# MARKETS IN FOCUS
## GENERAL INSURANCE

Insurance Pricing & Market Update

Q1 2023

# INTRODUCTION

COVID-19 caused a quick shift in the insurance industry in a number of ways. Technology is now more essential than ever in order for companies to run smoothly utilizing a virtual workspace.[1] As a result of the low-interest rates, demand for liquidity and the possibility of unexpected occurrences, organizations are being forced to modify their practices and specialize their insurance programs.[1]

The lack of adequate coverage is not only an issue for developing and established companies, but is also mirrored on a worldwide scale.[1] As the post-pandemic world gains more visibility, insurers will need to reassess how they connect with their customers, distributors, investors and other important parties.[1] There is growing anticipation for the industry to take the lead in creating transformation regarding environmental, social and governance (ESG) concerns worldwide.[1]

Amid a backdrop of complex financial, geopolitical, legal, technological and climate-related risks, companies are being forced to adjust their pricing structures, underwriting, reserving and distributing.[1] Businesses swift and ready to demonstrate fact-filled data will be rewarded, while the complacent and unprepared will be penalized with pricing and capacity constraints.

# MACROECONOMIC OUTLOOK

## INTO 2023

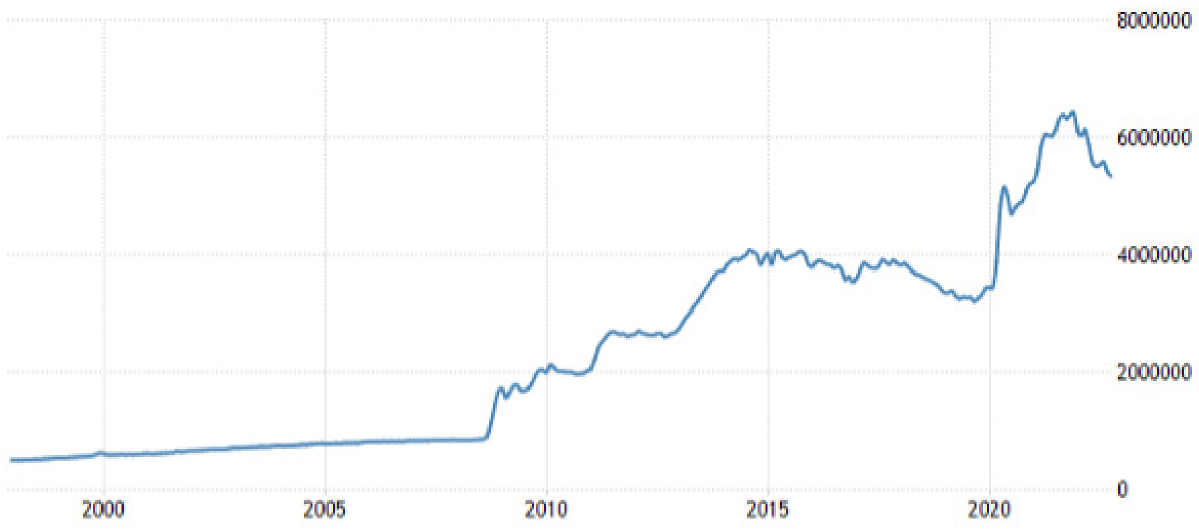
The macroeconomic environment heading into 2023 continues the trend we have experienced since early 2020, as uncertainty and complexity remain watchwords for the year. While individual narratives have changed drastically – from pandemic, lockdowns and domestic social unrest in 2022, to war, inflation and international social unrest, specifically in China – the common denominator remains the same: uncertainty.

## INFLATION

Since the 2007/2008 financial crisis, the U.S. M0 money supply has increased over 3x, with billions and subsequently trillions being injected into the economy, beginning with $475B for TARP in 2008 and most recently over $4T in total authorized expenditure for COVID relief efforts.[2] These large, and then massive, capital infusions coupled with over a decade of historically low-interest rates (enabled partially by historically low fed funds rates) created an environment for inevitable inflation.[3]

This inflationary environment was only worsened by supply chain constraints (specifically in China, as discussed in more detail below) and ballooning energy costs, driven partially by Russia's invasion of Ukraine and ensuing game of 'energy chicken' with Europe.[4]

FEDERAL RESERVE BALANCE SHEET




Source: tradingeconomics.com | Federal Reserve

A common narrative at this moment, particularly from those who debate the value and charter of the Federal Reserve is that the United States is headed for a hyper-inflationary trend similar to that experienced by the Weimar Republic in the 1920s. The simplest argument against this eventuality is that the United States is not saddled with massive war indemnities, has not had significant industrial production centers annexed by foreign powers and has not just lost 2M+ young men to a brutal four-year war.

What appears to be a more likely scenario is the United States will experience a prolonged period of high single-digit inflation as the Federal Reserve finishes its transition from dovish to hawkish back to dovish. While this number will be managed downward by the Fed likely increasing interest rates to cool down the economy by increasing debt costs, prices will likely continue to trend higher as American imports begin to move out of China to higher-cost areas such as Vietnam and Mexico.

## WAR, THE RUSSIA-UKRAINIAN CONFLICT

The ongoing Russian invasion of Ukraine is an extension of Moscow's existing strategy of attempting to exert influence over its eastern European neighbors, a strategy which was dealt a heavy blow in 2014 during the "Revolution of Dignity" whereby the pro-Russian Ukrainian President Viktor Yanukovych was overthrown, and the executive branch replaced with leaders opposed to Russian alignment. This action precipitated the Russian invasion and annexation of the Crimean Peninsula, which has been held by Russia since 2014.

The escalation of the Russo-Ukrainian war has two significant effects on the broader global economic ecosystem: more aggressive brinkmanship from Russia regarding their energy exports to Europe and the constriction of Ukrainian agricultural exports.[5]

**Russia provides Europe with approximately 45% of the eurozone's total natural gas consumption.[6]**

Gazprom, Russia's state-owned energy producer, reported that year over year delivery of natural gas was down 40% to countries outside of the former Soviet bloc (meaning primarily Europe). Several reasons were provided but the overriding narrative was the shutdown of the Nordstream 1 pipeline for maintenance. Gazprom and the Russian government have been attacked over this reasoning by western European governments who question the validity of the maintenance and accuse Russia of 'weaponizing' the energy supply as retribution for Europe's support of Ukraine.

Whichever narrative is to be believed, the effect of the energy conflict is both stark and dangerous. Natural gas prices in Europe are up 89% in the last year, with heating oil up 37%, forcing both the EU and individual European governments to consider price caps to enable Europeans to afford their energy bills during the 2022/2023 winter.[7]

The ongoing energy conflict between Russia and western Europe will have long-term and far-reaching effects as European leaders reconsider their reliance on Russian energy imports, particularly as Russia appears committed to a more aggressive and bellicose foreign policy posture.[8] A likely benefactor of the increasing tension between Russia and Europe are American liquified natural gas (LNG) producers and transporters as Europe searches for alternative sources of energy.

The United States already became the world's largest LNG exporter in the first half of 2022 as European and British imports simultaneously hit record highs, with the United States making up nearly half of all LNG imports to the UK and Europe.[6]

## CHINA

The current situation in China appeared inflexible as recently as early November, as swift resolution required President Xi Jinping and the Chinese Communist Party (CCP) to reverse a now three-year-old "zero COVID" policy[9]; which the CCP unexpectedly did, in December. It appears that the CCP's hand had been forced, given the extended bout of often violent protests, for instance, the one which gripped Foxconn's Zhengzhou plant in late November.

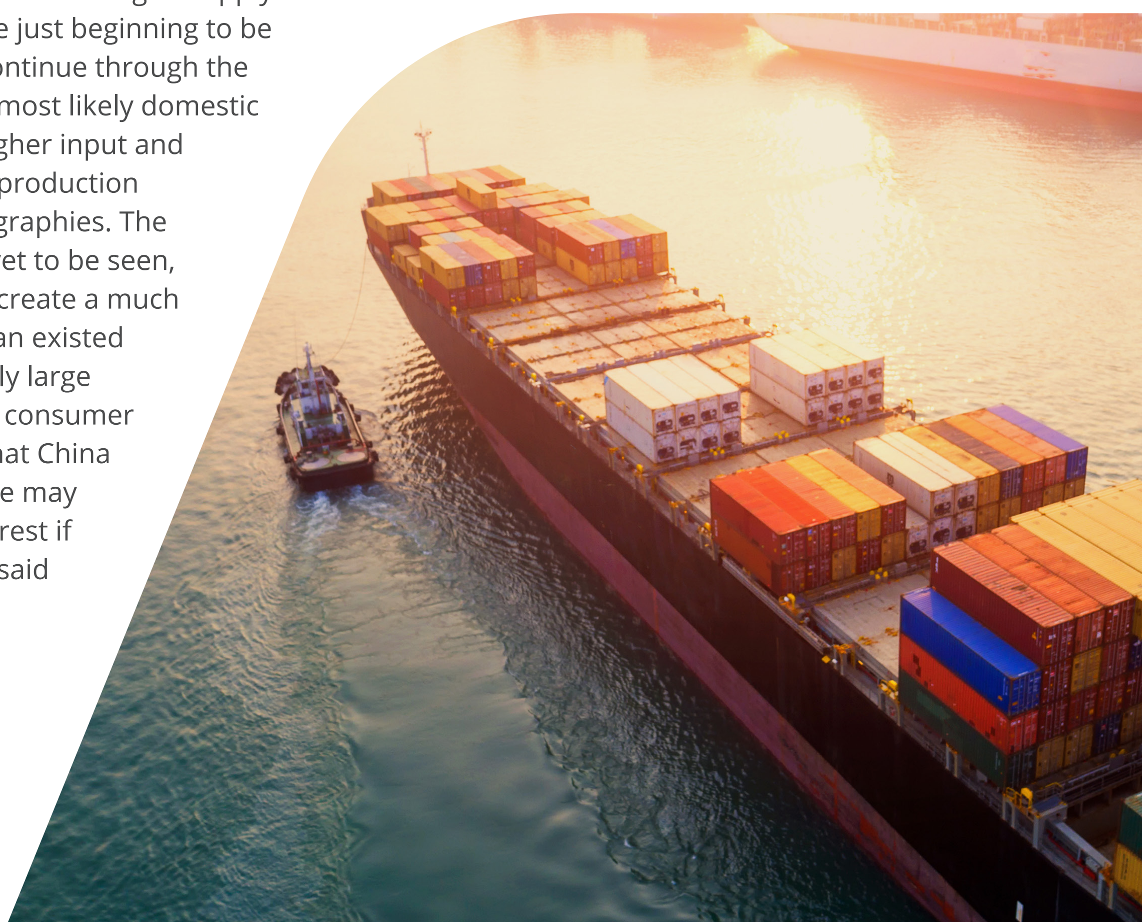
As to the CCP's response, it became apparent that China's "zero COVID" policy had, as projected, hamstrung the country's growth as entire metropolitan areas faced extended lockdowns in order to contain the spread of COVID.[9] Given China's anemic progress in vaccination, lockdowns remain the only arrow in the government's quiver insofar as taking direct action.[9]

As this loosening trend continues into 2023, it should help alleviate the supply chain constrictions which has hampered the production of everything from cars to computers.[9] While a pullback from "zero COVID" in China would help ease these issues, significant progress should not be expected until the third quarter or later.[9]

Finally, the new economic dynamic between the United States and China cannot be ignored. This dynamic has been forged by two key forces: new supply chain priorities and the increasingly bellicose relationship between the U.S. and China.

The last three years have forced those U.S. business leaders who rely on a China-centric supply chain to admit that supply chain control and stability is worth increased production costs.[7] This is precipitating an exodus of manufacturing and through-put work from China to the rest of Southeast Asia and in limited cases to the United States.[9]

The effects of this fundamental rethinking of supply chain and product sourcing are just beginning to be felt and will almost certainly continue through the remainder of the decade. The most likely domestic outcome of this shift will be higher input and increased consumer prices as production moves to more expensive geographies. The effect of this shift on China is yet to be seen, and while the CCP has helped create a much larger Chinese middle class than existed two decades ago, it is not nearly large enough to absorb the massive consumer product production capacity that China has established. This imbalance may lead to unemployment and unrest if the CCP is not able to redirect said labor capacity.



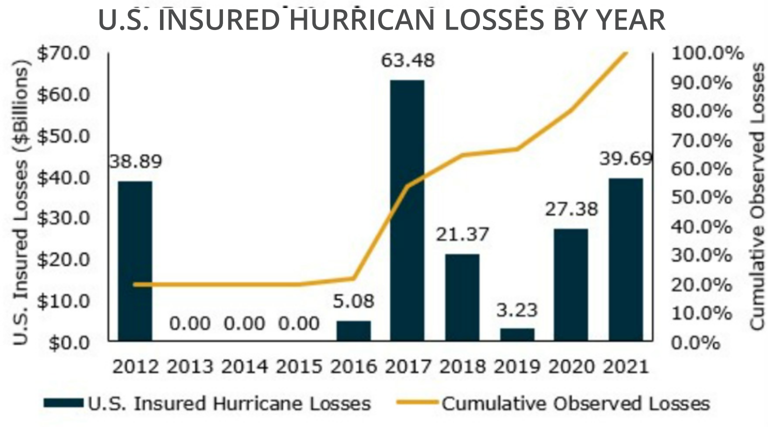
# MARKET OUTLOOK

## PROPERTY

The insurance marketplace in the last decade has been heavily influenced by catastrophic weather events. According to the Insurance Information Institute, Hurricane Katrina holds the record for the costliest hurricane on record, with approximately a $90B insured loss in 2021 dollars. Hurricane Ida follows behind with an estimated $36B in insured losses, while Hurricane Ian is predicted to have a $40-60B+ insured loss event.[10]

Apart from hurricanes, wildfires have burned through hundreds of thousands of acres in the United States, leading to unprecedented levels of destruction across the entire country.[11]

The cost of capital is increasing due to unmodeled global inflation, financial and economic uncertainty.[11] As a result, markets are driven to seek greater yields, causing a rise in interest rates and a lack of alternative capital options. This is creating pressure on investors to accept the best rate of return on their capital.[11]




Source: marshberry.com

**In today's commercial insurance marketplace, insurance carriers and underwriters are maintaining a healthy dose of skepticism with respect to reported property values – especially replacement cost values (RCVs).**

For the past three years, the global marketplace has been in a state of flux and rapid transition, caused at least in part by overlapping events such as COVID-19, supply chain and transportation bottlenecks and outright disruptions, supplier shutdowns, skilled labor shortages, and regional armed conflicts. When combined with a rapid increase in money supply as government stimulus programs sought to offset spikes in unemployment, a miasma of uncertainty has grown with resulting inflationary pressures, and the commercial sector must respond as the hallmarks of stagflation loom.

The undervaluation of property is one of several very real concerns facing businesses, and traditional valuation methodologies are inspiring less and less confidence in these nontraditional times. While valuation is relevant across the financial sector, within insurance, particularly property insurance, accurately valuing property is a quintessential variable for managing and transferring risk. As a result, within the insurance market today, two primary issues related to valuation create unique challenges for both insureds and insurers alike.

+ Values have increased more rapidly than the insureds or carriers can appropriately adjust, and continuing increases are expected until the global marketplace can stabilize. The means and methods classically used to manage changes in value are not well suited for the rapid escalation displayed in recent years.
+ The insurance market is suffering losses out of proportion with premiums charged as values increase more rapidly than updated valuations can be declared to the marketplace. Those inflated real values increase the probability of higher magnitude losses, compressing more exposure and coverage into the same location. As a result, an insurer's exposure increases without the additional premium normally accompanying an increase in RCV.

### Replacement Cost Value

The amount it takes or would take to repair or replace the damaged or destroyed property with new materials of like kind and quality, without deduction for depreciation and including the Insured's overhead associated with the replacement of damaged or destroyed property should the Insured participate in the repair or replacement of damaged property, all determined at the time of repair or replacement at the place of the loss.

## THE IMPACT OF INACCURATE VALUATIONS

Inflation and uncertainty have had a tremendous impact on property and asset valuations. Now more than ever, accurate valuations are in all parties' best interests.

Carriers need to be able to calculate appropriate premiums, estimate potential losses with some degree of certainty, and, in turn, optimize their portfolios for tenable business. Each of these are built on the reported values of insured property. Absorbing higher than expected losses, while at the same time charging premiums not commensurate with the actual value exposed, creates an unsustainable business model for insurers.

From an insured's perspective, systemic undervaluation creates a different set of challenges and can result in unexpectedly high risk retentions and losses, potentially also yielding unsustainable business outcomes. In addition, as an insurer's confidence in market-wide valuation wanes, insureds are vulnerable to dramatic, broad-stroke, valuation-based premium adjustments and reduced interest and participation from incumbent markets. Unfortunately, the result is often unfavorable renewal terms from incumbents, and far too often the need to recruit additional capacity from opportunistic carriers.

Further, the company's own internal risk management program and its evaluation of tenable losses must be based on accurate valuations, or else any valuation-based decisions are suspect. At very least, RCVs are the basis for performing loss estimate calculations, including estimated maximum loss (EML), which is frequently a driver in determining necessary coverage limits.

## WHERE WE FIND OURSELVES

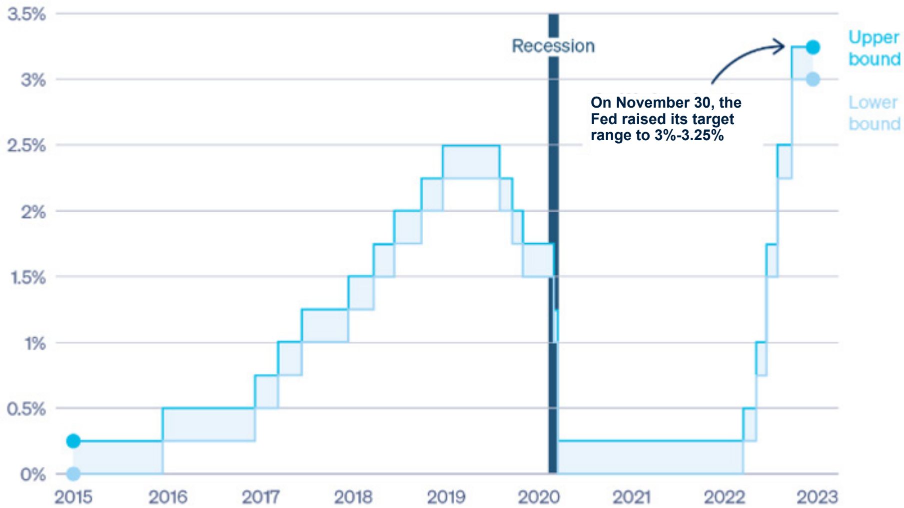
The insurance marketplace is responding to this valuation situation in a few ways. Underwriters are scrutinizing reported values and valuation methods like never before. They're routinely making requests for formal appraisals and reviewing a company's valuation methodologies.

Increasingly, underwriters are pointing to the uncertainty surrounding reported RCVs as a reason to pull back offered coverage limits, increase deductibles, and, of course, raise rates and premiums.

The starting point for renewals these days includes an underwriting assumption that an insured's values are likely underestimated. A company needs to make a very compelling case to prove otherwise and making such a case is not often a quick study. Even organizations with pristine loss histories, adequate renewal preparation time, and appropriate documentation can see their renewals quickly go off track when valuation concerns and stipulations arise in the 11th hour.

### THE FED RAISES INTEREST RATES FOR THE FIFTH TIME THIS YEAR

The Federal Reserve sets a narrow range for its target short-term interest rate




Source: Federal Reserve via FRED, Washington Post

As inflation and rates go up, it becomes increasingly important for the insured to review their reported values and raise them if needed to reflect accurate replacement costs and current rental/business income.[11] In other words, the cost of losses is rising.

### FLORIDA

Hurricane Ian, one of the most destructive storms in U.S. history, wreaked havoc across portions of Florida on September 28, 2022. The powerful winds, storm surges and extensive flooding have already caused billions of dollars of destruction to residential and commercial properties.[12] Unfortunately, the recovery process is expected to be both lengthy and costly due to increasing interest rates and shortages in labor and materials.[12]

GENERAL PRICING ESTIMATES

| | |
|---|---|
| **Non-CAT exposed property with favorable loss history** | 5% to 10%+ increase |
| **CAT exposed property with favorable loss history** | 15% to 50%+ increases |
| **Property with unfavorable loss history and/or a lack of demonstrated commitment to risk improvement (unresolved recs, pattern of same issues, etc.)** | 10%+ increases for non-CAT<br><br>25% to 100% increases for CAT exposed accounts<br>and higher depending on frequency/severity of losses |

## CASUALTY

### GENERAL LIABILITY

The Casualty market is still showing signs of subtle price increases, with primary General Liability rates staying relatively steady for risks experiencing no losses. Insurers are requesting more information on past losses and the preventative measures taken to mitigate similar losses from occurring in the future.

Depending on the risk profile and loss history of an organization, Commercial General Liability markets are going to see a slight uptick in pricing, coupled with more strenuous terms and limitations.

### EXCESS LIABILITY

To reduce potential threats, carriers are capping their capacity between $5M and $10-15M, which is much lower than the usual $25M limit. This means that it is essential to combine multiple insurance carriers to reach desired limits, consequently resulting in higher premium expenses.

### AUTO

The commercial auto industry has been facing considerable challenges recently, including large financial settlements, increased litigation costs and claims payouts outpacing revenues. This has been especially problematic for those managing large fleets of vehicles. In response, many auto carriers have invested in telematics and fleet monitoring technology to decrease their loss ratios.[13]

## WORKERS' COMPENSATION

Insurers have found Workers' Compensation to be a highly lucrative line of coverage, with pricing that is reasonable for those who are buying. Though modification factors and past losses will have a large impact on pricing, competition among carriers for accounts with good to excellent loss histories will ensure that prices remain low.

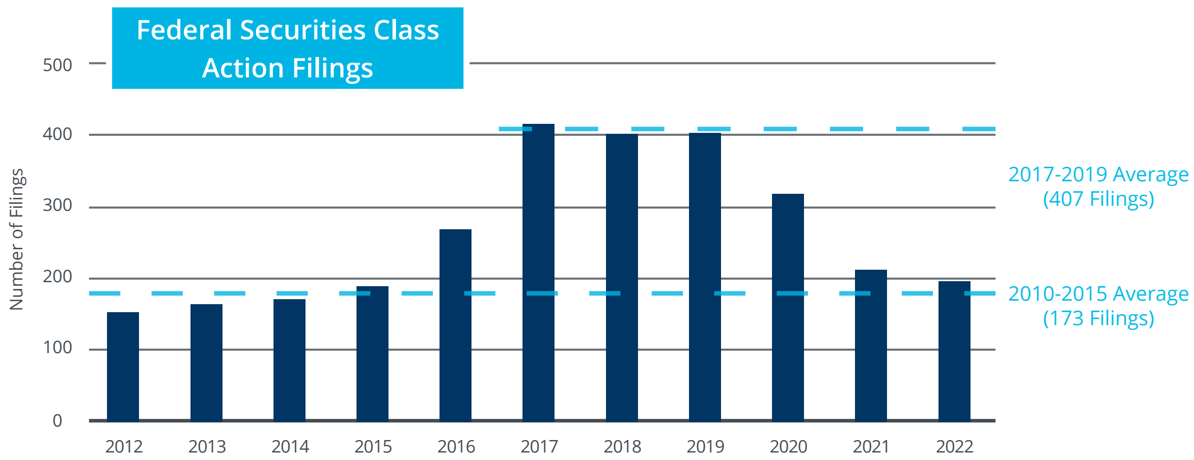
### GENERAL PRICING ESTIMATES

| | |
|---|---|
| General Liability | Up 5% to 15% increase |
| Workers' Compensation | Flat to Down 3% |
| Auto | Up 10% to 25%<br>Up 30% if large fleet and/or poor loss history |
| Umbrella & Excess Liability | Up 10% to 25% |

# EXECUTIVE RISK

## D&O

For two consecutive years before 2022, the number of D&O Federal Securities Class Action Claims decreased. In 2022, this trend continued, albeit at a slower rate, with 197 claims being filed.




The past three years have seen a decrease in D&O litigation, an increase in dismissals and a new capacity in the marketplace, resulting in more advantageous D&O pricing for recent renewals compared to the year before.

Companies eyeing an IPO or de-SPAC transaction can expect pricing and retentions to still be higher than in prior years, but not as high as before. The D&O pricing a company receives is based on their situation, so it is important to make sure to accurately portray the risk to the D&O underwriters.

The decreased amount of IPOs and de-SPAC transactions in 2022 has created increased competition among D&O carriers for existing company business, which is a major contributing cause of the better pricing environment.

Looking ahead to the beginning of 2023, we are confident that the trends we witnessed in the previous months will stay in place, leading to further cost reductions and capital development.

## CYBER

The Cyber insurance market is currently moving out of a hard market. Carriers are reallocating their portfolios in response to recent claims from 2020 and 2021, which has led to increased rates and a demand for technical controls. While ransomware claims are decreasing, the severity of other risks are still present, making this a volatile class of insurance. Despite the volatility, Cyber insurance is now considered a critical component of any organization's risk management plan.

+ Pricing increases are decelerating
+ Increased Carrier competition over accounts
+ Carriers are focusing on “must have” controls and increasingly reliant on external scanning technologies in risk assessment
+ Specific areas of focus:
    - Multi-Factor Authentication (MFA)
    - Remote Access
    - Privileged users
+ Enterprise implementation of Endpoint Detection & Response (EDR) solution
+ Data backup procedures:
    - Detection from the network or cloud-based
    - Encrypted
    - Restricted Access
    - Tested
    - Multiple Copies
+ Software patch management to ensure critical security patches are made within 30 days
+ Insureds that do not have satisfactory control in place may see non-renewals or a reduction in coverage. This reduction comes in the form of sub-limits or co-insurance provisions.
+ Carriers looking to reduce exposure to business interruption by reducing limits and increasing waiting periods – particularly true on contingent business interruption.

# Major Claims in the Sector

### $247 MILLION VERDICT

The parents of the deceased sued a trucking company and the vehicle operators for negligent operation of a vehicle and inadequate driver training after a van struck a tractor-trailer. As it backed into a driveway, the tractor-trailer blocked the road, causing the fatal collision.[14] The plaintiffs sought recovery of damages for past and future loss of companionship, loss of society, and mental anguish.[14] The jury found that the tractor-trailer driver was acting within the scope of his employment and was responsible for 65% of the incident, with the trucking company and company owner bearing 20% and 10% of the responsibility, respectively.[14] Consequently, the $260M verdict was lowered to $247M.[14]

### $82 MILLION VERDICT

The plaintiffs, who had previously gone to or worked at a school where the light fixtures contained Polychlorinated Biphenyls (PCBs), were granted an $82M award by the jury after filing a lawsuit against the school claiming that their exposure to the PCBs had caused them harm.[15]

### $1 BILLION VERDICT

During a party held at an apartment complex, a 14-year-old girl was subjected to an attack and assault by a security guard employed by Crime Prevention Agency (CPA).[16] In the subsequent lawsuit against CPA, the plaintiff's counsel argued that the firm was aware of the guard's history of inappropriate conduct towards other guests and tenants but still hired him even though he was unlicensed to carry a weapon.[16] Moreover, counsel contended that CPA disregarded any indications that could have foreseen the injury of the girl.[16]

### $366 MILLION VERDICT

The jury awarded a plaintiff, who had previously worked at FedEx and had made complaints about racial discrimination, a total of $366M in punitive damages, $1.04M for future pain and suffering, and $120,000 for past pain and suffering after she was terminated from the company.[16]

# Guidance

### BEGIN THE RENEWAL PROCESS EARLY

The **General Liability, Cyber, Excess/Umbrella** and **Property** markets are constrained and more challenging to navigate in the disciplined market, with an outcome of increasing prices across all lines of business and in every industry sector.

### PARTNER WITH INDUSTRY EXPERTS

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

### HIGHLIGHT CYBER SECURITY & PROACTIVE RISK MANAGEMENT

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

### ENGAGE LOSS CONTROL TEAMS

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

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