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PREPARING FOR A HARDENING INSURANCE MARKET

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Up until 2018, companies have enjoyed the fruits of a "soft" commercial insurance market. A soft market is generally characterized by declining insurance rates and increased availability of generous coverage enhancements. Many things contribute to a soft market: loose underwriting criteria, expanded carrier appetite that pulls business from the non-standard (higher-risk) markets, abundance of carrier capacity, and increased competition amongst carriers. It's a perfect situation that yields reduced rates and improved terms for policyholders.

As with most industries, there are cycles of expansion and contraction. Think of it in terms of residential real estate; the buyers' and sellers' markets. The insurance industry has been soft, a buyers' market, for many years. There are signs of a shift toward a hard market, a sellers' market, on the horizon. The current symptoms of the turn towards a hard market are evident and impossible to ignore. Take the auto liability market, for example.

AUTO LIABILITY MARKET STATUS

Most policyholders have watched the auto liability market harden over the past few years. The amount of carrier claim payouts exceeded the premium dollars coming in, which created an unsustainable environment for a majority of the auto carriers. Many factors contributed to increased claim activity and expenses (a healthy economy, rises in healthcare costs, expenses to fix cars with newer technology, increases in distracted driving, etc.).

Insurers have employed a few approaches to course correct their auto book with the same goal: break even and position to make a profit in the future. They are increasing rates, whether by implementing a long-term "rate creep" in which they gradually increase over several years, or increase by larger rate amounts over a matter of just a few years. Carriers are also being more selective about the quality and type of auto risk they take on, which reduces competition and increases rate for any losses challenged, or risks from smaller fleets that don't have the buying power or ability to spread risk.

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CARRIER PROFITABILITY

Carriers' profitability is continuing to decline for a variety of reasons. Their investments typically lie within bonds due to certain regulatory requirements. The yields have not been fruitful, putting a strain on operating budgets. This combined with continued expenses and poor loss ratios within some classes of business and coverage lines cause carriers to react by tightening their terms.

REINSURANCE CHANGES

While all of the above is happening, reinsurance has become more of a struggle due to capacity in the market shrinking. Carriers purchase and renew reinsurance on common renewal dates at the beginning and middle of the year. Reinsurance is utilized by insurance carriers to share in risk, usually on a tiered basis, where the carrier is responsible for a certain primary portion of the loss and the rest is backed by reinsurance.

Recent natural disasters and resulting catastrophic losses have caused reinsurers to suffer poor results and reevaluate their treaties/agreements. The California wildfires alone were estimated to produce $12 billion in insurance losses paid last year[1]. Severe shock losses such as these send ripple effects through reinsurance layers. Reinsurance is costing more, and additional restrictions on coverage that didn't exist before are being applied. This puts a strain on capacity within the market; as that capacity shrinks, insurance carriers are beginning to take on more risk that would have otherwise been reinsured. This creates an adverse effect on rates, underwriting flexibility, and carriers' appetites. The reduction in competition for risk creates a very vulnerable environment for the policyholder.

ACTUARIAL MODEL CHANGES

Recent natural disasters impacting loss ratios have caused carriers to change their modeling. In response, actuaries have identified and reclassified certain hazard zones, including coastal fronts, and flood or wind prone areas. Some carriers are limiting or excluding coverage based on jurisdiction due to poor loss results. The lack of affordable availability of coverage for certain jurisdictions puts more cards in the hands of the carriers that do provide coverage in those areas. These new models change their appetites and capacities for risk, contributing to the increased rates.

UNDERWRITING APPETITE

Poor underwriting results and tightened reinsurance cause carriers to start reevaluating classes of business they write. This causes a heightened sensitivity to underwriting guidelines and claim activity. Carriers begin to ask more qualifying questions, non-renewing accounts that are loss challenged and look to impose additional rates to subsidize their increased risk. As

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these appetites change, we start to see carriers back away from lines of business they previously wrote, revise and tighten risk qualification, and become less inclined to make exceptions.

SURVIVING IN A HARD MARKET

These are a handful of factors that have brought a storm over the formerly soft market. The signs are evident; however, the extent of how far the market is turning has yet to be determined. Various industry segments and lines of coverage are being affected in different degrees. The real estate and marine industries are taking the brunt of the impact, given that their exposure profile aligns with most of the coverage areas that have been hit the hardest. The construction industry is a close third, given the recent limitations on excess capacity and the existing auto fleet exposures.

As history tells, the duration or the makeup of the cycle can be different, but the market shifts between soft and hard are inevitable. The market continues to firm as we approach the close of the second quarter, and the overwhelming evidence is that the pendulum is shifting toward the hard market. At this time more than ever, it is imperative to have a proactive commercial insurance broker as your advocate to mitigate the market impacts on your specific insurance program. Reach out to an experienced broker today to learn more about how you can prepare for the hardening market.

References and Resources

1. Insurance claims from deadly California wildfires top $12B, https://www.djc.com/news/re/12121564.html