

OPPORTUNITIES

ONGOING

**MARKETPLACE
REALITIES
& RISK
MANAGEMENT
SOLUTIONS**

2011

SPRING UPDATE

Willis



MARKETPLACE REALITIES & RISK MANAGEMENT SOLUTIONS

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We also invite readers to visit **What We Think**, the publications page of willis.com, where you will find many articles and studies of immediate and enduring value to risk managers, financial executives and corporate governance stewards of every stripe.

Marketplace Realities is updated semi-annually.

EDITORIAL STAFF

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MARKETPLACE REALITIES & RISK MANAGEMENT SOLUTIONS

INTRODUCTION

RESILIENCY

Are the recent disasters in Australasia – flooding in Australia, earthquake in New Zealand, and the triple disaster in Japan – finally turning the soft market that has dominated our industry for several years? At first, many said yes, then many said no; now, as the loss estimates (insured and uninsured) begin to come into focus, we see a more nuanced answer. The Property market is shifting, especially for catastrophic risks. The overall marketplace, however, appears to be stable, and while the softening may slow, no major reversals so far are detected. This speaks volumes about the resiliency of our industry.

Overall surpluses are intact. Japanese insurance companies renewed reinsurance contracts without any drastic shifts. The conservative investments of most insurers continue to cushion against market volatility. The system, in other words, works: we provide contingent capital to cover losses from unforeseen events. Insurance provides assurance for organizations of every size and type that their work will continue.

Looking ahead, another truism for the industry is going to be more important than usual: “Let’s see what the Atlantic Hurricane season brings.” Early predictions again call for above average hurricane activity. So the predictions have gone the past few years, and, to everyone’s relief, so they have proved incorrect. This year, a big hit to the world’s carriers could well put us over the tipping point.

The Japan disaster is being called the largest since Hurricane Katrina. That event altered the marketplace in a way the Japanese quake, tsunami and nuclear radiation leak have not, largely because less than 20% of the hundreds of billions in catastrophic losses in Japan are insured. A large-scale hurricane on U.S. soil, where assets are broadly insured and those insurance policies covered by reinsurance policies, would be a blow that would resonate.

The good news is that we are not talking about a crippling blow. For most buyers, a hard market would mean giving back some of the gains they have enjoyed in recent years. The insurance markets would adjust their pricing, and the system would possibly bend but be very unlikely to break.

In the aftermath of the staggering devastation in Japan, many of us were astounded to watch the people of Japan handle such devastation with such apparent reasonableness and resolve. This displayed a resiliency on a human scale that inspires awe and admiration. We can only hope that in our industry we reflect a fraction of this tremendous display of fortitude.

For now, we caution our clients to seize the ongoing opportunities – outside of the Property market. For buyers of Property cover, especially those that face catastrophic exposures, now is the time to consider renewal strategies. For most other lines, conditions remain fairly stable. In all cases, however, buyers should be working closely with their insurance advisers to lay out options for the unknowns that lie ahead.

Todd Jones
President
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MARKETPLACE REALITIES & RISK MANAGEMENT SOLUTIONS

PROPERTY

- Underwriters' reactions following the Japan EQ/Tsunami has been **an end to rate reductions**.
- **The Japan EQ/Tsunami, coupled with the RMS updated version 11.0 will most likely bring the soft market to a close** and we forecast a stabilization of rates for Q2.
- **We do not, however expect a market reaction like that which followed Hurricane Katrina in 2005**, when we saw a huge reduction in CAT capacity and dramatic rate increases. A good portion of the losses in Japan will be retained by the local Japan insurance market.
- RMS 11.0 is producing some **dramatic increases in the modeled loss estimates in some tier two wind zones - up to 100% in some cases!**
- Ample CAT capacity remains, with the market seemingly able to absorb enormous losses so far in 2011: the New Zealand quake cost \$10B (according to Munich Re) and the Japan quake \$20-30B (AIR Worldwide – quake only, not tsunami losses).
- Prior to the Japan event, most of the market was pushing for flat renewals and acquiescing to minimal rate reductions if accounts were profitable.
- Q1 renewals averaged rate declines of 5-10%. Some accounts with loss experience renewed flat and accounts with little loss experience achieved rate reductions closer to 7.5-12.5%.
- Most accounts are still over-subscribed at renewal, as we saw in 2010.
- Treaty reinsurance costs were flat to -5% in January.
- U.S. Insurers' Policyholder Surplus has held steady at \$544B (compared to \$511B at the end of 2009).

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Non-CAT	-5 to -10%
CAT (or poor loss experience)	Flat to +5%

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CASUALTY

PRIMARY

- Well into the ninth year of a soft Casualty market, future reductions will depend on an account's exposures and industry. Overall, we are beginning to **see signs of rates leveling**, even as the market continues to offer abundant capacity and appetite for most risks.

- Flat to minimal growth is anticipated in most sectors for the rating bases and insured exposures (i.e., revenues, vehicles, units sold, etc). To maintain premium levels, some carriers are pushing for rate increases on their renewal book. This strategy, in a market rich with aggressive competition, has resulted in the movement of accounts.
- **The nimbleness of the smaller national underwriters and regional underwriters**, with their lower underwriting overhead costs, keeps significant competitive pressure on the larger carriers.
- **Larger auto fleets may begin to see less favorable Auto Liability rates** as well as slight pressure on exceptionally low attachment points. **Some confident carriers are trying to push for target rate increases on renewals** We are beginning to see some compression of the Auto Buffer market.
- Carriers continue to broaden coverages in their primary, umbrella and excess forms. Professional Liability is returning to some carriers' base forms. Loss-prone risks that tend to be marketed in London and Bermuda are seeing flat to slightly increasing rates.
- While the U.S. market primarily offers product recall via endorsement to the underlying liability, London and Bermuda lead the marketplace in offering stand-alone product recall and reputational risk covers.
- As carriers struggle for profitable premium growth in a low-interest environment, several are seeking to drive growth through **industry specialization**.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Minimal Products Exposure	Flat to -5%
Tougher Products	Flat to +5%

EXCESS/UMBRELLA

- We see preliminary indications that **the Umbrella Liability market is growing less soft. Carriers are seeking flat renewals or small rate increases on rising exposures**. Some Umbrella markets are not as hungry for new business as they have been in past quarters. On average, Q1 renewals saw flat rates. Buyers are feeling some light pressure on very low attachment points.
- **Excess Liability market remains very competitive**, with no immediate changes anticipated (except for energy accounts).
- **Markets are carefully reviewing energy exposures**.
- Capacity remains at an all-time high, but speculation abounds on **the impact of recent catastrophes on capacity and, consequently, rates**. On paper, industry capacity is well in excess of \$1.75B, realistic capacity on a single account is in the \$1.25B range, with slight restrictions since our last update.
- Competition notwithstanding, **buyers should anticipate more underwriting questions**. Carriers are standing firm on terms and conditions, and even walking away if buyers make unreasonable demands. For best results, buyers should be prepared to fully articulate how and where their products are ultimately used. They should also be prepared to discuss their vendor liability management practices.
- **Multiyear deals are fading away** as carriers are seeing the potential for higher premiums on the horizon.
- **Coverage for Punitive Damages can be obtained** several ways, including offshore wraps, most-favored venue (MFV) and coverage in base policy forms.
- Simple fixes to jurisdictional requirements for locally admitted coverage remain a challenge, but carriers are finally paying attention.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Non High Hazard Products	Flat to slight reductions
High Hazard/CAT Product Liability/Poor Loss History	Slight increases

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WORKERS' COMPENSATION

- **The soft Workers' Compensation market is expected to continue through 2011.** Payroll is the key driver for Workers' Compensation premium and, as employment stabilizes, so should rates.
- Workplace injuries often occur in the first few months of employment and **carriers are paying keen attention to hiring practices and safety training** as employers begin to ramp up payroll.
- Last year, many carriers struggled to secure rate increases on their renewal book to offset the impact of payroll reductions. Workers' Compensation combined ratios have reached 110%. **This year, several states are filing for rate increases**, including California, Florida and New York.
- Several states and districts have indicated they will **increase Workers' Compensation taxes, assessments and surcharges** to cover increasing administrative costs.
- **Guaranteed cost options are available to almost any employer.**
- Carriers are still aggressively competing for financially strong accounts and carriers are loosening credit terms and acceptable forms of collateral for these accounts.
- Even though the credit market has improved over the past 24 months, **collateral requirements remain a challenge** for many insureds, often prohibiting them from taking full advantage of market conditions.
- With rates low, there are fewer dollars to squeeze out of the premiums, leaving employers to focus on **loss costs, claim expenses and medical cost containment** as means to further lower Workers' Compensation costs.

PRICE PREDICTIONS

Flat by Q4

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EMPLOYEE BENEFITS

- **Health care reform continues to dominate the employee benefits agenda.**
- Given the higher costs that are expected due to health care reform, employers are seeking more aggressive cost containment strategies. This includes more **robust wellness programs, consumer driven health plans, self-funding**, increased use of advisers and brokers to seek the most efficient administration and vendor relationships and, if necessary, **additional cost shifting to plan participants.**
- Despite health care reform and ongoing economic uncertainties, most employers continue to maintain robust benefits programs and expect to maintain some type of benefits plan for their employees.
- The government continues to release detailed guidance fleshing out the details of the reforms. However, failure to release guidance on a timely basis has delayed the effective date of certain requirements, including the nondiscrimination rules that apply to insured, non-grandfathered plans and W-2 reporting requirements.
- Over the next few years, delivery system reforms are expected to raise costs two or three percentage points. The delivery system reforms (e.g., value-based purchasing) will result in hospitals receiving reduced compensation from government programs. This will lead hospitals to shift costs to employer plans.
- Attempts by federal and state politicians to amend or repeal the law continue.
- Employers struggle to balance shrinking revenues with competitive total reward strategies.
- Economic forces are putting pressure on employer pension and welfare benefit dollar allocations.
- As employees continue to take on more work, work/life balance issues persist.

PRICE PREDICTIONS

+12 to +14%, 2-4% attributable to coverage changes mandate in health care reform

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CYBER RISK

- The market for stand-alone Cyber policies is competitive, with rates flat to down 5% for renewals at present, **but with mounting losses, 2011 renewal rates may begin to flatten and even rise 5%.**
- **First-time buyers will likely find a continuing competitive environment**, though the range between insurers may narrow if losses mount.
- New markets include Travelers and, soon, Liberty. Several markets have revised their policies bringing in more robust data breach incidence response services.
- Policy wording continues to expand both for privacy coverage (fines/penalties and breach cost sublimits) and more dramatically for first-party coverage.

- Insureds that buy Errors & Omissions (E&O) policies are often able to add Cyber risk by endorsement. Exceptions include financial institutions.
- Insurers are moving to control loss costs and attract business by **providing privacy breach risk management services**, including panels of breach response firms. **Insureds agreeing to use the panels may be able to buy higher sublimits** for breach notification cover.
- Privacy laws continue to spread both in the U.S. and Europe. More than 45 states now have privacy breach notification laws and in the health care sector the HITECH Act adds a national privacy regulation for protected health information. We have seen health care clients assessed fines following breaches of private medical information.
- The European Union is considering mandating notification to residents following a breach of their personal identifiable data.
- 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.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Renewals	Flat to +5%
First-time buyers	Competitive

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DIRECTORS & OFFICERS

- The past half year brought some of **the most dramatic changes to Directors & Officers coverage** since entity coverage (Side-C) was introduced in the early 1990s.
- Many key carriers have introduced **enhancements on primary forms**, creating a new D&O landscape.
- The enhancements, which will likely be a boon to covered directors and officers, include:
 - Pre-claim inquiry costs for the executives
 - Personal liberty protection costs
 - Sarbanes-Oxley clawback “facilitation costs”
 - Express payment on behalf of the individuals where indemnification is denied or delayed (via the removal of the presumption of indemnification)
 - Removal of the pollution exclusion
 - Sharp curtailment of the insured-versus-insured exclusion
- These coverage enhancements (particularly the last three) will be familiar to purchasers of A-Side coverage. Their inclusion into traditional D&O programs puts pricing pressure on excess A-Side carriers providing difference-in-conditions coverage as the “differences” disappear.
- This transformation is spreading beyond U.S. and Europe.

- At home, some of these **coverage innovations are making their way into coverage for private companies and not-for-profit entities.**
- A new D&O-related product provides investigation cost coverage for *companies* in securities-related investigations. The question of the day is whether this remains an additional purchase or will be added to the D&O policy itself.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Commercial	-5 to -15%
FI	-5%

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EMPLOYMENT PRACTICES LIABILITY

- Employment Practices Liability (EPL) looms large in the age of the whistleblower, WikiLeaks and new/social media.
- **An unprecedented number of Employment Practices Liability claims were filed with the Equal Employment Opportunity Commission in the past year.**
- A number of carriers have introduced “new media” clarifications to policies. While these are unlikely to alter coverage, they can be reassuring to HR departments increasingly reliant on new media tools in the hiring and recruitment process.
- A number of key EPL carriers are also retooling the loss control arsenal they offer to their policyholders usually free of charge or with some element of cost sharing.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Private/Nonprofit	-5 to -20%
Public Company	-5 to -15%

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ERRORS & OMISSIONS

- **The global Errors & Omissions (E&O) market remains soft.** Despite an abundance of capacity, new entrants join the market and the appetite of existing markets is strong.
- While reductions will depend on exposure and industry type, **for many, premiums will fall by up to 5% or more. Desirable risks could see reductions of 10% or more.**
- In some cases, large losses are pushing primary insurers to a more conservative underwriting stance on price and capacity.
- Authorized global E&O limits top \$600M, though any single insured will likely find available capacity from \$350M to \$400M.
- **Competition will remain generally strong in the middle market** and continue on a more selective basis for large insureds through Q3 and possibly Q4.
- Competition will continue to focus on price and policy wording enhancements, with **most insurers standing firm on deductibles.**
- Policy forms for mature market segments will not expand meaningfully in terms of core coverage, although insurers will continue to compete vigorously on policy wording for specific accounts. Generally, insurers are working to **add or enhance options to cover Network Security and/or Privacy Liability in their E&O policies.**
- The expected recessionary spike in claims produced a number of large losses that are impacting the strategy of several insurers.
- For the remainder of 2011, desirable risks should find **ongoing opportunities to drive policy wording expansion and price reductions.**

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Good loss experience	Flat to -10% through Q3; flat to -5% by Q4
Poor loss experience	+5 to +10% through Q3; +15 to +20% by Q4

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FIDELITY

- **Pricing on mid-sized financial institutions and commercial accounts is aggressive.** While incumbent markets will try to hold the line on premium and offer flat renewals, **competition will often result in further reductions.**
- **Fortune 500 companies and large financial institution will likely see flat renewals,** as the number of lead markets willing to write primary on such accounts is very limited.

- Catastrophic losses appear to be down, though 2010 figures are not final. While large seven- and eight-figure losses still occurred; the startling number of nine-figure losses has dropped off.
- While the volume of claims has declined, claim activity is still significantly higher than in the pre-recessionary economy.
- Capacity remains plentiful, and newer entrants into the market who previously limited themselves to excess layers are now targeting primary layers for smaller to mid-sized institutions and commercial risks, adding to an already competitive market.
- **The excess Fidelity market for mid-sized commercial and FI accounts is exceedingly competitive**, with premium running as low as 35-40% in the commercial space and 40-45% for FIs.
- Although excess pricing for larger institutions and commercial risks is not as competitive, capacity is sufficient to offer opportunities for premium savings.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Commercial Crime	Flat or down slightly
FI Bond Market	Flat

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FIDUCIARY

- **In good news for purchasers of Fiduciary Liability insurance**, many markets that had retreated a few years back, pulling or limiting capacity, are now back in business.
- A number of these carriers have or will be **introducing new coverage forms**. Buyers face a unique opportunity to have their voice heard on how best they would like to see their coverage evolve.
- **Many policies include enhancements now available in the similarly changed D&O landscape.** These include:
 - Pre-claim inquiry costs for the fiduciaries
 - Personal liberty protection costs
 - Express payment on behalf of the individuals where indemnification is denied or delayed (via the removal of the presumption of indemnification)
- Undeterred by the legal and legislative debate over health care reform (the **Patient Protection and Affordable Care Act**), **carriers are braced for a potential spike in claims**, especially on the administrative side of the contract. Fiduciary policies will usually cover errors or omissions in administration of health and welfare plans.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Private and Not-for-Profit	-5 to -20%
Public Company	-5 to -15%
Without Company Stock	-5 to -20%

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HEALTH CARE PROFESSIONAL

- **The Health Care Professional Liability (HPL) market will likely remain soft through at least the first half of 2011**, but we believe the market is close to bottoming and underwriters will seek flat renewals later in 2011.
- Pricing will depend on such key factors as jurisdiction, loss experience and the particular layer of coverage, but rate reductions for now will average in the low single digits.
- Primary layers of coverage will see fewer pricing fluctuation than excess layers. High excess layer pricing continues to be extremely competitive, particularly in the layers above \$10M.
- HPL is one of the most profitable insurance lines, and hence one of the most competitive, with excess capital 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.
- **Coverage terms and conditions continue to expand as insurers attempt to compete on more than price.** Some Cyber Liability, Evacuation and other ancillary coverages are being included in HPL/Umbrella policies at no additional cost. Exclusions for punitive damages and molestation are being readily removed.
- 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 between insured and insurer as well as among insurers.**
- Tort reform trends must be closely observed over the next few years as the trial bar has succeeded in overturning non-economic damage caps in states such as Illinois and Georgia. Challenges to tort reform legislation in other states are underway.
- The potential impact of health care reform on HPL exposures is an enormous unknown. No meaningful federal tort reform was enacted as part of the legislation, although \$250M in the federal grant money is now available to states to study and enact malpractice reform laws.
- Observers have expressed 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 also presents significant liability exposures.

PRICE PREDICTIONS

Flat to -5%

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AEROSPACE

- Conditions continue to vary by sector:
 - **Airlines - The market is increasingly selective**, with premium increases in the low single digits.
 - **Aerospace - Single-digit premium reductions continue** for the manufacturers who dominate this sector.
 - **Corporate Aviation - Significant capacity is bringing reductions.**
- **Significant capacity in the Aerospace market** as a whole is applying downward pressure on rates, countered by increasing exposures.
- **Global economic recovery is expected to produce exposure growth** in most aerospace sectors and geographies. Oil prices could result in a slowing of this recovery.
- Annual airline losses once again exceed \$2B for 2010 and remained above the five-year average, extending a **run of loss-making years for underwriters.**
- **Ongoing consolidation in both the airline and increasingly the aerospace sector** will further reduce the number of buyers and shape many market programs. Economies of scale mean **lower premium increases for the top 50 airline programs.**
- Airline renewals are increasingly consolidated into the final quarter and in particular the last six weeks of the year.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
Airline	Flat to +10%
Aerospace	+/- 10%

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CONSTRUCTION

- Construction remains slow. With the final stimulus contracts awarded, federal and state budgets are under significant duress and construction funding will continue to suffer. **For the rest of 2011 a slow recovery is forecast.**
- Private building and residential is somewhat improved but most major work is confined to a few niches, such as health care, higher education and public-private initiatives.
- Following the catastrophe in Japan, some are forecasting material cost increases as demand for basic building materials spikes.
- Marketplace competition is fueled by the continued entry of more competitors.
- **Rates are not falling as they were in 2010 and we believe prices will begin to flatten as the year progresses.**
- New business is still attracting interest from virtually all carriers.
- Other factors impacting the market include acquisitions (notably international construction firms buying U.S. firms) and increasing bankruptcies.
- Claim disputes are on the rise, bringing vigorous debate on coverage interpretation, particularly in General Liability and Builders Risk.
- Markets are showing more flexibility on underwriting job-specific, General Liability wrap-ups, which is a key concern of many contractors and is welcomed by many.

PRICE PREDICTIONS

TYPE OF ACCOUNTS	
General Liability	Flat to +/- 10%
Workers' Compensation	-5 to +10%
Builders Risk	Flat with significant competition other than in higher catastrophic areas
Project Insurance (Wrap-Ups)	Flat with significant variation depending on job size, type of work and location

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ENERGY

UPSTREAM

- **Capacity is up, but recent losses have halted any market softening.**
- We see no sign yet of legislation amending the Oil Pollution Act – but an increase in limit of liability seems certain.
- Only 30% of the upstream market is writing stand-alone Operators Extra Expense (OEE), so if an OEE risk is presented on its own, it will be more expensive than if packaged with general upstream business.
- Specialist marine Third-Party Liability insurers are now changing the way this class of business is underwritten.
- The outlook for the remainder of 2011 depends on the long-term impact of the Japanese earthquake:
 - A bad North Atlantic hurricane season would likely force capacity to withdraw.
 - If losses are benign, insurers are likely to compete for business again in the second half of the year.

PRICE PREDICTIONS

Flat to modest price increases in the immediate future

DOWNSTREAM

- **More capacity is available, but serious losses have caused the market to pause for breath.**
- Carrier portfolios are still profitable – for now.
- If losses in Japan do not force capacity to withdraw, **a wide variety of options will be available to downstream insurers:**
 - Withdrawal from the market
 - Writing rejected business
 - Focusing exclusively on target business
 - Reducing deductibles
 - Offering full value policies
 - Offering capacity on a long-term basis
 - Competing for cross-class business

PRICE PREDICTIONS

Flat to modest price increases in the immediate future

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ENVIRONMENTAL

- The environmental insurance market continues to attract new entrants; however, expansion is slowing. The increased competition has delivered **many advantages for buyers**.
- The environmental sector is experiencing a **dilution of underwriting expertise** as personnel leave established carriers to join new market entrants. Some carriers are facing challenges in underwriting, policy servicing and claim handling as a result.
- **Underwriting appetites** range from near commoditization in some products (i.e., Contractors Pollution Liability) to very cautious in others (i.e., Cleanup Cost Cap).
- Softness in pricing has produced opportunities for clients to lock in **long-term savings through multiyear programs**, as well as to obtain **enhanced limits with broader coverage**. However, the availability of multiyear programs continues to decline with policy periods shrinking except for specific classes of business.
- We have seen **transaction-related environmental placement opportunities** (real estate, development and M&A) increasing in both frequency and success.
- While some markets are attempting to hold the line on pricing reductions or even obtain increases at renewal, for the most part pricing is still very competitive.
- We expect that any potential hardening of the environmental markets will lag at least three to six months behind any hardening of the Property and Casualty markets.
- Many companies are reinvesting the savings they have experienced in traditional Property and Casualty lines in **first-time purchase of environmental coverage**.
- A **worldwide increase in environmental regulatory requirements and enforcement** is also raising interest in environmental coverage.
- **With more coverage, we have seen more claims**, particularly in association with construction and transportation-related activities.

PRICE PREDICTIONS

PRODUCT	
Contractors Pollution Liability	-10% to +15%
Pollution Legal Liability (Including Combined GL/PLL)	-15% to +5%
Environmental Professional Liability (including CPL)	-5% to +10% %
Financial Assurance Instruments - UST, Closure (risk transfer), Bonds	Flat to +10%
Cleanup Cost Cap	Flat to +15%

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KIDNAP & RANSOM (SCR)

- The Special Contingency Risks (Kidnap & Ransom) market **is beginning to show signs of hardening**, driven by losses in Mexico, Venezuela and North Africa.
- **Flat renewals for exposures in low risk locations can still be expected.**
- While insurers continue to offer coverage extensions and customized solutions for unique exposures, they are **reducing event limits and adding aggregates.**
- Changes in the relationships between insurers and response consultants due to acquisitions and spin-offs in the security industry are expected to subside. However, new consultants without contractual connections to specific insurers may enter the field.
- Insurers are focusing on the deteriorating security situation in Mexico and Venezuela, which have seen dramatic increases in kidnappings and related criminal activity. Buyers with either operations or personnel regularly traveling to Mexico and Venezuela are being underwritten closely, with a spotlight on security measures and loss history.

PRICE PREDICTIONS



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MARINE

HULL

- Surplus capacity continues to influence the Marine market. **Rates are softening, yet fresh capacity is queuing up, particularly in Lloyd's.**
- Catastrophes in Australasia have not turned the market as some have predicted.
- The industry is showing tentative signs of recovery. The number of laid up vessels has fallen, the majority of freight rates are slowly increasing and ship values are no longer plummeting.
- Some new tonnage will be delivered during 2011, but many new-build contracts have been cancelled or renegotiated.
- Piracy continues to be a huge concern, spreading from the Gulf of Aden into the Indian Ocean. Claims increase with no solution in sight. Additional cover and support provided by a Kidnap (K&R) policies have proven invaluable in many instances.

- Growing sanctions against countries such as Iran and Libya have brought new challenges. Underwriters and brokers are constantly working to ensure they remain compliant with the various sanction regimes.

PRICE PREDICTIONS



CARGO

- Tentative economic recovery has meant increased cargo shipments and rising demand for coverage, **but competition in the global cargo insurance market remains fierce.**
- In the absence of major losses, the market dynamic of recent years will remain: **increased capacity, greater competition and reduced rates.**
- Recovery has raised demand for metals, particularly from China, yielding an increase in prices, especially for non-ferrous London Metal Exchange (LME) traded metals and certain minor metals.
- For commodities, we have seen a number of factors, including harvesting results, combining to create a volatile marketplace.
- Climate continues to have a far-reaching impact, causing sudden price hikes and unforeseeable volatility, as the recent Russian wheat export bans and the impact on cotton prices following the flood in Pakistan amply demonstrate.
- With rates low, buyers can focus on high limits and capacity required for storage and the danger of misappropriation.

PRICE PREDICTIONS



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POLITICAL RISK

- Despite turmoil in the Middle East and North Africa, **market stability remains** after a period of active claims in 2009-2010 when Political Risk products were vigorously tested and delivered their intended value.
- Premium rates rose in 2010, **but the market has flattened, and rates even decreased in certain countries** (e.g., Brazil, Turkey, Russia, Argentina).
- With no major claims or losses resulting so far from the uprisings in the Arab-speaking world, **no new significant claim notifications have hit the marketplace since Q4 2010.**

- Losses remain concentrated in **Ukraine, Kazakhstan, Brazil, Bahrain and Indonesia.**
- Recoveries are not likely to be as high as in previous claim periods due to the high incidence of commercial insolvency losses.
- Reinsurers continue to impose certain restrictions, such as not covering working capital loans or bullet loans over 24 months.
- **New underwriters continue to enter the market after** one significant carrier stopped writing new business in June 2010 despite extremely low claim experience.
- For 2011/2012, we anticipate several trends:
 - **Increased underwriter due diligence**
 - **Increased focus on structure and security**
 - **Downward pressure on premium rates**
 - **Policies above \$30M will need to be syndicated**
 - **More risk sharing between underwriters and insureds (carriers' preferred indemnity levels will be 60-75%)**
- **Middle East Update:** Stand-alone political violence coverage is not generally available, but certain countries, especially if they are pooled with other regions, such as LATAM or Asia, may be considered by underwriters:
 - **Bahrain** – Risks are expected to rise; the country may lose its edge as a financial center if banks withdraw.
 - **Jordan** – Exposure is decreasing since the Jordanian opposition movement agreed to rejoin the National Dialogue Committee.
 - **Kuwait** – Exposures will likely expand as political and ethnic tensions continue to rise.
 - **Syria** – Risks are growing as the Syrian regime is facing its most challenging crisis since Bashar Assad became president.
 - **Yemen** – The country has descended into further chaos as senior army officers defect.
 - **Libya** – Risks remain great as the civil war continues.
 - **Egypt** – Exposures should ease if the military maintains control until elections take place.

PRICE PREDICTIONS

Flat to -15%

CONTACT

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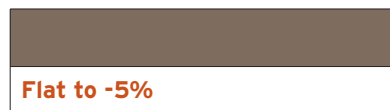
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SURETY

- The Surety market remains **very competitive for the best accounts and difficult for financially stressed contractors.** Surety underwriting remains conservative, but increasing surety credit capacity is available for stable large accounts.
- For strong companies, Surety rates are competitive, as a result of favorable surety company loss ratios and a soft top line driven by the lagging construction economy. The inverted pricing curve for small, middle and large capacity players is leveling off.

- Year-end 2010 Surety results show a modest decline in the top line and a very profitable 13.2% loss ratio.
- For entities facing underwriting challenges, we recommend diligent focus on business basics: manage overhead, bid appropriately, manage cash and debt and maintain an open flow of communication.
- Profit margins on projects are down due to the reduced number of opportunities and a contractor marketplace with excess capacity.
- Longer term, market conditions may change significantly. Surety losses typically lag behind economic downturns by three to four years. **We predict losses will increase by late 2011 and into 2012 and 2013, possibly tripling loss ratios.**
- Subcontractors with shorter duration backlog are likely to be among the first entities to create surety losses. As a result, underwriters are cautious to write bonds for specialty contractors, and they are placing more scrutiny on GC prequalification practices and tools to manage subcontractor default, such as sub-bonds, subcontractor default insurance, joint payments, etc.
- Construction spending fell again in 2010 to an estimated \$788B – the lowest annual spend since 2000. All major construction sectors declined, except power construction and roads and highways.
- The residential and private construction markets continue to suffer and await the anticipated rebound of housing and commercial construction markets.

PRICE PREDICTIONS



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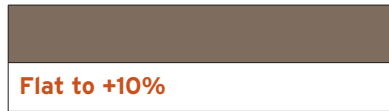
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TERRORISM

- As a consequence of widespread turmoil throughout the Middle East, **terrorism and political violence rates are showing a distinct firming globally.**
- **In the U.S., buyers in areas subject to high terrorism risk aggregation (tier-one risks) will struggle to purchase adequate limits.**
- Stand-alone terrorism capacity per risk stands at a theoretical maximum of \$3B for risks located outside of highly aggregated areas.
- Most policies still exclude nuclear, biological, chemical and radiological (NBCR) terrorism events. Stand-alone market capacity is limited to \$200M per risk.
- Captive insurance facilities continue to provide alternative, cost-effective terrorism capacity for U.S. risks, including broad coverage for Liability exposures and NBCR terrorism events.
- Approximately 65% of all companies purchase Property Terrorism insurance, either embedded in Property programs or on a separate, stand-alone basis. An estimated 40% purchase Liability Terrorism cover.
- Real estate, hospitality, utility, transportation and financial service companies are typically the largest purchasers of Property Terrorism insurance.

- Further extension of the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) beyond its current 2014 expiration date is uncertain. This will be problematic for the marketplace if unresolved by 2013. Without government support, the insurance industry would likely be unable to develop sufficient surplus to respond to the potential magnitude of a terrorist attack.

PRICE PREDICTIONS



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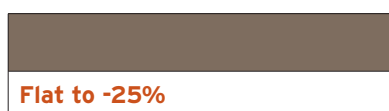
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TRADE CREDIT

- The convergence of a softening Trade Credit market, political upheaval in the Middle East and Africa, and uncertain economic times offers **significant opportunities for corporations wishing to transfer their risk of non-payment of receivables**. Policies cover non-payment exposures due to financial and political events.
- As the economy begins to revive, **the Trade Credit market is seeing significant relief from the hard market that followed the global credit crisis. Premium rates have dropped 15-25% from previous highs**. The soft market continues as underwriters aggressively bid for new business. New entrants into the U.S. market will add to the competitive landscape.
- This has led to more aggressive underwriting in coverage, policy structure and premium. Carriers on the whole are aggressively looking to improve their top line revenue numbers, pushing market rates back to pre-recession levels.
- Reinsurance capacity is plentiful for Trade Credit markets.
- The successful payment of a record volume of claims during the financial crunch validated the product as a means of mitigating the risk of losses due to bad debt. The constrained availability of the product during the downturn underscored the value of secure partnerships with insurers, as long-time buyers were better able to obtain and hold coverage. Although claim volumes have decreased over the last several years, Willis still helped settle 121 claims in 2010 with a total value of \$22M.

PRICE PREDICTIONS



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