

CATASTROPHE MODELING UPDATE - 2011

As you know, the property insurance market has continued to soften since 2007, generating rate decreases from 10% to 15% annually. However, after reducing prices for the last several years, underwriters are nearing the point where they will not be able to cut rates any further. It was predicted that rate decreases in 2011 would not be as dramatic and pricing would likely flatten out as underwriters look to stabilize their portfolios.

According to NAPCO, insurance industry net income more than doubled in the first half of 2010, helped by a significant improvement in investment gains. With the past few hurricane seasons being relatively quiet and capacity more abundant, underwriters have relaxed their guard and are competing for business they would have avoided a few years ago! However, underwriters are now beginning to analyze pure underwriting profitability more strategically.

For the first two months of 2011, most accounts saw rate reductions of 10% at renewal – and most carriers were willing to negotiate terms aggressively. **However, a new factor has been thrown into the mix . . . all underwriters are now mandated to run catastrophe models prior to quoting.** The use of modeling systems enables all companies to view results in a similar and consistent method – which typically translates into uniform underwriting outputs. Hurricanes are the principal driver of annual catastrophe risk in the US, in part due to the rapid growth of exposure along hurricane-prone coastlines. The most common model, RMS® U.S. Hurricane Model, quantifies hurricane risk through realistic simulations capturing multiple landfalls, surge inundation, and extra-tropical transition.

Here's the rub, two weeks ago, RMS (Risk Management Solutions, Inc.) announced it released its new version of the US Hurricane Model, which incorporates lessons learned from recent storms. According to published reports, this new modeling system was expected to:

- Increase the expected annual hurricane losses in some areas by as much as 25%
- Severely increase hurricane loss estimates in the Mid-Atlantic and even more so in Texas
- Show new and increased risk of storm damage in interior parts of the US, as far inland as TN and PA

Essentially, these updates were primarily geared toward inland areas, since coastal updates were current in the existing models. Those reports also indicated insurers that use this model may have to re-evaluate their capital levels and raise prices, but that the impact of the updated RMS model is “still unknown and will not be immediate.”

From personal experience in the past ten days . . . **the increases may be significant and immediate!** I'm renewing a risk located in Hillsborough County whose expiring premium is \$177,000 but the renewal (based on the carriers using the updated RMS model) is pricing around \$250,000 – a 41% increase for the same exposure, with sub-limited wind!

Reinsurers that use the RMS model may be impacted in similar ways. The updated model has the potential to drive increased demand on the part of reinsurance buyers while at the same time driving down the supply of reinsurance. Notwithstanding the new RMS model's impact, last year's BP oil spill and the recent earthquake and tsunami in Japan will likely also have significant impact on reinsurers, hence insurers and finally your property insurance renewal pricing. **I recommend budgeting up to 50% increases in your property insurance premiums for the next year . . .** Please bear in mind, there is no certainty that your property or a specific location will have this kind of increase, it may be less, it may be more – or it may yet have a slight reduction! Not every insurer uses the RMS model, although many do . . . at this point we don't

have a list of which carriers use RMS and if so, when they plan to implement the update. What I can say is that many carriers implemented the update within days of the release.

US Atlantic Hurricane Changes

Forensic Analysis Updates

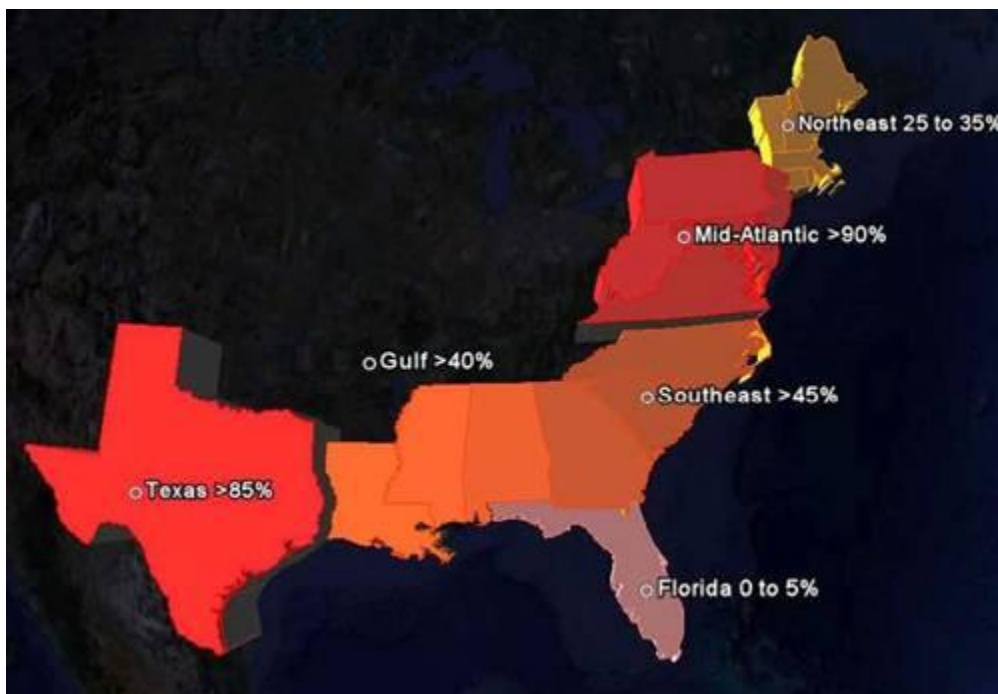
- Claims data from Hurricane Ike in 2008 indicates roofs fail at much lower wind speeds than previously thought
- Poorer than expected construction quality due to lack of enforcement and understanding
- Re-examination of code enforcement and building practices in other US wind-prone states

US Nationwide Results – Portfolio Average Increases

- AAL (Annual Average Loss) – increase of 35%
- 100-year increase of 20%
- 250-year increase of 10%
- 500-year increase of 10%
- 1000-year increase of 20%

The above yearly increases are the increased probability of hurricane loss in any given year, which are used to determine each risk's PML (Probable Maximum Loss), while AAL is the Average Annual Loss a carrier expects each year on clients. This means if a carrier expects a 35% increase in the loss on a specific client, when determining annual premium, they must add in expenses, administrative costs, surplus and profit . . . hence my recommendation of budgeting for a 50% increase in premium!

The map below shows expected portfolio loss increases based on the newly released US Atlantic Hurricane Model. Individual account losses will not necessarily represent the increases shown below.



Please remember, this is a very new development in the insurance marketplace and there's no guarantee that your specific property insurance premium will be affected . . . however, I want you to be aware of this potential increase so you can plan and budget accordingly.