2018 MARKET REVIEW AND FORECAST

SAFEGUARDING YOUR SUCCESS
Executive Summary

Last year, Sentinel predicted that it would take catastrophic losses in the range of $100 billion to harden the property and casualty market sufficiently to raise rates. A disaster scenario that seemed implausible at the time has now come to pass, bringing with it an upward pressure on rates and the tempering of an insurance market that in 2018 will be a little less competitive and a bit more restrictive.

Or will it?

Conventional wisdom would lead us to believe the headlines cranked out by insurance analysts while gale force winds from Hurricanes Harvey and Irma were still blowing, declaring: THE SOFT MARKET IS OVER. But the truth is, the soft market is not over. Not yet and perhaps not at all.

At least, the forces that shape the market are not changed enough to warrant such a conclusion. Not enough surplus gone. Too much capital left. A slightly worse combined ratio to close out 2017—true—but a global reinsurance market that in early 2018 is performing well and stands ready to stabilize and secure the industry’s position.

To get a clear picture of how the property and casualty market will perform this year, we must consider several factors, geopolitical and technological, that are still very much in play. Here at home, tax reform will most surely have an impact on the market. If repatriation of offshore capital is realized, it is likely that capital expenditures, job growth and higher wages will translate into higher insurance premiums. Further, mergers and acquisitions will likely increase in size and value.

Across the pond, Brexit will change the way business has been done in the UK, and the resiliency of those businesses will determine how they conduct their business post-Brexit. It is Sentinel’s view that the insurance market in the UK and globally is well positioned to continue to innovate and offer protection.

And the eyes of the entire industry are on the InsurTechs—small, tech-driven insurance start-ups that promise to streamline the industry, but at what cost? The answer there may be collaboration, as a recent study revealed nearly half of the world’s largest insurance carriers to be planning InsurTech acquisitions in the next three years.

While there is much we do not know, there are some very important things we do know. Chief among them is this: the carrier base wants very much to lead the insurance industry in this current climate. Carriers have experienced several soft, sluggish years and are now looking to drive higher profitability and better loss ratios the easiest way they know how—by raising rates. It is Sentinel’s position that many, if not most, of the rate increases sought by carriers in 2018 will be unwarranted, save for a few problematic lines of coverage.

What carriers really need is more premium, and they may well get it without raising rates, thanks to continued economic growth in the U.S., the very real possibility of new markets opening up in China and around the world, and emerging innovations in the digital sector.

Amidst all the punditry and predictions about the 2018 insurance market lies a shift in strategy that is long overdue. Sentinel contends that the year ahead will be less about the transaction of insurance, and more about the tenets of good risk management, than ever before. This may sound like ‘pie in the sky thinking,’ but consider the relationship between growing volatility in the market and the increasingly reactive behavior of insureds with regard to emerging risks.

Consider, too, that carriers prefer to insure enterprises that are proactive and planful, and will factor in risk mitigation efforts to their calculation of rate structures and the determination of limits and exclusions. In other words, today’s insureds have much more control over their rates and policy structures than in years past. And while businesses could once rely on the work of their insurance broker to secure favorable rates and terms, today’s insureds require a more strategic partnership to navigate an increasingly complex array of risks and exposures.

Sentinel’s distinction is clear. We are risk advisors and consultants. Our team operates on a higher level to help
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clients marshal internal resources and optimize their risk profile. Sentinel understands that every successful business has inherent risks. Our elite team of risk professionals ensures that every risk you take on is worth its weight, and those that aren’t are mitigated in the smartest, savviest way possible.

Your Sentinel team has a bevy of risk management resources and tools aimed at putting our clients and partners in the driver’s seat of today’s risk and insurance marketplace.

Something as simple as cataloging the positive differentiators in your risk profile, for instance, can go a long way toward keeping your rates as low as possible while leveraging the best coverage, terms and limits.

2018 Insurance Market Highlights

- Despite catastrophic losses in the range of $150 billion, 2018 will continue to be a buyer’s market for most lines of P&C coverage.

- Carriers will look to increase premiums, though that won’t automatically translate to higher rates for commercial consumers.

- Rates will be stable with a probable spread of (-/+ 5 percent across most lines of coverage; depending largely on the insured’s risk profile and history.

- Auto rates will rise between 5-15 percent, driven by expensive new technologies and distracted drivers.

- Look for rates to drop slightly in mid-to-late 2018 if U.S. job growth and investment remains strong through the second quarter.

- The industry’s combined ratio (profitability measure) is worsening heading into 2018. The combined ratio for 2017 was 110 percent, compared to 100.7 in 2016, and 97.8 in 2015. Combined ratio is calculated by taking the sum of incurred losses and expenses, and dividing them by earned premium. Therefore, the lower the number, the better.

In the graph below, note that there have only been three true “hard markets” in the U.S. since 1971. Further, the data suggests a strong relationship between net premium growth and Nominal Gross Domestic Product (GDP).

![NET PREMIUM GROWTH (ALL P/C LINES) VS. NOMINAL GDP: ANNUAL CHANGE, 1971-2016](image-url)
• Cyber coverage will expand, rates will remain fairly stable, and carriers will consider a business’ cybersecurity plans and protocols in setting rates and terms.

• Look for blockchain technology (digital ledger of incorruptible data) to gradually gain traction in 2018, forcing insurance companies to rethink the way they do business and handle claims, in particular.

• Alternative forms of risk transfer are increasingly being adopted by insurers, especially to drive down the cost of high-risk property coverage.

2018 Emerging Trends

Business Interruption
For too long, one of the biggest threats facing U.S. businesses has not even been on their radar. That appears to be changing, as companies are waking up to the reality that a significant business interruption event is more a probability than a possibility. Around 80 percent of businesses in the U.S. this year will experience some level of business disruption, and half of them are not adequately insured against these losses. What’s more, the vast majority do not have business continuity plans in place to mitigate losses and get their operations back on line, should a disruption occur.

**FACTORS THAT INFLUENCE THE COST OF DATA BREACH**

Though you can’t prevent every single data breach from occurring, you can reduce your company’s chance of experiencing the costliest cyber events from disrupting and damaging your business. The following data, provided by the Ponemon Institute, looks at the top 20 factors that impact the per-capita cost of a data breach in the U.S. today. (Measured in US$.)

| INCIDENT RESPONSE TEAM | EXTENSIVE USE OF ENCRYPTION | EXTENSIVE USE OF DLP | BCM INVOLVEMENT | PARTICIPATION IN THREAT SHARING | USE OF SECURITY ANALYTICS | BCM INVOLVEMENT IN THREAT SHARING | USE OF SECURITY ANALYTICS | INSURANCE PROTECTION | CISO APPOINTED | BOARD-LEVEL INVOLVEMENT | CPO APPOINTED | PROVISION OF ID PROTECTION | CONSULTANTS ENGAGED | RUSH TO NOTIFY | LOST OR STOLEN DEVICES | EXTENSIVE USE OF MOBILE PLATFORMS | COMPLIANCE FAILURES | EXTENSIVE CLOUD MIGRATION | THIRD PARTY INVOLVEMENT |
|------------------------|-----------------------------|----------------------|-----------------|-------------------------------|--------------------------|-------------------------------|--------------------------|--------------------|----------------|------------------------|--------------|-----------------------------|---------------------|----------------|----------------------|-----------------------------|----------------|------------------------|
| **Difference from mean (US$)** |               |                     |                 |                               |                          |                               |                          |                    |               |                       |              |                             |                     |               |                      |                             |                |                        |                      |
| (25)                   | (20)          | (15)                | (10)            | (5)              | 0                         | 5                       | 10                        | 15                        | 20                  | 25           | Difference from mean (US$) | 19.3         | 16.1                        | 12.5                | 10.9           | 8.0                   | 6.8                        | 6.2             | 5.7                     | 5.4                        | 5.2             | 5.1                     | 2.9                        | 2.0             | 2.7                     | 5.5                        | 7.6             | 8.8                     | 11.2                        | 14.3           | 16.9                    | 20                      | 25             |

- Difference from mean (US$)
Whether it comes from a data breach, natural disaster, terrorism, civil unrest or other cause, the resulting loss of business income coupled with damage to your brand and reputation, can prove devastating. Business interruption insurance is the bridge that takes your company from the emergency response to the restoration phase. But don’t assume that the business interruption insurance your company has will cover every loss in every disruption scenario.

Let 2018 be the year that your company commits to better business continuity planning. Sit down with your Sentinel team to assess your readiness for a business disruption event. Make use of Sentinel’s business continuity toolkit and business income technical assistance. Our team will help you balance the cost and benefits of your efforts.

**Cyber**

After years of rising cyberattacks and escalating costs relative to data breach, progress in 2018 will stem from a shift in corporate culture toward cybersecurity as a business priority. Look for a surge in the hiring of senior-level IT professionals who will work to make data security a bottom line objective that over time becomes a seamless part of operational strategy and tactic. That’s the long view, anyway. In the near term, a shortage of highly-skilled cyber specialists will lead companies to outsource these positions.

Other cyber trends for 2018 include:

A growing number of small businesses (<$25 million in revenue) will purchase cyber liability coverage this year; somewhere in the range of 20-25 percent. That’s up from 15 percent in 2016.

With more than 70 carriers in the U.S. cyber insurance market currently, look for a continued softening of the market and an unusually competitive environment.

Look for increased regulation at the state and federal level to dictate how companies store and share data, further driving demand for in-house cyber specialists.

Expect a rise in the incidents of ransomware attacks, which will be increasingly sophisticated, costlier than ever before, and with potentially deadly consequences. The healthcare industry is bracing for extortion-enabled disruption of medical records and even personal medical devices, such as pacemakers.

Businesses that have been lulled into a false sense of security by cloud storage could very well experience a rude awakening this year. Analysts see a massive cloud data breach on the horizon for 2018. Something as simple as enabling two-factor authentication on cloud data platforms will prevent many, if not most, of these breaches.

Work with your Sentinel team to evaluate your insurance portfolio relative to your cyber exposures and coverage.

**Fidelity/Crime**

The rise in social engineering is precipitating a change in how fidelity/crime coverage is underwritten. It’s important to note that unendorsed policies often do not cover instances of fraud by means of impersonation. That is likely to change in 2018, as insurance carriers and brokers have meaningful discussion and debate around coverage terms, limits and exclusions.

A complicating factor with fidelity/crime coverage is that it blurs the line with cyber liability, so Sentinel advises clients to consider what will be lost in determining terms and limits for this line of insurance. If, for instance, a social engineering event is likely to lead to the loss of real property or monetary assets, the fidelity/crime policy should be written to cover those losses. Cyber policies, in general, should be reserved for financial losses resulting from lost data records, damage to the brand and reputation.

**Tips to Safeguard Your Success in 2018**

Cyber crime. Catastrophic storms. Business interruption on the rise and carriers that are bent on increasing your rates. In the end, navigating your company’s risks and exposures becomes more about what you can control, and less about what you can’t.

Sentinel’s advice is simple and strategic. Differentiate your company. Document your risk management planning and outputs. Work with your Sentinel team to start the insurance renewal process early. Sentinel will share best practices, making the renewal process easy, predictable, and easy to replicate annually.
Initiate clear and concise communications, so everyone who has a hand in the renewal process at your company is apprised of internal deadlines. Make it easy by providing context with regard to needed information and documentation. For instance, send each person a copy of their response from the previous year, if possible.

Help Sentinel show your underwriters that you have a thorough grasp of your risk profile and the exposures that we are asking them to cover. Doing so ensures that we are building more than just business with our carriers, but a partnership that will benefit your company in a myriad of ways.

Keep in mind that in today’s risk and insurance arena, insurers are using technology to increase efficiencies and screen for risks on your behalf. Make sure that these predictive modeling innovations don’t lead to someone else knowing more about your company than you do.

Consider how best to marshal predictive modeling applications being designed to predict risky employee behavior, such as distracted driving and social engineering. Though this technology may seem intrusive and carry particular human resource challenges, it may well give your company a competitive advantage and help avoid losses.

Lastly, thank you for the power and privilege of our partnership. No matter what 2018 brings in the way of risk, Sentinel will be here every day and every step of the way. Our greatest endeavor this year, and every year, is safeguarding your success.
2018 Forecast for Specific Lines of Insurance

**Property**
*Rates flat to low, single-digit increases*

Even with catastrophic losses of around $150 billion in 2017, the property market is in good shape. Capital is still abundant and there are plenty of insurers in the market, as well as alternative providers of capital. Competition among insurers will keep rate increases, in scenarios where an increase is unavoidable, fairly low. Properties that are exposed to catastrophic risk, on the other hand, will see rate increases in the range of 10-15 percent.

**Liability**
*Rates flat to low, single-digit increases*

The surplus of capacity in the casualty market should prevent substantial rate increases, but poor earnings in 2016-17 will lead some carriers to test their ability to inch rates up. The general liability line is the perfect place for carriers to test the waters, so to speak. Still, any rate increases should be less than 5 percent.

**Automobile**
*Rates flat for personal line consumers; increase of 3-8 percent for commercial fleets; 10 percent or more for high risk accounts*

Technology is changing the auto industry, with ramifications for vehicle safety, claims expense, liability judgements, and distracted driving fatalities, in particular. While new innovations promise to keep drivers from engaging in risky behavior behind the wheel, full-scale implementation is still a ways off. For now anyway, technology is still a big part of the problem, not just with regard to the devices that take drivers’ eyes and attention off the road, but also in the way of vehicle advancements that are costly to repair when damaged. Factor in the rising cost to settle fatality claims, and you have a market that in 2018 can justify rate increases across the board commercially.

**Workers’ Compensation**
*Rates flat to decreases of up to 5 percent in most states*

The workers’ comp market is increasingly unstable, largely due to rising medical costs, the opioid epidemic in America and its impact on workers’ compensation plans, and a regulatory environment that is poised—at least in a handful of states—to increase rates in response to mandated compensation limits.

**Umbrella**
*Rates flat to low, single-digit decreases*

Umbrella market rates are still fairly low, though not as low as they were going in to 2017. 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 is one of the most uncertain lines of coverage for 2018. Environmental regulations are changing under the current administration, but it remains to be seen what impact, if any, those changes will have to liability and insurance. AIG’s decision to pull out of the site pollution liability market in 2016 has generated competition and a softening of the market in general. The outlook for late 2018 and beyond will be influenced by Hurricane Harvey and Irma pollution and clean-up claims, as well as new pollution liability products now in development.

**Errors & Omissions**
*Rates flat to low, single-digit increases*

The professional liability line is looking to reinvent itself, spurred on by new problems (large-scale data breaches, in particular) and a long-standing issue with vendor liability and contractual risk transfer. Not that there will be much impact on rates in 2018; insureds can expect little to no increase in premium. But do expect to sit down with your broker and take a hard look at what you expect from your professional liability (errors & omissions) coverage with regard to cyber and vendor contracts. This is one line of coverage, in particular, that can be impacted by your company’s ability to show carriers that detailed risk mitigation efforts are in place.
Employment Practices Liability (EPLI)

Rates flat to low, single-digit increases for mid-size companies, small employers (<200 employees) could see rate increases of 5-10 percent

The changing political landscape in the U.S. is perhaps most evident in the EPLI market. Capacity remains strong, yet a cacophony of wage and hour disputes between state and federal government have led to significant volatility. Carriers are bracing for an uptick in EPLI claims in 2018, following a wave of social movements relative to sexual harassment, gender and wage disparities in the workplace. There is little doubt that companies will see an increasing share of charges, and are likely to turn to EPLI coverage for protection. Carriers are showing a willingness to increase their appetite and are now offering coverage with broader terms and greater flexibility in retention levels.

Cybersecurity

Low, single-digit increases for most renewals

A trend toward expansion and specialization of cyber coverage will ramp up in 2018, as businesses and carriers alike become savvier in how they define and mitigate losses stemming from data breach. Some carriers are developing lines exclusively for ransomware and social engineering, and we can expect to see new blended lines, particularly property and cyber. Though we’re learning how to prevent cyber losses more and more all the time, the cost of a data breach only continues to rise. The per-capita cost of each lost record in 2017 was $225; up from $217 in 2016. Insureds should consider increasing their limits, as data shows that the total cost of a breach can be up to 10 times higher than first revealed.

Crime & Fidelity and Fiduciary

Rates flat with modest reductions in the low, single digits

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 flat with modest reductions in the low, single digits

The medical malpractice market remains fairly stable, though 2017 brought a worsening combined ratio due to an increase in malpractice judgments last year. Still, capacity is high and competition is good, owed to the simple fact that medical practice consolidation leaves insurers with fewer doctors purchasing policies.

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 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.
Sentinel Risk Advisors is a premier risk management and insurance brokerage firm with a reputation for exceptional client experience. 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.

For more information, visit sentinelra.com