INSURANCE MARKETS AND RISK TRENDS IN 2014
AVERAGE PROPERTY RATE CHANGES — ALL INDUSTRIES
8+ YEAR HISTORY

[KATRINA] [IKE] [CHRISTCHURCH TOHOKU] [SANDY]
INSURANCE MARKETS AND RISK TRENDS IN 2014
REGIONAL PROPERTY CATASTROPHE ROL INDEX, 1990 TO 2014

Source: Guy Carpenter
## INSURANCE MARKETS AND RISK TRENDS IN 2014
### PROPERTY AND CASUALTY INDUSTRY

<table>
<thead>
<tr>
<th></th>
<th>9 MONTHS 2013</th>
<th>9 MONTHS 2012</th>
<th>CHANGE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NET PREMIUMS WRITTEN</strong></td>
<td>$363.8</td>
<td>$348.2</td>
<td>4.5%</td>
</tr>
<tr>
<td><strong>NET UNDERWRITING GAIN (LOSS)</strong></td>
<td>$7.5</td>
<td>($4.7)</td>
<td>NM</td>
</tr>
<tr>
<td><strong>NET INVESTMENT INCOME</strong></td>
<td>$34.5</td>
<td>$35.5</td>
<td>-2.8%</td>
</tr>
<tr>
<td><strong>NET AFTER-TAX INCOME</strong></td>
<td>$47.7</td>
<td>$30.8</td>
<td>54.9%</td>
</tr>
<tr>
<td><strong>POLICYHOLDER’S SURPLUS</strong></td>
<td>$626.6</td>
<td>$586.3</td>
<td>6.9%</td>
</tr>
<tr>
<td><strong>COMBINED RATIO</strong></td>
<td>96.5</td>
<td>100.2</td>
<td>-3.7</td>
</tr>
</tbody>
</table>

Dollar values given in $US billions

Source: AM Best Company
INSURANCE MARKETS AND RISK TRENDS IN 2014
RISK AREAS TO WATCH IN 2014

• Cat exposed property risks including risks with flood zone exposures.
• Certain segments of:
  – Workers’ compensation.
  – Umbrella / excess market including lead umbrellas in the pharmaceutical, transportation, and energy sectors.
• Cyber liability and network security coverage:
  – Potential for more restrictive terms and conditions following recent losses.
• Specialty areas including:
  – Energy.
  – Marine.
  – Aviation.
Policies with effective dates after December 31, 2014, will extend beyond the expiration date of the legislation. This means that insurers must determine in advance how to deal with their terrorism exposures as of that date.

Source: Marsh Global Analytics
INSURANCE MARKETS AND RISK TRENDS IN 2014
TERRORISM INSURANCE OPTIONS

• Consider alternative solutions for terrorism coverage:
  – Standalone terrorism placements.
  – Reservation of capacity.
  – Sunset provision discussions.
  – Captive insurer strategies.

• Such alternatives may be appropriate even if TRIPRA is extended.

• For example, standalone policies:
  – May provide alternative and/or supplement to TRIPRA coverage.
  – May provide immediate coverage in the absence of the federal backstop program.
  – Can be reserved for either a short-term or for a full-term renewal.
  – Provide risk professionals with the ability to lock in capacity and pricing now.
# INSURANCE MARKETS AND RISK TRENDS IN 2014

## PROPERTY RATE CHART

<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>SEGMENT</th>
<th>RATE CHANGE Q4 2013</th>
<th>RATE CHANGE Q4 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>PROPERTY</td>
<td>NON-CAT-EXPOSED ORGANIZATIONS</td>
<td>10% DECREASE TO FLAT</td>
<td>5% DECREASE TO 5% INCREASE</td>
</tr>
<tr>
<td></td>
<td>MODERATELY CAT-EXPOSED ORGANIZATIONS</td>
<td>8% DECREASE TO 2% INCREASE</td>
<td>FLAT TO 10% INCREASE</td>
</tr>
<tr>
<td></td>
<td>(1% TO 30% OF VALUES IN CAT ZONES)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>LARGELY CAT-EXPOSED ORGANIZATIONS</td>
<td>8% DECREASE TO 5% INCREASE</td>
<td>5% INCREASE TO 15% INCREASE</td>
</tr>
<tr>
<td></td>
<td>(MORE THAN 30% OF VALUES IN CAT ZONES)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>LOSS-DRIVEN ORGANIZATIONS</td>
<td>DEPENDENT ON LOSS HISTORY AND EXPOSURES</td>
<td>FLAT TO 15% INCREASE</td>
</tr>
</tbody>
</table>

The above represents the typical rate change at renewal for average / good risk profiles.

## PROPERTY INSURANCE ISSUES

- Property prices stabilized and began to trend downward in 2013.
- Significant surplus of capital kept competition high and fueled softening.
- Trends expected to continue in 2014, barring unforeseen events.
• RMS v.13 of North Atlantic hurricane model released in 2013.
• Met initially with positive reactions.
• V.11 had resulted in some insureds seeing significant changes in insurance coverages and costs.
• V.13 includes updates to the RMS storm surge model and revised long- and medium-term rates.
• The major changes were in named windstorm.
  – Exposures in Southeastern US, inland Texas, and/or Mid-Atlantic states should consider re-modeling.
  – Could cause insurers to reevaluate their property portfolios.
  – Presents insureds with opportunity to better manage their exposures.
  – Critical to provide accurate data.
INSURANCE MARKETS AND RISK TRENDS IN 2014

FLOOD RISK

• No universally accepted modeling approach for flood.
• Most carriers:
  – Monitor portfolio locations.
  – Try to manage by limiting the amount of sublimit provided.
• New flood maps being proposed, but are not yet in play.
• The Biggert-Waters Flood Insurance Reform Act of 2012:
  – Requires the Federal Management Agency (FEMA) to adjust the way it manages the National Flood Insurance Program (NFIP).
  – Contains significant program reforms.
  – Aims to eliminate subsidies and discounts on flood insurance premiums.
  – Means that many organizations will face NFIP premium rate increases as a result.
  – Has come under intense fire from critics.
  – Has led to recent hearings in Congress pushing for postponement.
## INSURANCE MARKETS AND RISK TRENDS IN 2014

### CASUALTY RATE CHART

<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>SEGMENT</th>
<th>RATE CHANGE Q4</th>
<th>RATE CHANGE Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2013</td>
<td>2012</td>
</tr>
<tr>
<td>GENERAL LIABILITY</td>
<td>GUARANTEED COST</td>
<td>5% DECREASE TO 5% INCREASE</td>
<td>5% DECREASE TO 5% INCREASE</td>
</tr>
<tr>
<td></td>
<td>LOSS SENSITIVE</td>
<td>5% DECREASE TO 5% INCREASE</td>
<td>5% DECREASE TO 5% INCREASE</td>
</tr>
<tr>
<td>AUTOMOBILE LIABILITY</td>
<td>GUARANTEED COST</td>
<td>5% DECREASE TO 10% INCREASE</td>
<td>5% DECREASE TO 10% INCREASE</td>
</tr>
<tr>
<td></td>
<td>LOSS SENSITIVE</td>
<td>5% DECREASE TO 10% INCREASE</td>
<td>5% DECREASE TO 10% INCREASE</td>
</tr>
<tr>
<td>UMBRELLA AND EXCESS LIABILITY</td>
<td>LEAD</td>
<td>FLAT TO 5% INCREASE</td>
<td>FLAT TO 10% INCREASE</td>
</tr>
<tr>
<td></td>
<td>EXCESS LAYERS</td>
<td>FLAT TO 5% INCREASE</td>
<td>FLAT TO 10% INCREASE</td>
</tr>
<tr>
<td>WORKERS’ COMPENSATION</td>
<td>GUARANTEED COST</td>
<td>5% DECREASE TO 5% INCREASE</td>
<td>5% DECREASE TO 5% INCREASE</td>
</tr>
<tr>
<td></td>
<td>LOSS SENSITIVE</td>
<td>5% DECREASE TO 5% INCREASE</td>
<td>5% DECREASE TO 5% INCREASE</td>
</tr>
</tbody>
</table>

The above represents the typical rate change at renewal for average / good risk profiles.
• General liability:
  – At the start of 2013, many industry experts had anticipated prices to increase.
  – Instead, increases typically leveled off through the year.
  – Likely to continue entering 2014.

• Automobile liability:
  – Continued effects of large loss inflation.
  – Most impact felt through required attachment points for umbrella placements and the buffer layer pricing.
  – Underwriters continue to scrutinize non-owned vehicle exposures; focusing on safety plans and safety records.
INSURANCE MARKETS AND RISK TRENDS IN 2014
CASUALTY: UMBRELLA AND EXCESS

• Umbrella market:
  – Overall capacity increased in 2013.
  – Rates generally stabilized throughout the year.
  – Trend expected to continue into 2014.

• Excess market:
  – New insurers entered the marketplace from the US and London.
  – Should likely help to keep 2014 excess casualty rates relatively stable.
  – Exceptions may exist in some areas: energy, chemical, life sciences, and construction industries.
INSURANCE MARKETS AND RISK TRENDS IN 2014
MAXIMIZING RISK SPENDING

• Positioning and making informed decisions.
• Position as best-in-class risks with comprehensive pre and post loss strategy.
• Take advantage of all available analytics and modeling capabilities.
• Optimize retention levels.
  – For example, many organizations use analytics to determining probable maximum losses when looking at property portfolio.
  – However, generally not the same rigor around excess liability.
  – There are analytical tools to determine the probability of a loss that exceeds a firm’s limits.
### INSURANCE MARKETS AND RISK TRENDS IN 2014

**PERCENT OF US WORKERS’ COMPENSATION CLIENTS WITH RATE CHANGES**

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Reduction</th>
<th>No Change</th>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2013</td>
<td>33%</td>
<td>14%</td>
<td>53%</td>
</tr>
<tr>
<td>Q2 2013</td>
<td>32%</td>
<td>13%</td>
<td>55%</td>
</tr>
<tr>
<td>Q3 2013</td>
<td>34%</td>
<td>9%</td>
<td>56%</td>
</tr>
<tr>
<td>Q4 2013</td>
<td>39%</td>
<td>11%</td>
<td>50%</td>
</tr>
</tbody>
</table>

- Most rate increases driven by the rise in medical costs, the low interest-rate environment for insurers, and/or the general unprofitability for them of the line of business over multiple years.
- Insureds specific exposures and loss experience will have a greater influence on program pricing and retention levels.
- Affordable Care Act being watched for impact on workers’ compensation.

Source: Marsh Global Analytics
Numbers may not add up to 100% because of rounding.
“We will see a continued focus on the use of more meaningful analytics that can help to identify savings opportunities, formulate action plans, and measure the impact of change.”
### DIRECTORS AND OFFICERS (D&O) LIABILITY INSURANCE MARKETS AND RISK TRENDS IN 2014

#### SEGMENT | RATE CHANGE Q4 2013 | RATE CHANGE Q4 2012
--- | --- | ---
PUBLIC COMPANIES | 5% DECREASE TO 5% INCREASE | FLAT TO 10% INCREASE
PRIVATE COMPANIES | 5% DECREASE TO 15% INCREASE | FLAT TO 15% INCREASE

The above represents the typical rate change at renewal for average / good risk profiles.

### D&O PRICING
- Pricing pressure lost momentum in fourth quarter of 2013.
- Pricing into the second quarter of 2014 second quarter for public companies likely to range from 5% decrease to 5% increase.
- Rate pressure in the private segment likely to persist in 2014 along with higher retentions and tighter underwriting.
### SEC Enforcement Action Category

<table>
<thead>
<tr>
<th>SEC Enforcement Action Category</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broker-Dealer</td>
<td>121</td>
</tr>
<tr>
<td>Delinquent Filings</td>
<td>132</td>
</tr>
<tr>
<td>Foreign Corrupt Practices Act</td>
<td>5</td>
</tr>
<tr>
<td>Financial Fraud/Issuer Disclosure</td>
<td>68</td>
</tr>
<tr>
<td>Insider Trading</td>
<td>44</td>
</tr>
<tr>
<td>Investment Advisor / Investment Company</td>
<td>140</td>
</tr>
<tr>
<td>Market Manipulation</td>
<td>50</td>
</tr>
<tr>
<td>Securities Offering</td>
<td>103</td>
</tr>
<tr>
<td>Other</td>
<td>23</td>
</tr>
<tr>
<td><strong>Total Enforcement Actions</strong></td>
<td><strong>686</strong></td>
</tr>
<tr>
<td>- Actions in Second Half of 2013</td>
<td><strong>402</strong></td>
</tr>
</tbody>
</table>

**Total Penalties and Disgorgements**: $3.4 Billion

*Source: SEC 2013 Annual Report*
INSURANCE MARKETS AND RISK TRENDS IN 2014

REGULATORY CONCERNS

• Key questions to ask about regulatory exposures:
  – How are my organization and executives covered for regulatory investigations and inquiries? To what extent?
  – Is current policy language adequate?
  – Do we want corporate investigations coverage and if so, do we want to share the limit with our executives or do we want a standalone limit for the entity?
INSURANCE MARKETS AND RISK TRENDS IN 2014

CYBER RISK

<table>
<thead>
<tr>
<th>SEGMENT</th>
<th>RATE CHANGE Q4 2013</th>
<th>RATE CHANGE Q4 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>NETWORK, INFORMATION SECURITY, AND PRIVACY</td>
<td>FLAT TO 5% INCREASE</td>
<td>FLAT TO 5% INCREASE</td>
</tr>
</tbody>
</table>

The above represents the typical rate change at renewal for average / good risk profiles.

- SEC issued guidance in October 2012 regarding a company’s responsibility to make disclosures related to cyber security risks and incidents.
- Risk managers will probably face questions from leadership about the firm’s insurance coverage in the event an incident occurs.
Risk Interconnections Map

- Cyber attacks
- Critical information infrastructure breakdown
- Terrorist attack
- Global governance failure
- Data fraud/theft
- Organized crime and illicit trade

Reliance upon technology has created a unique set of risks.

Enhanced coverage addresses lost revenue and extra expense associated with a non-physical technology peril.

Cyber policies now have provisions covering nearly every aspect of an organization’s response to an actual or perceived breach.

Markets have moved beyond simple risk transfer, providing loss prevention and risk mitigation tools.

Source: Marsh Global Analytics
INSURANCE MARKETS AND RISK TRENDS IN 2014
MERGERS AND ACQUISITIONS

• Economic recovery fosters increased M&A activity.
• Private equity firms and corporations looking to:
  – Make investments.
  – Acquire new product lines.
  – Expand into new markets.
  – Control more of the supply chain or divest underperforming businesses.
• M&A transactions commonly involve numerous risk issues.
• If not properly identified and addressed, can negatively affect deal negotiations and the long-term financial success of a transaction.
• Risk management due diligence complements and enhances traditional accounting, legal, and investment banking due diligence.
INSURANCE MARKETS AND RISK TRENDS IN 2014
M&A: UNFAMILIAR EXPOSURES

• Consumer products organization considering acquiring competitor.
• Target company manufactured products containing BPA – a substance alleged to cause hormonal imbalances.
  – Could be risky enough to cause an end to the transaction.
  – Comprehensive analysis of the likelihood and potential magnitude of claims arising out of BPA.
  – A thorough review of available insurance coverage, including the buyer’s insurance as well as the seller’s.
  – Sufficient comfort for the buyer to proceed with the transaction.
• In other cases the outcome is quite different: Sometimes the best deals are the ones that don’t happen.
“Insurance capital can often provide the certainty buyers or sellers need to move forward with a transaction.”
INSURANCE MARKETS AND RISK TRENDS IN 2014
M&A: TRANSACTIONAL RISK

• Representations and warranties insurance (RWI):
  – Used to help resolve differences between buyers and sellers over issues such as the terms in the purchase agreement governing the survival of and indemnification for breaches of representations and warranties.

• Corporate clients undertaking cross-border deals and entering a new geography for the first time increasingly look to transactional risk insurance products as a prudent risk management tool.

• Private equity firms, corporate clients, and their law firms continued to use RWI strategically in auctions in 2013, both on the buy and sell side of the deal.

• Buyers have used buyer-side RWI policies as a way to distinguish their bid in an auction by requesting a lower than customary indemnity cap from sellers.
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MA14-12730