INSURANCE MARKET
MID-YEAR UPDATE

AUGUST 2014

AUSTRALIAN OVERVIEW

Soft market dynamics continue to be driven by an abundance of capacity in the (re)insurance market while competition among direct insurers has become more pronounced. Reinsurance treaty pricing for most lines of business continued to decline in the June/July renewal period as excess capital chased reduced demand.

In addition to sustained competition around pricing, there has also been a broadening in policy coverages. Insurers are offering multi-year agreements and, as is typical in soft market cycles, multi-line packaged deals have been negotiated.

While the current market dynamics remain in favour of the insurance buyer, the Australian market remains buoyant. This was evidenced in a recent announcement by the Australian Prudential Regulation Authority of a A$4.7 billion profit for (re)insurers and improved capital/coverage ratios in the 12-month period to March 2014.

PROPERTY

A record level of capital in the (re)insurance markets in 2014 has increased existing competitive pressures in the property insurance market to unprecedented levels, and most insurers are striving to gain market share and boost premium income. Clients are experiencing record low rates and there appears no end in sight to this highly-charged competitive environment.

Intense competition between insurers has been evident throughout the June/July renewal period. This has delivered improved policy conditions and deductibles, while driving rates lower for clients across most segments. Insurers continue to relax conditions surrounding natural catastrophe (NAT CAT) sub-limits and deductibles for both local and international assets.

Rate reductions varied across the Marsh portfolio, with small and medium enterprises (SME) clients experiencing reductions in the range of 7.5% to 15%. Corporate clients and major risk management clients generally enjoyed larger reductions, particularly those considered low risk and with positive claims histories.

AUSTRALIAN MARKET RATE CHANGES

AUSTRALIA	
PROPERTY (CAT)	▼
PROPERTY (NON-CAT)	▼
GENERAL LIABILITY	▼
WORKERS COMPENSATION	▼
FINANCIAL AND PROFESSIONAL LINES	▬
D&O LIABILITY	▼
PROFESSIONAL INDEMNITY	▼
FINANCIAL INSTITUTIONS	▬
HEALTHCARE/MEDICAL MALPRACTICE	▬
MOTOR VEHICLE	▼

▼ DECREASE 20% TO 30%
▼ DECREASE 10% TO 20%
▼ DECREASE 0% TO 10%
▲ INCREASE 30%+
▲ INCREASE 20% TO 30%
▲ INCREASE 10% TO 20%
▬ STABLE -5% TO +5%
▲ INCREASE 0% TO 10%

To some extent, clients' recent experience of rate reductions influenced the level insurers were willing to offer in 2014.

The more hazardous industries such as mining, utilities, and energy also experienced an improved market environment. However, this was not the case for clients in these industries with adverse loss histories. Several insurers relaxed their underwriting guidelines for these industries while others (re) entered the market for these risks. Continued downward pressure on premiums in these industries is anticipated in future, particularly as any rate reductions in recent years have been at lower levels compared to the general property market.

With the (re)insurance markets generating strong returns for investors, and in the absence of alternative high-return investment opportunities, the current abundance of capacity is expected to remain. Some industry experts now suggest that a catastrophe loss of US$80 billion to US$100 billion may only have a 10% impact on market capacity. It may therefore take a combination of a massive loss event(s) and economic factors, such as a sustained rise in interest rates, to cause investors to retreat from the (re)insurance markets. Only then would there likely be any material upward movement in property insurance rates.

GENERAL LIABILITY

There continues to be an abundance of local and international capacity, ensuring competition remains strong in the liability market. There are, however, some exceptions to this. Bushfire exposure in the government, power/utility, and contractor segments has seen insurers seek higher premiums and display a more cautious underwriting approach in providing capacity. Meanwhile, high-frequency claims accounts such as retail/shopping centre owners have also bucked the trend, due to the ever-increasing legal costs involved in defending claims, and court judgments that have seemingly become more favourable towards claimants.

For the first time in a number of years, competition has intensified in the major account space, particularly for multinational programs. Several large programs were coming out of long-term agreements, and the market took the opportunity to attack incumbent insurers' pricing.

Renewal premiums in this segment fluctuated wildly from "flat" on claims intensive accounts and/or less attractive industry occupations to reductions of 50% for the most sought after high-profile, large premium and low frequency/severity accounts.

The average premium movement in the SME and corporate segments was minus 10%. The competition is not as strong in these segments, with insurers seemingly more interested in the larger premium accounts. The excess liability market fell again in June, with premiums now at historic lows. It is difficult to envisage that premiums have much further to fall, however with supply so significantly exceeding demand, competition will remain strong for excess layers.

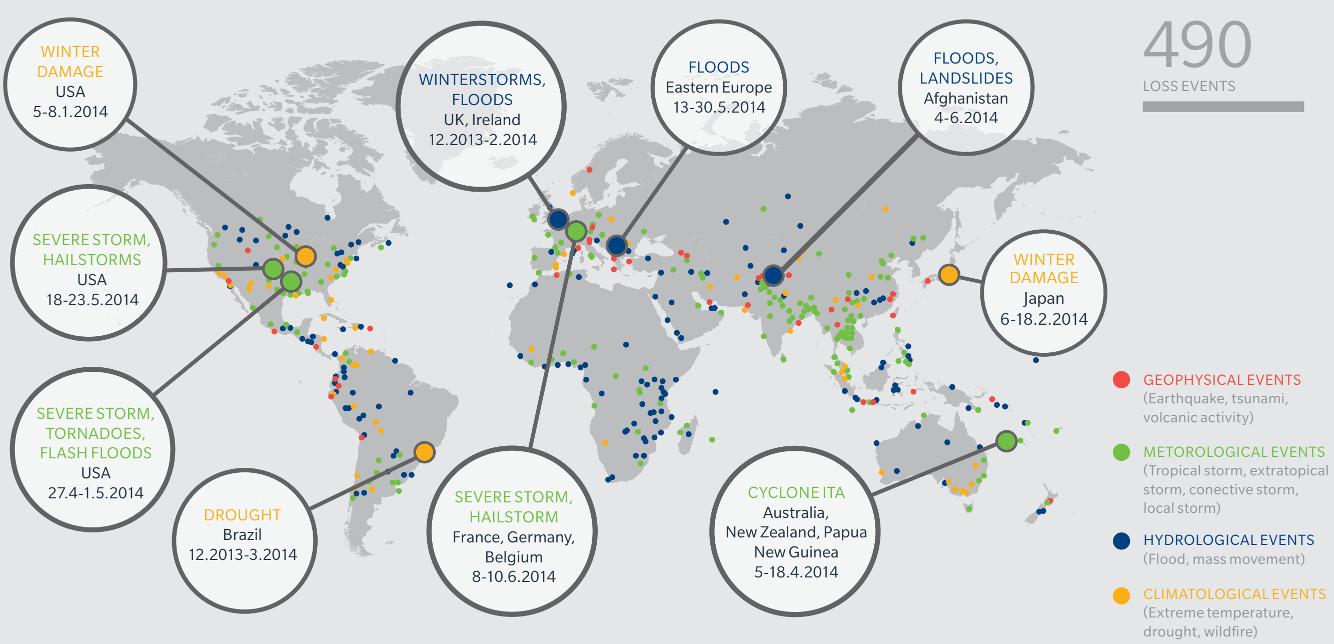
Market capacity continues to increase and this will drive strong competition throughout the remainder of the year and into 2015.

SPOTLIGHT

GLOBAL SNAPSHOT

- Improved loss ratios and lower reinsurance costs are driving competition across the globe
- 35 of the top 40 global insurers reported improved combined ratios for 2013 with 12 of them below 90%
- Natural catastrophe losses in the first half of 2014 were US$17 billion, 37% below the recent 10-year average of US$25 billion
- Severe weather (convective thunderstorm) and winter weather were primarily responsible for these losses, with the US, western Europe and Japan most affected
- Property reinsurance rates fell 15%-25% in Florida and 10%-20% in the US nationwide
- Reinsurance market surplus continues to rise; record levels of CAT bonds were issued in 1H 2014 albeit at reduced rates of return due to over-supply

GEOGRAPHICAL OVERVIEW OF LOSS EVENTS: JANUARY TO JUNE 2014



Source: Munich Re, NatCatSERVICE, 2014

WORKERS COMPENSATION

Workers compensation insurance in Australia has witnessed significant activity in recent months. Victoria, New South Wales, Queensland, and Western Australia have all announced that average premium rates are to reduce for the 2014-2015 financial year.

The Tasmanian scheme continues to underperform and it is believed this will result in increased rates for the next 12 to18 months.

Other schemes have returned steady results and minimal rate movement is expected for the upcoming period.

During 2014, the Australian Government lifted the moratorium on private corporations seeking to become self-insurers under the Commonwealth workers compensation scheme. In addition, the Comcare competition test has been removed, which will result in a number of existing state-based self-insurers and large scheme employers gaining access to Comcare.

FINANCIAL AND PROFESSIONAL LINES

The market continues to soften for professional indemnity and directors and officers (D&O) liability insurance. Pricing and terms and conditions for financial institutions and the healthcare sector remain relatively stable.

D&O LIABILITY

Despite high-profile class action settlements in the several hundred million dollar range, the overall supply of capacity to the commercial D&O liability market from both local and overseas insurers remains substantial. It is for this reason that the market continues to be favourable for clients with sound risk management and good claims records.

Competition remains strong in the higher excess layer placements.

While available to some buyers, few opted to take up insurers' offers of long-term agreements or direct/round-the-clock reinstatements.

PROFESSIONAL INDEMNITY

Strong competition for low-to-medium-risk professions developed in the market in the second half of 2013 and continued into 2014. The London market remains active, but local insurers are competing more aggressively to successfully maintain their dominant market share in the Australian client portfolio.

Infrastructure and resource developments have slowly started to resume, whetting insurers' appetites for the large premiums these projects generate. We expect competition to increase in both the local and international markets for large-scale project insurance placements.

FINANCIAL INSTITUTIONS

Despite softening market conditions, the unrelenting financial institutions claims activity around the world has insurers heavily scrutinising the exposures of clients in this segment. As losses continue, insurers are turning a sharper eye to risk profiles, especially around claims and notification history. The Australian market remains stressed by the weight of increasing claims from the wealth management sector, financial planners and, to a lesser extent, the retail banking sector.

Additional class actions on behalf of securities holders continue to develop, which is placing pressure on the securities entity component (Side C cover) of D&O policies. Insurers are becoming more receptive to those unaffected by wealth management, financial planning, and Side C D&O exposures, but continue to tightly control capacity. Most insurers are capping limits in the A$10 million to A$15 million range.

HEALTHCARE/MEDICAL MALPRACTICE

Australian insurers' increasing appetite for SME and middle market clients in the healthcare sector continues to place downwards pressure on pricing. As with most classes, buyers still need to demonstrate a comprehensive risk management strategy and independently audited claims data, specifically for portfolios involving malpractice claims. Appetite for clinical trials and obstetrics coverage remains challenging to find in the marketplace.

MOTOR VEHICLE

The first two quarters of 2014 have seen the continuation of competition between insurers for motor fleets with good loss histories. This competition has resulted in reductions in the underlying pricing for fleets with favourable loss ratios (below 60%) over the past three years, while fleets with loss ratios ranging from 60% to 75% are achieving rollover rates.

In addition to aggressive pricing on new business, insurers are offering extra incentives, such as waiving adjustment premiums upon renewal, in order to retain existing clients.

Competition in the market is expected to remain strong throughout the remainder of 2014.

ABOUT MARSH

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