Fixed Income P&C Reserve Seminar

Liberty Mutual®

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Forward Looking Statements & Basis of Presentation

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Agenda

- Liberty Reserving Methodology & Review Process
- Pros & Cons of Schedule P
- Reasons to Adjust Schedule P
  - Changes in Reinsurance Utilization Across Accident Years
  - Changes in Loss Distributions Related to:
    - Geographic Mix
    - Product Loss Composition
  - Unique Coverages Provided to a Large Customer
- Questions & Answers

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Reserving Methodology & Review Process

- Detailed analysis by SBU actuaries, e.g. by line, product, distribution, state, entity, etc.
- Major line analysis of each SBU by Corporate Actuarial
- Comprehensive quarterly review process
- Internal methodology incorporates more comprehensive data than that provided in Schedule P

***Objective:* Reserve to the Best Estimate**

Pros & Cons of Schedule P

Pros

- Filed by all companies writing business in the U.S.
- Uniform source of data that makes comparisons among insurers achievable

Cons

- Lack of data granularity
- Does not take into account differences in
  - Reinsurance utilization across accident years
  - Changes in loss distributions related to:
    - Geographic mix
    - Product loss composition
  - Unique coverages provided to large customers
- Potential incompatibility of data across accident years

Changes in Reinsurance Utilization

Changes in Reinsurance Utilization

Changes in reinsurance utilization across accident years can materially distort (both favorably and unfavorably) the loss development factors used to estimate a company's required net reserves

FACT: Beginning in 1999, LMG significantly increased its use of workers' compensation treaty reinsurance

Changes in Reinsurance Utilization[1]

Workers' Compensation Premiums Earned Excluding Servicing Carrier Business			
	1	**2**	**3**
(Data in 000)			(2/1)
	Direct & Assumed	Ceded	**Reins. Util %**
1994	3,404,802	272,857	**8%**
1995	2,941,756	252,262	**9%**
1996	2,777,399	253,505	**9%**
1997	2,620,294	201,586	**8%**
1998	2,885,260	255,958	**9%**
1999	2,726,836	445,765	**16%**
2000	2,904,948	554,135	**19%**
2001	2,806,080	494,421	**18%**
2002	3,246,825	671,595	**21%**
2003	3,944,732	605,468	**15%**

Note: The effects of the Servicing Carrier business is excluded to show the change in the Company's reinsurance purchase decisions over the last ten years. Service carrier business is business written on a direct basis and then 100% ceded back to the involuntary pools and associations.

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[1] Based on Liberty Mutual's 2003 Combined Annual Statutory Statement

Overview of Ceded Reinsurance Programs[1]

Workers' Compensation Only

- Traditional Excess of Loss Treaties
  - Coverage Period: 1999 – 2003
  - In 1999, purchased $750,000 excess of $250,000 for middle market business (excluded LDD policies)
  - Beginning in 2000, purchased $9M excess of $1M and $19M excess of $1M (includes LDD policies)
  - 94% of treaties are placed with A+ or better rated reinsurers

- Stop Loss Treaties
  - Coverage Period: 2000 - 2002
  - Cover losses up to $1M per claimant
  - Excludes LDD policies
  - 100% of treaties are placed with A++ rated reinsurers

[1] Commercial Markets only

Treaty Ceded Losses[1]

Workers' Compensation

Accident Year	Paid Losses	Case Reserves	IBNR	Total
1999	$ 17,867	$ 54,450	$ 30,414	$ 102,731
2000	52,828	87,142	89,312	229,282
2001	91,310	261,849	215,499	568,658
2002	3,849	248,499	316,682	569,030
2003	39	34,665	150,334	185,038
	$165,893	$686,605	$802,241	$1,654,739

FACTS:

- Losses relating to treaty purchases are largely IBNR
- As a result, net paid and case incurred reported losses do not reflect the benefit of reinsurance

Ignoring the benefit of these reinsurance treaties will significantly misstate the ultimate liability

[1] Refers to stop loss and excess of loss treaties discussed on page 9.

Example: ABC Company

Impact of Stop Loss Reinsurance on Loss Development

Assumptions

• Premium:	$2,000	A
• Estimated Ultimate Loss Ratio:	70%	B
• Estimated Ultimate Losses:	$1,400	(A x B)

Treaty Terms and Conditions

• Coverage Period:	2001 & 2002
• Loss Ratio Attachment Point:	45%
• Maximum Loss Ratio:	95%

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Example 1: ABC Company

Impact of Stop Loss Reinsurance on Loss Development

Incurred Loss Development as of December 31, 2003

Year	12	24	36	48	60	72	84	96
1996	756	1,042	1,148	1,202	1,231	1,250	1,264	1,275
1997	756	1,042	1,148	1,202	1,231	1,250	1,264	
1998	756	1,042	1,148	1,202	1,231	1,250		
1999	756	1,042	1,148	1,202	1,231			
2000	756	1,042	1,148	1,202				
2001	756	900	900					
2002	756	900						
2003	756							

Year	12 to 24	24 to 36	36 to 48	48 to 60	60 to 72	72 to 84	84 to 96
1996	1.379	1.102	1.047	1.025	1.015	1.011	1.009
1997	1.379	1.102	1.047	1.025	1.015	1.011	
1998	1.379	1.102	1.047	1.025	1.015		
1999	1.379	1.102	1.047	1.025			
2000	1.379	1.102	1.047				
2001	1.191	1.000					
2002	1.191						

Loss development patterns from 2004 National Council on Compensation Insurance, Inc. (NCCI) Annual Stat Bulletin - Countrywide data

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Example 2: ABC Company

Impact of Stop Loss Reinsurance on Loss Development

Incurred Loss Development as of December 31, 2005

Year	12	24	36	48	60	72	84	96
1996	756	1,042	1,148	1,202	1,231	1,250	1,264	1,275
1997	756	1,042	1,148	1,202	1,231	1,250	1,264	1,275
1998	756	1,042	1,148	1,202	1,231	1,250	1,264	1,275
1999	756	1,042	1,148	1,202	1,231	1,250	1,264	
2000	756	1,042	1,148	1,202	1,231	1,250		
2001	756	900	900	900	900			
2002	756	900	900	900				
2003	756	1,042	1,148					
2004	756	1,042						
2005	756							

Year	12 to 24	24 to 36	36 to 48	48 to 60	60 to 72	72 to 84	84 to 96
1996	1.379	1.102	1.047	1.025	1.015	1.011	1.009
1997	1.379	1.102	1.047	1.025	1.015	1.011	1.009
1998	1.379	1.102	1.047	1.025	1.015	1.011	1.009
1999	1.379	1.102	1.047	1.025	1.015	1.011	
2000	1.379	1.102	1.047	1.025	1.015		
2001	1.191	1.000	1.000	1.000			
2002	1.191	1.000	1.000				
2003	1.379	1.102					
2004	1.379						

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Changes in Geographic Mix

Workers' Compensation

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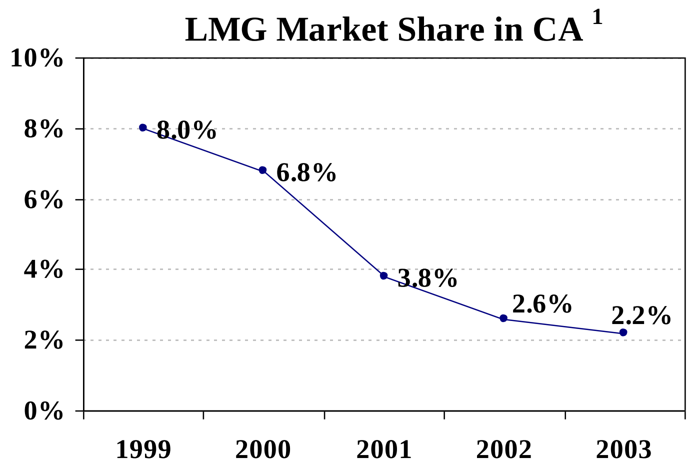
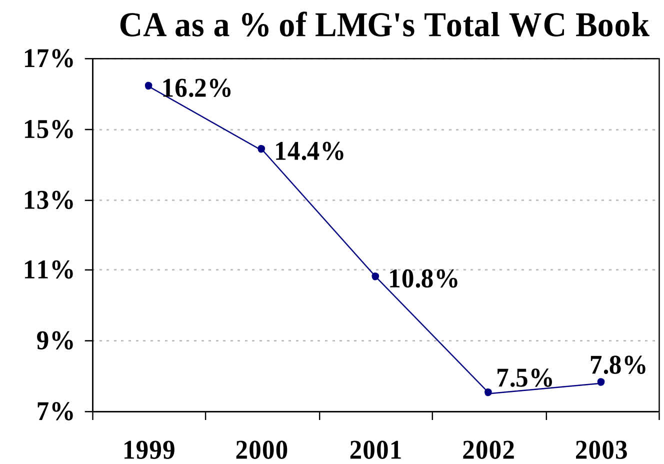
California vs. Non-California Exposure

Workers' Compensation





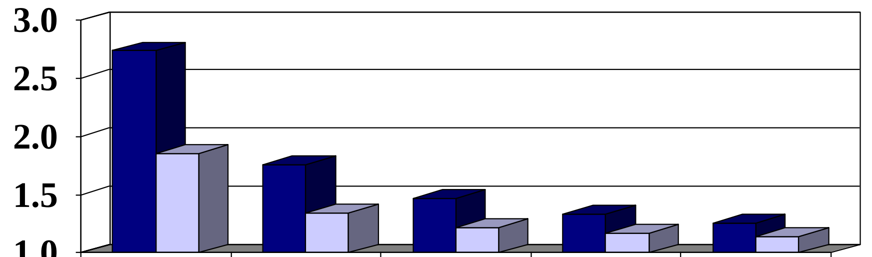
- LMG has proactively decreased its presence in California over the past five years
- Historically, California has seen higher medical severity than the rest of the U.S. From 1998 – 2002, medical severity has increased at an average annual rate of:
  - 17% in California (Source: The Workers' Compensation Insurance Rating Bureau of California (WCIRB))
  - 10% in the NCCI states, which excludes California (Source: NCCI)

[1] Market share includes California State Fund

California vs. Non-California Exposure

Workers' Compensation

Cumulative Two Year Loss Development Factors: Case Incurred



	1st / Ult.	2nd / Ult.	3rd / Ult.	4th / Ult.	5th / Ult.
California	2.739	1.758	1.465	1.337	1.252
Countrywide	1.853	1.344	1.220	1.165	1.137

Source: National Council on Compensation Insurance, Inc.

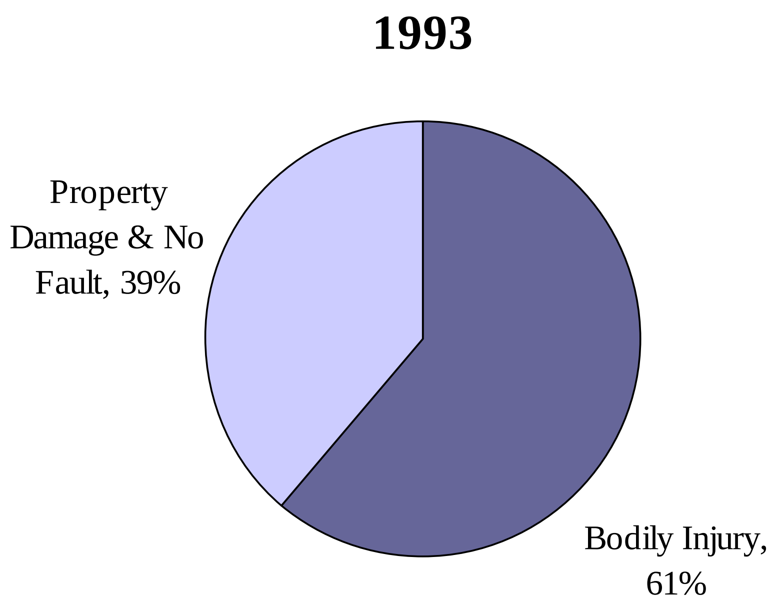
[1] Countrywide excludes independent bureau states (CA, MA, MI, MN, NY, TX, & WI).

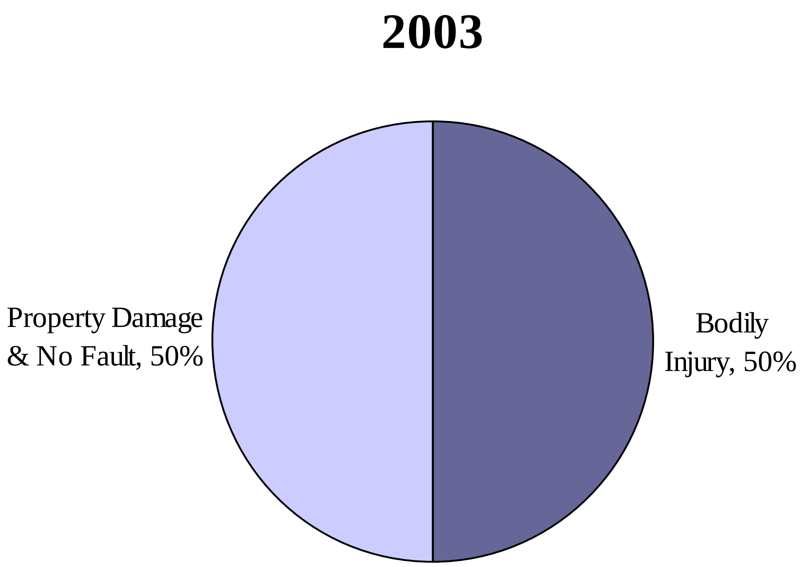
- California loss development is substantially higher than the rest of the country
- The California loss development factors above do not incorporate the recently passed reform
  - The WCIRB estimates industry cost savings of approximately $8 billion on outstanding reserves

Changes in Loss Distribution

Private Passenger Automobile

Changes in Loss Distribution
Private Passenger Automobile





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Changes in Loss Distribution
Private Passenger Automobile

FACTS:

- In the last ten years, LMG's personal automobile line of business has seen a sizable shift in the distribution of losses from <u>bodily injury</u> to <u>property damage and no fault</u>

- Property damage and no fault losses develop faster than bodily injury losses

Ignoring the impact of a shift in loss distribution will significantly misstate the ultimate liability

Example: ABC Company

Impact of Changes in Loss Distributions

A. Schedule P Methodology

Coverage	Incurred Losses @ 12 Months	Schedule P Combined Coverages LDF	Estimated Ultimate Loss
All Personal Auto	$100	1.533	**$153.30**

B. By Coverage Methodology

Coverage	Incurred Losses @ 12 Months	Coverage Specific LDF	Estimated Ultimate Loss
Bodily Injury	$36	2.000	$72.00
No Fault	27	1.150	31.05
Property Damage	37	1.100	40.70
Total	$100	1.438	**$143.75**

C. ***Impact:***

Total A / Total B = Difference in Estimated Ultimate

$153.30 / $143.75 = 1.066 or **6.6% Misstatement**

Adjusting for Unique Coverages

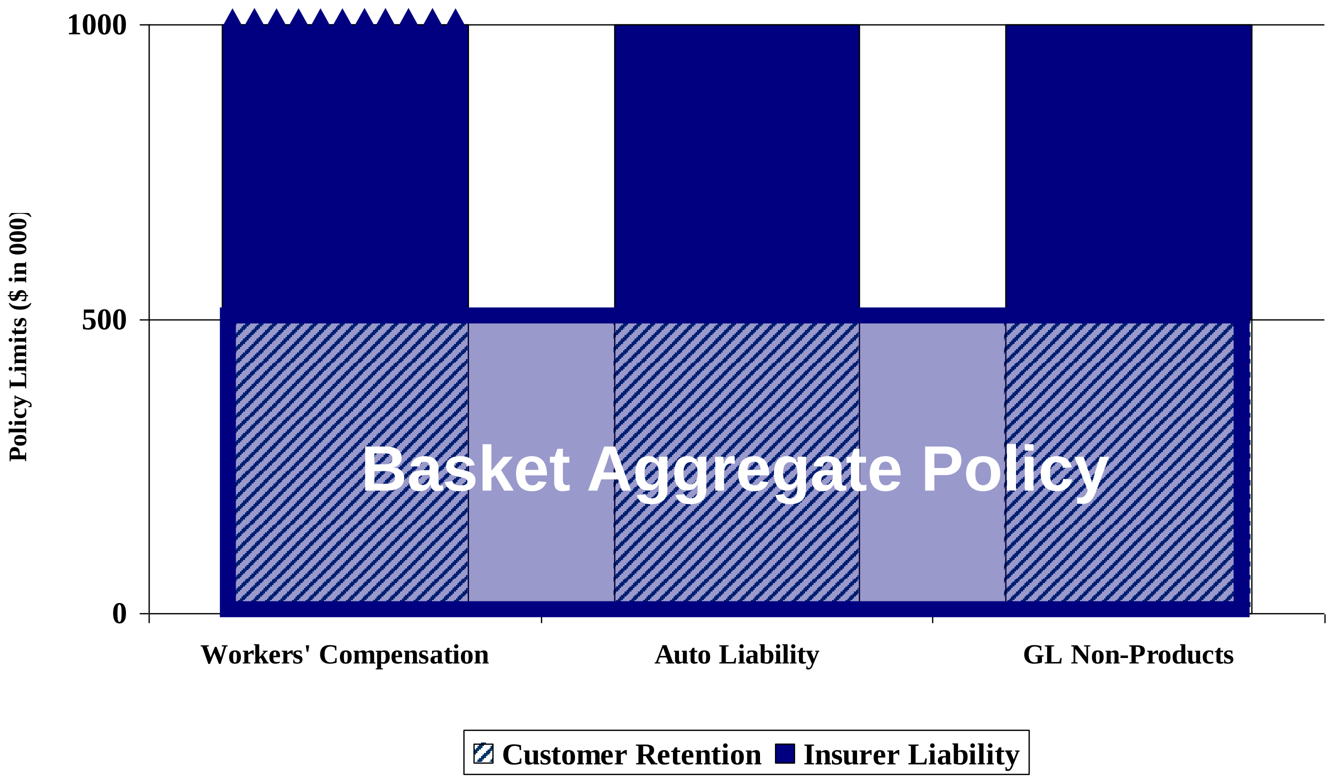
Other Liability Occurrence

Adjusting for Unique Coverages[1]

- Liberty provides a basket aggregate policy to a LARGE customer
- Loss reserves related to this policy represent between 20% and 30% of the total <u>other liability occurrence</u> ultimate losses for accident years 1998 - 2002

[1] Based on Liberty Mutual's 2003 Combined Annual Statutory Statement

Basket Aggregate Policies



Coverage Provided to a LARGE Customer

- *Ultimate losses* for the basket aggregate policy are established as a single case reserve under Other Liability Occurrence

- Failure to isolate the basket aggregate policy will greatly misstate the ultimate reserve by:
  - Increasing early development factors due to the spike between 12 and 24 months when the program is moved to ultimate
  - Overstating ultimate losses by applying incurred development factors to the basket aggregate policy, which is already set at ultimate