2017 MID-YEAR MARKET FORECAST

Executive Summary

At the midpoint of another "soft market" year for the insurance industry, rates are and will remain low across most major lines, as Sentinel forecasted earlier this year. On the surface anyway, not much has changed with regard to industry performance. Capacity is at an all-time high, prices are low, coverage is plentiful. And in the absence of a major catastrophic event, it's likely we will see more of the same as we head toward 2018.

Yet, there is something brewing just under the surface. A more complicated truth has emerged in this ongoing soft market. Consider the juxtaposition of a highly competitive marketplace against a consumer climate that at the moment appears to prefer inertia. Consider, too, that while rates may be low, coverages may not hold the value or offer the protection they once did. Meanwhile, in the background, complex risks continue to rise.

Why sound the alarm when things are (seemingly) going so well? For starters, because the current climate feeds a false sense of security among insureds. At a time when underwriters are more open than ever to negotiation, consumers are less likely to be on the lookout for unfavorable terms and conditions. When the focus is on price over policy, the consumer ends up unprotected. Gaps and exclusions in coverage are often common in a soft market; so, too, are overlapping policies.

For Sentinel, now is the time for increased innovation, to set new risk management strategies and above all, for better negotiation with carriers. This is also the time to map your risk, implement disaster recovery and business interruption planning, and to ensure that your insurance policies dovetail with those planning efforts.

With regards to planning, three lines of coverage merit extra attention through the remainder of 2017.

Cyber. The most hot-button topic in the commercial insurance arena shows no signs of cooling off anytime soon. Cyber is not the exclusive line it was once, with carriers ramping up their service offerings to create custom policies and programs capable of responding to today's complex data breach scenarios. Sentinel will help you take advantage of free cybersecurity planning tools available through many carriers; an important resource, especially in light of recent statistics showing a nearly 300 percent increase in cyberattacks from 2015 to 2016. Ransomware is, and will remain, the most likely form of cyberattack facing businesses this year.

Business Interruption. This is the line of coverage everyone should be talking about, yet for the most part, they aren't. The problem with business interruption policies is they are often too narrowly written to be effective. It is critical to understand the many factors that can stymie your business' bottom line, and it's imperative that any risk mitigation strategy take all those factors into account. For instance: the timing, terms and conditions of coverage; responsibility for expenses and exemptions; and vendor (subcontractor) agreement considerations, among others. Sentinel will work with you to conduct scenario planning that will effectively map out the cause and effect of business interruption, leading to the creation of custom loss prevention planning and insurance solutions to mitigate losses.

Auto. You can thank distracted drivers, increased healthcare costs, and higher physical damage costs due to innovation for another year of auto insurance rate increases. Insurers are looking to recoup losses, both due to frequency and severity, through increased premiums. Rates will increase more for commercial accounts that have large fleets, for those without fleet safety programs, and those with a loss experience that fares worse than their peers.

Q3–Q4 2017 Forecast for Specific Lines of Insurance

Property

Rates to fall up to 10 percent

Provided catastrophic losses remain low, options and alternatives will remain viable. Most renewals are experiencing rate reductions of less than 10 percent.

Liability

Rates to fall 10 percent or more

General liability rates will remain very competitive for most industries, though life science and chemical companies will see lower reductions.

Automobile

Rates to increase as much as 20 percent

This is the second year that auto insurance rates have risen subtly. Some insureds will see little to no increase, others will see a rate hike approaching 20 percent, while large fleets, especially those with heavier vehicles, can expect increases closer to 10 percent.

Workers Compensation

Rates to fall as much as 5 percent

Medical costs continue to increase, yet insurers continue to implement cost containment programs to minimize the upward pressure on pricing. Insurers are also offering increasingly innovative solutions to lower indemnity costs, such as return-to-work and alternative work programs for injured and recovering employees.

Umbrella and Excess Liability

Rates to remain flat

Most insurers have reached minimum premium levels for their capacity.

Environmental

Rates to fall around 5 percent

Despite insurer mergers (XL/Catlin and ACE/CHUBB), new entrants are filling the void and offer options. We still see this line of coverage as potentially volatile.

Errors & Omissions

Rates to remain flat

Accounts are realizing generally flat renewals. However, certain industries (retail, healthcare and financial institutions), particularly when significant cyber exposures exist, are seeing modest increases of up to 5 percent.

Directors and Officers Liability

Rates to remain flat

Public, private, not-for-profit and financial institutions are all realizing flat renewals, though some programs that are marketed to other insurers may see modest reductions in the 10 percent range.

Employment Practices Liability

Rates to remain flat

Rates will remain relatively flat for the remainder of 2017. Expect competing insurers to offer reductions, while incumbent insurers may press for a slight increase. Sentinel urges caution, as some insurers increase pricing at the next renewal to a level higher than it was previously. Changes in federal regulations (NLRB and FLSA) may increase volatility in the EPL market.

Cybersecurity

Renewal rates to remain flat, though new businesses may find pricing higher than expected

No other corporate exposure has and continues to receive more attention than Cyber. Stolen data, malware, ransomware, phishing, cyber extortion, property damage, business interruption, etc., are in the news daily. Many of these exposures are not targeted, but rather a constant application of pressure put upon networks, applications, systems, programs and emails until the perpetrator finds a vulnerability that can be exploited.

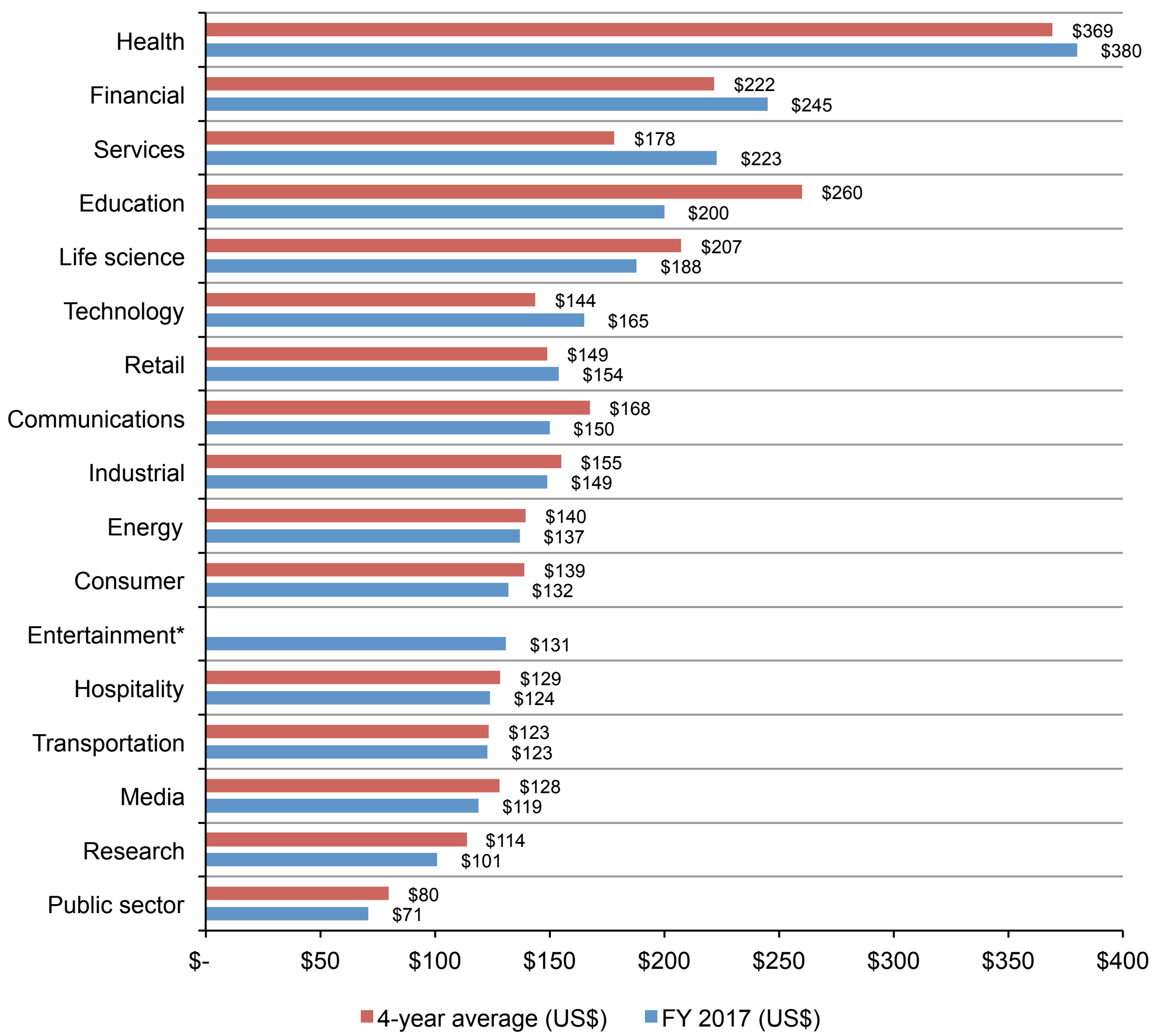
Rates are likely to remain flat through 2017, but the likelihood of volatility remains high. Businesses with greater exposures, such as banks, retail, healthcare, and those with either a large volume of records or multiple points of access to their systems will see increases of up to 10 percent, in addition to greater underwriting scrutiny.

Crime & Fidelity and Fiduciary

Rates to remain flat

The line between crime and cyber coverage remains blurred, particularly with regard to so-called impersonation fraud. This exposure area is often neglected and embedded into a commercial package policy; this raises the question of adequacy of limits and effectiveness of coverages.

Cyber insurance rates, terms and conditions can vary quite a lot across industries, due to the often substantial difference in cost. The following chart, from the Ponemon Institute's 2017 Cost of Data Breach Study, shows just how much the cost of a data breach can vary across industries. Heavily regulated industries, such as healthcare, banking, retail and life sciences, have a per capita data breach cost substantially higher than the overall mean of $141.



Medical Malpractice

Rates to remain flat with some reductions

Medical malpractice rates remain stable. Healthcare reform has the potential to impact ratings, but much is still uncertain. Tort reform could have an impact and result in lower rates.

International

Rates to fall up to 10 percent

Core lines of coverage (liability, property, cargo, etc.) remain competitive. Political risk remains volatile as economic instability plagues several countries, including those impacted by the migrant crisis.

Captives

Remain viable

Despite a very competitive commercial insurance market, Captives remain viable. Numerous types of captives are available and while the cost of access is variable, the low options have little to no increase in cost over the insurance market.

A Look Back: The 2016 Property and Casualty Market In Review

- $42.6 billion profit was 25 percent lower than 2015; however, a median result when compared to the previous 20 years and adjusted for inflation
- Policyholder surplus exceeded $700 billion for the first time in history ($700.9 billion)
- Insurers have $1 in surplus for every $0.75 of net written premium – the strongest ratio in recorded history
- Wages and salaries (non-farm) achieved a new high of $8.34 trillion for Q4 (2016)
- Combined ratio was 100.7 – insurers paid out slightly more than they took in as premiums
- Only seven of the past 16 years have been profitable for underwriters, with 2006 as the peak performance year , 2001 as the worst, and 2016 as the second-to-worst