2023 Q4 Umbrella and Excess Market Update

Growth and Losses

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As we enter the fourth quarter of the year, the Wholesale & Specialty Insurance Association (WSIA) marketplace is behind us, and conversations about plans and expectations for 2024 have begun. The most consistent themes in the casualty insurance market still headline: the marketplace's continued push for growth and the continued caution around loss costs and loss development. Let's discuss the evolution and drivers of these two topics in more detail.

LET'S START WITH GROWTH IN THE EXCESS AND SURPLUS MARKET

The excess and surplus (E&S) industry is quickly approaching the $100 billion mark in premium, and expectations are that it will grow to $150 billion in the very near future. It's important to point out that E&S isn't a bad phrase, but rather a market for alternate sources of capital to complement and help solve insureds' buying needs.

A year ago, the common theme of the WSIA marketplace was the need for underwriters and underwriting talent to keep up with the submission flows and opportunities that carriers were seeing. This year, most carriers say they are adequately staffed and poised for growth, with several looking at new products or offerings intended to capture a broader range of accounts than typically targeted. Two prominent carriers that typically target larger, more complex risks are creating lower-middle-market divisions with dedicated underwriting teams. Both carriers have seen tremendous growth in these areas.

Last year, as we left the 2022 WSIA conference in September, the majority of markets we met with had surpassed their underwriting goals for the year. At roughly the same point this year, only about 50% of the carriers have hit their goals for the year. A deeper dive shows that multiple factors are mostly likely driving this trend:

- We've talked about all the additional carriers coming into the marketplace over the past few years and having less deployable capacity available than at the start of 2019. With possibly twice as many excess facilities deploying that capacity, there has been a good amount of competition over the $10 million attachment point. This competition is starting to filter down to a $5 million attachment point, with a still-limited number of carriers targeting leads on larger, more challenging placements. This situation is pulling down retention rates across the excess marketplace, as agents and brokers strategically work to keep rate increases as low as possible.
- The second factor driving this trend is that the rate increases most carriers had been targeting for 2023 are actually coming in much lower than they planned. Most carriers had been looking for 10% to 12%, and while they might be getting this range in the lead, the layers excess of the lead are typically renewing in the lower single digits.

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As mentioned in previous updates, the quality of submissions continues to be a main point for carriers, as underwriting authority for direct underwriters still hasn't increased to its pre-pandemic levels. The need for a complete submission with detailed operations information, loss information, and safety procedures and protocols is still paramount for underwriters, as they continue to have to work with management and negotiate for risks that fall outside their direct authority.

MOVING ON TO LOSSES

Supply and demand are not driving today's casualty insurance market conditions, as was the case for many of the past challenging market cycles. Instead, the drive is a rationalization of pricing based on rising loss costs and the increased rates needed to maintain profitability. If we go back to pre-2019, loss costs were developing at around 4% or so per year. For 2022, that estimate is probably closer to 6.5%; with several carriers saying they see loss trends closer to 10% per year, which means a $500,000 loss today will be a $1 million loss seven to 10 years from now.

The other drivers are more frequent, large claims, nuclear verdicts, and more claimants. These changes, coupled with third-party litigation, lead us to conclude that excess casualty pricing will need to continue increasing over the long run to keep pace.

The positive for buyers is that there is an ample supply of capacity available, and all those carriers are looking to grow, which is creating a competitive environment right now. We would caution, however, that while minimizing rate increases in the short run is a positive and necessary deliverable, if trends continue, an inflection point eventually will come in which rates will need to go up to work back toward equilibrium.

In last quarter's report, we touched on the July 1 treaty renewals, and with the January 1 treaty renewals quickly approaching, it makes sense to provide an update in this area as well. In talking with various partners both on the insurance and reinsurance sides, ceding commissions are expected to come down three or four points for carriers with loss development in an expected bandwidth. Carriers with higher-than-expected loss development could be cut even more.

To offset the costs passed onto insured through the reinsurance market, many carriers increased the amount they take net. This strategy pushes more volatility onto their books, forcing them to make underwriting guideline changes more frequently as losses develop, compared to carriers who take larger reinsurance lines and can maintain guidelines with continued underwriting discipline.

COVID-19 litigation recess is clearly over, with nuclear verdicts continuing to go up in size and in number. The most recent large loss report from a prominent carrier confirms the continued increases and loss costs. We have seen insureds look to reduce capacity purchased to offset rising costs, which could be a good short-term plan. However, from the losses we have seen across the industry, the large loss conversation is turning to when it will happen—not if it will happen.

The conversation around growth and losses will continue to evolve over the coming months, and it will be clearer how 2024 will start once the January 1 treaty renewals are wrapped up. From a pricing standpoint, we expect carriers to continue to be aggressive on new business while being more conservative on renewals. Terms and conditions will be a focus from the underwriting side, as carriers look to protect themselves while being able to be aggressive from a pricing standpoint.

All in all, the E&S market is thriving and continuing to ensure it's a viable market over the long run.