STATE OF LOUISIANA OFFICE OF RISK MANAGEMENT

FINAL

PHASE II PROPERTY CONSULTING PROJECT DELIVERABLES

FEBRUARY 10, 2012

Willis

TABLE OF CONTENTS

STATE OF LOUISIANA PROPERTY CONSULTING PROJECT
RFP # UW-03
PROCUREMENT PRACTICES ASSESSMENT

In Phase II of the above captioned project, we agreed to provide an analysis of your current property insurance procurement practices to include contrasting your practices against those used by other states with similar exposures.

Our initial analysis of your current methodology identified numerous deficiencies that we believe are both antiquated and contrary to the best interest of the State. The greatest deficiency is the fact that your current methodology does not treat the procurement of insurance as a professional service. Instead, your practices are more aligned with the procurement of physical assets such as materials, supplies, computers, and other hard goods.

Your current procedures require that the State issue a RFP soliciting an actual quote for insurance as opposed to selecting a broker to enter the insurance market place and negotiate a tailored program to meet the States best interest using both domestic and foreign markets. The State further determines the specific structure of the program. A few of the greatest deficiencies with this approach are identified below.

REDUCES COMPETITION

Compared to other states, the State of Louisiana's property program is one of the more difficult placements due to your heavy exposure to the perils of wind and flood (CAT). There is a finite number of insurance carriers willing to entertain these exposures. Further, there is no single market willing to provide the full $200 million limit of insurance required by the State. Most markets are only able to provide $2.5m to $10m in CAT capacity. Therefore, the State's program is a layered and shared program whereby numerous insurance carriers participate. Currently there are nine (9) domestic carriers, four (4) Bermuda carriers, and in excess of twenty five (25) European markets participating on the placement. If these markets were to be excluded from the program there is not enough worldwide capacity to place the program.

It is a standard practice within the insurance industry that no carrier will provide a quote to more than one agent/broker on the same risk. With incumbent carriers being reserved for the incumbent agent/broker, all other agents/brokers are effectively blocked from providing a quote to the state because of the lack of remaining marketplace capacity to provide the needed limit of insurance. A moral hazard is thus created because the incumbent carriers and agent/broker recognizes that they are in no threat of losing the business to a competitor. A clear indication as to the scope of the problem is the fact that the incumbent agent/broker has handled the account for over the past 40 years. Further, the structure of the program as well as the terms and conditions of the coverage have remained basically unchanged for an extended period of time and have not kept pace with the ever evolving marketplace.

CREATES NO INCENTIVE FOR COST MINIMIZATION

Due to the lack of competition for the reasons stated above, there is no incentive for either the insurance carriers participating on the program or the agent/broker to work in the best interest of the State to bring the premiums in at the lowest possible level. The existing agent/broker as well as the wholesaler(s) are compensated by way of commission. The higher the premium the greater their income. Further, the lack of competition creates little incentive for the insurance carriers to quote their lowest possible premium level.

DOES NOT PROMOTE CREATIVITY IN THE INSURANCE PROGRAM DESIGN

Historically, the Office of Risk Management has determined the structure of the insurance program and has then given the agent/broker instructions to seek quotes consistent with the pre-determined program structure. There are a multitude of program design options that should be considered when presenting this type of program to the marketplace. We have discussed many of these options with you and have further described several in this report. The program that best meets the needs of the State will vary from year to year based on current marketplace conditions. At every renewal, numerous options should be considered. Those options should be presented to the State by the agent/broker, the advantages and disadvantages of each option clearly identified and discussed with the Office of Risk Management, and then the most advantageous program mutually agreed upon.

LIMITS THE DEPTH AND SCOPE OF RISK MANAGEMENT SERVICES

Given the complexity of the State of Louisiana's property insurance program, there are a relatively few number of agents/brokers that possess all of the service capabilities that the State should have access to. For over the past 40 years, Risk Services of Louisiana has served as your agent. While likely a very competent agent for most commercial risks, we do not believe they have all of the internal resources that the State requires. For example, Risk Services of Louisiana has a limited number of insurance carrier relationships and may likely not have the internal skills necessary to place such a complex problem. Therefore, they partner with a wholesale broker, in this case AmWins, to place the program on their behalf. This approach adds unnecessary cost to the program. While it is common for an agent/broker to engage the services of a wholesaler, an agent/broker with greater access to the insurance marketplace and with greater broking skills would only engage the wholesale broker to access markets with which they have a direct relationship. The remaining markets would be approached directly by the retail agent/broker. This approach would result in the State realizing a significant reduction in paid commissions.

In addition to the placement of the insurance program, there are numerous other services that a full service agent/broker could offer to the Louisiana Office of Risk Management that may not otherwise be available. A partial list of those services includes:

- Claim advocacy
- Safety and loss control advocacy

- Actuarial consulting
- Catastrophe modeling
- Property appraisal and valuation services
- Storm tracking
- Robust certificate issuance and tracking services
- Assistance with RMIS needs
- Rating
- Premium allocations

EXCESSIVE COMPENSATION TO THE AGENT/BROKER

There are numerous ways that an agent/broker can be compensated for their services. The most common include:

- Commissions stated as a percentage of the premium
- A flat fee
- Some combination of commission and fee

On very large placements similar to the Louisiana Property Insurance Program, it is extremely unusual for the agent/broker to be compensated by way of full commission. Typically the remuneration would be by way of a flat fee or a combination of a fee and a negotiated reduced commission.

On the July 1, 2011 through July 1, 2012 placement, the State paid premiums in excess of $26 million on the ORM main program and in excess of $6m on the RSD program . Standard commission levels vary from carrier to carrier and whether the business was placed in the domestic or foreign markets. Standard commissions levels typically range anywhere between10% and 22% with the average being roughly 18%. We believe that the State of Louisiana paid in excess of $5.5 million in commissions for the property placement. In addition, the State secured NFIP coverage with a premium spend of approx $6m. Standard commission with most NFIP carriers is between 22% and 24% thus adding another $1.3m in commissions paid for a total in excess of $6.8m. In our opinion, this level of remuneration is excessive and the state should strongly consider an alternative approach. We will make a recommendation in this regard later in our report. Conservatively, we believe this approach alone would save the state over $3 million annually.

When contrasting your procurement practices against those of other States, we chose to limit our comparison to states that shared your exposure to the catastrophic perils of wind and flood. A total of seventeen states were included in the survey. The states used for benchmarking purposes included:

- Alabama
- California
- Connecticut
- Delaware
- Florida
- Georgia
- Louisiana
- Maine
- Maryland
- Mississippi
- New Jersey
- New York
- North Carolina
- Rhode Island
- South Carolina
- Texas
- Virginia

We created a survey to address what we thought were the most critical components of the procurement practices. The eight question survey was approved by the Louisiana Office of Risk Management before being released. The eight questions included in the survey were as follows:

- How is your broker/agent selected?
  - RFP for broker services
  - Providing insurance specifications to open market then entertaining responsive/low bid quotes
  - Market assignment
  - Other
- Length of broker/agent Contract
  - 1 Year
  - 2 Years
  - 3 Years
  - 4 Years
  - 5 Years or More
  - Other
- Means of broker/agent compensation
  - Market level commission
  - Negotiated/capped commission
  - Flat fee
  - Combination
  - Other
- When a domestic wholesaler is used, how are they compensated?
  - Market level commission
  - Negotiated/capped commission
  - Flat fee
  - Wholesale commissions are paid by the retail broker/agent out of their compensation
  - Don't know or left to the discretion of the retail broker/agent to determine
  - Other
- When a foreign wholesaler (London or Bermuda) is used, how are they compensated?
  - Market level commission
  - Negotiated/capped commission
  - Flat fee
  - Wholesale commissions are paid by the retail broker/agent out of their compensation

  - Don't know or left to the discretion of the retail broker/agent to determine
  - Other

- Contingencies
  - Allow them to be taken by the agent/broker
  - Don't allow them to be taken by the agent/broker
  - Don't know or have no position on the issue of contingencies
  - Comments

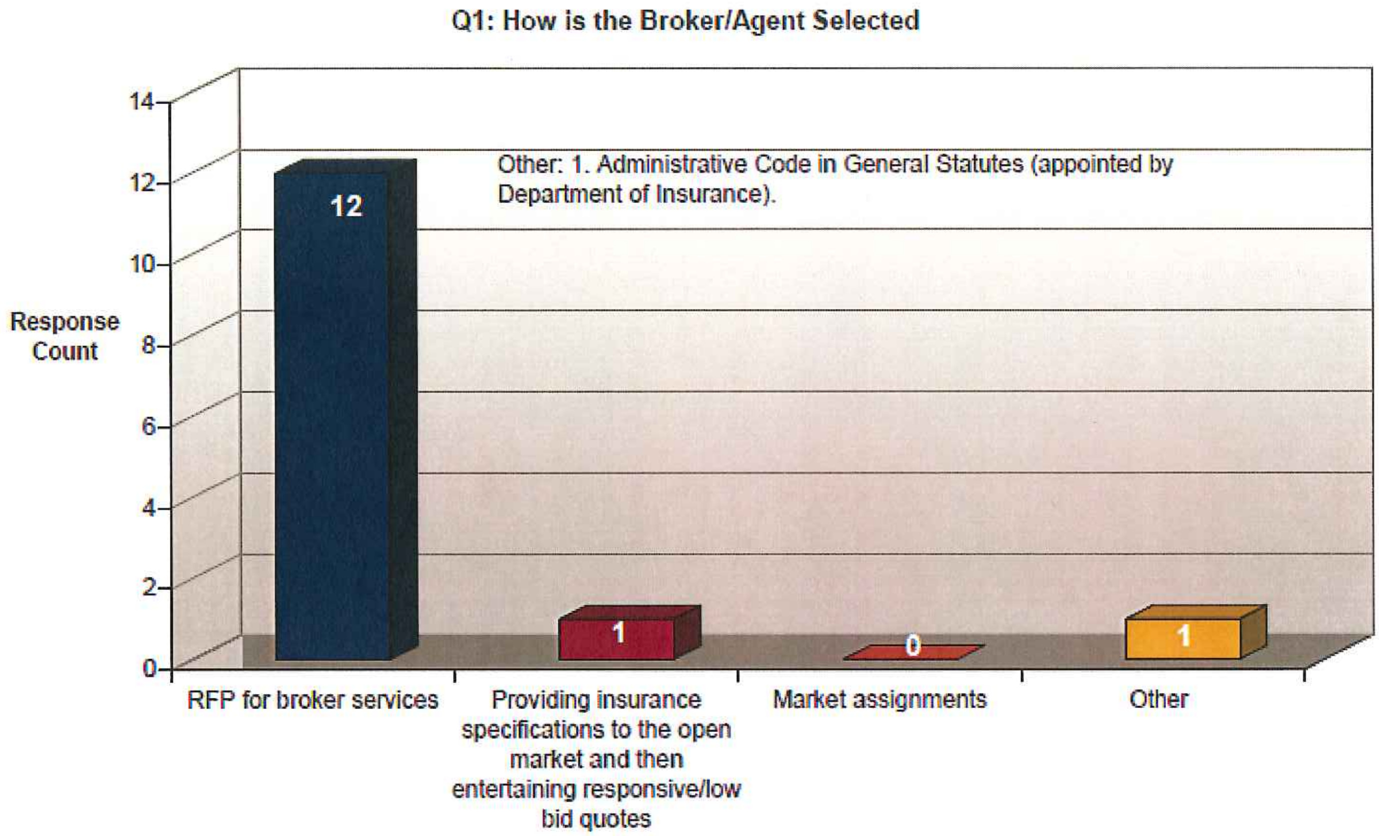
- Does the state have a requirement for the use of:
  - MBE's (Minority Business Enterprises)
  - SBE's (Small Business Enterprises)
  - DBE's (Disadvantaged Business Enterprises)
  - No requirements

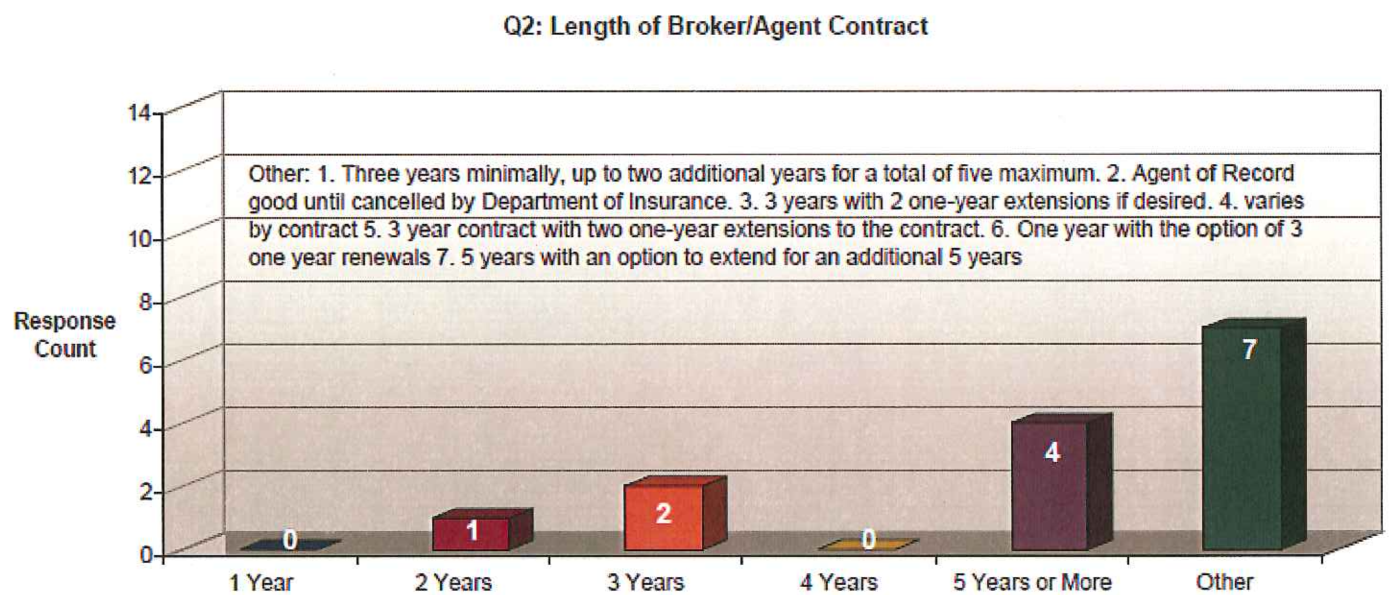
- Name and State of Respondent (Optional)

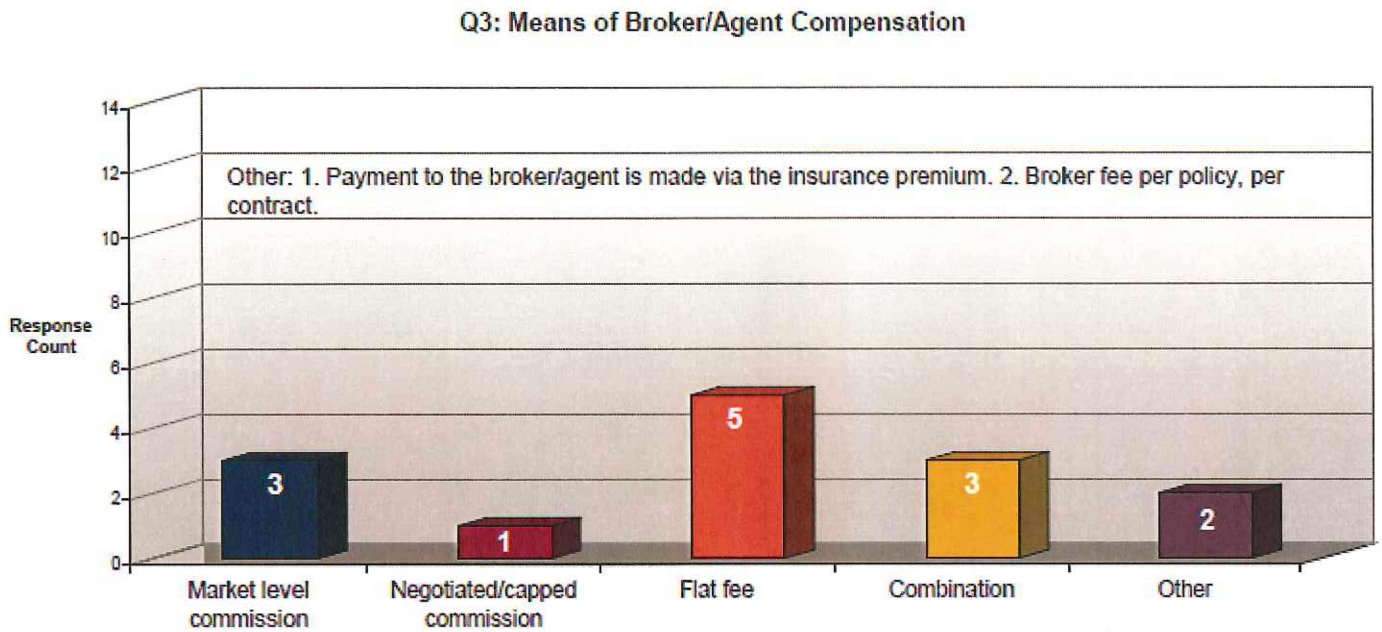
Of the seventeen states polled, we have received 14 responses. A summary for each question is shown below. A few points of significance include:

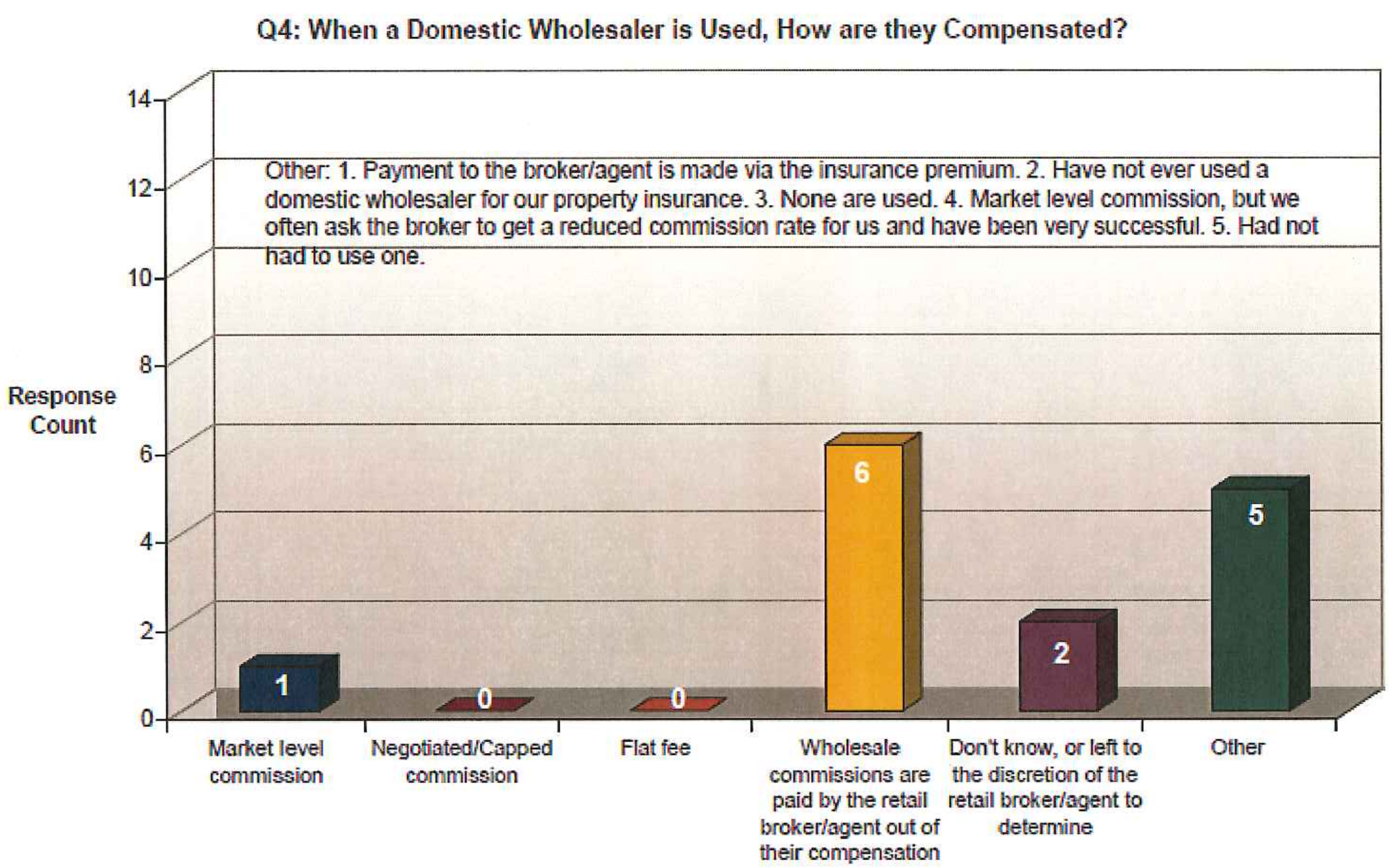
- 86% of respondents issue RFP's for broker services. With the exception of the State of Louisiana, no other state issues a RFP seeking actual premium quotes from the insurance marketplace.
- Every respondent issues the RFP with the intent of the contract being multi-year. Most respondents include some form of exculpatory language giving them the right to cancel the contract if the desired level of service is not being provided.
- Only 21% of the respondents compensate the agent/broker by way of market level commission.
- Only 7% of the respondents allow their domestic and foreign wholesalers to be compensated by way of market level commission.
- Only 8% of the respondents knowingly allow the agent/broker to accept contingencies.
- 54% of the respondents have no requirement related to the involvement of MBE's, SBE's, or DBE's. The remaining 56% have some level of MBE or SBE requirement.

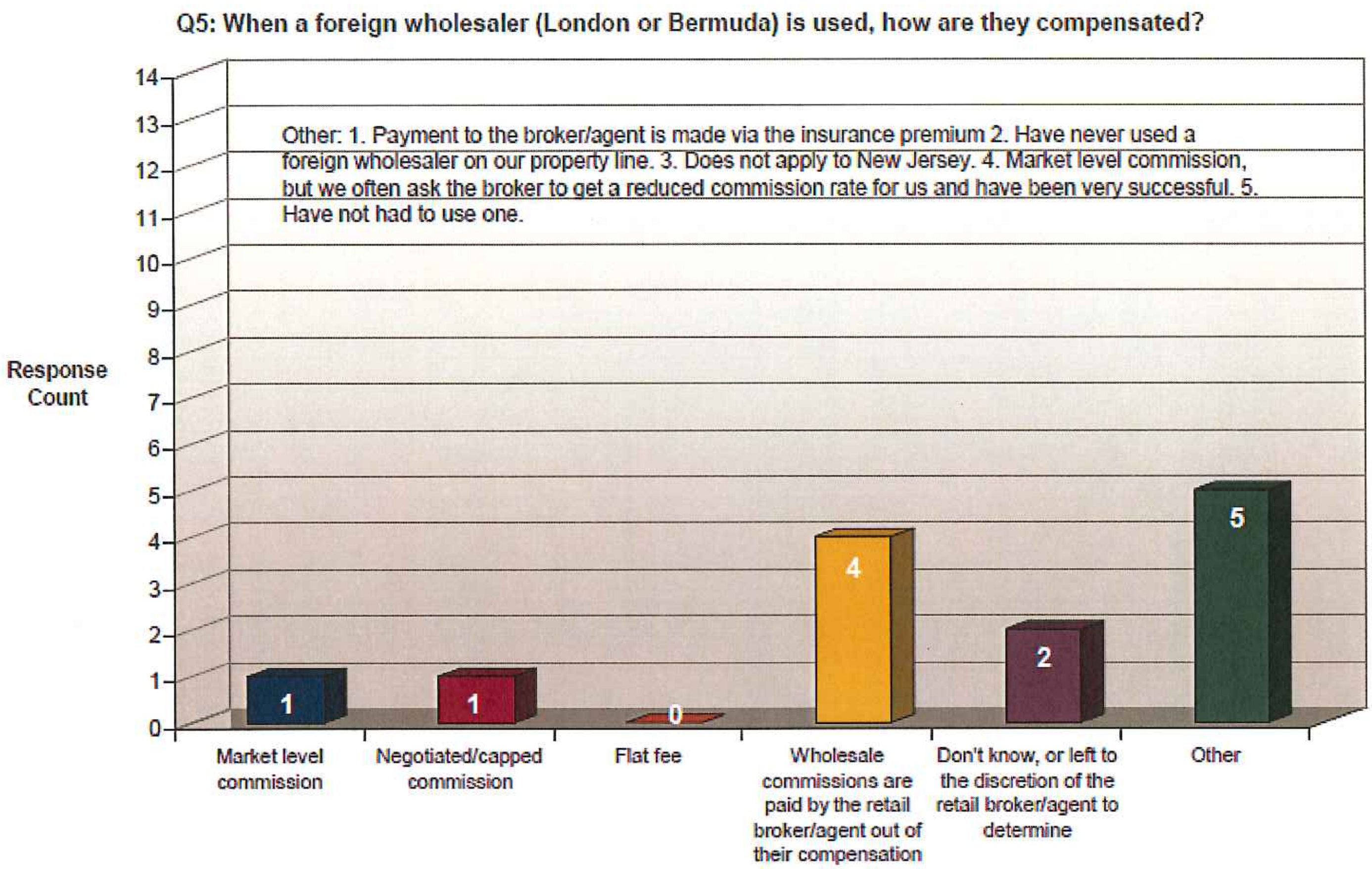
Below please find a summary chart for each of the eight questions included in the survey.

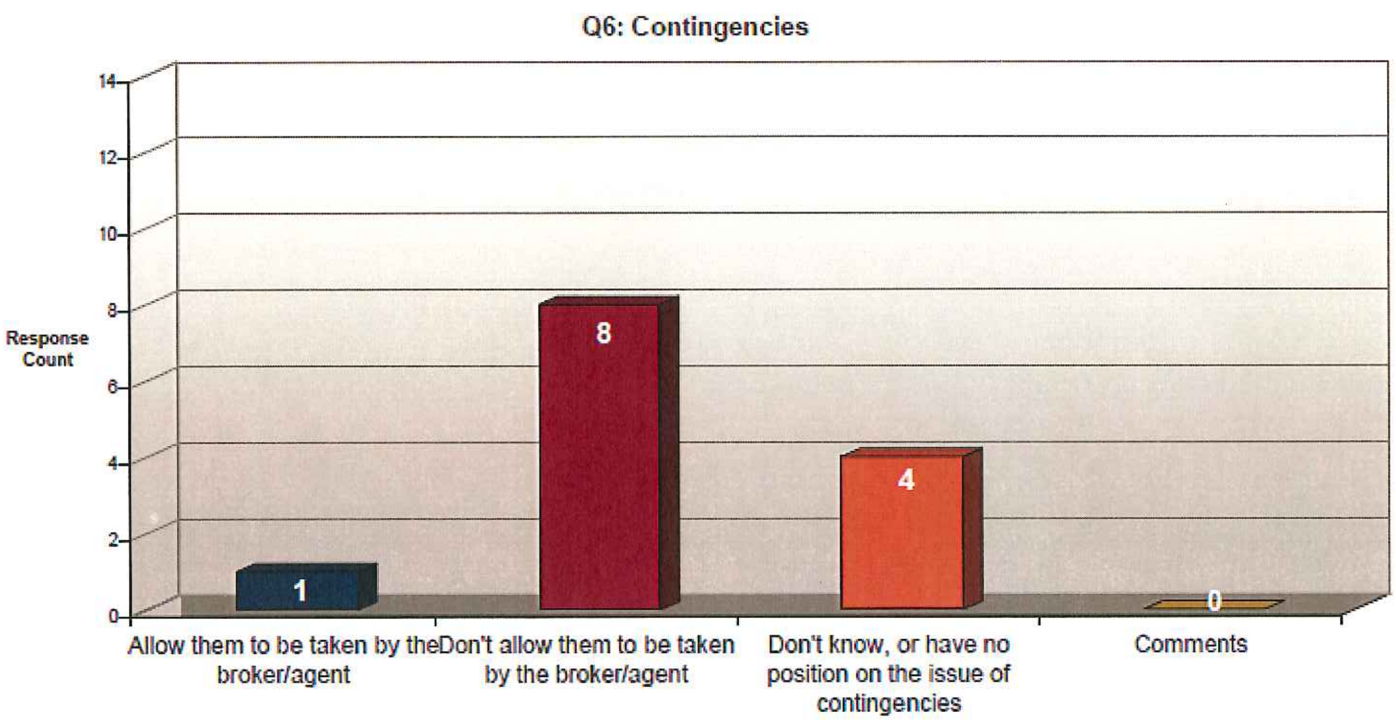

Q1: How is the Broker/Agent Selected
Response Count
14
12
10
8
6
4
2
0
Other: 1. Administrative Code in General Statutes (appointed by Department of Insurance).
12
1
0
1
RFP for broker services
Providing insurance specifications to the open market and then entertaining responsive/low bid quotes
Market assignments
Other

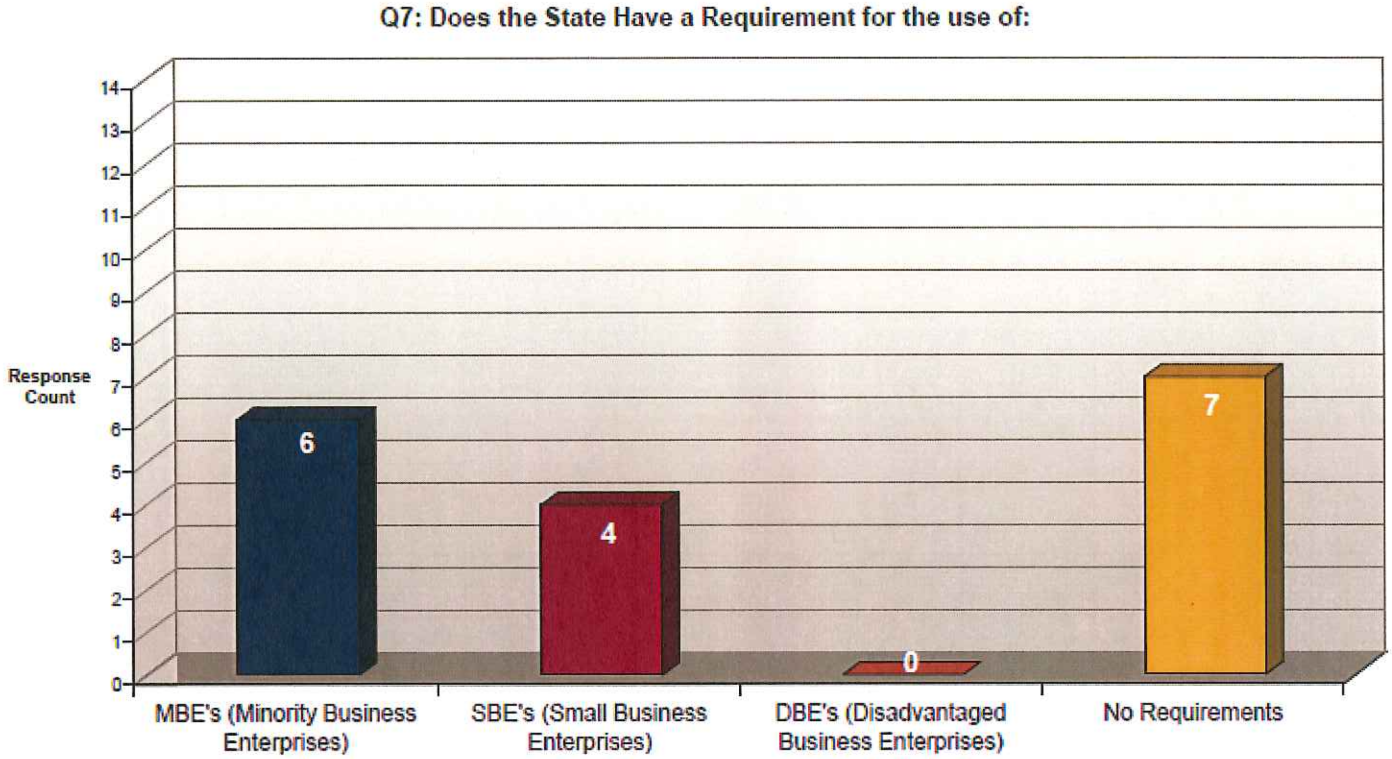

Q2: Length of Broker/Agent Contract
Response Count
14
12
10
8
6
4
2
0
Other: 1. Three years minimally, up to two additional years for a total of five maximum. 2. Agent of Record good until cancelled by Department of Insurance. 3. 3 years with 2 one-year extensions if desired. 4. varies by contract 5. 3 year contract with two one-year extensions to the contract. 6. One year with the option of 3 one year renewals 7. 5 years with an option to extend for an additional 5 years
0
1
2
0
4
7
1 Year
2 Years
3 Years
4 Years
5 Years or More
Other


Q3: Means of Broker/Agent Compensation
Other: 1. Payment to the broker/agent is made via the insurance premium. 2. Broker fee per policy, per contract.
Response Count
14
12
10
8
6
4
2
0
3
1
5
3
2
Market level commission
Negotiated/capped commission
Flat fee
Combination
Other


Q4: When a Domestic Wholesaler is Used, How are they Compensated?
Other: 1. Payment to the broker/agent is made via the insurance premium. 2. Have not ever used a domestic wholesaler for our property insurance. 3. None are used. 4. Market level commission, but we often ask the broker to get a reduced commission rate for us and have been very successful. 5. Had not had to use one.
Response Count
14
12
10
8
6
4
2
0
1
0
0
6
2
5
Market level commission
Negotiated/Capped commission
Flat fee
Wholesale commissions are paid by the retail broker/agent out of their compensation
Don't know, or left to the discretion of the retail broker/agent to determine
Other


Q5: When a foreign wholesaler (London or Bermuda) is used, how are they compensated?
Response Count
14
13
12
11
10
9
8
7
6
5
4
3
2
1
0
Other: 1. Payment to the broker/agent is made via the insurance premium 2. Have never used a foreign wholesaler on our property line. 3. Does not apply to New Jersey. 4. Market level commission, but we often ask the broker to get a reduced commission rate for us and have been very successful. 5. Have not had to use one.
1
1
0
4
2
5
Market level commission
Negotiated/capped commission
Flat fee
Wholesale commissions are paid by the retail broker/agent out of their compensation
Don't know, or left to the discretion of the retail broker/agent to determine
Other


Q6: Contingencies
Response Count
14
12
10
8
6
4
2
0
1
8
4
0
Allow them to be taken by the broker/agent
Don't allow them to be taken by the broker/agent
Don't know, or have no position on the issue of contingencies
Comments



RECOMMENDATIONS

Based on our analysis, we have several key change recommendations for the State of Louisiana Office of Risk Management relative to their procurement practices. We believe these recommendations would bring you closer in line with the best practices of other States. We believe that these recommendations would result in significant costs savings to the State. Further, we believe the changes would result in a better insurance program design and provide you access to risk management services available through the agent/broker community that you are currently not receiving. Our key recommendations are as follows:

BROKER SELECTION

The selection of your agent/broker should be viewed as a professional services contract. A RFP should be issued for broker services and the historic approach of issuing a RFP for insurance quotes abandoned. The benefits of this approach include:

- Allowing the Office of Risk Management to identify the broker that they believe has the experience, qualifications, and public entity expertise to competitively place the program while at the same time providing other risk management services previously articulated in this report.
- Through the broker selection process, the winning broker would be given access to all worldwide markets as opposed to only those markets not already aligned with competing agents/brokers. This approach would allow the broker to leverage all markets to guarantee the most competitive premiums on behalf of the State.
- Fees quoted by the broker will be held to a competitive level due to the fact that each responding broker recognizes that they are competing against other brokers desiring to represent the State.

PROGRAM DESIGN OPTIONS

The Office of Risk Management should abandon the practice of dictating the specific program design structure and then charging the agent/broker with the responsibility to secure quotes based on that predetermined program design.

The insurance marketplace is very fluid. Economic factors and the appetite of insurance carrier for public entity business changes from year to year. The agent/broker is in the best position to advise the Office of Risk Management of marketplace conditions and to design a program design to best align the State's needs with what is available in the market. Further, this approach gives the broker flexibility to move insurance carriers around in the placement to take full advantage of available capacity and the changing rate structure of the carriers.

BROKER COMPENSATION

The state should abandon the practice of compensation the agent/broker by way of paying market level commission. This alone has the potential of saving the State over $3 million a year. We suggest that the State compensate the Agent/broker by way of a combination of a fee and capped commission as outlined below.

- The RFP should require the agent/broker to quote a flat annual fee for their services. Out of that flat fee, the agent/broker should be required to pay any domestic wholesaler that they may engage to assist in the placement. Thus, the State is removed from any obligation to compensation the domestic wholesaler.
- Given the complexity of the State's property insurance program, the involvement of foreign wholesalers (Bermuda and London) will be required. Market level commissions for foreign placed business can run as much as 22%. We suggest that the Office of Risk Management stipulate in the RFP that foreign placements be held to a maximum of 10% commission.

- The RFP should stipulate that the agent/broker is prohibited from accepting any contingent income, profit sharing, enhanced commission or other forms of hidden income.
- The RFP should stipulate that the agent/broker provide to the Office of Risk Management on an annual basis a statement identifying all income earned by all parties on the placement of the property insurance program.
- From time to time, the agent/broker may be called upon by the Office of Risk Management to make small, ancillary insurance placements. The agent/broker compensation for these placements should be on a market level commission basis.

BROKER SELECTION METHODOLOGY

The most common methodology for States to choose a broker includes the State releasing a RFP articulating desired services and minimum broker requirements, setting a date for written responses, narrowing the field down to the top two to four respondents, and inviting those on the short list to make an oral presentation.

The States normally identify a committee of 5 to 8 people to reviews and rate the responses and participate on the oral presentations. The highest ranking responsive bidder is then offered a contact. There are numerous methodologies for ranking the broker. A common approach and one that we recommend would be to evaluate each response on a 200 point scale broken down as follows:

RATING FACTOR	MAXIMUM POSSIBLE POINTS	EARNED POINTS
Experience and Capabilities of Proposing Firm	50	
Experience of Proposed Service Team	40	
Quality of Written RFP Response	30	
Quality of Oral Presentation	30	
Understanding of the State's Needs and Current Insurance Program	25	
Proposed Compensation (Lowest responsive bidder is awarded the Full 25 points. Other bidders are awarded points based on their proposed fee divided into the fee of the lowest responsive bidder times the 25 points.)	25	
TOTAL	200	

ALTERNATIVE PROGRAM STRUCTURE CONSIDERATIONS

ORM PROGRAM FINDINGS

Based upon our analysis, we believe the ORM main program is priced fairly competitively. However, we do believe there are a number of opportunities to save premium and improve the overall structure of the program.

CONSIDERATIONS

- Deductibles should be significantly improved
  - Lower AOP – should not mirror Wind/Named Storm as the prospective losses do not correlate. Suggest $10m per occurrence
  - Aggregate Deductible Provided
- Terms & Conditions – Based on the current rate being charged, we would expect storm surge and flood to be covered within the excess. Therefore amending current Windstorm Deductible to a "Named Storm" deductible.
- Aggregate Flood and Earthquake Deductibles
- Additional limits – Based on our CAT modeling the overall loss limit purchased is significantly inadequate for CAT (Named Storm) related losses as well as from a fire PML standpoint given some of the larger structures within the portfolio.
- Layer Structure & Pricing
  - Currently the program is procured and placed in very clean layers of $50m and one $25m layer. While this gives the appearance of a well structured program, there are inefficiencies introduced by using this approach. It does not allow the markets to use their capacity in the most optimal way thus adding unnecessary cost to the overall program. We would suggest going out with a total limit request versus dictating the layer structure.
  - The current program utilizes "best terms" or "concurrent" layer pricing. While this approach was once an industry practice, it has long been deemed inefficient and unfair to insureds. Essentially markets who have priced a certain layer cheaper than another market receives the benefit of increasing their price to match the highest layer price obtained. Therefore, this adds a significant amount of unnecessary cost to the over program when all layers are aggregated. We would encourage bid specs to specify that ORM requires "Non-Concurrent" pricing.

POTENTIAL ISSUES OR COMPLICATIONS

- Until the procurement process is amended, the current providers have no motivation to make any alternative program work. This could result in the following results/feedback:

- Markets not interested or competitive
- Unreasonable credit given in the ORM main program for the removal of any entity (something less than the current blended rate which is circa .20 per $100)

TIMELINE & REQUIREMENTS

Most markets will need at least 60 days to underwrite this account. Consideration should be given to allow more than 60 days.

ORM PROGRAM CONSIDERATIONS

Current ORM Main Program

	$200m Limit/$25m AOP/$50m Wind/Named Storm Retention	
TIV	$ 16,158,685,029	Bound TIV
Excess Premium	$ 26,067,892	excluding taxes/fees
Excess Rate	$ 0.16	

Projected Renewal ORM Main Program

	$200m Limit/$25m AOP/$50m Wind/Named Storm Retention	
TIV	$ 16,158,685,029	
Excess Premium	$ 29,085,633	excluding taxes/fees
Excess Rate	$ 0.18	12.5% Increase

Based upon current market conditions, we would expect the overall rate to increase by 10% to 15% given the current procurement process.

ORM Without LSU

	$200m Limit/$25m AOP/$50m Wind/Named Storm Retention	
Projected Renewal		
TIV	$14,358,685,029	ORM Values Without LSU
Excess Premium	$ 25,845,633	excluding taxes/fees
Excess Rate	$ 0.18	12.5% Rate Increaes
Projected Total	$ 25,845,633	excluding taxes/fees
Total Premium Decrease	$ 3,240,000	

The above represents the program premium ORM should be able to obtain in the current market and removing the LSU values.

These rates/premiums do not reflect the additional premium that we would anticipate should ORM wish to build Flood coverage into the excess property. Please see the below comments around NFIP for Flood premium estimates.

NFIP FLOOD OPTIONS

Based on our assessment of the current NFIP spend and our understanding of your flexibility with FEMA to provide the equivalent of NFIP within your self insured retention, we believe the following should be considered:

- Self Insure the NFIP within the $50m SIR
- Purchase $100m (or limit deemed appropriate by NFIP) of Excess Flood

This approach should help reduce the administrative burden of managing the thousands of individual NFIP policies as well as potential produce some financial savings. We believe ORM should be able to procure $100m of Flood within the excess program for a premium of $3.5m to $5m. As a result, this should produce of a savings between $1m and $2.5m. We strongly encourage ORM to obtain advance approval from FEMA before moving forward with this option.

As previously outlined, we believe the policy form should also be amend to include Storm Surge within the definition of Named Storm. By addressing this issue, you will mitigate and clarify how a prospective Flood loss will be handled.

Should ORM wish to continue to purchase NFIP, we would suggest having a NFIP carrier manage this portfolio on a direct basis with strict contractual requirements around the administration. This would remove the burden from ORM.

POTENTIAL IMPLICATIONS

It is important to note that the self insured option does provide increased exposure to ORM. It is hard to quantify the exact amount of additional exposure this represents.

LSU STAND-ALONE PROGRAM

Based upon our analysis, we believe significant improvement to the terms and conditions can be accomplished if LSU is carved out of the ORM main program and structured as a stand-alone placement. Some of the benefits we believe will be gained include:

BENEFITS

- Pricing – The open market should produce more competitive pricing for this entity on a stand-alone basis.
- Retention – A lower retention should be obtainable
- Broader Coverage – Higher Ed specific exposures can be addressed in coverage form.
- Dedicated loss limit (Not shared with other state agencies)
- Increased Sublimits
- No Co-Insurance
- No Scheduled Limits (Blanket Coverage)
- No Margin Clause

POTENTIAL ISSUES OR COMPLICATIONS

- Until the procurement process is amended, the current providers have no motivation to make any alternative program work. This could result in the following results/feedback:
  - Markets not interested or competitive
  - Unreasonable credit given in the ORM main program for the removal of this entity (something less than the current blended rate which is circa .20 per $100)
- Coverage Form Concurrency
  - One of the markets that we believe would be very interested in looking at LSU and could offer the full capacity may not be willing to use the ORM issued form. They will likely insist on using their policy form. This may produce a few non-current terms and conditions, but for the most part, we would expect the proposed carrier form to match up well and perhaps be a little broader in certain areas.

STRUCTURE OPTIONS TO CONSIDER

LSU Current Allocation

	Within ORM Main Program (Shared $200m limit - $25m AOP/$50m	
TIV	$ 1,844,297,417	Bound TIV
Excess Premium	$ 3,742,775	
Excess Rate	$ 0.20	
ORM SI Fund Premium	$ 4,091,950	Ded Buy-Down to $1000
ORM SI Rate	$ 0.22	
Total LSU Premium	$ 7,834,725	
Program Rate	$ 0.42	

Option 1

	Stand-Alone Program $250k AOP/2% Named Storm Max of $1m
Excess Premium	$ 4,610,744
Excess Rate	$ 0.25
Total	$ 4,610,744
Prospective Savings from Expiring	$ 3,223,981
Negative Implications	LSU Assumes Full Retention

Option 2

	Stand-Alone Program Excess of $5m Retention	
Excess Premium	$ 1,844,297	
Excess Rate	$ 0.10	
ORM SI Premium	$ 1,844,297	
ORM SI Rate	$ 0.10	Half of current with lower retention
Total	$ 3,688,595	
Prospective Savings from Expiring	$ 4,146,130	

Option 3

	Stand-Alone Program Excess of $10m Retention	
Excess Premium	$ 922,149	
Excess Rate	$ 0.05	
ORM SI Premium	$ 2,139,385	
ORM SI Rate	$ 0.12	Half of current with lower retention
Total	$ 3,061,534	
Prospective Savings from Expiring	$ 4,773,191	

ALTERNATIVE MARKETS TO CONSIDER

- FM Global – Will write Direct
- XL
- Zurich

- Travelers

TIMELINE & REQUIREMENTS

Most markets will require at least 60 days to underwrite an account of this size. Given the concentration of values in one location, they will likely want to survey all locations in excess of $10m.

In addition, markets generally do not release terms more than 60 days prior to the effective date. Therefore it could be difficult to obtain quotes on a 7-1 effective date prior to May 1. We would suggest timing your bid on this entity to consider this constraint or releasing the bid with a moving attachment date of "between 5-15 and 7-1".

RSD PROGRAM FINDINGS

Our review of the current RSD program found the following areas of potential improvement:

- Overall program rate seems exceptionally high given the lack of storm surge and flood coverage provided.
- Deductibles should be significantly improved
  - Lower AOP – should not mirror Wind/Named Storm as the prospective losses do not correlate – we would suggest \$2.5m to \$5m per occurrence
  - Named Storm – Based on CAT Modeling analytics we would recommend moving to a 3% or 5% deductible. (Currently "Windstorm" deductible. We would suggest amending to "Named Storm" to include storm surge)
  - Aggregate Flood & Earthquake Deductible Provided
- Terms & Conditions – Based on the current rate being charged, we would expect storm surge and flood to be covered within the excess.
- Layer Structure & Pricing
  - The current program utilizes "best terms" or "concurrent" layer pricing. While this approach was once an industry practice, it has long been deemed inefficient and unfair to insureds. Essentially markets who have priced a certain layer cheaper than another market receives the benefit of increasing their price to match the highest layer price obtained. Therefore, this adds a significant amount of unnecessary cost to the over program when all layers are aggregated. We would encourage bid specs to specify that ORM requires "Non-Concurrent" pricing.
  - Currently the program is procured and placed in very clean layers of \$25m. While this gives the appearance of a well structured program, there are inefficiencies introduced by using this approach. It does not allow the markets to use their capacity in the most efficient structure thus adding unnecessary cost to the overall program. We would suggest going out with a total limit request versus dictating the layer structure.

RSD PROGRAM CONSIDERATIONS

RSD Current Program

	$225m Limit/$25m Retention to ORM/$1000 to RSD		
TIV	$	661,227,888	Bound TIV
Excess Premium	$	6,954,164	excluding taxes/fees
Excess Rate	$	1.05	
ORM SI Fund Premium	$	1,297,427	Ded Buy-Down to $1000
ORM SI Rate	$	0.20	
Total RSD Premium	$	8,251,591	excluding taxes/fees
Program Rate	$	1.25	

RSD Projected Renewal

$225m Limit/$25m Retention to ORM/$1000 to RSD			
Based on Current Market Conditions			
TIV	$	661,227,888	Approx $140m of Newer Facilities - $84.5m of New to Come on Line in 2012
Excess Premium	$	7,934,735	excluding taxes/fees
Excess Rate	$	1.20	12.5% Rate Increase
ORM SI Fund Premium	$	1,297,427	Ded Buy-Down to $1000
ORM SI Rate	$	0.20	
Total RSD Premium	$	9,232,162	excluding taxes/fees
Program Rate	$	1.40	

Option 1

Roll All RSD Into ORM Main Program at Expected Renewal Rate			
Excess Premium	$	1,110,863	
Excess Rate	$	0.17	
ORM SI Fund Premium	$	2,594,854	Assumed Doubling SI Fund Rate for Excess Retention of $50m vs $25m
ORM SI Fund Rate	$	0.39	
Total	$	3,705,717	excluding taxes/fees
Prospective Savings from Expiring	$	4,545,874	
Prospective Savings from Expected	$	5,526,445	
Negative Implications	Shared Limit of $200m with All State Agencies		
	Potential Market Resistence to Push Rate and Retention		

This option was requested by RSD and their consultant. While we believe this option does have the prospect of saving premium dollars, it comes with some significant risk and we would consider it inadvisable. Some of those risks include:

- Shared Limits – By rolling RSD into the main ORM program, you will dilute the already insufficient limits purchased. Based upon our previously discussed CAT modeling, the expected loss for ORM ranges from a low of $686m to a high of $1.5b depending upon the return period utilized. Therefore it suggests the current $225m limit purchased is inadequate. By adding RSD's exposure to the program, it will further deteriorate the loss expectancy by as much as $250m.
- ORM program markets may resist adding the additional exposure or may push for a significant rate increase due to the increased wind exposure. Additionally, based on the current procurement process, we do not believe any parties are motivated to make this particular option work.

Option 2

	Single Carrier (Amerisc) All RSD $200m Limit - 5% Named Storm $250k AOP
Excess Premium	$ 4,959,209
Excess Rate	$ 0.75
ORM SI Fund Premium	$ 1,297,427
ORM SI Fund Rate	$ 0.21
Total	$ 6,256,637
Program Rate	$ 0.95
Prospective Savings from Expiring	$ 1,994,954
Prospective Savings from Expected	$ 2,975,525

Option 3

	Restructuring Stand-alone RSD Program $200m Limit/$25m Retention
Excess Premium	$ 6,281,665
Excess Rate	$ 0.95
ORM SI Fund Premium	$ 1,297,427
ORM SI Fund Rate	$ 0.20
Total	$ 7,579,093
Program Rate	$ 1.15
Prospective Savings from Expiring	$ 672,498
Prospective Savings from Expected	$ 1,653,069

TIMELINE & REQUIREMENTS

Most markets will need at least 60 days to underwrite this account. Consideration should be given to allow more than 60 days. Based upon the information that was shared by RSD and their consultant on November 29th regarding the construction quality improvement of the portfolio and the measures that have been taken, we would suggest ORM in conjunction with RSD host an "inspection day". This would allow the markets the opportunity to fully understand the exposure and the risk mitigation efforts that have been taken with the new construction and the plans around additional renovations and their respective timeline.

POTENTIAL ISSUES OR COMPLICATIONS

- Until the procurement process is amended, the current providers have no motivation to make any alternative program work. This could result in the following results/feedback:
  - Markets not interested or competitive

MARKET CONSIDERATION

While we have not approached any markets on the RSD program, we do believe Amerisc Insurance Company would likely be very interested in this program. Amerisc would have the ability to write the entire program. Unlike FM Global, they are not a direct writer and would need to be accessed through an agent or broker.

RECOMMEND APPROACH/NEXT STEPS

Taking all of the above into consideration, we would suggest ORM consider the following as next steps:

2012 BIDS

- Bid LSU as a stand-alone program
- Bid RSD in hopes attracting interest from a new market that would drive down the premium spent and allow RSD to maintain separate limits.
- Bid ORM main program with recommendations made around layer structures, non-current pricing and various coverage and retention improvements.

2012/2013

- Work to amend current procurement legislation to allow ORM to contract with a service provider (Agent/Broker).
- Do Broker RFP

ALTERNATIVE RISK FINANCING TOOLS TO CONSIDER

INSURANCE LINKED SECURITIES TRANSACTIONS & CAT BONDS

Based on market conditions and the need to secure additional capacity, it may become necessary to explore or employee alternative capital vehicles such as Insurance Linked Securities or CAT Bonds.

Over the last 24 months, Willis has been exploring the use of capital markets transactions in some of our larger and more complex property placements. Due to the higher frictional set up costs (in the $1M plus range) and longer term contract periods associated with Catastrophe Bonds, we have focused our efforts on alternative triggers for Industry Loss Warranties (ILW). We have also discussed and crafted alternatives for pure parametric transactions or what is being characterized as a "CAT in the Box".

These transactions are private and are negotiated with both capital markets and traditional insurers and reinsurers carriers. All transactions are with carriers or security funds holding a minimum of an "A" rating. These transactions are also collateralized or contain a fronting arrangement.

We have identified two triggers developed in the last 18 months that we feel reduce the basic risk presented in a traditional ILW enough that contracts should be more closely aligned with the insured's traditional insurance placement, allowing for expanded market access at a similar or lesser price to traditional placements.

STATEWIDE ILW

Overview: Recovery is tied directly to the published PCS (Property Claims Services) industry loss number for the specific loss event. Recovery is not tied to the insured's loss amount; therefore, there is a significant chance that the insured could over or under collect in relation to their actual loss. The money collected from the parametric cover can be utilized in any way (i.e. it does not have to be used to rebuild).

Trigger: The attachment point is set a specific level of industry loss as published by PCS. PCS publishes the industry loss for each event based upon the reported losses from the actual carriers. Losses are published on a state by state basis. Trigger can be single state, regional, or nationwide.

Retention: Insured must retain a minimum of $10,000 in order to receive payment. This is to ensure the transaction qualifies as insurance rather than a derivative.

Limit: Single limit applies in the annual aggregate.

PARADEX OR COUNTY WEIGHTED INDUSTRY LOSS (CWIL) TRIGGERS

Overview: Both Paradex and CWIL are alternative triggers for any ILS transaction whether it is a CAT Bond, Industry Loss Warranty, Swaps, etc. As mentioned above, Willis has found that these two triggers allow for the transaction to be more closely aligned with the traditional insurance program.

Trigger:

- PARADEX
  - RMS trigger that creates an index loss based upon a hazard based index, modeled loss, and industry loss that is optimized with actual recorded wind speeds from the National Hurricane Center.
- CWIL
  - Trigger that uses either RMS or AIR to disaggregate the state wide PCS loss- i.e. break down the share of a loss to the county level based upon the post-event storm footprint.

Both triggers require modeling of the insured's portfolio prior to pricing in order to create the attachment point and exhaustion point of the limit as well as to develop share factors. The insured's share factors are based upon a combination of market share and vulnerability of the portfolio. The process with both triggers is slightly different, but the idea is to optimize both the share factors and the entry and exit of the chosen limit on the expected probability (EP) curve as to significantly reduce the basis risk normally present with a traditional Industry Loss Warranty. Basically, we will work to customize the contract to each insured. This, in turn, causes the structure of the transaction to more similarly mirror a traditional excess property insurance placement.

The most important difference between CWIL and Pardex is that CWIL uses the PCS published loss as the starting point for loss development and Pardex uses RMS based modeling/index. Some argue that the inability of Pardex to capture the "non-modelable" loss makes it a less desirable or predictable trigger. Willis is working with RMS to help them overcome this issue, whether it be the inclusion of a PCS backstop to the Paradex structure or simply moving the attachment point of the limit lower.

Retention: Insured must retain a minimum of $10,000 in order to receive payment. This is to ensure the transaction qualifies as insurance rather than a derivative.

Limit: Single Annual Aggregate or Annual Aggregate with reinstatement.

PARAMETRIC SOLUTIONS

Overview: Unlike traditional insurance, the parametric cover is not tied directly to the insured's loss. Instead, payment is triggered based off of where a named storm makes landfall and at what wind speed. The objectivity of the trigger is very attractive to carriers, meaning that the pricing falls below the traditional market. The money collected from the parametric cover can be utilized in any way (i.e. it does not have to be used to rebuild items on the schedule, but can be used for roadways, clean up of beaches, marshlands, etc.)

Trigger: Named Storm must cross at a pre-assigned latitude. Amount of payment varies based upon longitudinal point of crossing and wind speed at the time of crossing.
We can structure this trigger in a linear, radial, or rectangular fashion. Recently we have chosen to show a linear structure where we have varied the payout factors based upon population and wind speeds. We find that tying payout to recordings made by the National Hurricane Center removes all question from loss settlement and is a better measure that relying on wind stations alone (Wind-ex).

In order to correlate the wind speeds exactly to the Longitudinal points along the Latitudinal line set a weighted average is used between the two NHC reports issued closest to when the storm crosses agreed latitude/longitude points.

Retention: Insured must retain a minimum of $10,000 in order to receive payment. This is to ensure the transaction qualifies as insurance rather than a derivative.

Limit: The limit applies in the annual aggregate. The per event limit is determined based upon the maximum limit multiplied by the wind speed and location modifiers.

CATASTROPHE BONDS

Catastrophe bonds are securitizations of catastrophe risk that are offered to investors as a public or private placement. Catastrophe bonds and other securitization of risk in the capital markets may be a useful alternative to ORM if the market for natural catastrophe risk (windstorm) tightens substantially or if pricing for conventional coverage is prohibitively expensive. We will discuss "catastrophe bonds" to address all forms of securitization of hazard risks even though many such securitizations take place through structures that are not formally structured as marketable securities.

Catastrophe bonds (also known as cat bonds) are risk-linked securities that transfer a specified set of risks from the sponsor to the investors. They are often structured as floating-rate corporate bonds whose principal (or a portion thereof) is forgiven if specified trigger conditions are met. They are typically used by insurers as an alternative to traditional catastrophe reinsurance, but under the right circumstances, they are a feasible option for non-insurers, as well.

While cat bonds were developed to access the risk-bearing capacity of the capital markets in order to address the post-Hurricane Andrew reinsurance capacity crunch and are still predominantly issued for windstorm and earthquake risks, a cat bond or similar such vehicle may be attractive to investors for any risk which is at least to some degree quantifiable, has little or no correlation to other fixed income or equity investments, and which delivers a risk premium above LIBOR of 10% to 15% (although as low as 3% and as high as 20% is not unheard of). Willis believes that the ORM might use such a structure to supplement its potentially insufficient windstorm coverage.

The most difficult obstacle to overcome in issuing a cat bond is the ability of investors to quantify their risk; in terms of how likely it is that they will sustain a loss as well as how much they could lose. There are, however, a few ways to ease this constraint. First, the cat bond may be issued with a "parametric" trigger. With a parametric trigger, instead of actual losses to the sponsor triggering coverage, a particular type of event would do so. In the case of windstorm, such an event might be a Category 3 or higher hurricane making landfall within 25 miles of a certain location.

SELECTION OF PARAMETRIC TRIGGERS

Parametric triggers should, to the extent possible, be unambiguous measurements that are virtually always available from disinterested sources. This assures that there can be an objective determination of the amount due under the bond as soon as the information is available. Capital market risk financing agreements define the data set on which settlement is based so there will be no argument about which set is better or more appropriate.

HOW DOES THIS WORK OUT FOR TROPICAL STORMS?

The National Hurricane Center (NHC) reports on hurricanes in real time in the Public Advisories it issues with respect to each storm at 6 hour intervals. Additionally it may publish Interim Advisories to report critical changes in the development and progress of a hurricane which occur or are identified outside of the basic reporting schedules. Landfall often is such a critical change.

Occasionally, but not always, the NHC provides a summary report at the end of a hurricane's life, or at the end of each month during the hurricane season. The summary reports usually bring together the Public and Interim Advisories. At times the information reported real time is corrected in the summary reports.

In practice this means that the logical selection of a parameter might be what appears in the Tropical Cyclone Report in February or March. However, this could result in many months delay in payment from a storm early in the hurricane season. On the other hand, the use of an interim summary report introduces an element of basis risk to the sponsor because the storm evaluation may change.

Given the way hurricanes are reported there is no guarantee that a reporting node (e.g. the physical spot to which the data in the Public and Interim Advisories refer) will fall within any designated geographical area. Structures which rely upon NHC reporting usually include a formula, mutually agreed by seller and buyer, which defines the wind speed measure to be used. Among the possibilities:

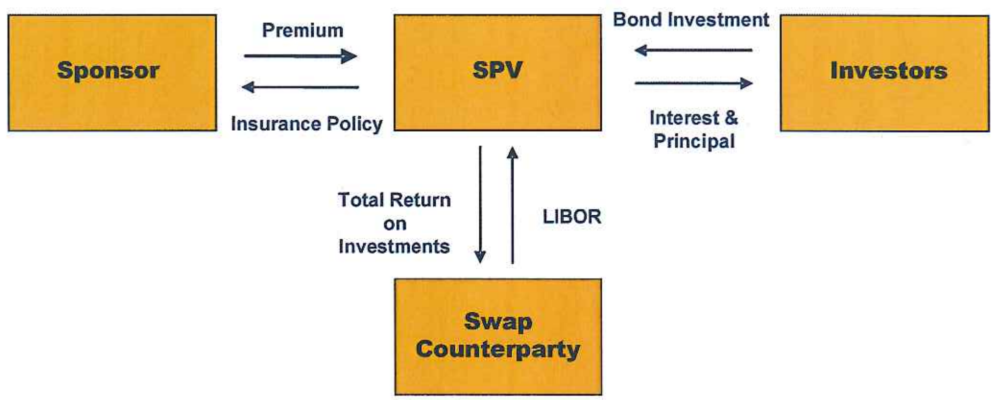
- Wind speed deemed to be the speed reported at the node closest to the border of the geographical area (box or circle) first traversed
- Wind speed deemed to be the average of the note closest to the border of the area before approach and after exit

TYPICAL CORPORATE CAT BOND STRUCTURE

The investors want to minimize any risk that the bonds will fail to pay principal or interest other than because of the event trigger. At the same time, the Sponsor wants assurance that they will be paid if the trigger event occurs so they wish to take no credit risk from the lenders. Thus, while it is theoretically possible to establish the relationships on a direct basis between the lenders and sponsor, in order to isolate the event risk from the creditworthiness of the sponsor and lenders, these transactions take place through a Special Purpose Vehicle (SPV) that collects the investment of the investors and pays them the principal and interest. If there is a triggering event, the SPV pays the appropriate amount to the Sponsor and reduces the payments of interest and/or principal to the investors. In summary, the SPV has three main functions:

- Issuing an insurance policy or other instrument to the corporation in exchange for a price to be determined
- Selling catastrophe bonds to investors through an investment bank.
- The proceeds from the sale of the bonds and the payments collected from the sponsor are usually swapped out to create a LIBOR based return

An illustration of this structure is below.



A multi-year transaction is possible (even preferable) with the following benefits:

- Allows amortizing up-front transactional costs over several years.
- Locks in spreads for long-term capacity in a market where reinsurance prices are increasing.
- At the end of the bond term, if there has not been a catastrophic loss, principal is returned to the bondholders back. The premium collected from the sponsor would be the amount necessary to give the investors an adequate return on their principal commensurate with the underlying risk.
- If a catastrophic loss exceeds the trigger, the SPV would pay what is owed per the index, model or other parameter (or would indemnify the corporation for its loss) and the bondholders would receive that much less in interest and principal repayment.

Most Cat Bonds pay floating coupons that are LIBOR based. The chart below shows the relationship among the parties to the transaction in a typical Cat Bond.

- The organization that is protected is called "the sponsor." When premiums are paid upfront the investors are almost indifferent as to who is the sponsor.
- Cat Bonds are used to transfer risk.
- When used to finance an organization's actual risk of loss, there is an element of basis risk. "Basis risk" is the risk that the sponsor will receive less (or more) from the bonds than its actual loss because the trigger for payment is something that differs from the actual loss of the sponsor.
- Cat Bonds are marketable securities and subject to SEC rules. They require a rating from one of the major rating agencies and a formal offering memorandum.

IN SUMMARY

The above options are but a few of the innovative approaches that can be used to assist you in the mitigation of your cost of risk. A multitude of hybrid options can be provided. However we believe these options can only become meaningful once ORM has successfully amended its' procurement laws which would enable you to engage with a broker to more efficiently set strategies that will have positive results on the excess property placement.