Q4 2022 State of the Property Market

James Rozzi, CPCU, ASLI
Area Executive Vice President

THE COMMERCIAL PROPERTY INSURANCE MARKET WILL SEE INCREASED RATES IN 2023, SO IT'S ESSENTIAL TO START RENEWALS WELL BEFORE DEADLINES.

Happy New Year! I hope everyone enjoyed a relaxing holiday with family and friends and that the end of 2022 provided a little downtime, because there will be no rest for the weary in 2023. Personally, the holiday season flew by way too fast and if I'm being honest, I am not really sure where 2022 went!

This year is already racing ahead at a breakneck pace, and the outlook for the 2023 Commercial Property insurance market looks a bit dire as we start the year. I'm a glass-is-half-full kind of guy, but I'm also a big believer in not sugarcoating less-than-ideal news — and 2023 will have very little positive news to offer to Property insurance buyers as the year unfolds.

The reinsurance market has decided that 2023 will be their year to make significant changes to the way they offer carriers protection. These changes will make the marketplace more challenging than it's been since the aftermath of Hurricane Katrina 2005 and 2006. Most seasoned industry brokers and underwriters agree that 2023 will likely be the firmest market they have ever experienced, despite most buyers feeling that they didn't think things could get much worse after the last few years.

CARRIERS EXPECTED TO PASS INCREASED COSTS ONTO BUYERS

I just returned from a week in London with one of our clients, and now that we're through the January 1 treaty reinsurance renewal cycle, the data and results suggest the same message for just about everyone. Almost universally, carriers have seen their retentions increase and their costs go up. The retentions for some have doubled, and the rates for many average somewhere between 15% and 100%. I won't name any names, but one of the major buyers we spoke with indicated their retentions for their excess-of-loss Catastrophe insurance (CAT) cover increased by $250 million, and their risk-adjusted pricing was still up over 40%.

Almost all carriers have had less reinsurance capacity and options available to them to offset these increases, so without any doubt, buyers need to be prepared for carriers to pass the bulk of these costs onto them. The cost increases will be deal by deal, and they certainly won't be dollar for dollar, but not anticipating the increased costs at this point would be flat-out ignorance.

Amplifying the challenges is that 2023 will effectively be the sixth straight year clients have seen double-digit increases in their Property insurance program costs. For many buyers, today's economic challenges make these costs unrealistic and tough to grapple with.

FACING HURRICANE IAN'S AFTERMATH

Hurricane Ian is going down in history as the costliest storm ever recorded. During our London meetings, various underwriters confirmed that Property insurance rates must continue to rise, and terms and conditions must be adjusted to help get their reinsurance programs back on track and start making a meaningful profit to yield some market stability down the road.

Carriers indicated that towards the end of 2022, they saw a significant uptick in rate increases and were binding business at average increases of 20% to 25% on clean CAT business; loss-affected business was well north of that. Rate increases definitely accelerated the last two months of 2022, as carriers started realizing what the results would be in their January treaty reinsurance renewals.

Stateside, we have had numerous conversations with all the major Excess and Surplus (E&S) players we trade with, and the story is more or less the same. Carriers who have April 1 treaty renewals have a really good handle on what the expectations will be. We anticipate they'll do what they can in Q1 2023 to help offset some CAT aggregate to alleviate some of the perceived challenges they'll go through as they negotiate their reinsurance programs.

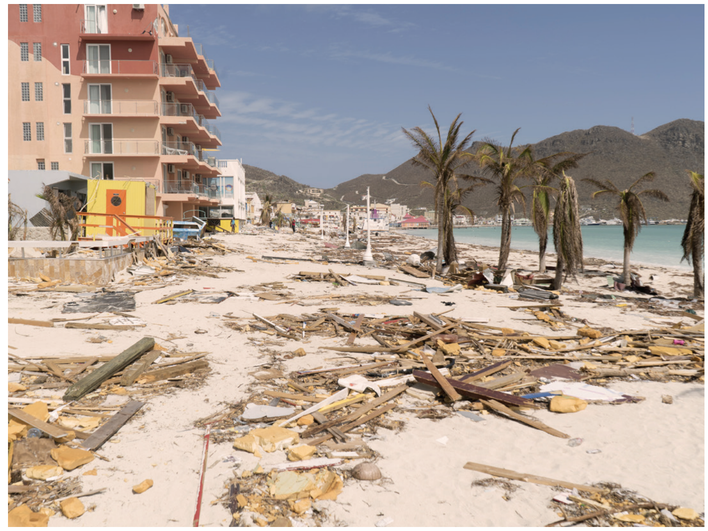
The most frustrating part about all of this is that before Hurricane Ian, I distinctly remember sitting at the Wholesale & Specialty Insurance Association's (WSIA's) annual E&S conference in San Diego, and everyone had a sense that there was light at the end of the tunnel. Carriers were headed towards record profits, and clients were headed toward a more balanced and competitive market. Hurricane Ian, however, solidified that we're not out of the tunnel yet and frankly, we may still have a ways to go.

5 REALITIES OF THE 2023 PROPERTY MARKET

As 2023 unfolds, here are some expectations and realities we'll need to start coming to terms with.

Property Valuation Issues

Valuation issues will continue to be one of the major talking points for the foreseeable future. Construction costs are coming down a bit, but labor costs across the U.S. remain at all-time highs, and many clients are years behind proper adjustments to their values. This conversation will be had on just about every risk, and even clients with good valuations will still need to make inflationary raises if they have any hopes of maintaining blanket coverage.



I expect that many programs will continue to see scheduled limitations or margin clauses, and a healthy group of markets have already indicated they wouldn't be offering blanket coverage to new business clients in 2023 regardless of their insurance-to-value metrics. Both trends will put a major strain on clients who have strict lending requirements, and some customers will be forced to pay surcharges or go with more expensive capacity if having scheduled limitations on their policy is a non-starter. Clients with less than stellar replacement cost values will be forced to make significant adjustments, which will add to the rate increases. Alternatively, they can make lesser adjustments but see much higher rate increases.

Catastrophe Insurance (CAT) Capacity

CAT capacity for geographically concentrated risks (especially Florida and Louisiana) will be expensive, and limits will be hard to come by. We've already seen numerous examples of clients who bought $100 million of limit last year paying the same for $50 million of limit this year, and that trend will continue.

Several carriers are indicating the need for Named Windstorm deductibles to move from the standard 2%, 3%, and 5% to levels north of 7.5%. Again, this increase will create issues with lenders and loan covenants, and it will be interesting to see how clients navigate the increase, given that most carriers feel that a client's lender concerns are not a carrier problem.

In general, carriers are moving towards a take-it-or-leave-it attitude, which isn't conducive to fostering the kind of long-term relationships they should want with their client base. I also imagine carriers need to be cognizant of the fact that too much price gouging will drive clients to buy less limit and take higher retentions, and it's unlikely that those premiums or layers come back into the market in future market cycles.

Carriers should heed the fact that this insurance cycle will turn the other way at some point and be cognizant to not pay lip service to partnership.

Excess and Surplus (E&S) Carrier Appetites

The carrier appetites of most E&S players will remain the same, and all the usual suspects have indicated that they plan to grow and write a healthy amount of new business as the year unfolds. At the same time, many E&S players will be cutting their line size deal by deal and increasing their minimum premiums.

I predict that most carriers will achieve their target growth without having to increase their aggregate exposure, and many will achieve their targeted growth even as they decrease their aggregate exposure. This strategy ultimately will ease the treaty reinsurance costs at future reinsurance renewals. Carriers are also raising minimum premiums to more effectively manage the volume of business they're seeing.

Terms and Conditions

Terms and conditions on all policies — and especially broker manuscript forms — will continue to be under major scrutiny. Carriers will continue to offer sub-limits that cap exposures they don't want, and items like Extra Expense, Expediting Expense, Landscaping, Building Ordinance, and Extend Period of Indemnity will likely be under a spotlight as the year unfolds.

Some carriers will be looking to exclude storm surge from all coverages and others will be moving away from putting up large lines in layers where loss creep has become quite common. What this means is that excess increases (much like what we have seen over the last two or three years) will be much larger than primary and buffer layers and we will likely need to inject multiple markets into layers that used to be written by two or three markets. On a few of our 12/31 renewals we saw increases of 200%+ in excess layers that went from one carrier to eight carriers in order to replicate the same capacity and maintain blanket limits.

Timing

The last major theme I want to leave you with for 2023 is timing. The volume of business coming into the E&S market continues to increase, and carriers simply don't have the bandwidth to capture it all. With treaty programs in ongoing negotiations from April 1 to July 1, we can also expect carrier appetites to continue to evolve. As a result, carriers will have a challenging time completing renewals and new business well in advance of effective dates.

For brokers and buyers the message is simple: start the conversations early and work as far out as possible, because it's likely that most large layered and shared deals will continue to come down to the wire, despite everyone's best efforts. Having patience for the process will be key and, while frustrating, it will be important to educate clients on what a reasonable timeline looks like. As insurance programs see changes and increased costs, clients will need to see various deductible and limit options, and each option will take time to iron out with carriers who will need to underwrite each option. Nothing will come easy in this market.

FORMULATE A PLAN TO EASE THE ROAD AHEAD

As I said in the opening of this update, there's not a lot of positive news to share, but I also don't want everyone leaving the conversation thinking the sky is falling.

The reality is that, if you're aware of what the road ahead looks like and formulate a plan to face the hazards head on, navigating it shouldn't be too difficult. Clients with a good story who are prepared and educated about the struggles carriers are working through will be better suited than those who haven't given any credence to the way the market has evolved these past few years.

As tools that can significantly offset some of the increased costs large buyers face, they will continue to use captives, retention levels and even adjustments to the level of capacity they buy. Single-location CAT risks will be a different story, but I have every confidence that carriers who partnered with clients over the years will continue to do so and provide solutions for them that are fair and equitable.

I also have every confidence that clients with minimal CAT exposure and remain profitable for their carrier partners will see competitive renewals that could range in the plus 5% to 15%. Even clients with CAT-heavy programs with risk characteristics that underwriters deem desirable will likely maintain coverage similar to what they had on expiring and see competitive renewals. However, their respective brokerage teams will work very hard to keep those renewals anywhere close to 12.5% to 20% up and, depending on how concentrated the CAT footprint is, the rate increases could be much larger.

Desirable risk characteristics are simple:

- Good replacement cost/insurance to value metrics
- Healthy retention levels that eliminate attritional exposures
- Low/profitable 5-year loss records
- Quality asset with a sound approach to risk management
- Part of stable layered and shared insurance program with bifurcated capacity
- Multiple long-term carrier partners

In summary, I expect that we'll see very few flat renewals in 2023, and even if we do, those clients likely went through meaningful deductible and limit changes. Depending on how much larger customers look to self-insure and use captives, rate reductions could be possible. However, if you do a risk-adjusted analysis, flat renewals and rate reductions are likely to be absent from the market throughout 2023. While we have a good idea as to what the road ahead looks like for 2023, the year is just getting started and lots of things could change.

It is critical to work with your brokerage team to make sure everyone is on the same page. Almost universally, clients of every geography and asset type will see increases when their insurance programs renew, but it will be critical for insurance buyers to be realistic about the tools they want to use to help make their insurance program a success.

I know that Risk Placement Services has the right people and the right carrier partnerships to handle all our clients' needs, and we welcome the challenges ahead of us.

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