INSIGHTS | OCTOBER 2020

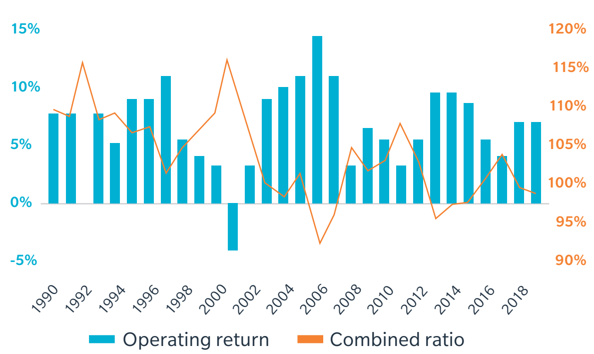
Managing Renewals in a Challenging Market

The global insurance market is characterized by long cycles of declining or stable premiums punctuated by brief periods of price increases and restrictions in coverage. For more than a decade — starting in the mid-2000s — commercial insurers' financial performance was largely driven by investment income that offset modest underwriting performance. Capacity across all lines was abundant, helping keep prices down and generally providing insurers with mid-single digit operating returns (see Figure 1). During this time, insurance pricing steadily declined, even amid significant economic and enterprise growth.

FIGURE 1

Since 1990, insurers have rarely generated returns of 10% or more.

SOURCE: AM BEST/DOWLING & PARTNERS



In late 2017 and 2018, however, commercial insurance pricing started to increase. And in 2019, the market began a rapid transition driven by an increase in claims severity and frequency. Globally and across all major lines, commercial insurance prices rose an average of 19% in the second quarter of 2020, according to the *Marsh Global Insurance Market Index*, the eleventh consecutive quarter of price increases and the largest year-over-year increase recorded since the index's inception in 2012. While the data is not yet finalized, third quarter results are expected to follow this trend.

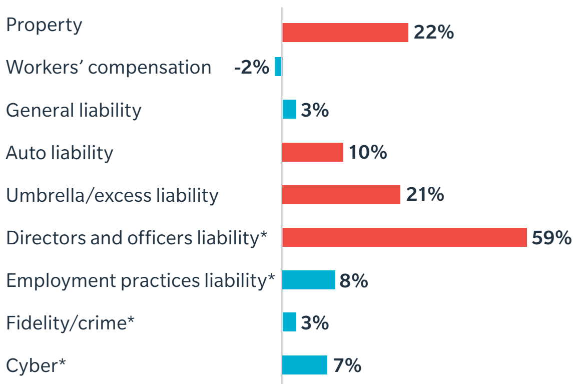
Why Has the Market Changed?

- **A decline in investment income.** After being consistently above 6% through the early 1990s, insurers' net investment income yield has steadily dropped over the last three decades to its current estimated level of 2.8%, according to a Dowling & Partners analysis.
- **Modest underwriting profit.** The industry combined ratio has generally stayed close to 100% over the last decade — and exceeded 100% during some especially bad years. To generate an operating return of 10% or more, an insurer's combined ratio must be at 90% or below.
- **Shrinking policyholders' surplus.** This is the result of years of soft pricing that have adversely affected profitability.
- **Historical underpricing of long-tail coverage.** Over time, this has resulted in massive increases in insurers' reserves.
- **A confluence of seismic industry events.** COVID-19 only adds to the pressures insurers already felt from "nuclear" jury verdicts, climate change-driven natural catastrophes, social inflation, and more.

FIGURE 2

The largest average US price changes in the second quarter were in property, auto liability, umbrella/excess liability, and D&O.

SOURCE: MARSH'S ANALYTICS SOLUTIONS



*Total programs
Note: The above figures represent *average* pricing changes for the second quarter of 2020. Individual results varied, with some buyers renewing at significantly higher rates.

Pricing increases are now being seen across most lines of business and in most geographies. This includes the US and Canada, where the most substantial increases are occurring in property, directors and officers liability (D&O), auto liability, and umbrella/excess liability (see Figure 2).

Loss activity through the first half of 2020 — dominated by COVID-19 — and low interest rates have exacerbated already difficult market conditions. With considerable uncertainty about insurers' ultimate COVID-19 losses and double-digit price increases becoming the norm, we expect the market to remain challenging for some time.

More Difficult Renewals Ahead

Although results for individual buyers will vary, rate increases are now being seen across most lines of business, industries, and geographies, including for buyers that have not suffered sizable losses. All buyers with upcoming renewals should be prepared for greater underwriting scrutiny and a more challenging process. Insurers may be more assertive in denying policy term extensions, paring back coverage and limits, applying exclusions, and scrutinizing claims more stringently.

Despite these conditions, risk professionals can work with their advisors to position their organizations to achieve more favorable outcomes at renewal and better manage total cost of risk. Sound renewal strategies will incorporate market intelligence to stimulate competition, consider new options and innovative strategies, and make use of data and analytics.

Best Practices for Insurance Buyers

Manage expectations for senior executives and boards.

Those directly involved in insurance transactions as well as their superiors should be ready for lengthy and potentially more difficult renewal and negotiation processes. Insurers are routinely requesting more detailed information than in past renewals — while some buyers may view this as onerous, insurers consider this essential to the underwriting process. Buyers should stay in regular contact with their brokers during the process to ensure they are well-informed of the status of their applications and any concerns being raised by insurers and so they can in turn keep leadership up to date.

Set a clear strategy before beginning renewal discussions.

The concerns and needs of one organizations can be dramatically different from that of another. Work with your broker to create a plan based on your specific risk appetite, culture, and budgetary considerations. Among other topics, you should discuss:

- Your primary objective(s). Some organizations may wish to reduce premium expense even if it means retaining more risk. Others may want to ensure robust coverage even if requires additional cost. And some may have specific and varying objectives by line of coverage.
- Where specific priorities rank — in other words, what you need to accomplish versus what you would like to accomplish and where you can be flexible.

Involve senior leaders in negotiation processes.

In addition to robust data and other key elements of an underwriting application, insurers need context to make decisions — and while advisors can provide valuable assistance, nobody is better positioned than you to tell your story. Personalizing the process — for example, through meetings involving your senior management and key insurer executives — can help you present a combination of quantitative and qualitative information to highlight how your risk is differentiated from your peers and how it has evolved over time. Including senior leader in discussions with insurers can also help them understand underwriters' concerns and reasoning.

Consider different approaches and solutions.

Given rising insurance pricing, it may be worth exploring new risk financing strategies. Think about:

- Altering program structure. This includes adjusting deductibles/ retentions, limits, and/or participating insurers.
- Expanding relationships with specific insurers. Placing multiple lines with a single insurer could drive better results, including greater access to capacity.
- Forming a new captive or expanding use of an existing one. A captive could help to control costs while still ensuring robust protection.
- Complementing traditional insurance policies with parametric solutions. Such policies are highly customizable, and can focus on either a specific risk or a combination of risks.
- Taking a global approach to program marketing. Exploring the full global market could yield better results for buyers that have traditionally focused solely on domestic insurers.

How Marsh Can Help

Regardless of overall market conditions, Marsh continues to act in our clients' best interests. We can help you strategize ahead of upcoming renewals, including identifying potential new insurers for your program structure, and aggressively remarket your account with a focus on your objectives and priorities.

For more on how Marsh can help, contact your Marsh representative.