

Spring/Summer Market Update



May 2020

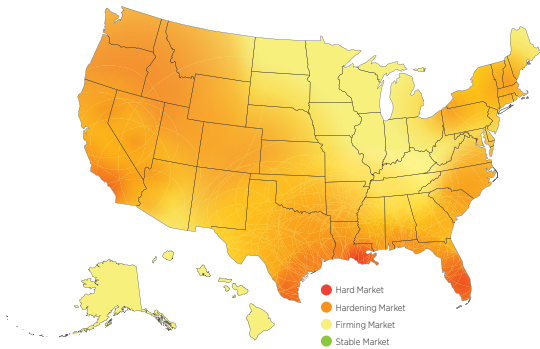


Gallagher

Insurance | Risk Management | Consulting

The disruption caused by COVID-19 has had a pronounced effect on our businesses and our lives. Across the insurance industry, communication channels have stayed open, submissions are being underwritten, and our client’s insurance renewals are being bound.

The table and heat map below show overall pricing, and most lines of coverage are firming or hardening in the current marketplace.



LINE OF COVERAGE	CURRENT MARKETPLACE (Range of rate increases)
CAT Property*	Greater than +10%
General Property	Greater than +5%
General Liability	+5% to +10%
Umbrella	Greater than +10%
Management Liability (Private)	Flat to +10%
Management Liability (Public)	Greater than +20%
Auto	+5% to +15%
Workers' Compensation	-5% to +5%

*CAT property is defined as a location portfolio with exposure to catastrophic loss (i.e., California EQ, flood, Florida/Texas/Gulf Coast—wind/hail, the Carolinas, etc.).

However, this is not the case for many of our clients who may have had to temporarily close their doors or scale back operations. Recognizing the difficult times these clients are facing, many of our carriers have offered relief through extended payment terms, and are allowing midterm exposure changes and premium reductions.

The legislative front is very active as state insurance regulators are issuing various orders to support policy holders in their respective states. These orders have ranged from requiring carriers to extend payment terms to issuing return premiums on certain lines of coverage. While we continue to monitor these updates on behalf of our clients, the position some of our carriers will take on these orders remains uncertain.

Leading up to Q2 2020, what had been driving the marketplace was fairly simple — for years, the industry’s rates hadn’t kept up with the loss cost trends. Put another way, rates stayed flat, but costs went up. In a normal operating environment (where interest rates are above 0%), insurance carriers can still make money on the investment income portion. When you combine interest rates holding at 0% for an extended period of time with severe weather and concerning liability trends (more on both of those later), you get the majority of businesses experiencing sizable increases in 2019 for the first time in years.

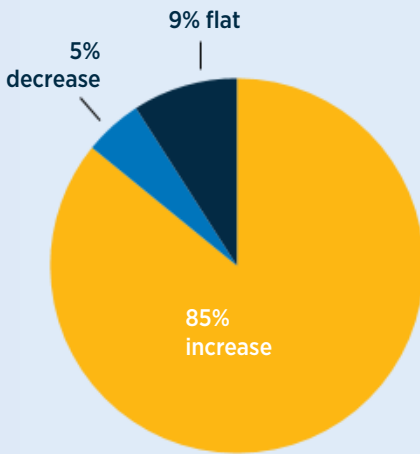
While much of the recent focus has been on the industry’s response to COVID-19, the challenging market conditions that were reported in our Market Update last quarter haven’t slowed down. Carriers remain intensely focused on underwriting discipline, ensuring they secure the right terms and pricing on certain lines of coverage that have historically not performed from an underwriting standpoint. As a result, we continue to see extreme differences in how the market is responding between classes and sizes of business.

Taking this into account, we will focus on these key general trends.

- 1. Property:** Overall costs accelerated faster than anticipated in Q1 2020.
- 2. Workers’ compensation:** Pricing remains competitive but is increasing for the first time in years.
- 3. Casualty:** Continued negative impact by mega verdicts.
- 4. D&O:** Public company D&O is the most distressed line of coverage in the marketplace.
- 5. Cyber:** Exposures have shifted with the changing nature of the remote workforce.
- 6. Hardening market:** Still exists in pockets.

Q1 Property Rate Changes

Gallagher — U.S. Clients



85%
of clients saw a
rate increase in Q1.

Historically, the second and third quarters are the largest from a CAT storm perspective. Catastrophic storm activity for the remainder of this year is still an unknown.

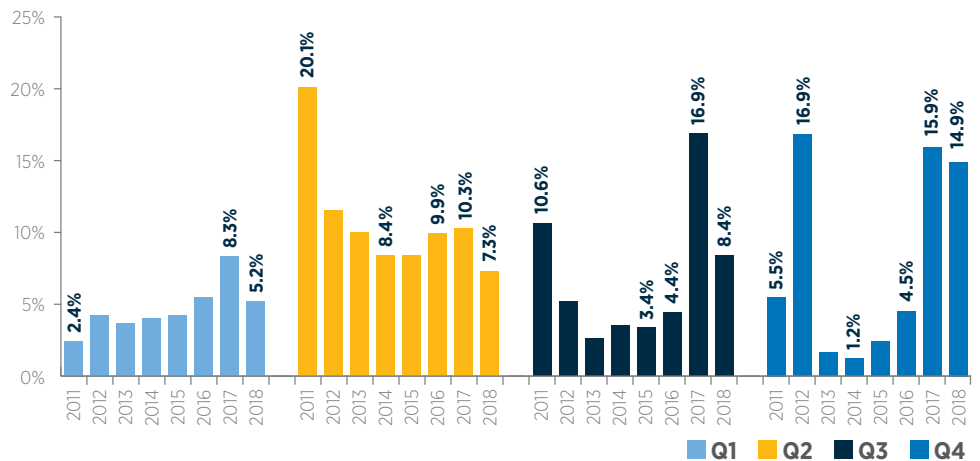
Property

Overall property costs accelerated faster than anticipated in the first quarter of 2020. Like many other lines of insurance, the property marketplace needed to increase rates to offset the increase in loss costs. In addition to rising rates, carriers have scaled back on discretionary limit deployment, and issued tougher terms and conditions.

- 85% of Gallagher clients saw a rate increase in Q1 2020, the highest number recorded since the early 2000s.
- Large national property clients (with TIV > \$150 million) saw average rate increases at 20.2%.
- Increasing deductibles, shrinking sublimits (especially CAT), and carriers' conservative limit deployment have led to less favorable terms and conditions for clients.
- The only monoline property carrier in the marketplace has been under duress, which has created challenges for the large national account space.
- Some industries — including habitational, public sector, healthcare, plastics, molten metals and clients with CAT exposure (including hail) — are seeing above-average rate increases and a generally harder market than the rest of the marketplace.
- The rise in attritional (non-catastrophic) storm losses continues to impact the industry. Total economic losses were estimated in excess of \$1.1 billion from the March 2020 storm system that produced several tornadoes and large hail in Tennessee, Missouri, Kentucky, Mississippi, Georgia and Texas, according to the National Oceanic and Atmospheric Administration ([NOAA](#)). The majority of these losses were covered by insurance.
- With the uncertainty regarding COVID-19 and carriers' potential exposure to business income losses, all eyes will be on the upcoming CAT season.

CATASTROPHE CLAIMS BY SEASON

Catastrophe claims as % of total claims

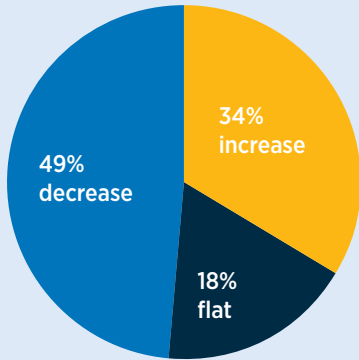


Losses are net of reinsurance but include loss adjustment expenses. Sources: ISO PCS; Insurance Information Institute calculations: <https://www.iii.org/presentation/industry-update-yesterday-today-and-tomorrow-101519>

Based on the above, as well as the uncertainty around the COVID-19 pandemic, we expect the current conditions in the property marketplace to continue, if not accelerate, through the end of 2020.

Q1 Workers' Compensation Rate Changes

Gallagher — U.S. Clients



49%
of clients saw a
rate decrease in Q1.

Workers' Compensation

Overall workers' compensation costs increased slightly in the first quarter of 2020. We predict that reduced exposures, negative rates and lower-than-expected claim frequency will lead to reduced premiums for insureds, and a better-than-expected combined ratio for carriers.

- Claim frequency was lower in the first quarter during the pandemic.
- Many businesses have transitioned to remote working models in order to promote social distancing, which resulted in a reduction in exposure and likely a reduction in claims as well.
- Our data is showing lower Q1 workers' compensation rates, which is also noted in other public sources of information, including [Ivans](#) (-1.81%) and [MarketScout](#) (-1.25%).
- Certain industries tied to the COVID-19 crisis, such as construction, healthcare, food and agriculture, etc., face an increased risk of exposure.
- There are many scenarios and prognostications about COVID-19, and the possibility that presumption of compensability may be extended to all employees could impact the workers' compensation industry.

» The National Council on Compensation Insurance (NCCI) estimates the effect of the pandemic and the extension of presumption to all workers could cost anywhere from \$1 billion to \$80 billion in states where NCCI tracks claims data (38 states, or about 50% of the country's direct written premium). In California alone, the estimate is that essential workers could cost anywhere from \$2 billion to \$34 billion (about 20% of U.S. direct written premium is in California).

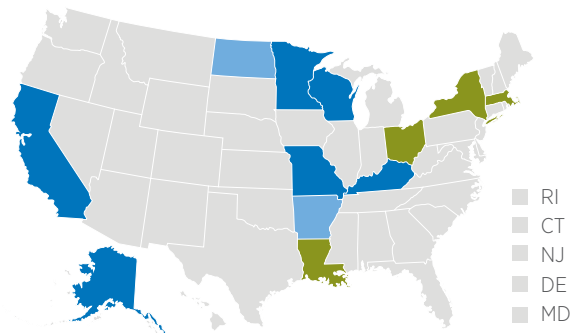
We expect the continued flat/soft workers' compensation marketplace to remain in place in the coming months. There are too many variables and assumptions at this point to predict what impact COVID-19 will have on the workers' compensation industry as a whole — the number of infected workers, jurisdiction of loss, severity of loss, compensability regulations, etc. However, it is reasonable to assume higher losses will eventually come in the long term, followed by higher premiums.

COVERING FRONT-LINE WORKERS

States are changing their rules and laws to make it easier for healthcare workers, firefighters and others to receive workers' compensation coverage if they get infected with COVID-19.

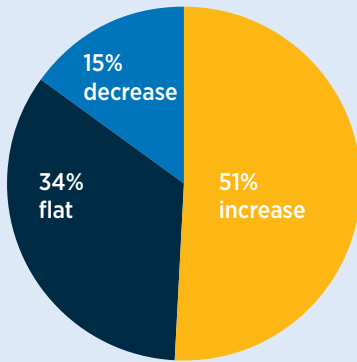
- Infected workers are presumptively eligible for workers' compensation
- Modified rules making it easier for workers to get benefits during quarantine
- Pending legislation

[Source: National Council on Compensation Insurance, May 2020](#)



Q1 Primary General Liability Rate Changes

Gallagher — U.S. Clients

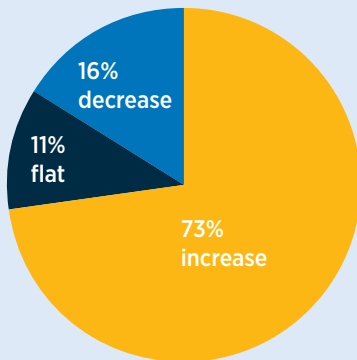


51%

of clients saw a
rate increase in Q1.

Q1 Auto Liability Rate Changes

Gallagher — U.S. Clients



73%

of clients saw a
rate increase in Q1.

Primary General Liability

General liability costs continued to rise in Q1, as the overall legal landscape shifted in the U.S.

- The frequency of large judgments, increases in litigation financing and an empowered plaintiff bar continue to challenge our industry.
- The median average verdict for the top 50 cases in the U.S. has doubled in the last four years.*
- Clients with tougher product exposure, or those operating in healthcare or other sectors where they are susceptible to higher frequency of lawsuits, can expect larger rate increases.
- An item the industry will certainly watch is whether there is a liability exposure arising from failure to adequately follow and communicate public health guidelines such as their responsibility to provide personal protective equipment (PPE).
- Insurance carriers are beginning to introduce or enhance their communicable disease exclusions in response to COVID-19.

Even though loss costs have been rising, plenty of capacity remains. We expect a firming rate environment to continue, with rate increases in the mid to high single-digit range for desirable risks.

Auto Liability

Despite several years of price increases in auto liability, rates continued to increase in Q1 as the price increases continued to not keep pace with the increases in claim frequency and severity.

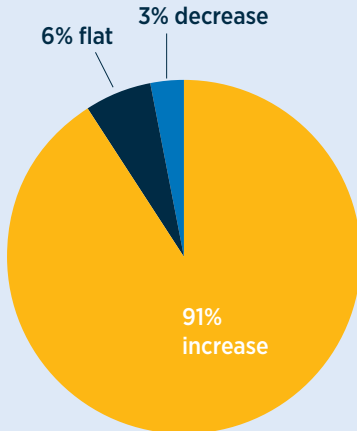
- Loss costs are rising as new technologies make vehicles more expensive to repair. We expect carriers to continue to push rate increases across the board in auto liability.
- Maybe more so than any other line of coverage, auto insurance has been directly impacted by COVID-19 with some estimates that vehicle usage is down 50% since mid-March.

Almost every major auto carrier for personal lines of insurance has outlined plans for premium rebates to customers, largely in the 15% to 20% range for two months. How will the commercial insurance sector respond to this change in exposure? We are expecting to see auto rates level off with the reduction in exposure (miles driven) related to COVID-19.

* Source: [Shaub, Ahmuty, Citrin & Spratt](#).

Q1 Umbrella/Excess Liability Rate Changes

Gallagher — U.S. Clients



91%

of clients saw a
rate increase in Q1.

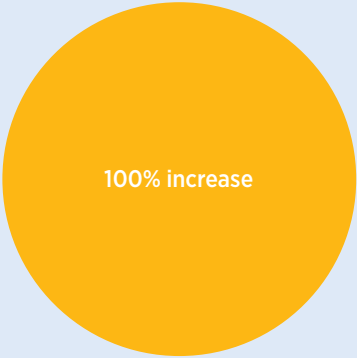
Umbrella/Excess Liability

Umbrella and excess liability placements have been greatly impacted by social inflation (generally defined as an increase in insurance costs due to rising litigation, larger jury verdicts and overarching anti-corporate sentiment in the economy). Q1 rates continued to climb to their highest levels in recent years.

- Social inflation goes to the sensibility of juries and how that translates into the expected value of claim outcomes.
- Carriers are concerned with a litigation environment so favorable to plaintiffs and climbing jury verdicts. Examples of some of the headline claims that are driving the umbrella/excess marketplace:
 - » **Active shooter:** hospitality, \$800 million settlement, late 2017
 - » **Class-action lawsuit:** product liability, \$2 billion to \$10 billion settlement, late 2018
 - » **Product liability/completed operations:** \$143 million settlement, late 2019
 - » **Active shooter:** retail, \$70 million settlement, mid-2019
 - » **Class-action lawsuit:** product liability, \$4.69 billion verdict, mid-2019
 - » **Sexual assault victim awarded:** real estate, \$1 billion, mid-2018
- Carriers are pushing significant rate increases — more than 15% on most renewals — with sharper increases on clients with heavy auto fleet exposure or operating in higher hazard industries.
- Carriers are also restricting the amount of limit they are willing to put forth or repositioning their capacity at a higher level. For example, carriers that have historically offered lead \$25 million umbrella policies are now limiting their lead positions to \$10 million or less in most cases.
- Capacity management has been a recurring message from the market. Carriers want to limit their exposure to these higher umbrella/excess layers. We have had multiple instances of clients not being able to buy the limit they purchased last year because of lack of availability.
- Umbrella and excess lines carriers are beginning to introduce or enhance their communicable disease exclusions in response to COVID-19.

Underwriters need to return to making money underwriting. Accordingly, we do not expect much change in the casualty environment for the rest of 2020. General liability and auto costs will continue to climb modestly, umbrella/excess pricing will rise, higher umbrella/excess layers will be limited, and the industry will keep a careful watch over the impact of COVID-19 on the workers' compensation marketplace.

**Q1 Primary D&O Rate Changes -
Public Companies**
Gallagher — U.S. Clients



100%
of clients saw a
rate increase in Q1.

Directors and Officers

More so than any other line of coverage, D&O is more bifurcated between public and private companies. Privately held companies with favorable loss histories are still seeing modest rate increases, whereas publicly held companies face an entirely different marketplace, as listed below.

Capacity

- Carriers are often reducing capacity.
- Some carriers have a moratorium on new public D&O business.
- Fewer and fewer carriers wish to write primary and first excess D&O layers.

Terms and Conditions

- Speculation on a COVID-19 exclusion.
- Bankruptcy exclusions are possible.
- Prior acts exclusions on new limits.

Pricing

- Very dependent on market segment, financial condition, claims history and current pricing.
- Unfavorable industries have seen or may soon see 50% to 80% increases. Most favorable sectors may still see 10% to 20% increases.
- Typical commercial D&O renewals can expect increases of 30% to 50%.

Market Segments of Most Concern

- Hospitality
- REITs (retail)
- Airlines
- Restaurants
- Retail
- Entertainment
- Automotive

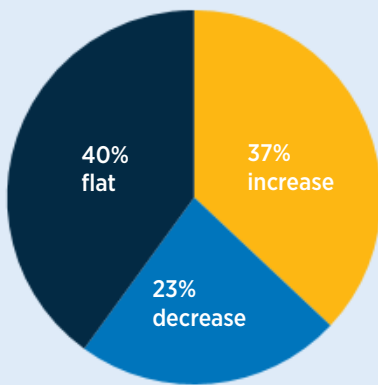
Also of Concern

- Life sciences
- Technology
- Large market caps
- Construction
- Higher education

Other Tips (All Companies—Public and Private)

- Discuss guidance philosophy with outside counsel. Be prepared to share with D&O underwriters.
- Reevaluate insider trading policies and windows (public).
- Review risk factors and disclosures with respect to operations in light of COVID-19 (and in general) with outside counsel.
- Be prepared to proactively address COVID-19 impact with D&O underwriters.

Q1 Cyber Rate Changes
Gallagher — U.S. Clients



77%
of clients saw a
rate increase or
remained flat in Q1.

Cyber

The Market Hardens

As predicted in the beginning of the year, the cyber insurance market hit an inflection point in the first quarter of 2020. All signs indicate that we have moved from a long period of flat to falling cyber insurance premiums to a marketplace where underwriters are regularly seeking rate increases in an approximate range of 5% to 20%. This trend cuts across most industry sectors and only some of the smallest of subject matter experts have been spared, most of which are seeing flat renewals.

The hardening cyber market has been driven mostly by an increase in frequency and severity of ransomware claims that manifested in 2019 and continue into 2020. The 2020 Beazley Breach Briefing* reported a 131% increase in ransomware attacks compared to the previous year. Additionally, reports of seven- and eight-figure ransom demands are becoming more common.

Heightened Cyber Risk: COVID-19 and the Remote Workforce

With the sudden onset of COVID-19 in March, the majority of the global workforce was moved to remote locations in an effort to stop the spread. In doing so, it became apparent for many organizations that their staff may be operating in an environment that is inherently less secure than their normal office space. Questions were raised regarding insecure Wi-Fi networks, the usage of personal devices, videoconferencing platforms potentially being open to cyber attacks and whether or not the increased strain on IT networks could lead to business interruption losses.

While we have not seen an abnormal rise in frequency in cyber claims directly attributed to employees working outside their normal environments as of this writing, there is evidence of several COVID-19-themed criminal phishing campaigns that are being aimed directly at the remote workforce.

Take Steps to Assess Your Cyber Risk

- Review cyber policies to evaluate the scope of coverage, and how it may cover cyber losses related to the use of employee-owned devices and remote networks. Specific focus should be concentrated on how a policy might define “computer networks,” “computer systems” and other key terms.
- Be aware that cyber claims costs for business interruption losses are almost always impacted by waiting periods before coverage will apply and limited to a specific period of restoration.
- Review policies carefully to see whether any portion of the loss may be covered. For example, if faced with a social engineering loss, it is possible that lost funds may not be covered in the cyber policy, and that other policies, such as crime policies, may apply.

The Hardening Market Still Exists in Some Pockets

While the hardening market is not as severe as compared with the market of the early 2000s, pockets of the marketplace certainly resemble that of a traditional hard market.

PROPERTY

- » Limits: \$50 million+ TIV
- » Frame/hab/auto/dealer
- » CAT exposure
- » Molten metals
- » Food/agribusiness
- » Plastics/polycarbon tech
- » Any locations with large hail exposure
- » Outstanding engineering recommendations

UMBRELLA EXCESS

- » Large limits: \$25 million+ capacity has diminished, and pricing has dramatically increased (mega-verdicts)
- » Any underlying exposure with a large fleet
- » Any underlying exposure with a moderate hazard GL exposure (especially construction)

EXECUTIVE LINES

- » Limits: \$15 million+
- » Publicly traded D&O
- » Sexual abuse and molestation

INDUSTRIES

- » Senior living
- » National accounts
- » Transportation/logistics
- » Marine
- » Habitational
- » Nonprofit
- » Public sector

Conclusion

The duration of the pandemic, the full magnitude of its economic impact and the subsequent impact on the insurance industry remain unknown. However, the underlying fundamentals we see with the environment today are likely to continue for some time. There's nothing that indicates the momentum will slow. If anything, it's picked up in recent months and is spreading more broadly.

Due to the highly nuanced nature of this market, it is imperative that you are dealing with an insurance broker who specializes in your particular industry and/or line of coverage.

Gallagher has a vast network of specialists that understand your industry and business, along with the best solutions in the marketplace for your unique challenges.

About the Contributors

Linton "B." Puckett is responsible for the leadership of Gallagher's national Market Relations practice. In this role, B. is responsible for developing and managing strategic carrier and intermediary relationships in Gallagher's U.S. Brokerage division. B. leads SmartMarket, Gallagher's platform that couples data with a dedicated engagement model to enhance carrier relationship strategies. B. also leads Gallagher's Client Advantage strategy, which partners with carriers to bring proprietary products and solutions to clients.

Linton B. Puckett

Vice President of Market Relations for Gallagher Global Brokerage — U.S.

Linton_Puckett@ajg.com



Linton B. Puckett

Mark Stachura is responsible for the leadership of Market Relations & Placement, and developing and managing strategic carrier relationships in Gallagher's Central zone. In addition, Mark is responsible for all placement teams and activities within the Midwest, South Central and Great Lakes regions.

Mark Stachura

Regional Vice President, Market Relations & Placement for Gallagher Global Brokerage — U.S.

Mark_Stachura@ajg.com



Mark Stachura

For more information, contact your local Gallagher representative.

For up-to-date information regarding COVID-19, please visit ajg.com/pandemic



Gallagher

Insurance | Risk Management | Consulting

The Gallagher Way. Since 1927.

Gallagher provides insurance, risk management and consultation services for our clients in response to both known and unknown risk exposures. When providing analysis and recommendations regarding potential insurance coverage, potential claims and/or operational strategy in response to national emergencies (including health crises), we do so from an insurance/risk management perspective, and offer broad information about risk mitigation, loss control strategy and potential claim exposures. We have prepared this commentary and other news alerts for general informational purposes only and the material is not intended to be, nor should it be interpreted as, legal or client-specific risk management advice. General insurance descriptions contained herein do not include complete insurance policy definitions, terms and/or conditions, and should not be relied on for coverage interpretation. The information may not include current governmental or insurance developments, is provided without knowledge of the individual recipient's industry or specific business or coverage circumstances, and in no way reflects or promises to provide insurance coverage outcomes that only insurance carriers control.

Gallagher publications may contain links to non-Gallagher websites that are created and controlled by other organizations. We claim no responsibility for the content of any linked website, or any link contained therein. The inclusion of any link does not imply endorsement by Gallagher, as we have no responsibility for information referenced in material owned and controlled by other parties. Gallagher strongly encourages you to review any separate terms of use and privacy policies governing use of these third party websites and resources.

Insurance brokerage and related services to be provided by Arthur J. Gallagher Risk Management Services, Inc. (License No. 0D69293) and/or its affiliate Arthur J. Gallagher & Co. Insurance Brokers of California, Inc. (License No. 0726293).