2016 MID-YEAR MARKET FORECAST

Executive Summary

The remainder of 2016 will be an insurance buyer's market, as low rates and losses, especially catastrophic losses, along with an abundance of capital are altogether good news for consumers. Earlier this year, Sentinel forecast rate decreases across most lines of coverage—some by 20 percent or more; a prospectus that is now reality.

The U.S. economy is feeding this trend. Low consumer spending and inflation, meager GDP growth of two percent and one of the lowest employment participation rates in a decade make for a highly competitive environment for insurance carriers. Factors that would materially change the current trend—an increase in interest rates, payroll, sales and property values—have yet to materialize.

With insurers struggling to realize organic growth, Sentinel expects the merger and acquisition trend to continue. Case in point: ACE/CHUBB finalized their merger in the first quarter of 2016. Merger and acquisition activity among brokers and agents continues, though many are property and casualty brokers acquiring employee benefit brokers in an effort to diversify their portfolios.

Executive liability and cyber policies, in particular, will continue to be more deeply underwritten through 2016.

Q3–Q4 2016: General Forecast

With the 2016 Hurricane season just beginning, the industry is keeping a watchful eye on the frequency and severity of storms. It is widely believed that the market will remain very competitive until losses greater than $50 billion are realized. For reference, Super Storm Sandy cost $20 billion.

The remainder of 2016 will see reduced rates ranging from the low single digits to greater than 20 percent. Accounts that have not been aggressively or widely marketed in recent years should readily exceed the 20 percent reduction level. Accounts with challenging loss experience, especially frequency, and marketed every year, will likely see single-digit reductions at best. Cyber is and will continue to be more deeply underwritten, though to offset rate increases, insurers are pushing increasing retentions and deductibles.

Incumbent insurers may offer lower reductions, however, competing insurers may be seen as more competitive and offer greater reductions.

Brokers and agents will continue their mergers and acquisitions as they strive for increasing growth and market share. There will also be an increasing trend of mergers and acquisitions of insurance companies. We expect this to be increasing in the specialty insurer and regional insurer markets.

Q3–Q4 2016: Forecast for Specific Lines of Insurance

Property

Rates to fall 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, while several are realizing 15 percent or higher.

Liability

Rates to fall 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 more.

Automobile

Rates to increase as much as 10 percent; more for large fleets

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 10 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 very competitive, and despite their limited geographic range offer outstanding claim management services. Accounts with high NCCI experience modifiers have increasing choices with insurers.

Umbrella

Rates to remain flat for some, fall by as much as 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.

Environmental

Rates to fall 5 percent or more

This line of coverage will need to be watched closely. While other lines attract new entrants and capacity, environmental lags well behind. The recent mergers of XL with Catlin and Chubb with ACE significantly reduced options. Further, long-tail losses are being realized. Accordingly, there are early indications 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 by as much as 10 percent for others

Public, private, not-for-profit and financial institutions are all realizing flat to modest reductions in the 10 percent range.

Employment Practices Liability

Rates to remain flat

Rates will remain relatively flat for the remainder of 2016. 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.

Rates are likely to remain flat through 2016, but much could change in 2017 as the demand for and complexity of coverage grows. American companies of all types and size are making the transition from worrying about cyber liability to planning for it. Those that are insured value the services--defense, forensic, regulatory, and communication--that enable compliance.

Roughly half of U.S. businesses today do not have a cybersecurity policy in place. That will almost surely change in the not-too-distant future. As the number of premiums increases, so, too, will competition.

In the more immediate sense, point-of-sale retail and large healthcare companies have the potential for steep rate increases to the tune of 50 percent or more.

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. The largest claim to date by a public company is $46 million, though frequency is low with claims of this type. Criminals have become quite savvy at using technology to steal money and property. Take care with the structure and design of these policies to prevent overlap and exclusions.

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 to fall 15 percent or more

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 cancelled. 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.

Captives

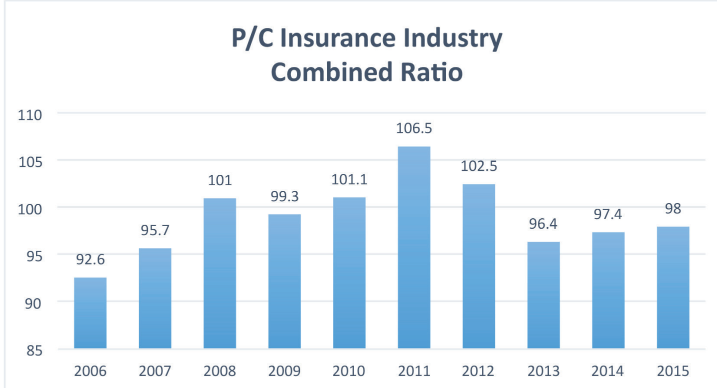
Remain viable

Although captives will remain viable throughout 2016, they are becoming harder to financially justify due to an extremely competitive property and casualty market. That said, the long-term viability of captives remains a strong option for financial protection.

Summary

For the remainder of 2016, we anticipate the continuance of the competitive market. It is increasingly important to understand your program structure and design as policy wording changes must be carefully monitored in conjunction with business operations and strategies.

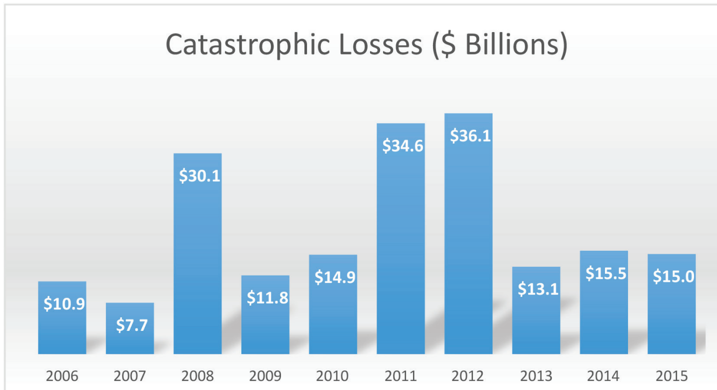
Insurance Market Statistical Analysis (2015)



Various agencies report statistics every year, but reports are often delayed several months into the following year. The following analysis highlights several key indicators and statistics, all of which support the increasing capitalization in the industry and continuing competiveness of pricing.

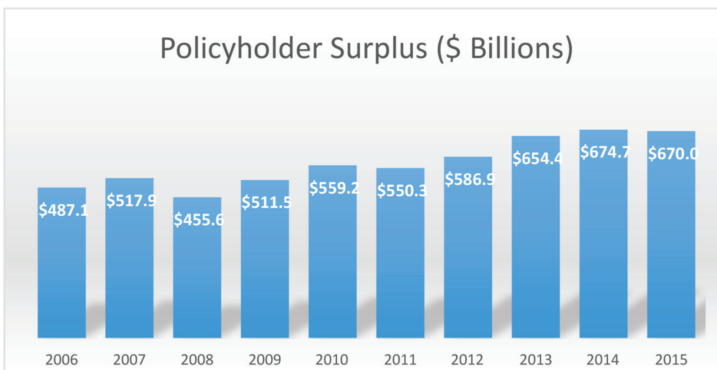
1. Net written premiums for 2015 in excess of half-trillion-dollars at $514 billion and increase of 3.4 percent over 2014.

2. Catastrophic losses in 2015 were $15 billion, down a half-billion from the year before, $4 billion less than the 10-year average and more than $5 billion less than the 20-year average.



3. Catastrophic losses are at record low levels. In 2015, catastrophic losses contributed 3.1 percent to the insurer combined ratio, or loss and expenses vs. premiums.

4. The policyholder surplus, which stands at more than $670 billion, has remained consistent for five years running.



5. The property and casualty industry has a dollar of surplus for every seventy-three cents of net written premium. The industry is near an all-time high in terms of financial condition.

6. Net premium growth for 2015 was 2.7 percent, the lowest level in five years.

7. The property and casualty industry's combined ratio was 98 percent in 2015, compared to 97.4 in 2014 and 96.4 in 2013. The 10-year average ratio is 99 percent.

8. Investment income in 2015 totaled $46.5 billion, an increase from $46.2 billion in 2014, despite continuing low interest rates.

9. Insurer profitability in North Carolina is about 45 percent higher than the U.S. average; good news for insurers who are incentivized to write new business, and for insureds who reap the benefits of a highly competitive buyer's market for insurance.

This market forecast is an observation about industry trends. How those trends apply to individual accounts will vary based on actual history, results and current rate posture. The material included herein is provided for informational purposes only and should be not taken as legal advice.

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