

Global Insurance Market Quarterly Briefing



BOARD DISCUSSION

Spotlight: Transactional Risk

Demand for transactional risk insurance grew 15% YoY in the first half of 2015.

Corporations are becoming more comfortable using transactional risk insurance.

GLOBAL MARKET RATES CONSISTENTLY LOWER IN SECOND QUARTER

NINTH CONSECUTIVE QUARTER OF DECREASES

Commercial insurance rates continued to decrease across the globe in most lines of business in the second quarter of 2015. Competitive market conditions — characterized by an abundance of global capacity and a lack of large insured loss activity resulting in reported underwriting results with favorable combined ratios — helped account for the ninth consecutive quarter of rate decreases.

Decreases were seen across regions and in most major lines of business. Notable exceptions were seen in specialized cyber coverages led by a firming cyber insurance market. The Asia-Pacific region experienced the largest composite rate decrease, followed by the UK, Continental Europe, Latin America, and the US (see Figures 1, 2, and 3).

In major coverage lines, property insurance showed the largest rate declines, greater than 5%, on average. Rate decreases, which occurred across all regions in the second quarter, were led by Asia-Pacific and Continental Europe.

FIGURE 1 Renewal Rate Change Ranges by Region and Line of Business Q2 2015
Source: Marsh Global Analytics

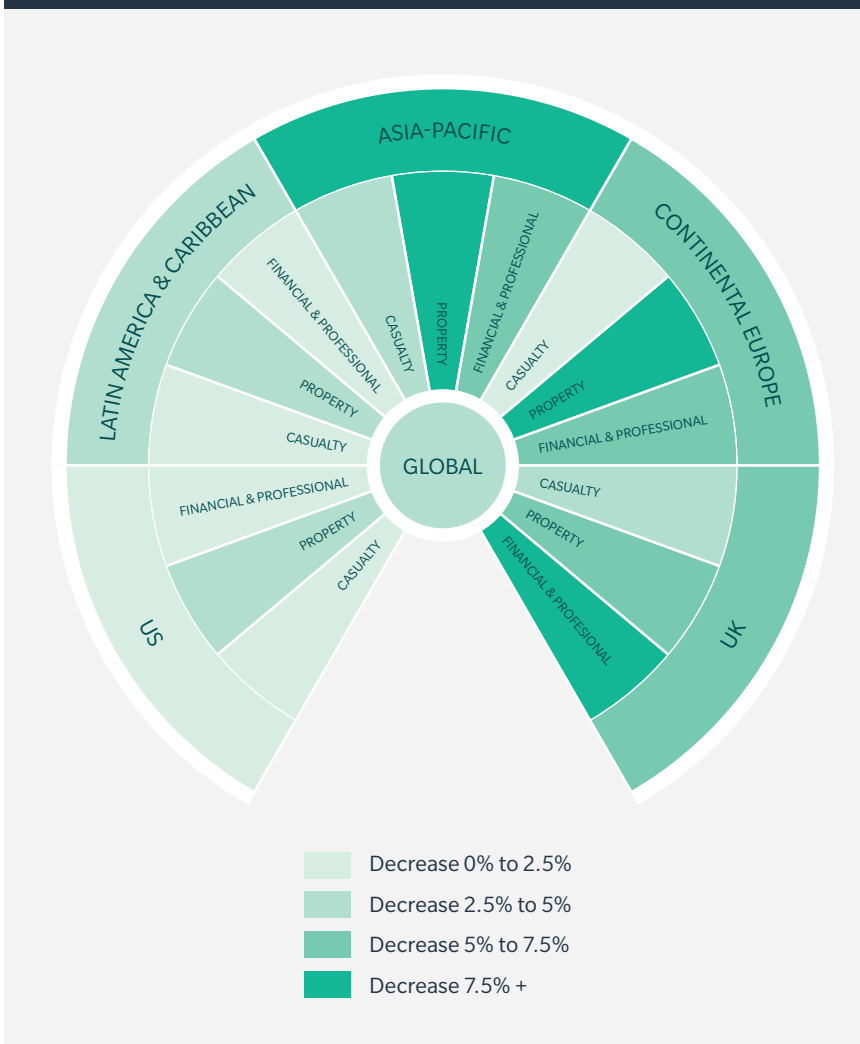


FIGURE 2 Composite Renewal Rate Change Ranges By Region
Source: Marsh Global Analytics

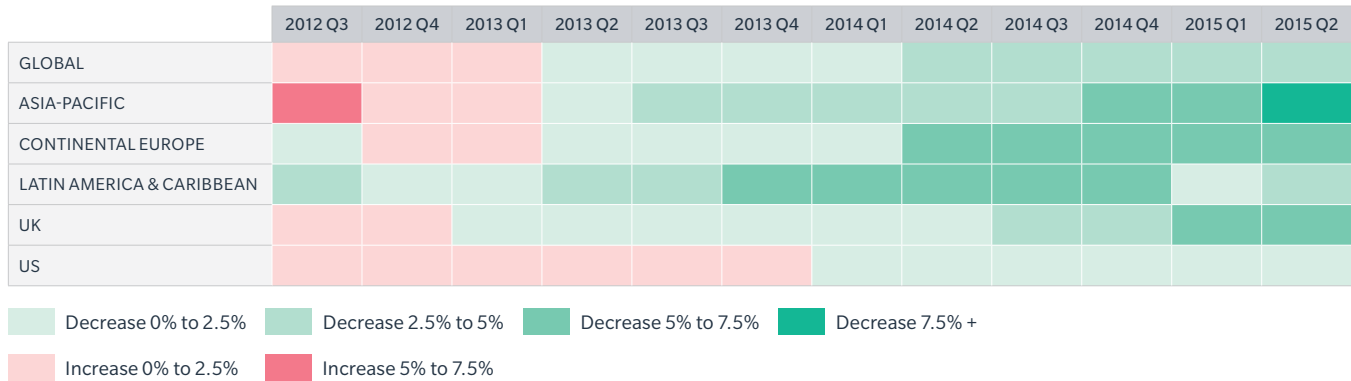
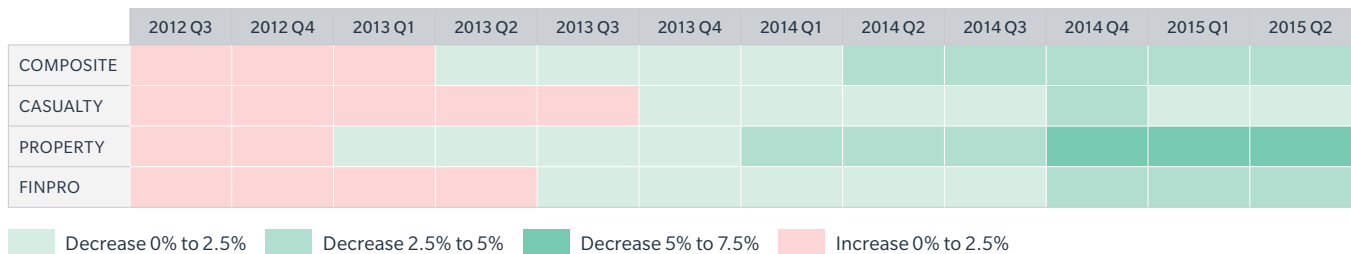


FIGURE 3 Renewal Rate Change Ranges By Insurance Line
Source: Marsh Global Analytics



Casualty insurance rates, on average, decreased more moderately than property, ranging from flat to down 5% — a consistent trend across all major regions. Asia-Pacific, as it did last quarter, had the largest decrease, followed by the UK.

Financial products had decreasing rate levels on average during the second quarter, consistent with the other major lines of business. The global composite rate change for financial products in the second quarter was a decrease of approximately 5%. As with casualty and property, financial products had consistent decreases regionally, with the largest decrease occurring in the UK.

SPOTLIGHT ON TRANSACTIONAL RISK

Demand for transactional risk insurance continued to grow during the first half of 2015, with an overall increase of 15% year-on-year in terms of limits placed by Marsh.

“The demand for transactional risk insurance on M&A transactions continues to grow rapidly, as competition among acquirers continues to remain intense,” said Karen Beldy Torborg, global practice leader for Marsh’s Private Equity and M&A Services Practice. “Dealmakers, both from the private equity and corporate space, are increasingly using insurance capital to get deals over the line, and we don’t see this trend subsiding anytime soon.”

The US experienced dramatic growth in demand from all sectors, on the back of a record year in 2014. In Europe, real estate deals continued to drive demand, and we are seeing a trend for deal makers to include title insurance as part of the transaction. Larger deal sizes and a greater acceptance of this insurance solution buoyed demand in Asia.

Private equity firms continue to be the heaviest users of transactional risk insurance, as they seek ways to reduce indemnity requirements when buying and make clean exits when selling (see Figure 4). Despite this historical trend, we have seen corporations become more comfortable with using transactional

risk insurance. This is especially true in the US and Asia-Pacific and with companies that are buying or selling companies on a regular basis.

Transactional risk insurance, including warranty and indemnity (W&I) or representations and warranties (R&W) insurance, tax liability, and other contingent liability solutions, is now widely available in most jurisdictions or geographies globally and has become an essential risk mitigation tool for deal makers.

The growth in capacity and availability in this niche insurance area is yet another example of insurers expanding from traditional property and casualty lines into more complex, solution-oriented specialist classes of insurance.

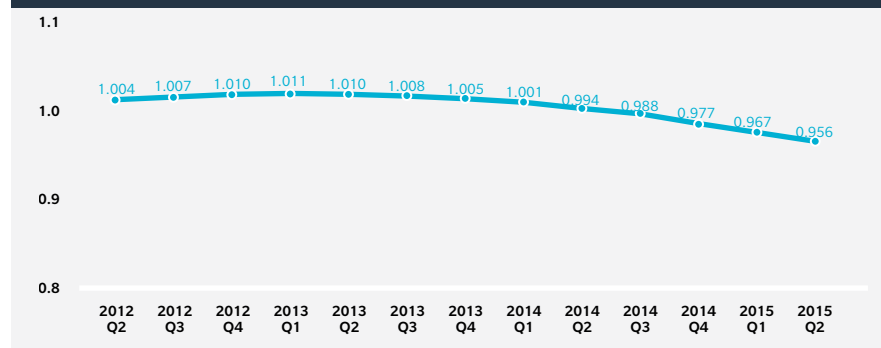
FIGURE 4 Transactional Risk
(First Half 2015)
Source: Marsh

	GLOBAL
Limits of insurance placed (US\$ millions)	\$4,047
Private equity policies (as % of policies placed)	73%
Corporate policies (as % of policies placed)	27%

COMPONENTS OF THE PRICING ENVIRONMENT

The Marsh Global Insurance Index stood at 0.956 in the second quarter of 2015, down from 0.967 in the previous quarter (see Figure 5). Our index methodology captures a rolling four-quarter view of rate movements. Each quarterly change shows the rate change for the current quarter over the prior year for the same period. By rolling the last four quarters together, we are able to capture the effective rate level for a full year and provide a quarter-to-quarter view of changes in the marketplace.

FIGURE 5 Marsh Global Insurance Index
Source: Marsh Global Analytics



As was the case in the first quarter, contributors to market conditions in the second quarter of 2015 included several underlying economic and market factors, which can be organized broadly within a supply-and-demand framework. We continue to describe this market framework through:

- Capital committed to the market.
- Insurer profitability.
- Insurer pricing methodologies. (Insurers are becoming more sophisticated with some of their underwriting tools and techniques, such as predictive modeling, and have been able to refine prices based on a better understanding of true exposure and loss potential.)

In addition, this quarter we added a component to our framework that drives profitability, but also impacts the environment beyond its direct contribution to returns:

- Global-impact losses: These are larger events, such as natural catastrophes, that have the potential to drive the market environment beyond their immediate and direct economic impact.

CAPITAL INFLOWS AND OUTFLOWS

Surplus levels typically remained at or near record levels, helping to drive the competitive marketplace during the second quarter. Additionally, the market has seen significant M&A activity (see page 2), a possible reaction to companies' appetites for growth and differentiation in an increasingly competitive environment. Alternative capital continues to flow into the industry and is creating an additional source of risk transfer, fueling competition, and helping to drive rate levels lower.

“While there are some insurers exiting certain lines of business, overall market capacity remained abundant during the quarter,” said Dean Klisura, Marsh Global Industry Specialties and Placement leader. “Aiding the market’s overall capacity has been the willingness of companies to consider capacity outside their regional geographies. This strengthens the global nature of the marketplace.”

INSURER PROFITABILITY

According to a recent AM Best Special Report, the US property/casualty industry saw a 12.9% increase in pre-tax operating income during the first quarter of 2015 compared to prior year first-quarter results. Combined ratios for the industry remain under 100%, a sign of underwriting profits, while interest rates remain at historically lower levels.

The result of profitable underwriting performance is that excess profit has typically been distributed as dividends to shareholders, used to repurchase stock, or put toward building surplus levels. Importantly, insurers need to write against that increased capital position to generate adequate returns. The pressure to write more premium grows each year. With several years of historically higher underwriting results, competition within the industry is increasing.

In addition to rate levels decreasing, more innovative coverages are being created as insurers look to differentiate their offerings. Emerging risk issues, such as cyber, provide a means for the industry to grow, especially as overall profitability remains relatively high.

INSURER PRICING METHODOLOGIES

Insurers continue to enhance their pricing methodologies, creating the ability to further segment their portfolios of risk. Segmentation allows insurers to price business on average more profitably and is part of the overall dynamic helping create a competitive environment.

“We are seeing insurers in Latin America increase their focus on profitability by product lines, which is leading to the launch of new lines of business in some countries and the withdrawal of specific products in others,” says Ricardo Brockmann, CEO of Marsh Latin America and Caribbean.

In Europe, insurers remain cautious with their pricing, balancing significant premium adjustments driven by Solvency II (and the associated necessity of increased provision of capital) with the large amounts of risk capital available globally at attractive prices. “In certain sectors such as marine, insurers are pushing for long-term agreements, but this is being met with resistance from clients due to current market trends,” says Flavio Piccolomini, CEO of Marsh Continental Europe.

ABSENCE OF GLOBAL-IMPACT CATASTROPHE LOSSES

Global natural catastrophe losses are continuing at historically low levels, thus helping drive insurer profitability and removing near-term catalysts for increased rates. Regional losses continue to emanate from a variety of perils, with the Texas-based floods in the US a notable example.

As modeling improves to gauge the potential impact of other perils, awareness of potential losses is increasing. “Capacity in the international marketplace remains abundant and, in certain cases, there is an oversubscription of capacity for limits being purchased, both of which continue to drive a reduction in rates and provide additional limits of coverage,” says Andrew Chester, CEO of Bowring Marsh. “It is anticipated that, unless there is a major catastrophe in the region, the next 12 months will continue to bring favorable market conditions for clients.”

Outside of natural catastrophe losses, there has been a relative lack of other large-impact loss events. For example, other potential catalysts, such as security class actions, have remained at historically low levels during the first half of 2015.

There are newer, emerging risks such as cyber that are creating a need for additional insurance and risk transfer solutions. Given the importance of cyber risk going forward, we will be keeping a close eye on its impact to the overall market environment.

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