MAKE A SOFT LANDING IN A HARD MARKET

The commercial property insurance market has hardened, but insurance buyers and their brokers can still take action now to help ensure they receive adequate coverage and the best rates, terms and conditions at renewal.

Understanding the Current Insurance Market

From wildfires ravaging the West Coast and windstorms sweeping through the Great Plains, to snowstorms freezing over the Midwest and Northeast, and hurricanes flooding coastal states, the United States is experiencing a continuous cycle of natural catastrophes that cause billions of dollars in damages, year after year.

Insurance carriers that cover extreme weather events act as economic first responders after natural disasters—and they are feeling the effects of this uptick in severe, unpredictable natural disasters firsthand. Insured losses from 2022 natural disasters approach $115 billion, according to a recent calculation, after $121 billion in 2021[1]. These numbers represent over 40 percent increases in the 10-year annual average.

Most recently, Hurricane Ian has dominated headlines, and it's easy to see why. The Category 4 storm caused widespread damage and is the deadliest to hit Florida since 1935—early estimates project that it will be a $53 billion to $74 billion event for insurers, which is sure to deal a blow to an already shaky commercial property insurance market.

While climate change and rising temperatures continue to fuel more frequent and severe weather, additional factors are putting pressure on the underwriting and pricing of property insurance: high inflation, a historic supply chain crisis, and labor issues in key industries. As a response to this conflation of a multitude of adverse variables, the property insurance market has hardened.

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When lines of insurance "harden," it means that carriers diminish their appetite for risk, offer less favorable terms for coverage, increase the cost of premiums, and heighten underwriting scrutiny—generally as a response to unfavorable market conditions and continued losses. In some worse-case scenarios, carriers may choose to pull out of riskier markets altogether. For insureds, this amounts to fewer options for coverage—and a higher price tag.

With property insurance rates likely to only continue to rise nationally, it's important for commercial insureds to be empowered to make informed decisions about how to navigate a hard market. The 1/1 renewal season is upon us, which means it is time for commercial insurance buyers to put a strategic plan in place to lead the conversation with underwriters. Insureds can partner with their broker to take proactive steps during the renewal process to get the results that best align with their company's risk tolerance and coverage requirements.

Natural Catastrophes, by the Numbers

The photos, videos, and stories that circulate on television and social media after natural disasters illustrate just how much destruction these events can leave in their wake. But what exactly does this damage amount to in terms of dollars?

- The U.S. accounted for over half of global economic losses in both 2021 and 2022[2].
- In the U.S., there were 15 separate billion-dollar weather and climate disaster events during the first 9 months of 2022[3].
- 2022 losses are hot off the heels of $145 billion of insured and uninsured losses in 2021, which was the third costliest year on record for the U.S.
- Hurricanes accounted for about 52% of natural disaster losses in the U.S. from 2010 to 2022, making them the most expensive weather events[4].
- In 2021, Hurricane Ida was the costliest natural disaster event globally, causing total losses of $65 billion. In 2022, early estimates for Hurricane Ian project losses in the $53 billion to $74 billion range[2].
- Severe windstorms have been the second costliest natural disaster in the U.S. from 2010 to 2022, with $259.9 billion in total losses for this time period. In December 2021, an unprecedented, record-breaking 163 tornadoes ripped through the Southeast and Midwest[5].
- Within the last decade, the U.S. has experienced 8 of the 10 costliest wildfires in recorded history with insured and insured losses of $92.7 billion for this time period[6].
- A historic cold wave hit several parts of the country in late 2021 through early 2022, leading to the costliest U.S. winter storm event on record. Direct losses for this event cost $25.2 billion, though experts estimate that indirect losses could be significantly higher[7].

- Worsening flood patterns continue to be a concern for all parts of the country, with annual flood losses predicted to jump 26% over the next three decades, from $32.1 billion to $40.6 billion by 2050[8].

Impact on Carrier Capacity

Insurers play a crucial role in supporting economic recovery following catastrophic events. They can provide financial protection to insureds and prevent economic hardship, as well as speed up building and recovery efforts by providing post-disaster funding and liquidity after a catastrophe. However, carriers can only deliver on this promise if they're able to remain solvent.

With climate change continuing to influence extreme weather events, property insurance carriers are met with the challenge of how to adapt to these unpredictable loss patterns. Both the primary insurance and reinsurance markets are feeling the pressures of an unpredictable natural catastrophe landscape, while also bracing against a multitude of socioeconomic pressures.

Primary Insurance Market

The pricing of insurance offered to policyholders depends on many variables. In the case of property insurance, these often include loss history, geographic location, and the age and construction types of buildings, though each carrier uses unique proprietary models to set their rates.

Traditionally, carriers will look to past events when making risk calculations, which is why they're now struggling to keep up with the impact of unpredictable, extreme weather events. Now the past is no longer indicative of the future. Primary insurers are struggling to adapt their underwriting strategies and develop climate modeling that reflects the nature of the interconnected weather events that are negatively impacting their bottom line. As a result, they have become extremely calculated and cautious in their risk selection and pricing.

Here's what commercial property insurance buyers could expect due to these conditions:

- Underwriting losses: The combined ratio is a measure of underwriting profitability that's calculated by taking the sum of incurred losses and expenses then dividing them by earned premium. In 3 of the last 5 years, this number has been over 100% for commercial property insurers, meaning the industry has suffered underwriting losses. For the first 9 months of 2022, indications are that Hurricane Ian and cumulative natural disasters could lead to another year of net underwriting loss. Insurers recorded $24.3 billion in net underwriting losses – nearly quadruple the losses from the same period in 2021[9].

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- Retreat from risky markets: We expect carriers might retreat from catastrophe property coverage and to focus on lines of insurance where they feel they can achieve growth more safely. The catalyst for these changes is expected to be reinsurance rate increases for property lines.
- Inflationary pressures: Primary insurers continue to deal with inflation, driven by supply chain disruption and shortages of skilled labor. Supply chain and labor issues have also resulted in seesawing prices for raw materials, and this volatility makes it difficult to accurately price coverage. As a response to these realities, primary insurers are likely to look for accurate property valuations from insureds.
- Valuation of assets: Many property valuations are composed incorrectly or have not been updated in years, an even more significant problem now, in the face of rising construction costs. Undervaluation of assets can leave insureds unprotected after a natural disaster. For carriers, it can leave them with an underwriting loss after claims are filed. Again, expect carriers to likely increase their scrutiny of property valuations.
- Increased underwriting scrutiny: In addition to accurate valuations, underwriters could focus on descriptions of property loss controls, proof of lessons learned on prior claims, and documented disaster recovery plans. They will want to see documentation that paints the clearest picture of the risk they're taking on.
- Shifting more risk to insureds: Carriers could be seeking higher retentions, imposing limiting coverage terms, and exercising limits management, among many other strategies to manage their exposure.

Reinsurance Market

Reinsurance is insurance for insurance companies. It enables insurers to transfer a portion of their risk to another company in order to limit their potential losses and remain solvent in the event of a major claim payout, such as a natural catastrophe.

However, certain risks like large natural disasters can expose even the reinsurance market and reduce its capacity. Combine claims from multiple recent global catastrophic events with sustained high inflation, the effects of climate change, and oscillating repair and construction costs, and we see why reinsurers' position is being impacted.

Here are ways catastrophic losses in property lines and economic pressures are affecting the reinsurance market:

- Capital challenges: Reinsurers face capital challenges stemming from rampant inflation and climate change. Additionally, investors have been fleeing to other investments with higher potential returns. With extreme weather events showing no sign of slowing down and the threat of recession looming overhead, these issues are only likely to worsen.
- Rate increases: 1/1/22 reinsurance renewal rates remained mostly flat, with some modest increases, but Q2 and Q3 renewal rates increased at a greater pace due to record-setting inflation that is driving up claim costs and property valuations. For property catastrophe reinsurance, early estimates suggest double-digit rate increases for 2023 renewals[10].
- Growing claims: Projections from catastrophe models have claim expenses increasing up to 30% due to the growing cost and availability of materials and labor, amongst other factors. Due to the growing number and cost of losses across the U.S. and the number of poorly capitalized carriers in geographic areas that have seen continuous natural disasters, reinsurers are expected to bear the brunt of these extreme events.
- Limited capital: Current projections by industry leaders show that additional capital that could ameliorate the impact of the hard market is unlikely to enter the reinsurance market, which implies the 2023 cat property insurance market will likely be even more difficult to navigate. Current conditions mirror the extremely hardened state of the cat property market of the mid-2000s.

7 Steps Businesses Can Take

Fortunately, all hope is not lost for property insurance buyers. By developing and implementing effective strategies to properly navigate the underwriting process, insureds can still obtain the best market results for their unique needs and circumstances.

Along with implementing loss controls at your business–a key factor in this period of increased underwriting scrutiny and a hardened property insurance market—take the following steps to prepare for your next renewal:

1. **Develop a strategy for your next renewal and put it in writing:**
   Begin as many as four months before coverage is bound (or as far in advance as possible). Documenting your strategies will increase accountability for clients and brokers.
2. **Evaluate risk tolerance:**
   Understand how much coverage you're purchasing and how deductibles impact your liabilities. Don't let your brokers be complacent about the minimum insurance requirements for assets and evaluating creative program structures like deductible buydowns, deductible indemnity agreements, deductible reimbursement policies (captive), and parametric insurance (loss mitigation). Insureds with higher risk tolerances can lower premiums after reviewing for financial feasibility.
3. **Use data to your advantage:**
   Keep up-to-date and accurate property schedules to maximize negotiations. Use cat modeling and other emerging analytics tools to structure your carrier RFP and enhance your negotiating leverage. Such resources can help estimate the likelihood of a loss, how much insurance to buy, and how much an underwriter should be charging you (most applicable to larger portfolios).
4. **Reconcile all valuations:**
   Most carriers are requiring higher replacement cost values for the assets they insure. Insureds and brokers need to confirm all assets are measured accurately. Be sure to evaluate the impacts of increasing square footage replacement costs as many months as possible before renewal.
5. **Prepare a narrative underwriters will understand:**
   Flooded with daily submissions, underwriters rely on data to rigorously evaluate your risk. Be sure to highlight specifics and the types of safeguards you have in place that make your property a preferred or favorable risk. When submissions are broad and incomplete, your risk will likely be put to the bottom of the pile and may not receive adequate consideration.
6. **Demand a detailed coverage analysis from carriers:**
   Both the broker and insured should have full policy forms and endorsements on file. Doing an audit of all policies ensures coverages are adequate and meet your goals. In a hard market, insurance companies will look to include endorsements and policy language that remove previously included coverages. Address all policy changes.
7. **Implement a stewardship plan:**
   Work with your broker to hold stewardship meetings to keep everyone informed of current market conditions and what to expect at renewal.

Find the Right Partner

With underwriting scrutiny at an all-time high and carriers providing less favorable terms for coverage, now's the time to work with a team of experts with a proven track record that is capable of navigating a hardened property insurance market.

Our clients can connect with their trusted local contact, who will help them understand their options and find coverage that aligns with their business' unique risk profile.

Business leaders interested in learning more about how we could help them land softly in the hard property insurance market can also visit our website and one of our advisors will contact them shortly: baldwinriskpartners.com/contact.

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