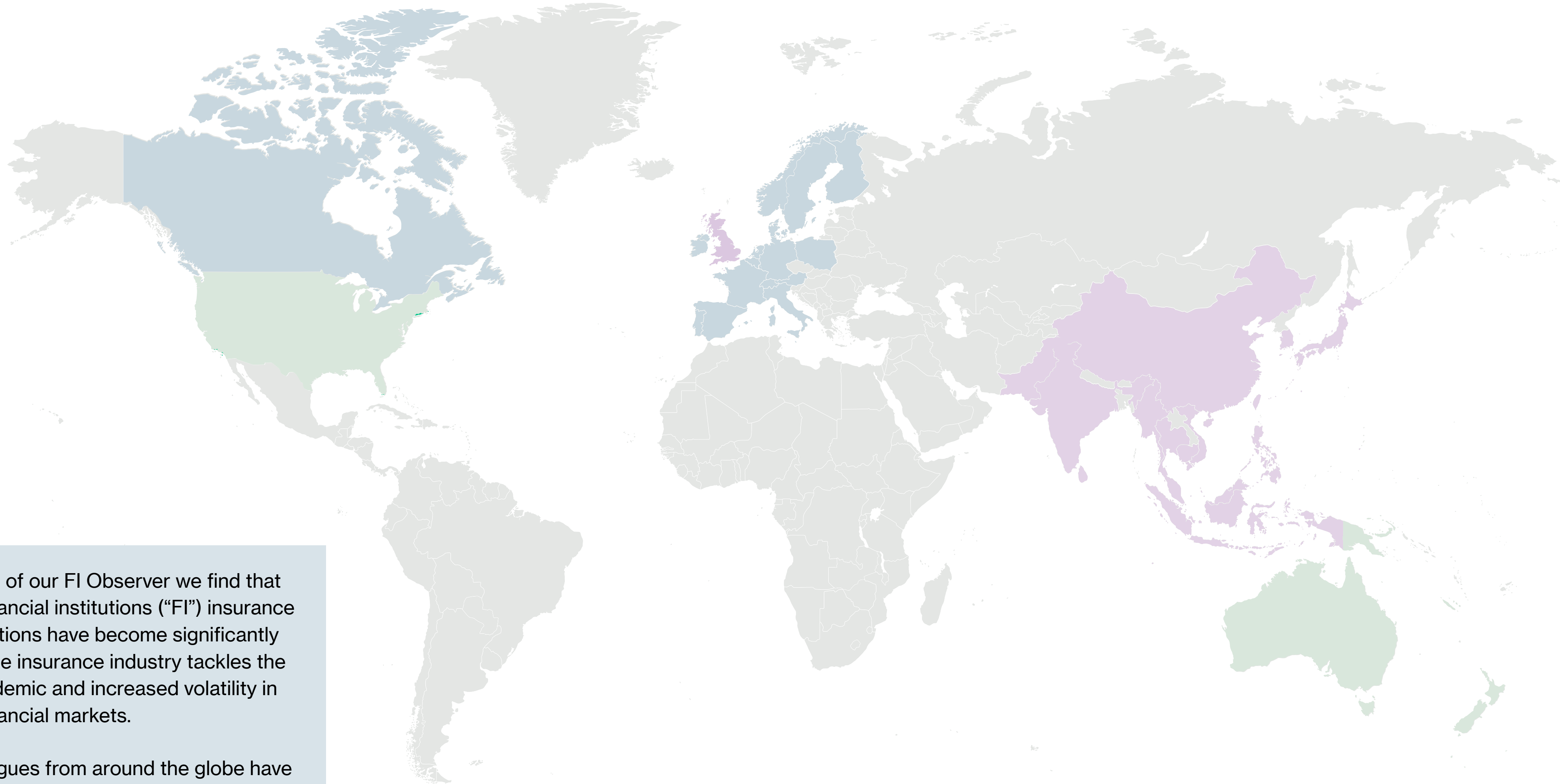
Global FI Market Conditions

Reflecting on Q3 2020

Enter

Introduction



In this edition of our FI Observer we find that the global financial institutions ("FI") insurance market conditions have become significantly tougher as the insurance industry tackles the ongoing pandemic and increased volatility in the global financial markets.

Our FI colleagues from around the globe have provided their insights into the changes seen in the global insurance market.

Please note, this is an overview of the current market conditions but due to the rapidly evolving situation, changes are occurring frequently and we encourage readers to discuss this further with us, or an appropriate professional, before making any decisions.

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Asia

Capacity

With buying habits in Asia arguably seeing lower limits of liability bought than other parts of the world, access to alternative capacity on any one program has still been achievable in order to temper insurers' ability to obtain significant increases in premium. However, we are seeing signs that the following factors may affect that landscape going into the tail end of the year.

- Global remits for a very select number of international insurers have filtered through to Asia with remits to take a holding position on the market to focus on the allocation of existing capacity and, in certain cases, put a hold on writing new business.
- Insurer capacity allocation is becoming a factor with insurers looking more closely at how they allocate their capacity on any one risk.
- Insurers' risk selection thresholds are increasing, risk profiles outside of investment strategies such as Private Equity, credit, special opportunity etc. have also been areas which until recently have been deemed mainstream. However, we are seeing insurers take a more finite view of risk selection outside of these sectors when considering the premium adjustments and capacity allocation.

Rating

Overall: Generally leading insurers are seeking increases of 5%-10% premiums on their renewal business. However, to date there have been limited increases on risks which are deemed to be on the lesser risk scale and where there are smaller limits allowing access to more choice of capacity has been achievable.

Asset managers with material changes in assets under management ("AUM"), mergers and acquisitions ("M&A") activity, challenged risk profiles and/or significant claims activity will likely experience greater underwriting scrutiny and adjustments to premium and/or retentions.

It is worth noting that the starting point for Asia based risk profiles coverage, premiums levels and capacity is broad, the above factors will naturally have an effect in shaping the landscape going forward, but we envisage the Asian market will still remain comparatively competitive.

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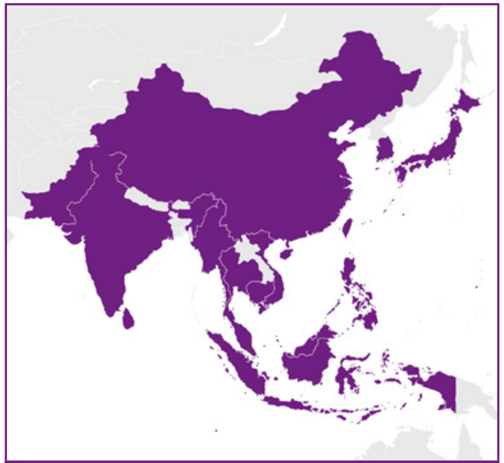

Asia

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Coverage

Broad coverage is generally still available, though some insurers are reassessing their portfolio and may seek to make adjustments to the scope of coverage. Notable coverage developments include:

- More focus on crime coverage and limiting non direct loss to the manager.
- *Cyber and Crime coverage:* Some insurers have looked more closely at the scope of cover and conditions of cover surrounding social engineering. However, to date sub-limits of restricted cover has been avoided.
- *"Silent Cyber and proactive cyber coverage":* Some insurers are looking to eliminate ambiguity regarding cover for cyber-related events by adding language clarifying the breadth and scope of what is (and what is not) covered under the D&O/E&O policies.
- *Mitigation and cost of correction cover:* This is a constantly present talking point and we do not anticipate the topic going away as market forces evolve and potential losses arise from a current volatile market and trading frequencies.
- Employee practice liability coverage has come under the spotlight at varying levels with some insurers attempting to seek extra premium for the coverage.
- Retentions are remaining flat. However, a select number of insurers are now looking more closely at retentions levels for US claims.

Exceptions: Again, Asset managers with material changes in AUM, M&A activity, challenging risk profiles and/or significant claims activity will experience insurers exercising closer scrutiny on breadth of coverage.

COVID-19

The impact of the pandemic on Asset Management Directors' and Officers' ("D&O")/Errors & Omissions ("E&O") renewals is yet to be fully determined and is evolving daily.

Right now, insurers are generally not taking broad negative actions across their book of business. They are currently assessing and asking for more information around an insured BCP and considerations in remote connectivity of employees, judging each risk on its own merits.

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Australasia

Capacity

Reductions in capacity in the Australian market continue with the few insurers still actively writing FIs. Those that do are limiting their capacity on any one risk with maximum lines of $5 million on any one risk being increasingly the norm.

Major player, AXA XL, announced at the end of June they will no longer be quoting for new business. They will continue to support and offer renewal terms for existing clients, with the exception of second tier lending companies which they are now non renewing.

While most mid-sized and all large FIs rely heavily on the London market, some smaller financial institutions, including funds and financial or wealth planners, struggled to obtain terms at all in June from the Australian market and were forced to seek options off-shore.

Rating

We are seeing rates continuing to increase with average increases exceeding 30% for Professional Indemnity ("PI") and D&O rates up over 50%.

Superannuation funds are experiencing larger rate increases than other financial institutions with terms up to 24% rate on line being offered for some primary programs.

Coverage

Retentions are increasing further across all the lines of insurance.

AIG have introduced new retentions for class action or multi-plaintiff claims which they are defining as claims brought by more than one claimant or plaintiff. Others are starting to follow this approach.

There remains pressure on coverage for investigations and insurers continue to reduce sub-limits of liability for this cover. Fines and penalties exclusions are still in focus where this cover hasn't already been removed over the last 12 months.

Insurers continue push back on manuscript wordings and increasingly impose their own standard wordings.

COVID-19

We are not seeing COVID-19 exclusions but we are seeing more insolvency exclusions targeted at smaller FIs and those with exposure to assets that have or are likely to drop significantly in value or are very illiquid.

Insurers have flagged concerns around the potential for a rise in crime and social engineering claims during the economic conditions that follow the stringent lockdown measures. There is now considerably more focus on all insureds' internal controls for this risk.

There is significant concern about investment performance and claims that may arise from breach of mandates. With the Government allowing early redemption of superannuation funds leading to unprecedented withdrawals, there is real concern about liquidity, appropriate application of the rules associated with this redemption program and the associated liability which may lead to claims.

Insurers are similarly concerned about REITs with particular focus on leverage and tenancy profile.

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Canada

Capacity

- Capacity remains largely stable for Canadian FI risks with a positive risk profile, although, some insurers are selectively reducing overall line size to $10 million for FINEX lines and repositioning deployed lines based on profitability. Certain subsets, such as Banking and Private Equity, are viewed as higher risk now and capacity is being reduced and retentions are increasing significantly.
- For risks with significant claims history, capacity has tightened considerably.
- Replacing incumbent insurers has become more difficult as insurers continue to be inundated with submissions and some insurers have filled their capacity lines.

Rating

- Risks with minimal to no increase in underlying risk exposures or claims are seeing increases of +10% - +20%. FIBs are no longer renewing flat, most FIBs are seeing increases of +5% - +10% and insurers are starting to scrutinize coverage enhancements more closely as insurers believe that the WFH environment will increase FIB loss frequency. The anticipated increase in loss frequency is also pushing retentions but we are still seeing more success in marketing this line of coverage than other FINEX lines.
- Some excess insurers are focused on achieving minimum Increased Limit Factors ("ILFs") in the 70% to 80% range depending on their layer/attachment point.

Coverage

- FI insurers continue to take a critical look at the scope of coverage and are introducing new restrictions and sub-limits.
- As a result of the pandemic, insurers are taking a close look at Business Interruption and Contingent Business Interruption valuations, limits and waiting periods in response.
- As expected, insurers are continuing to address the "silent cyber" issue on their 2020 renewal book (ie. specifically excluding cyber-related losses under insurance policies that were not intended to cover cyber risks).

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COVID-19

- Insurers anticipate that the current work from home environment will increase Cyber and FIB losses and therefore they are more concerned about IT operations and internal controls.
- Insurers are also concerned about the impact that the end of the Canada Emergency Response Benefit (CERB) will have on the Banking sector.
- Insurers are closely evaluating capacity, retentions, pricing and terms and conditions on all renewals.
- Communicable Disease Exclusions are being attached to the majority of Property & Casualty renewals.
- Early engagement is key – start the renewal process 120 days prior to renewal with a renewal strategy discussion.
- Be prepared to discuss the impact of the pandemic on your business, liquidity forecasts and credit reviews, and obtain complete and accurate underwriting information.
- Have underwriting meetings with insurers and the client's senior management. The client's senior management should be prepared to respond to underwriters' questions and highlight the organization's positive risk attributes.
- Use analytics to understand the organization's risk tolerance level should it be necessary to increase the retention.

Great Britain

Capacity

- The trend for reducing capacity on risks by key FI markets in London has continued in 2020. This has to some extent been more widespread than expected, given that this capacity management began in 2019. However, it has been noticeably more acute since the COVID-19 crisis began. There is a sense that the current COVID-19 situation has fast-tracked more challenging market conditions, which were brewing, resulting in harsher terms and heightened premiums being imposed. What is clear is that we are almost certainly now in a "hard" market with some sectors of the FI market, that have traditionally been sought after business, seeing reduced insurer appetite. Private Equity is a case in point, with insurers concerned with the financial performance of portfolio companies given the expected economic downturn. Competition for new business between insurers therefore continues to be dampened, with more focus on portfolio management of existing business.
- For those clients buying significant policy limits, the current conditions are felt the most. Insurance program structures are rapidly evolving in response to insurers' capacity and pricing changes.
- The total market capacity continues to contract and we believe this will continue for 2021, where we have seen pricing as the key driver in the prior 12 months we will see capacity management continue to be the focus with more stability around pricing, albeit continuing on an upward trend but in a more linear fashion. Since our last Market Realities we have seen Neon close its doors to FI business and AxaXL a lead FI market, looking to significantly reduce its portfolio.[1] At the same time Aviva, HDI and Convex are three insurers that have entered the FI market.
- As we stated previously, insurers are choosing to deploy less capacity. Across the market we still see inconsistent underwriting behavior. There are certainly some insurers who are taking advantage of the current remote trading and general tougher conditions.

Rating

- Insurer capacity continues to be under review, with a general reduction in the amount of capacity deployed per risk, heightened risk selection and double-digit premium increases the starting point.

Coverage

- Pushback on policy coverage enhancements continues other than for changes reflecting clarity or changes in legislation – in some cases coverage is being restricted. Any true broadening of wordings tends to attract additional premiums. Some excess insurers are refusing to follow any coverage changes in the primary.
- Insurers are seeking increased retentions across the board.

COVID-19

- At present COVID-19 (or related) exclusions are not being imposed and are fiercely contested by Willis Towers Watson. This is again true for Insolvency Exclusions (particularly relevant on D&O insurance).

[1] Breaking News: at the time of publication, AxAXL placed its London financial lines book into run-off – see http://communicatoremail.com/Qu3L5yz96OthZO_cXg64IKjVAZnUlcq5vYbjMi~Nnrg/WebView.aspx

Great Britain

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United States

Capacity

- Total market capacity remains stable with no real change in FI insurers (new capital or exiting).
- Most programs can still find adequate capacity, though many insurers have been reducing limits in certain areas and are more closely managing overall aggregation.
- Replacement capacity is often not available at a more competitive premium, but marketing programs is recommended to achieve best results.
- Bermuda markets continue to offer solutions for the right premiums, retentions, and attachments, while UK markets have become more conservative in deploying capacity for US risks.

Rating

Line of business/Business sector	Rating increase
D&O – Publicly traded financial institutions	+15% to +30%
D&O – Private financial institutions	+5% to +15%
D&O/E&O – Asset managers (excluding private equity/general partnership liability)	Large: +10% to +15%
	Middle Market: +5% to 10%
Bankers professional liability ("BPL")	Large: +12.5% to +30%
	Middle Market: +10% to +20%
Insurance company professional liability ("ICPL")	Life: +5% to +20%
	P&C: +10% to +30%

Coverage

The FI public D&O marketplace is continuing to deteriorate, with excess and Side A layers now seeing more substantial increases than the primary as insurers recalibrate Increased Limit Factors (ILFs).

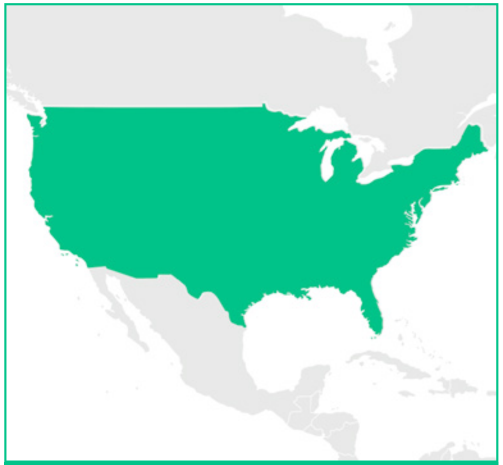
- Insurers continue to push for increased D&O retentions, with insurers indicating that retentions have not kept pace with the growth of insureds and as a result, we often see no meaningful credit for retention increases.
- There is generally adequate program capacity, but some insurers are reducing or looking to ventilate capacity.

We are seeing some FI private D&O insurers seeking premium increases, as claims continue to be on the rise against a background of historically thin pricing.

- Some insurers are seeking increased retentions and looking to tie in limits among previously separate towers, especially between D&O and Fiduciary.
- Side C/entity coverage is becoming narrower. Buyers should watch for entity investigations coverage exclusions, broad professional services exclusions, antitrust coverage exclusions and in some cases, removal of Side C coverage altogether.

Side-A/DIC D&O insurers are increasingly following the underlying D&O Side ABC increases.

- Side A pricing has become very thin over the years and in response to some large Side A losses and increased litigation costs, insurers are now seeking rate.
- The professional liability (E&O) marketplace varies by sector.



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Asset managers:

- The market continues to remain stable as an abundance of capacity is keeping rates competitive, although insurers are adjusting their deployment of limits, with many offering a maximum of only $10 million for any one program. Some insurers are requiring minimum retentions of $250k. Middle market asset management continues to be a growth area for insurers. Larger advisors and funds are experiencing more upward rate pressure.
- Private Equity, Business Development Companies ("BDCs"), Real Estate Investment Trusts ("REITs"), and managers with high exposure to Collateralized Loan Obligations ("CLOs"), Real Estate and other stressed investments should expect challenges at renewal.

Insurance companies:

- An already challenging market for insurance companies has become completely hard as a result of the COVID-19 pandemic. Very few carriers will now consider writing primary and the lack of competition has led to increased pressure on retentions, premiums and limitations in coverage for all classes. Primary markets are looking to impose COVID-19 exclusions on P&C renewals and there are no longer viable alternatives and sales & marketing coverage is not commonly available for Life insurers.
- P&C insurers are facing uncertainty regarding the outcome of pending cases alleging mishandling of business interruption claims arising out of COVID-19. Life insurers have been subject to greater scrutiny towards their investment portfolio, while issues like cost of insurance remain a significant concern.

Banks:

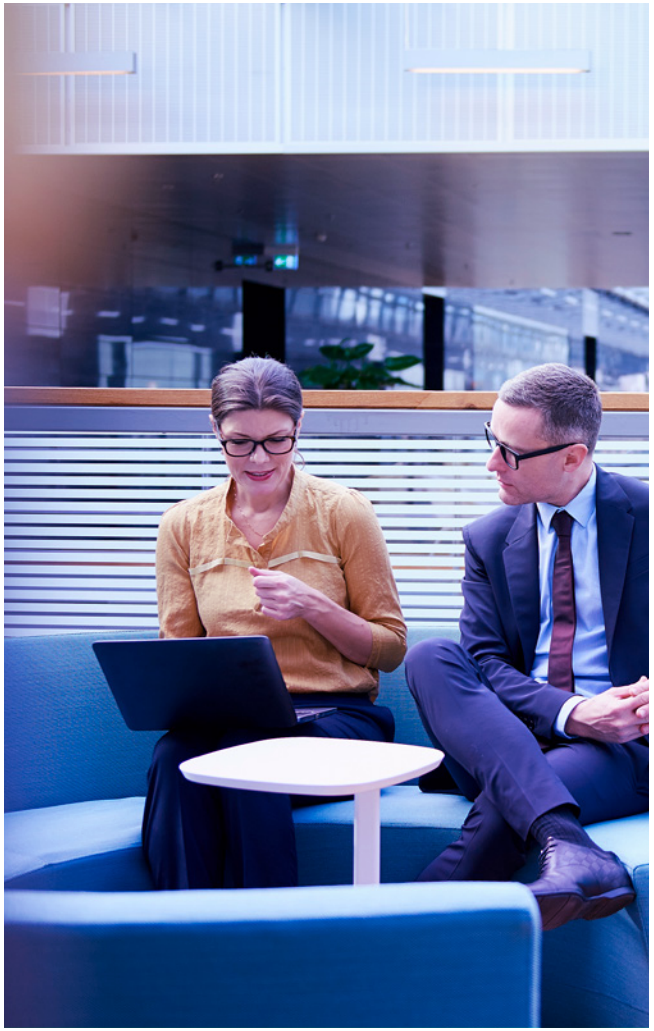
- Although banking regulatory actions have decreased under the current administration, the outcome of the November 2020 elections may mark a reversal and state attorneys general and regulators have stepped up their scrutiny. COVID-19 has created underwriting focus on the Paycheck Protection Program, provisioning and credit risk, loan forbearances, credit reporting, and liquidity risk. Additional scrutiny is also expected as the LIBOR sunset draws closer.
- BPL primary capacity continues to be limited, with some insurers becoming more conservative in appetite and putting more pressure on retentions and pricing. BPL insurers often require supporting lines.

COVID-19

- We have recently seen markets propose COVID-19 related exclusions on ICPL for P&C insurers. We will strongly contest any such restrictive wording.

Silent Cyber

- More insurers are adding cyber and privacy exclusions (E&O, Fidelity, EPL) to clarify coverage. As insurers continue to assess their silent cyber exposures, we recommend reviewing the new exclusions alongside of your cyber policies to ensure that coverage is being addressed appropriately.



Western Europe

Capacity

- Overall decrease for most large carriers with many countries seeing maximum of €10 million – €15 million.
- Challenges with completing large and more complex programs and an overall trend to reduce total limit especially on a Side ABC basis with more appetite for Side A only towers.
- Primary capacity is typically challenging to secure with more limited appetite.
- For risks with claims history, capacity has tightened significantly.

Rating

- FI marketplace remains more stable than the commercial marketplace but rates are increasing.
- We have been seeing anything from +10% to at least +100% for entities with US exposure listed entities or where there is claims activity but dependent on quality of risk.
- Premium increases more significant on Excess layers as they have historically been under-priced in comparison to the primary layers.

Coverage

- Fairly stable but most countries seeing higher retentions especially for Side C.
- Reluctance to enhance cover and increased underwriter scrutiny when assessing each risk and respective coverage.

COVID-19

- Pre-existing market hardening being amplified by COVID-19.
- Some insolvency and COVID-19 exclusions seen but not yet common place.
- Insurers are examining COVID-19 responses, crisis management and liquidity strategies.
- Increased potential of loan defaults and liquidity issues being monitored closely.

Western Europe

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Steps you may want to consider to mitigate your exposure to the market volatility

- Early engagement as insurers are expected to require more data and information for each renewal.
- Revisit program structure and offer alternatives (blended programs, increased side A, higher deductibles etc).
- Broaden market space and be open to looking at other markets as alternatives.
- Leverage strategic insurer relationships from other lines of business.
- Communicate effectively with your broker about your claims, do not notify matters late in the renewal process unless it is unavoidable.

Claims environment

Looking ahead we expect the following:

- Volatility in the markets is resulting in an increase in trade errors and claims arising from stock drops.
- Social engineering scams continue to increase in prevalence, as scams become more sophisticated and fraudsters seek to monopolize on the current working from home environment.
- There may be an increase in D&O notifications as the way boards manage companies through the COVID-19 situation is scrutinized by regulators and potential claimants alike.
- Notifications to employment practices liability (EPL) policies may increase as a result of the way employers manage the workforce through the pandemic.

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