STATE OF THE MARKET

Q1–2018

The insurance market is dynamic. In order to provide timely intelligence, AmWINS is committed to providing our clients updates as developments arise. With the 1/1 treaty renewals now on the books, it's a good time to look at how 2017 finally played out and what 2018 is likely to hold.

ON YOUR TEAM.

AmWINS® Group, Inc.

PROPERTY

Although market-hardening fears have not materialized, a repeat of last year's catastrophic losses could *shake the property sector in 2018.*

As 2017 neared its close, many industry observers were anticipating a fairly substantial spike in property renewal rates, a projection driven by an expected jump in treaty reinsurance renewals that would trickle down to retail brokers and their clients. Treaty increases of 20 to 30 percent were seen as possible, if not probable.

However, as 1/1 business closed, that prediction did not materialize. "Although we did see some firming of the market and an end to the five-year downward spiral of rates, increases have been held in the mid single-digit range for accounts with favorable loss experience, with poorer accounts subject to double-digit rate climbs," says Harry Tucker, AmWINS executive vice president and national property practice leader.

MARKET DRIVERS

Predictions of market hardening were based on 2017's catastrophic (CAT) loss experience. Last year was one of the worst ever for hurricanes, with 17 events and three Category 4 storms. Hurricanes Harvey, Irma and Maria caused an estimated $70B to $90B in industry losses.

Farther west, wildfires tore through thousands of acres, adding approximately $12.5B in losses during 2017. However, these losses have so far failed to produce true market hardening, with losses impacting earnings more than capital. In fact, much of the alternative capital that was affected by losses has already been replaced. "There simply is plenty of capital in the market," says Tucker. "Additionally, insurance carrier balance sheets are strong, despite CAT losses in 2017."

The Insurance Information Institute (III) reported that policyholder surplus has grown by 8.4% over the last 8 quarters, reaching an all-time high of $719.4B as of 9/30/17. "The industry now has $1 for every $0.76 of NPW, close to the strongest claims-paying status in its history." This new capital is flowing in from many sources. The alterative capital in the market reached $90B of capacity in 2017, up from only $10B in 2005. A record $12.56B of CAT bond issuance is also 38% higher than the previous record, according to Artemis.

Investments in Insurance Linked Securities (ILS) increased, dispelling concerns that a major CAT year would lock up capital and stifle the ability to write business going forward. ILS capital represents approximately $31B of the $90 billion of alternative capital in the market, again according to Artemis.

As always, exceptions can be found, largely in troubled classes. Primary habitational, wood and lumber, and dealer open lot risks continue to produce poor attritional loss experience. Those classes are experiencing a "micro hard market," characterized by shortage of capacity and significant price increases.

Additionally, RMS released version 17.0 during 2017, and modeling results for U.S. Hurricane and Earthquake have mostly decreased as a result of the updated version of the model. While this response runs counter to actual catastrophe experience for 2017, it could help insurers temper rate increases, as charging a similar renewal rate would yield a higher AAL multiple in version 17.0 versus the prior version.

“For earth quake, the new version seems to have lowered some modeling results in Southern California which helps to offset increase reinsurance costs," says Tucker. "The biggest problem is the new model is hammering locations is the South San Francisco Bay area (zones A2 and A3). This has caused significant increases in pricing in this area and is really the only spot in the EQ market that is truly hard."

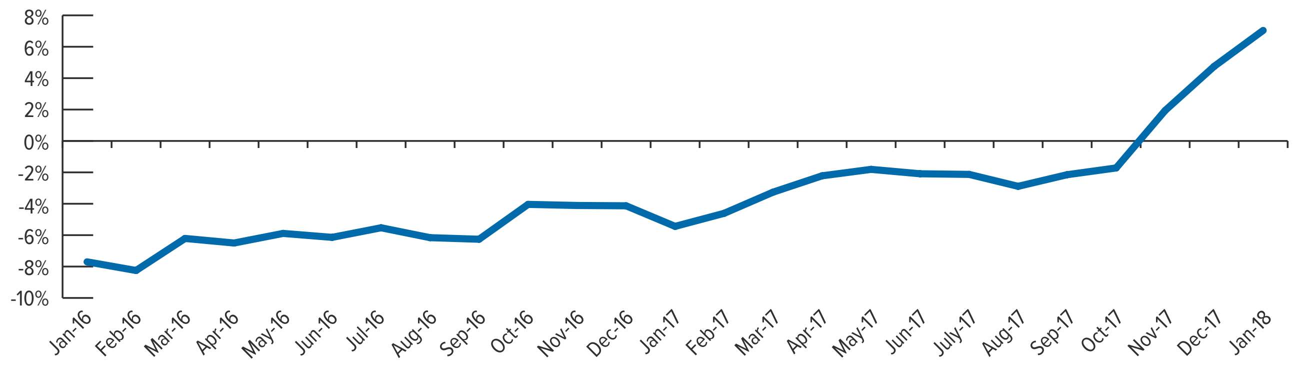
LOOKING FORWARD

Based on the reality of 1/1 renewals and activity seen in the first quarter, some projections can be made for the remainder of 2018. Through the second quarter, we believe clients should expect carrier behavior consistent with what was experienced at the end of 2017. With ample capacity in both primary and excess layers, good accounts can expect flat to low-single-digit increases, while those with tougher loss experience will see increases over 10% and higher retentions.

The long term is more difficult to predict, because it remains to be seen what the storm season of 2018 holds and, most importantly, if capacity can withstand a repeat of 2017. Declining carrier results would bring pressure from investors. In addition, anticipated interest rate increases—driven by growth in both the U.S. and global economies—could pull capital from the insurance market in search of higher returns elsewhere.

In this dynamic marketplace, it’s important that retail brokers partner with a wholesaler that can help them navigate the current market and that offers the data, specialization, CAT modeling and claims advocacy needed to successfully execute in the midst of volatility. A wholesaler with knowledge of the ILS marketplace, London capacity and the ability to structure loss-sensitive alternatives on larger and more complex accounts can make all the difference in writing property business in 2018.

RENEWAL PRICING TRENDS—PROPERTY RENEWALS, ROLLING QUARTERLY



Source: AmWINS property lines account data

CASUALTY

The new year brings insight into what the *2018 market* will look like for retailers and insureds.

Entering 2018, the question on many brokers' minds was how much market experience across all of P&C, not just liability lines, would drive pricing and capacity trends in casualty.

"2017 was one of the worst years for catastrophic property claims, so the question was how much that experience would trickle over into the casualty market," says Tom Dillon, National Casualty Practice Leader at AmWINS. "Additionally, the casualty market suffered some large losses with several catastrophic events of its own in 2017."

MARKET DRIVERS

Those events included the Las Vegas Strip shooting that killed 58 concert-goers and left hundreds injured. Attorneys have filed negligence cases on behalf of more than 450 victims against MGM Resorts International (the corporate owner of the Mandalay Bay resort), promoter Live Nation, and the Route 91 Harvest Festival concert venue.

Additionally, devastating California wildfires may have a liability cost, as attorneys look to assign blame. Under California state statues, if utility equipment is found to have been a substantial cause of the wildfire damage—even if the utility has followed established inspection and safety rules—the utility may be liable for property damage and attorneys' fees.

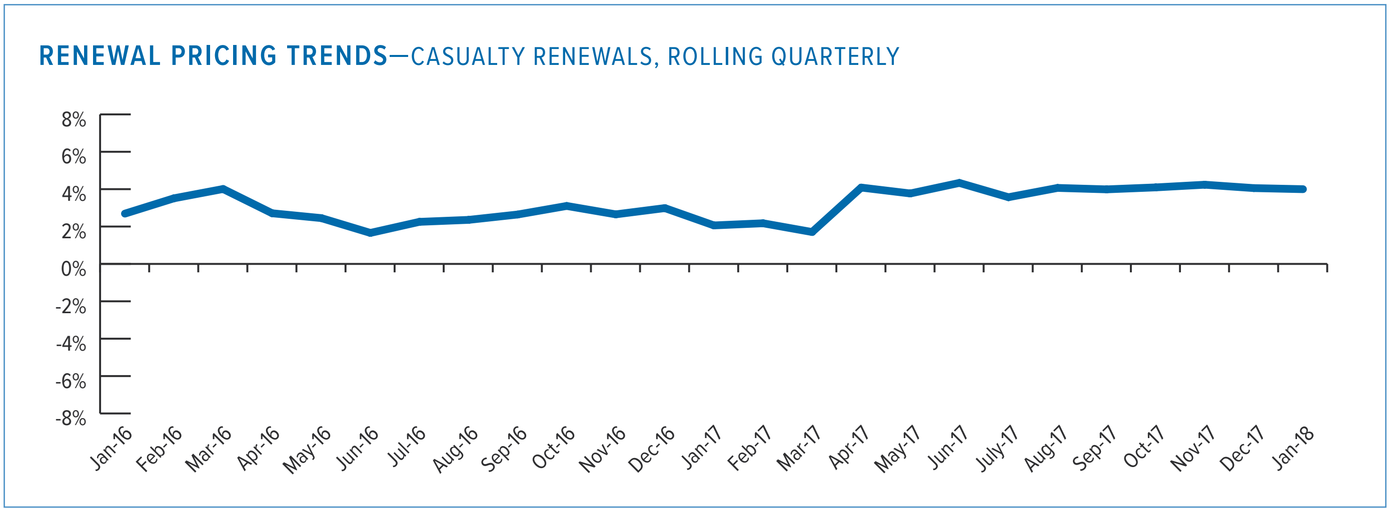
Brokers also have their eye on actions that underwriters have been taking in troubled casualty classes. Habitational, which had been a "loss leader" for companies coming into the casualty market looking to write premium, is no longer as attractive to underwriters. In loss-plagued commercial auto liability (both primary and excess), brokers are scrambling to find homes for accounts as carriers move into and out of markets. In addition, New York construction shows no signs of improvement.

MARKET IMPACT

As a result, many insurers were holding their breath in the fourth quarter of 2017, waiting to see how the large block of 1/1 renewals would play out and how much of an impact events would have on the casualty market. Ultimately, little impact was seen.

"Many renewals came down to the wire, as both insurers and reinsurers held out for rate increases that just didn't occur," says Dillon.

The casualty market as a whole did see some slight price increases on 1/1 business, but conditions are nowhere near approaching a hard market. Accounts renewing in 2018 should anticipate rates from flat to a 10 percent increase. The aforementioned troubled classes of habitational, commercial auto, and New York construction will experience greater upward rate pressure, as will accounts with poor loss experience and/or poor risk management practices.



Source: AmWINS casualty lines account data

In general, insurers with favorable loss experience saw flat to 5 percent treaty premium increases, while those with poor loss experience saw 5 to 10 percent, along with slight reductions in ceding commission for both.

As a result, the expectation for 2018 is that general liability, while pulling back from steep pricing declines of previous years, still offers a suitable environment and opportunity for retail agents, with few exceptions. Automobile liability still challenges buyers with significant rate increases and more carriers are reducing their exposure to this line of business.

In this dynamic market, retailers benefit from working with wholesalers who understand the trends, issues and developments shaping the casualty marketplace.

At AmWINS, our industry specialization and market knowledge can help brokers develop solutions and achieve complex insurance placements for their clients.

PROFESSIONAL LINES & CYBER

Differing conditions exist across the professional liability market, with indications of hard market pricing appearing in certain segments.

PROFESSIONAL

Professional liability is a tale of multiple markets. While miscellaneous professional lines continue to be soft, healthcare and private/non-profit D&O are seeing noticeable market shifts.

"What is happening in the Healthcare and Aging Services market is as close to a hard market as we have seen in years. Markets are pulling out, claims are horrific, premium increases are outrageous, and yet we are still seeing policies renew. We have seen renewal pricing come in two to five times the expiring premium and still renew," says David Lewison, senior vice president and national professional lines practice leader for AmWINS Group, Inc.

MANAGEMENT LIABILITY

In non-profit D&O, the market is very soft for traditional charitable foundations. Pricing can be well under $1,000 per million of limit and be bound with limited underwriting information. However, the story is different for healthcare-related risks. The insurers have been continuously hit hard with antitrust-related claims arising from mergers and acquisitions, as well as territorial monopolies. The uncertainty around government-sponsored healthcare continues to add to the complexity in this class.

In Private D&O, many insurers are dealing with the increased cost of bankruptcy-related claims, intellectual property-related claims from hiring key employees away from competitors, shareholder claims hitting the large, "new economy" private companies that look like public D&O claims, regulatory actions and antitrust. Some of the larger insurers are reevaluating their underwriting appetite, which will lead to higher rates and movement of renewals. Nevertheless, there is still plenty of capacity, so it cannot be classified as a hard market.

EMPLOYMENT PRACTICES LIABILITY

In 2017, the issue of sexual harassment—especially in the workplace—gained greater awareness as allegations of inappropriate behavior by high-profile individuals were constantly in the news. In many cases, sexual harassment lawsuits seriously impacted businesses and their respective insurers. As social tolerance of sexual harassment decreases, employers must consider the risk to their businesses as a result of harassment committed by an employee. In additional, wrongful termination claims filed by the accused harasser when they disagree with the allegations are likely to increase.

Employment practices liability insurance policies offer benefits beyond defending and covering losses. Many insurers provide risk management services specific to employment practices. These services could become more valuable in this litigious environment.

"EPL placements vary in complexity. Finding the right market will be determined by employee count, industry, geography, need for Wage & Hour coverage and claims history. We are seeing places like California and Florida, where loss experiences are high, continue to be a challenge for many insurers. AmWINS places EPL accounts with more than 75 markets, so we can provide many options for protecting your client," says Lewison.

CYBER

With cyber attacks on the rise, interest in cyber insurance continues to grow. In terms of cyber security breaches, 2017 was the worst on record, with over 5,200 breaches exposing 7.8 billion files. The business sector accounts for 39.4% of breaches, followed by medical and government.[1] Estimates of global cyber crime costs are currently in the range of $400 billion per year, with analysts predicting that annual losses could increase to a trillion dollars within the next few years.

Although many stand-alone markets for the coverage exist, because the division between cyber and professional risk is sometimes unclear, placing coverage with a professional lines market on a consolidated form remains the best practice to avoid coverage gaps when an account has both E&O and cyber risk.

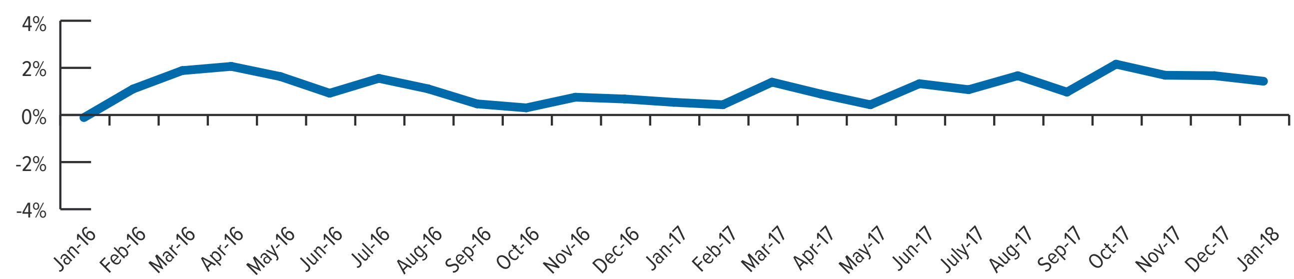
> ***"If you write D&O and a cyber event triggers a D&O claim, how will that claim be handled? Will you have a denial of claim by both insurers? Coordination of coverage is key," says Lewison.***

In the coming months, all signs indicate a continuation of soft professional liability market conditions. In this diverse marketplace, it is essential to partner with a wholesaler that devotes the time and resources to understanding the spectrum of the professional lines and cyber arena.

"This is a market where a wholesaler can add value to a retailer through specialization that the retailer can then bring to the client. We can answer questions for retailers on how to cover a particular risk, especially because there are many different forms, terms, and conditions," says Lewison.

[1] *Data Break Quick Review Report, January 2018, Risk Based Security*

RENEWAL PRICING TRENDS—PROFESSIONAL LINES RENEWALS, ROLLING QUARTERLY



Source: AmWINS professional lines account data

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