Fall 2009 Issue 4

MARSH

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Property Insurance News

In This Issue

1 Potential Flood Event in Washington's Green River Basin

2 The U.S. Property Market: Through the First Nine Months of 2009

4 Last Minute Extension Saves the NFIP Through December

4 Increased Need for Force Placed Insurance Coverage Challenges Commercial Property Insurance Marketplace

6 CAT Modeling: Is It More Than Just a Number?

7 Product Spotlight: Marsh's Excess Property Facility

Potential Flood Event in Washington's Green River Basin

On September 10, 2009, a state of emergency was declared in King County, Washington, as a result of announcements made by the U.S. Army Corp of Engineers (USACE) regarding the potential for flooding in the Green River Basin.

USACE discovered structural damage to the Howard Hanson Dam, which was designed principally to provide flood control in the winter months and fish enhancement in the summer. In January 2009, USACE discovered a variety of potential issues, including two depressions on the dam's right abutment. The dam is not in jeopardy of failing, according to USACE, but it presents an increased risk to downstream communities in the Green River Valley. As a result, USACE has placed restrictions on the storage capacity of the dam.

The Corp is evaluating the issues and working nonstop to repair the damage to the dam. Some repairs were scheduled to be completed as of November 1, 2009, with further evaluations and repairs taking between three and five years. Additional monitoring equipment has been installed and tests are ongoing.

These repairs have significantly lessened the chances the Green River will flood this winter to 1-in-25. Before the hurried repairs, the Corps said there was a 1-in-4 chance of flooding downstream. While these improvements are certainly good news, residents and businesses are urged to continue to prepare for the possibility of flooding.

According to the Army Corp of Engineers' official website, "Should a major flood event occur with the temporary restrictions on the pool level for flood storage, it is possible that levees in the lower valley could be overtopped. USACE will continuously reassess the pool restriction as conditions change and may raise or change the restriction on pool elevation after careful deliberation."

Marsh recommends its clients in the vicinity should:

- prepare, review, and/or test their emergency response and business contingency plans to deal with such an event,
- understand how their property policy will or will not respond in the event of a flood, and
- review the availability of flood coverage through the National

Flood Insurance Program (NFIP). It is important to remember that there is a 30 day waiting period before coverage takes effect unless it is required by a lender. The NFIP policy does not exclude intentional release of water by USACE.

Following is a list of useful websites and resources. Please contact your local Marsh representative to discuss potential flood insurance mitigation techniques for your company's exposures.

- Maps depicting downstream flood scenarios published by USACE
- King County government flood preparation
- King County Flood Control District
- Marsh Risk Consulting (MRC)'s Natural Hazards Risk Advisory (click here or email Marsh.PropertyRiskConsulting@marsh.comto subscribe to the email service).

The U.S. Property Market: Through the First Nine Months of 2009

The U.S. commercial property insurance market for the first nine months of 2009 was one in a state of transition. First quarter results showed a flattening of the market with a slight upward trend for heavier catastrophe (CAT)-exposed risks and larger increases for clients who experienced losses. While results in the early part of the year pointed to a "hardening" market, such a market never materialized. What resulted can best be described as a slight correction in rates, centered on two main accounts attributes: CAT exposure and losses.

Renewal results in the second and third quarters were erratic and varied based on overall CAT exposure and the loss experience of each individual account. However, a small spike in CAT pricing in the second quarter of 2009 has not materialized into a sustained turn upwards in pricing. Average premium rate increase remains approximately flat to 10 percent increase. Extremes can be found on both ends of this range, however, depending on individual account specifics such as loss history, CAT exposure, and overall CAT limits purchased. CAT capacity available in the market has not diminished significantly; although clients that purchased significant limits of CAT coverage (excess of $100 million) likely faced significantly higher pricing.

The low percentage of average rate increases is somewhat skewed. Many of Marsh's significantly-CAT exposed clients changed the terms and conditions of their property programs to offset potential increases. Marsh's benchmarking data shows that many CAT exposed clients employed one or more of the following tactics to minimize rate increases: reducing the amount of catastrophe coverage purchased, amending policy limits, increasing deductibles, and/or amending their policy limits and deductibles—more than one in five clients did so by more than 20 percent in the second quarter of 2009.

The Atlantic Hurricane Season

The relatively benign hurricane season along the Atlantic and Gulf coasts likely significantly mitigated the potential hard market forecasted in the early part of 2009. As the official end of the season nears—hurricane season runs from June 1 through November 30—there have been a total of nine named storms, including three hurricanes (two Category 3 or above). Experts at the National Oceanic and Atmospheric Administration (NOAA) forecasted seven to 11 storms and three to six hurricanes while the Colorado State University hurricane team predicted 10 named storms, including four hurricanes. Both organizations revised their outlooks in the middle of the season, lowering their predictions. The relatively low amount of losses sustained has helped to keep premium rates for both CAT and non-CAT property programs at fairly steady prices.

The H1N1 Virus

As we approach the flu season experts are predicting the H1N1 virus will continue to spread across the world. As of November 1, 2009, the World Health Organizations says 199 countries have confirmed cases of the virus. The Center for Disease Control (CDC) estimate 22 million people in the U.S. have been infected and nearly 4,000 have died. Those numbers are likely to significantly rise during flu season. Businesses should consider contingency plans

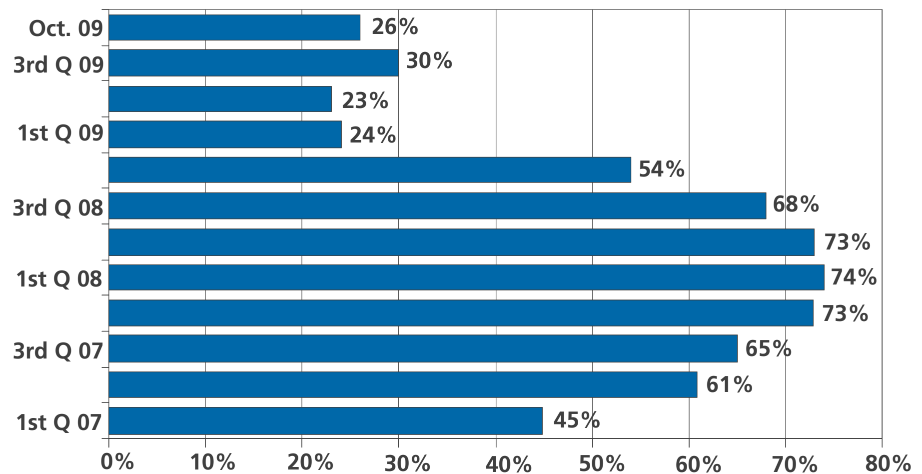
in the event of a large disruption to their operations, whether from a mass absence of workers, delays in their supply chain, civil or government action, or a variety of other potential challenges. There are few pandemic insurance options available in the marketplace and Marsh's experts are positioned to help organizations analyze potential solutions. Please visit Marsh's Pandemic Update Center to access a wealth of information and resources.

Upcoming January 2010 Reinsurance Treaty Renewals

According to Guy Carpenter, most reinsurers expect a flat market at the January 1, 2010, renewals. They also expect this to be a relatively late renewal with buyers holding out for the most competitive terms. Catastrophe pricing is likely to be relatively flat in most cases; renewals in non-peak zones may see up to a five to 10 percent decrease in price. Most large national programs should see modest downward price pressure on a risk adjusted basis. However, variation is expected region-to-region. Areas that saw the most increase in the January, June, and July 2009 renewals—along the FL and TX Gulf coasts, for example—could see more significant price decreases than the overall market as pricing regresses toward historical averages. Overall, however, reinsurers spoke of expanding their presences in the Northeast and Texas/Gulf coast, which could increase competition, moderate rate increases and/or put downward pressure on pricing.

To learn more about the reinsurance market, please visit Guy Carpenter's "Reports and Publications" web site.

Percentage of Accounts with Rate Reductions Greater Than Five Percent



Data is based on Marsh's historical property benchmark information.

Q4 2009 and Beyond

As we enter the fourth quarter of 2009 there are signs of stabilization in the property insurance market. Rate increases have moderated and insurers will likely need to aggressively write business through year end to make up for anticipated cost increases that did not materialize. Many insurers who sat out the first half of 2009 anticipating higher pricing in the latter part of the year are now faced with making their budgets in a short time frame. Additionally, the number of accounts coming into the market in the second half of the year has diminished significantly over the past few years.

We anticipate the following general pricing trends. Please note the following assumptions are highly subjective and may change quickly if a significant catastrophic event (landfall hurricane, earthquake) occurs. Premium rates will depend on each individual company's risk profile and history. Any discussions of rates are ranges based on averages and outliers will exist. To discuss your company's specific needs and opportunities, please contact your Marsh representative.

- Accounts with minimal to no CAT exposure should expect higher levels of competition and rate changes of minus 5 percent to plus 5 percent.
- Accounts with moderate to high CAT exposure will see higher average rate increases between flat to 10 percent.
- The number of accounts seeing rate decreases will increase as the end of the year approaches.
- CAT capacity levels should remain constant; however, pricing will remain an issue for accounts purchasing significant limits of CAT.
- CAT models may add confusion to an already erratic market.
- January reinsurance treaties are expected renew with flat to moderate increases. However, without a major catastrophe event many analysts expect downward pricing pressure.

Last Minute Extension Saves the NFIP through December

The National Flood Insurance Program (NFIP) was extended on Friday, October 30, 2009. The extension was part of an appropriations bill voted by Congress and signed by President Obama to extend the NFIP until December 18, 2009. The NFIP was originally set to expire on October 31, 2009.

This is the fourth short-term extension since September 2008 for the NFIP, as Congress debates whether or not to include coverage for windstorm damage. The Multiple Peril Insurance of 2009, introduced by Rep. Gene Taylor (D-Miss.), would create a new option in the NFIP to cover both wind and flood damage in one policy. Taylor's home was damaged by Hurricane Katrina in 2004. He has been lobbying the White House to insist on including windstorm damage, but it said to have met resistance from both the Obama administration and the insurance industry.

Jimi Grande of the National Association of Mutual Insurance Companies said, "We applaud Congress for ensuring the National Flood Insurance Program will remain in place and hope that it will enact a lengthier extension before the continuing resolution expires." However, Grande continued by expressing a desire for Congress to leave windstorm coverage off the table, saying it is "already being served by the private market."

Although most in the insurance industry are grateful for the extension, there is some criticism of the continued short-term fixes. A representative from the Professional Insurance Agents (PIA) was quoted as saying, "While we are heartened that the flood program was not allowed to slip into a technical lapse, these short extensions are insufficient to maintain certainty in the market." Many have highlighted the importance of addressing the needs of the program longer term and including reforms that would significantly improve coverage limits and make business interruption insurance available to companies.

The program was extended in its current form, with the change of the date the program's only modification. Marsh's Flood Service Center will keep abreast of any developments.

Increased Need for Force Placed Insurance Coverage Challenges Commercial Property Insurance Marketplace

The significant increase in mortgage defaults by both residential and commercial borrowers has been a hot topic of trade journals and mainstream media alike in recent months. As one would expect, many of these defaults result in foreclosure, creating a need for mortgage lenders and servicers to protect their collateral from physical damage losses through the purchase of foreclosed property coverage.

The U.S. property insurance market remains relatively soft—in part due to recent benign hurricane seasons along the Atlantic and Gulf coasts—and capacity for foreclosed property insurance remains readily available. Most seasoned underwriters are able to accurately assess the exposures presented by mostly vacant properties. Insurers have been successful in working with lenders and property managers to use risk mitigation tools such as frequent inspections, installation of alarm systems, and proper boarding of entrances to avoid costly vandalism and fire losses. As a result, there are a sufficient number of insurers competing for foreclosed property business.

An increase in the number of mortgage defaults also results in an increase in the number of borrowers who do not maintain the required insurance on the mortgaged collateral. When this happens and the lender or mortgage servicer becomes aware of the lapse in coverage, the lender/servicer has the ability to purchase force placed insurance to protect the collateral from physical damage losses, as per the mortgage documents. Typically, lenders are able to charge to cost of the force placed insurance back to the borrower.

Force placed coverage is much more complex than foreclosed insurance, and there are far fewer underwriters who thoroughly understand the coverage needs of mortgage lenders and servicers. Force placed coverage is unique in that the entity purchasing the coverage—the lender or mortgage servicer—does not have physical control of the property. Most

force placed properties are occupied by the very borrowers who have defaulted on their mortgages, few of whom are occasionally guilty of theft and vandalism to the collateral property. Lenders have no control over these actions yet suffer losses as a result of the damage caused by the defaulting borrower.

Another unique feature of force placed coverage is that the terms of the coverage are dictated by the insurance provisions in the mortgage documents, not by the insured. Typically, the insurance requirements for single family dwellings are detailed in standardized mortgage documents that simplify the insurance tracking and force placed requirements. As a result, there are multiple insurers who aggressively pursue residential force placed coverage.

The insurance requirements on commercial properties, however, are much more complicated and diverse. Depending upon the location, occupancy, and construction type of the mortgaged property, for example, lenders may or may not require coverages such as earthquake, flood, terrorism, loss of rents, mechanical breakdown, and others. Some commercial mortgage lenders outsource the insurance tracking and force placement responsibilities to a third party mortgage servicer. It is the responsibility of the mortgage servicer to review the insurance policy purchased by the borrower to assure that it complies with the coverage required in the mortgage documents. If the borrower's coverage is deficient—and the borrower will not or cannot obtain the required coverage—the mortgage servicer is contractually obligated to purchase the specific coverage to protect the lender's collateral. The use of sublimits on catastrophic perils and blanket limits on mortgages that contain multiple buildings further complicates the commercial mortgage servicers' tasks.

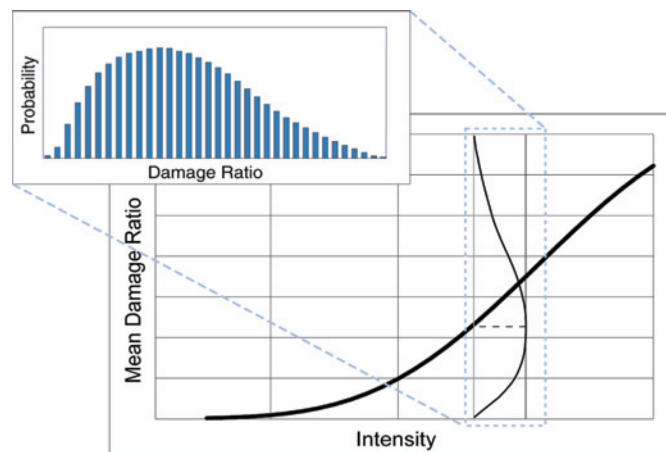
A properly crafted force placed program must provide the mortgage lender or servicer with the ability to purchase the required insurance to comply with the requirements of the mortgage documents. In the standard property insurance market property coverage is typically provided on an "all-risk" basis with optional perils or coverage enhancements only available as attachments to the building coverage. An insurer that provides force placed coverage must be willing to price and offer each coverage individually, allowing the mortgage servicer to purchase only the coverages for which the borrower's coverage is deficient. For example, if the borrower purchased insurance coverage on the building but was unable to obtain sufficient terrorism coverage, the force placed program must allow the mortgage servicer to purchase only terrorism coverage on the property. The ability to customize programs is a requirement of the insureds that generates significant underwriting issues due to the potential for adverse selection. The coverages that the borrower is unable to obtain (either due to availability or cost) are most likely the coverages that create the highest potential for loss. Additionally, many commercial mortgages have high values and require force placed limits of insurance that exceed the comfort level of many property underwriters. Also, because it is impossible for the lender or mortgage servicer to anticipate when a borrower's coverage will lapse, insurers must be willing to provide "automatic coverage" without an opportunity to underwrite each individual property.

It is the combination of unique coverages, the need for large limits, and the inability to underwrite individual properties that makes appropriate force placed coverage for commercial mortgage lenders and servicers difficult to obtain. There are specialty insurers who, if given detailed information about insurance tracking procedures and mortgage portfolio characteristics, will underwrite this class of business, but it takes a knowledgeable property broker to understand the coverage needs of the client and to effectively negotiate the broadest and most advantageous coverage terms.

Marsh has experienced property brokers who have been placing coverage for the United States' largest financial institutions for many years. Marsh is the only major U.S. broker with a dedicated Financial Institutions Specialty Property Practice that is committed solely to working with mortgage lending clients on force placed, foreclosed, and mortgage impairment exposures. This extensive experience and commitment makes Marsh uniquely qualified to broker force placed coverages for the top commercial mortgage lenders and servicers.

CAT Modeling: Is It More Than Just a Number?

Catastrophe (CAT) modeling has become commonplace in the property insurance placement process for portfolios that are exposed to catastrophic natural hazards. There was a time when a risk manager or insurance company would develop their earthquake probable maximum loss (PML) for a San Francisco property by subjecting it to some past catastrophic event. Risk managers would ask themselves, "What damage could I expect if the 1906 San Francisco earthquake were to occur today?" This was the best method available at the time. Today, we have at our disposal a stable of probabilistic loss models to help us in quantifying the loss potential.



Using the Great San Francisco Earthquake of 1906 to determine a company's PML will develop a loss projection, but this requires some assumptions that can cause problems. It assumes that this would be a worst case event for the portfolio; however, depending on the geographic location of the assets, it may not be the worst case event. This method also assumes that the earthquake of 1906 is the worst case event that could be expected in the San Francisco area, which also may not be true. More importantly, it assumes a 100 percent probability of the event occurring again. This does not provide a true measure of the risk. Risk is a combination of severity and probability.

CAT modeling offers a solution to all of these challenges. The models being utilized in the risk management industry are primarily experienced-based, which means the vulnerability or damageability functions are based on past claims data. These models have become increasingly sophisticated since their appearance in the market approximately 20 years ago and incorporate the latest science available for each peril (i.e., earthquake, windstorm, flood). This has made them significantly more useful in managing risk.

In contrast to the example above, CAT models consider the possibility of events of greater magnitude than the 1906 San Francisco earthquake. They also consider possible events along the entire length of an earthquake fault system or the coastline for windstorm events. This allows the model to develop scenarios that would expose a specific portfolio to the greatest intensity events and develop portfolio-specific loss projections. Finally, the models develop probabilistic loss projections for the portfolios being analyzed. These loss projections are expressed in exceeding probability curves, which are essentially risk curves that describe the loss potential at a wide variety of probabilities of occurrence or return periods. From these curves, loss projections can be accurately developed, as can probabilities, which complete the definition of risk.

The different players in the risk management industry currently use the models for different purposes. Insureds primarily use them to assist in setting limits. The models are run to develop a set of losses typically ranging from the 100-year to the 1,000-year return period and the client then chooses a return period that satisfies their appetite for risk given current market conditions and pricing of risk transfer. Insurers primarily use models first to determine a PML—in most cases the 250-year return period—and then to determine an Average Annual Loss (AAL), which is in risk management terms a "pure" or unloaded premium. The AAL can be developed for any layer of insurance and program structure. This is used by many underwriters as a base to determine pricing for a given layer. Insurance rating agencies use the models to compare a insurers' reserves versus the risk to their book of business for various CAT perils.

The models provide much more value than in the past due to their increased sophistication. The results

are being used to target facilities for upgrades, develop true risk based premium allocation programs, negotiate pricing on specific programs based on AAL, negotiate limit requirements required by investors or lenders, and gain a better understanding of a clients' true risk from CAT perils as well as the spread and drivers of that risk.

Marsh as a Differentiator

While many of insurance brokers offer modeling to clients, it is common to only provide loss projections for various return periods and an AAL. This service, while useful, does not leverage the true power of modeling. Marsh offers a much broader perspective. Rather than accept the numbers the model develops at face value, we investigate the drivers behind the loss projections and offer solutions to our clients that enable them to better manage their CAT risk. CAT coverage is, in most cases, the most expensive line item in a CAT-exposed client's risk management budget. Effective use of modeling is a potential solution that can reduce the actual or perceived (modeled) risk to a portfolio and/or the cost of coverage.

Managing the cost of coverage should begin with developing good data on the construction features for the property assets at risk. The modeling results are driven by this input information. While the models are extremely sophisticated, they remain dependent upon quality input data. In many cases, key pieces of data are missing, which causes the models to generate loss projections with much greater uncertainty. Most of these weaknesses in the data can be easily identified and corrected. In many cases, by carefully analyzing the output from the model, Marsh can develop a list of "target" facilities that are driving the risk to a portfolio and can then focus our efforts on developing solid input data for these locations. This is especially important if a client's portfolio is better constructed than the industry average or if mitigation measures have been implemented. Through this process, it is also possible to reflect, in the modeling results, the decreased vulnerability of buildings or structures that implementing mitigation measures can bring about. Being able to develop a financial return from decreased cost of insurance for mitigation measures will enable the construction of more robust structures or strengthening existing structures. This can result in decreased cost of coverage or the ability to lower limits.

Marsh is striving to utilize this wealth of information available from the CAT models to leverage our clients' positions in the market and realize a better outcome for their risk management program. At the end of the day, we are providing information that allows our clients to:

- understand their risk completely both from an property and operational standpoint,
- what locations or characteristics of these locations are driving this risk, and
- have confidence in their risk management program structure and/or insurance purchasing decisions.

So, is CAT modeling just a number? While CAT modeling does produce a variety of numbers, the possible use of these numbers extends into almost every aspect of a client's operational and property protection risk management programs.

Product Spotlight: Marsh's Excess Property Facility

In October 2009, Bowring Marsh, the specialist international placement broker at Marsh, announced major enhancements to its North American Excess Property Facility, which was originally launched two years ago. The facility provides up to $450 million of non-critical CAT capacity in the London market for companies. Previously, it provided only $262.5 million of noncritical CAT capacity.

The facility has been extended to include flood, windstorm, fire and earthquake risks, which were previously excluded. Available to companies worldwide, it covers "all risk" of physical loss or damage, including boiler and machinery. Up to $176 million of critical catastrophe capacity is available, an increase from the facility's original $111.75 million of capacity.

Two Lloyd's syndicates, Catlin Syndicate SJC2003 and Ascot Syndicate RTH1414, lead the cover and have the authority to bind catastrophe capacity on behalf of additional participating markets.

The facility quickly and efficiently accesses large amounts of capacity.

Its scope and the speed of underwriting make this facility an effective and attractive option for our clients. The facility responds within 48 hours and the majority of participating insurers agree to be bound on a catastrophic (non-CAT) basis by the leaders.

The Excess Facility incorporates

MARSH

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

unique elements that address the needs of each client. It is intended as an excess facility only and may not be used on a primary basis. The minimum attachment point is $50 million.

Richard Marks, a member of Marsh's Property Practice, said, "The improvements we have negotiated in the market will make this facility even more attractive. As companies manage their property risks more proactive they want to have the flexibility to be able to cover themselves for potentials catastrophes outside of the well-known California earthquake zones and the Gulf of Mexico windstorm region. They will now have the potential to access such a cover within a short time frame and be able to take cover at lower levels, as the minimum attachment point has fallen from $250 million to $50 million."

Mining, processing of natural resources (e.g., oil, gas, iron, steel, copper, coal, and fossil fuels), and contingent business income are excluded. Terrorism risk coverage can be negotiated with insurers on an individual account basis. While this is not a standalone terrorism product, there may be potential to obtain coverage if TRIA and/or non-certified terrorism coverage is required.

The Excess Property Facility is not restricted to United States-headquartered firms. All North-American-based companies are invited to participate in the facility.

Contact your Marsh representative to learn more about this facility and other alternative insurance solutions.

Contact Us

It is our mission to provide our clients with up-to-date and accurate property insurance market information. This newsletter was developed to help clients understand insurance issues and better plan their risk mitigation strategies.

To participate in a brief survey, please click here or copy and paste the link below into your browser:

http://www.surveymonkey.com/s.aspx?sm=yThqBLowoJD4cA9DArqrqQ_3d_3d

To talk with the *Property Insurance News* editorial department, please contact:

- Kate Byrnes
  (212) 345-9962
  Kathryn.E.Byrnes@marsh.com

*Note: When viewing electronically, this document is interactive. Text appearing in this format indicates active links that may be clicke d on for additional information

The information contained herein is based on sources we believe reliable, but we do not guarantee its accuracy. Marsh makes no representations or warranties, expressed or implied, concerning the application of policy wordings or of the financial condition or solvency of insurers or reinsurers. The information contained in this publication provides only a general overview of subjects covered, is not intended to be taken as advice regarding any individual situation, and should not be relied upon as such. Statements concerning tax and/or legal matters should be understood to be general observations based solely on our experience as insurance brokers and risk consultants and should not be relied upon as tax and/or legal advice, which we are not authorized to provide. Insureds should consult their own qualified insurance, tax, and/or legal advisors regarding specific coverage and other issues. All insurance coverage is subject to the terms, conditions, and exclusions of the applicable individual policies. Marsh cannot provide any assurance that insurance can be obtained for any particular client or for any particular risk.

Marsh is part of the family of MMC companies, including Kroll, Guy Carpenter, Mercer, and the Oliver Wyman Group (including Lippincott and NERA Economic Consulting).

This document or any portion of the information it contains may not be copied or reproduced in any form without the permission of Marsh Inc., except that clients of any of the MMC companies need not obtain such permission when using this report for their internal purposes, as long as this page is included with all such copies or reproductions.

Copyright © 2009 Marsh Inc. All rights reserved. Compliance No. MA9-