

May 2008

2008 Global Terror Update

*The global terror insurance market is constantly reshaped by new governmental and regulatory developments. Several measures were introduced in the past year, including Belgium's establishment of a terror pool, the extension of the terrorism insurance legislation in the United States and changes to terror programs in France and the Netherlands. Peru has implemented insurance measures related to terrorism coverage, as well. Market capacity for Aviation has grown significantly, and prices have fallen. For a more thorough perspective on developments pertaining to terrorism coverage, please use this update with *Global Terror Insurance Market: The World Continues on High Alert*, published by Guy Carpenter & Company, LLC ("Guy Carpenter") in June 2007.*

Belgium

Belgium's Terrorism Reinsurance & Insurance Pool (TRIP) was created on February 1, 2008 and will act as reinsurance buyer. TRIP, a non-profit organization, is intended to distribute the cost of terrorism cover among all participants according to the provisions of the law that created the pool. Policies that come into force as of May 1, 2008 will have terrorism coverage.

TRIP guarantees the cover of terrorism claims during a calendar year up to a global annual limit of EUR1 billion. This amount will be adjusted every January based on the Consumer Price Index (relative to December 2005). The Belgian government can change the amount based on several factors, including economic developments, the financial capitalization of the (re)insurers and the development of terror risk. Carriers are not required to participate in the pool. But, participant liability will be capped at EUR1 billion, while non-participant liability will not be capped at all. The King of Belgium can modify the EUR1 billion annual limit with the consideration of the Council of Ministers. At the treaty's inception date the TRIP members represent more than 90 percent of the market.

The current annual TRIP limit, based on the December 2007 CPI, is EUR1,047,849,203. Thus, the first layer becomes EUR447,849,203 in excess of EUR300,000,000 for 2008. Beyond the EUR700 million (indexed) capacity provided by the (re)insurance industry, the Belgian government will provide an additional capacity of EUR300 million. Market retention is based on TRIP member market shares. The first layer is placed in the reinsurance market, and the insurers can also participate as reinsurers at their discretion.

"TRIP guarantees the cover of terrorism claims during a calendar year up to a global annual limit of EUR1 billion."

The classes of business are required to cover damages caused by terrorism are:

- Workmen's Compensation Insurance
- Motor Liability Insurance
- Strict Liability Insurance for public places/scenes in case of fire or explosion
- Property "Simple Risks Insurance"
- Life Insurance classified by the Banking, Finance and Insurance Commission (CBFA) under n° 21,22 and 23
- Health Insurance classified by the CBFA under n° 02
- Accident Insurance classified by the CBFA under n° 01

For other classes of business, the law is applicable as far as the insurance policies provide terrorism coverage.

Some classes of business are excluded, including:

- Terrorism insurance contracts written as such
- Insurance for businesses classified by the CBFA as: railway hull (04), aviation hull (05), ocean hull (part of class 06), aircraft liability (11), ocean-going vessel liability (part of class 12) and railway liability (part of class 13)
- Insurance companies covering liabilities from nuclear risks pertaining to Public Liability and damage to nuclear installations in accordance with the Law of July 22, 1985
- Theoretical surrender value of life insurance

Nuclear, Biological and Chemical (NBC) terrorism is covered for policies where terrorism coverage is compulsory and where it is included in specific policies. When it is covered, "nuclear" can include "damage caused by weapons or machines intended to explode by a modification of structure of the atomic nucleus," but the law allows the exclusion of "nuclear bombs." NBC is not expected to be covered in new policies.

Buildings, including contents located at a single company site, are allowed a recovery of up to EUR75 million. All insured objects of a company in an area of less than 50 meters on the same risk-address are deemed to be one and the same location. The parent company and its subsidiaries are considered to be one insurance entity.

The Law provides a broad definition of terrorism, based on that provided by the Organization for Economic Co-operation and Development (OECD). The flexibility of the definition has made it necessary for a committee to decide whether a specific event can be attributed to terrorism. This committee includes a representative of the Minister of Economy, CBFA members and two representatives from the (re)insurance industry.

The committee meets on a monthly basis – of its own accord or at the behest of the government to decide if any events that have occurred since the last meeting could be construed as resulting from terror. A final decision must be rendered within six months of the event's occurrence. The total compensated amount will be set for the first time at this meeting, and revision is possible every six months. The final decision with respect to the total compensated amount will be set after three years (analogous to the consolidation principle of the Belgian workers compensation business).

France

Following the terror attacks of September 11, 2001 in the United States, insurers of French risks faced a difficult choice. They could reduce their exposures on large risks or insure them against attacks with no resort to reinsurance. Alternatively, they could seek alternative reinsurance solutions, which was unlikely given the state of the market and the limited lead time available. Against this backdrop, Gestion de l'Assurance et de la Réassurance des risques d'Attentats et Terrorisme (GAREAT) was formed on January 1, 2002 to provide a framework for covering large, medium and small risks.

GAREAT 1 Update: Large and Medium-Sized Risks (Risk Limits above EUR6 million)

Total capacity on the open market remains unchanged at EUR1.8 billion in excess of EUR400 million. Above EUR2.2 billion, the unlimited State warranty takes effect. Layering has been modified, though, with six layers of EUR300 million each. This is an increase from four layers of EUR400 million and one layer of EUR200 million. Also, co-participation of the members across the board is no longer mandatory.

The first stage is quotation. Reinsurers interested in GAREAT's large risks scheme had to provide prices and capacity for each of the layers in which they wanted to participate. Members were also authorized to provide quotes. Two options per layer were possible, with the total capacity – for both options combined – subject to the prior agreement of the reinsurers. Reinsurers were authorized to choose any of the layers they preferred, without obligation to quote and participate across the board.

Capacities for each layer were sorted by price, from least to most expensive (after applying GAREAT solvency rules). The average rate on line (ROL) for the entire program was calculated (EUR1.8 billion in excess of EUR400 million), and placement was validated at a meeting of the GAREAT board.

The second stage of GAREAT placement was for members only. Members were asked (on the basis of the average ROL) whether they wished to participate in 2008. Responses were used to determine the overall capacity needed (net of members' subscription around 25 percent at the end of the day). For final placement, reinsurers had their own conditions on each of the layers in which they participated.

GAREAT 2 Update: Small Risks (Risk Limits below EUR6 million)

For 2007 the overall market retention, when applying the above percentages, has been revised from EUR2.4 billion to EUR2.44 billion. For 2008 GAREAT is estimating a figure of EUR2.5 billion, split as follows:

C4 Categories	Revised C4 - EPI 2007	State attachment point - 2007	Revised C4 - EPI 2008	State attachment point - 2008
Personal Lines	6 750	1 350		
Professional Risks	3 650	730	3 750	750
Agricultural Risks (excl Hail)	700	140	700	140
Motor Vehicles (excl TPL)	11 00	220	11 000	220
TOTAL	22 100	2 440	22 400	2 500

Source: Guy Carpenter & Company, LLC

The amount of the premiums to be ceded to GAREAT is calculated on the basis of the incomes of reference declared in Statements C4, to which are applied GAREAT's additional premium rates.

Categories	Rate applicable to the 2007 subject income, Statement C4
Category 24: Personal Lines risks	0.600%
Category 25: Professional risks	0.900%
Category 262: Agricultural risks	0.450%
Unsplit "Property Damage" incomes	0.900%
Income for "Motor excluding Liability" (Category 23)	0.090%
Tourist Aircraft Hull	2.000%
Pleasure Craft Hull	1.000%

Source: Guy Carpenter & Company, LLC

These are reinsurance rates charged by GAREAT to its members. However, GAREAT member insurers are free to charge different rates.

2008 Pricing

GAREAT LARGE RISKS				Average ROL
TOTAL	1,800,000,000	XS	400,000,000	6.0976%

GAREAT SMALL RISKS 100% basis			Flat premium	ROL
L2	1,050,000,000	400,000,000	38,000,000	3.62%
L3	1,050,000,000	1,450,000,000	28,350,000	2.70%
(In excess of 2,5 billion : Unlimited State Gurantee coverage though CCR)				
TOTAL	2,100,000,000	XS 400,000,000	66,350,000	3.16%

Source: Guy Carpenter & Company, LLC
All Pricing in EUR

Netherlands

Nederlandse Herverzekeringsmaatschappij voor Terrorismeschaden (NHT; Netherlands Reinsurance company for Terrorism losses) was established as a reinsurance company, entering into a reinsurance contract with each of its individual participants. The NHT pooling arrangement limits the total exposure to EUR1 billion maximum per event per annum for all lines. The process involves attaching the NHT clauses to the underlying insurance policies. The exposure for property-business interruption risks is limited to EUR75 million per location per annum. It is possible to insure excess amounts elsewhere. However, this has happened on a very limited scale. Participating insurers, once having decided to become a member of the NHT, are deemed to cede all their terrorism exposure to the pool. There is no obligation for an insurer to declare individual risks to the pool because the entire participant's portfolio is "pooled."

The NHT buys retrocession capacity from international reinsurers, as well as the Dutch government. The NHT participants are charged for the reinsurance premium. The yardstick for distributing the reinsurance premium is the market share of the respective NHT member (applying its premium income as part of the total market premium volume).

The total NHT capacity for 2008 has been maintained at the level of EUR1 billion per annum, according to the distribution below. If the overall loss exceeds the capacity of EUR1 billion, the indemnification to policyholders by NHT participants will be reduced proportionally to the capacity available.

From January 1, 2006, public healthcare business (as far as written by the NHT members) also falls under the scope of NHT, due to the introduction of a basic healthcare coverage for all Dutch citizens. This situation has continued into 2008.

Excluded lines include aviation and aviation liability policies, as well as policies that have taken on terrorism as such. In order to be recognized as an event of terrorism, the NHT applies a franchise deductible of EUR7.5 million per event and per annum.

1,000M	2ⁿ Layer	€50M in excess of €950 M Coverage by Dutch government.
950M	1st Layer	€550M in excess of €400 M. Allocated on international reinsurance or retrocessional markets.
400M	Market Retention	€400 M Coverage by primary insurers (NHT participants).
EUR millions		

Source: Guy Carpenter & Company, LLC

Peru

In Peru, sub-limits for terrorism have been introduced into both proportional and non-proportional treaties, along with other conditions, exclusions and limitations. Peruvian insurers now have separate treaties specifically for covering terrorism and political risk. They generally are limited to 50 percent or less of the standard property perils limit. The two main Peruvian insurance companies, Pacifico and RIMAC, currently have excess of loss protection placed.

Given the risk of isolated incidents of civil unrest and terrorist activity, the facultative reinsurance market remains actively involved in offering cover for both terror and political risks. This persists despite the fact that large local capacities are available. In some cases, local insurers prefer to complement their capacities with purchased facultative reinsurance or by acting solely in the facultative market.

Peru does not offer a terror pool, and the government is not involved in providing terror coverage.

United States

The Terrorism Risk Insurance Act of 2002 (TRIA) was extended in 2007 for another seven years. This follows a two-year extension that was passed in 2005. TRIA, in its current iteration, requires insurers to offer coverage to a large majority of commercial policyholders. Carriers receive reinsurance protection above a USD100 million loss threshold. They are also subject to 15 percent co-insurance.

Following the terror attacks of 2001, insurers moved to eliminate cover from their policies. The United States created a program to support the insurance industry in providing terror cover to ensure that adequate coverage remained available and to mitigate the effects of a future catastrophe on the broader economy. U.S. Congress passed and implemented TRIA to provide a financial backstop for commercial insurers from potential insolvency arising from underwriting terrorism risks. Per the latest extension, TRIA is set to expire at the end of 2014.

TRIA's Essential Features

Limitation	Events less than USD5 million are not certified
Program Trigger	Events less than USD100 million
Insurer Deductible	20 percent of direct earned premium
Covered Lines	Exclusion of coverage on commercial auto, burglary and theft, surety, professional liability and farm owners multiple peril insurance
Insurer Shares (Co-Participation)	85 percent federal government, 15 percent insurer
Program Cap	USD100 billion per year for insured losses (federal and insurer combined). Policies to provide clear and conspicuous disclosure to the policyholder of the existence of the USD100 billion cap. Requires US Treasury to promulgate regulation for pro-rata shares when losses exceed cap
Recoupment of Federal Share via Policyholder Surcharge	Mandatory recoupment of all federal payments if insured loss < USD25 billion in 2006 and USD27.5 billion in 2007. Surcharges not to exceed 3 percent of premiums per year.
Foreign versus Domestic	All acts of terrorism are covered.
Expiration	December 31, 2014
Studies	The President's Working Group on Financial Markets was required to report to Congress in 2010 and 2013 concerning the long-term availability and affordability of terrorism insurance, including the availability and affordability of group life insurance, and NBCR.

Source: Guy Carpenter & Company, LLC, US Treasury Department

The issue of terrorism cover has been addressed at the state level as well. In the primary insurance market, 31 jurisdictions have legislated that property policies be based on the “1943 New York Standard Fire Policy” (SFP). SFP contains few exclusions and specifically does not exclude terror as a cause of loss by fire. Further, the hazard of “fire following” an event is covered even if the peril that causes the fire is not covered in the policy.

According to the National Association of Mutual Insurance Companies, 13 states have allowed terrorism exclusions to be added to the SFP since September 11, 2001: Arizona, Connecticut, Idaho, Louisiana, Michigan, Minnesota, Nebraska, New Hampshire, North Dakota, Oklahoma, Pennsylvania, Rhode Island and Virginia.

Aviation

Background

Aviation insurance for terrorism risks is an overriding issue for every country. Since airlines are required to have passenger and third-party liability insurance cover to receive landing rights, as well as a condition for leases, the cancellation of aviation insurance could threaten to shutdown the aviation industry completely. Following the events of September 11, 2001, aviation insurance attracted public attention as aviation insurers worldwide withdrew cover for acts of war, terrorism and related perils. Within days of the events, all aviation insurers issued a seven-day notice of cancellation to reduce third-party war risk liability insurance for air carriers and aircraft operators to a maximum of USD50 million annual aggregate cover, down from as much as USD2 billion for any one occurrence. Airports and service providers were not offered third-party cover until weeks later, although even then the majority of insurers declined to write security service provider risks.

With no further losses occurring in the months following September 11, 2001, and with third party war liability prices dropping materially, the majority of governments started to scale back the level of their involvement, and by the end of 2002, most government schemes had been withdrawn and replaced by commercial cover. The United States government, however, took the opposite approach. Legislation has been passed to extend the duration of this cover and the USD100 million third-party liability terrorism cap, and both are still in force today, until at least 31 August 2008.

Other governments still providing third-party liability cover in 2008 include Canada, Brazil, China, Jordan, New Zealand, Qatar and Saudi Arabia.

Market Conditions

Market capacity has grown and prices have dropped considerably. On primary liability covers, it is now possible to purchase USD150 million aggregate cover for air carriers and service providers and on Excess Third-Party War Liability covers excess of USD1 billion aggregate cover is available.

WMD Update

Insurers believe that a major weapons of mass destruction (WMD) attack, especially at an airport, could produce an accumulation of losses that could ruin the market. The aviation hull war market started to impose WMD exclusions on renewals in May 2005, but the liability exclusions have yet to be used. This delay is due in part to the terms of a settlement between the European Commission (EC) and London aviation insurers to conclude an EC investigation into the London aviation insurers' response to September 11, 2001.

In view of the continuing soft aviation insurance market conditions, it is unlikely that carriers will seek to change the current clauses in 2008. If a major terrorist loss occurs, though, it is possible that aviation insurers will withdraw all WMD cover. If this occurs, government guarantees will have to be provided until a longer term solution can be put in place.

One possible long-term solution is the Draft Convention on Compensation for Damages Caused by Aircraft to Third Parties, in the case of Unlawful Interference, which was scheduled to be considered at the ICAO Legal Committee meeting in Montreal from April 21, 2008 to May 2, 2008. If the meeting is successful, the Draft Convention will be submitted to a Diplomatic Conference (assuming the agreement of the ICAO Council). The Draft Convention is designed to ensure compensation to victims as a result of terrorist or other acts of unlawful interference to aircraft in flight. It is also designed to protect the aircraft operators and other industry participants, who are also victims, from the threat of insolvency caused by such acts, which are usually targeted at governments.

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