

An aerial photograph of a massive, swirling whirlpool in the ocean. The water is a mix of dark green and white foam, creating a dramatic, circular vortex. In the bottom right corner, a small white and black boat with orange life rings is navigating through the turbulent waters, providing a sense of scale to the immense size of the whirlpool.

HARD MARKET

Navigating the current Insurance Market dynamics is vital to getting the right cover in place

Mactavish

Setting the standard for insurance placement and claims outcomes

HARD MARKET

dynamics

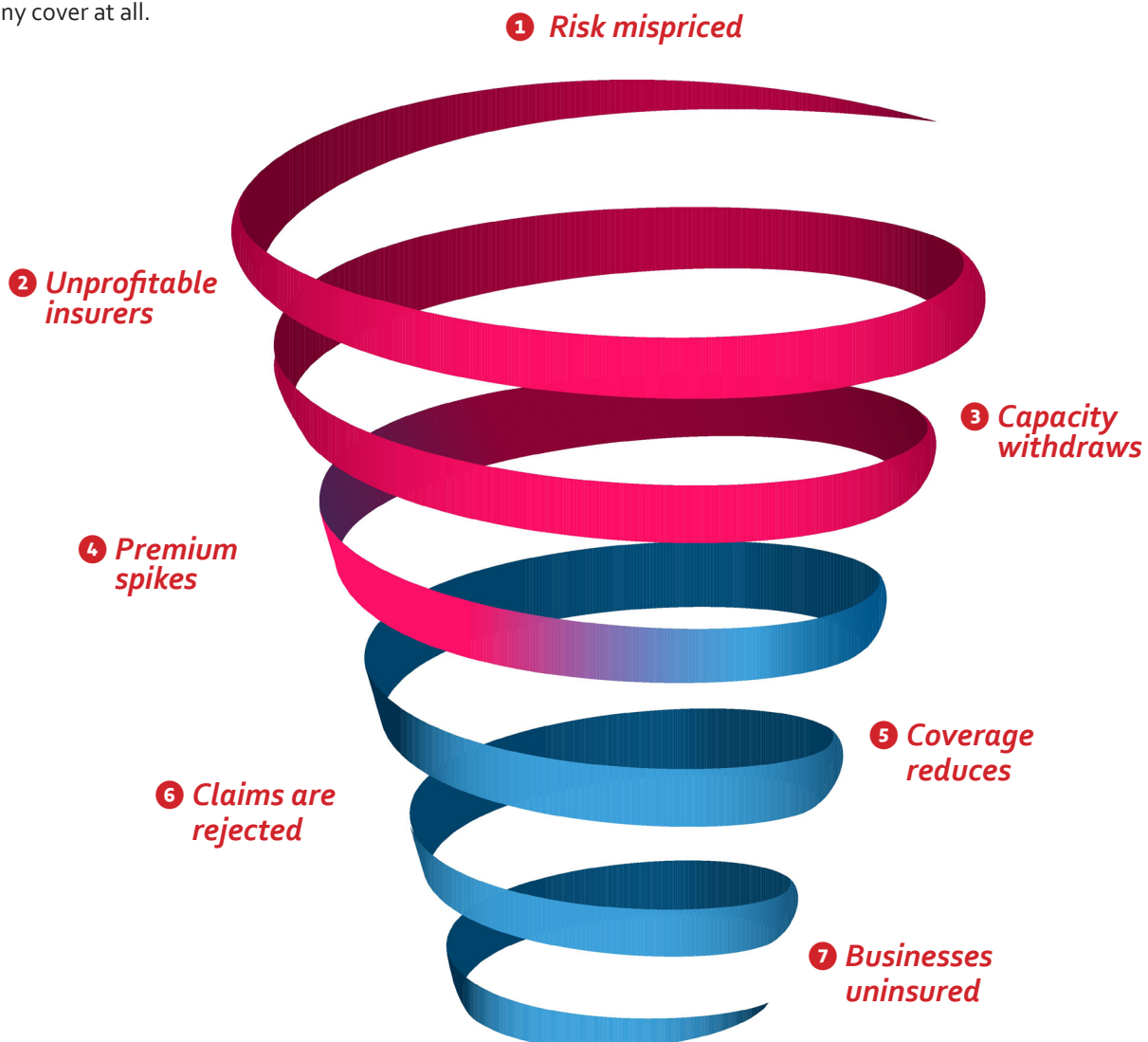
If you are the individual responsible for buying insurance for your company, the chances are you are used to a pretty straightforward renewal process and may even have enjoyed successive years of relatively static premiums or perhaps some reductions.

So, it is unlikely you are expecting your broker to come to you at renewal brandishing a 500% increase in your premium. Worse than that, your broker may also have to break the news that your cover levels have been reduced and that in certain areas they cannot secure you any cover at all.

This is not some kind of doomsday scenario – this is recent fact for insurance buyers in some sectors. Construction and engineering has been particularly hard hit with sharp increases in rates and reductions in cover for professional indemnity insurance in particular. Corporate directors' and officers' insurance has similarly been incredibly volatile over recent renewals across a range of sectors, with other classes likely to follow.

And what mysterious force is causing all of this? It is what is known in insurance circles as a hard market – and we haven't seen one for well over 15 years. Some companies have already fallen victim to these market forces, but that need not be the case for everyone.

There are warning signs you can look out for and steps you can take to mitigate the impact. Knowledge, as they say, is power – so it is worth understanding what a hard market is and what causes one before you start to plan your defence.



HARD MARKET

warning signs

1 *Risk mispriced*

In a very competitive market, insurers will misprice the risk (take on risks at a discount) in order to get business through the door. As the losses from previous, more benign years come through, it becomes apparent that the premiums charged in prior years were inadequate to cover the insurers' exposures. For example, in the D&O market, despite a marked increase in the cost of actions against directors and Marsh reporting a fourfold increase in D&O claims since the financial crisis, premiums for D&O policies remained stable or decreased until very recently.

2 *Unprofitable insurers*

When the cost of claims starts to outstrip the value of the premiums brought in, this has a direct impact on insurers' balance sheets and they are finally faced with financial reality. Premiums must start reflecting the risk posed. However, competitive pressures usually delay this until the action required is urgent and, sometimes, disproportionate. We have already seen this playing out with large insurers such as AIG and RSA posting significant underwriting losses. They won't be the last and some smaller carriers have even stopped writing new business altogether. This is the hangover following the soft market bingeing.

3 *Capacity withdraws*

As insurers face up to their unprofitability, they withdraw from difficult markets or reduce the capacity they are willing to provide. For example, some Lloyd's syndicates have withdrawn entirely from the professional indemnity market and capacity and limits offered in this class have reduced significantly across the market.

The impact of this is considerable. As an example, it is estimated that currently, for D&O and Crime risks, there is now only a third of the limit available in 2015/16.

4 *Premium spikes*

Reduction in capacity has a direct impact on premiums because there is less competition for the same number of customers requiring cover. This can occur suddenly and is already happening. The sudden spike occurs when the mispricing of risk starts to bite. Insurers' ability to prop up results using new capital inflows and by releasing prior-year claims reserves on to their balance sheets finally gives out, as the reserves run dry and the elasticity suddenly snaps. As insurers across the market catch on to the opportunity to increase prices, a rout starts to develop. This is where the UK Construction/ Engineering PI, D&O and Crime markets currently are, and other sectors will follow quickly behind.

5 *Coverage reduces*

To reduce their exposures and boost their profitability insurers decrease the coverage they provide. Lower limits, wider exclusions, removal of valuable extensions and requirements for increased deductibles are all key symptoms of the hard market – it is about far more than just price increases.

6 *Claims are rejected*

One of the most extreme manifestations of a hard market is a harder stance taken on claims. Claims account for more than 70% of a typical insurer's costs, so it will always be one of the first places they turn in an attempt to secure profitability. Insurers are already taking a much tougher stance on claims.

A Mactavish study conducted during the soft market found that 45% of large or significant claims were disputed. This is likely to be tougher in a hard market. Businesses should be prepared for a challenging environment for claims, especially in the most sensitive sectors.

7 *Businesses uninsured*

Major brokers are cautioning that clients might face the prospect of limits being unavailable irrespective of cost, policy exclusions taking out valued swathes of cover, some insurance classes not being renewable at all and businesses having to self-insure certain risks.

For example, some engineering and construction firms have faced such dramatic and material reductions in PI insurance cover, without any advance warning from their broker, that they have immediately breached the insurance requirements in their commercial contracts.

broker CHALLENGES

Brokers have some serious challenges which impact their effectiveness in a hard market.

First off, after such a prolonged soft market, most brokers won't have the corporate memory or skill set required to navigate a hard market.

Secondly, most brokers will benefit financially from a hard market as the commissions they earn (even on fee-based placements) increase in line with premiums.

And finally, as a hard market hits suddenly and with force, a broker's time is disproportionately taken up with the most difficult-to-place risks. Brokers' jobs are getting more complex and broker teams simply do not have the resources to support clients with more 'run of the mill' renewals. Even if those clients also face severe premium increases and cover reductions, they are likely to be told they are 'getting off lightly' compared to other businesses.

As a result of this, many businesses are getting caught out. For example, at a lot of recent Construction PI and Management Liability renewals, the first knowledge the customer had of any difficulties was when their premiums increased dramatically for a fraction of the cover.

The good news is that you are not completely at the mercy of these market forces and there are steps you can take to put yourself on the front foot.

The warning signs

There are tell-tale signs that your sector or the types of insurance you buy are heading for or are already in a hard market:

- You are told a limited number of insurers are interested in your risk or that only the incumbent insurer is offering a competitive quote at renewal
- You are running a normal renewal process, without starting earlier or suggesting a different approach despite the fact that you are aware there are shifts in the market
- Your broker is advising that you are getting off lightly compared to others, despite pricing increases
- Your claims are coming under greater scrutiny or are taking longer to resolve than normal
- You are seeing coverage restrictions creeping into policies

Early hard market: Recent client experiences

In 2018, one construction firm which renewed its professional indemnity risk, was hit with a more than threefold increase in both premium and deductibles together with a reduction in limits of more than 50% whilst cover was withdrawn entirely for some active territories. Taking all the above into account, the actual rate increase was more than 10 times the original.

The firm not only had to manage the sudden cost increase; the limitations imposed actually

affected its ability to trade. The limits required for commercial contracts were out of alignment, it had no cover at all for specific countries, restrictive sub-limits reduced the breadth of cover and it was unable to tender for new business as a consequence.

All this came without any prior warning from the broker or insurer and had to be digested and managed within the limited timeframe of the renewal period.

How to tackle a HARD MARKET

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The good news is that if you are experiencing the above, you are not defenceless. You can act to protect yourself:

- The renewal process: start around six months before the renewal date. Be clear on what you want to achieve, meet a wide range of insurers and explore the potential market for your risk more vigorously.
- Risk marketing: take control of how effectively you are explaining your risk to insurers. They are looking for the best risks, so try to position yourself as one. Provide more than the basic information regardless of what anyone else advises you to do. Move beyond mere compliance and "fair presentation" into creating a risk prospectus of your business to stand out. Conduct detailed analysis of your risk exposures, respond to insurer requests with as much information as possible, detailing risk management procedures and providing supporting documentation to evidence your processes.

- Market management: get the above right and you can start driving competition for your risk by building a wider and more direct insurer dialogue early. Consider engaging with more than one broker and encouraging them to provide a market-backed solution with firm wording commitments as part of their bid. This will give you a much broader and clearer view of the marketplace and the perception of your risk.

- Policy reliability: scrutinise your policy wordings to ensure they are fit for purpose for your business and get clarity on the boundaries of coverage which are deal-breakers for any insurer relationship.

In a hard market, your needs become less of a priority for insurers. By taking the above steps, you can differentiate your business risk, protect against premium increases, avoid coverage restrictions and buy more reliable cover. Ultimately, if you take a business-as-usual approach to your renewal in the

coming environment, you are likely to feel the full force of the hard market. Expect to be challenged with more exclusions, lower sub-limits and changes to the detail of terms and conditions. If you are not verifying that you have adequate protection, you could be needlessly exposing yourself. As noted above, companies that can differentiate their risk can make themselves a 'must have' for the market. As market pricing increases, insurers have greater scope to offer premium reductions on individual, attractive risks because more proactive underwriters will be looking to compete on what they view as high-quality risks.

Mactavish helps clients through these hard market challenges

Although this report should give you the necessary guidance to start identifying and navigating a hard market, professional support can make the difference between being one of the crowd or one of those sought-after risks.

What is the hard market doing to certain sectors?

Q1 2019 D&O and Crime renewals

- Routinely seeing up to 100% premium increases, especially for public companies with US exposures
- Multiple new exclusions drastically reducing cover available (e.g. for D&O claims consequent on business operational issues)
- Brokers warning that some businesses might need to self-insure some risks fully for Crime in 2019

Food and drink processing: Property Damage/ Business Interruption

- Sector impacted by several recent UK fires
- Supply-chain consolidation has hugely increased the concentration of BI risk in recent years
- Despite physical risk improvements to many manufacturing operations, there are already early warnings of a repeat of the last hard market approach to apply blanket increases to the entire food and drink sector irrespective of loss performance.

FIVE REASONS to start the journey to bolder business with Mactavish as your guide.

1 We are entirely independent

Mactavish will have no financial interest in any insurance product that you purchase.

The insurance industry is a complex arrangement of manufacturers (typically insurers) and distributors (typically brokers). In addition to receiving a fee from their client, some brokers also receive payments from insurers in respect of services they provide.

Mactavish receives no money from any insurance transaction and has no preference for which insurers you appoint. We are true, independent advocates for you – relentlessly committed to achieving the highest standards of reliability in all of your insurance contract arrangements.

2 We are experts

Mactavish's specialism is centred on objective risk and insurance contract analysis.

We identify the critical improvements you need and execute results working with the very best insurance barristers and provide practical, technical support to you and your broker in negotiating bespoke and innovative wording solutions with your insurers.

3 We offer a unique mix of skills

Mactavish's team of experts includes experienced insurance lawyers, expert barristers, risk analysts and management consultants. You can be absolutely confident that we understand the interaction between your processes, risks, compliance and contracts.

4 We get the job done

Mactavish is uniquely successful in implementing improvements, in fact we are the recognised market leader in negotiating contract changes and in developing compliant practices to manage the new legal era introduced by the Insurance Act of 2015.

5 We lead the way

As industry thought leaders, we were instrumental in the creation of the Insurance Act and Enterprise Act for the general benefit of insurance buyers - and have conducted the most comprehensive contemporary research programme into insurance market practices, giving Mactavish unrivalled insights that we can leverage for your business.

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