Willis Towers Watson

FI Observer: disruptive factors in the insurance market

In this edition of our FI Observer we review insurance market conditions as we move towards the end of Q1 2019, and offer our thoughts on how best to manage the market in the face of potentially disruptive factors.

1 2018 Look back to 2018

London FI Market macro conditions

- Capacity remained steady with no major new entrants or exits
- Stable with flat renewals the norm with single digit increases in certain sectors
- H2 saw significant shift – premium increases became widespread
- Significant concerns in the Australian financial services sector following the Royal Commission resulted in very substantial premium increases in Q4 – this was contained to Australian institutions

North American FI Market macro conditions

- Overall capacity remained steady with no major new entrants or exits
- The number of clients enjoying rate reductions in the D&O and EPL market reduced year on year

Territory	Primary capacity	Excess capacity	Pricing	Coverage	Retention
UK	↓	↔	↑	↘	↗
Europe	↔	↔	↔	↘	↗
Australia	↓	↓	↑↑↑↑	↓	↑
USA	↔	↑	↗	↔	↗
Canada	↑	↑	↗	↔	↔
LAT.Am	↓	↔	↑	↔	↔
Middle East	↓	↔	↗	↔	↗
Asia	↔	↓	↗	↔	↔

↑↑↑↑ marked increasing trend; ↑ increasing trend; ↗ gradually increasing trend; ↔ flat; ↓ decreasing trend; ↘ gradually decreasing trend

Indication of changes to the FI insurance market in 2019

2 2019 Key macro factors for 2019

London FI market

- Following the significant rate increases in Q4 18, 2019 has started out with flat to +5% rate increases[1]
- Stricter capacity management by insurers, particularly Lloyd's (see below "Decile10")
- Anticipated rate increases on excess capacity as insurers undertake portfolio management and reduce overall exposure
- Total market capacity is stable – although we have seen some insurers close part or all of non-performing FI portfolios, overall advertised capacity has not materially changed
- Expectation of general upward trend in premium rates

North American FI market

- We have seen a modest shift in the US marketplace with some increase in rates, particularly in Directors and Officers Liability (D&O), Employment Practices Liability (EPL) and Professional Liability (E&O) classes
- North American insurers are anticipated to push for flat to 5% rate increases[2]
- Continued focus on raising retention levels and adopting a more conservative approach on coverage expansion
- Clients with adverse claims records and those whose risk profile have materially changed will likely experience a relatively firmer market

Globally we anticipate a move towards careful carrier capacity management in the light of disruptive factors.

1. https://www.willistowerswatson.com/en-GB/insights/2018/02/marketplace-realities-report-2018-gb-edition
2. https://www.willistowerswatson.com/en-US/insights/2018/04/overview-insurance-marketplace-realities

3 Disruptive Factors in the Global FI Market

Lloyd's 'Decile 10' edict[3]

- 2017 trading loss of £2Bn (the worst since 2001) and a combined ratio of 114%
- 2018 spent analysing and addressing underperforming and unprofitable syndicates
- The 'Decile 10' edict required those syndicates to undertake sound turnaround plans on worst performing 10% of their business
- This triggered some organisations to close their FI portfolios, citing unprofitability (e.g. Canopius and Channel)
- More granular scrutiny from senior management at both Lloyd's Syndicates and company markets is expected to continue throughout the remainder of 2019

UK Capacity deployment

- Early signs suggest greater focus on capacity management rather than straight premium increases
- Key FI markets in London are proactively reducing and/or managing capacity on 2019 renewals
- Potential for insurers to non-renew or withdraw from some sectors. We saw Neon syndicate withdraw from LATAM and emerging territories FI business
- Less competition for new business as insurers work within current business plans and underwriting capacity
- Excess layer capacity management will drive pricing upwards particularly for clients buying large limits
- Primary capacity is down in UK, Australia, Latin America and the Middle East

Impact of the Royal Commission in Australia

- Australia remains an extremely volatile environment for the financial services sector as insurers deal with the fallout from the Royal Commission and a continuing litigious culture [4].
- The Australian D&O insurance sector has been especially problematic due to the large claims seen as a result of shareholder class actions. The Australian Prudential Regulation Authority (APRA) observed in its latest Insight publication that Side C (Securities claims) premiums for large listed entities are up by 400% and commented that "notwithstanding this correction, premiums are still insufficient to offset the many prior years of rate reductions and inadequate premiums"[5] .
- The result of this is that 2018 saw widespread withdrawals from insurers in the local Australian market resulting in a large quantity of business being placed in London with opportunistic insurers seeking significantly increased rates.
- Continuation of opportunistic underwriting expected throughout 2019, particularly on distressed risks. This could have an effect on available capacity in Q4 19 as insurers begin to approach the limit for their stamp capacity.

The impact of large claims[6]

- The timing of claims payments lags significantly behind general economics and we are now seeing payments and settlements in relation to large losses notified as far back as 2007 and 2008, in addition to claims arising from more recent conduct issues at some global financial institutions.
- In the meantime a steady flow of notifications in relation to social engineering, cyber and operational errors that trigger cost of correction or mitigation cover continues.
- It remains to be seen whether underwriters will push back on some of the wider wordings which have become available, particularly in the London market during that last ten years
- Recent large claims settlements may embolden FI insurers further

4 The keys to a smooth renewal process

Engage with your broker and insurers early in the placement process:

- Willis Towers Watson encourages face to face meetings your key insurer partners
- Your broker should help you anticipate issues and questions and be willing to help you provide additional information to insurers
- Consider all potential marketplaces: London, US, Bermuda and local (if applicable)
- Agree on a robust renewal plan with your broker that caters for problematic insurers. The key here is to have options in order to maintain leverage and make an informed decision on your terms

Use analytics and benchmarking to understand what the optimal structure may be based on different scenarios:

- Be flexible throughout the process and expect your existing programme structures and insurers to potentially change
- Understand the critical coverage points that you would like to include or retain in your policy wording
- If any material changes to the program are anticipated (limits, retention, coverage), consult with your broker and claims advocate to ensure all claims / notice of circumstances are made appropriately and in good time.

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3. https://www.lloyds.com/~/media/files/the-market/i-am-a/independent-reviewer/market-presentation-may-2017.pdf
4. https://financialservices.royalcommission.gov.au/Pages/default.aspx
5. https://www.apra.gov.au/class-actions-and-growing-importance-directors-and-officers-insurance
6. Willis Towers Watson FINEX 2018 claims data

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