Adjusters International
The *right* way to settle claims®

Insights for Your Industry®

PROTECTING YOUR PROPERTY

Navigating a Hardening Property Market

By: Kyle Gibbs

If you haven't done so already, **now** is the time to factor insurance premium volatility into this year's budget. With the insurance market having favored the insured for quite a few years now, concern for predicting next year's premium has been less than usual. Instead, a figure has been estimated, perhaps indexed a few points and then put in the budget. It has been a relatively easy value to forecast. Unfortunately, times have changed: the insurance market is hardening!

What is a Hard Market?

According to the International Risk Management Institute (IRMI), a hard market is "the upswing in a market cycle, when premiums increase and capacity for most types of insurance decreases. This can be caused by a number of factors, including falling investment returns for insurers, increases in frequency or severity of losses, and regulatory intervention deemed to be against the interests of insurers."

Characteristics of a Hard Market

In a hardening market, carriers show less desire for growth while placing more restrictions on underwriting eligibility criteria. Carriers analyze their books of business and adjust their risk appetite and capacity in the marketplace. They focus on correcting adverse loss ratios that were developed during the soft market.

As a result, insurance rates increase, capacity decreases and even the total number of carriers participating in the market decreases. Ultimately, it becomes more difficult for the insured to find the coverage needed

and their negotiating power becomes limited — if not eliminated — altogether.

Market Change is Cyclical

It's hard to anticipate the cyclical timing of market hardening and softening. Impacts can be severe or volatile, with premiums increasing an average of 10 percent to 60 percent, and in some cases even higher. The following chart, prepared by Broker USI Insurance Services and reformatted by the *Insurance Journal,* forecasted the impact of rate changes across various property/casualty insurance lines.

According to the forecast chart on page 2, property categorized as Non-CAT with good loss history is projected to see upwards of a 20 percent increase in premium rates. Meanwhile, CAT-prone property with minimal loss history is facing a 40 percent-plus increase in premium. Furthermore, whether a property is CAT

Sheila E. Salvatore, Editor | Editor@AdjustersInternational.com
Copyright © 2020 Adjusters International, Ltd. All Rights Reserved.

800.426.0677 | aipnw.com
Insights for Your Industry® is published as a public service by Adjusters International, Ltd.
It is provided for general information and is not intended to replace professional insurance, legal and/or financial advice for specific cases.
E04-1021

Navigating a Hardening Property Market

Continued

or Non-CAT, these insureds could see upwards of a 60 percent or more increase in their premium if they have a poor loss history.

Reducing the Impact

With the market hardening, organizations will feel the impact on their income statement. This could mean all divisions are forced to make cuts to their budget, employment, etc. However, with proper forecasting, analysis and planning, the severity of the impact on net income can be reduced. Quarterly or bi-annual assessments can help identify trends or changes in the market. In turn, organizations can properly and effectively make changes as needed to deal with the forecast more proactively rather than reactively. This effort is often lead by the finance and risk team.

Two areas of the property policy that might be analyzed to reduce an organization's premium cost are Limits and the Coverage Form.

USI Rate Forecast by Product Line

Product Line	Midyear Update	Q4 2019-2020
Property Non-Catastrophic *Good Loss History*	Up 10%	Up 10% to 20%
CAT Property *Minimal Loss History*	Up 10% to 40%	Up 25% to 40% +
CAT or Non-CAT Property *Poor Loss History*	Up 10% to 40% +	Up 30% to 60% +
Primary General and Products Liability	Flat to up 15%	Up 5% to 10%
Primary Automobile Liability *Fleet Lower than 200/Good Loss History*	Up 5% to 10% +	Up 15% to 25%
Primary Automobile Liability *Fleet lower than 200/Poor Loss History*	Up 15% +	Up 10% to 15%
Umbrella & Excess Liability *(Middle Market Buyers)*	Up 5% to 20% Layers possibly reduced	Up 10% to 25% (Factors in contraction of limits)
Umbrella & Excess Liability *(Risk Management Buyers)*	Up 5% to 20% Layers possibly reduced	Up 10% to 25% (Factors in contraction of limits)
Directors and Officers Public Company	Up 10% to 30% +	Up 25% to 50% 100% + if "troubled"
Private Company Management Liability	Up 5% to 10%	Up 5% to 20% 20% is claim dependent
Crime	Down 5% to up 5%	Up 5% to 25% Due to Social Engineering
Network Security & Privacy *(Cyber Insurance)*	Flat to 5%	Flat to 10%

SOURCE: USI COMMERCIAL PROPERTY & CASUALTY MARKET OUTLOOK — Q4 2020

Sheila E. Salvatore, Editor | Editor@AdjustersInternational.com
Copyright © 2020 Adjusters International, Ltd. All Rights Reserved.

Insights for Your Industry® is published as a public service by Adjusters International, Ltd. It is provided for general information and is not intended to replace professional insurance, legal and/or financial advice for specific cases.
E04-1021

Navigating a Hardening Property Market

Continued

Limits

Upon receiving their renewal premium invoice, organizations will typically look to reevaluate their limits as a way to reduce cost. Unfortunately, simply reducing limits is often not a wise decision without conducting a very thorough analysis. This could involve calculating the probable maximum loss, reassessing asset values and better understanding the organization's long- and short-term strategies.

Moreover, insureds will quickly learn that simply reducing their limits might not provide the financial relief they are seeking, but rather could actually put them in a situation where they are underinsured. In the following example, it is important to understand that the primary layers of insurance can be the costliest because the carrier(s) providing the limit is taking on the initial risk — which dramatically contributes to the majority of the premium cost.

Scenario: Manufacturing Company ABC has $400 million in limits on their property portfolio with a Total Insured Value (TIV) of $1.5 billion. The TIV is comprised of five locations with multiple buildings at each location, plus other associated business property and business income. Each of the five locations has a Probable Maximum Loss (PML) of $100 million; so in a catastrophic event, if all five locations simultaneously experienced an event — where the PML for each location was reached — then there would not be enough insurance to bring the insured back to whole or pre-loss condition.

There will most likely be multiple insurance carriers providing limits to make up the total of $400 million. The primary layer in this example is $100 million and makes up for 75 percent of the overall premium — with a quota share of four carriers each providing limits based on capacity they are willing to underwrite. The excess layer is $300 million and makes up the remaining 25 percent of the premium.

After a quick analysis, if limits were reduced by 75 percent, there could be a cost savings of 25 percent. It should be noted, however, that the insured already does not insure to the organization's total PML, so by reducing limits by 75 percent, the insured could leave themselves in a vulnerable situation.

The flip side to the argument to reduce limits could be that the PML's are higher than they need to be because the buildings are very old and would never be rebuilt to in-kind Replacement Cost Value (RCV). In this instance, the statement of values could be readdressed and the associated assets could be assessed based on their functionality and what it would cost to rebuild

Copyright © 2020 Adjusters International, Ltd. All Rights Reserved.

Insights for Your Industry® is published as a public service by Adjusters International, Ltd. It is provided for general information and is not intended to replace professional insurance, legal and/or financial advice for specific cases.

Navigating a Hardening Property Market

Continued

to today's functionality. Also, coverage forms could be considered to be changed to Actual Cash Value (ACV) or Agreed Value (AV), as buildings could still serve the same purpose but be replaced for less than they would cost to rebuild to the specs that applied when they were originally constructed. Without a very thorough analysis these decisions should not be made.

Coverage Form

While the limits as noted above can be changed to reduce premium, directly associated with these limits are the coverage forms. Most commonly used for property insurance are the RCV, ACV and AV forms. RCV guarantees to replace/rebuild the destroyed/damaged property as it would have been when it was originally constructed. ACV, on the other hand, is RCV minus depreciation. AV is the agreed value between the insured and insurance carrier, at the requested value of the property.

An AV form will waive the coinsurance requirement. Coinsurance requires that property be insured to the RCV by 80 percent to 90 percent, or whatever percentage the carrier requires. If the property is insured to less than the coinsurance requirement, then a penalty will be applied when recovery is sought following a loss. The following example will look at the impact of insuring to a value below the coinsurance requirement.

Scenario: Property limit is insured to a value below the coinsurance requirement. The resulting impact: Coinsurance penalty and reduced recovery.

Building limit:	$50,000,000
Value of the building:	$100,000,000
Coinsurance:	80%
Limit of insurance should be:	$100,000 x 80% = $80,000,000
The amount of insurance purchased is only 63% of the amount required ($50,000,000/$80,000,000). Coverage is afforded for only 63% of the repair cost.	
Cost to repair damage:	$30,000,000
63% of the repair cost is	30,000,000 x .63 = $18,900,000
Deductible	$1,000,000
The amount payable on RCV	$17,900,000

NOTE: Above example does not consider any depreciation being deducted from the cost of repairs.

In this scenario, if an organization believed they were willing to assume the risk and reduce limits to below the coinsurance requirement, they could see a cost savings upfront on a reduced premium — but ultimately reduce their amount to recover on should a loss occur.

Copyright © 2020 Adjusters International, Ltd. All Rights Reserved.

Insights for Your Industry® is published as a public service by Adjusters International, Ltd. It is provided for general information and is not intended to replace professional insurance, legal and/or financial advice for specific cases.

Navigating a Hardening Property Market

Continued

Next, we will discuss Probable Maximum Loss, as mentioned earlier. This is a point every risk advisor should understand well.

Understanding Probable Maximum Loss (PML)
Probable Maximum Loss is the expected loss at a given location in the event of a fire or other catastrophic event, quantified and expressed in a dollar value or percentage.

While underwriters use this tool to forecast potential loss scenarios, it is a good practice for any organization to use in-house as well. By multiplying the value of the business property by the highest expected loss percentage, you will be on your way to get the PML. The tricky part is determining the value of the business property and the expected loss percentage.

Scenario: Manufacturing Company XYZ has five locations and each has the same set of business property, with the same values. To calculate the PML, we will assume that the business property at location number one has a value of $125 million. We will then assume that the risk measures in place will mitigate the highest expected loss by 20 percent. By then multiplying the $125 million by 80 percent (the highest expected loss percentage), we have our PML of $100 million for location number one. Since we know that each location has the same set of assets and values, we can go a step further and calculate the PML for the entire organization's five locations giving us a PML of $500 million.

While the PML is not the true replacement cost of the business property, it is a good practice and method to understand when reviewing property insurance

and evaluating the organization's risk. Now that we understand what a hard market is, and the potential impacts, we can better navigate methods to prepare our organizations.

Note that this scenario does not consider business income valuations and the potential loss of business income associated with the physical loss to the business property.

How to Best Prepare Your Organization for a Hard Market

Conduct a Risk Assessment
- Asset identification
- Risk analysis
- Risk likelihood and impact
- Costs of solutions

Copyright © 2020 Adjusters International, Ltd. All Rights Reserved.

Insights for Your Industry® is published as a public service by Adjusters International, Ltd. It is provided for general information and is not intended to replace professional insurance, legal and/or financial advice for specific cases.

Navigating a Hardening Property Market

Continued

Strengthen relationships
It is essential to build strong working relationships with your broker(s) and underwriters. The goal is that all parties know the risk associated with your business property and the best methods to insure against possible loss or preventative measures to put in place. You are on the same team — and efforts and goals should be transparent. A strong line of communication will help build a better understanding of what lies ahead in the market, which will allow for better planning.

Conclusion
Markets are cyclical and while a hard market is always looming, it matters how decision makers respond and prepare for it. A proactive approach and investing ahead of time in risk measures such as forecasting, etc., can be more cost effective then reactively reducing limits and changing coverage forms to quickly reduce premiums. As explained earlier, the latter can result in reduced recovery should a loss occur.

While it might seem easier to look the other way, the most effective way to deal with a looming hard market is to forecast and properly prepare for it. The effort and resources invested will provide for a stronger and more risk-adverse future for your organization.

Special Note: *In wake of the COVID-19 pandemic, it should be understood that the principles and theories referenced here apply in normal times. In this unprecedented time, however, policies and coverages will be looked at with many new eyes and from many new angles. While no one knows yet what the ultimate outcomes will be, government will become involved and policies and their associated coverages will likely undergo change.*

About the Author
Kyle Gibbs, Risk Manager for the Philadelphia Regional Port Authority, has spent the past decade building his career in the fields of insurance and risk management along with disaster recovery. Working through catastrophic disasters and complex insurance programs, Mr. Gibbs brings unique perspective to the table.

Sheila E. Salvatore, Editor | Editor@AdjustersInternational.com
Copyright © 2020 Adjusters International, Ltd. All Rights Reserved.

800.426.0677 | aipnw.com
Insights for Your Industry® is published as a public service by Adjusters International, Ltd.
It is provided for general information and is not intended to replace professional insurance, legal and/or financial advice for specific cases.