

All options open to shareholders as OIL votes to create ANWS sectors

The story to date

On March 22nd the shareholders of OIL voted on three significant resolutions:

1. Adopting two additional sectors to take effect from June 1 2007, bringing the total number of sectors to 10. These sectors are optional for 2007 but true mutualisation will apply from 2008. The new sectors are:
 - Atlantic Named Windstorm Sector (ANWS) Onshore
 - ANWS Offshore
2. Incorporating a Top Up Pool for ANWS perils. The Top Up Pool is a mechanism designed to provide additional aggregation limit for ANWS events that exceed OIL's aggregation event limit, either by:
 - mutualizing the incremental risk above the aggregation limit to members electing to participate in the Top Up Pool, or
 - by potentially purchasing additional limits from the reinsurance market.
3. Allowing the OIL Board to set different aggregation limits for different perils.

A 75% majority is required for a resolution to pass. The first two resolutions passed with a majority vote of 77.25%, while the third resolution failed.

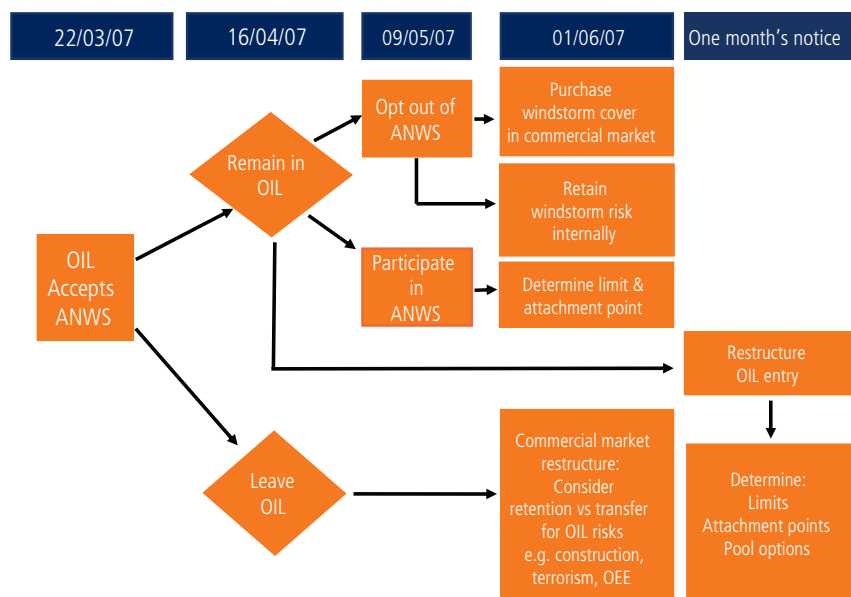
Immediately following the shareholder vote, OIL's Board of Directors voted to increase the aggregation limit for all risks/sectors to \$750 million effective June 1, 2007.

The first resolution had failed to secure a majority vote in Toronto in October 2006 and has only now passed by a very narrow margin. Having canvassed a good many members since the AGM, it is evident that the majority of shareholders are carefully weighing all the options open to them.

To stay or to go?

The chart below outlines the decisions that are now facing shareholders, and the respective timelines relative to the second policy period, effective June 1 2007:

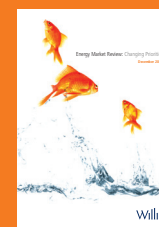
OIL Decision Tree & Timeline



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For any member who wishes to defer a decision as to whether to leave OIL, they are required by September 30, 2007 to give notice to withdraw from 2008.

Willis is pleased to discuss with clients the pros and cons of OIL membership, the barriers to exit and the commercial market alternatives available to fill the capacity gap. Care should be taken to assess not only the penalties for withdrawal compared to commercial market premium but also the differences in cover provided by the OIL and commercial insurance market products.

OIL advantages

- OIL continues to offer \$250m of A- capacity (albeit that this is scaled in the event the multi-insured aggregate of \$750m is imposed)
- Historically the capacity has been cheaper than the commercial market
- OIL offers automatic coverage for construction, OEE, S&A pollution, earthquake and terrorism coverage
- OIL's coverage has broad territorial limits
- Coverage has no Co-insurance or Average Clause imposed
- OIL provides a forum for exchange of information, together with bulk buying power, and significant lobbying opportunities

For Risk Managers with a history of supporting OIL, the above features are well recognized. However, for their Finance Directors, especially those without ANWS-exposed assets, the decision to remain in OIL will have to be defended on a financial basis, given the substantial increase in OIL premiums in recent years for the majority of members, not to mention the funding of the 2006 cash call.

Here's the rub. **Until all Shareholders have declared their intentions going forward, the individual shareholder can only guess at the membership profile of any given OIL sector and therefore can only "guesstimate" his individual exposure to premiums and cash calls from losses on or after June 1, 2007.**

ANWS

For those members with ANWS exposures, the short-term decision is whether to insure with OIL for windstorm, or adopt a commercial market or self-insurance alternative for this peril. We would suggest that they should additionally try to assess whether the coverage provided by OIL in fact offers an effective risk transfer solution. They should also determine at what level the purchase of OIL windstorm capacity becomes most efficient for them, once blended with any commercial market purchase. These decisions will have to be taken against a backdrop of not knowing the profile of the overall pool until well after the effective date of election to opt out (May 9 2007).

Essentially OIL is offering up to \$250m of Atlantic Named Windstorm coverage for a premium to be determined by the weighted gross assets declared to the pool overall and coverage profile of the pool, with a multi-insured aggregate limit of \$750m any one event. The important points to note are:

- Shareholders can only opt out of ANWS coverage for 2007. With effect from January 1 2008, OIL returns to the mutual mechanism, but with 10 sectors.
- The default ANWS retention is \$750 million. For Shareholders with an ANWS deductible above \$10 million, OIL will allow the deductible to be brought back down a minimum of \$10 million without the "other insurance" warranty being imposed.
- If a Shareholder elects an ANWS limit which is less than \$250 million, OIL is advising they will require a warranty that they have not purchased insurance excess of OIL.

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The coverage can be attached at any point from the minimum deductible levels, and as a guide OIL are suggesting the following credits may be given, based on current risk profiles:

Limit	Attachment point	ANWS Onshore credit	ANWS Onshore credit
\$250 million	\$100 million	65%	55%
\$250 million	\$250 million	72%	65%
\$250 million	\$750 million	90%	85%
\$100 million	As above	65% further credit on above	9% further credit on above

The considerations that members with ANWS exposures must weigh are:

- Will a lack of a windstorm limit with 100% guaranteed availability satisfy internal corporate governance and/or lenders' requirements?
- Is the commercial market able to offer an alternative?
- What are the results of the cost benefit analysis for each option?

Resolutions Two and Three

With regard to the Top Up provision, the limit is still to be determined and will be dependent on the take-up by the Shareholders.

With regard to the third proposal, we would comment that the failure to succeed appears to indicate the desire of Shareholders to retain the power to make decisions of this nature.

In Summary

It is our opinion that June 1 will see some withdrawals from OIL, many which are likely to come from the utility sector for whom the volatility of the OIL rating model jars with the highly regulated environment in which they operate. We anticipate some members, in an effort to ease the volatility, will shift their OIL attachment points up considerably. Equally, others nervous now of the degree to which they have mutualised their losses may exit "Pool B", and/or seek an external quota share placement with the commercial market.

However, our general sense is that OIL is still well supported by a large part of the current membership that is keen to see it succeed and determined to take enhanced ownership of the decision making.

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News Round-up

- **Lloyd's** has announced a £3,662 million profit for the 2006 underwriting year. The combined ratio was 83.1% (2005: 111.8%) which Lloyd's said compares favourably with an estimated average of 93% for US property and casualty insurers, 95% for US re-insurers, 94% for European insurers and re-insurers and 86% for Bermudian insurers and reinsurers. There was a 14.8% increase in central assets to £1,454 million (2005: £1,266 million). In the wake of the news of the finalisation of the first phase of the Equitas deal with Berkshire Hathaway.
- Following **Fitch Ratings** upgrade of **Lloyd's** insurance financial strength rating one notch from A to A+, rival rating agent **Standard & Poor's** which rates Lloyd's financial strength A, said that the rating could be increased if a combination of the following factors was met:
 - Further improvement with regard to the London market's administrative processes
 - Subject to normal catastrophe loss experience for 2006, the market posting a combined ratio of less than 95% and return on revenue of more than 10%
 - Lloyd's main capital providers remaining committed to the market
 - Catastrophe-related operational weaknesses being successfully strengthened
 - Capital adequacy remaining strong, as reflected in central assets available for solvency purposes remaining at about £1.75bn and Lloyd's solvency ratio remaining above 300%. (Insurance Day)
- Managing agency **Ark Syndicate Management** commenced underwriting on behalf of new Lloyd's syndicate 4020 for risks incepting on and after April 1. Former Wellington underwriter **Peter McIntosh** is the syndicate's hull underwriter, and it is understood that a well-known energy specialist is also shortly to join the syndicate. The syndicate, with a 2007 year of account stamp capacity of £114m, plans to underwrite energy (current capacity per program US\$20m), marine, property and casualty business lines with a roughly 65%/35% insurance/reinsurance split. The syndicate has been backed by **Jeff Greenberg's** New York-based private-equity company Aquiline Capital Partners LLC as lead investor, the Whittington Group (which will also provide third party services, IT infrastructure and other support functions), Swiss Re and private equity fund Lehman Brothers Co-Investment Partners.
- **Paul Calnan**, previously energy underwriter at the Millenium syndicate, has resigned and he will be joining the **CV Starr** syndicate in due course.
- Upstream energy underwriter **Chris Charlton** has resigned from **Swiss Re** in London.
- With effect from April 1 **AIG's Paul Hill** is taking up a new position which will be split 50% between being available as an Energy underwriter within David Hawksby's team and 50 per cent as head of Africa for AIG Energy, a role previously held by Dave Mcibben. With effect from March 1, AIG has increased its capacity for **downstream energy risks** to US\$200 million.
- **Alex Lumby** has resigned from Benfield's Corporate Risk division in Perth, Australia and will be joining **Ascot's Singapore** operation in due course. It is understood that he will then be moving to London in either 2008 or 2009.
- **Karen Barkley**, previously chief operations officer, has been appointed president and chief executive officer of **ACE Canada**, reporting to **John Lupica**, president and CEO, ACE USA.
- It is understood that **Stephen Way**, who built **HCC Insurance Holdings** into a US\$3bn international insurance company, is raising approximately US\$500 million to form a dedicated private equity and consulting firm specialising in the insurance and financial services sector.

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- **Standard & Poor's** has announced today that it has upgraded their ratings on both **Assuranceforeningen Gard** and **Gard Marine & Energy (Gard M&E)** to A+ from A, the highest rating of any marine mutual. The rating opinion comments favourably on many aspects of the business, including the Gard group's very strong capitalisation and reserving.
- **EQECAT Inc.** has formally presented a new **Offshore Energy Model** during its recent Catastrophe Management Conference. According to EQECAT, the driving factors behind the product were the losses sustained during 2004 and 2005 hurricane seasons, which significantly impacted the capacity and price of insurance for offshore exposures. The product is a response to increased demands from the upstream insurance market for revised models to quantify the risks and EQECAT said that their work for the offshore energy market is markedly different and more complicated than modeling for onshore property risks.
- **Allianz** has become the third major player to obtain a **Takaful licence** in Bahrain. Allianz already operates Takaful business in Indonesia and Malaysia but its newly licensed Allianz Takaful (Bahrain) will serve as a global hub for Islamic insurance. (Insurance Day)
- Lancashire subsidiary **Lancashire Marketing Services (Middle East) Limited** has received authorisation from the Dubai Financial Services Authority (DFSA) to operate in the Dubai International Financial Centre (DIFC). The new company will concentrate on marketing Lancashire's UK and Bermuda insurance subsidiaries in the Middle East. Lancashire has also announced that **Alex Maloney**, previously an energy underwriter for the company, has been appointed chief underwriting officer of Lancashire Insurance Co. (UK) Ltd.
- **PXRE Group Ltd**, which effectively ceased accepting new business after disastrous results following the 2005 North Atlantic hurricane season (it took a USD807m hit from Katrina, Rita and Wilma), is to merge with Texas-based Argonaut **Group, Inc** to form **Argo Group International Holdings Ltd** and will become the Bermuda holding company for PXRE's existing insurance subsidiaries, Argonaut's US operations, and Peleus Re. Some 73% of the new group will be owned by former holders of Argonaut shares, with the balance held by former PXRE shareholders.
- Lloyd's operation **Kiln plc** has announced that it plans to re-domicile to **Bermuda** by means of a newly incorporated Bermudian holding company Kiln Ltd, which will acquire Kiln via a court approved scheme of arrangement. Kiln stated that the Bermudian operations would be complementary to its Lloyd's business and said that in its view Lloyd's remains a commercially advantageous platform which will continue to form an important part of Kiln's future insurance activities.
- **The Chinese Regulatory Commission** has licensed Lloyd's Chinese operation. Shanghai, China-based **Lloyd's Reinsurance Company China Ltd.** will enable Lloyd's to underwrite onshore reinsurance business across the country as well as giving the Lloyd's improved access to the Chinese reinsurance market whilst at the same time giving Chinese insurers access to the Lloyd's market.
- Rating agency **A.M. Best** has downgraded the financial strength ratings of **The Steamship Mutual Underwriting Association (Bermuda) Ltd. and The Steamship Mutual Underwriting Association Ltd., London** to B++ from A-. The action in respect of the Bermuda P&I club is said to reflect potential volatility in its risk-adjusted capitalization, the continuing challenge the club faces in underwriting profitability and its reliance on investment income, while the London operation was downgraded because of its reliance on the Bermuda club for substantial reinsurance.

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