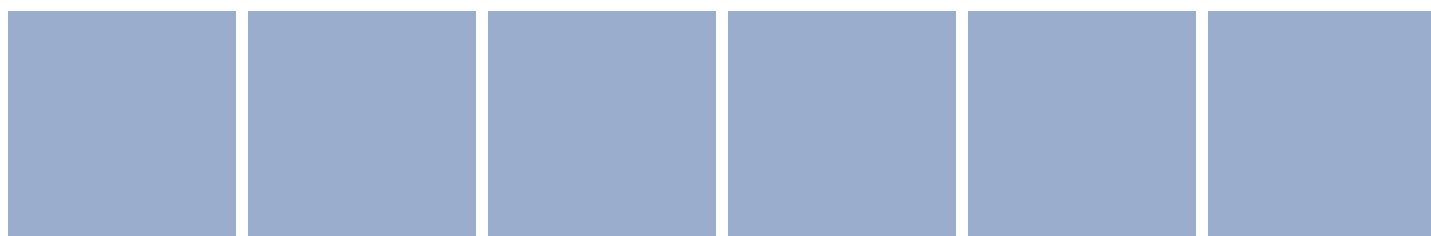


Research Report



**Marketwatch:
Terrorism Insurance—
2006 Market Conditions and Analysis**

Marketwatch: Terrorism Insurance— 2006 Market Conditions and Analysis

Introduction

Despite an ever-changing terrorism risk insurance market, businesses from every industry sector continue to purchase terrorism insurance—nearly 60 percent of businesses surveyed bought coverage. Until at least the end of this year, U.S. insurers are backed by the commitment of the United States government—through the Terrorism Risk Insurance Act (TRIA)—to provide reinsurance relief to help them manage the ongoing risk of terrorism. TRIA is set to expire on December 31, 2007, and although there is much optimism the Act will be extended, there is no guarantee of a federal backstop in the future. This has no doubt caused some market uncertainty.

Terrorism insurance and associated risk management strategies are dynamic and complex issues, with many interdependent factors contributing to managing the risk. Foreign relations, the effectiveness of homeland defense, and the ambiguous nature of terrorism risk make terrorism losses extremely challenging to predict and quantify. It is difficult for insurers to effectively price and to reserve capacity for their potential exposure to catastrophic terrorism losses.

This report, an addendum to Marsh's ongoing *Marketwatch: Terrorism Insurance* series, is designed to help clients address terrorism risk. It is part of Marsh's ongoing effort to inform clients of developments in the terrorism risk insurance marketplace, including fluctuations in pricing. To date, a decision has not been made regarding the upcoming expiration of TRIA, but there is speculation the Act will be extended in some form. Marsh's Terrorism Risk Specialty will keep abreast of developments. A comprehensive *Marketwatch: Terrorism Insurance* report will be released once the Act's future has

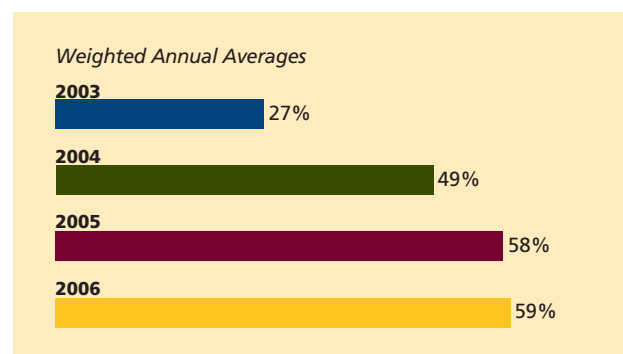
been decided. Marsh remains committed to helping our clients develop robust, comprehensive strategies to manage this risk.

Findings and Analysis: Property Terrorism Purchasing in 2006

The overall terrorism insurance marketplace remained very much the same in 2006 as it was in 2005. There has been a continuous increase in the take-up rate—the percentage of companies buying the coverage—over the four years that Marsh has been tracking the purchase of property terrorism insurance by our clients. A total of 59 percent of companies purchased or renewed their property terrorism insurance coverage in 2006, up slightly from 58 percent in 2005 (see Chart 1).

Take-up rates in the Midwest and West rose slightly in 2006, while the South and Northeast zones remained flat. Take-up rates rose slightly in 2006 among the smallest and largest companies in our sample but declined marginally for the others. The cost of terrorism insurance generally increased in 2006, albeit at a slower rate than for property insurance in general.

Chart 1: Terrorism Take-Up Rates by Year



Methodology

This chapter relies on data drawn from Marsh's offices across the United States. It focuses on Marsh's risk management and middle-market clients that buy property terrorism insurance and how much they are paying for it. Purchasing patterns are examined in the aggregate as well as on the basis of client characteristics such as size, industry, and region.

The 2006 data come from property insurance placements incepting during calendar year 2006. To account for skews within the regional and total insured values (TIV) data sets, the national annual figures were weighted to allow the findings to be extrapolated to the overall population. The study population does not include placements in the United States for foreign-based multinationals or for small-firm placements made through package policies.

The 2006 study was based on a sample of 1,437 firms with the following characteristics:

	Minimum	Median	Maximum
TIV	\$500,000	\$388 million	\$175 billion
Property Premium	\$2,000	\$433,000	\$57 million
Terrorism Premium	\$1	\$18,000	\$11 million

Unless otherwise noted, the calculations include TRIA policies, noncertified policies, standalone policies, and placements made through captives.

For comparison purposes, the 2003 figures do not include the first quarter of 2003, which had unique circumstances.

For some companies, insurers quoted only a nominal terrorism premium of \$1. These \$1 premiums were omitted from the calculations of the median terrorism premium rates. In respect to the calculation of terrorism premium as a percentage of property premiums, standalone terrorism premiums were omitted.

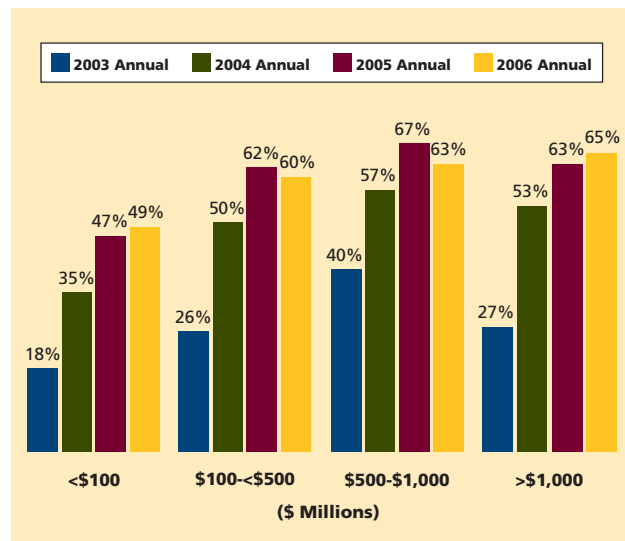
Companies were assigned to regions based on the locations of the Marsh offices that served them. Generally, this was the Marsh office most closely located to a company's headquarters. Many of our clients have multiple facilities across the country and around the world, meaning the potential risk for a terrorist attack may not be fully represented by where a company is headquartered. Having said that, the decision as to whether to purchase terrorism insurance is typically made at headquarters.

Take-up Rates by Company Size

Marsh's analysis established four categories of total insured value (TIV) as the measure of company size:

- Companies with TIV in excess of \$1 billion are major accounts for insurers, paying large premiums due to size alone. They typically work with several insurers. Many of these companies used their existing captives or established new captive insurers to provide TRIA coverage.
- Companies with TIV between \$500 million and \$1 billion are large organizations that typically work with multiple insurers and have layered programs.
- Companies with TIV between \$100 million and \$500 million tend to have no more than three insurers involved in their insurance programs.
- Companies with TIV less than \$100 million generally entail a smaller spread of risk, have lower overall premiums, and work with a single insurer.

Chart 2: Terrorism Take-up Rates by TIV



Take-up rates within all TIV ranges changed only modestly in 2006 from 2005. The take-up rates for smaller companies—with TIV values under \$100 million—rose slightly but were still well below the other TIV ranges (see Chart 2). There was a distinct difference in take-up rates at the \$100 million TIV breakpoint—63 percent of companies with TIV greater than \$100 million purchased terrorism coverage; 49 percent of companies with TIV less than \$100 million did so.

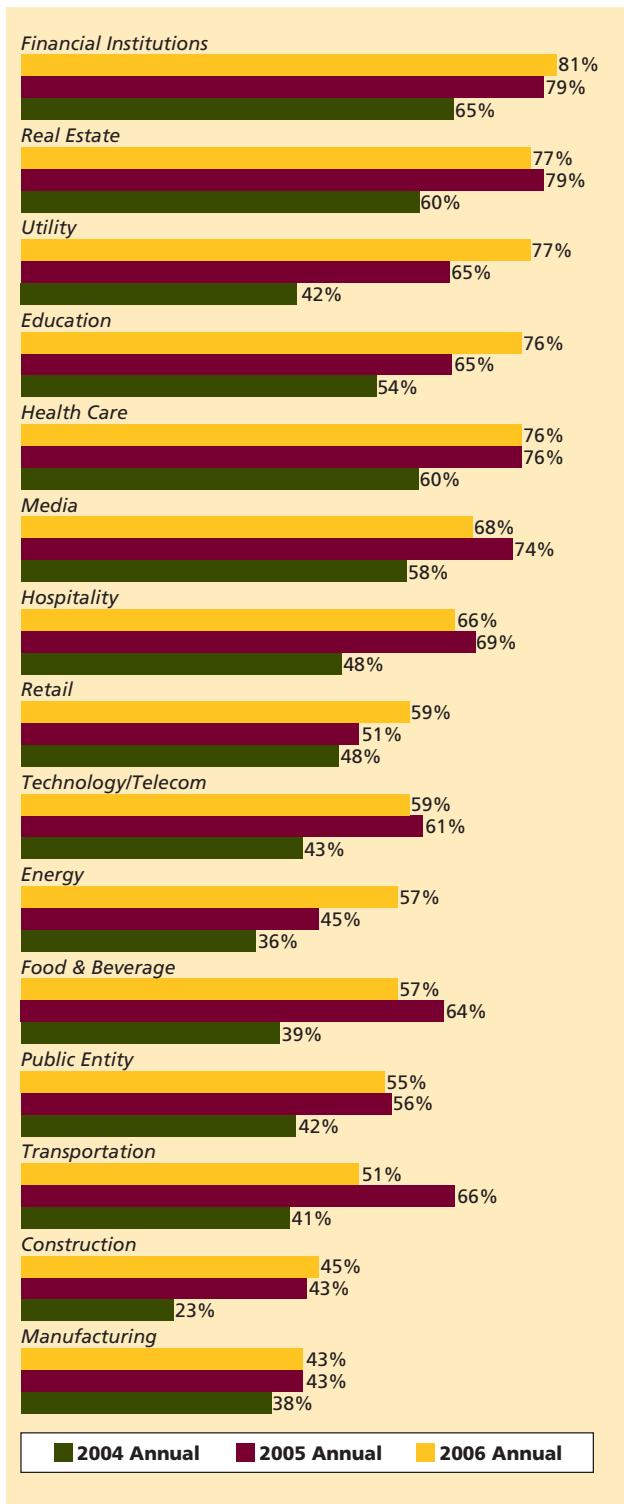
Industry Categories

This report examines property terrorism insurance purchasing patterns for 15 industry groups. These industries were selected based on criteria that included sample population size, perceived exposures, take-up rates, and premium rates. Other industry groups that are part of the overall analysis—but are not reported on individually—include agriculture, automotive, aviation, distribution, nonprofits, professional services, and general services.

The industry groupings in this report included, but were not limited to, the following lines of business:

- Construction: contractors, homebuilders, and general contractors
- Education: universities and school districts
- Energy: oil, gas, and pipelines
- Financial institutions: banks, insurers, and securities firms
- Food and beverage: manufacturers and distributors
- Hospitality: hotels, casinos, sporting arenas, and performing arts centers
- Health care: hospitals and managed-care facilities
- Manufacturing: all manufacturers, excluding food and beverage technology
- Media: print and electronic media
- Public entity: city, county, and state entities
- Real estate: real-estate and property-management companies
- Retail: retail entities of all kinds, including restaurants
- Technology/telecom: hardware and software manufacturers and distributors, telephone companies, and Internet service providers
- Transportation: trucking and bus companies
- Utility: public and private gas, electric, and water utilities

Chart 3: Terrorism Take-up Rates by Industry



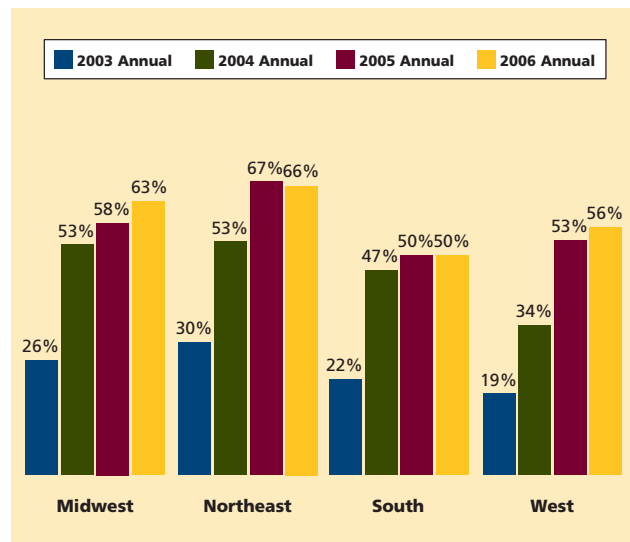
Take-up Rates by Industry

According to Marsh’s analysis, the property terrorism insurance take-up rate increased significantly for 4 of the 15 major industry groupings and decreased substantially for 3 others. The take-up rates for the remaining 8 industry groups remained relatively flat. The take-up rates for utilities, educational institutions, retailers, and energy companies rose by more than 8 percentage points from 2005 to 2006. Conversely, transportation, food and beverage, and media companies had take-up reductions greater than 6 percentage points. Financial institutions, real-estate firms, utilities, educational institutions, and health care facilities had the highest property terrorism insurance take-up rates in 2006, each exceeding 75 percent (see Chart 3). In contrast, less than 45 percent of general manufacturing and construction companies bought terrorism coverage.

Take-up Rates by Region

The 2006 property terrorism insurance take-up rate rose most significantly in the Midwest and West. For the second year in a row, every region had a take-up rate greater than 50 percent (see Chart 4).

Chart 4: Terrorism Take-up Rates by Region



The Northeast still has the largest percent of companies purchasing property terrorism insurance, although the Midwest is not far behind.

Types of Coverage Companies Are Buying

The vast majority of Marsh clients—90 percent—that purchased terrorism insurance did so as part of their property policies rather than as standalone placements. However, standalone policies are an important alternative or supplement to TRIA coverage for some companies. The primary purchasers of standalone policies were hospitality companies, large real-estate firms, and financial institutions. Retail companies, public entities, and utilities, however, also purchased significant, though lesser, amounts.

When companies purchase terrorism coverage as part of their property policies, they can purchase either TRIA coverage, noncertified acts coverage, or a combination of the two. In 2006, the vast majority—more than 75 percent—of companies purchased both TRIA and noncertified acts coverage.

The Cost of Terrorism Coverage

For this report, the cost of terrorism coverage was measured both as a premium rate—premium per million of TIV—and as a percentage of a company's overall property premium. The first method—premium rate—allows companies to track what they paid in absolute terms; the second shows how terrorism coverage affected a company's overall property insurance budget.

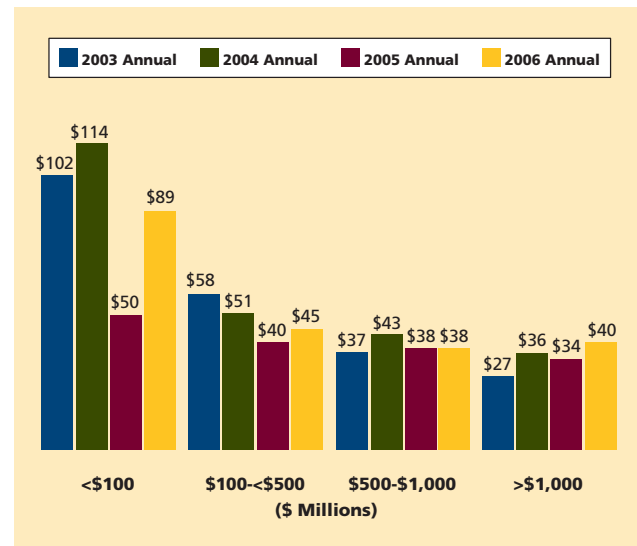
After significant price decreases in 2005, the cost of property terrorism insurance increased in 2006. Only the Midwest region saw flat prices. The median terrorism rate for 2006 was \$47 per million of TIV, up from \$43 per million of TIV in 2005. The median percentage of a company's annual property program costs attributable to terrorism premiums remained flat at approximately 4.2 percent.

Cost by Company Size

Property terrorism rates generally decrease as the size of the company increases (see Chart 5). Companies with TIV less than \$100 million experienced the largest increases in price, from \$50 per million of TIV in 2005 to \$89 per million in 2006. For companies with TIV between \$100 million and \$500 million, the median rate increased \$5 to \$45 per million of TIV; and for those with TIV between \$500 million and \$1 billion, rates remained flat. For

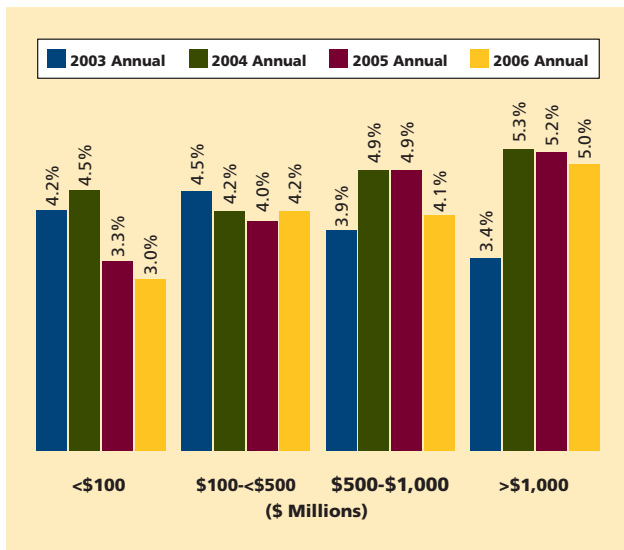
the largest companies—those with TIV more than \$1 billion—the median rate rose slightly to \$40 per million.

Chart 5: Terrorism Pricing—Median Rates by TIV



When examining cost as a percentage of overall property premiums (see Chart 6), 2006 saw modest reductions for all companies, except those with TIV between \$100 million and \$500 million. This indicates that the price for terrorism coverage did not increase as much as the overall property market rate increase experienced during 2006. Terrorism insurance does represent a larger proportion of the overall property insurance budget for larger companies than smaller firms. This trend can be explained in part because the largest companies tend to have greater terrorism exposures and lower property rates due to higher retentions and extensive loss control. Terrorism insurance rates do not tend to range as widely as property rates and are less subject to credits for higher retentions and loss-control efforts. Thus, terrorism represented a larger share of the overall property premium budget for the bigger companies.

Chart 6: Terrorism Pricing as Percentage of Property Premium by TIV



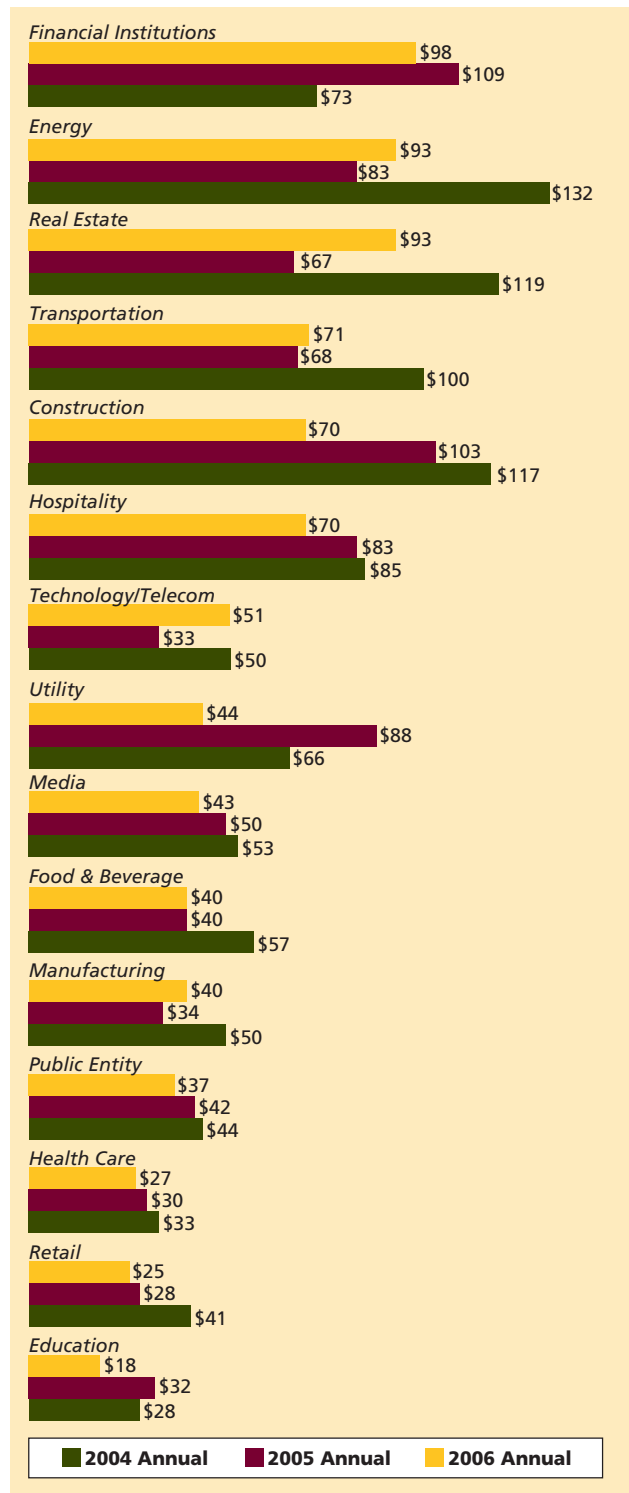
Cost by Industry

Comparing the 2006 median terrorism insurance premium rates by industry to past years' rates shows that the median rates decreased substantially for 6 of the 15 industry categories—financial institutions, construction, hospitality, utility, media, and education—and increased significantly for three—real estate, technology/telecommunications, and manufacturing (see Chart 7).

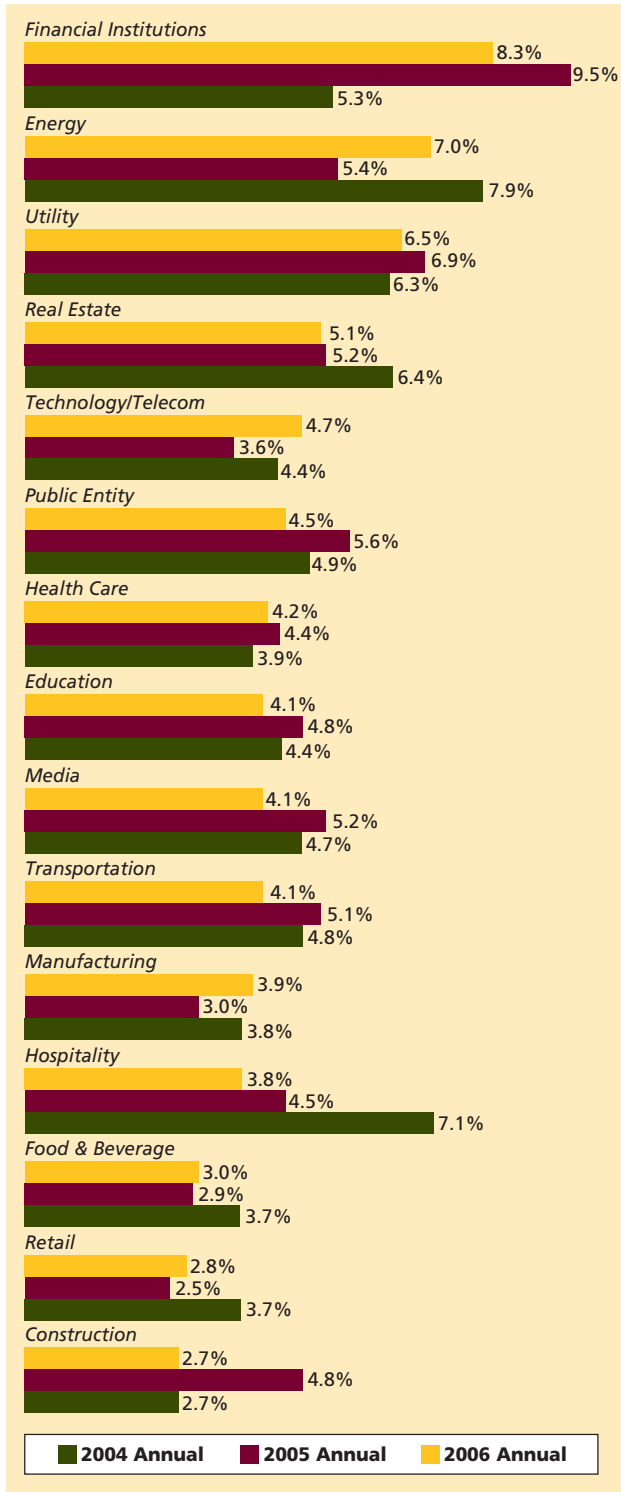
Terrorism insurance rates for financial institutions, energy, and real estate companies were the highest in 2006; rates for these groups exceed \$90 per million of TIV. Rates decreased most dramatically for utilities, down 50 percent to \$44 per million of TIV, and construction firms, which saw rates drop from \$103 per million to \$70 per million.

When looking at terrorism insurance pricing as a percentage of overall property premiums, financial institutions and energy companies had the highest median rates—8 percent and 7 percent respectively—even though financial institutions saw a 1.2 percentage point decrease from 2005 (see Chart 8).

Chart 7: Terrorism Pricing—Median Rates by Industry



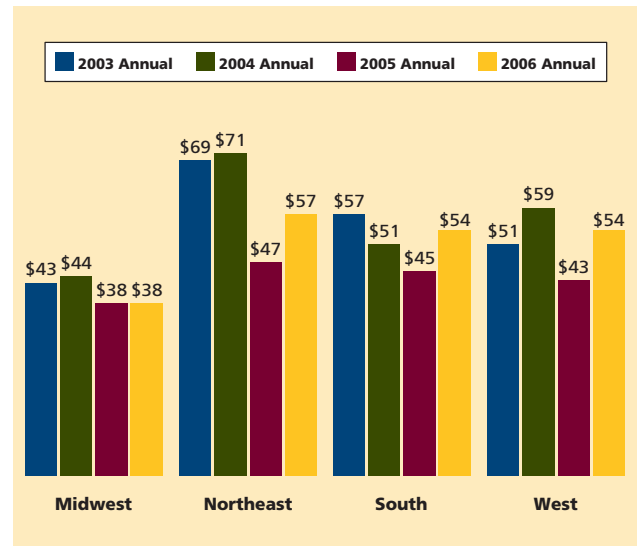
**Chart 8: Terrorism Pricing—
As Percentage of Property Premium by Industry**



Cost by Region

Terrorism insurance continues to be most expensive in the Northeast based on premium rate (see Chart 9), although the variation by region has narrowed. The median rate in the Midwest remained flat, compared to increases of 21 percent in the Northeast, 26 percent in the West, and 20 percent in the South. Interestingly, however, prices in the Midwest are significantly lower than in the other regions. The median rate in the Midwest stayed at \$38 per million of TIV, while the Northeast, West, and South all experienced median rates between \$54 and \$57 per million. This can be explained in part by the industry sectors represented in the regions. For example, financial institutions and real estate entities—the two industry sectors with the largest median prices—are not as concentrated in the Midwest as in other regions. Conversely, health care, education, and retail, which have the lowest median rates, are well represented in all regions.

**Chart 9: Terrorism Pricing—
Median Rates by Region**



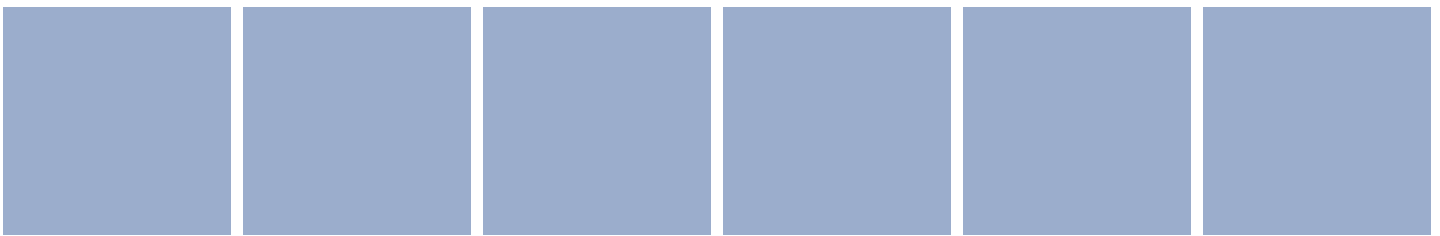
Conclusion

In 2005 terrorism insurance rates decreased virtually across the board. Due to the hardening of the property insurance market in 2006, we saw terrorism insurance rates increase, although not as significantly as for the overall market. On average, companies saw rate increases of 36 percent on their property programs. In many cases rate increases of more than 400 percent were experienced. This caused a ripple effect on pricing for terrorism coverage, and the result was clients experienced terrorism rate increases averaging just less than 10 percent. Therefore, although an increase in price was experienced, the increase was not as significant for terrorism coverage as for the overall property policies.

It was expected that as companies spent more on their overall property insurance programs they would cut back on their terrorism purchases. Surprisingly, this did not happen. Despite a changing and uncertain marketplace, terrorism take-up rates continued to climb to record levels during this period as companies of all sizes, in all industries, and in every region continued to purchase terrorism coverage. In fact, nearly 6 out of 10 companies have decided that property terrorism insurance is a coverage worth purchasing. Even in the face of significant property price increases, more companies, rather than fewer, opted to purchase terrorism coverage in 2006.

As previously mentioned, TRIA is set to expire at the end of the year; while this has caused uncertainty, it has not affected the property terrorism insurance market to the same extent as in 2005, when the original Act expired. There is tremendous optimism that an agreement will be reached and TRIA extended in some form. Unlike in 2005, we are not seeing as many insurers insisting on sunset clauses. Such clauses would terminate coverage for terrorism if TRIA is not extended. We expect that as the year progresses, we may see markets add the endorsements more often. This is especially true for those risks with exposures viewed as target risks, including those in urban areas and/or those in areas with high concentrations of values. Insurance markets have probably become accustomed to writing this coverage. Additionally, because of comments made by Congressional leaders, insurers have expressed confidence that an extension will be enacted, another likely reason for the lack of sunset clauses.

Clearly, the demand for terrorism risk insurance is there: companies across the United States have demonstrated this through the purchase of such insurance. Much depends on whether TRIA is extended, and in what form. Many Congressional leaders, including the chairs of the Senate Banking Committee and House Financial Services Committee have publicly stated their support of an extension and that they want it addressed early in 2007. Marsh's Terrorism Risk Specialty will keep abreast of developments in the property terrorism risk insurance market, and specifically with regard to TRIA. A more comprehensive, detailed *Marketwatch: Terrorism Insurance* report will be published once a decision has been made with respect to the future of the federal backstop.



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