

Quarterly D&O Pricing Index

Fourth Quarter 2013

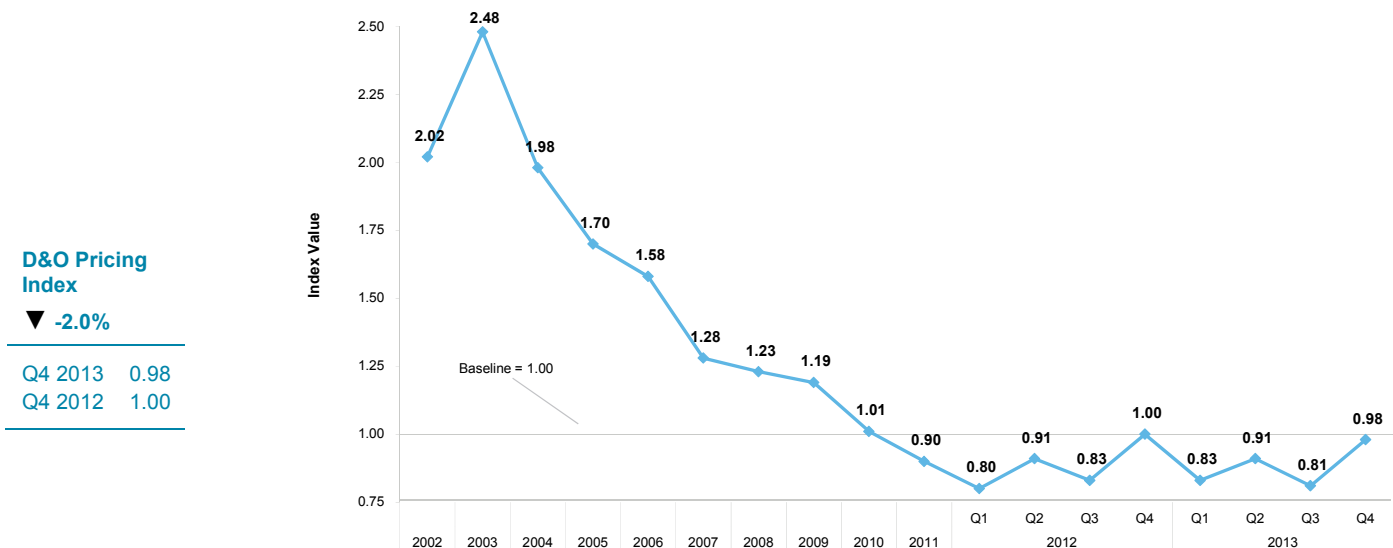
Each quarter Aon's Financial Services Group ("FSG") publishes a pricing index of Directors' and Officers' liability ("D&O") insurance that tracks premium changes relative to the base year of 2001.^{1,2} In the fourth quarter of 2013, the average price for \$1 million in limits increased 21.0 percent from the third quarter of 2013, with the Index moving from 0.81 to 0.98. The "increase" in Q4 2013 has more to do with the mix of business from one quarter to the next.

However, as we have said in the past, a more meaningful measure derived from this Index is to compare the current quarter with the prior year quarter, which for Q4 2013 was down 2.0 percent vs. Q4 2012. Since D&O policies are typically written for a 12-month period, this year-over-year comparison is a close approximation of renewal pricing and a more significant indicator of renewal results in the quarter.

An even better comparison is to look at only those programs that renewed in both Q4 2013 and Q4 2012. On that basis, pricing decreased 1.0 percent.

Quarterly Index of D&O Pricing

Q1-2002 through Q4-2013 | Base Year: 2001 = 1.00



D&O Pricing Index

▼ -2.0%

Q4 2013	0.98
Q4 2012	1.00

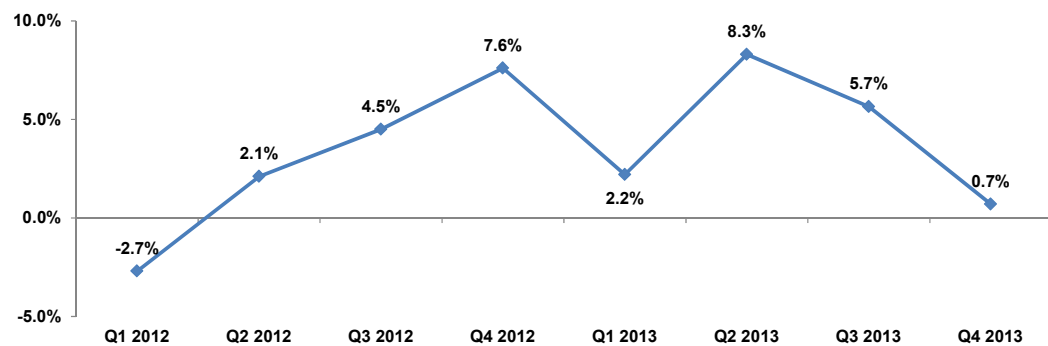
A Stable Environment

Prior to Q4 2012 we experienced year-over-year decreases in 35 out of 37 quarters dating back to Q4 2003. The two exceptions (Q4 2008 & Q2 2009) were during the Credit Crisis, and were primarily driven by results in the S&P Financial sector. As we watched with interest throughout 2012, we noticed the Index creeping towards positive territory, culminating with a year-over-year increase in Q4 2012. For the full year, the 2012 Index was flat (0.90). 2013 was a bit up and down by quarter with no real discernible pattern. In the end the full year has come in flat (0.90) for the second consecutive year. We would define this as a stable environment.

However, as we consider the overall stability of the market, we continue to look at the carrier's reaction to the various layers within a program. Primary policies that renewed in both Q4 2012 and Q4 2013 with the same limit and retention increased, on average, 0.7 percent. This is the lowest primary quarterly increase since we started tracking these increases eight quarters ago. Remembering that D&O programs are most often built on a layered basis, basic math would indicate that excess pricing is decreasing by enough to compensate for the increase in primary pricing, resulting in the average total program renewing down 1.0 percent. Again, pricing is still pretty stable overall.

Primary Price Changes

Q1-2012 through Q4-2013 | Same Limits and Deductibles

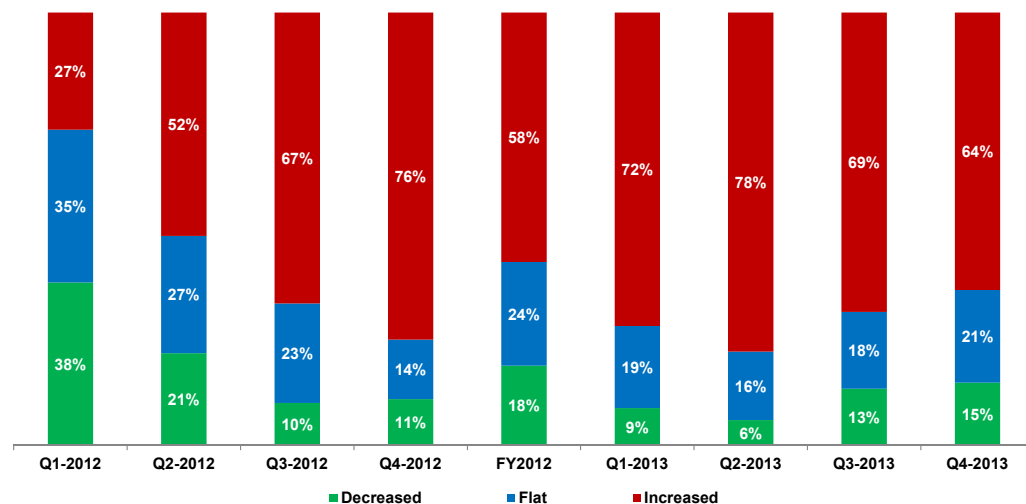


As the graph above indicates, increases in the primary layer had been gaining momentum from Q2 2012 through Q2 2013, but began reversing course starting in Q3 2013. Given that the D&O Index is relatively stable, this change of course on the primary (closer to flat) leads us to believe that the carriers' attitude on primary versus excess pricing appears to be more in sync than in recent history.

In addition to the average pricing change, we also look at the number of companies that experienced a decrease on their primary layer versus a flat renewal or an increase. While the total number of primary decreases is still in the minority, the number of clients receiving decreases on the primary layer was up to 15 percent in Q4 2013, rising steadily during the last three quarters of the year. Overall, the vast majority of primary renewals are flat to slightly up.

Primary Price Increases/Decreases

Q1-2012 through Q4-2013 | Same Limits and Deductibles

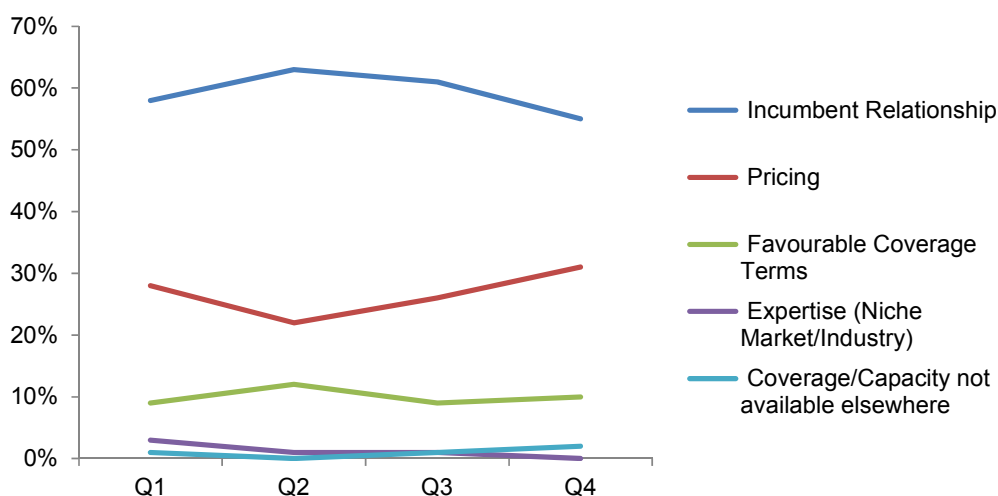


By month, the number of primary decreases in the fourth quarter was 18 percent in October, 14 percent in November, and 14 percent in December. The landscape appears to be changing in that for the time being, flat primary renewals may be considered a “positive” result, at least from the carriers’ perspective. Our clients may beg to differ.

For the year, 94.9 percent of all primary placements renewed with the same carrier. The average increase for those primary policies that renewed with the same limit/same deductible, and remained with the same carrier, was 5.5 percent. Interestingly, a number of our largest carriers posted a 100 percent retention rate for their primary renewals in 2013. This would indicate to us that for carriers, retaining business may be more important than increasing rate.

Why do Carriers win Business?

Why do clients choose one carrier over another? Aon Global Risk Insight Platform, or Aon GRIP, aggregates and analyzes Aon’s insurance placement activity across the globe—from submission to quotes to binding. We were not surprised to learn that in 2013 clients value relationship above all else. What was surprising to us was that clients seem to place very little value on expertise. Nor does it appear that a lack of coverage and/or capacity is a driving factor. This is yet another example of the highly competitive landscape.



Changes by Sector

In Q4 2013 seven out of ten S&P sectors decreased, one was flat, and two increased. At opposite ends of the spectrum, the S&P Utilities sector increased 4.0 percent, while the S&P Telecommunication Services sector decreased 18.3 percent. For the full year, four out of ten S&P sectors decreased, one was flat, and five increased. The S&P Energy sector decreased 8.2 percent, while the S&P Telecommunication Services sector increased 14.5 percent. Account specific issues (i.e., claims experience, pricing history, underwriting concerns at the time of renewal, etc.) and industry characteristics have an effect on individual customer’s D&O pricing. Fortunately, there appears to be a great deal of differentiation in the marketplace as underwriting due diligence has become more robust.

Limits & Deductible Purchasing Trends

In Q4 2013, our clients purchased on average 5.5 percent more limits than the prior year. Looking at only those companies that were in both the Q4 2013 and Q4 2012 samples, 25.4 percent of companies purchased higher limits than in the prior year. Only 2.1 percent of clients reduced their limits in Q4 2013.

For the full year, 19.9 percent of limits increased. Only 0.9 percent of limits decreased. This continues to illustrate the point that companies are still focused on limits adequacy.

We also monitor deductible changes within our book of business. During the quarter, 18.6 percent of D&O program deductibles increased, with those clients retaining more upfront risk. Only 2.2 percent of deductibles decreased during the quarter. Historically speaking, deductibles were fairly stable (79.2 percent remained unchanged) for the quarter. An interesting finding is that those that renewed with the same primary limit and a higher deductible also experienced a primary increase on average of 3.4 percent. It is likely that in these particular cases, the deductible increases were involuntary rather than a cost savings mechanism. Some carriers continue to push for higher retentions in general.

For the full year, 18.0 percent of D&O program deductibles increased. Only 1.2 percent of deductibles decreased during the year. 80.8 percent remained unchanged for the year.

A Change in the Landscape for D&O Claims

For years we have presented the incidence of low frequency, high severity Federal Securities Class Action (“SCA”) litigation. Our position was that individual carriers could manage their “severity” exposure through proper risk selection and managing their limits exposed. We suggested that what really kept carriers up at night was high frequency, low severity “systemic” risk.

Starting with the Credit Crisis in 2007, we’ve seen an uptick in other types of SCA litigation; e.g., Credit Crisis filings and M&A “Merger Objection” filings. Add to those the increase in other non-SCA litigation (suits brought by law enforcement agencies and regulators, breaches of fiduciary duty and derivative actions) and you have a noticeable increase in the type of litigation inventory that largely tends to impact the primary layer. For the past few years, there has been a relatively small fraternity of primary carriers bearing the brunt of this increased frequency. We believe that is the reason why we’ve seen an uptick in primary pricing over the past eighteen months as those carriers work to address the profitability of their portfolio of primary policies. Since “normal” SCA litigation typically results in higher severity, increases in these types of claims may have more of an impact on excess carrier’s results. We will continue to monitor the recent increase in this activity. According to Cornerstone Research and the Stanford Law School’s Securities Class Action Clearinghouse, there were 166 SCA filings for the full year, a 9.2 percent increase over the 152 filings in 2012. “The 2013 filings are below the historical average from 1997 to 2012. One possible explanation for filings remaining below the historical average in recent years is the decline in the number of unique companies listed on the NYSE and NASDAQ. The number of companies on these exchanges as decreased 46 percent since 1998, providing fewer companies for plaintiffs to target.” In another recent development, “Rule 10b-5 claims have been more prevalent in the past two years [84.5 percent of filings] compared with the previous three years [68.7 percent].” Even with this increase, we firmly believe that the overall D&O marketplace will remain competitive for the foreseeable future due to a stable (frequency & severity) claims environment, some potentially favorable law and increased primary and overall capacity.

Insurer Behavior – A Developing Trend

Our experience is that we’ve seen carrier underwriting and claims behavior, as a whole, improve in 2013. Perhaps this is another sign of a more competitive marketplace? That being said, we’ve recently observed some new and aggressive coverage positions by some primary carriers on derivative claims.

We assume this has to do with their profitability issues, but will closely watch and push for developments over the next few quarters.

Insurers Report Full Year Results

Historically insurers were able to manage to a slight underwriting loss (just over a 100 percent combined ratio). But with the ability to invest the premium and earn reasonable investment returns, firms could still generate adequate returns on capital and make a profit. The game has changed somewhat in this era of historically low interest rates. In order to provide adequate returns, insurers are now forced to manage the business to metrics closer to a 95 percent combined ratio vs. the historical standard of 100 percent.

Full Year Results	P&C Combined Ratio		Net Income/(Loss) in millions		
Insurer	2013	2012	2013	2012	% Change
ACE Limited (NYSE: ACE)	88.0	93.9	\$3,758	\$2,706	38.9
American International Group (NYSE: AIG)	101.3	108.5	\$9,083	\$3,438	164.3
Chubb Corporation (NYSE: CB)	86.1	95.3	\$2,345	\$1,545	51.8
XL Group plc (NYSE: XL)	92.5	95.3	\$1,060	\$651	62.8
Zurich Insurance Group Ltd. (PINK:ZURVY)	95.5	98.4	\$4,028	\$3,887	3.6

Source: Corporate earnings reports: ACE, AIG, Chubb, XL, and Zurich

For the full year, four of the five largest providers of D&O insurance⁵ posted a combined ratio⁶ under 100 percent during the quarter, with three out of five of them posting combined ratios that were under 95 percent. It should be pointed out that, excluding catastrophe losses, industry loss ratios remain at historically low levels and that all five carriers improved their P&C combined ratios year over year. Lower loss ratios coupled with firming of premium rates have contributed to these types of results.

Of note, however, there has been some recent reserve strengthening by a few carriers specific to their D&O books of business. We will watch this carefully to determine if their underwriting appetite also changes.

Market Capacity – More Primary D&O alternatives

In the past we've talked about the effect "supply and demand" has on D&O pricing. The "theoretical capacity" available to any one buyer of D&O insurance has increased to just over \$1.4 billion. Throughout the year we have been discussing the fact that new entrants to the market have been building management liability teams. As of the end of the year, we did experience activity from this new capacity and we expect to see much more deployment of capital from these firms throughout 2014. For the first time in many years, some of this new capacity will be focused on the primary D&O space as opposed to simply playing in "Commodity" excess layers. The overall increase in capacity coupled with some potential new players in the primary D&O space should make for a stable to improving D&O marketplace for customers in 2014. Incumbent carriers should consider flat to be a winning proposition given these dynamics.

Summary

In summary, Aon FSG's observations about the D&O marketplace for **Q4 2013** are as follows:

- Overall, D&O price per million was down 2.0 percent compared to the prior year quarter
- The price per million on programs that renewed in both Q4 2013 and Q4 2012 decreased 1.0 percent
- Primary layer price per million increased 0.7 percent compared to the prior year quarter
- 85 percent of primary policy premiums were either flat or increased
- Companies purchasing higher limits compared to the prior year quarter was 25.4 percent
- 18.6 percent of deductibles increased compared to the prior year quarter.

In summary, Aon FSG's observations about the D&O marketplace for the full year **2013** are as follows:

- Overall, D&O price per million was flat (0.0 percent) compared to the prior year
- The price per million on programs that renewed in both 2013 and 2012 decreased 1.0 percent
- Primary layer price per million increased 4.6 percent compared to the prior year
- 89 percent of primary policy premiums were either flat or increased
- Companies purchasing higher limits compared to the prior year was 19.9 percent
- 18.0 percent of deductibles increased compared to the prior year

On a macro basis we believe that the surplus of capacity, combined with overall positive P&C underwriting results, will continue to make for an overall stable D&O pricing environment for public companies. We believe that a stable environment equates to a buyers' market as we continue to be at or below the 1.00 index established in 2001.

¹ The Quarterly D&O Pricing Index is compiled using the proprietary policy data of the Aon Global Risk Insight Platform ("Aon GRIP"). The D&O Pricing Index is currently comprised of policy information on over 8,275 D&O programs for publicly traded companies between January 1, 2001 and December 31, 2013. The Index represents the weighted average cost of \$1,000,000 of D&O insurance (Total Premium / Total Limits). The average "rate per million" of limit includes D&O placements (A/B/C Coverage), Side A only (non-indemnifiable loss) placements, and Side A DIC (difference-in-conditions) placements. Programs with blended coverage (e.g., a shared limit for D&O and Fiduciary Liability combined) are excluded from the Index.

While the Index data includes a small number of foreign companies that trade on a U.S. exchange, the majority of the companies are U.S. issuers traded on U.S. exchanges. As such, the data is representative of the U.S. D&O market and not the global D&O market.

FSG first produced the Quarterly D&O Pricing Index in Q2 2006. The base year (2001) is the average price per million for \$1,000,000 of D&O coverage costs for the 2001 calendar year.

² In the first quarter of 2008, FSG began adding S&P's Compustat company data to our proprietary policy data. Some companies previously included in our pricing index are not included in this S&P data, primarily foreign issuers not traded on U.S. exchanges and some smaller U.S. companies (e.g., OTC:BB). These companies have been removed from the D&O Pricing Index which resulted in some minor changes to prior results. We do not view these changes as material to the overall results of the Index.

³ Advisen Ltd. D&O Claims Trends: 2012 Wrap Up.

⁴ Cornerstone Research Securities Class Action Filings: 2012 Year in Review.

⁵ The top five public company D&O insurers based on gross written premium placed by Aon in 2012.

⁶ Combined Ratio is defined as Loss Ratio⁷ + Expense Ratio + Dividend Ratio. It measures the percentage of premium used to cover losses, expenses and policyholder dividends. If the combined ratio is below 100 percent, the company is operating at an underwriting profit. If the ratio is above 100 percent, the company is dependent on Investment Income to earn a profit. (Source: Highline Data LLC 2008)

⁷ Loss Ratio is defined as (Losses + Loss Expenses Incurred) divided by Net Premiums Earned. Loss Ratio is a component of the Combined Ratio measuring the percentage of premium dollars used to settle claims. This measure can be affected significantly by changes in estimates of losses from prior years. (Source: Highline Data LLC 2008)

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About Aon Global Risk Insight Platform ("GRIP")

The Global Risk Insight Platform is the world's leading repository of insurance placement activities. By capturing information about key broking activities, GRIP provides timely insight into market trends and client buying behaviours. As a result of the contributions of 7,220 Aon GRIP users spanning 20 countries in North and South America, Europe, Asia and the Pacific, Aon GRIP* provides insights into:

- US \$114 billion in premium flow
- 2.0 million opportunities to quote
- US \$75.2 trillion in total limit
- 173 client countries
- 1,339 global carriers
- 100,000 global clients
- 51 lines of coverage
- 27 global carriers with GRIP Dashboard
- *as of February 2014

About Aon's Financial Services Group

Aon's Financial Services Group is the premier team of executive liability brokerage professionals, with extensive experience in representing buyers of complex insurance products including directors' and officers' liability, employment practices liability, fiduciary liability, fidelity, and professional liability insurance. FSG's global platform assists clients in addressing their executive liability exposures across their world-wide operations. Aon's Financial Services Group manages more than \$2.2 billion in annual premium, assists with claim settlements in excess of \$3.5 billion, and uses its unmatched data to support the diverse business goals of its clients.



Aon Global Risk Insight Platform