COMMERCIAL LINES INSURANCE MARKET UPDATE – SECOND QUARTER 2020

Executive Summary

2020 just keeps getting more interesting for the commercial insurance buyer (and not in a good way). As we released our Q1 update, the pandemic had shut down the United States and most of the world. The main impact of the pandemic that we were seeing at the end of Q1 in the insurance market was business interruption (BI) claims and their subsequent denial by insurers due to lack of physical damage to property. Just about every insurer offering BI coverage has now been sued for denial of these claims and several states have introduced legislation to force insurers to pay them.

To date, no legislation has been signed into law, but what is believed to be the first COVID-19 court decision arrived on July 1st. The suit was brought by a restaurant management company that had submitted a business interruption claim after its restaurants were closed due to Michigan's stay-at-home order. A US circuit court judge ruled that there was no coverage under the business interruption component of the insurance policy because there was no direct physical loss or damage to property. The policy did include a virus exclusion which the plaintiff alleged was vague. The judge rejected this and stated the exclusion would apply even if there was direct physical loss or damage. This issue is far from settled due to the number of cases filed and the variations in policy language.

As Q2 unfolded, we started to see the impact of COVID-19 in more places. *The National Law Review* examined US court filings from late March through June 4, 2020, and noted numerous employment lawsuits based on COVID-19. The most common allegations were unsafe workplace and retaliation—which are undoubtedly connected as individuals allege retaliation after complaining about workplace safety. Employment Practices Liability (EPL) insurers have noticed these trends; EPL premiums continue to rise and EPL buyers should expect to be able to answer COVID-specific questions as part of their EPL renewal.

D&O insurers are also expressing concern about the pandemic, specifically around the risk disclosures that public companies are required to provide in SEC filings. As we reported in our Q1 update, this market was already experiencing sharp premium increases and COVID concerns have only exacerbated these trends. Some insurers have tested COVID exclusions, but this trend has yet to gain momentum. Like EPL, D&O buyers should expect COVID-specific questions at renewal. Insurers are increasingly concerned about financial problems arising from COVID at private companies and therefore have been releasing quotes with bankruptcy exclusions to companies with weak financials.

As the world was struggling to contain COVID-19 through the second quarter, protests over the murder of George Floyd turned to rioting in some locations. Damage from riots is covered on property policies and most insurers have reported losses arising from the riots. As Q2 was coming to a close, exclusions for Strikes, Riots, Civil Commotion (SRCC) began to emerge on property quotes coming from some syndicates at Lloyd's of London. To date, this trend has not gained much momentum, especially since US insurers have not adopted an SRCC blanket exclusion. Instead, US insurers are applying tighter underwriting standards to locations deemed risky.

Let's now look at the developing trends by product segment.

D&O: Market Update

OUR POV

Public D&O rates continue to go up as increased litigation frequency and severity contribute to carrier losses, which drives premiums up.

MARKET TRENDS

- Market-leading carriers continue to seek large premium increases and upward adjustments on retentions, while in some cases simultaneously cutting limits; increases are generally more severe on excess layers. The COVID-19 outbreak has exacerbated these trends.
- The economic uncertainty created by the COVID-19 shutdown is resulting in more D&O litigation due to factors such as misleading statements about the outbreak, deceptive claims regarding potential vaccines and treatments, and privacy concerns; some underwriters are testing COVID-19 exclusions.
- As a result of the March 2018 *Cyan* decision IPO pricing and retentions have skyrocketed, though the recent *Sciabacucchi* ruling on federal choice of forum in the Delaware Supreme Court may provide some relief.

CONTEXT FOR CURRENT TRENDS

- Securities class actions are increasing in both frequency and severity.
- Number of total cases and likelihood of being sued have set new records in each of the past five years.
- 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 (McKesson, PG&E, Wells Fargo, Tesla...) tapping "A-Side only" insurance.

5%
Likelihood of Being Sued (all-time high)

7.2%
Litigation Rate for S&P 500

$13.6M
2019 Median Cash Settlement (10-year average $8.3M)

$37M
2019 Average Settlement (10-year average $29.8M)

D&O: Carrier Perspective

CARRIER POV

Inadequate compensation for risks assumed

REASONS WHY PREMIUMS ARE GOING UP					
	Same # of publicly traded companies + more SCAs = higher frequency	Increasing severity of derivative actions	Continuous innovation by plaintiffs' bar	Event litigation & follow-on suits from regulatory actions	Claim cost inflation + social inflation

"In North America, areas that we focused on for improved financial performance [in Q1] include our excess casualty, which achieved over 30% rate increases, **financial lines overall and D&O specifically, which achieved over 20% and 40%, respectively**...

– Peter Zaffino, President, COO & CEO, General Insurance, **AIG**

"From a rate perspective, although, there are a number of unknowns with COVID-19, I do not believe the dynamics that underpinned the hardening market over the past 18 months have fundamentally changed. If anything, the outlook for the protracted low interest environment has deteriorated. **So, I think rate movement should continue at the current pace throughout 2020, and we have seen that in April.**

– Dino Robusto, Chairman & CEO, **CNA**

"Now most of our business units within professional lines [in Q1] saw double-digit pricing increases… **Public and private D&O showed impressive average increases of over 40% and 25%, respectively. We're definitely entering hard market territory in these lines."**

– Albert Benchimol, President & CEO, **AXIS**

"...Out of every event, and every event creates trial bar, ambulance chasing, drive-by shooting where they get most of the money and the supposed aggrieved get very little. **I have no doubt that there will be COVID-related D&O suits related to price drop and disclosure, et cetera.** And frankly, it is frivolous. It is an unnecessary tax on business and society at this point."

– Evan Greenberg, Chairman & CEO, **Chubb**

Property: Market Update—Mid-Sized Organizations

OUR POV

Losses directly impact capacity which, in turn, impacts premiums—increased claims and losses and past undervaluation continue to push rates up.

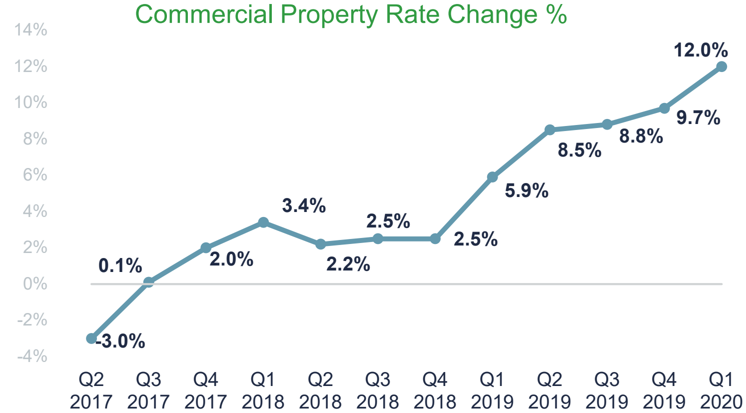
MARKET TRENDS

- Insurers are continuing to quote rate increases.
- +4% to +25% rate increases for standard renewals.
- +20% to +50% rate increases, or non-renewal, for problematic accounts.
- Problematic accounts classified as loss-driven, no demonstrated commitment to risk improvement, or catastrophe-prone.
- Many carriers are putting increased emphasis on verifying reported values following losses revealing undervaluation.
- Retail occupancies are seeing increased deductibles and premiums due to looting losses.

CONTEXT FOR CURRENT TRENDS

- 2017/2018: The 2017 hurricanes, 2018 wildfires, hail, and multiple large risk losses significantly hurt profitability for carriers.
- 2019: Carriers focused on underwriting and rate adequacy after years of rate decreases and expanding policy terms.
- 2020: Carriers with January 1st reinsurance treaty renewals saw increased costs (10%+ increases). Losses from damages resulting from riots have been significant.

Commercial Property Rate Change %



Source: The Council of Insurance Agents & Brokers

Property: Carrier Perspective

CARRIER POV

Commercial property pricing in the United States has increased every month since October 2017.

REASONS WHY PREMIUMS ARE GOING UP:

1) The Commercial Property insurance industry has been losing money. In fact, the P&C industry has been above a 100 combined ratio in 6 of the last 9 years. Only 2013–2015 were profitable, explained by extremely low losses from natural disasters.

2) Low interest rates are impacting insurer investment portfolios.

3) Non-catastrophe losses (i.e. hail and water damage) have been increasing at an accelerated rate over the last few years.

4) Decreased capacity—insurers are cutting limits and alternative capital has pulled back.

> In terms of rate increases, rates for major accounts were up 13%. And in Westchester and Bermuda, they were up 16% and 42%, respectively."
>
> Regarding COVID-19 and insurance, "For the most part, except for those customers who discretely purchased it, BI insurance doesn't cover COVID-19. It covers and requires direct physical loss to a property."
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> – Evan Greenberg, Chairman & CEO, **Chubb**

> Our property policies require direct physical damage to the property from a covered peril for coverage to attach. And on property policies. whether issued in the US or international, all have exclusions barring coverage for viruses. So, **with respect to business interruption, our property policy exclusionary language does not provide coverage for COVID-19**, and as such we never collect a premium for it."
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> From a **rate perspective**, although there are a number of unknowns with COVID-19, I do not believe the dynamics that underpinned the **hardening market** over the past 18 months have fundamentally changed. If anything, the outlook for the protracted **low interest rate environment** has deteriorated. So, I think rate movement should continue at the current pace throughout 2020, and we have seen that in April."
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Property: Market Update—Large Organizations

OUR POV

Losses directly impact capacity which, in turn, impacts premiums—increased claims and losses and past undervaluation continue to push rates up.

MARKET TRENDS

- Insurers continue to quote rate increases.
- Problematic accounts—loss-driven, no demonstrated commitment to risk improvement, or cat-prone—have higher rate increases or non-renewal.
- Many carriers are putting increased emphasis on verifying reported values following losses undervaluation.
- Retraction in capacity in the Insurance-Linked Securities (ILS) market due to trapped capital and cooling of investor appetite.
- Retail occupancies are seeing increased deductibles and premiums due to looting losses. Most London markets now exclude Strike, Riot and Civil Commotion losses.

CONTEXT FOR CURRENT TRENDS

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+9% to +30%

Rate increases for standard renewals

+30% to +90%

Rate increases or non-renewal for problematic accounts

Property: Carrier Perspective

CARRIER POV

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Cargo and Stock Throughput: Market Update

OUR POV

Losses directly impact capacity which, in turn, impacts premiums—increased losses continue to push rates up.

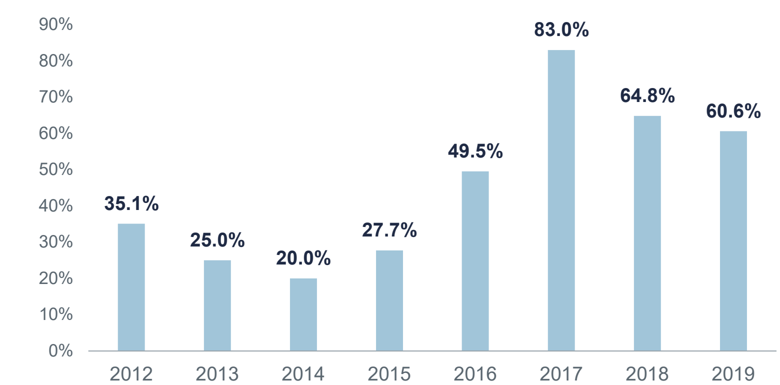
MARKET TRENDS

- Cargo-only policies with good loss history are seeing single-digit rate increases.
- Stock Throughput policies are seeing rate increases from 12% to 50%; companies with significant losses are seeing even larger increases.
- Companies with transit exposures in Mexico are seeing warranties that require special security procedures.
- Most Lloyds markets are excluding losses from strikes, riots, or civil commotion.
- The following occupancies are seeing the largest rate increases:
  - Pharmaceuticals, Food, Wineries, & Retail

CONTEXT FOR CURRENT TRENDS

- The Marine Cargo industry was not profitable in 2016, 2017, or 2018.
- In 2019, several Lloyd's Syndicate locations were closed following the decile 10 review, reducing available capacity.
- 2020 is already off to a challenging start for Cargo market: The tornado that hit a Dell storage facility in Nashville, TN resulted in one of the largest individual stock losses the Lloyd's insurance market has seen in years. Carriers are seeing significant losses from looting following riots.

Proportion of Lloyd's syndicates reporting underwriting losses



*Excludes quota share SPAs without separate underwriting teams, syndicates in run-off and RITC syndicates
Source: S&P Global, Insurance Insider

Cargo and Stock Throughput: Market Perspective

MARKET POV

The Marine market continues to adjust to the efforts of the Lloyd's of London market to improve profitability.*

HIGHLIGHTS OF CARRIER BEHAVIOR

- Neon will no longer offer Maritime insurance through Lloyd's. Lloyd's is considered the foundation of Maritime insurance.
- Swiss Re closed its Ocean and Marine Cargo unit in 2019.
- Carriers who have remained in the marine market are taking corrective actions such as increasing rate and deductibles while decreasing capacity.

> "Lloyd's of London hard stop leaves Californian wineries in 'total crisis.' (Losses) resulted in Lloyd's taking a hard stance against wine stock halfway through 2019, leaving the US domestic market under great pressure to provide the much-needed coverage."
>
> – Bethan Moorcraft, **Insurance Business America**

> "Premiums for marine insurance, which until 2018 had fallen for years due to rising competition and lower claims, are increasing after a surge in catastrophe losses in the past two years and growing geopolitical tensions. For **Lloyd's, still reeling from two years of losses due to the heavy claims from natural disasters, it will still take 12-24 months before the segment returns to profit, Chief Executive John Neal told *Reuters* in New York.**"
>
> – Carolyn Cohn, Jonathan Saul, & Suzanne Barlyn, **Reuters**

> "**Lloyd's of London Reviews Marine Insurance Market as Losses Mount**
>
> Lloyd's of London Ltd., a marketplace that controls about a fifth of the global marine insurance market, is reviewing a number of loss-making members, a move that could drive up costs for insuring the world's ocean carriers.
>
> The review comes after a loss of $2.6 billion at Lloyd's last year and involves a number of Lloyd's 80-plus insuring groups that have been unprofitable for the past three years."
>
> – Costas Paris, **The Wall Street Journal**

> "Lloyd's 2019: 60% of syndicates still generated underwriting loss. The proportion of loss-makers falls 4 points from 2018 but is three times as high as 2014."
>
> – Catrin Shi and Khilan Shah, **Insurance Insider**

*Luke Callin, Reinsurance News

Casualty: Market Update

OUR POV

Umbrella and Excess Liability rates rising at fastest rates in decades due to reductions in capacity and increased frequency of huge liability claims. Soft WC market starting to harden due to insurer fears related to COVID-19.

MARKET TRENDS

- Insurers continue to maintain increased discipline in risk selection and pricing development.
- Continued adverse claims development for Commercial Auto and General Liability is prompting insurers to continue to seek high single-digit rate increases
- WC rate reductions are slowing after years declining prices due to insurer uncertainty over the impact of COVID-19.
- Excess Liability underwriters are demanding rate increases for historically underpriced layers and instituting "look-up provisions" to prevent liability tower price inversion.

CONTEXT FOR CURRENT TRENDS

- Years of decreasing Casualty rates coupled with a recent surge in large liability losses have left current Casualty premium levels generally inadequate relative to future loss expectations
- Nuclear jury verdicts involving huge punitive damages awards are driving up the value of settled claims and prompting Excess Liability insurers to obtain rate increases for even well-managed risks.
- Capacity has become difficult to secure at any price for risks with high perceived severity potential: communicable disease (in real estate, hospitality, facilities management), wildfires, mass shootings, certain chemicals, e-cigarettes.
- Commercial Auto underwriting results, which have delivered net losses to underwriters since 2010, continue to deteriorate despite recent rate increases.

By-Line First Quarter 2020 Rate Changes Ranged From -1.2% to +17.3%

Period	Auto	WC	GL	Umbrella
Q1 2020	9.6%	-1.2%	5.7%	17.3%
Q4 2019	10.5%	-1.9%	5.8%	13.6%
Q3 2019	9.1%	-2.7%	4.6%	9.8%
Q2 2019	8.4%	-2.5%	3.2%	5.7%
Q1 2019	8.8%	-3.3%	2.0%	3.3%

Source: CIAB Q4 Rate Survey

Casualty: Carrier Perspective

CARRIER POV

Continued Fear of Catastrophic Liability Claims Drives Rate Increases

HIGHLIGHTS OF CARRIER BEHAVIOR

- Increased attachments for Umbrella policies
- Underwriting discipline in demanding increased premiums and reduced limits, even for high excess.
- New focus on coverage terms and conditions, particularly related to COVID-19

What CIAB member brokers are saying about Umbrella rates:

- **80%** reported rate increases.
- **75%** reported increase of 10%–50%.
- **80%** reported reduction in Lead Umbrella limits.

- CIAB Rate Survey, Q1-2020

"Another possible cause for Umbrella's increases was a market correction. Respondents said that Umbrella had been 'historically underpriced' and 'premiums have been flat for many years.'"

Council of Insurance Agents & Brokers, May 27th, 2020

"We are and will continue to benefit in terms of growth from improved technical conditions as many insurance companies take actions to reduce exposures or improve their rate to exposure to correct for inadequate underwriting."

- Chubb, Q1 2020 Earnings Call

Cyber Liability: Market Update

OUR POV

Pricing is increasing and terms are tightening. Ransomware and regulatory changes are driving increases in frequency and severity for carriers. Many clients analyzing limits given changing risk environment.

MARKET TRENDS

- Both frequency and severity of losses are increasing for most carriers—led by ransomware attacks.
- Sweeping regulatory changes around consumer privacy rights driving increased concerns over more costly losses on the horizon
- Board oversight of cyber and privacy risk is increasing as a result of changing workplace dynamics such as remote working.

CONTEXT FOR CURRENT TRENDS

- Ransomware was the largest attack style in 2019, as attackers pivoted towards enterprise-level targets with ransom demands in the millions and higher. Companies now being publicly shamed for not paying ransom.
- Penalties for violations of privacy laws such as GDPR and CCPA are steep—through direct fines or private rights of action granting statutory damages.
- Securities class action and shareholder derivative suits following high-profile data breaches have boards asking more questions about cyber risk and insurance. Notable suits: Yahoo, Equifax, Marriot, FedEx, Capital One.

25%

Growth in frequency of ransomware attacks from Q4 2019 to Q1 2020

33%

Growth in severity of ransomware payments from Q4 2019 to Q1 2020

Cyber Liability: A Closer Look at the Trends

CARRIER POV

The Impact of Growing & More Sophisticated Cyber Attacks

HIGHLIGHTS OF CARRIER BEHAVIOR

- Many carriers now asking more underwriting questions with regards to backup procedures to stem ransomware risk.
- Hiscox has retreated from manufacturing and construction risks due to losses in the space.
- Rates are firming across Technology E&O exposed risk, as well as excess Cyber placements due to losses sustained.

Ransomware threat is growing

- 25% growth in frequency of ransomware claims from Q4 2019 to Q1 2020, according to Beazley.
- 33% growth in average ransomware payment during Q1 2020 compared to Q4 2019, according to Coveware.
- 15 days average downtime from a ransomware infection during Q1 2020 according to Coveware.

Privacy regulation is taking hold

- GDPR fines: 4% of annual revenue
- CCPA fines: up to $7,500 per violation (read: *per consumer*)
- CCPA private right of action: Statutory damages between $100–$650 per consumer
- IL BIPA private right of action: up to $1,000 per individual
- 18 States considering similar consumer privacy legislation

Board oversight of cyber and privacy risk is increasing

- Many boards now require annual, or more often, privacy and cyber risk update
- Cyber risk analytics are key to supporting cyber insurance limit decision
- Security frameworks (e.g., NIST, CIS Top 20 Controls) provide structure for boards/management to facilitate discussion
- Cyber incidents more frequently leading to SCA claims against company and directors and officers

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