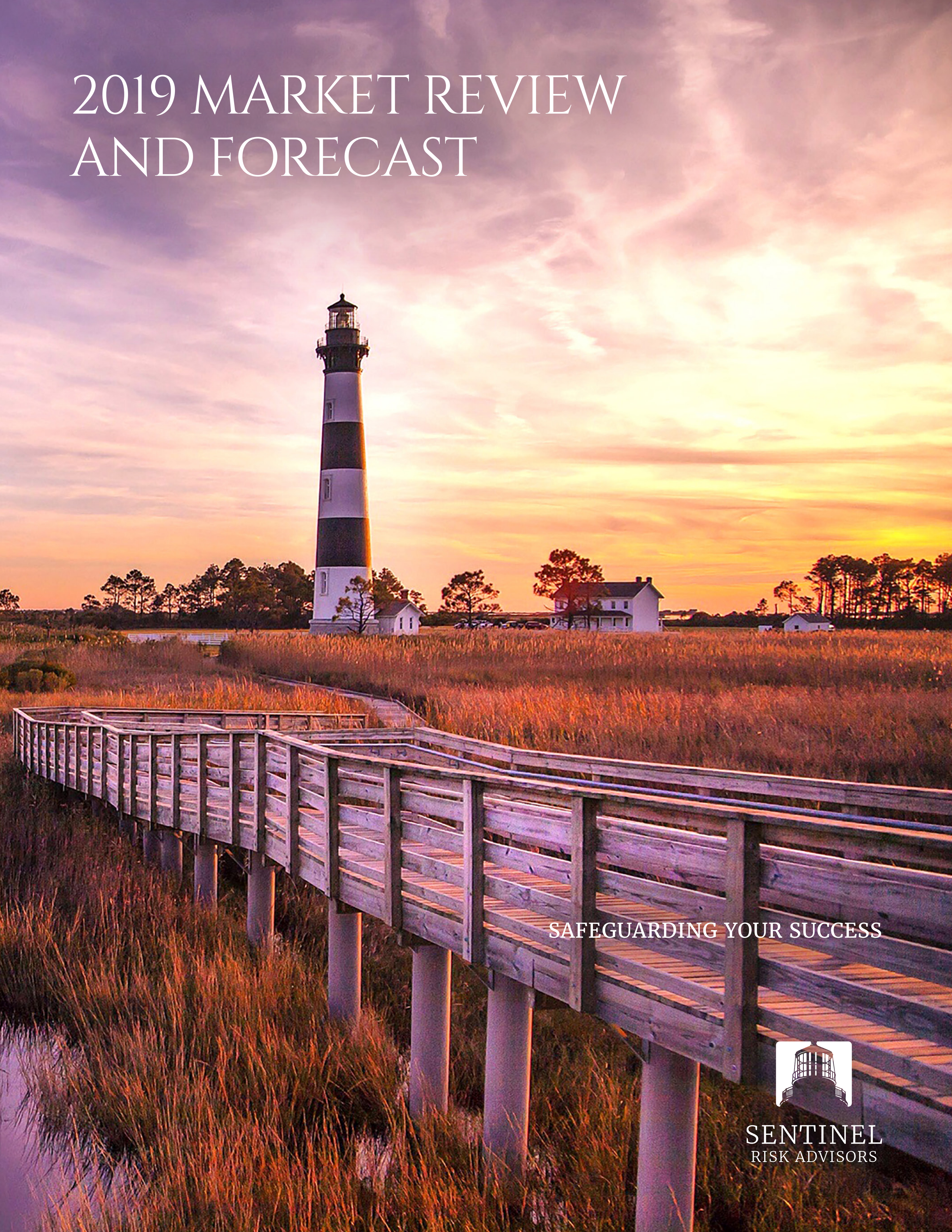
2019 MARKET REVIEW AND FORECAST



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Executive Summary

It's been said that in times of great change, the learners inherit the earth, while the learned find themselves well equipped to deal with a world that no longer exists. Traditionally, the insurance industry has relied on what it already knows as a predictor of how the market will perform in the future. But today's property and casualty market is much changed, and that change begs for a different view.

Sentinel's 2019 Insurance Market Review and Forecast reveals an industry grappling with an increasingly complex array of risks, uncertainty over integration of new technologies, a continual reshuffling of metaphorical chairs amid mergers and acquisitions, and a growing realization among carriers that they can no longer count on cyclical shifts in the market to deliver the net premium growth they need.

Change and uncertainty aside, the property and casualty market is profitable and well positioned heading into 2019. In fact, 2018 marks the first year that underwriters expect to turn a profit since 2015. A return to normal losses on the catastrophic front helped recoup some of the damage done by the monster storms of 2017, leading to an industry surplus that, as of this writing, is at an all-time high. Industry investors are happy, too, as favorable interest rates pushed an 8.3 percent return on statutory equity; the best rate of return in more than six years.

And we cannot understate the positive driver that is the U.S. economy at present. Slow and steady growth for several years running, coupled with low unemployment, higher construction costs, and a beefed up supply chain, has spurred gains in the property and casualty market from both sides; investment income and new net premiums. Across the pond, while the United Kingdom struggles to finalize a Brexit withdrawal deal, businesses across Europe are learning the value of adaptation—a lesson the U.S. property and casualty market would do well to emulate.

We'll take a closer look at the state and status of the insurance market, but first, an answer to the question on everyone's mind: What will happen to commercial insurance rates in 2019? Carriers and learned industry analysts tell us to expect modest increases for most primary lines of coverage. But here, too, Sentinel takes a different view. In fact, there are just three lines of coverage that Sentinel is watching closely for all-but-certain rate increases—auto, property with catastrophic exposure, and employment practices liability (EPLI).

If you are wondering which version of the rate increase prediction holds water, the answer depends on who you entrust to hold the cup. Make no mistake—every insurer will talk about across-the-board rate increases in 2019. Remember, they need more premium, and the best, easiest way to grow net premiums is by raising rates. Consider, too, that an industry seeking to increase its profitability in order to attract investors and adapt to new technologies and emerging risks is not the villain of this story.

Regardless of who and what you choose to believe, ultimately, the price and value of your insurance program in 2019 will depend on how much credence you give the following statement.

The year ahead will be less about the transaction of insurance, and more about the tenants of good risk management.

Those words were true when Sentinel first proclaimed them in 2017, and even more so today. The industry has gradually shifted its focus from a reliance on insurance products, to risk management strategy and service. Navigating today's risks and exposures requires a consultancy approach from an advisor with the acumen to manage and mitigate the risks you face today, while affecting positive change over time as an extension of your team.

Gone are the days when all your company required of an insurance broker was someone to do just that—broker the lowest rate on your insurance policies with carriers. To be clear, rates are still important in this evolving marketplace, but are a tactical part of a larger play, and not the end game.

Brokers today are competing for your business on the basis of what makes them different; the depth of intellectual capital, the complexity of strategy, the value added solutions, the superiority of service—these are the new commodities for sale.

The face of today's risk and insurance marketplace is changing, too—quite literally. While the industry still does business based on relationships, a team-based approach is replacing the traditional single point-of-contact broker. Service teams, made up of specialists with expertise in key areas, are capable of delivering high touch, customized solutions in a way that no traditional broker relationship ever could.

Still, vast discrepancies persist in the risk and insurance arena on the broker/agency side, making it difficult for insureds to comparison shop amidst wildly different service platforms. That will change as the industry continues to evolve with a preference for strategy over transaction, but in the meantime, separating the good from the not-so-good is not terribly difficult. It starts with asking key questions that, for premier level advisors, are a matter of course.

What is the single biggest risk facing my business today?

What plan of action are you currently executing to maximize results relative to those significant risks?

What emerging risks are you monitoring, and how will my risk and insurance program adapt to meet those risks?

Describe how a focus on loss prevention and mitigation factors into the risk management strategy.

Do you embrace the total cost of risk as an analysis and benchmarking tool? If so, how?

How do you employ enterprise risk management as a comprehensive strategy?

Do you utilize alterative risk financing strategies, and if so, how?

An advisor who responds with reluctance, gives short shrift to the answers, can't or won't answer at all, is likely not well positioned to navigate the increasingly complex array of risks facing middle market companies.

Remember, too, that in the underwriting process, the risk advisor and broker is the only thing standing between your company and uncovered losses, insufficient limits, and poorly constructed policies that, often in the fine print, carry coverage-limiting endorsements and exclusions.

It may take years for those weaknesses in your risk and insurance program to come to light. But sooner or later, they will. And the cost could well be more than you can pay. In the meantime, gaps in coverage, policies that overlap, and outdated terms and conditions leave you overpaying and overly exposed. In the midst of all the change and disruption facing the insurance market in 2019, the evolving role of commercial brokerage firms is among the most positive and powerful. Just as success in business increasingly depends on the ability to adapt quickly and efficiently to changes in the global economy and marketplace, adaptation will determine which risk advisory firms survive and thrive amid ongoing industry consolidation.

Insureds can and should expect more of their risk advisor in 2019: more time, more strategy, more expertise. Brokers who compete on service, rate and relationship alone will come up short, losing favor to risk consultants with the teeth to give insureds what they need most—a true partnership with the depth of field and scope of service to create a true competitive advantage.

2019 Insurance Market Highlights

2019 will be a buyer's market across most lines of coverage. Insurers will push for modest rate increases in the 5 percent range, while Sentinel sees a much flatter rate structure for all but three lines of coverage: auto, employment practices liability, and property with catastrophic exposures.

The P&C industry's combined ratio (profitability measure) improved in 2018 to end the year better, it would seem, than last year. The combined rate sat at a healthy 96.4 midway through 2018; the most recent quarter for which data is available. Comparatively, the combined ratio was 101 at the end of 2017. Any number under 100 indicates a net underwriting profit.

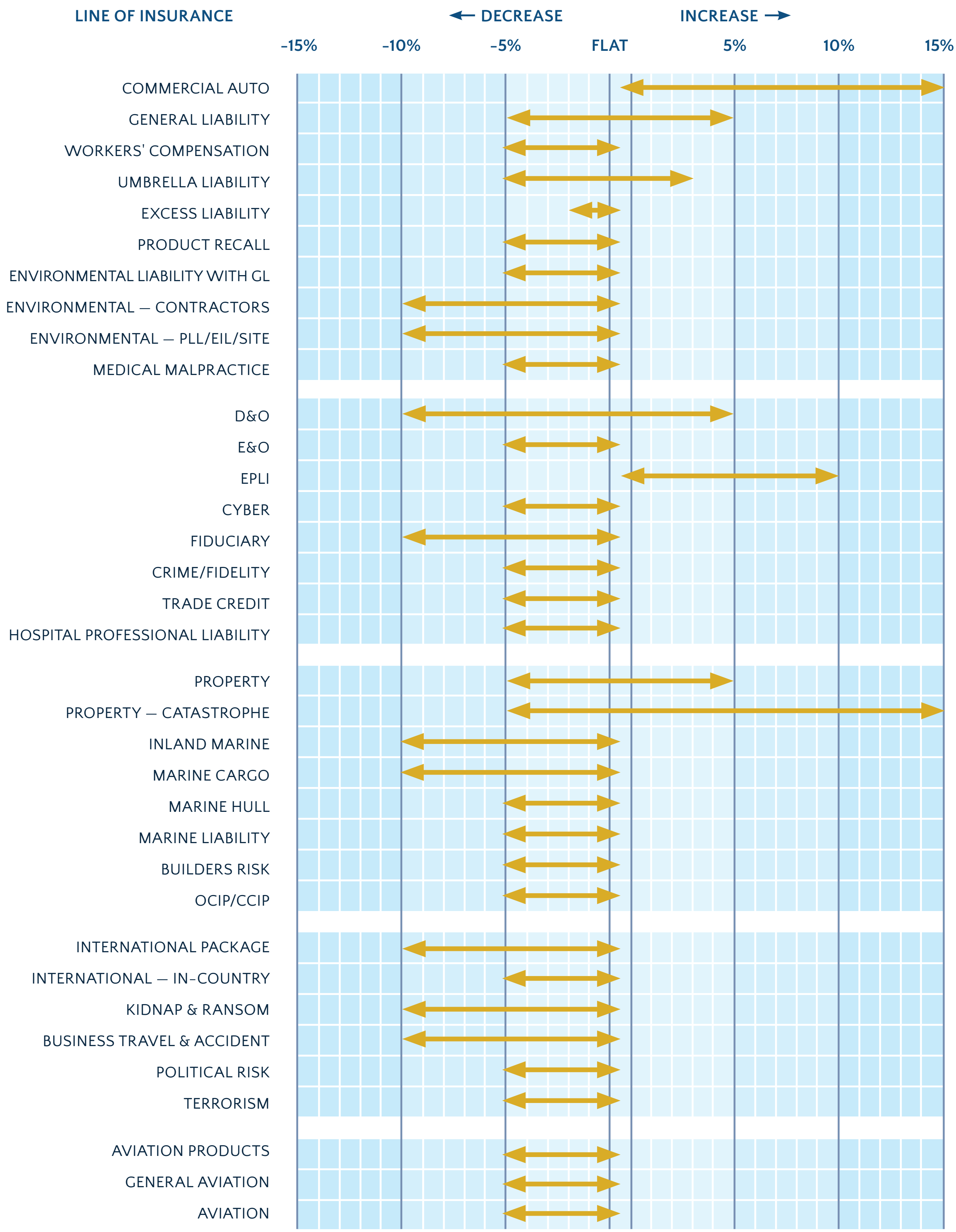
The U.S. property and casualty market, currently a $35 billion industry, enjoyed one of its best years in recent history to end 2018 flush with surplus, buffeted by a $6 billion gain in underwriting performance and a 15 percent improvement in net investment income.

Expect mergers and acquisitions to ramp up through 2020, further disrupting an industry in a perpetual state of flux. While mega mergers have tightened global markets and led to greater efficiencies and new product lines, industry consolidation on the regional level could well mean fewer brokers, less competition and a shortage of options for insureds.

Look for a more willing insurance industry to embrace new technologies and digital products in 2019 as a means of keeping up with regulatory changes, demands for transparency and greater efficiency, and to keep insureds happy and where they've indicated they want to be—in the driver's seat.

Blockchain technology, a digital public ledger recording transactions across multiple computers, will continue to

2019 RATE FORECAST



emerge and be integrated into the property and casualty space. This comes amid new regulations requiring source data to origination that promise to go deeper than first realized.

The predicted rush of InsurTech acquisitions hasn't exactly come to pass, but is taking shape in both the personal and commercial space. What that will mean for insurers is the development of automated product and service lines for small and middle-market companies via digital and mobile applications.

Cyber will continue to lead risk management discussions through 2020 and beyond, and even though there isn't as much new to say about cyber as you might think, Sentinel will keep data security a top priority in every client engagement of 2019. The truth about cyber is that the emerging, high-tech threats that grab headlines and beg for attention aren't nearly as scary as the fact that the average business in the U.S. is still not prepared to ward off the most common, and costly data breaches.

The increasing use of robots in the workplace poses an altogether different dilemma, as insurers grapple with the far-reaching implications of developing a product that crosses multiple lines of coverage, including cyber.

2019 Emerging Trends for Specialty Lines

Employment Practices Liability Insurance (EPLI)

Among the non-standard lines of coverage, employment practices liability is undoubtedly under the most pressure headed into 2019. Skyrocketing lawsuits, unprecedented media attention, scrutiny from underwriters and claims processors—2018 was a chaotic year for EPLI, 2019 shows no signs of slowing down, and the bad news for businesses is that they are more likely to be sued by an employee for harassment, retaliation or wage disparities than ever before.

In the past, EPLI claims tended to follow economic trends, but today, this emotional and culturally driven product is struggling to keep up with rapid fire changes in employment and anti-discrimination laws. Insurers are worried that the increased attention on harassment claims will increase frequency and severity of other employment practices related claims; a valid concern given that employees today are more aware of their rights and more confident to exercise them than ever before.

One year into the #metoo movement, the Equal Employment Opportunity Commission (EEOC) is reporting a substantial increase in the number of lawsuits by employees claiming sexual harassment in the workplace. Add to this the heightened legal environment for pay equity in many states, and you have underwriters asking tough questions, carriers eager to write more business, and investors looking to reap the benefits of an upcoming rate increase of around five percent with higher retentions for middle market companies.

To be clear, businesses of every size should have employment practices liability insurance. Even before the #metoo movement, EPLI was a highly recommended line of coverage if for no other reason than the high cost of defending these cases in court. But considering that judgements are most often for the plaintiff, you might assume that EPLI is an easy argument to make for risk managers and advisors. It is not. Only one-third of U.S. businesses with more than 500 employees are currently protected by employment liability insurance.

It's important to note that EPLI protects your business against accusations made by employees of wrongful termination, discrimination, harassment and other employment related issues. That's significant, because an accusation does not have to be well founded to cost your company thousands upon thousands in legal fees.

And because even the most well-intentioned employers can fall short on compliance in light of ever-evolving human resource rules and regulations, the built-in technical assistance included on most EPLI policies is an important value-add for small and mid-size businesses.

Sentinel expects insurers to reshape certain coverage-related policies and claims handling in 2019 as part of a national effort to discourage the silencing of sexual harassment claims. Some states are enacting legislation that will prevent confidential settlements, while the federal Tax Cuts and Jobs Act does its part by eliminating the tax deduction for sexual harassment or sexual abuse settlements, including attorney's fees related to such payment, if subject to a confidentiality agreement.

Underwriters have their work cut out for them across the board this year. Wage and hour provisions must be redrafted in response to a slew of recent claims brought by unpaid interns, underscoring the need for proper classification of employees. Discrimination provisions must be written broadly enough to offer protection from claims brought by LGBT employees, all while the EEOC and the Trump Administration do battle over whether or not LGBT workers are covered by current discrimination laws.

And the legalization of marijuana for medicinal and recreational purposes poses a different set of challenges for EPLI underwriters, as the industry races to develop coverages that protect employees and employers alike. Many employers in or near states where marijuana has been legalized are dropping marijuana from drug-test panels, yet anti-discrimination provisions are not yet in place. This area of the law is moving quickly, but perhaps not quickly enough.

It's worth noting that purchasing employment practices liability insurance alone will not reduce your company's risk of being sued by an employee. There is no substitute for managing and mitigating your risk with up-to-date human resource policies, adhering to laws that govern the treatment of employees, acknowledging your responsibilities as an employer, and creating a workplace culture that values each employee as a respected individual.

Yet, the truth of the matter is that you can do all of that and more, and you are still likely to be sued by an employee someday. What if someday is today? Are you prepared to defend your company, employees, and stakeholders from the threat of a costly lawsuit? Employment practices liability insurance will not keep you out of court, but it will keep you in business.

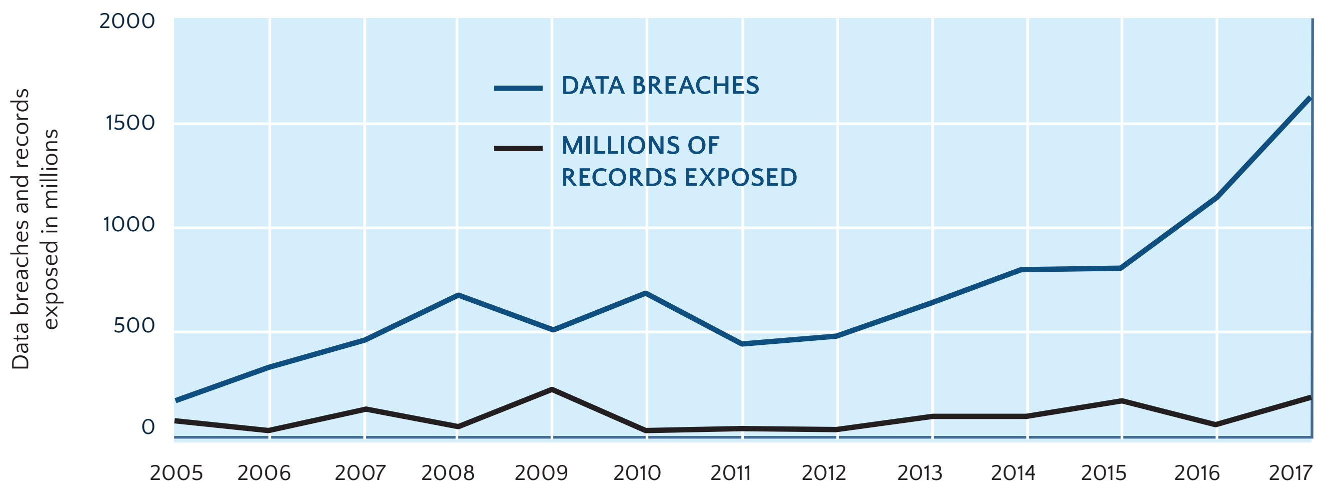
Talk to your Sentinel advisor to learn more about your company's risks and exposures relative to employment liability. Your Sentinel team will keep you ahead of changes in employment law, and help implement mitigation tactics to keep lawsuits and losses to a minimum.

Cyber

Everyone, it seems, is getting what they want on cyber. Insureds are getting on board with cyber insurance, thanks in part to competitive pricing, as the rate of new policies jumped significantly in 2018. Insurers are getting more premium, as the global market nears the $10 billion mark. Investors are getting a solid rate of return, fed in part by a steady increase in capacity. And cyber criminals are getting more sophisticated about how they deploy ransomware and cyber extortion attacks.

Cyber remains the most hot button topic in the risk management industry, with good reason. Nearly every enterprise in the U.S. today carries some risk relative to data security. Essentially, any business that stores employee information, customer data, or utilizes computers in its operation, is vulnerable to a cyber attack, or the loss of records

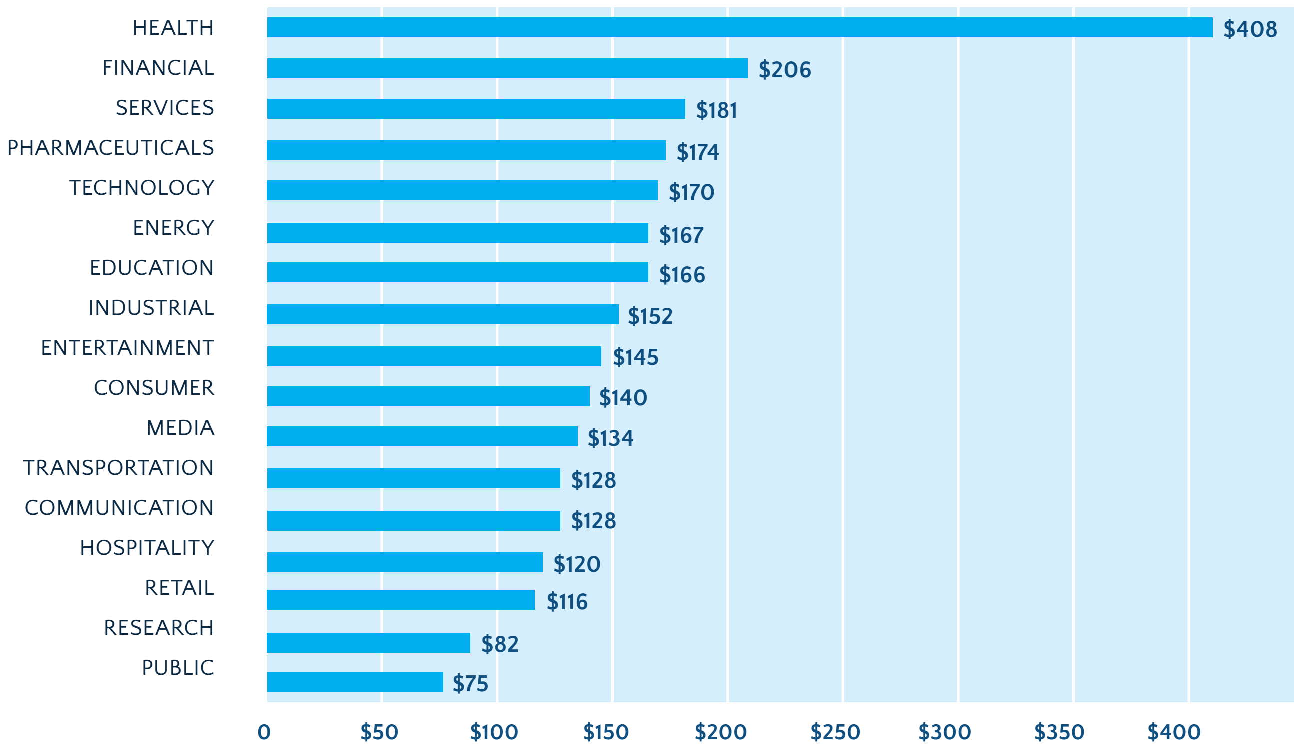
ANNUAL NUMBER OF DATA BREACHES AND EXPOSED RECORDS IN THE UNITED STATES FROM 2005 TO 2017 (in millions)



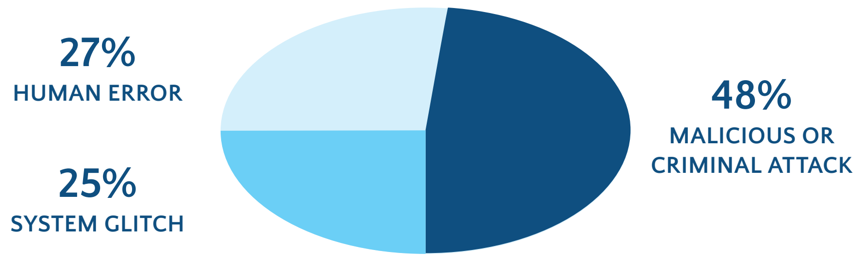
Sources: Identity Theft Resource Center; CyberScout © Statista 2018 Additional information: United States; Identity Theft Resource Center; CyberScout; 2005 to 2017

Are we winning the battle but losing the war on cybersecurity? That's a valid question upon review of the current statistics on the number, cost and cause of data breaches in the United States annually. Nearly 179 million records were exposed last year. Of those, slightly more than half were caused by human error or a technology related failure. Yet, the number of malicious threats is on the rise, as well. Businesses are taking cybersecurity threats more seriously, shoring up data infrastructure, implementing cyber protocols and purchasing cyber policies. The result? A nearly 10 percent drop in the overall cost of the average data breach, alongside a 2 percent rise in the average size of each breach. In short: the average U.S. business is losing more records than ever, most often by employee or system error, but is paying slightly less for each record lost.

COST OF DATA BREACH BY INDUSTRY (in millions)



DISTRIBUTION OF THE BENCHMARK SAMPLE BY ROOT CAUSE OF THE DATA BREACH



in a data breach. The former gets most of the attention, whereas the latter is more likely to occur.

Cyber insurance is more affordable, more readily available, and increasingly, more specialized as we head into 2019. The coverage continues to evolve in new and creative ways, as carriers compete to build their brand around the more complex risks, and underwriters address gaps in coverage and losses to a business' brand and reputation following a cyber incident.

Business interruption, as well as contingent business interruption, are primary areas where coverage has grown, as companies are becoming more and more dependent on third party vendors. It is crucial that businesses are adequately reviewing third party contracts, as there is a common misconception that if a business pays for a service, it is protected by the vendor in the event of a breach. This is often not the case and one of the many reasons businesses should purchase their own coverage.

Additionally, many carriers are adding reputational harm coverage to their policies. The industry now has data to substantiate the devastating impact of the loss of consumer confidence after a data breach has occurred, opening the door to an expansion in coverage for qualified claims. Because this area is a new one, the limits and coverage afforded can vary from carrier to carrier, and it is important to assess your risks and know what your policy covers.

Look for 2019 to bring other changes, including new, blended policies that combine cyber and property coverages together in one policy as a means of bridging coverage gaps. The industry is calling for modest rate increases in the 2-5 percent range, but Sentinel sees a continued flattening in this line of coverage for 2019.

As coverage continues to evolve in the cyber space, it is important to be reviewing your coverage at least on an annual basis and making sure that you have the latest enhancements added to your policy. Many carriers also now offer a la carte policies, so insureds may have the ability to pick and choose what coverages are most important to them, adding further value to an already competitive line of coverage.

Crime

The hot button topic in crime coverage remains money transfers involving fraudulent emails. Insurers pushed back in 2018, denying claim after claim amid ongoing debate over liability. This led to an uptick in lawsuits filed against insurance carriers, with insureds prevailing in many of these cases. Many of the denied claims could have been avoided if, quite frankly, the risk advisor and broker had done a better job reviewing the fine print of their client policies.

Most carriers continue to sublimit this coverage on crime forms, but in some cases, higher limits can be found through cyber liability policies. Both policies should be reviewed for coverage to make sure the insured is adequately protected. Most importantly, businesses must be practicing what they preach. Policies for voice verification prior to wire transfers should be in place and strictly enforced.

Directors & Officers (D&O)

Underwriting disciplines will be stepped up in the D&O line, considerably for some, as insurers look to an insured's financial stability in 2019 to determine everything from rates, coverages, limits and retentions. Other trends of note relative to D&O coverage include an uptick in the purchase of standalone Side A coverage, and limited capacity for publically held companies and IPOs, in light of a damaging Supreme Court case.

The D&O policy is threefold. Side A provides coverage for the individual directors and officers in the event the corporate entity does not or cannot indemnify them. Side B reimburses the corporate entity when they provide indemnification to the directors and officers. Side C provides coverage for the entity itself should it be brought into an executive liability suit.

Separate standalone Side A policies may be purchased for many reasons, but most often as a means of providing excess limits, in the event the limits under the primary form are exhausted, and as a failsafe, in the event that an exclusion or other coverage restriction applies. These policies can provide a great deal of peace of mind to those serving on the board and executive roles, and they can also be beneficial in attracting key talent for the organization.

Errors & Omissions (E&O)

The professional liability line is finally ready to address long-standing issues around deployment of technical services and related liability, policies that overlap with cyber coverages, and contractual risk transfer. Expect a fairly flat rate structure for 2019, with increases reserved for businesses with unstructured cyber risks.

Do plan to sit down with your risk advisor 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.

2019 Forecast for Specific Lines of Insurance

Property

Rates flat to low, single-digit increases

The predicted hardening of the property market after sustaining nearly $145 billion in catastrophic losses in 2017 never came to pass, offering an important lesson on the value of alternative capacity that has some analysts questioning long-held beliefs around the cyclical nature of the insurance industry. In a soft market cycle, the industry had come to count on natural disasters to help initiate the swing back toward a seller's market. But as the worst year for natural disasters in recent history was not enough to put insurance sellers back in the driver's seat, we can expect insurers to find new and creative ways to get the premium they need in 2019.

Automobile

Increases of 5-15 percent for commercial fleets; in addition to a state authorized 7.86 auto recoupment surcharge in North Carolina

Perhaps the only thing worse than the steep rise in commercial auto rates these last few years, is the headache of trying to maintain a fleet safety program amid an ever-changing, highly volatile auto industry. Technology promised to make risky driving behaviors less so, but full-scale implementation is still being realized.

Meanwhile, North Carolina companies face one whopper of a rate increase in 2019—more than 22 percent for some. Of that, 7.86 percent is an auto recoupment surcharge authorized by the state to replenish the uninsured motorist pool. It remains to be seen whether the recoupment will continue every year, or be phased out once the pool is replenished.

In this current environment, it is crucial for companies with commercial fleets to have comprehensive, strategic driver safety programs in place to help offset rising costs. Sentinel will focus on risk management strategies for commercial auto in the mid-year insurance update.

Environmental

Rates to remain stable; some reductions of up to 10 percent

Sentinel called the environmental line one of the most uncertain and unsettled lines of coverage at the start of 2018. It's a year later, but not much has changed. From the outside looking in, the environmental line appears to have hardened slightly since mid-2017. Carriers are moving away from environmental lines they deem problematic, tightening competition among the carriers who remain.

Mergers and acquisitions will drive one of the most significant changes in 2019: claims handling. Carriers are bracing for complaints and possibly even lawsuits in cases where the claim protocols of acquired brokerages are scrapped in favor of the acquiring broker.

International

Rates flat to decreases of 10 percent

Regulation and compliance will drive much of the new activity in the international line in 2019, and while rates are even better this year than were in 2018, the carriers who dominate the international space will not automatically lower rates. Other factors are far more important in a global insurance program, particularly service capabilities, communication, transparency and, above all, responsiveness.

Businesses are becoming more intentional about the structuring of their global insurance programs, as an increasingly global economy makes international travel less of an anomaly for many American workers. Employers are conscious about attending to the many details that go into ensuring the safety and well-being of their employees who travel abroad. Thus, we are likely to see an uptick in kidnap and ransom coverage in 2019, as well as a more consumer friendly approach to the basic tenets of international coverage.

Claims activity is up in the international space, not so much with regard to the number of claims filed, but the complexity of losses being experienced. Look for risk advisors to meet complex scenarios with alternative risk structures and captives.

Surety

It's hard to remember a better time for the surety industry than the present. Increased capacity, reduced rates, better underwriting conditions, improved loss ratios and mergers that have consolidated the surety market without hardening it, make the bond forecast practically rosy going in to 2019.

Over time, the mergers and acquisitions of 2017-18 will have an impact on regional markets through the reduction in brokers. In other words, the outlook for Q3 2019 may not be quite so positive, but any competitive changes should be offset by emerging markets and opportunities created by improved bond ratings and performance.

Workers' Compensation

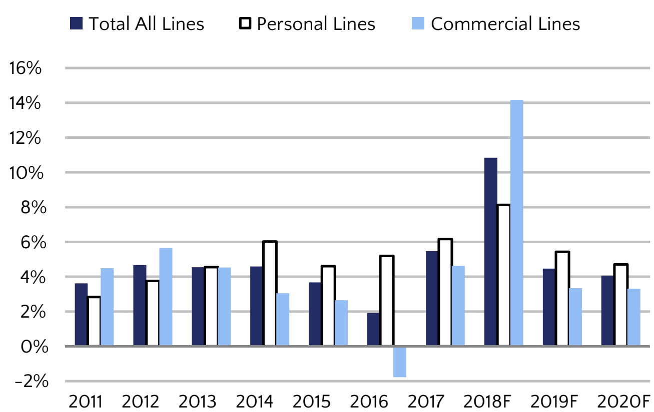
Rates flat to decreases of up to 5 percent in most states

North Carolina is one of many states to cut workers' compensation rates headed into 2019; the result of fewer and less severe claims for several years running. To be clear, rising medical costs and the opioid epidemic continue to pose long-term challenges for employers and carriers alike, but continued low unemployment and a more safety conscious business community are driving industry innovations and keeping a lid on rates. North Carolina's Industrial Commission credits workers' compensation reforms in 2014 with cutting costs and improving workplace safety.

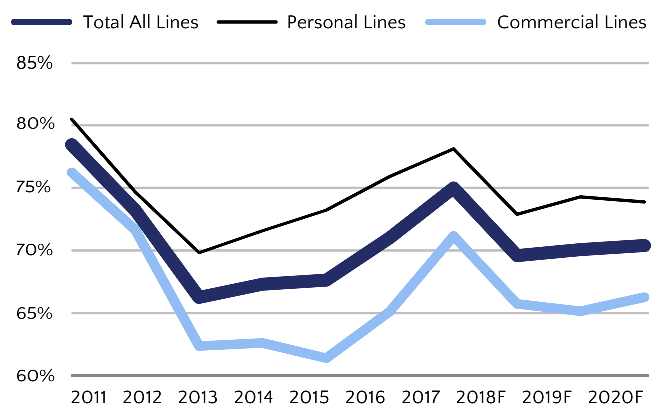
HISTORICAL RESULTS AND PROJECTIONS

Total All Lines, Personal Lines, Commercial Lines

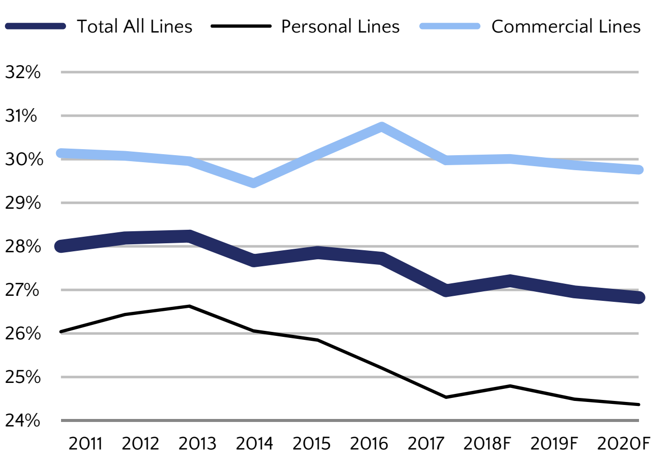
% Change in Net Premiums Written



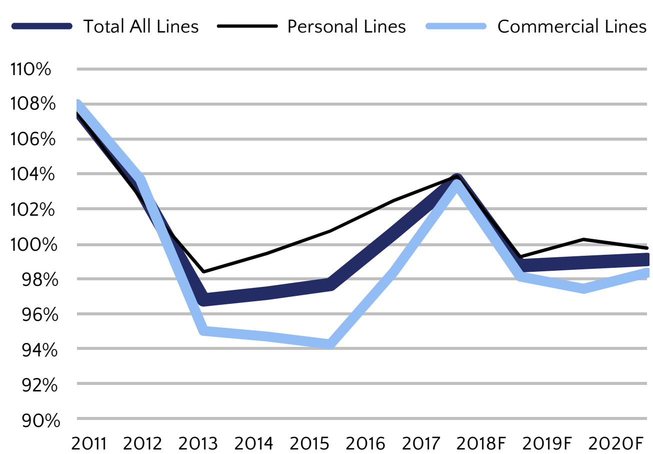
Incurred Loss Ratio



Underwriting Expense Ratio



Combined Ratio



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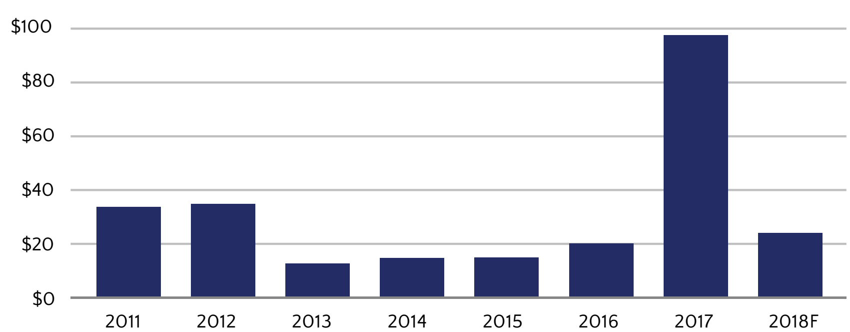
In the graphs above, the outlook for property and casualty premiums is for moderate growth, a return to underwriting profitability (combined ratio <100), and continued growth in investment income.

In the graph at right, insurance models predict a slightly better than average year for catastrophes in 2019, coming off 2017's history making year.

INSURED CATASTROPHES BY YEAR (Direct)

$ in billions



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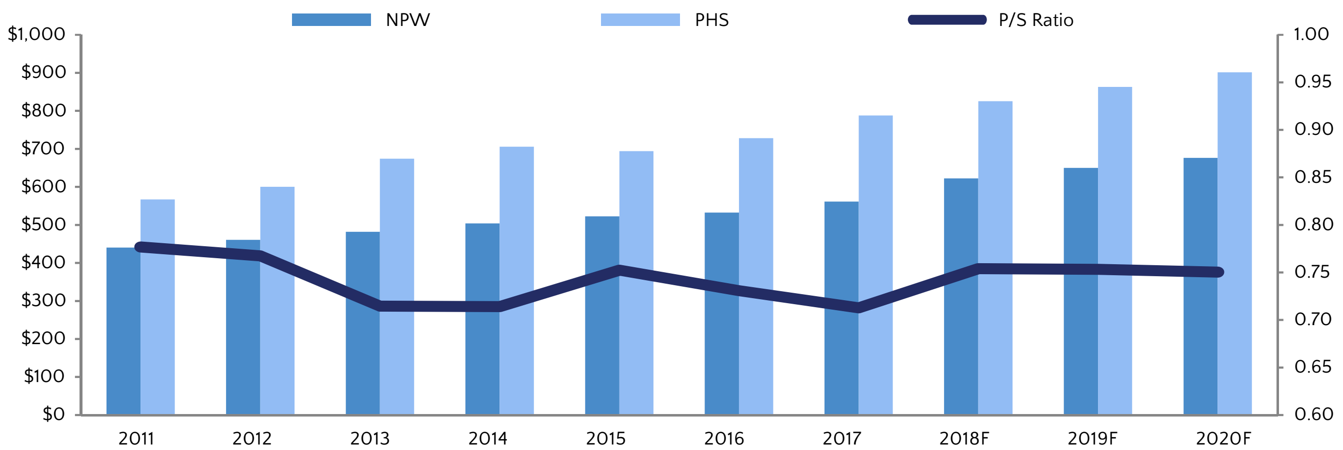
NET PREMIUMS WRITTEN TO POLICYHOLDER SURPLUS

$ in billions



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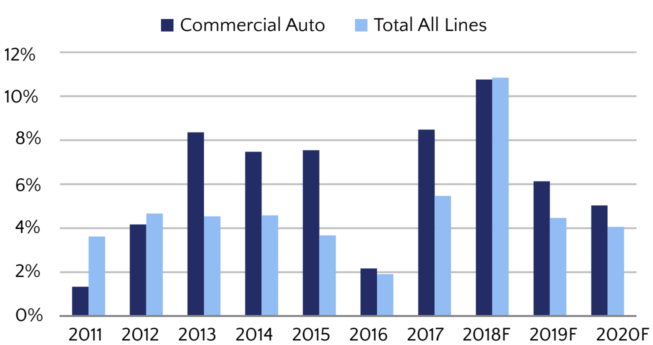
Above: The insurance industry is expected to have more operating leverage in 2019, the result of federal tax changes and the relative impact on the ratio of premiums to surplus.

Below: Premium growth in commercial auto is primarily driven by rate increases and a growing economy, particularly in auto-dependent industries, such as construction.

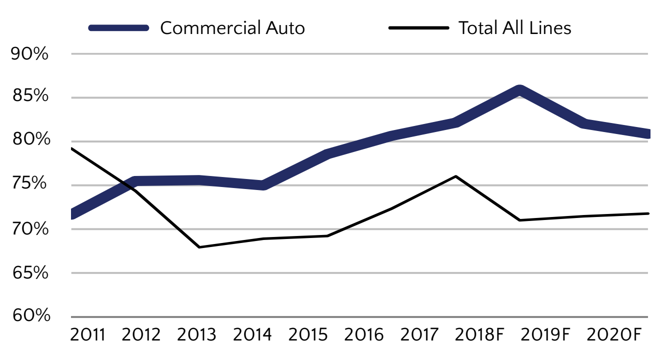
HISTORICAL RESULTS AND PROJECTIONS

Commercial Auto vs. Total All Lines

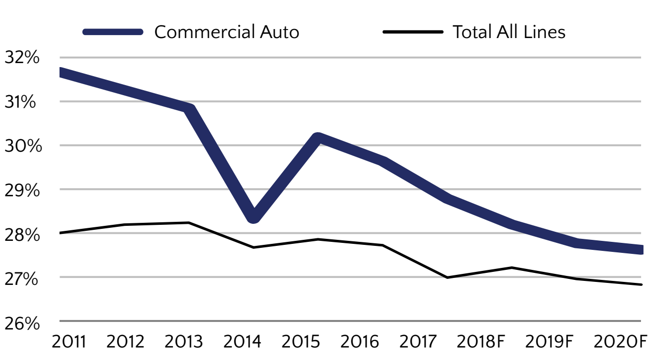
% Change in Net Premiums Written



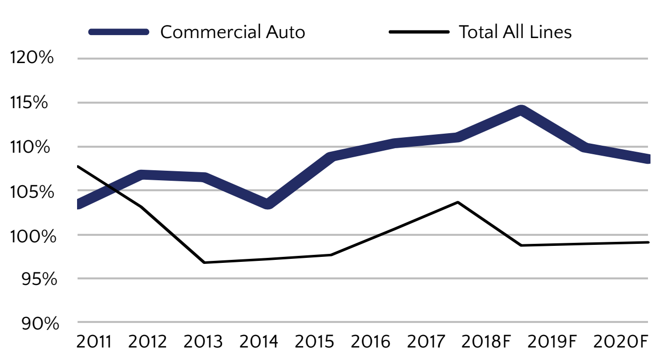
Incurred Loss Ratio



Underwriting Expense Ratio



Combined Ratio



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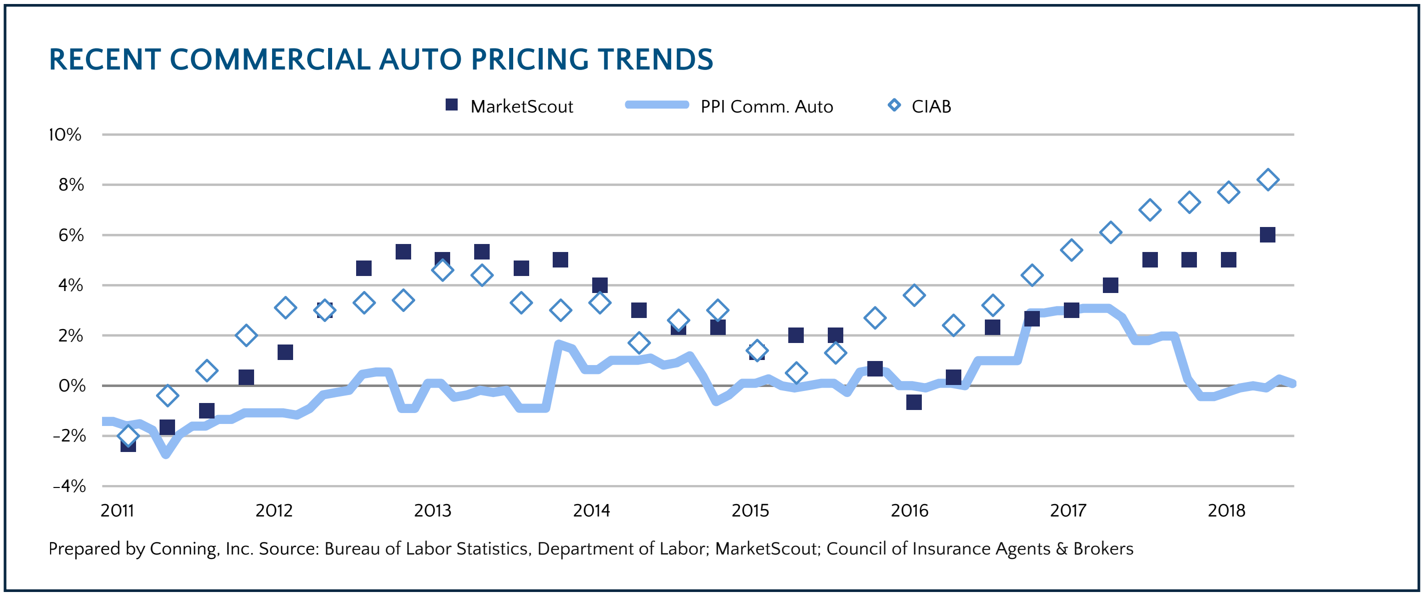
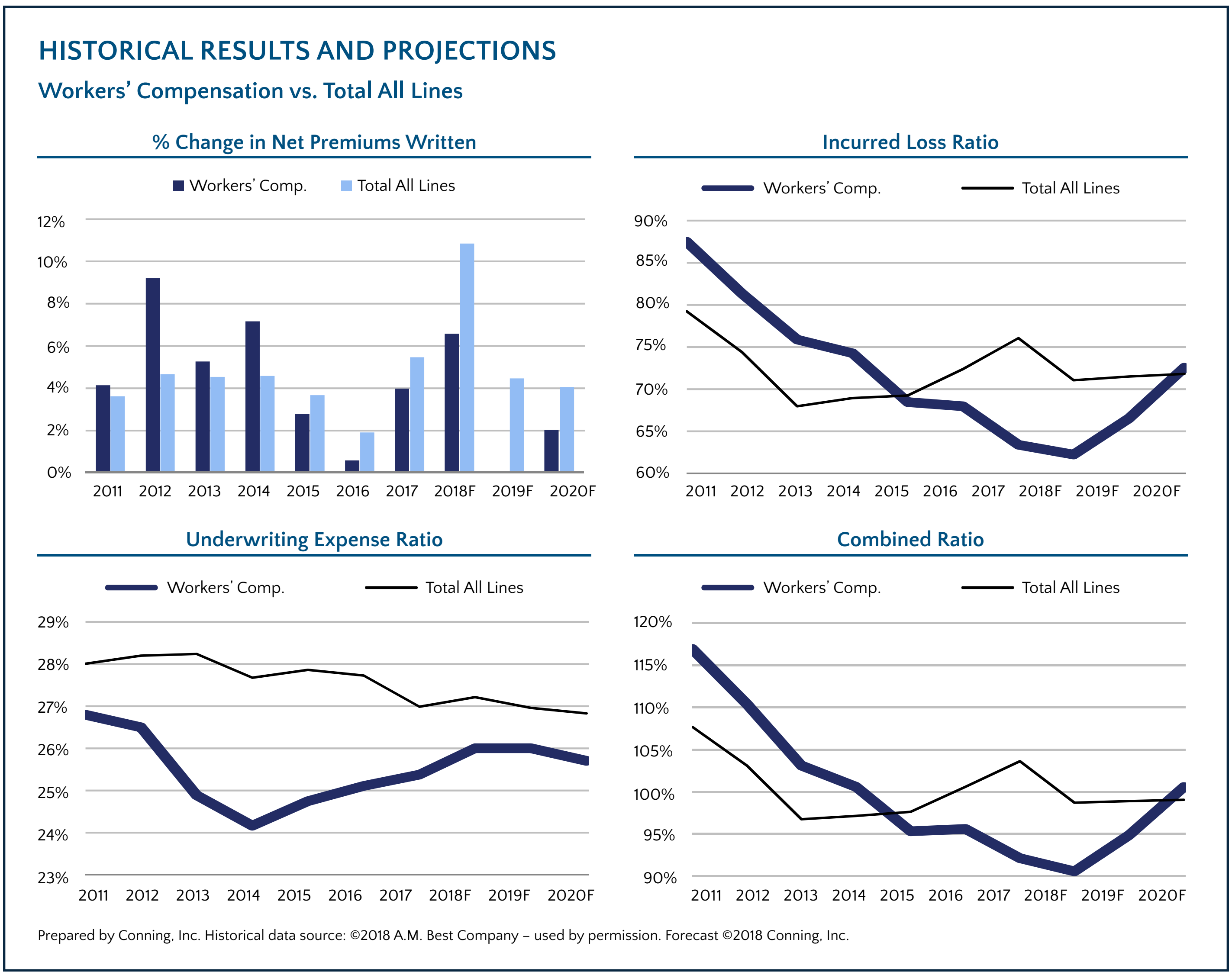


Above: Conning expects commercial auto exposures to rise by low single digits in 2018-2020 for both liability and physical damage.

Below: The outlook for premium growth in workers' compensation is for flat growth of direct new premiums written, but expect a stronger showing for net premiums tied to economic growth and tax reform.

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