Global Insurance Market Quarterly Briefing

BOARD DISCUSSION

Spotlight on Cyber

Cyber insurance was the only line with consistent, large rate increases, averaging more than 15% in the US.

Average cyber insurance limits purchased pierced the $20-million level for the first time.

TENTH CONSECUTIVE QUARTER OF GLOBAL RATE DECREASES

DECLINES MODERATE IN SOME INTERNATIONAL REGIONS AND PRODUCTS

The third quarter of 2015 experienced commercial insurance rates declining globally in all regions and most lines of business. Renewal rates decreased in all regions in the third quarter, contributing to a 4.8% global composite decline (see Figures 1, 2, and 3). The UK and Asia-Pacific regions posted the largest composite rate decreases, followed by Continental Europe, Latin America, and the US, respectively.

Ample capacity and a low level of catastrophic loss activity accounted for healthy underwriting results and satisfactory combined ratios for insurers.

Among the major coverage lines, property insurance showed the largest rate declines, with decreases averaging more than 5%. Rate decreases for property insurance, on average, occurred across all regions in the third quarter, led by Asia-Pacific, followed by Continental Europe and the US, with Latin America and the UK showing the smallest decreases regionally.

FIGURE 1 Average Renewal Rate Change Ranges by Region and Line of Business Q3 2015
Source: Marsh Global Analytics

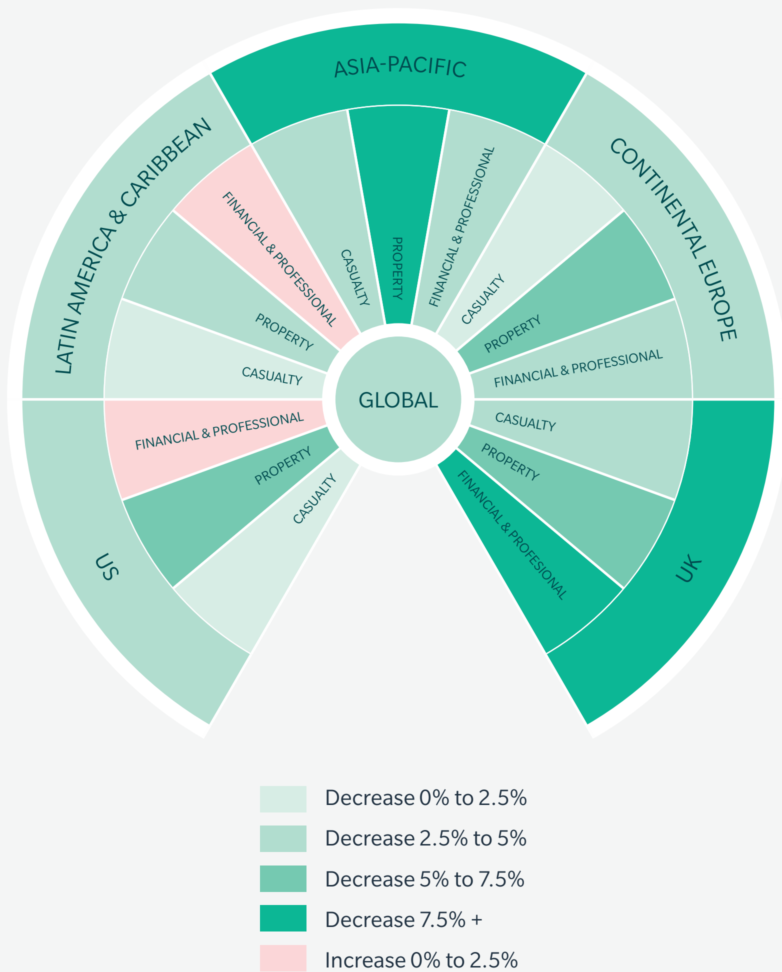


FIGURE 2 Average Composite Renewal Rate Change Ranges By Region
Source: Marsh Global Analytics

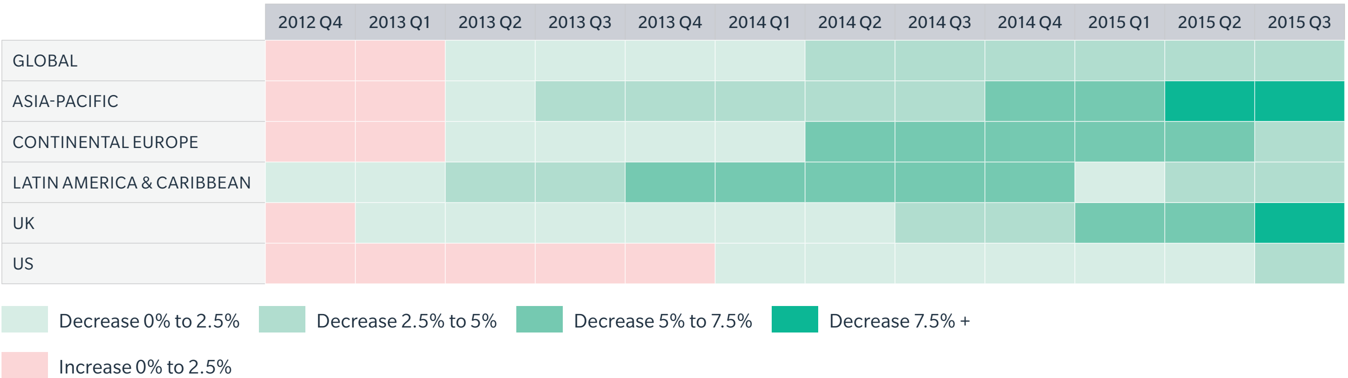
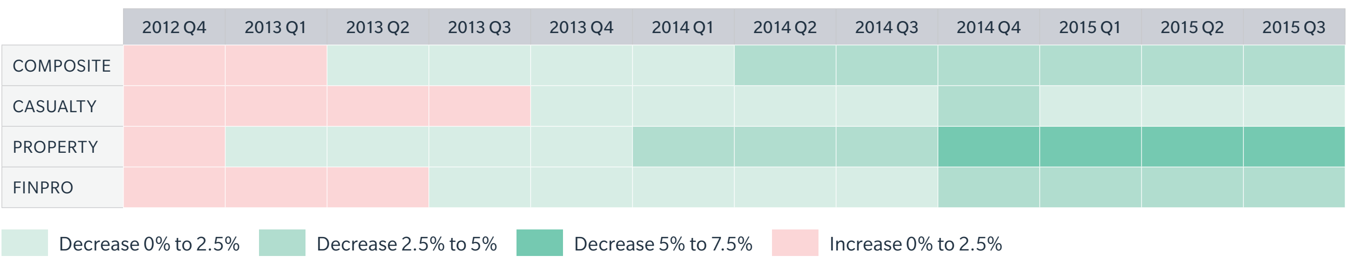


FIGURE 3 Average Renewal Rate Change Ranges By Insurance Line
Source: Marsh Global Analytics



Casualty insurance rates, on average, decreased less than property rates, but still showed average declines consistently from 2% to 4% across all major regions, led by Asia-Pacific and the UK.

Financial and professional lines of business presented mixed rate results during the third quarter. The global composite index for financial products decreased 5%; however, the US and Latin America both posted small increases. This was largely a consequence of cyber insurance, which in the US experienced average rate increases of more than 15% in the third quarter. Financial and professional rates declined steadily in other regions, particularly in the UK.

SPOTLIGHT ON CYBER

Cyber insurance stood out in the third quarter as the only line with consistent, large rate increases, averaging more than 15% in the US.

Concerns around the possibility of harmful cyber-attacks grew for most companies, as the nature of potential threats continued to evolve and the frequency and severity of meaningful attacks increased. The average cyber insurance limit purchased grew in the third quarter, piercing the US$20-million level for the first time, according to data gathered by Marsh. Limits purchased were up more than 10%, on average, in the third quarter compared to the same period last year.

At the same time that overall insurance prices are increasing, all stakeholders — including insurers, exposed organizations, regulators, and customers — are working to better understand the exposure to cyber-related losses. Cyber losses have traditionally been viewed as those emanating from an outside attack against a company to steal personally identifiable information (PII), such as credit card numbers. For example, some of the best-known data breaches from cyber-attacks against a company's internal defenses have stolen the PII of millions of customers in one fell swoop. These ongoing external threats come from a diverse array of actors.

In addition to external threats aimed at PII, companies are now concerned with internal threats, including those seeking to extort money, steal intellectual property, cause embarrassment, or that have other goals. Understanding the motivation of attackers and the nature of access to systems and data is critical as companies pursue better defenses against possible threats emanating from inside.

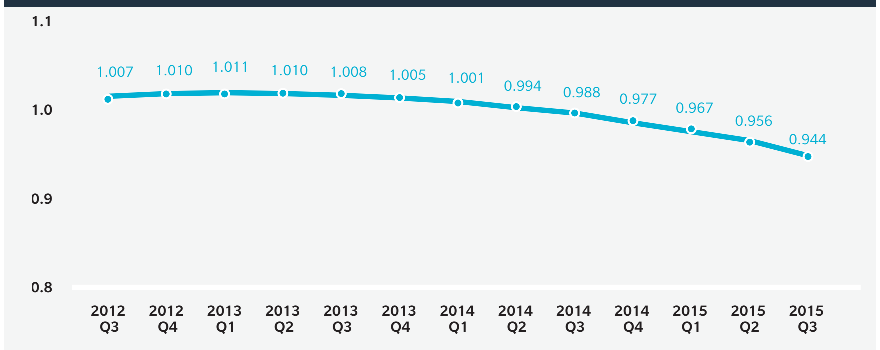
"Cyber is a unique exposure — it continues to evolve and it is clearly here to stay," said Paul Denny, Marsh's Northeast US FINPRO leader and US E&O leader. "Organizations that understand the nature of potential threats and their exposure to cyber attacks will be best suited to develop a comprehensive risk management strategy to counter them."

Given the clear difference in rate levels between cyber and other product lines, insurance rate changes are reflecting a certain level of segmentation today. It will be interesting to see to what extent increasing segmentation is possible with the benefit of more robust data sources, which can include company-specific information concerning both the motivation of potential attackers as well as a company's ability to defend itself against attack.

COMPONENTS OF THE PRICING ENVIRONMENT

The Marsh Global Insurance Index was 0.944 in the third quarter of 2015, down from 0.956 in the previous quarter (see Figure 4). Our index methodology captures a rolling four-quarter view of rate movements. Each quarterly change shows the rate change for the current quarter over the prior year for the same period. By rolling the last four quarters together, we are able to capture the effective rate level for a full year and provide a quarter-to-quarter view of changes in the marketplace.

FIGURE 4 Marsh Global Insurance Index
Source: Marsh Global Analytics



In the third quarter, contributors to market conditions included several underlying economic and market factors, which can be organized broadly within a supply-and-demand framework. We continue to describe this market framework through:

- Capital committed to the market.
- Insurer pricing methodologies. (Insurers are becoming more sophisticated with some of their underwriting tools and techniques, such as predictive modeling, and have been able to refine prices based on a better understanding of true exposure and loss potential.)
- Global-impact losses: These are larger events, such as natural catastrophes, that have the potential to drive the market environment beyond their immediate and direct economic impact.

CAPITAL INFLOWS AND OUTFLOWS

Market surplus continues to be robust based on historical levels, and is one of the largest determinants of rate activity. Large mergers among insurers/reinsurers have occurred recently (see Figure 5), while alternative capital continues to fuel transactions. One of the most recent examples is the Amtrak catastrophe bond valued at $275 million.

Dean Klisura, Marsh's head of global placement, noted: "There's an increased level of M&A, which signifies the type of competitive marketplace we've seen for the last several quarters. It's a global phenomenon, with companies looking for ways to grow beyond their regional boundaries."

FIGURE 5 P&C and Reinsurance Notable Deals YTD 2015
Source: Best's Journal, September 28, 2015

ANNOUNCE DATE	TARGET NAME	ACQUIRER NAME	TOTAL VALUE (US$ MILLIONS)
7/1/2015	THE CHUBB CORP	ACE LTD	$28,300
6/10/2015	HCC INSURANCE HOLDINGS INC	TOKIO MARINE HOLDINGS INC	$7,500
5/1/2015	IRONSHORE INC	FOSUN INTERNATIONAL LTD	$1,840
3/31/2015	MONTPELIER RE HOLDINGS LTD	ENDURANCE SPECIALTY HOLDINGS LTD	$1,742
2/17/2015	BRIT PLC	FAIRFAX FINANCIAL HOLDINGS LTD	$1,878
1/25/2015	PARTNERRE LTD	EXOR SPA	$5,911

The October 12 *AM Best* report showed that surplus levels grew slightly during the first half of 2015, rising close to $700 billion for the US property and casualty (P&C) industry over the last six months. With interest rates continuing at historically low levels, and overall underwriting performance, insurers are looking for returns from writing more business. Relatively modest levels of natural catastrophe losses have helped this dynamic.

With strong capital and surplus levels, the market remains competitive, with expected line of business and regional variations continuing.

INSURER PRICING METHODOLOGIES

Looking over the last several quarters, there continued to be significant variation in pricing across lines and by region. This quarter, as noted in our Spotlight (see page 2), cyber insurance was a clear outlier with rates increasing more than 15% against overall rate levels, which showed a decrease of 5%. This type of differentiation in pricing signifies the market's need to segment its book of business based on views of the underlying exposure to risk and potential losses.

Additional sources of data, predictive modeling, and better ways to operationalize new pricing approaches are contributing to carriers' ability to more accurately price risks. This helps explain the market's strong capital position in light of the continued decreases in rate levels.

LACK OF GLOBAL-IMPACT LOSSES

The relative lack of large, high-impact natural catastrophes continued in the third quarter. The recent Pacific hurricane, Patricia, which slammed into the Mexico coast, was the strongest hurricane ever recorded in the Western Hemisphere; however, initial reports indicated that insured loss levels are unlikely to be high.

"Without the near-term catalyst that larger wind or earthquake events have historically provided, the property rate environment continues to be competitive with most accounts typically seeing rate decreases at renewal," said Nick Holmes, Marsh's head of placement for Continental Europe.