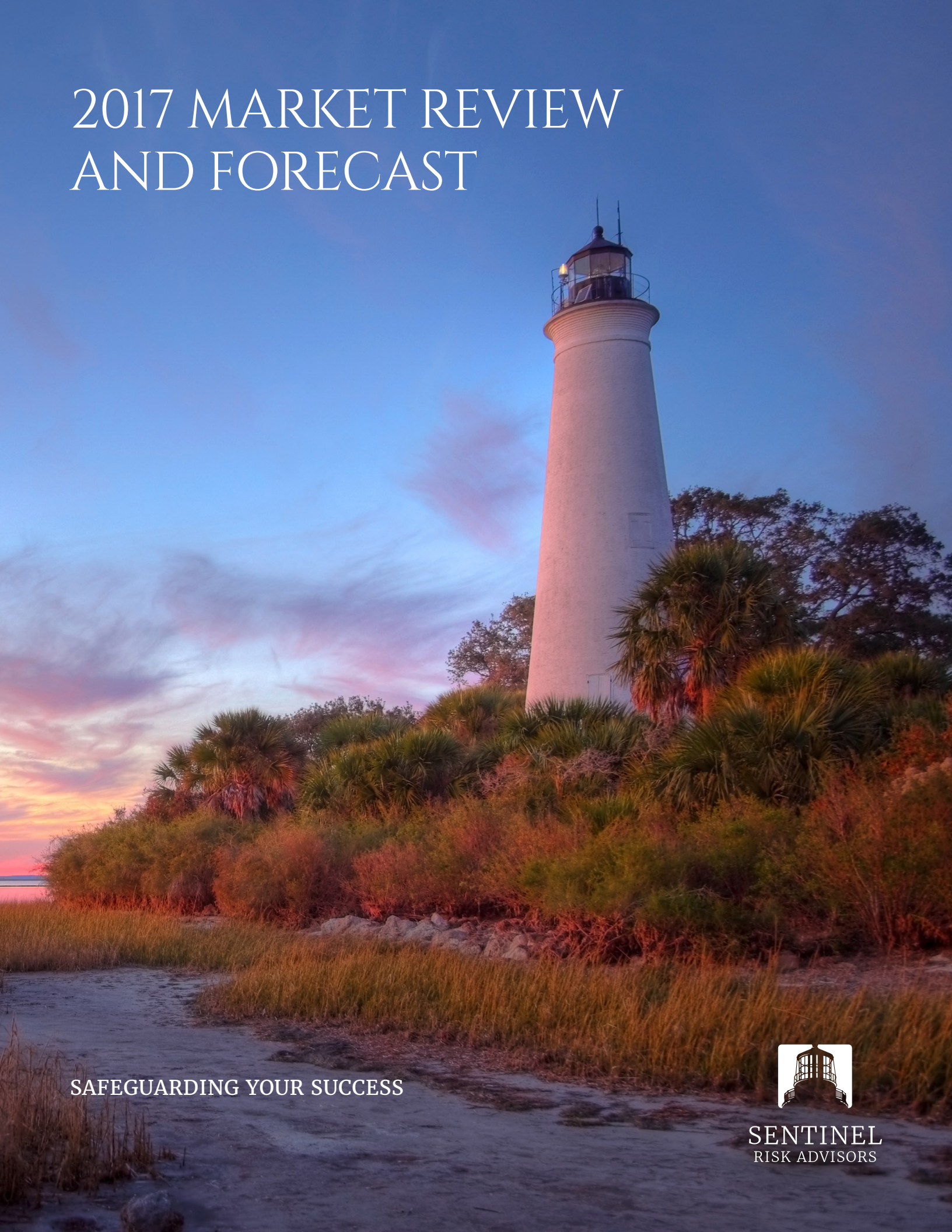
2017 MARKET REVIEW AND FORECAST



SAFEGUARDING YOUR SUCCESS

SENTINEL
RISK ADVISORS

Executive Summary

If 2016 taught us anything, the lesson would be not to rely on data for which there is no method of accounting. Put another way: It is best not to plan for tomorrow's prosperity based on today's conventions and perceived predictability.

Indeed, 2016 was the year that the unexpected defied expectation. On the world stage, Brexit shook the UK and European Union to the core. Here at home, the results of a bitterly divisive presidential election delivered a shock to the system and proved, beyond a doubt, that the polling process is enormously flawed.

So what does this have to do with forecasting an up or down shift in the property and casualty market? The answer is nothing and everything. Nothing because, as any risk professional knows, traditional insurance forecasting methods rely upon what is known to extrapolate expected future results, ignoring the all-important unknowns. Everything because, in fact, the best risk mitigation strategies succeed due to those very unknowns, not in spite of them.

The work, then, is to use the most diverse information at hand to plan for the most potentially damaging what-ifs we can imagine.

Here's what we know:

As predicted, 2016 was a buyer's market for most lines of property and casualty coverages.

The economy will continue to grow in 2017, albeit at a slower pace than recent years.

The insurance industry's surplus capacity is at an all-time high, due to the lack of significant natural disasters.

Insurance rates are likely to remain steady or drop slightly in 2017. Most lines of coverage will see modest reductions in the range of two-to-eight percent, though select lines will see moderate-to-significant increases.

Executive liability and cyber policies, in particular, will be more deeply underwritten as the complexities of data breach and cyber-related disruptions drive demand for policies with fewer limitations and exclusions.

Increased globalization will create new opportunities; with those opportunities will come greater risk and instability.

Economic, political and societal instability typically drives a reactive market response, and in 2017, that response will be more strategic and comprehensive than ever before. Insurance carriers will continue to refine and make good use of "smart" data and analytics to develop insurance products that carry more weight and depth. Effective risk management strategies will increasingly account for loss in a more general sense – loss to the company's brand and reputation, for instance.

Emerging trends for 2017 include:

- Traditional insurance policies alone will not keep pace with the demands presented by today's increasingly complex risk scenarios.
- Commercial auto rates will rise as much as 10 percent, owed to frequent and severe losses.
- Cyber policies will be deeply underwritten, focusing on digital infrastructure and related losses caused by criminals who take control of unsecured, Internet-connected devices and use them to launch malware and other attacks.
- Alternative forms of risk transfer will be utilized more than ever before, to drive down the cost of high-risk property coverage, including catastrophe bonds and other capital investment tools.
- Demand will grow for civil unrest policies, due to the volatile nature of today's political landscape, as businesses seek damages and reparations for lost revenue.

- Carriers will look to capitalize on the high net worth sector by creating specialty lines of coverage for affluent clients.

- Alternative risk financing strategies will continue to gain popularity.

- Industry consolidation will lead carriers and retail firms to turn their focus away from small business. Look for the increased use of service centers in the small business insurance arena.

- The likelihood of a global pandemic will rise in 2017, as it does year by year, whether from a natural occurrence or due to bio-terrorism.

- The insurance industry's focus on price over policies, terms and conditions will leave many clients unprepared for and unprotected against the emerging risks to come.

The market's new volatility is actually not so new. It's been playing out for the last decade, in fact. Yet, emerging and escalating risks have presented themselves in dramatic fashion. For instance, cyber insurance can no longer focus solely on protecting data, but must now safeguard the production and manufacturing of goods and services, as well as intellectual property.

An issue for ongoing discussion and negotiation is the emergence of policy exclusions or limitations, warranties, etc. A business defense needs to target a total and absolute protection guarantee, or immediate containment of the breach at a minimum.

Sentinel develops effective risk strategies and smart insurance solutions by culling data and intelligence from the risks we can identify and assess today, with best and worst case exposure scenarios for tomorrow. The margin for error is quite small, when what is at stake is the future of your business. Therefore, it is critical to take prescriptive steps toward identifying and evaluating risk, between quantifying and qualifying risk, and between developing alternative risk strategies alongside traditional mitigation tactics.

One final note: A business' risk register will become a more dynamic tool in 2017 and beyond as exposure scenarios become exceedingly more complex. Business susceptibility to risks and exposures will change quite rapidly depending upon supply chain dynamics. Developing and maintaining a risk register ensures sufficient attention is paid to structure, consistency and accountability within the enterprises management plan of risk.

The following is Sentinel's forecast of likely rate scenarios for 2017.

2017 Forecast for Specific Lines of Insurance

Property

Rates flat to reductions of 10 percent or more

Provided catastrophic losses remain low, increasing capacity and competition are likely. New catastrophic markets continue to surface, which will bolster choice, options and alternatives. Most renewals are experiencing rate reductions of less than 10 percent.

General Liability

Rates flat to reductions of 10 percent or more

General liability rates will remain very competitive, though life science and chemical companies may see lower reductions. Overall, however, liability rates will track closely with property rates, with most accounts seeing rate reductions of 10 percent or less.

Automobile

Rates flat to increases of 10-20 percent

Since late 2015, auto insurance rates have been subtly on the rise. Some will see little to no increase, others will see a rate hike near 20 percent, while large fleets, especially those with heavier vehicles, can expect increases of at least 10 percent.

Workers Compensation

Rates to fall as much as 10 percent

Regional insurers remain fairly competitive, yet some industries will see reduced capacity. That, combined with increased retentions and fewer guaranteed cost policies being underwritten, makes for a less stable market than in past years.

Umbrella

Rates to remain flat for some, fall by up to 10 percent for others

Umbrella market rates are the lowest they've been in 20 years or more, a result of greater than normal capacity. Many excess (of umbrella) policies are already priced at minimum premium levels so expectations are for flat renewals.

Environmental

Rates to remain stable; some reductions of up to 5 percent

This line of coverage will need to be watched closely. AIG decided to no longer offer pollution legal liability (site liability) but their underwriting teams moved to other/new markets and continued underwriting. This is evidence of the availability of capacity entering the market. Further, long-tail losses are being realized. Insurers continue to warn of increasing rates deeper in the year.

Errors & Omissions

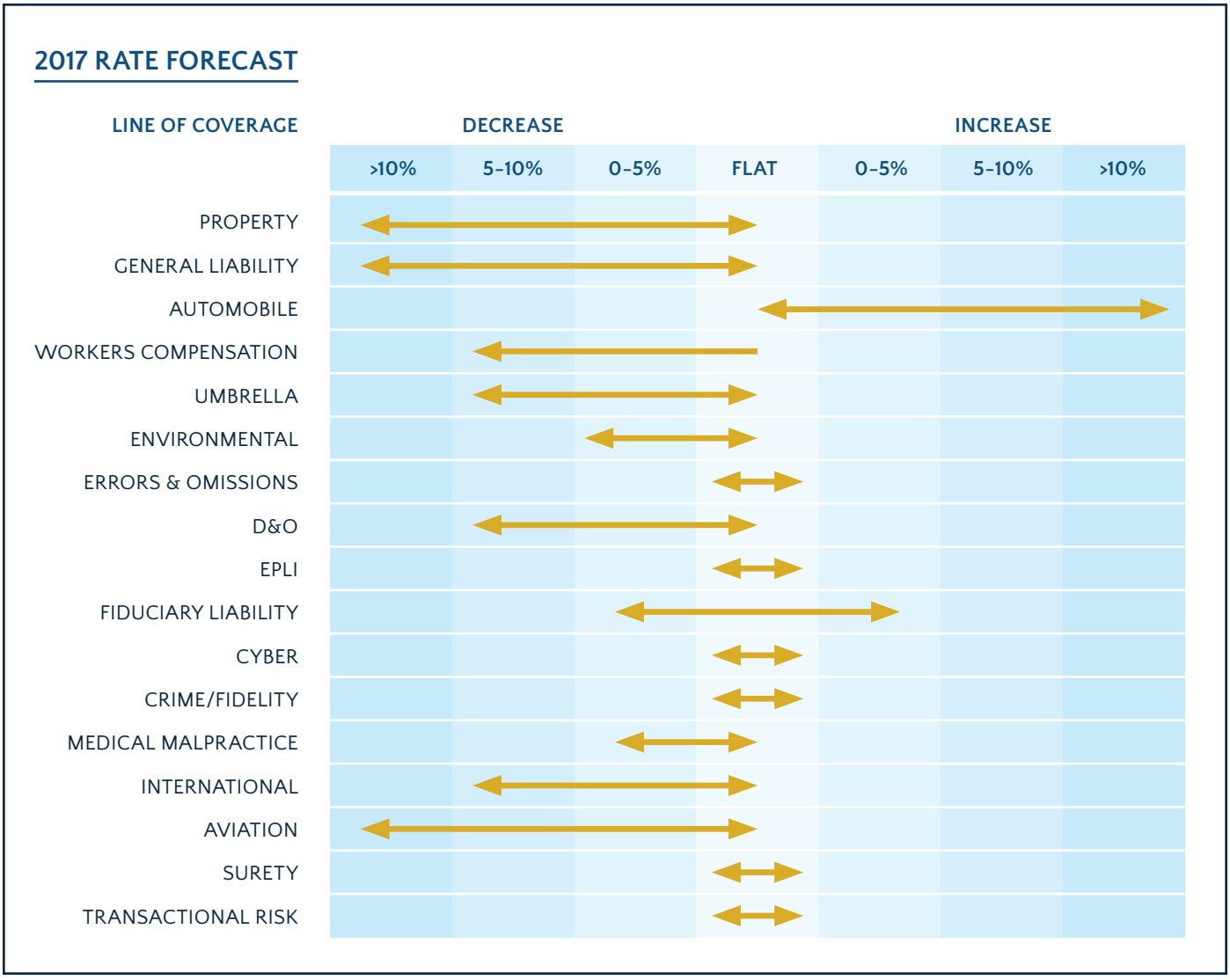
Rates to remain flat

Accounts are realizing generally flat renewals, though there are some increases and occasional reductions. Insurers are shifting, with some pulling out of certain industries (retail, healthcare and financial institutions), particularly when significant cyber exposures exist. However, new and specialized insurers are filling the void.

Directors and Officers Liability

Rates to remain flat for some, fall 5-10 percent for others

Public, private, not-for-profit and financial institutions are all realizing flat to modest reductions in the 5-to-10 percent range. Capacity is abundant, but many insurers are at minimum rates for their capacity.



Employment Practices Liability

Rates to remain flat

Rates will remain relatively flat for 2017. Expect competing insurers to offer reductions while incumbent insurers may press for a slight increase. Changes in federal regulations (NLRB and FLSA) will increase volatility in the EPL market.

Cybersecurity

Rates to remain flat

The data breach arena is one that continues to evolve each year. The industry is faced with increasingly sophisticated threats, including an exponential rise in exposures from ransomware and other extortion tactics. And it's not just information technology that is at risk, but operational technology, as well.

The warning for this coverage is that every policy is different so caution must be taken to ensure that coverage is what you expect.

Crime & Fidelity and Fiduciary

Rates to remain flat

The line between crime and cyber coverage is increasingly blurred, particularly with regard to so-called impersonation fraud. Take care with the structure and design of these policies to prevent overlap and exclusions. In conjunction with cyber coverage, monitor terms, conditions and limits to ensure adequate protection.

Medical Malpractice

Rates to remain flat with some reductions

Medical malpractice rates remain highly competitive and very stable. Capacity is high, but rates will remain fairly flat due to uncertainty over the Affordable Care Act.

International

Rates flat to decreases of 5-10 percent

Core lines of coverage (liability, property, cargo, etc.) remain very competitive. Much of the business in this arena is still written under long-term policies, which can be very punitive if canceled. Kidnap and ransom insurance rates appear to be flat, though depending on the country, increases may be seen. Political risk remains volatile as economic instability plagues several countries, including those impacted by the migrant crisis.

Aviation

Rates flat to decreases of 5-10 percent

The market is broad with varying levels of competitiveness. Aviation products and completed operations has substantial capacity, but losses have been sizable. General aviation (other than commercial airlines) is seeing stable to modest rate reductions of up to five percent. Commercial aviation will experience rate reductions, with exceptions for aging fleets and poor safety ratings.

Surety

Rates flat

Capacity and pricing are strong for both contract surety and commercial surety. The surety market may be more competitive in 2017 as a result.

Transactional Risk – Representations & Warranty

Pricing increasingly competitive

More markets and better capacity will lead to an increase in competition, but the nature of the risk requires individual risk underwriting. Retentions are generally at the most acceptable levels insurers will offer. With expected increase levels of cash in the market, we expect an increase in M&A activity and increasing use of R&W insurance.

Captives

Remain a viable option

There are many types/structures of captives available. Microcaptives (IRS Code 831(b)) are intended to offer smaller middle-market sized business a captive option. Group captives remain a favored option for a large number of businesses. Single-Parent captives are most generally available for the most sophisticated risk and financing oriented companies.

2017 Market Summary

Overall, 2017 will be a competitive market. Incumbent insurers will often seek increases or flat rates for renewals. Competing insurers may offer lower rates as they seek to gain market share and grow premiums. The coming year will trend much the same as 2016 and the continuation, for most lines, of a buyer's market and declining rates. However, there are some changes of which to be aware.

With increasing optimism for the US economy, payroll, sales and growth in real estate provide an opportunity for insurers to realize premium growth without increasing rates. Indications are that interest rates will increase and this may improve investment income opportunities for insurance companies.

The insurance market continues to attract capacity, which in turn creates surplus capital. From that surplus, we can expect new products and enhanced competitiveness for several lines of coverage. New products will run the gamut between simple enhancements of existing policies to brand-new policies to cover new and emerging threats, such as workplace shootings, acts of terrorism, etc. Look for catastrophic bonds and other forms of alternative capital to continue attracting new investors.

Areas for concern include:

- There is a potential for a significant increase in catastrophic losses. Only one-third of the catastrophic loss that occurred in 2016 was insured. A particularly damaging hurricane season could have big implications on insurance rates for 2018 and beyond.

- Continued uncertainty around the Affordable Care Act (ACA) leads to instability in the medical marketplace. Medical costs will continue to increase, but the degree of cost impact needs to be monitored.

- 2016 saw a 30 percent increase in securities class action suits; a trend that will likely continue in 2017.

Expect the mergers and acquisition trend among brokers to affect insurance companies, as well, as less-than-stellar sales trends persist. Post-acquisition is often a time for long periods of introspection and lower expenses.

Underwriting will get a closer look by insurers in 2017, as the need for a more thorough risk analysis becomes ever clearer.

Sentinel Risk Advisors is a premier insurance brokerage firm with a reputation for exceptional client experience in 36 states. Sentinel offers a broad scope of property, casualty, and risk management services for today's global marketplace. Clients depend on Sentinel Risk Advisors to protect their assets, preserve their wealth, and elevate their personal and professional position.

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