The current insurance marketplace remains in a state of uncertainty as insurance and reinsurance carriers seek to understand the full scope of their recent catastrophe (CAT)-related losses. Estimates for hurricanes Harvey, Irma and Maria as well as the California wildfires and Mexico earthquakes total at least $135 billion.

**WORLD NATURAL CATASTROPHES BY OVERALL AND INSURED LOSSES | 1980-2017**

Sources: © 2018 Munich Re; Geo Risks Research; NatCatSERVICE. As of January 2018.
Much has and is being written relative to the catastrophe loss experience in 2017 and the impact on, and subsequent direction of, the global property market. The market remains transitional but does not have the characteristics of a hard market.

As previously mentioned, the total 2017 losses from global catastrophe events are estimated to be around $135 billion. The most notable of these events are hurricanes Harvey ($30 billion), Irma ($23 billion) and Maria ($27 billion). In addition, there were wildfires in California ($12.5 billion), earthquakes in Mexico and worldwide weather-related events. Combined with attritional losses throughout 2017, the industry combined ratio is estimated at 120 to 130 percent.
The insurance market remains well-capitalized. Jan. 1 reinsurance treaty and retrocessional renewals broadly reflected this. While increases were experienced, there was enough capacity in the property market to help mitigate some of the increases. Exceptions to this existed for Caribbean insurers, who saw more substantial changes.

As direct insurers seek to move toward “rate adequacy” following several years of rate decline, we expect to see increased underwriting discipline, a focus on risk quality, and some tightening of terms and conditions. Many senior leaders have indicated that they will be seeking to approach risks on a case-by-case basis. There remains a significant amount of capacity within the market, and this will benefit clients because competition will help moderate the level of rate increase.

While the next few months are very active for property renewals, the broader property market appears more reminiscent of post-2012 (Superstorm Sandy) than post-2005 (hurricanes Katrina, Rita and Wilma). Certain properties, such as wood frame, multifamily, builder’s risk and accounts with heavy losses, will experience rate increases on the higher end of the range. Generally, here is what we expect for property rates in 2018:

- Property accounts with CAT losses: 10 to 20+ percent increase.
- Property accounts with CAT exposure (but no losses): 5 to 10 percent increase.
- Property accounts with low or no CAT exposure (no losses): Flat to 7.5 percent increase.
Global market capacity remains abundant at $700 billion, and this has dampened upward pressure on casualty rates. In addition to the near-record capacity, we are beginning to see the casualty marketplace evolve because of significant movement amongst carrier leadership. While the results of these moves have yet to play out, they do set the stage for changes in direction or underwriting philosophy at some carriers.

For now, casualty carriers are still focused on top-line growth and continue to compete aggressively to win and retain business. While casualty can vary significantly by industry sector and line of business, there are some broad trends:

- **Auto:** Driven by an average combined ratio of 110 percent during the past seven years, commercial auto liability rates continue to rise. Drivers are putting in more miles and have become increasingly distracted. Rising medical costs and jury verdicts have also made losses more expensive to resolve. As a result, claim frequency and severity have risen sharply, and carriers are committed to mitigating profitability concerns. For clients with large fleet exposures, underwriters continue to seek a combination of higher retentions, rates and attachment points. These clients can differentiate their risk by providing underwriters with an overview of safety efforts, including driver quality and the use of telematics. See Lockton’s recent white paper on commercial auto for more details.

- **Workers’ compensation:** Underwriting results for workers’ compensation carriers have been profitable during the past three years. This has driven more competition for this coverage in 2017 and leading into 2018. Medical trends have been more aligned with overall inflation, supporting marketplace profitability. We anticipate a competitive marketplace throughout 2018.
Excess casualty: Several large global insurers have signaled concerns about reserve adequacy in their US commercial general liability portfolios. As a result, some clients are seeing closer scrutiny on attachment points, limits and rates. Analytics are increasingly being used to guide underwriting decisions, and the use of “short limit” umbrellas ($10 million to $15 million versus the more traditional $25 million) has also expanded.

Rate expectations

While we do not foresee the casualty market hardening, we do expect carriers to push for flat rates with possible single-digit increases. Here is what we anticipate being the new normal for casualty rates in 2018:

- Workers’ compensation: -5% to +4%
- Commercial auto: +5% to +10%
- General liability: Flat to +3%
- Excess liability: Flat
- Umbrella liability: Flat to +5%

Rate change for major lines ranged from -2.3 to +7.3 percent in Q3 2017

<table>
<thead>
<tr>
<th></th>
<th>Commercial auto</th>
<th>Workers’ compensation</th>
<th>Commercial property</th>
<th>General liability</th>
<th>Umbrella</th>
<th>Average</th>
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</thead>
<tbody>
<tr>
<td>Third quarter 2017</td>
<td>7.3%</td>
<td>-2.3%</td>
<td>0.9%</td>
<td>-0.8%</td>
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<td>6.1%</td>
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<td>First quarter 2017</td>
<td>5.4%</td>
<td>-1.9%</td>
<td>-3.1%</td>
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<td>Fourth quarter 2016</td>
<td>4.4%</td>
<td>-2.9%</td>
<td>-4.4%</td>
<td>-2.6%</td>
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<td>-1.4%</td>
</tr>
<tr>
<td>Third quarter 2016</td>
<td>3.2%</td>
<td>-2.6%</td>
<td>-4.5%</td>
<td>-3.0%</td>
<td>-1.7%</td>
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<tr>
<td>Low</td>
<td>-11.6%</td>
<td>-12.3%</td>
<td>-14.8%</td>
<td>-13.6%</td>
<td>-13.5%</td>
<td>-13.1%</td>
</tr>
</tbody>
</table>

Fifty-nine percent of brokers reported an increase in the number of flood claims, and 64 percent of brokers saw an increase in demand for flood coverage.

Eighty-one percent of all brokers reported an increase in demand for cyber coverage.

Across all sizes of accounts, respondents reported that underwriting practices remained relatively similar to that of last quarter, except for two new trends: automated underwriting of small accounts and tightening of underwriting for commercial auto.

Large, sophisticated buyers are generally buffered from overall market trends because of their ability to manage their retentions and attachment points. Underwriting of these risks is also highly individualized with a heavy emphasis on loss history and risk quality. For buyers of all sizes, carriers will look closely at factors such as safety, contractual controls, risk management protocols and product liability trends. Companies that can demonstrate that they are “best in class” will continue to receive better-than-average pricing and terms.

Executive lines

The executive lines market is showing signs of firming. This is primarily being driven by deteriorating directors and officers (D&O) and employment practices liability (EPL) claims. Although capacity is currently stable and abundant, some insurers are starting to “manage” limits on certain risks.

Directors and officers liability

In 2017, federal securities claim filings hit an all-time high. While much of this was driven by merger objection suits moving from state to federal circuit courts, traditional securities lawsuits also contributed to the record-setting numbers. In addition, the Securities and Exchange Commission (SEC) has increased its interest in private company security transactions with regulators expressing concerns around unicorn companies and lofty valuations before initial public offering.

Nonsecurity exposures include cyber, intellectual property, tortuous interference and competition issues. An increasing number of sexual harassment suits have made their way into the D&O sector. A recent example is a derivative lawsuit filed against Steve Wynn and the Wynn Resorts board of directors. The plaintiff alleges that the board knew of Wynn’s misconduct and failed to investigate it, resulting in harm to the company. This illustrates that companies need to consider both their EPL and D&O coverage as it relates to sexual harassment exposure. Check out Lockton’s recent white paper on coverage for sexual harassment cases.
While the underwriting community has taken note of the number and pace of filings, we have seen little impact on coverage terms and conditions so far. However, there are some things to be mindful of based on company type and industry:

- **Private and small public sector company rates may be on the rise.** Carriers are starting to push for rate increases for these companies because they feel that this space has experienced years of a soft market and underpriced risk. The increase in private company bankruptcies is also driving the desire for additional premium and less underwriting flexibility.

- **While the market has remained flat to slightly down for primary public D&O, we expect a shift in pricing from flat to slightly up.**

- **There is strong competition for excess placements.** Therefore, we expect there to be pricing pressure to at least maintain the already aggressive rates.

- **Midsized financial institution risks continue to enjoy a favorable rate and premium environment.** This is particularly true for traditional and alternative asset managers and hedge fund risks. These areas have several major markets offering increasingly competitive terms and, in many cases, decreased retention levels to gain or regain market share.

- **Some classes of business, including broker/dealers and community banks, are seeing rate pressure, including pressure on previously granted multiyear deals.** As has been the case for several renewal cycles, large bankers professional liability (BPL) programs are also seeing overall rate pressure.

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**Employment practices liability**

Given the abundance of capacity and competition, the EPL markets generally continue to hold steady on terms and conditions. However, EPL retentions are increasing based on loss history and location of employees, particularly in California. Except risks perceived to be relatively poor and some targeted underwriting and pricing of certain risks in specific counties or states, EPL rates should remain flat or increase by just a few percentage points.

Wage and hour claims continue to be a key part of employment-related claim matters, particularly those that settle for large dollar amounts. The industry continues to be cautious in how it approaches wage and hour coverage — either outright excluding it or limiting its coverage to small, defense-only sublimited amounts. Full indemnifications of defense and settlement costs are not available in the US, but some carriers are offering solutions offshore. However, they come with significant retentions and high premiums due to the likelihood of a severe claim.
Fiduciary liability, excessive fees

Employee Retirement Income Security Act (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. Plaintiffs’ attorneys are drawn to these suits based on some recent large settlements. Traditionally, they have targeted plans with over $1 billion in assets, but attorneys have started looking into fees assessed in smaller plans. Some underwriters have reacted by asking more specific questions relative to third-party service provider selections, due diligence and fee determination. However, fiduciary liability premiums and retentions continue to be very competitively priced in areas where there is not significant claim activity.

Crime market

While the crime marketplace is generally providing flat renewals, retentions are increasing where exposure warrants and losses exist. There is an overall greater underwriting focus in the market, which means more stringent information requirements to secure both renewal and new business quotes.

Social engineering claims are on the rise; though, policy language is not keeping up with the evolution of these claims. Coverage is typically sublimited, but higher limits are available from a few insurers.
Global risk

International casualty continues to be a priority for all insurers as they seek to gain market share in a popular and profitable line of business. As with 2017, we expect that 2018 will see several new insurers trying to break into this market. Between this and existing players working hard to grow their books of business, we anticipate that pricing will continue to be very favorable for clients. Renewals have been flat for accounts that are free of losses.

Some insurers are changing their strategies and investments in global programs. Traditionally, insurers have competed to expand their networks and ownership of offices around the world to better control pricing and underwriting decisions in controlled master programs. Recently, insurers are relying more on networks of partner offices as opposed to owned offices. The primary implications for insurers writing global programs include:

- **Less control over the pricing on locally admitted policies.** In situations where global insurers rely on nonowned offices, locally admitted policy pricing may rise because more risk is being retained in country. Nonowned offices may also refuse to reduce costs to issue local coverage.

- **Reduced leverage with partners to issue broad local policies in a timely fashion.** If not prompted by a broker 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. Policy issuance timing standards may 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. Regardless of how insurers go about issuing policies, the resources and technology that the insurer and broker have in place to oversee implementation, adjust claims and move money around the world will make the difference in the success or failure of a global casualty program.
The Tax Cuts and Jobs Act is the most substantial change to US federal income tax law in 30 years. Generally, the act provides a significant reduction in the corporate income tax rate as well as a 20 percent deduction on most pass-through income (e.g., S corporations, limited liability companies [LLCs] and partnerships). Captive insurance companies are taxed as C corporations and will also get taxed at the reduced federal income tax rate. However, deductions for premiums will generally be at a lower rate.

There are quite a few changes in the tax law, and a few of the significant ones for captives are:

- Discounting rules for insurance reserves.
- Computation method on life reserves.
- Definition of a US shareholder for controlled foreign corporation (CFC) testing.
- Definition of an offshore captive that will be treated as a personal foreign investment company (PFIC).

Given the significance of tax reform on rate structures, the potential for decreased tax benefits of deferral and many changes in the law, captive owners should determine whether a captive still provides the same net benefit to the organization. As implications of tax reform become clearer, captive owners should also continue to monitor captive program design and evaluate overall benefits.

Note: For information on tax reform implications for employee benefits and retirement, check out the recent webinar hosted by Lockton experts. And to stay on top of changes as tax reform implications become clearer, continue to check Lockton Insights.
Surety

The construction boom as well as catastrophe losses are driving changes in the surety marketplace. To help monitor and protect your business through this uncertainty, it is important to partner with a surety company that maintains underwriting principles and a broker that understands your business.

United States

The US surety industry has enjoyed consistently profitable quarterly results for the past 10-plus years. In addition, the revival of the commercial construction industry and continued increase in construction costs have driven surety industry premium totals to their highest levels in history. These trends along with low loss ratios have brought new competitors into the surety market. This will create downward pressure on premium pricing, and terms will become more favorable for those purchasing surety coverage.

Lockton continues to monitor surety companies that are growing quickly. In a competitive market, this suggests an underwriting appetite outside of historical standards. These companies are often the first to see heightened losses and are at risk for abrupt exits from the surety industry.

There are two main areas to watch for potential near-term surety market adjustments:

- **Significant surety losses:** While these are hard to anticipate, there are two large surety users that are currently in widespread default, Carillion and Odebrecht. We are watching these situations closely for potential losses to the market that could drive up surety rates.

- **Losses in the reinsurance market:** Surety business outside of the US involves a lot of reinsurance support. Thus, any reinsurance losses, whether in general or because of large international surety losses from situations described above, could impact surety rates and the market.
Global surety

Overall, both the domestic and the global surety market (outside of Canada and the US) will continue to grow. Much of this growth is driven by these factors:

- **Growth in the North American construction market.** Large multinational construction firms from Asia Pacific, China and Europe will continue to invest in North American construction firms and US infrastructure projects. Current tax reform for large C corporations will drive funds repatriation into the US, which will in turn increase economic growth and productivity.

- **Growth outside of North America (2017 Basel III Reforms).** Global surety providers are targeting areas of the world, such as the South America, Europe and Asia Pacific markets, for growth. Sureties will continue to gain market share in areas where financial guarantees are provided interchangeably by banks and sureties, such as the UK and Continental Europe. In the bank-dominated markets, such as Europe and Asia Pacific, sureties have the opportunity to replace bank guarantees, create syndicated arrangements with banks or even provide some back-to-back guarantees where bank instruments must be used to fulfill a financial assurance requirement.

- **Opportunities with companies based in China.** Global sureties will continue to explore opportunities with Chinese-based companies, given their continued investment in other countries outside of China. Some of the global, sophisticated sureties are working toward developing underwriting protocols for Chinese companies that need bonds outside of China. Some of these protocols include:
  - Gaining a better understanding of Chinese companies’ financial statements via discussions with the global auditing firms.
  - Understanding how Chinese lenders underwrite and securitize loans.
  - Partnering with local Chinese sureties to understand their methodologies of securing indemnity from these firms.

Until global sureties figure out how to perfect parental indemnity from a Chinese-based company, most sureties will continue to require an asset base they can attach with some form of capital retention agreement and/or collateral in the country where the bond is written. At this time, there appears to be little to no appetite for US-domiciled sureties to provide surety credit inside of China.

Latin America, a $2.1 billion surety market dominated by Mexico, Brazil, Columbia and Argentina, continues to be a saturated market. The Brazil construction economy is down given the difficulties faced by its national contractors, such as Odebrecht, and finding large sophisticated contractors in Brazil is a current challenge. Argentina and Colombia will continue to push infrastructure initiatives, but financing will continue to be a challenge.
The construction industry has recovered well from the last recession. It is estimated that construction growth in 2018 will be near 5 percent. Single-family and multifamily home construction both continue to see healthy growth.

With this growth, there are many new insurers entering the primary and excess construction market, and capacity for construction risk is on the rise. Despite insurers’ attempts to drive profitability by applying pressure to renewal rates, the increase in market entrants means that the insurance market remains very competitive for businesses with well-performing programs and well-controlled risk profiles.

In addition to increased market capacity and competition, we see the following trends:

- **Increased use of controlled insurance programs, specifically general liability-only programs.** The increase in competition of carriers using these programs has led to a steady decline in the overall cost of risk for liability and excess towers for these projects.

- **The builder’s risk market remains consistent, except for frame projects.** Due to an increase of catastrophic wood frame fires and damage from the 2017 storms, the frame builder’s risk market has lost capacity. Thus, rates have increased dramatically in the past 12 months. Since the market has been soft for some time, these increases have brought the market back to rate levels seen in mid-2000s. In addition, carriers are mandating security measures for frame projects through warranties; the use of after-hours watchmen are being mandated for high-valued risks. These costs need to be recognized during the bidding processes.

- **Electronic data liability endorsements on general liability are more widely available.** Excess carriers are willing to add additional sublimits that provide coverage should a client’s operations cause a data loss to others. An example is cable damage or an electrical surge that causes the inability for someone else to use or access data. It does not cover cyber-related losses; a separate cyber policy is needed for that.

- **Rapid hiring is leading to headaches.** With construction labor shortages, there is a desire to hire people quickly to get jobs done. However, new labor can wreak havoc on loss control. The greatest number of incidents comes from new hires during their first year of employment. Early training and monitoring of new hires can help control losses and prevent potential insurance implications.

- **As mentioned in the casualty update, auto liability rates are up.** Due to the nature of construction, the industry is being hit by these increases, and it appears that more increases are ahead for construction auto risk in 2018. In specific cases, these increases can be offset by reductions in other primary casualty lines. Each account is being underwritten on its own merits, and rate increases are not being seen across an entire book of business or a specific construction class.
Multifamily construction is on the rise, which means more multifamily units that need to be insured. Overall, capital increases and rising rates mean that new markets will enter the fray; however, this capacity will be somewhat offset by carriers exiting the space.

- Carriers’ rate strategies will be deployed on an account-specific basis versus a broad brush across their entire books of habitational business.
- Apartment-heavy portfolios have been plagued in recent years by attritional losses (e.g., fires and water damage) and large hailstorms as well as the 2017 hurricanes. Thus, this will continue to be one of the hardest segments to place and is experiencing some of the largest rate increases of any market sector.
- Clients with heavy exposure in areas hit by recent catastrophes are experiencing double-digit increases across the board, with historically unprofitable accounts receiving the biggest rate hikes.
- Carriers can no longer use CAT premium to subsidize fire, hail and all other peril losses, so buyers without traditional CAT exposure are also experiencing rate increases.
- Carriers are also pressing clients to take higher deductibles across the board. This includes increased Tier I named windstorm retentions and newly instituted percentage wind/hail deductibles in non-Tier I areas (especially Texas, Oklahoma, Colorado, Nebraska and Missouri).
- Carriers will push back more on manuscript forms and language as they push for lower sublimits and more restrictive terms and conditions.

When clients start preparing for their renewal, it is important to start early and get experts involved to help with the process. Here are some of the strategies we take to support our real estate clients:

- As carriers grow more conservative, leveraging relationships will become even more critical, including in-person client meetings with underwriters.
- Modifying deductible structures to address specific clients’ loss history, including plus-aggregate retentions and creative wind/hail designs, can help offset rate increases.
- Mitigation of attritional losses through robust loss control strategies and practical measures, like fire stops and renters insurance, appeal to certain carriers and could help pricing or deductible requirements.
Healthcare

In the medical professional liability (MPL) market, supply of insurance continues to outpace demand. Healthcare operators are consolidating as participants seek to gain scale in their operations, help improve margins and adapt to the newer reimbursement models. The result is less demand for insurance. Combined with an increase in MPL market capacity, there are fewer available buyers for carriers to write. This continues to keep rates relatively low for now. Short of significant exposure changes, premiums remained relatively flat for virtually all fourth-quarter 2017 renewals.

While favorable renewal terms continued for most clients, we have observed limited cases of rate increases and upward movement in self-insured retention levels. Renewal results differ by industry segment, venue and the healthcare provider’s loss experience. Here are some general trends by segment:

- **Physicians:** An abundance of carrier surplus (supply), coupled with decreasing numbers of independent physician groups (demand), continues to drive a soft MPL market for physicians. While incumbent carriers may increase rates on accounts with adverse loss experience, alternative markets seem to be willing to renew at current or improved terms.

- **Hospitals:** Carriers have been indicating for some time that they’re seeing an increase in very high severity claims. These large losses have begun to affect some clients, and in some instances, renewal terms have been impacted. For hospitals with losses, a handful of carriers are asking for higher per-occurrence and aggregate self-insured retentions and increasing rates on hospitals with worsening loss experience. There have been instances where alternative markets have not been willing to match terms, so these higher rates have stuck.

- **Senior living:** Established carriers in this segment are experiencing a deterioration in underwriting results and thus plan to increase rates. Some carriers have withdrawn capacity from the market, but currently, enough capacity remains to keep rates stable.
Although rates currently remain flat, signs point toward a possible inflection point coming in the MPL market driven by 2016 underwriting losses and the expectation that these losses continued in 2017. Here’s why the underwriting losses could lead to rate increases later this year:

- **Reserve releases:** Historically, reserve releases have helped carriers stabilize results because in other years, they have released reserves to supplement relatively poor accident-year performance. However, with the decrease in redundant reserves, MPL insurers may need to increase rates to generate acceptable underwriting profits.

- **Low interest rates:** Underwriters often look to make up for losses with investment gains. The extended low interest rate environment decreases their ability to do this, so rates may need to increase to make up for underwriting losses.

With all of this in mind, this year may be a challenging one. In order to minimize the impact of possible adverse changes in rates and terms, we recommend that clients take a proactive approach and start the MPL renewal process early.
Transportation

While the market for transportation risk has calmed some during the past year, primary and excess markets are still seeking rate increases. Clients with good loss experience and a strong safety profile are seeing single-digit increases.

For transportation risks with excess loss activity, creative risk financing solutions may be needed for difficult-to-place layers. These can include corridor deductibles, swing plans, profit sharing and multiyear aggregate limit layered programs.

There are a couple of attributes specific to trucking companies that carriers are monitoring and may consider when determining rates and conditions:

- Insurance carriers continue to evaluate trucking companies on key safety profile differentiators:
  - Historical and planned investment in technology, including automated braking, lane departure, cameras and critical-event monitoring.
  - Use of data in coaching drivers.
  - Driver hiring and retention practices; maintain high driver qualification standards even in the face of the driver shortage.

- Beginning in December 2017, trucking companies had to comply with the electronic logging device (ELD) mandate. ELD takes the place of paper log books used to record compliance with hours-of-service regulations.
  - All motor carriers subject to hours-of-service regulations should be compliant at this point.
  - Enforcement of the mandate will be phased in through April 1, 2018.
  - Effective April 1, 2018, inspectors will begin placing commercial vehicles out of service for noncompliance.
  - Full enforcement of the mandate resulting in citations and potential out-of-service violations could have a big impact on underwriting and pricing.
  - If trucking companies are not in compliance and they accumulate violations, they will become difficult, if not impossible, to place from an insurance standpoint.