WOODRUFF SAWYER

COMMERCIAL LINES INSURANCE MARKET UPDATE – FIRST QUARTER 2023

Executive Summary

The basic economic principle of supply and demand is the theme of the first quarter. The supply of capital is driving pricing behavior in all segments of the commercial lines market.

Let's start with the directors and officers (D&O) market, where the free fall in premiums continued through the quarter. Given the record level of securities claim settlements in 2022 and the increase in derivative claims, the falling premiums seem to defy logic until one accounts for the number of new entrants in the D&O market in the last two years. The high D&O premiums of 2020 and 2021 attracted new capital. The number of new players coupled with a frozen IPO market has led to a lot of capital chasing a finite number of opportunities—the result is very favorable pricing conditions for D&O insurance buyers.

The story in the cyber market is similar, with most buyers with Q1 renewal receiving a premium decrease. A few years ago, premium increases in this market were driven by frequent and severe ransomware losses. Ransomware losses decreased in 2022—some believe this was because hacker rings in Russia and Ukraine were distracted by the war. Regardless of the cause, decreased losses led cyber insurers to once again chase market share with competitive quotes.

Although there are still premium increases in the casualty market, pricing trends continue to stabilize, which was a trend we observed through the last half of 2022. Workers' compensation is a line where most commercial insurance buyers can expect to save some money. Insurers tell us that losses are increasing in this segment, but their behavior suggests that it continues to be a profitable line as rates are decreasing.

We will close with property, which is the most challenged part of the commercial lines market. This is another segment where the law of supply and demand is at work. In our Q4 2022 update, we reported that many insurers were expecting difficult reinsurance renewals. That expectation is now a reality, and many insurers paid a lot more for a lot less reinsurance. The impact is most apparent in catastrophic coverages but all property buyers, regardless of catastrophic exposure, should expect a premium increase. On the bright side, a segment of the property market—cargo and stock throughput—is experiencing stabilizing premiums. New entrants have come into this market in the last 12 months, and this increased capital supply is moderating the level of premium increases for buyers.

D&O: Market Update

OUR POV

With an oversupply of insurance capacity and few IPOs, insurers are competing for public D&O renewal business, driving rates and retentions down for almost all companies.

MARKET TRENDS

- While mature public companies are experiencing rate relief, newly public companies are seeing significant decreases due to higher starting premiums.
- Last year's slowdown in IPO activity continued through Q1 2023 as companies remain on the sidelines while interest rates, inflation, and uncertainty around the banking crisis settle down.
- When the initial public offering market opens again, more stable pricing is expected due to 2020's *Sciabacucchi* decision regarding federal forum provisions, which has led to numerous state court Section 11 suit dismissals.
- Businesses continue to face macroeconomic challenges including inflation, higher interest rates, the threat of recession, the war in Ukraine, supply chain issues, and a volatile stock market, all of which represent potential claims threats.

CONTEXT FOR CURRENT TRENDS

- Securities class action severity remains high. There were 92 settlements totaling $2.4B in 2022, exceeding the 2020, 2021, and 10-year medians. In 2022, 34% of all settlements were over $20M. With 473 open cases yet to be resolved, 2023 has the potential to be another notable year in total settlement dollars.
- The likelihood of a public company being sued reached a record high of 5% in 2019 when 268 lawsuits were filed, but declined in 2020, 2021, and 2022. The total number of suits dropped to 210 in 2020, 182 in 2021, and 168 in 2022. In Q1 2023, 48 cases were filed, on par with the number filed in Q1 2022.
- Litigation is being driven by new and increased exposures, including cyber (data breach), privacy oversight (GDPR), #MeToo, ESG issues such as climate change, and COVID-19.
- Derivative actions are on the rise, with notable settlements (Renren, Boeing, First Energy, American Realty, Wells Fargo, etc.) tapping "A Side-only" insurance.

3.0%
Likelihood of Being Sued (decline for 3rd year in a row after 2019 all-time high)

473
Number of Open SCA Cases Pending

$12.8M
2022 Median Settlement (10-year average $8.8M)

$25.5M
2022 Average Settlement (10-year average $28.5M)

Property: Market Update

OUR POV

Capacity is challenged in many industry segments. Rate increases vary greatly by layer and occupancy, particularly in excess layers. Forced to underwrite more accounts on a net basis due to reinsurance program changes, carriers are charging more and reducing line sizes of CAT-heavy portfolios. Non-CAT risks experience more favorable renewal results.

MARKET TRENDS

- Reinsurance continues to be the theme in 2023.
- Bifurcation exists primarily based on CAT exposure and industry
- Trending of values remains a key focus for property carriers.
- Insureds are considering more options around deductibles and policy limits.
- For most industries, there are few changes to policy terms and conditions.
- Risk improvement remains a key aspect of differentiation.
- Relationships and in-person meetings are yielding more favorable outcomes.

CONTEXT FOR CURRENT TRENDS

- There has been a retraction in global reinsurance capacity as a result of volatility in returns in recent years.
- Macroeconomic and geopolitical realignments, alongside persistent outsized natural catastrophes, reset supply and demand dynamics in several areas.
- Due to inflationary pressures, carriers continue to scrutinize valuations. Evidence that supports proper replacement cost values remains paramount.
- While many property carriers were profitable in 2022, they continue to seek long-term profitably, which could lengthen this challenging market cycle.
- Demonstrating risk quality and risk improvement is a key component to navigating a difficult property insurance market.
- Relationships continue to play a key role in building trust and credibility with markets. In-person meetings and site visits are resulting in better renewal outcomes.
- Determining appropriate levers to adjust ahead of renewals leads to stronger results.

Q2 2023 PROJECTED RATE CHANGES

7.5%–10%
Non-CAT accounts with favorable loss history

15%–20%
CAT accounts with favorable loss history

20%–30%+
Non-CAT accounts with unfavorable loss history

40%+
CAT accounts with unfavorable loss history

Cargo and Stock Throughput: Market Update

OUR POV

The cargo market continues to see stabilization for another quarter, into Q2. Reinsurance renewals earlier in the year have provoked some minor changes to appetites, with a particular focus on wordings. There is more capacity in the market, so underwriters are using more creative ways to secure accounts.

MARKET TRENDS

- Hurricane activity continues to increase underwriter focus on CAT rating.
- The "Five Powers War Clause" has been a requirement on all wordings since the start of 2023, driven by underwriters' reinsurance wordings.
- Russia, Ukraine, and Belarus exclusions are required on every risk from most insurers.
- Some underwriters are now factoring inflationary rises into their pricing.
- Underwriters require an accurate basis of valuation, and detailed COPE information or surveys of larger locations. There is particular focus on CAT-prone locations.

CONTEXT FOR CURRENT TRENDS

- Inflationary costs continue to rise and are being passed onto insureds in some cases.
- Underwriters continue to focus on obtaining as much risk management information as possible, particularly around building protections.
- Supply chain issues led to large peaks in values at certain storage locations. Underwriters are wary of an increase in ground-up exposure (or first loss exposure on excess placements), which can require an additional carrier for capacity.
- Carriers will be challenged to manage CAT aggregates throughout 2023. Some markets will pull out of or reduce line size, primarily due to inflationary, profitability, and reinsurance pressures.
- Many reinsurers have excluded coverages for Russia, Ukraine, and Belarus. While there is some scope for coverage in these areas, war on land coverage is excluded, forcing risk placement elsewhere. Some carriers are capitalizing on the opportunity, albeit with very healthy rates. This coverage is excluded by many reinsurers from 1/1, meaning some carriers are forced to take net lines affecting line size and appetite.
- Capacity in the market remains strong. In the last 12 months, we've seen a rise in new entrants: Everest Re, Parsyl, and Navium. Underwriters are utilizing their creative flair by providing different options to insureds to help secure good, profitable business with well-managed risks.

Q2 2023 PROJECTED RATE CHANGES

2.5%–7.5%

Accounts with favorable loss history and a focus on risk management

15%–25%

Accounts with unfavorable loss history or those that do not meet rate adequacy for underwriters

Casualty: Market Update

OUR POV

Stabilization of the casualty market continues. WC remains profitable for insurers while GL and Auto rate increases are slowing due to rate adequacy and competition. Lead umbrellas remain challenging due to ongoing large claim activity, while high excess remains competitive.

MARKET TRENDS

- Primary casualty insurers continue to seek rate increases on GL/AL overall for the 22nd consecutive quarter to keep up with loss trends.
- Workers' compensation is the most competitive and profitable line of coverage, but with wage and medical inflation impacting indemnity claims and potential frequency increases given the return to in-office work, rate decreases may begin to fade.
- The high excess market has stabilized, with increased capacity and competition. Lead umbrella insurers continue to achieve rate increases due to sustained large claim activity and limited competition.

CONTEXT FOR CURRENT TRENDS

- Large verdicts and settlements continue to impact the market as cases await trial in the backlogged court system. Social inflation and litigation financing are putting upward pressure on settlements to avoid unpredictable juries.
- Organizations with large auto fleets, high-hazard products, or significant premises exposures are facing difficult umbrella renewals. Using buffer layers to increase attachments can help mitigate premium increases. Healthy capacity in higher excess layers has increased competition and stabilized the market.
- Mix-shift in renewal exposures is important to monitor as any deterioration can lead to rate change pressure.
- Incumbent casualty insurers are generally seeking rate increases and are facing rate pressure from competing markets.
- Enhanced technology in vehicles coupled with supply chain issues is resulting in increased auto physical damage and third-party PD claims. Longer repair times are also affecting supplemental claim costs like rental car reimbursement.
- Carriers continue to refine coverage terms and conditions. Insurers seek to apply exclusions for biometric data privacy, abuse and molestation, assault and battery, PFAS (forever chemicals), wildfire, and Russia/Ukraine/Belarus.

By-Line Q1 2023 Rate Changes Ranged from -0.5% to +8.5%

	Auto	WC	GL	Umbrella
Q1 2023	8.30%	-0.50%	4.60%	8.50%
Q4 2022	7.30%	-1.10%	4.90%	9.60%
Q3 2022	7.60%	-0.70%	5.70%	11.30%
Q2 2022	7.20%	-1.20%	4.70%	11.30%
Q1 2022	5.90%	-0.50%	3.90%	10.50%

Source: CIAB Q1 2023 Rate Survey

Cyber: Market Update

OUR POV

After two years of rate increases, pricing is starting to come back down as more carriers compete.

MARKET TRENDS

- Competition is increasing. More carriers are competing for primary and low excess placements.
- Coverage restrictions hit the market:
  - Systemic risk exclusions
  - Non-breach privacy (GDPR, CCPA, BIPA)
  - Media liability
  - Dependent business interruption and system failure—largely sublimited
- The technology sector remains a tougher class than other cyber risks:
  - Concerns about systemic and widespread risks remain high at cyber insurance carriers.
  - Layoffs in the tech sector are leading to claims of employees taking data.

CONTEXT FOR CURRENT TRENDS

- Erosion of Wrongful Collection coverage in response to claims
  - There have been increases in claims for violations of federal wiretapping and Video Privacy Protection Act laws.
  - California Privacy Rights Act (CPRA) implementation suggests increased enforcement.
  - Multiple carriers are now refusing to provide coverage for wrongful collection of data, which previously was added to the privacy liability section of a cyber policy.
- Systemic risk is becoming a priority concern for cyber insurance carriers.
  - The threat of a single attack has downstream impacts on many companies all at once.

2/3 of cyber clients saw total cost decreases in the first quarter.

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