COMMERCIAL LINES INSURANCE MARKET UPDATE – FOURTH QUARTER 2021

Executive Summary

Market conditions did not change materially in the fourth quarter of 2021 from the previous quarter. We continue to see stabilization in many sectors of the commercial lines market and cyber continues to be a concern for insurers as ransomware losses are not slowing down. Cyber buyers are feeling the pain and premiums continue to increase. We are cautiously optimistic that insurance buyers will experience premium stabilization in many parts of their insurance program in 2022, but there are some issues that could impact this cautious optimism.

One of the issues we are monitoring is the impact of the unseasonal catastrophes in December. Specifically, the December 10th tornado outbreak that covered multiple states and the December 30th Colorado wildfire. Both events were driven by unseasonably warm weather, and both were catastrophic in terms of property damage. The prospect of extended or maybe even year-round catastrophe seasons would have a chilling effect on the property market. The other area of concern is inflation. If this inflationary environment persists, insurer loss costs will increase. More expensive building materials and auto parts will impact property and auto rates.

A bright spot is the Directors & Officers liability market. In Q3 we reported that premium increases were slowing down here except for IPOs and SPACs. This trend continued in Q4 and there are signs of premium decreases for stable companies with good financials and loss history. A driver in this trend may be that securities class action filings against public companies decreased for a second year in a row. This is a notable development because it reverses a 10-year trend in increasing filings. IPO and SPAC premiums are likely to remain high due to persistent litigation related to these transactions.

Cyber is the dark cloud over the optimistic trends we've been seeing in the commercial market. Buyers experienced the dual pain of premium increases and coverage restrictions in Q4 and this is expected to continue through 2022. Our Cyber Team recently released an in-depth review of trends in their *2022 Cyber Liability Looking Ahead Guide.*

Let's look more closely at each segment.

D&O: Market Update

OUR POV

Public D&O rates continued to rise in 2021, but there are signs that the market is in transition and that relief is on the way.

MARKET TRENDS

- Market-leading carriers continue to seek premium increases, but there is a deceleration in the rate of increase; upward adjustments generally still larger on excess layers.
- Economic uncertainty created by COVID-19 is resulting in more D&O litigation due to factors like misleading statements about the outbreak, deceptive claims regarding potential vaccines and treatments, and privacy concerns.
- March 2020 *Sciabacucchi* ruling on federal choice of forum in the Delaware Supreme Court has led to numerous state court Section 11 suit dismissals, and IPO pricing is starting to stabilize. Underwriter concerns have shifted to the surge in SPAC IPOs and de-SPAC transactions. Pricing for those deals continues to increase, with fewer underwriters willing to quote.

CONTEXT FOR CURRENT TRENDS

- Securities class action severity remains high. There were 101 settlements totaling $3.2 billion in 2021, the largest total annual settlement amount in the last decade.
- Likelihood of a public company being sued reached a record high of 5% in 2019 when 268 lawsuits were filed but declined in both 2020 and 2021. Total number of suits dropped to 210 in 2020 and 182 in 2021, a 13% year-over-year drop.
- Litigation is being driven by new and increased exposures including cyber (data breach), #MeToo, privacy oversight (GDPR), climate change, and COVID-19.
- Derivative actions are on the rise with notable settlements (American Realty, McKesson, PG&E, Wells Fargo, Tesla...) tapping "A Side-only" insurance.

2.7%
Likelihood of being sued (decline for 2nd year in a row after 2019 all-time high)

484
Number of open SCA cases pending

$11M
2021 median cash settlement (10-year average $8.5M)

$32M
2021 average settlement (10-year average $29.6M)

Property: Market Update

OUR POV

Property carriers showed preferential treatment of insureds that demonstrate risk improvement, submit adequate valuations, formalize and implement business continuity plans, and have intimate knowledge of operations and potential impacts post-loss.

MARKET TRENDS

- Rate continues to stabilize for insureds that demonstrate risk improvement, with a loss history to validate.
- Policy terms and conditions remain consistent.
- Valuation continues to pose issues.
- Carriers are increasing capacity and generating competition for favorable risk profiles.
- Despite loss costs exceeding 2020, some property carriers achieved profitability in 2021.

CONTEXT FOR CURRENT TRENDS

- Valuation continued to be a concern in Q4 2021, and that trend will be amplified in 2022. Due to labor and material costs, various sources suggest building trend factors of 10%–18%. Equipment trend factors range from 5%–10%. Insureds should be proactive in addressing valuations. Not all insureds will experience such drastic increases.
- Formalizing risk improvement and business continuity plans inures to clients' benefit. Explaining the impacts of potential down-time and the contingencies in place sets insureds apart.
- Loss-affected accounts and challenging occupancies may experience higher deductibles.
- Per NOAA, there have been 20 $1-billion weather events in the US. 2021 experienced the fourth highest insured losses in the 21st century. While some property carriers anticipate profitability in 2021, additional work will be done to address the frequency and severity of natural catastrophes and secondary perils.

2%–5%
Non-CAT accounts with favorable loss history

5%–10%
CAT accounts with favorable loss history

15%+
Non-CAT accounts with unfavorable loss history

30%+
CAT accounts with unfavorable loss history

Cargo and Stock Throughput: Market Update

OUR POV

Continued rate stability combined with pre-existing coverage remediation creates a positive outlook for 2022. New capacity encourages conservative competition and markets look to capitalize on growth opportunities.

MARKET TRENDS

- Carriers are looking for a balance between rate and risk, the result being single-digit increases. We are seeing flat renewals on larger pieces of business.
- New entrants continue to foster competition, largely through MGAs/MGUs, startups, and Lloyd's syndicates returning to the class.
- Markets previously opting to abstain from writing certain interests continue to broaden their horizons as top-down underwriting mandates loosen. Options are returning for most interests, even if at a certain price.
- Focus on "minimum premiums" that emerged over the last few years seems to be diminishing.

CONTEXT FOR CURRENT TRENDS

- Insurers are no longer willing to miss out on good, profitable business just because of its size/interest. A return to underwriting on a risk-by-risk basis with less senior management intervention.
- New capacity and growth targets still hold true, with markets maintaining underwriting discipline, insofar as coverage, but far more malleable on price for clients that demonstrate continued risk improvement and favorable loss history.
- New capacity beginning to write large and lead lines on business and no longer only serving as follow capacity.
- London insurers are actively considering new line-slip and binder opportunities, which had retrenched significantly over the past two years.
- US Cargo/STP carriers have limited appetite for retail exposures.
- The seemingly inevitable stress on global supply chains has led to make-shift storage, excess stock demand, poorly stacked vessels, increased frequency of fire losses, port delays, and accumulation issues at ports; all major concerns due to struggling supply chain support.

5%–10%

Accounts with favorable loss history and a focus on risk management

10%–20%

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

Casualty: Market Update

OUR POV

Rate pressure persists due to insurer concerns around rising claim severity. GL & AL stabilized, with rate increases consistent with prior quarters. The umbrella/excess market, while especially difficult for lead umbrellas, has shown signs of improvement.

MARKET TRENDS

- Primary casualty insurers continue to seek rate increases for the 16th consecutive quarter in order to keep up with loss trends.
- Workers' compensation remains the most competitive and profitable line of coverage with average rates around flat for the last 12 months and a decrease in the last quarter.
- Lead umbrella placements are difficult for many industries and increased attachment points and reduced capacity continue to strain the market. Increased competition in higher excess layers has reduced the overall pace of rate increase over the last year.

CONTEXT FOR CURRENT TRENDS

- A top concern of liability insurers remains the increasing frequency of nuclear verdicts. The primary drivers of large casualty losses are social inflation and litigation financing.
- Lead umbrella demand is outpacing supply, straining capacity. For excess layers above $25 million, new capacity and increased competition are finally providing rate relief for non-umbrella excess.
- Underwriters continue to pursue 5%–10% increases in primary General Liability and Auto Liability to improve profitability impacted by the rise in claims costs coupled with weak net investment income.
- Underwriting and risk selection discipline continues as carriers refine coverage terms and conditions. Certain industries, difficult exposures, and accounts with extensive loss history are experiencing more challenging marketing and adverse outcomes.

By-Line 3rd Quarter 2021 Rate Changes Ranged From under -1% to +17%

	Auto	WC	GL	Umbrella
Q3 2021	7.40%	-0.30%	6.30%	16.90%
Q2 2021	6.80%	0.30%	6.00%	17.40%
Q1 2021	9.00%	1.00%	6.20%	19.70%
Q4 2020	9.10%	0.40%	7.30%	21.30%
Q3 2020	11.00%	1.50%	6.70%	22.90%

Source: CIAB Q3 2021 Rate Survey

Cyber: Market Update

OUR POV

If 2021 was the year of rate increases, 2022 will be the year of coverage restrictions—and more rate increases.

MARKET TRENDS

- Coverage restrictions coming to cyber market include:
  - Dependent business interruption
  - System failure
  - Failure to timely patch vulnerabilities exclusion
  - Non-breach privacy (GDPR, CCPA, BIPA)
  - Media liability
- Rates are increasing across the board.
- Excess rate increases are accelerating faster than primary rate increases.
- Underwriting process is more involved and intensely focused on ransomware security controls.

CONTEXT FOR CURRENT TRENDS

- According to Coveware, in Q4 the average ransom payment increased 30% above Q3.
- Federal BIPA cases increased more than two times from 2019 to 2020, according to Bloomberg Law. This is leading to carriers reducing coverage available for non-breach privacy claims.
- Technology supply chain attacks like the SolarWinds hack and zero-day vulnerability exploits like Log4j are driving significant carrier concern around risk aggregation and patching procedures.

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