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The Current Economy and its Impact on Insurance Companies

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Assurant Employee Benefits
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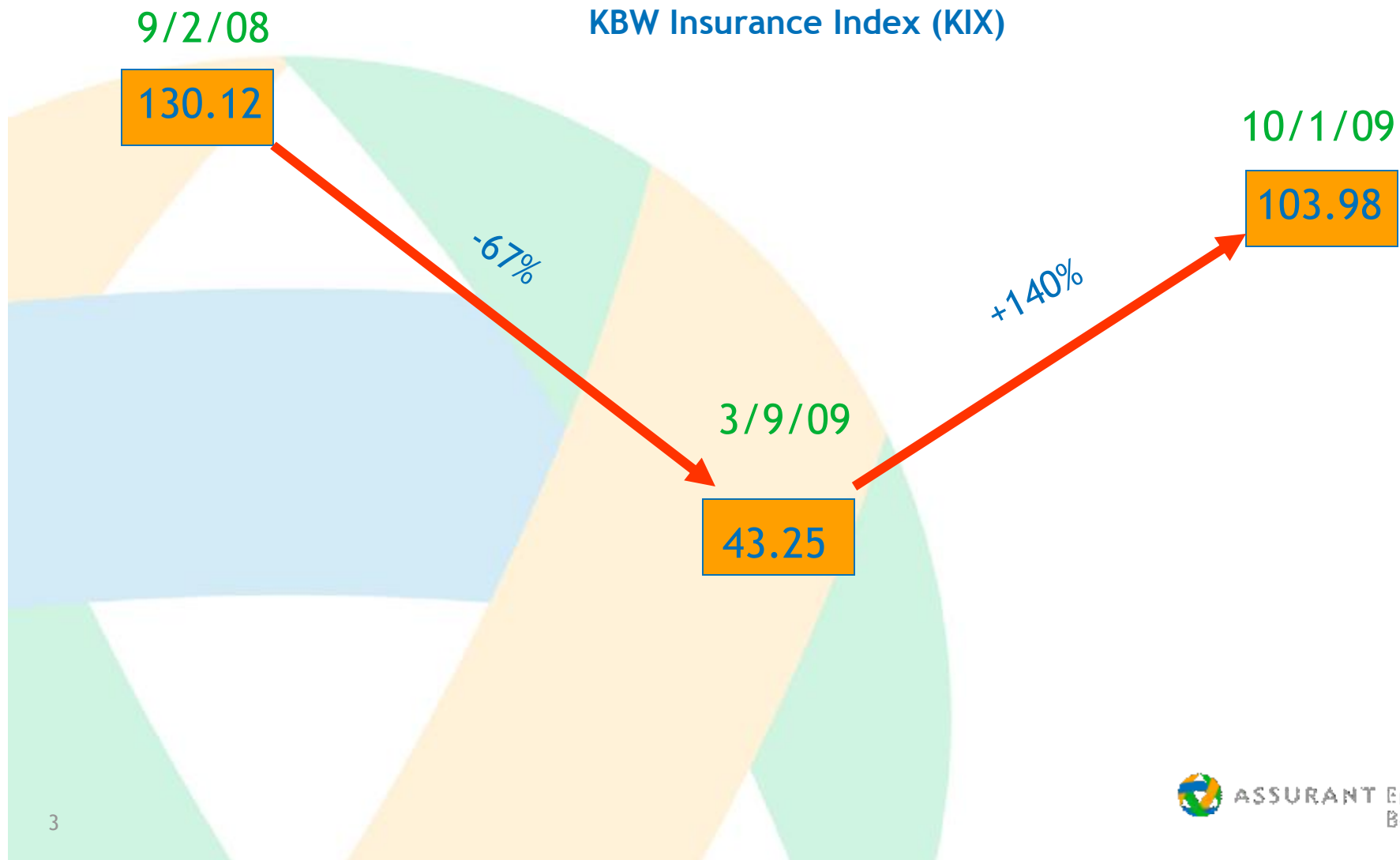
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The Next 60 Minutes...

- **The economy & its impact on the insurance industry**
 - What happened?
 - Where are we today?
 - Why does it matter for disability insurance & you?
- **What are disability insurers watching?**
- **Plenty of opportunity in disability market**

A Tumultuous Road...

The Worst Economic Event in 80 Years



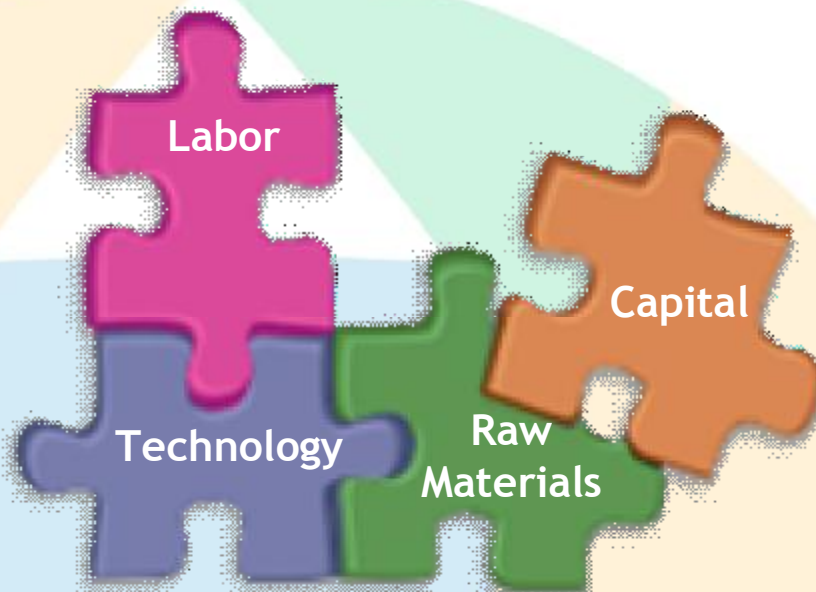
Let's Start With This Question About Economic Systems...



How do we produce, distribute & consume scarce goods & services?

Economic Systems

How does an economic system work? That depends on the system...



Capitalism:

- Where should investors put their financial capital?
- They choose from various investment opportunities to try to maximize their return
- Prices should be market-based & reflect intrinsic value
- There should be motion of capital and resources to the most optimal uses

Bubbles

- Occasionally, a good will develop an escalating price based on speculation, frenzy, etc. far in excess of its intrinsic value.
- That will also attract capital from investors based on escalating prices/returns that cannot be sustained.
- This is a “bubble”.
- Prices will eventually crash & investors will not get their returns.

Famous “bubbles”

- Tulips, Holland, 1630’s
- Railway Mania, Britain, 1840’s
- Florida Land Boom, US, 1920’s
- Dot Coms, US, 1990’s

So What Happened?

- Housing bubble 2000's
- Mortgage capital poured in
 - Investor demand to invest in mortgages was high
 - Complex mortgage-backed securities were created
 - Mortgage lending standards grew lax
- By 2007-8, investors are starting not to get their return. Cracks appeared (Bear Stearns, FNMA, etc.)
- The dramatic events of mid-Sept. 2008 resulted in *great fear* (e.g. the failure of Lehman).
- Fearful people tend to move to safety, then stop moving

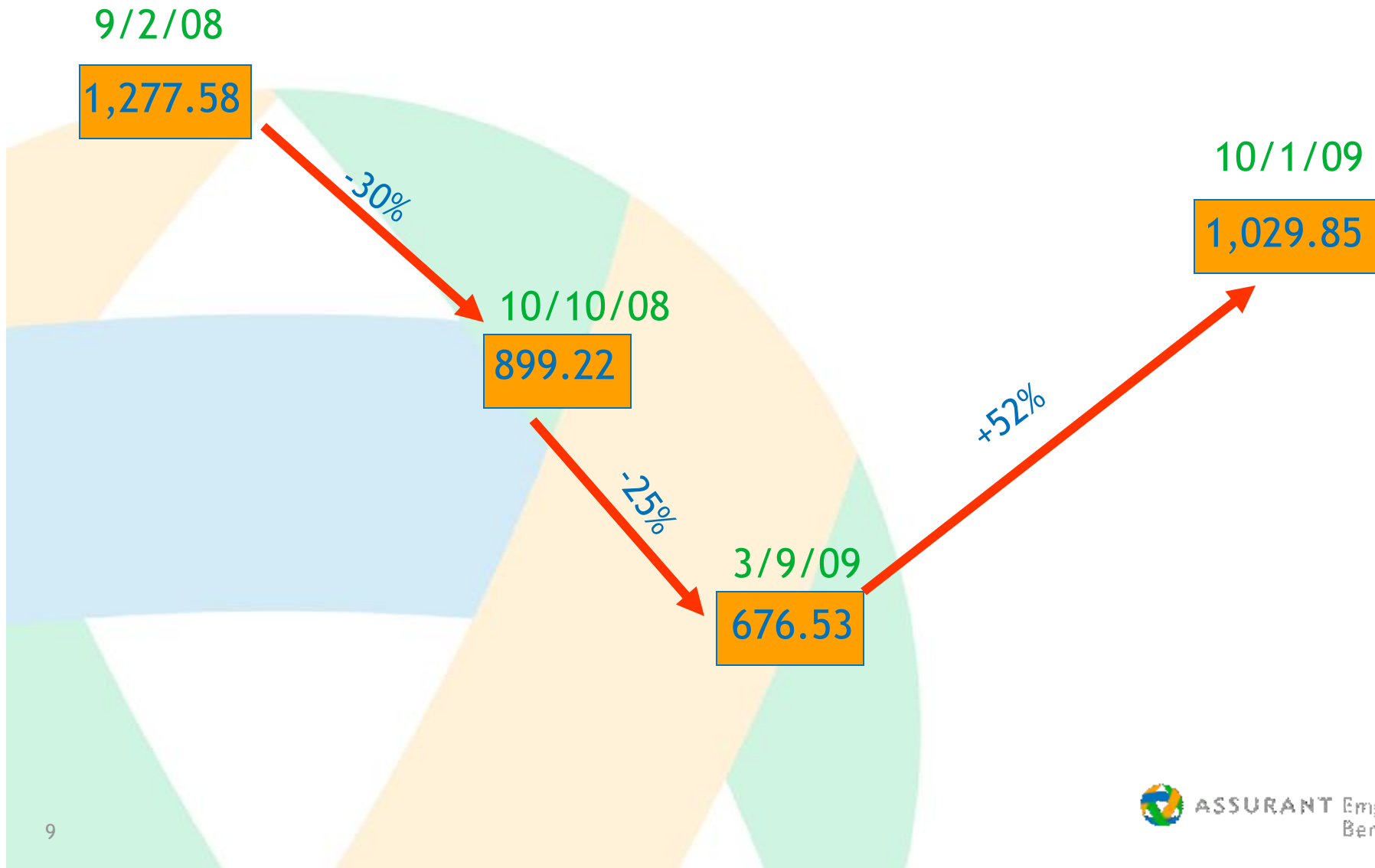
So What Happened?

Late 2008/Early 2009

- Motion stopped (no lending, investing, borrowing, buying, selling, hiring, manufacturing, etc.)
- Investors moved to treasuries (safety), then stopped moving
- Prices of stocks & bonds (other than treasuries) plummeted

Market Reactions

S&P 500 Index



Market Reactions

Dow Jones Corporate Bond Index

1/1/08	103.5	
8/31/08	99.4	slight drift downward throughout 08
9/30/08	92.4	fear
10/17/08	85.6	more fear
12/31/08	96.7	rebound
3/31/09	94.8	another dip
6/30/09	102.5	another rebound
9/30/09	108.7	rebound continues

Treasury Bonds show the opposite pattern over this period.



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The Impact to Insurers

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Shrinking Investments Impacted Insurers

Despite Ratings

- Insurers have large sums invested
- By early 2009 stock & bond prices (except Treasuries) declined significantly
- Bonds with no market prices, and no market-observable inputs (“level 3”) are hard to value, even more so in a distressed time
- Largest public insurers* had over \$170 billion (pretax) of realized, and additional unrealized, asset losses in 2008 alone

* Excludes mutual companies, privately-held companies and smaller publicly-held companies

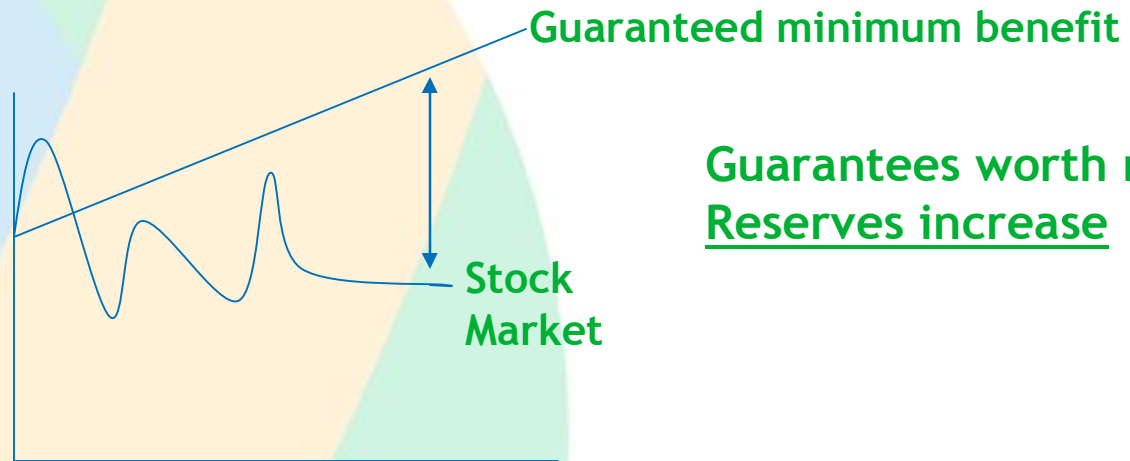
Source: Filings of 25 public insurance companies

Variable Annuity Insurers Felt Additional Impacts

- Like a mutual fund
- By early 2009, account balances (and hence, insurer fees) down
- Value of guarantees up

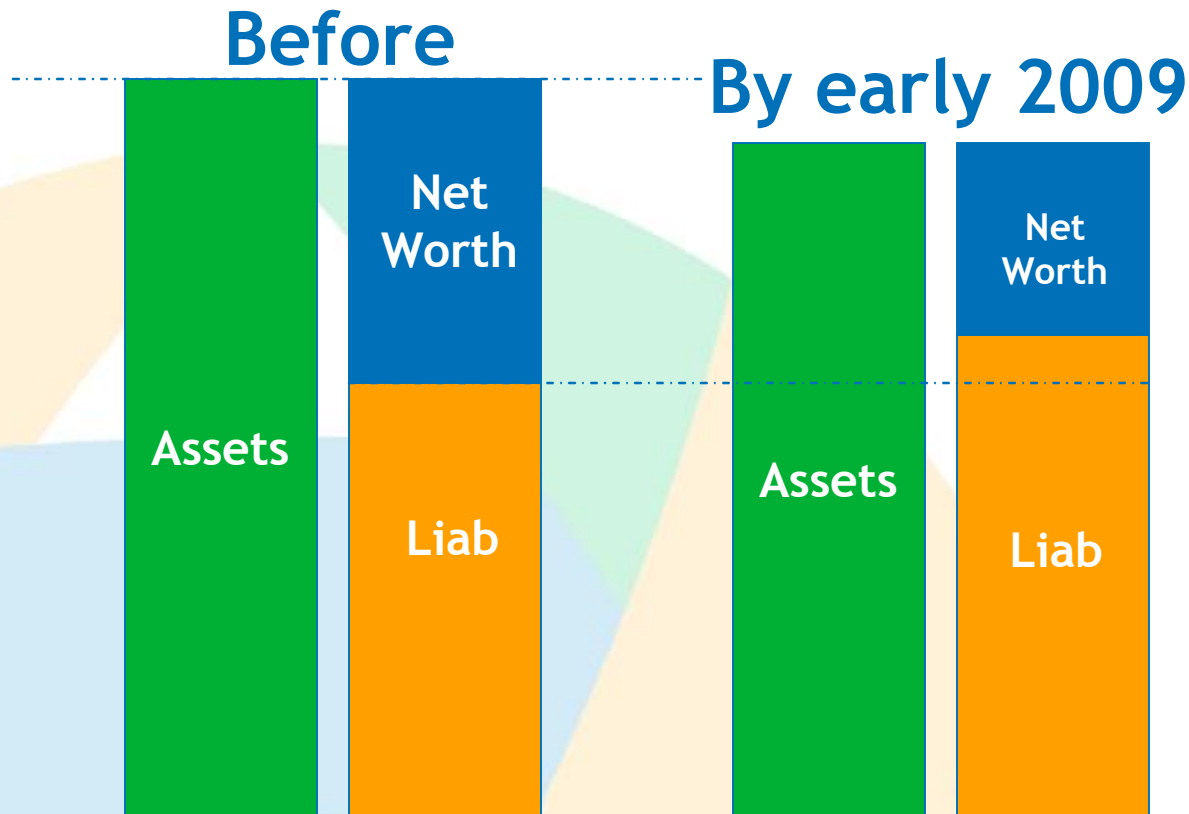
“Guaranteed Minimum Death Benefit”

“Guaranteed Living Benefit”



Guarantees worth more Reserves increase

Impact on Insurer Balance Sheets



- Assets lower
- Liabilities higher
- Net Worth squeezed

What Policymakers Set Out to Do

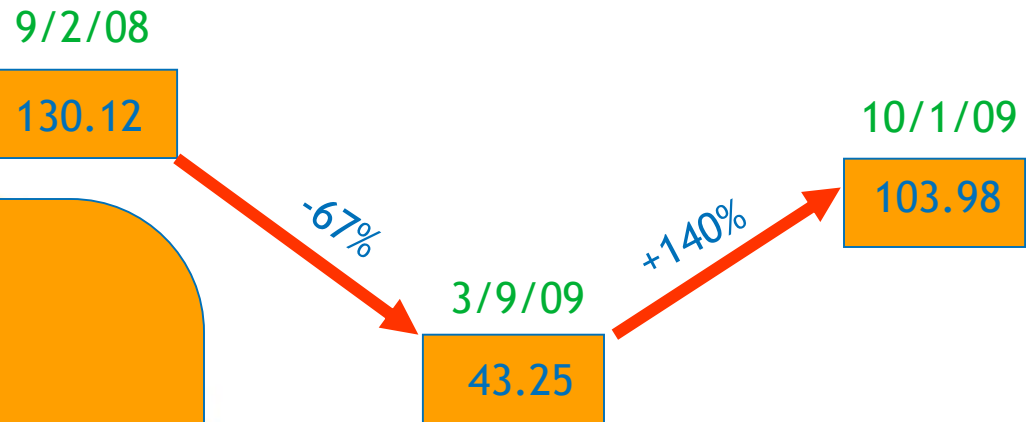
- **Stabilize the Financial System**
 - TARP, TALF, TLGP, etc.
 - Bailouts
 - Other actions by the Federal Reserve & Treasury
 - Guarantee of Money Market Funds
 - Purchases of Treasury Bonds & Mortgage Backed Securities (MBS)
 - Other
- **Stimulus package (February 09)**
 - \$787 billion
 - Controversial as to size & composition

What Policymakers Set Out to Do

- **Financial industry regulation overhaul**
 - Nothing done as of mid-October 2009
- **Deal with government debt in the long-term**
 - Nothing done as of mid-October 2009
 - Health care reform makes this worse?

By Summer 2009 Markets Stabilize, Insurers Begin To Recover

KBW Insurance Index (KIX)



How Have They Done It?

- Recoveries in stock & bond markets have helped
 - Stemmed tide of asset write offs
 - VA business performing better
- Some raised capital in the capital markets
- A few took TARP money

What Is The Takeaway?

- **Ratings don't always tell the whole story**
 - Some companies that had difficulties were/are rated higher than some that did not
- **When recommending a carrier, look deeper:**
 - Ratio of assets to equity (how vulnerable is a company to losses in assets?)
 - Investment composition & philosophy
 - Do they have a variable annuity business, and what condition is it in?
 - Performing stress tests through an Enterprise Risk Management Program?

Ratio of General Account Assets to GAAP Equity, 12/31/07

Company	Ratio
N	1151%
X	1038% *
V	904%
R	867% *
K	866% *
B	683% *
E	631%
Y	614% *
I	545% *
W	525%
O	513%
U	398%
T	392% *
C	345%
M	336%
F	287%
Q	281%
D	277%
J	246%
A	245%
P	227%
G	207%
S	174%
L	126%
H	28%

High ratios of invested assets to GAAP Equity caused problems.

*Received TARP or Bailout, or applied for TARP & later declined it.

Source: Public Company Filings, 12/31/08

Excludes mutual companies, privately-held companies and smaller publicly-held companies



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Percentage of General Account Assets That Were “Level 3”, 12/31/08

Company	Percentage
W	24%
N	21%
I	17% *
B	13% *
V	10%
T	10% *
Y	9% *
K	9% *
P	8%
A	8%
E	7%
S	5%
U	4%
R	3% *
X	3% *
O	2%
F	2%
J	2%
M	2%
G	2%
D	1%
L	1%
Q	1%
C	0%
H	0%

High levels of “Level 3” investments caused problems.

*Received TARP or Bailout, or applied for TARP & later declined it.

Source: Public Company Filings, 12/31/08

Excludes mutual companies, privately-held companies and smaller publicly-held companies



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Who Sells Annuities?

Company	Sell Annuities?	
I	Y	*
T	Y	*
G	Y	
W	Y	
B	Y	*
Y	Y	*
V	Y	
R	Y	*
X	Y	*
K	Y	*
J	N	
E	N	
M	N	
A	N	
S	N	
D	N	
L	N	
N	N	
H	N	
P	N	
F	N	
C	N	
Q	N	
O	N	
U	N	

Annuity business presented problems (not for all annuity writers, but for some)

*Received TARP or Bailout, or applied for TARP & later declined it.

Source: Public Company Filings, 12/31/08

Excludes mutual companies, privately-held companies and smaller publicly-held companies



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What About Disability?

- Disability business did not contribute to the problems just discussed.
- However, there are still economic trends being watched by disability insurers...



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What Are Disability Carriers Watching?

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What Are Disability Carriers Tuned Into?

Recession Double-Dip

- Will the economic recovery stall?
- Will negative GDP growth continue?
- Are the capital markets (stocks and bonds) out of the woods yet?
- Will we retest March 2009 lows?

What Are Disability Carriers Tuned Into?

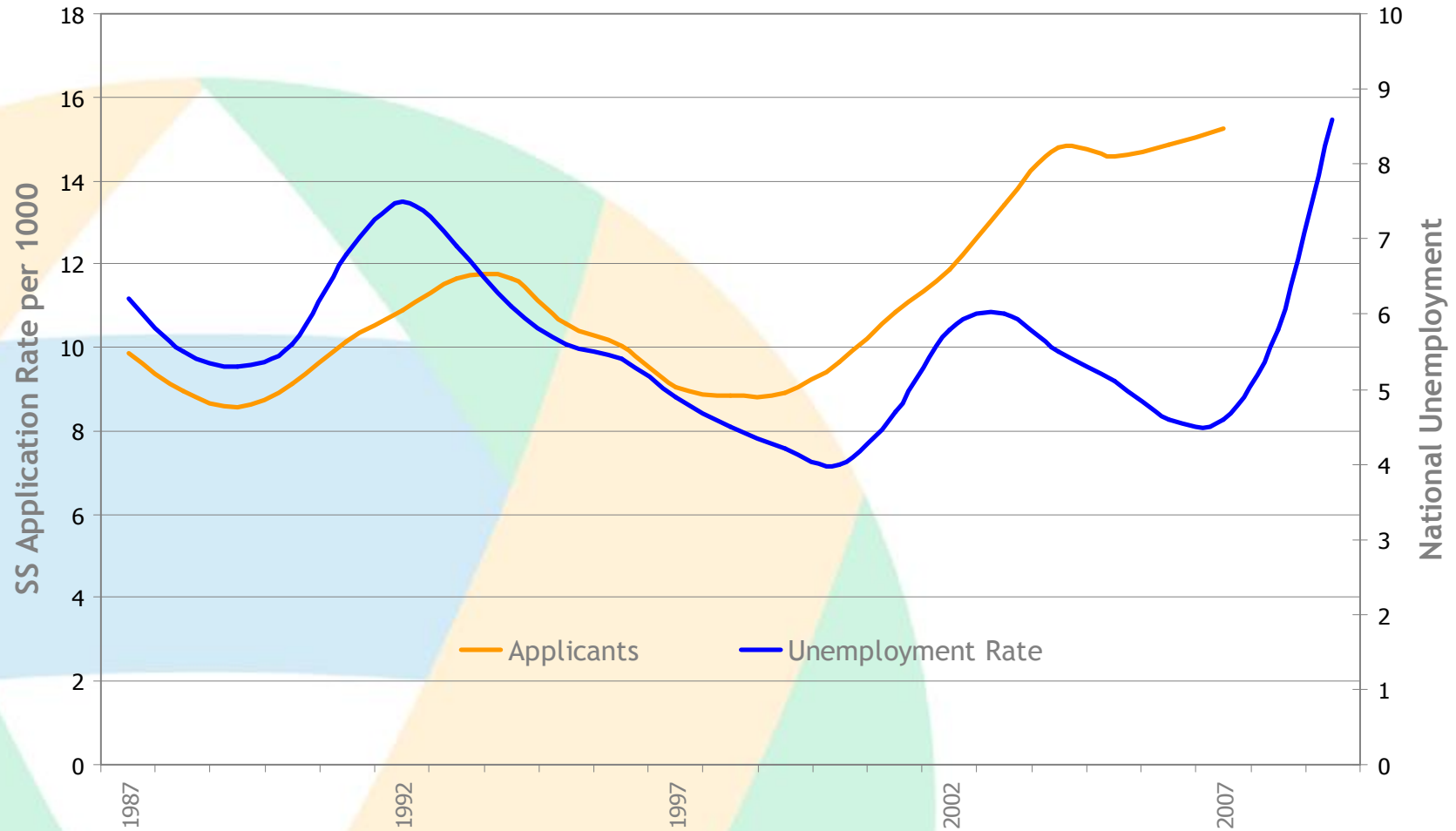
Incidence Trends

- Conventional wisdom...an increase in new claims during a recession ('incidence')
- Has held true in previous recessions
- Few have reported increased incidence thus far, but it could still happen

What Are Disability Carriers Tuned Into?

Incidence Trends

Social Security Applications vs Unemployment



Sources: Social Security Administration, Bureau of Labor Statistics

What Are Disability Carriers Tuned Into?

Interest Rates & Termination Trends

- **Interest Rates**

- Corporate bond yields are now very low following months of high yields
- Anticipated investment income on reserves is a component of pricing
- If corporate yields remain low, pricing will come under pressure
- 100 basis point drop in interest rates makes LTD cost 4-5% more to produce

- **Termination Trends**

- Return-to-work for existing claimants is more difficult
- Reported by some carriers thus far this recession
- Unemployment trend headed up/down?

What Are Disability Carriers Tuned Into?

Buying & Enrollment Patterns

- **Will/are businesses & people buying disability?**
 - Businesses are squeezed with some cutting back on benefits
 - If buying...they are buying less of it (fewer employees)
 - Little or no growth in covered payroll (merit increases)
 - Resulting in pressure on expense levels at insurers

What Are Disability Carriers Tuned Into?

Healthcare Reform

Possible Elements as of mid-October 2009...

- Public option?
- Health Exchanges?
- Tax changes?
- Coverages other than medical affected (e.g. dental)?
- Pay or play for employers?

...just a few scenarios that may impact carriers and/or brokers



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Plenty of Opportunity in Disability Market

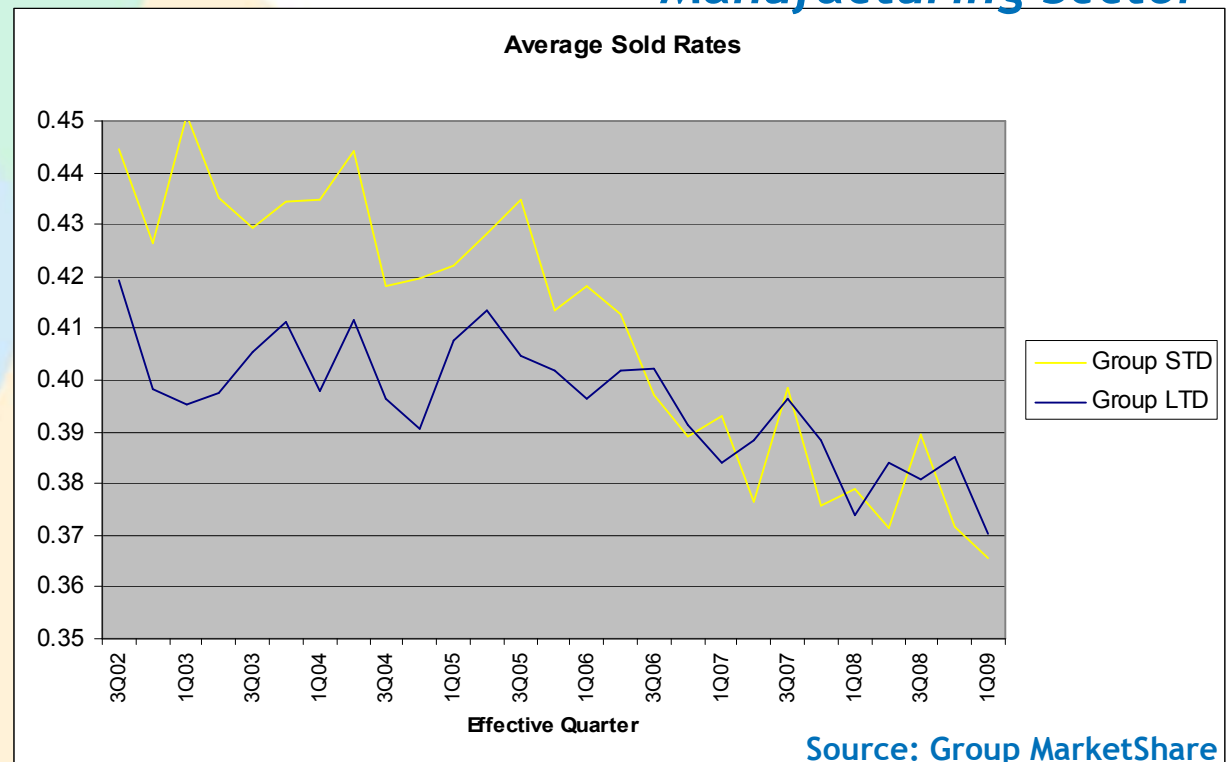
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The Statistics Remain Unchanged

- Myths, misperceptions & denial remain constant
 - *It won't happen to me...or it won't last long*
 - *Can't get it (industry)*
 - *My employees don't need it*
 - *Too expensive*

**STD & LTD
Cases
w/10-499
Lives**

Manufacturing Sector



The Statistics Remain Unchanged

- Disability is highly under penetrated and highly misunderstood by businesses & consumers

100+ million workers do not have private disability income insurance.

—Council for Disability Awareness, LTD Claims Review, 2005

70% of the private sector workforce has no long-term disability insurance.

—SSA Fact Sheet, 1/31/2007
(Council for Disability Awareness)

There is plenty of opportunity...awareness, perspective and education are needed.

5 Important Broker Resources

Awareness, Perspective & Education

- **Council for Disability Awareness**

- www.whatsmypdq.org
- www.disabilitycanhappen.org



- **U.S. Department of Labor**

- <http://www.dol.gov/dol/topic/disability/statistics.htm>

- **JHA** - www.jhawebsite.com

- **Financial Information**

- Annual report, quarterly filings, etc
- Yahoo Finance - finance.yahoo.com
- Google Alerts - www.google.com/alerts

- **Your Carrier Representative**

- Access 3rd party industry information (plan design prevalence, statistics, etc.)
- Contract comparisons

Finally, Good Perspective

The screenshot shows a three-step process. Step 1: 'My PDQ is: 43%'. Step 2: 'My EIQ is: \$2,575,000'. Step 3: 'How can I protect my ability to earn \$2,575,000'. Below this is a section titled 'HERE'S THE NUMBER SO MUCH DEPENDS ON.' with a progress indicator '1 2 3'. The main content area shows 'Your EIQ is: \$2,575,000' with a blue circle around the number and an arrow pointing to it. Below this is a paragraph explaining the importance of EIQ and a note about the tool's assumptions. Navigation buttons for '< BACK', 'NEXT, PLAN AND PREVENT >', and 'PRINT YOUR RESULTS >' are visible. The footer includes the Council for Disability Awareness logo and a link for more information.

My PDQ is: 43%

My EIQ is: \$2,575,000

How can I protect my ability to earn \$2,575,000

HERE'S THE NUMBER SO MUCH DEPENDS ON. 1 2 3

Your EIQ is: **\$2,575,000**

This gives you an idea of the income you're depending on, and why it's so important for you to take steps to minimize your chances of disability impacting your income.

Note: this tool provides an estimated calculation of your future earnings potential based on your current income and your projected retirement age. It assumes an average annual income increase of 3 percent.

< BACK NEXT, PLAN AND PREVENT > PRINT YOUR RESULTS >

Sample Lifetime of Earnings At Risk

Want more information and advice on protecting yourself from disability? Click here to visit the Council for Disability Awareness.

Price for annual auto insurance coverage? (MO, good driver, etc.) \$700-\$800/year

Annual cost to cover lifetime of earnings? \$200-\$400/year