



SNL Insurance Brokerage Seminar

SNL  CENTER *for* FINANCIAL EDUCATION

New York Athletic Club
New York, NY
February 26-27, 2007





Understanding the Wholesale Market

Dale A. Myer

Senior Vice President

Gill and Roeser Holdings, Inc.



GILL AND

ROESER



Presentation Outline

- Foundation of the insurance industry.
- Historical overview of the insurance industry in the United States.
- Analysis of the wholesale insurance market vs. the retail insurance market.
- Distribution of wholesale insurance products.
- Financial review of wholesale distributors.
- Questions and Answers.



Foundation of Insurance Industry

- Risk (the possibility of suffering harm or loss) is inevitable in all personal or business endeavors.
- Risk takes many forms, affects one's physical well being and/or financial security.
- Types of risks change over time and continue to change at a rapid pace.
- Risk of loss carries uncertainty and cannot be eliminated, but it can be managed, mitigated, and transferred.
- Goal of insured is to transfer risk to another party.
- Goal of insurer is to accept risk and make a profit.
- Many times there is an intermediary between the insurer and the insured. This can be a broker or agent.



Foundation of Insurance Industry (cont'd)

- 3000BC the Babylonians added a “risk premium” to capital and interest charges supporting trade ventures.
- 750BC the Greeks created risk sharing concept of “general average”.
- 200BC the Romans created life insurance.
- 450 Merchant and Artisan guilds are created in Holland.
- 1300 the Venetians created the “polizza” or policy to cover risks.
- 1688 Lloyds of London was created in a coffee house and became the center of information on the British shipping empire.
- 1700 brokers are hired to look for the best insurers for ship owners.
- 1769 New Lloyds is formed with a code of behavior. The original had become a mecca for “lowlifes and gamblers”.
- 1780 French and Spanish capture 55 British ships; 1.5MM pound loss. Many syndicate failures and there is no reinsurance.
- 1885 reinsurance is allowed for a fire company.
- 1902 excess of loss reinsurance created for catastrophes.



Historical Timeline for U. S.

- 1700's Philadelphia was center of America's commerce and insurance.
- 1721-1724 insurance brokerage offices open in Philadelphia and Boston.
- 1725 Phoenix Assurance of London writes fire coverage through agents in America.
- 1752 Ben Franklin starts the Philadelphia Contributorship.
- 1795 first U. S. Agency is formed in Charleston, SC. It is appointed by two companies and gets a 2.5% commission.
- 1792 INA is formed to write a "totine" life insurance.
- 1800's U. S. is growing rapidly and changing rapidly. Risks are changing and the insurance industry is responding.
- 1811 New Madrid earthquake.
- 1853 New York required unearned premium reserve for companies.
- 1858 Massachusetts appoints first insurance commissioner.
- 1864 Travelers Insurance is formed. Start of casualty insurance.
- 1869 National Association of Local Fire Agents was formed, now known as the IIAA.
- 1884 there were 218 registered brokers in the U. S.
- 1906 San Francisco earthquake.
- 1907 first U. S. auto policy.



2006 P&C Market

Source: Insurance Services Office, Insurance Information Institute, P&C Insurance Association of America

9 Months Ended	9/30/06	9/30/05
Net U/W Gain	\$24.4B	-\$2.5B
Net Written Premium	\$338B	\$321B
Surplus	\$468B	\$414B
Combined Ratio	91.5%	99.9%
Net Profit A/T	\$45B	\$30B
ROE (STAT)	13.4%	9.8%
Direct Cat Losses	\$7.6B	\$51.1B
Non Cat Losses	\$201.5B	\$201.6B



Current P&C Conditions

- Relatively high surplus levels at primary companies and reinsurers. New capital continues to come in.
- Reserve redundancies at many primary companies.
- Minimal cat losses in 2006 versus 2005.
- Adequate reinsurance terms and conditions.
- Slow growth in overall economy.
- Strong profits based on historical comparison.
- Underwriting profit in 2006 and forecast for 2007.
- Relatively low leverage (premiums/surplus).
- Cat exposed areas still high property rates.
- Commercial rates continue to weaken.
- P&C insurance is a low ROE business.
- Generally soft market conditions.
- Terrorism Risk Insurance Act expires 12/31/07.
- Industry retentions are up significantly from 2005 (20% of DEP from 15%).
- Industry aggregates are capped at \$27.5B up from \$15B in 2005.
- Legal concerns.



Wholesale Definitions

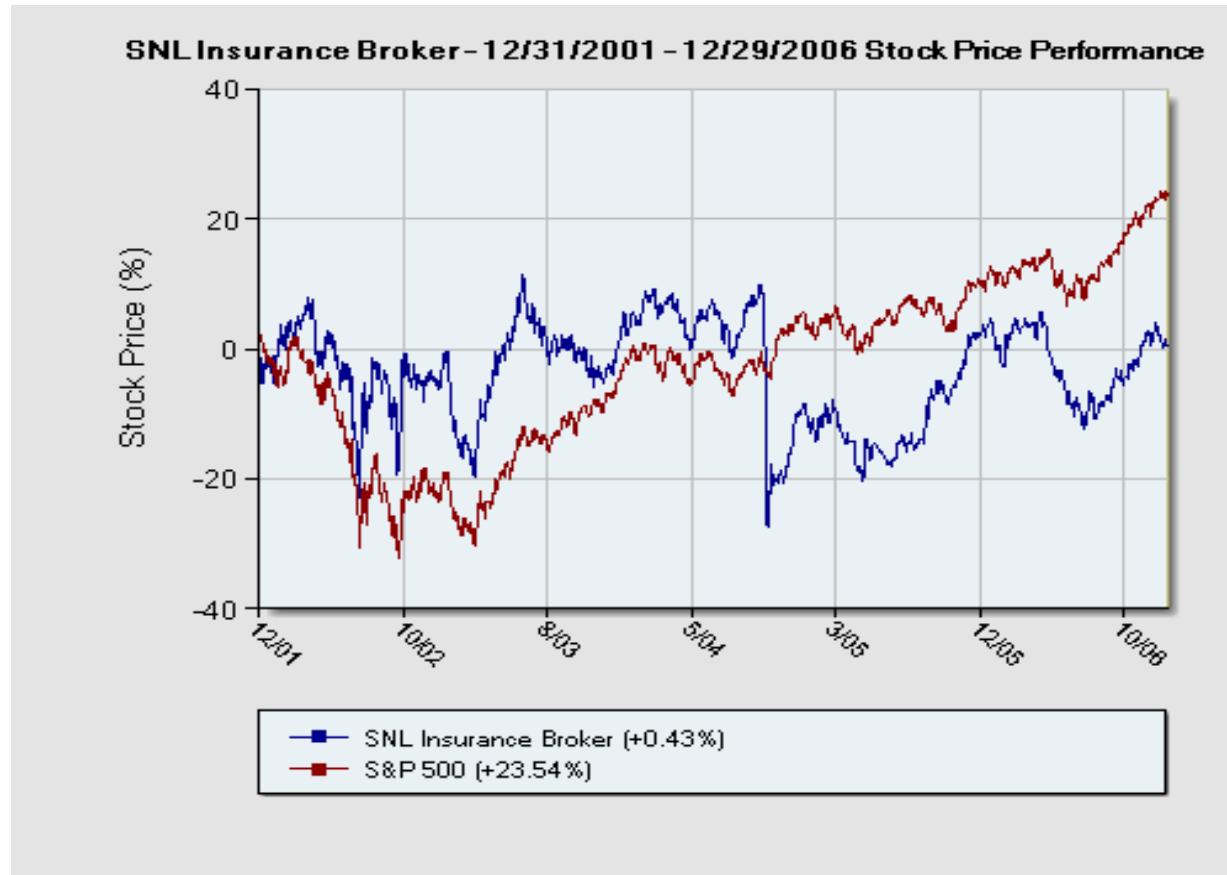
- Nonadmitted Insurance: P&C insurance permitted to be placed directly or through a surplus lines broker with a non-admitted insurer.
- Nonadmitted Insurer: an insurer not licensed to engage in business in a specific state. No solvency, rate, or form regulation for surplus lines insurers, except NJ. May not compete directly with licensed primary carriers, business is exported to the surplus lines market by an intermediary.
- Managing General Agent: properly licensed person holding contractual authority to perform underwriting and other services on behalf of an insurer and whose principal source of premium volume derives from retail third party sub-producers.
- Wholesale Insurance Broker: licensed broker providing specialized insurance products to retail insurance agents and brokers.
- Wholesale Markets: insurers who consider risks (either on an admitted or nonadmitted basis) that a retail agent cannot place with their standard markets.
- Program: an effort by a wholesaler to serve a niche market. The key is the underwriting process in the target market, but claims and administrative functions may also be required. Compensation metrics to wholesaler are changing, carriers are requiring more skin-in-the-game.
- Reinsurance: sharing of underwriting risk and premium by insurers and reinsurers.
- Agent: authorized to sell insurance on behalf of an insurance company.
- Broker: paid by insured to look for insurance on its behalf.



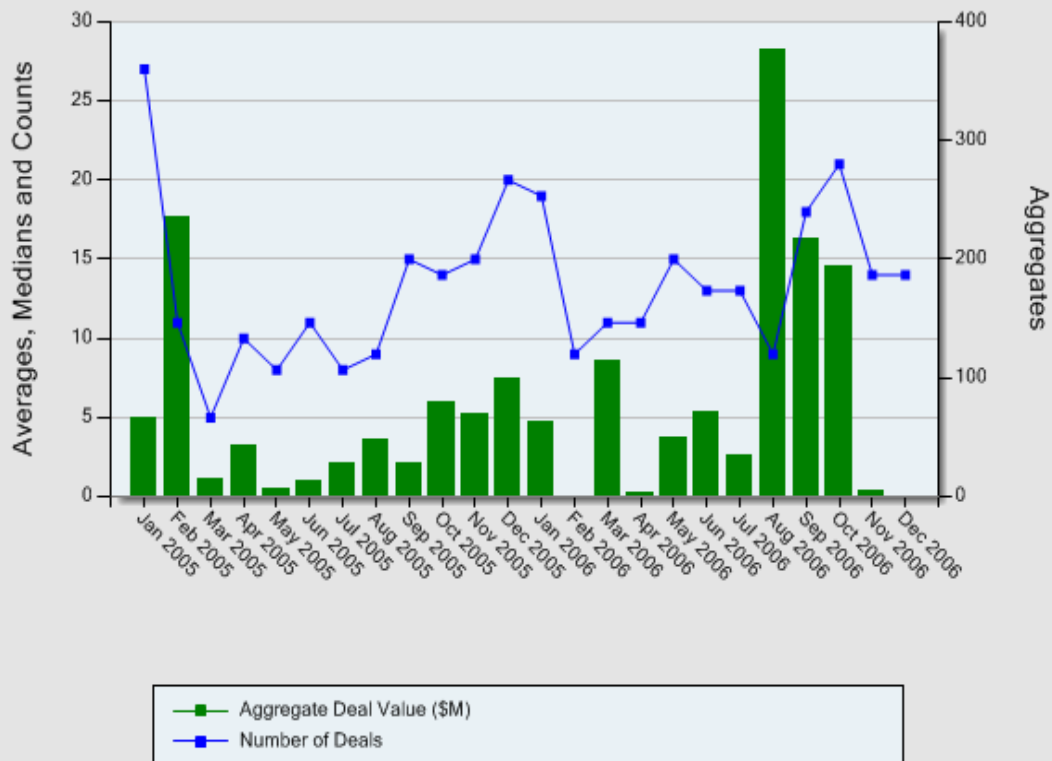
The Spitzer Effect

- Disrupted or destroyed vertical integration in insurance distribution.
- Aon/Swett & Crawford to Hicks, Muse & Tate.
- Marsh/Crumpp to J. C. Flowers.
- Willis/Stewart & Smith to American Wholesale.
- New players such as Mercator Risk Services.
- Willis and KKR make a run at Marsh.

Insurance Broker Stock Performance



Deal Value





Surplus Lines Market Size

- E&S lines are designed to write risks that do not fit into the underwriting and rating “boxes” of standard companies. They are designed to be flexible with each risk underwritten and rated on its own merits. The underwriter’s experience, expertise, reinsurance protection and perspective influence the tailored coverage.
- 2005 total U. S. Direct Written P&C Premiums \$489B.
- 2005 total U. S. Commercial Premiums \$261B.
- 2005 total E&S Lines Market \$33B.
(A. M. Best 2006 Surplus Lines Market Special Report. Data is compiled from 68 E&S insurers to make up its E&S composite index).
- Standard markets to E&S market to ART market.
- Flight to quality as the top 25 E&S companies have 83% of market.
- AIG has 21% of the market and Lloyds has 14%.



Current Market Issues

- Standard lines are moving into surplus lines markets especially in non-coastal areas.
- New phase in the underwriting cycle.
- Lower premiums = lower commissions = lower EBITDA = lower purchase prices for agencies.
- MGA results are closely tied to the underwriting results generated for their insurance partners.
- MGAs look to develop long-term carrier and insured relationships.
- New programs without historical underwriting results are hard to place.
- Technology and actuarial data.
- Experience of principals, commitment to business, perpetuation.



Risks in Reviewing Wholesale Deals

- Insurers suffer losses in unrelated lines affecting leverage, ratings, risk tolerance.
- Loss of paper.
- New company formations.
- Timing in the underwriting cycle.
- Fragmented market with low barriers to entry.
- Consolidation of primary paper and reinsurance sources can reduce support.
- Reinsurance prices and terms can change frequently.
- Reinsurance is a critical factor in the program business. MGAs work with reinsurers for financial support and acceptable terms and conditions.
- Reinsurance provides four functions.
 - Capacity
 - Catastrophe
 - Stabilization
 - Finance
- Loss frequency, severity and concentrations can change over time.



AAMGA 2005

Income and Expense Survey

- Results reflect 2004 data.
- Commissioned by AAMGA and NAPSLO.
- 56 responses, 11% response rate.
- Response too low for 2006, working on new study for 2007 based on 2006 data.
- Differences in response base makes year-to-year comparison difficult (2004 to 2003).
- Performance measured by:
 - Net retained revenue growth.
 - Profitability.
 - Productivity.
 - Liquidity.
- Two categories in the study:
 - Binding Authority = MGA or 50%+ of income is from underwriting.
 - Broker = Wholesale broker or 50%+ of income is from brokering business.
- Soft market conditions impacted results beginning in 2004 and same general trends continue today.

AAMGA 2005

Income and Expense Survey

Business Mix	2004	2003
MGA Commercial	56%	60%
MGA Personal	20%	11%
Total MGA	76%	71%
Broker Commercial	22%	28%
Broker Personal	2%	1%
Total	100%	100%
Comm. MGA	10.8%	10.7%
Comm. Broker	7.3%	8.8%

AAMGA 2005

Income and Expense Survey

Segment	Number of Respondents	Avg. Retained Revenues	Avg. Number of Employees
All	56	\$5,920M	47.7
Binding Authority	46	\$6,005M	50.8
Broker	10	\$5,533M	33.2
Top Performers	10	\$5,535M	27.0

AAMGA 2005

Income and Expense Survey

Retained Revenue Growth Rates

Segment	2004	2003	2002
Binding Authority	-2.4%	11.3%	18.4%
Broker	5.7%	14.8%	16.5%
Top Performers	2.2%	23.7%	20.6%
All	-1.4%	12.1%	17.5%

AAMGA 2005

Income and Expense Survey

Pretax Income/Retained Revenues

Segment	2004	2003	2002
Binding Authority	17.8%	25.7%	27.1%
Broker	21.3%	20.8%	9.6%
Top Performers	45.6%	48.6%	40.3%
All	18.4%	25.0%	25.0%

AAMGA 2005

Income and Expense Survey

Per Employee Revenue/Pretax Income

(\$ 000 omitted)

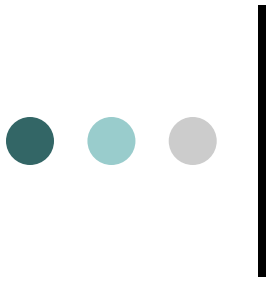
Segment	2004	2003	2002
Binding Authority	118/21	167/43	110/25
Broker	167/35	179/37	155/22
Top Performers	205/94	198/96	161/65
All	124/23	168/42	120/24

AAMGA 2005

Income and Expense Survey

Liquidity/Working Capital

Segment	2004	2003	2002
Binding Authority	118/21	167/43	110/25
Broker	167/35	179/37	155/22
Top Performers	205/94	198/96	161/65
All	124/23	168/42	120/24



Questions

GILL AND

ROESER