

U.S. Property and Casualty Overview

Market Update Spring 2010



U.S. Property and Casualty insurers saw improved results in 2009 as underwriting losses were reduced, investment gains improved, and reserve releases by several carriers added to profitability. These results were achieved despite continued declines in premiums written.

With these profitable outcomes, buyers will see a favorable pricing environment continue or even accelerate. Industry surplus has rebounded to near pre-recession highs. Supply continues to chase lower levels of demand. Most buyers continue to have reduced exposures due to the impact of the economy. Pressure on insurers to retain business may present a favorable scenario for buyers.

For companies with strong financials and loss histories, ample capacity will likely extend the “soft” market in most lines of business. Although surplus is high, this favorable market could suddenly change. Recent catastrophes have served as reminders of how events inevitably impact the insurance markets.

This overview will provide an explanation of what occurred by the end of 2009, and how it may impact insurance buyers now and in the future.

Surplus Rebounds To Near Its High Levels, Which May Extend The Soft Market

Policyholder surplus rebounded to more than \$510 billion by the end of 2009, which is more than a 10 percent increase from 2008 when policyholder surplus declined to around \$450 billion. This return to near-record levels is due to gains in investments, improving profitability, and additional capital entering the market. As noted earlier, this high level of capacity may extend the soft market as well as provide ample ability to protect against losses.

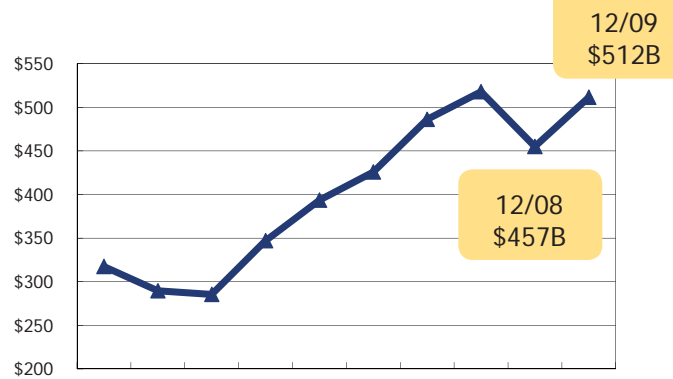
Improved Underwriting Results Due To Lower Levels Of Losses

The combined ratio (a measure of underwriting results) of U.S. P&C insurers improved to 101 percent by the end of 2009.

These are significantly improved results from 2008, when the combined ratio soared to over 105 percent. A major factor in the improvement in 2009 underwriting results was the mild hurricane season with low catastrophe losses. Casualty claims cost trends have been favorable as well.

Insurance Surplus 2000 to 2009

U.S. Policyholders Surplus (or Capital)

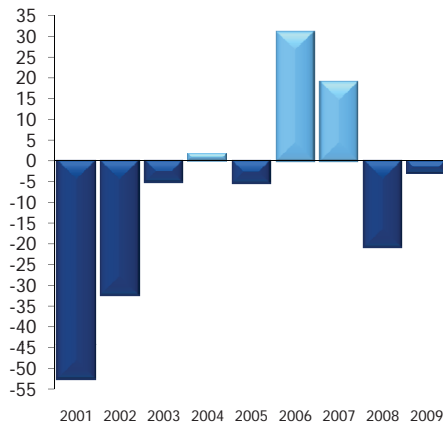


▲ Actual

Sources: 12/09 estimate from Insurance Information Institute

Underwriting Performance

U.S. 2001 to 2009

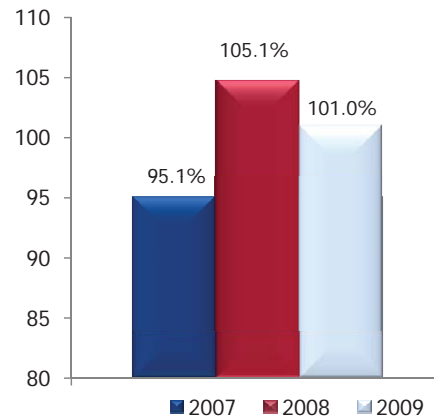


Sources: Insurance Information Institute
*Includes mortgage guarantee insurers

While improved, the U.S. P&C industry still saw an underwriting loss in 2009. This was largely a result of the negative premium growth. Net written premiums declined 3.7 percent year-over-year in 2009, the largest decline in years. This is a result of the continued soft pricing market as well as the shrinking exposure base from the recession.

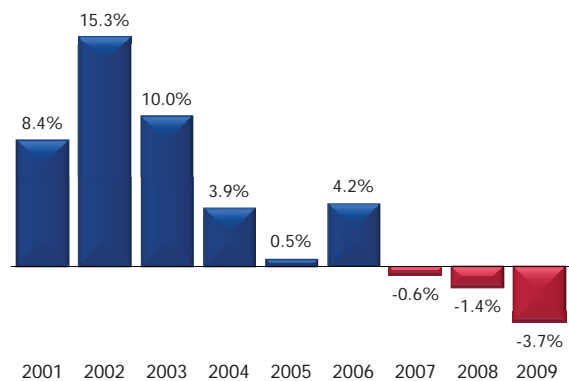
Combined Ratio

U.S. 2007 to 2009



Net Written Premium Growth

Year-to-Year Change in NWP 2001 to 2009



Improvement In Investment Gains, But Yields Remain Fairly Low

As yields on their conservative investment portfolios remain low, insurers continue to see relatively modest investment income. On the other hand, as capital markets improved, insurers saw more than \$15 billion in overall capital gains during 2009. Of \$14 billion in write-downs on impaired investments, nearly all occurred in the first half of the year. The overall impact from capital gains and investment income resulted in improved net investment gains in 2009, improving profitability. Overall, lower-than-normal investment gains will pressure underwriters to maintain discipline to achieve profitability.

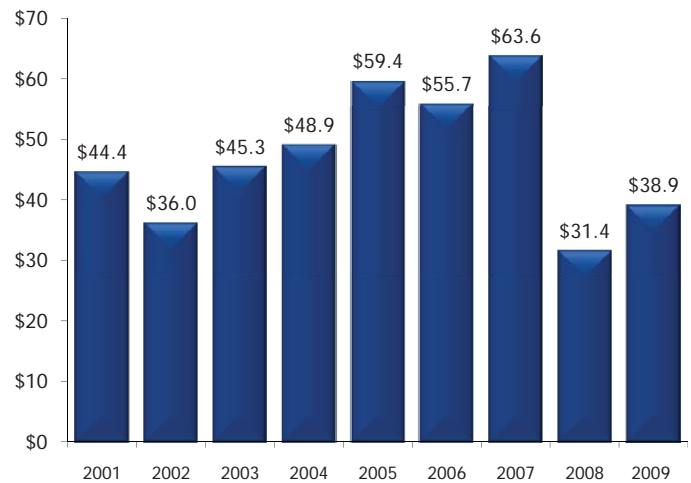
In 2009, property casualty insurers saw a profit of \$28 billion, a significant improvement from last year. After a loss in the first quarter, the last three quarters of 2009 saw positive net income. This is due to improved underwriting results and investment gains as well as reserve releases.

Due to favorable development trends, a number of insurers released reserves from previous years. While some believe this has left low reserve cushions, it had a short-term benefit on the results. A notable exception was Chartis (a property casualty arm of AIG), which reported a \$1.8 billion loss in the fourth quarter when they strengthened reserves. Results for Chartis weighed down what would have been a more profitable year for the industry as a whole.

Overall, return on equity for U.S. P&C insurers is low compared to historic standards, which is not surprising given how the downturn has impacted all sectors of the economy. The extended soft market and lower exposure base should continue to apply some pressure on results.

Investment Performance

U.S. Property Casualty Investment Gains 2001 to 2009

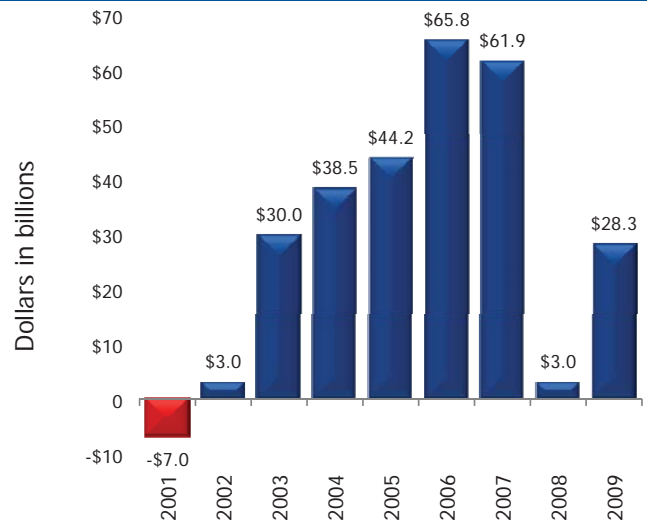


Sources: ISO, Insurance Information Inst.

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

P&C Profitability

P/C Net Income After Taxes 2000 to 2009



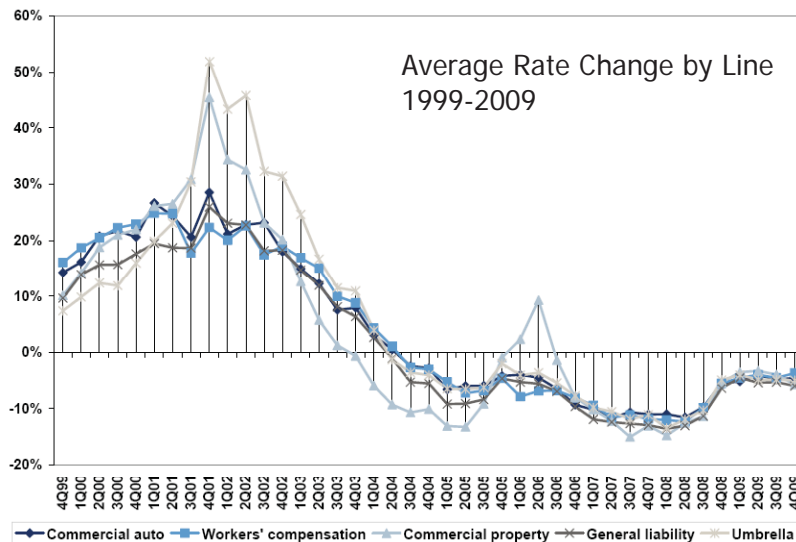
Sources: ISO, Insurance Information Inst.

Conclusion

2009's vast improvement in results compared to 2008 has led to a continuation of the favorable market for commercial insurance buyers. Rates for most risks are generally either flat or seeing slight declines. Pressure to maintain market share with clients facing their own economic concerns has generally supported continued lower rates, even if they are not as steep. There will continue to be variation by line, industry, and the company's financial results and loss history. The *Council of Insurance Agents & Brokers* reported across all lines an average decline in rates of nearly 6 percent in the fourth quarter of 2009. While these are lesser declines than 2008, it is evidence that the soft market continues.

Commercial Insurance Pricing

Insurance Cycle Is An Inevitable As It Is Unpredictable



Source: Council of Insurance Agents & Brokers

In the following *Market Update*, top Lockton experts discuss the state of the insurance market, including in their area of industry expertise. Lockton analysis includes:

Casualty Lines

- ❖ Our view is for a continuing soft marketplace characterized by declining prices and strong carrier competition and choice as well as improving terms and conditions.
- ❖ The business environment is increasingly forcing buyers to market their business to attain the best deal. Carriers have consistently generated solid retention rates over the past several years, but they may be asked to concede more today to retain the business given the dynamics of the marketplace. These conditions set up a very favorable environment for buyers.
- ❖ In the current credit environment, buyers are seeking to minimize collateral. This places more carrier emphasis on retaining its existing business and has caused carriers to drop prices, sometimes significantly.
- ❖ The insurance market across all global regions and classes is *generally* still competitive, with no real signs of a hardening market.

Property Lines

- ❖ Competition is driving down the price of property insurance for almost all market segments and classes. Cash is king and insurers are choosing to lock in what business they can—even at a discounted price—rather than hold the line on price and lose good business to a competitor.
- ❖ Natural catastrophes are, as always, the wildcard in this equation. A rash of natural catastrophes in recent months has the insurance market on edge.
- ❖ The global property market remains relatively soft, and competition for market share is fierce. All over Europe the domestic placements are extremely competitive as underwriters look to grow their portfolio.

Reinsurance

- ❖ The market's disciplined approach to rate reduction, in a market where supply significantly exceeds demand, suggests a keen awareness that a clement claims environment like last year's is not to be relied upon.
- ❖ Reinsurers have maintained pricing discipline through the January and April renewals. Where we go from here depends essentially on how long this will last in the absence of market-changing claims activity.

Financial and Executive Risk

- ❖ Overall capacity for D&O insurance, as well as other Executive Liability lines such as Fiduciary Liability and Employment Practices Liability, is remarkably high. The supply/demand factor is, for the most part, keeping prices down.
- ❖ As we move into the second quarter of 2010, the D&O, EPL, and Fiduciary markets show no signs of hardening. The theme for most risks, with the exception of some financial institutions, is general stability and softness.