STATE OF THE MARKET

Q4 | 2019

As the year draws to a close, the pace of change taking place across the E&S landscape remains rapid and unprecedented. Collectively, we continue to make adjustments as markets analyze data and adjust their appetites. In our final edition of the State of the Market for 2019, our AmWINS experts examine the latest issues in the property and casualty space and provide insight into what continues to drive this dynamic marketplace.

ON YOUR TEAM.

AmWINS Group, Inc.

PROPERTY

The current conditions in the property market are expected to continue *well into 2020.*

The property market continues to harden, and carriers continue to look for increases, particularly on cat-exposed business. Rates are expected to maintain their climb through the first quarter of next year, as many feel the Q1 2019 accounts did not receive the full correction as those in later quarters, especially in tougher exposures.

When it comes to forecasting the future of property, weather is always the wildcard. “We dodged a bullet with Dorian, and we still saw rate increases,” says Harry Tucker, AmWINS Executive Vice President and National Property Practice Leader. “Also, while we still see Florida catastrophe capacity accessible, we anticipate that will tighten up over the course of the next 12 months.”

Additionally, we cannot diminish the effects of increased attritional losses. Hailstorms in the South and Midwest, water damage; CA wildfire; etc. are all adversely affecting the property market. The result appears to be significant rate and deductible increases, as well as a tightening of terms and conditions.

PROPERTY MARKET FACTORS

- **Conservative limit deployment**
- **Likely increase in reinsurance pricing**
- **Trapped ILS capacity**
- **Attritional Losses**
- **Loss creep on prior year losses**
- **Valuation**
- **Carrier De-Risking**

Overall, there has been a decrease in property capacity. Carriers are being more conservative in deploying limits on any one risk. While theoretically their capacity may not have changed, their working limits have. This strategy is in line with the overall objective of returning property books to an underwriting profit.

The lack of inexpensive reinsurance is a secondary factor. Carriers are not as willing to deploy their own capital where they once used inexpensive reinsurance. Reinsurance costs have increased, and less limit purchased means less working capacity.

A third factor is the decrease in capital allocated to insurance-linked securities (ILS). “The ILS market has shrunk modestly in 2019 after over 10 years of strong growth, largely due to ‘trapped capital’ and the aftereffects of the large storm seasons of 2017 and 2018,” says Tucker. “The ‘trapped capital’ phenomenon is due to the fact that capital cannot be fully released from collateralized ILS vehicles until there is a level of certainty around the ultimate claims payments; thus, during large loss seasons, investors have to hold capital back to pay potential claims rather than rolling this capital forward into the next year’s placements. While this has created a headwind on the ILS market during 2019, we still expect to see growth in the ILS space over the long term.”

UNDERWRITING’S ULTIMATE IMPACT

A new phenomenon which is causing strife within the underwriting world is public adjustors reopening closed claims (including closed no pay) resulting in loss creep. Public Adjustors are suing in order to renegotiate outcomes regardless of merit. Recently, an excess claim was closed, and then the carrier was sued, which resulted in a multi-million-dollar payout for what was initially declined. This practice has potential to escalate, much like assignment of benefits (AOB) did in Florida, and will require legislative action to rectify.

Property valuation is an item of discussion among underwriters, with many carriers taking a hard look at what they had agreed to over the past ten years. We expect this issue will persist and there will be a push for higher replacement cost figures as well as evidence of how values were determined. The consequence if one is not careful is a greater cost differential for the client: new higher TIV x new higher rates = greater premium increase.

Finally, standard lines carriers are de-risking certain exposures, causing more business to migrate from retail to the wholesale channel. Fewer standard carriers are offering large ground up limits, forcing agents to build capacity through multiple carriers on these tougher classes.

For tougher classes, the market is especially dynamic. This includes but is not limited to:

- The habitational property marketplace, particularly in TX & FL
- Undervalued accounts and accounts with a poor loss history
- Wood-frame Builders Risk
- Risks with significant exposures to convective storms
- Woodworking operations

Gone are the days of an indiscriminate shotgun approach to marketing. There is a strong flight to quality. Quality of data, submissions, brokers with expertise, a strong team and market knowledge will be critical for clients' positive outcomes.

SEGMENT SPOTLIGHT

Within the property market, some classes have seen notable challenges. In this edition of AmWINS State of the Market, we are focusing on three: Recyclers, Motor Truck Cargo and Dealer Open Lot.

RECYCLERS

Recycling operations have been plagued by property losses, primarily fires related to the storage and processing of scrap. As a result, rates have skyrocketed. "We've seen rates go from 18 to 60 cents and deductibles more than double. Even operations without losses will still see noticeable rate increases," says Tom Cesare, Executive Vice President, AmWINS Brokerage.

MOTOR TRUCK CARGO

Motor Truck Cargo has seen notable movement by carriers both entering and exiting the space. However, pricing has remained competitive overall. Many accounts are loss rated, so rate increases are hitting the accounts with tough loss experience the hardest. Incumbents are still typically the most competitive on tough renewals and are pushing for higher retentions in many circumstances.

Many markets are pulling back on motor carriers with fewer than three years in business. Commodities commonly targeted for theft, such as pharmaceuticals, auto parts, automobiles and heavy equipment, are also harder to place, requiring more excess policies to be written.

The additional challenge for brokers is that loss-distressed motor carriers, already struggling with thin margins and an experienced driver shortfall, struggle to absorb any increase in insurance rates. "We are seeing a significant uptick in consolidation and downsizing of our trucking insureds. The good news is they are putting a much heavier focus on safety, which is an investment but will significantly improve the performance of the class," says Judd O'Neal, Executive Vice President, AmWINS Group.

DEALER OPEN LOT

This class has always been subject to convective storm and hail. With increased storm activity and ever-increasing equipment values (new tractors can be worth $200,000 today versus less than $100,000 just 10 years ago), loss severity has skyrocketed, and the insurance market is becoming more distressed. Banks, which had often offset insurance losses with profits from vehicle financing, are seeing margins become thinner, driving more business to the E&S marketplace.

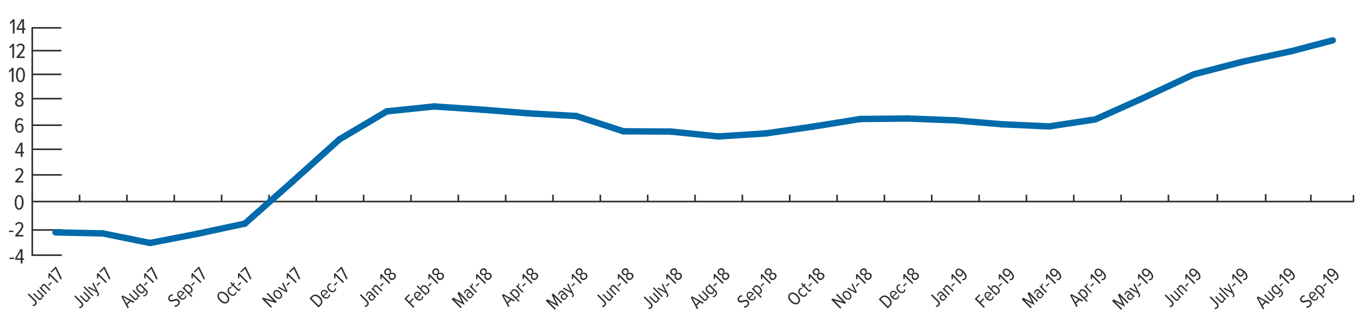
SUMMARY

The pace of hardening in the property market, expected to continue well into 2020, will present an ongoing challenge for retailers. Additionally, increased submission volume in E&S property is allowing underwriters to be more selective in their risk selection and large loss limits have become less attractive. It's imperative that brokers partner with a wholesaler that has broad market access and the ability to structure deals as they become more complex.

"If there's one upside for brokers in this tough market, it's that customer acquisition and retention should increase," Tucker says. "As long as you're getting a deal done, nobody will come and take it away from you."

RENEWAL PRICING TRENDS—PROPERTY RENEWALS, ROLLING QUARTERLY

Source: AmWINS property lines account data



CASUALTY

In a hardening market with time-strapped underwriters, class of business expertise and strong partnerships are *key to success.*

"Submission counts are up 25 to 35 percent with all carriers," says Tom Dillon, AmWINS Executive Vice President and National Casualty Practice Leader. "Underwriters are overwhelmed with submissions and need help in identifying the right opportunities."

Hardening in casualty continues in both primary and excess lines. There is continued rate pressure in the transportation, New York construction, long-term care and habitational segments, as well as marginal rate increase in products liability and non-habitational OL&T risks. Additionally, there is a significant volume of accounts being remarketed.

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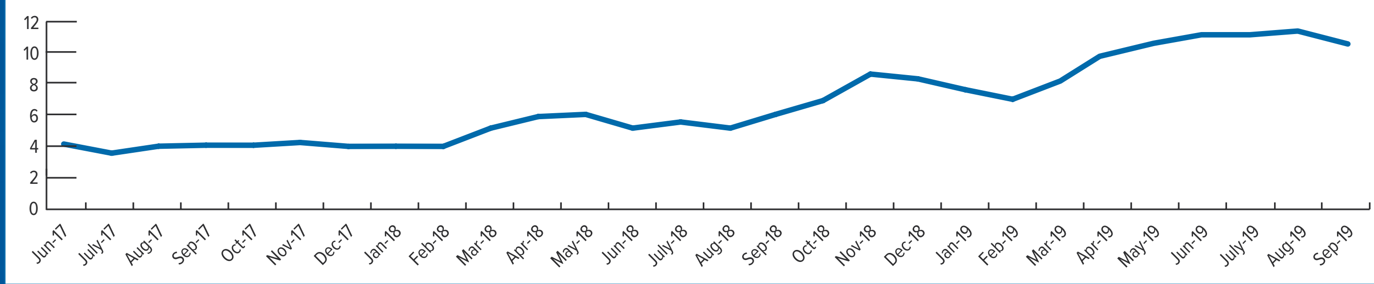
REAL ESTATE

Apartment risks remain one of the toughest casualty segments and, as noted in Q3, more owners are looking to obtain insurance themselves rather than be included within a property management company's portfolio in order to save money. Third-party slip-and-fall claims plague this sector, along with assault and battery, depending on the area of the country the risk is located. Verdicts continue to go up, especially in areas like FL, NY, GA, CA and TX. Sadly, the jurisdiction in which the claim takes place is becoming the much larger factor in what carriers can do instead of the actual way in which the locations are managed.

Markets are also looking to place additional exclusions on accounts. "We are seeing more carriers wanting to restrict coverage by adding punitive forms such as habitability exclusions in California, action over exclusions in New York, and A&B sub-limits or exclusions in Georgia and Florida," says Corey Alison, Executive Vice President, AmWINS Brokerage of Georgia.

Another notable shift is in the amount of loss runs a carrier will require. Not too many years ago three to five years was sufficient, which then shifted to five years being mandatory. Now it is not unheard for a carrier to request six, eight or even ten years of loss runs. The need for loss runs on new acquisitions is also necessary in most situations now as well.



RENEWAL PRICING TRENDS—CASUALTY RENEWALS, ROLLING QUARTERLY

EXCESS & UMBRELLA

Claim severity is an ongoing issue in the excess space. Continued multi-million-dollar judgements driven by sympathetic juries, time-limit demand changes, and social inflation have played a huge role in carrier behavior. Unfortunately, positive changes in tort reform are not expected anytime soon.

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There is shrinking capacity in almost all areas of excess, especially auto, wildfire and active-shooter exposed risks. Shrinking capacity has caused rates to increase across the board. It is not uncommon to see capacity being cut in half while premium remains at the expiring or higher. Carriers are also being strategic as to where they participate on excess towers and are cautious as to the amount of capacity they provide on those towers.

The segment most affected by this capacity limitation is the trucking space. “Many carriers have either completely exited the space, reduced their capacity and/or moved up the tower. This has created a market where we need more carriers to build large towers, as well as the need to access the London and Bermuda marketplace in order to complete placements,” says Tim Larocca, Executive Vice President, AmWINS Brokerage of the Midwest.

EXCESS & UMBRELLA *(CONTINUED)*

Additionally, we continue to see a lack of carrier interest in lead $10m for real estate accounts. Many RPG programs that were offering $100m to $300m in limits have evaporated, creating a large demand with few carriers eager to write the class in a lead position in the brokerage marketplace. Those willing to participate are looking for premium levels at multiples of the expiring RPG program pricing and sometimes rely on facultative reinsurance to support their capacity.

“Players in excess habitational consider the lead $10 million to be a working layer and are pricing for it similar to the underlying primary,” says Terrance Villar, Executive Vice President, AmWINS Brokerage of California.

SUCCESS FACTORS

In a challenging casualty market, submission quality is essential to success. “Underwriters are pressed for time. They want to get the full picture of an account up front and hear the story of why a risk is a good write,” says Dillon. “Phone conversations and face-to-face discussions are still the best way to sell a deal.”

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Client preparation is vital as well. Insureds deserve to be properly advised of the rapid change in our marketplace. Delivering difficult news is not pleasant, but the quicker brokers can identify and address a situation, the better the outcome will be for clients.

PROFESSIONAL LINES

Conditions vary widely across a diverse professional liability insurance sector, highlighting the importance of wholesale partnerships.

Professional Lines has always been a diverse market that defies a single characterization of condition. For instance, financial institutions remain competitive with relatively stable capacity, whereas opposite conditions exist for health care facilities and others. Only by looking at individual segments can a complete picture of the professional lines market be painted.

DIRECTORS AND OFFICERS

The D&O space has traditionally been a tale of two markets: private, which was competitive, and public, which was not. Although that is still the case overall, the private D&O market has seen some firming. “Carriers are pushing rate and expecting to get it,” says Kevin Dorse, Executive Vice President, AmWINS Brokerage of Georgia.

Although there have been some new entrants into the public D&O space, the market remains firm, especially for IPOs, technology, and biotech operations. In particular, the IPO D&O market is the hardest in history, with only a handful of markets writing primary.

“Premiums are through the roof, and $750,000 retentions have gone to multiple millions,” says Dorse. “However, we still have carriers out there willing to come in and pick up accounts.” This rate environment should be consistent for the next 12 months.

In excess public D&O, capacity is an issue, and the market is incredibly firm. Excess pricing is typically three times more expensive for the primary, often running at 90-110% rates. Underwriters are currently overwhelmed by submissions and are working with those they know and trust.

“When the market is hard, more communication is essential. Suggesting creative alternatives that an underwriter may accept are a way to differentiate your submission from others,” says Dorse.

MEDICAL PROFESSIONAL

Medical professional liability continues the hardening seen throughout 2019. “There are fewer and fewer players in the space, including recent withdrawals of Swiss Re and OneBeacon,” says Philip Chester, CPCU, Senior Vice President, AmWINS Group.

“There have always been a limited number of players for correctional health, and it’s becoming more limited,” says Chester.

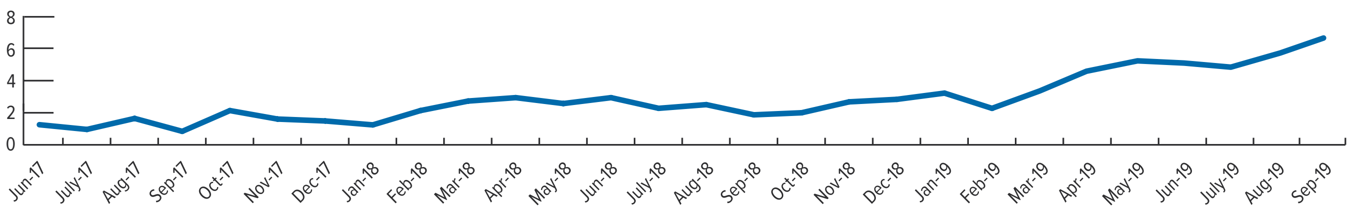
Long-term care is one of the toughest sub-sectors, with markets taking double-digit increases and demanding higher retentions. Carriers are also taking a stricter position on drug and alcohol rehab facilities and correctional facilities.

“There have always been a limited number of players for correctional health, and it’s becoming more limited,” says Chester. “This typically is a frequency-driven class. Prisoners have a lot of time and flood carriers with meritless claims that have to be defended. Carriers that had low retentions paid an exorbitant number of claims.”

Markets also are looking more closely at underwriting sexual misconduct exposure. “Plaintiffs’ attorneys are more aggressive and we are seeing more severity,” Chester says. “We have seen several markets cut back on abuse and molestation limits.”

RENEWAL PRICING TRENDS—PROFESSIONAL LINES RENEWALS, ROLLING QUARTERLY

Source: AmWINS professional lines account data



FINANCIAL INSTITUTIONS & CYBER

Financial institutions, including private equity, hedge funds, banks, and other asset management firms, are a bright spot in the professional lines market, remaining stable with ample capacity available, particularly for small- and mid-sized accounts.

Cyber is a key coverage for the financial sector and remains a highly competitive market. "There are a plethora of markets and coverage is ridiculously broad in some cases," Dorse says. "Even if you run across a carrier not looking to write certain cyber coverages, there are so many carriers that it's not a problem."

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"We are seeing $1,500, even $1,000 premiums, and that is concerning," Chester says. "At some point that has to come to roost because of the claim activity out there."

OTHER LINES

Employment Practices Liability (EPL) continues to firm, particularly in problem jurisdictions. "California is an absolute nightmare right now, but there are markets willing to do it outside the real hotbed areas like Orange County," says Dorse. Accounts that have seen significant growth in staffing may have an easier time digesting increasing higher premiums for EPL, based on cost per employee.

Architects & Engineers is seeing a bit of firming, especially for the more challenging areas of design, but there is still is a great deal of capacity for wholesale brokers.

The bottom line for retailers is that conditions vary widely across a diverse professional liability insurance sector. Success starts with partnering with a wholesaler that understands this diversity and has the market access and established underwriter relationships to write and retain business.

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