AIRMIC BENCHMARKING REPORT

Property Damage/Business Interruption Insurance Benchmarketing Report 2009

Report sponsored by Willis

Undertaken in partnership with Advisen Europe

Willis

ADVISEN Productivity & Insight for Insurance Professionals

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PD/BI Insurance Survey and Market Outlook

Introduction and Executive Summary

One of the important requirements of AIRMIC members is access to more and better benchmarking data. In response to this requirement, AIRMIC commissioned Advisen to undertake research with the membership into Property Damage / Business Interruption (PD/BI) insurance. The research and the publication of this benchmarking report have been sponsored by Willis, the global insurance broker.

The initial survey has yielded some interesting data. However, to make this benchmarking report even more valuable for members, AIRMIC will conduct the survey annually. It is hoped and anticipated that AIRMIC members will provide more and richer data such as rates, key cover and service issues each time the survey is conducted.

AIRMIC will also welcome feedback about the benchmarking statistics that are most useful, so that this benchmarking report delivers real benefit to the AIRMIC membership. The individual data sets collected are treated confidentially.

The key findings of the first survey are:

- more than two thirds of respondents purchase limits of £100 million or more PD/BI insurance cover;
- more than 50% of survey participants pay more than £1 million per year for PD/BI insurance coverage;
- companies that pay higher premiums are more likely to make use of engineering consultants; and
- captive insurance companies remain an important risk financing tool for this class of insurance

With the hard market of 2001/2002 now becoming a distant memory for many who work in the insurance industry, the property damage and business interruption (PD/BI) market faces a number of intriguing questions:

- will the soft market continue throughout 2010 and what type of event might it take to drive rates up?
- can the market respond to the changing risks presented by changes in technology, such as "cloud" computing?
- with the often made claim that extreme weather events are becoming more severe and frequent, will insurers actually impose new climate related limitations?

AIRMIC PD/BI Survey

On behalf of AIRMIC, Advisen conducted an on-line survey of members in November 2008. Of 737 risk managers receiving invitations to participate, 277 completed at least some portion of the survey, resulting in a very strong response rate of 38%. When more than one response was received from the same company, the most complete response was used and other responses were discarded to avoid double counting. Data sets were reviewed for consistency and verified using outside sources, as appropriate and where available.

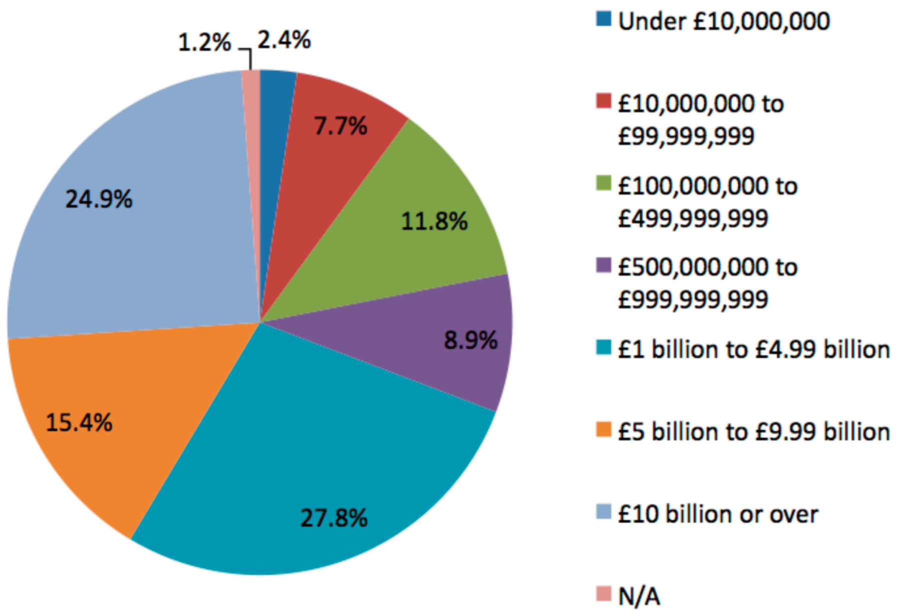
Separate questions were asked for UK and non-UK premiums and limits in various size ranges. To get a consolidated view of the premiums and limits for respondents reporting both UK and non-UK premiums, the greater of the two ranges was taken and used as the range for the company. If a company had UK and non-UK premiums or limits that fell in the same range, that range was used for the company.

Advisen administered the survey and provided the analysis for this report. While questions were asked about several classes of insurance cover, this report analyses only those specifically related to PD and BI.

Respondent Demographics

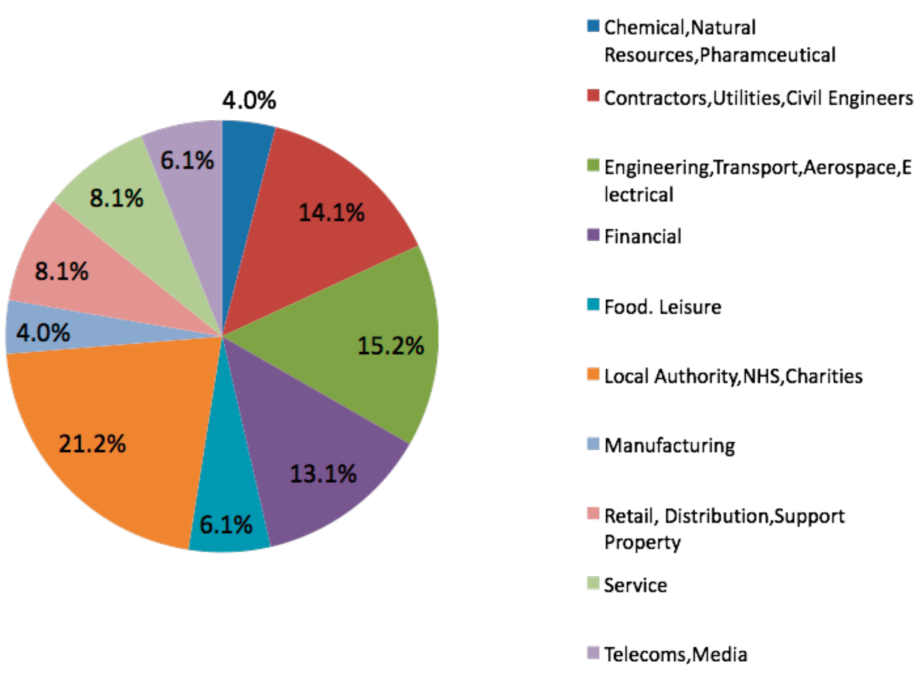
Most survey participants represented large, geographically diversified companies. One quarter of respondent companies has annual turnover of more than £10 billion, with two thirds having turnover of more than £1 billion (Exhibit 1).

Exhibit 1 Survey Participants By Annual Turnover



Respondents were widely distributed across industry sectors, though somewhat overweight in governmental entities and charities (21.2 percent) (Exhibit 2).

Exhibit 2 Survey Participants by Industry Sector

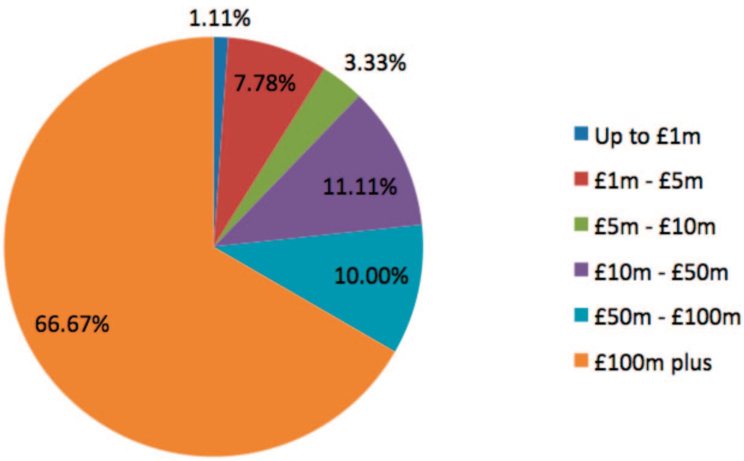


Nearly 60 percent of respondents were from companies with head offices located in the UK. Of the UK respondents, 38 percent have their head office in London. Most respondents with head offices outside the UK were located either in continental Europe or the US. Nearly two-thirds of respondents have operations in more than one country, with 15 percent being geographically highly-diversified companies with operations in eight or more countries / regions.

Program Limits

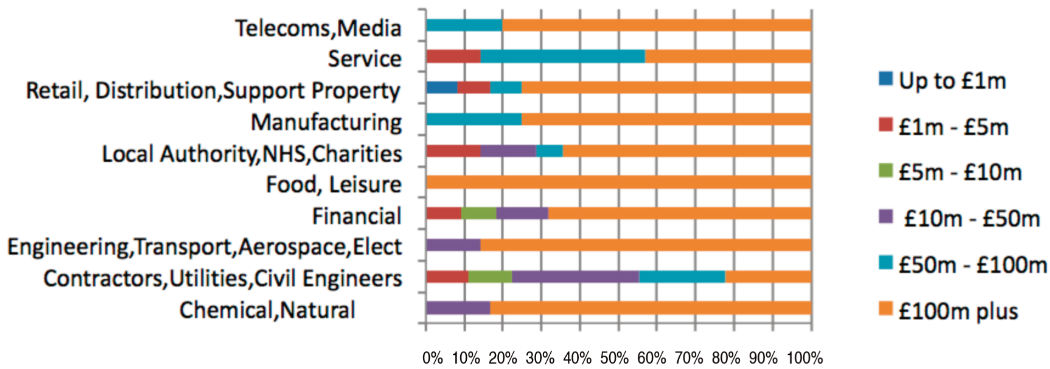
Exactly two-thirds of participating companies purchased PD/BI program limits of more than £100 million (Exhibit 3).

Exhibit 3 Distribution of Total PD/BI Program Limits



Limits were found to vary materially by industry. Companies in the Contractors, Utilities and Civil Engineers segment were noteworthy for having the lowest average limits of any industry group (Exhibit 4). All survey participants in the Food and Leisure segment reported property limits greater than £100 million.

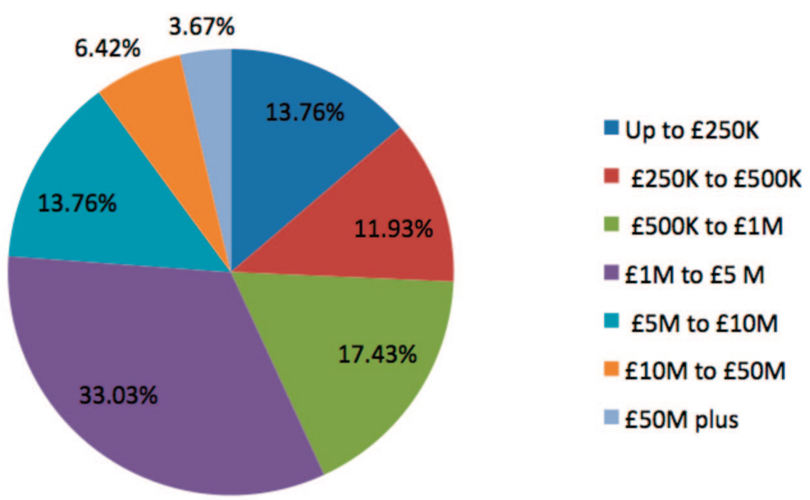
Exhibit 4 Distribution of Limits by Industry



Premiums

Well over half (57%) of survey respondents reported paying total PD/BI premiums of more than £1 million. Slightly more than 10 percent pay total premiums of more than £10 million, of which about four percent said their companies pay more than £50 million for PD/BI insurance (Exhibit 5).

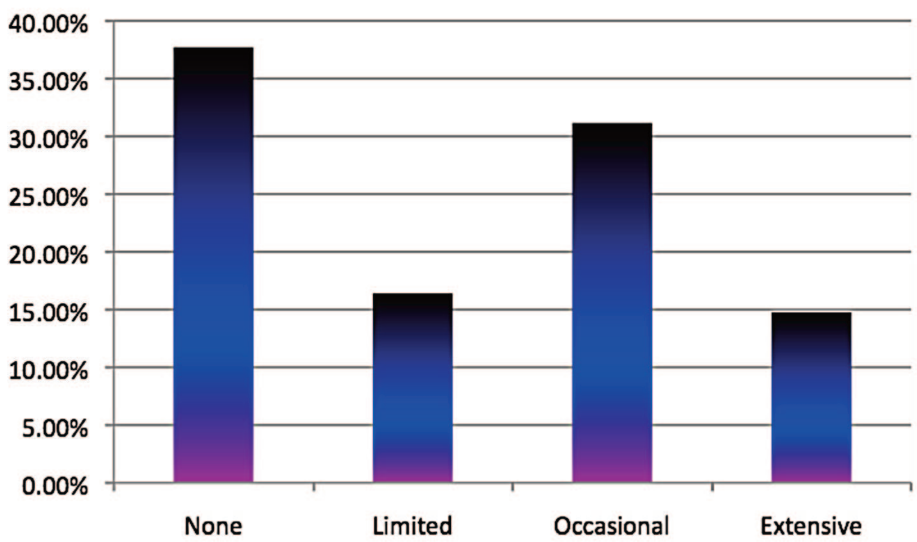
Exhibit 5 Total Property Premium Distribution



Other Findings - Engineering consultants

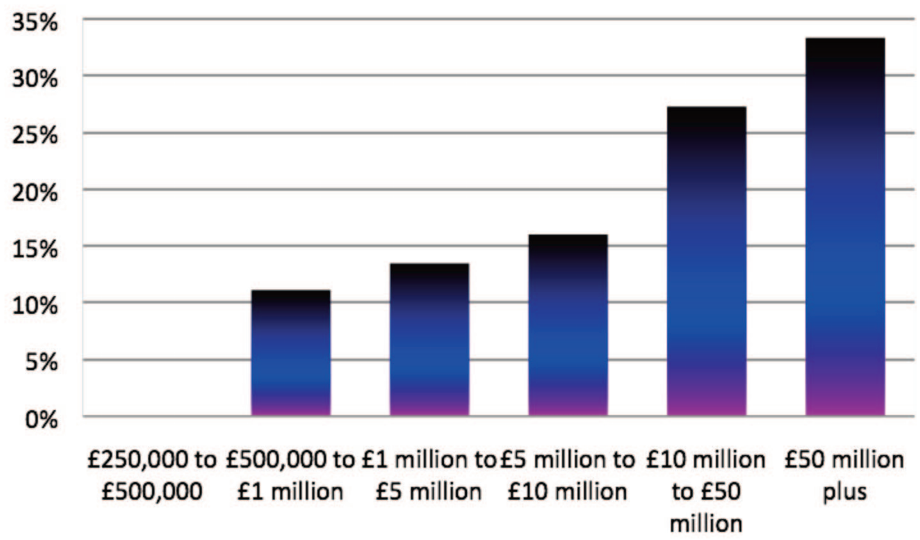
Roughly two-thirds of survey respondents said their firms make use of engineering consultants. About 15 percent make "extensive" use of them (Exhibit 6).

Exhibit 7 Use of Engineering Consultants



The correlation between company size (as measured by annual turnover) and the use of engineering consultants is weak. There is a much stronger correlation between the use of consultants and the amount of PD/BI premium paid. Fewer than half of companies paying less than £1 million in property premium engage engineering consultants. The relationship between premium and the use of consultants is particularly evident when looking at those reporting "extensive" use of consultants. The companies most likely to make extensive use of engineering consultants pay more than £50 million in annual property premium (UK and non-UK) (Exhibit 7).

Exhibit 7 % Respondents Making "Extensive" Use of Engineering Consultants



Captives

Survey participants were asked about their use of captive insurance companies. While the question did not differentiate by line of business, it is likely that Property Damage / Business Interruption (PD/BI) is one of the most significant exposures managed through captives.

About 65 percent of respondents said their company uses a captive for PD/BI insurance, with larger companies more often making use of a captive than smaller ones. Roughly 12 percent said that between 30 and 50 percent of their total premium is paid to their captive insurance company.

Survey Summary and Conclusions

This is the first of what is planned to be an annual survey of risk managers regarding their PD/BI insurance programmes. Survey findings will support risk managers in making informed decisions about programme structures and costs. Over time, survey data will also provide insight into market trends – especially pricing trends.

The response rate to this survey was very strong – more than one-third of risk managers invited to participate completed at least a portion of the survey. AIRMIC anticipates that continued strong support will result in a valuable, annually updated tool that will enable risk managers to make better-informed insurance buying decisions and to better manage the cost of risk for their companies.

The results of this survey are the first steps in providing AIRMIC members with useful benchmarking data about all aspects of their PD/BI programmes. However, the most beneficial results will be gained from the best input data and AIRMIC therefore looks forward to working with members to improve and extend the survey.

Market Challenges and Outlook

It will hardly be a secret to AIRMIC members that in broad terms the PD/BI market is soft at time of writing this report (December 2009). Research by Willis indicates that many risks are now paying the same or lower rates than in 2000. For the majority of risks, there is no shortage of capacity and new capacity will enter the market in 2010.

Some trades (at least from a UK perspective) remain challenging, notably waste recycling and food manufacture. The earthquake market remains relatively tight. It will be interesting to see how the market for wind and storm in the Caribbean and the S.E United States responds to the very "quiet" season in 2009 leaving insurers and reinsurers with substantial profits. Anticipated rate rises of 25%+ for the 1 June 2009 renewal season fell back to around 15%.

Whilst these market conditions are undoubtedly good for AIRMIC members, many insurers argue that rates must rise, particularly in light of lower investment returns. Indeed some have made attempts to drive prices forward but with little success. Does this mean that the soft market is the new "black"? Will conditions remain soft with a very occasional and temporary uptick? Or, will insurers have to wait for the return of a growing economy before they can see premiums begin to rise?

One of the arguments often given for current market conditions is the "benign" loss environment - at least if we ignore the UK summer floods of 2007 at a cost to the commercial market in the region of £500 million. But weather aside, perhaps these benign loss conditions are not surprising given the continued investment in risk management by AIRMIC members. This is an area where future surveys of AIRMIC members need to become an effective tool in demonstrating the value of loss prevention and in separating real changes in trends from the "noiseness" of loss statistics.

So what might cause conditions to change? What is the Black Swan? We have seen that the near collapse of the Western financial system has had little lasting impact. Also, the sequence of events that led to the last hard market seems unlikely to be repeated.

Terrorism remains an important threat. According to the Home Office, the current terrorism threat level for the UK is "Substantial", which means that a terrorist attack is a strong possibility. However, despite the tragic loss of life in London during the 7 July 2005 and subsequent attacks, the PD/BI losses were relatively small and in most countries the exposure of the market to terrorism is mitigated by pooling and government reinsurance arrangements. Weather (in particular flood) is a definite concern for insurers and this is discussed below. Solvency 2, due for implementation is 2012, is perhaps too far off to predict its impact on insurance rates and capacity.

It would be hubristic to deny the possibility of a single market changing event. However, the most likely drivers are nothing new. Prolonged underwriting losses, reduced investment returns and the ending of reserve releases will all make life more difficult for insurers. The view of Willis is that these soft conditions will continue throughout 2010.

BI in the Cloud

PD and BI risks are no longer confined to tangible assets such as buildings and their contents but increasingly encompass numerous exposures to telecommunications networks. In a very interesting lecture to the London Business Interruption Association on 7 December 2009, Chris Maurice the risk financing manager of BT Group plc described the challenges presented by "cloud computing", which has grown rapidly in business to business transactions over the past two years.

The rapid and widespread adoption of this technology involving a multiplicity of contractors, outsourced providers, data warehouses and server farms has had a profound effect on business interruption exposure. It makes establishing where risk lies, calculating maximum exposures and assessing the real value of losses in the event of network interruption more complex. Chris said that the news is not all bad as one of the great benefits of this technology is vastly improved business resilience. In fact, whilst this dynamic change in risk will present new challenges in data security and the management of contractual risk, it may actually reduce the BI risk. This is another important area that future benchmarking surveys need to track.

Natural Catastrophe

The UK is one of the windiest and rainiest countries in Europe and is regarded by reinsurers as a significant natural catastrophe region. The October 1987 hurricane, the fourth most severe storm since records began, caused damage estimated at the time as £1.9 billion or around £4 billion in 2009 prices. The UK is nowhere near as seismically active as, say, California or Japan, but the rate of seismicity is sufficiently high so as to pose a hazard to installations such as dams and chemical plants. The most powerful earthquake in 25 years, registering 5.2 magnitude, occurred on 27 February 2008. It was centered near Market Rasen in Lincolnshire and the tremor was felt in Newcastle, Yorkshire, London, Cumbria, the Midlands, Norfolk and also parts of Wales.

However, it is flood that gives insurers and reinsurers the biggest headache with 5 million people living in flood risk areas in England and Wales. In 2007, the country experienced one of the wettest May-to-July periods in recent history leading to a series of destructive floods. The most severe occurred across Northern Ireland and in Yorkshire, the Midlands, Gloucestershire, Worcestershire, Oxfordshire, Berkshire and South Wales. Heavy rain in the latter part of 2009 caused severe damage in Cumbria and South West Ireland with possible insured losses in excess of £500 million. Industry models indicate a massive Thames Valley flood could result in an overall insured loss of £6.2 billion, of which £4.6 billion would be residential and £1.6 billion commercial property.

Climate change allegedly caused by man has become an increasing concern of insurers and many commentators say that the extreme weather described above is a direct consequence. The Willis Research Network (WRN) has published a number of papers on this diverse subject. In particular, Professor Stuart Lane of the Institute of Hazard and Risk Research, Department of Geography, Durham University (a member of WRN) published a paper titled "The 2007 UK Summer Floods, a Scientific Perspective" which examined the weather behind the floods.

In his paper, Professor Lane considers the impact of climate change, but also looks at the possibility of natural variation and discusses the problems created by the lack of accurate long term rainfall records. A copy of the paper may be found on the WRN site at:

http://www.willisresearchnetwork.com/Lists/Publications/DispForm.aspx?ID=6&Source=http%3A%2F%2Fwww%2Ewillisresearchnetwork%2Ecom%2FWebPart%2520Pages%2FPublications%2Easpx

Insurers frequently state that the frequency and severity of PD/BI losses has increased. According to Swiss Re, insurers sustained the second worst year on record in nominal terms for natural catastrophe losses in 2008 - $50 billion (£31 billion). However, in one analysis of US hurricane losses (Pielke, Landsea and others Feb 2008), after adjustment for growth, inflation and population there is no discernible trend.

Insurers, through Climate Wise and the Geneva Association, are promoting awareness but the real impact on individual insureds is unclear. An example comes from Munich Re which is one of the most active participants on climate change. It put forward a proposal for a $10bn climate insurance pool scheme for inclusion in the final report from the United Nations Climate Change Conference in Copenhagen in December 2009.

Munich Re's head of Geo Risks Research, Peter Höppe, said that the initiative would compel industrial polluters to pay the premium for a $5bn insurance pool to cover the biggest climate-related risks in developing countries. The Munich Climate Insurance Initiative (MCII) proposes a further $2bn for local microinsurance schemes - insurance for low income individuals - in the developing world and another $3bn for preventative measures, such as flood barriers and population relocation, to reduce the risk of climate-related losses in the first place.

Clearly a focus of AIRMIC benchmarking surveys in the future will be how individual members are responding to climate change and how they view new policy terms that may be imposed by insurers as a result.

About Advisen

Advisen is headquartered in New York and integrates business information and market data for the commercial insurance industry and maintains critical risk analytics and time-saving workflow tools for over 530 industry leading firms. Through its work for the broadest customer base among information service providers, Advisen delivers actionable information and risk models at a fraction of the cost to have them built internally. Designed and evolved by risk and insurance experts and used daily by more than 100,000 professionals, Advisen combines the deepest data sets in the industry with proprietary analytics and offers insight into risk and insurance that is not available on any other system. For more information, visit www.advisen.com or call +1 212 897 4800 (New York) or +44 20 7929 5929 (London).

About Willis and the Willis Research Network

The Willis Research Network (WRN) is the largest partnership between academia and the insurance industry in the world. Willis has teamed up more than 20 leading institutions across a full range of disciplines from atmospheric science and climate statistics, to geography, hydrology and seismology, to evaluate the impacts on the environment via engineering, exposure analysis and Geographic Information Systems. Additional information can be found at: www.willisresearchnetwork.com

The WRN is funded by Willis Group Holdings Limited (NYSE: WSH), a leading global insurance broker, developing and delivering professional insurance, reinsurance, risk management, financial and human resource consulting and actuarial services to corporations, public entities and institutions around the world. Willis has more than 400 offices in nearly 120 countries, with a global team of approximately 20,000 Associates serving clients in some 190 countries. Additional information on Willis may be found at: www.willis.com

About AIRMIC Membership

AIRMIC has a membership of nearly 850 and represents the insurance buyers for about 75% of the FTSE 100, as well as very substantial representation in the mid 250 and other smaller companies. AIRMIC members control about £5 billion of annual insurance premium spend. A further £2billion of premium spend is allocated to captive insurance companies within member organisations. Additionally, members are responsible for the payment of insurance claims from their company finances to the value of at least £2 billion per year. In addition to insurance responsibilities, many AIRMIC members are responsible for broader risk management activities, including project, operational and enterprise risk management. Many members operate at very senior level within their organisations with direct input at Audit Committee and / or Executive Risk Management Committee, as well as making regular Board presentations. Further information on the benefits of AIRMIC membership can be found at: www.joinairmic.com

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