MARKETS IN FOCUS

HOSPITALITY:

Hotels + Casinos

Q2 2021

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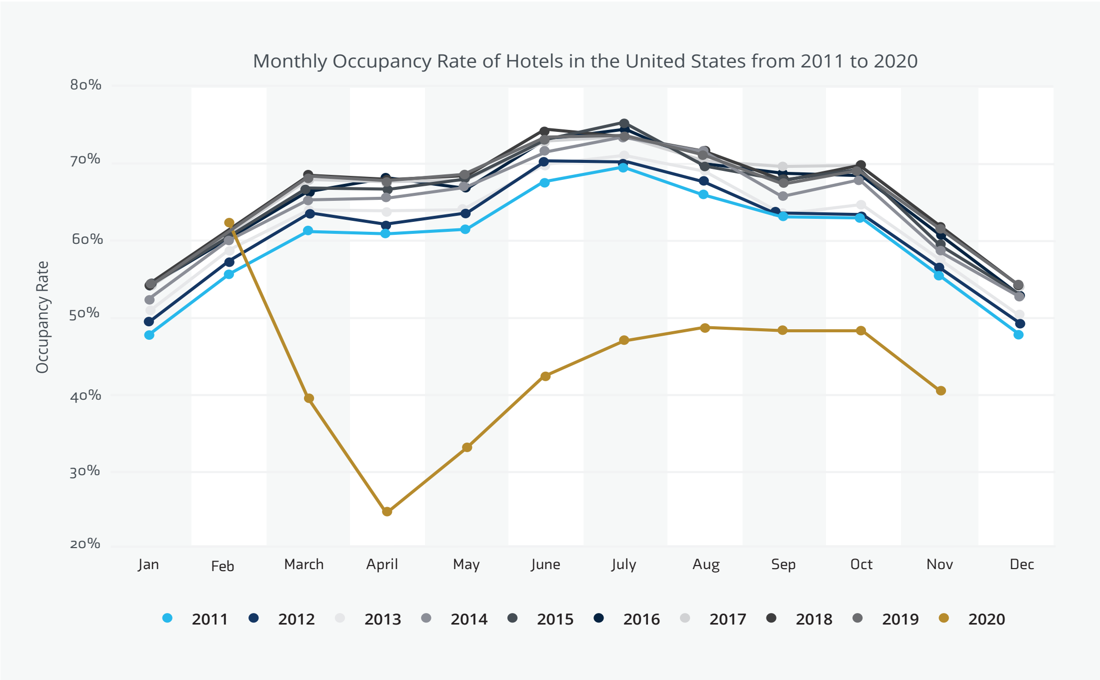
Introduction

While many industries faced challenges in 2020, few were impacted by COVID-19 quite like the travel and leisure industry. Per the American Hotel & Lodging Association, the impact of COVID-19 on the travel industry was nine times worse than that of 9/11. In particular, hotels, resorts, and casinos experienced their most devastating year in decades, resulting in historically low occupancy, low revenues, massive job loss, and closures across the country.

These industries were some of the first to be affected by the pandemic after travel was forced to a virtual halt in early 2020, and it appears they will be one of the last to recover, as global air travel is not expected to return to 2019 levels until 2024[1]. Despite this, casinos, resorts, and hotels are doing their best to move forward and create an inviting environment for when travel begins to return in 2021, and patrons become more comfortable as vaccines are more widely distributed. As such, business owners in this space will be keeping a close on their P&L statements as business slowly starts to improve. One key component they will be watching is their risk management and insurance costs, which have become a more significant portion of their budget.



Source: Statista

2020 Insurance Market in Review

Unfortunately, the hospitality sector also saw difficulties in the insurance marketplace as P&C premiums in all industries generally increased as the broader insurance market continued to harden in 2020. This was particularly true for the property and umbrella insurance markets, which, on average, saw double-digit increases each quarter in 2020. The reasoning for the significant increases in these lines of coverage was due to the combination of factors:

+ Several years of underpriced policies
+ A record-setting year for named catastrophic storms in 2020
+ A significant increase in losses related to wildfires
+ Rising cost of claims due to social inflation
+ Significant property damage claims related to civil unrest
+ A low interest rate environment negatively impacting carrier's investment returns
+ A reduction in overall market capacity as admitted carriers pulled back significantly in 2020

Moving forward, insurance carriers will be looking to recalibrate after yet another significant year of losses and the hard market is expected to continue into 2021. Firms operating in all sectors of the real estate sector will need to work closely with their brokers in 2021 to minimize the impact on their insurance budgets.

By-Line Fourth Quarter 2020 Rate Changes Ranged from 0.4% to +21.3%

	Comm'l Auto	Workers' Comp	Comm'l Property	General Liability	Umbrella	Average
Fourth Quarter 2020	9.1%	0.4%	12.9%	7.3%	21.3%	10.2%
Third Quarter 2020	11.0%	1.5%	14.2%	6.7%	22.9%	11.3%
Second Quarter 2020	9.6%	.7%	13.3%	6.8%	20.0%	10.1%
First Quarter 2019	9.6%	-1.2%	12.0%	5.7%	17.3%	8.7%
Fourth Quarter 2019	10.5%	-1.9%	9.7%	5.8%	13.6%	7.6%
High	28.6%	24.9%	45.4%	26.0%	51.9%	35.3%
Low	-11.6%	-12.3%	-15.0%	-13.6%	-13.5%	-13.2%

Source: The Council of Insurance Agents & Brokers

2021 Insurance Market Outlook

Many of the market factors leading to the further hardening of the insurance market in 2020 are still in effect in 2021. The U.S. is still in a low-interest-rate environment, and the storms of the first quarter of 2021 are already breaking records: February's Winter Storm Uri was the costliest winter storm in history and inflicted $18B in estimated insured losses. As such, carriers will continue to place an emphasis on generating revenue through more rigorous underwriting practices, as underwriters will closely scrutinize business performance, occupancy rates, retentions, pricing, as well as reduce limits and capacity.

This is particularly true for admitted carriers, causing a shift towards placing more business in the E&S market. These carriers are often better equipped to implement pricing and policy language more in line with the current risks in the market. It is expected that larger property and umbrella/excess programs in the hospitality space will require more carriers to achieve desired limits in 2021 as carriers that once provided $15M to $20M layers will now offer reduced $5M to $10M layers.

+ **Property –** There was a significant infusion of capital into the property market in the past 6 months as newly-formed Bermuda and London E&S carriers and recapitalized U.S. E&S carriers helped stabilize pricing and capacity. Despite the additional capital, rate increases are still expected, especially for companies with a poor loss history. While admitted carriers and carriers impacted by Uri look to rebalance their portfolios, the additional disciplined capital entering the space is looking to take advantage of firm market conditions and utilize E&S policies to achieve more advantageous pricing and policy language.
+ As of late, there has been a significant increase in construction costs due to shortages in labor, rising costs of raw materials, and delays due to global supply chain issues. As such, there have been many discrepancies between underwriters and insureds regarding the true replacement cost of property.

+ **Admitted and E&S carriers** are weary of insuring property exposed to catastrophic storms (such as coastal properties) and are simply declining submissions with wildfire exposures. Additionally, many carriers seek to increase All Other Peril deductibles and add or increase convective storm deductibles in higher-risk locations like Texas, Oklahoma, and Colorado, even if an account has a favorable loss history.
+ **Builder's Risk –** Like other markets, Builder's Risk policies are seeing increases in pricing and retentions due to significant losses as a result of large fires but also as a result of an increased frequency of smaller claims. Large wood frame, modular construction, and renovation projects are proving to be the most challenging projects owing to the higher frequency and severity of claims in these sectors. Additionally, because of delays in projects, many insureds are seeking extensions, which can be problematic for carriers.
+ **Casualty –** Capacity in the casualty market continues to be very tight in the hospitality space, as the casualty market did not see the influx of capital experienced by the property market. Many companies in the hospitality space are finding it difficult to obtain more than $1 or $2 million in General Liability limits and are finding that umbrella/excess carriers are only willing to expose $5 million within the first $10 million of excess limits. There is generally more carrier appetite above the $25 million attachment point, but even layers excess of $25 million are seeing a greater need for quota share and layered participation.
+ **In response to COVID-19,** many General Liability carriers are adding communicable disease exclusions thus removing coverage for the transmission of communicable diseases. This exclusion even applies when negligence is claimed in the form of testing for communicable diseases, failure to prevent the spread of disease, or when employees infect or spread diseases to others.
+ **Primary and Excess/Umbrella underwriters,** in general, are very concerned about "nuclear verdicts" and if an insured's loss history is indicative of a potential large loss. As such, casualty underwriters are requiring longer history of loss information as well as more details related to losses and any subsequent changes made to prevent future loss.

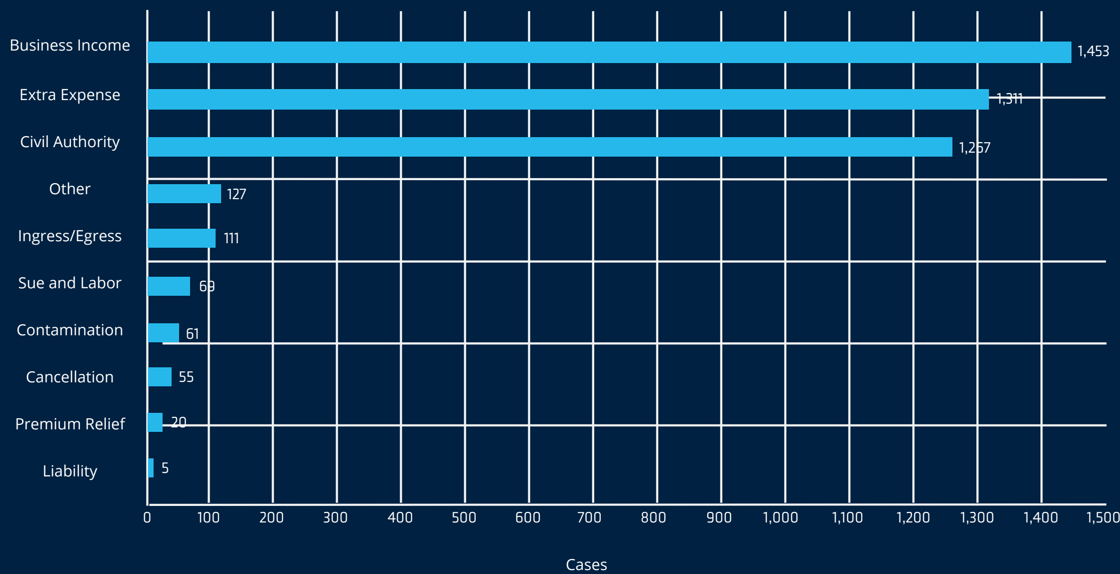
COVID-19 Related Claims & the Courtroom

To date, insureds have not had much luck in court when challenging carriers' denial of coverage for COVID-19 related claims. According to a COVID-19 litigation-tracking effort at the University of Pennsylvania Carey Law School, of the more than 200 rulings in suits pitting businesses against insurers, more than 80% have been found in favor of insurers. As a whole, 1,464 cases have been filed in the United States with 165 (11%) coming from the "accommodations, amusement, gambling, and recreation" industry category and the lion's share (565 or 39%) coming from the "food services and drinking places" industry category.

As can be seen in the charts below, the majority of these allegations have sought coverage under Business Interruption (also called Business Income or shortened to "BI") policies that have featured no virus exclusions. However, carriers have been able to successfully argue that no physical damage has been caused by the COVID-19 pandemic, which is the key requirement to triggering insurance coverage. BI coverage has a long history dating back to the early 1900's when these policies were designed to protect manufacturers from broken boilers or other failing equipment that closed factories, and physical damage has always been a trigger for coverage. As such, the coverage has been challenged many times in court throughout history and there is strong legal precedent.

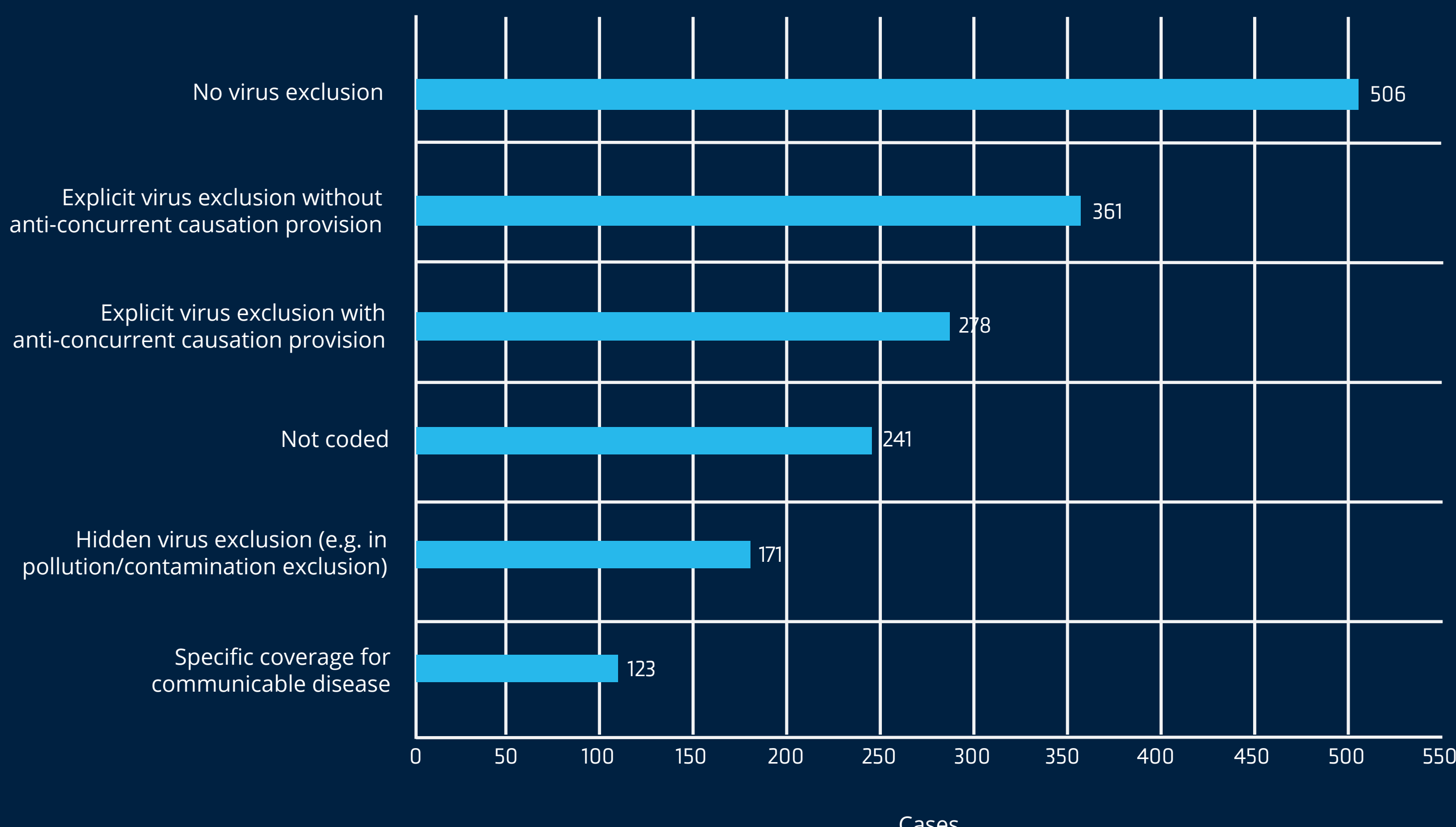
The latest, and possibly the most public, BI challenge came from Caesars Entertainment Inc., who filed a suit against their Lloyds of London syndicate consisting Allianz SE, Chubb Ltd, Markel Corp., and Aspen Insurance Holdings Ltd in March 2021. In the suit, after coverage was denied, Caesars alleged that the losses from closures and capacity restrictions due to the pandemic constituted physical damage, but the courts have ruled in favor of the insurance syndicate. Per Michael Menapace, an insurance lawyer at Wiggin and Dana LLP who commented on the ruling in the *Wall Street Journal*, "Courts have ruled that the loss of an intended use of a property doesn't constitute physical loss or damage the same way a fire obliterates a building[2]." IMA will continue to watch as more of these cases unfold, but it appears that the trend of insurance carriers having the upper hand in BI coverage suits for COVID-19 related losses will continue to hold.

Allegations



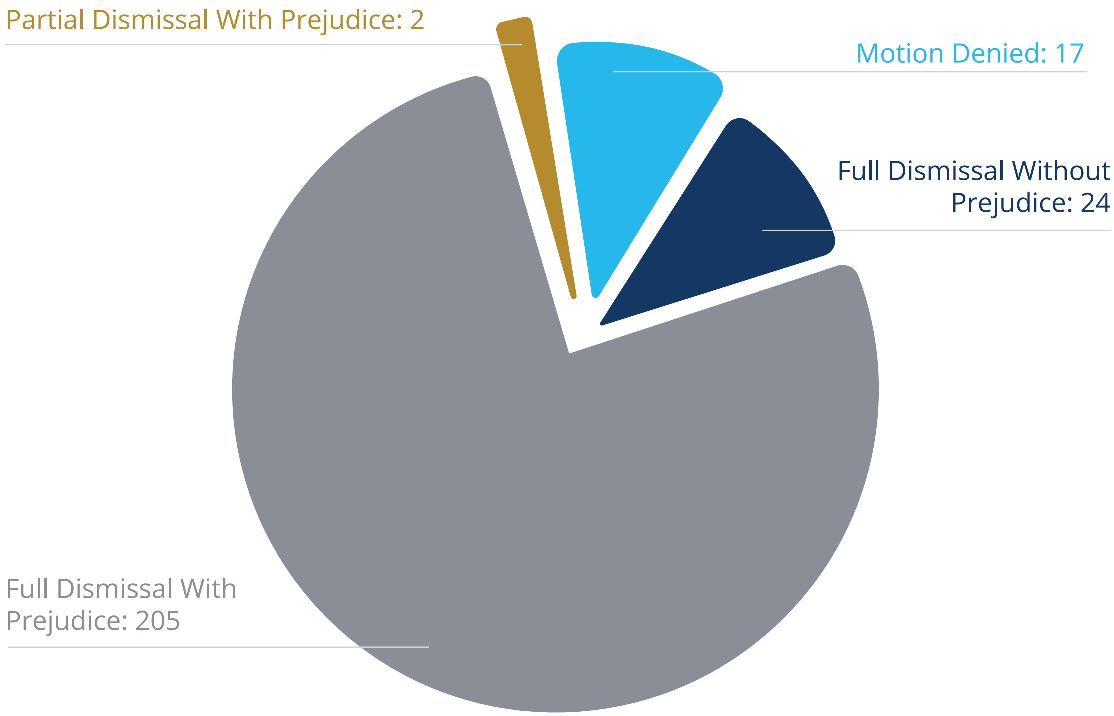
Coverage Sought

Policy Provisions Disease (Beta Test Version)

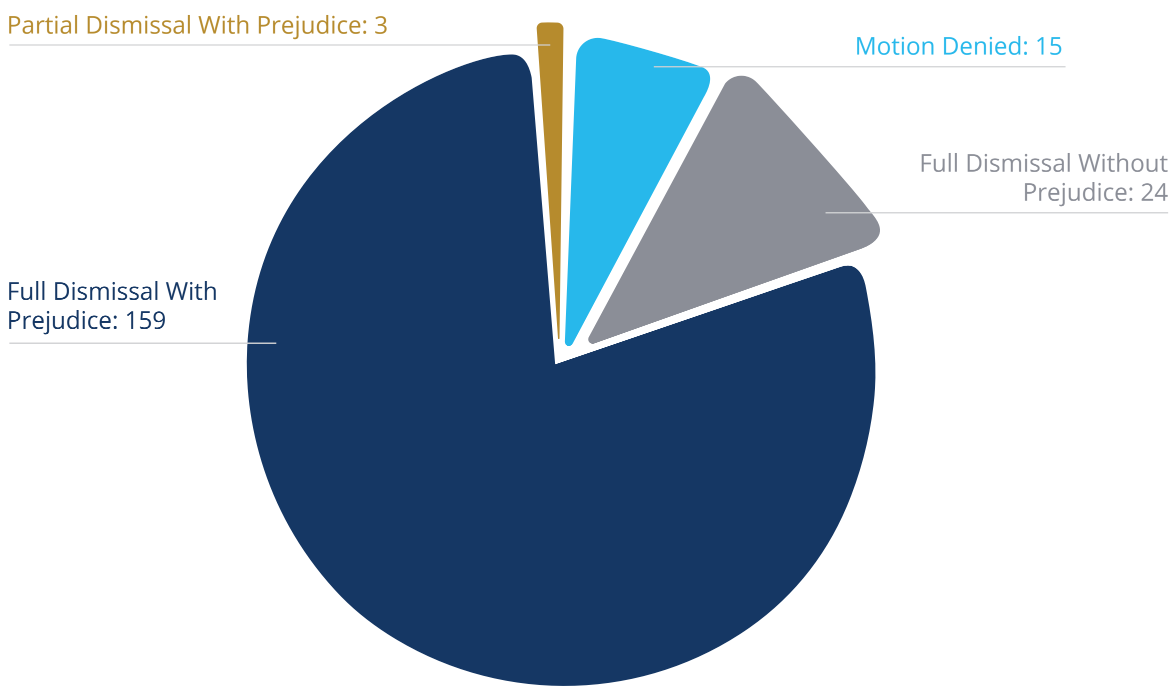


Per University of Pennsylvania Carey Law School *https://cclt.law.upenn.edu/*

Merits Rulings on Motions to Dismiss in **Federal Court**



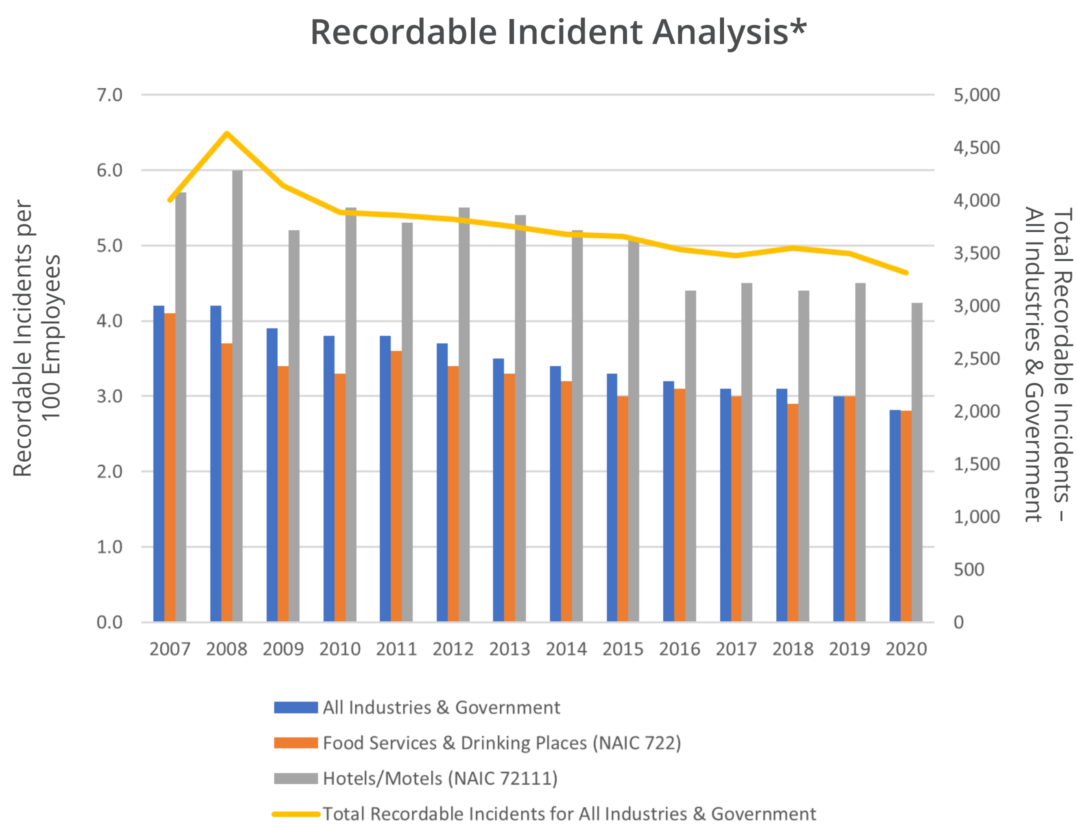
Merits Rulings on Motions to Dismiss in **State Court**



Workers' Compensation + the Post-COVID World

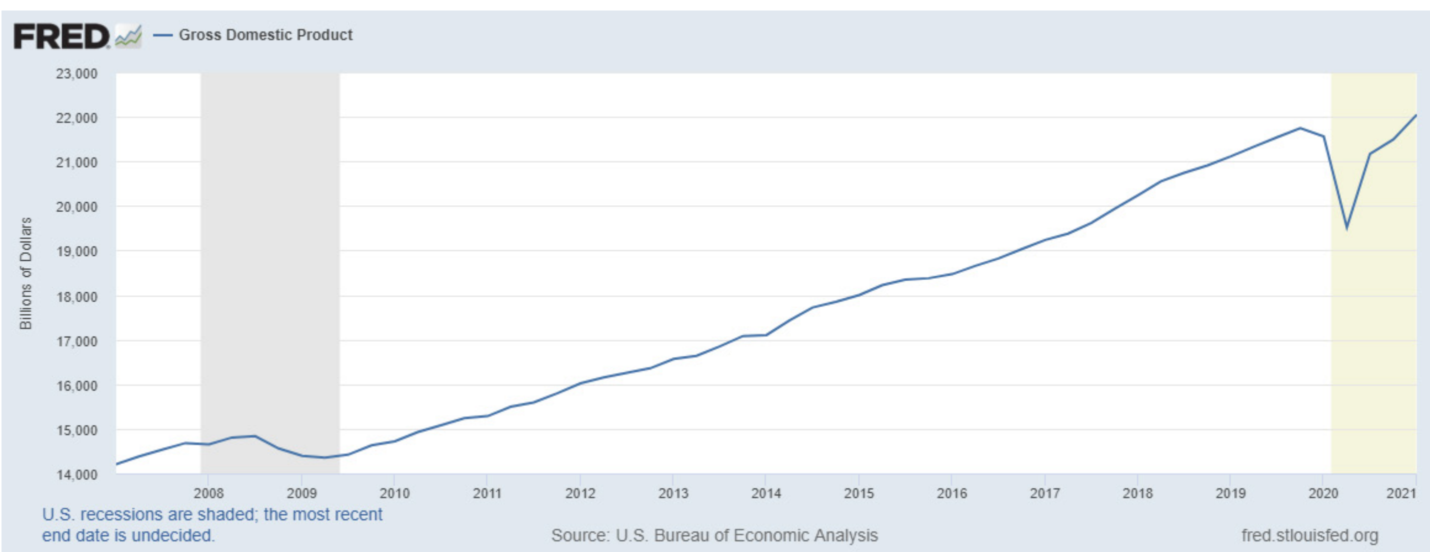
For most lines of coverage, the soft market of the last decade was driven by available capacity but for Workers' Compensation it was more likely the result of a downward trend in claims. As can be seen in the graph, Workers' Compensation recordable incident rates have been declining significantly since 2008, which saw an uptick that was correlated to the last major recession the U.S. faced. Even for hotels and motels, which have experienced a higher recordable incident rate than the national average, there has generally been ample capacity and reasonable pricing.

Generally, in times of recession, Workers' Compensation claims tend to also increase, but 2020 was likely an exception since so many employees worked from home, were furloughed or laid off due to the global pandemic. Unlike the last recession which saw a decline in Workers' Compensation recordable incidents the year following the end of the economic downturn, many believe that there will be an increase in reportable incidents in 2021 and 2022 as employees return to work and less experienced employees take on new positions. It is also likely that there could be an increase in slip and fall claims as more customers return to hotels and casinos. Business leaders in these industries should have a plan and be prepared for these upticks, especially considering the rise of nuclear verdicts, or else they could be in store for some surprises on their income statement.



*Data source: U.S. Bureau of Labor Statistics

Data only available through 2019, regression analysis using last 13 years was used to calculate 2020 figures



Employment Practices Liability

Due to forced closures, limited capacity requirements, and an overall decline in travel and leisure activities due to COVID-19, many hotels, casinos, and resorts were forced to furlough employees, cut hours, or even layoff much of their staff. Thus, many companies in these spaces have exposed themselves to employment practices claims, which are allegations of "wrongful" employment-related acts. Most of the claims arising from these incidents can be classified in four categories, and are covered by Employee Practices Liability Insurance (EPLI):

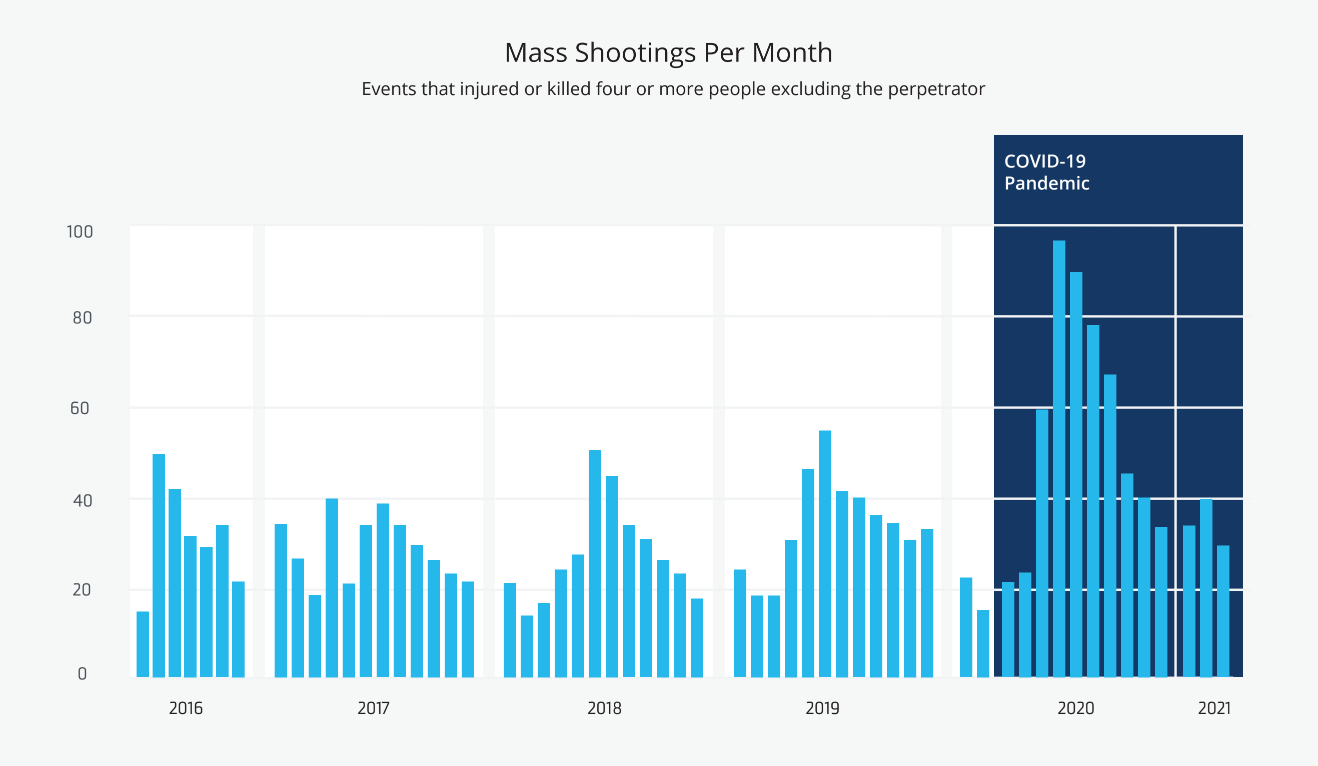
+ **Employment Status Claims:** EPLI policies often cover an employer's alleged wrongful termination, demotion, evaluation, or failure to promote an employee.
+ **Discrimination Claims:** Employees asserting the employer discriminated against them as a member of a protected class or that supervisors engaged in harassment or bullying can trigger EPLI coverage.
+ **Privacy Rights Claims:** EPLI programs routinely respond to employment-related defamation lawsuits or alleged employee privacy rights violations, including unlawful disclosures of an employee's confidential medical or financial information.
+ **Negligence Claims:** EPL claims alleging the employer was negligent in failing to adopt or implement employment-related policies and procedures, including the failure to train employees, can also trigger EPLI coverage.

Though vaccines are helping improve economies and are getting more and more people back to work, employers need to be cautious in order to avoid legal consequences from exposing employees to unsafe working conditions. Additionally, employers will need comply with a broad range of employment laws and guidelines from regulators including the EEOC, CDC, OSHA, and the ADA. Employers would be wise to consult with legal counsel and IMA Risk Control professionals to ensure that return to work plans adhere to employment law and pandemic guidelines.

Public Acts of Violence

+ **Active Assailant**
  Despite the pandemic, acts of public violence are becoming a more frequent occurrence and incidents tend to be catastrophic in nature. In March alone, active shooters were responsible for the deaths of 8 people at three spas in Atlanta, GA, and 10 deaths at a supermarket in Boulder, CO. Unfortunately, these horrible acts remind us that these are risks business owners must think about, particularly if the business involves large groups of people. The insurance market has responded to such events by creating a product that covers various types of violent attacks, not just active shooters, as these events can be carried out in multiple ways.

  Though General Liability and Business Interruption coverage is available in the marketplace and can respond to these events, a standalone policy will be more robust and include both first-party and third-party coverages. For example, these policies typically provide medical expenses, counselling costs, and funeral costs for third parties and employees, all of which may not be covered under standard BI and General Liability policies. Additionally, these policies provide ancillary support services such as dedicated crisis management and proactive loss control in order to best plan for and respond to these events. Organizations should speak to their IMA team about this product and how it can complement their risk management program.



Source: Gun Violence Archive

+ **Terrorism: TRIA and Non-Certified Terrorism**

Ever since 9/11, it remains a serious concern that political violence and terrorism can occur at any time. Given today's more volatile and politically charged climate, the potential for a violent actor(s) perpetration of an attack remains a realistic concern.

Private Terrorism policies offer an alternative to the standard TRIA (Terrorism Risk Insurance Act) policy that is obtainable as an addition to property coverage. In order for TRIA to respond to a claim, the act or event must be certified and deemed a "terrorist event" by an organized "terrorist group" by the U.S. government. Only certified acts are eligible for coverage through TRIA and, as such, insureds should consider purchasing Private Terrorism insurance since certification is not required. The private market remains very flexible with a full range of options, including the ability to include political violence cover, including adding strikes, riots and civil commotion (SRCC) to this coverage

Historically, however, many property and BI policies have been silent on SRCC, leaving coverage to be implied - neither explicitly included nor excluded. As a result of recent civil disturbances across the U.S., many insurers are now routinely attempting to exclude Strikes, Riots and Civil Commotion coverage. As such, insureds should work with their IMA team to discuss how this coverage can be implemented in risk management programs.

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Navigating 2021

Building Valuations
As mentioned previously, construction costs are on the rise and as such, insureds should evaluate if their limits can adequately cover a total loss and rebuild in the current cost environment. To aid in confirming, values are being reported on a replacement cost basis, and indices detailing cost trends by geographic area and type of occupancy are available. This provides a cost trend factor to apply based on the current age and location of properties currently scheduled or will be scheduled.

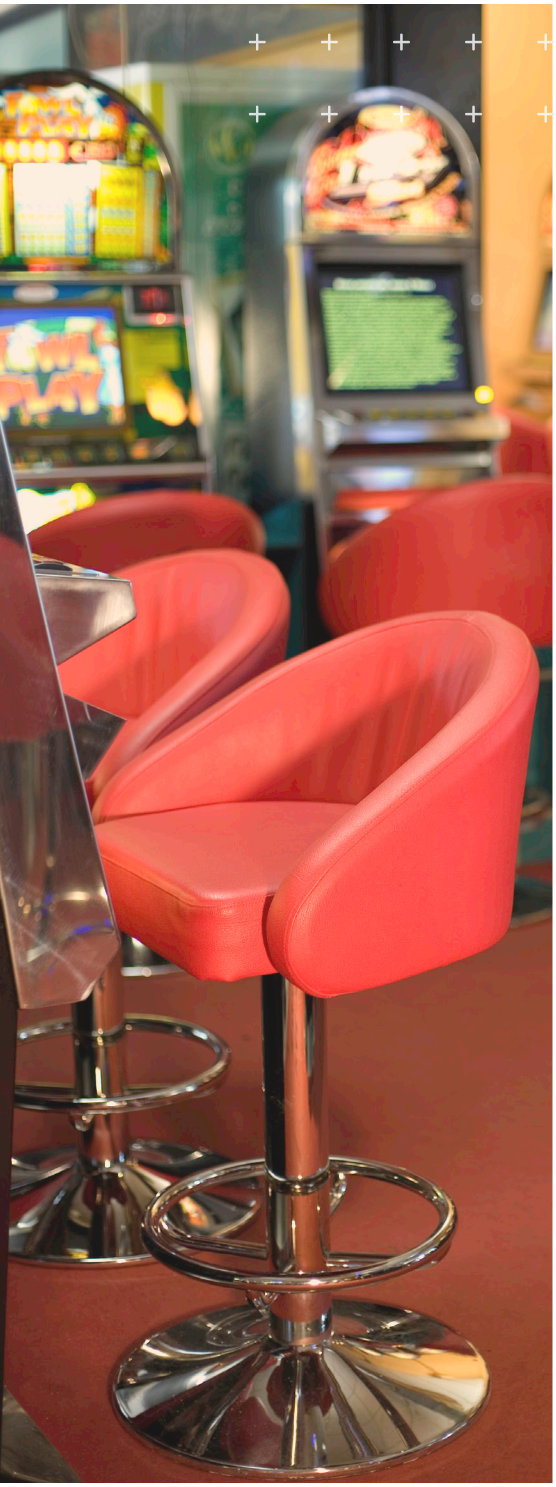
+ **Higher Claims in Times of Recession** – Statistics evidence a significant increase in claims (and fraudulent claims) during times of recession. In particular, there is a significant uptick in slip and fall claims against property owners. Insureds in the hospitality space should especially be aware of this trend and have a plan to address these incidents.

+ **Business Interruption Assumptions** – Even though there is a lot of optimism around vaccines helping improve the economy and allowing employees to return to offices, companies should be realistic with their revenue projections when making assumptions for the purposes of business interruption calculations.

  Unlike General Liability, Workers' Compensation, and Auto policies, BI is not audited; meaning there is no reconciliation at the end of the year or credits granted for overestimating revenues. As such, insureds should be conservative on their revenue estimates since there are many factors and regulations impacting when vaccines will reach critical mass and when workers will start spending more time at the office. Additionally, many companies are looking to adopt a flexible in-office schedule or may even allow employees to permanently work from home thus resulting in less office space demand. Conversely, underreporting too much can result in being significantly underinsured if/when occupancy and rent rates return; coverage is based on a percentage of monthly estimates and trailing twelve-month actuals. All of these factors should be contemplated so that insureds are not overpaying for their BI insurance but still carrying adequate coverage.

- **Vacancy Exclusions –** Many property polices include provisions which remove or restrict coverage when a building is deemed vacant. Typically, vacancy restrictions are triggered by a percentage of occupancy for a consecutive number of days (often 60 to 90) but they can also be triggered if the building has been repurposed from its originally intended use. The day trigger can sometimes be negotiated with underwriters prior to renewal, but they are less likely to negotiate percentage of occupancy or changes in intended use. For buildings with exceptionally low occupancy, underwriters may require evidence of building safeguards (i.e. cameras, alarms, etc.) before issuing coverage. Many carriers may opt to use these exclusions given rising concerns surrounding the numerous hazards associated with vacant buildings, including bursting water pipes, fires, vandalism, and damage caused by vagrants. However, insureds can improve their position in the market by highlighting their security programs and protection measures in place during their submission process.

- **Higher Switching Costs –** If forced to switch from an admitted carrier to the E&S market, insureds must remember that these policies come with stamping fees and surplus lines taxes. Additionally, these policies are generally more expensive (before the additional taxes and fees) as they are designed to cover more risky lines of businesses/occupancies or provide coverage for non-traditional types of exposures.



Keys to Success in 2021

+ **Begin the Renewal Process Early** – The General Liability, Excess/Umbrella, and Property markets have become constrained and more difficult to navigate in the hard market. Furthermore, many blue-chip admitted carriers in the hospitality space are offering less capacity and more carriers are being required to achieve desired limits. Due to general price increases across all lines of coverage and all industry sectors, underwriters are being inundated with submissions as brokers and insureds look to minimize the additional costs. As such, turnaround times for quotes are increasing. In order to achieve the best results, insureds should begin their renewal processes earlier than usual as to allow for brokers to successfully canvas the market, work diligently with underwriters in detail, and negotiate the best terms.

+ **Look to Partner with Carriers When Possible** – Strong relationships with key trading partners are always important, but even more so in difficult times. This business philosophy also applies to insureds' relationships with carriers. Where possible, insureds should look to meet (even virtually) with their current and prospective carriers. This interaction not only builds rapport and allows the insured to put a face (or voice) to a submission by telling their company's story, it also allows for insureds to control the narrative of their risk versus letting underwriters decide. This is particularly true if there have been losses and insureds are then able to explain what happened and use the opportunity to discuss lessons learned and what new practices have been implemented. This is certainly preferable to an underwriter simply reading a loss run with no context.

+ **Reevaluate the Cost to Get Buildings Rebuilt** – As mentioned previously, construction costs are on the rise due to multiple factors. This is not expected to decline as the construction industry is forecasted to see an overall increase in demand in 2021 and 2022. Insureds should look to reevaluate the cost to repair their buildings at the current market prices in order to obtain adequate limits.

- **Be Familiar with Vacancy Language –** Insureds should work with the IMA team to fully understand what triggers vacancy exclusions in order to avoid uninsured losses. Though there is general optimism around vaccines and improved economic conditions helping improve vacancy rates, insureds should remain vigilant by understanding this exposure.

- **Repurposed Buildings –** If a building has been repurposed, let your broker know immediately so that coverage can be maintained and to avoid potential uncovered claims. Nobody likes surprises when managing a claim, but communication before there is ever a claim can help limit unexpected issues.

- **Highlight Safeguards –** When working through submissions documents, highlight protective safeguard features in buildings and share specific details on security systems, insurance requirements of tenants, water sensors, sprinkler systems, building enhancements, and anything else demonstrating diligent care of the property. It will be important to prove to carriers that insureds are investing in their properties and doing their best to protect from total losses, vandalism, vagrant damage, theft, etc.

- **Highlight Maintenance Program –** Share details on maintenance programs, winterization precautions, and details regarding improvements and betterments. This is especially important if the property is older, in an area exposed to natural catastrophes, or if occupancy has dropped. After Winter Storm Uri, many property carriers are interested in the integrity of pipes and what insureds are doing to protect their property in cases of extreme weather. Carriers may also want to ensure that properties are still receiving planned maintenance when occupancy drops, despite negative impacts to cash flow, as leaks and other problems may take more time to notice and thus cause more damage.

- **Familiarity with State & Local Laws –** Insureds should work to be familiar with the state laws applicable to their insurance program, risk management strategy, and operations. There can be significant differences in litigation outcomes state by state and even county by county, depending on the jurisdiction.

[1] *https://www.cnn.com/travel/article/air-travel-recovery-2024/index.html*
[2] *https://www.wsj.com/articles/caesars-sues-insurance-carriers-saying-they-declined-to-cover-2-billion-plus-of-losses-11616443725*

More Than Just Insurance

IMA is a diversified financial services company specializing in risk management , insurance, employee benefits and wealth management. It is the sixth-largest privately-held and employee-owned insurance broker in the country and employs more than 1,200 associates.

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