



Construction Market Update

Catalyst of change

For an industry known for the slow pace of change the last few weeks have seemingly rewritten the rulebook. The pre-christmas period saw large scale withdrawals from the writing of construction insurance business with rumours of more to come in 2019. But, cutting through the chaos, it is important to examine the context and recent history to help make sense of what is playing out before us. The construction insurance market had grown strongly over the past 10 years with plentiful capacity provided by a mix of traditional and new carriers supported by capital markets looking for solid returns from new growth areas. Together these dynamics not surprisingly resulted in a soft market but insurance is cyclical, and, to re purpose a well hackneyed phrase -What goes down must come up. For many new entrants a hard market is new and unsettling whilst for the more experienced it creates an opportunity to demonstrate unique, stand out skills in challenging conditions.

Harvey, Irma and Maria

The first winds of change arrived very literally last year with hurricanes Harvey, Irma and Maria (now referred to as HIM). Insurers very quickly implemented rate rises for construction projects in the affected areas but with no discernible changes outside of these geographies. In fact, outside of the HIM changes, the international construction market had not seen any tangible change in rates or conditions for 12 months.

Understandably, the losses prompted insurer reviews across the highlighted regions and it became clear that further sizeable claims would cause significant financial difficulties for some underwriters. Whilst many insurers and Lloyds syndicates were relieved that they missed the large HIM losses it prompted a more stringent business review from Lloyds across all of its affected syndicates. In some cases this has now been extended to all insurance classes. The HIM events certainly appear to have been the “Catalyst of Change” in the construction market.

Making Claims

2018 has seen at least 6 major loss events (valued between \$1.2bn - \$100m) ranging from HIM to fires. Whilst the majority of the large losses in the last 12 months have been natural perils related claims there has been a spike in a few major claims relating to paint protection in connection to Liquid Nature Gas (LNG) facility's in Australia. This has caused upward pressure on loss ratios at a time when business was already under close scrutiny. The large losses, when considered in quantum with large numbers of attritional losses, have caused many insurers to take a draconian approach to rectifying the books. Whilst some have favoured using rate increases and tighter underwriting as a remedy, others have decided to walk away from the class completely.

Exiteers

We have seen 4 Lloyds syndicates leave the class in very quick succession. This equates to \$202.5m of Possible Maximum Loss (PML) capacity. In tandem other markets are readjusting their underwriting appetite. Companies which have exited the markets are:

MARKET	RATING (S+P)	CAP USD (PML)
Beazley Syndicate 623	A+ (Lloyd's)	USD 62,500,000
Brit	A+ (Lloyd's)	USD 50,000,000
Hardy Syndicate 382	A+ (Lloyd's)	USD 40,000,000
Talbot Syndicate 1183	A+ (Lloyd's)	USD 50,000,000
Total capacity withdrawn		USD202,500,000

Royal & Sun Alliance Insurance Plc, S&P rating A, (PML = USD 120,000,000) pulled out of CAR (Construction All Risks) business in the UK but are still writing Erection All Risks (EAR).

Starstone, A- (A.M. Best), has stopped underwriting CAR risks, whilst maintaining the EAR appetite but with a reduced capacity of PML = USD 25,000,000. (prior to this announcement Starstone's original PML capacity was USD 150,000,000).

Tokio Marine Kiln (Lloyds), S&P rating A+ (Lloyd's), (PML = USD 100,000,000) reduced appetite for construction mainly focusing on UK projects.

Remainers

It is important to mention the key lead insurers who are still actively involved in this sector. The mainstream lead companies: AIG, Allianz, AXA XL, Chubb, HDI, Munich Re, Scor, CV Starr, Swiss Re & Zurich are all of true engineering heritage. These companies understand both the "long tail" nature of this class of insurance and they have successfully underwritten in these different market cycles. This experience cements their credentials as markets which can withstand the cyclical nature of insurance and has the financial strength to underwrite risks through even the longest project period.

There have been a number of mergers and acquisitions over the last couple years, most notably ACE/Chubb and recently AXA/XL Catlin. Whilst the mergers have not helped capacity both carriers still have strong construction teams combined with an appetite to write business.



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Conclusion

It is important to understand that, even with the major construction losses, the construction markets are resilient and financially capable of handling these events. Whilst change has happened quickly in London, the international insurance hubs of Asia, Dubai and Miami provide strong competitive alternatives. China is also noteworthy as increasing visibility and capacity is evident. Substantial capacity from insurers such as PICC, Ping An, Huatai and CIPC has created an independent market now looking at expanding out from its current domestic focus.

Despite the hype we expect market capacity to be strong and significant with this being in the region of USD 4.5 billion on a Possible Maximum Loss (PML) useable capacity basis. In seeking to access capacity there has always been significant benefit for all parties when both client and broker work together to present risks to the insurance markets. These are:

1. Raising the profile of our clients projects in a busy market place
2. Forming strong working relationships which are important throughout the period of the project (especially on risk management issues, delays, change orders and potential claims).
3. Refocusing insurer's minds back on to the true risk and exposure. Using measures such as in-depth risk engineering analysis to give a full view of the key risk mitigation measures and possible maximum loss scenarios. This helps counter any "hard market" mentality on the part of insurers.

In these turbulent times, with market changes and a more difficult operating environment, it is essential that clients select a broker which has an experienced team who have successfully navigated the full range of market cycles. Willis Towers Watson has a strong track record of success for our clients by correctly and robustly presenting risks in the best format for insurers to comprehend.

Market Key Facts Summary 2018

- Construction continues to be a specific technical class with specialized reinsurance markets; capacity remains stable albeit with some downwards movement during 2018
- Capacity available for specialist engineering and construction insurance remains healthy – some market withdrawals during 2018 predominantly in Lloyd's
- Downward readjustment of Income Projections from most insurers
- 2017 and 2018 - Unprecedented Period of Large Losses in addition to attritional Losses
- Hardening Insurance market (Rates, Deductibles, Waiting Period, Sub-limits) – Insurers starting to "Walk the Talk"
- Reinsurer drive to reduce Ceding Commissions and avoid further price reductions
- Increasing importance of strong broking and risk engineering to understand and present risk.

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