Marketplace Realities 2017

The search for growth
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We also invite readers to visit the Insights page of www.willistowerswatson.com, where you will find many other articles and studies of immediate and enduring value to risk managers, financial executives and corporate governance stewards of every stripe.

Marketplace Realities is updated semi-annually.

Editorial staff
Matt Keeping | Jonathan Fried | Erin Dubord | Paulette Callen

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The search for growth

Everyone is looking for growth, our carrier partners are no exception. Management, investors and analysts are all looking for growth. That doesn’t make it easy to come by. The headwinds insurers have faced for several years now show no signs of abating. Rates are soft, interest rates low. Balanced against relatively benign nat cat events and a steady influx of alternative capital, these factors are nonetheless manageable. Year-to-date, two-year and five-year returns are quite good, albeit not always where the analysts predict or prefer they should be.

Stock prices of course reflect more than modest numbers. They also reflect the opinions and expectations of the analysts. It occurred to me recently in reading analysts’ discussions of our sector that for many of our analysts the current conditions are all they’ve ever known directly. They see an industry given to good and sometimes fair short-term performance with difficult future prospects given GDP growth trends and competitive conditions. The analysts haven’t seen the hard and soft cycles that for years ruled the industry, creating an environment of potential volatility and keeping investors and analysts on their toes.

It may not matter. Those days may never return. The fundamentals of the industry, the forces that guide the flow of capital, may have changed sufficiently that things may really be different now. I still can’t help thinking, however, that a broader perspective might be useful.

Before taking a broader look, let’s look at 2016 and address the possibility that some of the prevailing conditions may actually be at last shifting. Claims are up this year, with nat cat losses accumulating. We saw (as of this writing) hurricanes hit Florida for the first time in 11 years and are still calculating the impact of Hurricane Matthew. I would argue, however, that tragic and awful as the storm damage may be, here is a case of the exception proving the rule. All indications are that the industry’s ample policyholder surplus and the steady supply of alternative capital will allow insurers to easily handle this upturn in outflow. Combined ratios of insurers seem solid and few observers are expecting any broad market hardening at all.

A similarly benign and yet complicated picture emerges as we look closer at industry activity and pricing this year. Some property rates have bottomed out and yet others still have room to fall further. Increases are occurring in a few lines (see the following pages), led by cyber, though those increases are in some cases less steep. The net for many is fairly flat.

Some carriers are growing, some by buying other related businesses. Some are shrinking, by shedding lines. But mostly large insurers are attacking the slow-growth quagmire through structural and strategic methods of expense management. Talent is being shed, but it’s not lost, as the few new, smaller carriers entering the scene will hire that talent — another case where the big-picture net result is flat. Many see growth by merger as the inevitable strategic solution that insurers will pursue. For now, we’re not seeing it.

So what are we seeing? We could call it a rather uninspiring period of flat growth and uncertainty. I prefer to call it a sign of stability. I’d also point out that in a heavily regulated industry like ours this is not a bad thing. This is a good thing. This stability, in fact, reflects the main social and economic purpose of our industry: that when disaster strikes, we can be relied upon.

We could also put it this way. The reward for investing in insurance carriers is lower than most would like. At the same time, the risk is lower, too. And again, that’s exactly the way it’s supposed to work. In the broader view, the picture I believe is a positive one. It certainly is for the insurance buyer, our clients. But I believe that it’s ultimately positive for both carriers and brokers as well. Here’s why.

Searching overseas

One obvious source of growth for many organizations of course is in international markets. Just as new markets offer new opportunities, they come with their own risks, and the marketplace for transferring those risks comes with its own set of rules, regulations, customs and complications.

With that in mind we have added a new section under the casualty heading that looks at the marketplace for international casualty coverage. These policies are usually bought separately and while the overall forces influencing this marketplace are the same as those impacting the domestic casualty landscape, a successful strategy will be aided by an understanding of the issues that pertain to international placements.

Developing and implementing such a strategy for this or any line of coverage depends on careful analysis of how each organization’s risk profile and ultimate business objectives can be served by a broad risk management plan developed with a close, trusted partner-advisor. Having a line-by-line view of the marketplace factors at work will, we believe, certainly help in the process.
Looking ahead I see possibilities that point not just to continued stability but to significant opportunities. The chief opportunity we see is in the understanding that one of the most powerful paths to growth and performance is by understanding and leveraging the intersection of people and risk. In most organizations today, these are two siloed worlds. “Risk” is about insurance, “people” is about talent acquisition, HR and benefits. The data we see reveals this to be a false dichotomy.

We are finally attacking a prime example. Workers’ compensation and health benefits are still under different budgets and often in entirely different departments. But how different are they? Aren’t they both part of the same effort: to support a healthy and productive workforce? It would of course be a big change to bring those two together. But big change is what makes for growth and advancement. With conviction, vision and the data to back it up, we can make that happen.

Another avenue for growth is narrowing the gap between economic and insured losses by widening the availability of risk transfer. For example, new technologies (see our recent postings on blockchain) hold out the promise of automating some of the process in distributing micro-insurance and spot insurance products. To some, these kinds of developments stand in blatant contrast to the underwriting partnership that remains the basis of our industry. I would argue that we need to embrace such developments, to position ourselves to guide them and, ultimately, to own them. Rather than a threat, they may be a golden opportunity.

That is the kind of view I hope the analysts will consider. Yes, fast growth may not materialize in this quarter or the next. But in the long run, the future is rich in promise and I would encourage the analysts to grow their perspective.

Matt Keeping
Head of Broking
Willis Towers Watson North America
Senior Editor
Marketplace Realities
## Commercial insurance rate predictions for 2017

<table>
<thead>
<tr>
<th>Insurance product</th>
<th>Rate Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental: combined with casualty</td>
<td>20</td>
</tr>
<tr>
<td>E&amp;O, poor loss experience</td>
<td>15</td>
</tr>
<tr>
<td>Cyber for POS retailers</td>
<td>10</td>
</tr>
<tr>
<td>Casualty: primary (with losses)</td>
<td>5</td>
</tr>
<tr>
<td>Casualty: auto</td>
<td>0</td>
</tr>
<tr>
<td>Cyber</td>
<td>-5</td>
</tr>
<tr>
<td>Employee benefits: insured plans</td>
<td>-10</td>
</tr>
<tr>
<td>Employee benefits: self-insured plans</td>
<td>-15</td>
</tr>
<tr>
<td>E&amp;O, good loss experience</td>
<td>-20</td>
</tr>
<tr>
<td>Construction: XS</td>
<td>-25</td>
</tr>
<tr>
<td>Kidnap &amp; ransom</td>
<td>-25</td>
</tr>
<tr>
<td>Employment practices liability</td>
<td>-25</td>
</tr>
<tr>
<td>Casualty: workers comp</td>
<td>-25</td>
</tr>
<tr>
<td>Surety</td>
<td>-25</td>
</tr>
<tr>
<td>Construction: CIP</td>
<td>-25</td>
</tr>
<tr>
<td>Construction: GL</td>
<td>-25</td>
</tr>
<tr>
<td>Construction: WC</td>
<td>-25</td>
</tr>
<tr>
<td>Political risks</td>
<td>-25</td>
</tr>
<tr>
<td>Fiduciary</td>
<td>-25</td>
</tr>
<tr>
<td>Trade credit</td>
<td>-25</td>
</tr>
<tr>
<td>Casualty: primary</td>
<td>-25</td>
</tr>
<tr>
<td>Fidelity</td>
<td>-25</td>
</tr>
<tr>
<td>Health care professional</td>
<td>-25</td>
</tr>
<tr>
<td>D&amp;O</td>
<td>-25</td>
</tr>
<tr>
<td>Construction: CIP (GL-only non-condo)</td>
<td>-25</td>
</tr>
<tr>
<td>Aerospace: airlines</td>
<td>-25</td>
</tr>
<tr>
<td>Aerospace: products/services/airports/municipalities</td>
<td>-25</td>
</tr>
<tr>
<td>Casualty: international</td>
<td>-25</td>
</tr>
<tr>
<td>Casualty: umbrella &amp; excess</td>
<td>-25</td>
</tr>
<tr>
<td>Construction: builders risk</td>
<td>-25</td>
</tr>
<tr>
<td>Environmental: CPL</td>
<td>-25</td>
</tr>
<tr>
<td>Environmental: PLL/EIL</td>
<td>-25</td>
</tr>
<tr>
<td>Marine</td>
<td>-25</td>
</tr>
<tr>
<td>Terrorism</td>
<td>-25</td>
</tr>
<tr>
<td>Property: non-cat risks</td>
<td>-25</td>
</tr>
<tr>
<td>Property: cat-exposed risks</td>
<td>-25</td>
</tr>
<tr>
<td>Aerospace: general aviation</td>
<td>-25</td>
</tr>
<tr>
<td>Aerospace: financial institutions/lessors</td>
<td>-25</td>
</tr>
</tbody>
</table>
A look back at our last few *Marketplace Realities* reports confirms our picture of a marketplace that is complex yet stable — mostly a soft market, but not entirely, with some of our forecasters expecting rates to drop further than predicted last spring (or small increases to be even smaller) while nearly an equal number anticipate slight upward pressure. For property, rates will likely continue drop, though no more or less steeply than before. For casualty lines, we call for a mix of small increases and decreases. Overall, 10 lines are expected to offer price decreases, six to offer increases and seven a range of both. Increases for cyber coverage, still highest among the lines we highlight, are not expected to be quite as jarring. One line, fidelity/crime saw a reversal – instead of small increases, most buyers will enjoy small decreases.

**Market trends**

*Lines facing increases, decreases or a mix*

<table>
<thead>
<tr>
<th>MR Issue</th>
<th>Decreases</th>
<th>Increases</th>
<th>Mix/Flat</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017*</td>
<td>10</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>2016 Spring Update</td>
<td>9</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>2016</td>
<td>10</td>
<td>5</td>
<td>7</td>
</tr>
</tbody>
</table>

*The 2017 figures reflect the addition of international coverage as a separate line.*

Overall, a buyer’s market maintains. The best way to take advantage of the opportunities presented by the marketplace — and to avoid the pockets where otherwise plentiful capacity might be tight — requires a careful look at the nuances for each line of cover and a broad, well-considered strategy.

Our Commercial Lines Insurance Pricing Survey (CLIPS), which compares prices charged on policies underwritten quarter by quarter for over a decade, provides further confirmation of an overall view that is benign. Q2 of this year saw the second quarter in a row that registered a combined result of +0.70%. This slight increase reflects the natural growth of risks to insure as businesses expand, as well as the decline of the overall rate charged to transfer those risks.

**CLIPS Q2 2016**
The outlook

- For 2017, 10 lines are expecting decreases.
  - Property
  - Aviation
  - Directors & officers
  - Energy
  - Fidelity
  - Health care professional
  - International
  - Marine
  - Political risks
  - Terrorism

- Six lines are expecting increases.
  - Auto
  - Cyber
  - Employee benefits
  - Employment practices liability
  - Errors & omissions
  - Trade credit

- The remaining seven lines are predicted to deliver a mix of small increases and decreases.
  - Casualty
  - Workers compensation
  - Construction
  - Environmental
  - Fiduciary
  - Kidnap & ransom
  - Surety

For more insight on how these trends affect your organization's search for growth, contact your local Willis Towers Watson representative.

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**Property**

- **Capacity** — The over-supply of capacity continues to support a buyer’s market. Recent entrants into the marketplace struggle to lure buyers from incumbents, who are fighting hard to maintain existing business.

- **Reinsurance** — Although many on the reinsurance side of the industry have cautioned that the market has found the floor with respect to reductions, others are not convinced. Willis Re confirms that they saw further reductions at recent renewals.

- **Loss experience** — Global catastrophe losses were $27 billion in the first half of 2016 versus $37 billion for the entire 2015 year, which translates into a claim increase of 46%. If this pace continues through the end of 2016, some insurers will be posting negative combined loss ratios at the end of the year.

<table>
<thead>
<tr>
<th>Year</th>
<th>Overall insured property losses (10-year avg. = 62)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>45.0</td>
</tr>
<tr>
<td>2014</td>
<td>36.0</td>
</tr>
<tr>
<td>2015</td>
<td>37.0</td>
</tr>
<tr>
<td>2016 (6 months)</td>
<td>27.0</td>
</tr>
</tbody>
</table>

(Sources: Munich Re, Swiss Re, Insurance Information Institute — in $billions)

- **Profitability** — In 2016, profitability continues to erode for insurers. Fitch’s latest report (8/26/16) states that aggregate GAAP operating earnings for 44 (re)insurers decreased by 10.8% for the first half of 2016. Lloyd’s saw deterioration in first half results driven mostly by cat losses, which increased Lloyd’s loss ratio from 87.4% to 90.9%. At the same time, the combined loss ratio for Bermuda insurers increased by nearly 5%, from 89.9% to 94.8%. What is alarming is that these results occurred without any exceptionally large cat events. One large cat event would likely drive combined loss ratios over 100%.

- **Alternative market capital** — The influx of alternative capital continues to pressure the reinsurance market, and use of this capacity continues to increase every year. To a limited extent, alternative market capital is being used for primary coverage in the large account space, and now we are seeing evidence of it in middle market space and in parametric trigger products.

<table>
<thead>
<tr>
<th>Year</th>
<th>Use of alternative capital in reinsurance market</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>8.4%</td>
</tr>
<tr>
<td>2013</td>
<td>10.2%</td>
</tr>
<tr>
<td>2014</td>
<td>11.5%</td>
</tr>
<tr>
<td>2015</td>
<td>15%</td>
</tr>
</tbody>
</table>

(Sources: A.M. Best, ISO, Insurance Information Institute)

- **Exceptions** — As we have reported, habitational risk remains challenging because insurers struggle to turn an underwriting profit. Given the current emphasis on pure underwriting results, insurers can ill afford to make bold moves in an area that consistently produces undesirable results.

**Price predictions**

<table>
<thead>
<tr>
<th>Type</th>
<th>Price prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-cat</td>
<td>-7.5% to -10%</td>
</tr>
<tr>
<td>Cat*</td>
<td>-10% to -12.5%</td>
</tr>
</tbody>
</table>

*In the first half of 2016, 78% of accounts saw a rate decrease and 43% were in the range of -5% to -15%.
Casualty — primary & excess

- **Casualty continues to be a buyer’s market for most companies and most industries.** In general, rates have been flat with some single-percentage increases or decreases, although auto rates have consistently seen increases in the 3% to 7% range.

- Throughout 2016 we have seen notable exceptions to these soft market conditions in New York City construction, energy and trucking risks. We expect this to continue in 2017.

- The re-underwriting of casualty risks by two major casualty insurers this year has resulted in losses of business — 20% for one of the insurers. However, ample casualty capacity has absorbed this business without significant disruption to buyers. It is noteworthy that the moved business has been absorbed by several insurers; no one insurer has won the lion’s share, a sign, we believe, of the general health of the U.S. casualty market.

- The personnel movements reported in the spring have led to the emergence of new and re-tooled casualty capacity that is likely to ensure favorable market conditions for most clients for the foreseeable future.

- Umbrella and excess liability remains the softest of the casualty lines, with rate decreases of 5% to 10% for most industries. However, clients with large vehicle fleets (i.e., 500+) and low umbrella attachment points, continue to face higher auto attachments (e.g., $5 million) and have experienced single-digit rate increases on their umbrella programs.

- Competition continues to be fiercest in the first excess position (i.e., attachments above the lead umbrella) leading many insureds to consider shorter lead umbrellas in order to access the competitive first excess market quicker in their excess towers.

- For trucking risks the excess auto buffer layers (i.e., attachments excess of $1 million to $5 million and limits of $5 million to $15 million) continue to be challenging, with rates increasing by double digits and capacity scarce. The facultative reinsurance market for auto buffer risks has generally fallen in line with the direct buffer market, so using facultative reinsurance to avoid rate increases is less effective.

- The London market (i.e., Lloyd’s) continues to aggressively compete for lead umbrella and excess liability layers that have been dominated by U.S. markets for years.

- Product recall insurance capacity continues to grow both in London and in the domestic U.S. market. There have been notable underwriting personnel moves as talent is in short supply and high demand. Pricing is beginning to soften as a result of the increased capacity.

### Price prediction

<table>
<thead>
<tr>
<th>Primary Casualty</th>
<th>Flat to -5% for most risks. +5% to +10% increases for risks with loss activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Umbrella &amp; Excess</td>
<td>Flat to -10% for most risks, +10%+ for truckers and NYC construction</td>
</tr>
</tbody>
</table>

**The one thing**

We continue to recommend that all clients with loss activity (e.g., insureds with loss ratios of 60+) consider alternative primary casualty insurers given the re-underwriting that will continue for the next one or two quarters.

**Contact**

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Workers compensation

In late April, the Florida Supreme Court ruled in the Castellanos vs. Next Door Company, et al, No. SC13-2082, matter that the attorney fee schedule for workers compensation that was passed in 2009 is unconstitutional. The fee schedule functioned as a cap on attorneys’ costs. **As a result of the ruling, workers compensation loss costs are expected to rise.** NCCI has requested a nearly 20% rate increase for the state of Florida.

**Overall, combined ratios for workers compensation carriers continue to improve, which should sustain favorable conditions for most clients,** although certain states (e.g., Florida, New York and Massachusetts) pose challenges to those with large payrolls.

The opt-out movement (i.e., alternatives to workers compensation akin to the non-subscription option that has long existed in Texas) was dealt a serious blow by the Oklahoma Supreme Court. The Court found Oklahoma’s recently enacted option to be unconstitutional. It is noteworthy that the Court ruled only on the viability of the specific law that was subject to the litigation. The Court did not opine on the viability of alternatives to workers compensation generally. While the Oklahoma decision was a serious setback for opt-out proponents, the continued success of the Texas non-subscription option will likely keep interest alive for future legislation in other states.

**Price predictions**

-2.5% to +2.5%; +15% in Florida.

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Auto liability

- In the first half of 2016, we saw auto rates rise on average 4%, but the upper range of increases was much higher for those with large fleets and poor loss experience.
- Many insurers cite deteriorating loss ratios due to increased frequency and severity, so we expect rate increases for auto to continue into 2017.
- Risks that can demonstrate robust driver safety programs, use of telematics and other loss control techniques are faring much better with insurers.
- Umbrella underwriters continue to look for increasing attachment points (i.e., $5 million and higher) on risks with large fleets. The facultative reinsurance market should be considered as a possible alternative for buffer layer risks, but we have found that rates in the reinsurance markets are converging with those in the insurance market.
- As we said above in our casualty section, the first excess positions in most umbrella programs is where competition remains fierce. For risks with larger auto fleets, a shorter lead umbrella (e.g., $5 million to $10 million) can facilitate quicker access to competitive excess players.
- Self-driving vehicles keep getting closer to our streets and highways. The industry is watching these developments closely. The impact on insurance is expected to be significant over time, but it is too early to discern what that impact will be.

Price predictions

+3% to +10%

The one thing

We continue to recommend that clients with large auto fleets consider alternative insurers as well as restructuring their programs with higher primaries and deductibles, facultative reinsurance, and shorter lead umbrellas.

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International casualty

- **Competition in the market remains strong, with single-digit reductions for the commercial client segment and larger decreases available for growing global clients with favorable loss experience and an aggressive marketing effort.**
- Middle-market clients should consider a stand-alone foreign program to protect their foreign travelers and assets. Policies are inexpensive and generally are available on a guaranteed cost basis.
- Underwriters at both international casualty and property insurers continue to manage their administrative costs and initiate conversations with an eye on rate and fair allocations. Therefore, planning and allowing time for competition are essential to achieving best results.
- **There is plenty of capacity and we have seen many new entrants into the international arena.**
- Insurers continue using technology and account relationships to differentiate themselves in the marketplace. In addition to savings and coverage, service quality — accuracy, timeliness and process — is a major focus for most global clients.
- Many top-tier international insurers own their network of offices worldwide or use long-standing partners, which tends to allow for more underwriting flexibility and better service. In addition, they have developed advanced client portal systems that help clients and their brokers monitor their international policy administration and issuance, payment and claim history.
- Some insurers have developed a travel app to provide insured travelers with assistance.
- A tight partnership of broker, client and insurer is essential to achieve optimal results.
- Most insurers are increasing sub-limits and offering additional product enhancements to attract and retain clients. Common options include:
  - Sub-limited crisis response
  - Accidental death and dismemberment
  - Business travel accident
  - Kidnap and ransom
  - Care, custody and control
  - Pure financial loss
  - Extended products
  - Terrorism
  - Data privacy
- Insurers are focusing on more clearly defining what “good local standard” means in their locally issued policies. These trends will continue into 2017.
- Foreign governments from the U.K. to China are increasing local tariffs and insurance premium taxes (IPT). They are auditing clients for IPT payments, often going back years. The most active have been Canada, Germany, Belgium and Italy. The recent Brexit vote will likely lead eventually to changes related to structuring freedom of services policies.
- **For Defense Base Act exposure, coverage is available through several key markets.** Insureds should focus on loss control and claim management to avoid premium increases over time.

<table>
<thead>
<tr>
<th>Price predictions</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>International casualty</td>
<td>Flat to -10%</td>
</tr>
<tr>
<td>Defense Base Act coverage</td>
<td>Flat to -5%</td>
</tr>
</tbody>
</table>

The one thing
Most companies with international operations continue to be concerned with compliance and are considering additional underlying policies or higher limits on a country-by-country basis.
Employee benefits

- The health care benefits market is in a state of uncertainty. The Department of Justice has publicly opposed the two mega mergers of Anthem/Cigna and Aetna/Humana and filed lawsuits to block both acquisitions. The insurers have indicated they plan to fight the lawsuits.

- While the excise tax (Cadillac tax) on health plans has been deferred until 2020, there is still significant employer focus on implementing measures to reduce cost trend and the underlying base cost by improving health, delivering better care and implementing high-value solutions.

- The viability of the public exchanges has come into question. Many state-based co-ops have gone out of business, and two major health insurers (Aetna and United) have announced plans to reduce the number of states in which they participate in the public exchanges, citing significant financial losses.

- While public exchanges continue to encounter difficulties, we have seen an increase in adoption of private exchanges as employers modernize their benefit programs to address the varied needs of a multi-generational workforce. Employers find that if they provide employees the opportunity to shop in a marketplace that spells out actual cost, ensures meaningful choice and provides an appropriate level of guidance, the exchange model can deliver employee satisfaction and lower costs.

- Employers are redesigning or expanding the range of supplemental and voluntary benefits they offer, reflecting changing employee needs and the rapid generational workforce shift. The voluntary benefits in greatest demand include identity theft insurance, critical illness benefits and pet insurance.

- Long-term disability rates continue to harden due to prolonged low interest rates, a backlog in social security submissions and a decline in social security approvals. Meanwhile, life insurance continues to be very competitive and rate guarantees are increasing in length.

- In a recent Willis Towers Watson survey, 88% of employers identified managing pharmacy spend and high-cost specialty drugs as their top priority over the next three years. In addition, employers are increasingly adopting telemedicine services and participating in value-based contracting and reimbursement arrangements offered by health plans.

- The trend toward high-deductible health plans with tax-advantaged savings accounts continues, with more employers moving to full replacement. Employers are also moving to benefit designs that incent employee participation in health-related activities.

- Redesign and expansion of paid parental leave benefits are increasing along with support programs for parents, such as adoption assistance and back-up child care benefits.

- As paid sick leave legislation continues to spread across states and municipalities, employers are quickly moving to redesign company sick time policies to ensure compliance and consistency.

- Mobile apps and tools are now being used to manage retirement savings across multiple generations.

- In dental and vision benefits we are seeing increased cost sharing and a movement to voluntary contributions. Claim pricing trends for these coverages remain low, and administrative costs are on the rise as a result of the cost-sharing strategies.

### Price predictions

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-Insured</td>
<td>+4.5% to +5.5%</td>
</tr>
<tr>
<td>Fully Insured</td>
<td>+7.2% to +8.2%</td>
</tr>
</tbody>
</table>

**The one thing**

Meeting the varied needs of a diverse, multi-generational workforce is a major reason employers should consider modernizing their benefits — in addition to controlling costs.

**Contact**

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Cyber risk

The one thing
In approaching the markets, be prepared to discuss your organization’s incident response, disaster recovery and business continuity plans as well as what types of employee training you provide.

- Total annual cyber premiums have reached $2.5 billion and some industry observers expect premiums to reach $20 billion by 2020. A recent industry report shows a U.S. marketplace with $1 billion of cyber premiums written, but this is limited to filed stand-alone products.
- Cyber renewals continue to see average primary premium increases of 5% – 10%. POS retailers and large health care companies are still seeing increases but nowhere near the level they faced following the Target, Home Depot and Anthem breaches in 2014 and 2015. These increases are being followed in excess layers.
- For clients with strong controls, premium increases can be softened, thanks to increased competition in the marketplace.
- Middle-market clients (annual revenues below $1 billion) are still seeing a very competitive marketplace with aggressive pricing and broad policy language, as many carriers are eager to write these accounts.
- Retailers are seeing carriers heavily scrutinize controls related to the implementation of point-to-point versus end-to-end encryption of credit card transactions. This is having a material impact on the aggressiveness of some markets.
- Carriers are more effectively managing limits, looking to deploy no more than $10 million on a given placement. With proper ventilation some carriers will consider offering additional limits on a case-by-case basis.
- Despite reduction in capacity by some carriers, readily available limits in the marketplace are approximately $350 – $400 million, though we have placed programs for clients with limits of $500 million.
- Insurers are focusing more on key factors that are shown to correlate with cyber intrusions: employee satisfaction, employee training, how sensitive data is handled, holistic security practices for outsourced data infrastructure and internal reporting structure. Overall, underwriters want to understand the culture of the organization and how data privacy protection is embraced across operational functions.
- Carriers are more willing to accept manuscripted applications and conference calls in lieu of standard applications. This has helped buyers gather competitive quotes and manage increased demand for information in their submissions.
- With the increased reliance on cloud-based networks, cyber exposure is expanding in the utility, manufacturing and managed care industries. This has led more carriers to address the bodily injury and property damage gaps in coverage.

Price predictions

| Renewals (non-POS retail; non-large health care) | Flat to +10% |
| Renewals for POS retailers & large health care | +15% to +20% for non-material loss history |
| First-time buyers | Competitive market conditions depending on industry and size of company |

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Directors & officers (D&O)

- **No sign of capacity diminishing materially** — A robust market continues, with no sign that competition or capacity will diminish. Nevertheless, carrier feedback reflects greater scrutiny on profitability.

- **Opportunities continue!** D&O markets continue to roll out coverage enhancements. Buyers are obtaining unprecedented value in the trade-off between terms and price.

- **Rate** — Rate increases are rare, unless adverse risk profile developments push markets to focus on financial health, liquidity and claim activity in the underwriting process.
  - **Public companies:** For companies with favorable risk profiles, we still see slight decreases or flat renewals for primaries, depending on starting points. Rates for excess, particularly higher excess, often hit minimums. While those minimums occasionally slip, capacity can fall off quickly when rates get too low.
  - **PNP:** Relatively flat pricing continues for private companies and nonprofits without significant changes in exposure.
  - **Financial institutions:** Rates continue to be competitive due to abundant capacity. Decreases persist on both a primary and excess basis. We are seeing some resistance to mid-excess layer pricing as carriers seek to move down into higher premium layers or up into high excess attachment points.
  - **Excess Side-A:** Carriers universally have a healthy appetite for Side-A. A super competitive market is pushing pricing floors downward.

- **Securities class actions** — These are back with a vengeance. The Securities Class Action Clearinghouse reports 175 filings just through September 28. This could be a record year.

- **Rising state court claims** — Section 11 claims being brought in state court will continue since the plaintiffs’ bar loves the friendly forum. These claims will cost more to litigate and to settle.

- **Individual accountability** — The Yates memo has had a real impact on loss costs as executives and employees now demand their own lawyers much earlier.

- **Cyber/technology** — Cyber remains a top — maybe the top — boardroom concern.

- **M&A** — M&A activity continues to yield D&O claims. The good news for buyers is that frequency is down due to heightened scrutiny of non-monetary settlements. However, plaintiffs’ firms are working to find ways around Delaware. Worse yet, it is now much harder to settle claims.

- **Effective global coverage** — The trend toward purchasing international D&O policies (largely underliers) in conjunction with their U.S. policies continues, and markets are responding with more tools.

**Price predictions**

<table>
<thead>
<tr>
<th>Category</th>
<th>Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>-7.5% to Flat</td>
</tr>
<tr>
<td>Public company – Primary</td>
<td>-5% to Flat</td>
</tr>
<tr>
<td>Public company – Excess</td>
<td>-5% to -15% (includes Side-A, capped at minimums)</td>
</tr>
<tr>
<td>Private companies</td>
<td>-5% to +5%</td>
</tr>
<tr>
<td>Nonprofit entities</td>
<td>Flat to +10%</td>
</tr>
<tr>
<td>Financial institutions</td>
<td>Flat to -5% (Excess -7% to -10%)</td>
</tr>
</tbody>
</table>
Employment practices liability

- Rates have been mostly stable since Q1, with average primary rates of 5%, unless loss experience, mergers and acquisitions, or changes in exposure dictate a greater increase. California’s increased rates, for example, continue to fluctuate between 5% and 15%, based on the heightened legal requirements in that state.

- As predicted, 2016 has proven thus far to be the Year of Pay Equity:
  - Additional states have joined New York and California in enacting or updating pay equity laws to include anti-retaliation provisions and additional remedies to aggrieved parties. In July, Massachusetts became the first state to require employers to first make a salary offer to an applicant, rather than asking the applicant about his/her desired or current salary — a bold, first-of-its kind move. Other states are expected to follow.
  - In June 2016, several companies signed the Equal Pay Pledge, a White House initiative that includes a commitment by participating companies to conduct annual pay equity analysis and make salary adjustments where necessary to ensure equal pay. This initiative, along with the recent state laws, is expected to reduce the number of claims involving allegations of pay disparity on the basis of race, gender and ethnicity.

- Joint employer liability remains a significant area of concern for companies, particularly those in the franchise, hospitality and staffing industries. Companies are advised to carefully review any contracts pertaining to contingent workforce arrangements to ensure that any indemnification agreements and/or obligations are appropriately aligned with their coverage.

- In May, the Department of Labor delivered on its promise to raise the annual salary threshold for overtime or minimum wage exemption under the Fair Labor Standards Act (FLSA). The new salary threshold for exempt employees is $47,476 (more than double the previous $23,660). Employees formerly considered exempt and earning less than $47,476 may automatically be considered non-exempt after December 1, 2016.

- Companies must remain vigilant about pay practices and classification issues. There has been a heightened interest in wage and hour insurance as a result of these developments. Fortunately, markets’ appetites have increased to meet the demand:
  - Flexibility in retention levels and markets’ willingness to offer blended wage and hour/EPL policies have led more companies to purchase or obtain quotes for wage and hour products.
  - Markets in Bermuda, London and the U.S. now offer defense and indemnity coverage.

- Recent court decisions have placed a spotlight on enforceability of class action waivers in FLSA cases. Employers should proceed with caution and engage counsel when drafting these provisions.

- The EPL market remains competitive, with capacity of over $800 million in the U.S., Bermuda and Europe combined.

### Price predictions

<table>
<thead>
<tr>
<th>Category</th>
<th>Rate Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>Flat to +3%; California: +5% to +15%</td>
</tr>
<tr>
<td>Large global companies</td>
<td>Flat to +3% (primary); -5% to flat (excess)</td>
</tr>
<tr>
<td>Mid to large domestic firms</td>
<td>Flat to +3% (primary); -5% to flat (excess)</td>
</tr>
<tr>
<td>Private and nonprofit entities</td>
<td>Flat to +10%</td>
</tr>
<tr>
<td>Smaller employers (&lt; 200 employees)</td>
<td>+5% to +15%</td>
</tr>
</tbody>
</table>

The one thing

In addition to preparing for claims alleging pay discrimination, buyers should conduct wage and hour audits to ensure compliance with new FLSA amendments.

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Professional liability (E&O)

- New and traditional carriers are seeking to expand market share in the professional liability space. The resulting competition has moderated the pricing increases we continue to see and broadened policy language.
- The marketplace continues to contemplate the effect of large data/privacy losses in the retail sector as well as the effect of other large technology losses. This has yet to impact E&O programs and, in fact, some carriers are getting more aggressive on combined cyber/E&O programs.
- Professional services definitions remain heavily scrutinized due in part to the influx of new hires in the underwriting world, as the newcomers do not understand the services as well as their more experienced predecessors.
- Large technology companies with new media and service offerings can expect to see increases due to expanding global privacy laws. However, the middle-market tech E&O space is very competitive in coverage and pricing.
- Technology service providers are routinely being asked by their clients and prospective clients to provide evidence of insurance coverage — and they are looking for higher limits.
- More clients are seeking to expand coverage to include REITs and joint ventures where majority ownership or majority voting rights are not with the named insured.
- Excess markets have seen more competition due to increased capacity, and rates remain flat, with savings sometimes available.
- Wording enhancements are still available. Companies with no losses and manuscript wording can expect to have their coverage improved.
- Retentions are being reviewed on a case-by-case basis, driven by the overall size of an organization and the professional services being provided.
- Authorized global E&O limits are approximately $750 – $850 million. Typical insureds should be able to buy from $500 to $600 million.

Price predictions

<table>
<thead>
<tr>
<th>Good loss experience</th>
<th>Flat to +5%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor loss experience or difficult industry sectors</td>
<td>+15% to +20%</td>
</tr>
</tbody>
</table>

The one thing

Be prepared to discuss your company’s approach to vendor contracts and service agreements, particularly how you limit your liability and what dispute resolution and elevation processes are in place.

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Impersonation fraud (social engineering) — The impersonation of an employee, client or vendor with instructions to transfer funds remains a leading cause of loss to commercial entities, including financial institutions, second only to employee theft. While many underwriters have seen some drop in the number of social engineering claims, attempted fraud remains common and many still fall prey to it. However, as clients further implement authentication measures to detect and prevent these scams, we expect the frequency of loss will continue to decline.

Technology-related fraud — This continues to be a major concern, particularly for financial institutions. Firms remain proactive in training employees in the detection and prevention of spear-phishing attacks and in detecting malware in their computer systems. However, they also recognize that even the most robust precautions cannot guarantee a computer breach will not occur. To this end we are constantly testing the adequacy of coverage afforded under the computer systems’ insuring agreements of crime and financial institution bonds, and we are challenging the market to close gaps in coverage. Markets continue to respond cautiously to these challenges.

Fidelity market loss results — Taken as a whole, the fidelity market remains profitable. However, the 2015 Surety & Fidelity Association Survey of loss results reflected the fact that several of the lead markets for Fortune 500 commercial accounts and financial institutions did not fare as well. While we did not see an increase in pricing, several of these carriers became less aggressive in pricing renewals and in new business opportunities.

Breadth of coverage — Despite the poor results from several of the leading fidelity markets, we have seen little effort to increase deductibles or reduce the breadth of coverage afforded under new or existing policies. We do not expect the breadth of coverage to decline in the next year, and we remain guardedly optimistic that the market will continue to make strides in improving technology-related coverages.

Market capacity and pricing — The number of mainstream fidelity markets has never been higher and, after a year spent clearing regulatory hurdles, new entrants have expanded the number of viable fidelity markets available to buyers. While many underwriters continue to bemoan the low premium rates, particularly those with marginal results, the availability of markets writing fidelity makes it difficult for carriers to drive rate upwards. We expect rate to remain flat to -5% through the 2017 calendar year, a shift from the modest increases we were predicting in the spring.

Price predictions
Flat to -5%

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Fiduciary

- Remarkably, fiduciary liability capacity remains stable notwithstanding loss cost escalation.
- Primary fiduciary placements in all industry sectors should continue to see stable pricing through the balance of 2016 into early 2017, if not beyond.
- Exposure trends continue to put pressure on fiduciary profitability — particularly for primary coverage. For now, that pressure has not translated into pressure on pricing or terms. Markets continue to look to fiduciary as well-priced, desirable business.
- Fee cases continue to push settlement limits. Asset managers may experience heightened underwriting scrutiny if they offer their proprietary investment vehicles as plan offerings.
- On the issue of settlor liability coverage, the majority of carriers now offer language explicitly acknowledging the coverage.

Price predictions

<table>
<thead>
<tr>
<th>Category</th>
<th>Price Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>-5% to +5%</td>
</tr>
<tr>
<td>Companies with large concentrations of their stock in benefit plans</td>
<td>-3% to +7%</td>
</tr>
<tr>
<td>Companies without/limited company stock in their plans</td>
<td>-3% to -10% (on excess layers)</td>
</tr>
<tr>
<td>ESOP-owned firms</td>
<td>+5% to +10%</td>
</tr>
<tr>
<td>Private and nonprofit entities</td>
<td>-3% to +5%</td>
</tr>
</tbody>
</table>

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The one thing
Expect sharper focus on fiduciaries as a result of broader fiduciary regulation and heightened enforcement.
Health care professional liability

The one thing
With new market entrants eager to write HPL, companies should explore all options: domestic — including new entrants and traditional physician carriers — Bermuda and London.

- HPL continues to be a very competitive line and marketplace entrants in 2016 have furthered the trend. Traditional physician insurers have also greatly expanded their facility underwriting capabilities in recent years and have been gaining market share, especially for excess liability coverage. The competition has helped keep pricing low for health care industry buyers.

- We expect the health care professional liability (HPL) market to remain soft into 2017, with flat-to-low double-digit decreases at typical renewals depending on loss experience, exposures and territory.

- Many buyers may need to adjust terms and conditions to address evolving risks, such as batch claims, cyber/network privacy risk, regulatory risk and pay-for-performance reimbursement and executive risks.

- More carriers are willing to write integrated programs with excess coverage layered over some of these types of evolving risks as well as auto, general liability, crime/fiduciary coverages. Many hospital excess carriers are offering multi-year programs.

- Beyond hospitals, the competition for physicians/groups has helped lower premiums as well for miscellaneous facilities. Long-term care facilities are generally seeing lower premiums, but a few carriers are shying away from that segment.

- Loss frequency remains low and, while severity is increasing, it is actuarially predictable and thus has yet to materially impact overall underwriting results. The number of large verdicts, however, should continue to be watched, as it is one of the industry’s few negative factors. Carriers are concerned about the cyber/network privacy risk bleeding into the health care professional liability. Carriers are seeking to limit losses by exclusions and other coverage limitations.

- Another continuing source of downward pressure on rates is a steady decline in demand, due to consolidation in the health care industry and the increased use of captives and risk retention groups (RRGs) in recent years.

- A few states have overturned tort reform laws in recent years but we do not see a trend. Several states with caps on non-economic damages are contemplating indexing these caps on some basis yet to be determined.

- Regulatory risk coverage is available and, while the retentions are significant and the pricing can be high, some buyers are purchasing these policies to address a meaningful risk in the era of reform.

- Due to the long tail of HPL, however, health care reform has not yet affected claims. Yet the Affordable Care Act (ACA) will shape malpractice risk and underwriter response as many health care organizations manage ACA implementation, shift to value-based reimbursement and clinically integrate their organizations.

Price predictions
Flat to low double-digit decreases depending on experience and territory

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Aerospace

- While we are seeing increased carrier scrutiny with more selective and disciplined approaches to underwriting, aerospace insurance buyers are still benefitting from an oversupply of capacity in both the domestic and overseas markets. Given the broader spread of premium among insurers, maintaining market share is important and new business is being aggressively priced.

- **Airlines** — The first half of 2016 saw a continuation of the rate and premium reductions available during the final quarter of 2015 although they were not quite as steep. Capacity remains plentiful for all classifications of airlines, with slightly more available capacity for narrow body aircraft operators, who enjoyed slightly larger decreases. Despite several significant claims around the world, the overall loss totals remain below the five-year average. We expect further rate reductions as we head into the busy fourth quarter, though probably not at the level seen at the end of 2015.

- **Products manufacturers/service providers** — This segment has seen an overall average reduction of just over 6%, led by more significant reductions for fuel providers (around 15%). Realignment and program structure changes for some major OEM programs continue to slightly skew the figures as less flight-critical, component product manufacturers remain particularly attractive to insurers and can attract more meaningful reductions in premium.

- **Airports and municipalities** — Pricing remains relatively flat with occasional reductions to retain business or gain market share. Retentions continue to hover at all-time lows. Current conditions are not likely to change in the near future due to both capacity and attractive multiyear contracts.

- **General aviation** — The industrial aid subsector is still experiencing pricing reductions, though less than in prior years due to already depressed rates. The aircraft charter market has seen less flexibility in pricing due to insurers' loss experience and severely depressed rates over the past few years. The commercial rotor-wing subsector is still experiencing reductions on profitable accounts while increases are being sought on accounts with losses. New business is still being sought aggressively as underwriters try to make up for depressed rates on their renewal books. One of the most talked about emerging risks in the industry remains the advent of drones, or unmanned aerial vehicles, into the public airspace. Many underwriters have developed specific policy forms to cover such risks and the market is extremely aggressive.

- **Financial institution/lessors** — Aircraft leasing industry consolidation continues at an active pace, with profitability for underwriters still making this class an attractive segment of the aviation market. Rates remain very competitive and market appetite is very high.

- **Space** — The satellite insurance market (for launch and in-orbit risks) has seen more than a decade of positive results, which keeps attracting significant market capacity and driving down premium rates. There is, however, substantial differentiation between launch risks, with the best-performing launch vehicles attracting rates that are roughly a third of those applied to launch vehicles with recent performance issues. For in-orbit risks, one-year policies are at historic lows, with standard GEO satellites now attracting premium rates in the region of 0.5% or less.

**Price predictions**

<table>
<thead>
<tr>
<th>Category</th>
<th>Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airlines</td>
<td>-10% to flat</td>
</tr>
<tr>
<td>Products manufacturers/service providers</td>
<td>-10% to flat</td>
</tr>
<tr>
<td>Airports and municipalities</td>
<td>-5% to flat</td>
</tr>
<tr>
<td>General aviation</td>
<td>-15% to flat</td>
</tr>
<tr>
<td>Financial institutions/lessors</td>
<td>-20% to flat</td>
</tr>
</tbody>
</table>

**The one thing**

The market is teetering at the edge of rock bottom and the Q4 airline renewals will influence the cycle as we enter 2017.

**Contact**

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Construction

Construction remains stable and growing in North America, but we are seeing a slowing of project financing as we head toward 2017. While projects are not getting cancelled, start date delays are increasing.

Construction firms are being challenged by technology innovations and shortages of skilled tradespeople.

**General liability** — Pricing remains flat or down for risks with little or no loss activity; an exception being New York State (due to jurisdictional issues). Because of a growing emphasis on data and analytics, securing quotes is taking more time.

**Workers’ compensation** — The marketplace is competitive, subject to state-by-state rate and benefit rules. A number of indicators — aging population, increased medical-only costs, removal of caps on legal fees — point to a market that should be hardening. However, that has not happened through Q3 2016.

**Automobile liability** — Distracted driving is pumping up loss experience and rates. Since this is a catastrophic exposure, insurers struggle to capture loss dollars in their renewal pricing. We have seen 2%–5% average rate increases with some facing spikes up to 25%.

**Excess/umbrella liability** — Significant capacity remains but we are seeing pricing and program structure challenges in the lead $25 million position, especially for risks with worrisome profiles. The marketplace is very challenging for anything residential and for large fleet programs.

**Property (builders risk and contractors block)** — Barring any significant natural or man-made catastrophes, terms and conditions are expected to remain competitive into 2017. Domestic carriers continue to increase their net and treaty capacities as new, formidable players enter the space. In an effort to remain competitive, many carriers are continuing to refine and revamp their master builders risk and project builders risk forms.

**Professional liability** — The PL marketplace continues to be very competitive, with a growing carrier presence and the largest U.S. capacity to date. For-sale residential continues to be the most challenging class for professional liability carriers.

**Controlled insurance programs** — CIPs are still popular for both general contractors and owners with cap spend budgets. While two-line CIPs continue to be placed, particularly on larger, complex projects, the GL-only CIPs grow in popularity, driven by the lower deductibles (hence no collateral) and the completed operations coverage of 10 years or through statute of repose, whichever is less.

**Price predictions**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General liability</strong></td>
<td>Generally flat</td>
</tr>
<tr>
<td><strong>Workers’ compensation</strong></td>
<td>Flat</td>
</tr>
<tr>
<td><strong>Automobile liability</strong></td>
<td>+5% to +20%</td>
</tr>
<tr>
<td><strong>Excess liability</strong></td>
<td>Flat to 5%</td>
</tr>
<tr>
<td><strong>Builders risk</strong></td>
<td>-10% to flat</td>
</tr>
<tr>
<td><strong>Professional liability</strong></td>
<td>Flat</td>
</tr>
<tr>
<td><strong>Controlled insurance program (CIP)</strong></td>
<td>Flat (-5% to -7% for GL only, non-condo risk)</td>
</tr>
</tbody>
</table>

The one thing Although it has not happened yet, an uptick in construction workers’ compensation rates is probably imminent and buyers should be ready.

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Energy

Downstream

- **The softening in the downstream market continues.** In 2016, with the loss record remaining relatively benign, rating reductions have continued, but less steeply than we have seen in the last two years.

- **The lower oil price has meant higher business interruption values at a time when premium income streams have been on the decline.** These higher values have been maintained as the oil price has steadied at around $45 – $48 (as of this writing).

- **As 2016 is likely to yield overall underwriting profits for this class, competition for premium income and market share should continue into 2017.** However, some insurers are beginning to scale back their involvement in some of the less attractive parts of the portfolio.

- With the continuing profitability of this sector, no market has withdrawn. However, the dwindling premium income pool may eventually leave some insurers unable to afford as much reinsurance protection as they have sought in the recent past.

- **Downstream insurers continue to compete on price and price alone,** with little movement on breadth of coverage. We see no sign of any movement in retention levels or policy wordings.

- **Regional insurers continue to expand into the global arena.** The London market in particular is coming under sustained pressure to maintain its current portfolio in the face of competitive pressures from regional markets.

Price predictions

Continued but decelerated softening

Upstream

- **Capacity remains plentiful,** with theoretical levels topping $7 billion in 2016. We see no signs as yet of any withdrawals as we look ahead to 2017.

- **This continues to fuel the softening process,** but at a time of lower premium income and increased losses, particularly from back years, as long-standing claim issues are now beginning to be resolved and paid by the market.

- **Business interruption values remain depressed** following the oil price collapse, while pressure to cut costs keeps buyers focused on price reduction rather than coverage enhancement.

- Some insurers, particularly in Lloyds, are now scaling back their involvement in this class as they seek to survive the current market environment.

- **The market softening will continue until at least the middle of 2017.** However, the rate of softening has decelerated for most programs as the realistic capacity put out by the market shows signs of decreasing. Some insurers are now actively pulling back from offering their maximum participation on a regular basis.

- **Cyber continues to be a headache for this market.** Despite the introduction of new offshore cyber policy forms during 2016, the market appetite for this cover remains muted.

- **Market apprehension has increased.** The deterioration of some recent back-year results has demonstrated that the sector cannot remain profitable if the current softening continues for much longer.

Price predictions

Continued softening, but on a decelerating basis as more insurers retrench from the less attractive parts of the portfolio

Contact

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Environmental

Price predictions

- The environmental insurance market continues to be shaped by AIG’s 2016 decision to exit the site pollution market. As we enter the second year of AIG non-renewals, insurers are competing for this displaced business on pricing and on their creative solutions to the limited availability of engineering data.

- Approximately 40 AIG underwriters have moved to other carriers looking to expand operations across North America. They are aggressively competing for AIG’s non-renewing site pollution and related contractors pollution business.

- Carrier consolidation has slowed, but two new carrier entries are looking to write on a primary basis. Carriers approaching five years of successful marketing experience are expanding capacity, lines of coverage, underwriting staff and geographic reach.

- Changes in underwriting appetites and capacity limitations may necessitate the involvement of multiple carriers to create program continuity and satisfy contract requirements. The limitation of underwriting authority in the field has required significant involvement of senior carrier leadership in obtaining underwriting approval.

- The market continues to experience a hardening in the environmental plus casualty/professional coverage lines. As expected, the monoline site pollution market has experienced increased competition (especially for displaced AIG PLL business) and a continued soft market for all but the most difficult site pollution placements.

- Sustained construction activity and soft market conditions have fueled demand for contractors pollution liability products and their combination with builders risk coverages, especially in conjunction with wrap-up products.

Claim update

- Highly publicized catastrophic claims have increased regulatory scrutiny on transportation/railroad, mining, energy and pipeline exposures, resulting in the reevaluation of these sectors by underwriters and inspiring a new push to shift liability to users of the facilities.

- Additionally, high-profile claims associated with water quality issues in the higher education, public housing and water treatment sectors have increased the scrutiny of coverages for products liability, sewer backup and lead.

- Carrier attempts to broaden coverages for standard P&C lines (general liability, builders risk, property, auto) have increased the potential for overlapping coverage with environmental policies, although the severity and complex nature of environmental claims necessitates a close look at potential gaps in the coverage provided by property and casualty policies.

Price predictions

<table>
<thead>
<tr>
<th>Coverage</th>
<th>Price Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractors pollution liability</td>
<td>-10% to flat</td>
</tr>
<tr>
<td>Site pollution liability (PLL/EIL)</td>
<td>-10% to flat</td>
</tr>
<tr>
<td>Combined environmental + casualty/professional</td>
<td>+10% to +25%</td>
</tr>
</tbody>
</table>
Kidnap & ransom SCR

- Buyers with exposures in the U.S. and low-risk overseas locations can expect flat renewals or low, single-digit decreases; while companies with exposures in South America, Africa and the Middle East can expect higher costs.
- Insurers continue to expand their assault/workplace violence coverage offerings as policy extensions to address the threat of active shooters and other violence in the workplace. Business interruption and crisis management support tend to be the drivers behind the buyer’s decision to purchase cover.
- Kidnap for ransom remains a risk to both local and foreign nationals in numerous parts of the world. The risk is greatest in countries suffering from internal conflict, weak rule of law and economic instability.
- In Latin America, Colombia’s peace deal with the guerrilla group FARC has led to a decline in politically motivated kidnappings. The removal of FARC from Colombia’s criminal underworld, however, is leaving a power vacuum which will likely be filled by the country’s second largest guerrilla organization, the National Liberation Army (ELN) as well as paramilitary successor groups known as BACRIM. The ELN has refused to formally renounce kidnaps and BACRIM use kidnap for ransom as a means of generating funds. Economic collapse in Venezuela continues to drive ever-increasing rates of kidnap of both local nationals and foreigners throughout the country. Meanwhile, in Mexico an uptick in violence throughout 2016 has accompanied high rates of kidnap, especially express kidnap.
- The fragmentation and conflict which currently define the Middle East and much of North Africa will continue to be the main drivers of kidnap for ransom. Terrorist groups such as the Islamic State, while much diminished, will continue to carry out kidnappings for political, ideological and financial reasons. The sheer numbers of armed actors in the region ensure that the kidnap threat remains broad and varied, with, for example, Shia militias in southern Iraq increasingly taking part in kidnap for financial motives.
- Piracy with the intent to kidnap rather than steal product materials has been the dominant threat in West Africa throughout 2016. Pirates and kidnap gangs based in and around the Niger Delta have been terrorizing the waters of the Gulf of Guinea, turning it into one of the most dangerous areas off the coast of Africa. Unrest in the Niger Delta will continue to fuel these kidnappings. Al-Qaeda in the Islamic Maghreb (AQIM) remains the principal threat throughout the West African mainland and the Sahel, and the kidnap threat to both local nationals and foreigners remains high, especially in Mali and Burkina Faso.
- In South Asia, Pakistan, Afghanistan and India remain the highest risk locations. The ongoing Taliban insurgency is increasing kidnap risk in Afghanistan. Professional kidnap gangs tend to alternate between operating independently and selling their victims to the Taliban and other insurgent groups. In Southeast Asia, the highest risk areas are in the southern Philippines and eastern Malaysia. Islamist terrorist groups, such as the Abu Sayyaf Group (ASG), employ piracy to conduct kidnaps, despite counter-insurgency operations conducted by the Philippine military.
- In Russia and Eurasia, most kidnappers tend to target local nationals and kidnaps are usually financially motivated. There has been a recent increase in the number of kidnappings in Ukraine, particularly in the conflict-ridden eastern part of the country. This is likely to continue as the conflict slowly freezes into a stalemate.

Price predictions
-5% to +5%

The one thing
In the event of a threat or incident, either domestic or international, buyers need to be prepared to manage the interests of internal and external stakeholders.

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Marine

**Hull & machinery**
- The continued surplus of underwriting capital is maintaining downward pressure on rates.
- Additional capacity, expected to enter the H&M market through 2017, will maintain this cycle.
- This trend is being furthered by a depressed shipping market (in the majority of sectors).

**Marine liabilities**
- Over-capacity and the subsequent softening of the market continue in this sector.
- There is no sign of any letup in the fierce competition for attractive business.
- Premium reductions are still common on most types of business with pricing levels only maintained on market capacity risks and specialist coverages or niche products.

**Cargo**
- Continued insurer competitiveness is demonstrated through rising limits, falling deductibles and broader coverage — including profit commissions — without increases in pricing.
- The accumulative impact of several major losses to the cargo market is anticipated to have a slowing effect on the current downward cycle.
- While isolated instances of insurers taking firmer stances have been seen, competition remains fierce for new business and significant premium reductions can be obtained when risks are remarkeighted.

**Key highlights**
- Insurers are willing to provide extended cover and increased limits in order to retain clients.
- While the downward cycle continues, specific industries have been affected by major losses within their sectors. For example, the losses at Tianjin have affected pricing, coverage and the availability of capacity for the automotive sector.
- Insurers are looking for increases or flat renewals for cat-exposed accounts.
- Deductibles remain generally stable.
- Continued global political unrest exposes potential gaps in cover for insurrection, terrorism and political violence.

**Price predictions**

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<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>Cargo</strong></td>
<td>-5% to -10%</td>
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<tr>
<td><strong>Hull</strong></td>
<td>-5% to -10%</td>
</tr>
<tr>
<td><strong>Marine Liability</strong></td>
<td>Flat to -10%</td>
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**Contact**

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Political risk

Since last spring, we have witnessed a failed military coup in Turkey, expulsion and expropriation of more firms in Venezuela, England voting to exit the European Union, continued political and economic crises in Brazil, and disturbing nuclear tests by North Korea. Many of these events came as a surprise, even to well-informed analysts. Political risk is rising around the globe. The risk, however, is often underestimated by multinational companies. Many clients report that they may analyze local political risk when entering a new country, but very few have a continuous process for updating that analysis. Despite the rising exposure, the political risk insurance market remains benign, due to a continued influx of capital. Rates have not generally increased (except selectively in the riskiest locales) and small decreases are often obtainable. Specific locales to note:

- **Turkey** — A failed coup is the latest event in Turkey’s already uncertain political climate. Embattled by an overflow of refugees from Syria, Kurdish separatism and the growing threat of ISIS, Turkey faces several other serious challenges.

- **Venezuela** — President Maduro has created headlines by expelling and expropriating multinational companies operating in the country. In the midst of widespread public protest against the dire economic conditions, the president has resorted to familiar populist measures.

- **Brazil** — Dilma Rousseff’s impeachment has not solved the political problems in Brazil. Now President Michel Temer could face renewed street protests against corruption. Implementing promised economic reforms will not be easy. Some markets are beginning to approach their aggregates on their Brazilian capacity, especially regarding currency nonpayment and inconvertibility.

- **Middle East** — The Middle East remains in a volatile period of potentially fundamental transition. Clearly this creates a ripe environment for political violence, regime change and sovereign nonpayment.

- **Russia** — Russia’s actions in Syria have continued to generate debate about President Putin’s intentions on the international stage. Meanwhile, the economy struggles, tensions with the U.S. mount and some fear that Russian retaliation against sanctions could produce a cat event in the PRI market.

- **Former Soviet States** — While low oil prices imperil economies, the demise of President Karimov in Uzbekistan has created a political vacuum in the heart of Central Asia. Leadership crises in these countries are imminent as many of the leaders who have held power since the demise of the Soviet Union are aging.

- **Ukraine** — Violence persists, as does political instability, rendering reform nearly impossible. Some markets will not write any new Ukraine risk.

- **Argentina** — President Mauricio Macri’s first few months in office have brought a welcome change but his path ahead is uncertain. Political risk underwriters appear to look positively at this new administration but several are waiting for a credit rating upgrade before changing their position.

- **China** — Several factors could create political unrest, from the volatile housing and equity markets to ethnic and socio-economic struggle. Tensions in the South China Sea may escalate following an international court ruling against Chinese claims.

- **Pakistan** — Prime Minister Nawaz Sharif faces a possible corruption scandal after the revelation of offshore accounts held by family members. The economy is still ailing as the government struggles with a power crisis in the country. Terrorism risk has increased.

- **South Korea** — Nuclear tests in North Korea and especially loud saber rattling have heightened security concerns.

**Price predictions**

Flat to -2%
Surety

While significant capacity remains available for contract and commercial surety, we expect the downward pressure on rates to ease somewhat, driven by modest topline premium growth for the industry and a moderate uptick in claim activity. We predict minimal decreases for commercial surety and flat to nominal increases on the contract side.

Overall, the surety industry continues to enjoy strong profits and we see the trend continuing. For the 2015 calendar year, the Surety & Fidelity Association of America (SFAA) reported a direct loss ratio of 18.1%, making 2015 the ninth consecutive year of profitability. In 2015 direct written premium grew by 2.75% and the direct loss ratio increased by 17.5%. However, through Q1 of 2016 the industry reported direct loss ratio of 16.9% with direct written premium increasing by 6.4% versus Q1 of 2015 — an increase of 27% versus Q1 2015 reported loss ratio.

Surety market options have been reduced by ACE’s acquisition of Chubb, but we expect to see one or more new carriers enter the surety marketplace during 2016 and 2017.

While we do not expect additional market disruptions, it cannot be ruled out given the increase in loss activity during 2015 and 2016.

International surety is growing. Reverse-flow business in the U.S. is rising due to acquisition activity and more P3 opportunities. Leading U.S. sureties are now global, with significant premiums outside U.S., which improves premium growth and profits. We are also seeing a growing use of surety in place of bank guarantees as well as pay-on-demand facilities for international work (in Australia, Europe, South Africa, Brazil, Peru, Colombia, Venezuela, etc.).

Sureties are aggressively pursuing new business as the construction economy continues to recover. The competitive environment is keeping sureties focused on middle-market contractors and commercial surety.

With increased pressure on financial institutions (Federal Reserve’s stress tests, Basel II & III in Europe, etc.), we have seen commercial surety play a key role in facilitating complicated transactions and capital allocation strategies. Since surety remains the most cost-effective form of capital, many companies are maximizing their surety capacity to replace ILOCs and release restricted capital at preferred terms.

As with previous economic cycles, the current increase in construction activity will put pressure on contractors’ working capital, which will trickle down to subcontractors. The potential for more subcontractor defaults underscores the need for general contractors to emphasize subcontractor prequalification and to consider requiring surety bonds from subcontractors or using a subcontractor default insurance product.

We continue to see alternative procurement methods such as P3 becoming more prevalent, with more than 30 states having some form of P3 legislation. While conventional surety bonds continue to support billions of dollars in P3 projects, lenders remain focused on having more liquid security than traditional surety bonds typically offer. Several sureties continue to work towards addressing this demand for liquidity with the rating agencies and lenders.

Price predictions

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<tbody>
<tr>
<td>Contract</td>
<td>Flat to +2.5%</td>
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<tr>
<td>Commercial</td>
<td>-2.5% to flat</td>
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</table>

The one thing
Contractors should establish a standby or backup surety relationship. Commercial surety buyers should explore a shared surety approach to maximize capacity.

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Terrorism

- Unfortunately, 2016 has seen a marked increase in successful, ISIS-inspired, lone-wolf terrorism and active shooter attacks in the West. Deploying relatively unsophisticated modes of attack with the objective of causing mass casualties and inciting panic, these incidents represent a broadening spectrum of potential risk exposures.

- In response, markets have introduced a new suite of hybrid products to address the changing profile of terrorism and active shooter events. Many of these programs incorporate supplemental pre- and post-event consultancy services in addition to conventional risk transfer.

- New programs address:
  - Loss triggered by the threat of an attack, mitigating the financial impact of a threat that triggers an evacuation
  - Property and casualty losses which result from acts of domestic and global political violence, including strikes, riots, civil commotion, sabotage, civil and cross-border war
  - Nuclear, biological, chemical and radiological terrorism
  - First-party cyber physical damage and business interruption coverage addressing the consequences of a malicious attack on electronic control systems, regardless of the perpetrator, that results in property damage, damage to digital assets and business income losses
  - Active shooter programs providing extensive coverage for property damage, time element and extra expenses to recover from an incident, potentially extending to cover ensuing liabilities, public relations costs, counseling costs, job retraining and loss of attraction
  - New parametric trigger products focus on the post-event impact to revenue streams as a result of loss of attraction.
  - Enhanced terrorism risk analytics provide enhanced accuracy in deterministic modeling of property and casualty losses as a consequence of a wider range of attack modes.
  - The stand-alone terrorism market continues to evolve, with expanded product scope and new capacity. Major metropolitan areas (Tier One) continue to present challenges.

### Terrorism capacity

- **Property Terrorism**
- **PV**
- **Liability Terrorism**
- **NCBR**

### Price predictions

<table>
<thead>
<tr>
<th>Tier</th>
<th>Prediction</th>
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<tbody>
<tr>
<td>Non-Tier 1</td>
<td>-5% to -10%</td>
</tr>
<tr>
<td>Tier 1</td>
<td>-5% to flat</td>
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The recent entrance of many new (and credible) insurers into the U.S. trade credit marketplace is forcing established insurers to stay aggressive to achieve revenue goals, despite the increase in claim ratios being reported in 2016. That said, most buyers can expect low single-digit increases, with higher increases for those with exposures in South America or Eastern Europe.

- Carriers are prepared to aggressively pursue new business in industries that have not traditionally purchased the coverage, whereas they may struggle to provide capacity for industries (such as retail) that commonly purchase it.

- Past due notifications have increased since the spring, resulting in increased claims in both number and size. Carriers are beginning to brace for a somewhat difficult year.

- Prospective insureds that meet basic risk appetite and underwriting targets should receive multiple proposals with very feasible pricing, while prospects in challenged industry sectors or high-risk countries will likely receive reduced (or possibly no) choices.

- Credit insurance support for debtor risks in the oil and gas industry will continue to be a struggle for the foreseeable future, although in exceptional cases coverage may still be available.

- Market capacity is beginning to tighten in the commodities sector. With rising claims, we expect a hardening of the market, though we have only seen small corrections to date.

- Asset-based lending, receivables purchase programs and securitization wraps continue to trend higher as companies monetize their receivables and bolster balance sheets.

- Capacity for Latin America continues to be a challenge, given the economic uncertainty in the region. Capacity for Brazilian risk in particular continues to shrink.

**Price predictions**

<table>
<thead>
<tr>
<th>Region</th>
<th>Prediction</th>
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<tbody>
<tr>
<td>North America</td>
<td>Flat to +5%</td>
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<tr>
<td></td>
<td>+5% to +10% with South American/Eastern European risk</td>
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Willis Towers Watson

Willis Towers Watson (NASDAQ: WLTW) is a leading global advisory, broking and solutions company that helps clients around the world turn risk into a path for growth. With roots dating to 1828, Willis Towers Watson has 39,000 employees in more than 120 countries. We design and deliver solutions that manage risk, optimize benefits, cultivate talent, and expand the power of capital to protect and strengthen institutions and individuals. Our unique perspective allows us to see the critical intersections between talent, assets and ideas — the dynamic formula that drives business performance. Together, we unlock potential. Learn more at willistowerswatson.com.