



ABUNDANT CAPITAL REMAINS

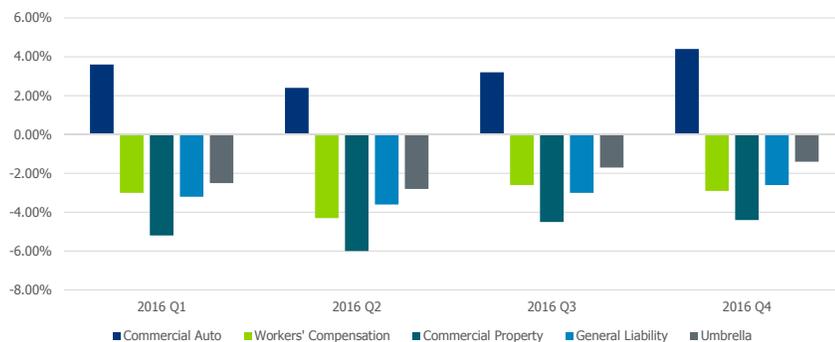
It's Still a Buyer's Market

Current market conditions continue to favor buyers as we move into the second quarter. Despite low interest rates, ample capital from long-term underwriters and growth in new and expanding entrants are keeping property and casualty insurance terms and conditions at very competitive levels.

Underwriting companies continue to refine their client offerings, focusing on product and industry specialization and deploying capital to support their growth plans. We expect to continue in the same direction, with overall prices, terms, and options benefiting buyers.

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Rate Changes by Coverage Line*



*Source: The Council of Insurance Agents & Brokers



Casualty

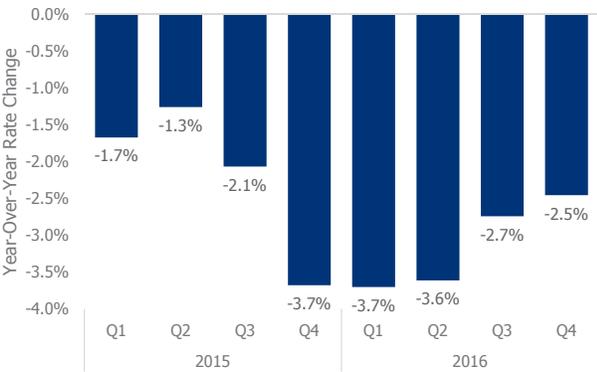


Commercial casualty insurance remains highly competitive across workers' compensation (WC) and primary and excess casualty. The exception is commercial auto, where both claim frequency and severity are increasing industry loss costs (see graphs below). Clients continue to experience WC and general liability rate reductions, while lead umbrella and excess liability rates appear to have bottomed out—particularly where high excess layers are already at market minimum pricing thresholds.

Of Note:

- ❖ Workers' compensation rates dropped about 2 percent in the latest quarter. For clients that changed carrier at renewal, that drop is 7 percent. This is motivating underwriters to secure desired client renewals at modest rate declines and avoid competing in an expansive marketing effort.

Guaranteed Cost*



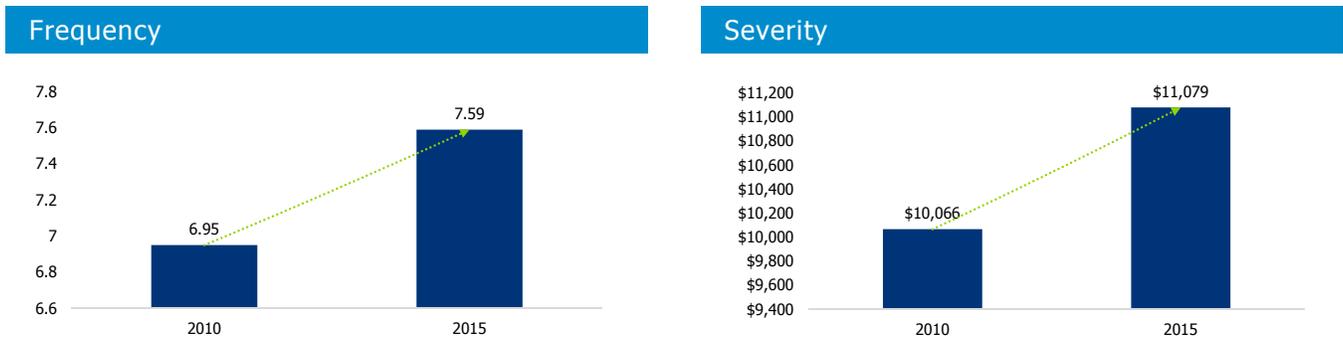
Loss Sensitive*



*Source: Lockton Analytics



- ❖ Commercial auto frequency and severity rates have been increasing at a rapid pace. Based on Lockton analytics, frequency has increased 9 percent since 2010, while severity has increased 10 percent. With this adverse severity trend, it is unsurprising that losses historically contained within a \$1 million combined single limit are piercing excess layer dollars and putting pressure on lead umbrella pricing.



- ❖ Largely influenced by commercial auto exposure, lead umbrella rates vary widely based on the client's overall fleet composition. Prices have firmed for large fleet operations, while smaller fleet risks see tempered pricing actions. In addition to the impact on prices, underwriters are carefully evaluating attachment points and limits to arrive at what they consider sustainable program structures. A \$5 million umbrella attachment point is increasingly common for companies with 1,000+ vehicles, while \$1–\$2 million remains a viable attachment for less substantial fleet risks.

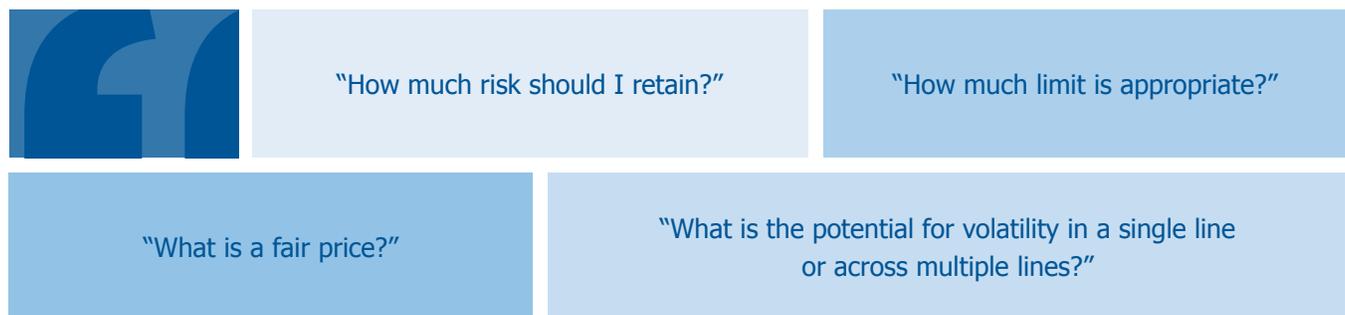
The purchase of insurance is being subjected to the same rigor as any other capital expenditures. Recognizing the strategic aspects of insurance, buyers are intently focused on “how” they buy insurance, looking for the most efficient risk transfer structure.



The market for large transportation risks remains tight, with capacity deployed very selectively. Large jury verdicts in the trucking space, and poor loss ratios in commercial auto overall, continue to drive rates upward. Underwriters look closely at technology as a differentiator in submissions. Collision mitigation equipment, lane departure and blind spot warnings, electronic logging devices, and camera technology play a significant role in the underwriting process. Insureds can present themselves in the best possible light by identifying the technologies they use and how this equipment has affected their losses.

Stepping Outside Market-Cycle Influences to Make Strategic Buying Decisions

Even in a buyer-friendly market, companies buying insurance with larger limits remain focused on fundamental questions:



These questions have historically been addressed using a combination of risk quantification, claim and safety practices, and benchmarking—also largely influenced by market dynamics and budget constraints.

Today, buyers with access to capital resources are changing the conversation by examining alternative ways to finance risk beyond traditional use of insurance company capital. They benefit when their broker partner provides a tailored evaluation using an insured's own cost of capital, loss history, and risk tolerance threshold to assess the potential for loss in any given layer of risk. When the benchmark cost of retaining that risk can be estimated and compared against the corresponding cost of insurance premiums, the outcome is a more informed buying strategy that weathers the inevitable market cycles.

With this adverse severity trend, it is unsurprising that losses historically contained within a \$1 million CSL are piercing excess layer dollars and putting pressure on lead umbrella profitability.

Debbie Goldstine, Excess Casualty Practice Leader

We expect to continue in the same direction, with overall prices, terms, and options benefiting buyers.

Mark Moitoso, Analytics Practice Leader

Property



Property Market Update

The property market sector continues to soften, giving the advantage to the insurance buyer. Ample capacity and a lack of substantial industrywide losses are keeping markets aggressive and competitive, resulting in lower prices and stronger coverage.

New markets are taking a more aggressive role in underwriting risks. Meanwhile, markets striving to write more business are abandoning outdated practices based on occupation or class of business in favor of high-risk classes of business. The combination of new markets and strong underwriting appetites means even difficult classes of businesses are finding easier access to insurance.

California earthquake coverage rates (see page 7 for more details) continue to drop, which can be attributed to an increase in capacity, as well as the lack of any substantial earthquake activity or catastrophic event in the past two decades.



As prices drop, buyers must decide whether to pocket the premium savings or reinvest them to secure lower deductible(s). Risk transfer arbitrage calculations are becoming more prevalent and necessary to create a personalized cost-benefit analysis.

Beyond the standard property coverages, first-party cyber coverage continues to emerge and evolve. More markets are coming to grips with the reality of cyber risk and the importance of providing better coverage with higher limits, and they are facing pressure to remove limiting cyber exclusionary endorsements. The main proponents of this shift understand the changing landscape driven by the many cyberattacks reported in the media.

Most important, upticks in property losses arising from cyber events have highlighted the link between property and cyber. Few markets currently offer ensuing peril damage arising out of a covered cyber event, and it is subject to negotiation on an account-by-account basis.

Additional product offerings that provide a host of client solutions include privatization of flood cover, parametric trigger programs, multiyear single limit programs, deductible buyback, active shooter, and political violence terrorism coverage.

Foreign Casualty



Foreign Casualty Expands

Foreign casualty continues to be a priority for most insurers. Given their focus on gaining market share, they continue to offer favorable terms, conditions, and pricing, with flat renewals as the norm. Whether a new entrant or an established traditional player, insurers are expanding their offerings and investing in technology and resources to appeal to multinational buyers.

While insurers are making these investments, many are also undertaking cost-cutting initiatives to change the way they implement and manage global programs. Traditionally, insurers have competed to expand their network and ownership of offices around the world so they could better manage pricing and underwriting decisions in a controlled master program.

Today, several large and established global insurers have announced the divestiture of their owned offices across dozens of countries, relying instead on a third-party network of partner offices. Unburdened by legacy organizational structures, many new entrants in this space have followed suit and are writing global programs without any attempt to invest in ownership of offices around the world. This shift in operational strategy means insurers writing global programs may have:

- ❖ **Less control of the pricing on locally admitted policies.** This may prompt a pricing rise as more of the risk is retained in country.
- ❖ **Reduced leverage with partners vs. owned offices to issue broad local policies in a timely fashion.** If not prompted by a broker and/or enforced by the insurer referring the risk into the country, local insurers often issue standard policies deemed to be “good local standard,” regardless of the nuances and requirements of the insured’s business.

With the shift toward relying more on a network of nonowned insurers, nonaffiliated local insurers may be reluctant or unwilling to agree to broad terms and conditions without increasing premiums drastically. Policy issuance timing standards may also suffer as insurers move to a more decentralized model of issuing policies worldwide.

This trend of insurers moving away from an owned network reinforces the need for a strong technical team that knows the foreign space to oversee global programs from the insured’s home country. The resources and technology that the insurer and broker use to oversee implementation, adjust claims, and move money around the world will determine the success of their foreign casualty program.

California Earthquake



The lack of significant earthquake activity in California allows for lowering the risk transfer cost for many California companies.

California earthquake insurance follows the overall property market, with the continuation of ample capacity and downward pressure on rates in the first quarter of 2017. The lack of significant earthquake activity in California allows for lowering the risk transfer cost for many California companies. However, underwriting information such as retrofit data, construction characteristics, and building protection is still crucial in obtaining favorable terms and pricing.

In addition, those properties in historically high-hazard areas of Northern and Southern California are still viewed closely by underwriters because severity, not frequency, drives decisions when it comes to the peril of earthquake. Multiyear single limit (MYSL) programs are available in the market, allowing insureds to secure earthquake insurance limits at a prepriced level for two or three years, with reinstatement options. This particular aspect of MYSL programs is particularly favorable to insureds, as pricing after a large loss could increase the overall market cost to purchase insurance.

In some geographic areas, we have been able to obtain deductible reductions from 5 percent to 3 percent, and innovative products such as parametric trigger programs are becoming more widely available. These programs allow coverage to be triggered at a predetermined Richter scale-event level.



Builder's Risk

Builder's Risk Market Appetite

US and international insurance markets continue to soften as competition among carriers escalates. Terms and conditions are now very broad, with the rate of change in breadth of coverage slowing down. Premium rates and deductibles also show signs of bottoming out, with discounts available for taking higher deductibles.

In the US construction insurance marketplace, competition remains abundant, resulting in a prolonged soft market. With excess capacity available in both US and international markets, we expect price and coverage to remain competitive even in high-catastrophe (CAT) areas. Insurers are showing aggressive business goals for property, which may result in enhanced or tailored coverage.

Adding to the increased competition among existing players is the emergence of new markets looking to underwrite construction projects. Recently, there have been some current frame fires in North Carolina and Kansas City. A few years ago, we faced a similar situation when San Francisco, Los Angeles, and Texas suffered frame fires in a single month. The frame market responded with a short-term increase in rates. It's too soon to determine whether a similar market reaction will occur as a result of the recent fires.

We continue to see commercial buildings and multifamily/apartments leading the way in construction. High-rise developments, in particular, are exploding in cities across the US as space becomes increasingly limited in higher population areas.



There is also an influx of sports and entertainment construction projects in the US. With the NFL's recent announcement of a new team in Las Vegas, there will be a new state-of-the-art large-capacity football and entertainment complex constructed in the coming years.

US politics also may influence the construction market. With a new administration eager to add jobs domestically, there may be an increase in road, bridge, and other public projects. In addition, executive actions allowing for energy pipeline creation, such as the Dakota Access Pipeline (DAPL), may bring new opportunities for the construction industry. Currently, the administration has eight oil and gas projects in the works.

Locations with a high CAT exposure, whether named wind storm or earthquake, are receiving very competitive rating from London and European markets. Where there is an exposure to earthquake in Munich Re Zone 3 or 4, we have experienced favorable rating for nuclear power projects and hydroelectric power projects. To a certain extent, rating is driven by the RMS system, but large discounts are being applied to contain the price impact. The heavy industrial sector—especially the midstream petrochemical sector—is seeing rating discounts, albeit more conservative.

Some carriers are quoting particularly aggressively with respect to unproven/prototypical gas turbines. However, these quotations require that the manufacturers' warranties remain primary to the policy.

Contractors who have a good reputation for producing quality work, and who demonstrate an exemplary attitude to risk management and resultant good claims conduct, continue to benefit from attractive rates and coverage.

The builder's risk market remains soft in 2017 due to several factors:

CONTINUED PROFITABILITY

This is largely driven by a lack of significant catastrophe loss events. Though projected to be the highest year for US-insured catastrophe since 2012, the projected losses of \$21.4B as of October remain below the overall 10-year average of \$19.2B. Non-hurricane-related wind and thunderstorm (including related floods) remained the largest driver of overall catastrophe losses, with significant loss events throughout the Southeast US and Texas.

MORE PLAYERS

Non-US-domiciled insurers continue to grow their presence within the US on a retail basis. In addition, as global capacity and competition continue to increase, London insurers have strengthened their focus on US business. This is most evident in larger, more technical projects and those with significant CAT exposures.

INCREASED CAPACITY

As competition increases, insurers look to differentiate themselves. One way they do so is by touting overall capacity amounts. Insurers continue to take advantage of the competitive reinsurance market to increase their overall capacity on a single-risk basis, as well as within annual master programs.

Farm-to-Table



Mergers and acquisitions set the tone for 2016 in the food and agribusiness industry. America's corporate food titans are using venture capital money to invest in new food companies, along with traditional acquisition strategies to capture sustainable food brands. While the sector is healthy, the current political and regulatory landscape have potential impact on future trade and labor amid pending policy changes relating to taxation, immigration, and minimum wage.

From a micro perspective, additional pressures can affect an individual company's risk profile. For example, compliance with the Food Safety and Modernization Act (FSMA) calls for a significant effort, but it ultimately benefits discussions with insurance carriers by demonstrating the company's commitment to ongoing evaluation of its operational standards.

Product labeling remains a focus, as regulatory requirements remain fluid on genetically modified organisms (GMOs), natural and organic products, and various allergens. Additionally, companies are reevaluating the impact of cyber exposure on their operational technology. Emerging loss scenarios are potentially catastrophic, including manufacturing equipment loss of use, as well as product quality and safety issues that include compromised water filtration and ingredient balancing systems. The food and beverage sector is responding quickly to evaluate their risks and is demanding that the insurance industry keep pace.

This is an ideal time in the marketplace to enhance terms and conditions. It's also worthwhile for companies to work with their brokers to assess how their program would support corporate priorities and what insurance products can reduce risk and uncertainty inherent to operations.

In response to all of these factors that influence risk management for food and related companies, Lockton has established a Farm-to-Table team of coverage and risk professionals that addresses these evolving risks.

Financial Services



Securities Claim Activity Leads the Charge in D&O

2016 was a record-setting year for federal securities claims, and the pace continues with 66 additional filings through February 2017. The pharma, biotech, healthcare, and financial industries have taken the biggest hit.

The private company directors and officers (D&O) marketplace has its own loss activity, with one carrier publishing the average loss at \$390,000. Private company D&O carriers have paid out claims for customer disputes, regulator claims, bankruptcies, competitor claims, and other business-/contractual-related D&O claims. Some carriers continue to cite California as particularly problematic.

Despite these conditions, the D&O marketplace has not reacted with a rate backlash. In fact, rates continue to hold steady in the primary space. A few markets are pushing for rate increases in the small to mid-sized market cap, commercial public, and private D&O space, but these increases are not consistently sticking.

Accounts with financial distress and those in certain industry classes are seeing some upward rate adjustments, but terms and conditions are holding firm or broadening. D&O insurance capacity continues to grow, and carriers are quick to provide market-competitive renewal terms in order to keep a good account. We expect D&O rates to hold steady in 2017 as long as all other rating factors remain the same.



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Midsized financial institution risks continue to enjoy a favorable rate and premium environment. Insurance carriers are eager to diversify their financial institution capacity into midsized alternative asset management types, with the exception of broker/dealer and insurance company risks. While there is some underwriting concern around the regulatory scrutiny and the potential for SEC enforcement actions against registered investment advisors, the marketplace is not reacting with any significant underwriting requests or changes.

We expect flat to modest premium decreases on the primary with the potential for larger decreases in excess layers. Smaller risks may start to feel the effects of hitting minimum premiums. Large asset managers and money center banks also see a more limited underwriting appetite. There are markets for these risks, but they are not as prolific as they are for a midsized asset manager.

Employment Practices Liability—Southern Calif. and Wage and Hour Still Tough

The marketplace has generally stabilized for employment practices liability (EPL) due to the abundance of capacity. With the exception of some targeted underwriting and pricing of certain risks in certain geographical areas, EPL rates should remain flat to up a few percentage points.

Wage and hour claims continue to be a key part of any employment-related claim, especially those that settle for large dollar amounts. Carriers approach wage and hour coverage with caution—either excluding it for certain industry classes and states or limiting its coverage to defense-only sublimited amounts. There are some stand-alone wage and hour products, but they are offered with significant retentions and high premiums due to the likelihood of a claim.



Fiduciary Liability—Excessive Fees—The New Fiduciary Claim du Jour

ERISA class action disputes against employers have increased dramatically during the past two years. These lawsuits allege breaches of fiduciary duties based on excessive fees paid to the ERISA plan service providers. Some underwriters have reacted by asking more specific questions regarding third-party service provider selections, due diligence, and fee determination. However, fiduciary liability premiums, terms, and conditions have not been affected.

Crime—Stable Market Continues

The crime market continues with stable capacity and terms and conditions. The marketplace is generally providing flat renewals. Social engineering fraud coverage, which covers scams used by criminals to trick, deceive, and manipulate their victims into giving out confidential information and funds, is now included as a small sublimit of coverage by most carriers. However, there are a few markets that can provide full limits for social engineering fraud coverage, subject to underwriting and premium considerations.

Cyber



Cyber Risks in the Boardroom Expected to Increase

The corporate boardroom faces increasing cyber risks, prompting directors and officers to update their governance structures.

Enterprises can no longer rely solely on their IT department to prevent cyber risks, according to a March 13 article in *The Financial Times*. Authored by Robert Hannigan, head of the UK Government Communications Headquarters (the UK's equivalent of the US National Security Agency), the article emphasizes the need for the private sector to update corporate governance for the digital era.

Although boardrooms now accept that cybersecurity is important, it is still seen as “a baffling problem for IT experts to fix, and an unavoidable cost of doing business.” Increasing regulatory scrutiny means time is fast running out to adapt to a governance culture. On March 1, New York state's Department of Financial Services launched one of the first major industry sector cybersecurity regulations. It aims to set minimum requirements for governing cybersecurity policies, data security standards, and reporting requirements. Although limited to financial institutions, it is widely expected

that more regulation will follow, which in turn will drive additional underwriting scrutiny from insurers.

Understanding the challenges companies face, Lockton recently launched a partnership with Cyberance to offer an automated cyber risks governance control system. By continually monitoring critical systems and providing ongoing guidance based on national standards, the platform drives shared collaboration across the enterprise for implementing the controls required to reduce risks and build cyber resilience.

Despite increasing cyber threats, the lack of large-scale breaches and severe losses has kept pricing flat on most renewals. The market continues to expand, with new capacity introduced in the US and London. As a result of the growing appetite among carriers, new business submissions benefit from very competitive pricing.

However, some high-risk categories have less capacity and higher pricing, including healthcare and large retail companies. Also, as insurance companies become more sophisticated in assessing cybersecurity policies, clients with insufficient controls are more difficult to place. They face higher pricing and retention, lower limits and sublimits, and more narrow coverage.

Real Estate



The property market continues to favor the buyer. Given the absence of catastrophic events in 2016, capacity, and competition abound. As a result, we expect rate reductions to continue in the single to low double-digit range—driven by loss experience, asset quality, and location.

Carriers remain open to expansions in coverage, terms, and conditions for no additional premium. Increased sublimits, lower deductibles, and amended policy language lead to more robust coverage.

The multifamily segment shows signs of stabilization. Despite the absence of catastrophic events, underwriting profits for insurers are down, largely due to an increase in hail and flood losses—specifically in Texas. Although there is less capacity in the market than in commercial real estate space, strong competition remains. It is critical that insureds be able to speak to past losses and what their company is doing to mitigate future risk. Additionally, insurance-to-value can have a meaningful impact on rate, and companies should consider multiyear rate deals.

The general liability market remains stable, with rates ranging from flat to low single-digit reductions when the insured has favorable loss records and effective loss control procedures. A proper retention level, based upon past and future predicted activity, is essential to limit an insured's exposure while ensuring the most competitive rate.

General liability loss development in the multifamily space has become an increasing concern for carriers. Some have reduced market share or completely exited this class of business, but increased appetite from others has helped to offset capacity loss. Insurers are taking a harder look at certain underwriting criteria, such as the amount of subsidized housing and/or student housing, as well as crime statistics. Loss performance, program design, contractual risk transfer, and loss prevention/training programs each help drive results.



Terrorism



Advantage: Buyers

The terrorism and political violence market for 2017 shows continued growth of capacity and a softening of rates. The abundance of marketplace appetite has led to significant competitive pressures, placing buyers in a strong position.

Overall capacity figures of \$4.5 billion are often mentioned, but this is influenced by factors such as the physical location of each risk and aggregation issues. For a single risk exposure, more realistic limits of approximately \$2 billion are commercially available. Major metropolitan concentrations such as New York, Chicago, San Francisco, London, and Singapore are still challenging for underwriters.

In response to ever-changing terrorism threats, markets are developing broader coverage and extensions to policies tailored to individual client requirements. These products include cover for nuclear, chemical, biological, and radiological (NCBR) terrorism; business interruption; and liability. Coverage is also now available for nondamage business interruption as a result of threat or hoax, loss of attraction, active shooter, active assailant, and cyber-terrorism. These solutions can support companies stressed by a shortage of resources and cash flow to survive extended periods of business interruption.

Together with Hiscox, Talbot, Beazley, and XL Catlin, Lockton has developed a product that encompasses the broadest marketplace offerings, including terrorism liability with business interruption extensions and shooter covers. The product is called Terrorism Crisis Solutions (TCS) and is available from Lockton on a worldwide basis.