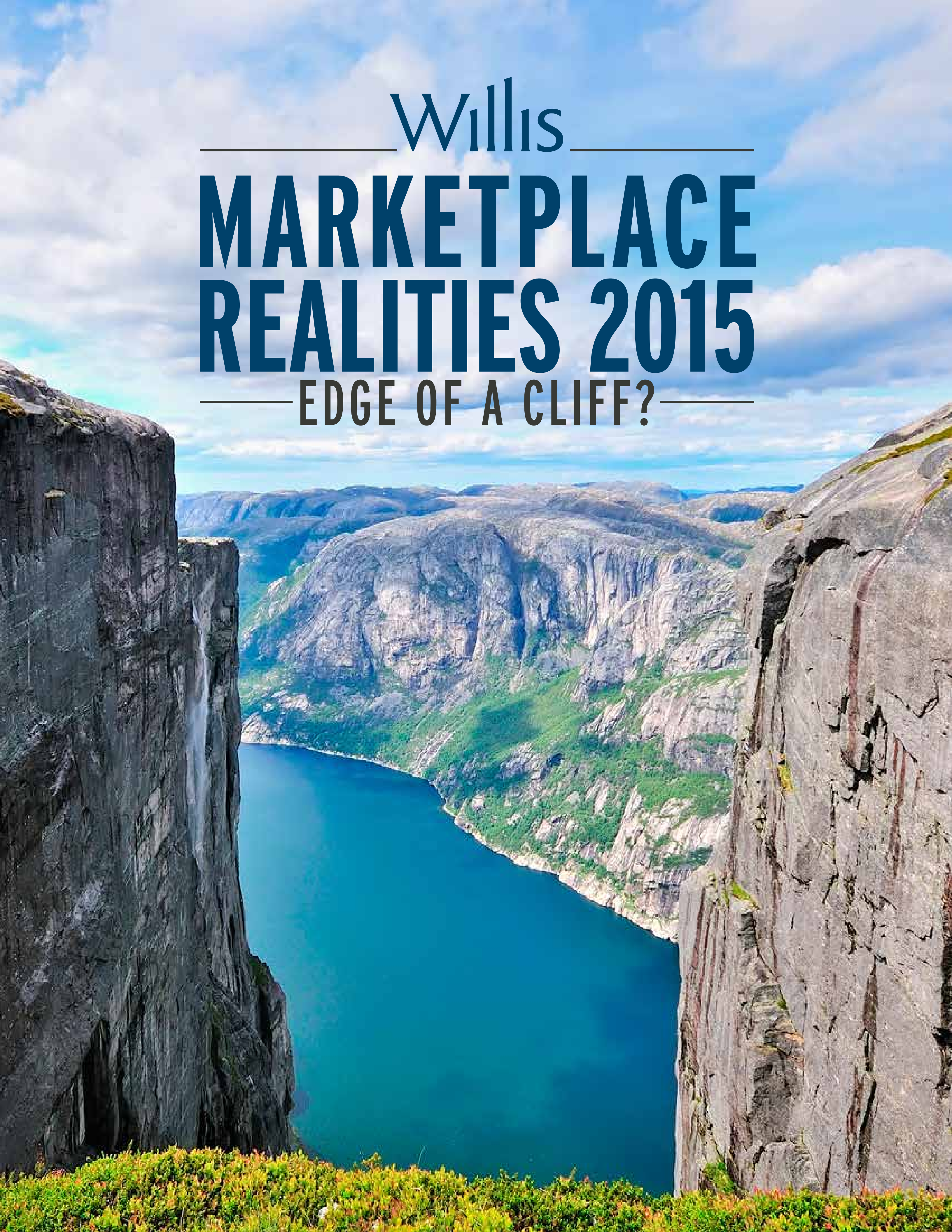
Willis

MARKETPLACE REALITIES 2015

EDGE OF A CLIFF?



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Marketplace Realities is updated semi-annually.

EDITORIAL STAFF

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MARKETPLACE REALITIES: EDGE OF A CLIFF?

It's long been common wisdom in the insurance business that whatever we say about rates should come with an asterisk. The asterisk refers to a note that says something along the lines of, "Of course, in the event of a mega disaster, everything could be different. The market could turn overnight."

A softening market would suddenly turn hard and a hardening market would get harder. Those are the basics of the hard and soft market dynamics that have more or less ruled our world for the past several decades.

But the insurance marketplace is evolving and the changing dynamics currently underway may spell the end of traditional market cycles. For example, we see the possibility that in the face of a mega disaster today, a softening market could actually turn softer, or at least maintain its downward turn. And in the absence of a major loss, this softening could accelerate. We could be at the edge of a cliff, possibly standing with one foot over the edge.

Here's why we think so...

- In the current long-term, low interest investment environment, sources of capital continue to hunt for opportunities. The reinsurance marketplace is bursting. Alternative capital is now pressing on the primary side. Add that to a year of relatively low insurable losses and a hurricane season that is following predictions of light activity, and we have a plentiful supply of capital exerting a steady downward pressure on the marketplace.
- $100 billion isn't what it used to be in today's massive global insurance environment. In a **recent report**, a major insurer wondered if a $100 billion loss would really shock the marketplace. No one doubts that the impact would be felt, and certainly we would expect that a loss of that magnitude would carry a human toll that would affect all of us in the insurance world and beyond. But in terms of changing the supply and demand curves of insurance, maybe not so much.
- The new capacity seems so eager and steady that even in the face of a mega disaster, we do not see a withdrawal of that capacity. On the contrary. Anticipating a rise in rates, which usually follows a huge loss, more capacity might come in. That could well counter the withdrawal of capacity by insurers paying out the mega claims for the mega loss, and rates would continue to decline. With more modest losses – as we've been seeing the past two years – we could be headed over the edge.
- Insurance carriers are likely to be able to withstand these conditions. They are becoming more efficient and more stable as a result of improved balance sheets and the access to additional forms of capital.

For insurance buyers and risk professionals, now is the time to think about the strategic possibilities as renewals approach. Work with your insurance broker to optimize your risk management investment and protect your business. We are sure that insurance carriers will welcome the opportunity to be creative to win new and retain existing clients as they look to maintain and grow market share and thrive in a marketplace undergoing, potentially, fundamental change.

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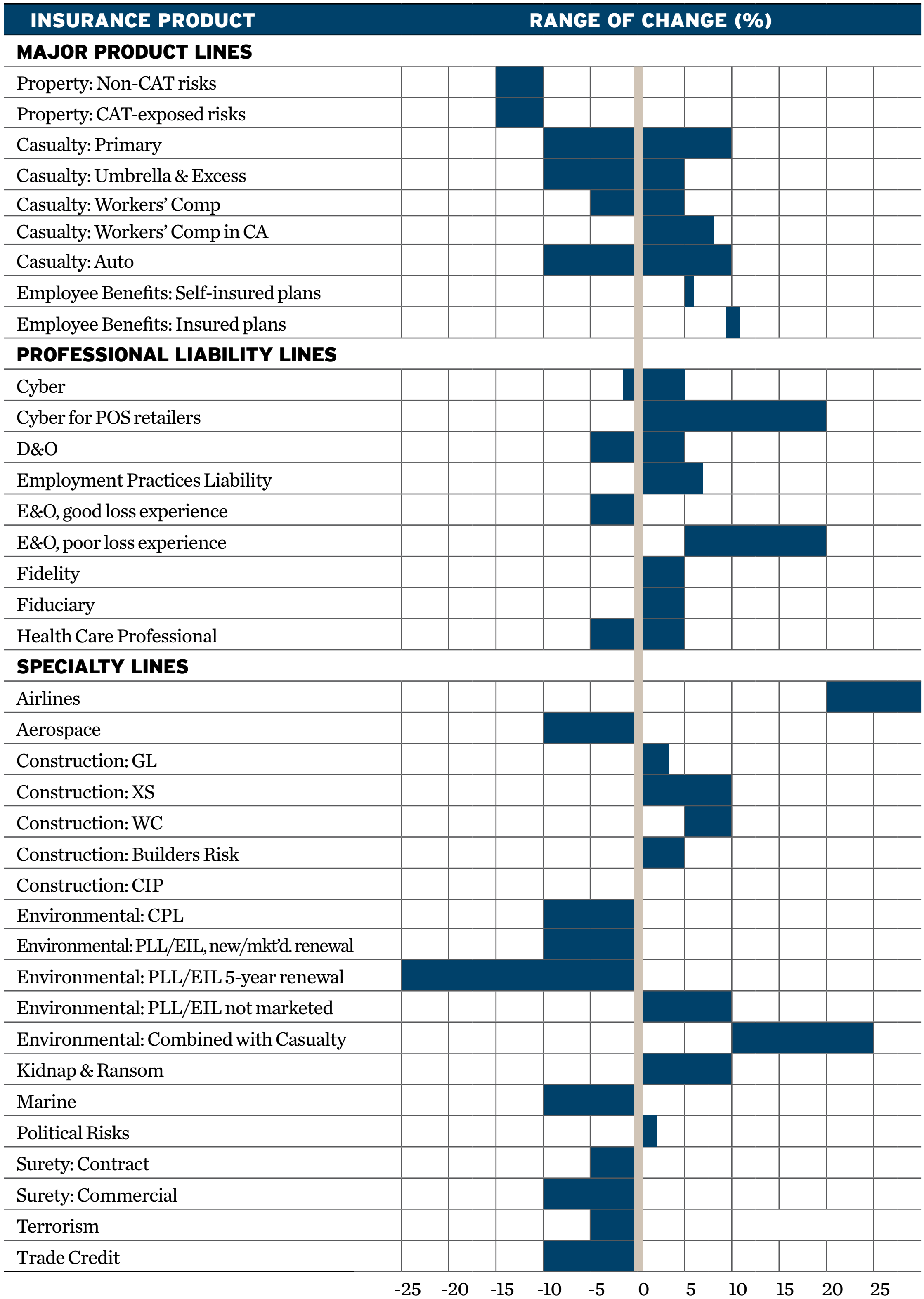
COMMERCIAL INSURANCE RATE PREDICTIONS FOR 2015



Rate predictions by Willis subject matter experts relate to Property/Casualty business placed for clients larger than SMEs, other than in Employee Benefits where clients of all sizes are included.

LOOKING FORWARD, LOOKING BACK

The *Marketplace Realities* series is focused firmly on the future – renewals approaching, risk management trends taking shape, the marketplace we'll all be facing in the year ahead. In putting together this issue, we asked our contributors to also take a quick look back and compare our **predictions of the spring** to what they – they and the many Willis colleagues they poll to generate these predictions – actually saw in the marketplace.
Our goals were gaining a broader perspective on the trends we're tracking and on the inexact science of predicting the marketplace, and perhaps improving the guidance we offer the risk management community.

Given the stability of the market and the relatively benign level of catastrophic losses so far in 2014, we were not surprised to find most of our predictions borne out. There were a few modest, but interesting, exceptions.

- **Casualty:** Rate increases have tempered as we suspected they might, to the point that we are now forecasting some small decreases as well as smaller increases for 2015.
- **Terrorism:** The absence of major Terrorism losses in the West and abundant capacity exerted stronger downward pressure than anticipated.
- **Airlines:** Our spring predictions of Airline rates continuing to fall were upstaged by major loss events.
- **Health Care Professional:** We slightly underestimated the price-easing impact of marketplace competition for these risks.
- **Fiduciary:** Overall, our spring predictions proved to be slightly high, as carriers more aggressively looked to cross-sell Fiduciary Liability coverage, ERISA tag-along settlements waned and a limited number of new tag-along cases emerged.
- **Employment Practices Liability:** We may have underestimated the challenges in California.

Stability and generally softening conditions should prevail in the year ahead. Policyholder surplus reached a record $683.1B in the first half of 2014, according to AM Best. This augurs well for buyers in the marketplace for 2015. The situation could change in the event of a major catastrophic loss. In which direction that change might go, however, remains a matter of debate. As always, we will be keeping a close watch on the various marketplaces our clients face as we work side by side with them in understanding and managing their risks.

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PROPERTY

Rates have been falling for several consecutive quarters and given loss numbers and present marketplace conditions, we do not see an end to this trend. The following dynamics support soft market conditions continuing into 2015:

- **Capacity** – Many insurers increased their CAT capacity in 2014 and refused to be marginalized by larger insurers. **Insureds had many options in 2014 and should enjoy the same in 2015.**
- **Loss Experience** – Aside from a recent earthquake in Napa ($1B estimated insured loss), losses have been benign in 2014. As of this writing, no major hurricane has hit mainland U.S. since Ike in 2008 and none have hit the vulnerable peninsula that is Florida for nine years. (Sandy's wind speeds in 2012 fell just short of the hurricane threshold.) According to **Swiss Re**, worldwide Property losses totaled $21B for the first six months of 2014, compared to $25B from the same period in 2013 and an average of $27B over the past decade.
- **Reinsurance** – The influx from the capital markets has had an impact on the reinsurance market as insurers have been able to replace the highest priced reinsurance capacity with this alternative capacity. According to a **recent report**, the combined ratios for top reinsurers averaged 87 compared to 86 in 2013. So despite falling rates (-15% to -20% in 2014) and expanded terms and conditions, the reinsurance market continues to make decent returns due to the favorable loss experience. **Although various factors point to continued price softening, we believe that further price reductions will be less pronounced in 2015.** Reinsurance prices are only expected to slide another -5% to -10%.
- **Profitability** – Despite falling rates, most Property insurers should see a reasonable return on their respective portfolios, albeit not to the levels achieved in 2013. According to **recent reports**, the 2014 midyear combined ratios for the top insurers averaged 94.
- **Exceptions** – The one sector that remains outside of these trends is Habitational risk, especially those exposures close to the U.S. coastline. There are a limited number of insurers writing these risks on a primary basis and, accordingly, this sector remains challenging.

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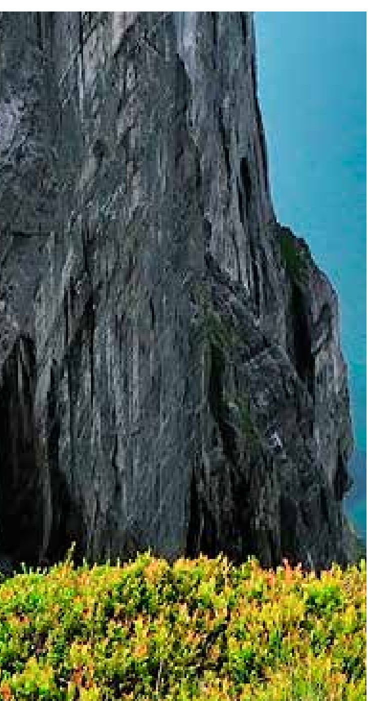
PRICE PREDICTIONS

NON-CAT	-10% to -15%
CAT	-10% to -15%



CASUALTY – PRIMARY AND EXCESS

- **Capacity is still abundant and carriers are still redefining their appetites;** some are cutting back on Workers' Compensation or raising umbrella attachments to improve their profitability and others are aggressively underwriting to grow their market share on the same lines.
- While our prediction calls for a range of Primary rates from -10% to +10%, our price data reveals a narrower average. The average rate change for September 2014 was an increase of 1.4% to 2.1%, down from 3.9% to 4.6% for September 2013. **We believe many buyers will see rates softening fractionally in the months ahead.**
- **Underwriters are generally a bit less flexible when considering manuscripted endorsement language** and are more likely to insist on ISO language unless higher retentions or only incidental exposures are involved.
- New York's archaic Scaffolding Law continues to create havoc for New York contractors and other parties, as "fall from elevation" losses temper carrier appetites for this exposure. While New York rates remain high, appetite and availability of cover are bigger issues than price.

PRICE PREDICTIONS

PRIMARY	-10% to +10%
UMBRELLA & EXCESS	-10% to +5%

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WORKERS' COMPENSATION

- **Overall, combined ratios for Workers' Compensation carriers appear to be continuing to improve in 2014,** due to pricing trends, attachment strategies and some improvement in medical inflation trends.
- **A key trend to watch is the interest of hedge fund capital in Workers' Compensation.** Despite several leading carriers moving away from the line, the hedge funds see predictability and profits, even if one of the predicable aspects of Workers' Compensation is that 15-20% of the loss cases can last the life span of the injured employees. Part of the hedge fund interest is in ancillary services associated with Workers' Compensation and managing of the claims.
- Several states remain challenging Workers' Compensation environments: New York, Massachusetts, Pennsylvania, Illinois and California. That said, **California rate increases are at their lowest levels in years and 15 states have applied for rate reductions.** However, carriers continue to fine tune their state-specific appetites.
- While the full impact of the Affordable Care Act on Workers' Compensation cannot yet be measured, industries that are making more jobs part-time and hiring more part-time employees continue to see increases in loss frequency that are typical with newer employees. In states like California with sizable agriculture, manufacturing, hospitality and retail employee populations, this dynamic is more visible. As increased frequency will negatively impact an employer's experience mod this trend may increase Workers' Compensation premium.
- While we expect Congress to extend the terrorism reinsurance backstop under TRIA before it expires on December 31, 2014, uncertainty remains. We do not expect the House of Representatives to vote on a bill before the midterm elections. In the interim, many carriers are using the NCCI endorsement, which is intended to address the uncertainty surrounding the renewal of the current program.
- Markets remain reluctant to underwrite monoline Workers' Compensation and excess Workers' Compensation for qualified self-insureds. Additionally, some carriers have filed new excess Workers' Compensation products which allow them to offer excess Workers' Compensation without offering Terrorism coverage; New York and Florida remain the only states that have not approved these products.

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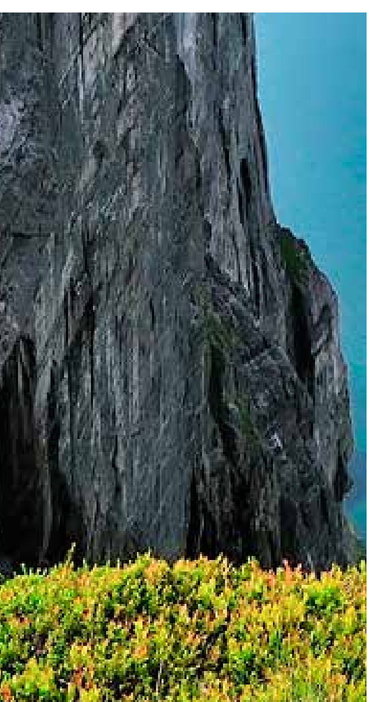
PRICE PREDICTION

-5% to +5%, up to +8% in California



AUTO LIABILITY

- Some underwriters continue to push for higher primary auto retentions for insureds with large fleets, difficult auto exposures such as heavy trucks and unfavorable loss experience. Some of this is driven by reinsurance pricing, which has not fallen for Auto markets as it has elsewhere. **Fortunately, underwriters are now offering more realistic terms to the better risks.**
- While both the primary and excess markets are beginning to recognize the benefits of investment in advanced safety technology, these gains have been tempered by the severity trends in recent auto losses.
- **Umbrella underwriters continue to require higher attachment points for risks with large fleets and heavy trucking exposures with poor loss experience.**
- Carriers that offer both primary Casualty and umbrella products are better prepared to offer higher primary limits than they were last year.
- Many companies with large auto fleets are benefiting from reconfiguring their towers to introduce shorter layers in their lead umbrella and taller quota shared layers in their excess; a competitive combination of domestic, London, Bermuda and global capacity is yielding the best terms.

PRICE PREDICTION

-10% to +10%

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EMPLOYEE BENEFITS

- Led by the pay-or-play mandate that becomes effective for most employers in 2015, the Patient Protection and Affordable Care Act (PPACA) will increasingly impact employers in the year ahead. **Employers face new reporting requirements and additional employee disclosure and notice requirements.**
- Employers continue to take aggressive steps to stem the rising costs of health care:
  - Incorporating limited network options, including narrow networks and Accountable Care Organizations (ACOs)
  - Implementing Minimum Essential Coverage (MEC) or "Skinny" plans
  - Shifting costs to employees and requiring even greater contribution levels to cover dependents (Spousal surcharges are becoming more common and in some cases, employers are eliminating spousal coverage.)
  - Managing the health of populations through wellness programs, with increasing focus on high-risk and high-cost populations
  - Self-insuring risk (for larger employers)
  - Promoting consumer-directed plans including high-deductible health plans in combination with health savings accounts
  - Promoting telemedicine
- Employers are beginning to take incremental steps to avoid the Cadillac tax, which becomes effective 2018.
- **While the adoption of private exchanges has been modest in 2014, employer interest remains high. Utilization is expected to rise in 2015 and beyond.**
- Factors driving benefit cost increases in 2015 include:
  - Aging workforce
  - Increased prevalence of chronic disease
  - Expanded population of covered individuals as a result of PPACA
  - Fees and taxes related to PPACA
  - Increased costs and prevalence of specialty pharmaceuticals

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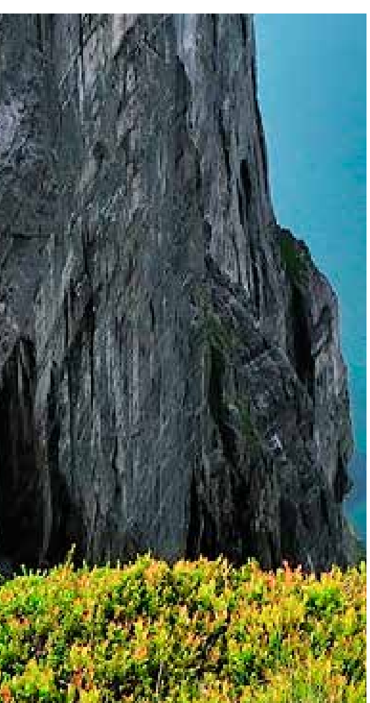
PRICE PREDICTIONS

SELF-INSURED	+5% to +6%
FULLY INSURED	+9.5% to +10.5%



CYBER RISK

- With Cyber breaches becoming alarmingly common and increasingly severe, the demand for stand-alone Cyber policies is rising. **Yet rates are competitive, with renewals coming in primarily flat, though point-of-sale (POS) retailers are seeing increases in premium due to recent significant breaches at retailers.**
- Underwriters are increasing retentions and premiums, while reducing their capacity for POS retailers or exiting the sector altogether.
- **First-time buyers (except POS retailers) will be more likely to find a competitive environment but not to the extent we have reported in previous updates.**
- In 2013, there were more than 2,100 privacy breaches reported in the U.S. – roughly six per day. So far 2014 is offering little relief. Over 552 million identities were exposed via breaches in 2013 – an increase of 493% over 2012.
- Preventable breaches (caused by a failure to encrypt data storage devices) continue to decrease, while breaches involving hackers/organized crime and rogue employees continue to increase. As a result, claim severity has spiked dramatically, especially in the retail sector. Eight of the top 15 largest breaches of all time occurred in 2013.
- **Board level attention and scrutiny have increased dramatically in light of recent events at many large, publicly traded companies.**
- Underwriters are starting to aggregate limits at large cloud providers as they assess the probability of catastrophic cyber losses.
- **Carriers continue to introduce Cyber policies in Europe and other countries**. For most non-U.S. corporations without U.S. operations, Network Business Interruption coverage has offered greater value than Data Privacy Liability coverage. This is starting to change as reputational and governmental oversight increases.
- **Regulatory fines and penalties continue to be assessed following data breaches, particularly in the health care sector.** Payment care industry (PCI) fines, especially in the retail sector, are growing due to an increase of breaches. **Underwriters have paid them.**

PRICE PREDICTIONS

RENEWALS (NON-POS RETAIL)	-2% to +5%
RENEWALS FOR POS RETAILERS	Flat to +20%
FIRST-TIME BUYERS	Competitive but becoming more restrictive

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DIRECTORS AND OFFICERS (D&O)

- D&O capacity is still extremely plentiful for the vast majority of market segments and industries, including the financial institutions sector.
- **Primary D&O placements for public companies should see stable pricing in 2015.** For larger programs, buyers may continue to see modest price relief on the excess layers, depending on expiring pricing. The companies that should anticipate premium increases are those with significant claims activity or material changes in exposure, due to growth, acquisitions, divestitures and/or deviations in their business models.
- **Private companies and nonprofits, which have experienced the highest rates of increase over the past few years, likely will continue to see upward pressure on premium and retentions.** Expect the same for health care companies, homeowner/condominium associations and educational institutions.
- Carriers still have significant concerns regarding antitrust and other unfair business practices exposure and continue to monitor the rapid increase in costs/attorneys' rates on private D&O-related matters.
- Newer entrants into the market are gaining momentum and competing with traditional primary and lower excess markets. Buyers may be forced to choose between a familiar and experienced market looking to maintain rate and a new entrant that may be more competitive but is relatively untested.
- Excess Side-A pricing remains very competitive. Rates per million of more than $3,000 are achievable for financially strong buyers. Reinstatement of policy limits, or double-aggregate limits, for multiple unrelated claims are becoming the norm – at no or little additional cost.
- Stock market valuations remain near all-time highs. A major stock-price correction could give pause to the D&O markets.
- In the *Halliburton* case, **the Supreme Court gave defendants (D&O buyers) potential help in resisting class action status.**
- Carriers are now adding endorsements to clearly cover costs to contest class action certification in securities claims.
- D&O markets will now be looking at other upcoming Supreme Court decisions that may impact future D&O litigation.
- The evolution of coverage for investigations and earlier claim triggers continues and there is a general trend toward recognizing coverage for subpoena-related costs within D&O policies.
- **Public and private companies continue to evaluate and, in many cases, purchase international D&O policies in connection with a U.S. policy.** Carriers are recognizing this need and continue to build their networks to provide those policies.
- Other trending issues: tax-related decisions for corporations (inversions, repatriating cash to U.S.), major cyber attacks impacting businesses and implicating board oversight and by-law reforms, including "loser pay" shifts in litigation.

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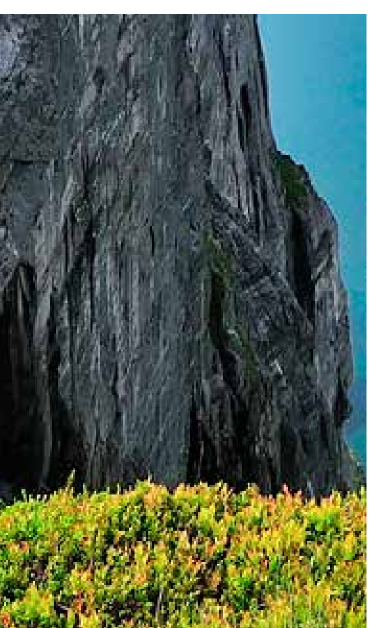
PRICE PREDICTIONS

OVERALL	-5% to +5%
PUBLIC COMPANY – PRIMARY	-5% to +5% on primary
PUBLIC COMPANY – EXCESS	-10% to flat on excess, including side A
PRIVATE COMPANIES	Flat to +10%; financial services: Flat to +3%
NONPROFIT ENTITIES	Flat to +10%, life science +5% to +10%; health care: +10% to +15%



EMPLOYMENT PRACTICES LIABILITY (EPL)

- EPL capacity remains plentiful, but limited in certain geographies and industries.
- **More cautious underwriting positions (relative to Fiduciary and Crime) may limit the amount of competition and lift rates. Modest premium increases and upward pressure on retentions may force buyers to market their coverage to obtain status-quo terms.**
- For California buyers, rate increases may reach double digits as claim levels increase.
- For financial institutions, some large-scale claim settlements may make insurers more conservative in setting rates.
- Restaurants, health care companies and hospitality firms are also likely to face more challenging renewals.
- **Wage & Hour exposure/coverage is a major issue for many buyers.**
  - Claims include disputes over: exempt vs. nonexempt, independent contractor misclassification, overtime and minimum wage, bonuses and regular rate calculation, break time and automatic deductions, and preliminary and postliminary activities.
  - Carriers (Bermuda and London mostly) are now beginning to offer Wage & Hour coverage as part of EPL coverage instead of just as a stand-alone product.
  - **Policies cover liquidated and punitive damages, back wages, defense costs and plaintiffs' legal fees.**
- Social media exposures are evolving and many buyers still don't have formal social media policies and procedures.
  - Overbroad social media policies may violate employee rights.
  - More EPL claims involving alleged wrongful termination of employees who criticize employers on social media are being supported by the National Labor Relations Board (NLRB) through Section 7, which protects concerted activity – employee rights to self-organize, join unions, assist unions or bargain collectively.
  - Many companies using social networking sites to research candidates/employees may face more claims alleging wrongful failure to employ or promote, or negligent hiring.
- The Equal Opportunity Employment Commission (EEOC) continues to be proactive, monitoring pregnancy-related accommodations and the protection of lesbian, gay, bisexual and transgender individuals in the workplace under Title VII.

PRICE PREDICTIONS

OVERALL	Flat to +7% (at expiring retentions); California: +5% to +15%
LARGE GLOBAL COMPANIES	Flat to +5% on primary, flat to +3% on excess
MID TO LARGE DOMESTIC FIRMS	Flat to +7% on primary, flat to +3% on excess
PRIVATE AND NONPROFIT ENTITIES	Flat to +10%
SMALLER EMPLOYERS (< 200 EMPLOYEES)	+5% to +15%

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ERRORS AND OMISSIONS

- Competition from new and traditional carriers seeking to expand market share is limiting upward pressure on rates, **and attractive risks continue to enjoy small rate reductions**. **We expect the remainder of 2014 and early 2015 to continue along similar lines.**
- Accounts with poor loss experience are facing related price and deductible increases as well as possible changes in wording.
- Authorized global E&O limits are approximately $850M. Typical insureds should be able to buy from $500M to $600M. Insurers continue to closely manage their capacity, often reducing their capacity commitments, **but capacity reductions have been offset by additional players entering the marketplace.**
- The market seems to be considering the effect of large data/privacy losses from the retail sector and other large technology losses. **Higher quotes have been issued by some carriers but the long-term impact of these events is still uncertain.** The losses have mainly affected Cyber for the retail sector and the increases have been in the 15% to 40% range in lower layers of retail Cyber towers.
- Industry sectors at risk for large claims and litigation will continue to see upward pressure on rates. **Large technology companies and companies with new media services, for example, could see increases up to 20% due to expanding global privacy laws.**
- **FINANCIAL INSTITUTIONS: The E&O market for financial institutions is in a state of persistent volatility – especially for clients in the banking or insurance company sectors – as insurers continue to experience a lack of profitability on this portion of their underwriting portfolios.**
  - Insurers report that the nature and origin of claims vary widely and are difficult to anticipate. As a result, primary insurers are asking insureds to bear a greater share of the risk by pushing deductibles (retentions) higher.
  - Deductibles and coverage terms have become negotiating levers for clients facing challenging renewal pricing.
  - Coverage terms are generally stable, with few markets introducing new forms. Regulatory investigations coverage continues to be elusive even with more clients experiencing regulatory issues.
- **Technology service providers are now more routinely being asked to provide evidence of higher insurance coverage.**
- Wording enhancements continue to be achievable. Insurers continue to add or enhance Network Security and/or Privacy Liability coverage and provide broader terms for First-Party Cyber exposures. Companies with manuscript wording should be able to improve coverage.

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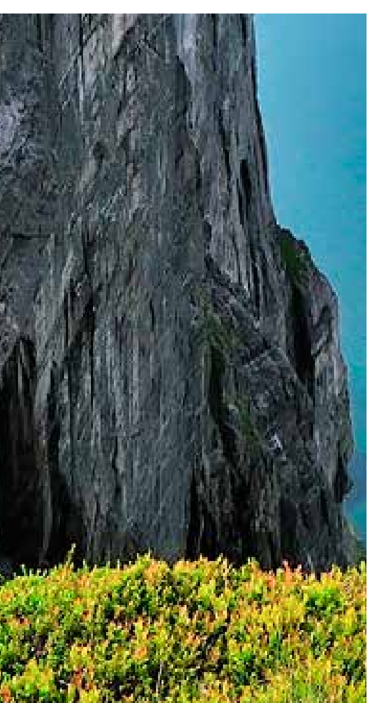
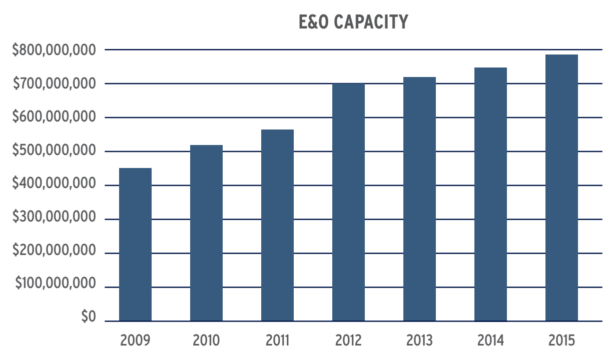


PRICE PREDICTIONS

GOOD LOSS EXPERIENCE	-5% to flat
POOR LOSS EXPERIENCE OR DIFFICULT INDUSTRY SECTORS	+5% to +20%



FIDELITY

- The Surety Association has confirmed earlier expectations that the overall financial results for the Fidelity market showed modest improvement from the prior year.
- Despite the slight upward tick in profitability, market leaders continue to bemoan the thin pricing attached to the product. **Abundant capacity, however, will not likely allow a material firming of the market.**
- The most common loss scenario afflicting the Fidelity market continues to be vendor fraud losses (the submission of fraudulent invoices by an officer or employee of the insured for goods or services that were never provided).
- **The fastest growing new loss scenario is technology related.** It involves a hacker hijacking the computer of an insured's customer or employee to send fraudulent emails instructing the insured to wire funds to an outside person or entity. **Standard crime policies and FI bonds do not respond to claims of this nature.** The FI bond market has crafted endorsements to address this exposure and these should be available when the insured has adopted proper authentication methods. The commercial market, however, has been slow to respond, with only an exceedingly limited number of lead markets addressing this exposure.
- We have not experienced a tightening or retraction in the breadth of coverage. In fact, the Fidelity market is being pressed to expand coverage further. New policy forms continue to be generated by a handful of markets in both the FI bond and commercial space.
- Virtual currencies continue to present a challenge for underwriters and insureds as more and more large retailers begin to accept them. The exchanges and depositories that handle the currencies as well as the retailers accepting them have exposures, but Fidelity underwriters are extremely cautious about these risks. Several markets, however, are now offering coverage though many remain on the sidelines.
- **Additional Fidelity markets are in the early stages of development and are expected to start accepting submission in the first half of 2015.**
  - Plenty of capacity for mid-sized companies
  - Primary placements for large financial institutions and Fortune 500 companies largely limited to four or five lead markets

PRICE PREDICTION

FLAT TO +5%

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FIDUCIARY

- **Fiduciary Liability capacity remains constant.** Some markets are targeting Fiduciary Liability to diversify their overall Management Liability books. More than one market is now willing to consider multi-year deals.
- **Primary Fiduciary Liability placements should see stable pricing in 2015. For larger programs, buyers should continue to see modest price relief on the excess layers.**
- A key premium rating factor continues to be total pension/retirement assets and funding levels. These are generally increasing, suggesting that premiums would otherwise rise but for the impact of marketplace competition.
- The most important variable rating factor is the amount of the company's own stock in its 401(k) and other types of pension and retirement plans.
- Uncertainty about the national health care agenda may present additional underwriting questions or concerns.
- Transaction activity (M&A, spinoffs, buyouts) may result in an uptick in ERISA Fiduciary claims.
- Firms that eliminate plans altogether may find a potential gap in Fiduciary Liability insurance for any subsequent claims concerning necessary disclosures made post-plan termination.
- **The monetary value of the largest ERISA class action settlements of the last few years is generally waning over time.**
- The U.S. Supreme Court recently held (*Fifth Third Bancorp v. Dudenhoeffer)* that ESOP fiduciaries are not entitled to a special "presumption of prudence" and are subject to the same "reasonable" duty of prudence that applies to ERISA fiduciaries in general. **This case could encourage ERISA tagalong litigation relating to employer securities. Rate movement, however, is not anticipated unless litigation trends materially change.**
- Class certification in ERISA cases, especially in potential class actions involving 401(k) plans, has been strongly impacted by the Supreme Court's 2011 *Dukes v. Wal-Mart* decision. The upshot may be that *no class* is certified and permitted to proceed in this case – or that hybrid or smaller classes are crafted.
- The ongoing migration of recent D&O coverage enhancements into Fiduciary policies may positively affect potential coverage for investigations and/or individual liabilities.
- On the issue of settlor liability coverage, the majority of carriers now offer language explicitly acknowledging the coverage.

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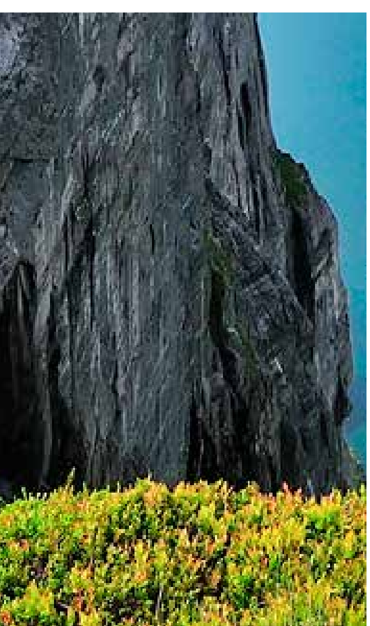
PRICE PREDICTIONS

OVERALL	Flat
COMPANIES WITH LARGE CONCENTRATIONS OF THEIR STOCK IN BENEFIT PLANS	Flat to +5%
COMPANIES WITHOUT/LIMITED COMPANY STOCK IN THEIR PLANS	-3% to -7% on excess layers
ESOP-OWNED FIRMS	+5% to +10%
PRIVATE AND NONPROFIT ENTITIES	Flat



HEALTH CARE PROFESSIONAL LIABILITY

- The Health Care Professional Liability (HPL) market will continue to flatten through early 2015, **with flat to low single-digit decreases or increases at typical renewals. Accounts with good loss experience may occasionally see low double-digit reductions.** HPL pricing is also driven by limits purchased, program structure and attachment points.
- This line remains one of the most stable and profitable P&C lines and **this should continue through 2015, even as the HPL industry combined ratio has crept up closer to 100.**
- Loss frequency remains at historically low levels (with perhaps a slight uptick). Severity is increasing slightly but is actuarially predictable.
- The market is shrinking with fewer buyers and the growth of captives and risk retention groups (RRGs) in recent years.
- One trend that bears watching is the recent case law overturning damage caps in Missouri and Florida (wrongful death claims) and the California ballot initiative (Proposition 46) that may overturn the landmark MICRA laws.
- Due to the long tail of HPL, health care reform has not yet impacted claims. **But changes wrought by the Affordable Care Act will shape malpractice risk and underwriter response,** as many health care organizations manage ACA implementation and clinically integrate their organizations**.**
- Many buyers may need to adjust terms and conditions to address evolving risks such as cyber crime and pay-for-performance, as well as Executive Risks.
- Regulatory risk coverage is available and while the retentions are significant and the pricing can be high, some buyers are purchasing these policies to address a meaningful risk in the era of reform.
- Merger and acquisition activity by hospitals and hospital systems remains very high in 2014 and should continue in 2015. This has translated into fewer buyers, especially in the hospital and physician segments, which historically have generated large amounts of premium. There is some growth in the long-term care, miscellaneous facility, allied health professional and managed care segments.

PRICE PREDICTION

-5% TO +5%

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AEROSPACE

- **We have seen significant and high-profile accidents in 2014.** While these losses do not reflect a deterioration in industry safety, they have impacted some insurers substantially.
- Overall airline market losses are projected to be above the sector's five-year average. Excluding these exceptional losses, however, the industry safety experience remains good.
- **A market divided by loss experience is creating a desire from insurers to increase premiums.**
- **Given abundant capacity, it remains to be seen what level of premium can be achieved in a bid to balance premium and loss levels.**
- Economies of scale will continue to secure better-than-average results for the largest programs.
- The Aerospace sector continues to see consistently soft market conditions.
- Corporate Aviation continues to see competition driving down premium volumes and bringing improvements in coverage.

PRICE PREDICTIONS

AIRLINES	+20% to +30%
AEROSPACE	-10% to flat

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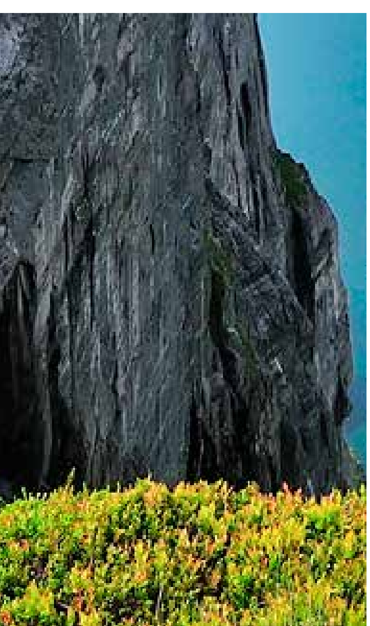

CONSTRUCTION

- Construction activity in the U.S. has continued to rise steadily in 2014. The growth has been encouraging due to the diversity in construction type and geography: residential projects (both homebuilding and multifamily), arenas/stadiums, office buildings, highway/road projects, manufacturing, water, power and alternative power projects.
- **While in many cases incumbent carriers continue to push for rate increases, they are being pressured by competitors on new business.** Workers' Compensation in some states is still seeing increases but these remain modest.
- **Property – The expected rate decreases predicted for CAT-exposed risks in 2014 have materialized and are expected to continue for the remainder of 2014 and into 2015 and reductions for non-CAT risks should be more pronounced.** The trend is due to expanded capacity and the absence (so far) of major CAT events.
- **General Liability** – **We are seeing renewals from flat to +5% in 2014.** Construction defect exposures combined with uncertain legal environments in several states are creating regional rate differences. New York, for example, continues to face major market disruption due to its unique labor laws.
- **Controlled Insurance Programs (CIPs) –** Several carriers are now pursuing CIPs and more owners/contractors are looking at sponsoring such programs. The significant increase in apartment and condominium construction, as well greater interest by owners and contractors building commercial projects, is driving more interest in job-specific solutions. Carrier appetite for General Liability-only wrap-ups is expanding, especially in residential construction. **Rising demand, however, is being met by rising capacity and we expect rate stability in the residential segment into 2015.**
- **Workers' Compensation** – We expect continued rate pressure for the remainder of 2014 but less than what we saw in early 2014. For a few very profitable client cases, flat and even small decreases could be realized.
- **Excess/Umbrella Liability** – We have seen some additional competition in the excess space. While we continue to see markets push for increases, we are seeing flat to +10% on excess/umbrella Liability renewals. Higher underlying limits are often being required by carriers, which can add cost.
- **Auto Liability** – Auto Liability remains stable in the last few years, and we continue to predict rates to be flat or up low single digits for 2014 and beyond.
- **Builders Risk –** The Builders Risk market continues to be very competitive and capacity remains robust. The buyer's market is predicated on the continued absence of major CAT events, risk profile and location and loss history in the case of master Builders Risk programs.
- **Professional Liability** – A competitive marketplace continues due to new capacity that entered the marketplace (both domestic and international). Project-specific PL continues to be in high demand, with capacity and pricing varying significantly by project type, delivery method and PL product. Carriers are cautious about residential work for project-specific coverage and for contractors with large volumes of residential work.

PRICE PREDICTIONS

GENERAL LIABILITY	Flat to +3%
EXCESS LIABILITY	Flat to +10% (less on excess layers)
WORKERS' COMPENSATION	+5% to +10% (higher in some states)
BUILDERS RISK	Flat to +5% (higher in CAT areas)
CONTROLLED INSURANCE PROGRAM (CIP)	Flat (with significant variation by job type)

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ENERGY – DOWNSTREAM

- The market at present is dominated by major market insurers – most of whom have been recording overall combined ratios below 100.
- Downstream underwriters have little choice but to accept macro-economic conditions, including the impact of profitable insurance companies armed with increased capacity.
- **The sector saw some notable losses in 2014, but none to upset the overall softening dynamic.**
- **Rates will continue to decline, and we see little chance of any return to "technical" rating.**
- However, some discipline still remains with regard to:
  - Retention levels
  - Policy wordings
  - Little or no expansion into problem areas (Supply Chain, Cyber Risk)
  - The failure of the most aggressive broker bids

PRICE PREDICTION

CONTINUED MODERATE SOFTENING

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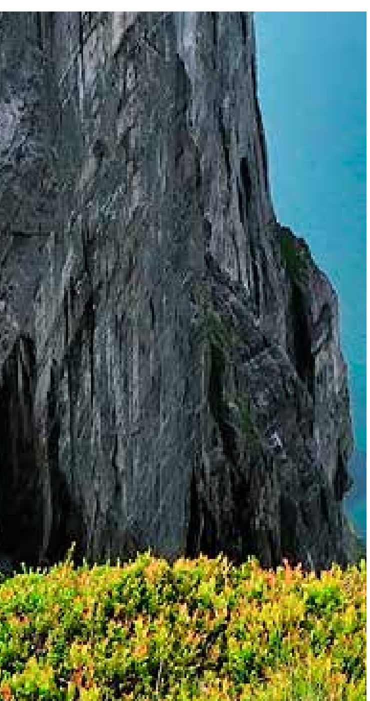
ENERGY – UPSTREAM

- The portfolio is still generally profitable, despite falling rating levels.
- The sector's loss record remains basically benign in comparison to hurricane-affected years (2004, 2005, 2008).
- Recent Gulf of Mexico windstorm profits are easing some insurers' concerns.
- **The offshore construction market is also beginning to soften more rapidly.**
- **The market is not completely soft:**
  - Primary reinsurance remains on the pricey side for these risks
  - Insurers still must justify underwriting decisions to management
  - Retentions are holding steady, as are policy forms
  - Drilling Operator's Extra Expense (OEE) cover is still rated on Authorization for Expenditure (AFE)
- **However, we see no sign of any market floor – nothing materializing that could act as a brake on the softening trend.**
- Buyers at renewal face a decision: stick with trusted insurer partners or move to more competitive markets.



PRICE PREDICTION

ACCELERATED SOFTENING

ENVIRONMENTAL

- The Environmental marketplace has experienced another year of relative stability in the number of carriers, resulting in a continuation of flat to decreasing rates for preferred classes of monoline pollution business, and increases for combined (Environmental + Casualty) policy forms and non-preferred classes of monoline business.
- **Premium increases result from rising client revenues, while decreases result from shortening of term at renewal; but exposure class and claim history remain primary drivers of rate.**
- Increased claims activity associated with site pollution and combined (Environmental + Casualty) forms has resulted in a decreased appetite for certain higher exposure classes of business.
- **The frequency of Environmental claims has continued to rise 20% to 30% each year since 2009.**
- The severity and complex nature of Environmental claims has increased the importance of a holistic coverage approach utilizing Environmental insurance products to address potential gaps in traditional Property and Casualty lines.
- **Highly publicized catastrophic claims have increased regulatory scrutiny on transportation/railroad, mining, energy and pipeline exposures, resulting in the reevaluation of these sectors by underwriters.**
- Clients are considering the value of emergency/crisis response coverages and access to environmental consultant vendor networks in their purchase decisions.
- Carriers are seeking to reduce risk by utilizing their capacity on a shared-risk basis via layered programs whenever possible.
- Carriers continue to cautiously re-approach the Cleanup Cost Cap product – having yet to successfully write any meaningful programs thus far.
- An increase in North American construction activity combined with softening market conditions has increased demand for Contractors Pollution Liability products.
- A noticeable increase in M&A and redevelopment activity has been optimistically but cautiously received by carriers looking to protect themselves from longer-term and moral hazard exposures associated with known conditions and voluntary testing.
- **International regulatory changes in China, Mexico, Canada, South America and the European Union have continued to expand interest in coverage for global Environmental exposures.**
- We anticipate that the market will continue to redefine what is (and isn't) covered by Environmental insurance products as emerging and non-traditional pollution issues are identified.

PRICE PREDICTIONS

CONTRACTORS POLLUTION LIABILITY	-10% to flat
SITE POLLUTION LIABILITY (PLL/EIL) – NEW BUSINESS AND MARKETED RENEWAL	-10% to flat
SITE POLLUTION LIABILITY (PLL/EIL) – RENEWING FROM >5 YEAR PROGRAMS	-25% to flat
SITE POLLUTION LIABILITY (PLL/EIL) – NON-MARKETED RENEWAL	Flat to +10%
COMBINED ENVIRONMENTAL + CASUALTY	+10% to +25%

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KIDNAP AND RANSOM (SCR)

- Rates in the U.S. Special Risks (Kidnap and Ransom) market remain stable, with higher cost for companies with significant exposures in the hot spots mentioned below.
- Buyers with exposures in the U.S. and low-risk overseas locations can expect flat renewals.
- **State fragility throughout the Middle East and North Africa** has and will increase risks to staff in Libya, Egypt's Sinai Peninsula, Yemen, Lebanon, Syria and Iraq. The so-called Islamic State presents a major threat to journalists and aid workers within their Syrian and Iraqi areas of influence. The kidnap and terrorism threat to foreigners from militant group al-Shabab remains high in Somalia and in parts of neighboring Kenya.
- **In Ukraine**, kidnap trends emerging in Donetsk and Luhansk could spread to other parts of the country, particularly if civil unrest and conflict continues despite diplomatic efforts.
- **In Latin America, Mexico continues to register the greatest overall number of kidnap cases.** Abductions in Venezuela also remain high but the vast majority target local middle-class workers or professionals and last less than a day. In both, the mortality rate remains high. More cases of both express and conventional kidnappings are now being reported in the southern cone while kidnapping continues to increase in Central America, particularly Guatemala.
- **In Asia, Islamist and purely criminal abductions are a high threat in Afghanistan and Pakistan.** With the international security force's departure this year, political tensions are likely to further stoke lawlessness in Afghanistan. **Al-Qaeda's recent announcement of its intention to establish itself in South Asia may bring an increase in targeted kidnap risk to foreigners in India, Bangladesh and Mynamar.** Visitors and residents in the Philippines remain exposed to both militant Islamic and criminal abductions.
- **In Sub-Saharan Africa**, the presence of Boko Hara in northeast Nigeria and the consistently high level of kidnap throughout the country make Nigeria increasingly dangerous as the country moves towards elections. The Ebola outbreak in West Africa, if not controlled, could lead to a breakdown in law and order, thus raising the kidnap threat. In the Sahel, there remains a reduced presence of tourists, NGO and aid workers that formerly made up the majority of kidnap victims. Nevertheless the risk from Al-Qaeda in the Islamic Maghreb (AQIM) remains high.

PRICE PREDICTION

FLAT TO +10%

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MARINE

- **The Marine market continues to be very favorable for insurance buyers, driven by huge over-capacity.**
- **Hull & Machinery**
  - The number of entrants to the H&M market keeps rising due to carriers diversifying and Marine being seen as an attractive, predictable class.
  - **The drop in CAT losses in 2013 has turned the Hull market to profitability, which in turn has created further downward pressure on rating.**
- **Cargo**
  - With the leeway to offer premium reductions reduced by falling margins, Cargo insurers have been far more willing to satisfy their client's demands for increased limits, reduced deductibles and broader coverage – with no increase in pricing.
  - **However, competition remains fierce for new business and the right account can still achieve significant premium reductions when remarketed. Renewals are generally flat or with single-digit reductions, although loss-hit accounts are seeing increases.**
- **Other Key Highlights**
  - An increasing number of markets are now writing international rather than just domestic risks.
  - Increased volumes in international trade are relieving some of the pressure on insurers brought on by falling rates.
  - Insurers are pressing to maintain pricing on CAT-exposed accounts.
  - Deductibles are stable, although we are seeing increased deductibles on accounts with adverse records where the insureds are unwilling to pay premium increases.
  - Piracy issues are less of a concern, with fewer additional premiums being charged to ship owners.
  - **Increasing political unrest has highlighted the possibility that Cargo clauses may provide insufficient cover for insurrection, terrorism and political violence.**
  - With reduced pricing required to win new accounts, insurers are more willing to provide extended cover to retain accounts.

PRICE PREDICTIONS

CARGO	-10% to flat
HULL	-10% to flat
MARINE LIABILITY	-10% to flat

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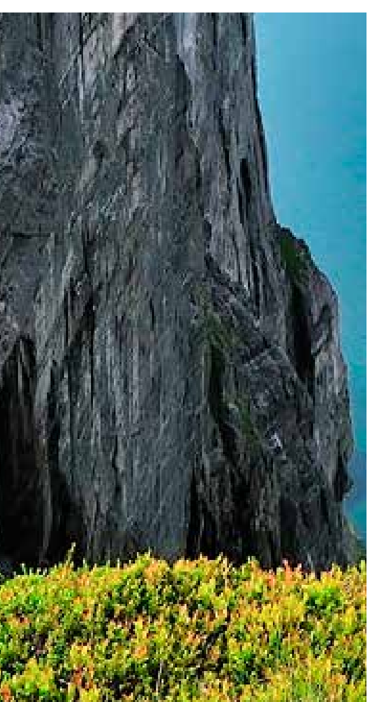

POLITICAL RISK

- Political risks are significant in several locales:
  - **Iraq –** The threat of increased political violence from the growing conflict with the Islamic State of Iraq and Syria (or the Levant), known as both ISIS and ISIL, in addition to the already challenging political environment, has resulted in **most PRI markets ceasing to write new Political Risk policies for Iraq and increasing premiums significantly on existing Iraqi exposures.**
  - **Russia –** The crisis in Ukraine has raised tensions with the West not seen since the demise of the Soviet Union. The situation remains fluid, with the rollout of increased sanctions against Russia and the uncertainty over the effectiveness of diplomatic solutions. Markets are generally reluctant to take on new Russian exposures.
  - **Ukraine –** Ukraine is currently undergoing the most politically turbulent period in its post-independence history. There is a real threat to Ukraine as a unitary state from the Russian-promoted federalization campaign that would drain centralized power from the capital. Ukraine's president believes there can be no military solution to his country's crisis and intends to focus on rebuilding the shattered economy through reforms.
  - **Venezuela –** The economic crisis of the Maduro presidency continues to worsen, with rumors of default on its bonds in October amid Standard & Poor's cut of Venezuela's credit rating to CCC+.
  - **Argentina –** The technical default of June 30 brought on by Argentina's non-payment to bond holders is exacerbating a rise in political and economic tensions this year, as the end of President Christina Fernandez Kirchner's term approaches. Continuing interventions in the economy, including the possibility of further renationalization, will continue to discourage investment in many key sectors.
  - **China** – China's GDP growth is not on pace to meet the annual target of 7.5% for 2014. Of possibly greater concern is the potential for the current real estate bubble to burst. This could produce an economic crisis, as the housing sector accounts for roughly 15% of GDP. Meanwhile, labor activism is an increasing source of unrest. International companies are also concerned by Beijing's recent imposition of tighter legal and administrative controls over the flow of information between local and foreign entities, particularly in state-controlled economic and media sectors.
  - **Ghana –** From January to August, the local currency lost 40% of its value, despite the Bank of Ghana's stabilization efforts. Mass capital flight fuelled this depreciation, which in turn exacerbated significant fiscal and trade deficits. An IMF agreement will likely be required to provide much-needed foreign exchange, essential for shoring up international confidence in Ghana's ability to deal with its economic crisis.
  - **Mexico – The government's strategy on using overwhelming force in conflict areas, along with the arrest or killing of cartel leaders, appears to be paying off, particularly in places like Michoacán.** However, it is unknown if this represents a brief respite or a genuine trend.
  - **Turkey** – Experts express increasing concern that the Syrian conflict could spill over the border in the form of terrorist attacks.

PRICE PREDICTION

FLAT TO +2%

SURETY

- The Surety industry continues to enjoy strong profits and we see the trend continuing into 2015. Through the second quarter of 2014, the Surety & Fidelity Association of America (SFAA) reported a direct loss ratio of 17.2; it is projected that 2014 will be the eighth consecutive year of profitability.
- **The market remains competitive and sureties are aggressively pursuing new business as the construction economy continues its slow recovery. The competitive environment is pushing sureties to focus on middle market contractors and commercial surety.**
- As new surety players continue to enter the marketplace, we expect the rate and underwriting environment to remain very competitive.
- Possible points of contention in contract negotiation surround extended warranties, consequential damages and other onerous conditions that owners are asserting with contractors. Contractor profit margins, meanwhile, remain low, narrowing their margin for error.
- **Consistent with previous economic cycles, the current uptick in construction activity will put pressure on contractors' working capital, which will trickle down to subcontractors.** This will lead to the possibility of more subcontractor defaults, underscoring the need for general contractors to emphasize subcontractor prequalification and to consider requiring Surety bonds from subcontractors or utilizing a subcontractor default insurance product.
- While conventional Surety bonds continue to support billions of dollars in P3 projects, lenders remain focused on having more liquid security than traditional Surety bonds typically offer. Several carriers continue to work towards addressing this demand for liquidity with the rating agencies and lenders but so far we have seen very little traction.

PRICE PREDICTIONS

CONTRACT	-5% to flat
COMMERCIAL	-10% to flat

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TERRORISM

- The renewal of the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), also known as TRIA, before it expires on December 31, 2014 continues to dominate Terrorism insurance renewal strategies.
- Meanwhile, the absence of major Terrorism losses in the West and abundant capacity in the insurance sector are turning the rate environment. **We see rates declining slightly or remaining flat – assuming TRIPRA is extended.**
- The U.S. Senate has voted to extend TRIPRA for seven years with minor changes; the House of Representatives, however, remains divided as to the scope and term of any extension, complicating rating models and portfolio management.
- Terrorism risk continues to prove dynamic and unpredictable, as well-funded terrorist organizations expand their influence and explore new attack tactics and Western targets, including national infrastructure and major metropolitan areas.
- **The stand-alone Terrorism insurance market offers creative and flexible alternatives to TRIPRA-supported programs and can provide more than $3.4B per risk.**
- The use of captives to access TRIPRA indemnities continues to provide access to coverage for catastrophic terrorism events otherwise unavailable in the traditional Property and Casualty marketplace, though this option will be susceptible to changes under TRIPRA.
- Ongoing refinement and increasing sophistication of deterministic models provides important risk management metrics that are valuable to both buyers and sellers of insurance cover.

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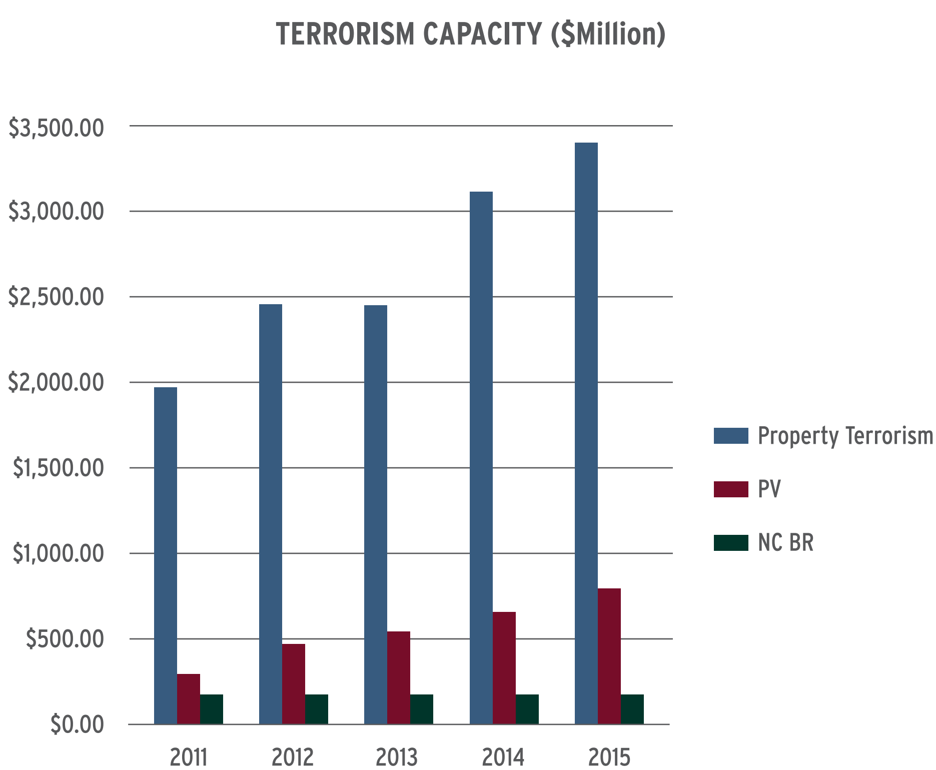
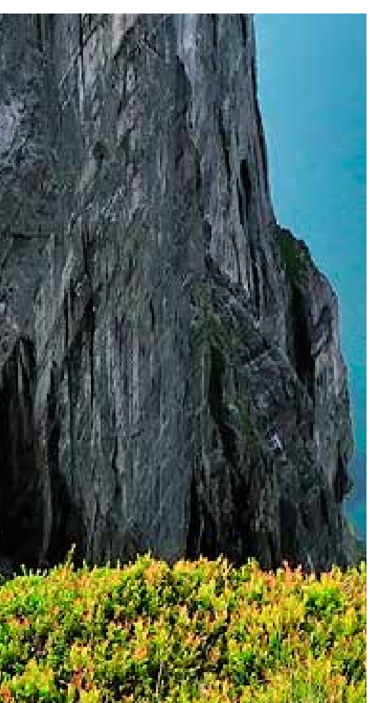
PRICE PREDICTION

-5% TO FLAT (+5% TO +15% IN THE ABSENCE OF TRIPRA RESOLUTION)





TRADE CREDIT

- Trade Credit insurance rates and retention/deductible levels are **leveling off after more than two years of soft market conditions.**
- **Abundant capacity is still available outside of the retail industry, and we expect a buyer's market for the next 12 months.**
- Claims volume and collection actions remain moderate domestically but are more active in Europe (due to financial distress) and Asia (due to cultural issues).
- Payment plan requests are still frequent.
- Despite an impressive record of claim payments associated with the 2007–2008 financial crisis, purchase of credit insurance in the U.S. lags behind other countries.
- **Despite ongoing conflicts in the Middle East and Ukraine the overall global economy remains mostly stable.** However, the cooling of major emerging markets such as China and Brazil continues to cause concern in the credit markets.
- Capacity for Ukraine will not appear as long as the civil conflict continues. The growing sanctions regime against Russia contributes to a strong sense of caution with Russian risk.
- The current premium rate environment offers significant opportunities for small, medium and multinational corporations wishing to transfer the risk of non-payment of receivables.

PRICE PREDICTION

-10% TO FLAT

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