USI®

2019 - 2020

COMMERCIAL PROPERTY & CASUALTY MARKET OUTLOOK

Q4 Update

Insights from USI National Practice Leaders

THE USI ONE ADVANTAGE®

RATE FORECAST BY PRODUCT LINE

- Increase in the Market
- Decrease in the Market
- Stayed the Same

2019 Rate Forecast by Product Line	Mid-year Update	Q4 2019-2020
Property Non-Catastrophic with Good Loss History	Up 10%	Up 10% to 20%
CAT Property with Minimal Loss History	Up 10% to 40%	Up 25% to 40% +
CAT or Non-CAT Property with Poor Loss History	Up 10% to 40% +	Up 30% to 60% +
Primary General/Products Liability	Flat to up 15%	Up 5% to 10%
Primary Automobile Liability with Fleet Lower than 200 and Good Loss History	Up 5% to 10% +	Up 10% to 15%
Primary Automobile Liability with Fleet Lower than 200 and Poor Loss History	Up 15% +	Up 15% to 25%
Primary Automobile Liability with Fleets in Excess of 200	Up 15% to 30%	Up 15% to 30%
Excess Automobile Buffers	Up 15% to 20% +	Up 35% +
Umbrella & Excess Liability (Middle Market Buyers)	Up 5% to 20% Layers possibly reduced.	Up 10% to 25% Factors in contraction of limits.
Umbrella & Excess Liability (Risk Management Buyers)	Up 5% to 20% Layers possibly reduced.	Up 15% to 30% + Factors in contraction of limits.
Workers' Compensation Guaranteed Cost	Down 10% to up 5%	Down 10% to up 5% Dependent on state.
Workers' Compensation Loss Sensitive	Down 3% to up 3%	Down 5% to up 5%
Public Company Directors' & Officers'	Up 10% to 30% +	Up 25% to 50% 100% + if "troubled" CoB.
Private Company Management Liability	Up 5% to 10%	Up 5% to 20% 20% is claim dependent.
Representations & Warranties	Down 5% to 10%	Down 5% to flat
Employment Practices Liability	Up 5% to 20%	Up 5% to 20% State/claim dependent.
Crime	Down 5% to up 5%	Up 5% to 25% Due to Social Engineering.
Fiduciary	Up 5% to 10%	Up 5% to 10%
Network Security & Privacy (Cyber)	Flat to 5%	Flat to 10%
Technology & Professional Errors & Omissions	Flat to up 10%	Up 10% to 15%
Kidnap & Ransom	Down 5% to up 5%	Flat to up 5%
Medical Malpractice	Flat to up 15% +	Up 5% to 15%
International Liability	Flat/Auto up 15% +	Flat/Auto up 15% +
International Property	Up 5% to 10% +	Up 5% to 15% +
Aviation	Up 15% to 30%	Up 15% to 30%
Environmental Combined General Liability/Pollution	Flat to up 7%	Up 5% to 8%
Environmental Contractors Pollution	Flat to down 10%	Flat to 10% decrease
Environmental Pollution Legal Liability	Down 5% to up 5%	5% decrease to up 5%

As the year comes to an end, we take this opportunity to present USI's Q4 2019-2020 Market Outlook & Forecast, which illustrates the continuation of market trends that were previously reported in our Mid-Year 2019 report. These trends include ongoing rate increases across a number of coverage areas as well as continued reduction in capacity. The market conditions referenced in the corresponding chart, and discussed on the pages that follow, are expected to continue into the first part of 2020—and for some product lines, well into the year.

PROPERTY

Property insurance carriers continue to retrench because losses are significantly eroding their profits. This flight to quality results in many carriers exiting or severely reducing capacity in areas prone to Natural Catastrophe (CAT). Three market leaders, AIG, FM Global and Lloyd's of London are highly scrutinizing their North American property business impacting capacity, rates, and coverage. The combination of attritional losses with CAT losses in the past several years is resulting in pricing adjustments and coverage deterioration. Adding insult to injury, many of the CAT losses of 2017 and 2018 continue to include higher than expected loss development. It is our opinion that resetting this market will likely carry through the balance of 2019 and into 2020.

It is important to note that carriers are especially focused on the following areas:

Flood: Recent Tropical Storm Imelda created a second 500-year frequency event impacting Houston in the last three years. Carriers providing flood capacity in coastal areas are paying out unprecedented claims even in areas outside the designated flood zone. These losses are not only impacting coastal areas but non-coastal areas as well.

Tornado and Hail: Exposed U.S. States continue to see large convective storms impacting property risks resulting in a change in underwriting these risks. Carriers are pushing primarily in the area of retentions to reduce their exposure in the form of percentage deductibles.

Wildfire: An increase in the frequency of fires and the impact of the losses has resulted in carriers pricing for the risk and exposure where in the past, this was a "throw in."

Non-flood Water Damage: Pipe breaks and overflowing receptacles have resulted in a meaningful increase in the frequency and severity of these attritional losses. Carriers are looking at client risk mitigation techniques where these losses have impacted the overall loss record.

How USI Can Help

USI works closely with property clients to mitigate current market conditions. Our suggestions include:

- Starting the renewal process as early as possible.
- Reviewing alternative retention and structure options based on analytics.
- Providing quality exposure data along with current and future capital expenditure information.
- Explaining risk mitigation techniques if losses have occurred.

As mentioned in our Mid-Year 2019 Market Outlook & Forecast, these techniques can help with underwriters who now must be highly selective and pass on accounts that lack submission quality.

CASUALTY

Despite industry surplus sitting in excess of $800 billion and growing, the firming of the insurance market for the majority of coverage lines is not being driven by capacity constraints. Over the past three quarters, the overwhelming majority of capital is being deployed much more conservatively and selectively, causing a significant firming of the Primary Liability and Umbrella/Excess Liability marketplace. While commercial auto rates have been increasing year over year for the better part of three years, rates are still not adequate to offset the increase in frequency and severity of loss. Moreover, legal financing trends, higher settlement verdicts and a more socially conscious public are all contributing to rising severity rates.

While commercial Automobile Liability began firming three-to-four years ago, the Primary General/Products Liability and Umbrella/Excess Liability marketplace firmed rapidly beginning in the 4th quarter of 2018. Attempts to raise rates in prior years were short-lived, however, the current environment of more restrictive risk selection, tighter underwriting standards and reduced competition for premium dollars is turning out to be much more uniform, prolonged and severe than anticipated. Deteriorating loss trends characterized by increased frequency of severity losses has caused markets to exit certain lines of business, reduce their capacity and raise rates considerably, and this is cutting across all industries and classifications regardless of tenure with markets or past loss history. The demand for rate increases is not expected to slow dramatically for the duration of 2019 and into the 3rd or 4th quarter of 2020.

For Liability lines, we expect insurers to continue to demonstrate conservative underwriting and not deploy surplus capital to write new business, with very few exceptions. While we are hopeful rates will begin to level off in the latter part of 2020, we don't expect aggressive competition for premium dollars to manifest itself, at least to the degree necessary to begin stabilizing the marketplace. As a consequence, insureds must begin to look at assuming more risk themselves in order to offset the rate increases.

Workers' Compensation, by contrast, is the lone casualty line in which a competitive market exists for most industries in most states. Workplace injuries continue to decline year over year and loss ratios remain favorable and the majority of states continue to approve rate reductions. Rate reductions cannot continue forever and at some point, rates will level off and may begin turning upwards. The recent decision by California to classify independent contractors as employees will add billions in payroll and premium and, consequently, losses in the state and other states may be forced to follow suit.

The Market Today and Market Capacity: For 2019 year to date, the general marketplace has shown little change over the prior several years from a Workers' Compensation trends perspective. Although slowing, workplace injuries continue to decline year over year and the combined ratio in most states has been well below 100% for over three years and reserve redundancies continue to climb. As a consequence, the Workers' Compensation market continues to remain a competitive line for the majority of buyers.

However, there are headwinds including an increase in average indemnity and medical severity trends. Additionally, a recent study by PwC's Health Research Institute indicates medical costs are expected to increase in 2020 compared to the flat trends seen in 2018 and 2019. If this trend continues, we may very well see the combined ratio begin to climb, resulting in rates flattening out in more states.*

For guaranteed cost buyers, we have seen a continued competitive premium environment with mid to high single-digit reductions depending on the state and classification of business. For clients on loss sensitive programs, the majority experienced flat renewals as rates have bottomed out for many buyers. In circumstances where clients are experiencing greater loss severity or where clients have a real need for premium savings, the market is reacting with increasing retention levels.

The expiration of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA 2015) in December of 2020 will also begin impacting clients in the coming months, especially those insureds with policies having an expiration date beyond 1/1/2021. Insurers need to plan for the potential the act will not be renewed and begin managing their aggregate exposure to loss in urban areas. Many may cease writing accounts in high risk areas and/or look to raise premiums significantly.

Notwithstanding, the remainder of 2019 and 2020 will show a very similar underwriting and pricing approach to that experienced in 2019, however, with slightly lower rate reductions on average.

How USI Can Help

- USI advises clients to re-evaluate the effectiveness of pre-loss safety and post-loss claims handling mitigation efforts and dialogue with their broker and insurer partners to ensure they are achieving optimal results from both initiatives.

USI also advises clients to:

- Work with your broker to leverage proper loss and financial analytics to determine your capacity to assume risk at various retention levels.
- Revaluate applicable collateral alternatives, premium levels at various retentions and loss allocation methodologies.
- Ensure experience modification factors are properly calculated.
- Ensure payroll by classification codes are accurate.
- Assess the current and future utilization of independent contractors to determine impact on Workers' Compensation costs and losses.

*https://www.pwc.com/us/en/industries/health-industries/library/behind-the-numbers.html

COMMERCIAL AUTOMOBILE LIABILITY

The market for Automobile Liability continues to be challenging with no improvement since we released our 2019 Mid-Year Market Outlook & Forecast. Claims frequency and severity trends persist and coupled with a more liberal claims settlement environment, profitability issues persist for commercial automobile underwriters. While advances in technology and the growth of telematics in vehicles will continue to reduce accidents over time, benefits are being offset by:

- More vehicles on the road driven by less experienced drivers.
- A deteriorating public road infrastructure.
- The increasing rate of distracted driving.
- The increasing rate of medical inflation trends.
- The increased rate of high-speed accident survival, which corresponds with exorbitant rehabilitation costs.
- Increased property damage losses due to advances in technology and higher cost of vehicles.

The confluence of these events has reduced overall available capacity in the marketplace. Primary markets continue to walk away from writing the coverage and many will not entertain a risk unless they obtain a rate that they deem adequate. Additionally, it is now more common for Umbrella insurers to demand primary attachment points of $2 million per accident for insureds with fleet sizes of even 500 or lower with potential higher attachments for larger fleets, and this is driving up the cost of the primary capacity that does exist. As a consequence, the demand for automobile buffer layers is prevalent but capacity at a competitive cost is minimal.

The vast majority of insureds with a commercial automobile exposure are experiencing significant cost increases regardless of vehicle class, driving radius or geography.

PRIMARY GENERAL/PRODUCTS LIABILITY

The Market Today and Market Capacity: The Primary General and Products Liability market has also been experiencing firming over the past few quarters. The rapid increase in severity of loss stemming from large jury verdicts, longer claims reporting tails today that are impacting the normal takedown of prior years' loss reserves and increasing medical inflation trends overall. Moreover, we are increasingly seeing markets unwilling to write Primary Liability lines on a stand-alone basis without Workers' Compensation, especially for larger accounts. This is making it increasingly difficult to split up program lines to achieve the most favorable renewal outcome.

The current market is characterized by mid to high single-digit rate increases for the majority of our client base and we expect this trend to continue for the duration of 2019 and persist into calendar year 2020.

UMBRELLA AND EXCESS LIABILITY

The Market Today and Market Capacity: This current market is characterized by high single to low double digit rate increases for the majority of our client base as well as the elimination of a significant amount of capacity overall.* We are seeing the reduction in average lead Umbrella capacity of $25 million to $15 million or less, with no corresponding decrease in rates and the reallocation of capacity higher up in towers. Additionally, whatever existing capacity exists is being deployed with more scrutiny across geographic and industry lines and at increasingly higher primary attachment points while pulling back on coverage, terms and conditions. Unlike in past years, markets are walking away from what they perceive to be below market pricing and new market capacity is not entering the market. In particular:

- The increased practice of litigation financing in which third parties provide funds to finance suits in exchange for a portion of the settlement is driving settlements up. It is expected that a high majority of plaintiff law firms will utilize some degree of litigation financing in the next 12- to 24-months.
- The shrinking number of lead umbrella players—with the majority in the market preferring to write Excess of $10-$15 million.
- Liberal jury verdicts due to empowered plaintiff bar, misgivings about companies' corporate intentions and juror empathy for plaintiffs are on the rise.
- Increasing medical inflation trends overall.
- Adequate reserving for Liability losses continue to be problematic and the normal takedown of prior years' loss reserves is being pushed back.
- Liability loss dollars for claims settlements above $5 million now account for over 20% of all loss dollars, which is substantially higher than 10+ years ago.
- Lack of reinsurance support meaning retail markets must take more net.
- The likely consolidation of the surplus lines market will result in even more selectively deployed capital.

The demand for rate increases is not expected to slow dramatically for the duration of 2019 and for the calendar year 2020. We expect insurers to continue to demonstrate conservative underwriting practices and not deploy their surplus capital to write new or expanded business, with very few exceptions. In addition to insureds with poor historical loss experience, clients with exceptional loss experience and who demonstrate appropriate management of their risks will also be negatively impacted.

While we expect the growth of alternative capital solutions for casualty lines to increase in interest, we do not see significant use of these types of solutions in the short term. Prices are still too low to generate Insurance-Linked Securities (ILS) investor interest.

How USI Can Help

In working one-on-one with clients who purchase Auto Liability, General Liability, or Umbrella Coverage, USI assists in developing a plan of action and dialogue with incumbent and prospective markets. We also suggest that they take the following steps to ensure a better outcome.

- Prepare early, develop a plan of action and dialogue with incumbent markets at least 120- to 150-days in advance of renewal expectations. Discussions should consider reductions in capacity and corresponding rates on a price per million-basis.
- Clearly describe the qualities of your risk in the carrier submissions with the objective to differentiate your risk profile from others in the industry. Risk quality comes in several forms including: safety, contractual risk management, risk mitigation, capital expenditures, willingness to engage risk control and overall risk management philosophy.
- Complete a loss analysis early to assess impact of program structure, retention, collateral, and risk mitigation efforts.
- Push incumbent markets to provide early indications to understand your options.
- Work with brokers to stay abreast of specific market conditions and develop a plan of action.
- If switching carriers, evaluate coverage terms and conditions appropriately to ensure consistency across carriers.
- Meet with underwriters more frequently and develop a deeper relationship with long-standing carrier partners.

Here are some vital steps that USI's risk advisors will take when working with their Commercial Automobile Liability clients:

- Update driver lists and safety protocol; provide complete analytics on loss history and exposure; and provide a data-rich submission with clear underwriting goals from the client's perspective.
- Review CSA scores and take corrective actions. The CSA score, which is used to rate motor carriers in various categories, such as unsafe driving, crash indicator, hours-of-service compliance, and driver fitness, is now the first underwriting factor used by insurers to assess a company's risk profile and what they should pay for coverage.

*For Auto Liability, rate increases average in the mid double digits.

PUBLIC COMPANY D&O

It appears both the speed and severity of increases has been underestimated given what is now being seen broadly across the market in both renewal and new business (i.e., Initial Public Offering) placements. We do not expect this trend to abate in the Q4 of 2019 or for FY 2020; in fact, we expect conditions to continue deteriorating.

There has been more upward rate movement in the first three quarters of 2019 than we have witnessed in the past 16-years and we have clearly now transitioned into a carrier-dictated market. It is likely premature to state that we are in a public D&O "hard market" as favorable policy coverage terms remain in place for the most part, and pricing is still below historical highs seen, at least through YE 2019.

Public company clients with 1H 2019 renewals saw only 10%-20% premium renewal increases with market pricing continuing to deteriorate significantly since then into 2H 2019 with 20-30% increases being seen widely. Depending on class of business, claims history and regulatory exposure, these increases have been well over 30% in 2019 for some clients (trending to over 50%-150% for some clients/classes). Clients with perceived "higher risk profiles" in certain industry sectors (such as biotechnology, life sciences, general healthcare and technology) or those with D&O claims activity in the past five-years are experiencing the highest renewal premium increases. Initial Public Offering (IPO) clients are particularly challenging, with very few carriers able or willing to quote primary layers. Underwriters are very selective about deploying capacity on both Primary and Excess limits. $10M+ retentions for Securities Claims on IPOs are not uncommon and these trends are expected to continue into full-year 2020.

Many clients with layered D&O programs have seen Excess pricing increase even faster than Primary premiums, with insurance carriers willing to walk away from business if they feel they cannot obtain adequate rates. Excess layers Rate on Line (ROL) pricing has increased rapidly—increases from 55-60% ROL to 70-80% ROL are becoming commonplace and can reach 100% (or more) of the underlying premium. Side A and Side A DIC tower pricing, while offering some pricing savings on a percentage and real dollar basis, are also increasing rapidly (though not as quickly as "ABC" D&O coverage) for two reasons: 1—an increase in size and number of derivative claims and 2—increases can be secured by underwriters. On a practical level, it takes longer to secure quotes and build programs as underwriting authority is being pared back with the need for senior leadership approval as D&O risks increase.

While there are several factors contributing to this hardening market—"Event-Driven Litigation (EDL)," and fewer public companies and IPOs to offer new premium as examples—the main driver is simply increased loss costs colliding with more than a decade of historically low premiums in the D&O space, eroding insurer profitability. Combined with more and larger loss in Security Class Actions (SCAs), this hardening is inevitable. 2019 is on pace to match or exceed 2018's SCA record filings and exceed 2018 average settlement numbers; 436 projected filings for 2019, roughly twice the historical norm with projected $35 million average settlement value in 2019 vs. $33 million in 2018, adjusted for outliers, not inclusive of defense costs.

Post the Cyan decision by the U.S. Supreme Court, shareholder claims are now being pursued in both state and federal courts, which is also driving up defense expenses. Beyond SCA claims, some notable and very large derivative claims settlements have also adversely impacted D&O insurers' bottom lines. Finally, another near-record level year of regulatory enforcement actions against public companies and their directors and officers in 2019 shows no signs of abating.

Given this situation, continued premium increases, Self-Insured Retention (SIR) increases, and ROL/Excess rate increases affecting all public companies can no longer be viewed as a temporary or short-term correction. The pace of 'hardening' has picked up in 2H 2019 and we believe that the current difficult market environment may continue into FY 2020 and beyond regardless of a macroeconomic event that may exacerbate these projections in 2020.

How USI Can Help

USI offers these practical and effective suggestions to public companies that are considering their D&O coverage needs:

- Communicate early and often with your broker and D&O carriers. Preparation is key.
- Evaluate all options with your broker:
  - "Buy less D&O" is a real answer and can be a prudent one if an enterprise's true risk exposure is understood.
  - "Buy different D&O," to lessen pricing impact—Side A DIC vs ABC cover.
  - "Buy D&O with a higher SIR," to help mitigate pricing increases.
  - Seek solutions not widely seen in the last 10-15 years—co-insurance, catastrophic SIR considerations, etc.
- Set appropriate and realistic expectations with all stakeholders within your organization.

PRIVATE COMPANY D&O

While not as pronounced as public company increases in D&O premium, retentions, and ROL, Private Company D&O is seeing a faster than anticipated rise in premium and SIRs than initially detailed in last year's FY 2019 projections and indeed, even in the June 2019 update. "Flat" pricing and SIRs morphed from 5-10% premium increases being seen through 2019, on average, depending on class of business. For private companies that have suffered claims losses or are expanding/changing operations, are heavy in Mergers & Acquisitions (M&A), or are in the "unicorn" class, premium and SIR increases are typically higher: 10%-25% on Primary premium and 25%+ SIR increases on average are being seen.

The major drivers of these changes are the increasingly diverse number of claim types hitting the D&O policies and increased costs to defend these claims. The private company Excess market remains competitive for firms under $1 billion in revenue, but for those firms over $1 billion in revenue, especially those with claims, increases in ROL are being seen (up 15-20% or more). Additionally, given the broad-form nature of Private Company D&O insurance contract terms and conditions, especially in light of the recent spike in EDL, terms and conditions are tightening– meaning an understanding of what is currently carried and the impact of losing a coverage term should be understood. With SEC actions against private companies on the rise and D&O carriers looking for ways to offset faltering public company books, it is likely the FY 2020 private company D&O market will see increases on average of 10%+ on Primary layer premium, increases in SIRs of up to 40% and terms and conditions shaving at renewal. For troubled firms, 20-25% increases in premium as a starting point may be inevitable, regardless of a macroeconomic event that may exacerbate these projections in 2020.

Side A and Side A DIC coverage increases are typically flat to 5% for private companies, offering a potential good value to protect individual directors and officers with cost-effective policy types.

How USI Can Help

Here are just some of the ways that USI assists private companies that are considering their D&O coverage needs:

- By securing favorable baseline terms grants as part of a "Broker Group Panel."
- By negotiating expanded D&O terms and conditions through "panel carrier" coverage, making it harder for underwriters and carriers to break out coverage grants on individual accounts.
- By identifying potential emergent EDL exposures as part of holistic underwriting. USI is working with clients and prospects to identify specific emergent risks that could trigger D&O policy coverage while evaluating placements on related lines (i.e., Employment Practices, Cyber, etc.)

TRANSACTION LIABILITY - REPRESENTATIONS & WARRANTIES (R&W)

From 2017 to the present, the number of insurers and capacity available in the R&W space grew exponentially (from 6 or 7 to just over 20) and rates slid on average 10% or more each year. In the latter half of 2019, rates are still falling but not as steeply; flat to down 5%. This pace is expected to continue through to the onset of 2020 and likely through 1H 2020. While rates continue to soften, Self-Insured Retention (SIR) levels have fallen below 1% of the Enterprise Value (EV) of the transaction. Transactions over $350-$500 million EV now often have a .75% SIR with smaller EV transactions garnering a .9% SIR. In most cases the SIR will reduce to .5% after 12-18 months.

The number of policies written for M&A transactions continues to increase as more parties find the product to be a useful tool providing value to both the buyer and seller in the transaction. Furthermore, formal investment bank bid processes/auctions typically require that bidders agree to the purchase of a R&W policy as part of the transaction. Oftentimes there is a negotiated sharing of both the SIR and the premium due.

Claim frequency continues to run in the 20% range (one claim for every five transactions). Transactions larger than a $500 million EV are typically incurring claims marginally over 20% with smaller transactions just under 20%. In a trend to watch for 2020, there are several large $50 million and $100+ million claims facing R&W insurers in the U.S. this year, which we believe may be the moderating factor seen in rate decreases. Coverage terms remain broad with fewer deal-specific exclusions being included in policies.

Some newer developments seen in 2019 and expected to continue into 2020 include interest in transactions of $20 million EV—considered "too small" historically—reaching all the way to $2 billion in EV. Also, cyber exposure focus continues to rise, with insurers looking to see that there is thorough IP/IT/Network Security diligence conducted by the buyer and adequate cyber insurance in place for the target company. Finally, with a more crowded R&W market, more insurers are looking to develop expertise in Tax Liability and Contingent Liability products, areas historically with little carrier penetration.

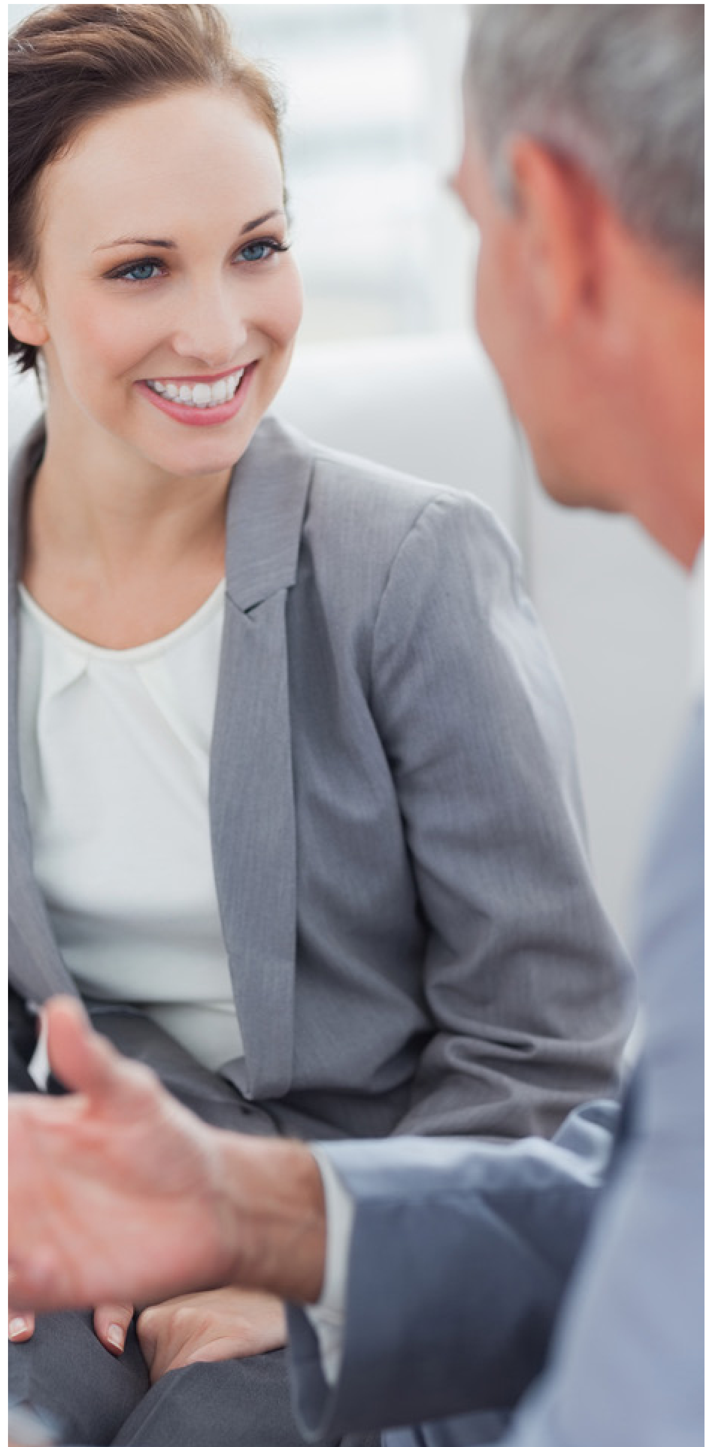
How USI Can Help

- Investment Bankers (IB) and legal counsel are not typically experts in R&W coverage. USI, on the other hand, has extensive experience and capability in Transaction Liability.
- When brought into the front end of deal negotiation, USI can demystify the R&W procurement process and shed light on pricing, underwriting requirements, policy terms, timing and other expectations—paving the way for a "no surprises" experience.

EMPLOYMENT PRACTICES LIABILITY (EPL)

While we predicted in our 2019 Market Review an increase of 5-20% depending on class of business for EPL premiums, and our mid-year adjustment remained unchanged, the actuality for Q4 2019 has been that outside of accounts with specific issues, EPL pricing has seen a flat to 10% increase in premium overall. Larger firms have seen some bigger percentage increases in both pricing and SIR, but mostly in "problematic" states like California, Illinois, and New York; overall the market has remained stable. However, a major concern has been insureds "jumping too quickly" to try and settle matters and running afoul of insurers' provisions and practices. While this is not unexpected in the era of reputational harm brought about by #MeToo, #TimesUp, etc., it can lead to uncovered or partially covered EPL claims. Anecdotally, per leading EPL carriers, this same rush to settlement to avoid reputational risks is driving settlement values up and may impact EPL premium and retentions in the latter half of 2020 and beyond.

For Q4 2019 and into the first half of 2020, we believe the market conditions noted above will continue. Factors that may trigger increased hardening of the EPL market in 2020 include age discrimination claims related to an aging U.S. workforce, several pending supreme court decisions (most notably LGBTQ rights in the workplace); and an increased frequency in sexual harassment claims.



How USI Can Help

USI offers these best practices to firms that are interested in mitigating their EPL risk:

- Make sure terms and conditions minutiae is understood. Consider the definition of "employee" in your EPL contract, especially in the states mentioned previously, and consider "other insurance" clauses in relation to Professional Employer Organizations (PEOs), etc.
- Explore options for EPL-adjacent coverages before they are needed: punitive damage wraps, Wage and Hour standalone coverage and other EPL coverage "add-ons" may be available and have been dropping in premium cost and SIRs; this will not last in a market turn.
- Work with your broker to ensure you understand your EPL contractual obligations and to identify, defend and settle any claims from first knowledge onward.

CRIME AND FIDUCIARY LIABILITY: CRIME

Our 2019 market projections for Crime Policy coverage remained correct through Q4 2019 (in other words, a slight decrease to slight increase can be expected based on account unique underwriting but usually within 5% either way). However, with the mounting number and severity of "Social Engineering" losses and crime policies offering higher limits and lower SIRs typically than Cyber policies for this loss type, we predict that 2020 will see a flat to 10% increase in premium and a much more likely increase of up to 50% in SIRs, particularly around Social Engineering SIRs, which have been historically low to the impact of the risk.

Insurers will continue to rely on main form application and supplemental application detail around "control and verification" procedures used by insureds (this is an area that needs to be watched in 2020 especially around Social Engineering coverage). All carriers use different versions of the "control and verification" questions and some of them incorporate exclusionary language around the failure to follow these controls, which are difficult to overcome in a claim.

How USI Can Help

- USI can assist in understanding the information, practices and actions expected by an insurer of an Insured on the front end, prior to a claim.
- USI uses knowledge of clients' placements across a worldwide geography to help differentiate a risk within specific industries.
- USI suggests that when prepping to renew a Crime Policy, best practices for IT and Accounts Payable/Finance should be considered and improved and/or highlighted for underwriters in the space.

CRIME AND FIDUCIARY LIABILITY: FIDUCIARY

Our mid-year Market Forecast and initial 2019 projection were both in line with the current renewal environment (approximately 5-10% increases YoY). However, SIR size, and in particular those companies with their own public company stock holdings exposure have seen the biggest jump (we are seeing SIR increases of 25-100%, however, these are increases to a rate base that was at a historical low for the past decade and therefore represents small dollar amounts). Q4 2019 and full-year 2020 are expected to follow a similar pattern barring a major macro-economic downturn.

How USI Can Help

- Ensures appropriate controls are in place, including expertise on fiduciary advisory boards and regular interaction with Boards of Directors.

NETWORK SECURITY/PRIVACY LIABILITY (CYBER)

The market for cyber insurance remains competitive in Q4 2019 and into 2020, with premiums and retentions remaining flat in most cases, as predicted, particularly when contemplating those companies under $1 billion in revenue, annually, which are the vast majority of firms. However, it is critical to note that those over $1 billion in revenue and those in "challenging classes" like Retail, Hospitality, Healthcare and Financial Institutions, remain outliers in regard to pricing and SIRs. For these larger companies and challenge classes of business, increases in premium of up to 20% and SIR increases of up to 50% have been seen. We expect to see this continue in Q4 2019 and through the first half of 2020. Those accounts with $1 billion+ in revenue and claims paid can expect 20-35% baseline premium increases and 30-50%+ increases in SIR with the potential lessening of some sub-limited coverage, especially when there has been claim activity.

The reason for the focus on larger firms and those firms with previous losses are that both are considered "prime targets" for bad Cyber actors to attack, particularly with ransomware. Larger firms are attacked due to the sophistication in ransomware malware we have seen in 2H 2019, leading to a rapid increase in demands from extortionist hackers (well over $1 million in many cases) and those companies or entities with previous losses are seen to have lax controls. Additionally, heavy M&A activity is typically seen as creating an exploitable opportunity in terms of ransomware.

For many clients with layered programs, Excess rates are being reduced, even if the primary carrier secures an increase in premium (usually due to claims activity). This is expected to continue into 2020, as there are now over 175 markets writing Cyber in the U.S. alone in FY 2018 (last available). However, for large insureds in high hazard industries with loss history, Excess rates are firming as the carriers consider even high Excess position to be in the "burn layer" (i.e., they are vulnerable to catastrophic cyber losses up the entire tower of $50 million, $100 million or more limit in many cases).

How USI Can Help

Through its vast network of regional, national, and international cyber solution specialists, proprietary tools, and expertise in privacy and network risk, USI is well equipped to help clients understand their coverage options and pursue the appropriate solution.

- USI helps clients understand the interaction between cyber and other coverages including Crime, Property, EPL, and Kidnap and Ransom (K&R), and how to optimize them.
- USI helps clients understand the difference between coverage options and their impact, i.e., whether a Ransom cover on a K&R policy offers the same coverage as a Cyber Ransomware cover, etc.
- USI facilitates interaction between C-suite, IT, and risk management stakeholders to help differentiate your risk.

ERRORS AND OMISSIONS COVERAGE (VARIOUS LINES)

While our 2019 full-year prediction is echoed in our Q4 2019 to 1H 2020 projection of flat to 10% increases in premium with stable SIRs, there are certain sectors that have experienced outsized premium impact in 2H of 2019 and we expect these areas to see that same impact in Q4 2019 and 2020.

Specifically, large firm Lawyers' Professional coverage, large Architects and Engineers cover, project-specific construction E&O and Trust E&O (and any valuation-based service or risk) are experiencing a lack of markets and 15-50% increases in premium and SIRs. Additionally, 15-30% premium increases and terms pull-back are being seen in the large real estate E&O market.

How USI Can Help

- USI understands the overall E&O market and has global reach to help clients obtain the most favorable outcome.
- This includes understanding which markets are most aggressive in their space, which are willing to offer specific tradeoffs for premium impact, and why they are seeking to do so vs. their peers.

AVIATION

The Market Today: Dramatic changes continue to occur in the aviation insurance marketplace. Rates continue to climb as losses of unprecedented levels are being realized with the end of the year in sight. As predicted, 2019 has been the most volatile year in the aviation insurance market since the fallout of September 11, 2001.

The Boeing 737 losses with Ethiopian Airlines and Lion Air along with the subsequent grounding of the 737 MAX jets have resulted in unprecedented losses. Other groundings in the helicopter industry have added to the issue and underwriters are struggling with changing contract language for Grounding Liability coverage. Several severe crashes with fatalities in high valued owner flown turbine aircraft and commercial helicopters are also a factor in the market correction. Reinsurers have exited the market, and two domestic carriers have left in less than a two-year period, leaving remaining markets finding ways to brace themselves for the continued hard market cycle.

The single digit, gradually increasing rates of the past two years have now turned into double digit increases on most risks and a tightening of underwriting guidelines on most risks. Several markets are declining to quote risks they would have entertained in the past, and there is less flexibility with training requirements, high Liability limits, and other risk factors. The loss history of an account is also highly scrutinized. Increases are not uniform and vary greatly depending on the type of aviation risk and the individual risk factors involved.

Moving Forward: Depending on loss levels and class of business, increases can range from 10% to as high as 30% and even more in some cases. All lines of aviation including general aviation, airports and municipalities, service providers and product manufacturers are seeing increased renewal premiums and tighter underwriting standards. Reduced limits, fewer supplemental coverages, increased examination of operational protocols such as pilot training and safety management, and higher retentions are some of the things that the aviation insurance consumer can expect to see for the remainder of 2019 and into the first part of 2020.

How USI Can Help

- USI's aviation professionals will negotiate the best coverage for your premium and leverage their expertise with the markets to bring you higher limits and the broadest insurance contract language.
- USI will meet with key underwriters to effectively communicate your risk profile and will present the most relevant, complete information on your business. USI will also highlight your safety culture, training requirements, loss control measures, and other positive business practices, and will help you identify ways to push safety procedures and loss control across your organization to achieve measured outcomes.
- USI will develop a strong marketing strategy by examining your risk, creating a comprehensive timeline and establishing goals during the renewal cycle. Letting you know the incumbent market's position can help you plan for increases and pass that cost along to your consumers to help your cash flow.

INTERNATIONAL

- **Primary Foreign Casualty:** Rates for Guaranteed-cost programs have stabilized and are remaining flat.* In addition, we've seen a lowering of limits (redeployment of capacity on upper layers and lowering of limits Excess of $5 million).
- **Primary Foreign Property:** 5%-15% increase range and much more (30%+) on risks in exposed catastrophe zones.

How USI Can Help

- USI facilitates a global risk assessment for companies with decentralized multinational insurance programs. By moving to a centralized Controlled Master Program, clients can achieve overall premium savings, have concurrency and consistency of coverage, eliminate coverage redundancy and eliminate potential gaps in coverage.
- USI guides clients toward establishing schedules and protocols for identifying and evaluating international exposures throughout the year.
- USI guides clients toward developing and establishing processes to push standardized loss control and safety procedures across their organizations.

*On Automobile, we are seeing rate increases of 15%+.

A continuing upward trend of environmental claim severity and frequency will be the theme for 2020. Insurers have started to retrench in certain areas and will be more cautious on risk selection. There is no getting around it, environmental risks are getting more complicated and complex.

There are myriad reasons why this is true. With better technology, the science is getting more accurate around the potential harm that various chemicals or "pollutants" can cause to people and the environment. We also continue to see the uptick of natural disasters that lead to significant spills, releases or mold damage. There is more recognition today that our drinking water is a precious finite resource and that may be jeopardized by any possible contamination. Spurring the risks to even greater heights is our frenzied social media activity. While it creates more awareness of the risks, it may also influence outsized court awards.

Over the past decade, the environmental marketplace has expanded significantly to include over 50 insurers in the space, which has led to significant competition and more customized solutions, all with a much better risk-trade for buyers. We likely will continue to see new players enter the marketplace, which will put pressure on pricing. As a result, those insurers with more mature books will be more thoughtful about the coverage offered and may apply more coverage restriction or higher retentions for higher risks classes. They may also push for higher rates in 2020.

The Market Today:

- Highly competitive.
- 50+ Insurers.

Market Capacity:

- Over $600 million. Stable, more new players but with Mergers & Acquisitions (M&A) activity likely keeping overall capacity stable.

Overall Marketplace Trends

- Expansion of Coverage: More markets offering some broader coverage enhancements to capture greater market share, such as: bacteria, viruses, first-party diminution in value, and defense outside of limit either at a defined limit or, in some cases on a Contractors' Pollution Policy, unlimited defense coverage.
- Transactional Risks: 10-year term policies for historical Pollution Legal Liability are still available from a short list of insurers.
- Higher Hazard Risks: Such as energy, mining, petrochemical, power and utility firms and fuel hydrant systems, including airports, may find short policy terms of one- to two-years only available.

With a booming construction industry, Environmental Owner-Controlled Insurance Program (OCIP) or Controlled Insurance Programs (CIPs) are commonly placed even for projects less than $100 million in construction values, generally paired with a Pollution Legal Liability policy.

Environmental Casualty, which are policies that combine General Liability and Pollution Legal Liability, are still very popular, particularly with companies having products that could cause environmental contamination if they fail. The rates are increasing for environmental casualty, especially for environmental firms and contractors whose losses are increasing.

A version of the popular Cost Cap coverage, which was used extensively to cap known cleanup liabilities for brownfields risks and that went out of favor around 2011 due to enormous losses, has returned for cleanups generally exceeding $10 million.

How USI Can Help

- Create an environmental profile to identify exposures associated with operations; quantify and qualify the impact on the organization to set risk management and insurance strategy.
- Develop formal and customized risk maps to identify frequency and severity of fines and penalties for noncompliance, spill events, known and unknown remediation, and Toxic Tort Liability.
- With significant liabilities, develop sophisticated risk model platforms using Monte Carlo analytics to look at range of probabilities and to forecast potential liabilities over a long horizon.

Forecast for 2019

Rates will be fairly stable, except Environmental Casualty combined General Liability/Pollution structures that will have more volatility. Specifically, we predict:

- Pollution Legal Liability: 5% increase to 5% decrease.
- Contractors' Pollution: flat to 10% decrease.
- Combined General Liability/Pollution: 5-8% increase. More rate on Excess if it includes auto exposure.

MANUFACTURING & DISTRIBUTION: MARINE CARGO INSURANCE

The Manufacturing & Distribution market has and is performing in line with the projections noted throughout this report, with one additional trend worthy of mentioning:

Following years of competitive terms, pricing and capacity, we have seen a firming of the marine cargo market, driven by CAT losses, adverse loss development and poor underwriting results, with London leading the pack. We saw the London market begin to retrench in 2018, with a focus on improving syndicate performance. This has included a handful of syndicates exiting the marine market all together and others taking corrective action to restore profitability of book by restricting specific classes of business, coverage terms, and implementing higher deductibles and rate increases. This shift in the market has continued over the last 18-months with tougher classes of business such as perishable goods, soft commodities and poor loss history, seeing premium increases upwards of 100+%.

As a result of continued corrective action by Lloyd's, we are seeing the U.S. marine cargo market step up and fill the void as an alternative to London. Although also impacted by the firming market, we're seeing a more balanced approach by U.S. carriers in terms of coverage, capacity and rates.

Despite rate firming, the marine market is flush with capacity and remains competitive with clean, preferred risks being sought after by both London and U.S. markets.

How USI Can Help

In guiding clients toward achieving favorable coverage outcomes, USI recommends taking the following steps:

- Begin the renewal process 150-days prior to inception.
- Get an early start, which allows for early indications from incumbents to understand your options around limits, retentions, coverage and price.
- Work with your broker to evaluate all market options, focusing on risk appetite and industry as well as across both U.S. and London markets.
- Additionally, it is imperative that each risk be clearly identified and differentiated to the marketplace, reinforcing risk quality and mitigation efforts.

The Construction market has performed at about as projected in our December 2018 report, with the following comments:

- Builder's Risk: Frame projects. Capacity is shrinking because of losses largely due to the most recent natural catastrophes and wildfires. With the reduced capacity, rates are starting to increase substantially. It is critical to have protective safeguards such as fencing, guards and Closed-Circuit TV (CCTV) on these projects in order for markets to respond.
- Auto: The entire industry is getting hit with auto increases, so this is not indicative of Construction only. We are seeing carriers request increased rates from high single digits all the way up to 25%, although not with much success at the high end.
- Umbrella: While capacity is ample, there is increasing pressure on Umbrella markets to drive rates up because of poor underlying performance. Again, this is not construction specific. Industry-wide issues are at work here.
- Labor Shortage: Plaguing the industry and driving up worker's compensation costs. There are three issues – skilled labor shortage, aging workforce and temporary labor. These issues are putting pressure on safety protocols as well as claims management in order to get workers back to work as well as effectively manage the cost of the claims.
- Labor: When more seasoned workers get injured, they are out of work longer with a tendency for larger claims-driving severity. For newer workers, there is a propensity to have more claims because they're still learning their job, which drives frequency. Temporary labor is causing different issues around who is responsible for the injured employee, so clear contract language is needed in both the contract with the leasing firm as well as the insurance policy in order to manage the risk appropriately.
- Fire Mitigation: For Contractors doing business with utilities or in high vegetation areas: some carriers are putting affirmative Wildfire Exclusions on their policies. Having a detailed fire mitigation plan and current copies of construction contracts with the owners will be critical to submit to the insurance carriers for consideration.
- Casualty: Frame construction, both commercial and residential, is becoming more and more challenging to write as similar capacity issues plague the casualty carriers as they are for builder's risk carriers.

How USI Can Help

Working hand-in-hand with its construction industry clients, USI's risk advisers encourage a strong safety culture and proactive, disciplined risk management approach. In guiding clients toward achieving more favorable coverage outcomes, USI recommends taking the following steps:

- Begin discussions early at the design phase to create a construction risk assessment plan.
- Identify and assess risk in order of importance with the right risk management partners.
- Monitor risks at each stage of the project and address any real or perceived risks in real time using the construction risk assessment plan.
- Consider the construction project risk management goals with a clear understanding of the exposures that can be transferred.
- Be mindful of capacity deployment because capacity for construction insurance remains competitive as insurers are becoming increasingly selective in this area.

USI also offers these suggestions for working productively with your risk advisors:

- Consult on market submissions with the intention of highlighting a strong/improving safety culture and risk management approach and to communicate your organized and developed claims trend and strategy.
- Develop analytics around various risk financing opportunities, which can lead to improved decision-making and better outcomes.
- Ensure property and builder's risk policies are structured properly when making decisions about material purchasing, to minimize cost and maximize coverage.

MARKETPLACE STRATEGY

As suggested throughout this report, current market conditions are expected to continue through year-end 2019 and into the New Year and may be further affected by the various factors referenced within the previous product sections. With this in mind, we will remain abreast of market conditions and share any new findings and observations in advance of mid year 2020, in our 2Q 2020 Market Outlook & Forecast report. Between now and then, USI will continue working diligently on behalf of our clients to mitigate risk as well as the impact of the current market conditions, securing the most favorable outcome in terms of coverage and pricing.

How can we help?

For more information regarding this topic, please contact your USI Consultant, or visit us at www.usi.com