Insurance - Cash Flow and Reserve Insight

A Weekly Report Spotlighting Key Issues Driving Insurance Stocks

Highlighted Analysis:	Other Liability Claims-Made (OLCM) Reserves

Featured Stocks: Chubb, HCC, and Travelers

Issue Summary: Other liability claims-made (OLCM) reserves, which mainly comprise directors and officers insurance, have the potential to be a major swing factor. These reserves are long-tailed, and the ultimate losses are not known for many years and can have wide variability. Reduced directors and officers pricing, a significant increase in claims related to the financial crisis, and a proliferation of nonsecurities class-action claims suggest that reserve development will likely shift.

Conclusion: Our analysis shows that OLCM reserves are in transition. The effect of good accident years (2003 to 2007) will become less prominent, and bad accident years (2008 to 2010) will have a bigger influence. The result is that this OLCM reserve development will go from being additive to earnings to neutral or potentially negative for 2012 earnings.

Stock Implication: This shift in profitability is likely to pressure companies with higher-than-average exposure to OLCM reserves. We are reaffirming our Underperform ratings on Chubb and HCC, as the negative shift in reserve trends has the potential to cause earnings misses. Travelers (rated Market Perform) has relatively less exposure and therefore should have more insulation from adverse OLCM development.

Insurance Trading Pattern:	Financial Sector Correlations During Recent Stock Market Corrections

Trend to Monitor: The markets have experienced a swift sell-off that has taken down nearly every sector to their lows for 2011. Within financial services, that indiscriminate selling pattern appeared to hold true during the third-quarter sell-off, with the majority of subsector index correlation factors ranging from 0.8 to 1.0. Our analysis shows that the insurance brokers are beginning to regain their historical defensive advantage. If the sell-off continues, investors with significant exposure to the financial services sector should be able to realize some diversification benefits from the insurance brokers.

Financial Services¦ **Property & Casualty Insurance**

September 07, 2011

The Chubb Corporation

Stock Rating:	**Underperform**
Company Profile:	**Core Growth**
Symbol:	CB (NYSE)
Price:	$59.33 (52-Wk.: $55-$66)

HCC Insurance Holdings, Inc.

Stock Rating:	**Underperform**
Company Profile:	**Core Growth**
Symbol:	HCC (NYSE)
Price:	$27.53 (52-Wk.: $25-$33)

The Travelers Companies, Inc.

Stock Rating:	**Market Perform**
Company Profile:	**Core Growth**
Symbol:	TRV (NYSE)
Price:	$48.53 (52-Wk.: $47-$64)

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Highlighted Analysis: Other Liability Claims-Made Reserves

Executive Summary

Other liability claims-made (OLCM), which is mainly driven by directors and officers insurance, has the potential to be a major swing factor for Chubb and HCC, with limited impact on Travelers. Statutory reserves for OLCM in 2010 constituted 45.7% and 27.1% of total reserves for HCC and Chubb, respectively; Travelers' OLCM reserves represented only 6.9%. OLCM reserves are long-tailed, and the ultimate losses are not known for many years and can have wide variability. For example, the 2001 accident year industry loss ratio increased from an initial pick of 74.2% to 105.7%. With the increased claim activity from the financial crisis, it is likely that insurers have not fully built into their estimates the skewed downside risk of a surge in high-cost settlements.

Our analysis shows that we are in a transition where results from good accident years (2003 to 2007) will become less prominent as a result of bad accident years (2008 to 2010). On an industrywide basis, development from good years has been a big boost to profits in the last two calendar years. The 2008 to 2010 years are being affected by lower pricing, a significant increase in claims related to the financial crisis, and a proliferation of nonsecurities class-action claims. The result is that this OLCM reserve development will go from being additive to earnings to neutral or potentially negative for 2012 earnings.

Insurance Industry
Statutory Other Liability Claims-Made Loss Ratios (%)

Accident Year	2003	2004	2005	2006	2007	2008	2009	2010
Initial Loss Ratio	66.29	65.92	63.14	64.19	66.85	72.40	70.46	70.10
Loss Ratio @ 12/2010	64.83	46.92	47.08	53.35	62.23	72.57	72.01	70.10
Points of Development	**(1.46)**	**(19.00)**	**(16.06)**	**(10.84)**	**(4.62)**	**0.17**	**1.55**	**NA**

Source: SNL

This shift in profitability is likely to pressure companies with higher-than-average exposure to OLCM reserves. We believe it will cause Chubb and HCC to miss earnings. Travelers has a smaller relative position, but could still be affected. Development will likely be worse in recent years, but uncertainty remains high given the long-tail nature of the OLCM claims. By the end of 2010, only 15%-25% of incurred losses have been paid for the 2009 accident year and 33%-37% for 2008. Adding to the uncertainty is that less than half of financial crisis claims have been resolved, but when these claims are resolved, the average settlement is 3 times higher than other claims. Our estimates (shown below) assume relatively stable claim patterns, although if settlements rise from this period, the impact could be materially worse.

Commercial Insurers
Statutory Other Liability Claims-Made Reserve Summary

	Statutory OLCM % of total GAAP earned premium	Statutory OLCM % of total GAAP net loss reserves	OLCM development % of 2009 EPS	OLCM development % of 2010 EPS	OLCM development % of 2011E EPS	OLCM development % of 2012E EPS
HCC	24.4%	45.7%	-3.9%	-3.9%	-5.5%	-5.4%
TRV	4.4%	6.9%	-1.5%	1.5%	1.9%	0.8%
CB	14.6%	27.1%	12.1%	6.0%	6.0%	4.5%

Source: Company reports, and William Blair & Company, L.L.C. estimates

Featured Stocks:

	Ticker	Rating	Price	2011 EPS Estimate	2012 EPS Estimate	2011 P/E	2012 P/E
CHUBB	CB	Underperform	$60.38	$5.64	$5.42	10.7x	11.1x

Investment Summary: Declining operating cash flow trends provide an early indication of deteriorating fundamentals, which we believe should begin to manifest in reported results during the latter half of 2011 and into 2012. We continue to believe that Chubb will underperform the group, as we do not see a reason for additional multiple expansion given deteriorating fundamentals and tough market conditions.

Impact on Chubb

OLCM favorable reserve development was $404 million in 2009 and $173 million in 2010; we project this to decline to $100 million in 2012. This is a loss of $0.50 compared with 2009 and a $0.11 differential from 2010. This decline in favorable reserve development accompanied by a higher projected accident year loss ratio will depress earnings in 2012. Our projection is for earnings per share to decline from $5.64 in 2011 to $5.42 in 2012.

	Ticker	Rating	Price	2011 EPS Estimate	2012 EPS Estimate	2011 P/E	2012 P/E
HCC	HCC	Underperform	$27.86	$2.63	$2.78	10.6x	10.0x

Investment Summary: Although the stock is down, we recommend that investors steer clear. Pressure from the professional liability book and a higher level of catastrophe-oriented business suggest that return on equity will be lower and potentially more volatile. The stock looks inexpensive at just below book value, but actually remains expensive at roughly 8 times cash flow.

Impact on HCC

HCC's OLCM has seen adverse development in 2009 and 2010 of $21 million and $20 million, respectively, compared with favorable development of $36 million in 2008. This was a shift from $0.20 per share of additional earnings to adverse development subtracting $0.12 of earnings. We project $25 million of adverse development in 2011 and 2012, which will be a $0.15 (5.5%) hit to earnings each year.

	Ticker	Rating	Price	2011 EPS Estimate	2012 EPS Estimate	2011 P/E	2012 P/E
TRAVELERS	TRV	Market Perform	$48.87	$4.07	$6.10	12.0x	8.0x

Investment Summary: On a valuation basis, Travelers remains attractive, but we do not see sufficient positive catalysts to drive the stock higher in the near term. Travelers has the second-lowest price-to-book value of our commercial group, and on a price-to-cash-flow basis, the company remains attractive at only a small premium to the historical five-year median.

Impact on Travelers

The impact on Travelers from deteriorating OLCM will be limited, given the relative exposure Travelers has compared with the other two featured insurers. Travelers had $83 million of adverse development in 2009, which amounted to a hit of $0.09 per share, although 2010 had favorable development, adding $0.09 to EPS. We project $50 million of favorable development in 2011 and $30 million of favorable development in 2012, adding $0.08 (1.9%) to 2011 EPS and $0.05 (0.8%) to 2012 EPS.

OLCM Segment
An OLCM policy provides liability coverage where a claim is reported during the policy period and the claim occurred within the “prior acts date” of the policy. This is different than an occurrence policy, where a claim is covered as long as the damage occurred during the policy period, even if it is reported after the policy period. Just about all professional liability policies are written on a claims-made basis because of the difficulty in evaluating exposures on an occurrence basis owing to the long-tail nature of the line.

Insurance Industry
Other Liability Claims-Made (Total Filed)

2010 Rank	Institution	2010 Direct Premiums Written ($000)	2010 Market Share (%)
1	American International Group	3,131,683	17.54
2	Chubb Corp.	1,591,839	8.92
3	CNA Financial Corp.	1,395,620	7.82
4	XL Group plc	1,064,965	5.97
5	Travelers Companies Inc.	993,507	5.57
6	Zurich Financial Services Ltd	913,404	5.12
7	ACE Ltd.	835,174	4.68
8	HCC Insurance Holdings Inc.	619,174	3.47
9	AXIS Capital Holdings Ltd.	536,855	3.01
10	Hartford Financial Services	452,049	2.53
	Total OLCM Market	**17,852,637**	**100.00**

Source: SNL

AIG (AIG $23.32) is the biggest player in the OLCM market at 17.6% market share, followed by Chubb at 8.9% and CNA (CNA $22.60) at 7.8%. Among the top 10, only AIG and AXIS (AXS $27.35) increased their market share in the OLCM market since 2009; all others experienced modest declines.

The table below shows the accident year loss ratios in OLCM for the top 10 companies in the market. The accident year results are as of report date December 2010, so the older years are based on a larger number of years of development than newer years; that is important to note when comparing accident years. Results for all the top carriers have deteriorated significantly in the 2007 through 2010 accident years, as claims have increased while pricing has been soft.

Insurance Industry
Other Liability Claims-Made
Statutory Accident Year Loss Ratios
Report Date December 2010

Accident Year	AIG	CB	CNA	XL	TRV	ZURN	ACE	HCC	AXS	HIG	Industry
2001	120.0%	112.9%	99.2%	82.4%	111.0%	126.9%	140.6%			118.6%	105.7%
2002	98.7%	117.4%	104.4%	83.3%	94.7%	91.8%	163.9%	58.6%		102.2%	93.9%
2003	61.8%	68.2%	74.0%	30.7%	74.5%	93.8%	63.5%	26.2%	43.2%	57.5%	64.8%
2004	42.3%	46.9%	53.6%	33.7%	43.7%	59.7%	37.1%	37.9%	49.6%	36.9%	46.9%
2005	45.4%	49.8%	52.0%	42.8%	44.2%	47.0%	38.9%	39.6%	40.1%	34.6%	47.1%
2006	51.8%	63.0%	53.1%	46.1%	59.0%	67.3%	52.5%	46.9%	58.9%	36.5%	53.4%
2007	62.6%	68.2%	60.7%	62.7%	61.3%	79.1%	63.1%	63.5%	86.8%	43.5%	62.2%
2008	72.8%	79.2%	76.3%	75.4%	82.8%	95.4%	82.0%	74.9%	90.5%	55.6%	72.6%
2009	75.9%	75.5%	70.0%	71.6%	68.1%	88.3%	70.0%	67.9%	73.0%	63.4%	72.0%
2010	77.1%	70.8%	69.3%	67.5%	66.0%	87.7%	69.5%	61.5%	68.4%	62.0%	70.1%

Source: SNL

OLCM Reserve Trends

Insurance Industry
Other Liability Claims-Made
Incurred Loss Ratios by Accident Year (%)

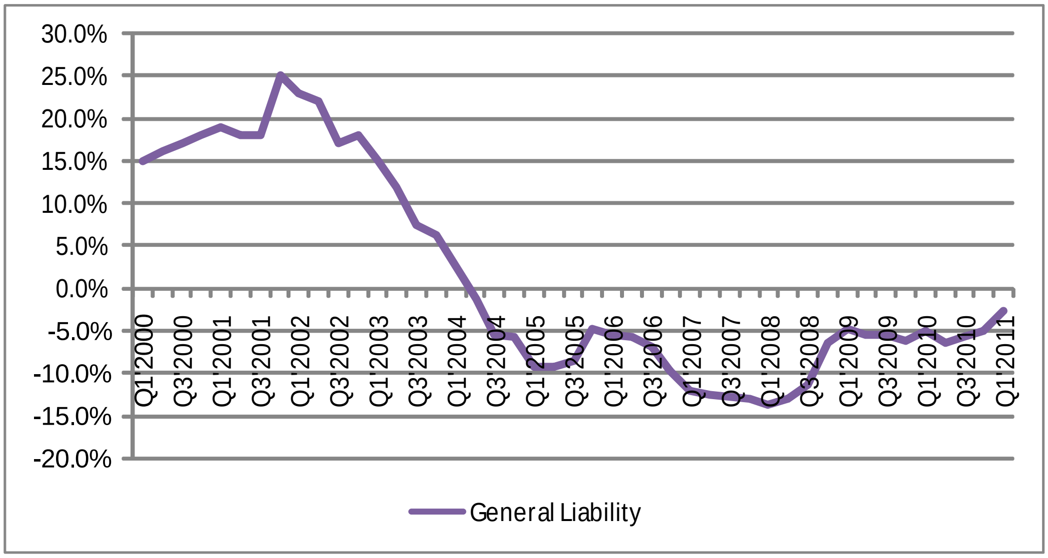
Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months	Points of Development
2001	74.17	74.80	82.31	92.59	102.77	104.61	105.14	105.66	106.56	105.68	31.51
2002	68.93	68.72	77.84	88.64	92.93	94.64	94.76	94.08	93.86		24.93
2003	66.29	63.85	64.68	64.39	64.64	64.56	64.66	64.83			(1.46)
2004	65.92	58.15	55.62	53.90	49.30	47.22	46.92				(19.00)
2005	63.14	57.74	55.74	51.04	48.09	47.08					(16.06)
2006	64.19	63.32	59.57	55.64	53.35						(10.84)
2007	66.85	65.98	64.92	62.23							(4.62)
2008	72.40	75.12	72.57								0.17
2009	70.46	72.01									1.55
2010	70.10										0.00

Source: SNL

The incurred loss ratio triangle above shows that industry results have been deteriorating since 2004; 2008 marked the first accident year in which there was adverse development, and that was off an initial loss ratio pick that was 5 points higher than 2007. The 2009 and 2010 accident years have also had high initial loss ratio picks (70.5% and 70.1%). One surprise is that even though the industry experienced adverse development on the 2008 accident year at 24 months, the industry still underestimated 2009 accident year losses at 12 months and took an adverse development of 2 points at 24 months. OLCM is a long-tail line that can have high volatility. The 2001 and 2002 accident years developed from initial loss ratio picks of 74.2% and 68.9% to 105.7% and 93.9%. It took six years before the full extent of that adverse development was realized. This shows why conservatism and caution must be taken when pricing and reserving for this line of business.

The CIAB pricing survey shows that general liability rate declines started in 2004 and dropped to nearly -15% in 2007 on an annual basis. The pricing is still negative in 2010 and first quarter 2011 despite the poor underwriting results of 2008-2010 accident years. The rate declines have slowed but are still negative, and we expect pricing to be negative for another two years. The pricing has been softer in casualty than other lines as a result of the delay in when the insurer will know the final cost of goods sold. This market becomes very dangerous at pricing inflection points due to several years of the business being underpriced before the insurer realizes the rates are inadequate. Once the insurer sees that losses are worse than expected and tries to raise rates, there will already be many accident years of loss reserves on its balance sheet, which will experience adverse development (or not as favorable development), thus depressing earnings. The large favorable development for the accident years 2004-2006 has been supporting earnings today, but it is unlikely that the 2007-2010 years will experience the same kind of development, so future calendar-year combined ratios are likely to deteriorate.

Insurance Industry
CIAB Pricing Survey
Annual Rate Change



Source: CIAB

The paid-to-incurred-loss ratios have increased for the 2008-2010 accident years, signifying that on a paid basis, the incurred losses are understated relative to the 2004-2007 accident years for how much has been paid out so far. Paid losses are useful to look at because with the exception of a few issues like changes in settlement pattern policies by the insurance company, they are unaffected by either the claim adjuster or actuary estimates. The 2001 and 2002 accident years had significantly higher paid-to-incurred ratios than 2004-2006 accident years at 12, 24, and 36 months, and the results turned out to be much worse. The paid-to-incurred ratio for 2008-2010 is not quite as bad as 2001-2002, but it suggests that results are deteriorating more than what is reflected in the incurred triangle.

Insurance Industry
Other Liability Claims-Made
Paid to Incurred Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	8.41	33.89	53.14	67.68	72.92	77.91	82.77	87.53	89.95	92.91
2002	9.28	29.30	48.63	61.84	72.30	78.43	85.32	89.50	93.09	
2003	5.54	22.16	40.42	56.38	66.59	76.67	83.48	88.04		
2004	4.54	18.03	34.14	50.96	65.54	75.02	82.76			
2005	4.23	17.37	33.87	52.90	66.93	77.04				
2006	5.24	18.41	38.92	55.39	68.50					
2007	5.33	21.22	38.25	55.47						
2008	7.21	24.07	43.05							
2009	6.29	23.69								
2010	5.92									

Source: SNL

Reported losses are the amounts estimated by the claims adjusters in the insurance claims department for each claim. These claims estimates are then sent to the actuary, and the actuary puts an extra loss estimate on top called a bulk and IBNR reserve, which sums to an incurred loss. For our purposes here, we will define bulk and IBNR reserve as IBNR. Looking at reported losses can be quite useful for identifying trends that we are unable to see from the incurred loss number due to it including actuarial projections.

On a reported-to-incurred basis, the 2008-2010 accident years have been slightly higher than years before at 12 months, and there is a noticeable increase at 24 and 36 months. A higher reported-to-incurred ratio means the actuaries are including less IBNR at the report date as a percentage of incurred loss. A lower IBNR number suggests that there is not as much reserving conservatism in recent years compared with the 2004-2006 accident years.

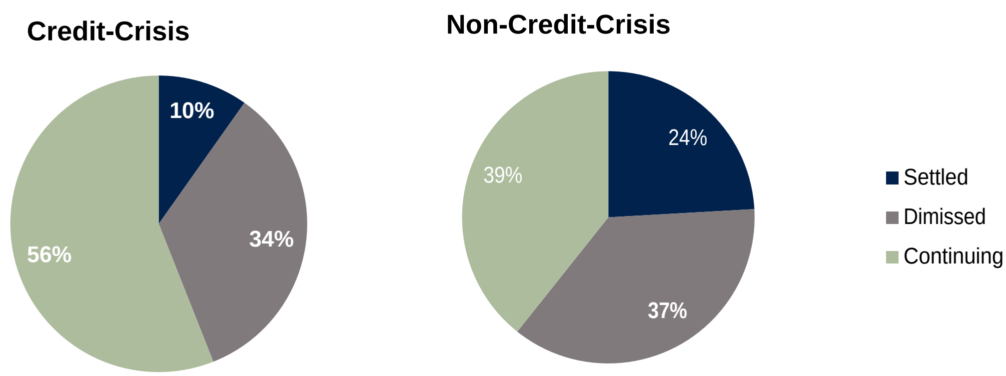
Insurance Industry
Other Liability Claims-Made
Reported to Incurred Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	33.33	60.79	78.54	88.77	87.05	89.79	93.10	94.82	95.52	96.15
2002	27.75	55.54	77.94	82.55	87.66	90.43	93.54	95.51	96.37	
2003	18.73	44.24	62.56	75.56	83.15	87.59	91.93	94.32		
2004	17.00	35.45	55.28	66.64	78.62	85.71	90.01			
2005	17.15	36.37	52.73	68.42	78.60	86.38				
2006	16.19	36.16	54.88	69.43	78.74					
2007	17.41	39.00	55.91	70.68						
2008	18.63	41.64	59.14							
2009	18.95	43.59								
2010	18.38									

Source: SNL

The figure below shows there is evidence that D&O claims filed during the 2007-2009 recession differ based on whether they were directly related to the credit crisis or not. A recent Cornerstone research piece suggests that credit crisis claims are not only taking longer to settle, but also settling for nearly triple the amount of non-credit-crisis claims.

D&O Insurance Study
Credit-Crisis vs. Non-Credit-Crisis Filings (2007-2009)



Settlement Amounts ($MM)

Average: $103
Median: $31

Average: $32
Median: $10

Source: Cornerstone Class Action Filings Study 2010, Cornerstone Class Action Settlements Study 2010

The Chubb Corporation
OLCM reserves should provide less benefit to Chubb's earnings going forward. Chubb benefited greatly in 2008 and 2009 from reserve development in the OLCM line with $215 million and $404 million of favorable development, respectively. This effectively increased by an average of 8% in the last three years. The benefit to earnings should decline to below 5% by 2012. We project $150 million of favorable development in 2011, followed by $100 million of favorable development in 2012, and this could worsen if claim patterns deteriorate.

Chubb Corporation
Financial Impact of OLCM Prior Year Reserve Development
(dollars in thousands except per share data)

	2008	2009	2010	2011E	2012E
OCLM earned premium (Statutory)	1,784,678	1,742,942	1,639,231	1,622,839	1,557,925
OLCM reserve development (Statutory)	-215,907	-403,589	-173,723	-150,000	-100,000
% of OCLM earned premium	-12.1%	-23.2%	-10.6%	-9.2%	-6.4%
% of total development	24.7%	53.0%	23.3%	24.0%	30.5%
Per share impact of OLCM development	$0.38	$0.74	$0.35	$0.34	$0.24
% of earnings per share	6.9%	12.1%	6.0%	6.0%	4.5%

Sources: Company reports, SNL, and William Blair & Company, L.L.C.

Given the long-tailed nature of the line of business and a shift in claim patterns, historical data is not as useful as for analyzing other lines of business. The financial crisis in 2008 has led to many professional liability claims that will likely not develop in the same way as claims did for the 2004-2005 accident years. We estimate that Chubb's statutory OLCM reserves for the 2001-2010 accident years are redundant by $671 million, or 12.9% of OLCM reserves. Our estimated reserve of $4.537 billion compares with the company selection of $5.207 billion. Our low end of the reserve range has redundancy of $984 million, or 18.9% of company selected OLCM reserves. The high end of our estimate is a deficiency of $257 million, or 5.0% of reserves. The financial crisis has brought a new type of claim that was not as common historically, and as these claims work through the courts, it is possible that the historical years (even 2001-2002) may not be a reliable indicator for how the recent accident years' reported and paid losses develop.

Chubb Corporation
Other Liability Claims-Made
Incurred Loss Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months	Points of Development
2001	79.20	83.34	91.76	99.40	109.46	113.98	111.86	112.28	112.53	112.92	33.72
2002	89.42	97.77	108.48	114.51	116.68	117.36	119.72	117.83	117.37		27.95
2003	78.14	76.33	70.71	71.47	68.29	68.24	68.56	68.19			(9.95)
2004	70.97	68.76	63.19	59.98	53.60	47.51	46.88				(24.09)
2005	71.28	66.62	64.52	58.09	51.11	49.78					(21.50)
2006	72.28	71.95	70.11	65.54	62.99						(9.29)
2007	72.63	74.21	71.56	68.24							(4.39)
2008	78.22	79.06	79.23								1.01
2009	75.80	75.47									(0.33)
2010	70.75										0.00

Source: SNL

Chubb's 2004-2005 accident years have developed quite favorably, with 24 and 21 points of favorable development each. This slowed noticeably for the 2006-2007 accident years, and the 2008 accident year actually experienced adverse development as well as a higher initial loss ratio pick of 78.2%. The 2009 accident year improved from 2008; however, it is still higher than the initial picks of 2004-2007. The 2010 accident year initial loss ratio pick is surprisingly below every accident year for the past 10 years. On an industry basis, 2010 was the fourth-worst accident year loss pick of the past 10 years. The industry's initial loss pick was flat from 2009 to 2010 compared with Chubb's improvement of 5 loss ratio points.

Chubb's paid-to-incurred ratios have increased in accident years 2006-2010 compared with 2004-2005. This means there are less case + IBNR reserves at the same point in time as a percentage of incurred loss than during the highly profitable years, which is another data point suggesting that there will not be as much favorable reserve development for the most recent accident years.

Chubb Corporation
Other Liability Claims-Made
Paid to Incurred Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	7.25	25.78	41.31	56.60	69.24	72.99	80.50	85.28	89.47	91.98
2002	4.30	23.50	42.73	58.61	68.60	80.37	86.62	91.44	94.53	
2003	2.77	13.79	30.17	47.27	60.38	72.61	78.68	84.13		
2004	2.24	13.32	26.12	43.04	58.51	72.66	78.44			
2005	2.20	11.99	28.63	45.17	60.42	71.36				
2006	2.54	15.05	33.66	49.56	64.51					
2007	2.47	13.74	30.76	45.50						
2008	5.45	17.54	33.45							
2009	2.79	15.11								
2010	4.60									

Source: SNL

The paid loss ratios have also jumped compared with 2004-2005 at each reporting period for accident years 2006-2010. This shows that results are deteriorating not only from an actuarial estimate (incurred) perspective, but from a paid claims perspective, which is not subject to the same adjustments. With the worsening results, it will be tougher for Chubb to release reserves from the 2006-2010 accident years to support calendar-year earnings like it did with the 2004-2005 accident years. Without the help of prior-year reserve releases, Chubb’s earnings will decline and the stock price will likely be affected.

Chubb Corporation
Other Liability Claims-Made
Paid Loss Ratios

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	5.74	21.49	37.91	56.26	75.80	83.20	90.05	95.75	100.67	103.87
2002	3.84	22.97	46.35	67.11	80.04	94.32	103.70	107.75	110.95	
2003	2.16	10.52	21.33	33.78	41.24	49.55	53.95	57.36		
2004	1.59	9.16	16.51	25.82	31.36	34.53	36.77			
2005	1.57	7.99	18.47	26.24	30.88	35.52				
2006	1.83	10.83	23.60	32.48	40.63					
2007	1.79	10.19	22.01	31.05						
2008	4.26	13.87	26.51							
2009	2.11	11.40								
2010	3.25									

Source: SNL

HCC Insurance Holdings, Inc.

The financial impact of OLCM prior-year reserve development has been -$0.12 a year for 2009 to 2010, and we expect this to continue, with it cutting $0.15 from EPS in 2011 and 2012. The professional liability segment has already had roughly $16 million of adverse development in the first half of 2011, so our full year 2011 adverse development OLCM projection of $25 million could be optimistic.

HCC Insurance Holdings, Inc.
Financial Impact of OLCM Prior Year Reserve Development
(dollars in thousands)

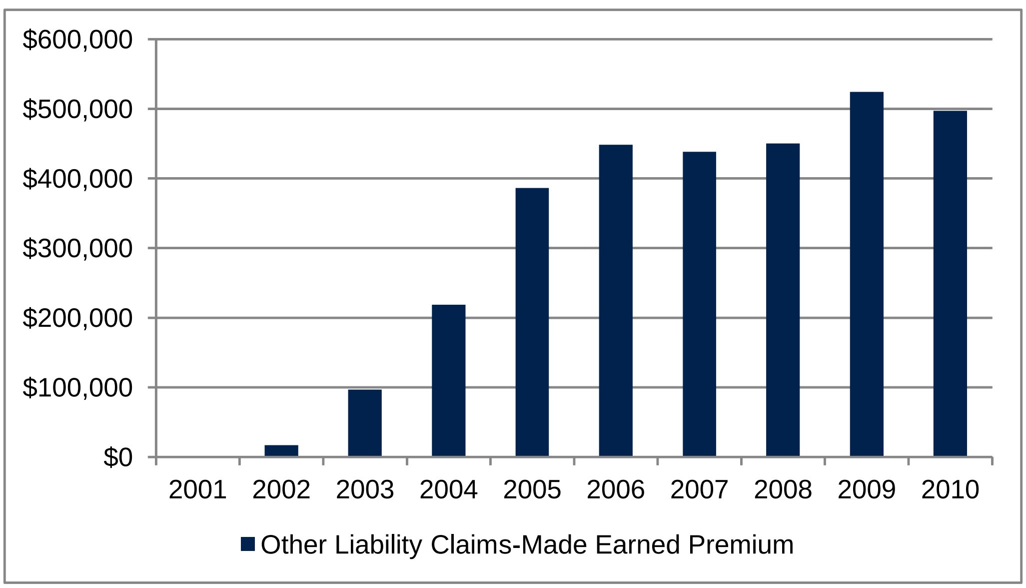
	2008	2009	2010	2011E	2012E
OCLM earned premium (Statutory)	450,266	524,545	497,453	477,555	468,004
OLCM reserve development (Statutory)	-36,306	20,836	20,408	25,000	25,000
% of OCLM earned premium	-8.1%	4.0%	4.1%	5.2%	5.3%
% of total development (GAAP)	44.1%	-38.9%	-90.0%	277.8%	188.0%
Per share impact of OLCM development	$0.20	-$0.12	-$0.12	-$0.15	-$0.15
% of earnings per share	7.3%	-3.9%	-3.9%	-5.5%	-5.4%

Sources: Company reports, SNL, and William Blair & Company, L.L.C.

We estimate HCC's statutory OLCM reserves for the 2001-2010 accident years to have a deficiency of $49 million, or 4.2% of OLCM reserves. The limited data available on HCC's OLCM line of business because of its recent entry into the market makes this analysis more difficult than with more established insurers that have 10-plus years of data. Our selected reserve of $1.203 billion compares with the company selected reserve of $1.155 billion. We estimate a low- and high-end range of $150 million plus or minus from our estimate, which would give a redundancy of 8.8% ($101 million) at the low end and 17.2% deficiency ($199 million) on the high end.

HCC is the eighth-largest player in the U.S. statutory OLCM market, with $619.1 million of 2010 direct written premiums. On a net earned basis, the company has grown from $17.2 million in 2002 to $497 million in 2010. It did not write this line of business in 2001. A concern with any company entering a new long-tailed line of business is the inexperience from a claims and reserving perspective that HCC has relative to Chubb, which has been in this line for a long time. OLCM represents 25% of HCC's 2010 earned premium and is at least 45% of HCC's reserves (HCC has some OLCM internationally that does not show up in statutory and is not split out in the 10-K). Professional liability alone represents 43% of HCC's total net reserves. HCC made a major play in the OLCM segment and it will be a significant driver of the extent of its profitability over the next few years.

HCC Insurance Holdings, Inc.
Other Liability Claims-Made Statutory Earned Premium
(dollars in thousands)



Source: SNL

HCC's OLCM statutory incurred loss triangle below shows that the 2003-2006 accident years experienced material favorable development; however, the 2007-2009 accident years have had adverse development. The initial loss picks are also higher for the 2007-2010 accident years compared with 2003-2006. It is important to keep in mind that the earned premium for 2002 and 2003 is very small as HCC was just entering the line, so those accident years are not particularly useful for calculating ultimate losses for the 2005-2010 accident years. Of the top eight OLCM players, HCC is the least experienced in this line and has less data from which to predict how its claims will ultimately cost. HCC has written a lot of professional liability insurance for financial institutions, which saw an increase in claims due to the financial crisis; however, results had been deteriorating since 2006 and the 2010 initial loss pick is higher than any year prior to 2008. This suggests that the soft pricing of the long-tailed liability markets, in addition to the increase in claims from the financial crisis, has affected HCC's profitability.

HCC Insurance Holdings, Inc.
Other Liability Claims-Made
Incurred Loss Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months	Points of Development
2001	NA	NA	NM	NM	NM	NM	NM	NM	NM	NM	XXX
2002	49.10	49.14	42.08	37.16	5.80	35.49	32.30	30.74	58.64		9.54
2003	49.56	50.23	56.04	53.41	38.29	40.05	31.06	26.22			(23.34)
2004	52.67	50.60	52.79	44.96	39.90	38.94	37.88				(14.79)
2005	52.12	52.57	51.97	44.89	39.99	39.58					(12.54)
2006	55.88	55.30	52.00	47.38	46.85						(9.03)
2007	57.06	60.66	65.46	63.48							6.42
2008	61.61	72.82	74.91								13.30
2009	62.96	67.88									4.92
2010	61.50										0.00

Source: SNL

The increase in loss ratio has been seen industrywide; however, the adverse development from initial loss ratio picks for HCC has been larger than the industry. The 2007-2009 accident years for HCC have all experienced adverse development at the 24-month period, which is not a good sign. This contrasts with the industry's cumulative favorable development in 2007, followed by minute adverse development in 2008 (at 36 months) and 1.5 points of adverse development in 2009. The mix of business HCC has is different from the industry, so these numbers are not directly comparable; for example, HCC has a much higher proportional exposure to professional liability for financial institutions.

HCC Insurance Holdings, Inc.
Other Liability Claims-Made
Incurred Loss Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	Points of Development
2006	55.88	55.30	52.00	47.38	46.85	(9.03)
2007	57.06	60.66	65.46	63.48		6.42
2008	61.61	72.82	74.91			13.30
2009	62.96	67.88				4.92
2010	61.50					0.00

Insurance Industry
Other Liability Claims-Made
Incurred Loss Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	Points of Development
2006	64.19	63.32	59.57	55.64	53.35	(10.84)
2007	66.85	65.98	64.92	62.23		(4.62)
2008	72.40	75.12	72.57			0.17
2009	70.46	72.01				1.55
2010	70.10					0.00

The table below shows the prior-year reserve development for the GAAP professional liability segment and OLCM statutory line of business for HCC on a calendar-year basis. Some differences between the two are that the GAAP professional liability segment includes international professional liability premium, while the statutory line of business does not, and the OLCM includes some other casualty premium that is not included in the professional liability GAAP segment. Even with these differences, it sheds light on where the business is trending, especially for the U.S. portion, which has had significant adverse development the past two years. The professional liability segment has seen adverse development for 2010 and the first half of 2011, a stark difference from moderate favorable development in 2008 and essentially no development in 2009. The U.S. OLCM had 8% of favorable development in 2008, followed by 4% adverse development in 2009 and 2010. On an overall company basis, the amount of favorable development declined in years 2008 through 2010, and became unfavorable in the first half of 2011.

HCC Insurance Holdings, Inc.
Calendar Year Unfavorable (Favorable) Prior-Year Reserve Development
(dollars in thousands)

	2008	2009	2010	2011 Q1	2011 Q2
Professional Liability (GAAP)	-18,675	-674	9,624	5,000*	10,800*
% of Professional Liability earned premium	-5.2%	-0.2%	2.3%	5.0%	10.5%
U.S. Other Liability Claims-Made (Statutory)	-36,306	20,836	20,408	NA	NA
% of OLCM earned premium	-8.1%	4.0%	4.1%	NA	NA
All Lines of Business (GAAP)	-82,371	-53,524	-22,663	9,000	13,300
% of total GAAP earned premium	-4.1%	-2.6%	-1.1%	1.8%	2.5%

* Estimated based on earnings release / conference call

Source: Company reports, SNL, and William Blair & Company, L.L.C.

The Travelers Companies, Inc.

The financial impact of OLCM reserve development on Travelers' overall business is minimal. In 2010, it contributed only $0.09 to EPS, representing just 1.5% of the company's overall operating EPS. We project that future OLCM reserve development will add $0.08 and $0.05 per share to 2011 and 2012 operating EPS, respectively.

The Travelers Companies, Inc.
Financial Impact of OLCM Prior Year Reserve Development
(dollars in thousands)

	2008	2009	2010	2011E	2012E
OCLM earned premium (Statutory)	962,582	982,672	934,462	887,739	869,984
OLCM reserve development (Statutory)	-2,112	82,652	-68,221	-50,000	-30,000
% of OCLM earned premium	-0.2%	8.4%	-7.3%	-5.6%	-3.4%
% of total development	0.1%	-6.2%	5.5%	6.0%	6.3%
Per share impact of OLCM development	$0.00	-$0.09	$0.09	$0.08	$0.05
% of earnings per share	0.0%	-1.5%	1.5%	1.9%	0.8%

Sources: Company reports, SNL, and William Blair & Company, L.L.C.

Our estimate of Travelers' statutory OLCM reserve redundancy is $126 million. This represents 5.1% of OLCM reserves, or 13.5% of 2010 OLCM statutory earned premium. This analysis was conducted on the accident years 2001 through 2010. A big swing factor will be how the 2008 through 2010 accident years develop. The 5.1% overall OLCM redundancy incorporates a net deficiency of $1 million total for 2008-2010 (-0.2% of 2008-2010 reserves). If 2008-2010 accident year reserves were to be found deficient by 10%, this would cause the overall OLCM reserves to be deficient by $32 million.

Travelers is the fifth-biggest player in the U.S. OLCM market, with $993,507 of 2010 direct written premiums. Despite its large market share, this line of business represents only 4.3% of Travelers' 2010 net earned premium.

Travelers' OLCM has seen significant deterioration in loss ratio for 2008 through 2010. The line of business benefited greatly over time from the favorable development from the 2004 and 2005 accident years, and since then has not seen any meaningful favorable development, and has seen adverse development in accident years 2008 and 2009. The loss ratios have increased steadily since the 2004-2005 period; with the soft casualty pricing, they are likely to get worse.

The Travelers Companies, Inc.
Other Liability Claims-Made
Incurred Loss Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months	Points of Development
2001	70.24	57.17	80.85	96.36	103.52	107.23	110.77	115.74	115.05	111.02	40.78
2002	62.23	54.64	86.77	95.49	101.88	100.44	93.47	95.38	94.66		32.43
2003	57.78	52.66	60.21	70.01	72.54	73.24	72.87	74.50			16.72
2004	64.62	53.87	53.66	54.14	48.68	44.90	43.74				(20.88)
2005	58.59	53.42	54.24	53.73	46.47	44.24					(14.35)
2006	58.08	60.89	65.55	59.53	59.01						0.93
2007	62.49	60.62	66.97	61.33							(1.16)
2008	66.32	86.97	82.79								16.47
2009	65.37	68.06									2.69
2010	66.02										0.00

Source: SNL

The paid-to-incurred ratios are consistent for the recent accident years with the exception of 2009, which has a 26% paid-to-incurred ratio at 24 months, compared with an average of 22% for the previous four accident years. This suggests that the reserve for this year may be light and that more adverse development in this line of business is possible.

The Travelers Companies, Inc.
Other Liability Claims-Made
Paid to Incurred Ratios by Accident Year (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	5.27	37.83	47.01	59.72	70.36	75.28	78.33	78.36	83.24	88.09
2002	7.11	37.34	42.72	54.91	64.64	72.54	79.47	82.57	86.21	
2003	4.96	20.55	49.51	60.92	72.47	76.61	84.19	84.29		
2004	2.72	16.89	37.60	49.45	66.33	78.72	87.56			
2005	4.00	23.79	41.53	54.43	72.66	83.51				
2006	5.78	20.63	37.96	51.62	63.73					
2007	5.52	22.41	36.11	51.71						
2008	7.42	19.48	37.00							
2009	5.61	26.38								
2010	5.57									

Source: SNL

Insurance Trading Pattern: Financial Sector Correlations During Recent Stock Market Corrections

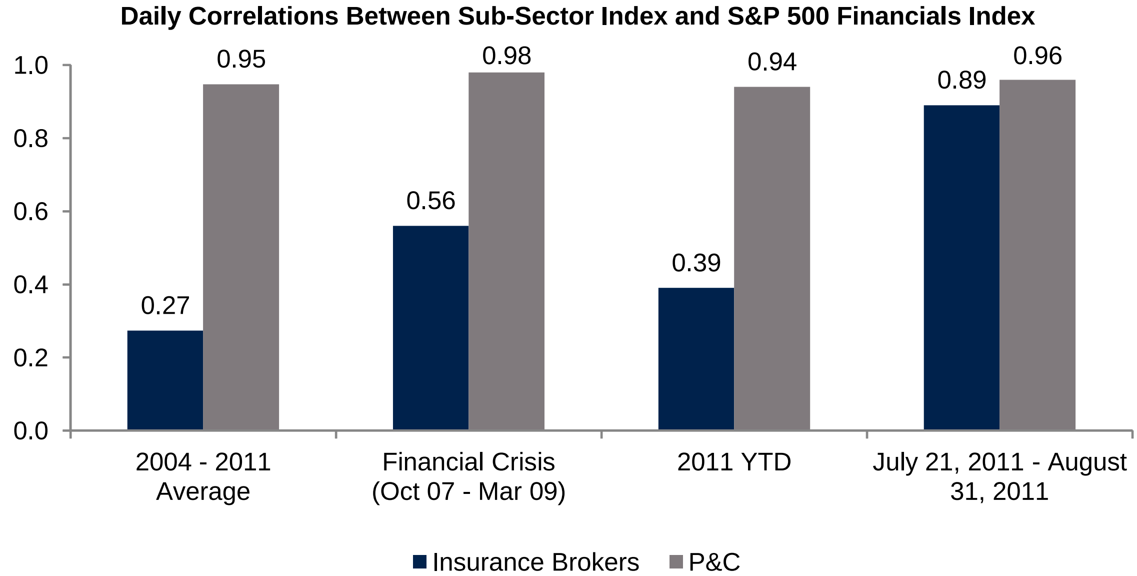
As the European sovereign debt crisis has again come into focus during the third quarter, the markets have experienced a swift sell-off that has taken down nearly every sector to their lows for 2011. During these periods marked by extreme volatility and panic selling, correlations between asset classes and between sectors within equities tend to rapidly approach 1. Within financial services, that indiscriminate selling pattern appeared to hold true during the third-quarter sell-off, with the majority of correlation factors ranging from 0.8 to 1.0.

Daily Correlation Matrix Between S&P Indices
(July 21, 2011 - August 31, 2011)

	S&P 500 P&C Insurance Index	S&P 500 Insurance Brokers Index
S&P 500	0.97	0.93
S&P 500 Financials	0.96	0.89
S&P 500 Capital Markets	0.92	0.82
S&P 500 Banks Index	0.94	0.87
S&P 500 Investment Banks & Brokerages Index	0.90	0.77
S&P 500 Asset Management & Custodian Index	0.94	0.87
S&P 500 Insurance	0.98	0.89
S&P 500 Life & Health Insurance Index	0.93	0.80
S&P 500 P&C Insurance Index	1.00	0.94
S&P 500 Insurance Brokers Index	0.94	1.00

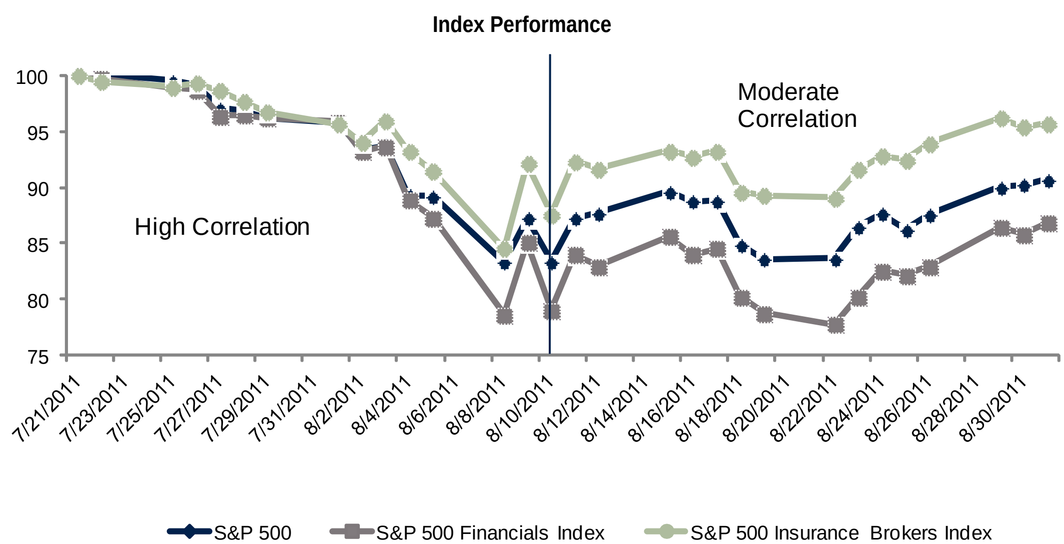
Source: Thomson, William Blair & Company LLC

Historically, however, the insurance brokers have been a fairly defensive segment in the financial services sector, especially compared with P&C insurance stocks. On average, the Insurance Brokers Index has had only a 0.27 correlation with the overall S&P financials since 2004. Even during the financial crisis, the correlation between the brokers and the rest of the financials was only 0.56. P&C insurance stocks, on the other hand, have had extremely high correlations to the overall financial services sector, through both downturns and strong performance in the marketplace.



Note: Historical Correlation from 2004-2011 is based on weekly pricing data
Source: Thomson, William Blair & Company LLC

Insurance brokers have not been hit nearly as hard as other financials during the recent downturn in the markets, primarily because they have few to no investment assets and thus have little exposure to the sovereign debt crisis. As the market continues to find its footing over the remainder of the third quarter, we would view the brokers as a more defensive subsector in financial services. We believe that investors with significant exposure to the financial services sector should be able to realize some diversification benefits from the insurance brokers as they retreat back to correlation levels more in line with their historical average, and we would expect them to hold up better than many other financial subsectors, particularly P&C insurance stocks.



Source: Thomson, William Blair & Company LLC

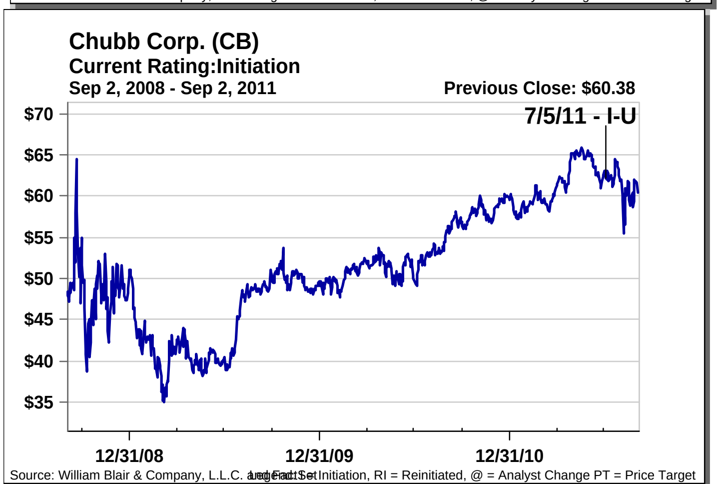
Insurance Industry: Cash Flow and Reserve Insight
William Blair Insurance Universe Performance
(Week of 9/4/2011-9/10/2011)

PERFORMANCE UPDATE:

	Stock Fundamentals							Stock Performance								Estimates			
	Ticker	Market Cap	Rating	Current Price 9/5/11	52-Week Range High		52-Week Range Low	Week Ending 9/5/11	MTD	QTD	YTD	March 9, 2009[1] to Date	P/E 2011E	P/E 2012E	Price to Book	William Blair 2011 EPS Estimate	Consensus 2011 EPS Estimate	William Blair 2012 EPS Estimate	Consensus 2012 EPS Estimate
S&P 500 Index				$1,173.97	$1,370.58		$1,091.15	0%	-9%	-11%	-7%	74%							
S&P Financials Index				$168.53	$158.91		$231.20	-2%	-15%	-19%	-22%	101%							
S&P Insurance Index				$156.09	$151.86		$202.30	-1%	-12%	-16%	-17%	104%							
Insurance Brokers																			
AON Corporation	AON	14645.59	Outperform	$44.83	$54.58	-	$37.40	-3%	-7%	-13%	-3%	16%	13.3x	11.3x	1.8x	$3.38	$3.40	$3.97	$3.85
Arthur J. Gallagher & Co.	AJG	3058.62	Market Perform	$27.18	$31.92	-	$24.29	-2%	-3%	-5%	-7%	75%	20.4x	16.2x	2.8x	$1.33	$1.35	$1.68	$1.76
Brown & Brown, Inc.	BRO	2854.18	Market Perform	$19.97	$27.07	-	$18.19	-2%	-8%	-22%	-17%	28%	18.2x	16.9x	1.9x	$1.10	$1.12	$1.18	$1.26
Marsh & McLennan Companies, Inc.	MMC	15702.77	Market Perform	$28.99	$31.57	-	$23.40	0%	-2%	-7%	6%	61%	15.2x	12.9x	2.5x	$1.91	$1.82	$2.24	$2.17
Willis Group Holdings PLC	WSH	6523.63	Outperform	$37.70	$42.42	-	$30.29	-1%	-8%	-8%	9%	100%	13.3x	10.6x	2.5x	$2.83	$2.87	$3.55	$3.33
Average Insurance Broker								-2%	-6%	-11%	-2%	56%	16.1x	13.6x	2.3x				
Commercial Insurers																			
AmTrust Financial Services, Inc.	AFSI	1381.4	Outperform	$23.05	$24.74	-	$13.44	2%	-1%	1%	32%	234%	7.9x	7.7x	2.0x	$2.90	$2.82	$3.00	$2.87
The Chubb Corporation	CB	17264.13	Underperform	$60.38	$66.00	-	$55.39	2%	-3%	-4%	1%	73%	10.7x	11.1x	1.2x	$5.64	$5.72	$5.42	$6.08
HCC Insurance Holdings, Inc.	HCC	3064.6	Underperform	$27.86	$33.12	-	$24.66	-1%	-8%	-12%	-4%	37%	10.6x	10.0x	1.0x	$2.63	$2.56	$2.78	$3.01
National Interstate Corporation	NATL	423.06	Market Perform	$21.76	$24.36	-	$18.66	-3%	-3%	-5%	2%	49%	11.5x	10.5x	1.4x	$1.90	$1.84	$2.08	$2.08
RLI Corp.	RLI	1276.78	Market Perform	$60.59	$66.53	-	$50.86	1%	-4%	-2%	15%	40%	12.1x	12.1x	1.8x	$5.01	$5.09	$5.02	$4.29
The Travelers Companies, Inc.	TRV	21053.87	Market Perform	$48.87	$64.17	-	$46.62	1%	-11%	-16%	-12%	46%	12.0x	8.0x	0.9x	$4.07	$4.02	$6.10	$6.01
Tower Group, Inc.	TWGP	944.1	Market Perform	$22.90	$27.86	-	$20.00	5%	0%	-4%	-11%	4%	8.8x	7.4x	0.9x	$2.61	$2.62	$3.10	$3.12
Average Commercial Insurer								1%	-5%	-8%	-2%	35%	11.0x	9.6x	1.2x				
Insurance Services																			
The Crawford Company	CRD'B	310.27	Outperform	$6.62	$8.39	-	$2.35	-4%	-8%	-6%	95%	-2%	9.6x	8.7x	3.9x	$0.69	$0.72	$0.76	$0.60
Fortegra Financial Corporation	FRF	103.93	Market Perform	$5.05	$12.20	-	$4.88	-5%	-35%	-36%	-54%	NA	8.0x	6.6x	0.9x	$0.63	$0.67	$0.77	$0.90
Average Insurance Services								-4%	-21%	-21%	20%	-2%	8.8x	7.6x	2.4x				

William Blair & Company, L.L.C. is a market maker in the security of The Chubb Corporation, HCC Insurance Holdings, Inc., and The Travelers Companies, Inc. and may have a long or short position.

Additional information is available upon request.



Current Rating Distribution (as of 08/31/11)

Coverage Universe	**Percent**	**Inv. Banking Relationships***	**Percent**
Outperform (Buy)	59	Outperform (Buy)	8
Market Perform (Hold)	31	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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