MARKETPLACE REALITIES

SOLID FOOTING AND A FOUNDATION FOR GROWTH

2012
SPRING UPDATE

Willis

MARKETPLACE REALITIES

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Marketplace Realities is updated semi-annually.

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MARKETPLACE REALITIES

INTRODUCTION

A QUESTION OF VALUE

What can you say about a marketplace that last year withstood the second highest total of insured losses ever – fairly handily? A marketplace that remains well capitalized (at around half a trillion dollars) despite a recovering global economy struggling to pick up significant momentum? A marketplace that shows little inclination toward uniform firming in accordance with historical soft/hard market patterns – even as loss ratios jump up past 100 from the mid-90s for many insurers?[1]

You can say that rates are coming up for CAT-prone Property risks. You can say that an aging population will increase Liability risks and that rising health care costs are also exerting pressure on the Casualty side. You can say that the tornadoes keep coming and, after a winter without much snow in most of the country, it's tougher than ever to predict Mother Nature.

You can also say that while those who don't learn from history may be condemned to repeat it, those who expect the same patterns to continue forever may be severely disappointed.

So can anything be said about this marketplace in a general sense that is useful? We think so. We think this is a good moment to take a broad perspective.

As the recession began to take hold in 2007, the demand for insurance began to fall. With less business, there is less to insure. At the same time, supply was strong and rates fell – and premiums declined on both accounts. With several years of relatively benign catastrophic losses, surplus kept the market on a gently softening trajectory. What does this tell us about the marketplace today?

To find an answer we asked our Marketplace Realities authors, specialists in their product areas, this question: If, in 2007, a risk cost $100 to insure, what would it cost to insure that same risk today?

As you'd expect, answers varied by line and by sector (and we exclude the benefits side, where ongoing health care cost increases create a different kind of story). But the years of gently softening trajectory were not so gentle on the average cost of risk, pushing it down to a rough average of $70 – a decline of 30%.

Put another way, that means a 30% cut in premium income. Even as a very rough estimate and an oversimplification, that is a startling number. For most companies a steady decline like that precipitates some drastic action – mergers, acquisitions, price jumps, overhauls. There has been some of that, but from what we see much less than anticipated.

Why? One reason is the nature of insurance itself. Insurance (and reinsurance) is built on the pooling and spreading of risk, within each insurer, but also between all the insurers.

That changes the competitive landscape. In many industries, a five-year decline of 30% for one company means a huge incline for its competitors; one company's loss is often another's gain as market share is the beginning and the end of the game. In the insurance industry, demand for products and the impact of major losses are in many ways shared. Competition is real and drives a focus on quality and service in the way that competition should at its best. But insurance companies are like separate boats riding in the same seas. Some sail better, some faster, and they may have differing destinations and designs; but when the storms come they all have to ride it.

Through reserve reduction, cost containment, streamlining – through belt-tightening and good management – the insurance industry outlasts the storms.

There's another fundamental factor at work here, too. The role of the insurer is to *make sure* they survive the storms so that when their clients need them, they will be here. What insurers offer, what they are selling, in the end, is their own resilience.

We suggest that risk managers and others in charge of risk mitigation and risk transfer may benefit by taking a similar view of your own work. That, ultimately, is your job as well: ensuring resilience. You are not here simply to make sure that when things break they are fixed – although that is certainly an important part of it. You are here to make sure that your organization can ride your storms, in whatever form they may arrive.

So as rates may rise here and there and you may need to do something you have not done in several years – present unpleasant news at budget time – keep in mind not just the cost but the value of what you're buying. You've been paying less – in many cases much less – for things that are hard to put a price on: protection, resilience and the freedom from risk that allows you to take chances and achieve what you and your stakeholders want most to achieve.

As always, we will bring to bear every resource we have to help give you the greatest possible protection, resilience and freedom from risk at the best possible price. That is how we bring value as a broker and risk adviser, and we look forward to delivering that value as we face the uncertain seas ahead.

Joe Plumeri
Chairman & CEO
Willis Group

[1] Fitch: Catastrophe Losses Pressure U.S. Property/Casualty Insurers 2011 GAAP Underwriting Results, March 14, 2012, **www.fitchratings.com**.

MARKETPLACE REALITIES

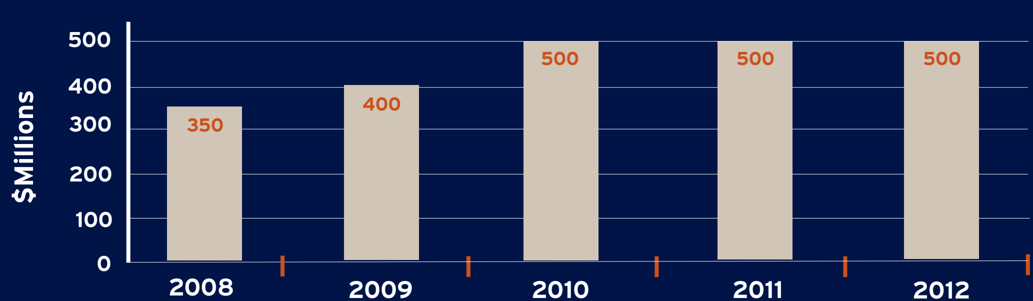
PROPERTY

- 2011 was a challenging year for the Property insurance market in the wake of several mega-disasters, led by the earthquake/tsunami in Japan and including an earthquake in New Zealand, flooding in Thailand, a record-setting tornado season in the U.S. and Hurricane Irene.
- **Global Property losses totaled $108B, second only to $123B in 2005, resulting in many insurers posting combined loss ratios in excess of 100%**.
- Interest rates, meanwhile, remained anemic, meaning little investment income to counter the underwriting results.
- RMS 11.0 model was released in February 2011 and most carriers began implementing it by the start of the Q3. The new loss projections for windstorm and storm surge increased by 40-60% (and sometimes more) for exposed coastal areas. Underwriters were forced to either increase the price for their windstorm capacity or reduce the amount of capacity they were providing. Renewals during the first half of 2012 will feel the effects.
- Reinsurance costs continue to rise.
- **Although rates for CAT risks are rising in 2012, abundant capacity and the continuing weak economy have tempered the upward pressure**.
- CAT-exposed accounts saw rates climb an average of 5-10% in Q4, but we did notice more increase in the 10-15% range. This trend has continued into Q1 2012.

PRICE PREDICTIONS

Type of Accounts	2012 Q1 Forecast
Non-CAT	Flat
CAT (or poor loss experience)	+7.5% to +12.5%

"CAT" PROPERTY CAPACITY ON LARGE "CAT" ACCOUNTS



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CASUALTY

- **More than 75% of insureds are seeing modest rate increases on renewal**. Gradual increases in revenues and rating exposures are putting upward pressure on premiums.
- As in other primary Casualty lines, underwriters are pushing for higher retentions.
- Underwriters are putting a greater emphasis on the quality of financials in setting collateral and pricing.
- Many Workers' Comp carriers are trying to balance their portfolios by writing additional Liability lines. The marketing of Liability accounts continues to provide opportunities to minimize the impact of rate increases.
- Umbrella underwriters are asking for higher underlying limits in many cases.
- Underwriters are showing less flexibility on coverage. For example, we have seen carriers adding exclusions for Sports Team Participants Liability and EMF while being less willing to grant Waiver of Subrogation endorsements where they are not already included in the form.

PRICE PREDICTIONS

+Flat% to +7.5%

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UMBRELLA AND EXCESS

- **Approximately 75% of insureds are seeing rate increases for umbrella renewals and about half are also experiencing rate increases for their excess liability layers**. It to be expected that market firming would have less impact on excess layers than on umbrella coverage as carrier attachments move further from potential risk.
- As previously stated, umbrella underwriters are, in many cases, requiring higher underlying Auto and GL attachments on renewal.
- Capacity remains stable but occasionally lead carriers want to move to a first excess position, and others that were comfortable in the first excess layer are considering higher layers of attachment.
- **More restrictive coverage terms in the primary layer may carry through to the umbrella and excess layers, as many umbrellas are utilizing a follow-form approach**.

PRICE PREDICTIONS

Umbrella	+2.5% to +7.5%
Excess	Flat to +7.5%

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WORKERS' COMPENSATION

- **About 90% of insureds are experiencing rate increases on renewals**. This continues to be most prevalent in California and the Northeast.
- **Almost 50% of clients are seeing increases in their experience mods**; very few are seeing decreases in their mods. (See the recently released Willis briefing document on the new NCCI mod calculations available at www.willis.com.)
- Payrolls in some sectors are also expanding as the economy begins to improve.
- Increased rates, premium modifiers and payroll are driving increases in Workers' Comp premiums.
- Healthy market competition is still delivering positive premium results for many buyers.
- Premium increases in guaranteed cost programs are leading more buyers to investigate loss-sensitive rating plans, higher retentions and self-insurance.
- With fewer market options, the stand-alone Excess WC marketplace is becoming somewhat less competitive on pricing and coverage terms.

PRICE PREDICTIONS

+2.5 to +7.5%

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AUTO

- **Approximately 80% of insureds are experiencing rate increases on renewal**.
- Auto Liability continues to generate a steady flow of severe losses for many large underwriters.
- Accurate reporting of fleet by type of vehicle, good loss experience and ongoing loss control are critical to favorable renewal efforts.
- Underwriters are pushing for larger retentions for those with loss-sensitive programs and retentions for other insureds with moderate to large fleets that had been on guaranteed-cost programs.
- Umbrellas are pushing for higher underlying auto attachments, which must be addressed by increasing primary limits or purchasing buffer excess layers from markets willing to offer them.

PRICE PREDICTIONS

Flat to +10%

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MARKETPLACE REALITIES

EMPLOYEE BENEFITS

- Employers are now focused on elements of the health care reform law that will become effective in the next few years but are frustrated by the lack of timely guidance from the government agencies charged with implementing the law.
- Attempts by federal and state politicians to amend or repeal the health care reform law continue. The U.S. Supreme Court heard legal challenges to the law in March and a decision is expected in June.
- **The cost of insurance is continuing to rise as insurers pass down the costs of complying with the health care reform law**. The recently published **Willis Health Care Reform Survey** bears this out, with employers indicating that complying with health care reform mandates raised their costs by as much as 5%.
- **Variables such as delivery system reforms are creating significant uncertainty and as a result cost trend estimates by the experts vary from +5% to over +10%**.
- Employers are actively seeking more aggressive cost containment strategies in an effort to stem the rising costs of health care. **More employers are considering self-insurance options and shifting a greater portion of the costs to employees**.
- The correlation between improving employee health and reducing health care costs is causing interest in wellness programs to grow. Employers with existing programs are making greater investments in them.
- Economic pressures continue to thwart employer efforts to offer competitive total reward programs.
- More employers have decided to forgo the grandfathered status provided by the health care reform law for plans that remain unchanged, as cost-cutting plan design changes remove the protected status.
- **While some employers may still be uncertain about the future, health care reform has stopped few employers from providing benefits to their employees**.

PRICE PREDICTIONS

+8%

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MARKETPLACE REALITIES

CYBER RISK

- The market for stand-alone Cyber policies remains competitive, with **rates flat to down 5% for renewals. With increased losses, a few markets are looking for slight increases over expiring premiums**.
- **First-time buyers should still find a competitive environment**, though the range between insurers may narrow if losses mount.
- More stringent privacy laws in the U.S., Europe and other countries have multinational corporations addressing the risk enterprise-wide.
- New markets have entered the space.
- Several markets have revised their policies, bringing in more robust data breach response services, Payment Card Industry (PCI) fines coverage, and other enhancements.
- More markets are putting up excess limits, building capacity for large placements, while the competition is driving down the price.
- Insureds that buy Errors & Omissions (E&O) policies are often able to add Cyber risk by endorsement. Exceptions include financial institutions.
- A new SEC guideline recommends that financial reports address exposure to Cyber attacks, the potential disruption of computer networks, and how public companies will respond financially to the potential loss.
- Both Houses of the U.S. Congress have filed amendments to the Homeland Security Act seeking certain Cyber security requirements/compliance for corporations that make up the financial and utility infrastructure (i.e., banks, power grids, etc.). The concern is about potential Cyber attack disruption of thousands of businesses and, consequentially, the economic system.
- 450 privacy breaches were reported publically in 2010, down from 612 in 2009. Stolen laptops were involved in 19% of the breaches and 61% were the result of external intrusion, according to the Open Security Foundation. **Despite the decline in the number of privacy breaches, the overall cost of Cyber crimes continues to rise**.

PRICE PREDICTIONS

Renewals	Flat to -5%
First-Time Buyers	Competitive

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MARKETPLACE REALITIES

DIRECTORS & OFFICERS (D&O)

- **Primary D&O price decreases are becoming less common for public company coverage as carriers are mandating flat renewals when they are not seeking modest increases. In certain sectors, private companies and nonprofits are seeing small price increases**.
- Capacity, meanwhile, remains constant, with no new entrants into the marketplace for commercial (non-financial) risks. **We expect competition to drive single-digit reductions in excess pricing where minimum premiums have not already been reached**.
- Capacity for financial services firms remains stable as carriers respond to the unexpected financial demise of two major options and commodity traders.
- Coverage enhancements for public companies that were first made available at a price in 2010 will be rolled into placements in 2012 at no additional premium.
- **The most significant product changes are in the area of investigations. Limited coverage is most often available for individual directors and officers rather than the companies**.
- Despite the fact that reinsurance does not play a large role in either the pricing or terms and conditions for D&O insurance, it is consistently cited as a reason for carriers to refuse to write multiyear deals for for-profit companies. The cost of reinsurance on other coverage lines and the cost of catastrophic Property losses may also be driving the increased discipline in D&O underwriting.
- As derivative and opt-out D&O claims become more common, global claim settlements grow more complex and costly.
- More companies are looking at independent directors-only coverage or increasing the limits that they carry in this top segment of their D&O tower.
- Another major D&O trend is the expansion of global programs to incorporate local placements (where non-admitted coverage is not permitted).
- As the lead A-Side D&O carriers seek to differentiate their product offerings, look their way for coverage innovations.

PRICE PREDICTIONS

Overall	-5% to +5%
Large Public Company	-5% to +10% on primary, flat to -10% on excess layers
Other Public Companies	-5% to +10% on primary, flat to -10% on excess layers
Private Companies	Flat to + 5%
Nonprofit Entities	-5% to +5%

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MARKETPLACE REALITIES

EMPLOYMENT PRACTICES LIABILITY (EPL)

- **Market conditions largely follow those seen in D&O – with rates of decreases flattening**.
- Carriers in the U.S., Bermuda and London are likely to offer competitive terms on larger risks while London continues to be a prime competitor for middle market accounts.
- Capacity overall remains abundant but at least two major carriers have announced their intention to restrict their maximum capacity on primary layers.
- The marketplace has not yet reacted to the two potentially positive U.S. Supreme Court decisions from 2011: *Dukes v. Wal-Mart* and *Concepcion v. AT&T Mobility*, deeming it too soon to impact their risk portfolios.
- **Significant EPL claims are being brought outside the U.S. and this is expected to continue into 2012. While the frequency is low, the severity is beginning to attract adverse attention from carriers**.
- **A trend to look for is policy wording addressing new media exposures**.
- EPL carriers still have little appetite for wage-and-hour claim coverage, with limited coverage available only to smaller organizations.
- Strategic buyers will look for opportunities to leverage their D&O purchase with potential EPL markets while private and nonprofit firms usually combine the purchase.

PRICE PREDICTIONS

Overall	Flat to -5%
Large Global Companies	Flat to -10% on primary, -5 to -15% on excess layers
Mid-Size to Large Domestic Firms	-5 to +10%
Private and Nonprofit Entities	Flat to +/-10%
Smaller Employers (fewer than 200 employees)	Flat to -10%

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MARKETPLACE REALITIES

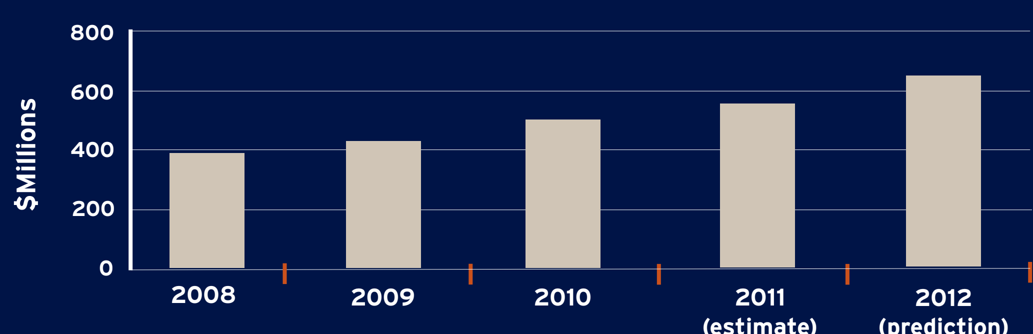
ERRORS & OMISSIONS (E&O)

- The market has entered a generally flat phase. **As 2012 wears on we expect growing pressure for increases in the 5% range. By Q4 a clear pricing upward trend is anticipated**.
- Insurers with large market shares are increasing their effort to keep rates flat or obtain rate increases. Willingness to engage in heated competition has declined as more insurers hold to their pricing targets.
- **However, a large section of the market is still competing for market share and may continue to entertain reductions to achieve this goal in the short term**.
- **Competition will remain generally strong in the middle market through 2012**.
- Abundant capacity continues to influence the market and keep competition alive, though on a more restrained basis. New entrants keep arriving. **How long this capacity will maintain is the key question**.
- Authorized global E&O limits are approximately $700M. Typical insureds should be able to buy from $350M to $400M.
- Contract wording enhancements continue to be the focus of competition. However, insurers are looking at this more carefully and the enhancements previously available are becoming more difficult to achieve.
- Policy forms for mature market segments will not expand meaningfully in terms of core coverage, although insurers will continue to **add or enhance options for Network Security and/or Privacy Liability coverage**.
- For several market segments – real estate, for example – large claims will make rate reductions and even flat renewals difficult to attain.

PRICE PREDICTIONS

Good Loss Experience	Flat to +5%
Poor Loss Experience	+10 to +20%

E&O CAPACITY



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FIDELITY

- Although figures for 2011 are not yet available, few leading markets are anticipating a major uptick in profitability. Surveys by independent auditing and fraud examiners have all reported a material increase in fraud incidents over the past several years.
- Capacity remains very strong for Fortune 1000 and mid-sized firms. Larger financial institutions and Fortune 100 accounts, however, will continue to find fewer primary markets, resulting in less competition for their business than their smaller counterparts will find.
- ISO has recently filed a 12.5 % increase for Crime policies effective May 1 and the Surety Association of America is conducting an actuarial study to determine the adequacy of Fidelity rates, with an eye towards recommending an increase.
- **Some markets are seeking modest increases at renewal, particularly on primary placements for financial institutions and to a lesser extent on larger commercial risks. Current market capacity, however, will likely encourage sufficient competition to keep rates flat in the near term for most commercial risks.**
- The good news for insureds on the coverage front is that the market is quite stable. Underwriters are not seeking deductible increases for firms whose exposures and loss history have not materially changed; nor have we seen a material contraction in the limits they are providing.
- Brokers and risk managers continue to seek broader coverage, for example, more contemporary language regarding technology exposures (computer fraud coverage) in the FI Bond space. Several markets have indicated that they are developing products accordingly.

PRICE PREDICTIONS

Overall	Flat
Comprehensive Crime: ■ **Middle Market and Fortune 1000** ■ **Fortune 500**	Flat to -5% Flat to +10%
Financial Institution Bonds: ■ **Small to Mid-sized** ■ **Regional to Large Institutions**	Flat to +10% Flat to +10%

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MARKETPLACE REALITIES

FIDUCIARY

- **Rate decreases are flattening out on both primary and excess layers, as minimum pricing levels are approached on some of the largest placements**.
- Capacity remains constant, with no new entrants into the marketplace.
- Expensive ERISA tagalong litigation continues and suits involving cash balance plans are still making their way through the courts.
- However, the strong challenge that *Dukes v. Wal-mart* created for class actions is beginning to impact ERISA matters, particularly those involving individual accounts (such as 401(k) plans), so stay tuned.
- The ongoing financial crisis continues to afflict pensions but, as the equity markets recover and interest rates remain low, plan funding is beginning to recover.
- Uncertainty about the national health care agenda and potential changes in the definition of "fiduciary" in the health care context are a significant concern that is not yet reflected in the marketplace.
- **The migration of recent D&O coverage enhancements into Fiduciary policies is expected to continue throughout 2012**. This can include affirmation wording relating to (presumptive) indemnification and advancement of defense costs as well as expanded coverage for investigations.

PRICE PREDICTIONS

Overall	Flat to -5%
Companies with large concentrations of their stock in their employee benefits plans	Flat to -5% on primary, -5 to -15% on excess layers
Companies without company stock in their plans	Flat to -5/+10% on primary, with -10 to -15% on excess
ESOP-Owned Firms	Flat to +/-15%
Private and Nonprofit Entities	Flat to +/-15%

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MARKETPLACE REALITIES

HEALTH CARE PROFESSIONAL

- **The Health Care Professional Liability (HPL) market will remain soft through the first half of 2012**.
- Pricing will depend on jurisdiction, loss experience and layer of coverage, but **rate reductions for now will average from flat to low single digits. Certain long-term care risks may see slightly higher increases due to shifts in the legal environment that have led to large losses**.
- **Loss frequency remains at historically low levels (although some observers report a very slight increase) while severity has moderated and is actuarially predictable. Of note are recent "jumbo" verdicts in 2011 and early 2012 but these have not moved market pricing**.
- Health Care Reform (PPACA) will continue to shape malpractice risk and underwriter response as we get ready for the 2012 Accountable Care Organization (ACO) implementation. Many primary policies will need to adjust terms and conditions to address cyber-related diagnosis and transmission failure, inter-related provider contracting and a new world of pay-for-performance.
- HPL is the most profitable P&C insurance line, with a combined ratio well below 100 for an unprecedented five consecutive years, and hence is also one of the most competitive, with excess capacity chasing a shrinking pool of insureds as health care industry consolidation accelerates and the larger health care organizations assume more risk, particularly physician risk.
- Consolidation of insurers in the HPL industry will also continue, particularly among the physician insurers.
- Some insurers worry that "integrated occurrences" (i.e., related acts or batch coverage) have expanded to the point where almost any group of incidents can be aggregated and presented as a single loss (and therefore subject to only one retention or deductible). This issue can be divisive for insured and insurer as well as among insurers.
- Despite a few recent court decisions, there is no clear trend towards overturning the malpractice reform legislation enacted in many states in the last decade. Some state courts have recently upheld reform laws or enacted more physician-friendly reform laws.
- Observers continue to express concern that a rising volume of patients seeking primary care services will overburden the health care delivery system and compromise care.
- The rapid adoption of the electronic medical record may present significant liability exposure while potentially reducing claims through better communication.
- The movement of physicians away from private practice to the hospital employment model accelerates.

PRICE PREDICTIONS

Overall: Flat to -5%
Long-term care providers: Flat to +12.5%

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MARKETPLACE REALITIES

AEROSPACE

- **Downward rating trends continue, but with airline exposure growth, premiums are largely holding at current levels. Where exposures are contracting, rates remain static**.
- Low levels of airline renewals during Q1 followed a typically hectic renewal season during Q4 2011.
- **Market appetite for airline risks varies significantly, resulting in dramatically different renewal results**.
- Economies of scale will improve results for the largest programs.
- The Aerospace sector continues to see softening market conditions.
- Corporate Aviation continues to see competition driving down premium volumes and bringing improvements in coverage.
- Excess capacity is available across all sectors but is not being fully utilized. New entrants in 2011 added only small lines to this already competitive sector.
- **Industry and program consolidation in all sectors continues to erode premium levels**.
- Airline losses are at a seven-year low, making 2011 a profitable year for underwriters.
- No losses involving large numbers of fatalities have occurred for several years.

PRICE PREDICTIONS

Airline ■ **Premium** ■ **Rates** ■ **Exposures**	 +/- 10% Flat to -20% +/- 10%
Aerospace	Flat to -5%
Corporate Aviation	+/- 10%

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MARKETPLACE REALITIES

CONSTRUCTION

- **Rates for Property and Casualty continue to trend upward, but by no means are we calling this a hard market**. Incumbent carriers continue to push for rate increases. Guaranteed cost programs (policies without retentions) are experiencing the highest increases.
- Loss-sensitive programs are receiving slightly lower increases. Some consumers are procuring higher retentions to offset the rate hikes.
- The western U.S. is experiencing the largest increases; the Midwest, Southeast and Northeast regions are experiencing the lowest.
- **Workers' Compensation – Rate increases are averaging 10%**. Key drivers are industry-combined ratios in excess of 110%, low investment return outlook for the next few years and medical cost inflation in the range of 5-12%.
- **General Liability – Construction defect exposures and various state litigation trends are creating volatility.** At the same time there are a number of carriers underwriting this line, which tempers the rate increases most say are needed.
- **Excess/Umbrella Liability – Most 1/1 renewals were flat or saw small (up to 5%) increases**. Follow-form excess policies are becoming more popular to ensure coverage consistency from the heavily negotiated GL placements. Limits of $500M are available, with most of the larger contractors carrying $25M-100M.
- **Auto Liability** – Renewals are stable. Most 1/1 renewals were flat to +5%.
- **Property** – **Many clients are experiencing increases of up to 10%**. Flat renewals are considered a good result. Claim history and CAT continue to be key drivers.
- **Project Insurance (Wrap Ups) – Expanding insurer interest and a decline in the number major projects have sparked competition**. Sponsors are now asking many more questions about insurer financials with an eye to the Statute of Repose.

PRICE PREDICTIONS

General Liability	Flat to +10%
Excess Liability	Flat to +10%
Workers' Compensation	Flat to +10%, state-by-state increases could be higher
Builders Risk	Flat to +10%, higher in high catastrophe areas
Project Insurance (Wrap-Ups)	Primary and excess rates remain flat with significant variation depending on job size, type of work and location

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MARKETPLACE REALITIES

ENERGY

DOWNSTREAM

- **Market conditions remain relatively stable, as capacity increased by 14% in 2012**.
- However, the run of losses in this sector continued through 2011.
- Of particular concern to many insurers following the losses of 2011 has been Contingent Business Interruption (CBI), with particular focus on supply chain, named suppliers and sublimits.
- **Current rating levels remain at their lowest in more than 20 years**.
- Markets are differentiating even further between those risks and risk partnerships that they truly value and those that have been impacted by recent losses.
- Increased values have served to disguise low current rating levels.

PRICE PREDICTIONS

Generally flat

UPSTREAM

- **Overall capacity levels are now nearing the $5B mark**.
- Those insurers that have continued to write the windstorm book have reaped the benefits of another loss-free year.
- The Gryphon A FPSO accident in the North Sea has proven to be a loss of profound significance to the market, and this has been followed by a similar loss involving the Banff FPSO, also in the UK sector of North Sea.
- Insurers are therefore focusing on accurate underwriting information for FPSO risks, looking closely at:
  - The age of the FPSO, and the sophistication of its design
  - The nature of the Dynamic Positioning System (DPS)
  - Details of the mooring system
  - Details of the alarm system
  - Details of the unit's electrical system.

PRICE PREDICTIONS

Generally modest rises

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MARKETPLACE REALITIES

ENVIRONMENTAL

- The market appears to have reached its peak, with 30+ carriers focused on environmental underwriting. Some markets have either dropped certain coverage lines or reorganized their underwriting divisions.
- **Competitive terms and pricing continue with respect to the base coverage forms for Contractors Pollution Liability and site-specific Pollution Legal Liability insurance. However, prices are up slightly for select risks and product lines**.
- **Many insurers have expanded base Contractors Pollution Liability and site-specific Pollution Legal Liability coverage**, so that manuscripting is less common than a few years ago.
- Certain product lines continue to move toward commoditization (e.g., Contractors Pollution Liability), while others are being "re-underwritten" by some carriers. Some products have become extremely difficult to procure (e.g., Cleanup Cost Cap). And some risks are more difficult to obtain terms for (e.g., Underground Storage Tanks more than 15-20 years old).
- **Breadth of product offerings, capacity and underwriting appetite differ dramatically from market to market**. In some cases, new forms are being developed or coverages are being added to existing pollution policies. In other areas, coverage terms are being limited or the market appears reticent to offer terms for certain risks (e.g., certain fracking exposures).
- **Given the plentiful capacity in the market, many insureds are implementing layered program structures**. Ten years ago, a handful of environmental insurers had single-policy capacities of $50M to $100M. Today very few have more than $25M.
- Long-term policies are less available for operational exposures. One- to three-year terms are instead preferred. Ten-year terms are still available for project-specific applications and for historical protection – most often relevant to transactional placements. In some cases, Contractors Pollution Liability project terms plus completed operations coverage may still be available for as many 17 years.
- Increased writings and the development of longer term policies placed in prior years continue to drive an increase in claim activity among the various product lines. The first 10+ year PLL policies terms were written about 15 years ago; claims and loss development are topics of discussion among all veteran markets.

PRICE PREDICTIONS

Contractors Pollution Liability	-15% to +5%
Pollution Legal Liability (including combined GL/PLL)	-10% to +5%
Environmental Professional Liability (including CPL)	-5% to +10%
Financial Assurance Instruments (USTs, Closure, Performance Bonds)	Flat to +5%
Cleanup Cost Cap	+10% to +20% (if available)

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SPECIAL CONTINGENCY RISKS

- **The U.S. Special Contingency Risks (Kidnap & Ransom) market is generally stable in terms of premium rates, but firmer with respect to companies with significant exposures in Latin America, Africa and the Middle East**.
- Areas of primary concern for kidnap and extortion activity are Mexico, Venezuela, Nigeria, Pakistan, Afghanistan, Philippines, Iraq and Somalia.
- Countries of growing concern due to the recent emergence of kidnapping include Mali, Mauritania, Niger, Sudan, Malaysia and Kenya.
- **Due to the Arab Spring and the subsequent political evacuations, carriers continue to be cautious in their approach to Emergency Political Repatriation and Relocation coverage**. In some cases, limits are being reduced and/or certain North African and Middle Eastern countries being excluded.
- Somali piracy remains a problem and the underwriting of exposures in impacted waters is cautious.
- Buyers with exposures in the U.S. and low-risk overseas locations can expect flat renewals.

PRICE PREDICTIONS

Flat to +10%

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MARKETPLACE REALITIES

MARINE

- **For most insurers 2012 is off to a poor start with the loss of the cruise liner Costa Concordia**.
- While the loss may have stiffened the hull market, its long term effects remain questionable. **What may prove more damaging are the P&I and Liability aspects which could be of far greater significance later in the year**.
- The fast growing economies in Asia – most notably China – together with the emerging economies of India and Brazil and signs of recovery in the U.S. will help counter the financial woes in Europe, but as the maritime industry depends greatly upon the financial services industry, the concerns over European Sovereign debt spell another year of uncertainty for the maritime industry.
- Piracy continues to blight our industry without any concerted resolution in sight. Although the number of successful attacks has diminished, the demands and expectations of those that are victimized are increasing.
- The market for Hull & Machinery is diverse, with the majority of underwriters in the London market adamant that premium reductions are history and even flat renewals are unacceptable, while in other markets, particularly in the Far East and in Scandinavia, underwriters are less adamant.
- **P&I renewals are averaging approximately 4%, though that figure disguises a broad range of results**.
- **Marine Liability underwriters are hoping that the Costa loss drives a general hardening in rates throughout the sector and many are stating that they will be looking to achieve minimum 5% increases going forward**. Whether this can be achieved is unclear, as there is still overcapacity in the sector.
- **Cargo clients continue to enjoy the benefits of a soft market**, with reductions in both premium and deductibles and increases in limits at little or no additional cost.
- While the rest of the world suffered from large loss events in 2011 – the March tsunami in Japan ($210 billion), the New Zealand earthquake ($20 billion) and the Australian floods ($7.3 billion) – the overall U.S. Marine insurance environment remained reasonably stable.

PRICE PREDICTIONS

Modest hikes in Hull, soft conditions elsewhere

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POLITICAL RISK

- **The market is continuing to stabilize after a historic period of political upheaval from 2009 to 2011**. Throughout this period Political Risk products were vigorously tested and delivered their intended value.
- Losses have been concentrated in the Middle East, North Africa and Southeast Asia, particularly in Vietnam.
- Outside of Syria, the Middle East is looking calmer than in previous years.
- Premium rates rose in 2011, **but the market has flattened somewhat and rates even decreased in certain countries** (e.g., Brazil, Turkey, Russia, Argentina). We see a big discrepancy between the lower-risk emerging market countries and their higher-risk counterparts.
- In 2012, we anticipate several trends:
  - **Moderation of upward pressure on premium rates**
  - **Increased underwriter due diligence and increased focus on structure and security**
  - **Policies above $30M will need to be syndicated**
- Resource nationalism in Venezuela and Bolivia and now even Argentina, as well as the Arab Spring, has focused attention on Expropriation cover.
- The premium base for 2012 is expected to be around $1.4 B, with losses at less than 100% of that amount.
- The Eurozone debt crisis is limiting the outflow of capital while increasing cost of funds for global investments. As of this writing, we are seeing some market stabilization, although the flow of capital is still constrained.
- Brazil, Peru and Colombia are seeing the greatest inflow of capital because of their sustained "Investment Grade" status as well as stronger macroeconomic policies in relation to the rest of Latin America. Chile remains a strong bet because of its institutional strength. Political instability seems to be declining slightly in Mexico.
- Markets are concerned about the risk of a hard landing for the real estate market in China.
- New underwriters have either entered the market or are planning to enter before mid-2012.
- Sub-sovereign risks have proved to be problematical as the sovereigns sitting behind these risks have not supported them when they have run into financial problems. Underwriters are looking for more sovereign business and less sub-sovereign risk (municipalities, states or quasi-government companies).
- **Reinsurers continue to impose certain restrictions, and as a result some underwriters are more conservative in their underwriting, which is affecting the diversity of business that can be underwritten**.

PRICE PREDICTIONS

Flat to slightly decreasing

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SURETY

- The Surety and Fidelity Association of America (SFAA) continues to report exceptional loss ratios – 12% through Q3 2011.
- Insurer desire for sureties to grow in the face of a sluggish economy combined with new entrants in the marketplace has further increased competition.
- **Capacity is readily available for contract and commercial bonds**.
- Reinsurance capacity remains stable and adequate to meet market demand and is available from both existing and new markets.
- **There is growing evidence of surety loss development throughout the country and sureties are seeing an increase in payment bond activity and contractual disputes. Based on the SFAA Q3 2011 results, loss ratios are starting to increase across the board and the market is anticipating an increase in loss frequency in 2012**.
- The level of interest in the utilization of public private partnerships (P3) continues to escalate across the U.S.
- In anticipation of an increase in the P3 delivery method, some sureties have developed new P3 performance bond solutions addressing the liquidity concerns and security requirements of lenders funding these projects.

PRICE PREDICTIONS

Moderate Fluctuation

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MARKETPLACE REALITIES

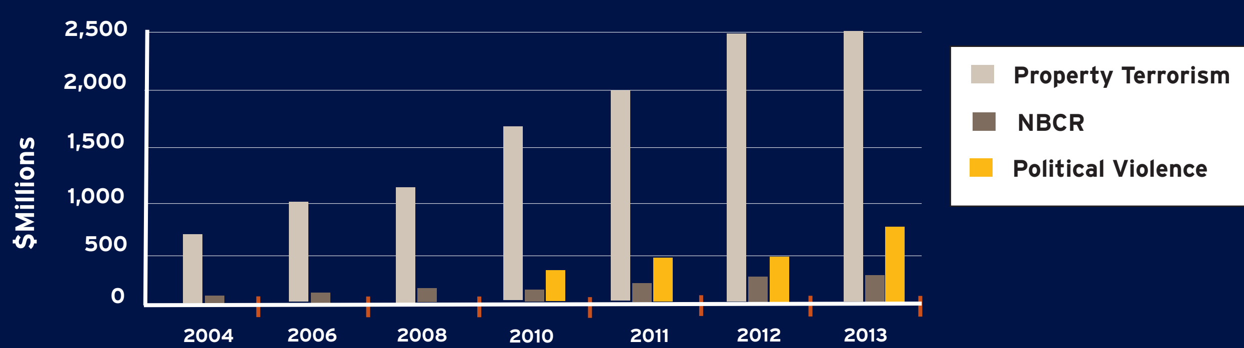
TERRORISM

- Rates for stand-alone Terrorism are trending upwards. Major metropolitan areas remain the most seriously impacted.
- The market is expected to continue to harden through 2013 as the potential for the expiration of the Terrorism Risk Insurance Protection Reauthorization Act looms.
- Terrorism capacity is available at an estimated maximum of $2.5B per risk, though it is significantly reduced in major metropolitan areas.
- Heightened awareness of more complex Terrorism risks has led to the development of industry-specific programs which combine coverage for Property and Liability terrorism risks.
- There has been a growing interest in nuclear, biological, chemical and radiological (NBCR) Terrorism coverage. Maximum capacity for NBCR risks is estimated at $200M per risk.
- **Captives continue to be utilized to address otherwise uninsurable Terrorism risks, including NBCR Terrorism, with interest in increased reinsurance capacity covering non-certified Terrorism events in anticipation of a non-renewal of TRIPRA in 2014**.
- **Political flashpoints around the globe continue to foster interest in Political Violence extensions to global Terrorism programs**.

PRICE PREDICTIONS

Flat to +5%

TERRORISM CAPACITY



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MARKETPLACE REALITIES

TRADE CREDIT

- Despite unstable economic and political conditions worldwide, Trade Credit insurance rates and capacity remain aggressive, **offering significant opportunities for corporations wishing to transfer the risk of non-payment of receivables**.
- **Market conditions continue to soften with rates down around 30-40% from historic 2008 highs. Risk appetite is also strong in 2012**.
- If any shocks occur (such as European default contagion), however, a swift and sharp increase in premium rates and contraction in available capacity should be expected.
- Reinsurance capacity remains plentiful for Trade Credit markets.
- The record volume of claims paid during the financial crunch validated the product as a means of mitigating the risk of losses due to bad debt. In 2011, carriers saw a reduction in the frequency and average size of claims from the highs experienced in 2008 and 2009. At the same time, **claim activity remains above prerecession levels in terms of frequency**.

PRICE PREDICTIONS

Flat to -20%

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