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2021 / Q2 Q3

State of the Professional Lines Market

Second and Third Quarter, 2021

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State of the Professional Lines Market

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Similar hard market conditions experienced in the first quarter of the year continue to impact many professional lines of business in the second and third quarter of 2021.

There are reasons to be optimistic as the economy reopens. However, our post-pandemic environment may unleash a backlog of professional liability claims and coverage issues that the industry needs to prepare for.

All professional lines are feeling the effects of a hard insurance market. Cyber liability, however, has and continues to experience the greatest degree of change. In addition to facing increasing rates and more restrictive terms, buyers will be asked to demonstrate their commitment to cybersecurity risk mitigation as underwriters become more selective, declining and non-renewing risky accounts.

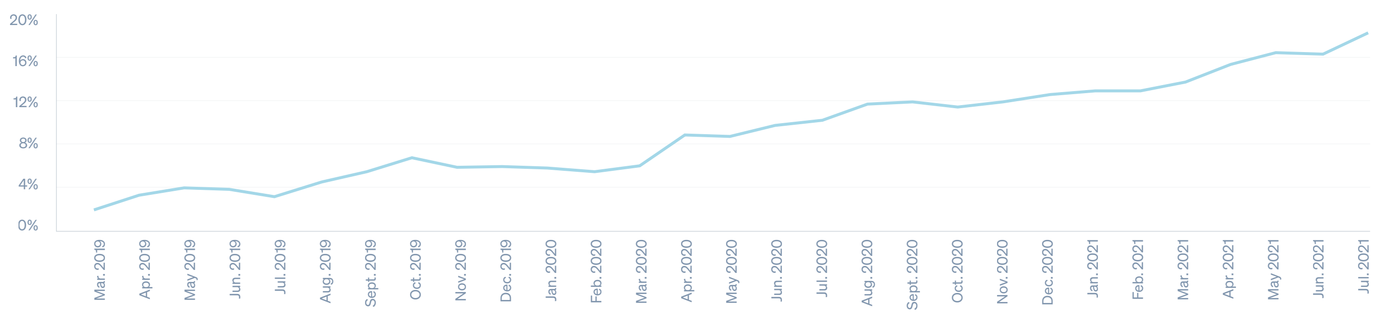
Despite the economy attempting to return to normal, there are some lasting exposure changes from the pandemic, such as telemedicine. Many insurers now offer e-health package policies to address medical malpractice and privacy-related issues, with this business anticipated to grow even faster.

The area of Employment Practices Liability is likely to experience issues as more employment-related claims are filed, potentially stemming from return-to-work mandates or rehiring furloughed employees.

While D&O liability has experienced some degree of rate flattening, this could abruptly change as activity surrounding mergers and acquisitions and special purpose acquisition companies increase. Moreover, the post-pandemic reopening of the judicial system may also become a potential driver of D&O claims. Additionally, strong market outlook exists for reps and warranties liability, as struggling businesses in the wake of COVID-19 look to cash out, increasing the number of corporate transactions over the next several months.

To close this introduction on a positive note, contractor's professional and architects & engineers business is positioned for significant growth and opportunity as the economy improves and building projects resume – not to mention the potential boost from proposed Infrastructure Bills.

Renewal Pricing Trends – Professional Lines Renewals, Rolling Quarterly



Professional Lines Segment Snapshot

Architects & Engineers / Contractors Professional

Cannabis

Cyber

Directors & Officers

Healthcare

Architects & Engineers / Contractors Professional

Overall Segment Trends

Many construction projects are continuing to see scheduling delays and once completed, we will likely see an increase in claims activity for contractors due to these project delays and alleged negligent construction management, leading to a significant increase in project costs. While most of the current challenges causing inflation and delays are out of the contractor's control, professional liability coverage will be increasingly important (albeit more costly), as it helps contractors defend against allegations.

– **Inflation.** Inflation will continue to have a huge impact on construction. As a sector dependent on materials and skilled labor, both of which are scarce resources in the current market. Rectification costs on the claims side are also at an all-time high, and many insureds have yet to factor in these inflation costs and adjust their professional liability limits to reflect the increased cost of the exposure. Now is a good time to re-evaluate limits.

– **Claims.** We are seeing above average claims frequency pertaining to alleged MEP and HVAC design errors at healthcare facilities, along with an increase in residential claims, particularly with condo work. While structural and geotech engineers have always been tougher classes, we are finding that chemical and mechanical engineers are also falling into a higher risk rating class.

– **COVID-19.** As a result of COVID-19, we believe there will be increased pressure on mechanical/HVAC design professionals regarding air quality and the unhealthy/toxic indoor environment that some HVAC designs have the potential to cause. Mechanical/HVAC contractors may have a heightened responsibility to correct poor design work when working with someone else's design plans.

– **Federal Legislation.** New federal legislation will make funds available for infrastructure repairs and improvements for the foreseeable future, particularly for civil engineers, structural engineers, architects and surveyors. And while this bodes well for the industry, it puts additional pressure on construction employers to find the labor and materials they need. Additionally, the new infrastructure bill includes significant requirements for the construction industry when it comes to addressing climate change by reducing carbon emissions.

Exclusions and Coverage Limitations

Exclusions that should be a concern for brokers include cost overruns, delay in construction/delay in delivery and faulty workmanship. The most meaningful coverage limitation in the A&E space pertains to limits profile management, where carriers appear to be far more selective in offering limits greater than $5M. Some markets are going so far as to put low limits caps on specific disciplines.

Capacity and Pricing

Capacity remains plentiful in the A&E space. On average, we're seeing 5-10% increases. However, some accounts can see up to 25% increases, depending on claims activity.

On the contractor side, smaller contractors working on residential condo projects will likely have a difficult time finding a minimum premium policy. Today, we're seeing carriers underwriting more to the project than ever before, which leaves small residential contractors with few affordable options for their professional liability policy.

While pricing is an important consideration when choosing an A&E carrier, an insurance company's claims handling experience should be another critical factor in the decision-making process.

Insight provided by:

– Katie Kruizenga, EVP with Amwins Brokerage in San Francisco, CA
– John Grise, SVP with Amwins Brokerage in Hopkinton, MA
– Brett Fowler, VP and Program Manager of Amwins' A&E Insurance Program

Cannabis

General Segment Trends

Without broad stroke legalization, the cannabis/CBD marketplace remains extremely limited and will continue to be. The fact is, despite industry growth and opportunities in the cannabis insurance space, few carriers are willing to write the risk. And while passage of the SAFE Banking Act will expand access to banking and other financial services for the cannabis industry, it will also likely trigger new market entrants into the space.

Exposure Changes – Cyber

Cyber claims and rates are on the rise, with a trickle-down effect as it pertains to the cannabis sector. Currently, only three carriers in the cyber space write cannabis operations, and they are generally raising rates and retentions.

To obtain coverage under a cyber policy, cannabis operations will be required to complete a ransomware supplemental application. If risk mitigation controls aren't there, carriers will either decline coverage, offer a small sublimit or attach a co-insurance endorsement asking the insured to share in the risk/loss. Currently, we are seeing carriers provide insureds with proactive suggestions for implementing better cybersecurity safeguards that, once complete, may lead to less restrictive terms.

Today, less than 10% of U.S. cannabis companies buy cyber insurance. This is an alarming trend given that in 2020, CNN predicted that cannabis would be the next big target for hackers. Retailers must stress to clients that no company is immune from a cyberattack, and a single event could put them out of business.

Capacity and Pricing

Retentions and premiums are increasing across all lines, while simultaneously, carriers are capping their limit output. However, this is a normal reaction given the level of uncertainty in the marketplace and only a few carriers shouldering the industry's exposure. D&O is a perfect example, where a carrier that has paid the most in claims is asking for the highest retentions.

The cost of running a cannabis business remains extremely high, with debilitating tax implications. In states like California, the black market is alive and well, so that drives competition up and prices down. In turn, the cost of insurance and higher retentions (in the event of a claim) all negatively impact a company's bottom line. For many of these businesses – even the most successful ones – there remains a challenging uphill climb.

Insight provided by:

– Brian Savitch, SVP with Amwins Brokerage in San Francisco, CA

Cyber

Overall Segment Trends

Ransomware has been the biggest claims driver over the past year – in both frequency and severity – and is an issue most often triggered by lenient security controls.

Extortion demand amounts are surging, with payouts running into the seven-figure range. The severity of these claims can cause a problem regarding limit adequacy, and as a result, benchmarking appropriate limits becomes impossible when the extortion demand amount itself can swing to such severe levels.

The lack of multi-factor authentication (MFA) usage by clients is proving to be a challenge when securing coverage. Currently, we are seeing underwriters put pressure on the security controls employed by insureds to better mitigate risk exposure.

Moving forward, the market will require insureds to demonstrate they have the necessary risk mitigation security controls in place, such as MFA on remote access, email and/or privileged IT accounts as well as backups in the cloud (or otherwise segregated from the network). Companies that lack this may see higher premiums, coverage restrictions or find that coverage is unavailable to them.

- **Municipalities and Education.** These two sectors remain prime targets for ransomware attacks. Being budget-driven industries, allocated funds available for cyber security or a CISO/security team are often less robust than that of other industries. They also serve a large constituency, so interruptions are especially problematic – of which hackers are aware. Currently, we are seeing many carriers pull out of this sector. Those that remain are extremely selective or have initiated a moratorium.

- **Energy.** The Biden administration has openly addressed ransomware, and the DHS is publishing guidance and requirements around cyber incidents in the energy space. Currently, we're seeing state governments adapt and update their statutes – hopefully, these conversations will lead to action.

- **Other Industry Classes.** Manufacturing, distribution, warehousing and transportation have traditionally paid very competitive rates due to lack of personal identifiable information (PII). However, loss trends have changed as ransomware has taken over as the leading cause of loss. Business interruption due to locked up and ransomed networks has triggered costly losses in the manufacturing sector.

Capacity and Pricing

Cyber liability differs from other hard market environments in that capacity remains available, although the maximum capacity available to individual accounts has been reduced.

Currently, we are seeing very few markets willing to offer $10M limits. Most accounts that purchased a $10M limit from a single carrier in 2020 are now seeing those limits cut to $5M – with pricing increasing, sometimes dramatically, on renewal.

Due to the growing number of ransomware losses, carriers are attempting to drive multi-year corrections across their books in a single underwriting year. Premiums are likely to continue rising well into 2022, but hopefully at a much more subdued rate.

Insight provided by:

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Directors & Officers

Overall Segment Trends

With substantial growth in the Special Purpose Acquisition Companies (SPAC) space, the SEC is increasingly scrutinizing structures and internal controls. This has caused an already difficult D&O market to take note of the additional risks inherent to SPACs and the de-SPAC process.

Currently, the market for SPAC D&O has become even more challenging, with only a handful of interested markets. Given the avenues for lawsuits available to plaintiffs' attorneys and increased SPAC activity, legal action has also exploded – with the rate of new lawsuits in 2021 more than tripling from that of 2020.

This has raised underwriting concerns and underwriters may elect to assess and price accounts on a portfolio basis, rather than an individual basis, hoping to collect enough premium to cover portfolio losses in the absence of data or experience on which to base individual account pricing.

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Capacity and Pricing

While SPACs, de-SPACs and IPOs continue to command high retentions and premiums, the market for IPOs seems to be expanding due to more opportunistic pricing and terms. However, the market for SPACs and de-SPACs seems to be constricting further due to "lessons learned" from claims against the early writers of de-SPACs. Underwriters are pricing SPAC extended reporting periods at 275-300% for six-year periods.

For the D&O market as a whole, we're currently seeing renewals between 9% and 12% — higher for accounts with losses or greater risk exposures.

Exposure Changes

Class action suits for alleged faulty or inadequate disclosures in transaction documents are on the rise, with suits being brought by investors, as well. SPACs have also become targets of "strike suits" where actions are filed in an attempt to prevent a merger and are quickly settled with a large payout to the plaintiffs and their attorneys, allowing the merger to proceed.

Coverage Limitations and Exclusions

D&O insurers across the nonprofit, private and public spaces are addressing cyber and privacy risks with specific exclusions where they had previously remained silent. As cybersecurity issues in the D&O space grow, we'll likely see this trend continue.

Underwriters are now offering only Side A D&O coverage – using an 'ABC' policy form and subtracting B&C coverage – on risks they perceive to be difficult.

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Healthcare

Overall Segment Trends

Market conditions for healthcare have yet to soften, with a few major carriers electing to either pull out of certain types of healthcare risks or pull out of the space entirely. For carriers that remain, many are non-renewing accounts in challenging classes, such as long-term care, but are still actively writing other miscellaneous healthcare risks. The good news is there are new market entrants on the horizon – headed up by industry veterans with credible backgrounds – that will bring capacity and hopefully more stability to the healthcare insurance market.

As the world reopens from the pandemic, we haven't seen the amount of medical professional liability claims some expected. However, it's too early to say that the storm has passed. We can expect factors such as applicability of state and federal immunity laws to impact the outcomes of any emerging litigation in this space.

Capacity and Pricing

For the most part, the coverage restrictions and pricing trends that we saw implemented in the second half of 2020 have continued through the first half of 2021. However, while rates in the healthcare marketplace continue to increase, we are seeing a slowdown in the percentage increases. Capacity overall is picking up as the new market entrants get their forms up and running. We expect to see rate changes leveling off in late third quarter or fourth quarter due to the new capacity and competition. This will depend on the particular class of healthcare risk and where that capacity chooses to play.

We continue to see challenging placements in plaintiff-friendly jurisdictions and venues. This likely won't change until respective laws and tort reform go into effect.

Capacity for cyber has been extremely difficult this year, with ransomware attacks dominating the national news. The healthcare sector has not been immune to this issue. Due to the increased risk, limits and market capacity for cyber liability in the healthcare sector are shrinking, while rates and retentions have increased.

Purchasing Behavior

With reduced revenues and added expenses in areas such as PPE, many healthcare insureds – especially in long-term care and home healthcare – are keeping a close watch on their bottom line and simply can't afford the current rate increases. July's 30-40% renewal increases will likely drive insureds to seek alternatives, such as self-insured or risk retention groups (RRGs). However, retailers need to be aware of the potential pitfalls in placing coverage with an RRG as well as issues in tail coverage when moving back to the traditional insurance market.

The ongoing challenges faced by hospital professional liability has initiated self-funding programs and captive considerations that are typically only seen with major healthcare systems. Today, however, we are beginning to see mid-level hospitals evaluate these options through feasibility studies.

Coverage Limitations

More carriers are moving away from writing professional risks on an occurrence form, making the switch to claims-made, as well as mandating deductibles and no longer offering first dollar coverage.

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