MARSH JLT SPECIALTY

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Construction Insurance Market

2020 Pacific Insurance Market Recap

MARSH

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SECTION 1

Global construction market snapshot

The global construction market's dynamics have shifted significantly in the last 12-18 months, with an unprecedented number of insurers exiting the market. Many insurers have placed their construction books into run-off, with almost US$1 billion of capacity withdrawing from the market in the last 18 months. Despite market moves to increase rates, to date we have not seen any major new entrants to the construction market.

Globally, a series of high profile power, hydroelectric, and oil/gas project failures have intersected with a number of natural catastrophes in recent years, including active hurricane and typhoon seasons, flash floods, and landslides. This has resulted in significant losses for construction insurers across the globe. Such market-defining losses throughout 2018 and 2019 have demonstrated that the construction sector is not immune to major events. Consequently, several insurers have withdrawn from the construction sector, as a result of deteriorating profitability.

COVID-19 exacerbates transitioning market

Government restrictions and lockdowns imposed across various countries in an effort to control the spread of COVID-19 have led to business disruptions and economic downturns. Insurance markets across the globe responded swiftly by limiting their exposure via new policy exclusions. While the market and brokers continue to discuss and review the various COVID-19-related policy exclusions and clauses, insurers are now considering coverage restrictions on all new placements in the construction sector.

COVID-19 has impacted construction sites across the world, in particular leading to extended periods of cessation of works. In the Pacific region, the construction sector was deemed an essential service and therefore continued to trade with project sites staying open through 2020. Indeed, there were disruptions, but fortunately no complete site closures.

The factors above, coupled with the limited availability of reinsurance capacity, continue to push the market to a state of transition.

FIGURE 1

Global composite insurance pricing change

SOURCE: MARSH GLOBAL INSURANCE MARKET INDEX, Q4 2020

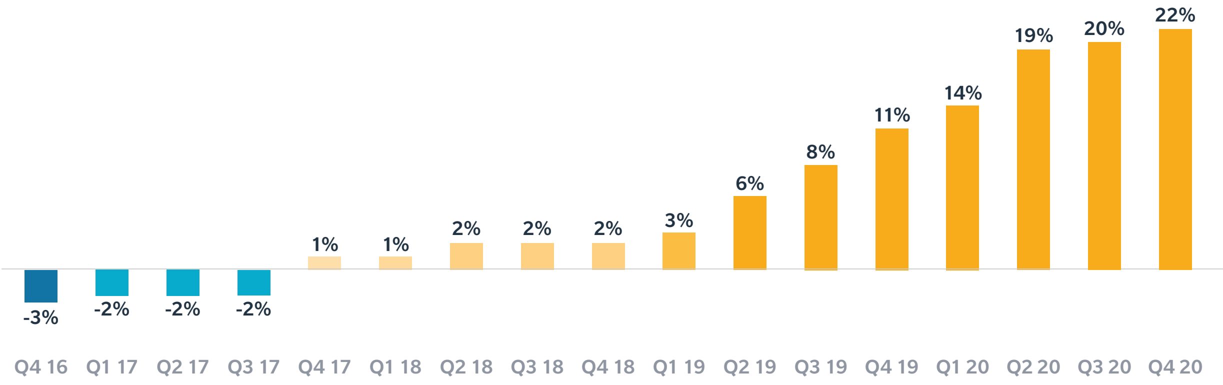
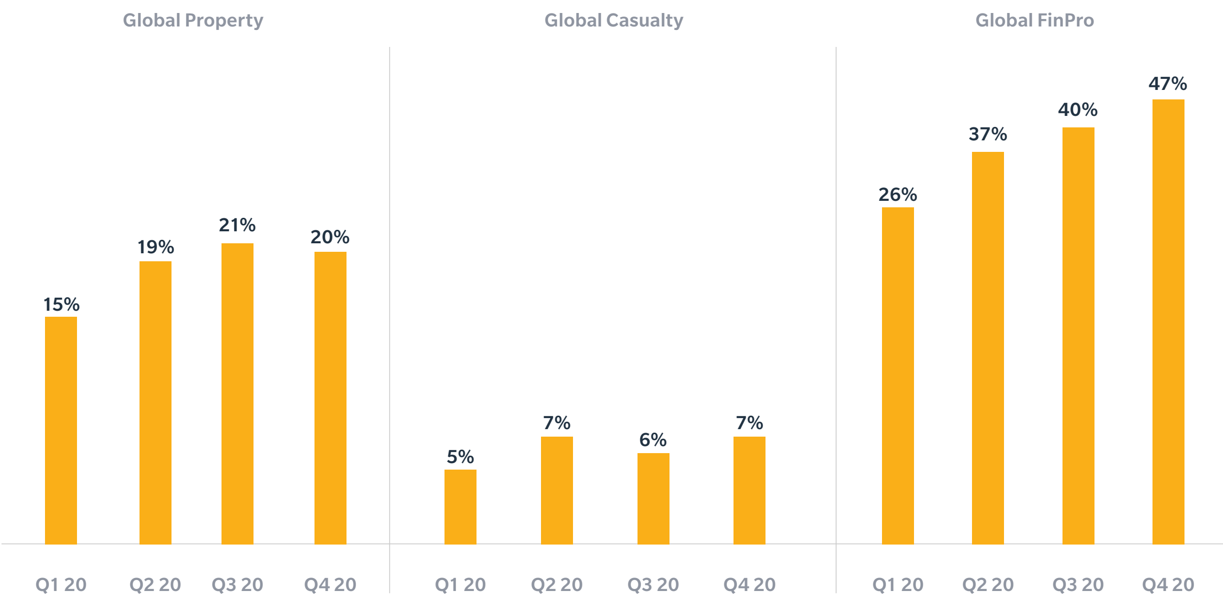


FIGURE 2

Global composite insurance pricing change — by coverage line

SOURCE: MARSH GLOBAL INSURANCE MARKET INDEX, Q4 2020



SECTION 2

Pacific region construction market

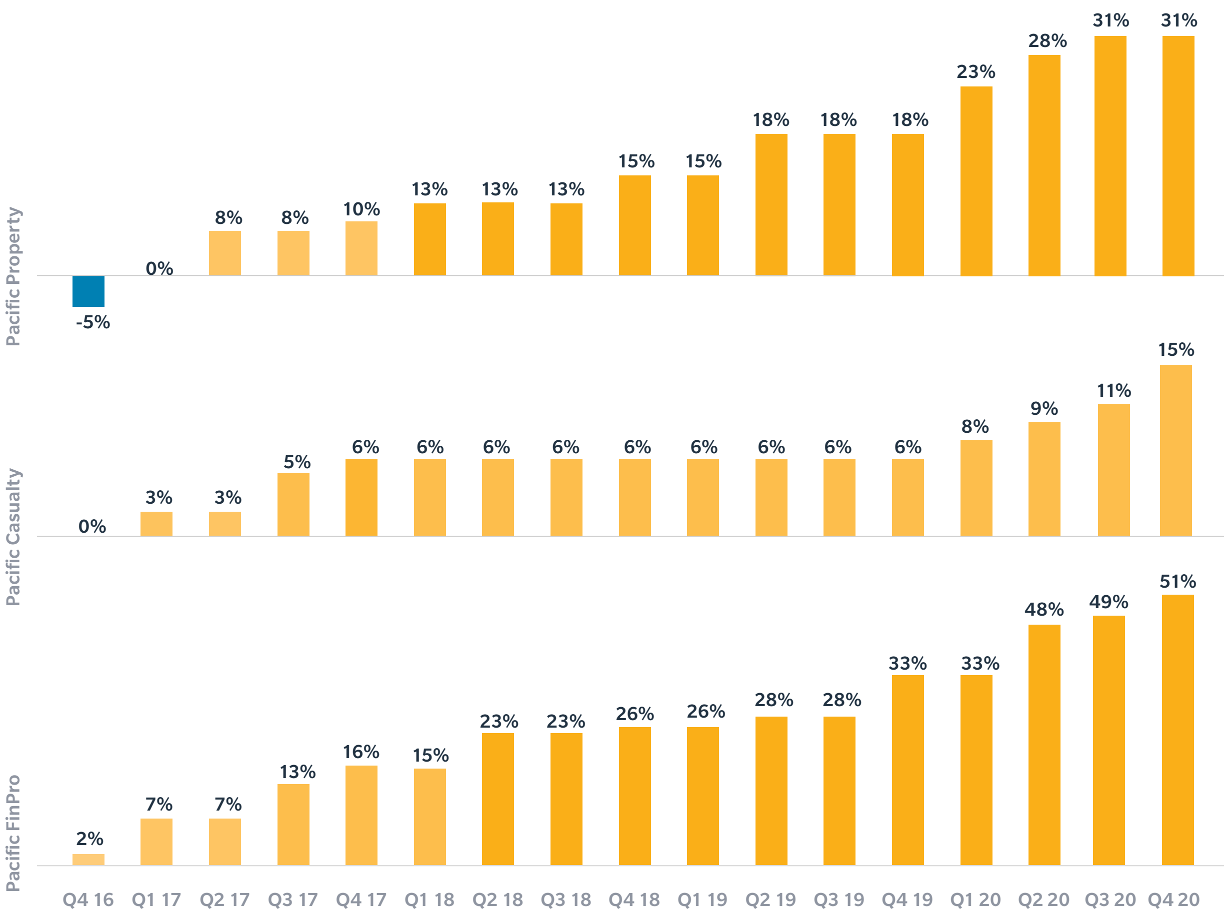
Similar to global construction market trends, the Pacific region has seen an overall reduction in market capacity and an increase in pricing. Financial and professional lines experienced average pricing increases of 51% across their portfolios in the fourth quarter of 2020. Note that this reflects all lines and is not construction specific, although construction professional indemnity (PI) premium increases have been substantial.

All composite lines of insurance (including property and casualty) are on an increased rate trajectory.

FIGURE 3

Pacific composite insurance pricing change — by major coverage line

SOURCE: MARSH GLOBAL INSURANCE MARKET INDEX, Q4 2020

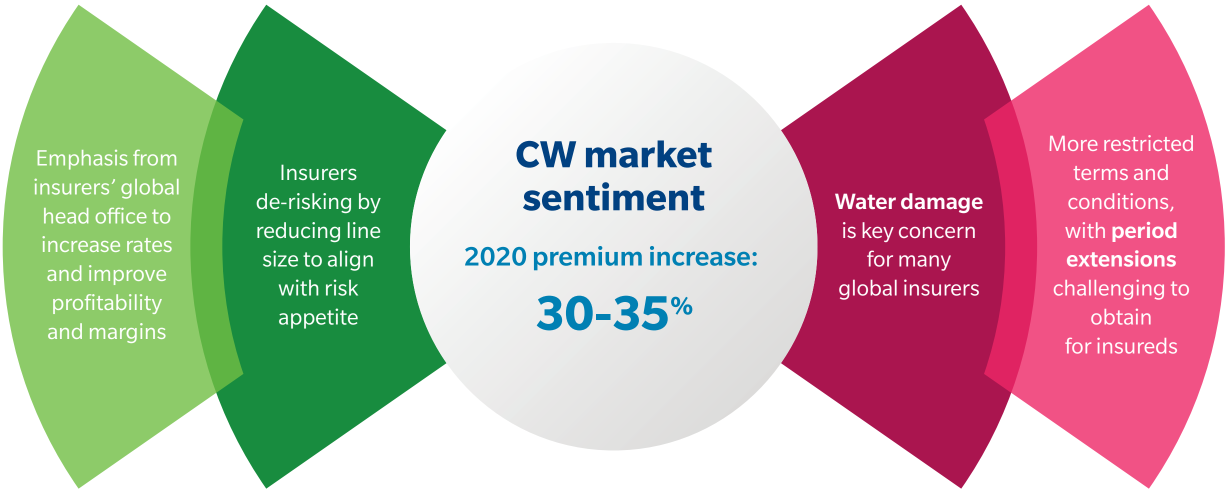


The next section provides the year-in-review for the Pacific region in relation to the following construction specific insurance classes: contract works (CW), construction third party liability (TPL), and construction professional indemnity (PI).

Contract works (CW) insurance market

FIGURE 4

CW market sentiment 2020



In the last 12-18 months, 15 global lead markets who were active in the Pacific region withdrew from underwriting construction risks and providing CW insurance, resulting in a significant reduction in market capacity of approximately US$1 billion.

Major markets walked away from risks that do not meet strict underwriting guidelines as insurers' global head offices adopt an underwriting approach focused on technical adequacy and profitability.

Average premium increases of 30%-35% were observed throughout 2020 within the CW market.

A sustained period of falling insurance premiums and broadening coverage within construction is now making way for a shift towards increased premium rates, higher excess levels, and more restrictive coverage.

Coverage and underwriting trends

The following trends have been observed across the CW market globally, and have also had a direct impact on local markets:

- Insurers are no longer under pressure from their management to write new business. The emphasis has shifted to writing business at profitable terms and conditions.
- Reinstatement coverage relating to delay in-start up (DSU) insurance is increasingly challenging to obtain.
- Project extensions and policy changes require longer negotiation times, further complicated by the fact that some markets no longer write this class and are in run-off. Simple extensions and policy changes that were negotiated and agreed with insurers without issue previously can now create a challenge.
- Stricter guidelines mean underwriters are required to obtain approvals from global head office for large or complex risks. Once lead terms (based on technical rating models) and referrals are approved, approaching the non-successful lead markets to seek support to other lead terms is challenging as underwriters are restricted from deviating from their original approved terms. Consequently, many underwriters are waiting for lead terms to be finalised before considering their participation and starting the referral process.
- Insurers are placing greater emphasis on analytics and reliable data, particularly in respect of historic claims activity.
- Water damage is a key concern for insurers, with extensive claims activity for residential and building projects relating to risks of water ingress. As a result, premiums have increased and, in some instances, cover is sub-limited or excluded altogether.
- Some authorisation points for insurers have seen more input from head office or major hubs, which can delay new and existing policy negotiations.
- There has been significantly reduced market appetite for long contract periods, which is an indication that capital is moving away from long-term risk and back to short-term risk exposures.
- Within certain sectors, such as residential, some insurers are downsizing their portfolios, with fewer underwriters offering lead terms.
- Broader coverage terms and conditions are a challenge to obtain in the current market.

Major claims in the construction sector

The year 2018 proved to be catastrophic for international construction insurers with regard to loss activity, the impact of which is materialising over subsequent years. Not only has the market suffered from natural catastrophe events, there has also been several significant losses emanating from technical engineering aspects of projects.

While the natural catastrophe events will have been modelled and catered for in insurers' profit estimates, the combination of this with some unprecedented engineering losses has driven several insurers to review the long-term sustainability of their participation in construction.

This has been the case across a number of sectors but more so among high profile oil and gas, power, and hydroelectric projects affecting insurers' underwriting results.

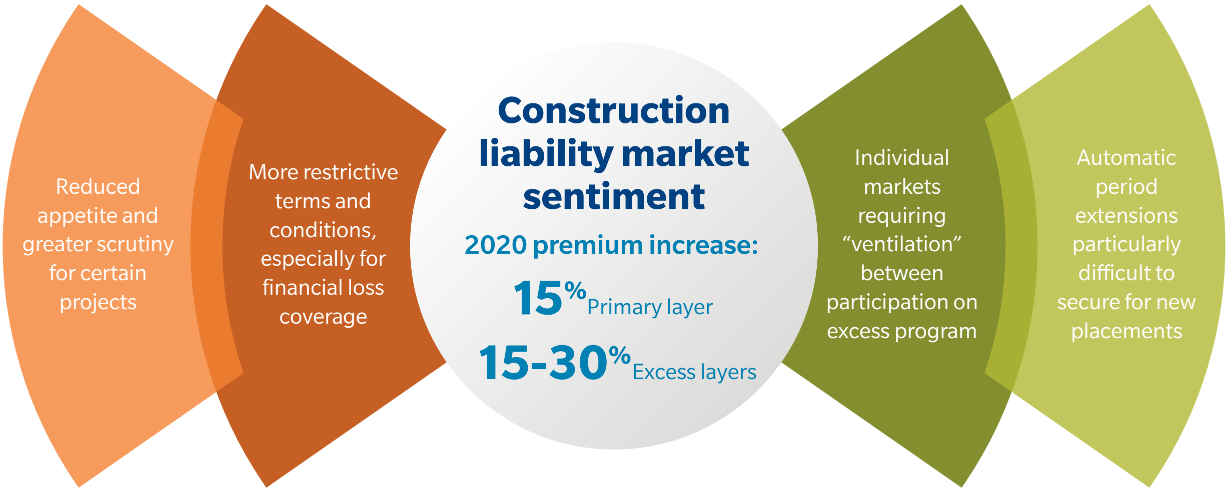
There has been extensive claims activity for residential and building projects relating to risks of water ingress. Escaping water claims account for over 60% of all claims within the London market.

All of this has directly contributed to the upward premium trend and more selective underwriting across the construction market.

Construction liability/casualty insurance market

FIGURE 5

Construction liability market sentiment 2020



Insurers are imposing more restrictive policy terms and conditions, in particular for financial loss coverage. On average, excess layer pricing increased at a higher percentage (15%-30%) than that of primary layers (15%) in 2020 across the construction liability insurance market.

Despite restrictions to coverage and increase in premium rates, capacity is still available in the market. In the last 12-24 months, three global markets that were active in the Pacific region withdrew from the construction third party liability (TPL) and construction professional indemnity (PI) markets.

Casualty insurers are looking more closely at their underwriting profits and cost of capacity. Similar to the CW market, there is a growing emphasis for insurers to write business at profitable terms and conditions only.

Coverage and underwriting trends

Some key coverage and underwriting trends observed in the construction liability market include:

- Project extensions and policy changes require longer negotiation times.
- Increasing use of sub-limits on certain extensions or restrictive terms. For example, reluctance to provide professional liability write-back cover in relation to property damage and personal injury.
- Increasing use of COVID-19 related coverage restrictions. Due to the long tail business nature of casualty lines, underwriting portfolios can take 10 years to develop.
- Automatic extension clause (previously at nil premium and/or pro rata) are challenging to obtain in current market.
- Financial loss coverage increasingly challenging to place.
- General desire from insurers to increase attachment points and require “ventilation” or gaps between layers on liability programs in order to spread their risk across a program and avoid over-exposure within an excess tower.
- Reduced appetite and greater scrutiny for projects involving airside and airport consequential loss exposure, tunneling risks for road and rail, US liabilities, marine works, COVID-19, cyber, thermal coal, dams, wildfire, and storms in the context of global warming.

SECTION 3

Where to from here

As the insurance market seeks to correct and re-balance, we expect insurers to continue to focus on writing profitable business and being more selective with their terms and conditions of providing cover for construction risk.

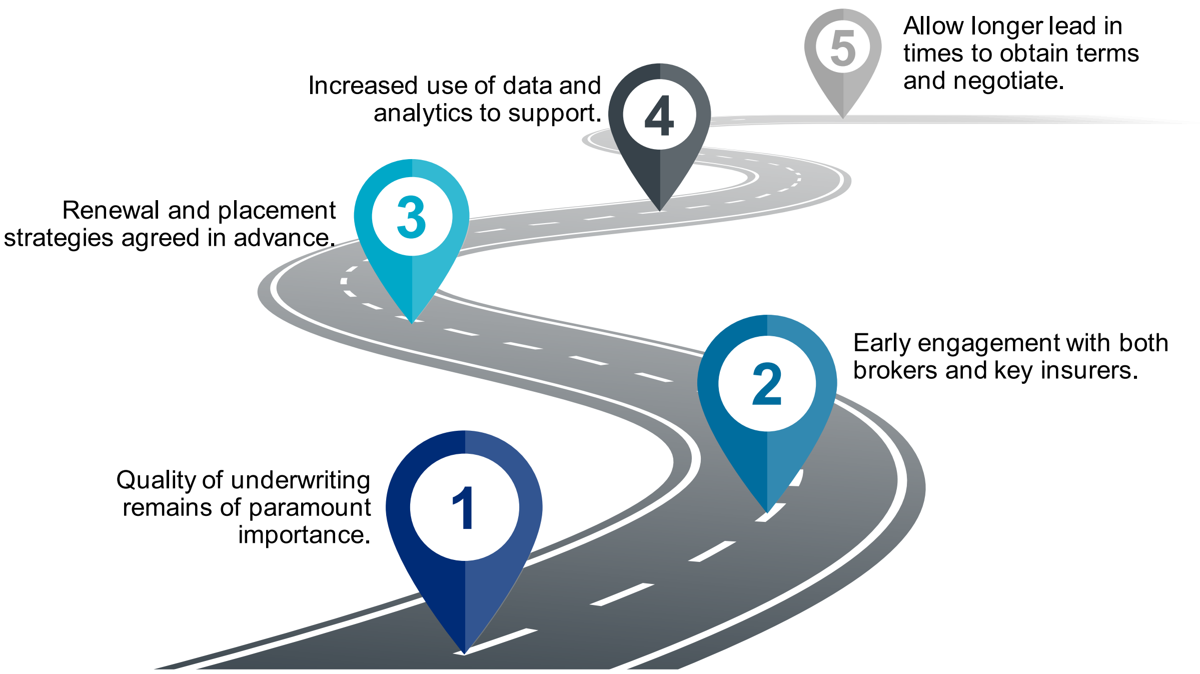
The treaty renewals completed on 1 January 2021 saw an increase in reinsurance costs for direct insurers, which will be passed onto insureds through premium increases. In addition, treaty reinsurers have indicated potentially moving away from "medium term" construction risks to shorter-term annually renewable risk exposures.

Despite a challenging market entering 2021, insureds can position themselves to generate better outcomes and navigate the market successfully in order to limit cost increases. It is important to invest time into working with your brokers to develop an organised and methodical risk transfer strategy.

The more effort dedicated in the early stages to developing and evaluating risk information, the more effective the risk transfer will be.

Those insureds that can continually demonstrate risk quality, articulate a proactive approach to reducing risk and associated capital spend, minimise claims experience, and maintain key insurer relationships will be best-positioned to obtain the broadest available cover and above average pricing changes.

FIGURE 6 Navigating your risk transfer successfully



ABOUT MARSH

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