In today’s insurance market, excess capacity and increased competition (for the most part) have created opportunity in negotiating terms and conditions. Depending on the line of business, this has come in the form of flat to reduced rates, multiyear agreements, and/or improved coverage.

Overall, we are seeing an easing of terms and heightened competition for business for clients with good to great loss experience.

**Property Softens as Competition Stiffens**

According to Jim Collins, Senior Vice President, Enterprise Team Leader, middle market property has become increasingly competitive, leading to flat renewals, especially given the rather tame tornado season. Specifically in California, as Mark Zwickel, Executive Vice President, Manager-CID, points out, the state is seeing continued softness with a few new entrants chasing middle-market property business.

While the energy sector continues to face challenging market conditions due to wind, we are seeing aggressive rate decreases with larger property accounts, especially on shared and layered programs. Accounts that manage risk well continue to see rate decreases, according to Matt Edelheit, Senior Vice President in Denver.

**WHAT IS A “SOFT” MARKET?**

The terms “hard market” and “soft market” denote favorable or unfavorable conditions in the property and casualty insurance markets. A soft market is a buyer’s market. Industry has excess capital, which translates to more underwriting capacity. In a soft market, competition is stronger. With an aggressive pursuit of business, the cost of insurance drops (i.e., lower rates). By contrast, during a hard market, capacity shrinks, putting upward pressure on the cost of insurance. It’s a typical supply versus demand scenario.
“There continues to be a tremendous amount of property capacity and seems like most carriers are waiting to see what the storm season will bring,” Edelheit said. “But for now, the incumbents are facing stiff competition as a result.”

Overseas, James Rubel, Global Property Executive Vice President, noted significant changes in the London market. In the past, all London capacity followed one lead pricing syndicate from Lloyd’s of London. All subsequent capacity followed that one lead underwriter, resulting in the identical pricing formerly known as “best terms.”

The protocol has changed in recent times, Rubel said. Now, there may be two or three leads, all with different pricing terms.

“The easiest way to explain it is that the London market has ceased to fly in formation,” Rubel explained. “Instead, it is allowing pricing to vary within one marketplace and any given account. This change of protocol has led to intra-market competition with Lloyd’s, to the benefit of our clients.”

Ample Capacity Keeps Casualty Rates Steady

The casualty business is still relatively flat for large accounts, with some price fluctuation where the incumbents face competition.

“Opportunity for flat or reduced rate also correlates to clients whose businesses are growing,” said Debbie Goldstine, Senior Vice President in Chicago. “Reductions are not as readily available for clients experiencing year-over-year exposure reduction because they are often already at minimum premiums.”

According to Edelheit, we are starting to see some carriers offer unsolicited multiyear agreements. This indicates they are attempting to solidify their relationships with clients in anticipation of increased competition trending decreased rates.

As an example, in our first six months of 2014, we saw the average for large, primary workers’ compensation placements in the low single digits. Any clients that went to market saw the same modest rate decrease as clients that did not go out to market.

Regardless, we continue to see ample capacity in the casualty market, which is keeping rates steady despite carriers’ attempts to push them higher than what the current marketplace will allow for primary casualty insurance.
Meanwhile, for excess casualty programs, some leads are looking for their typical 5 to 10 percent rate increase. Again, introducing competition is an effective line of defense that typically keeps rates flat.

“Historically, we have seen challenges for tough risks in the lead umbrella/excess space, where we didn’t have many market alternatives to the incumbent,” said Stacy Seaberg, Executive Vice President in Houston.

“Recently, we have seen more players interested in these tougher classes of business. These market additions create a competitive climate that ultimately brings rate relief and options to our clients.”

The situation is even more favorable for clients in the mid-market space. According to Seaberg, most markets are actively targeting mid-market casualty business. This creates a flurry of market interest, which ultimately keeps rates declining for insureds.

**Capacity Shifts From Primary to Excess for D&O Coverage**

Publicly held companies are faring well when it comes to directors and officers (D&O) policy rates, although we’re seeing some insurance carriers move capacity to excess, where we see an expanded marketplace and more capacity than in primary.

“Excess is very competitive right now on the publicly held side, where primary D&O is less so,” said Mark Pederson, Senior Vice President in Kansas City. “On the private side, it’s a firmer marketplace. We see higher rates and some narrowing of coverage.”

Employment practices liability (EPL) also continues to firm due to higher loss experience in California and a few other states.

**Today’s Buying Environment**

Even commercial clients in long-term client/insurer partnerships feel the need to annually market their programs. As Seaberg explained, “For renewals, we have seen incumbent markets try to hold firm on rate, but inevitably the market supports moderate rate decreases in most circumstances. Incumbents must remain aggressive and treat each renewal as though it is a new piece of business.”

We are seeing a mix of clients choosing to pursue renewals with incumbents versus a marketing effort. For those choosing to pursue renewals with their incumbent, we are seeing early renewal offers that are resulting in slight reductions to flat rate renewals. One line of coverage may go up a little bit as others go down, resulting in the overall flat to slightly reduced rates we’re seeing today.

Collins offered perspective on workers’ compensation renewals in today’s marketplace, explaining that some of the carriers are not taking into account, in their rate increase, a reduction in the experience modification factor or “mod.”

A mod is a rating assigned by the National Council on Compensation Insurance (NCCI) based on a client’s workers’ compensation loss history. Fewer injuries result in a better score and should mean improved insurance rates. Typically, a higher mod score means higher rates. Collins noted that as a result of the current status, the net effect is that companies may not see the rate reductions they are expecting.
Cyber: Learning From Recent Breaches That Rocked Retail

Since Target’s security breach in which 70 million customers had their payment card and personal information stolen last year, other major retailers, such as Michaels, Neiman Marcus, and Home Depot, have also made headlines with similar breaches as hacks are getting more sophisticated, with teams of hackers in multiple countries.

“A breach can cause not only major financial loss, but also significant damage to brand and reputation if handled badly,” said Emily Freeman, Lockton’s Risk Management Cyber and Professional Liability Specialist for the company’s Global Technology & Privacy Practice. “Pretending that a breach cannot happen to your business is no longer an option. B2C companies are asking this essential question post-Target at their shop: ‘How bad can a bad day be?”

Freeman explained that some retailers now ask underwriters for a higher retention quote in order to shift funding to severity (i.e., higher tower), but there is no equal swap for retention to fully fund another $10 million on the tower. For $1 billion plus revenue retailers, retentions start at $1 million and typically range to $2.5 million.

Underwriters understand there is an underlying security vulnerability of magnetic swipe cards versus Europe’s adoption of EMV “smart” chip-and-PIN payment cards. This danger is compounded by the retail industry’s lack of threat intelligence, compared to others such as major financial institutions.

Even static defense models (e.g., antivirus and intrusion detection) are not sufficient to prevent a systemic data breach. In addition, while outsourcing provides process efficiencies and expense reduction, it does not reduce security risk, particularly in the age of ever-evolving technology, the shift to communications as a service (including cloud), and multiplicity of access points to vendors.

As a result, companies may ask to have “best market wordings” for their security and privacy exposures, resulting in constantly evolving coverage requests with insurers. Organizations are concerned about the whole data breach response and coordination with underwriters. Freeman advises that a solid response must consider possible jurisdictions and venues of the affected individuals who could be in multiple states, provinces, and countries.
International Property & Casualty Package

Small- and middle-market international package rates remain soft, creating increased competition for this line of business. Several markets that had withdrawn from this space due to significant 2011 and 2012 property losses are beginning to reenter it with revised offerings and new products. Where we previously saw a small gap in the market, we expect new competition, which will create opportunities for improved terms and conditions, as well as continued pressure on rates.

“In addition, carriers are encouraging less reliance on package policy ‘throw-ins’ as differentiators, such as limited business travel and AD&D coverage,” says Michael Lombardi, Senior Vice President, Account Executive. “Instead, they are advocating for stand-alone placements for these coverages to complement international package policies.”

International Casualty—Large Multinational Risks

Despite continued competition for large international casualty business among the limited number of carriers able to write these programs, insureds are proving less likely to move their business for modest relief on pricing. Why? Because the complexity of designing and implementing a large global program, along with the increased need for contract certainty, often proves more important than price. As a result, carriers are focusing on improving product offerings, limits, and local coverages.

Eager to capitalize on the loyalty of insureds and the profitability of international casualty business, certain insurers are integrating foreign and domestic U.S. coverage into a single “global” policy, with the ability to issue local underlyers in foreign countries.

While this structure may be more efficient, insureds should be aware of the potential challenges of an integrated program.

- The loss of an international policy may eliminate separate, dedicated limits for international coverages.
- Deductibles on U.S. domestic casualty policies are typically much higher than those on stand-alone international casualty policies.
- Combining U.S. and international loss experience may negatively influence program pricing and allocations on both programs.
HEALTHCARE

These are confusing and challenging times in the healthcare industry, triggered by the following.

- Hospitals are gobbling up physician practices.
- Health systems are creating Accountable Care Organizations (ACOs).
- Physicians are fretting over new CMS reimbursement rules.
- Hospitals are offering insurance.
- Insurance companies are coordinating care.

“Much of the commotion centers around the Patient Protection and Affordable Care Act (ACA),” said Kevin Junod, Executive Vice President, Healthcare Practice Leader in Philadelphia. “With many key provisions of the ACA taking effect in 2014, it is a critical time for healthcare organizations to be sure of their footing and direction.”

Mergers & Acquisitions

Health systems are building out their networks in order to best operate within the ACA framework and keep pace with new care-delivery models. Shifts to bundled payment structures are receiving a lot of attention. No group continues to be impacted more than physician practices. Changes in CMS reimbursement rates and the move to electronic medical records have been squeezing profit margins and motivating physicians to align with hospitals.

“Hospitals continue to acquire physician practices at a frenzied pace,” said Dana Switzer, Senior Vice President of Healthcare in Kansas City. “Lockton has also seen significant merger activity in staffing, surgery centers, and home health, to name a few. Some hospitals and hospital systems are establishing or acquiring home health operations and health insurance companies.”

The tallies for 2013 year-end revealed that total hospital deal volume in dollars was the largest since 2006, marked by the blockbuster deals of Tenet Healthcare acquiring Vanguard Health System for $4.2 billion and CHS acquiring HMA for $7.6 billion. Trinity Health and Catholic Health East also merged to create one of the largest Catholic health systems in the country.
Antitrust Implications

The FTC has been very active in reviewing healthcare mergers and acquisitions (M&As). Typically, their rulings come well after both the close of the transaction and when organizations have already poured hefty sums into completing deals. Companies are then faced with expensive antitrust litigation expenses, in addition to the sunken costs of financing the deals in the first place.

New Exposure Related to ACOs

As hospitals and health systems begin creating and operating under ACO models, it opens up a host of new exposures previously outside the scope of a traditional hospital. Many of the new exposures would typically fall under managed care errors and omissions coverage. Healthcare organizations traditionally focused on their medical malpractice and clinical risk will need to be sure to address these new exposures.

Market Outlook

From a medical professional liability standpoint, we continue to see strong capitalization and surplus in the market. Pricing stability and adequate capacity are mainly attributed to three factors:

1. New entrants into the market
2. Little attrition from established carriers
3. A lack of major changes to medical malpractice tort laws

In fact, capacity is arguably at a historic high. Most medical professional liability underwriting companies are reporting stable combined ratios, solid earnings, and confidence with reserve adequacy and exposures currently on their books. From a pricing standpoint, rates are generally flat, with aggressive pricing obtainable on good risks.

Healthcare organizations are encountering market tightening in the management liability insurance sector. Prior to the passage of the ACA, M&A activity in the healthcare industry was trending upward, and the enactment of the ACA has encouraged more consolidation within the industry. Antitrust allegations have followed in the wake of heightened M&A activity, triggering an increase in both responses and payments under D&O policies. Not surprisingly, the response from the D&O market has been to restrict coverages and increase prices. Many carriers have withdrawn from the industry altogether, with few new players entering.

Privacy and cyber coverage remain at the forefront of any client discussion. Electronic medical record adoption has brought both opportunities and challenges as hospital and physician office staff navigate new systems. In spite of frequent breaches, the market for this coverage remains soft, with abundant capacity and expansion of coverage.

Excess workers’ compensation has become a challenge for self-insured hospitals, with only a handful of markets willing to write this coverage. There is competition in the large-deductible marketplace for hospital and long-term care risks, less so for healthcare staffing. Guaranteed cost capacity for smaller accounts continues to be meager.

Capacity exists for nonpatient auto risks, although it is not abundant. The market is even more limited for patient transport vehicles, although carriers in this space welcome the opportunity to quote new business.
REAL ESTATE

The insurance landscape for the real estate industry continues to trend in a positive direction. This is especially true with regard to property insurance, which has seen upward of double-digit rate decreases for large property placements with retentions at or above $25,000 and good loss experience.

Smaller accounts, with retentions at $5,000 to $10,000, have seen much less relief in rate and in some cases are still seeing increases, especially those with tough loss histories. Program design is a key factor in driving positive results, with quota share/layered programs leading the way on higher-hazard occupancies.

Overall, wind and earthquake catastrophe (CAT) rates remain under pressure due to good treaty reinsurance rate reductions at the beginning of the calendar year and a continued benign CAT environment year to date. The exception to this trend is with high-hazard flood and hail.

Coverage in high-hazard flood zones has come under much stiffer underwriting guidelines, higher deductibles, and/or pricing based on a location’s base flood elevation and loss history. As with high-hazard flood, locations in high-hail zones have seen deteriorating loss trends over the last couple of years. States like Colorado, Texas, and Oklahoma have seen significant losses tied to hail, and carriers are looking to address this through higher rates and/or deductibles in this region.

On the casualty side, the market remains in a flat to 5 percent increase range, with small decreases given primarily to best-in-class clients. Retention, loss experience, and geography are the driving factors, just like property. Rates in the Northeast and California are generally higher and have seen the biggest increases when compared to almost any other region or state. Market participation increases as deductibles/self-insured retentions (SIR) gets closer to $25,000, while guaranteed cost markets remain limited.

“Overall, the combination of favorable property treaty renewals at the beginning of the year, higher client retentions during the brief hard market, and a relatively benign global CAT environment year to date, has created a downward trajectory in the industry’s highest cost insurance line,” explained Pete Romano, Senior Vice President in Denver.

The remaining lines remain mostly flat to slightly up, driven by overall loss experience. In addition to the positive insurance outlook for the industry, the overall business environment for real estate is strong, with subsectors such as multifamily driving a construction boom in many parts of the country. The combination of low interest rates, high occupancy rates, and lower expenses are driving some of the industry’s best results.
CONCLUSION

Overall, we expect rates to remain relatively flat throughout the rest of the year, reflecting the industry’s ample capacity and competitive climate. Companies that take a proactive stance in the marketplace should continue to see the advantages that come when carriers compete for their business.
U.S. PROPERTY & CASUALTY INDUSTRY AT A GLANCE

UNDERWRITING PERFORMANCE:
IMPROVING NET UNDERWRITING GAINS (LOSSES)—2004–2014

The industry saw a halving of underwriting profits due to higher underwriting loss and expense and slower premium growth.

Source: Insurance Information Institute

NET WRITTEN PREMIUM GROWTH:
MODEST YEAR-TO-YEAR CHANGE IN NWP—2004–2014

Net premium growth fell slightly to 3.6% in Q1 2014, but was still higher than Q1 2013.

Source: Insurance Information Institute

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


The industry combined ratio, a measure of underwriting profit, rose to 97.3% in 2014, up from 96.1% in 2013.

Source: Insurance Information Institute

**INVESTMENT GAINS: MODEST IMPROVEMENT 2004–2014**

Low interest rates continue to challenge insurers, although total investment gains rose 10.3% to $14.1 billion, up from $12.8 billion in Q1 2013.

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.