Life Sciences Insurance Marketplace Realities

Willis Towers Watson

Contents

Introduction

In Willis Towers Watson's Insurance Marketplace Realities reports over the past 18 – 24 months, we have highlighted the growing challenges to buyers of insurance from a hardening market. The extent of the impact will vary depending on the business, its risk profile and its strategy for risk management. One thing that is clearer than ever is that certain industries are more deeply impacted by market conditions than others. In this publication we explore how market conditions are impacting life science companies.

For life science companies, the most challenged lines of insurance (i.e., those experiencing the most widespread price increases and capacity withdrawals) are D&O, property and cargo. In these classes especially, the insurance market is demonstrating unprecedented discipline. Buyers have already faced price increases and capacity reduction through 2019 and 2020, and we predict that rate hikes and capacity constrictions will continue throughout 2020 and 2021. On a positive note, product & professional liability in this space has proven immune to the blanket adverse market conditions, and there is a small but developing market for product recall for certain companies.

Naturally, the insurance markets have been severely impacted by the COVID-19 pandemic; the full extent of that impact is unknown presently. What is clear is that the pandemic and the resulting economic downturn will very likely extend the hard market through 2021. It may not expand it – rate increases for most lines may not increase further than they've been increasing for the past several months – but market discipline and upward rate pressure will continue as losses from the pandemic materialize and investment income deteriorates. Market conditions are driving many renewal negotiations down to the wire, but the work is getting done. In the life sciences arena, insurers are inundated with submissions for new business relating to the pandemic, whether it is clinical trials for tests, vaccinations or treatments or the volume of PPE manufacturers seeking product liability coverage. A constant theme throughout all lines of insurance in this report is to start renewal negotiations early and allow yourselves time for a longer and more detailed underwriting process.

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Alternative risk transfer

Key takeaway

Some ART solutions have been on the market for many years, while others are just emerging. All are benefiting from new technologies and increasingly robust analytics, which lay the foundation for many of these products. When life science companies face challenges in finding traditional insurance solutions, these products offer them meaningful solutions.

ART concepts have been the vanguard of innovation and progress in the insurance industry for decades. Captives, integrated risk, structured programs, parametric solutions, catastrophe bonds, insurance-linked securities and other products that are now widespread, started as bespoke solutions for a targeted problem.

While the ART market is a steady force throughout traditional market cycles, it is during hard market cycles, like the present, when ART concepts can deliver the most value and receive the most attention from risk buyers – deservedly so.

Today turmoil continues to spread across many lines of insurance as insurers struggle to address high combined ratios, low interest rates and now the economic upheaval brought on by the COVID-19 pandemic.

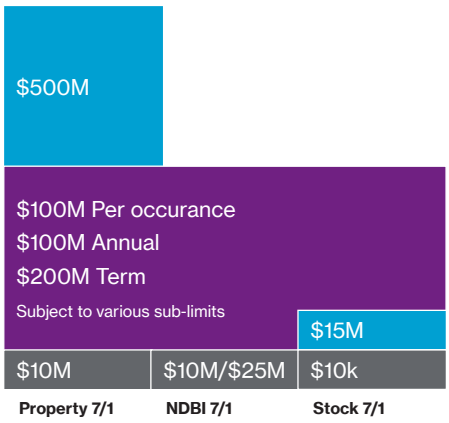
The ART marketplace offers insurance buyers alternative risk transfer/financing solutions, which in most cases are customized for each situation. When insurers withdraw coverage, ART solutions allow basic needs to be met, providing evidence of cover, managing per-claim volatility, capping aggregate volatility, obtaining desired limits and deductibles. These alternatives can provide protection that might otherwise be unavailable for catastrophic risk (earthquake, hurricane, etc.) or other hard-to-insure risks (pandemic, weather, reputational risk, product liability and product recall), while mitigating the impact of a large loss to corporate financial statements.

While our Alternative Risk team creates solutions for clients in all industry groups, two recent deals are highlighted below that addressed challenges in the traditional insurance market. There are many ART approaches that can be deployed to address market challenges, and the Willis Towers Watson team stands ready to help.

Portfolio programs/Integrated risk

Adopting a long-term view of risk transfer, this life science company successfully created an integrated risk program that blended excess casualty, financial lines, cyber, environmental and E&O. This provided benefits, including certainty of cost and capacity, and efficiency in use of capital and administration.

Facing a challenging renewal in its property lines, the company leveraged its carrier relationships to expand the integrated program for its property, non-damage business interruption and stock throughput program. This again created certainty of capacity and cost, while reducing the administrative burden of annual renewals.



Parametric solutions

Parametric solutions address specific NATCAT or weather risk via an index-based approach, where the index chosen is highly correlated to likely loss.

This life science company had key facilities in earthquake-prone areas. A parametric earthquake program was created to complement the property program. It added capacity that responds/settles within 15-30 days of an event and addresses any loss cost arising from the event (with very few exclusions).

EQ Intensity PSA 0.3 (%g)	% Limit Available	Payout Amount
>115 %g	100%	$10,000,000
90 %g to 115 %g	75%	$7,500,000
75 %g to 90 %g	50%	$5,000,000
60 %g to 75 %g	25%	$2,500,000
45 %g to 60 %g	10%	$1,000,000

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Cargo

Key takeaway

We anticipate a challenging market well into 2021 with insurers' continuous focus on profitability seeking rating increases and implementing more restrictive terms. Conducting a renewal strategy early with a focus on differentiating your risk from your peer group, as well as alternative program options will best position you during this challenging market.

Rate predictions

Transit only

Good loss experience: +10% to + 30%

Marginal to poor loss experience: +30% to +60% and higher

Stock throughputs

Good loss experience: +10% to + 30%

Marginal to poor loss experience: +30% to +60% and higher

The market for all life science risks and especially for pharmaceutical companies continues to harden due to a high frequency of claims and significant number of large losses. Capacity constrictions that are hitting all cargo buyers are especially pronounced for life science clients. Starting renewals early is critical, especially for stock throughput programs. Detailed renewal data is also critical and is impacting terms, conditions and price.

In conjunction with increased rates, markets are also seeking higher retentions.

Rate increases vary with loss experience and/or risk profile characteristics, including but not limited to NAT CAT profile. Retention levels are being assessed on a case-by-case basis.

Accounts with catastrophe-exposed storage risks are seeing higher rate increases. Retention levels on this business are usually going up as well.

Accounts with poor loss history may see significant rate increases in addition to severe retention increases and, in certain instances, they may see more restrictive coverage terms, as insurers focus on account profitability.

The already limited U.S. market capacity for excess stock has further eroded.

Quota sharing risks in many instances has become necessary, especially for catastrophe-exposed storage risks.

Insurers are revisiting their underwriting strategy, risk appetite and underwriting guidelines as they look to return to profitable underwriting.

Detailed underwriting information is critical. Insurers are requesting more details surrounding carrier vetting, contract reviews, standard operating procedures in both transit and inventory, and concentrating on warehouse survey reports or requiring warehouse survey to be performed and what is being done/has been done with recommendations

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Casualty

Key takeaway

We anticipate a challenged casualty environment through the balance of 2020. Umbrella/excess carriers will seek material rate increases and higher attachment points while restricting coverage terms and conditions for the next several quarters. In addition, carriers are actively seeking to add communicable disease and COVID-19 exclusions.

Rate predictions

General liability: 7.5% to 15%+
Automobile liability: 8% to 15%+
Workers compensation: Flat to +4%

Umbrella:
High hazard/Challenged class: 50%+
Low/Moderate hazard: 30%+

Excess liability:
High hazard/Challenged class: 150%+
Low/Moderate hazard: 75%+

Automobile liability

Auto liability continues to be unprofitable for insurers, as claim payments remain on the rise. Insureds are experiencing continued rate increases and potential program restrictions. Q2 2020 experienced a large average rate increase of 12.3%. This marked the third consecutive quarter of double-digit average rate increases.

2019 was to be the ninth consecutive year with a combined ratio over 100% for auto liability. Loss costs for bodily injury and personal injury protection have increased by 6.7% and 4.8%, respectively.

Rate pressure is causing some insureds to reevaluate higher deductible thresholds.

As a result of increasing claims cost, umbrella carriers continue to demand higher attachment points on auto liability, resulting in a "stretching" of primary limits or introduction of excess "buffers."

Workers compensation

Workers compensation (WC) rate decreases are flattening, as we are beginning to see slight rate increases in the wake of high severity excess losses. WC continues to be the casualty coverage with the most COVID-19 claim activity. Insurers are doing their best to answer questions on coverage issues but are taking each on a case-by-case approach. The circumstances around coverage are complex, vary by state and are impacted by new presumptive legislation.

Despite National Council on Compensation Insurance (NCCI) estimates that total medical and indemnity severity has increased 11.5% over the past five years, WC remains profitable, with the most recently reported industry combined ratio of 83%. The impact of COVID-19-related losses remains to be seen but could impact profitability going forward.

General liability/umbrella/excess liability

The umbrella/excess liability marketplace continues to experience significant disruption, with carriers increasing rates significantly, amending underwriting appetites, reevaluating coverage grants and requiring changes to program structures, i.e., reducing available capacity and requiring higher attachment points.

The North American liability marketplace continues to be impacted by significant catastrophic liability losses resulting in unsustainable loss ratios industry-wide — a primary driver of hardening rates.

Losses are driven by such factors as:

- Liberal class action certification
- A highly organized plaintiffs' bar
- Many umbrella insurers posting combined ratios exceeding 150%
- Uptick in frequency of punitive awards

Loss severity is increasing along with the percentage of litigated claims. The median value of the top 50 U.S. verdicts has more than doubled since 2014 (from $27.7M in 2014 to $88M in 2019). These numbers have become the benchmark for future claims. They are the result of aggressive litigation, litigation financing, the impact of changing attitudes toward corporate accountability among juries, and a numbness to stratospheric awards.

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Cyber

Key takeaway

Given the dramatic increase in ransomware incidents, both in frequency and magnitude across all industries over the past year, organizations should be proactive in assessing their cyber resilience and be able to demonstrate this resilience to underwriters.

Rate predictions

Good loss experience: +5% to + 15%
Marginal to poor loss experience: +15% to +20% and higher

The explosion of ransomware losses in 2019 has had a direct impact on premiums. One study has estimated that global ransomware damages have increased 60 times since 2015.

With most of the corporate work force working remotely due to COVID-19, bad actors are targeting vulnerabilities with VPNs and other remote access applications. Specifically, the surge in remote access usage has resulted in the increased use of Microsoft Desktop Protocol (RDP), and some reports have suggested that exposed RDPs have increased by as much as 127%, so underwriters are looking closely at what insureds are doing to secure endpoints.

The General Protection Regulation and California Consumer Privacy Act have imposed new, onerous privacy and data collection compliance requirements on life science companies and can impose significant penalties for non-compliance. Therefore, underwriters are asking questions on what steps policyholders are taking to comply with GDPR, CCPA and other emerging privacy regulations.

As incidents and losses mount, carriers have been reevaluating their positions in large towers and looking more closely at rates in perceived burn (low attachment) layers.

Carrier strategy regarding excess layers revolves around obtaining adequate premium for perceived risk. There is less competition to get on excess towers, especially if pricing is considered too thin.

While some cyber towers may still maintain a rate per million under $10K/M, the excess markets are generally looking to increase their rate per million to $8K to $15K, but that can fluctuate up or down based on attachment point and risk.

Cyber capacity is starting to tighten as losses continue to rise.

According to the 2019 Cost of a Data Breach Study from the Ponemon Institute and IBM Security, the average cost of a data breach is now $3.92M, a 12% increase over the last five years. Costs remain highest in the U.S., where the average price tag for a data breach was $8.19M, more than twice the global average.

Business interruption/system failure continues to be an area of concern for underwriters. Life science companies, and especially pharmaceuticals, can be heavily exposed and have often seen increased underwriting scrutiny.

Cyber underwriters are working more closely than ever with their counterparts in other lines to address “silent cyber” coverage (coverage for cyber exposures provided in other lines of insurance due to a lack of specific exclusion). Carriers are withdrawing or limiting cyber coverage in non-cyber insurance lines due to concern over aggregation.

Certain insurers in the cyber marketplace are now able to address other consequential losses a life science company may suffer as a result of a cyber incident, such as failure to supply products, property damage and bodily injury.

There is an increasing awareness of the overlap of manufacturing risk and technology risk for medical device and technology companies. As product liability insurers look to address the ‘silent cyber’ risk, it is increasingly important to create a unified insurance product to address product liability, errors & omissions and cyber/network risks.

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D&O

Key takeaway

Underwriters are laser-focused on (1) liquidity, (2) industry, (3) pending milestone events and regulatory interactions and (4) the impact of and disclosures specific to COVID-19.

Rate predictions

Publicly traded pharmaceutical and biotechnology companies: +50% to +100% or higher
Private pharmaceutical companies: +25% to +100% or higher
Public medical device and other life science companies: +25% to + 100% or higher

We continue to work with our clients to consider and create **alternative program structures designed to offset current market conditions in the short term** to mitigate price and capacity reductions. These strategies include quota sharing insurers' participation, corporate risk retention by insureds up the tower and an analytical review of the limits historically purchased.

The COVID-19 environment is applying more pressure to an already firming D&O marketplace.

Unprecedented environment: The global economy is experiencing unprecedented challenges as a result of the COVID-19 pandemic.

Industry: The life sciences segment (and especially pharma and biotech) is seeing heightened pressure. Capacity is becoming harder to find to complete some programs.

Claims: In recent years, life science has been one of the most sued industries in shareholder class action litigation. Following the COVID-19 outbreak, it has been among a smaller group of industries that has seen shareholder class action arising out of pandemic-related issues. Specifically, class actions have been against life science companies alleging misrepresentations regarding the progress/efficacy of pandemic-focused products/services, such as vaccinations, treatments, "cures" and testing kits.

Renewals are challenging, with the COVID-19 environment heightening underwriting scrutiny of D&O exposures — all in addition to the continued firming of primary and excess rates.

Capacity: Even before COVID-19, some carriers had signaled their intent to limit company-specific D&O exposure by reducing capacity and/or layer size. Today's D&O insurance buyers with larger towers will likely find renewing towers challenging. Replacement capacity may be hard to find and may require innovative solutions. The life science sector faces a hard market — reduced or withdrawn capacity and increased retentions — on both public and private D&O. Even A-Side coverage, historically a cheaper alternative, is being priced higher and has seen reduction in available capacity.

Excess layers: Excess recalibration continues: In the second half of last year, underwriters started to recalibrate how they priced excess relative to underlying layers. This often results in insurance tower prices increasing even more than the primary pricing, and that is likely to continue through the rest of the year.

Underwriting: Insurers are more focused on exposure to the consequences of the COVID-19 environment. More specifically, carriers are looking at liquidity/solvency, ability to conduct clinical trials, burn rate versus commercialization timeline, guidance and disclosures, revenue disruption, supply chain and logistical concerns, and changes to business plans. Underwriter questionnaires or question lists are providing some consistency. As mentioned above, carriers are looking to increase retentions and decrease limits — for most life science companies.

Initial public offerings: With a high volume of life sciences IPOs, insurers have taken a very conservative approach to pricing, retentions and deployment of capital. Primary premiums are being calculated as % of the limit being offered (rate on-line anywhere from 20% to 40%) with self-insured retentions, which are based on market cap and offering size, starting at $5M and often higher. There is little pricing drop-off for excess layers, which are often priced at close to 100% of the primary; higher layers may drop to 85% of the underlying premium. Programs take time to build as many insurers have reduced deployed capital for IPO risks to $2.5M – $5M.

Organizational distress: One of the inescapable consequences of the COVID-19 outbreak and resulting economic downturn is that companies across numerous industries, including life sciences, are exploring bankruptcy, restructuring and M&A options. Should organizations consider their options in the face of crisis, renewals may become more challenging, giving rise to the essential need for specialized restructuring and M&A brokerage support.

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Product liability

Key takeaway

The life sciences product liability market remains consistent with many clients seeing flat renewals. Claims activity remains stable and profitability has not been challenged in the way that we have seen on other lines. As a result, for most companies we can create competition. Detailed underwriting information is key to a successful outcome, a lack of understanding of an insured, its products or its regulatory experience by an insurer can lead to artificially inflated rates.

Rate predictions

The market is stable, with rate predictions averaging 0 to +5% for clients with favorable loss experience, no recall activity and no products in multi-district litigation or class actions. Subsectors include:

- Pharmaceuticals and biotech
- Generic pharmaceuticals
- Medical device and technology
- Nutraceuticals (including CBD products and energy drinks)
- Contract research organizations
- Contract manufacturing organizations
- Laboratory developed tests

Spotlight on COVID-19

- With the dramatic increase in companies manufacturing, distributing and selling COVID-19 products in response to the pandemic, underwriters in the life sciences space are inundated with submissions. Coupled with a trend toward more detailed and diligent underwriting, turnaround times are longer than ever.
- Those insureds with new COVID-19 products who are already in the life sciences space are generally viewed more favorably than those without experience in dealing with the FDA.
- It is important for insureds to understand how the PREP Act and CARES Act may provide immunity from claims related to manufacturing, testing, developing and distributing of these products, which are collectively called "covered countermeasures." Adherence to FDA and state and federal guidance is critical, as is the contractual risk transfer between parties collaborating on such products.
- Insureds with any direct patient care will be carefully reviewed for potential transmission exposure and could see communicable disease exclusions.

Capacity

- Overall capacity remains stable for life science risks with a handful of new markets entering the space over the past several years.
- Except for certain high hazard risks (i.e., orthopedic implants, opioids, other litigated classes), most insureds should have several carriers willing to offer terms.

Claims and litigation

- Pharmaceutical and medical device manufacturers continue to be a target for product liability lawsuits, with social inflation leading to larger settlement amounts and bigger jury awards.
- The suspension of the courts has caused delays in the looming opioid litigation, as well as other high-profile cases.

Coverage considerations

- Product liability carriers are now adding exclusionary language for claims arising from or related to the actual or alleged presence of nitrosamines (NDMA and related carcinogenic contaminants), which is of particular concern for pharmaceutical risks.
- Standard markets continue to decline risks with CBD-related exposures while non-admitted and wholesale-only carriers will typically offer terms.
- Carriers continue to release new policy forms which should be carefully reviewed for nuances in coverage.

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Product recall

Key takeaway
After largely shunning the life sciences industry in the past, insurers are developing an appetite to engage on these risks.

Product safety is flying somewhat under the radar these days, but at a time when many sectors are seeing increases in consumer demand, it's essential that companies safeguard their production processes.

The FDA has decided to temporarily cease supplier verification onsite audits.

Manufacturers have less management oversight due to the implementation of teleworking.

Many manufacturers are looking to diversify their scope of products to fill gaps in consumer needs caused by the current pandemic, but new products come with new risks. These companies should not let their quality-control guard down.

For drugs and medical devices, the number of recalls issued by the FDA has remained relatively constant when comparing H1 2020 (67) to H1 2019 (69). July and August 2020, however, have seen a large increase due to low quality/counterfeit hand sanitizer flooding the market; numbers have also been buoyed by significant PPE recalls as production shifts to meet demand for these products.

The recall insurance marketplace appears to be taking a flexible underwriting approach during this chaotic time. While the market is hardening in 2020, in the early days of the COVID-19 crisis many carriers communicated a willingness to consider flat rates for clean renewals and simplify the data collection process.

That being said, underwriting outcomes for new and distressed risks vary greatly with hardening rates and reduced capacity. For these, a thorough and detailed approach to information is key to success.

Having ample time to market renewal submissions is also crucial in this climate.

The recall market appetite for life science products (especially drugs and biologics) remains narrow. The few that will consider these risks are looking for high retentions and lower capacity when compared to other industries.

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Property

Key takeaway

Rate increases are continuing and, in some cases, accelerating. Capacity remains available but it is being applied cautiously. Compliance with risk control recommendations is more important than ever.

Rate predictions

+30% to +100% or more
With losses: +50% or more

Programs where capacity needs to be replaced or added are likely to see rate increases at or above the high end of the figures quoted above.

The hard property market continues.

The life sciences market, and especially for pharmaceutical companies, has been hit due to historical severity of losses. Capital remains available but deployment of such capital is increasingly disciplined.

Two years of combined ratios exceeding 100% have forced underwriters to push for profitability.

Programs below technical pricing or facing a loss of key capacity are seeing the largest rate corrections.

While the extent and impact of the current economic downturn on insurers is unclear, capital has remained available. Nevertheless, insurers have been reducing overall line size and repositioning deployed lines based on profitability – meaning that capacity, at least so far, is available – but at a price.

The price, however, may be very steep for buyers with cat exposures and cat losses.

Certain life science companies have been hit particularly hard; we are seeing increases ranging from 20% to 300% – and sometimes higher.

Shared and layered placements have seen an increase in the number of markets needed to fill the program – making renewal negotiations more complex and longer to finalize.

Along with raising rates, underwriters continue to take a more critical look at exposures, restricting many coverage terms previously offered.

Coverage is tightening on contingent business interruption (CBI) and service interruption; we are seeing underwriters scrutinize property schedule valuations. This can have a significant impact on supply chain coverage for life science companies.

First-party cyber exclusions are common.

Life sciences is one of the industries facing heightened challenges:

- Risk control is still being heavily scrutinized, and buyers need to be prepared to address open recommendations prior to renewal. The lack of a response to open recommendations may have a negative impact on negotiations and on limits available, and insurers may walk away from accounts where the recommendations are not followed.
- Insurers are continuing to press for increased deductibles and time-element deductibles for business interruption in order to eliminate attritional losses, e.g., water damage and hail percentage deductibles.
- Some insurers are looking to include exclusions for strike, riot and civil commotion leaving a gap that may need to be filled in the terrorism market.

To sum up the marketplace: capacity restrictions + technical underwriting = continued hardening that will last into 2021.

Insurance buyers can take steps to get the most out of a difficult marketplace.

Be ready for constant change in guidelines and rate expectations. Start early!

Be ready to await approval from senior management, not underwriters. Start early!

Prepare for heavy scrutiny on engineering.

Provide accurate and complete data in submissions (full SOV, loss info, business continuity planning, etc.).

Be proactive – and get ahead of the timeline delays that can be expected to grow with the length of the pandemic crisis.

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