FIRST LOOK: 2012 FIRST QUARTER RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

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It appears that 2012 is shaping up to be a continuation of recent financial trends for insurance companies that specialize in medical professional liability (MPL). A number of themes prevail: premiums are still declining, putting pressure on underwriting results, and the enduring drop in treasury yields is pressuring operating results.

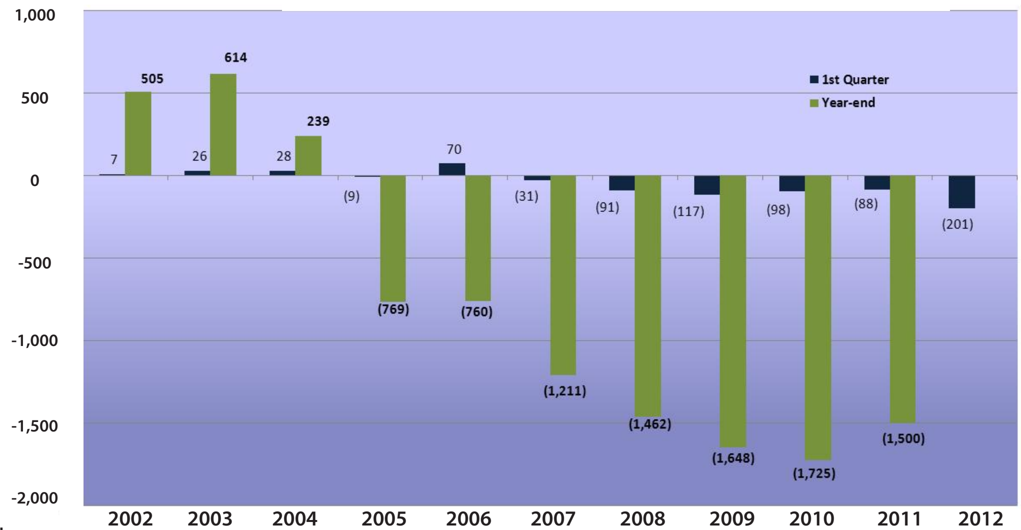
On the positive side, MPL insurers continue to benefit from the persistent, favorable reserve releases which, as has been the case for several years now, support excellent calendar-year underwriting results and increasing policyholder dividends.

Based on data compiled by SNL Financial, we examined the collective financial results of a composite of insurers specializing in MPL coverage with direct written premium amounting to approximately $7.3 billion in 2011. It should be noted that, starting in 2012, we have considerably expanded the composite that we have been tracking for the past two years. As a comparison, our previous composite wrote approximately $4.1 billion of premium in 2011. The criteria for the new composite are current statutory companies in existence since at least 2002, with MPL premiums comprising at least 50 percent of total premiums.

Premium Levels Continue to Decline

As illustrated in Figure 1, first-quarter-2012 direct written premium is down another 0.9 percent compared to first quarter 2011. However, what looks like a moderation of the trend that saw average annual premium declines of 3.8 percent during the last five years is likely welcome news to MPL specialty insurers. Direct written premium for this composite is down almost 20 percent since its peak in 2006. It should be noted that the premium decline has not yet led to industrywide rate inadequacies as loss costs have followed suit, driven by the persistent decline in claim frequency.

FIGURE 2 Cumulative Reserve Development by Quarter ($Millions)



Favorable Reserve Run-off Continues to Boost Calendar-Year Underwriting Results

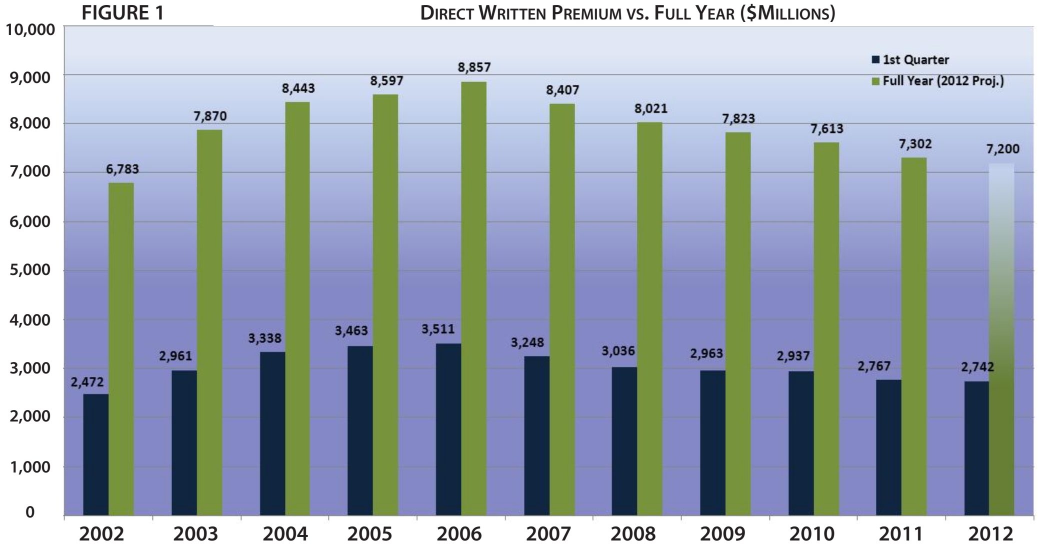
For a number of years now, reserve releases from prior coverage years have had a significant impact on calendar-year underwriting results for MPL insurance writers. This trend appears certain to continue in 2012.

Figure 2 compares first-quarter to full-year reserve movements on prior coverage years. It suggests that first-quarter reserve development often provides a fair prediction of the direction, if not the magnitude, of reserve development for the entire year. For this composite, favorable reserve development through the first quarter of 2012 is the greatest it's been during the past decade. If we use history as our guide, this certainly bodes well for the 2012 results come year-end. Since we believe it unlikely that the full-year reserve development for 2012 will be more than double the $1.5 billion we saw in 2011, we will take a wait-and-see approach for another quarter before making a 2012 prediction.

Investment Income Continues Downward Trend

Investment income is expected to continue pressuring operating results as U.S. Treasury yields continue their downward trend. As shown in Figure 3 (see page seven), the 10-year U.S. Treasury bond yield has declined from

FIGURE 1 Direct Written Premium vs. Full Year ($Millions)



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5.1 percent in 2006 to a first-quarter 2012 low of 1.6 percent. Investment income continues its downward trend for this composite in 2012, even though the invested asset base continues to grow.

As shown in Figure 4, investment income has declined by 20 percent between 2006 and 2011. Total investment income continues to decline even thugh average invested assets during the same time period has increased by more than 15 percent for this composite from $32.2 million in 2006 to $37.1 million last year.

'Pricing pressure continues to be fueled by high surplus levels and the desire to maintain exposures against increasing competition and the physician movement to employment settings that provide self-insured plans.'

Dividends Expected To Grow

Record profitability has boosted the surplus of these MPL insurers from approximately $6.7 billion at year-end 2002 to $14.7 billion at the end of first-quarter 2012. As a result of strong risk-based capital positions, dividend payouts are expected to continue growing (see Figure 5).

Conclusion

The early indications for 2012 suggest that good times will continue for MPL specialty insurers. We expect to see another strong operating margin for this composite in 2012, although it is hard to imagine it will be greater than 40 percent, as it has been the last two years. This is because pricing pressure continues to be fueled by high surplus levels and the desire to maintain exposures against increasing competition and the physician movement to employment settings that provide coverage through self-insured plans.

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FIGURE 3 INDUSTRY YIELD VS. TREASURY BOND YIELD

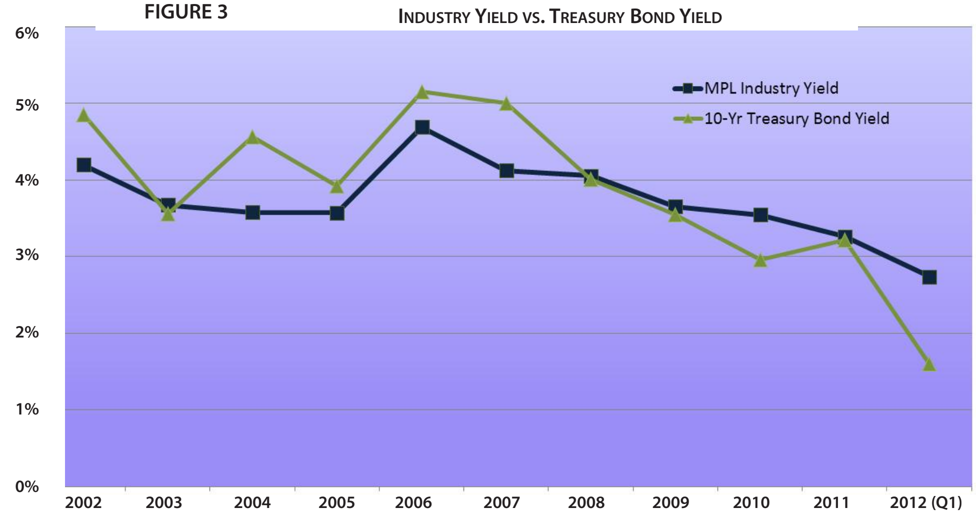

FIGURE 4 INVESTMENT INCOME - 1ST QUARTER VS. FULL YEAR ($MILLIONS)

FIGURE 5 DECLARED POLICYHOLDER AND STOCKHOLDER DIVIDENDS