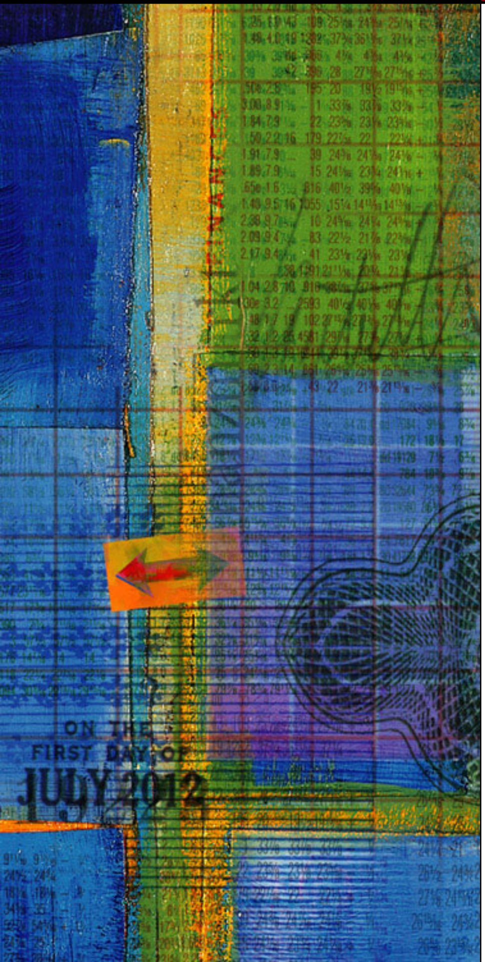
STANDARD & POOR'S



Managing Financial Risks -The Insurance Industry

International Monetary Fund Economic Forum

June 30, 2004

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The McGraw-Hill Companies

Presentation Overview

- Standard & Poor's Rating Process
- Health of Life Insurance Industry
- Tools Used to Assess Risk
- Challenges Ahead

A Key Decision-making Tool for a Wide Audience

A Standard & Poor's rating is considered to be the global benchmark opinion of an insurer's financial strength

- **Buyers of insurance, including consumers, risk managers, and employee benefits managers utilize the ratings to choose coverage**
- **Insurance brokers and agents use the ratings to help them meet professional "due diligence" standards, as an impartial opinion in their marketing efforts, and as a part of their disclosure requirements**
- **Investors and banks look to our ratings in their credit evaluations**
- **Regulators rely on them as an objective tool for effective industry monitoring**

We are an open organization, happy to engage in dialogue about our methodology and models

Rating Definitions

SECURE

AAA
Extremely Strong Financial Security

AA
Very Strong Financial Security

A
Strong Financial Security

BBB
Good Financial Security

VULNERABLE

BB
Marginal

B
Weak

CCC
Very Weak

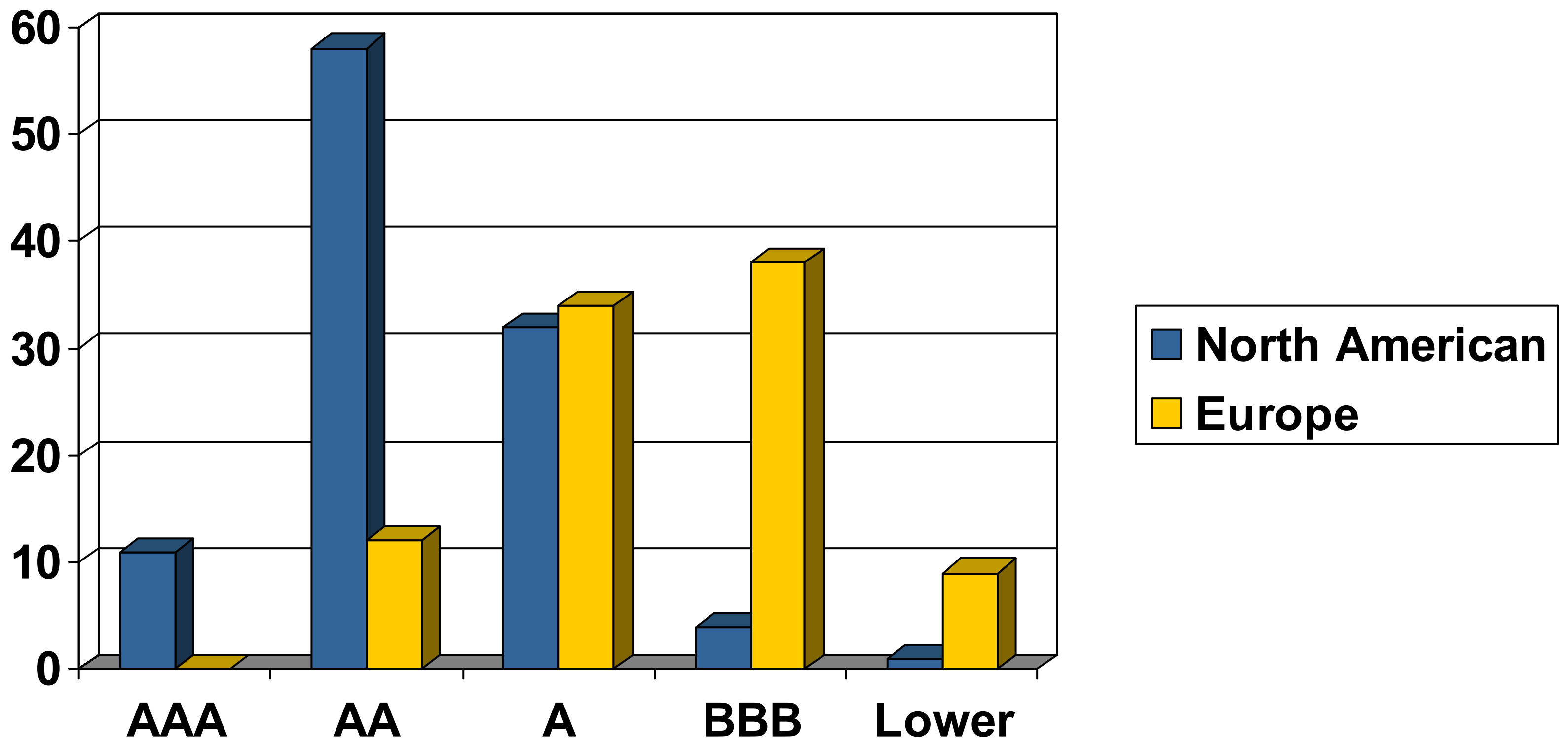
CC
Extremely Weak

Insurance Company Rating Factors of Financial Strength

1. Competitive position
2. Management & corporate strategy
3. Operating performance
4. Investment analysis
5. Capital & reserve adequacy
6. Liquidity / financial flexibility

Rating Distribution of Life Insurance Cos

Ratings as of June 25, 2004



Life Industry Strengths

- **Strong, Recovering Capitalization**
- **Benign Credit Trends and Improved Asset Quality**
- **Gradually Rising Interest Rates**
- **Improved Operating Efficiency**
- **Lessons Learned From Past Economic Stress**

Life Industry Challenges

- Tight Credit Spreads
- Uncertain Interest Rate Outlook
- Flat Equity Markets
- Increasing Product Risk with Reduced Reinsurance Capacity
- Increasing Regulatory Burden
- Evolving International Financial Reporting Standards

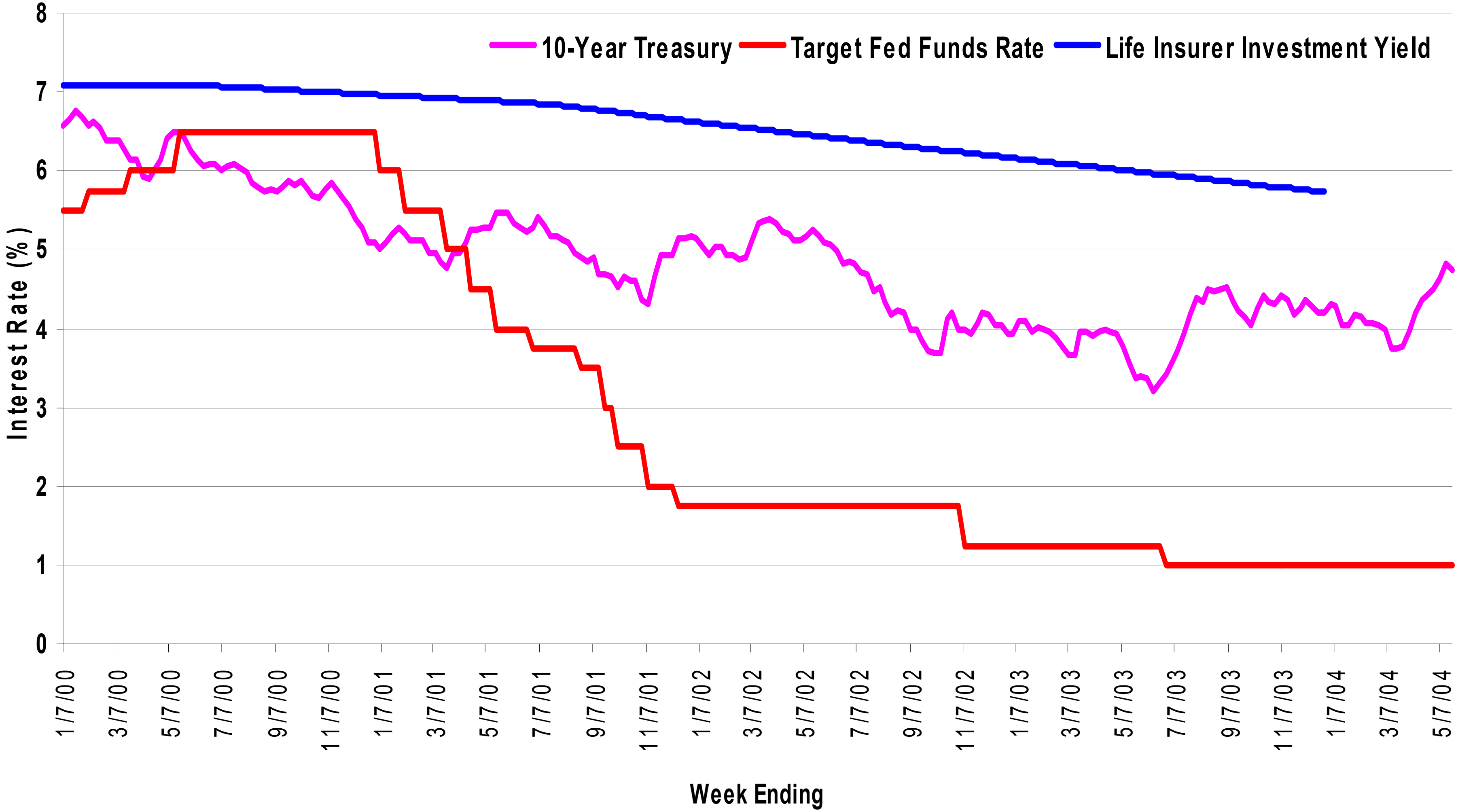
Mid-2004 North American Life Sector Outlook

The outlook for the remainder of 2004 is
***Stable* …but cautious.**

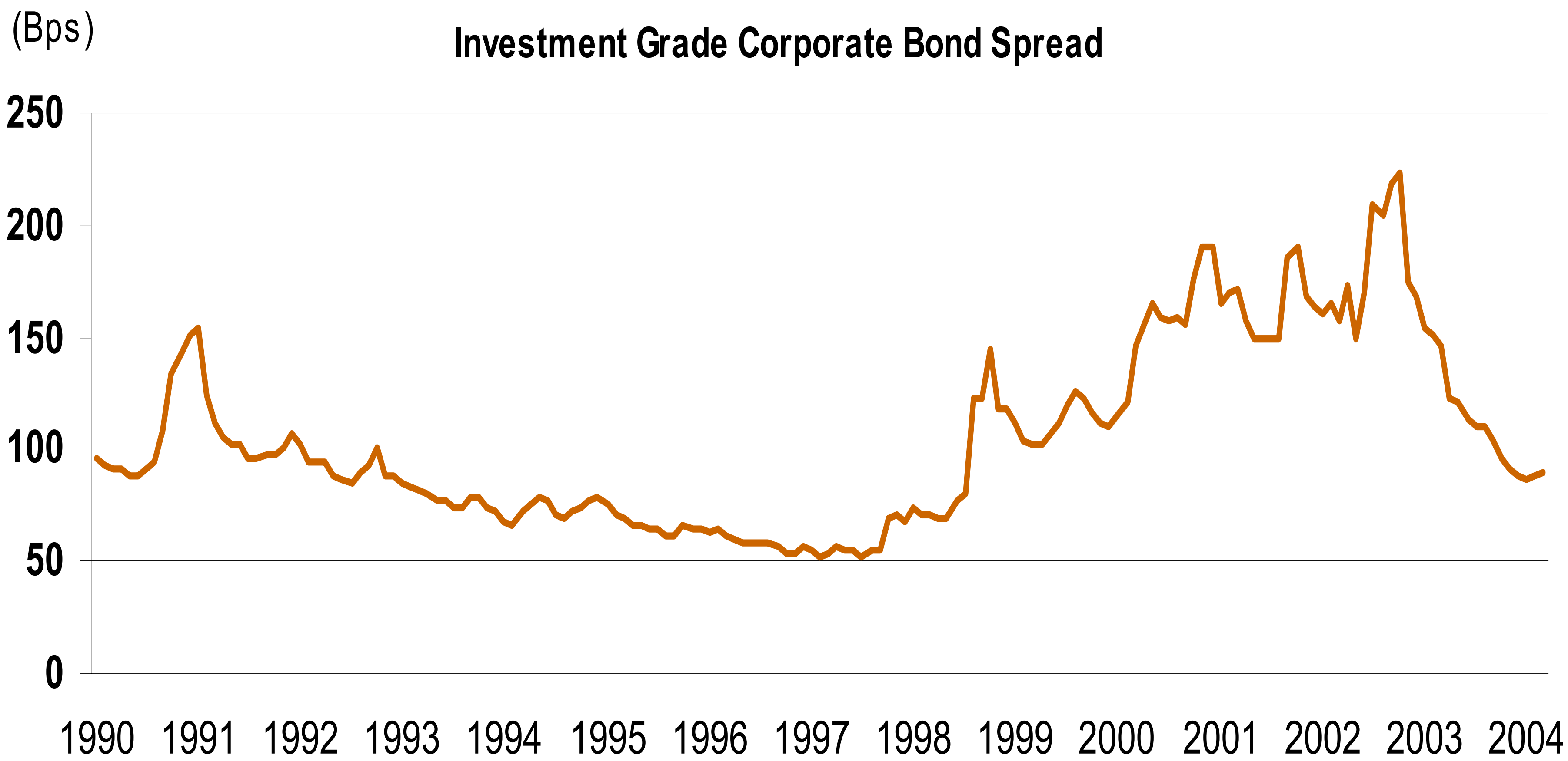
Following nearly two years with a negative outlook, various factors have improved.

- ***Few rating movements are expected over the remainder of the year, with downgrades slightly outpacing upgrades***
- ***Most downgrades will be for company-specific reasons, not macro issues***
- ***Economic stresses have subsided, but material risk remains***

Falling Investment Yields



Corporate Bond Spreads are Tight …But May Have More Room to Fall



Bps--Basis points. Sources: Standard & Poor's Global Fixed Income Research; monthly data

Rising Interest Rates: 1994 Revisited?

Will there be another 3% rise in rates over less than 12 months?

- Fed has given ample warning of impending rise in rates, intention to move gradually – much of the rise is already priced into Treasury rates
- Credit conditions continue to improve – unlike 1994 credit crunch as banks unwound positions
- Lower absolute level of rates dampens impact on borrowing costs

S&P Economic Forecast:	31 Dec 2004	31 Dec 2005
Fed Funds	1.5%	4%
10-year Treasury	4.75%	6%

Rising Interest Rates: Implications for the Industry

- **Near-term reduction in pressure on spread income**
- **Projected gradual rise in rates should have limited adverse impact**
- **Unexpectedly sharp rise still a concern**
- **Rising annuity surrenders – will companies retain spread discipline?**
- **Some companies have extended asset duration to enhance yield in the low rate environment – *These companies are the most at-risk***

In an uncertain rate environment, attention to asset-liability risk management is vital to maintaining financial health!

Standard & Poor's Life Capital Adequacy Ratio (CAR)

Numerator: **Total Adjusted Capital less Asset-related risk charges less credit-related risk charges**

Denominator: **Pricing risk plus Interest rate risk plus Other business risk**

Assessment of capital adequacy	CAR %
Marginal	Below 100%
Good	100%-124%
Strong	125%-149%
Very Strong	150%-174%
Extremely Strong	175% and above

Additional Tools for Refining Capital Allocations

Customized analysis of hedge fund of fund risks including a tailored asset risk charge that replaces the generic charge.

Underwriting large excess of loss property catastrophe exposures warrants a separate risk adjusted capital charge.

Enhanced analytical tool to evaluate insurance financial product companies'(FPC) risks.

New application of FPC model to size the expected risk-based capital adequacy for very discrete portfolios of spread-lending products; some of which, such as annuity contracts, had insurance features.

Quality of Capital is another Important Consideration

Models offer important insights into the level of capital adequacy at a point in time.

However, qualitative measurements will also be incorporated into the overall evaluation of capital strength in relation to the business risks.

Product Risk: On the Rise

Variable Annuity Risk – Ratcheting Up Again

- New types of living benefits (GMAB/GMWB) bringing new risk
- Improved use of hedging – but not universal
- Policyholder utilization – how can you hedge what you don't know?

Universal Life Secondary "No-Lapse" Guarantees

- Pricing is increasingly aggressive, product design is complex
- Companies avoiding "AXXX" statutory reserves
- Impact of future mortality improvements, interest rates?

In both cases, reinsurance is unavailable to help, meaning today's new products maybe tomorrow's major headaches!

Life Reinsurance Market

1997 Rankings

1. **Security Life**
2. **Transamerica Re**
3. **Lincoln Re**
4. **RGA**
5. **Swiss Re**
6. **Life Re**
7. **Phoenix Home**
8. **Allianz**
9. **AUL**
10. **ERC**
11. **BMA**
12. **Munich**

2003 Rankings

1. **Swiss Re** ***(Life Re, Lincoln Re, Cigna Re)***
2. **RGA** ***(Allianz Life Re)***
3. **ING Re** ***(Security Life, Reliastar)***
4. **Transamerica Re**
5. **Munich Re** ***(CNA)***
6. **Scottish Re** ***(parts of ERC, Phoenix Home, AUL)***
7. **Generali Life Re (BMA)**
8. **SCOR Life Re** ***(Partner Re)***

Now 90% of the market covered by only 8 Companies

Source: SOA survey conducted by Munich Re, based on recurring premium business assumed

Life Reinsurer Consolidation

Implications for Primary Companies

- **Reinsurance rates had consistently fallen for a decade – now level to rising**
- **Assembling a diversified panel is increasingly difficult**

  May have to compromise, accepting lower financial strength ratings or higher prices
- **Harder to find adequate capacity**

  Especially true for jumbo cases, and some financial reinsurance
- **Some sub-sectors have only one to three competitors => rates are high**

  Catastrophe, group, long-term care, accident & health
- **Capital markets are an alternative for larger companies**

  Securitization of term insurance and UL reserves; embedded value securitization

Consolidation

More disciplined approach to M&A

- Fewer whole companies – more lines of business
- Sellers deciding to jettison non-strategic lines, focus on core
- Buyers add scale in select businesses, leave undesirable lines behind

Ratings impact:

➢ As companies acquire to add scale in the areas they know without picking up as many potential problems, M&A is likely to be short-term neutral and in some cases long-term positive to acquirers

➢ Longer term, M&A is likely to be negative for those who stay on the outside – small players without competitive advantage who are squeezed by larger, more efficient competitors

Regulatory Risks

Challenges Abound

- **Tax**

  Threats to the Tax Advantages of Life Insurance Products

- **Oversight**

  New York AG, SEC, and NASD Increasingly Active

- **Sarbanes-Oxley**

  Expensive Compliance Burden May be Extended to All Insurers

- **Accounting**

  \- New Challenges Every Quarter Bring Volatility and Confusion

  \+ More Consistent Accounting Standards and Increased Disclosure Will Enhance Comparative Analysis of Financial Performance Globally.