

STATE OF THE INSURANCE MARKET

2018

*(THIS INFORMATION HAS BEEN CONSOLIDATED
FROM VARIOUS INDUSTRY SOURCES)*

ACCEL - December 2017

Presented by:

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Alliant Insurance Services

Alliant

- Highlights
- Property/Casualty Industry Performance
- Impact of Natural Catastrophes
- Cyber Security & Data Breaches
- Emerging Risks: New & Evolving
 - Drones, Self-Driving Cars, Impersonation Fraud, Hate Speech...
- Looking Ahead...

Munich Re estimates insured losses from Hurricane Harvey will be \$30 billion; the Miami Harold estimates insured losses from Irma will be \$17.5 billion to \$27 billion; and AIR Worldwide estimates insured losses from Hurricane Maria will be \$45 billion to \$85 billion. The insured losses from these CAT storms could reach \$150 billion.

Key Industry Metrics

- The P&C Combined Ratio was 99.6% as of 3/31/17.
- Policyholder surplus was \$700.9B as of 3/31/17 -- A record high.
- Net income after taxes dropped to \$7.7 billion in first-quarter 2017 from \$13.4 billion in first-quarter 2016—a 42.2 percent decline.

Weather extremes (Hurricanes Harvey, Irma and Maria, flooding in Florida, Louisiana, Texas and California), catastrophic losses (Northern California fires and earthquakes in Mexico) and investment earnings are areas of concern for carriers.

Property/Casualty Industry Performance

Commercial Insurance Prices in the U.S. Remain Flat During the Second Quarter



Commercial insurance prices were again nearly flat during the second quarter of 2017, according to Willis Towers Watson's most recent Commercial Lines Insurance Pricing Survey (CLIPS) data.

Three lines -- Workers Compensation, Property, Directors & Officers Liability -- indicated modest price **decreases**.

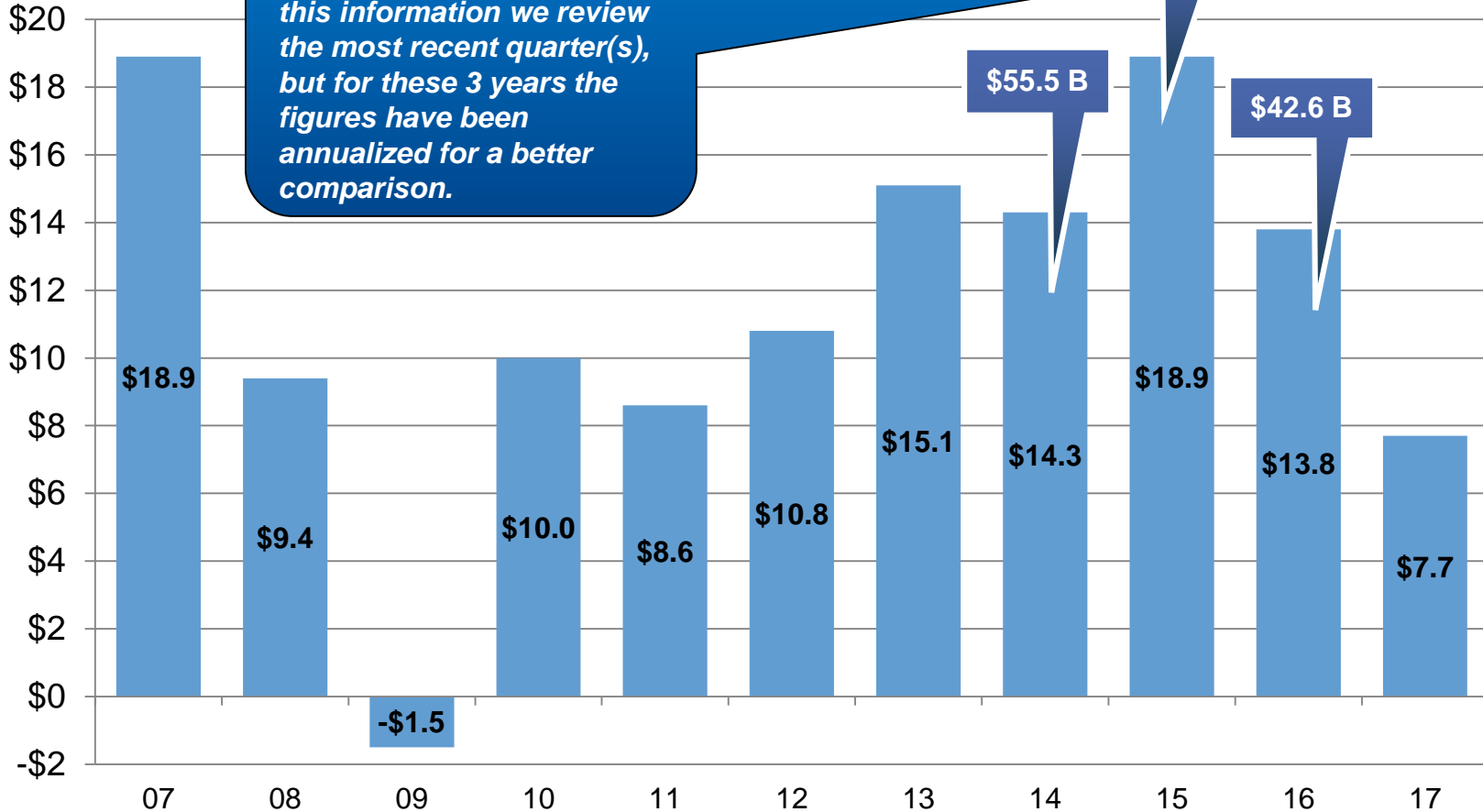
The outlier in this year's results continues to be Commercial Auto Liability, where meaningful price **increases** are again reported and appear to be accelerating somewhat.

Price changes for most other lines fell in the low single digits, but these trends may quickly change for all lines of coverage, especially Property if more large loss events occur before the end of this year.

P/C Industry Net Income After Taxes*, 1st Quarters of Each Year, 2007-2017



\$ Billions,
2017 dollars



Due to the delay in reporting this information we review the most recent quarter(s), but for these 3 years the figures have been annualized for a better comparison.

**In the first quarters of the year, net income varied.
2017 was the second-lowest profit in the last 11 years.**

*adjusted for inflation using the BLS CPI calculator, to 2016 dollars
Sources: A.M. Best; ISO, a Verisk Analytics company; Insurance Information Institute.

Property/Casualty Insurance Industry Investment Income: 2000–2016:Q1



(\$ Billions)



Investment earnings are still below their 2007 'pre-crisis' peak

Due to persistently low interest rates, investment income fell in 2012, 2013 and 2014 but showed a small (1.9%) increase in 2015—another drop in 2016 seems likely

1 Investment gains consist primarily of interest and stock dividends.

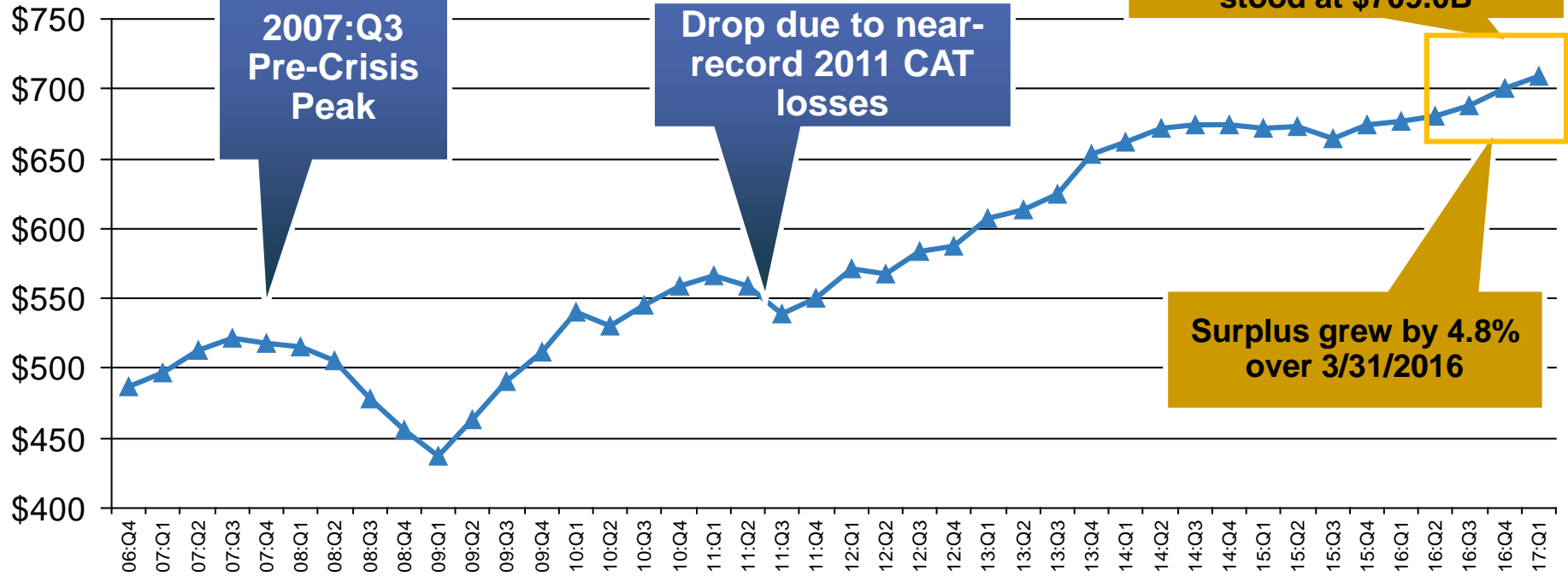
*2014 figure is estimated based on annualized data through Q3.

Sources: ISO; Insurance Information Institute

Policyholder Surplus, Quarterly, 2006:Q4–2017:Q1



(\$ Billions)



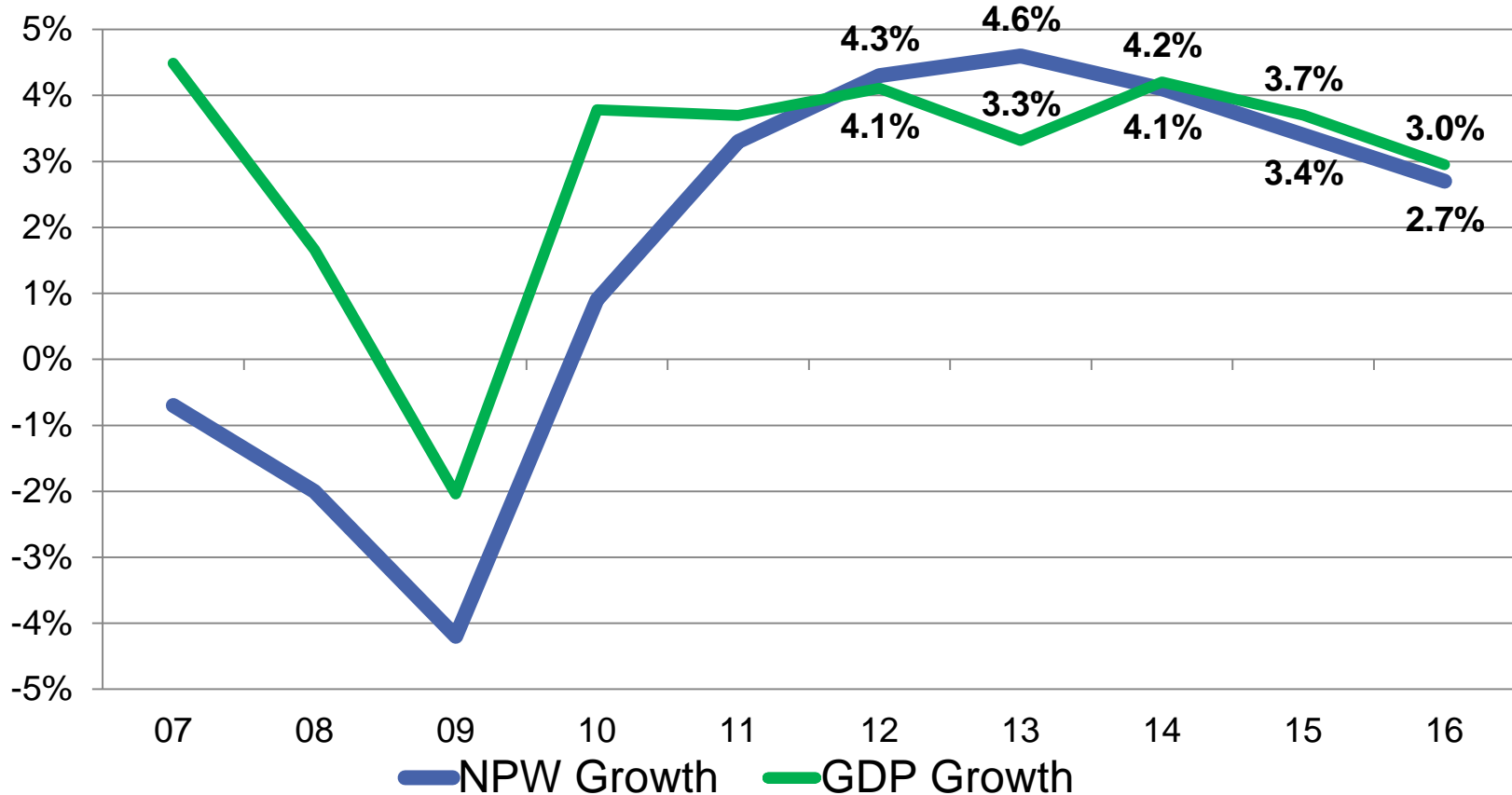
The industry now has \$1 of surplus for every \$0.75 of NPW, the strongest claims-paying status in its history.

2010:Q1 data includes \$22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business.

Sources: ISO, A.M. Best.

The P/C insurance industry is, in 2017, in very strong financial condition.

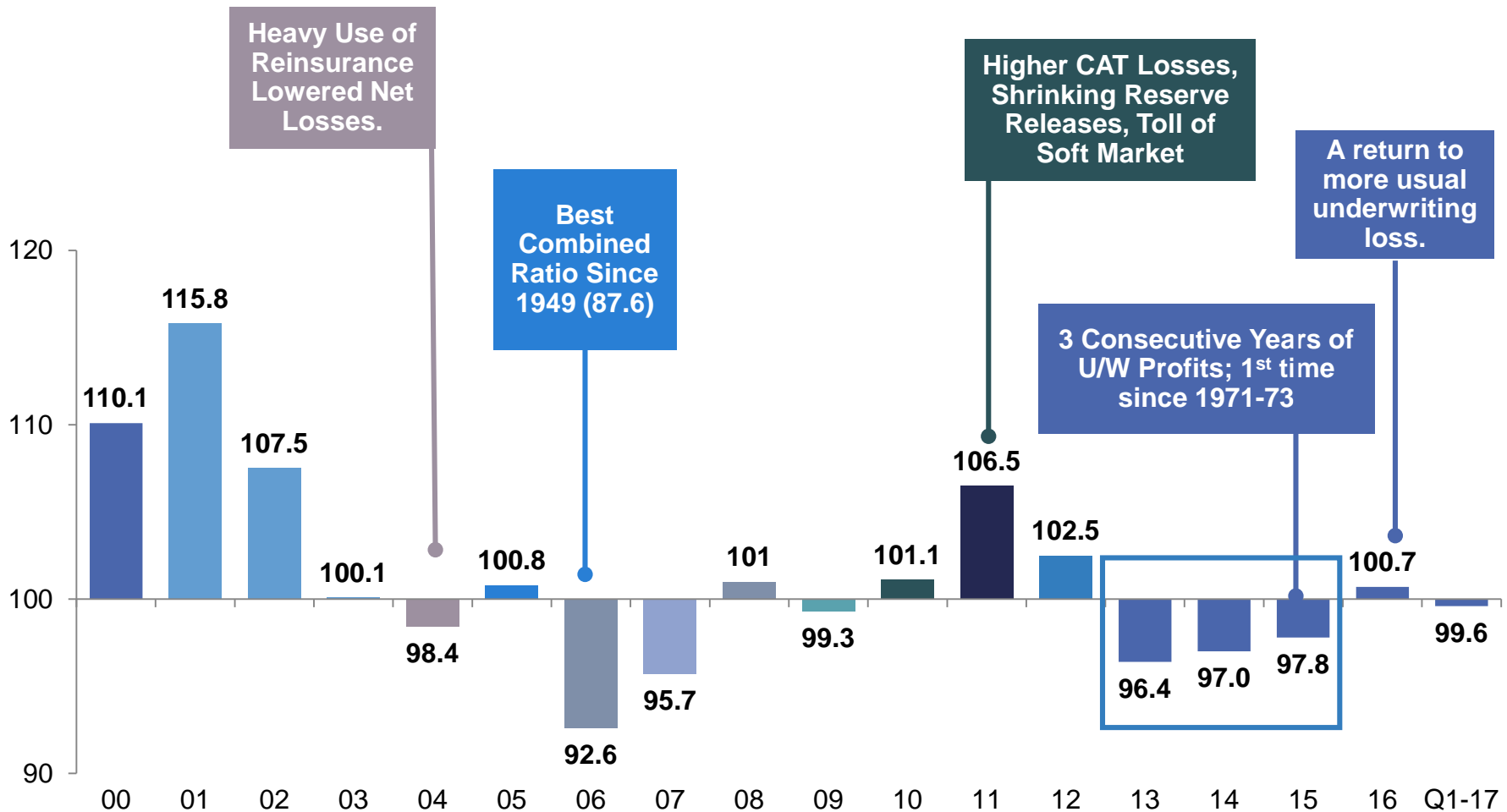
Net Premium Growth (All P/C Lines) - - Annual Change, 2007-2016



Premium Growth Has Followed Economic Growth and Inflation.

SOURCES: A.M. Best (2007-2013), ISO (2014-16), Federal Reserve Bank of St. Louis (FRED), Insurance Information Institute.

P/C Insurance Industry Combined Ratio, 2001-2017*

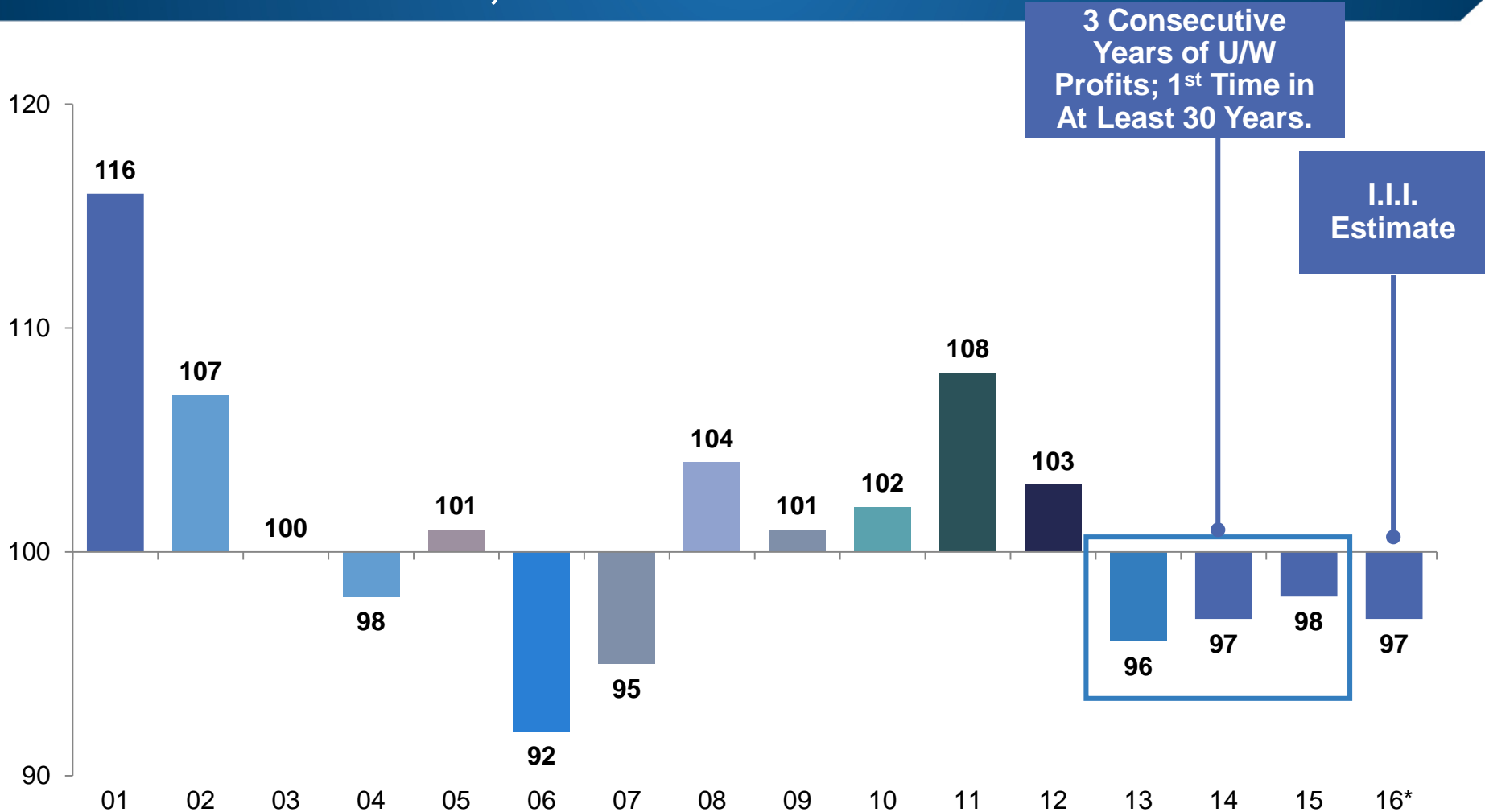


**Excludes Mortgage & Financial Guaranty insurers 2008-2014.

Including M&FG, 2008=105.1, 2009=100.7, 2010=102.4, 2011=108.1; 2012:=103.2; 2013: = 96.1; 2014: = 97.0.

Sources: A.M. Best; ISO, a Verisk Analytics company; I.I.I.

Workers Comp Private Carrier Combined Ratio, 2001-2016*



- *Projected.
- SOURCES: NCCI, Insurance Information Institute (2016 projection).

Cyber Security & Data Breaches

Large Data Breaches in Headlines



2014 / 110 Million / \$236 Million



2007 / 90 Million / \$1.7 Billion



2015 / 80 Million / \$115 Million



Heartland
PAYMENT SYSTEMS™

2015 / 130 Million / \$140 Million



2017 / 143 Million / \$125 Million



2014 / 1.2 Million / \$2 Million



2013 / 3 Billion / \$350 Million



2014 / 56 Million / \$62 Million



2014 / 18 Million / \$1 Billion+

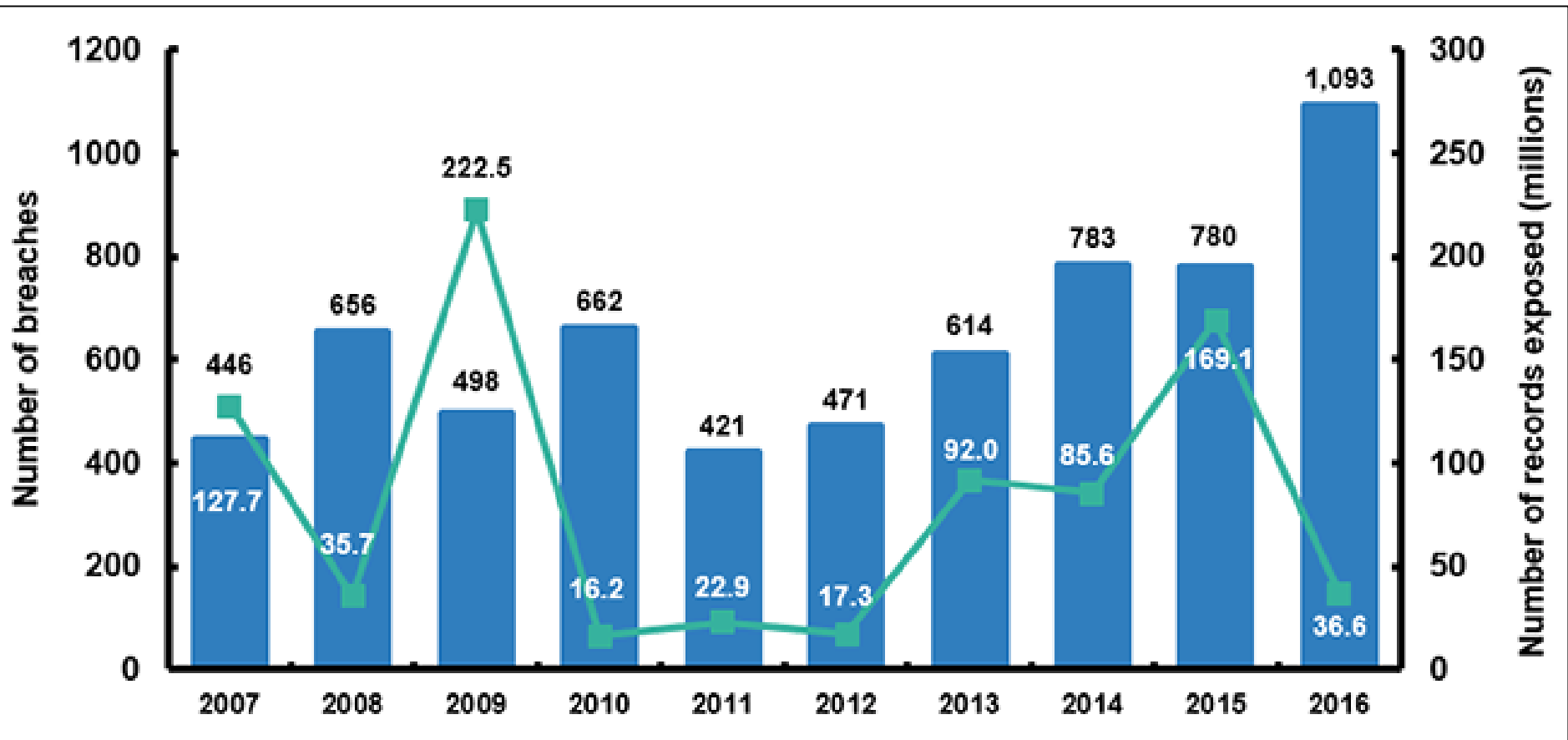
Year / # Record / Estimated Cost

U.S. number of Data Breach *Events* by Industry, 2005-17



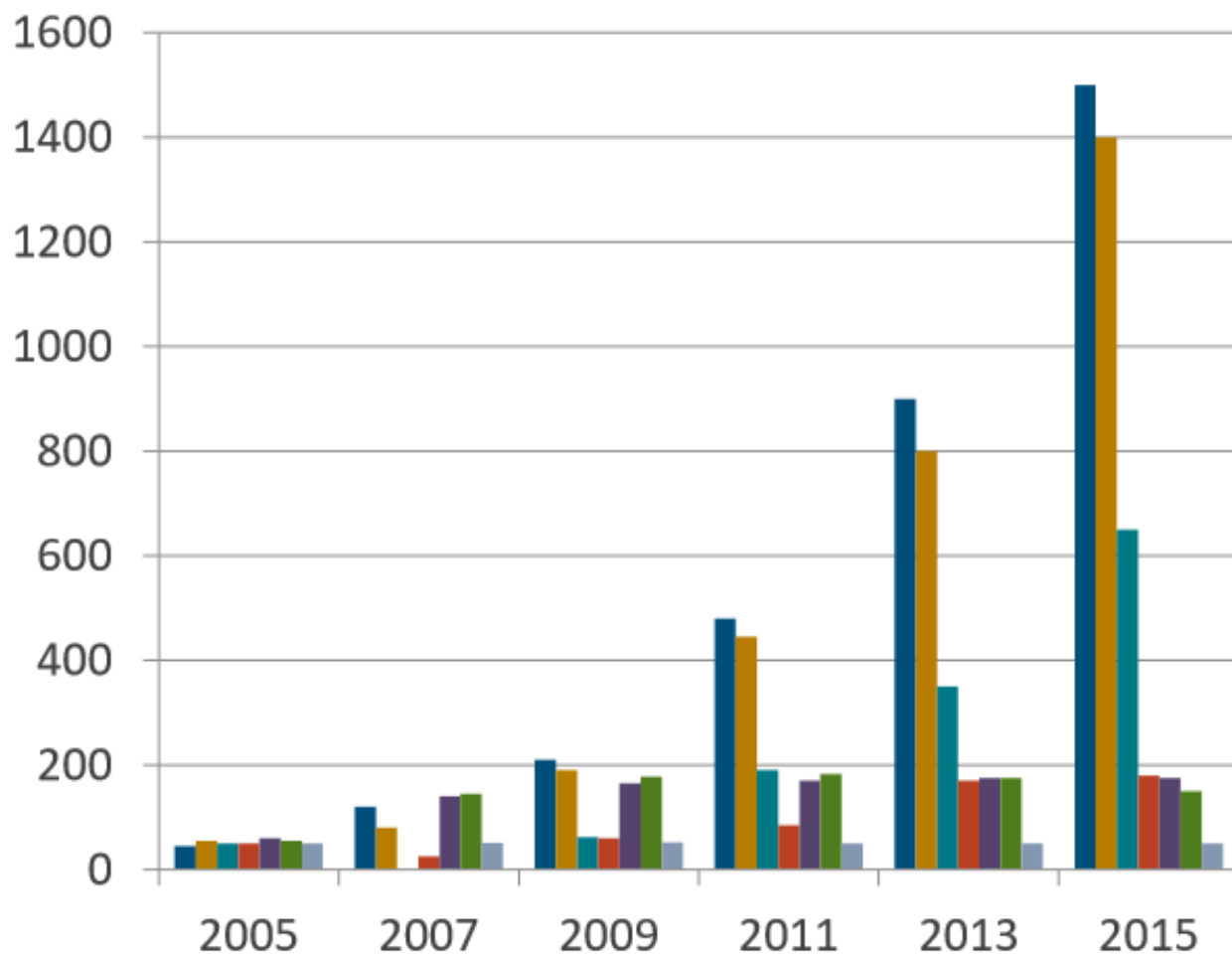
Data Source: Identity Theft Resource Centre

Data Breaches 2007-2016, by Number of Breaches and Records Exposed



The Identity Theft Resource Center says there have been 956 breaches in 2017 so far (as of August 30) with 19.3 million records exposed. The business sector accounted for 57 percent of the 2017 breaches. These figures do not include the many attacks that go **unreported**. In addition, many attacks go **undetected**.

Data Breaches and Cyber Attacks are Increasing in Costs and Frequency



89% of breaches in 2015 had a financial or espionage motive.
 ~ Verizon 2016 Data Breach Report

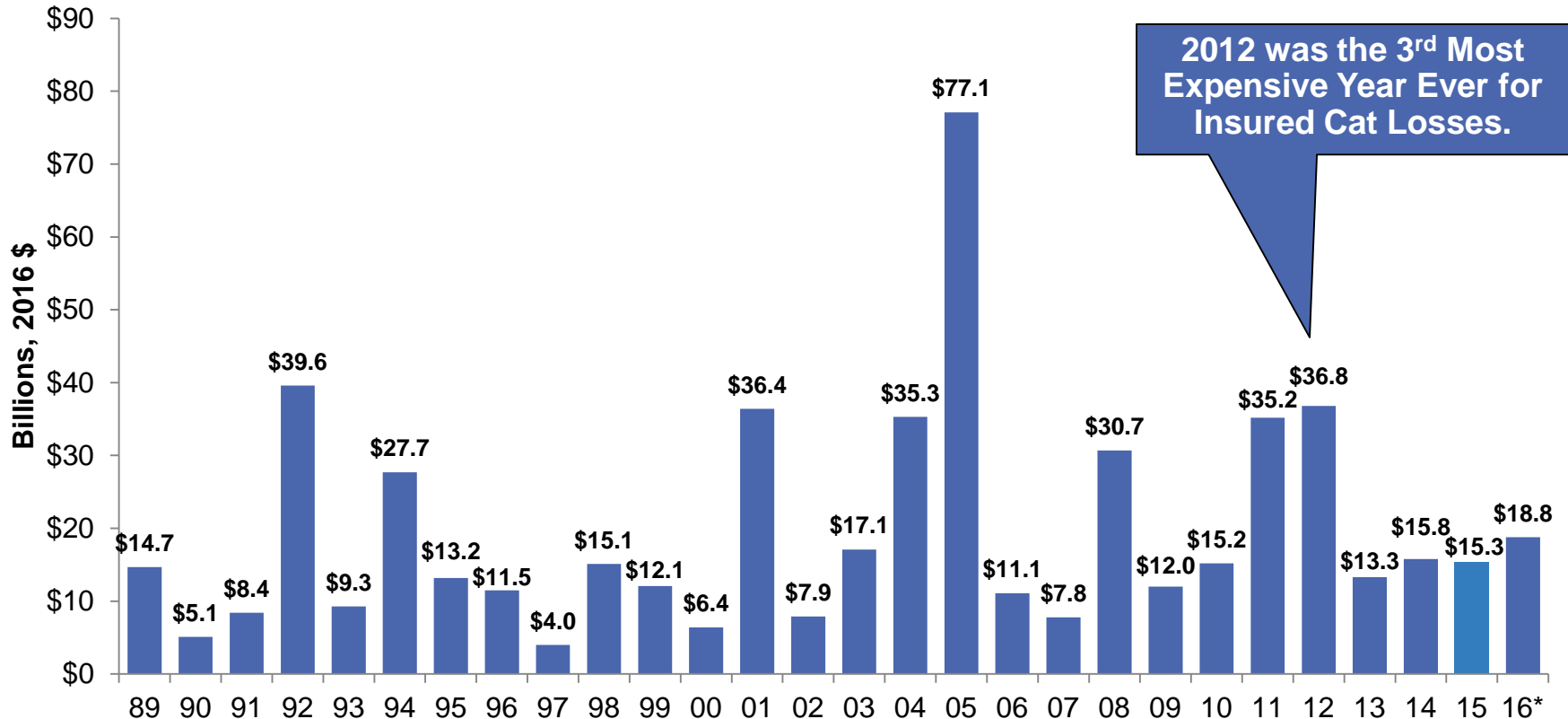
Cybercrime already costs the global economy approximately **\$445 billion** a year.
 ~ McAfee; CSIS (2014)

- Hacking
- Malware
- Social
- Error
- Misuse
- Physical
- Environmental

*Source: Verizon 2016 Data Breach Report

Impact of Natural Catastrophes

U.S. Insured Catastrophe Losses

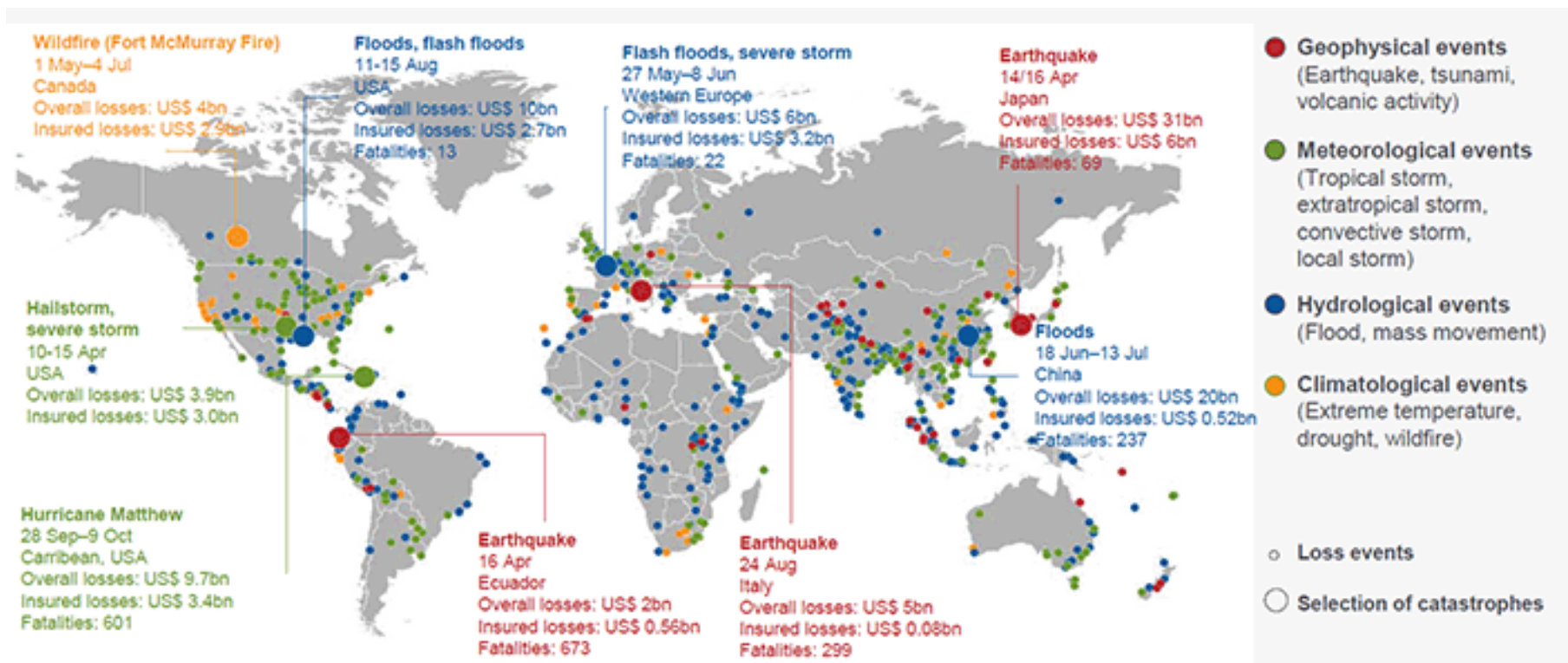


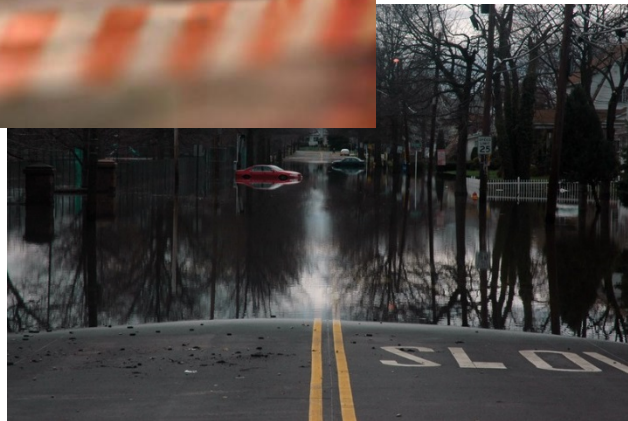
2012 was the 3rd Most Expensive Year Ever for Insured Cat Losses.

2013/14/15 Were Welcome Respite from 2011/12, Which Were Among the Costliest Years for Insured Disaster Losses in U.S. History. Longer-term Trend is for More – Not Fewer – Costly Events.

- *2016 is first nine months
- Note: 2001 figure includes \$20.3B for 9/11 losses reported through 12/31/01 (\$25.9B 2011 dollars). Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = \$12.2B (\$15.6B in 2011 dollars).
- Sources: Property Claims Service, a Verisk Analytics business; Insurance Information Institute.

Overall Losses From Worldwide Natural Catastrophes in 2016 Totaled \$175 Billion, Up From \$103 Billion in 2015





- Hail
- Hurricanes
- Floods



Hurricane Harvey Texas, August 2017

When we hear “Hurricane”, we often think about the cost of losses and how they will impact our insurance premiums. Life for many is disrupted and sometime even lost. The impact on businesses can be devastating. The hurricanes will cost Southwest Airlines \$100M in revenue.

Santa Barbara: Micro Burst

- Sunny Sunday Afternoon
- 30 degree temperature drop
- 80 mph winds
- Debris, injuries, closed businesses



City Takeaway:

- Approx. \$100K of city damage
- Could have been much worse, but storm stuck to coastline area
- Occurred during lower staff levels, focus on off-hour preparedness plans.



Santa Rosa (Wine Country Fires: \$4 TO \$6 Billion

(But it's too early to estimate now).

PG&E power lines have been blamed for the fires. PG&E carries **\$800M** in wild fire liability insurance.

Total damage is expected to be considerably higher than the insurance PG&E carries, as a result, PG&E's stock has taken a nose dive.

Earthquakes



Mexico suffered two deadly earthquakes last month --

An 8.1-magnitude quake on Sept. 7 that killed around 100 people in the southern states of Oaxaca and Chiapas and,

A 7.1-magnitude quake on Sept. 19 that left 369 people dead in Mexico City and central states.

Emergency Readiness



Ready For Anything?

Lately, every day we wake up wondering what's next.

A number of natural catastrophic events have shown that we might not be as prepared for the challenges faced as we might think.

Don't think "*That could never happen to here*", **because it can**. Be sure that your crisis management plans take into account the **truly** unexpected for your area.

The First 72 Hours

- What needs to happen



1. First, contact members of the team that you will need for the situation:
 - Staff & supporting agencies
 - Restoration contractor
 - Broker
 - Adjuster
2. Preserve/protect property from further damage to the extent possible.
3. Protect property & people from potential liability claim situations.
4. Consider obtaining an Emergency Proclamation so you can secure the contracts needed to start repairs quickly.

The First 72 Hours

- What needs to happen (Continued)



5. There are variations between jurisdictions as to what constitutes an emergency. You will need to know your locality's definition to trigger services.
6. On-site meetings with key players.
7. Agree to an action plan.
8. Set up regular meeting schedule; plan for on-site, via conference call or both.
9. No surprises. Adjusters hate surprises.
10. Dealing with mold in the first 72 hours.

The First 72 Hours

- What needs to happen (Continued)



11. Valuable papers-need to stabilize conditions.
12. Insurance adjustment team - who will it be comprised of
 - Adjuster
 - Forensic Accountant
 - Engineers
 - Construction cost estimators
 - Other specialized trades
13. Insured's team
 - Selected restoration contractor/agreed rates
 - Forensic Accountant
 - Construction Cost Estimator, if needed
 - Structural Engineer
 - Industrial Hygienist
14. Temporary housing decisions & approvals

New & Evolving Emerging Risks



We are seeing the development, or possibly a re-awakening, of a movement. And with it, the concepts centered around a new term: *DISRUPTION!*

It's confusing right now, and combines historical terms such as:

- Civil Disturbance
- Civil Unrest
- Social Unrest
- And the evolving concepts of Civil Society

Generally, civil society has been referred to as a political association governing social conflict through the imposition of rules that restrain citizens from harming one another.¹

So How is this an Emerging Risk?



Disruption takes a left turn by uprooting and changing how we think, behave, do business, learn and go about our day-to-day. It's not just Civil Unrest

Think of:

- Charlottesville, Virginia riots
- Fake News
- Russian Facebook Impacts
- UC Berkeley Republican Speakers

All of these impact our public agencies costs, and more importantly have a direct social impact that will forever be altered.

Hate Speech might be evolving as a sub-set of this Emerging Risk!

Definition of Hate Speech

Noun

1. Speech that is intended to offend, insult, intimidate, or threaten an individual or group based on a trait or attribute, such as sexual orientation, religion, color, gender, or disability.



Cagle.com

The United States is one of very few countries that has **Free Speech** rights that are as broad, and that do not limit **Hate Speech** in the same ways as others. This comes from a long history of our Constitution and Supreme Court decisions. In some countries, a victim of **hate speech** may seek redress under civil **law**, criminal **law**, or both.

Although not soon, it is likely we will see legal discussions and possible changes in our laws to better protect us from the many versions of Hate Speech recently re-occurring.



Hate speech are spoken words that are offensive, insulting, and/or threatening to an individual or group based on a particular attribute (*such as race, religion, ethnic origin, sexual orientation, disability, or gender*) of that person or persons being targeted.

Targeted attributes include such traits as ethnic background, sexual orientation, race, or disability, though there are other target attributes.

In the U.S., another term for hate speech is “fighting words,” as such talk is likely to provoke an otherwise reasonable person into acting rashly against speaker doing the provoking.

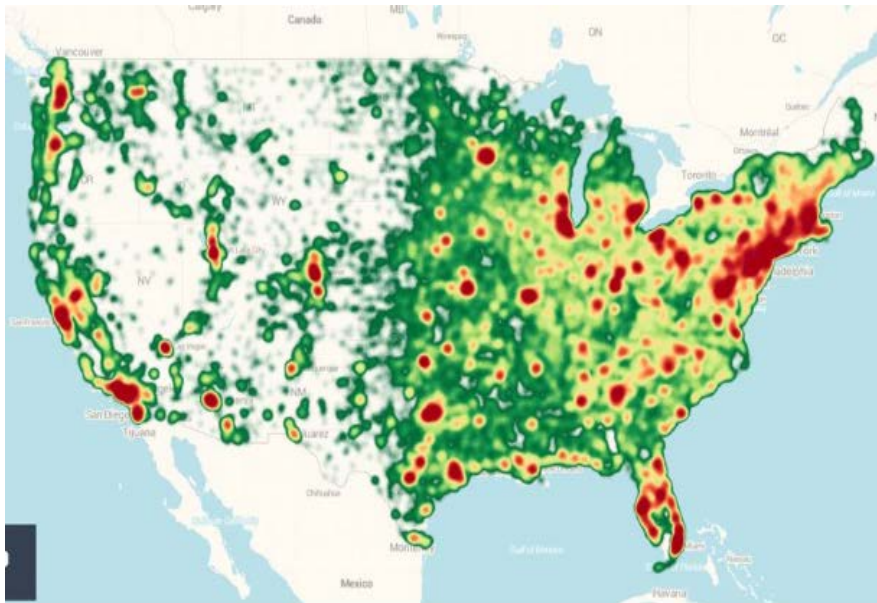




The United States Department of Homeland Security defines the **active shooter** as "an individual actively engaged in killing or attempting to kill people in a confined and populated area; in most cases, **active shooters** use firearms(s) [sic] and there is no pattern or method to their selection of victims."



EVOLVING: It's a Bird, It's a Plane



Drones have overtaken the skies in ways - and volumes - never imagine. There are now over 325,000 registered Drones in the US - - more than the number licensed private aircraft. It's estimated that there are an equal number of unlicensed Drones in the air today.



The FAA receives over 100 reports each month from aircraft that have visual sighting of Drones while flying.



The FAA warns unauthorized drone operators that they may be subject to significant fines if they interfere with emergency response operations.

Flying a drone without authorization in or near the disaster area may violate federal, state, or local laws and ordinances, even if a Temporary Flight Restriction (TFR) is not in place.

Allow first responders to save lives and property without interference.

Risks Related To Public Entity Use Of Drones



Accidents resulting in personal injury or property damage

- Pilot error/Inadequate training
- Drone malfunction/maintenance
- Failure to supervise/protect against dangers
- Workers' compensation

Trespass – either into airspace or onto property itself

Privacy and civil rights violations

Cyber Risks

- Breach of drone technology
- Inadequate maintenance and storage of collected data and information

Regulatory violations





- Establishing a Drone use policy
- Operator(s) experience
- Intended use
- Interaction between operator & observer
- Weather & environmental issues
- Video capabilities
- Ensuring drone airworthiness
- Pre-flight and/or post-flight checks
- Drone maintenance

Government entities or organizations (e.g. law enforcement agencies, public universities, state governments, local municipalities) have 2 options for flying UAS:

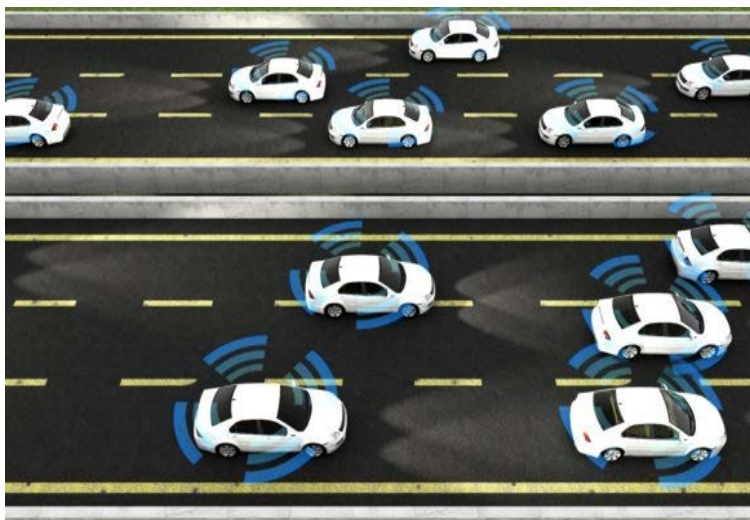
1. Fly under the small UAS rule – follow all rules under 14 CFR part 107, including aircraft and pilot requirements

-OR-

2. Obtain a blanket public Certificate of Waiver or Authorization (COA) – permits nationwide flights in Class G airspace at or below 400 feet, self-certification of the UAS pilot, and the option to obtain emergency COAs (e-COAs) under special circumstances



Looking At The Future



Market expecting massive growth as a result of Autonomous Vehicles (\$81B projected opportunity – between now and 2025).


Long Term Outlook – decline in premium as auto becomes a better risk.

Safer Conditions = reduced accidents

Policy to Support Manufacturers

“Autonomous-vehicle technology will drive a significant shift in risk from human error to malicious third party, software, hardware and infrastructure risk,” said Chen Liu, co-author of the report and a research assistant at Stevens Institute of Technology. “Understanding and proactively responding to this anticipated enterprise transformation is imperative.”

Mitigating Risk

- Shift in liability: Operator  Manufacturer of Self-Driving Technology
- What level of automation was in play during accident?
- Public liability aside:
 - Costly suits (i.e. defense)
 - Reputational damage
- Coverage needed for Emerging Risk
 - Product Liability (Incl. Software/Hardware)
 - Cyber Liability
 - Public Infrastructure



Schools, summer programs, recreation department, friends of the library, exposures involving:

- Supervision of minors
- Hiring practices (background checks)
- Retention of employees with known complications

Leading to:

- Large verdicts: up to \$7,000,000 per claimant
- Flood gates opening on multiple claimants stepping forward:
Single USD: \$175M claim, \$88M claim, \$35M claim
- Restricting Insurance Market

EXPANDING: Employee Theft; Let's Do the Numbers



Entity	Amount	Description
City of Pasadena, CA	\$6 million	Public Works official used false invoices to direct \$6.4M of funds to personal accounts, funds were supposed to be used for placing utilities underground
City of Placentia, CA	\$4.8 million	Finance Analyst with access to wire transfers allegedly transferred money to personal accounts and forged documents to hide transactions
Los Angeles Unified School District	\$9 million	Procurement official conspired with plumbing supplier to divert materials over several years
Association of Bay Area Governments	\$3.9 million	CFO falsified payments to a contractor & diverted them to personal use
City of Bell, CA	\$5.5 million	Seven Bell city officials were convicted on conspiracy, misappropriation of public funds, and falsification of public records that nearly bankrupted the city
City of Dixon, IL	\$54 million	The Comptroller of this small Illinois city was arrested for misappropriating city funds, dating back to 1990, from various bank accounts through a series of wire transfers & checks payable to "Treasurer"

EXPANDING: Impersonation Fraud Coverage

We will also pay for loss of “funds” resulting directly from a “fraudulent instruction” directing a financial institution to transfer, pay or deliver “funds” from your “transfer account”.



Notwithstanding the above requirement that the loss of “funds” results directly from a “fraudulent instruction,” we will also pay for the loss of “funds” resulting from your receipt of a fraudulent phone call or email from a purported vendor, which advises you that the vendor’s bank account information has been changed and you suffer a loss of “funds,” because you issued a payment or payments to this fraudulent bank account, based upon your confirmation controls, you believed the fraudulent instruction to change the vendor’s bank account information to be valid.



Toward the Future



Looking ahead, expectations are that property rates will firm. It's too early to tell how the market will react to the recent natural disasters, but buyers of property insurance should budget conservatively. We could see **rate increases in the 5%-10%** range and bigger increases for insureds with losses.

Some casualty lines of coverage may see modest decreases, while others such as law enforcement liability, commercial automobile liability and employment practices liability (EPL) may see price increases.

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Thank You

*Please contact us if you would like
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Questions?

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