



2018

Insurance Market Outlook
Insights from our national practice leaders

THE USI  NE ADVANTAGE®



TABLE OF CONTENTS

03	Executive summary
06	2018 Market Outlook premium trends forecast
07	Property
09	Casualty–liability
11	Workers’ compensation
13	International
15	Environmental
17	Aviation
19	Public company directors’ and officers’ liability
21	Fiduciary liability
22	Private/non-profit management liability
23	Employment practices liability
24	Crime
25	Medical malpractice
27	Kidnap, ransom and extortion
29	Representations and warranties
30	Technology and professional errors and omissions
31	Network security and privacy risk (cyber)
32	Commercial surety
33	Contract surety
35	Commercial construction project risk

CONTRIBUTING WRITERS

Doug O’Brien
Steve Zimmer
David Karr
John Scales
Glynis Priester
Beverly Fant
Higgins Manker
Barbara Gubitose
Liz Olsson
Debbie Hughes
Jill Boehler
Tom Heim
Nicole Brown
Tim O’Connor
Dena Cusick
Kathleen Mitchell
Bill Maroney
Jamie Pincus



EXECUTIVE SUMMARY

As predicted in last year's Insurance Market Outlook, calendar year 2017 through November 1, 2017 was mostly a buyers' market for both property and casualty commercial insurance and affiliated lines. A majority of insureds experienced rate decreases across a broad range of coverage offerings, with a few coverage line exceptions. Abundant market capacity and healthy competition for new business helped maintain or drive prices down—despite an environment of marginally increasing treasury yields.

The summer and early fall of 2017 saw record loss activity resulting from unprecedented windstorm and flooding events (arising out of Hurricanes Harvey, Irma and Maria)—with estimated total losses for commercial lines ranging from \$85 billion to \$100 billion. Combined with a number of additional losses from wildfires, hail, and tornadoes, the market is now in a situation where losses and expenses are outpacing premium growth for many insurers and reinsurers. As a result, it appears that insurers will attempt to push through higher pricing in property and affiliated lines. The question is: How long will this persist before capital sitting on the sidelines is deployed to win new business and thereby begin to reduce or stabilize rates? And, will the impact of property losses bleed over to casualty and other lines of insurance?

At this time, we believe that the loss results of 2017 will mostly be a short-term earnings event compared to a more meaningful capital erosion event. Industry surplus reached an all-time high in mid- 2017, exceeding \$700 billion. While this surplus will be reduced significantly from these loss results, there is still ample existing capital that can be deployed into the market, including capital from players not impacted by catastrophic events.

Nevertheless, the effect on earnings—coupled with multiple years of annual rate decreases—means thin profit margins for many carriers. Combined with a slowdown in reserve releases, this will certainly lead underwriters to seek property rate increases overall and they will employ more selective underwriting for property-related lines. More conservative terms

and conditions across the board can be expected. Many property markets will obtain rate increases in the short to intermediate term, notably for catastrophe-prone areas, but sustaining the magnitude of these increases will be a challenge as the year progresses (barring any future property losses of significance).

Some markets will attempt to apply rate increases beyond the property market and into other lines such as casualty. According to one insurance company executive, the lack of major catastrophic events in the years prior to 2017 may have masked some of the profitability challenges markets faced with most casualty lines, and the effect of the recent property losses on earnings will expose underwriting weaknesses in the other lines.

Ultimately, we do not expect any dramatic increases in casualty rates except for guaranteed-cost buyers with poor loss histories and insureds with medium to large commercial auto fleets. While we see this persisting into 2018, any serious attempt to raise casualty rates substantially should be offset quickly.

Specific factors and trends that will affect the 2018 property and casualty (P&C) market include:

- It remains to be seen what the ultimate impact of numerous property-related losses will be and how much additional capacity will be deployed (into both the property and casualty markets) to offset any desired rate increases at worst, or to stabilize rates, at best.
- How will alternative forms of reinsurance capital such as the catastrophe bond market be impacted by the 2017 catastrophic events and how will their appetites change going forward?
- How can insureds differentiate their risk profile from other companies?
- With cleaner data being used in analysis, the continued focus on data analytics to develop more sophisticated and accurate predictive patterns and trends of losses for a variety of P&C lines will increasingly factor into underwriting decisions.

- For cyber liability, increased competition and a sufficient supply of capacity will keep the market competitive, however, aggregation remains a concern for carriers as a single data privacy event could result in multiple claims reported to the same insurance companies.
- High profile data breaches and impostor fraud are now common events, increasing board-level focus on cyber, crime, and reputational risk loss mitigation.
- For environmental liability, rates will remain competitive, although given the uncertainty around long-term profitability, it is not clear how long this trend will last.
- Terrorist events are increasingly occurring on US soil.
- A continued rise in medical cost inflation, with a 6% year-over-year growth rate will continue to affect workers' compensation and liability loss totals.
- There will be a continued increase in cost shifting from healthcare plans to workers' compensation due to the profitability challenges faced by the Affordable Care Act as well as other challenges.
- Securities class-action filings have been increasing year over year.

With the likelihood that more insureds will experience rate increases than decreases or flat renewals, especially for property related risks, insureds and their brokers need to be proactive. They should begin to assess the risk/reward of higher retentions relative to their risk tolerance levels in many lines of coverage, as well as design strategies to clearly articulate how their specific risk profile differs from other companies within the same industry. Pre-loss safety and loss control and post-loss claims handling strategies should be revisited and clearly laid out in market submissions.

Relative to past years, the use of analytical tools to assess the frequency and severity of risk is of utmost importance. While the ability to avoid rate increases may not be possible for certain lines of coverage, the ability to minimize rate increases in the short to intermediate term using all legitimate arguments should be aggressively pursued.





2018 MARKET OUTLOOK FORECAST TRENDS

Property	Flat to up 15%
CAT property	Up 5% to 20%
Primary general liability—guaranteed cost	Down 5% to up 5%
Primary general liability—loss sensitive	Flat to a 10% decrease
Primary auto liability—guaranteed cost	Up 5% to 10%
Primary auto liability—loss sensitive	Flat to up 5%, more for larger fleets
Umbrella liability	Flat to down 5% to 10%
Excess liability	Flat to down 10%
Loss-sensitive workers' compensation	Down 5% to up 5%
Guaranteed-cost/low-deductible workers' compensation	Down 10% to up 10 %
International	Down 5% to up 5%
Environmental—pollution legal liability	Down 5% to up 5%
Environmental—contractors' pollution	Flat to 10% decrease
Environmental—combined general liability/pollution	Flat to 5% increase
Aviation	Down 5% to up 5%
Public company directors' and officers' liability	Down 5% to 10%
Fiduciary liability	Flat to up 5%
Private/non-profit management liability	Down 5% to up 5%
Employment practices liability	Flat to up 5%
Crime	Down 5% to up 5%
Medical malpractice	Flat to up 10%
Kidnap, ransom and extortion	Down 5% to up 5%
Representations and warranties	Down 5% to 10%
Technology and professional errors and omissions	Down 5% to up 5%
Cyber	Down 5% to 10%
Commercial surety	Down 5% to up 5%
Contract surety	Flat
Commercial construction project risk (WC&EL, railroad protective liability and owners' professional protective liability)	Down 5% to up 5%
Commercial construction project risk (builders' risk and primary general liability)	Up 5% to 10%

PROPERTY

With the near record loss activity in 2017 stemming from unprecedented windstorm and flooding events related to Hurricanes Harvey, Irma, and Maria (with insured loss estimates ranging from \$75 billion to \$100 billion), and with an abundance of attritional losses (hail, tornado, etc.) in the first two quarters of 2017, it appears that the general property market is in for some changes to pricing and terms and conditions.

The market today

- The time period from 2012 through 2016 was mostly profitable for commercial property carriers from a macro perspective, however, 2017 results had carriers already running at, or close to, 100% loss ratios.
- While loss figures from each of the events continue to be fluid, the combination of insured losses from Hurricanes Harvey, Irma and Maria, and two major earthquakes in Mexico, may surpass \$100 billion according to a recent outside agency report. A combined insured loss of this size would approach or potentially exceed the largest quarterly insured loss in history.
- Overall, we are opining that the loss results of 2017 will mostly be an “earnings event” versus a “balance sheet event.” However, with profitability already razor thin for many carriers, this could lead to underwriters seeking rate and/or terms changes.

Market capacity

- Deployment of working capacity for high-hazard catastrophic perils will likely be reviewed carefully by many insurers.
- Additional new capacity (particularly in the wholesale community) will soon be entering the marketplace.
- While capacity moves into the system efficiently when there is a need, the question remains if catastrophe (CAT) bonds that pay out losses will be reinstated.
- Capacity for stand-alone terrorism coverage is broadly available with approximately \$2 billion available in the global marketplace.

Topical issues

- Many carriers are conveying a desire to capture increases in named storm or hurricane deductibles for accounts that have secured deductible improvements over the prior one to three year period. Additionally, there is a potential push for migration to percentage deductibles for hail.
- Use of manuscript property policies may be under pressure for tightening of terms and conditions (e.g., storm surge coverage within named windstorm or flood).
- High-hazard flood continues to be analyzed and underwritten cautiously.
- Tornado and hail damage continue to drive loss records and will be scrutinized more closely going forward, as these perils have been loss leaders in recent years.
- Deductible buy-down markets are likely to be affected. If we start seeing higher deductibles and higher pricing for buy downs, this could add significant premium expenditure to those clients that require low deductibles.
- The combination of losses in 2017 led to rate increases during the January 1, 2018 treaty renewals, and carriers will be watching this closely as part of their continued pricing strategies.
- Data quantity and integrity remain paramount to achieve optimal results.
- Insurance to value (ITV) continues to be important for property carriers.
- Cyber security is becoming more of a concern (even on the property side) and will be a hot topic for years to come.
- Most carriers are indicating a moratorium on multiyear programs.

Forecast for 2018

- Accounts with hurricane-related exposures and losses will almost undoubtedly face renewal situations with increased pricing, potentially less broad terms, and perhaps less available capacity.
- Accounts with large catastrophic exposure footprints and losses will see the most pressure on rates and terms.
- After 19 consecutive quarters of soft-market pricing, it is reasonable to assume that most carriers will not be offering rate reductions and will likely be looking to increase rates across their portfolios.
- The availability and cost of facultative reinsurance are in flux as well. As these costs potentially increase for property insurance carriers, they will certainly look to pass on these costs and more restrictive terms.
- The biggest question is whether or not the events of 2017 will lead to a “regional” or localized event versus an “industry-wide” event as it relates to pricing.
- If in fact the industry moves in the direction of increasing property premiums across the spectrum, it will remain to be seen whether that approach could be sustainable over any sort of extended period. The market is still healthy and there will always be competition for accounts with high-quality risk protection, favorable loss records, and good spread of risk.
- We expect property insurance underwriters will likely continue to be competitive for new business opportunities with first-class risk profiles.
- Accurate, high-quality underwriting data will further improve renewal outcomes, with insurers remaining disciplined as profitability is crucial. Modeling will continue to affect capacity and pricing guidelines. By having the most comprehensive data (including secondary modifiers), insureds will be in a better position to understand their true risk profile and will be more likely to achieve favorable renewal outcomes.
- Overall, we expect the property market to firm up with respect to pricing, terms and conditions, with renewal rates ranging from flat to increase of 20%.¹



After 19 consecutive quarters of soft-market pricing, and recent storm activity, it is reasonable to assume that most carriers will not be offering rate reductions and will likely be looking to increase rates across their portfolios. The question is will increasing rates across portfolios be sustainable for those property insurance carriers?

¹Most projected rate changes are predicated on positive/favorable loss experience. Accounts with loss frequency and/or severity issues will continue to be evaluated carefully and many may not see pricing in line with peers that have better experience, construction, and exposures.

CASUALTY-LIABILITY

In 2017, we have seen continued competition for premium dollars, and increasing amounts of new capital entering the market. However, increased natural disaster losses during the fall of 2017, combined with the net underwriting loss, could leak into the casualty market and slow the competitiveness of the marketplace in 2018.

The most aggressive pricing will be maintained for those clients with exceptional loss experience and who demonstrate appropriate risk management. The use of predictive analytics modeling will continue to drive a more selective marketplace.

The most profitable insurers recognize that lowering premiums every year to gain market share is not sustainable, and, therefore, they continue to underwrite accounts prudently.

The market today

- Competition for premium dollars still exists, with a slight climb in overall pricing. Premium competition will not be nearly as aggressive for more volatile industries.
- The market for automobile liability has been more volatile than primary general liability and umbrella and excess liability. Auto liability remains competitive for clients with substantial fleet safety initiatives and positive loss experience. However, retentions are continuing to move upward to maintain aggressive pricing.
- Automobile premiums for smaller, private passenger and service fleets are competitively priced, but with slightly higher rates. The wholesale market for small and large auto risks is still viable and becoming ever more specialized, although pricing may continue to climb.
- Pricing in the umbrella and excess liability market remains very competitive. However, markets are seeking a reduction in single-layer limits to secure improved premiums.

Market capacity

- The liability market remains flush with capacity and new capital. Continued insurance mergers and acquisitions (M&A) have not had a visible effect on market capacity.
- Automobile liability capacity remains adequate but is shrinking somewhat for larger to medium-sized fleet risks. There is still adequate capacity in both the retail and wholesale marketplace, though pricing continues to climb slightly.
- For stand-alone products liability, the market remains limited, with only a select number of insurers willing to compete aggressively on risks that have inherently difficult product lines and severe and volatile loss experience.
- Capacity for lead umbrella and excess liability continues to be plentiful. However, pricing per million on the upper layers has reached minimum levels, thereby reducing insurers' willingness to reduce premiums further.

Topical issues

Clients need to conduct insightful analytics to best assess optimal risk/reward—regardless of the program design: guaranteed-cost, lower deductibles, and larger loss-sensitive programs. Analytics include assessments of safety initiatives, claims mitigation measures, and loss analytics.

- While insurers seek to grow market share, there is more disciplined underwriting, and the best terms will be given to existing and longstanding clients. Multiyear deals are also still available and may prove to be a client's best option.
- Alternative forms of collateral to letters of credit (LOC) remain available, but are restricted to clients with stronger financials. Cost of collateral from financial institutions will continue to increase for clients with suspect financials.

Forecast for 2018

For 2018, we expect the continuation of a concentrated underwriting discipline, both in selection of risk and the pricing of the individual risk. We believe preferred pricing will be reserved for clients with exceptional loss experience, appropriate risk management initiatives such as the deployment of telematics, and the desire for long-term partnerships.

Primary casualty:

- Insureds with higher retentions are expected to see a flat to a 10% decrease in rates. Guaranteed-cost buyers will see rates impacted +5% to -5%.
- Insureds with medium to heavy fleet exposures will likely experience greater automobile liability rate increases, and clients with average experience will see flat to slightly increasing rate increases. The market will require larger retentions and potential increased rates of up to 10% or more for clients with poor loss experience.
- More increases than decreases are likely with guaranteed-cost programs based on deteriorating loss ratios experienced by the property and casualty marketplace.

Umbrella and excess liability:

- Lead umbrellas are still competitive. Increasing capacity and staunch competition should continue in 2018. Expect flat to 5% to 10% pricing decreases, but with an effort by the market to raise attachment points and reduce limits for auto liability, particularly on tougher auto fleets.
- Excess liability rates are expected to vary based on the layer, with rates flat to decreasing 10% for mid-limit layers and upper-layer rates leveling out at the current pricing.



Third-party liability coverages are expected to continue to show aggressive pricing, as the general casualty market continues to be profitable overall. However, certain products liability coverages and medium to larger auto fleet pricing, will have a more direct correlation on a client's specific loss experience and risk profile than the balance of primary and excess liability coverages.

WORKERS' COMPENSATION

In 2017, we saw a continued downward trend in workers' compensation (WC), including a reduction in premium rates overall, particularly in the loss-sensitive marketplace.

Given the lack of deterioration in many larger carriers' combined loss ratios, we expect similar aggressive targeting to grow market share in 2018. While returns for low-risk investment opportunities remain limited, the marketplace's appetite for premium will drive aggressive—yet prudent—pricing. However, there is underwriting discipline for those clients with poor loss results, declining financials, residence in particular states (i.e. FL, CA, NY, and others) and those in more volatile industry classes.

Carriers will seek higher retentions as the result of client-specific loss severity or in circumstances when clients are pursuing greater premium savings.

The market today

- Competition for premium dollars remains, and is driving desirable pricing, particularly for loss-sensitive programs with properly aligned retentions and losses.
- Increased retentions will continue due to increased underwriting discipline and stronger claims (pre- and post-) mitigation measures taken by clients.
- More consideration is being given by carriers to unbundling claims service.
- Guaranteed cost is less attractive for clients not driven by absolute budget certainty or balance sheet variability—a movement away from guaranteed cost has been driven by clients' increasing risk tolerance, continued medical cost inflation, statutory benefits escalation, adverse court decisions, and encroachment of employee benefits claims into the WC area.

Market capacity

- There is plentiful capacity writing workers' compensation for both loss-sensitive and guaranteed-cost programs.
- Specific industries will continue to experience reduced capacity and a smaller marketplace from which to secure alternatives, mainly due to the loss severity and volatility associated with those industries.

Topical issues

- Pre- and post-loss mitigation and proactive claims reserving and resolution are being used to mitigate such things as continued medical cost inflation, increasing severity, and increasing levels and cost of collateral.
- Numerous alternative forms of collateral exist to address the decreasing capacity for, and cost of, letters of credit (LOC).
- We expect clients to continue to receive loyalty and longevity-based pricing and collateral benefits from the incumbent carrier, including multiyear rate offerings.
- Continued internal reserve strengthening for older policy years, seems to have only moderate impact on the general markets' competitive pricing.
- Analytics relative to past and future loss data are becoming an absolute necessity to intelligently negotiate optimal pricing, program design, and collateral. Predictive modeling has become a key underwriting tool for pricing and post-loss mitigation.
- While self-insurance remains an alternative to insured workers' compensation, individual states are becoming more conservative on their collateral position for many qualified self-insureds. Additionally, many companies are looking more closely at their existing self-insured status because of onerous associated administrative costs.

Forecast for 2018

- Pricing will be driven by maintaining or increasing market share; although profitable market share is most important. Expect to see more underwriting discipline exercised. For clients with good risk profiles, positive loss experience, and the right appetite for risk retentions, competition will remain very strong.
- We expect a continued upward movement of retentions due to increases in claim development/severity.
- A client's pre- and post-loss mitigation activities will be key underwriting factors, as these activities show a measurable effort to slow loss development
- Pricing for loss-sensitive programs is likely to be flat to down 5% for clients with clean and/or improving loss experience. Clients with deteriorating loss experience will see a +5% rate fluctuation and may need to adjust retention levels accordingly.
- Guaranteed-cost programs are expected to experience an estimated -10% to +10% change; exceptions will be for clients with extremely clean loss experience. Guaranteed-cost pricing will also vary by a client's specific state payroll distribution due to states' legislative pressure on adequacy of rates.



The ever-increasing capacity will provide more opportunities for other carriers, but more sophisticated analytics will drive pricing and underwriting.

INTERNATIONAL

In 2017, we continued to see a softening of casualty and property rates—largely driven by the overall positive performance of these risks across multiple classes of business globally.

We have seen some carriers that historically did not participate on controlled master programs or in the international marketplace enhance their product offerings and aggressively price new business. This has resulted in rates being reduced by as much as 15%+ at renewal.

The market today

- Compliance, governance, and attention to premium tax collection continue to be concerns for clients. More countries and carriers are enforcing collection and payment of admitted and non-admitted premium taxes overseas.
- Insurance regulators around the world are taking a more proactive stance and enforcing existing regulations.
- We advise clients, where it makes economic sense, to have local coverage placed.

Market capacity

- For the remainder of 2017 and in 2018, we expect a continued soft market internationally with declining rates due to significant capacity and a very competitive marketplace. The year 2018 would mark the fifth consecutive year of steadily declining rates.
- Though global reinsurers have been affected by catastrophic losses, there should not be much of a turn in rates relative to foreign risks. The speculation is that these catastrophic losses would not have a significant effect on foreign-located risks.
- Casualty rates, depending upon country-specific issues, current legislation and business class will continue to see 5% to 15% rate decreases with the exception of auto, which continues to perform negatively in many geographical areas.

- Property rates, depending upon geographic location and business class, are seeing moderate 2% to 8% increases. The recent hurricanes and earthquakes affected insurers and reinsurers and have had an impact on rates. We have seen rate increases overseas, especially in higher risk regions.

Topical issues

United Kingdom, Insurance Premium Tax (IPT) increases: The standard IPT rate went from 6% to 9.5%, effective November 1, 2015. October 1, 2016 IPT was increased to 10% and on June 1, 2017 was increased again to 12%.

United Kingdom, Ogden Rate change: The Ogden Rate, or discount rate, is used by the UK courts to determine how much insurance companies should pay out to customers in severe personal injury claims. Up until 2017, when the law changed, the discounted rate of .025 was applied against the loss amount and then subtracted from the loss amount. With the change in the law, a new rate of .0075 is applied against the loss amount and then added to the overall loss amount. Therefore, a £1,000 loss amount prior to 2017 would be worth £975 and now that same loss would be worth £1,007.50. The change has prompted UK insurers to increase their UK motor rates and UK employers' liability rates, and in some cases dramatically.

EU, Data protection reform/General Data Protection Regulation (GDPR): The European Commission has proposed to reform the current European data protection framework (Directive 95/46/EC), to be effective May 25, 2018, which covers those organizations that are processing personal data, regardless of the business sector in which the organization operates. It requires the following:

- Organizations processing personal data must take appropriate measures to ensure the security appropriate to the risks presented by the processing.
- For all business sectors, the obligation to notify national authorities as soon as possible on personal data breaches is mandatory.

- Individuals must be notified if it is likely there will be an impact on their privacy.

Increased fines for non-compliance under the articles of the GDPR for violations of the articles' provisions can trigger fines up to €20,000,000 or 4% of a company's annual revenue.

India and Brazil: While both India and Brazil have always maintained strong rules prohibiting non-admitted insurance, cyber liability coverage was not often purchased locally. As risk exposures in these countries have increased, clients are now purchasing local coverage. Since this coverage is relatively new in these markets, greater attention must be paid to what is being offered. For example, in India the policy may include some third-party cover, but no first-party cover.

Forecast for 2018

Primary foreign casualty: Guaranteed-cost programs should experience stabilized but moderate rate decreases of 5% to 15%.

Primary foreign property: Property programs should experience stabilized but moderate rate increases of 2% to 8% (with the exception of risks exposed in catastrophic zones).



Compliance, governance, and attention to premium tax collection continue to be central concerns for clients. The collection and payment of admitted and non-admitted premium taxes overseas is being enforced.

The environmental insurance industry is moving into a transformative era. The marketplace has reached significant maturity after more than 25 years. The market has proven that it could easily absorb the \$1+ billion in AIG expiring premiums, since AIG's announced exit of its pollution legal liability coverage in 2016. With new entrants coming into the market each year, environmental insurers are transforming and innovating to grow and remain competitive. The environmental insurance marketplace is estimated to be over \$2 billion in annual premiums with double-digit growth, outpacing the annual growth rate of the general property and casualty marketplace. Much like the rest of the insurance industry, environmental insurers will use big data for analytics to drive new solutions, and to adapt business models and develop target niche areas/solutions.

We raised a question last year: If after 30 years of actuarial data, AIG couldn't be profitable in this space, what carrier might be next and, more importantly, when will the "musical chairs" stop and rates start to rise? It's our prediction again for 2018, that profitability will be, in effect, postponed until the future, because there are simply too many players, and, therefore, excess capacity.

Frequency and severity of environmental claims are expected to continue in 2018. With significant hurricane and flooding in 2017, toxic release and mold claims are still being adjusted, but these don't seem to have much bearing on future coverage or rates, except that underwriters will examine more closely those risks with exposure to coastlines or flooding.

We are confident there will be continued growth with a soft market in 2018 for most classes or risks—except for higher risks such as petrochemical, oil and gas, power and utility, and mining. There will also be some measured constraints for certain higher real estate risks, such as hospitality, regarding indoor air quality—with the potential for higher retentions and coverage limitations. Risks that pose potential for liability for water contamination will have more measured underwriting with an increased focus by the public and regulators on water contamination.

The market today

- Highly competitive
- Close to 50 insurers

Market capacity

- All signs point to more growth, with over \$600 million in capacity and more new players, including some limited London market participation, after decades of no interest.
- Capacity varies by line and by industry segment.
- Tougher classes, such as energy, risks from downstream to upstream, and power and utility risks, may have significantly less capacity as the EPA heightens its scrutiny of these industries' impact to air and water.
- Business interruption claims are also increasing from operational spill events and indoor air quality matters to violent storm events. Companies frequently cite business interruption risks as one of their top concerns and environmental related business interruption risks can create significant financial consequences if not addressed adequately.
- Ten-year term transactional risk policies for pollution legal liability are still available in the market, but only from certain insurers.
- One-year policy terms are becoming more the norm for difficult risks, such as the day-to-day operations of energy, mining, petrochemical, and power and utility firms, and will create volatility for these classes of business as well as possible risk of gaps in coverage.
- With a booming construction marketplace, the demand for contractors' pollution liability continues, making the marketplace highly competitive. Prices are continuing to drop with no floor in sight. Additionally, the use of environmental-owner or contractor-controlled policies is becoming more common today even for projects smaller than \$100 million in contract values—largely due to the continuing increase in construction defect/environmental claims and very competitive pricing.

- Environmental casualty policies, which combine general liability and pollution legal liability, continue to be very popular and are growing at a double-digit pace.
- Coverage for complex mergers and acquisitions, contaminated properties, and brownfield projects, requires more time to be customized. Losses on policies written for redevelopments have caused insurers to become tougher on insurance terms regarding contamination, and policies can include many restrictions, along with short terms.

Topical issues

New Threats:

- **Brand value:** Companies are very sensitive to financial losses that might occur due to failure to prevent major environmental damages. Cases such as the Flint, Michigan water crisis, and other high profile industrial spills, have damaged organizations' brands.
- **Environmental terrorism:** Risks from nuclear, chemical, radiological, and bioterrorism are top concerns of municipalities and other public entities. In a world of more civil unrest, many terrorism experts now believe it is only a matter of time until there is some biological or chemical event. Cyber terrorism is a growing threat—pollution policies can cover pollution released in a cyber terrorism attack that targets a refinery or power plant.
- **Product pollution liability risks:** These risks are becoming more of a forefront issue, especially for higher risks that have big consequences if a product fails and causes water contamination or personal injury to consumers—since these might result in a lawsuit.

Forecast for 2018

Rates are likely to be fairly stable, but vary by coverage line. Specifically, we predict:

- Pollution legal liability: 5% increase to 5% decrease.
- Contractors' pollution: flat to 10% decrease.
- Combined general liability/pollution: flat to 5% increase.



With an estimated \$2 billion in annual premiums, and double-digit growth, the environmental market is outpacing the annual growth rate of the general property and casualty marketplace.

We've seen a continuation of premium and rate reductions in 2017 at a scale that is slightly less steep than in previous years. With 2016 having been the second safest year in aviation history, underwriters were unable to hold to threats of increases or even flat renewals in some cases. An abundance of capacity continues to negatively influence rates, which have been labeled unsustainable for years. However, with recent catastrophe incidents, including earthquakes and hurricanes, which are bound to have a global insurance effect, some suggest these will be the catalyst needed to produce a turn in the aviation market.

The market today

- The products/completed operations sector of the market has had a tough year, with overcapacity putting pressure on premiums. Deterioration of old losses, combined with some new losses, is causing underwriters to hold the rates steady for most renewals. The year 2018 could see increases in this sector if reinsurers are successful in their demands. The Airbus grounding loss alone is predicted to chew up almost all of that market sector premium, with the loss in the neighborhood of \$500 million and the total income for that sector (as of 2016 year end) at \$535 million.
- The airport sector continues to see falling premiums and high capacity with some insureds seeking multiyear deals.
- General aviation is still experiencing reductions in premium and competition for market share. Premium reductions of 5-6% from policy expiration are often seen on business with low loss levels, strong management, and an established safety culture.
- The airline sector remains much the same as 2016, with those accounts that show fleet growth and strong safety programs receiving rate reductions in the market, while those with no fleet growth receiving flat renewals. Early in the fourth quarter of 2017, we are seeing some stability in the flag carriers (airline) area, with fewer reductions—which might be a sign that the 2018 market will turn and remain at least flat with some increases, instead of a steady decline.
- The war hull market has seen several insurers withdraw this year and last year due to the lack of profitability. Even with no losses to date, this market has not recovered from the major losses in the past three years and remains an area of concern.

Market capacity

Current capacity levels remain over the top and are the largest contributor to market conditions. However, there have been mergers between insurance carriers, and some syndicates have left the aviation market, with rumors that some others are reviewing their appetite for aviation. As income is reduced and losses accrue, there is a real feeling that long overdue change is coming.

Topical issues

- The unmanned aircraft systems (UAS) area continues to be fast growing with continued regulations being implemented and underwriting practices being formed. The Federal Aviation Administration (FAA) estimates that there are as many as 2.3 million UAS units in the hobbyist fleet and as many as 235,000 units in the commercial fleet in 2017.¹ With widespread commercial use potential, industries such as filmmaking, agriculture, real estate, aerial photography, government, industrial inspection, and others are investing considerable amounts of money into this emerging industry. The registrations and applications filed by owners and operators continue to pour in to the FAA by the thousands each week.
- Fourth-quarter large renewals are still in negotiations in London, with hints that stable premiums are being seen more than the past decreases in rates and premium, which has produced whispers of hope that the aviation market will start to correct itself in 2018.

Forecast for 2018

- New aircraft orders and increased passenger numbers for both charter operators and airlines continue to project an optimistic long-term outlook for aviation.
- Unmanned aircraft systems (UAS) will be the most dynamic growth sector within aviation, but with small premiums for most of these units, the aviation insurance market impact with respect to premium contribution is unknown at this point. Underwriting companies will continue to assimilate policies to cover the risks and pricing structures, limits, and operating requirements. Continued FAA involvement and rulemaking will iron out the operating standards and help determine how to safely integrate the UAS into the national airspace.
- Subtle signs have been seen in 2017 that suggest the trend of rate reductions and soft market conditions will flatten out and maybe even begin to self-correct in 2018. Several natural disasters in 2017 will presumably have some effect on global insurance market terms, which in turn may cause underwriters to tighten their approach in their entire portfolio, resulting in a trickle down tightening in the aviation market. This combined with years of soft market conditions and large capacity may be enough to move the aviation market in the right direction.



Clouds on the horizon...more selective underwriting and stable market capacity may begin to move the aviation market in the right direction.

¹Source for UAS sales info https://www.faa.gov/data_research/aviation/aerospace_forecasts/media/FY2017-37_FAA_Aerospace_Forecast.pdf

PUBLIC COMPANY DIRECTORS' & OFFICERS' LIABILITY

Favorable buying conditions remain the norm. Markets remain willing to expand coverage and compete on pricing. Capacity remains abundant; however, some markets are beginning to exhibit greater pricing and underwriting discipline.

The market today

- **Pricing:** In general, a 5 to 10% decrease in pricing remains achievable for mainstream risks. Markets can be observed to compete vigorously for favored risks and/or to maintain share on such risks. However, while not uniform, there is an emerging market discipline and push back on continued premium softness. Primary pricing reductions have abated. Incumbent carriers generally will cooperate to retain positions on programs. Challenged risks, as always, will require greater premium.
- **Retentions:** Generally, retention levels remain stable and consistent with no great movement in either direction. Mergers and acquisitions (M&A) retentions are seen on a case-by-case basis but are not uniformly applied. Some attempts to increase securities retentions are observed.
- **Terms and conditions:** No constriction in coverage is observed. Either by producing updated policy forms and coverage offerings or by providing broker-driven coverage, markets continue to compete with coverage. Improved coverage continues to be available at primary, excess, and Side A layers.
- **Excess capacity and Side A:** Pricing competition remains present in excess and Side A coverage as such layers usually remain the true new business opportunity for many markets. However, due to the extended period of market softness, at times, some carriers have been observed to get off risk rather than further erode premium.

Market capacity

Public company directors' and officers' liability theoretical capacity currently exceeds \$1.5 billion and surpasses client demand.

- Industry consolidation has continued at a rapid pace (Sompo/Endurance, Fairfax/AWAC, Liberty/Ironshore). To date, capacity and market behavior have remained consistent. As integration continues, there is carrier activity in appetite repositioning (Liberty/Ironshore). Continued such behavior may begin to have a slight moderating impact on capacity.
- Primary carrier options are fairly stable and some historically excess markets are clearly repositioning to pursue primary roles. Excess capacity continues to seek premium lift by taking lower layers when available. Excess capacity continues to be robust, with no recent entrants.

Topical issues

- Securities class-action filings have been increasing at record rates. For the first half of 2017, the number of securities class-action filings dramatically outpaced historical norms and the prior year same period. At present rates, securities class-actions filings are on track to result in the second most prolific year since the Private Securities Litigation Reform Act (PSLRA). While a significant component of the increased filings is attributable to M&A litigation brought in federal court, the non-M&A filings are also on record pace. Additionally, the rate of filings (percentage of firms sued) against US listed firms has substantially increased.
- M&A related (merger objection) filings have increased substantially year over year. Given the Delaware Chancery Court's opposition to "disclosure-only" settlements, M&A filings have migrated to federal court.

- Regulatory enforcement activity remained on record pace during the first half of the year consistent with that observed in 2016. The appointment of Jay Clayton to head the Securities and Exchange Commission (SEC) has resulted in a transition lull as policy is revisited. It is expected that while the SEC's focus may change, robust enforcement activity will continue. Some uncertainty remains, however, due to the current administration.
- Cyber continues to occupy a prominent position both in board rooms and at the SEC. New leadership at the SEC has made clear that cyber security enforcement will be a priority.
- As international securities litigation increases, firms with international exposure continue to be evermore focused on obtaining globally compliant programs. More markets are also focused on expanding and improving efficient international coverage placement capabilities so as to better compete and serve their clients.
- Entity investigation coverage continues to evolve and invite client consideration. Client purchase of this coverage remains low given pricing and underwriting dynamics.

Forecast for 2018

The present market conditions are expected to continue into 2018, although some dynamics are observed that could have a shifting effect (pricing discipline, appetite repositioning). In the absence of significant market volatility, disruption or major triggering event, it is largely expected that current conditions will extend through 2018.



Get it while you can. Focus on expanding and improving coverage where possible.

FIDUCIARY LIABILITY

While the fiduciary liability market has been fairly stable, insurers continue to monitor the impact of excessive fee litigation on their books of business.

The market today

- Rates remained relatively stable in 2017, although underwriters will ask more questions with regard to fiduciaries' monitoring of third-party service providers and fees.
- Based on recent cases filed, and additional scrutiny on higher education industry risks, insurers will look to manage capacity and retentions on these programs.

Market capacity

- Capacity continues to drive the market in general, but will be more difficult to obtain for higher education risks and for financial institutions with proprietary funds included in their portfolio of investment options.
- While significant overall limits are available, we may continue to see some insurers less inclined to provide large limits on any one risk.

Topical issues

- **Excessive fee cases:** Insurers are seeking additional underwriting information regarding the insured's procedures and oversight of plan service providers, benchmarking of fees, and performance of investment options.
- **Current litigation landscape:**
 - 403(b) plans in the higher education sector:** The initial focus of the lawsuits was directed against large universities but we are expecting to see a movement toward litigation against smaller universities and colleges.
 - 403(b) litigation against a large healthcare system:** This was filed recently, with similar allegations to the 403(b) university suits. We may begin to see cases filed against other not-for-profit organizations.
 - 401(k) litigation specific to the financial industry:** Plans with proprietary investments are also an area of underwriting focus. We see insurers looking to reduce limits offered in some cases, as well as increase retention levels for this class of risk.

Forecast for 2018

- Expect rates to be flat to up 5% on average, depending on total plan asset value and overall changes in exposure with more scrutiny on the larger plans.
- Rate increases of greater than 5% for risks with significant plan assets/growth, adverse loss history, or other underwriting concerns.
- Insurers may also focus on retentions and move to increase retentions based on overall risk profile.
- While we still see significant capacity in the mix, underwriters are keen on maintaining their existing clients and growing new business. Given the litigation landscape, this will continue to be an interesting environment as insurers evaluate rates.

While there is ample capacity for this line, the litigation landscape may begin to change underwriters' appetites.



PRIVATE/NON-PROFIT MANAGEMENT LIABILITY

After the merger of two of the largest providers of executive liability insurance to private companies and non-profit organizations in the previous year, 2017 was relatively quiet from an insured's perspective. A number of carriers in this space have reorganized their executive leadership or are re-evaluating their underwriting strategy, resulting in shifts in underwriting appetite. Some have become quite aggressive and some are more closely managing industry exposure, capacity, and rate. Clients are now beginning to see the results of these internal changes, both positive and negative. While we don't expect any sea change in the marketplace, there are definitely pockets of opportunity for improvement for clients with strong risk profiles.

The market today

- Rate conditions are stable overall for most companies and the scope of coverage terms available has not changed significantly.
- Specific industries (healthcare, pharmaceuticals, retail, and hospitality) are continuing to find underwriting more challenging.

Market capacity

- Despite some contraction in the marketplace via acquisition, there are plenty of carriers with an appetite for private and nonprofit business.
- Overall capacity remains plentiful, although carriers continue to manage limit and retention structures on any given program.

Topical issues

- Private companies continue to see claims from employment issues, particularly Fair Labor Standards Act exposures, mergers and acquisitions activity, and bankruptcy filings.
- Crime claims are becoming more complex with some coverage litigation working its way through the courts.

Forecast for 2018

- With some carriers combining and some experiencing leadership changes or appetite shifts, we predict an emphasis on marketing in 2018 as clients look to obtain the best terms available from carriers that may have a different approach than in the past.
- Carriers continue to differentiate themselves through coverage terms, and offering enhancements and coverage extensions, rather than competing solely on premium.

We predict an emphasis on marketing in 2018 as clients look to obtain the best terms available from carriers with different risk appetites than in the past.



EMPLOYMENT PRACTICES LIABILITY

In 2017, we've seen several high profile employment-related matters surface. From Bill O'Reilly and Roger Ailes, to discrimination and harassment in Silicon Valley, the business community has seen the negative impact and press that can result from an employment practices situation. Reviewing the data trends from the last couple of years, it is evident that the Equal Employment Opportunity Commission (EEOC) has continued to be aggressive with its pursuit of justice.

Employment practices liability insurance is written to cover employers from alleged failure to comply with federal, state, and local laws and regulations. There are multiple actions that can be brought against employers stemming from employment laws, discrimination, harassment, wrongful termination, corporate downsizing, and more.

The market today

EEOC filings have trended up and down over the last couple of years as follows:¹

- Fiscal Year 2012 – 99,412
- Fiscal Year 2013 – 93,727
- Fiscal Year 2014 – 88,778
- Fiscal Year 2015 – 89,385
- Fiscal Year 2016 – 91,503

Market capacity

- Capacity continues to be plentiful and rates are stable.
- Large states, such as California, Texas, and New York can be problematic for many employers.
- Fair Labor Standard Act wage and hour claims continue to be problematic.
- Bermuda and London offer stand-alone policies to address this exposure for insureds that are interested.

Topical issues

Issues of interest to the EEOC (from the EEO-1 survey and other industry sources):

- Diversity in high tech
- African Americans, Hispanics, Asian Americans, American Indians, Alaskan natives, and women in the workforce
- Diversity in the finance industry, including investment banking
- Diversity in the media
- Retail distribution centers and department stores
- Diversity in law firms
- Glass ceilings for women

Forecast for 2018

No organization, regardless of whether it's public, private or non-profit, is immune from the threat of litigation. If there's an employee, there is a chance that the organization could be sued. It is important to protect the balance sheet and make sure that adequate coverage is in place that addresses all of an organization's exposures.

California will continue to see carriers minimize premium rate increases by using sub-limits and/or increased retentions to manage potential risk exposures.

With the recent media attention that's been given to harassment in the workplace, we would expect a heightened focus on employment-related claims.

¹ <https://www.eeoc.gov/>

CRIME

The crime insurance market remains stable. A concentrated interest in impostor fraud is still the main focus of carriers, brokers and customers. Insurance carriers continue to improve capacity for impostor fraud coverage and have pulled back on some of the original underwriting criteria needed to offer this coverage. In some cases, answers to just a few limited questions are needed versus supplemental applications that were required previously. Most carriers have also virtually eliminated the call-back verification requirement.

The market today

- Competing carriers continue to promote rate stability.
- Employee theft claims dominate the type of claims seen by carriers.
- Impostor fraud losses are the fastest-growing claim type.
- Loss discovered forms are rapidly becoming the normal offering.

Market capacity

- Capacity remains plentiful.
- Multiyear policies for risks with favorable loss histories continue to be offered.
- Higher limits for impostor fraud are readily available compared to past years when the coverage was a newer concept.
- Coverage for stand-alone impostor fraud is not available but a few insurers will consider writing the coverage excess and difference in conditions (DIC) over an underlying policy. Typically this is only offered on a surplus lines basis.

Topical issues

- **Regulation 209:** Issued in the state of New York, this regulation prohibits insurance companies from denying crime insurance coverage to New York businesses that employ people with criminal convictions. Insurers fear that this will lead to increased losses for the industry. Some insureds have expressed concerns that premiums and retentions will increase as a result.

- **Virtual currency:** An endorsement to the policy that is designed to incorporate virtual money, such as bitcoin, into the definition of “money” as defined by the policy has emerged. Currently available by request from most insurers, determining the value of a loss continues to be a concern since bitcoin is not backed by a central bank.
- **Impostor fraud:** In discussions with insureds over the past year, most have experienced some sort of attempt by a fraudster. In many cases, these attempts have been thwarted due to good controls put into place by C-suite-level executives and accounting departments with heightened awareness.

Forecast for 2018

- Rates continue to be relatively flat.
- Changes in premium typically based on changes in ratable risk factors (i.e. revenues, employee count, claim activity).
- The market is competitive for insureds with good claim history and strong external controls, financials controls, and procedures.
- We expect these trends to continue through 2018.
- Impostor fraud will continue to be a concern for underwriters moving forward.

Claims for crime losses are more numerous today due to economic circumstances, such as continued structural unemployment, price inflation, fluctuating interest rates, and the ever-evolving advances in technology.

MEDICAL MALPRACTICE

Medical malpractice continues to be a primary expense driver for the overall healthcare industry. While the medical malpractice market is relatively stable overall, cost continues to be high relative to other commercial insurance coverages.

Though overall medical malpractice rates are somewhat stable, certain businesses—including physician specialists, senior skilled healthcare, and jurisdictional specific hospital and acute care facilities—are seeing rate increases and a tightening in coverage terms and conditions.

Negative developments, which mirror the industry environment during the last hard market, are once again evident. These include increased loss trends, depressed premiums, escalating jury verdict awards, and combined ratios exceeding 100%.

- Capacity remains abundant
- Carriers becoming more selective with coverage enhancements
- Increased scrutiny on losses and jurisdictional issues
- Willingness to manuscript coverage and extended terms continues where an entity is using a captive

The market today

Year-end 2016 marks the tenth consecutive year of declining medical malpractice premiums. Following increases that began during the 2000 – 2001 hard market, direct-written premiums reached a high of \$6.7 billion in 2006 and have decreased annually since—ending the year 2016 at \$4.7 billion, a reduction of nearly 43%. Indications are that year-end 2017 and calendar year 2018 will see a continuation of this overall trend. Key medical malpractice statistics:

- 2016 combined ratio of 101.9% represents the first year of loss since 2004, which saw a combined ratio of 107.6%.
- 2016 underwriting income decreased 178% from \$404 million in 2015 to \$145 million in 2016—the lowest level since 2004, which recorded \$221 million.
- Since 2007, underwriting income has decreased from \$1.3 billion to \$145 million, a loss in real dollars of nearly \$1.2 billion, or 800%.

Market capacity

Generally, medical malpractice market capacity is specific to a given business (hospital, physician, facility, senior care, etc.), however, emerging trends throughout the country could ultimately reduce capacity and increase cost:

- Medical malpractice losses—top states per capita (per capita loss analysis is a good indicator as to the legal environment of a particular state):

Largest Payouts per Person	Lowest Payouts per Person
New Hampshire	Wisconsin
New York	North Dakota
Rhode Island	South Dakota
Massachusetts	North Carolina
Pennsylvania	Texas
Illinois	Wyoming
New Mexico	Alaska
West Virginia	Alabama
Connecticut	Tennessee

- New York Department of Insurance fires the administrator and “attorney in fact” for the second largest medical malpractice insurance company amid charges of self-dealing, cronyism, and mismanagement.
- Several high-profile liquidations and insolvencies by physician malpractice insurers organized as risk retention groups are affecting the medical providers who bought the policies. Hospitals and other institutions that accepted those policies in good faith to meet credentialing and attending requirements are also being impacted.
- Reinsurance and excess markets for medical malpractice continue to be strong, especially for organizations with good experience.
- Reduced medical malpractice insurance company capacity as a result of industry merger and acquisition activity of two of the larger specialty insurers:
 - One Beacon was acquired by the largest Canadian P&C company, Intact Financial Corp, for US \$1.7 billion.
 - Liberty Mutual acquired Ironshore for approximately US \$3 billion.

Topical issues

Ancillary exposures are creating increased medical malpractice exposures and liability.

- **Cyber and technology-based risks:** A readiness assessment by the Healthcare Industry Cybersecurity Task Force in June 2017 identified the following as likely to affect the delivery of patient care, leading to increased medical malpractice exposure:
 - Severe lack of security talent
 - Legacy equipment—including industrial controls, unsecured devices, and a variety of inter-connected devices
 - “Meaningful use” requirements driving hyper-connectivity
 - Catastrophic denial of service and ransom exposures
 - “Known vulnerability epidemic,” including pacemakers and other electronic equipment
 - Electronic health records and software weakness
 - 3D printing—customized implants, prosthetics, and transplants
 - Robots—surgical and remote patient care
- **Creative liability filings:** Plaintiffs bar is becoming experienced at developing and utilizing strategies to circumvent medical malpractice caps by bringing claims under general liability.
- **Foreign liability:** The plaintiffs bar throughout Europe, Asia, and elsewhere is filing claims in their own jurisdiction with awards growing annually. Physicians traveling on business outside the US would be wise to evaluate the purchase of a policy to provide a set of limits for any work done in-country.

Forecast for 2018

- Annual consolidation among insurance companies will continue into 2018, and with each merger or acquisition overall capacity in the new organization is likely to decrease by a small percentage.
- Clients with well-structured programs and low losses are likely to see a slight rate decrease and perhaps improvements to terms and conditions.
- Medical malpractice rates, coverage terms and conditions will vary based on overall industry.



As the healthcare industry grows in scale and sophistication, so do the risks it faces every day. Previously focused on clinical delivery and patient care, this industry must now shift its focus to emergent exposures arising across the entire enterprise.

KIDNAP, RANSOM & EXTORTION

The market today

- Key insurers remain committed to kidnap, ransom, and extortion (KRE) insurance and coverage quality. Market leaders include Hiscox, HCC, AIG, Chubb, Starr, Travelers, and XL, among others. However, industry consolidation may lead to insurers re-evaluating their coverage offering over the upcoming months.
- Insurers such as Hiscox are seeking to advance the breadth of coverage available to clients as evidenced by their recent launch of a Security Incident Response (SIR) policy that provides coverage designed to confront evolving terror, criminal, and political violence threats. Such offerings, when carefully crafted, can help provide seamless coverage for evolving risks faced by multinational organizations.

Market capacity

Although market capacity remains consistent with most insurers willing to offer \$10 million to \$25 million in coverage limits, some insurers are seeking to limit exposure to cyber-extortion, which continues to be an increasing risk for both domestic and international concerns.

Topical issues

- KRE insurance policies are often viewed as a core coverage and essential for larger organizations. Problematic countries such as Mexico, Venezuela, Turkey, Syria, Pakistan, Iraq, Nigeria, Libya, Afghanistan, Sudan, and Lebanon are still reasons for concern. According to the crisis management firm Unity Resources Group, in Q1 2017 and Q2 2017 the most affected regions were:¹

Q1 2017		Q2 2017	
Africa	36%	Africa	65%
Asia	31%	Asia	15%
Americas	24%	Americas	12%
Middle East	8%	Middle East	6%
Europe	1%	Europe	1%

Notable was Unity's assessment that organized criminal groups were responsible for over half of the abductions, and the number of foreigners kidnapped while traveling abroad rose significantly in the first quarter of 2017.² During the second quarter of 2017, a significant increase was noted in Africa—specifically the Gulf of Aden—which accounted for over a third of the kidnapping cases in the region.

- It's noteworthy that crisis response firms such as Unity continue to highlight terrorist events as a growing concern, especially in Europe where traditional kidnapping risk has been fairly insignificant. As lines blur between traditional kidnapping and crisis incidents, it becomes increasingly necessary to approach these threats holistically.
- Mexico continues to represent significant exposure for kidnapping. According to red24, the majority of kidnappings in Mexico are resolved within seven days, with 59.8% being resolved in less than 24 hours (which further underscores Mexico as a hub for express kidnapping.)³ Moreover, virtual kidnappings continue to represent an enterprise for many criminal groups and drug cartels in Mexico and are often committed by imprisoned individuals. Red24 forecasts that virtual kidnappings will increase to include "cyber-crime" by employing more sophisticated methods, including surveillance of social networking sites and stolen identity data.

Forecast for 2018

- Competition among insurers remains healthy and will continue to keep rates and pricing aggressive. We expect this trend to continue during 2018, resulting in pricing that is flat to +/- 5%, depending on specific risk factors.
- It will be increasingly important to coordinate a client's KRE, cyber, general liability, and crime insurance programs given recent efforts to abate cyber extortion exposure by some KRE insurers.
- As the trend of active shooter and other workplace violence incidents continues to permeate society, proactive engagement of crisis management firms is paramount. Clients should regularly review their incident response plans and seek expert assistance where needed.
- As always, review of a client's global footprint in relation to that of its crisis response firm continues to be material to the decision-making process.



As lines blur between traditional kidnapping and crisis incidents, it becomes increasingly necessary to approach these threats holistically.

¹https://www.unityresourcesgroup.com/images/unity_reports/risk-map-2017.pdf

²<http://www.hiscoxgroup.com/news/press-releases/2017/26-01-2017.aspx>

³<https://ipmimagazine.com/medical-health-insurance/en/health-medical-travel-expatriate-insurance-product-news/item/4786-hiscox-launches-security-incident-response-coverage-in-the-us>

REPRESENTATIONS & WARRANTIES

Mergers and acquisitions (M&A) activity for 2017 is tracking below 2016 overall levels by deal count (5-10%), however, several sources note an increase in average transaction size. Regardless of overall deal volume, we continue to see increased uptake in the Representations and Warranties Insurance (R&W) for M&A transactions ranging between \$50 million and \$2 billion. We estimate that 30% or more of the transactions in this range include R&W insurance.

The market today

- Insurers continue to cite growth rates in excess of 20%.
- The number of insurers writing US domestic transactions is nearing 25 now, up from 10 in 2015.
- The increased number of insurers and capacity has led to lower premiums vs. 2016 levels (down roughly 10%).
- Uptake levels continue to increase despite modest fall off in transaction levels.
- The increased number of insurers has led to greater interest in writing R&W insurance for transactions in the \$25 million to \$50 million range—an underserved segment of the market until last year.

Market capacity

- The number of insurers and overall R&W market capacity continue to grow.
- Most insurers have at least \$25 million in capacity with a growing number now offering \$50 million to \$100 million.
- We do not expect a marked increase in the number of R&W insurers for 2018.

Topical issues

- Claims data is becoming more available as the product matures. AIG released a claim study of its 2011 through 2015 policy years in April of 2017, citing:
 - AIG cites claim frequency of 18% (for policy years 2011 through 2015).

- Financial statements and tax claims make up 34% of those claims with material contracts and compliance with laws each accounting for roughly 15%.
- Fifty-five percent of the claims filed have greater than \$1 million claims cost, and 7% have costs over \$10 million.
- Terms remain broad with a trend towards fewer deal-specific exclusions being written into policies.
- Self-insured retentions tend to be 1% of transaction value and purchase price.
- Insurers are more frequently writing transactions where there is no seller indemnity provided to the buyer.

Forecast for 2018

- For 2018, we expect to see increases in:
 - The uptake for this insurance, as more and more sellers require buyers to procure the coverage as part of the transaction.
 - The purchase of R&W insurance by strategic buyers.
 - The number of insurers and capacity (but not as significant as past years).
- We expect coverage terms to remain broad and pricing to continue to soften for 2018.
- We expect more data to become available relative to claims as the product continues to mature.

2017 was a year of significant growth and maturity for R&W insurance market, with more frequency of purchase, more active insurers, and abundant capacity. We expect the momentum to continue into and through 2018.

TECHNOLOGY & PROFESSIONAL ERRORS & OMISSIONS

The market for professional liability for technology and other professional service firms has become extremely competitive with the entry of new capacity into the market, and fewer new buyers.

The market today

- The rate for this coverage continues to go down as competition increases.
- Risks that present class-action exposure (business to consumer) or have large volumes of personally identifiable information in their care, custody, and/or control may be underwritten more heavily; but, rates in this class are more competitive than in previous years.
- While carriers are becoming more creative in this space, they continue to be reluctant to offer coverage for Telephone Consumer Protection Act (TCPA), anti-trust, and other “business practice” related risk.

Market capacity

- We have seen an increase in capacity as new carriers are entering the space.
- Strong lead carriers continue to look to pool their capacity with reinsurers to put up large blocks of capacity (\$50 million to \$100 million). These risks are put under a slightly more magnified lens, but the cost savings and streamlining of claims handling is becoming increasingly attractive to clients.
- There are many carriers offering capacity in this space, but fewer are offering primary forms with the breadth and depth of coverage that a complex client would require.

Topical issues

- Aggregation remains a concern for carriers as a single data privacy event could result in multiple claims reported to the same insurance companies. This is more concerning as coverage for network business interruption expands to include dependent business interruption creating a ripple effect through many policies from a single event or vulnerability.
- Many clients are seeing requirements for increased limits, higher limitations of liability, and broader indemnifications.

Forecast for 2018

- We expect market capacity to remain stable at \$500 million to \$600 million as new syndicates continue to offer capacity at Lloyd's and the Bermuda market expands its appetite for network security and privacy insurance.
- Underwriters are offering a reduction in rate to insureds that are free of claims. We expect this trend to continue and for the rate reductions to grow as we move away from large litigation and data privacy incidents. A large data privacy breach would put an immediate halt to any premium and/or rate reductions to risks with class action exposure or for risks that collect, store and/or control large volumes of personally identifiable or confidential information.
- Carriers will continue their innovation on capacity maximization as it creates a cleaner and more streamlined program for larger complex risks. It also assists in the claims process should there be a large loss.

Aggregation remains a concern for carriers as a single data privacy event could result in multiple claims reported to the same insurance companies. This is more concerning as coverage for network business interruption expands to include dependent business interruption creating a ripple effect through many policies from a single event or vulnerability.

NETWORK SECURITY & PRIVACY RISK (CYBER)

The increase in frequency and severity of data privacy incidents and ransomware events over the past year has continued to keep “cyber risk” concerns at the board level and top of mind for leaders in the risk space. “It’s not if, but when” is going from cliché to reality.

The market today

- While there have been many headline grabbing data privacy and ransomware events, the market remains competitive and stable.
- Carriers have increased innovation in attempts to bridge the gap between the physical and non-physical perils that exists in policies today.

Market capacity

- Capacity continues to increase as clients explore higher limits options.
- There are many carriers offering capacity in this space but fewer are offering primary forms that offer the breadth and depth of coverage that a complex client would require.

Topical issues

- Carriers have been offering broader triggers for network business interruption in an attempt to make the coverage more accessible and valuable.
- It is important to review all policies, from property to crime, to ensure that there aren’t gaps or overlaps. Many policies are offering limited coverage that could materially impact a network security/privacy liability insurance and visa versa.
- Carriers are paying more attention to patch management and vendor access management as well as disaster recovery and incident response plans, as management in these areas can mitigate a loss.
- Aggregation remains a concern for carriers as a single data privacy event could result in multiple claims reported to the same insurance companies. This is more concerning as coverage for network business interruption expands to include dependent business interruption, creating a ripple effect through many policies from a single event or vulnerability.

Forecast for 2018

- We expect market capacity to remain stable at \$500 million to \$600 million as new syndicates continue to offer capacity at Lloyd’s and the Bermuda market expands its appetite for network security and privacy insurance.
- The increased competition will continue to force rates down for domestic carriers.
- Carriers will continue their innovation and evolution in coverage as the buyers become more educated and the walls between lines of coverage come down.
- Coverage for dependent business interruption will become more accessible and standard as carriers make this offering more robust to attract buyers.
- Third-party cost management will become more of a focus and many carriers may bring value-add services (table top exercises to test incident response plans, for example) in house to increase profitability.

Barring a catastrophic data privacy event in retail, healthcare, or credit card processing, rates will continue to come down as coverage is expanded.

COMMERCIAL SURETY

The commercial surety market remains soft, with pricing for some classes of bonds as low as they were in the mid 1990's. Capacity is still strong given the number of carriers in the commercial surety marketplace. A shortage of underwriting talent and continuity planning on the broker side continues to be of concern.

The market today

- Surety year-end results from 2016 (released Oct -2017) indicate commercial surety direct-written premiums at approximately \$1.69 billion (estimated to comprise 35% of all surety premium).
- Commercial surety loss ratio fell from 2.9% to 1.8% in 2014 and 2015 retrospectively.
- There was little consolidation in 2017 as carriers focused on expanding their global reach.
- Pricing is still trending consistent with or, in some cases, lower than the letter of credit costs.
- Larger carriers continue to focus their growth on expanding middle market opportunities as well as improving their international footprints.

Market capacity

- The number of new carriers entering the marketplace has stabilized.
- Capacity is not an issue and exceeds client demand.
- We have seen cases where capacity can be extended in excess of \$1 billion, primarily with the top five carriers: Travelers, Zurich, Liberty, CNA, and Chubb.

Topical issues

- Mergers and acquisitions (M&A) activity has been on the rise, causing consolidation among clients, and increasing competition.
- With a large percentage of retirements looming in the next one to five years, the acquisition and shortage of seasoned surety talent is an industry-wide concern.

- Carriers and brokers will continue to look for more efficient ways of handling the miscellaneous classifications of bonds through carrier portals and instant issue platforms.
- The importance of creating efficiencies through technology solutions is a focus for carriers, brokers and their clients.

Forecast for 2018

- There are concerns that the current political environment could have an impact on the surety industry leading to changes in regulation.
- Concerns with property and casualty claims that will be incurred from Hurricanes Harvey, Irma, Maria and the Mexico earthquakes loom as carrier reserves and reinsurance could potentially have an impact on surety. A boost in infrastructure and new building may provide temporary relief for surety but underwriting could start to tighten towards the end of 2018.
- A shortage of talent will continue to stretch resources within the surety marketplace, impacting underwriting results.
- The importance of creating efficiencies through technology solutions is a focus for carriers, brokers, and their clients.
- The international surety market will continue to expand and see an increase in opportunities.
- As baby boomers continue to retire, M&A activity among the surety industry client base will continue to increase as a means to improve growth and to acquire needed talent.

Carriers continue to focus on expanding middle market opportunities as well as improving their international footprints.

CONTRACT SURETY

This past year was, and the foreseeable future will be, an exciting time in the contract surety marketplace. Infrastructure development and improvements are moving forward. Housing starts continue to rise. Construction continues to be a major growth stimulator of the economy. Economists estimate that for every \$1 spent on construction, \$7 flow into the economy.

The market today

- The 2016 year shows \$5.882 billion in surety premium revenue at a loss ratio of 12.9% and 6-month fast-track figures for 2017 are showing \$3.134 billion in revenue, at a loss ratio of 13.6%. While the losses may be slowly creeping up, the product is still profitable.
- Year-end 2017 may well break the \$6 billion premium level.
- The market has a number of new surety carriers coming onto the scene. Carriers are reentering the market or entering the market for the first time, while some other carriers are exiting the surety marketplace.
- Surprisingly, the underwriting discipline seems to be stable but surety losses, especially contract surety losses, take time to develop.
- The contract surety markets are still looking most favorably at middle market contractors. Contractors with limits of \$50 million per job, with aggregate programs of \$100 million to \$150 million, are the most desired.

Market capacity

- The surety marketplace capacity was not an issue in 2017 and will not be a problem going forward into 2018.
- Mega projects are being handled through major multiple ventures or consortium organizations, with their respective sureties pooling resources to meet the challenge of the large bonds required. Bonds in excess of \$1 billion have been provided.
- In addition to the primary surety markets, there is a great deal of capacity available in the reinsurance marketplace, which has resulted in new contract surety carrier entrants into the

business, and additional support being provided to established surety markets.

- More and more banks and related financial institutions are requiring bonds as part of their financing packages for builders and developers.
- Organizations are looking for contract surety bonds to protect them from the exposures of non-performance and non-payment on projects. We continue to see growth in this area, to a point where the private sector surety bond needs are catching up to public sector surety bonds.

Topical issues

- Subguard and subcontractor default insurance (SDI) are still available for sophisticated general contractor or contract manager (at risk) to aid in the risk management exposure in the handling of the exposure presented by subcontractors and material providers. The past year has shown a tightening of policy terms and conditions, in addition to price increases.
- Public-private partnerships (PPP or P3) are being looked at by public entities as a form of project procurement. The challenge presented by a lack of funding for public works projects has made the PPP or P3 a more viable alternative. The planning and completion of the project has the added requirement of providing the long-term (15 to 20 years) financing of the project by way of tolls, or private sector financing. The contract completion of the actual construction contract is where the surety bonds are required. This is a new and cutting edge aspect of the construction industry and having the expertise in the surety field is an advantage.
- Continued experience in the international sector of surety is presenting opportunities from both directions. The reverse flow of business is overseas entities looking to perform on US contracts on both a public procurement and private procurement basis. Conversely, we are seeing US contractors pursuing work overseas. Both of these scenarios are opportunities that are fraught with perils, yet present opportunities for our clients.

Forecast for 2018

- As the Subguard SDI market programs tighten up, a more level playing field for the surety product becomes available, especially for subcontractors and material providers.
- In 2017 and continuing in 2018, we expect the surety market to continue in growth mode, due to the abundance of capacity available in both the primary and reinsurance venues.
- The impact of this year's hurricane season on the insurance industry is a factor to consider as the market tightens and carriers find it more profitable and advantageous to put their capital into more lucrative lines of coverage.

Continued growth and success of the contract surety product is assured, and our work with clients in both the present and future offers a vast well of exciting opportunities.



COMMERCIAL CONSTRUCTION PROJECT RISK

The commercial construction project risk insurance markets are dependent on growth forecasts for the construction industry. Construction projects on a global basis generally require economic growth triggers and political stability.

Controlled insurance programs (CIPs), whether sponsored by an owner or general contractor, are used on most construction projects for greater control of construction exposures.

The expected growth areas for construction project risk include residential, commercial, lodging, and manufacturing. Areas where construction is likely to remain stable include transportation and healthcare. As a result of uncertainty about federal assistance to state and local governments, we may see a decline in highway and street, water supply, sewer, and waste construction.

The market today

Generally, competitive market conditions exist in the commercial construction segment:

- Builders' risk available limits and cost remain competitive, with low deductibles offered. Capacity is available with full limits in non-catastrophic locations for earthquake and wind.
- Workers' compensation and employers' liability (WC&EL) remain competitive with high deductible/loss-sensitive programs. Collateral is still required and availability to post over a three-year period (step-up) still exists.
- Primary general liability (GL) is somewhat competitive in certain jurisdictions and for non-residential construction. Low deductible/no collateral requirements are offered for mixed-use development. GL-only CIPs are available for residential construction in the excess and surplus lines marketplace (non-admitted insurance companies).
- Excess liability remains competitive with reinstatement of aggregate limits annually to follow the primary GL.
- Railroad protective liability remains competitive and limits provided will typically follow the requirements of the railroad.
- Owners' professional protective liability remains competitive and represents a portion of the risk undertaken. Capacity will depend upon the risk and this insurance is available on a primary or excess basis.

Market capacity

- Capacity varies by line of insurance, construction type (wood frame, concrete and steel structure, infrastructure) as well as jurisdiction.
- Industry consolidation continues (Ironshore and Liberty Mutual follow Ace, Chubb, and XL Catlin) without a reduction in capacity or competition.

Topical issues

- Clients need to become familiar with the new 2017 American Institute of Architects (AIA) construction contract documents. The owner-contractor agreement has specific differences in its approach. The parties must understand coverage and impact on project risk and project cost as multiple decisions are now required under the 2017 version.
- Increased use of controlled insurance programs requires a complete review of construction contracts, insurance requirements of all parties involved to prevent gaps in coverage, and clear communication of risk that is transferable.

Forecast for 2018

The industry continues to calculate losses as a result of the natural disasters in 2017. Underwriters may look for rate increases in 2018 to fund losses. Total construction spending may show about a five percent increase in 2018 compared to 2017. Most likely by the end of the second quarter of 2018, the current soft market will be behind us.

- Builders' risk up 5% to 10% due to recent hurricanes and earthquakes from 2017.
- Workers' compensation and employers' liability (WC&EL) should remain flat +/-5% as safety requirements are followed more closely in most jurisdictions.

-
- Primary general liability up 5% to 10% due to third-party property damage claims. Higher deductibles will likely be offered as well.
 - Excess liability is expected to remain flat +5% as frequency in claims has limited impact, unlike the primary general liability underwritten with lower deductible levels.
 - Railroad protective liability should remain flat +/-5% and is required for contractors who perform work on or around a railroad to indemnify the railroad for losses.
 - Owners' professional protective liability is likely to remain flat +/-5% as clients value financial stability. This product continues to evolve to meet the complicated requirements of the construction industry.
-

The construction industry will continue to see slow but solid growth as insurers look to achieve a sustainable balance.



How can we help?

For more information regarding this topic, please contact your USI Consultant, or visit us at www.usi.com

This material is for informational purposes and is not intended to be exhaustive nor should any discussions or opinions be construed as legal advice. Contact your broker for insurance advice, tax professional for tax advice, or legal counsel for legal advice regarding your particular situation. USI does not accept any responsibility for the content of the information provided or for consequences of any actions taken on the basis of the information provided.

© 2018 USI Insurance Services. All rights reserved. MAY16038