Willis Towers Watson

Insurance Marketplace Realities

2020

How long will it last?

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How long will it last?

Call it what you will: a firming market, a challenging market, a seller's market, a disciplined market, an unconventional hard market — North American businesses are paying more for insurance. The extent will vary, as always, depending on the business, its risk profile and its strategy for risk management, but the story that emerges in the pages that follow is clear. We are predicting increases, many sizeable, for more lines of insurance than we've experienced in recent memory. The most challenged lines of insurance (i.e., those experiencing the most widespread price increases and capacity withdrawals) are property, umbrella and public company D&O. In these classes and others, the global insurance market is demonstrating unprecedented discipline. For years, during soft market conditions, many said price reductions couldn't last forever. So, we've seen it coming, and here we are. The big question now is how long will it last?

We predict that rate hikes and capacity constrictions will continue throughout 2020 and likely into 2021. However, we expect a more orderly market to emerge by mid-2020, especially for property. By that point, the bulk of the re-underwriting by some major property insurers should be largely complete. Pricing will most likely continue to rise as insurers seek profitability, but those increases and market capacity for most risks should be more predictable than they have been during the past two quarters. The other most challenged lines, umbrella and D&O for public companies, are likely to be difficult and unpredictable for the next four to six quarters. Why? Because we are experiencing what appears to be a fundamental and systemic change in liability losses — and not for the better. Loss severity in auto and general liability, and therefore umbrella, is spiking due in large part to so-called "social inflation." In D&O, the annual number of shareholder class action lawsuits has doubled in less than three years. The median settlement value for shareholder class action suits has remained constant at about $13M. If loss frequency has doubled but the median settlement value has remained constant — you do the math.

Nevertheless, as the market seeks a new equilibrium, there are reasons for optimism: the alternative capital market is showing some renewed enthusiasm for the reinsurance market after a year or so of tepid interest, the overall industry has more capital than ever, insolvencies are a rarity, InsurTech companies seem to have largely abandoned their bad-boy disruptor image and are now working with insurance market participants to improve the client experience by helping us all be smarter, cheaper and faster, and the inexorable laws of supply and demand still apply to our industry. This challenging market will not last forever.

Property conditions

We'll start with property. From Hurricane Dorian, with its record strength that caused horrific devastation in the Bahamas and narrowly missed making epic landfall in the U.S., to the drenching rains of Imelda in — again — Texas, the 2019 hurricane season has so far served as a reminder that while the threat of extreme weather is growing, the insurance industry remains well capitalized and sufficiently resilient to play its role in helping organizations bounce back. If we get through this hurricane season without a major U.S. landfall — and as of this writing it looks like we will — one might expect that the good news for insurers would, as in the past, push the supply and demand curve eventually in the buyer's favor.

In 2019, we saw big property hikes for those renewing in Q2, Q3 and so far in Q4. Q1 2020 buyers, it's your turn. And with carriers showing a steady willingness to withhold capacity in their disciplined approach to underwriting these days, the rate hikes in many cases are going to leave a mark. (We also note that there are property buyers who are in the midst of long-term deals. When such deals expire, those buyers should be prepared for a major re-underwriting.)

But what about the next renewal? After what those on the carrier side might call an overdue marketplace correction — and insurance buyers who enjoyed quite a few years of declining property rates might quietly agree — carriers will certainly be interested in sustaining these higher rates. But the moderating forces that contributed to the long soft marketplace of recent years could well return.

One of those forces is competition. While we have witnessed unprecedented global market discipline with no renegade players, we do not expect that to last beyond 2020. There are a few new players coming into the market (even if their entry was planned before current conditions took hold) and insurers will, we expect, begin posting solid earnings. With a higher rating floor, insurers will have incentive to sell more insurance. Increasing market share becomes a more appealing goal, which tilts the marketplace back toward the buyer.

The alternative capital story line

Another force is alternative capital. In the wake of two big cat years in 2017 and 2018, some observers assumed that investors in instruments like ILS (insurance-linked securities) would get cold feet and flee. There was (and is) a lot of talk about loss creep (i.e., increases in loss estimates after initial reports), which may have come as a surprise to some investors unfamiliar with the slow-moving wheels of insurance claims. To be fair, loss creep from some of the mega losses of recent years has seemed high even to those who expected it. That's largely been driven by business interruption, which is subject to economic forces, many of them local, at work in the aftermath of a disaster. At the end of 2018, when an air of caution emerged and brought downward pressure on the overall capital flowing into the risk business, we could have guessed – and many of us did – that upward pressure on rates would follow.

However, alternative capital is not going away. It's not even retreating to any great extent. Many institutional ILS investors are in it for the long term. There are pockets of interest in the investor community to increase stakes in the property reinsurance industry, given the rising rates. When supply goes up in the reinsurance market, eventually the news is good for insurance buyers as we've seen in the past. Moreover, as modeling capabilities get ever more sophisticated, the ability of the market to profitably underwrite this short-tail line increases – even in the face of systemic climate risk.

Different pressures for liability lines

We see something of a different story on the long-tail side. In liability lines, the losses of yesterday are paid for tomorrow. The marketplace timeline is elongated. In auto, for example, losses having been climbing significantly for at least eight years and premium rates, which have been rising for years now as well, are still catching up. General liability is starting to show signs of distress due to loss severity. Both of these lines impact umbrella programs, which are now in a very distressed state. Similar dynamics are hitting public company D&O.

There are several factors at work – some situational and some systemic. As for the situational, we remain in a period of strong economic growth. That brings with it some risk factors. For example, a strong labor economy means companies rely more on inexperienced workers. Inexperienced workers have a higher rate of accidents, especially in the trucking industry. A strong economy means more vehicle traffic, leading to more accidents, especially when the plague of distracted driving continues to be a factor. A strong economy also leads to higher stock valuations and even higher expectations by shareholders, which contribute to shareholder actions when things go wrong. Another situational factor that is beginning to feel more permanent is the persistence of low interest rates. As we (re)enter a period of "lower for longer" interest rates, insurers cannot rely on investment yields to overcome underwriting losses.

As for systemic issues, many fingers point to social inflation. While there are many aspects of this phenomenon, the key characteristics include a trend to hold corporations and other organizations responsible to a much greater degree for their actions – sometimes for actions in the distant past. There is also a noticeable trend toward holding corporations accountable for societal ills where the corporation may have been an actor or just a bystander. Consider the opioid litigation that is ensnaring many organizations. Consider the reviver statutes that are aimed at clerical abuse, but create a specter of unending litigation, legitimate and spurious, for schools, health care institutions and non-profits when statutes of limitations are abandoned. Combine these considerations with juries that are numb to monetary values in the days of nine-figure incomes for CEOs, sports stars and celebrities. Fear of the jury verdict wheel of fortune is also driving higher settlements. Adding further fuel to social inflation are advances in health care. As medical technology expands, treatments become more expensive, but also more effective. People are living longer, which is a wonderful thing – with a big impact on compensatory damages and benefits that are paid out for a lifetime.

Some are beginning to point toward the need for legislative action to curb runaway juries. While worthy of consideration, there is no indication that will happen anytime soon. In the meantime, liability insurers are demonstrating discipline by raising rates and hedging their bets by deploying much lower limits on any one risk. But as rates climb, capital investors may again prove interested – better potential returns can make even the most complex and risky line seem more appealing. Property will attract more capital. But don't count out liability lines entirely. In the big picture, insurance is still a hyper competitive industry, with ever lower barriers for capital to enter.

Looking ahead to a major risk of tomorrow: climate risk

Like any prediction about insurance, so much depends on what happens: natural and human-made disasters, world events, a U.S. election that could yield big changes in perspective and in the economy. So, what to do now?

We offer two pieces of advice. In the short run, there's work to be done to avoid the worst of the rate hikes. Organizations should allot plenty of time to work with their advisors, provide robust risk information to potential risk takers, consider options across the global marketplace, and take advantage of increasingly sophisticated and user-friendly analytic tools that can help both decision-making and differentiating your risk in the market. Organizations should also continue to invest in risk control measures. The cheapest loss is the one avoided.

In the long run, we offer an additional suggestion. We urge risk professionals to keep an ear to the ground on the topic of climate risk. What's having a major impact in places where increasingly extreme weather has a direct catastrophic impact – places prone to flooding and wildfires, for example – may soon have an impact on every business, and on the way we look at organizational risk. Climate risk is increasingly a regulatory issue, with governments around the world demanding transparency and accountability. Investors are also taking notice of climate risk in their valuations. At some point soon, organizations may need to account for climate risk on their balance sheet. Accounting rules could change to reflect this.

It's daunting stuff. But it's also an opportunity for professionals in the risk business who are schooled in risk measurement, risk mitigation and risk transfer. This is a call to action for risk professionals to become involved and to lead. That's our intention, for ourselves and our clients – our partners in risk.

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Commercial lines insurance pricing survey (CLIPS)

When we assemble our prognostications for the coming year in *Insurance Marketplace Realities*, we're also looking back at recent price movement reported by insurers, grounding us in firm data. CLIPS, Willis Towers Watson's retrospective look at commercial P&C prices, is based on both new and renewal business figures across all segments, obtained directly from carriers underwriting P&C business. CLIPS participants represent a cross section of U.S. P&C insurers that includes many of the top 10 commercial lines companies and the top 25 insurance groups in the U.S.

U.S. commercial insurance prices surged in the second quarter of 2019. This represents a significant pickup from increases of close to 2% for each of the previous five quarters.

For more, review the recent CLIPS report.

Looking forward, looking back

Comparing our rate predictions for 2020 to those from our spring 2019 issue, we're looking almost entirely in one direction: up. In fact, this year we're seeing the biggest upward shift in years. The gap between the number of lines reporting increases and those reporting decreases, no change, or a mix of increase and decreases is the largest in memory: 20 versus 7. Perhaps most striking, more than 13 lines we report on are now expected to deliver steeper increases than predicted in the spring.

Here are highlights from our 2020 predictions:

- Property rate increases are expected to be twice as high as our predictions from the spring.
- GL predictions moved from the mixed category into the single-digit-increase category for virtually all buyers.
- Forecast auto rate increases are holding at +6% to +12%.
- D&O buyers should again brace for significant price hikes.
- Two lines showed some softening pressure since our spring report: political risks and kidnap and ransom, despite rising global tensions.
- Several lines are looking at increases topping out at well over 25%.
- Capacity is available in all but the most challenged cases, but underwriters are demonstrating unprecedented discipline in capacity deployment, especially for risks they are leery of.

The message is not hard to decipher. Buyers are in a seller's market across most lines and we expect that to be the case throughout 2020.

Overall, 19 lines are expected to see price increases, two (international casualty and surety) will see decreases and six will see a mix of both (or flat renewals). These six are fiduciary, environmental, marine, kidnap and ransom, and terrorism insurance. The rest, including property and casualty lines, will see increases.

Market trends: lines facing increases, decreases or a mix*

Year	Decreases	Increases	Mix/flat
2020	2	20	5
2019 spring update	2	14	9
2019	2	14	9
2018 spring update	2	10	10
2018	7	7	9
2017 spring update	10	6	7
2017	10	6	7
2016 spring update	9	8	5

*The 2020 figures reflect the addition of personal lines and financial institutions – FINEX as separate entries. The 2019 figures reflect the addition of marine, cargo and senior living/long-term care as separate lines of business. The 2018 spring update figures reflect the absence of marine in that issue; the 2017 figures reflect the addition of international coverage as a separate line; and the 2018 figures reflect the addition of product recall and the subtraction of employee benefits, which are no longer covered in this report. Casualty lines are discussed in one combined report but are included in this table as separate items (GL, auto and workers compensation).

For more insight on how you can prepare for a marketplace in flux, contact your local Willis Towers Watson representative.

Property

Key takeaway

The market is hardening and rate increases are accelerating with each succeeding month. Cat losses aside, attritional losses continue to bedevil financial results for insurers.

Rate predictions

Non-CAT: +5% to +15%
CAT: +10% to +20%
CAT with losses: +15% to >+30%

Property market conditions continue to harden with sustained escalation in rates.

- Over and above our baseline pricing predictions, a micro-hard market has produced increases of 50% - 100% and even up to 400% for challenged occupancies with poor losses and/or risk control deficiencies. Challenged occupancies include food, manufacturing, dealers open lot, hospitality, primary habitational/multi-family, woodworking, senior living, waste management and schedules with significant cat exposure.
- We expect these conditions will persist through 2020; as one senor industry exec has said, “It’s not one and done.” However, we also expect that rate increases and capacity deployment will become more predictable by the end of Q2 2020 as most of the re-underwriting by major property insurers should be completed. (We note that there are some long-term deals in the market that have not yet gone through a re-underwriting process.)
- If a major catastrophe does occur during the year, conditions will get much, much worse and prolong the duration of seller’s market.
- Accounts below technical pricing and those losing key capacity are seeing the largest rate corrections.
- Two years of combined loss ratios exceeding 100%, along with the previous prolonged soft market, have driven the market correction and insurers’ push to return to profitability.
- Prognosis: continued market firming even for benign risks.

While capital remains available, insurers continue to reduce overall line size, repositioning deployed lines based on profitability.

- Market dynamics are impacting certain carriers as well as certain classes of business disproportionately.
- Deployed capacity has tightened significantly on cat-exposed/ loss-impacted renewals, which will not generally see the benefits of otherwise healthy market capitalization.
- Adverse losses have pushed markets to reduce aggregate exposures across the board.
- Carrier consolidation and market withdrawals have accelerated overall market deterioration.
- However, there is some good news… alternative capital providers, who largely sat on the sidelines in the latter half of 2018, are starting to show some enthusiasm to deploy more capital in the reinsurance market. Historically, plentiful alternative capital in the reinsurance market has had a dampening effect on rates in the property insurance market over time.

Underwriters continue to take a more critical look at exposures, restricting many coverage terms previously offered in the soft market.

- We are seeing upward pressure on cat deductibles, which are returning to 5% with removal of caps.
- Coverage is tightening on contingent business interruption (CBI), service interruption and first-party cyber.
- Reductions in standard sublimits and increased waiting periods are common.
- We advise buyers to scrupulously update and validate values in anticipation of underwriters’ renewed scrutiny of this data.

As property conditions continue to harden, we recommend that all key stakeholders take a close look at the changing environment.

- Insurers are overwhelmed with submission activity. Increased volume allows for greater scrutiny and a more selective approach to renewals.
- With loss control measures heavily scrutinized, addressing open recommendations prior to renewal is imperative.

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Casualty

Key takeaway

The commercial liability marketplace is worsening, with deteriorating loss trends continuing to negatively impact underwriting profitability, except in workers compensation, where competitive conditions continue.

Rate predictions

General liability: +2.5% to +7.5%
Automobile liability: +6% to 12% or more
Workers compensation: -2% to +2%
Umbrella liability:
High hazard: +30% or more
Low/moderate hazard: +15% to +25% or more
Excess liability:
High hazard: +25% or more
Low/moderate hazard: +15% or more

The umbrella/excess liability marketplace is experiencing significant disruption, with insurance carriers adjusting their underwriting appetites, reducing deployment of capacity, increasing attachment points, requiring changes to program structures and increasing rates.

- Several key insurance carriers have pulled their capacity or reduced their offerings for the largest insureds (Fortune 500) and those in high-hazard risk classes.
- Buyers are seeing more non-renewal notices on various layers throughout their umbrella/excess liability towers.
- Carriers are no longer applying traditional rate relativity methodologies to price excess layers.
- The North American liability marketplace continues to be plagued by an unpresented number of nuclear verdicts, and consequently high settlements, stemming from both conventional hazards (e.g., auto accidents) and unforeseen issues (e.g., #MeToo litigation), the opioid epidemic and California wildfire.
  - The median settlement of the top 50 U.S. verdicts nearly doubled over the last four years ($54M in 2018 vs. $28M in 2014)
  - A highly organized plaintiffs' bar is using advanced litigation tactics, including reptile theory, to appeal to juror emotions, resulting in unprecedented liabilities for defendants.
- Accounts with large commercial fleets are still seeing significant increases in the lead umbrella pricing (25%+) after several years of increases. These increases are also putting upward pressure on excess layer pricing.
- The use of short limit lead umbrella policies is becoming more prevalent, driving risk managers to leverage the global marketplace to generate the necessary capacity for their accounts.
- While tariffs have slowed growth in some industries, liability exposures continue to grow with overall GDP expansion.

Auto liability continues to be unprofitable for personal and commercial insurers as average claim payments rise. Insureds should expect further rate increases.

- 2018 was the eighth year in a row with a combined ratio in excess of 100 for auto lines.
- From 2016 through 2018 the average claim payment for bodily injury rose 6.7%, and personal injury protection claims rose 4.8%. These increases in loss costs, combined with a higher frequency of accidents, have led to continued rate increases.
- The economic impact of districted driving is estimated at $40B per year.
- While drunk driving has fallen by a third in the last three decades, the number of drivers under the influence of marijuana and other drugs is on the rise.

- A strong economy over the past three years has led to a measurable uptick in total miles driven within the U.S. In 2018 drivers logged over 3,223B miles on U.S. roads with 1.11 fatalities per 100M miles driven. Fortunately, in H1 2019 fatality rates are down in both rate (1.06 fatalities per 100M miles driven) and in totality (16,890 versus 17,479 in H1 2018). These rates are still up considerably from 2014, when there were 1.01 fatalities per 100M miles driven.
- Rate pressure is causing some insureds to consider restructuring deductibles to mitigate increases.
- There has been a rise in the number of cases alleging sleep apnea and sleep deprivation as key contributing factors in accidents. Employers have been found legally liable for damages, including assessment of punitive damages, as a result of not properly managing fatigue and sleep issues faced by their employees. With over 43% of the workforce indicating they are sleep deprived, this is becoming a major issue for risk managers.

Near-term workers compensation rate decreases may begin to flatten, with high severity risks and accounts experiencing excessive losses starting to see minor single-digit rate increases.

- Accounts written on guaranteed cost will continue to benefit from consistent rate decreases filed in most states, a trend that has continued since 2015.
- NCCI has estimated that, as of year-end 2018, the overall reserve position for private carriers was a $5B redundancy. A reserve redundancy in workers compensation has not been observed in the last 25 years.
- Workers compensation's combined ratio has improved to its lowest level in over half a century. NCCI estimated that as of year-end 2018, private insurers had a $5B loss reserve redundancy – the highest in at least 25 years.
- Advancements in medical technology have contributed to workers compensation mega claims, which are defined by the NCCI as workers compensation claims in excess of $10M. These claims have become more frequent in recent years, with 70% of mega claims arising from motor vehicle accidents and falls from elevation.
- State supreme courts are challenging insurers who deny reimbursement for medical marijuana. On March 7, 2019 the State of New Hampshire joined Connecticut, Maine, Minnesota, New Jersey and New Mexico in supporting marijuana as an acceptable form of treatment for work-related injuries. The court found that it does not believe reimbursement will cause the insurance carrier to "possess, manufacture, or distribute" a controlled substance, which is against federal law.
- The growth of telemedicine in the workers compensation industry may play a key role in providing quicker, more efficient access to high-quality medical care, mitigating associated medical expenses and lost time from work and leading to reduced claim severity. Some states are moving quickly to introduce legislation and rule changes to advance the use of telemedicine.
- Prescription drug management is becoming increasingly important to risk managers, particularly in light of the opioid epidemic and the rising costs of brand name drugs. Since 2014, brand name Rx drugs prescribed to injured workers saw a 65% increase in costs, while in the same period generics experienced a 35% reduction in costs. Over the next year, Lyrica, one of the costliest and most commonly prescribed drug to treat injuries, will be available in generic form – leading to a meaningful decrease in Rx spend.
- NCCI reports that 2018 average indemnity claim severity increased by 3% year on year, while medical lost-time claim severity increased by 1%. If loss costs continue to rise, premium rate will see upward pressure.

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International casualty

Key takeaway

Key to delivering a program that delivers value is a disciplined approach to timelines, with teams beginning the process early, documenting clear objectives and tapping into the expanding expertise and capabilities available.

Rate predictions

-5% to flat

The international casualty marketplace remains a competitively priced buyer's market, offering opportunities to improve terms and/or pricing in certain areas. Buyers who will capitalize most effectively are those who:

- Can demonstrate that they have communicated detailed risk management protocols with their various stakeholders
- Deliver clear and consistent underwriting data and related documentation
- Leverage their purchasing with strategic carrier relationships
- Partner with their broker, carriers and internal teams to take a disciplined approach to the renewal timelines, allowing for a thorough review of localized coverages and claims handling plans, which help deliver on renewal objectives

Rate reductions and coverage enhancements are available, with certain caveats:

- The overall portfolio of placements continues to grow, particularly in the middle market space.
- Carriers who write global lines of coverage are often able to partner with insureds on other lines and offset certain administrative costs.
- As organizations look to measure the quality of their global programs, issues beyond price should be a priority. The most successful carriers are often those who drive and document accurate and timely policy delivery, deliver quality post-binding services around the world, and offer an insured the ability to influence localized policy coverage terms.

Capacity continues to grow, despite continued merger and acquisition activity.

- The abundance of capacity continues to drive pricing as carriers look to retain renewal positions on their portfolios.
- Some of the new competition is coming from established carriers entering the international market, many of whom are already household names in other areas of the marketplace. Additional competition emanates from European carriers with experience in international casualty who are expanding their offering to include coverage for U.S.-domiciled insureds. For certain insureds with large and complex international risks, European-based markets can offer distinct benefits by tapping into an alternative access point:
    - Higher primary limits and expanded coverage territory
    - Higher or full limits which allow insureds to evidence certain unique coverages, such as pure financial loss and extended products liability, among others
    - These extensions can be evidenced on the master policy, offering wider coverage territory
- Recent global carrier mergers have yet to reduce the abundant supply of capacity. So far, we've seen this consolidation enhance market offerings by bolstering underwriting depth, expertise and international office networks.
- International casualty programs require significant administration and collaboration, so, rather than differentiate purely through price, many of these carriers are creating and/or enhancing operational tools, leveraging technology and offering underwriting flexibility and/or enhanced transparency around country-specific coverages.
- Multi-year agreements, which offer certain advantages relating to coverage/rate certainty, are available in some instances.
- Carriers are under strict guidelines to obtain clear and consistent exposure information from insureds, limiting or even removing the ability to offer coverage for "if-any" exposures, as well as excess-DIC coverage, without clear details about the primary coverage in local geographies.

To Brexit or not to Brexit

- While the outcome of Brexit remains uncertain, carriers have been preparing by repositioning certain underwriting and/or service functions (e.g., freedom of service (FOS) infrastructure) to alternative European locations (e.g., Luxembourg, Ireland, Spain and Belgium), requiring a fair amount of movement and re-training of staff. Carriers are looking to offer flexibility where they can. However, insureds and brokers should be encouraged to seek details where there are unknowns in advance of renewals.
- Additionally, insureds who may have received a FOS policy from a carrier's U.K. office, also representing local coverage for the U.K., should consider the need and benefits of requesting a separate local policy in the U.K. at renewal.
- When a renewal involves a potential change of where a FOS policy will be issued, we suggest carefully considering the implications of the governing laws of that policy. For example, the U.K. relies on common law whereas other European countries rely on civil law, and there will be differences in how claims are managed.

Changes in market regulation and issues of compliance are crucial.

- State-driven regulation and rising protectionism continue to impact the marketplace. For example, federal agencies in some regions are requiring participation of in-country insurance capacity into global programs, which impacts pricing, exportability, control and renewal timing.
- Insurance and tax audits as well as requirements for insureds to provide know your client (KYC) documentation are evidence that local regulators are actively seeking to ensure that programs are locally compliant.
- Enforcement remains prevalent around premium payment warranties (e.g., "cash before cover"), which should encourage buyers and their brokers to be ready to bind 30+ days in advance of renewal.
- Buyers should be aware that any restrictions on the exportability of risk and premium will limit the corresponding amount of underwriting and claim settlement authority that can be centralized.
- The marketplace offers a certain amount of flexibility in terms of where international premium allocations can be collected for most countries, providing insureds the ability to centralize most of the cash flow and administration. However, diligence is increasingly important for insureds to evidence a consistent and defensible premium allocation methodology in the event of a program audit.

Global programs of all sizes are becoming more sophisticated.

- Buyers who may be just beginning the journey toward globalization or with smaller international risks have opportunities to impact their total costs and ensure compliance by taking a centralized approach to certain functions, starting with a focus on the safety of their traveling employees by taking a global approach to foreign voluntary workers compensation (FVWC), kidnap, travel assistance, health coverages, etc.
- For companies with existing global programs, opportunities are available to streamline operations by leveraging relationships with a select number of global carriers, minimizing coverage gaps and ensuring economies of scale.
- For the buyers of large, complex global programs, clarity of coverage will be increasingly important, not just at the master-policy level but also at the locally admitted level. Third-party contracts can include specific insurance requirements that could also impact program design, including localized higher liability limits and/or inclusion of specific terms.
- Opportunities exist for insureds to expand the breadth of an international casualty program to add additional local policies, such as local EL and auto, particularly where those risks are significant.
- Global businesses are experiencing complex claims in a widening array of geographies, requiring a close examination of admitted local coverages as well as their claims handling procedures.
- Several major carriers have issued new international casualty policy forms, and most others seek to include extensions that refine or occasionally limit coverage intent. Depending on the extent of the need, flexibility can be facilitated through alternative risk structures, captives or manuscript policy forms. One example where we've seen some retraction is in sexual abuse and molestation coverage, especially for youth-related risks.

- One of the ways higher admitted limits can be obtained is by asking the international casualty carrier to raise its master policy limits, enabling flexibility around what limits can be localized. An additional benefit of raising the primary limits is to drive pricing relief in the excess layers. Alternatively, an umbrella carrier that has a global network can issue its own local umbrella policy as and where needed. Teams should consider both options and compare associated costs.
- Not all carriers offer the same local policy terms and conditions, even within the same country, and this should be considered when marketing a program.

Alternative risk programs remain an option.

- The market for fully fronted programs remains fairly limited; however, they can be popular for insureds who wish to control cost allocations and centralize coverage documentation. The carriers that write programs with significant retentions are often well-established and have the underwriting expertise, global network, technology and cash flow capabilities to handle these programs effectively.
- Fronting fee costs remain a focal point, and calculations reflect the amount of administration involved in managing the program (e.g., number of claims, number of local policies, limits issued, etc.). Upward pressure on those costs can be mitigated in certain cases by leveraging the relationship with the same carrier across other products.
- The allocation of premium should begin early. Carriers will have unique approaches and internal guidelines, so insureds/brokers should initiate discussions early in the timeline, with consideration of issues such as exportability and taxes and to assure timely execution.
- While collateral is a concern for insureds, the amount of collateral required is often less than is typically required on U.S.-domestic program since international programs typically have lower claims activity. If the same carriers require collateral on other lines, there may be an opportunity to negotiate collateral across all collateralized lines.

Program administration remains an important focus.

- Many carriers supplement the delivery of international programs with online platforms, some of which are made available to insureds and brokers. The ability to reduce friction and improve clarity continues to be a differentiator, so carriers continue to invest in tools that offer transparency into network instructions, posting of policy documents and other improvements in efficiency.
- Shared online access to claims data remains a topic of conversation for future enhancements.

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Product recall

Key takeaway

While increasingly complex supply chains, tougher regulations and more sophisticated detection methods intensify product recall risk – the average cost of a recall is currently around $10M – tighter contractual requirements mean that more of this risk is being placed at the door of manufacturers and producers.

Rate predictions

+5%

The recall marketplace is stable from an overall capacity standpoint, although changes in underwriting and Lloyd's of London participation are impacting rates.

- Carriers are cautiously managing their primary capacity while seeking larger self-insured retentions.
- Loss activity has leveled off over the past year, but some underperformances by casualty and property books are negatively impacting recall carrier reinsurance treaty agreements, adding the upward pressure on rates.
- Many carriers have a baseline 5% rate increase on renewals.
- There were two notable exits by Lloyd's recall syndicates in Q2 and Q3, 2019, though these exits were offset to some extent by the entrance of a new syndicate in the space.

The market for product recall insurance varies by industry segment.

Food and beverage

- Foreign material was the top cause for FDA and USDA recalls for the second time since 2016.
- Nationwide recalls have been on the rise – 20% of FDA recalls were national, the highest since Q1 2016.

Automotive

- Electrical and software components are under increasing regulatory scrutiny; vehicle recalls continue to rise because of these components.
- While there's been a slight decline in auto recall announcements, the average number of units affected per recall has increased substantially.

Consumer products

- Children's products make up almost 60% of the total recalled units reported to the Consumer Products Safety Commission (CPSC).
- Due to the risk of fatalities from recalled products, the CPSC isn't holding back from issuing recalls.

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Cyber risk

Key takeaway

With ransomware incidents increasing dramatically across all industries in frequency and magnitude, including some high-profile breaches, we are starting to see an uptick in premiums and a cautious deployment of capacity across the global marketplace.

Rate predictions

Flat to +10%

Primary and excess cyber renewals are now averaging premium increases in the 5% to 10% range, though flat renewals should be possible for some buyers.

- Increases have largely been driven by the explosion of ransomware losses during the second half of 2019, when the average loss jumped from $500,000 to well over $1,000,000.
- Carriers have been reevaluating their positions in large towers and looking more closely at rates in perceived burn layers.
- In excess layers, carrier focus revolves around obtaining adequate premium for perceived risk. There is no longer competition to participate in excess towers, especially if pricing is considered too thin.

Cyber capacity is starting to tighten, as insured losses continue to rise.

- The cost of data breaches continues to increase year by year, with reputational and regulatory costs the main drivers.
- According to the 2019 Cyber Risk Outlook, prepared by the University of Cambridge, incident response costs are also driving the increase in the cost of data breaches. As the cyber threat landscape becomes more complex and demand for cyber security resources increases, so do the costs in remediating data breaches, particularly for large-scale events.
- The human element continues to be the leading cause of cyber loss.
- Recent high-profile breaches highlight the need for companies going through a merger or acquisition to engage their IT staff early in the process to evaluate cyber breach risks. The potential harm, both from a reputational and financial perspective, could have a significant impact on the business to the point of undermining the potential value of the merger/acquisition.
- Certain carriers are adjusting their ransomware coverage appetites and considering sublimits and co-insurance alternatives.

Coverage continues to evolve and expand to cover regulatory risk, reputational damage, forensic accounting and gap exposures.

- The E.U. General Data Protection Regulation (GDPR) went into effect in May 2018, and the California Consumer Privacy Act will go into effect in 2020. We have seen cyber markets more affirmatively address coverage for claims stemming from the GDPR and for claims anticipated under the California Consumer Privacy Act. Markets are also offering expanded wrongful collection and compliance coverage in response to these regulations.
- Other coverage expansions include forensic accounting coverage, reputational damage coverage and reinstatement of limits provisions in certain industries.
- Business interruption/system failure continues to be an area of concern for underwriters. Heavily exposed industry classes, such as aviation, manufacturing and transportation, have seen increased underwriting scrutiny. While coverage remains available, some industries will experience significant premium increases.

- Despite concern over system failure losses, some cyber carriers are now beginning to offer business interruption/system failure coverage for outsourced providers that fall under critical infrastructure (cable, Internet, utilities) – previously a non-starter for carriers. They are providing solutions, in the form of small sublimits, to help address these exposures. Whether these sublimits will be followed throughout excess towers remains to be seen.
- Cyber underwriters are working more closely than ever with their counterparts in other lines. Cyber and property underwriters in particular are combining forces as carriers continue to expand their coverage offerings in business interruption. Given the experience and understanding of how business interruption losses play out, it is a natural pairing that should help cyber underwriters understand what they face in claim scenarios. Notwithstanding this cooperation, we are seeing carriers withdraw or limit cyber coverage in non-cyber insurance lines due to concern about aggregation.

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Directors and officers liability

Key takeaway

Firming has continued at an accelerated rate. Most programs can find adequate capacity, but for certain segments and larger programs, willing capacity for new or replacement layers can be sparse.

Rate predictions

Overall – Firming to hard and changing rapidly

Public company – primary: +17.5% to +50% or higher

Public company – lower excess layers: Recalibrated to 75%–90% of underlying layer

Public company – higher excess layers: Recalibrated to 70%–80% of underlying layer

Private and not-for-profit – overall: +5% to +35%

Financial institutions* – public: +2.5% to +10%

Financial institutions* – private (other than private equity, which is higher): +2.5% to +10%

Side-A/DIC: Flat to +20%

*See the section on financial institutions – FINEX

Increases are the new normal. With the excess recalibration, total program increases may be more substantial.

- **Marketplace:** With some carriers looking to pull back capacity, building larger towers can prove particularly challenging and require innovative solutions. Additional increases due to the recalibration of excess pricing have compounded primary increases. Insurers are also looking to increase retentions, particularly for public companies.
- **Competition:** Leading insurers have demonstrated effective discipline and are more conservatively deploying capacity in the face of profitability challenges. London market appetite for D&O (including U.S. publicly traded D&O) has waned. New coverage may be challenging to place.
- **Support of incumbent carriers versus marketing:** While replacement capacity may not always be available at a less aggressive price, it is often prudent to engage the full marketplace to ensure optimal results.
- **Private and not-for-profit companies:** An insured's financial health and industry classification matter. Financially distressed firms, companies in volatile or emerging industries and firms that have anti-trust exposures will likely continue to see premium increases, higher retentions and/or coverage restrictions.
- **Excess:** The high cost of defending claims is putting lower excess D&O insurers in the burn layer. Excess markets are now having success recalibrating increased limits factors (ILFs). Where programs may have seen excess layers with ILFs of 45% to 65% of the underlying layer, we are now seeing those ILFs commonly reset to 75% to 90% of the underlying layer for lower excess and 65% to 80% for higher excess. Each successive increase up the tower leads to much higher total program increases. Any good news? Perhaps. Excess D&O layers that have ILFs in the 80s and 90s likely become the first areas of competition once the marketplace stabilizes. When that happens is TBD.
- **Side-A/DIC:** Even Side-A (which covers individuals' losses in the absence of indemnification), which historically has remained very competitive, is now seeing some firming.
- **Industry:** Certain industries (life science/biotech/crypto/cannabis) may see premiums double.

Underwriting discipline may mean more active responses to loss drivers.

- **Securities class actions (SCAs):** Frequency trends remain at historically high levels. The severity of losses could worsen as relatively higher stock prices could produce precipitous stock drops.
- **Cyber, M&A and privacy:** Social accountability, social media's impact (e.g., #MeToo), privacy compliance risks and dynamic cyber security risks could put pressure on terms and conditions. Privacy issues are blurring the lines between cyber insurance and D&O insurance, creating D&O insurer concerns.
- **IPOs:** These risks continue to be much harder to place as insurers monitor the still-unfolding impact of the SCOTUS decision in *Cyan, Inc. v. Beaver County*; however, as the scarcity of capacity for IPOs pushes rate and terms, there are opportunistic carriers willing to step in – for the right price.
- **Coverage:** New, broadening features are less likely, and meaningful improvements may come, again at a price. Areas of focus are likely to include investigation coverage, social media, crisis and reputation protection, #MeToo-related and Side-A DIC enhancements.

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Employment practices liability

Key takeaway

The EPL market is firming across the board, driven by higher frequency and severity of claims, and increased legislation.

Rate predictions

Primary: +5% to +15%
Excess: Flat to +5%
California: +5% to +25%

The EPL market is firming, with California exposure continuing to be the most difficult to underwrite.

- While overall primary rates are rising in the +5% to +15% range, this can be higher for certain industries, e.g., health care.
- More prominent than rate increases are the increases in retentions and cutting back of limits, with some markets having minimum retentions of $250,000.
- California exposure continues to be more difficult to underwrite because of employee-friendly legislation and a plaintiff-friendly judicial system. Some carriers have raised retentions for California exposure, and some have pulled out altogether.

Claims and losses are rising.

- The EEOC remains quite active. In 2018, they filed 199 merits lawsuits, including 117 individual suits, 45 suits involving multiple victims or discriminatory policies and 37 systemic discrimination cases.
- Title VII claims accounted for 56% of all filings. Seventy-four percent of all filings targeted sex-based discrimination with a 13.6% increase in sexual harassment claims.
- In addition, legislation in Illinois (the Illinois Biometric Information Privacy Act [BIPA]) has been the subject of a slew of class action claims. BIPA prohibits an entity from collecting, capturing, purchasing or otherwise obtaining a person's biometric information, unless it satisfies certain notice, consent and data retention requirements, and provides for a private right of action.

The growth of the gig economy may be problematic from an underwriting and compliance perspective.

- Employers are relying more on independent contractors and freelancers to reduce their payroll costs and tax liabilities. Gig workers, unless improperly classified, are not entitled to such employment benefits as FLSA minimum wages and overtime pay. The use of more independent contractors leads to risk for more misclassification claims – whether the employer has made a mistake in applying the local laws regarding employer classification to an entire segment of their workforce or if an individual alleges they have been personally misclassified.
- With the emergence of the gig economy, there have been changes in the law, particularly in California, with other states surely to follow. These changes impact when an individual is considered an employee versus an independent contractor.
- These changes present significant underwriting concerns because a threshold inquiry in the underwriting process is number of employees. Given the changes in the laws, determining the number of employees at an organization versus independent contractors has become much more complicated and requires extra scrutiny.

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Errors and omissions

Key takeaway

E&O is increasingly complicated. Overall, the marketplace today is stable, with some areas experiencing a mild firming.

Rate predictions

+5% to +10%
Large law firms: +10% to +20%
Technology: +5% to +10%

Errors and omissions, or professional liability, is arguably the most complex area of specialized insurance, with several distinct marketplaces:

- Stand-alone E&O for certain professions (lawyers, consultants, accountants)
- Technology E&O, sometimes stand-alone, but often coupled with cyber insurance
- Miscellaneous professional liability (MPL), including those industries without a specific, dedicated policy form

Lawyers: the market for large law firms began to harden in the 4th quarter of 2018 in response to mounting losses.

- Insurers and reinsurers have reacted to correct past rating deficiencies, respond to the new loss dynamics and regain long-term profitability.
- For a variety of reasons, including insurer mergers and acquisitions and/or decreased appetite, there has been a reduction in capacity coupled with increased layer ventilation.

Technology: evolving product and service delivery technologies are pushing the edges of technology E&O into other coverages, including CGL, cyber and other types of professional liability.

- Internet of Things (IoT) devices, in particular, are interacting with people, property and equipment in new ways.
- Property damage and bodily injury risks from deploying, using or monitoring services using IoT and connected networks and hardware/software are creating new liabilities, contract requirements and interactions between insurance policies.

Other traditional miscellaneous E&O, or MPL: the marketplace is contracting.

- Two large carriers are retrenching their books.

The overlap of cyber and E&O coverage is a major area of focus.

- When buying cyber, buyers often ask about splitting E&O and cyber apart. We often recommend combining all coverage in one policy, as E&O claims alleging a failure to properly render professional services are increasingly overlapping with traditional cyber coverages.
- Further, in the conflict between E&O and cyber, cyber is winning in that more buyers are including E&O as part of their cyber programs. Traditional E&O market capacity continues to erode as carriers focus on underwriting pure cyber risk.

Insureds should be proactive in reviewing their E&O exposure and existing coverage as they determine the best strategy to address growing cyber exposures.

- When insurance is required in a customer contract, the type of insurance (E&O and/or cyber) should be specified.
- Contractual requirements continue to drive requests for E&O coverage.
- Companies should review the limitation of liability and indemnification clauses in their customer contracts, as underwriters are more closely scrutinizing these provisions, especially as they relate to cyber risk.
- Companies should review customer-use policies and guarantees regarding any estimated or guaranteed service availability.

E&O underwriting is becoming more sophisticated and complex.

- Excess carriers are looking more closely at rates and making sure that they are getting adequate premium for the risk.
- Insurers have tightened pricing and retention guidelines for companies offering just-in-time services or guaranteed uptime or output time in their service contracts.
- Carriers are focusing more on middle market business and being more cautious when it comes to writing technology E&O for companies with over $1B in annual revenues.
- Certain carriers are limiting or restricting certain classes of business in response to large recent claims.
- Carriers are reviewing and examining their exposure to intellectual property risk and are reviewing insureds' intellectual property clearance procedures to understand the risk of third-party intellectual property claims.
- Although carriers continue to accept manuscript policies to directly address professional services risk, they are beginning to increase premiums for these policies.

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Fidelity/crime

Key takeaway

Fraud is still on the rise. Cyber criminals are becoming more sophisticated and continue to prey on trusting or careless employees to access company assets and data.

Rate predictions

Flat to +5%

The 2019 AFP Payments Fraud and Control Survey Report showed that 82% of companies were targets of payments fraud last year. The survey also revealed that in 2018:

- 80% of organizations experienced business email compromise (BEC)
- 54% of organizations reported financial losses as a result of BEC
- 70% of BEC scams targeted checks, followed by wires at 43%

It isn't enough to educate your employees.

- A company culture allowing for employees to trust their instincts and ask questions is key.
- In addition, a recent report sponsored by CyberScout recommends organizations take the following actions:
  - Remind employees to "think before you click" and only log in to secure websites.
  - Run company-wide phishing drills.
  - Use two-factor authentication when possible.
  - Make it easier to report suspicious emails.

While cybercrime becomes more and more prevalent, employee dishonesty remains the number one cause of loss to organizations.

- Internal fraud perpetrators have the inside knowledge to avoid detection, allowing their theft to continue for longer periods of time, thereby increasing the size of the loss.

We continue to see the potential for the intersection of coverage between fidelity/crime policies and other (cyber, K&R,) policies.

- Organizations are looking to their brokers to evaluate their exposure and determine which policies are most likely to respond.
- Carriers are starting to impose restrictive language to specify which policy should respond.
  - For losses involving funds or tangible property, insureds should look first to their fidelity/crime policy.
  - For losses involving theft or loss of intangible assets, such as data, insureds should look first to their cyber policy.
  - For ransomware attacks and the like, a K&R (special crime) policy may provide some coverage as well. (See our section on Special Contingency Risks/Kidnap and Ransom for developments in this line of coverage.)

Buyers need to be careful about exposures to cryptocurrency and other digital assets.

- Traditional policy wording may not be adequate.
- Markets offering coverage present unique challenges and demand vigorous underwriting.

U.S.-domiciled commercial risks that are placed in the London market are experiencing more challenging renewals as a result of a decrease in capacity.

- This has led to significant increases in retention levels coupled with increases in premium that are beyond the percentages we are experiencing in the domestic market.

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Fiduciary

Key takeaway

The underwriting process is more challenging, as fee and investment suitability-related litigation and proprietary fund exposure continue to put pressure on this segment.

Rate predictions

Overall: Flat to +7.5%
Commercial companies with plan assets exceeding $500M or large concentrations of company stock in benefit plans: Flat to +12.5%
Other commercial companies: Flat to +7.5%
Financial institutions with proprietary fund exposure: Flat to +50% (or more)
Financial institutions without proprietary fund exposure: Flat to +7.5%
Employee (ESOP) owned firms: +5% to +20%
Universities: +5% to +15%
Health care: Flat to +12.5%
Other commercial private and not-for-profit (NFP) entities: Flat to +7.5%

Continue to expect stable pricing except on challenged classes.

- **Stable capacity:** The fiduciary market remains competitive, with over $500M in advertised capacity. Financial institutions with proprietary funds in their plans and universities, however, may not easily find willing capacity.
- **Underwriting focus:** Expect heightened underwriter focus – especially on process, policies or procedures for evaluating professional fees or investment options. Supplemental excessive fee questionnaires have become more common.
- **Primary market concentration – large and complex:** A few carriers continue to lead most larger programs, with others willing to be opportunistic and competitive. This concentration heightens difficulties for risk segments deem challenged, such as primary capacity for financial institutions with proprietary funds within sponsored plans.
- **Blended coverage – small and medium-sized private and NFP enterprises:** Most smaller private/NFP companies continue to buy fiduciary liability coverage as part of an executive risk package policy, which is an option many carriers offer.
- **Rate:** Premiums and retentions are generally close to flat with some extreme pockets of firming (proprietary fund exposure). Opportunistic players may see post-claim plans as better risks and increase competition. Excess rates remain competitive. Material changes in plan assets, specifically employer stock, may result in increases in premium (and the securities retention for publicly traded companies). Universities, health care institutions and public plans likely will continue to see increased rate pressure due to carrier concerns over trends in 403(b) suits (see below).

Coverage terms are generally stable as well.

- **Challenged classes:** Carriers are looking to either heighten attachment points or seek restrictions – or both. Financial institutions with proprietary fund exposure, universities and health care organizations will likely face substantive action to materially restrict coverage in the form of limits, pricing, retentions and/or other terms.
- **Regulatory dynamics:** While fiduciary risk has seen heightened regulatory uncertainty and change – such as new privacy laws, including the EU's GDPR – we have not seen carriers innovate to provide enhanced solutions or limit coverage in response to new/heightened exposures. Restrictive changes seem to be limited to risks facing challenged classes.

While claims and losses are driving rate pressure, a Ninth Circuit decision, if upheld, may provide relief.

- **Fees/suitability:** Fee cases continue to drive loss development. These cases allege that fees paid to financial institutions have eroded employee retirement plan assets, and less expensive, non-proprietary investment options should have been offered. Potential suit targets are broadening as this cottage industry grows. These suits are no longer limited to large plans. The risks represented by these cases continue to drive severity and, correspondingly, available limits. A wave of 403(b) fee cases has carriers looking more cautiously at universities and the health care industry. Plaintiffs are now pushing for jury trials, which could put upward pressure on awards and settlements.
- **Mortality tables:** We are seeing ERISA claims alleging that plans calculate the amounts of non-single life annuity benefits using unreasonable mortality table assumptions, with the effect of lowering benefits below what ERISA requires. Plaintiffs in these lawsuits seek the difference between their plan benefits and their benefits calculated using the assumptions set by the Secretary of the Treasury pursuant to Internal Revenue Code sections 417(e)(3) and 430(h)(3).
- **Financial institutions:** Insureds with proprietary funds in their plans will face the most challenging renewals in 2020.
  - Already been sued? Although it may seem counterintuitive, a financial institution that has already been sued may be seen as a better risk to a new insurer. Incumbent insurers adjusting a claim will want a premium increase.
  - No such claim yet? Claims-free may NOT be seen as a good thing. Insurers believe that for financial institutions with proprietary funds in their plans, it is only a matter of time before a proprietary fund-related claim will be made. Accordingly, renewal terms from the incumbent will likely look to push rate and restrict terms. Also, there could be very limited interest from other insurers.
  - At least one leading insurer has been looking to broadly exclude this risk without any premium credit.
- **Are limits adequate?** In an environment of rising frequency and severity, buyers should evaluate whether their limits are adequate for their exposure.
- **Regulation and enforcement uncertainty:** With the DOL's Fiduciary Rule vacated, the SEC proposed its Best Interests Rule, and a new DOL rule is expected to raise risks and increase uncertainty. Until the dust settles, the heightened risk will continue to be a challenge.
- **Governance:** Developments in plan governance have heightened fiduciary exposure to potential sanctions, correction expenses and litigation. IRS determination letters, once extensively relied upon by plan sponsors to ensure that a plan document complied in form with the tax qualification requirements, are no longer issued in most circumstances. Today's employers must navigate this regulatory change and ambiguity without IRS validation.
- **Law:** Supreme Court rulings have heightened fiduciary risk, and they are expected to do so again in 2020. (See An ERISA session for the Supreme Court for details).
- **Hope!** There is one potential bright spot that could change the game and relieve some rate pressure – the Ninth Circuit Court of Appeals recently ruled that, contrary to prior circuit precedent, the presence of an arbitration provision in an employee benefits plan could compel arbitration. If that precedent is not overturned on appeal, it could profoundly undermine the fee case trends.

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Financial institutions – FINEX

Financial institutions present unique exposures to the financial, executive and professional lines (i.e., FINEX) insurance market. In many cases insurers employ underwriters who specialize in this class, thereby creating a distinct marketplace. For those reasons we have created a dedicated section to financial institutions' financial lines market conditions as part of this and future editions of *Insurance Marketplace Realities*.

Key takeaway

Decreases are essentially gone, but increases are manageable.

Rate predictions

D&O: Publicly traded financial institutions: +2.5% to +10%
D&O: Private financial institutions: +2.5% to +10%
D&O/E&O: Asset managers (excluding private equity/general PL): Flat to +10%
Bankers professional liability (BPL): +2.5% to +10%
Insurance company professional liability (ICPL): +2.5% to +10%

Note: For employment practices liability (EPL), fiduciary liability and fidelity (crime), please see dedicated sections in this report

- **Overall competition:** Leading insurers have demonstrated pricing discipline in general. While replacement capacity may not always be available at a more competitive price, it is often prudent to market programs to ensure optimal results, especially if not marketed in the past few years. The U.K. and Bermuda markets continue to offer solutions for the right premiums and retentions or attachment, but will pass on thinly priced programs.
- **D&O marketplace:** On a relative basis, the FI D&O marketplace is more stable than the overall commercial industries marketplace, which is experiencing severe increases. One driver of this phenomenon is that rate decreases for FIs over the last 10+ years were not as pronounced as in other industries. While more stable than other industries, FI rate increases are no longer limited to the primary. Excess carriers are also pushing to follow underlying increases to avoid deterioration in their increased limit factors (ILFs). ILFs for FIs, however, had not dropped to the same levels as on commercial excess placements (<65%), and the needed correction is not as significant.
- **Side-A/DIC D&O:** Even Side-A, which historically has remained very competitive, is now flat. Some carriers are trying to achieve rate increases on lead Side-A and follow underlying ABC increases, but in general, most carriers are supporting flat pricing.
- **IPOs:** All public offerings are facing a much tougher marketplace, regardless of industry.
- **Retentions:** Insurers are also looking to increase retentions applicable to merger objection claims (M&A claims) for public companies/D&O.
- **E&O (professional liability) marketplace:** E&O is a historically challenging line of coverage for most FIs, with carriers wary of claims severity in their portfolios. Today, there is some upward rate pressure, but nothing materially different from prior years.
    - **Asset managers:** The overall market continues to remain relatively stable as an abundance of capacity is keeping rates more competitive. Middle market asset management is consistently the area that carriers are looking to grow, with many offering new policy forms and/or enhancement endorsements. Middle market advisors and funds are experiencing a more competitive environment, with pricing flat to +5%. Larger advisors and funds are experiencing more upward rate pressure – up to +10%.
    - **Banks:** Regulatory concerns seem to have waned in the last few years given the change in administration and the financial crises fading in the rearview mirror, but any shock to the economy could put banks back under regulatory scrutiny. Banks are particularly judged on the institution's loss history, loan portfolio quality and change or expansion in services. Bankers professional liability (BPL) primary capacity continues to be limited, and most markets will not write stand-alone BPL without other supporting coverages.

- **Insurance companies:** Insurance company professional liability (ICPL) claims development continues to be adverse, driven by bad faith claims, cost of insurance litigation (which is impacting life insurers) and increased regulatory burdens. Primary capacity is limited, but we have seen a few excess-only markets selectively testing the primary market. Overall, carriers maintain a conservative appetite and are putting pressure on retentions and pricing. But they are still willing to offer broader coverage.

- **FinTech:** Capacity fluctuates depending on the scope of services being provided and is most limited for those including cryptocurrency or blockchain exposure. Rates remain elevated compared to traditional FI industry classes given the novelty of this segment, as carriers are still refining their FinTech underwriting appetites.

Will commercial industry trends bleed into FIs in 2020? These general trends need to be watched.

- **Securities class actions (SCAs):** Frequency trends remain at historically high levels, with 400+ SCAs annually now common. The severity of losses could worsen as relatively higher stock prices could produce precipitous stock drops.
- **Cyber, M&A and privacy:** Social accountability, social media's impact (e.g., #MeToo), privacy compliance risks and dynamic cyber security risks could put pressure on D&O terms and conditions for all industries, including FIs. Privacy issues are blurring the lines between cyber insurance and D&O insurance, creating D&O insurer concerns for all industries.

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Health care professional liability

Key takeaway

The health care professional liability market is experiencing continued hardening, as carriers seek to return to profitability through rate increases, underwriting discipline, controlled capacity deployment and other de-risking strategies. Given the increased underwriting rigor, presenting high-quality submission data is critical.

Rate predictions

Entity medical malpractice: +3% to +15%

- **Loss-affected accounts:** highly variable rate increases

Physicians medical malpractice: +3% to +10%

- **Loss-affected accounts:** highly variable rate increases

Managed care errors and omissions: Flat to +5%

- **Blue plans:** +10% to +30%

Insurers are seeking a pathway to profitability.

- Profitability is front and center for carriers due to medical malpractice combined ratios that have been in excess of 100% from 2015 through 2018 and increasing loss severity. Increased loss severity is occurring in single-plaintiff cases, as well as in batch cases. Insurers are also concerned about potentially catastrophic losses from systemic exposures. These dynamics put continuing pressure on rate, terms and conditions and available capacity.
- Underwriters are inundated with submissions, but are focused on profitability, not top line growth. This means that submission differentiation through quality data is paramount. Clean data in an easily navigable format allows underwriters to differentiate risks and price their products accordingly.
- Many are grappling with the question: Is the departure of a significant reinsurer from the medical malpractice space in Q3 2019 a harbinger of more market withdrawals?
- One of the most challenging health care segments is managed care E&O. Markets are retracting terms and conditions asking for higher retentions and seeking increased rate.

Insurers are focusing on systemic risk.

- There are several systemic risks (i.e., risks that span an entire industry, not just one organization) currently plaguing the health care industry: opioids, sexual abuse and molestation, and technology. Technology issues include cyber breach risk, implementation risk and risks resulting from lagging regulatory guidance, as the regulators struggle to keep up with technology changes in the space.
- Insurers are paying increased attention to these systemic risks as they consider their entire portfolio of health care accounts. They are rigorously underwriting these exposures through detailed requests for exposure and loss data, risk management procedures and litigation management strategies.
- Medical malpractice markets are limiting their exposure to systemic risk through the application of limiting and/or clarifying language, sublimits and potentially outright exclusions on their forms.

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Senior living and long-term care

Key takeaway

Increasing severity, frequency and volatility (higher value verdicts and settlements) are creating continued hardening and rate firming. Some carriers are restricting excess limits, resulting in more multi-carrier tower structures.

Rate predictions

General and professional liability

Favorable loss experience and venues: +10% to +15%

Adverse loss experience and poor venues: +30% or more

Auto: +15% to +20%

Property

Non-cat exposed: +5% to +15%

Cat-exposed without losses: +10% to +20%

Cat-exposed with losses: +15% to +30%

The general and professional liability marketplace continues to tighten due to insurers' drive for profitability and emerging loss trends.

- Carriers are reporting increases in loss frequency and severity of 8% – 12% over the course of the previous year.
- Capacity is contracting and some carriers are leaving the marketplace altogether.
- Buyers are seeing less favorable terms and conditions.
- In addition to rate increases, buyers may be subject to step factors – additional charges when a new risk or new asset, for which no historical loss data is available, is involved.
- Several carriers report that they are adjusting bed rates mid-term (for additional exposures added to a policy between renewals) to keep up with negative claim trends.
- Retentions (deductible or self-insured retentions) are on the rise.
- We see competition, however, for insureds with more stable loss experience.
- A back-to-basics approach requires more detailed submissions, face-to-face meetings with underwriters, thorough supplemental information, clinical and risk analytics and longer lead times to obtain quotations.
- Underwriters are delving deeper into operators' policies and procedures regarding high-profile risks, including falls, elopement and resident abuse.
- As some carriers re-underwrite their books, they are hyper-focused on troubled venues where severity and frequency trends are more pronounced.
- More clients are considering captive solutions and creative ways to drive down the cost of risk while maintaining compliance with lender and stakeholder requirements.
- Owners are reducing the volatility of their managers' insurance expense by securing insurance on behalf of those operating their assets.
- Class-action lawsuits focused on anti-consumer, staffing, marketing and ADA violations are prevalent in California but could be coming in more states.
- Expanded litigation beyond urban areas is affecting results in suburban and exurban venues more dramatically.
- As the industry struggles with employee retention, the full employment economy in many regions accelerates staff turnover. Turnover disrupts continuity of care, compliance practices, documentation and record keeping. In turn this often leads to increased litigation, inflated defense expenses and higher costs to resolve claims.
- Natural disasters, including wildfires, catastrophic storms and flooding, are drawing underwriter attention to disaster preparedness.

The auto market continues to worsen.

- Fewer insurers are offering monoline auto options as this line of business continues to face profitability issues.
- Brokers are having to become more creative in finding package solutions, e.g., packaging auto with workers compensation or other lines of coverage.
- Claim severity resulting from loading and unloading residents and distracted drivers is a major concern for underwriters.

Several factors are creating a hardening property market.

- Property market conditions continue to see an acceleration in rate increases as two years of combined ratios exceeding 100% have forced underwriters to push for profitability.
- Capacity is shrinking, especially in catastrophe-prone areas.
- Attritional losses are driving higher retentions, which can also be a factor in minimizing rate impact, as carriers may push higher retentions as a strategy for keeping rate increases at bay.

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Aerospace

Key takeaway

Capacity reductions and market withdrawals continue, with rumblings of more to come. Rate increases and coverage restrictions are expected as underwriters scrutinize enhancements that were the result of soft market conditions for many years. Buyers need to be prepared to differentiate themselves to realize the lower end of our pricing forecast range.

Rate predictions

Airlines: +25% to +40%
Aircraft lessors/banks: +5% to +15%
Product manufacturers and service providers: +10% to +25%
Airports: +10% to +20%
General aviation: +10% to +25%
Space: Increases to be expected, percentage range not applicable

Airlines: This sector continues to harden. Capacity is shrinking but remains adequate.

- Market withdrawals and merger activity among insurers continue to put pressure on total available capacity.
- Worldwide premiums over the last several years have been insufficient to cover underwriters' payments on attritional claims and hull losses.
- Underwriters have a sense of urgency to correct this loss ratio imbalance, concerned that if they don't make meaningful progress this year, they may not be open for business next year.
- Following market pricing has increased faster than lead pricing, narrowing the vertical premium rate spread.
- Losses in 2018 have surpassed 2017 loss levels and, in 2019, we have seen several high-profile losses, which are likely to embolden underwriters and strengthen their argument for rate increases.
- Accounts with favorable loss ratios can expect a 25% rate increase, at minimum, regardless of exposure growth. Accounts with losses can expect increases of up to 40% or more.

Aircraft lessors/banks: This segment is experiencing relatively modest premium increases due to the overall market hardening and underwriters' resolve to achieve minimum percentage increases across their entire book of business.

- The impact of reduced capacity and a tougher pricing environment in the wider market has caught up with this class.
- Despite the uplift in pricing, and tightening of capacity, risks with fleet growth and good loss experience continue to attract sufficient capacity.
- Overall market hardening may further tighten capacity and pricing may increase.

Product manufacturers and service providers: Although this segment remains relatively stable for non-critical manufacturers and for those buyers with loss-free programs, rate increases are expected.

- Large loss reserves and recent aircraft groundings are impacting overall profitability, causing insurers to look for financial recovery through premium growth.
- As the entire aviation market continues to harden, we expect rate increases to become more common, especially from incumbent insurers on programs.
- Following insurers are looking to close the rate differential from the lead insurer, with pricing above lead terms now common and expected.
- While accounts are still being underwritten on a case-by-case basis, most buyers will face price hikes.

Airports and municipalities: This segment continues to harden.

- Multi-year terms are no longer available.
- A few shock losses have brought upper insurance company management attention to certain coverages and limits, forcing line underwriters to more closely scrutinize particular enhancements, e.g., excess auto liability.
- Many markets are less inclined to offer high limits on a 100%, horizontal basis, meaning vertically structured placements are becoming more common.

- Excess layers over working layers are increasingly attractive to insurers and are more competitively priced.
- Marketing will be necessary if municipal boards want to benefit from competitive options.

General aviation: This segment continues to harden faster than other aviation sectors due to consistent loss activity, along with premiums well below the attritional loss level.

- Several markets, both domestic and international, have withdrawn or reduced their capacity, with rotor-wing and single-pilot operations being the hardest hit due to significant losses over the past few years.
- Rate reductions are a thing of the past, with most markets pushing for low double-digit increases on long-term profitable accounts and significant increases on accounts with loss activity.
- New and creative marketing approaches, presenting an attractive narrative and approaching alternative insurers are essential.
- Market conditions are stimulating innovation in the use of excess policies, different retention structures and swing protections.

Space: This sector has experienced significant hardening in the last 10 months due to major losses.

- This hardening is a result of a worsening adverse loss streak that began in 2014.
- Two major incidents in 2019, incurring more than $600M in losses, are driving this ongoing shift.
- Premium levels are now insufficient to pay for such catastrophic losses – the industry's 2019 combined ratio is 280%.
- Capacity is declining, with some insurers withdrawing from this sector entirely and others re-assessing their participation levels.
- Rate increases are expected on both new and renewal business, regardless of loss history.

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Cargo

Key takeaway

Increases in the frequency and severity of cargo claims over the past several years coupled with shrinkage of market capacity have resulted in U.S. and London markets that continue to firm. However, broad coverage terms remain available.

Rate predictions

U.S. market
Good to marginal loss experience: +7.5% to +15%
Poor loss experience: +15% to +30% and higher

London market
Good loss experience: +15% (+20% with nat cat stock exposures)
Marginal to poor loss experience: case-by-case basis

The market is currently looking for higher retentions and increased rates.

- Risks that have minimal catastrophic exposure and plain vanilla transit risks are seeing the lower end of forecast increases, unlike those with highly exposed catastrophic-storage risks and risks in highly scrutinized industries, such as pharma/life science, food/beverage and auto.
- Pricing for clients with poor loss history has become unpredictable. We've seen a wide range of renewal results with a few instances of triple-digit rate increases, but most are falling into the +12.5% to +25% range.
- When marketing profitable new business, we are still securing relatively competitive pricing.
- Virtually no buyers are seeing reductions in price.
- Capacity is shrinking and is being more carefully deployed.
- Excess stock capacity in U.S. market has all but dried up.
- Structuring programs or layers as quota-shares has often become necessary, especially for catastrophic-exposed storage risks.
- Coverage for industry segments such as pharma/life science, food/beverage and automobiles is being underwritten carefully.
- Insurers are revisiting their underwriting strategy, risk appetite and underwriting guidelines as they look to return to profitability.
- Detailed underwriting information and best practices for risk control are critically important for achieving the broadest coverage terms at the best price.

Broad manuscript policy terms are still achievable, but underwriters are scrutinizing the following coverages and risk factors:

- Broad wording for spoilage, deterioration and decay
- Broad control of damaged goods cover, including fear of loss coverage for voyage frustration
- Coverage for processing risks
- Highly exposed catastrophic risks for goods in storage
- Packing, security details on loss sensitive risks and high value products

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Construction

Key takeaway

The marketplace for construction continues to tighten, resulting in rate increases across multiple lines of insurance coverage. Whether their focus is cost containment, program sustainability or alignment with long-term risk management objectives, contractors should be prepared to evaluate different program structures and risk transfer techniques to achieve the best results.

Rate predictions

General liability: Flat to +15%
Workers compensation: -2% to +4%
Auto liability: +3% to +20%
Umbrella/excess liability:
Umbrella: +15% to +30% or more;
Excess: +15% to +25% or more
Builders risk: +5% to +10%
Professional liability: Flat to +5%
Project-specific/controlled insurance programs: Flat to +5%;
Flat to +5% for excess
Subcontractor default: +5% to +10

General liability (GL)

U.S contractors are facing an array of headwinds from general liability carriers. Underwriters are responding to poor loss experience by increasing rates, closely evaluating program structures and attempting to add more restrictive policy wordings.

- Submission flows to carriers are up significantly, and markets are exercising more underwriting rigor.
- New business is not encountering the same flexibility and ease in the underwriting process as in prior market cycles.
- Adverse combined ratio results remain top of mind as underwriters analyze rate adequacy. Over the past few years, well-publicized challenges in auto liability have resulted in many instances of GL rates being suppressed as underwriters sought ways to offer total account pricing that was competitive. At the same time, however, legal expenses continued to rise, and plaintiff verdicts delivered unprecedented, catastrophic outcomes, putting pressure on carrier portfolios. The window to discount GL has closed and we can expect greater scrutiny ahead.
- Rising loss activity from premises and operational risk, historically overshadowed by long-tail completed operations losses, persists. Carriers have tightened their appetites and are seeking out best-in-class risks, as well as requiring extensive underwriting data and engineering information.
- Comprehensive underwriting information is more critical than ever in the renewal process – including thorough descriptions of newly formed and/or acquired entities, loss experience and historical exposures. Carriers are increasingly influenced by predictive modeling to drive underwriting decisions, thus making accurate exposure data imperative.
- More intensive underwriting has significantly slowed the quotation process. Providing adequate lead time to obtain renewal terms is key.
- Wildfire exclusions have become commonplace and wildfire capacity is now extremely limited.

Auto liability

Auto liability remains the most challenging line for insureds, with persistent rate increases and program structure changes. Underwriting scrutiny is intense, often irrespective of individual loss experience.

- Commercial auto insurers have pushed price increases for 31 consecutive quarters (August 2019 Fitch Ratings Report) with no indication of reversing course. Results from 2018 produced a 108 combined ratio, and despite some improvement year over year and a rise in direct written premiums, signs still point to underwriting losses for 2019.
- More claims are being litigated, with verdict outcomes often in seven or eight figures. High-value verdicts mainly stem from traumatic brain injury claims (TBI), negligent entrustment/driver selection, distracted driving, and the influence of “social justice” in the courtroom. A rise in third-party litigation finance is further encouraging lawsuits.

- The robust economy is putting more vehicles on the road, increasing the frequency of accidents. Current low unemployment rates translate into driver shortages, pushing companies to hire less experienced drivers.
- Auto physical damage pricing continues to rise. Comprehensive/collision claims can escalate quickly due to increased technology in vehicles – a bumper is no longer just a bumper, it's also a sensor and a camera. Auto physical damage deductibles for comprehensive and collision are also climbing, with some carriers setting a minimum of $2,500 for light trucks.
- Rate increases are hovering between 3% and 10%. Larger fleets, heavier fleets and risks with adverse loss experience are subject to greater increases – in some cases north of 20%. Jurisdictional considerations (Cook County, IL, for example) can also impact the level of rate increase.
- Auto concerns are not just relevant to practice programs. In controlled insurance programs or project-specific policies, contractors on site are generally responsible for providing comprehensive automobile liability insurance. While coverage can usually be provided by the contractor's practice policy, hired and non-owned coverage is increasingly not included, or limits are inadequate. In these scenarios, we may recommend adding the coverage into a project CIP, provided the proper underwriting information is available.

Workers compensation

The workers compensation outlook remains positive for buyers, offsetting difficulties in auto liability and general liability. While overall a very positive signal to the health of this line of business, it has carriers worried about maintaining profitability and premium volume.

- Favorable loss experience in the aggregate continues to drive state-approved base rate decreases and sustained competition within the market.
- The line's combined ratio has improved to its lowest level in over half a century. NCCI estimated that as of year-end 2018, private insurers had a $5B loss reserve redundancy – the highest in at least 25 years.
- Annual written premiums are expected to decrease over 10% for full year 2019 as a result of decreasing filed rates and a competitive market.
- Exceptions remain in California and New York, where carrier appetites (and historical results) still present challenges for buyers. Florida presents another unique dynamic, as base rate suppression and restrictions on discretionary pricing mechanisms have caused insurers to question whether they can be profitable.
- Positive loss trends are attributable in part to the marked increase in both the insurers' and insureds' stake in managing risk, including use of managed care, enforcement of return-to-work programs, nurse triage, fee schedules and telehealth.
- Managed care vendors, carriers and TPAs continue to focus on reducing opioid use through alternative pain management methods, including legalized marijuana. However, legal marijuana may also present an entirely new host of workplace issues.

Umbrella/excess liability

Construction umbrella and excess liability placements are very challenged, and we expect this complicated environment to continue through 2020.

- The lead umbrella marketplace continues to struggle with construction risks. Construction underwriters are increasingly scrutinizing rate, capacity and attachment points.
- The bench for lead umbrella players is limited, with those still willing to write leads reducing capacity. Historical lead umbrellas of $25M have become exceedingly rare. Virtually all programs require more carriers to complete desired limits.
- Unsupported umbrella programs (where the umbrella market does not also write the primary casualty program) are particularly challenged.
- On excess placements, minimum premiums have risen significantly, a problem especially for smaller risks. Where excess carriers would historically offer limits for as low as $1,000 per million, we now see minimum premiums approaching $2,500 per million and higher.
- Fleet exposures and attachment points, while a focus in the broader umbrella market for some time now, are seeing continued scrutiny in the construction space, especially for street and road/civil contractors. Buffer auto liability programs are a potential response; however, this marketplace has undergone a significant retrenchment since 2016 when key carriers exited. The result is highly selective deployment of capacity and high rates online.

- Wildfire exclusions are prevalent, and capacity for coverage in high hazard areas (i.e., California) is virtually non-existent in the standard market. Securing coverage up through the tower will be difficult for most insureds. Many are turning to project-specific programs to address this exposure, especially major utilities in compromised areas. Players here are predominantly E&S, and pricing reflects high premium to limit ratios.

Controlled insurance programs (CIPs)

Recent increases in reinsurance rates are driving up CIP pricing, and we have seen capacity begin to pull back. Markets remain competitive on commercial business, but residential programs have become difficult in certain geographic regions.

- Rolling programs continue to be popular, facilitated by carrier creativity and flexibility, e.g., pay-as-you-go (enroll) options and subscription programs. The volume in these types of programs tends to yield more competitive rates (i.e., economies of scale).
- Dual-line CIPs remain steady, while general liability-only programs continue to grow in popularity – driven by ease of placement and administration, low retentions and limited (or zero) collateral requirements.
- While the GL-only realm is dominated by the E&S marketplace, standard markets tend to be aggressive on larger projects, leveraging multiple lines of coverage. Enhancements may also include lower SIR options to reduce/remove collateral requirements and early close-out options to move accrued liabilities off the sponsor's balance sheet.

New York general liability

- In 2019 we've seen significant movement in the E&S space, with new carriers entering and others exiting the New York market for trade contractors. In general, the environment continues to harden due to the increased size of payouts on labor law claims. Many carriers with historical experience in New York have either pulled away or restricted their overall program offerings. In certain cases, and depending on the trade classification, carriers are requiring 100% premium to limit on primary general liability.
- While some new capacity enters the New York marketplace for primary general liability, excess carriers are reluctant to attach above newer players with little or no experience in New York, which is driving excess pricing up further.
- The standard markets (which offer large retention structures only) remain opportunistic by picking and choosing where they are going to play. Best-in-class risks may still encounter favorable terms on renewals.
- Otherwise, markets continue to seek mid to high single-digit rate increases. Contractors seeking low deductible programs continue to find themselves in the challenging E&S space.
- Historically, London markets have provided solutions where the domestic carriers have pulled back. Due to poor overall results, London has reduced its available capacity and is looking for higher rates and attachment points.

New York controlled insurance programs/project-specific placements

- CIPs remain a common solution to ensure coverage certainty and unified terms and conditions, but general liability retention levels continue to rise. The standard markets have either pulled away or require increased retentions and large collateral outlays. Carrier concerns are no longer confined to just erosion of their maximum program aggregate but also paying out defense dollars on labor law claims that settle above the retention.
- The minimum general liability retentions in New York have risen and are now in the $2 – $5M range. Lead excess pricing (up to $10M) continues to be a challenge with carriers seeking up to 100% premium to limit depending on the project exposures. Further, we are seeing defense costs structured inside the limit as carriers are trying to mitigate their overall exposure on labor law claims. As collateral has become a large part of a CIP, carriers are open to creative solutions featuring pay-as-you-go options for both collateral and premium payments.
- As an alternative to a CIP, combined owner-general contractor liability programs have increased in popularity. In addition to adequate coverage and dedicated limits for the project, they offer potential cost savings. Rising demand has led to the development of several branded options.

Builders risk

The North American builders risk market continues to exhibit signs of firming, though not to the degree we have seen in the fixed/operational property market, as ample capacity continues to drive competitive terms for the right risks.

- The global builders risk marketplace has experienced a rash of major losses in recent years, the result of natural catastrophes, large-scale fires, water damage and numerous losses in the energy sector.
- This loss experience, in concert with a decade of eroding marketing conditions, has reduced builders risk capacity in the London marketplace. Lloyd's, for example, has seen several syndicates exit the construction marketplace entirely.
- The shift in market conditions is starting to be seen in increased underwriting scrutiny, a reduction in carrier appetite for projects with a heavy exposure to natural catastrophe, and/or unique means and methods (e.g., modular construction), an increase in rates, as well as tightening of terms and conditions (e.g., increased scrutiny regarding requests for the defective part via LEG 3, requirements for higher water damage deductibles, etc.).
- Buyers should be alert to the likelihood of cost increases following a significant time lag between the initial pricing (quotation) and project inception. Pricing should be refreshed frequently, and insureds would be wise to prepare to pay more than initially indicated in the bidding process.
- Buyers should consider alternative program structures to ensure optimization of risk transfer at an acceptable cost, e.g., increasing retentions, exploring cat carve-outs, etc.

Professional liability

The construction professional indemnity/liability market remains competitive, though domestic carriers are selectively making upward pricing adjustments.

- Over a dozen carriers offer primary forms and several others provide either primary or excess coverage. Total U.S. capacity is now in excess of $300M with an additional $150+M available through London, Bermuda and other international markets.
- For contractors' professional, we anticipate slight upward pressure on rates through the balance of 2019 and into 2020, with rates flat to +5%, depending on loss experience and carrier results. Many contractors have taken advantage of historically competitive market conditions and obtained increased limits with favorable terms.
- Product enhancements reflect the evolution of technology, delivery methods and contractual terms and conditions.
- Protective indemnity and rectification coverages are now included in standard forms offered by key carriers, but terms and limits must be carefully analyzed as they can vary considerably.
- Defined technology services cover has become widely available in response to the growing exposure brought by technology to the professional liability space.
- For owners' protective professional, increasing project values create a corresponding rise in professional liability risk, and many contractors and design professionals do not carry limits that adequately address these now larger exposures. As a result, owners are routinely purchasing owner's protective professional indemnity policies for further project protection.
- Traditional project-specific professional liability policies covering all design risk on a job can still be obtained, but typically buyers prefer the cost efficiency that protective products provide.
- Interestingly, we are also seeing increased interest in owner's protective professional for much smaller projects (down to $50M), driven primarily by market capacity and the product's cost effectiveness.
- While construction professional indemnity/liability continues to be competitive in North America, there are some trends to watch over the next 6 – 12 months:
    - Increased claim activity in the professional liability market and the abundance of large projects over the past several years are lifting claim severity.
    - Some U.S. carriers are reviewing PL books of business and selectively reducing capacity and increasing rates depending on loss experience and class of business.

- Hardening market conditions in London, Australia and the rest of the world may begin to impact U.S. buyers as global carriers try to recoup losses from outside the U.S.
  - Nine insurers exited from construction PI market in last 18 months, removing $130M of capacity.
  - Capacity is being restricted across the board and subscription placements are increasingly necessary, even for smaller clients. Capacity reductions by individual carriers on individual programs of between 30% and 50% are not unusual.
  - We are seeing increased scrutiny by underwriters on excess/SIR levels – insurers expect clients to have more skin in the game.
  - Some observers are concerned that market capacity in London may be exhausted before the end of the year.
  - Rate increases in Australia are ranging from 50% to well over 100% with increased retentions and capacity reductions.
- General hardening in other lines of coverage as well as continuing year-over-year rate reductions may begin to impact capacity and rates.
- Owners' protective project coverages, typically written by the same contractor professional markets, may have a negative impact on carrier loss experience as the market matures and projects reach completion.

Subcontractor default insurance

The subcontractor default insurance (SDI) market may soon see another entrant. The steady increase in capacity, now eight years in the making, has resulted in a competitive market in both pricing and terms for clients with positive loss experience.

- Currently, six markets provide this coverage, with varying appetites and capacity of up to $75M per loss. A seventh market has recently hired a product leader with the goal of entering the market for 2020.
- Given that SDI policies renew every few years, buyers at renewal can expect single-digit increases.
- Recent losses have been led by residential risks, framing scopes and the generally high backlogs that subcontractors are holding – which are placing strains on subcontractors' ability to perform from a labor and cash flow perspective. These trends are expected to impact placements with frame or residential exposures, as well as any clients with adverse loss history.
- The cost of tail coverage is increasing while terms are shrinking in many cases. Over the past 24 months, most of the carriers' coverage for tail has been shortened on a year-over-year basis from inclusive of 10 years to inclusive of two or three years post-substantial completion. We have seen pricing increases of up to 25% on an additive basis to maintain tail coverage of 10 years, while some markets are declining to entertain (even at a price) the full 10 years.
- Residential risks in particular are seeing significant pricing increases for tail coverage and limited carrier appetite for tail over five years post substantial completion. Factors impacting coverage availability are loss experience, GL wrap limits, geography/jurisdiction and, of course, contractor controls, such as financial prequalification and project QA/QC.
- Often, the largest subcontracts and/or most unique subcontracts with little performance history are being removed from the subcontractor default program due to selective bonding, carrier appetite or owner requirements.
- Carriers are seeking increased transparency around financial qualifications, operational ability, subcontractor selection criteria and risk mitigation planning.
- Overall, however, the subcontractor default marketplace is robust, providing contractors with multiple options. While we expect rates to remain stable – except for buyers that have not yet renewed their programs under the new tail pricing structures – the competitive landscape offers more choices than have historically existed for this coverage.

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Energy

Key takeaway

Downstream
More losses reported in the $100 – $400 million range are hurting the direct market as it increases reinsurance program retentions – resulting in an accelerating hardening process.

Upstream
Although the upstream energy portfolio remains profitable for now, buyers must understand that the hardening conditions in related lines are having an increasingly negative impact on pricing.

Price predictions

Downstream
Favored business: +20% to +30%
Less favored: +30% and above

Upstream
+2.5 to +10%
Loss-impacted/North American exploration and production (E&P) business: +10% to +30%

Downstream

This is the first year that capacity has fallen in the downstream market since 2002.

- Theoretical capacity is down to $6.25B (from $6.5B) for international, $3.7B (from $4B) for U.S. risks. Realistic capacity – capacity that can actually be obtained in practice – is $3B and $2B respectively. As we move further into 2019, achieving even these capacity levels is becoming an ever-increasing challenge.
- Lloyd's (i.e., the corporation of Lloyd's) has been scrutinizing the profitability of individual syndicates and has refused to grant more capacity to syndicates writing downstream energy.

Loss record continues to deteriorate.

- Losses in recent years may be declining but overall the picture is bracing: $6.5B in 2017, $4.2B in 2018 and over $3B projected for 2019.
- Recent losses in North Africa, the U.S. and the Middle East fuel the fire.
- Indirect effects of Hurricane Dorian and the Saudi drone attack contribute to market resolve.

The hardening process now intensifies as alternatives are hard to find.

- Favored business – buyers with good loss records loyal to leading insurers – can expect less severe increases.
- Reinsurance pricing moves remorselessly upward – and insurers are retaining more risk.
- Double-digit rate increases are now standard: 30%+ for refining clients, more for loss-impacted programs.
- Line sizes are being trimmed, resulting in fewer placements being over-signed.

Upstream

Upstream capacity is still at record levels.

- Theoretical capacity is over $8B; realistic capacity is at $6.5B for operational risks.
- Buyers may still find it difficult to secure full market participation at competitive terms.
- Programs for some construction projects valued at over $5B will prove challenging to complete.

Buyers face a modestly hardening rating environment.

- We are seeing increases of 2.5% to 10% for highly regarded risks, but larger increases (+10 to +30%) for loss-impacted risks and North American E&P business.
- The sector is profitable but is being affected by negative results in related lines of business.
- The placement process is taking longer.
- More centralization of underwriting authority is contributing to pricing upswings.

Insurers are differentiating between various parts of upstream portfolios.

- North American E&P business is being particularly impacted by poor loss records.
- We expect a significant upward rating trend for offshore construction, particularly for subsea exposures. Some insurers are reducing their offshore construction all-risks portfolio.
- Major offshore infrastructure is being treated much more leniently.

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Environmental

Key takeaway

Environmental coverage and capacity continue to evolve as a result of the market's heightened awareness of increased exposures, legal liability and regulatory risk.

Rate predictions

Contractors pollution liability: Flat to +10%
Site pollution liability (PLL/EIL): –5% to +15%
Combined environmental + casualty/ professional: +5% to +15%

Hard market conditions in standard lines of insurance have had both positive and negative effects on the environmental insurance market.

- As demand and application for environmental products continue to grow, a major reduction of capacity from a single market was offset by slight capacity increases from its competitors and the entry of wholesalers now quoting for the retail market — with a flat net effect on overall market capacity.
- Many clients facing hardening conditions in the property and excess casualty markets are strategically locking in multi-year operational environmental programs (2 – 5 years) where available to mitigate future market uncertainty.
- While longer policy term programs (5+ years) are available for transactional business, carriers are less likely to offer them based on regulatory uncertainty surrounding emerging risks; some clients are less likely to purchase them (when they are offered) due to pricing considerations.
- In 2020 we will see recently merged underwriting units looking to form a combined underwriting identity that may or may not benefit their insureds depending on the prevailing appetite for risk.
- While there were few market entrants into environmental insurance in 2019, several carriers that had previously offered environmental insurance through wholesalers widened their distribution platform to the retail market. This trend is expected to continue in 2020.
- As buyers seek access to additional limit capacity, brokers are employing inventive solutions, such as layered, quota-share and captive programs, to address the demand.
- Markets are looking to protect their limits on larger, layered programs by participating at higher levels and on a ventilated basis whenever possible.
- Most buyers can expect rate increases. The only reductions we can foresee are for site pollution liability buyers with expiring policy terms greater than five years or in favorable classes of business — and with excellent loss histories.

Environmental coverage and claim trends reflect the changing treatment of environmental risk.

- Although four of the top five global risks identified during the World Economic Forum 2019 in Davos, Switzerland were environmentally related (climate change, extreme weather events, water crises, natural disasters), the environmental insurance industry is anxiously awaiting markets to offer products that affirmatively address these exposures.
- Coverage for mold and legionella for the hospital, hospitality, residential and education (K-12 and sometimes colleges and universities) sectors is becoming limited. If carriers do offer coverage, it is subject to higher premiums and more restrictive terms and conditions. Carriers are relying heavily on individual property engineering and multiple deductibles (per door/per bed) at each location for certain exposures, such as mold.
- Perfluoroalkyl and polyfluoroalkyl substances (PFAS) continue to garner attention from regulatory entities as well as from insurers who are in various stages of reacting to potential regulatory changes surrounding these chemicals.

- Product-related claims arising from covered operations exposures associated with the application of chemicals or installation of building products are on the rise.
- Construction-related claims continue with great frequency. Exposures arise from indoor air quality, installed building products and excessive siltation.
- To mitigate the risk of multiple claims from a single incident, environmental carriers are relying on other insurance provisions and multiple deductibles to share risk among other lines of coverage (GL, property) and insureds, respectively.

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Special contingency risks: kidnap and ransom

Key takeaway

The special risks insurance markets continue to reduce their exposure to cyber extortion events.

Rate predictions

-5% to +5%

Insurers are adjusting policy language pertaining to cyber events that could be considered part of a ransom scenario.

- Two insurers have now introduced blanket exclusions for cyber extortion, one applying the exclusion on virtually all their new and renewal quotes and the other applying the exclusion selectively to industries deemed more susceptible to cyber extortion threats.
- The introduction of blanket cyber extortion exclusions by these two insurers is recent, but we expect other markets to follow over the next 12 to 18 months.
- Most markets have already restricted overall policy coverage to reimbursement of ransom, crisis consultancy fees and expenses, and limited special expenses, such as public relations.
- "Other insurance" clauses have also been specifically applied or modified to clarify that coverage is to apply in excess of any other valid and collectible insurance.
- Sublimits for cyber extortion business interruption continue to be applied by all insurers.

Interest in active assailant coverage is growing.

- Kidnap and ransom (K&R) insurers, as well as insurers underwriting crisis management risks, have shown increased interest in active assailant coverage and begun offering customized solutions (either via endorsement or stand-alone policies) with a focus on post-incident crisis management support, legal liability coverage, business interruption coverage (as a result of both physical and non-physical damage) and indemnification of a variety of incident-related expenses.
- These solutions go beyond traditional terrorism or political violence coverage and are increasingly being used to complement traditional policies in an insurance portfolio.

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Marine

Key takeaway

The marine market remains hard, though rate increases may ease compared to increases seen in recent months. Underwriters will aggressively pursue new business and, as we have seen in the U.S. workers compensation market, USL&H rates are softening.

Rate predictions

Hull (new business): Flat to -5%
Hull (renewal): +5% to +10%
Marine liability (new business): Flat to -5%
Marine liability (renewal): Flat to +5%
Excess liability: Flat to +5%
USL & H: -5 to -10%

The London Lloyd's market, a key player for U.S. marine risks, has recently seen several key syndicates cease underwriting.

- The remaining syndicates were asked by Lloyd's management to provide business plans with a strategy for profitability.
- These developments have already resulted in a tightening of pricing, which likely will continue into 2020.
- U.S. inland and coastal tug and barge tonnage is still attractive to the domestic hull market, which has a robust appetite for premium. Thus, our prediction of flat to -5% on new business.

Marketplace consolidation is a key factor in changing marketplace conditions.

- Following two major mergers that were launched or completed in 2018, we have not seen a dramatic change in philosophy or appetite for underwriting.
- However, with this consolidation of markets, competitive leverage will decrease on renewal business.

There remains ample capacity in the marine liability market in both the U.S. and London.

- Most marine liability renewals are not facing the same pressure for increases seen in the hull markets and, as in hull, conditions are competitive on new business. Some underwriters will expand terms and conditions in lieu of reductions.
- Some underwriting capacity in the U.S. has expanded in 2019, which could counter-balance the impact of recent consolidation.

In 2019, retaining expiring pricing is now considered an unusual result and most markets are increasing rates, even for those with perfect loss records. We expect this trend to continue through 2020.

- For best renewal results, early planning and discussions are a must.
- Clients should also be prepared to sacrifice long-term relationships with their underwriters if they want to achieve optimal financial results.

Drewry's *Ship Operating Costs Annual Review and Forecast* predicts continuing hard conditions and we concur, though we think it's premature to forecast two years ahead in such a dynamic market. Below are highlights from Drewry's forecast.

- Rate increases and tightened terms and deductibles will continue for at least two more years.
- Over the next few years, H&M premiums will increase by up to 10% year-on-year for shipowners with good loss records and by as much as 20% for those with bad loss records.
- Inflationary pressures in the reinsurance market will force P&I clubs to raise fees for cover in the coming years, potentially by double-digit percentages.

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Personal lines

We have included a section on personal lines insurance market conditions for this and future editions of *Insurance Marketplace Realities*. Results in the personal lines market are increasingly interwoven with the results of commercial insurers and impact their overall risk appetite. Furthermore, many of our commercial risk managers are involved with personal lines insurance for the executives of their firms.

Key takeaway

Rates are up across the board for personal lines, most significantly in cat-prone areas such as Florida and California.

Rate predictions

Most risks: +5 to +7%
Cat-exposed: +15 to +50%
Cat-exposed with losses: +50 to +100%

Extreme weather patterns continue to plague the insurance industry with an increase in both frequency and severity.

- After a quiet start, 2019 delivered Hurricane Dorian, the most powerful storm ever recorded in the Atlantic, exposing the risk that coastal communities face.
- Wildfires increased 20% from 2017 to 2018; the 2018 wildfire season was the deadliest and most destructive ever recorded in California. Wildfires are now threatening communities all year long.
- In 2018, nearly every state experienced at least one large hailstorm, with most hail events occurring in the Midwest states nicknamed Hail Alley.

Personal auto has shown signs of improved underwriting performance.

- Rate action by many insurers in recent years is now helping to improve underwriting results.
- However, the severity of claims continues to increase as technologically advanced vehicles become more expensive to repair and medical expenses swell.
- As telematics become more sophisticated, we expect more accurate data on losses, leading to more effective preventive measures.

Analytics and technology will continue to impact underwriting.

- Predictive modeling and greater access to data will continue to support underwriting discipline.
- Insurers continually reevaluate their risk models, which tends to narrow their risk appetite and tolerance.
- We expect more non-renewals and/or restrictive coverage terms as carriers continue to limit their overall downside.
- Preventive measures will play a larger role in risk mitigation for all buyers.

High net worth (HNW)/family office clients will have particular challenges in 2020.

- With market consolidations, fewer markets are catering to successful families.
- HNW carriers will continue to introduce additional restrictions on policy language to limit their overall exposure.
- Successful individuals tend to live in areas with more cat exposure, leaving them with fewer alternatives.

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Political risk

Key takeaway

As we move toward a multipolar world with nationalism on the rise, American businesses may come under scrutiny not only because of who they are but also where they are.

Rate predictions

Low-risk countries: Flat
High-risk countries: +10%

Companies could be caught in the crosshairs of an increasingly confrontational geopolitical landscape exposing them to sanctions, import/export embargoes, revocation of licenses and selective discrimination.

- A shift in the geopolitical landscape toward nationalism and populism is taking hold in many places across developed and developing markets.
- As international relations are influenced by a trend from a unipolar to a multipolar order, some analysts predict increased competition between adversarial great powers and more clashes for regional dominance.
- We advise global companies with exposures in countries mentioned below to seek political risk cover while capacity is available.

The impact of global and regional geopolitical tensions is felt not only by companies operating on the ground but also by businesses whose supply chains are connected to these regions. Observations on some key markets include:

- **China:** Mass demonstrations in Hong Kong against the government-proposed Fugitive Amendment Bill have brought some retail and hospitality business in the administrative region to a halt. Several international businesses have gotten caught in the escalating conflict, particularly if they are perceived as taking a stance in the heated debate. In the meantime, U.S.-China trade war rhetoric continues unabated.
- **Middle East** tensions remain high as the blockade imposed by the Gulf Cooperation Council on **Qatar** enters its third year. The recent attack on **Saudi Arabia's** oil fields via drones left the country's oil output stalled for days and escalated tensions with **Iran**.
- Long-simmering tensions between **Japan** and **South Korea** took a dramatic turn when Japan imposed export controls on semiconductor material shipped to South Korea, prompting business associations to call for a swift resolution.
- **Colombia:** In addition to the humanitarian and economic crisis across the border in **Venezuela** and a surge of refugees into Colombia, there is now increased fear of regional conflict following Venezuela's alleged harboring of a FARC splinter group and Venezuela's conducting military exercises along the Colombian border.
- **Brexit** is proving to be a protracted battle for the U.K. government internally, showcasing the political risks in developed markets.
- **Upcoming elections: Argentina's** general elections in the fall will decide the fate of President Macri, who faces an uphill battle for reelection. **Ukraine's** next parliamentary elections will determine the makeup of the next government, and President Volodymyr Zelensky's party may win a first-ever one-party majority in the Parliament, which would help advance his reform agenda.

While political risk markets remain competitive due to an influx of capital, we are now observing country capacity shrinking in several jurisdictions.

- The total capacity per risk has surpassed $3B, more than doubling the capacity of $1.3B available a decade ago, which has kept the marketplace competitive.
- However, we are starting to see capacity shrinking in high-demand countries, such as China and Mexico, where rates may rise due to increased political risk.
- Additionally, we foresee capacity decreasing for higher risk countries, such as **Argentina, Pakistan, Nigeria, Angola, Azerbaijan, Guinea, Mozambique and Zambia.**

Political risk losses and insurance innovations are both expanding.

- Currency inconvertibility/non-transfer and business interruption continue to be popular political risk coverages in the face of rising losses.
- Recent claims experience has prompted policy wording enhancements, such as shorter waiting periods and broader wordings.

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Surety

Key takeaway

Though excess capacity and soft rates remain, contractors should remain proactive in managing their risks, primarily backlog and cashflow positions. Inflation potential and global economic instability could bring quick and material credit changes.

Rate predictions

Rate prediction: -5%

Marketplace

- Significant M&A activity, including an acquisition by the second largest global surety, is consolidating capacity and could tighten the market, particularly for middle-market buyers.
- The Surety and Fidelity Association of America (SFAA) reports that direct premiums in the U.S. grew from $6.2B in 2017 to $6.6B in 2018. Surety premiums should continue to see growth into 2020.
- We expect contract and commercial surety markets in 2020 to remain competitive with rates remaining soft, unless there are significant surety losses, which could result in reinsurance market tightening, creating an environment ripe for rate hardening and capacity limitations.
- The global surety market is expected to grow to $28.77B by 2027, from $15.33B in 2018. A shortage of skilled surety professionals is restraining market growth to certain extent.

Contract surety

- Construction projects over $250M are the only market segment with signs of challenges due to hesitant capacity and tightening underwriting conditions on very large projects.
- There is more surety capacity available today for projects under $250M.
- With significant interest rate volatility, construction lending is expected to tighten. Contractors should remain aggressive by paying down debt, locking in low rates and limiting use of lines of credit.
- The construction industry continues to wait on new infrastructure spending plans from the Trump administration.

Commercial surety

- Surety companies are looking for new growth, and commercial surety remains a focus area. New products are being developed, although only a limited number have been deployed so far. There is a renewed effort by surety companies and brokers alike to push surety bonds as an option to replace letters of credit where the obligees are open to them. Insurance program bonds as well as environmental and creative commercial contracts are being written by sureties more readily and bonds are being accepted more frequently.
- The commercial surety market remains soft with significant downward pressure on rates, expansion of capacity thresholds and favorable underwriting conditions. The push for revenue growth is paramount for commercial surety leadership, bringing with it the need for innovative means to deliver premium growth.

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Terrorism and political violence

Key takeaway

The marketplace is on edge awaiting another extension of the Terrorism Risk Insurance Act (TRIA), set to expire in December 2020. The anticipation of a protracted debate over the extension of the program will once again influence property and casualty market strategies.

Rate predictions

Flat

The long and bumpy road for TRIA continues.

- The TRIA reauthorization debate has moved forward, with the House Financial Services Committee passing a resolution to extend the legislation for an additional seven years. This is a positive first step in the reauthorization process, though parallel action in the Senate, not yet initiated, will also be required..
- There is relative market calm in comparison to the previous extensions in 2007 and 2015, due in part to a gradual increase in market retentions under TRIA.
- The changing nature of events may precipitate change in coverage scope under TRIA, including a greater focus on domestic and cyber terrorism.
- Captive insurers, which rely most directly on the federal backstop, would feel the greatest impact from dramatic changes to the program.

Stand-alone terrorism rates have remained remarkably static in an otherwise firming market.

- Increased availability of U.S. domestic capacity for terrorism risk is creating a competitive environment in an otherwise firming property market. While global aggregate terrorism was reduced by recent merger activity among insurers, barring additional M&A or major claims, we expect capacity to remain stable.
- Reduced frequency of claims globally continues to make this line of business attractive to insurers and reinsurers.
- Additional capacity for major metropolitan areas is anticipated, though markets will ultimately be sensitive to any major changes to TRIA – or its expiration – in December 2020.

Programs designed to respond to the increasing number of active assailant events continue to evolve.

- The increasing number of cases where active shooter incidents may be classified as domestic terrorism has precipitated an evaluation by insureds of coverage gaps in traditional property and casualty programs.
- Stand-alone active assailant programs continue to expand risk prevention and response services as an adjunct to insurance coverage.
- New entrants to this market are providing an expanding suite of coverage combining liability, physical damage, business interruption and loss of attraction coverage.

Analytics have once again become a major value-add for clients taking a serious look at terrorism insurance.

- A new generation of analytics has become available to enhance site security and evaluate optimal facility design and pedestrian choke points.
- Blast modeling provides critical third-party counterpoints in the development of probable maximum loss estimates from terrorism events.
- Advanced analytics now allow insureds to model chemical and radiological dispersion methods, helping them better understand less conventional terrorism risks.

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Trade credit

Key takeaway

Bank usage of trade credit insurance is at an all-time high and will continue to trend higher over the next several years, due to increased supply chain financing and the ability of banks to use trade credit insurance to obtain capital relief.

Rate predictions

–5% to +5%

Conditions vary by industry sector.

- Awareness of trade credit insurance has risen across all sectors in the last several quarters. Macroeconomic factors (negative economic forecasts and a greater need for access to capital) and microeconomic factors (a greater awareness of incorporating the product into a client's total risk management strategy) are playing a significant role in this spike.
- Capacity continues to remain restrictive or selective in the automotive, retail and commodities industries. Conversely, insurers continue to display an aggressive appetite for energy, computer/telecom and food sector risks.

For most buyers, rates are expected to remain flat into 2020 but market capacity is hardening.

- Economists at several trade credit insurance markets are predicting a market recession in the first quarter of 2020. As a result, the market is beginning to harden, with capacity tightening in certain sectors, but, contrary to typical hardening markets, pricing remains competitive.
- Bank business has continued to grow as originators and sellers seek more competitive terms from their banks. Supply chain financing partners are purchasing more cover, but insurers are becoming increasingly selective in the deals they support.

Financing and access to capital continue to play a major role

- In cooperation with their banks, buyers continue to seek credit insurance to support more aggressive asset-based lending offerings and to access higher levels of capital financing.
- Financial institutions continue to turn to credit insurance to support accounts receivable purchase programs and securitization programs, as demand for liquidity and access to capital continues to increase.

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