:H1*

Combined Ratio Points

Avg. CAT Loss Component of the Combined Ratio by Decade

1960s: 1.04
 1970s: 0.85
 1980s: 1.31
 1990s: 3.39
 2000s: 3.52
 2010s: 4.15*



The Catastrophe Loss Component of Private Insurer Losses Has Increased Sharply in Recent Decades

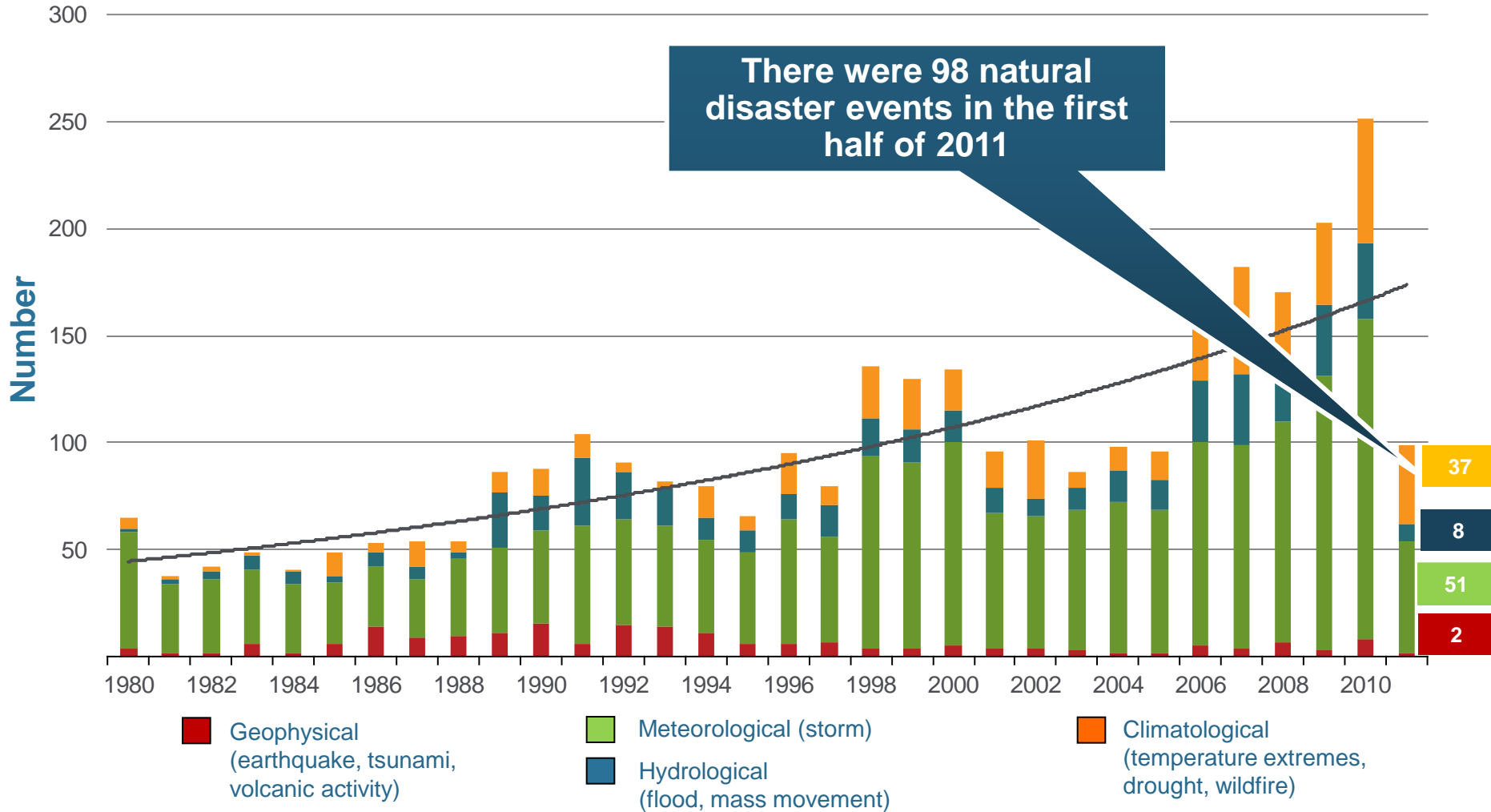
*Insurance Information Institute estimates for 2010 and 2011:H1

Notes: Private carrier losses only. Excludes loss adjustment expenses and reinsurance reinstatement premiums. Figures are adjusted for losses ultimately paid by foreign insurers and reinsurers.

Source: ISO; Insurance Information Institute.

Natural Disasters in the United States, 1980 – 2011*

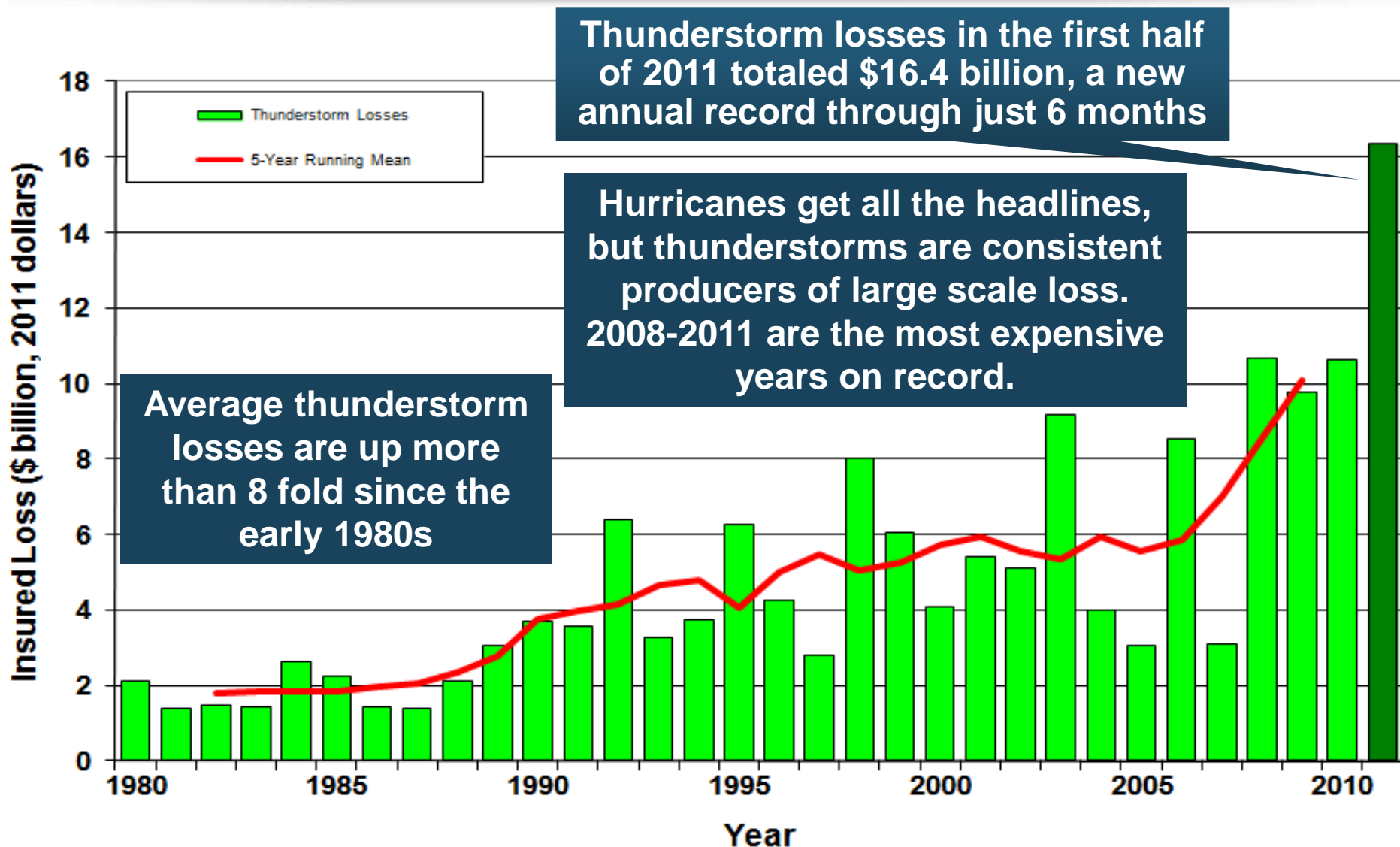
Number of Events (Annual Totals 1980 – 2010 and First Half 2011)



*Through June 30.

Source: MR NatCatSERVICE

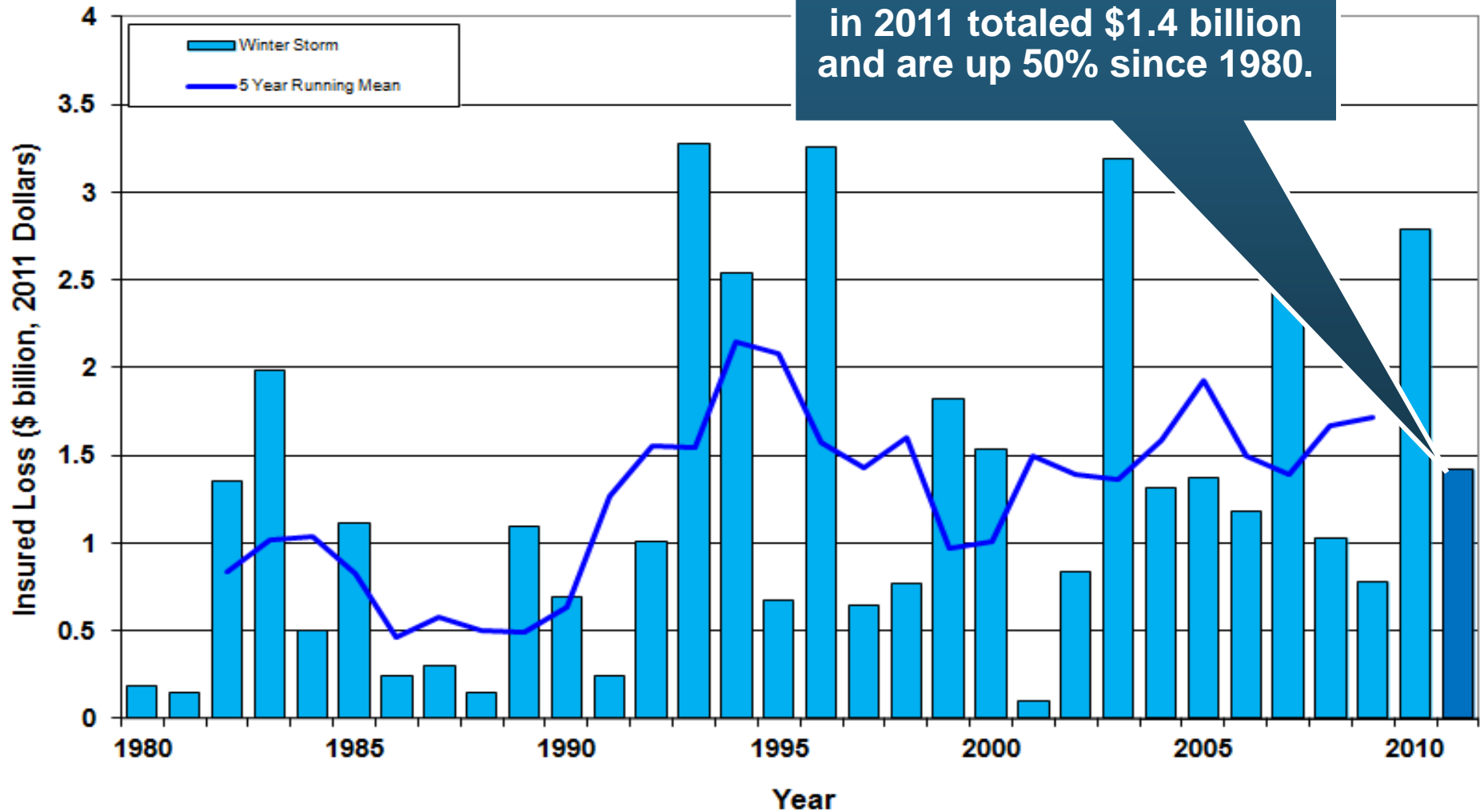
U.S. Thunderstorm Loss Trends, 1980 – 2011*



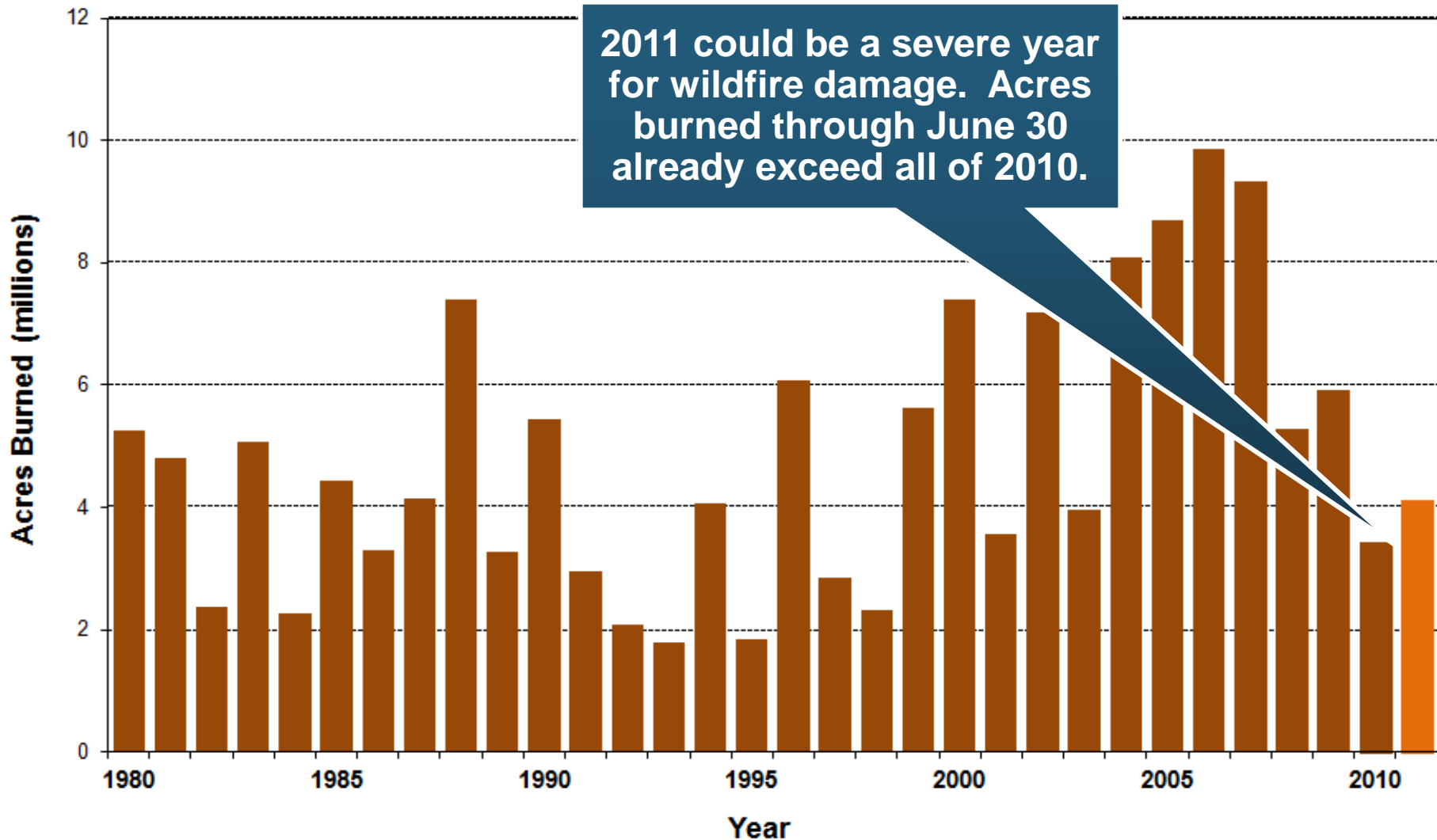
*Through June 30, 2011.

Source: Property Claims Service, MR NatCatSERVICE

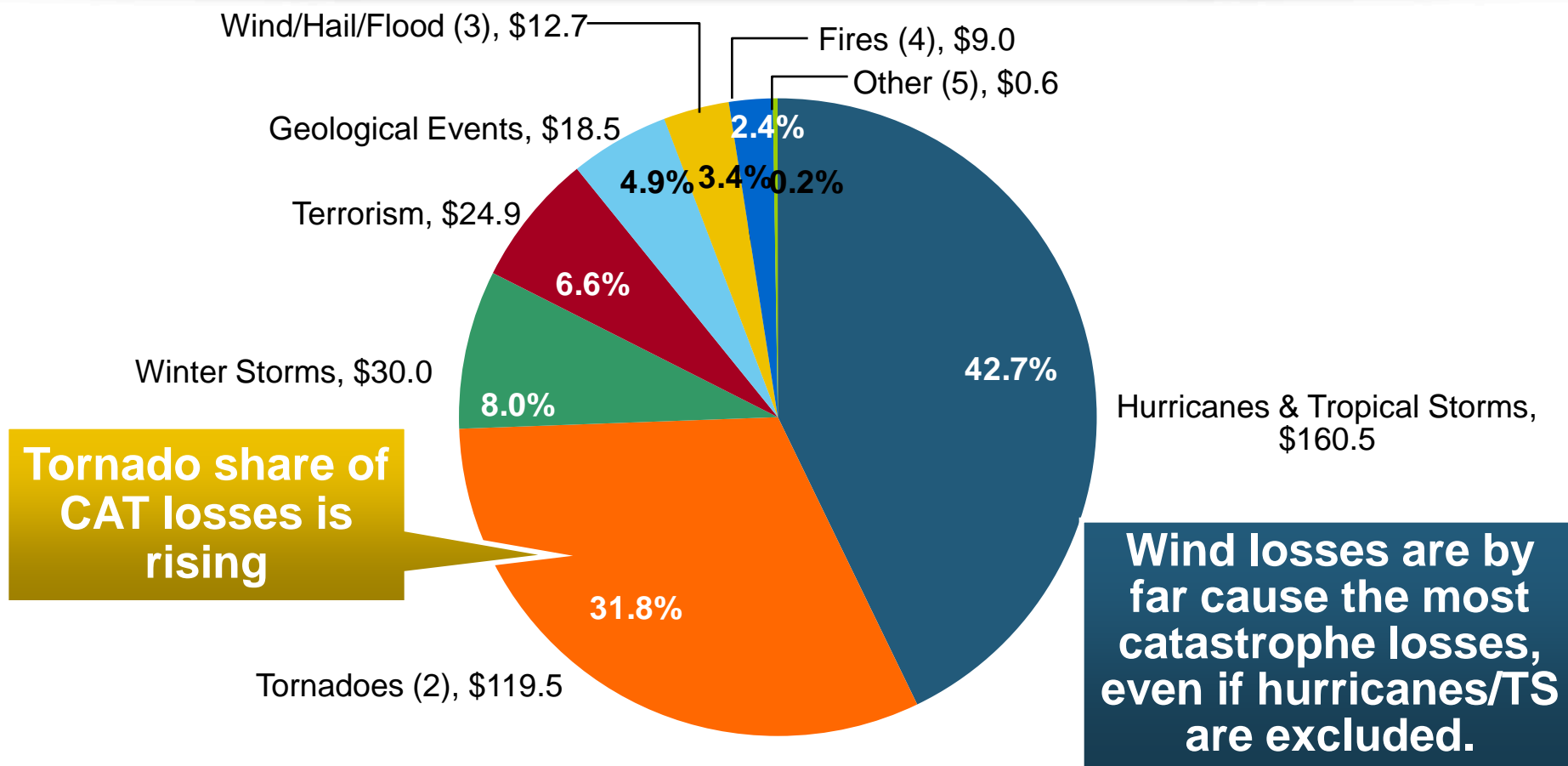
U.S. Winter Storm Loss Trends, 1980 – 2010 (Annual Totals) vs. First Half 2011



U.S. Acreage Burned by Wildfires, 1980 – 2010 (Annual Totals) vs. First Half 2011



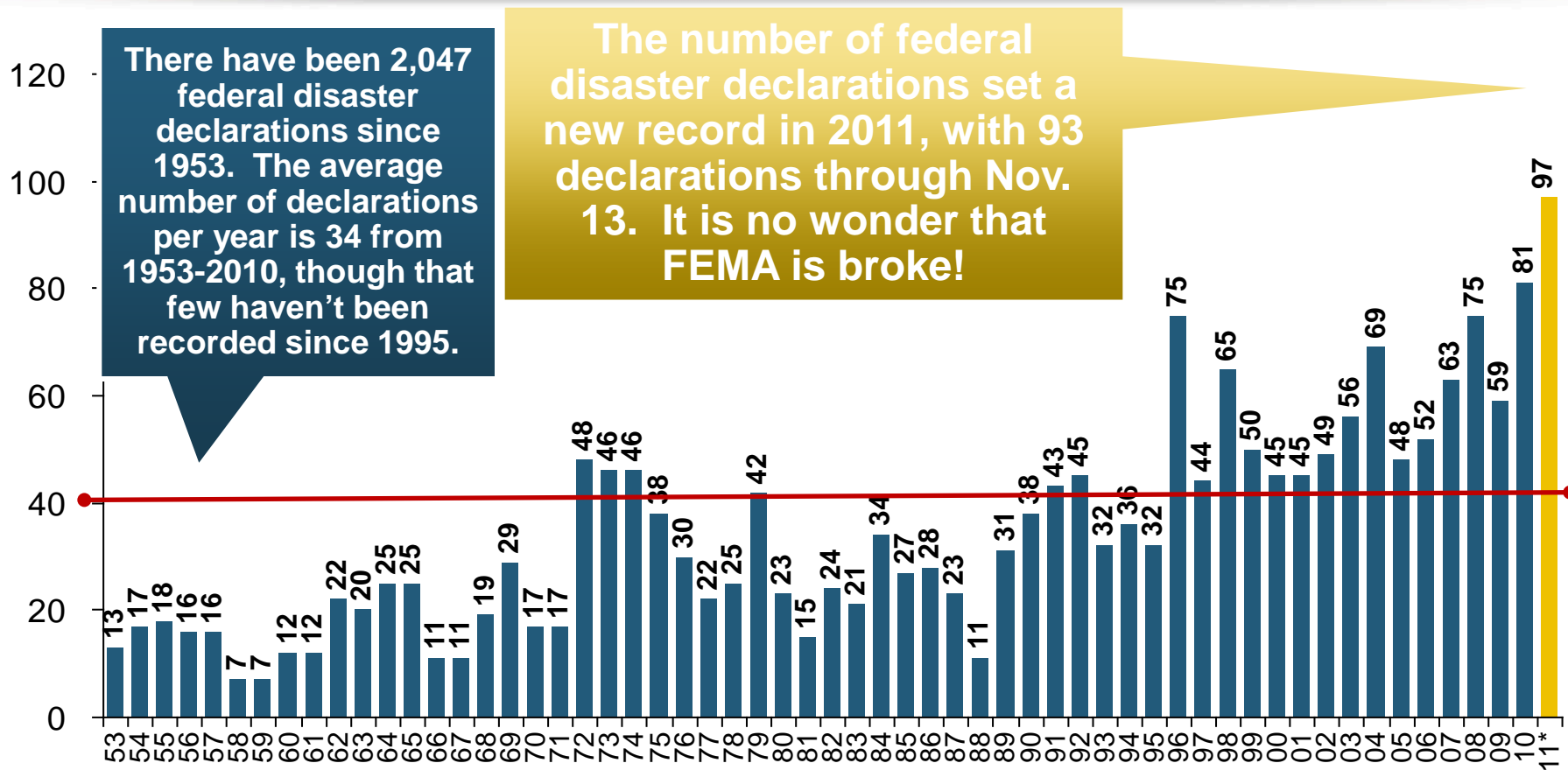
Inflation Adjusted U.S. Catastrophe Losses by Cause of Loss, 1990–2011:H1¹



1. Catastrophes are defined as events causing direct insured losses to property of \$25 million or more in 2009 dollars.
2. Excludes snow.
3. Does not include NFIP flood losses
4. Includes wildland fires
5. Includes civil disorders, water damage, utility disruptions and non-property losses such as those covered by workers compensation.

Source: ISO's Property Claim Services Unit.

Number of Federal Disaster Declarations, 1953-2011*

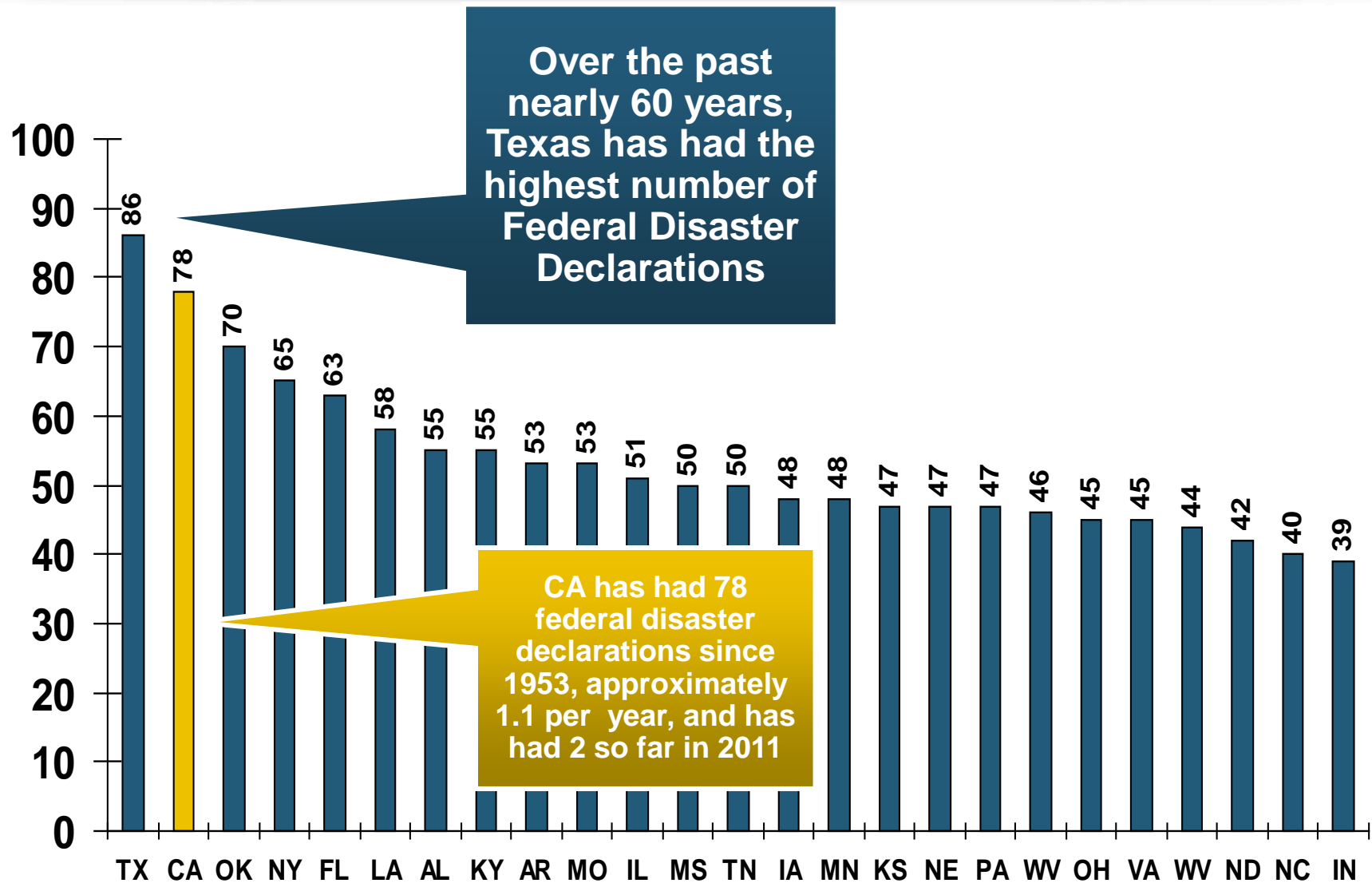


The Number of Federal Disaster Declarations Is Rising and Set a New Record in 2011

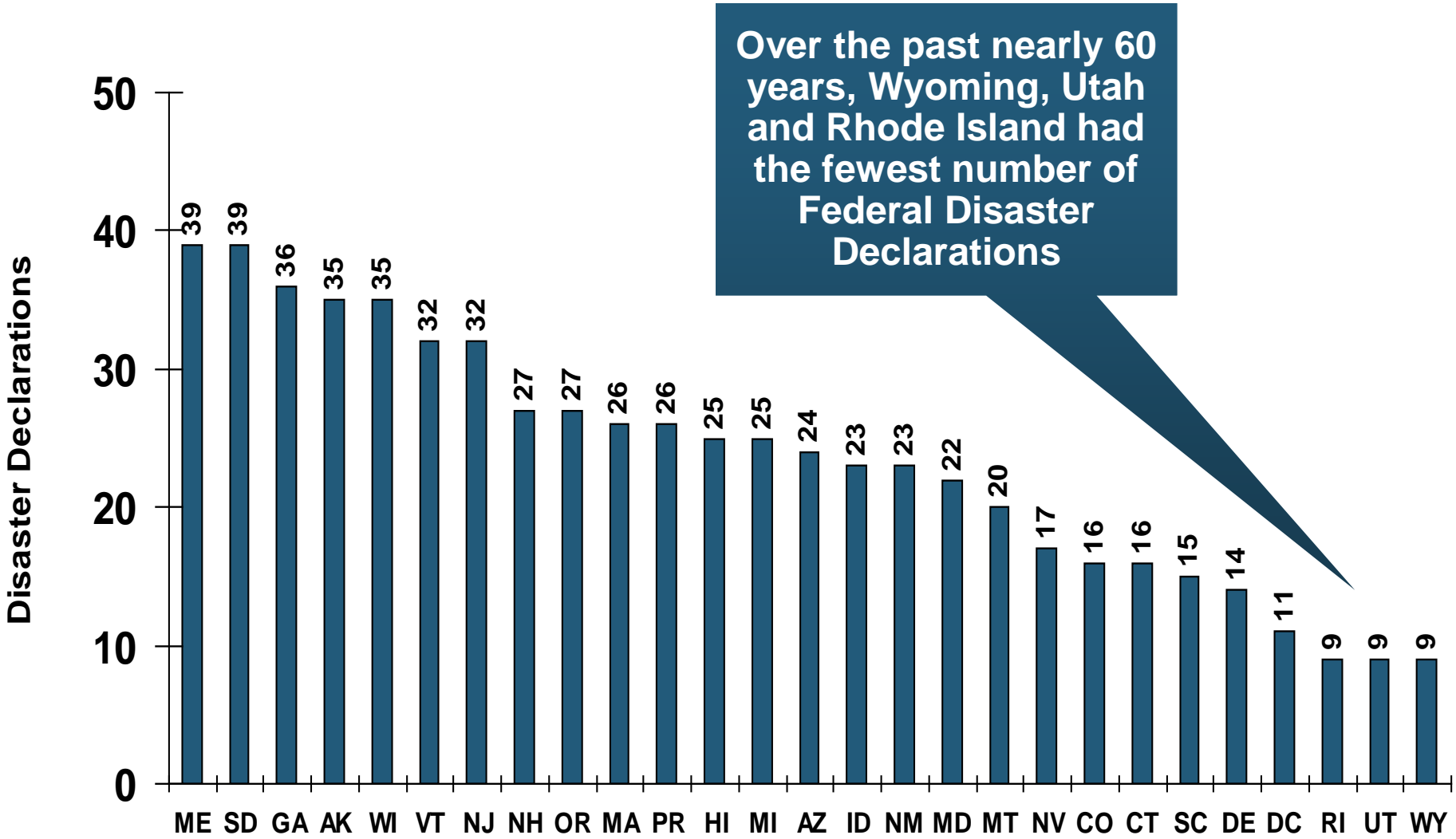
*Through December 4, 2011.

Source: Federal Emergency Management Administration: http://www.fema.gov/news/disaster_totals_annual.fema; Insurance Information Institute.

Federal Disasters Declarations by State, 1953 – Nov. 13, 2011: Highest 25 States



Federal Disasters Declarations by State, 1953 – Nov. 13, 2011: Lowest 25 States*



*Includes Puerto Rico and the District of Columbia.

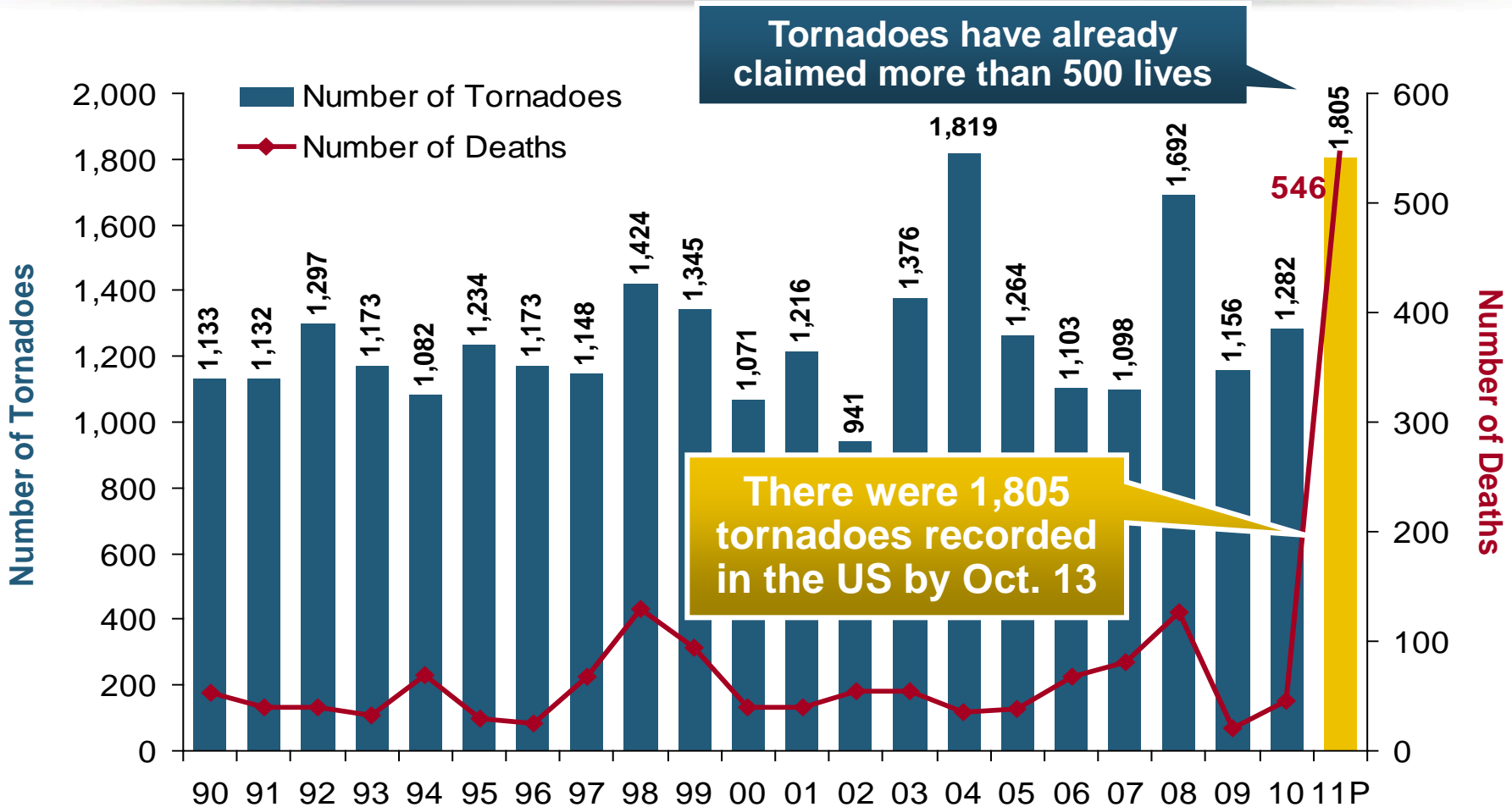
Source: FEMA: http://www.fema.gov/news/disaster_totals_annual.fema; Insurance Information Institute.



SPRING 2011 TORNADO & SEVERE STORM OUTBREAK

**2011 Losses Are Putting Pressure on
US P/C Insurance Markets**

Number of Tornadoes and Related Deaths, 1990 – 2011*



Insurers Expect to Pay at Least \$2 Billion Each for the April 2011 Tornadoes in Alabama and a Similar Amount for the May Storms in Joplin

*2011 is preliminary data through October 13.

Source: U.S. Department of Commerce, Storm Prediction Center, National Weather Service.

Insurers Making a Difference in Impacted Communities

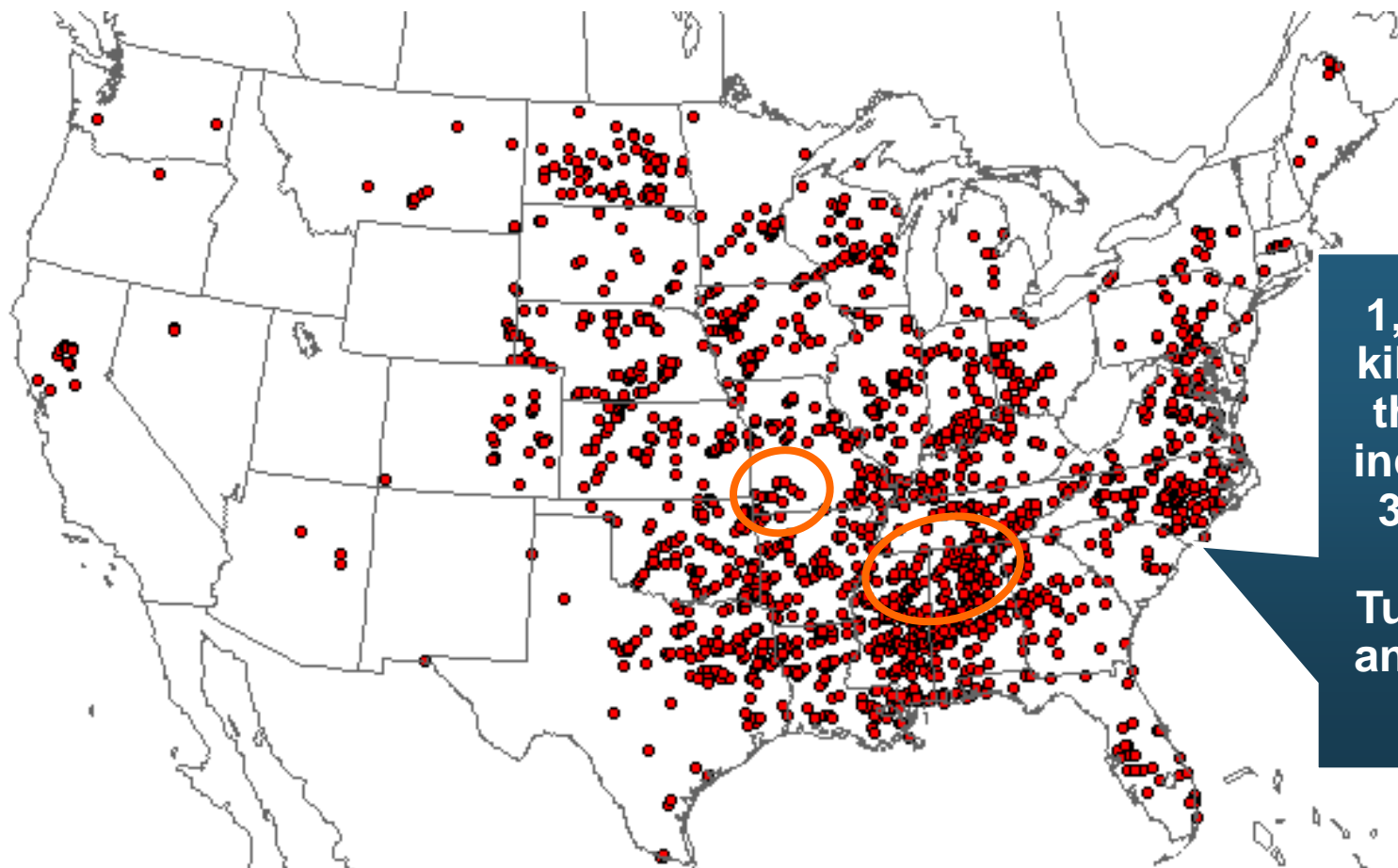


Destroyed home in Tuscaloosa. Insurers will pay some 165,000 claims totaling \$2 billion in the Tuscaloosa/Birmingham areas alone.

Presentation of a check to Tuscaloosa Mayor Walt Maddox to the Tuscaloosa Storm Recovery Fund



Location of Tornadoes in the US, January 1—December 5, 2011



1,885 tornadoes
killed 546 people
through Dec. 5,
including at least
340 on April 26
mostly in the
Tuscaloosa area,
and 130 in Joplin
on May 22



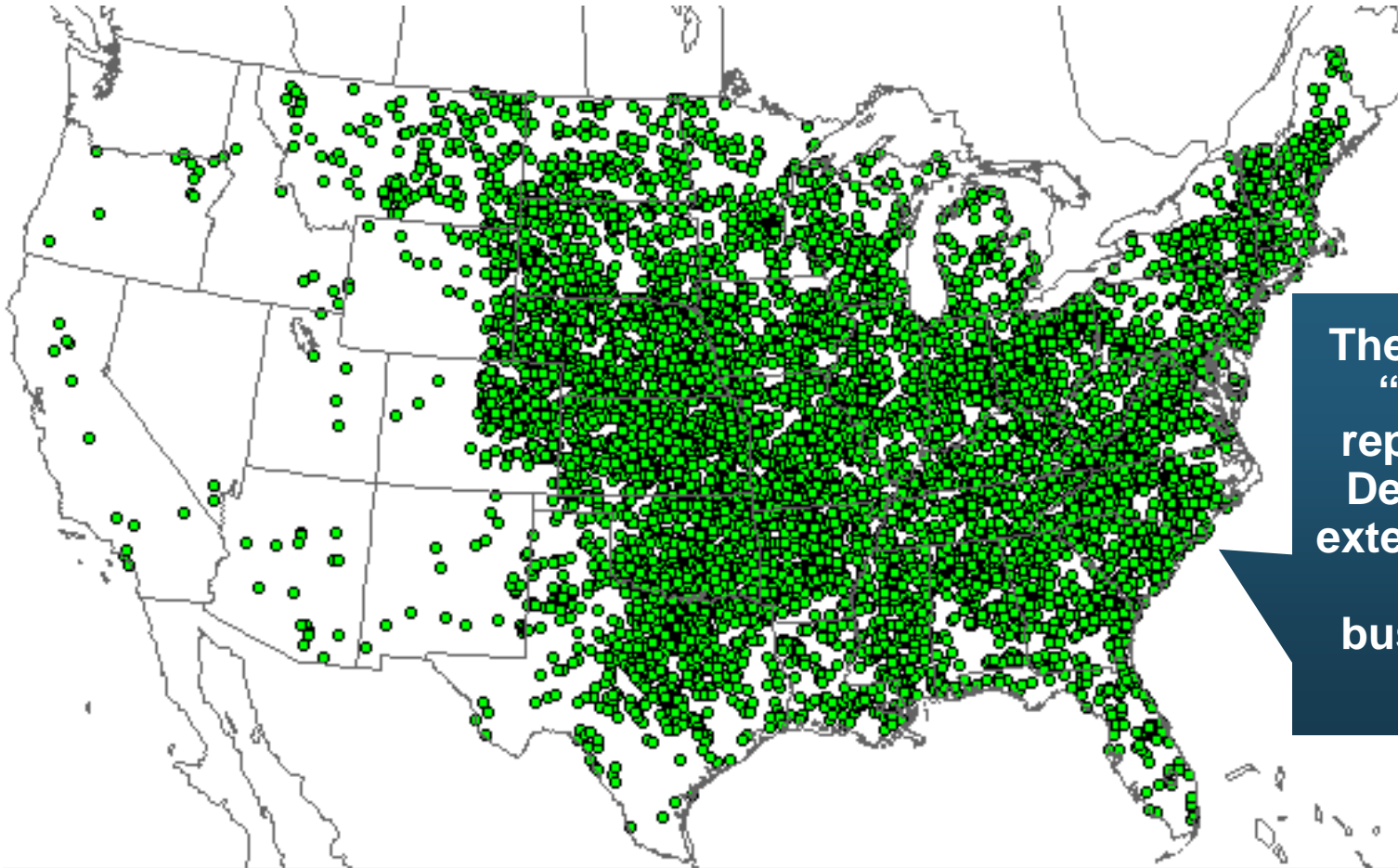
PRELIMINARY SEVERE WEATHER
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Tornado Reports
January 01, 2011 - December 05, 2011

Updated: Monday December 05, 2011 08:18 CT

Location of Large Hail Reports in the US, January 1—December 5, 2011



There were 9,413
“Large Hail”
reports through
Dec. 5, causing
extensive damage
to homes,
businesses and
vehicles



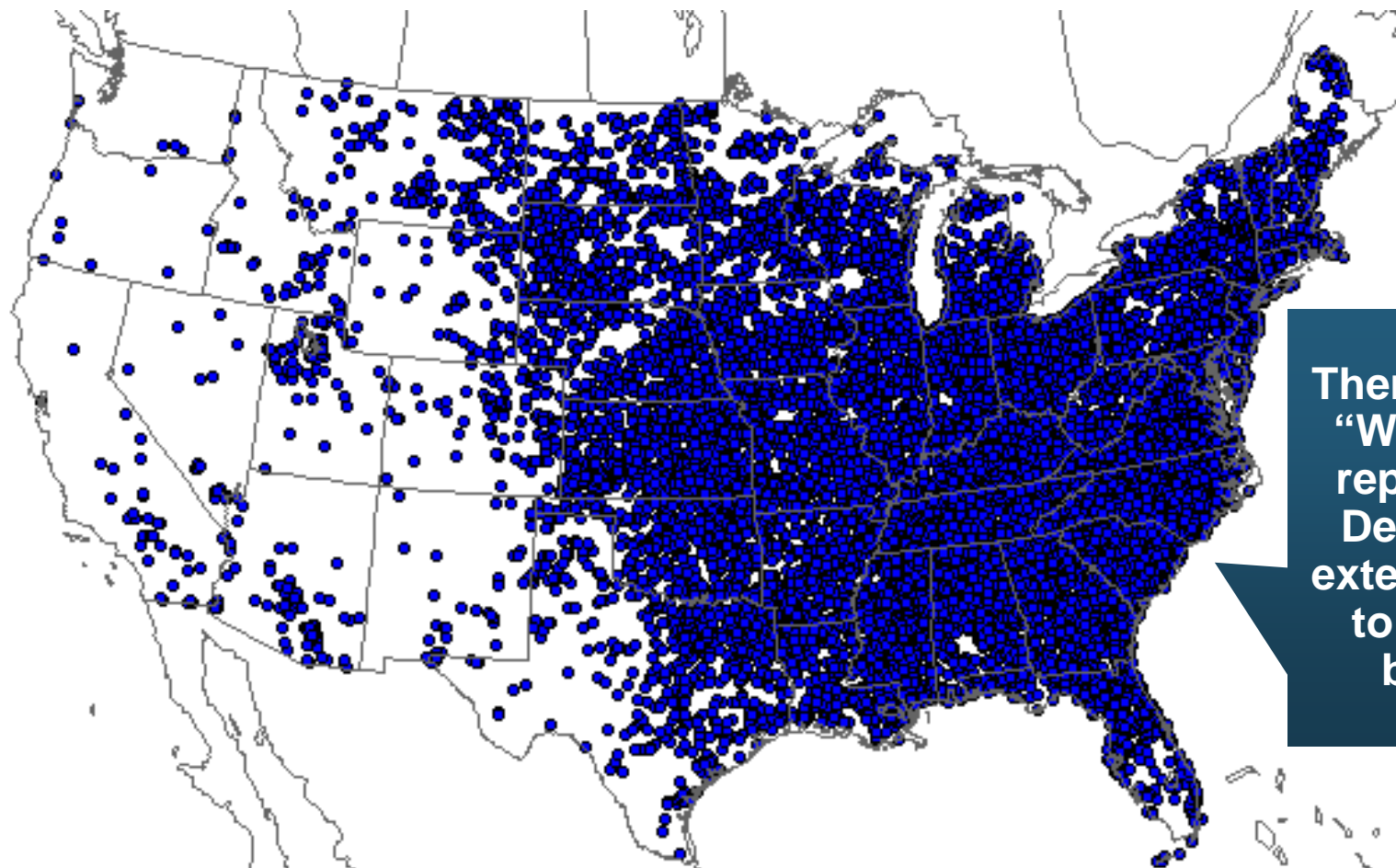
PRELIMINARY SEVERE WEATHER
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Hail Reports
January 01, 2011 - December 05, 2011

Updated: Monday December 05, 2011 08:18 CT

Location of Wind Damage Reports in the US, January 1—December 5, 2011



There were 18,580
“Wind Damage”
reports through
Dec. 5, causing
extensive damage
to homes and,
businesses



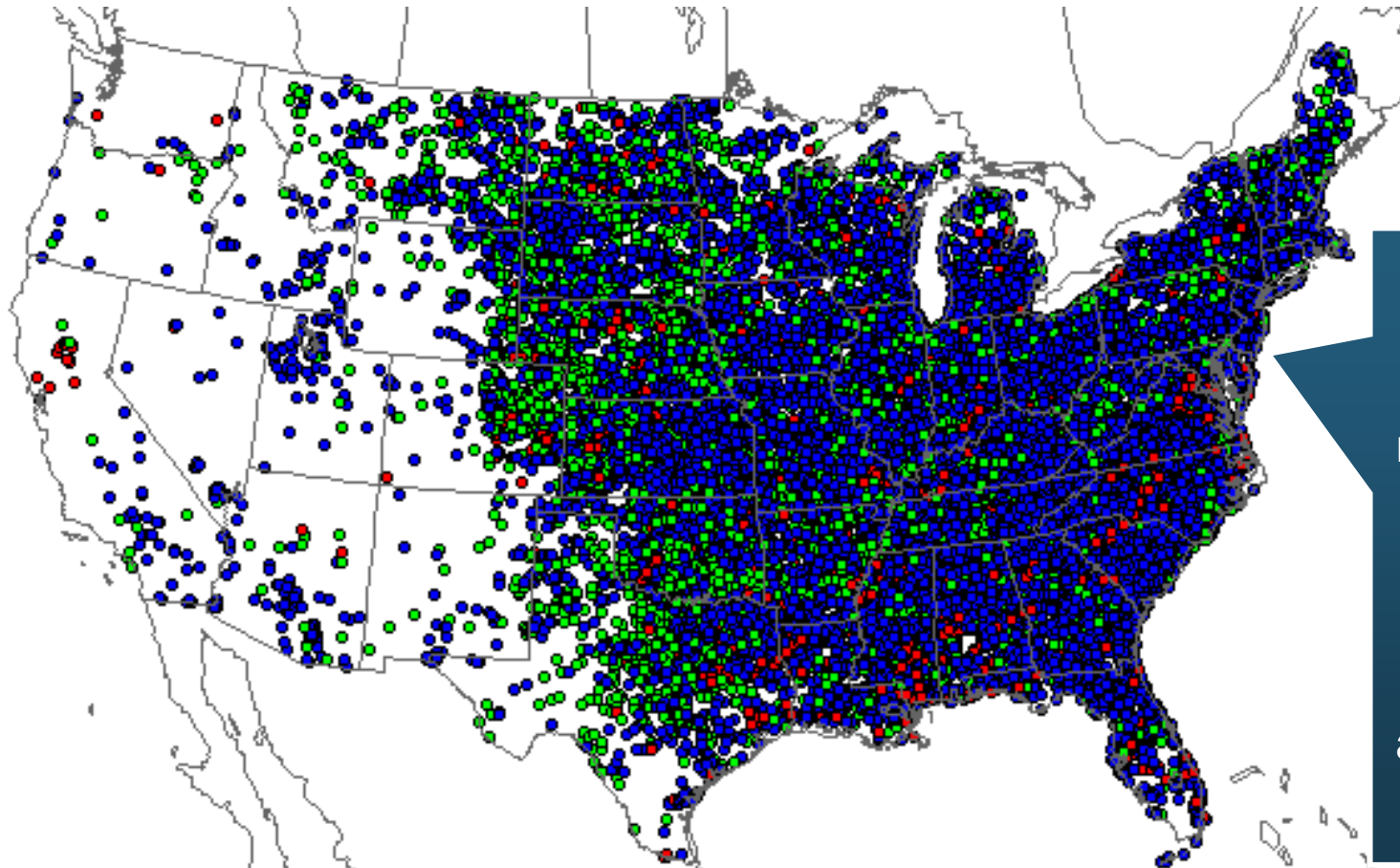
PRELIMINARY SEVERE WEATHER
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Wind Reports
January 01, 2011 - December 05, 2011

Updated: Monday December 05, 2011 08:18 CT

Severe Weather Reports, January 1—December 5, 2011



There have been 29,885 severe weather reports through Dec. 5; including 1,881 tornadoes; 9,413 “Large Hail” reports and 18,580 high wind events



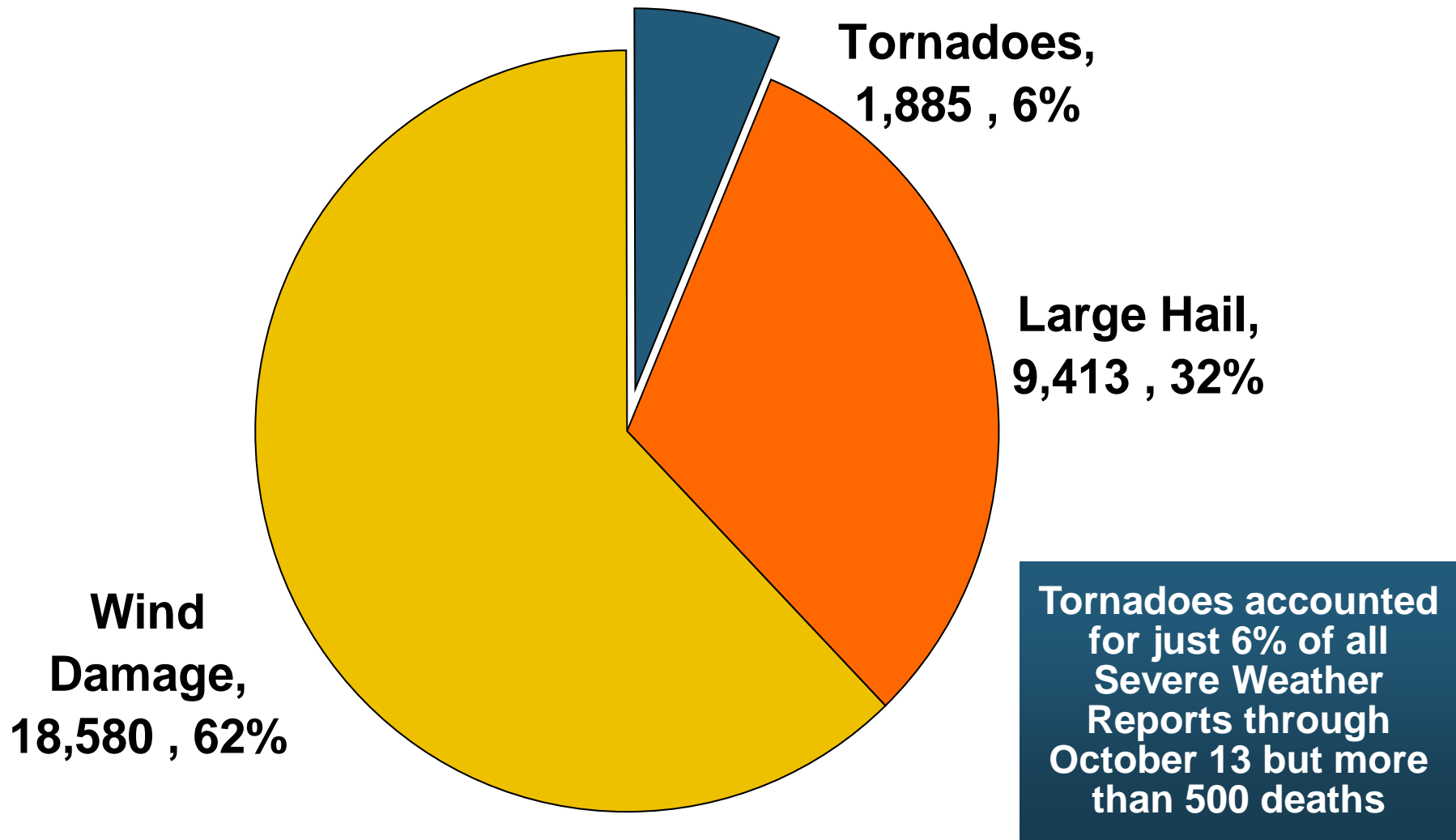
PRELIMINARY SEVERE WEATHER
REPORT DATABASE (ROUGH LOG)

NOAA/Storm Prediction Center Norman, Oklahoma

Severe Weather Reports
January 01, 2011 - December 05, 2011

Updated: Monday December 05, 2011 08:18 CT

Number of Severe Weather Reports in US, by Type: January 1—December 5, 2011



**The BIG Question:
When Will the Market Turn?**

**Are Catastrophes and Other Factors
Pressuring Insurance Markets?**

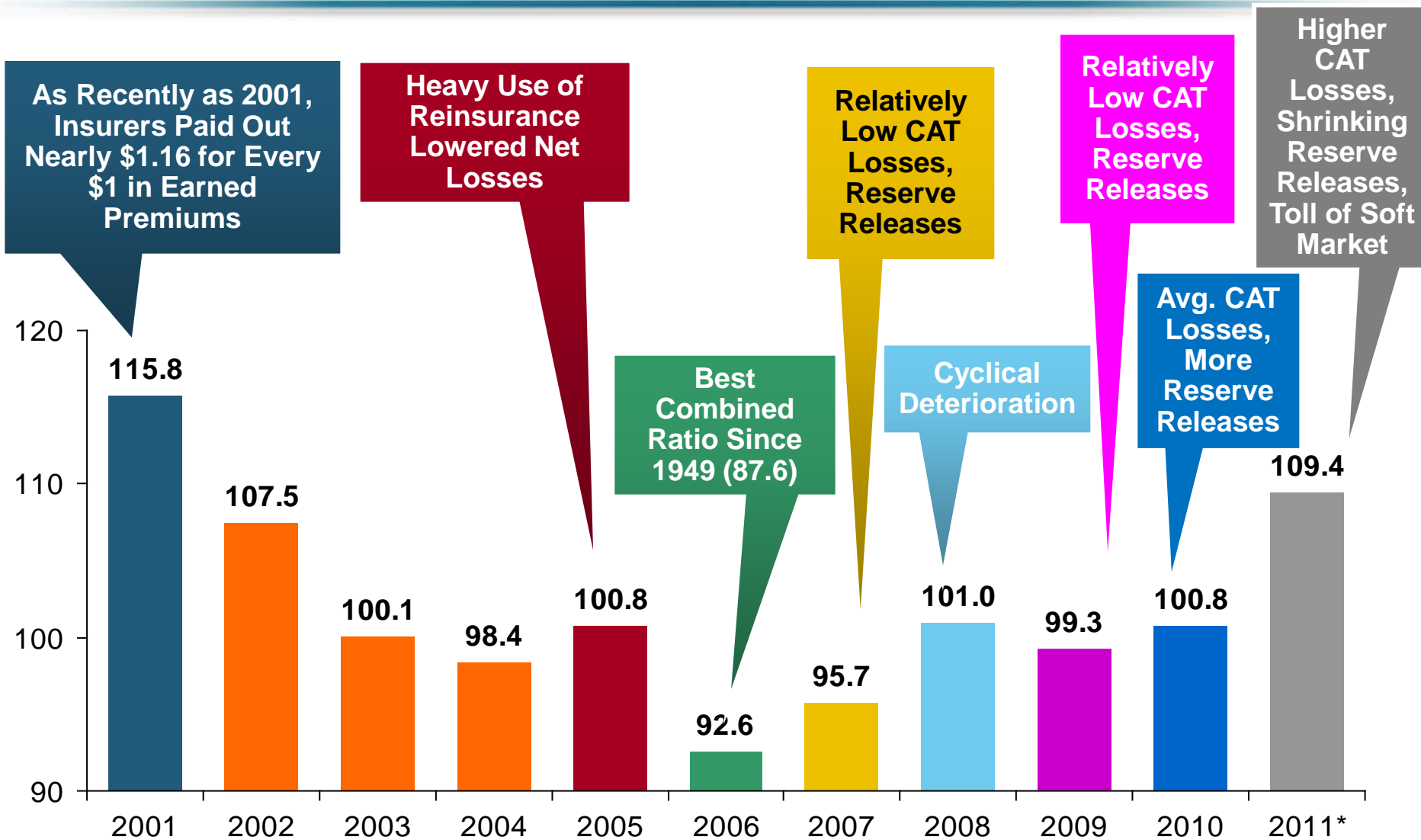
Criteria Necessary for a “Market Turn”: All Four Criteria Must Be Met

| Criteria | Status | Comments |
|--|--|---|
| Sustained Period of Large Underwriting Losses | <i>Early Stage, Inevitable</i> | <ul style="list-style-type: none"> • Apart from Q2:2011, overall p/c underwriting losses remain modest • Combined ratios (ex-Q2 CATs) still in low 100s (vs. 110+ at onset of last hard market) • Prior-year reserve releases continue reduce u/w losses, boost ROEs |
| Material Decline in Surplus/ Capacity | <i>Entered 2011 At Record High; Since Fallen</i> | <ul style="list-style-type: none"> • Surplus hit a record \$565B as of 3/31/11 • Fell by 1% in Q2 2011 • Little excess capacity remains in reinsurance markets • Weak growth in demand for insurance is insufficient to absorb much excess capacity |
| Tight Reinsurance Market | <i>Somewhat in Place</i> | <ul style="list-style-type: none"> • Much of the global “excess capacity” was eroded by cats • Higher prices in Asia/Pacific • Modestly higher pricing for US risks |
| Renewed Underwriting & Pricing Discipline | <i>Some Firming esp. in Property, WC</i> | <ul style="list-style-type: none"> • Commercial lines pricing trends turning from negative to flat or up in some lines (property, WC) • Competition remains intense as many seek to maintain market share |

1. UNDERWRITING

**Have Underwriting Losses
Been Large Enough for Long
Enough to Turn the Market?**

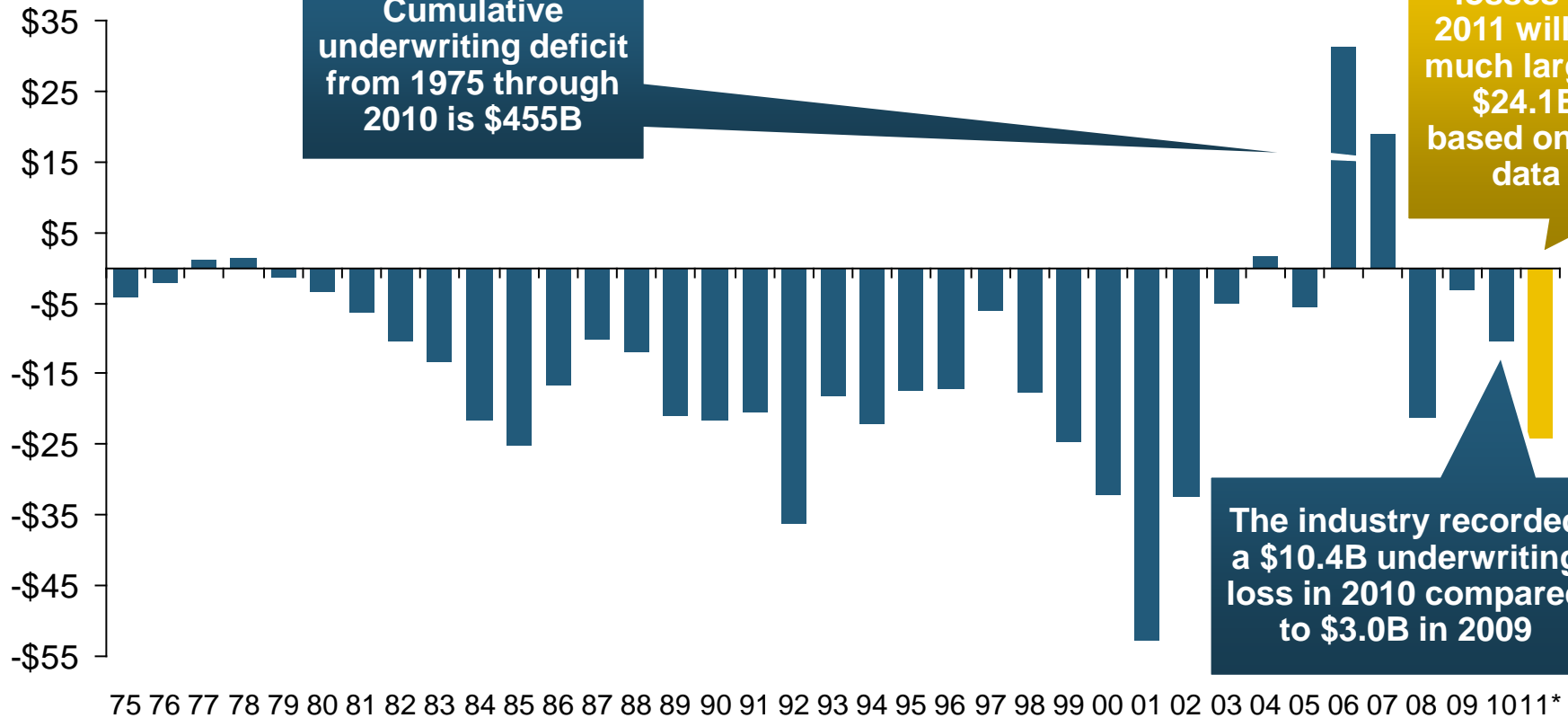
P/C Insurance Industry Combined Ratio, 2001–2011:H1*



* Excludes Mortgage & Financial Guaranty insurers 2008--2011. Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=110.5
 Sources: A.M. Best, ISO.; III Estimated for 2011:H1 (Q1 actual ex-M&FG was 102.2).

Underwriting Gain (Loss) 1975–2011*

(\$ Billions)



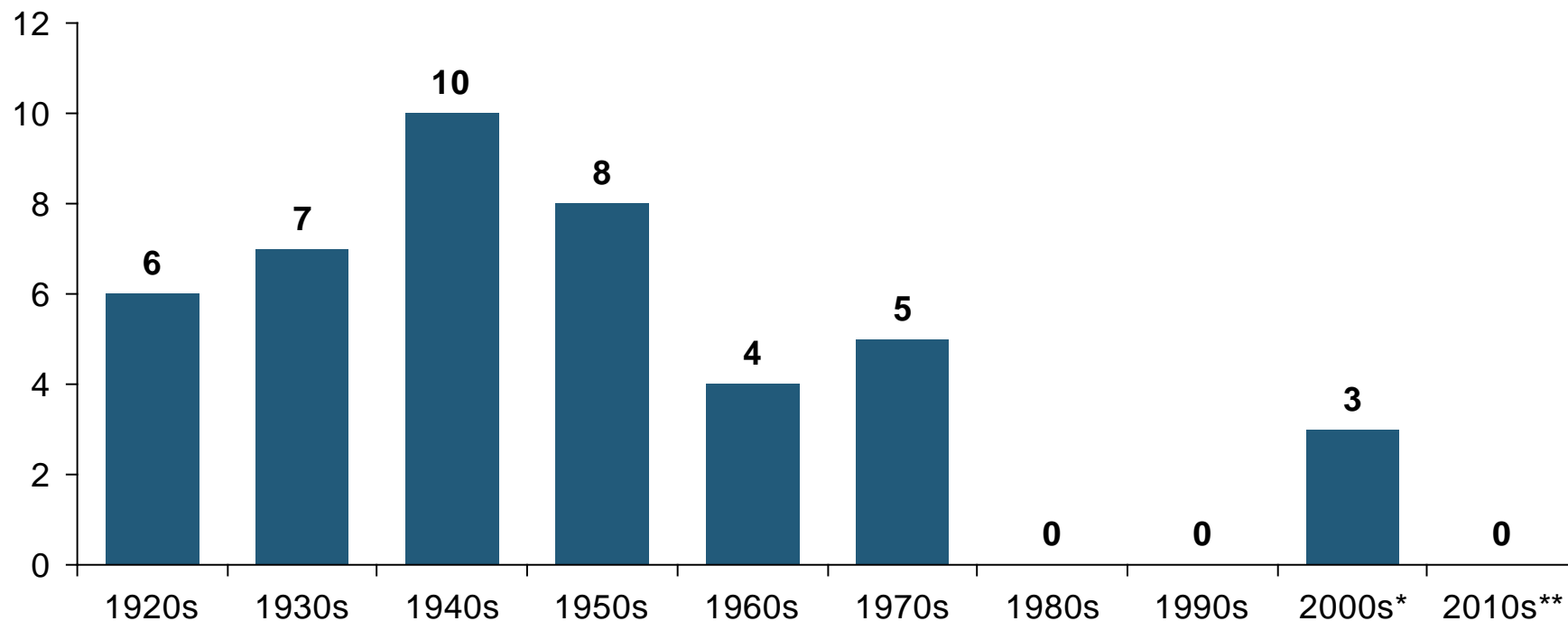
**Large Underwriting Losses Are *NOT* Sustainable
in Current Investment Environment**

* Includes mortgage and financial guaranty insurers in all years. 2011 figure is actual H1 underwriting losses of \$24.098 billion.

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

Number of Years with Underwriting Profits by Decade, 1920s–2010s

Number of Years with Underwriting Profits



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

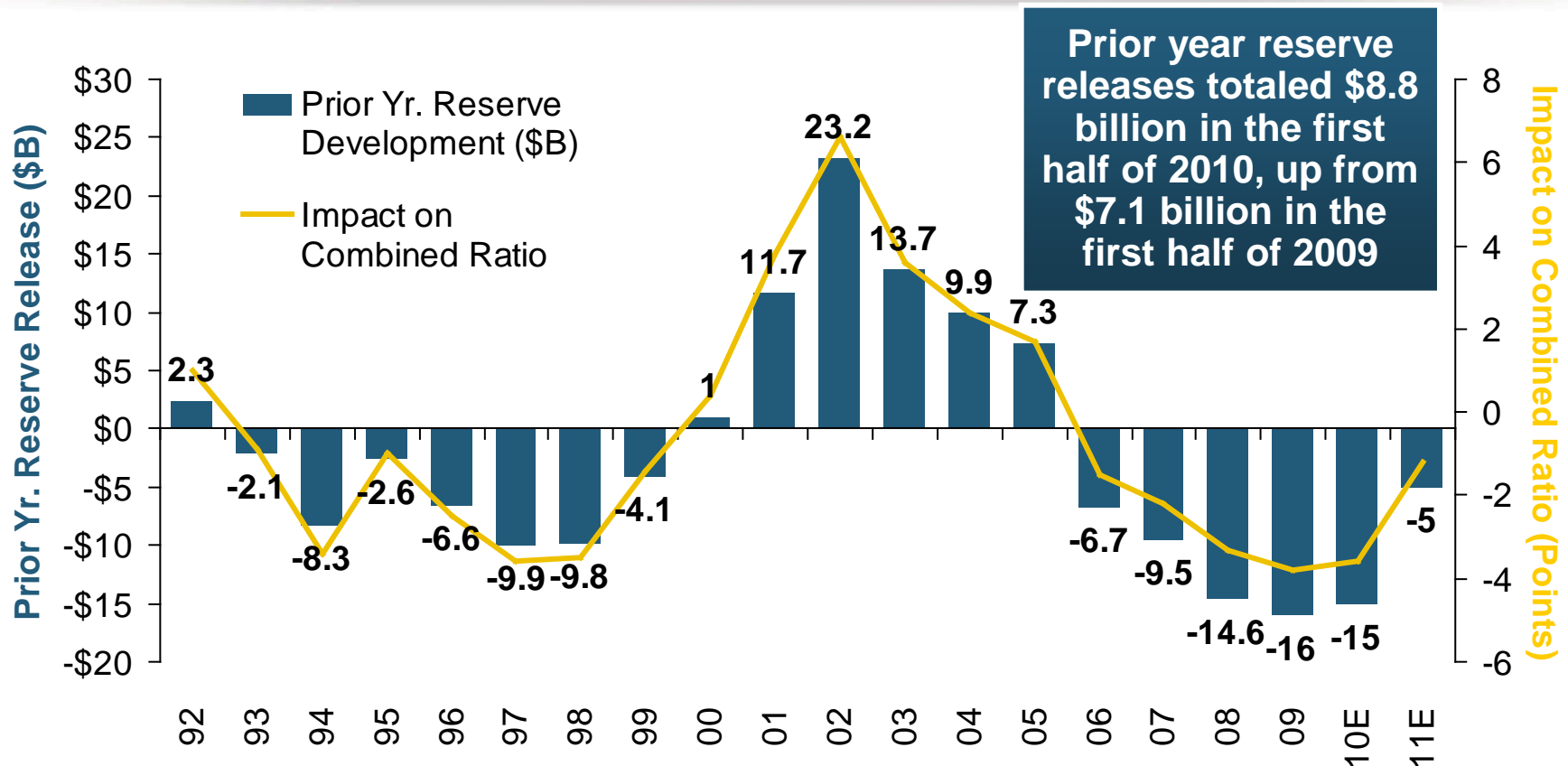
total to 4 years with an underwriting profit.

**Data for the 2010s includes 2010 and 2011.

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

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

P/C Reserve Development, 1992–2011E



Prior year reserve releases totaled \$8.8 billion in the first half of 2010, up from \$7.1 billion in the first half of 2009

Reserve Releases Are Remained Strong in 2010 But Should Begin to Taper Off in 2011

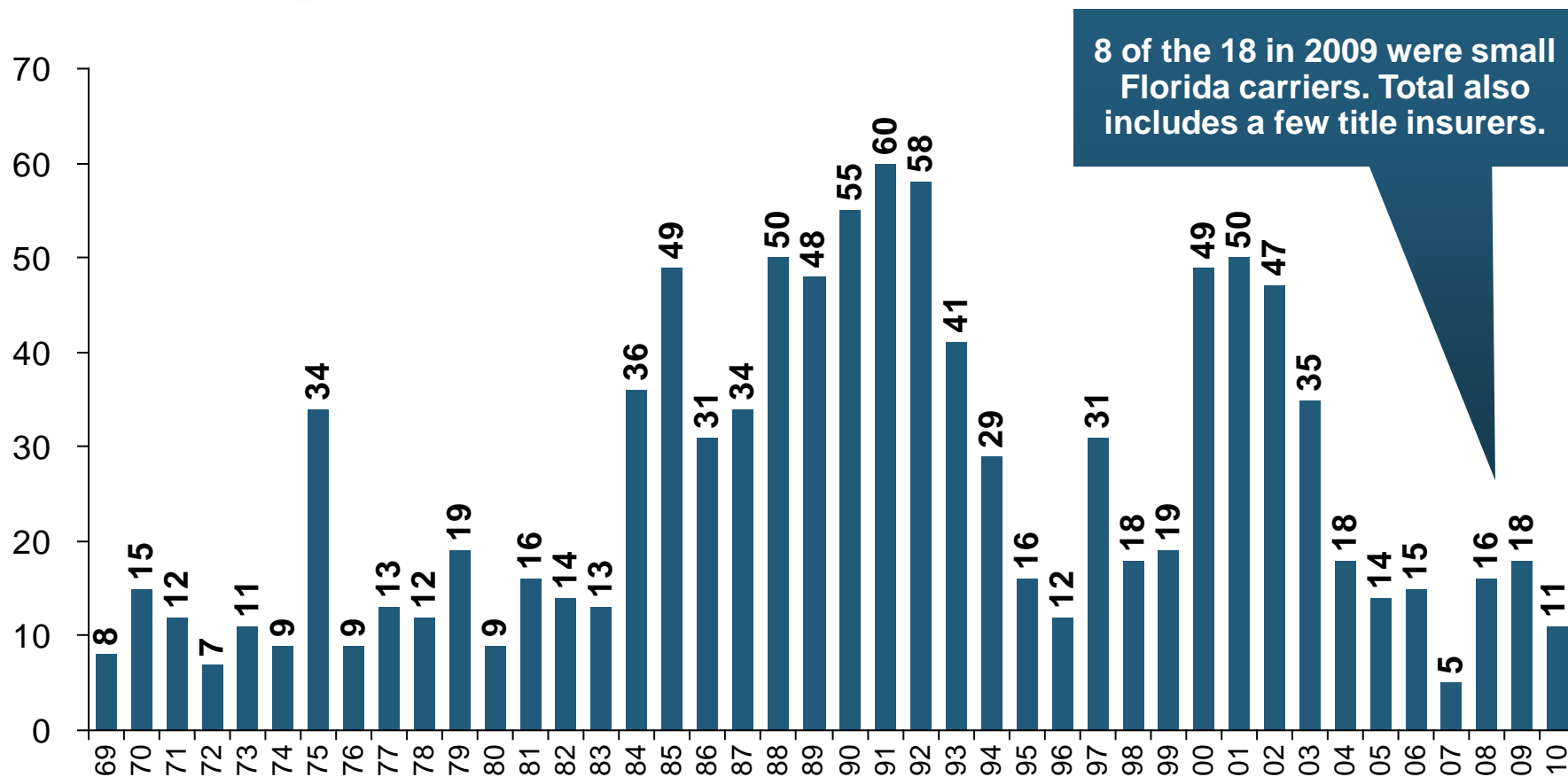
Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.

Sources: Barclay's Capital; A.M. Best.

Financial Strength & Underwriting

**Cyclical Pattern is P-C Impairment
History is Directly Tied to
Underwriting, Reserving & Pricing**

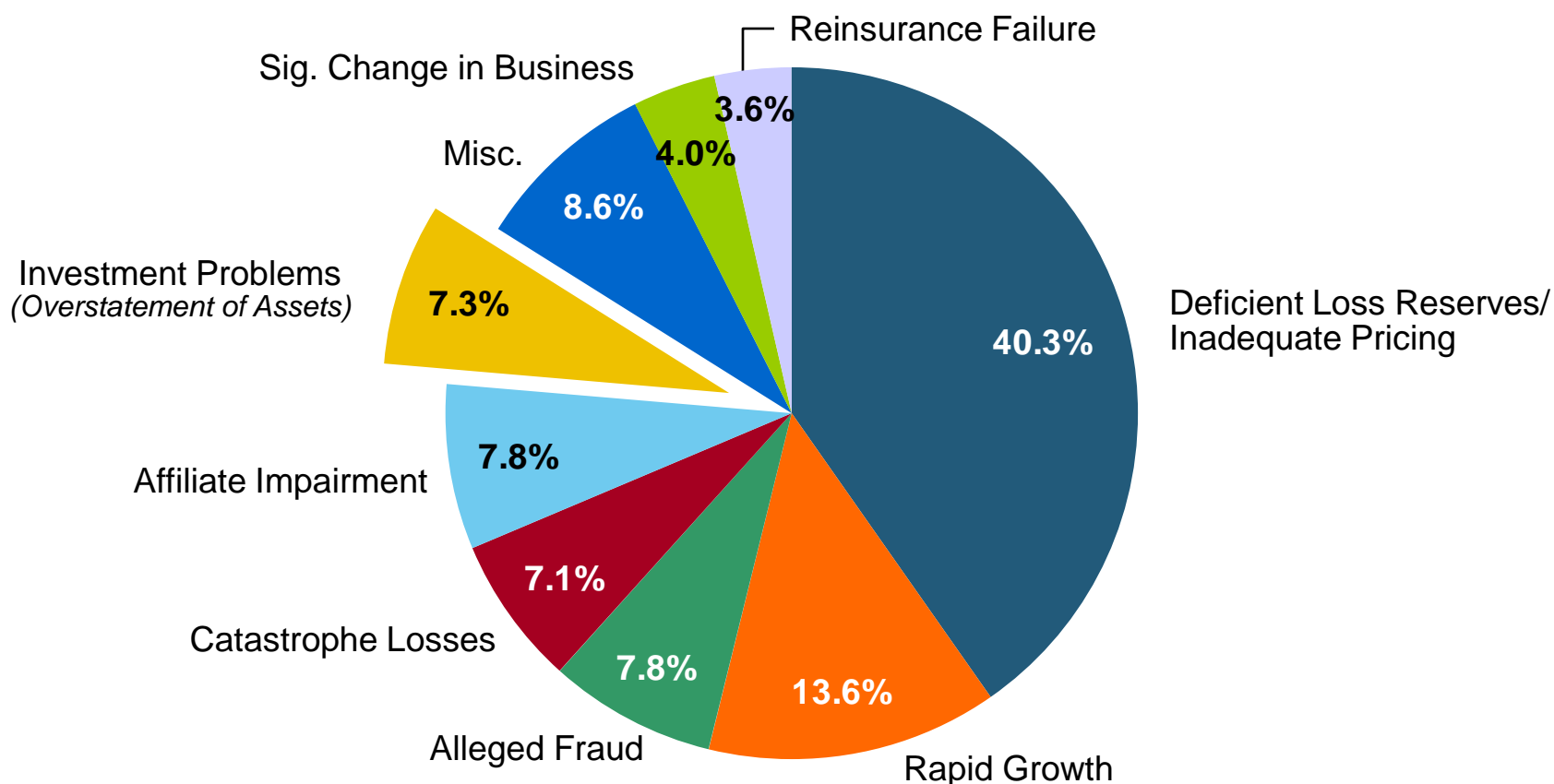
P/C Insurer Impairments, 1969–2010



The Number of Impairments Varies Significantly Over the P/C Insurance Cycle, With Peaks Occurring Well into Hard Markets

Reasons for US P/C Insurer Impairments, 1969–2010

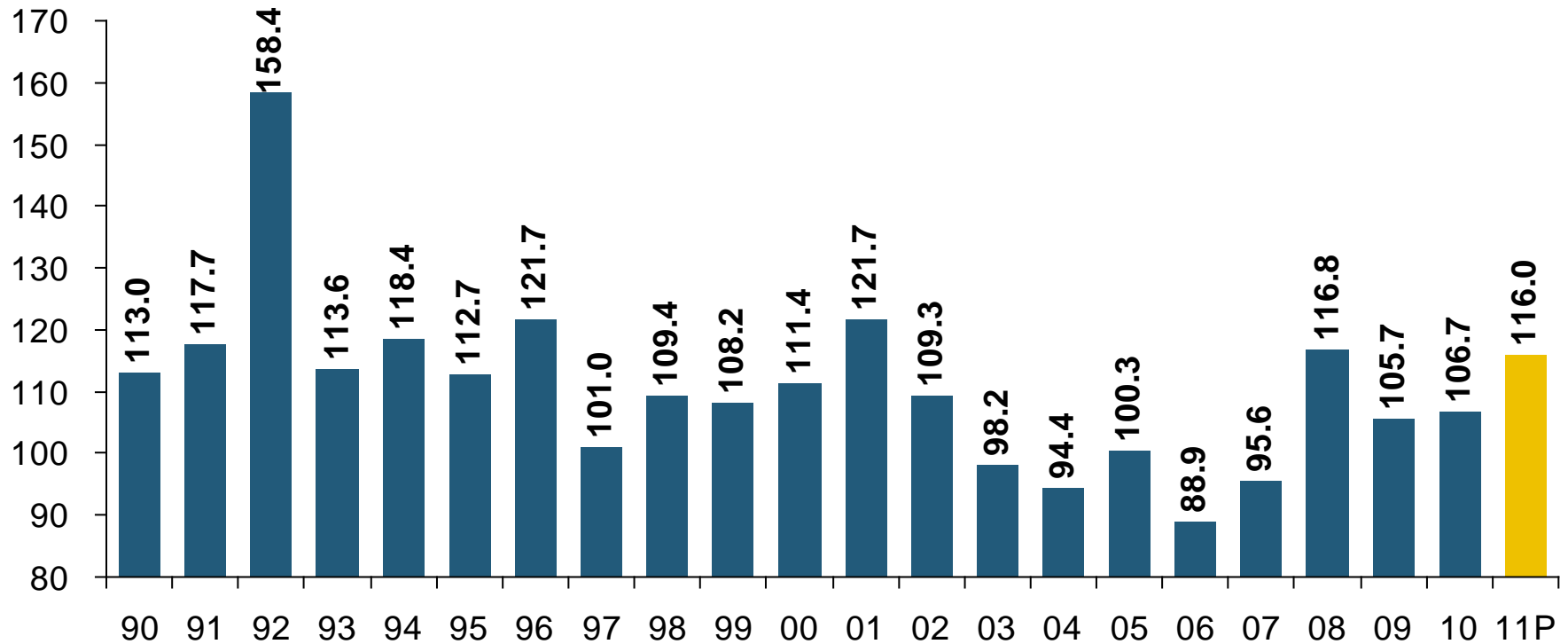
Historically, Deficient Loss Reserves and Inadequate Pricing Are By Far the Leading Cause of P-C Insurer Impairments. Investment and Catastrophe Losses Play a Much Smaller Role





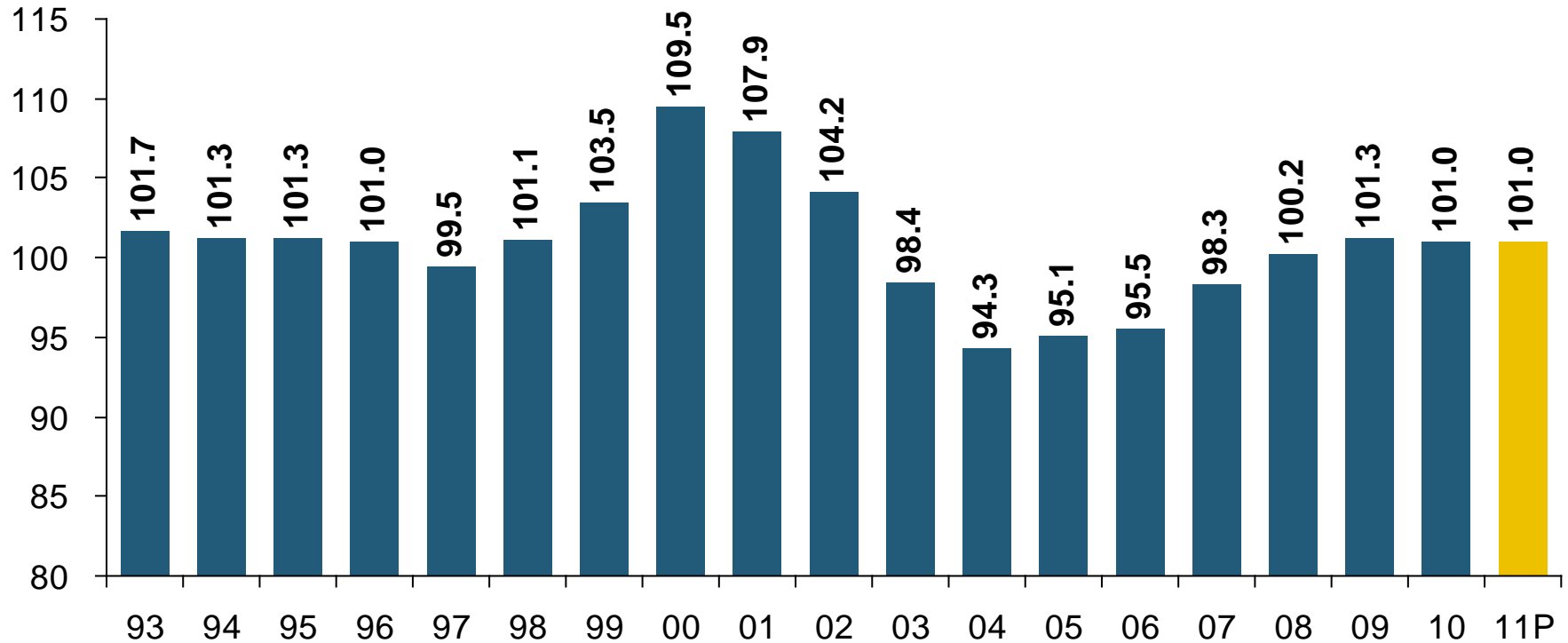
Performance by Segment: Commercial Lines

Homeowners Insurance Combined Ratio: 1990–2011P



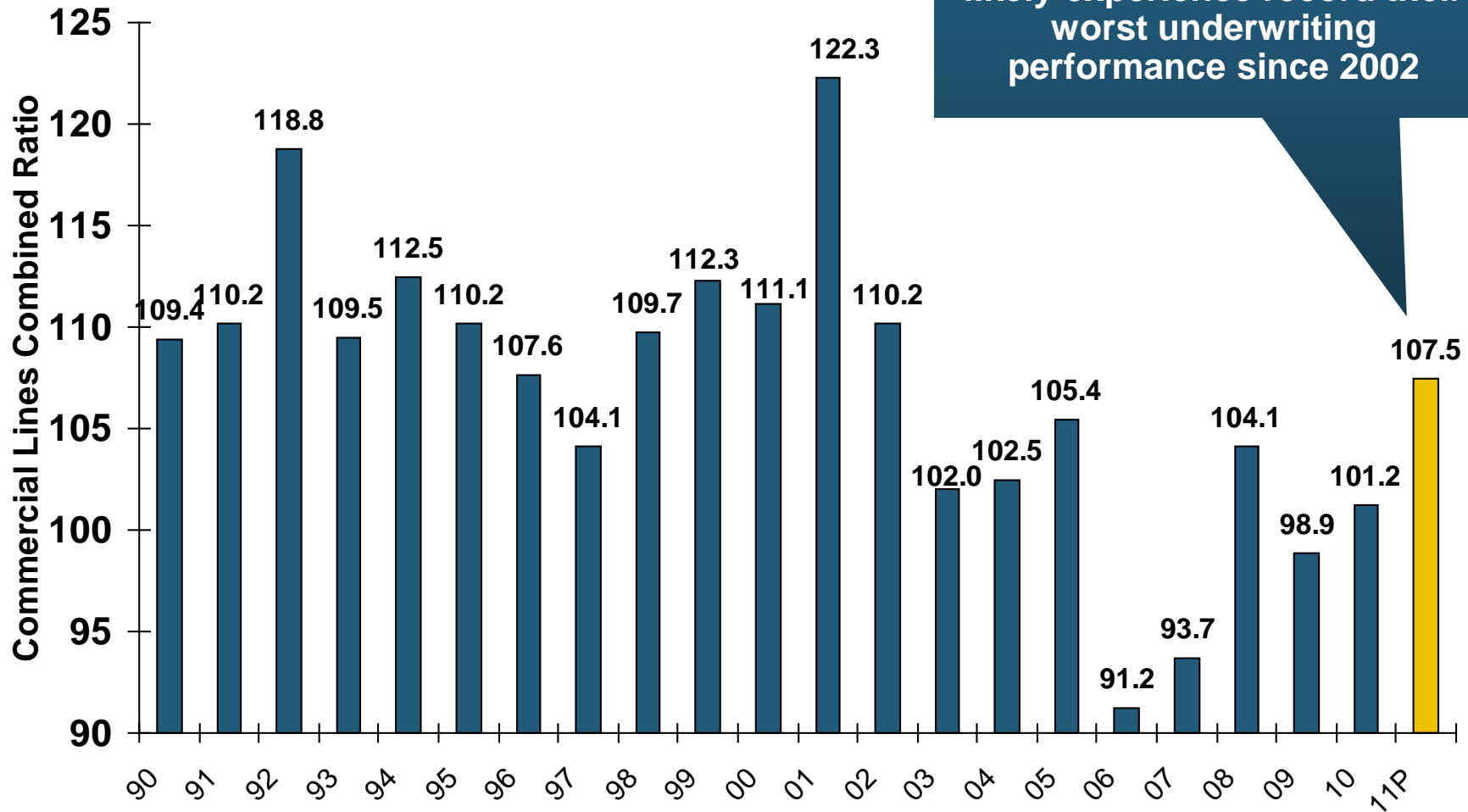
Homeowners Line Could Deteriorate in 2011 Due to Large Cat Losses. Extreme Regional Variation Can Be Expected Due to Local Catastrophe Loss Activity

Private Passenger Auto Combined Ratio: 1993–2011P

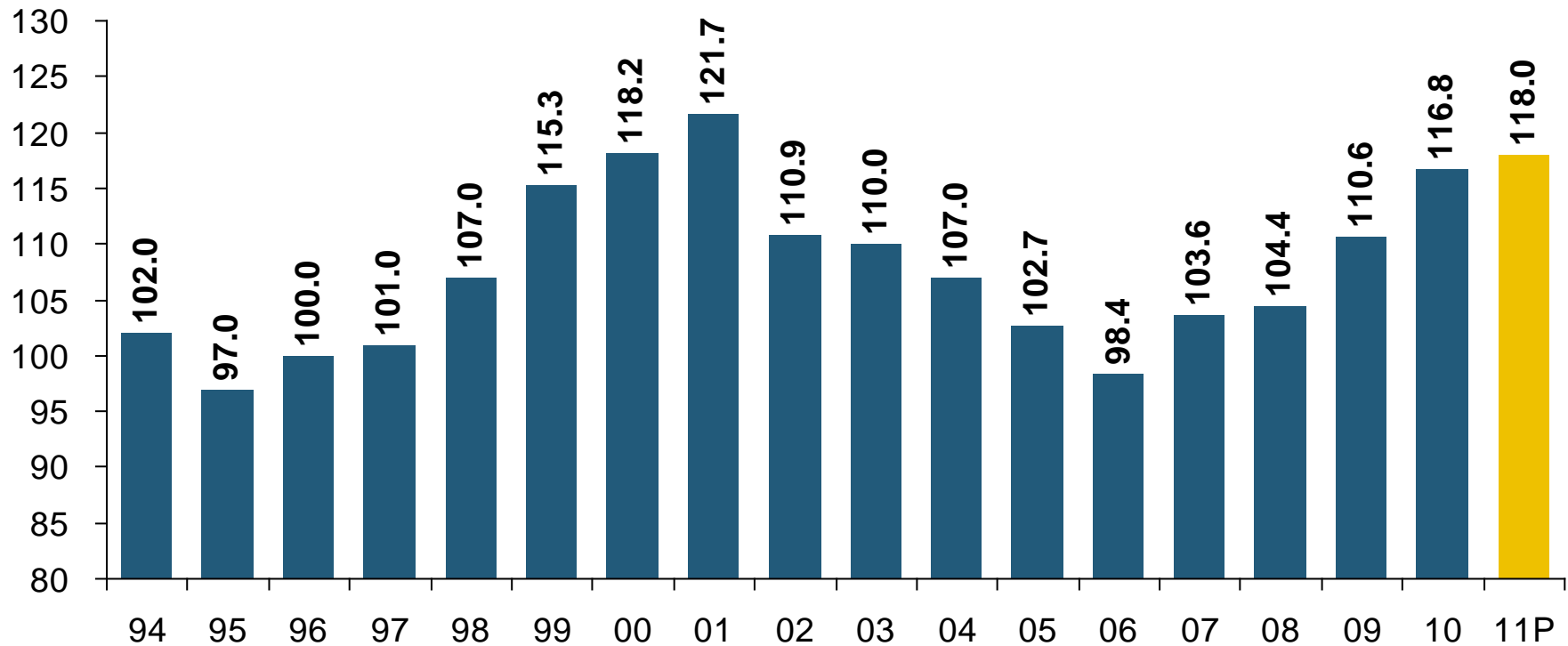


Private Passenger Auto Accounts for 34% of Industry Premiums and Remains the Profit Juggernaut of the P/C Insurance Industry

Commercial Lines Combined Ratio, 1990-2011P



Workers Compensation Combined Ratio: 1994–2011P

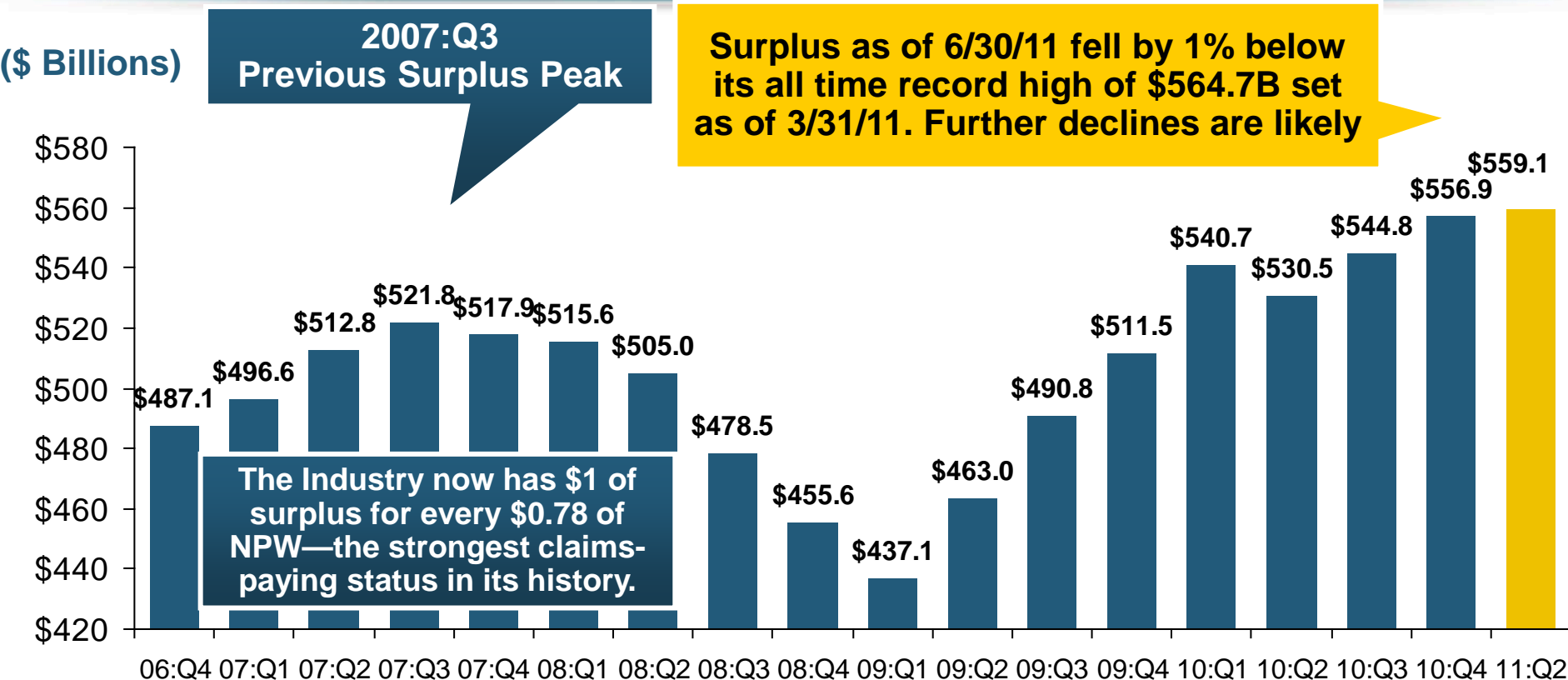


Workers Comp Underwriting Results Are Deteriorating Markedly and the Worst They Have Been in a Decade

2. SURPLUS/CAPITAL/CAPACITY

Have Large Global Losses Reduced Capacity in the Industry, Setting the Stage for a Market Turn?

Policyholder Surplus, 2006:Q4–2011:Q2

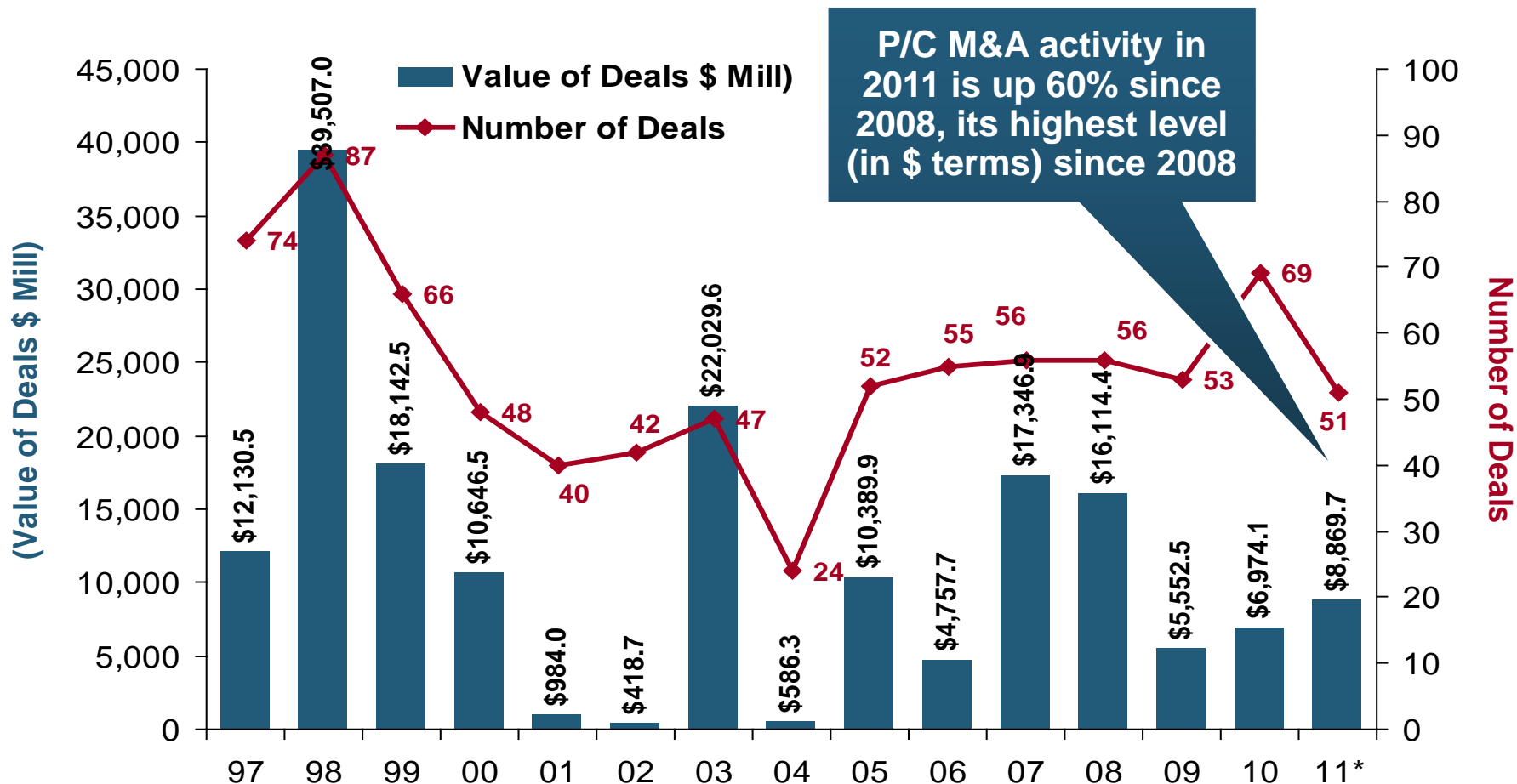


Quarterly Surplus Changes Since 2007:Q3 Peak

| | |
|---------------------------------|--------------------------------|
| 09:Q1: -\$84.7B (-16.2%) | 10:Q2: +\$8.7B (+1.7%) |
| 09:Q2: -\$58.8B (-11.2%) | 10:Q3: +\$23.0B (+4.4%) |
| 09:Q3: -\$31.0B (-5.9%) | 10:Q4: +\$35.1B (+6.7%) |
| 09:Q4: -\$10.3B (-2.0%) | 11:Q1: +\$42.9B (+8.2%) |
| 10:Q1: +\$18.9B (+3.6%) | 11:Q2: +\$37.3B (+7.1%) |

*Includes \$22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business in early 2010.

M&A Activity in the US P/C Insurance Industry, 1997-2011*



P/C M&A activity in 2011 is up 60% since 2008, its highest level (in \$ terms) since 2008

M&A Activity in the P/C Insurance Industry Remains Well Below its 1990s Peak

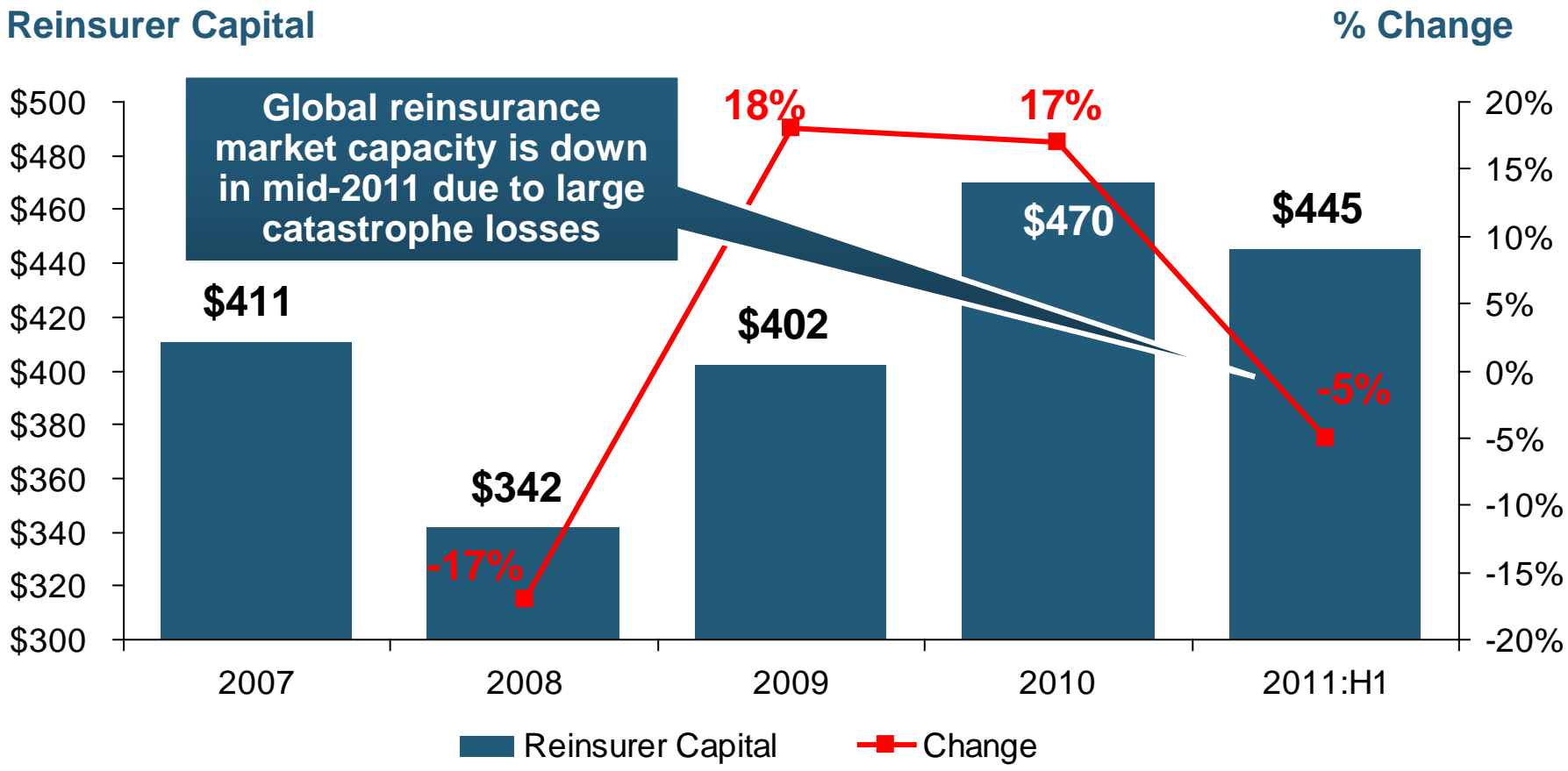
*2011 data are through December 1.

Source: SNL Securities; Insurance Information Institute.

3. REINSURANCE MARKET CONDITIONS

**Record Global
Catastrophes Activity is
Pressuring Pricing**

Global Reinsurance Capital, 2007-2011:H1

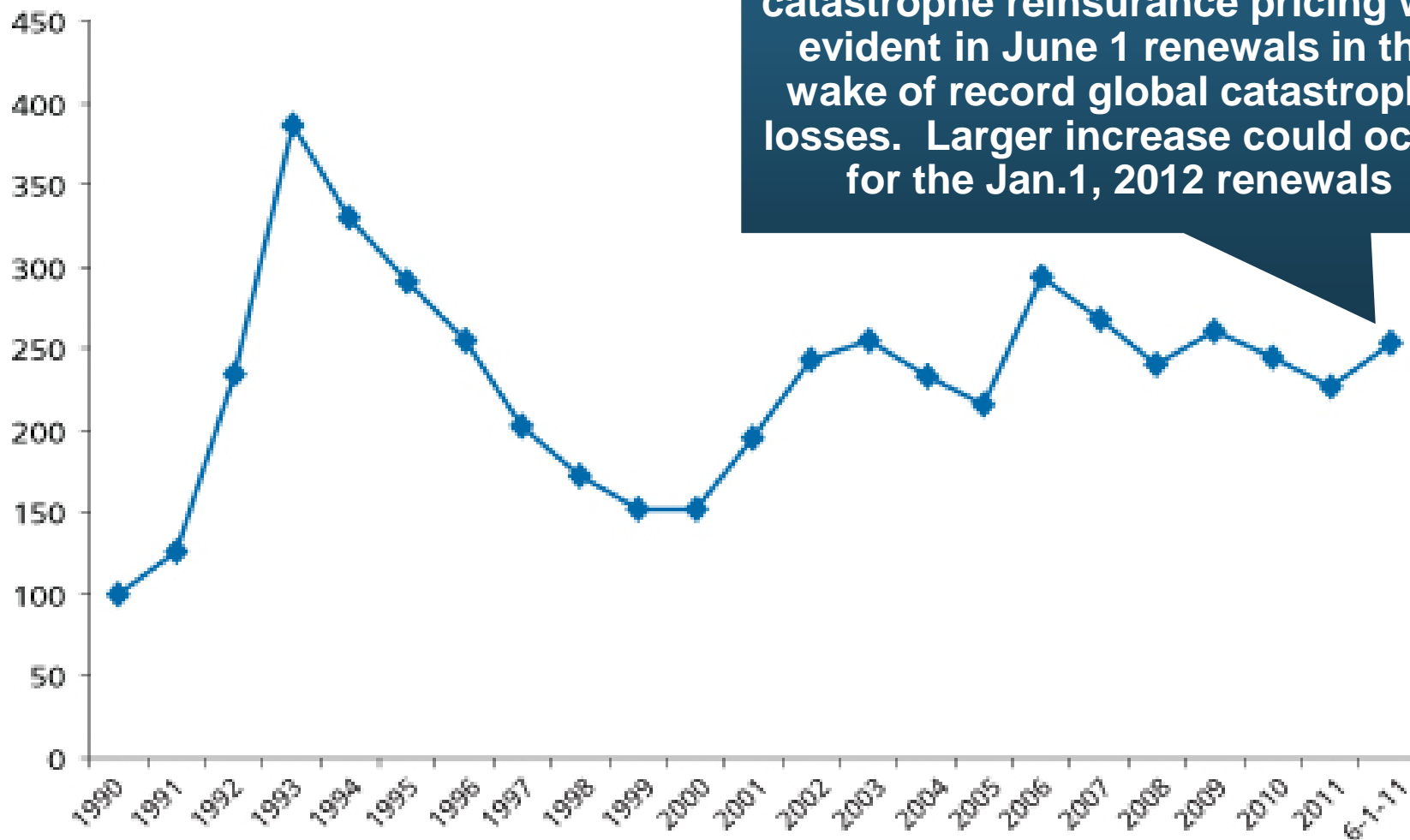


High Global Catastrophe Losses Have Had a Modest Adverse Impact on Global Reinsurance Market Capacity

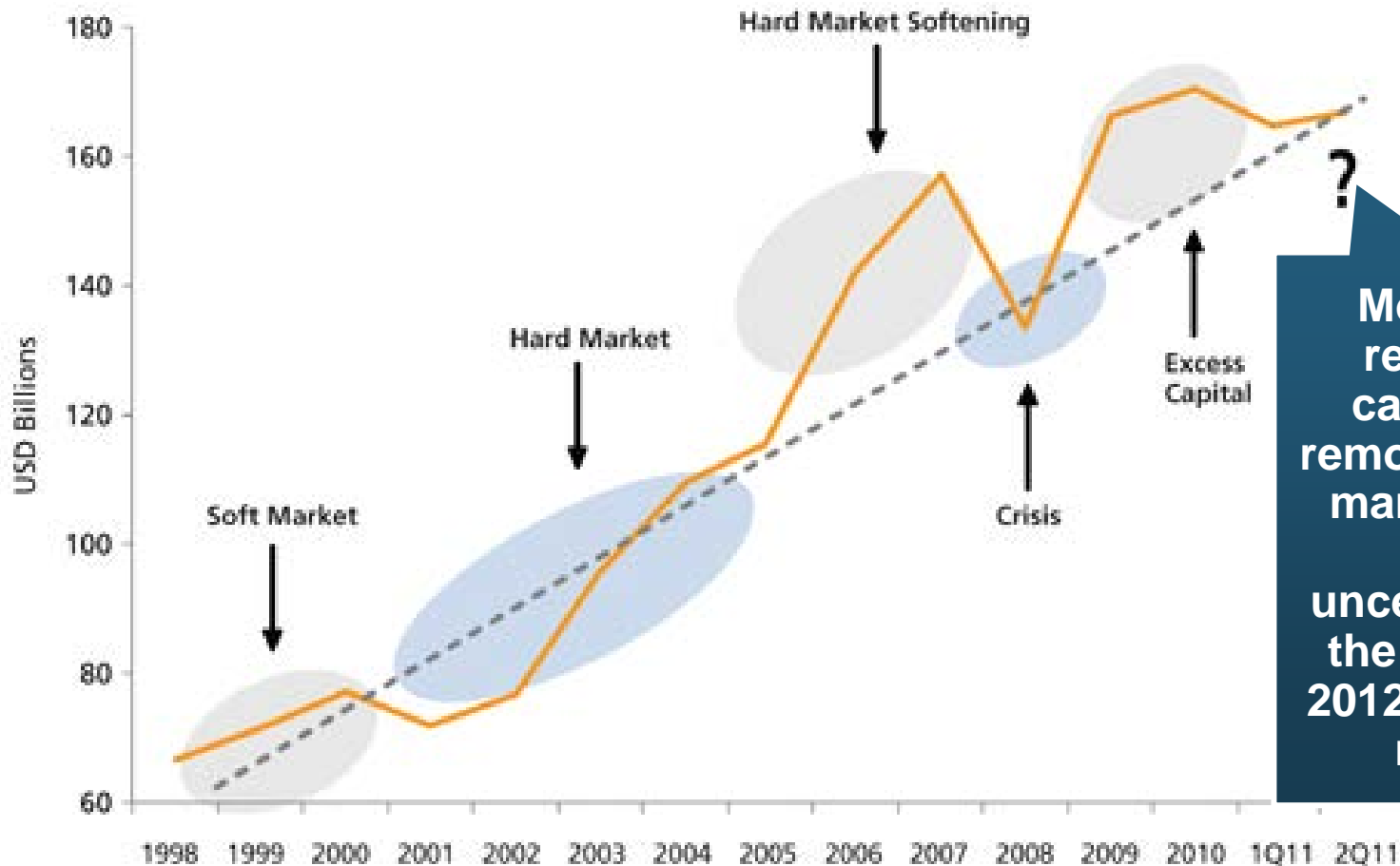
Source: Aon Reinsurance Market Outlook, September 2011 from Individual Company and AonBenfield Analytics; Insurance Information Institute.

Global Property Catastrophe Rate on Line Index, 1990-2011 YTD (6/1/11)

A modest increase in global property catastrophe reinsurance pricing was evident in June 1 renewals in the wake of record global catastrophe losses. Larger increase could occur for the Jan.1, 2012 renewals



Historical Capital Levels of Guy Carpenter Reinsurance Composite, 1998—2Q11



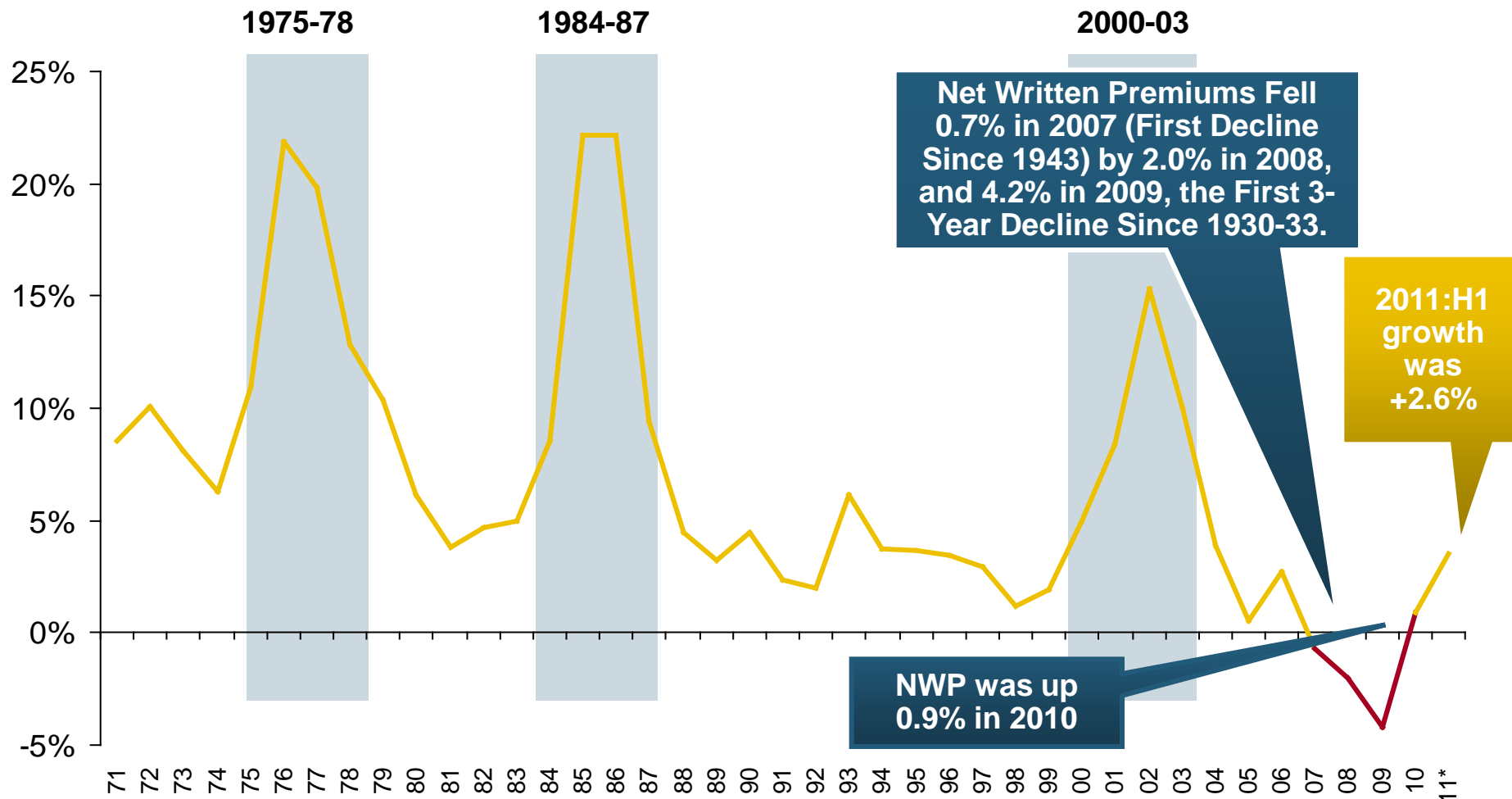
Most excess reinsurance capacity was removed from the market in 2011, leaving uncertainty as to the direction of 2012 reinsurance renewals

4. RENEWED PRICING DISCIPLINE

**Is There Evidence of a Broad
and Sustained Shift in Pricing?**

Soft Market Persisted in 2010 but Growth Returned: More in 2011?

(Percent)

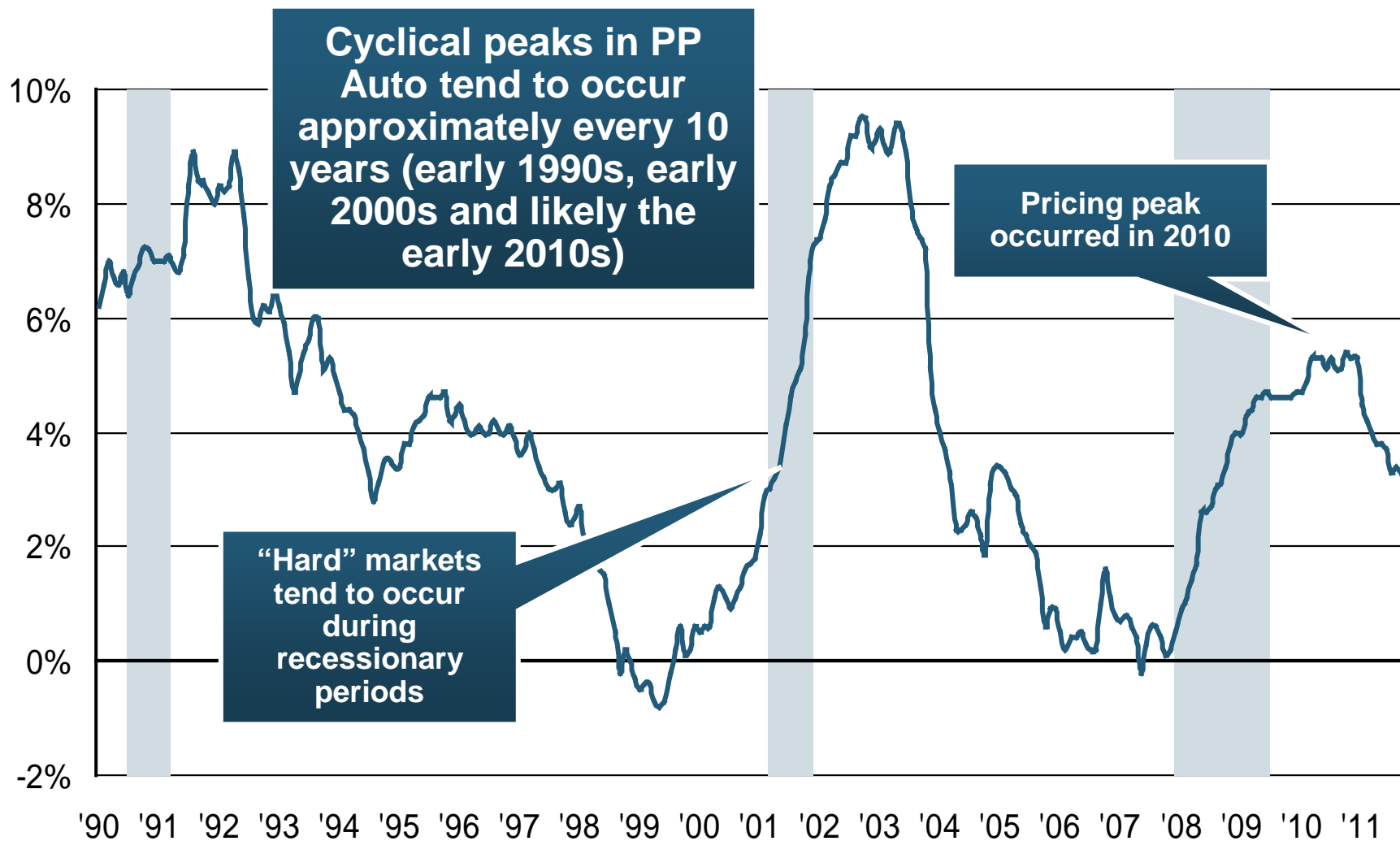


*2011 figure is for H1 vs. 2010:H1.

Shaded areas denote "hard market" periods

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

Monthly Change* in Auto Insurance Prices, 1991–2011*



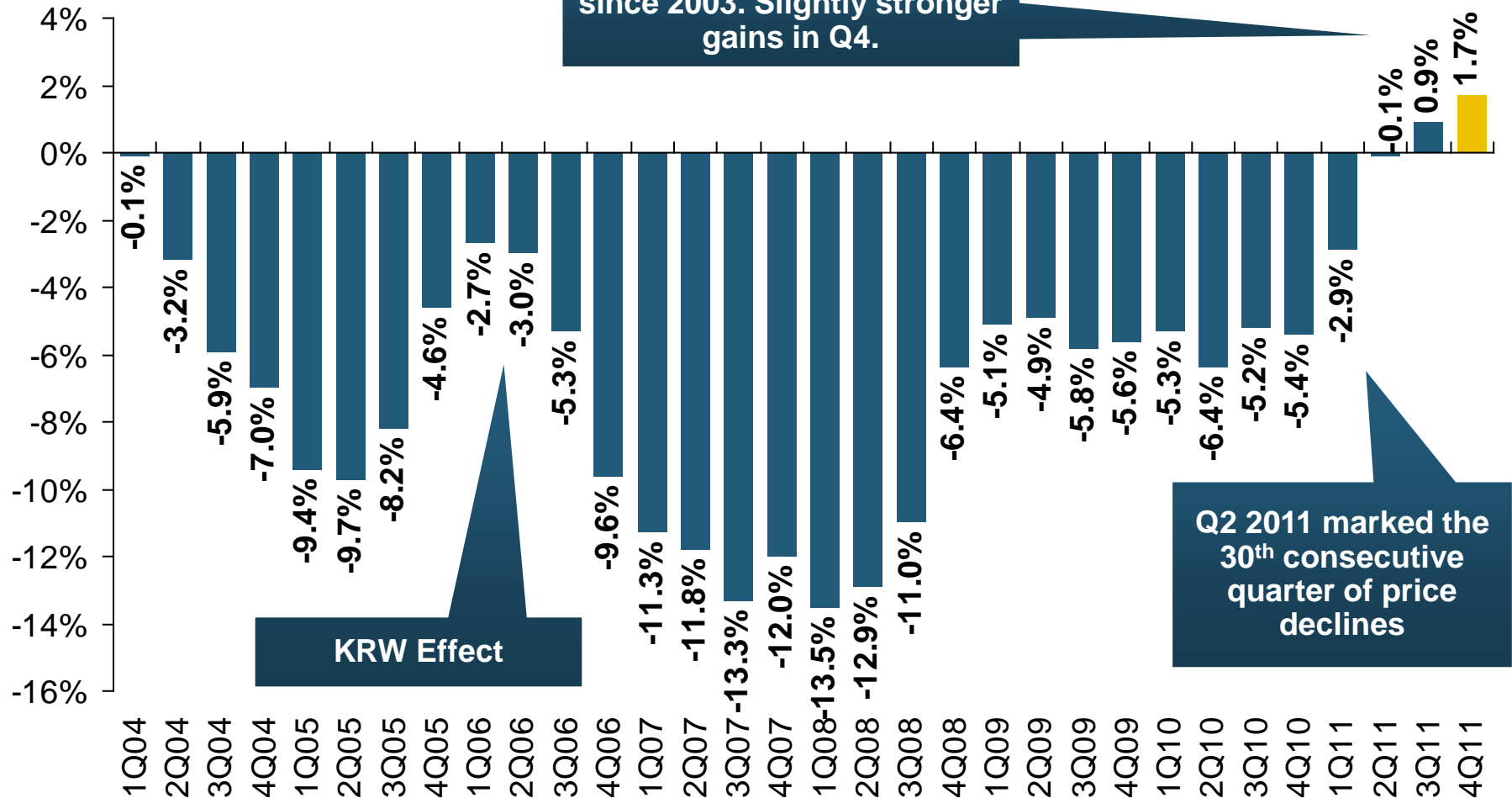
*Percentage change from same month in prior year; through October 2011; seasonally adjusted

Note: Recessions indicated by gray shaded columns.

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

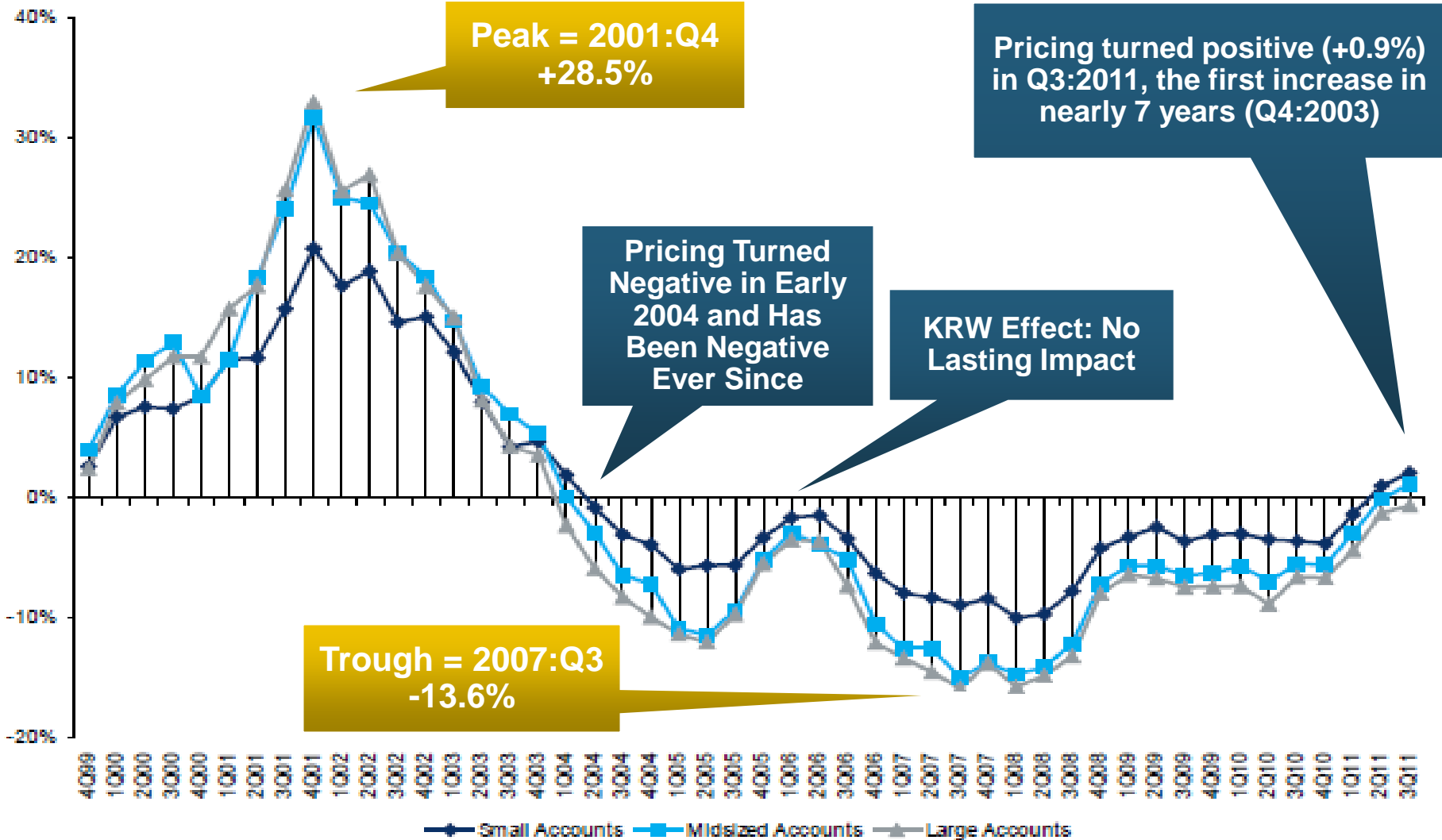
Average Commercial Rate Change, All Lines, (1Q:2004–4Q:2011E*)

(Percent)



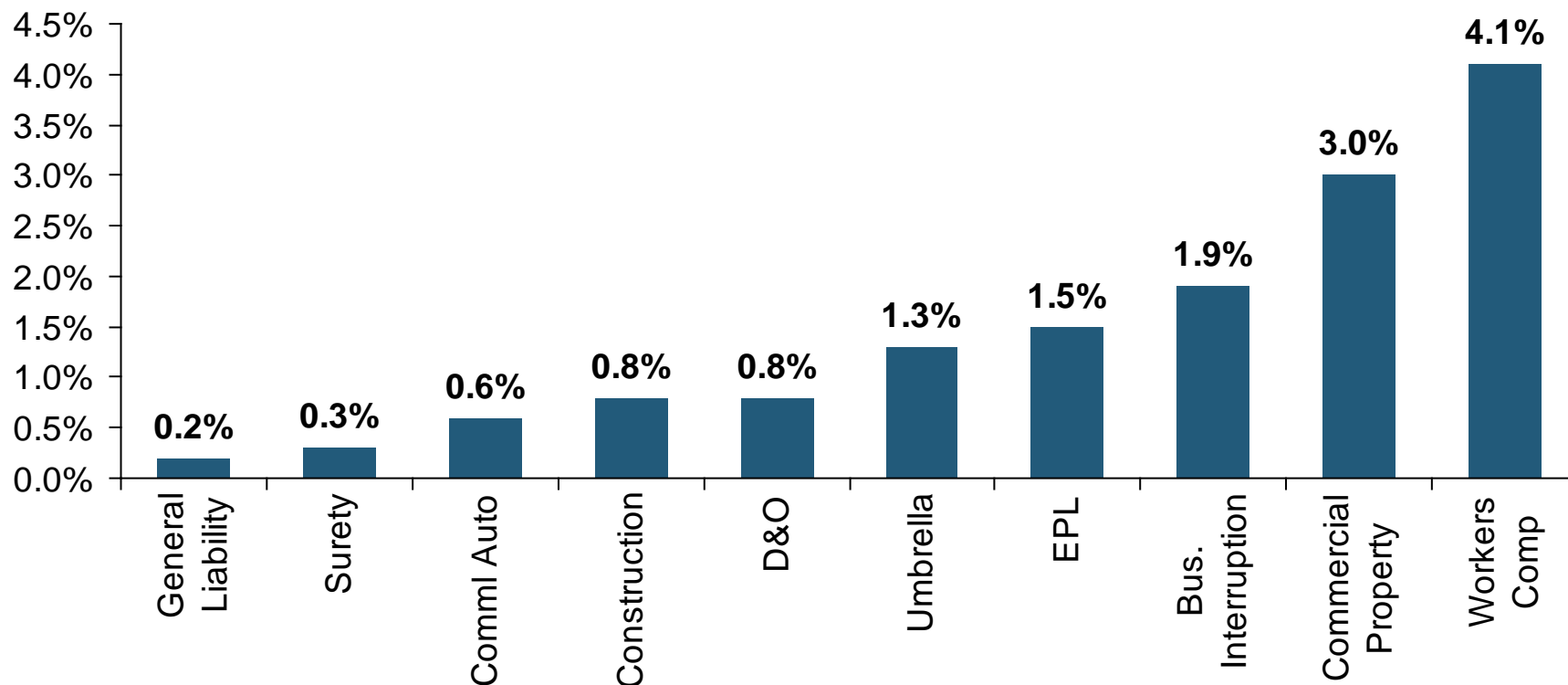
Change in Commercial Rate Renewals, by Account Size: 1999:Q4 to 2011:Q3

Percentage Change (%)



Change in Commercial Rate Renewals, by Line: 2011:Q3

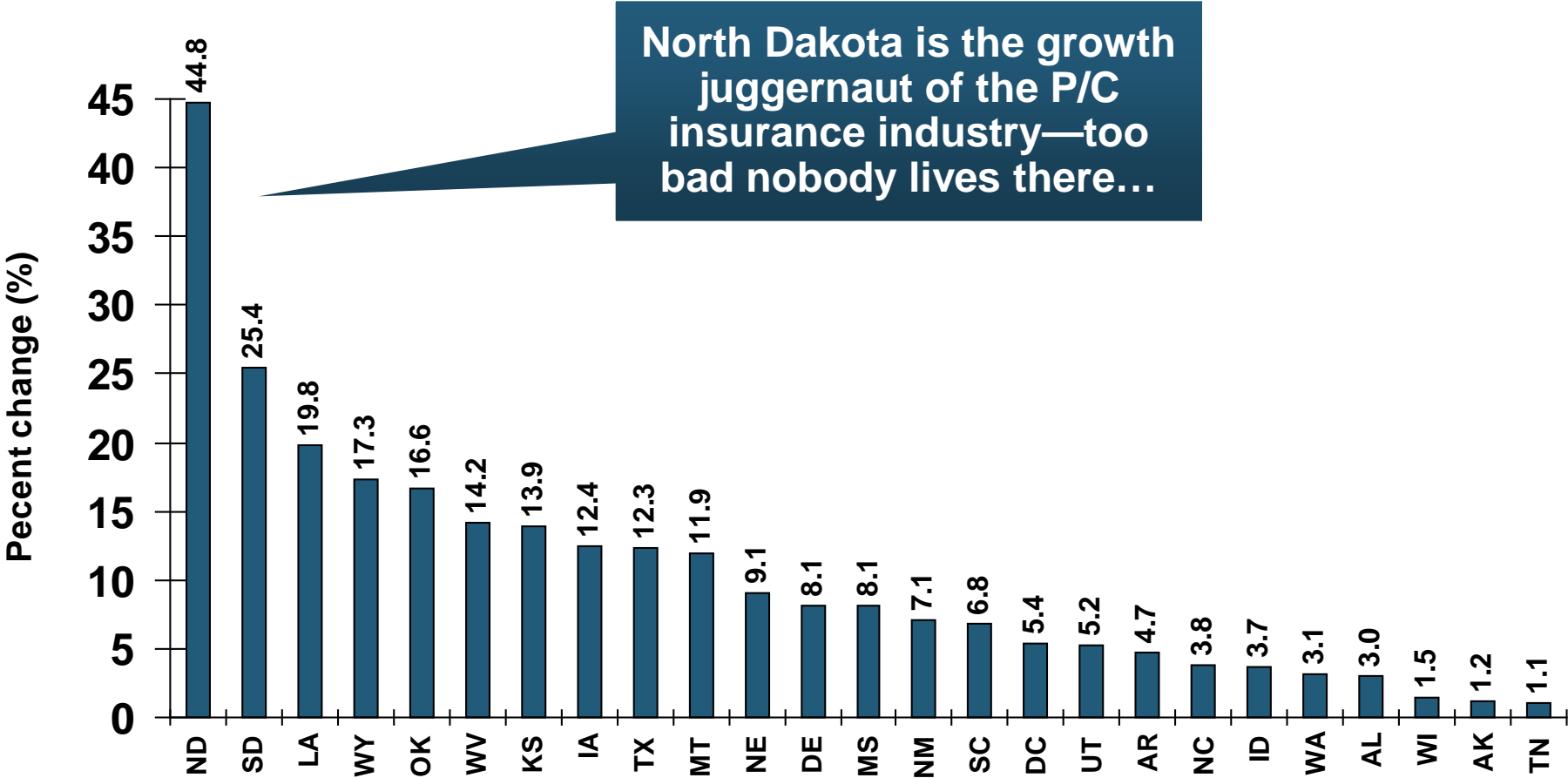
Percentage Change (%)



Major Commercial Lines Renewed Uniformly Upward in Q3:2011 for the First Time Since 2003, With Workers Up More than Any Other Line

Direct Premiums Written: All P/C Lines Percent Change by State, 2005-2010

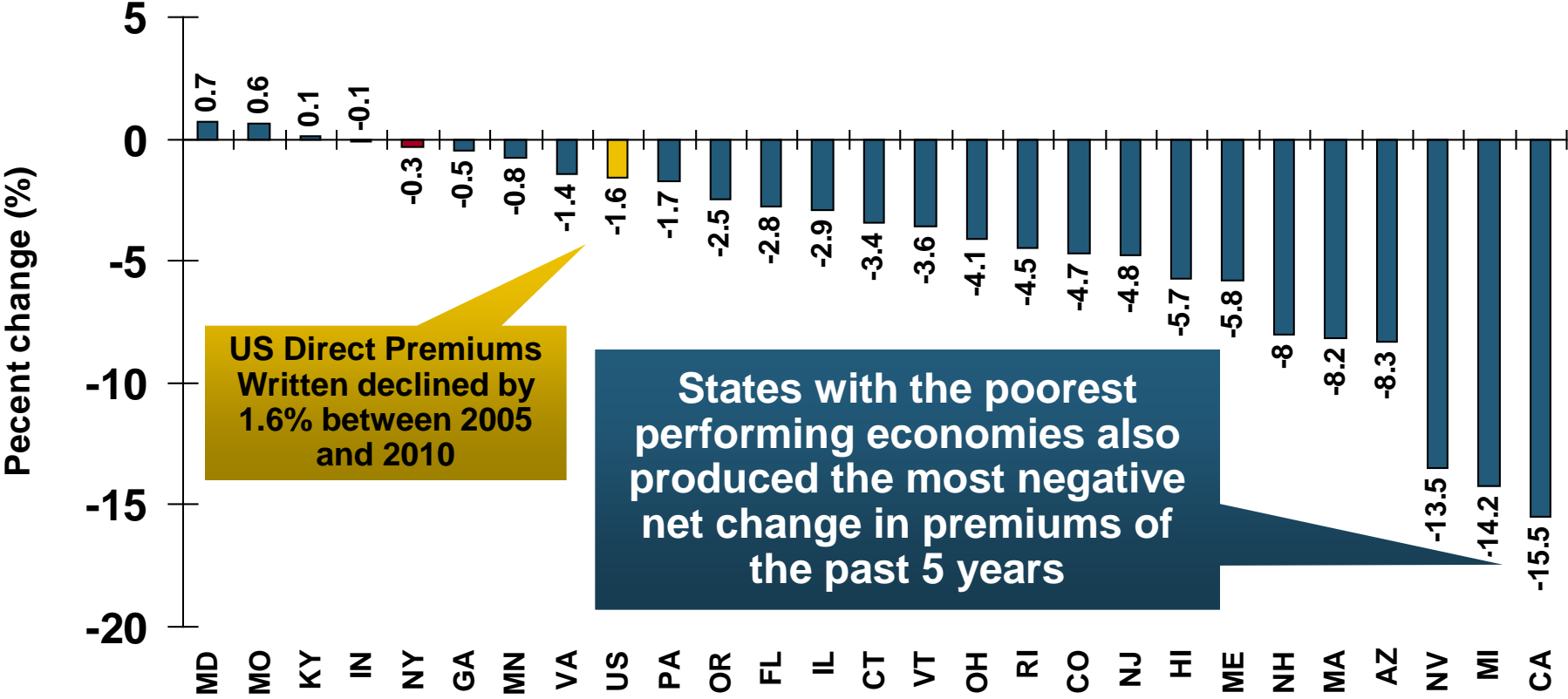
Top 25 States



Sources: SNL Financial LC.; Insurance Information Institute.

Direct Premiums Written: All P/C Lines Percent Change by State, 2005-2010

Bottom 25 States



Sources: SNL Financial LC; Insurance Information Institute.

Other Cycle-Influencing Factors

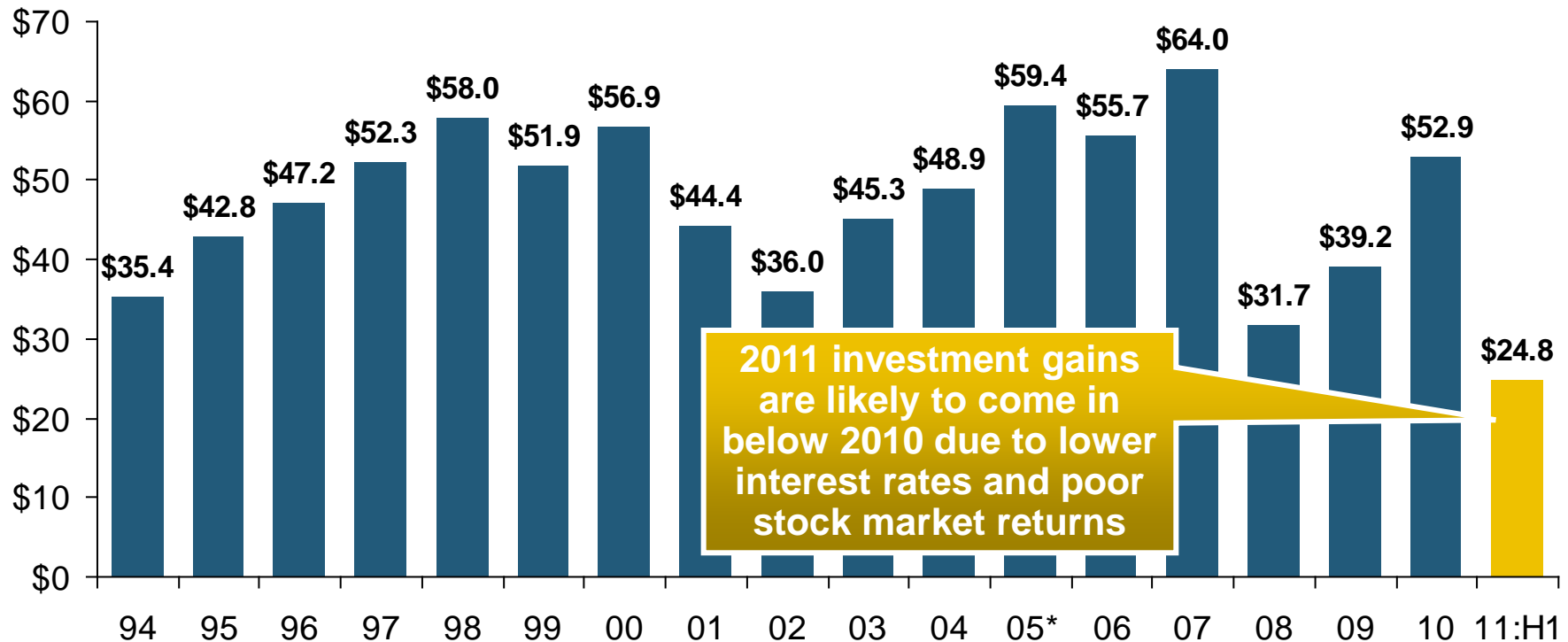
**Could Other Factors Act as
a Catalyst to Turn the
Market?**

INVESTMENTS: THE NEW REALITY

**Investment Performance is a
Key Driver of Profitability
*Does It Influence
Underwriting or Cyclicalities?***

Property/Casualty Insurance Industry Investment Gain: 1994–2011:H1¹

(\$ Billions)



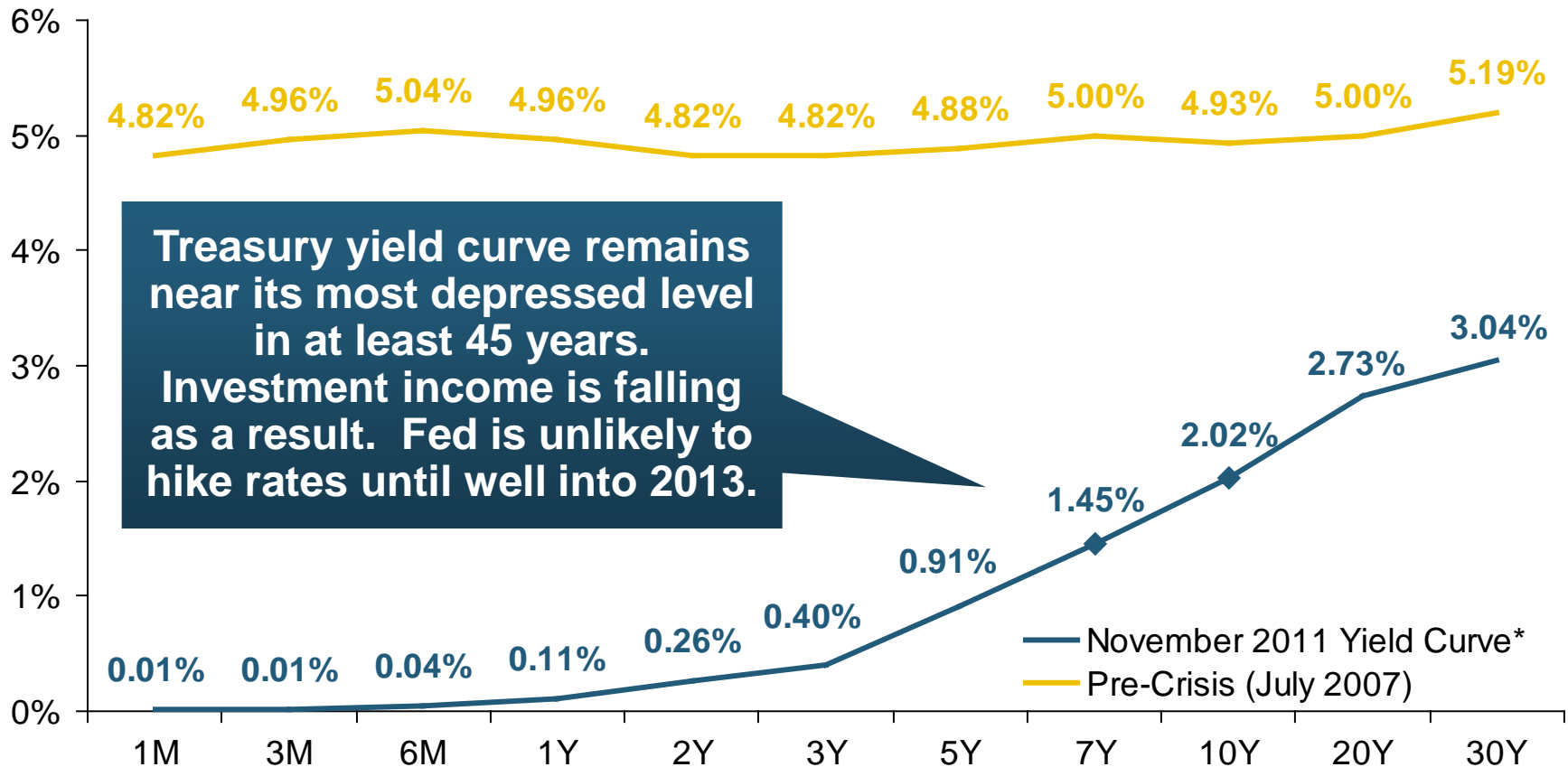
Investment Gains Recovered Significantly in 2010 Due to Realized Investment Gains; The Financial Crisis Caused Investment Gains to Fall by 50% in 2008

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

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

Sources: ISO; Insurance Information Institute.

Treasury Yield Curves: Pre-Crisis (July 2007) vs. Nov. 2011*



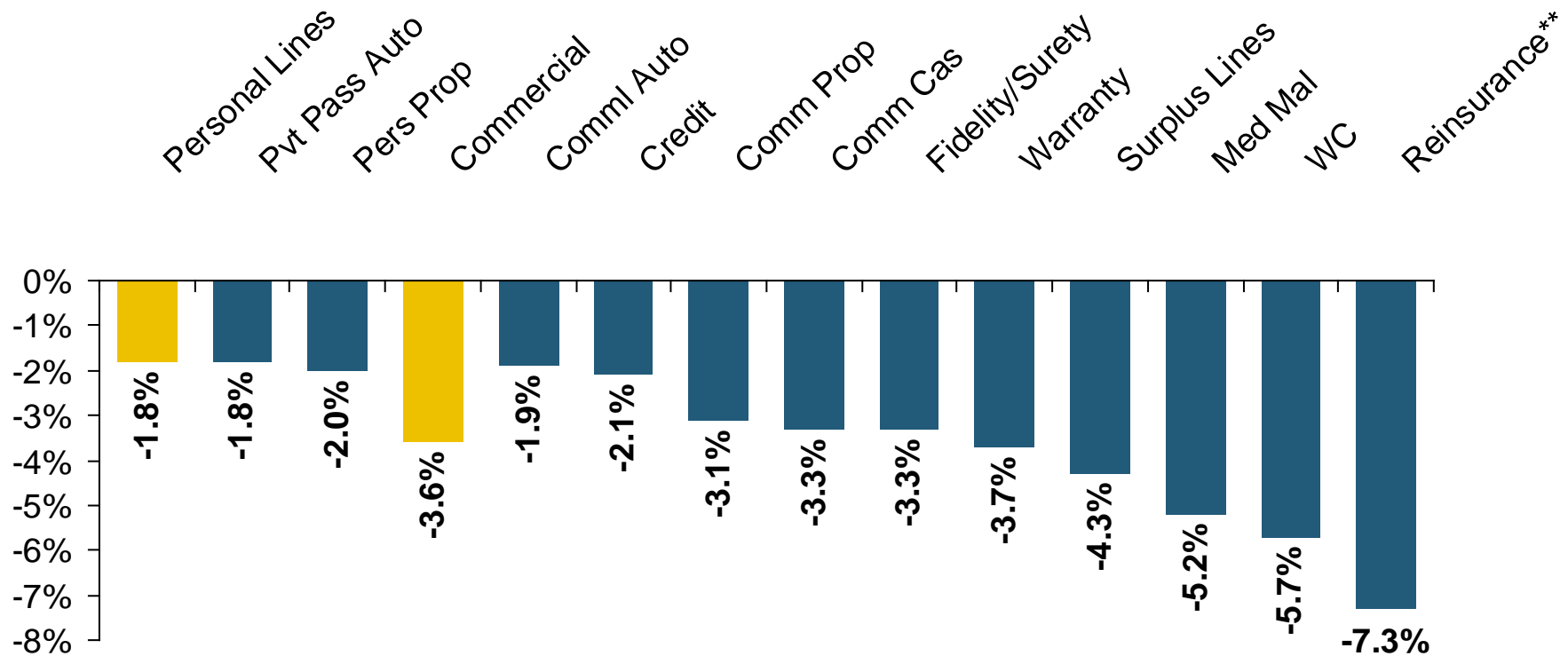
Treasury yield curve remains near its most depressed level in at least 45 years. Investment income is falling as a result. Fed is unlikely to hike rates until well into 2013.

The End of the Fed's Quantitative Easing Is Unlikely to Push Interest Rates Up Substantially Given Ongoing Economic Weakness

*Week ending Nov. 25.

Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.

Reduction in Combined Ratio Necessary to Offset 1% Decline in Investment Yield to Maintain Constant ROE, by Line*



Lower Investment Earnings Place a Greater Burden on Underwriting and Pricing Discipline

*Based on 2008 Invested Assets and Earned Premiums

**US domestic reinsurance only

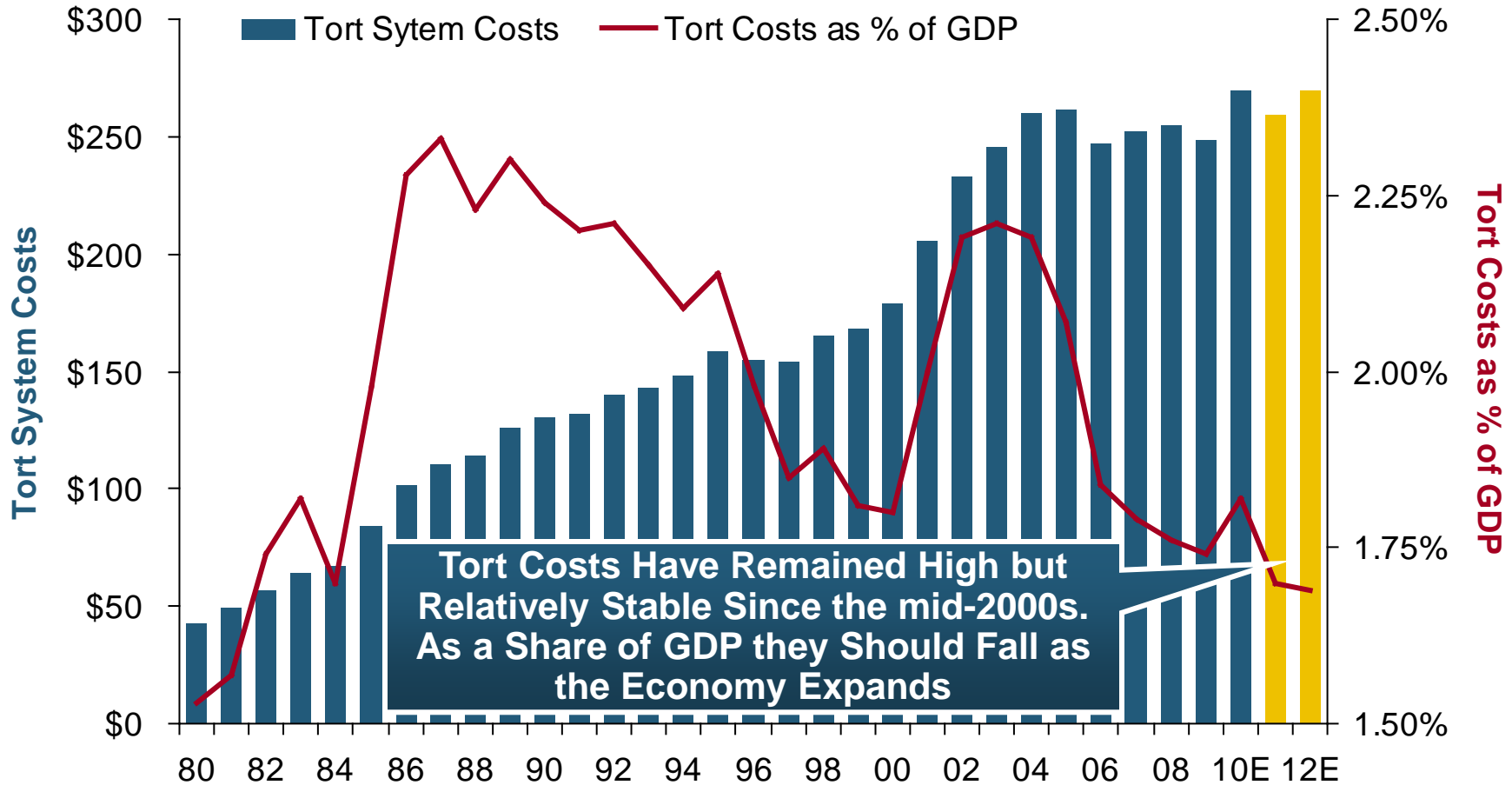
Source: A.M. Best; Insurance Information Institute.

Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

Over the Last Three Decades, Total Tort Costs as a % of GDP Appear Somewhat Cyclical

(\$ Billions)



Inflation

**Is it a Threat to Claim Cost
Severities**

Annual Inflation Rates, (CPI-U, %), 1990–2017F

Annual Inflation Rates (%)



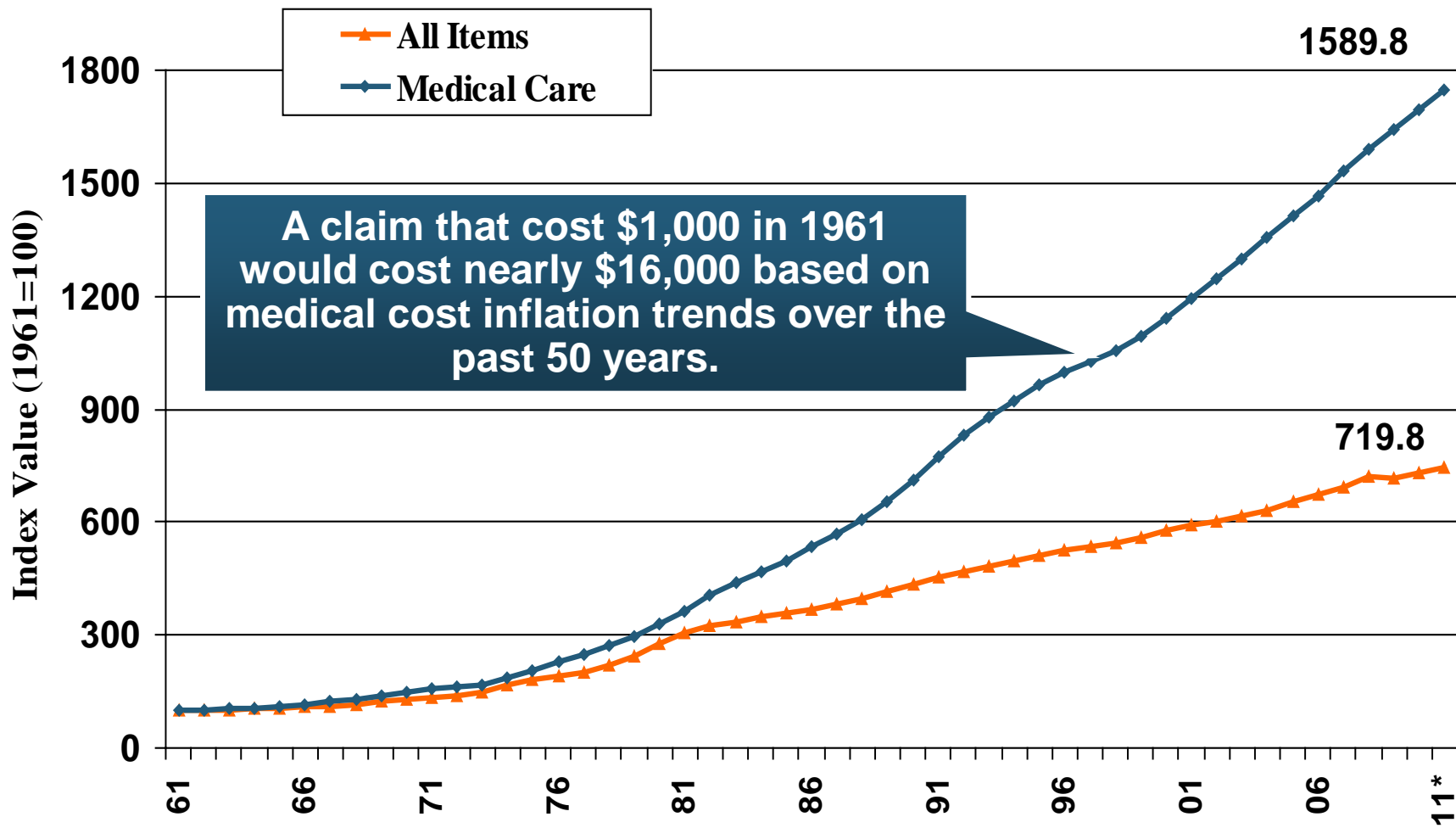
Inflation peaked at 5.6% in August 2008 on high energy and commodity crisis. The recession and the collapse of the commodity bubble reduced inflationary pressures in 2009/10

Higher energy, commodity and food prices are pushing up inflation in 2011, but not longer turn inflationary expectations.

The slack in the U.S. economy suggests that inflation should not heat up before 2012, but other forces (commodity prices, inflation in countries from which we import, etc.), plus U.S. debt burden, remain longer-run concerns

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, 10/11 and 11/11 (forecasts).

Medical Cost Inflation Has Outpaced Overall Inflation Over 50 Years



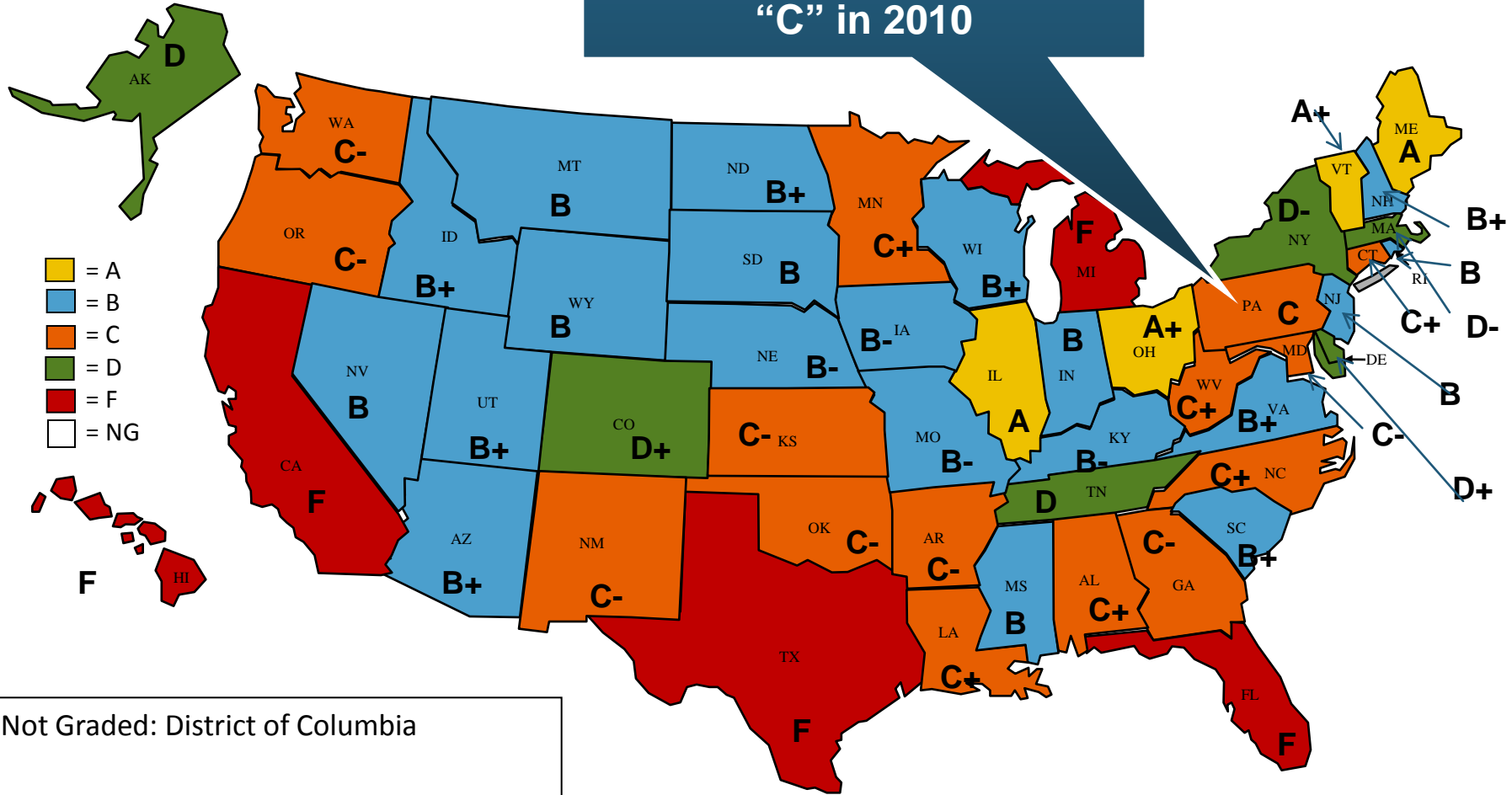
*Based on change from Feb. 2011 to Feb. 2010 (latest available)
Source: Department of Labor (Bureau of Labor Statistics)

Regulatory Environment & Financial Services Reform

**Insurers Not as Impacted as
Banks, But Dodd-Frank
Implementation Has Been a
Concern for Insurers**

2010 Property and Casualty Insurance Regulatory Report Card

Pennsylvania's regulatory environment got a grade of "C" in 2010



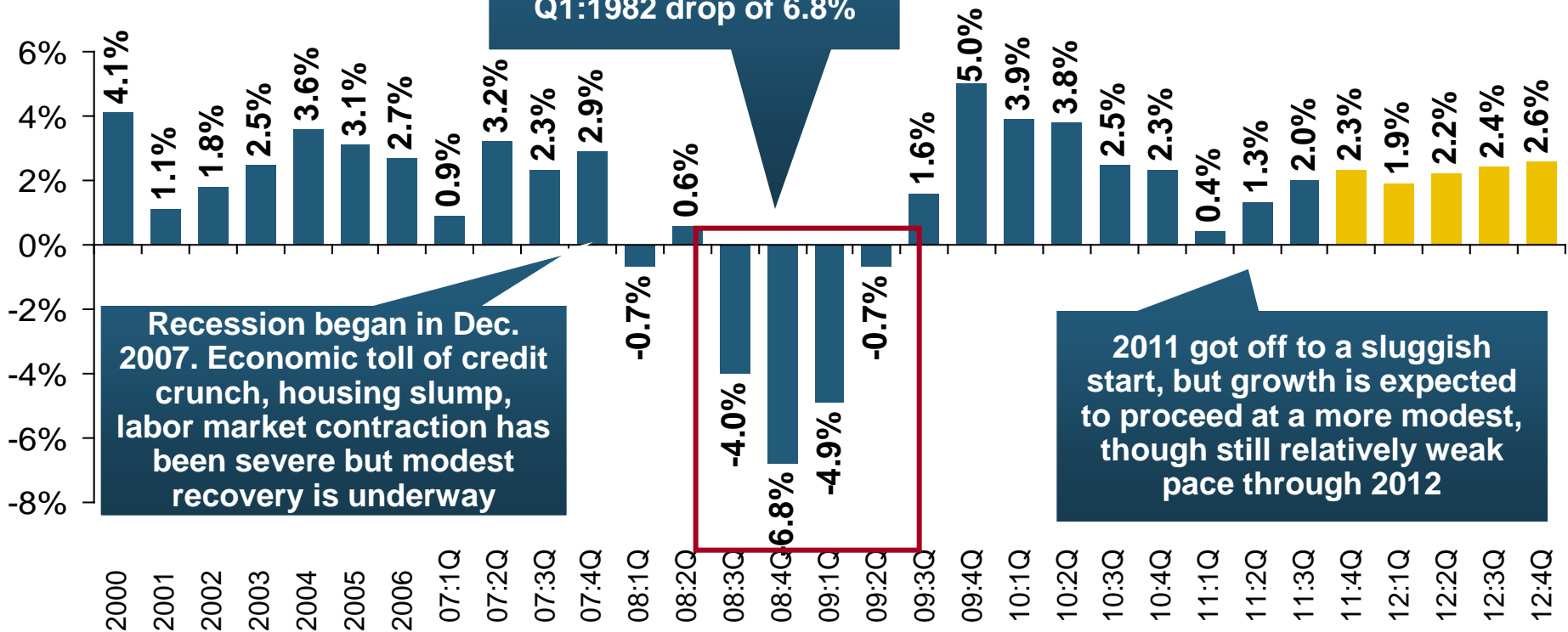
Not Graded: District of Columbia

The Strength of the Economy Will Influence P/C Insurer Growth Opportunities

**Growth Would Also Help Absorb
Excess Capital**

US Real GDP Growth*

Real GDP Growth (%)



Demand for Insurance Continues To Be Impacted by Sluggish Economic Conditions, but the Benefits of Even Slow Growth Will Compound and Gradually Benefit the Economy Broadly

* Estimates/Forecasts from Blue Chip Economic Indicators.

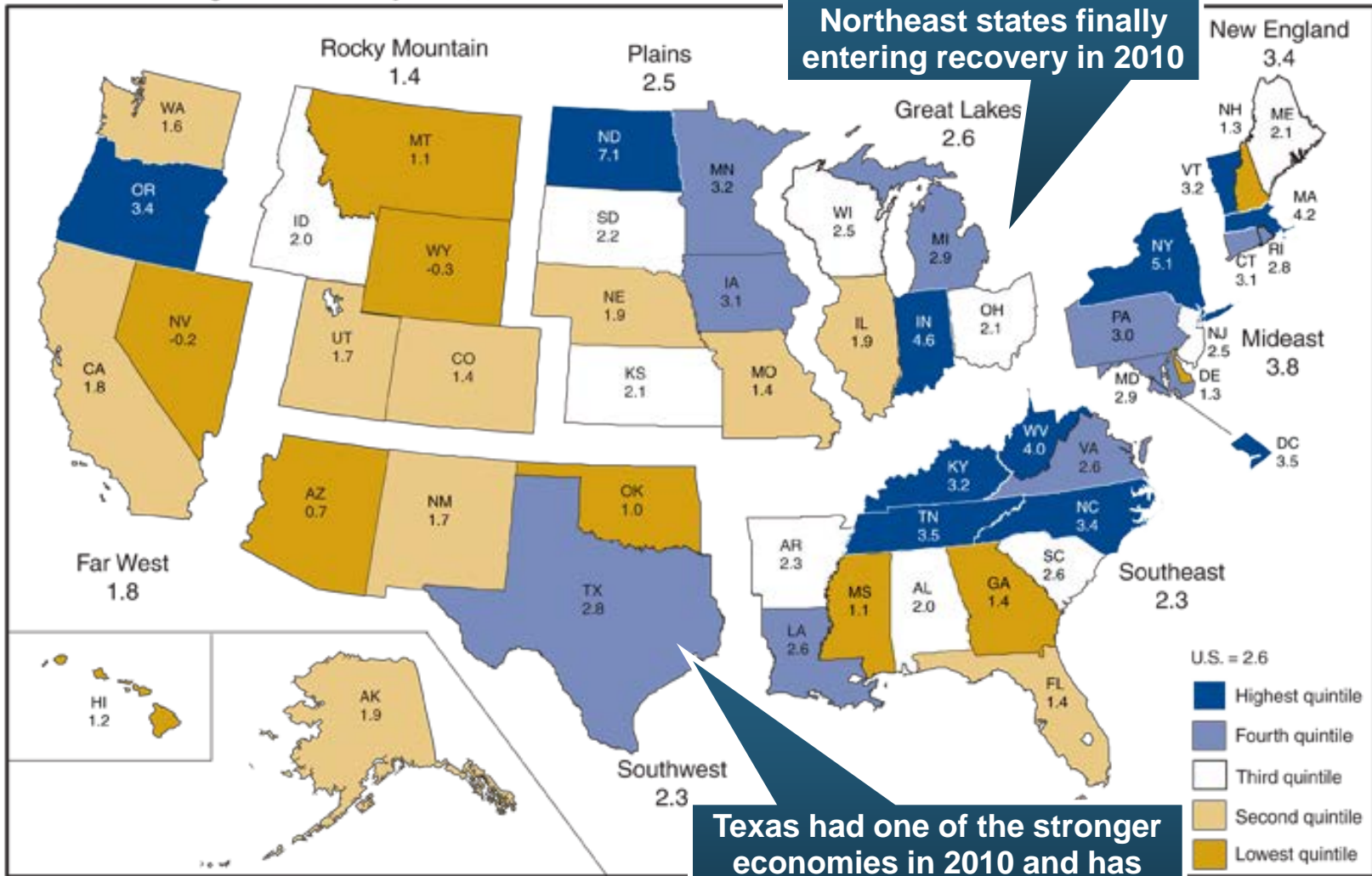
Source: US Department of Commerce, Blue Economic Indicators 11/11; Insurance Information Institute.

2011 Financial Overview

State Economic Growth Varied in 2010

Chart 1. Percent Change in Real GDP by State, 2009-2010

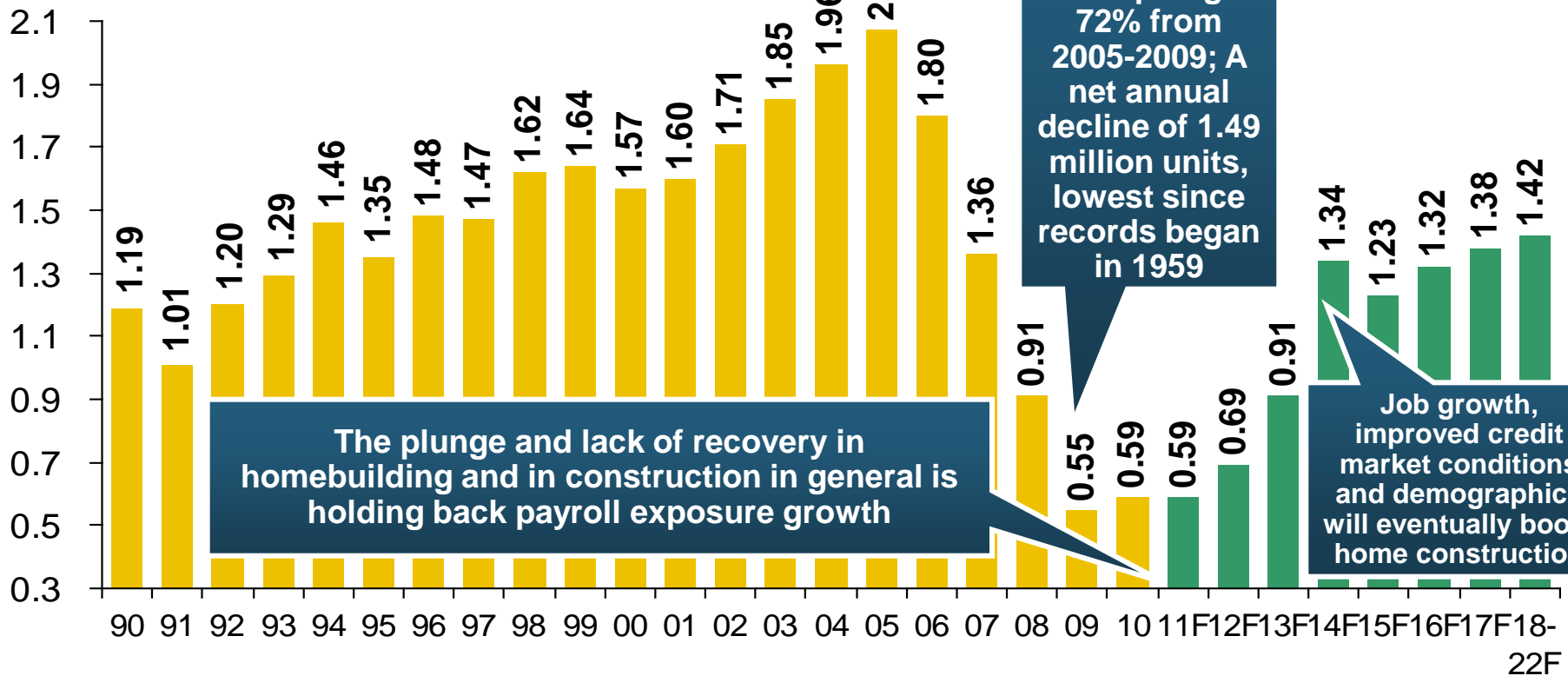
Hard hit Midwest and Northeast states finally entering recovery in 2010



Texas had one of the stronger economies in 2010 and has generally outperformed during the economic downturn

New Private Housing Starts, 1990-2022F

(Millions of Units)



The plunge and lack of recovery in homebuilding and in construction in general is holding back payroll exposure growth

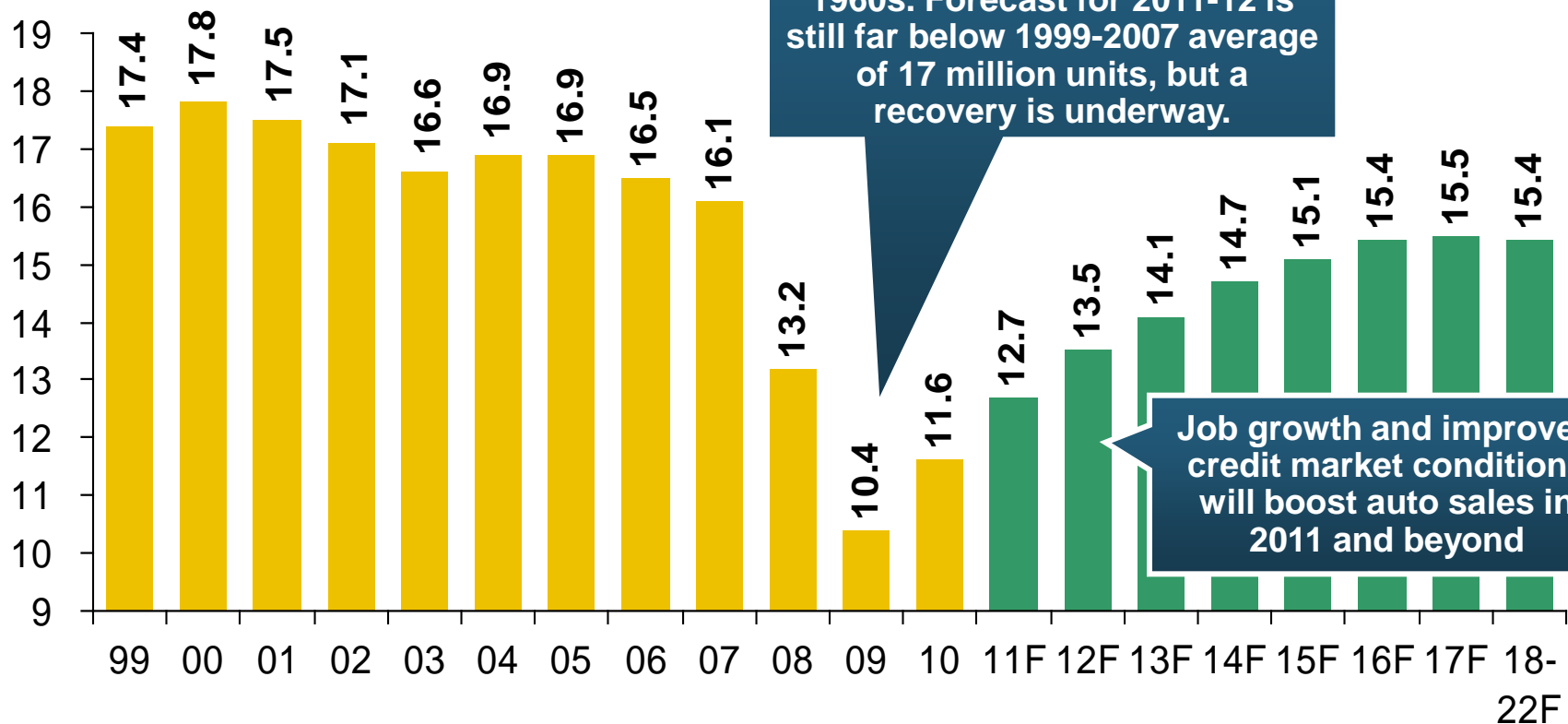
New home starts plunged 72% from 2005-2009; A net annual decline of 1.49 million units, lowest since records began in 1959

Job growth, improved credit market conditions and demographics will eventually boost home construction

Little Exposure Growth Likely for Homeowners Insurers Until 2014. Also Affects Commercial Insurers with Construction Risk Exposure, Surety

Auto/Light Truck Sales, 1999-2022F

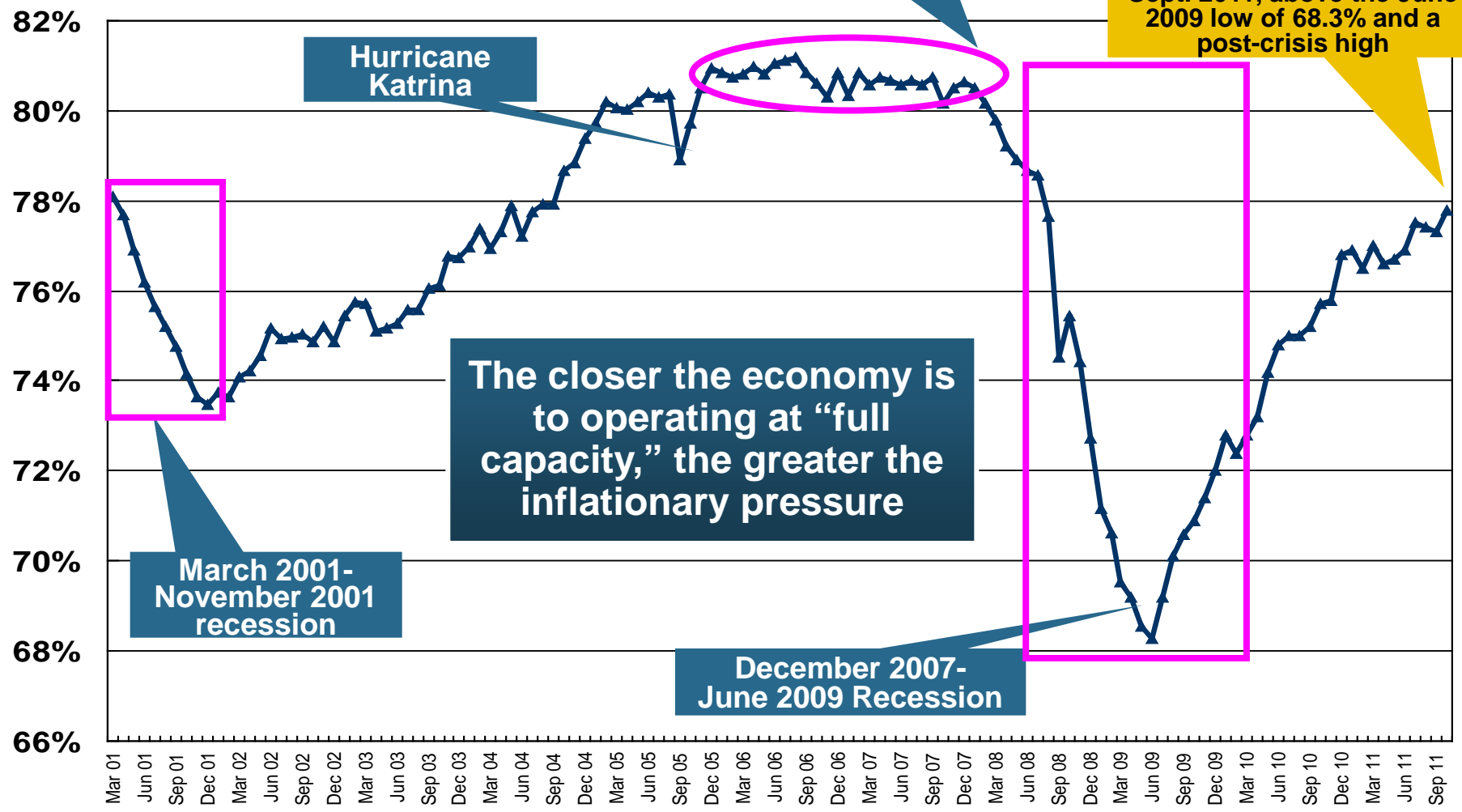
(Millions of Units)



Car/Light Truck Sales Will Continue to Recover from the 2009 Low Point, Bolstering the Auto Insurer Growth and the Manufacturing Sector.

Recovery in Capacity Utilization is a Positive Sign for Commercial Exposures

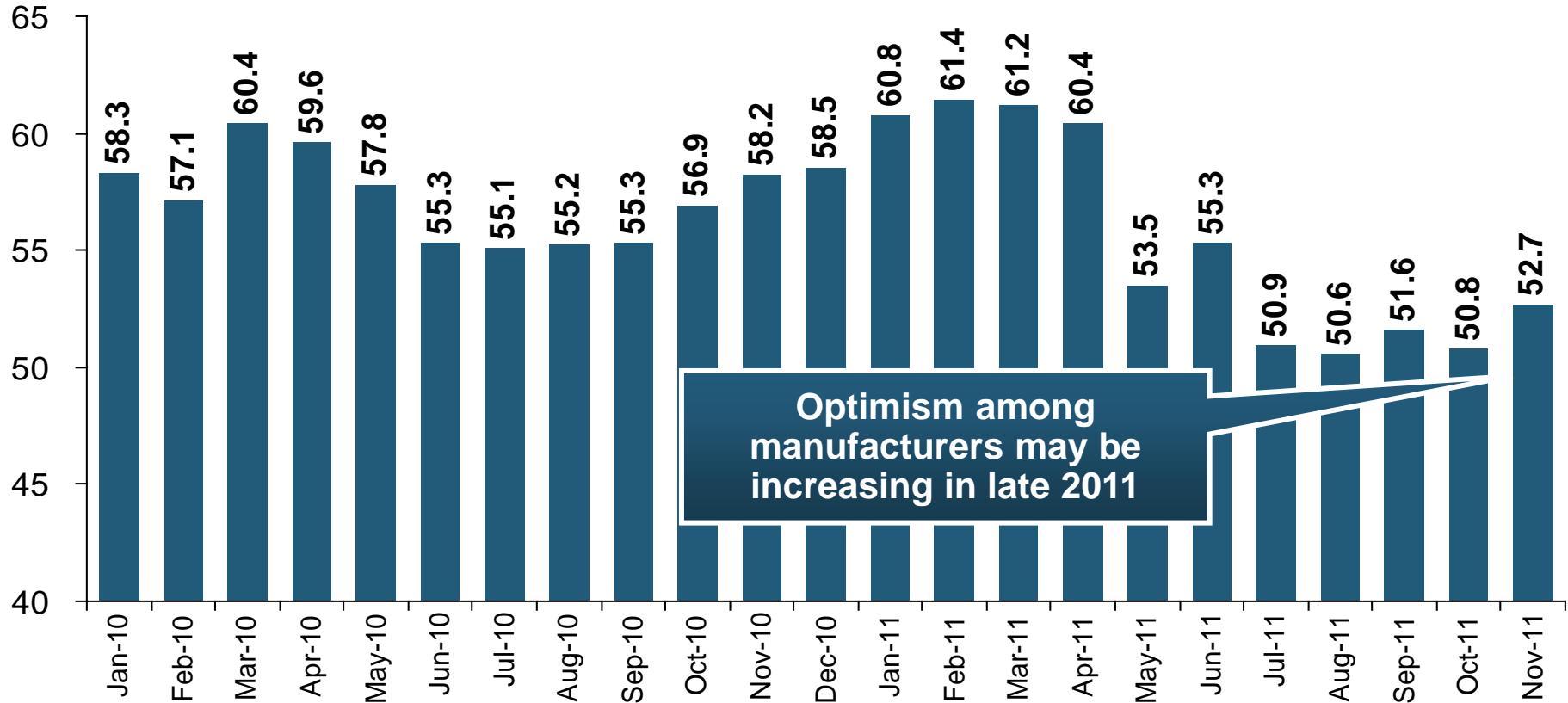
Percent of Industrial Capacity



Source: Federal Reserve Board statistical releases at <http://www.federalreserve.gov/releases/g17/Current/default.htm>.

ISM Manufacturing Index (Values > 50 Indicate Expansion)

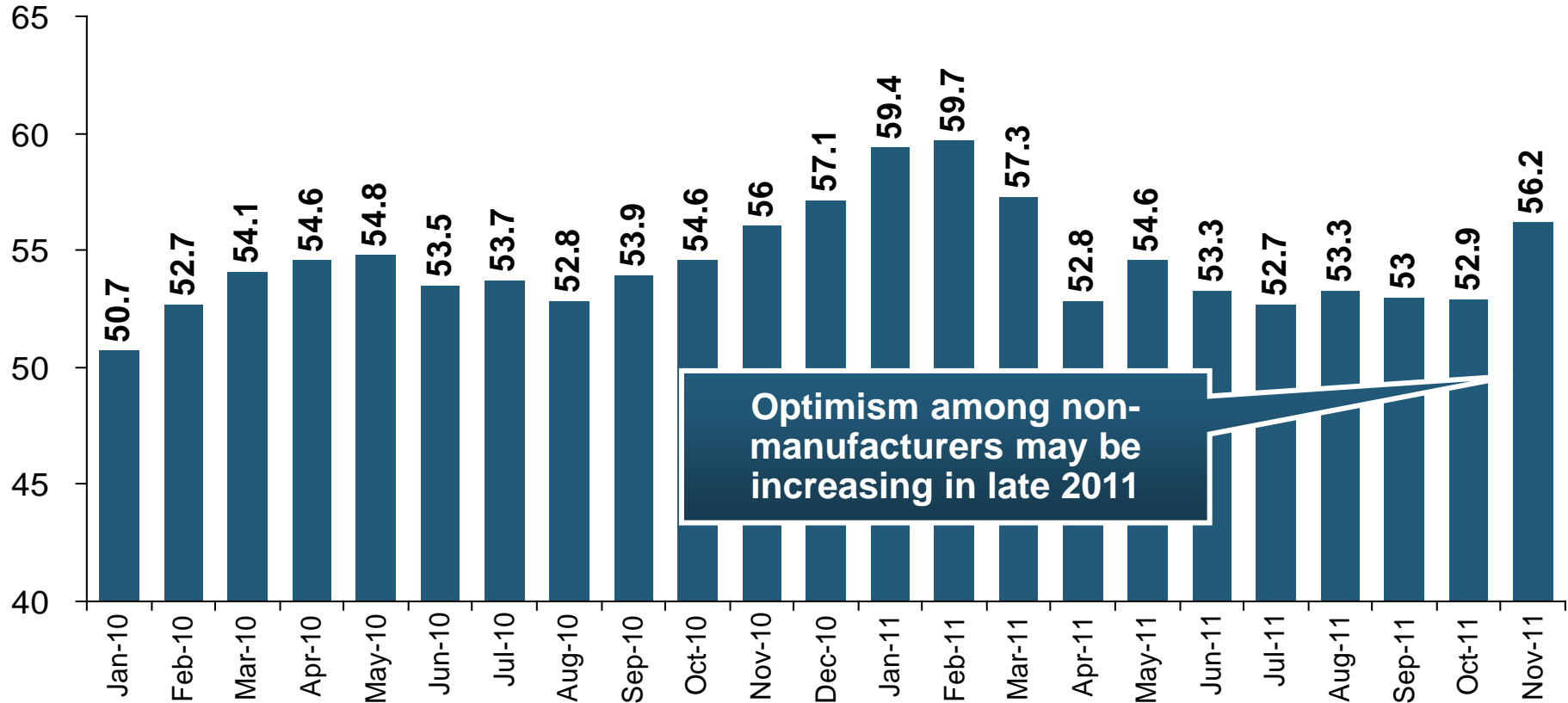
January 2010 through November 2011



**The manufacturing sector has been expanding and adding jobs.
The question is whether this will continue.**

ISM Non-Manufacturing Index (Values > 50 Indicate Expansion)

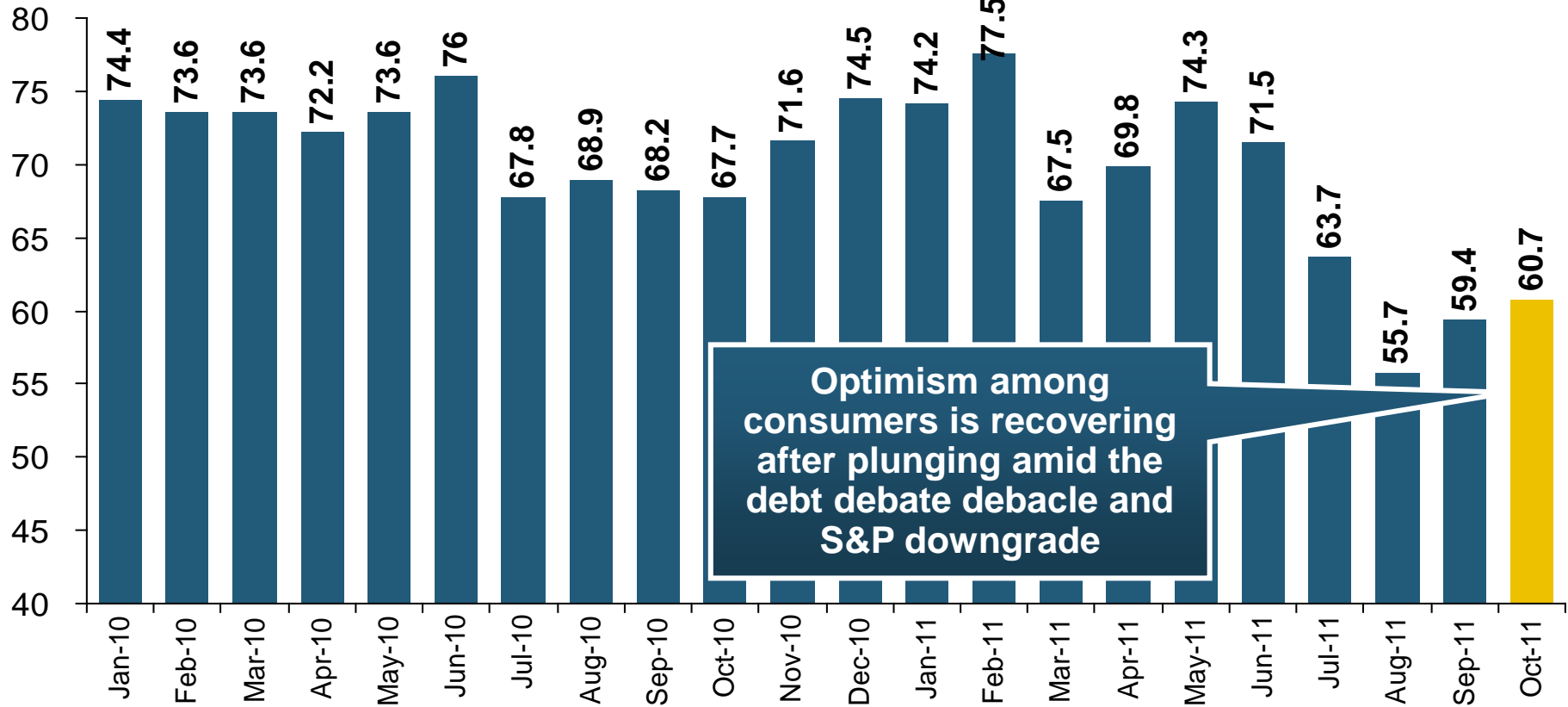
January 2010 through November 2011



Non-manufacturing industries have been expanding and adding jobs. The question is whether this will continue.

Consumer Sentiment Survey (1966 = 100)

January 2010 through August 2011



Consumer confidence has been low for years amid high unemployment, falling home prices and other factors adversely impact consumers, but may be improving marginally

11 Industries for the Next 10 Years: Insurance Solutions Needed

Health Care

Health Sciences

Energy (Traditional)

Alternative Energy

Agriculture

Natural Resources

Environmental

Technology (incl. Biotechnology)

Light Manufacturing

Export-Oriented Industries

Shipping (Rail, Marine, Trucking)



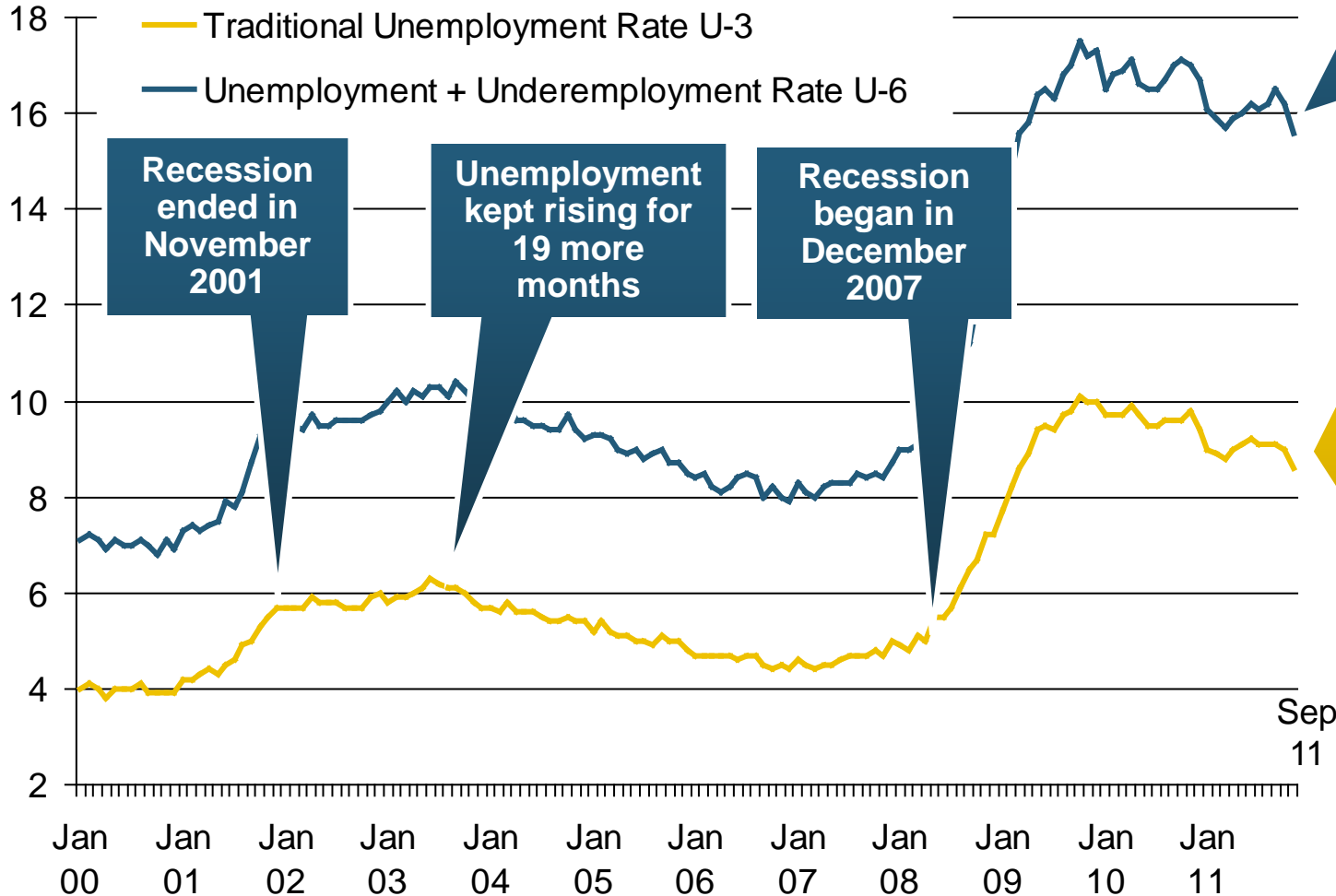
Many industries are poised for growth, but many insurers do not write in these economic segments

Labor Market Trends

Massive Job Losses Sapped the Economy and Commercial/Personal Lines Exposure, But Trend is Improving

Unemployment and Underemployment Rates: Stubbornly High in 2011

January 2000 through November 2011, Seasonally Adjusted (%)



U-6 went from 8.0% in March 2007 to 17.5% in October 2009; Stood at 16.2% in Oct. 2011

Unemployment stood at 8.6% in October

Unemployment peaked at 10.1% in October 2009, highest monthly rate since 1983.

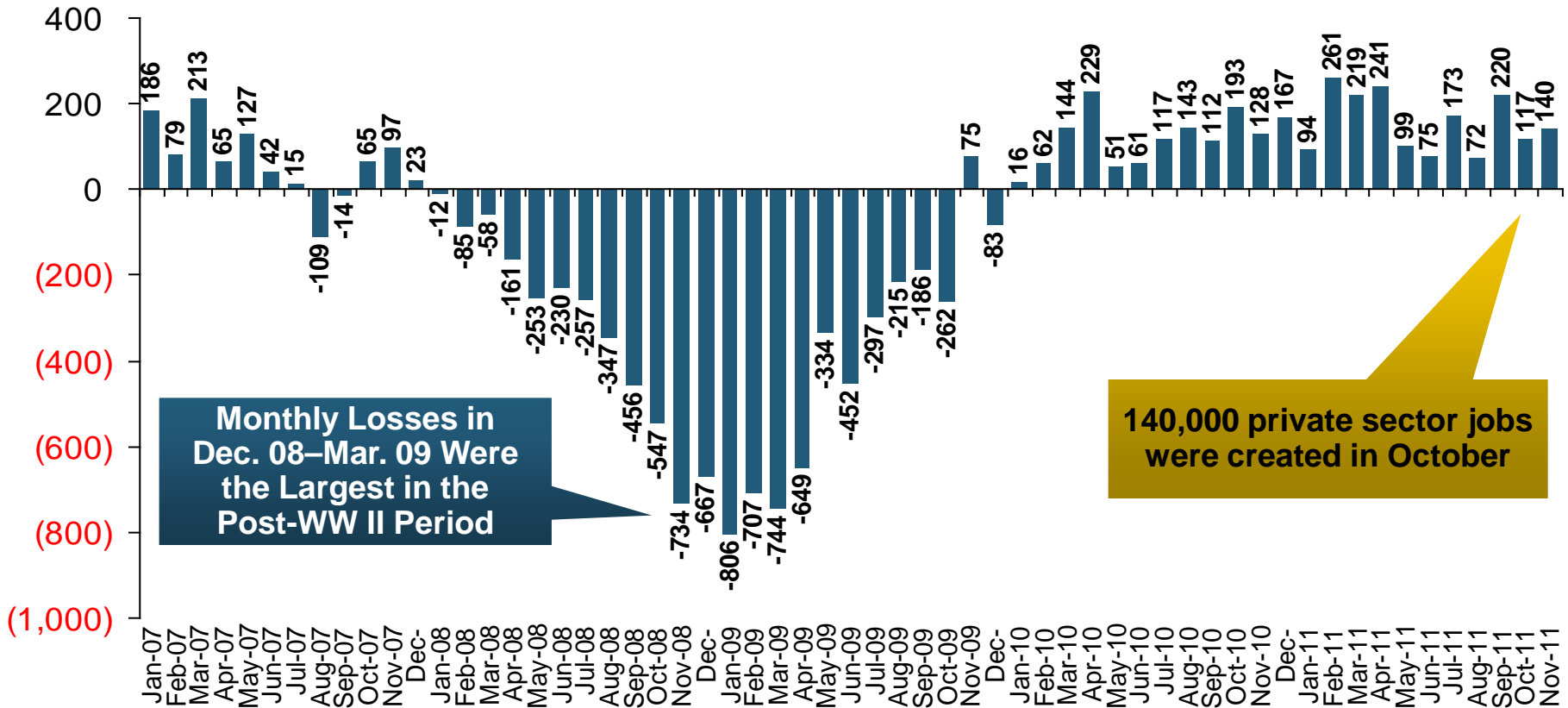
Peak rate in the last 30 years: 10.8% in November - December 1982

Stubbornly high unemployment and underemployment will constrain overall economic growth

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

Monthly Change in Private Employment

January 2008 through November 2011* (Thousands)

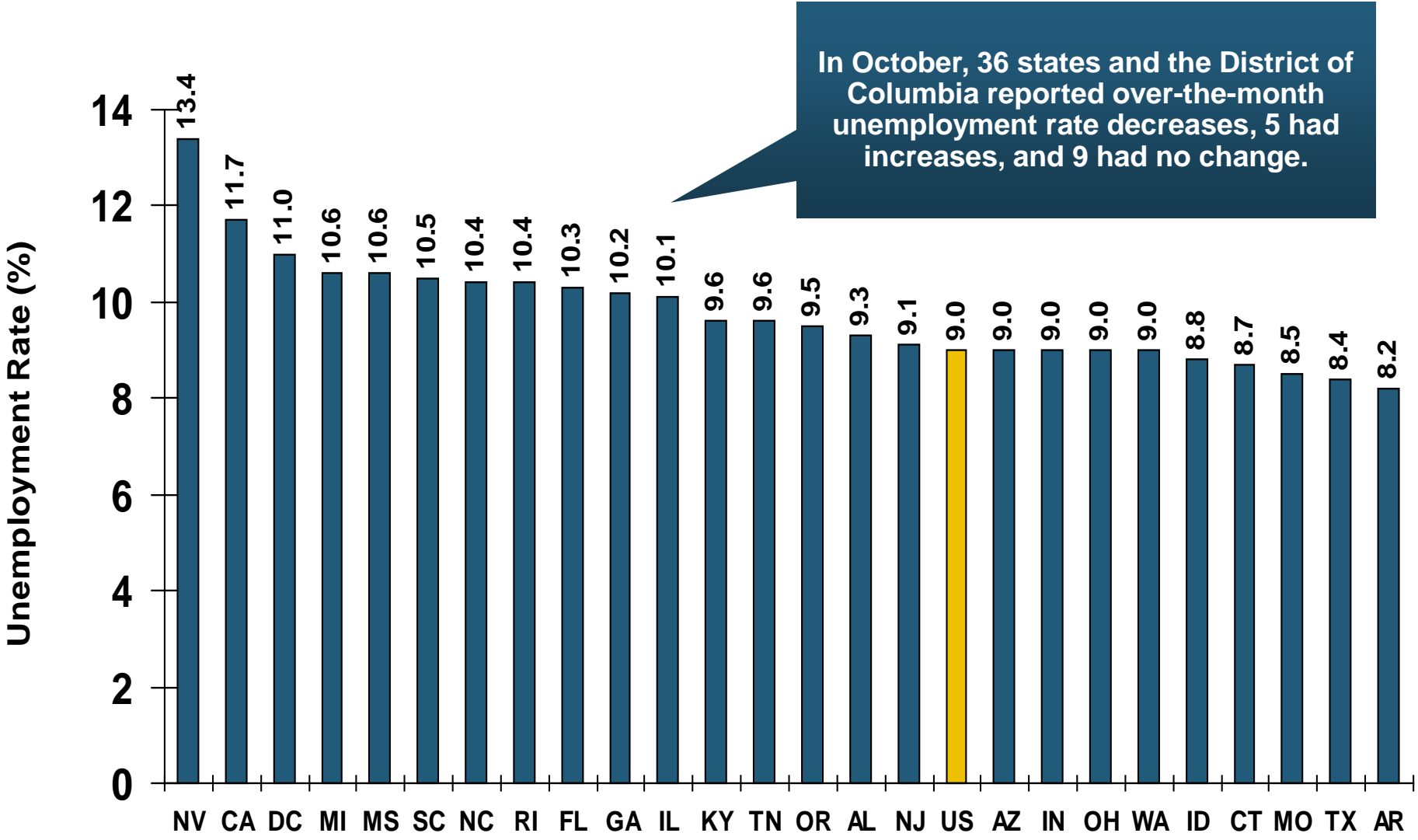


Monthly Losses in Dec. 08–Mar. 09 Were the Largest in the Post-WW II Period

140,000 private sector jobs were created in October

Private Employers Added 3.134 million Jobs Since Jan. 2010 After Having Shed 4.66 Million Jobs in 2009 and 3.81 Million in 2008 (State and Local Governments Have Shed Hundreds of Thousands of Jobs)

Unemployment Rates by State, October 2011: Highest 25 States*



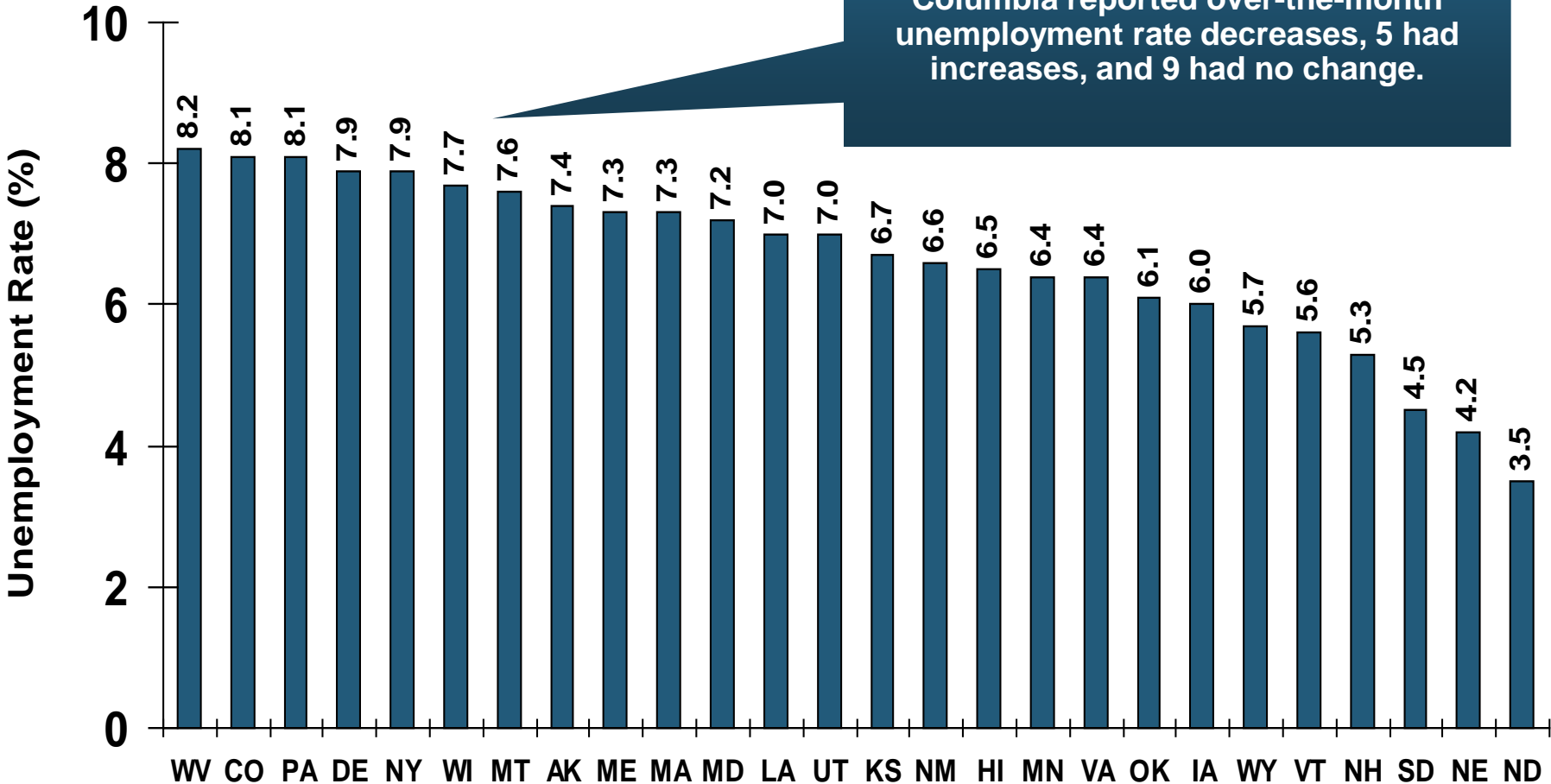
In October, 36 states and the District of Columbia reported over-the-month unemployment rate decreases, 5 had increases, and 9 had no change.

*Provisional figures for October 2011, seasonally adjusted.

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

Unemployment Rates By State, October 2011: Lowest 25 States*

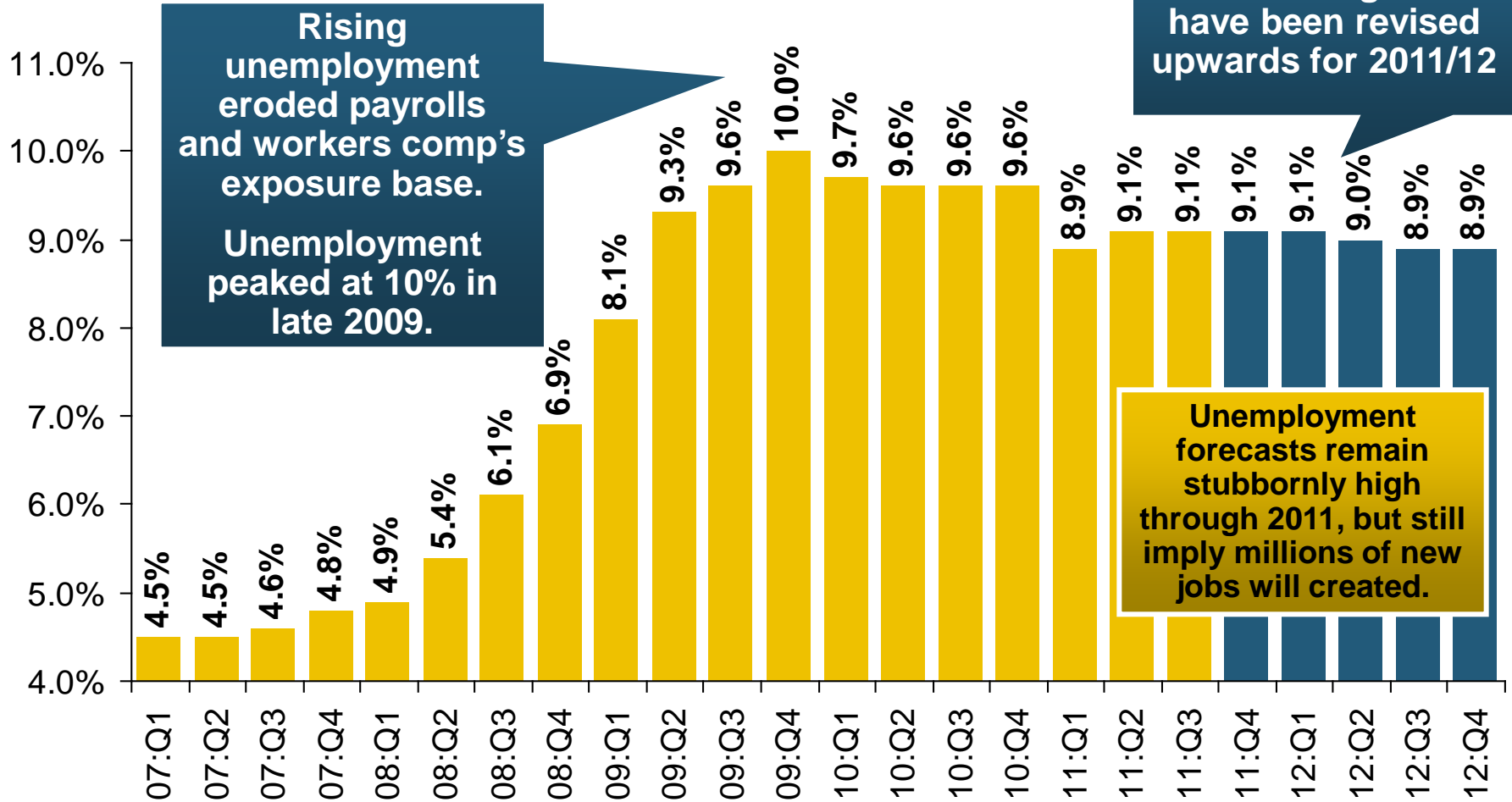
In October, 36 states and the District of Columbia reported over-the-month unemployment rate decreases, 5 had increases, and 9 had no change.



*Provisional figures for October 2011, seasonally adjusted.
Sources: US Bureau of Labor Statistics; Insurance Information Institute.

US Unemployment Rate

2007:Q1 to 2012:Q4F*



* ■ = actual; ■ = forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (11/11); Insurance Information Institute

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