

September 2007

Specialty Insurance Programs

Issuing Carrier Survey

Program Manager Solutions

Specialty Practice

GUY CARPENTER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN



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Overview

As part of our continuing efforts to provide specialized services to current and prospective managing general agents and issuing carriers, Guy Carpenter's Program Manager Solutions Specialty Practice has surveyed, for the third consecutive year, a number of domestic insurance companies that entertain specialty programs written through program administrators. Our goal was to illuminate their appetites and requirements for program business.

The survey results presented here provide an overview of issuing carriers, their program appetites, program administrator criteria, claim administration requirements, monitor and control practices, reinsurance purchasing practices, and views of specialty program market conditions. The Specialty Insurance Programs Issuing Carrier Survey was conducted via email and sent to key individuals at insurance companies that write a significant amount of program business through program administrators.

This survey marks our third annual look at the current state of the specialty programs market. We look forward to continuing to document this market's noteworthy developments and historical trends in the future.

To all those who took the time to respond, we thank you!

Following are the survey's major highlights and findings:

- Change and evolution remain hallmarks in the specialty programs marketplace. This is evidenced by the continuing flow of new capital into this market segment resulting in the emergence of new markets as well as ongoing merger and acquisition activity.
- Specialty program markets appear to be actively seeking profitable new business both from new program administrators as well as with existing partners by building product and volume. Underwriting appetites are robust across multiple lines, as carriers look for new ways to maintain premium writings while still maintaining profitable rate levels.
- Based on survey results, carrier markets operating in this space today should be interested in most program opportunities presented in 2007. However, the key to making successful marriages between program administrators and carriers is a clear understanding of carrier requirements, program needs, as well as program administrator experience, expertise and servicing capabilities.

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Whether a company seeks to enter the specialty programs market or grow existing businesses, the opportunities are there to be found. With greater knowledge of what specialty program carriers are looking for, and what they require of their program administrators, it is our hope that everyone working within this marketplace will be able to operate effectively and efficiently.

For more information, please contact Carl Bach, Program Manager Solutions Specialty Leader, at +1.860.550.8244 or carl.a.bach@guycarp.com; or John Barrows, Vice President, Program Manager Solutions Specialty Practice, at +1.860.550.8279 or john.h.barrows@guycarp.com.

Company Information

- Over the years, the specialty programs market has grown to include both traditional insurance companies with a specialty programs division and companies whose business model is to write specialty programs exclusively. This year's survey respondents were fairly evenly spread between traditional carriers (52 percent) and specialty carriers (48 percent).
- Regardless of whether their business model focuses exclusively on specialty programs or not, the survey suggests that carriers have the ability to write programs in most states and utilize both admitted and non-admitted paper. Eighty-six percent of the respondents have access to admitted paper in 40 or more states, while only 72 percent had non-admitted paper in 40 or more states. Of those having non-admitted paper, 27 percent had it available in 25 or less states.

Responding markets are projecting they will end up writing a total of 65-75 new programs by year-end 2007.

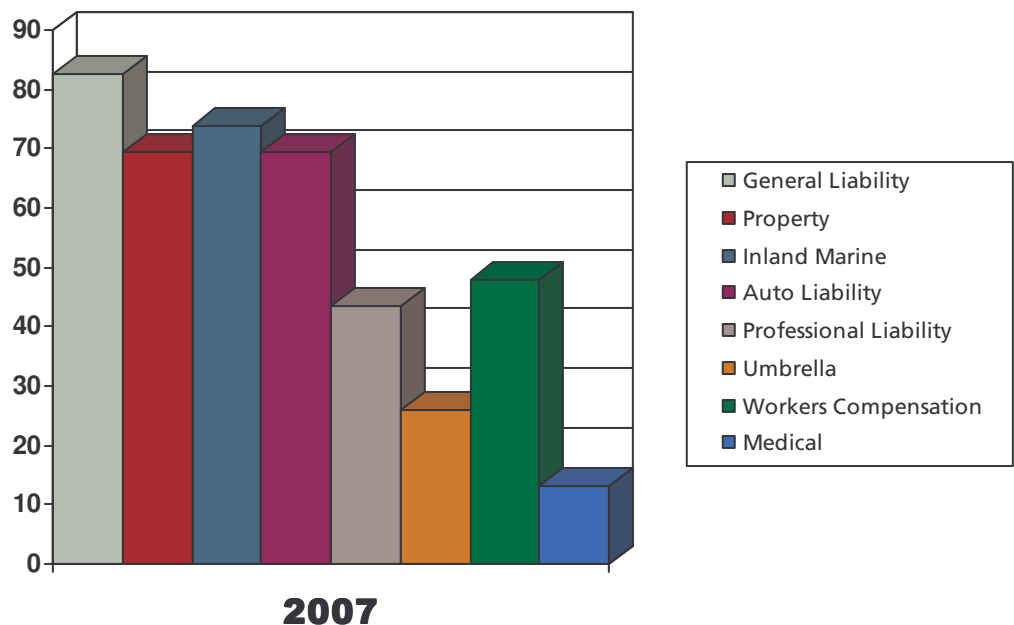
- Carriers continue to find benefits in attending industry annual meetings and conferences. This year, more so than in the past, the respondents were fairly evenly spread with respect to which meetings were most useful: NAPSLO (61 percent), AAMGA (52 percent) and others, such as PLUS, NCCI and various Captive meetings (65 percent). There appears to be an increased interest in meetings focused on specialty lines of business and market segments rather than the more general E&S/MGA conferences.
- Regarding premium growth and expansion, responding carriers indicated they are looking to both new and existing program administrators for premium growth and expansion. Adding new lines of business to existing programs (69.6 percent), expanding territory (60.9 percent) and growing by acquisition (43.5 percent) were other key responses.

Program Appetite

Responding carriers continue to look for growth in most commercial lines of business in today's marketplace. For the most part, growth in the major classes is being sought – general liability, property, auto, professional and inland marine. The two most notable changes from last year were in the workers compensation line, where 48 percent of the respondents are looking to grow their books (20 percent increase) and umbrella liability, where only 26 percent of the respondents are looking for growth (versus 65 percent last year).

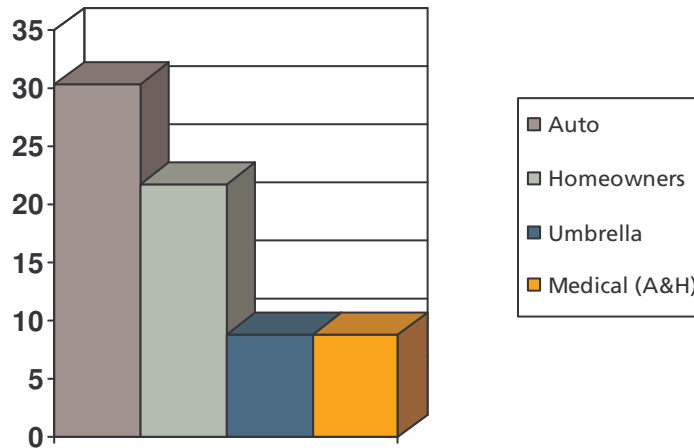
More than 45 percent of respondents noted seeking growth in workers compensation, up 20 percent from last year's results.

Lines of Business - Commercial



- With respect to personal lines (homeowners, auto and umbrella), it appears there is a lessening interest from responding companies in growing their personal lines programs. This year, 60.8 percent of the respondents indicated a desire to grow personal lines as compared to 65 percent in 2006. Interest in homeowners growth dropped 28 percent from a year ago while umbrella decreased 13 percent. There does, however, appear to be an interest in growing personal auto as 30 percent of respondents are seeking growth in this line as compared to 25 percent in 2006.

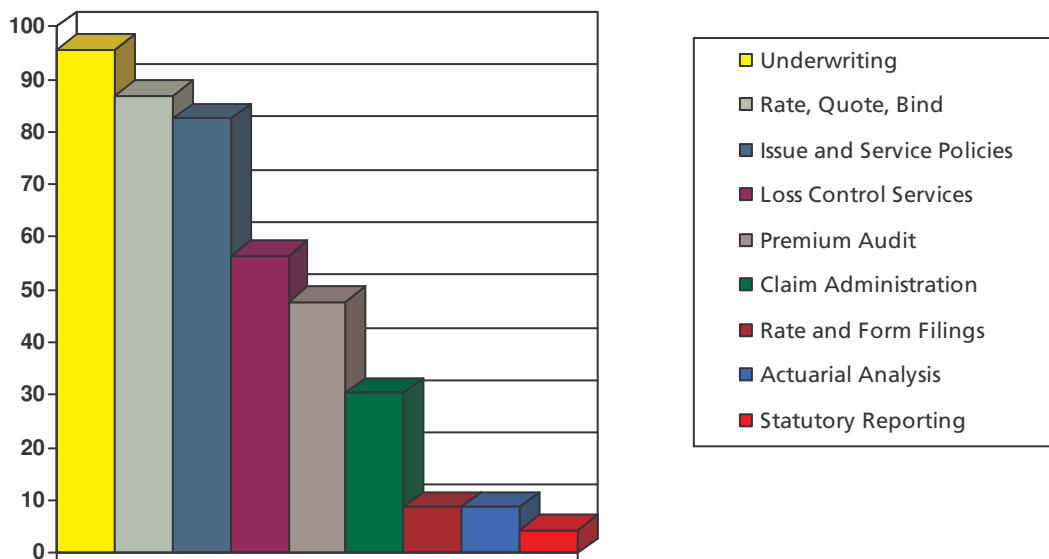
Lines of Business – Personal



- Responding carriers seem to prefer programs that are regional (65.2 percent) over national (26.1 percent) and single-state (8.7 percent) programs. Only single-state differed significantly from 2006, down 13 percent. These results are consistent with last year's responses.
- This year's survey reveals a slight movement toward a lower targeted annual program premium size compared with 2006. The average program size being sought remained fairly constant at \$10 million - \$15 million annual GWP (44 percent of respondents). The smaller programs (less than \$10 million GWP) appear to be slightly more appealing this year, as 39 percent of respondents indicated this size as their target versus 35 percent in 2006 and only 25 percent in 2005.

- When asked what services they expect their program administrator to perform, 95.7 percent of respondents say they expect or allow the program administrator to perform the underwriting function, up from 90 percent in 2006 and 81 percent in 2005. Just more than 82 percent indicated a desire for the program administrator to issue and service policies, down from 90 percent in 2006. More than half of respondents (56.5 percent) expect loss control services from their program administrator, while 47.8 percent allow for the outsourcing of the premium audit, up from 35 percent last year. Only 8.7 percent expect rate and form filings, although 30.4 percent expect claim administration, up 100 percent from 2006. Carriers still appear to want to provide the actuarial analysis as only 8.7 percent expect their program administrator partners to provide this service.

Expected Program Administrator Services



- When asked whether they prefer use of their own or their program administrator's rating/quoting/binding/issuing systems, some 68.2 percent of respondents indicated flexibility, an increase from 45 percent in 2006. Of those expressing a preference, 13.6 percent require their own systems to be used over the program administrator's (18.2 percent).
- Given the significant number of responding carriers that allow the program administrator to perform underwriting and policy issuance services on their behalf, one can understand why carriers require program administrator partners to carry adequate E&O and fidelity limits, although the required limits vary.

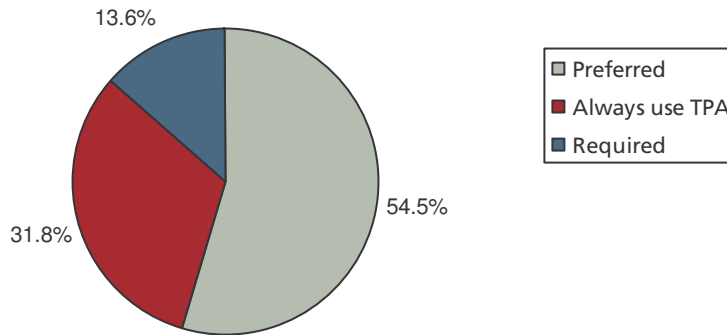
- Of respondents this year, 56.5 percent say that they require \$5 million in E&O limits, a significant increase from 15 percent just a year ago. This increase is further evident in the number mandating a minimum of \$1 million to \$3 million in E&O limits, as this amount dropped to 13 percent in this year's survey, compared with 30 percent in 2006 and 50 percent in 2005. It appears the bar has been raised.
- Some 73.9 percent of respondents require more than \$1 million in fidelity limits, up from 55 percent in 2006, while 13 percent require limits greater than \$5 million, a decrease from the 25 percent required last year.

Fifty-six percent of the responding markets say they require \$5 million in E&O limits, a significant increase from 15 percent a year ago.

- In exchange for requiring program administrators to take on a variety of traditional insurance company services, 91.3 percent of responding carriers appear willing to pay commission levels commensurate with the services provided, rather than a pre-determined percentage in excess of commissions paid to their production sources. This approach has remained consistent since 2005.
- In line with the desire of carriers (and their reinsurance partners) to increasingly align the interests of all underwriting parties, a number of responding markets are requiring a level of risk sharing on behalf of program administrators.
- More than 90 percent of respondents appear to feel that a sliding scale commission is an appropriate alignment, up from 65 percent in 2006 and 33 percent in 2005. Less than half (43.5 percent) of responding carriers are still paying flat commissions. In those instances where true risk sharing is required, greater than half (56.5 percent) of respondents report utilizing a number of other available or allowed vehicles, including an agency captive, a carrier's rent-a-captive facility, a third-party rent-a-captive facility or a group/association captive.

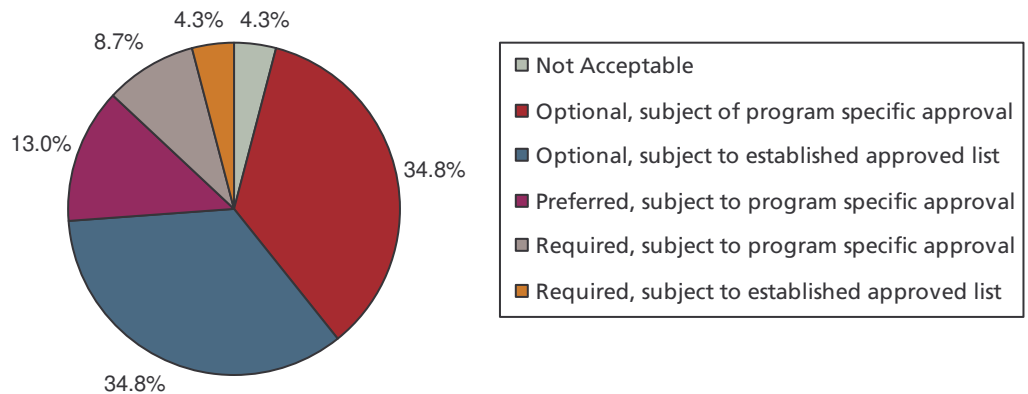
- Professional claim management goes hand in hand with a profitable specialty program. Therefore it is not surprising that a number of the responding carriers are becoming more flexible in their use of third-party administrators to manage claims. While many still require or prefer that claims be handled internally, others appear comfortable utilizing TPAs. While 31.8 percent allow the use of TPAs, down from 45 percent in 2006, 54.5 percent *prefer* to use their own in-house claim department (up from 40 percent last year), and 13.6 percent *require* the use of their in-house claim department. Last year 15 percent of the respondents required use of their in-house claim department, down from 25 percent in 2005.
- Forty-two percent of responding carriers, however, will not allow the use of a program administrator-owned TPA, although this figure is down from the more than 75 percent who said it was not acceptable in 2006.

In-House Through Carrier's Claim Department



- When a TPA is used, various criteria established by the carrier must be met. As the chart indicates, there are many nuances in the approval process.

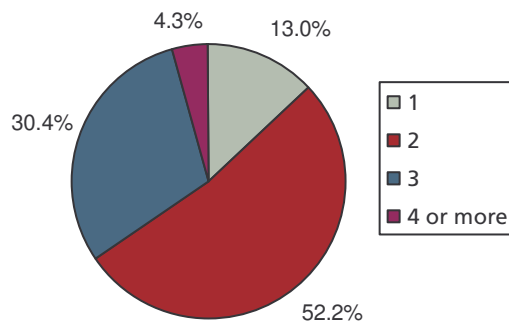
Use of Third Party Administrators



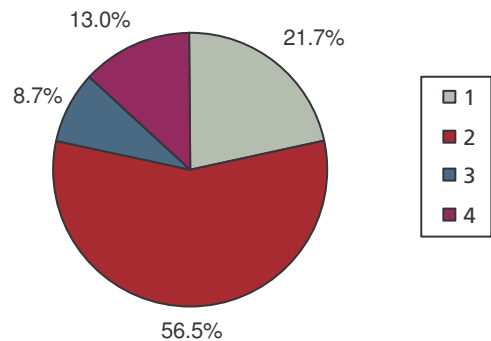
Program Monitoring and Control

- The industry's general expectation is that ongoing monitoring by the carrier's underwriting, regulatory and claim departments is central to a specialty program's success, and carriers constantly consider the resources required to manage their programs. The survey indicates that 30.4 percent of carriers aim to keep the number of programs managed by their program underwriters to three, while 34.8 percent will allow management of four, 17.4 percent allow two, and 13 percent handle five or more. The number varies by carrier depending on the services they outsource to the program administrator, the size of their overall specialty program book, their ability to electronically monitor the program administrator's activities, and other factors.

Underwriting/Operational Audits Per Year



Claims Audits Per Year



- The number of audits conducted annually also can vary by carrier, however, the number of respondents requiring two or more underwriting/operational audits per year increased to 86.8 percent this year, up from 80 percent in 2006.
- A more dramatic increase in the frequency of claims audits conducted annually by the carriers was evident this year. Nearly 80 percent of respondents indicated they are requiring two or more claims audits each year compared to only 63 percent a year ago.



Reinsurance

- The reinsurer is an important specialty program partner. A carrier supporting specialty programs can either roll a program into its corporate treaties or elect to purchase program-specific reinsurance. Fifty-two percent of carriers responding to this year's survey indicate a preference for rolling a program into the corporate treaties, as compared to 60 percent last year.
- This year, respondents were 55 percent more likely to prefer excess of loss over quota share structures. Versus last year, where results indicated they would be 85 percent more likely to utilize an excess of loss structure versus quota share.

Ninety-one percent of responding markets want to see their program sources compensated for bringing them new business.

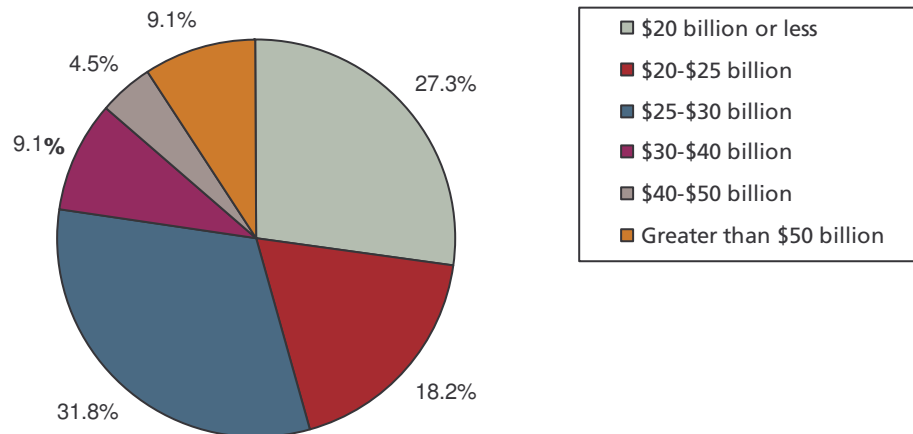
- More than 30 percent of responding carriers approach reinsurers through an intermediary. The remainder of respondents report utilizing the services of both intermediaries and direct market reinsurers.
- When program-specific reinsurance is not placed, more than a third (36.4 percent) of respondents indicated they will pay a finder's fee to the source bringing them the program, while another 55 percent indicated they will increase the program administrator's commission, allowing them to pay the source.

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Market Conditions

- Fifty percent of respondents estimate the size of the program administrator specialty program market segment at \$20 billion to \$30 billion of annual GWP, while the rest of the respondents are split between less than \$20 billion (27 percent) and greater than \$30 billion (23 percent). These numbers show a perceived smaller market size than noted by last year's respondents, of whom 16 percent indicated less than \$20 billion, 44 percent estimated between \$20 to \$30 billion and 40 percent suggested greater than \$30 billion.

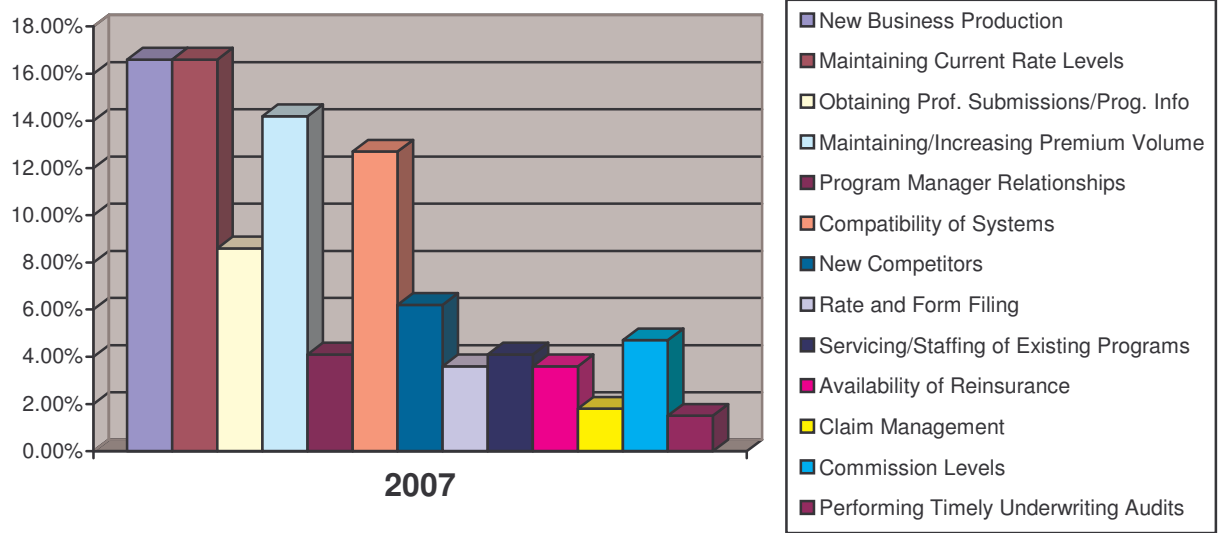
MGA/PA Market Size



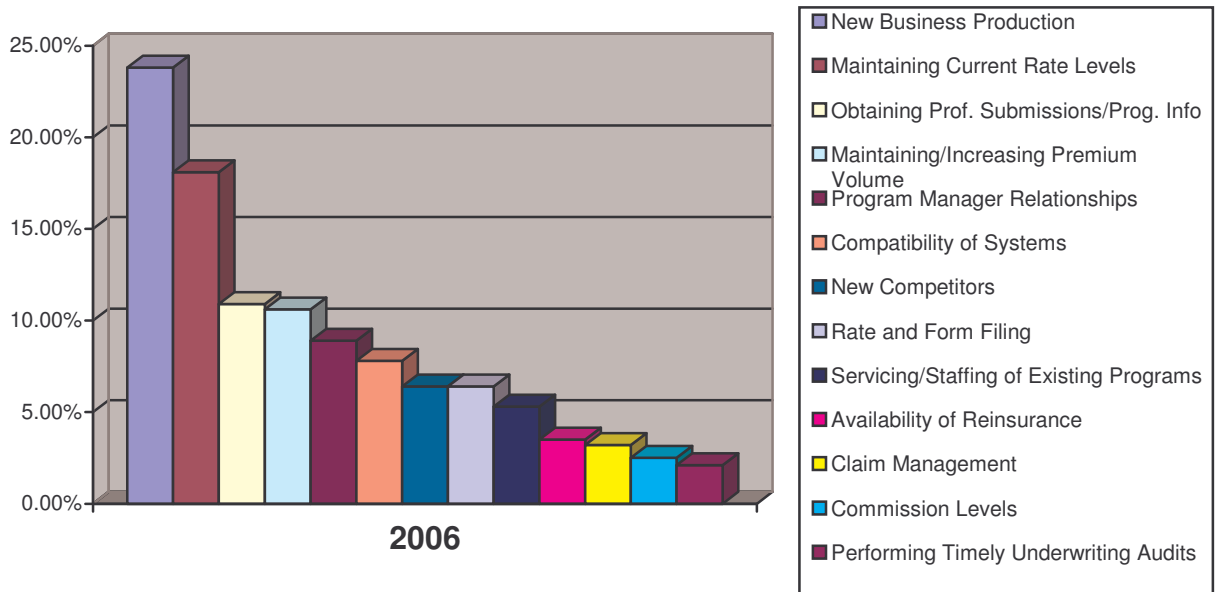
Fifty percent of the respondents indicate that they see the program administrator program market size between \$20 billion and \$30 billion.

- When carriers were asked about the biggest challenges they face as specialty program writers in 2007, new business production, which topped the list in 2006, shared the number one spot with maintaining current rate levels, which was number two in 2006 and number one in 2005. Maintaining/increasing premium volume was second, while compatibility of systems was third. By contrast, obtaining professional submission/program information ranked third in 2006, similar to 2005.

Biggest Challenges Facing Program Writers - 2007



Biggest Challenges Facing Program Writers - 2006



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MARSH MERCER KROLL
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Guy Carpenter & Company, LLC
One Madison Avenue
New York, NY 10010-3658
917 937-3000