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GUEST COLUMN: 2023 Commercial Property Insurance Market Report: Mid-Year Update

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We're past the halfway mark of 2023, and it's been a year unlike any other for the commercial property insurance market. As the Council of Insurance Agents & Brokers (CIAB) stated in their Market Report, ***"Property as a whole experienced the quickest hardening market anyone can remember in a lifetime."***


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This likely isn't the first time you've heard we're in a hard property and casualty market, as we've been experiencing this phenomenon for 23 consecutive quarters according to the CIAB. But the property market in particular is in a heightened state of alert, if not panic – reeling from economic conditions and actuarial projections that have both missed their mark for several years.

We understand that this is a tough environment for our clients. You're focused on growing your business and creating economic opportunity, or even supporting the success of your community as a public entity or a nonprofit. M3 is committed to working with each of our clients to get the most competitive rate and coverage possible in this environment, so you can keep working toward your goals.

In this mid-year commercial property market report, we'll dig into the factors contributing to the hard market in commercial property, what the outlook is, and what this truly means for American businesses like yours.

The Basics: How Property Insurance Works

Your property insurance company very likely only inherits a certain amount of your risk. They do this for two primary reasons.

- They don't want to be on the hook in the event your individual loss exceeds a certain amount/threshold.
- They literally can't afford to be on the hook for an even bigger loss if a natural disaster causes a loss to you and many other companies they insure within a geographical area.

So, they turn to the world's reinsurers, those companies insuring the insurance companies we know and love. You've likely heard of them, but have probably never seen them on your insurance proposals or policies, names like Munich Re and Swiss Re. The reinsurance they provide primarily exists in two forms – treaty reinsurance and facultative reinsurance.

Treaty reinsurance is negotiated annually and is a pool of reinsurance that is available to a retail insurer for all risks they choose to insure each year. It has its boundaries, but it allows the retail insurer to generally use it at their discretion on an as-desired basis. The retailer can use part of this "bucket" of funds to transfer risk beyond that which they are comfortable inheriting in-house.

For example, let's say an insured has $100M of total insured values at a location, and the retail insurer is unwilling/unable to lose more than $20M in the event of a major loss. They access treaty reinsurance capacity from multiple reinsurers to get them to $100M so they can write the insured's entire property schedule while retaining only a portion of its exposure in-house.

Facultative reinsurance is acquired by retail insurers on an individual account basis. It can be purchased to increase capacity/limit beyond what the treaty insurance allows, or in place of treaty reinsurance if a risk is unique or unable to fit within a treaty's appetite.

It is through one or both avenues that your property insurance carrier limits their risk surrounding any one loss (and any series of losses) while still providing you with the amount of insurance you need to replace what you've insured through them.

The Property Problem

Property insurers and reinsurers alike are losing money. There are several factors at play, but the drivers are:

Catastrophic Losses
They're up in recent years. Billion-dollar weather-related events are both increasingly frequent and increasingly severe when they occur. Climate change is a factor, as is urbanization.

Climate change can present itself through temporary events but appears to be here to stay long-term…as suggested by Ernst Rauch, Chief Climate Scientist at Munich Re: "Two factors should be kept in mind when considering the 2022 natural disaster figures. Firstly, we are experiencing La Niña conditions for the third year in a row. This increases the likelihood of hurricanes in North America, floods in Australia, drought and heatwaves in China, and heavier monsoon rains in parts of South Asia. At the same time, climate change is tending to increase weather extremes, with the result that the effects sometimes complement each other."

Inflation

Add cost of construction (materials and labor) inflation to the above. The inflation spike that followed the COVID-19 outbreak has added further fuel to insured losses. Since the start of the pandemic, property insurance exposures have grown even faster than headline inflation. The fastest rising prices have been in sectors such as construction and vehicle sales, directly impacting claims costs in some of the largest lines of insurance – another area insurance actuaries had not fully predicted.

Capacity/Uncertainty

There's yet another contributing factor to the shakiness of the ground the property market is reliant upon – capacity. The reinsurance market, like most, relies on investor confidence. Investor trust in the reinsurance segment is shaky at best, given six years in a row of industry losses. This is restricting new capacity, further challenging reinsurers' ability to support retail insurers looking to transfer risk beyond what they can handle in-house.

Catastrophic Losses in the News

All of these factors are combining to create the perfect storm. In a recent article from Business Insurance, it was reported that Travelers Insurance reported a 98% fall in quarterly property profit due to severe weather, which "caused the insurer's catastrophe losses net of reinsurance to jump to $1.48 billion from $746 million a year earlier", also noting that storms across the U.S. contributed to 65% of all global first-half losses. That's one carrier. Contemplate what that likely means for the insurance companies insuring Travelers AND many other retail companies simultaneously.

What This Means for American Businesses

What can you expect?

While the latest quarterly data from the CIAB showed a commercial property premium increase of 18.3%, your renewal could far exceed that if your schedule presents a challenge for the market. Further, "a challenge" can be defined a lot of different ways in a market where insurers are looking for reasons to increase rate, decrease their capacity, and shy away from property as a percentage of their book of business.

A few scenarios presenting more challenging terms include:

- Inadequately protected properties (poor fire protection, housekeeping, storage configurations, etc.)
- Properties in higher protection classes (requiring longer fire department response times)
- Those with values exceeding their insurer's appetite
- Locations geographically more vulnerable to natural disasters.
    - Locations presenting a challenge in the current marketplace are often seeing (and likely will continue to see) 100%, 200%, even 300% premium increases at renewal time as retail carriers dig deeper into their reinsurer's pockets or ask other retailers to participate in layered programs, to protect themself from major losses.

What can you do?

Start by having a conversation with your broker if they have not reached out to proactively discuss the current commercial property market. Ask what it might mean for you at your next renewal, based on the above considerations and others.

Don't expect finite answers to questions surrounding pricing – they likely won't know until closer to renewal. But they should be able to help you contemplate those variables within your control, discuss likely ROIs surrounding implementation, and discuss the approach they will take come pre-renewal time. Some variables (for example: geography) are likely out of your control. Others may be relatively easy fixes if you have enough time to address them as a business (housekeeping, contingency planning surrounding business interruption, etc.). The rest likely lie somewhere in between and could be addressed at a cost (sprinkler systems, firewalls, construction type, roof updates, etc.).

Your broker should be your chief risk advisor. Consider them and their agency and carrier teams an extension of your internal team. Make sure they are connected with your internal operations and safety teams so they can collaborate and put you in the best possible position in advance of your next property insurance renewal!

While the current property market offers many challenges you'd just as soon not be dealing with, it also offers a great opportunity for you to evaluate your broker's value and make sure you are with a trusted advisor who thinks of you throughout the year, not just come renewal time.

Please reach out to your M3 account executive today to have a customized conversation regarding your risk, renewal strategy, and how the hard market may affect your organization specifically.

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