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EXECUTIVE SUMMARY

Following are some key takeaways from Marsh's US Insurance Market Report 2015.

MAJOR COVERAGE LINES

Property

► The US commercial property insurance market softened in 2014, and is set to continue doing so into 2015, barring an unforeseen change in circumstances. Insureds with good loss histories at the end of 2014 typically saw favorable rates, terms, and conditions.

► Entering 2015, the property insurance market was significantly oversupplied with capacity, including from alternative capital flowing into the reinsurance market from non-traditional sources such as hedge funds, pension funds, and other institutional investors. Such a scenario generally fosters competition among insurers and favorable rates for insureds.

► Contingent business interruption (CBI) coverage continues to be a challenge for many organizations, particularly those with large supply chain networks. Gathering accurate information from second- and third-tier suppliers remains challenging for the insurance industry.

Casualty

► Pricing in the US casualty insurance market appears poised to soften in 2015. This follows a stable 2014 in which rates generally edged upward, but the pace of increase slowed.

► In 2015, general liability (GL) insureds will continue to face cyber risk challenges stemming from a 2014 decision by the Insurance Services Office. ISO contends that damages related to data breaches and certain data-related liabilities are not intended to be covered under GL policies, and should be addressed through dedicated cyber insurance policies.

► Although 2014 is projected to be the first profitable year for workers’ compensation since 2006, insurers continue to press for rate increases. Entering 2015, market conditions vary significantly for individual insureds; those with good loss histories and in good classes of businesses generally are seeing favorable results, while those with adverse loss histories and other negative factors face a difficult marketplace.

► Strong competition generally prevented large rate changes for umbrella and excess liability; most insureds renewed in the fourth quarter with rate decreases. Insurers, however, are exhibiting greater discipline and requiring more detailed underwriting submissions.

Financial and Professional

► Cyber remains one of the fastest growing sectors in the insurance market, as evidenced by continued growth in premium and policy count, as well as the steady influx of new capacity. Continued growth in supply and demand for cyber insurance, coupled with unexpected loss activity, led to significant volatility in pricing during 2014, which is likely to continue in 2015.

► Directors and officers (D&O) liability insurance capacity entering 2015 was robust, with neither significant new capacity entering nor long-term capacity exiting the global market. Average pricing for public companies decreased in 2014 from the highs seen at the end of 2012. Insurers consistently pushed for higher rates on primary layers, which was offset by competition and reductions in excess layers.

► The much-anticipated 2015 release of the revised Fair Labor Standards Act (FLSA) regulations is likely to increase wage and hour claim filings, a key issue to watch in employment practices liability.

Terrorism Insurance

► Congress adjourned in December 2014 without extending the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), a move that created some turmoil in several coverage areas, notably property and casualty.

► The 114th Congress made TRIPRA a priority and extending it, with some modifications, was the first piece of legislation passed in 2015. In the end, terrorism insurance and capacity were not expected to be significantly affected entering 2015.
SPECIALTY COVERAGE LINES

Aviation
► Airline insurance buyers experienced a volatile 2014, which started with average renewal decreases typically in the 15% to 25% range. Several air disasters, however, caused insurance rates to rise, and most third and fourth quarter buyers saw typical rate and premium increases of up to 25%; only to see rates in the fourth quarter decrease up to 15% for a few select airlines. It is unlikely that 2015 will have such volatility, barring unforeseen events.

Captives
► Captive owners should be vigilant about evolving regulations in domiciles foreign and domestic. For example, a number of regulatory inquiries by the Internal Revenue Service and international insurance supervisors in 2014 challenged some captive arrangements, a trend that is likely to continue as the captive market grows.

► Cyber risk has been gaining traction in captive arrangements, a trend that is expected to continue in 2015.

Employee Benefits
► Employers predict that in 2015 their health benefit cost per employee will rise by 4.6% on average. This increase reflects cost-cutting changes without which costs would have risen by an average of 7.1%.

► Employers of all sizes added consumer directed health plans in 2014.

Energy
► Overall energy insurance market capacity has increased since early 2014, generally putting downward pressure on pricing. Much of the capital that has recently been invested in the energy insurance market may be there for the long term, meaning soft market conditions could persist, barring unforeseen events.

► The energy industry remains at high risk for cyber-attacks seeking to disrupt critical infrastructure. Emerging cyber insurance solutions designed for the energy industry are being written to specifically address this risk.

► The drop in energy prices is already having an effect on many companies, ranging from decisions to postpone construction and development to decreasing workforces.

Environmental
► Demand for multinational environmental insurance programs is growing as global environmental regulation presents a hurdle for many businesses.

► In 2014, ample capacity and increased merger and acquisition activity were key drivers of the environmental insurance market. Rates remained generally flat, with some programs seeing a marginal decrease at renewal. However, for certain high risk, catastrophic exposures, insurers began increasing rates.

Marine
► Competition across marine lines led to rate decreases in 2014 for most insurers with favorable loss profiles. However, insurers with challenging loss experience saw moderate rate increases.

► Marine cargo and stock throughput insurers have become more focused on their potential exposures to catastrophic events.

► Marine insurers are requiring more underwriting data and details on transit routes, loading and discharge ports, and consolidation and deconsolidation points. Stock throughput insurers are also requiring more underwriting details on stock and inventory locations.

Political Risk
► With political risk insurance capacity at record levels, buyers in 2014 experienced generally favorable market conditions, which are expected to extend into 2015, barring unforeseen events.

► Despite overall favorable conditions, coverage remains expensive or difficult to secure in some countries, including Argentina, Libya, Mali, Myanmar, Pakistan, Russia, Sudan, South Sudan, Syria, Ukraine, and Venezuela.

Surety
► In 2014, the surety market remained stable, producing the ninth consecutive year of underwriting profitability. The surety industry outlook for 2015 is generally positive.

► Market capacity continued to expand in 2014, with new entrants to the surety line and many underwriters willing to take larger exposures.

Trade Credit
► The market for trade credit insurance was generally favorable in 2014, and is expected to remain that way into 2015, barring unforeseen events.

► Bankruptcies in the US retail sector caused some trade credit insurers to express concerns and take steps to reduce their exposure to that industry; however, there does not appear to be an effect on the overall market.

Note: For specific insurance market and risk trends by industry, see the “Industry Specialties” section of this report.
Clients further explored creative solutions to address specific portfolio concerns, including aggregate solutions, stop-loss covers, global solutions, and segment-specific covers. Some key points include:

- Premium base/exposure increased by approximately 5% as prior rate increases were realized, along with economic growth.
- Favorable market conditions continued to make purchases cost-effective, stabilizing retentions and moderately increasing limits.
- In addition to CAT price decreases, per-risk pricing decreased on average 5% to 10%, although loss-impacted programs generally experienced slightly decreased to slightly increased pricing.
- Instances where there were significant exposure increases saw some larger risk adjusted decreases.
- Pro rata placements generally were able to achieve 1 to 3 point increases in ceding commissions or equivalent improvements in overall economics.
- There was a noticeable increase in multi-year placements.

**US Property**

Virtually all segments of reinsurance pricing globally were impacted by the continued oversupply of capacity (see Figure 1). Pricing for US property catastrophe coverage decreased by 7% to 14%, on average. Convergence capital was fairly stable for the January 1 placements, but grew overall through year-end 2014. Some markets also increased focus on broadening line-of-business and product offerings. As traditional reinsurers continued to employ client-focused strategies to compete with the capital markets, many renewals achieved broader coverage that included extended hours clauses, expanded terrorism coverage, enhanced reinstatement terms, removal of exclusions, and the addition of non-modeled lines.
US Casualty

In the US, insurers focused more on expansion, whether through new lines of business or new geographic regions. As carriers continued to use reinsurance and other risk transfer options to support these strategies, traditional reinsurers responded by providing solutions to match evolving client needs.

As 2015 began, the expectation for the broader US casualty reinsurance market was that the dramatic rate reductions that occurred throughout 2014 would moderate. Ample capacity remained across nearly all casualty lines of business, and reinsurers continued to seek new opportunities for growth.

Some key points regarding auto liability, general liability, casualty, excess/umbrella, directors and officers (D&O), and errors and omissions (E&O) include:

► Rates and terms generally continued to soften on quota share and excess of loss programs.

► An increased number of markets were diversifying into casualty lines and professional lines, increasing overall capacity.

► Ceding commissions continued to increase, but not nearly to the degree they did at January 1, 2014 renewals.

Some key points for workers’ compensation include:

► US premium for workers’ compensation has grown steadily for the last three years. The early stage of premium growth originated from increased rates and a decrease in competition. Increased payrolls from an improving economy have contributed to the most recent growth. Primary results for workers’ compensation have improved steadily and insureds are actively pursuing growth strategies.

► There was a continuing trend to improve terms and conditions and still achieve year-on-year program cost savings. An increasing number of clients used projected 2015 reinsurance program savings to purchase additional single claimant/working layer limits and increase overall CAT limits for 2015.

► Rates on line for catastrophe programs have fallen to a level where some reinsurers are reducing authorizations or electing to retire from programs. Remaining reinsurance market capacity is eager to take the place of retiring capacity and overall reinsurance capacity is still ample for programs in the market, but has declined slightly in total at current pricing levels.

Marketing Dynamics/Drivers of Renewals

CAPITAL

The continued influx of new capital into the (re)insurance industry constitutes the largest change to the sector’s capital structure in recent memory and acts as a catalyst for further innovation. Over the past 24 months, approximately $20 billion of new capital has entered the market through investments in insurance-linked securities (ILS) funds, sidecars, hedge fund-backed reinsurance companies, and collateralized reinsurance vehicles.

Guy Carpenter completed the estimate of dedicated reinsurance sector capital again this year in conjunction with A.M. Best for year-end 2013. Our estimate is not a simple aggregation of the capital of all companies that write reinsurance since some of that capital is allocated to the insurance business or other outside interests. A.M. Best and Guy Carpenter have estimated the amount of capital dedicated to writing reinsurance by reviewing A.M. Best’s proprietary capital model (BCAR) results as well as line of business allocations. At year-end 2014, Guy Carpenter’s preliminary estimate indicated marginal growth in the traditional sector capital as strong earnings again sustained share buybacks and dividends as reinsurers sought to maintain, but not expand, their capital position. Meanwhile, convergence capital continued to pour into the industry in 2014 through CAT bond issuance, collateralized reinsurance vehicles, and sidecars. Guy Carpenter’s current estimate of convergence capital including CAT bonds is $60 billion, up approximately $12 billion from the prior year.

Guy Carpenter estimates global property CAT limit exceeds $300 billion (see Figure 2) with alternative capital in the form of CAT bonds, sidecars, collateralized reinsurance, and industry loss warranties increasing from 15% last year to an estimated 18%. This is more than double the 8% of 2008.

Note: The information in this chapter is excerpted from Shaping the Future: Positive Results, Excess Capital, and Diversification, the annual reinsurance renewal report from Guy Carpenter, one of the Marsh & McLennan Companies.
Utilization of capital markets capacity saw the market surpass the impressive growth trends seen in 2013. Capital markets investors continued to be drawn to (re)insurance primarily due to the advantages it offers as a natural, noncorrelating asset class. In addition, the absence of attractive risk-reward opportunities in more traditional fixed income markets continued to drive investors to participate in the ILS market. Capacity outstanding and the size of overall global property CAT limits continued to expand for all forms of capacity. While the contribution from industry loss warranties decreased through 2014 as price decreases made indemnity protections more attractive, this was more than offset by growth in collateralized reinsurance, sidecars, and CAT bonds.

**CAT BONDS**

As of December 24, 2014, Rule 144A CAT bonds set a record for year-to-date issuance at just over $8 billion. Private CAT bonds set a record for year-to-date issuance of $561 million, while the risk capital outstanding stood at $22.9 billion. The CAT bond market continued to attract new investors interested in the diversifying effect of insurance risk on their overall portfolio variance. Traditional asset managers continued to allocate capital to dedicated ILS funds, in addition to asset managers participating directly in transactions, making the overall investor pool large enough to provide liquidity and capacity support to more than $22 billion of outstanding 144A CAT bonds and private transactions, such as Reg D/S CAT bonds, sidecars, collateralized quota shares, and collateralized reinsurance vehicles.

The institutional investor base has broadened its capital sourcing to include a retail component (both US and European) for the same diversification benefit that the institutional funds have identified. This broader base supported both alpha and beta investment strategies in insurance risk. The impact of convergence capital on reinsurance program cost and structure has been substantial in the US and will continue to prompt evolution in the industry as reinsurers leverage new sources of capital to create additional operational efficiencies and more cost-effective solutions.

The use of capital markets-based risk transfer capacity by public entities, insurers of last resort, and compulsory catastrophe pools and disaster facilities continued to expand. This type of capacity provides cost savings for public entities by helping them build surplus, reduce public debt, and limit the risk that natural perils can pose to the state’s balance sheet.

**Loss Activity**

Overall benign loss activity continued in 2014. Global significant insured losses reached approximately $30 billion compared to $40 billion in 2013, and well below the $51 billion in 2012 and $101.5 billion in 2011. Winter storms in the US and Japan were the major natural catastrophes of the first quarter of 2014, while more severe weather in the US and a European windstorm contributed to the bulk of the losses in the second quarter. An earthquake in California’s wine region and a hurricane in Mexico marked the third quarter’s natural disasters. In the fourth quarter Hurricane Gonzalo inflicted damage in Bermuda, while a cyclone struck India. Among man-made disasters, the aviation and aerospace sector was marked by several high-profile, tragic losses. Despite the losses, abundant capacity dampened upward re-pricing in the sector.

Note: The information in this chapter is excerpted from *Shaping the Future: Positive Results, Excess Capital, and Diversification*, the annual reinsurance renewal report from Guy Carpenter, one of the Marsh & McLennan Companies.

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Through the first three quarters of 2014 (the latest data available at this writing), the US property/casualty (P/C) industry’s underwriting performance remained positive, although it lagged behind prior year results, which had benefited from lower catastrophe losses and other developments. The industry had accumulated significant catastrophe and other weather-related losses in the first nine months of 2014, though not as high as in 2011 or 2012. The industry has produced seven consecutive quarters of profitable underwriting results; however, weather volatility and the investment environment remain challenges. Overall, most insurers entered 2015 financially strong, with strengthening of income statements likely to remain a top priority (see Figure 1).

Insurers’ profitability continued to face pressure in 2014 given the pace of economic recovery, low interest rates, and an expected reduction in reserve releases. Competition among insurers is expected to remain intense in 2015 as they are pressured to generate returns that meet their cost of capital and improve market share. With an abundance of capacity, further rate flattening is likely as the year progresses and market competition picks up. Nonetheless, P/C insurers can be expected to focus on fundamentals: protecting their balance sheets through such measures as pricing adequacy, underwriting discipline, capital planning, and preparing for catastrophe (CAT) events.

The industry’s financial performance through the first nine months of 2014 was impacted by increased catastrophe activity and reduced support from reserve releases, which offset the effect of moderate rate increases. CAT-related losses totaled $17.5 billion through the first nine months of 2014, about a 25% increase over the same period in 2013 and contributing 0.8 points to the industry’s combined ratio. In addition, the industry reported nearly 31% less favorable development of prior years’ losses through September 30, 2014.

According to A.M. Best, the US P/C industry posted a combined ratio of 97.9 through September 30, 2014, down 1.7 points from prior year. Despite lower levels of underwriting and investment income, the industry continued to post profitable net results; however, the lower levels had a negative impact on the industry’s return on equity (ROE). The industry’s net income, while still favorable, decreased 22.3% from the prior year, same period. While net investment income continued to fall, the rate of decline slowed.

**Investment income**: Insurers’ investment performance remained challenging in 2014. Insurers’ investment portfolios generally consist of high-quality fixed income securities with relatively short durations, and with high allocations to corporate, municipal, and US government and/or agency backed bonds. The decrease in investment income reflects, for the most part, the reinvestment of these maturing...
bonds at lower prevailing interest rates than previous investments paid. The industry is beginning to see moderate growth in higher yielding asset classes offsetting impact of low interest rates.

Despite some companies’ choice to allocate a greater portion of their portfolios to higher-yielding asset classes and lower-rated bonds, the US P/C industry’s comprehensive portfolio remains strong. The persistent low interest rate environment remains at the forefront of insurers’ concerns. While bond yields increased over the course of 2013, they declined since the beginning of 2014. On the plus side, because investment income remains a major component of profitability for insurers, the constraints that low interest rates place on investment income should continue to promote underwriting discipline.

Reserves: Insurer results are likely to be affected in 2015 and beyond by the continued decline in the pace of reserve releases. Although reserve releases continue to support earnings to some degree, reserve redundancies are gradually shrinking, and the absence of considerable redundancies should further influence pricing discipline.

Entering 2015, claims inflation was low; reserve releases are generally based on new estimates of the cost of claims occurring in past accident years. The potential for unexpected claims inflation is a longer term challenge for insurers as the margin for error to absorb reserving shortfalls has narrowed. With reserve releases gradually weakening, the industry’s ability to boost 2015 underwriting profitability through prior year redundancies should temper.

Capital: The US P/C industry remains extremely well capitalized. Policyholders’ surplus through the first three quarters of 2014 reached record levels despite high catastrophe losses in recent years and in the first half of 2014. Primary drivers of the increase were higher realized and unrealized gains on investments offset by lower earnings, shareholder dividends, and share buybacks.

The industry continued to prove its resilience by rapidly and fully recouping its losses to surplus in the wake of events such as the 2008 financial crisis and years with high catastrophe losses such as 2011 and 2012. The industry entered 2015 with sufficient capacity to endure such adversity. Share buybacks remained on insurers’ agendas in addition to shareholder dividend payments due to robust capital levels. A reduction in share repurchases and level dividends over the longer term is likely as profitability is challenged, lower investment returns persist, and more modest reserve releases impact earnings.

Premiums: Net premiums written continued to grow at a steady pace, and were up 4.6% through the first nine months of 2014, according to A.M. Best. Growth in the third quarter reflected higher retention rates, which are typically a primary driver of premium increases in addition to a rise in insurable exposures resulting from an improved economy. Most US P/C insurers had reported continued premium rate increases across all business lines at the end of 2013; however, the magnitude of these increases was receding in certain classes, such as property insurance.

Pricing from an insurer’s perspective in the US P/C market has improved during the past two years, however, price increases were abating entering 2015; a Council of Insurance Agents and Brokers (CIAB) survey showed signs of rate stabilization in the commercial P/C market in the third quarter of 2014. Price increases in recent years were primarily driven by earnings shortfalls as opposed to capital necessity. Generally, liability lines have fared better than property in terms of pricing. Casualty lines should see further improvement after reserve releases give way to adverse development. With an abundance of capital heading into 2015, rate increases are likely to recede and give way to heightened competition as underwriters seek new business to meet their goals.

Challenges: The US P/C industry remains strong financially, although challenges remain. Through the first nine months of 2014 — despite posting meaningful CAT and other losses — the industry’s combined ratio was below 100.0 and policyholders’ surplus again reached record levels. These results combined with displays of resiliency in recent years should not be taken for granted. Insurers are likely to continue to focus on underwriting discipline and profitability, which will be crucial to maintain financial strength as investment returns and reserve releases are not expected to support earnings to the level they had in the past.

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<th>COVERAGE</th>
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<th>RATE CHANGE Q4 2014</th>
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</tr>
</thead>
<tbody>
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<td>PROPERTY</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

The US commercial property insurance market softened in 2014, and is set to continue doing so into 2015, barring an unforeseen change in circumstances, such as significant catastrophe losses. Many buyers in the fourth quarter of 2014 experienced rate decreases and favorable underwriting terms and conditions. Along with an influx of alternative capital into the insurance and reinsurance arenas, limited catastrophe (CAT) losses fueled the downward trend. Entering 2015, the property insurance market is significantly oversupplied with capacity as insurers fight for business. The 2014 wind season was less active and came on the heels of 2013’s $31 billion in insured losses from natural catastrophes, well below the 10-year average of $56 billion.

Non-CAT-exposed organizations generally can expect strong competition for their property insurance programs in 2015, with favorable terms and conditions and price decreases typically averaging between 5% to 15%, depending on an insured’s specifics. CAT-exposed organizations also can generally expect rate decreases in the 10% to 15% range, depending on their risk profile and concentration in catastrophe-prone areas. Insurers will continue to scrutinize coverage terms and conditions around such areas as flood, storm surge, and contingent business interruption.

Although large CAT-exposed schedules such as energy risks and terrorism aggregation risks in major US cities may be difficult to place, insurers generally have appetite for all types of risk. However, insureds with significant loss histories and unprotected risks may have a slightly less favorable experience with insurers. More moderate rate decreases are achievable for certain industry segments such as semiconductor, multifamily housing, and/or clients within tornado alley.

CAPACITY

Although few new insurers entered the property market in 2014, carriers overall increased underwriting capacity and ultimately grew their business. Catastrophe capacity for earthquake and named windstorm increased significantly over the past 12 months. Many insurers looked to expand their capacity at pricing that is attractive enough to dislodge competitors, resulting in the significant oversubscription of many property insurance renewal placements. As a result, incumbent insurers are being non-renewed or cut back as insureds strive to take advantage of additional capacity offered at lower prices.

Organizations are also exploring alternative risk management solutions. To lock in low rates, some insureds sought to secure multiyear policies, to which insurers have become more amenable. Such policies are often offered at discounted rates with attractively priced aggregate coverage reinstatements. Several insurers have actively pursued such contracts, hoping to lock in premium for several years.

ALTERNATIVE CAPITAL

Capital continues to flow into the reinsurance market from non-traditional sources such as hedge funds, pension funds, and other institutional investors. In excess of $50 billion of new capital entered the reinsurance market in the last 24 months, including traditional and alternative facilities such as CAT bonds, sidecars, and collateralized reinsurance. This additional capital flowing into the property market has driven down the cost of traditional reinsurance, which in turn has led to lower premium rates for insureds. Increased alternative capital and more aggressive stances from insurers have pressured reinsurers to decrease...
CAT models are highly sensitive to uncertainty driven by poor or missing data. When data quality is addressed, it is possible to produce better quantification and qualification of the risk being considered, which can result in significant returns in premium savings. Organizations should work with their insurance advisors to validate modeling data that increases accuracy, decreases uncertainty, and better informs underwriters.

**Cyber Risks**

Business interruption losses stemming from cyber-attacks are an increasing concern for many organizations. Data breaches, hacking attacks, technology outages, and software failures resulting in supply chain and operational disruptions can cause significant loss of income, increase operating expenses, and damage an organization’s reputation. Property policies typically limit coverage to damage to and/or loss of use of tangible property resulting from a physical peril. Several insurers go further, expressly excluding coverage for any damage to data. Cyber policies can provide limited coverage absent physical damage for business interruption, extra expense, and contingent business interruption. Cyber insurance, however, is just one part of a well-planned and effective risk management program that also includes policies and protocols to prevent and mitigate technology risks.

**Communicable Diseases and Pandemics**

The recent outbreak of the Ebola virus compelled many organizations to review and revise their disaster and crisis management plans related to communicable diseases and pandemics.

Generally, each insured’s property policy should be reviewed individually in this area. Very few policies include time element coverage for “infectious disease outbreaks/notifiable disease,” typically under clauses for communicable disease. Absent such language, coverage is unlikely since property contracts generally require physical loss or damage triggers by an insured peril either to the insured’s property or to the property that precludes ingress/egress to the insured’s property, including civil authority extensions. Coverage may be available through endorsements adding notifiable diseases, communicable disease, or outbreak provisions/extensions, but these will be limited in scope and will provide small sublimits.

**Contingent Business Interruption**

Contingent business interruption (CBI) continues to challenge organizations, particularly those with large supply chain networks. CBI coverage rates are ultimately determined from underwriting information from suppliers, which can be difficult for companies to obtain. The scope of CBI coverage can vary from one policy to the next; for example, cyber policies provide very limited CBI coverage. But even under broad coverage forms some causes of loss to suppliers and customers may not be covered. Organizations that work with underwriters and brokers to best understand and quantify their supply chain risks often fare better in terms of coverage and price.

**PROPERTY TERRORISM RISK**

The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), created as a response to the attacks of September 11, 2001, has been an important consideration in property programs. Most industry observers were surprised that Congress allowed TRIPRA to expire at the end of 2014, although it acted quickly on the matter upon reconvening in January 2015. For details, please see the Terrorism Risk section of this report.
Casualty

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

Market Commentary

The US casualty insurance market remained stable in 2014, with rates generally flat to low single-digit increases in the fourth quarter. Although rates continued to edge upward, the pace of increase has slowed, and the casualty insurance market appears poised to soften in 2015, barring unforeseen changes.

Insurers have historically accepted a certain level of unprofitability in underwriting during periods of strong investment income. But with interest rates low over the last several years, insurers have not generated significant investment income for some time. This has led to greater underwriting scrutiny — with a focus on exposures, loss experience, and coverage grants — as insurers sought to return to profitability.

As results have improved, insurers are now generally focused on securing nominal average rate increases across their renewal books of business and profitable growth through targeting favorable areas with good loss experience. For most insureds, this translates into an increasingly competitive marketplace regarding pricing and terms. Insurers typically priced new business more aggressively, and tried to secure rate increases with renewal business. Some insurers pre-negotiated renewals with clients to avoid marketing, while two-year rate deals were available (with rates in the second year often flat to up 5%).

GENERAL LIABILITY

Guaranteed cost general liability (GL) rates came in generally flat to low single-digit increases in the fourth quarter of 2014. For loss-sensitive clients, GL rates were down 5% on average. The market was stable for most companies, with more positive outcomes for those with favorable loss histories and appropriate retention levels.

PERCENT OF GENERAL LIABILITY CLIENTS WITH RATE CHANGES

Source: Marsh Global Analytics
Numbers may not add up to 100% because of rounding.
AUTOMOBILE LIABILITY

Guaranteed cost automobile liability rates were generally flat in the fourth quarter of 2014; rates increased on average less than 1%. For insureds with loss-sensitive programs, rates were down an average of 2%; however, such results can vary significantly depending on the class of business. While claims severity has long been an issue for the segment, insurers are now concerned about the increasing frequency of auto liability claims. Reduced competition for insureds with adverse experience or with more difficult risks — such as trucking fleets — could result in larger rate increases. Insurers may also hold the line on slight rate increases being sought for insureds with more positive loss profiles.

UMBRELLA AND EXCESS LIABILITY

With other significant insurance segments — such as property and directors and officers liability — remaining soft, some insurers sought to expand their business in umbrella and excess liability. Capacity from the US, London, and Bermuda markets increased in 2014, bolstering competition and generally keeping rates in check. On average, rates increased less than 3% in the fourth quarter, with the majority of clients renewing with decreases.

RISK TRENDS

Cyber Exclusions in General Liability

In May 2014, the Insurance Services Office, Inc. (ISO) introduced to its GL policies one mandatory and two optional exclusions that preclude some or any coverage with respect to access or disclosure of confidential or personal information. ISO contends that damages related to data breaches and certain data-related liabilities are not intended to be covered under GL policies, and should be addressed through dedicated cyber insurance policies.

ISO’s view is that the internet and electronic commerce were not contemplated when the GL policy form was created. The three ISO exclusions are intended to clarify its view on the policy’s original intent. Multiple insurers have begun adding some combination of these exclusions to their GL policies, which will typically trigger the same or similar exclusions being added to any umbrella/excess policy sitting above. While clarifying the intent to exclude cyber coverage from GL policies, the endorsements may create coverage uncertainty for bodily injury and property damage resulting from a cyber event.

Despite overall insurance market stability, insurers entering 2015 are more closely scrutinizing their risk portfolios and ceasing to write coverage in areas that have not generated profitable underwriting results. Some insurers are no longer willing to underwrite medical devices, chemical risks, and certain exposures in construction, life sciences, and energy. Broadly, insurers are requiring more information in submissions from insureds — for example, asking more detailed questions about business units that generate relatively little revenue but could create sizable casualty losses.

Organizations should work with their insurance advisors to attempt to remove these exclusions whenever possible. If removal is not possible, insureds and their advisors should attempt to:

► Restrict any exclusions being added to policies held by insureds with clearly associated exposures.

► Modify these exclusions by endorsing coverage for consequential physical bodily injury (BI) and consequential tangible property damage (PD).

Those clients that have renewed with the above exclusions should continue to work with insurers to try to endorse consequential physical BI and tangible PD language retroactively.

Product Innovation and Differentiation

In a competitive marketplace, insurers must differentiate on more than price. In 2015, many insurers will likely seek to do so in product innovation and in flexibility in coverage terms and wording to address emerging risks. For example, more insurers recently appeared willing to expand policy terms and conditions, including adopting new endorsements or policy forms to create more consistency in excess casualty program towers. Carriers are also becoming more aggressive in collateral requirements, both in terms of amounts and acceptable forms. Insurers may also seek to introduce new products to address cyber, professional liability, and pollution exclusions in GL policies.

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WORKERS’ COMPENSATION

Workers' compensation rates continued to climb on average in 2014, but at a slower pace than in the recent past. Premium rates were generally stable for insureds with favorable loss histories. On average, guaranteed cost rates were up less than 2% and loss-sensitive rates were flat in the fourth quarter; rates ranged from about 10% lower to 10% higher, depending on the class of business and individual loss history. Slightly more than half of all companies renewed with rate increases.

Many insurers have improved their profitability in workers’ compensation to some degree. The combined ratio for workers’ compensation dropped from 108% in 2012 to 101% in 2013, and is projected to fall to 96% in 2014, according to the National Council on Compensation Insurance (NCCI). If this projection is accurate, 2014 would be the first year of overall profitability in workers’ compensation since 2006. Still, many insurers continued to press for rate increases and remained aggressive on collateral needs to win or retain business.

More broadly, the marketplace has divided into two clear segments:

1. Organizations with sound loss experience, in good classes of business — for example, companies in the communications, media, technology, retail, and food and beverage industries, along with some light manufacturers — or with best-in-class loss control programs. These typically saw favorable results at renewal.

2. Organizations that are unable to take on large deductibles or that have adverse loss histories, sizable exposures in California, or monoline placements. These insureds may face a more difficult marketplace.

This market separation is likely to continue in 2015.

The standalone excess workers’ compensation marketplace — which provides excess coverage for qualified self-insureds — may grow more challenging in 2015. Many insurers have pulled out of this space due to generally poor loss histories for self-insured organizations. There may also be a tendency for insurers to believe that self-insured companies do not always report their workers’ compensation losses. Communicable disease treatment will also likely become a concern, stemming from the recent Ebola outbreak.

As insurers improve their ability to analyze and manipulate data, there will likely be greater underwriting scrutiny based on several characteristics of insureds — for example, location, class codes, and loss trends. Risk managers should work with their insurance advisors to better portray their risks in underwriting meetings by providing examples of best-in-class loss mitigation programs and using data and analytics to support their arguments.

WORKERS’ COMPENSATION RISK TRENDS

Terrorism Insurance

The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) has been an important consideration in workers’ compensation programs. Most industry observers were surprised that Congress allowed TRIPRA to expire at the end of 2014, although it acted quickly on the matter upon reconvening in January 2015. For details, please see the Terrorism Risk section of this report.

Medical Cost Management

Medical expenses now represent about 60% of all workers’ compensation claims costs, compared to 40% in the early 1980s. These expenses are expected to grow in 2015 and beyond, prompting employers to explore strategies to better manage such drivers as prescription drug costs. For example, many employers have explored establishing pharmacy benefit networks (PBNs) through which they can direct injured employees to use only a specific set of pharmacies. Through a PBN, employers can establish guidelines for how narcotics and other medications are dispensed — for example, to stop or limit prescriptions of certain narcotics until the employer’s medical team has discussed potential alternative treatments with the physician. This can reduce expenses for the employer, and also help avoid employees becoming addicted to pain medication.

In addition, nurse case management services can help both employers and employees in reducing costs and accelerating their return to work.

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The international casualty insurance market became more competitive in 2014, with most insureds renewing their programs with rates flat or with decreases of 10% or more. Barring unforeseen circumstances, favorable conditions are likely to continue into 2015, buoyed by new market entrants. Still, many insureds believe that international casualty rates have bottomed out or will soon do so, and are seeking to lock in rates through long-term programs. Many insurers are willing to offer two- or three-year programs with rate guarantees in an effort to retain existing business and to attract new business by showing their long-term commitment.

Competition increased in 2014 on new business for both controlled master programs (CMPs) and international package policies (IPPs). Automobile CMPs again saw a relatively high frequency of price increases compared to other classes of business, driven largely by higher loss activity and concern about the ancillary effect of rising medical costs; still, rates typically were flat to increases in the single digits.

Market Commentary

The international casualty insurance market became more competitive in 2014, with most insureds renewing their programs with rates flat or with decreases of 10% or more. Barring unforeseen circumstances, favorable conditions are likely to continue into 2015, buoyed by new market entrants. Still, many insureds believe that international casualty rates have bottomed out or will soon do so, and are seeking to lock in rates through long-term programs. Many insurers are willing to offer two- or three-year programs with rate guarantees in an effort to retain existing business and to attract new business by showing their long-term commitment.

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RISK TRENDS

International Policy Databases

A higher level of service is being demanded from brokers and insurers as corporate boards and senior leaders increasingly ask for real-time information about individual countries from a variety of perspectives including insurance, regulatory, tax, and country-by-country insurance program design. Insurers and brokers with the strongest international technology platforms will be in the best position to help their clients thrive. Many new systems are able to capture information about local policies that are part of a controlled master program. The more advanced solutions take it a step further and capture information about all local policies serviced in the local market. International databases will need to keep up with the changes happening in client operations and in regulatory compliance.

Higher Local Limits

Historically, multinational companies generally have purchased international casualty coverage with primary policy limits of up to $2 million; all local policies issued globally would fall under this limit. But this approach no longer appears to meet multinational companies’ needs. Over the last two years, companies have faced demands from local regulators to present evidence of higher limits. Although their strategies are evolving, insurers have responded. In cases where a single insurer underwrites both the primary and lead umbrella program, some insurers have been able to “localize” excess limits to provide additional primary limits for an individual country. Other insurers have instead expanded their reinsurance treaties to enable them to write higher limits. Few carriers will localize the umbrella program when they are not writing the primary layer, but with increasing demands for local excess liability, the market may supply these types of solutions.

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The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), created as a response to the attacks of September 11, 2001, has been an important consideration in insurance programs for more than a decade. Most industry observers were surprised that Congress allowed TRIPRA to expire at the end of 2014, although it acted quickly on the matter upon reconvening and on January 8, 2015, TRIPRA became the first bill passed by the 114th Congress. Passage of the law brought greater certainty to organizations that depend on terrorism coverage, and should generally prevent any short-term increase in pricing. Had TRIPRA not passed — or had it taken significantly longer to do so — the market dynamics for terrorism insurance would have been disrupted, with many predicting increased pricing and reductions in available capacity. The unexpected delay in getting TRIPRA reauthorized served as a reminder to organizations of the importance of such best practices as risk differentiation and business continuity planning.

TRIPRA 2015 PROVISIONS

The 2015 version of the Act is the third reauthorization since it was originally enacted as the Terrorism Risk Insurance Act in 2002. The law — created in response to a severe insurance market shortage after 9/11 — provides reinsurance coverage to insurers in the event of a terrorist act that is certified as such under the law. Among its provisions, the 2015 Act increases:

- The industry aggregate loss trigger from $100 million to $200 million, which will be phased in starting in 2016 by annual increments of $20 million for five years.
- Insurer co-participation from 15% to 20%, which will be phased in starting in 2016 in 1% increments.
- The Treasury’s recoupment rate from 133% to 140%.

IMPAKT ON INSUREDS

Pricing and Capacity

TRIPRA’s short-lived expiration raised significant pricing and capacity concerns for organizations that purchase terrorism insurance, particularly for those located in central business districts in major cities. In these areas, known as Tier 1 locations — which include Atlanta, Boston, Chicago, New York City, San Francisco, and Washington, DC — terrorism insurance is typically more expensive due to risk aggregation issues.

With TRIPRA now reauthorized, however, pricing and terms and conditions that changed upon expiration are likely to return to pre-expiration levels. Insurers may achieve this on a blanket or account-by-account basis. The new law’s most significant changes — including to the program trigger and co-insurance — do not take effect until January 2016. For that reason, organizations generally can expect negligible impacts on pricing at this time.

Retroactive Coverage

TRIPRA’s lapse raised issues such as the potential for gaps in coverage, violations of loan covenants requiring the coverage, and confusion over the terms and conditions within policies that excluded coverage. At the outset of 2015, organizations are encouraged to work with their brokers, captive managers, and insurers to clarify the handling of any sunset provisions that were extended when the law expired at the end of 2014. Organizations may need to determine, among other things, if:

- Terrorism coverage is automatically in effect.
- Endorsements are necessary.
- Additional premiums must be paid.
- Stopgap arrangements that were put in place should be adapted further or canceled.

The Treasury Department is expected to issue guidance and regulations in early 2015 to implement the program retroactively.

Property/Casualty Considerations

The confusion created by TRIPRA’s expiration means that insureds should be diligent as they look over their terrorism risk insurance programs entering 2015. Among the steps they should take are:

- Thoroughly review all policies and terrorism endorsements and understand how the coverage applies.
- Consider requesting endorsements to reflect the new terrorism backstop terms and conditions. Collect and share with workers’ compensation insurers the highest quality data possible on insured employee concentrations to ensure that risk profiles are accurately reflected in the underwriting process.
Captive Considerations

- Review the structure of captive insurers that seek to purchase reinsurance for their terrorism obligations and assess the impact of the trigger change and co-insurance increases. Additional capacity may need to be secured to address the phased co-insurance increases.

- Captive managers should review the capitalization of each vehicle to ensure it adequately supports the terrorism obligations.

- Owners of captives that provide TRIPRA-subject lines of insurance, such as property, workers’ compensation, and general liability, should ensure that existing policies and procedures reflect the reauthorization.

STANDALONE COVERAGE

The drawn-out process to reauthorize TRIPRA shone a spotlight on alternative terrorism insurance solutions. For example, the standalone terrorism insurance market is an alternative source of capacity that can replace embedded coverage either partially or completely. Maximum achievable limits in the standalone terrorism insurance market are approximately $3.5 billion; available capacity is significantly lower for exposures in the central business districts of Tier 1 cities.

In light of TRIPRA’s renewal, standalone terrorism insurance pricing is not expected to increase and will likely offer competitive terms for risks as insurers will be competing with the embedded terrorism markets; however, supply and demand will continue to determine pricing for organizations located in major cities.

BEST PRACTICES

The period of uncertainty around TRIPRA serves as a reminder of key risk management best practices, including the importance of differentiating your risk.

Quantifying Terrorism Risks

Terrorism risk modeling and other analytical tools can help organizations determine how much coverage to purchase, whether capacity is in short supply or not. Among other benefits, such models can help organizations understand their financial exposure, determine appropriate insurance deductibles and limits, and optimize risk finance strategies.

Risk Profiles and Employee Data

The quality of the data provided to underwriters can make a significant difference in how insurers evaluate an organization’s terrorism risk. Insurers need to understand the exact risk a company presents with actual employee exposure in a particular building at a particular time. Such details can have a tremendous impact on employee concentration concerns, one of the key issues in workers’ compensation underwriting for terrorism risk.

Sharpen Business Continuity Plans

To improve the risk profiles they present to underwriters and for their own business resiliency efforts, organizations should review and update their business continuity plans to ensure they are well-prepared in the event of a terrorist attack. Insurers often look for current and well-formulated business continuity plans as a foundation of good risk management.
Financial and Professional: Directors and Officers

INSURANCE MARKET CONDITIONS

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<tr>
<th>SEGMENT</th>
<th>RATE CHANGE Q4 2014</th>
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<tr>
<td>PRIVATE COMPANIES</td>
<td>FLAT TO 15% INCREASE</td>
<td>5% DECREASE TO 15% INCREASE</td>
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The above represents the typical average rate change at renewal for average/good risk profiles.

Market Commentary

Average pricing for directors and officers (D&O) liability insurance for public companies decreased in 2014 from the pricing highs seen in the fourth quarter of 2012 as insurers’ consistent push for higher rates on primary layers was offset by robust competition and reductions in excess layers. In the fourth quarter of 2014, rate increases averaged 1.9% for primary programs with average decreases at 1.5% for total programs. Robust competition for excess and A-side difference-in-conditions (ADIC) program layers along with abundant capacity remain dominant market forces heading into 2015.

Insureds with strong and stable risk profiles generally experienced rate reductions, typically while maintaining retention levels. Those with more volatile profiles experienced retention and rate increases with a frequency that outpaced overall averages. For the last 12 to 18 months, private and nonprofit organizations have experienced rate and retention pressure. This trend follows a prolonged period of softer rates, expanding coverage, and rising claims frequency and severity.

Overall, D&O capacity was robust, with neither significant new capacity entering nor long-term capacity exiting the global market. A proliferation of new forms has been introduced over the last 12 to 24 months. That pace has slowed, with insureds working to reap the benefits from new coverages. Select new or expanded coverages include improved regulatory investigations coverage, affirmative plaintiffs’ fees coverage, and limit reinstatements — the latter most readily available within the ADIC part of programs.

RISK TRENDS

Entering 2015, a number of issues potentially affecting the D&O liability arena are expected to develop further or achieve resolution, including:

▶ Corporate inversions: 2014 was the year of cross-border transactions, but swift changes to US tax rules in September may have changed the future for companies looking to re-incorporate abroad to offset taxes. Inversions are expected to continue, but at a much slower pace while Congress considers next steps.

▶ Shareholder activism: Activist campaigns featured prominently in 2014 as hedge funds and other activist shareholders attempted to influence corporate agendas from governance to strategy. Continued and increasing activity is expected in 2015 in the US and Canada.

▶ Insider Trading: A late 2014 decision by the US Court of Appeals for the Second Circuit may have made it more difficult for the SEC to bring civil actions pursuant to criminal insider trading prosecutions. Essentially, the court said that in order to establish insider trading liability, the government must prove beyond a reasonable doubt that the tippee has knowledge of the personal benefit to the tipper, and that what constitutes personal benefit in this context now requires a quid pro quo relationship.

CLAIMS TRENDS

While the number of federal securities class-action cases hit a 10-year low at $6.5 million in 2014, increased filings in specific areas may be in store for 2015.

litigation. An initiative in Delaware was tabled until 2015, when legislative action is expected to address fee-shifting amendments to corporate bylaws for public companies incorporated there. At the same time, other states have already adopted provisions authorizing corporations to adopt fee-shifting amendments to their bylaws. Large companies incorporated outside the US would likely experience no impact from any such ruling in Delaware.
As companies continue to pursue initial public offerings (IPOs), plaintiffs are bringing a consistent claims flow under Section 11 of the Securities and Exchange Act of 1933 during the first 12 to 24 months after a prospectus is filed. This exposure came into focus in 2014, which saw more IPOs than any year since 2000.

In addition, the increasing settlement value of independent derivative actions was of concern because, as with IPO follow-on suits under Section 11, derivative actions are easier for plaintiffs to bring and may be more likely to succeed compared to traditional securities class actions. After the US Supreme Court’s 2014 *Halliburton* decision made it potentially more difficult to bring securities class actions, plaintiffs may seek new and more efficient litigation tactics. High numbers of merger-objection suits were present in 2014, and although such suits tended not to be brought by the major plaintiffs firms, continued activity and exposure is expected to extend into 2015.

Public companies faced high levels of enforcement actions by the SEC and other government regulators as a result of investigations and whistleblower tips. Many of these actions involved resultant civil litigation. The SEC filed a record 755 enforcement actions in fiscal year 2014, driving $4.6 billion in disgorgement and penalties, increases of 686 and 2.6% from 2013. Bounty award payments for successful tips also picked up, with the agency making more awards in 2014 than in prior years combined. Since the program’s inception in 2011, 431 enforcement actions have been brought as a result of whistleblower tips, nine of which received bounty payments in 2014, including the largest payment to date of $30 million.

Another trending claims concern is the rapid escalation in public and private company exposure to cyber-related losses. Although a cyber-attack itself would typically not be covered under a D&O policy, most policies do not include cyber exclusions. Insureds may have potential coverage, subject to respective policies’ terms, conditions, and limitations, in such areas as alleged disclosure related issues and alleged breach of fiduciary duty.

**COVERAGE ISSUES**

**Regulatory investigations:** Coverage for regulatory investigations under D&O policies remains a critical issue. While individual insureds are typically covered, the corporate entity is generally not covered unless named with an insured individual who is a target, and then only once a collateral securities claim is triggered under the policy. Varying coverage options are available within the policy form or by endorsement from several primary insurers, but traditional, primary D&O policies usually do not cover corporate investigation costs before a securities claim is noticed and accepted under the policy. At least three standalone policies offering coverage for corporate targets in regulatory investigations are available in the current market; two have been out for several years, however, there has been little uptake due to issues including cost. Coverage advancements and new options are expected in 2015.

**Global liability:** Globalization of traditional D&O exposures — for example, mergers and acquisitions, bankruptcy, and insider trading — along with the continuing harmonization among regulators worldwide has significantly expanded the liability arena for directors and officers. More insureds than ever now place master global programs and local policies around the world. Related issues include the rise of class- or collective-action litigation in some jurisdictions, while litigation funding — where organizations that are not party to litigation agree to fund it in return for a proportion of the damages — is also increasing.

**Terrorism insurance:** The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), created as a response to the attacks of September 11, 2001, has been an important consideration in insurance programs for more than a decade. Most industry observers were surprised that Congress allowed TRIPRA to expire at the end of 2014, although it acted quickly on the matter upon reconvening in January 2015. For details, please see the Terrorism Risk section of this report.

**DIRECTORS AND OFFICERS LIABILITY INSURANCE HISTORICAL RATE (PRICE PER MILLION) CHANGES: AVERAGES**

Source: Marsh Global Analytics

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<th>PRIMARY PRICE PER MILLION CHANGE</th>
<th>TOTAL PRICE PER MILLION CHANGE</th>
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<td>Q4 2013  4.1%</td>
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Financial and Professional: Commercial Errors and Omissions

INSURANCE MARKET CONDITIONS

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<th>COVERAGE</th>
<th>RATE CHANGE Q4 2014</th>
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<tr>
<td>ERRORS AND OMISSIONS</td>
<td>FLAT TO 8% INCREASE</td>
<td>3% DECREASE TO 7% INCREASE</td>
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</table>

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

Market Commentary

The commercial errors and omissions (E&O) insurance market remained competitive in 2014, with rate changes generally less volatile than in 2013. Technology product companies, media firms, property managers, and technology service providers continued to seek out E&O coverage. Average commercial E&O renewal rates in the fourth quarter of 2014 ranged from no change to an increase of 3%, compared to a range of a 3% decrease to a 7% increase during the same quarter in 2013. This trend is likely to continue into 2015.

RISK TRENDS

Cloud Computing

Business interruption was an area of particular concern for third-party vendors in 2014. With more businesses relying on their cloud provider for mission-critical systems, service providers increasingly bought coverage to protect against business interruption for themselves and their customers. When cloud services go down completely or intermittently, companies can often be out of business until the cloud is restored. This has been more of an issue for small and midsize companies, which tend to rely on the cloud for more of their infrastructure needs. Large companies have typically had more thorough business continuity plans, and consequently are more likely to have their critical operating systems run in-house.

Social Media Risks

Social media remains a prominent E&O risk. For example, a mishandled ad can generate the wrong kind of social media exposure, which can lead to lawsuits both in the United States and abroad. Media companies continued to seek E&O coverage to address defamation risks — such as liable and slander — from the material they broadcast, publish, or otherwise disseminate.

Due to the speed with which information travels via social media, insureds realized that different channels of distribution are replete with risks. With instant posting of information, it has become harder for companies to control the content, how it is used, and where it will appear. Companies are becoming aware that they can be at risk for exposure even after they may have removed a questionable comment or posting. Employees at media companies are at particular risk compared to those in other industries, as they often produce original content aside from what they produce for their firms.

Privacy Exposures

Protecting private data and the intellectual property they hold for third parties was a crucial concern for media companies and other service providers in 2014, and will remain so in 2015. In order to improve the efficiency of their insurance purchase and to avoid potential gaps in coverage, media companies with significant privacy exposures tended to buy cyber insurance as part of their overall E&O and media liability program.

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INSURANCE MARKET CONDITIONS

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

Market Commentary

Cyber remained one of the fastest growing sectors in the insurance market in 2014, as evidenced by continued growth in premium and the steady influx of new capacity — trends expected to continue in 2015. Demand for cyber coverage continued to rise across industry groups in 2014.

Cyber insurers saw an increase in both the frequency and severity of losses in 2014. While the market was robust, increased loss activity caused pricing challenges for some insurers at the end of 2014, particularly in the retail sector. The average cost of a large data breach was $3.5 million, 15% more than estimated in 2013, according to the Ponemon Institute’s 2014 Cost of Data Breach Study: Global Analysis. The magnitude of cyber losses exceeded some carrier expectations, with loss severity higher than previously forecast by common pricing models borrowed from the professional liability sector.

Continued growth in supply and demand, coupled with loss activity, led to significant price volatility in 2014. Although rates generally held steady or increased slightly, predicting market reaction to specific organizations was difficult. Pricing pressure was particularly keen for retailers, large organizations, and excess placements, where the ever-expanding range of sublimited coverage enhancements was challenging to assess and price. In 2015, combined rates are generally expected to be flat to slightly higher than in 2014. However, it is likely that rate volatility will continue, due to headline claims activity, new market entrants, and greater demand from current buyers looking to increase sublimited coverages and expand excess limits.

Insurance innovation in 2014 included expanded availability of loss-control services such as risk assessment tools, breach preparation counseling, and breach response assistance. The expanded roster of services and updated policy language provided additional value from policies, usually without a specific added premium. Such innovation can be expected to continue in 2015.

RISK TRENDS

Cyber Litigation

The most challenging and evolving issues in cyber litigation continue to be valuation of damages by plaintiffs, identification of a standard of care for defendants, and the establishment of class standing to bring claims. For example, a Minnesota judge in December 2014 ruled that third parties (in this case, banks and credit unions) in a data-breach incident at a large retailer do have standing and that their claims can survive a motion to dismiss. At the time of the incident in 2013, personal information was stolen from about 110 million customers and about 40 million credit cards were compromised. The ability of claims to survive a motion to dismiss is a troubling development for victims of cyber-attacks as it increases both the likelihood of third-party litigation and the expected cost of these attacks, as claims surviving a motion to dismiss are generally more expensive to defend.

In a more positive development for damage valuation, several cases limited the ability of plaintiffs to recover statutory damages for data breaches. In many of these cases, most importantly in California, defendants avoided statutorily imposed damages for data breaches where no significant risk of harm resulted from disclosure of confidential information. While these cases were limited in scope to certain statutes and jurisdictions, their impact may be felt more broadly.

Business Interruption

Cyber business interruption risks drew attention in 2014, a trend expected to continue in 2015. Denial-of-service (DoS) attacks aimed at disabling corporate systems continued, and the arms race is likely to escalate in 2015 as attackers counteract the increasing technical sophistication of cyber defenders. Several large cyber-attacks that were primarily data breaches resulted in significant secondary business outages,
highlighting the growing risk of slow-burning business interruption to corporate systems from otherwise unrelated attacks. When criminals target corporate systems like payment infrastructure or email, significant first-party business interruption costs may arise. The “collateral damage” from cyber attacks can be expected to grow over the next few years as their increased sophistication makes post-event investigation and remediation more time-consuming. Additionally, as mission-critical systems have moved out of corporate data centers and onto mobile devices and federated, cloud-based or hosted services, the effects of cyber business interruption have been felt by more enterprises; over than one-third of respondents to the most recent KPMG business continuity survey indicated an IT failure in the past year had required activation of business continuity plans.

**New Threats**

Despite companies spending ever-more time and money on information security, the number of cyber-attacks continues to grow and attackers become more sophisticated. Many criminals have shown a willingness and ability to use cyber-attacks technology that was previously expected only from government or military resources. Recent incidents include:

- Highly targeted attacks on executives, including directed social engineering and hacking hotel, conference, and other public systems to target executives and their devices while in transit.
- Physical damage to machinery and infrastructure from cyber-attacks.
- Prolonged, multifaceted intrusions aimed at disrupting operations and damaging corporate reputation rather than simple theft of sensitive or economically valuable data, often coupled with cyber-extortion.

**Regulators**

Regulators were active in policing cyber risks in 2014, and companies should expect regulatory oversight to expand significantly over the next several years. Traditionally active cyber regulators — including the Federal Trade Commission, state attorneys general, and the Department of Health and Human Services’ Office for Civil Rights — expanded the scope and frequency of regulatory activity. In addition, other entities took a renewed interest in cyber risk, including assessment, investigation, and enforcement.

“COMPANIES THAT HAVE ALREADY HAD A DATA BREACH SHOULD EXPECT STRONGER OVERSIGHT IN 2015; REGULATORY REACTION TO ‘REPEAT OFFENDERS’ HAS BEEN NOTABLY SEVERE.”
Financial and Professional: Employment Practices Liability

INSURANCE MARKET CONDITIONS

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<tr>
<td>MIDSIZE ORGANIZATIONS</td>
<td>FLAT TO 5% INCREASE</td>
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</table>

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

Market Commentary

Employment practices liability insurance (EPLI) rates reflected a transitioning market as average rates in the fourth quarter of 2014 decreased nearly 2% from the prior quarter, and were considerably lower than the average increase in the fourth quarter of 2013. Rates were generally flat to declining for companies with more than 4,000 employees, where the average rate increase was 1.5%. However, rates increased an average of 5.9% for companies with 1,000 to 4,000 employees, a segment that has seen a high frequency of single-plaintiff losses. In addition, standalone and/or blended wage and hour and EPL submissions and quotes increased in 2014, with the Bermuda market still leading the placements. No significant changes are expected in the market for 2015.

RISK TRENDS

Wage and Hour

The much-anticipated 2015 release of the revised Fair Labor Standards Act (FLSA) regulations is likely to increase wage and hour claim filings. The Department of Labor (DOL) revised the definition of companionship services that are exempt in order to clarify and narrow the definition. Previously, the FLSA exempted under its overtime provision domestic service employees that resided in the household in which they provide services. The revision, which becomes effective January 1, 2015, defines the term “companionship services” as “providing fellowship and protection for an elderly person or a person with an illness, injury, or disability who requires assistance in caring for himself or herself.” The companionship services exemption is not applicable when the employee spends more than 20% of the work week performing care services; in such work weeks, the employee is entitled to minimum wage and overtime pay.

Until recently, EPL insurers had resisted providing any type of coverage for wage and hour claims, typically citing concerns over frequency, severity, and insurability of the actual wages owed. Virtually all EPLI policies now include a restrictive exclusion for claims alleging violation of the FLSA or similar state laws. There have been some successful challenges to these exclusions; however, those successes primarily have been in instances in which a wage and hour lawsuit also included an EPLI allegation that was covered and the policy at issue was a duty-to-defend policy. Although some insurers provide sublimited defense-costs-only coverage for smaller companies, wage and hour exposures remain generally unaddressed for midsize and large employers.

Given the complexity, even a diligent employer can run afoul of wage and hour laws. To continue to minimize these exposures, employers should stay abreast of changes in the laws, engage third-party providers and outside legal counsel to conduct regular wage and hour audits, and be vigilant in ensuring proper classification of all employees and independent contractors.

The DOL recently ramped up its enforcement of the FLSA. Among targeted industries were retail, construction, health care, financial services, and staffing agencies. DOL complaints and similar lawsuits under state wage and hour laws increasingly named directors, officers, and managers as individual defendants.

Equal Employment Opportunity Commission (EEOC) Activity

Despite a reduction in funding during 2014, the EEOC is expected to continue in 2015 an aggressive pursuit of its current Strategic Enforcement Plan, which focuses largely on systemic discrimination. The plan is geared toward litigation of “pattern or practice, policy and/or class cases where the alleged discrimination has a broad impact on an industry, profession, company, or geographic location.”
Currently, these represent 25% of the SEC’s outstanding lawsuits filed, an all-time high. Two major EEOC areas of focus in 2014 were:

**Criminal Background Checks:** The EEOC focused on criminal background checks in the job application process. The use of arrest or conviction records is not expressly prohibited under Title VII of the Civil Rights Act of 1964, according to guidance released by the EEOC in 2011. However, an employer could be found to have violated Title VII if the use of such records has a disparate impact on a “protected class.” A few states (including Hawaii, Oregon, and Washington) have passed laws to restrict the manner in which and when employers may use employment background checks, including criminal records. Similar laws (so-called “ban the box” legislation) have been enacted or proposed in other states, including Connecticut, Georgia, Illinois, Indiana, Maine, Maryland, Michigan, Missouri, New Jersey, New York, Ohio, Oklahoma, Pennsylvania, South Carolina, Vermont, and Wisconsin.

**Disability Discrimination and Genetics:** The EEOC announced its intention to continue enforcement of amendments to the Americans with Disabilities Act, which broadly define disability under the ADA and require employers to make efforts to provide reasonable accommodations to individuals with disabilities. The EEOC also settled its first class-action lawsuit under the Genetic Information Non-Discrimination Act (GINA). It is devoting more resources to enforcement of the law to ensure that employers are not discriminating against job applicants or employees on the basis of a genetic disposition. Claims under GINA could potentially overlap with the ADA to the extent that some individuals could suffer from disabilities as a result of genetic dispositions.

Emerging issues for the EEOC in 2015 and beyond include corporate wellness programs to the extent such programs may be discriminatory against individuals with disabilities or genetic diseases under the ADA and GINA. Underwriters are discussing whether the EEOC’s recent disability discrimination lawsuits involving corporate wellness programs could have an impact on rates. The EEOC is also expected to focus on the protection of lesbian, gay, bisexual, and transgendered people under Title VII; pregnancy discrimination; and discrimination against veterans.

In fiscal year 2014, the EEOC received 88,778 charges from employees alleging employment practices violations — such as discrimination, harassment, and retaliation. This represented about a 5,000-charge decrease from the prior year.

**Court Cases to Watch**

Some court cases in 2015 will likely impact pregnancy and religious discrimination claim trends. The US Supreme Court is set to render its decision in *Young v. UPS*, in which a delivery driver sued her company for gender- and disability-based discrimination after she became pregnant. The case discusses whether, and under what circumstances, an employer that provides accommodations to non-pregnant employees with work limitations must provide accommodations to pregnant employees who are “similar in their ability or inability to work.”

Another case, *EEOC v. Abercrombie & Fitch*, questions whether or not employers must ask applicants whether they need religious accommodations. The US Supreme Court is expected to decide whether an employer can be held liable under Title VII of the Civil Rights Act of 1964 for refusing to hire an applicant or discharging an employee based on a religious observance and practice if the individual did not directly request an accommodation and the employer did not know the individual needed one.

**Additional Exposures**

- California-based exposure was one of the key areas of interest for insurers in 2014, given the frequency of single-plaintiff claims and losses there. Retention levels and rate increases specific to California were common.

- Although most insurers are no longer as flexible regarding the ability to select counsel in duty-to-defend policies or non-duty-to-defend policies that require the use of panel counsel, this accommodation was one of the most advocated issues for clients in 2014. In an effort to be more competitive with Bermuda insurers, some domestic carriers showed flexibility in removing rate caps for clients with a retention greater than $1 million.

- Underwriters also focused in 2014 on whether information obtained in credit reports, pursuant to the Fair Credit Reporting Act, would have an impact on claims alleging failure to hire.

- Globally, as employment claims are no longer limited to just the US, carriers are beginning to respond to international exposures, often after a significant non-US EPL claim has been filed or paid.

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INSURANCE MARKET CONDITIONS

<table>
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<th>RATE CHANGE Q4 2013</th>
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<td>COMMERCIAL ORGANIZATIONS</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

With an abundant supply of capacity in the fidelity/crime insurance market in 2014, average rates at renewal were generally in the flat to 5% increase range, where they are likely to remain into 2015. Some new insurers that launched in the directors and officers (D&O) liability insurance market created fidelity components to round out their product offerings. The new entrants meant that insureds generally were able to market their programs, or use the threat to do so, to avoid the rate increases insurers pushed for. Both commercial businesses and financial institutions continued to face threats from employee theft, fraudulent funds transfer schemes, and theft of protected information and its resulting financial losses.

RISK TRENDS

Account Takeover

Phishing scams in which hackers take over an employee’s corporate email to obtain confidential information to transfer funds from a bank are on the rise. Vendors have been particularly susceptible to this kind of fraud. While financial institutions were more immune to large account takeovers from theft via electronic funds transfer, smaller commercial firms and nonprofits, in particular, were prime targets in 2014. Firms with fewer employees tend to have less robust compliance checks when it comes to transferring funds. Currently, account takeovers are not addressed in all crime insurance policies. Many insurers are in the process of determining whether and how to address this exposure.

Information Theft

Information-related fraud continues to be a major concern. A 2012 ruling by the Sixth US Circuit Court of Appeals (Retail Ventures v. National Union) has had a considerable impact on the fidelity/crime insurance market. The court ruled that financial losses resulting from the use of the stolen information constituted direct loss under the policy, and that the typical confidential information exclusion wording did not encompass customer card and account data. Insurers since have adjusted policy language to incorporate more robust exclusions to apply to cyber/privacy liability exposures.

Nontraditional Employment/Outsourcing

Outsourcing and entering into nontraditional employer-employee relationships were common practices for insureds in 2014, and are likely to continue to be in 2015 as companies look to reduce employment costs. Therefore, the definition of “employee” in the fidelity/crime policy should be reviewed to ensure that individuals such as consultants, leased employees, and independent contractors are covered when performing employee duties.

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<td>PLAN ASSETS UNDER $250 MILLION</td>
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<td>FLAT TO 5% INCREASE</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

Risk profiles were the key drivers of rates in the fiduciary liability insurance market in the fourth quarter of 2014. Insureds with plan assets of more than $1 billion saw rates decline 3.8% on average, while companies with plan assets less than $100 million saw an average increase of 5.3%. Since capacity is strong, those companies with stable to favorable risk profiles should expect steady fiduciary rates in early 2015.

RISK TRENDS

ERISA Stock Drop Cases

It remains to be seen whether there will be an increase in stock-drop cases based on the Employee Retirement Income Security Act (ERISA) following the US Supreme Court’s June 2014 decision in *Fifth Third Bancorp v. Dudenhoeffer*. The decision eliminated the “presumption of prudence,” or the presumption that fiduciaries acted prudently when deciding whether to buy or hold company stock. The case brings increased litigation uncertainty for employee stock ownership plans (ESOPs) and certain 401(k) fiduciaries and their insurers. The Court held that the same duties of prudence that apply to all plan fiduciaries generally apply to ESOP fiduciaries. It also provided valuable guidance on how lower courts should address motions to dismiss ESOP-related complaints. Subsequent to the Supreme Court’s ruling, there were several amended complaints and motions to dismiss filed, which could result in further court decisions in 2015.

Excessive Fee Litigation

A notable excess fee case in 2014, *Tibble v. Edison International*, has implications for future 401(k) monitoring by employers. The case called into question whether a plan fiduciary could be liable under ERISA for imprudent investments that were selected more than six years before the suit was commenced, and if those decisions could have been altered during the six-year timeframe. The Supreme Court heard the case on October 2, 2014, and amicus briefs in support of both sides were due by year-end. The case will be a key area of interest in 2015 since it could open the door to increased liability over what constitutes a fiduciary breach. More cases, including those with broader class-action status, could follow its example.

Since 2006, more than 30 lawsuits against plan sponsors, service providers, and other fiduciaries for excessive fees relating to 401(k) plans have commenced. With eight settlements and one adverse court decision, the average settlement/court award to date is $17.5 million, excluding defense costs.

Affordable Care Act

The Affordable Care Act of 2009 imposed a variety of requirements on group health plans, such as who must be afforded coverage, what types of services must be covered, and what coverage limitations can be imposed. As fiduciary policies limit coverage to plans sponsored by the insured organization, certain insurers are willing to expand their policy and protect policyholders against errors and omissions in connection with the purchase (or attempted purchase) of insurance through a health care exchange.

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<td>MIDSIZE FIRMS (200 TO 500 ATTORNEYS)</td>
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<td>SMALL FIRMS (50 TO 200 ATTORNEYS)</td>
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<td>5% INCREASE</td>
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The above represents the typical rate change at renewal for average/good risk profiles

Market Commentary

The lawyers professional liability (LPL) market remained competitive in 2014, and, from a pricing and coverage perspective, insurers and law firms were generally in sync. Insureds should expect the competitive environment to continue in 2015, barring unforeseen developments.

LPL insurers typically asked for limited rate increases in 2014 as the frequency and severity of claims from the financial crisis continued to dwindle. In fact, many of those claims resolved with better-than-expected outcomes for insurers. As a result, carriers generally were able to maintain high levels of capacity and limit rate increases. Some insureds, in turn, purchased higher program limits.

Insurers in excess or support underwriting roles generally had a larger amount of capacity compared to law firms’ lead insurers. Broad manuscript policies were generally favored over those more narrowly defined.

RISK TRENDS

Mergers and Acquisitions

Law firms overall reported modest revenue growth in 2014, although it was not consistent across firm size, geography, or practice area — making the sector ripe for consolidation. Law firms will likely see merger activity continue in 2015, following the spate of regional and international/global combinations seen in 2013 and 2014.

Trust and Estate Litigation

Trust and estate work has always been an area of concern for law firms, and has recently drawn an even higher level of focus. For example, a number of malpractice claims have sprung from matters involving real estate and other investments that, at the time of distribution, saw the value of disbursements being less than what the distributee expected. The aging population coupled with 10 years of challenging investment and real estate markets have given rise to an increase in these types of claims, which are costly to defend and settle.

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Cyber Protection

Many of the security breaches in the US over the last five years have involved employee data, often due to internal theft by rogue employees. Law firms, like all businesses, are becoming more vigilant about protecting employee and client data and following applicable laws and other guidelines, such as those from the American Bar Association.

Technological advancements bring a number of exposures and the potential for charges of negligence that could result in civil and criminal proceedings and allegations of professional misconduct. The use of websites and other online services, for example, pose risks related to content, advertising, copyright, online contracts, and legal and compliance issues. Data and confidential information can be improperly managed or lost.
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37 Marine
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40 Surety
41 Trade Credit
Aviation

INSURANCE MARKET CONDITIONS

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<td>AIRLINES</td>
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<td>15% DECREASE TO 20% DECREASE</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Airline Insurance

Airline insurance buyers experienced a volatile 2014, with the first half of the year seeing average renewal decreases typically in the 15% to 25% range. However, the two Malaysian Airlines occurrences had a major impact on renewals worldwide. For most of the third and fourth quarters, airline buyers generally saw rate and premium increases of up to 25%. Finally, late in the fourth quarter, a few select airlines attained rate decreases of up to 15%. Timing was the most important factor in 2014; however, it is unlikely that 2015 will have such volatility, barring unforeseen events.

US airlines buying war risk insurance commercially helped stabilize premiums in the US, and the stabilization is likely to continue in 2015. Entering 2015, rates were generally in the flat to 5% decrease range.

General Aviation Insurance

In 2014, aviation insurance buyers continued to benefit from soft market conditions — the result of overcapacity in the aviation insurance marketplace and competition between insurers for increased market share. Aviation premium dropped significantly over the past few years, and total premium volume eroded to levels they were at before the September 11, 2001, terrorist attacks (barely enough to cover attritional losses). Even the numerous airline accidents occurring in 2014 (including the two Malaysia Airlines, TransAsia, and Air Algerie incidents) had little impact on aviation insurance premiums. As a result, no major change in rates or premiums is anticipated entering 2015. Underwriters will continue to review individual risks and may in some cases request small increases. Aircraft values also remain an issue for the general aviation insurance marketplace as swings in values can affect premium rates. Detailed, thorough, and accurate underwriting information is critical during renewals, particularly for insureds with significant loss activity.

Current risk issues in the general aviation marketplace include: human factors, such as fatigue; detrimental reliance on technology; cyber-attacks and data breaches; increased commercial use of drones (unmanned aerial systems); and air traffic management.

Airline Manufacturing Insurance

Up to $2.25 billion in capacity was available for risks at year-end 2014, and was relatively uniform for companies of all sizes. However, capacity was not plentiful in some areas, such as general aviation aircraft manufacturers and for insureds with loss ratios consistently above 100%. In those cases, retentions were usually established to keep the premium levels competitive and minimize overall total cost of risk. Some coverage continued to expand, including excess grounding and some limited instances of recall insurance. Overall, the market in 2014 was robust, with some insurers writing as much as $850 million on their own capital; 2015 is expected to remain favorable, although there may be some capacity consolidation.

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Captives

MARKET COMMENTARY

Fueled by a strong demand for captives by small and midsize companies, the captive insurance market continues to expand in the US (see Figure 1). Legislation in additional states has made it easier for companies to form captives, and new organizations are inquiring about the benefits of a captive arrangement.

Domiciles

Bermuda and Cayman still lead the captive count offshore, while Vermont is the largest US domicile, with 588 captives. Utah is the leading domicile for small captives, with 342 captives, followed by Delaware, which has grown in the small and large area with special purpose vehicles (SPVs), for a total of 298 captives, including cell facilities.

In the last two years Oregon, Ohio, North Carolina, and Texas have implemented captive legislation, expanding the portfolio of choices for captive owners and encouraging captive growth in the US market. As more states enact legislation, competition to attract captives will grow, allowing new owners to select a state that best serves their needs and giving bargaining power to existing captive owners. The US now has more than 35 states with captive legislation, a clear sign that the number of captives in the US is likely to increase.

Regulatory Issues

A wave of regulatory inquiries by the Internal Revenue Service and international insurance supervisors in 2014 challenged some captive arrangements, a trend that is likely to continue as the captive market grows. However, this can be viewed as a positive development, as it should encourage captive insurance market participants to create captives for the proper business and risk management reasons.

In a recent captive-friendly court case, Securitas Holdings, Inc. v. Commissioner, the US Tax Court further clarified when a captive arrangement between a corporation and a wholly owned subsidiary will constitute insurance for federal income tax purposes.

The impact of the Foreign Account Tax Compliance Act (FATCA) — a US law aimed at foreign financial institutions and other financial intermediaries to prevent tax evasion by US citizens and residents through the use of offshore accounts — should be considered by US companies with offshore captives not using the 953(d) tax election.

Lines of Coverage

Terrorism risk: The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), created as a response to the attacks of September 11, 2001, has been an important consideration in many captive insurance programs. Most industry observers were surprised that Congress allowed TRIPRA to expire at the end of 2014, although it acted quickly on the matter upon reconvening in January 2015. For details, please see the Terrorism Risk section of this report.

Cyber risk: Encouraged by the recent increase in cyber-attacks, cyber risk, a non-traditional coverage, has been gaining traction in captive arrangements, a trend that is expected to continue in 2015.

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For employers, the impact of the Patient Protection and Affordable Care Act (ACA) on costs and employee enrollment in health benefit plans continued in 2014. The law's individual mandate, requiring the purchase of health insurance, took effect as planned, while the employer mandate, which requires the extension of coverage eligibility to all employees working 30 or more hours per week, will take effect — after a year-long delay — in 2015. And as the ACA took hold, the private exchange marketplace gained strong momentum as an alternative for employers to provide benefits to employees.

Action was taken on several fronts to hold down growth in the average per-employee cost of health benefits to 3.9% in 2014 (see Figure 1). While this was slightly larger than last year's historically low increase, it was still well below the 7% average rate of growth over the past 15 years. According to the National Survey of Employer-Sponsored Health Plans, conducted annually by Mercer one of the Marsh & McLennan Companies, total health benefit cost for employers with 10 or more employees averaged $11,204 per employee in 2014; this includes employer and employee contributions for medical, dental, and other health coverage. Low increases among small employers helped to slow overall cost growth.

Employers predict that in 2015 their health benefit cost per employee will rise by 4.6% on average. This increase reflects changes they will make to reduce cost; if they made no changes to their current plans, they estimate that cost would rise by an average of 7.1%.

Meanwhile, just 4% of all large employers believe it is likely that they will terminate their employee health plans within the next five years, down from 6% in last year’s survey. And while small employers are still more likely to be considering an exit strategy, the percentage of those with 50 to 199 employees that say they are likely to drop their plans fell from 23% in 2013 to 16% in 2014.

Helping to hold down cost growth in 2014 was the largest one-year increase in enrollment in high-deductible consumer-driven health plans (CDHPs), from 18% to 23% of all covered employees, according to the Mercer survey. In addition, 3% of large employers (those with 500 or more employees) moved to a private exchange in 2014 (or for 2015) to provide benefits to their active employees — and another 28% say they are likely to do so within the next five years.

Many employers anticipate spending more to cover more employees in 2015 as an ACA provision goes into effect that requires employers to extend coverage to substantially all employees working 30 or more hours per week. Well over a third of large employers (38%) were affected by this rule, and while some have already taken steps to comply, the majority will do so in 2015. What may drive up enrollment still further is that employees who have chosen not to elect coverage in the past now have a stronger incentive to do so as the minimum tax penalty for not obtaining coverage rises to $325 for 2015 from $95 in 2014.

Mercer’s survey found that employers have taken steps to limit the number of employees gaining eligibility, most often by carefully managing the schedules of those who occasionally worked 30-plus hours a week and by keeping new hires to fewer than 30 hours. About 10% of all large employers say they reduced the hours of employees who consistently worked 30 or more hours per week. However, few have reduced headcount (3%) — in fact, more say they have increased headcount (9%) in response to the new rule.

### Figure 1

**ANNUAL INCREASE IN TOTAL HEALTH BENEFIT COST PER EMPLOYEE**

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<tr>
<th>Year</th>
<th>Percentage</th>
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<tr>
<td>2011</td>
<td>6.1%</td>
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<tr>
<td>2012</td>
<td>4.1%</td>
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<td>2013</td>
<td>2.1%</td>
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<tr>
<td>2014</td>
<td>3.9%</td>
</tr>
<tr>
<td>2015</td>
<td>4.6%</td>
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Source: Mercer National Survey of Employer-Sponsored Health Plans
Dependent coverage has also come under scrutiny as employers look for other ways to manage enrollment growth. Some employers now impose a surcharge on the premiums for spouses who have other coverage available (9% of large employers) or even make them ineligible for coverage (also 9%). The median surcharge is an additional $100 per month.

The largest organizations, which tend to offer more generous coverage and can become “dependent magnets,” have moved the fastest to impose surcharges: 27% of employers with 20,000 or more employees did so in 2014, up from 20% in 2013. However, only 5% of these jumbo employers exclude spouses with other coverage.

Private Exchanges

Employers’ increasing focus on cost management strategies, along with a growing emphasis on account-based plans, is likely to spur steady growth in the use of private exchanges for employee benefits and benefits administration. One fourth of employers surveyed by Mercer say they are considering moving to an exchange within two years, and nearly half (45%) are considering it within five years. A 2014 analysis of purchasing behavior on Mercer’s own exchange — Mercer Marketplace™ — showed that, given the opportunity to choose from a range of benefit options, many consumers purchased lower-cost medical plans.

CDHPs and Wellness

Employers of all sizes, but especially large employers, added CDHPs in 2014. Offerings of CDHPs jumped from 39% to 48% among employers with 500 or more employees, and from 63% to 72% among jumbo employers (see Figure 2). CDHP enrollment spiked from 18% to 23% of all covered employees, while enrollment in health maintenance organizations (HMOs) fell to just 16%, the lowest level of enrollment seen since the survey began in 1993. Enrollment in traditional preferred provider organizations (PPOs) fell as well, from 64% to 61%.

These plans are also a top strategy for employers looking for ways to avoid paying the “Cadillac tax” in 2018 — a 40% excise tax on health coverage that costs more than $10,200 for an individual or $27,500 for a family. Mercer estimates that about a third of employers are currently at risk for triggering the tax in 2018 if they make no changes to their most costly plan.

Among large employers with health management (or wellness) programs, 56% offer employees financial incentives, up from 52% last year. While incentives for participating in programs are the most common, in 2014, 23% of large employers used outcomes-based incentives (for achieving or showing progress towards specific health status targets). This is up from 20% in 2013.

Voluntary Benefits

Meanwhile, as employers continue to move from traditional defined benefit programs to a defined contribution approach that blends employer- and employee-paid elements, growth can be expected in voluntary and ancillary benefits, through both private exchanges and traditional benefits programs. The continuing evolution of technology, product offerings, and targeted marketing strategies will help employees make more informed choices in the insurance marketplace, enhancing employers’ prospects for retaining healthy, productive workforces.

Life Insurance and Disability

In general, the stability of premiums for group life insurance and related coverage has been a given from year to year. Many employers that provide employer-paid life coverage have attacked costs by reducing the “multiple of pay” for all employees or reducing maximum benefits, which reduces coverage for highly paid employees; this trend is likely to hold as life insurance options increase in the voluntary marketplace, with easier online enrollment.

As for disability coverage, most employers continue to offer it. There is overall a proactive emphasis on wellness and return-to-work programs to counter the direct cost of incidental absence and disability benefits, which are equivalent to 4% of payroll costs, according to Mercer research. With low interest rates expected through much of 2015, upward pressure on disability insurance premiums can be expected, although aggressive vendor management, plan redesign, new executive disability products, and improved health management strategies can help to offset rising costs in this area.
Energy

INSURANCE MARKET CONDITIONS

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<td>OFFSHORE SHELF (NON-WIND)</td>
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<td>5% DECREASE TO 10% DECREASE</td>
</tr>
<tr>
<td></td>
<td>OFFSHORE DEEP (NON-WIND)</td>
<td>15% DECREASE TO 20% DECREASE</td>
<td>7.5% DECREASE TO 12.5% DECREASE</td>
</tr>
<tr>
<td>ONSHORE PROPERTY/ DOWNSTREAM</td>
<td>DOWNSTREAM (NON-WIND)</td>
<td>20%+ DECREASE</td>
<td>10% DECREASE TO 15% DECREASE</td>
</tr>
<tr>
<td></td>
<td>DOWNSTREAM (WIND)</td>
<td>15% DECREASE TO 17.5% DECREASE</td>
<td>FLAT TO 10% DECREASE</td>
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<tr>
<td></td>
<td>MIDSTREAM (NON-WIND)</td>
<td>15% DECREASE TO 20% DECREASE</td>
<td>15% DECREASE TO 25% DECREASE</td>
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<td>MIDSTREAM (WIND)</td>
<td>10% DECREASE TO 12.5% DECREASE</td>
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<td>CONTROL OF WELL</td>
<td>OFFSHORE SHELF</td>
<td>12.5% DECREASE TO 17.5% DECREASE</td>
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<tr>
<td></td>
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<td>15% DECREASE TO 20% DECREASE</td>
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<tr>
<td></td>
<td>ONSHORE</td>
<td>17.5% DECREASE TO 20% DECREASE</td>
<td>10% DECREASE TO 15% DECREASE</td>
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<td>PRIMARY LIABILITIES</td>
<td>OFFSHORE AND ONSHORE</td>
<td>FLAT</td>
<td>FLAT</td>
</tr>
<tr>
<td>EXCESS LIABILITIES</td>
<td>ONSHORE AND OFFSHORE</td>
<td>FLAT TO 5% DECREASE</td>
<td>3% INCREASE TO 7% INCREASE</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

Overall energy insurance market capacity has increased since early 2014, generally putting downward pressure on pricing. Whether all insurers will be able to withstand continuous market softening into 2015 is unclear. But much of the capital recently invested in the energy insurance market may be there for the long-term, meaning that soft market conditions could persist, barring unforeseen events. Underwriters are attempting to maintain profitability in the midst of a decline in premium volume.

While the downward pressure on rates remains the starting point in renewal negotiations, retention and coverage terms are generally holding steady.

OFFSHORE PROPERTY/RIGS

The offshore market has not suffered a major loss since mid-2013, which has helped drive underwriting profitability in the sector. However, the market remains generally soft, and a continued downward rate trend is evident. The offshore energy construction market is at its lowest rating levels since the late 1990s.

Offshore underwriters faced double-digit rate reductions and struggled to maintain market share in 2014. Capacity continued to grow as new domestic and international entrants looked for returns on capital and existing insurers increased their line sizes. Meanwhile, captive participation increased, and 2014 was the sixth consecutive year without a Gulf of Mexico (GOM) named windstorm loss. Combined, these factors accelerated rate decreases for most insureds.
CONTROL OF WELL
Rating and deductibles for deepwater GOM drilling remain high relative to other offshore international projects. However, 2014 saw significant rate reductions as more insurers competed for this business, which has had no significant losses since the 2010 Macondo event. Joint service agreements between operators and joint venture partners in the GOM mandate that high limits for control of well and resultant seepage and pollution are maintained, meaning there is less market competition at the upper end of limits being purchased, and significant premiums are generated at this level. There is nothing to prevent further reductions throughout 2015, and more domestic markets are expected to participate in this sector and offer alternatives to the traditional Lloyd’s and international market leads.

ONSHORE ENERGY PROPERTY — UPSTREAM
Competition in upstream onshore energy remains strong, with domestic and international markets adding capacity. These markets compete to retain and grow market share. Market dynamics mirror those seen in offshore property, although reductions can accelerate at a quicker pace in the onshore segment, where capacity constraints and GOM wind are not factors. The current advantageous market for insurance buyers would likely not be affected unless there were to be at least two losses of more than $1 billion each.

ONSHORE ENERGY PROPERTY
DOWNSTREAM / MIDSTREAM
Energy property insurance capacity remains robust at around $2.5 billion for US downstream and midstream risks. Although a handful of US downstream and midstream underwriters withdrew from the marketplace, overall capacity has not been adversely affected. With ample capacity and few recent natural catastrophes affecting the segment, insureds typically achieved rate reductions of 10% to 20% at renewal in the fourth quarter of 2014. Reductions of 20% or more have been possible for preferred risks — for example, those with good engineering, profitable loss records, and limited or no natural catastrophe exposure. Insurers’ loss history remained positive, with only a few losses of $300 million or more being reported in the last eighteen months. While natural catastrophes and contingent business interruption remained key areas for underwriters, their primary focus in 2015 will likely be on maintaining market share.

PRIMARY LIABILITIES
There remains a limited panel of underwriters that participate on primary liabilities in the energy sector, which helped to keep rates stable in 2014. Many insurers achieved single-digit rate increases across their portfolios, but in the fourth quarter moderate rate reductions were also possible. This trend is likely to continue into 2015. Going forward, a decline in projected exposures due to falling oil prices is expected to reduce the revenue and payroll growth that occurred over the past 18 months.

EXCESS LIABILITIES
Umbrella and excess liability rates trended flat in 2014, with modest rate reductions typically being achieved at the end of the year. Overall capacity remained in excess of $1 billion, with Bermuda continuing to be an important contributor of excess liability capacity. Although lead umbrella options remained relatively limited, alternative lead umbrella markets and other new entrants in London are emerging. Insureds are likely to continue to secure modest rate reductions in 2015, barring unforeseen changes.

Fleet risk exposure remains an issue, with large verdicts and settlements being reported by insurers. This has led to an increase in attachment points for automobile liability, which necessitated the use of buffer layers to satisfy higher underlying requirements for certain lead umbrella and excess liability insurers. Driver training and hiring practices are being scrutinized, and more information is now being required for underwriting submissions. Similarly, there is a heightened underwriting focus on pipeline and rail exposure in certain sectors.

“THE ENERGY INDUSTRY IS DISPROPORTIONATELY AT RISK OF CYBER-ATTACK.”
RISK TRENDS

Declining Oil Prices

With the Organization of the Petroleum Exporting Countries (OPEC) maintaining current levels of production, the price of oil consequently declined in the second half of 2014. The OPEC daily basket price was below $50 as of mid-January, down from above $100 in August. Sustained low oil prices will likely mean more competition among insurers to maintain market share and will fuel depressed ratings. A decline in oil prices would also likely have significant macroeconomic effects.

If oil prices hold steady at $60 or less, many energy companies are expected to reduce capital expenditures for exploration and production, especially in high-cost project areas, such as deepwater drilling and Arctic exploration. Onshore fields and shale projects can remain economically viable up to a point. But companies backed by private equity firms looking for returns or smaller, leveraged companies borrowing on the basis of a high oil price may find drilling plans delayed and become vulnerable to takeover and industry consolidation. A knock-on effect is likely in the midstream and onshore sector, slowing down and delaying what was a rapid increase in construction and infrastructure projects.

Meanwhile, lower prices would likely reduce inflationary pressures and political risks in many oil-producing countries. But sustained lower oil prices could adversely affect net oil exporters, according to political and credit risk analysis firm Business Monitor International. Countries at severe risk include Angola, Chad, Equatorial Guinea, Iran, and Venezuela, which is particularly vulnerable as oil accounts for more than 90% of its exports and more than half of government revenues.

Oil Insurance Limited

Effective January 1, 2015, industry mutual insurer Oil Insurance Limited (OIL) will increase its per-occurrence limit from $300 million to $400 million, and its event aggregation limit from $900 million to $1.2 billion. The Atlantic Named Windstorm (ANWS) limits offered will remain at $150 million part of $250 million with a $750 million event aggregation limit. This move is yet another factor that will take premium out of the commercial energy market and contribute to increased competition, benefitting insurance buyers.

Cyber Risk

The energy industry is disproportionately at risk of cyber-attack: Of the more than 250 incidents investigated by the Department of Homeland Security’s Industrial Control Systems Cyber Emergency Response Team (ICS-CERT) in 2013, 59% (151 incidents) occurred in the energy industry. Although most attacks to date have been data-driven, the possibility of a targeted attack causing catastrophic physical damage or a disruption of the energy sector is real. Energy companies have been quick to embrace new internet-connected industrial control systems (ICS) to realize cost reductions and operational efficiencies, but this may also mean that they are more susceptible to cyber-attacks.

Standard commercial insurance policies, including property and general liability, contain exclusions for bodily injury, property damage, and business interruption resulting from a cyber-attack. But evolving cyber insurance can fill many of these gaps, providing direct loss and liability protection for technology risks. Emerging cyber insurance solutions designed for the energy industry are also written to specifically address this risk.

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Environmental

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<th>RATE CHANGE Q4 2013</th>
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<td>CONTRACTOR POLLUTION LIABILITY (CONTRACTOR OPERATIONS COVERAGE)</td>
<td>5% DECREASE TO 10% INCREASE</td>
<td>5% DECREASE TO 10% INCREASE</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

Ample capacity and increased merger and acquisition activity were key drivers of the environmental insurance market in 2014. Rates remained generally flat, with some programs seeing a marginal decrease at renewal. However, for certain classes of business, insurers began increasing rates. Available capacity contracted, in particular, for some high-risk, catastrophic exposures and for large limit programs or those with material loss experience, making it more difficult for insureds. Some insurers reduced term limits and included more restrictive terms and conditions.

Managing legacy risks was common in 2014 as organizations sought to control costs associated with unknown pre-existing conditions, cost overruns related to cleanup obligations, and joint and several liability associated with formerly divested properties and non-owned disposal sites. For complex legacy transactions, particularly those with terms in excess of five years, average rates typically flattened or increased. Even though there was sufficient market appetite for 10-year terms for legacy risks, there was a stronger preference for short-term, renewable business. Early engagement with incumbent carriers together with the development of robust submissions and supporting information will be keys to an effective strategy in 2015 for corporations seeking environmental coverage.

CLAIMS

The number of environmental claims climbed in 2014. The combination of increased use of environmental risk transfer, the significant number of long-term legacy policies in force, and the widening in coverage provided over the past five years will likely drive significant claims activity for years to come. This is a major factor in the rebalancing of insurers' books with a preference for shorter-term policies, and lower limit programs.

RISK TRENDS

Environmental Regulation

Global environmental regulation continues to present a hurdle for businesses, and demand for multinational environmental insurance programs is growing. The US is perceived as having an onerous operating environment as a result of joint and several liability, long-established regulatory enforcement, and a highly litigious legal framework. China’s legal framework now mimics the US joint and several liability principle, while also placing the burden of proof on alleged polluters.

Brownfields Redevelopment

Brownfields redevelopment, together with projects related to base realignment and closure (BRAC), also showed signs of expansion in 2014. Although the volume of construction-related transactions increased, the complexity of the projects, regulatory issues, and financing challenges resulted in a significant time lag from bid to closure. Bank refinancing drove much of the need for corporations to seek environmental risk transfer solutions.

Known Pollution

Interest continued for environmental solutions related to known pollution conditions and associated cleanup, which are excluded under traditional environmental coverage, such as pollution legal liability (PLL) and contractors pollution liability (CPL). There is demand for this using the re-emerging, albeit limited, cost cap insurance market and non-insurance risk management solutions, such as guaranteed fixed price remediation, environmental liability buyouts, and loss portfolio transfers.

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Marine

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<td>FLAT TO LESS THAN 5% DECREASE</td>
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<td>LARGE ORGANIZATIONS</td>
<td>FLAT TO 5% DECREASE</td>
<td>FLAT TO 5% DECREASE</td>
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<td>CARGO STOCK THROUGHPUTS</td>
<td>MIDSIZE ORGANIZATIONS</td>
<td>FLAT</td>
<td>FLAT</td>
</tr>
<tr>
<td></td>
<td>LARGE ORGANIZATIONS</td>
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<td>FLAT TO LESS THAN 5% DECREASE</td>
</tr>
<tr>
<td>MARINE LIABILITIES</td>
<td></td>
<td>FLAT TO 7.5% DECREASE</td>
<td>5% INCREASE TO 20% INCREASE</td>
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<tr>
<td>BLUE WATER P&amp;I</td>
<td></td>
<td>3% INCREASE</td>
<td>AVERAGE 7.5% INCREASE</td>
</tr>
<tr>
<td>BLUE WATER HULL</td>
<td></td>
<td>FLAT TO 10% DECREASE</td>
<td>FLAT TO 5% INCREASE</td>
</tr>
<tr>
<td>BROWN WATER HULL / P&amp;I / POLLUTION</td>
<td></td>
<td>FLAT TO 5% DECREASE</td>
<td>FLAT TO 5% INCREASE</td>
</tr>
</tbody>
</table>

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

Market Commentary

Added capacity from new market entrants generally helped to prevent marine insurers from increasing rates or imposing restrictive terms and conditions in 2014. Generally, most marine market insureds with favorable loss profiles renewed flat or with rate decreases; however, underwriters remained concerned about aggregate exposures. Many insurers are adjusting their participation on specific accounts in order to manage high-hazard risks. Underwriters continued to ask insureds to provide more detailed information at renewal, including about their claims history and safety and quality control programs.

MARINE LIABILITIES, HULL, AND PROTECTION AND INDEMNITY

Underwriters generally were not able to sustain late 2013’s upward pressure on rates (largely focused on marine liabilities, but with some spillover into hull risks). By April 2014, the abundance of capacity in the US and London had made the market more competitive. Barring significant catastrophic marine losses or substantial reduction in marine reinsurance capacity, current market conditions should continue into 2015.

Competition on blue water hull continues to drive rate reductions. Insurers in London remain the most aggressive in terms of targeting new blue water business, followed by insurers in Norway.

At the opposite end of the spectrum, the US market is currently the most conservative and most resistant to large cost reductions. London underwriters continue to target select Gulf of Mexico risks, making an already competitive market even more so.

Certain marine liability underwriters are deemphasizing or reducing their excess book, preferring to commit resources and capacity to primary layers. This shift in capacity and focus, however, is not likely to have a significant effect on excess rates.

The International Group of P&I Clubs (IG), holding record levels of free reserves, is in a position to allow considerably lower general rate increases than has been the norm over the last several years. Not all
IG clubs are exhibiting the same business development behavior; several clubs are actively diversifying into a portfolio of non-poolable covers and going well beyond protection and indemnity, while the balance are sticking to traditional poolable risks. The growing market presence of the former group is adding to pressures on capacity and rating among traditional (non-club) markets.

Despite downward pressure on pricing, underwriters continued to apply greater scrutiny on liability policy wording.

**MARINE CARGO AND STOCK THROUGHPUT (STP)**

Capacity in the marine cargo and stock throughput (STP) market grew to approximately $2 billion in 2014, driven by the addition of new syndicates in London and growth in the Asian marine marketplace. Cargo and STP programs remained profitable lines for the global marine insurance marketplace. In 2014, client demand remained high for STP programs, which offer an attractive alternative to traditional property insurance for coverage of stock and inventory. The marketplace for project cargo, including delay in start-up, was active, with capacity typically abundant and rates competitive.

Overall, the market was generally stable and competitive for most risks. Rates were generally flat, although slight reductions were consistently achieved for organizations with good long-term loss records. For those with poor loss records, some insurers attempted to negotiate rate increases, with mixed results.

Cargo and stock throughput capacity is expected to expand further in 2015. Overall, cargo and STP terms and rates will likely remain competitive for most risks. Although there is more marine stock throughput capacity now than ever before, organizations with large stock values in catastrophic peril zones are likely to be reviewed in detail by insurers. Meanwhile, higher retentions and the use of captives are expected to increasingly be considered as options, particularly when meaningful premium credits are to be achieved.

**RISK TRENDS**

**Losses**

Continuing a trend that began in 2012, attritional losses in the cargo and STP market increased in 2014. Several large transit losses along with some notable large stock/inventory losses appear to have affected some marine insurers more than others. This could lead some insurers to attempt to raise rates and pressure for higher retentions in 2015.

**Greater Underwriting Scrutiny**

Marine cargo and stock throughput insurers have become more focused on their potential exposures to catastrophic events, driven by increases in the values and accumulations of insured goods onboard vessels, within port areas, in distribution centers, and in warehouses.

Meanwhile, for operations in countries or geographies known for high theft rates or with limited transit and storage infrastructure, some marine insurers restricted coverage and/or required higher deductibles. Certain products, such as automobiles, temperature-sensitive products, and high-valued consumer goods, may become more difficult to insure as some insurers have withdrawn from or reduced their participations in these classes of business.

Marine liability insurers were also beginning to pay more attention to the amount of insurance their clients require from counterparties, including vendors, contractors, and charterers.

To better position themselves for competitive and comprehensive marine insuring terms, organizations should provide detailed underwriting information to insurers well in advance of their renewal dates. Indications of shipment values on a single conveyance and at consolidation points along with details of major shipping routes and loss control measures are important to setting proper limits and achieving the most competitive terms. For stock throughputs, organizations should provide a complete statement of stock values with construction, fire protection, and security details of the stock locations.

**Transportation**

Through the first nine months of 2014, US tank barge construction was on a record pace; nevertheless, tank barge availability was constricted. Several lessors in this space have advised that they are backing away from financing tank barges over concern that reductions in the price of crude oil will damage the economic viability of the overall tank barge fleet.

The expected expansion of the Panama Canal is leading clients engaged in transportation and storage of dry bulk and liquid cargo to increase their fleet size and terminal and storage capacity in the Gulf of Mexico to accommodate what they expect will be greater shipping volume to the Pacific Rim.

Meanwhile, lack of US rail capacity will likely push more corn and soybeans to the river system.

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Political Risk

INSURANCE MARKET CONDITIONS

<table>
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<th>RATE CHANGE Q4 2013</th>
</tr>
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<td>FOREIGN INVESTMENT INSURANCE (EXPROPRIATION AND POLITICAL VIOLENCE COVERAGE)</td>
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<td>FLAT, EXCEPT FOR HIGH-DEMAND OR HIGH-RISK AREAS, WHICH MAY SEE INCREASES OF 10% OR MORE</td>
</tr>
<tr>
<td>CONTRACT FRUSTRATION/ NON-PAYMENT INSURANCE</td>
<td>5% DECREASE</td>
<td>FLAT</td>
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</table>

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

Market Commentary

Buyers of political risk insurance in 2014 experienced generally favorable market conditions, which are expected to extend into 2015. With rates generally soft in such coverage areas as property and directors and officers liability, many insurers have turned to specialty lines such as political risk to improve their profitability. This has helped to drive political risk insurance capacity to record levels, thus sparking competition. In the fourth quarter of 2014, rates for foreign investment insurance remained stable for most countries. Pricing for non-payment insurance — purchased most frequently by banks — is often driven by interest rates, which have fallen to pre-financial crisis levels. In the fourth quarter of 2014, rates for contract frustration and non-payment insurance fell on average by 5%.

Despite favorable conditions globally, coverage remains expensive or difficult to secure in some countries for a variety of reasons, including general political instability, war risk, economic sanctions, and threats of default. Difficult countries include Argentina, Libya, Mali, Myanmar, Pakistan, Russia, Ukraine, Sudan, South Sudan, Syria, and Venezuela.

RISK TRENDS

Political Violence

The Arab Spring revolutions that began in late 2010 appear to be only the first phase in a long-term transformation of the Middle East and North Africa. Much of the region — including Libya and Syria — remains at war, while the influence of the Islamic State terrorist group has contributed to instability in Turkey, Iraq, and elsewhere. This regional instability has raised red flags among underwriters about countries that have historically been considered stable, such as Saudi Arabia. Beyond the Middle East and North Africa, underwriters also remain concerned about potential violence in Ukraine, Thailand, Hong Kong, and Taiwan.

End of Quantitative Easing

In late 2008, the US Federal Reserve adopted a policy known as “quantitative easing,” through which the Fed would periodically purchase Treasury bonds in order to keep interest rates low and stimulate the economy. This policy helped to stimulate the economies of many countries for which the US dollar is the reserve currency, including virtually every emerging market. Japan and several European governments have also engaged in quantitative easing since the financial crisis.

The US ended quantitative easing in late 2014. Some governments — for example, Peru and the Philippines — recognized that quantitative easing would not be a permanent policy, and passed needed reforms and restructured their economies over the last several years to prepare for its inevitable conclusion. Other governments did not act in the same manner and are now seen as at risk of suffering economic downturns. This divergence of emerging markets is increasingly being factored into decisions by investors and underwriters, which previously had treated emerging countries as a homogeneous group.

Looking ahead, this could adversely affect political risk insurance rates for countries whose economies begin to falter.

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Surety

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

Market Commentary

In 2014, the surety market remained stable, producing the ninth consecutive year of underwriting profitability. The surety industry outlook for 2015 is generally positive, with sufficient capacity and continued market stability expected, although increased losses could temper future profitability. Market capacity expanded in 2014, with new entrants to the surety line and many underwriters willing to take larger exposures.

CONTRACT SURETY

Construction project expected to be put in place in 2015 through 2017 are predicted to grow in the range of 7% per year, providing continued growth prospects for the contract surety segment. Large construction and public private partnership (P3) opportunities are expected to drive the upturn; homebuilding and development are experiencing growth as well. Underwriters remain concerned with small and midsite contractors that saw their market share squeezed, lower margins that did not address overhead, and subcontractor failures.

COMMERCIAL SURETY

Commercial surety capacity is expected to grow, with new market entrants and increased available capacity from existing sureties. Commercial surety underwriters are in a competitive pricing cycle, a trend that is likely to continue in 2015 providing that reinsurance continues to support new entrants and loss trending remains flat. Underwriters are supporting opportunities to use surety bonds in lieu of letters of credit — a real value to clients that aim to use financing capacity for business expansion and bonds to secure other administrative obligations.

INTERNATIONAL SURETY

Major underwriters are expected to expand foreign surety writings by establishing licensed, foreign domiciled, guarantee companies and through acquisitions of foreign guarantee companies. This may provide organizations with more options to use surety/insurance guarantees in lieu of bank guarantees as contract security.

RISK TRENDS

Alternative Project Delivery Methods

Public owners are increasingly aware of, and comfortable with, using alternative financing techniques for projects to meet and maintain needs for roads, bridges, and other public infrastructures.

Subcontractor Default

A major subcontractor default poses significant risks to the financial health of the prime contractor. As an added risk mitigation measure, contractors should consider using subcontractor financial benchmarking services.

Contract Terms

Owners continue to push construction risks downstream to contractors. Contractors can use the services of a skilled surety broker to help them negotiate for less onerous final contract terms and conditions.

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Trade Credit

INSURANCE MARKET CONDITIONS

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<td>TRADE CREDIT</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

The market for trade credit insurance was generally favorable for buyers in 2014, with conditions expected to remain that way into 2015. Trade credit insurers have expressed some concerns about retail bankruptcies in the US and have taken steps to reduce their exposure to that industry, but that does not appear to be having an effect on the overall market. In the fourth quarter of 2014, rates typically decreased 5% to 10%.

Trade credit claims, driven by bankruptcies, increased slightly in 2014 in both frequency and severity. Among underwriters concerns: the potential effects of the recent bankruptcy of a leading global ship fuel supplier, ongoing economic sanctions in Russia, and debt concerns in Argentina and Venezuela. Still, the overall global claims environment remained relatively benign, and trade credit insurance capacity continued to increase in the US and elsewhere.

RISK TRENDS

Syndication

Underwriters have become more disciplined in the trade credit market, and syndication has become a more attractive approach as insurers seek to share risk. Syndication can occur via either a top-up program, in which a single underwriter covers most of a portfolio and another provides excess capacity, or by assigning specific risks to individual insurers.

Multi-Country Programs

Multinational companies with sizable exposure to Russia or other global trouble spots may have difficulty securing standalone insurance coverage for those risks. Such organizations are increasingly turning to multi-country trade credit insurance policies, which can be customized to provide broad coverage for as many as 20 countries in a specific region, or spread globally. Because multi-country policies allow underwriters to spread risk across several countries, they often include more favorable terms and conditions than single-country policies — for example, more attractive pricing or higher limits.

Requests for Longer Payment Terms

Borrowers continue to apply pressure on lenders for additional working capital needs, but banks are not necessarily funding these increased financing requirements on their own balance sheets. Instead, trade credit insurance buyers are now asking underwriters to build longer payment terms for their suppliers into trade credit policies to address this additional risk. Insurers have generally been amenable to supporting this longer risk period.

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<td>LOSS SENSITIVE</td>
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<tr>
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<td>EXCESS LIABILITY</td>
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<td>FLAT</td>
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<td>CONTRACTOR POLLUTION LIABILITY</td>
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<tr>
<td>POLITICAL RISK</td>
<td></td>
<td>FLAT</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

### Market Commentary

**PROPERTY**

Rates in the property sector began falling in the first quarter of 2014 and continued to do so throughout the year. This trend is likely to continue in 2015, absent major losses, as capacity remains abundant. Insurers are competing for business, which is holding the reins on rate increases. Natural catastrophe perils, such as windstorms, floods, and earthquakes remained top priorities for chemical companies and insurers. Contingent time element coverage, such as with third-party property losses involved, was another key area of focus for firms in 2014. To best position a chemical risk, companies should be prepared to present insurers with updated insurable values and risk engineering reports outlining the company’s focus on continuous risk improvements.

### CASUALTY

The primary casualty markets were generally stable in 2014, with slight increases of less than 5% at renewal on average for chemical insureds, though new business was priced aggressively. Some insurers have attempted to achieve slight increases, but are generally willing to stay flat for what they consider to be good risks.

Capacity in the casualty market for the chemical sector was ample. The excess market, in particular, saw increased competition among carriers seeking to become lead insurers for companies with favorable risk profiles. The recent shift in a leading insurer’s chemical business...
away from the US to London has opened up opportunities for other carriers. In this environment, new business may be able to achieve rate decreases into 2015. To help achieve the best possible outcomes at renewal, companies should ensure they provide a complete underwriting submission and actively participate in insurer underwriter meetings.

ENVIRONMENTAL
Sufficient capacity and increased merger and acquisition activity were key drivers of the environmental insurance market in 2014. Rates remained generally flat, with some programs seeing a marginal decrease at renewal. Short-term, renewable programs were typically favored by chemical firms purchasing environmental insurance. More complex, legacy transactions — particularly those with terms in excess of five years — were of less interest and, consequently, typically saw flat to increased rates at renewal.

The number of environmental claims in the sector climbed in 2014. The combination of increased use of environmental risk transfer, the significant number of long-term legacy policies in force, and the widening coverage provided over the past five years is likely to drive significant claims activity for many years. This is a major factor in the rebalancing of insurers’ business to shorter term policies and lower limit programs.

POLITICAL RISK
Chemical companies can typically buy broad coverage for political risk in all geographies at competitive rates, except in those countries deemed to be experiencing political unrest. Coverage considerations are a keen area of focus for insureds since terrorism insurance often costs more than political risk insurance that includes terrorism coverage. Market conditions are likely to remain the same in 2015, although they could change if underwriters see significant losses in countries experiencing unrest.

RISK TRENDS

Macro Exposures
The cost of manufacturing in the US dropped considerably because of the decrease in energy prices; however, chemical firms face macro risks including global expansion, increased regulation, and “green” initiatives. President Obama’s executive order to improve the safety of chemical facilities after the West Texas fertilizer plant explosion of 2013 is likely to have ramifications for chemical firms as they follow product safety management (PSM) requirements. Similarly, European Union regulations — such as Registration, Evaluation, Authorization, and Restriction of Chemicals (REACH) — will be a key risk area for insureds in 2015. EU biodiversity and other ecosystem regulations, in particular, will be closely watched. Overall, chemical firms looked to be more eco-friendly in 2014, which will likely continue in 2015 and beyond.

Product Risks
Product recalls, chemicals presenting a toxic inhalation hazard, the transportation of chemicals by rail, and products that use nanotechnology have become increasingly difficult to insure. Companies that use petrochemicals were hard to insure in 2014, and are likely to remain so in 2015. Insureds should be able to address underwriters’ questions regarding such risks and differentiate their operations from their competitors.

Natural Hazards/Supply Chain
Catastrophes such as floods, earthquakes, and windstorms remain difficult to insure for chemical companies. Organizations should continue to focus on ways to mitigate preventable risks and prepare for unforeseen events. Chemical companies should review the adequacy of insurance coverage for business interruption risks related to natural catastrophes. Risk managers can work with risk engineers to make recommendations, and with risk advisors to quantify exposures and develop natural hazard modeling to share with underwriters. Providing complete and accurate data from a reliable source regarding loss estimates can help organizations achieve the best outcomes at renewals.

Cyber Risks
With increased focus on security, chemical companies are evaluating the operational risks they may face should they experience a breach in cyber security.

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Communications, Media, and Technology

Insurance Market Conditions

<table>
<thead>
<tr>
<th>Coverage</th>
<th>Segment</th>
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<th>Rate Change Q4 2013</th>
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<td>Workers’ Compensation</td>
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<td>Employment Practices Liability</td>
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<td>Fiduciary Liability</td>
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<tr>
<td></td>
<td>Errors and Omissions</td>
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</tbody>
</table>

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

Market Commentary

Property

The property insurance market in 2014 continued to soften for communications, media, and technology (CMT) companies, driven largely by an influx of alternative insurance and reinsurance capital, insurer competition, and limited catastrophe (CAT) losses. The trend is expected to continue into 2015 barring major CAT losses or other unforeseen conditions. Software and media companies with low to moderate property exposures could see premium decreases of about 7.5%, while large hardware and communications companies with extensive property programs may see decreases ranging, on average, from 10% to 15%.

Business interruption and contingent business interruption remain key risks for CMT companies, and are among the most difficult to value and underwrite. Companies with a short or unknown list of key suppliers typically had more difficulty obtaining large limits on contingent business interruption insurance. Companies that can more clearly account for and name their suppliers may be able to secure higher contingent business interruption limits in 2015.

Casualty

The overall casualty insurance market was generally stable, with many CMT organizations achieving significant rate decreases in the fourth quarter of 2014. Ample capacity and insurer competition contributed to generally declining rates; and, barring unforeseen circumstances, insureds can likely expect to see flat to decreasing rates in 2015 for core general liability and auto liability exposures. Companies that marketed their insurance programs well before renewals typically achieved better rates, a trend that is expected to continue in 2015. After some variability in workers’ compensation prices in the fourth quarter of 2014, rates are expected to generally remain flat in 2015.

As technology companies have expanded their hardware products into new industries, casualty programs have become more complex. Liability from hardware products included in medical devices, aviation, rail, and other industries are typically excluded by insurers from general
liability policies. As a result, companies may need to purchase multiple towers of insurance, which can fracture a liability program. Alternative insurance programs may be more efficient, less fragmented, and less expensive for technology companies.

**FINANCIAL AND PROFESSIONAL**

For many CMT sectors, rates for errors and omissions liability (E&O) were flat in 2014. The excess insurance market experienced rate increases throughout 2014, as capacity could not keep up with demand. In particular, rates for organizations with data security or mobile operations increased more than others. As a result, insureds should try to differentiate their risk profile with thorough presentations at renewals.

Overall capacity generally remained strong for technology E&O in 2014, ranging from $200 million to $400 million depending on the class of the insured; new entrants bolstered capacity in both primary and excess markets. Individual insurer appetite changed significantly depending on class; available capacity was limited for certain sectors, especially those with retail exposures such as transaction processors.

Directors and officers (D&O) liability rates softened for CMT companies with stable stock prices and no claims history; these companies can expect flat to slightly decreasing rates in 2015. Companies with challenging risk profiles, recent claims, volatile stock prices, or recent stock drops may see increases.

Large data breaches in 2014 led to greater interest in privacy and cyber liability insurance. CMT organizations should expect cyber insurers to push for higher rates in 2015, especially on large risks. Generally, companies with existing cyber coverage purchased higher limits at renewals. Many businesses handling significant amounts of their customers’ sensitive data face specific insurance requirements from those customers. Generally, the requirements are within insureds’ program limits, but the scope of coverage requested has expanded to include network, information security, and privacy insurance.

**RISK TRENDS**

**Global Risk**

CMT companies depend on a network of international systems, global operations, and supply chains that are often exposed to natural catastrophes, civil unrest, and political risks. As a result, CMT companies can be vulnerable to unpredictable and devastating global risks, some of which may be uninsurable. An effective enterprise risk management framework and governance structure can help CMT organizations plan and respond to specific threats.

**Supply Chain**

The convergence of major suppliers through recent mergers and acquisitions (M&A) increased supply chain risks for many CMT organizations. This is of particular concern for hardware companies that require greater specialization from vendors amid a shrinking pool of available suppliers due to industry M&A. As a result, the potential failure or disruption of one supplier can affect the entire industry by severely restricting the availability of key hardware components. Understanding and quantifying total supply chain exposures can help CMT companies develop effective insurance and risk management programs.

**Information Infrastructure**

The technological risks of cyber-attacks, data fraud and theft, and breakdowns in critical information infrastructure are strongly connected to each other and to risks such as terrorist attacks and global governance failures. This reflects the changing nature of vulnerability in an increasingly digitized world.

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**PERCENT OF US GENERAL LIABILITY CMT CLIENTS WITH RATE CHANGES**

Source: Marsh Global Analytics
Numbers may not add up to 100% because of rounding.
Construction

INSURANCE MARKET CONDITIONS

<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>SEGMENT</th>
<th>RATE CHANGE Q4 2014</th>
<th>RATE CHANGE Q4 2013</th>
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<td>LARGE/MIDSIZE ORGANIZATIONS</td>
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<td>ALL OTHER PERILS</td>
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<td>CONTRACTORS POLLUTION AND PROFESSIONAL LIABILITY</td>
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<td>5% DECREASE TO 10% INCREASE</td>
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</table>

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

Market Commentary

PRIMARY CASUALTY

Commercial general liability (CGL) rates for construction firms are likely to generally renew in the range of flat to 7% increases in 2015. Residential contractor rates may increase further due to construction-defect claims for condominiums and apartments. Insurer competition was a key to achieving favorable renewal results. Insurers in 2015 will likely seek to “round out” accounts by aggregating their efforts across product lines. Insureds with high loss frequencies or severities are likely to experience significantly higher than average workers’ compensation rate increases in 2015.

Significant challenges remain in Chicago and in the states of Colorado, Florida, New York, and Washington, particularly for residential constructors. Insurers continue to increase deductibles and add higher attachment points for umbrella programs. Some excess and surplus insurers assumed a strategy of offering lower deductibles in concert with substantial rate and premium increases.

EXCESS CASUALTY

Rate increases and attachment points generally trended higher in New York due
to labor laws. Outside of New York, excess casualty rates generally increased in the low single-digits in the fourth quarter of 2014; rate decreases were rare. With capacity abundant, similar conditions are likely in 2015.

PROFESSIONAL LIABILITY

New market capacity and increased underwriter appetite kept the professional liability market generally competitive for small and midsize firms in 2014. Although firms that considered changing insurers typically experienced strong competition on pricing and enhanced policy terms and conditions, such decisions should be carefully considered. Organizations are likely to see additional pricing pressure on the primary professional liability marketplace in 2015.

ENVIRONMENTAL

The market for contractors pollution liability (CPL) is likely to remain competitive in 2015, especially for small and midsize firms. Rate increases in 2014 were typically driven by adverse loss history or revenue increases. Layered programs involving multiple underwriters remained popular for large contractors, and were often necessary in light of capacity restrictions or aggregation issues.

PROJECT-SPECIFIC POLICIES

GL Wraps

The use of project-specific policies by contractors, architects and engineering firms, and project owners increased in 2014. Contractors and project owners experienced a competitive market, largely driven by an abundance of capacity for most projects types in most jurisdictions. In some instances, insurers offered admitted paper for general liability wraps with favorable risk and client profiles. New York’s labor laws remain a challenge; insurers willing to underwrite New York projects increased premiums and retentions, a trend expected to continue in 2015. Several insurers restricted coverage for residential projects as residential condominium construction increased.

Workers’ Compensation

Demand for contractor controlled insurance programs (CCIPs) — GL, excess casualty, and workers’ compensation — increased. Contractors able to assume and manage subcontractor risk found that wrap-ups can offer competitive advantages. Underwriters in 2015 will likely continue to seek more detailed information on budgets, schedules, and parties involved.

Builders Risk

Demand for builders risk insurance grew in 2014, driven in part by an increase of projects in southeast Florida. New entrants increased capacity, but this did not typically affect rates.

Professional Liability

While coverage for project-specific professional liability insurance remained restrictive, insureds in 2014 benefited from additional capacity. Owner’s protective insurance remains a popular and less costly alternative. Contractor’s protective professional indemnity provided flexible, cost-effective protection in support of design-build and engineering, procurement, and construction (EPC) contracts. On new projects, owners typically demanded higher limits from design firms and introduced more restrictive indemnification agreements from subcontractors and subconsultants. Despite an uptick in residential projects in 2014, capacity in 2015 will likely remain restrictive in 2015, particularly for California and Florida.

Environmental

Project-specific policies covering pollution legal liability and contractors pollution liability continue to be used for large, complex projects. Owners’ and lenders’ environmental insurance requirements are now often higher than any single insurer’s capacity, resulting in the need for layered programs. Ample excess capacity is generally available to meet the needs of most projects, and primary and excess layers remain very competitive. The use of owner’s protective CPL coverage is gaining popularity, although offered by a limited number of insurers.

RISK TRENDS

Subcontractor Default

Competition in the subcontractor default insurance market increased in 2014, with many insurers launching SDI products and targeting smaller firms. Although losses are becoming a concern for some underwriters, rate reductions of 5% to 15%, and coverage/claim improvements, were generally possible.

Punitive Damages

State laws regarding punitive damages constantly evolve. Organizations should consult legal counsel for updated and current information on the punitive damage rules for particular jurisdictions. At renewals, organizations should assess their individual risks by reviewing the potential exposure of products or services at risk for punitive judgment, and the availability and pricing of offshore punitive wrap-around policies.

Cyber Liability

Construction firms that fall prey to cyber-attacks can incur significant costs when remediating data breaches. Many GL policies include specific exclusions for cyber claims, but standalone cyber policies can provide coverage for data breaches and similar losses.

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Following trends seen in the overall insurance market, most education clients saw their property programs renew in the fourth quarter of 2014 with flat rates or with slight reductions. Many institutions have competitive programs borne out of their participation in group or consortia program arrangements that give them greater buying power. Better outcomes were generally realized by education insureds that aggressively marketed programs after being penalized by an incumbent insurer for losses.

Although underwriters remained concerned about education clients with natural catastrophe exposures, strong capacity enabled many of them to maintain or even increase catastrophe peril limits at a reduced premium. Underwriters continued to focus on large maximum foreseeable loss exposures at colleges and universities, typically associated with main libraries and power generation facilities. The loss potential from tornadoes and other convective storms due to the dense concentration of insured properties in campus settings is a growing concern for underwriters, particularly in the Midwest and Southeastern US. For the most part, abundant capacity has prevented underwriters from introducing new coverage restrictions or increased pricing for these risks.

The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), created as a response to the attacks of September 11, 2001, has been an important consideration for education institutions’ property insurance programs. Most industry observers were surprised that Congress allowed TRIPRA to expire at the end of 2014, although it acted quickly on the matter upon reconvening in January 2015. For details, please see the Terrorism Risk section of this report.

Some carriers are unwilling to provide full coverage for sexual molestation claims stemming from childcare operations, summer sport camps, campus housing, fraternities, and athletics. For most education exposures, insurers generally require additional information on controls and policies, especially around concussion awareness training in athletic programs. Although rates have moderated, underwriting remains conservative.

Excess workers’ compensation rates for the sector are expected generally to increase an average of 5% to 15% in 2015, with market capacity remaining limited. Depending on individual state filing and loss experience,
midsize schools with guaranteed cost programs will likely see typical increases in the 5% to 10% range. The greatest volatility in excess workers’ compensation pricing continues to be seen in California.

**FINANCIAL AND PROFESSIONAL**

Not-for-profit institutions saw the market for educators’ legal liability insurance — including directors/trustees and officers (D&O) liability, employment practices liability (EPL), and educators’ errors and omissions (E&O) liability — begin to firm in the second half of 2014, driven by an increase in EPL losses. In the fourth quarter, the average renewal increased 5% to 7%. Underwriters remained concerned about antitrust and gainful employment claims and class-action litigation related to allegations of misleading job placement statistics. Insureds generally should expect rates to continue to firm in 2015. For-profit and publicly traded institutions are often forced to purchase D&O and EPL coverage separately from E&O coverage. The professional liability market for these insureds remained limited entering 2015.

**RISK TRENDS**

**CONCUSSIONS**

United Educators (UE) has installed a policy change regarding traumatic brain injury (TBI) and potential litigation from sports-related injuries. UE’s primary commercial general liability and general liability excess policies will now have separate aggregates for TBI. Most other education underwriters are assessing the potential impact of TBI risks. Concussions have primarily received attention in football; however, underwriters are concerned about the risks in club sports, where there is often limited oversight of injuries.

**CYBER RISK**

Colleges and universities collect a sizable amount of personally identifiable information from students, faculty, and others, as well as protected health information from patients via affiliated medical facilities. In 2013, higher education was the second most frequent target of cyber-attacks, according to Kroll, with malicious intent attributed to 73% of these attacks. Institutions should regularly review and update cyber risk mitigation strategies, including their cyber insurance coverage. It’s important to understand what coverages are — and are not — likely to respond to a cyber-attack.

**CRISIS MANAGEMENT**

Beyond the sheer physical harm, acts of violence and other crises can disrupt normal campus operations, damage reputations, and affect financial viability. For example, primary and secondary schools, colleges, and universities were the locations for nearly one-third of all so-called “active shooter” events in the US between 2000 and 2012, according to the ALERRT Center at Texas State University. And there were a number of shootings at institutions in 2014. Meanwhile, colleges and universities continue to expand study-abroad programs, potentially exposing students, faculty, and others to a range of new risks, including terrorism, kidnappings, political violence, and, as seen in 2014, communicable diseases, such as Ebola.

Effective emergency and crisis management programs can help to protect organizations and facilitate a return to normal operations after a shooting or other incident. Emergency plans should address communication between faculty and other stakeholders, evacuation and lockdown strategies, and how to work with law enforcement; post-event management plans should include provisions on counseling for injured or affected students and families, community and media relations, and post-incident reviews. These plans should be designed for specific locations, and be well-tested ahead of an event.

**REGULATORY COMPLIANCE**

A change in laws or regulations at either the state or federal level can dramatically increase the costs of conducting business — for example, adding requirements for compliance audits, staff education, and other responsibilities, or altering the competitive landscape. For example, in 1990, Congress passed the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act (known as the Clery Act), which requires higher education institutions to report crime statistics and disclose security-related information. In 2013, Congress passed the Campus SaVE Act, which amended the Clery Act by affording additional rights to on-campus victims of sexual and dating violence and domestic violence.

Many higher education institutions are adopting an enterprise risk management (ERM) approach to assure compliance with these new provisions. ERM creates a strategic risk management concept that enables an institution to understand its overall risk profile, treatment of risks, and prioritization of risk drivers with appropriate mitigation solutions. Boards of trustees at colleges and universities have also adopted more stringent measures to capture relevant information and receive regular feedback as part of their fiduciary responsibility to their institutions.

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Financial Institutions

INSURANCE MARKET CONDITIONS

<table>
<thead>
<tr>
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<th>RATE CHANGE Q4 2013</th>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

PROPERTY

Property insurance rates for financial institutions generally softened in 2014, driven by limited catastrophe losses, an oversupply of capacity, strong competition, and an influx of alternative insurance and reinsurance capital. The soft property market is likely to continue into 2015, barring major catastrophe losses.

Insurers scrutinized coverage terms and conditions, with a focus on flood, storm surge, and business interruption (BI). Calculating BI exposures challenged financial institutions, particularly banks, which increasingly sought the coverage. With limited information available about the costs associated with losses, insurers are likely to struggle to underwrite BI. Organizations that present underwriters with comprehensive business continuity plans and detailed information about their properties — including construction type, age, year built, and other factors — may see generally positive responses from insurers at renewals.

The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), created as a response to the attacks of September 11, 2001, has been an important consideration in property insurance programs. Most industry observers were surprised that Congress allowed TRIPRA to expire at the
end of 2014, although it acted quickly on the matter upon reconvening in January 2015. For details, please see the Terrorism Risk section of this report.

CASUALTY

Casualty insurance rates decreased in the fourth quarter of 2014 for less than half of financial institutions. Generally, casualty rates are likely to remain flat in 2015. Financial institutions’ workers’ compensation lines were challenged in terms of pricing and capacity, particularly for organizations with sizeable exposures in large metropolitan areas. Capacity is not expected to substantially increase in 2015, and financial institutions are likely to experience a difficult workers’ compensation market.

In 2014, many insurers sought to exclude cyber risks from policies, highlighting the need for organizations to purchase separate cyber insurance. Many sought to exclude cyber risks from bodily injury and property damage losses from commercial general liability (CGL) policies; excess insurers sought similar cyber exclusions. As cyber policies typically do not cover such exposures, organizations in 2015 may consider working with their insurance advisors to ensure that bodily injury and property damage losses stemming from a cyber event are covered.

FINANCIAL AND PROFESSIONAL

While financial and professional liability insurers generally sought rate increases in 2014, the market remained flat, with plentiful capacity. Increased regulatory oversight and inquiries of large financial institutions continued to challenge large errors and omissions (E&O) underwriters, particularly in the primary and low excess portions of programs. Barring unforeseen circumstances, financial institutions can expect generally flat overall rates in 2015; however, E&O and cyber liability could experience greater volatility due to the risk factors associated with these products.

Rates for directors and officers liability (D&O), employment practices liability (EPL), and fidelity bonds for financial institutions will likely remain flat for most firms in 2015, barring unforeseen events. Certain industries — including asset management firms and insurers — are more likely to achieve rate decreases in excess insurance pricing due to the highly competitive environment.

RISK TRENDS

Regulatory Compliance

Banks, investment firms, and insurers face increased regulatory scrutiny in 2015. The Securities and Exchange Commission (SEC) is preparing new rules aiming to increase oversight of mutual funds to better understand how the asset management industry can potentially affect the stability of the US financial system. As part of the National Association of Insurance Commissioners (NAIC) modernization initiative, all midsize and large US insurers will be required to file an Own Risk Solvency Assessment (ORSA) in 2015. This requirement gauges insurers’ current and future risks through an internal risk self-assessment process that informs regulators of an insurer’s ability to withstand financial stress.

Banks continue to adjust to the rules and procedures imposed by the Sarbanes-Oxley and Dodd-Frank acts. Clawback provisions that require disclosures and recovery of incentive compensation are especially difficult to insure since few carriers are willing to extend coverage to address the provisions, the penalties of which can significantly increase the overall fines and penalties paid by a bank.

Cyber-Attacks

The importance of cyber insurance was reinforced in 2014 after a major US-based financial institution experienced a cyber-attack that affected an estimated 76 million households. The notification and investigation costs of a data breach are a significant concern for financial institutions; and regulatory scrutiny of cyber security procedures pose a particular issue for investment companies. The average cost of a data breach increased to $3.5 million in 2014, according to a Ponemon Institute study. The SEC announced that cyber security was an examination priority in 2014, which could lead to additional recommendations in 2015. In a recent Marsh poll of fund managers with assets under management of more than $100 billion, more than 47% said they now buy cyber insurance.

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Health Care

INSURANCE MARKET CONDITIONS

<table>
<thead>
<tr>
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<th>SEGMENT</th>
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<td>5% INCREASE TO 10% INCREASE</td>
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<td>HEALTH CARE</td>
<td>MEDICAL “TREND” INCREASE TO CLAIMS-DRIVEN INCREASE</td>
<td>MEDICAL “TREND” INCREASE TO CLAIMS-DRIVEN INCREASE</td>
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The above represents the typical rate change at renewal for average/good risk profiles.

Market Commentary

The ongoing rollout of the Affordable Care Act (ACA) shaped the health care industry in 2014, and will continue doing so in 2015. Faced with declining reimbursements — resulting from the shift from fee-for-service to value-based health care — providers must determine how to deliver care and manage structural and clinical changes to drive down costs. Merger activity is at an all-time high as consolidation is seen as both a growth and a survival strategy. However, increased antitrust scrutiny from the Federal Trade Commission (FTC) has forced some health systems to look to other operational strategies. As health care is the most regulated industry in the US, providers face ever-increasing compliance requirements to ensure maximum reimbursement from government entities and avoid costly fines, penalties, and reputational damage.

MEDICAL PROFESSIONAL LIABILITY (MPL)

Medical professional liability (MPL) insurance remained a competitive area through 2014. Capacity was stable, and even grew, throughout the year as insurers generally offered renewals at flat to downward trending rates for organizations with stable exposures in stable venues. The competition among insurers coupled with consolidation among health care organizations added to the favorable environment, as mergers and acquisitions (M&A) led to fewer large purchasers of MPL. There appeared to be an uptick in severe or catastrophic claims in the MPL area; however, this was not expected to create a general firming of rates in the foreseeable future. In addition, insurer reserves from prior accident years have a positive impact, even with recent accident year loss ratios moving higher.

DIRECTORS AND OFFICERS (D&O) LIABILITY

The health care D&O insurance marketplace in 2014 was driven by consolidation within the industry and underwriter concerns about strategy risk and antitrust risk associated with M&A activity. In 2015, average rate increases are likely to moderate slightly as most buyers have been through two or more renewal cycles where rates increased and coverage restrictions around antitrust exposures were imposed. Underwriters generally will need to be able to point to ongoing claim activity in order to justify imposing premium increases. The initial underwriting uncertainties and anxieties around health care reform are likely to largely abate as insurers switch their focus from trying to understand reform to underwriting strategy risk as their clients execute business strategies into 2015 and beyond.

MANAGED CARE ERRORS AND OMISSIONS

The managed care errors and omissions (E&O) liability insurance marketplace remained generally stable in 2014. Insurer participation remained static except for one new entrant in the second quarter. Insurers typically sought single-digit rate increases for most insureds, but typically pushed for larger rate increases for companies that expanded their membership or otherwise increased in size. Capacity was generally stable heading into 2015. Underwriters carefully evaluated their exposures to health plans in light of the ongoing antitrust multidistrict litigation (MDL), for which discovery is expected to conclude in early 2017. Although some health plans focused on traditional areas of operations, others have expanded by purchasing clinics, hiring physicians, and providing data services to other plans as they form accountable care organisations.
orgnizations (ACOs). Insurers focused on the resulting managed care E&O risks, which may not have been originally contemplated when underwriting a client’s risk profile. Larger payers are looking at expanding into areas that oftentimes solicit the expertise of technology firms, such as wellness program management and population health.

The health exchange environment and implementation of the ACA have led to uncertainty about future litigation and unknown uptake on utilization by new health insurance purchasers in the private market. Accounting safe havens — also known as “risk corridors” — for health plans participating in exchanges will likely only help through 2015. Court cases also bear watching in the federal district court of appeals in Washington, DC, which challenge an IRS loophole related to the legality of federally based exchange subsidies. Without this subsidy, it is uncertain what the future of ACA holds.

Many insurers are troubled by the issue of coverage for regulatory and antitrust issues; some have instituted limit management guidelines across their managed care book. Insureds have taken the opportunity to market primary positions to ensure that coverage and price are still in line with their individual risk profile. Some insureds have taken measures to preserve their regulatory coverage while renewing with new carriers that don’t require restrictive mandates specific to regulatory coverage.

**RISK TRENDS**

**Patient Safety/Quality**

Care models are transitioning due to the cost reductions inherent in the fee-for-value payment model under ACA. These changes are expected to improve outcomes for patients through collaborative care models. However, the formation of ACOs that link various providers across a continuum of care for patients may, in the short term, increase the likelihood and severity of malpractice risk. Factors include the potential conflict of improving quality while seeking cost reductions, clinical integration through the employment of physicians, strategic alliances across different providers, a greater reliance on nurse practitioners, expected new standards of care, heightened patient expectations, and a reliance on new forms of information from electronic medical records.

**Physician/Provider Strategy**

The move to employ large bases of physicians may help health care systems control costs, improve revenue, and grow market presence. However, it shifts organizations’ risk profiles as they now include employed physicians in self-insured retentions, trusts, and captives, and place excess towers of insurance above a growing exposure base without the buffer of individual physician limits. Although this provides more control over claims, joint defense, and possible overall improvements in claims costs, systems have increased involvement and defense expense in first-dollar medical malpractice events. Additionally, many provide claims-made tail coverage for physicians at the time of employment. This may result in potential liability for physicians’ prior acts, regardless of their previous affiliation. The Department of Justice and the Federal Trade Commission have challenged the acquisitions of some physician practices, alleging antitrust violations in certain markets. The management of costs is driven down to the individual provider level by the ACA. Acute systems struggle to find ways to capture costs at the individual level, including allocations for the medical malpractice and claims activity.

**Reimbursement Risk**

The shift from fee-for-service to a fee-for-value payment model that incentivizes ACOs is driving significant risk for health care providers. As health systems work with an expanding list of quality and compliance requirements, reimbursement levels are decreasing. Various providers are forming strategic alliances, partnerships, and joint ventures to create enough scale to weather the downward pressures from reimbursement cuts, capture market share, and incentivize savings payments under the “at risk” ACO reimbursement plans. Many systems are also entering into “at risk” contracts with commercial insurers, shifting the risk of catastrophic medical costs to the provider. Acute systems seek efficient risk financing solutions to mitigate overall reimbursement risk and M&A risks or “at risk” contracting, such as transactional risk products and provider excess loss coverage.

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Life Sciences

INSURANCE MARKET CONDITIONS

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

Market Commentary

PRODUCT LIABILITY

Overall rates generally decreased across the various segments of life sciences product liability insurance in 2014. However, medical device companies with implantable and/or invasive products generally experienced increases. Firms with catastrophic losses generally faced increases, capacity reductions, and increased attachment points. Many organizations marketed or restructured their programs, deployed captives, or quota-shared their risks, seeking more favorable renewal negotiations. Risk differentiation strategies will remain critical in 2015.

FINANCIAL AND PROFESSIONAL

Life sciences companies typically present challenging risk profiles to directors and officers (D&O) liability underwriters: 18% of all securities class-action filings in 2013 were against life sciences companies, according to NERA Economic Consulting. For example, bio-pharmaceutical firms may become targets after experiencing large stock-price movements when announcing negative clinical trials, FDA non-approval of new drug applications, or problems with drugs on the market.

RISK TRENDS

Operational Environment

The costs and complexity of research and development (R&D), manufacturing, and global sales and marketing continue to reshape the life sciences industry. In 2014, extensive mergers and acquisitions activity was driven by efforts to build vertically integrated, core competency therapy areas along with accompanying R&D pipelines, as well as by tax-inversion efforts to re-domesticate to more favorable tax jurisdictions. At the same time, the impact of US health care reform has led to severe pricing pressures for many life sciences companies.

Regulatory and Legal Landscape

Although the biotechnology sector continues its rapid growth, many companies face challenges in managing shareholder expectations regarding the drug discovery cycle and commercialization phase, resulting in stock volatility and a higher rate of securities litigation. The evolving global regulatory climate and an increase in sourcing from less regulated, developing regions is a concern.

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### Manufacturing & Automotive

#### INSURANCE MARKET CONDITIONS

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</table>

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

### Market Commentary

#### PROPERTY

Property insurance market conditions remained generally favorable to manufacturers and automotive companies in 2014, driven by continued profitability for insurers. Entering 2015, competition was strong, with surplus capacity in the market. Through the first six to eight months of 2014, manufacturers and automakers without losses generally renewed with rates flat to down 10%; in the fourth quarter, some insureds secured rate decreases to 20%. Insureds were often able to secure more favorable coverage terms in 2014. For clients with moderate to poor loss histories, incumbent insurers typically asked for low single-digit increases, although this was at times tempered by market competition. Much larger decreases were possible, and generally involved marketing and replacement of incumbent insurers.

#### CASUALTY

The casualty insurance market remained competitive in the fourth quarter of 2014 for favorable classes with good loss experience on a loss-sensitive basis, but insureds with poor loss experience faced more challenging renewals. In a difficult interest rate environment, insurers are pushing for rate increases where they can in order to achieve profitability.

In light of the Ebola outbreak of 2014, insurers are paying greater attention to coverage for communicable diseases in casualty insurance policies. Also in 2014, several insurers began to introduce cyber exclusions in general liability policies, although some insureds have been able to remove or restrict such exclusions.
Exposure values — including revenues, headcount, payroll, and autos — continue to slowly increase; more exposure growth is expected in manufacturing, resulting in net written premium growth. As US manufacturers continue to recover and “re-shore” jobs that were previously sent overseas, they could see an increase in losses, particularly in workers’ compensation. Manufacturers and other industries continued to face workers’ compensation challenges in California, where recent reforms (SB 863) have not generated expected savings. Employers are also concerned about Florida, where a court ruled in August 2014 that the state’s Workers’ Compensation Act is unconstitutional as a result of amendments made to the law in 2003. (As of this writing, the decision was under appeal.)

FINANCIAL AND PROFESSIONAL

Entering 2015, there was ample capacity in the directors and officers liability (D&O) market. Manufacturers and automakers typically renewed programs with rates flat to down 5% in the fourth quarter of 2014. Primary D&O rates for public companies are expected to remain stable in the coming months. For larger programs, buyers are likely to generally achieve savings on excess layers, depending on expiring pricing. Companies with adverse claims experience and/or material changes in exposure, however, should typically anticipate premium and retention increases.

Private companies and nonprofits, which have seen the highest rates of increase over the last several years, will likely continue to see upward pressure on premiums and retentions. D&O insurers remained concerned about antitrust and other unfair business practices exposures, and continued to monitor increasing legal expenses on private D&O-related matters.

Cyber risk awareness has reached the board level, and many manufacturing and automotive companies are considering or have purchased cyber insurance. Manufacturers and automakers’ cyber concerns tend to be for denial-of-service events that could disrupt supply chains and result in business interruption claims.

MARINE

Global capacity for marine cargo and stock throughputs (STPs) grew to $1.75 billion in 2014 with the addition of new syndicates in London and continued growth in Asia. The marine market was stable and competitive for most manufacturing and automotive risks entering 2015. Rates were generally flat at year’s end, but slight reductions were generally available for organizations with favorable loss histories. Insurers attempted to secure rate increases from insureds with recent losses, with mixed success.

Some marine insurers have withdrawn from difficult classes of business, including automobiles, temperature-sensitive products, and high-value consumer goods. Coverage can also be difficult to secure for operations in countries or geographies with high theft rates or limited transit and storage infrastructure. And despite record STP capacity, underwriters have been closely scrutinizing insureds with large stock values in catastrophe-prone regions.

RISK TRENDS

Product Risk and Recall

Through contractual agreements, original equipment manufacturers (OEMs) require suppliers to provide financial information and compensation for the cost of safety recalls. Additionally, the risk of suppliers having to maintain “products made” insurance coverage where historically there was no such requirement remains a threat to cost structures. The advent of 3D printing and advanced manufacturing processes will likely create new risks and rewards, which will affect product liability and recall underwriting and risk transfer.

Technology

Advanced technology — including autonomous vehicles, drones, robotics, and “connected” work cells and assembly lines — have become more readily available and affordable for manufacturers and automakers. Much of the technological innovation has been driven by consumer demand for customized vehicles, smartphones, and other everyday products. In addition to potential product recall risks, adopting new technology may open the door for cyber-attacks and other forms of data and intellectual property risk.

Regulation

The cost of compliance with environmental, workplace safety, and tax regulations continued to escalate, with no sign of relief in the near future. As manufacturers adopt new technologies and expand further into emerging markets, regulatory risk will remain significant. New regulations to promote “green” sources of energy and reduce US reliance on fossil fuels may be on the horizon, adding to regulatory costs.

Supply Chains

Global supply chains are critical to the competitiveness of manufacturers, but in recent years they have grown more complex and thus increasingly vulnerable. Lean manufacturing, just-in-time inventory, outsourcing, supplier consolidation, and expansion into emerging markets have generated financial gains, but these efforts could make their supply chains more susceptible to interruptions as a result of typhoons, political unrest, and port disruptions. Manufacturers are addressing some of these risks by seeking to gain a deeper understanding of their supply chains, including second- and third-tier suppliers, along with insurance solutions such as multi-country political risk insurance policies.

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INSURANCE MARKET CONDITIONS

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

Market Commentary

With sustained downward movement in commodity prices, mining companies faced continued pressure to contain risk and insurance costs in 2014. To defer costs, companies continued to balance the retention of risks with the transferring of risks through insurance. They again looked for creative solutions to retain risk in both traditional and non-traditional ways. Capacity was generally adequate, except for the largest firms or those with extensive underground operations, which helped to ease pressure on rates slightly. While the overall marketplace for mining, metals, and minerals is somewhat limited, expansion is being considered by current insurers and new entrants are eyeing the sector. Some insureds could see rate improvements as a result of increased competition.

With the exception of California risks, workers’ compensation rates remained generally flat with some slight increases. Excess liability rates typically did not change. Insureds benefit from safety and loss control programs in two ways: lower overall claims and related costs, and better outcomes at insurance program renewals. After some major loss events in 2014, insurers are expected to focus heavily on environmental controls in 2015. For example, insurers are reassessing original designs and current condition of facilities and operations, and scrutinizing organizations’ environmental mitigation strategies and potential losses. Surety rates for coal were generally flat to up 10% in the fourth quarter; pricing for hard rock was typically flat. Reclamation surety bond capacity remained ample in 2014, and the product remained attractive as a financial assurance mechanism because of competitive rates and collateral. As companies focus on production goals — and, in some cases, survival — 2015 will be a year of transition in the marketplace, with some sureties exiting and others becoming more opportunistic.

RISK TRENDS

Financial Issues

Commodity prices were dropping entering 2015, but operating costs were not following suit. This has put significant pressure globally on mining companies, many of which were struggling to achieve profitability. In a difficult environment, many companies have idled facilities or canceled planned or existing projects. Industry consolidation could be on the horizon, as well as improvements in technology to achieve greater efficiencies.

Operating Environment

Gaining support and acceptance of potentially lucrative projects by regulators, nongovernmental organizations, and the general public is critical to the success of mining companies, often making the difference in whether a company survives. These outside forces are applying more scrutiny to mining company operations than ever. Mining companies must better communicate their strategies and proposed plans; otherwise, they risk delays, public concessions, regulatory requirements, and royalties continuing to rise through 2015 and beyond.

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Power and Utilities

INSURANCE MARKET CONDITIONS

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

Market Commentary

PROPERTY

Conditions in the property insurance market were generally favorable for power and utilities companies entering 2015. In the fourth quarter of 2014, most companies in the sector with average or good risk profiles renewed with rates flat to down 10%. Many companies were also able to secure better terms and conditions — notably in the Northeast, where increased catastrophe limits were made available for insureds that could demonstrate improved protection against flood and wind.

Loss activity remained low in 2014; although there were some significant events outside of North America, there were no significant domestic catastrophes affecting utilities. On the whole, property insurers reported positive results for power and utility books of business, and many insurers looked for opportunities to deploy additional capacity where possible. In the fourth quarter, for example, AEGIS introduced an increase in capacity from $200 million to $300 million via a new facility, which it has used for several clients.

In 2015, insurers can be expected to maintain generally flat rates for loss-free, well-engineered organizations with minimal catastrophe exposures, although underwriters will likely remain selective. Policy wordings and sublimits will remain under close scrutiny by insurers — particularly for catastrophe exposures and high-hazard wind or 100-year flood areas. As some insurers consider using flood questionnaires, insureds could better position themselves with underwriters by providing more detailed information, including location data, equipment evaluations, and engineering reports.

CASUALTY

Capacity for utility casualty clients stabilized this year after contracting over the past two years, but renewal results varied widely depending upon company-specific exposures and loss history. AEGIS results typically showed across-the-board increases of 10% or more, although clients with unfavorable loss ratios often renewed with increases of 20% or more; AEGIS is expected to be less aggressive on rate increases in 2015. EIM generally sought increases of between 3% and 6%; clients with challenging loss records typically experienced significantly higher increases. Stockholder-owned insurers remained wary of companies with difficult loss histories entering 2015, and replacement capacity options were limited.

Many insurers have entered the energy and utility marketplace, perhaps attracted...
by the higher rates of the past few years. But insurers have reported an increased frequency and severity of energy losses, driving weaker underwriting results. Insurers — particularly commercial insurers — remain selective in terms of rate and attachment point for lead umbrella offerings.

FINANCIAL AND PROFESSIONAL

Rates for directors and officers liability (D&O) continued to increase, but at a slower rate; overall, results for power and utility companies were slightly better than the overall market. Excess capacity remains abundant. In cases where primary D&O rates were flat or slightly higher, many clients were able to negotiate excess decreases resulting in overall savings. Risk profile differentiation remained a consideration in renewal negotiations.

Cyber security threats and preventive measures to address them at US utilities have received significant attention, with utilities increasingly citing cyber threats among their material risks. Insurers, including AEGIS, have improved their cyber product offerings to address relevant exposures for power and utility clients. More power and utility companies now buy cyber insurance policies, and are purchasing higher limits as the product has evolved to provide broader coverage.

NUCLEAR

US nuclear power generation risks remain well positioned to mitigate continued volatility in the global nuclear pooling system, driven by increased emerging market demand for capacity, shifting regulatory requirements, changing risk appetites, and increasing levels of competition. Despite material claims activity, rate increases, and reductions in non-nuclear capacity in previous years, nuclear energy capacity remained stable and excess of demand in 2014, and rates are expected to remain stable in 2015 at levels below the global average.

US nuclear risks are expected to continue to benefit from the development of supplementary capacity and alternative risk financing models in 2015. In response to demand for non-nuclear property capacity for nuclear generating sites, NEIL Specialty Insurance Company, an industry group captive, began operations in 2014, successfully bringing $750 million in excess property capacity to roughly 30% of US risks on its first day of operation.

Looking ahead, a recently completed risk finance optimization project for NEIL appears likely to impact property and business interruption buying decisions as well as group and individual risk retention strategies for these products.

RENEWABLE ENERGY

Competition in the market for pure renewable energy risks was driven in 2014 by non-admitted insurers and managing general agents. As renewable energy technology evolves, underwriters are likely to increase their focus in 2015 on engineering in order to inform their interest in particular risks. Capacity for new construction “all-risk”/delay in startup through operational coverage remained abundant, approaching limits of $700 million on a given risk. Rates generally remained flat to up 5% for wind and solar in the fourth quarter of 2014.

For operational property insurance, capacity remained plentiful, with typically stable rates for companies with good loss histories. Although the property insurance market for renewables has seen significant losses over the past two years, there has yet to be a push for increases. Liability markets remained generally competitive and stable. Coverage for catastrophic events such as high wind is becoming more prominent as projects are constructed in in areas exposed to these risks.

RISK TRENDS

Distributed Generation

Residential and commercial solar installations increased in 2014, driven by regulatory incentives and an overall reduction in the cost of solar panels. In 2015, electric utilities are likely to face load-balancing challenges and may need to upgrade transmission and distribution in several locations to accommodate customer generation.

Early Retirement of Coal and Nuclear Stations

Natural gas supply is increasing because of fracking activity, while the price of oil decreased significantly in the second half of 2014. This will likely affect electric generation in 2015 and beyond, including possibly resulting in the early retirements of coal and nuclear generation stations and a slowdown in construction of renewable energy facilities.

Coal Ash Storage

Coal ash storage lagoons received particular scrutiny from underwriters in 2014 after high-profile releases attracted national attention. Local and national regulators are determining the best course of action to address these facilities, and their management will be a high priority for utilities in 2015.

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Public Entity

INSURANCE MARKET CONDITIONS

<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>RATE CHANGE Q4 2014</th>
<th>RATE CHANGE Q4 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>INTEGRATED PROGRAMS SUBJECT TO SELF-INSURED RETENTION</td>
<td>FLAT TO 7% INCREASE</td>
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<tr>
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</tr>
<tr>
<td>EXCESS UMBRELLA</td>
<td>5% INCREASE TO 10% 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.

Market Commentary

PROPERTY

The property market for public entities stabilized in 2014, a trend expected to continue in 2015 barring unforeseen circumstances.

CASUALTY

Casualty insurance rates for public entities increased slightly in 2014. Capacity remained abundant, and several new markets helped drive competition in states with favorable tort immunity statutes. Some softening is expected in 2015, but this should not affect capacity. Few markets are able to provide primary limits in excess of $10 million. Higher limits can be secured through a layered approach using multiple carriers. Tort immunities in Western states have not held up as well as those in Eastern states, and multimillion dollar verdicts on the West Coast have restricted the market in both capacity and pricing. However, there is not a drastic difference by region in terms of appetites, rates, and coverage availability.

There remains limited capacity for low deductible and guaranteed cost programs. In states where they are permitted, pools and risk retention groups write the bulk of this business. Monoline automobile markets are limited, especially for programs that include emergency vehicles, 15-passenger vans, shuttles, buses, and para-transit. The market for guaranteed cost workers’ compensation for public entity is virtually nonexistent.

With medical costs becoming more difficult to contain, the excess workers’ compensation marketplace remained unstable; only five markets were willing to entertain public entity risks.

RISK TRENDS

Cyber Risk

According to the Government Accountability Office, the number of federal government data breaches involving personal identifiable information — including Social Security numbers and patient health data — has more than doubled since 2009.

Sovereign Immunity

When considering risk financing alternatives, public entities rely heavily on sovereign immunity and tort caps. But these immunities and caps are regularly challenged, which can affect buying behavior.

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The real estate and hospitality sectors have made a solid recovery following five difficult years. Real estate, as an asset class, is changing fast, with dramatic improvements in the industrial market, an expanding hospitality market, sustained recovery in the commercial investment market, and a forecast of solid growth across all sectors. In order to obtain the best underwriting outcomes, clients need to clearly define and prioritize their renewal goals and ensure that their data is complete and accurate.

PROPERTY

A significant surplus of both traditional and alternative capital in the insurance and reinsurance segments fueled a softening property insurance market and kept limits available in most areas, with the exception of the multifamily space, where poor loss experience has resulted in higher prices and declining limits. Habitational insureds — particularly multifamily frame housing — are also seeing poorer results than other parts of the real estate sector. In addition, organizations within tornado alleys will continue to be challenged at renewal.

The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), created as a response to the attacks of September 11, 2001, has been an important consideration for real estate company programs. Most industry observers were surprised that Congress allowed TRIPRA to expire at the end of 2014, although it acted quickly on the matter upon reconvening in January 2015. For details, please see the Terrorism Risk section of this report.

CASUALTY

Rates in the overall casualty insurance market were generally flat to low single-digit increases in the fourth quarter of 2014, and the pace of increases slowed. The casualty insurance market appears poised to soften in 2015. In real estate, some sectors experienced more casualty insurance rate volatility than others.

<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>SEGMENT</th>
<th>RATE CHANGE Q4 2014</th>
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<td>PROPERTY</td>
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<tr>
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<td>UMBRELLA/EXCESS LIABILITY</td>
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<td>GENERAL LIABILITY</td>
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<td>REAL ESTATE INVESTMENT ADVISORS</td>
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<td>MANAGEMENT LIABILITY</td>
<td>REAL ESTATE OPERATING COMPANIES</td>
<td>5% INCREASE TO 5% DECREASE</td>
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</table>

The above represents the typical rate change at renewal for average/good risk profiles.
depending on such factors as occupancy size and geography. General liability insurance rates increased faster for habitational exposures than for any other segment, with few insurers willing to write portfolios with significant habitational components. Some insurers have restricted the writing of new apartment exposures, which likely will lead to further firming in this area in 2015.

At the same time, underwriters continue to request to see contractual wording for all vendors to ensure appropriate risk transfer, and insurers are less willing to offer unlimited per-location limits. Diversified real estate portfolios saw ample capacity in the marketplace, and competition tempered significant rate increases and in some cases resulted in rate reductions. The student housing sector also experienced rate increases, along with standalone hospitality portfolios, which are seeing greater rate increases than mixed portfolios.

FINANCIAL AND PROFESSIONAL

Pricing for management liability insurance for both public and private companies softened in 2014 as more capacity entered the marketplace, affecting both primary and excess rates. Pricing changes have not been consistent across all real estate sub-sectors. For example, non-traded real estate investment trusts (REITs) and mortgage REITs were still seeing pricing headwinds entering 2015. Further, real estate clients that have experienced dramatic changes to their risk profile generally saw pricing that differs from average and median renewal data. Although the overall rate softening in financial and professional lines is likely to continue in 2015, litigation trends could have an impact. In the second half of 2014, there was an uptick in litigation against public REITs that could have some impact in the future. Real estate clients should continue to focus on differentiating their risk profile to insurers.

ENVIRONMENTAL

The real estate industry continues to be a preferred segment for environmental insurers. Significant capacity was available to build higher limits for pollution legal liability (PLL) and contractors pollution liability (CPL) insurance. Market competition kept pricing at renewal generally flat, although some insured's saw rate swings, depending on class of business and loss history. There was a notable uptick in the number and frequency of property additions to portfolio programs.

Real estate clients demonstrated a tendency to “move up the risk curve” by purchasing sites with more significant environmental legacies, including urban infill. These sites do not always fit well into existing portfolio programs, and as a result there was an uptick in the need for standalone policies to support real estate transactions.

The increase in the frequency of site additions has tested insurers comfort in their automatic acquisition pricing, and as a result real estate organizations renewing multiyear programs in 2015 could see premium increases, including automatic acquisition rate increases. In 2014, carriers continued to demonstrate an appetite for brownfield transactions; however, a number of the leading environmental insurers tended to reduce policy term and were less supportive of projects with considerable legacy risk. While there continues to be sufficient appetite for 10-year policies, underwriting requirements continue to be comprehensive, meaning that information availability and quality are critical requirements for a successful placement.

RISK TRENDS

Capital Market Environment

Commercial real estate executives generally are bullish on the outlook for the industry through the next 12 months. Likewise, the steadying US economy is drawing foreign investors in great numbers to the domestic commercial real estate market. Private equity groups will continue to invest heavily in select service hotel portfolios, and office investment sale activity is expected to grow in select core suburban areas.

Vacancy Rates

The real estate recovery clearly gained in strength in 2014. Offices, manufacturers, and retailers all showed growth in 2014. In the multifamily sector, strong absorption continues, while an uptick in new housing is expected to drive vacancy increases across varying markets. With supply projected to continue to outpace demand into 2018, vacancy rates are anticipated to head upward. However, the rift between new construction and net absorption should not be great, causing vacancies to increase slowly over a number of years. Apartment market fundamentals are strong as nearly all of the new household formation in the past 10 years has come from renters and not homeowners.

Asset Management

Asset management CEOs are preparing for growth and becoming more confident from both rising equity markets and growing demand. Although investors recognize that many economies have not overcome all their fiscal difficulties, real estate companies are actively investing in their businesses and seeking to accelerate both organic and inorganic expansion. Due to high competition, commercial property values are rapidly increasing. As a result, the market is largely transitioning to a seller’s market. Neighborhoods throughout New York City are a prime example of the surge in property values.

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INSURANCE MARKET CONDITIONS

<table>
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<tr>
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<th>SEGMENT</th>
<th>RATE CHANGE Q4 2014</th>
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<tr>
<td>PROPERTY</td>
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<td>FLAT TO 5% DECREASE</td>
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<tr>
<td></td>
<td>MIDSIZE, CAT-EXPOSED ORGANIZATIONS (TIV LESS THAN $250 MILLION)</td>
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<td>LARGE, CAT-EXPOSED ORGANIZATIONS (TIV MORE THAN $250 MILLION)</td>
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<td>PRIVATE COMPANIES</td>
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</table>

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

Market Commentary

PROPERTY

The retail, wholesale, food, and beverage (RWFB) sector did not experience significant catastrophic losses in 2014, while at the same time property insurers benefited from a calm hurricane season. The property insurance marketplace is soft entering 2015, with abundant capacity as insurers compete for business by lowering rates and relaxing policy terms to broaden coverage. The property insurance market in 2015 is expected to remain soft, barring major catastrophes.

CASUALTY

The casualty insurance marketplace remained competitive for RWFB companies with good loss experience, particularly for loss-sensitive businesses. Rates in the sector were generally stable in the fourth quarter of 2014, and are likely to remain so into 2015, barring unforeseen events. Difficult to insure risks for RWFB companies included children’s products and imported products, especially those from China. Capacity remained strong with the exception of monoline and California workers’ compensation.

Many insurers are focusing on past loss experience, safety programs, pre- and post-loss activities, “named insured” wording, acquisition activity and attachment points. There is also an increased focus on cyber exposures with new exclusionary endorsements being added; such wordings vary widely and should be reviewed carefully.

In 2015, risk management focus areas for RWFB companies are likely to include food safety practices, product liability, and fleet exposures. Insureds may benefit by starting the marketing and renewal process early and making detailed submissions that include descriptions of pre- and post-loss measures.
Overall, pricing in financial and professional lines were generally more favorable in 2014 than in 2013, although slightly less so for retailers compared to most other sectors. In 2015, rates for directors and officers (D&O) liability insurance and ancillary lines — including employment practices liability insurance (EPLI) — are expected to remain favorable. Some insurers are offering rate decreases on excess D&O; others are slightly increasing rates for EPLI. New financial and professional lines insurers have entered the retail market, particularly for additional excess capacity for D&O. For D&O in 2014, insurers were generally more readily willing to negotiate terms and conditions such as coverage enhancements to differentiate themselves, a trend likely to continue in 2015.

Retailers in 2015 should expect cyber insurance rates to increase and overall capacity to shrink, particularly for organizations with more than $1 billion in revenue. Alternative risk transfer structures — including co-insurance, large retentions of $50 million to more than $100 million, and use of captives — are being considered by some retailers. The use of captives, however, may not necessarily be a cost effective option due to the relatively immature marketplace for cyber.

Cyber analytics and modeling can help make appropriate resource deployment decisions, including around such insurance issues as the right level of retentions and coverage limits.

Workers’ compensation continues to be the largest component of the total cost of risk (TCOR) for RWFB companies. Businesses are using data, analytics, and catastrophe models to understand how they can reduce losses. The legalization of marijuana in several states in 2014 will likely be a focus for many companies as they mitigate the associated safety and other risks. Also, companies will continue to monitor the impact of the Affordable Care Act.

Many RWFB companies grew internationally in 2014, particularly food and beverage companies. Much of the growth was a result of M&A activity. While international expansion typically indicates success, RWFB companies must be prepared for new risks, including around political, tax, and regulatory issues.

In 2014 RWFB companies saw increased scrutiny among federal and state regulatory agencies. Risk issues ranged from food and workplace safety to fleet/auto and wage and hour claims. Government agencies such as the Occupational Safety and Health Administration, Department of Transportation, Food & Drug Administration, Environmental Protection Agency, and the Department Of Labor have increased their monitoring and compliance enforcement activities. Going into 2015, RWFB companies will need to pay particular attention to ensure they are in compliance with these and other workplace policies.

To better position themselves in this challenging market, companies should start the renewal process early, expect to provide significantly more information about their card processing environment and POS systems, and make their senior information security personnel available to underwriters.

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Sports, Entertainment, and Events

INSURANCE MARKET CONDITIONS

<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>SEGMENT</th>
<th>RATE CHANGE Q4 2014</th>
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<td>FLAT TO 5% INCREASE</td>
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</tbody>
</table>

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

Market Commentary

PROPERTY

Organizations with catastrophe (CAT) exposures experienced flat to 3% rate reductions in 2014, while non-CAT-exposed companies saw flat to 10% rate reductions. With some new entrants in the market, insurers competed for business in most lines of coverage on both insurance pricing and terms and conditions. Although insurers sought rate increases for companies with higher than average loss ratios and significant CAT exposures, firms with good loss experience attracted additional capacity. These market conditions are expected to continue in 2015.

CASUALTY

Except for organizations with increasing claims activity, rates typically decreased by 5% to 10% for sports, entertainment, and events companies. New market entrants in the commercial general liability (CGL) and excess liability lines, and additional capacity in the professional liability segment, maintained abundant capacity, outside of workers’ compensation.

FINANCIAL AND PROFESSIONAL

Insureds generally experienced flat to 5% rate decreases in 2014, a trend that is expected to continue in 2015. Insurers continued to compete for business in most of the financial and professional lines in terms of pricing and coverage terms and conditions.

RISK TRENDS

Safety and Security

Sports teams, leagues, and other organizations are more closely monitoring safety and security issues, ranging from outbreaks of bacterial infections to liquor liability to shootings and other instances of violence to severe weather.

Workers’ Compensation

With potential employment increases in certain sectors of the entertainment and events industry, workers’ compensation variable costs will remain a risk driver in 2015.

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Transportation: Rail

INSURANCE MARKET CONDITIONS

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

Market Commentary

PROPERTY

A competitive property insurance market led to generally soft prices for railway property insurance entering 2015, with aggressive pricing allowing for even greater reductions for insureds with good risk profiles. However, railways with loss experience saw more disparity in their renewals in 2014, even though the softening market tempered pricing for all but those operators most affected by catastrophes. Capacity was generally unchanged in 2014, and underwriters focused on lower attachment points in structured programs. This trend should continue into 2015.

RAILROAD LIABILITY

The casualty insurance market for railroads was generally stable with a slight firming for certain rail classes in 2014, which is expected to continue in 2015. Average rates for railroad organizations are expected to generally range from flat to 3% increases in 2015. Underwriters are likely to increase pressure to raise self-insured retention levels for certain rail classes. They are also likely to focus on individual railroad’s renewal exposure and loss history as several markets have cut capacity because of loss history.

RISK TRENDS

Underwriting Data Quality

Railway underwriters continued to demand improved data quality — in both accuracy and depth. Recent loss events increased scrutiny on the accuracy of value reporting, and in some cases where the exposures were questioned underwriters looked for margin clauses. Pressure remained heightened for more data in areas such as business interruption; chokepoint identification; and infrastructure assets, including track GPS coordinates.

Flood

Though difficult to quantify and nearly impossible to model effectively, flood exposures for both freight and passenger railways remained a pivotal concern for insurers. Railways that purchased flood insurance on their critical assets may not have seen rates decline as much as those that did not purchase the coverage as there is a trend toward “minimum pricing” for that capacity. However, in some competitive pricing situations underwriters may be slightly more generous with this coverage in order to differentiate and win or retain business.

Crude by Rail

The railroad accident in Lac-Megantic, Quebec in 2013, along with eight hazardous material derailments between 2013 and 2014, have increased underwriter and regulatory scrutiny on the crude by rail industry. The Canadian Transport Agency is seeking to implement minimum liability insurance requirements for freight railroads in Canada based on the type and amount of commodities hauled, which is expected to be a key area of interest in 2015.

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Insurance Market Conditions

<table>
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<tr>
<th>Coverage (Excluding Motor Cargo)</th>
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<tr>
<td></td>
<td>Moderately Cat-Exposed Organizations (1% to 30% of Values in Cat Zones)</td>
<td>10% Decrease to Flat</td>
<td>8% Decrease to 2% Increase</td>
</tr>
<tr>
<td></td>
<td>Largely Cat-Exposed Organizations (More Than 30% of Values in Cat Zones)</td>
<td>10% Decrease to Flat</td>
<td>8% Decrease to 5% Increase</td>
</tr>
<tr>
<td></td>
<td>Loss-Driven Organizations</td>
<td>Variable</td>
<td>Dependent on Loss History and Exposures</td>
</tr>
<tr>
<td>PRIMARY CASUALTY</td>
<td>Large Organizations (Sales Greater Than $5 Billion)</td>
<td>3% Increase to 8% Increase</td>
<td>3% Increase to 12% Increase</td>
</tr>
<tr>
<td></td>
<td>Midsize Organizations (Sales Less Than $5 Billion)</td>
<td>5% Increase to 10% Increase</td>
<td>3% Increase to 12% Increase</td>
</tr>
<tr>
<td>EXCESS CASUALTY</td>
<td>Large Organizations (Sales Greater Than $5 Billion)</td>
<td>3% Increase to 8% Increase</td>
<td>5% Increase to 10% Increase</td>
</tr>
<tr>
<td></td>
<td>Midsize Organizations (Sales Less Than $5 Billion)</td>
<td>Flat to 10% Increase</td>
<td>5% Increase to 10% Increase</td>
</tr>
<tr>
<td>WORKERS’ COMPENSATION</td>
<td>Guaranteed Cost</td>
<td>10% Increase to 20% Increase</td>
<td>10% Increase to 30% Increase</td>
</tr>
<tr>
<td></td>
<td>Loss Sensitive</td>
<td>3% Increase to 15% Increase</td>
<td>6% Increase to 25% Increase</td>
</tr>
</tbody>
</table>

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

Market Commentary

PROPERTY
Following the overall property insurance market, rates for motor truck cargo (MTC) were generally flat to down 5% in the fourth quarter of 2014, although results for individual organizations varied based on their loss histories. The trend is likely to continue in 2015 barring unforeseen events. The MTC market was affected in 2014 by a series of natural catastrophes, including tornado losses in Oklahoma and winter storms across the Midwest and Northeastern US.

CASUALTY
Primary casualty insurance rates stabilized in 2014, with most programs rates renewing flat to up 10% depending on coverage, exposure, and loss history. Accumulating losses created challenges for some clients; some primary carriers sought to limit their aggregate risks in some regions, while others declined to write certain risks.
In some cases, however, insurers have shown a willingness to reduce rates if there is competition. Workers’ compensation will likely remain a challenge in 2015; most insurers avoided monoline workers’ compensation placements, particularly for California–based accounts.

Umbrella rates generally stabilized toward the end of 2014, ranging from flat to up 10% for good risks in 2014. Amid concerns about losses and safety and compliance measures, some insurers withdrew from the transportation sector completely. Others increased attachment points or pulled back from specific segments, such as excess primary layers (up to $5 million) or insureds with inadequate federal Compliance, Safety, Accountability (CSA) scores.

TRUCK BROKERAGE

Truck broker liability continued to be excluded from automobile liability by some primary insurers, requiring such coverage to be placed on a monoline basis. With reported losses increasing, fewer insurers participated in the primary to $15 million layer. Many losses related to claims of negligent hiring, which has led insurers to closely scrutinize insureds’ hiring protocols. This line of coverage will likely remain challenging in 2015.

RISK TRENDS

Driver Shortage

Facing a long-term shortage of qualified drivers, motor carriers are considering increasing pay, offering drivers incentives similar to employee benefits, reducing waiting times at pickup and delivery locations, and making routes more driver-friendly.

Litigation and Regulation

Pricing models used by excess auto underwriters have been influenced by two recent judgments of more than $40 million involving single-auto accidents. Jury verdicts in several jurisdictions have come down in favor of plaintiffs, owing in part to sympathy for claimants and the “deep pockets” of many trucking companies. Some judges appear to have taken a negative view toward the industry, and are paying closer attention to trucking companies’ compliance with federal and state regulations.

The Federal Transportation Safety Administration and various states have introduced legislation that would restrict driving hours, require more safety inspections, and force truck owners to obtain new clean burning emission engines in 2015.

Independent Contractors

A federal court ruled in August 2014 that a major trucking company’s drivers are employees rather than independent contractors under California and Oregon wage and hour laws. If the same classification were to occur at a national level, it could create extra payroll and employee benefits costs for the transportation industry, and have significant insurance implications. To help alleviate this risk, some motor carriers are requiring independent contractors to obtain their own operating authority and purchase primary general liability, automobile liability, cargo legal liability, and workers’ compensation coverage, with the motor carrier listed as an additional insured.

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