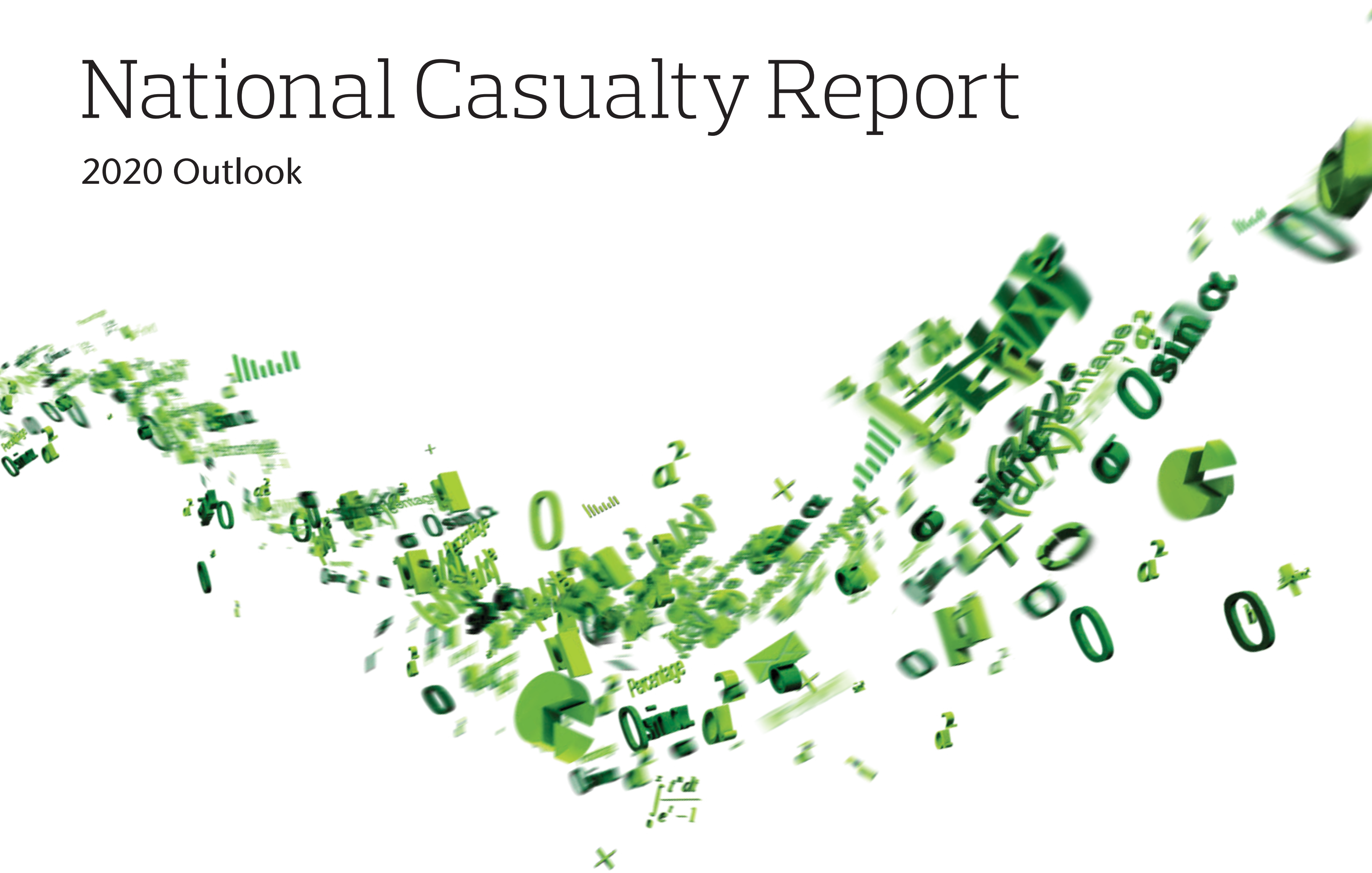
National Casualty Report

2020 Outlook



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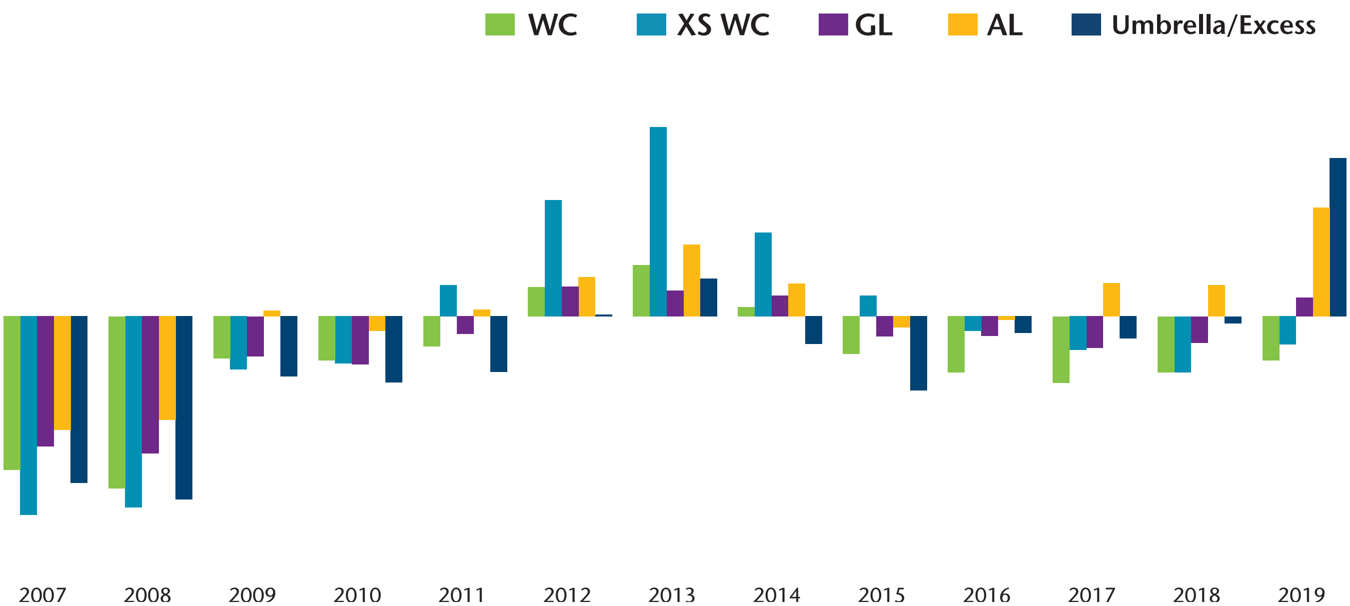
Introduction

Throughout 2019, the excess casualty insurance market changed significantly for our clients, with the pace of change accelerating in the third and fourth quarters as insurers sought to reset deployed capacity, attachment points and pricing to respond to dramatic increases in the severity of claim litigation. The primary casualty market was less volatile but trending modestly higher. Many insurer groups have bolstered casualty reserves for prior years and this portends more changes ahead. Overall movement in rates over several years among our National Casualty clients are depicted in the following chart:

Exhibit 1

Average Rate Change 2007-2019



As we have launched into 2020, it is critical to have a proven, trusted advisor helping you navigate your casualty insurance program. Aon's National Casualty team has the track record to partner with you in this changing marketplace landscape and help you obtain a world class casualty program. In this paper, our team highlights the current factors impacting the casualty marketplace and what you can expect in 2020. We are hoping this paper assists you in preparing for the challenging year ahead.

Primary Casualty Market

Countering historical trends, Workers' Compensation (WC) has remained profitable for most insurers. As a result, rates have hovered near flat with modest rate reductions common in 2019. In addition, with improvement in the economy, more than two-thirds of our National Casualty clients showed growing exposure bases in 2019.

Medical cost inflation continues to increase average claim severity for many clients. In addition to annual medical cost inflation averaging between 3 to 6% in the U.S., advancements in treatment options and technology drive increases. Many clients are offsetting these severity increases with improvements in frequency of claims.

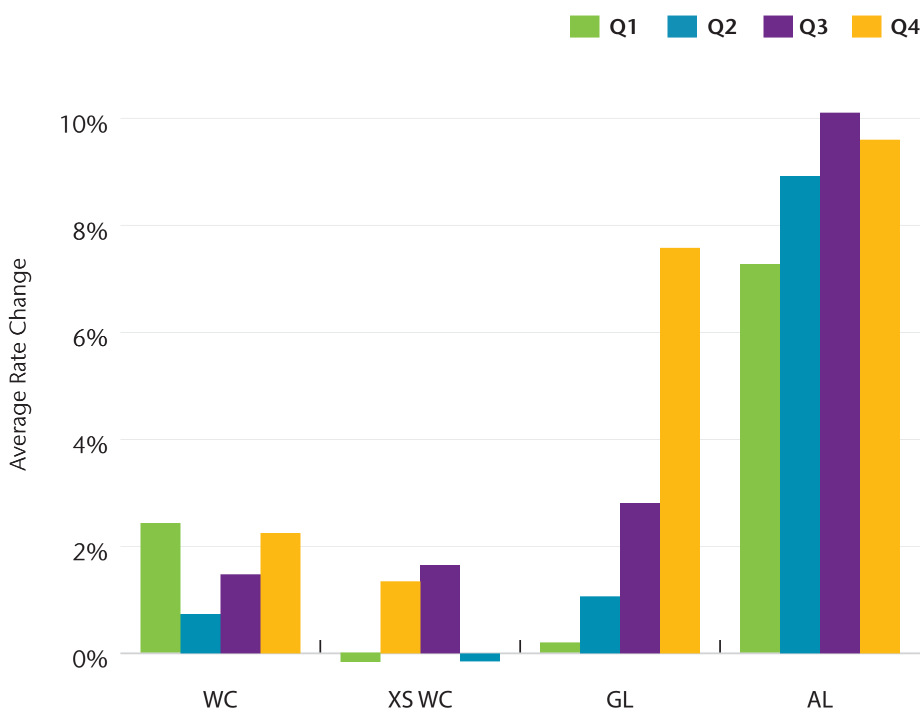
On the other hand, primary Auto Liability risk transfer has been one of the most unprofitable lines in the Commercial insurance industry for several years but has started to catch up in 2018 and 2019. Similarly, General Liability lines have seen increasing volatility of claim results associated with "social inflation". As such, primary risk transfer for General and Product Liability has become unprofitable for most of the commercial insurance industry.

The majority of our clients kept primary casualty deductibles and retentions the same in 2019 but some were increased to free up premium for increases in other lines, including excess casualty. Due to the significant booked premium for Workers' Compensation as well as the profitability of this line, carriers deployed increasingly aggressive and creative techniques in pricing and collateral in order to gain new customers for primary casualty.

Overall, for our National Casualty book of larger and more complex programs, mean rate change by quarter for 2019 was as follows in the chart below.

Exhibit 2

Primary Casualty Rate Change by Quarter 2019



Excess Liability Market

The U.S. Excess Liability insurance market began showing signs of greater underwriting discipline in Q1 2019 and transitioned into a firming market in Q2 2019. The quantum of capacity restrictions and pricing increases then accelerated significantly in Q3 and Q4 and into January 1, 2020 renewals, leaving many risk managers experiencing significant challenges with program structure, available capacity and pricing of that capacity. For several years, insurers have warned of the need for rate improvement without success. Insurers succeeded in moving the market in 2019, driven by the following factors:

- Years of declining premium rates against exposures (nine of the past twelve years have seen average premium rate declines).
- Increased frequency of severity outpacing any meaningful movement in rates.
- Large loss events yielding nuclear jury verdicts and pushing up the value of negotiated settlements.
- U.S. medical cost inflation and advancements to improve quality of life for the injured.
- Growth of industry catastrophic exposure including wildfires, opioid epidemic, gas explosions, talc, mass shootings, traumatic brain injury, and emergence of various state "Children's Victims Act" laws.
- Continuous improvement in science and technology to identify losses and their causes as well as increased publicity including social media and product recall announcements.
- 'Social Inflation' including injustice sentiments and anti-corporate philosophy, leading to desensitized view of enormous jury awards. "Reptile Strategy" implementation in litigation has further exacerbated this trend.
- Erosion of the concept of fault, where juries are more likely than in the past to award large verdicts based on the scope of injury, with less regard to fault.
- Lack of reinsurance capacity in the primary buffer layers, especially for auto risks.
- Increased focus on all large vehicle risks including non-owned vehicles and the impact on auto attachment points.
- The advent of third-party litigation finance to support plaintiff action.
- Adverse reserve development both for clients and carriers.

While insurers have always maintained that they underwrite each client individually, of late the marketplace is driving up rates in a very coordinated pattern. Many insurers are focused on rate adequacy across their book to address overall profitability goals. This presents difficulties for individual insureds in light of client specific experience or loss mitigation efforts. To help address this, Aon works diligently with our clients to differentiate their unique risk and help insurers to quantify the value of client investments in safety, product efficacy, and overall risk avoidance techniques. In addition, evidence still prevails that long-term, high-quality relationships with the insurers benefits clients in both renewal and claims outcomes. We have seen this work pay off for our clients.

The pressures of the factors outlined above--together with capacity restrictions and reductions in the Excess Casualty market—are creating significant challenges for many of our clients.

A Looming Catastrophe in the Casualty Market?

As a long-tail exposure, key indicators into the health of the casualty insurance market include carriers' treatment of prior year reserves. Indeed, in the fall of 2019, certain industry insiders have predicted a coming casualty "catastrophe" in the form of reserve inadequacy. We do see Travelers' announcement of $294m in unfavorable reserve development in the third quarter alone as well as AIG's enhancement of reserves by $667m for 2019 through third quarter as the "canaries in the coal mine" predicting more reserve strengthening to come. Those reserve changes, however, were not exclusively for casualty lines, and some carriers have fared better. On improving underwriting margins, Chubb lowered reserves by $619m through the first 9 months of 2019.

While industry analysts have predicted increases in operating income for the industry, this income will be further weighed down by continued unfavorable reserve development in 2020. In fact, some analysts believe many carriers will "stair-step" reserves up which they believe may be more damaging to market caps than more significant one-time changes.

The "Here and Now" of Capacity and Pricing

Capacity

As mentioned above, we have seen a continuing constriction of available capacity for Umbrella and Excess Liability placements. Since mid-year 2018, we have seen more than $400 million of capacity disappear from the market. This reduction has affected the markets in the U.S., Bermuda and particularly in London. These reductions in capacity manifest in many ways:

- Insurers who have ceased writing Excess Liability completely
- Insurers who have reduced available capacity across the board
- Insurers who have reduced available capacity for certain classes of business
- Insurers who are managing deployed capacity by size of Insureds
- Insurers who are aggregating capacity across their geographical platforms
- Insurers who are deploying less than their full capacity and/or positioning their capacity at different positions in the tower

All of these changes have caused considerable disruption in the market. There are insurers who theoretically have not reduced their capacity, but in reality are deploying less. This is very evident for lead Umbrella placements. Many carriers who write in the lead Umbrella space are reducing their limits deployed in this area. Many of the lead $50 million layers that were available in the past are all but gone, and the $25 million layers have been reduced in many instances to $10 to $15 million for larger clients. We are seeing this increasingly in the excess layers now as well. It is common for carriers to deploy less than their maximum capacity available on many of our recent renewals.

This current pressure on capacity is rivaled only by the pressure for increased rate. The combination of the two has resulted in a significant shift in the profile of the lead Umbrella placement, as well as continued pressure on pricing throughout the remainder of the tower.

In addition to the lead Umbrella, available capacity has been reduced and/or is being managed in the excess layers. Capacity is being affected by class of business, coverage provided and overall aggregate exposure of the carrier in question. For example, we have seen:

- Swiss Re pull out of the US market for casualty, other than construction
- QBE change their strategy for writing large global accounts
- Liberty Mutual stop writing most if not all unsupported Lead Umbrellas
- AIG, and others, managing overall capacity deployed across all venues and platforms
- Many Lloyd's syndicates reducing casualty writings to keep in line with business plans approved by Lloyds, as well as syndicates that have ceased writing business for certain industry categories
- AxaXL reducing their combined capacity to $50 million across platforms in the US, Bermuda, London and Dublin

A few new market facilities have opened, bringing small additions to capacity, but nothing close to the level of reductions.

Significant marketplace announcements respecting capacity restrictions over the past year include the following:

Exhibit 3

Recent Capacity Changes: Excess Casualty

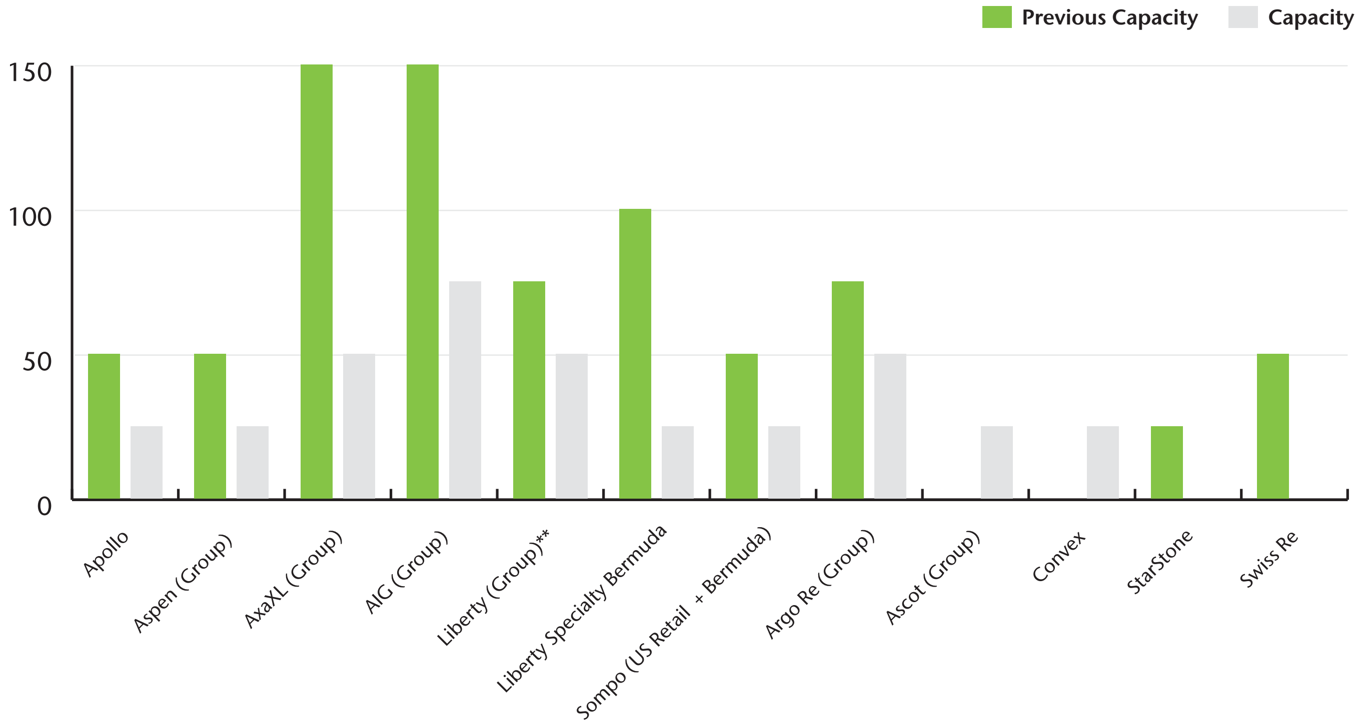
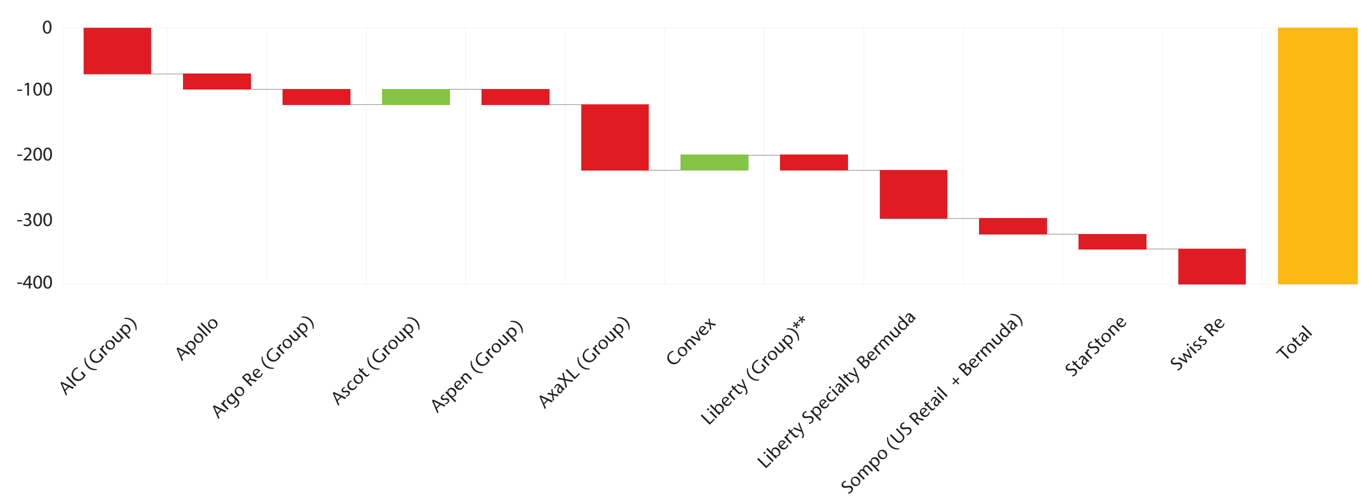


Exhibit 4

Recent Capacity Lost: Excess Casualty



* Capacity is based on carriers' stated positions through January 2020 and may vary for individual clients or classes of business.

** Few exceptions

These are just a few examples of the daily shifts we are seeing in the market. All of these factors are multiplied considerably for any accounts which have experienced recent loss activity. In addition, clients that buy significant towers of insurance (more than $500 million in total limits) are experiencing difficulty in generating enough competition to help defray significant pricing increases. If they are in a class of business considered to be 'challenged', some are finding it difficult to duplicate the limit previously purchased at any cost.

Pricing

For the fourth quarter of 2019, three-quarters of our clients have experienced rate increases, even those with growing exposures. In 2018 and prior periods, clients with exposure growth were more likely to see declining premium rates. The magnitude of pricing and rate increases accelerated significantly in Q3 and Q4 2019 and even into January 1, 2020 renewals. Average tower rate increased by nearly 25% in Q4; however, it is worth noting that approximately 50% of our clients saw increases of 13% or less. More challenging risks saw rate increases on average of just over 100%. In addition, the volatility of results has increased continuously since 2018 as measured by two standard deviations from the mean. We don't anticipate this trend slowing in the near term as the market is seeking to find a 'new normal'. Indeed, it is clear that the marketplace is focused on premium growth more so than rates. Evidence of these trends within Aon's excess casualty business includes:

- Average umbrella/excess rate change is at the highest level we have seen in the last 10+ years.
- 72% of umbrella/excess accounts experienced a rate increase in 2019, double the number of accounts with rate increases in the prior year.
- Average rate increases for total umbrella/excess towers reached double digits by July 1, 2019.
- For third and fourth quarter renewals, over 30% of clients experienced a structural change to their program (i.e. lead limit reduction, attachment point change).

Coverage

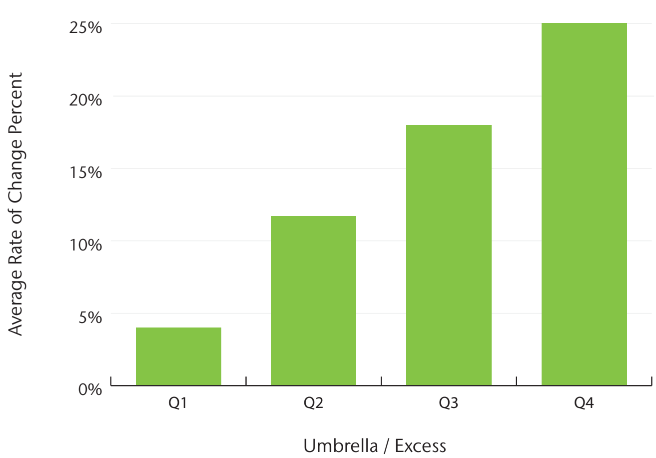
One of the most significant changes we have seen is the elevated pressure by carriers on increased attachment points for lead Umbrella layers. This is particularly true with respect to Automobile liability attachment. Despite the increase in attachment; however, the push for rate shows little leniency for the change in attachment points.

The breadth of coverage we have seen in Excess Liability programs has stabilized with very little broadening of terms and conditions taking place. Coverage for certain classes of risk continues to be restricted or is diminishing. Insurers continue to explore coverage specific restrictions or evaluations for certain products, or risk classes including:

- Wildfire
- Implantable Medical Devices, pharmaceuticals and medical product distribution
- Opioids
- Traumatic Brain Injury
- Certain transportation risks, including those accounts with a contingent exposure
- Cannabis-related exposures
- Electronic Data Events
- Certain types of chemical compounds such as, for example, glyphosate and diacetyl

Exhibit 5

Umbrella / Excess Liability Rate Change by Quarter 2019



Conclusion

In summary, many clients are experiencing a 'perfect storm': reduction in available capacity, increased pricing, and potential reduction in coverage afforded, both in terms of policy language and forced higher attachment points.

To help create competitive options for clients and to strengthen the industry, Aon has invested in building new market capabilities and resources. These include but are not limited to the Aon Client Treaty (ACT), which expands capacity for multiple lines of coverage within the London market, Lloyd's Lead Aon Excess Facility (Aon LLEAF), a proprietary facility for lead layer Umbrella and excess liability placements, and Aon Overwatch, a newly created facility to help protect our clients from the effects of events of malicious violence, including Active Shooter events. Further, we have made significant investments in data and analytics. These investments deliver highly valued loss and program design analytics which help ensure our clients not only have unique insight into their risk profile, but also make highly informed risk decisions.

For questions about Aon's National Casualty practice, please contact:

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If you have questions about your specific program, please contact your Aon broker.

About Aon's National Casualty Practice

Aon's U.S. National Casualty Practice is the premier team of casualty broking professionals, with extensive experience in representing buyers of large and complex insurance and risk financing products including primary casualty & collateral, umbrella & excess, loss portfolio and structured transactions, excess workers' compensation and non-subscription, complex claims advisory, and data and analytics with partner resources across Aon's industry practice groups, Aon Global Risk Consulting, and Aon Global Client Network. Casualty's global platform assists clients in addressing their casualty exposures across their worldwide operations. Aon's casualty team places more than $4.7 billion in annual premiums from the U.S. and uses its unmatched data to help empower its clients' diverse business goals and results.

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