The US property and casualty insurance market is continuing to soften in many areas with ample capacity and favorable rates, especially in property. Experts from Lockton® do not expect this trend to change, barring a catastrophic event.

“It would take an event of extreme magnitude to change the current trajectory,” said Vince Gaffigan with Lockton in St. Louis.

Mike Andler, Lockton’s Property Leader, agrees that it would likely take a very large unforeseen event to reverse present market dynamics and deplete the surplus growth the market has experienced for the past few years.

“We have already had annual periods where multiple events have come close,” said Andler. “And even that did not affect the market greatly.”

He also noted the alternate forms of reinsurance capital are having an influence on retail capacity, driving a buyer’s market.

“The collateralized reinsurance capital market is prompting traditional reinsurers to become more competitive to maintain market share,” explained Andler. “As a result, property reinsurance pricing is also extremely soft, which has created more—and more competitive—capacity in the retail space.”

Conditions remain the same in the middle market area, as well, where carriers are competing to write business. According to Jim Collins, with Lockton in Kansas City, incumbent carriers remain at a disadvantage because “If a profitable program gets out in the marketplace, whether it’s property or casualty, it’s going to get discounted.”

“Carriers are still exhibiting some restraint on auto, but everywhere else—especially for a well-performing risk—the market is driving prices down,” agreed Steve Kubicki, Lockton Kansas City.
Markets “Creep” and Offer More Flexible Terms and Conditions in Casualty

The abundance of capacity has prompted what some call “E&S creep.” Excess and surplus (E&S) lines have historically been accessible only through wholesalers. But in the past few years, many have entered the retail-access space, thereby creating more competition for standard-lines markets.

“We’ve also seen this dynamic in the other direction, with standard-lines markets willing to look at risks that traditionally fall in the E&S sector,” explained Debbie Goldstine, Excess Casualty Practice Leader for Lockton. She also noted an increased emphasis on form innovation service standards as carriers look for ways to differentiate themselves other than price.

“This is all consistent with what you expect to see in a softer market,” she said. “There is definite interest among insurers on considerations outside of premium, such as flexibility in terms and conditions.”

Whether it be alternative capital sources or the continued transformation of E&S and traditional market distribution strategies, the sourcing of capital is evolving and going to have a continued impact on the overall market.
Workers’ Compensation Follows the Competitive Trend

While the long-term outlook remains challenged for workers’ compensation, we are starting to see some competition on that line of coverage.

“We’re noticing more flexibility around collateral and, more importantly, the instruments of collateral,” explained Gaffigan. “We are also seeing carriers more willing to negotiate on charges related to PPO access and medical bill repricing, things that before were generally off limits.”

GUARANTEED-COST PROGRAMS

As it relates to guaranteed-cost programs, Lockton’s data shows, dating back to the third quarter of 2012, rates had been relatively stable for 15 months. However, beginning in the first quarter of 2014, a downward trend began, culminating with a 3.4 percent rate decrease for guaranteed-cost programs.

LOSS-SENSITIVE PROGRAMS

In 2014, we saw very stable rates, which are expected to continue with increased competition.

Overall, during the past 12 months in loss-sensitive programs, Lockton has seen:

- 4.0 percent of policies changed carriers at renewal.
  - 12.0 percent median rate decrease when changed carriers.
  - 2.2 percent median rate increase when renewed with same carrier.
Financial Services Sees New Entrants in D&O, With Cyber Causing Concern

A number of new carriers have entered the market for public primary D&O while others have increased their appetite for these placements.

“The entrance of Berkshire, QBE, and others certainly increases the competition for these placements and could potentially have a downward effect on pricing,” said Chris Casper with Lockton in Chicago.

While some markets have entered the public D&O market, some carriers in the cyber security market are headed the other direction, as the Anthem breach has heightened concerns for a number of carriers.

“The systematic nature of the Anthem breach, with numerous insureds and insurers being potentially impacted, has insurers taking a much closer look at their cyber books, especially in the managed-care space,” noted Casper.

Healthcare Catastrophe Exposure Climbs With Cyber Risk

The aggregation of data in health plans brings significant catastrophic exposure, and we saw the effects of that with the Anthem and Premera Blue Cross breaches earlier this year.

“Healthcare is certainly a major target,” stated Kevin Junod, Healthcare Practice Leader at Lockton in the Northeast US. “We are working closely with our customers to evaluate their cyber exposures, and often increase their limits because they have recognized their data is often not segregated. Thus, a massive number of records can be exposed in the event of a breach.”

Risks exist on both the provider side and the payer side, and even in how information moves between health plans, employers, and individual providers. The volume and breadth of exposed information brings significant risk to this sector, probably more than in most, according to Junod.
“In most circumstances, we are advising our healthcare clients to increase cyber limits,” said Junod. “Given the claim activity seen throughout the industry, more than 75 percent of our healthcare clients are buying higher limits year-over-year.”

While many are focusing on data breach and privacy issues, questions are also bubbling up on E&O programs for health plans.

“We are getting feedback from managed care E&O underwriters that they are growing less comfortable with providing the technology E&O risk within their managed care policies as well as picking up damages for HIPAA violations,” explained Junod. “There can be overlap in cyber and E&O coverage forms, and carriers are currently sorting it out.”

Meanwhile, the traditional medical malpractice market continues to be soft. One key sign is that we see more carriers are offering multiyear terms for both primary and excess layers. It’s often advantageous for both parties to lock in capacity and pricing for multiyear periods, and as the program runs, it can often be rolled out in order to continue to provide clients with an extended time horizon of protection.

“As the insurance market tries to keep pace with the changes in healthcare delivery, the breadth of insurance products available has expanded,” said Junod. “Healthcare systems have been acquiring physician groups, home health organizations, and even health plans, in order to provide the full spectrum of healthcare services with more complete cost control.

“As a result, healthcare systems are looking for carriers to integrate the managed care E&O and the medical professional liability to address the evolving risks.”

SPECIAL UPDATES

The cyber market continues to evolve in the face of advanced, persistent threats. Before they offer terms and conditions, underwriters have driven potential insureds to provide higher-quality information on their network security and privacy practices.

Premium and retention increases have continued to rise for large organizations, specifically in the retail, healthcare, and financial services sectors. While the market capacity for cyber insurance continues to hover around $300 million, the market for retail risks has shrunk considerably.

“The cyber market also continues to see a contraction in the market, with three carriers pulling out of cyber insurance during the past few months due to the high severity and unpredictability of losses,” said Ryan Gibney, part of the Global Technology and Privacy Practice in Washington, DC.

“The recent breaches caused significant focus on HIPAA/HITECH notification laws and the overall response to the event. This year is sure to see even more significant uptake in cyber insurance if and when larger attacks and breaches come,” advised Gibney.
Most of the largest sureties are building out capabilities across the globe with so-called “boots on the ground,” or they have created the necessary fronting arrangements with local carriers.

Surety

Through September 2014, the surety market experienced a 15.5 percent direct loss ratio. If this holds, it would mark the sixth straight year the average loss ratio was less than 20 percent, continuing the industry’s streak of very profitable results. Despite this, concerns over future surety losses remain, though the cause for these concerns has changed.

Construction Surety

On the construction side, two major concerns exist: growing backlogs of overextended cash-strapped contractors and labor shortages.

“An increasing number of new residential real estate projects, apartment complexes, and mixed-use property is creating a strong demand for subcontractor trades,” said Jeff Carey, Surety Operations at Lockton in Kansas City. “We believe the surety industry will monitor subcontractor backlogs carefully.”

The surety industry also continues to make inroads into the public private partnership (P3) arena.

“Each P3 project continues to be unique, and most of the major sureties have developed their own bond forms,” explained Chuck Teter, Vice President at Lockton in Kansas City. “New surety products will continue to appear to address the financial assurance requirements of those projects, including a potential product similar to conditional demand guarantees used abroad.”

Many sureties have looked to international opportunities for growth. Most of the largest sureties are building out capabilities across the globe with so-called “boots on the ground,” or they have created the necessary fronting arrangements with local carriers.

For example, in Australia, surety capacity appears plentiful despite recent surety losses in the mining industry.

“Commercial building and property development are both faring well, and there is significant infrastructure spend going on nationally, which is causing a number of large European players to enter the market to assist local providers,” said Teter. “Pricing has become more competitive for financially sound companies as more sureties have entered the market and bank requirements have become more stringent. On-demand guarantees continue to be the norm.”

In South and Latin America, sureties continue to expand capacity to fulfill governmental financial assurance requirements for growing infrastructure, such as highways, roads, and the power sector.
Commercial Surety

According to Carey, commercial surety has become extremely competitive, with several new entrants to the market.

“Underwriting in this space has moved outside of traditional guidelines, raising concerns over a shakeout,” said Cody Fuchs, Surety Account Executive at Lockton in Kansas City. “Since 2012, 13 new carriers have entered the commercial surety space, creating excess capacity and competitive terms/rates. Existing sureties have played defense by entrenching themselves with their current client base and revamping terms to retain as many quality clients as possible.”

This has forced new players to support substandard credit for revenue, resulting in higher losses at unsustainable pricing. One surety has already left the marketplace due to poor results, and expectations are more will follow.

“However, buyers should be wary of limited coverage terms, such as defense cover within the limit of liability or restrictions on aggregate reinstatement for project-specific policies. These caveats apply mostly to surplus-lines carriers taking advantage of mixed use, residential construction resurgence and the healthy premiums associated with providing general liability and excess coverage for such projects.”

Overall, the construction market offers plenty of capacity, with varying rates and term limits.

While the general insurance industry remains healthy and rates continue to be stable, the market is not treating all construction risks equally.

“Capacity is available in tough jurisdictions such as New York, but terms and conditions are still very conservative,” explained Mary Ann Krautheim with Lockton’s Construction and Design Services Group in Kansas City. “In the lead umbrella position, carriers will provide lower limits with very high prices. There are new entrants into the construction insurance market assuring plenty of capacity in certain sectors.

Large, complex industrial and infrastructure projects are becoming more prolific, challenging underwriters to provide project coverage over a long period of time. Timelines of seven to ten years are becoming more common.

This fact, along with the increase in long-term design, build, finance, operate, maintain (DBFOM) projects, has introduced complicated break-and-review clauses as insurers are not in a position to guarantee rates for a long period of time, nor are they comfortable with the operations and maintenance exposures.

“The good news is that a few seasoned insurers are beginning to see the value in providing turnkey coverage for such risks coupling coverage for design build and operations and maintenance,” said Krautheim.

Overall, the construction market offers plenty of capacity, with varying rates and term limits based not only on geography, but also on the type of infrastructure projects being completed.
The property (platforms, pipelines, and rig physical damage) and well control sector currently has a large amount of available capacity.

“This available capacity, coupled with good loss history and a downturn in the market, has led to large rate reductions and decreased line sizes for the insurance carriers,” explained Akil Harris with Lockton Global Energy in Houston. “With utilization rates down to nearly 40 percent of 2014 projections, the rig physical damage side and control of well (COW) coverage has seen the greatest decline in pricing.”

Offshore activity has not decreased to the degree that onshore has, with decreases holding firm across the board.

“With no Gulf of Mexico hurricanes since 2008, clients that buy wind are reevaluating their purchasing philosophy,” said Harris. “They are taking hard looks on current retention sizes and overall limits to determine if it is the correct spend of their capital in what can be described as a depressed oil and gas market.”

Some carriers that have primarily focused on first-party cover such as COW and property are now looking to write more liability line as the competition seems to be less abundant. The rates are not decreasing at the rate the rig physical damage (PD) and COW lines of coverage are descending.

“At the current price of oil, we’re finding those clients that weren’t operating efficiently, but yet making profits, are having the most difficulty sustaining viability and market share,” noted Harris. “They do not have the flexibility to follow the downward curve for the pricing of their services, therefore leading to bankruptcy or acquisition by those in a much more formidable position.”

The expectation is for continued bankruptcies and increased acquisition activity during the next 12 months while the price of oil hovers around its current level.

In regard to the liability sector, pricing remains soft. There is heavy pressure by insureds to reduce costs across the board as they are forced to do the same for their customers. Whether it is midterm adjustments, cancel rewrites, or reduction of limits, all alternatives are being explored.

Finally, domestic US and Bermudian insurers are seeing increased competition from the London markets. What was once deemed out of their appetite has now become part of their appetite as they look to cover budgets that are being supported by the first-party market in energy.

“Even Bermuda has expressed that they are now reconsidering previous attachment levels and coverage provisions such as drop-down attachments in order to write more business,” said Harris.

**Conclusion**

The main theme across the board is “the softening trend continues.” Overall, the market’s plentiful capacity and continued competitive pressures support ongoing buyer-friendly conditions.
US PROPERTY & CASUALTY INDUSTRY AT A GLANCE

UNDERWRITING PERFORMANCE: IMPROVING NET UNDERWRITING GAINS (LOSSES) (2004-2014)

Source: Insurance Information Institute

NET WRITTEN PREMIUM GROWTH: MODEST YEAR-TO-YEAR CHANGE IN NWP (2004-2014)

Source: Insurance Information Institute

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


Source: Insurance Information Institute

INVESTMENT GAINS: MODEST IMPROVEMENT (2004-2014)

All charts include mortgage and financial guaranty insurers.
MARKET UPDATE FAST FACTS

**six**
NUMBER OF YEARS THE AVERAGE LOSS RATIO IN THE SURETY MARKET IS LESS THAN 20%, SHOULD THE 2014 DIRECT LOSS RATIO HOLD

**12%**
MEDIAN RATE DECREASE WHEN CHANGING CARRIERS (LOSS-SENSITIVE PROGRAMS)

**75%**
NUMBER OF LOCKTON HEALTHCARE CLIENTS BUYING HIGHER CYBER LIMITS YEAR-OVER-YEAR

**7-10 years**
TYPE OF PROJECTED COVERAGE TIMELINE BECOMING MORE COMMON IN THE CONSTRUCTION MARKET

**40%**
UTILIZATION RATES DOWN THIS AMOUNT OF 2014 PROJECTIONS IN THE ENERGY MARKET FOR RIG PHYSICAL DAMAGE AND CONTROL OF WELL COVERAGE

**$300 million**
CURRENT MARKET CAPACITY FOR CYBER INSURANCE