MARSH

INSIGHTS | 2016

UNITED STATES INSURANCE MARKET REPORT 2016

# FINANCIAL INSTITUTIONS

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# FOREWORD

As part of our commitment to keeping you informed, Marsh is pleased to present you with this excerpt regarding the financial institutions industry from our *US Insurance Market Report 2016*. Through data and analysis, it provides a snapshot of current market conditions and risk trends across major lines of coverage and industry/specialty sectors. The report reflects the experience of Marsh insurance professionals who work daily with the global insurance marketplace and provide clients with risk management advice.

With 2016 under way, the global insurance marketplace appears to be heading in the general direction of soft pricing, reflecting insurer capacity, competition, and relatively low catastrophe losses. At the same time, the insurance industry will continue to be affected by macro dynamics, including global economic, political, regulatory, technological, and environmental developments.

In addition, the insurance industry is also experiencing some significant developments that bear watching throughout 2016, including:

- Large-scale mergers and acquisitions.
- Executive leadership changes.
- A reduction in and changes in underwriting appetite at several companies.
- Some insurers' disposition of unprofitable segments.
- Recent announcements regarding potential and actual reinsurance underwriting.

These developments may ultimately produce positive outcomes, such as a prolonged healthy, competitive market with higher levels of innovation, new product offerings, and improved service.

Companies of all sizes and in all industries around the world choose Marsh for our breadth and depth of experience, expertise, and capabilities. These traits are critical in a volatile market, as is our ability as a trusted strategic advisor to help you navigate complex risk challenges and assess and recommend markets.

We thank you for the trust you place in Marsh every day. Should you have any questions about this report or the industry and market environment, please do not hesitate to reach out to your Marsh representative.

Best regards,

Rob

Robert Bentley
President, US and Canada Division

# EXECUTIVE SUMMARY

Following are some key takeaways from Marsh's *US Insurance Market Report 2016*.

## RISK ISSUES

### Cybersecurity

Cybersecurity is now a mainstream business concern across all industries as most companies have either been the victim of a cyber-attack, conducted business with a company that has been attacked, or expect to be attacked at some point. There is a realization that cybersecurity needs to be managed across the enterprise. From individual employees to the board of directors, everyone has a stake in cybersecurity.

### Drones

Insurers are paying increasing attention to the use of unmanned aerial systems — drones. Coverage for the risks presented by drone use may be excluded from casualty policies, and insurers are concerned about personal and advertising injury risks related to drones, although bodily injury and property damage coverage may also apply. In 2016, organizations that use drones may be expected to answer detailed questions from insurers including, but not limited to, questions about drone size and intended purpose.

### Mergers and Acquisitions (M&A)

M&A activity in 2015 was exceptionally high in many industries, including insurance, health care, and communications, media, and technology. Activity is expected to be high again in 2016, barring any unforeseen changes. Among the risks heightened by M&A activity are environmental exposures, including legacy pollution issues; technological risks, such as integration of systems, data protection, and cybersecurity; and regulatory issues.

## INSURANCE COVERAGE ISSUES

### Property

- The US commercial property insurance market continued a two-year softening trend in 2015, one that is expected to continue into 2016, barring unforeseen changes in conditions. Rates are generally decreasing for buyers as catastrophe (CAT) losses were again low in 2015, insurer competition is at a high level, and alternative sources of capital are expected to continue to buoy the market.
- The quality of data that insureds submit to underwriters will continue to play a significant role in determining property insurance pricing, particularly regarding catastrophe risks.
- Cyber issues are playing out in property policies as business interruption losses stemming from cyber-attacks are an increasing concern for many organizations.

### Casualty

- The US casualty insurance market generally softened in 2015 and, barring unforeseen changes, these conditions are likely to continue into 2016.
- Automobile liability remains among the most challenging of casualty areas. Nearly half of all auto liability clients renewed with rate increases in the fourth quarter of 2015, with trucking exposures facing a particularly difficult market.
- The workers' compensation insurance market continues to improve, with generally favorable conditions for buyers. Prescription drug prices remain a cost management concern.

## Financial and Professional

- Entering 2016, demand for cyber insurance continues to grow across all industries and segments. Demand for protection against data breaches remains strong as concern over business interruption risks is growing. Capacity will continue to increase for most classes, barring unforeseen changes, but organizations should be prepared to fully outline their cyber security controls for underwriters for the best results.
- Employment practices liability insurance rates generally declined in 2015 and are likely to do so again in 2016, barring unforeseen events. Wage and hour claims filings have increased, as have related insurance offerings.
- Directors and officers (D&O) insurance rates are likely to continue to decline in 2016, barring unforeseen changes in conditions. Insurer and broker coverage innovations are also expected to continue.

## Aviation

- The airline insurance market is expected to remain soft in 2016, barring unforeseen events. In the fourth quarter of 2015, most buyers renewed with decreases of between 15% and 25%. Competitive markets are also expected for general aviation and aerospace manufacturers.

## Captives

- In early 2015, the Internal Revenue Service (IRS) included the formation of small captives on its annual list of questionable tax avoidance strategies. Any company seeking to form a small captive should follow a strict and detailed approach to ensure compliance.
- More captives may access terrorism insurance in 2016 as awareness of the potential benefits increases.

## Employee Benefits

- Employers predict that in 2016 their health benefit cost per employee will rise by 4.3%, on average, according to Mercer, one of the Marsh & McLennan Companies.
- Employers are becoming more creative in how they support workforce health. For example, about one-fourth of large employers (24%) encourage employees to track their physical activity with a "wearable" device.

## Energy

- Overall energy insurance market capacity increased in 2015, putting downward pressure on pricing. Barring unforeseen events, soft market conditions will likely continue in 2016.
- Energy companies have generally increased their focus on cybersecurity, including on regulations and adherence to certain contractual risk allocations to better manage each party's risk and exposure to cyber loss.

## Environmental

- Barring unforeseen changes, the soft environmental insurance market conditions seen in 2015, which were driven by abundant capacity, are likely to continue in 2016.
- The rapid pace of M&A activity has led to an increase in environmental insurance purchases to help facilitate transactions.

## Entertainment

- The market for entertainment and events insurance was relatively soft in 2015.
- Drone use and terrorism risk are expected to be prominent issues in 2016.

## Marine

- The marine market significantly softened in 2015, largely driven by a continued influx of capacity, a soft reinsurance market, and reduced losses.
- A high number of mergers among marine underwriters in 2015 did not affect the overall market.

## Political Risk

- Despite significant global political turmoil and violence, political risk insurance rates generally declined in 2015 and should do so again in 2016, barring a significant change in conditions.
- High risk areas are exceptions. For example, it is difficult to obtain coverage for Russia, while portfolios that included Turkey or Brazil generally saw increases of about 10% in the fourth quarter of 2015.

## Surety

- Surety market outlook for 2016 is positive, assuming continued strength in the construction industry.

## Trade Credit

- The market for trade credit insurance is expected to remain generally favorable for buyers into 2016.
- Larger rate reductions were possible in 2015 for portfolio programs covering multiple debtors (as opposed to single-debtor programs).

*Note:* For specific insurance market and risk trends by industry, see the "Industry Specialties" section of this report.

AHEAD IN 2016

General property and casualty insurance rate softening likely to continue.

Regulator focus on cybersecurity and preparedness.

# Financial Institutions

## INSURANCE MARKET CONDITIONS

| COVERAGE | SEGMENT | RATE CHANGE Q4 2015 | RATE CHANGE Q4 2014 |
|---|---|---|---|
| FINPRO | DIRECTORS AND OFFICERS LIABILITY | 5% DECREASE TO 5% INCREASE | 5% DECREASE TO 5% INCREASE |
| | EMPLOYMENT PRACTICES LIABILITY | 5% DECREASE TO 5% INCREASE | 5% DECREASE TO 5% INCREASE |
| | ERRORS AND OMISSIONS | 5% DECREASE TO 5% INCREASE | FLAT TO 5% INCREASE |
| | FI BOND | 5% DECREASE TO FLAT | 5% DECREASE TO 5% INCREASE |
| | FIDUCIARY | 5% DECREASE TO 5% INCREASE | 5% DECREASE TO 5% INCREASE |
| PROPERTY | NON-CAT-EXPOSED ORGANIZATIONS | 10% DECREASE TO 5% DECREASE | 17.5% DECREASE TO 10% DECREASE |
| | LARGELY CAT-EXPOSED ORGANIZATIONS | 15% DECREASE TO 5% DECREASE | 15% DECREASE TO 7.5% DECREASE |
| CASUALTY | GL GUARANTEED COST | 9% DECREASE TO 3.5% INCREASE | 10% DECREASE TO 5% INCREASE |
| | GL LOSS SENSITIVE | 4.5% DECREASE TO 10% INCREASE | 5% DECREASE TO 5% INCREASE |
| | AUTO GUARANTEED COST | 3% DECREASE TO 10% INCREASE | 5% DECREASE TO 10% INCREASE |
| | AUTO LOSS SENSITIVE | 3% DECREASE TO 10% INCREASE | 5% DECREASE TO 10% INCREASE |
| | WORKERS' COMPENSATION | 5% DECREASE TO 5% INCREASE | 5% DECREASE TO 5% INCREASE |
| | UMBRELLA/EXCESS LIABILITY | 5% DECREASE TO 5% INCREASE | 5% DECREASE TO 10% INCREASE |

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 2015, driven by limited catastrophe losses, plentiful capacity, new capital entrants, and lower treaty costs. In some cases, large banks experienced significant reductions with enhanced terms and conditions. Barring unforeseen events, these trends will likely continue in 2016.

Insurers continue to scrutinize coverage terms with a focus on business interruption. 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. Many financial institutions are considering insurers that offer multiple products and risk transfer solutions across all coverage lines. This strategic approach has helped build a stronger relationship and support some coverage lines that may have had a negative claims experience.

While the overall property marketplace is favorable for financial institution clients, standalone coverage for lender-placed, real estate-owned, and mortgage impairment continues to be limited given the number of insurers participating in the space. The loss experience as well as available underwriting data will often dictate the results for these coverages.

The passage of the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) of 2015 had a positive impact for financial institutions, particularly for those in central business districts in the US.

#### CASUALTY

The casualty insurance market softened in 2015, a trend that continued into the fourth quarter, generally resulting in rate decreases for organizations with good loss profiles. Financial institutions with concentration issues in major cities experienced flat rates, or in some cases, rate reductions. Capacity loosened slightly for workers' compensation risks; however, some insurers continued to carefully monitor aggregation issues of specific organizations in major cities. These trends are expected to continue in 2016, barring unforeseen changes in conditions.

Many insurers in 2015 excluded cyber coverage from commercial general liability policies, causing many organizations to consider standalone cyber insurance. Coverage and "give backs" for bodily injury and property damage vary among insurers, with many seeking to include their own endorsement language. Excess insurers sought to do the same on lead umbrella and excess liability placements. Organizations in 2016 may consider working with insurance advisors regarding bodily injury and property damage losses stemming from a cyber event as cyber policies typically do not cover such exposures.

#### FINANCIAL AND PROFESSIONAL

While financial and professional liability insurers generally sought rate increases in 2015, the market remained competitive, with plentiful capacity. Increased regulatory oversight, regulatory investigations, and the cyber risk landscape continue to challenge underwriters, particularly in the primary and low excess portions of programs. Barring unforeseen circumstances, financial institutions can expect generally flat overall rates in 2016; however, errors and omissions (E&O) and cyber liability could experience greater volatility. 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 2016, 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

### Cybersecurity

The severity of recent cyber-attacks highlighted the importance of cyber insurance for many financial institutions. Rating agencies warned some banks of the risk of a credit rating downgrade due to lack of preparation for cyber incidents. Standard & Poor's is questioning, in particular, whether banks have cyber insurance policies.

The notification and investigation costs of a data breach are a significant concern for financial institutions, and regulatory scrutiny of cybersecurity procedures poses a particular issue for investment companies. Marsh clients with revenues of more than $1 billion have increased their cyber insurance limits by 42% on average since 2012. Over the same time period, financial institutions expanded their coverage by 22%.

### Regulatory Compliance

Banks, investment firms, and insurers face regulatory scrutiny in a number of areas, including:

- The Securities and Exchange Commission (SEC) in 2015 advanced rules aiming to increase oversight of mutual funds.
- The National Association of Insurance Commissioners (NAIC) now requires all midsize and large US insurers to file an Own Risk Solvency Assessment (ORSA). The concept, now embedded in the International Association of Insurance Supervisors (IAIS) standards, gauges insurers' current and future risks through an internal risk assessment process that informs regulators of an insurer's ability to withstand financial stress.
- Banks continue to adjust to rules and procedures imposed by the Sarbanes-Oxley and Dodd-Frank acts.
- Cybersecurity will remain a priority for various regulators, including the Federal Financial Institutions Examination Council (FFIEC) and its members.

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