Treaty renewals are now on the books, London is undergoing performance management changes and the amount of alternative capital being deployed continues to rise. And still, insurance markets have remained stable. In our Q1 State of the Market, our experts address the latest issues to face the property and casualty space and trends that may impact your business.
As we entered the latter part of 2018, underwriters were still offering flat renewal rates on non-catastrophe exposed property. However, the question loomed whether pricing conditions could hold into 2019. With 1/1 renewals now on the books, the answer is that the property market overall has seen some firming; however, there are significant differences between non-CAT and CAT-exposed business.

“There is still competition for clean, non-CAT business, particularly in desirable classes,” says Harry Tucker, executive vice president and national property practice leader for AmWINS. Those accounts can still expect moderate to flat pricing renewals.

However, catastrophe-exposed and loss-affected business could see double-digit rate increases, with spikes of 40% not out of the question. Additionally, a micro hard market is affecting specific classes that will continue to struggle with both capacity and pricing. These classes include multifamily habitational, sawmills and woodworking, dealer open lot, recycling operations, and large hospitality schedules, as well as properties with significant convective storm exposure in the Midwest.

Reinsurance also follows the overall property trend. Disciplined, prepared carriers with good loss records received risk-adjusted rate reductions from reinsurers, from flat to -5%. However, loss-impacted carriers are dealing with rate increases. The retrocession market also saw double-digit rate increases across loss-affected accounts.

It is important to point out that while reinsurance is a credible barometer of where the overall market is going, it does not tell the whole story. Reinsurance costs fluctuate depending on several factors, including carrier retention, limits purchased and risk characteristics. Additionally, by and large, reinsurance is an excess play. Direct carriers bear most of the primary exposure. “The primary carriers have suffered the most over the last two years, and this has caused many primary markets to tighten their underwriting guidelines, push for rate, or exit classes of business,” says Jeff McNatt, executive vice president and Florida region leader for AmWINS. Therefore, we need to understand how individual carriers view risks and what fits into their appetite and not draw specific conclusions.

“By offering Insureds specific exposure coverage where they see the most need, carriers can allocate expense to match their appetite for risk and help manage cash flow,” says Tucker.
MARKET DRIVERS

Capacity is abundant in property, although there has been carrier consolidation over the past few years: Markel acquired Nephila, AXA acquired XL Group, AIG acquired Validus, and Hartford acquired Maxum Specialty. Additionally, there is a trend toward more conservative underwriting, whether reducing limits or tightening terms. For instance, AIG announced a new CEO for its wholesale-dedicated arm, Lexington, in August and are changing appetite to reduce limits being offered, increase pricing, and reviewing attachment points. Carriers like Aspen are in the process of rehabbing their property book in light of the recent CAT losses and acquisition by Apollo. These and other carrier actions are part of a broader trend being seen throughout the industry.

In London, Lloyd’s is undergoing a performance management process that is expected to shrink its 2019 gross written premium by around five percent. Traditionally, Lloyd’s has been a large supporter of multifamily housing. More than a few syndicates have been asked to close their North American open market property operations entirely or exit certain classes of business in North America in which they have not been able to demonstrate the ability to maintain profitability. We are seeing the effects of this change in the loss of capacity from a number of Lloyd’s cover holders. However, those with proven track records continue to thrive and grow, including our property MGA (AmWINS Special Risk Underwriters).

"It is important that brokers partner with wholesalers who have trading relationships with a broad spectrum of the market," Tucker says.

Carriers were hit globally by severe storms in 2018, although it was not the worst year of CAT losses, by far. Worldwide CAT loss estimates for 2018 are expected to be close to $80B, far below the 2017 record high of $144B but above the 20-year average of $57B. Domestically, the fourth quarter saw both Hurricane Michael and wildfires in California, which combined are expected to generate losses between $18-28B – well above the typical Q4. Additionally, Hurricane Irma loss development was a source of significant adverse experience seen by insurers and reinsurers in 2018. Non-CAT attritional losses also put pressure on rates as losses climb and carriers are unable to allocate CAT premium to subsidize their attritional exposures.

 Catastrophe losses have had an impact on the insurance-linked securities (ILS) market. Although ILS expansion continues its upward trend into 2019, there is a difference in how investors are allocating their funds in light of high losses. With investors unable to release capital allocated to wildfires and hurricanes, the question is whether they are willing to commit additional funds.

"We are still seeing an influx of new ILS capital, albeit not to the degree as in years past," Tucker says. "The biggest difference today is that new capital is being deployed more strategically."

LOOKING FORWARD

The property market is working on innovations on several fronts. Swiss Re has predicted the next stage in the evolution of innovative insurance products will be the development of non-physical damage business interruption (NDBI) covers, in some cases referred to as named-peril earnings insurance. In parametric insurance (which pays if the parameters surrounding a loss event are triggered, such as a certain wind speed, rather than just the event itself), 2019 will see more affordable, customized insurance options become more readily available.

"By offering Insureds specific exposure coverage where they see the most need, carriers can allocate expense to match their appetite for risk and help manage cash flow," says Tucker.

Through the year, it is highly likely that firming will continue, with a more noticeable overall impact anticipated in Q2, beginning with 4/1 reinsurance renewals. However, signs do not point to a significant market correction. Capacity is still ample, and increased use of modeling leading to greater underwriting sophistication and pricing precision is producing better returns than in the past, despite claim activity.
The casualty landscape remains a story of contradictions. On one hand, we have markets exiting, constricted capacity, rate increases, and restricted terms and conditions for problem areas such as primary casualty in Florida, much of the transportation sector, and New York Construction. On the other hand, we have new entrants, increased capacity, competitive pricing and terms in lessors-risk, the sharing economy, and liability coverage for cannabis producers.

REAL ESTATE

In 2019, brokers will find competitive markets for lessors-risk business, and with the expanding economy, there is plenty of business to be had. Conversely, habitational business remains problematic, as both primary and excess markets continue to increase pricing and pull back on underwriting of apartments.

“Capacity in some geographies and sectors is more restricted than in other areas, but there is still enough to meet market needs,” says Tom Dillon, executive vice president and national casualty practice leader for AmWINS. “There is no shortage of business out there, and we do have the capacity, albeit at increased rates for certain classes.”

AUTOMOBILE LIABILITY

Automobile liability presents a familiar scenario for brokers and buyers in 2019: increasing rates and continued market constriction.

“We are seeing rate increases in both the primary and excess transportation spaces,” Dillon says. “It’s not just trucking accounts—it’s sales fleets, contractors’ vehicles, livery, and all commercial auto that are being affected.”

The problem is profitability: the industry’s combined ratio topped 110 in 2017 and is likely to do so again when the numbers for 2018 are tallied. Underwriters are seeing massive, seven-figure judgments and settlements in commercial auto, along with greater accident frequency that is tied to more miles being driven.

“No matter how much insureds focus on safety and loss control, accidents happen, and we’re seeing a difficult legal environment with sympathetic juries,” Dillon says. As one example, he cites a recent ruling where a driver was not speeding at the time of the accident, but because he had been speeding 30 minutes prior, the jury deemed him at fault as they determined his rig would not have been at the site of the accident had he not been exceeding the speed limit.
AUTOMOBILE LIABILITY (CONTINUED)

One area in the transportation sector that is seeing increased carrier interest involves the “sharing economy;” specifically, transportation network companies (TNCs), such as Uber and Lyft. More personal lines carriers are also stepping up to offer coverage to bridge the gap between a TNC driver’s personal policy and the coverage provided by the network company. Auto carriers, particularly in the TNC space, are increasingly turning to technology in an attempt to provide customers with real-time risk management tools and to specifically tie risk pricing to driver behavior. Telematics, whether using on-board data recorders or via software embedded into the drivers’ own smartphone application, provides this real-time feedback.

“**We are seeing strong rate increases in both the primary and excess transportation space,**” Dillon says. “**It’s not just trucking accounts—it’s sales fleets, contractors’ vehicles, livery, and all commercial auto that are being affected.”**

SHARING ECONOMY

More carriers are jumping into the sharing economy space beyond transportation, as well. This area encompasses all kinds of largely app-based, on-demand businesses, such as “taskers” that provide help with household chores and dog walking, shared office space, deliveries of all types by a large variety of means (e.g. on foot, bicycles, scooters, etc.), meal sharing, and more. These types of businesses are only as limited as the entrepreneur’s imagination, and the space is growing exponentially, providing ample opportunity for retail brokers.

PRODUCT LIABILITY & RECALL

In contrast to the tight underwriting appetite for habitational risks and auto liability, underwriters are bullish on product liability business. Standard markets continue to be aggressive in this space, meaning that the best opportunities for retailers in the E&S space are accounts with poor loss history, as well as the perpetually problematic classes of pharmaceuticals, invasive medical products, and tobacco products.

In product recall, movements into and out of the market have served to cancel each other out and create a holding pattern scenario. While some U.S. markets have reduced their capacity for certain classes, there has been a recent aggressiveness on the part of London underwriters to increase their overall share of the U.S. market.

“We do not expect to see any change in overall capacity in 2019,” says Matt Carpenter, senior vice president, AmWINS Brokerage of the Midwest. “The U.S. markets are trying to push rate increases whenever they can, as most markets think the need for – and ability to obtain – rate increases is now possible. Since it is challenging to sell rate increases, especially for first-time purchases, an experienced wholesale partner is key.”

ENVIRONMENTAL

In 2019, pricing will remain very competitive for some lines of coverage, including CPL and small site (new conditions only, one location) operations. However, tougher “Eagle-like” business—General Liability, Environmental Impairment Liability, and excess liability lines—will see slight increases and a possibility of fewer market options as carriers decline those risks with a greater likelihood of loss.

Several new markets have entered the space, and market mainstays, like Colony, are becoming increasingly competitive. New entrant Serius International Insurance is offering up to $25M in capacity. Similarly, Everest Energy and XL Energy, with their ability to cross the line between energy and environmental, are providing increased flexibility to brokers and insureds.
On pollution/professional combined, there used to be only a few carriers providing true professional coverage that included coverages such as mitigation/rectification and professional protective. Today, carriers continue to enter that space, and those that cannot offer combined coverage are at a disadvantage on the more complex deals.

The most difficult placements continue to be blended GL/CPL in New York state, as well as old tanks and sites with pre-existing contamination. Downstate New York contractors are very challenging placements, and excess on those placements is even more difficult. The market also continues to closely watch issues related to polyfluoroalkyl substances (PFAS) in drinking water, and at least one carrier has added exclusions for glyphosate, which is an area of growing concern.

There is a focus on underwriting profitability in the public entity space, leading to heightened sensitivity on individual risk and loss performance profiles, as well as the desire by underwriters to move their attachment point up on some risks. On large, self-insured municipalities, in particular, underwriters are looking to be truly excess. Carriers are also looking to diversify portfolios and dilute concentrations on non-tort protected states, particularly as specialized plaintiff attorney firms are focusing on niche litigation within the public entity realm.

Despite these challenges, the public entity space continues to have relatively stable market participations, although appetites vary by venue and jurisdiction. In Liability, we have seen the consolidation of capacity in terms of limits and QS participation. Carriers are also taking creative approaches to loss control, including providing or partnering with providers of additional risk management services, such as predictive loss analytics and anonymous reporting applications. As a new generation of risk managers moves into leadership roles at public entities, there is an increased focus on data and analytics. In response, some markets are undertaking conceptual design discussions around the use of parametric triggers for certain liability exposures, as well as targeting legislative reforms to mitigate severity of loss trends in non-tort protected states.

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ENERGY

While we do not expect any carriers to enter or exit the energy space, we may see carriers divest from classes of business that have performed poorly or that have a large impact environmentally (i.e. sand, coal, disposal wells). AIG Energy, which had been writing $5M and $10M limits on energy transportation risk, has changed their appetite and are non-renewing risk where most of the operations are oilfield trucking, both primary and excess. Replacement markets will be on non-admitted paper, and multiple markets will likely be needed to build the excess tower on these transportation risks.

LONDON

Faced with excessive losses over the last few years, Lloyd’s is undergoing a performance management process that is expected to shrink its 2019 gross written premium by around five percent. As a result, brokers are closely watching London to see what impact this performance management may have.

“We have already seen some London markets pull out of U.S. construction, but there is still ample capacity available,” Dillon says.

REINSURANCE

For several years, casualty reinsurance premiums had been on the decline. However, that trend appears to have halted in 2018. Going into 2019, we expect continued, modest increases in primary casualty reinsurance rates, except in workers’ compensation.

Rate increases are being driven by several factors, including the performance management initiative affecting Lloyd’s syndicates. Overall, with Lloyd’s expected to shrink its 2019 gross written premium by around five percent, we anticipate long-term improvement in underwriting results but higher rates in the near term.

Auto will continue to be the primary driver for many energy placements, and oilfield auto/trucking markets are limited.

While we anticipate flat renewals if loss history is favorable and rate increases on accounts with losses or in undesirable classes, we expect to see excess carriers reducing limits, especially in the lead $10M layer. Furthermore, auto will continue to be the primary driver for many energy placements, and oilfield auto/trucking markets are limited.

Finally, with environmental markets and some E&S energy markets offering professional and contractors’ pollution, insureds’ expectations regarding terms and conditions have been redefined upward.
In professional liability, the market remains soft overall, particularly in miscellaneous lines. However, there are notable differences across individual classes of business. Some examples include:

- Debt collection services continue to be a problem in E&O due to frequency of Federal Debt Collection Practices Act (FDCPA) claims.

- Medical professional liability for doctors working in correctional facilities continues to be very hard to place. The claim severity has not diminished.

- Insurance Agents E&O had some unexpected price increases in 2018. Minimum premiums have risen to around $5,000. The frequency of storms, wildfires, cyber events and other losses, if uninsured or improperly insured, can cause a rise in E&O claims against the agents that placed or failed to place the insurance.

- Solo practitioner law firms that do not fit the state bar programs may see price increases. Smaller firms often don’t have the infrastructure of the larger firms, which can lead to more errors and claims.

Other caution signs around D&O and E&O can be seen as we head into 2019. “Underwriters are becoming increasingly concerned with underpricing Public D&O risk combined with loss trends,” says David Lewison, executive vice president and national professional lines practice leader for AmWINS. “Merger and acquisition claims activity is always a concern, and settlement values just keep going up.”

The employment practices liability insurance (EPLI) market still has not firmed as some had predicted, although underwriters are carefully watching claim activity due to #MeToo. Claims activity has picked up, but the market has not yet adjusted. “As we moved through 2018, we saw retaliation allegations included in half of all employment practices claims, but the market has not changed as a result,” Lewison says. “If you are buying Employment practices, you definitely want to have prior acts coverage. The allegations that pop up today could be from many years ago, as evidenced in the Weinstein claims. If you’re a growing business, make sure you purchase higher limits to keep up with the risk.”
High-profile, headline-grabbing breaches haven’t been enough to give the cyber market pause, with underwriting appetite remaining strong. Although this is good news for buyers, the market is becoming more challenging for E&S brokers because interest from admitted markets is simultaneously broadening coverage and depressing pricing, with 30 percent renewal decreases not unheard of.

“My team wrote an additional 100 cyber accounts last year, but our overall cyber premium remained flat,” says Rich Fernandez, executive vice president, AmWINS Brokerage of Georgia in Atlanta. “Everyone is working a lot harder to put almost the same amount of premium on the books.”

The E&S market still has an important role to play in securing excess limits, as well as bespoke cyber coverage for challenging risks. AmWINS also introduced a program designed for small, transactional cyber risks.

“We have the ability to provide admitted paper in that program, which is important for retailers competing for smaller accounts,” says Sam Kravitz, senior vice president, AmWINS Access.

Although cyber coverage continues to broaden overall, there are some signs that insurers are taking a closer look at problem areas such as social engineering and ransomware, with some markets applying sublimits to those coverages.

“We are also seeing carriers looking at their property and liability coverage forms for ‘silent cyber’—ways they are unintentionally covering cyber and making sure that they are either charging for that exposure or changing their policy language,” Lewison says.

Excess cyber losses are also a growing concern. “Underwriters are paying limit losses on $10 to $20 million excess layers on large programs that were already underpriced to begin with,” Fernandez says.

“Cyber is definitely still a buyers’ market, but like any market, it will eventually change,” says Kravitz. “The only question is who makes the first move to change the market.”

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The amount of alternative capital in the global reinsurance industry surpassed $95 billion in 2018 and is on track to reach $100 billion in 2019. Although alternative capital is still less than 20% of the value of traditional reinsurance in the market (approximately $595 billion), it is notable that traditional capital growth remained flat during this same time span.

Although ‘alternative capital’ is a broad term, it typically refers to capital from institutional investors (primarily pension funds) that is given to a fund manager in order to assume insurance risk. The objective is to provide investors with “pure” exposure to insurance as an asset class, eliminating the other sources of risk—such as equity market risk and management risk—that exist when investing in (re)insurance companies. This capital is typically invested in financial instruments whose values are driven by insurance loss events and that can be linked to losses, especially property losses caused by natural catastrophes and weather events. They fall under the umbrella of Insurance Linked Securities (ILS) and include collateralized reinsurance, sidecars, aggregate retro products, and catastrophe bonds.

POISED FOR PAUSE?

Although alternative capital expansion continues its upward trend into 2019, there is a difference in how investors are allocating their funds in light of two years of significant losses. Hurricane Michael caused up to $10 billion in damage, and the Camp and Woolsey Fires in California combined for $13 billion, making it the second year fires passed the $10 billion mark.

“We are at an inflection point with the ILS market—a stage we haven’t reached previously with investors seeing existing capital tied up beyond year-end. However, we continue to believe that ILS capital will be a long-term sustainable source of capital for our industry,” says Scott Purviance, CEO of AmWINS Group, Inc.

Those capital restrictions come from elevated losses over the past two years, including adverse development from 2017 losses. With current investors unable to release capital allocated to those claims, the question is whether they are willing to commit additional money. However, even if certain investors choose not to re-invest, we believe other existing and new investors can fill that gap.

“Historically, alternative capital was deployed deeper in the value chain. Today, investors are increasingly moving toward collateralized reinsurance, which allows them to develop relationships with MGAs and deploy capital behind more defined pools of risk,” says Ben Sloop, COO of AmWINS.
Two words are shaping the London market as we enter 2019: performance management. Faced with massive losses over the last few years, high structural costs, and new leadership bringing in a different perspective, Lloyd's is undergoing a focus on performance management that is expected to shrink its 2019 gross written premium by around five percent and, ultimately, generate improvement in underwriting results.

For the retailer, this could create a potential impact as several major syndicates pursue a reduction in capacity. Some syndicates have been left with no choice but to close down some of their loss-producing classes.

"Lloyd's is going to write slightly less and demand more in pricing going into 2019. There will be a pullback going forward on loss-affected accounts," says Purviance.

But even with all this change and uncertainty, London will continue to provide the backbone for worldwide specialty insurance. “Our expectation is that the Lloyd’s market will remain hugely relevant across both its retail and E&S businesses. We are hopeful that after this period of retrenching in 2019, we will see a healthier, more vibrant, and entrepreneurial Lloyd’s in 2020 and onwards,” says Toby Colls, Director at THB Group. “Lloyd’s is still the number one E&S lines carrier in the world, and we do not expect this to change either in the short or the long term.”

And ultimately, the “short-term pain for long-term gain” strategy should benefit retailers, buyers, and the entire market.

“There will indeed be a change in the structure of many syndicates’ portfolios, and we will seek increased writings in some classes and reduced writings in others. However, we strongly believe this will benefit all of our clients who value their long-standing relationships with their London carriers,” Colls says.

**IMPORTANT PARTNERSHIPS**

What the changes in both alternative capital and London mean for retailers is that establishing partnerships with experienced wholesalers is more important than ever. In addition to providing connections to alternative capital, AmWINS has access to over 400 colleagues in the London market and other global regions under the THB brand, as well as direct relationships with global markets that can deliver solutions to retailers.

"The marketplace is very complex, so retailers need a wholesaler who can understand the market and be positioned to make use of available capital,” says Sloop. "Particularly as ILS funds move forward in the value chain, we can help access that capital in a more direct and effective fashion."