PROPERTY & CASUALTY MARKET OUTLOOK

2018 - 2019

Employee Owned

SCOTT

Est. 1864

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INTRODUCTION

At Scott, our clients often ask us for predictions on how their insurance costs will change year-over-year. While every company has unique characteristics that impact pricing, we can make some general observations and recommendations based on past and current market conditions that can help when preparing for the future.

With the exception of auto coverage, the commercial insurance market remained soft for the first half of 2017, a continuation of the trend in 2016. In the third quarter of 2017, we began to see the market tighten a bit with fewer rate reductions due to a rise in underwriting losses. While there continues to be significant capital across the insurance marketplace, recent natural disasters, including storms, fires and earthquakes, are expected to have further implications on pricing for the remainder of 2018 and into 2019.

Collectively, the property and casualty insurance market is stable. While we believe there will always be competition for accounts with high-quality risk protection, favorable loss records and good spread of risk, there may be some fluctuation as the market finds a new equilibrium.

In this report we look into some of the key drivers of current market conditions, examine some of the most utilized coverage lines and pricing expectations. Remember, the Scott Insurance team is here to help your organization find the most appropriate insurance coverage for the unique risks facing your organization.

MARKET FORCES

The property and casualty insurance market is constantly changing due to catastrophes, ever-evolving technologies, increasing and expanding cyber threats, and terrorism. These, along with a variety of other factors, impact profitability for insurance carriers and create a need to adjust their risk tolerance and pricing models, as well as the way they interact with their commercial policyholders.

PROFITABILITY

According to A.M. Best's most recent estimates, the property and casualty insurance industry in the U.S. recorded net underwriting losses of $23.5 billion for 2017, 31 percent more than the $18 billion paid out in 2016.

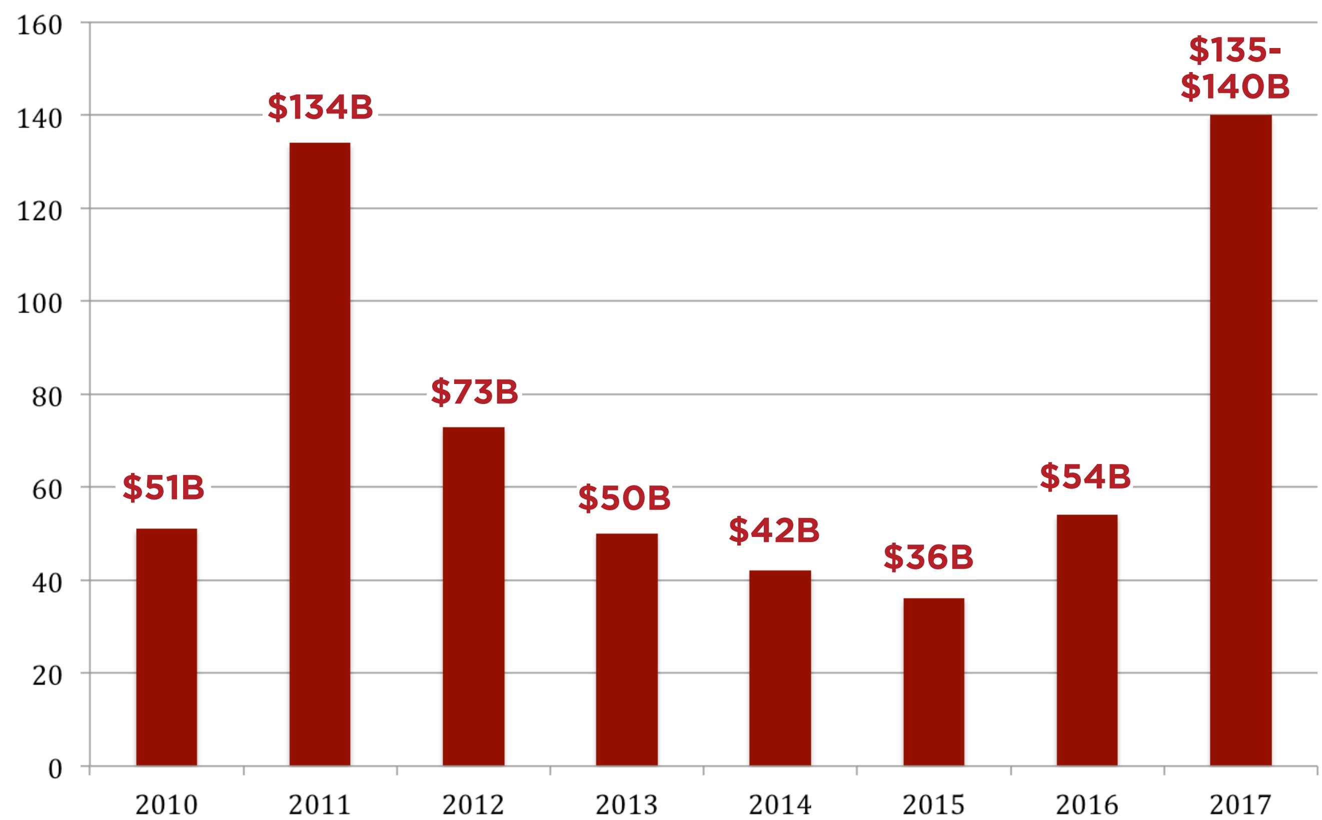
The overall industry combined ratio increased 3 points to 103.8 – the worst the industry has seen in the last 5 years.

CATASTROPHES

For 2017, $52.9 billion was paid out for losses related to catastrophes. This is double what was paid in 2016.

Globally, catastrophic losses are estimated to be between $135 billion and $140 billion, making 2017 one of the largest global catastrophic loss years in history.

GLOBAL NATURAL CATASTROPHES - INCURRED LOSSES (CURRENT USD, B)



**2017 total is estimated*

***2016 and prior includes losses from government-sponsored programs, e.g. NFIP.*

Source: 2016 & prior - Aon, RMS, Swiss Re, Munich Re

PROPERTY

Property losses were at an all-time high in 2017 due to unprecedented windstorms and flooding events from the trifecta of hurricanes that occurred in Q3/Q4 (Harvey, Irma, and Maria). Prior to the hurricanes experienced in 2017, the costliest hurricane on record was Katrina in 2005 with estimated losses of $160 billion. Total estimates for 2017 storms are currently in excess of $200 billion.

Additional losses from wildfires, hail and tornadoes resulted in incurred losses and expenses rapidly overtaking premium dollars.

After several years of rate decreases, we expect to see a push from insurance carriers to recoup some of the losses they experienced in 2017. Property risks not exposed to catastrophe should expect pricing to range from flat to +5 percent while catastrophe-exposed risks will potentially rise 10 to 20 percent, with higher increases of 20 to 25 percent on those accounts that experienced losses in 2017.

It remains to be seen whether or not the push to increase rates will be sustainable over an extended period of time or will become more localized versus industry wide.

PRICING PREDICTION

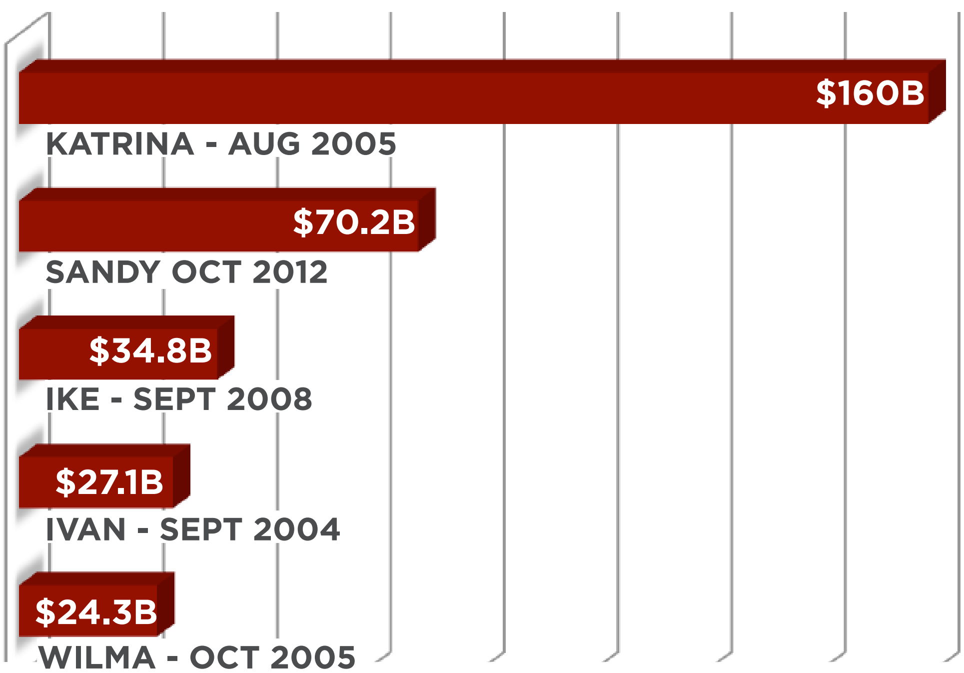
Flat to +5% for risks not exposed to catastrophe

+10% to +20% for risks exposed to catastrophe

+20% to +25% for accounts that experienced losses in 2017

TOP 5 COSTLIEST U.S. HURRICANES SINCE 2000

These are the costliest storms since 2000 in the U.S. While the total price tag for Harvey's damage in 2017 is still unclear, experts estimate that cost could be as high as **$190 billion** in total economic impact.



**Estimated costs in billions (inflation adjusted) Source: National Oceanic and Atmospheric Administration*

WORKERS' COMPENSATION

We saw a continued downward pricing trend in workers' compensation coverage in 2017. Loss-sensitive programs tended to have greater reductions than guaranteed-cost programs; however, both saw moderate to significant decreases.

Underwriting margins for this line of business remain healthy. With allocable capital remaining strong in the industry, we don't expect to see the workers' compensation market hardening in the near future, although price reductions may not be as drastic as we've seen in the past two years. Medical cost inflation is expected to rise 6 percent, which places conservative price predictions at -2 percent to flat for most risks.

Dividend plans have made headway in the marketplace over the last year, offering a competitive option for most companies who maintain favorable loss history year-over-year.

PRICING PREDICTION

-2% to flat for most risks

AUTO

Little change is expected for auto coverage for the upcoming year. Pricing is reflective of the continued struggle for insurance carriers to maintain profitability on this line of business, despite price increases in 2017. Standard & Poor's (S&P) projected auto losses to hit $154 billion in 2017. Distracted driving is the leading cause of accidents and losses. Increased amounts of time spent on the road, inexperienced drivers, a significant rise in fatalities, increased medical costs and increased repair costs are also key factors.

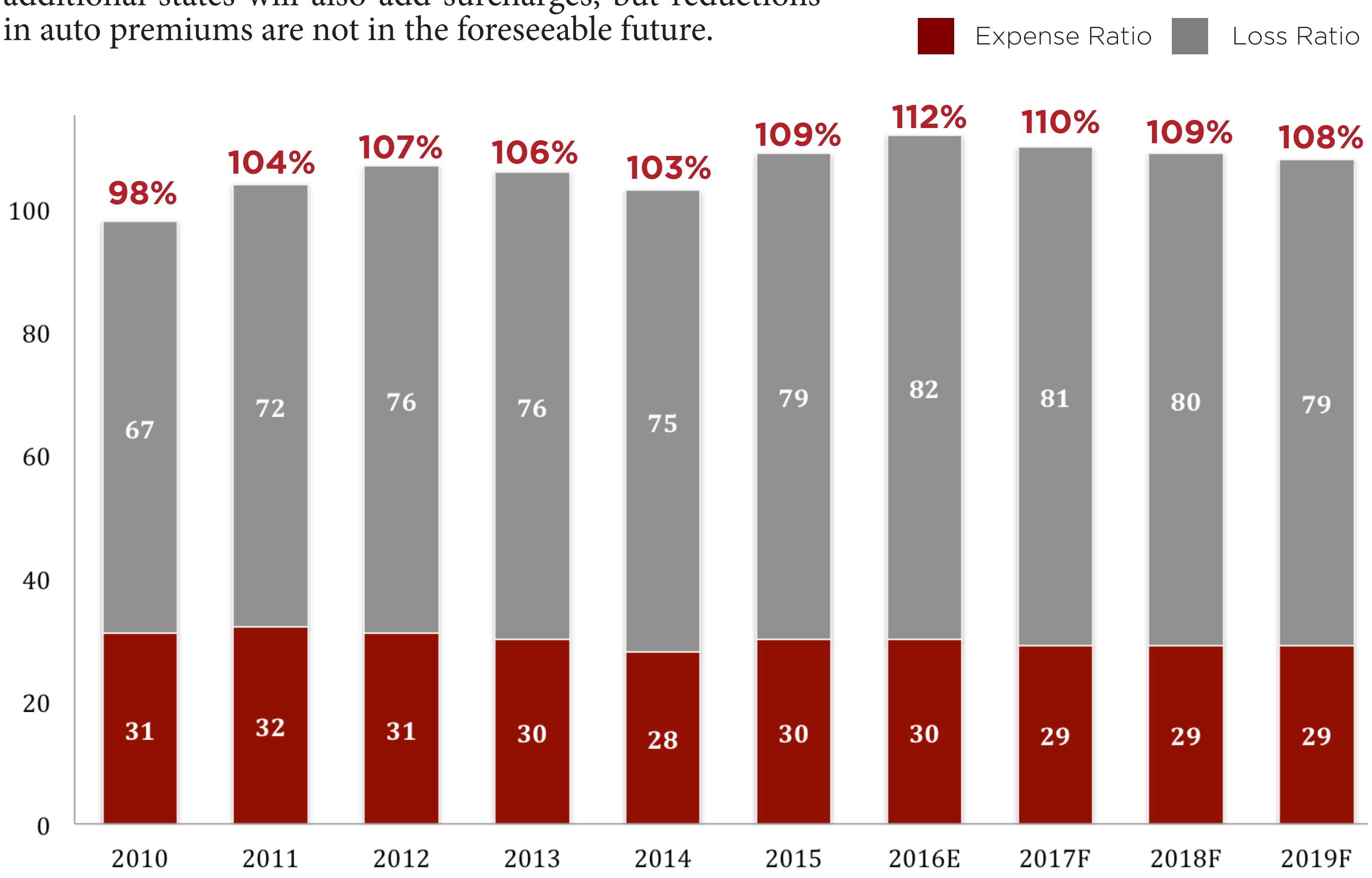
In general, we expect increases from 3 to 8 percent across the board. Those accounts with heavy fleets and/or losses may see double-digit increases. Certain states, such as North Carolina, are adding surcharges for all risks within the state in order to "recoup" a portion of the losses they sustained *(Note: the recoupment surcharge for NC is 14.61 percent and will be implemented on 10/1/2018 for all new and renewal commercial auto policies)*. It is not clear if additional states will also add surcharges, but reductions in auto premiums are not in the foreseeable future.

PRICING PREDICTION

+3% to +8% across the board

+10% and above for heavy fleets or accounts with losses in 2017

COMMERCIAL AUTO INDUSTRY COMBINED RATIO (2010-2019)



Source: Conning, Inc., Property/Casualty Forecast & Analysis FirstQ2017; Commercial Auto Year-End 2016. Historical data from A.M. Best

GENERAL LIABILITY

PRICING PREDICTION

-2% to +2% for most risks

General Liability remains the most stable of all casualty lines, outside of accounts with heavy and/or unique products exposure. Carriers are still looking to grow market share and aggressively pricing risks that have favorable loss histories.

Less overall reductions in premiums were seen in 2017 as compared to the prior two years. This trend is expected to continue with most accounts experiencing a -2 to +2 percent change in premium pricing.

EXCESS / UMBRELLA

PRICING PREDICTION

Flat for most risks

Flat to -10% for mid-upper layers

Many of the catastrophic auto losses that adversely affected that line of business also bled into the excess/umbrella space. In 2017, we saw an effort by the market to raise attachment points for certain industry classes and reduce limits for auto liability, particularly on tougher auto fleets.

With that said, lead umbrellas are generally still competitive. Increasing capacity and competition should continue throughout 2018. Rates will vary based on the layer. Lead excess/umbrella policy rates are expected to remain relatively flat, whereas we expect to see up to a 10 percent decrease for mid and upper layers.

DIRECTORS & OFFICERS

There is a slight push for rate increases on primary public company business due to a near-record-setting year of securities claims in 2017. Rates could climb as high as +7 percent; however, companies with little merger and acquisition activity and strong balance sheets may still see a slight reduction.

The rest of the market continues to remain in softer territory for excess layers, Side A, and Private and Non-Profit organizations, with price expectations ranging from flat to -5 percent.

PRICING PREDICTION

Up to +7% for public companies

-5% to flat for private & non-profits

CYBER LIABILITY

Cyber exposures continue to evolve and expand as new scenarios play out daily. High-profile data breaches and impostor fraud are now common events, increasing board-level focus on cyber crime and reputational risk loss mitigation. Despite the public awareness of such events, capacity remains ample, with an increasing number of carriers vying for market share. As a result, cyber policies are expected to see decreases of up to 3 percent where buyers can demonstrate increased security and internal controls, but may rise as much as 5 percent in other cases.

PRICING PREDICTION

-3% to +5% depending on security controls

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ABOUT SCOTT INSURANCE

For over 150 years, Scott Insurance has served the risk management needs of our clients. Our philosophy of embracing risk and rewarding performance has yielded valuable solutions for our clients. As an employee-owned company, every member of the Scott team is dedicated to delivering the highest level of service in the insurance industry. Through talent, experience and innovation, Scott brings accountability and clarity to an environment of complexity and uncertainty. In turn, our clients are equipped with the tools and support required to meet the dynamic challenges that face today's businesses.

Specialties include property and casualty insurance, risk performance services, employee benefit services, health risk management, bonds and private risk.