

Delaware – First State, First in Business, First Choice for Captives

Your CAPTIVE & the MARKET: *Impact & Choices*

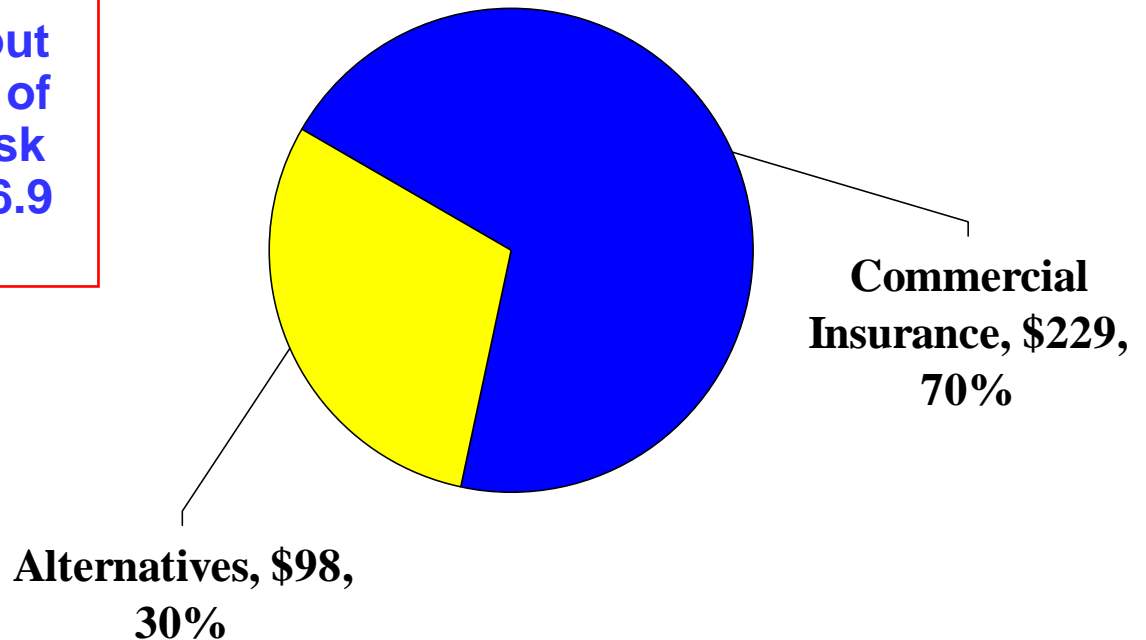
Bill Whitehead, MIM,
Lexington Insurance Company
October 2, 2007

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Total Commercial Risk Protection Market (2004)

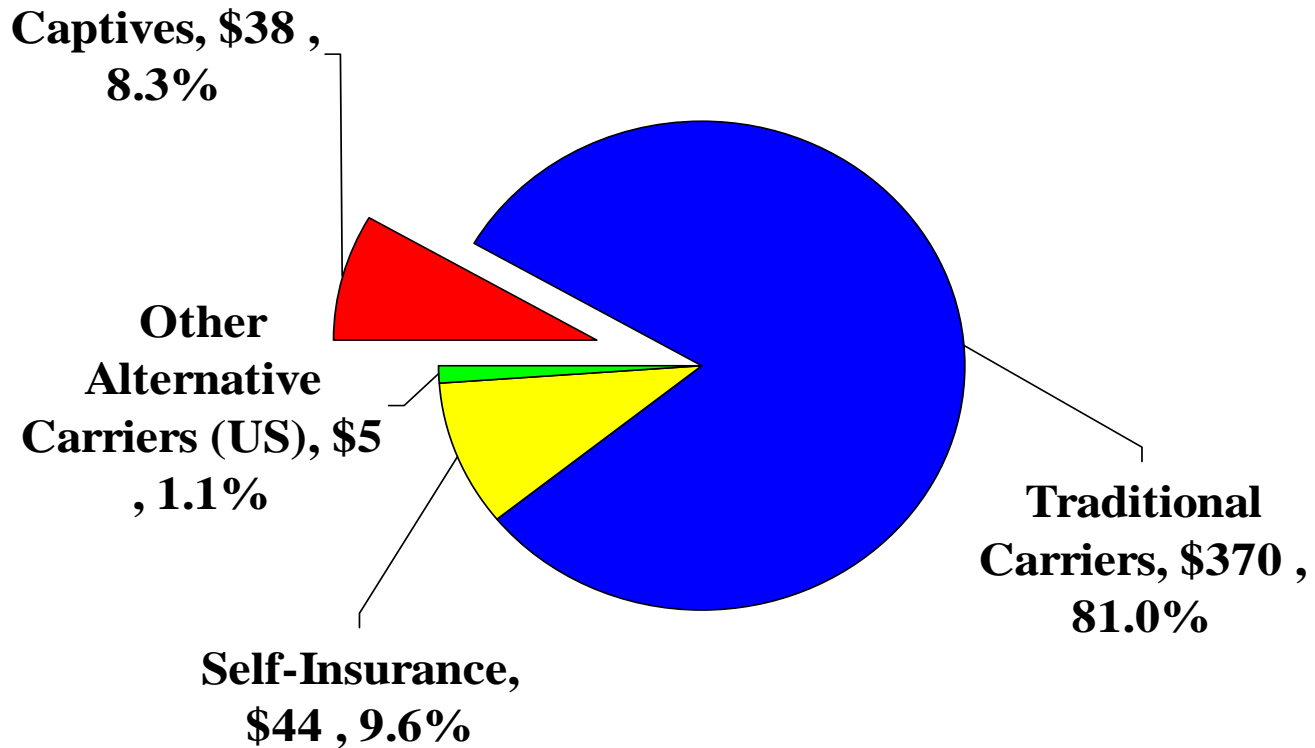
Alternative market mechanisms cover about 30 percent (\$98 billion) of the total commercial risk protection market (\$326.9 billion)

\$ Billions



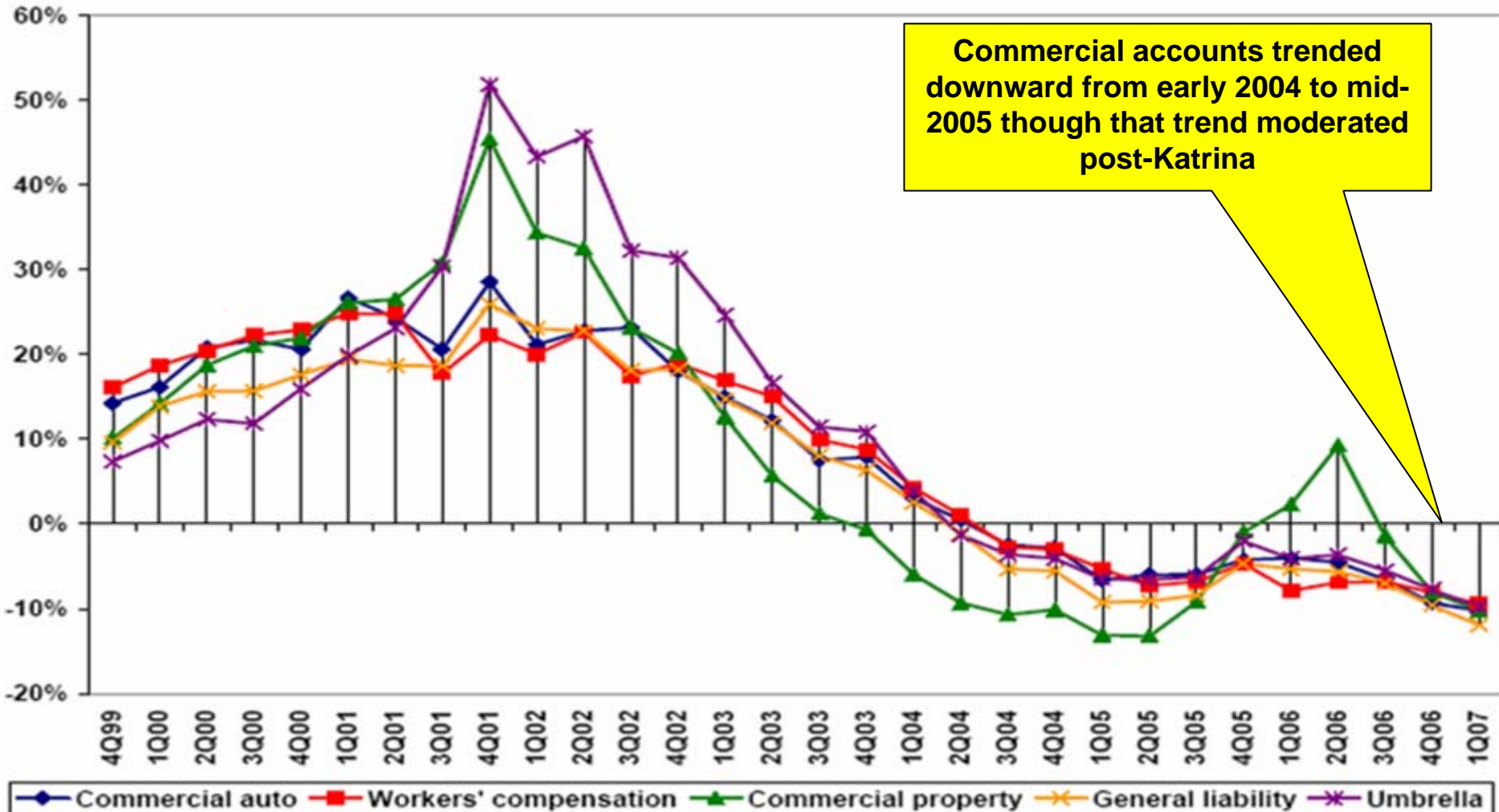
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Size of ART Market; 2001 Direct Written in Billions



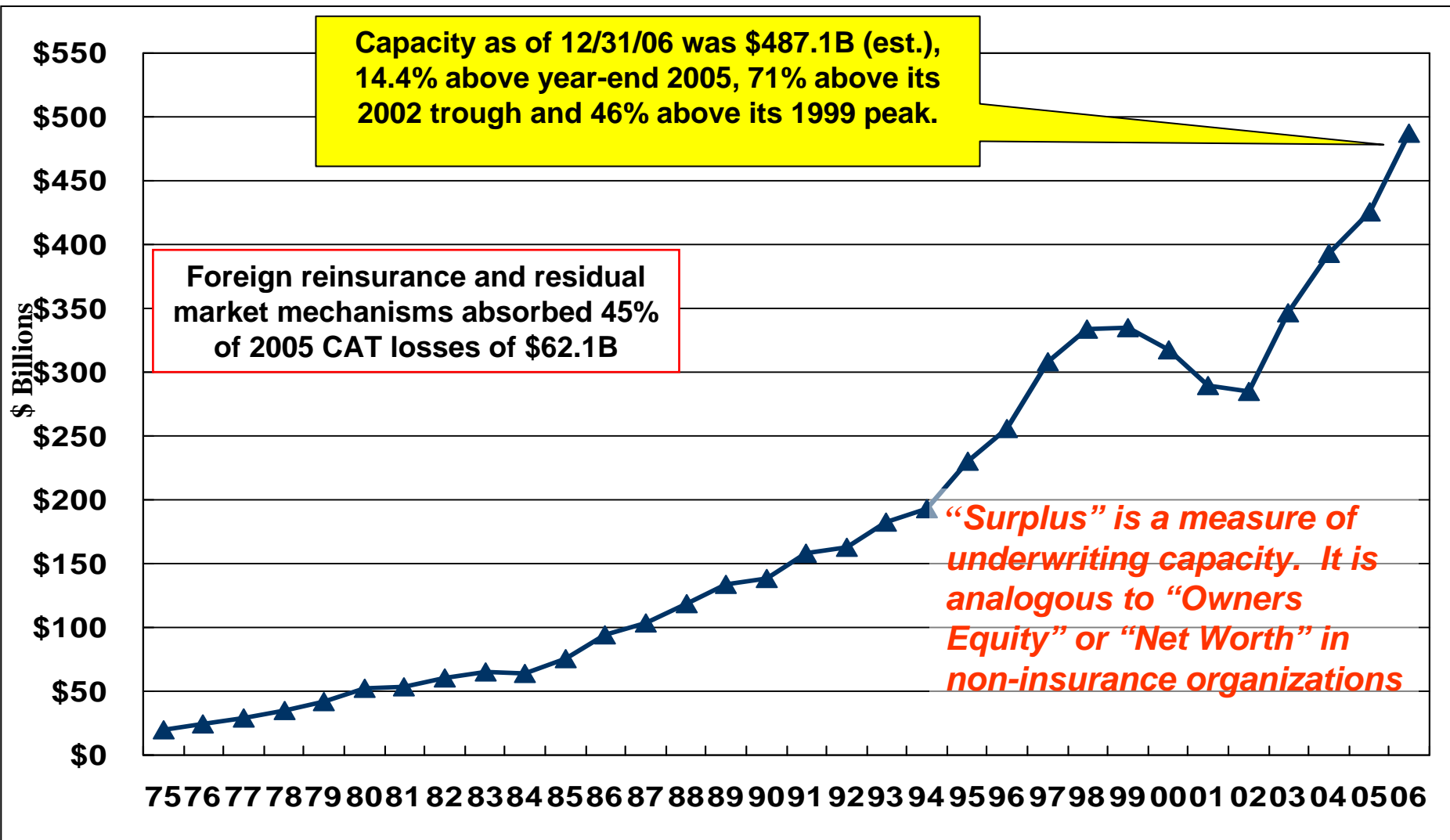
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Average Commercial Rate Change by Line: 4Q99 – 1Q07



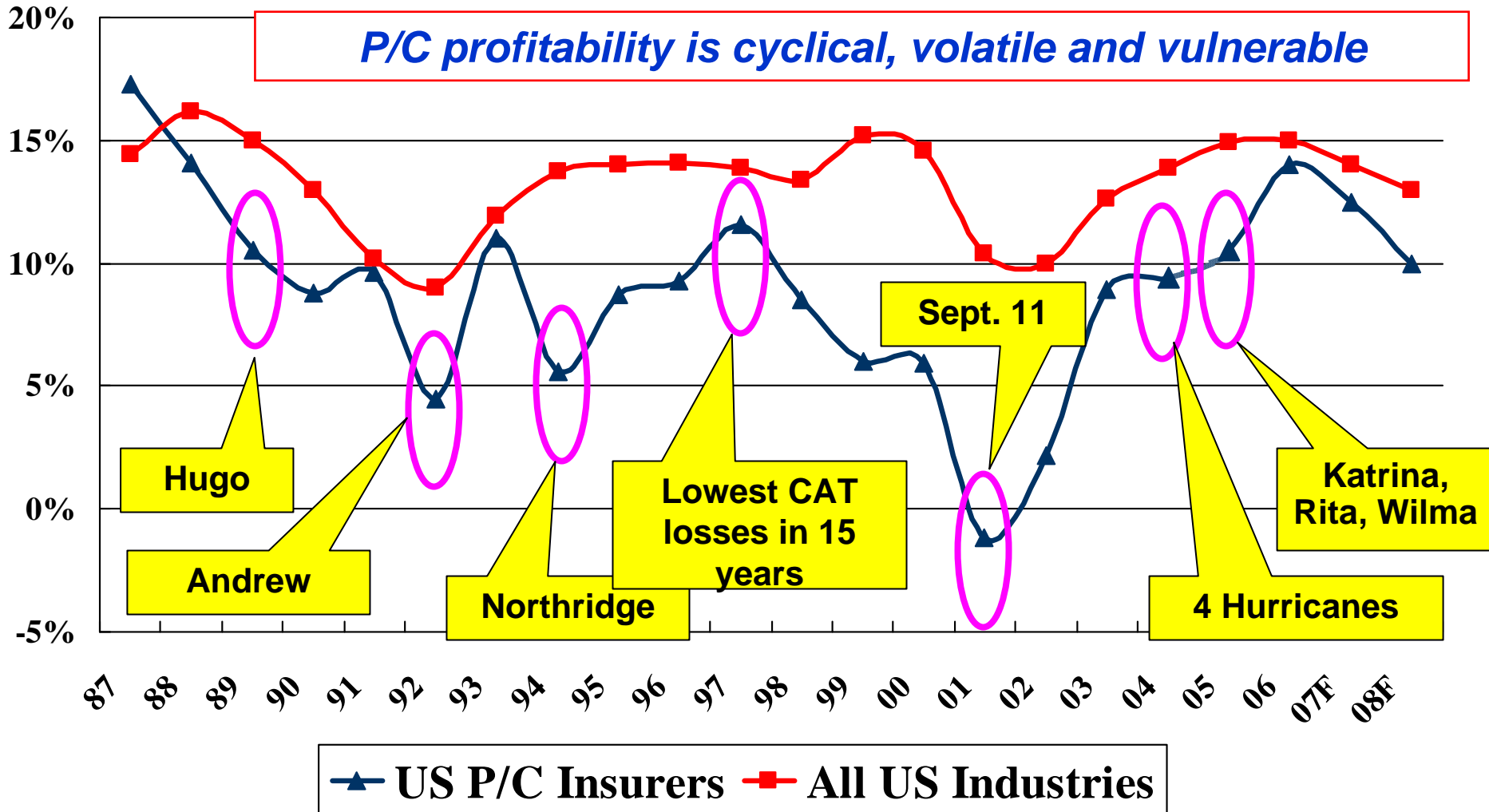
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U.S. Policyholder Surplus: 1975-2006



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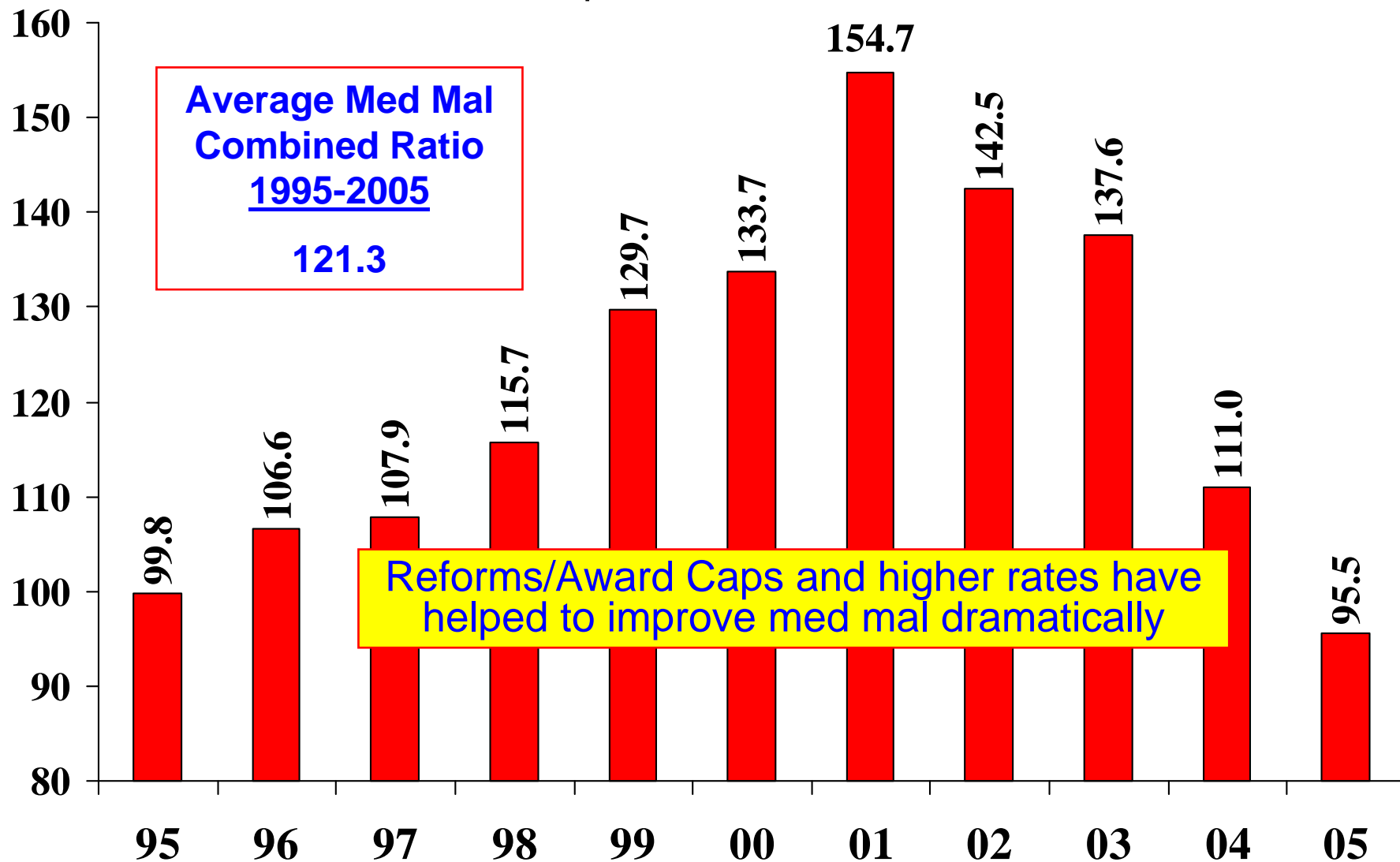
ROE: P/C vs. All Industries 1987–2008E



*2007-08 P/C insurer ROEs are I.I.I. estimates.
 Source: Insurance Information Institute; Fortune

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Medical Malpractice Combined Ratios



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Medical Malpractice Recent Developments

- **Market Conditions**
- Conning’s study, “New Opportunities Emerging? Or the Eye of the Hurricane?” suggest med-mal market turn around stems from rate increases over past four years + tort reform (esp. caps on non-economic damages) plays large role
- Med-mal costs have stabilized and decreased for most specialties, although still higher than 5-6 years ago
- Many physicians who reduced coverage at the height of the crisis are not yet rushing to raise it again
- Physicians who left the traditional market for alternatives for captives or RRGs remain for the most part (Whitehead—always some leakage on fringes)
- Overall, medical professional rates in the traditional market are falling
- *The number of claim incidents is down, but the average value is up (see tort costs)*
- Aon’s study shows severity increasing at a rate of 6% annually
- The average amount to plaintiff’s increased 3% while the amount to defend increased 17%--more aggressive defense
- Combined ratio for med-mal in 2005 was 100.1 vs. 138.8 in 2003. (Whitehead: should this trend continue, capital rushes back into market—but at what terms and rates? POP QUIZ: What does this do for predictability?)

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2007: Past the Peak, Hold on to Your Seat

Dr. Robert P. Hartwig, CPCU
President and Chief Economist
bobh@iii.org

The financial performance of the property/casualty insurance industry during the first quarter of 2007 was generally excellent, but at the same time provided confirmation that the industry is now *past its cyclical peak in profitability* of 14.0 percent achieved in 2006. The only question that now remains is how long the decline in profitability will last and how many years it will take to get to the bottom. History may offer some guidance. Since 1975 there have been four cyclical troughs in profitability: 2.4 percent (1975); 1.8 percent (1984); 4.5 percent in 1992; and -1.2 percent (2001). The descent from previous peak to trough can be steep or gradual—lasting anywhere from 3 to 7 years (4.75 years, on average). The associated decline in profitability, however, has invariably been severe, tumbling 13.5 percentage points on average over the last four market cycles. If historical norms for the past 35 years hold, the industry can expect ROEs to bottom out in 2011 at about 1 percent—not reaching another peak in profitability until 2015 or 2016.

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Whew!! So What Could this Mean for You & Your Captive?

A Captive Primer/Review

- Captives/ART Usually Driven by “Forced Placement”
 - Availability
 - Affordability
- Once under operation, successful captives realize:
 - PREDICTABILITY
- You must always start with a superior foundation, lest everything you build up be on unstable footing & subject to collapse
 - Mission—what do you provide, to whom, to what end?
 - Congruence of financial goals—are insureds also financial stakeholders?
 - Capital & surplus are everything

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What are the Critical Issues to Understand?

- You are running an insurance company
- You must be competent & conversant on:
 - Risk analysis
 - Regulatory Compliance
 - Claim management & administration
 - Investment strategies
 - Reinsurance support
 - Distribution alternatives & dynamics
- Selecting quality partners is critical to your success
 - Domicile - Law Firm
 - Actuarial firm - Audit Firm
 - Commercial carrier - Broker
 - Investment manager - Third Party Claim Management

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Selecting Your Captive Business Partners: the VALUE Proposition

- Whether broker, insurer, domicile, TPA, actuarial firm, law firm, etc., qualify and memorialize in an evaluation:
 - Does this provider understand my business & goals? How do you know?
 - Does this provider ask for more insight, enter into a dialogue and provide suggestions for improvements and alternatives
 - Did I receive a formal proposal/offer in writing, detailing deliverables/terms & conditions?
 - Is the provider responsive to my requests/questions?
 - Am I a client or a customer in the eyes and attitude of this provider?

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Whitehead contact information

William G. (Bill) Whitehead
Lexington Insurance Company
100 Summer St., 19th FL
Boston, MA 02110
617-443-4630
Bill.Whitehead@AIG.com