2022 Mid-Year Market Review and Forecast

SENTINEL

EXECUTIVE SUMMARY

Over the years, Sentinel remains proactive to help you stay ahead of the curve and avoid unnecessary surprises. In early Quarter 4, 2021, we released our 2022 Budget Planning Guide as we believe it is important for every business to plan their risk and insurance budgets for the coming year. This update is designed to provide additional insight and guidance as the market continues to evolve.

James L. Holmes, Jr., CPA
Managing Partner

The 2022 Mid-Year Market Review and Forecast is heavily intertwined with increasing global supply chain concerns, the continuing impact of the pandemic, escalating fuel costs, forecasts of global food shortages, inflation, rising interest rates, and talk of an impending recession, among countless other factors. As a result, the insurance market remains in flux and is rapidly changing.

We are not financial analysts nor economists, but we strive to translate the 'so what' of these issues and convey how it can impact you and your business directly. As we move forward into even more challenging and risky times, we believe it is wise to be as well informed as is practicable. We trust you will find this report informative and insightful.

SAFEGUARDING YOUR SUCCESS

While slowing slightly, the hardening, less competitive insurance market has continued into 2022. This trend has been progressing for the last 3 years. Early indications are that overall Property and Casualty insurance performance declined in 2021 by 1.2% to a combined ratio of 99.6%. AM Best indicates that although premium growth rebounded after dropping in 2020, loss experience deteriorated by 11.7% and underwriting expenses had a 5.4% increase.

Lackluster 2021 financial results, a looming economic recession (which can negatively affect investment income) in addition to catastrophic losses and inflationary pressures (economic and social) could all work to stall the end of the hard market. While we are beginning to see a very slight decrease in the elevating rates for most lines of insurance, a couple lines of coverage are continuing to increase substantially.

COVERAGE SPECIFICS

PROPERTY

Several factors are thought to contribute to property rate and premium increases including:

RISING COSTS OF CONSTRUCTION

Travelers has reported the cost of construction has increased 28% over the last five years. In 2021, total nonresidential reconstruction costs increased 16.5%, led by a 51% increase in structural steel and a 22.7% increase in the cost of lumber. Construction materials and labor will increase at a rate equal to or greater than inflation. So, expect insurers to force an insurable value increase to adjust closer to inflation.

LABOR SHORTAGES

Project delays and material shortages partnered with supply chain concerns and shortage of skilled workers significantly increase the amount of time and funds required to rebuild all structures.

UNDERINSURANCE

It is estimated that 75% of commercial businesses are underinsured by 40% or more according to Risky Business. Starting in 2020, carriers began to study building valuations and have focused on increasing values to properly match exposures. Claims analysts confirm the acceleration of claims inflation grew, beginning in 2019 due to undervalued schedules.

REINSURANCE

Most carriers buy "insurance" known as reinsurance for major catastrophes. Over the past five years increasing CAT losses have driven reinsurance costs higher and higher and analysts predict that trend will continue.

LOSS OF INVESTMENT INCOME

As recently as 2019, carriers made significant investment gains. Beginning in 2020 and continuing throughout 2021 to 2022, these carriers incurred significant capital loss in those investments with a dramatic effect on their overall profitability.

CATASTROPHIC EVENTS

Businesses with catastrophic exposures (i.e., Flood, Earthquake, Wind, Wildfires) will continue to see increasing rates. Over the past five years, there have been 86 catastrophic events in the United States; each with losses exceeding $1 billion. In 2020, there were 22 catastrophic events which set a new annual record according to the NOAA. The following year, 2021, had 20 catastrophic events. There is growing evidence that climate change may increase the severity and duration of many types of weather events.

WORKERS' COMPENSATION

Workers' Compensation has stabilized with real reductions coming from improvement in the Insured's experience modifier.

Best-in-class accounts with top management focus on safety and risk management continue to lead the pack with competitive programs.

Many states are still filing overall rate decreases. There are many carriers that are eager to write Workers' Compensation insurance both monoline and in combination with package lines.

The marketplace for higher hazard Workers' Compensation has fewer carrier options, so the pricing is not as competitive as more innocuous exposures.

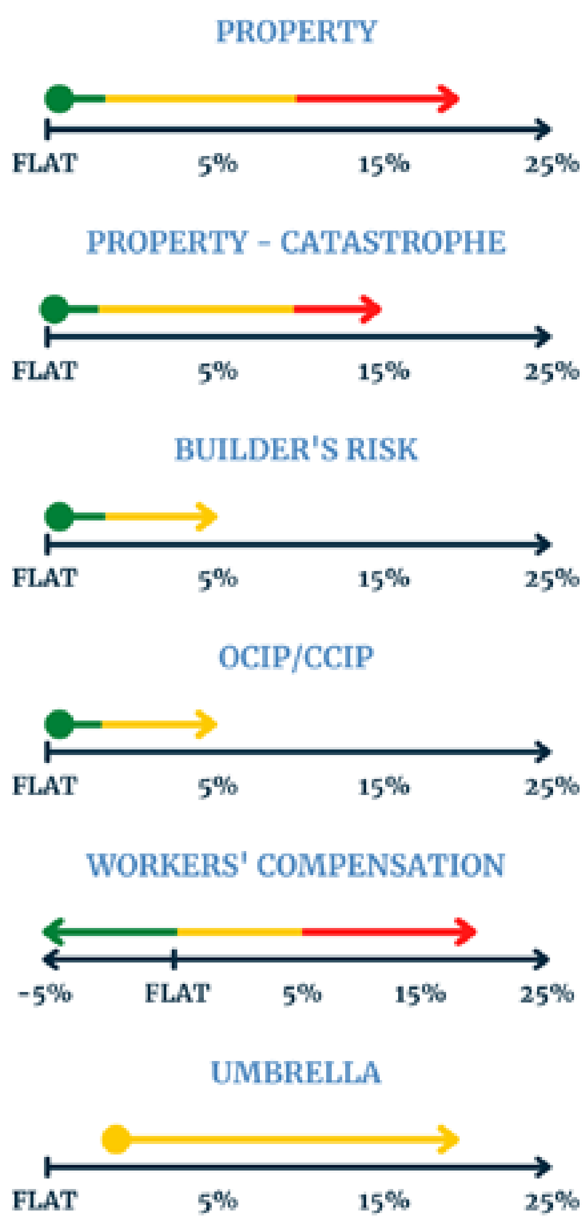
UMBRELLA

The Umbrella/Excess Liability market continues to stabilize into 2022.

High-hazard risks will continue to see larger increases (15% to 30%) than lower hazard risks (flat to 15%) attributed to social inflation, anti-corporate juror sentiment and growing jury verdicts.

Pricing remains strong by incumbent and new carriers into the marketplace.

INSURANCE RATE CHANGES



COVERAGE SPECIFICS

SPECIALTY LINES

EMPLOYMENT PRACTICES LIABILITY INSURANCE

EPLI has been impacted by more factors than ever before. Social inflation, the pandemic and vaccine requirements, #MeToo and #TimesUp litigation, remote work and biometric data privacy laws have contributed to increased claim activity in this space.

FIDUCIARY LIABILITY

Fiduciary Liability continues to be impacted by excessive fee litigation. These claims allege that defined contribution plan administrative and investment fees are too high.

Fiduciaries of plans have a duty under ERISA law to ensure these fees are reasonable and investments are performing at a reasonable level. Nearly 200 excessive fee claims have been filed in federal court since 2015, 90 of which were filed in 2020. Of those, only 25% of cases have been decided in favor of the defense.

Underwriting requirements now include supplemental questionnaires relevant to the insured's approach to record keeping and investment expenses.

Executive lines of insurance continue to be tightly underwritten and increased rates will proceed. Underwriters continue to focus on a company's financial strength, industry, and prior loss history.

We are all anxious to see a stabilizing (little to no rate increase) insurance market and eagerly anticipate that trend in late 2023, but it's likely to hold off well into 2024.

While we believe rate reductions will be delayed until 2024, that will be impacted by insurer results. Large catastrophic losses could delay any decreases.

INSURANCE RATE CHANGES

CYBER

Cyber remains extremely volatile and increases are expected to continue as claims settle and new claims continue to be reported in record numbers. It is likely that insurers will reduce their capacity (limits they offer) at risk and push for higher retentions. There will also be pressure from insurers to restrict policy wording and reduce sublimits.

Many carriers are also requiring more adherence to much more stringent underwriting guidelines; for example, accounts that have not implemented multi-factor authentication (MFA) are often declined for further consideration. Drivers of soaring cyber insurance rates include:

INCREASED FREQUENCY AND SEVERITY OF CYBERATTACKS

Many cases have been documented with personal data breaches: email addresses, social security numbers, credit card numbers, passwords, etc.

Cyberattacks increased by over 31% from 2020 to 2021, and that trend continues into 2022. IBM lists the average cost of a data breach in 2022 at $4.24 million. Hackers continue to become more sophisticated over time.

WORKFORCE CONCERNS

According to VMware, 82% of surveyed organizations are concerned their company is vulnerable to cyberattacks and 49% of organizations lack the expertise and tools for adequate incident response.

At the end of 2021, there was a security workforce gap of 377,000 jobs in the U.S and 2.7 million globally, according to the (ISC)2 Cybersecurity Workforce Study, 2021. The ISACA State of Cybersecurity 2021 Part 1 survey states that 61% of organizations feel they are understaffed in terms of cybersecurity professionals. Fifty percent of respondents said applicants were not sufficiently qualified for security positions.

According to that same survey, a key challenge with filling cybersecurity positions is that only 31% of human resources staff understand their organization's cybersecurity needs. Additionally, the study found that only 27% of recent graduates in cybersecurity education programs are prepared for the workforce.

GROWING CARRIER LOSS RATIOS

Top cyber carriers reported loss ratios up to 114.1% in 2021. As a result, carriers are apprehensive and asking more questions resulting in premium increases averaging 30% but up to 300% depending on the industry, loss history and security controls in place.

ADDITIONAL RISKS TO MONITOR

LOSS RATIOS AND FREQUENCY

We are finding that even in the current challenging hard market, a business with exceptionally good loss experience remains extremely attractive to underwriters and will readily receive interest from multiple insurers, most of whom will be very competitive.

Businesses with losses and loss ratios (losses divided by premium) greater than 40% will likely continue to face increasing insurance rates. The higher the loss ratio, the greater the increase and the more likely the rate increasing trend will continue. Those insureds may also face restrictions in coverage or coverage limits as an approach to return the account to profitability.

Businesses with loss frequency, even if they avoid severity, will be treated as adverse risks. While it may be possible to implement various loss control initiatives, insurers will want to see unmistakable evidence of favorable trends before offering their most competitive pricing. Similarly, businesses with outstanding loss control recommendations (property and life safety) will be under tremendous pressure to comply or seek other insurer options.

SUPPLY CHAIN AND TRADE RESTRICTIONS

Global supply chains are common and involve many geographies. A disturbance anywhere in the chain can result in severe consequences. Tied closely to supply chain, trade restrictions can trigger inflationary pressure or shortages of goods.

While there is increasing governmental pressure for Electric Vehicles, the batteries are dependent upon the mining of 'rare earth' minerals (the mining of which are mostly banned in the US). These minerals are being mined by countries with whom there are increasing trade tensions and complexities, including boycotts.

INFLATION

Since the last major bout with inflation in the 1980s, economists and the government have changed the 'basket of goods and services' so there is no longer an 'apples to apples' comparison.

Today's 'basket' has been adjusted to mellow inflationary numbers, though the reality of the actual basket of goods and services is just as painful as in history.

Increases in inflation will often lead to increases in wages. It is probable that inflation pressures will ease and reverse, but wages will have become fixed.

As of now, the longevity of inflation remains questionable. However, it is widely acknowledged that unless the Federal Reserve increases rates to equal or exceed inflation, inflation will remain the bane of all businesses and personal interests.

AGING INFRASTRUCTURE

Concerns about the increased utilization of utilities (water, electricity, wastewater/waste, gas lines, etc.) where the supply cannot meet demand are growing.

The very nature of these utilities include extremely high capital investment, long lead times, numerous regulations, and environmental concerns.

Many private producers are reluctant to invest in long term projects due to ever changing regulations and political directions, since most projects transcend any one governmental administration.

INDUSTRIES

Certain industries are at a greater risk for leading the rate increase trend: those in heavier industries, transportation, trucking, large fleets, larger venues for people, and those that have greater product liability exposures.

FUEL PRICE & AVAILABILITY

If the US decides to become a net exporter of fuel once again, that may have a positive impact on pricing and availability of fuel to run our businesses.

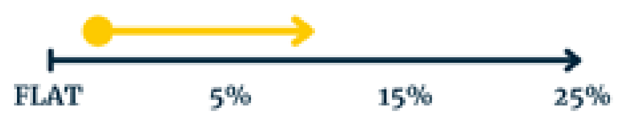
Meanwhile, there is more emphasis on achieving a net-zero carbon footprint; there is legislative and social pressure for businesses to measure their carbon footprint costs.

INSURANCE RATE CHANGES

TRADE CREDIT

MARINE CARGO

AVIATION



INTERNATIONAL

ADDITIONAL RISKS TO MONITOR

ECONOMIC RECESSION

Recent indications are that the economic growth in the United States has slowed down and even reversed some in the first part of 2022. Inflation is high at 8.4% and unemployment is at 3.6%. There is too much money and not enough goods to meet demand. Also, wage inflation is necessary to fill jobs, but exacerbates inflationary pressures.

The US Federal Reserve will have to find a balance between increasing interest rates enough to curb inflation, but not so much that economic development stalls and shrinks the largest economy in the world. Otherwise, businesses that struggled to remain open during the pandemic may finally succumb to further reducing supply.

WAR & INTERNATIONAL TENSIONS

The global insurance industry could be facing billions of dollars in losses because of Russia's invasion of Ukraine.

The ripple effects of this situation will be felt across the entire world through Cyberattacks, continued high inflation, rising costs of goods and interest rates.

THE 'GREAT RESIGNATION' IMPACTS

Initially driven by pandemic-related mandates, the increase in turnover is continuing due to other social-economic factors (fuel costs to commute and COVID-19 variants included).

While the number of lost employees may be small, the turnover costs to businesses will be large.

'BLACK SWAN' EVENTS

Unpredictable events that are beyond what is normally expected and have severe consequences have generated a lot of attention from the public.

In 2019/2020 it was the COVID-19 pandemic. In 2022 it could become the result for global territorial tensions (Russia and Eastern Europe, China and Taiwan).

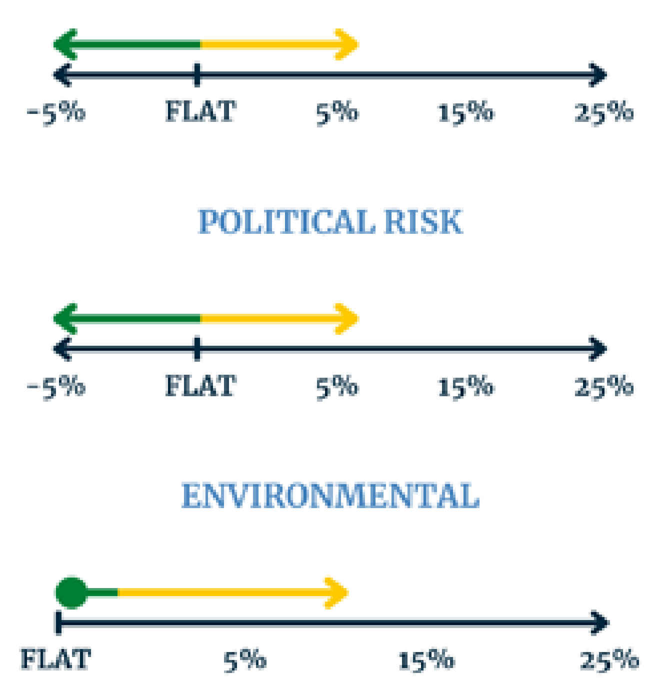
US MID-TERM ELECTIONS

Although it is too soon to predict, mid-term elections can significantly alter the legislative, social, and economic landscape of our country. Policies put into place in the last few years could quickly reverse.

Federal spending may be constricted and access to raw materials may reopen. Conversely, we may see continued government funded projects and increased focus on net-zero business operations aimed at reversing climate change.

These changes can have profound implications for the economy and the costs and challenges businesses will face.

INSURANCE RATE CHANGES



WHY ARE THESE FACTORS IMPORTANT?

1. Negative impacts on business' financials
2. Value of sales could increase
3. Inflation could change premium costs

These risks can all have a negative impact or pressure on the financials of a business. This may be experienced through the inability to obtain merchandise, raw materials and all other inputs for your business and everything you do receive will cost more.

This ripple effect will readily transcend 2022 and all of 2023, with potential to run into 2024 even. If a business' liability premium is rated on an exposure base of 'Sales' (revenue), that business could sell the exact same number of units in one year as the next. However, the impact of inflation (among other factors) could increase the sales value by 25% to 50% (or higher), yet the actual 'exposure' from the business (the units sold) has not changed. Unfortunately, their insurance premium costs will.

Similarly, due to inflation, any increase in the wage paid per hour will have impacts on certain liability coverages and especially Workers' Compensation. For example, if you paid one employee $15/hour but now pay them $20/hour, the Workers' Compensation premium would increase by approximately 1/3; with no change in the work or exposure. Granted, if the employee were injured their benefit for lost time would be slightly higher as well.

A renewed focus on employees will be the cornerstone for success in 2022. Due to an increasing number of employees who are no longer satisfied with the status quo, workers are now demanding more from their employers.

Employees are less likely to remain with their current employer if they feel that their current employer undervalues them in terms of salary, benefits, and upward mobility. Workers are more willing and able than ever to find employers who will.

The reality of the current labor market is that employees have higher expectations and greater leverage than ever. Many employers are more than willing to provide employees with rewards that will improve their job satisfaction. The problem is that while employee expectations have risen, the budget for employee benefits has not.

Even historically adequate employee benefits budgets may not be sufficient this year. Healthcare costs are set to rise as a greater number of patients seek services that were deferred during the pandemic. This leaves employers in a position of needing to rein in spending while still providing competitive benefits offerings to attract and retain top talent.

Employers, more than ever, need to think creatively about how they can accommodate employee needs and desires while also controlling costs and ensuring the worker's health and well-being. Employers are expected to reconsider how and where they invest their benefits dollars.

For instance, employers may consider utilizing alternative health plans, expanding telemedicine offerings, or providing more targeted voluntary benefits. What works for one employer might not work for another. Employers will need to evaluate their work force and decide what benefit programs cater to their unique circumstances.

CURRENT CONDITIONS

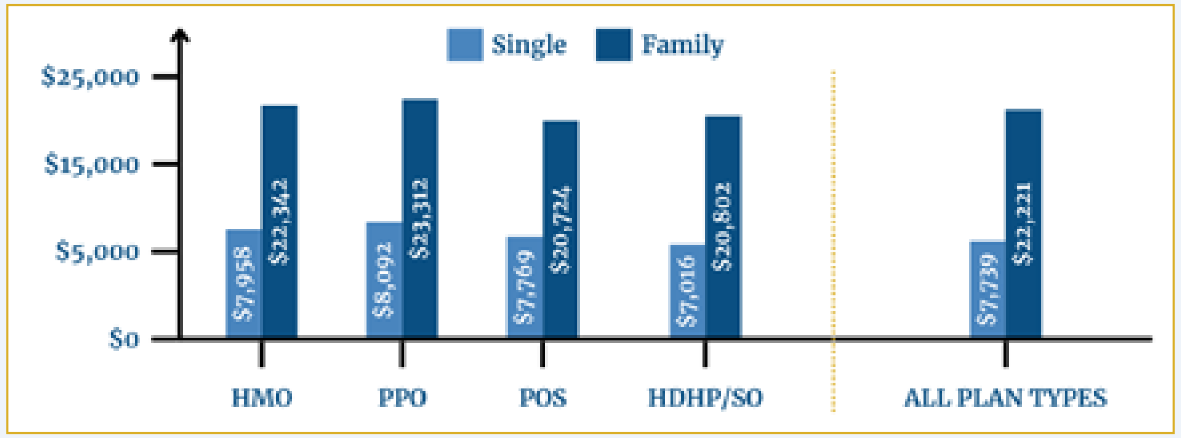
RISING HEALTHCARE COSTS

Healthcare costs have been steadily increasing for well over a decade. Consider employer-sponsored health plans, for instance. According to a Kaiser Family Foundation report, family coverage premiums have gone up 22% over the last five years on average; 47% over the last 10 years. Employee contributions toward those premiums have risen 45% over the last decade as well, according to the report.

Due to COVID-19, costs have continued to rise over the last couple of years. According to a Willis Towers Watson survey in 2020, employers saw a 2.1% cost increase for medical benefits expenses, a figure significantly lower than the 4% increase from 2019. This smaller figure was due to individuals deferring nonemergency health care and elective procedures at the onset of the pandemic.

After the initial stages of the pandemic, individuals gradually began returning to their usual healthcare routines, which led industry experts to predict a 5% cost increase for 2021 and an average 0f 5% to 7% in 2022. Faced with cost increases, employers were forced to reconcile limited budgets with employees demanding more value than ever from their benefits offerings

The graph below depicts 2021's average annual premiums for covered workers based on plan type for single and family coverage.



LABOR SHORTAGES

It is no secret the COVID-19 pandemic caused dramatic shifts in the U.S. job market. Since the onset of the pandemic, countless businesses have closed, furloughed, or laid off workers. This forced millions of people to rely on unemployment aid and forfeit their employee benefits. In early 2021, many economists expected employees to return to the workforce in large numbers. However, that did not happen, and many workplaces are left severely understaffed.

The COVID-19 pandemic fundamentally altered how large segments of the workforce view their labor and the value of employee benefits, particularly in the service sector. These employees often had no employee health plans, no 401(k)s and limited career mobility.

Throughout the pandemic, workers began questioning whether their current wage was worth risking their physical and mental health. Workers are now expecting more from their employers and a greater value in their employee benefits.

TRENDS TO WATCH

COVID-19 DISRUPTIONS TO CONTINUE

The COVID-19 pandemic has shown some signs of slowing down in 2022. However, employers can expect disruptions to continue well into the future. The pandemic was the catalyst for many workplace trends that will be discussed in this section. COVID-19 has contributed to greater health spending, significant labor shortages, an increased need for mental health resources, and an expanded adoption of telemedicine solutions.

The pandemic also shed light on workplace issues that have garnered little attention for years, particularly concerning behavioral health. Approximately 4 in 10 U.S. adults have reported feelings of anxiety or symptoms of depression during the pandemic, according to the Kaiser Family Foundation. These issues should be top of mind for many employers as they make decisions on future employee benefits.

Amid the COVID-19 pandemic, employers must realize worker health is a major concern. That is why a considerable number of employers are looking to expand their employee benefits to include more well-being offerings; ones that directly address issues affecting employees and focus on improving overall health. Among others, these offerings include flexible scheduling, mental health resources, telemedicine access and financial well-being services. Such benefits help combat the issues that COVID-19 has brought to employers to the forefront.

TELEMEDICINE GAINS POPULARITY

Telemedicine allows consumers to visit their doctor over the internet. Unsurprisingly, it exploded in popularity during the COVID-19 pandemic and is not expected to slow down any time soon. Instead, more businesses are likely to embrace offering more telemedicine options.

Before the pandemic, only 11% of U.S. consumers utilized telemedicine. As of the beginning of 2022, 46% of consumers were using telemedicine to replace the in-person health visits they had originally planned. Additionally, 76% of consumers said they were interested in using telemedicine going forward, according to a separate McKinsey & Company survey.

While virtual doctor visits are useful under limited circumstances (non-emergencies only), they do offer patients greater flexibility and savings when compared to in-person appointments. Plus, their convenience helps encourage employees to see their doctors more frequently, which helps maintain overall health. In turn, this helps reduce health costs over time by detecting problems early and preventing more costly treatments down the road.

HOLISTIC APPROACH TO VOLUNTARY BENEFITS

A holistic approach to voluntary benefits focuses on overall well-being and is typically more niche than a traditional health plan. According to a Randstad survey, 94% of employees said they want benefits that have a "meaningful impact on their quality of life". This approach helps employers attract and retain top performers and provides them with a multitude of rewards.

Money is a top stressor for employees, and the pandemic has reinforced that fact. When employees experience lower financial stress, employers may see greater employee productivity and morale and less absenteeism. Popular financial well-being benefits can include retirement savings plans, safety net insurance, emergency savings funds, student loan repayment, and financial planning or coaching.

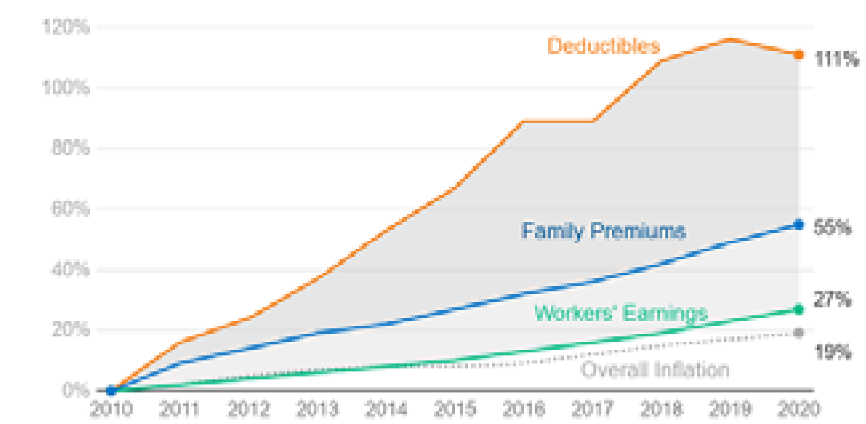
HEATHCARE COSTS WILL CONTINUE TO RISE

Industry experts have predicted anywhere from a 5% to a 7% cost increase in 2022 into 2023. In addition to traditional factors, employers are likely to see cost increases because more people have resumed seeking medical services that were deferred earlier in the pandemic, such as nonemergency tests and elective surgeries.

Mental health issues and substance addiction have soared during the pandemic, spurring more people to seek treatment.

Beyond that, many individuals stopped exercising and eating well during the pandemic, increasing the likelihood of future costly chronic health issues.

The graph to the right, from the Kaiser Family Foundation, depicts how employer premiums and deductibles have risen much faster than wages since 2010.



PRESCRIPTION DRUG COSTS PROJECTED TO INCREASE

Prescription Benefit Managers (BPMs) and employers continue to struggle with prescription drug costs. The largest cost driver over the past few years has been specialty drugs; those that require specific handling and administration methods and are oftentimes expensive to develop.

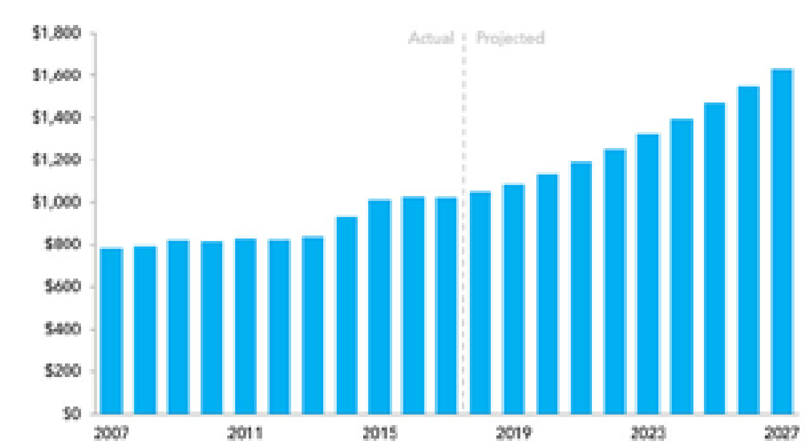
According to a Segal report, specialty drug prices are projected to increase by 13.4% in 2022, while non-specialty prescription drug costs are only projected to rise by 4.6%. Most insurance carriers are trending towards more restrictive Rx formularies and limiting access to target specialty drug pharmacies. The graph below, from the Peter G. Peterson Foundation, depicts how much spending on prescription drugs will continue to climb over the next decade.

Educating employees is the key to managing and reducing prescription drug costs. Without adequate knowledge, an employee might opt for name-brand prescriptions each time they need medication.

The employee might not even know to ask their doctor about generic alternatives, which are equally effective and significantly more affordable.

Providing employees with a thorough explanation of their coverage and other prescription drug basics can go a long way toward reducing expenses and boosting morale and organizational loyalty.

TOTAL PRESCRIPTION DRUG EXPENDITURES PER CAPITA



TRENDS TO WATCH

ALTERNATE FUNDING OPTIONS

In recent years, employers have increased employees' share of health plan costs. Many individuals are struggling financially and are prepared to leave their jobs for those with better benefits offerings. Employers will need to be extremely careful when addressing rising healthcare costs with their employees. One strategy for cutting costs is adopting an alternative health plan funding model.

Some popular funding alternatives are:

LEVEL FUNDING

An increasingly popular option for smaller employers with less than 100 employees that have not had access to self-funding options due to employer size and financial risk. Level Funding was developed several years ago to combat the ACA mandates required of fully insured plans. With Level Funded plans (sometimes referred to as "partially self-funded" plans), employers pay a set amount each month to a carrier. This amount typically includes the cost of administrative and other fees and the maximum amount of expected claims based on underwriting projections as well as embedded stop-loss insurance.

The carrier will pay employees' claims throughout the year. If payments exceed claims at the end of the year, the employer will receive a refund from the excess paid in monthly claim. If the claims exceeded what was paid into the program, stop-loss insurance will cover the overage amount in most cases. Unlike traditional self-funded plans, if an employer chooses not to renew, there is terminal liability built into the cost structure, therefore the employer is not left with the potential of significant "run-out" claims.

REFERENCE-BASED PRICING (RBP)

Gaining popularity in recent years as a creative way to limit health costs, RBP works by using an established benchmark (i.e., Medicare rates plus a percentage) to set spending limits on certain procedures or services. This means an employee would only be covered up to the established limit for these services and would have to pay the cost difference out of pocket.

However, limits are typically set on "shoppable" services. These are services where an individual can take time to make a thoughtful decision based on price and quality for things such as prescriptions, lab tests or joint replacements.

In all these examples, there are lower-cost options that are typically of the same quality as the more expensive alternatives. Employers who use RBP have the potential for two main benefits: lower total healthcare expenses and higher employee engagement in healthcare decisions.

INDIVIDUAL COVERAGE HEALTH REIMBURSEMENT ARRANGEMENTS (ICHRAs)

Funded solely by employer contributions, an ICHRA is a type of account-based group health plan that reimburses eligible employees for medical care expenses up to a maximum dollar amount for a coverage period. According to a Willis Towers Watson survey, approximately 1 in 6 employers (15%) intend to or are considering offering ICHRAs to at least some employees beginning in 2022 or later.

Additionally, a Small Business Trends survey found that 78% of organizations currently signing up for ICHRAs are small businesses. That makes sense, as small businesses have smaller budgets and, therefore, potentially have more to gain from the many benefits of ICHRAs.

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CONCLUSION

In conclusion, the Risk and Insurance market and the Employee Benefits market remain in flux with a growing number of contributing factors. Each factor plays a role in changing insurance rates and premiums and your overall profitability and financial success.

Sentinel is uniquely positioned to help you weather the current and any approaching market storms. Our team of professionals are dedicated to safeguarding your success in today's changing marketplace and beyond.

INNOVATIVE SOLUTIONS

Risk Management
Sentinel Benefits Consulting
Private Client Services
Surety Practice Group

RESOURCEFUL SERVICES

Sentinel Risk Performance Group
Sentinel Connect
Health and Well-Being
Prepaid Legal Services

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SENTINEL STORM CENTER

Hurricane season officially kicks off June 1st and runs through November 30th. This upcoming 2022 hurricane season is expected to be an above average year, with forecasts predicting 19 named storms – four of which could become major hurricanes.

To help you weather the storms, we have launched our Sentinel Storm Center website that provides essential information on how to effectively prepare and recover from a storm.

Please visit sentinelra.com/storm-center for more information.

SAFEGUARDING YOUR SUCCESS