

FORESTRY INSURANCE

BROKER INFORMATION PACKAGE

2011-2012



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Appendices (attached)

 Includes:

 1. SISL/ForestRe information flyer: General

 2. SISL/ForestRe information flyer: As Safe as Houses

 3. SISL/ForestRe information flyer: Mother Nature’s Shock and Awe

 4. Simmlands Non Binding Indication Application

FORESTRY INSURANCE – BROKER HOW TO PACKAGE 2011

Introduction:

Forestry is an established and respected industry within Canada, delivering stable strong returns to business owners and investors alike, *providing Mother Nature is kind*. Income from such a valued resource needs protecting from catastrophic events that could wipe out businesses, decrease land value, and/or severely curtail returns within forestry investment portfolios. With strong evidence that climate change is increasing forest and plantation losses, so the need for protection against catastrophic losses is also increasing. In a resource-based economy, can Canadian companies afford to remain unprotected against such calamities?

The Problem:

Recent scientific studies show that what was once thought of as a 1 in 100 year event for extreme temperatures is now closer to 1 in 12. This is an 8 times increase in frequency. Extreme temperatures drive hurricanes and typhoons, severe rainfall, floods, droughts and forest fires. Fires are growing in frequency, severity and cost. Frequency is a function of increased human activity creating ignition sources, while severity is responding to fuel moisture, wind and temperatures.

Companies involved in forestry self-insure frequent losses. Such losses may be only 0.1% or 0.2% of total values, with many years loss free. The problem arises from the unexpected catastrophic event that shock timberland managers who generally consider fire and other threats as controllable.

However, it is clear that fire cannot be managed when conditions are severe. In a catastrophic loss, typically over 10% of the total area may burn in a single year. This can equate to the order of US\$35 million for forestry for a large risk, but it can be much bigger.

A strong trend in fire losses has been observed among plantations and natural forests, suggesting that in the last thirty years 75% or more of the largest loss events have occurred since 2000. This trend is particularly observable in the severity of losses. Due to increasing instability in the climate worldwide, fire prone conditions may occur more frequently and in consequence, a fire starts that cannot be attended to and so grows to damage significant areas. Other contributors to this higher loss scenario are changing seasonal patterns, such as earlier or new dry seasons and changing land use patterns due particularly to demographic changes.

Thus every year, the need for protection against these kinds of catastrophic forestry and plantation losses is accelerating.

The Solution:

ForestRe Limited is a London based company who specializes in the design of insurance and reinsurance products and solutions for forestry and tree crops worldwide. ForestRe's capacity within Lloyd's is provided by seven Syndicates, with a combined capacity of CAD 3.2 billion (2007). The credit rating of Lloyd's is A+.

Simmlands Insurance Services Ltd. (SISL) is a distributor of niche insurance products in Canada. Serving as a Managing General Agent, SISL is capable of providing unique insurance solutions to a variety of clients through a network of more than 200 brokers nationwide.

In partnership with ForestRe, Simmlands brings to Canada a unique insurance product designed to protect government institutions, forestry investors, and those companies who work

in or are dependent on resources provided by forestry and plantation industries. A few of the needs that can be served by this new product are:

- capping catastrophic losses in event of exceptional fire, wind or other natural hazard event;
- balance sheet protection & maintaining debt-equity ratios on investment portfolios;
- limiting plantation losses due to contingent expenditure on fire fighting and/or debris-removal costs;
- providing business interruption costs cover for mills due to a shortage of wood to process;
- increased stability of planned budget expenditure from year to year;
- increased borrowing can be secured on insured collateral (the growing trees);
- maintaining share price through management taking seriously their fiduciary responsibility in protecting down-side movements due to plantation losses.

Case Examples:

With such varying sizes and scopes of risk, ForestRe specializes in tailoring their product to the need. For example, on a worldwide basis since start-up, ForestRe:

1. has designed and priced a product for 2,000 small forest owners in Portugal across 700,000ha
2. has designed a forest derivative product on a million hectares of forest for the government of Cataluña to cover the risk of excess costs of cleaning that they need to do after fires and other forest disturbances to reduce fuel loads and maintain the environment
3. has rated a product for the largest Spanish pulp operation and taken a share of this risk with SwissRe
4. has designed and rated a new insurance for the major pulp operator in Portugal
5. has priced individual small grower covers for Australia and other parts of the world (New Zealand, Indonesia, China etc)
6. is working with a state forest management company to develop a product that may meet the needs across all European forests
7. is actively working on several forest carbon projects for the voluntary markets.

Each of these is a unique forestry account and each has a different risk bearing ability, requiring a different risk transfer structure.

The Policy:

As demonstrated above, each policy can be tailored to the needs of the Insured depending on size, location, and situation, and can cover many perils and major catastrophic events including:

- Fire
- Lightning
- Explosion
- Aircraft
- Wind, Cyclone and Tornado
- Hail, Frost, Snow and Ice
- Earthquake, Landslide and Flood
- Strike, Riots, Civil Commotion and Material Damage (SRCCMD)
- Fire fighting costs

The intent of the policy is to cover the catastrophic losses, thus deductibles are set to remove about 95% of events. In forestry, about 80% of the area lost is the largest in 2% of fire events. The basic deductible will vary from area to area depending on lot size, tree type and environment management.

Any insured may choose to have a larger deductible to help reduce premium cost. Typically for small forest owners a basic deductible would usually range between 2 and 20 hectares. Larger forestry businesses should consider reasonably large deductibles where they are confident that they can spot and fight fires efficiently. They will be concerned with the catastrophic fire event rather than every fire that occurs.

Insurance may be structured to cover a single forest with its own insured values, retained risk and legal title to indemnity payments following a loss. But a policy may also be designed to cover a whole portfolio with a collective limit of liability. The costs will vary according to which model is chosen.

The policy is based on the size of the Insured:

Scope of coverage depends on several factors. An Insured's needs will vary depending on their size:

Small forest owners:

'Vanilla' (plain) insurance products are designed for the small to medium sized grower. These are policies with small to medium sized deductibles to reflect the risk retaining ability of the insured. The policies can pay up to full value, for the whole forest will be at risk.

Such policies have a part to play in corporate forestry, for as in countries such as Brazil, the UK, South Africa, some 20% or more of wood fibre is produced for the corporate mill by 'out growers'. These small forestry enterprises may have anything from a few acres to hundreds of acres. Such growers need protection against natural events that could make them unable to deliver timber to mills and threaten their survival. Rates on total values may typically range from 0.5% to 3.5% according to risk profile and forest size.

Large corporate and Institutional portfolios:

For corporate or institutional investors that have developed their own geographically diversified portfolio, insurance has a role to protect that portfolio from catastrophic loss. This typically might be the 1 in 30, 50 or 100 year event that causes serious losses which in turn affects returns across the portfolio or affects share price.

These policies have medium to large deductibles, for example US\$200,000 or more per loss event. The sum insured is not the full value of the forest but it is set at a loss limit estimated to be the maximum possible loss (MPL) such a forest would incur in a single catastrophic event such as a 1 in 100 years loss. For forests worth US\$100's millions or billions, then this is a logical design feature as the whole forest cannot be lost. Loss limits of US\$5m or US\$10m are very common. Such limits represent typically about 3,000 – 5,000 hectares depending on timberland valuation. Larger limits are bought up to the capacity of the reinsurance market, which currently is about US\$30m. Premium rates as a percentage of total value may be from 0.3% to 0.025% according to size and of course, loss history.

It should be recognised that a US\$5m limit across one location is less at risk than US\$5m across say, 10 locations each one of which is valued at greater than US\$5m, so rates will be different for the same loss limit. Risk pricing reflects the structure of the insurance, the forest risk profile and the institution's appetite to retain risk in the form of a deductible and or annual aggregate loss.

Underwriting

Each risk will be required to complete the SISL Industrial Tree Crop Non-Binding Indication Application (attached). We will review the application and request additional information where necessary.

ForestRe uses the best data available on commercial timberland to generate a theoretical loss profile for certain risks. For example, hurricane data for the past 157 years can help project an 'as if' loss profile for that time period for areas of land to be covered by the policy. This helps the Insured estimate for any plantation or for the entire portfolio, the potential for catastrophic loss and its frequency.

Risk profiling results can alert investors and their forest managers to the true nature of the risk, including the improbable coincidence of extreme events. Thus, this will assist with prospecting as well.

Prospective Clients

The concern of this policy is with forests, native forests, industrial trees and fruit trees or any plantation type enterprise. The types of operation on Canada that can benefit from this coverage include:

- National and local government institutions
- Small and medium sized forest enterprises
- Pulp and paper corporations
- Forest communities and out-growers for pulp & paper factories or other processors
- Forestry management organizations
- Forestry investment funds
- Timberland investment schemes (TIMO's)
- Real estate investment trusts (REIT's)
- Natural forests which are managed under the Reducing Emissions from Deforestation and Forest Degradation (REDD) or other sustainable forestry initiatives
- Ski resorts, camping areas, lakeside housing developments, or any facility which depends upon inherent value of the operation due to nearby tree cover.

How to Apply:

Key information is required by Simmlands prior to quoting or confirming cover. To gather this data we have a Non-Binding Indication Application that is attached, and also available from our website (www.simmlands.com). This form is designed for small and medium sized forests. For larger risks it provides a useful starting point, though there may be further questions & dialogue prior to our being able to qualify the risk.

The information requested should be for each location, as risks may be different in each.

The three main categories of information required are as follows:

1. Loss data

This is the most important data set and is the loss data from invested forests by location. This data should be for last ten years (if possible) and list losses by date of loss; plot/block name or ID affected; area affected in hectares, and finally net loss area (hectares of totally damaged trees due to the loss event or net financial loss).

Insured-provided information is then backed up with national or provincial data about forest losses. Normally these refer to fire, but also may include other causes of forest disturbances such as wind or disease. This information provides an indication of the background risk from natural hazards in which the forest grows. A format for such a loss table is available on our website within the Non-Binding Indication Application.

2. Schedule of forests/growing trees, including

- 2.a. An annual summary for ten years of the total area of growing trees by location, referred to as the 'exposed area', which is used to gain an accurate loss rate over time.
- 2.b. For the current year, a full detailed schedule of the growing trees – what is growing, where, species, area etc.
- 2.c. A map of where the trees are located within each province or country. Of particular interest is the distance between the separate location, as we consider any forest blocks closer than 25km one location. Latitudes and longitudes of the main locations enable us to map the forests.

3. Valuation

We need to know what the growing trees are worth; this is usually part of the schedule. Some schedules also show salvage values expected following losses (i.e. the net loss) and this is very useful.

We can operate a net of salvage policy that reduces the sum insured by the pre-agreed salvage, so that following a loss event we simply agree the affected area and pay the claim without a lengthy loss assessment process that for many events may take months.

Conclusion

We hope the above has given a good overview of the growing need for protection against catastrophic forestry and plantation losses, the solution provided by SISL/ForestRe, and the prospective clients that can greatly benefit from this coverage.

To learn more about this exciting new venture, please contact John Barclay or refer to the Simmlands website at www.simmlands.com.