STATE OF THE MARKET

Q2 | 2018

The market continues to evolve, often in unpredictable ways. In an inherently dynamic environment, and with hurricane season now underway, AmWINS is committed to providing our clients with insightful, timely intelligence based on recent developments. In this report, our national practice leaders address the latest issues and their expected impact on the insurance marketplace.

ON YOUR TEAM.

AmWINS Group, Inc.

PROPERTY

***Abundant capacity* characterizes current property market, with few exceptions; CAT pricing continues to be up marginally entering 2018 hurricane season.**

As we enter the second half of 2018, it's clear that predictions of significant rate increases made in late 2017 have not materialized. Underwritng companies hoping to see a meaningful hardening of the overall property market have been disappointed. Renewal rates have been flat to up marginally on non-catastrophe exposed property. Insurers that anticipated hardening and pushed for rate increases early saw themselves losing business.

Nevertheless, there are pockets of exceptions. Catastrophe-exposed and frame habitational, woodworking-related businesses, dealer open-lot, cat-exposed hospitality and accounts with consistently poor loss experience can expect a tighter market. A good portion of this tightening is a result of carriers' realization that loss expectancy is much higher than prior expectations for the class. Larger national placements with multiple carrier participants are often faced with limited options as most new capacity has not entered this space and we've seen a retraction or reevaluation by most carriers.

Cat-exposed properties are seeing mid to high single-digit increases, and those that also have adverse loss history or that have lost capacity from incumbents seeking to increase or decrease their cat aggregates can expect more. Yet even among these more challenging sectors, brokers can find better deals for clients by providing quality submissions to underwriters.

"The better, more detailed exposure data we can provide to carriers, the better we can negotiate terms," says Harry Tucker, national property practice leader at AmWINS. "Brokers used to think that it was better to provide less information about a risk. Now, with modeling playing such a large role and defaulting to worse case when information is left out, we have found it best to be as granular as possible to obtain optimal results." Advanced modeling is leading to greater underwriting sophistication and pricing precision, moving the industry toward a much more level and stable market and minimizing the need for drastic corrections.

The key driver behind the continued competitive property market is capacity. "In spite of the historic catastrophe season of 2017, the market has remained stable. Alternative capital continues to enter the market at an increasing pace," Tucker says.

Alternative capital was up 17 percent in 2017—from $75B to $88B, according to WTW—and accounted for 12 percent of total industry surplus. Furthermore, industry surplus reached an all-time high of $719.4B, up $18.6B from $700.8B at the end of 2017.

BUILDER'S RISK

As we close out the second quarter of 2018, brokers can expect more of the same competitive market conditions in builder's risk. Capital continues to enter this space seeking accounts with best-in-class risk characteristics. As a result, aggressive rates on desirable classes remain at or below historic lows.

Frank Catalano, executive vice president and builder's risk specialist at AmWINS Brokerage of the Midwest in Chicago, is confident that the pace of construction can be sustained. "Large developers continue to have robust pipelines of projects, both commercial and residential," Catalano says.

As is traditionally the case, most of the E&S growth opportunity is in more challenging frame and coastal construction. Although the industry has seen approximately $500M in frame losses over the last 24 months from severe fires, there is a market and capacity for the class, albeit at higher rates and more restrictive terms/conditions.

Rates are up roughly 15 percent compared to the first quarter of 2017 within the E&S sector of the builder's risk market. Carriers are pushing actuarial data in a broad stroke approach for this class of business. This approach is unfavorable for best-in-class developers, as underwriters are using benchmark pricing for the class instead of underwriting the merits of each client or project individually.

Despite the challenges of insuring frame construction, intense competition from standard markets is driving rates as low as 4 cents on concrete construction, Brokers may also find standard markets pursuing some stick-built risks in an effort to grow premium.

Critical CAT pricing is stable and we expect it to remain consistent going into the 2018 wind season. In catastrophe-prone coastal regions, standard markets are competing to write quality, wind-resistant construction projects, presenting only limited opportunities for E&S markets. However, when standard markets come up short in named windstorm, flood, and earthquake limits, the E&S marketplace is able to play a role.

Renovation activity has also increased. Renovation pricing varies widely based on the scope of work (cosmetic versus structural) and exposure to catastrophe risk. Detailed engineering and geological reports are compulsory to obtain the best possible terms.

EARTHQUAKE

Earthquake capacity continues to grow and is now at an all-time high. Moreover, we believe between $750M and $1B is available through wholesale distribution; more is available in the global marketplace (mostly linked and supported by the all-risk placement). Abundant capacity exists despite media reports of the massive exposure that exists and compelling new studies detailing the extent of U.S. earthquake risk. In fact, the U.S. Geological Survey recently referred to the East Bay fault as a “tectonic time bomb” more dangerous than San Andreas.

“Because there hasn’t been a major earthquake in California since Northridge in 1994, carriers overall are being aggressive, despite the inherent risk,” Tucker says. Large accounts are seeing flat to 5 percent reductions, with only thinly-priced, old, or substantially exposed properties seeing 5 to 10 percent increases. On newer buildings and large schedules, one percent deductibles are also achievable.

As always, there are exceptions. Updates in RMS 17 and a new version of AIR have doubled the probable maximum loss (PML) on some exposures, including areas along the Hayward fault (South San Francisco Bay Area, towns of Hayward, Union City, Fremont and regions around San Jose). The resulting micro-hard market in those areas has pushed premiums up anywhere from 10 to 50 percent.

Despite the record-high capacity already in earthquake, new capital is constantly looking to participate in the market. In this environment, brokers do well to partner with a wholesaler that has broad market access, specialized knowledge, and strong underwriting relationships to obtain the best deal.

LOOKING FORWARD

- Expect the overall current conditions in property to continue;
  - Increased alternative risk appetite, combined with increased traditional carrier surplus, will produce a stable market
  - Increased upward rate pressure on poor performing accounts and classes
- Greater dependence on modeling due to increased value of complete and accurate account data
- In builder’s risk, a strong economy will continue to fuel growth in building projects;
  - If federal infrastructure spending becomes reality, construction will see an additional uptick
  - Standard markets will compete aggressively on desirable infrastructure projects, including utility construction, energy facilities, and associated buildings
- Unless and until there is significant loss activity, additional capacity will continue to flow in to earthquake, keeping overall conditions soft.

CASUALTY

The second quarter brought few surprises, but a dynamic casualty market *requires expertise to navigate.*

Although the casualty market saw some slight price increases on renewal business in the first quarter, conditions were nowhere near indicating the return of a hard market. Through the second quarter, those conditions have held consistent. Heading into the second half of this year, most clean accounts can anticipate seeing flat pricing to slight increases in the 3 to 4 percent range.

"We are seeing smaller rate increases than many anticipated at the end of 2017," says Tom Dillon, national casualty practice leader at AmWINS.

The dual drivers of this market condition are significant capacity and, despite some large loss concerns, generally favorable returns. "We still have a lot of capacity in the marketplace," Dillon says. "While combined ratios have ticked up and some carriers are struggling, many have reported decent first quarter results, and I would expect the same for second quarter. Also, topline revenue growth is helping produce positive earnings, offsetting some of the increases in combined ratios. Reserve releases are playing a role, as well."

High-stress areas in casualty remain habitational business and New York construction, both primary and excess, with some insurers exiting those markets in recent months. Additionally, casualty coverage for utility companies in West Coast regions is difficult to obtain without a wildfire exclusion.

"Carriers still struggle to write habitational business profitably," Dillon says. "Losses from slips and falls, assault and battery, and other causes have simply been outpacing the premium. At the same time, there are few large or bulk buyers in habitational. There are a lot of individual property owners who can't afford to take on high-deductible exposure that would help make the line more profitable."

INCREASED CAPACITY, PRICING STABILITY EMERGE IN AUTO

Automobile liability continues to be a problematic line for carriers; however, there are signs that conditions in commercial auto are changing, with new capacity entering the market and pricing beginning to level off in both primary and excess, particularly for clean accounts.

“We are finding more carriers willing to write auto, although at new 'normalized rates.' Because most carriers have taken significant rate increases over the past few years, many carriers that are committed to the space are getting close to the premium where they feel more comfortable underwriting the risk,” Dillon says.

“However, it’s far too soon to say that we’re out of the woods because losses continue to come in, particularly on trucking risks,” he cautions, adding that settlements in excess of $50 million are being made on the line.

Brokers can expect to see continued activity among underwriters impact the market in 2018. “In London in particular, we are seeing more interest in casualty business, and we are investing in a stronger London presence as a result,” Dillon says. “We’ve also seen increased creativity from London, especially with regards to loss-sensitive plans, which is an area where we can help retailers.”

In addition to market exits by insurers, carrier consolidation continues in casualty. Notably, AXA acquired Bermuda-based XL in the first quarter, and more M&A activity is expected in 2018. Offsetting any capacity reduction from consolidation is the continued inflow of capital from private equity and alternative sources.

“The casualty market remains dynamic,” Dillon says. “Retailers should partner with wholesalers who understand the trends impacting the marketplace and who have the relationships, specialized insight, and market knowledge to help brokers succeed in placing business for their clients.”

PROFESSIONAL LINES & CYBER

A mixed professional lines market presents some challenges, but *plenty of opportunities,* as well.

In a market as diverse as professional lines, it's not surprising to see significant differences in pricing and appetite across different sectors. Understanding those differences is key to brokers' growing their professional lines business.

"As with any E&S line, there are challenges for brokers, and there are opportunities. At AmWINS, our specialized knowledge of these individual sectors allows us to help retailers successfully navigate the marketplace and grow their business," says David Lewison, senior vice president and national professional lines practice leader at AmWINS.

OBSTACLES

The good news for brokers and buyers is that, in general, the professional lines market remains well-capitalized and competitive. "There is some micro-hardening, but most areas present no significant obstacles to placement," Lewison says.

Two areas where the professional market continues to be difficult are cannabis and cryptocurrency risks. Regulatory and legal hurdles make those classes particularly challenging.

Another notable exception is professional liability for elderly services and care. As claims have increased in both frequency and severity, several carriers have pulled back from the market. At the same time, others have re-underwritten or sold their book to other insurance companies.

"In healthcare, long-term care, or other aging-related services, we've seen rates quadrupling or more. However, facilities are still binding coverage because they need to buy," says Lewison.

There are also some regional pockets of hardening that buyers will need to contend with. "In Cook County, as well as some parts of Florida and Kentucky, we continue to find healthcare underwriters being very cautious about professional lines because the courts in those regions have been painful to them," Lewison says.

OPPORTUNITIES

In most professional lines, brokers and buyers can find a competitive E&S market. Despite claim severity, financial service firms have been an area where AmWINS has experienced strong growth with retailers. A portion of that market growth can be attributed to demographics: as baby boomers approach retirement, they're looking more closely at what they have saved for retirement and are more sensitive to investment performance.

"The financial services errors and omissions space has always been a really tough area for underwriters because of constantly changing laws and trends in litigation. However, with our knowledge of the marketplace, we rarely have difficulty placing business," says Lewison.

Lawyers professional is also poised for growth. "With changes occurring both with law firms and in the insurance market, there has been turmoil in that market. Wherever there is turmoil, we look at it as opportunity. We have an exclusive market for firms with 25 or fewer lawyers with a broad appetite that has helped us win new business," Lewison says.

Private company D&O continues to be handled effectively by the standard market, but with increasing losses, some business has been moving to E&S. Private D&O insurers are seeing losses related to bankruptcy, intellectual property theft allegations arising from new talent recruitment, and increased complexity of claims against the larger private companies.

The market for public companies was expected to firm due to frequent mergers and acquisition claims and bankruptcies, but thus far has not. “Litigation against public companies for mismanagement slows down with a rising stock market, although there is some nervousness as stock valuations keep rising,” Lewison says.

The uptick in merger and acquisition activity has led to increased sales of representations and warranties insurance. And with overall economic growth, architects and engineers (A&E) has also seen a notable spike in purchasing activity.

“Our A&E book has grown rapidly over the last year and a half. That’s important for retailers because if you want to grow your business, you need to focus on sectors that are themselves expanding.”

CYBER

In cyber, despite the seemingly daily avalanche of data breach activity, insurers aren’t seeing those breaches turn into liability losses beyond their expectations. As a result, buyers will find increasingly competitive rates.

“When the cyber market started 20 years ago, underwriters were charging an uncertainty premium that they have now worked out as they have become better at understanding the exposure. At the same time, the number of markets continues to increase,” Lewison says.

However, the rate of cyber purchasing has notably slowed. “For the past few years, underwriters could count on 30 to 50 percent growth. Now they are telling us that they expect to see around 15 percent,” says Lewison.

This slowdown in growth can be attributed to the fact that most of the larger buyers have already purchased coverage, and the adoption rate of companies under $500 million in revenue has been low. However, this low purchasing rate means there is growth potential for retailers who focus on educating small-company prospects about the need for cyber and who partner with a wholesaler that has access to the right markets and products.

“Small-company cyber is an area where we will be focusing,” Lewison says.

“We believe it is a relatively untapped market that presents a good opportunity. A year ago, our AmWINS Access division launched a small cyberliability binding authority with an admitted carrier. The product has most of the coverage advantages seen on larger risks, but at a small business price. At the low premium levels, we didn’t want to be held up negotiating terms for each and every account, so it’s all baked in for a quick quote-to-bind experience.”

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