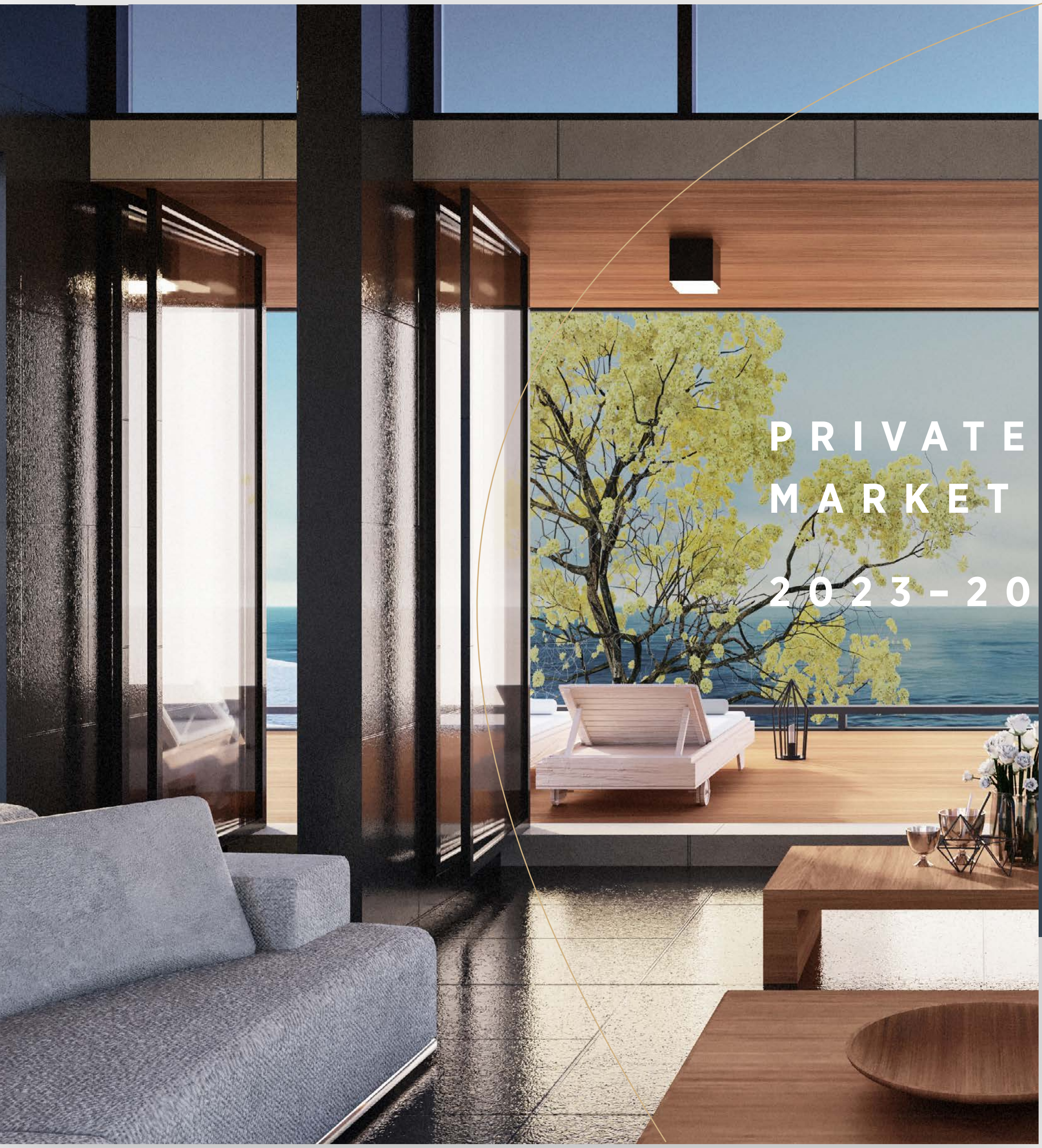


PRIVATE CLIENT MARKET OUTLOOK

2023–2024

Gallagher
PRIVATE CLIENT

AS CHALLENGES MOUNT, **STRATEGIC EXPERTISE REMAINS** OF UTMOST IMPORTANCE.

At its core, Private Client insurance acts as a stronghold for high-net-worth (HNW) individuals and families, restoring their carefully curated lives should the unthinkable become unavoidable. For the past several years, an unprecedented confluence of economic, climate and social issues — not to mention a worldwide pandemic — have resulted in extraordinary challenges for insurance brokers and carriers. This often results in additional stresses for clients if they are not kept abreast of the current state of the market. This report exists to inform those who are served by Gallagher Private Client so they may be properly apprised of the forward-thinking strategies needed to achieve their unique — and often challenging — long-term risk management and insurance goals.

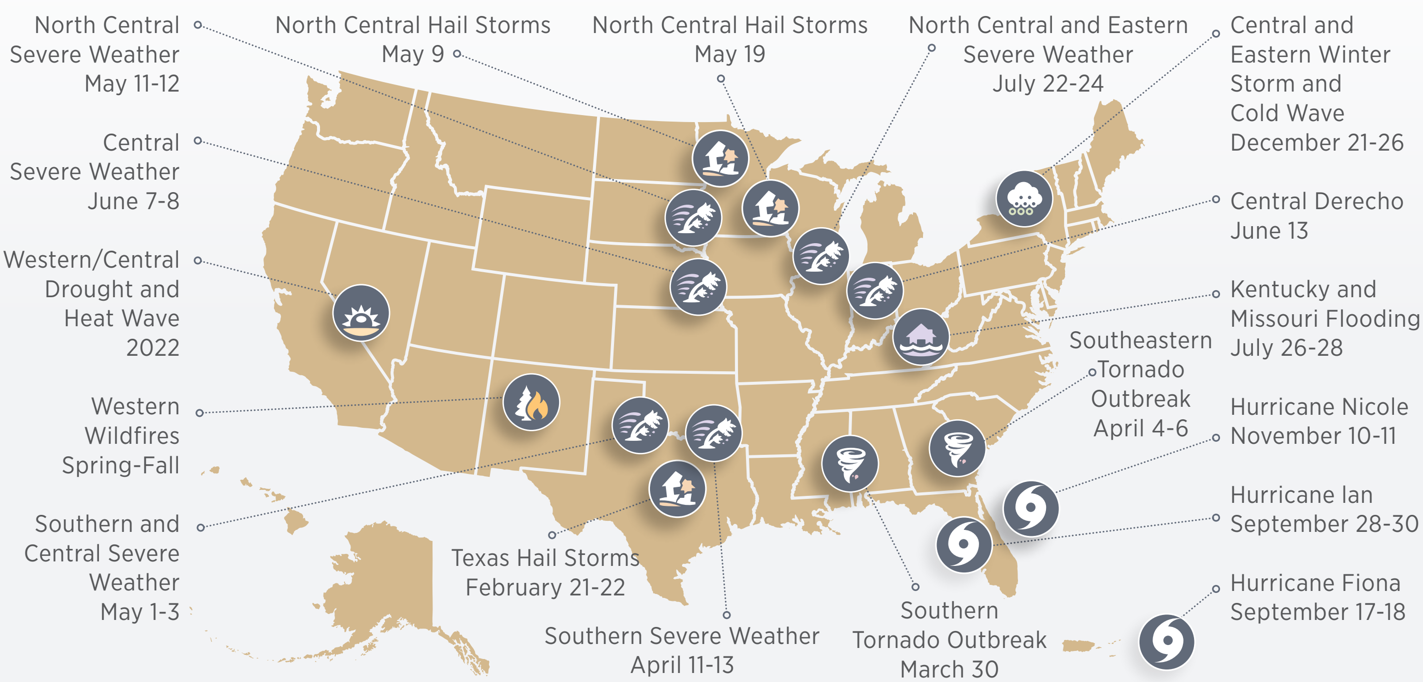
Today's HNW client is increasingly more aware of the need for specific, customized strategies if they wish to adequately protect their properties, assets and even reputations. Underwriting in the Private Client space has long been a niche endeavor, and the enhanced risks facing the current market further limit the desire to service this segment. Savvy clients understand both the increased risks associated with certain decisions — such as owning assets in catastrophe-prone regions — and the vital need for personalized coverage only an experienced, empathetic risk-mitigation team can provide.

THE PRIVATE CLIENT MARKET HAS WITNESSED A SIGNIFICANT CONTRACTION, WITH ONLY A HANDFUL OF MAJOR PLAYERS CURRENTLY OFFERING VIABLE "ADMITTED MARKET" SOLUTIONS.

IMPACT OF WEATHER EVENTS

Not only have catastrophic natural disasters such as hurricanes, wildfires, hailstorms and floods continued to increase in both frequency and severity, they have also spread into regions not historically associated with such high-loss events. In 2022 (see chart below), weather- and climate-related events resulted in a staggering $17 billion in losses, with a disconcertingly high percentage occurring in previously considered "safe" areas. As this trend is not forecasted to abate, all major carriers recognize most of the U.S. must be considered as

U.S. 2022 BILLION-DOLLAR WEATHER AND CLIMATE DISASTERS



This map denotes the approximate location for each of the 18 separate billion-dollar weather and climate disasters that impacted the United States in 2022. Source: NOAA Climate.gov, climate.gov/media/14987

susceptible to natural disasters, regardless of population density. As a result, the Private Client market has witnessed a significant contraction, with only a handful of major players, such as Chubb, AIG, Berkley One, PURE and Cincinnati, currently offering viable "admitted market" solutions. In other words, owning a luxury cabin in the woods is no longer a guarantee of a lower premium — or even the ability to find coverage at all.

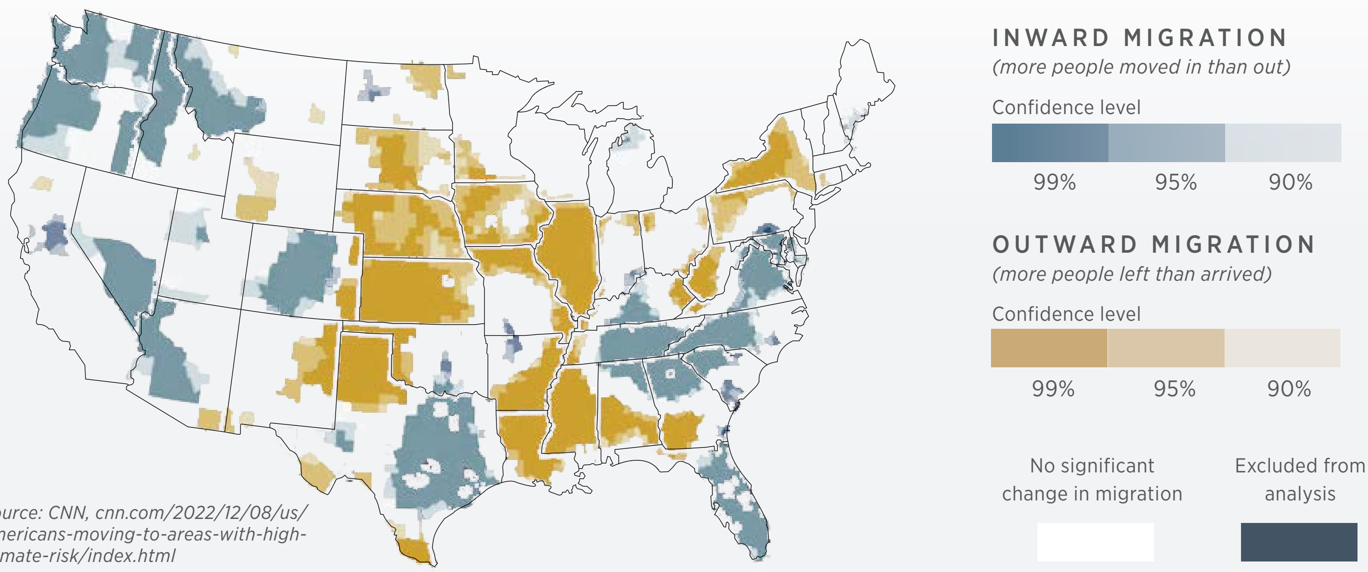
INSURANCE CARRIERS' APPROACH TO CLIMATE CHANGE

A 2018 study published in the *Proceedings of the National Academy of Sciences* reported that 43% of homes constructed from 1990 to 2010 were built near areas at peak risk for wildfires. A separate study recently demonstrated that counties in the U.S. facing the most substantial climate risks — droughts, river floods, hail, etc. — are also experiencing the most rapid growth rates.

Even within individual counties, areas with elevated risk continue to attract a higher influx of residents. The most beautiful landscapes, it would appear, are also bountiful with risk.

This population shift to higher-risk locations has prompted insurers to undertake significant changes in their approaches to managing such uncertainty. Many are declining to offer policies in certain fire-prone regions of California and Colorado, among other states, while some are completely withdrawing their offerings from certain regions. Where coverage options remain, premiums have surged. According to LexisNexis Risk Solutions, Texas saw a 40% increase in home and property rates, while Colorado experienced a 41% rise and Florida encountered a staggering 57% increase. These major increases are more than double the national average increase of 21%, which is itself no small amount.

AMERICANS MOVING INTO HIGH-RISK ZONES FOR WILDFIRES, DROUGHT AND HURRICANES



Source: CNN, cnn.com/2022/12/08/us/americans-moving-to-areas-with-high-climate-risk/index.html

While some insurance companies have taken proactive steps to address climate change and its associated risks, others have been more reactive in their approaches. This could be due to several reasons:

1. **Uncertainty –** Climate change is a complex and long-term phenomenon, making it challenging for insurers to predict its impacts and associated risks accurately. This uncertainty may have led some companies to take a wait-and-see attitude.
2. **Short-term focus –** The pressure on publicly-traded insurance companies to deliver profits to shareholders is no different than with other industries. And, as the market at large often attests, such pressures can lead to a short-term focus rather than long-term planning. Companies that chose this path are now playing catch up, attempting to align their rates with current exposures.
3. **Regulatory environment –** The influence of regulations — or the lack thereof — is strong. In some cases, a dearth of regulatory mandates might have reduced the urgency for certain companies to act more swiftly.
4. **Reinsurance coverage –** Insurers often purchase reinsurance to protect themselves from catastrophic losses. While reinsurance can be a sound strategic option, it may also lead some insurers to rely too heavily on that coverage rather than investing in more proactive measures.
5. **Cost-benefit analysis –** For some insurers, the cost of implementing proactive measures to mitigate climate risks may have been perceived as too high compared to the benefits gained from potential premium adjustments.

THE CURRENT SITUATION OFFERS A STRONG REMINDER OF THE CORE CONCEPT OF INSURANCE: **A COLLECTIVE POOL OF FINANCIAL RESOURCES USED TO ADDRESS RISK.**

THE EFFECTS OF REINSURANCE ON THE PRIVATE CLIENT SPACE

Reinsurance — basically insurance for insurance companies — protects carriers from bearing the full financial burden of a given risk. This scenario can prove beneficial to Private Clients in a number of ways, among them:

1. **Enhanced capacity –** Reinsurance allows insurance companies to take on more policies and extend coverage to Private Clients who reside in higher-risk locations without exposing themselves to excessive risk. This may, in some instances, result in more policy options and higher coverage limits for clients.
2. **Financial stability –** By offloading some risk to reinsurers, insurance companies can maintain financial stability even in the face of significant claims. This reassures Private Clients that their insurance provider will be able to honor policy commitments when needed.
3. **Customized coverage –** Reinsurance enables insurance companies to offer tailored insurance packages to Private Clients, addressing their unique needs and assets. This can include coverage for high-value properties, luxury assets, collectibles and other unique risks.
4. **Claims handling –** Reinsurers often work closely with insurance companies to manage claims and provide expertise in assessing complex or high-value claims. This can result in smoother and more efficient claims processing for Private Clients.
5. **Market stability –** The presence of reinsurance in the insurance industry contributes to overall market stability. By spreading risks across multiple entities, it helps avoid systemic shocks and ensures the availability of insurance products even in times of significant losses.

As the demand for reinsurance has surged in recent years, reinsurers have responded by pricing themselves accordingly. In other words, they've been raising their rates quite rapidly. This higher cost to carriers is, not unexpectedly, passed on to clients. Additionally, as reinsurers have begun to shun certain risks or specific geographical areas, the Private Client market has been left with fewer and fewer viable options. For example, in early 2022, AIG Private Client could not find a reinsurer willing to cover its book until it reduced its risk profile.

Additionally, AIG's announcement of its recent partnership with private equity firm Stone Point Capital illustrates how the Private Client market continues to evolve. Stone Point will be the majority investor in a new independent managing general agency (MGA) named Private Client Select Insurance Group. This new MGA will possess the authority to quote and bind policies and will be how agencies access AIG Private Client coverage going forward.

THE TREND TOWARD EXCESS AND SURPLUS LINES SOLUTIONS

Excess and surplus lines (E&S), aka “non-admitted,” refers to insurance coverage that is not available in the standard insurance market. E&S markets offer more flexibility and customization without adhering to certain state regulations, which in turn allow insurers to offer coverage more tailored to the complex exposures of Private Clients.

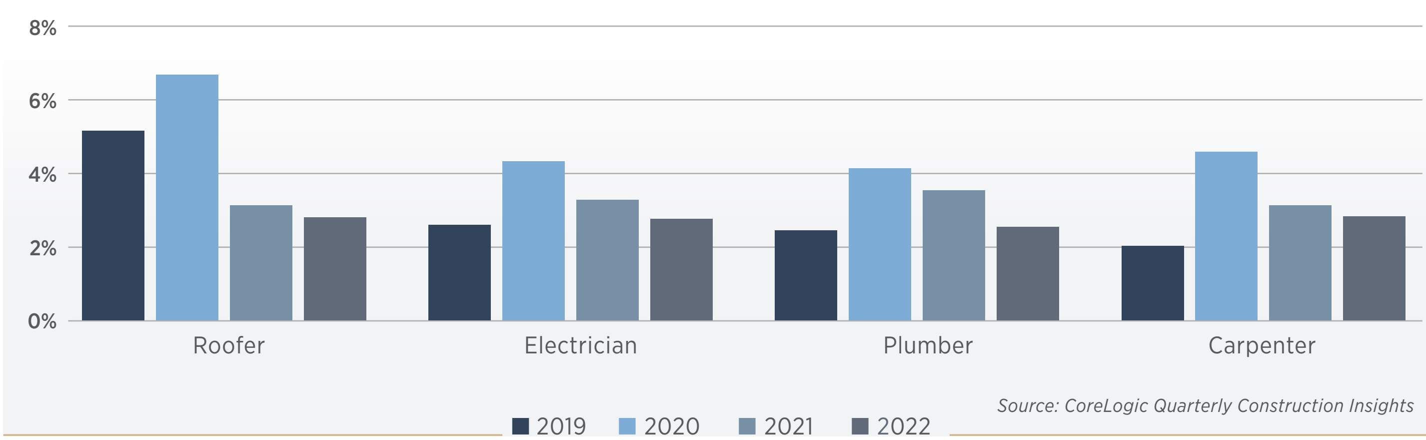
E&S is emerging as a key tactic in enabling clients to obtain coverage for their challenging exposures. After all, as the propensity of HNW individuals to own property in challenging areas grows, so do their unique risks and exposures. Traditional insurance markets have been increasingly unwilling or unable to provide coverage for these specific risks, forcing Private Clients and their insurance advisors to seek alternative options. Where at one point in time, E&S solutions were used in exceptional cases, they are becoming a normal part of business. While this can be a positive in that coverage is provided, such policies typically have higher premiums and significant coverage limitations when compared to traditional insurance.

LABOR COSTS AND TALENT RETENTION

A scarcity of specialty craftsmen has forced construction companies, along with auto dealers and third-party repair shops, to offer higher salaries to attract and retain such workers. In turn, the cost of property claims — be it home or auto — has increased accordingly. But not merely because of pure wage inflation. In general, insurance claims have become increasingly complex, requiring more time and more expertise to adjudicate. This is especially true in the Private Client market, where specialized appraisers, adjusters and experienced craftsmen are often needed to unknot complicated claims.

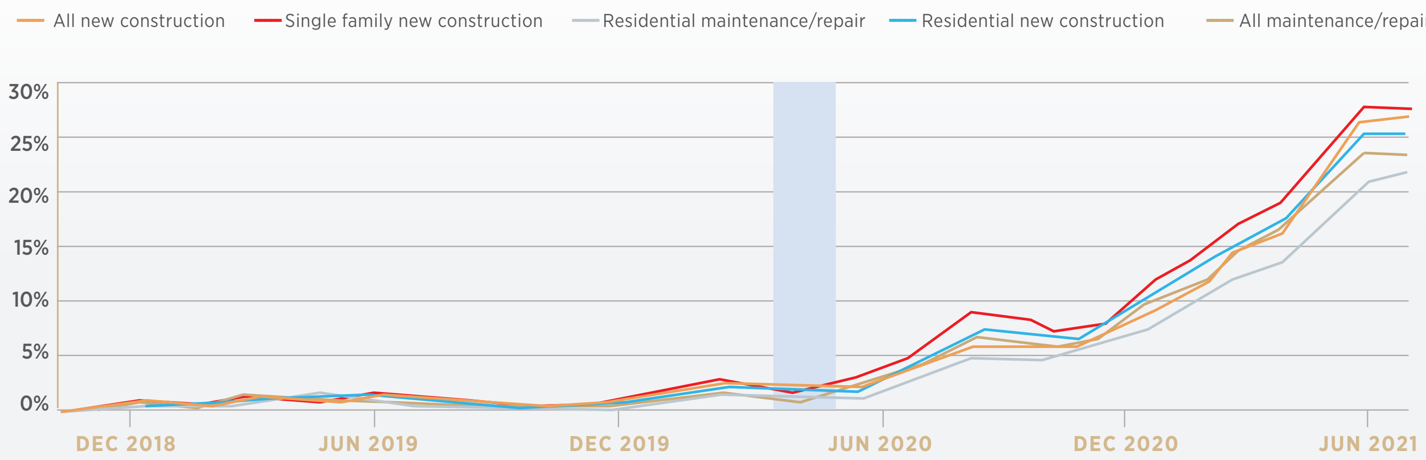
Rising labor costs are not exclusive to those who repair or replace assets either. Like nearly every other industry extant, insurance companies are also facing the pressures of a tight labor market. Nowhere is that more exemplified than in the Private Client space. Private Client insurance specialists must not only possess a keen comprehension of risk assessment and coverage solutions but must also possess the appropriate manner, empathy and hospitality skills required for working with a discerning clientele. Finding, training and retaining such rare individuals will always be a challenge.

LABOR COST CHANGE IN THE U.S. BY OCCUPATION



Source: CoreLogic Quarterly Construction Insights

CHANGE IN PRODUCER PRICES FOR CONSTRUCTION MATERIALS



Shaded area represents a recession as determined by the National Bureau of Economic Research.
Source: U.S. Bureau of Labor Statistics

LIFESTYLE TRENDS

HOME

CONSTRUCTION COSTS AND PROPERTY VALUATIONS

Luxury homes face unique challenges due to the high construction costs associated with their locations, quality of construction and the use of specialized materials. Insurance carriers constantly evolve their evaluation methods, employing the latest technology to assess rebuilding costs in specific locations. They regularly collaborate with high-end home builders to stay informed about market trends and true replacement costs. This proactive approach helps ensure accuracy and provides precise replacement values to prevent underinsurance.

Underinsurance is a legitimate concern as replacement costs continue to shoot upward. For example, the average per-square-foot building cost for a luxury home in Aspen, CO, ranges between $1,500–$2,500. In East Hampton, NY, the average per-square-foot building cost ranges between $1,000–$1,500. Coverage that may have been perfect two years ago would today fall woefully short. And this trend is not limited to certain wealthy enclaves but rather exists in every market in the country.

FLOODING

Flooding is both the most frequent and most costly natural disaster in the U.S., with more than 75% of federally designated disasters related to such events. Increased development, changing storm and precipitation patterns and rising sea levels are just a few reasons why — and it's not limited to high-risk areas. Of particular significance is the fact — one that is supported by insurance carriers' statistics and actuarial data — that homes which have already experienced water damage are likely to face such challenges again.

Those whose properties suffer significant water damage often find themselves displaced from their homes for an average of three months — underscoring the increased pressure on carriers to provide "loss-of-use coverage," which in turn puts pressure on the insured's rates.

NON-FLOOD WATER DAMAGE

Non-weather-related water damage is the single greatest loss driver in HNW homes. If a home has had a water loss, the insurance company will add a surcharge to the premium, which can last up to five years, plus proof of mitigation efforts must be presented. Loss mitigation is so important that some insurance companies will include proactive loss prevention costs as part of the claim settlement. Yes, they basically pay the property owner to install mitigation measures such as water shut-off devices and other mechanisms.

It is likely that insurance carriers will eventually — and sooner rather than later — make such mitigation measures a prerequisite for providing coverage. In doing so, carriers aim to lessen the risks associated with water-related losses and promote greater resilience within the sector.

LIABILITY AND UMBRELLA

The cost of litigation continues to increase at alarming levels as social inflation drives personal liability judgments to staggering heights, with so-called nuclear verdicts — those with judgments of more than $10 million — becoming increasingly common.

Just what is "social inflation?" It is the shift in societal attitudes that led juries to award larger settlements to injured people. National Association of Insurance Commissioners (NAIC) data shows that incurred claim losses outpace those that economic inflation would have predicted. Injured parties are more willing to pursue litigation, and juries are more sympathetic to awarding compensation, as proven by the increases in settlements, judgments and defense costs. Insurers are, at times, more apt to award plaintiffs an "unreasonable" amount relative to their loss — rather than continue to pay legal fees — despite the possibility of a smaller claim payout. The consequence of all of this to the insurance market is rather obvious.

THE MOST COMMON TYPES OF WATER LOSSES ARE:

- **Leaking or burst pipes –** typically at the joints
- **Appliance malfunction –** typically, the attached hoses
- Toilet overflow
- Clogged gutters or ice dams
- Roof leaks

A TYPICAL HOUSEHOLD LEAK CAN EQUATE TO 270 LOADS OF LAUNDRY, 600 SHOWERS OR 1,200 LOADS OF DISHES IN THE DISHWASHER!

WATER DAMAGE IN U.S. HOUSEHOLDS

#1 Cause of home damage

1 out of 50 homes has water damage

$55k average damage cost

14k new incidents daily

Losses of over $500k have doubled in recent years

$20 billion in annual losses

Sources: Chubb, chubb.com/us-en/individuals-families/agent-marketing/water-coverage.html
IPropertyManagement, ipropertymanagement.com/research/water-damage-statistics

Other trends affecting the liability insurance market:

- **Increasing attorney advertising and involvement –** Increased attorney advertising drives more people to file suit more frequently while promising ever-larger settlements.
- **Legislative actions expanding liability –** In many states, legislatures push plaintiff-friendly legislation. For example, some have extended statutes of limitation and retroactively applied the new time limit to expired claims.
- **Lack of tort reform –** Supreme Courts have overturned caps on non-economic damages (pain and suffering) in several states, quashing efforts to enhance predictability, stability and lawsuit affordability.

AUTOMOBILE

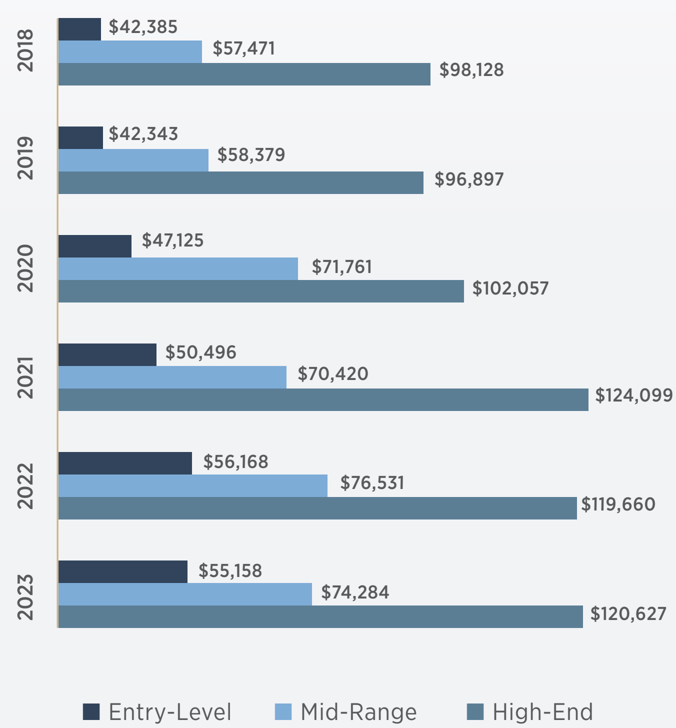
The auto insurance sector has never been a hotbed of innovation, but that is starting to change. Usage-based insurance — with metrics that measure speed, acceleration and harsh braking, along with mileage and the time of day you drive — enables carriers to establish premiums based on exposure to actual risk. While the trend of auto refunds and credits during the pandemic established a consumer mindset of connecting actual driving habits to premiums paid.

The average price of a new car has increased over 17% since 2020, with post-pandemic supply chain issues mostly to blame. Additionally, the advanced technologies and sophisticated features in modern vehicles have led to a notable rise in auto repair costs. Where your grandfather could conceivably repair or replace 98% of the family station wagon, you wouldn't dream of going anywhere near your SUV's infotainment setup, myriad sensors, cameras or 48-volt hybrid drive system. While these advancements contribute to improved safety, performance and comfort for drivers, they also increase the need for specialized repair equipment and training. Repair shops now require advanced — and expensive — diagnostic tools and software. Additionally, mechanics need specialized training to understand new technologies, and their expertise commands higher wages.

To add insult to injury, as demand for auto repairs grows, repair shops may struggle to meet the workload, potentially leading to delays and inconvenience for car owners.

AVERAGE COST OF A NEW LUXURY SEDAN, 2018-2023

Data does not include applied consumer incentives. Data from 2018 to 2022 are all from December of each year. 2023 data is based from March.



Source: Kelley Blue Book

COLLECTIONS

FINE ART

Fine art collections have been characterized by a mix of trends over the past few years. The market has shown resilience despite the challenges posed by the pandemic. Technology is providing collectors with new ways to engage with the art world — online art sales are on the rise, and virtual art fairs have gained popularity. In terms of specific art movements, contemporary art remains highly sought after, with works by blue-chip artists achieving significant prices at auctions and private sales. Additionally, interest in digital art and NFTs (non-fungible tokens) has surged, creating a new dimension in the art market.

WINE

In the wine market, rare and collectible labels continue to be sought after by Private Clients and collectors. Bordeauxes, Burgundies and certain vintage champagnes have been particularly popular of late. As an investment instrument, fine wine has acquitted itself well, delivering rates of return averaging 13% in 2022 (vinx.com).

JEWELRY

In the jewelry segment, demand for diamonds from emerging markets, particularly in Asia, has piqued the interest of both collectors and clients. The popularity of lab-grown diamonds as a more sustainable and affordable alternative to natural diamonds has also influenced the market. Private Clients should be mindful to regularly obtain updated appraisals instead of relying on the inflation-based increases in value that many carriers automatically apply each year.

Rolex and Patek Philippe are renowned luxury watch brands highly sought after by collectors and enthusiasts worldwide. Historically, the demand for these brands has consistently outpaced supply, leading to waiting lists and limited availability, even for authorized dealers. While values have leveled off this year, the watch market, in general, continues to experience a surge in interest and value appreciation in comparison to previous years. Certain rare and vintage models of various makes now command premium prices whether they trade hands — or, more accurately, wrists — at auction or via private sale. The collectible luxury watch segment is expected to grow by 75% by 2030, fueled by Millennials and Gen Z (Deloitte).

PRIVATE CLIENTS SHOULD BE MINDFUL TO REGULARLY OBTAIN UPDATED APPRAISALS INSTEAD OF RELYING ON THE INFLATION-BASED INCREASES IN VALUE THAT MANY CARRIERS AUTOMATICALLY APPLY EACH YEAR.

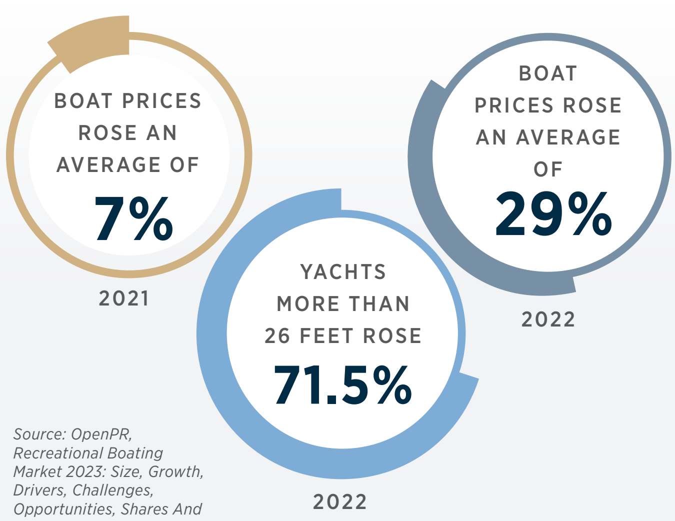
PRIVATE AVIATION

An increase in aviation-related accidents and other losses in the industry as a whole has led to increased premiums across the board, including within private aviation. Capacity constraints fueled by geopolitical and other concerns only exacerbated the issue, with many insurers limiting the availability of coverage for certain risks.

A bright spot exists, however. As technology invariably marches forward, aircraft of all types should become safer and safer. To that end, insurance companies actively encourage private aviators to invest in and upgrade safety-related technology as warranted with an eye to reducing both incidents and, in turn, premium increases.

WATERCRAFT

During the pandemic, people turned to outdoor activities to occupy their time, including watercraft use. This led to an increase in boat sales, and as demand increased and supply decreased, boat prices rose an average of 7% in 2021 and 29% in 2022. For yachts more than 26 feet, prices increased even higher — as much as 71.5%.



Source: OpenPR, Recreational Boating Market 2023: Size, Growth, Drivers, Challenges, Opportunities, Shares And Forecast Analysis By 2032

Additionally, the mega yacht market saw increased interest from Private Clients and charter companies, with atypical growth from emerging markets such as Asia. This resulted in an expanded need for tailored insurance solutions. As these vessels are often highly personalized and always highly valuable, insurance providers strove to offer comprehensive coverage that addressed the specific needs and risks associated with each yacht. Needless to say, the increase in vessel values, unique natures of said vessels and an associated increase in hull losses and crew liability issues drove up premiums in dramatic fashion. A lack of reinsurance capacity has also played a part — especially in the mega yacht sector — causing the market to constrict with fewer specialists willing to offer terms on large yachts, especially those with risky itineraries.

As with aviation, insurance companies encourage yacht owners to embrace advanced safety protocols and state-of-the-art technology and to hire experienced crew members. Such risk reduction efforts are so vital that some carriers will not offer terms unless these loss mitigation strategies are implemented.

CYBER AND FRAUD

It should come as no surprise that the cyber insurance market is by far the most rapidly evolving sector within the industry. As cyber threats and data breaches have become more prevalent and costly, so, too, has the recognition that cyber insurance is more of a necessity than a nice-to-have — even for individuals. As both demand for policies and the losses associated with events grow, premiums for cyber insurance do so, as well. HNW clients and family office risk managers should expect to experience both rate increases and stricter underwriting for the foreseeable future.

Recent experience illustrates the growing need for cyber coverage:

- More than 25% of affluent families and 20% of family offices experienced a cyberattack over the past two years.
- HNW individuals are 43% more likely to be victims of identity theft.
- In the first quarter of 2022, attacks increased by 32% versus the same period in 2021.

Many carriers now require cyber policy holders to prove their "computer hygiene" by allowing professional security scans of home networks along with proof of multifactor authentication, payment processing safeguards and more. Many cyber insurance providers offer risk assessment and prevention services to help their clients identify vulnerabilities and improve their cybersecurity posture. These services can include cybersecurity training, vulnerability assessments and incident response planning.

AS CYBER THREATS AND DATA BREACHES HAVE BECOME MORE PREVALENT AND COSTLY, SO, TOO, HAS THE RECOGNITION THAT CYBER INSURANCE IS MORE OF A NECESSITY THAN A NICE-TO-HAVE.

Ultra-high-net-worth families should consider using the services of a dedicated cybersecurity firm to monitor devices, networks and activity. In this case, a pound of prevention is worth a ton of gold of cure.

TRAVEL

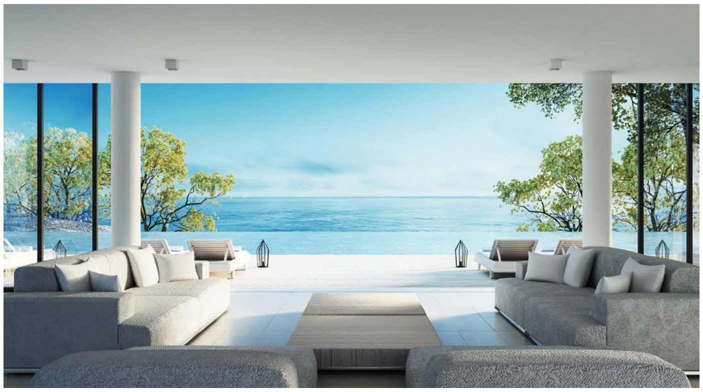
The luxury travel market continues to experience a stunning post-pandemic rebound — apparently, "revenge travel" (wanting to reclaim experiences that were, to a certain degree, stolen from people) is a real phenomenon. While some travelers turned to private jet travel and exclusive villa rentals during the pandemic to maintain a sense of safety and privacy while still enjoying luxurious experiences, many put their voyaging on hold. Now, however, the luxury travel so many love — the premium services and experiences, lavish accommodations, personalized itineraries, exclusive tours and high-end amenities — have returned in full force.

With the resumption of international travel, the importance of travel insurance has become more evident, especially for overseas excursions. Policies typically cover numerous incidents that may occur leading up to or during travel, such as trip cancellations, medical emergencies, repatriation expenses, lost luggage and travel delays. Given the complexity and investment associated with luxury travel, HNW clients would be wise to consider including such coverage in their risk portfolios.

MITIGATING RISKS AND MAXIMIZING VALUE AMID RISING COSTS

CONSIDER HIGHER DEDUCTIBLES

The higher the deductible, the lower the premium. What was true of your first ride still applies to your latest collectible supercar — and everything else you insure. Additionally, higher deductibles dissuade you from filing smaller claims, which can hurt your future insurability and drive up your premiums.



TAKE ADVANTAGE OF CREDITS

You may be familiar with a few of the more basic credits that carriers offer, but many lesser-known credits exist that may serve to further lower your premium. For example, do you have an alarm with cell signal backup? Does your home have wind mitigation features? Has your home been renovated in the last 10 years? Is your property fully fenced or in a guarded, gated neighborhood? All of these items may qualify you for premium reduction credits.

RISK MITIGATION IN YOUR HOME

With claim severity and frequency on the rise, carriers are upping the ante and incentivizing homeowners with enhanced credits to incorporate risk management features into their homes. Most beneficial are water-leak detection systems with automatic shut-off capabilities, whole-house generators, brush and fire hazard removal, interior sprinkler systems and automatic earthquake shut-off valves.

HOLISTIC STRATEGIES

Even if you have limited options for reducing the cost of your homeowners policy — or you've already taken advantage of all practicable measures — there may yet be ways to bring down your overall cost of insurance, often by adjusting limits or coverages on supplemental policies. Can you drop glass breakage coverage on your auto policy? Can you have your jewelry reappraised to earn a collection policy appraisal credit? Such options are usually not obvious, yet they are hiding in plain sight. Your Gallagher Private Client Team will be more than ready to provide considered advice for your particular situation.

AVOID CANCELLATION AND MITIGATE RATE INCREASES

Carriers are making efforts to reduce their risk footprint in more catastrophe-prone areas. This is a polite way of saying they would rather cancel certain policies if they could. In this regard, issuing cancellations for late payment or nonpayment or for frequent claim activity is far from uncommon. Make sure to pay premiums on time and avoid filing claims if you can easily absorb the cost yourself. If you are dropped by your current carrier, the next best option might be significantly harder to come by and will almost certainly be more expensive.

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