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MANUFACTURING

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PERSPECTIVES ON P&C INSURANCE FOR MANUFACTURERS AND DISTRIBUTORS

Cliff Rudolph | Principal, Vice President, Account Executive

EXECUTIVE SUMMARY

Welcome to our annual review of the insurance marketplace relative to manufacturers and distributors. Our goal is to stay aligned with our clients in the manufacturing and distribution industries, and provide insight and practical information to help them make informed decisions. We hope that you find this review informative as you consider your insurance options for 2018.

Our Manufacturing and Distribution Practice Group at Parker, Smith & Feek saw significant growth and activity in 2017. Our goal entering 2018 was to demonstrate at every opportunity that we were part of the Northwest's robust manufacturing and distribution industries as opposed to merely vendors. Some of the opportunities included:

- Partnered closely with the Center for Advanced Manufacturing Puget Sound, Regence BlueShield, Group Health, and Delta Dental to put together a healthcare trust to help lower healthcare costs by pooling manufacturers and distributors together
- Introduced a proprietary inventory protection program to help our clients lower their cost of risk and provide more comprehensive coverage for earthquake and flood
- Held our first quarterly HR roundtable for those in the manufacturing and distribution industries
- Hosted a number of dinners bringing CFOs within the industry together to share ideas
- Took board positions with CAMPS and ACG, and developed a significant relationship with PNAA, along with many other industry associations in which we participate that bring resources and new ideas to our clients
- Wrote a number of articles and white papers to help inform and educate our clients, including "Attracting Millennials to Manufacturing Careers", "Preparing Generation Z for the New Tech Jobs", and "How 3-D Printers are Changing the Aerospace Industry".
- Sponsored The Washington Manufacturer Awards, The CAMPS Awards, The Family Business Awards, The CFO of the Year Awards, and many other events

Thank you to all of our clients, centers of influence, and the industry associations that bring value to the manufacturing and distribution industries.

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THE STATE OF THE U.S. INSURANCE MARKET FOR MANUFACTURERS AND DISTRIBUTORS

Last year, 2017, proved to be a challenging year for insurers. According to Fitch Ratings, low interest rates, significant pressure on auto insurance profitability, and third/fourth quarter catastrophic hurricane, earthquake, resulted in U.S. property and casualty insurers dealing with a 104.4 combined ratio for 2017 (up from 100.7 in 2016). Further, 2017 also saw Tokio Marine (one of the top 10 writers of commercial lines in the U.S., see below) cease writing new commercial middle market business and choose not to renew existing accounts. Those with significant auto or earthquake/flood exposures often saw increases in overall premium.

Top 10 Writers Of Property/Casualty Insurance By Direct Premiums Written, 2016 ($000)

RANK	GROUP/COMPANY	DIRECT PREMIUMS WRITTEN (1)	MARKET SHARE (2)
1	Chubb Ltd.	$16,528,891	5.6%
2	Travelers Companies Inc.	16,463,566	5.6
3	Liberty Mutual	15,056,251	5.1
4	American International Group (AIG)	13,144,961	4.4
5	Zurich Insurance Group (3)	12,554,597	4.2
6	CNA Financial Corp.	9,763,122	3.3
7	Nationwide Mutual Group	8,335,275	2.8
8	Hartford Financial Services	7,679,737	2.6
9	Berkshire Hathaway Inc.	7,650,236	2.6
~~10~~	~~Tokio Marine Group~~	~~6,256,196~~	~~2.1~~

(1) Before reinsurance transactions; includes state funds.
(2) Based on U.S. total; includes territories.
(3) Data for Farmers Insurance Group of Companies and Zurich Financial Group (which owns Farmers' management company) are reported separately by S&P Global Market Intelligence.

Source: NAIC data, sourced from S&P Global Market Intelligence, Insurance Information Institute

https://www.iii.org/fact-statistic/facts-statistics-insurance-company-rankings

LOOKING AHEAD

Recently, the Federal Reserve agreed to raise its key interest rate on the heels of an economic growth forecast of 2.5 percent for 2018. Similarly, Moody's announced a stable outlook for P&C insurers in 2018, as "continued economic expansion, and robust capitalization"[1] offset profitability pressures from rising claim costs and still-low interest rates. Our assessment is that insurers will find stability in 2018 and, barring catastrophic anomalies, will revert to 2016 combined ratios and rates. Increases in premiums will be relatively isolated to key areas of coverage that are seeing the most pressure, i.e. earthquake/flood, forest fire, exposed property, and auto. Further, we believe that the impact of the #MeToo movement will shift from Hollywood and political circles to our everyday lives and clients. As a result, we expect to see heightened pressure on insurers for employment practices liability and increased premiums in the third and fourth quarter. As most of our clients have significant exposure in these areas, we have developed proprietary insurance products to minimize premium increases.

PROPERTY

For most of our manufacturers and distributors here in the Northwest, property, earthquake, and flood will see increases as insurers have reported losses totaling more than $130 billion in 2017. We are seeing insurers withdraw a bit in terms of coverage and willingness to put up large limits when it comes to earthquake and flood, and many are increasing deductibles. Those organizations that have experienced recent large property losses will be the most affected. We expect that non-catastrophe-exposed risks to see flat rates or mild single digit increases, as significant capacity still exists. For most of us however, with exposure to earthquake and flood, we should expect to see increases in the 5-10 percent range.

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Marine, cargo, and hull will see similar market outcomes. Stock throughput continues to be a very viable option for our manufacturer and distributor clients, especially those with overseas cargo exposures or significant inventory with exposure to earthquake and flood. Again, those without catastrophe exposures have enjoyed flat renewals, while those with exposure to earthquake and flood have experience increases of 5-10 percent.

CASUALTY

On the liability side, specific to product liability for manufacturers and distributors, claims are becoming more complex, expensive, and globally dispersed. A report by Allianz Global states, "Product liability and product defect/recall are the main drivers for large liability claims globally."[2] Further, "consumer protection laws have been strengthened in many countries and US-style litigation continues to spread around the globe."[3] The report went on to predict that global class action by consumers and investors will become more significant.

We expect that in 2018, pharmaceutical and automotive parts manufacturers will be hit hardest due to the impact of talcum powder and airbag litigation affecting capacity for insurers that typically write these industries. Insurers will also be more interested than ever in proactive risk management and will be looking very carefully to make sure that manufacturers and distributors are implementing proper risk transfer in contracts and managing certificates of insurance appropriately. For excellent risks with low loss history and outstanding risk transfer, we believe that the market will offer flat renewals. Those risks that are more complicated or do not have exceptional risk transfer will see 5-10 percent increases in the first two quarters, but believe the market will become more competitive in quarter three and four.

A bright spot for our clients lies in the aerospace industry, which continues to benefit from a soft market. We have significantly improved coverage and pricing for many of our current and new clients in the aerospace industry, and recommend to all organizations that procure aviation/aerospace products liability market their program to take advantage of the marketplace. One key area of concern that insurers have brought up is that while claim frequency has decreased, the severity and complexity of claims has increased. As a result, our renewals will include options for increased limits to provide our clients with additional perspective. There is some level of concern that pricing may see increases in the near future.

Unfortunately, automobile insurance continues to see increases, having huge impacts on our distributors. Many of the increases have occurred already, but insureds should be prepared to continue to see 5-10 percent increases in premium on good risks. For those auto risks with loss ratios above 35 percent, one can safely expect that underwriters will increase premium to account for a 35 percent loss ratio going forward.

EXECUTIVE RISK

As mentioned earlier, #MeToo will begin to impact our clients in 2018 as individuals turn from the television and look to their personal lives. As a result of a strong economy, the market for management liability is fairly soft (outside of risks with significant California exposures), and we expect flat renewals as insurers attempt to increase their coverage offering to offset

increased competition. However, as claims increase, we do warn that the employment practices liability may firm up in quarter three and four, especially for those with claim activity.

New insurers continue to offer cyber products, and the flood of capacity in this line of coverage is resulting in lower premiums and better terms for our clients. The cyber markets are very interested in writing premium for manufacturers and distributors to offset the number of healthcare entities, financial institutions, and large retailers they are writing. We expect a 5-10 percent rate decrease for our clients who purchase data privacy/ cyber insurance.

GLOBAL RISK

Our manufacturing and distribution practices specialize in global risk transfer. Our ownership in Assurex Global, the largest privately owned insurance brokerage group in the world, gives us unparalleled access and insight into risk transfer strategies for our American clients doing business outside of the U.S., as well as foreign-owned organizations doing business in the States.

While litigation outside of the U.S. is increasing at an alarming rate, capacity for coverage is putting pressure on pricing. We are seeing very positive renewals and insureds should expect flat to 5-10 percent decreases in pricing. We also believe it is an ideal time to ask for broadened terms and coverage. Tying into cyber, as discussed above, it will be important that cyber policies account for new European cyber laws, GDPR and NISD, if applicable and allowable. Many policies specifically state that they will pick up U.S. regulatory actions and fines, but are silent when it comes to regulatory actions elsewhere. Limits for fines and penalties must also be reviewed, as the maximum fine for not complying with GDPR is €20 million, or four percent of an organization's worldwide revenue.

LOOKING FORWARD

An analyst at AM Best recently stated that the outlook for commercial insurers has improved due to, "An embedded change in the sophistication of the segment's pricing and underwriting infrastructure and the segment's resilience amid a variety of macroeconomic and insurance market issues."[4] In essence, underwriters are making better-informed decisions – they are attempting to keep insureds without losses from having to subsidize those with losses. However, this can create a tough environment for our clients who are looking for consistent underwriting, not knee-jerk reactions from underwriters.

In 2018, with the help of our outstanding risk services team led by Mike Woltersdorf, we will be working with our clients to proactively mitigate risk and loss. In today's age of excessive data, the best opportunity to help our clients reduce their overall cost is to help them prevent losses from happening in the first place. Whether it is having Kevin Sayler (a Certified Industrial Hygienist and member of our team) work with our clients to help them with noise and air sampling, or asking Shawn Hjort (one of our many Claims Executives) to help our clients evaluate the best medical provider network for workers' compensation claims, our team and resources are dedicated to our local clients and helping them mitigate and lower the cost of risk.

We hope this "Perspectives on P&C Insurance for Manufacturers and Distributors" is a helpful look at what lies ahead and a guide as you negotiate your upcoming insurance renewal and beyond. As the market turns a bit, it is important that you have a broker with the experience and resources to help in all areas of risk management. Our team of dedicated risk management professionals is focused in the manufacturing and distribution industries; they are not generalist, but are highly specialized to see trends and effect a positive impact on your organization.

We look forward to working with you!

Sincerely,

Cliff Rudolph

References and Resources

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