COMPETITIVENESS CONTINUES AS MARKET PLAYERS ADJUST

Weakened Global Economy Prompts Cost Pressures for Buyers

Today’s competitive insurance market still gives a clear edge to the buyer; however, this may be impacted in the future by robust changes with some major market players.

PROPERTY & CASUALTY

Property Market Features Underwriter Flexibility; Casualty Market Sees Stable Rates

Large-Account Property: Alternative Capital Affects Overall Rates

“Rate reductions are in the range of 10 to 20 percent, and alternative capital continues to affect overall insurance and reinsurance rates,” said Lockton Property Leader Mike Andler. “Property underwriters are trying to be as flexible as possible to maintain capacity on programs.”

Middle-Market Property: Decreases Continue

According to Jay Little, with Lockton in Kansas City, middle-market property is not experiencing cuts as deep as those in large property.

“While the decreases are not as significant as what we saw last year, we are still seeing 5 to 7 percent reductions across the board,” said Little.
Casualty: Ample Capacity and Aggressive Goals Keep Rates Stable

In general, casualty rates are decreasing, driven by ample capacity and aggressive new business goals.

Meanwhile, the weakening global economy has led to an increased level of cost sensitivity. As a result, Vince Gaffigan, with Lockton in St. Louis, said clients are looking for new strategies and showing an increased willingness to change structures or carriers if it means a potential decrease in premiums or costs.

“In competitive situations, incumbents continue to do whatever is necessary to hold business, including lowering retentions (at rates close to expiring) and showing increased flexibility around collateral negotiations,” noted Gaffigan. “While industry sector, quality of the risk, loss history, and starting point still matter, most lines are continuing to decrease by 5 to 7 percent,” said Gaffigan. “Workers’ compensation rates are generally flat to down 5 percent.”

In large-fleet risks and the transportation sector, carriers are responding to adverse loss performance and profitability, and capacity is constricting to the point where programs will likely look different at renewal versus the previous year. This would appear as potentially higher attachments or how the excess casualty program is designed.

“While some key primary and excess carriers have recently left the market, the long-term impact on the marketplace remains to be seen,” said Matt Payne, with Lockton’s Transportation team in Kansas City. “The sky is not falling. We are monitoring the developments and continue to deliver client solutions in this highly dynamic marketplace.”
Primary Casualty: Rate Decreases Continue

According to Mark Moitoso, Lockton’s Analytics Practice Leader, there continues to be ample capacity for most casualty products, and collateral remains a highly competitive strategy used to keep business. Lisa Wall of Lockton’s Risk Finance Practice agreed.

“We continue to find markets that are popping up to take over capacity where others are perhaps closing their doors to some lines,” she said. “Legacy collateral continues to be a competitive advantage for most incumbent markets.”

Perhaps the most talked-about news in the industry is the recent merger of ACE and Chubb and the reorganization and reunderwriting at AIG and Zurich.

“We perceive a bit of uncertainty on the front lines of these carriers. Lots of changes in management, appetite, and strategy.” Gaffigan said.

### RATE CHANGES BY COVERAGE LINE (2014 Q4 TO 2015 Q4)

- **Commercial Auto**
  - 2014 Q4: 3.0%
  - 2015 Q1: 0.7%
  - 2015 Q2: 1.5%
  - 2015 Q3: 0.5%
  - 2015 Q4: 1.3%
- **Workers’ Compensation**
  - 2014 Q4: -3.0%
  - 2015 Q1: -2.5%
  - 2015 Q2: -2.7%
  - 2015 Q3: -3.0%
  - 2015 Q4: -3.0%
- **General Liability**
  - 2014 Q4: -4%
  - 2015 Q1: -3%
  - 2015 Q2: -2%
  - 2015 Q3: -1%
  - 2015 Q4: 0%
- **Umbrella**
  - 2014 Q4: 2%
  - 2015 Q1: 1%
  - 2015 Q2: 2%
  - 2015 Q3: 3%
  - 2015 Q4: 4%

Sources: The Council of Insurance Agents & Brokers and Barclays Research
Excess Casualty: Attachment Points Seeing Shifts in Both Directions

As with primary casualty, much depends on the client’s industry, loss history, and current premium levels.

“For layered programs, position in the ‘tower’ also matters, as some carriers are moving away from offering capacity at high-excess attachment points where they perceive rates to be inadequate,” said Debbie Goldstine, Lockton’s Excess Casualty Practice Leader. “In those instances, the marketplace remains plentiful, with competitively priced alternative capacity. Outside of those situations, and select re-underwriting of lead umbrella, we continue to see relatively stable carrier renewal retention in both the lead and excess positions.”

Rates are generally down 5 to 7 percent, although the rate of decrease from the prior year has slowed. The exception being high-excess layers, which on many programs have been at minimum premium levels during the past year and are, therefore, not realizing material premium savings at renewal.

“Similar rate decreases are occurring in Bermuda,” said Josh Dircks, with Lockton in Bermuda. “The accounts we have here are quite diverse, but that number seems to track well.”

According to Jonathan Stokes from Lockton’s London office, the trends in Europe are similar to what we see in the US, with rate reductions across the book.

“However, a recent shift of market appetites, in particular in the transportation space, could reverse this trend in the coming months,” said Stokes. “From a market perspective, Lloyd’s is seeing a reemergence as a market for North American casualty business, writing across a broad appetite and attachment.”
Market Attracts Carriers Looking to Stand Apart

According to Simone Hanraads, International Practice Leader in the Pacific US, many new carriers want a role in the foreign casualty market. Generali, specifically, is a significant newcomer to the market. As such, the main players find themselves forced to price aggressively.

“The key players recognize the need to distinguish themselves by touting their robust overseas service platform,” Hanraads explained. “They are willing to be creative and broaden terms and conditions, which translates to more dovetailed solutions. As an example, carriers are offering localized umbrella in Canada and other overseas territories, which will help clients comply with contractual requirements they often need to meet in specific jurisdictions.”

Innovating Coverage

In general, on primary directors and officers placements, rates range between flat and down by 5 percent, with more significant competition in the excess layers, resulting in greater savings the more limits that are purchased.

Chris McBee, with Lockton in Dallas, also noted significant new capacity in the marketplace.

“Terms and conditions are improving across the board in directors and officers insurance,” McBee said. “We’re also observing some innovations, such as social engineering coverage, as it relates to crime coverage, and wage and hour coverage, as it relates to employment practices liability.”

Welcoming New Entrants

While there have been some large surety losses in the market, the overall industry is profitable, keeping the market quite competitive.

“Commercial surety has seen softness for the past year and a half,” said Lockton Surety Team Leader Patrick Pribyl in Kansas City. “We've also seen approximately 10 new entrants into the surety space, so we expect it to continue to be soft for the foreseeable future.”

“The only variable is the ACE-Chubb merger and how those changes will play out,” noted Evan Sizemore, with Lockton in Kansas City. “But, it is not expected to cause too much disruption.”
HEALTHCARE

Organizations Changing Under Strain

While there are some indications that medical professional liability/general liability results may be worsening as evidenced by a handful of recent carrier result announcements, there continues to be more supply than demand in this space. This imbalance is driving a continued soft market for buyers.

Network security and data privacy continue to be a growing concern for healthcare organizations. Given the significant healthcare breaches in 2015, the cyber market has hardened a bit, with additional underwriting scrutiny of security measures and response plans.

“Clients who are only now adding stand-alone cyber coverage, or adding new limits, are seeing higher premiums than those organizations that have had longer standing programs,” said Michael Egan, with Lockton in Minneapolis.

Regulatory actions within the healthcare space are also a growing concern, with potential increased Department of Justice focus and continued whistle-blower actions. Healthcare organizations are working to improve internal compliance programs and are increasingly looking at regulatory insurance programs.

The move away from fee-for-service is gaining momentum. Healthcare organizations, including senior living and physician groups, are increasingly looking at risk-sharing arrangements.

The move away from fee-for-service is gaining momentum. Healthcare organizations, including senior living and physician groups, are considering risk-sharing arrangements, where provider stop-loss programs can mitigate downside risk.

At the same time, access to cost and quality data is becoming increasingly critical for healthcare organizations.
“The collective impact of all of these factors, and more, has put a tremendous strain on healthcare organizations,” said Kevin Junod, Lockton Healthcare Practice Leader in the Northeast US. “We see headlines each week about hospitals closing. Continued profitability headwinds will ultimately cause credit problems, and that may not bode well for organizations that retain a lot of risk on their balance sheet.”

Senior living also is becoming more challenging, despite the addition of a few new market entrants. According to Liz Spink, with Lockton in St. Louis, rates are increasing at least 5 to 7 percent, and even more where there are losses and/or facilities located in challenging venues.

“Punitive damage cover for this senior-living exposure remains difficult to negotiate but is critical, as there have been significant recent awards,” Spink said.

On a positive note, rates continue to decline by more than 5 percent in both primary and excess hospital professional liability and premises pollution liability, with coverage enhancements readily available. Spink noted ample capacity in the market for both. She also commented on the significant merger and acquisition (M&A) activity in healthcare.

“Behavioral health has been an active target, likely due to new funding under the Affordable Care Act,” Spink said. “This influx of PE funding is creating greater need for creative, competitive tail offering (or definition), and the market is responding.”
Market Hardening for High Risk Businesses

Network security and privacy liability (cyber) exposure is still a relatively new area of risk for many companies. The same can be said for the insurance products designed to cover those risks.

“As with any new insurance product, the market can be volatile,” said Michael Born, with Lockton in Kansas City. “Initial offerings are based on actuarial data from related products, such as errors and omissions insurance, that is not always applicable. This data is often supplemented with predictions, conjecture, and just plain guesswork.”

Despite the uncertainty, many carriers originally viewed cyber insurance as a chance for organic growth in a soft market, and this opportunity resulted in a flood of products and capacity. At last count, more than 40 insurance companies were offering some type of cyber insurance, with still more providing excess capacity only. While the occasional $500 million limit placement exists, our experience indicates that $300 million would be a better estimate of the capacity available on any given account.

According to a recent ITProPortal article, global premiums are estimated to have reached US$2.4 billion in 2014, up from US$1.3 billion in 2013, and some Lloyd’s insurers estimate that the mushrooming global cyber insurance market will be worth US$85 billion.

“Predictably, these premium increases are being applied first to those industries that have been the primary targets of cyber attacks, including retail, healthcare, hospitality, governmental, and financial services,” Born said.

For these high-risk exposures, we have seen an increase in pricing as high as 100 percent or more, along with rising deductibles/retentions, reduction of capacity, and a heightened level of underwriting scrutiny that often requires underwriting calls with the insured’s information security team. Many underwriters have invested in their own IT security experts to assist in the evaluation of applicants’ security systems and protocols.

These market adjustments may be part of the predictable cycle of a new insurance product. However, Born said that is little comfort to companies facing difficult placements and renewals.

“While we have little control over the insurance market reactions, we can achieve the best results by starting the marketing and renewal process early and being prepared to supply more detailed information on this exposure,” Born said, adding that it’s also important to be prepared to seek alternative quotes even on accounts with no claims and a history with the incumbent carrier.
Low Price of Oil and Natural Gas Drives Down Activity, Lowers Energy Market Premiums

“The energy insurance supply-and-demand balance has been fundamentally altered the past 18 to 24 months,” explained Mark Mullervy, with Lockton in Houston. “As the global energy market has hit a trough not seen in decades, activity across the sector has plummeted. Energy firms are ruthlessly cutting CAPEX, resulting in less drilling, less construction, lower volumes and, consequently, far less demand for risk transfer.”

“In spite of this demand change, the supply dynamic has remained constant. After a decade of steady growth across their energy portfolios, some insurers have been reluctant to cut the capacity committed to the sector. Indeed, there are numerous examples of insurers increasing maximum line sizes and continuing to put more capital to work in the energy space. The positive knock-on effect for buyers has been a pricing environment for insurance that is the softest in decades.”

Some of the key indicators directly impacting the energy insurance market include:

- US rig count dropped for the seventh week in a row to its lowest level since early 2010. Baker Hughes (a large energy service company tracking rig activity) has reported rig count is down to 467.
- Price of oil is currently hovering around $30 to $31 per barrel (West Texas Intermediate) and $34 per barrel (Brent). This is a drastic difference from oil per barrel being $110 in 2011.²
- Oil and gas companies around the world have laid off more than 250,000 employees in order to manage cost. Oil field service companies represent 75 to 80 percent of the layoffs, but we are now even seeing layoffs in other areas, such as midstream companies.


Energy insurers continue to search for ways to adjust to the reduction in premium volume entering the insurance market. “We predict that the premium volume will be down 40 to 50 percent this year,” said Bobby Bierley, with Lockton in Houston.

Whereas some insurers see the current environment as an opportunity to take market share, others have chosen to exit or limit certain classes of business.

“It is very rare that the industry has dealt with so many stressors at the same time, such as record-level capital surplus, decreased purchasing appetites, and increased broker consolidation,” noted Bierley. “This is coupled with the reintroduction of ‘energizers’ taking the pen away from underwriters. We likely won’t know the winners until at least 2017.”
Upstream (Exploring for Oil/Gas)

With drilling activity being down due to low oil prices, premium volume is also down.

“This is due to a significant push in cost management in the oil and gas industry and ample capacity to create competition,” said Bierley. “Most programs are renewing with rate decreases.”

Downstream (Transporting Oil/Gas)

Downstream is one area that has remained relatively positive because profit margins are intact in sectors such as refining. This does not mean the downstream sector is seeing rate pressure from insurers.

“A lot of this has to do with a lack of material losses impacting this sector for several renewal cycles,” explained Bierley. “The result has been double-digit rate decreases, with the size of the decrease depending on an insured’s specific underwriting results.”

Liability

Energy liability insurance has seen a drop in exposure bases from most insureds. However, depending on the sector seeking insurance, the market has continued to be limited from a competition standpoint. Bierley commented that this has resulted in primary insurers and lead excess liability insurers continuing to hold on to some level of normalcy. While reductions are achievable, they have been more limited on average. Larger reductions can be achieved in the excess liability tower, compared to the primary and lead layers, depending on the limits purchased.

Marine

The offshore hull and machinery insurance market continues to be competitive. Most renewal discussions revolve around layup credits and how they can be applied to manage a lack of vessel activity. In addition to offshore hull and machinery insurance, Bierley said marine liability also continues to be competitive.

“The 13 International Group P&I Clubs renewed entries up 1.9 percent on average prior to individual member underwriting factors,” he said. “The one major loss impacting all marine classes of business was the Tianjin Port explosion, which is now estimated at $5B to $6B with 50 percent of it being marine-related.”
New Perspectives Likely to Change Appetites

The state of the market for environmental insurance products remains fluid and highly competitive. Lockton has seen pricing expectations for renewals generally flat to down 5 percent from expiring. There are currently more than 20 insurers offering this coverage in the marketplace, and with AIG, one of the largest insurers, exiting the pollution legal liability (PLL) space, new entries could emerge.

“There continues to be a surplus of capacity in the marketplace, and it is still a buyer’s market for the majority of our clients,” explained Matt Pateidl, with Lockton’s Environmental team in Kansas City. “Carriers are more cautious about challenging classes of risk and have raised retentions and/or lowered their policy limits to control their maximum risk of loss.”

“Coverage continues to evolve, and carriers are developing industry-specific forms to address the unique exposures common among certain classes of business,” said Katrina Hagen, with Lockton’s Environmental team in Denver. “Among these forms are those specific to real estate, food and beverage, the energy sector, healthcare, education, and construction with site, contractor, and combined casualty exposures.”

“In the UK, the environmental market remains soft and profitable with more capacity set to enter the market,” said James Pryke, from Lockton’s Environmental team in London. “The length of policy continues to reduce, and five years is usually the max PLL. The Lloyd’s market remains hungry for new risks and is keen to assist US clients.”

Given the carrier’s current watchful approach, the broker relationship with the carrier matters a great deal. Lockton remains a preferred broker with carriers offering environmental liability coverage.
Residential Is the Most Challenging

Residential remains the most challenging side of construction. In the absence of capacity, many owners, developers, and contractors are opting to move to owner-controlled insurance programs or contractor-controlled insurance programs.

“We’re seeing a lot of activity on the wrap side but not a lot of activity in the traditional annual renewable. The lack of capacity is causing most to stay where they are with their program or shift over to the wrap side,” said Mike Roark, with Lockton in Denver.

Commercial construction tells a different story. Many national carriers are very interested in writing commercial construction business, so we’re starting to see 5 to 7 percent overall decreases in casualty. On the property side, some large fires across the country during the past 12 months stabilized some of the pricing.

“A couple of renegade builder’s risk programs were pushing the rate, but most of the builder’s risk carriers are pretty stable and flat right now,” said Roark.

Many of the workers’ compensation markets in the construction space had become quite healthy, according to Roark, resulting in downward trending in those areas.

Market Conditions Continue to Soften

According to Peter Romano, with Lockton in Denver, many of the market conditions that existed in fall 2015 remain unchanged. Property rates continue to soften across all industry segments, including multifamily, especially accounts with good loss experience or substantial retentions. General liability rates for some clients and markets remain under pressure because of adverse historical loss development.

REFERENCES:

1http://www.itproportal.com/2015/02/07/heres-cyber-insurance-industry-worth-55-6-billion/
2West Texas Intermediate and Brent are common benchmarks for oil pricing.
US PROPERTY & CASUALTY INDUSTRY AT A GLANCE

UNDERWRITING PERFORMANCE:

The profit of $7.1B in Q3 2015 rebounded from a $0.67B loss in Q2 2015.

NET WRITTEN PREMIUM GROWTH:
MODEST YEAR-TO-YEAR CHANGE IN NWP (2005–2015)

Net premium remained at 4.1% in Q3 2015, the same growth rate as in Q3 2014.

All charts include mortgage and financial guaranty insurers.
US PROPERTY & CASUALTY INDUSTRY AT A GLANCE


The industry combined ratio, a measure of underwriting profit, was 96.9% in Q3 2015, an improvement over 97.7% in Q3 2014.

Source: Insurance Information Institute


Low interest rates continue to challenge insurers, with total investment gains rising 1.0% to $43.7 billion in Q3 2015, up from $43.3 billion in Q3 2014.

Investment gains consist primarily of interest, stock dividends, and realized capital gains and losses.
Sources: ISO, Insurance Information Institute

All charts include mortgage and financial guaranty insurers.