MID-YEAR | 2020

US CASUALTY INSURANCE OUTLOOK

RT CASUALTY COMMITMENT

The volume of submissions and premium flow into the E&S market continues at an accelerated pace and is further fueled by the continuing pandemic. Retail brokers and their clients are facing a challenging casualty marketplace. The current confluence of extraordinary conditions further highlights the importance of working with a strong wholesaler team with specialized product and industry expertise and a proven track record of delivering solutions. The RT Casualty team combines many years of experience to deliver unparalleled results. In addition to brokerage services, RT Specialty employs claims handling professionals to assist our clients with advocacy and resolution of claims disputes, TPA selection, claim reviews, case law and coverage assessments, all supported by the unwavering commitment by RT's senior management to retain and acquire the best talent in the industry.

"The RT Casualty team offers a deep bench of talented brokers focused on offering cutting edge solutions. We are prepared to handle all the challenges our retail brokers and their Insureds are facing in this changing marketplace," says Chris Houska, Managing Director and President of RT's National Casualty Practice.

CONTACT

For more information please contact your local RT Casualty broker.

RTSPECIALTY.COM

MARKET OVERVIEW

Following a prolonged soft market, the North American casualty market showed initial signs of firming in 2019. Major contributing factors at that time included heightened catastrophic loss activity, adverse development, reserving inadequacy, social inflation and climate change concerns.

The firming has accelerated over the past 18 months, as the primary liability and umbrella / excess lines premiums have moved significantly higher, often with double-digit percentage increases, even for above average accounts with good loss histories and proper management controls. For stressed accounts and those with poor loss histories, the pricing pressure has yielded even more significant upward variance, especially in the excess liability space where renewals are being bound at multiples of the expiring premiums.

As we move into the second half of 2020, the lingering COVID-19 pandemic has created additional uncertainty and challenges for the insurance markets. As a result, the pace of rising premiums and capacity restrictions has accelerated across all commercial casualty lines.

Although seemingly all casualty lines have been tightening, the amount varies by class and industry segment. There also are some outliers. As an example, for the past several years, right up until the pre-COVID-19 portion of 2020, the commercial auto liability market was experiencing among the highest premium rises within the overall casualty sector. The current shelter-in-place orders and the choice by many to minimize their movements have substantially decreased vehicle usage and auto traffic. This has resulted in a significant reduction in auto-related claims with a related reduction in auto insurance premiums.

At the present time, the placement of umbrella / excess liability coverages has become the most challenging as many insurers have reduced their available capacity. As a result, carriers have been significantly increasing premiums as dictated by the economic law of supply and demand.

In addition, and depending upon their view of the risk, underwriters are also seeking higher attachment points. This has led to a significant disruption in the excess liability marketplace, and in many cases, has required structural changes to the larger portfolio programs. Other casualty lines, such as transportation, real estate, hospitality, public entity and utilities, continue to be price sensitive with individual carriers now reducing their capacity or withdrawing from certain segments altogether. Later sections of this report will provide additional details that will further highlight present conditions and challenges within certain specific casualty lines and industry market segments.

Insurance carriers, through their casualty underwriters, are expected to continue focusing on profitability versus premium growth. In response to their senior management directives, underwriters are implementing more immediate corrective actions during the renewal process:

- Across all casualty lines and segments, expect a continuation of limited market capacity through reduced limit offerings, requiring more markets to fill out placement requirements.
- Year-over-year renewals will continue with significant upward rate pressure, resulting in more insureds choosing higher retentions and deductibles to manage premium increases.
- There is now more emphasis on negotiating higher limits on primary casualty placements to offset the rising premiums of umbrella / excess liability coverage.
- Insurers are also concerned about the long-term impact of potential pandemic losses and claims handling expenses which have not been previously accounted for in their current pricing models. This includes an additional concern about legislative and regulatory initiatives designed to benefit policyholders in their pursuit of COVID-19-related insurance recovery. In a recent statement, the Wholesale & Specialty Insurance Association (WSIA) advised that it

is "monitoring all state and federal activity in an effort to recommend consistent regulatory responses, and we continue to strongly oppose proposals that would require our industry to pay for losses arising from the COVID-19 pandemic that are not covered under existing insurance policies."

- Further on COVID-19, most of the carriers are revising their policy forms to include more restrictive terms and conditions. Most of these modifications reinforce the application of certain exclusions to minimize any policy triggers related to communicable disease exposures. Heavy emphasis has been directed towards the hospitality, retail and healthcare segments.

REINSURANCE

The reinsurance market's deployable capital among both the traditional and alternative sources already was tightening prior to the onset of the COVID-19 pandemic. These conditions were primarily a result of compounding catastrophic losses and subsequent creep sustained over the last three years. Third-party capital inflows into collateralized reinsurance and sidecar vehicles, began to slow in 2019. Reinsurance markets and investors are now assessing the uncertainty associated with COVID-19 and its potential to have a long-term effect on future market conditions. The below Guy Carpenter summary highlights the additional effect the COVID-19 pandemic had on the recent June 1 and July 1 reinsurance treaty renewals.

Post-COVID-19

- Acceleration of firming fueled by:
  - Reinsurer total risk profile concerns
  - Uncertainty of potential losses
  - Volatile financial markets
  - Restricted capital inflows due to financial market conditions
- Focus on treaty exclusions related to COVID-19 and pandemic, as well as other contract features that increase risk to reinsurers

Source: https://www.gccapitalideas.com/2020/06/23/june-1-2020-reinsurance-renewal-the-market-reevaluates-exposures-as-conditions-tighten/

FIGURE 1: US Property / Casualty — Product Line Underwriting Trends (2014-2020P)

	Net Premiums Written		Combined Ratios						
	2019E						Actual	Estimates	
Product Line	Share	Growth	2014	2015	2016	2017	2018	2019E	2020P
Private Passenger Auto	37.8%	2.5%	102.3	104.6	106.3	102.6	97.7	98.3	99.1
Homeowners & Farmowners Multi Peril	14.9	3.5	92.7	91.8	93.1	107.1	103.6	97.5	98.2
Workers Compensation	7.9	-2.5	100.9	95.8	95.6	92.5	87.0	90.5	92.6
Commercial Auto	6.7	8.5	103.4	108.8	110.5	111.1	108.0	109.4	107.9
Commercial Multi Peril	6.1	4.0	99.2	94.7	101.8	107.9	106.5	104.3	103.0
Fire & Allied Lines[1]	5.5	14.0	86.4	85.6	89.7	123.9	107.7	99.7	102.6
Inland Marine	2.4	4.0	83.3	83.8	84.0	89.9	86.4	88.1	87.0
Medical Professional Liability	1.4	3.0	103.6	102.3	106.5	101.7	104.0	106.5	109.5
Other & Products Liability[2]	10.1	6.0	101.4	103.4	111.1	101.0	101.1	107.1	108.7
All Other Lines[3]	7.3	10.0	79.5	84.0	87.2	103.6	97.7	95.8	96.4
Total All Lines	100.0%	4.2%	97.4	98.3	100.9	104.0	99.6	98.2	99.1

E=Estimated, P=Projected

[1] Fire & Allied Lines includes earthquake, multiple peril crop, and federal flood.

[2] Other Liability includes professional liability, D&O, excess casualty/umbrella, environmental/pollution, general liability, and EPLI.

[3] All Other Lines includes accident & health lines, mortgage guaranty, financial guaranty, ocean marine, aircraft, fidelity, surety, burglary & theft, boiler & machinery, credit, international, excess of loss reinsurance and miscellaneous.

Source: Best's Statement File Supplement - Insurance Expense Exhibit (IEE) - P/C, US (2014-2018)

Source: Courtesy of AM Best http://www3.ambest.com/bestweekpdfs/sr774997420811afull.pdf

MARKET SEGMENTS

The following market segments represent specific casualty lines and industry verticals which this report further addresses. Within RT Casualty, there are dedicated broker teams representing these segments, and several others, in order to deliver specific industry expertise and advanced product knowledge to our retail broker clients and mutual clients.

AUTO LIABILITY

The commercial auto liability segment leads the way in price increases. It is on a steady rise with little sign of leveling off. The increase in frequency and severity of losses over the last several years has made this an unprofitable line of business for several carriers participating in this segment. The combined ratios have been exceeding 100% for several years. Refer above to the US A.M. Best Property / Casualty chart comparing the combined ratios of commercial auto to the other major insurer product lines over the last 6 plus years. (See Figure 1).

There are several factors contributing to the increase in auto liability claim payouts. There are more vehicles on the road covering more miles than ever before. Plus, there is an increase in accidents caused by distracted drivers, rising medical expenses, a shortage of qualified drivers, and a continuing evolution of large jury awards. A key factor that leads to large verdicts and settlements for a corporate defendant is evidence of the driver's failure to follow the policies and procedures established by the employer, demonstrating their improper management and training. Stand-alone hired and non-owned coverage remains very price sensitive, with limited market participation.

As noted, however, the onset of COVID-19 earlier this year has substantially reduced miles driven, traffic and accidents, but the underlying fundamental issues with this segment still exist. Therefore, from an underwriting viewpoint, the current reduction in frequency and severity of losses is considered temporary. The key trends impacting the commercial auto market are likely to reemerge as the economy recovers.

Moving forward, commercial auto liability pricing is expected to continue trending upward with increased movement towards higher retention levels for employers with mid-to-larger fleet exposures. As mentioned in previous updates, another factor causing increased premiums is a continued reduction of reinsurance capacity for the primary insurers seeking buffer layer protection.

UMBRELLA AND EXCESS

Over the past year, the casualty segment with the most price volatility has been umbrella / excess liability. When budgeting renewal cost, the potential of 2X and up to a 10X multiple of expiring premiums should be considered. In addition to a market with pricing running at a dramatic upward pace, there continues to be less available capacity offered and stricter terms and conditions relative to the type of exposure and the class of business.

After several years of offering low premiums in contrast to the actual exposure of the risk, umbrella / excess liability loss trends have significantly deteriorated. Starting predominantly with the mid-2019 renewal cycle, several of the excess carriers have been implementing corrective actions and closely managing capacity by offering smaller line sizes.

With the umbrella / excess market capacity constricting, participation by more carriers is required to complete program limit requirements. In many cases, the lead umbrella, and the others following excess markets, are renewing at 50% of prior limits. A further challenge for the larger placements is that several carriers are requiring higher attachment points. This is especially prevalent with accounts having prior loss history or those situated in one of the more challenged classes of business.

In order to address these issues, program restructuring often will be required. It is critical to initiate advance planning with the retail broker and apply innovative strategies. Examples include:

- Stretching primary limits to mitigate or soften increases in umbrella / excess pricing, along with making up for capacity reductions;
- Identifying certain carriers which are willing to coordinate and quote the primary, together with an additional placement on the umbrella or one of the excess layers;
- Obtaining comprehensive historical exposure and loss data with the proper analytical tools to accurately forecast expected losses and evaluate the insureds' working layers, providing a solid evaluation of alternative retentions and incorporating cost versus risk trade-offs;
- Highlighting and expanding the detail of the insureds' safety plans and investments in risk mitigation as part of the submission process, then positioning pre-renewal meetings with key underwriters to present this information with customized materials.

These four bullet points all are highly beneficial in order to achieve favorable results during this very challenging umbrella and excess market.

REAL ESTATE

Despite the COVID-19 pandemic, the multi-family real estate industry sector continues to show growth and activity, especially with the increased demand on rental housing. E&S premiums related to multi-family real estate also represent a large portion of the surplus lines growth over the last year. Over several years, this segment historically experienced low premiums against a backdrop of increasing casualty-related loss trends. As a result, several admitted carriers have been reducing their primary and umbrella / excess participation which has created a predominant shift of this class into the E&S marketplace.

The larger liability programs are coming under pressure to stay intact. Carriers are starting to limit the number of units for a program size. Depending on the risk profile, splitting up location schedules to separately place the more attractive properties together may represent the best alternative to achieve overall cost benefits for the entire portfolio.

In addition to intense pricing pressure on renewals over expiring, both admitted and non-admitted carriers are adding more policy restrictions and limitation endorsements to address the continual rise in violent attack and assault & battery claims. Account portfolios containing heightened exposures or having more than the average loss activity with slips and falls due to poor facility maintenance are also coming under heavy underwriting scrutiny. As a result, there are an increasing number of stand-alone liability placements moving into the non-admitted market. Section 8 (low income), student housing and senior / assisted care remain as some of the most challenging risks to address.

Legacy guaranteed cost placements with low deductibles are now being renewed and replaced with larger retentions and SIRs for the larger portfolios. For the smaller to mid-size schedules, minimum liability deductible levels will range from $5,000 to $10,000. More and more programs are being renewed with a single loss limit in lieu of a per location basis. Innovative strategies and advanced renewal planning previously mentioned for umbrella / excess also apply to Real Estate.

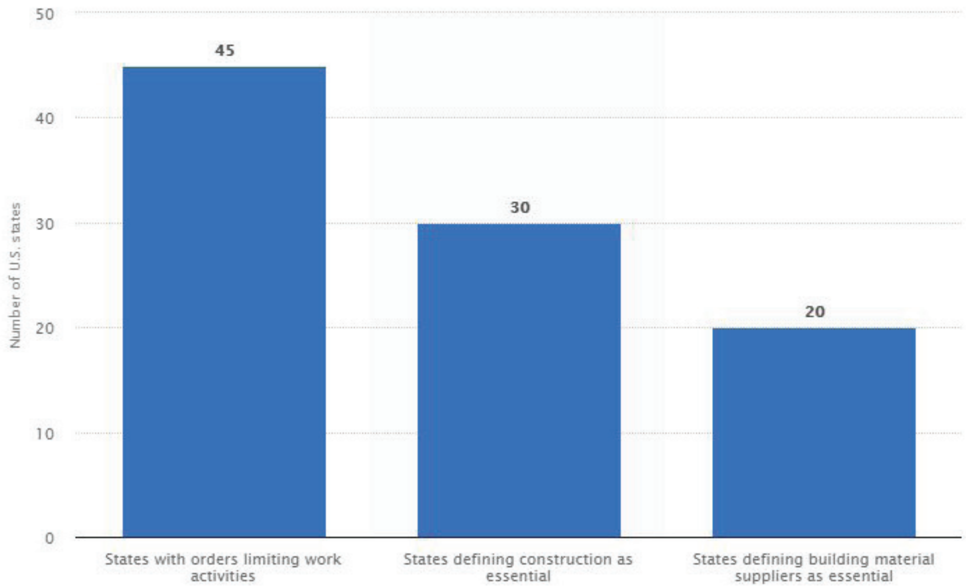
CONSTRUCTION

New construction activity generally has slowed or paused in several geographic regions as a result of the pandemic, although many projects that commenced before the virus have continued in place. The pandemic has also put more pressure on general contractors and subcontractors to meet labor demands. The industry already was facing a general labor shortage, in addition to having difficulty filling skilled positions. (See page 4, Figure 2).

Similar to other industry segments, the tightening casualty market has directly impacted construction. Over the years, commercial liability placements have been supported by a niche group of carriers. Over time, these companies have developed specialized underwriting expertise and products unique to the construction industry. Up until recently, the casualty market primary and excess capacity overall has been adequate to support the demand for both commercial / residential contractors and project specific / wrap-up business.

The current and developing market conditions include upward pricing pressure and reduced capacity, which results in less options for the construction industry. This is especially amplified in the excess liability space, where several of these carriers are lowering their limit offerings for both lead umbrella and excess layers participations, in addition to requesting higher attachment points. The shortened capacity and the need to add additional participants to fill out program requirements are driving up the cost of insurance significantly over expiring premiums. Retention levels are rising on many programs to off-set the impact of the premium

FIGURE 2: Construction Activity During COVID



Source: statista.com https://www.statista.com/statistics/1109617/covid-19-response-of-us-states-construction-limits/

increases. Construction is also faced with the same carrier movement for more restricted policy form modifications, such as adding or reinforcing the policy language that can include communicable disease exclusions.

Specific geographies, such as New York, remain challenging because rates remain high with limited carrier options. In certain jurisdictions, residential construction continues as a key issue to overcome due to the abundance of construction defect claims.

The current slowdown and pause in construction has resulted in a decrease in insureds' revenue forecasts and other exposure reported to the carriers. In addition, policy extensions as a result of construction delays, are being requested in many cases. Both aspects can be challenging for the insured and their brokers to obtain flexibility from the carriers. Premium adjustments typically are addressed within the policy terms and usually must await audits scheduled to be undertaken several months after the current term.

As the economy continues to reopen in fits and starts, there is an expectation that construction activity will be back on the move. It remains uncertain as to what level will be achieved compared to the robust activity running up to the months before the pandemic. A strong rebound should create some stabilization in casualty pricing, but the current tightening market would be expected to continue, especially in the excess liability space. Underwriting submissions need to be of high quality, organized and detailed to define the claim trends and expand on where the quality of the risk deviates from the average.

HOSPITALITY & SHARING ECONOMY

At the time of our previous Casualty Outlook near the end of 2019, the hospitality segment was continuing to expand along with the sharing economy to respond to rapidly changing customer demands. Technology advances have been enhancing customer experiences, such as home sharing platforms, restaurants and delivery services. Insurance challenges and issues were evolving and catching up to address these new unique exposures. At the same time, the traditional risk drivers remained in this class. Areas of underwriting focus included measuring the degree of the host liquor liability exposure and incorporating more exclusions and limitation endorsements to address the increased frequency and severity of A&B (assault & battery) claims and abuse and molestation.

The hospitality segment has gone into a significant pause as it awaits a more generalized recovery of the economy from COVID-19. While the pandemic persists, the carriers and their casualty underwriting units that specialize in this class are moving ahead with reissuing coverage forms that include more restrictive policy language around the communicable disease exclusions. In addition, they are reevaluating their pricing structures, which are driving rates further upward and increasing deductibles to higher minimums.

During this pause, there are additional underwriting challenges due to the current high percentage of occupant vacancy and changing risk profiles as a result of repurposing some facilities. Maintaining proper maintenance and continuation of safety and security services has become critical for property owners and managers to meet underwriter standards necessary for continues coverage of the risk.

Pricing pressure for the hospitality segment has seen the most dramatic increase from excess liability insurers. With the drop in the revenue base for several accounts impacted by the pandemic, many insureds are reassessing their liability insurance programs by lowering limits, raising retentions and adjusting reporting times to achieve cost savings and improve cash flow. Similar to other industry sectors, the tightening casualty market is expected to continue even after the pandemic conditions soften. The rebound period for hospitality is expected to be longer and lag other industries since it is tied closely to travel. This will have a compounding effect with the dedicated insurance carriers supporting this sector, creating potential shifting and withdrawals from this underwriting space.

The sharing economy is not a recent development, but it has greatly expanded over time, especially as advances in technology accelerated over the last ten years. Primarily through third party digital networks, individuals are sharing goods and services on a greater scale than ever before. An estimated 80 million Americans will use some form of a sharing economy service in 2020. This has brought about an economic and cultural shift and has created significant changes to both consumer expectations and employment trends. Along with this rapid growth, the sharing economy creates new challenges. One area is identifying the liable party in regards to commercial and consumer insurance. This is one of the factors, that has driven an increase in the amount of verdicts and settlements. Consumer insurance and regulatory issues need to be carefully navigated.

The casualty insurance market recognizes the tremendous growth opportunity of the sharing economy space and has been continuously working towards developing a better understanding of the exposures associated with it. Even with current pandemic conditions and its downward effect on the ride sharing business, this is being offset by the increased utilization and expansion of the short distance deliver-of-goods companies. The overall exponential growth of shared economy companies results in the need for additional insurance capacity. The tightening market, especially excess casualty lines, has created a challenge to meet this demand. RT is on the cutting edge and has created an owned facility with coverage forms broader than the traditional marketplace typically offers.

LOOKING FORWARD

Even with the disruption wrought by COVID-19, which can cause vacillating claim results, the deteriorating loss trends are expected to continue over the long term and will be the primary driver keeping the casualty market tightening. There are specific industry segments of casualty risk that are more challenged than others, with greater pricing pressure, decreased market capacity, and more restrictive coverage terms. The current pandemic has created additional uncertainty for the industry and potentially will create some structural changes and add new components to underwriting casualty risk.

In order to maximize results and differentiate the insureds' risk in a further tightening casualty market, there needs to be a thought-provoking "go to market" strategy. This starts with transparent communication of current market conditions and incorporates full vetting of the incumbent relationships with other potential carriers. The quality of the submission can be further enhanced by incorporating additional loss years and exposure data, along with a well-thought out strategy for pricing targets. This approach should be used in order to avoid immediate declinations from underwriters in this tightening market. Throughout the negotiation, agents and brokers should review and analyze alternative program structures for best terms and pricing options to achieve favorable results.