PARKER SMITH & FEEK
An IMA Company

COMMERCIAL INSURANCE
EMPLOYEE BENEFITS
PERSONAL INSURANCE
RISK MANAGEMENT
SURETY

GENERAL

Markets in Focus

Insurance Pricing & Market Update

Q3 2022

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INTRODUCTION

Even though the commercial insurance industry has grown over the past few years and revenues have been increasing, the market slightly slowed down because of the COVID-19 pandemic[1]. This was mainly due to the severe economic downturn, with businesses closing temporarily or permanently.[2] With businesses ceasing operations, there was a sharp rise in the unemployment rate, creating lower demand for industry services.[3] The demand for businesses considered to be essential and the corresponding increased premiums were enough to offset the effects of the pandemic.[4] As businesses reopen and the economy recovers, industry revenue will continue to rise.[5] Growing businesses are more likely to expand their operations when profit levels increase, but to expand, they need to purchase more insurance for employees and facilities to continue operating as a legal business entity.[6] Industry revenue is anticipated to grow at an annualized rate of 4.4% to $240.2 billion in 2022 including a 2.8% rise in 2022 alone.[7] While pricing is still relatively elevated, capacity remains available within the market for favorable accounts. To reflect this change in the market from the pricing peaks of 2020 and early 2021, we are no longer referring to the general P&C market as a "hard market," but instead have transitioned into what we are calling a "disciplined market."

As Federal Fund Rates (FFR) and interest rates rise to combat inflation, it has become significantly more expensive to finance acquisitions and fund projects with debt.[8] As such, the elevated cost of capital for companies tends to result in a slow-down in the economy and an overall decline in demand for business insurance.[9] In the past, extended recessionary environments have typically led to a lagged "softening" of the overall insurance market – the most recent example of this occurred in the ten-year soft market that arose after the 2008 Financial Crisis. Not all recessions are the same nor have the same market forces, and the next anticipated global recession (which the U.S. might technically but unknowingly be in at the time of writing, since Q2 GDP figures have not yet been calculated) will most likely include some unique factors. These include ongoing global conflict, labor shortages and supply chain woes keeping pricing for goods and services elevated despite economic turmoil. We will continue to monitor the changing market landscape and keep our clients informed on how to achieve the best results with their risk management programs.

> While pricing is still relatively elevated, **capacity remains available** for favorable accounts

2H OUTLOOK

Property

The market continues to bifurcate between CAT exposed risk and non-CAT exposed risk.

- Facultative reinsurance and 7/1 treaty reinsurance rates are on the rise for heavily CAT-exposed properties, which is expected to impact primary rates moving forward.
- With multiple years of difficult hurricane losses, an anticipated 20 named-storm hurricane season in 2022[10] and reinsurance difficulties for some carriers[11], coastal properties will continue to be a challenge from pricing and capacity standpoints.
  - This is particularly true for the residential property market.
- Wildfire-exposed properties are also receiving extra scrutiny in western states, but larger wildfire losses have primarily been associated with residential and hospitality-focused properties.
- Inflation and supply chain woes have resulted in a rise in demand for Business Interruption coverage, which has generally caused an increase in pricing and additional scrutiny from underwriters. Insureds with more complicated risks should be prepared to provide supply chain maps, forensic accounting reports and engineering analysis in order to get underwriters more comfortable with writing their risk.
- Many underwriters are challenging valuations for properties and business interruptions due to recent deltas in reported property values and total claims costs.
  - Third-party valuation reports have become the norm for quotes.

General pricing estimates

Non-CAT exposed property with favorable loss history	Flat to single digit increases
CAT exposed property with favorable loss history	Flat to 10% increases
Property with unfavorable loss history and/or a lack of demonstrated commitment to risk improvement (unresolved recs, pattern of same issues, etc.)	10%+ increases for non-CAT 25%+ increases for CAT exposed accounts and higher depending on frequency/severity of losses and when there are limited markets for a risk due to occupancy/class of business or concerns related to loss control

Casualty

The industry experienced 24 months of dramatic rate increases and capacity reductions, but in recent months it has moderated.

- The overall casualty market remains in good standing, with primary general liability rates continuing to remain flat in areas of risk with favorable loss histories.
- As the back-logged court systems catch up to the pace of pre-pandemic operations, carriers are keeping a close eye on loss trends across the country. Carriers are expecting large settlements and judgments from sympathetic juries, compounded more than ever with the pressure from social inflation.[12]
- Carriers are typically looking for more history of loss information, more details related to past losses and any subsequent changes made to prevent future losses.

Nuclear Verdicts (Verdicts Greater than $10M) – In recent years, as plaintiff attorneys continue to push for increasingly higher awards, businesses can lower the chance of a nuclear verdict by implementing the proper risk management tactics.[13]

- One strategy is to have proactive communication between your claims team and defense counsel. The outcome can be detrimental to a business if the claims team has delayed communication on a case that could have been settled earlier but is now headed to court.[14]
- The best defense counsel can mitigate the risk of nuclear litigation. In selecting a lawyer, claims leaders should use data from past cases to match their most capable attorney with the right type of cases as they enter litigation.[15]

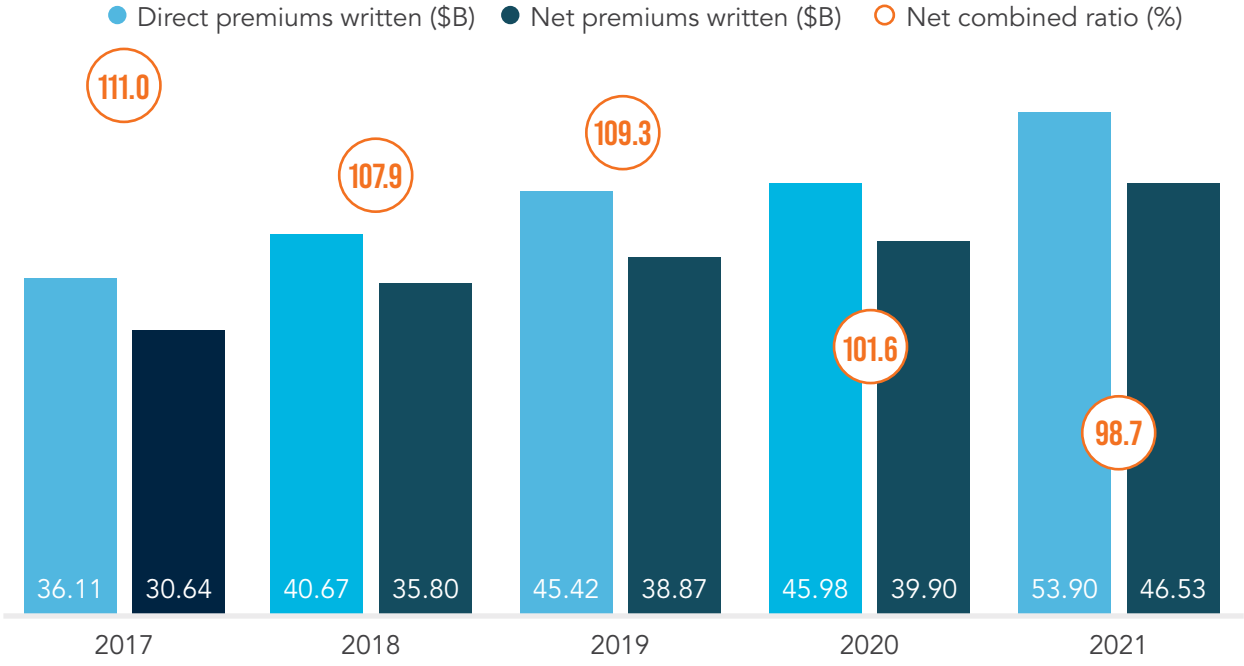
Umbrella/Excess – Excess capacity remains adequate but lead Umbrella underwriter offerings are being required to reduce offered limits from traditional $25M layers to $15M with some offering as little as $5M. In turn, a stacking of insurance carrier tiers are generally needed to achieve desired limits.

Auto – The auto industry had loss ratios above 100.0 for the 10 years prior to 2021, which now has resulted in challenges for those who have large fleets. Social inflation and nuclear verdicts have hit this sector hard, and carriers have taken note. The demand for fleet monitoring technology is on the rise, and many auto carriers are investing in telematics in hopes of improving loss ratios.[16] New "insurtech" entrants are driving the trend toward telematics implementation and adoption in the auto industry, which will allow underwriters more rate flexibility on new business, but also help insure less favorable drivers.[17]

- **Auto physical damage (APD)** coverages are seeing scrutiny from underwriters due to the difficulty of assessing vehicle valuations.[18] For the first time in the foreseeable past, the values on in-use tractors and trailers have been on a steep incline as supply chain issues cause delays and an increased demand for equipment and critical components.[19] A trusted broker should advise their clients to carefully appraise their fleets, as actual cash value of their units listed on the policy may not be sufficient to replace with a comparable unit in their marketplace if they were to experience a loss.[20]

Industry's combined ratio under 100% for first time in at least 5 years

Industry's commercial auto combined ratio dropped below 100% in 2021



Date compiled April 25, 2022.
Data reflects the aggregation of all individual property and casualty filers that submit regulatory statements to the NAIC. Based on the annual NAIC statutory property and casualty statements. U.S. filers only. May include business written outside of U.S., if reported in NAIC statement. Direct data is derived from exhibit of premiums and losses, prior to consideration of reinsurance for commercial auto physical damage, commercial auto liability, and commercial auto no fault reported lines of business. Net data is derived from insurance expense exhibit, after consideration of reinsurance for commercial auto physical damage in commercial auto liability reported lines of business. It was common practice to ensure premium credits during 2020 for auto insurers, but there was no standard practice for this among insurers. No effort was made in the exhibit to fully adjust the premiums for year over year premium growth beyond what was reported by each company. Combined ratios displayed hour before policyholder dividends. Source: S&P Global Market Intelligence.

+ **Workers' Compensation** – This line of coverage continues to be a bright spot for insurance purchasers, which has been a profitable line of business for many carriers and capacity remains stable. Pricing is still dependent on loss history and Modification Factors, but carrier competition over accounts with adequate to strong loss history continues to help pricing.

General pricing estimates

General Liability	Up 5% - 15%
Workers' Compensation	Flat to Up 5%
Auto	Up 10% to 25% Up 30% if large fleet and/or poor loss history
Umbrella & Excess Liability – Middle Market	Up 10% to 25% +
Umbrella & Excess Liability – Risk Management and other Complex/ Hazardous Exposures	Up 25% to 150%

Executive Risk

D&O and Cyber markets are seeing their own set of unique challenges.

D&O – After a very hard market in 2020 and much of 2021, rates stabilized in early 2022 and there now appears to be small downward pressure on rates for the second half of 2022.

- Multiple years of substantial rate increases have lowered the insurers' loss ratios, returning them to profitability, broadly speaking
- Because of the attractive rates in the D&O space from the insurers' point of view, additional insurance capital has entered the market over the last 6–12 months
- At the same time, there has been a large decrease in the number of traditional IPO's, SPAC IPO's and De-SPAC transactions. With these areas no longer demanding insurance capital, the insurers are competing more aggressively for traditional / mature companies. This, in addition to the reasons mentioned above, has shifted the supply / demand dynamic and created a more favorable market for policyholders over the last few months
- Despite the comments above, there are certain sectors that continue to be in a "hard" market, including certain industries (i.e., Crytpo, Cannabis, etc.) and certain risks such as SPAC's and De-SPAC's

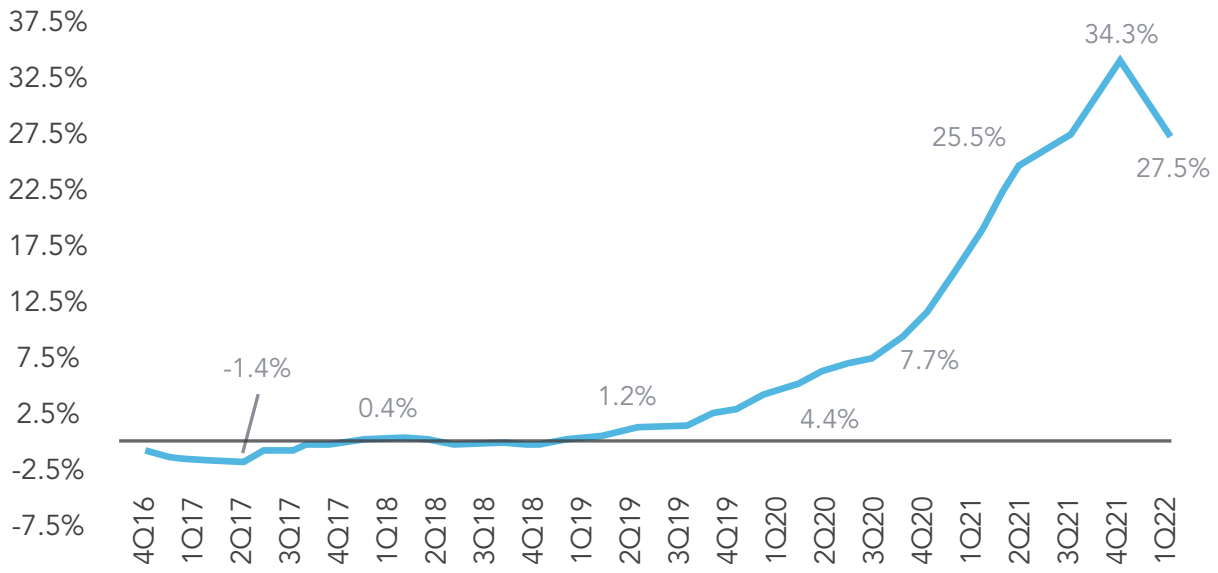
Cyber – The Cyber insurance market is best categorized as "transitioning out of a hard market".

- Loss activity has decreased in the aggregate
- According to Moody's Investor Service, the sector's loss ratio improved to 62% in 2021 from 65% in 2020
- Frequency has decreased but severity remains an issue

Average and Median Ransom Payments in Q1 2022

+ Average Ransom Payment: $211,529 (-34% from Q4 2021)[21]
+ Median Ransom Payment: $73,906 (-37% from Q4 2021)[22]
+ We continue to see a change in tactics amongst attackers. Due to improvements in data backups, the attackers are avoiding the encryption step altogether but focusing exclusively on stealing data and demanding payment to prevent disclosure of that data
+ Carriers are still focused on "must have" controls and increasingly reliant on external scanning technology in risk assessment
+ Pricing increases are still the norm
+ According to the CIAB, the average premium increase in Q1 was 27%
  - We caveat that is an average and certain industry groups continue to see substantially higher increases

Premium Change for Cyber, Q4 2016 - Q1 2022



Source: https://www.ciab.com/wp-content/uploads/dlm_uploads/2022/05/Q1-2022-PC_FINAL.pdf

MAJOR CLAIMS

Property loss

During May of 2022, a Canadian manufacturer – Tolko, reported a fire at one of their sites in Alberta.[23] This loss was a major hit to the property space (direct and facultative), and the market is expecting a $175M ground-up loss from this incident, while the cargo market is set to absorb a claim of $140M-$190M from lost stock resulting from the fire.[24]

Shutdown of Freeport LNG refinery in Texas

After experiencing an explosion very likely to exceed $300M, the worst-case scenario could spiral to over $1B.[25] The loss is fresh and in the early stages of development, with Business Interruption payouts expected to run more than $100M per month.[26] The company's BI coverage was placed in both U.S. and London markets.[27]

COVID-19 Business Interruption

COVID-19 Business Interruption cases are not being dismissed at the rate they once were. State courts refused to dismiss litigation from a California hotel and restaurant against Allianz and a Colorado senior living facility against CNA, which has many insurers concerned that the early courtroom victories on pandemic-related business interruption may be short-lived.

GUIDANCE

Begin the renewal process early

The **General Liability, Cyber, Excess/Umbrella** and **Property** markets are constrained and more challenging to navigate in the disciplined market. With an outcome of increasing prices across all lines of business and in every industry sector, brokers are being swamped with submissions from their insureds who want to minimize these additional costs.

Partner with Industry Experts

It is important to work with your broker's industry experts who truly understand the business and the market for placing the specific risk. Collaborating with a team who can best represent your risks, and partner with your operations, is more important than ever during this disciplined market we are experiencing.

Highlight Cyber Security & Proactive Risk Management

Frequency and severity of cyber claims are constantly on the rise, resulting in more underwriter scrutiny of companies' cybersecurity hygiene. The importance of **highlighting any additions in cybersecurity staffing** or **updated system protocols cannot be overstated**.

Engaging loss control teams

Frequent communication with your broker's loss control team is a top priority, especially when a claim arises. Engaging your loss control team in the event of a claim can help reduce the impacts to your business financially and operationally. We work with you to understand your financial goals and operational challenges so we can identify, develop and deliver Risk Control Solutions that strategically mesh with your objectives.

Contract review

Our **Contract Review** teams add value to our clients overall risk management program by making sure the indemnity language is market standard and doesn't expose our clients to unforeseen losses that may not be insurable.

Sources

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