December 2017

U.S. Power Industry Update

In this Issue

A Message from Mark Fishbaugh

On behalf of Aon Global Power, I am pleased to share our U.S. Power Industry newsletter for December 2017. In this issue, we provide an overview of the latest market updates and a look ahead to industry trends in 2018 for Property, Casualty, Financial Products and Cyber risks.

In 2017, our Power team demonstrated Aon's industry commitment through continued investment in specialized resources that allowed us to drive innovation, best-in-class solutions and service excellence for our clients. Through our U.S. Power bench strength, we will continue to provide clients with our unmatched expertise to help them drive optimal results for their businesses.

On behalf of the entire U.S. Power team, we wish all of you a very joyous holiday season and blessings for the new year!

Best,

Mark Fishbaugh

U.S. Power Practice Leader
Aon Risk Solutions

Empower Results®

Property Market Update

By Alex Post, Jonathan Keller, and Muhammad Walijah

Alex Post

Jonathan Keller

Muhammad Walijah

Review and Outlook

Soft market trends persisted through August 2017 but with the impact of recent natural catastrophe events such as Hurricanes Harvey, Irma and Maria, the earthquakes in Mexico and wildfires in the western US, we are seeing a market with upward trending rate pressure. It is important to note that not all major property markets were materially impacted for the US power and utility insureds since AEGIS, EIM and NEIL all made it through the recent catastrophic events with minimal impact. We will also be tracking the upcoming 2018 treaty reinsurance renewals for insurers to understand what sort of increases they may encounter, and how much of that they may seek to transfer to their insureds.

The power generation property market is really a tale of two markets as we close on 2017 and enter 2018. Clients with programs driven by the industry mutuals (AEGIS, EIM, and NEIL) and FM Global should generally have more stable renewals, while insureds with programs driven by traditional stock insurers (such as AIG and Lloyds) will likely experience more pressure to increase rate. For all clients, it will be important to start the renewal process early in order to determine your lead insurers' position as respects renewal terms. This will give clients an opportunity to think about alternative solutions well in advance of the renewal date, if needed. It remains to be seen, as the calendar turns to 2018, whether this dichotomy will continue into the forseeable future, or whether it will only represent a temporary market imbalance.

Capacity

After the recent NAT CAT events, we have not yet seen traditional power generation capacity leave the marketplace so currently there is still an oversupply, which should help mitigate some of the upward rate pressure from the stock insurers.

With the latest announcements from Zurich and Lloyd's regarding their intent to review their investments in coal-heavy businesses, we expect this trend to continue into 2018. These two companies joined other large European insurers such as Allianz and AXA who made similar announcements over the last few years, although large US-based insurers have generally been silent on the matter to date. The effect of such policies on the insurance writings (vs. investment holdings) at these companies is still to be determined but it is something we will monitor closely throughout 2018 as we expect such initiatives to likely reduce insurance capacity available to coal-dependent US power and utility clients over the next few years. We expect, however, that insurers will be cautious before making abrupt wholesale changes in their underwriting policies that would affect long-time clients in this industry segment.

Aon continues to drive more insurance capacity into the market in order to better serve its power and utility clients. Two examples of this are as follows:

- **Aon Client Treaty**[1] – Offers up to a 20% add on to Aon London placed lines, which can be used to complete a program that may not be able to be successfully completed on the open market.
- **RE-GEN** – Provides up to $500 million in construction and operational capacity dedicated specifically to the onshore renewable energy industry (wind, solar and battery storage).

Key Market News & Developments

AEGIS NJ

- Increased their total property consortium capacity up to a maximum of $425 million for certain risks, with an eventual goal of $500 million.
- As mentioned earlier, AEGIS was not materially impacted by the recent NAT CAT events and clients that rely on the mutual to lead their property program should expect stable renewals, with the potential for increased lines as they look to utilize their expanded consortium capacity.

EIM & NEIL

- Similar to AEGIS, EIM and NEIL were not materially impacted by the recent NAT CAT events. We expect that their capacity will continue to be stable.

FM Global

- Continue to be more flexible in their approach to new clients in an effort to grow their power and utility client base over time.
- Impacted by the recent NAT CAT events but FM prides themselves on being a stable, long term capital provider and will not chase the market through peaks and valleys.
- FM has issued a Membership Credit for 5 straight years but it remains to be seen if this will continue for a 6th year due to the impacts from the recent Nat CAT events.

Stock Insurers (AIG, Lloyds of London, etc.)

- Most stock insurers were impacted or materially impacted by the recent storms. The majority are looking for single or even double digit rate increases depending on the risk, loss history, engineering quality, etc.

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1. Source: Various estimates by Moody's Analytics

Property Market Update

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Coverage, Terms and Conditions

Over the last few years we have seen a gradual broadening of policy coverage, terms and conditions as insurers look to position themselves to maintain or grow their lines. In 2016 and 2017, many clients opted to purchase multi-year deals, in an effort to increase the longevity of the soft market. As a result of the transitioning market, most stock insurers are not looking to do multi-year deals right now but they may still be achievable from the industry mutuals and FM Global.

Since the NAT CAT events, we have not seen a tightening of coverage, terms and conditions for clients who are not materially exposed to NAT CAT. For clients that are NAT CAT exposed, we would expect to see increased scrutiny on NAT CAT deductibles, limits and potentially other terms and conditions. In general, markets seem to be focused on rates.

Losses

Over the last few years markets have seen an increase in attritional losses (e.g., gas turbine, steam turbines, transformers, renewables, and fires) while there have been limited NAT CAT events in the US. In the last couple of months, however, there have been 3 major hurricanes impacting the US and Caribbean, earthquakes in Mexico and the wildfires in California. Losses are still being determined and the scale of Time Element losses (e.g., BI and CBI) will not be known for a while.

These NAT CAT events have had a material impact on the results of most US property insurers but less of an impact on the industry mutual markets (AEGIS, EIM and NEIL). Here are some facts on the recent loss events:

- **Hurricane Harvey** ended the longest gap between major landfalls that the US has ever experienced.
- **Hurricane Harvey and Irma:** First time the US was hit by two CAT 4 hurricanes in a two week period.
- **Impact of Maria:** Parts of Puerto Rico are experiencing the longest blackout in US history.

Hurricane Harvey and Irma: First time the US was hit by two CAT 4 hurricanes in a two week period.

Renewable Energy Market

The renewable energy market is tightening after recent hurricane events in the US and Caribbean. Capacity providers such as GCube, PERse, Axis and Travelers have incurred notable losses from these events and are no longer looking to grant rate reductions on renewing business, regardless of NAT CAT exposure or loss history. While losses from these hurricane events will impact insurer/MGA profitability for 2017, they are not expected to be catastrophic to the major renewable energy markets. We anticipate premium rating for NAT CAT exposed risks will come under particular strain over the next 12 months as these markets look to demonstrate to stakeholders prudent portfolio underwriting following recent events.

These markets continue to look very closely at insured's maintenance regimes, business continuity plans and strategies to cater to older technology reaching obsolescence. There is also now a strong focus on cyber security regimes, and it is important for insureds to demonstrate their cyber security plans and mitigation measures when approaching the market for renewal terms. ◆

For more information or if you have questions please contact Alex Post, Jonathan Keller or Muhammad Walijah.

Casualty Market Update

By Christine Palomba and Cindy Fee

Review and Outlook

Christine Palomba

Cindy Fee

As 2017 draws to a close and we look forward to what 2018 brings, a big question is what impact the catastrophic losses of 2017 will have on the market. While a significant portion of the losses were property driven CAT losses, these losses still hit the bottom line of many key insurers/reinsurers which could lead to some rate pressure across all lines, including primary and excess casualty. In addition to these losses, investigations continue into the cause(s) of the October 2017 wildfires in Northern California and it remains unclear what long-term impacts this event will bring to the market. Many markets are watching and waiting. Others we have seen take an immediate conservative position for new or expanded excess casualty limits for California utility risks as they "circle the wagons" to analyze aggregation and pricing exposures. Preliminary loss projections are in the $4 - $8 billion dollar range, which is regarded as one of the most destructive fires in the last 20 years.

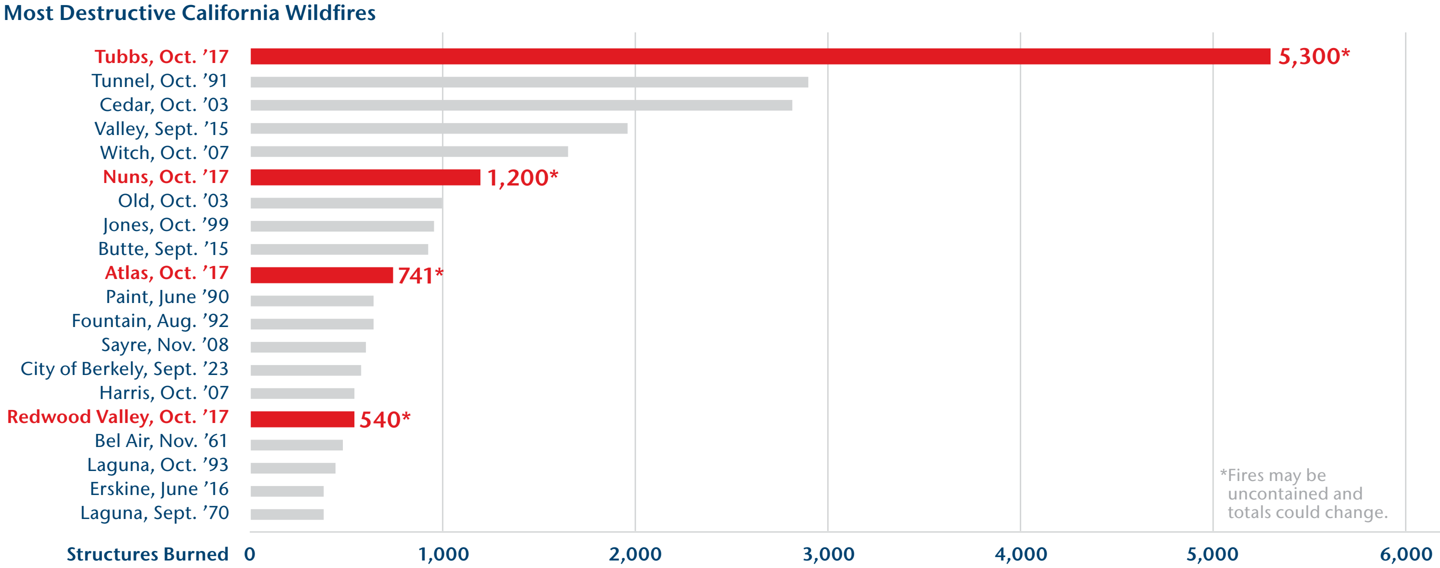
While significant capacity still exists, our prediction is that the combined property and casualty losses of 2017 will affect rates and capacity to some extent in 2018 and into 2019 once markets post their final losses. However, until these final losses are posted, we continue to see competitive conditions for our Power and Utility clients. As always, clients with considerable gas pipeline, gas storage, transmission line or exposure to California Wildfire continue to see less benefit from favorable market conditions as these risks remain the most concerning for high excess casualty markets.

As we look to 2018, here are some key updates/projections:

- **On November 29th it was announced** that Owen Ryan resigned as CEO of AEGIS. Bill Cullen is serving as interim CEO and at this time, no additional information is available.
- **Within the last few weeks AEGIS** has started ***offering $50M limit options for certain renewals.*** According to AEGIS there is also the potential for higher limits to come, for which reinsurance and other evaluations are underway. Aon will continue to monitor progress as this further develops.
- **AEGIS is still looking** for "trend" increases to keep up with inflation with 3-5% increases as the norm for non-loss rated accounts.
- **Continuity Credit for Excess Liability** was declared for 2017 renewals and took effect for renewals beginning July 1, 2017. An announcement for 2018 will come in the spring, likely around April.
- **Capacity above AEGIS remains competitive.** EIM remains a strong option based on follow form features, industry specific knowledge, and availability of $100M in limits.
- **Bermuda and London continue** to be our go-to markets for follow form excess cover above the industry mutuals. Competition between the two markets have kept pricing competitive for 2017, and while we haven't heard of any major pending changes we do anticipate 2018 could bring a leveling off.
- **Liberty Mutual's follow form AEGIS** excess policy has gained some traction over the past year and is a viable option for excess capacity.
- **For primary lines of cover** we are still seeing significant competition. Even with some pressure being put on business auto rate, primary casualty for power clients remains a desirable risk and we anticipate this will continue for 2018. ◆

Aon's Casualty Team wishes you and your families a wonderful holiday season. Please contact Christine Palomba or Cindy Fee if you have any questions or would like additional information.

20 Most Destructive California Wildfires



Source: Facebook

Cyber Liability Market Update

By Gary Gresham

Gary Gresham

Capacity and Terms

The cyber liability marketplace continues to be competitive with overall market capacity increasing with over 65 carriers offering stand-alone cyber- liability policies. Many of the power/utility clients who purchase stand-alone cyber policies purchase primary coverage from Aegis. Aegis recently announced an expansion of capacity to $75 million. Approximately 30% to 40% percent of the utilities are currently purchasing some form of stand- alone cyber insurance, while others remain uninsured or feel their current policies (property and/or casualty polices) will provide some loss protection in the event of a cyber related claim.

As the stand-alone cyber book has grown and insurers have begun to settle claims, terms and conditions have broadened gradually with certain sub- limits increasing or in some cases removed. The market has also seen property polices and casualty policies restricting or excluding cyber losses, as these carriers have experienced increased claims activity, which had not been priced into those policies.

While still a time consuming and arduous process, cyber carriers have improved new business and renewal underwriting processes, making them a bit easier and insured-friendly.

Losses

There has been what seems like a never ending parade of cyber losses occurring in the industries with the highest being personal identifier information and/or healthcare personal information. The broader cyber marketplace has seen cyber breach losses relating to consumer notification costs, remediation costs, ransomware payments and other costs. Poneman Institute's 2016 Cost of Data Breach Study: Global Analysis study reports a 29% increase in total breach costs since 2013. We continue to watch court decisions related to board of directors and officer liability as it relates to cyber losses.

News releases noting breaches impacting retail, credit agency, or health care providers occur so frequently they receive little notice weeks after the breach is reported. Outside of breaches of employee information and/or spear-phishing the utility sector has not publically reported any large breaches to date. Over the summer it was reported that a nuclear plant operator experienced a spear-phishing hacking attack, however the hacker did not gain access to the industrial control systems controlling the nuclear plant operations.

If You Are Faced with a Claim or Breach

The Aon Financial Services Group (FSG) Brokerage and Claims Teams are ready to assist as your claims advocate if you are faced with a claim.

The team has 12 dedicated attorneys with a total staff of 35 who have assisted in the handling of 29,000 management liability claims since 2012, including 14% of the federal securities class action claims and over 350 cyber claims. Aon has invested heavily in market relationships; data and analytics and a brokerage process which has resulted in placement of over $ 2.5 billion in annual management liability premiums.

Stroz Friedberg, an Aon company, focuses on cybersecurity, with industry leaders in digital forensics, incident response, and security science; investigation; eDiscovery; intellectual property; and due diligence. They were named a Leader in Forrester's Digital Forensics and Incident Response Service Providers Wave, Q3 2017.

Cyber-attacks are expected to continue with hackers continuing to evolve and grow more sophisticated in tactics and approaches. To that end, in late October the FBI and Department of Homeland Security issued a unique warning that hackers were targeting certain targets, including utility and nuclear companies. Ransomware and spear-phishing attacks have been profitable for hackers, thus these attacks will continue. The outcome of the cyber related D&O claims are being closely monitored. More specifically for power and utilities companies, it is expected that social/political activist hackers and sophisticated nation state hackers will continue to present challenges. It is therefore, more imperative to have a contingency plan and incidence response plan in place prior to a breach.

Until next time... ◆

For more information or questions please contact Gary Gresham or your local Aon broker.

Poneman Institute's 2016 Cost of Data Breach Study: Global Analysis study reports a 29% increase in total breach costs since 2013.

Directors and Officers Liability Market Update – More of the Same?

By Gary Gresham

Gary Gresham

D&O Pricing Trends

The D&O marketplace continues to be a familiar marketplace for publically traded policyholders, with pricing decreases continuing. Aon's Quarterly D&O Pricing Index Report shows a 5.9 % reduction in D&O pricing for third quarter 2017 compared to the same quarter in 2016. This Index tracks D&O premium trends for publically traded companies. The Index shows seventeen consecutive quarters of year over year premium decreases and over the past five years only two quarters with price increases. This equates to rates in 2017 having the lowest rate points since inception of this Index in 2001. Although these numbers are for the D&O marketplace in general, the utility sector has seen similar results, with most of these reductions being realized in the excess layers and Side-A layers, above the attachment levels typically occupied by the utility sector industry mutuals.

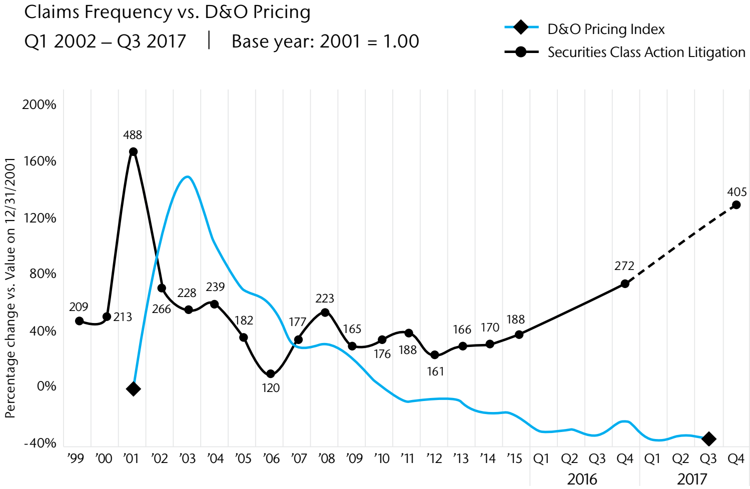
D&O Litigation Trends

Let's take a closer look at some of the dynamics in the general D&O marketplace. As reported by the Stanford Law School's Securities Class Action Clearinghouse, 328 federal securities lawsuits were filed in the first three quarters of 2017 compared to 195 filed in the same period in 2016, which is an increase of 68 %. Many of these suits relate to mergers and acquisitions (M&A) claims as suits have shifted from state filed action to federal actions as a result of recent unfavorable state court M&A related decisions. However, even without the M&A suits included in the data, federal securities suits are up 35 %. The Clearinghouse's data indicates federal securities suits have been on the rise since 2012, see chart A below.

Chart A - Market Indices vs. Claims Frequency vs. D&O Pricing

Claims Frequency vs. D&O Pricing

Q1 2002 – Q3 2017 | Base year: 2001 = 1.00



Stanford Law School's Securities Class Action Clearinghouse as of October 19, 2017. These totals include IPO Allocation, Analyst, and Mutual Fund filings.

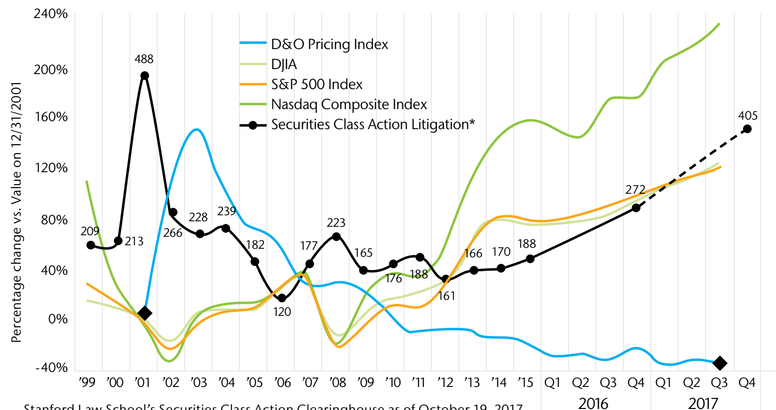
* Projected annual filings based on trailing twelve-month totals.

Wait a minute - Chart A shows an inverse relationship between public D&O rates and federal securities claims? Shouldn't a trend of increasing federal securities suits equal increasing D&O rates? Chart B may tell some of the story.

Chart B - Market Indices vs. Claims Frequency vs. D&O Pricing

Market Indices vs. Claims Frequency vs. D&O Pricing

Q1 2002 – Q3 2017 | Base year: 2001 = 1.00



Stanford Law School's Securities Class Action Clearinghouse as of October 19, 2017. These totals include IPO Allocation, Analyst, and Mutual Fund filings.

* Projected annual filings based on trailing twelve-month totals.

Three of the major stock indices (Dow Jones Industrial Average, S&P 500, and Nasdaq Composite Index) are benefitting from the extended bear market, the second largest in history and all in their highest levels in over 17 years. Generally, when the economy and stock market performs well, under-performing companies can somewhat hide their financial losses and operational issues, as investors may not look as closely at their financials or the companies can explain away underperformance or negative trends. A company's under-performance becomes more apparent as the economy contracts, spurring more allegations and suits involving securities law violations. The capital marketplace has also seen capital move to insurance, as investors seek higher returns creating more capacity.

According to Cornerstone Research's 2016 Review and Analysis of Securities Class Action Settlements, the median settlement amount in 2016 was $ 8.6 million. They further reported that there were 10 settlements (mega-settlements) over $100 million with those mega-settlements averaging $ 318 million, which was twice the median in 2015. In 2016, the courts approved more than $5.9 billion in total settlement value, compared to $ 3.073 billion in 2015.

D&O Pricing Outlook

It seems the current increase in securities claims filings and settlement trend would be enough to nudge D&O marketplace change, but what else is influencing the current pricing? A market change could likely result not directly from issues in the D&O marketplace but deterioration in the stock market and overall insurance carrier results

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Directors and Officers Liability Market Update – More of the Same?

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stemming from events such as the recent Gulf of Mexico and Caribbean hurricanes, and the west coast wildfires. These will likely cause D&O rates to increase as carriers look to shore up their capital surplus and overall financials. As of this writing, Hurricanes Harvey, Irma, and Maria are forecasted to result in losses of $85 to $140 billion range. The western wildfires losses are projected to exceed $15 billion, with initial reports considering power lines and utility assets as potential or contributory causes. Can the insurance marketplace support these large property losses? As far as the western wildfires, if previous claims and litigation trends continue, power companies and the general liability carriers will likely see losses as a result. One California utility has publically communicated that their wildfire losses may exceed their $800 million general liability insurance tower. If these property and casualty losses turn out to be as large as projected and D&O claims settlements continue to expand, D&O rates should begin to see upward movement in the next 18 to 24 months, trailing increases in the property and general liability markets.

Until next time... ◆

For more information or questions please contact Gary Gresham or your local Aon broker.

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SPECIAL REPORT

Hurricanes Underscore Need for Power/Utility Firms to Review Catastrophe-related Claims Prep

By Jill Dalton

Jill Dalton

With property damage and business interruption losses from Hurricanes Harvey, Irma and Maria now estimated at $200 billion or more, the 2017 hurricane season already ranks among the most destructive in U.S. history. While the power/utility sector in the continental U.S. generally escaped major damage, risk managers need to be especially vigilant about protecting their companies and locations from potential losses from future events. This includes both pre- and post-loss measures.

Catastrophe Claims Planning and Pre-Loss Measures:

- **Check policy deductibles.** Make sure your deductible is appropriate. See if it's a blanket or a per location percentage deductible. If the latter, is it a percentage of total insured value (TIV)? Do separate deductibles apply to physical damage and business interruption? Be sure you understand your waiting period and business interruption (BI) deductible. A 2% BI deductible equals seven days of self-retention (365 x 2%).
- **Review definitions of covered perils.** Note references to "storm surge," "named windstorm" and "flood." Many carriers treat flood resulting from named wind as named wind damage and the respective named wind deductible applies.
- **Determine how your BI coverage addresses payroll.** Ideally coverage is structured to treat payments to hourly workers as a fixed expense (ordinary payroll), especially during CAT events.
- **Designate an adjuster in your insurance policy.** Meet with your adjuster and your insurer's claims director or examiner before any loss. In addition to informing them about your company's operations and claim strategy, a meeting helps structure the claims process and provides a foundation for collaboration should a loss occur.

Independent Power Producer – Claim Example

A leading independent power producer engaged Aon Property Risk Consulting to resolve a claim it inherited through the acquisition of a cogeneration merchant facility. The loss involved damage to a steam turbine and the client company was unsure how to measure and present its losses under the policy. In this case, the coverage was under an insurance policy placed by the acquired firm's incumbent insurance broker, which did not assist with the claim.

For nine months before Aon was engaged, no claim was submitted and no payments were received from the insurance company. Within three months, Aon's team prepared a fully documented physical damage and time element claim, and presented it to the insurance company. Within three months, the client recovered 99.5 percent of the loss as claimed. The insurer also paid 240 percent more for the time element loss than what it offered before Aon was engaged.

- **List your claims team in your emergency response plan.** Having a team in place – including broker claim advocate, restoration company, forensic accountant, engineer and building consultants – will help the team members mobilize rapidly following a major loss event.
- **Engage with internal business continuity personnel.** Having a clear understanding of your organization's business continuity management (BCM) plans, and an awareness of the key emergency response and business continuity stakeholders, can help expedite response and ultimately drive operational resiliency.

Managing a Catastrophic Claim Event:

- **Communication is key.** Keep your C-suite, operations, procurement and legal teams fully informed of your loss situation and claim process. Give employees instructions for setting up loss accounts, invoicing, tracking internal labor, inventory, fixed asset ledgers, and on purchases to help mitigate the loss. Make sure they understand the sensitive nature of any discussions with insurance company representatives.
- **Act quickly to assess the loss.** Immediately evaluate and document (photographs when possible) the extent of property damage and obtain recommendations on temporary repairs and remediation needed to preserve and protect property. Show the adjuster the full scope of the loss so an appropriate reserve is established.
- **Designate a key team member to coordinate your claim.** This individual will coordinate, manage and communicate activities of emergency resources, remediation, restoration vendors, environmental specialists, and other providers involved in your claim. This encompasses all site inspections and remediation, timelines, target dates, ownership of issues and accountability, as well as facilitate expedited reviews of damaged inventory.
- **Be responsive to your insurer.** Work closely with your insurer throughout the loss adjustment process, as well as to negotiate partial payments based on expected short-term expenditures.
- **Get outside help for complex losses.** Engage external specialists and special resources (such as drone and satellite technology) to determine extent of loss and any T&D damage. Meanwhile, external claim professionals are skilled in preparing accurate damage and business interruption assessments, and ultimately can make a material difference in your recovery. (See example.)

Aon's Claims Preparation, Advocacy and Valuations team has extensive experience in helping clients in all segments of the power/utilities industry with complex claim preparation and submissions. ◆

For assistance with the many aspects of your claims planning, preparation and management, contact Jill Dalton.

1. Source: Various estimates by Moody's Analytics

Key Contacts

Jill Dalton
Managing Director
Aon Property Risk Consultants
202.534.3294
jill.dalton@aon.com

Gary Gresham
Senior Vice President/
Cyber Team Leader
813.636.3511
gary.gresham@aon.com

Alex Post
Power Property Leader - U.S.
Aon Global Power Specialty
832.476.5657
alex.post@aon.com

Cynthia Fee
Senior Casualty Specialist
Aon Global Power Specialty
916.369.4808
cynthia.fee@aon.com

Jonathan Keller
Senior Vice President
Aon Global Power Specialty
617.574.2160
jonathan.keller@aon.com

Christopher P. Scontras
Managing Director
Aon Global Power Specialty
617.210.4964
chris.scontras@aon.com

Mark A. Fishbaugh
National Power Practice Leader
Aon Global Power Specialty
704.343.8648
mark.fishbaugh@aon.com

Christine Palomba
Power Casualty Team Leader - U.S.
Aon Global Power Specialty
401.553.6638
christine.palomba@aon.com

Muhammad Walijah
Property Broker
Aon Global Power Specialty
832.476.5615
muhammad.walijah@aon.com

About Aon

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