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CONSTRUCTION PRACTICE

Construction Insurance Market in Asia: Increased Scrutiny, Higher Prices

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As insurance markets become more restrictive, data-centric underwriting submissions are central to successful placement.

After a prolonged soft market, construction insurance pricing began to shift at the end of 2018. Stricter terms and conditions followed increased pricing, challenging companies, many of which had little experience in a transitioning market.

Budget challenges were pronounced. Because the lead time between negotiations and tender award typically ranges between six months and one year, many companies faced discrepancies between insurance conditions outlined in a contract and what was commercially available. Often, because prices had climbed substantially, the original budget for insurance was no longer sufficient and insureds had to cover the discrepancies, eating into already thin profit margins.

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INCREASED UNDERWRITING SCRUTINY

Overall poor performance of the global engineering book has led to tighter underwriting guidelines and more control on capacity deployment. When setting terms, many insurers are carefully analyzing the experience and reputation of contractors and specialist subcontractors involved on a project as they decide whether to participate on a specific risk.

Underwriters also are carefully reviewing each project, and generally considering the experience and reputation of all contractors involved. Domestic markets are typically more competitive and able to offer favorable terms, meaning smaller and less complex projects are generally able to attract more competitive terms when there is adequate capacity from local carriers.

However, when insureds must seek coverage from international markets, they may be unprepared for the more stringent requirements. This is typically affecting larger projects that are unable to obtain the needed coverage from domestic markets. Circumstances may differ when there are Chinese, Korean, or Japanese interests involved in a project since these countries tend to have strong domestic insurers with more capacity, which they are able to offer to support domestic interests.

PANDEMIC EXACERBATES CHALLENGES

The COVID-19 pandemic and actions taken to stem its spread continue to pressure the construction industry. Projects – both new and ongoing – are generally experiencing significant delays, mainly due to:

- Difficulty bringing workers to sites in areas that are under a lockdown or where the authorities have imposed travel restrictions.
- Deteriorating economic conditions, leading to poor market demand.
- Reviews of project feasibility.

New health and safety measures necessitated by the pandemic, including increased social distancing at job sites, are likely to translate into additional operational costs. Further, many companies are experiencing delays in existing projects, with extended timeframes adding uncertainty.

Conditions are difficult across the construction market, although cost and coverage challenges are likely to vary between classes of insurance required by companies operating within the industry. Pricing and terms and conditions are heavily dependent on the type of project, its location, the different lines of cover needed, sums insured, and limits of indemnity, among other issues.

Current market conditions are unlikely to improve in the short to medium term. Cost continues to be a major challenge for companies, which are spending substantially more to secure required coverage. Changes in rates and terms continue to challenge insureds to budget appropriately and satisfy financing requirements.

Shrinking capacity means that most insurers are not competing for business in the same way as recent years, instead they are seeking terms based on their underwriting guidelines. Due to more stringent internal controls, underwriters often request changes to lead terms, even when those are coming from reputable or credible lead markets. Insurers also are being more restrictive with coverage limits and extensions, and are reluctant to offer automatic extensions on material damage policies, or offer them subject to low loss ratios.

TIME, DATA CRUCIAL FOR SUCCESSFUL PLACEMENT

Despite the ongoing challenges, insureds can take action to improve the possibility of obtaining the right coverage. Most importantly, companies need to allow enough time for the today's more thorough underwriting process. This requires starting underwriting discussions significantly earlier than they are accustomed to, ideally with at least 4 to 12 weeks lead time, depending on the nature of the project.

The underwriting process is becoming data-centric, with insurers requesting more detailed information than was typically required previously. Insureds need to work with their broker to present in-depth data that demonstrates their awareness of various risks and share their risk mitigation strategies. Insureds also should submit a comprehensive underwriting application that allows underwriters sufficient time to review.

In a fast-changing market, insureds face risks regarding the sufficiency of their insurance budgets, and whether terms and conditions as outlined in a contract will be commercially available at the time of placement. Companies should engage with their broker early on and remain updated on shifts in the market, including emerging policy exclusions and changes in terms and conditions that may need to be considered when bidding for a project. Your broker may be able to engage capacity that is not typically available in a region. Further, insureds need to ensure that their budgets allow for increased coverage costs.

As capacity continues to shrink from traditional classes of insurance and underwriting guidelines tighten, alternative risk transfer options, such as parametric cover, may become more relevant and cost effective to transfer risk. Your broker or advisor can help you identify the best risk tran sfer solutions.

SURETY

Surety underwriters in Asia are responding to the pandemic in various ways; some are retaining underwriting criteria, others are abandoning existing criteria except for specific accounts and adopting a wait-and-see approach.

Generally, surety underwriters are more carefully assessing projects, particularly for industries worse hit by the pandemic, including travel, aviation, and cruise ship operations. Although there have been some slight rate increases, most clients with a good track record and a very good financial standing have been able to maintain stable rates.

The pandemic’s overall effect on the construction industry — including supply chain disruption, halted projects, and a reduction in productivity — is contributing to more cautious underwriting. Sureties want to make sure that contracts include clauses that protect against certain risks, for example, a force majeure clause allowing for extensions.

Sureties continue to view each project case-by-case, examining clients’ financial strength, performance capability, and the viability of the project itself.

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