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# The cost of risk in a changing market - Spencer Macalaster

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Spencer Macalaster

The last couple of years was defined by an unprecedented number of varied natural catastrophes, political and social unrest, COVID-19 variant concerns, supply chain crisis and surging ransomware attacks. As we enter the second quarter of 2023 and look to the future, the cost of risk in our dynamic environment will be determined by how insurance carriers underwrite these risks and how businesses evolve and manage their risks.

The following factors and events are part of what is driving market transformation and they will continue to fuel change in the insurance industry for the foreseeable future.

• Severe Weather Events: Severe weather events are now occurring almost every year, creating a frequency of severity situation. Unanticipated events such as the Texas freeze last January, and the unexpected tornado event ravaging the Kentucky plains in December, are becoming all too common. These natural catastrophes are hitting carriers hard, with billions in insured losses estimated due to the Kentucky tornado alone. Events such as the before mentioned, Ida, Uri, the European floods and others have all affected end-of-the-year reinsurance renewals and will carry over to property insurance premiums in the new year. Catastrophic loss estimates are over $200 billion.

• Shock Loss: Whenever a tragic and terrible event occurs, underwriters tend to narrow terms, raise rates and in some cases withdraw from similar exposures. When the Surfside condominium collapsed in June 2021, insurers tightened their underwriting for habitational real estate even further than they had previously. As a result of hurricane Ian, the Florida market is in chaos. California wildfires have resulted in several carriers exiting the state. As a result of these unforeseen events and the resulting reaction by the insurance industry, scrutiny will be given to underwriting these types of exposures and well-engineered, well-protected risks will fare better than the rest.

• Cyber Liability: The increase in frequency and severity of ransomware attacks over the last two years has impacted profitability for insurers across the marketplace. As a result, carriers have taken corrective action by increasing rates, increasing self-insured retentions, reducing capacity and carving back coverage. Carriers remain concerned about the potential for ransomware attacks and systemic events that could impact their entire portfolios.

After significant losses due to the above concerns and others, carriers continue to adjust to remain profitable. They are managing capacity, being more judicious about the limits offered, tightening underwriting requirements, raising rates and in some cases declining renewals.

Combining these issues with the ever-increasing jury awards, aka “social inflation”, the predictive modeling that has historically been used by carriers may be, in some cases, less credible, so underwriters are looking to alternative ways to set rates. Their research and analytics have become more sophisticated and more applicable to our uncertain time, using tools such as updated, more stringent flood maps to reduce coverage where possible.

For cyber liability, IT risk management and prior-to-loss education has become a key focus for underwriters. They are raising awareness of the problem and refusing to cover companies who cannot demonstrate proper cyber risk management protocols.

In many lines of business, given the events mentioned above, the traditional admitted market structure has become stressed for those underwriters in the space. Tough risks continue to shift to the excess and surplus (E&S) lines market. Habitational Real Estate, CAT Property/Western Wildfire, Security Market Line (SML) exposed risk and others continue to find their way to the E&S Market. This shift helps alleviate the availability and capacity issue, but the affordability aspect is still quite stressed and coverage terms can be considerably narrower.

With many commercial markets remaining hard, businesses across industries are turning to captives as an alternative risk management strategy. Within Risk Strategies, the Captives group is one of our fastest growing practices. Our growth has been fueled by insured's seeking to control their long-term exposures and costs. We have seen captives grow in popularity in other hard market periods, as businesses see them to reduce their overall insurance spend and take better control of managing their risk. However, captives are not a one-year solution that an organization can enter and exit as rates fluctuate. Captives are a long-term risk management strategy that offers insureds a way to control their own destiny.

Going forward it will be extremely important for corporate management to build strong relationships with their underwriters. Loss prevention measures combined with claims management and strong contractual protection present the best possible risk to the underwriters. Building risk management relationships with your broker and underwriters will allow for the negotiation of the most competitive program the markets will offer.

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