Aon Risk Solutions

Retail and Wholesale Industry Report

2015, Powered by Aon GRIP SM

Risk. Reinsurance. Human Resources.

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Introduction

In today's environment, retail and wholesale trade companies are facing increasingly complex challenges: network security breaches, uneven global economic recovery, supply chain disruptions, food safety, rising employment related litigation, natural disasters, and healthcare reform, all of which could potentially cause tremendous disruptions to a business and damage to its reputation. The stakes for the sector are high. With increased scrutiny on operating efficiencies and a need to constantly innovate in an omni-channel environment, it is critical to access accurate and timely information and proactively address risk at every level of the organization.

At Aon, our 69,000 colleagues in more than 120 countries handle more Risk and People issues on a daily basis than any company in the world. As the leading provider of risk and human capital solutions we have an appreciation for the challenges these issues create and the opportunities that can be unlocked if they are identified and addressed.

We believe in the power of data and analytics to provide insight in this era of greater complexity and are committed to leveraging our unmatched global network to provide leading organizations with business intelligence.

Aon's 2015 Retail and Wholesale Trade Industry Report provides comprehensive, industry specific data on key issues and concerns. These findings allow organizations to benchmark their risk management and risk financing practices against those of their peers and help identify practices or approaches that may improve the effectiveness of their own risk management strategies.

If you have any comments or questions about the survey, or wish to discuss the findings further, please contact your Aon account executive.

Best regards,

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Executive Summary

In the age of information overload, the retail and wholesale trade industry is facing a barrage of data about their customers, but many are struggling to make sense of the information and figure out how to capitalize on it. Aon aims to bridge this gap. It is Aon's belief that information and analytics will be the way to complement and supplement the knowledge base of our clients, enabling them to understand the risks and succeed in today's tough competitive environment.

As part of our efforts to help companies stay abreast of emerging issues and learn what their peers are doing to manage risks and capture opportunities, we have compiled this report, which is based on Aon's 2015 Global Risk Management Survey and contains some detailed facts and analyses on the retail and wholesale trade sector. Topics in the report include:

- Current and projected top risks
- Risk readiness and losses
- Techniques utilized to identify and assess major risks
- Organizational risk maturity
- Risk management department and function
- Risk financing
- Cyber risk coverage
- Multinational programs
- Captives
- Market insights
- Financial insights

Key Findings

Topic	Key Finding
Top 10 risks	Increasing competition is ranked as the most challenging risk for the retail and wholesale trade sector. Second on the list is damage to reputation/brand, followed by economic slowdown/slow recovery. Given the recent high profile cyber attacks on retailers, it is not surprising that computer crime/hacking/viruses/malicious codes has jumped in ranking, from number 22 in Aon's 2013 survey to number four this year.
Risk preparedness for the top 10 risks	In comparison with that of 2013, overall readiness for the top 10 risks has increased from 57 percent to 62 percent. Preparedness for failure to attract or retain top talent has experienced the greatest change, increasing from 31 percent to 60 percent, while increasing competition has registered the largest decrease in readiness of over 10 percent.
Losses associated with top 10 risks	Once again, increasing competition and economic slowdown/slow recovery top the list of income losses related to the most cited risks in the past 12 months, at 53 percent and 51 percent respectively. On average, reported loss of income from the top 10 risks has decreased from 41 percent in 2013 to 24 percent in 2015.
Projected 2018 top 5 risks	When asked to project the top five risk concerns in the next three years, respondents in the retail and wholesale trade list increasing competition, economic slowdown/slow recovery and computer crime/hacking/viruses/malicious codes as the top three risks. Interestingly, the retail sector breakout has indicated that computer crime/hacking/viruses/malicious codes is projected to be a number one risk, reflecting growing concerns about rampant data breaches that companies have been experiencing in recent years.
Identifying and assessing of major risks	Senior management judgment and experience is cited as the method most often used by surveyed organizations to identify and assess major risks facing their organizations (63 percent).
Risk maturity	The Aon Risk Maturity Index (RMI) includes a variety of questions concerning risk management practices, corporate governance and management decision processes. Overall, an organization can rate at a maturity level ranging from initial ("1") to advanced ("5"). The retail industry sample set includes over 50 organizations to date, with an average risk maturity of a "3", or "defined". This is in line with the current global average that represents all industries.
Chief Risk Officer	About 21 percent of retail and wholesale trade respondents report having a CRO.
Risk management department	Sixty-nine percent of retail and wholesale trade respondents have indicated that they have a formal risk management department. Ninety-four percent of organizations over $1 billion have a risk manager. Those with an in-house risk management department typically maintain a staff of one to five people.

Key Findings

Topic	Key Finding
External drivers strengthening risk management	Economic volatility and cyber threat environment are the most important external drivers strengthening risk management for the retail and wholesale trade industry.
Risk management budget	In the survey, 27 percent of retail and wholesale trade respondents have indicated a marginal or significant planned increase in risk management spend / resources over the next 12 months. Only seven percent of respondents say they are planning to decrease risk management spend.
Retentions/deductibles	The majority of organizations have not changed their retentions from the prior policy period. General liability and property have experienced the most changes in retention levels (18 percent)
Limits	Retail and wholesale trade respondents say the most commonly purchased umbrella/excess liability limit stands at $100 million and the average limit purchased for all surveyed companies totals $129 million. Similar to umbrella/excess liability, directors and officers liability limits purchased by publicly traded consumer discretionary companies is in direct proportion to a company's revenue size. The highest limit purchased was $450 million, while the lowest limit purchased was $4 million.
Cyber risk coverage	Thirty-seven percent of respondents say their companies have purchased cyber insurance coverage, and 21 percent plan to purchase this coverage. Among companies that have purchased cyber insurance coverage, 78 percent of respondents feel the terms and conditions are sufficient and effective to manage their exposures. However, respondents are less satisfied with the liability limits, with over half expressing concern over the adequacy of their limits carried.
Multinational programs	In the survey, 52 percent of retail and wholesale trade respondents with operations in more than one country have indicated that their corporate headquarters purchase some lines and leave local offices to handle while only 35 percent say their corporate headquarters control procurement of all of their global and local insurance programs. General liability and property coverage continue to be the lines of business most frequently purchased on a multinational basis.
Captives	About 21 percent of retail and wholesale trade respondents have reported having an active captive or Protected Cell Company (PCC), with four percent also indicating a plan to create a new or additional captive or PCC in the next three years. General third-party liability and property are the most frequently underwritten lines of coverage within a captive, at 55 percent and 64 percent respectively. Cyber liability/network liability and employee benefits are the two risks cited with the greatest growth potential in the next five years within captive entities.
Priorities in choice of insurer	Coverage terms and conditions was cited as the top criterion in an organization's choice of insurers, followed by value for money / price.
Desired market changes	Respondents are looking for more flexibility (i.e. underwriting, coverage, pricing), along with broader coverage/better terms and conditions.
Common carrier win reasons	When it comes down to selecting a carrier, the most common win reason is incumbent relationship, or taking a boxing metaphor, it is "you need to knockout the champ".
Common reasons for carriers not quoting	The most common reason for a carrier not providing a quote is pricing. This is consistent among all the lines reviewed except for financial lines, which cites underwriting as a concern.
Common reasons for rejecting a carrier's quote	The reason most often given by clients for rejecting a carrier's quote is inferior pricing.
Financial insights	Over the past 12 months, the share price of the Russell 3000 Index has generally outperformed retail and wholesale trade companies. If we compare employment numbers for the retail and wholesale trade sector and the overall non-farm sector for the prior 12 months, we can see that non-farm sector companies have fared better than the retail and wholesale trade sector. But growth has been positive for the sector since at least January 2013. The average Consumer Confidence Index figure from July 2014 - June 2015 stood at 95.4 percent. However, consumers' short-term outlook is at its highest point of 101.4 for the second time since January 2009.

Top 10 Risks

In Aon's 2015 Risk Management Survey, respondents are provided a list of 53 risks and asked to select 10 that they believe to be the top risks facing their organizations. Increasing competition is ranked as the most challenging risk for the retail and wholesale trade sector. Second on the list is damage to reputation/brand, followed by economic slowdown/slow recovery.

If we break down the retail and wholesale industry group further to sub-categories, we'll see that retailers see damage to reputation/brand as a number one risk whereas it is number seven for the wholesale trade respondents. The finding is hardly surprising. In 2014, a long list of well-known retailers saw their reputation affected by unexpected incidents – data breaches, customer services, offensive language on apparel, inappropriate remarks or behavior by company executives, and supply chain disruptions. In an age of 24-hour news cycles and instant social media, a crisis could spread globally within hours or minutes. As a result, reputation, which was categorized by experts as "priceless" or "an intangible asset," is becoming increasingly "pricey," exerting a direct impact on the company's bottom line as consumers exercise their choice of where to shop.

The response to reputational crisis must be swift and on point. In addition, globalization means that multiple cultural appropriate approaches to managing risk are needed to handle crisis across an organization's global operations. Meticulous planning for crises, understanding individual roles and responsibilities and developing a road map are keys to protecting a brand.

When comparing with the ranking of various risks in the 2013 survey, we have noted that computer crime/hacking/viruses/malicious codes has jumped from number 22 to number four. This change has a lot to do with the large number of high-end data breaches that have recently occurred. Personal records and financial information are stolen and sold on the black market by criminals in a matter of days and hours. Every company with a website or smart phones has global exposure to cyber attacks, which are difficult to understand and predict.

The Center for Strategic and International Studies, a well-known Washington think tank, has estimated that the annual cost of cyber crime and economic espionage to the world economy runs as high as $445 billion—or almost one percent of global income. The average time to resolve a cyber attack is also rising, climbing to 45 days, up from 32 days in 2013. As cyber crimes are becoming more rampant, more costly, and more time consuming to resolve, businesses are faced with an increased possibility of legal exposure, reputation damage, and operational interruption that can wreak havoc on their bottom line.

While proactive measures to mitigate risk can be costly and time consuming, experts say they are far less demanding than the consequences of a serious breach. Moreover, having a robust, well documented program to monitor cyber risks may provide favorable evidence of the company's efforts, thus reducing liability should an incident occur.

Similar to the prior survey, our study findings highlight the interdependency among many of the top risks. For example, a company with a damaged reputation might find it hard to be competitive and attract talent. The lack of talent would result in failure to innovate and meet customer needs. The list goes on. This interdependency between risks illustrates that organizations can no longer evaluate risk in isolation but must consider their interconnectedness.

Retail and Wholesale Trade Industry 2015 Top 10 Risks

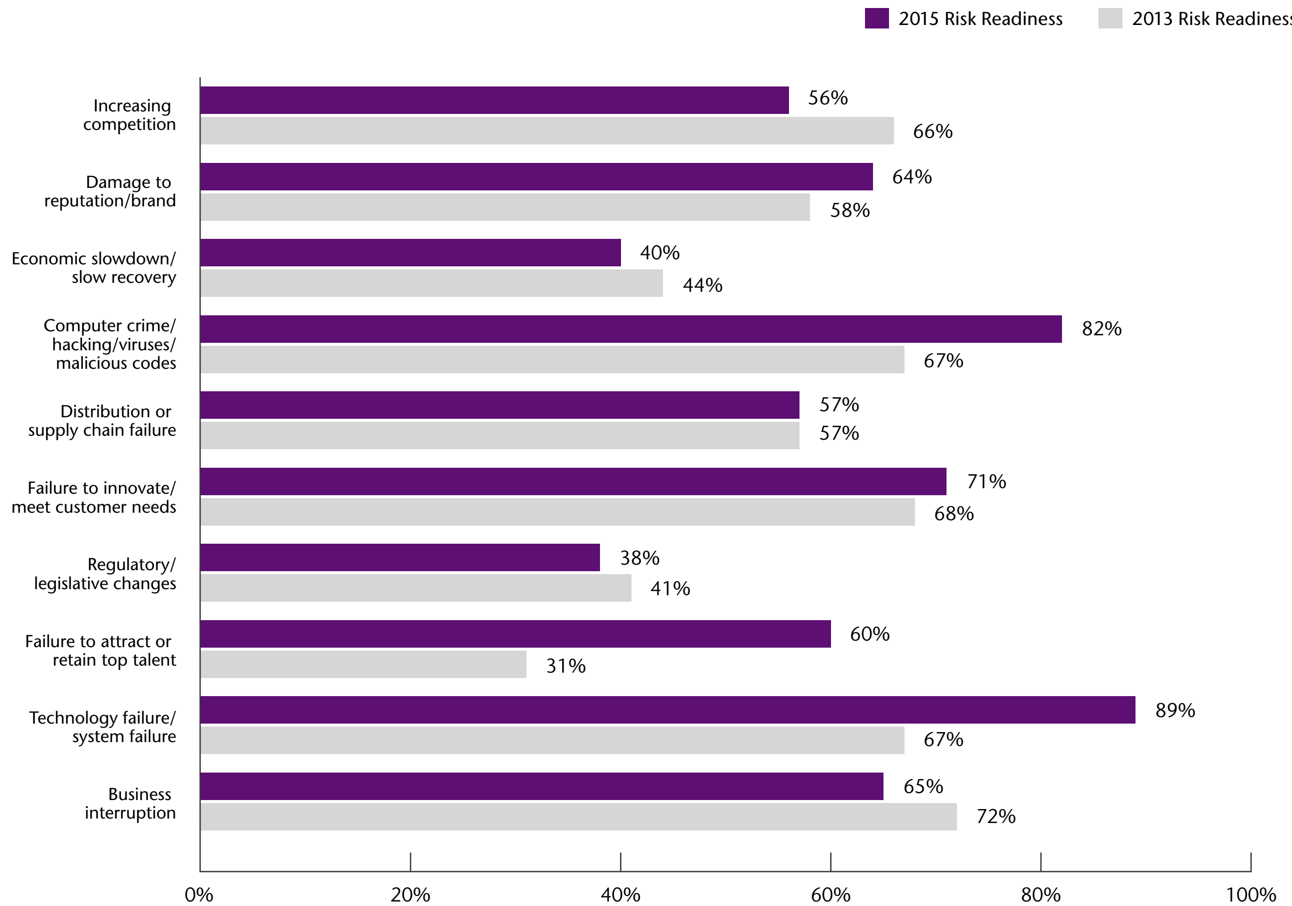
Rank	Retail & Wholesale Trade	Retail Trade	Wholesale Trade
1	Increasing competition	Damage to reputation/brand	Increasing competition
2	Damage to reputation/brand	Increasing competition	Counter party credit risk
3	Economic slowdown/slow recovery	Computer crime/hacking/viruses/malicious codes	Regulatory/legislative changes
4	Computer crime/hacking/viruses/ malicious codes	Failure to innovate/meet customer needs	Commodity price risk
5	Distribution or supply chain failure	Economic slowdown/slow recovery	Economic slowdown/slow recovery
6	Failure to innovate/meet customer needs	Failure to attract or retain top talent	Distribution or supply chain failure
7	Regulatory/legislative changes	Technology failure/system failure	Damage to reputation/brand
8	Failure to attract or retain top talent	Distribution or supply chain failure	Third party liability
9	Technology failure/system failure	Business interruption	Exchange rate fluctuation
10	Business interruption	Property damage	Property damage

Data Source: 2015 Global Risk Management Survey
Note: Where ranking for a risk was tied, the All respondent ranking was utilized to determine what risk would be ranked higher

Risk Readiness for the Top 10 Risks

Risk readiness refers to the level of a company's risk preparedness —undertaking a formal review of risks and putting in place a comprehensive risk management plan. In comparison with that of 2013, overall readiness for the top 10 risks has increased by five percent to 62 percent. This is a positive trend and could be attributed to the fact that corporate leadership is taking a more active role in managing risks.

Risk Readiness for the Top 10 Risks – Retail and Wholesale



Source: 2015 Global Risk Management Survey

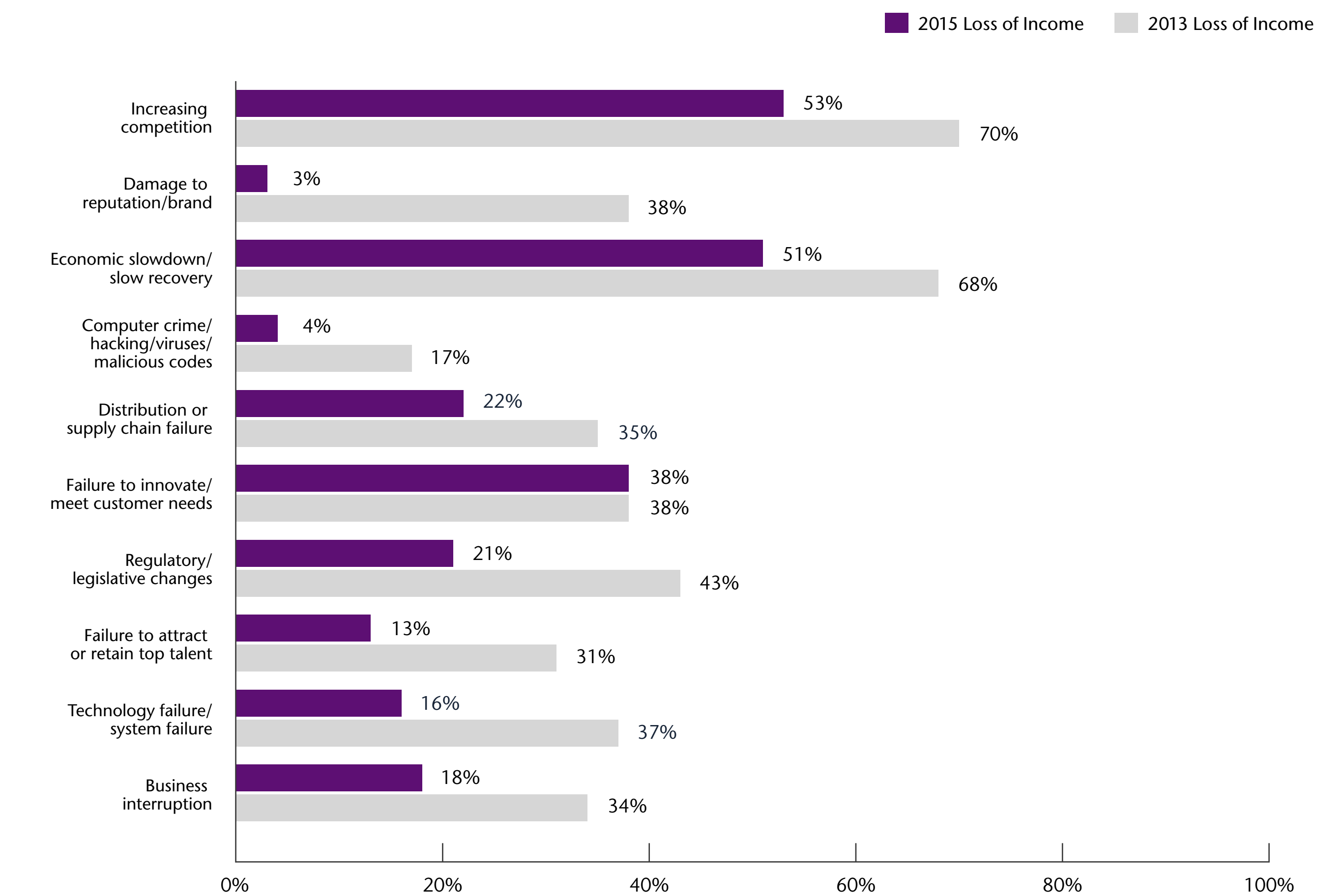
Preparedness for failure to attract or retain top talent has experienced the greatest change, increasing from 31 percent in 2013 to 60 percent this year, while increasing competition has incurred the largest decrease in readiness, from 66 percent in 2013 to 56 percent this year. Overall, regulatory/legislative changes remained the least prepared risk for retail and wholesale trade industry, at 38 percent.

Losses Associated with Top 10 Risks

Once again, topping the list of income losses relating to the most cited risks in the past 12 months are increasing competition and economic slowdown/slow recovery, at 53 percent and 51 percent respectively.

On average, reported loss of income from the top 10 risks has decreased from 41 percent in 2013 to 24 percent in 2015. All but one of the top risks for the retail and wholesale trade sector have registered a decrease in losses in the past 12 months with damage to reputation / brand experiencing the greatest decrease of 35 percent, placing loss level similar to that in the 2011 survey. This might be contributable to more risk readiness by the industry.

Losses Associated with Top 10 Risks – Retail and Wholesale Trade



Source: 2015 Global Risk Management Survey

Projected 2018 Top 5 Risks

When asked to project the top five risk concerns in the next three years, retail and wholesale trade respondents have listed increasing competition, economic slowdown/slow recovery and computer crime/hacking/viruses/malicious codes as the top three risks.

Interestingly, the retail sector breakout shows that computer crime/hacking/viruses/malicious codes is listed as the top projected risk, reflecting growing concerns about rampant data breaches that companies have been experiencing in recent years. Cyber risk is fast-moving, impossible to predict, and difficult to understand, but the damage can be immense.

As risk is always evolving, and organizations must constantly monitor and evaluate risks and make corresponding plans.

Projected 2018 Top 5 Risks – Retail and Wholesale Trade

Factors	Retail & Wholesale Trade	Retail Trade	Wholesale Trade
1	Increasing competition	Computer crime/hacking/viruses/ malicious codes	Increasing competition
2	Economic slowdown/slow recovery	Increasing competition	Economic slowdown/slow recovery
3	Computer crime/hacking/viruses/ malicious codes	Damage to reputation/brand	Commodity price risk
4	Damage to reputation/brand	Failure to innovate/meet customer needs	Counter party credit risk
5	Failure to innovate/meet customer needs	Economic slowdown/slow recovery	Regulatory/legislative changes

Data Source: 2015 Global Risk Management Survey
Note: Where ranking for a risk was tied, the All respondent ranking was utilized to determine what risk would be ranked higher

Identifying, Assessing, Measuring and Managing Risk

Identifying & Assessing Major Risks

Risk identification and assessment give an organization a clear view of the potential internal and external obstacles it needs to manage and overcome, and the opportunities on which it can capitalize. A sound assessment enables leaders to define the company's risk appetite and tolerance, and fashion an effective response to risk. In today's global environment, risks are evolving fast and becoming more volatile and complex. Risk managers can no longer rely on one method. They have to cultivate a comprehensive process to identify and assess current and emerging risks.

When asked to assess and rate their organizations preparedness to identify, assess, and manage current and emerging risks, retail and wholesale trade surveyed companies have achieved an average score of 6.53 out of 10.

Risk experts have long recommended that organizations tackle current and emerging risks with a structured enterprise-wide risk identification and assessment process. Overall, 40 percent of retail and wholesale trade surveyed organizations utilize a structured enterprise-wide method to identify risks, while 34 percent use this process to assess their risks. In practice, a majority of respondents are using two or more methods for identifying and assessing.

Senior management judgment and experience is cited as the method most often used by surveyed organizations to identify and assess major risks facing their organizations (63 percent).

Identification of Major Risks

Category	Retail & Wholesale Trade	Retail Trade	Wholesale Trade
Structured enterprise-wide risk identification process	40%	48%	26%
Board and/or management discussion of risk during annual planning, risk assessment or other processes	49%	48%	50%
Senior management judgment and experience	63%	61%	65%
Risk information from other function-led processes (e.g. internal audit, disclosure, compliance, etc.)	47%	45%	50%
Industry analysis, external reports	34%	23%	52%
Other	2%	1%	4%

Assessment of Major Risks

Category	Retail & Wholesale Trade	Retail Trade	Wholesale Trade
Structured enterprise-wide risk assessment process supported by a standard toolkit and methodology	34%	39%	26%
Board and/or management discussion of risk during annual planning, risk assessment or other processes	48%	45%	52%
Senior management judgment and experience	63%	60%	70%
Risk modeling / risk quantification analysis	23%	27%	15%
Consult with external service provider/advisor	24%	17%	37%
Other	1%	1%	0%

Data Source: 2015 Global Risk Management Survey

Risk Maturity

The Aon Risk Maturity Index (RMI) includes a variety of questions concerning risk management practices, corporate governance and management decision processes. Overall, an organization can rate at a maturity level ranging from initial (“1”) to advanced (“5”).

The retail industry sample set includes over 50 organizations to date, with an average risk maturity of a “3”, or “defined”. This is in line with the current global average that represents all industries. We typically observe organizations at the defined level to be:

- Developing capabilities to identify, assess and prioritize risks across the organization
- Developing capabilities to analyze risk consistently, but approach may be primarily qualitative
- Developing capabilities for monitoring existing risk exposure across the organization
- Informal and inconsistent consideration of risk and risk management information in decision making
- Developing understanding of Enterprise Risk Management (ERM) and its application

One section of the RMI is dedicated to best practices regarding identification of existing and emerging risks. When it comes to these practices, there are a few interesting differences between those organizations at lower levels of risk maturity (2.5-) and higher levels of risk maturity (3.5+). Specifically, over 60 percent of less mature organizations rarely or never collaborate with their strategic partners to identify potential emerging risks, while over 86 percent of more mature organizations collaborate on an ad-hoc basis, if not more consistently through a defined process. In an increasingly interconnected world, this difference illustrates the importance of collaboration outside of just an internally focused risk identification process.

There also appears to be a notable difference between how organizations measure and track risks once identified. Based on our research, not only do more mature organizations have processes in place to identify risks at an enterprise level, but they are also more than twice as likely to follow through with implementing, measuring, and tracking risk management activities to completion.

Risk Management Department and Function

Chief Risk Officer

Twenty-one percent of retail and wholesale trade respondents report having a CRO. The responsibilities of a CRO vary from company to company and industry to industry. Often, CROs are given the tasks including managing credit risk, market risk, regulatory risk and compliance risk, which may or may not include insurance/ hazard risk. About 67 percent of participants say they do not have a CRO nor do they plan to create one. They choose instead to leverage existing teams and use risk committees for driving change.

Chief Risk Officer

Role	Retail & Wholesale Trade	Retail Trade	Wholesale Trade	All
Yes, but this role does not include risk management	8%	9%	5%	11%
Yes, this role includes risk management	13%	16%	7%	17%
No, but we are considering creating this position	9%	8%	11%	8%
No, and we do not plan to create such a position	67%	64%	73%	59%
Don't Know	3%	3%	5%	5%

Data Source: 2015 Global Risk Management Survey

Risk Management Department

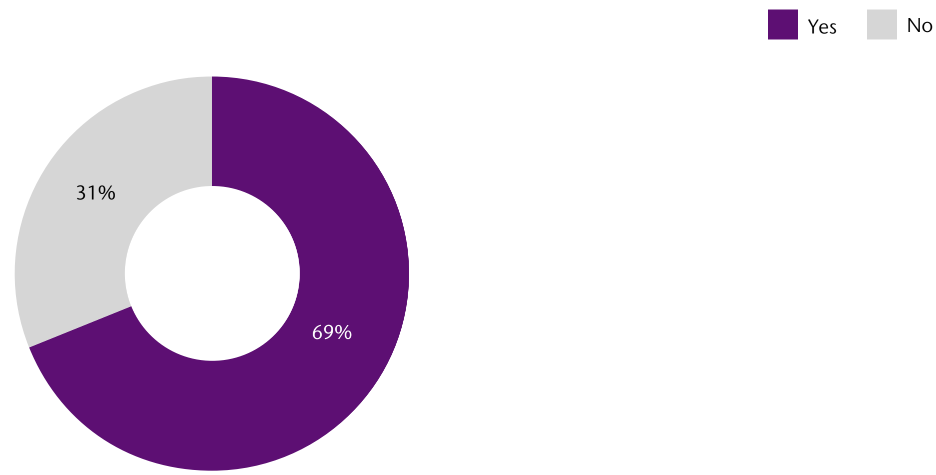
The growing importance and visibility of risk management have led to the increasing integration of such functions with an organization's strategic plan. To succeed in today's competitive and heavily regulated business environment, companies have gradually come to the realization that they have to incorporate risk management into all aspects of their operations.

Sixty-nine percent of retail and wholesale trade respondents have indicated that they have a formal risk management department. If we look further at this group by organizations over $1 billion we can see organizational size plays a significant role. Ninety-four percent of organizations over $1 billion have a risk manager.

Among organizations with a risk management department, 68 percent say their risk management department reports to the Finance/Treasury/Chief Financial Officer. In the case where no formal risk management department exists, 32 percent say their CFO handled risk management.

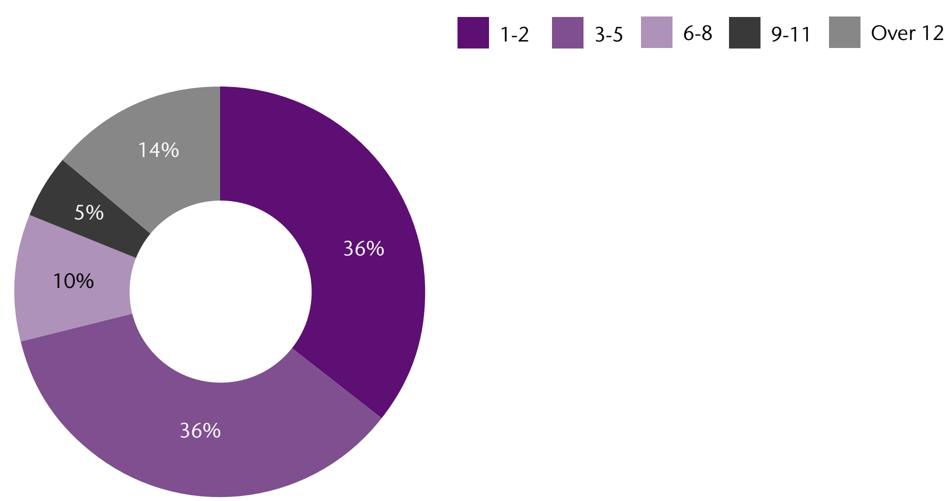
Those with an in-house risk management department typically maintain a staff of one to five people.

Formal Risk Management/Insurance Department/Function



Data Source: 2015 Global Risk Management Survey

Number of People In Your Risk Management/Insurance Department/Function

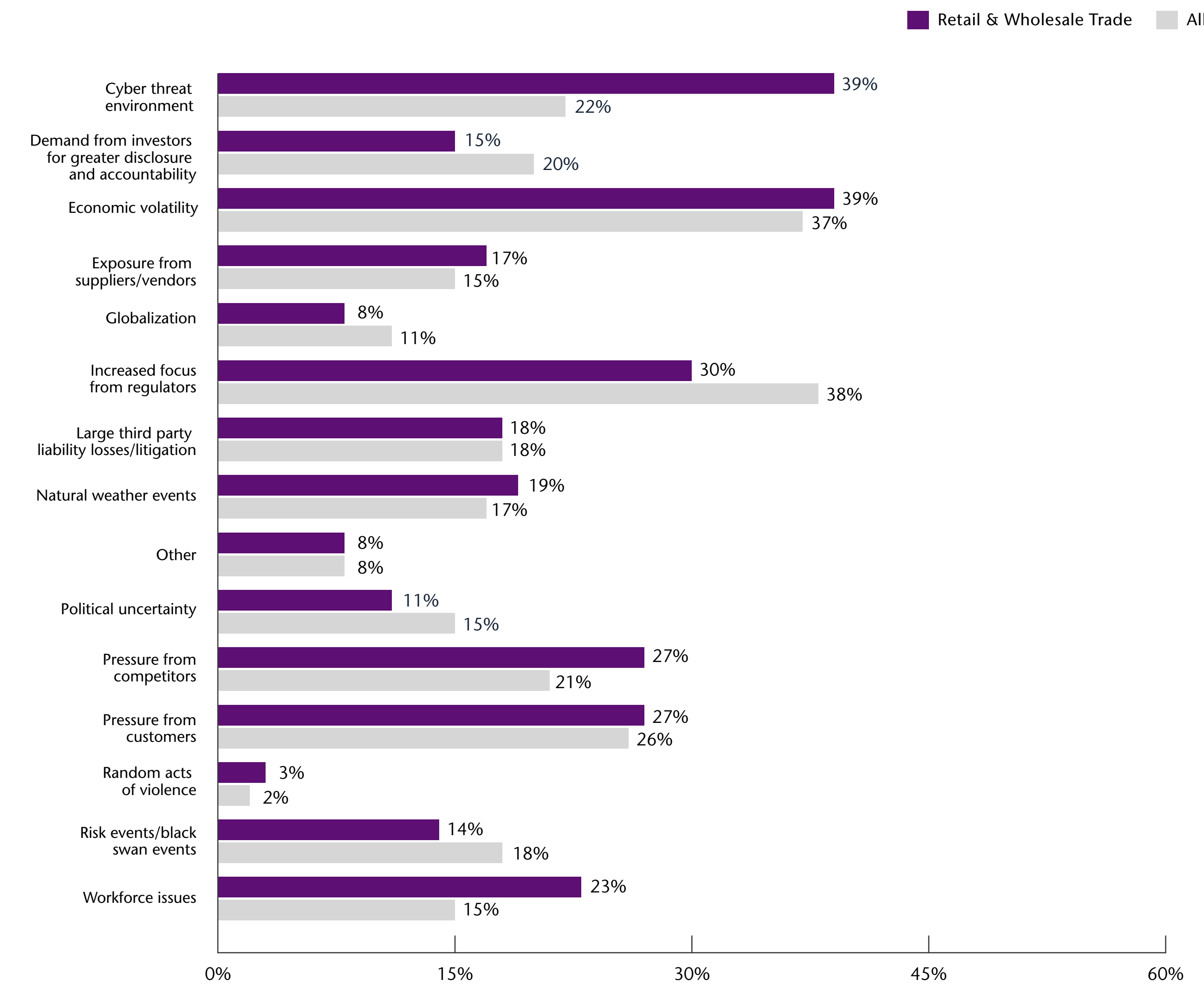


Data Source: 2015 Global Risk Management Survey

External Drivers Strengthening Risk Management (Past Two Years)

Economic volatility and cyber threat environment are the most important external drivers strengthening risk management for the retail and wholesale trade industry. Cyber threat environment has displayed the greatest deviation from the all industry average for external drivers strengthening risk management, being 17 percent higher than the all industry average. This is most likely driven the by a number of highly publicized cyber attacks on large retail companies in 2014 and increased interest from boards and c-suites.

External Drivers Strengthening Risk Management – Retail and Wholesale Trade Industry (Past Two Years)

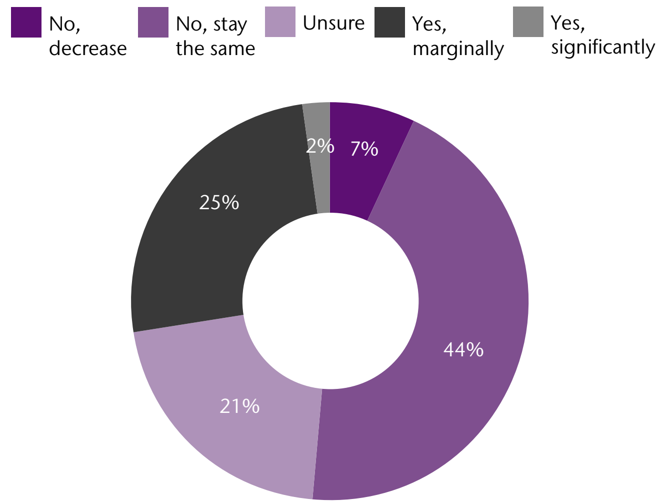


Source: 2015 Global Risk Management Survey

Risk Management Budget

Risk management is a process by which business risks are identified, analyzed, engineered, reduced, eliminated or transferred. In recent years, the tougher regulatory environment and evolving risk landscape are profoundly changing the way an organization manages its risks. The Board of Directors and senior executives are under increasing pressure from various stakeholders to maintain effective oversight of risk management. At the same time, there's been a rising interest in risk management as a competitive advantage both in decision-making (tackling the risk the organization wants or needs to take, and planning accordingly) and event response (crisis management, business continuity, etc.). Such heightened attention might have driven an organization's increase in risk management spend. In the survey, 27 percent of retail and wholesale trade respondents have indicated a marginal or significant planned increase in risk management spend / resources over the next 12 months. We would prefer to see this as a very positive trend following years of declining risk management budgets. Only seven percent of respondents say they are planning for a decrease in risk management spend.

Change in Risk Management Budget in Next 12 Months



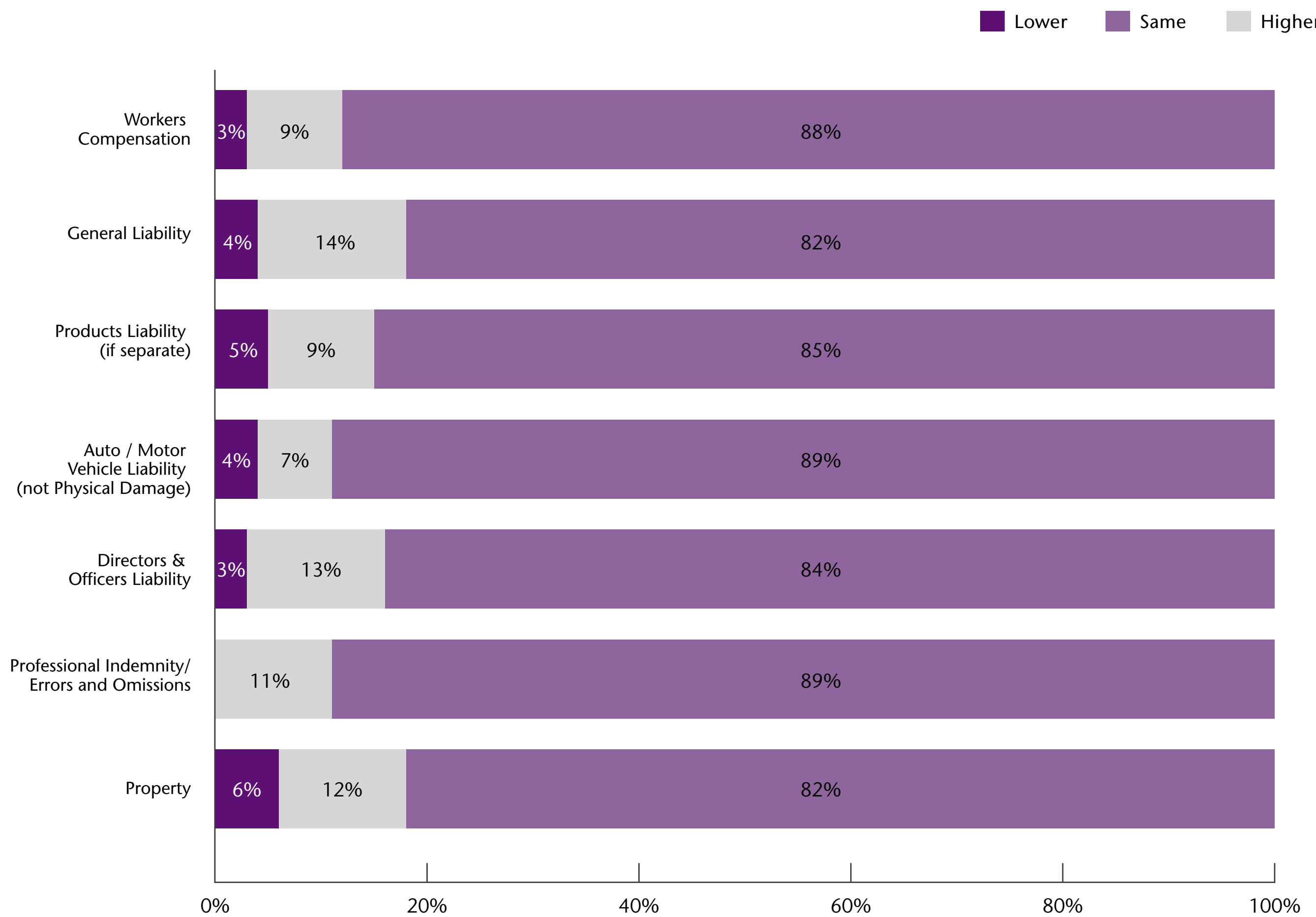
Data Source: 2015 Global Risk Management Survey

Risk Financing

Retentions/Deductibles

The majority of organizations have not changed their retentions from the prior policy period. When a change does occur, it's normally an increase due to an organization's rising exposure to natural catastrophe risk, an adverse loss experience, or the desire to control premium spend. General liability and property have experienced the most changes in retention levels at 18 percent.

Changes in Retentions/Deductibles



Source: 2015 Global Risk Management Survey

Limits

Umbrella/Excess Liability

When an organization considers what level of risk to transfer via insurance policies, it has to take into consideration multiple factors. These include: risk severity, risk mitigation measures already in place or under consideration, the regulatory landscape, an organization's historical trend of loss activities, the insurance marketplace and appetite for risk. The choice made by one individual organization may not work for another. Consideration must always be given to the impact of that loss retention on an organization's ability to achieve its objectives.

In Aon's 2015 survey, retail and wholesale trade respondents say the most commonly purchased limit stands at $100 million and the average limit purchased for all surveyed companies totals $129 million. The level of limits purchased is in direct proportion to a company's revenue size -a larger company with a higher profile could represent a bigger target for legal actions.

Umbrella/Excess Liability Limits

Revenue	Minimum	1st Quartile	Average	Median	Mode	3rd Quartile	Maximum
All	$1,000,000	$50,000,000	$129,205,357	$100,000,000	$100,000,000	$150,000,000	$600,000,000
$1M-$500M	$1,000,000	$40,000,000	$42,705,882	$50,000,000	$50,000,000	$50,000,000	$75,000,000
$500M-$1B	$5,000,000	$50,000,000	$53,333,333	$50,000,000	$50,000,000	$50,000,000	$125,000,000
$1B-$3B	$25,000,000	$75,000,000	$84,038,462	$87,500,000	$100,000,000	$100,000,000	$150,000,000
$3B-$5B	$29,000,000	$100,000,000	$116,357,143	$112,500,000	$100,000,000	$125,000,000	$200,000,000
$5B-$10B	$8,000,000	$93,750,000	$133,937,500	$125,000,000	$125,000,000	$156,250,000	$350,000,000
$10B-$20B	$83,000,000	$112,500,000	$187,200,000	$150,000,000	$100,000,000	$200,000,000	$500,000,000
Over $20B	$100,000,000	$200,000,000	$300,000,000	$250,000,000	$200,000,000	$400,000,000	$600,000,000

Data Source: 2015 Global Risk Management Survey and other Aon proprietary databases

Directors and Officers Liability

Similar to umbrella/excess liability, directors and officers liability limits purchased by publicly traded retail companies is in direct proportion to a company's revenue size. The highest limit purchased was $450 million, while the lowest limit purchased was $4 million.

S&P Information Consumer Discretionary Sector

Market Cap	Minimum	1st Quartile	Average	Median	3rd Quartile	Maximum
$5M-$100M	$4,000,000	$7,500,000	$22,000,000	$25,000,000	$35,000,000	$40,000,000
$100M-$250M	$5,000,000	$25,000,000	$46,666,667	$35,000,000	$45,000,000	$200,000,000
$250M-$500M	$10,000,000	$22,500,000	$45,681,818	$30,000,000	$75,000,000	$100,000,000
$500M-$1B	$25,000,000	$40,000,000	$48,846,154	$40,000,000	$60,000,000	$95,000,000
$1B-$3B	$45,000,000	$65,000,000	$99,565,217	$75,000,000	$100,000,000	$280,000,000
$2B-$5B	$60,000,000	$75,000,000	$110,555,556	$95,000,000	$125,000,000	$280,000,000
$5B-$10B	$50,000,000	$105,000,000	$129,545,455	$135,000,000	$150,000,000	$250,000,000
$10B-$50B	$110,000,000	$150,000,000	$203,913,043	$200,000,000	$227,500,000	$450,000,000

Data Source: Aon Financial Services Group

Cyber Risk Coverage

Cyber risk has emerged as a leading risk for many organizations as mobile technologies advance and cloud computing, corporate bring-your-own-device policies, and big data are becoming increasingly popular. At the same time, cyber criminals are using more sophisticated tools and state-sponsored espionage is getting more frequent. In the face of more frequent contractual insurance requirements for cyber liability, forward-thinking companies are taking proactive steps to explore and transfer cyber risks. The table below depicts the coverage offered by cyber insurance in comparison with traditional insurance policies, such as property and general liability.

Cyber Risk

No coverage | Limited coverage | Coverage

	Property	General Liability	Crime/Bond	K&R	Professional Indemnity	Cyber
1st Party Privacy/Network Risks						
Physical damage to data only	Limited coverage	No coverage	Limited coverage	No coverage	No coverage	Coverage
Virus/hacker damage to data only	Limited coverage	No coverage	Limited coverage	No coverage	No coverage	Coverage
Denial of service attach	Limited coverage	No coverage	No coverage	No coverage	No coverage	Coverage
B.I. loss from security event	Limited coverage	No coverage	No coverage	No coverage	No coverage	Coverage
Extortion or threat	No coverage	No coverage	No coverage	Limited coverage	No coverage	Coverage
Employee sabotage of data only	Limited coverage	No coverage	Limited coverage	No coverage	No coverage	Coverage
3rd Party Privacy/Network Risks						
Theft/disclosure of private info.	No coverage	Limited coverage	Limited coverage	No coverage	Limited coverage	Coverage
Confidential corporate info. breach	No coverage	Limited coverage	Limited coverage	No coverage	Limited coverage	Coverage
Technology E&O	No coverage	Limited coverage	No coverage	No coverage	No coverage	Limited coverage
Media liability (electronic content)	No coverage	Limited coverage	No coverage	No coverage	No coverage	Coverage
Privacy breach expense/notification	No coverage	No coverage	No coverage	No coverage	Limited coverage	Coverage
Damage to third party's data only	No coverage	Limited coverage	No coverage	No coverage	No coverage	Coverage
Regulatory privacy defense/fines	No coverage	No coverage	No coverage	No coverage	Limited coverage	Coverage
Virus/malicious code transmission	No coverage	Limited coverage	No coverage	No coverage	Limited coverage	Coverage

** For reference and discussion only.*

In Aon's 2015 survey, 37 percent of respondents say their companies have purchased cyber insurance coverage, and 21 percent plan to purchase this coverage. If we separate the results by sector, retail organization nearly purchase the coverage three times more often than wholesale organizations, and plan to purchase the coverage at more than twice the level.

The following activities by these industries may result in more risk exposure, and have led to higher take up rate:

- Storing and disseminating personal information
- A high degree of dependency on electronic processes or computer networks
- Engagement with vendors, independent contractors or additional service providers
- Regulatory compliance
- PCI Security Standards/Plastic Card Security compliance
- Contingent bodily injury and property damage that may result from cyber incidents
- Operation reliant on critical infrastructure (Personally Identifiable Information risks are less prominent for industries such as utilities, manufacturing and logistics)
- Intentional acts by rogue employees
- SEC Cyber Disclosure Guidance of 2011

Among companies that have purchased cyber insurance coverage, 78 percent of respondents feel the terms and conditions are sufficient and effective to manage their exposures. However, respondents are less satisfied with the liability limits, with over half expressing concern over the adequacy of their limits carried.

Purchase of Cyber Insurance

Category	Retail & Wholesale Trade	Retail Trade	Wholesale Trade
Insurance currently purchased	37%	50%	15%
Not purchased and no plans to purchase	43%	24%	73%
Plan to purchase	21%	26%	12%

Data Source: 2015 Global Risk Management Survey

Effectiveness of Current Cyber Insurance

Category	Retail & Wholesale Trade	Retail Trade	Wholesale Trade
Yes	78%	85%	40%
No	22%	15%	60%

Data Source: 2015 Global Risk Management Survey

Adequacy of Limits For Cyber Insurance

Category	Retail & Wholesale Trade	Retail Trade	Wholesale Trade
Yes	47%	48%	40%
No	53%	52%	60%

Data Source: 2015 Global Risk Management Survey

Multinational Programs

Globalization continues to be a consistent theme for companies pursuing improved operational results. As such, risk managers need to focus on larger geographic spread while addressing variations in regulatory controls, exposures, available solutions, and options for optimal risk finance program design.

Looking at control and placement of multinational risks, 52 percent of retail and wholesale trade respondents with operations in more than one country have indicated that their corporate headquarters purchase some lines and leave local offices to handle, while only 35 percent say their corporate headquarters control procurement of all of their global and local insurance programs.

General liability and property coverage continue to be the lines of business most frequently purchased on a multinational basis. However, there have been increases in the number of respondents purchasing multinational programs for other lines including directors & officers liability, workers compensation and employers liability, and crime coverage. These upticks may be attributable to the continued need for certainty of coverage and costs, all of which could drive the decision to purchase multinational programs.

Multinational Insurance Purchasing Habits

Category	Retail & Wholesale Trade	All
Corporate headquarters controls procurement of ALL insurance programs (global/local)	35%	45%
Corporate headquarters controls some lines and leaves local office to purchase other lines	52%	44%
No, each operation buys its own insurance with no co-ordination from corporate headquarters	13%	11%

Data represents respondents operating in more than one country
Data Source: 2015 Global Risk Management Survey

Importance to Multinational Program Purchase Decision

Category	Retail & Wholesale Trade	All
Certainty of Coverage - Knowledge of what coverage is included in the program	1	1
Cost - This approach is more economical	2	2
Statutory Compliance -Access to local admitted coverage where non-admitted is prohibited	3	3
Fiscal Compliance - Ability to pay insurance premium and related taxes	4	4
Program Performance - Access to local claims and/or other services from local insurer/policy provider	5	5
Accounting - Ability to allocate risk transfer costs to local operations vs. pay from corporate	6	6

Data represents respondents operating in more than one country
Data Source: 2015 Global Risk Management Survey

Types of Multinational Insurance Coverages Purchased

Category	Retail & Wholesale Trade	All
General Liability/Public Liability	72%	81%
Property (Property Damage and Business Interruption)	85%	79%
Directors & Officers Liability	64%	73%
Marine/Ocean Cargo	57%	49%
Workers Compensation/ Employers Liability	51%	48%
Auto/Motor Vehicle Liability	36%	42%
Crime	38%	42%
Product Recall and Contamination	17%	18%
Trade Credit	17%	17%
Other	6%	11%

Data represents respondents operating in more than one country
Data Source: 2015 Global Risk Management Survey

Captives

Organizations in all industry groups and geographies continue to use captive insurance companies as an effective way to take financial control and manage risks. About 21 percent of retail and wholesale trade respondents have reported having an active captive or Protected Cell Company (PCC) with four percent also indicating a plan to create a new or additional captive or PCC in the next three years.

Even though the insurance market continues to be challenged with soft rates and low interest rates, an appetite for captive utilization still exists. Aon's survey shows that retail and wholesale trade companies use captives predominantly as a strategic risk management tool (39 percent) that facilitates greater control over their risk program, particularly around policy terms and conditions.

Survey results also demonstrate that general third-party liability and property are the most frequently underwritten lines of coverage within a captive, at 55 percent and 64 percent respectively. Continuing the theme of strategic risk management, cyber liability/network liability and employee benefits are the two risks cited with the greatest growth potential in the next five years within captive entities.

Organizations with a Captive or PCC

Category	Retail & Wholesale Trade	All
Plan to create a new or additional captive or PCC in the next 3 years*	2%	6%
Currently have an active captive or PCC	21%	18%
Have a captive that is dormant/run-off	1%	2%
Have a captive that is dormant/run-off	4%	1%

Data Source: 2015 Global Risk Management Survey

Current and Future Coverage Underwritten

Category	Retail & Wholesale Trade - Currently underwritten	Retail & Wholesale Trade - Continue/ plan to underwrite same/new risk in next five years	Percentage change
Auto liability	23%	35%	12%
Aviation	5%	4%	0%
Catastrophe	18%	17%	-1%
Credit/Trade credit	14%	17%	4%
Crime/Fidelity	14%	22%	8%
Cyber Liability/Network liability	18%	43%	25%
Directors & Officers liability	14%	13%	-1%
Employee benefits (excluding health/medical and life)	0%	17%	17%
Employers liability/Workers compensation	36%	48%	11%
Employment practices liability	5%	17%	13%
Environmental/Pollution	18%	17%	-1%
Financial products	0%	0%	0%
General/Third party liability	55%	61%	6%
Health/Medical	0%	4%	4%
Life	0%	4%	4%
Marine	23%	35%	12%
Product liability and completed operations	41%	43%	3%
Professional indemnity/Errors and Omissions liability	14%	17%	4%
Property (Property damage and business interruption)	64%	52%	-11%
Terrorism	18%	17%	-1%
Third-party business	18%	22%	4%
Owner controlled insurance program/contractor controlled insurance program	9%	13%	4%
Sub-contractor default insurance	0%	0%	0%
Warranty	0%	4%	4%
Other	23%	17%	-6%

Data Source: 2015 Global Risk Management Survey

Priorities in Choice of Insurer

An insurance policy is only as broad as its terms and conditions. When an organization purchases an insurance policy, it expects to be compensated in the event of a covered loss. If the insurance carrier does not fulfill this promise or there is a long delay in reimbursement, the organization's operations and balance sheet could be adversely affected. In the worst case scenario, such delay or failure to pay could bankrupt a business. This explains why respondents to survey cite coverage terms and conditions as the top criterion in an organization's choice of insurers.

The second most important criterion is value for money/price which is always top of mind in purchasing decisions.

It is interesting to note that the ranking of financial stability, a top criterion for insurance buyers from 2013, has been gradually downgraded, from number two in 2013 to number four in this year's report. This change leads to the conclusion that many organizations now see financial stability as more of a "hygiene factor" in the choice of an insurer, as improved economic conditions worldwide and much stricter regulations governing the insurance industry have boosted people's confidence in the financial well-being of insurers.

Priorities in Choice of Insurer

Category	Retail & Wholesale Trade	Retail Trade	Wholesale Trade	All
Coverage terms and conditions	1	1	1	1
Value for money/price	2	2	5	3
Claims service & settlement	3	3	2	2
Financial stability/rating	4	5	3	4
Long-term relationship	5	4	8	7
Capacity	6	7	6	5
Industry experience	7	8	7	6
Flexibility/innovation/creativity	8	6	9	8
Speed and quality of documentation	9	9	4	10
Ability to execute and deliver risk finance support proximate to global locations	10	10	10	9

Data Source: 2015 Global Risk Management Survey

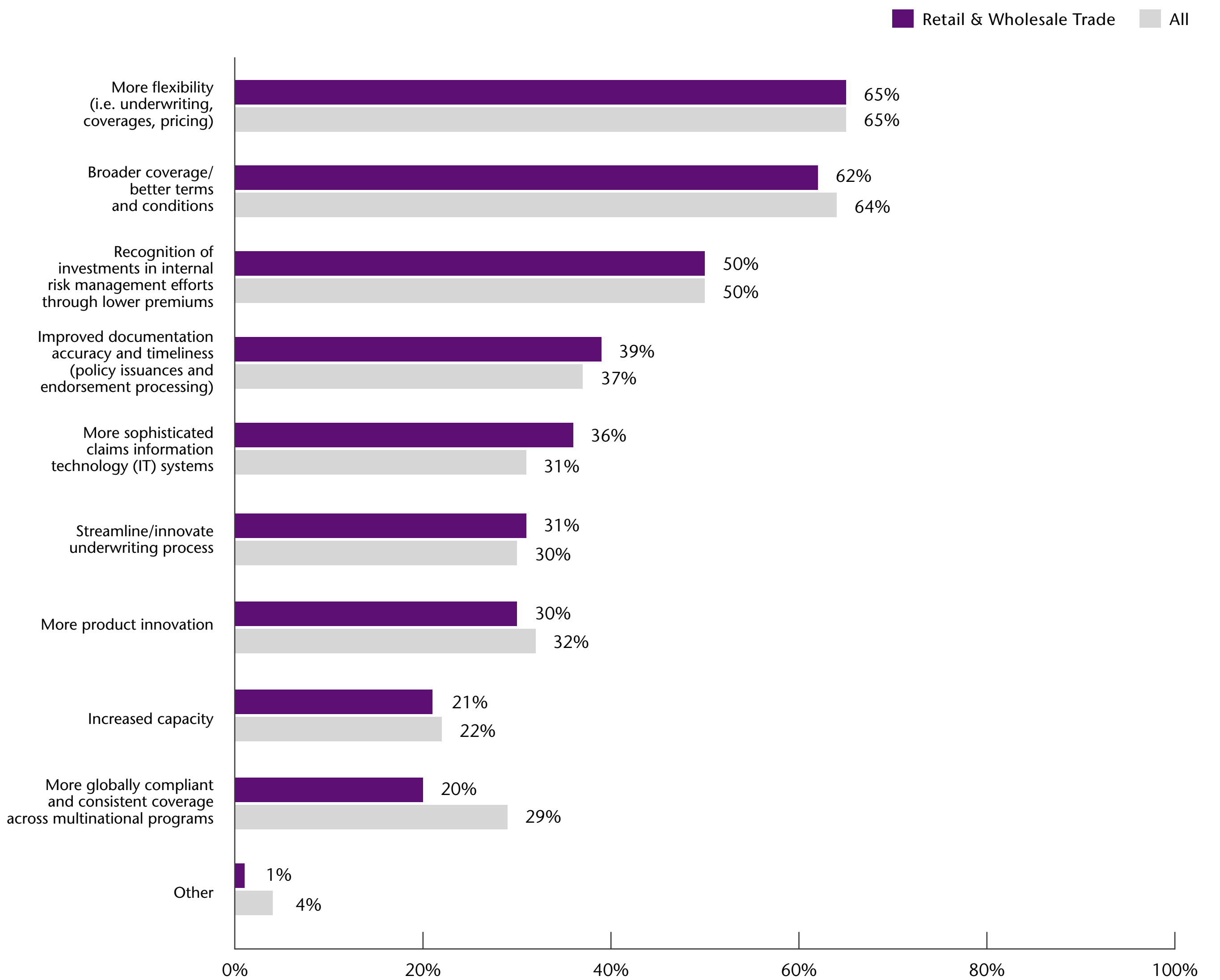
Desired Market Changes

When asked what changes retail and wholesale trade organizations would most like to see in the insurance market, the majority of respondents desire:

- More flexible (i.e. underwriting, coverage, pricing)
- Broader coverage/better terms and conditions
- Recognition of investments in internal risk management efforts through lower premiums

It's a clear indication that organizations are expecting their insurers to offer broader terms and more flexible solutions for meeting risk management objectives as they are coping with new risk and challenges.

Desired Market Changes (Past Two Years)



Source: 2015 Global Risk Management Survey

Top Carriers by Premium Volume U.S. (Alpha Order)

The exhibit below, based on information from Aon GRIP℠, provide insights into carrier/marketplace participation for casualty/liability, automobile liability, workers compensation, financial lines and property. This data are based on Aon placements only.

Casualty/Liability	Automobile	Workers Compensation	Financial Lines	Property
Ace	AIG	Ace	Ace	Ace
AIG	Liberty Mutual	AIG	AIG	AIG
Liberty Mutual	Sompo	Hartford	Axis	FM Global
Swiss Re	Tokio Marine	Liberty Mutual	Chubb	QBE
XL	Travelers	Zurich	Zurich	Zurich

Data Source: Global Risk Insight Platform

Common Carrier Win Reasons

When it comes down to selecting a carrier, the most common win reason is incumbent relationship, or taking a boxing metaphor, it is "you need to knockout the champ."

Casualty/ Liability	Automobile	Workers Compensation	Financial Lines	Property
Incumbent relationship	Incumbent relationship	Incumbent relationship	Incumbent relationship	Incumbent relationship
Pricing	Pricing	Pricing	Pricing	Pricing
Favorable coverage terms	Favorable coverage terms	Favorable coverage terms	Favorable coverage terms	Favorable coverage terms
Coverage/capacity not available elsewhere	Flexibility in response to client needs	Flexibility in response to client needs	Expertise (niche market/ industry)	Coverage/capacity not available elsewhere
Flexibility in response to client needs	Expertise (niche market/ industry)	Coverage/capacity not available elsewhere	Flexibility in response to client needs	Expertise (niche market/ industry)

Data Source: Global Risk Insight Platform

Common Reasons for Carriers Not Quoting

The most common reason for a carrier not providing a quote is pricing. This is consistent among all the lines reviewed except for financial lines, which list underwriting as a concern.

Casualty/ Liability	Automobile	Workers Compensation	Financial Lines	Property
Pricing	Pricing	Pricing	Underwriting concerns	Pricing
Class of business	Underwriting concerns	Underwriting concerns	Pricing	Terms & conditions
Underwriting concerns	Class of business	Class of business	Class of business	Class of business
Terms & conditions	Terms & conditions	Terms & conditions	Terms & conditions	Underwriting concerns
Capacity	Loss experience	Loss experience	Capacity	Capacity

Data Source: Global Risk Insight Platform

Common Reasons for Rejecting a Carrier's Quote

The reason most often given by clients for rejecting a carrier's quote is inferior pricing and inferior terms and conditions.

Top Retail and Wholesale Carriers Financial Strength Rating

A number of rating agencies estimate and publish the financial position of insurance companies, including A.M. Best, Standard & Poor's, Moody's Investors Service, and Fitch Ratings. For this review, we have provided an overview of ratings for key retail and wholesale trade markets as assigned by A.M. Best and Standard & Poor's. All of the insurers below currently carry ratings considered to be secure. Ratings can change at any point in time and should be regularly track to assure they continue to meet industry standards.

Top Retail and Wholesale Trade Carriers Financial Strength Rating

Carrier	A.M. Best Rating	A.M. Size	A.M. Best Outlook	S&P Rating	S&P Outlook
Ace	A++	XV	Negative	AA	Negative
AIG	A	XV	Stable	A+	Stable
Axis	A+	XV	Stable	A+	Stable
Chubb	A++	XV	Negative	AA	Negative
FM Global	A+	XV	Stable	A+	Stable
Hartford	A+	XV	Stable	A+	Stable
Liberty Mutual	A	XV	Stable	A	Stable
QBE	A	XIV	Stable	A+	Stable
Sompo	NR	NR	NR	A	Stable
Swiss Re	A+	XV	Stable	AA-	Stable
Tokio Marine	A++	XV	Stable	AA-	Negative
Travelers	A++	XV	Stable	AA	Stable
XL	A	XV	Stable	A+	Stable
Zurich	A++	XV	Stable	AA	Stable

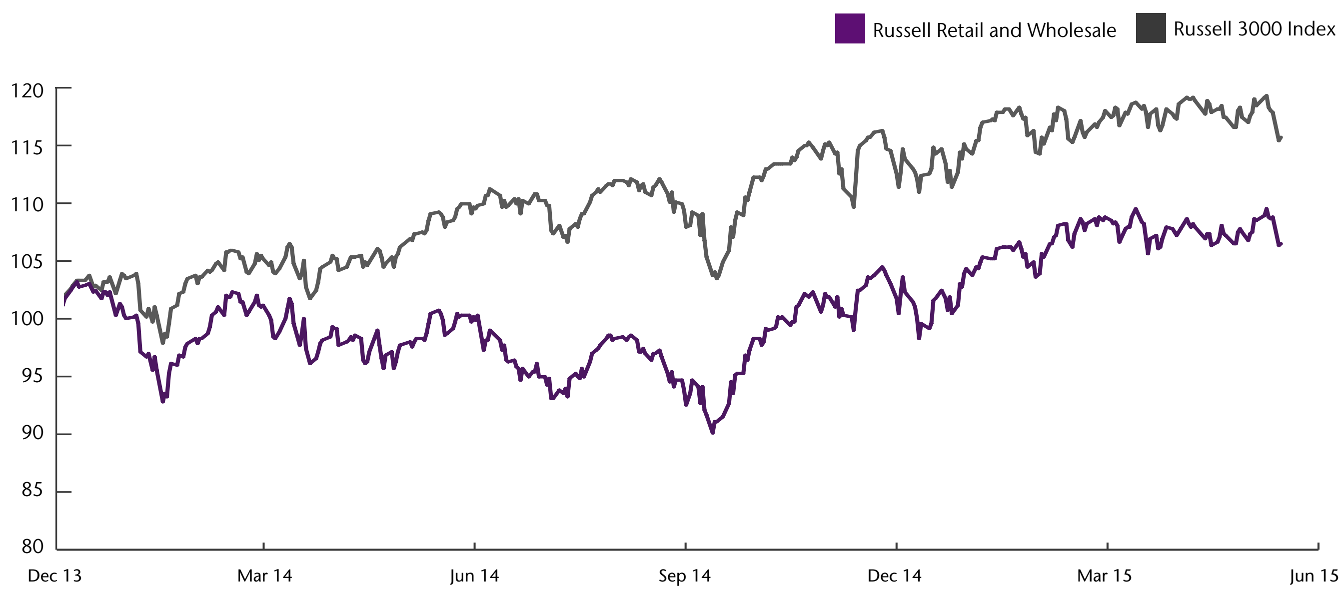
Ratings as of 8/6/15
Data Source: A.M. Best Reports through BestLink for all statutory filing data and S&P Reports for the S&P categories

Financial Insights

Over the past 12 months, the share price of the Russell 3000 Index has generally outperformed retail and wholesale trade companies. If we compare employment numbers for the retail and wholesale trade sector and the overall non-farm sector for the prior 12 months, we can see that non-farm sector companies have fared better than the retail and wholesale trade sector. But growth has been positive for the sector since at least January 2013.

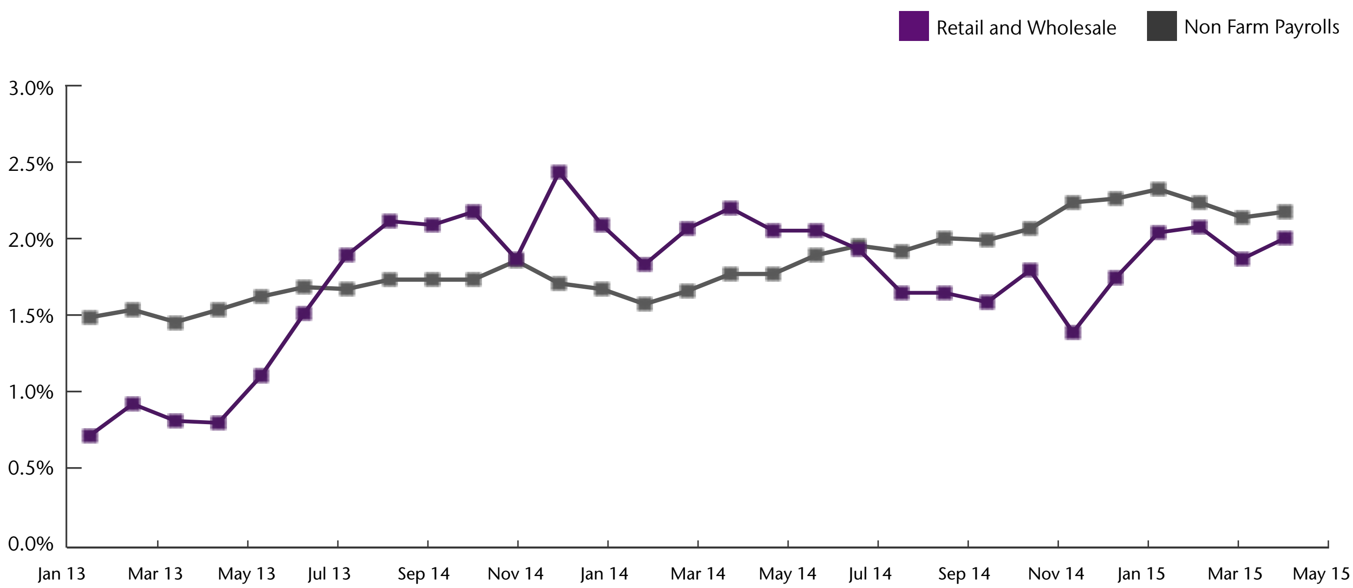
The average Consumer Confidence Index figure from July 2014-June 2015 stood at 95.4 percent. However, consumers' short-term outlook is at its highest point of 101.4 for the second time since January 2009.

Share Price Performance



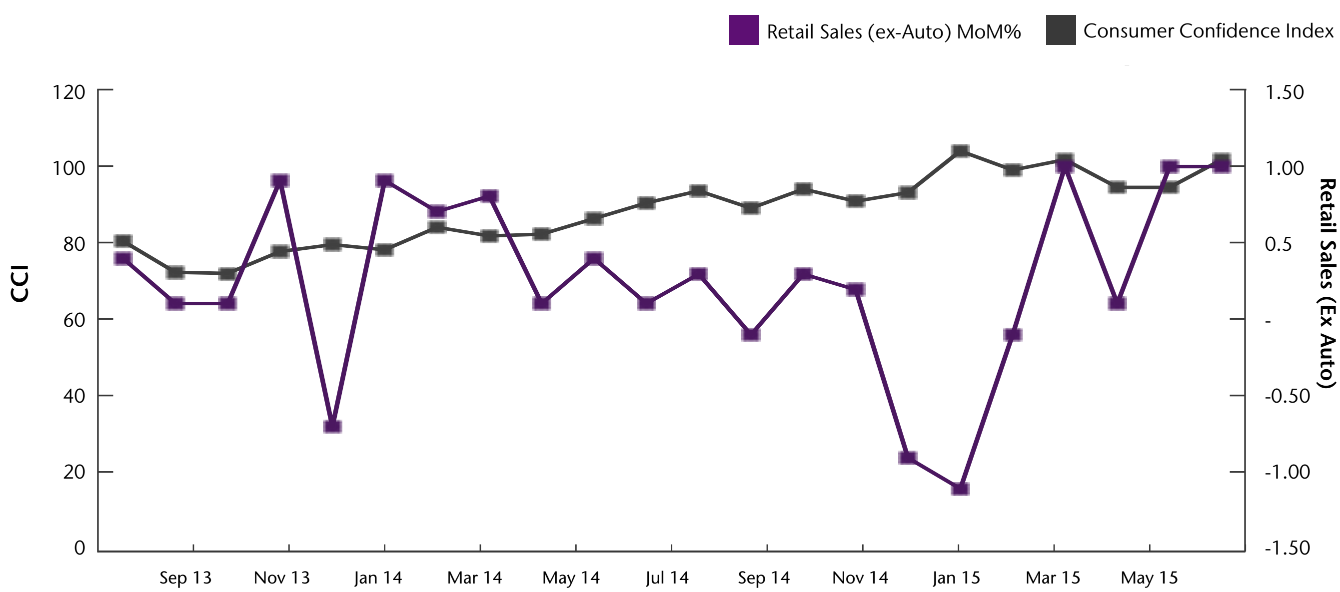
*Source: Bloomberg *Russell 3000 Companies*

% Change in Annualized Employment



*Data Source: Bloomberg *Russell 3000 Companies*

Consumer Confidence Index and Retail Sales (MoM%)



*Data Source: Bloomberg *Russell 3000 Companies*

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