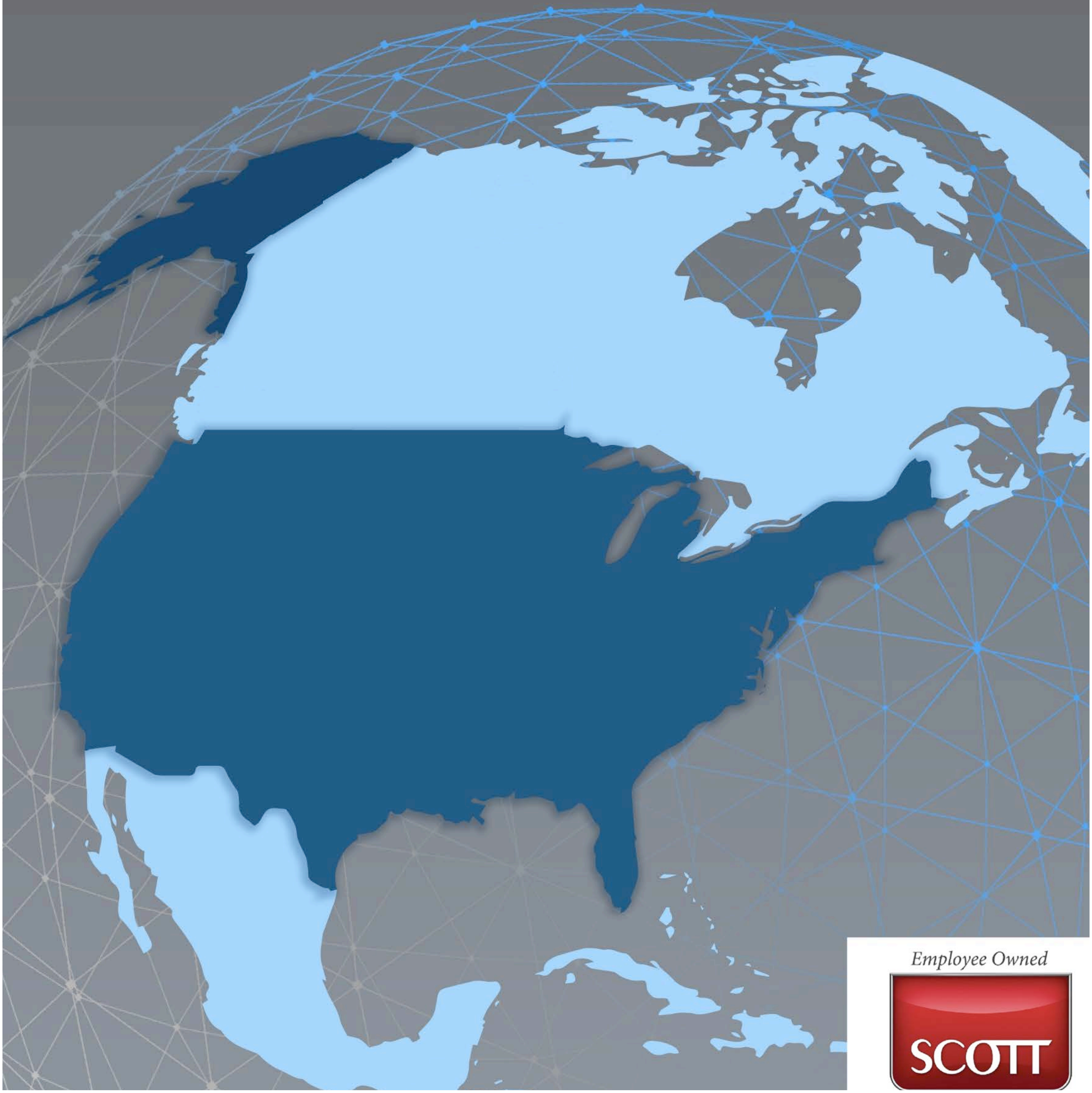
P&C MARKET OUTLOOK
2017



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INTRODUCTION

Property and casualty (P&C) insurance tends to be one of the most important items businesses review on an annual basis. At Scott, our clients often ask us to predict how their insurance costs will change each year. While no two businesses are exactly alike and many factors go into the pricing of insurance policies, we can make a number of predictions based on the current state of the insurance market.

Despite flat or declining investment returns for some insurance companies, 2016 was generally a buyer's market for property and casualty insurance. Market capacity and competition among insurance companies helped drive prices down for many businesses. Many commercial insurance buyers experienced single to low double-digit rate decreases across a range of insurance lines with auto coverage being the major exception.

So far in 2017, outside of auto liability, businesses have continued to see premium reductions on their commercial insurance. Many experts believe this will continue, although reductions may not be as great as those seen in recent years. Insurers are facing a changing dynamic with evolving regulations, low interest rates, increased automation, and rising risks of cyber and privacy threats. These conditions are challenges, but they are also opportunities for growth that are transforming the way businesses operate and their need to mitigate risk with insurance products. Reinsurance rates are at an all-time low and businesses will continue to benefit from increasing market capacity in the form of new markets competing for business and broader terms and conditions.   This report will examine some of the more popular insurance lines and their pricing outlook in detail.

Overall, the P&C insurance market remains relatively stable in an ever-changing environment. This is welcome news for an industry that is predicated on providing financial relief when disaster strikes.

Scott Insurance is here to help your organization find the appropriate insurance coverage. Contact a Scott Risk Advisor today to discuss your unique needs.

DETERMINING PREMIUMS

Generally speaking, insurance premiums are dictated by the amount of risk an insurer accepts on behalf of a client. Insurers consider the likelihood of a client or a group of clients making a claim, and how much those claims will likely cost.

While many of the factors that contribute to the overall cost of insurance can be influenced by the policyholder (for example, proper risk management, selection of proper policy limits, deductibles and claims history), there are many external factors that drive insurance costs up and down.

The following external factors influence insurance premiums:

- **The cost of reinsurance**: Reinsurance is insurance for insurance companies, which insurers buy for risk they cannot or do not wish to retain fully. Premium rates for insurance buyers are stabilized by reinsurance. The supply of reinsurance capital is at an all-time high. As a result, primary insurance companies are paying lower premiums for reinsurance and, in many instances, are passing savings along to their policyholders.

- **Investment income**: Another factor that can influence the pricing of insurance policies is the return on investment that insurance companies receive. Insurers invest mainly in domestic government and corporate bonds, and in preferred and common stocks. Over the past few years, insurers have reported low investment yields.

- **Underwriting profitability**: Insurers measure their underwriting profits with their combined ratios. Combined ratios are calculated by dividing the sum of incurred losses and operating expenses by premiums. If an insurer has a combined ratio of less than 100 percent, it is making a profit. A combined ratio of more than 100 percent reflects a loss. Initial reports from U.S. insurers show relatively stable combined ratios in 2016. However, some insurers experienced an uptick in their combined ratio due to exposure to significant weather events.

- **Inflation**: Insurers will often adjust premiums to keep pace with inflation. In 2016, the consumer price index measured inflation at 2.1 percent.

WHERE PREMIUM DOLLARS GO

There are many common misconceptions about what insurance companies do with the money they receive through insurance premiums. Every year, insurance companies must settle claims, pay taxes and cover operating expenses. What's more, insurance companies set aside funds so they can respond quickly to costly disasters.

The following is a breakdown of the amount of payment on premiums received per dollar:

- **Claims payments:** Insurance carriers use a large portion of premiums to pay for their customers' losses. However, claims costs can fluctuate greatly depending on a variety of factors. Furthermore, carriers do not collect enough premiums to pay for the losses of all of their customers. Instead, they use statistical models to anticipate how many of their customers will experience a loss and then use a portion of the collected premiums to compensate any covered losses. Typically, about 50-60 percent of premiums are used to make claims payments.

- **Investments:** After insurance carriers collect premiums, they often put that money into low-risk investments, such as bonds or real estate. However, carriers are required to have enough money on hand to pay for insurance claims, and many states limit the amount of investments carriers can make. Around 10 percent of premiums are directed either to investments or straight profit, although this amount varies by location and industry.

- **Expenses:** Just like any other business, insurance carriers must maintain staff and offices, pay taxes, and market their products. Approximately 20 percent of premiums go toward these operational expenses.

MARKET FORCES

The P&C insurance market is facing an environment of change. Increasingly, insurance companies have to reimagine their approaches to large-scale catastrophes, evolving technology and cyber security. All three of these challenges have changed the way insurance companies interact with their commercial policyholders.

STAYING AHEAD OF CATASTROPHES

In 2016, catastrophic weather events worldwide led to $54 billion in insured losses, and over half of those losses occurred in the United States. When considering the overall damage from these weather events, 2016 was the second costliest year for catastrophes since the National Centers for Environmental Information (NCEI) began tracking the costs of storms.

In the future, there is a possibility that major, catastrophic events will increase in frequency and severity, making it all the more important for insurers to stay ahead of the game. While no two catastrophic events are the same, the insurance industry has an incentive to learn from past disasters.

For example, by learning from past disasters like Hurricane Katrina in 2005 and Hurricane Sandy in 2012, the industry used advanced satellite imagery, more powerful information technology and improved connectivity during severe storms in 2016. These innovations improved insurers' ability to connect their policyholders with claims adjusters, leading to better monitoring and assessments of losses.

In 2017, many insurance companies are looking to advance their tools and shared best practices for assessing and responding to catastrophic disasters, whether natural or man-made.

ADDRESSING NEW TECHNOLOGIES

Technology can help connect insurers with policyholders and improve assessments of exposures. While technology can be used to mitigate risks, it can also create new ones.

The onset of ride-sharing platforms, telematics, artificial intelligence and the popularity of drones has created new perils for insurers to consider. And with the potential for self-automated cars and commercial vehicles on the rise, 2017 and beyond will feature new areas of liability that have never been explored.

With the emergence of new technology-related risks, insurers have their work cut out for them—particularly when it comes to understanding any apparent risks and performing their due diligence. Proper risk management and governance of the underwriting, claims and pricing processes will be key in 2017.

MARKET FORCES

What's more, advances in technology will continue to change customer expectations. A slew of new products, policy options and business practices—like 24/7 access to on-demand coverage—are set to disrupt the current insurance landscape. If insurers are unable to adapt, the market could be ripe for less organic growth and more mergers and acquisitions.

CYBER SECURITY

Last year saw a drastic increase in cyber risk insurance policies. This is a trend that is likely to continue in the foreseeable future. However, because cyber liability insurance policies are relatively new, there is little in the way of pricing guides, data on loss experiences, or best practices related to underwriting and claims management.

What's more, is that cyber threats are apparent for insurers themselves, who, in order to better connect with their clients, will have to turn to digital business solutions in 2017 if they have not already.

To protect themselves, insurers and businesses alike must seek two-fold protection. First, they need to take the proper precautionary measures, including setting up monitoring and response plans. Next, it is important to consider the fact that these strategies might fail and to seek the right coverage.

WORKERS' COMPENSATION

2017 Price Prediction

- **Positive loss experience**: -10 percent to flat
- **Guaranteed cost and low deductible plans:** Flat to 10 percent

Looking Ahead

UNDERWRITERS ARE BEGINNING TO FOCUS ON PRE- AND POST-LOSS MITIGATION in order to limit the costs of medical cost inflation and continued time away from work. As a result, **BUSINESSES THAT FOCUS ON RISK MITIGATION AND RETURN-TO-WORK PROGRAMS MAY WELL EXPERIENCE DISCOUNTS.**

A number of issues in 2016 caused the average combined loss ratio for workers' compensation insurance to rise, which led to less profit for insurance carriers. As a result, 2017 should see more careful underwriting processes that focus on a business's size, loss history, industry and location.

Location will be an especially important topic in workers' compensation in 2017. A number of states are expected to introduce new workers' compensation legislation this year. Other states introduced legislation in 2016 and are just now seeing the results. Businesses in states such as California, Florida and New York may have difficulty securing new coverage, although retaining existing coverage should be less difficult. Additionally, changes made by the Trump administration may affect the enforcement policies for federal agencies, such as OSHA and the Department of Transportation.

Underwriters will also carefully review a business's loss history and risk mitigation programs while writing a new policy. The market capacity should remain for businesses with good risk profiles and positive loss experience, and competition among carriers should lead to flat or even moderate discounts. However, businesses looking for guaranteed cost or low deductible policies may have to pay more to secure coverage.

PROPERTY

2017 Price Prediction

- **Catastrophic:** -10 percent to flat
- **Non-catastrophic:** -10 to -7.5 percent

Looking Ahead

Although the market contains a large amount of **CAPACITY FOR PROPERTY COVERAGE,** future losses from tornado, hail and flood damage will be assessed carefully. **THESE STORMS HAVE RECENTLY BEEN LOSS LEADERS, AND APPLICABLE POLICIES WILL BE UNDERWRITTEN CAREFULLY.**

From a pricing and availability perspective, both the domestic and global commercial property insurance markets remain competitive for insurance buyers. In 2016, similar to the several years before it, there was a lack of substantial industry-wide catastrophic insurance loss.

The main exception was Hurricane Matthew, with estimated insured losses of $8.8 billion. However, these losses did not have a major effect on insurers' capital strength, as reinsurers bore a significant portion of the losses.

Overall, the commercial property insurance market can be characterized as steady and capacity-rich. This environment should continue throughout 2017, assuming normal loss activities continue.

As a result, we expect property insurance rates to be very competitive in 2017, with continued single to low double-digit prices or rate reductions available to most commercial property insurance clients—especially those with favorable loss records and superior risk quality.

GENERAL LIABILITY

2017 Price Prediction

- **General liability**: -5 percent to flat for most risks. A 5 to 10 percent increase for risks with loss activity

Looking Ahead

Many insurance carriers in the **GENERAL LIABILITY MARKET ARE LOOKING TO GROW THEIR MARKET SHARE.** However, more disciplined underwriting practices will mean that the best terms will be given to existing clients. As a result, **MULTIYEAR DEALS MAY BE THE BEST OPTION FOR NEW CUSTOMERS.**

In 2016, competition among insurers, as well as new capital entering the market, resulted in favorable conditions for businesses purchasing general liability insurance.

Looking ahead, less than stellar loss ratios and decreasing returns on investments for insurers suggest that pricing for general liability insurance may not be quite as favorable in 2017. While competition among insurance companies for premium dollars is still expected to exist, a slight climb in overall pricing for some insureds may occur. The best pricing will be for businesses with exceptional loss experience who demonstrate appropriate risk management.

Auto liability remains competitive for businesses with substantial fleet safety initiatives and positive loss experience. However, it should be noted that insureds with heavy fleet exposures and a record of losses may experience a hardening market.

CYBER

2017 Price Prediction

- **First-time buyers:** Competitive market conditions based on industry and size of company. However, there are fewer new providers compared to prior years.
- **Renewals:** Flat to 10 percent

Internal and External Factors

Internal and external factors that contribute or could contribute to a cyber attack will be a point of close examination for insurers in 2017. Such factors may include the following:

- Industry type
- Employee cyber training
- Sensitive data handling procedures
- Holistic security practices
- Data breach reporting procedures

By 2020, industry experts believe that global cyber insurance premiums will reach $20 billion. In today's business climate, cyber attacks are no longer a question of if, but when. This is especially true in the United States, which remains one of the most wired countries in the world and has seen an increase in political hacktivism. It is no surprise that cyber security was ranked as the third most important issue facing the commercial insurance industry today.

RENEWALS

Renewals for cyber liability insurance will continue to see average premium increases up to 10 percent. Highly publicized data breaches across North America have created an environment where premium increases are to be expected. This is especially true for organizations in the retail and health care sectors due to their unique exposures.

WORKPLACE CONTROLS

While premium increases are expected over the course of 2017, organizations could soften the blow by implementing strong workplace controls to help curb the threat of cyber attacks. In fact, carriers will be more aggressively scrutinizing the systems their clients have in place in order to ensure that potential risks are being controlled wherever possible.

DIRECTORS AND OFFICERS LIABILITY

2017 Price Prediction

- **Overall:** -7.5 percent to flat
- **Public companies:** -10 percent to flat
- **Private companies, including nonprofit entities:** -5 to +5 percent

Despite recent merger and acquisition activity among insurance companies, the marketplace for directors and officers (D&O) liability insurance is experiencing a cycle of softening premium rates. This soft pricing cycle began in 2015, continued throughout 2016 and is expected to remain throughout 2017 with no signs of diminishing.

COVERAGE ENHANCEMENTS

The market continues to provide coverage improvement, either as part of a self-generated offering or in response to broker-initiated requests.

CYBER SECURITY

Cyber security is an emerging risk concern for D&O underwriters. Directors and officers are a common target of cyber criminals, which may be a consideration taken by insurers whenever organizations are shopping for a policy. Experts also believe that the Securities and Exchange Commission (SEC) may begin to take enforcement actions regarding the disclosure of cyber liability.

ALLEGED WRONGFUL ACTS

PERCENT OF ALL CLAIMS COSTS

Governance	Fiduciary	Employment Practices
5%	1%	94%

NUMBER OF CLAIMS

Governance	Fiduciary	Employment Practices
117	51	1,346

LARGEST CLAIM

Governance	Fiduciary	Employment Practices
$775,000	$82,000	$938,000

AVERAGE CLAIM

Governance	Fiduciary	Employment Practices
$23,000	$6,000	$33,000

DEFENSE COSTS AS % OF TOTAL

Governance	Fiduciary	Employment Practices
75%	86%	45%

(Source: Nonprofits Insurance Alliance Group)

ERRORS AND OMISSIONS

2017 Price Prediction

- **Good loss experience:** -5 percent to flat

Looking Ahead

THE MARKET CAPACITY FOR E&O COVERAGE REMAINS HIGH, and underwriters sometimes offer slight discounts to clients that are free of claims. **HOWEVER, CONTRACT NEGOTIATIONS THAT COULD AFFECT E&O CLAIMS ARE GENERALLY BECOMING MORE COMPLEX.**

The errors and omissions (E&O) insurance market has remained relatively stable due to the lack of large claims and judgments. And, although the rates for E&O coverage also remains stable, insurance carriers are reluctant to write certain coverage areas, such as first-party recalls and cost of corrections.

CYBER AND CLOUD COMPUTING EXPOSURES

Protecting private data and the intellectual property they hold for third parties was a crucial concern for many types of businesses. In order to improve the efficiency of their insurance coverage and to avoid potential gaps in coverage, organizations with significant privacy exposures have started to buy cyber insurance as part of their overall E&O liability program.

EMPLOYMENT PRACTICES LIABILITY INSURANCE

2017 Price Prediction

- **Overall:** -5 to +5 percent

Labor and Employment Trends to Watch in 2017

LEGALIZATION OF MARIJUANA:

Many states have legalized the use of recreational or medicinal marijuana, and others plan to offer referendums regarding the use of marijuana. These developments will affect employer efforts to ensure a safe workplace.

Employment-related lawsuits are a growing concern for employers of all sizes. Each year, thousands of employment disputes are litigated across the United States, which cost employers thousands in legal fees. Additionally, employment regulations frequently vary by state, making it difficult for employers to know whether or not they are in compliance. As costs for litigation and awards for damage climb, more and more organizations are rounding off their insurance coverage with employment practices liability insurance (EPLI).

EPLI rates, while stable overall, could fluctuate for some organizations whenever instances of loss, mergers, acquisitions or other changes in exposures take place. Buyers should take notice and prepare themselves for claims related to compensation discrimination, harassment and more.

Moving forward, the EPLI market will continue to become more competitive and insurers will offer a greater variety of policies to meet the demands of buyers. Having the appropriate employment policies and HR best practices in place can make all the difference when it comes to managing premiums.

EMPLOYMENT PRACTICES LIABILITY INSURANCE

Labor and Employment Trends to Watch in 2017

INCREASING DAMAGE AWARDS AND PENALTIES:

Federal agencies, such as OSHA and the Equal Employment Opportunity Commission (EEOC), have been levying harsher penalties against employers, directors, officers and supervisors for violations of human rights, occupational health and safety, and employment standards legislation. This trend is expected to continue into 2017.

KEY CLAIMS

Employers should take note of potential Fair Labor Standards Act (FLSA) claims, as most of them have class or mass action status. In order to be well prepared for potential EPLI claims, employers should attempt to eliminate barriers in recruitment and hiring, protect vulnerable employees (e.g., immigrant and migrant workers), and ensure equal pay protection.

MOVING FORWARD

It can sometimes seem as if the forces determining your insurance rates are beyond your control. But as an insurance buyer, it's important to know how your premium is calculated, what trends influence the market and what you can do to get the best price.

Your claims history—which you can control—has an enormous impact on whether your rates go up or down. As a result, implementing a solid risk management plan will help steer your pricing in a more favorable direction, both now and in future renewal periods.

Business owners who proactively address risk, control losses and manage exposures will be adequately prepared for changes in the market and will get the most out of each insurance dollar spent.

The following are five key components of a successful risk management strategy:

1. Pinpoint your exposures and cost drivers.
2. Identify the best loss control solutions to address your unique risks.
3. Create a solid business continuity plan to account for disasters and other unpredictable risks.
4. Build a workplace culture that's focused on safety.
5. Manage claims efficiently to keep costs down.

Remember, the insurance landscape is complex, and while our predictions for the future are based on expert research, they are provisional and subject to change. Fortunately, your partners at Scott Insurance are diligently monitoring the market throughout the year and will keep you informed of any changes that might affect your business.

And, if you have any questions about the lines of coverage outlined here, or have any other concerns, please call 888-747-8588 today.

For more details regarding the information contained in this report, contact Scott Insurance today.

In addition to helping you navigate the insurance market, Scott Insurance has access to resources to assist in your risk management efforts. Business owners who proactively address risk, control losses and manage exposures will be adequately prepared for changes in the market and will get the most out of each insurance dollar spent.

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