

GUY CARPENTER

**The Specialty Insurance Programs
Issuing Carrier Survey**

Program Manager Solutions Specialty Practice
September 2006



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 second 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, claims 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 e-mail and sent to key individuals at insurance companies that write a significant amount of program business through program administrators.

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

Overview (cont'd)

Following are the survey's major highlights and findings:

- Change and evolution remain hallmarks of the specialty programs marketplace. This is evidenced by the continued introduction of new markets, new program administrators and new products; merger and acquisition activity; a rising number and variety of third party service providers; as well as increased use of non-admitted paper and alternative risk mechanisms.
- Specialty program markets appear to be actively seeking profitable new business. Underwriting appetites are robust across multiple lines and the market seems poised to expand as long as current rate levels are maintained and sufficient, reliable program information can be obtained.

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- Based on survey results, carrier markets operating in this space today should be interested in most program opportunities presented in 2006. However, the key to making successful marriages between program administrators and carriers is a clear understanding of carrier appetites, program needs, and program administrator servicing capabilities.

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 860.550.8244 or carl.a.bach@guycarp.com.

Company Information

- Over the years the specialty program market has grown to include both traditional insurance companies with a specialty program division and companies whose business model is to write specialty programs exclusively. The majority of this year's survey respondents (65%) describe themselves as writing specialty programs exclusively, up from less than half (48%) of respondents last year.
- 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 of the 50 United States and utilize either admitted or nonadmitted paper, or both. However, they appear to be migrating toward nonadmitted paper. Last year some 90 percent of respondents were licensed in 40 or more states for admitted and/or nonadmitted paper. This year the percentage of respondents saying they were licensed to write on nonadmitted paper in 40 or more states jumped to 94.1 percent, while a lower 78.9 percent of respondents report being licensed to write on admitted paper in 40 or more states.

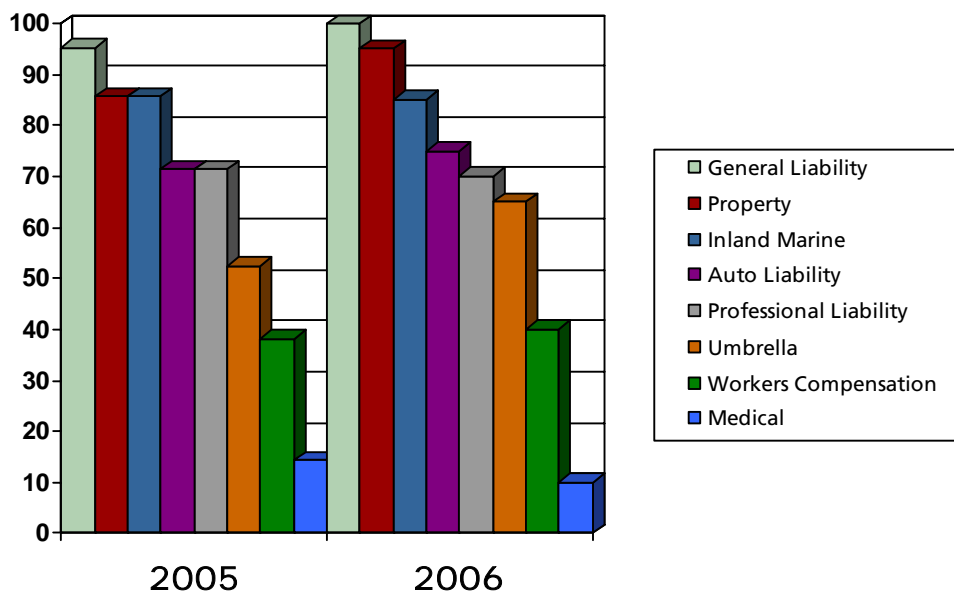
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- The aggregate premium writings of responding carriers were just over \$6 billion at year-end 2005. Underscoring their commitment to this market segment, responding markets are projecting that they will write a total of at least 80 to 100 new programs in 2006 and expect their resulting premium volume to exceed \$7 billion.
- Responding carriers indicated that the AAMGA and NAPSLO annual meetings are by far the most useful meetings for them to attend to achieve their business goals, keep abreast of market trends, and nurture relationships. Ninety-five percent cited the AAMGA annual meeting as beneficial, while 80 percent cited the NAPSLO annual meeting as beneficial. Of note this year, industry specific attendance at such meetings as PLUS, Bermuda Captive and VCIA was also cited as beneficial.

Program Appetite

- Responding carriers can write most commercial lines of business in today's marketplace. A full 100 percent of respondents noted an appetite for general liability insurance. The majority also indicated an appetite for property, inland marine, automobile liability, professional liability, and umbrella liability, and fewer indicated writing workers compensation (40%) and medical (10%). The most significant change from last year is evidenced in commercial umbrellas, with some 65 percent expressing a willingness to underwrite that line now as compared to 52 percent last year.

Lines of Business - Commercial

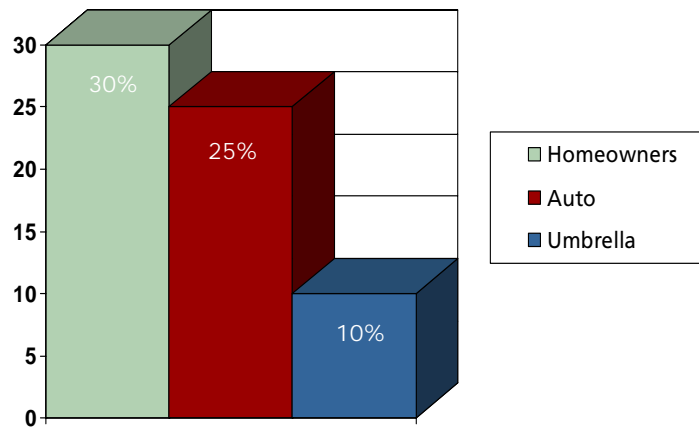


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Program Appetite (cont'd)

- With respect to personal lines (homeowners, auto and umbrella), it appears that more companies are looking to grow their personal lines programs. This year, 65 percent of the respondents indicated a desire to write personal lines as compared to only 42 percent last year, with 30 percent having interest in homeowners, 25 percent indicating an appetite for auto, and 10 percent for umbrella. It should be emphasized that the survey sought to determine those personal lines in which respondents wished to grow in 2006, not necessarily those they are currently writing.

Lines of Business - Personal

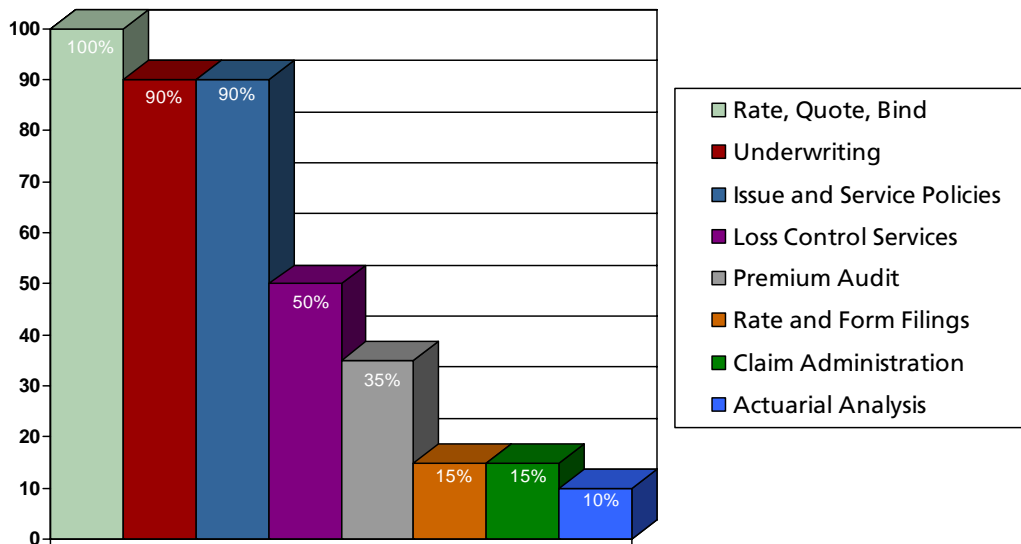


- Responding carriers seem to vastly prefer programs that are regional (65%) over national (25%) and single-state (10%) programs. This is a dramatic shift from 2005 when respondents were fairly evenly split, with 40 percent saying they preferred regional programs and 30 percent each indicating a preference for either national or single-state programs.
- This year's survey reveals movement toward a lower targeted annual program premium size compared with 2005. Forty-five percent of responding carriers indicate that they are looking for \$10 million to \$15 million in annual gross written premium (GWP) compared with 50 percent a year ago. Thirty-five percent indicated a preference for smaller programs (below \$10 million), up from 25 percent last year. Only 20 percent of respondents indicate a preference for larger programs (above \$15 million), down from 25 percent in 2005.

Targeted Program Administrator Parameters

- When asked what services they expect their program administrator to perform, respondents unanimously say they want the program administrator to rate, quote and bind business on their behalf. A full 90 percent of respondents expect or allow the program administrator to perform the underwriting function as well as issue and service policies. This marks an increase over last year when 81 percent of respondents indicated a desire for underwriting and just over 75 percent indicated a desire for issuing and servicing policies. More than half of respondents (55%) expect loss control services from their program administrator, while 35 percent allow for the outsourcing of the premium audit. Only 15 percent expect rate and form filings as well as claims administration, and 10 percent expect actuarial services to be performed by their program administrator partners.

Expected Program Administrator Services



- When asked whether they prefer use of their own or their program administrator's rating/quoting/binding/issuing systems, some 45 percent of respondents indicated flexibility. Of those expressing a preference, 30 percent require their own systems to be used over the program administrators' (25%).

Targeted Program Administrator Parameters (cont'd)

- 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 limits required vary.
 - Thirty percent of respondents this year say that they require at least \$3 million to \$5 million in E&O limits. The number mandating a minimum of \$1 million to \$3 million in E&O limits dropped to 30 percent in this year's survey compared with 50 percent a year ago. Only 15 percent of respondents this year require \$5 million to \$10 million in E&O limits, down from 28 percent a year ago.
 - Some 55 percent of respondents require more than \$1 million in fidelity limits, while 25 percent require limits greater than \$5 million.

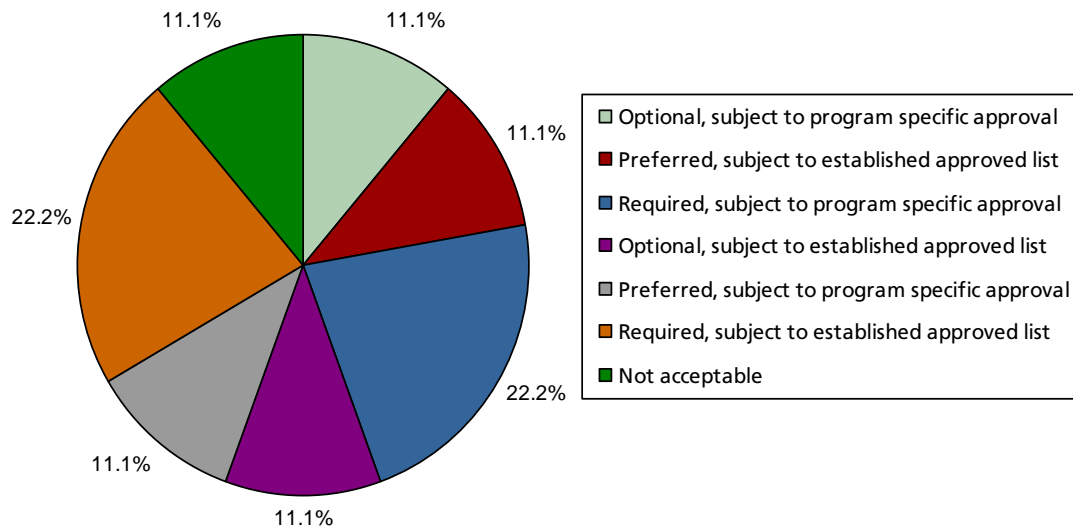
A number of responding markets are requiring a level of risk sharing on behalf of program administrators.

- In exchange for requiring program administrators to take on a variety of traditional insurance company services, a full 90 percent of responding carriers appear willing to pay commission levels commensurate with the services provided, rather than a predetermined percentage in excess of commissions paid to their production sources.
- 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.
- Approximately 65 percent of respondents appear to feel that a sliding scale commission is an appropriate alignment, up from one third last year. Nearly half (45%) of responding carriers are still paying flat commissions. In those instances where risk sharing is required, greater than half (55%) 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.

Claims Administration

- Professional claims 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 TPAs to manage claims. While many still require or prefer that claims be handled internally, others appear comfortable utilizing third party administrators. While 45 percent always use a TPA, 40 percent prefer to use their own in-house claims department and 15 percent require the use of their in-house claims department. Last year 25 percent of the respondents required use of their in-house claim department.
- More than 75 percent of responding carriers, however, will not allow the use of a program administrator-owned TPA.
- 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.

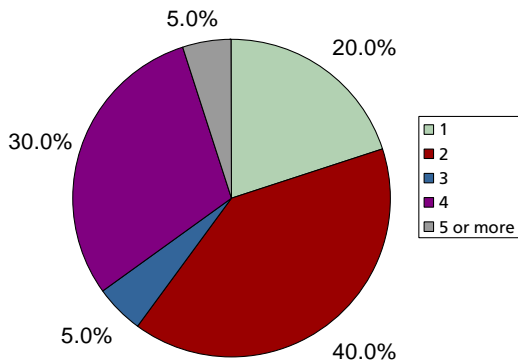
Use of Third Party Administrators



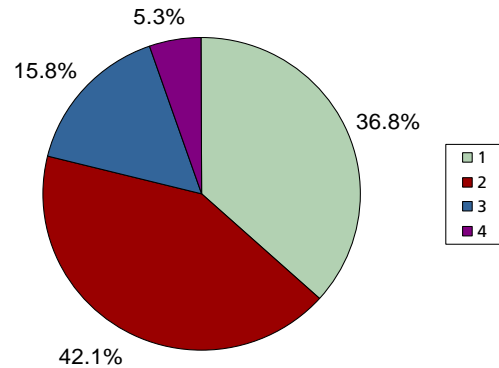
Program Monitoring and Control

- The industry's general expectation is that ongoing monitoring by the carrier's underwriting, regulatory and claims departments is central to a specialty program's success, and carriers constantly consider the resources required to manage their programs. The survey indicates that 35 percent of carriers aim to keep the number of programs managed by their program underwriters to three, while 30 percent will allow management of four, 20 percent allow two, and 10 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 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, this year the survey appears to indicate a slight increase in the frequency of underwriting/operational audits, from 45 percent performing two to three audits last year to 75 percent performing two to four audits in 2006.

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. Sixty percent of carriers responding to this year's survey indicate a preference for rolling a program into the corporate treaties, as compared to 48 percent last year.
- Once again this year, responding carriers are 85 percent more likely to prefer excess of loss over quota share structures (excess of loss: 65%, quota share/proportional: 35%).
- More than 25 percent of responding carriers approach reinsurers through an intermediary. The remainder of respondents report utilizing the services of both intermediaries and direct market reinsurers.

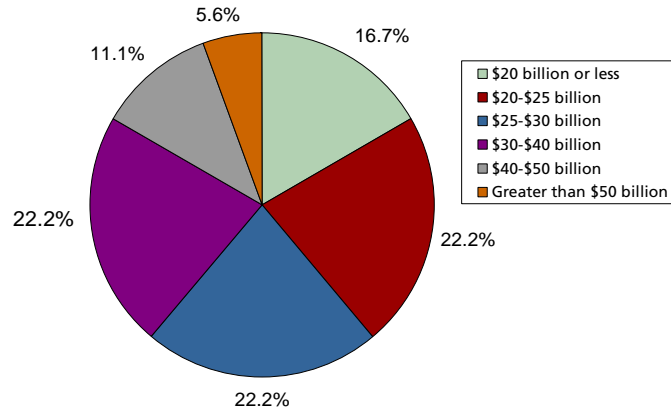
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- Among those that do not buy program-specific reinsurance, nearly half (47%) of respondents pay a finders' fee to the source bringing them the program. Approximately 20 percent increase their program administrator's commission to pay the source.

Market Conditions

- More than 65 percent of respondents estimate the size of the program administrator specialty program market segment at \$20 billion to \$40 billion of annual GWP. Sixty-five percent say they expect the program market to grow during 2006. This is a positive change from last year where only 38 percent of respondents anticipated growth.

MG/PA Market Size

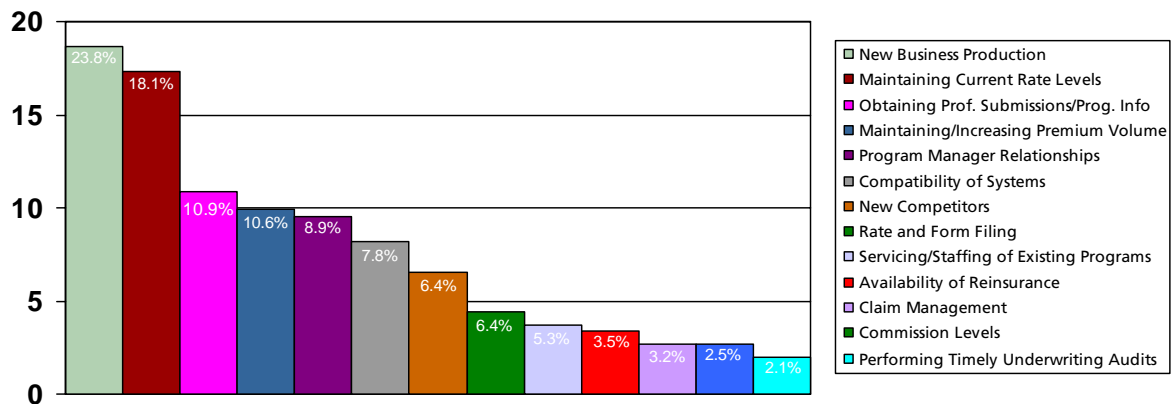


55 percent indicate that they see market results for the last three years continuing through 2007.

Market Conditions (cont'd)

- When carriers were asked about the biggest challenges they face as specialty program writers in 2006, new business production, last year's number two challenge, topped the list. Maintaining current rate levels, which was first on their list of challenges in 2005, was number two this year, while obtaining professional submission/program information came in third in 2006, similar to last year.

Biggest Challenges Facing Program Writers



- Prospects for future growth seem bright. Sixty-five percent of respondents say they view program market results over the last three years as more profitable than the standard market, and more than half – 55 percent -- indicate that they see market results for the last three years continuing through 2007.

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