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2018 Insurance Market Outlook: What Can You Expect?

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For many companies, insurance is one of their largest costs. When you add up premiums for Property, General Liability, Auto, Workers' Compensation, Employee Benefits, Life Insurance and other lines of coverage, it can often total five percent of revenues or more. And that is only the direct costs. If you factor in the indirect costs *(shown at right)* this number can more than double!

Due to the magnitude of these costs, it is critical to understand not only how to proactively manage them, but also how to forecast your costs as you look into your next fiscal year.

In the long run, the only way to lower the cost of risk is to lower the frequency and severity of claims that drive the premiums as well as the indirect costs. In the near and intermediate future, however, you will also be affected by the insurance marketplace. The purpose of this article is to give some perspective on where the insurance industry is today and how the industry's current finances and underwriting objectives may affect your business in 2018.

INDIRECT COSTS OF RISK

The indirect costs of risk include but are not limited to:

- **Time spent analyzing risk**
- **Money spent on risk control including salaries for Safety, Human Resources and Claims Management personnel**
- **Cost of educating employees on safe practices**
- **Cost of complying with laws and regulations imposed by OSHA, the Department of Labor and other governmental agencies**
- **Money spent paying uncovered losses or funding deductibles**
- **Time spent dealing with losses**
- **Productivity costs due to time lost by injured workers and the cost of training new workers**

The Insurance Industry Today

Table 1 below shows that from 2008 to 2012, the industry's "Return on Average Net Worth" was poor. This was attributable to a lousy combined ratio and a low level of investment return (the majority of an insurance company's portfolio is invested in debt obligations; they can only invest about 20% in equities).

The industry needs to attract capital (surplus) to continue to grow. In order to do that, it needs to earn 10% or more in returns. When returns deteriorate like they did from 2008 to 2012, underwriters try to get more rate (increase premiums). This is reflected in the rate increases illustrated in ***Table 2*** on page 3.

The industry in 2013, 2014 and 2015 performed well, but not great. Insurers earned modest underwriting profits but decent overall returns. Rates in these years were flat and started trending down. This decrease in pricing adversely affected 2016 results. Insurance companies basically broke even on underwriting (combined ratio of 100.7%) and overall returns dropped from 8.4% to 6.2%, a 26% drop!

The first six months of 2017 continued the downward trend. The industry recently posted a $5.1 billion underwriting loss for the first six months of this year compared to a $2 billion loss in the same period last year. Net income year over year fell from $15.4 billion compared to $21.6 billion in 2016.

The industry will be further impacted by the devastating effects of the recent hurricanes. Hurricanes Harvey and

INSURANCE COMPANY ECONOMICS - SIMPLIFIED

Insurance companies are in business to accept risk in exchange for premiums. Like any other business, they want to make money and earn a fair return for their shareholders. Absent a decent return, they will not be able to attract additional capital and the insurance industry thrives on capital or surplus.

Insurance companies make money in two ways: underwriting and investments.

An underwriting profit is earned when losses plus expenses divided by premiums is less than 100%. This factor is called a *combined ratio*. If an insurance company has a combined ratio of 98%, it means they are making a 2% underwriting profit. If the ratio is 105%, it means they are losing 5%.

Insurance companies also earn money investing their policyholders' surplus that they hold in trust as well as the cash reserves they have set aside to pay future claims. It is not uncommon for an insurance company to have an underwriting loss, but make up for it with investment income, especially when interest rates are high.

$$\text{COMBINED RATIO} = \frac{\text{Losses paid plus expenses incurred}}{\text{Premiums}}$$

Table 1 - Insurance Cycle

$ in Billions

Description	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net Written Premium	$440.60	$434.90	$418.40	$423.80	$438.0	$456.90	$477.7	$487.6	$505.8	$523.5
Combined Ratio	95.5	105	101	102.4	108.1	103.2	96.1	97.0	97.8	100.7
Investment Income	$55.1	$51.5	$47.1	$47.6	$49.1	$48.0	$47.4	$46.2	47.2	46.3
Operating Income	$73.4	$30.6	$45.0	$38.2	$15.4	$33.3	$64.3	$55.6	57.3	42.6
Policyholder Surplus	$517.90	$457.30	$511.50	$556.90	$553.70	$586.8	$653.3	$674.7	$673.7	700.9
Return on Avg. Net Worth	10.9%	0.1%	5.0%	5.6%	3.0%	5.1%	10.3%	8.4%	8.4%	6.2%

Source: Insurance Information Institute (iii.org)

Irma promise to be two of the worst national disasters to ever hit mankind and it is estimated that total damages could be as high as $100 billion. Insured losses could range between $30-40 billion, although as I write this it is too early to have a more precise answer. To put this in perspective, Katrina cost somewhere in the neighborhood of $176 billion, of which $82 billion was insured.

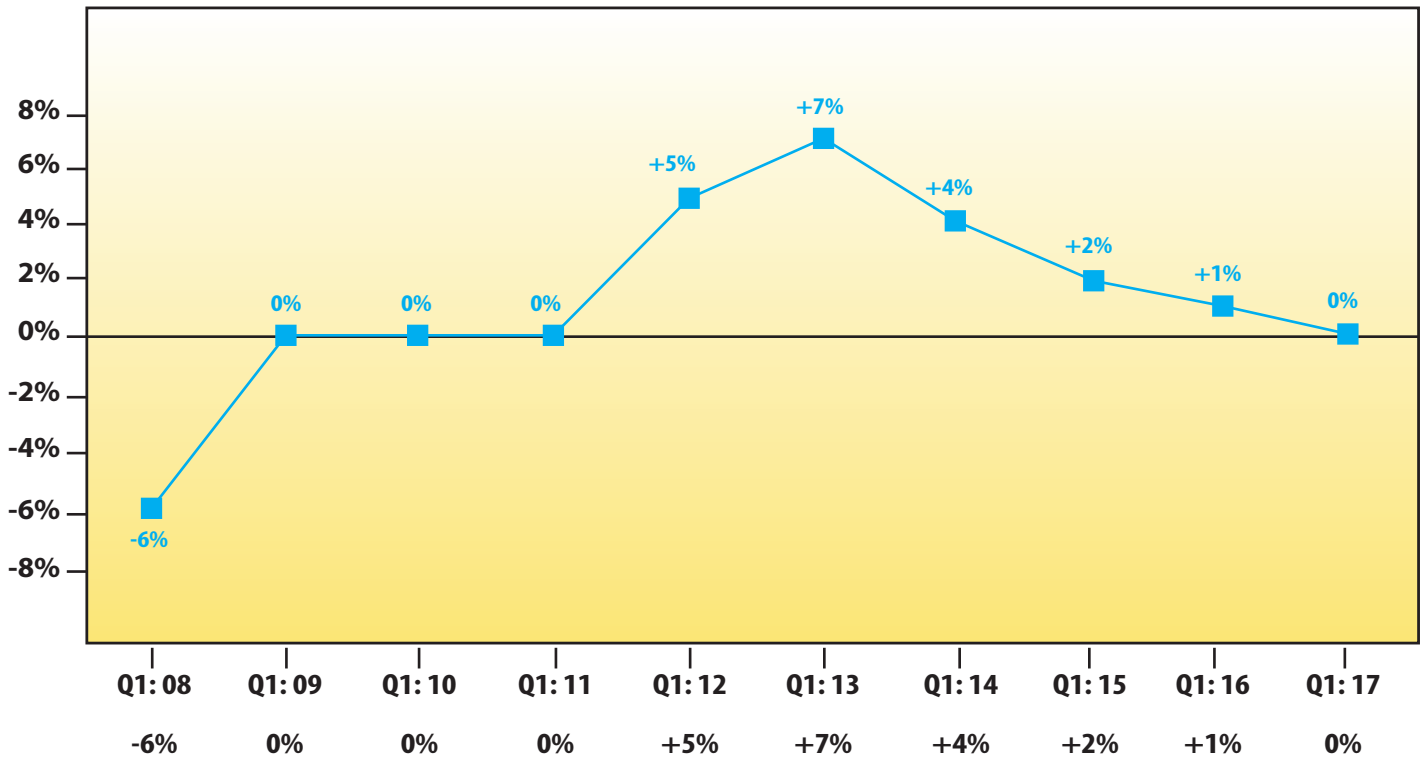
Fortunately, this should not significantly impact the insurance industry as a whole; although, individual insurance companies with heavy concentrations of business in the affected areas could be affected. Currently, the industry's surplus is at an all-time high: $700 billion as shown in ***Table 1*** on page 2. Analysts estimate it would take $100 billion or more of insured losses in a 12-month period to cause distress within the insurance industry.

Overall the Property and Casualty Insurance industry remains in pretty good shape and although it does have its share of challenges, we are still projecting flat renewal rates with modest rate relief for preferred accounts. This, of course, will vary by line of coverage.

Allied Lines

Allied Lines includes Property, General Liability, Auto and Umbrella. With the exception of Auto premiums, these lines should stay relatively flat. That does not mean that underwriters will not seek modest rate increases -- they will. However, in most cases, rate increases can be negotiated. Auto is the exception. Auto experience has deteriorated recently, and it is estimated that State Farm lost over $7 billion on their auto book in 2016! The deteriorating results are attributable to increased claims frequency (distracted driving) and increased severity. The increased severity is driven (no pun intended) by higher medical costs which affect bodily injury claims and higher physical damage costs to repair damaged vehicles. The cost to fix a sensor and camera laden bumper today is a lot more than it cost to just replace the bumper ten years ago. On top of that, it is estimated that over 500,000 vehicles have been destroyed by Hurricane Harvey alone and flood damage is not excluded on most auto policies.

Table 2 - Commercial Lines Rate Changes



source: Willis Towers Watson / The Hales Report

Professional Liability – Also Known as Errors & Omissions Insurance

The market for architects, engineers, lawyers, CPAs and other professionals remains competitive with a large number of companies competing for preferred accounts. Every policy written for this line is manuscripted by the insurance company providing the coverage. In addition to coverage, the type of risk management resources offered and the quality of the claims handling differs greatly between insurance companies. Moreover, some of the "opportunistic" new players in this market may not be around in five years. Insurance is not a commodity and it is imperative that coverage, risk management, and claims be considered in addition to price.

Like Allied Lines, preferred Professional Liability risks should be able to negotiate renewal terms that are flat to minus five percent from expiring rates. If you operate in what is considered a higher risk profession, such as geotechnical engineering, or attorneys specializing in class action cases, or if you have adverse loss experience, the market is much narrower. It is suggested that your terms be negotiated early and your program marketed if necessary.

Executive Risk

Executive Risk includes Directors & Officers (D&O) Liability, Employment Practices Liability (EPL) and Fiduciary Liability. The headache from the last economic downturn appears to be waning and these lines of coverage are reasonably competitive. As mentioned above regarding Professional Liability, every form is different and there are a number of new players who may not be around in five years. On average, we are expecting flat renewal terms with some opportunities for rate relief.

Workers' Compensation

Workers' Compensation experience in California has improved significantly since 2011 and rates on average have dropped 15% since the first half of 2015. The rate reductions are even more impressive when you look back to 2003 when the Average Charged Rate (ACR) was $6.29 as shown in ***Table 3*** on page 5. Through the first six months of 2017 the ACR in California is $2.58 (nearly a 60% decrease!) Since 2013, combined ratios for this line of coverage have been positive (under 100%) but losses are trending up and 2017 is likely to come in close to 100%, see ***Table 4*** on page 5. Despite this, rates have continued to trend down. This, however, may change.

2017 Risk Management Seminar Series

Legal Update: What You Need to Know for 2018

Friday, November 10th

7:30am Registration

8:00am - 10:00am Program

Sexual Harrassment Prevention Training

Friday, December 1st

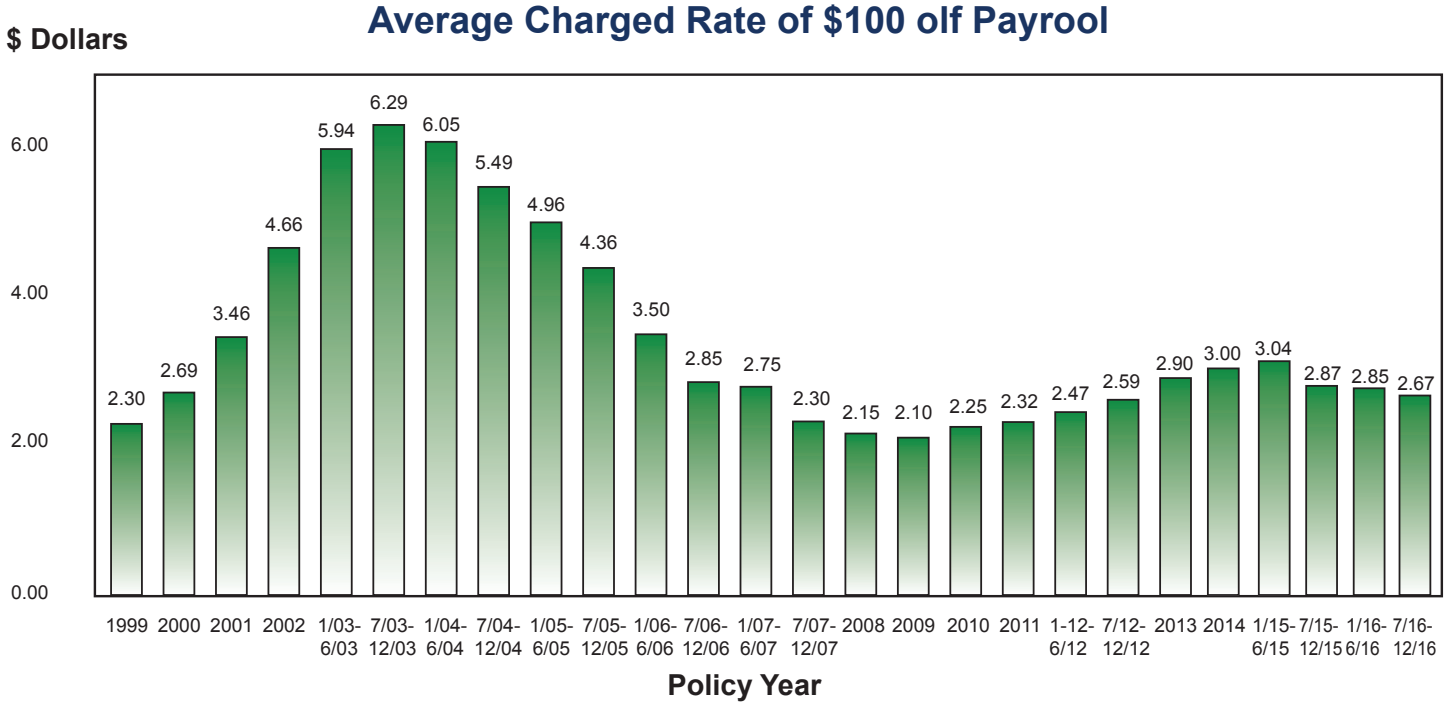
7:30am Registration

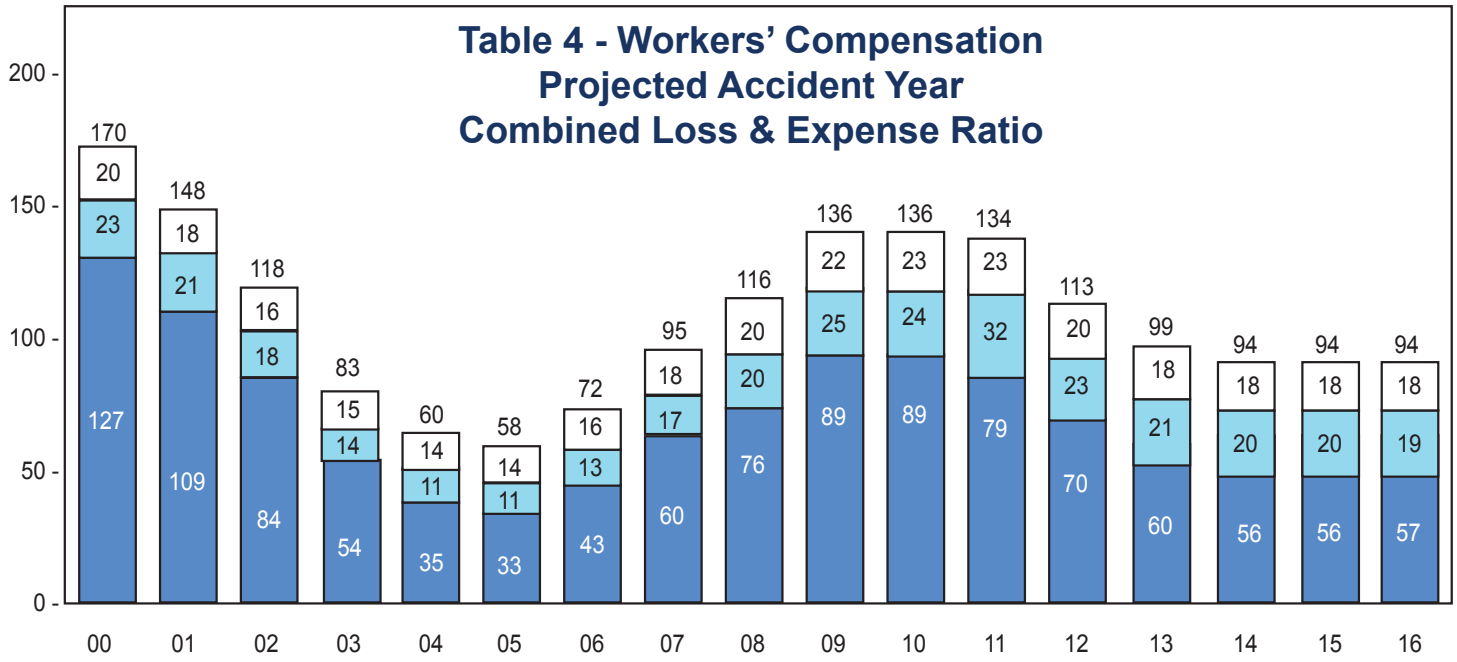
8:00am - 10:00am Program

2018 seminar schedule to be released soon

Reserve Early, Seating is Limited!
To register, click on the 'register now' button in the announcement email, or contact Sara Taylor at staylor@cavignac.com or call 619-744-0559.

Table 3 - California Workers' Copmpensation Industry Average Charged Rate of $100 olf Payrool





The Workers' Compensation Insurance Rating Bureau (WCIRB) proposes Pure Premium Rates which are then approved by the Insurance Commissioner. Every insurer then publishes its own rates. It is the average charged by all the insurers in the state that make up the Average Charged Rate. The Bureau has submitted its January 1, 2018, pure premium rate filing to the California Department of Insurance proposing advisory pure premium rates that average $1.96 per $100 of payroll. This is slightly less than the current recommended pure premium rate of $2.00. The proposed decrease follows five consecutive advisory pure premium rate decreases since early 2015 that have totaled more than 27%.

Our projection is that rates in 2018 will on average be flat to down 5%. It is important to point out, however, that rate changes will vary by classification and by insurance company.

Surety Bonding

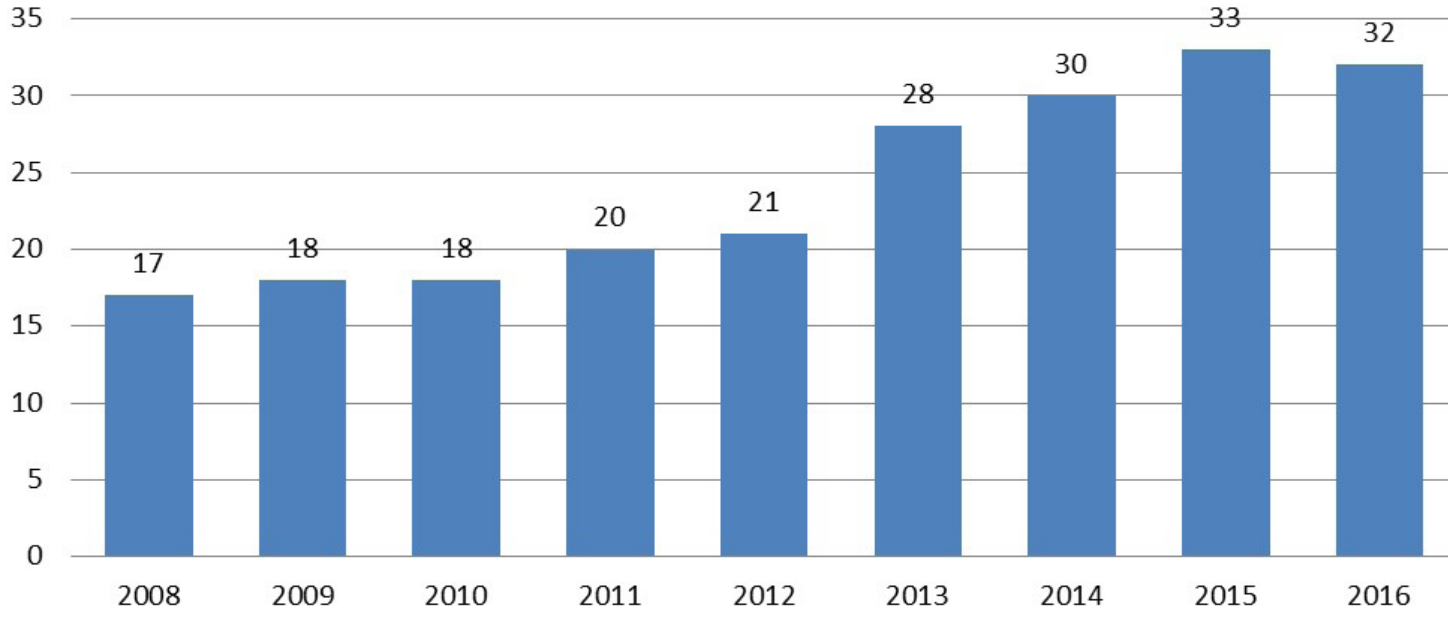
In 2018, the Surety industry in the United States will continue to post further growth in overall premiums and below average loss activity.

The total direct written premium for the calendar year end for 2016 was up to $5.88 billion from the prior 2015 year of $5.62 billion (a 4.5% increase). Impressively, at the same time the surety industry loss ratio fell in 2016 to 15.5% from 18.3% the previous year. This high water-mark for surety industry volume, continued to increase through the second quarter of 2017 to $3.13 billion in revenues with a 13.6% loss ratio (compared to $2.98 billion in revenues with a 18.4% loss ratio at the second quarter of 2016).

Strong growth and profitability since 2005 has attracted an increased number of new sureties to the market creating fierce competition for market share. During the last five (5) years alone, start-up front-line contract and/or commercial surety operations have included: AmTrust, Axis, Ironshore, Freedom Specialty, Allied World, Berkshire Hathaway, QBE, Euler Hermes, Navigators, Crum & Forster, Patriot, Endurance, Everest, Sirius, Markel and Argonaut. The number of reinsurance markets have almost doubled since 2008 as shown in ***Table 5.*** Although underwriting standards are relatively stable, overall supply has out-paced demand. This fresh credit capacity will likely cause increased pressure to further relax and soften terms and conditions (i.e., capacity, rate, indemnity) throughout the surety market.

The slow and steady economic growth has extended the current building cycle to a sluggish pace. This has also lengthened the surety industry's positive historical results. Continuing labor shortages, inflation, interest rate hikes, and other factors will likely further slow the economic engines in the coming years. Wise contractors are now getting margins, building their balance sheets and conserving for a rainy day. Contractors should begin positioning themselves for the impending shift ahead by retaining the best management team and labor talent, closely managing material, field and overhead costs, and demanding acceptable margins to ensure long-term success.

Table 5 - Growth in Reinsurance Capacity Mirroring Primary Market
Number of U.S. Surety Reinsurers



Health Insurance

The Affordable Care Act (ACA) is still the law. A number of "repeal and replace" bills have failed to pass so the law will continue to be enforced. We are still waiting on information about the Cadillac Tax and if regulations will be implemented. For 2018, the number of age bands is likely to change. Currently, for small groups (2-99 employees), most insurance carriers have one rate for children under 20 years old. In 2018, insurance carriers will divide the 0-20 age group into seven bands: 0-14, 15, 16, 17, 18, 19 and 20. As a result, premiums for age 20 and below could see significant increases of 20-50%. We will keep you informed of any changes.

Rates for all "small" employers will be based on the employee and their dependents' individual ages, plan design and location of the company. For example, a family of five will pay for each family member based on each individual's age and the plan they select. Some younger employees or families with one child may realize lower premiums. All of the small group plans have changed to conform with the law and most have higher deductibles and copays, therefore, employees will have to pay more when they use the services.

The actuaries at all the major insurance companies have determined that, to stay in compliance with the ACA's metallic tier guidelines, they must change plan benefits every year. The ACA guideline gave a percentage requirement for each tier – 90% = Platinum, 80% = Gold, 70% = Silver and 60% = Bronze. As costs increase, the value of the percentage changes and therefore the plan benefits change. Using the Platinum Plan as an example, if the actuarial value of a plan this year was $1,000, then the Platinum Plan has to cover 90% ($900) and pass 10% ($100) to the plan member. In the second year, if the actuarial value goes up to $1,100, 10% ($110) can be passed to the plan member and the benefits will change. This will always be a moving target until the values are fixed or the law is changed.

The provider networks are still changing and are offering a lower number of choices for doctors and medical groups. The industry calls them skinny networks. Often the price looks good, but your employees will have very few choices for doctors. Be sure to run a report to compare current providers to those associated with any programs you are considering. Insurance carriers continue to seek greater discounts from hospitals, medical groups and doctors and are offering patient exclusivity in return. Some insurance carriers will allow skinny networks to be offered side by side with full networks, with the price and contribution being set by the employer to favor one or the other. 2018 will see an overall 0 – 10% rate increase and benefit changes for "small" employers and 5-15% for "large" employers.

Captives, self-funding and partially self-funded plans are becoming more popular and should be considered for companies with over 50 employees. Industry trust plans for all size employers could lower the overall cost and stabilize the benefits. Other ways to reduce cost include buying a Bronze Level Plan and supplementing it with Cancer, Hospital, Accident and Critical Illness plans. Dental, Life, Vision and Disability continue to be very popular benefits with employees.

Conclusion

The insurance industry remains in a solid financial position. Despite the costs of the hurricanes, rates on average should be consistent if not trending down slightly. The Industry however has a good memory and has not forgotten the mediocre returns experienced from 2008 to 2012. Most underwriters still want more rate but the industries capacity (as measured by surplus) continues to have a downward effect on pricing.

While the health of the insurance market will directly affect what you pay for insurance, a much more important element is your Risk Profile. When an underwriter considers your account, they will evaluate your overall operations, your Human Resources practices, safety culture and overall safety practices, as well as your loss history.

A positive Risk Profile will result in substantially better pricing than a poor Risk Profile. This underscores the importance of proactively managing your cost of risk. The only way to lower your insurance premiums and the total cost of risk in the long run is to reduce the frequency and severity of the claims that drive this risk. While you cannot control the insurance marketplace, you can directly control your Risk Profile.■

Spotlight On

Cavignac & Associates is proud to support local and non-profit civic organizations, including the Challenged Athletes Foundation

MISSION

It is the mission of the Challenged Athletes Foundation (CAF) to provide opportunities and support to people with physical challenges, so they can pursue active lifestyles through physical fitness and competitive athletics. The Challenged Athletes Foundation believes that involvement in sports at any level increases self-esteem, encourages independence and enhances quality of life.

OUR VISION

Challenged Athletes Foundation vision is to be a recognized leader in a movement through which physically challenged athletes are accepted and respected at the same level as able-bodied athletes, to have a great and significant impact on each physically challenged athlete served, and to reach out to the physically challenged community by providing inspiration, awareness and mentoring.

For more information, go to www.challengedathletes.org

LIVE WELL WORK WELL

Health and wellness tips for your work and life—

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Hidden Dangers at Your Child's Bedtime

Babies should always be put to sleep on their backs, according to the National Institutes of Health (NIH). Yet, only 44 percent of U.S. mothers report they always use this method, according to a new study.

Sleeping on the back reduces a baby's risk of sudden infant death syndrome (SIDS) and other sleep-related dangers like suffocation. Because of this, the NIH has campaigned for over 20 years to promote this sleeping method.

Mothers who do not always put their babies to sleep on their backs cited baby comfort and family members' advice as reasons against the safer sleep method. However, pediatricians stress that sleeping on the back is the safest position for babies, despite misinformation.

You can further protect against SIDS by sleeping in the same room (but not the same bed) as your baby. Ensure your baby sleeps on his or her back on a firm surface with a tight-fitted sheet. Do not give the baby pillows, blankets or anything that can cause suffocation.

10 Easy Halloween Safety Tips

Halloween should be an exciting time of year for children and their parents, but too often the celebration devolves into tragedy. This season, make safety the top priority for your family.

Best Practices for Parents

The U.S. Centers for Disease Control and Prevention (CDC) has compiled a list of Halloween best practices. Follow these tips to keep your family safe.

1. Always accompany young children when trick-or-treating.
2. Watch for motorists and cross alleys carefully.
3. Only visit houses that are well-lit when trick-or-treating.
4. Use reflective tape or other light-up devices to increase your child's nighttime visibility, especially when wearing dark costumes.
5. Do not let children eat strangers' homemade treats.
6. Avoid candles and open flames, especially when in costume.
7. Keep costume accessories soft and flexible (for example, swords or knives).
8. Examine your children's treats for choking hazards or tampering before they eat.
9. Remove any costume makeup before bed to avoid skin and eye irritation.
10. Make sure costumes and accessories do not impair visibility or inhibit movement.

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BAKED APPLES & SWEET POTATOES

5 sweet potatoes (cooked, nearly tender)
4 apples (cored, sliced)
½ cup brown sugar
½ tsp. salt
¼ cup margarine
1 tsp. nutmeg
¼ cup hot water
2 Tbsp. honey

PREPARATIONS

1. Heat the oven to 400 F. Grease a casserole dish with butter or margarine.
2. Slice the apples and sweet potatoes.
3. Layer the dish with sweet potatoes, apple slices, and some brown sugar, salt and margarine pieces (in that order). Repeat this layer pattern until the dish is filled.
4. Sprinkle top layer with the remaining brown sugar, margarine and nutmeg.
5. Mix hot water and honey, then pour the mix over the top layer. Bake for about 30 minutes.

Makes: 6 servings

Nutritional Information (per serving)

Total Calories	300
Total Fat	8 g
Protein	2 g
Carbohydrates	60 g
Dietary Fiber	6 g
Saturated Fat	2 g
Sodium	320 mg

Source: USDA

Have a Healthy Halloween

Nutrition can be easily overlooked during a holiday best known for its abundance of candy and sugary treats. That is a shame, since about 1 in 5 school-aged children are obese, according to the CDC. This Halloween, consider being the one house on the block that offers healthy trick-or-treat alternatives.

Here are some store-bought snacks that can double as trick-or-treat offerings:

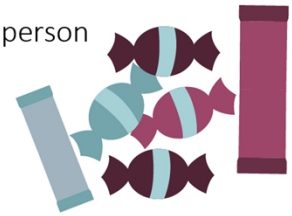
- Dried fruit
- Sugar-free gum
- Pretzels
- Juice boxes
- Snack crackers
- Apples
- Fruit bars
- Cheese sticks

SPOOKY STATS

$8.4 billion — Total U.S. Halloween spending in 2016

71% — Americans who hand out candy to trick-or-treaters

$25 — How much an average person spends on candy



$30 — How much an average person spends on costumes

Source: The Balance