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News Release

Willis Group Reports on Insurance Marketplace Conditions

- **Competitive conditions return to certain segments of the marketplace.**
- **Capacity has grown, but not everywhere.**
- **Quality of risk profile is key in negotiating terms and conditions.**
- **Sarbanes-Oxley requirements coming on line may impact D&O liability claims and underwriting.**
- **Marketplace security issues remain, although industry conditions are improving.**

New York, NY, April 19, 2004 – Healthier conditions in the insurance industry have led to growth in capacity and competition, while some segments remain "hard" and continue to challenge risk managers. This update addresses three core marketplace segments – **Property**, **Casualty** and **Directors & Officers Liability** – and also looks at the overarching issue of **Marketplace Security**.

Property

The global Property marketplace has shown significant growth in usable capacity, fueling a resurgence in competition for desirable business, driving down pricing and reducing deductible thresholds for programs that had experienced "over-correction" in the recent hard market. Competition has also created opportunities for some easing of previously restricted terms and conditions where the terms targeted for improvement are prioritized and the case can be made persuasively.

We do not see a return to undisciplined behavior, however. Underwriters continue to be charged with producing a pure underwriting profit.

As respects natural catastrophe perils, while losses are considered to have been abnormally low in 2002 and 2003, underwriters' memories are not that short, and constraints are still being applied to:

- California, New Madrid, MO and the Pacific Northwest – all earthquake-prone zones.

- Coastal Windstorm regions (some underwriters include the Northeast)
- Flood coverage for FEMA designated areas.
- Certain natural catastrophe perils for "high hazard zones" – variously defined – in global programs.

The Terrorism Reinsurance Act (TRIA) will be a headline matter throughout the year. The Department of Treasury is in the process of recommending whether carriers should be required to make certified terrorism coverage available in 2005. During 2005, Treasury must also make a recommendation whether to extend TRIA protection past the December 31, 2005 expiration date, depending on whether it is deemed that primary and reinsurance markets have "healed" themselves sufficiently to obviate the necessity for governmental protection and limitations on liability. Buyers of terrorism insurance should let their voices be heard, as the expiration of TRIA would lead to impairment of commercial insurance offerings for the peril of terrorism.

Casualty

Today's US Casualty insurance marketplace is an unusual one, unprecedented in diversity and nuance. For most industry groups, rate increases have given way to flat renewals or decreases. While capacity is relatively tight in the primary marketplace, it is increasing for umbrella and excess liability. Although these developments in pricing and capacity are for the most part positive, the marketplace is still hard as respects terms, conditions and breadth of coverage provided on commonly used coverage forms. Insureds therefore need to balance their buying decisions by taking factors other than cost into consideration. Financial stability of the carrier and claims handling standards are also governing factors that need to be weighed when selecting carriers.

There are several classes of business where pricing remains hard. Many pharmaceutical, healthcare and petrochemical manufacturing companies continue to experience rate increases on program renewals.

The financial difficulties of several major carriers in the US have caused a reduction in the available capacity for Workers' Compensation and the other primary liability lines of coverage. The year 2004 may see additional carriers experiencing these same difficulties and withdrawing capacity from the marketplace.

The opposite is true for the umbrella and excess liability marketplace. Capacity in Bermuda continues to expand, with several of the newer facilities offering large blocks at very competitive pricing. Domestic carriers continue to aggressively pursue umbrella and excess liability business as well. With abundant capacity, securing competitive pricing will not be the issue. Rather, obtaining preferred terms and conditions will be the greatest challenge for many program renewals – a condition that affects all segments of the Casualty marketplace. Form changes, exclusions and alternative wordings on heretofore standard endorsements are widespread. Stringent underwriting continues to apply to pollution wordings, mold exclusions and professional liability coverages.

Overall, conditions in the Casualty marketplace demonstrate that insurance carriers believe that they can once again underwrite US liability business profitably.

D&O Liability

After two to three years of skyrocketing rates and constricting terms, competition and creativity are re-entering the D&O marketplace. New capacity comes from two areas – the ten insurance carriers that have entered the D&O business and current carriers whose underwriting premium "successes" in 2002 and 2003 prompted them to substantially increase D&O division budgets. With a finite number of companies to insure and thus a finite pool of premium, these conditions create a competitive environment that is counterintuitive, given the industry's losses.

Optimism arising from increases in capacity and competition must be tempered by the following realities:

- Record-size D&O claims continue to be made and paid, with significant current claims inventories held by all the major markets.
- 'Tag-on' Fiduciary Liability claims – where the company's pension plan holds company stock – are ratcheting up carriers' costs of D&O securities claims.
- Mutual fund investigations and claims are now migrating from the E&O claims arena into D&O and Fiduciary Liability litigation.
- New Sarbanes-Oxley requirements relating to internal loss control come on line starting in 2004; these may result in an up tick in D&O as well as Fidelity claims.

There are approximately 1,400 current outstanding D&O securities claims. Factoring in industry averages for dismissal rates, defense costs and settlements, the potential insurance company payout exceeds $25 billion. To put that number in perspective, in 2003 the total premium for the entire D&O industry was $6.5 billion.

There is no doubt that the D&O insurance industry is experiencing a period of softening premiums and liberalization of policy terms. With a much more stringent regulatory environment, a plaintiff's bar that is hungrier than ever and insurance companies experiencing record claims frequency and severity, it is entirely reasonable to question how long the perceived softening in the D&O marketplace will last. Only time will tell.

Marketplace Security

Marketplace security is an ever-present requirement and issue for insurance buyers. In the 2004 edition of *Marketplace Realities and Risk Management Solutions*, Willis addressed marketplace conditions, stating: "In the quest for certainty – paying for insurance to meet future contingencies – there is no greater concern today than that of counterparty risk."

The advent of competition in several segments of the marketplace is not unexpected, given two years of escalated premiums and rigorous underwriting. It is a reflection of improved profits, growing surplus and stronger balance sheets.

Ratings agencies such as S&P, Fitch and A.M. Best are the industry's "watchdogs", relied upon by many insurance buyers in making placement decisions. In a recent study comprising 4,936 US companies over the 25-year period 1977 to 2002, A.M. Best looked at long-term impairment rates, defined generally as "any official action by state regulators that restricts the business activity of an insurance organization."

Much of the North American market uses A- as a minimum rating guide when choosing carriers. However, A.M. Best defines a "Secure" company as one with a Financial Strength Rating of B+ and above. A measure of the reliability or predictive quality of the rating system may be taken from Best's citation that "among companies with Secure ratings, 97.9% maintained their ratings or were upgraded over a one-year period." The study also looked for correlations between impairments and economic activity, citing a generally inverse relationship between the two – as one might expect.

Although strengthening balance sheets, improvement in economic conditions and recent ratings up ticks give some cause for optimism about marketplace security, vigilance and security-minded management of insurance program placements are always the order of the day.

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